
QUALITY PRIORITY IN HOUSING

by Stephen E. Roulac & Bruce R. Christy

Quality is important in every aspect of society and especially housing. The perceived quality of property influences its pricing, marketability, and value. Confirming and communicating quality are crucial to real estate transactions. Subsequent shortfalls of actual quality relative to representations of quality in such communications can impose significant liability for both those who build and sell properties and also for those who provide professional services to transactions.

Understanding consumers' expectations of housing quality can both increase the prospects of positive property performance and also aid a developer in building a brand name and strong market identity. Concurrently, understanding the role of quality in property transactions is crucial to mitigating litigation risk. This manuscript explores the role of quality in the context of housing decisions.

ABOUT THE AUTHORS

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QUALITY CONTEXT

Over the last two decades quality has been thoroughly ingrained in every aspect of society. Fundamental to Japan emerging as a major economic power was its national commitment to quality, transforming *Made in Japan* from representing something of shoddy workmanship and unreliable functionality to high standards of precision assembly of materials and reliability. Central to the resurgence of the United States' economy during the second half of the 1980s through the 1990s has been a pervasive, intensive commitment to quality. The much-publicized Malcolm Baldrige Award raised consciousness of quality concerns throughout the business community and motivated many companies to commit significant resources to enhancing the quality of every aspect of their operations. The proselytizing of quality gurus such as Edward Demming, Joseph Juran, and Philip Crosby, through their books, speaking, quality training and consulting, has

had a significant impact upon raising quality consciousness broadly.

The explosion of the media coverage of business has furthered the awareness of quality. Suddenly, the attention to best practices has caused those purchasing for business and consumers to raise their expectations of the quality of every good and service they buy. Specifically, the best product and service experience encountered in one setting is transferred by expectation to all settings. The quality of products and services has improved dramatically in recent years, which has therefore stimulated even higher expectations in every purchase decision, product experience, and service encounter.

The shingle theory holds that any individual or business representing to the public that it provides goods and services – by the very act of *hanging out its shingle* – communicates that the consuming public can reasonably rely upon that professional and company to possess appropriate levels of competence so that the work such professionals and organizations do is characterized by appropriate levels of quality. Thus, every individual and organization associated with housing goods and services are expected to be competent in their roles generally, and to deliver goods and services that meet society's quality expectations specifically.

The property markets have not been immune to the higher standards of consumer expectations concerning the quality of property goods and services. The implementation of quality expectations through real estate occurs in several ways, including: 1). professionals' and private enterprises' own standards; 2). behavior guidelines of professional associations; 3). regulations administered by government agencies charged with protecting the public interest; 4). the legal principles of fiduciary responsibility; and 5). the shingle theory. Among the means by which quality in housing is implemented are the following:

- Professionals and enterprises with property involvements employ their own quality standards concerning what is to be done, how it is to be done, and what internal quality control mechanisms are employed to confirm that the desired quality objectives are realized.
- Professional associations promulgate codes of ethics and behavior, specifying the standards of service that consumers of professional services should expect.

- Government regulations address the public's reasonable expectations of professional competence, diligence, and disclosure.
- Fiduciary law imposes explicit responsibilities for professionals representing their clients in terms of the standard of care that should be employed in such representation.
- Purchasers of property employ professionals to provide due diligence services to confirm construction quality, property value, mechanical systems functionality, fire and safety standards compliance, and related concerns.

Shortfalls in quality expectations can be accompanied by legal liability, which can lead to litigation and substantial awards for damages.

HOUSING QUALITY CONTEXT

Quality expectations are especially significant in housing. Housing is both a household's largest expenditure and also, in many instances, a primary component of the household's wealth portfolio. People expect to receive value consistent with what they pay. The higher the price of a particular expenditure, the higher the expectations of the value and quality of what is bought with that expenditure. Especially for a significant capital expenditure, for a product in which functionality and durability are crucial consumer expectations, consumers perceive a close correlation between the amount of what they spend with the quality of what they get. Simply stated, when a consumer spends more, that consumer expects to get more – in multiple realms of the product's attributes, and especially its quality.

