Pricing Affordable Housing

Without delving into the definition of "affordable", which is beyond the scope of this one-pager, the clear objective of both developers and governments is to make housing for the middle and lower-middle class as inexpensive as possible in order to address this significant population segment and the one that can most afford holistic housing solutions. One way of achieving such pricing nirvana is for governmental housing authorities to require developers to conform to a mandated price range, irrespective of the quality of homes, their location and amenities, comparable sales of similar units or profit margins of developers. This approach to pricing has become accepted is some locations, and we believe it is wrong and misguided and will ultimately lead to a bigger housing crisis and banking crises in the future. This point will be addressed below.

TWO APPROACHES TO VALUATION

Ideally, housing should be priced fairly based on open market principals of supply and demand. Pricing Is not an exact science, and typically it is a resolution of two different approaches: (i) intrinsic market value; and (ii) production cost build-up. On the market value side, homes are typically priced based on their size, quality, location and supporting amenities like access to schools, shopping, and recreational areas. Affordable housing tends to be less expensive if located in suburbs that are more distant from city center or other more desirable (and expensive) locations. On the production cost build-up side, affordable housing will be less expensive if it is built using ordinary or standard finishes and offers less space and/or higher density than middle or upper-middle class housing. Developers can contribute to the pricing efficiency (effectively lowering the cost of production) by using modern and cost-efficient building technologies, building with good execution in large quantity, and by accessing construction finance at reasonable cost.

WHAT ABOUT SUPPLY AND DEMAND FACTORS THAT AFFECT PRICING?

As with any other commodity, more housing supply will cause housing prices to stabilize at a market-clearing level which is the price at which similar existing properties have sold for in the recent past. In many emerging market countries, demand is already high because of the persistent housing deficits. However, effective demand is much lower because of financing constraints. Housing finance's key variables in this respect are: (i) prudential minimum down payment requirements, (ii) high interest rates and (iii) short loan tenors. Reforms that may take place on the housing finance side that lower (a) the cost of mortgages and (b) the cost of mortgage lending are initiatives that should improve the affordability picture. However, these moves will have little impact if the local home building industry does not increase new home production to match the increase in demand that is sure to follow from less expensive mortgages.

SHOULD GOVERNMENT MANDATE HOUSING PRICES TO ACHIEVE AFFORDABILITY?

We have come across several initiatives by governments in the sub-Saharan Region to encourage the private sector, both domestic and international, in developing large-scale housing estates with a high percentage of affordable housing units. Many governmental authorities adopt a practice of mandating a price range, price target, or maximum price for housing in order to "force" affordability. This will result in one or more of the following: (i) poor quality housing; (ii) low profit margins for developers, with follow-on exit from the market; (iii) distortion of market-based pricing mechanisms for non-affordable housing. Since all these effects are negative and destructive, they must be avoided. If housing developers are forced by government requirement to build an affordable home at a fixed price, these developers – if they choose to participate at all – will deliver poorer quality homes in order to achieve a profit margin that compensates adequately for risk, return on invested capital and expenses. The result will be an inevitable deterioration in the quality of housing stock.

Interference in the natural demand-supply relationships are sure to cause distortion, disruption, and displacement. The ordinary owner-occupier homeowner loses because his home should be an asset that costs little to maintain and builds in value over a long period of time, providing financial security and wealth. Non-occupier investors in homes, like REITs, will be harmed (and disincentivized to invest) for similar reasons, and mortgage lenders will be put at-risk because it is highly likely that the value of a home created in such a regime will, at some point, drop below the balance of the mortgage, foreseeably leading to a housing and banking crisis. All these effects should and can be avoided.