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FUNDAMENTAL AND CHARACTERISTICS

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ABSTRACT

Recent 2003 Thailand's economic regain from the 1997 crisis brings about many up trend business cycles including real estate cycle. The country's GDP has average of 5% with the possibility to reach 5.5%. Thailand government has promoted the real estate industry as a sector, which can help boost the country's economy. Many governmental supporting policies and statements have been issued. Consumers, who are, of course, the real demand, are increasingly buying. Many companies that managed to survive the crisis, and many companies which have been resurrected from the bankrupt companies, have begun to compete in the business again, although with caution having learnt a hard lesson. Even that the past wound has not been completely cured yet.

Questions have now emerged as to whether this increased buying, and thus an increase in prices will, one day, become a new crisis. With afraid that past bad experience will be too soon to forget. It is interesting to study whether the recover of the real estate industry is on a strong ground or not.

This paper explores the fundamental and characteristics of the 2003 up trend real estate cycle. The aim is to elicit factors and their characteristics important to vision the fundamental of the country real estate cycle.

The study explores present circumstances of the real estate industry both demand and supply; the situation of real estate development companies' financial situation and business management strategies and characteristics. The Government remedies for the past pitfalls and supporting policies and regulations for demand and supply sides, and the Government prevention against overheat business in supply production are then described. The paper then compare the characteristics of this Thailand's real estate cycle with the other earlier cycles and analyzes the trend of this cycle.

1. INTRODUCTION

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Real estate has ups and downs cycle same as every other business, and occurs in every other country. The recent 1997 real estate down turn was a part of the cycle but the severity of the bust was beyond imagination. Now in the second half of 2003 that Thailand has stable political standing and booming economic situations. Up turn of real estate cycle creates, again, almost unlimited optimism of real estate investment profit. The question rises whether this boom is a real one with what characteristic ground.

The aim of this paper is to study the fundamental and characteristic of the 2003 up trend real estate cycle. The objective is to explore critical factors to describe fundamental and characteristics of Thailand's real estate cycle.

The scope of the study covers the fundamental and characteristics of the 2003 up trend real estate cycle in Thailand. The paper reviews the characteristics of the 1992-1997 cycle to study important factors that drive the previous crisis. The paper then matches the characteristics of recent real estate cycles that occurs in other countries to see any correlation among the global real estate cycle. In addition, the paper explores factors that support the up trend cycle including government support and prevention relating to real estate business for this up trend, characteristics of supply in real estate business, and demand sides.

The research approach is through synthesizing and analyzing information, critiques, and documents concerning the real estate cycle both domestic and global relationship, and through linking the banking crisis and financial crisis.

2. 1992-1997 REAL ESTATE CYCLE CHARACTERISTICS

This cycle can be described into three phases: (1) 1990-1993 the beginning of financial liberalization, (2) 1994-1996 the booming years, (3) 1997 the crisis year as depicts in Figure 1 (Vanichvatana 2003). After the crisis, 1997-2000 the recovery years, was described in the later section.

1990-1993: The Beginning of Financial Liberalization

There were two important milestones in Thailand that begin the financial system liberalization (Siamwalla 2000). The channels of monetary policies were rapidly changing with liberalization deregulation and financial innovations.

1. In 1990, the acceptance of the obligations under Article VIII of the International Monetary Fund which required the lifting of all controls on all foreign-exchange transactions in current accounts.
2. In 1993, the gradual opening of capital accounts by launching of the Bangkok International Banking Facility (BIBF)².

The aftermath of these two milestones were the failure in the Nation's financial policy including: inadequate supervision, poor assessment and management, maintenance of relatively fixed exchange rate, implicit government deposit guarantee, and lending system approval tiding to property by using property as collateral.

In the periphery of real estate sector, there were high inflow of foreign capital that were majority short to medium term loans that were used for medium to long term real estate projects. With easy project lending, numerous poor investment decisions were made not driven by yields, sustainable rents, or capital value. Also that any one can start real estate development projects with little or none professional development capability.

1994-1997: The Booming Years

During this phase, asset price was over appreciated including land, property, and stock. There was so much appeal for profits in real estate business. Over supply, over price, poor investment with short-term loan for medium and long-term investment in majority of real estate segments, including office building space, low-rise housing, condominium, industrial estates. Consumer also in high attitude for over spent both for real demand and for speculators. In 1995, over supply were noticeable especially in office space and poor quality condominium.

