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The Hoyt Heist

Homer Hoyt, the economist who led the field with his study of cycles in land values, believes that the 18-year cyclical trends — in the USA, at any rate — no longer operate. Yet in our analysis of the British economic depression of the mid-'70s a major role was assigned to the causal influence of land speculation, and stress was placed on the predictive value of the 18-year pattern. But if Hoyt is correct, the theoretical value of the 18-year cycle has been extinguished. Its apparent presence in the UK would turn out to be a fluke, a random event of no scientific value in terms of its ability to yield general hypotheses about the effects of land monopoly.

If the speculative influence of the land market has been removed — thereby smoothing out the peaks in the trends in land values — we want to know how this came about. Was it due to institutional innovations, or a change in the psychological motives of investors? Then there is the challenge to Henry George's thesis that speculation is the major cause of recessions. If land speculation had diminished in importance, why is it that the world economy took a deep dive into an economic trough in the 1970s? Was George's analysis at best relevant to a bygone age? On the other hand, could it be that the cycle in land values is alive but disguised, and still operating to undermine the economic system? If it transpires that the latter possibility is correct and relevant to the US economy, we would have discovered a second modern case to verify the 18-year cycle.

Hoyt had no sooner concluded his study of the cycles in Chicago land values than he felt disposed to predict, as early as 1933, that

> the sequence of events just described may in the future be of interest only to historians delving in the habits and customs of 'early machine age culture in the United States,' and the knowledge of the mode of behaviour of forces in the real estate cycle will have no value in forecasting the trend of future events.[1]

Thirty-five years later he concluded that his prescience was warranted. He decided that 'The fluctuations in the real estate cycle which characterised our

economy in the 150 years prior to 1933, have ceased'.[2] He reaffirmed this view in correspondence with the present author in 1976, and also when interviewed at his home in Washington — at the age of 83 — in 1978. As one of America's most distinguished land economists, Hoyt's views are authoritative and command respect. A contrary view has to be well-documented. Three sorts of evidence have been collated to show that Hoyt is wrong.

Chicago real estate appraisers were interviewed, to establish whether there was any discernible trend in the values of the land in the city in the post-war years. It will be recalled that, in Chapter 5, the Chicago cycles were reported to be a sound barometer for what was happening in the rest of the economy. To what extent did a pattern emerge in the postwar years, and how did this (a) reflect trends elsewhere in the economy, and (b) sustain the hypothesis that there is a causal relationship between land speculation and industrial depressions?

In addition, it is now possible to evaluate some aggregate data which was not available when Hoyt undertook his Ph.D research in 1930. But our starting point is an examination of the successes and failures of a distinguished land speculator, whose business biography may provide clues and therefore suggest a general pattern. That speculator is none other than Homer Hoyt himself.

Homer Hoyt's grandparents emigrated from Germany in 1853. They settled in South Dakota in the 1880s, and their daughter gave birth to Homer in 1896. Homer recalls that his mother had a burning desire to own land, and this desire was inherited by her son. His earliest impressions of the fortunes to be made from land speculation were acquired while he was living in Chicago in the early 1920s. In 1925 he decided to buy some land in Cicero Avenue. But he made a cardinal mistake: he bought at a time when prices were at their peak, and although he held on to the land for over four years he lost money. The price of the land collapsed and he could not find a buyer. That was one of the reasons for his decision to study the history of land values in Chicago for his Ph.D thesis, upon which he embarked in 1930.

Vacant land, it seemed to Hoyt, was a bad risk: the Chicago venture had left him 'disgusted' with land which failed to yield an income, and he was determined not to repeat the mistake. In 1943 he bought some orange groves in Florida. Unfortunately, however, he was to fare no better out of this deal. The land was valuable because the US military forces were paying high prices for the oranges. But when the war ended and the soldiers were demobilised, the army stopped buying oranges! The bottom fell out of the market, the value of Hoyt's land slumped, and once again he realised that he had bought at the wrong moment: at the peak of the prices. The secret, he told himself, was to buy land early in the cycle in values, and then sell before the down-turn. Someone else should be left holding over-valued land when

the slump came. These hard-learnt lessons were to stand Hoyt in good stead, and were to help him to become a multi-millionaire.

