

Average Home Price Does NOT Increase With Increased Average Floor Area

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When reviewing real estate commentaries from China on China markets, the following perception is often cited = As the economy grows, so does the average home floor area, and because the average floor area is increased, so does the average home price. At first glance, this seems perfectly logical, more floor area, more money is required for purchase. But this is in fact **a common misconception**. As the economy grows, it may mean people on average are making more money, and with more money, they can afford to pay more for a home. YET, whether the home correspondingly increases in size is another matter. Many markets will do that as living standards improve upon having achieved higher earning abilities, though this is NOT a rule. This depends on the market structure, land and real estate policies, social culture, buyers' preferences or demands etc:

- a) **Economy grows, average home floor area also grows** = EXAMPLE = USA =
Based on the private home market, the typical home in the 50s or 60s seemed to be a bungalow of some 1,500 ft² with 1 to 1.50 baths. Nowadays, the typical home is a two-storey detached house of some 2,000 to 3,000 ft² with 2.50 baths. Using statistics from the National Home Builders Association, the average floor size had grown from 1,400 ft² in 1970 to today's 2,200 ft². During the period, the USA economy has grown from US\$1,000B to US\$10,000B.
- b) **Economy grows, average home floor area has not grown** = EXAMPLE = Hong Kong =
Based on the private home market and a commentary by the South China Morning Post a while ago, and especially in the 1980s and 1990s, the increase in total gross floor area (GFA) constructed has not been able to catch up with the increase in GDP. In fact, Hong Kong has been building less GFA with increased GDP. Nonetheless, the 1980s and 1990s were also decades when household formations were growing and peaking in Hong Kong. This means the average home unit would have to be smaller than the ones built earlier and may also reflect in part the land supply restriction prior to the handover in 1997, i.e. with increased number of buyers, and with land supply and thus the total GFA that could be built relatively limited, the real estate developers simply build smaller units to accommodate the increased number of potential buyers (while prices on the whole were increasing). Note however we are NOT talking about people moving up the real estate ladder from a smaller unit to a larger one, but the 'counterpart equivalent' of a home seemed to have grown smaller compared to earlier decades. Visual proof = just watch some of the Hong Kong movies made in the 50s to 70s and middle class homes then seemed larger.
- c) **The average home price that an economy may afford could be roughly calculated, but the average home floor area depends on market "interactions"** = what people in an economy can pay for a home could be roughly estimated, taking into account factors such as economic performance, income distribution, demand, supply and the like. What average size (quantity) and quality of home the market actually supplies depends on interactions on 2 levels = 1) Interaction between suppliers or market competition = If a developer can sell a 1,000 ft² home for \$1M, he / she is unlikely to build a 1,200 ft² unit in order to sell for the same home price,

unless competition demands so, though he / she will be tempted to build a 800 ft² unit IF the same \$1M could be obtained. Generally, the higher the competition, the better the quality of homes etc. 2) Interaction with the pool of buyers = this depends on how the buyers see home ownership and their collective steadfastness among other factors such as demand, supply etc. For instance, if buyers generally view a home more as an investment than a part of their lifestyle, small home sizes may not be too much of a hurdle. If the buyers generally view a home more as a product (solely a place to live) rather than an investment, homes that are too small may have problems selling or reselling in the long run.

In all, if it is observed that the average home price does indeed increase with increased floor area, it may simply mean the best possible home price had not been efficiently “revealed” earlier. Putting it another way, if home prices can ‘really’ be increased simply by building more floor area, real estate developers will then just have to keep on building more floor area and larger units and throw out all calculations of affordability etc. Naturally, it does not work like this.

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