Strategies To Prevent Mid-Stream Abandonment Of Housing Projects In Malaysia

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Abstract

Housing delivery systems around the globe may be categorised into two types: "Build then Sell" (BTS) and "Sell then Build" (STB). BTS is implemented in developed countries such as the United Kingdom and Australia where housing demand and supply are quite adequate. On the other hand, STB is normally implemented in developing countries like Malaysia. Now, as the country is facing the challenges of globalisation, there is a renewed call to change the system from STB to BTS. The purpose of this paper is to study the possibility of implementing BTS concept in Malaysia. Postal questionnaire has been used as a means of primary data collection. A group of 20 developers and 100 persons have been randomly selected for questionnaires distribution. The findings indicated that BTS concept could be implemented in Malaysia. However thorough study needs to be carried out by the relevant bodies in order to ensure the success and promotion of BTS. Perhaps this paper could help the government agencies and developers to overcome hurdles faced in implementing such concept.

Keywords: Housing delivery system, BTS, STB, abandoned projects, housing problems.

INTRODUCTION

Housing delivery system can be categorised into two types; **"Sell then Build" (STB) and "Build then Sell" (BTS)**. BTS has been implemented in developed countries such as the United Kingdom and Australia where housing demand and supply is quite adequate. Meanwhile, STB is normally been implemented in developing countries such as Malaysia and China as a result of high rates of population growth (Yang, 2001). Now, these countries are facing the challenges of globalisation and a comeback from the economic crisis partly contributed by an inflated property market, there is a renewed call to change the system from STB to BTS.

In Malaysia, the conventional approach to housing provision is the STB system. The housing development industry is principally regulated by the Housing Developer Act (Control & Licensing) 1966 (Act 118). In order to obtain a license to carry out any development, a developer has to comply with all requirements under the Act as well as other related statutory requirements. Having obtained the license, the developer is permitted not only to commence construction but also to initiate sales and enter into Sale and Purchase (S&P) Agreements with the house buyers. S&P agreements would allow the developer to collect progress payments in accordance with a progress certification made by a certified architect or a quantity surveyor, appointed by the developer. In short, the purchase price is collected progressively prior to the completion of the project. This is clearly permitted in the Housing Developer Act (Control & Licensing) 1966 (Act 118).

However, the present arrangement has its shortcomings. There is a possibility that the developer will fail to complete the project due to financial and management problems, incompetent contractors, unsuitability of sites and location, delays in getting plans approved and ultimately a "softening" of the property market. A study conducted by Newell and MacFarlane (1993) found that property investors consistently underestimate the risk associated with property investments. As a result, the investors may not be achieving an adequate anticipated return from their investment in the development to compensate for the relatively high level of risk.

BTS CONCEPT

BTS is not a new concept in the construction industry worldwide. According to National Housing Department, Ministry of Housing and Local Government, unlike the sell then build concept, housing developers can only sell the fully constructed houses together with the issuance of Certificate of Fitness for Occupancy (CFO). There is no progress payment made by house buyers to the developers under this concept. The developers have to bear all costs by using their own capital or loans from financial institutions or both. In short, BTS is totally a reversal of the current housing development practice of STB. The BTS concept can be explained as follows:

i) A developer cannot sell his product until completion (with the Certificate of Practical Completion or Certificate of Fitness for Occupancy (CFO) issued); and
ii) A developer can sell his product before or during construction but he can only collect a small deposit from the house buyer. The developer is not allowed to collect progress payments based on certifications from architect, as under the STB concept.

The first interpretation is similar with the definition given by the Ministry of Housing and Local Government (MHLG). The latter, however, is more likely to what is being practiced in Australia whereby a developer can collect certain amount of the selling price (10%) from potential house buyers once the

Sales and Purchase Agreement (S&P) is signed. The 10% amount is held by a stakeholder. The balance of the selling price is paid at the end of the construction period with the issuance of CF. In other words, there will be no progress payment made by the house buyers, as currently been practiced in Malaysia construction industry. Under STB concept, a developer will begin launching their units after the approval of Building Plans and Development Order by relevant local authority. In these circumstances, the developer is hoping to sell as many houses as possible and collect the progress payments made by the house buyers. The developer then initiates construction works including construction of the unsold units. This may help them to ease from the unnecessary financial burden since part of the project costs would have already been paid by buyers through end finance.

