

Risk and Time in a Land Lease Economy

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SUMMARY

In many transitional economies, public officials have been experimenting with public leasehold systems to minimize economic and political conflicts that arise from land reform. One hope is that leasing public land may lessen tension between communists' (or socialist) desire to uphold public land ownership and reformists' demand for increasing private property rights. This paper is the author's summary of "Leasing Public Land, Policy Debates and International Experiences" , Lincoln Institute of Land Policy 2003, which discusses and compares land leasing experiences from around the world.

The paper begins with a set of charts showing the major features of public land leasing for a select group of countries around the world. Then the author will present some lessons learned from these international experiences, as well as common themes found across the varied land leasing systems of the world. This paper will conclude with a narrative discussion of these systems and their history of public land leasing, and will include some of the perceived strengths and weaknesses of the systems and how they changed over time.

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INTRODUCTION

Land reform in many former socialist countries and transitional economies often seems to have no clear direction. Despite promises from reformists that the restitution of private property rights in land will bring forth the efficiency of a private land market, mechanisms for allocating land still rely predominantly on officially determined criteria and prices. The absence of market mechanisms plagues the restoration of private land ownership with corruption, bitter conflict, and inefficiency. These unfortunate short-term effects (which could last for years or even decades) could escalate into a reversal trend from private markets before the social and economic benefits of a private land market are enjoyed.

The Lincoln Land Institute of Land Policy organized a two-day conference on international experiences in leasing public land as a land disposal method and tenure arrangement for transforming economies. In June of 2000, seventeen scholars from nine different countries gathered and presented research papers and critical comments on this subject. The information and papers were compiled in “Leasing Public Land, Policy Debates and International Experiences” , Lincoln Institute of Land Policy 2003. This work is the primary source of information for this paper and I have attempted to distill this 303-page book to the following paper to provide an abbreviated version of the text. As such, this is an unofficial summary of a larger work published by the Lincoln Institute of Land Policy. Some additional thoughts and comments were added by Steven L. Nystrom, MAI, as appropriate, and we highly recommend this book as an important compilation of information on a subject that has not received as much scholarly attention as it deserves.

Lessons Learned - Risk and Time in a Land Lease Economy

Six established leasehold systems were analyzed. These include Canberra, the Netherlands, Sweden, Finland, Israel and Hong Kong. China, Poland and Ukraine have newer leasehold systems and the lack of long-term data makes it difficult to assess them. Nevertheless, they show a good example of how a country in transition can use public leasehold, and suggest many of the early strengths and weaknesses of such a system. Several prominent leasehold systems were not analyzed herein. These include Russia, Singapore, and Vietnam as notable exceptions to our analysis.

Among all of the systems, Hong Kong was the most financially successful, with proceeds more than enough to cover the cost of public works and land development. The revenue generated helped finance public infrastructure, and many social services. One of the reasons for the relative financial success of Hong Kong is the reliance on public auctions, which is keeping the system more efficient and allowing near or full market value to be paid for the land use rights. The Public leasehold systems in the Netherlands, Sweden, and Finland also

helped generate public funds, but lease revenue played a much smaller role in those countries. The Canberra leasehold system has not generated relatively significant public funds.

The fiscal objectives of land leasing are always set within the broader public considerations of public objectives. An example of this would be maintaining low land costs for the construction of public facilities and housing.

It appears that if the government wants to maximize lease revenue, as well as other major objectives (such as strong land planning, or the construction of a affordable housing on subsidized land), the governing body may find the process to be quite difficult. It may not be possible to achieve two widely-differing objectives within the leasehold system. This can be seen in the experience in Hong Kong (under the new government) when the more affordable home ownership goal contributed to sharp declines in value, and a public outcry from the propertied class. This eventually led to the government abandoning the initiative. A somewhat similar occurrence was also faced by The Hague in the 1980's.

The *following items contribute to the difficulty in raising adequate public funds via a leasehold system*. Minimizing these problems makes leasehold more financially efficient, relative to a freehold system:

- The lack of frequent changes to land rent as land values increase
- A premium system that gives the perception of freehold ownership (increasing resistance when a new premium needs to be paid)
- The public resistance to the leasehold system (especially in times of rising land values)
- The difficulties and legal costs associated with valuing the land and leasehold interests
- The reliance on assessed value (instead of market value) as the basis for land lease payments
- The common use of private negotiation in the sale of land leases (instead of a more market-based or auction process)
- The cost of managing the system, in so much as it *may* be more costly than a freehold system
- The inefficiency arising from sub-optimal use of land in a leasehold system

Based on these experiences, an inherent tradeoff appears to exist among public policy goals that policy-makers feel are achievable via a public land lease system. Because policy goals may at times be mutually exclusive (or at odds with each other to a lesser degree), none of the governments studied were able to achieve all of their policy targets. It would be unduly optimistic for policy makers and analysts to believe that governments can avoid difficult policy dilemmas by adopting public leasehold systems. To assume such will surely lead to disappointment.

One of the most achievable goals appears to be reserving land for the construction of public housing. Several of the countries studied were able to successfully use subsidies and discounts to encourage public housing. They were able to avoid having to purchase the land

from private owners at what could well have been much higher prices. There was somewhat less success in influencing the timing of the development of public housing, for several reasons.

Urban development requires both public and private investment in land. State involvement is needed to facilitate certain economic and social development (infrastructure, public housing, etc.). In other areas private investors can do a much more economically efficient job of utilizing scarce land resources and the role of government should be minimized. Public leasehold systems should have the paramount aim of bridging the gap between the needs of public control over land and private interest in property investment.

The leasehold systems examined herein do not appear to have very strong roles in controlling land use such as a planning body would. Most of the countries examined have other working systems that accomplish this goal. Enforcement of land use provisions also appears to be somewhat lax. Public leasehold systems have shown some success in assisting governments to influence initial land development. However, there is no evidence that they are equally effective in facilitating urban re-development (Canberra and Hong Kong have had notable difficulties).

One lesson learned from the land reform in Eastern Europe and the PRC is that governments cannot restructure land tenure overnight. The process takes a great deal of time. This is largely due to the changeover of institutions and organizations from their previous socialist arrangements to more market-based systems. This has encountered both political resistance and technical problems.

When everything is in flux and the future is highly uncertain, governments may need a transitional mechanism for reallocating land from state to private entities for development. It may be helpful for the mechanism to be flexible enough to allow these governments to experiment with different property rights arrangements without committing to one system prematurely. This can avoid a government selling public land at excessively low prices due to the nascent stage of the emerging real estate market. This transitional mechanism can also provide infrastructure funds during these early stages of the development of a well functioning market.