The postwar years saw the beginnings of a new trend in the United States: the emergence of large shopping centres to suit the needs of the age of the motor car. Hoyt was involved with these enterprises at the outset. He was employed as a consultant to appraise the profitability of the complexes which were planned from coast-to-coast. He earned fat fees in return for his remarkable talent for predicting the income streams which could be expected from these developments. His close study left him in no doubt that the biggest profits accrued to whoever owned the land, which 'skyrocketed'. His interest in vacant land was rekindled.

In 1953 Hoyt bought an interest in 620 acres in Fairfax County, near to Washington DC, for between $200 and $350 an acre. At the time, he recalls, there was a total lack of demand for land. So he was buying in the trough of the cycle, when values were rock bottom. He sold out in 1972 for $7,000 an acre — an average increase per acre of nearly 2,500%, reaping him a profit of $2m. What does this tell about any cycle in values which might have been at work? Hoyt cannot identify when the value of his land started moving up, but he points out that the turning point in the speculative boom was in mid-1973. This is an overall period of 20 years, which is close to the theoretical cycle of 18 years. But the issue is complicated by the fact that the value of the land did not dramatically slump in the recession which followed, for in 1976 Hoyt placed a value of $10,000 an acre on the land which he had formerly owned. Here, then, we have our first feature apparently inconsistent with previous cycles: if the boom in land speculation terminated in 1973, why was it not followed by a collapse in land values?

Hoyt's assessment may have been coloured by his own prospects, which are well illustrated by some of his deals in Florida. This south-eastern corner of the union, sun-soaked and washed by the warm waters of the gulf, has been a traditional hunting- (and burial-) ground for land speculators. Hoyt had successfully completed a number of deals in the postwar years, including one near Fort Lauderdale. He bought a tract with 950 feet fronting onto the Atlantic. Because the land was being eroded by the ocean, no-one was interested in it. So Hoyt bought it for $1,700 a front foot, sank piles into the ocean at a modest cost to protect the coastline, and resold within two years at $3,000 a front foot, netting him $900,000. Other properties were not speedily resold. One of the most speculative of these was a lake of 360 acres used by anglers in Washington County. Hoyt did not own any of the shoreline land, so the property returned an annual loss of nearly $300 — the tax he had to pay on the property. What was the value of the lake? He used a nominal value of $100 an acre, but conceded that valuation was difficult. After all, he had received a number of enquiries from oil prospectors who

wanted to explore the lake for black gold, and if any *was* found then the $100 would have to be revised!

But the most illuminating transaction, for our present purposes, was the property called Treasure Beach. Hoyt sent a camera crew to film the Miami coastline from the sky. When the film was developed, he saw how intensive had been the building northwards for 100 miles. The only vacant site of any size which had not been exploited was on Hutchinson Island, in St Lucie County, one mile south of Fort Pierce. This was a golden opportunity, for by the mid-1960s prime sites fronting onto the ocean were scarce. Swiftly, Hoyt bought up four separate tracts — some of it swampland — at $200 a foot front. All told, he paid $1m. Six years later, in September 1972, he sold the land for $3m. to a Fort Lauderdale-based developer, Warren F. McFadden. The developer made a down payment of $400,000, and met his annual payments of $400,000 in 1973 and 1974. In March 1975, however, he defaulted, crippled by the 12% interest he was paying on his mortgages. Hoyt instituted foreclosure proceedings, kept the $1.2m. he had already received from McFadden and recovered his land. McFadden's downfall was a classic example of what happens to the unwary at the peak of a land boom.

The belief that money can be made from nothing — as, for shrewd operators in the land market, it can be[3] — generates a swift flow of short-term funds into speculation. This enables buyers to pay high prices, but unless they re-sell to other speculators before the crisis they are left with over-valued assets which they may not be able to re-mortgage to finance original loans. The demand for funds to speculate in land helps to push up interest rates, and when the bottom falls out of the market the speculators sink into bankruptcy with it. The movement of funds and interest rates are summarised in Table 8:I.

Homer Hoyt was willing to share the crucial lesson of timing in land deals. In 1967 he published the insights which he had acquired in a remarkable document, *Market Value Versus Speculative Value*.[4] This is a guide for successful land speculation. The object of the exercise is to buy land at a price which enabled the speculator to re-sell at a price which included its *future* value. Thus, knowledge of plans to build a new highway or airport, or careful study of the direction of expansion of a growing town, enabled the land dealer to buy at current use value and then hold the land until he could capitalise on future values. 'Often the full value has been added to the price in advance,' in which case it was profitless to buy at such a price. The presence of amenities such as sewerage disposal systems increased the value of land, which is what happened with Hoyt's land in Fairfax County, which in addition had the presence of the nation's capital: 'land values have sky-rocketed'.