A major part of the income that people realize from their employment is devoted to housing expenditures. Housing is the largest expenditure for most households, generally taking 25 percent to 33 percent of income, or even more. Consequently, most people spend more time working to pay for their housing than they do for any other good or service that they consume. The expectations of consumers and businesses as to a product's quality is directly influenced by the purchase price. A high price generally, and especially a price that requires a substantial portion of an individual's or household's earnings, signals high expectations as to quality.

When people work harder for something, they reasonably have higher expectations associated with what they worked so hard for, than for other expenditures to which they make a lesser commitment of time and effort. Today, every person is challenged in work to be more productive and to deliver more

quantity at higher quality in less time and cost. Inevitably, the market's expectations of an individual's productivity influences that individual's own expectations in their personal consumption decisions. Housing quality that might have been tolerated or accepted in the past is no longer tolerated or accepted today.

The pressures on housing quality today are exacerbated by the higher price of housing. Housing costs in the U.S. have increased dramatically, as evidenced in *Exhibit 1*, showing how the cost of a single-family home has gone from \$25,700 in 1970 to \$72,800 in 1980 to \$168,300 in 1999, a 555 percent

increase since 1970. While average household earnings have also grown dramatically, as seen in *Exhibit 1*, the ratio of housing price to earnings continues to expand. Although part of this expansion reflects the consequences of innovations in mortgage finance as well as changing costs of capital, the daunting price of housing for virtually every segment of society motivates higher quality expectations.

SURVEY OF REAL ESTATE AGENTS

Insights into factors influencing housing expectations are provided by the results of survey research of agents representing prospective homebuyers in

Exhibit 1

**Housing Affordability Decreased
Changing House Price and Household Income Relationships
- United States -**

Year	Average House Price	Average Household Income	Price/Income Ratio
1970	\$25,700	\$12,636	2.03
1980	\$72,800	\$27,626	2.64
1990	\$115,300	\$50,634	2.28
1999	\$168,300	\$70,253	2.40

Source: Woods & Poole Economics, CEEDS 1998; Bay Area Real Estate Information Service; National Association of Realtors; Roulac Group, Inc.

Exhibit 2

**Housing Affordability Decreased
Changing House Price and Household Income Relationships
- Marin County -**

Year	Average House Price	Average Household Income	Price/Income Ratio
1970	\$37,845	\$17,791	2.13
1980	\$168,508	\$42,347	3.98
1990	\$379,581	\$84,018	4.52
1999	\$590,821	\$124,204	4.76

Source: Woods & Poole Economics, CEEDS 1998; Bay Area Real Estate Information Service; National Association of Realtors; Roulac Group, Inc.

an upscale Northern California market. Surveys were conducted in the spring of 1999 of residential real estate agents who were top performers, with long-time involvement in the Marin County housing market. Marin County is an especially significant market to study housing quality because of its distinctive attributes of housing prices and household income, as reflected in *Exhibit 2*.

The housing in Marin is not only highly coveted but amongst the least affordable anywhere. Although average 1999 Marin County household income of \$124,204 is 1.7 times the national average of \$70,253, the average 1999 Marin County house price of \$590,821 is 3.5 times the 1999 national average of \$168,300. The average housing price in Marin has increased dramatically, from \$37,845 in 1970 to \$590,821 in 1999, a nearly 15-fold increase since 1970. While the pricing of housing in Marin in terms of income was slightly higher than the national average in 1970, with a price-income ratio of 2.13 for Marin comparing to the national average of 2.03, by 1980 this relationship had changed dramatically from a ratio of 2.64 for the country overall to 3.98 in Marin.

As of 1999, the price premium for Marin housing was even more distorted, with the average house price in Marin being 4.76 times the average household income, which compares to 2.40 for the country overall. The high household incomes of Marin mean that home purchasers tend to be both more discerning and more financially sophisticated than average. Further, because purchasers of Marin housing are paying more than \$400,000 above the average house price that applies to other parts of the country, those Marin households who do purchase a house make a more major commitment to housing than applies in other parts of the country. Such households pay more in aggregate and also devote a greater amount of their income and household wealth to housing. Consequently, issues of housing quality loom especially large in Marin.

