

TRANSACTION COST AND LANDOWNERSHIP CONSTRAINTS IN THE SUPPLY OF BROWN FIELD SITES IN KUALA LUMPUR

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ABSTRACT

The study deals with landownership constraints that restrict the supply of brown field sites onto the market for redevelopment purposes. The constraints may disturb the effectiveness of the land market. As a result, the underutilized area may become derelict and needs regeneration in the form of urban renewal programs. Empirically, the study investigates sources of landownership constraints in the area of brown field sites in Kuala Lumpur. Data were gathered using interview with selected landowners of undeveloped and developed sites to examine why they had developed or simply abandoned their lands undeveloped. Qualitative analysis was undertaken to collect data from respondents using either direct and/or indirect quotations. The main finding is that landowners were unwilling to undertake redevelopment due to landownership constraints as revealed by transaction costs involved in the initiatives to transfer the indigenous lands. The findings enable various interested parties to strategize their actions in the future to redevelop brown field sites in Kuala Lumpur.

Keywords: transaction cost, landownership constraint, brown field sites, Kuala Lumpur

INTRODUCTION

There are two elements that drive the manner in which actors make decisions, externally and internally (Djurdjani, 2008). The former are determined by the institutional environment surrounding the actors, whilst the latter is more related to the actors themselves which is influenced by cost and benefit considerations (Eggertsson,

1995). According to North (1996), institutions or 'rules of the game' provide incentives and restrictions which affect human decisions. As part of institutions that govern human decisions and actions, transaction costs which are associated with the internal element affect human decisions too.

The way institutions affect transaction costs would subsequently influence landowners' decisions to participate in the supply of land for development. In this context, there are three circumstances of possible sources of transaction cost known as institutions or 'the rules of the game', the existing property and contract rights and the transfer of existing property rights (Furubotn and Richter in Benham and Benham, 2001). In addition, there are another three characteristics of transactions; namely uncertainty, frequency and asset specificity which characterize the presence of transaction costs (Williamson in Petersen, 1995). In relation to land rights, there are two types of land rights that are attached on land which are fixed or legal rights and variable economic rights (Lai, 2001). In term of cost, the former usually is in the form of fixed cost and the latter varies depending on the presence of land attributes.

There are therefore, various factors causing landownership constraints on the transfer of land rights affecting landowner behavior towards the supply of land for development. Among others are passive landowners (Adams, 1994) and multiple ownership of urban land (Adams *et al.*, 2000). In this context, landownership constraint is a complex phenomenon whereby the flow of land onto the market is restricted and hence, limits agents' interactions in the market. As a result, the price of land tends to increase due to higher demand compared to the restricted land available in the market.

The transfer of lands is one of the initial steps in the land development activities (Cadman and Topping, 1995). Transfer of lands does not mean to transfer the land in its physical form, but rather the rights therein (Alchian & Demsetz, 1973). During the exchange process, North (1996) says that measuring the valuable attributes of what is being exchanged, protecting rights, policing and enforcing agreements are among those activities that may produce transaction costs. According to North (1996), institutions reduce uncertainty and so the costs. Cost does not necessarily be in the form of financial terms, but rather in the form of time, opportunity and effort (Buitelaar, 2004). Here, there are transaction costs that include the costs of resource utilization for the creation, maintenance, use and change of institutional rules (Furubotn and Richter in Benham and Benham, 2001).

This study is aimed at understanding the landownership constraints of brown field sites of indigenous lands in Kampong Baru, Kuala Lumpur. The study uses transaction cost within an institutional economics analysis to explain the way in which landownership influences the decision of landowners in defining, maintaining, utilizing and transferring the rights for exchange in the market (Benham and Lee Benham, 1998).

LANDOWNERSHIP CONSTRAINTS

There are various factors forming landownership constraints that influence the supply of brown field sites for redevelopment. First, the social factor that influences landowners' decisions to make the brown field sites available in the market for development. Passive landowners are those who take no particular steps to transfer the sites, even though there is high demand for such lands in the market. In fact, there are landowners who are willing to participate but only on restricted terms and conditions, such as the willingness of the potential buyers to buy at a higher price. Although, they are willing to buy at a higher price than the open market value, it happens that the offer is not high enough to the sellers. As a result, the transaction of such land is aborted and not happening in the market. In addition, there are landowners who are expecting higher prices in the near future; the landowners are still looking forward to keeping the lands for speculation or for land hoarding purposes (Adams, 1994). Moreover, the multiple ownership of the urban land is most likely to perform as a constraint which may distort the smooth flow of land supply onto the market for redevelopment purposes (Adams *et al.*, 2000).

