

HOUSING AND THE 18-YEAR LAND PRICE CYCLE

by Bryan Kavanagh

HOUSE PRICES

The present political discourse is rightly focused on the cost-of-living crisis and escalating house prices. Australia faces an inadequate supply of housing, and many people believe homes to be unaffordable. However, much of the analysis has conflated the issues of *supply* and *affordability*, assuming that an increase in supply will automatically make homes more affordable. This assumption is flawed, because more houses are not like a glut of tomatoes on the market which will indeed reduce *their* prices.

While it is true that construction costs have risen due to COVID-19 supply chain disruptions and labour shortages, and that inflation, government stimulus, and bureaucratic delays have contributed to rising house prices, simply building more homes may *not* lead to more affordable housing. Here's why: -

According to the Australian Bureau of Statistics' "Total Value of Dwellings" report and Table 61 to the national accounts, land now accounts for over 85% of the **cost** of the average home. This means that even *if* builders construct more homes, they can't lower the land price component, because they must purchase sites at market value. Therefore, the high cost of land will remain a significant problem.

Real estate valuers know that while supply and demand, population growth, location, zoning, and the characteristics of a site will affect its rent, the **price** of the land is largely determined by: (1) what banks are willing to lend against it, (2) the mortgage interest rate, and (3) rates and taxes levied on the land. If governments were to capture the full rental value of the site via a land tax, the market value of the land would be *zero*, as there would be no rent to capitalise into a price.

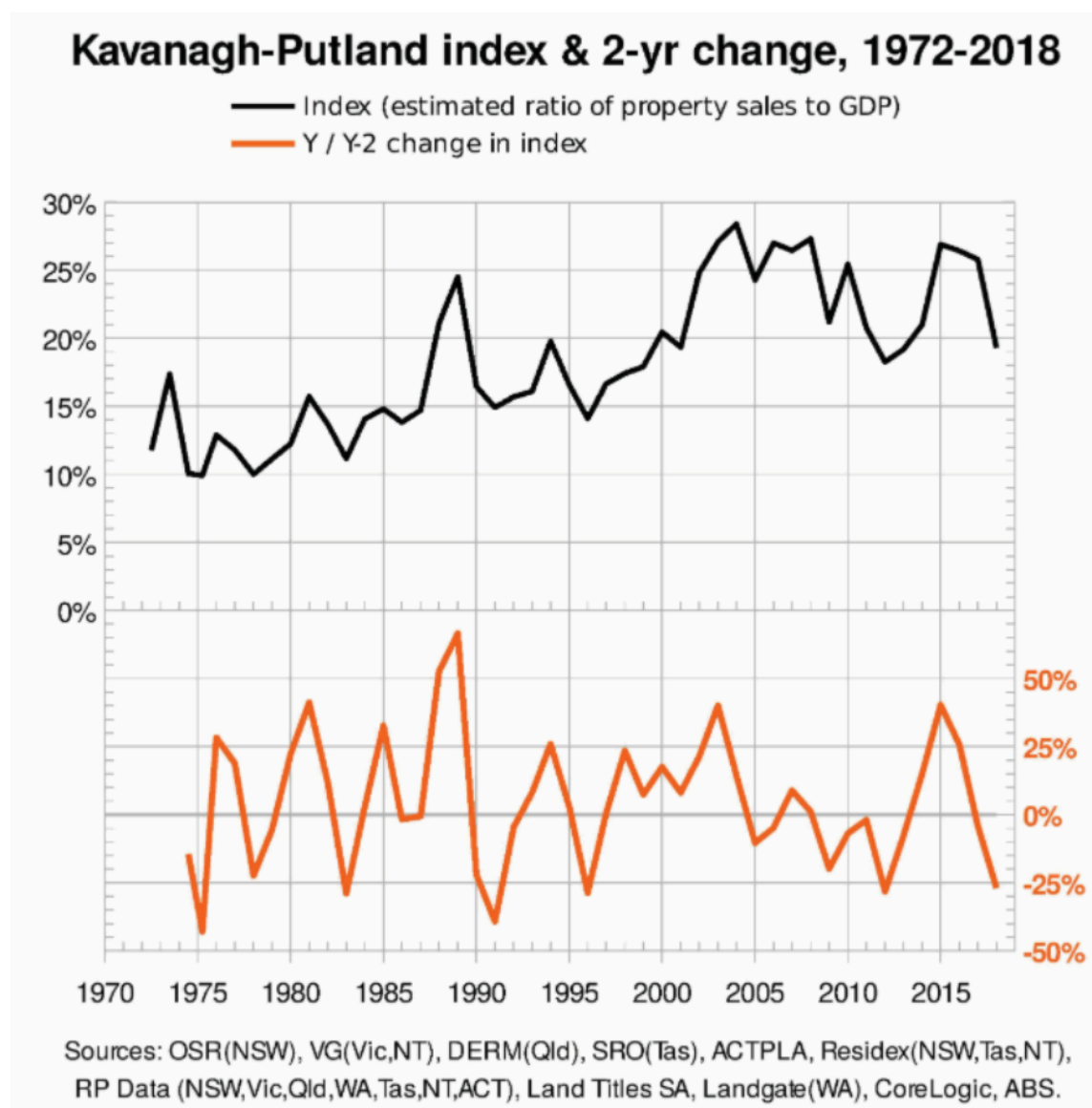
Recent increases in land tax in Victoria and Queensland have led some landlords to seek investment opportunities elsewhere, with reported declines in land values. So, taxes on land values *do* influence the land price component.

