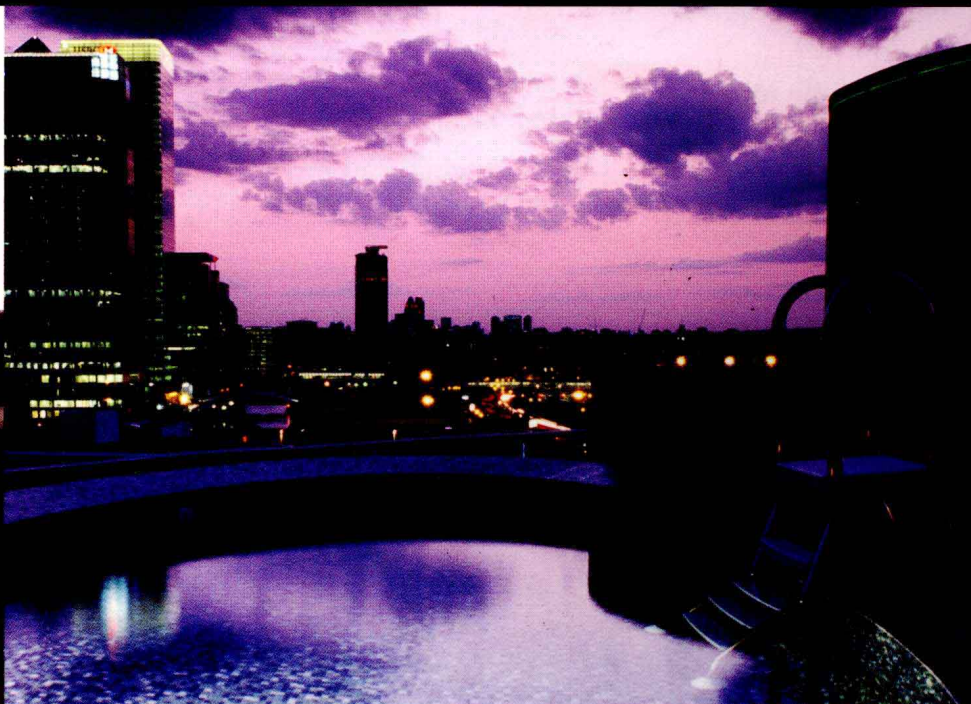


Danny Myers

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Preface



There have been many changes since the first edition of this text was published in 1994. For instance, the number of entry routes into the property industry has increased, as the range, and nature, of relevant three-year degree courses has broadened and one-year postgraduate conversion courses leading to a Masters qualification have been introduced. A unifying factor of these courses is the prerequisite of understanding some economics; indeed, the expectation is normally imposed by the RICS, and other professional institutions, as part of their accreditation.

The text is written to support those who come to the subject with no previous academic knowledge of economics. The key aim throughout is to explain economic concepts and make their relevance to property clear and understandable. For example, this edition commences by clarifying the role of property during the financial crisis that impacted on world-wide markets throughout the writing phase. In fact, Mervyn King (the Governor of the Bank of England) confirmed in October 2010 that the aftermath of this crisis would 'hangover' markets for many years to come. As a consequence the revisions that have been made to the text explain much about the current debate relating to the size and role of the state; and the policies that appear necessary to secure long term growth and sustainable development. Also in this new edition a greater emphasis is placed on the importance of understanding data, and the making of economic forecasts; as to fully master any subject you need to be able to use it. Therefore we strongly recommend an active approach and encourage you to take part in discussions and consider the questions that follow the readings and online resources by engaging with the language and ideas of economics between your tutors and peers.

As in previous editions several readings are provided to consolidate the content. Many of these extracts and the related resources available on the web are derived from the *Estates Gazette*; who fortunately continue to associate themselves with this title; and a specific acknowledgment should be made to Sarah Jackman, Professional and Legal Editor, who for a number of years has been a valuable support; allowing copyright permission and access to the *EGi* web material.

The list of organisations and people that contribute to developing a textbook of this nature is surprisingly lengthy and the team effort should not be taken for granted. In this instance it began with Eleanor Blow and Mike Travers, who set the project up on behalf of the publisher; next in the supply chain was the production team, managed by Renata Corbani, who organised the editing and proofing.

Alongside those working for Elsevier, I should also acknowledge the contributions made by Chris Wade who, as always, has been a great help in creating the Tables, Figures and PowerPoint slides that support this title. Thanks are also due to Dr. Melanie Dunster and Dr. Andrew Tallon for allowing me to draw on the ideas and resources that they use to support a module related to this title; their good work is explicitly evident in the *Topic Guides* that can be accessed from the web.

