



# Property rights and housing prices: An empirical study of small property rights housing in Shenzhen, China



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## ARTICLE INFO

### Keywords:

Property rights  
Institutional analysis  
Housing price  
Small property rights housing  
China

## ABSTRACT

Small Property Rights Housing (SPRH) is an important part of informal housing in China. SPRH is defined as housing developed with collective land ownership that is then sold to outside homebuyers such as non-indigenous villagers. This housing practice is legally forbidden and comes without formal titles. SPRH is popular in big Chinese cities where formal housing prices are constantly rising and increasingly unaffordable for many urban residents. However, research on SPRH is rare. Therefore, this study aims to investigate the effects (or the lack thereof) of de-jure property rights on housing prices by using the empirical case of Shenzhen where SPRH and FPRH estates constitute the main sources of urban housing for its residents. We collected both SPRH and formal Full Property Right Housing (FPRH) data in the Shenzhen housing market and adopted the Boundary Fixed Effect method and matching strategy to mitigate the bias caused by unobservable location and neighborhood factors. This empirical study shows that the lack of de-jure property rights has negative and significant effects on housing prices. The average housing price for SPRH apartments is, *ceteris paribus*, 52.82% lower than for formal FPRH apartments. Also, the premium of property rights varies across two administrative regions with different locations and economic environments, and the premium decreases as the age of the building increases.

## 1. Introduction

Housing reforms in China have transformed the previous administrative allocation system of urban housing development to a market-oriented system (Wang and Murie, 1999; Wang, 2001; Wu, 2005). The urban housing market and development in China are institutionally based on a peculiar urban-rural dual land system. According to the land administration law, only state land ownership is allowed for commercial housing development. In practice, the formal commercial housing provision constitutes only one portion of the housing supply to the rapidly increasing urban population. As in other developing countries, informal housing development is dominant in Chinese cities today (Deng, 2009; Liu et al., 2012; Paik and Lee, 2012). Millions of people live in urban dwellings without possessing formal titles to these dwellings. In Shenzhen, land occupied by informal housing buildings covers an area of 113.8 km<sup>2</sup>, while the land for formal housing buildings covers an area of 70.6 km<sup>2</sup> (Lai et al., 2016). It has been estimated that more than 9 million people live in informal housing apartments (Zha, 2007) in Shenzhen. Small Property Rights Housing (SPRH) is an important part of informal housing in China and is a substitute for Full

Property Rights Housing (FPRH)<sup>1</sup> within the urban area. SPRH is not a legal concept but a conventional term for such housing. In previous studies (Deng, 2009; Paik and Lee, 2012), SPRH was loosely defined as housing developed with collective land ownership and sold to outside homebuyers such as non-indigenous villagers. This housing practice is legally forbidden and comes without formal government issued titles. According to this definition, SPRH includes two main types of housing: individual village housing based on housing spots locally known as “zhaijidi” and newly developed housing quarters based on collective farmland or redeveloped housing quarters based on zhajidi. Both these types of housing are informal yet distinguishable from each other by their different development processes and spatial outcomes. Generally speaking, newly developed housing quarters or redeveloped housing quarters are developed by village shareholding cooperative companies or real estate developers, while village housing is developed by individual village households. The former generally has a higher level of building quality than the latter. In many cases, newly developed housing quarters or redeveloped housing quarters have a similar spatial layout, landscape design, infrastructure standards, and building materials as those of formal residential estates. In this study, we pay

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<sup>1</sup> The FPRH is also referred to commercial formal housing.

particular attention to two types of SPRH, newly developed housing quarters or redeveloped housing quarters, which have similar physical components to formal housing quarters.

SPRH is popular in big Chinese cities where formal housing prices are constantly rising and increasingly unaffordable for many urban residents. Our fieldwork in Shenzhen shows that numerous SPRH estates with a high occupancy rate have been developed and constructed from the middle 2000s to the present. However, research on SPRH in China is rare. Against such a background, this study provides an empirical study of SPRH in Shenzhen to better understand the essential components of the property rights associated with SPRH and how these incomplete property rights affect SPRH market outcomes. We collected both SPRH and formal commercial housing data in the Shenzhen housing market and adopted the Boundary Fixed Effect method and matching strategy to measure the effects (or the lack thereof) of de-jure property rights on housing prices.

The remainder of this paper is organized as follows: Section 2 reviews the theoretical literature on property rights and examines the property rights associated with SPRH in the specific context of urbanization and urban housing development in China. Research gaps are then identified and research questions are proposed at the end of this section. Section 3 introduces the research methods and data to address the research questions. Section 4 presents empirical findings on the effects of incomplete property rights on SPRH price. Section 5 presents the conclusion of the study.

