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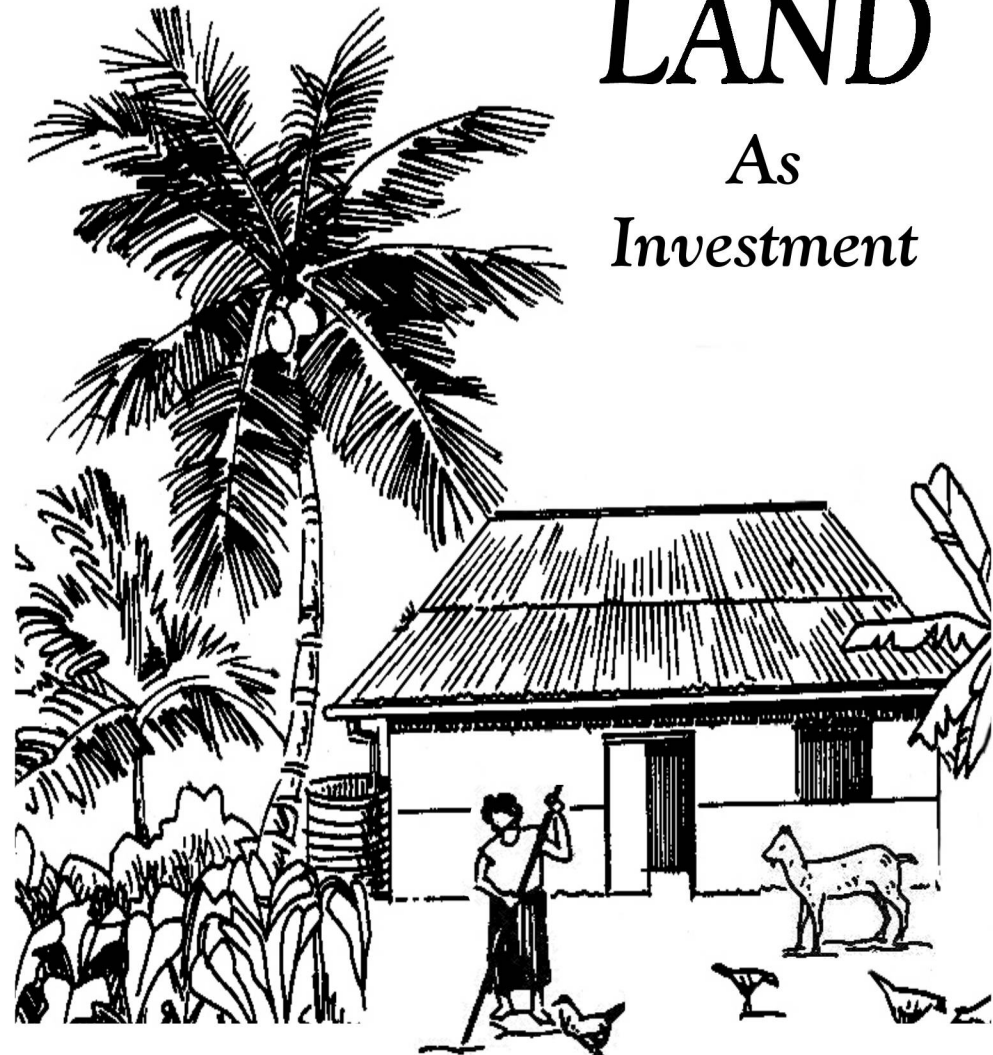


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LAND As Investment



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Land—A Buried Treasure?

Land is a resource that should be used, not left untouched. To let it go unused is like putting money in a sock and burying it outside the house. One of the servants in the familiar gospel story does just this when he tucks away the piece of gold he is given by his master because he is terrified of losing this treasure. At the master's return, however, the servant is chided for letting the treasure lie idle, while the other two stewards who have invested their pieces of gold and doubled their original investment are praised for their good sense and resourcefulness. What are we doing with our treasure?