FORECASTING ECONOMIC TRENDS

Economists have a poor track record when it comes to forecasting recessions. This probably reflects the adage, "The future is unknowable." However, some real estate professionals—particularly valuers and agents—seem to have a better understanding of real estate market trends, and therefore, possible economic outcomes.

For example, back in July 1987, I published an article in the journal *The Valuer* which forecast an economic recession in 1991/92. According to Paul Keating, that was the recession "we *had* to have," but I believe it could have been avoided had we tweaked land taxes upward—particularly an all-encompassing land tax, not just one on investment properties.

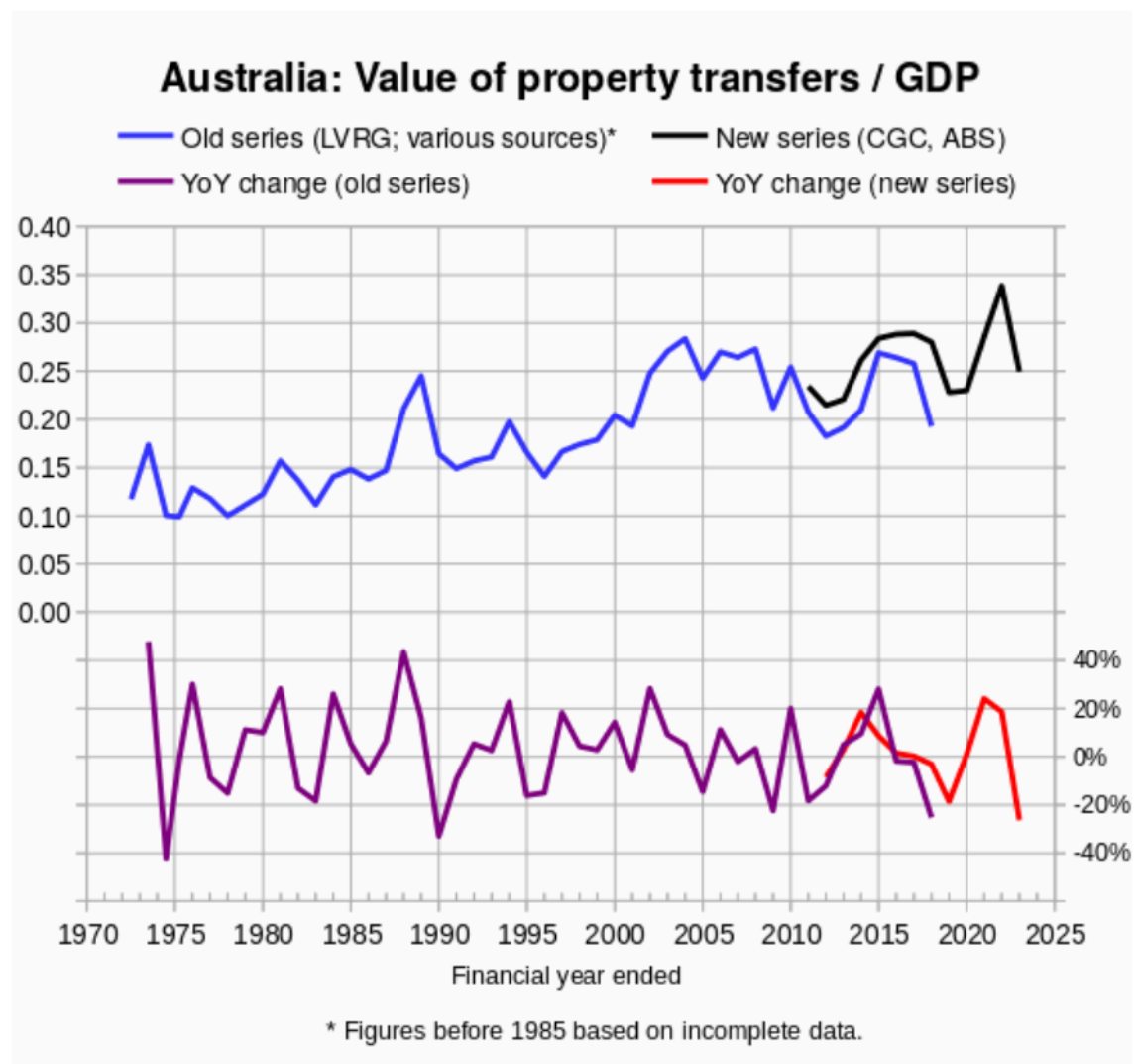
MY FORECASTS



My economic prognostications have been based on trends in the Australian real estate market as a whole. Although there are of course many sub-markets, I employ two *national* aggregates, namely, total real estate sales--that is, all residential, commercial, industrial, and rural sales--and gross domestic product. The index compares total real estate sales to GDP. My colleague, Dr Gavin Putland, added the year-on-year change in the index, finding that a 25% drop suggested recession within the next two years.

Obviously, I could not foresee the COVID-19 pandemic, but I was able to forecast a recession in 2020, based on the methodology. The sharp decline in the index in 2018 pointed to a likely recession. *MacroBusiness* published an article on 18 January 2019 quoting me as saying that “*turnover and price declines in Sydney and Melbourne during 2018 indicate an economic recession in the 2019-20 financial year.*” The recession occurred, exacerbated, of course, by the pandemic. Despite its immediacy, the media ascribed the financial recession *entirely* to the effects of the pandemic.

UPDATING THE CHART



We had to establish a new series to account for data revisions from the Commonwealth Grants Commission and the Australian Bureau of Statistics when updating the analysis to 2023. Although a 25% decline in the index *did* occur in 2023, it was not accompanied by the general drop in sale prices that would necessarily signal a 2025 recession.

Despite several of my articles being published in *The Age* and *Herald Sun*, I've found that mentioning an impending recession is considered *taboo*. Maybe we prioritise maintaining public "confidence", even at the cost of overlooking the likelihood of economic recession. ...In these circumstances, maybe we emphasise the 'con' in confidence?

