

# **A model for integrating institutional analysis with mainstream economics in quality-led property development**

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## ***Abstract***

This paper seeks to bridge the gap between theory and practice in delivering quality places through urban design. It complements the behavioural-based theoretical concepts of neoclassical economics with the institutional analysis in property development from the perspective of adding value through quality design. This approach focuses on the drivers and the relationship between actors in the planning, design and development process. The paper follows a sequential path of incrementally building a framework of institutional analysis to eventually present a model for delivering quality in the built environment. The final product presents a 'meso-range' theoretical framework that links concepts of neoclassical economics to institutional analysis and follows two principles. First, mainstream economics and institutionalism in property development should be complementary rather than exclusive of each other. This is based on the concept that institutional analysis and behavioural theories can be used complementarily to understand and describe the delivery of a value added product through the property development process. Second, since very little of the broad economic perspectives have been applied to the property discipline, there should be a theory with an economic focus that serves to support and link institutional models.

Keywords: Neoclassical economics, Development models, Behaviouralism, Institutionalism, Urban design quality

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## **Extended Summary**

The dynamics of the interrelationship between urban design and the real estate development process have received particular attention in the recent literature (Tiesdell and Adams, 2011). There is a growing body of literature that, in the quest for providing urban design with the missing theoretical underpinnings (see Cuthbert, 2007), makes use of economic principles. These studies approach [the product of] urban design as a commodity to be traded (Hack and Sagalyn, 2011; Webster, 2007; 2010). The starting point of the argument provided in this paper is based on the underpinnings of neoclassical economic theory. More specifically, urban design is considered as a public or collective good, the latter being identified with the principles of 'inclusiveness' and 'non-rivalry'. Thus, from an economic perspective a (pure) public good is one that is consumed by many and where the marginal cost of an additional consumer is zero. In the case of urban design the concept of 'public good' implies two dimensions. First, the profession itself through the provision of expertise to communities by designers/architects and second, the more concrete public spaces such as plazas, squares, parks, carefully designed (pedestrian) streets etc.

Associating urban design with economic principles has received growing attention from academia mainly because of the well-grounded and widely-accepted theoretical underpinnings and robust quantitative approaches that economics offers. The latter is a broad scientific field and since urban design is only part of a larger set of built environment professions the sheer difference in scale constitutes the main drawback in interrelating the two together. In this context, a more appropriate economic approach to mainstream urban design is provided by real estate economics. The main rationale behind this reasoning is the fact that urban design and the real estate development process share the same product: the built environment (Madanipour, 1997; Tiesdell and Adams 2011). Convergence of two disciplines/professions at the end product constitutes excellent opportunities for the adoption of an intra-disciplinary approach with the main benefactor being the end product itself, in this case the built environment.

Especially during the last decade there has been an increased attention towards the quality of places we build and the whole process involved with the delivery of quality [in the built environment]. From a real estate perspective, based also in its economic dimension, the focus has been on the value of the product of the real estate development process. More specifically, the focus has shifted on the added value [of the built environment] accrued through superior design. This paradigmatic shift has influenced the neoclassical approach to

urban design (that considered urban design as a public good). From a process-centred point of view urban design is seen as acquiring public goods through creating better places that collectively contribute to city building and city sense (Hack and Sagalyn, 2011). A product-centred perspective treats *well-designed* urban form as public good (Webster, 2010).

This paper bridges the behavioural-based theoretical concepts of neoclassical economics with the practice in property development and delivering quality through urban design. This is based on the concept that rather than rejecting behavioural theories institutional analysis can be used in a complementary fashion to understand and describe the delivery of a value added product through the property development process (Adams et. al, 2005; Ball et.al. 2006; Verma, 2007). Especially within the UK context, a quality built environment is a product of the property development process. Therefore, it is useful to start the discussion of delivering quality from the broad perspective of property development. This is a dynamic and complex process – a fact which counts for the wide range of models devised since the mid-1950s (Ratcliffe et.al. 2009). Two papers are of particular interest and constitute the basis for the discussion of development models. Healy (1991) and Gore and Nicholson (1991) review the literature on development models in property and land development processes. The papers suggest classifications of the models bearing slight taxonomic variations with Healy being more supportive of the particular ‘structure-agency’ model and Gore and Nicholson adopting a more critical and dynamic approach.

