The problem of unaffordable "affordable" houses

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- **Government** intervention in any business market is rarely a long-term solution and is usually seen more as short-term controls for certain commodities

Supposedly affordable houses in Malaysia remain seriously unaffordable to many households mainly due to insufficient financial capabilities as house prices are way too expensive.

Bank Negara Malaysia (BNM) points out that the prices are beyond the affordability of Malaysians – 73% of unsold properties are deemed to be above the affordability ceiling – with Johor recording the most number of unsold houses followed by Selangor, Kuala Lumpur, Perak and Penang.

According to the median multiple methodology developed by Demographia International and recommended by the World Bank, United Nations and Harvard University, a house is deemed affordable if it is priced not more than three times the annual household income, according to BNM's Financial Surveillance Department director Qaiser Iskandar Anwarudin.

"The affordability in Malaysia has deteriorated, with the median multiple affordability (the ratio of house price to households' annual income) rising to 4.8 times in 2016 from 3.9 times in 2012," he notes.

Currently, the nationwide maximum affordable house price in Malaysia is RM282,000, based on the median household income. However, the average price of new properties launched is RM417,262, proxied by the average transaction value in the primary market.

This is nearly 50% more than the affordable house price.

Price control mechanism

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"Government intervention in any business market is rarely a long-term solution and is usually seen more in short-term controls for certain commodities.

"Prices have risen due to a number of factors, such as developers chasing higher profit margins that are found in the luxury segment, as well as rising operational and compliance costs," he tells ***FocusM***.

He feels that market forces should dictate prices.

"This is in fact underway, with the lowering of the foreign purchase threshold as an interim measure to address the ongoing residential overhang. It is hoped that the lessons learnt from the overhang can be applied to supply moving forward," he adds.

From the government perspective, Fernandez says, perhaps tariffs on imported materials and equipment as well as other regulatory factors can be managed to reduce the impact of rising costs on developers and contractors – as long as this reduction is reflected in the final prices for home seekers.

Nawawi Tie Leung Real Estate Consultants Sdn Bhd investment/research and consulting executive director Brian Koh says a holistic approach is needed to control the price hike.

"It is important to, among others, reduce bureaucracy (time and processes), increase transparency, better estimate infrastructure costs, release the Bumi quota (houses to be put on the open market from the quota for Bumiputras that are not taken up), and more open competition for tenders.

"Singapore is a good benchmark for an open market. The tender prices for government land sales reflect the developers' slender profit margins," he adds.

Koh opines that the government should not intervene but focus on ensuring that public policies are supportive and market-friendly.

"Let the market resolve the issues through pricing adjustment or other industry initiatives," he says.

Sunway University Business School's Professor of Economics Dr Yeah Kim Leng notes the current high price levels are the result of strong price increases, especially between 2011 and 2015 when the annual price increase averaged 10.5% per annum.

"By contrast, income per capita grew at 5.5% annually, thereby causing the house price-income gap to widen," he adds.

According to Yeah, it will be a gradual process for income to catch up with the house price levels.

"Alternatively, a market price correction can lower prices to boost demand or non-price incentives can be given by developers to entice purchasers.

"In a buyers' market, developers will be weighing the holding costs against price reduction or incentives given to buyers as well as their own financial situation in clearing the excess supply," he says.

There are no quick fixes to an oversupply situation. It is best to allow market forces to operate freely without excessive intervention, he emphasises.

Yeah notes that the home ownership campaigns and lowering the threshold for foreign buyers are part of the remedial measures taken by the government in collaboration with the developers to address the property overhang.

"The government can further facilitate smoother market adjustments by lowering transaction costs, improving access to financing and enhancing administrative and information efficiency to better match buyers' needs and offerings by the developers," he adds.

However, Didian Realtor Sdn Bhd director Chow Nam Kit disputes the contention that it is impossible to reduce price hikes to a much lower level as he feels that quality housing with facilities and a minimum of 850 sq ft at a reasonable location within Klang Valley can be priced in that price range.

"Construction cost alone accounts for slightly less than half the cost of an apartment. Add in the land cost, soft costs and compliance cost and it doesn't leave much profit for the developer," he laments.

He notes that the government's introduction of a rent-to-own (RTO) scheme to help prospective first-time homebuyers who are unable to afford the initial 10% deposit is an excellent solution in helping to clear the unsold properties.

The solutions

Despite all the concerns, land cost has increased tremendously throughout the year due to economic activities.

Safuan Group Holdings Bhd group executive chairman Tan Sri Matshah Safuan says, "When we look at affordable housing in Malaysia, the requirement should be confined to states where land prices have increased over the years due to economic activities.

"For instance, the Klang Valley, Johor Bharu and Penang have witnessed major economic transition and have developed rapidly.