LAND PRICE BUBBLES

There have been people historically who understood the risks of inflated land prices. Just before the Great Depression, a young Robert Gordon Menzies, who was to become Australia's longest-serving prime minister, warned of the dangers of post-WWI inflated land prices. In 1928, he stated: *"Since the war, we have suffered from an unnatural prolongation of post-war inflation of land values, keeping up land values at an artificial level."* His warnings proved prescient, as the land price bubble burst just before the 1929 stock market collapse.

In more-recent times, the 2008 Global Financial Crisis was another example of a real estate bubble-burst. During the GFC, the housing market collapse in the US *was* directly linked to inflated land prices, after banks failed the risk management tests in lending against overinflated values. Australia was impacted less, because with Treasury assistance the government acted quickly to pump some \$50 billion in public works into the economy.

The political environment around real estate remains sensitive. The property industry, financial institutions, and investors are heavily invested in real estate, making it difficult to consider fiscal measures that would *reduce* land prices. However, history has shown that these bubbles inevitably burst, and the damage they cause is far worse than taking pre-emptive action.

ROCKETING LAND PRICES

year	\$trillion	increase	% increase	*1971	population	value/capita	source
1971	0.0258	-	-	-	13,100,000	\$2,000	Dwyer
1972	0.0345	0.009	33.7%	1.34			Dwyer
1973	0.0399	0.005	15.7%	1.55			Dwyer
1974	0.0432	0.003	8.3%	1.67			Dwyer
1975	0.0558	0.013	29.2%	2.16			Dwyer
1976	0.0600	0.004	7.5%	2.13			Dwyer
1977	0.0660	0.006	10.0%	2.56			Dwyer
1978	0.0724	0.006	9.7%	2.81			Dwyer
1979	0.0913	0.019	26.1%	3.54			Dwyer
1980	0.1442	0.053	57.9%	5.59			Dwyer
1981	0.1742	0.030	20.8%	6.75	15,000,000	\$11,600	Dwyer
1982	0.2213	0.047	27.0%	8.58			Dwyer
1983	0.2422	0.021	9.4%	9.39			Dwyer
1984	0.2451	0.003	1.2%	9.50			CGC
1985	0.2792	0.034	13.9%	10.82			CGC
1986	0.3021	0.023	8.2%	11.71			CGC
1987	0.3547	0.053	17.4%	13.75			CGC
1988	0.4715	0.117	32.9%	18.28			CGC
1989	0.6719	0.200	42.5%	26.04			ABS
1990	0.6813	0.011	1.7%	26.48			ABS
1991	0.6711	-0.012	-1.8%	26.01	17,000,000	\$39,500	ABS
1992	0.6692	-0.002	-0.3%	25.94			ABS
1993	0.6860	0.017	2.5%	26.59			ABS
1994	0.7525	0.066	9.7%	29.17			ABS
1995	0.7803	0.028	3.7%	30.24			ABS
1996	0.8218	0.042	5.3%	31.85			ABS
1997	0.9528	0.130	15.8%	36.89			ABS
1998	1.0173	0.066	6.9%	39.43			ABS
1999	1.1169	0.100	9.8%	43.29			ABS
2000	1.2550	0.138	12.4%	48.64			ABS
2001	1.3601	0.105	8.4%	52.72	19,000,000	\$72,500	ABS
2002	1.6628	0.303	22.3%	64.45			ABS
2003	2.0119	0.349	21.0%	77.98			ABS
2004	2.3112	0.299	14.9%	89.58			ABS
2005	2.5001	0.189	8.2%	96.90			ABS
2006	2.7811	0.281	11.2%	107.79			ABS
2007	3.1684	0.387	13.9%	122.81			ABS
2008	3.7712	0.603	19.0%	146.17			ABS
2009	3.2843	-0.487	-12.9%	127.30			ABS
2010	3.8083	0.524	19.0%	151.48			ABS
2011	3.9722	0.064	1.6%	153.96	22,360,000	\$178,000	ABS
2012	3.8120	-0.160	-4.0%	147.75			ABS
2013	3.9873	0.175	4.6%	154.55			ABS
2014	4.3849	0.398	10.0%	169.96			ABS
2015	4.9108	0.526	12.0%	190.34			ABS
2016	5.2123	0.302	6.1%	202.03			ABS
2017	5.9055	0.693	13.3%	228.90			ABS
2018	6.0578	0.132	2.2%	234.02			ABS
2019	5.8485	-0.189	-3.1%	226.69			ABS
2020	6.3757	0.523	8.9%	246.87			ABS
2021	7.7330	1.361	21.4%	259.73	25,700,000	\$300,000	ABS
2022	8.9229	1.190	15.4%	345.85			ABS
2023	8.9572	0.034	0.4%	347.18			ABS
2024	9.7397	0.782	8.7%	377.51	26,713,200	\$366,000	ABS
Average increase		12.2% pa					