Over the centuries Micronesians have been using their land to support themselves and their families. They have usually been careful not to squander it, maintaining it for their heirs as well as for their own use. Micronesians today should be just as careful to preserve the land, but they will have to use it, just as their ancestors always have, to provide for their families in the future. We should be no more willing to lose our land than people in the past, but we ought to be prepared to use it differently than they did. Why? Because times have changed, our needs and wants have multiplied under the growing cash economy, and we have a modern island nation to develop.

The FSM economy, like any family, depends on the wise use of its scarce resources. Besides fish, what does this nation have by way of resources? People and land seem to be the main ones. The strength of the economy in the future will depend on how the people of FSM use the land that constitutes its main resource for development. FSM citizens all share the responsibility of using well those resources that we have. In the past we might have sat around and waited until the government did something to develop industry, but we have learned that this just doesn't work. Government-sponsored development projects have failed again and again in the past. If we expect development, we'll have to take the initiative ourselves.

Land is also a resource to be used for the profit of the individual. Wise use of land can generate income for the family, just as it once did in the days when people made copra on their land for spending money.

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they obtain. New legislation will undoubtedly make it easier for commercial banks to claim land in the event that the loan is not repaid. Even this new legislation, which is designed to protect banks against bad loans and allow them to continue operating to fund other projects, will offer maximum protection for the landowner. Whenever possible, defaulters will retain the ownership of land but will lose control of the use of this land until the loan is repaid.

The towns of Micronesia are dotted with dilapidated buildings that bear mute testimony to past business failures. This is no reason not to risk going into business, but a very good reason to seek good advice on your project before taking out a loan.

If you feel that you can't plan and manage the business yourself, consider making land available to an investor who has the assets and skills to do so. Not so long ago, many people sneered at this option, regarding it as an invitation to enrich outsiders with our own land. It was precisely to protect the poor unsophisticated local people against such cunning schemes that the many legal safeguards were legislated in our states. The problem is that these safeguards protected us so well that very few outsiders with money were willing to consider doing business in these islands. Changes in legislation and enforcement practices are now being proposed to encourage outside investment. Extension of the term of land leases and better protection against squatters are examples of these changes. At the same time, other changes are being proposed to ensure that landowners will receive a fairer share of the business profits throughout the entire lease term. This is the point of the recommended periodic reappraisal of the land and a percentage of the gross profits for the landowner. With more balanced legislation, there is hope of luring investors to these islands and protecting the interests of local landowners.

The future is ours to shape. We can leave our treasure buried and unused, or we can invest it to provide a livelihood for ourselves and become a source of wealth for our nation.

This is the second of a series of three articles that Micronesian Seminar will be distributing on land use in Micronesia



Although the copra market has fallen and prices have plummeted, there are other new and creative ways to replace copra as a source of cash through the use of land. Land can remain our source of life and strength even today.

How Can Land Be Used?

Many people are making their land work for them today. Over half the people in FSM still grow much of their own food, harvesting their breadfruit trees, cultivating taro and yams on their land, and raising pigs and chickens for their own consumption. The food they grow is a help for them and it represents a tremendous cumulative resource for the nation. Without this local production, which is estimated at one-quarter of the total value of the goods and services in the nation, we would all be poorer. Nothing that is presented here is intended to discourage in any way the production of local food.

“The strength of the economy in the future will depend on how the people of FSM use land.”

Besides using their land to feed themselves, many use it to provide a small cash income for their families. Most often this is done by cash-cropping—that is, when the family sells vegetables, betelnut, sakau, citrus fruits or other produce at the local market or ships it abroad. Small cash-cropping can generate a surprisingly large amount of money when totals are calculated. Sakau production on Pohnpei is a million-dollar-a-year business overall, and betelnut exports from Yap two years ago were said to bring in a quarter million dollars annually. In addition, there are many other types of small family businesses that generate an income for the owners. Besides the mom-and-pop stores, which spring up everywhere but often close down soon afterwards, there are car repair shops, fish markets, bakeries, tourist facilities and handicraft stands, to mention just a few.

