THE GLOBAL Financial Crisis, arising from the post-2007 meltdown of the subprime mortgage market in the United States, firmly positioned ‘property’ within discourses of economic crises and macro-economic change. In a dramatic turn of events, the humble residential mortgage had become implicated in destabilising global flows of finance and credit.

Avoiding future financial crises will mean jettisoning some long-held beliefs about property.
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highlighted the role of property markets in the global economy. While the root causes of this particular financial crisis can be traced to issues of poor governance, information asymmetry and moral hazard in the US mortgage market, the unfolding crisis has highlighted the role of property markets in the global economy.

In contrast to economic discussions that have emphasised globalisation and hyper-mobile flows of capital, it is somewhat ironic that an internationally ‘non-tradable’ and locally-embedded asset—residential property—was at the centre of the financial maelstrom. Yet, the relative surprise in policy and academic circles at the contribution of property to the Global Financial Crisis needs to be seen in the context of a significant reconfiguring of property markets over the past 50 years and the increasing significance of cities and urban space in the global economy.

Now, for the first time in human history, more than half of the world’s population lives in urban centres. Cities operate as the strategic loci of economic, social and cultural processes and are essentially vast built environments consisting of various forms of functional spaces (houses, offices, factories, warehouses, roads and so on) that are built, owned and managed over long time horizons. Given the scale of global urbanisation, it is unsurprising that property markets represent a significant component of national economies.

Indeed, the sheer size of the property market is truly impressive. In 2011 the Economist newspaper estimated that the combined value of residential and commercial property in rich countries alone, following the Global Financial Crisis, stood at US$80 trillion (US$ 80,000,000,000,000). By comparison, the value of equity markets was US$20 trillion. Property services company DTZ put the total value of the global ‘investable’ commercial property market in 2009 at US$11 trillion. In addition, home ownership has expanded globally over the past 50 years to the point where in 2008 there were 75 million home owners in the United States and more than 130 million in the European Union. It has been argued that the EU, a quintessential economic union of sovereign states, could be legitimately termed a ‘Union of Homeowners’. Underpinning the growth of home ownership has been the increasing availability of mortgage finance. Annual residential mortgage originations in the US alone amounted to US$ 4 trillion in 2004. Locally, even though New Zealand has witnessed a significant decline in its home ownership rate—from 73 per cent to 66 per cent—the total value of residential assets was estimated to be NZ$600 billion in 2010, which is more than three times the country’s GDP. While a house is a small investment in terms of the total investment domain, housing is the largest asset class in the global economy.

Given the scale of property assets in the global economy and the myriad ways in which property processes affect economic, social and cultural practices, there is a clear need to better understand its role in business and economic processes. In what follows, I would like to address five property market myths and to identify five looming issues.

Five Property Myths

MYTH: Housing markets are fundamentally the same

NOTWITHSTANDING the real estate mantra of ‘location, location, location’, most commentators on residential markets (both academic and industry) tend to treat such markets as relatively homogeneous. In this context, the concept of ‘average house price’ exerts considerable psychological and market power. Announcements regarding year-on-year house price increases are media events that have significant meaning for individual home owners and for the financial institutions that originate and/or securitise residential mortgages. Yet, housing markets are characterised by heterogeneity and locational fixity. Within national housing markets there are clear regional disparities in house price performance and even individual cities contain distinct sub-markets. While hedonic price models are premised on the notion of the ‘law of one price’, research has repeatedly demonstrated that markets consist of these clearly defined sub-markets.

While recognising the fragmented and differentiated nature of housing markets, it is also necessary to acknowledge the legal and institutional differences that exist across national jurisdictions. Home ownership in the US differs from home ownership in the UK, Australia or China, because it is produced and exchanged through very different institutional structures and agents. Given this, it needs to be recognised that the financial benefits of home ownership are not intrinsic to the tenure, but rather are a product of the geographical and physical attributes of a property, combined with the institutional arrangements that support the tenure. Significantly, international studies confirm that the financial benefits of home ownership are disproportionally skewed toward higher-income households.

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MYTH: There is a simple relationship between residential rents and house prices

IN THE WAKe of the global property boom, and ensuing debates about the true value of property markets, considerable attention has been given to the explanatory power of the house price-to-rent ratio. This simple ratio represents an attempt to value housing as an investment asset. Popularised by the Economist, house price-to-rent ratios have increasingly been used to assess the overvaluation of housing markets. As house prices have tended to increase faster than rents, this ratio has been used to identify ‘speculative bubbles’.

However, the price-to-rent ratio is problematic at a number of levels. It assumes a constant discount rate (or yield), which may or may not hold. Researchers from both Harvard and the University of Reading suggest that, in reality, the user cost of capital is influenced by a range of factors, including house price expectations, credit market constraints (both real and nominal interest rates), tax provisions and transaction costs.

