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Fixing a broken housing market-

A call for a 'BACK TO BASICS' approach.

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Introduction

"The trends in Malaysia suggest that both B40 and M40 households are likely to end up in some form of social housing if the relevant interventions are not made urgently."

Making Housing Affordable, KRI (2015)

Our Malaysian housing market is broken. As early as 2015, KRI's "Making Housing Affordable" report highlighted the plight of deteriorating housing affordability conditions in our country. Even now; houses remains unaffordable to a significant proportion of society and yet, we continue to suffer from an over supply (glut) in the high-end property market (residential units above RM600,000) .

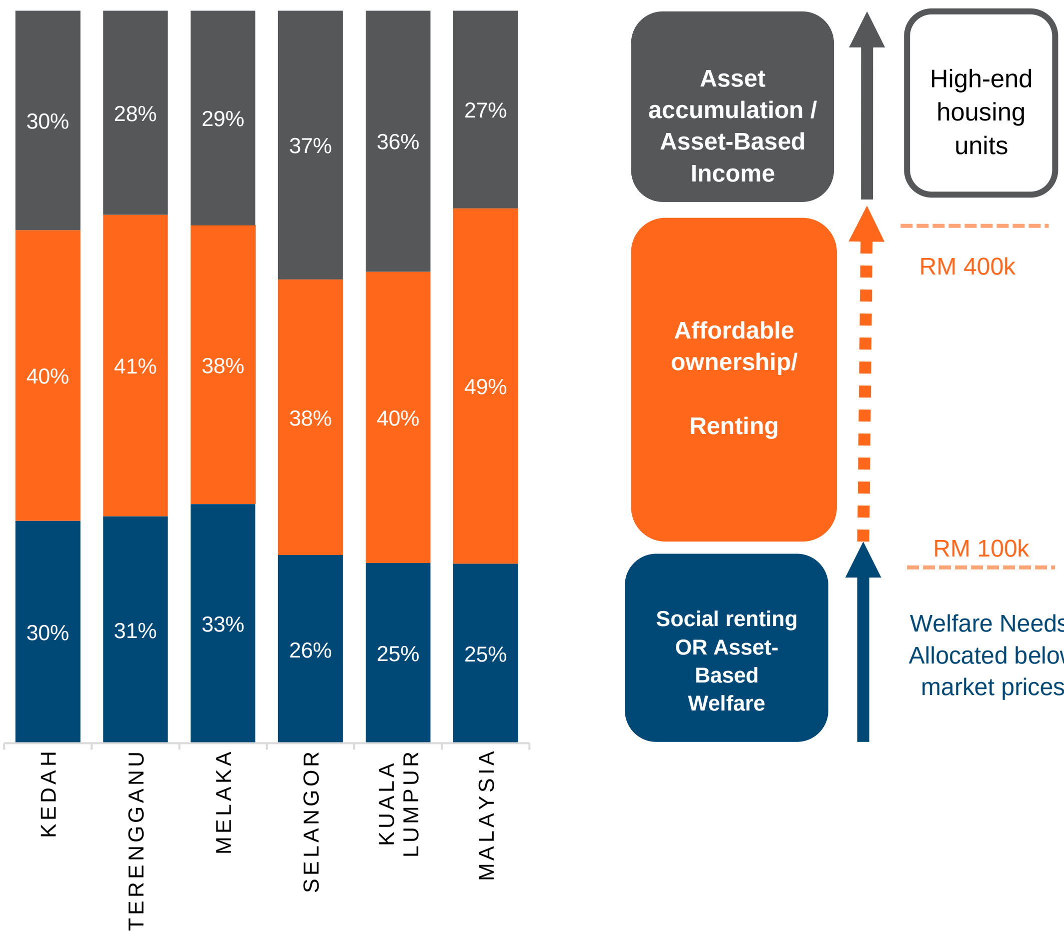
The policy responses as witnessed in Budget 2018 and 2019 were claimed to be highly 'innovative' - introduced by the private sector and supported by the government. In 2018, the government introduced Peer 2 Peer financing (P2P); a financing package enabling home buyers to partner with investors to 'afford' expensive homes. More recently in 2019, the government went as far as opening unsold high-priced units to foreign buyers, in order to assist private developers 'clear the market' to largely foreign buyers, rather than let the 'market' naturally push house prices down for local buyers.

