

The Impact of Financial Crisis Towards the Real Estate Developments and Market in Colombo during 2020-2023

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Abstract

Sri Lanka's economic collapse began in 2019 with the Easter bomb blast and worsened in 2020 due to the Covid-19 pandemic. The crisis affected industries like apparel, exports, tourism, and the construction industry. The Real Estate sector, which contributes to the economy, is crucial for retail, industrial, and commercial sectors. A research study aimed to identify the impact of the financial crisis on the Real Estate sector and identify strategies to overcome it. Semi-structured interviews with ten Real Estate Developers revealed risks such as withdrawal of investments, loss of sales, abandonment of businesses, and loss of opportunity cost. Strategies to overcome the crisis included small-scale projects and engaging in real estate or non-real estate-related alternative businesses. This study could help the Real Estate development industry proceed with construction projects and inform future research on strategies and business protection during economic collapse.

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Keywords: Real Estate developments; Financial Crisis; Sri Lanka; Economy

Introduction

Crises of the commercial banks inside the country, international financial crises and economic crises due to recession and depressions are identified as main reasons which are causing for an overall financial crisis within a country. There can be other reasons results for a financial crises such as macroeconomic circumstances or microeconomic policies (Hemachandra , 2011). Sri Lanka currently facing for severe financial crisis due to lack of foreign currency, forex issue, speed increase of inflation, unstable political background. Due to above mentioned issues, many industries in Sri Lanka now facing on critical issues on their industry. As one of the largest industries when comparing to the other industries, construction industry can be identified as an industry which is in a critical position due to this financial crisis. According to the opinion of Ceylon Institute of Builders (CIOB) it is hard to proceed the construction industry due to the dollar shortage, depreciation of rupee and increase of price of the raw materials (“CIOB Chairmen Dr. Karunaratne” Says ‘Construction Industry Crises for Survival’, 2022).

It was identified both in developed and developing countries, there is a direct effect to the Real Estate market when there is a financial crisis in a specific country (Xiao, 2010). The commercial Real Estate industry plays a vital role by contributing to the economy based on three major categories. They are retail, industrial and commercial. The volume of Real Estate businesses is used as an economic indicator, which indicates when Real Estate transactions are increased, businesses become more expanded (Lussier, 2005). In 1997 the Asian countries faced a financial crisis, and the reason identified for the Asian financial crisis was fall of the property sector and the damage of it caused to the financial systems of every Asian country. Due to this in a financial crisis era of a country mainly what is happening in the Real Estate market is, that there will be a burst in the price bubble of the Real Estate products such as land, residential, factories (Takayasu et al., 2010).

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It has been identified that sometimes the crises in the Real Estate sector also can cause the collapse in the financial system of a country. Thus, the correlation between the property prices, the real estate market and the fluctuations directly decides the place where the economy of the country reaches (Zhao et al., 2017).

The objective of the study

Most of the investors' main target is to protect their assets against financial inflations. Due to this, investors used to increase their general price levels by increasing the rents or the selling price. Then, the consumers may refuse on purchasing or renting out Real Estate properties because the final output of the Real Estate construction is coming as a value-added service. Due to the uncertain return of the investments, investors are in a fear to dedicate their financial or other fixed assets in this kind of risk emerge situation (Abdul-Rasheed & Tajudeen, 2006). The aims of the study are as follows.

1. To identify the impacts of financial crises on the Real Estate developers and their businesses.
2. To analyze the strategies used to manage the impact of the recession by the Real Estate developers.

Literature Review

A. Impact of financial crisis towards the Real Estate market and developments

In middle of 1997, financial panic occurred including East Asian countries such as Indonesia, Korea, Malaysia, Philippines, Thailand. The diagnose regarding the crisis was identified that the financial systems of all those countries were administrating by the corruptions, insider dealings, and weak governance where the capital inflows of those countries turned in to capital out flows (Radelet et al., 2014). The panic generated with the damage done by the property sector of the Thailand towards the financial system of the country reached to splash more confused situation in Asian financial crisis (Xiao, 2010). In this International Monetary Fund (IMF) intervened and facilitated some arrangements regarding the financial system of these countries to overcome the crisis situation (Hemachandra, 2011). Even though, there were stabilized macroeconomic policies regarding financial crisis, Sri Lanka is facing a severe financial collapse since 2019 due to results of 2019 terrorists attack and since 2020 the Covid - 19 pandemic (Tripathi et al., 2022). The causes of financial recession towards the construction industry dragged the total industry in to the issue in payment outstanding, suspension or termination on construction projects, investments barriers and usage on more concessionary funds (Wijeratne, 2022).

