

ABILITY TO SECURE HOME FINANCING AMONG FIRST-TIME HOUSE BUYERS IN THE KLANG VALLEY, MALAYSIA: PERSPECTIVES FROM INDUSTRY PLAYERS

Noorame Mohd Foudzy¹, Rosli Said², Yasmin Mohd Adnan³

^{1,2,3}, Department of Real Estate, Faculty of Built Environment
Universiti Malaya

¹ ameyfoudzy@um.edu.my, ² rosli_alambina@um.edu.my, ³ yasmin_alambina@um.edu.my

ABSTRACT

Home financing facilities provide significant financial support in pursuing the homeownership dream. However, securing home financing can be a challenge to households who are restricted by financing constraints comprising high gearing ratio, poor credit track record and small residual income to serve monthly instalment of home financing. Therefore, this study examines the factors that influence the ability to secure home financing among potential first-time house buyers in the Klang Valley, Malaysia. By adopting the qualitative approach, this study examines the factors that influence the ability to secure home financing from the perspective of industry players such as financial institutions, affordable housing agencies and other related government agency. The results show that credit quality and income constraints are significant factors in influencing the ability to secure home financing among potential first-time house buyers. Thus, the key implication suggests that potential first-time house buyers should possess good credit track record and maintain a stable pecuniary resource prior to the application of home financing facility. Moreover, these resources will reveal the financial capacity to take on long-term financing obligation such as home financing until full settlement or the end of financing tenure.

Keyword: *Borrowing constraint, first-time house buyers, home financing, homeownership*

1. INTRODUCTION

House is a major asset and often form as one of the largest and longest investment in a person's life. A large sum of money is required to purchase a house and it is unlikely to be purchased outright. Therefore, securing home financing would be the option to partially finance the purchase of a house. Nevertheless, having the option to secure a home financing may be challenging to some as typically households may be restricted by liquidity constraint to enter the housing and home financing market and hinder the realisation of homeownership. According to the World Bank (2019), about 93% of adults do not have access to formal housing finance and hence they are not able to live in a decent home.

In Malaysia, many house buyers depend on home financing solutions to finance the cost of home purchases. However, a report by the Central Bank of Malaysia (BNM) highlighted that home financing applications are often rejected due to highly indebted applicants that have little residual income to meet the scheduled financing repayment without considering the possible increase in the interest rates in the future (Bank Negara Malaysia, 2018). The pressure to overcome the home financing rejection has led the government agencies to introduce a few initiatives such as a fund for affordable home by the BNM to help the potential first time house buyers (Cagamas, 2011). Despite the initiatives, there is constant disagreement between the stakeholders on the issue of high rejection rate of home financing that continue to hamper house buyers, particularly to those who want to become a homeowner for the first time (Yong, 2017).

In response to this, this study intends to examine the factors that influence the ability to secure home financing among potential first-time house buyers in Klang Valley. The outcome of this study will reveal the factors that related to borrowing constraints (i.e. income, wealth and credit quality constraints) and expenditure patterns influencing home financing ability among the said population.

2. LITERATURE REVIEW

2.1 Ability to secure home financing

The connotation of the word "ability" that links the housing and home financing affordability provides the risk indicator to the home financier towards the grant of approval of home financing facility to an eligible applicant. It is opined that homeownership is achievable when potential house buyers are able to show that they have sufficient fund to pay for the down payment, can afford the monthly repayment without jeopardising their ability to pay for other non-housing consumption and also, possesses a healthy credit background (Barakova et al., 2014; Bourassa, 1995; Gan & Hill, 2009; Linneman & Wachter, 1989; Quercia et al., 2003). Additionally, the measurement of financial ability should include the ability to cover daily household expenses so as not to end up borrowing to meet the basic needs (AKPK, 2018). One needs to ensure that their cashflow is sustainable and able to stay resilient after taking on a large and long tenure financing commitment such as home financing.

2.2 Borrowing constraints

Having identified the main factors under the borrowing constraints, a further discussion is made pertaining to them under the following subsections.

2.2.1 Income constraints

Income, a primary financial resource to a household, is an important determinant that potentially affects families' purchasing power and consumer demand. A stable

and consistent income flow is much needed in order for an individual manages their expenses including home financing obligations. As such, household income influences homeownership and home financing decision (Zulkifli & Ismail, 2023).

Generally, income refers to a human capital endowment, be it in the form of a regular salary received in a fixed interval typically monthly or wages received on a daily or weekly basis, plus the income of the individual's spouse; if there is one as well as other households (Bourassa & Shi, 2017). Other than regular salary and wages from part-time job or services, a regular financial transfer is another financial resource that can support liquidity constrained households (Lee et al., 2018; Spilerman & Wolff, 2012).

