



Urban LandMark

MARKET FAILURE IN THE HOUSING SECTOR

....SOME ISSUES TO CONSIDER

Rob McGaffin

[Urban Land Markets Programme
Southern Africa]



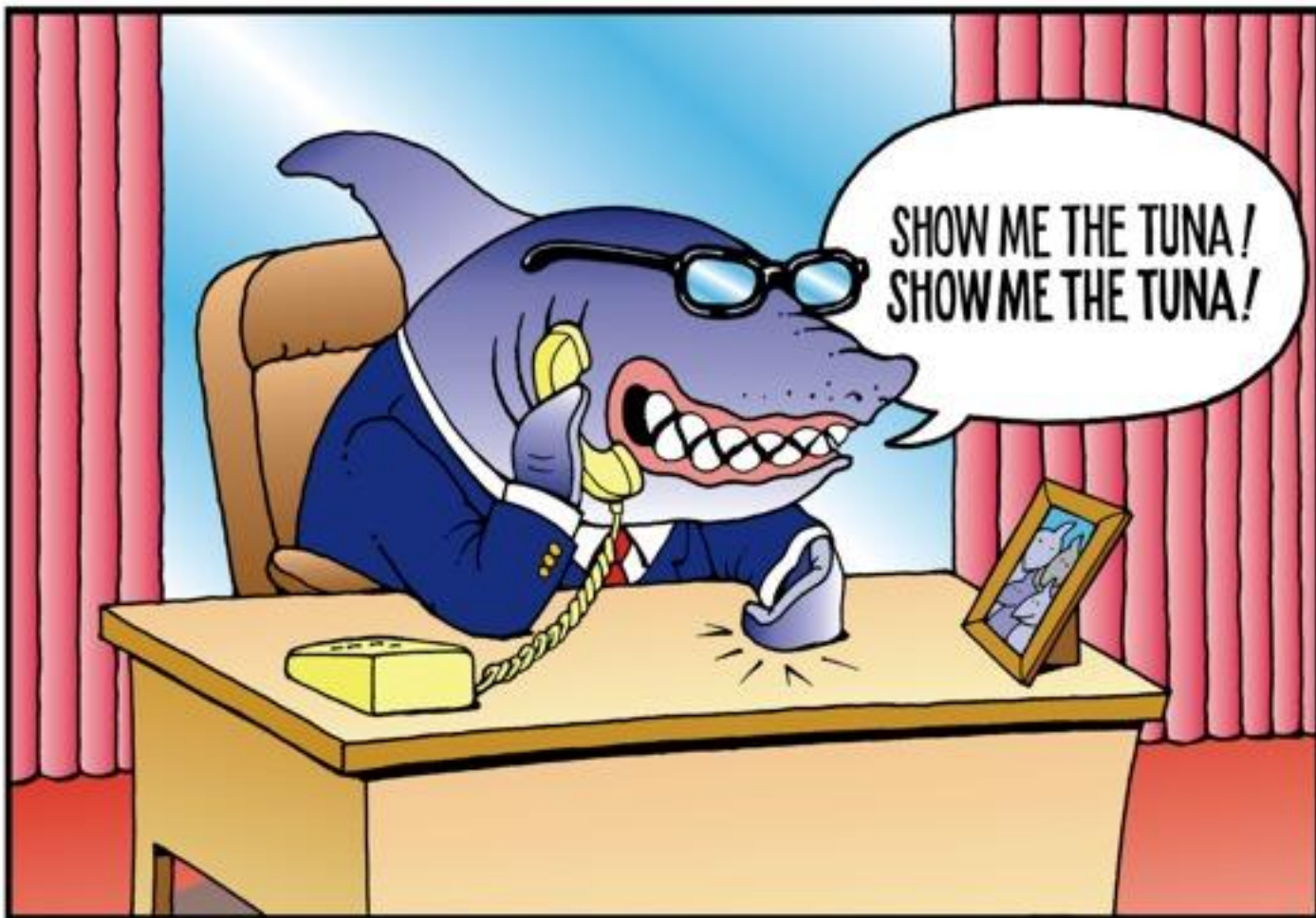
MAKING URBAN LAND MARKETS WORK FOR THE POOR

What do we mean by “the market”?



