

Managing Through the Crisis –Strengthening Key Sectors for Cambodia’s Future Growth, Development and Poverty Reduction: Real Estate, Property and Construction

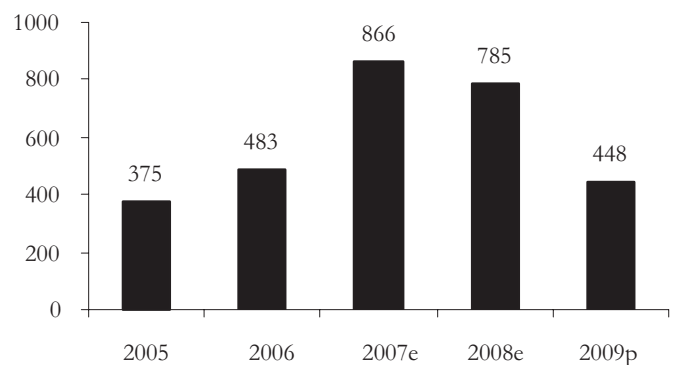
This article summarises the presentations by H.E. Ngy Tayi, Mr Sung Bonna, and Mr Anthony Galliano¹ during session 3B(ii) of the 2009 Cambodia Outlook Conference.

Cambodia’s Real Estate Sector: From Boom to Bust

Cambodia’s real estate downturn comes after a distinct period of boom in 2007. During that year, land prices in Phnom Penh soared by as much as 80 percent. Investments, especially from South Korea, were flowing into the country, and several highly anticipated mega-projects were under construction. These inflated expectations fuelled significant risk-taking and speculation. The real estate bubble was created because many people saw unhindered continued profitability from investing in real estate. The popular perception was that land and newly built apartment units would continue to be in high demand and thus could be sold easily for a high return. There was also unguarded optimism about the robustness of foreign investment inflows. Since much construction is for business and residential real estate, this optimism spilled over into the construction sector.

The crisis, both an outcome and a cause of the global real estate meltdown, eventually caused the bursting of Cambodia’s domestic real estate bubble. By 2008, signs of overheating, such as overpriced construction materials and labour, could be detected. Real estate prices continued to escalate at least until the middle of 2008, to as much as 100 percent over the prices of a year earlier. However, as the crisis deepened in the final two quarters, the bubble was unsustainable in the face of a worsening credit crunch, tighter bank

Figure 1: FDI (USD million)



Source: IMF (2009)

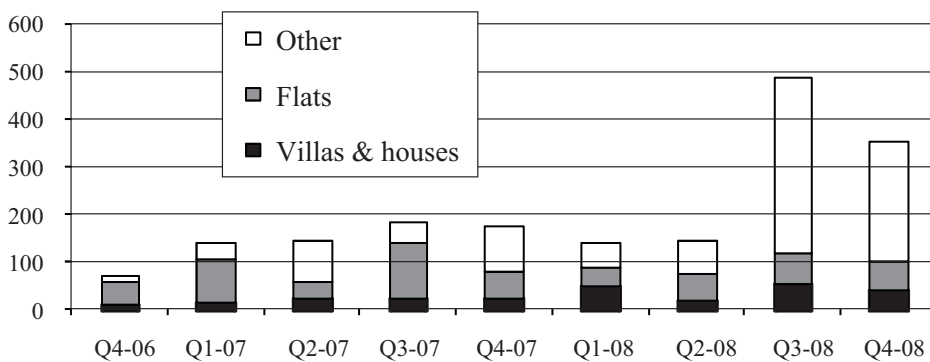
lending, investment flight and greater investor and consumer wariness.

The global crisis dissolved the previous confidence in the real estate sector. On the supply side, it is said to have pushed the number of suppliers up by 45 percent as more people sought to get rid of their lower priced holdings in worsening conditions. Demand is said to have stagnated or even decreased to about 5 percent. As a result of these dynamics, prices went down by 30 to 40 percent and sales plummeted by 50 to 80 percent. Overall, the construction sector is estimated to have contracted in 2008 after growing by 6.7 percent in 2007.

These developments resulted in tax losses for the government and adversely affected employment. As companies either cut back on operating costs or closed, significant lay-offs and increased underemployment occurred. It is estimated that about 15,000 construction jobs were lost by the middle of 2008. A worse estimate is that around 30 percent of construction workers in the country have lost their jobs as a result of projects being suspended or stopped. The crisis has not affected only construction workers. Brokers, architects and other higher skilled employees in real estate and construction have likewise suffered job losses or increased underemployment.

Currently, the real estate industry and, by

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

Source: Municipality of Phnom Penh

implication, the construction sector are operating in a highly uncertain and risky environment. Real estate investors, traders and buyers have already voiced grave concern regarding this sudden turn from boom to bust. The downturn is largely attributable to the slowing down of foreign investment and reduction in wealth. Tighter financing conditions and worsening growth prospects have prompted suspension or scaling back of investment plans. As their country's economy was hit by the crisis, drying up credit and tightening bank lending, South Korean investors have been compelled to rein in their investments. According to IMF data, foreign direct investment in Cambodia is estimated to have decreased from about USD866 million in 2007 to USD785 million in 2008. Knowing the heightened risks in lending for real estate, banks in Cambodia have noticeably restrained their lending to the sector. Having reduced wealth, slashed incomes and damped confidence, the crisis prompted people to curb their spending as a precaution. An exacerbating factor was the weak and incomplete legal framework governing the domestic real estate industry. Had there been a better framework, the downturn might not have been as severe.

