

DISCUSSION OF “RATIONALITY AND EXUBERANCE IN LAND PRICES AND SUPPLY OF NEW HOUSING”

ALEX ANAS AND DEBARSHI INDRA

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What I liked...

- ▣ Model carefully thought out and analytically explicit
- ▣ Sophisticated and appropriate state-of-the art econometrics
- ▣ Detailed (to a fault?) and logically ordered description of rationale for specification, data, estimation methods
- ▣ Important question: Decomposition of investor's reservation price for land over time into systematic (rational) component supported by fundamentals and an entropic "irrational exuberance" component driven by idiosyncratic random profit shocks
- ▣ Findings:
 - Land investors exhibited clear evidence of "irrational exuberance" on the upside as well as "irrational pessimism" on the downside
 - Homebuyers displayed even greater departures from rationality

Comments and issues:

- Is a somewhat greater degree of parsimony possible in model specification and estimation?
- Data availability is limited to a degree, e.g.
 - Investor/developer risk-adjusted rates of return
 - Parcel size, entitlements?, platted lots (or a single lot)?, developed infrastructure?, infill? Etc.
 - Variance (dispersion)
- Sufficiently realistic description of the realities of the series of transactions that take place in the land development process?
- Only a brief mention of the potential importance of financing terms and availability and government interventions over the cycle. In fact were of paramount importance
- Assumption of a one-year lag between construction and sale?
- Are city-year fixed effects sufficient to justify OLS for the land value/house value/FAR equations, thus eliminating the need for a structural equation model?

Comments and issues (continued):

- ❑ Increase in value of land and housing with distance from highway a misspecification?
- ❑ Optimal FAR vs. actual varies by location. Large-lot zoning not typical in LA County
- ❑ “More volatility in the idiosyncratic random profit shocks *increase* the expected maximum return and therefore the reservation price that would be bid for the land”. Is this right?
- ❑ “Land prices rose early, then “bubbled back” to the 2000 level before house prices peaked” implies very high price for improvements above construction cost? Any residual values should attach to the land.
- ❑ Common peaks in entropy before S&L Crisis as well as Financial Crisis? Had very different causes/effects on housing market