TABLE 8:I

	1960	1965	1968	1969	1970	1971	1972	1973	1974	1975 (March)
	FUNDS: Uses and Some Sources, in billions of dollars[1]									
USES										
Investment	27.4	44.4	54.3	60.2	66.4	101.1	114.7	111.3	111.5	
Short-term	13.8	23.4	26.2	35.7	19.0	20.5	42.5	65.5	66.9	
SOME SOURCES										
Savings and Loans Associations	7.3	9.6	10.2	9.5	12.5	28.9	35.8	25.4	20.8	
Mutual Savings Banks	1.5	3.9	4.4	2.8	4.2	9.8	10.2	4.7	3.0	
Real Estate Investment Trusts	(z)	(z)	0.2	0.9	2.1	2.5	4.9	4.5	1.4	
Commercial Banks	9.5	28.6	40.0	17.1	36.5	49.7	74.6	78.2	62.5	
	Selected Money Market Rates[2]									
Prime commerical paper	3.85	4.38		7.83	7.72	5.11	4.69	8.15	9.87	6.06
Euro $ deposits	NA	NA		9.76	8.51	6.59	5.40	9.24	11.01	6.85
Short-term bank loans to business	5.16	5.06		8.21	8.48	6.32	5.82	8.30	11.28	9.94
Federal Reserve discount rate (high and low)	3-4	4-4½		6.00	5½-6	4½-5¼	4½	4½-7½	7½-8	6¾-7¾

(z) = less than $50m.
NA = not available

Sources: 1 *Statistical Abstract of the US 1975*, Washington DC: US Department of Commerce, Table 765.
2 *Ibid.*, Table 776.

> After sewer and water lines have been extended to an area, there will of course be a sharp advance in land prices. In order to make a substantial profit on his investment, the buyer must anticipate the possibility or probability of the extension of the utilities before others do.[5]

This ensuing increase in land values results in people paying *twice* for public services. The first payment is made out of taxes for the installation of the basic facilities, such as sewer works; the second when land is bought (either for private homes, factories, shops and offices, or for public amenities such as schools or hospitals) at a price which capitalised the benefits of the publicly-financed facilities.

McFadden had not learnt these basic lessons well enough. He bought land from Hoyt at its full future value, and at a time when interest rates were reaching their peak. One of the institutions which suffered along with McFadden was the Kentucky Mortgage Company, which lost a total of about $2m. on his deals. The company found that when land values levelled off after the 1974 peak it had to re-sell the land of defaulting mortgagees at a time when sellers were willing to accept half of their original asking prices. The Kentucky, however, was not alone. A series of real estate investment trusts (REITs) — operating as the equivalent of secondary banks in Britain in fuelling land speculation — were burnt in the process.

The contribution to our story of the REITs began in 1961 with the Real Estate Investment Trust Act. This law exempted investors from federal taxes on income derived from real estate at the corporate level. This tax break was a powerful incentive for channelling money through the trusts into property. For the investor, a most attractive element of the law was the requirement that trusts had to distribute at least 90% of net income annually to shareholders.

In the early years the REITs concentrated on buying equity in existing properties. This ensured a reliable flow of income and avoided the risks of development, but it missed the chance to earn the substantial profits to be wrung out of speculative enterprises. The speculative phase began in earnest in 1969, and took the form of lending money for buying land and financing buildings. These construction and development REITs proved to be irresistible money-spinning institutions. They secured short-term bank loans at rates sufficiently below their lending rate to provide them with attractive profit margins. There were additional financial features which encouraged the established financial institutions to give their blessings to this new growth industry. The net effect was to turn REITs into 'Everyman's key to the hallowed halls of high finance'.[6]

In 1969 the assets of REITs doubled from $1bn. to $2bn., more than doubled again by the end of 1970 to $4.7bn. and sustained that rate of growth through 1971, to over $8.1bn.[7] The growth rate accelerated. Banks

lent them about $11bn. between 1972 and 1974, and their total assets climbed to over $20bn.

During the 1969-70 period of tight money, which affected the orthodox financial institutions — commercial banks and savings and loans associations — the REITs forged ahead: loans for construction and development rose from $260m. to $2.5bn., a staggering increase of 890%. Operators like Warren F. McFadden agreed to pay hugely inflated prices for land because the trusts were pouring funds into their pockets. Money was no obstacle to any deal which appeared — on paper — to offer bonanza profits. The easy-money period which followed in 1971 aggravated the speculative fever which gripped the economy. Commercial banks increased their construction loans by nearly $3bn. in that one year alone.[8] Prestigious banks, like Chase Manhattan, set up REITs, using their names to sell stocks and debentures to the public.

