

## THEMATIC AREA 4: ENCOURAGING PROGRESSIVE URBAN LAND & HOUSING MARKETS

### Enabling Markets with Appropriate Policies

93. *Starting in the early 1990s, many developing country governments and donors adopted an “enabling markets” approach to housing based on policies encouraged by the World Bank.*<sup>48</sup> This approach focused reforms on such issues as securing land property rights, providing access and cost recovery for infrastructure, and improving the balance sheets of housing institutions. World Bank and donor projects have helped to reform and expand mortgage credit with considerable success, spreading these systems worldwide. The hope has been that pushing this and other aspects of the formal sector housing systems “down market,” eventually would reach low- and moderate-income households.<sup>49</sup>

94. *Despite some successes, affordability problems persist and informality in the housing and land sectors abounds.* By the mid-2000s, it became clear that the enabling markets approach was “far too sanguine” about the difficulties of creating well functioning housing markets where everyone is adequately housed at a reasonable share of income on residential land available at a reasonable price. The general principles of enabling markets are still valid, but must be combined with sensible policies and pragmatic approaches to urban planning and targeted subsidies for the urban poor. As one World Bank report put it, “Well-functioning housing and land markets are powerful but difficult to create and maintain and must frequently be supplemented with interventions’ to overcome large-scale market failures.”<sup>50</sup>

### Four Areas of Critical Importance – Lessons Learned

95. There are four key housing and land issues that consistently pose the greatest challenges in most urban areas – (i) planning for markets, (ii) public land management, (iii) property rights, and (iv) housing finance. Dealing with each set of challenges requires putting policies in place to push formal housing and land systems “down market,” while at the same time creating and sustaining more “bottom-up” approaches that serve the poorest. Each is addressed in more detail below.

#### Planning to Facilitate Markets

96. *By not adjusting urban planning regulations to allow for greater density in tandem with urbanization, many cities today face expanding informality at the urban fringe.* Data clearly show that the urban footprint in most of the world’s largest cities is expanding. The Bank’s Urban Growth Management Initiative (UGMI) has been tracking urban expansion (among other variables) for 120 metropolitan areas over the past two decades. All but a few are sprawling well beyond their physical boundaries of a decade ago. (See Annex E, Figures E-15 and E-16). In fact, on average, as population growth has doubled, land consumption has tripled. Partly, this outward expansion is driven by limits on density in the inner-city that push people outward in search of affordable housing. At the same time, in the urban periphery, stringent restrictions on land use conversion from rural to urban uses also produce shortages of affordable land, hurting migrants to a city. For this reason, the average ratio of the median house price to the median annual household income in many African and Asian cities is twice that in many large U.S. cities. Bangladesh has a per capita income of \$1,230, less than 3 percent of the U.S. per capita income

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<sup>48</sup> Mayo and Angel 1993.

<sup>49</sup> Freire, Ferguson, Lima, Cira, and Kessides 2007.

<sup>50</sup> *Ibid.* 2007.

of \$44,070. But in Dhaka prime land prices are similar to those in New York City. As much as 20 percent of the city's inner area is underserved. Tracts of centrally located, publicly owned land remain idle and underdeveloped, while the rest is allocated for low value-added uses—a cantonment, public housing, and residential areas for government workers.

97. ***Some land shortages are the result of natural, physical limitations. However, scarcity is just as likely to result from ill-considered urban planning policies and regulations.*** Consider the case of Mumbai. The city imposed restrictions on building floor-area ratios (the amount of floor area that can be put on a lot). Imposed in many places in the world, FAR restrictions should “follow the market,” providing a way for city planners to ensure consistency in the physical character of neighborhoods. In Mumbai, however, the FAR policy was put in place in an effort to discourage both density and further in-migration to the city. Introduced in 1964, the FAR initially was set at 4.5. However, rather than raising the allowable FAR to accommodate urban growth and facilitate density over time, planners in Mumbai did the opposite by lowering the index to 1.3 in 1991. These regulations hold Mumbai's buildings to between a fifth and a tenth of the number of floors allowed in major cities in other countries. Space consumption averages 4 m<sup>2</sup> -- one-third the level in Shanghai and less than one-fifth of that in Moscow. The city's topography should exhibit a high-density pattern similar to other burgeoning metropolises, but it is instead mostly a low-rise city with densely packed “illegal” slums, land and housing costs beyond the reach of much of the population, coupled with highly contested land disputes.

