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Transaction Costs and Housing Affordability in Asia

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Asia is home to some of the fastest growing cities in the world. As urbanization increases, demand for housing also increases. Well functioning housing markets can minimize problems associated with rapid urbanization such as unaffordable housing and urban slums. This paper explores the different aspects of the residential property sales markets in Asian countries. Using data gathered by the Global Property Guide, transaction costs associated with residential property purchases are analyzed. Housing markets are also examined in terms of tenure, protection of property rights, and openness and transparency. Roundtrip transaction costs for buying properties are high, above 10% in several countries in Asia. High transaction costs and unaffordable housing combined with weak protection of property rights are seen to be conducive to the creation of urban slums.

Keywords

Property markets; Transaction costs; Housing affordability; Slums

1. Introduction

Asia is home to the largest and fastest growing countries in the world, both in terms of population and economic size. With its current size and anticipated rapid economic transformation and growth, the highest rural-to-urban shift is expected to occur in Asia. It is estimated that urban population in the region will swell from 1.5 billion in 2005 to 2.6 billion in 2030, an annual growth rate of 2.1% (UN, 2006).

Urban population growth in Asia has led to the rise of mega cities, metropolitan areas with ten million inhabitants or more. Asia's mega cities include Tokyo and Osaka in Japan, Beijing and Shanghai in China, Seoul in South Korea, Jakarta in Indonesia, and Metro Manila in the Philippines. As shown in Table 1, population densities in Asia's cities are among the highest in the world, especially in Manila, Jakarta, Kuala Lumpur and the city-states of Hong Kong and Singapore.

Table 1 Major Cities in Asia

| City | Metropolitan or Urban Agglomeration ¹ | Population (millions) 2005 | Area (sq km) | Population per sq km 2005 |
|---------------------------------|--|----------------------------|--------------|---------------------------|
| Tokyo | Greater Tokyo Area | 35.197 | 13,500 | 2,610 |
| Seoul | Seoul National Capital Area | 22.770 | 11,790 | 1,996 |
| Shanghai | Shanghai Municipality | 14.503 | 3,920 | 3,700 |
| Jakarta | Jabotabek Metropolitan Area | 13.215 | 1,360 | 9,700 |
| Osaka-Kobe | Osaka-Kobe urban areas | 11.268 | 2,070 | 5,452 |
| Beijing | Beijing Municipality | 10.717 | 7,860 | 1,363 |
| Manila | Metro Manila | 10.686 | 636 | 16,801 |
| Hong Kong | Hong Kong SAR | 7.041 | 1,100 | 6,529 |
| Taipei | Taipei-Keelung Metropolitan Area | 6.752 | 2,457 | 2,748 |
| Bangkok | Bangkok Metropolis | 6.593 | 1,570 | 4,206 |
| Singapore | Singapore | 4.326 | 690 | 6,407 |
| Kuala Lumpur² | Kuala Lumpur City | 1.800 | 243 | 7,407 |

¹ Urban agglomeration include a central city, and neighboring communities linked to it by continuous built-up areas or commuters, inhabited at urban density levels. Some metropolitan areas have more than one central city, for instance, Metro Manila or the National Capital Region is composed of 14 cities and 3 municipalities.

² Kuala Lumpur and its suburbs, known as the Klang Valley, has a population of more than 5 million in 2006, however, there are no set boundaries for this metropolitan area.

Source: World Bank, UN, National Statistics

As the population and urbanization increases, demand for housing for owner-occupancy and rental increases. Resources already devoted to housing become strained due to limited supply of land in cities. The inadequate supply of housing in the region can be seen in the high house-price-to income ratios and high share of slum dwellers in the urban population.

Developments in the housing markets are interlinked with a country's general economic conditions (Leung, 2004; World Bank, 1993). While governments recognize the importance of housing and the right to adequate housing, they need not provide housing directly by building huge housing estates such as in Singapore and Hong Kong. Governments could promote adequate and affordable housing by allowing the market to work efficiently. Transaction costs associated with property purchases can be lowered.

The paper explores the different aspects of the housing markets in Asian economies, particularly China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand. Using data gathered by the Global Property Guide, the costs involved in property transactions are analyzed. Housing markets are also examined in terms of tenure, protection of property rights and openness and transparency.

The paper finds that the total roundtrip transaction costs for property exchanges in Asia are generally low in Hong Kong, Japan, Malaysia, and Singapore. However, in Thailand, Taiwan, China, South Korea, Philippines and Indonesia total costs can exceed 10% of property value. In the Philippines and Indonesia, total costs can reach up to 35% and 47%, respectively. Housing markets in developing countries in Asia also lack openness and transparency.

Further, countries with serious housing affordability problems generally have high transaction costs and weak protection of property rights. To bring down transaction costs and enhance transparency, certain taxes and fees can be removed.

The next section explores the relationship between housing affordability and the rise of urban slums. Section three examines the overall characteristics of Asian housing markets in terms of tenure, property rights and openness and transparency. Section four looks at the breakdown of property transaction costs and examines which taxes and costs can be removed to bring down transaction costs. Section five gives the conclusion and recommendations.

2. Housing Affordability and Urban Slums

Access to adequate housing is a fundamental human right enshrined in various international conventions and the constitution of most countries. This is supported by laws that promote the “full and progressive realization of the right to adequate housing” (UN Habitat, 2005).

Public concern over housing affordability is due to the fact that housing is the single largest expenditure in the budget of most families and individuals (Quigley and Raphael, 2004). A major factor faced by households is the price of housing units. In the Asia-Pacific region, the house-price-to-income ratio was around 11.3 in 1998; much higher than the ratio of 5.8 in highly-industrialized countries and 5.4 in Latin America. The house-price-to-income ratio is one of the simplest measures used to determine housing affordability (UN Habitat, 2001).