So although the cover might imply this is all my own work the book would clearly not have reached you without this team support, so thank you to all of them. Finally if you spot any errors or have questions then please encourage your tutor to get in contact through the book's companion site.

Danny Myers

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An Introduction to Economics

1

Aims and Objectives

The aim of Chapter 1 is to introduce the central role of economics to understanding government policy, such as the current interest in achieving more with less; and analysing markets such as those involving property and the built environment. Specifically by the end of this chapter you should understand:

- The broad scale and nature of the subject matter
- That economics is about the allocation of scarce resources
- Property, as an asset, that makes a significant draw on these resources
- How to identify and retrieve the relevant data to support a study of property economics

The need for a new edition of *Economics and Property* gained momentum from the financial crisis that began in the American housing market during 2007 and took hold across Europe and beyond during 2008 to 2010. This period of instability and economic decline is thrown into sharp relief by the relative calm and continual economic growth that had set the backdrop for the previous two editions (dating back to 1994). Furthermore, a recovery from this low point would require a different regulatory approach to the risks involved in funding commercial property development and residential mortgages; as property assets represent around 75% of the loans made on behalf of the world's banks and financial institutions.

In a nutshell, what had happened in the run-up to the financial crisis was the relatively free flow of finance from banks to property owners had led to what some commentators called a credit bubble which, in turn, fuelled a bubble in property prices. The use of the term 'bubble' is interesting, and popular, because it captures the idea of something vulnerable, inflating and inflating, until it eventually bursts. Famous bubbles include the price of black tulips, which had been the subject of a bubble in Holland in the 17th century; and the value of British South Sea stock, whose bubble inflated and burst in 1720; and the more recent dotcom bubble in internet company shares that burst in 2001. The current bubble, however, represents the biggest of them all. Property prices and credit allowances had both inflated at unbelievable rates – from 2002 to 2007 – a good deal further and faster than any forecaster could imagine. Then the inevitable happened, the bubble burst. It had begun to leak here and there in 2007 and eventually burst across the world economies in 2008 – not with a pop but an all-mighty crash – as property (unlike black tulips) affects everybody.

Subsequently, thousands of customers of all major Banks and related organisations simultaneously defaulted on loans – to the tune of several trillion – and this led to the bursting of another bubble in which the people struggling to pay debts sold property assets which were rapidly falling in price. This incredulous breakdown in the financial system had serious worldwide implications for employment, productivity welfare and prices. As the press coverage at the time portrayed it: the credit crisis (and related asset bubble) had sucked the life out of the economy.

The lesson that can be learnt from this recent event is that, unless the assets of a business, a bank, an economy, or a household are sufficient to cover the liabilities of that business, bank, economy, or household, then the balance sheet is out of kilter; imbalanced, bankrupt, insolvent, *kaput* – whatever you want to call it. The reason for stressing the point is that the precise same fact applies to natural assets. But unfortunately the monetary value of ecosystems cannot be quantified as easily as the debts of financial institutions, and the imbalance is often overlooked. As environmental economists have consistently observed since the 1960s, the world should not be viewed as a gigantic economic production system, capable of supporting ever-increasing amounts of output without incurring worrying amounts of environmental debt. In short, just as a business can go through the sad experience of bankruptcy, so too can an ecosystem. Or to extend the analogy introduced above, just as the credit crisis can suck the life out of an economy, an environmental crisis could suffocate the ecosystem.

So this new edition is published during a time when financial stability and sustainability – in particular the greening of assets – are becoming increasingly important objectives of broad corporate strategy and government policy. Property economics, therefore, should not be considered as a narrow specialised entity, as it significantly contributes to these major concerns. Indeed, a case could be made to extend the title of this third edition to encompass more than just property. Retaining the ethos of the previous editions, however, property is still the ‘key focus’ and although more than 16 years have elapsed since the first edition, the prime objective is essentially the same: to provide a general introduction to economics for students of the built environment following courses leading to professions in surveying, planning and construction.

Obviously, new sections have been added to account for the impact of the financial crisis; and to review the progress of sustainable development in the property and construction sectors. The new edition has also provided the opportunity to revise all the data – which in economic terms, has generated many exceptional facts that need to be understood and discussed in a built environment context. In July 1999, the Urban Task Force reported to the UK government that there are four main forces responsible for transforming our towns and cities; namely technological, ecological, social and economic, and this text places economic factors squarely at the heart of these forces.