In the context of this study, income is the main component in the credit underwriting parameter since it is the initial step towards the repayment of the financing amount. Taking out large financing facility such as home financing is risky for the low-income earners as compared to the higher income households who foreseen to have better cash flows (Nguyen, 2019). Meanwhile measuring the level of income is crucial to the financiers in order to reduce the exposure to risky borrowers such as one with low household income. As such, income plays an important role in promoting homeownership and determines the likelihood for the grant of home financing facility (Carter, 2011). Hence, potential first-time house buyers should have an established income flow in order to have a better opportunity to secure home financing.

2.2.2 Wealth constraints

Wealth is defined as the value of things or assets that people owned at a single point of time (Parkin, 2009). It includes accumulated savings, inheritance, proceeds from selling off assets, investments and accumulated financed or non-financed assets. In the context of homeownership, the wealth must be liquid and ready to be used to invest in a house. Therefore, the definition of wealth used in this study comprise accumulated cash sourced from own savings (Carter, 2011), financial transfer from parents (Lee et al., 2018) and bequest (Tiwari et al., 2007), annual dividend received from unit trust investment (Bourassa & Shi, 2017) and provident fund that was created through a mandatory contribution from the employers and employees (Tang & Coulson, 2017). Although the main function of the provident fund as retirement saving plan, regulators in certain countries have allowed the provident fund to be partially withdrawn for other purposes such as housing. In Malaysian context, the provident fund which is known as Employees Provident Fund (EPF) has allowed an individual contributor to partially withdraw from their retirement savings to finance the purchase of a house (Doling & Omar, 2012). These initiatives provide alternative to the potential house buyers and closing cost assistance to new home buyers.

Since decades, research has shown that down payment requirement has deterred the homeownership especially among first-time house buyers and the requirement has likely led to liquidity constrained (Bourassa, 1995).

This barrier has been the reason for first-time house buyers delaying in upgrading their tenure from renting to owning. Low of income has reduced household's ability to save for down payment and later reduced their ability to oblige with monthly home financing repayment (Badrudin et al., 2022; Bourassa, 1995; Nwuba & Chukwuma-Nwuba, 2018).

According to Bourassa (1996), sufficient accumulated wealth is needed in housing to pay the down payment while any remaining wealth and income will still be enough to pay the home financing instalments and other remaining housing costs. Stacy et al. (2018) have mentioned that the ability to pay down payment is one of the items under the underwriting measure that indicate the preparedness of the prospective borrowers for homeownership and how far the down payment provides a cushion against default. This suggests that cash-out for a down payment reveals one's readiness to carry a long-term commitment and responsibilities as a homeowner.

2.2.3 Credit quality constraint

Getting access to credit assists household to finance their current consumption, purchase durable goods, housing, or any types of assets. Typically, households are assumed that they could repay the debt through the expectation of their higher future income. However, this notion seems feasible in a world with the perfect capital market that would enable the household gets the financing as desired (Chen & Chivakul, 2008). Realistically, households who are interested to borrow or borrowing more to finance their consumption, may not be able to do so due to credit constraint.

Credit constraint can be defined as a condition in which households who have a history of credit denials, received only a partial amount of debt from the full amount requested (Rosenthal, 2002), have a high level of credit utilisation (Calem et al., 2010), lack or have no credit track record (Calem et al., 2010), or have a poor status of credit history (Barakova et al., 2014; Ebekozen et al., 2019). All these characteristics may affect the level of creditworthiness, hence reducing the credit quality of the households.

In addition, it is impossible to predict who will default on their repayment obligations. Thus, it is a duty of a lender to conduct customer's due diligence to examine borrower's ability to meet the existing and upcoming financing obligations. The assessment will inform the lender about the household's creditworthiness and the amount of credit risk that they will face if the credit facility such as home financing is extended in the future. In sum, a careful and sensible credit examination is crucial to reduce the degree of loss.

2.3 Expenditure patterns

Household expenditures are the amount of money spent by resident households to meet their necessities such as food, clothing, housing, energy, transport, durable goods (notably cars), healthcare, leisure, and miscellaneous services (OECD, 2020). In Malaysian landscape, household consumption expenditure is defined as the expenditure for private consumption on goods and services during the reference period. The expenditure refers to the value of consumers goods and services acquired whether they are used or paid by a household through cash, credit, own-account production, or barter as income; for the purpose of fulfilling the residents' satisfaction of needs and wants (Department of Statistics Malaysia, 2019). From an economics viewpoint, an individual sets a budget allocation based on their income for maximisation of utility on household goods and services. Typically, households spend their income on the basic needs that correspond to the standard of living. As such, it is common to note that income has been used to measure the level of affordability.