These are just two examples of policies that support the steady growth of high-end housing products that remains unaffordable to most locals. More recently, the private sector has yet proposed another so-called 'innovative' financing scheme to assist homebuyers buy homes which in reality they cannot afford. This time it is in the form of an intergenerational house loan for the B40. In essence, this means children in this category will more likely inherit a 'house loan'- though not necessarily a house.

Build homes for the people you have, not the people you aspire to have…

It is most unsettling when the production of houses in the country remains focused on unaffordable homes, especially when Malaysia's housing market is unable to facilitate the 'housing ladder' phenomenon – where households can transition from one type of house to another over the course of their life-cycle. Below is the demarcation of households in our country:

Figure 1 : Selected demarcations[1] of population in Malaysia and the proposed property segments



Source: KRI calculations

[1]Hamid et al. (2019). KRI employs three demarcations of households based on their combination of income and expenditure. These were 'Poor', 'Middle-range' and 'Aspirational'. 'Poor' households were struggling to satisfy basic needs, 'Middle-range' households were facing a spectrum of trade-offs, while 'Aspirational' households were privileged to realize their aspirations.

Half of the population in Malaysia are made up of those in the middle-range, with the proportion varying across states. Therefore the housing market should reflect this demarcation---high-end housing units for those in the aspirational group, affordable ownership/renting options for the middle-range, and social renting or asset-based welfare for the poor.

Figure 2A and 2B shows the different segments of society and the affordable price range based on the median-multiple calculation[2].

Figure 2A: Distribution of households by income category, (2016)

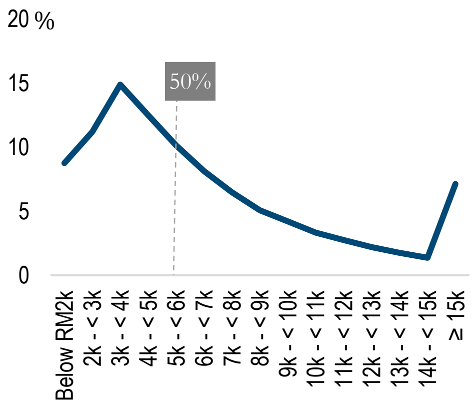
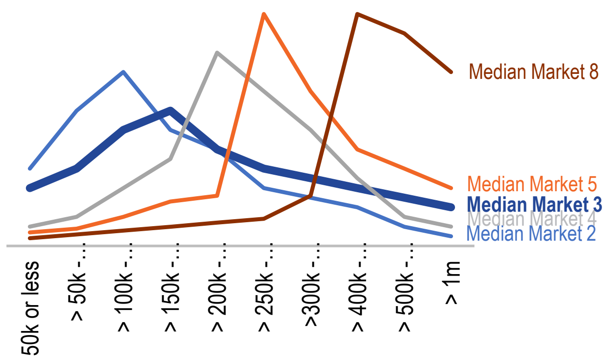


Figure 2B: A Monte Carlo Simulation of the housing median market for 2, 3, 4, 5 and 8



Source: KRI calculations

The signal of a well-functioning housing market is when most prospective buyers can afford to buy a house irrespective of which segment of the income distribution they occupy. This is best reflected when the median price of the housing market is 3x the median gross annual household income. This happens when the distribution of housing supply is priced more in line with distribution of households by income.