The text is structured around two basic principles:

1. Firstly, that property represents a major financial asset underpinning the wealth of every economy – Figure 1.1 highlights how the stock of built assets is distributed across the UK economy where it represents two thirds of all the wealth that society holds. This data emphasises the significance of the sector and the broad opportunities that it offers for employment in the management and development of property. (In Chapter 8, the distribution of wealth and income is discussed further.)
2. Secondly, that students using this book intend to become involved in one stage or other of a building’s life cycle – as outlined in Table 1.1 (see page 4). Some may be studying for jobs that require an understanding of all stages, while others may become specialists concerned with one specific sector, such as the appraisal or marketing of new projects.

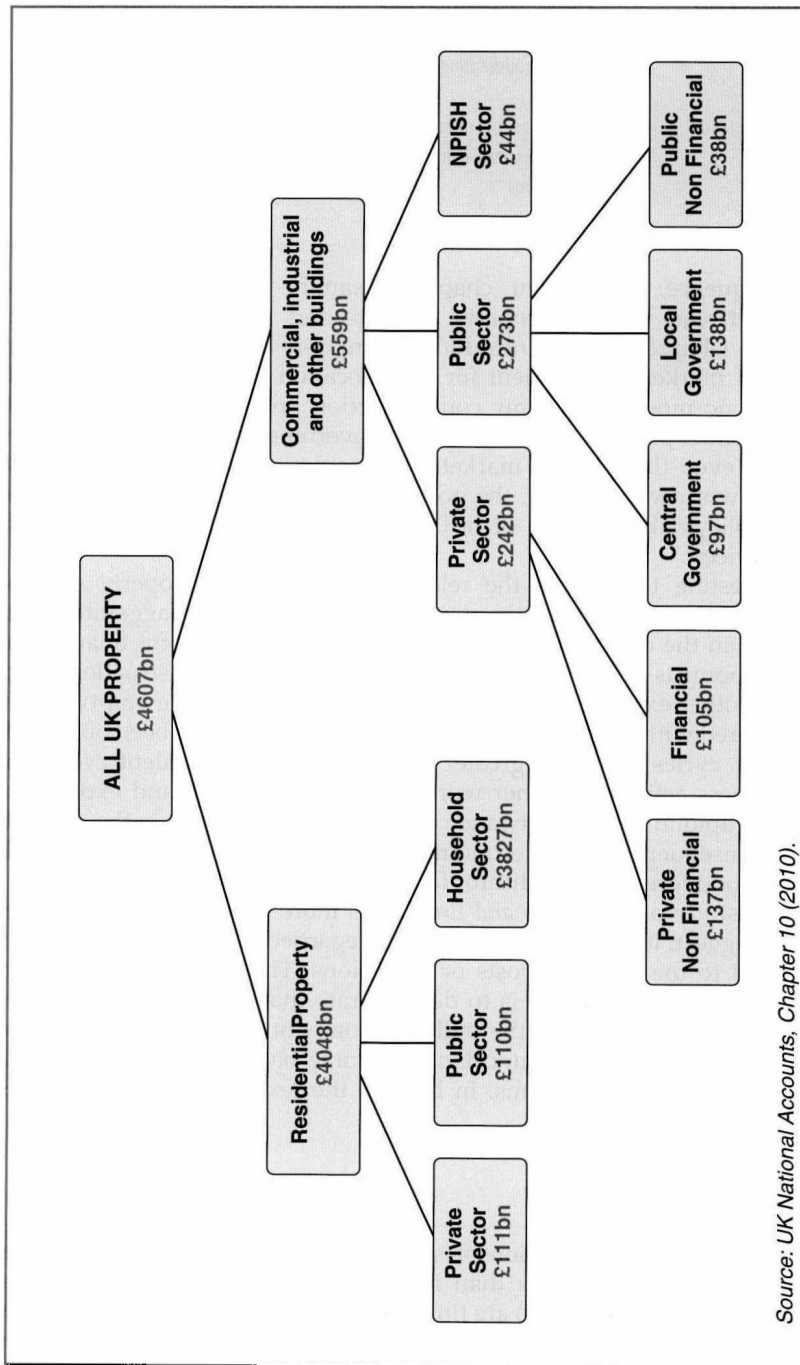


Fig 1.1 Value of property (2009)

Note: NPISH – Non Profit Institutions Serving Households, such as charities, universities, churches or trade unions.

