

Development Land Markets and Development Gain – Stylized Facts from a Nordic Country

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ABSTRACT

This paper compares the prices of housing, housing lots and development land over time and space in Finland. The focus is in the ratio of prices of housing lots and development land, and how the development gain is calculated, if costs are known.

The theoretical context is based on simple identity of the composition of housing prices:

$$(1) \quad \text{Housing price} = \begin{aligned} & \text{House building costs} \\ & + \text{Entrepreneurs profit} \\ & + \text{Lot servicing costs} \\ & + \text{other development costs} \\ & + \text{development gain} \\ & + \text{agricultural / existing land value} \end{aligned}$$

$$(2) \quad \text{Development gain} = \text{Sellers profit} + \text{buyers profit}$$

Observed prices of development land reveal how then gain is shared between seller and buyer.

Most of the variables (1) are known. The intermediate price levels (lot and development land prices) can be observed. However, the development land transactions are usually scarce for valuation purposes.

This paper describes and models and compares lot and development land markets based on 100,000 lot sales and 10,000 sales of undeveloped land bought by Finnish municipalities.

In Finnish system the public sector is the provider of basic services. The public sector is also a dominant player in the development land market. In fact, the land market can be viewed as a mechanism partly to finance the costs of the public services.

When houses are expensive lot prices tend to be much higher than agricultural land prices, often in the degree of 2 or 3. Emerging development gain is large, and to measure it accurately is critical in financing development costs.

To understand development land market as a way of finance, the composition of house prices should be known better than it is now. The task is to solve the identity (1) with some degree of accuracy. This task is not performed yet. My research provides extensive data on some of the variables needed. The most important missing variable so far is the development costs, which should be defined in a standard way and then measures and modeled accurately.

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