Box Article 2

Imbalances in the Property Market

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HIGHLIGHTS

- **Supply-demand imbalances in the property market have increased since 2015.**
- **Unsold residential properties are at a decade-high, with the majority of unsold units being in the above RM250,000 price category.**
- **The oversupply of office space and shopping complexes in the major states will be exacerbated by incoming supply, potentially becoming more severe than during the Asian Financial Crisis.**

Introduction: Property market imbalances have increased

In Bank Negara Malaysia's 2015 Annual Report[1], the risks of property market imbalances in Malaysia were highlighted. Since then, the supply-demand imbalances in the residential and commercial property segments have increased. This article is aimed at providing an update on recent developments and to highlight existing and potential actions that may be taken to mitigate the risks.

Residential Market: Total unsold residential properties currently stand at a decade-high, primarily on account of the mismatch between the prices of new housing launches and what the households can afford to pay

In 1Q 2017, total unsold[2] residential properties stood at 130,690[3] units, the highest in a decade (Chart 1). This is close to double the historical average of 72,239 units per year between 2004 and 2016. About 83% of the total unsold units were in the above RM250,000 price category (Chart 2). 61% of total unsold units were high-rise properties, out of which 89% were priced above RM250,000. Johor has the largest share of unsold residential units (27% of total unsold properties in Malaysia), followed by Selangor (21%), Kuala Lumpur (14%) and Penang (8%).

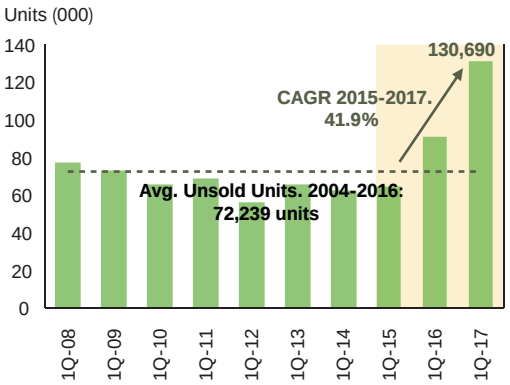
The large number of unsold properties is due to the mismatch between the prices of new launches and households' affordability[4]. Over the period 2016 to 1Q 2017, only 21% of new launches were for houses priced below RM250,000. This is insufficient to match the income affordability profile of about 35% of households in Malaysia (Chart 3). Secondly, the mismatch was exacerbated by the slower increase in median household incomes (CAGR 2012-2016: 9.6%) relative to median house prices (15.6%). These factors have resulted in median house prices in Malaysia being 5.0 times annual median household income in 2016, rendering house prices "seriously unaffordable"[5] in Malaysia. The housing affordability issue is even more acute in certain states, with house prices being "severely unaffordable" in Sabah and Penang (median multiple of 5.5). Such a wide disparity between the supply and demand of affordable homes has worsened the imbalances in the housing market.

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[1] Bank Negara Malaysia 2015 Annual Report box article "Assessing Demand-Supply Conditions in the Malaysian Property Market".
[2] Total unsold residential properties include unsold properties that have been completed (overhang) and unsold properties currently under construction (Source: National Property Information Centre).
[3] The figure includes small office/home office (SOHO) and serviced apartments (Source: NAPIC).
[4] For a more in-depth discussion on the topic, please refer to the Bank Negara Malaysia 2016 Annual Report box article "Demystifying the Affordable Housing Issue in Malaysia".
[5] Affordability thresholds are based on the Median Multiple approach by Demographia International (2017)

Chart 1: 130,690 unsold residential units, the highest in the decade

Total Unsold* Residential Properties

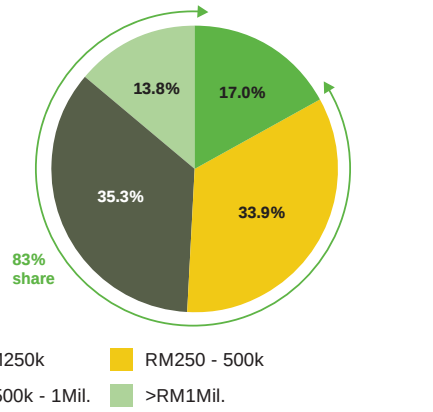


Note: *Includes overhang and unsold residential properties under construction. Includes Small Office/Home Office and serviced apartments