Table 1.1 The stages of a building's life cycle

Five stages	Examples of activities
Acquisition and Appraisal	Negotiate price of land; pay fees to solicitors, etc.; organise funding for land
Design and Construction	Estimate building costs; liaise with architects, quantity surveyors, engineers; funding building costs
Marketing	Organise advertising; liaise with letting agents; sale/rent of completed building
Repair and Maintenance	Monitor energy usage; facilities management; refurbishment at a later date
Redevelopment	May necessitate demolition; negotiate planning permission; satisfy building regulations

As a consequence, subsequent chapters examine the interrelationships that exist between various property markets and the broader economy. For example, Chapters 2 to 5 introduce an analysis of markets as, without some kind of market arrangement for the allocation of land, property, and construction, no modern economy could function properly. Chapters 6 to 9 look at the broader picture and the role of the government in managing a stable economy; as even though free markets, democracy and personal freedoms have gained worldwide appeal, the government still has a role to play as a regulator, policymaker, lender of last resort, and significant consumer of property services.

It is interesting to observe the relationships between property sectors and the rest of the economy as the property cycle seems to exaggerate what is happening in the economy generally. For instance, a powerful image of a booming economy is a town centre bustling with cranes and construction sites; while, at the other extreme, a strong symbol of a slump is large empty office blocks, plastered with 'to let' signs. Indeed, over the years it has been observed that property cycles show far greater amplitude than equivalent cycles in general business activity. In other words, periods of decline and expansion are far more rapid in the property and construction sectors than in the general economy. Consequently, many economists regard trends in property related sectors as a good forecasting indicator for the economy.

Clearly, a study of *Economics and Property* is more encompassing than the title might suggest; it certainly should not be regarded as a narrow discipline solely related to the study of costs or valuations. The subject matter is far wider, and one aim of the text is to demonstrate that economics affects the work of all professions within the built environment. The following section introduces the meaning and importance of some basic economic concepts. Further clarification of key terms, in bold in the text, can be found in the glossary at the back of the book.

Scarcity

Economics is about the allocation of scarce resources that have alternative uses. This is far more complex than it first appears. Many of the world's resources (factors of production) are finite, yet people have infinite wants. We are, therefore, faced with a two-pronged problem: at any point in time there is a fixed stock of resources, set against many wants. This problem is formally referred to as **scarcity**. In an attempt to reconcile this problem, economists emphasise that people must make careful choices – choices about what is made, how it is made, and for whom it is made; or in terms of property, choices about what investments are made, how they may be constructed, and whether they

should be developed for rent or purchase. In fact, at its very simplest level, **economics** is 'the science of choice'.

Intriguingly, the challenges facing the surveying profession have been presented in a similar way. As the **Royal Institution of Chartered Surveyors (RICS)** point out in their publicity blurb: the world is already over populated (growing at a rate of about 240,000 people a day) and everyone needs to be fed and housed; yet the earth's resources are not infinite! According to the RICS, part of the solution to scarcity lies in the sustainable use of land and maximising the long-term value of all kinds of property. So they highlight that the choices we make affect not only how we live today, but how others will live in the future.

Resources (or Factors of Production)

Resources can be defined as the inputs used in the production of those things that we desire. Economists tend to refer to these resources as **factors of production** to emphasise that to produce any goods or services, various factors need to be combined. Therefore, the total quantity or stock of resources that an economy has determines what can be produced. To construct any property, for example, labour is required to develop a plot of land, and plant and equipment – which may be hired or purchased – is required to facilitate the process. Put in another way, land and labour are always combined with manufactured resources to produce the things demanded. These factors of production may be classified into three groups: natural, human, and manufactured resources.

Natural Resources

Land is the natural resource we think of most often as any property is dependent on the existence of a plot of land; and it is required in the production of all goods and services. To date, however, there has been a limited analysis of the supply of land, as in a purely theoretical sense it is ultimately fixed in supply and completely immobile (rural land cannot get up and move to seek better opportunities in urban areas). Land exists regardless of financial reward; its earnings are determined entirely by demand!

In the jargon of economics, the quantity of present and future available supply is completely inelastic with respect to price (this will be explained in Chapter 4). This has several economic implications; to take one current example, China is undergoing a period of unprecedented growth and the demands for property in cities such as Beijing and Shanghai are changing rapidly. In short, economic change has created new patterns of demand for land use and property in China – but the actual amount of Chinese land has not changed.

In the long run, which may be defined as the period of time firms need to adjust to price changes, it is the level of rent that signals changes to land use. In effect, rent (or price) allocates the use of land between buildings and other uses. It identifies what becomes used for transport infrastructure, for agriculture, for commercial and residential use and so on. As with every resource bought and sold in competitive markets, the highest reward determines its current use. In other words, the value of land is derived from its end use; the higher the value, the higher the rent. For example, some land is extremely fertile and commands its best value when used for agriculture, while other land is incapable of growing anything in its natural state and reaps far more value when it property is developed for sale or rent.