Nevertheless, Alaudin et al. (2016) suggested that a household's well-being is better measured by expenditure rather than income. This is because expenditure and behaviour of

spending are important indicators for a financial standing that reflect the level of affordability of a household in a country. In addition, there are conditions that a large portion of income may be utilised to cope with a household's daily expenses, especially among lower income earners. Higher expenditure derived from high debt commitment and high household expenses can lead to liquidity constraints that will affect the households' ability to further take additional financing commitments. In agreement with Sohaimi et al. (2018), measuring housing and home financing eligibility should not only consider the household income but also the expenditure pattern since it can affect the financial standing of the household.

3. RESEARCH METHODOLOGY

In this study, a qualitative approach is employed. Purposive sampling technique was adopted in view to reach out the knowledgeable participants of the interviews in capturing their opinions regarding the ability to secure home financing among first-time house buyers. As such, 12 participants were involved and they were from the financial institutions, affordable housing agencies, and other related government agencies who have the experience in handling affordable housing and home financing related matters. The participants were individuals who hold managerial position, whose role in the organisation was significant enough in overseeing various activities involving home financing matters first-hand (Table 1). Depending on the respective organisation they represented, their roles include empowering home financing information and knowledge to potential first-time house buyers, enabling the home financing applications, making a recommendation based on the merit and demerit of each case and deciding on the home financing applications. The interviews were conducted through face-to-face, phone calls and video calls. The set of interview questions were aimed to explore and understand the influence of borrowing constraints and expenditure pattern in securing home financing from the perspective of industry players. The key patterns from the interviews were established and any redundant comments were merged before drawing the conclusions of the key findings.

Table 1: Details of Interviewees

Interviewee	Current position in organisation	Organisation
HA1	Principal Assistant Director	Government housing agency
HA2	Senior Assistant Director	Government housing agency
HA3	Sales and Marketing Director	Government housing agency
HA4	Sales Manager	Government housing agency
HA5	Head, Sales	Government housing agency
HA6	Head, End Finance	Government housing agency
B1	Retail Credit Manager	Commercial bank
B2	Assistant Branch Manager, Sales & Marketing	Commercial bank
B3	Retail Credit Manager	Commercial bank
B4	Assistant Branch Manager, Sales & Marketing	Commercial bank
B5	Head, Strategic Alliance Mortgage Business	Commercial bank
GA1	Manager, financial education	Government agency

4. ANALYSIS AND DISCUSSION

The interviews with respective personnel from the real estate industry have unpacked the factors that influence the ability to secure home financing.

4.1 Income Constraint

Income was found to be significantly influence the ability to secure home financing as it is the first way out to pay the home financing instalments. The participants (B1 and HA1) opined that income level should not only sufficient but also consistent and stable for the whole financing tenure.

“...the bank needs to know whether the borrower has the capacity to sustain the repayment for 30 years. They do not want to give the loan today but, the loan account turns to default after 6 to 7 months.” (HA6)

The stability of household income determines the survival of households in maintaining current standard of living. As such, the result further revealed that consistency and sustainable income will be the key to justify the eligibility. The financial buffer should be enough so that they can continue living comfortably without stretching their cash flow. The result was seen in line with the previous study (Mohd Aini et al., 2016). Nevertheless, the interviews discovered that there is an alternative way to improve the level of income which through a joint household income, receiving income from part-time job, and/or income from small business activities. All participants were collectively agreed on the alternative as this way increases the chances to secure home financing. While other literature found that regular financial transfer from parents or family members can be used to overcome liquidity constraint and increase the eligibility to secure home financing (Cox, 1990; Engelhardt & Mayer, 1998; Lee et al., 2018; Spilerman & Wolff, 2012).

4.2 Credit Quality Constraint

Household credit background is critical in credit evaluation as it tells the financiers on the reputation of the household in handling debt obligation. Besides that, this factor helps the financiers to learn the potential risk exposure of the financing contract. The assessment of credit profile reveals the applicant's character in handling its past and current financing obligations and at the same time enable the financier to gauge their character as a paymaster to the upcoming debt such as home financing (Purohit et al., 2012). One of the participants responded that,

“Bank will evaluate the character, i.e., the stability of the borrower, how long have you been with the current job, and loan repayment history, whether the borrower is a good paymaster or bad paymaster. This credit background would determine whether the loan can be approved or not.” (B4)

The results of the present study show that building a good credit track record is important to improve the eligibility to secure new financing facilities. Furthermore, this study learned that being debt-free and highly indebted were also among the top reasons that can cause home financing applications get rejected. The results were consistent with the report by the Central Bank of Malaysia (BNM) (Bank Negara Malaysia, 2020) and other literatures (Barakova et al., 2003; Barakova et al., 2014; Calem et al., 2010; Kim et al., 2020; Rosenthal, 2002). In

sum, being a credit worthy is vital as it depicts the level of responsibilities of the borrowers in handling their debt obligations.