The commercial Real Estate industry with its business perception used to provide multistorey condominiums, warehouses, and factories under three main categories retail, industrial and commercial buildings (Lussier, 2005). The increase in population growth, rapid urbanization, increase in housing requirement and the tourism sector make demand on the Real Estate sector of Sri Lanka (Dias, 2020). The residential Real Estate sector which contains single and storied houses, annexes, apartment units and twin houses plays a major role in the development of the country. In the 60s'and 70s' the governments of Sri Lanka implemented a strategy to construct housing apartments to control the limited land availability of the Colombo district. 90% of Real Estate constructions are located in Colombo district of Sri Lanka (Prathapasinghe & Gedara Ariyawansa, 2018). Between 2005-2007 Condominium Management Authority (CMA) has issued certificate for 914 condominiums (Jayaweera & Rajapaksha, 2021).

The volatility within the Real Estate sector is used as an indicator to identify the volatility within the finance industry. Though there is a direct simultaneity between the Real Estate market and the financial industry, the deviation in each industry can affects both. Thus, the global financial crisis can lead into a panic where the land and property values may cause business failures, diminish the wealth of consumers, government intervention on financial commitments and collapse on economic activities which are more relatable with the Real Estate market. Due to the Asian financial crisis during 1997-1998 most of the companies that owned Real Estate assets suffered lower returns and higher risks during the crisis and after the crisis (Dayaratne, 2012 & Gunawardhana, 2013).

Due to the 2008 – 2009 global financial crisis, individual investors were affected worst. The returns from the negative stock market decreased the portfolio values of investors during this crisis period. When the crisis is in a peak situation return expectations of the investors were decreased (Hoffmann et al., 2013).

The United Arab Emirates (UAE) caught the global financial crisis which occurred in 2007, and a report released in 2011 indicated that UAE has been contributed up to 60% of this global financial recession. As the main reason for such percentage, they have identified that is the “Housing Bubble” in UAE. Due to the financial recession the prices and the rents related to the Real Estate market dropped by 20% - 50% where the most of the Real Estate construction projects were terminated (Al-Malkawi & Pillai, 2013).

The keen decrease in housing prices straightly has been caused for the financial crisis and the Gross Domestic Production (GDP) recession in China. (Zhao et al., 2017). From 2008 to 2010 property and house prices dropped by generating a major impact towards the economic system of Slovenia. During the recession period most of the investors who lived in Slovenia trusted that the risk bonded with the property prices could be reduced by keeping a very high price level (Golob et al., 2012).

Spain maintained a construction dependent economy and it brought a critical situation to the Real Estate and construction sector. Because the unemployment raised with the global financial crisis dragged Spain’s economy into a vulnerable situation though they were totally depended on construction related activities (Ren et al., 2014).

B. Behavior of the Real Estate Strategies During the crisis

When studying on behavioral aspects within Real Estate companies, the effect of the decision-making process becomes important. Thus, the Real Estate companies are motivated to use the valuation process under the behavioral perspective (Renaud, 2012).

The studies have identified that there are collaborations of Real Estate markets of different countries with the financial recession. As an example, after the 1997 financial crisis in China and Hong-Kong Real Estate markets were integrated (Kim, 2009). Transitional Real Estate Development (TRED) projects are used to facilitate upper middle classes using mixed use projects. These type projects mainly target on upper middle class of a society though they are affordable consumers for their constructions. In worldwide the investors of TREDs are selecting locations through the geographical of the specific country to proceed their developments. This TRED concept is Collaborated concept with the Foreign Direct Investments (FDI). The Port City, Colombo Construction of Sri Lanka is an example for TRED concept (Koelemaij & Derudder, 2021).

Methods

A. Data Collection

Qualitative method was used as the research approach to collect the required data. Semi structured interviews were conducted among the 10 Real Estate firms which were continued the Real Estate developments during the recession period to collect the required data to proceed the study. The interview questionnaire was developed by covering the background of the organisation, nature of the Real Estate business within the organisation, how this financial crisis situation impacted to their developments, organisations and business concurrent to the objectives of the research study as open-ended questions. The data was collected via zoom meetings and over-the phone calls despite the busy schedules of the interviewees.

B. Population

In this research the targeted population was the Real Estate development organisations and Real Estate development projects occurred within the Colombo district of Sri Lanka which were continued the Real Estate developments during the recession period.

C. Sample

Purposive sampling method was used to select the sample because the main target of the study is Real Estate companies who were engaged within the Real Estate developments during the peak situation of the financial crises in Sri Lanka since 2021. Thus, the sample includes Real Estate organisations executives, Real Estate construction project managers and Engineers, Real Estate sales managers.