Human Resources

In order to produce anything, a human resource must be used. That human resource consists of the productive contributions of **labour** made by individuals who work, such as architects, estate agents, project managers, surveyors and construction workers. Whenever labour acquires training, the potential contribution to productive output increases; in other words, there is an improvement in **human capital**. Finally, there is another type of human resource; namely, entrepreneurial ability.

The **entrepreneur** is associated with the founding of new businesses, or the introduction of new products and techniques. But it means more than that. It also encompasses taking risks (possibly losing large sums of wealth on new ventures), inventing new methods of making existing goods, and generally experimenting with any type of new thinking that could lead to a monetary benefit. Without entrepreneurship, businesses would find it difficult to survive and property would not be developed. Entrepreneurship as a human resource is scarce: not everyone is willing to take risks or has the ability to make successful business decisions.

Interestingly, over the past 50 years there has been a significant number of government reports commissioned to encourage the construction industry towards a greater utilisation of its labour resource. A relevant example is the effect that good trained management can have on the efficiency of a construction project. Yet management expertise, throughout the world, seems to be one of the scarcest resources of the construction industry. The constraints imposed by inefficiencies in this sector will inadvertently affect the property developer, as cost overruns and time delays will impact on their budget and time horizon. (Property development as an example of entrepreneurial skill is explored further in Chapter 5.)

Manufactured Resources

When any form of labour or entrepreneurial skill is applied to land for agricultural or development purposes, something else is used. It may be a plough, tractor or cement mixer. In other words, land and labour are always combined with manufactured resources to produce the things that are in demand. Manufactured resources are often referred to as **capital**, and include things such as machines, buildings and tools.

A framework for classifying resources is shown in Table 1.2.

Table 1.2 Resource classification

Natural resources	Human resources	Manufactured resources
Land	Labour + entrepreneur	Capital

Economic Goods

Scarce resources produce what are called **economic goods**; and we face constant decisions about how best to use them. In direct contrast are **free goods** that do not depend upon scarce resources, as they are available from nature at a zero or free price. In short, if resources are not scarce there is no economic problem! In previous editions of this text there was a brief description of free goods and a short list of historic examples including: air for industrial uses, drinking water and even land for mining. However, as population and production has increased, the few 'free' goods that existed have become 'economic' goods; and

nowadays all the previously stated, old examples come to market with a price attached; as resources become increasingly scarce. This comparison between 'economic' and 'free' goods helps to clarify the subject matter of economics and identify the essence of most formal definitions.

Definition

Economics is the study of how individuals and societies choose between the alternative uses of limited resources to satisfy unlimited wants.

Opportunity Cost

Analytically, it is necessary to consider carefully the definition(s) of economics as, by implication, every individual has competing wants but cannot satisfy all of them given limited resources. Therefore, choices must be made, and choosing just one thing inevitably means that another possible opportunity has been missed, lost or foregone. To highlight this dilemma, economists refer to the concept of **opportunity cost**.

In other words, economics emphasises how every want that ends up being satisfied results in some other want, or wants, remaining unsatisfied. Adam Smith, who wrote the first treatise of economics *The Wealth of Nations* (published in 1776) discussed opportunity cost in the context of whether a country should produce guns or butter. Today the choice is between more esoteric items and the alternatives have increased tenfold; for each decision made there is a trade-off between one use of a resource and several alternative uses.

Definition

Opportunity cost is the value of the alternative that is foregone when a particular activity is chosen.

Investment

In mainstream economic texts the property sector is not usually referred to. It does, however, represent a major form of investment; directly as residential or commercial property (as defined on page XXX) and indirectly via institutional funds and instruments.

From a purely economic perspective, **investment** refers to additions to productive capacity; activity that makes use of resources today in such a way that they allow for greater production in the future. For example, when a business puts funds into new equipment or develops a new factory, it is making an investment to increase its capacity in the future.

Two meanings of investment are usually distinguished: net and replacement. Replacement investment corresponds to depreciation and is determined by the rate at which capital wears out and net investment represents new additions to capital stock. The former is relatively constant as it is determined by time, but the latter is related to changes in economic activity.

