

Buyers Beware! Why Your Mortgage Could Be a Risky Conduit Deal with No Guarantee

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Introduction

When most people think about a housing loan, they imagine a straightforward transaction: a buyer chooses a completed house, the bank lends them the purchase price, and the buyer repays the loan over time. This is the typical mortgage model in many countries, especially where off-plan sales are not accepted or common.

However, in Malaysia, especially for new housing developments (which are sold under the sell-then-build system, which is a common practice), the real picture is quite different. Typical home financing in Malaysia resembles project financing, where the buyer's loan is used for construction rather than a direct consumer purchase. This article explains why and the risks involved.

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For housing under-construction deal, it is not a mortgage

In a conventional mortgage, the loan is disbursed in full to the seller upon completion of the sale of **built** houses or properties. It is quite straightforward when buying a ready house because the house already exists. In Malaysia's system, for under-construction properties, your mortgage disbursement is tied to the construction schedule of the projects. Buyers' banks release the loan amount in stages directly to the Housing Development Account (HAD) account of the developer as the project progresses. These disbursements are based on construction milestones, such as completion of the foundation, structural works, or roofing¹.

This progressive payment system means that the bank lends money to the buyers so that buyers can use the money to finance the project's development process. However, it is arranged with minimal risk mitigation and almost no guarantees that are normally arranged in other construction project dealings to safeguard the clients or lenders during the construction period. For example, an Independent Checking Engineer will help clients to monitor progress at the construction site for infrastructure projects and to justify before releasing any payments to the delivering party². However, there is no provision in the housing law that allows house buyers (who are the clients) to act similarly, and the end-financing money is disbursed upon verification of the developer's architect, who could act dishonestly³.

If we think thoroughly, the money from house buyers is actually being used as working capital for the developer's project, but it is a loan under the homebuyer's name. Thus, it resembles conduit financing, where the issuer (house buyers) is also the purchaser of the project. Instead of issuing a conduit paper, home buyers will apply for a "mortgage" in order to finance the housing project. This also means that the sell-then-build system allows housing developers to do business without sufficient working capital to finish construction of projects, which puts many risks to the buyers.

Construction risks are on the clients, yet they can not do much about them

In typical project financing arrangements, lenders often assess the feasibility and risks of a project, along with the credibility of borrowers, before disbursing the loan. Credit risk in commercial deals, including construction project financing, is carefully managed and hedged, often with strong contractual protections for the lenders⁴. It is not uncommon for lenders to protect themselves with risk-ringfencing mechanisms (compulsory and additional) such as insurance, debentures, and guarantors.

Meanwhile, house buyers who purchase under-construction houses are essentially the lenders to developers but have limited risk mitigation capacity. As they are buying a non-existent house, they are expected to be well-versed and manage the project risks, including the credibility of a housing developer. Assessing the information on the developers regarding their past

¹ PropertyGuru (2024) in reference to the Housing Development Act (Act 118)

² Nooriha Abdullah et al. (2014)

³ Nuarrual Hilal Md Dahlan (2019)

⁴ Jerry Tiew and Leong Yew Seng (2024); BNM (2023)

performance and their available financial position is an example of the assessment buyers can do. In reality, the due diligence from buyers could not help much to properly evaluate project risks.

More detailed information to properly assess a developer, such as land title, appointed contractors and consultants, financial position of the appointed contractors and consultants, and personnel in charge⁵, is likely either confidential, requires a long time to process, or is not within an average person's consideration. That is essential information, but it is still limited and made hard for home buyers to obtain—probably, not even the salesperson at the sales gallery is aware of it.

Unlike banks and other institutional lenders that provide loans in construction project financing, accessing such information could be easier for them, as they have the rights, specialised manpower and capital to do so.

Also, it is not unusual for clients in any other construction projects to sign with contracting contracts that safeguard themselves against any risks, as they are not very well versed in the construction industry's operating system⁶. While for house buyers, neither the sales purchase agreement (SPA) nor the home financing contract does so.

When home financing and SPA are confirmed, buyers face construction risks while waiting for the house. Unlike the lenders of project financing facilities, buyers will have limitations in monitoring and intervening in the construction progress, though their money is at stake. Buyers cannot simply come to construction sites to personally assess the progress or through an independent party and make a final decision to disburse their money or not. Similarly, it is unlikely that bank officers who approved the loan would care to be on the housing project site and advise the buyers on the construction risks they would observe, as they are depending on the architect's report.

Even if the buyers can fully access the construction risks, they cannot simply stop the disbursement of their approved home financing from the bank to the developer. Meanwhile, in other construction projects, clients have control over the building process, even to not paying the contractor if they are not satisfied with the progress⁷. Therefore, again, even at the construction phase, there is not much the home buyers can do to mitigate the risks.

Furthermore, the buyer is still contractually obligated to repay the borrowed amount, even if the property is incomplete and uninhabitable, unless the SPA is cancelled. However, the legal procedures to cancel the SPA are lengthy, and the compensation is unlikely to be commensurate with the efforts. On top of that, home buyers do not have default rights over any developers' assets that can be liquidated to recover the losses⁸.

⁵ More on the fragmented nature of housing delivery system from KRI (2015)

⁶ More on construction contracts at KRI (2015)

⁷ Groák and Householder (1990)

⁸ Buyers have weak protections and remedies when a housing project is abandoned, as discussed in Md Dahlan (2015)

Conclusion: Humanising Housing needs Humanising Banking

Home financing in Malaysia for under-construction properties operates less like a standard mortgage and more like a project financing arrangement i.e conduit financing, but without any guarantees for the home buyers. Through the progressive payment system, the buyer's loan is channelled to the construction stages of a project, transferring key risks from the developer to the buyer. However, home buyers cannot manage the risks except to accept them. The financing arrangement has resulted in financial burdens for sick, delayed, and abandoned housing victims⁹ and give developers financial advantages¹⁰.

Thus, to move forward towards the humanising housing agenda, people should have not only access to housing but also a secure pathway to it, i.e. free from construction project risks. That would call on policy makers to make build-to-sell mandatory, as aspired to in the recently announced 13th Malaysia Plan (RMK 13) and other past policy documents.

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⁹ Theebalakshmi Kunasekaran (2024)

¹⁰ Nur Fareza Mustapha (2025)

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