Land Value, Land Rent and Progressive Housing Policy

by Stephen E. Barton

Land value is created by the larger society, not the private owner of housing. The rent tenants pay to private landlords pays for *both* the building and the land, or location, so the land rent exacts payment from tenants for value the tenants have helped to create. Understanding the social nature of land value and land rent can strengthen our arguments for progressive housing policies.

Many progressive policies, such as inclusionary zoning, rent controls and non-profit housing development, have in common that they help shield lower income people from the exaction of land rent. Policy analysis drawing on the concept of land rent refutes much of the market-based critique of progressive housing policies on its own terms, since standard economic theory accepts that land rent can be regulated or taxed without harmful effects on the production and maintenance of housing. The progressive agenda should explicitly call for recapture of socially created land value to fund alternative forms of ownership, such as community land trusts and nonprofit housing corporations, which remove residential land from the market.

The current American economic structure is designed to enable businesses to convert socially created value into private profits, and the collectively created value of urban life is no exception. Residential real estate is a form of property that combines buildings and land. When people rent an apartment, part of their payment supports construction, operation and maintenance of the building (building rent) and part is for access to that location (land rent). While the owners (or the owners' employees) are responsible for operating and maintaining buildings, the value of the land is a creation of the entire community and the owners are paid for the land value generated by the society around them. Tenants contribute to making the city a better and more interesting place and in so doing they increase land values, which increases the rent they have to pay to continue to live there.

A recent study conducted by the Berkeley Rent Stabilization Program found that the high rents in the San Francisco Bay Area, where the median monthly rent is approximately $1,200 compared with an average of less than $700 for all U.S. cities, cannot be explained by higher quality, higher operating costs or higher construction costs. The higher rents are simply land rent.

Land rent is a form of "economic rent," meaning unearned business revenue that is over and above the price that would be sufficient to produce, operate and maintain housing in a perfectly competitive market. This rent is based on ownership of scarce resources, in contrast with profits that are earned through production of additional goods. While these concepts are a standard part of neoclassical economic analysis, conventional public economic discourse avoids mention of them since they could help reveal that excess profits and exploitation are a routine part of our current economic system.

Idealized free market discourse draws its persuasive power from implied moral claims and explicit policy claims that are clearly false when land rent or other forms of economic rent are significant factors. The first and most important implied moral claim is that business revenue is normally earned through production of goods and services. Business revenue from land rent clearly violates this claim. The landowners are paid not for what they have produced but for what urban society has collectively produced.

A closely related policy claim is that price increases that generate economic rents will be temporary until increased production brings prices back down to the necessary minimum. In most areas with high housing costs, however, economic rent is a long-term feature of the housing market. In the Bay Area rents have increased faster than the average rent for all U.S. cities since the late 1950s.

A second related policy claim is that if housing prices remain high this is because government is interfering with the free market through land use regulations, so that the solution is removal of regulatory barriers to housing development. Neoclassical economic theory concedes that taxes or regulations that affect only economic rent will not have harmful effects on the production of desired goods and services such as housing, but conventional economic rhetoric tries to bury this point by pretending that land rent can be eliminated.

In reality, land rent is a long-term structural feature of many successful urban areas. Residential buildings are easy to build, but land suitable for multi-family residential development can be extremely difficult to "produce," particularly within the already densely developed urban centers around the San Francisco Bay. Three quarters of the area within fifty miles of downtown San Francisco is either water or steep hills, and major public investments in rail transit have reinforced the value of central locations. There was a serious proposal in the 1950s to fill in most of the Bay to allow for development. This would have provided a market-oriented solution—by removing the Bay—adding hundreds of square miles of new land and lowering the value of the surrounding land. (This dystopian vision led to creation of the San Francisco Bay Conservation and Development Commission.)

Many suburban communities restrict development of multi-family housing, denying lower income tenants access to all areas of the metropolis. These discriminatory barriers should be removed; if people are good enough to work in a community they should be free to live there as well. The best available evidence, however, is that in California highly restrictive land use regulation is found mostly in scattered, upper-income suburban cities and has little effect on overall rent levels because development takes place in other nearby cities instead.

A clear understanding that land rent is a permanent feature of many regional housing markets leads directly to an understanding of the need for progressive local housing policies that help shield low-income people from the market, create long-lasting organizations that can help build the movement for social justice and provide working examples of alternative ways of organizing society. Progressive housing policies typically include regulation of the existing rental housing market, requirements or incentives for new development to include some housing at below-market rates and alternative forms of ownership. All of these programs help reduce or redistribute land rent, and they can be made more effective if the redistribution is systematically considered as part of their purpose.

