CONSTRAINTS FACED BY PROPERTY DEVELOPERS IN THE FUNDING OF RESIDENTIAL PROPERTY DEVELOPMENT IN MAURITIUS

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ABSTRACT

During the last few years, many residential projects, more precisely the construction of residential complexes, have ground to a halt mainly due to the financial constraints which are faced by property developers. Therefore, this aspect of property development – the funding process - calls for an in depth analysis of the problem. This study aims at investigating on the sources of finance for residential property development and the problems involved in obtaining it. Owing to the nature of property development in Mauritius, where developers inject funds from the proceeds of sales, the role played by the marketing department in charge of boosting sales is also covered. An analysis has also been effected to determine the marketing constraints which may adversely affect sales which in turn affect the ability to inject funds in developmental projects. Other constraints considered include- physical and legal constraints. The extent to which problems can hamper residential property development is considered before drawing appropriate conclusions.

Keywords: Residential projects, property developers, nature of property, financing, constraints.

1 Introduction

During the last two decades, the property sector in Mauritius has witnessed an unprecedented boom such that a large number of residential projects have been undertaken. But with the advent of the economic crisis in 2008-2009, the construction sector endured a severe shock with the result that a large number of projects have been paralysed. Such a paralysis has resulted in uncompleted projects, social and economic problems in the construction sector. Some places have turned up to real eyesores. This state of affairs has affected the livelihood of the construction workers, the profitability of financial institutions, property developers and the hardship of buyers. Therefore, the need for this investigation is seriously felt.

An inability to complete the residential projects due to a lack of funds also causes economic loss to all stakeholders involved in the property development process. Banks who lend money often find themselves stuck with poor security as the open market value of incomplete constructions is low. Property developers themselves receive no return on their investment until the project is completed. Moreover, they have to pay high rates of interest to banks where funds are borrowed to finance construction. Construction workers go jobless when developers are unable to complete their projects. Buyers who make partial or initial payments to the seller do not receive the end product as promised on the date of completion of all works.

It is interesting to consider what has been said about the constraints in residential property development in Mauritius, though there is a dearth of material in this respect. Construction materials account for as much as 60% of total project costs (Bourne, 1981; Haskell, 2004).The economic constraint that developers face consists mainly of the unprecedented rise in the price of construction materials over the years. According to a report by Statistics Mauritius (2014), the construction price index rose from 111.0 in June 2013 to nearly 113 in March 2014. This increase was mainly attributed to a rise in wages of construction workers, rises in the prices of building materials (block, sand and aggregate) and of metallic openings. The rise in prices was partly offset by a fall in the price of steel bars.Construction of a residential building ranged from 800-900 Mauritian Rupees (MUR) per square foot in 2008 and it has now reached the rate of 1200-1400 MUR per square foot in 2014.

Increases in the costs of building materials in the construction industry are also a cause for major concern. A report by the Construction Industry Development Board (CIDB) (2007) on the building and construction sector in South Africa notes that prices of building materials such as sand, cement, steel, timber, bitumen and masonry increased by up to 100% between October 2000 and 2006. Statistics South Africa (Stats SA) (2010a) and The Bureau of Economic Research (BER) (2011)reported price increases ranging from 70%–241% between 2000 and 2010. In addition, BER (2011) came to a conclusion that the prices of building materials increased linearly at an average rate of 70% between 2002 and 2010 and that price of all building materials increased up to 2008, when the material prices reached their peak. According to Van Wyk (2003), significant growth in the construction industry is dependent upon price stability in material costs, which have increased at rates higher than the inflation rate. Cockayne (2011a; 2011b), the CIDB (2007) and Enslin-Payne (2007) determine that increases in building material prices result in the inability of developers to deliver affordable housing, high tender valuations and poor construction industry performance.

Residential property development is also faced with financial constraints. Banks often refuse to finance speculative development based ‘on plan’ only since they are reluctant to rely on the security of a project when construction has not yet started. Those willing to lend compensate for the high risk by charging a high rate of interest. According to the Bank of Mauritius (BOM), the rate of interest for loans provided for residential puposes increased from 8% in 1970 to 14.5% in 2000. Property developers need the banks to finance the building process and the purchaser needs to access a mortgage to finance the purchase of a house or apartment. In addition, mortgage rates have fluctuated between 13% and 24%, causing substantial problems, with households finding it difficult to afford the higher interest payments and as a result, failing to pay their mortgage bonds (Tomlinson, 2010).