The framework developed in this paper starts by adopting an end-user centred approach to the development process. The argument also builds upon the event sequence approach to modelling development as an analytically convenient starting point (Gore and Nicholson, 1991). It gives a consideration of delivering quality in the built environment from the perspective of the *actors* involved in this process. Despite the incrementally building sequential framework of the model, property development should be seen as a set of interrelated processes (Ratcliffe et.al. 2009).

There are arguably three main activities related to the delivery of a quality product in the built environment namely; provision & finance, control & guidance and implementation (Figure1). According to Ball et. al (2006) the organisational types – actors – directly involved in the development of property are distinguished as users, property developers and financial investors. These actors are mainly involved with the provision and finance side of delivering quality in the built environment and are driven by the objectives of utility maximisation. Users seek to maximise their utility by showing willingness to pay for a product that offers

better amenities. Developers and financial investors on their side, expect higher returns for extra investments on quality. The whole mechanism works according to the principle that quality is supplied by the latter actors as a response to the demand by the users. The upper (demand) arm of the model is driven by utility maximisation of the users whereas the lower (supply) arm is driven by developers trying to maximise their returns. In the case of delivering quality the weighting of returns against risk plays an important role as certain developers are willing to take higher risks thus counting for the added value. Entrepreneurial efforts of the developers play a key role in delivering quality in the built environment (Roulac et. al 2006).

Control & guidance of delivering quality in the built environment involve actors directly related to the design dimension. These are: the government (central and local) governmentally accredited bodies and professional bodies. Figure 1 represents the engagement of each of these actors in controlling and guiding especially the design dimension of quality. The central government with its accredited bodies and the professional bodies are actors which set 'the rules of the game' by providing both statutory and non-statutory control and guidance. This upper arm of the model is largely institutional in its content and will be examined in more detail later.

The lower arm of the model is almost exclusively related to the local government. Although local governments provide site specific statutory and non-statutory bindings the focus here is on their relationships with the private sector in the development process. From a behavioural perspective, this model argues that it is the entrepreneurial effort of the local governments engaging in partnerships with the private sector that adds value to the urban development process. Especially in the UK, the wide applicability of partnerships is related to the neo-liberal politics adopted by the government (Jones and Evans, 2008; McCarthy, 2007). As part of a broader 'urban entrepreneurialism' partnerships are particularly appealing to governments because they allow a variety of interests to be addressed, spread responsibility and achieve public goals through resources other than that of the government (McCarthy, 2007). Entrepreneurialism is said to add value by the principle that the whole is greater than the sum of the parts (Roulac et. al. 2006). In the case of producing quality in the built environment entrepreneurial efforts of the local government and the private sector (as described in Figure 1) in partnership engagement mean that the partnership holds greater value than the sum of all of the agents constituting it.

The model suggests that a new approach is needed to delivering quality in the built environment that would also take in consideration the rules of the game and the players as well as the interactions between these players. Institutional research begins by distinguishing between ‘institutions’ and ‘organisations’. Institutions are understood as the framework of rules norms or practices whilst organisations are the corporate bodies directly or indirectly involved in playing according to these rules of practice (Ball et. al. 2006; Gonzales and Healy; 2005). Non-institutional approaches in social sciences emphasise the role of the individual. The best illustration to this approach is the (property) market which is regulated by collective decisions of the individuals and depends on the preference of the actors (Jones and Evans, 2008; Kauko, 2004). On the other hand, institutionalism claims that individual behaviour is not always based on preferences and that society through its rules, norms and regimes creates another layer on which institutions act by affecting decisions and having a major say in the process.

From a broad economic perspective institutionalism in property research arose because of the dissatisfaction with mainstream economics and Marxist approaches’ explanation of urban development processes (Guy and Henneberry, 2000). As D’Arcy and Keogh (1998) explain ‘the simple notion of profit or utility maximisation as the driving force behind market choice is inadequate’ (p. 1220). Similarly to research in urban design, institutional analysis originated in related fields rather than in property research itself. Ball (1998) claims that although institutional economic analysis has found a wide application in mainstream economics very little has been applied to the property world. However, Guy and Henneberry, (2000) identify in Healy’s work what they define as the ‘institutional turn in property research’.

