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MECHANISM OF THE HOUSING MARKET FUNCTIONING

Summary: Real estate market is quite specific because of the features of the object of trade. It works differently from other markets, especially considering time effects. It needs some external support because in short term changes are hardly seen. There is a place for government activity here.

Housing and real market policy is connected with giving some financial and administrative support for market participants. This activity influences the way people behave. However, people's behaviour is determined by many other elements. Thus, the public authorities should not omit these psychological and sometimes social determinants of the way people make decisions on the real estate market.

Keywords: housing market, real estate market, housing policy, determinants of behaviour.

1. Introduction

Modern economies are still aiming to give more and more freedom to their participants. In some parts (i.e. on stock market) it is quite easy but in others it is very difficult. Obviously even when the official intervention is small, there must be some statutory regulations, which ensure participants that all their rights are being kept. In case of housing market it is impossible to leave it without any official intervention. The problem lies in the incompatibility of supply and demand of dwellings.

Such an intervention decides also about the ability of consumers' behaviour. They cannot act freely and are limited by the rules that government puts on the market and by their own abilities of analyzing information from the market.

2. How does the housing market behave?

The first reason of this incompatibility is the imperfection of housing market, which comes from some of its features. A perfect market can work only under specific circumstances, such as¹:

¹ E. Kucharska-Stasiak, *Nieruchomość a rynek*, Wydawnictwo Naukowe PWN, Warszawa 2000, p. 42-68.

- homogeneity of the products, which means that all participants make their decisions basing only on the price of the product,
- complete knowledge about the market, which means that all participants have all important information about products,
- maximization of utility and profits, which means that participants make their decisions only thinking about the measurable effects for themselves, excluding other terms (e.g. neighbourhood),
- large amount of buyers and sellers, which means that none of them has a possibility to create prices, and there is no possibility to make any conspiracy between these objects,
- freedom of in-and-out, which means that every participant can decide about change in the subject of investment, when it can provide more profits.

In fact, there are only a few markets that can fulfil these conditions. Unfortunately housing market is not one of them. The homogeneity of dwellings will be possible only when all buildings are the same having the same surface and quality. Practically it is impossible to happen as well as to possess the complete knowledge about the house to buy. There will always be something that a seller will not inform a buyer about, especially when the evidence of previous changes is unclear or incomplete. Maximizing profits is quite obvious, because every buyer thinks about money he wants to spend and the result he wants to achieve. However, in case of housing he cannot exclude things that are directly connected with the conditions of living, such as place, environment or other features. There are rarely a lot of buyers and sellers who are interested in one object. Dwelling as a product of investment is rather an expensive good and there is only a small probability that a lot of buyers have enough money and the same preferences at the same time. Also the sellers rarely offer similar objects at the similar price, in the same time and place. Furthermore, there can always be an agreement between some of them, which makes other participants unequal in the act of buying or selling. The freedom of participating in housing market is very difficult to achieve, because of character of buildings. They are strongly attached to a specific location and it is impossible to move it. They are also rather rare, which means that in fact there are no two identical buildings, even in the close area. Moreover, moving in or from the house needs a large sum of money, which is an additional difficulty. Therefore, some participants, even if they want to make a move on the housing market cannot do this, because they cannot afford it.

Described features decide that housing market cannot be called perfect, and that is why supply and demand of dwellings cannot achieve a state of equilibrium. The market mechanism works only on such a market and causes the adjustment of supply prices to the demand prices. With regards to the housing market it is impossible because of the reasons mentioned before and additionally because of unequal dividing of income. People with lower income have strong difficulties with working on this market.

The supply's graph shows that the increase of price causes appropriate change of supply. In short term changes of supply are rather invisible, because there is no more dwellings to sell. It means that supply is fixed and its graph is vertical.

The increase of price does not cause the increase of number of dwellings offered on the market. It is possible to happen only in the middle term when some resources can be freed and offered to sell. However, the biggest change can be seen only in long term, because the process of investment on the housing market needs more time.

Such a situation can be seen also in case of demand. Changes in price do not cause in short term adequate changes in demand. Also in the middle term changes are rather small, because there are only few households which can gain enough money then or which has gained the money and want to buy a house.

More changes can be observed in long term. Therefore, when we consider both supply and demand at the same time, we can see that there is almost no chance to find the point of equilibrium.

All these barriers decide that housing market cannot work automatically. Participants cannot work well without help from outside. They need some support coming from organisations with a bigger possibility of creating market and its prices, e.g. banks or public authorities. This is very important, because it helps to create the market as well as the policy of the country (in this case, housing policy).