1997: The Crisis Year

Thai Baht currency was attacked by the currency speculator during 1997. The mistake made to fight with the attack by the governmental body derived the lift of currency exchange system to float system, thus drove the depreciation of Baht. The crisis caused sudden diminish of foreign capital flow which also caused financial institutes stop lending to many business including real estate. Real estate companies all had cash flow problem as lending stop and demand decreased. Moreover, the companies that had foreign loan, all loss in foreign exchange. Consumers drastically diminish as there were high rate of laid-off with lose in job secure. Existing consumer delay and-or stopped spending.

3. IMPORTANT FACTORS

² Bangkok International Banking Facilities (BIBF) was established in 1993 to grant significant tax advantages from getting deposit or borrowings in foreign exchange from abroad. Banks (Thai commercial and foreign banks) that had been granted BIBF license by 1996 could significantly increase the magnitude of short-term capital inflows by reducing borrowing costs and easing access to foreign capital markets.

Factors that caused the up and down turn of the previous cycle were summarized below (Vanichvatana 2003):

National policy problems

Liberalization in capital market

Lifting of all controls on all foreign-exchange transactions in currency account

Gradual opening of capital accounts by launching of the Bangkok International Banking Facilities (BIBF)

Financial system deregulation and governance

Weak financial system control with inadequate financial sector supervision

Poor assessment and management of financial risk on lending approval

Maintenance of relatively fixed exchanged rates

Implicit government deposit guarantees

Financial system tiding to property, lending based on property collateral not based on yield and capital value

Governance weakness with lack of corporate transparency and fiscal accounting, and lack of important data

Real estate sector problems

Poor private investment decision

Poor professional management

Lack of important real estate data

The 1992-1997 Thailand economy, including real estate sectors, was accelerate international capital flows with the capital market liberalization, financial system deregulation and poor control, and lack of preparation in the structure of domestic financial system, good governance and real estate professional.

4. FUNDAMENTAL OF DEMAND AND SUPPLY

This section presents the circumstances of the real estate industry both demand and supply. Fundamental of up-trend cycle can be described as in three parts: (1) Government support policy, (2) Demand Situation, and (3) Suppler Situation.

4.1 Government Supporting Policy and Protection Action

The real estate industry, including other related parties, accounts for about 25% of Thailand's GDP (Jatusripitak 2002). The rise and fall of real estate will have a great deal of impact on many other sectors of the economy because of its sheer size and extensive links. Real estate utilizes local labor forced and materials that are mainly locally produced. The production procedure itself is a low

technology industry, labor intensive, and independent from currency exchange rate risks. As the real estate industry increases, this will boost a major part of the national economy.

Despite the damage to the real estate sector during the crisis, the efficiency and stability of the real estate sector is a major component of Thailand's competitiveness (Renaud 1998). The Thai Government perceives the fact and promotes this industry by issuing many incentives policies and regulations.

4.1.1 Supporting Policy

The main Governmental supporting strategy is to create equilibrium between demand and supply (Jatusripitak 2002). Government policies are to promote demand by homebuyers and to strengthen those who are in the real estate business and related fields. Such policies can be categorized into two following groups.

Supporting Policy in Demand Side

The demand side policies were to encourage homebuyers to make quicker buying decisions. The policies have been related to reducing the cost on owning a house by providing taxation privileges and reducing transfer fee.

1. Taxation Privileges and Transfer Fee Reduction

Many following incentives will be offered during 2001 and 2003

- Reduce Special Business Tax rate
- Reduce Personal Income Tax by deducting the expense of buying a house and by deducting interest expense on a loan
- Reduce the real estate title transfer fee rate
- Reduce the fee rate on the registration of real estate as loan collateral

2. Create Home Purchasing Atmosphere through Independent State Agencies

Two major approaches that government created to support demand side are: (1) Incentives for Government official under the Government Pension Funds (GPF) and the State Enterprises staffs, and (2) Provide special low price housing for non-stable-income population.

(1) Starting early 2002, Government Pension Funds (GPF) and State Enterprises cooperated with the Government Housing Bank (GHB) provides special criteria to grant home mortgage loans with special mortgage loan packages to government officials (GPF 2003) (GHB 2003).

