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Yangon's real estate challenge

After a pause while investors awaited the outcome of elections, the property market in Myanmar's biggest city is picking up again, but some sectors will do better than others.

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Myanmar has experienced dramatic changes economically and politically over the past few years. As foreign investors rush to set up shop in the newly open market, office space in the country's commercial capital is among the most expensive in the world.

In a country where most people earn about two dollars a day, annual rents in Yangon climbed to as much as US$100 per square metre per month in 2013 -- more expensive than downtown Manhattan and about four times the going rate for the best business addresses in Bangkok.

But last year the property boom came to a halt, office rents slid and residential sales paused. Businesses and consumers alike adopted a wait-and-see approach in the run-up to the Nov 8 elections, and many are still waiting for a clear picture of what a government led by Aung San Suu Kyi will look like.

Antony Picon, managing director of Colliers International in Myanmar, told Asia Focus from Yangon that the slowdown was expected given the election and political restructuring that has followed.

"It wasn't a surprise for us," he said, adding that he was seeing the return of positive upward trend for the market this year.

"People who are already here, both local and foreign investors, are still very active and confident," he said. "They are very bullish and the market is very upbeat. We are very busy with existing investors expanding their projects."

However, those who are not yet in the market are cautious and are still waiting for the post-election dust to settle, he added. "If one is not yet on the ground, he or she tends to be more concerned and that is natural."

Andrew Tan, managing director of Yangon-based Consult-Myanmar Co Ltd, said some sectors were approaching equilibrium after a lot of speculative investments over the past three years.

"The real estate market will see a consolidation this year, especially in the condominium sector and high-quality retail space rents," he said, adding that some properties would be sold at a loss in the short term. Many of these are apartments priced above $500,000 each -- way above the ability of the local market to absorb.

In the office market, supply has started to catch up with demand with the completion of new developments, resulting in a doubling in the amount of available space in the past two years. As a result, the market is now reaching equilibrium.

"We will see greater demand for prime quality offices and tenants will have higher bargaining power," said Mr Tan. "Prices are expected to remain stable, if not lower, but the competition in the high-quality office segment will rise."

BUSINESS HURDLES

The outlook is not as sunny for many completed residential projects in Yangon, a lot of them luxury developments targeting cash-rich local residents and foreign expats, a relatively small market. However, the combination of a weak legal structure, expensive land, lack of liquidity and an undercapitalised banking system has discouraged purchase and ownership.

"At present, the skyrocketing land prices, royalties on ownership title, and high rental rates and room prices inhibit the growth of the real estate market in Myanmar," said Yangon-based Nwe Oo, senior attorney-at-law with Tilleke & Gibbins Myanmar.

"Land prices and ownership are biggest factors driving prices sky-high," said an analyst with one of Myanmar's leading real estate developers who asked not to be identified.

"[Developers] have to acquire the land from private owners which makes the price very high. There is no central registry system that can keep track of owners and transactions are done privately," he explained.

In addition, there is now an oversupply in the market, especially in the residential sector given that high-end buyers represent only 1-2% of the total population.

A recent Colliers International report found that take-up rates during the first half of 2015 were at an all-time low of 49%. Total unsold inventory at the end of last year stood at 6,654 units -- double the figure for all of 2014.

Rules and regulations in the Myanmar real estate market are another big hurdle that confuses both locals and foreigners alike.

However, a ray of hope emerged when the Union parliament, after years of debate, finally passed a new Condominium Law, which took effect on Jan 29 this year. It grants foreigners property ownership in Myanmar for the first time, though it is limited to a maximum of 40% of the space available on the sixth floor and above in a building.

"Observers have predicted that sales of condominium units may increase in the near future. But there will be some issues related to projects under construction and whether they will meet the requirements under the new law," said Nwe Oo.

In any case, said Mr Tan, the passage of the Condominium Law is a good start in bringing clarity to the market.

"The condominium market will pick up in the coming year as [the law] will spur the development of condominium projects outside Yangon, especially along the Chinese and Thai borders that can legally be sold to foreigners and will qualify to be treated as condominiums under the new law," he said.

His hope is that buyers of condominiums will be able to arrange for bank financing, which is also allowed under the new law. Currently most apartment purchases by local people are paid for in cash.

"The law is important as it gives legal status to the property and allows the buyer to arrange for bank financing using the property as collateral," he said.

In addition to providing clarity in terms of ownership, the law is a big step toward more transparency in the market and a stronger legal footing, said Andrew Gulbrandson, head of research and consulting with JLL Thailand, who coordinates the firm's consultancy work in Myanmar.

However, it is not going to change the dynamic of the market overnight.

"There aren't a lot of foreigners who would want to buy a condo in Yangon now. There would be limited foreign demand even with the law being introduced," said Mr Gulbrandson.