D. Data Analysis method

The collected data and information were analysed using the content analysis procedure because all data were collected using the literature review and conducting the semi structured interviews with open ended questionnaire. Thus, all the opinions, judgments and perceptions are in descriptive form, most suitable analysis method is content analysis method.

Results and Discussion

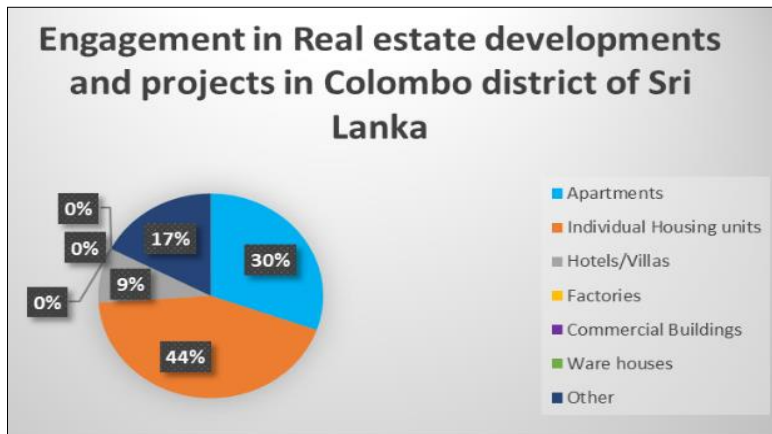
A. Respondents Profile

Table 01 shows the basic details about the interviewees. The interviewees will be named by using the codes mentioned in table 01 in the analysis section.

Table 01: Details of Interviewed Real Estate Professionals

Interviewee	Designation	Experience (Years)
I1	Managing Director and Senior Quantity Surveyor	25
I2	Chief Operating Officer	16
I3	Senior Planning Engineer	13
I4	Engineer	11
I5	Senior Sales Manager	25
I6	Senior Quantity Surveyor	20
I7	Senior Sales Manager	25
I8	Managing Director	30
I9	Chief Operating Officer	18
I10	Project Manager	25

Figure 1: Engagement of the Real Estate developers on different Real Estate developments in the Colombo district of Sri Lanka



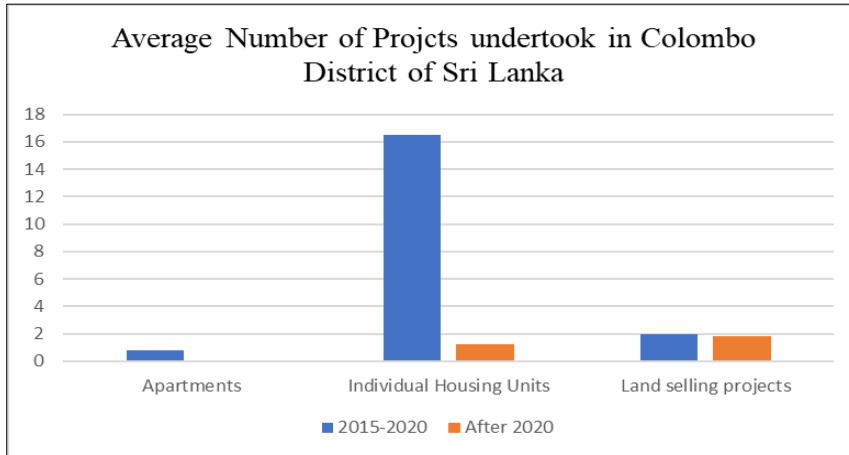
Source: Compiled by Author

According to figure 01, most of Real Estate developers are engaged in developing individual housing units and apartments in the Colombo district. Real Estate developers do not undertake any factories, commercial buildings and warehouses constructions as Real Estate developments in Colombo district.

During the Covid – 19 period demand towards the apartment constructions were decreased and the demand for the individual housing units were increased. According to the opinion of all interviewees, the selection of the Real Estate development type they are going to undertake depends on the current market demand for the specific construction.

Figure 02 shows the average number of projects that the interviewed organisations undertook between 2015-2020 and after 2020.

Figure 2: Behaviour of the Real Estate developments before and during the financial crisis



Source: Compiled by Author

According to figure 02 it is obvious that after the year 2020, there is a decrease in Real Estate development and their businesses. According to the reveal of the interviewees, after 2020 they were reluctant to start the new projects, and they were focused on completing the started projects which were caught with several delays as well.