(2) National Housing Authority (NHA), with strong political support, plans to provide about 11,000 housing units during 2003 to 2004. The products offered are condominium (size 24 square meter) at the price of 330,000 Baht and single-detached and town houses (land size 20 square Wah) at the price of 470,000 Baht. Three state banks plan to offer 100% mortgage loan (NHA 2003).

Supporting Policy in Supply Side

On the supply side, the government also issues policies to support real estate developers. The strategy is to create equilibrium between demand and supply for the real estate industry.

1. Amendments to the Bankruptcy Act

In 1999, the Bankruptcy Act was amended. These amendments added a new section on Company Rehabilitation. This allows business corporations to have opportunities to resolve and compromise with lenders before filing for bankruptcy. These opportunities provide a period for debtors and lenders to set up a team to continue operating the business while rescheduling and restructuring debts (Ministry of Justice 2003).

2. Resolve Non-Performing Loan Problems by Set up TAMC

Thai Assets Management Corporation (TAMC) was set up in 2001 to solve non-performing (TAMC 2003) as one of the Governmental measures imposed to resolved financial problems after the 1997 crisis. TAMC is an organization established under the Emergency Decree of the Thai Asset Management Corporation B.E.2544.

TAMC transferred non-performing assets from commercial banks and other financial companies. Because of loan payment condition prior to the TAMC set up, much of the decline in the non-performing loans (NLP) was due to rescheduling rather than tangible restructuring (BizAsia 2001).

TAMC issued approximately 300 billion worth of promissory notes with the guarantee of the state rescue fund in exchange for debt transferred by the private sector financial institutions. Assets from the commercial banks were purchased at a price below the loan recovery amount. TAMC then manages these acquired assets by restructuring debts, restructuring businesses, and/or sell the debts (for property mostly through auction). TAMC allows financial institutions to release bad debts and allow businesses to negotiate for continued operations.

3. Increase Investment Capital through Property Funds

Since 1997, under the Ministry of Finance, the Securities Exchange Commission approved principles and related regulations for the establishment of five types of property fund³. Property Funds are a major source of capital to be invested in properties. This form of capital market share is an investment risk.

³ Property Funds have been under the care of the Office of Securities Exchange Commission (SEC). The four (out of five) types of Property Fund directly related to solving real estate issue are: Property Fund for Public Offering, Type I Fund—Property Fund, Type II Fund - Property Fund for Resolving Financial Institution Problems, Type Fund IV — Property and Loan Fund. The other type is Type III Fund — Mutual Fund for Resolving Financial Institutions Problems (SEC 2003) (SEC 2000).

4.1.2 Protection Action

The Bank of Thailand has guarded against the recent past mistakes on monetary and financial controls. Clear examples of recent improve monitors were the followings:

- (1) Tight Control on Currency Attack
- (2) Limited size of mortgage loan

To prevent against overheat real estate high price product of single-detached houses at the price over 10 million Baht. Mortgage loan for this type of housing will be limited to 70% of the market price.

4.2 Demand Situation

Demand of real estate in Thailand diminished as the result of the economic crisis. Consumer's real demand for residential and commercial space, especially intending homebuyers, delayed and postponed their buying decision. The main reason was to wait for better bargains, for cheaper housing price, which during the year 1997 till 2000 reduced year by year.

As the economic gradually recover starting from the second half of 2001. New home registration start climbing up gradually.

4.3 Supply Situation

Right after 1997, only 10%, 200 out of 2000 of the suppliers, real estate developers, survived from the crisis. The number of land sell approval shown in Figure 2 depicts part of the supply side situation during 1997 and 2003.

Real estate companies that survived through the crisis apply several strategies and capital support from foreign investors as summarized as follow:

Surviving Strategy during 1997 and 2000

The surviving ones apply several strategies including:

- Cash flow management
 - Maintain cash in-flow: reduce prices and get rid of existing inventory, and Down size the company and continue existing projects
 - Reduce cash out-flow: reschedule payments, drastically reduce operation expenses, lay-off employees, and limit advertising expenses
- Financial settlement and strategy
 - Extend repayment period, reduce interest rate, join with foreign investor
- New product strategies

Foreign Investors after 2000

Majority of listed real estate public companies that survived from the crisis has supports from foreign investors. Examples of four such companies are shown in Table 1 below.