Source: National Property Information Centre

Chart 2: 83% of unsold residential units were in the above RM 250,000 category

Unsold* Residential Properties by Price Categories



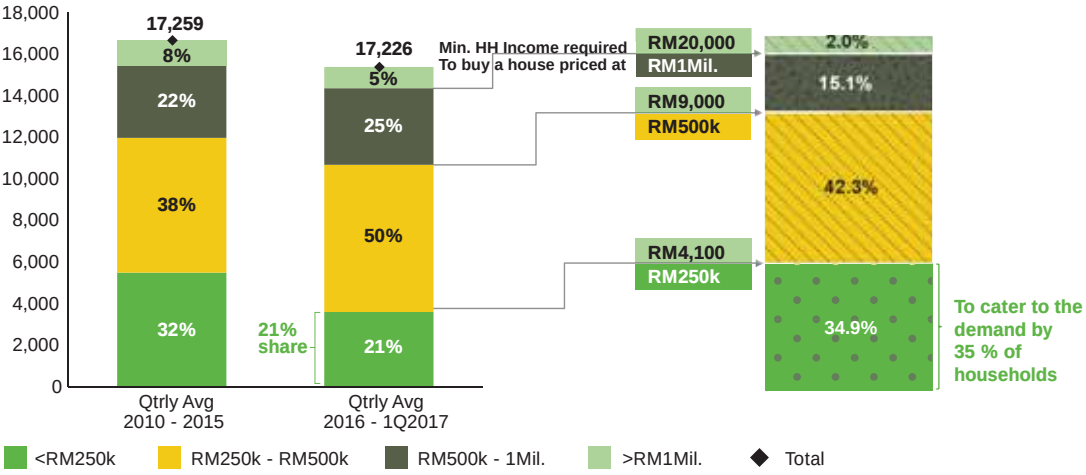
Note: *Includes overhang and unsold properties under construction, as well as Small Office/Home Office (SOHO) and serviced apartments.

Source: National Property Information Centre

Chart 3: 21% of new launches are for units priced below RM250,000. This is insufficient to cater to the demand by 35% of households

New residential launches by price category

Percentage of households and minimum gross household income required to purchase houses in the respective price segments



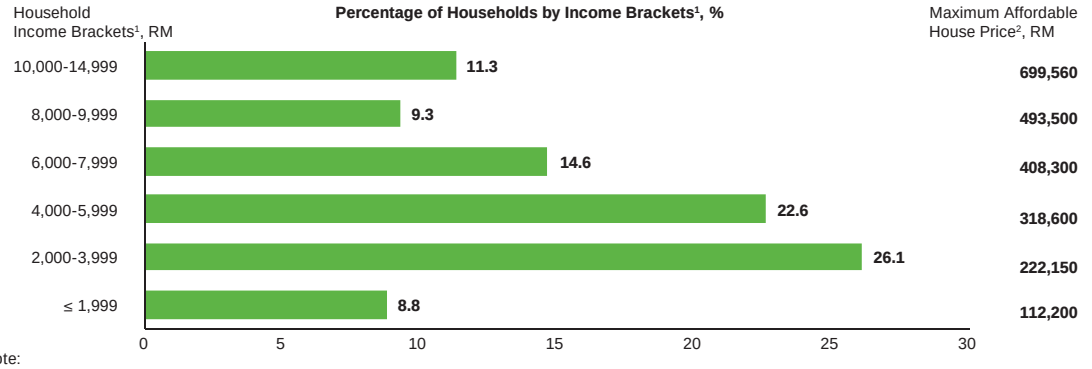
Note:
1. The above assumes households will purchase a house at the maximum price given their income levels.
2 Derived using the Housing Cost Burden Approach, in which a house is deemed affordable if the monthly housing repayment cost do not exceed 30% of household income. Estimates are based on prevailing interest rates and 35 year mortgage tenure.
3. Based on the 2016 Household Income and Expenditure Survey (HIES). Estimates for households earning above RM9,000 and RM20,000 are based on the HIES (2014), due to the lack of granular data at the point of analysis.
4. Data on new residential launches presented above uses final figures up to 1Q 2017. 2Q 2017 figures have not been included as they are preliminary, hence subject to revision.

