

Foreign investors are eyeing Malaysia!
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This could be good news or bad news. The reader has to be the judge. RICS Global Distressed Property Monitor, a quarterly guide to the developing trends in the commercial property investment and occupier market, reports that Malaysia topped the list for enquiries into distressed property listings from specialist funds, with the net balance improving from +22 to +47.

Specialist funds are one of the places where the 'smart money' sits and waits for opportunities, as opposed to the other type of money which just runs with the herd. The specialist funds are not rushing in yet, but their collective interest level in Malaysian distressed commercial properties is twice the amount of said properties that fell into the market in the last quarter.

A distressed property is defined as a property that is under a foreclosure order or is advertised for sale by its mortgagee (the real owner of the property aka The Bank). Distressed properties usually fetch a price that is below market value.

Note that in a typical real estate cycle, non-residential (commercial and industrial) real estate follows residential trends with a time lag of about five quarters (the historical range is 3-8 quarters).

This raises some questions.

1. Why is the 'smart money' eyeing something which many of us believe has not happened yet, or as some believe, will never happen?
2. Why is Malaysia ahead of all other countries and property markets, sitting squarely on the bulls eye?
3. If the smart money is already targetting the distressed commercial real estate sector, what is the story with the residential market then?
4. Or is this just a lagging response to the minor house price correction from Q4 2007 to Q3 2008?

The answer is important because many subscribe to this belief, 'housing provides the only feasible investment opportunity during crisis...' (Source: Rehda presentation slides). And this can set us up for a meltdown if we ignore the warning signs that may or may not be out there.

A visit to the latest Bank Negara banking statistic reports gives the following picture. This is the best available after wading through the heaps of numbers there, please bear with them, or skip the numbers and just read the conclusions

Borrowers are repaying most of their debts at a higher rate than before, except in the residential sector, which has fallen -7.2% in real terms (the nominal fall and the shortfall from the aggregate increase year-on-year).

The data for the repayment by type is incomplete at BN, but with what is available, the numbers show that the mortgage delinquency rate amongst borrowers from the lower end

of the spectrum is falling, and increasing at the higher end.

This might seem contrary to logic until you consider that the rich are far more ruthless when it comes to their investments, they will just walk away, but the working class Joe will scrimp and suffer to meet their obligations.

The next question is whether the banks are sitting on the foreclosed inventory as is happening in the West in an effort to keep valuations high enough so that more will enter into debt with them?

If delinquency rates are increasing at the upper spectrum of the housing market, we should see a decrease in mortgages applied and approved, that is not the case. 'New bookings are leading a boost in home loan application. 61 percent reported mortgage applications for residential properties rose. Approval for housing loans are equally appealing with 50 percent confirmed that approval of such loans have increased.' (Rehda)

In terms of supply, 57 percent of developers had new launches in H12010, as compared to 37 percent in H2 2009. The best part is that new launches for apartments, condominiums, semi-D's and bungalows have increased the most. Semi-D/Bungalow from 19 percent in H2 2009 to 28% of all launches in H1 2010. (Rehda)

Where does this put us in the real estate cycle? The reader has to be the judge.

The stages of the real estate cycle:

1. Population growth and commercial growth at the early stage of the economic cycle, often supported by government encouragement/low interest rates, creates an increase in the demand for housing and commercial buildings in excess of current supply.
2. It takes time for construction to gear up. This construction increases demand for vacant land. Bank loans are attracted to construction and real estate sales as prices begin to rise.
3. As vacant land prices rise a boom in land develops, leading to sub-divisions and speculative resale.
4. The real estate cycle peak is characterised by a high volume of subdivision and sales.
5. Construction catches up with demand and a small surplus is created. Rents can't go up enough to support the higher property costs, making new construction and rental property investment unprofitable. Land values start to adjust downwards, the bubble/mania is broken.
6. Rising interest rates hurt confidence and profits, adding to the downwards pressure on prices. Real estate enters a 'hanging' slow phase. Asking prices stay high but there are few buyers. Building, subdivisions, and speculation drops quickly. Sometimes a panic or crash begins at this point; often the market just slowly dies. Many keep speculating during this phase as they're unaware of the market having turned.
7. Real estate starts to get marked down in price. This tends to take quite a while as owners tend to cling to mortgaged property longer than they would to other assets, like shares. Foreclosures rise but the foreclosure process is not quick.
8. Mortgage costs/interest rates are higher, rents decline, and vacancies increase. The

market is dying rapidly. Foreclosures increase; speculators and investors are forced to sell as the capital value of their property decreases below lending margins and rents decrease below holding costs.

9. The bottom of the market has the following characteristics: high vacancies, low construction rates, foreclosures and no speculation. Debt must be written off and properties sell at a deep discount. Only those who entered stage six with little or no debt survive to buy the dramatically discounted properties.

A quick look at the US, as there is no market better studied than that. Look at housing. The facts are grim. This is from Charles Hugh Smith:

About two-thirds of US households own a house (75 million); 51 million have a mortgage and 24 million own homes free and clear (no mortgage). Most of the other 36 million households are moderate/low income and have limited or no access to credit and limited or no assets.

If we look up all the gory details in the fed flow of funds, we find that household real estate fell from US\$23 trillion in 2006 to US\$16.5 trillion at the end of 2009. That is a decline of US\$6.5 trillion, more than half the total US\$11 trillion lost in the credit/housing bust. Home mortgages have fallen a negligible amount, from US\$10.48 trillion in 2007 to US\$10.26 trillion at the end of 2009.

As of the end of 2009, total equity in household real estate was a paltry US\$6.24 trillion of which about US\$5.25 trillion was held in free-and-clear homes (32 percent of all household real estate, i.e. 32 percent of US\$16.5 trillion).

That leaves about US\$1 trillion – a mere 1.85 percent of the nation's total net worth – of equity in the 51 million homes with mortgages...US\$6 trillion in wealth is gone - from 'What we know – and don't want to know – about housing', Charles Hugh Smith, of two minds.com)

Are we going to have a bust in the property market? Maybe it's not all bad news, if we look at the 'Property Recommendations Mid 2010' by Global Property Guide.

'With a slightly sinking feeling, we make the following recommendations: Malaysia. Kuala Lumpur is relatively low cost, has good yields, and low transaction costs. Capital gains taxes are low but income taxes are high. The worry is high capital flight, which indicates that something is amiss in Malaysia's economic environment.'

Apart from this recommendation and another one meant for the super rich who are looking for multimillion dollar properties, we are absent from everywhere else. The latest focus is on Colombia, Turkey, South Africa, Egypt, Thailand, Vietnam and Indonesia as far as emerging markets go, apart from the usual suspects i.e BRIC.

Conclusion? A double dip in the global economy, which is looking like a sure thing, will not see FDI inflows in the areas we would like, but will see money come in to snap up properties at fire sale prices. The beneficiaries are the banks, the victims will be all of us.

I wish I could send some strongly worded questions to the shadow minister for housing; does anyone know who he/she is, and where he/she is hiding?

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