In addition, the price-to-rent ratio downplays the role of housing as a necessary consumption item (it is hard to avoid the need to be housed) and the fact that house buyers may not be primarily concerned with the investment characteristics of property when purchasing a house.

MYTH: What goes up must come down

IN MANY popular accounts of the possible impacts of the Global Financial Crisis on housing markets, considerable attention has been given to the likelihood of significant house price declines. For example, the Reserve Bank initially suggested a possible 30 per cent decline in New Zealand house prices. Underpinning this argument is the notion that during the boom prices got out of line with fundamentals and that the in the succeeding slump prices will return to an appropriate level, determined by

fundamentals. However, in the absence of a significant oversupply, house prices are characterised by a ‘ratchet effect’ in nominal (if not real) prices. This ratchet effect reflects home owners’ behaviour during a slump. Under full-recourse mortgage systems (as in the UK, Australia and New Zealand), when prices begin to fall household are reluctant to sell. This reluctance becomes evident in the increased time taken to sell a property and in a decrease in the number of properties for sale. As the supply of housing on the market declines, prices tend to stabilise. If home owners are able to service their mortgages and therefore do not need to sell, then they are not under pressure to go to the market and take a capital loss.

In econometric modelling of housing markets, this ratchet effect is described in terms of a price asymmetry between upturns and downturns. Significantly, this modelling suggests that during a boom, house price expectations are autoregressive (as house prices go up, we expect them to go up more), but during a slump negative price expectations do affect current prices to the same extent. This asymmetry in price behaviour over a boom slump cycle suggests that the price effects of a boom can be long-term.

MYTH: Rationality rules the market

GIVEN THE enormity of the global property market and the relative size of individual housing transactions compared to a household’s income, markets could be expected to operate rationally. Indeed, many accounts of the recent global property boom emphasise what Yale economist Robert Shiller terms ‘irrational exuberance’.

Implicit in this phrase is the idea that property markets are fundamentally rational but subject to bouts of irrational behaviour. Research on how households search for, and choose, housing indicates that they adopt logical search criteria in response to sets of ‘push’ and ‘pull’ factors. Moreover, credit constraints and conservative lending criteria also ensure that households are rational in their housing choices.

Yet, notwithstanding this, there is also clear evidence that emotion and sentiment are important in property decisions. In contrast to sharemarket investment decisions, the word ‘love’ is often used by house buyers to describe why they chose a particular property. Moreover, in a rising market, buyers are willing to pay a premium on a property because of the ‘fear’ of losing out. These emotions are not irrational and they point to the importance of geographies of affect. Moreover, in contrast to share portfolios and bank deposits, people have memories and experiences invested in properties and this affects their understanding and valuation of them.

MYTH: Property is deadweight on the real economy

IN THE context of property booms, considerable policy attention has been directed toward what is viewed as the unproductive nature of property investment. Implicit in these discussions is the view that owners are receiving unearned ‘economic rent’. The policy prescription arising from this perspective is either to promote consumer restraint—by raising interest rates—or to wait for a cyclical slump.

While this view has some merit, it tends to downplay the real benefits of property to the national economy. The building sector is an important source of both direct and indirect employment. Home owners’ ‘do-it-yourself’ enthusiasm directly supports jobs and profits for hardware chains and garden centres. Property transactions generate considerable benefits for a range of professions including legal, insurance, real estate, banking and exchange services. As a counterweight to the rather negative perception of housing as a problem sector, PricewaterhouseCoopers partner Suzanne Snively argued in a presentation to a 2009 Reserve Bank workshop that housing was a consumption and investment good, an industry, and an important component of New Zealand’s infrastructure. Snively highlighted the tangible and intangible benefits of homes and the extent to which they influence house prices and economic stability. She also pointed to the non-housing outcomes of good housing—namely, its positive effects on “health, education, labourforce participation and productivity”.

In addition to the housing sector, the commercial property sector plays a pivotal role in facilitating economic activities. The physical infrastructure of cities affects their economic performance, while the availability of high-quality buildings has a significant effect on the locational decisions of global financial services firms. Indeed, property-led urban regeneration programmes are at the heart of many cities’ attempts to become globally competitive.
Five Emerging Issues

Property and sustainability

Increasingly, cities face major sustainability issues and property processes are a key component of both the problem and the solution. A study commissioned by the Royal Institution of Chartered Surveyors has found that the global construction industry produces significant waste and greenhouse gas emissions. In response to this concern, governments around the world are promoting urban intensification and pressing for zero-carbon property development. In addition, large pension funds and global investors, in tandem with large corporate tenants, are demanding ‘green buildings’. These drivers of change will not only shape how we provide buildings but will also transform the way we live and work. In searching for new and more sustainable development practices there is a need to reflect on the existing building stock. The appetite for new, environmentally-sound buildings creates strong redevelopment pressures, particularly in the commercial core of cities. But demolishing existing buildings has significant energy and emissions implications. In seeking to meet the needs of the future we must balance the demand for new green buildings with effective retrofits of existing ones.

