

It's the Land, Stupid: How the Homebuilder Cartel Drives High Housing Prices

Henry George was right about land values. And today we have a homebuilder cartel rooted in control of land and financing.

MATT STOLLER
AUG 15, 2024

253

20

Share

Welcome to *BIG*, a newsletter on the politics of monopoly power. If you'd like to sign up to receive issues over email, you can do so [here](#).

In 1879, anti-monopolist Henry George published *Progress and Poverty*, one of the most important books on the politics of industrialization. At the time, unparalleled technological progress through the deployment of railroads and telegraphs had generated massive wealth. But instead of broadly shared prosperity, Americans saw deep poverty in the midst of all the bounty. George asked why. In the tradition of Anglo-American land reformers, he concluded that the root cause of radical inequality was neither labor nor capital, but land.

George's argument went as follows. While mankind could pool its labor and efforts to create a surfeit of new consumer goods, the amount of land - an input into everything - was fixed. Moreover, the value of land had no relationship to work. Simply owning a lot around which a city grew up meant you'd get rich, where if your lot remained in a sparsely populated area, you wouldn't. Conversely, if you ran a business or a factory to help build that city, or lived in a rented apartment, your income would be increasingly sucked up by the landowner profiting from the value you created by operating or living there. It was the social community that generated the wealth of the landowner, not the landowner itself.

The result, George argued, was an entire rentier class of landowners, men who did nothing but grow fat on the backs of both capital and labor. The solution was to tax land, because such a tax, unlike taxes on incomes or tariffs, couldn't be avoided. The book was a runaway bestseller, not just in America, but worldwide. Woodrow Wilson's cabinet had many Georgeists, and the National Park system, among other American institutions, was shaped in part by it, as was in some ways the mid-20th century libertarian movement. The profession of economics formed in opposition to George's popularity. There are still Georgeists today.

And indeed, George has a lot to teach us about one of the key drivers of inflation for the middle class - housing. While inflation isn't as high as it was in 2022, prices are still the number one concern for voters. And it's not hard to see why. Yesterday, the Bureau of Labor Statistics came out with [inflation](#) statistics, showing that though price aren't going up as fast, costs are still rising, especially in a category of something everyone needs. "The index for shelter rose 0.4 percent in July," wrote the Bureau of Labor Statistics, "accounting for nearly 90 percent of the monthly increase in the all items index." That's... a lot.

Prices for housing are already at a record high, because of a pervasive long-term structural housing shortage in America. Since 2022, interest rates have increased, so homeowners with a locked in low mortgage rate don't want to sell their homes and move, the result being fewer existing homes on the market. One would think that the response would simply be to build more housing, especially on the cheap end. And yet, that's not happening. The traditional "[starter home](#)" for a young family just doesn't [exist anymore](#).



And it's puzzling why there isn't more construction. One reason, posited by a noisy group who self-identify as "YIMBY's," which stands for "yes in my backyard," argue there are too many local rules limiting development put forward by annoying people that want to maintain the local character and high housing values of their neighborhood by keeping others out. And yet, just pointing at over-regulation in and of itself isn't a satisfying explanation. After all, the collapse in housing starts really began in 2007, and it hasn't rebounded. Something is wrong with the market, as price signals aren't working.

To understand what is going on, the low output of housing production in the face of high demand, let's start with a slide in the [most recent investor presentation](#) from the number one homebuilder in America, D.R. Horton. Here the corporation maps its market share - on the right - with the number of homes sold - on the left.

Growth in Market Share



In 2005, when D.R. Horton sold a record number of homes, it [made](#) \$1.47 billion. In 2023, when it built roughly half as many, its [profit](#) was a little over three times as high, or \$4.7 billion. And this dynamic isn't because it focused on the high end, its overall market share was twice as high in 2023!

D.R. Horton isn't some anomaly, it's the market leader, along with Lennar, PulteGroup, Toll Brothers, and NVR, who round out the top five. In fact, these firms have gained so much pricing power and margin that Warren Buffett, who prefers purchasing firms with what he calls a competitive "moat," aka market power, [recently bought](#) stakes in D.R. Horton, Lennar, and NVR.