Using property prices for Asian cities collected by the Global Property Guide, a decent 35 sq. m. condominium unit in the city center costs around six to thirty times the annual average income. Table 2 shows that there are serious affordability issues in Asian cities, especially in Manila, Jakarta and Shanghai.

Table 2 Condominium Affordability in Asian Cities*

| City | Income per capita (US\$) ¹ | Condominium Price per sq m (US\$) ² | Condominium Price (US\$) ³ | Price to income ratio ⁴ |
|---------------------|---------------------------------------|--|---------------------------------------|------------------------------------|
| Kuala Lumpur | 6,991 | 1,222 | 42,770 | 6.1 |
| Tokyo | 45,425 | 8,000 | 280,000 | 6.2 |
| Taipei | 13,036 | 2,330 | 81,550 | 6.3 |
| Singapore | 28,578 | 6,000 | 210,000 | 7.3 |
| Hong Kong | 27,670 | 6,427 | 224,945 | 8.1 |
| Bangkok | 6,317 | 1,667 | 58,345 | 9.2 |
| Seoul | 10,305 | 3,300 | 115,500 | 11.2 |
| Manila | 2,217 | 1,300 | 45,500 | 20.5 |
| Jakarta | 1,861 | 1,250 | 43,750 | 23.5 |
| Shanghai | 2,474 | 2,200 | 77,000 | 31.1 |

* The figures presented here are only indicative and is not meant to be authoritative.
¹ Data for 2005 from Gill and Kharas (2006)
² Data for 2005 from Global Property Guide, www.globalpropertyguide.com
³ Assuming a 35 sq m condominium unit in city center
⁴ Condominium price divided by income per capita

High house-price-to-income ratios indicate general level of excess demand in housing markets. These are typically associated with low owner-occupancy rates, crowding and low dwelling space per person. High house-price-to-income ratios are also correlated with high land prices and high construction costs. This is in part due to tight regulatory frameworks regarding land use and housing construction, combined with complicated and cumbersome regulations (UN Habitat, 2001).

Recent studies show that house-price-to-income ratios in several Chinese cities are above internationally accepted standards, particularly in Shanghai (Chen et. al., 2006) and Beijing (Lau and Li, 2004). Low housing affordability is also observed in urban areas in Indonesia (Hoek-Smit, 2005) and South Korea (Chung and Kim, 2004).

In the Philippines, low housing affordability is partly due to faster rate of increase of urban land prices compared to income. The rapid increase in land prices is due to several reasons; including poor planning and infrastructure developments, administrative bottlenecks, problems on property rights, and inefficient and inequitable land distribution (Ballesteros, 2002).

Another serious constraint on access to housing is high transaction costs associated with property purchases. With population growth and urbanization, the demand for housing in cities is increasing. However, supply is almost always finite in the short-run. This may lead to rapidly rising real estate prices (DiPasquale, 1999; Glaeser and Shapiro, 2003; Glaeser, and Kahn, 2003).

To address rising prices, some governments attempt to moderate housing demand by imposing price caps and increasing taxes associated with property transactions (Ball, 2002). Higher taxes on capital gains and sales and transfers of real estate, however, discourage sellers from engaging in property transactions. Government regulations and the strategic interactions among property developers also play a part in the housing supply equation (Lai and Wang, 1999; Wang and Zhou, 2006; Wang et. al., 2000).

A vicious circle may actually exist that perpetuates unaffordable housing systems. Government's attempt to push prices down by raising taxes lead to higher transaction costs; as costs increase, property prices end up rising further. Housing policies intended to promote welfare and development can also end up restricting supply further. Zoning and building restrictions intended to protect the environment, limit urban expansion or ensure safe housing can lead to disastrous consequences by limiting supply (Mayo, 1994; Glaeser, Gyourko and Saks, 2005).

Further, several governments impose higher taxes and fees on new properties. This is viewed as a progressive tax measure since it is assumed that richer people purchase brand-new properties. However, this can lead to adverse effects on housing availability and affordability. As richer households move to better and newer housing, households in the lower income hierarchy move to occupy the void they left, a process called the filtering effect. And because of the filtering effect, any policy that makes it difficult or expensive to produce any type of housing restricts the available stock of low-cost housing (Malpezzi and Green, 1996; Quigley and Raphael, 2004).

In South Korea, for instance, 'green belt' legislations introduced in the 1960s and 1970s focused on the arrangement of systems and institutions related to housing. These laws were intended to protect the environment, limit urban expansion, and ensure safe housing; but they froze land development leading to intense housing shortages (Son and Kim, 1998).

When house prices started rising rapidly in South Korea, this was addressed by a special law discouraging speculative activities. The government imposed price caps and heavy taxes on capital gains inducing owners to withhold their properties from the market. When housing shortages became more acute, the government intervened by producing housing directly, thus displacing private building (Koh, 2004).

Proliferation of regulations and excessive taxes cause the market to turn to the informal sector, exacerbating the problem. As the housing market becomes more informal and less transparent, real estate agents and lawyers may increase their fees, further increasing transaction costs.

Aside from the official costs associated with property purchases, corruption is a major factor in almost every transaction in developing countries in Asia. Insufficient protection of property rights distorts incentives and encourages the extraction of

resources through graft and corruption (Acemoglu, 2006; Acemoglu and Robinson, 2000, 2006; Leung, Tang and Groenewold, 2006).