The survey of the significance of quality in housing was conducted through phone interviews with some 15 agents, who average approximately a quarter century of experience selling real estate in Marin County. The agents had sold an average of some 20 to 26 residential units annually, with 16 percent of their sales being condominium units. Agents were surveyed for their assessments of market conditions in 1985-1987, as contrasted to 1999.

Data is unavailable on the duration of market involvement by licensed real estate sales agents in

Marin. Interviews with real estate agents and residents of Marin lead to the conclusion that agents with a quarter-century of experience selling real estate in Marin County represent perhaps 5 percent to 7 percent of the total real estate sales agents active in the Marin housing market. As of January 2000 there were approximately 1,050 licensed real estate sales agents who were members of the Marin Association of Realtors, some of whom had been licensed since 1976. Consequently, the survey respondents are drawn from approximately 50 to 75 real estate sales agents, with survey respondents representing some 20 percent to 30 percent of those with approximately a quarter century of experience selling real estate in Marin County.

HOUSING DECISION PREFERENCE

Housing decision preferences reflected more quality-based reasons than financial considerations. Among the reasons agents identified that a condominium was preferred to detached home ownership were the social benefits, specifically the opportunity to interact with neighbors; the ability to rely on professional construction quality; and the ability to rely on professional management. The inability to afford a detached home was cited in only one of the 15 responses. As seen in *Exhibit 3*, the housing decision preferences were not meaningfully different in 1999 from what housing decision preferences were in the 1985-1987 time period. Overall, quality factors were meaningful influences in housing decision preferences for detached home ownership.

MEANING OF QUALITY

Given the importance of quality of society, the agents were asked to address what *premiere quality* meant as compared to *average quality*. Quality factors considered include the incidence of repairs, problems, and maintenance, which collectively can be considered outputs. Among the inputs considered were design, materials, attention to detail, and the skill and experience of those involved in the construction process itself. The responses summarized in *Exhibit 4* reflect that two factors emerge as being perceived by the real estate agents surveyed to be influential: high quality materials and more attention to detail. One conclusion from these survey responses is that quality embraces multiple output measures and is achieved by a collection of many inputs.

HOUSING QUALITY

The results of the survey indicate that in the Northern California community of Marin County,

Exhibit 3 - Housing Decision Factors

Survey of 15 Marin County Real Estate Sales Agents

<u>Reason to Prefer Condo to Detached Home Ownership</u>	<u>1985-1987</u>	<u>1999</u>
Cannot afford detached home	1	1
Ability to rely on professional management	6	5
Reduced maintenance of grounds and exterior	3	3
Reduced interior & exterior repairs required by owner	3	4
No time to take care of a detached house	2	2
Ability to rely on professional construction quality	7	7
Amenities (Pool, tennis, clubhouse, etc.)	4	4
Social benefits (Opportunity to interact with neighbors)	8	8

Source: Roulac Group, Inc.

Exhibit 4 - Meaning of "Premiere Quality" Compared to "Average Quality"

Survey of 15 Marin County Real Estate Sales Agents

<u>Premiere Quality</u>	<u>Response</u>
High quality materials	12
More attention to detail	8
Low repair incidence	5
No major problems in first several years	5
Efficient and attractive design	5
Use of highly skilled and experienced trades people in construction	4
Low Maintenance	3

Source: Roulac Group, Inc.

housing quality varies significantly between detached housing and townhouse/condominium housing. The finding of inferior quality of attached housing relative to detached housing is by no means unique to Marin County, for severe quality issues are not limited by geography. The issue of housing quality is of broad concern to all with property involvements.

The overall housing quality has meaningfully improved since the mid-1980s, the agents reported that the incidence of detached houses being of poor quality with significant defects, has dramatically reduced over the last 15 years. Detached housing

that is regarded excellent or above average in quality has not meaningfully changed, being 25 percent and 36 percent, respectively, over the 1985-87 to 1999 periods, as reflected in *Exhibit 5*.

Improvements in housing quality have been most pronounced for condominium and townhouse complexes, as reflected in the data shown in *Exhibit 6*. Whereas in 1985-1987 periods, agents rated the quality of all condominium and townhouse complexes as poor with significant defects; by 1999 some 60 percent of condominium and townhouse inventory, including new and existing, was rated as average or above average.