Public Company	Foreign Investors	% of	Total Foreign Investment
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		share	
Land and Houses	Government of Singapore	18.01	27.74
	HSBC (Singapore) Nominees	4.00	
	Clearstream Nominees	3.04	
	State Street Bank and Trust	1.35	
	Chase Nominees Limited 42	1.34	
Quality Houses	Government of Singapore	8.00	33.00
	Other Foreign Groups	25.00	
Sansiri	Morgan Stanley & Co. Int. Ltd.	7.95	12.56
	Capital Sign Investment Ltd.	4.61	
Natural Park	E-Street Properties Ltd.	33.18	38.36
	Morgan Stanley & Co. Int. Ltd.	5.18	

Source: RE Journal of Thai Real Estate Association, Sept – Oct, 2003

Figure 3 shows the number of new housing development projects registered, during 1988 and 2003, which also depicts the sharp reduction in supply side in 1997-1999 and gradually increase since then until 2003.

Loan to real estate business as shown in Figure 4 also depicts the similar direction of sharp down turn during 1999 to 2000. Interestingly, the loan down turn was about two years behind the number of project declined shown in Figure 3.

Figure 5 shows the accumulation of direct foreign investment in real estate business during 1987 and 2003. The curve shows the sharp increase since 1992, as of capital market liberalization. Since 1996, the level of investment has been quite level.

5. UP TREND CYCLE CHARACTERISTICS

The up turn cycle started since early 2001 based on the following factors:

- Governmental incentive policies

This up-trend has benefits from government support. As explained above, the government supporting policy give part of the fundamental of demand and supply. Even though some of the above supporting policies decrease government income in terms of personal income tax and fees from real estate transactions. However, as the real estate business has its won cycles, many related businesses then generate another round of cash flows cycles. Thus, such cash flow cycles create economic growth and consumer confidences, and therefore political stability.

- Attracting historical low interest rate, due to the decreased interest rate in western countries

Low interest rate and abundant liquidity favored real estate investments (supporting with present stable political situation). MLR rate has dropped from about 16.5% in 1997 to about 5.75% on November 2003.

- Real demand start to has confident with stable political situation and secured job
- New marketing strategies from real estate developers

Although this up trend business which start since the early 2001. However the up beat of the cycle was delay until May of 2003 because of two episodes.

- (1) Iraq War was cooking since the last quarter of 2002 and erupted from February and ended in March 2003.
- (2) Sever Acute Respiratory Syndrome (SARS) epidemic broke out during March and April 2003. Many sectors relating to tourism and hotel were intensely effected by the epidemic but fortunately not for real estate sector.

Dramatic enthusiasm of the Thai real estate business broke out since May 2003, as the fearful state of the Iraq War and SARS epidemic subsided.

Comparison between the 2000s Cycle and 1990s Cycle

The table below assembles and compares the important figures between the situation at the beginning of the two cycles.

Table 2: Comparison of Important Figures in Financial and Monetary Systems and Real Estate Information between the Period Prior to 1997 during 1900s cycle and the 200s cycle.

Events	1900s Cycle	2000s Cycle	Change(as of year)
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Financial and Monetary Systems			
* Currency Exchange System	Fixed	Float	1997
* No. of Financial Institutions (1)			
- Thai Commercial Banks	16	13	2003
- Finance Companies, Finance and Securities Companies	83	18	2003
-			
* MLR Rate	16.5%	7.75%	November 2003
Real Estate Information (2)			
* Number of RE Developers	2000+	200+	End of 2002
* New Home Registration(unit/year)	130,000-140,000	16,000-17,000	1993-1996
* New Project Finance (Baht)	2 million	1.2 million	1993-1996

Source: (1) Bank of Thailand, (2) Jatusripitak 2003

7. CONCLUSION

The downturn of Thailand's real estate cycle started since 1995, however the currency attacked in 1997 worsen the normal situation. The up-turn gradually picked up since early 2001, but the sharp up turn has been vividly since May 2003 after the Iraq War and SARS epidemic. The up turn cycle was based on many factors especially from incentives from government in tax incentives and other financial system strategies; low interest rate; stable political situation; economic and political situations

The Bank of Thailand has performed tight control and policies against caution events on currency attack and financial lending for real estate sector. The prediction of the down turn is beyond the scope of this paper. However, momentarily, the data shows that based on the current National up turn economy, the real estate cycle up trend will still in a high opportunity direction. The conclusion comes with a final note that the hoping of smooth cycle needing the tight control against overheat business in supply production.