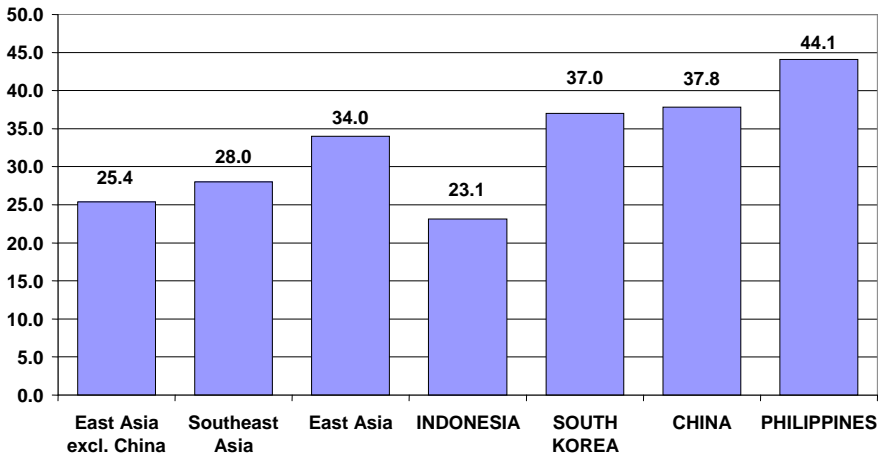
In China, for instance, bribes to government officials and bureaucrats for property transactions are considered standard business practice. These corruption costs are transferred directly to homebuyers (Zhang, 2006).

In the Philippines, the government imposes a 6% capital gains tax on “selling price or zonal value, whichever is higher.” To minimize this tax, most buyers bribe property tax assessors to lower the appraised value of the property. A survey in 2002 found that sales prices were 2.44 times higher than the assessors’ official appraised zonal value. Further, about 50% of the real estate market is informal, and therefore, is not recorded (LAMP, 2002).

Unaffordable housing and high transaction costs combined with weak protection of property rights are conducive to the creation of urban slums. Households turn to self-built houses and illegally occupy vacant lands to avoid high property prices (World Bank, 1993).

UN Habitat (2002) defines slum as “a contiguous settlement where the inhabitants are characterized as having inadequate housing and basic services.” About a third of East Asia’s urban population lives in slums, a ratio that is higher than other middle-income countries in Latin America and the Middle East (see Figure 1). In Southeast Asia, one out of every four urban residents lives in slums (UN Habitat, 2003).

There were about 250 million slum dwellers in South and South East Asia in 2001, 178 million in China alone. Countries with serious slum problems included Indonesia (with 21 million slum dwellers), Philippines (20 million) and South Korea (14 million) (UN Habitat, 2003). These are the same countries that have serious housing affordability conditions.

Figure 1. Slum (% of urban population, 2001)

Source: UN Habitat 2003

3. Housing Markets

Among the measures that can increase the efficiency of the real estate market are fixing property rights, promoting open and transparent real estate markets and lowering transaction costs. Well-functioning mortgage markets, low construction costs and removal of excessive land restrictions are also essential (Ball, 2002).

Asian housing markets differ widely due to the different levels of economic development and different economic systems adopted by each country. There are also differences in terms of housing tenure, level of protection of property rights and level of transparency and openness of real estate markets.

3.1 Housing Tenure

To address housing affordability issues and promote owner-occupancy, Asian governments chose different paths with varying levels of success. Most countries established specialized agencies, ministries, and other institutions focused on housing.

Hong Kong opted to provide huge public rental sector with subsidized home ownership schemes, mainly through the Hong Kong Housing Authority. Singapore, through the Housing Development Board (HDB), focused on public housing intended for owner-occupancy while maintaining a relatively small social rental housing sector. Taiwan provided loan interest and tax subsidies for buyers of publicly constructed housing units (Ronald, 2006).

With their success, Hong Kong was able to increase owner-occupancy from 28% in 1981 to 57% in 2004, while 31% of the population lives in public rental housing. Singapore managed to increase owner-occupancy from 29% in 1970 to 92% in 2005, while only 5% of the population lives in social rental housing. In Taiwan, owner-occupancy was around 86.8% in 2004 with a very small social rental market.

Table 3 Housing Tenure and Urbanization

| Country | Owner-occupancy Rate (%) | Rental Rate (%) | Others (%) | Year of Censuses | Urban Population (as % of Total) | | |
|-----------------------|--------------------------|-----------------|------------|------------------|----------------------------------|--------|--------|
| | | | | | 1995 | 2005 | 2015 |
| Indonesia | 95.9 | 4.1 | .. | 2001 | 35.6 | 48.1 | 58.5 |
| Singapore | 92.0 | 7.0 | 1.0 | 2005 | 100.00 | 100.00 | 100.00 |
| Taiwan | 86.8 | 8.1 | 5.1 | 2004 | 53.1 | 57.7 | .. |
| Malaysia | 85.0 | 12.8 | 2.2 | 1991 | 55.6 | 67.3 | 75.4 |
| Thailand | 82.1 | 10.1 | 7.8 | 1996 | 30.3 | 32.3 | 36.2 |
| Philippines | 71.1 | 10.1 | 18.8 | 2000 | 54.0 | 62.7 | 69.6 |
| Japan | 61.2 | 36.6 | 2.2 | 2003 | 64.6 | 65.8 | 68.2 |
| China (Urban*) | 59.0 | 38.7 | 2.4 | 2000 | 31.4 | 35.8 | 50.8 |
| Hong Kong | 57.0 | 43.0 | .. | 2004 | 100.00 | 100.00 | 100.00 |
| South Korea | 54.0 | 43.0 | 3.0 | 2000 | 78.2 | 80.8 | 83.1 |

* No national owner-occupancy figures due to different ownership structures in urban and rural areas.
Source: UN, National statistics

On the other hand, owner-occupancy in other countries in Asia ranged from 54% in South Korea to 96% in Indonesia (see Table 3). With the exception of Singapore, countries in Asia with higher urbanization rates generally have lower owner-occupancy rates, consistent with the findings of Fisher and Jaffe (2003). Rental housing is more popular in highly-urbanized countries such as Japan, Hong Kong and South Korea.