Over the past 40 years, it is proven that STB concept had been successful in fulfilling or meeting the housing demands in Malaysia. The only problem is that some of the projects lack the quality of the end product i.e. the completed house. The other weakness of the STB concept is that the house buyers are at risks where the project could be abandoned at any time due to a possible financial problem faced by the developers. The introduction of Housing Developers Account and standard Sale and Purchase Agreement by the government has been slow in tackling this problem of abandoned housing projects.

However it cannot be totally solved since a projects are abandoned for a host of other 'non-financial' reasons, such as problems with squatters, disputes between developers and architects, management problems, developers disappearance, problems with Public Works Department, etc. (Sothi, 1992). Malaysia is a country that has a Housing Developers Act, standard Sale & Purchase Agreements and Housing Development Regulations. In some countries like China there are no standard S&P agreements and trust accounts available therefore, it is difficult to buy a house and have it delivered properly as compare to Malaysia.

HISTORY OF BTS IN MALAYSIA

As one of the developing countries, Malaysia faced an insufficient supply of housing units aside from other problems such as difficulty in getting CFO and the land titles approval, late delivery and abandoned projects which have affected most house buyers (Sen 1985). The issue of BTS was raised again by the then Minister of Housing and Local Government at the end of January 1999. The **2002 statistics from the Ministry of Housing and Local Government shows the number of abandoned housing projects nationwide was 544, involving 125,649 units of houses worth over RM9.4 billion and affecting 80,070 buyers**.

Historically, the Federation of Malaysia Consumers Associations (FOMCA) first called for such a concept as early as 1980 after the problems of abandon projects faced by house buyers become more serious. Later, in the mid-80's, when the number of abandoned projects increased substantially, the BTS concept resurfaced. Newspaper reports indicated that in 1986, the Real Estate Housing Developers Association (REHDA) itself, through an executive official, suggested BTS concept as a solution to the problem of abandoned projects. In the late 1980's, the MHLG identified the Housing Development Account as a solution to the problem of abandoned projects and is undeterred in their persistency in their call for the implementation of the BTS concept.

Under the enforcement of Housing Development Account as in Section 7A, Housing Developers Act (Control and Licensing) 1966 (Act 118), states that every developer is required to have an account for every development either in banks or financial institutions. All incomes and expenses with regard to the development are required to be

paid into or through this account. This regulation was introduced on 26 August 1991. After almost a decade, it can be seen clearly that the Housing Development Account itself cannot resolve the problem of abandoned projects because it is not applicable to Sabah and Sarawak i.e. the west coast states of Malaysia. In addition, up to 70% of the projects are abandoned for a host of other 'non-financial' reasons, such as problems with squatters, disputes between developers and architects, management problems, developers "disappeared" and problems with Public Works Department (Sothi, 1992).

BTS VS STB
ADVANTAGES OF BTS

These are the advantages of BTS concept:

Ready Product with Certificate of Fitness for Occupancy (CFO)

Under the BTS concept, buyers are able to see and inspect the house that they are buying, just like buying a car. It is generally believed that the readymade unit can help the house-buyer to make the right decision asides from the paramount consideration of the unit pricing.

One of main problems faced by the STB house-buyers is that the vacant house is handed over without a CFO. Without the CFO, the house-buyers could not occupy the unit. There are several cases whereby the house-buyers did not get the CFO, even ten (10) years after the hand-over date. By implementing the BTS concept, all the problems could be solved.

Minimising House-buyer's Risks and Extra Expenses

When house-buyers buy off the plan, they have to shoulder many risks, whether or not the house will be completed on time, the possibility of the project being abandoned, delayed or varied from its original plan. Meanwhile, they may have to incur rental or other expenses while waiting to move into the new house. Thus, substantial savings in interest payment and no rental payments are necessary. Razzi (1995) considered that buying an un-built house was an act of faith because of the possible major and/or excessive buildings defects. Buyers often need to spent substantial time and effort to negotiate with developers to rectify problems. Blumenthal (1994) reported that although warranties are generally provided on the new residential properties, the coverage is limited.