Because of the many varied ways that formal and informal rules, cultures, and past institutions are intertwined, there is no universal model that supporting institutions should optimally follow. The basic concept and form of land leasing has undergone numerous transformations over its history in the countries examined. Many of these alterations were due to changing institutional environments. Very often the changes will be driven by the demands of the public, which may conflict with the desires of the governing body.

In each of the established public leasehold systems, constitutional or special legislation provided the necessary legal framework for governments to lease public land and for lessees to transfer their leasehold rights to other parties. Without this well-defined legal framework it would be very difficult to convince the public or lending institutions that public leasehold

was a viable form of tenure. Thus, without this legal framework, the governing body would be unable to reach its public policy goals.

Freehold and public leasehold systems are not mutually exclusive. A governing body may find that using both systems in individual situations affords them much greater flexibility to serve their constituents as well as foreign investors. This flexibility can be especially useful for transitional economies in which domestic and foreign investors may be very reluctant to commit long-term capital until they see political and economic reform (which can lower risk) progress to more mature stages. A flexible system that can adjust overtime has a greater chance of winning the support and confidence of both the public and private investors. The Israeli and Finnish systems are good examples of this.

Special interest groups should not be allowed to dominate the process of re-negotiating the land leasing rules. If this happens, the system can lose credibility in the eyes of the public and short-term goals could overshadow the long-term benefits of the system. Corruption could begin to flourish when officials have the power to bend the rules to accommodate special circumstances. A system of checks and balances should be put in place to assure a balance of flexibility and consistency in evolving and implementing the public land lease policy. The systems in Beijing and Ukraine may suffer from some of these problems, now in the early stages of public land leasing.

The success or failure of public land leasing is also heavily affected by informal rules such as local ideology, conventions, and social norms. An ideological conviction can become an obstacle to change when the holders of the belief are nearly blind to other alternatives. A system that works in a specific place may very well not work when adopted in another situation. As such, any belief in a single universal model of land tenure will only increase the chance of making incorrect policy decisions. Governments in Eastern Europe have found that transition will very likely take longer than originally anticipated because the needed institutional changes require more than just a new set of formal rules and enforcement procedures. Transition also requires an understanding of how ideology shapes people's preferences, what affect this will have on the economics of the region and an examination of what tools are available to modify informal institutions over time as the land tenure system evolves. These ideological changes occur slowly.

Under a framework set by both the formal and informal rules, the parties involved in land leasing will negotiate a set of lease conditions for guiding land investment and the distribution of land benefits. Lease conditions will require continued maintenance and rigorous enforcement carried out by supporting institutions such as:

- A land registry to record and secure public land rights
- A working and effective cadastre
- A working lending system to finance purchases of leasehold property
- A well designed judicial system
- A professional valuation group to accurately appraise leasehold and freehold properties

The effectiveness of these organizations will determine the extent to which a government can accomplish its policy objectives by leasing public land (as well as other land tenure choices). For instance, no public leasehold system could have persisted without a judicial system or professional appraisers to ease land-leasing conflicts. Competent administrations, staffed by highly trained real estate professionals in key positions will greatly increase the chance that public policy objectives will be achieved. Finland is a good example of this.

It is possible that a private or quasi-private agency could more effectively administer the public leasehold system. Problems have arisen in Canberra, Beijing, and Hong Kong when the organizational design of the public leasehold system was directly administered by the state. A somewhat independent agency would have an arm's length relationship with government (which helps avoid internal favoritism and conflicts of interest), but would still be subject to government regulation. However, there are several issues involved in creating a private or quasi-private agency in transitional countries:

- How can policy makers create incentives for local governments to relinquish control over land?
- What are the constitutional or legislative requirements for facilitating the transfer of public land to a private or quasi-private agency?
- What is the proper governing structure for the agency?
- What is the oversight procedure for the agency?
- How should the officers in charge of the agency be elected or appointed?
- If an election is considered appropriate, how can that be accomplished in countries that are not democratic?

In a system like this, publicly used land can record lease revenues foregone for public allocation. This will help ensure the accountability of reporting the real costs of subsidizing public development. It will tend to eliminate the confusion between leasehold charges and taxes, which has weakened public land leasing in other countries. Separating land leasing from the direct machinery of government may help prevent public officials from forfeiting the communities' land assets to achieve short-term political or personal gain. It may align land managers incentives of maintaining their jobs with the financial well being of the community, thereby minimizing corruption and political pressure from special interests.

The history of the established public leasehold systems suggests that policy makers should not be overly optimistic about the usefulness of public leasehold. The implementation of public leasehold systems has not been trouble free, and will very likely not meet all policy objectives. However, neither will any other land tenure system (in all likelihood). Perhaps the flexibility of the public leasehold systems may allow it to endure in industrialized countries. Perhaps it will be an adequate bridge of land tenure to a more freehold like system as the supporting organizations and public needs evolve in these industrialized countries. Perhaps public leasehold is a viable long term, or bridge land tenure system for transitioning economies as well. Each country and culture is very different and one tenure solution or tenure evolution will surely not work in every case.

History and Experiences of Public Leasehold Systems Worldwide

Leasing Public Land – Canberra, Australia

The decision to build a new national capital was a central focus for the development of Canberra, Australia. In 1921 the population of Canberra was a $\pm 2,000$ person construction camp focusing on the administration and planning for the building of the future capital city. In 1996 the population had increased to $\pm 297,000$, and the planned city was truly a reality.

Canberra has a reputation as one of the most successful planned cities in the Western world. This is partly due to the willingness of the Commonwealth government to invest heavily in its development. However, it is also because public ownership of land allowed for strong governmental control during development. The government was able to anticipate demand and release an adequate supply of land as appropriate.

Much of the success of Canberra, especially as regards its planning, has been accomplished via public leasehold and by public ownership of land prior to urban development. Despite this, many aspects of the system failed to achieve the goals of good public planning and finance over time.

In the 1970's and 1980's, the economic environment began to change and growth rates declined. There was a decision to *abolish land rents* in 1971. This was due to land rents becoming unpopular, and they appeared to be inequitable in a period of rapid inflation. Land rents could be vastly different on similar properties because of the timing of the *20-year revaluation cycle*. This long period led to the unpopularity of the land lease system and apparent inequities in land rent levels.

Before the abolition of land rent, a land use change (changes of purpose clauses in land leases) would trigger a revaluation of the land and often an increase in land rent. Under the purely premium system introduced in 1971, some other method was required. Changes of Use Charges (CUC) were set at 50% of the betterment of the increase in land value that resulted from the land use change. As such, the government was not capturing full land value increases for these use changes. The CUC charges have varied from 50% to 100% over the following years and the definition of betterment also changed, but flaws in the process continue to hamper the government's ability to capture full land value increases. As of 2002 the CUC was set at 75% of the betterment. The government failed to be active in initiating redevelopment and changes of land use, even when that could be profitable.

