Land Ownership and Land Use Development

The Integration of Past, Present, and Future in Spatial Planning and Land Management Policies
Creative Destruction for Sustaining a Land Development in Residential Areas

Latvian experience in resource allocation for development of housing sector

Abstract

The development of the housing sector indicates the household formation and relates to the residential real estates. Therefore the assessment of the developments may provide the decision makers with necessary information on the state and potential of the housing sector, market situation and particular socio-economic development trends. The study is concerned with an examination of resource allocation in order to promote a sustainable development of housing sector in the context of evolving residential real estate market during period 2002–2015 in Latvia. The findings of the study show limited opportunities to create a solvent demand, providing high-quality dwellings in case of the existing institutional environment in housing policy in Latvia. The outcome points to the necessity and potential finding conceptual solutions and increasing the management efficiency.

Key words: housing sector; creative destruction; land development; residential areas

1. Introduction

A historical evolution shows that the system of market economy has no inherent a stability – it has been changing and cyclic. The national economy of Latvia is comparatively small and opened that has been moving towards a developed market economy since the renewal of independence in 1990. The development trends and peculiarities of real estate market should be explored in conjunction with the development of market economy if observing the last 20 years. A professional’s argument on characteristics of real estate market in Latvia expresses its disparity from similar markets – it never really could be considered as wholly Latvia’s market (Kļavis et al. 2013: 12). Accordingly, the development of real estate market has persistently been influenced by changing and peculiar external factors. Many of transactors were being foreigners. Mortgage lending has been mainly provided by foreign banks, which significantly influenced the developing of households during the last 15 years, because 80.5% of the Latvia’s banking sector formed foreign capital (FKTK 2014).

Residential areas represent one of the major segments of real estate market. The research on its development is related to real property transactions within the housing sector. This sector involves the housing stock of both individual residential houses and high-rise multi-family residential buildings.
Concept of “creative destruction” in relation to real estate

It is generally known from the economic theory that a competition is the most important characteristic and driver of the development of market economies. Well-known economist J. Schumpeter introduced the term “creative destruction”, which he derived from Marxist thought and popularised as theory of economic innovation (Reinert and Reinert 2006). The expression of this concept indicates to the situation, in which new market participants replace outdated ones, thus creating place for newer, more efficient and wealthier entities and goods (Schumpeter 1994: 83). In consequence, guided and introduced innovations into market cause a replacement of previous ideas, approaches, methods and technologies, but “creative destruction” is then a reason for continuous progress and improvement of living standards and human welfare (Henderson 2008). Developing the ideas about systemic contradictions in capitalism, the influence of urban environment on making goods and territorial attraction of a capital has been explored (Harvey 2001). Therefore, an idea was substantiated that in order to overcome periodical crisis and soften the crisis occurrence, the investments in construction and infrastructure improvement are necessary, for instance, in the case of ‘bubble blast’ of real estate around the year 2007 in Latvia. Urbanisation may be considered as a way to absorb the capital surplus (Harvey 2011). However, this process should not create the negative effects of so-called ‘unplanned urban sprawl’, as a result of which, a ‘dead capital’ can occur, for instance, either unfinished new developments with serious physical depreciation or damaged amelioration systems. Most commonly this process is guided by regulations on land use and development, which are elaborated and implemented within the framework of spatial planning system. As the possibilities of capital use cannot abide a limit to profitability, ever more frantic forms of “time-space compression” arise, often impelling technological innovations (Harvey 1992). These technological innovations can be introduced in order to increase speed of turnover, to develop faster transport and communications’ infrastructure as well as to create flexible accumulation of the capital. However, it should be admitted that the findings of innovative solutions often boosts instability, uncertainty and risks, because the innovations need some time for its recognition and acceptance, as well as its financially sound demand should be promoted. For example, it is widely experienced that the ecologically sound, energy-efficient or ‘smart’ houses have been placed on the real estate market, which provide the dwellers with accordingly healthy living conditions or possibility to reduce the maintenance costs. Globalization can be viewed as some ultimate form of time-space compression, allowing the movement of capital investment geographically. Thus, it is concluded that a concept of “creative destruction” can be applied to prefer the efficiency measures and sustain the land management.