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR



SHOW ME THE TUNA!
SHOW ME THE TUNA!

Amstel
CITYPROPERTY
Urban Renewal Project
Put Yourself In Our Space
378 - 3200

CHICKEN PIECES R5,00
FISH BONES 70 MAY
loss draw 40
ICE CREAM 60 R22
BEER 330
Cold drink
WORS 150
STOU

©ULM Database



...is there a role for the “the market”?

Eskom example....



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR

Therefore, standardised policies, while trying to be equitable, are by definition blunt and therefore are not very successful in intervening in complex situations where individually-informed responses are required.



Advantages of the market system

- Flexible and has greater scope to adapt
- It is democratic and it allows people who best understand their situation to make the trade-off decisions.
- It represents significant levels of resources levels of capacity, expertise and efficiency needed to tackle major societal problems





.....it's operating out there, so one way or another, we have to engage with it.



What markets can do.....

They can help achieve economic efficiency:

When resources have been allocated in a manner such that the maximum possible satisfaction is achieved given a specific amount of societal wealth:

- Productive efficiency - for given inputs, output is maximised
- Allocative efficiency - when goods are allocated such that one can no longer provide a good without making someone worse off



However, markets can't achieve economic efficiency when:

- Market conditions (profit maximisation, high levels of information, many players exist, limited entry/exit barriers, inputs can be shifted easily in response to price signals etc.) don't exist
- There are externalities (indirect costs or benefits to third parties)
- Goods are “public” or “merit” (“non rival and non excludable”)



What markets can't do.....

Maximise welfare by distributing income between members of society

.....therefore, just because the market doesn't provide a good or service, doesn't mean there is market failure. In fact, if there is no effective demand, then the market may be acting in a very successful manner by not providing the good



How does this relate to housing ?

Examine according to:

- Income levels/Effective demand
- Market conditions
- Externalities
- Public Goods



Income

Affordability:

- Need to recognise that part of the housing problem is a real income and affordability issue. This is a broader societal issue that will not be solved by housing practitioners alone
- No amount of technical and financial manipulation will overcome this problem
- Poor lending & development practices in the absence of effective demand led to sub-prime crisis



- ...it could be argued that the market didn't fail but state intervention (poor regulations, "too big to fail" approach) didn't allow the market to self-correct
- ...the "moral hazard" of state protection led to poor lending and development practices