98. ***For the very poorest residents of cities, subsidies will be required.*** Realistically, the private sector alone cannot house the cities' poorest. Nor can governments afford the type of mass public housing projects that have failed in the past. The fact is that it is very difficult to build affordable permanent housing in low-income countries. For example, a recent analysis of Nigeria showed that to construct a unit with minimum space of 5 square meters per person for a family with an income of less than \$2/day (30 percent of which would go to housing costs) means that housing would have to be provided for less than \$219 per year.<sup>51</sup> Most developed countries do not house the poor with new construction. Rather, they rely on filtering old housing. As higher income people move into new houses, they leave their old, slightly depreciated, and therefore cheaper, houses behind. But very poor countries tend not to have much old housing (let alone new housing) in urban areas. Far too many of the slightly better off households out-compete those on the lower rungs of the economic ladder for used housing. Therefore, to serve those on the bottom rung, limited government resources are best spent providing serviced land and/or infrastructure –water, sewer, electricity, drainage and roads.

#### Public Land Management

99. ***However well-intentioned, direct public interventions in urban land markets often further distort them.*** Bank research has confirmed that when the public sector dominates the private sector in land development, land market outcomes in cities are on average less favorable in terms of housing affordability and access to land by firms. Cities that auction public land as well as those that do limited or no land banking also tend to have more affordable housing. These observed outcomes may be due to unfair competition that private developers face against large public land developers who sometimes carry both developmental and regulatory powers. It may also be partly explained by the high transactions costs and limited decentralization often associated with public land management as well as the non-strategic withholding of prime public land from the market.<sup>52</sup>

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<sup>51</sup> Green 2009.

<sup>52</sup> These findings and arguments are elaborated in Rajack, 2007.

## Property Rights

100. ***Clarity of property rights underpin functional urban land markets.*** The Bank's systematic and regular monitoring of investment climate and doing business indicators over the last decade has reinforced the importance of property rights clarity and supporting institutions for encouraging investment. The MNA region has been particularly noteworthy for the hindrances that potential investors face on account of deficiencies related to these rights and systems. The rapid expansion of housing finance systems in the last decade, beyond the traditional North American and OECD markets also needs to be met by systematic improvements in registering and transferring property rights if it is not to lead to shelter price inflation. Clear and tradable property rights are also needed for the implementation of other urban policies such as urban renewal in ECA and transferable development rights (TDRs) as applied in Mumbai.

## Financing

101. ***Mortgages remain an indispensable element of housing finance.*** A lack of access to finance is one cause of informal settlements, which in turn make service provision less efficient and more expensive. But large disparities exist within and across countries in accessing formal housing finance. In Thailand, 80 percent of households have access to housing finance, where as in Mexico, a country with GDP per capita three times higher than Thailand, only about 15 percent of the country has such access.<sup>53</sup> To the extent that formal housing finance systems can be pushed "down market" -- rather than just serve the wealthiest households -- private markets can create housing opportunities for households of more modest means. At the same time, subsidy systems need to be rationalized to better target households with relatively lower incomes. Such measures become all the more important in periods of financial crisis in which it may be even harder for households to access formal finance systems. In times of rising unemployment, caution among lenders may lead to stricter underwriting guidelines and a shift away of capital available for the construction and finance of housing and real estate. Even before recent events, there were limits on how far "down market" traditional finance systems could go -- median income or slightly above, but certainly not much below 40 percent.

102. ***In cities in the developing world where the majority of homes are built incrementally, many households cannot be reached by the traditional, formal sector.*** According to some estimates and depending on the country, incrementally-built housing accounts for up to 70 percent of the stock.<sup>54</sup> That is, a foundation is dug, walls are put up and rooms or separate stories are added as household resources permit. Sometimes incremental housing is built on usurious terms or without financing at all, in violation of zoning or building codes and on land not legally owned. This is in contrast to developed cities where most housing is provided by private developers in the form of completed units, and financed through private formal channels. Formal finance systems are not designed to accommodate incrementally built housing.