Land development in residential areas

In Latvia, like in many parts of the world, the local governments are in charge of the public decision-making to develop and approve the spatial development plans (Saeima 2011). However, local stakeholders – property owners and developers implement these plans through management of the properties and development of necessary infrastructure and buildings in accordance with planning regulations, including functional zoning, permitted
land use and set land use restrictions in a specific territory. “Land development” is concerned with an implementation of spatial development plans, thus promoting new development proposals and developing appropriate to either urban or rural environments. However in practice the distinction between both environments often is not clear. Generally, land development measures refer to the changes in land use intensity. Nowadays various stakeholders – real property owners, developers, financial institutions, central and local governmental authorities, qualified experts and others whose interests can be affected are involved in a development process. It is typically expected that the real property value will increase as a result of land development at a specific area. However, contemporary challenges and addressed issues during the implementation of development measures, in particular in residential areas, are related to the acquisition and preparation of the development sites. Accordingly, specific due diligence procedures and real property transactions are performed as well as investments attracted for financing the projects and its implementation phases.

General provisions related to local spatial planning, land use and building within the territory in Latvia have certain impacts on types of land use for providing a housing function such as envisaging an appropriate infrastructure, thus determining (Cabinet of Ministers 2013): (1) individual house building – a functional zone for solitary lifestyle and the main type of use of which is individual house and summer cottage building; (2) low-storey residential building – a functional zone with the building of up to three storeys; (3) multi-storey residential building – a functional zone with building of four and more storeys. The main type of use of a low-storey residential building territory is individual house building, terraced house building and multi-apartment house building up to three storeys, but the main type of use of a multi-storey residential building territory is multi-storey and terraced house building.

Hypothesis and purpose of the research

The real estate market is never perfect; there are market failures. Various economic sectors, institutions and processes need following the efficiency domain to rationalise their performance and gain the best possible outcome. The housing stock is aging if it is not renewed to the extent required. The real estate market can offer real estate upgrading as well as production of new houses, taking into account not only the need for provision of housing functions, but also the potential to create a financially sound demand by offering high-quality dwellings in new and modern development projects. For this purpose conceptual solutions can be found to increase efficiency measures and to promote the housing sector management in accordance with the public interest (Geipele and Auziņš 2016).

After 1990 the land reform started with following processes of privatisation and restitution of real properties in both rural and urban areas in Latvia. At the same time, the denationalisation of building properties was carried out. As a result of restitution and denationalisation, so-called ‘splitted’ real property tenure occurred. In Riga City the land properties have been restituted to previous owners (before 1940) and their heirs in the former property boundaries in spite of the built infrastructure (e.g. roads and buildings) on these properties during
the Soviet period. Moreover, it was politically stated that the acceleration of the land reform should strengthen the national independence. In reality, the weak and fragmented institutions were established for land use and housing management. First version of spatial planning law was introduced just in 1994. The law has been gradually improved during next 10 years. The quality of spatial planning documents also has been gradually improved till meaningful changes there were possible to introduce in spatial planning system in 2011. Private land ownership still significantly dominates versus public ownership in Latvia. As on January 1, 2015 only 1.5% of registered land area belonged to municipalities, but 19.5% to the state (mostly forests). About 1.5% of municipal land was registered as land area for residential building (SLS 2014). Finally, it is concluded that insignificant areas are in the possession of local governments, the land tenure is still fragmented and overlapping, the residential building infrastructure, i.e. buildings, open space, engineering networks, is mostly in poor condition (e.g. high energy consumption, obsolete management and architectonic standards, chaotic parking areas for cars, people unwilling to cooperate). But, at the same time, the real property market is developing largely on the basis of formerly built and comparatively old residential apartments, reasonable land readjustment procedures to form more efficiently manageable real properties still lack, and new residential development projects urgently need sustainable housing policy support.

If considering the development trends of the housing sector and analysing such aspects as diversity and aging of housing structure in relation to development of residential real estate market, the following hypothesis of the research arises to be tested: a “creative destruction” is possible within the segment of residential real estate market and it may contribute to an efficient management and sustainable development of the housing sector in Latvia. On the one hand, the land use patterns of residential areas indicate the potential for development of housing sector, but, on the other hand, the development of housing sector indicates the possibilities for development of households. Accordingly, the purpose of the research is to investigate the current state in housing sector and land-related resources for its support, to analyse the development trends of residential real estate market, to assess the potential and possibilities in resource allocation for successful implementation of development projects in residential areas and make some contribution to significant improvements in the housing policy of Latvia.

