THE MANAGEMENT OF PROPERTY DEVELOPMENT RISKS IN MALAYSIA – THE PROPERTY DEVELOPMENT PROCESS: A REVIEW

ZAHARAH MANAF
MOHD LIZAM MOHD DIAH

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Zaharah Binti Manaf & Mohd. Lizam Bin Mohd. Diah
Department of Construction and Real Estate Management
Kolej University Teknologi Tun Hussein Onn, Johor
Malaysia

1. INTRODUCTION

Property development is one of the most dynamic, risky, and challenging businesses. However, the industry has a very poor reputation for managing risk, with many major projects failing to meet deadlines and in some cases units which have been completed but end up with no takers. The Property Market Report published by the Valuation and Property Services Department, Ministry of Finance, Malaysia, for the year 2004 reported that the number of residential overhang contained, shops overhang are high and industrial overhang remained. Properties listed as 'overhang' are those units which have been completed and available in the market but are not sold within nine months of its completion. On the other end of the scale, there are projects being abandoned, which recently have been reported in the media and become the main agenda facing the Ministry of Housing and Local Government. Overhang and unsold units are just a few of the risks faced by property developers in Malaysia.

As an industry which actively contributes towards the economic growth of a country, property development requires huge investment with volatile returns, and it is inherently risky (Newell, G. 2005). Financial institutions forked out huge sums of money in the form of bridging finance to property developers while consumers spend their entire life savings to buy properties and at the same time, spend a good number of years paying back their house installments. Due to the inherent risks involved in property development and the impact of abandoned projects and overhang units to the real estate industry as a whole, as well as the financial repercussions on individuals and financial institutions, property developers need to implement risk management strategies. Billions of Ringgit being spent to revive abandoned projects and completed properties with no takers lying idle in the market, could jeopardize the property market and taint the reputation of developers in this country. Due to the significant contribution of property development to the nation in general and also to end consumers, a study should be carried out to find out if property development risks are being managed effectively and hence lessen the risks of problems facing the developers.

Unfortunately, not much research is being done to study risk management in property development in Malaysia. Instead, a lot of effort is being channeled towards the study of property investment risks which is one of the major concerns of property investors without realizing that investment in property actually starts with property development.

2. PROPERTY DEVELOPMENT IN MALAYSIA - BACKGROUND

The property development industry in Malaysia, includes a wide range of organizations and individuals involved in developing and operating property to meet the housing, employment and social needs of communities. More importantly, property development has been a major contributor to the Malaysian economy and ultimately, it has a multiplier effect on other industry which supports property development. The industry is predominantly made up of private companies involved mostly in the residential and commercial development sectors in the Klang Valley. During the financial crisis which hit Malaysia in the late nineties, many property development projects were either abandoned, frozen or the scale was very much reduced. The increasing number of properties categorized as 'over hang', by the National Property Information Center (NAPIC) of the Ministry of Finance, Malaysia, also indicates that property development is a cyclical in nature with many risks associated with the development process. The number of overhang properties as at the end of December 2004 stood at 99,369 units compared with the corresponding figure of 84,454 in December 2003 and 59,750 units at the end of December 2002 (Table 1). Completed lots ready for the market but are not sold is just one of the risks that needs to be addressed by property developers in Malaysia.

Table 1 - RESIDENTIAL OVERHANG AS AT DECEMBER 2004

	Overhang (Launched, completed and unsold)	Launched and unsold (Under construction)	Unsold (Launched and not constructed)	Total Overhang
Malaysia	15,558	63,950	19,861	99,369 *
Klang Valley (KL & Selangor)	5,154	23,768	5,953	34,876 **
Johore (State)	3,785	14,032	4,556	22,373
Penang (State)	629	2,921	406	3,956

(Source: Property Market Report 2004, published by NAPIC)

*December 2003 – 84,454 units and December 2002 – 59,750 units

** December 2003 corresponding figure was 24,413 and December 2002 was 12,776

Majority of the overhang properties are in the lower end of the market and they are growing in numbers and may impact the upper levels as well. Checks can be instituted, such as an even higher infusion of unbiased information into the market and effective controls such as the insistence by approving and licensing authorities as well by the financial institution on, independent, proper and detailed market and feasibility studies before approvals are granted or funding agreed to. The very insistence of such studies together with risk management strategies implemented by property developers may strike an important balance in the market (Fernandez, A 2004). Developers, in particular the publicly listed companies should also be made to become more transparent about actual sales take ups in the market.