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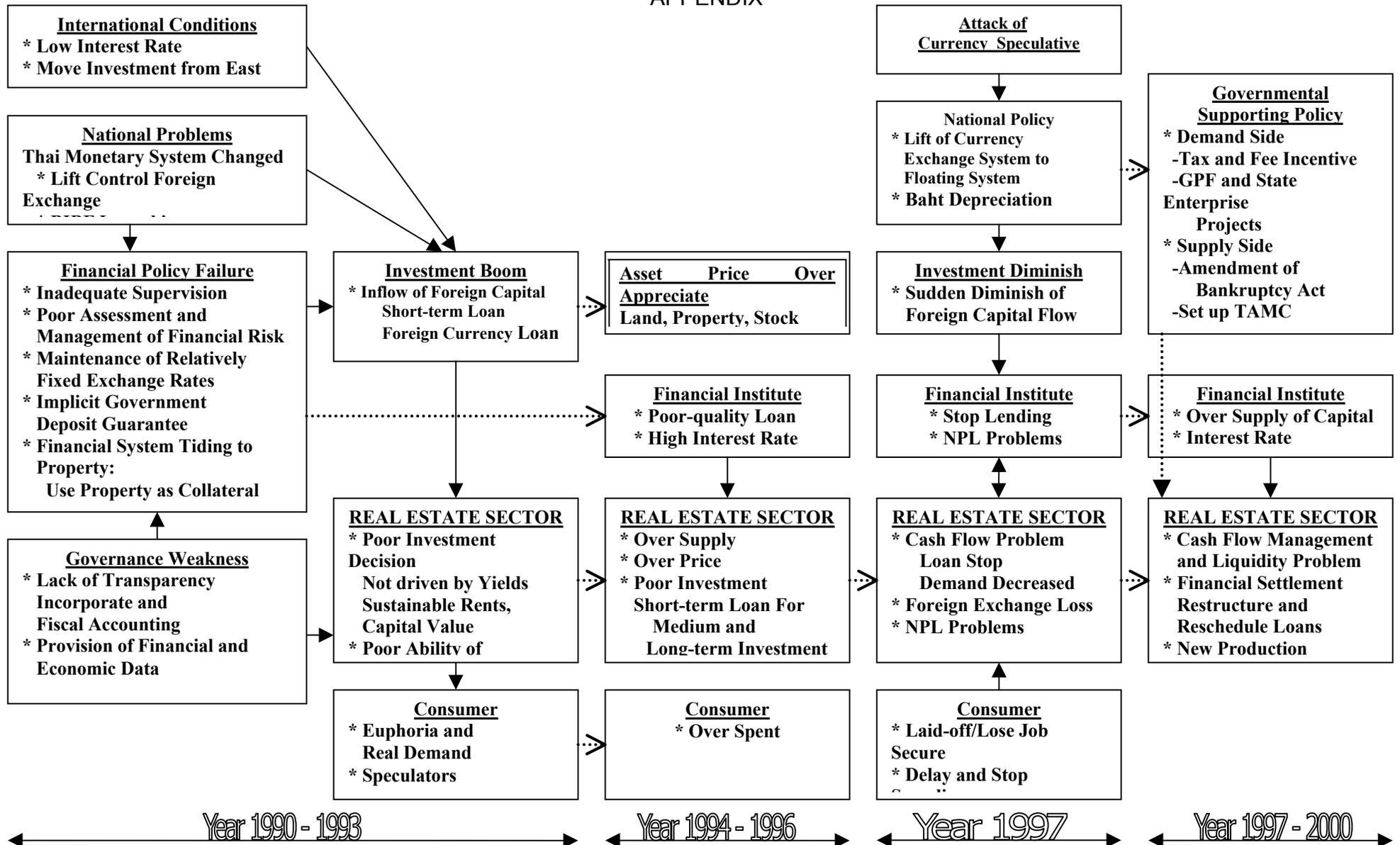
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APPENDIX



Source: Vanichvatana 2003

Figure 1: Summary of Circumstances and Factors Related to Economic Crisis and Recovery