> The prestigious Chase Manhattan launched a trust with a $50m. line of credit and announced, with fanfare, a public offering of $112m. worth of shares and debentures. Chase's idea was to get into the field of risky short-term, high-interest loans, designed to yield quick profits, by wearing the hat of its REIT affiliate — a game it wouldn't dare to play under its own parent name.[9]

The pressure to find borrowers willing to pay high rates of interest encouraged the less reputable trusts to employ unorthodox business practices. One of these was to agree to defer receipt of interest until the original loan matured, at which time the borrower was obliged to pay back both the capital sum and the interest in one go. This proved tricky, for by law the trusts had to distribute at least 90% of their 'profits' every year. And according to their accounts, these 'profits' included the interest from loans, the actual receipt of which had been deferred. So the trusts could meet their current commitments only by drawing on income from earlier loans or from the sale of shares to the public. They were therefore distributing profits before these had actually been received.[10]

The isolated warnings were ignored. People who are infected with the gambling fever generally refuse to recall the tragic lessons of history, like the collapse of the speculative boom of the mid-1920s (after all, everyone thinks he is holding the winning cards). The speculation continued through 1973, but the yields were starting to come down, and along with them the flow of funds.

At the bottom of the whole operation was the furious trading in land, from which the developers hoped to make their windfall gains. Eventually, however, illusions have to be shattered. The people left holding the land bought at speculatively-high prices have to service their mortgages out of

rental income. In the case of vacant land — in the naked condition created by nature — there is no productive economic activity and therefore no income. Where capital improvements, such as shops, offices and warehouses, have been undertaken, rents tend to be at penal rates. They have to be pitched high in order to try and recover the original capital outlay and meet prevailing interest rates. Under these conditions, however, the tenants are not forthcoming. For they can only pay rents out of current income, based on actual output: whereas speculative rents assume a higher, fictitious rate of output based on expectations about the future.

And so the collapse was bound to come. For with buildings standing empty, many people left holding high-priced land find themselves unable to service their mortgages. Speculators and builders alike are forced into bankruptcy, and the weakening foundations brought about the first major collapse in December 1974. Walter J. Kassuba Realty, a Florida building corporation which had invested $550m. into nearly 120 properties, filed for bankruptcy. A dozen REITs found themselves holding $110m. in bad loans. Nearly 200 trusts had mushroomed during the height of the boom; by the end of 1975 the share prices of those which had preferred construction lending had sunk to 78% below book value (book value determined *after* massive write-downs). The bubble had burst. Some REITs disappeared rapidly. Others managed to float on. The Chase Manhattan Mortgage & Realty Trust, the country's largest, clung on until May Day 1978, before it defaulted on more than $38m. in loan notes.[11]

In principle the idea of real estate investment trusts was a sound one, if the objective was to marshall funds in sufficient quantities to enable capital improvements to be undertaken by developers. With a growing population, an aging stock of homes, shops, offices, and industrial buildings requires constant renewal. If the purpose of REITs had been to further this goal, in the pursuit of interest on investment which would ultimately be comparable with yields from other sectors of economic activity, the trusts would have been admirable. The intrinsic defect, however, was the monopolistic basis of the land tenure system, which held out the powerful temptation of enormous, unearned, gains from inflated land prices.

The end of the speculative boom in real estate broke many people. For the resourceful rich, this merely meant having to explore new ways to recover their fortunes. Egyptian film star Omar Sharif lost a great deal of money on his investments in real estate at the time. His solution was a simple one: stop gambling and produce a few more films.[12] But for the hundreds of thousands of wage earners who hoped to fructify their hard-earned savings through REITs, the end of the boom was a disaster.

The diffusion of ownership in the equity of a nation's physical assets was something to which Homer Hoyt had developed an early commitment.

Sitting at a desk in the lobby of a hotel in Washington in 1918, he drafted an article in which he warned that concentrated ownership over land would lead to communism.