Generally, based on our calculations, on average (it might differ between states), 49% of the population can afford houses within the price range of RM100K-400K whilst 25% of population should be placed under the social agenda (a case for government allocation) for shelter. This 25% is, of course, a crude measure since poverty is multi-dimensional and a filtering process based on household incomes only (irrespective of household size and conditions for example) is limiting. However, this 'crude' example is sufficent to demonstrate that the most vulnerable groups (B25-30) should not be subjected to 'innovative' financing schemes, especially those that take the form of inter-generational loans.

It is apparent that the supply of houses are not following the income demographics of our population, as depicted in Figure 3 below.

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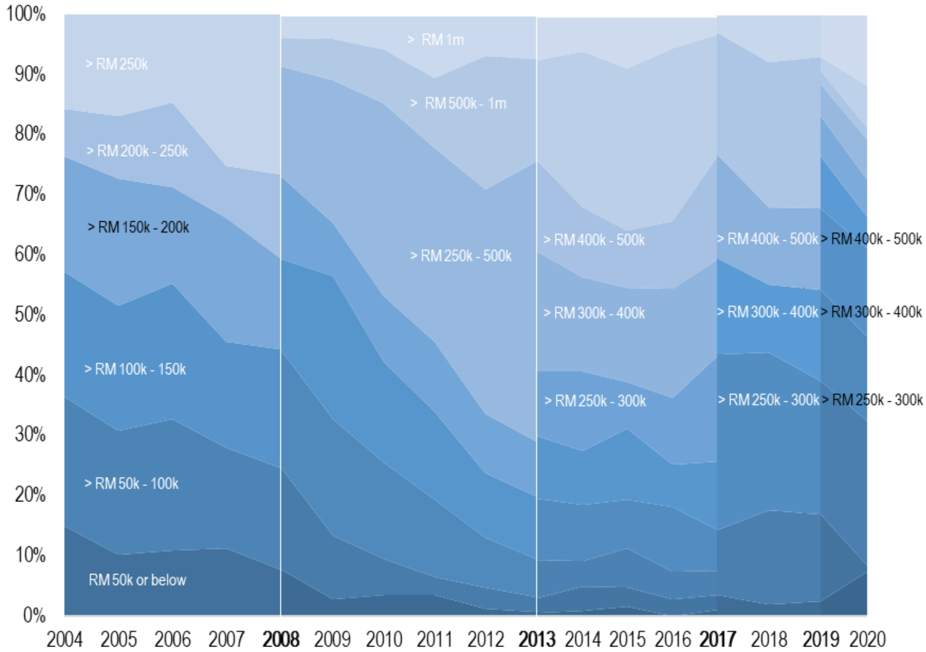
[2] KRI (2015), Ismail et al. (2019), BNM (2017), Demographia (2015). The median multiple is the preferred measure of housing affordability because it is not subjected to distortions from financing. The median multiple is the median house price divided by annual household income

Figure 3: Composition of residential properties launched, by price range, 2004 - 2020