These problems were compounded by the difficulty of appraisers in estimating value under the hypothetical condition of "existing lease conditions" relative to the value "after the change in permitted use". Many of the assessments were reduced on appeal, further weakening the financial benefits of public land leasing.

The lease requirement for completion of all land development within a specified time limits the opportunities for speculative land holding by the private market. However, the requirement that development must occur within a limited time has not been enforced with

respect to rights of redevelopment. This allowed some speculative profits by the private market.

Relatively little public revenue has been obtained from publicly owned land in Canberra. Certainly *not* enough to pay for a large portion of the cost of building the national capital, as was hoped in 1890. Much of the generally poor performance of the ACT leasehold system was blamed on a poor administration. This was partially due to a lack of professional real estate qualifications and professional real estate related guidelines among public servants entrusted with these tasks.

Leasing Public Land – Netherlands

Around the beginning of the nineteenth century, the largest cities in the Netherlands started to buy land and dispose of it for building on long-term ground leases. The primary goal was greater control over the development and use of this land, as well as being a source of income for the “community”. In general, the practice of public land leasing is declining in the Netherlands.

In 1981, 12% of municipalities used “ground leases mostly”, compared to 6% in 1994. In 1994, 76% of municipalities used ground leases some times. Approximately 80% of Amsterdam’s real estate and 65% of The Hague’s real estate is owned by the municipality.

Most municipalities have no land reserves. As such, when they sell ground leases, they must first acquire the development land. This has been very widespread practice over the past few decades, and almost all building in Netherlands (except for very small plots) has occurred on land purchased from the municipality. Beginning in the 1990’s, land values increased to the point where speculative profits began to increase, causing more friction for the municipality when it attempted to purchase land for possible redevelopment.

Dutch municipalities want land developments within their boundaries to meet high quality standards, and a building permit may be refused if it is not in conformity with the land use plan. Land leasing is often done when the statutory powers are considered inadequate for the level of control the municipality wants to exercise over a specific development. In the case of The Hague, building land was acquired precisely so that the municipality could impose stricter quality standards on the growing housing supply as workers flooded into the city (many poor quality homes were being built based on the more limited national building standards).

Additional Planning Powers via Land Leasing

- Regulating the use of land over a longer period
- Requiring the lessee to maintain the buildings on the leased land
- Assembling land for redevelopment schemes

One of the prime reasons for municipal land leasing was explicitly intended to be “to benefit from expected rises in land value and to capture increases in land values for the community”.

This was principally done by revising ground rent at the expiration of the ground lease. Initially these leases were for 50 years and later for 75 years. Ground rent and premium payment was possible.

There was a great deal of opposition to public land leasing when very large ground rent increases were applied after being flat for 50 to 75 years. Additionally, it was difficult to value the land separately from the buildings on them (which were the property of the lessee). In the 1960's and 1970's, some municipalities allowed ground rents to be index linked (adjusting every five years). Opposition to land rent increases continued even in areas with indexed ground rents.

Additionally, potential increases in ground rents are triggered when a site is redeveloped by the lessee (increased intensity of use, or change to a higher value use). There is little opposition to this practice and it is apparently considered fair by the public. It has been argued that this practice deters privately initiated urban renewal since the lessee does not gain from increased land value.

Land leasing is practiced by many municipalities in the Netherlands and they state that the primary reason is for "the extra planning powers this affords them". However, there is little evidence to show that they use those powers systematically. Additionally, many of the municipalities have given up some of the financial advantages of land leasing under pressure from the public (land leasing is not popular).

Lessons Learned from Land Leasing in the Netherlands

- *How strong is the need for additional Planning Powers through public leasing?* If statutory powers are comprehensive, then there may be little need for land leasing to supplement them (and the reverse could also be true).
- *What are the financial consequences to the lessee?* Typically, a leasehold interest allows for lesser rights of use than a freehold title. This can affect the value of the real estate and lending arrangements that the lessee can qualify for.
- *What are the financial consequences for the public lessor?* A distinction should be made between value increases caused by changes in land use and value increases due to general increases in land value. It is often difficult to increase ground rent levels due to general land value increases. This is especially true when ground rents have been flat for a very long period. Public opposition to land leasing was directly related to this factor, which in turn made it difficult for the municipality to increase ground rents in line with current land values.
- *Both the short and long term effects must be considered.* Valuing the leasehold of developed land is quite difficult, and often the public will be against or at least critical of land leasing. This problem is most prominent when land leases start to expire and long-term flat ground rents are expected

to increase. If the public outcry is great, the ability of the land lease to capture land value increases can be lost in political compromise.

- *How can the municipality balance planning and financial objectives?* If the planning aspect is greatest then the municipality may not be able to focus as much on the financial gains. Doing so may risk a public outcry that could end the entire land leasing program (the reverse is also true).

Leasing Public Land – Sweden

Site leasehold was first introduced in 1907 and was originally confined to the Swedish capital of Stockholm. In the 1930's and 1940's the use of site leasehold spread to other municipalities. Unlike site leasehold in many other countries, in Sweden the primary objective was to capture increases in land value and only rarely for planning purposes.

The introduction of site leasehold had two essential motives. One was in response to a severe housing shortage. Municipalities could spur housing development with favorable site leasehold rents. Currently, ground rents for single-family homes are discounted by up to 33%. The second motive was fiscal, and was a means to capture increases in land values over time through increasing ground rents and reclaiming land at the end of the lease term. In 1999, ground rents accounted for 5% of total revenue for the city of Stockholm.

Private lending institutions doubted the creditworthiness of site leasehold interests and were unwilling to treat it as collateral. Over time private lending institutions began to provide credit to leasehold owners, but for many years only specialized lending institutions would accept site leasehold interests as a form of security.

Because a primary motive for leaseholds is the capturing of land value increases, the calculation of ground rent payments is essential. This can be quite difficult and specific methods have varied over the years. The initial ground rent remains unchanged for typically 10 years, after which it is adjusted upwards to reflect the change in land value. After the initial 10-year term, reassessments occurred every 5 or 6 years. Ground rents were increased at the inflation rate between reassessments. There was a great deal of litigation regarding the calculation of ground rent, and it was estimated using a wide variety of methods.

Currently, municipalities are less interested in retaining site leaseholds because they do not want their capital tied up in land holdings. Leaseholds were sold as freehold estates and very large discounts from assessed value have been offered (sales were between 30% and 75% of assessed value). Sales were still generally very slow with only a few percent of leaseholders buying the freehold rights on any given year.