Compliance with the law relating to residential property development is imperative. If the law is flouted the authorities will be prompt to enforce it in all its rigour. Very often when developers fail to comply with conditions laid down in the building permit, the matter is settled in court. Court procedure is onerous and time-consuming. Contracts are disrupted much to the detriment of all stakeholders.

The physical constraint relates to the size and shape of the site, the qualities of the subsoil, the presence of underground pipes and cables, old foundations, contamination of land as a result of a previous activity, floods, wetlands, historic remains and big boulders under the surface necessitating several additional hours of work. Thus site preparation could be an onerous proposition. This problem has not yet been made a subject of research. However, the most common problem might be the levelling of the land and the removal of rocks.

In light of the above, this paper therefore aims at investigating the sources of finance, the financial constraints as well as the marketing strategy and constraints faced by developers.

2 Methodology

A questionnaire survey was carried out to determine the following key constraints investigated:

1. Funding of developments
2. Marketing of property development
3. Relationship between developers and other stakeholders

Based on the assumption that there is a general population of 50 professional property developer in Mauritius, the sample size was determined based on a confidence level of 90%, a margin of error of +/- 5% and a response distribution of 50%. The sample size of the survey was determined as 28.Following the above a questionnaire survey of 30property developers in Mauritius

3 Results and Discussion

3.1 Background of Property Developers

The background of the property developers used in this research is detailed in terms of number of years of experience, number of projects, project turnover, investments made and type of development.

65 % of the respondents had less than 15 years of experience as developer. The survey also revealed that 66.6% of developers had a license to operate whereas the rest operated

illegally. The total number of projects undertaken by developers between 2011 and 2013 is summarised in Figure 1. The graph shows a downward sloping curve indicating a slight decline of 3 projects (10.3%) from 2011 to 2013.The study revealed that small developers with a turnover of less than Rs 10 million formed the majority (74%), medium developers (Rs10-15m) accounted for 18.5% and big ones for 7.4%. 88.8% of developers invested less than Rs 10 million annually, 7.4% invested Rs 10-15 million and only 3.7% of them invested more than 15 million rupees. This is shown in Figure 2.

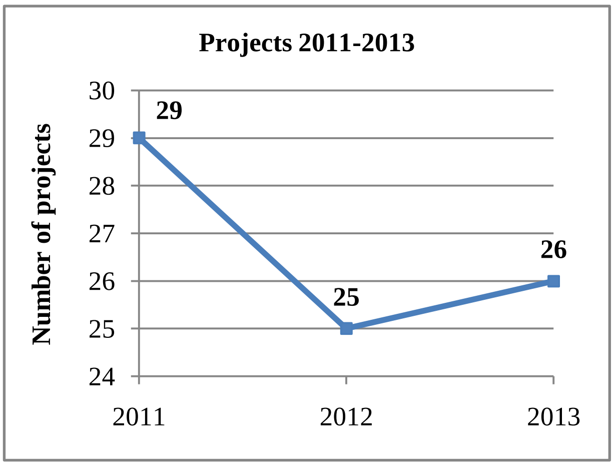


Figure 1 – Number of Projects in 2011-2013

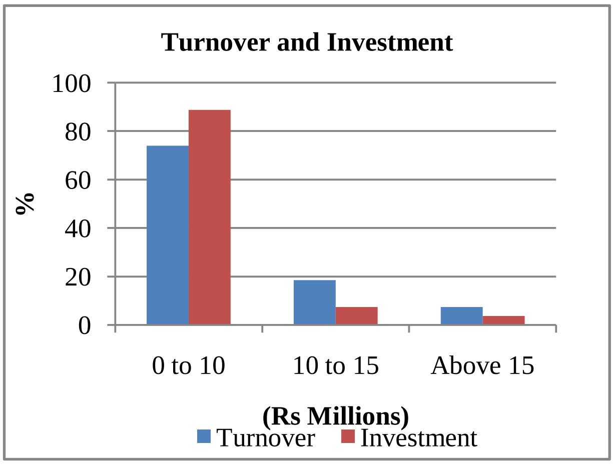


Figure 2 – Turnover and Investment

It was also found that 51.8% developers catered for the middle income group, 11.1 % for the high income group and 37.1% for social housing.

3.2 Funding of developments

3.2.1 Sources of finance for property developers

The study confirms that 62% of developers view banks as their main source of finance. 14% uses their own funds whereas 16 % obtains funds from clients in the form of deposits for future constructions that is where sale 'on plan' occurs. This is shown in Figure 3.