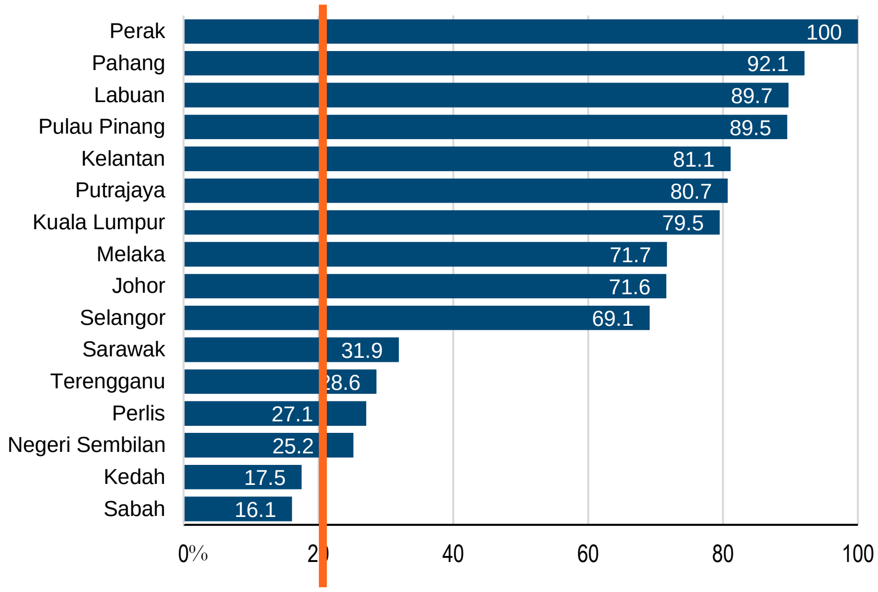


Source: NAPIC and KRI calculations

There has been a steady decrease of supply for the 49% of population, but a steady increase of houses for the consumption of the Top 27% of society. Starting 2013, nearly 40% of newly launched homes were affordable to the Top 27% of society, but not the rest of the population. The maths does not add up : 27% of households will not be able to consume 40% of incoming stock, in a given year. Therefore, it was highly probabable then, that we would end up with a high-end property glut, which we ARE experiencing now. Unfortunately, the real estate industry is still continuously launching houses within this price range.

Due to the inefficiencies of the supply sector, the government has stepped in by providing housing assistance to nearly 100% of population as depicted in Figure 4 below:

Figure 4: Total population under state affordable housing programmes qualifying income criteria, 2019

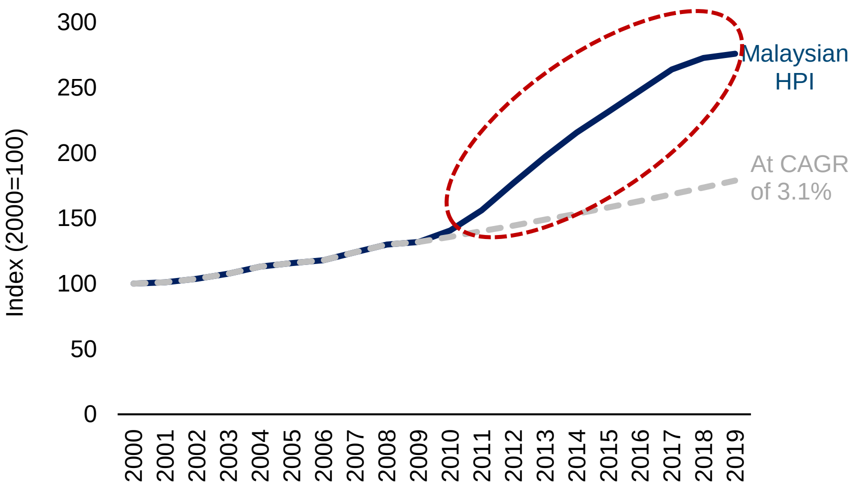


Rather than concentrate on providing decent housing to the Bottom 20-30 of population for the social sector, in many cases the government has had to assist the majority of population instead. This too, can be seen as evidence of a 'market failure'.

Ensure Malaysia's house prices come back to a healthy CAGR 3.1-4.0%

The proliferation of unaffordable homes in Malaysian cities is not primarily a wage stagnation problem, because no amount of wage increments can commensurate or 'catch up' with Malaysia's rapid house price escalation. For example, in 2014, the median house price increased at a CAGR of 26% from RM170,000 to RM270,000. During the same period, median household incomes grew significantly slower at a CAGR of 12.4%, less than half the rate of increase in house prices. Is it reasonable to expect wages to go up at a CAGR of 26% to keep pace with house price increases? The short answer is "no".

Figure 5: Malaysian House Price Index (HPI)



Starting 2009, house prices grew at CAGR of 7.7% (the red circle). These rapid price escalations backed by speculative demand/ innovative financial schemes can create a housing bubble because prices do not reflect the real worth of properties. When a significant number of households falls short of mortgage repayments and are forced to sell the house, the valuation will fall short from the original mortgage price. More often than not, the bank's valuation will follow the predicted stable CAGR (in this graph 3.1%). This shortfall of 5% is sufficient to induce loan insolvency amongst households, and therefore lead to a house-market crash, since most banks will repossess the property and auction it off at a lower value (refer to the United States 2008/2009 housing sub-prime crisis). This is the reason why house prices cannot be left to rise to steeply, too quickly.