Source: National Property Information Centre, Department of Statistics, Malaysia, Bank Negara Malaysia estimates

There are unsold residential units within the affordable price range of below RM250,000 (17% share). Several factors hamper the take-up of these properties. Firstly, this reflects the unattractive location of some affordable housing projects due to factors such as distance from work places and low transport connectivity. Secondly, the unsold affordable homes may reflect households' preference towards landed properties over high-rise properties. Thirdly, applicant registries maintained by providers of affordable housing may comprise many non-creditworthy[6] applicants, resulting in delays in the allocation of affordable homes.

[6] Applicants who do not have the financial means to even buy an affordable home.

Information Box: Housing Affordability by Income Levels



Note:
1 Based on the Household Income and Basic Amenities Survey Report 2016. Households earning RM15,000 and above account for 7.1% of total Malaysian households.
2 Estimates of maximum affordable house price is derived based on the upper-end of each income bracket, using the Housing Cost Burden Approach, in which a house is deemed affordable if the monthly housing repayment cost do not exceed 30% of household income. Estimates are based on prevailing interest rates and 35 year mortgage tenure.

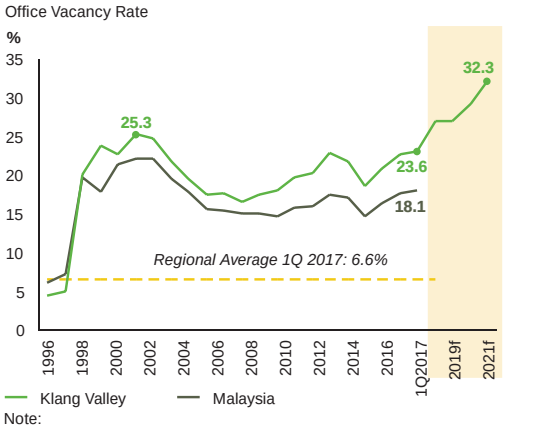
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Office Space: Incoming supply could exacerbate the glut in the Klang Valley

Since 1Q 2015, the office vacancy rate in the Klang Valley has increased steadily from 20.9% to 23.6% in 1Q 2017. This is higher than the national average of 18.1%, and more than three times the regional average of 6.6%[7] (Chart 4).

The incoming supply of 38 million square feet (msf) of office space could exacerbate the glut. The office vacancy rate is projected to reach an all-time high of 32%[8] by 2021, far surpassing levels[9] recorded during the Asian Financial Crisis. In other words, if current supply-demand dynamics persist, 1-in-3 offices in Klang Valley could be vacant in 2021. Total incoming supply could potentially be higher if future phases of the ongoing large development projects[10] are taken into account. This may result in further downward pressure on office rentals, which are already the lowest[11] in the region.