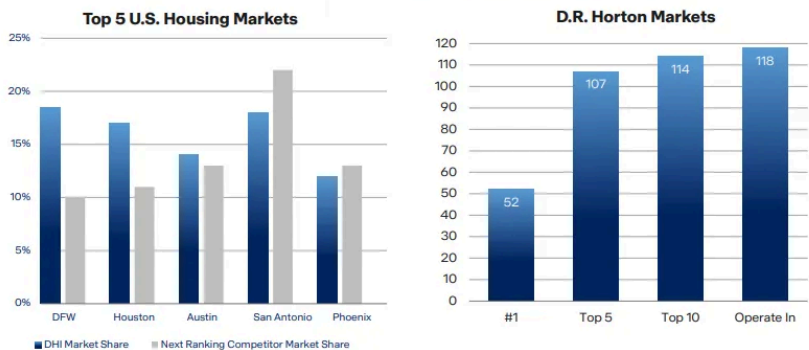
The story here, in other words, is consolidation. In 1994, the ten largest builders [had](#) just 10% of the national market. By 2018, the top ten builders had a little less than a third. Partly this consolidation is due to a credit crunch. During the financial crisis from 2007-2012, 55% of residential developers disappeared. There were also post-crisis mergers, like [Pulte Homes and Centex](#), [Lennar and CalAtlantic](#), [Tri Pointe and Weyerhaeuser](#), and so forth, but many of the acquisitions these days are smaller roll-ups, like D.R. Horton [buying](#) an Arkansas specialty builder Riggins Custom Homes, Gulf Coast builder [Truland Homes](#), or [lot developer Forestar Group](#), or Lennar [acquiring](#) developer WCI Communities. Analysts are projecting 2024 to be another strong year for M&A.

Of course, such numbers understate consolidation; national shares matter very little, since housing is local, and concentration is higher when you get to local levels. In Miami-Fort Lauderdale, [for instance](#), Lennar has 47% of the market for new homes, in Los Angeles, D.R. Horton has about a third. As economist Luis Quintero [noted](#) in a paper, 60% of local markets are now "highly concentrated," a new phenomenon. In 25 of the top 82 markets, one builder [controls](#) at least 25% of the market. That's [60% of the housing](#) markets in "Virginia, Maryland, Delaware, New Jersey, New York, and western Pennsylvania."

D.R. Horton brags to its investors about this fact, because local dominance is the name of the game.

Market Share Dominance

D.R. Horton is the largest builder in 3 of the top 5 U.S. housing markets & in 52 of the 118 markets in which we operated at September 30, 2023



Source: Zonda and D.R. Horton estimates for the trailing twelve months ended 9/30/23



So why all the consolidation? And more importantly, why hasn't the number of builders bounced back? If margins are up, why aren't there new entrants coming in to take profit and share? To answer this question I started by reading a bunch of investor documents from the big homebuilders. And I realized that to call these businesses "homebuilders" is misleading. It's striking how little of their business has to do with, well, building. For instance, here's D.R. Horton [in 2023](#): "Substantially all of our land development and home construction work is performed by subcontractors." Here's Lennar [in 2023](#): "We use independent subcontractors for most aspects of land development and home construction." I suspect most of the other big guys would say something similar. These aren't builders, they are financiers that borrow cheaper than real developers and use that cheap credit to speculate in land, hiring contractors to do the work. They are, in other words, *middlemen*.

These are large financial institutions that own a bunch of land which appreciates in value, and then build on it and sell homes. It can be quite risky, since they have to hold land on their books and that land can go down in value. But for the last fifteen years or so, it's been a bull market.

A centralized industrial structure for building is a new phenomenon in America. Homebuilding used to be decentralized, with hundreds of thousands of contractors. And to some extent, it still is. You can hire a contractor to build a house. However, smaller developers increasingly struggle, as going to a bank to borrow and start or grow a development is difficult. So is access to land. And that means that over the past three decades, the center of the industry, the construction of the starter home that millions of people need, has been centralized in the hands of a small number of players. As the Wall Street Journal [reported](#) in 2017. "By the Commerce Department's count," wrote Justin Lahart, "there were about 368,000 construction firms operating in the U.S. as of 2014 (the last year with available data). That compares with about 530,000 in 2005, and is the lowest number on record going back to 1977."