A. The impact of the financial crisis toward Real Estate developers and their businesses

Most of the organisations encountered the risk of withdrawal of local and foreign investments, they have mentioned that when the fixed deposit rates increased in commercial banks, the local investors were reluctant to invest in the Real Estate market because those investors identified that they could gain more advantage from investing those cash or assets as fixed deposit in a commercial bank which gives high fixed deposit rate. Al-Malkawi & Pillai, 2013, as well mentioned that in their study during a financial crisis situation withdrawal of foreign investments is happening because investors are nervous to keep their assets in such situations within another country.

The forex issue and the devaluing of the Sri Lankan currency directly have affected on the increase in material prices. When quotations called for the materials, those quotations were valid only for a one day because the dollar rate is fluctuating on daily basis. And the amounts in all the quotations were in dollars. When materials and other items are imported the payments must be done in dollars. According to the opinion of the Ceylon Institute of Builders Chairmen Dr. Karunarathne (2022) it is hard to proceed the construction activities with the dollar shortage in the country.

Sales loss is a huge risk faced by the Real Estate companies. At the beginning of the recession the sales level of some companies were decreased up to zero. In Dubai their Real Estate prices got increased and the demand got decreased specially for the Real Estate housings during the 2008-2009 recession period (Renaud, 2012). Both Real Estate developers and consumers are facing problems regarding the Real Estate constructions. The loan and debt conditions as well affected to both consumers and the Real Estate developers. Most of the consumers use to buy the Real Estate properties by affording the loans. But with the recession situation, interest rates for the housing loans

were also increased. Because of this, consumers got nervous about buying the housing units or Real Estate properties by taking a loan.

Beyond the above factors there were some other risks which were encountered by the Real Estate developers which made an impact are mentioned below,

1. Abandonment of businesses by medium-scale Real Estate developers.
2. Central bank restrictions on making investments in the Real Estate market.
3. Lending restrictions from the commercial banks.
4. Increase in the costs of construction materials and services.
5. Competition among Real Estate developers.
6. Loss of opportunity cost.
7. Increase of unemployment in the industry.

B. Usage of different strategies to overcome the issues occurring during the financial recession

According to the opinion of the interviewees their organisations must maintain their proceeding with the “running costs”. If an organization using these running costs, it means that there is not any loss as well there is no profit. Real Estate developments can be promoted among the Sri Lankan citizens who live in overseas. Organisations have started acquiring investments through social media campaigns as well to identify the potential investors who are willing to invest on the Real Estate market of Sri Lanka. Thus, the continuation of trades within Real Estate market is required according to the opinion of the interviewees. Because abandonment of the projects causes for the loss of the business as well it motivates the investors to proceed their investments. Dayaratne,2012 & Gunawardhana, 2013 mentioned that investors get motivated to the positive stock valuations, and they restart their investments and trading.

“Distributed payment planning” to the consumers is another strategy following by the developers during the critical situations. When consumers are going to invest on the property, they during this critical period consumers cannot afford the total amount at the beginning. By getting the property price as monthly, quarterly or yearly as instalments the consumers become affordable on the prices.

Transitional Real Estate Developments (TRED) is a globally using concept by integrating two Real Estate markets of two different countries. According to the literature review it has identified that during the after the 1997 financial recession period the Real Estate markets of Hong Kong and China were integrated (Kim, 2009). According to the opinion of the interviewees when it is considering on the legal system of Sri Lanka it is cannot integrate industries of two different countries.

Strategies which are currently being used by the Real Estate companies to proceed with their developments are mentioned below,

1. Engaging in a business that is Real Estate related like land selling
2. Engaging in a business that is not related to the Real Estate like starting a material manufacturing company
3. Disposing lands from existing land assets of the company to get an immediate cash inclusion.
4. Engaging in small-scale Real Estate developments by keeping small profit margins.
5. Improving marketing strategies within the company.
6. Changing the purpose of the constructed building into a currently demanding Real Estate Construction type

Conclusion

This research study was conducted to identify the impact of the financial crisis towards the Real Estate market of the Colombo district during 2020-2023 period. This study was limited to the Colombo district of Sri Lanka, because most of the Real Estate developments are proceeding over there. Even though there is a collapse in the Real Estate market due to the economic collapse within

the country, the organisations are focussing on proceeding the constructions due to the business aspects of that. According to the opinion of the interviewees, they have recommended several recommendations to proceed constructions while protecting the business. The recommendations include introducing affordable housing units for customers and valuable for developers, introducing value manageable new construction technologies from international construction industry, controlling artificial escalations in property prices by organisations, introducing distribution payment planning to the consumers.

Future Research Directions

Identification of demand drivers, innovation and value addition to ensure quality Real Estate developments.

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