In conclusion, site leaseholds created two problems for municipalities. First, city governments had their capital tied up in land with the ability to collect ground rent only. Second, the uncertainty surrounding changes in ground rent and land value was controversial and led to a great deal of litigation. This was rare in the case of single-family homes due to the high cost of litigation. Site leasehold did allow for the capture of land value increases, but

there has been little demand from the public to buyout the freehold interest and high discounts were required to prompt sales.

Leasing Public Land – Finland

Public land leasing is most common in medium and larger sized municipalities, and much less so in rural areas. These cities tend to have competent staff and land values tend to be higher. For example, the City of Helsinki owns 68% of all land within its boundaries. As such, public land leasing is done primarily in urban areas.

Because land ownership in Finland has a special sentimental value in the mind of the Finnish public, many people found public leasehold less appealing. However, there is also a common feeling that “land, as a special and unique resource, must first serve the community interests; the interests of private landowners are secondary”. As such, opinions and feelings regarding public leasehold are mixed.

Only a minority of municipalities have prepared and approved their own land policy programs. Some common goals are to facilitate land use planning, stabilize land prices, recapture increased land values, prevent land speculation, and promote industrial development.

Land rent is typically determined through negotiation between the lessor and lessee. Land rents are adjusted based on the criteria in the specific lease, but are normally tied to the living cost index (LCI). Defaults on land rent are quite rare. Land value is also adjusted every 30 years in long-term 100-year lease situations, to reflect real changes in land value. Commercial and industrial land rents are adjusted only annually and have shorter lease terms (50 and 20-30 years respectively).

Starting in the mid-1990’s, public agencies also had to pay an internal land rent for using public land, and this was instituted to help public agencies recognize the land cost of their operations, reduce the amount of idle land, encourage “optimized” land allocation, and to direct land costs to appropriate users. Additionally, non-profit and charitable organizations may pay zero ground rent, and this too is presented as a government expenditure to recognize an approximate of the land rent revenue lost due to these subsidies.

When a lease expires, the lessee may renew the contract. If the contract is not renewed then the lessor has to compensate the lessee for building improvements (usually 60% to 70% of the “technical value” of the building improvements). Compulsory purchase is extremely rare in Finland, but the lessor can cancel a land contract.

The main goal of public land leasing in Finland is not to maximize lease revenue. Rather, it is to promote municipal development and public housing. One major advantage of public land leasing for the private developer is that the initial capital investment is smaller. Also, since the assessed value is usually well below the market value (at most around 75%), leasing can also be a cost saving to the lessee. Offsetting this is the cost of the implied governmental

subsidy that this shortfall would create. In general, both the lessor and lessee seems fairly satisfied with the public leasehold system.

THE PROS AND CONS OF PUBLIC LEASEHOLD

For Municipalities (Lessors)

Pros

Municipalities may be able to capture a portion of the unearned land value increments by adjusting land rents regularly.

Public leasehold may restrain rises in land prices and thus keep housing affordable to the population.

Public leasehold may discourage land speculation.

Leasing may generate a stable stream of rental revenues for municipalities.

Leasing may allow the government to repossess land for redevelopment after leases expire.

Cons

Lessees may neglect the maintenance of leasehold improvements when the lease term is approaching its expiration.

Administering public leasehold requires government lessors to have a high level of integrity and land management expertise. Small municipalities usually do not have the political autonomy and experienced staff to manage public leasehold.

Income accumulation is slow if the prepayment of annual land rents is not used.

For Lessees

Pros

Developers may not need to raise huge initial investment capital to buy land for real estate development.

Leasing may reduce property tax liability.

Cons

Lessees may lose their properties when leases expire.

Contract may include irksome conditions.

Leasehold may not give lessees the same psychological satisfaction as freehold.

Credit worthiness of expiring leasehold rights may be less than freehold.

Land rent will change periodically and this increases uncertainty.

Lessees may not profit from increments in land value.

The following are some common factors that policymakers in other countries should consider, based on the experience of the Finnish leasehold history. These are as follows:

- Develop good leasehold legislation
- Design a competent and non-corrupt administration
- State clear policy goals supported by enforceable lease conditions
- Institute a complementary planning system

First, leasehold rights are very strong in Finland and there is no real fear of eviction. Second, under political pressure, a government lessor might favor lessees by converting leaseholds to

freehold interests at bargain prices. This has not happened in Finland. Third, because of the difficulty in valuing leaseholds in a timely fashion and collecting land rents, a leasehold system might not be suitable for smaller municipalities. Fourth, municipalities impose a development timeline on all leases, giving a limited amount of time for a developer to build on the leased land. This prevents land speculation and is rigorously enforced. Fifth, one objective of the leasehold system was to ensure housing affordability and lower starting capital requirements and some lower rent levels are discretionarily offered in some municipalities. Fifth, conflicts between lease provisions and land use controls are not a problem because statutory land use plans always have priority over contractual agreements.

Leasing Public Land – Israel

Israel is a democratic advanced economy country, where state or quasi-state agencies own the vast majority of the total land area, and government leaseholds predominate the land system. An estimated 93% of the country's total land area is owned by state and quasi-state agencies. Israel's large public leasehold system has resulted in special policies that have gradually moved toward a private market (termed *gradual privatization*). The result is a market in which there is little differentiation between leasehold and freehold values, based on a review of sales of similar properties.

Israel's small geographic size, demographically growing population, policies favoring mass immigration, accelerated economic growth, and geopolitical and security needs have very likely encouraged policymakers to harness urban, regional, and land policies to achieve national goals. Like many other countries, Israel has moved along the path of decentralization, deregulation, and privatization.

One of the main goals of Israel's land policy, public land ownership, was seen as a key instrument for achieving the country's territorial and demographic stabilization. Their geopolitical agenda yielded a strong focus on distributing its population as widely as possible to both the north and south after the 1984 War of Independence. Population distribution and a territorial presence were viewed as being best achieved by planning many small rural villages that were widely dispersed, rather than through urban concentrations. This pro-rural stance was at odds with the factual reality that the vast majority of Israel's residents prefer to live in urban areas.

Despite the fact that leasehold land quantitatively dominates the land market, the concept of private property dominates both legally and politically. The reason for this is as follows:

- The small percentage of freehold land (7%) has always played a much bigger role than its numeric size might imply because of the high quality nature of much of this land.
- Most real property taxes apply equally to both private land and long-term leased land.
- Court decisions strongly support leaseholder property rights, narrowing the rights gap between leasehold and freehold ownership.

- Publicly initiated development has greatly declined and development on public land is normally carried out by the private sector with private financing.
- Approximately 70% of Israeli households own or hold a long-term lease on their housing units. This is comparatively high on an international scale, and represents the highest-value asset held by the vast majority of households.
- The market for urban land hardly distinguishes (in price / value) between similar properties located on private or public land.