Small businesses like these can often be built with money from the family savings. But how do we go about getting



bigger businesses started, businesses that are capable of generating a larger income and providing more jobs for local people? The establishment of larger businesses requires the investment of larger sums of money. In the past the government might have financed some of these projects, but it will probably not be able to do this in the future. Investment for major development projects will have to come either through bank loans (if we want to develop the projects ourselves) or through foreign investors (if we are willing to allow outsiders with money to help develop our islands).

Any kind of investment, whether from outside money or through bank loans, will inevitably involve the use of our land, as we shall see. In the case of bank loans, we will be required to use our land as collateral to ensure the repayment of the loan. Bigger projects that require a level of funding and skills that we don't possess may demand investment from an outside developer who has what is needed to get the project started and make it work. A large resort hotel complex that will cost millions to build or a large fish processing plant are examples of the kind of business project that will require outside help. To make such a project possible, we will have to lease our land to an investor with the money and know-how to establish and run the project.

Doing It Ourselves: Business Loans

Most people finance their business venture by obtaining a bank loan. To do this they work out a business plan, draw up a budget for labor costs and other expenses, work out an estimate of revenues over time, and apply for a bank loan to cover the anticipated construction and start-up costs of the business. If the bank grants the loan, they will require that we offer collateral—security for the repayment of the loan. This usually means that we will have to be willing to put up our land for this purpose. If we are unable to pay back the loan, the bank gains control of our land.

Why can't we just get risk-free loans from the government the way we used to? Because the FSM doesn't have as much development money from the Compact as it once did. The limited



periodic adjustment of the rental price for the land. Every five or ten years the rent can be adjusted to the actual value of the land, which might well have appreciated since the lease began. This can be done in several different ways. The land can be reappraised (although professional appraisers are in very short supply in the islands). The consumer price index (CPI) can be used as an approximation of the land value changes. Another possibility is to charge a minimum base rent plus a percentage of the gross income from the project, as recommended above. This satisfies the needs of the investor and ensures that the landowner receives a fair rental value for the land not just in the beginning of the lease term but throughout the entire lease period.

Conclusion

Land is the most prized possession of all island peoples. As Mark Twain is reputed to have once remarked, "They're not making land anymore." Still, people can use the land they have to make money for themselves and their families. Realistic planning must go into their business projects, however. A business venture should be more than buying a raffle ticket and hoping that our number is called giving us a big one-time payoff.

Going into big business is especially risky when it means obtaining a loan from the bank. Loans for worthwhile projects are always available, just as they always have been, but the terms will be more stringent than in the past. In the future banks will require potential businessmen to stake some of their land against the loans





absolves him from inflationary adjustments and shifting market values, the developer is getting a bargain by paying up front. Landowners like it because it gives them a large cash payment right now that is entirely at their disposal.

Often enough, of course, the landowner will spend the money. With a large cash payment he is a target for pleas for help from his relatives. The pressure to spend while the money is still there is hard to resist in island culture. The thrill of having cash in abundance soon gives way to frustration after the money is all spent. The landowner may look at land values some years after his lease has been made and realize that he has sold cheap and thinks that he is entitled to more. The result is often bitterness. He may look for ways to break or renegotiate the lease. He and the developer, who should be partners in the project, become competitors. Sometimes there are law suits contesting the validity of the lease. Someone will usually feel cheated, either the landowner or the investor. But the ones who feel most cheated are the heirs, who find themselves without the use of their family property, to which they feel they were entitled. It's gone for a more or less long period of time, the money has been long spent, and they must go without any of the yield of the land.