In fact, commercial banks are very reluctant to finance such developments. The developer finds it hard to obtain finance from banks to start development when land is bare. Also banks are very stringent when clients purchasing apartments 'on plan' seek borrowed funds from their banks. Findings also revealed that 98% of all property developers borrowed funds for their development as shown in Figure 4. Over 55% of developers borrow from 50-

75% of their project total cost. This can be explained by the fact that banks require developers to inject their own funds at first to cover at least 30% of the total project cost. This is done to mitigate the risks by the banks.

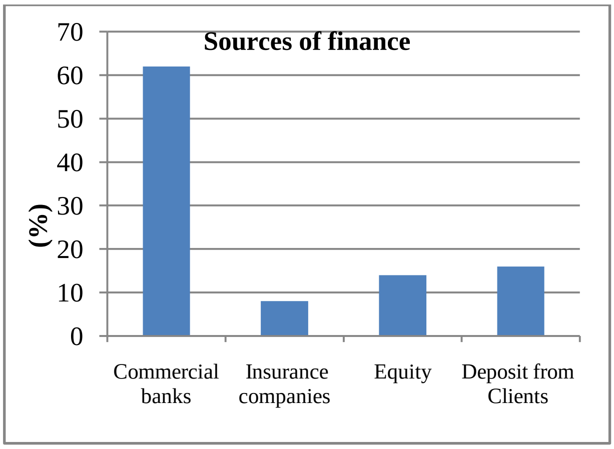
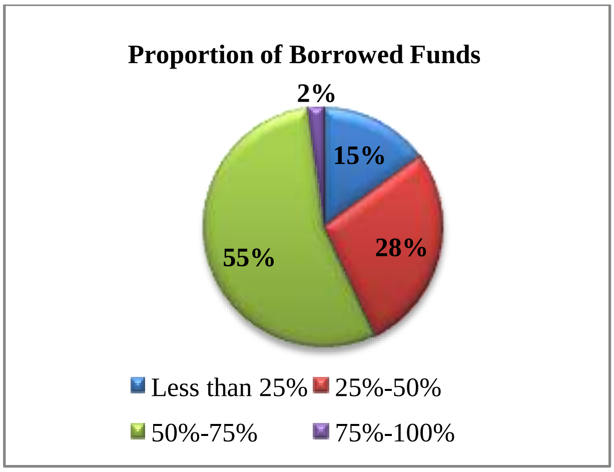


Figure 4 – Proportion of Borrowed Funds



3.2.2 Rate of interest charged by finance banks

Figure 5 shows the rate of interest developers paid for funds. 70% of developers who borrow from banks pay a rate of interest ranging from 10 to15%. In fact, 55% of those who borrow perceive this rate as a constraint which affects them to a large extent as shown in Figure 6. This confirms that the rate of interest is one of the major financial constraints faced by the developer.