Exhibit 5 - Quality Assessment of Detached Housing

Survey of 15 Marin County Real Estate Sales Agents

	Percent Distribution		
	1985-1987	1999	Variance
Excellent	8%	12%	4%
Above Average	17%	24%	7%
Average	34%	48%	14%
Poor - significant defects	42%	18%	(24%)

Source: Roulac Group, Inc.

Note: Rounding was employed, thus items may add up to more than 100%.

Exhibit 6 - Quality Comparison of Condominium/Townhouse

Survey of 15 Marin County Real Estate Sales Agents

	Percent Distribution		
	1985-1987	1999	Variance
Excellent	0%	0%	0%
Above Average	0%	20%	20%
Average	0%	40%	40%
Poor - significant defects	100%	20%	80%

Source: Roulac Group, Inc.

Exhibit 7 - Quality Comparison of Detached Housing to Condominium/Townhouse

Survey of 15 Marin County Real Estate Sales Agents

	Percent Distribution			
	1985-1987		1999	
	Detached Housing	Condo-minium	Detached Housing	Condo-minium
Excellent	8%	0%	12%	0%
Above Average	17%	0%	24%	20%
Average	34%	0%	48%	40%
Poor - significant defects	42%	100%	18%	20%

Source: Roulac Group, Inc.

Marin agents responding to the survey perceived the quality of detached housing to be significantly better than condominium/townhouses, as seen in *Exhibit 7*, which compares perception of housing quality in the 1985-1987 period, for housing and condominiums, to housing quality in 1999. Although the differences in 1999 are not nearly as pronounced as 1985-1987, the differences are still significant, for a buyer of a single-family home has a much greater prospect of living in a residence that has above average to excellent quality than for a condominium/townhouse.

CONDOMINIUM ASSOCIATION

A singular difference in the housing experience of single-family residences versus condominiums and townhouses is that the latter has a formal board of directors to act collectively on behalf of and to represent the interests of residents. Most single-family homeowners, except for those who live in a subdevelopment with homeowners' associations, operate autonomously and independently without collective representation. The Marin real estate sales agents were mixed in their assessment of the degree to which the presence of a condominium board of directors served as an effective professional representative of home buyers' interests, with six respondents asserting that the board did provide representation and seven asserting that it did not. Of those agents who perceived that the condominium board of directors provided professional representation to homebuyer's interests, somewhat fewer than half reported that the presence of a condominium board influenced home buyers' motivation to buy. The majority of Marin sales agents did not report that the presence of a condominium association provided assurance to homebuyers regarding overall construction quality in the assessment of a particular housing unit that was being considered for purchase. Only three Marin sales agents felt that a condominium association provided assurance of construction quality.

REPRESENTATIONS AND KNOWLEDGE

Real estate agents perceive that they have more knowledge and expertise than the average buyer most of the time, if not always. The survey responses in *Exhibit 8* reinforce that real estate sales agents perceive they contribute knowledge and expertise to servicing their buyers.

Fundamental to the real estate transaction process are representations made by builders and sellers, the reliance placed upon those representations, and the relative general knowledge of agents and

buyers. There is no consensus as to how much real estate agents rely upon representations by builders and sellers, but builders and sellers are definitely relied upon, as reported in *Exhibit 9*. Real estate agents generally rely upon builders and sellers some or most of the time. The primary reason agents would rely upon the representations of builders and sellers is because they have access to information not otherwise available. Selectively, agents consider that builders and sellers have specialized knowledge that merits reliance upon their representations.

PREFERENCE FOR NEW

All agents responding reported that buyers preferred new units over existing units. Reasons buyers prefer new units over existing units are reported in *Exhibit 10*. When a purchaser has opted for a condominium, they prefer a newer unit to benefit from *modern styling* and *fixtures*. These two categories were chosen by 12 of the 15 respondents (80 percent), whereas the next highest response rate was "5" for *high quality materials* and *no major problems in the first several years*.