4.3 Wealth Constraint

The findings revealed that down payment is the first hurdle in realising home ownership. The amount of down payment somewhat determined by the margin of finance (MOF) approved by the financier. The lower the MOF the higher the down payment that needs to be paid. Moreover, down payment is required as it helps to gauge the borrower's preparedness and commitment in taking risks in the home financing contract. In line with this, B2 and B4 were jointly agreed that a large contribution by the borrowers increases the chances for the home financing application to be approved. On the other note, the combination of down payment with the home equity as an excellent collateral, will likely leads the home financing borrowers to enjoy a lower financing cost and leniency in other credit terms (Stacy et al., 2018).

4.4 Expenditure Pattern

Expenditure pattern appeared to be a factor that indirectly influence the ability to secure home financing. The insignificant result can be due to the underwriting criteria which has not include the measurement of expenditure pattern. Financiers are more interested to gauge whether the borrower can serve the repayment obligations in timely manner for the whole financing tenure. Nevertheless, the analysis discovered that the total household expenditures likely affect the disposable income and determine the financial capacity to take on debt obligation. As participant HA3 responded,

"High cost of living especially among people in the urban area did impact the ability to borrow. That is what I meant on household debt for consumption. When the financial commitment is getting higher, disposable income is insufficient to add on new loan." (HA3)

The participants (B4 and GA) added that overspending, over-indebted and less saving are the things that influence the repayment ability among the potential first-time house buyers. Moreover, it is proven that overspending reduces one capacity to save money and affects their financial standing. Thus, delays homeownership among young households (Ab Majid et al., 2014; Badrudin et al., 2022). So, it is the households' call to manage their income and spending in order to allow them to serve the debt obligation without jeopardising other expenditures (Abd. Rashid et al., 2018; Yunchao et al., 2020). Potential borrowers are encouraged to spend within their means and cultivate good saving habits to have a positive and stable cash flow that will help to improve their ability in securing a home financing.

5. CONCLUSION

This study examined the factors that influence the ability to secure home financing among potential first-time house buyers in Klang Valley. Preparedness is the key to home financing and homeownership dream. The stability and consistency of income flow will assist the household to meet all the financial commitments regularly and timely without jeopardising household ability to meet daily consumption.

Further exploration on home financing product innovation is suggested to be carried out in the future to assist potential house buyers in overcoming the financing constraint. An example of innovative home financing products that can be investigated is contractual saving for housing whereby the

accumulated saving can be converted to home financing facility in the future. Another instance is a financing product with a specific feature to facilitate the income earners who received irregular income from gig economy activities. This will help them to overcome the issues relating to insufficient fund and lack of financial background to enter the housing and housing finance markets. Eventually, assists the households to stay afloat and survive financially so that they are able to make up a room for adjustment in coping with the home financing repayment obligations without jeopardising the ends meet.

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Appendix A

Interview Questions

Research background

In order to further investigate the issue in concern, interviews are arranged to gain more insight about the borrowing constraints that influenced the ability to borrow a home financing among potential first-time house buyers Malaysia. The targeted respondents for the interviews are professional experts that have experienced in handling home financing application and related matter. Since the ability to purchase the house is depending on the ability to obtain a home financing, opinion from these group of experienced personnel are sought.

1. In your opinion, what are the common issue(s) that delay homeownership among potential first-time house buyers?
2. In your opinion, what could be the factors that influenced the ability to secure home financing facility?
3. What do you think of the current level of income and the ability to cope with monthly financial obligation?
4. What do you think on the current level of household expenses nowadays?
5. What is your view on deposit requirement? How does it play a role in terms of home financing affordability?
6. What do you think of applicant's credit background in securing home financing? How does credit track record play a role in one's ability to secure home financing?
7. In your opinion, which one should be emphasised by potential house buyers, sufficient income, enough fund for down payment and other entry costs or good credit background? (The most important category)
8. From your professional perspective, what is your recommendation to assist potential first-time house buyers to secure home financing?