The achievements of Hong Kong and Singapore are highly exceptional and difficult to replicate. Grand scale projects generally have negligible impact on housing conditions, unless the projects improved regulatory environment (World Bank, 1993). The exceptional success of Hong Kong's housing policies market can be seen in the strong link between the construction industry and the over-all economy (Leung and Wong, 2004).

3.2 Protection of Property Rights

Secure property rights are seen to directly increase home and land values, increase households' access to credit, and promote investment in housing structure and home-based enterprises. Secure tenure can also lead to more effective property taxation and more efficient land use and planning control (Bell, 2004).

The lack of protection of rights in terms of rental contract enforcement also leads to imbalance detrimental to the development of the rental market. This puts undue pressure on home ownership typically leading to worse housing affordability conditions (Casas-Arce and Saiz, 2006).

Table 4 Corruption and Property Rights

| Country | Protection of Property Rights ¹ | Government Effectiveness ² | Regulatory Quality ² | Control of Corruption ² |
|--------------------|--|---------------------------------------|---------------------------------|------------------------------------|
| Hong Kong | 1.0 | 1.63 | 1.89 | 1.68 |
| Singapore | 1.0 | 2.14 | 1.79 | 2.24 |
| Taiwan | 2.0 | 0.40 | 0.38 | -0.24 |
| South Korea | 2.0 | 1.00 | 0.77 | 0.47 |
| Japan | 2.0 | 1.16 | 1.17 | 1.24 |
| Malaysia | 3.0 | 1.01 | 0.50 | 0.27 |
| Thailand | 3.0 | 1.11 | 1.07 | 0.63 |
| Philippines | 4.0 | -0.07 | -0.02 | -0.58 |
| China | 4.0 | -0.11 | -0.28 | -0.69 |
| Indonesia | 4.0 | -0.47 | -0.45 | -0.86 |

¹ Scores are from 1 to 5; a score of one indicates very high protection of property rights. Source: Index of Economic Freedom 2006

² Scores are from -2.5 to 2.5, with higher values corresponding to better governance outcomes. Source: World Governance Indicators 2005

Problems on property rights, such as fake titling, delays in agreements of right of ways, and land grabbing, further increases transaction costs (Ballesteros, 2002). Table 4 shows that most developing countries in Asia do not provide sufficient protection of property rights. Poor governance and weak control of corruption are also observed in China, Indonesia and the Philippine; countries that have serious housing affordability problems.

A clear manifestation of insufficient protection of property rights is the incomplete property titling in several Asian developing countries. For instance, in the Philippines, only 10 million of the estimated 25 million (40%) parcels were registered. Further, at the current rate of property titling in the Philippines, it is estimated that it will take 75 years before complete titling coverage is achieved. In Indonesia, only 23% of the estimated 84 million parcels of property were registered in 2003. Complete property titling can only be expected after 40 years (Bell, 2004).

In China, the influx of foreign investment in the real estate industry led to illegal land grabbing in rural areas. Farmers are often inadequately compensated when local officials sell land use rights to foreign developers. These sparked protests and uprisings in several rural areas. The Ministry of Land and Resources reported in 2006 that about 60 to 90% of land acquisitions since 2004 are illegal (Saich, 2006).

3.3 Openness and Transparency

Transparency of information is a foundation for an efficient real estate market. Countries with more open and transparent real estate markets generally have higher transaction volumes. Transparent real estate markets are also correlated with higher GDP per capita, less corruption and better business environment (JLL, 2006).

Table 5 shows that countries with worse affordability figures have lower transparency ratings, particularly, Indonesia and China. Among the countries under consideration, the Philippines has the most number of procedures involved in registering property, followed by Indonesia and South Korea.

Table 5 Real Estate Transparency

| Country | Transparency Index ¹ | | Registering Property ² | |
|--------------------|---------------------------------|---------|-----------------------------------|-------------|
| | Score | Level | Procedures (number) | Time (days) |
| Hong Kong | 1.30 | Highest | 5 | 83 |
| Singapore | 1.44 | Highest | 3 | 9 |
| Malaysia | 2.21 | High | 4 | 143 |
| Japan | 2.40 | High | 6 | 14 |
| Taiwan | 2.86 | Semi | 3 | 5 |
| South Korea | 2.88 | Semi | 7 | 11 |
| Philippines | 3.30 | Semi | 8 | 33 |
| Thailand | 3.40 | Semi | 2 | 2 |
| China | 3.50 | Low | 3 | 32 |
| Indonesia | 3.90 | Low | 7 | 42 |

¹ Scores are from 1 to 5; lower scores denote more transparent real estate markets.
Source: JLL 2006
² Source: Doing Business 2006

Publication of house price and rent indices can greatly enhance the transparency in the real estate industry. The information provides guidance to real estate players and policymakers. Hong Kong and Singapore provide the best information regarding the real estate market, as reflected in their transparency scores.

In countries with higher transparency ratings, foreigners can purchase real estate with minimal restrictions. The real estate markets of Japan, Hong Kong, Singapore and South Korea are general open to foreigners. On the other hand, foreigners face several ownership restrictions in Indonesia, Thailand and the Philippines as seen in Table 6.