Land leases are typically drawn up for two periods of 49-years (98-years), with some as long as two 98-year periods. The marketplace does not seem sensitive to the remaining duration before the lease runs out. Even in cases in which there are only a few years remaining, most potential buyers rarely ask or make a price adjustment for this factor. Lessees have the right to extend the land lease for another period without any upfront payment and with only a minimal extension payment.

Land rent subsidies are currently used (as of 2002) to encourage development in peripheral regions of the country. These subsidies are as follows; 100% or full market price (no subsidy) for coastal and central regions; 50% of market price for non-distant peripheral areas; and 33% for more distant peripheral areas; and 0% of market price (no land rent) for border areas with active hostilities.

The Israeli government decided early on that the public land lease system should *not* be used for the purpose of land use planning control. Land is released for development only after a statutory land use plan is in place. However, there was a policy shift in the 1980's toward a growing planning and development role.

In conclusion, Israeli public leasehold has undergone what is referred to as a *crawling privatization*, whereby property rights granted to leaseholders have gradually come to resemble freehold ownership. Only minor controls remain in the hands of the administration. The market for leasehold interests is very similar to the market for freehold ownership, as are the prices obtained.

Because the system is so large, administrative intervention became too cumbersome to manage, and too politically onerous. Thus, it was altered over many years to become much more like a private property market in which market forces are allowed to work almost unfettered by administrative intervention. This has allowed the system to operate reasonably well.

Leasing Public Land – Hong Kong

The original leasehold system in Hong Kong was established in the 1840's, soon after the British arrived on the island. In Hong Kong, the government owns the most valuable and scarce resource in the city, the land.

Some people argue that the economic success of Hong Kong was mainly because of the British government's laissez-faire approach to managing the economy. The British government maintained a minimum level of involvement in regulating business practices and labor relations. There were no trade restrictions on goods or capital, and corporate and personal income taxes were kept low to stimulate private investments. After Britain returned Hong Kong's sovereignty to the People's Republic of China (PRC) in 1997, these principles of economic governance remained essentially intact.

The original lease terms offered were for 75 years with no option to renew. A few years later, under pressure from lessees, the government later extended these leases to 999 years at no additional charge. For approximately 50 years, leases were made with terms of 999 years. In 1898, the 999-year leases were no longer offered and 75-year leases with an additional 75-year option were made. At this time, the 75-year lease term became the standard, until 1997. Since 1997 the standard lease terms has become 50 years.

The government assigns land rights to private parties via land leases. These leases state the amount and type of development rights the government grants to private lessees. They also identify the period during which lessees can enjoy the granted rights. The government possesses title to the land, and private lessees acquire land rights during the lease term. These rights can be transferred to other parties. The lessees also have the right to benefit from all land development and transactions, subject to payment of land premiums, annual rents, rates, and property tax to the government. The government collects from lessees a land rent every year, land premiums at initial public offering, at the time of lease modifications, and during lease renewals. The government also levies rates on all properties based on the value of both land and building improvements. In 2002 this rate was 5%, but it has been as high as 11.5% in the 1970's.

The government has tried to employ lease conditions to enforce land use regulations for many years. Unfortunately, enforcement through lease conditions has been problematic. This is primarily due to the wide variety of lease structures that are currently present in Hong Kong, the long land leasing history in the city, and the fact that many of the leases predate current zoning plans. For these and other reasons, the planners in Hong Kong have been seeking other ways to enforce land use regulations instead of relying on lease purpose clauses.

Many, but not all, land leases are publicly auctioned. The government provides some land for public housing, special industries, and non-profit organizations through a structure known as a *private treaty grant*. If the government approves the grant application it will then negotiate with the lessee for the amount of the premium and specific lease conditions. These can be offered as nominal premium grants, reduced premium grants, and full market value grants. The government has subsidized many public housing projects through premium grants. In the early 1990's, housing programs covered about half the population of Hong Kong.

Complaints about housing prices began to increase during the 1990's as the "sandwich class" began to increase in size. This "sandwich class" was generally lower-middle income families with earnings too high to qualify for government housing subsidies, but too low to allow them to purchase their own homes. The new government, after 1997, responded by promising

to increase land supply and build additional housing. However, the timing of this well-intentioned policy occurred when the Asian financial crisis spread to Hong Kong. Weak housing demand coupled with increased supply greatly depressed housing prices. This prompted the propertied class to call for the government to stop intervening in the private housing market and to halt all land auctions. With the population split, the government faces a continuing dilemma which affects the way they lease public land.

Between 1996 and 2000 annual revenues generated from public land leasing were more than enough to cover the cost of infrastructure and land development (with only 1998 as the exception due to the Asian Financial Crisis). Lease revenues accounted for approximately 17% of total government revenue, which was the second most important source of funds after personal and corporate income taxes. The Hong Kong government seemed very capable of retaining a large portion of the land value by leasing public land. The Hong Kong public leasehold system used four mechanisms to capture land value:

- Initial public auction or tender
- Collection of annual land rent
- Lease modifications
- Lease renewals

In Hong Kong, over the 1970 to 1995 period, 75% of the total land lease revenue came from initial auctions and grants, and 20% came from lease modifications. This reliance on initial public auctions is somewhat risky and the government will have to carefully schedule its land leasing. Had the government leased all land sites rapidly, at the time when their values were low, it would have lost its ability to capture future increments because demanding additional payments from lessees for lease modifications and renewal had proven either politically controversial or technically difficult. Additionally, timing the supply of land is also tricky as it is difficult to predict future demand. As such, a careful balance between leasing too quickly (for the previously stated reason), or too slowly (which inflates land prices) is required. This attempt has been a constant struggle and is politically controversial. This reliance on initial public auction to capture land value could lead to high land and housing costs and might also increase the volatility of the property markets. Many conflicting studies have been performed on this and related topics.

In conclusion, one of the primary goals for public leasing in Hong Kong has been to raise a substantial amount of revenue from leasing public land, and in this respect it has been mostly successful. Public land ownership has also allowed the government to subsidize public housing programs for the poor and the development of special industries. However, high initial land premiums has not been helpful in lowering the high housing costs in the private housing market. The government was able to balance the fiscal considerations and provide affordable housing during the 1960's and 1970's, but this method became ineffective in the 1990's when housing prices increased to the point where middle-income families found it difficult to purchase their homes.

The housing sector has become very rigid, with strong pressure from both the propertied and non-propertied classes. The domination of the development market by a few large developers

(which was encouraged by the government's leasing policies) was also considered to be a contributing factor to the high prices.

