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Two case Studies on constraints faced by property developers in Mauritius

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Abstract: One of the major problems encountered by property developers in Mauritius include the funding of particular projects in hand and ensuring that the projects attain successful completion in scope and time. Consequently, the island has witnessed some major projects either never reaching completion or experiencing a very slow progress of works. This paper attempts through the selection of two case studies, to describe the limitations or constraints observed by identified property developers in the construction industry for residential development. While financial and marketing constraints were common and serious for the two case studies; economic, physical and planning constraints have also been observed.

Keywords: Limitations, constraints, property developers, residential projects, case studies

I. Introduction

Indeed any project that has not reached completion or witnesses very slow problems imparts major problems to the various stakeholders concerned. Some property developers in Mauritius have recently encountered serious constraints that have influenced the smooth progress or even have resulted in the non-completion of their respective progress. Nathan S. Collier, Courtl and A. Collier and Don A. Halperin., (2008), state that the developer's knowledge of financial markets is essential. He must be aware of the sources capable of funding the type of projects being worked on. They also added that if visions of development projects are to become realities, the successful investor or developer must find reliable sources of funding. In Mauritius the most important source of finance is the commercial banks. However, such banks are reluctant to lend for purely speculative development because of the high risk involved. They prefer low risk pre-let or pre-sold development; and stick to lending criteria such as repayment capacity, size of companies, nature and size of development, length of loan, security offered, the assets of the companies and their cash flows and finally, the location of the development, prime locations being preferred to less important ones. The viability of projects and the need for rental income to cover interest payments weigh heavily in the scales. But the authors do not consider the various constraints that developers face apart from certain disadvantages. Rughooputh et al., 2014, comment on the various constraints faced by property developers in the funding of residential property development in Mauritius. Among the main limitations faced and discussed, financial and marketing constraints were further elaborated and found to be more critical. Marketing tactics are dealt with extensively by Bevan (1991). He analyses every possible tactic that relates to the property industry. He deals with a wide range of tools used to promote sales of properties like advertising, the use of media which consist of TV, radio, newspapers, magazines, and other forms of media advertising like cinema and posters. Attention is also focused on media events as a promotional tool in the property industry. The role of Chartered Surveyor Weekly which reports on sporting events or the launching of new enterprises is also emphasized. Bevan (1991) does not fail to distinguish between market research and marketing research. The former deals with the size and nature of the market place while the latter looks at the reasons behind demand. This distinction is important since much confusion results in this respect. In spite of all the details given by Bevan (1991) on marketing of residential property the thirst of the researcher remains unquenched in terms of constraints in marketing apart from the drawbacks of certain marketing techniques.

This paper aims at analysing the main constraints faced by some property developers locally through the selection of two case studies (fictitious names). The objectives were to select two companies that have faced serious defined constraints, identify and analyse these limitations that the developers have faced.

II. Methodology - Case studies

Two uncompleted residential projects in Mauritius were used as case studies in order to identify the sources of finance, financial constraint, marketing strategy and other constraints faced by developers in the island.

II.1 Case Study 1 - A Construction Ltd

A Construction Ltd is a property developer specializing in the construction of residential complexes for the middle income bracket which has now gone under administration. It successfully completed two residential projects. The property developer has been facing financial difficulties and around seven of the twelve residential

projects it undertook have been left uncompleted with only skeleton structures standing on land. This property developer did not play an active role internationally except that in 2008 it was in partnership with a South African firm, which was entrusted with the marketing of flats. But this partnership no longer exists.

II.2 Case Study 1 – B Construction Ltd

B Construction Ltd launched one of the biggest and most prestigious residential projects consisting of luxury apartments. Construction has stalled and out of five towers only three structures have been erected and left unattended for over 6 months. The project started in 2012 comprising 250 luxury apartments with prices ranging from Million Mauritian Rupees (MUR) to 5 Million MUR, per finished unit. The project was valued at 1.8 Billion MUR with an additional 1.5 Billion MUR development in terms of commercial facilities attached to the original project. Since July 2014, this company has also gone under administration. The chairman of the same company is a renowned property developer and an award winning architect. The project (in plan) has received various Design and Development awards and received in 2012 two other recognitions, the International Star for Leadership in Paris and the International Diamond Prize by the European Society for Quality Research in Rome.

III. Analysis

III.1 Case Study 1 - A Construction Ltd

The main constraints faced by *A Construction Ltd* are summarised below.

III.1.1 Financial constraints

(a) Reluctance of banks to finance

As the company sold its flats 'on plan', that is, before construction had even started, the banks which were the main source of funding refused to lend to such a company. Banks are usually unwilling to lend to companies which either do not have assets or have insufficient assets as security. Thus the developer relied wholly on the payments made by clients who had to make a reservation deposit of 25% of the total amount. Further payments were made accordingly as construction proceeded.

(b) Clients' failure to pay

A Construction Ltd had started site clearance after 60% of reservations had been made. But as work proceeded a number of clients failed to pay on time thus creating a shortage of funds for further works. The only way out for the company was to borrow from banks through limited overdraft facilities at an exorbitant rate (18-19%). At a certain construction stage the bank became flexible in giving loans.

III.1.2 Marketing constraints resulting in lower sales of apartments

The Marketing manager of *A Construction Ltd* operating under the name of *A Marketing* highlighted the following constraints in the disposal of his flats which in turn resulted in lack of funds to reinvest in the development.

