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Housing outlook positive, but where will supply come from?

JEDDAH: ARAB NEWS

There are only a handful of developers across the Kingdom who can deliver large-scale housing projects.

No one can deny that housing is of critical importance to the Kingdom. A recently released report from the National Commercial Bank (NCB) confirms most assessments that demand for new units is expected to increase from 195,000 units per annum in 2011 to 264,000 units totaling 2.4 million units by 2020. That means that the outlook for the Saudi housing sector is very positive, as a young, fast-growing, affluent Saudi population will continue feeding demand for housing. The mortgage law has been enacted and the Saudi Arabian Monetary Agency (SAMA) is working on issuing the implementing regulations — key drivers for facilitating end-user financing. But the critical question is where will the units to meet this demand come from? Despite its size, even the government's plans to construct 500,000 units will meet less than a quarter of the demand.

Small- and medium-size developers

There are only a handful of developers across the country who can deliver large-scale housing projects. The majority of units in fact come to the market from small- and medium-size developers who usually supply less than 50 housing units per project. Many of these developers are either family businesses or are contractors turned into real estate developers. In some cases, individuals have also entered the market with their personal savings and are developing housing units.

The main constraint faced by small- and medium-size developers is a lack of construction finance, which restricts capable parties from undertaking additional or larger scale projects.

estate brokers estimate that around 65-70 percent of the current housing supply in Saudi Arabia comes from the small- and medium-size developers.

The housing supply target set by the 9th Development Plan of the Ministry of Economy and Planning (MEP) and project data available with MEED Projects further corroborates this estimate.

According to the 9th Development Plan, the supply of housing units during the 5 years ending 2014 is estimated to be around 950,000 units, against an estimated demand of 1,250,000 units. Out of the total estimated supply, MEP targets 775,000 units (about 80 percent of the total) to be built by the private sector. Based on the data available with MEED Projects, large-scale housing projects (in

onerous over-collateralization requirements, and lengthy due-diligence processes.

Developers have said that the time taken to arrive at a financing decision is often so long that it makes it redundant for the developers to borrow from them.

The few institutions which finance developers are few and far in between and do so only on a selective basis without programmatic approaches that allow developers to develop long-term financing relationships based on standardized criteria.

On the other hand, banks are increasingly open to provide housing finance to home buyers and as a result the demand supply gap is increasing.

Accepted designs and vetted engineering details will bring added customer confidence into developments by small- and mid-size developers.

While developers already use market-accepted designs, since they are focused on what will sell quickly, there is always a risk for the buyer since there is no formal oversight or approval.

Developing a new solution

Given the overall need for new units and the capacity constraints of large-scale developers, the best and most viable solution to the housing shortage is in systematically supporting small- and medium-size developers.

This support must primarily be given in the form of dedicated financing programs

Banks do not have products specifically designed to meet their needs.

Their formal and intricate risk management guidelines and requirements, such as audited financials and proof of regular income make it difficult for small- and medium-size developers to acquire financing from banks.

Thus, small- and medium-size developers mainly rely on their own sources often using accumulated capital or pooled capital from within a group of trusted investors, usually friends and family.

Atif Bassas, general manager of Rock Building Company in Riyadh, said the company is entirely dependent on partners and individuals, when it comes to financing its projects. He said he did not resort to bank loans, since banks want to recover their loans in the shortest period of time, regardless of any challenges or difficulties that the project or developer might encounter, which can be beyond our control during the building process.

Abdulatif Al-Numair, chairman of Abdulatif AlNumair Group in the Eastern Province, added his voice to that of Bassas, confirming that he does not resort to loans and that they would be drain on his business if he were to access them.

He said equity investment in his residential projects would be more beneficial for the sector, in terms of increasing supply and reducing the overall building costs.

How many homes do they build?

Independent industry experts and real execution or planning stage) are estimated to contribute around 85,000-100,000 units over the same period, representing approximately 10 percent of the total estimated supply.

Considering this, housing supply by small- and medium-size developers is estimated to be approximately 70 percent.

Essentially, small- and medium-size developers are not looking to develop signature developments — rather, they bring a pragmatic approach to developing homes that are going to sell.

This means they want to develop homes that are of an accepted design, in areas that are already largely occupied and are priced for the middle-market.

While recognizing their constraints, developers in this segment believe that there is an opportunity for them to grow and increase their profits through larger projects. The question is how to help them grow?

Lack of financing options

Small- medium-size developers mainly rely on informal financing sources such as capital from friends and family.