- *Regard the investor as a partner, not a competitor. Work out the lease in such a way that you have a stake in the business.*

A spirit of good will and mutual support can be encouraged between the investor and the landowner if both have an interest in the success of the business. While the landowner should not demand so much as to make it impossible for the investor to make a profit, he should share in the good fortune of the investor. This can be done by stipulating that a percentage of the gross profits will be paid to the landowner.

- *Be sure that your land lease allows for a periodic readjustment to reflect the real market values of your land.*

The landowner and the investor can work out a system for

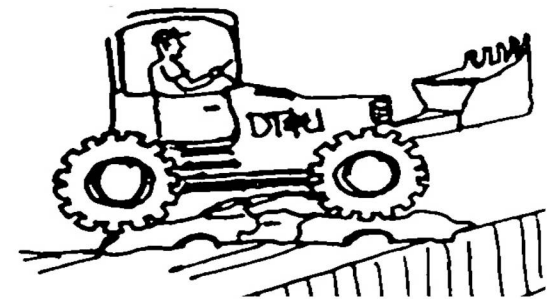


funds available have to be used carefully and parceled out to fund those projects most likely to succeed. We have the FSM Development Bank and other commercial banks, but these banks demand some surety that the loan will be repaid. The days of easy loans are over. There was a time when a person might default on his loan and suffer no worse consequences than the embarrassment caused when his name was mentioned on the list of defaulters on the radio. But money is harder to come by these days, and the easy loans of yesteryear are no more.

What if the business fails and the owner defaults on his loan? He could lose his land to the bank altogether, or his land could go back to the bank for leasing, with the lease payments used to pay off the remainder of the loan. Possibly, some of the lease payment might even go to the landowner so that he gets some cash value from his land. Under this arrangement, once the loan is repaid, the landowner would regain the use of his land or the claim to full lease payments until the lease is ended. This option is important because it lets the owner down easily. He remains responsible for paying off his loan, but he does not necessarily lose ownership of the land—just lease rights over it.

Even so, there will be cases where the person might lose title to his land. This is a risk that he takes when he opts to start the business. If he wishes to avoid this risk completely, he might do better growing watermelons or pineapples on his land. Or perhaps letting an investor use his land and take the risk; for in this way, at least, he is ensured a fair rental price for the land.

Banks must have a strategy for recovering their money when the borrower finds that he is unable to make the monthly payments. To do this they must have the power to foreclose on loan defaults—that is, to



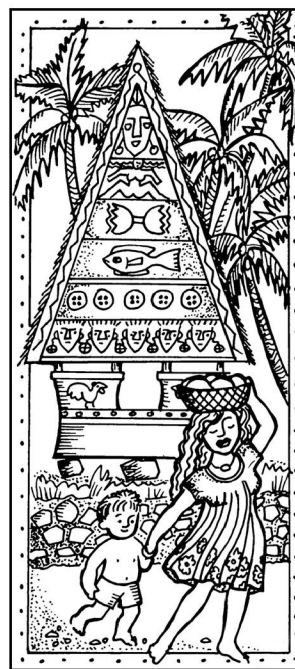


take over the property of the owner and put it to use. It should be obvious that this is not easy to do in a place like FSM. Landowners are not likely to stand by idly while the bank takes over their property. Indeed, foreclosure has never happened in the past, although there are instances where it was called for and a few instances in which it is in progress right now. Lenders (meaning mostly banks) must be assured that foreclosure is at least a possibility. They need this confidence to extend loans and have hope of recovering the collateral that is being used.

Letting Someone Else Do It: Land Leases

If we don't want to take the risk of developing our own land, we can lend it to someone with the money and experience to do this for us. This option would mean that we would lease our land to an investor for a stipulated period of time so that he can establish a business on it. In return, we receive rent for our land at a price that is mutually agreed upon. Much of the development overseas happens through such lease arrangements with foreign investors.

