

Appreciating Land

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“They’re not making any more of it” is a common refrain used to justify lofty estimates of land appreciation. With supply fixed, the argument runs, demand will drive prices, and demand for the right piece of land, like that for a given piece of art, can be nearly infinite. While potentially true in isolation, the notions of fixed supply and near infinite demand cannot be true in aggregate. In fact, the actual supply and demand dynamics for land create appreciation potential roughly equal to inflation, plus a slight premium for the occasional transformation of an area to its “highest and best use.”

That the value of land grows at only about the rate of inflation may come as a surprise. But there are a number of commonsense factors that help to mitigate its appreciation potential, including:

- **Mobility**—One can move from a central business district to cheaper suburbs or to other geographies altogether.
- **Substitution**—One can substitute capital for land, if zoning permits, by building higher in the existing location.

- **Technology**—Improved transportation and communications allow businesses and workers to disperse locally without a corresponding increase in cost and inconvenience.

Focusing on these factors should help correct much of the mythology around the question of land valuation and steer analysis toward more empirical data. The few long-term studies that exist suggest that commercial property appreciation in Manhattan and Amsterdam, two of the wealthiest and most densely populated cities in the world, barely kept up with inflation over the past one and four centuries, respectively.[†] Consider the Big Apple: The lack of real land appreciation in twentieth-century urban New York can be understood in the context of the vertical growth of the city, the advent of the streetcar, subway, automobile, and computer, as well as the commercial growth seen in neighboring urban and suburban areas.

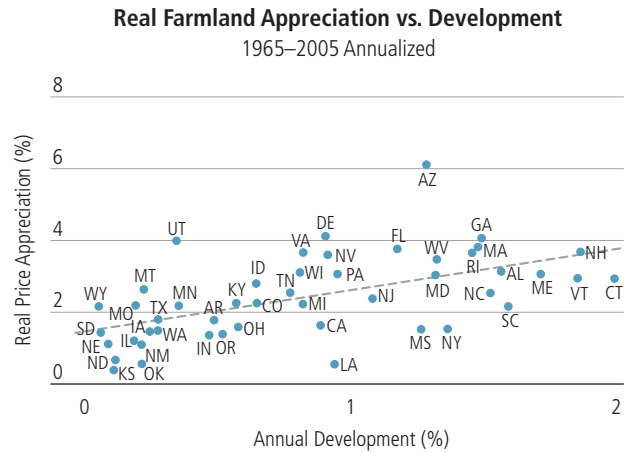
* Bernstein Global Wealth Management, which was founded in 1967 to manage investments for families and individuals, is known for its research. This article is the product of Bernstein’s Wealth Management Group, a team of professionals with expertise in money management, trust and estate planning, tax management, and quantitative analysis.

† In “Four Centuries of Location Value: Implications for Real Estate Capital Gain in Central Places,” Piet Eichholtz and David Geltner, March 2002; “100 Years of Commercial Real Estate Prices in Manhattan,” William Wheaton and Mark Baranski, May 2006

Nevertheless, prolonged periods of strong real price appreciation are possible. As an area transitions from farmland to residential or residential to commercial usage, prices rise to a permanently higher level. The *display, right*, illustrates this premium by showing that farmland in states with the most development over the past 40 years exhibited the highest price appreciation.

So in aggregate, the rate of land appreciation can be understood as inflation plus a (re)development option. Pick the right parcel, geography, or time period, and this development option could be worth far more than underlying inflation. Choose poorly, and no amount of supply constraint or development potential will remedy the mistake. ■

Prices track the climb in a “land use hierarchy” from farms to residential to commercial usage



Source: US Department of Agriculture and AllianceBernstein

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