Australia's tax system has played a significant role in inflating land prices excessively. The combination of generous tax policies for property investors—such as negative gearing and the 50 per cent capital gains tax discount—has encouraged land price inflation. Meanwhile, state governments have been slow to use land tax to cool the market. It's all left to the Reserve Bank of Australia - and RBA cash rate policy hasn't succeeded,

It's probably difficult to see the data in this table, but the long and the short of it is that since 1971, Australian land prices have increased at an incredible average rate of 12.2% per annum. In 1971, total land values in Australia were only \$258 million, but by June 2024, the figure had grown to \$9.74 *trillion*. We may want to ascribe this to population growth, but whereas total land prices represented \$2,000 per head for every man woman and child in 1971, they've now risen to an astonishing \$364,000 per capita. I consider this foreshadows a correction.

AUSTRALIA'S FUTURE TAX SYSTEM

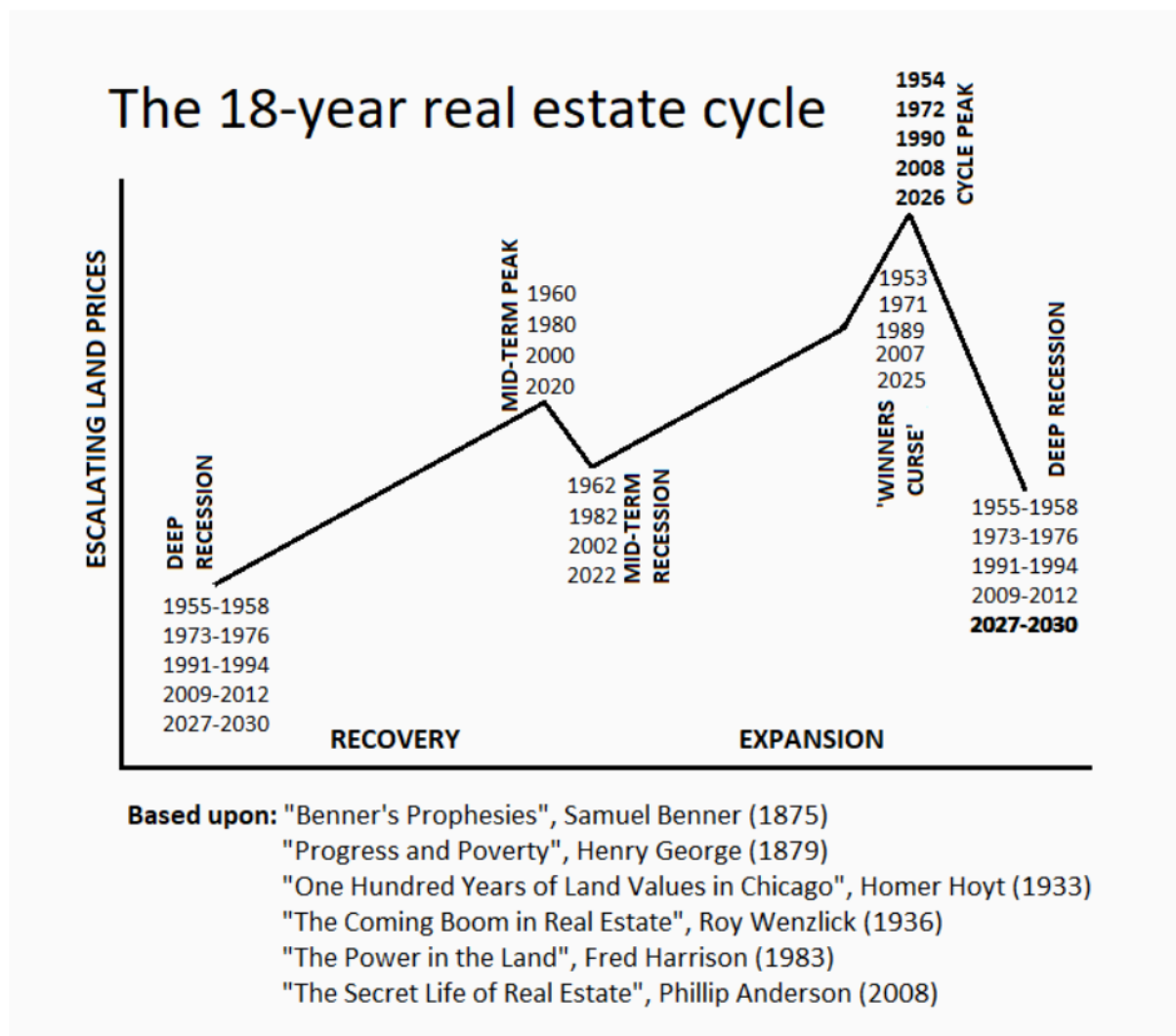
In 2010, the *Henry Tax Review* recommended an all-in land tax, alongside income tax, the GST and a mining tax, to replace all other state and federal taxes, as a trade-off. If implemented, this could have tempered the growth in land prices. However, after a failed attempt by the Rudd government to introduce the recommended super-profits tax on mining, tax reform has stagnated, and land prices have continued to rise unchecked.

LAND MARKETS WILL HAVE THEIR WAY WITH US

If politicians remain unwilling to address the issue of land price inflation through tax reform, the real estate market will eventually correct itself. Historically, real estate markets follow a regular pattern of boom-bust, with land prices rising to unsustainable levels before the inevitable crash.