Keep in mind, though, that land leases are not foreign aid; they are an investment. Land is leased by people whose overriding purpose is not to subsidize our nation, but to make a profit. As they are making their profit, of course, they also help us. They help the nation by providing the money and initiative for development, and the family that owns the land by providing a cash income for the use of their resource. They are not an evil force from the outside to be kept out if possible, tolerated if necessary, but on no account welcomed to the islands. They are allies, not the enemy.



- *Be reasonable in what you expect to get for your land.*

People are inclined to inflate the value of their land, sometimes expecting an entirely unrealistic sum of money for the rental. Land value depends in great part on the demand in a particular location. There is a huge difference between the going price of beachfront property in the tourist section of Saipan and interior land on Kosrae or Pohnpei. For that matter, there is a significant difference between the lease rates of property in town and those in a remote village. The landowner would do well to know these values ahead of time so that he is in a favorable position to bargain with the investor. Be aware that you need not estimate the potential value of the property 25 or 50 years from now. If these recommendations are followed, a procedure will be adopted permitting rent adjustments for the changing value of the land in the years ahead.

- *Be sensible in the payment schedule you ask for.*

Don't accept all the money at the beginning of the lease term. For one thing, this presents too much of a temptation to squander the money long before the land lease runs its term. We have all heard the stories of how the money offered in a single lump sum payment by Japanese developers to some of the landowners in the Marianas was spent on Rolex watches and Infiniti automobiles. There are stories of some families who spent the money by the end of first year of the lease. An even bigger problem is that there is nothing left for those in the family who come later. They're bound to feel cheated when they realize that the money for "their" land, received in a one-time payment years before, has long since been spent by an earlier generation.

Instead of the lump sum payment, in which the entire lease payment is made at the beginning of the lease term, a periodic payment model is recommended. The land rental should be paid yearly, except perhaps for a five-year up-front payment at the beginning of the lease term. One of the benefits of smaller payments throughout the lease term is the lease figure can be adjusted for inflation and market changes. Most developers prefer paying a lump sum up front because it takes care of their land costs for the entire term. Of course, since it



To provide secure lease agreements will mean speeding up the land registration that has been carried on in the states for years now. Land in those areas that are most desirable for investors will have to be given priority in the registration program. Also required here is a expeditious process for clarifying the status of a parcel of land that is being considered as a site for a development project.

- *Investors who establish a business in the islands will have to be protected against local squatters.*

The examples given earlier in this paper represent only a fraction of the cases in which squatters have disrupted the efforts of developers to bring a project to a successful conclusion, whether the project be a business or a school or church. When this happens in the future, the government will have to intervene forcefully on behalf of the party with valid lease rights. To fail to do so would send negative messages about the willingness of the local government to back developers in cases where they have a justifiable complaint.

- *The courts must show impartiality in their judgments, for courts that rule in favor of local interests regardless of the merits of the case will only discourage outside investment.*

In land cases as in other disputes, it's always easier to rule against the outsider, who will be gone soon anyway. State courts have often done just this very thing. If it continues, word will pass through the international investment community that FSM has no intention of giving these people a fair hearing when disputes occur. This will certainly create a reluctance to invest in this country.

Advice to the Landowner

Landowners as well as investors need protection, as we have stated again and again. The suggestions made here are not so much in the form of legal protection as in advice to a person who is considering leasing his land.



Checks and safeguards to protect the interests of its citizens are a necessary precaution in a new nation like the FSM. Yet, they should not be so numerous and stringent that they discourage foreign investment at the very time the nation needs it most. In the future, most of the development money for the nation will almost certainly be furnished by outside investors. Present attitudes and laws are not very welcoming, it would seem. As one former high-ranked FSM employee writes: "Many believe that the courts, especially at the state level, are biased in favor of squatters over owners, citizens over non-citizens, debtors over creditors."