3. How does the policy determine housing market?

Depending on the range of intervention of the government into the housing situation (market) there can be distinguished two modes of housing market financing²:

- supplementary mode, which means that activities made by the government are going to fulfil specified needs and to solve specific problems. These activities are based on occasional interventions into the housing market, which generally works as a free market (but not perfect). The support is directed to the precisely described groups of society that have e.g. problems with job, which makes them unable to work at the market properly,
- comprehensive mode, which means that the government excludes independent and free housing market. The housing policy deals with direct help given to the society, which is connected with directing the flows of publicly financed housing resources for the whole society's sake. It is realised by controlling the amount, time and location of new built houses by the government. The distribution of these resources is strictly under government's control and regardless of the social incomes, which means that everyone depends on the public decision about being given the right to tenure.

² L.J. Lundqvist, *Housing Policy & Equality. A Comparative Study of Tenure Conversions and their Effects*, Croom Helm, London 1986, p. 12.

Obviously, this specification does not include specific conditions under which the national economy works. They depend on many features, including the character of the society and historical conditions.

The most important feature of supplementary mode is the small role that the government plays on the housing market. The main mechanism that works here is free market, where participants fulfil their needs only at the level they are able to. This mode seems to be the most efficient way of dividing the housing resources.

Comprehensive mode makes government a more active participant. It treats a house not as a product, which is only a subject of transaction of buying-and-selling. It makes the house more like a social than private good. In this mode, physical features of the house make it a private good, but from the social point of view it is almost a public one. That is why in the supplementary mode the most important criterion deciding on the order of access to dwelling is income, because only this can guarantee proper work of free market. In contrast, the comprehensive mode needs and social equality are the most important criteria. This attitude emphasizes a right of all citizens to the basic goods and services, which include also the right to a house as a place of living.

According to the instruments used by the government to realise these aims there can be distinguished two modes³:

- administrative decisions of granting houses mode, which means that it is the government (or its agencies) which decide about the level of fulfilment of housing needs. The family is a passive participant on the housing market and its role is limited to someone who waits and at the same time who has no opportunity to influence this period and the future effect of waiting. A weak connection between the level of needs and the possibility of fulfilment is a very specific feature of this mode.
- individual mode, which means that people can fulfil their housing needs only in the range they can afford to.

The first mode has grown as a part of socialist economy and it worked instead of free market, where a house was a social good. The second mode is based on free market economy, where a house is one of the goods and it can be freely bought and sold, without any differences between other consumer goods.

These modes are opposite and deal with extreme situations, while the practise shows that such extreme modes do not work properly. On one hand they are very hard to realise for the government and the public budget, but on the other they cause social disapproval. That is why a lot of countries with a free market economy use some additional instruments to support housing market. They treat a house as a consumer good with some social features that cannot be passed over.

³ M. Bryx, *Kierunki pożądaných zmian w polityce mieszkaniowej*, „Sprawy Mieszkaniowe” 2001, nr 1-2, p. 5-6.

Therefore, the question if the market can ensure a proper distribution and access to houses is very important for all the participants. As it was shown earlier, housing market is not a perfect market, what suggests that it cannot be regulated automatically and needs some external support. On one hand leaving housing market as totally free would be fair, because it would let people fulfil their needs in the way and at the level they really can. But on the other hand, because the house is a very capital-intensive good, its price must be adequate, which means very high. That is why some people can be deprived of the possibility of buying a dwelling, because they cannot accumulate enough money. The more difficult the economic position of the country, the more common the financial problems of its citizens and the harder to gain savings. Considering this situation, it is also impossible to assume that all people will not be able to afford a house and therefore to put this problem in advance in the hands of government. It totally discourages people from saving to buy a house.

It is the government who decides about the kind of instruments used in the process of supporting financing of housing. They can be chosen from one of the groups⁴:

- administrative orders and bans,
- financial instruments and economical help,
- direct activities of public authorities.

Administrative orders and bans are connected with these activities of public authorities that decide about special statutory regulations (e.g. enfrashisement act). It helps the government to control the economy. Financial instruments are connected with these activities that support individual or institutional investments on the housing market (e.g. tax reductions). Economical help deals with these activities of the government that are aiming to support these participants who are unable to function unaided (e.g. housing benefits). Direct activities of public authorities are connected with the actions made especially by local authorities that are aiming to increase housing resources.

Actual policy of the government decides which group of instruments dominates. In countries with centrally controlled economies, administrative orders and bans are the most popular with the big share of economical help. This countries usually do not have free market. This excludes all participants except public authorities from the process of creating housing market. In countries with free market economy instruments that support some social groups are the most important. They are directed to these who cannot work unaided, e.g. retired, homeless, disabled. But this economy does not exclude other instruments such as administrative orders and bans because they help to organise proper work of all housing market's participants.

Every country has its own history and its own policy connected with housing. These differences cause that they have specific housing relations, which are mainly connected with the character of ownership and the range of public support. After

⁴ J. Zapart, *Polityka mieszkaniowa w Polsce. Zarys przemian*, Wydawnictwo AE, Wrocław 1999, p. 15.

the World War II some countries handed over housing problems and building of houses into public hands, while the others left it only for private investors. That is why some countries have a large resource of private houses while the others does not have. The character of ownership relations also influences the character of used financial instruments. Therefore even the countries which are situated close to each other differ in case of housing relations.

