

What do we know about housing development: some lessons from Around the World

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Overview of the talk

- What do we know about the land underneath it?
- What do we know about building it?
- What do we know about owning it?
- Should we think more about renting it?
- What do we know about financing it?
- How much should we worry about it?

What do we know about land development?

- Successful models of land development integrate housing and infrastructure
 - Places that have worked:
 - Hong Kong
 - Singapore
 - China
 - A “mystery” country.
 - Places that haven’t
 - India
 - Bangladesh

Why are Hong Kong, Singapore, and Shanghai successful?

- Use proceeds from land sales (or, in Singapore's case, property taxes and pension funds) to finance infrastructure. Assures that infrastructure projects have a funding source and are positive NPV projects
- No fear of high Floor Area Ratios leads to efficient land use
- Recognition that low income household need access to jobs

Why are India and Dhaka less successful?

- Difficulty in financing infrastructure
- Hostility to building upward
- Lack of technical expertise in subdivision
- Multiple government agencies own large amounts of land
- Political economy of changing regulations: some developers *like* regulation







A word on the “Mystery” Country

- In 1950, per capita GNI was comparable to Brazil’s today
- In 1940, only half of housing units had indoor toilets
- Developed an entrepreneurial, technically adept industry that “manufactured” housing: while built on-site, repetition of floor plans led to building efficiencies



Who should build it?

- Can governments have the capacity to build?
- Even if they have the capacity, will they know what and where to build?
- Evidence of a problem: houses resold for less than construction cost
- Examples of poor practices:
 - Krakow (Nowa Huta)
 - Moscow
 - US Public Housing





Why is the pernicious?

- People wind up with unsatisfactory dwelling arrangements
 - Location
 - Trade-off with other goods.
- Scarce subsidy funds get wasted
- Overwhelming evidence is that subsidies to individuals go further than subsidies to building

Back to the where

- Monsieur Bertaud and my colleague Chris Redfearn give us great work on spatial structure
- In South Africa, the legacy of apartheid creates serious distortions in settlement patterns
- Subsidy patterns and regulatory frameworks to overcome these distortions might be very effective policy.

What about owning? For LAC, South Asia and South African, is everything about Property Rights?

- Property Rights are not a Panacea, but they relate to other rights
- Property rights fail to have meaning if actors have no confidence in legal institutions
- Illiterate people are in a poor position to defend their contract rights—or even to acquire them
- People who are ill will be hard pressed to be productive—even if they control property.

Property Rights Are Important

- Formal development can only take place when there is confidence in title
- Transparency: Brazil is very good by LAC standard; not so good based on world standard
- Two examples from Krakow from 1995
 - Vacant property values
 - Office Building development

Capital Markets will not participate in markets in which they lack confidence in legal institutions

- Capital Market Players Evaluate Four types of risk
 - Credit Risk
 - Market Risk
 - Legal Risk
 - Political Risk
 - The interesting case of South Korea

Capital Markets Need to “Rate” Debt

- Legal standing of the collateral
- Can leases be enforced?
- These attach to credit risk management

A Digression on Leasehold property rights

- Enforcement of lease terms is a two way street
- Landlords must have the freehold interests left over from leases protected
- But the benefits of the lease to the tenant must be enforced with equal diligence

Credibility of Contracts—including those defining property rights, depends on agents having a sense of fairness

- Places where fairness is a challenge
 - Bangladesh, where literacy is defined as the ability to sign one's name
 - Mississippi—partition sales
 - In the US, predatory lending (confession, I came late to the party on this)

Sanitation and property rights interact

- How valuable are urban property rights without adequate infrastructure?
- But property rights can secure funding for infrastructure through a system of ad valorem property taxes

Property Rights are perhaps best thought of as a necessary but not sufficient condition for economic development

A plea for a rental market: Housing Policy for Emerging Countries focuses on Ownership

- Ownership is doubtless a good thing
 - Green and White (1997)
 - DiPasquale and Glaeser (1998)
 - Haurin, Parcel and Haurin (2004)
- Prejudice against landlords
 - Ricardo's lasting influence?
 - Bad behavior on the part of some landlords?

But Renting can be an important part of the puzzle

- UN Habitat report emphasizes the importance
- Cash Flow Affordability
- Ability to reserve savings for other kinds of investments
- An investment opportunity for the emerging middle class (two unit buildings)
- Information Benchmark
- Labor mobility

How to finance?

- Lots of variation among OECD countries in the development of mortgage markets
- Very much a function of differences in legal institutions

Construction Finance

- Good news: banks are well suited to do short term lending such as construction finance
 - Short term liability structure
 - Knowledge of local markets
- Banks are common

Problems with Construction Finance

- Legal standing of the collateral
- Infrastructure provision—will it be delivered reliably and efficiently
- China shows problem when developers don't have capital at risk
- Issue in developed countries as well—consider Canary Wharf

Policy Implications

- Market failure arising from incomplete information
- Private sector will not alone engage in price discovery
- Example of a non-functional, bank financed market—US Mortgages in the early 1930s
- Government Intervention was needed to jump-start the market
- The subprime debacle shows problems of moral hazard and adverse selection
- Securitization remains a good technology, but it is clearly not a panacea

How to begin a well developed mortgage market

- Use of sovereign debt to lower cost of funds (HOFC)
- Use of government credit guarantee (FHA)
- Allows for price discovery
- Allows for capital market funding
- No return on equity requirement

But as we now know, it is important to be careful

- Moral hazard problem is large
 - Investors have much less incentive to do due diligence
 - Potential for corruption is large
- Strong regulation is necessary
 - Capital requirements of lenders
 - Consistent underwriting requirements
 - Government should not hold the loans in the long term.

Final Point: Sequencing of Housing as Part of Economic Development

- Places that have had extraordinary development: S. Korea, Taiwan
- Human Capital and Plant and Equipment came *before* Housing (see Ed Mills)
- Housing Conditions lagged general economic well being
- Housing Conditions have recently caught up.
- But this is *not* the Singapore story