Let's look at this a little more closely. Squatters tend to move onto land, especially land that is in the hand of foreigners, with impunity. Police enforcement against this kind of squatting is lax, even more so when the business owners have no social ties or power base in the community. When a church group leased land in one place to set up a radio station, squatters moved in on them soon after the building was finished. Stone throwing and shouting matches erupted, driving the church group off the land. The dispute went to the court, but the courts are reluctant to throw squatters off the land for they are seen as citizens in need of land. In the mind of many FSM citizens, it does not seem fair that some foreigner should exercise rights over a relatively large parcel of land when the local people have nothing. In the case of the radio station, years have gone by without any resolution of the squatter issue.

There are dozens of other cases that could be used to illustrate this point. A family that leased land to another religious group for a church abruptly terminated the lease and reclaimed the land after the church was built. The family now lives in the church, although they reportedly keep the sign on the lawn because it gives them tax exempt status. A private school, which received land from the government that was formerly used as a dump, cleaned up the area and put in an access road. Once the reclamation was complete, squatter families moved in to share the land with the school. Gradually they took over more and more of the area, interfering with classes and other school activities and sometimes demanding that the school children be quiet so as not to wake up their sleeping children. Eventually the pressure became so



strong that the school had to move to another location. Its old site has been entirely taken over by the squatters.

FSM and its states are seeking investment dollars and the economic growth that it brings, but we are inviting investors to play a game on an uneven field. We will take their money, but will not offer them the opportunity they seek for the hope of a reasonable profit. In the event of a dispute with squatters or the landowner, the local people will almost always win in the courts. No investor with any sense would do business with us under conditions such as those. We'll have no takers. And with no investors and with Compact development funds running out, who will provide the seed money for development that is so badly needed?

Please note that we are not talking about radical liberalization of land law that will result in massive land alienation. There is no question of selling off land en masse—or of selling off land at all, for that matter. No one envisions a repetition of what happened in Latin America: the sale of huge tracts of land to a Pacific version of the United Fruit Company, so that we all can become peons working for someone else on our own land. Foreign ownership of land is not a real option in Micronesia, given the small amount of land in the islands. Not now, and perhaps never. Land is limited in these islands, and people would rightly like to keep it. The only question is how they can use it wisely and productively.

How Do We Change the Investment Climate?

If FSM wants to attract foreign investment, the climate here will have to change. This does not mean dropping all the protectionism designed to benefit local landowners, but it does mean that present legislation will have to offer similar safeguards to protect the investments of those funding the development dollars for the islands. The enforcement of the existing and new legislation must also be tightened so that they protect the rights of citizens and non-citizens alike.



The most important changes are these:

- *Land leases must be of sufficient length to attract investors, even if this means lengthening the maximum lease period stipulated by law.*

Some larger businesses require a long time before the business repays the huge investment. A major tourist resort complex, for instance, can take years before it begins to turn a profit. Such resorts often operate at a loss until they build up a clientele, and even then it might be years before they recoup the huge outlay for construction that usually runs into the millions. Even if the developer intends to sell out early, the resort will be less attractive and command a smaller price if only a few years are left on the lease term. In general, short-term leases are far less attractive to investors than long-term leases. Investors are understandably afraid that after the 25-year lease expires, the landowners will demand impossibly large rent for a lease extension or repossess their land, with the resort on it, if their demands are not met.

The land lease laws will probably have to be changed to allow for longer leases. Pohnpei's maximum lease length was only 25 years, but the legislature allows for 55-year leases if certain difficult conditions are met. Yap's longest lease term is 50 years, but even this might have to be extended in the case of very large investments. The other two states, Kosrae and Chuuk, have no legislation governing lease terms.

- *Lease agreements must be secure so that investors have a fair chance to recoup their money without fear of the landowners reneging on the lease.*

There are many unfortunate cases in which investors have signed lease agreements only to find out, after the project is well underway or even completed, that the person who signed the lease agreement did not have title to the land after all. The land which the signer represented as his land might have been owned by an extended family group, some of whose members were not consulted before the transaction. Or his claim to the land might have been under dispute from the start, unbeknownst to the investor.