## 2. Literature review and theoretical questions

### 2.1. The role of land property rights in urban development

Institutional arrangements on property rights critically affect decision-making regarding resource use and affect economic performance (Libecap, 1989). A property right is the exclusive authority to determine how a resource is used and whether that resource is owned by the government, collective bodies, or by individuals (Alchian and Demsetz, 1973). Property rights are viewed as an attribute of an economic good referred to as a bundle of rights including the right to: i) use the good ii) earn income from the good iii) transfer the good to others and iv) enforce property rights (Eggertsson, 1990). Property rights play an important role in land development processes, outcomes, and land values (Choy et al., 2013; Lai et al., 2017). Properties without full property rights are not able to transact at the public housing market and hence have to sell at a discount price due to liquidity risk (Hui and Wang, 2014; Zheng and Hui, 2016). It is believed that strong property rights occupy a prominent position in the list of prerequisites for market economies to function well (Lanjouw and Levy, 2002). Clearly defined land property rights can facilitate land transactions in land markets. Thus, potential gains can be achieved from the trade (Besley, 1995; Griffith-Charles, 2004). In contrast, vague and incomplete property rights in urban areas inhibit land transactions by increasing transaction costs in sales markets (Lanjouw and Levy, 2002). Empirical studies based on select titling programs in countries in South America have explored the effects of property rights on a wide range of variables relevant to economic behaviors and performance. In a series of papers, Field (2005, 2007) examined and theorized the impact of a large titling program in urban squatter settlements in Peru. Field (2007) found that the lack of titles reduced total household labor supply by about 14%. She also found significant effects on housing investment associated with titling, but financed without the use of credit (Field, 2005), and without effects on formal credit from private banks (Field and Torero, 2003). Finally, Field (2003) also found an association between land titling and fertility reduction. Galiani and Schargrodsky (2010) studied the effects of titling by exploring a natural experiment of land occupation in the outskirts of Buenos Aires, Argentina, in 1981. The results showed a strong effect of land titling on different forms of housing investments which aggregate into an index showing 40% more investment in titled

houses. Galiani and Schargrodsky (2004) also found better nutrition and lower teenage pregnancies for children in titled households.

Several studies have investigated the effects of land property rights on property values. Miceli, Munneke and Turnbull (2002) compared land transactions under two different title systems—the recording system and the registration system—in Cook County, Illinois. Their study showed that land title systems affects property values differently. Specifically, the registration system led to higher land values. Other factors, including the expected risk of property and transaction costs, also have impacts on property value. Using survey data from Ecuador, where households have both formal and informal claims to urban residential property, Lanjouw and Levy (2002) found that possessing title to a property is associated with a sizeable increase in the expected value of the property—on average, 23.5% over untitled property values. Thus, the literature review indicates that land property rights may have significant effects on land and property transactions and values. However, it is worth noting that the effect of formal property rights on welfare depends on the availability of informal sources of rights (Lanjouw and Levy, 2002). More empirical work is needed to better understand the nature of property rights and the effect of property rights on asset values. To do so, we need to put property rights into specific development contexts which directly shape the formation and determine the structure of property rights. In this study, we provide new, empirical information on the impact of de-jure property rights on housing value, using the case of SPRH and FPRH estates in Shenzhen, China.

### 2.2. The formation of SPRH in the chinese urbanization process

To better understand the property rights of SPRH, it is worthwhile putting it in the broader context of the urbanization and urban housing development in China over the past few decades. China's traditional urban housing system was characterized by a highly-centralized planning system within which work-unit housing was the main type of urban housing. Work-unit housing was produced and allocated to work-unit employees in a state-funded system. Since the economic reforms the production of urban housing has been gradually transformed (Wu, 2005). Local governments and real estate developers now play a key role in new urban housing production. In the development process, real estate developers buy the state land use rights from local governments for the development of new housing apartments in cities. According to the law, urban land is owned by the state and represented by the local government in matters of land development practice. The local government has the legal rights to acquire agricultural land and change it to urban land. Its use rights can then be transferred to the real estate developers (Lai et al., 2017). In this sense, formal housing land provision in urban areas is highly monopolized by the local governments (Wu et al., 2016). Over the past decade, an extensive amount of land has been converted from agricultural use to urban use in the urbanization process (Deng et al., 2010; Lin, 2007; Xiao et al., 2006) and a huge number of formal commercial housing apartments have been built and transferred to urban housing markets.

In the rapid urbanization process, informal housing apartments have also flourished across the country. Strictly speaking, the development of SPRH violates the land law. According to the law, land in China can be classified into two types of ownership—urban land, which is owned by the state, and rural land, which is owned by the collectives. Collective land cannot be transferred for non-agricultural use (Lai et al., 2014) because the state imposes specific restrictions on the use of collective land. According to these regulations, collective land can only be used for agricultural production, individual villager housing plots (zhaidiji), and township enterprises. As the original owners of agricultural land, villages are not permitted to transfer their land for urban housing development. The development process of SPRH is therefore without the formal procedures of housing development that require approval by government sectors including the Land Resources

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