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Landlords Are Not Developers (and Vice Versa)

Daniel Herriges · September 2, 2021

Here's a fact you need to understand if you want to understand the housing affordability crisis gripping much of the U.S. and Canada: *Landlords and developers are not the same.*

That statement probably seems head-slappingly obvious when stated so plainly. But it's something that a striking number of commentators and advocates get wrong without always realizing they're doing it. For example, if only I had a dollar for every time I read something like this (from a story about a proposal for funding a housing trust fund in Kansas City):

> *KC Tenants also proposes levying taxes on developers to generate funds....Proposed taxes on developers include an anti-speculation tax meant to stop investors from buying and reselling properties. KC Tenants proposes a 15-20% tax on properties transferred to a new owner within two years. Another proposed tax is a linkage fee, a development impact fee on new construction.*

There are two taxes described in that paragraph, and only one of them is actually a tax on developers. The linkage fee specifically targets new construction. The transfer tax, on the other hand, targets the resale of existing properties. These are two completely different proposals with very different economic effects, and to lump them together as affecting "developers" is beyond unhelpful.

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Seeing Big Real Estate—developers, investors, speculators, flippers, Wall Street REITs, institutional landlords, mortgage lenders—as a unified front makes intuitive sense to people whose political instincts are anti-corporate and/or anti-elite.

I largely share those political instincts. Nonetheless, this kind of conflation prevents us from understanding the housing market in a coherent way. Different players in the market make their money in very different ways, and have different interests and policy preferences as a result.

A Crucial Distinction

What is a developer? The simplest definition is anyone who increases the value of land by altering it and/or building upon it. (To get nitpicky, the developer plans and oversees the project, hiring the skilled contractors they need: a developer is to a building as a producer is to a Hollywood film.)

What is a landlord? The simplest definition is someone who owns property and collects rent from its user.

These are two fundamentally different roles. The same actor can of course play both of them, at different times or simultaneously. But far more often, it's not the same people, because it's not the same business model.

A landlord profits by **possessing** real estate.

A developer profits by **creating** real estate.

This distinction, as it turns out, makes all the difference.

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Scarcity

Landlords, as property owners, benefit financially from any form of scarcity which makes their property more desirable and expensive. It is low vacancy that allows them to raise the rent and be choosier about their tenants. And low vacancy happens when housing production lags housing demand.

Scarcity is in your financial interest if you're a small-time landlord who owns some duplexes. It's in your financial interest if you're a land speculator sitting on a parking lot for decades waiting to sell to a developer. Scarcity is certainly in your financial interest if you're a big corporate investor like the infamous Blackstone. The REIT's own SEC filings explicitly identify the "continuing development of apartment buildings and condominiums" as a business risk which could cause it to lose profit.

The benefits of scarcity apply not just to those who rent out their property, but to individual homeowners who treat their home as an investment. Even if they don't primarily think of it as one, if they ever intend to sell it or borrow against it, they have at least some stake in continuing unaffordability. As I wrote in "Rage Against the Machine," although homeowners are often posited as virtuous community voices standing in opposition to a "Growth Machine" consisting of big real estate and local politicians, the truth is that homeowners are, in numerical terms, the biggest land speculators in cities. For each hour spent at the office, a homeowner in San Jose, California collects $100 in rising equity.

As Josh Stephens memorably puts it, "Those who buy pork bellies do not make bacon.... To the person who owns pork

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Developers Profit by Making High-Returning Investments

Something to understand about developers: Mostly, they don't own the properties they develop until it's time to start putting a project together.

This is not strictly true. Sometimes a developer will speculate on an area they believe is up-and-coming by acquiring land early and sitting on it, and big ones may spend years "assembling" a whole block full of small lots in order to do a big project.

But developers, as a rule, acquire land with an eye to developing it. They're rarely sitting on huge real-estate portfolios, for the simple reason that they couldn't afford to do that and also, well, be developers.

Making buildings is extremely expensive and puts you in a lot of debt, and selling a completed building is generally the least risky way to pay off that debt and walk away with your profit margin, versus getting into the property management business and having to ride years of market swings. Usually it's necessary to sell off completed projects in order to afford to begin the next project.

When a developer buys land, who is profiting? Any windfall goes to the previous owner, the one who sold to the developer, because they're going to sell it for the highest price they can get. Again, the key point here is that making money on the passive appreciation of property value, or the

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Huge developer profit margins do happen sometimes, of course, but they happen most often by successfully betting on an up-and-coming market niche—be that a location or a type of product for which demand has been underestimated. It's a combination of luck, savvy, good timing, and (often) connections.

