

Review of the Property Market 1999

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This year saw cautious optimism in the residential property market. Strong take-up rates for affordable homes were registered but they were mainly confined to select prime locations. Buying interest in the outlying areas, although it has shown some improvement due to lower interest rates and improved market liquidity, was still subdued despite the price differentials. In terms of supply, the recession saw the exit of new and less experienced developers from the market, resulting in a relaxation of supply-side pressure. Overall, a renewed sense of optimism arising out of an improved market sentiment was evident.

Market response to new launches at the end of last year has been mixed and segmented. In response, several home ownership campaigns were launched, offering attractive discounts to house buyers, such as no stamp duties and reduced legal fees, but noticeably, they involved the harder to sell units. More established developers with projects in desirable locations were conspicuously absent from the sales campaigns. Nevertheless, by all accounts, the campaigns did achieve their objective of clearing most of the unsold stock in the housing market.

Several measures were undertaken by the government to stimulate the housing market. They included establishing a number of funds to support the construction of low and medium cost housing where demand remains strong in spite of the recession, import content was low and sectoral linkages were high. Lending for houses costing less than RM250,000 was relaxed, and were exempted from the 20 per cent lending limit to the broad property sector. Ceiling prices of low-cost houses were relaxed to ensure a greater supply of such houses in the market.

In the second half of the year, an increasing number of new residential launches in the primary market were evident. This happened as developers moved to capitalise on the current low interest rate environment and the market expectation of a recovery in the underlying economy. There is also growing evidence of market stability, particularly for landed residential properties in both the primary and secondary markets. The lower BLR rates by about 4.85 per cent from its peak level led to more affordable houses being built and purchased, as developers enjoy lower borrowing costs and buyers lower monthly interest payments.

The strong take-up in established locations was due to two main factors. First, there was a mismatch between effective demand and physical supply due to a scarcity of units available for sale in prime residential areas.

Second, developers adopted marketing strategies that offered more affordable units in prime neighbourhoods.

Prices showed a slow but steady recovery. By the end of 1999, residential property prices are expected to gain around 20 per cent over last year's prices, quite an achievement considering the sentiments in the property market barely two years ago. Prime property prices are, however, still lower than their levels in 1996, just before the economic crisis hit the region. However, these increases are not across the board, but segmented according to locations and price ranges, with the affordable units in major development areas enjoying the greatest price hikes.

Banks, which are under government pressure to achieve a loan growth of 8.0 per cent for

1999, are becoming receptive to end financing. Foreign banks in particular are aggressively offering competitive mortgage rates in a move to increase their market shares in mortgage lending. Spreads over the base lending rate for the foreign banks are reduced to 0.5 to 1.0 per cent for the first two years, from 1 to 1.5 per cent previously.

Expectations for 2000

Positive macro-economic developments in 1999 include the improved sentiments, a pick-up in vehicular and manufacturing sales, an improvement in the Industrial Production Index, progress on the banking sector restructuring and upgrades by most of the major international rating agencies. At the same time, Danaharta has acquired nearly RM29 billion worth of non-performing loans from banking institutions, of which land forms approximately half, mostly from small, inexperienced developers. It reflects the bank's continued reliance on property as collateral for loan approvals.

The mass residential property market should benefit from the shifts in household allocation, given the lack of investment alternatives in Malaysia after the onset of capital controls. Additionally, the low yields on fixed deposit rates, an undeveloped bond market and an increasingly overvalued equity market after the recent liquidity rally will further boost the residential property market. Stock prices looked like they have reached their highs, which may channel excess domestic liquidity from equity into property. The impact of such flows will be segmented, with the strongest concentrations on selected prime locations. The main concern remains supply saturation in newly-established townships that have yet to attain critical residential mass.

Domestic interest rates should not be affected too much by movements in the US or regional interest rates since international liquidity flows are curbed with the imposition of capital

controls. The intervention rate, which sets the benchmark base lending rate, is now at a huge 275 bps premium to the three month KLIBOR (3.25 per cent) when compared to the historical spread of about 70 to 80 bps. Coupled with recent evidence of weak inflation numbers, this suggests there is room for further cuts in the future. With interest rates expected to remain low, consumer sentiments improving and developers still cautious with their pricing, a revival in the housing market is foreseeable.

A significant 25 per cent increase in office space, or about 12.8 million square feet, is expected to come onstream in the next year, creating a total supply of 63 million square feet by the end of this year. Of this amount, about 89 per cent would be located in the areas outside of the Golden Triangle. However, the actual physical supply may be less than projected as developers are likely to phase out the completion of these new buildings. On the demand side, corporate downsizing and merges of banking institutions are likely to result in negative office space absorption. This may be moderated by the expected slight pick-up in the national economy.

In terms of office rentals, the divergence between gross and effective rental rates should widen in the year ahead as landlords of established buildings compete to retain tenants. The rate differential is expected to be widest in buildings located in less established areas outside of the Golden Triangle, where supply saturation is most acute. Capital value expectations of the implied residual land value for commercial property may fall to near zero. The average rental rates in the Golden Triangle, have fallen by a further 10 per cent in the second quarter of 1999, to around RM3.00 to RM3.50 psf. In the suburban areas, the rental rates have plunged by as much as 60 per cent, to as low as RM1.00 psf, which just meet the service/maintenance costs of the building. □