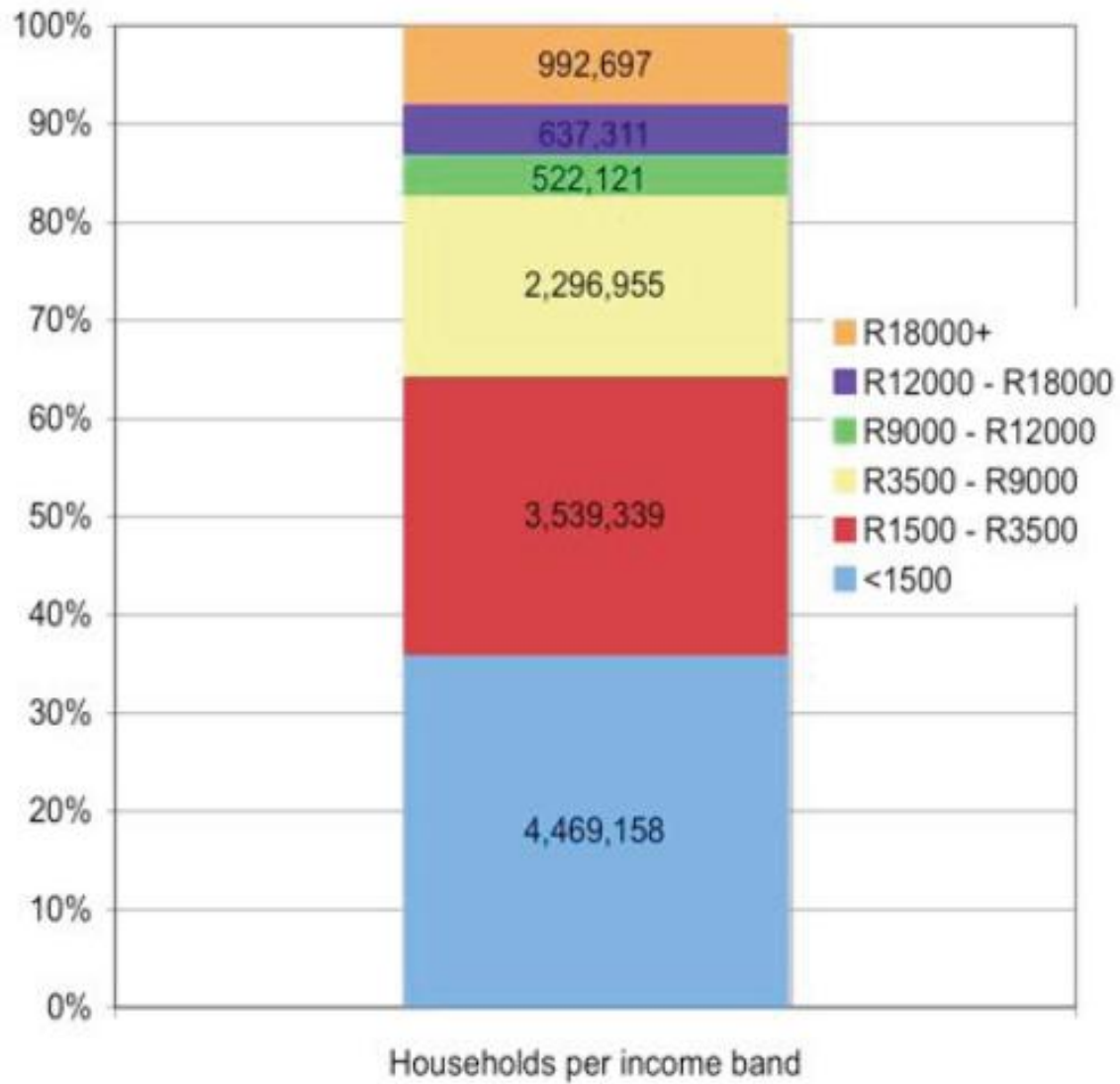


Effective demand in SA?