The Hong Kong experience revealed that there is a tradeoff between raising public funds and stabilizing housing costs. This begs the question, "To what extent can a government, acting as custodian of public land on behalf of its citizens, maximize the financial returns on land leasing without impairing its duties or legitimacy as the protector of public interests?"

Leasing Public Land – Ukraine

The role of leasehold in today's Ukraine is still being determined and "The Land Code of 2001" implemented the language of the constitution regarding property rights. The choice of tenure for urban land in independent Ukraine has been heavily influenced by the nation's socialist past as part of the USSR, from which Ukraine gained their independence in 1991. Additionally, the fragile economy, in which GDP fell by 66% between 1990 and 2000, was an additional constraint on the choice of tenure since entrepreneurs and households had little access to credit to finance the acquisition of land.

Starting in 1990 and increasingly after independence, Ukraine gradually moved to divest itself of the ownership of various types of land. Some lands have been placed effectively, although not yet legally, into the hands of local governments. Steps have also been made to place farmlands in the hands of collectives and individuals, and municipalities have been privatizing urban residential lands. As of 2000, 23% of the population, rural and urban, held residential land "given in use", while 20% held land in freehold. The state, acting through cities, is offering some enterprise land for lease or purchase at auction or by negotiated sale.

Fee title sale (freehold), initially limited to individuals, has been extended to enterprises and has become widely accepted, although with a variety of constraints. There is still dispute about the validity of such sales, but many councils act on the presumption that it is valid. Thus, it is more public policy and fiscal constraints that determine whether land is to be leased or sold, or, as is the dominant practice, to be "given in permanent use".

Adequate laws do not yet exist to govern title registration, mortgages, cadastres, bankruptcy, and division of ownership of public lands between the state and local governments. Such laws were not relevant under state socialism, but are essential for a market system for real property to function effectively and efficiently.

The many laws enacted over the period from 1989 to the present demonstrate the ongoing shift in attitude toward private land ownership and toward the government's role in the management of this resource. From the state as owner of all land, the first step was to allow very limited rights of ownership for small house plots and related lands.

The pervasive use of tenure by "gift of use" shows the state's readiness to have private rights in property while retaining a greater measure of state control than is likely to exist under freehold or leasehold tenure systems. The state gives the use rights on its terms and, at least

in concept, has greater ability to revoke those rights than under a leasehold or freehold. The grantee pays land tax in the same manner as if holding a freehold title.

Land rent and land tax remain two different terms for what are apparently similar charges. Laws state that land rent may not be less than land tax, but there is no evidence that land rent has actually been higher than land tax. Both charges are deposited in the same account, and there is no differentiation in accounting between them.

The state has effectively (if not as yet legally) transferred to the municipalities the right to manage, sell, or give away land if they so desire. Land for enterprises may be offered as leasehold or freehold, and may be sold through negotiation or by auction.

Land tax is important to local budgets and accounted for 8.5% of local revenues and 3.9% of state revenues in 1998. There is as yet no comprehensive real estate tax law that covers structures as well as land. Both state industries and agricultural enterprises have been opposed to the proposals because they would then be subject to greater taxation. The creation of a land appraisal system and appraisal licensing is also not fully in place.

In 1994 land auctions were performed in several cities across the country. These auctions created an opportunity to understand the market value of land parcels, providing crucial information for buyers, sellers, and to help land valuation efforts. The auctions involved the sale of leaseholds with terms of 49 years, and a 49-year option to renew. They were fully transferable and allowed for specific types of development.

Currently, the only financing available is payment deferral offered by local councils, but negotiations are underway with the National Bank of Ukraine for loans to be offered for land purchases. The vast majority of the privatized plots were transferred through “gift of use” (93%), while 4% were freeholds, and 3% were leaseholds. Of all of the sales, only 14% were by auction as municipalities prefer negotiated sales to the auction process. Unfortunately, this allows for a greater chance of corruption.

Ukraine has active real estate markets but there remain some unresolved impediments to a successful urban land market. The lack of adequate underlying policy, legislation, regulation, conflicts between existing laws, insufficient judicial response, lack of transparency in administration, and public / private corruption hamper the development of the market. This tends to deter investment by both domestic and foreign parties.

To some extent, the privatization choices reflect the reluctance of some municipalities to release land fully. These choices reflect the fragile state of the Ukrainian economy and the unsatisfactory structure of laws and practices governing the privatization of land. Individuals privatizing plots they formerly held under “gift of use” did not have to pay for these plots. Entrepreneurs, generally short of funds, and without financing options, had a choice between gift of use, purchase of fee title, or leasehold (93% transferred as gift of use). Payments averaging 30% of the sales price were deferred by the municipalities.

The lack of a clear, publicly accessible system for managing market transactions is another great disincentive for investment in land. Potential investors are more concerned with the existence of a reliable, stable, and transparent structure than with the specific nature (tenure) of property rights. The government hopes that an active market in land will yield a substantial tax revenue to support public services. The passage of land laws and practices alone cannot invigorate the economy, but it can play a significant role. Many draft laws have been submitted in recent years, only to perish in Parliament. Passage of a wide range of land laws is considered urgent.

Many cities in Ukraine need redevelopment of older sections. For example, many apartment structures date to the Second World War and are in bad repair. Many industrial structures are empty and abandoned. Giving land in temporary use or leasehold may enable the city to more quickly invigorate these sectors. Fringe areas of growing cities (Kyiv for instance) may benefit from a short-term leasehold system by allowing it to use land for infrastructure during its expansion, and avoid the heavy expense of re-acquisition.

Offering land at auction offers several advantages for Ukraine. Auctions are a relatively open process, and in a country beset by corruption and the perception of corruption, transparency is a great asset. Auctions can also give firm evidence of actual market demand and value for land. As Ukraine trains qualified land appraisers, data from actual sales under competitive circumstances will enhance their accuracy and effectiveness.

The choice of tenure is still in debate. “Gift of Use” is well established in Ukraine for both land and structures. On one hand, it produces revenue (land tax) and can provide flexibility to the public sector concerning the future use of the property. On the other hand, it limits the users options and does not fully place the property in the market. Leaseholds have proven to be quite successful in some countries, but the legal right to resume title at the end of the lease term and the right to raise rents periodically are politically difficult. This can slowly transform the leasehold system into something much more like a freehold system. However, leaseholds allow for greater governmental control. The advocates of a freehold system insist that this form of tenure offers owners more freedom to determine what to do with land and is less subject to government intervention.

As can be seen here, tenure choices and the long-term structure of the Ukrainian market are still coalescing. It is likely that it will be some years yet before a stable platform for economic growth is firmly entrenched in this transitioning economy.

Leasing Public Land – China

The People’s Republic of China was founded in 1949. Prior to this, private property was the foundation for land ownership and property taxes were a major source of local public finance. In the mid-1950’s, all land transactions become illegal and a planned allocation system was established. It was emphasized that “any organization or individual cannot occupy, trade, lease, or use other methods to transfer land”.