Table 6 Restrictions on Foreign Ownership of Residential Real Estate

| Country | Land | Other real estate |
|---|--|---|
| China | Land ownership for locals and foreigners alike is limited to land use rights up to 75 years | One year residency Supervisory procedures for about a week. |
| Hong Kong | Land ownership for locals and foreigners alike is limited to renewable leases. | None except for Afghans, Albanians, Cubans, North Koreans and Chinese from the mainland (unless they are permanent residents in another country). |
| Indonesia | Foreigners are not allowed to own freehold land. | Right of Use (Hak Pakai) - 25 years (renewable up to a total of 100 years) Right of Building Lease (Hak Sewa Atas Bangunan) open to resident foreigners for unlimited period (not registered in land office) |
| Japan | None | None |
| Malaysia | Permanent Residents are allowed to purchase up to two residential properties subject to a minimum value of RM250,000 (US\$68,194) and the approval of Foreign Investment Committee, inclusive of: <ul style="list-style-type: none"> • two condominiums (max. 50% foreign ownership within a block); OR • one condominium and one of the following: 1.) Terrace or linked houses above two stories, but limited to 10% of all units built of this type; or 2.) Lands/bungalows and semi-detached houses, but limited to 10% of all units built of these type | |
| Philippines | Foreigners cannot own land. | Foreigners are allowed to own condominium units or apartments in high-rise buildings as long as the foreign component does not exceed 40%. |
| Singapore | Subject to the approval of the Singapore Land Authority. | Foreigners can buy apartments in buildings of less than six stories without prior government approval. |
| South Korea | None | None |
| Taiwan | Subject to the approval of the Ministry of Economic Affairs (MOEA); and conditional on the existence of a reciprocal arrangement allowing Taiwanese to invest in the home country of the individual. | |
| Thailand | Foreigners cannot own land. | Foreigners are allowed to own condominium units or apartments as long as the foreign component does not exceed 40%. |
| Source: Global Property Guide, each country's constitution and laws | | |

4. Transaction costs

The sale and purchase of property involve several costs: registration costs, real estate agent fees, legal fees, and sales and transfer taxes. High transaction costs are correlated with lower transaction volumes and less transparent deals. If transaction

costs are excessively high, the market may cease to exist altogether (see Allen, 1999 for a survey of related studies).

In real estate, lower transaction costs can stimulate market turnover and enhance the responsiveness of housing markets to macroeconomic stimuli. Rising demand is more likely to have a larger impact on house prices in countries with lower transaction costs (Zhu, 2003).

Further, in countries where costs are high, most individuals postpone their decision to purchase properties. Co-habitation and extended families are common, leading to congestion and overcrowding. In Europe, countries with higher transaction costs are observed to have lower market turnover and bigger household sizes (Earley, 2004).

4.1 Registration costs

Registration costs include registration fees, stamp duties, and notary fees. In most countries in Asia, registration costs are low. Except in Thailand, the buyer typically pays registration fees.

Table 7 Registration Fees*

| Country | Remarks |
|--------------------|---|
| China | Registration Fee: CNY100 for Individual Ownership in Shanghai Ownership Certificate: CNY5 per document; Transfer Fee: 0.5% Stamp Tax: 0.1% for Property Transfer Documents Stamp Tax for Ownership Certificate: CNY 5 per document Notarization fee: 0.01 – 0.30% |
| Hong Kong | Registration Fee: HKD100; Stamp Duty: 0.75% - 3.75% |
| Indonesia | Registration Fee: IDR25,000; Sale and Purchase of Land Deed: 1% Stamp Duty: IDR6,000 per document for notarial deeds and copy |
| Japan | Registry License Tax: 1% (subject to reducing measures of up to 0.10%) Stamp Duty: 0.02 – 0.15% |
| Malaysia | Registration Fee: MYR100; Stamp Duty: 1 – 3% Stamping Fee: MYR10 per document |
| Philippines | Registration Fee: PHP4,398 + PHP45 for every PHP20,000 in excess of PHP1,700,000; Documentary Stamp Tax: 1.5% Notarial Fees: PHP 200 per title or document |
| Singapore | Registration Fee: SGD70; Stamp Duty: 1 – 3% |
| South Korea | Registration Tax: 2% (plus Education Tax at 20% of Registration Tax) Stamp Duty: 0.01 – 0.20% |
| Taiwan | Registration Fee: 0.10%; Stamp Duty: 0.10% Notarization Fee: 0.01 - 0.10% |
| Thailand | Registration Tax: 2%; Stamp Duty: 0.5% |

*unless otherwise stated, percentages refer to proportion of property value
Source: Global Property Guide, Doing Business (2006)

4.2 Real Estate Agent's Fees

A real estate agent or broker acts as a middle man in a property purchase, matching buyers with sellers. They typically assist buyers throughout the registration process. Demand for brokers tends to increase as the process for property purchase and registration becomes more complex and cumbersome. Residential brokerage fees, on the other hand, decreases as the overall market becomes more efficient. Higher incidence of corruption is also generally correlated with higher brokerage fees (Delcours and Miller, 2002).