Phillip J. Anderson's *The Secret Life of Real Estate and Banking* traces this US land price cycle back to 1800. It demonstrated a recurring 18-year cycle. Australia's property market follows the US cycle quite closely, although it's rarely discussed publicly, due to political reluctance and vested interests in maintaining *status quo*.

THE 18-YEAR CYCLE



Let's take a look at a diagram of the 18-year land price cycle since World War II. It's based upon the writings of the six people shown at the foot of the chart and is not financial advice. The 18-year cycle peaks were in 1954, 1972, 1990, and 2008, with *another* anticipated in 2026. After each peak, there's a steep four-year correction, followed by a recovery and a mid-term peak. The mid-term top is usually accompanied by a two-year recession. As we approach the final "Winner's Curse" phase of the cycle, shown at the top of the chart, whereas many analysts had expected a recession in 2023/24, it has failed to materialise. So, if the 18-year cycle *does* hold, it may be a case of "*off to the races*" next year, with a land price surge that could herald a crash in 2027. I guess we'll see?

TO CONCLUDE

CEDA, the Committee for Economic Development Australia tells us that productivity is at a 60-year low. GDP grew only 1.5% last financial year, the weakest since 1991/92. With land prices averaging increases of 12.2% per annum since 1971, the tax regime has been directing us into real estate investment by taxing productivity excessively. As we tank towards another real estate bubble burst, maybe it is time for Australians to consider taxing land values more and incomes and purchases less?