In the inner urban areas, the land supply constraints generally come from the combination of four factors; namely critical physical, ownership, planning and valuation constraints (Adams, 1994). Physical difficulties are commonly associated with derelict or contaminated areas with bare infrastructure facilities. The landownership constraint comes from the landowners who are reluctant to respond uniformly to market mechanisms, who are keeping the lands because they are looking for a better price in the future or who are keeping the lands due to sentimental value towards the lands. In Kenya, land owners are still reluctant to sell their lands because of several considerations. Among others are (1) land is perceived as a crucial asset for the present and/or future subsistence of the family (2) it is a secure form of holding wealth and a good hedge against inflation (Green, 1987). For the low income households, the willingness to put the lands in the market area is also affected by the degree of uncertainty of their future after they release the lands (Howe in Adams, 1994). The valuation constraints emerge because of the land value disputes. In this case, the landowner and buyer/developer have different estimation prices of the land. Commonly, the landowner's price is higher than the proposed land developer/buyer's price. Sometimes these market constraints are closely related to the landownership difficulties which influence the behavior of landowners. The planning constraints exist whenever the local authorities provide not-comprehensive planning, so that it creates uncertainty for the developers and landowners.

With regards to indigenous land, restriction in interests that disallows the transfer of land is aimed at protecting it from being eliminated and hence, pushed up the cost of changing the ownership. As a result, this has reduced the profitability of any potential investment value attached to the land. In the end, the restrictions are causing the

market to get smaller, lower in value and limited in its usefulness for the purpose of collateral. The difficulty of locating owners and the cost of establishing trusts strictly affected the ability of owners to develop land and subsequently hindering economic development and finally produce land supply constraint (Guerin, 2003).

The inability to sell off the land contributed gradually to the fragmentation of land tenure among the successors such as what happened to Native American land tenure (Anderson and Lueck in Guerin, 2003). In addition, multiple ownership increases the cost of obtaining common agreement among the landowners, and this reduces the willingness of individual owners to put effort into development indecisively. This means that the valuable land with indecisive multiple ownerships may discourage potential uses to put the land up to highest and best uses (Guerin, 2003).

Consequently, landownership constraints provide direct impacts on the land and property market in terms of increasing land price which subsequently push the price of developable lands higher in the market. On the one hand, landownership constraints create extra burden in the form of higher costs and put limits to the supply onto the market and finally prevent the maximization of economic value of the lands (Ismail *et al*, 2009; Priyono, 2008). On the other hand, landownership constraints may cause underutilization and to a certain extent may produce deterioration of surrounding properties, leading to an overall decline in the property values nearby (Ambrose, 2005).

RESEARCH METHODOLOGY

The empirical framework was designed to assess the applicability of transaction cost analysis. The questionnaires were distributed to the landowners in the study area. The purposive sampling technique is used to select the respondents based on the current condition of the sites such as the developed-undeveloped lots and lots which have been transferred.

The study area is located in Kampong Baru adjacent to the Central Business District of Kuala Lumpur which is the biggest area of indigenous lands in Kuala Lumpur. The total area of study is 101.02 hectares (excluding two kampongs in the whole Kampong Baru area of 112.38 hectares) which under Section 6, 1897 Land Enactment was established as Malay Agricultural Settlement (MAS) with the main purpose of alienating land to landless Malays in Kuala Lumpur. Kampong Baru is selected as the study area as the city is fast growing in terms of social, political and economic development. The current condition of Kampong Baru provides an interesting case due to the fact that indigenous lands in Kampong Baru are with restrictions in interest, slow land market, slow development activities, and located in central Kuala Lumpur area as shown in Appendix A.

The total number of lots in the study is 957 lots. A group of 50 undeveloped, developed and traded lots were selected for investigation. Out of 50 lots, 47 are occupied by individual landowners, the rests are occupied by corporate land owners. About 88 percent of dwellings in Kampong Baru (out of the 56 percent of lands in this area are categorized under residential land uses) are considered under-utilized and 11 percent is vacant or unimproved residential land.

