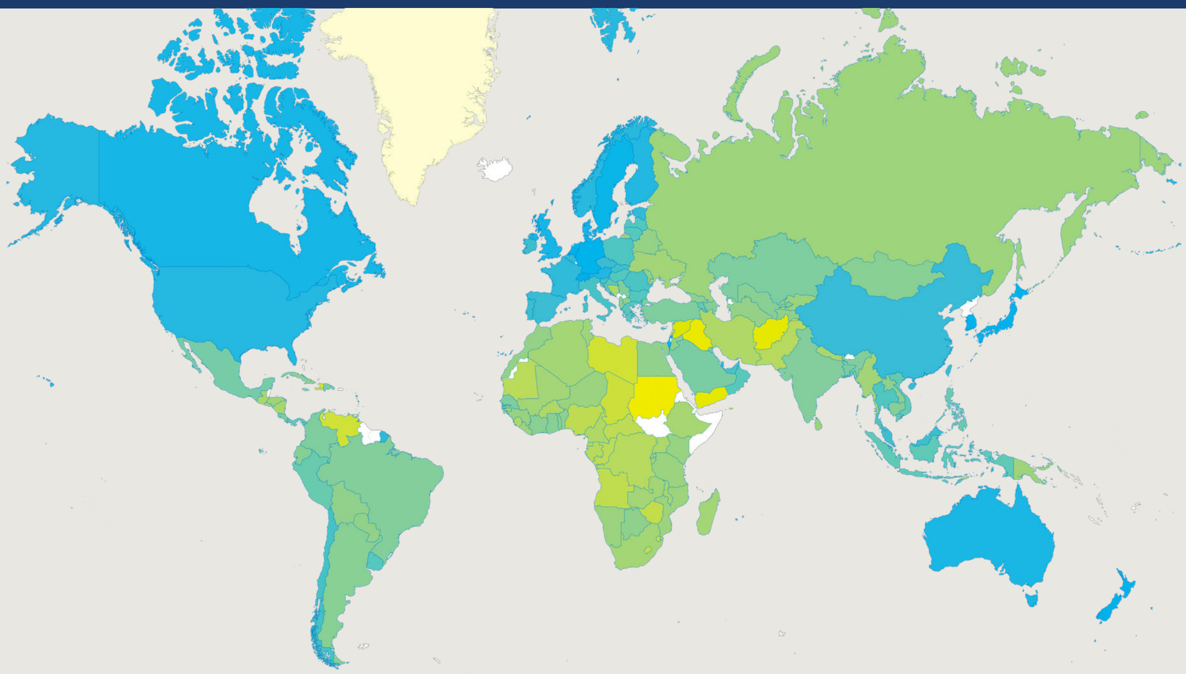
ELITE QUALITY INDEX
EQx2024

This is a contribution from the following book:

ELITE QUALITY REPORT 2024

Finetuning the Political Economy for Value Creation in the Real Estate Sector

The Housing Affordability Index (HAI) analysis was written by Dr. Marcus Schütz (Swiss Forecast) and the Construction supply gap (CSG) by Martin Langen (Swiss Forecast)



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Finetuning the Political Economy for Value Creation in the Real Estate Sector

Housing is essential for humans, and hence a source of Value Creation in the economy. Yet it is also possible for real estate to be extractive as is evidenced by shortages, rent inflation, or price bubbles. Given the importance and the income that the sector generates it is clearly an elite business model in most political economies. The EQx, in partnership with Swiss Forecast, has chosen two indicators to establish the Value Creation or extraction of the sector in the economy: the *Housing Affordability Index* (iv.10, HAI) and the *Construction supply gap* (iii.7, CSG), both of which are now discretely analyzed.