In terms of property investment, these two categories can be associated with: the repair and maintenance of existing property assets, and new additions to property being let or sold for the first time. This distinction is useful as it serves to explain why the property sector is prone to fluctuate more than other sectors. Investment expenditure on maintenance and repairs will be fairly constant, whereas new additions will be one-offs to support expected changes to overall activity. For example, if a retail or manufacturing group manages £100 million pounds worth of property assets, they may spend a percentage of that (say 5%) each year on maintenance (£5,000,000). If economic activity in their sector rises, however, they will need to both maintain their existing property and increase their capacity for sales or manufacture by adding to the stock of property assets.

This example might be easier to understand from the converse position where economic activity decreases and, as a result, the firm releases or sells some of its property stock; in effect, it can meet the present level of demand with zero property investment. As a consequence, property investment tends to alter with greater amplitude than other sectors.

From a property perspective, however, it might be useful to broaden these traditional economic interpretations of investment to include the ownership of any asset that might enhance the flow of income in the future. This is because the relative returns made on other investments such as government bonds, company shares, or general business activities, might be more profitable. Investment in property must always be seen as an opportunity cost. In short, it is not possible to understand property in isolation; it is essential to recognise that it competes as an investment with other assets. Some of the interactions between property markets and the broader economy are discussed further in Chapter 7.



Chapter Summary 1.1

- The basis of economics emerges from the concepts of scarcity and opportunity costs. In very general terms, it is the study of how choices are made, and the subject matter relates to many stages of a building's life cycle.
- Scarce resources – such as land, labour, capital, and entrepreneurship – are required to produce any economic good or service.
- Scarcity is a two-sided concept; with competing wants on one side set against limited resources on the other.
- Economic goods are those demanded, but not directly obtainable from nature to the extent desired.
- The use of every resource involves an opportunity cost because an alternative use is sacrificed.
- Investment includes expenditure on repair and maintenance and new additions to stock. These are made primarily to generate income streams in the future.

Methodology

An important aim of this introductory chapter is to explain what economics of the built environment is about, so apart from identifying the basic concepts, the methods employed by economists also need to be reviewed; as the methodology of an academic discipline says a lot about the nature of the subject. In general terms, economics is a social science and it attempts to adopt the same kind of value-free approach as other sciences. In common with biology, physics and chemistry, therefore, economics uses **models** or theories; and empirical evidence is sought to validate the analysis.

Models can take on various forms such as verbal statements, numerical tables, and graphs and, at levels beyond this text, mathematical equations.

The type of assumptions made in economic models include generalised characteristics such as: all individuals behave in a rational manner; that information is freely available; that supply responds to demand; that prices adjust quickly; that investors seek to maximise profits, and so on. The model subsequently forms a reference point for asking 'what if' questions about the real world. The fact that the simplifying assumptions may not apply still throws light on to the central issues of the subject. For example, students may be expected to commence their course by completing an assignment based on

Definition

Economic models are simplified representations of the real world, based on generalised assumptions, to understand, explain and predict economic phenomena.

a theoretical economic model of competition in a specific marketplace. This provides a simple introduction to the economic framework and the opportunity to demonstrate how property markets deviate or reflect this reference point. In short, the model provides a starting point – it enables us to proceed.

Microeconomics and Macroeconomics

Textbooks of Economics are typically divided into two types of analysis: **microeconomics** and **macroeconomics**.

One way to understand the distinction between these two approaches is to consider some generalised examples. Microeconomics is concerned with determining how prices, values and rents emerge and change, and how firms respond. It involves the examination of the effects of new taxes and government incentives, the characteristics of demand, determination of a firm's profit, and so on. In other words, it tries to understand the economic motives of individuals – such as landowners, developers, builders, occupiers and investors. This diverse set of interests that represent the property market is fragmented and at times adversarial; but microeconomic analysis works on the basis that we can generalise about the behaviour of these parties. This type of analysis is introduced in Chapter 2 and we look at the theory of demand and the theory of supply in Chapters 3 and 4, respectively. The nature of specific markets for development, construction and occupation are then considered in greater detail in Chapter 5.

In contrast, macroeconomics is concerned with the outcome of *all* decisions made in the economy as a whole; taking account of the purchases made by all consumers, total capital investments made by businesses, the goods and services procured by central and local government and the balance of trade between imports and exports. In short, macroeconomics deals with aggregates or totals; analysing the overall level of prices, output and employment. Although at present there is a distinct lack of cohesive thinking about the overall role of property and how it could better serve the economic fabric of society, a broad understanding of the economy is central to anyone wishing to participate in the property world. Macroeconomics forms the basis of Chapters 7 and 8.