Rent control is widely disapproved of by conventional economists on the grounds that price regulations will reduce the quality and quantity of the controlled housing stock. This assumes a perfectly competitive market in which land rent does not exist. Economist Lee Friedman has pointed out that in the presence of land rent, "rent control could, in theory, affect only economic rents and cause no supply inefficiency even in the long run." Neil Mayer points out that in tight markets where low-income tenants have few alternatives, the market does not provide substantially lower rents for units with poor maintenance and that rent controls can improve maintenance through the threat of rent reductions for violations of the housing code.

Strong rent controls meet constitutional standards when they allow increases for increased operating costs and at least a partial inflationary adjustment for net operating income. This is roughly equivalent to preventing future increases in economic rent. However, regulating thousands of different landlords locks into place a permanent political conflict between well-organized and well-financed landlord organizations and more numerous but usually poorly organized and financed tenants. Strong rent controls were abolished in Massachusetts and California, surviving for a long period of time only in New York City and some nearby cities in New Jersey.

California continues to allow moderate rent stabilization systems in which units are decontrolled on vacancy and then recontrolled again at the new market rent. Moderate rent stabilization systems protect all tenants from displacement and unjust evictions and can provide economic benefits to long-term tenants. The dot-com bubble of 1999-2001 created an upward spike in Bay Area rents that would have displaced far more tenants than it did if rent regulation had not been in place in San Francisco, San Jose, Oakland, Berkeley and East Palo Alto. Moderate rent regulation does little to hold down land rents overall, however, since most tenants move within a few years.

Metropolitan areas with high land rent are characterized by tight housing markets and a severe shortage of units affordable to low-income tenants. Subsidies for new construction or rehabilitation of existing housing for the benefit of low-income people are essential but need to be accompanied by forms of social ownership that permanently remove land rent from the cost of housing so that the housing will not revert to market rents or prices. Social housing ownership can take different forms: nonprofit housing corporations, community land trusts that lease the underlying land to people who buy the house or apartment above it, resident-owned corporations such as limited-equity cooperatives or mutual housing associations.

Social ownership creates long-lasting organizations with an interest in developing more affordable housing and in other social equity issues important to the residents. Rent controls and rental subsidies are both subject to being reduced in scope or even abolished if there are political changes. In contrast, non-profit-owned land and housing is constitutionally protected as a form of private property. Subsidies for new development could be cut off, but most of the organizations and their affordable housing would survive. (Social ownership reduces the need for ongoing rental subsidies but does not replace them because there are many people with incomes too low even to pay the operating costs of their housing after land rent is removed from their rents or share payments.)

Changes in land use that allow developers to build at higher densities generate unearned increases in land values. Nico Calavita and Alan Mallach have described the density bonus programs and inclusionary zoning requirements that many state and local governments use to tap into these increased land values in order to provide below-market rate housing. The case for tapping into increased land values is particularly strong when the increases in land value clearly result from public investment and publicly created plans and accompanying changes in land use regulations, as in the creation of transit-oriented development corridors.

Valuable as these programs are, they miss the extraordinary levels of land rents in the already existing rental housing stock, especially in coastal California and the Boston-New York-Washington D.C. corridor. Currently the total annual rent paid by tenants in the high rent areas of coastal California totals over $48 billion: $15.6 billion in the Bay Area, $26.6 billion in the Los Angeles area and $6.3 billion in the San Diego area. At least one-quarter and probably one-third of this amount, $12 to $15 billion a year, is land rent. Taxes on this unearned revenue from land rent, even if limited to future increases, would provide an equitable and economically efficient means for state and local government to support housing programs to mitigate the harm done to low-income tenants by high land rents.

Joseph Schumpeter pointed out that over the long run economic efficiency is much less important than creativity and innovation. Most of the critiques of progressive housing policies claim that these policies are inefficient, something an analysis of land rent can often refute. But what really matters is finding the policies that best support the creativity of American cities. We need to find ways of managing the urban economy that more fully value the contributions of the writers, researchers, artists, craftspeople, teachers, nurses, attendants to the disabled, gardeners, workers in neighborhood restaurants and retail shops and the many others who are only sometimes financially successful but who together make cities great places to live. One of the ways to do this is to identify strategies for recapturing land rent—a privatized form of our socially created wealth—and reinvest those resources in making housing decent and permanently affordable for all the diverse people of urban America.

Stephen E. Barton, ~~(sbarton@ci.berkeley.ca.us)~~, Ph.D., is deputy director of the Berkeley Rent Stabilization Program. The views expressed in this article are those of the author and do not necessarily reflect those of the Berkeley Rent Stabilization Program or its Board