EMPIRICAL FINDINGS AND DISCUSSION

Landowners and the brown field sites were taken randomly for investigation. The common respondents' background is dominated by old people and less to undertake development (more than 67 per cent), medium education and less professionalism (87 percent) and low household income families and, hence less financial affordability (85.8 percent have income less than RM 2,000 per month). Whilst, for the site characteristics, most of them were inherited, which means that high sentimental values to further bequeath, owned by more than one owner which means multiple landownership (81 percent), owner occupied and less speculative (95.2 percent) and using the site for own use other than occupation such as trading and renting (88.1 percent).

Transaction costs affecting land supply

Whenever actors perform land transactions, a fixed cost should be spent as a consequence of transferring fixed and legal rights in the form of legal fees and legal taxes. In land dealings, the market has internalized the externality so that the transaction cost is already attenuated (Guerin, 2003). However, the landowners asserted that the restrictions in interest and the nature of multiple landownership are the two institutional factors that seem to be responsible for the creation of transaction costs in land dealings. The costs are in the form of opportunity, decision making, effort and time taken and actual transaction in the market. Table 1 summarizes the activities that produce transaction costs in the land dealings.

Table 1: Activities and type of costs that affect landowners to release the land

Institutions	Activities that produce transaction cost	Type of cost (lot number)
Restriction in interests	Decision to release land	Lose opportunity to have dignity and amenities
Multiple ownership	To bring into market and development	Effort and time to get agreement among owners
	To make transaction	Lose opportunity to get buyer and better value (78 per cent of landowners)

Transaction costs and the process of land transfer

During the period 1996-2006, only certain buyers were actively participating in the slow indigenous land market. It was recorded that among 43 transactions, only 26 buyers were actively participating in the land transactions. Three corporate owners who have bought more than one lot during 1996-2006 are Naza Properties, and Rah Properties who had bought 2 contiguous lots respectively, and two individual owners who had bought more than one lot. The landowner has to approach active buyers such as Rah Properties and Naza Properties either to buy or to jointly develop their lands (Onn, 2006; Hamisah, 2005). This means that with a limited market, the sellers have to bring about the land to the market and hence, they have to spend extra cost in terms of effort to get the best buyers.

Conversely, those few buyers who have been actively participated in the land market have knowledge about the potential buyers. This is due to the fact that the restriction in interests may influence the land transaction, since it would only be possible among the Malays. The willing seller – willing buyer relationship has always been recognized during an ‘arm’s length transaction’. This means that both buyer and seller are acting sincerely without undue duress and know exactly the consequences of dealing with landownership constraints (Onn, 2006).

There are reasons for landowners refusing to part from their lands. They refused to sell off the lands due to the fact that this is the only Malay area in the heart of Kuala Lumpur. In the long run, the identity of the Malays in the urban area will be no longer available. In a way, this means that the transfer will incur high social costs to the landowners in the long run. This is not only a matter of economic reason, but also a political reason which is synonymous to the survival of the Malays in the urban areas (Nik A Majid, 1993). Table 2 summarizes the institutions, the activities that produce transaction cost and the type of cost that may incur in any transaction of the land in the area.

Table 2: Institutions, activities and type of cost which affects land transaction

Institutions	Activities that produce transaction cost	Type of cost (Lot number)
Restrictions in interests	To obtain buyers	Opportunity to get the best buyers (asset specificity)
	To change institution	Opportunity to have dignity (60 per cent of landowners) Political cost (for government)

Transaction costs and the external factors

Most of landowners agreed with the argument that the government is responsible for land redevelopment. In fact, the role of the government in developing the area is

dominant especially during the 1990s where land acquisition had been proposed but failed due to landownership constraints (Ismail, 1999; Suleiman, 2000). As a result, the landowners believe that the future of Kampong Baru is also in the hands of the government. This perception hinders landowners' intentions to develop their land. In institutional terms, this phenomenon is known as bounded rationality (North, 1996) in which the actors' decisions are based on the information and knowledge acquired.

There are cases whereby some landowners have been cheated by errant land developers during development initiatives in the 1980s and 1990s. They have been persuaded to secure a bank loan for development by certain land developers with the promise of being partnership and joint venture development schemes. Unfortunately, the proposed land development schemes failed to materialize, but their documents of title were listed with encumbrances. With the bad experience in their minds, most of them would prefer to stay away from development and at the same time, given priority to own occupation, renting out or speculating the appreciation in the value of the lands (Ismail, 1999). These create social costs to the landownership that constrain the landowners' decisions once they refuse to undertake redevelopment of their lands due to risks expected out of undertakings. Uncertainty about the future is another factor that produces transaction costs and subsequently affects landowners' decisions (North, 1996).