Table 8 Real Estate Agent's Commission*

| Country | Rate | Remarks | | | | | | |
|---|-------------------|---|----------------------------|------|---------------|-------|-----------|-------|
| China | 1 - 2% | Negotiable; Typically paid by the seller | | | | | | |
| Hong Kong | 1 - 2% | Negotiable; Typically 1% paid separately by buyer and seller, | | | | | | |
| Indonesia | 5% | Paid by either buyer or seller, but not both | | | | | | |
| Japan | 3.15% + JPY63,000 | Inclusive of local taxes, based on standard fee and paid by buyers | | | | | | |
| Malaysia | 2 – 2.75% | Regulated by the Board of Valuers, Appraisers and Estate Agents Malaysia (LLPEH) and paid by either buyer or seller subject to a maximum discount of 30% but a minimum fee of MYR1,000 per case <table style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Value of Property (in MYR)</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>First 500,000</td> <td>2.75%</td> </tr> <tr> <td>Remainder</td> <td>2.00%</td> </tr> </tbody> </table> | Value of Property (in MYR) | Rate | First 500,000 | 2.75% | Remainder | 2.00% |
| Value of Property (in MYR) | Rate | | | | | | | |
| First 500,000 | 2.75% | | | | | | | |
| Remainder | 2.00% | | | | | | | |
| Philippines | 5% | Typically paid by the seller | | | | | | |
| Singapore | 3% | Negotiable; The Institute of Estate Agents recommends the following: For Seller: Min. of 2% as sales commission For Buyer: 1% as finder's service fee | | | | | | |
| South Korea | 0.8 – 1.2% | Based on standard fee scale and paid separately by buyer and seller <ul style="list-style-type: none"> • less than KRW50 million 0.6% • KRW50 million to 200 million 0.5% • KRW200 million to 600 million 0.4% | | | | | | |
| Taiwan | 4 – 6% | Based on standard fee scale payable by either the seller or buyer, or both, and cannot exceed 6%. In practice, the buyer pays 1 to 2% while the seller pays 3 to 4%. | | | | | | |
| Thailand | 3 – 5% | Negotiable; Typically paid by the seller | | | | | | |
| *percentages refer to proportion of property value Source: Global Property Guide, Delcours and Miller 2002, LLPEH, IEA | | | | | | | | |

Because of the nature of their work, most agents' fees are negotiable. Even in countries with standard fee scales, agents are allowed to give discounts or to move within a range. Countries with less transparent markets and more registration procedures have higher estate agent fees, particularly Philippines and Indonesia.

4.3 Legal Fees

In most countries, property buyers are advised to avail of services of lawyers in the preparation of the sales contract. Lawyers are typically asked to ensure that there are no liens on the property. Most legal fees are negotiable or within a certain band recommended by the bar or the association of lawyers. If the registration process and the sales transaction are clear and simple, legal fees generally do not exceed 1% of property value.

Table 9 Legal Fees*

| Country | Remarks | | | | | | | | | | | | |
|---|---|----------------------------|------|---------------|------|--------------|------|----------------|------|----------------|------|----------------|------|
| China | Negotiable; 0.2 – 0.4% | | | | | | | | | | | | |
| Hong Kong | Negotiable; 0.5 – 2.0% | | | | | | | | | | | | |
| Indonesia | Negotiable; 0.5 – 1.5% | | | | | | | | | | | | |
| Japan | Negotiable; 0.1% - 0.3% Legal Scrivener (Shiho Shoshi) Fee | | | | | | | | | | | | |
| Malaysia | <p>Solicitor's fee is based on standard fee scale</p> <table border="1"> <thead> <tr> <th>Value of Property (in MYR)</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>First 150,000</td> <td>1.0%</td> </tr> <tr> <td>Next 850,000</td> <td>0.7%</td> </tr> <tr> <td>Next 2,000,000</td> <td>0.6%</td> </tr> <tr> <td>Next 2,000,000</td> <td>0.5%</td> </tr> <tr> <td>Next 2,000,000</td> <td>0.4%</td> </tr> </tbody> </table> <p>where the consideration or adjudicated value is in excess of MYR7,500,000, it is negotiable on the excess, but shall not exceed 0.4% of such excess</p> | Value of Property (in MYR) | Rate | First 150,000 | 1.0% | Next 850,000 | 0.7% | Next 2,000,000 | 0.6% | Next 2,000,000 | 0.5% | Next 2,000,000 | 0.4% |
| Value of Property (in MYR) | Rate | | | | | | | | | | | | |
| First 150,000 | 1.0% | | | | | | | | | | | | |
| Next 850,000 | 0.7% | | | | | | | | | | | | |
| Next 2,000,000 | 0.6% | | | | | | | | | | | | |
| Next 2,000,000 | 0.5% | | | | | | | | | | | | |
| Next 2,000,000 | 0.4% | | | | | | | | | | | | |
| Philippines | Negotiable; generally at PHP20,000 and up In some instances, legal fees can reach up to 10% of property value | | | | | | | | | | | | |
| Singapore | <p>Negotiable; The Council of Law Society has set fee guidelines for conveyancing transactions to meet the "fair and reasonable" criteria of the law:</p> <ul style="list-style-type: none"> • For Seller: 0.15% of sale price for transactions not exceeding SG\$2 million, subject to a min fee of SG\$900 • For Buyer: 0.3% of sale price for transactions not exceeding SG\$2 million, subject to a minimum fee of SG\$1,800 | | | | | | | | | | | | |
| South Korea | Negotiable: between KRW100,000 and KRW 250,000 per hour of work. On average, a lawyer will charge between 5 and 10 hours to prepare the sale agreement | | | | | | | | | | | | |
| Taiwan | Negotiable; about NT\$5,000 | | | | | | | | | | | | |
| Thailand | Negotiable, generally between THB 5,000 – 25,000 depending upon the difficulty of transaction. Services may include title verification, conveyancing and assistance for title registration | | | | | | | | | | | | |
| * percentages refer to proportion of property value Source: Global Property Guide, Doing Business 2006 | | | | | | | | | | | | | |

4.4 Sales and Transfer Taxes

Sales and transfer taxes are imposed by local and national governments on the sale and purchase of real estate. They include Deed Tax, Transfer Tax and Value-added Tax (VAT). In some countries, other taxes are imposed in lieu of VAT, such as Business Tax (in China) and Specific Business Tax (in Thailand).