Land users had to apply to the government for land, and after approval they were allocated the land free and forever. When land was allocated out, it was extremely difficult for the government to reallocate it to other work units. Land user's demand was unlimited because land was free and the more powerful the unit was within the administration, the more land they were able to obtain, with little regard for real economic need. This system also created a peculiar urban structure with 25% to 30% industrial use in many cities. It also became difficult to renovate downtown or older areas. Heavy governmental subsidies for industrial use limited revenue for other land uses as well as for infrastructure.

As part of the economic reform in China that began in 1978, urban land reform is a response to problems of traditional urban land use in socialist cities. The approach of the land reform is similar to reforms in other sectors, in that it is gradual, partial, and dual track. The successes and problems in urban land reform also stem largely from China's decentralized public finance system.

Land leasing in China began in the 1980's, relatively later than other economic reforms. Only in the late 1980's did China experiment with public land leasing in addition to the traditional administrative allocation system. In 1990, China officially adopted land leasing as the basis for assigning land use rights to urban land users. Since then, China's urban land reform has created a fast-growing real estate market that is now transforming the urban landscape.

Local government and the growth of the private sector are two of the driving forces behind urban land reform. One of the severe problems with the administrative land allocation system is that it is not compatible with the growth of a market-based economy. The economy demands better delineation and protection of property rights. Under fiscal decentralization, local governments are strongly motivated to maximize property-related revenue and to generate prosperity. As a result, public land leasing has become the basis for China's land allocation method. Hopefully, it will increase the efficiency of urban land use by creating an active real estate market where resources flow to where they are most needed.

In Beijing, public land leasing has vitalized local public finance that has traditionally relied heavily on local state-owned enterprises (SOE's). However, various problems in Beijing's land leasing system point to the important role of adequate political institutions in public land leasing. Additionally, the multiple roles of government can cause conflict within the process. One important finding from Beijing's is that the political system is essential in aligning local officials' interests with the public well-being. There remains a tension between the growth of the private economy and the internal promotion system of the Chinese Communist Party (CCP). This helps explain why administrative allocation and private negotiation in leasing are so common in Chinese cities.

Since the beginning of urban land reform, the old administrative allocation system and public land leasing have been coexisting. Local authorities tend to claim that allocation is only used for government and non-profit public organizations, but SOE's have also received land through this method. The central government has tried to reduce the scope of administrative allocation but the results are as yet unclear.

Land leasing is applied to vacant urban land, newly acquired farmland, redeveloped urban land only and companies that issue stock to the public. Land obtained by administrative allocation prior to reform will be unaffected. In theory this helps local governments capture land value without disturbing existing users, but in practice it is still very common that local officials assign land to private users through administrative allocation.

The goal of urban land reform is to “improve urban land use system, develop and manage rationally, strengthen land management, and promote urban construction and economic development”. In other words, to improve local public finance, and optimize urban land use through the reestablishment of private property rights. The first goal directly helps local governments and the second is what private and foreign firms require.

Why not transfer land in freehold and tax it? The underdevelopment of market institutions, the lack of respect for law, and widespread corruption in China make it somewhat problematic to levy land taxes. Many Chinese are still not used to the concept of paying taxes, since it has been absent for 30 years before the economic reform.

Many old cadres angrily denounced the experiment of land leasing (as it relates to a Japanese company leasing a large tract of land in the Hailan Province in 1990) as “selling the national sovereignty”. This event did not hinder land reform but it did show the strong legacy of socialist ideology and the potential for political resistance toward selling land. Unlike selling land, land leasing has several attractive features (at the likely cost of some economic efficiency). First, it is somewhat more politically feasible because the government retains title to the land. Second, land leasing fits into China’s general track record of economic reform (which is gradual and partial). Third, China is in a period of rapid urbanization and large-scale infrastructure projects and land use controls may be easier to accomplish under a land lease system. Fourth, the land leasing experience of Hong Kong will very likely influence China’s adoption of public leasehold.

The maximum lease terms are 70-years for residential land, 50-years for industrial, and 40-years for commercial. There are three ways to obtain a land lease, private negotiation, private tender, and public auction. Private negotiation is the most common and is the direct negotiation between the land user and the government. In private tender, multiple land users bid for a parcel with an offer price and a land use plan. The winner is not necessarily the highest bidder. In contrast, the public auction sale goes to the highest bidder. In the latter two methods there are usually restrictions on who can participate, and they usually must be developers with licenses issued by the government.

Payment for leasing land usually consists of three major components, a lump sum premium, an urban infrastructure fee, and a community infrastructure fee. Each city has a standard guideline that stipulates land prices for different parts of the city. These are supposed to set the minimum leasing prices. However, they are produced with questionable techniques, and are only updated every five years or longer. Additionally, most leasing relies on negotiation between local governments and developers.

After obtaining a lease, the lessee must pay a land use tax each year, and often a myriad of annual fees depending on the city. The lessee must still apply for a planning permit before developing the land. Urban planning is considered a state power and superior to lease contracts. The government does not generally use lease contracts to implement urban planning. The power struggle between urban planning agencies and land administration agencies is a serious problem for both central and local governments.

The lease usually requires the lessee to complete a certain portion of land development within two years (to generally prevent land speculation). However, many are still vacant after this period and it is debatable as to the extent to which this is enforceable. The two-year limit has not worked in practice as yet.

A lessee can negotiate with the local government for a lease renewal. In the absence of a renewal, both land and building improvements revert to governmental ownership. Because the land leasing system is so new in China, many potential contractual problems, such as lease renewal, lease modification, and regulatory takings and remedies have not arisen as yet.

Revenues from land leasing are shared between different levels of government. In the early 1990's the central government tried to retain 30% of the revenue but the local governments hid their revenue, making it difficult for the central government to enforce this. In sum, city governments are in charge of land leasing and retain the vast majority of the revenue.

In conclusion, public land leasing is the core of the urban land reform in China. This system was chosen for several reasons that include; a government that is politically powerful but economically weak; government role in large-scale infrastructure; a socialist legacy; and the influence of the Hong Kong public leasehold system.

In Beijing, there has been general success in urban land reform by generating local revenue, freeing land from the rigid planned system, and assisting urban renewal and housing reforms. However, because local governments own SOE's they face strong pressure to subsidize these enterprises by granting them land at no cost.

The effect of public land leasing on local public finance and the land market critically depend on the behavior of the local officials. In a democratic society, the link toward an efficient system is the flow of votes, but in China the only link is the internal promotion and disciplinary systems. Corruption in China's public land leasing shows the severity of this problem. If local official's interest is not aligned with public interest, many positive properties of public land leasing will be lost.