## **World Bank Strategy: Encouraging Progressive Urban Land & Housing Markets**

103. ***A renewed urban housing and land agenda for cities should recognize that urbanization will continue to put pressure on already limited access to land and seek to eliminate regulations and policies that exacerbate this pressure.*** Urban regulations are indispensable for markets to function, but they should be assessed for their impacts on land and housing supply, affordability and city spatial structure. Urban spatial structures evolve slowly but often irreversibly through market responses to infrastructure investments, regulations and

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<sup>53</sup> [http://www.gyoder.org.tr/sunum/kf3s/Bertrand\\_Renaud.pdf](http://www.gyoder.org.tr/sunum/kf3s/Bertrand_Renaud.pdf)

<sup>54</sup> Figure cited in Ferguson and Navarrete 2003. The UN Human Settlements Programs cites figures ranging from 43 to 70 percent depending on the region. See UNCHS 2003, p.13

taxation. The effects of ill-conceived policies therefore are difficult to undo. How, then should cities proceed? Experience suggests that only a few regulations are critical: (1) minimum plot sizes and minimum apartment sizes, (2) limitations on floor area ratios (3) zoning plans that limit the type of use and the intensity of use of urban land, and (4) land subdivision ratios of developable and salable land in new greenfield developments. “Urban Planning Audits” are essential tools that cities can use to determine which regulations should be changed to enable density and urban form to move in tandem with urbanization. The Bank will be developing a global knowledge product that cities and Bank task teams can use to more systematically assess urban planning regulations and guidelines and their potential distortionary effects.

104. ***Given the predictable rapid increase in city populations, a more proactive public role in preparing the peri-urban fringe to accommodate new settlement would in many cases be sensible.*** One approach would likely require governments and municipalities to acquire land for block-level infrastructure rights of way<sup>55</sup> around the peripheries of its rapidly growing cities. For some cities, former irrigation networks may be a useful starting point. This approach should be complimented by institutional measures to protect these rights of way from encroachment prior to the actual building of infrastructure, which should only occur after effective demand is confirmed and resources are available. Yet compulsory acquisition is administratively complex and lengthy to implement,<sup>56</sup> and courts in many countries are increasingly limiting such practices while insisting on higher levels of compensation.<sup>57</sup> Governments and the Bank will therefore need to explore a variety of policy options in addition to compulsory acquisition. One such option is land readjustment or land pooling, which generally refers to the process of combining small land parcels, often with multiple owners, into a larger land area for efficient subdivision and development. Once improvements are made – usually in the form of infrastructure or public spaces – smaller but more valuable reconfigured plots are returned to the owners. This approach has been extensively used in East Asia and in post-World War II Europe as well as in India through Town Planning Schemes in states such as Gujarat. Although the Bank has limited experience with land readjustment as a tool, it does have considerable experience in supporting initiatives to strengthen the facilitating conditions related to land market regulation, land tenure clarity, credit market function and public sector capacity.

105. ***Recent Bank work in providing technical assistance to governments on public land management is paying dividends and should be expanded to policy-based lending where appropriate.*** While not all governments are large land holders, those that do control a large stock in the public sector need to be strategic in the way they manage those assets, including in the way they are disposed. Bank advice in the domain of public land management has addressed issues of inventorying and accounting for public land assets, clarification of rules and decision making chains related to the use of these lands, and improving information systems related to these assets. Where appropriate, governments are advised on the design and execution of market-based auctions of some public land assets. In recent years, such auctions have raised massive sums of municipal finance in Cairo, Mumbai, Bangalore, Istanbul, Cape Town and Bogota among other places.<sup>58</sup> This approach would need to balance the risks of making municipal budgets too dependent on land-based finance, which can be a significant source of vulnerability during an economic downturn.

106. ***The deficit of affordable shelter supply and the dominant incremental construction patterns of the urban poor, suggest a continuing role for sites and services projects.*** Once the

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<sup>55</sup> World Bank 2005.

<sup>56</sup> See Hazards of Nature, Risks to Development, World Bank 2006, Washington D.C. which found land acquisition projects to be among the most lengthy to implement, typically taking 7.3 years.