In preparing the planning proposal, the physical attributes of the land become the main factor concerning infrastructure and land size. Average size of the site was less than 808.3 square meters (Ismail, 1999). To arrive at an economic size of the land for development, amalgamation of more than one contiguous small lot has to be done and the planning requirements must be fulfilled by landowners. In this context, multiple landowners need to come together and agree with the terms and conditions (Ismail *et al.*, 2008; Djurdjani, 2008; Priyono N D, 2008).

As Syamsul (2006) mentioned:

"It isn't enough to just make a plan. You have to do extra work to materialize the plan".

A corporate owner, who bought a number of lots in Kampong Baru scattered at several sites mentioned about the additional cost that he has to pay:

"Holding cost. Due to nature of land-small and narrow, you have to buy a few lots around before the land can be properly developed. You must wait for surrounding owners to sell"

Besides physical and planning attributes, landownership constraints have also been influenced by the marketability of the developable sites. The completed product of the land development can only be occupied or purchased by particular Malay buyers.

Therefore, the affordability of those certain buyers may influence the future investment value since the future market would be limited to the Malays only. One of them mentioned:

“If too high a value (of the land), development cost is high. Selling price (will be) higher than middle income Malays cannot afford to buy. This defeats the original intention – to allow the Malays retaining their ownership of Kampong Baru”

Table 3 shows external factors and costs affecting the decisions to develop the sites.

Table 3: Institutions, activities, type of cost in the planning of development

Institutions/ Land attributes	Activities that may produce transaction cost	Type of cost (Lot number or case)
Ownership	Prepare planning proposal	Time and effort to get consensus Uncertainty (grant not in hand)
Physical attribute	Prepare planning proposal	Time and effort to get economic land size Time and effort to amalgamate lands
Planning regulation	Prepare planning proposal	Opportunities to maximize the use of the whole surface of land.

Transaction cost and landowners’ attitude

As shown in Table 3, combinations of 4 attitudes and the current condition of the lands provide 6 possible decisions that landowners have chosen for action. In the table, there are 8 landowners who have 2 basic intentions; namely intention to sell and intention to develop. In a way, these are the strategies held by landowners of less developed sites. Conversely, many landowners of developed sites are taking the initiatives in a positive way with the main reason to grasp the opportunity of capital appreciation and good rental income which are available in the market.

Due to no intention to release their lands, they also refused to take up any investment thereon. Most of the landowners either refused to sell or were reluctant to undertake the development themselves. This resulted in the brown field sites remaining underutilized elsewhere in the area. The reasons for these passive behaviors were inherited land and would like to further bequeath, financial less affordability, less urgent to go for redevelopment and to preserve the Malay identity in the urban areas. Table 4 illustrates these 6 decisions in a table form.

Table 4: Landowners' attitude and the current condition of the land

No	Attitudes	Final/current condition	Lots
1	Not intend to sell Not intend to develop	undeveloped	10 lots
2	Intend to sell (Has not been sold) Not intend to develop	undeveloped	3 lots
3	Intend to sell (Has not been sold) Intend to develop	undeveloped	8 lots
4	Not intend to sell Intend to develop (Has not proposed proposal)	undeveloped	20 lots
5	Not intend to sell Intend to develop (Has obtained approval and/or have developed)	developed	8 lots
6	Intend to sell (Has been sold)	Sold	1 lot

In relation to the transaction costs, there are various type of transaction costs that emerge during the process to supply the lands for development purposes such as opportunity costs (to enjoy dignity, to enjoy amenity, to obtain good buyer, to achieve better land value, to maximize the use of the land), time (to have consensus among landowners, to achieve acceptable amount of compensation, to amalgamate lands, to achieve economic land size), effort (to have consensus among landowners, to achieve acceptable amount of compensation, to amalgamate lands, to achieve economic land size). For the government, the most related cost is political cost; particularly when the government changes the current status of MAS area. Table 4 shows that there is a relationship between landowners' decisions, the landowners' attitudes, the type of transaction cost and the sources of cost that affect landowners' decisions.