The experience of public land leasing in China has shown that it might be a appropriate transitory land tenure arrangement for transitional economies. It also suggests problems associated with the multiple roles of government in leasing and managing land, and careful institutional design of local government may help mitigate these problems.

Another lesson from China is that political institutions are very important to a well function land leasing system. The traditional bureaucratic system within the CCP was unable to fulfill

this task, at least in the long run. Very little attention has been placed on potential contracting problems, complications involved in lease renewal, and contract modification. These and other difficulties will have to be faced sooner or later as land leasing matures in China.

Leasing Public Land – Poland

In Poland, almost all non-urbanized land is held in freehold, and some portion of the urban land is held in leasehold. The typical long-term ground lease used in Poland is called a *perpetual usufruct*. Land is leased for 40 to 99 years (and can be extended for an additional 40 to 99-years) and the lessee owns the improvements on the land. Consequently, existing improvements (if any) must be purchased by the lessee upon granting of the lease. This form of lease can be created by the state or local government only.

Another type of partial land interest is private or public land leasehold, but this is for shorter periods of up to 20-years. In this case, the lessee must not have an interest in the improvements and there is no title record, as there is with a perpetual usufruct.

As an example, in the city of Krakow (the third largest city in Poland), public freehold accounts for 21%, public leasehold for 15%, and public enterprises 13%, with private freehold representing 46% and other 5%. The capital city of Warsaw has a much higher percentage of leaseholds.

The granting of a perpetual leasehold interest requires a competitive tender procedure with a 21-day public notice. There is open public bidding and the government can constrain the land use. This can somewhat pre-select the bidders. Anyone without a criminal record can bid after lodging a security deposit. This bidding process can be waived for the following reasons;

- A person may have a statutory priority to obtain leasehold of a particular parcel
- There is a transfer between two public agencies
- The lessee is engaged in non-profit or public benefiting work
- There is an exchange or gift
- The subject property improves the use of an adjacent property
- The land is an in-kind contribution
- The lessee is acquiring land after developing it
- The land is for housing purposes by a non-profit organization

Land rent can be adjusted upwards annually, but this is rarely done due to manpower shortages and the difficulty of re-appraisal. Leasehold agreements specify what land use is permitted, and the agreement must specify the following.

- The date of commencement and completion of building improvements
- The type of building improvements
- The duty to keep them in proper condition
- The terms and conditions of re-building

- Compensation to the lessee for buildings at termination

The contractual agreements are recorded and are binding on both the initial and successive lessee's. A valid public purpose is the only reason the state may not grant an extension.

In a transitional economy, where the economic and political processes are critically interrelated, the ground lease can be a useful tool. The following are some reasons why long-term public leasehold was considered a good choice in Poland.

- Where local land use planning systems may not be in place, the long-term ground lease provides a mechanism for local governments to influence the land use of key parcels owned by the state (while still placing the parcels under the effective control of the private sector).
- Where local governments are responsible for building local infrastructure but lack sources of revenue due to limited local taxation systems (such as an area-based property tax versus a value-based property tax), public leasehold system provide local governments a critical revenue source.
- Public leasehold systems also allow local governments to benefit from the growth in land values that the government, in part, facilitates through the creation of the infrastructure. This ultimately is dependent on the interplay among growth, validity of the infrastructure investment and the effectiveness of the lease contract.
- If the availability of equity capital is limited and mortgage markets are in their early stages, public leaseholds systems permit local government to finance the use of land for private purposes creating a capital market where one does not exist.
- Where land is transferred to local government to provide a source of wealth as a basis for building urban infrastructure, a public leasehold system provides a means of benefiting from that wealth, given that capital markets are just in their evolution and property tax systems are likely not in place.
- Public leasehold system allows local government a significant role in determining future patterns of land use and to be proactive regarding changes in the pattern of land use that is the legacy of the prior economic system.
- Public leasehold systems may provide more flexible land disposition instruments, allowing a local government to postpone sale until more stable market conditions evolve. This assumes that planners can anticipate market movements, although there is no consensus that this is feasible.

- Public leasehold systems may provide a more politically palatable mechanism for making land available to nonresident investors for needed urban development.
- Public leaseholds systems can use contracts similar to those used in mature market economies, allowing the contracts to be readily understood by international investors while enhancing the choice of instruments.
- While public leasehold systems may be viewed by some as unnecessary relics of centralized or planned economies, long-termed ground leases have a long history in many market-based economies.

There seems to be several reasons why public leasehold systems can be practical in transitional economies. Unfortunately, unless the leasehold documents are carefully crafted, or if the lease terms are short (or do not include a renewal option) there can become a divergence in incentives between lessor and lessee. This can cause the property to be under-maintained toward the end of the lease period, and can cause sub-optimal development of the land in general if the original lease was not of sufficient length to satisfy the business needs of the original lessee. As such, the term and conditions of the land lease will affect redevelopment options, the nature of the structure originally developed, and repair / maintenance decisions. This can negatively affect the economic well-being of the business if the land lease terms are divergent with its land needs.

A statistical analysis of the typical polish perpetual usufruct, a leasehold with an automatic extension (equal to the number of years previously elapsed), and freehold ownership has been analyzed. These leases were compared and the net present value was statistically estimated. This will show a good approximation of the efficiency of the leasehold systems in question, relative to freehold ownership.

A detailed discussion of the statistical study parameters goes beyond our story here, but the net present value conclusions showed 346 for the perpetual usufruct with no right to renew, 383 with the automatic lease extension, and 400 for the freehold owner. This indicates a 4.2% loss of efficiency (as defined by NPV) of the automatic lease extension leasehold system, relative to the freehold system. It also indicates a 13.5% loss of efficiency for the perpetual usufruct and no renewal, relative to the freehold system. This implies that, all else equal, other significant benefits from a leasehold system would have to accrue to the government and people of a given country for the leasehold system to be economically equivalent to a freehold system (as it will likely fall short on a present value basis).

The results of this analysis and the current experience in Poland suggest the following. The uncertainty about the ability to extend a lease, or if leases are of a short enough term to impact development choices, then redevelopment will occur sooner and lower densities will be more common, repair / maintenance decisions will be affected (minimal expenditures near the end of the lease), and improvement quality levels will be affected (likely lower and based on lease term). These factors will also affect the overall economy through the real estate factor of production.

There may be some pragmatic economic benefits to long-term public leasehold in transitioning economies. However, many of these benefits tend to fade away as the capital markets evolve, alternate sources of capital emerge, land planning and regulatory systems are put in place, and as the local culture begins to be receptive to private real estate markets.

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BIOGRAPHICAL NOTES

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