The number of persons per dwelling also reflects the housing policy. The richer the country, the less persons per one dwelling. However, being a rich country does not mean that the government does not help its citizens with housing conditions. It is even characteristic that the richer the country, the bigger the help given to its inhabitants (though the help is less direct). For example in Spain, where there are quite strict regulations and private housing is dominating, the number of persons per dwelling is the highest. On the contrary, in France, where a social housing is a priority, the number of persons per dwelling is the lowest⁵.

The experience of European countries shows that housing market really needs external support and that the range and way of support decides about the housing situation in the country. This is obviously very important for citizens because it determines the living standard. And common knowledge is that the happiness of citizens affects their satisfaction of government, which is a political aim of every authority. It is very useful for countries that do not have stable housing policy and that are constructing their own way of dealing with the housing problem. Surely, the instruments must be verified including specific circumstances that are characteristic of the country. Only some of them can be adapted and continued in the future. Those, that are considered for the application, must be updated and subject to criticism.

4. How do people behave in the housing market?

According to economic theories people should behave rationally and analyze all information about the object of decision. Unfortunately they do not do it. They usually base on their own experience and known heuristics which make the decision making process faster, easier and simpler, but also more fallible.

There are some well identified reasons of such a situation, i.e.⁶:

- different marking of the same object by different people,
- different perspective depending on the order of marked objects presentation,
- emotions, moods or feelings that can modify the marking procedure and effects,
- being under influence of other people,
- stereotypes and bias,
- chosen procedure of marking,

⁵ *Rocznik Statystyczny*, GUS, Warszawa 2001, p. 633.

⁶ T. Tyszka, *Psychologiczne pułapki oceniania i podejmowania decyzji*, GWP, Gdańsk 2000.

- difficulties with deciding about the probability of situation to happen,
- self-fulfilling prognosis.

Different marking by different people is connected with their subjectivity. In fact, it is very difficult to make an objective choice as every person has different experience, different preferences and different expectations from the object of decision. Therefore the same dwelling can be marked as acceptable or unacceptable by two persons without any changes in the object.

The order of presenting objects can determine the marking process by giving better or worse reference point. This trick is often used by real market dealers. First they present an ugly object and afterwards a better one with the same price.

It is also proved that people's feelings, moods or emotions can influence the decision making process. Good mood can lead to a faster decision but made without paying much attention to details. This can cause that effect of this decision can be unsatisfying.

Also the strength of interpersonal relations can decide about the choice. People who are under strong influence of their relatives can make decisions basing rather on their needs and expectations than on their own preferences.

Stereotypes and bias can decide about the acceptance or rejection of some elements of objects. On the real estate market this can be connected with a lot of things, i.e. area, which can lead to the conclusion that the estate itself is fine but its neighbourhood is unacceptable.

A chosen procedure of the decision making can cause differences in marking especially when the choice is connected with buying own dwelling or looking for the one for somebody else.

People sometimes have difficulties with estimating the probability of things to happen. Some situations are underestimated (like bad things), while the others are overestimated (like positive things). This effect is probably responsible for the real estate market crisis. People believe that all the negative signals about the market situation cannot happen to them.

This effect is additionally supported by a self-fulfilling prognosis, which causes that information about the future that is widespread among people really happens. People believe this information and behave according to it.

All these problems can lead to an unsatisfying decision and cause effects that are unacceptable to the decision maker. Of course it is not a full list of effects that can influence people behaviour but they confirm how difficult it is to be a rational market participant. Real estate market is not unique and it is not a proof for the irrationality of people.

5. Conclusions

Real estate market is quite specific because of the features of the trade object. It works differently from other markets, especially considering time effects. Because in short term changes are hardly seen it needs some external support. And here is a place for government activity.

Housing and real market policy is connected with giving some financial and administrative support for market participants. This activity influences the way people behave. But people behaviour is determined by many other factors. Thus, the public authorities should not omit these psychological and sometimes social determinants of the way people make decisions on the real estate market.

In fact, all these three elements (market, public authorities and people behaviour) should be considered together.

Literature

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MECHANIZM FUNKCJONOWANIA RYNKU MIESZKANIOWEGO

Streszczenie: Rynek nieruchomości jest rynkiem specyficznym ze względu na dokonywane na nim transakcje. Działa on inaczej niż pozostałe rynki, jeśli weźmiemy pod uwagę kryterium czasowe. Efekty zachowań działających na nim podmiotów są widoczne dopiero w dłuższej perspektywie czasu, wielokrotnie po udzieleniu mu finansowego i administracyjnego wsparcia ze strony państwa. Wsparcie to, obok wielu innych czynników, np. psychologicznych czy socjologicznych, oddziałuje na zachowania podmiotów rynkowych.

W praktyce trzy elementy: rynek nieruchomości, polityka i działalność państwa oraz zachowania podmiotów rynkowych, powinny być rozpatrywane łącznie.