Table 5: The relation of decision, landowners' attitude, sources of costs, type of cost and land owners

Decision	Landowners' attitude	Sources of costs	Type of cost	Land owners
1	Not intend to sell Not intend to develop	Restriction in interest Multiple ownership Bounded rationality	Opportunity cost Effort Time	10 sites
2	Intend to sell (Has not been sold) Not intend to develop	Multiple ownership Physical characteristic Bounded rationality	Effort Time	3 sites
3	Intend to sell (Has not been sold) Intend to develop	Restriction in interest Multiple ownership	Opportunity cost Effort Time	8 sites
4	Not intend to sell Intend to develop (Has not proposed proposal)	Restriction in interests Multiple ownership Physical characteristics Uncertainty Asset specificity Bounded rationality Planning regulation	Opportunity cost Effort Time	27 sites
5	Not intend to sell Intend to develop (Has obtained approval and/or have developed)	Restriction in interests	Opportunity cost	8 sites
6	Intend to sell (Has been sold)			1 site

Table 5 recognizes that in the supply of lands for development, there are 4 transactions; namely the purpose to achieve intention to sell, achieving intention to develop, transferring the rights and obtaining approval for development. By adding the actors involved, the activities in the transaction as well as the manner in which landowners may supply land for development, the transaction costs approach in the supply of land is shown in Table 6.

Table 6: Transaction costs in the supply of land for redevelopment

Stage	Seller	Buyer	Activity	Transaction
A. Supply land through land transfer				
(1)Intention maturation	Individual owner	Owners as a unity	To have consensus of interest	Initiation
(2) Land transfer	Previous landowner	New landowner	To make a contract; negotiation	Transfer ownership
B. Supply land through planning proposal				
(1)Intention maturation	Individual owner	Owners as a unity	To have consensus of interest	Initiation
(2) Planning approval	Landowner/ developer	Local authority	To make planning proposal and to get approval from local authority	Procurement

Intention to maturation means the intention to sell or to develop with a comprehensive consideration to the existing internal and external factors. In other words, the intention to sell and to develop the lands is influenced by the existing institutions such as restriction in interests and land development regulations as well as the cost benefit consideration inclusive of countable and uncountable values. Initiation is the transaction effort with the intention to maturation stage which consists of any (initial) steps to ignite and to achieve the intention to either sell or develop the land. For example, landowners have no intention to release the land because they are eager to take advantage of the opportunity to enjoy amenity and dignity currently existed in the market (3 landowners). Some landowners refused to sell their lands since they hesitate to spend the cost in the form of time and effort to achieve consensus among them (2 landowners).

In the supply of land through land transfer, the previous owner is the seller and the new owner is the buyer. Activities involved in this stage are getting information on the land price and buyers and to negotiate as well as to make a contract. Ownership is the object to be transferred. From the empirical data, a landowner of lot 31 failed to transfer the land because restriction in interests have produced asset specificity so that only limited buyers can be found.

Procurement is the transaction to supply the land through a planning proposal. Procurement means the seller is expecting something, for example the planning approval by fulfilling planning requirements established by the authority. In this case, the seller is the developer or landowner, the buyer is the local authority. Any cost spent to fulfil requirements and to get approval is considered as part of the transaction costs.

In the transfer of indigenous land rights, the restrictions in interest play important roles limiting the transfer of land from a seller to a buyer. The landowners see restriction in interests as a mean of preserving the dignity and amenities to the Malay landowners, and this has restricted the landowners from releasing the land. In addition, ownership constraints restrict the market that certain buyers can only buy the lands; hence, sellers lost opportunities to get the best buyer and the best price.

In fact, there are linkages between landowners' behaviour, land attributes, transaction costs and land development initiatives. By measuring the transaction costs, actors make decisions such as to sell or to develop the lands. To a certain extent, actors may change the institutions if these institutions are no longer capable either to accommodate their interests or to solve their problems efficiently. Positive decisions will stimulate development, so that development can be materialized.

CONCLUSIONS AND RECOMMENDATIONS

There are two formal institutions that affect actors' decisions to supply land for development in Kampong Baru as indigenous land for Malays and the code of valuation practice. The first formal institution produced Malays' sentiment to the lands and also the ownership restriction. The second institution caused the refusal of landowners to release the lands, or if this system was implemented a big cost has to be spent in terms of time and effort.

First, the written rules that there is ownership restrictions in interests that disallowed transfer of indigenous lands to non-Malays. From a property rights point of view, restriction attenuates landowners' right to sell (delineate) the land to any buyers. From a land market point of view, this restriction limits the market. Incomplete rights and limited market will reduce the value of the land. Also, it will be less attractive for land developers and financiers for development purposes. So that the purpose of the amendment is to attract more land developers and investors to undertake development of Kampong Baru area. As one of the solutions, amendment can be made to any individual title through surrendering to government, then re-alienating back to registered landowners and amending the restriction of interest to allow foreigners or non-Malays to occupy the site.