Making a distinction between micro and macroeconomics is arbitrary, and trying to identify the point in the analysis where the actions of a number of firms cease to be microeconomics and transfer over to macroeconomics is a futile exercise. For example, the total number of bankruptcies is important in describing the macroeconomic scene, but it does not provide a complete picture of every company in the economy. Even during the worst recession some firms will be performing well and increasing turnover; even though the aggregate bankruptcy data may suggest that most firms are doing badly. For example, during the run-up to Christmas 2009, high street retailers were said to suffer some historically poor results, yet Carphone Warehouse and Mothercare both bucked the trend and increased sales during the same period.

This is not stated to undermine the importance of either approach; the aim is quite the contrary. It demonstrates that an understanding of property sectors requires both micro and macroeconomic approaches, as effective property management necessitates an assessment of the current and future macroeconomic conditions and an insight into the related markets. For example, if interest rates rise sharply, consumer spending tends to decline and the demand for residential, retail and manufacturing property reduces and, in some instances, may even become surplus to requirements. Foreseeing these general cyclical turns is part of becoming a successful property entrepreneur; being able to recognise the exceptions to the rule is even more promising!

Definition

Microeconomics is the study of how individuals and firms allocate scarce resources.

Definition

Macroeconomics is the study of economy-wide phenomena resulting from all decision-making in an economy.

The Built Environment

The built environment is made up of various types of property (residential, commercial, industrial, etc.); linked by infrastructure (sewers, canals, roads, tunnels, etc.) and separated by spaces in between (parks, woods, playing fields, landscaped areas, squares, etc.). The professions shaping and creating this environment tend to be fragmented by function and culture. For example, there are approximately 100,000 registered surveyors in the UK and their professions are broken down into an array of specialist areas, such as building surveying, construction, facilities management, planning and development, project management, quantity surveying, valuation, and even, waste management. A recurring role with respect to economics is the surveyor's contribution to transactions; the buying and selling of property for occupation or investment; the giving of financial advice regarding the state of the market and/or the economy, and so on. In fact, much of their work can be broken down into technical or economic aspects; surveyors specialising in the latter are often referred to as 'agents'. Another form of categorisation may crudely divide the participants into different stages of the process and it is common to distinguish between those involved in development and those involved in the related stages of investment, construction and management.

Official economic statistics generally distinguish between construction and property activity: construction sector data tends to relate to the value-added activity of firms that construct buildings and infrastructure. Property sector data, on the other hand, specifically relates to the development, management, letting, buying and selling of commercial or residential property. The standard industrial classification (SIC) system, which historically forms the basis of most definitions, restricts the construction industry to include firms that are involved with building and civil engineering. This embraces a range of 'on-site' activities including those relating to infrastructure, new construction, repair, maintenance and (eventually) demolition. By comparison, a property industry is never clearly defined although 'real estate' is specified. This classifies a range of 'office based' business activities, dealing broadly with the development, management and marketing of commercial or residential property; rather oddly, this SIC classification also includes architecture and engineering! Furthermore, academics researching and writing within these specialist areas also tend to concentrate on either construction or property; the paradigms of each are kept separate. The implications of these fragmented and diverse sectors are discussed further in Chapters 5 and 9.

The Construction Sector

Table 1.3 indicates the type of work classified as construction activity and shows the associated monetary values in 2006 and 2008 for Great Britain. Repair and maintenance are clearly of major importance as they comprise nearly 50% of the total annual activity – this includes work carried out on houses, infrastructure and commercial buildings. On closer scrutiny, it is also evident that government departments and their agencies are significant clients of the construction industry. As Table 1.3 shows, official statistics draw a distinction between public and private sector activity. The public sector includes everything that is owned or funded by national or local governments such as: infrastructure, the National Health Service, schools, sports and leisure facilities, the police and fire services. The public sector accounts for at least 30% of construction industry turnover. Obviously this includes a range of contracts: varying in size from £10,000 for the maintenance of a small flood defence scheme to £500m to construct a new British Library. Private sector

Table 1.3 Value of construction output in Great Britain

Type of work	£ million 2006	£ million 2008
Infrastructure	6,532	7,735
Housing-Public	3,442	3,967
private	19,572	16,268
Public non-residential	9,939	12,287
Private industrial	4,888	4,124
Private commercial	20,138	23,448
Repair and maintenance	49,058	55,755
Total (of all work)	113,569	123,584

activity includes the construction of shops, garages, offices, houses and privately funded schools and hospitals.

