

“Real Estate is Safe Investment” – Myth Vs Reality

Md. Abdullah Abu Syade
Principal Officer

&

Md. Rabiul Hassan
Principal Officer

Research & Development Unit, DBSL, Dhaka Bank Limited

April 18, 2013

According to an article “Dhaka: Past, Present & Future” written by Mr. Subedur Islam Khan, published in 1989 on Ford Foundation Publication, the price of land in Dhaka has never gone downwards since the time of the Mughal forces. We all know the rest of the soaring upward price movement story in real estate sector till now. But will the sector continue to grow at prevailing rate or the growth be stagnated and slowed down in future and cause a burst of existing bubble of price? We will try to find the answer based on historical trend and present information through our analysis. We will also try to figure out the appropriateness of myth regarding the real estate price movement from Bangladesh perspective. Before beginning let’s take a brief look on present scenario of real estate sector around the globe and compare it with our country.

The real estate sector can be classified under two broad categories, one is Apartments or Building and another one is Land & Land Development. Unlike other investments, real estate is dramatically affected by the condition of the immediate area where the property is located - hence the well-known real-estate maxim, "location, location, location." With the exception of a national or global recession, real estate values are affected primarily by local factors such as the economic activities, availability of jobs, crime rates, and infrastructural facilities. Many of us think that the upward slope in real house prices is due to land constraints in some areas. In addition to that, the value of land increases faster than inflation with an increased population. But recent slowing economic activity and credit crunch contributed to a decline in housing activity, prices and construction in most major economies.

Starting from the FY 2000, land price in Bangladesh took a fierce upward movement and it continued till FY 2010. But for the last few years, land price has not increased in such robust nature even land price in some areas experienced downward trend. The main reason behind this can be attributed to some factors. The price has reached such a high that it has become exorbitant for people to make their dream of owning a home come true. According to Price elasticity of demand, the price has to come down to a certain level to satisfy the existing demand. The World Bank in a recent report said the unprecedented 400-500 percent surge in urban land and apartment prices has essentially put them out of reach for most households. As a result, the number of people willing to buy lands or flats is mostly coming from the upper wealthy class of the population. In addition to that the bulk of the properties, i.e., lands or the apartments, are purchased with cash, bank deposits or undocumented “black” money. Few take out mortgage loans. But the sudden drop-out of many of these “elite”, “wealthy” buyers from the market will make the scenario worse than ever.

Why are the “elite”, “wealthy” buyers leaving the market? We anticipate that the present growing political unrest is hinting towards an uncertain future as the tenure of the present government ends at the very end of 2013. The political parties are still split on various issues and there is no sign of reaching an accord. Keeping post one/eleven situation in mind where haunting wealthy corrupted people was a daily activity, most of these real estate buyers may think of reentering the market after end of current political anarchy.

In addition to that, the bearish trend in the Capital Market since the end of 2010 aggravated the problem to a greater extent. Those having larger amount of investment in the market suffered huge loss due to price adjustment. People having invested a lot are feeling the heat in a devastating way. Some of them are even going for selling their lands and other properties but due to prevailing lower demand, they are not getting their properties sold. With the continuing bearish trend in the capital market, they are forced to sell their lands at a much lower level to settle their loans and other liabilities. It is mounting the growing problem of the real estate sector to a large extent.

Research & Development Unit

The growing real estate companies are building flats and apartments with modern interior and other facilities and increasing the price. Taking the opportunity, the raw materials providers and the land owners are also increasing the price. What is the end result? The price of lands and apartments has reached a position where the number of sellers is much higher than the number of buyers. The average sales of both flats and land plots have dropped by 60 per cent in 2012 compared to the level of the previous year due to the lack of gas and electricity connections, non-availability of bank credits and rise in the prices of land and construction materials. The situation of depressed sales results in building up of unsold record high inventory of more than 22,000 flats.

One of the reasons behind this large block of unsold flats and plots may be the emergence of so many real estate companies as well as illegal housing projects. The situation may become shoddier in coming days with drastic fall in price of plots and flats. Normal Demand Supply theory says as there is a large supply of goods compared to its demand; price automatically falls to create a new equilibrium at a lower level. This is also applicable in case of land and plots. Then what will be the consequences of this pilling? It is obvious that price of land and flats will fall. It will have direct impact on the amount of loans provided by the financial institutions with plots and flats as collateral. Most of the real estate loans will get rescheduled or become Bad loans in the worse situation.

At present, the amount of outstanding loan to the Real Estate Sector has grown up to Tk 18,000 crore. Over Tk 10,000 crore loans are getting rescheduled because of irregular repayments of loan installments by the related clients and most of the remaining loans are on the verge of becoming bad loans, if the current situation persists. According to the market statistics, almost 70%-80% of total financial sector loans have been given by taking real property as collateral which are not so easy to liquidate in case of default. With the current crisis in the Real Estate Sector, the risk of default has become very high. Therefore, the banks and other financial institutions should be very cautious in providing Real Property collateralized loans.

There are some rays of hope in this crisis situation. The Government is getting proactive to revive the once growing Real Estate sector by planning to regulate the disorganized sector. As a foot step towards the future, recently the restriction on Gas and Electricity connectivity has been withdrawn. This step may recover the real estate sector a bit from the crisis. Overall liquidity situation of the country has improved recently with the upsurge in remittance inflow. As soon as the overall economy gets back the confidence to reenter in the economic activities in full swing, the Real Estate sector may overcome the prevailing crisis.