



Capitalization of legal title: Evidence from small-property-rights houses in Beijing



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ABSTRACT

Small-property-rights housing is one of informal ways of providing housing units in Chinese cities. Yet, there are still relatively few studies of informal settlements in China. This paper addresses that gap in the literature by tracing the source of informality in the context of the property rights system in China and empirically investigating the value of a legal title in urban China. It uses housing project data collected in Beijing and spatial econometric models to estimate the value of a legal title. The findings show that a legal title adds value to properties. Housing price falls by 45–60% if housing property does not have a legal title, after the physical and locational characteristics of the housing properties are controlled. It also finds that the value of a legal title tends to change across space and across housing physical characteristics.

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Introduction

How much would you be willing to pay for a legal title of a house? How much is a legal title worth in house prices? Legal title is the most visible form of ownership recognized by official institutions and government (Alston, Libecap, & Schneider, 1996). With formal recognition endowed in legal title, it can play a key role to reduce private enforcement cost in securing ownership, to protect investors' rights to pursue and retain their investment returns, to facilitate transfer of ownership, and to enhance the accessibility to the credit market (Alchian & Demsetz, 1973; Besley, 1995; Carter & Olinto, 2003; Conning & Deb, 2007; De Soto, 2000; Durand-Lasserve & Selod, 2007; Hoy & Jimenez, 1996; Jimenez, 1984; North, 1990, 1992; Tu & Bao, 2009; Wannasai & Shrestha, 2008). With or without legal title, therefore, makes real difference in getting the value of their assets work or not in the market.

Yet, there is limited research to estimate the value of a legal title. The paper addresses this gap in the literature by using hedonic model and spatial econometrics methods to compare housing prices for formal and informal housing projects. In addition, as value of legal title may vary across space and property types, we test whether and to what degree the contribution of title on the

value of housing would change with location and physical characteristics of the properties.

The rest of the paper is organized as follows. The next section presents the literature review. The third section highlights the institutional framework behind the informal housing sector in China. The fourth section introduces the development of one informal housing development in China, which is small-property-rights housing (SPR housing hereafter). The fifth section uses housing project data, hedonic model and spatial econometrics method to empirically analyze the capitalization of legal title into house prices in Beijing. The last section is the conclusion of the paper.

Literature review

Informal housing properties are “the most significant mode of housing provision” for urban residents in developing countries (Payne & Durand-Lasserve, 2012: 6). According to the United Nations Human Settlements Program (UN-Habitat), by 2005, there was 36% of urban population in developing regions in the world still living or squatting in slums (United Nations, 2009). China is not an exception. From 1995 to 2002, Lin and Ho (2005) found that there were 945,213 total cases of illegal land occupation in China, nearly as many as the number of cases legal land conveyance (964,848 cases). Such illegal land uses “involved a total land area of 189,792 ha, or 42% of the land obtained through legal conveyance” (pp. 427–8). Crucially, this does not “include the numerous cases of

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illegal land use conversion that were never caught” (Lin & Ho, 2005: 425). In these active and pervasive illegal land uses, SPR housing is a prominent type of illegal housing developments in China (Wang et al., 2014).

This high prevalence of informal settlements poses enormous challenges for the local governments to provide safe and affordable housing to the urban residents. International development agencies, academics and practitioners in urban issues proposed legalization program to provide clear property titles to the residents in informal settlements. However, the implementation of legalization program may have detrimental effects (van Gelder, 2009). In fact, registration of property rights can increase land prices, thereby forcing the displacement of the residents or leading to greater rent seeking efforts by political-economic elites (Varley, 1987; Wang et al., 2014). Given that legal title is usually a valuable good, it is not surprising to see that people would try every political or economic means to capture the windfall of legalization program. We can also expect that the higher value of a legal title is often associated with the more fierce competition or rent-seeking activities. The question would then be: how valuable is a legal title? To estimate the value of benefits bestowed by a legal title, in our view, could be a preliminary step to evaluate the benefits, costs and distributional impacts of legalization program (Friedman, Jimenez, & Mayo, 1988).

In Manila of Philippines, Friedman et al. (1988) used survey data and hedonic model to estimate the value of legal title. They argue that the difference between formal and squatter household can be interpreted as the market-determined premium of a legal title, after the other factors which would affect housing prices are controlled (Friedman et al., 1988: 189–90). They use hedonic model to regress housing prices by controlling physical characteristics of the housing properties such as total area of housing unit, age of the building, number of bathrooms, availability of toilet, for formal and squatter settlements separately. They find that “on average a rented squatter unit in Manila would rent for 15% more if it were a formal sector unit. An owned squatter unit would sell for 25% more if it were a formal sector unit” (Friedman et al., 1988: 185).