Not a United Front

Land owners benefit from scarcity and as such may support policies that drive property values higher. Do developers? This is far less clear, and often the answer is, "No."

There are a tiny fraction of developers who specialize in truly luxury construction, like the infamous Manhattan supertalls providing many a pied-a-terre to Russian oligarchs. There are far more whose niche involves stuff like the many "boxy" 5-over-1 apartment complexes with trendy-sounding two-syllable names that aren't truly catering to the superrich, but still sport showy amenities and are expensive enough to build that they wouldn't be viable if not for high rents.

For the rest of the development world, however, being able to build more homes for more people is preferable to being able to build fewer homes for fewer people. For small-scale developers in particular, land costs are often the most prohibitive barrier to entering the market at all.

When it comes to zoning and other land regulation, different categories of developers have opposing interests. So the notion that "developers" are a unified front when it comes to land use policy or regulation is an illusion.

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landlords. Small-time ones might have a stake in their community in other ways than pure profit. Homeowners often have interests other than just the investment value of their home. Questions like "Will my kids be able to live here?" can tug at their heart strings, but so can more self-interested matters like views, quiet, or perceived or real exclusivity. (The latter, of course, can have an ugly side.)

U.S. housing policy, on the whole, is designed to make housing a secure investment, largely to the benefit of those who got in on the ground floor, and to the detriment to anyone seeking to move to *or* build in an already-expensive place.

I didn't write this to essentialize any group as having comparatively noble motives or rapacious ones. Rather, it's helpful to understand the different *interests* that different groups may have and may or may not choose to act on. Step 1 in understanding an intractable problem is to understand who benefits from the status quo, and how.

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Daniel Herriges

Daniel Herriges has been a regular contributor to Strong Towns since 2015 and is also a founding member of the organization. His work at Strong Towns focuses on housing issues, small-scale and incremental development, urban design, and lowering the barriers to entry for people to participate in creating resilient and prosperous neighborhoods. Daniel has a Masters in Urban and Regional Planning from the University of Minnesota, with a concentration in Housing and Community Development.

Daniel’s work with Strong Towns reflects a lifelong fascination with cities and how they

Daniel has lived in Northern California and Southwest Florida, and he now resides back in his hometown of St. Paul, Minnesota, along with his wife and two children.

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David Albrecht
2 years ago edited

Nice article.

As a landlord (which I am), I'm in the business of delivering shelter--as much as I can, for as long as possible, while making money doing so and investing prudently for the long term. In a lot of ways, it's like any other business--you're buying inputs (construction labor, roofing, etc), selling an output, and trying to make a profit. This is very much business/investment. Scarcity isn't really a part of it for me, either--if rents get high enough, people will just move, and I'll have vacancy. It has to work for everyone.

As a homeowner (which I also am), the outlook is completely different. Money spent housing me is *consumption*--groceries or gas--not an "investment".

I don't think this is something we can change in the short term, but longer-term, I think getting away from the idea that primary home = investment, would be massively beneficial. There are a lot of actors in the system (Fannie, real estate agents, mortgage lenders) with a vested interest in getting people to spend more and pushing prices up, which ultimately just makes it harder for first-time buyers to buy. It kind of reminds me of gold -- I read an article calling it "the 6,000 year bubble" -- we all sort of agree that

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Auros Harman ➜ David Albrecht
2 years ago

Our nation made a huge blunder back in the '40s when we decided that we were going to build the middle class fundamentally by encouraging the

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can see plenty of examples in the modern world of this working very well -- a bunch of developed countries (Norway is probably the most prominent example) have some kind of Sovereign Wealth Fund, and all citizens are taken to have a stake in it. You could do a national 401(k) type fund where the money was kept in a SWF, invested in the global economy in a diversified way.

The problem with saying we want people to mainly invest in a house, is that housing cannot be "a good investment" in the long run, without creating problems. After all, what does it mean for something to be "a good investment"? Well, its price has to appreciate faster than inflation. OK, but how do you determine the price of a piece of residential real estate? It's the Net Present Value of its potential rental income flows, less the expenses to run it (maintenance, taxes, etc.)

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David Albrecht ➜ Auros Harman
2 years ago

Absolutely nailed it.

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John Hawkins
2 years ago

That's a good distinction to keep in mind, but I wanted to point out another angle in the Developers-Landlords-Homeowner's interaction. In a place experiencing growth, there is an inevitable cost to the existing residents from that growth - more traffic, more pollution, more crowded public accommodations, at some point the transformation of the entire character of the place. If the growth doesn't provide enough value to offset those costs, then the existing residents are effectively being exploited by the developers and those who sell the land to them for profit.