Second, there are unwritten rules that affect costs and actors' decisions such as landowners' perceptions on land development, multiple landowners and financial difficulties. Passive landowners may refuse selling off their lands or refuse to participate in the development initiatives. In this case, more information on the property market and encouragement to participate such as entering into partnership or a joint venture financial arrangement might be useful. In addition, multiple landowners may restrict the flow of supply and push up the cost to get consensus among landowners; particularly to determine the future of the lands. The solution is to

establish an electronic registration policy that limits the number of landowners and to encourage cooperation among landowners to ease joint venture into land development.

Institutions and land attributes will dictate the characteristics of transactions such as uncertainty and assets specificity which then produce transaction costs which may be in various types of costs such money, time, effort and opportunities. This transaction costs then influenced the landowners' decision, based on the cost consideration to bring the land either in the market or in the land development process. In the case that the transaction costs are quite big and the actors can't afford it, to change existing institutions is an alternative way to overcome the obstacle of the development. The actors' decisions, to actively or passively participate in the land market and land development as well as to modify the institutions, will influence the output of development, subsequently affecting the existing institutions or the current land attributes.

For the future of the Kampong Baru area, a comprehensive redevelopment planning that considers the benefit of all societies should be established; particularly the Malay settlement in the urban area. In doing so, a powerful body responsible for the redevelopment of MAS area should be founded. This body consists of at least three departments that are responsible to handle the financial aspect, land status and land planning aspect as well as the legal aspect. Prior to the redevelopment, some formal institutions have to be reviewed such as ownership restrictions and valuation in practice so that asset specificity and uncertainty can be reduced. In relation to the actors' attitude and the affordability of Malay empowerment, programs for landowners and private Malay companies should be taken into account.

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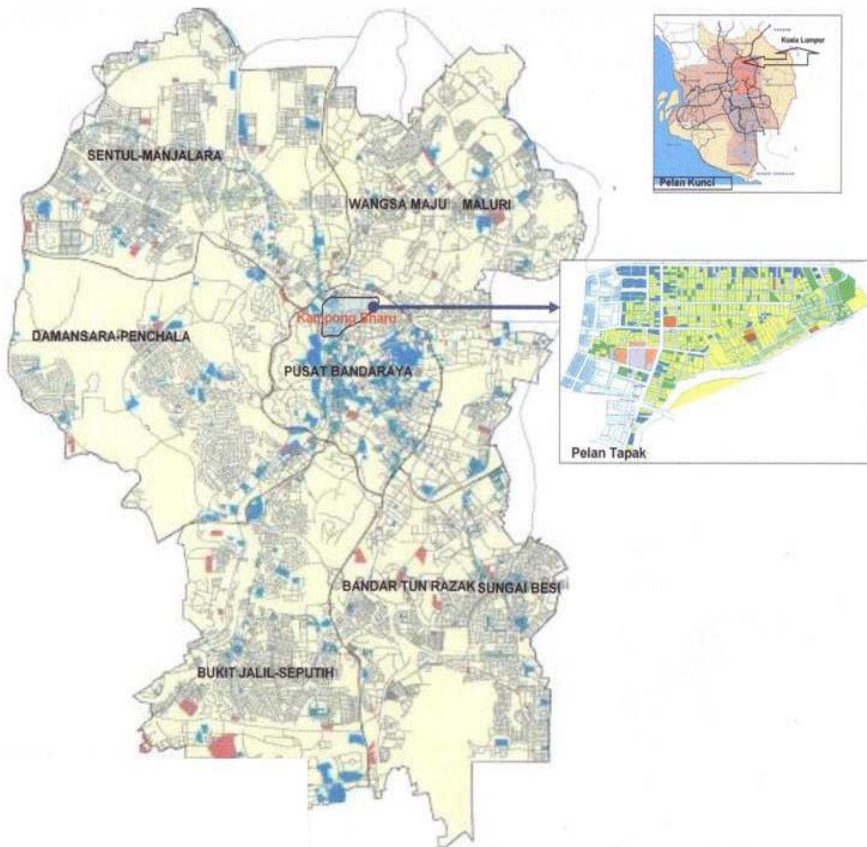
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Appendix A: The location of study area



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