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The effects of changes in land value on the value of buildings

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Abstract

We show that increases in land value generally lower the value of existing buildings by amounts roughly proportional to the square of the difference in size between the existing building and a new building of optimal size. Our model suggests that the sight of deep discounts for space in new buildings in a growing city is not necessarily a sign that developers have overestimated demand; it might rather reflect their anticipation of continued urban growth. Our model offers an intuitive way of dividing property values between the land and the structures on it, which is relevant for establishing the appropriate base for taxes on land rent, for identifying the correct income tax deductions for depreciation, and for assessing appropriate amounts of property insurance.

JEL classifications: R14, R41, R52

Keywords: residual; transportation improvement; urban growth

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