Table 10 Sales and Transfer Taxes*

| Country | Remarks |
|---|--|
| China | Title Deed Tax: 3 – 5% (3% for Shanghai and Beijing) Business Tax: 5% City Maintenance and Construction Tax: 7% of the Business Tax for cities, 5% for counties and 1% for other areas |
| Hong Kong | None |
| Indonesia | Transfer Tax: 5% VAT: 10% Sales Tax on Luxury Goods: 20% |
| Japan | Real Property Acquisition Tax: 3% (subject to deductions of up to JPY12 million) |
| Malaysia | None |
| Philippines | Local Transfer Tax: 0.50 – 0.75% (0.50% in Manila and Makati) Capital Gains Tax: 6% VAT: 12% |
| Singapore | None |
| South Korea | Acquisition Tax: 2% Special Tax for Rural Development: 10% of Acquisition Tax VAT: 10% |
| Taiwan | Deed Tax: 6% |
| Thailand | Withholding Tax: 1% Specific Business Tax: 3% Municipal Tax: 10% of Specific Business Tax |
| * unless otherwise stated, percentages refer to a proportion of property value Source: Global Property Guide | |

Sales and transfer taxes are substantial and comprise the bulk of transaction costs in several high cost countries. For equity purposes, certain non-luxury units are given tax exemptions in China, Indonesia and the Philippines.

In Indonesia, low-cost housing, modest flats and student accommodations are exempt from 10% VAT. On the other hand, buyers of luxury houses have to pay the 20% Sales Tax on Luxury Goods, a one-time tax applied at manufacturing level. Luxury houses include

condominiums with a unit size of more than 150 sq. m. and landed houses with a building size of above 400 sq. m. or electricity capacity above 6,600 watt.

In the Philippines, sale of real property utilized for low-cost and socialized housing; residential lot valued at PhP1,500,000 and below; house and lot and other residential dwellings valued at PhP2,500,000 and below are exempted from 12% VAT.

In China, disposal of normal standard residential properties held for over five years is exempt from Business Tax. As part of the government's efforts to cool down the real estate market and discourage speculation, the seller must now pay 5% Business Tax if the property is held for less than five years (previously two years). If the property is held for more than five years, the business tax is levied like a capital gains tax, i.e., the 5% tax is imposed only on the increase in the property value, instead of the entire sales price.

4.5 Roundtrip Transaction Costs

Roundtrip transaction cost is the difference between what the buyer pays and the seller receives as compensation. It includes all the costs involved in the transfer of property from buyer to seller including registration fees, legal fees, real estate agent fees and sales and transfer taxes.

Roundtrip transaction costs are generally low in Hong Kong, Japan, Malaysia and Singapore. On the other hand, in China, South Korea, Taiwan and Thailand, costs can exceed 10% of property value. In the Philippines and Indonesia, total costs can reach up to 35% and 47%, respectively, due to additional sales and transfer taxes such as VAT and Sales Tax on Luxury Goods.

Table 11 Roundtrip Transaction Costs

(All values are presented as percent of property value)

| Country | Total | Buyer | Seller |
|-------------|---------------|---------------|--------------|
| Singapore | 4.45 - 6.45 | 2.30 - 4.30 | 2.15 |
| Malaysia | 3.40 - 6.75 | 1.40 - 4.00 | 2.00 - 2.75 |
| Hong Kong | 2.25 - 7.80 | 1.75 - 6.75 | 0.50 - 1.05 |
| Japan | 5.00 - 10.00 | 5.00 - 10.00 | 0.00 |
| Thailand | 10.00 - 12.30 | 0.20 - 0.50 | 9.80 - 11.80 |
| Taiwan | 10.20 - 12.30 | 7.20 - 8.30 | 3.00 - 4.00 |
| China | 4.86 - 13.65 | 3.81 - 11.60 | 1.05 - 2.05 |
| South Korea | 10.90 - 15.62 | 10.57 - 15.02 | 0.40 - 0.60 |
| Philippines | 13.20 - 35.75 | 0.73 - 23.25 | 12.50 |
| Indonesia | 13.00 - 47.50 | 10.00 - 42.50 | 3.00 - 5.00 |

Source: Author's calculation

Except for Thailand, and in certain cases in Malaysia and the Philippines, buyers generally shoulder the bulk of the cost. In an economic point of view, however, it does not matter who pays the taxes and fees. The actual payer of the cost depends upon the elasticity of demand and supply, or whether it is a sellers' market or a buyers' market. In a sellers' market, there are more buyers than sellers, giving the seller bargaining power to make the buyer pay all the costs. The costs that must be paid by the seller can be frontloaded to the selling price.

To analyze the transaction costs more clearly, a hypothetical case is adopted where a citizen of the country purchases a property that is worth ten times the country's gross national income per capita. To make the case as simple as possible, the property is paid in cash. The unit is a condominium located in a major city. Only official costs are considered. Property and capital gains taxes are not included although they are required to be paid before the property is registered.

Table 12 Roundtrip Transaction Costs - Worked example

(All values are presented as percent of property value)

| Country | Registration Costs | Legal Fees | Estate Agent's Fees | Sales & Transfer Taxes | Total Costs |
|--------------------|--------------------|------------|---------------------|------------------------|--------------|
| Hong Kong | 1.42 | 0.50 | 2.00 | 0.00 | 3.92 |
| Malaysia | 1.56 | 0.94 | 2.75 | 0.00 | 5.25 |
| Singapore | 1.82 | 0.45 | 3.00 | 0.00 | 5.27 |
| Japan | 0.04 | 0.10 | 3.30 | 2.16 | 5.59 |
| Taiwan | 0.30 | 0.10 | 4.00 | 6.00 | 10.41 |
| China | 0.31 | 0.30 | 2.00 | 8.16 | 10.77 |
| Thailand | 2.50 | 1.77 | 3.00 | 4.30 | 11.57 |
| Indonesia | 0.03 | 0.50 | 5.00 | 7.59 | 13.11 |
| South Korea | 1.29 | 0.31 | 1.00 | 12.02 | 14.62 |
| Philippines | 2.14 | 2.80 | 5.00 | 6.50 | 16.44 |