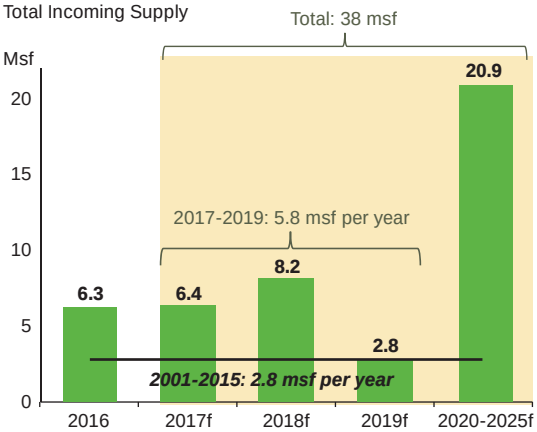
Chart 4: About 1-in-3 offices in Klang Valley projected to be vacant by 2021



Note:
1 Shaded area represents estimates of office vacancy rates going forward. For projects in the planning stage, new supply is assumed to enter the market by 2020 (45%) and 2021 (55%).
2 Regional average refers to the simple average for Hong Kong SAR, Beijing, Singapore, Shanghai, Seoul and Bangkok in 1Q 2017

Source: National Property Information Centre, Jones Lang Wootton, Jones Lang LaSalle and Bank Negara Malaysia estimates

Chart 5: Annual incoming supply from 2017-2019 to more than double the past 15 years



Note:
1 Shaded area represents estimates of incoming supply going forward. For projects in the planning stage, new supply is assumed to enter the market by 2020 (45%) and 2021 (55%).

Source: National Property Information Centre, Jones Lang Wootton and Bank Negara Malaysia estimates

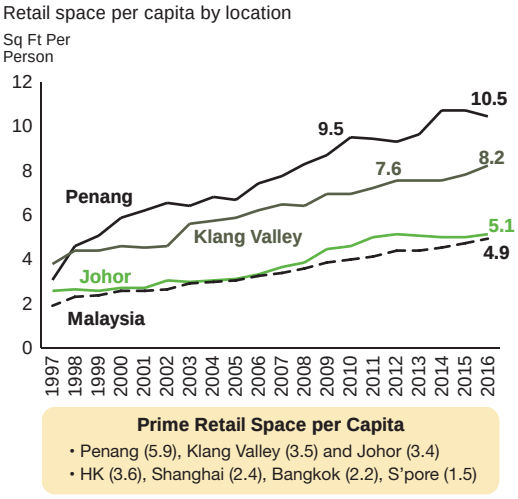
[7] Refers to prime office buildings. Corresponding vacancy rate is 22.6% in 1Q 2017 in the Klang Valley (Source: JLW).
[8] Projections assume all 38 msf of new supply enter the market by 2021, new demand of 2.6msf per year and GDP growth of 5.0-5.5%. Projections for new demand of office space are consistent with similar periods of economic growth during 2004-2016.
[9] Vacancy rate of 5.1% (1997), 20.1% (1998) and historical peak of 25.3% (2001).
[10] Tun Razak Exchange and Bukit Bintang City Centre.
[11] Monthly rents of prime offices in Kuala Lumpur (RM5.30 psf) are lower compared to Manila (RM7.40), Bangkok (RM11.10), Singapore (RM24.80) and Hong Kong (RM 85.00) (Source: Knight Frank Research).

Shopping Complexes: Large incoming supply to aggravate the oversupply across Klang Valley, Penang and Johor

Total retail space in the major states has increased sharply over the years. In 2016, Penang had the highest retail space per capita in the country (10.5 sq ft per person), followed by Klang Valley (8.2) and Johor (5.1). In higher-income regional cities such as Hong Kong SAR and Singapore, prime retail space per capita is only 3.6 and 1.5 respectively (Chart 6).

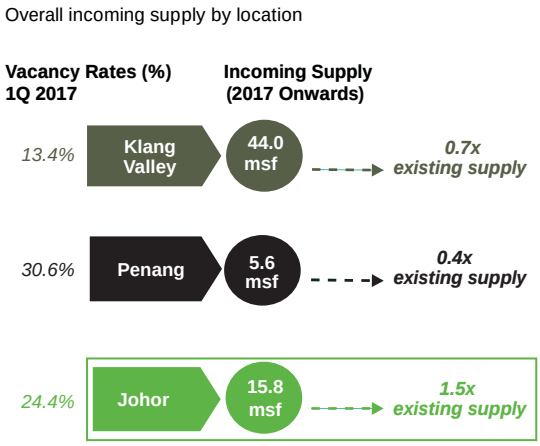
The incoming supply of 140 new shopping complexes by 2021 across the Klang Valley, Penang and Johor is expected to worsen the oversupply going forward (Chart 7). While Penang currently has the highest prime retail space per capita, it will be overtaken by Johor by 2018. The large incoming supply of 15.8 million square feet of retail space in Johor will be 1.5 times the existing supply.

