Are developers really making too much?

LATELY, there have been many ongoing discussions on the topic of high property prices. It made me ponder on the various causes that might have contributed to the situation, including the question of whether developers are making too much.

As I took a sip of tea, many thoughts came to mind which I found interesting and worth sharing before we dwell further into the real factors of rising property prices.

Based on annual reports (see chart) of three major property developers in Malaysia, namely SP Setia, UEM Land Holdings and Mah Sing Group, they are generating an average of 18% profit margin from their projects, and at the same time incurring a staff cost of about 7% of their total revenue.

These companies are major developers in mass residential properties which have high sales turnover, and therefore a good reflection of the average developers' profit margin in the residential market.

These findings may contrast with people's perception of the profitability of the property development industry. Though it may sound like a fantasy, assuming I could converse these three property developers to give back their entire profit to their customers, it would mean an average of 18% discount on property prices for the year in question.

This would seem like a fantastic bonanza for the buyers of the properties in question. But would a 18% discount really make these properties affordable? I would imagine that people will still find these properties expensive.

Let's take an example of a terrace house that costs RM700,000 in Petaling Jaya. It would be priced at RM574,000 after the 18% discount.

If a home buyer is able to secure a 90% loan with a maximum repayment period of 30 years, the monthly loan installment for RM700,000 and RM574,000 would be RM3,081 and RM2,526 respectively (based on a BLR-2.4% loan package with current BLR at 4.6% per annum).

From the above example, while the discount may seem substantial at absolute price, it is not significant in terms of monthly loan installment for home buyers.

The debt commitment level for the latter is still considered high and out of reach for most people especially those who have just started their career.

Now, let's take a hypothetical scenario that the property developers decide to make their staff work for free that year.

It would mean another 7% discount to customers after deducting staff cost. Even with this total discount of 25%, property prices in many areas would still be considered unaffordable to many.

Anyhow, back to reality, it is impossible for any commercial enterprise to work for free or give up its profit if it was to run a sustainable business, as well as to satisfy its shareholders' expectations.

For the property development industry which has a product life cycle of four to six years (starting from land acquisition to handover of keys to customers), it is a challenge to further compress the profit margin after taking into account the risk and inflationary factors involved in such a long product life cycle.

Let us look at other industries as a comparison and review their profit margins.

For the banking industry, the three largest local banks that were selected are Maybank, CIMB and Public Bank. Likewise, the three major players from the mobile telecommunication services were AsiaTele, Maxis and Uoi.

The results showed that the average profit margin for the banking industry is 35%, while the mobile telecommunication services had an average profit margin of 26%.

So, back to my question - "are developers in Malaysia really making too much?"

Compared with the average profit margin of the banking and telecommunication industries, the profit margins of property development companies are significantly lower and definitely not on par in terms of the actual profit before tax figures.

Putting aside the profit margin for property development which is already relatively low compared with the other two industries, what are the other factors that are causing high property prices?

Many other underlying factors could be looked into in relation to the escalating property prices, instead of merely contemplating the issue as a market trend or as a result of developers' profits.

The Government, property developers, home buyers, as well as NGOs (non-government organisations) will need to work together to identify the root causes of inadequate supply of affordable housing in Malaysia.

Let's ponder this issue over the next few weeks and I welcome any suggestions and feedback to shed some light on it as I dwell further into this crucial topic in my next article.

- CRAIG STIRLING, Asia-Pacific chairman Datuk Alan Tong has over 20 years of experience in property development. He is also the group chairman of Bullet Krisa Properties. For feedback, please email feedback@fabcis Achilles.com.

Viewpoints - Food for Thought

Are developers really making too much?

Average profit margin of banking, telco and property industries

<table>
<thead>
<tr>
<th>Industry</th>
<th>Formula</th>
<th>Profit before tax</th>
<th>Profit margin (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>A / 100</td>
<td>0.20</td>
<td>40</td>
</tr>
<tr>
<td>Mobile</td>
<td>A / 100</td>
<td>0.20</td>
<td>40</td>
</tr>
<tr>
<td>Property</td>
<td>A / 100</td>
<td>0.18</td>
<td>40</td>
</tr>
</tbody>
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Source: Bursa Malaysia

If a home buyer is able to secure a 90% loan with a maximum repayment period of 30 years, the monthly loan installment for RM700,000 and RM574,000 would be RM3,081 and RM2,526 respectively (based on a BLR-2.4% loan package with current BLR at 4.6% per annum).

Transactions rose 11% in July from the previous month, double the more usual 5% gain seen at this time of year, Acadametrics said.

"This may reflect the return of buyers to the market after taking part in street parties, watching television and enjoying an extra bank holiday during the queen's jubilee," the previous month, Williams said. "We would expect that transactions will remain weak at around the 60,000 per month level," compared with 100,000 during the property boom of the last decade.

Acadametrics and LSL combine initial transaction data from the Land Registry and results from other price measures to produce their housing index.

Williams stressed that the Acadametrics measure differs from property indexes by mortgage lenders such as Lloyds Banking Group's Halifax division or Nationwide Building Society because it tracks actual transactions rather than loan offers, which are granted earlier in the buying process. This month's data can therefore be compared with those of Nationwide for May, which showed a 0.3% monthly increase, rather than July.

"UK house prices on the rise" by Craig Stirling

They have reached a 4-year high in July following boom in London

UK house prices increased to a four-year high in July as London's booming property market widened its divergence with the rest of the country, Acadametrics Ltd said.

The average cost of a home in England and Wales rose 0.2% from June to £225,789 (1053635,000), the most since June 2008, Acadametrics and LSL Property Services Plc said in a report published in London. Price climbed 3.2% from a year earlier.

"This month we report stunning growth in some London boroughs," Peter Williams, chairman of Acadametrics, said in a statement.

"The Greater London housing market is another country compared with the remainder of the UK" and is "likely to continue to move further out of line with all or most of the market in the rest of England and Wales."

The figures highlight how the British capital is skewing the national picture at a time when mortgage rationing and job losses are cutting demand for homes elsewhere in Britain.

The Bank of England said this week that overall house prices have remained "broadly unchanged" in the past two years and that, adjusted for inflation, they have actually declined.

London prices rose 11.8% in June from a year earlier, driven by gains of 38% in Kensington and Chelsea, 21% in Camden and 20% in Westminster, Acadametrics said.

Such increases dwarfed a gain of 3.6% for England and Wales as a whole and masked price drops recorded in the north of England, the West Midlands and the northwest.

High-end property: Victoria Road in London's Kensington district takes the top spot in an annual list of the most expensive UK addresses as the nation's priciest streets gained in value. - Bloomberg

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