The model presented in this paper is useful in explaining the roles of each actor/organisation and their interaction within the network which according to Gonzales and Healy (2005) is the focus of institutional analysis. The diagrammatic model is supplemented by the concepts of power, contestation and market institutions in order to accomplish an integral institutional analysis of delivering quality places. The main strength of this model stands in the fact that it complements not only different institutional analysis with each other but also complements behavioural theory with institutionalism in delivering a value added product through quality design. The resulting framework examines the process and the associated actors and networks from a ‘macro’ institutional perspective. The structure is bipolar where one side is concerned with property development and the other has a more narrow focus, that of urban design

quality. Each string is divided into two subgroups namely organisations directly involved in the practice and organisations with indirect relation to the practice (Figure 1). Organisations directly involved in property development are identified as users, property developers and financial investors (Ball et.al, 2006). Organisations directly involved in delivering quality urban design are identified as the government: central regional or local, government's accredited bodies which deal with the issues of quality urban design (e.g. CABI in the UK) and professional bodies (e.g. RUDI, RTPI, RICS).

The starting point of the sequence is related to behavioural theories. Property development related actors are driven by utility maximisation in their production and consumption of quality. While developers and investors seek value for money, users try to get value in use for the money spent. The main contribution of these actors to the network of urban design quality practice is in the field of financing. On the other hand, the organisations with direct involvement to delivering quality urban design make their contribution by providing control and guidance during the process. This whole scenario constitutes the network and hierarchy of power and contestation in delivering quality places. Especially in the UK, there has been a switch in the planning approach in the early 1990s. Previously (during the 1970s and early 1980s), power holding actors (local governments) were regarded as contestation mediators, later these actors started to use their power to persuade developers and investors to 'meet desired local aims' (Ball, 1998). This paradigmatic shift from a rational planning practice to strategic and inclusive planning has shifted the arena in which contestation takes place from within the planning apparatus itself to the partnerships formed and the focus of institutional analysis on interactions rather than decisions. Contestation within the grouping of actors directly involved in property development as shaped by institutional constraints and opportunities arising from the power exerted by power holding organisations, triggered a downward spreading of power (delegation) by the latter which in turn displaced the contestation arena from formal/statutory to more informal/participatory institutions such as the partnerships (Figure 1). Consequently, the process started to involve actors involved in service provision.

Contestation implies competition which is a concept supported by mainstream economics in the claim that the formation of value occurs through the competitive market mechanism. It is also argued that the emergence of specific type of partnerships could well be explained by mainstream economics. Deng et. al (2007) claim that 'it is market competition that prompts real estate developers to bundle governance structure with physical development. Profit

maximising behaviour is the invisible hand behind the growth of common interest developments CIDs' (p.196). On the other hand power implies that economic outcomes are a result of institutional change and power relations. Kauko (2004; 2012) identifies this approach as 'old institutionalism' and stresses that it considers value as being formed by a technical planning apparatus instead of a competitive market mechanism. Notwithstanding these opposing views, the discussion on the model developed above favours their complementary use in describing the formation of value in quality design.

In addition to Provision & Finance and Control & Guidance there is also the Implementation aspect of delivering quality places. The current trends in implementing urban development projects are characterised by an increasingly involvement of the private sector in the process mainly through public private partnerships. This increasing trend has been fostered by a shift in public values favouring entrepreneurial behaviour (Miles et. al 2007). Entrepreneurial efforts applied to institutional analysis involve assembling different actors/organisations so that the whole is more valuable than the sum of the parts. In this case the whole (the Partnership) is a more valuable organisation than if the organisations forming it would operate separately. This is what Gonzales and Healy (2005) identified as 'governance capacity' or in other words 'the ability of institutional relations in a social milieu to operate as a collective actor' (p. 2056).

In more general terms governance encompasses the concept of delivering the aims of the state through a broad involvement of actors (Jones and Evans, 2008; McCarty, 2007). Hence the justification of the entrepreneurial approach from the state to the implementation aspect of delivering quality places. This practice tries to find incentives for the private sector by introducing the prospect of sharing both risks and benefits. The implementation aspect includes also organisations responsible for service provision. These actors comprise landowners, professionals such as planners, architects, engineers and urban designers, banks and other financial organisations which by interacting give shape to the implementation process.