The percentage of public sector work in the UK has fallen considerably since 1980, as many of the activities traditionally in the public domain have been privatised; see Chapter 2, especially Table 2.2. For example, in the UK, privately owned utilities and services such as gas, electricity, water supply, telecommunications and railways were previously state owned activities. More recently, the private sector has been given a greater role in the funding, building, maintenance and management of public facilities such as hospitals, schools, prisons and roads. In these **public private partnerships**, the private sector organises the funds and manages the risks, while the public sector specifies the level of service required and ultimately owns the assets – as they are commonly returned to public ownership after 10, 15 or 25 years. The important point for our purposes is that expenditure on the construction of public facilities – such as new schools and hospitals – is increasingly classified as private sector expenditure in the official data.

The Property Sector

Property can be classified into two broad sectors: commercial and residential. As a general rule of thumb, the commercial market is of interest to institutional investors seeking profit, and the residential market is the concern of individual investors seeking utility.

The Commercial Sector

Commercial property can be divided into four categories. The most obvious are office buildings and business parks. Less obvious are the industrial estates and traditional warehouses that formed an important part of the industrial age. Leisure outlets, such as hotels, pubs and cinemas, represent an increasing proportion of commercial property. And finally, but by no means least important, are retail properties, such as shopping centres, shops, supermarkets and department stores. These high street outlets represent the most significant proportion of the commercial sector.

The majority of commercial property development in the UK occurs for investment purposes insofar as more than 50% of these properties are built with no specific tenant in mind. In fact, much of the UK commercial property market is characterised by a separation of occupation and ownership. Commercial property is leased to occupiers (tenants) by investors (landlords). The freehold is owned by the investor who, in return for the capital outlay (purchase price), receives an income in the form of rent from the occupier. So, whereas the occupier is concerned with the property and its contribution to the

business, the investor is concerned with the rate of return on the investment. Often requirements of the investor and occupier conflict so the developer acts as an arbiter, hopefully producing a property attractive to both parties. It is important to note that this situation will continue as long as occupiers in the commercial market prefer to rent rather than own property.

One of the key attributes of a commercial property developer is the ability to see things from both the occupier's and investor's point of view. These relationships are explored further in Chapter 5. (For a detailed analysis of the commercial market that takes into account the history of relationships between occupiers, developers and investors, the student might wish to read *Property and the Office Economy* by Rob Harris. See references to further reading for full details.)

The Residential Sector

Residential property can also be divided into four sub-categories. The majority of homes in the UK are of interest to the individual investor – more commonly referred to as the owner-occupier. A far less significant number (around 10% of the housing stock) represent investment property purchased to rent out to tenants. At present, more than 70% of this rented stock is run by small private landlords managing one or two properties. In the foreseeable future, the rental residential sector may expand as institutional funds via **Real Estate Investment Trusts (REITS)** are developed. (UK investment funds, however, traditionally favour commercial property.) Finally, there are two types of residential investment supported by the public sector: property rented from a local authority and property rented from **registered social landlords**. Together, this latter group provides social housing to about 20% of UK households. (More details on the residential sector are stated in Table 2.1, Chapter 3 and tutorial reading number 2.) For those that want a fuller account of the distribution of resources to housing in the UK they can refer to *Housing, Markets and Policy*, edited by Malpass and Rowlands. Their text draws on authoritative contributions from the main academics in UK housing studies over the last 40 years, and their combined analysis suggests that the housing system and policy that we have today can be traced back to the 1970s. For full bibliographical details, see references to further reading at the close of the text.

Property Sector Review

Table 1.4 summarises the way that commercial and residential sectors are typically divided, and the bottom line indicates the importance of each sector in terms of the number of transactions (the actual proportion allocated to each sector has been estimated by the author). Clearly, the number of transactions in the residential sector far exceeds the number for commercial property. In fact, the annual ratio is approximately 10:1; so in a typical year when one and a half million residential properties might exchange hands, there would be approximately 150,000 transactions in the commercial property market (but the actual numbers vary according to the state of the economy and, as a consequence, in 2009 there were relatively fewer transactions in all markets). In Table 1.4 the residential transactions represent a specific address bought or sold for any one of the forms of tenure, and the number is based on the **particulars delivered** to the land registry. A commercial transaction, however, may represent several properties as it could be a collection of buildings, such as a business park or shopping centre; the way the transactions are recorded are consequently somewhat *ad hoc*; the information presented here is based on returns relating to stamp duty land tax.

A further distinction between these two property sectors relates to the development process. Residential property is usually speculatively developed, in the sense that it is built ('on spec') without a specific purchaser (or tenant)