Responding to the Crisis: Policies and Issues

To stave off the deceleration in real estate and construction activity, the government implemented measures such as the elimination of the 15 percent cap on bank lending to the real estate sector. It is yet to be seen whether this move can cause banks to lend, given the continued risks. A more controversial government step was the issuance of regulations aiming to increase government control over the sector. An associated purpose of these regulations is to afford property buyers greater

protection from developers who have insufficient capital. The regulations include: creation of an inter-ministerial body to oversee the sector; management and control of the issuing of licences; and a requirement of locked accounts for client deposits. Some quarters have heatedly opposed these regulations and

called for their retraction or delay. They believe that they would further choke off investment at this time of crisis in the sector. Supporters of the regulations reply that they should not be delayed because protection from bad developers and investments is even more necessary at this time.

Uncertainties and risks in Cambodia's real estate sector are predicted to continue in 2009. This will have direct repercussions on the construction industry, one of the country's four key growth pillars. It is estimated that growth of construction this year will slow further, to 5.7 percent. It is also projected that 100,000 to 150,000 jobs in construction, brokerage, architecture and related jobs will be lost this year.

Feeling that the government has shown more concern about mitigating the impact of the crisis on other sectors, private real estate developers have appealed for greater attention from the authorities. Among recommended policies, a principal one is the development of the relevant legal framework. Standards have to be set on valuations, fees and commissions and real estate agency operations. A housing development act also needs to be adopted, together with a code of conduct for developers. Other recommendations include: integration of the National Valuers Association of Cambodia into the ASEAN Valuers Association; establishment of an institute for real estate professional training; establishment of a housing developer association; attracting more investment by making relevant documents more accessible to investors and simplifying bureaucratic processes; better enforcement of the laws that protect investors; lowering of the interest rate on banks loans for real estate; and wider dissemination of information on the prices of land. To prevent another real estate

bubble, there is no question that filling in the gaps in supervision and regulation is vital. The difficulty comes in finding a consensus as to exactly where

the gaps are and how far-reaching regulation should be.

Did you know that

... the subprime mortgage crisis, which set off today's global economic meltdown, was caused by the bursting of the US real estate bubble?

Higher than expected foreclosures and a bottoming out of prices starting in 2006 in many parts of the US led to rapid devaluation of mortgage-related assets, which lowered the credit quality of other assets and resulted in massive losses for many major financial institutions, prompting their eventual collapse. Arguably, real estate bubbles are hard to detect accurately in advance; however, there are indicators that can be used to gauge their existence, including price-to-income ratio and debt service ratio.

Sources: ADB (2008); Wikipedia

... the construction of highly anticipated mega-projects in Phnom Penh is said to have continued despite the downturn, although some delays have been reported?

Mega-projects in Phnom Penh include Camko City, Grand Phnom Penh International City and Diamond Island City. In the case of the Grand Phnom Penh International City, it has been reported that completion had to be moved back by about a year.

Source: Phnom Penh Post (2009)

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government, its development partners, the private sector and educational institutions can work together to respond better to Cambodia's human resource development needs, particularly vocational skills for a skilled labour force; what strategies will enable the country to best manage its way through the crisis, and to protect and strengthen key sectors for Cambodia's growth and development—agriculture and rural development, tourism, manufacturing and real estate, property and construction; what priority policies and actions should be on the country's development agenda in response to the crisis for collaboration among the government, development partners, the private sector and research and policy institutes; and how regional and global institutions, including international financial institutions and multilateral development banks, can better serve the needs of developing countries in response to the crisis and in the prevention of future crises.

There is much that needs to be done, and much that can be achieved with the strong commitment and cooperation of the Royal Government and its development partners, the private sector and research and policy institutions, working together in the best interests of Cambodia.

Box 1: Key Challenges Posed by the Crisis

- Challenge 1: To diversify the markets for our garments and other manufactured goods into east Asia, the Middle East, Africa and other non-traditional markets
- Challenge 2: To further improve tourism infrastructure and develop more tourism destinations and attractive tour packages
- Challenge 3: To broaden and diversify the agricultural sector, attract more quality investments in agri-business and improve agricultural trade linkages, land reform and agro-processing
- Challenge 4: To further invest in infrastructure development, particularly energy generation to reduce energy costs
- Challenge 5: To promote aggressively and support wealth creation and improve the people's livelihood according to the principles and procedures stipulated in Cambodia's constitution
- Challenge 6: To help the poor and vulnerable cope with the crisis through strengthening the social safety net with such measures as food relief and cash transfers
- Challenge 7: To fortify cooperation with regional partners and fellow less developed countries in advancing common interests in the international arena