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR

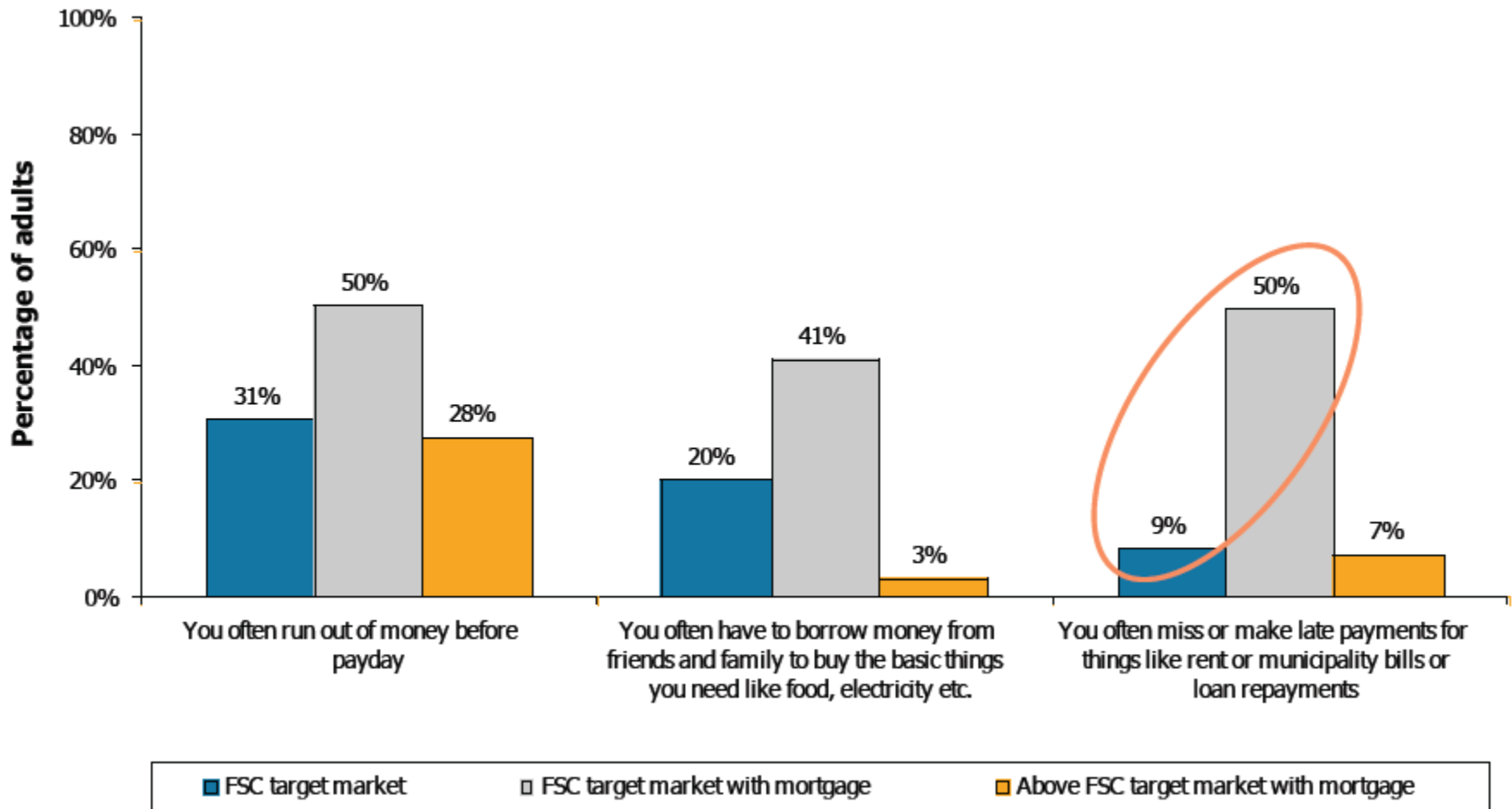


(Rust, 2010)



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR



(Rust, 2010)



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR

Income

Guarantee schemes:

- Moral Hazard?
- Increase credit = increased effective demand BUT in the absence of increased supply, one just has more money chasing the same number of houses, which will push prices up



Income

Access to credit:

50% of hhholds earning between R3500 and R7000 have formal credit (retail stores, vehicles etc.) but only 3.4% in that bracket has a mortgage

- Are people misdirecting expenditure away from housing investment towards consumption spending because of a lack of supply of affordable houses?
- Will the lack of supply encourage downward raiding thereby increasing the price & availability of lower end housing?
- Does high consumer indebtedness impact on equity and LTV levels...and consequently lending levels?



Income

Effective demand:

Households just above the subsidy level can afford a R140 000 house and therefore can contribute significantly to their housing needs. However, there is a very limited supply of R140 000 houses to purchase:

- Due to issues of saleability, there is a reluctance to finance, develop and build a house of a similar quality as a subsidy house
- Uncertainty wrt to the market and development processes increases developer profits, which increases prices
- Cross-subsidisation in integrated developments, can increase prices (e.g. RoC 14% vs 6%)