I've called it strip-mining the value of a community, but to put it in Chuck's Bad Party analogy, the people already living in the town have created a party nice enough other's want to join in, but the REIT's and developers are selling tickets to the party, pocketing the money, and not providing much in the way of snacks or drinks for the new partygoers.

Our existing land-use regulation tools don't often do a very good job of preventing this exploitation, and I believe this leads to a lot of the intransigence from existing residents. And I think it's about the non-financial stakes people have in their communities far more than it is the financial ones. If growth drives up the price of real estate, the existing homeowners can always sell and realize their profit, but if growth

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more traffic, more pollution, more crowded public accommodations"

I would challenge the statement that this is inevitable. Yes, badly designed growth is going to do that, and with the "drought or firehose" that we have tended to see in the past fifty years, you get bad design.

Well designed growth through "many small bets", on the other hand, will tend to adapt to serve local needs. You can have, for instance, missing middle housing units that allow super-commuters, who were adding smog and traffic to your streets, to move in to the community and start walking to work. With a somewhat denser population, and legalization of "Accessory Commercial Units" or other methods of mixing commercial activity into formerly-residential-only areas, instead of crowding more people into the existing amenities you can just have more different amenities in more parts of town. More corner stores that meet 80% of your grocery needs (so you do a few small shopping trips by walking or stopping in on the way home from work, and only stop at the mega-mart once in a while for non-staple stuff). More

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John Hawkins ➜ AurosHarman
2 years ago

While I understand what you are getting at, I stand by the inevitability of growth having costs. Of course better thought out, more complementary, etc., etc. will have lower costs than the typical "throw up another office tower downtown, another SFH subdivision on the edge of the metro area, and a 20 mile urban freeway to connect them", but the costs are never zero and don't get trapped into thinking it's only about density.

What you are talking about are the benefits, and that's also what I'm talking about. The growth has costs, creates issues, so those have to be compensated for by the benefits delivered to the people already there. The coffee shop you mention is a benefit. It burdens the sewer system a little more, or the road network, or - shudder - parking, but if it delivers a benefit to the residents, then it's welcome.

But one very important consider is that those costs skyrocket with the pace of growth. Beyond a certain level, no growth can have the costs of disruption for the existing residents mitigated by the

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Dan Allison ➜ John Hawkins

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seen, and I upvoted it for that reason.

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John Hawkins ➜ Dan Allison
2 years ago

Thanks Dan.

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Mr. Flute ➜ John Hawkins
2 years ago

Please specify the 'costs' that are removing 'value' in your exploitation scenario(s).

I curious about your view and where/how you're coming to it.

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John Hawkins ➜ Mr. Flute
2 years ago

I'm curious about your view if you don't intuitively understand this.

How about you try to articulate it. You should be able to : what might the costs be to a long-time resident of a neighborhood if there is a sudden growth spurt?

Keep in mind, costs and benefits are distinct. A new restaurant can be a benefit that also comes with some costs. Just because there is a benefit doesn't mean the costs don't exist. We have to acknowledge and account for the costs to understand if the benefits are ultimately worth it.

So... your turn, what costs can you hypothesize from growth in a neighborhood?

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Mr. Flute ➜ John Hawkins
2 years ago

It seems that you're over-emphasizing impact and cost as it relates to scale.

Our built environments exist because of growth (and our capitalist society/economy too). On the scale of a community, one new restaurant is going to have less and less percentage 'impact' (whether subjectively good or bad) at a community scale, especially for communities that are effectively at build out.

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That new restaurant/grocery store/general services strip center on the commercial corridor adjacent to my residential neighborhood and physically 4 houses from my house is great because I can get to it quickly and even walk (hopefully, depending on physical connectivity). Of course the house directly adjacent may have a different opinion.

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John Hawkins ➔ Mr. Flute

2 years ago edited

You haven't addressed the issue of costs. Please do so.

As to where my people came from, they have moved from time to time as has everyone. Does that somehow obviate the pain felt by those who are moved off their land? It's an odd sort of argument you are on the verge of making, that one act of shoving a people off their land excuses all such future acts.

You should reconsider your argument. At best it simply says might makes right, in which case, get off my lawn.

Also unexamined by your "I know you are but what am I" response is the difference between moving somewhere to displace a group and moving somewhere to piggyback on top of what they've built. Past migrations/invations/displacements have largely been about taking the land from some tribe unable to defend it. Today, migrations are more about being sold access to the

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Mr. Flute ➔ John Hawkins

2 years ago

Who has been 'moved off their land'? What are the other specific 'costs' you appear to be so concerned about? You haven't substantively delineated any so far as I can see.

I suspect that we're going to continue talking past each other, so I bid you godspeed.

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Seth Zeren

2 years ago

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