On the other hand, as at 2004, the total number of abandoned projects in Malaysia is at 227, worth over RM 7 billion. Selangor has the highest number of abandoned projects at 55 (Ministry of Housing and Local Government, 2004)

Risk management is not a new concept. It has been incepted into many businesses including property development, but they have been applied instinctively, with risks remaining implicit and managed by judgments and informed by experience. Managing risks effectively allows for clear identification of risks, formally describing them and making them easier to manage. In other words, systematic risk management is a management tool, which requires practical experience and training in the use of the techniques but more importantly, it can be implemented in the property development process

3. PROPERTY DEVELOPMENT PROCESS AND RISK MANAGEMENT

This paper is concerned with the risks faced by property developers in Malaysia and whether the property developers implement risk management strategies to ensure the success of their property development projects. Risks is an inherent part of businesses and public life. Dynamic market relations increases the uncertainty of the environment where businesses and public organizations work. Keeping high competitiveness' requires the organizations to start initiatives that may have different outputs. The possibilities of these outputs occurring determine the risk confronting the organizations Tchankova, L. 2002). Risks need to be identified, analyzed and appropriate action taken to manage them. Risk management is the process of measuring or assessing risks and then developing strategies to manage them. Steps involve in the risk management process include:

- Identification and assessment
- Possible actions available
- Creating risk management plan
- Implementation
- Review and evaluation of the plan.

Property development and property development process is susceptible to various risks at every stages and it is important to plan and manage them even before they occur. Hence this paper, which is part of a study on risk management in property development in Malaysia will review literature and previous research in the property development process while another paper deals with risk identification which is pertinent to property development. The paper continues with a study to find out if property developers in Malaysia implement risk management strategies in the development process and whether such measures have any impact on their projects.

4. THE OBJECTIVE OF THIS PAPER

The main research has four objectives:

- To identify the property development risks at different levels of the development process
- To assess and categorize the risks which confront property developers in Malaysia and the risks management strategies they adopt
- To apply the risk management strategies they adopt, into an improvised academic framework
- To assess the implications of risk management strategies in the Malaysian property development industry

Hence, this paper take the opportunity to review recent literature and studies involving the property development process elsewhere which will form the basic work for the main research to be carried out in Malaysia. To do this, the following needs to be defined:

- Property development
- The property development process or phases
- Risks attached to the different phases in the property development
- Risk management framework for the property development process

5. A REVIEW ON PROPERTY DEVELOPMENT PROCESS

A review of the available literature revealed that there was a limited availability of academic literature on property development and property development risk management although there are considerable number of literatures on risk management. Although there is a recent study on risk management in Malaysia, the scope was limited to construction projects (Anuar Alias, 2002).
Bajaj (1997) reported that if a risk is not identified it cannot be controlled, transferred or otherwise managed. Therefore risk identification is a necessary first step before risks can be analysed and an appropriate response determined. Hence it is

necessary to identify risks inherent in property development as a first step towards effective risk management. Risk management is not a one-off activity; instead it should be applied continuously throughout the life of the property development However, it has been recognized for many years that research into property development risk is limited (Whipple, 1988); particularly given the role of the property cycle (M. Usilappan, 2000) and its strategic implications for property and property development (Pyhrr et al, 1999).

According to Godfrey (1996), systematic risk management helps to:

- identify, assess, and rank risks, making the risks explicit;
- focus on the major risks of the project;
- make informed decision on the provision for adversity, e.g. mitigation measures;
- minimise potential damage should the worst happen;
- control the uncertain aspects of construction projects;
- clarify and formalise the company's role and the roles of others in the risk management process;
- identify the opportunities to enhance project performance.

Since risks can occur during the property development process, it is important to identify each stages or phase of the development and later, risks pertinent to each phase or stage could be identified and act upon appropriately. Most property development texts include an account of the stages or phases of the development process, though the headings are never the same (Cadman and Topping, 1996; Miles *et al.*, 2000, Syms, 2002). Birrell and Gao (1997) list 14 phases of development:

i. opportunity/site selection;
ii. market analysis;
iii. site investigation;
iv. feasibility study;
v. professional appointments;
vi. financing;
vii. planning application;
viii. site assembly/purchase;

ix. design;
x. tendering/contracting;
xi. construction;
xii. promotion;
xiii. letting; and
xiv. sale.

While the above phases form a fuller list of the development process, a more comprehensive risk management technique to reduce risk is based on what is known as the ' Eight Stages of Development' (Miles et al 1996) which are:

i. inception of an idea
ii. refinement of the idea
iii. feasibility
iv. contract negotiation
v. formal commitment
vi. construction
vii. com pletion and formal opening
viii. property, asset and portfolio management

Although, there is no marked distinction between property development process of different types of property, it appears that there are four important dimensions to the development process for a commercial property (Fisher,P & Collins, T, 1999) which are:

(1) the structure;

(2) the actors;

(3) the events; and

(4) the site.

Risk can and will occur ant anyone of the above phases or in anyone of the four dimensions, and if left unattended, they can potentially have damaging consequences for the rest of the property development process.