<sup>57</sup> Azuela 2007.

<sup>58</sup> Peterson 2009.

mainstay of the Bank's urban assistance, these projects are increasingly rare in the Bank's portfolio except in post-disaster reconstruction. However, for governments with large tracts of public land they sometimes offer a politically irresistible opportunity for direct intervention in urban shelter markets. Going forward, Bank support for such projects will aim to engage Governments in careful scrutiny of the proposed locations based on effective demand and transport connectivity to labor markets. Governments also need to be careful to adopt infrastructure servicing standards and design densities which would keep the plots affordable to the intended target group. Even then, the opportunity cost of these projects should be calculated up front without discounting the value of the underlying land simply because it is already owned. With such an approach, the next generation of sites and services projects would also benefit from the recent rapid expansion of housing finance systems, the rise in influence and engagement of NGOs and the growth of technologies that allow for cross-country learning.<sup>59</sup>

107. ***The Bank can now finance compulsory acquisition of land when a direct role in land development is justifiable.*** Compulsory land acquisition is already commonplace in many Bank operations and in the urban sector may be justifiable for road or rail network improvements to increase inter- and intra-city mobility. It may be required for negotiated resettlement or relocations associated with informal settlement upgrading or inner city regeneration.<sup>60</sup> Approved in April 2004, the new Bank Financing Policy (OP/BP 6.00) provides for increased flexibility in the use of Bank funds, including for the purchase of land.<sup>61</sup> Such acquisitions may be justifiable for rights of way for road or rail network improvements to increase inter and intra-city mobility. They may also be needed in order to bring trunk level infrastructure services within reach of existing informal settlements on the edge of the city or to provide adequate transport links between sites and services projects on the periphery and income earning opportunities in the heart of the city. They may also be required for negotiated resettlement or relocations associated with informal settlement upgrading or inner city regeneration.

108. ***The Bank's Land Administration Projects are likely to remain both relevant and responsive to client needs in the coming decade.*** The development agenda in cities requires governments to simultaneously pursue investment-led growth as well as urban welfare and poverty alleviation. Historically the Bank has a long and substantive experience with interventions aimed at clarifying and registering property rights through cadastre development and business reengineering interventions. In ECA for example, almost every country has a land administration project that is so focused. In almost every other region there are multiple projects of this nature. With the projected trends in globalization and housing finance growth, this product line is likely to retain strong demand in the coming decade. One drawback, however, has been the tendency for such projects to side-step the complexity associated with informally settled parts of the city notable for unresolved underlying property claims. While there is no straight-forward solution in such areas, the use of intermediate land tenure and administration tools (as discussed below) holds promise. Such tools can simultaneously reduce tenure insecurity and expand the functional reach of city administration without asking governments to prematurely forego their prerogative to later resettle some informal communities if this turns out to be in the city's best interest.

109. ***Prerequisites for a functioning primary mortgage market include land titling or at least a registry system, enforcement of contracts including foreclosure procedures, and fair and transparent underwriting guidelines.*** The World Bank has helped and will continue to assist countries develop primary mortgage markets. In Mexico, Brazil and Morocco for example, the Bank provided a series of housing development policy loans in excess of \$1 billion, as well as a

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<sup>59</sup> Cohen 1988.

<sup>60</sup> See WB Operational Policy 4.12 on Involuntary Resettlement.

<sup>61</sup> Details of the application of this policy to urban areas can be found in Rajack and Ford 2006.

technical assistance to promote the conditions needed to push formal finance “down market.” As part of this effort, the Bank helped rationalize the system of homeownership subsidies by targeting lower income households. Work on housing finance and subsidy reform is expected to continue in Egypt, India, Brazil and elsewhere as countries look to the formal housing sector as a source of economic stimulus in the current downturn. Likewise, where primary markets exist, it makes sense for countries to pursue a secondary market strategy as a source of long-term capital for financial institutions – as long as the lessons from the recent experience of lax underwriting and lack of oversight are incorporated.