HEARD ON THE STREET [Follow](#)

Fewer Home Builders Means Happier Home Builders

One reason behind optimism among housing construction companies is there is less competition among them, which has limited supply

By Justin Lahart

May 15, 2017 1:54 pm ET



Gift unlocked article

The big homebuilders are clear about their advantages, which have nothing to do with operational efficiency. Here's [D.R. Horton](#):

"We believe that our national, regional and local scale of operations provides us with benefits that may not be available to the same degree to some other smaller homebuilders, such as **greater access to and lower cost of capital due to our balance sheet strength and our lending and capital markets relationships** and **volume discounts and rebates from national, regional and local materials suppliers and lower labor rates from certain subcontractors.**"

Capital, construction supplies, and labor are all cheaper for the big guys. Neat trick. And then there's land. "New builders also have to secure land to build on," reported the WSJ, "which is difficult in areas where large builders have already secured the most attractive lots." Large builders with access to capital can [hold](#) land for long periods of time, especially in a period like the post-financial crisis era when the Fed held interest rates quite low. In May of this year, the CEO of Toll Brothers [described](#) this dynamic to investors, discussing how their advantage in capital leads smaller players to sell out their land holdings.

So, what we're actually seeing more from the smaller builders who are facing some capital crunch is land deals that they have tied up, they've processed approvals on, they thought about building homes on, they're having a hard time finding the regional banks to finance them. And while they can't make a full profit they would have made had they built homes, they can make a fair profit by flipping the land to us. And so, we're seeing quite a few deals like that out of the smaller, more local and regional builders.

In other words, these middlemen are really all about financing. From 2008-2022, the Federal Reserve held interest rates at zero, which allowed those who could borrow to do so very cheaply. But of course, whether you could borrow makes all the difference in the world, as I noted when discussing [the Cantillon effect](#). Big middlemen can borrow, whereas smaller players or new entrants cannot, so land ends up in the hands of those with strong balance sheets.

BIG is a reader-supported newsletter focused on the politics of monopoly and finance. It's one of the only places to get journalism that explains how corporate actually works, and it only exists because of your support. So if you can afford it, please consider becoming a paying subscriber. You can subscribe by clicking [here](#).

Type your email...	Subscribe
--------------------	-----------

In 2022, the Fed raised rates, changing the industry. Big builders no longer want to hold billions of dollars of land on their balance sheet because financing costs have gone up. So what they've done is pay a financier, often private equity, to hold the land for them and take the risk of the land dropping in value, which is called a "land light" strategy. In return the financier gets a fee. Builders retain the right to buy the land back if they want it, through a "[right of first offer](#)" contract. Here's an example of a deal between D.R. Horton and lot management company Forestar.

MASTER SUPPLY AGREEMENT

The Master Supply Agreement formalizes the business relationship with DHI as both companies identify real estate opportunities and protects FOR's interests via the Right of First Offer process

A Right of First Offer (ROFO) is very different than a Right of First Refusal (ROFR)

- A ROFO agreement helps establish a fair market price/terms, whereas a ROFR is advantageous to the buyer by providing a "last look"
- The ROFO provides DHI the "first look" on available lots at market terms set by Forestar
- If FOR and DHI fail to agree on terms, FOR can offer the lots to other customers at similar terms offered to DHI

1 Lots Sourced by DHI

FOR must offer 100% of the lots sourced by DHI to DHI at current market terms

2 Lots Sourced by FOR

FOR must offer 50% of the lots in the first phase to DHI and 50% of the lots in any subsequent phase if DHI purchases at least 25% of the lots in the previous phase at current market terms

3 Lots Sourced by Third Parties

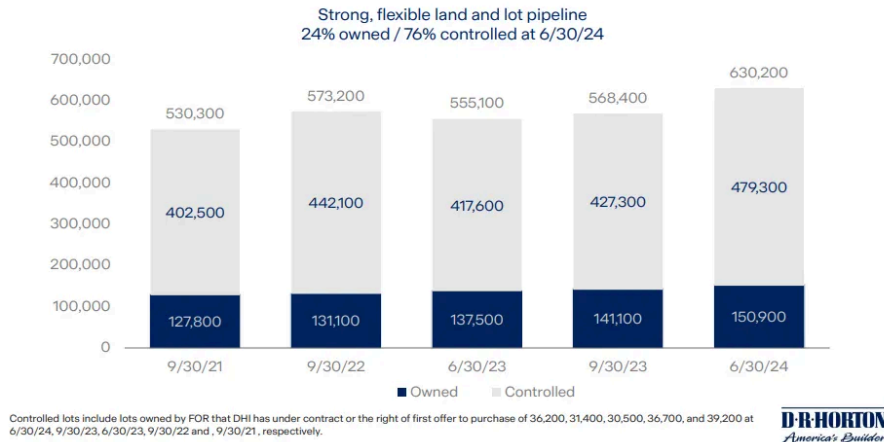
FOR offers the lots to the respective customer on third-party sourced development opportunities and is not contractually obligated to offer DHI the "first look"

Note: The Master Supply Agreement continues until the earlier of (i) the date which DHI owns less than 15% of voting shares of FOR or (ii) June 20, 2027; however, FOR may terminate the MSA at any time when DHI owns less than 25% of the voting stock of Forestar



Here's how D.R. Horton characterizes their control of housing lots.