Chart 6: Retail space per capita in key Malaysian states has increased sharply over the years, and is considerably higher than regional peers



Source: National Property Information Centre, Department of Statistics, Malaysia, Savills Research and Bank Negara Malaysia Estimates

Chart 7: Incoming supply of 140 shopping complexes in Klang Valley, Penang and Johor to worsen the oversupply situation going forward



Note: msf – million square feet

Source: National Property Information Centre, Jones Lang Wootton and Bank Negara Malaysia Estimates

Severe property market imbalances can pose risks to macroeconomic and financial stability

History has shown that excesses in the property market can pose risks to the wider economy. According to the IMF (2003), historically, housing booms have been followed by busts about 40% of the time, with housing busts being associated with longer economic downturns and larger output losses[12] compared to equity price busts. Given that there are imbalances in both the residential and commercial property markets in Malaysia, this is a source of concern as the property sector has linkages to more than 120 industries, collectively accounting for 10% of GDP and employing 1.4 million Malaysians.

Malaysia's own experience during the Asian Financial Crisis demonstrated that sharp corrections in the property market can have severe repercussions on the wider economy (Chart 8). In the years leading up to the Asian Financial Crisis, the Malaysian economy experienced a period of strong growth (1992-96: 9.6%). This fuelled exuberance in the property market, resulting in an increase in property prices and overdevelopment across the different property segments. This encouraged an increase in lending by banks to households for the purchase of properties and developers to fund the development of new projects. The ensuing construction frenzy also demanded large amounts of imports, which worsened

[12] On average, output loss following a housing bust was 8% of the level based on average growth rates before the bust (equity price bust: 4%), and lasted about 4 years (equity price bust: 1.5 years).

the current account of the Balance of Payments. When the crisis[13] struck and the property market crashed in 1998, projects were abandoned as developers' debt-servicing capacity weakened. Banks suffered losses as non-performing loans to the property sector doubled, resulting in a credit crunch. Spillovers to other industries then resulted in widespread layoffs and a severe economic recession. A similar story unfolded in Spain, Ireland and the US during the Global Financial Crisis – in these cases, large fiscal stimulus and bailouts had also strained the governments' balance sheets.

Chart 8: A vulnerable property sector poses risks to the economy



Source: Bank Negara Malaysia

The banking system has remained supportive of house financing, while becoming more cautious in the commercial property segment

Banks continue to play an important role in providing financing to house buyers, with more than 70% of all housing loans being given to first-time buyers. In the first nine months of 2017, RM121.6 billion of new housing loans were approved by banks, benefitting close to 300,000 borrowers. Of this, 60% were channelled for the purchase of houses priced below RM500,000.

With respect to the commercial property sector, banks have become more cautious in lending to this segment due to the oversupply situation, as shown by the lower loan approval rates for the construction and purchase of commercial properties. The banks' current exposure to the commercial property segment remains small, accounting for 5.1% of total bank loans.

These developments have reinforced the importance of existing micro- and macro-prudential regulations, such as the broad property sector concentration limit and single customer exposure limit as a means to ensure bank exposures to the overall property sector and individual property-related companies remain within prudent limits. Furthermore, current loan-to-value (LTV) ratio limits[14] also remain relevant to discourage speculative activity that drives up house prices and exacerbates the housing affordability problem. The Bank has also intensified monitoring of the banks' underwriting and credit risk management practices, particularly those related to the commercial property sector. In some instances, banks are required to enhance internal processes to ensure that related risks are effectively mitigated.