To come up with a property development process model, developer respondents to a survey listed “letting”, “market analysis”, “feasibility survey”, “design” and “opportunity/site selection” as the top five most important phases (Fisher, P. 2005). The author stresses that the phases should be seen as one part of a generalised model of the property development process and that the actual sequence of events depends on circumstances. One problem with such an events-sequence approach is that it implies a speculative developer-centred process. For example, planning is presented as a hurdle for the developer rather than as a legitimate, independent force. Design is, of course, central to development, with implications for all aspects and all parties. For this reason the final design must emerge from an iterative process involving feedback and revision. The result of the feasibility study largely depends on the predictions made concerning the five phases of “financing”, “site purchase”, “procurement”, “letting” and “sale”. These all involve transactions in real property markets creating legal contracts and financial risk. Though each events-sequence is unique and evolutionary it must form part of a holistic development model.

Risk can affect productivity, performance, quality, and the budget of a development project. However, risk can not be eliminated, but it could be minimized, transferred or retained (Burchett, 1999). This is where risk management strategies play an important past in minimizing risks confronting property developers in general.

Taking into account the 'Eight Stages of Development” model, a fundamental techniques of property development risk management was developed according to the likely stages where risks might occur and the suggested actions to be taken(Miles et al, 1996):

- avoid risk by stopping in stage one, two or three before much money is committed
- increase the research and know more about the possibilities by completing a more substantial study in stage three
- engage in some form of 'loss prevention', the most obvious of which is a competent development team assembled in stages four and five

- transfer potential loss to other players through the contracts negotiated in stage four
- combine and diversify to reduce the pain of large losses by buying insurance for stages six through eight
- assume risks. Even after adopting the above five strategies, the property developer must assume some amount of residual risk

It seems Miles et al (1996) provides one of the better attempts in coming up with a property development process or phases which is later used as a model in identifying techniques for managing property development risks and this will form the basis of the study among property developers in Malaysia although there is a need to modify the techniques to allow for local property development process, existing law and guidelines and also local work culture.

6. PROPERTY DEVELOPERS IN MALAYSIA - THE DATABASE

The vast majorities of property development companies are in private ownership and hence have very limited data availability. Therefore, it was deemed appropriate to research and analyse publicly listed property development companies in Malaysia. Currently there are 94 companies listed under the category of Property Development of the *Bursa Malaysia*.

To support the main research to be carried out, two forms of primary data will be collected; through a survey of all listed property development companies and each company's annual report and financial performance over a minimum period of five years analysed. This means , a qualitative research will be carried out by way of a survey of publicly listed property developers in Malaysia and an assessment of their annual reports over a five-year period, 2000 to 2004 will be made. The survey will be designed to identify which are the listed developers' key property development risk, likely phases where they occur and property development risk management strategies. This will be followed by a detailed quantitative analysis of the annual financial statement of the property development companies over the 2000-2004 periods which will concentrate on measures of business risk and financial risk.

The qualitative and quantitative analyses will then be compared, producing a list of key property development risk and property development risk management strategies. They will then be placed into an academic framework, being Miles' "Eight Stages of Development" model.

7. CONCLUSION - SIGNIFICANCE OF THE RESEARCH TO THE PROPERTY DEVELOPMENT INDUSTRY IN MALAYSIA

Malaysia has gone through a few property cycles (M. Usilappan, 2000) and at the end of each cycle, there are inevitably a number of property development companies which either fail or seriously under perform. It is also likely that many property development projects commenced late in the upturn of a property cycle are undertaken by inexperienced property development companies which do not fully understand or adequately manage property development risk which occur during the property development process. Property development companies which have survived one or more property cycles are likely to have managed property development risks more adequately than others. As mentioned earlier, property development is generally considered to be a high risk business enterprise. The process is made up of several sequences of events and each event is susceptible to different types of risks which need to be identified and managed effectively. Any risk that extended the time of the project had the effect of delaying the income stream and increasing finance costs.

If property development is an inherently risky business, then it is pertinent that the risks are managed effectively and property developers should implement a form of risk management strategies during the development process itself so as to ensure that the development project is successful. Hence it is equally important to identify the property development process earlier so that any risks which may have occurred in any of the phases can be dealt with appropriately. Other property developers must also be ready to emulate the more successful developers in managing the multitude of risks which confront them. Although, effective risk management strategies will not remove all risk from a project; its principal aim is to ensure that risks are managed in the most efficient manner to ensure that the development is completed within the stipulated time frame and completed units are taken up by prospective buyers, the moment they are ready for the market.

Risk management should also be viewed as a positive process, and can be one of the most creative tasks of the project manager. Its aim is to generate realistic expectations and increase the control of the process. In addition, it can open the way to finding innovative solutions that may not have otherwise been considered before.

Risk management is an important part of the decision-making process during the property development process. Risk and uncertainty can potentially have damaging consequences for some construction projects and they can affect productivity, performance, quality, and the budget of a project. Hence a study of the management of risks among the property development companies in Malaysia will ensure that the best risk management framework/tool is developed for the benefit of the all parties concerned.

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