"Therefore the government should concentrate on building more affordable houses in these states and allocate the necessary budget," he adds.

He suggests that to implement these affordable houses, the following approaches should be taken:

- All government land suitable for residential housing should be frozen and not earmarked for joint ventures or any other arrangement to individuals or corporations.
- On these land plots, the government should issue tenders for contractors to build affordable houses. This results in zero land cost.
- The infrastructure costs for a project should be borne by the utility companies as they are selling water and power to the rakyat. The current practice is that developers are required to build the infrastructure and the costs are passed on to the buyers.

Acording to Matshah, to build affordable houses, three main costs should be taken into account - land, construction and infrastructure.

"If we can eliminate the land and infrastructure costs, what is left is construction cost which ranges from RM100 to RM150 psf. For a two-room unit at 700 sq ft, the cost is about RM70,000 to RM105,000.

"For a three-room unit at 1,000 sq ft it will be RM100,000 to RM150,000," says Matshah.

Another of his suggestions is that to make loan repayments affordable, the loan period should be extended to 30 to 40 years with minimum interest rate and covered by mortgage reducing term (MRT) insurance in case of untimely demise. There should not be any entry cost.

"The current unsold properties are houses built by developers with inflated prices. Their properties should be adjusted according to market needs and forces.

"Affordable housing loans should be handled by various building society and cooperative institutions and/or lending institutions which are not governed by BNM's rigid procedures and requirement," he argues.

Fernandez describes the unaffordable housing market as a complex ecosystem with its own inertia.

"There is no short-term solution or easy answer to this dilemma short of heavy-handed intervention, but that might cause more problems than it would potentially solve.

"The current interim measures to reduce the foreign purchase threshold (from RM1 mln to RM600,000) has been positioned as a short-term solution to keep developer cash flows going and to prevent larger economic impacts," he adds.

Moving forward, he adds, stakeholders must internalise the factors driving the current residential overhang and avoid repeating these mistakes for new launches.

According to Fernandez, the lending guidelines which banks currently pursue were formulated to curb speculation while safeguarding household solvency.

"Having people purchase properties they cannot afford isn't an ideal situation for either banks or home seekers," he notes.

Fernandez advises prospective house buyers to visit online portals such as PropertyGuru's "Home Loan Pre-Approval" to determine their pre-approved home loan amount ahead of time.

"Home seekers can turn to such financial eligibility tools as this will help them avoid the black marks of loan rejections while streamlining bank approval processes," he says.

While banks may also benefit from more community-focused approaches, it is more likely that the current residential overhang traces its roots to other factors such as location, overall income and demand-supply mismatches, he says.

"Industry analysts have already pointed to the past few quarters as a turning point for the property sector. We take a neutral outlook on the next few quarters, and it's worth noting that even with ideal conditions, the industry's boom-bust cycle is generally measured in years," he adds.

Mismatch in price and income levels

Yeah also agrees that properties are seriously unaffordable due to the mismatch in price and income levels of the majority of the first time home buyers.

"It is also reflective of the 'mistargeting' by developers who have overbuilt high-priced homes.

"Over time, developers will need to adjust to the market conditions by building lower cost or affordably priced homes for the lower to middle-income segments.

"This will mean slimmer profit margins unless the land and construction costs can be brought down substantially," he opines.

Yeah reminds that banks are strict in approving loans to protect themselves as well as the buyers, especially if the latter do not qualify for the loans as had happened in the subprime mortgage crisis in the US during the 2008-09 global financial crisis.

"Widening the guarantee schemes for eligible first time home buyers introduced by the government is one way to ease the financing difficulties faced by medium to high-risk borrowers," he says.

Yeah feels that barring a shock such as a property market downturn that will see prices correct sharply, the excess supply will clear gradually as income and savings rise over time.

"A sustained rise in income and confidence in the country's growth prospects will see the excess supply diminishing quickly over the next three to five years," he notes.

Didian's Chow says the issue of unaffordable homes is not unique to Malaysia. In fact, this is happening worldwide affecting both developed and developing countries.

"Even in countries like the US and UK, first time home buyers often struggle to find housing within their budget. I don't think there is a short term solution for this.

"Long term wise, we need to increase the household income of Malaysians so that their affordability will improve," he adds.

He disagrees that strict lending guidelines by the banks contribute to the overhang in the property market.

"Banks are in the business of lending money and it's their responsibility to scrutinise the credit profile of the buyers before extending them loans.

"Forcing banks to lend money to buyers with poor credit profiles is reckless as this may eventually lead the buyer to default which will cause foreclosure.

"This will indirectly worsen the the property market and (damage the) economy."

Based on data from the National Property Information Centre (NAPIC), Malaysia's property market will need at least another three years to absorb the unsold properties assuming status quo in historical transaction volume.

He says this means a meaningful recovery is expected by 2023. FocusM