Ground Rent Dynamics in Residential Housing Markets in England - theoretical foundations

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Abstract

This paper investigates the relationship between real estate investment and housing dynamics in England through the lens of Marxian ground rent theory, rent gap theory, and the Circuit of Landed Capital model. These theoretical frameworks challenge key assumptions of Eugene Fama's efficient market hypothesis by revealing the presence of information asymmetries, market inefficiencies, and unaccounted externalities in housing markets. By analysing the roles and behaviours of key actors in the housing production process, the paper demonstrates how the pursuit of ground rents shapes their strategies and decisions. Insights from interviews with local residents, activists, and councillors contextualise the theoretical analysis within the real-world dynamics of housing markets. The paper argues that the pursuit of ground rents influences housing affordability, quality, and supply in England in ways that deviate from the predictions and expectations of an efficient market. The research aims to enrich the theoretical understanding of housing market dynamics and inform more effective policymaking to promote equitable and sustainable housing outcomes. It advocates for improved data transparency, interdisciplinary research, and policies that empower local communities in development processes.

Keywords: Ground rent dynamics, Housing markets, Urban political economy, Financialization, Marxian theory

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Theoretical Frameworks

- Marxian ground rent theory: DR1, DR2, AR, MR
- Neil Smith's rent gap theory
- Circuit of Landed Capital model (M-L-M')

Challenges assumptions of Fama's efficient market hypothesis.

DR1 - differences in land fertility or location, where more fertile or better-located land generates higher rent.

DR2 - successive capital investments on the same land, with diminishing returns over time.

AR - land scarcity and private ownership, allowing even the least fertile land to generate rent for landlords. It is the excess of the price of agricultural production over its production cost.

MR - consumer demand and unique land/commodity features without close substitutes. Landowners can charge a premium due to the uniqueness and desirability of the land or commodity, generating Monopoly Rent.

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Focus: Marxian rent theory emphasises the social and economic power relations that underlie the extraction of rent and the distribution of surplus value. It highlights the role of rent in shaping the strategies and decisions of various actors in the production process. The common understanding of rent, on the other hand, focuses primarily on the exchange value of a property and the contractual agreement between the tenant and the landlord.

Rent gap is the disparity between the current rental income of a property and the potential rental income that could be achieved if the property were put to its "highest and best use”. When the rent gap is sufficiently large, it creates incentives for landowners, developers, and investors to redevelop the property, leading to gentrification and displacement of existing residents.

EMH - asset prices in financial markets fully reflect all available information.
Assumptions:
1. Investors are rational and value securities rationally.
2. Information is freely and widely available to all market participants.
3. Transaction costs are minimal.
4. Investors react quickly to new information, and stock prices adjust accordingly.

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In the M-L-M' circuit, money capital is invested in land, which is then used in the production process (e.g., housing development) to generate surplus value in the form of rent.

Both the rent gap theory and the circuit of landed capital provide critical insights into the dynamics of urban development and housing markets, challenging the assumptions of neoclassical economics and highlighting the contradictions and inequalities inherent in the capitalist production of space. They emphasise the importance of understanding the strategies and motivations of different actors in the development process, and the ways in which the pursuit of rent shapes urban spatial patterns and social outcomes.

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Development Actors and Relationships

- Key actors: landowners, asset managers, developers, investors, planning authorities
- Pursuit of ground rent shapes strategies and decisions
- Investors prioritise demand-side risks, developers focus on development and planning risks
- Power imbalances and information asymmetries characterise relationships

Information Asymmetries: Institutional investors and developers often have access to privileged information about the development potential of a site, such as its zoning status, infrastructure plans, or market trends. They may use this information to identify profitable investment opportunities and to negotiate favourable terms with landowners or planning authorities.

Power Imbalances: Institutional investors, such as asset managers and pension funds, often have significant financial resources and political influence, which they can leverage to shape urban development projects in their favour. They may pressure local planning authorities to approve projects that maximise their returns, even if these projects have negative impacts on local communities, such as gentrification or displacement. Local communities, on the other hand, may lack the financial resources and political clout to effectively oppose these projects or negotiate for more equitable outcomes.

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Example: A large asset management firm identifies an opportunity to redevelop an industrial site in a low-income neighborhood into luxury apartments. The firm has access to insider knowledge about a planned transit extension that will increase the site's accessibility and market value. It uses this information to negotiate a low purchase price with the landowner and to lobby the local planning authority for favourable zoning changes.
The local community, unaware of the transit plans and lacking the resources to conduct their own market analysis, may initially support the redevelopment project, believing it will bring job opportunities and economic growth. However, as the project progresses, they realise that the luxury apartments are unaffordable for most residents and that the development is contributing to rising rents and displacement pressures in the neighbourhood.
In this example, the power imbalance between the institutional investor and the local community, combined with the information asymmetry about the site's true development potential, results in an outcome that prioritises the investor's financial interests over the community's needs and desires. This illustrates how power imbalances and information asymmetries can perpetuate uneven urban development and exacerbate social inequalities.

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Case Studies and Local Perspectives

- Southwark: ghost flats, gentrification pressures, cross-party political support for development
- Brixton: Hondo Enterprises development plans threaten local culture and community
- Insights from local residents, activists, and councillors contextualise theoretical analysis

"Hondo enterprises, run by a guy called Taylor McWilliams who's a Texan property guy and he bought most of the market, he bought loads of property, a couple on Brixton main road, and he has bought up the area around Pope's Road and he wants to build a massive tower. There's a big fight on to stop this tower going up because it will dwarf everything else in Brixton. It will completely change areas of the market that will have long term stakeholders, like quite culturally important areas for lots of people. And everyone sees this as just an attempt to purchase and then commodify and then market whatever positive creative spirit Brixton has." (Kieron, Lambeth resident and organizer, interviewed on 3rd May 2022)

"The result of overseas investors buying flats in Southwark has been first -- a series of ghost flats -- not occupied merely sitting there as investments -- meaning any of the supposed new community vitality promised by the developers simply does not happen; second, some investors buy for or place their university age kids in the flats -- e.g. the Strata Tower -- the result has been an increase in East Asian eateries etc targeting this new population who attend London universities. The gentrification pressures are obvious already on Walworth Road as old shops are closing down and new shops catering to a very different population (different by class and ethnicity) are opening up." (Loretta Lees, interviewed on 26th July 2021)

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Policy

1. Capture and redistribute ground rent (e.g. land value taxation, community land trusts)
2. Strengthen planning regulations and affordable housing requirements
3. Promote transparency and accountability in the housing market
4. Encourage collaborative partnerships to develop innovative, sustainable solutions

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Conclusion

Interdisciplinary approach crucial for understanding complex housing market dynamics

Ground rent pursuit influences affordability, quality, supply; deviates from efficient market expectations

Future research directions: engage marginalised communities, incorporate feminist/postcolonial perspectives

Transformative policy and scholarship needed to promote housing justice and right to the city