CONCLUSION

The concept of quality has become integral to business and society. With higher property prices, especially in housing, people reasonably expect that the standards of quality that apply and their other expenditures will apply to housing. Yet housing quality often lags meaningfully behind consumers' expectations. Survey research of real estate agents active in Marin County, Northern California, indicated that quality embraces multiple output measures and is achieved by a collection of many inputs. Although housing quality has improved, since the mid-1980s, it still lags meaningfully behind consumers' expectations.

Household incomes and housing prices are very different in Marin than in many other parts of the country. Although whether these differences alter consumer expectations as to quality was not examined in this research, no research has been encountered that would suggest that households making substantial financial commitments do not expect the houses they buy to reflect quality commensurate with the magnitude of their financial commitment. Consequently, lacking any explicit evidence that prospective homeowners do not place an emphasis on quality, the findings of the research concerning Marin County buyer behavior and expectations are generalizable and applicable to all homebuyers, irrespective of geography.

Exhibit 8 - Comparison of Average Real Estate Agent to Average Buyer

Survey of 15 Marin County Real Estate Sales Agents

Does the Agent Have More Knowledge?	Response	Cumulative Percent*
Always	3	25%
Most of the time	9	100%
Some of the time	0	--
Rarely	0	--
Blank	3	--
	<hr/>	
	15	

* Of those responding

Source: Roulac Group, Inc.

Exhibit 9 - Reliance Upon Representations by Builders & Sellers

Survey of 15 Marin County Real Estate Sales Agents

Real Estate Agents Rely Upon Representations by Builders & Sellers	Response	Cumulative Percent*
Always	1	8%
Most of the time	6	62%
Some of the time	5	92%
Rarely	1	100%
Blank	2	--
	<hr/>	
	13	

* Of those responding

Source: Roulac Group, Inc.

Exhibit 10 - Reasons for New Unit Versus Existing Unit Preferences

Survey of 15 Marin County Real Estate Sales Agents

	<i>Response</i>
Modern styling	12
Modern fixtures	12
No major problems in first several years	5
High quality materials	5
Low repair incidence	4
Low maintenance	4

Source: Roulac Group, Inc.

If purchasers know that the units are marketed as having premier construction quality or that the units are relatively new, then they expect high quality materials with modern styling and fixtures. Furthermore, during the transaction process, the real estate agent is almost always considered to be more knowledgeable, and buyer's inspection reports are important.

After the social benefits of condominium living, the ability to rely on construction quality was the most important factor in motivating the purchase of a common interest development over a single-family residence. This conclusion is especially striking, because it is readily known that the construction quality of condominiums is considered to be very low, as reflected by considerable publicity in local Marin papers about problems resulting from deficit construction quality. The quality of detached housing was perceived to be meaningfully superior to that of condominiums and townhouses. The quality of condominiums, today, is perceived to be sufficiently superior to that of what it was in the mid-1980s.

The shortfall in consumers' experience of housing quality relative to their expectations is an important issue that should concern all with involvement in the housing sector of the property markets. Divergence between consumers' experiences of housing quality relative to representations of housing quality inevitably lead to dissatisfaction. Dissatisfaction can lead to litigation, which can result in significant liability. Those with property involvements need to confirm that housing units possess the requisite quality, that appropriate professional work is done to confirm the actual quality of housing, and that communications of housing quality are accurate and not misleading.

When you hang out your shingle, increasingly knowledgeable consumers demand more of your services and representations. All involved in real estate are expected to be competent in what they represent they do. Those who sell property goods and services are accountable for the representations they make. Property professionals are expected to possess fundamental competence and to be responsible in their representations.^{REI}

ABOUT THE AUTHORS

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president of American Real Estate Society. In 1999, he was named a Millennium Real Estate Award Honoree by the

U.C. Berkeley Fisher Center for Real Estate and Urban Economics, recognizing those 100 individuals who have had the greatest impact upon the real estate industry in the 20th century. Author of the forthcoming Renaissance of Place and Space, which documents the story of strategic geography, he has written over 350 articles and numerous landmark books. Much in demand as a professional speaker, he has delivered keynote presentations and training sessions to some 500 organizations. He hosts the national NPR weekly talk radio show, Location Matters.

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