> If the concentration of wealth under the legitimate rules of the game should proceed to the point where a few toil little and enjoy disproportionately much and where the many work long and receive disproportionately little, then there will come into existence a reason for revolution.[13]

At the same time, however, he deplored 'the gambling spirit' which served to 'attack the soul of a nation like a dry rot'. Was this not a criticism of the speculative forces which drove up land values to unrealistic peaks? Hoyt did not recognise it as such, for in his analysis of the cyclical upward thrust of land values he emphasised real factors such as the growth of population. The presence of empty offices and shops at the end of the cycle in land values he censured on the grounds of a failure to correctly appraise demand, rather than as being the result of an over-extension of the speculative — i.e. gambling — spirit. As for the downturn in the cycle, this was a historical phenomenon of no relevance to the modern era. Hoyt explained the downturns of the past as a result of monetary deflation. Periodically, the authorities realised that the money supply had got out of hand; the real value of the dollar had declined. So the remedial action was to contract this supply.

> So we had periods of falling prices and wages, unemployment, bankruptcies and foreclosures, which dragged down real estate values to low levels.[14]

This explanation, while it may relieve the consciences of speculators, is a curious one for the economic historian to advance. The rhythmic pattern in the timing of remedial action allegedly taken by governments over a period of one hundred years ought to have alerted Hoyt to its implausibility, thereby opening up other avenues of scholastic enquiry. In any event, he would write off the counter-argument advanced here as of academic interest, for since the Second World War, without the discipline of the gold standard, the situation had changed. As a result of the consistent inflation of the money supply, there was little risk of a repeat of past slumps in land values, and thus, in his view, the role of land speculation in de-stabilising the economy is effectively neutralised.

Yet the latest round of land speculation in the US preceded the slump which struck the economy in 1974. The causal connections are uncovered in the next chapter. Meanwhile, however, we have to recognise that land values did not collapse in a way that we might have expected on the basis of historical experience. Treasure Beach, for example, which Hoyt had sold to McFadden in 1972 for $3m., was on the market in May 1978 for $6m. ('I

might take $5m.'). Many people, including foreign buyers — some of them Arabs — showed strong interest. But no deal was concluded, and when re-interviewed in October 1982 Hoyt said that the price had risen to $9.5m. ('I might take a million less'). The reasons why the land market did not fold like a snowman in a Florida heatwave will be explained in Chapter 19. We can say, however, that a long upward trend in land values terminated in 1974. Nonetheless, while this may be the end of the cycle, we have yet to establish its beginnings in order to verify that a cycle of approximately 18 years duration was operating, a manifestation of both real economic growth in the economy and, grafted onto it, the speculative activities of a relatively few people who were attacking 'the soul of [the] nation like a dry rot'.

Notes

1 *One Hundred Years, op. cit.*, p. 423.
2 Homer Hoyt, *The Changing Principles of Land Economics*, Washington: ULI Technical Bulletin No. 60, 1968, p. 11.
3 The profits from land speculation, of course, are recognised as not only legitimate but — for many people — morally defensible. The opportunities presented by the land market, however, have attracted their fair share of fraudulent deals. For a documented account of one land swindle perpetrated at this time, by teamster boss Jimmy Hoffa, in Titusville, Florida, see D.E. Moldea, *The Hoffa Wars*, London: Paddington Press, 1978.
4 Originally published by the Urban Land Institute, Washington, DC, reprinted in *According to Hoyt*, 1970, pp. 792-5.
5 *Ibid.*, p. 794.
6 Leland Frederick Cooley and L.M. Cooley, *Land Investment USA*, Los Angeles: Nash Publishing, 1973, p. 222.
7 P.A. Schulkin, 'Real Estate Investment Trusts in an Era of Innovation', *Real Estate Review*, Fall 1972, Table I.
8 *Ibid.*, Table 2.
9 D.L. Thomas, *Lords of the Land*, New York: G.P. Putnam's Sons, 1977, p. 286.
10 *Ibid.*, p. 287. For a critique of unorthodox accounting practices used after the REIT crash, see J.B. Levy, 'No Bargain Basement: REIT Accounting Compounds the Risks for Investors', *Barron's*, 13.6.77.
11 *The New York Times*, 3.5.78.
12 Omar Sharif, *The Eternal Male*, London: W.H. Allen, 1977, pp. 152-3.
13 'Bolshevism and the Laws of Property', originally published in *Open Court Magazine*, 1918, republished in *According to Hoyt*, pp. 114-15.
14 Homer Hoyt, *The Urban Real Estate Cycle – Performances and Prospects*, Washington: ULI Technical Bulletin No. 38, 1950, p. 9.