Homebuilding Land And Lot Position



Interestingly, I suspect there's a cartelization effect going on as well. Here's Toll Brothers CEO Doug Yearley [a few years ago](#):

"We're doing significantly more third-party land banking where we assign a contract to a professional land banker, who then feeds us land back on an as-needed basis," Yearley said. "And then, we're doing joint ventures with either Wall Street private equity or **with our friends in the home building industry, the other builders.**"

What exactly does that quote mean? I don't know, but it seems kind of crazy that large homebuilders would be doing joint ventures with each other on land acquisition, when that could very easily lead to holding supply off the market and preventing smaller developers from competing to build cheaper homes.

More broadly, the story here is the differentiation of homebuilding into two different groups. The first are the financial middlemen who contract everything out and control the industry, buying cheap and hoarding land. The second are actual developers who want to build, but are boxed out because they can't borrow money. I suspect that in this dynamic we might find an incentive for local overregulation. I don't know much about the political strategy of the homebuilders, but it would be weird if they didn't use such a competitive weapon. And we do see some elements of that, such as when D.R. Horton and its private equity partner Brookfield were [able to get valuable](#) underpriced land in Arizona because of their financing advantages.

Regardless, [the net effect](#) of consolidation of homebuilders is significant, estimated at keeping 150,000 new homes from being built every year, which is roughly \$100 billion of construction. So what's the solution?

Well, in this case, the answer is likely a combination of policy interventions. The most important is to equalize credit access for smaller and local developers. We should foster the creation of more local banks, or offer local subsidies or preferential treatment of local developers in buying public land. Another big part of this dynamic is a lack of knowledge. Policymakers and smaller developers need more information about who holds local land lots and who are the big builders, especially at a municipal or regional level.

There aren't great sources of data for who holds undeveloped parcels off the market. Another is to impose land limitations to prevent land hoarding, or tax the land of lot developers so they don't hold land off the market. Finally, the Federal Trade Commission and Antitrust Division have a loophole in their merger disclosure form, which is called the Hart Scott Rodino form, which

allows big firms to avoid telling the Federal government when they make acquisitions of real estate. That's a problem, considering the likelihood of consolidation.

Regardless, it's important to move the discussion about housing away from the focus on local regulations, as this dynamic is clearly a national problem involving a market structure where price signals are not bringing in more supply, but are bringing higher margins to a small group of players. In some ways, the land monopoly is the very first monopoly America ever addressed, through the equal parsing out of land lots through the Northwest Ordinance in 1787. In the 1850s, Frederick Douglass [ascribed](#) the cause of slavery as consolidation of "land monopoly" and called for "land limitation" in response. Many states today still have land limits on the books, though these are [often ignored](#). Henry George, in other words, was just representing an American tradition. And it's one we should take seriously.

Thanks for reading. Send me tips on weird monopolies, stories I've missed, or comments by clicking on the title of this newsletter. And if you liked this issue of BIG, you can sign up [here](#) for more issues of BIG, a newsletter on how to restore fair commerce, innovation and democracy. If you really liked it, read my book, [Goliath: The 100-Year War Between Monopoly Power and Democracy](#).

cheers,

Matt Stoller



253 Likes · 37 Restacks

20 Comments



Write a comment..



steph k 22 hrs ago Liked by Matt Stoller

Fascinating. Thank you for this breakdown.

LIKE (11) REPLY SHARE ...



Erwin Cuellar 19 hrs ago Liked by Matt Stoller

That's disappointing to hear but not surprising. Consolidation is also happening in the material supplier industries. These supplier companies aren't as commonly known as the builders and they get sold to PE or strategic companies, flying under the radar since they aren't public companies.

I'm in this industry if you'd like more info.

LIKE (9) REPLY SHARE ...

1 reply by Matt Stoller

18 more comments...