2. Materials and methods

For the purpose to explore the dynamics and development trends of residential areas and market transactions of related real estates over the years 2002–2015 as well as to assess the peculiarities of housing sector in certain research territories, appropriate materials and methods have been used. Those factors that affect the aging of housing sector and the stagnant nature of real estate market over the last five years have been explained when assessing the structure of housing sector and the intensity of real estate transactions in the residential market segment. Based on the research results and their discussion, meaningful conclusions were drawn and proposals for promoting development projects within housing sector were made.
Classification of real estate objects provides background information for analysing trends and development characteristics that will give opportunities for analytical assessments that will reveal challenges and opportunities within both the housing sector and the real estate market. The structure of residential buildings gives an idea of the composition and state of the housing stock. The variability of construction output, issued building permits and commissioned residential buildings in new construction projects provide an overview of new housing supply in the real estate market. The dynamics of real estate transactions and the development trends of real estate market in its certain segments identify the market activity and potential.

In accordance with established official classifications the dynamic statistical data series about appropriate territories in Latvia have been analysed, the objects of real property transactions have been identified as well as the housing sector assessed. Although there exist various problems when analysing land use-related classifications regarding terminology, criteria and their characteristics, the classification of functional zoning basically complies with the classification of objectives of real property use (Cabinet of Ministers 2006), which has been developed and is being used mainly for cadastral evaluation needs and administration of real property tax.

The research indicates a number of restrictions and constraints that have affected the context of the research conducted and the interpretation of the results obtained. The research analyses statistical time series, including the whole territory of the Republic of Latvia, including the territory of Riga City and the territory of Pieriga Region. Pieriga Region composes a statistical territory covering Riga City as well as 17 amalgamated municipalities of the former Riga District, which until the changes in the administrative-territorial division in 2009 (Saeima 2008) were part of the territory of Riga District, and additionally 12 municipalities, which presently composes the agglomeration of the capital of Latvia – Riga. These separated territories have been selected because of higher concentration of population and more active real estate market compared to other parts of the country.

To conduct the research, the methods of statistical and comparative analyses are mainly used to analytically evaluate the dynamic time series by classification of real estate objects as well as the housing sector structure and the real estate market in the residential segment. The methods of logical construction and historical analysis are used to explore the relevant concepts to research context as well as to analyse the housing sector, to identify the development trends, to choose and assess the development projects.

3. Discussion and results

3.1 Land use dynamics

In order to analyse the land use classification in Latvia, the division by the groups of objectives of real property use (ORPU) is used, which in the housing sector comprises: land areas for individual residential building (code: 06) and land areas for multi-family residential building (code: 07). The ORPU are assigned by local municipalities considering the spatial
development plans and registered in the National Real Estate Cadastre Information System (NRECIS), which is maintained by the State Land Service (SLS). Municipalities determine ORPU for all existing and planned land units and their parts (Cabinet of Ministers 2006).

Assessing the division of land areas for residential building by the two groups of ORPU for the period of 2002–2015 (as of January 1) in the territory of the Republic of Latvia, the Riga City and the former territory of Riga District (SLS 2015a), the statistics of these groups and their dynamic time series indicate that, comparing the both types of land areas, a higher number of land units and land areas occupied are intended for individual residential building, except Riga City where multi-family residential areas dominate. If comparing with other groups of ORPU registered in the NRECIS, the land areas for individual residential building changed in the territory of Republic of Latvia from 0.6% to 0.7%, in the Riga City from 11.2% to 9.9%, but in the Riga District from 1.9% to 2.9%. The land areas for multi-family residential building changed only in the Riga District from 12.2% to 9.0%, but in the other two areas remained the same 0.2%. It is identified that in some municipalities within Riga District territory, which are bordering to the Riga City, significantly changed the number of land units and registered areas in both types. Exploring the changes in both number of land units and land areas, significant increase has been observed during the period of 2005–2010 in all research territories, except Riga City, which indicates to the relatively rapid formation on new land units and land areas for residential usage. Since 2010 relatively insignificant changes in the number of land units and areas have been observed in the research territories, showing the permanence of the housing sector in the provided land areas in general and, thus, by these two characteristics pointing to the invariance of the housing sector development in Latvia (Geipele and Auziņš 2016).