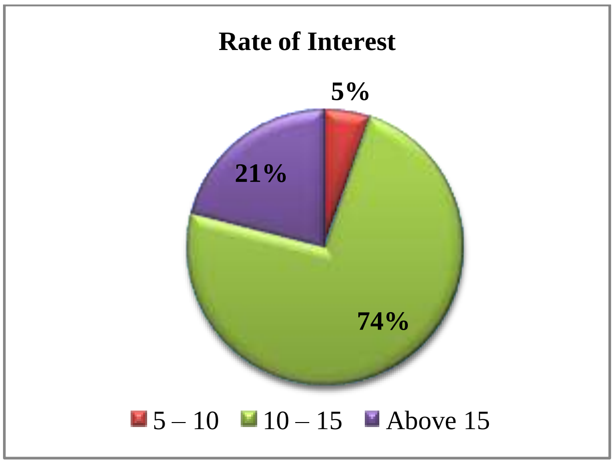


Figure 5 – Rate of Interest paid by Developers

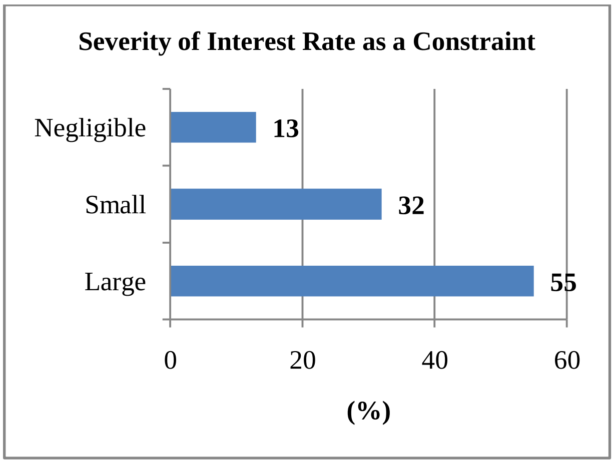


Figure 6 – Severity of Interest Rate as a Constraint

3.3 Marketing of development

According to the study, 71.4 % of developers sold their products by advertising. 71.4% relied on personal contact, 78.6% on the press, and 64.3% on the internet while 'For Sale' boards were used by 35.7% of developers. The billboard was used by 14.3% developers only. It was found that a developer used several techniques concurrently as shown in Figure 7. As shown in Figure 8, the findings also indicate that 57% of the developers found marketing costs to be so high that development was hampered while 43% found them to be reasonable. However, the vast majority of developers consider marketing as a tool that boosts sales of properties to an exceedingly large extent.

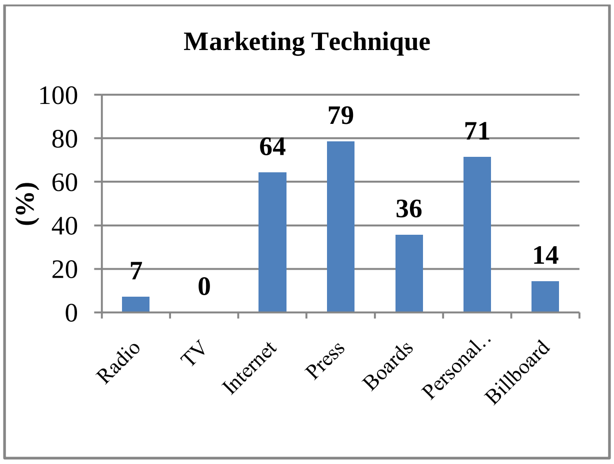


Figure 7 – Marketing Technique

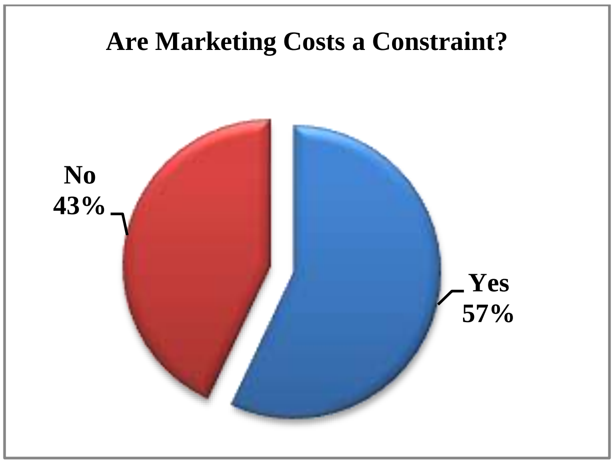


Figure 7 – Marketing Costs as a Constraint

3.4 Relationship between developers and other stakeholders

The findings from the questionnaires revealed that 73% of developers were mostly concerned with banks and contractors and 64% with banks, estate agents, contractors and planning authorities. Only 2% dealt with valuers while 2% was least concerned with insurance companies. 55% of developers thought that bankers were most cooperative while 42% were in favour of estate agents. 45% was of the opinion that contractors did not honour their contracts and that could result in losses due to considerable delay in delivery.

The relationship between developers and estate agents was also investigated. Some developers admitted that estate agents not only charged a 2% commission as was the practice but charged more than that. However, the developer continued to do business with them because of their expertise and assistance.

4 Conclusions and recommendations

The study aimed atproviding an insight into the various constraints faced by the residential property developers in funding residential property development.

Evidence shows that the Mauritian property developer faces numerous constraints. Apart from financial constraints which really hamper their development, they also have to face economic, legal and physical problems. Financial and economic constraints prove to be major obstacles in the funding process of property development.

Findings confirm that the bank is the main source of providing funds for development. However, the interest rate is deemed to be high and this acts as a disincentive to small developers.Commercial banks' reluctance to finance new development especially where sale is on an 'on plan' basis is another major constraint faced by the small and medium developers.

The rising construction costs - building materials and labour costs – also adversely impact on the construction industry. Developers who plan to complete their projects within 2 years are now unable to do so as they have exceeded their budget.

Marketing costs and estate agent fees play an important role in the ability to market the developer's products. Such costs and fees are too high especially for the small developers. Those who are unable to properly market their properties in this highly competitive market are left with unsold products which restrict their ability to fund new development.

Taxes in the form of registration duty and land transfer tax also impact adversely on the developer's profit. All of them cannot afford to sell at low prices because of these rates imposed by the government. The result is that sales cannot be boosted and funds are not available for other projects.

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