Bank Negara cautions of severe property market imbalances

thestar.com.my/business/business-news/2018/03/28/bank-negara-cautions-of-severe-property-market-imbalances/

KUALA LUMPUR: Severe property market imbalances due to the acute oversupply of the office space and shopping complex segments, if left unchecked, can pose risks to macroeconomic and financial stability, warns Bank Negara Malaysia.
In its Financial Stability and Payment Systems Report 2017 issued on Wednesday, it said that last year banks' end-financing for the purchase of non-residential properties stood at RM213.4bil (2016: RM209.1il). This was an annual increase of 2.1% (2016: 6.1%).

"Such financing accounted for 26.1% of banks' exposures to the property market or 13.5% of banks' total outstanding loans.

"End-financing for the purchase of shops accounted for the bulk (40%) of banks' exposures to non-residential properties or 5.4% of banks' total outstanding loans. Exposures (via end-financing) to the office space and shopping complex segments, where oversupply is particularly acute, accounted for 3.2% of banks' total outstanding loans," it said.

Bank Negara pointed out that activities in the commercial property segment (comprising shops, office space and shopping complexes) remained soft, amid an oversupply in these segments and challenges faced by businesses in the oil and gas (O&G) sector.

The volume of commercial property transactions declined by 8.2% (2010-2016 average: -4.7%) to 16,025 units during the first nine months of 2017. The value transacted nonetheless increased by 3.8% to RM17.8bil driven by higher transactions of properties priced RM1mil and above.

Slower activities in the commercial property segment were observed in most major states such as Kuala Lumpur, Selangor, Johor and Penang.

“Severe property market imbalances, if left unchecked, can pose risks to macroeconomic and financial stability

“Risks remained heightened in the office space and shopping complex segments, given the oversupply situation,” it said.

Based on Bank Negara’s analysis, the incoming supply of 38 million square feet of new office space in Klang Valley is expected to drive vacancy rates to an all-time high of 32% by 2021 (1997: 5.1%; historical high in 2001: 25.3%), far surpassing levels recorded during the Asian Financial Crisis (AFC).

Similarly, the incoming supply of 140 new shopping complexes by 2021 across Klang Valley, Penang and Johor is expected to worsen the oversupply condition in this segment.

In 2016, major states such as Penang, Klang Valley and Johor already had higher retail space per capita (10.5, 8.2 and 5.1 square feet per person, respectively) relative to regional cities such as Hong Kong and Singapore (3.6 and 1.5 square feet per person, respectively).

This will continue to exert downward pressure on occupancy rates and rentals.

Bank Negara pointed out that as at third quarter of 2017, vacancy rates of shopping complexes increased moderately to 18.8% (2016: 18.6%; 2010-2015 average: 19.5%) despite rental rates remaining stable.

Vacancy rates of office space declined to 16.8% (2016: 17.7%; 2010-2015 average: 16.3%).

“While overall business sentiment is expected to improve, risks remained heightened in the office space segment with continued cost-cutting measures by businesses, including downsizing of office space or relocating to lower-cost premises.

“The average rental rate of office space in the Klang Valley remained depressed at RM5.83 (2016: RM5.94) per square foot per month,” it said.

Shops account for more than half (56%) of commercial property transactions, with about 60% of outstanding loans to purchase shops taken by individuals.

Trends in this segment typically follow developments in the housing market given that shops are viewed as an alternative investment asset class to residential properties.

In the first nine months of 2017, the number of shops transacted recorded a smaller decline of 7.4% to 8,918 units, compared to 9,629 units during the same period last year (January to September 2016: -29.4%; 20102016 average: -11.3%).

Total value transacted grew by 0.2% to RM6.94 billion during the same period (January to September 2016: -35.3%; 2010-2016 average: -8%).

“Planned supply of shops continued to decline for the third consecutive year (3Q 2017: -37.7%; 2016: -17.9%).

“The lower supply of new shop units, to some extent, has contributed to the decline in the overhang of shop units thus containing the risk of oversupply in the near term,” said Bank Negara.

As at end-September 2017, the number of overhang shop units declined by 22% (2016: 20.1%; 2010-2016 average: 0.6%) to 3,811 units, with a similar trend observed across most price segments.

Speculative purchases of shops remained contained. The growth in the number of borrowers purchasing multiple shop units or combined shop and housing units continued to decline (2017: -0.7%; 2016: -0.6%).

Such speculative purchases accounted for 7.3% (2016: 7.4%) of total borrowers of loans to purchase houses and shops. This reflects muted speculative activity in this segment, hence reducing the risk of sharp price adjustments in the future.

The number of loans to purchase shops settled within three years, another indication of speculative purchases, declined to 12.3% (2016: 13.4%) of total loans to purchase shops that were settled during the year, well below levels observed in 2012 (close to 30%).

“Arising from the oversupply situation, banks have become more cautious in lending to the office space and shopping complex segments, as reflected in the markedly lower loan approval rates for the construction and purchase of such properties (2017: 70.9% and 72.8%, respectively; 2016: 76.8% and 80.2%, respectively).

“Banks’ current exposures to these segments in the form of loans and holdings of corporate bonds and sukuk amounted to about RM84bil. These exposures accounted for 4.9% and 5.4% of banks’ total outstanding loans, and holding of corporate bonds and sukuk respectively.

“Impaired loans ratio for the non-residential property segment remained low at 1.1% in 2017 (2016: 1%),” it said.

Similar to housing loans, vintage default rates for loans to purchase non-residential properties originated across the years since 2007 continued to show improvement.

Bank Negara said in general, banks are able to withstand a broad property slowdown, including from the oversupply situation in the office space and shopping complex segments.

“Sensitivity analysis conducted by the Bank indicated that banks have sufficient buffers to absorb potential losses arising from property price corrections and its spillover to other industries that are highly dependent on the performance of the property sector,” it said.