The *Housing Affordability Index* (HAI): Targeting Policies for Inclusiveness

Housing affordability indicates how much of an individual's available income is spent on residential costs. In this model, housing can be obtained both through renting and home ownership. While rental rates must be high enough to produce profitability for investors, home ownership is driven by low financing rates, reducing building and planning costs, and land supply. High ownership rates moderate high rental expenses on the demand side. They can be boosted by regulatory measures to reduce construction costs, provide preferred financing rates, curb bureaucracy, ensure sufficient land supply, offer low property taxes, and institute preferable inheritance laws. Low financing rates, however, can be a double-edged sword, as they may not only lead to an increase in new construction but also increase transaction volumes and, through that, raise inflationary tendencies in the available housing stock. Furthermore, the asset-based securitization of mortgages requires at least moderately rising housing prices to stabilize the financial viability of lenders. This poses high risks for financial stability and ownership affordability. For example, the 2008 US financial crisis triggered a drop in housing affordability, even in a housing market with declining prices, resulting in diminishing home ownership as a consequence of financial turmoil.

Generally speaking, countries and regions where property prices have been subject to speculative pressures see declining housing affordability because rental rates increase while home ownership falls. Such tendencies can be reduced by targeted taxes and regulations that reduce incentives to speculate on future price rises. However, utmost caution is required: government interference in rental prices under high-demand scenarios could potentially spark a cycle of low construction activity and subsequent undersupply.

The availability of infrastructure can mitigate geographical housing supply and demand imbalances by affecting commuting times and the desirability of certain regions.

The model used for the *Housing Affordability Index* (HAI) contains the ratio of household income in USD at purchasing power parity (ppp)—normalized on the average of the listed countries—in relation to the normalized rent per square meter moderated by the home ownership percentage rate.

In this year's HAI (iv.10), the top countries were Oman and Saudi Arabia (jointly ranked #1), followed by India (rank #3) and Norway (rank #4). Countries with considerable room for improvement include the Philippines (rank #81), Ghana (rank #80), and Kenya (rank #79).

Beyond these described policy measures, housing affordability and stable housing markets are driven by an optimal ratio of underlying housing demand and supply, which is quantified by the *Construction supply gap* (CSG). As can be seen, the positioning of this indicator is dependent on the basket of countries and regions ranked, though the factors determining a similar ranking can be the result of very different policies and economic factors.

EQx2024 Indicator Scorecard

Housing Affordability Index

Sub-Index (Level 2)	Value
Index Area (Level 2)	Economic Value
Pillar (Level 3)	Producer Value
Indicator ref. (Level 4)	iv.10_HAI
Indicator wgt. (in EQx)	0.6%
Indicator wgt. (in Pillar)	5.0%
Countries covered	81
Inclusion year	2024
Conceptual optimum	No
Data Source	Swiss Forecast (proprietary data)

Description

The Housing Affordability Index measures national average house prices against local incomes. A high value in the HAI indicates affordable residential housing prices compared to local incomes. A low value indicates unaffordable house prices compared to local incomes.

Rationale

To be able to afford a house is relevant in relation to the development of children, life satisfaction, and in addressing wealth inequalities. A widening gap between house prices and local incomes represents Value Extraction, as a reduction of affordability raises inequalities, and contributes to the segregation of social classes. House price growth that outpaces income growth translates into the elite business model of capital gains. Eventually, the decoupling of prices from incomes points to unsustainable development and is a predictor of financial (and social) fragility. Affordable housing is Value Creation.