Following Guy and Henneberry's (2000) suggestion that the structure-agency institutional approach lacks a meso range linking theory with an economic focus, this paper delivers a two-perspective approach to the concept of value formation. It also examines the network of relations in this process to complete the framework that attempts to link institutionalism to mainstream economics. In his explanation of modelling preferences for house markets Kauko (2004) adopts a two-step framework – a macro-micro model – that is based on institutional

restrictions (and opportunities) and individual (actor) choices which collectively shape the market. This constitutes the starting point for examining the interrelationships in Figure 1 as it clearly points out the micro and macro levels which are later to incorporate the meso level framework. From a macro perspective it is the institutional constraints and opportunities mainly exerted through the planning apparatus and represented in the model by the upper-right arm of the 'rules' which shape the upper-left arm of the model – that of user demand. On the other hand, at the micro level analysis the collective individual decisions lead to an aggregate market outcome. According to this logic the outcomes in the market result from individual choices made by specific actors (D'Arcy and Keogh 1998).

Therefore, the market outcome is viewed as developers and investors trying to meet user demand. Investigation of the relationships between the actors in provision and finance of delivering quality in the built environment (Figure 1) gives a better understanding of this process. Since the aim at this level of analysis is to understand the nature of value formation and the roles played by actors the focus remains at the 'meso range framework'. As explained in earlier, the actors on this side of the model are driven by utility maximising criteria. The model forwards the idea that value is formed through the entrepreneurial efforts of the developers willing to take higher risks in supplying users with quality products that offer better amenities. From this point of view value is considered as the price of a commodity.

On the Control & Guidance side of the model power holding organisations are driven by public interests in directing the delivery of quality places. From a hierarchical point of view, while central governments involve mostly in setting statutory rules, local governments concentrate on following these statutory rules and delivering non-statutory ones. The planning apparatus not always delivers desired outcomes therefore it is because of the market but also political failure that market institutions evolve. As a result of pure market competitions urban institutions such as growth coalitions or common interest developments (CIDs) or even public private partnerships PPPs evolve (Deng et. al. 2007). These partnership institutions benefit from delegated power from the power holding organisations and once formed constitute a decision-making and power-holding entity on their own.

This new trend in the implementation aspect of delivering quality has also affected relations on the Finance & Provision side of the model. The relationships between users, investors and developers explained above tend to evolve in a contested medium. The emergence of partnerships as power holding organisations has shifted the contestation arena within these entities giving them unprecedented importance and value. Thus the model claims that it is the

entrepreneurial efforts of the local governments willing to engage in partnerships with the private sector that forms the value of the partnerships. This concept of value arises from the institutional perspective – the value enclosed in institutions.