Back to Basics : A Demand and Supply Approach

The current method adopted to improve housing affordability tend to concentrate on negotiating house prices once the house is received by households at the end of the production process. It appears to accept the relatively inelastic supply curve for houses that are generally unaffordable and is predominantly aimed at enabling consumers to 'afford' houses as they become increasingly more expensive.

These include policies allowing consumers to borrow more (for example increasing the ratio for loan to house value/ LTV), and new 'innovative' schemes - P2P and intergenerational house loans. These interventions tend to support and buffer inefficiencies within the supply sector, at the expense of both households and governments due to increased costs[3].

Our suggestion is simple: **we must build more genuinely affordable homes[4]**.

It is often suggested by the private sector that supplying homes in the 'affordable ownership' (mid-range) and 'social sector' (vulnerable groups) market segments is not profitable. The requirement to cross-subsidize the construction of low-cost homes disincentivizes supplying houses that are genuinely affordable. Therefore we suggest differentiating the policy responses for the social and market sectors. The issues surrounding these two sectors are vastly different. The social sector are those units administered to the vulnerable group based on needs, and are given (rented or ownership) at below market prices. It should, therefore, reside under the purview of the State.

We propose the below targetted interventions:

A) **Market Sector** (Middle-Range Households): RM 100-400K

1) **Transfer the development rights to another area OR to other efficient developers that can build cheaper without sacrificing the quality of the houses built**. Housing developers can transfer development rights to another development site, provided it has similar public infrastructure and amenities within the surrounding area. This intervention will also provide opportunities to other developers who have the expertise to build cost-effective, decent homes to participate in the development of affordable housing.

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[3] Apgar Jr, William C (1990), Jones and Watkins (2009), Glaeser and Gyourko (2018)

[4] Refer to Rethinking Housing: Between State, Market and Society [Ismail. et al (2019)] for a more comprehensive discussion on the creation of a sustainable housing ecosystem

2) **Liberalize this market to international contractors on a joint-venture project basis with local firms**. Foreign developers/ contractors that have invested in technology and employed integrated method of contracting can supply housing units with more competitive prices, even under the Build-then-Sell system[5]. As such, the delivery of affordable housing units can be profitable, and our local firms will also benefit with the transfer of technology.

B) Social Sector (Vulnerable Households): under RM100K

Some of the general principles that could be observed for this sector are as follows:

1) Discontinue building low standard housing ostensibly for attaining the objective of higher affordability. Low space standards results in larger households living in overcrowded conditions.

2) Create multiple Gross Floor Areas (GFA) and define the occupancy levels for different GFAs to prevent any inefficient use of space (under-consumed/over-crowded).

3) The new standard for 'affordable housing' as recommended by CIDB should also be the minimum standard for social housing. There is a need to replace low cost housing standards with new standards as outlined in National Housing Standards, 2019.

4) Renting scheme is encouraged, and an 'exit policy' scheme is needed in order to assist 'graduating households' to participate in asset-based welfare sechemes created by the government (or public/private partnership) under the broader agenda of social equity initiatives.

Conclusions

Let us be clear. Greater financialization does not equate to either higher affordability nor macroprudential innovation. Rather, it appears more as an example of economic opportunism, and can create problematic outcomes for society at large.

Let us go 'back to basics' and build more genuinely affordable houses for the majority of our society. This might just fix our broken housing market.

These issues are explored more comrehensively in http://www.krinstitute.org/Publications-@-Rethinking_Housing-;_Between_State,_Market_and_Society.aspx

[5] Cheong (1996), KRI (2015) and BNM (2017)

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