3.2 Housing stock

According to building registration data as on January 1, 2015 in the NRECIS 1,393,789 constructions were registered, of which 1,367,519 or 98% were buildings (non-residential buildings 1,007,622 or 72%, and residential buildings 359,897 or 26%) and 2% or 26,270 engineering constructions. 86% of all registered buildings belonged to private persons, 3% – to municipalities, but 1% – to the state. There are no available data about the owners’ status regarding to residential buildings in the NRECIS (SLS 2014).

Before performing the analysis of real estate market of the housing sector, the age distribution of the housing stock in Latvia was find out (see Figure 1).

As shown in Figure 1, in the period of 1946–1970 the largest number of the residential buildings was constructed, i.e., 25%. It is obvious that most of the current Latvian housing stock has been built in the period until 1990, in terms of volume making up the most significant part of residential buildings – 86%. Only 10% of residential buildings have been constructed in the period of 2000–2011, which means that the housing stock in Latvia is changing and developing relatively slowly. Furthermore, analysing the information from different sources, including about a proportion of multi-family residential buildings and its maintenance and partly renovation, one can conclude that the Latvian housing stock is still
developing slowly, and its correct registering and evaluation require general indexing of residential buildings or identification and inspection, as well as the existing ‘serial type’ residential buildings have served for the considerable time period and are no longer considered to be energy efficient according to the evaluated characteristics. Thus, the research allows identifying the necessary contemporary challenges to building renovation or demolition. They should substantiate the implementation and development of housing policy at the national level, as well as assessing the housing potential and recognizing the threats and opportunities related to the housing stock.

3.3 Construction output: volume changes and market supply

In a long-term perspective the real estate market is considered to be a function of the economic development. But “construction” – is a function of various economic related forces, which unlike those sectors that characterize supply. Residential building is associated with the consumption that characterizes a demand. To demonstrate the development nature and trends of the housing market, it is important to identify the construction output and the number of newly built apartments that make up the real estate market supply (Geipele and Auziņš 2016). Law on Residential Properties (2011), which prescribes the status of a residential property, the rights, duties and accountability of an apartment owner, as well as the competence and decision-making procedures of the community of apartment owners, defines a residential property, hereafter – an apartment, as an independent immovable property which has been legally partitioned in a residential building. Within the framework of the research, following the Central Statistical Bureau (CSB) methodology, the analysis has been performed for the period of 2002–2014 in the Republic of Latvia as a whole as well as in Riga City and Pērīga Region. Accordingly, Figure 2 demonstrates the construction output index at current prices and the number of newly built apartments in these territories.
Since 2002 the construction output increased approx. 3 times. After the sharp drop in the period of 2007–2010, when the real estate market experienced downturn, the value of construction output has started to moderately increase since 2010. A similar trend appears in the analysis of the number of apartments built in appropriate territories in the specified period of time. As Figure 2 demonstrates, despite the fact that the largest number of apartments built in the Republic of Latvia and Riga City was observed in 2011, the number is still 3.5 times lower in the Republic of Latvia and 2.63 times lower in Riga City compared to that of 2007.

To recognize the development of housing market and its characteristic processes, besides above mentioned, some research has been done to determine the number of building permits issued and newly erected residential buildings commissioned (Geipele and Auziņš 2016). The analysed data indicate that the construction rate of residential buildings has significantly decreased at the end of the research period in 2014 compared to indicators eight years ago when they showed an increase in the number of building permits issued and the buildings commissioned in 2006 and 2007, and at the end of 2007 – a rapid reduction. The studied housing development trends in the period of 2002–2014 suggest that despite the systematization of the housing stock at the national level, the number of new projects under construction at the end of the research period has decreased, which can be explained by socio-economic and legal-political situation in the country. This finding suggests that the national policy should find ways to improve and develop the institutional environment in housing and housing market, especially by means of the construction of new projects due to the aging of residential buildings.