Unlike Bangkok, Yangon is not a big, vibrant metropolis like and it faces persistent problems including congestion, poor internet connections and unstable electricity supply. It's not really a desirable place to live unless one has to be there for work, he said.

"It's not a second or third home for wealthy people, like Bangkok," he added

In addition, some high-rise projects in Yangon have been suspended as part of a campaign by elected city officials to ensure compliance with building and zoning regulations.

The 68 Residence, for example, breached the rules for floor-area ratio (FAR) and other regulations for high-rise buildings. The high-rise project located in the heart of Yangon is being developed by a local privately owned company.

The Yangon City Development Committee (YCDC) took office in early 2015 after the first elections in the city in 50 years. It is now trying to suspend most of the high-rise projects in the city of 5 million people because they do not comply with the Zoning Plan.

"Many of these high-rise projects are constructed in the compounds of ministerial and military premises, and in accordance with the approval of relevant authorities other than the approval of the YCDC," explained Nwe Oo.

In the past, officials were reluctant to speak up about egregious violations by developers with military or political connections. But since the election of the YCDC, the public is more aware of the need for issues to be raised, he said.

"A more explicit and transparent zoning law in Yangon and for most cities would also help in the development of the real estate market in Myanmar," added Mr Tan.

In addition, better infrastructure including roads, public transport, car parking, power and water supply will help as Yangon is still operating on infrastructure that was built 50 years ago, he added.

The banking system in Myanmar is another big hurdle. It remains underdeveloped and there is very little in the way of an established mortgage system. The maximum loan term in Myanmar is 12 months with interest rates around 12-13%, so unless you have cash, you are highly unlikely to be able to buy a property.

A top-end condominium in Yangon currently costs around US$4,000 or 140,000 baht per square metre (sq m), comparable to Bangkok prices, while mid-market units cost about half that amount.

Public attitudes toward banks in Myanmar are similar to the lack of trust that prevailed in other Southeast Asian countries half a century ago.

"They have the money stashed in their houses," said Mr Gulbrandson. "This is part of the reason why the banking system is so undercapitalised."

Project finance is another big problem. As was seen in Thailand in the late 1980s and early 1990s, many developers in Myanmar open sales and use the cash from early buyers to fund construction. In some cases they aren't able to sell enough units upfront to finance their projects and they cannot go to the banks for loans, so developments either stall or never get off the ground.

Based on the number of completed projects, the residential market in Yangon may be approaching equilibrium. An oversupply is possible if all of the projects announced by developers actually get built, but that is difficult to predict.

"What will determine how the market will look like over the next year or two, other than the laws and the banking system, is how many developers will actually build the projects that they have announced," said Mr Gulbrandson

RETAIL OPPORTUNITY

One area that continues to show promise is retail space. The retail market in Myanmar for decades had been very sheltered and inefficient with no real competition before 2013. Over the last three years, however, the shopping scene in Yangon has been transformed by the entry of international investors and brands, according to Mr Tan.

For example, the new Myanmar Plaza by HAGL was almost fully rented out before its opening despite having five floors. International brands such as Nike, Skecher, Chopard, Zegna and many more can be found there, he said.

"Although most people in Myanmar still do not have high spending power, they are saving up to enjoy international products and services that offer better quality," he added.

Mr Tan said there had never been a better time to come and do business in Myanmar as the influx of foreign investment and tourists has helped to spur the growth of a middle class in Yangon that aspires to own international brands and seeks international standards of quality and service.

However, Mr Gulbrandson cautioned that the purchasing power of local residents was still limited and foreign brands needed to be aware of what will work in the country.

Looking at the bigger picture, he said that if developers and investors choose the right segments of real estate, there are great opportunities ahead. In his view, the industrial and hospitality sectors are the winners.

"Investors that have made quality investments in the hospitality sector such as hotels and serviced apartments are doing quite well. Big mixed-use projects and industrial developments are seeing a great deal of interest from Thailand, Japan and Korea," he said.

He added that in Myanmar, the standard government lease is usually 50 years, followed by another two 10-year renewals. "The lease length is much more attractive than in Thailand, which has only 30-year leases, even though the [Myanmar] market is more risky," he said.

In his view, residential and retail spaces are not as attractive.

A tenant can only obtain a 12-month lease and that is a risk that retailers or occupiers have to take compared with Thailand, where a 3+3+3 structure -- three consecutive leases of three years each -- is common.

Mr Tan added that mixed-use developments that offer retail space, offices and serviced apartments offer a good opportunity for investors. Given the poor infrastructure in Myanmar, mixed-use developments that bring together complementary, quality services will create a strong attraction for local people and for international businesses.

"This would also mean that many of these developments will have to be pushed out of Yangon City itself as there are not many big plots of empty land left for such a big developments, and even if you can find one the price per square foot may be prohibitive," he said.

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