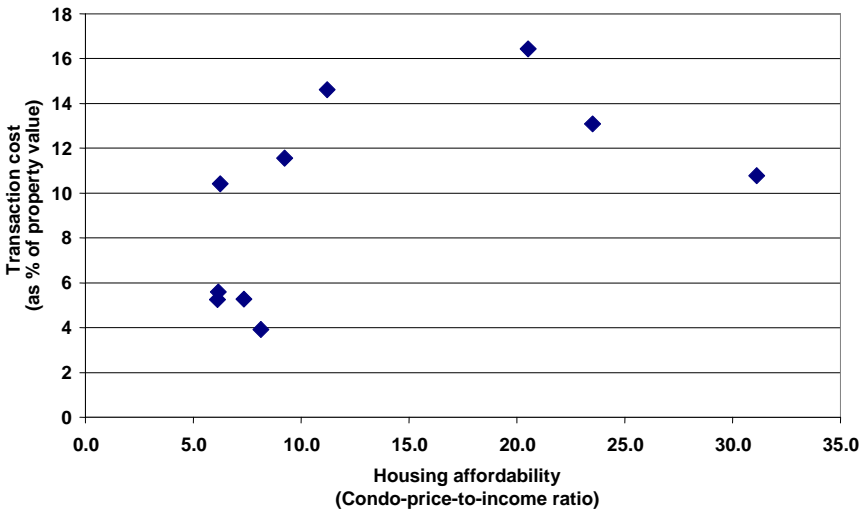
Source: Author's calculation

Table 12 confirms the general observations discussed. Using the assumptions above, roundtrip transaction costs in property exchanges are below six percent in Hong Kong, Japan, Malaysia and Singapore. On the other hand, total costs in Taiwan, Thailand, China, Indonesia, Philippines, and South Korea are above 10%. For these countries, bulk of the costs goes to sales and transfer taxes and real estate agent's fees.

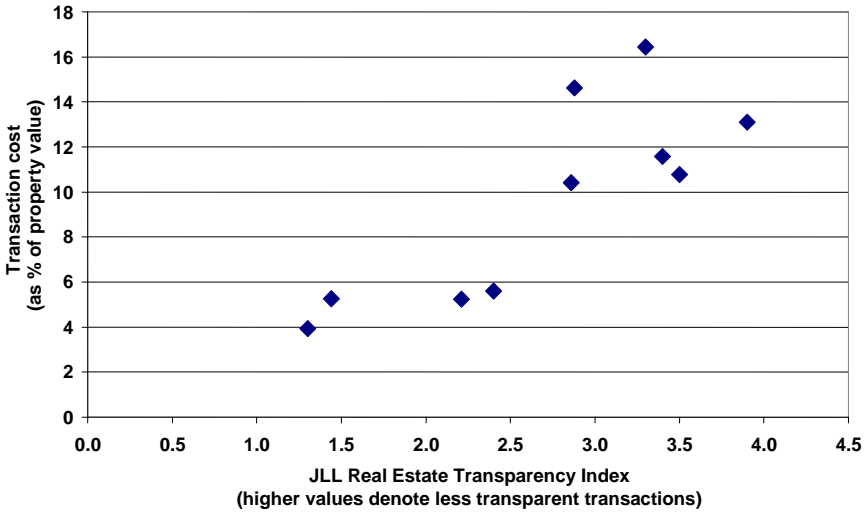
Asian cities with higher transactions generally have less affordable housing. The correlation between high transaction costs and high condo-price-to-income ratios is

seen in Figure 2. The imposition of taxes and fees on property transactions tends to discourage sellers and developers from participating in the market, leading to less affordable housing.

Figure 2. Transaction cost vs. Housing Affordability



Low transaction costs are also correlated with high real estate market transparency (Figure 3). Hong Kong, Malaysia and Singapore, countries with more transparent real estate markets have the lowest transaction costs. These countries do not impose additional taxes on sale and transfer of properties aside from registration fees. Removal of sales and transfer taxes would lead to a substantial reduction in transactions costs, up to 12 percentage points in the case of South Korea.

Figure 3. Transaction Cost vs. Transparency

5. Conclusion

Countries with the higher transaction costs are generally the ones with worse housing affordability conditions such as higher house-price-to-income ratios and large slum population. Governments of high transaction cost countries such as South Korea, Indonesia and the Philippines can reverse the vicious circle of unaffordable housing by cutting taxes imposed on property transactions.

Low transaction costs could induce property owners and developers to participate in the market more. As property transaction volume increases, real estate market transparency may improve. With increased transparency, fees charged by real estate professionals such as brokers and lawyers go down. This lowers transaction costs further.

Opening the real estate market to foreign investment could also increase transaction volume and transparency. However, this must be done with utmost care. Opening the real estate market without sufficient protection of property rights can lead to disastrous consequences. Due to increased demand from foreigners, unscrupulous people may find it irresistible to produce fake titles, depriving the real owners of their property. Property titling must be completed beforehand.

Simple measures such as making zonal valuations public through the internet can lead to significant improvements in promoting transparency and efficiency. The

internet must be utilized fully; the most basic measures shall be that government websites contain necessary information regarding the real estate market.

A one-stop shop for property purchase registration and tax payment may be established. Taxes even intended for the local government units could be collected by the national tax authority, to reduce the procedures involved in property registration. Excessive taxation of property transactions should be reduced.

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