



Cambodia Outlook Brief*

2009, N° 06

Managing through the Crisis—Strengthening Key Sectors for Cambodia's Future Growth, Development and Poverty Reduction: Real Estate, Property and Construction¹

“The real estate industry is operating in a highly uncertain and risky environment ... Not enough regulations, legislations and standards exist to govern the ... industry.”

Nguy Tayi, undersecretary of state and chair of the Inter-Ministerial Task Force, Ministry of Economy and Finance

The Crisis and Cambodia's Real Estate: Impact and Gaps

Cambodia's real estate industry presently operates in a highly uncertain and risky environment, causing worry among investors, traders and buyers. These uncertainties spill over into the construction sector, one of the country's four key growth drivers.

In 2007, real estate was experiencing a boom. Land prices in Phnom Penh were reportedly up by 50 to 80 percent during that year. Many investments were arriving from South Korea, and several construction mega-projects were scheduled. These fed confidence and resulted in too much speculation. The emergence of a real estate bubble was hardly surprising. Caught up in the hype, many perhaps were unmindful or even unaware of the risks. They did not see an end to the profitability of investing in real estate—newly built apartments units would keep on selling, land could be re-sold easily with a high rate of return and South Korean investments would remain strong.

¹ This is a summary of the presentations and discussion in session 3B (ii) of the 2009 Cambodia Outlook Conference. Presenters for this session were Mr Anthony Galliano, head of Corporate and Institutional Banking Relationships, ANZ Royal Bank, Business Banking Centre; Mr Sung Bonna, director and CEO, Bonna Realty Group; and H.E. Nguy Tayi, undersecretary of state and chair of the Inter-Ministerial Task Force, Ministry of Economy and Finance.

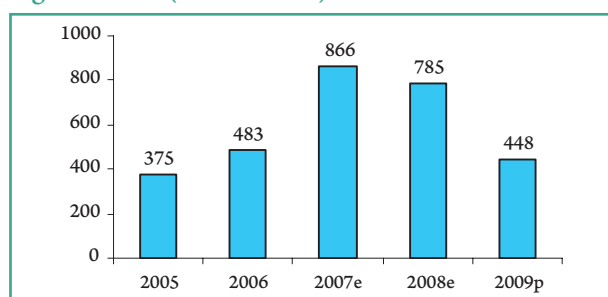
By 2008, signs of overheating, such as overpriced construction inputs, including labour, were visible. Still, prices kept rising for some time, skyrocketing by as much as 100 percent from the year before. Indeed, it was felt that, like any other economic bubble, the domestic real estate bubble would burst eventually. But with the impact of the crisis, and helped by the slowdown in global real estate, the bubble burst sooner and more violently than expected.

The crisis dissolved the previous trust and confidence in the sector. According to estimates, it pushed the number of sellers up by around 45 percent as more investors decided to give up on their lower priced holdings, expecting the situation to get worse. It also caused the number of buyers to collapse to 0 to 5 percent of their previous number, prices to drop by 30 to 40 percent and sales to decline by 50 to 80 percent. It drove companies to cut the number of their employees or close their operations. It is estimated that 15,000 construction jobs were lost by the middle of 2008. Around 30 percent of construction workers in the country have lost their jobs as a result of construction projects being cancelled or suspended.

Brokers, architects and other higher skilled workers depending on this sector have also lost jobs or suffered increased underemployment. The growth of construction is estimated to have slowed from 6.7 percent in 2007 to -0.3 percent at the end of 2008. All these developments suggest tax losses for the government.

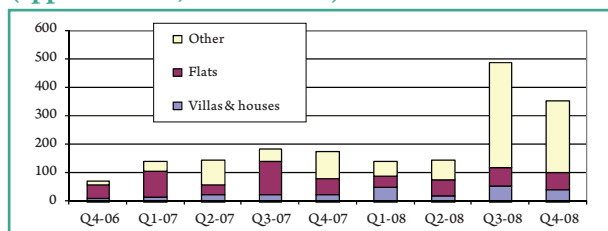
This turn from boom to bust in real estate can be explained by the impact of the crisis on investment and income. The crisis cut the inflow of external money to Cambodia. With their economy badly hit by the crisis, South Korean investors, for instance, found it harder to get credit from banks or financing from their parent companies. This forced some of them to withdraw their investments or delay their projects. Seeing the risks and uncertainties in real estate increase, both foreign and domestic banks tightened their lending to the sector. Meanwhile, the crisis also reduced incomes and decreased citizens' confidence in the economy, compelling them to keep their money "under the mattress" rather than spend or invest. For those who bought properties meaning to re-sell them later for a profit, declining prices and the bleak outlook for real estate motivated a number to sell quickly or, with demand low, to wait and cope with the forgone profit. Compounding the problem was the weak and incomplete legal framework governing real estate.

Figure 1: FDI (USD million)



Sources: IMF, NBC (p = provisional)

Figure 2: Value of Construction in Phnom Penh (approval basis, USD million)



Source: Municipality of Phnom Penh

In an attempt to rein in the effects of the crisis on real estate, the government removed the 15 percent cap on bank lending to the sector and issued regulations to increase supervision and protect property buyers from investors without sufficient capital. The regulations include the creation of an inter-ministerial body that will oversee the sector, management and control of the issuing of licences and a requirement of locked accounts for client deposits.

The effectiveness of these measures has been debated by critics. Given the bigger risks and gloomy prospects for real estate, it is uncertain whether banks will respond

positively to removal of the loan cap. Protests also met the regulations aiming to increase government control. Opponents complained that some of the regulations could drive companies to their death at this time of crisis, arguing that withdrawal or delay in the implementation of the directives is called for. However, supporters of the regulations believe that they should be implemented because they will provide buyers protection from bad developers or investments.

The Crisis and the Way Forward: Outlook and Future Policy Directions

Uncertainties and risks in the sector are predicted to continue this year. This will affect construction. Growth of the construction industry is expected to slow further to 5.7 percent this year. Employment predictions are not encouraging. It is projected that 100,000 to 150,000 jobs in construction, brokerage, architecture and related areas will be lost in 2009.

Critics feel that the government has shown more concern to address the effects of the crisis on other sectors, neglecting real estate in the process. Thus, the government is strongly called upon to direct attention also to real estate. Some crucial policy options that it can undertake are:

- development of the legal framework for real estate (significantly incomplete at present) by establishing standards for valuation, commissions/fees and real estate agency operations; adopting a code of conduct for developers; and enacting a housing development act;
- integration of the National Valuer Association of Cambodia into the ASEAN Valuers Association;
- establishment of an institute for real estate professional training;
- establishment of a housing developer association;
- making relevant documents more accessible to investors, reducing the bureaucratic complexities caused by local officials and enforcing the laws that protect investors;
- suspension of the enactment of regulations that tighten government control or increase the difficulties of investors;
- lowering of the interest rate on banks loans for the real estate sector;
- wider public availability of data on the prices of land.

Real estate players are now largely reaping what they sowed at the time of the boom. Excessive speculation always comes with a heavy price. To prevent another bubble, government supervision together with a clear legal framework is necessary. However, how far this supervision must go is a debate that is yet to be settled.

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