Figure 2

Number Land Sell Approval during 1988 and 2003

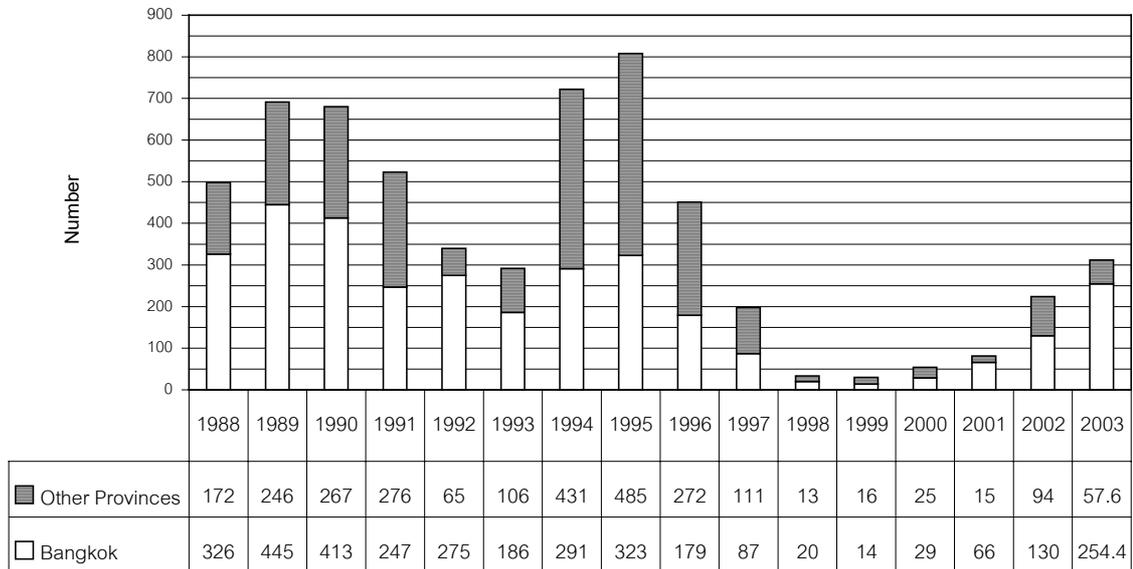
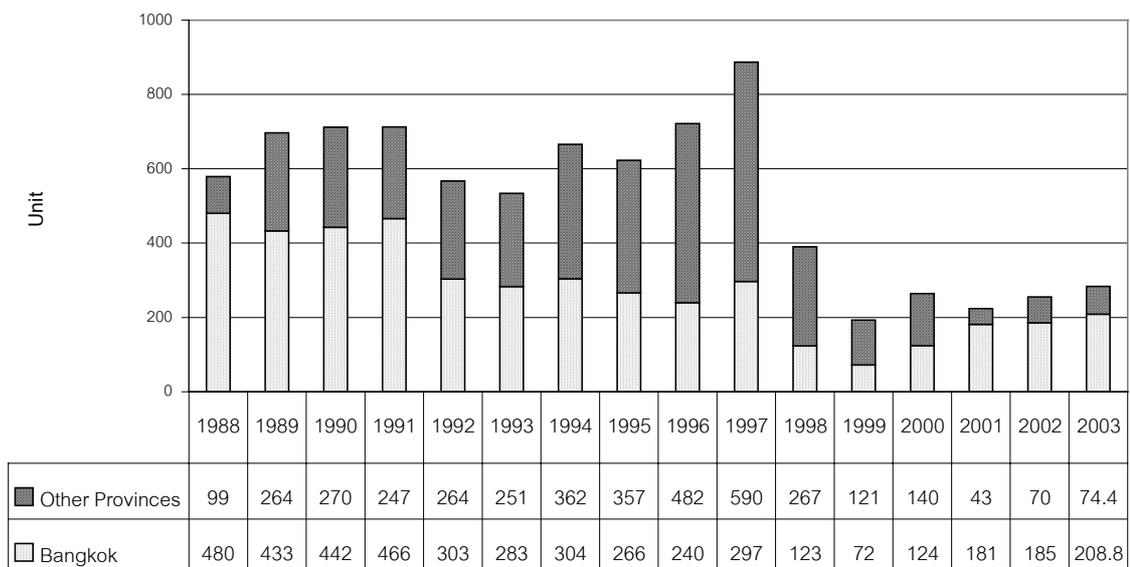