Rank /81	Country	Score
1	**Oman**	**100.0**
1	**Saudi Arabia**	**100.0**
3	**India**	**93.6**
4	**Norway**	**93.3**
5	**Korea, Rep.**	**86.0**
6	**Finland**	**84.6**
7	**Belgium**	**82.7**
8	**Latvia**	**77.8**
9	**Croatia**	**76.0**
10	**Bangladesh**	**74.6**
11	Estonia	74.3
11	Sweden	74.3
13	Netherlands	73.1
14	Romania	72.2
15	Spain	70.1
16	Bulgaria	69.9
17	Japan	69.7
18	France	69.1
19	South Africa	69.0
20	Hungary	67.3
21	Denmark	67.0
22	North Macedonia	66.7
23	United States	64.8
24	Malaysia	64.4
25	Slovak Republic	63.6
26	Italy	62.9
27	Czech Republic	61.9
28	Lithuania	61.6
29	United Kingdom	60.0
30	New Zealand	59.2
31	China	58.9
32	Slovenia	57.4
33	Canada	57.1
34	Poland	55.7
35	Germany	55.2
36	Australia	54.9
37	Austria	54.7
38	Israel	54.0
39	Moldova	53.0
40	Russian Federation	52.6
41	Greece	50.2
42	Switzerland	49.3
43	Nepal	47.2
44	Ireland	46.4
45	Algeria	46.1
46	Singapore	45.6
47	Jordan	45.0
48	Albania	44.6
49	Tunisia	44.1
50	Pakistan	42.8
51	Iraq	41.5
52	Argentina	38.9
53	Serbia	37.7
54	Vietnam	36.7
55	Portugal	36.6
56	Cyprus	35.3
57	Azerbaijan	35.2
58	Brazil	35.0
59	Mexico	33.9
60	Ukraine	33.5
61	Morocco	32.3
62	Kazakhstan	31.3
63	Bolivia	30.8
64	United Arab Emirates	26.8
65	Peru	26.4
65	Indonesia	26.4
67	Egypt, Arab Rep.	24.9
68	Nigeria	24.7
69	Thailand	23.1
70	Turkey	22.6
71	Mongolia	20.4
72	Uzbekistan	20.2
73	Armenia	19.9
74	Honduras	18.6
75	Guatemala	15.6
76	Georgia	13.1
77	Iran, Islamic Rep.	12.7
78	Ethiopia	9.0
79	Kenya	8.2
80	Ghana	4.6
81	Philippines	3.6

The Elite Quality Report 2024 (EQx2024) provides Country Scores and Global Rankings for 151 countries

The *Construction Supply Gap* (CSG): When Real Estate Markets are Healthy

Real estate encompasses a significant sector of industrial activity, playing a pivotal role in societal development across its comprehensive value chain and in determining housing affordability. A meticulously managed real estate market contributes substantially to a nation's economic prosperity and the welfare of its citizens. Nonetheless, instances of Value Extraction are evident in scenarios where the equilibrium between supply and demand diverges due to a variety of potential factors.

The supply and demand dynamics within the real estate sector and the construction industry are interconnected, albeit with a time lag. An upsurge in demand for residential properties is indicative of heightened rental and purchasing costs that, in turn, ought to catalyze an increase in construction activities. However, given the substantial nature of real estate as an asset class and the characteristically prolonged duration of its delivery, a transient discrepancy, referred to as the *Construction supply gap* (CSG) typically emerges. During periods of supply deficit, investors are inclined to capitalize on the prospects of elevated project yields, guided by a homogeneity in investment decisions. This can eventually precipitate a scenario of oversupply, culminating in a reduction in property prices. In severe instances, this phenomenon manifests as 'real estate bubbles', the bursting of which transcends the confines of the real estate sector, significantly undermining the stability of the financial system.

The CSG serves as way to gauge the vitality of a nation's real estate sector. Empirical research underscores that a marginal undersupply not only facilitates housing affordability but also enhances the sector's profitability, thereby invigorating investment. Conversely, significant supply discrepancies or oligopolistic frameworks are deemed to be extractive, analogous to the conditions of oversupply, where investment is diverted to alternative sectors, leading to a contraction in construction output.

From the perspective of demand, the CSG is instrumental in assessing the requisite increment in household numbers, domestic migration patterns, and alterations in household dimensions. Supply-side considerations encompass the net valuation of new constructions and demolitions, the inventory of second homes, and the provision of tourist-oriented real estate. The influence of second homes on the market varies by country, with notable prominence in nations such as France. Although these properties contribute to construction output, they do not augment the housing supply for additional households.

The CSG is calibrated to a baseline of 100, signifying the complete satisfaction of residential real estate demand. It is posited that achieving a perfect equilibrium between supply and demand at a CSG level of 100 is suboptimal; a slight undersupply is advocated to stabilize market dynamics, preserve real estate values, and foster further investment, thereby safeguarding the financial sector against the ramifications of non-performing loans.