According to these developers, bank requirements are usually very impractical with few or no products specifically designed for their needs.

Among the factors that make banks impractical as a source of financing are preference for larger scale projects, a lack of standardized criteria for small- and medium-size developers, reliance on strength of corporate balance sheet,

Creating tailored programs

Since small- and medium-size developers make up 70 percent of market supply, financing them is a key to ensuring housing supply in Saudi Arabia, which is understood by all market players to be already constrained.

However, the development of tailored financing programs will need to do more than just extend funding to increase the volume of units coming into the market.

A critical part of developing tailored financing programs will be the concurrent development of standards and codes enforced or required by financiers.

While many small and medium developers build high quality, sustainable units, there are some in this category who do not build consistently or deliver substandard product to the market.

These developers are often inexperienced or have chosen to cut corners in developing their product.

The presence of these should not take away from the often excellent quality units delivered by most of the developers in this segment.

But even among the best small- and medium-size home developers, variation exists between the methods, materials and finishes standards used by different developers, which sometime make it difficult to compare apples to apples.

A financing program for small- and medium-size developers can help bring standardization to an informal market.

that address the specific characteristics of this developer segment.

The majority of small- and medium-size developers are not structured enough to provide audited financial statements and other documentation as generally required by banks. Furthermore, each developer will be unique in its market focus, strengths, weaknesses, etc., so the new approach taken must incorporate flexible qualification criteria and documentation requirements.

Such a solution requires a completely different new approach, which is tailored toward judging each project on its own merits but based on a predictable review process that developers can provide answers to thereby increasing the likelihood of their receiving financing.

This review process will need to combine not only financial and legal due diligence but also include core development and marketing guidance to assist developers in the concept and sales phases — producing units that are more relevant to their markets, which sell faster.

Under their broad mandate to support the growth of the housing sector, Capitas Group International and its partner, the Islamic Corporation for the Development of the Private Sector, are in the process of launching a unique company offering capital designed specifically to foster the growth of small- and medium-size developers so as to increase the supply of affordable housing units in the Kingdom's main urban centers.

Story Text:

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The main constraint faced by small and medium size developers is a lack of construction finance which restricts capable parties from undertaking additional or larger scale projects. Banks do not have products specifically designed to meet their needs. Their formal and intricate risk management guidelines and requirements, such as audited financials, proof of regular income etc. make it difficult for small and medium sized developers to acquire financing from banks. Thus, small/medium-sized developers mainly rely on their own sources often using accumulated capital or pooled capital from within a group of trusted investors, usually friends and family.

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The housing supply target set by the 9th Development Plan of the Ministry of Economy and Planning (MEP) and project data available with MEED Projects further corroborates this estimate. According to the 9th Development Plan, the supply of housing units during the 5 years ending 2014 is estimated to be around 950,000 units, against estimated demand of 1,250,000 units. Out of the total estimated supply, MEP targets that 775,000 units (about 80% of the total) to be built by the private sector. Based on the data available with MEED Projects, large scale housing projects (in execution or planning stage) are estimated to contribute approximately 85,000-100,000 units over the same period representing approximately 10% of the total estimated supply. Considering this, housing supply by small and medium sized developer is estimated to be approximately 70%.

Essentially, small and medium sized developers are not looking to develop signature developments – rather, they bring a pragmatic approach to developing homes that are going to sell. This means they want to develop homes that are of an accepted design, in areas that are already largely occupied and are priced for the middle-market. While recognizing their constraints, developers in this segment believe that there is an opportunity for them to grow and increase their profits through larger projects. The question is how to help them grow?

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Small/medium-sized developers mainly rely on informal financing sources such as capital from friends and family. According to these developers, bank requirements are usually very impractical with few or no products specifically designed for their needs. Among the factors that make banks impractical as a source of financing are preference for larger scale projects, a lack of standardized criteria for small/medium size developers, reliance on strength of corporate balance sheet, onerous over-collateralization requirements, and lengthy due-diligence processes. Developers have said that the time taken to arrive at a financing decision is often so long that it makes it redundant for the developers to borrow from them.

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Creating Tailored Programs

Since small and medium sized developers make up 70% of market supply, financing them is a key to ensuring housing supply in the KSA, which is understood by all market players to be already constrained. However, the development of tailored financing programs will need to do more than just extend funding to increase the volume of units coming into the market. A critical part of developing tailored financing programs will be the concurrent development of standards and codes enforced/required by financiers.

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