Lanjouw and Levy (2002) also agree that one approach to quantifying the value of a legal title is to compare the sale value of a property with a legal title to that of a similar property which differs from the first one only in that it does not have a legal title associated with it via hedonic price regression (Lanjouw & Levy, 2002: 986). Yet, they argue that there could be endogeneity concern involved with the relationship between housing price and property titles (Lanjouw & Levy, 2002: 989). Titling, on the one hand, could promote housing prices. But on the other hand, “there may be unobservable characteristics of properties or communities which influence both the value of the property and whether the owner has obtained title” (Lanjouw & Levy, 2002: 1004). To tackle this endogeneity issue, they design a survey in urban Ecuador to estimate ‘within’ property changes in price by using “responses to questions about the value of property in hypothetical title states”. The factors considered in the regressions include the age of community, distance from city center, education of household head, adult males, years of resident in community, and percentage of squatter households who paid a boss. The physical and locational characteristics of the housing properties (except distance from city center) are excluded in the regression analysis. They find that “unconditional effect of granting title is to raise properties’ value by 23.5%”. “This estimate is comparable to the effect of title found in hedonic price equations using urban data from Manila and Davao” (Lanjouw & Levy, 2002: 1010), where the marginal effect of titling is found to raise the value of property by 14–58% (Friedman et al., 1988; Jimenez, 1984). Lanjouw and Levy (2002) further reveal that title is particularly important for the vulnerable households or

recently settled communities where the system of informal rights is weak (p. 989). For example, granting title, according to their results, can induce a 46% increase in the value of property owned by newly established household with no adult males.

By using survey data and census data, Alston et al. (1996) empirically investigate the value of legal title in Brazilian frontier. They argue that “titled and untitled land will have different net present values because of differences in productivity-enhancing investments, exchange possibilities, and private enforcement costs” (Alston et al., 1996: 33). At the market center where transportation costs are the lowest, untitled land “will be subject to more intense competition, raising private enforcement costs and increasing uncertainty of control” (Alston et al., 1996: 33). The contribution of title to land value in the market center is, therefore, the greatest. Moving away from the market center, land owners have less demand for state enforcement of title. The competition for legal title is reduced, and the value of title declines accordingly. They evaluate the contribution of title to land value after the municipal-level variables rather than land specific variables are controlled. These variables include the distance from the municipal capital to the state market center, average soil quality in the municipal, the percent of municipal agricultural land that is cleared of forest, municipal population density, and whether the municipal was the site of conflict over land, et al. The title-distance interaction variable is used in the OLS regression to test the effect having title on land value with respect to distance. The results confirm the contribution of title in promoting land value. They also find that moving from the market center towards the frontier, the contribution of title on the agricultural land value declines (Alston et al., 1996).

Miceli, Munneke, Sirmans, and Turnbull (2002) used a natural experiment in Cook County, Illinois, to compare land values under two different property title systems, namely, Torrens system and recording system. They propose that “the title system affects equilibrium land prices, although the net effect depends upon the relative claim probabilities and differences in transaction costs” (Miceli et al., 2002: 571–2). They collect vacant land transactions in Cook County, Illinois during the calendar years of 1986 and 1987 to derive transaction prices, the location and physical characteristics of the sites. To evaluate how the title system affects land prices, they argue that an empirical model which is constructed regressing land prices on location and physical characteristics as well as a dummy variable representing the title system choice might be too simple, because this approach treats the assignment of land between two title systems as exogenous. In the United States, however, when the two title systems operate side-by-side, the selection process underlying the choice of a title system is probably not random. It is expected that the relative land prices under the two alternative title regimes can play a role in determining which title system the local residents would choose (Miceli et al., 2002: 574). The authors then construct a two-step selectivity model to capture land prices as well as the choice of title system in two equations. The choice of title system is explained by land prices and other factors that may determine the choice of title system. And land prices are determined by the choice of title system as well as physical and location characteristics of land parcel. In the regressions, the physical and location characteristics of land parcel are represented by lot area of the parcel, distance to central business district, distance to major airport, distance to high concentration of rail activity, and distance to high concentration of road activity from the parcel. The regression results illustrate “that the Torrens system increases land value relative to the recording system when controlling for self-selection effects” (Miceli et al., 2002: 565).

Existing empirical work enhanced our knowledge by assessing the value of legal title in different countries. However, there is great

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