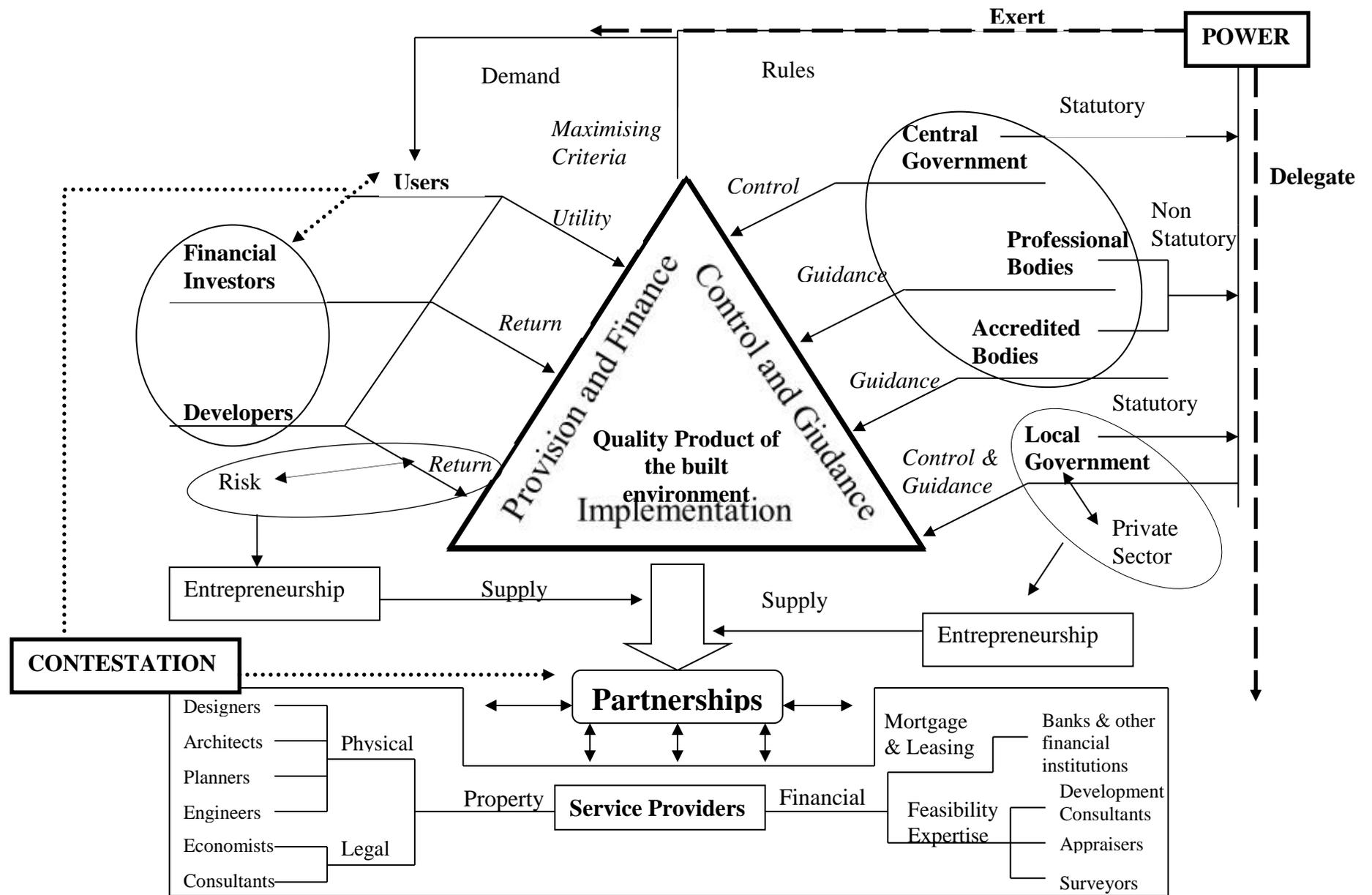
In the UK, property-led regeneration was leading urban development in a time marked by the shift from social democracy to neo-liberalism. This, coupled by the belief that market forces favour projects offering short term return and neglect risky ones (Turok, 1991) resulted in an overemphasis on ‘the brick and mortar’ development. During this period of short term money lending and speculation banks and other financial institutions were playing a key role in property development. The shift experienced especially in the last decade towards a designed urban regeneration approach can mainly be attributed to the consolidation of the post-modernistic principles placing the focus on the individual rather than emphasising the group (as in social democracy). From the institutional change perspective this resulted with the changing of weights in the roles played by actors in partnerships. More specifically designed approaches emphasise the role of the designer/architect (the individual) whereas property-led approaches favoured the growth of banking or other lending institutions (not individuals).

By and large, it can be concluded that the analysis of delivering quality places should include economic and institutional dimensions alike. Mainstream analysis based on econometric models has in certain ways blocked the inclusion of institutional variables into the price formation formulas by making assumptions (Kauko, 2004). Any particular piece of analysis has to make assumptions and here it is true that many economic models have only limited, stylised institutional behaviour. *Those that wish for greater institutional input, however, have to demonstrate the greater explanatory power of doing so* (Ball, 1998, p.1515 emphasis added). Also, according to Kauko (2004) ‘in Europe, the institutions matter more and the particular market place is sometimes seen embedded in the development’ (p.1510). The above mentioned evidence favours the inclusion of institutional variables – defined by Kauko (2004) as legal, political, cultural and administrative – into economic models of value analysis.

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**Figure1:** An institutional-economic model of value formation in delivering quality places (after Ball et. al, 2006; D’Arcy and Keogh, 2002; McCarthy, 2007; Miles et. al, 2007)