Creating competition among sellers of land can facilitate land assembly and development

One of the most difficult parts of any development project is acquiring land. Large projects, especially in dense urban areas, often require developers to purchase land from several different landowners, and these landowners have an incentive to delay selling to elicit a better offer from the developer. Such strategic behavior by sellers is often referred to as the holdout problem—sellers holdout even if offered a price greater than their own value with the hope that their land becomes critical for the project so they can command an even higher price.

The holdout problem is often cited as a justification for eminent domain, but there are other less intrusive ways to facilitate land assembly. In an article in the Journal of Urban Economics, Florida State professors Mark Isaac and Carl Kitchens, along with Florida State economics PhD graduate Javier Portillo, use experimental economic methods to analyze how competition among sellers affects land assembly. They find that creating competition among sellers significantly increases the chances of successful land assembly without the use of eminent domain or contingency contracts.

KEY FINDINGS

Higher probability of successful land assembly
In their experiments, buyers of land (the developers) are given several different sites to choose from, which means the sellers of land must compete with one another. The authors find that when buyers have options for assembling the required amount of land, successful land assembly occurs at least 84% of the time, depending on the exact number of options, compared to only 40% of the time when there is only one option. These results suggest that the holdout problem can be resolved when there is competition among sellers due to the presence of alternative sites.

Larger development incentives relative to contingency contracts
Creating competition among sellers also has advantages over a contingency contract, which is another option developers use to avoid the holdout problem. A contingency contract makes the purchase of any parcel of land for a particular project contingent on the developer being able to purchase all the land required to move forward. While these contracts increase the probability of acquiring the necessary land, they also shift the gains from trade, or economic surplus, from the buyer to the sellers. This shift in surplus decreases developers’ incentive to undertake new projects. Alternatively, Isaac et al. find that developers can expect to keep more of the surplus
when there’s competition among the sellers, which should lead to more development relative to the use of contingency contracts.

**Developers are more likely to negotiate with owners of large parcels than smaller ones**

The study also helps explain why development is more likely to take place near the periphery of cities, where tracts of land tend to be relatively large, rather than the urban core, where land tends to be more fragmented among multiple owners. In one of the experiments, buyers could either negotiate with several sellers to assemble a piece of land large enough for development or a single seller who owns an appropriately sized piece. The authors find that buyers are much more likely to negotiate with the single-piece seller than the fragmented landowners. They also find that negotiations are faster and buyers are willing to pay a premium for land that is already assembled, both of which may be due to the higher transaction costs associated with negotiating with multiple sellers simultaneously.

**POLICY IMPLICATIONS**

Overall, the authors find that development is more likely to occur when developers have multiple sites to choose from or where large parcels of land already exist. These findings have policy implications for city officials who want to spur development.

First, eliminating single-use designations for land (e.g. residential, commercial, industrial) would likely increase development by increasing the number of viable sites, which creates competition among sellers. If that’s too drastic, making it easier to rezone land from one use to another would also foster competition.

Second, relaxing maximum lot sizes in urban cores, or eliminating them altogether, would make it less costly to assemble land in downtown areas relative to a city’s periphery, which would decrease the bias towards suburban development. Cities could also consolidate adjacent parcels of land using land banks and make the parcels available for development.

Local officials who implement these policies to facilitate land assembly may also find that they can reduce their often-controversial use of eminent domain for development projects.