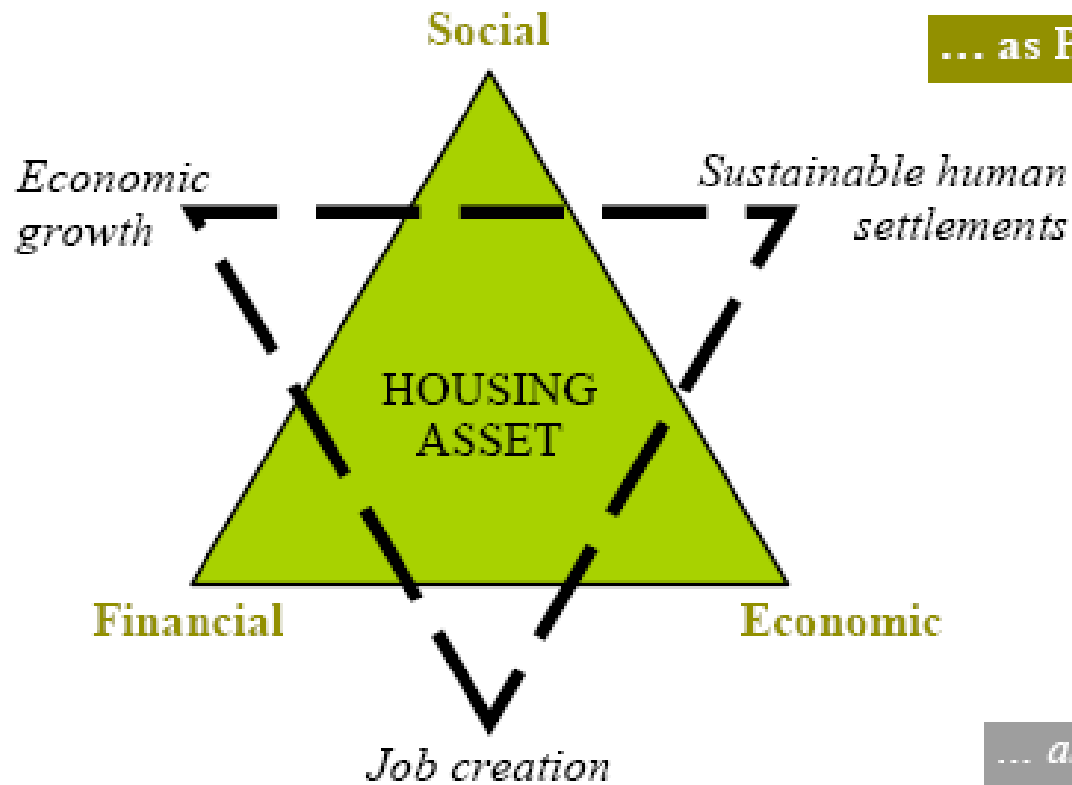
Market Conditions

Poor functioning of the market:

Consumers and producers must be able to respond to changes in price relatively quickly and without too many constraints

- Restrictions on sale of units - Sec 10A Housing Act
- Restrictions on the rental of units
 - “...News24: MEC throws man out RDP house - a man running a shop from an RDP home he was renting in Coligny was thrown out of the house by a visiting North West MEC”





... as **PRIVATE ASSET**

... as *PUBLIC ASSET*

Rust, 2008



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR

Market Conditions

- Barriers to entry/exit
 - High transactions costs - conveyancing etc. “....a legal system dysfunctional in the context of the poor” ($\pm 8\%$ [R5m] versus 27% [R20k]) (Downie, 2011)
 - High costs of information - numbers of estate agents, “township” property data - of the $\pm 6\text{m}$ residential properties on the Deeds Registry, about 3.5m are valued at below R500k.....what do the Saturday Property papers look like? (ALHDC, 2010)



Market Conditions

Poor functioning of the market:

The market is responding....and in innovative ways - affidavits, power of attorneys, court orders and other social practices etc.

However, the lack of legal recognition places end-users at risk

...and is it just about title deeds? Recent work by Downie in the Overberg region suggests not. See Downie Paper:

“Urban Pro poor registrations: Complex - Simple: the Overstrand Project”



Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR

Market Conditions

Inflexible supply of inputs

The factors of production have to be able to move easily in response to the changes in relative prices

- Shortages of land & infrastructure - recent Minister's comments
- LAA agreements...cumbersome
- Land use planning constraints.... duplication/dated ...need for the LUMB and capacity
- Design issues...the poor can compete/bid - size issue



Market Conditions

Poor information:

- Have poor data by market segmentation e.g. it is currently not possible to determine whether FSC borrowers performed worse or better than their higher income counterparts in the traditional mortgage market. How is the government to assess the risk it is going to underwrite with the R1bn fund?
- The ALHDC is currently trying to locate and track the performance of all state delivered housing over the past 15 years. Without having accurate data, how can one make informed investment decisions going forward?