Figure 2: Construction output changes at current prices and the dynamics of newly built apartments (figure made by authors using source: CSB 2015).
3.4 Real property transactions and market development

It is assumed that on the basis of the development of real estate market it is possible to evaluate the nature and trends of economic development. The research involved and analysed the transaction dynamics and average market value changes in the residential real estate market. The analysis of transactions with vacant residential land units, which indicates the development potential and individual residential properties, which indicates already developed land units was performed gathering data about the number of transactions for the period of 2002–2014 in the Republic of Latvia as a whole as well as in Riga City and Riga District. In general, the results of the analysis illustrate the cycle and trends of Latvian real estate market in all indicated headings for the period. After the relatively rapid reduction in number of transactions in between 2007 and 2009 follows modest uplift, which may be explained by cautious supply of real estates into market and careful entering into transactions after the crisis period.

Relatively speaking, Latvia’s rapid economic growth during the research period has contributed not only to rapid development of real estate market, but also to relative stagnation if observing the development trends in apartments’ real estate market during the last few years. Figure 3 shows the changes in average market value and transaction dynamics of apartments in formerly built (mostly serial type) residential buildings in the Riga City and Riga District for the period of 2002–2014.

Figure 3: Average market value and transaction dynamics of apartments in formerly built residential buildings in Riga City and Riga District (figure made by authors using sources: Latio 2015; SLS 2015b).

Figure 4 shows the changes in average market value and transaction dynamics of apartments in newly built (starting from 2000) residential buildings in the Riga City (the neighbourhoods, city centre, old town) and Riga District for the period of 2003–2014.
As the market of apartments is usually the most active one, it best reflects the dynamics and intensity of the real estate market transactions. The common characteristic (see Figures 3 and 4) in the data for the research period indicates to the development cycle of Latvia’s residential real estate market and its changing nature. Therefore, the average market values and the number of transactions have risen up till 2006–2007 and then fallen. The moderate upward of market trend started from 2010 in formerly built residential buildings. The growth of number of transactions in newly built residential buildings has resumed already in 2009 and rapidly risen after 2011.

Although since 2011 the real estate market has become balanced in terms of average market value and transactions have resumed with apartments in all types of residential buildings, the construction rate of newly built residential buildings is not as dynamic, despite the development and aging of Latvia’s housing sector. Thus, the future development scenario of residential real estate market depends on the national policy addressing the housing issues, which should envisage drawing up strategic planning documents of the market development directions and evaluating its effectiveness taking into account socio-economic, political and institutional factors, so that a decision-making process in real estate and construction sectors become systemized and effective.

4. Conclusions

The dynamics of construction output and market supply as well as transactions with residential real property for the research period basically reflect the cycle of economic development – relatively rapid growth during 2002–2007, then rapid recession up till 2011, and then slowly increase. Although since 2011 the real estate market has stabilised and transactions intensified, the supply dynamics of the new building projects is far too slow if considering the existing structure of housing sector. The development of real estate market
largely depends on development of construction industry. On the basis of the research results, it can be stated that the research hypothesis has been confirmed partly, because taking into account the development trends of residential real estate market, the existing structure of housing sector and the development rate of new projects in residential areas in case of the existing institutional environment in housing policy issues, there are limited opportunities to create a solvent demand, providing high-quality dwellings, especially in multi-family buildings. However, the results of the performed analysis at the same time point to the necessity and potential to find socially acceptable conceptual solutions and to increase the management efficiency within housing sector in Latvia. The potential policy issues of the Latvia’s housing development should envisage the assessment of factors affecting the development of real estate market in relation to the functioning of the market, which would allow efficiently using resources and increasing the investments in real estate and construction sectors, thus promoting an expected and stable socio-economic development of the territory in the long-run period. The performed analysis and its most significant results substantiate the necessity to continue the study towards development opportunities of real estate market in several directions, including the creation of high-quality housing supply by providing the most suitable land areas and creating the appropriate solvent demand, as well as the assessment of challenges, effects and risks by attracting foreign capital and foreign investments in real estate development. Thus, a feasibility of “creative destruction” in real estate market should be justified by quality assessment of housing availability and initiative of local governments enabling to implement the building projects under permitting.

References