An oversupply, indicated by a CSG exceeding 100, can inflict severe repercussions on property owners, the financial sector, and investment availability. Historical precedents of such adverse outcomes have been observed in Spain, the United States, and Ireland.

In this year's CSG ranking, the top performers were Turkey and Ireland (jointly ranked #1), followed by Belgium (rank #3) and Sweden (rank #4). Countries with room for improvement include Serbia, Lithuania, and South Korea (all ranked #47). China, given its considerable oversupply and current real estate crisis, stands at rank #45.

Given the integral role that construction plays in financial institutions, and its potential to ensure affordable housing for the populace, the CSG is a critical indicator. Its inclusion in the EQx2024 provides a valuable reference for evaluating the Value Creation or extraction that the sector is responsible for in a national economy and the impact this has on living standards.

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EQx2024 Indicator Scorecard

Construction supply gap

Sub-Index (Level 2)	Value
Index Area (Level 2)	Political Value
Pillar (Level 3)	Giving Income
Indicator ref. (Level 4)	iii.7_CSG
Indicator wgt. (in EQx)	0.3%
Indicator wgt. (in Pillar)	4.1%
Countries covered	49
Inclusion year	2024
Conceptual optimum	Yes
Data Source	Swiss Forecast (proprietary Indicator)

Description

The Construction supply gap Indicator measures the health of a national real estate sector by comparing demand for dwellings in relation to available dwellings. This Indicator therefore measures supply as a percentage of demand. A positive value indicates an oversupply of housing while a negative value indicates an undersupply.

Rationale

Housing is an important public good and its adequate supply affects a nation's economic growth. It plays a key role in wealth creation and preservation and is an important factor in financial crises. The construction industry is a major employer and contributor to GDP. It is crucial to stabilize house prices as on the one hand undersupply leads to price appreciation, reduced affordability, inequality, speculation, and the formation of price bubbles, as well as impaired economic growth. On the other hand, housing oversupply leads to the misallocation of resources, falling prices, and a drop in investment levels, causing a downturn in construction output. When housing supply is in line with demand, it promotes the sustainable development of real estate value, encourages further investment, and ensures affordability. Due to the time lags associated with construction, a slight undersupply of housing in relation to demand is the optimal scenario.

Rank /49	Country	Score
1	**Ireland**	**68.9**
1	**Turkey**	**68.9**
3	**Belgium**	**68.7**
4	**Sweden**	**68.5**
5	**Chile**	**68.4**
6	**Norway**	**68.2**
7	**Iran, Islamic Rep.**	**67.9**
7	**Switzerland**	**67.9**
9	**Latvia**	**67.3**
10	**Greece**	**66.9**
10	United Kingdom	66.9
12	Austria	66.6
13	Slovak Republic	65.5
13	Romania	65.5
15	Germany	65.2
16	United States	63.9
17	Netherlands	63.3
18	Cyprus	62.1
19	Japan	61.8
20	France	61.6
21	Hungary	61.4
22	Czech Republic	60.8
23	Spain	59.8
23	Colombia	59.8
25	Poland	57.0
26	Australia	55.7
27	Portugal	55.4
28	Russian Federation	53.6
29	Ukraine	52.9
30	Kazakhstan	50.8
31	Italy	48.4
32	Bosnia and Herzegovina	48.3
33	Albania	47.2
34	Slovenia	46.9
35	Denmark	46.7
36	Philippines	45.0
37	Canada	44.4
38	South Africa	44.0
39	Qatar	43.8
40	North Macedonia	41.9
41	Israel	41.2
42	Estonia	41.0
43	Croatia	40.1
44	Finland	31.9
45	China	23.4
46	Bulgaria	18.0
47	Korea, Rep.	0.0
47	Lithuania	0.0
47	Serbia	0.0

Rank /49	Country	Score

Rank /49	Country	Score

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