(a) High marketing costs

The manager allocated huge financial resources to modern means of advertisement. He complained about the high costs of advertising on TV, radio and the press. He expressed the view that he was in favour of government intervention to regulate advertising costs so as to boost up property sales. The company spent fifty thousand rupees monthly on advertising and admitted that it was not sufficient to promote sales in the property market.

(b) Cut throat competition in the property market

The Manager was of the view that cut throat competition was prevailing in the buoyant property market. The supply of flats increased as more and more developers turned towards such a market. The company lowered its price of flats so as to compete out other developers. This price cutting policy paid handsome dividends but the situation was complicated by late payments by clients.

III.1.3 Other constraints

In addition to funding constraints faced by *A Construction Ltd*, other constraints were also noted as summarised below:

(a) Economic constraint

- 2 acres of land were brought for the project at a price of 40 Million MUR. This was indeed a high price when compared to the Open Market Value of comparable properties in the area.
- Scarcity of skilled labour- This resulted in attracting skilled labour from competing firms at a higher cost.
- The prices of building materials skyrocketed.

(b) Physical constraint

- The existence of wetlands- Wetlands were governed by stringent law. The first site chosen by *A Construction* for the project was not suitable and had to be given up in favour of the current one because it would have caused great damage to the ecosystem.
- The construction company further experienced much hardship due to the rocky nature of the land. An increase in both costs and time taken occurred thus causing considerable delay in keeping within the time frame.

(c) Planning (Legal) constraint

In Mauritius, stringent guidelines for a Building and Land permit and other planning requirements need to be satisfied. Not much could be done about that. The District Council took too much time to deliver building permits for huge projects. Delay beyond limit was an impediment and resulted in higher costs.

III.1.4 Summary

The main findings from Case Study 1 – A Construction Ltd are as follows:

- Banks were reluctant to finance a development where sales were on an ‘on plan’ basis because of the high risk profile of the project.
- Clients’ failure to pay once construction had started resulted in an inability on the part of the developer to complete the project on time.
- Prices of building materials increased significantly during the construction period which was scheduled for 2 years thus causing an increase in expenditure on materials.

III.2 Case Study 2 - B Construction Ltd

The main constraints faced by A Construction Ltd are summarised below.

III.2.1 Funding process

(a) Commercial banks

Reservations for flats were taken before construction had started. Commercial banks did not have any issues with financing the purchase of flats by their customers as payments were made in instalments depending on the stage of construction. Furthermore, the project enjoyed a good reputation as it had recently completed a big project successfully.

(b) Stock Exchange of Mauritius

Funds were also generated through the sale of shares on the SEM. According to information available at the registrar of companies (verbal communication), in October 2012, the company changed ownership, split at 41.6% each between D Investments Ltd and E Properties Ltd. The remaining 16.8% was floated on the SEM to attract capital into the project.

III.2.2 Financial Constraints

(a) High expectations on returns

The first problem was that the developers oversold the project to potential investors and customers. Investors were promised rich returns and according to documents presented by the company; these investors were told that profits of the company would jump by over 42% a year between 2012 and 2015. In 2012 (verbal communication), for instance, when profits of 64 Million MUR were promised, the company made only 51 Million MUR and in 2013 instead of the 109.4 Million promised MUR, a profit of only 32 Million MUR was reaped. These differences among figures floated by the company and the profit projections led to the suspension of the company from the Stock Exchange.

(b) A major contraction in demand

According to the developers, there was a major contraction in demand which led to sales falling drastically thereby generating a shortage of funds to complete the project. As funds were needed to complete the construction and since the company was suspended from the SEM, a fall in sales of units complicated matters and a lack of revenue resulted in construction being stopped. Sales of apartment stopped at 108 out of 250 units.

(c) A reduction in the ability of commercial banks to finance the purchase of flats in the project.

Commercial banks were no longer willing to finance their clients’ purchase of flats in this project. As the construction did not progress at a reasonable pace and with all the problems encountered by the developers, doubts about the viability of the project were amplified. Clients who had paid first and second instalments could not obtain additional funds from their banks for the completion of their units. According to figures supplied by the company itself (verbal communication), 84.9 Million MUR were received in deposits and with all the instalments paid for the 108 units sold, this figure rose to up to 300 Million MUR.

III.2.3 Summary

The main findings from Case Study 2 – B Construction Ltd are as follows:

- There was a major contraction in demand for apartments which led to a drastic fall in revenue thus reducing the cash flow of the company and making it difficult to repay its creditors.
- Commercial banks were reluctant to finance their client’s acquisitions of apartments when it became obvious that the company would default and construction was not progressing at a reasonable pace
- The developer oversold the project to investors promising wild returns on the Stock Exchange of Mauritius. When these high expectations were not met, SEM suspended the company therefore further exacerbating their financial condition.

IV. Conclusions

The research attempts to identify constraints faced by the residential property developers. The philosophy behind it is to produce something that has rarely been dealt with in the country by professionals in the field. In this connection two case studies in Mauritius were selected, analysed and reported. Evidence shows that the

Mauritian property developer faces numerous constraints. Among the identified limitations were those of financial and economic, marketing; as well as legal (planning) and legal ones. Moreover, client's inability to pay for their already reserved apartments is another constraint the developers face. Some developers thrust the blame on the economic crisis. Others believe that an oversupply of apartments and housing units in residential complexes over the last 5 years is the cause of failure for new projects. Hence in light of the study, it is expected that similar works be conducted to substantiate the need to encourage major residential projects in the island.

V. References

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