Property and the macro-economy

Notwithstanding the Global Financial Crisis, property will continue to be an important component in national economies and will pose significant challenges for economic policymakers. For example, reflecting on the role of housing investment in the US economy, the Economist argues that new house construction contributes significantly to the “volatile bit” of the economy and that housing has had an important role in driving economic recoveries. While property booms are potentially inflationary, with a likelihood of becoming speculative bubbles, property downturns can exert a significant drag on GDP growth and prolong economic recessions. The International Monetary Fund recommends that, for
economies with more advanced mortgage markets, economic stabilisation requires a monetary policy approach that “responds to house price developments in addition to consumer price inflation and output developments”. It is noteworthy that since the Global Financial Crisis New Zealand’s Reserve Bank has sought to further regulate the activities of the banks in the mortgage market.

Property Insecurities

HOME OWNERSHIP is viewed by many as an enduring source of financial and psychological security. Yet, as the fallout from the US subprime mortgage crisis has demonstrated, the benefits of home ownership are not immutable. Home ownership is characterised by fragmentation and differentiation. The growth of home ownership necessarily involves the incorporation of lower income groups into the tenure—and in terms of housing costs, capital appreciation and security of tenure, their experience varies significantly from that of wealthy home owners.

Given evolving mortgage markets and changing building practices, the experience of housing will undoubtedly change. In New Zealand, the rise of ‘leaky building syndrome’ following implementation of the Building Act (1991) has had serious consequences for owners of houses with monolithic cladding. Michael Rehm, of The University of Auckland Business School’s Department of Property, has calculated that the stigma associated with leaky building syndrome has stripped $1,000 million from the market value of such houses. In the future, we are likely to see greater diversity and risk associated with housing markets and tenures.

The limits of asset-based welfare

AROUND THE world, the expansion of home ownership has been facilitated by favourable housing policies. Underpinning this political support is a set of beliefs regarding the benefits to such tenure. In addition, governments have increasingly viewed property ownership as a component of welfare policies. It is argued that, irrespective of the rate of capital appreciation, outright home ownership reduces poverty among older households —and can lower the demand for pensions —by reducing housing expenditures. This possible effect on pensions is important. As the global population ages, future pension demands are likely to put increased pressure on countries’ resources. In the face of a potential pension tsunami, governments have increasingly considered the possibility of ‘asset-based’ welfare.

Proponents of asset-based welfare view home ownership as a form of pension, arguing that the wealth stored in housing can be released in old age to pay for essential services such as health care and residential care. However, research on the practices of home owners highlights the fact that home owners are generally resistant to reverse-equity mortgages and instead seek to preserve their assets. Countries everywhere are grappling with the implications of aging populations, age-specific differential home ownership rates, uneven wealth distributions...
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The dynamics of property as a global asset class has profound implications for national economies, cities, households, investors, industries and services. Governments, businesses, households and city managers must incorporate more complex interpretations of property processes in their decisionmaking.

Property is too big to be ignored, and too important to be marginalised, in either government policy or business practice.

Conclusion

THE UBIQUITOUSNESS and familiarity of the built environment has tended to foster a perception that land and buildings are merely a passive backdrop to economic activity. However, the sheer scale of property (both commercial and residential) as an asset, its role in business cycles, individual consumption and savings, and the operations of corporations and small businesses, means that property matters.

New Zealanders have been reproached for their love of property, yet they are not unique in this respect. Singapore, a high-tech knowledge economy, has a home ownership rate of over 90 per cent and the booming Chinese economy has a home ownership rate, in urban areas, of 80 per cent. Though the love of property is not the root of all evil, property booms and slumps are implicated in significant global and local crises. In the aftermath of the Global Financial Crisis, there is a clear imperative to understand the complex interdependencies that shape property dynamics and to move beyond general myths that inform policy prescriptions. This requires a twin agenda. First, there needs to be more research into the specificities of property markets, their dynamics, institutional structures and evolving agents and actors. Second, property markets and processes need to be placed in wider business and social science debates. Property is too big to be ignored, and too important to be marginalised, in either government policy or business practice.

Key take-outs

- The dynamics of property as a global asset class has profound implications for national economies, cities, households, investors, industries and services.
- Governments, businesses, households and city managers must incorporate more complex interpretations of property processes in their decisionmaking.
- Property is too big to be ignored, and too important to be marginalised, in either government policy or business practice.