Overall, banks are assessed to be able to withstand a slowdown in the property segment as: (i) total loan exposures to segments with acute oversupply (i.e. commercial property and high-end high-rise residential) only account for 8% of total bank lending; and (ii) impaired loans ratio for the commercial property and housing segments remains low and stable at 1.2% and 1.1% respectively. Internal stress test simulations done on large corporate borrowers also indicate that banks' excess capital is sufficient to withstand potential credit losses from exposures to these borrowers, including large property developers.

[13] During the pre-AFC period (1992-96), property-related credit grew by 26%, construction activity by 14.8%, while house prices increased by 11.2%. During the AFC, real GDP contracted by 7.4% in 1998 (1997: 7.3%) with an increase in unemployment rate to 3.2% (1997: 2.5%). Private investment declined by 55.2% (1997:+9.4%), construction activity by 6.7% while fiscal deficit increased to 1.8% of GDP (1997: +2.4%). During the post-AFC period, there were continued weaknesses in house prices (1999-2003: 2.2%), fiscal balance (-4.8% of GDP), unemployment rate (3.4%), private investment (-4.1%) and construction activity (0.7%).

[14] LTV ratio limit of 70% on the third and above housing loans of individuals and 60% on all housing loans of non-individuals.

Policy considerations need to go beyond financial regulatory measures

A multi-faceted approach should be considered to address the imbalances in the property market (Table 1) as the effect of regulatory constraints on lending is limited. This is because developers also fund their projects using internal funds and proceeds from capital market issuances. There is a need for all parties, from the Federal and state governments, to property developers, to act in a concerted manner to manage the imbalances in the property market.

Table 1: Reducing Supply-Demand Imbalances in the Property Market

Issue	Segment	Policy Options	Details
High level of unsold residential properties	All price ranges	Encourage rental market	• Develop a strong rental market by enacting the Residential Tenancy Act and establish a Tenancy Tribunal to safeguard the rights of both tenants and landlords[15]
	Affordable housing	Increase efficiency in provision of affordable homes	• Establish a single entity for affordable housing to accelerate the rebalancing of supply towards the affordable range • Ensure that the development of new projects are in decent locations with good transport connectivity
		Increase efficiency in allocation of affordable homes	• Ensure applicant registries are regularly updated, verified and filtered to prioritise credit worthy households • Direct ineligible applicants to rental housing
Large incoming supply of commercial properties	Office and shopping complexes	Managing new incoming supply	• Commercial viability of any new project must be thoroughly assessed before it is commissioned. • Developers to be cognisant of current and future demand conditions: – Cannibalising effects on tenants and customers (from new malls and offices) – High costs of living – Rising e-commerce market
High vacancy rate and low rental rates in existing buildings		Repurposing vacant commercial buildings	• Vacant commercial spaces in prime locations could be repurposed into economically meaningful assets: – Corporate housing, en-bloc rental accommodation – Art centres – Indoor parks
		Increasing demand for existing space	• Intensify efforts to attract foreign companies to set up businesses and to expand their footprint in Malaysia • Encourage occupancy by start-ups by giving rental rebates

Conclusion

Over the past decade, property-related investments have risen significantly (2016: 25% share of total investments; 2005: 18%). Currently, the property market is characterised by an oversupply of non-affordable housing and idle commercial space, and conversely, an undersupply of affordable homes. This situation could worsen if the current supply-demand conditions persist. Within the country, Johor is poised to have the largest property market imbalances (highest number of unsold residential properties and potentially the largest excess supply of retail space). As such, it is timely for all parties to act now to mitigate any potential risks to macroeconomic and financial stability.

[15] Globally, governments have safeguarded the rights of tenants and landlords by enacting specific legislations such as Tenancy Act (Australia and New Zealand) or have incorporated these qualities into their Federal Law (Germany).

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