Market Conditions

Barriers to entry and exit

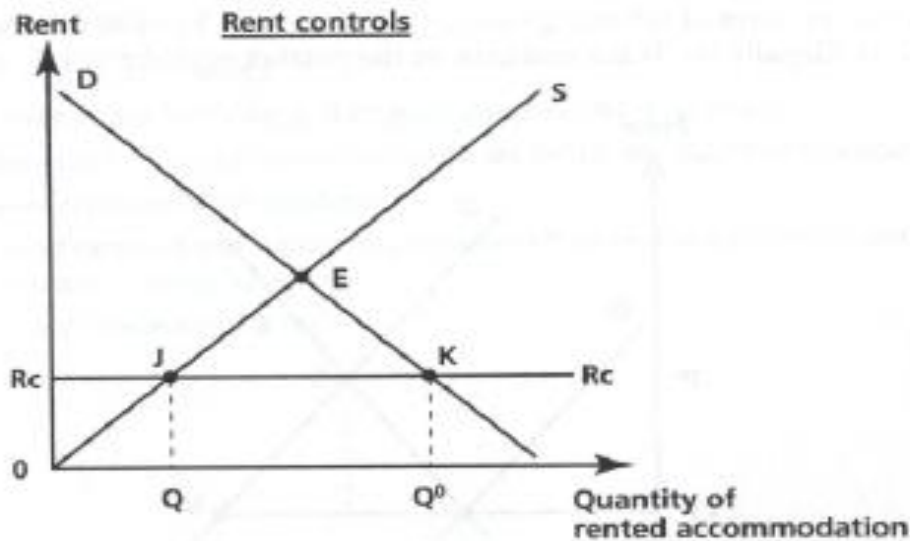
- Individual households have the ability to supply housing stock but they do not have the ability to provide land and infrastructure
- As it currently stands if one is poor, one either takes part in a land invasion or joins a waiting list for a subsidy house. One is illegal and the other is time consuming/uncertain and could result in one being housed in a location where you do not need to be
- Recent initiatives around the incremental tenure and upgrading are a move in the positive direction



Externalities

Inclusionary and Integrated Housing Projects

- Form of rent control and can distort the market signals wrt to supplying additional units



Externalities

Inclusionary and integrated housing projects

- Sophistication required wrt project viability and the market conditions of the time
- The high standards of the subsidy house, significantly reduces the supply of market-driven affordable housing in the price bracket.
- The costs of such standards is often directly borne by the GAP market



Public Goods

- The high standards of the subsidy house, significantly reduces the supply of market-driven affordable housing in the price bracket.
- Poor delivery of public goods in the form of land and infrastructure
- Curious how we stipulate how people spend the housing subsidy but not a social grant or pension...



Conclusion

We create artificial barriers that prevent the sub-markets interacting with each other ...creating a “poodle” effect, which in turn creates significant barriers to the creation of a housing ladder and a system of pools and flows that will enable a household to maximise their development within their current context.



Conclusion

The key is to understand the value-chain of housing delivery and to understand what:

- The market can deliver
- Interventions can stimulate the market's positive contribution in the process
- Interventions will hamper and distort the markets contribution to dealing with the housing process



Positive steps?

- Incremental tenure work - ULM/City of Joburg
- Affordable Land + Housing Data Centre (www.alhdc.org.za)
- Leslie Downing - Overstrand Pilot
- Land Use Management Bill
- Consolidation of infrastructure provision at a metropolitan level





Urban LandMark

MAKING URBAN LAND MARKETS WORK FOR THE POOR



Urban LandMark



www.urbanlandmark.org.za

MAKING URBAN LAND MARKETS WORK FOR THE POOR