110. ***Housing microfinance holds promise as a way to reach individuals or families who build incrementally or who are too poor to qualify for conventional loans.*** Most housing microfinance experts believe there is vast potential demand for their products.<sup>62</sup> Moreover, in the past decade, important lessons have been learned about how to best implement these programs. So far, experience suggests that housing microfinance products have served the low-income salaried poor, and even those with irregular incomes, with encouraging results. Subsidies are not necessary as long as loan amounts are reasonable and terms are short. One of the most promising innovations in the field is the “hybrid value chains” concept in which private sector companies (such as cement or floor tile companies in Mexico) team up with microfinance providers and citizen groups to lower the cost of producing housing.<sup>63</sup> Here, the Bank can help promote, expand and evaluate existing and new microfinance efforts.

111. ***The financial fallout in homeownership markets provides an unexpected opportunity to focus on the often-neglected rental sector.*** In the past policymakers have had a bias against rental housing, in general, and landlords, in particular. Yet, rental housing is an important component of a balanced housing policy. Renting may be a better option for smaller households, newer households, and poorer households. Rental housing also allows workers to more easily move to jobs, which in turn is important to economic development. By the same token, high homeownership rates are not synonymous with high rates of development. Even in the developed world homeownership rates vary from 35 percent in Switzerland to 80 percent in Spain. Studies have shown there is no statistical relationship between the rate of homeownership in a country and the level of per capita income.<sup>64</sup> One reason is that renting frees up capital for other types of investments. Meanwhile, in developing countries, the demand for rental housing is substantial, accounting for between one-third and up to two thirds of the housing stock in many cities.<sup>65</sup> In a rapidly urbanizing world, the demand for rental housing will continue to grow.

112. ***Segmenting rental markets will lead to better-targeted policies to assist the sector.*** Some overall policies may make sense – sensible codes, balanced landlord-tenant relations, elimination of rent control, tax incentives. However, a more nuanced picture of local rental markets is needed to develop local policies. “Landlords” are not all one and the same. Surveys in such diverse places Indonesia, Nigeria, England and Russia – show the variation within each country of providers of rental housing.<sup>66</sup> Developers, small scale operators, those that share living quarters with tenants – all have different needs and motivations. Nor are tenants a monolithic group. Some are temporary, some permanent, some rent the building and land, some rent the unit, and others a room and shared facilities. Therefore, a variety of policies are needed to move market segments towards formality. For example, landlords in informal housing with live-in tenants might benefit from legal titling whereas small scale landlords may be mainstreamed with financing, while non-profit landlords might require public subsidies. To get

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<sup>62</sup> Cities Alliance 2003.

<sup>63</sup> Ferguson 2008.

<sup>64</sup> Lemer 1987.

<sup>65</sup> UNHCS 2003, p. 10.

<sup>66</sup> Allen and McDowell 2005. Or Dubel, Brzeski, Hamilton 2006.

there, the Bank is well positioned to provide research and technical assistance to cities seeking information on such issues as: the various ways rental properties come to market (conversions, constructions, constructed incrementally), how these properties are financed, how land pressures affect the operation of rental markets, how migration affects rents. The goal is to determine what incentives make sense for which segments of the market.

113. *The Bank intends to help client countries expand the use of intermediate land tenure and administration tools such as Street Addressing in informal urban areas.* During the last

decade, the Bank's Africa team has been implementing a relatively new product line to address the very large gap left by conventional land administration projects. Street addressing, now implemented in over 50 African cities, basically maps existing settlement patterns regardless of the land tenure or ownership complexity and translates that spatial information into a GIS that city administrators have been able to use for a wide variety of purposes ranging from postal delivery to

**Profile 11: Street Addressing.** A relatively simple intervention can make a significant difference for the delivery of urban services, by making it easier to locate residents, operate emergency services, and enforce collection for user-pay services, such as water and electricity.

epidemic monitoring. In the coming decade, the Bank will seek to expand use of this product in other regions where appropriate. It will also explore the possible use of other emerging incremental approaches to consolidating property claims including those that are linked to existing legally recognized forms of land tenure. The experience of Trinidad and Tobago with a progressive three-tiered system of consolidating informal land tenure is one such approach.<sup>67</sup> Rapid advances in the availability of spatial images, particularly through Google Earth, also offer potentially new and cost effective options for rapid coverage.

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<sup>67</sup> Rajack and Barhate 2004.