Figure 3

Number of New Housing Development Projects during 1988 and 2003



Source: Department of Land, Thailand, 2003

Figure 4

Loan to Real Estate Business (Baht) during 1987 and 2003

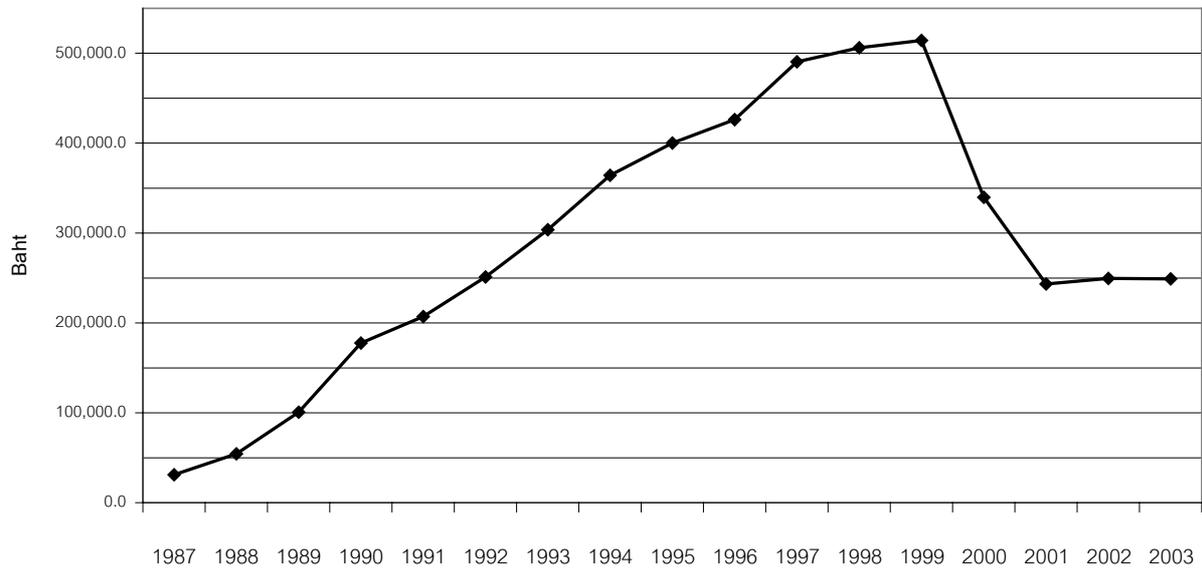
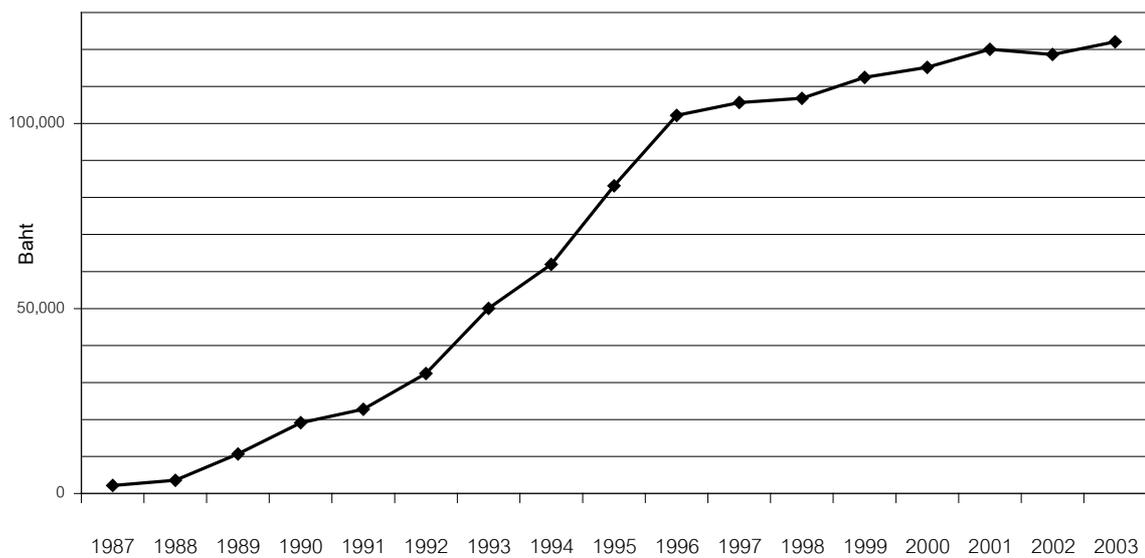


Figure 5

Accumulation of Direct Foreign Investment in Real Estate Business
during 1987 and 2003



Source: Bank of Thailand, 2003