House Quality and Availability

Under BTS concept, a potential house-buyer can see and inspect the units physically before deciding whether to buy or not. In this circumstance, the developer will have to do a better job, i.e. good design, good quality of workmanship, faster completion and high quality of finishes. As for the house-buyers, they can benefit through the quality of the units whereby the developers can gain through the shorter duration of the project which shortens the holding cost and can save on the development cost. By implementing a BTS concept, the house-buyers can move in straight away to their new house. Obviously, the house-buyers will be too happy to buy a completed house as they can pick and choose and then move in right away instead of having to wait for two to three years for the house to be completed and take vacant possession.

A sell than build property buyer is exposed to certain risks such as higher building defect risk. Building defects have always been a concern for a newly developed residential property taken over by a forward house-buyer. They may range from minor problems such as missing window screen to serious water leakage problem caused by poor workmanship (Razzi, 1995).

Reducing the Possibility of Abandoned Project

The advent of BTS concept will reduce the incidence of abandoned projects. Although it may not totally eliminate the problem, nevertheless, in the event that such incidences do occur, the house-buyers or end-financiers will not be caught. There would also be fewer obstacles in reviving abandoned projects as the question of obtaining concurrence from house-buyers to waive their claims for liquidated damages for late delivery will no longer arise. The other advantages of BTS concept are: no requirement for a Housing Development Account, less administrative works and maximisation of developer's profit.

DISADVANTAGES OF STB

There are several disadvantages of STB Concept. They are:

Abandoned Housing Project

Principally, the main reason why the Ministry of Housing and Local Government introduced BTS concept is to overcome the abandoned projects problem. There is financial risk incurred by buyers who make progress payment when something goes wrong with the project, for instance, the project is abandoned. The buyers then have to repay the loan sums plus the interest to the bank or loan provider, although without ever getting delivery of the house due to the abandonment of the project. Failure to complete the project does not only happened to private developers, but also happened to the cooperatives, statutory bodies and state development corporations. Statistic shows that only 30% of abandoned projects are caused by financial problems (Gurmeet, 1999). The majority of others are caused by non-financial factors such as incompetent contractors, unsuitability of sites and locations, inadequate market survey and/or feasibility study and delays in getting plan approval. All these problems are faced by the developers. Unfortunately, it is the buyer who has to bear with the problems caused by the abandoned project.

Late Delivery of Houses

Previous studies e.g. Sothi, 1992, have shown that 80% of developers failed to complete their projects and deliver the house to the buyer within the specified time of 24 months as required by The Housing Developers Act (Control & Licensing) 1966 (Act 118). This is due to the lack of expertise. The other reasons are factors such as uncertain climates/ weather, shortage of building materials and/ or labor and delayed in certain works. The lost will then be transferred to the house-buyers. It is true that The Housing Developers Act (Control & Licensing) 1966 (Act 118) protects house-buyers' by requiring developers to deliver the house within 24 months from the date of Sales and Purchase Agreement is signed. Furthermore, the regulations also provide a measure of compensation for late delivery as laid down under Item 20, Schedule G (S&P Agreement) of the Act 118, "the vendor shall pay immediately to the house-buyer liquidated damages to be calculated from day to day at the rate of 10% per annum of the purchase price." However, it is common that erring developers do not comply with the regulations. In addition, most of the house-buyers do not know of their rights. The BTS concept is introduced with the intention to solving the problem.

Failures/postponement in the issuance of Certificate of Fitness for Occupancy (CFO)

The Housing Developers Act 1966 stipulates that a house is deemed to be delivered on the issue of Certificate of Fitness for Occupancy (CFO) and once the water and electricity supply has been connected (item 21, Schedule of the 118 Act). Nevertheless, the Ministry did not link the house delivery with the issuance of a CFO. Without a CFO, house-buyers cannot move into the new completed house since it is considered as an illegal house.

This will therefore cost them extra expenses for renting a house.

Local Authority Act 1976 (Act 171) stipulated that owner/buyer of any house which has not been issued with CFO will lose their right to occupy or to do any alteration to the building due to safety reasons. Only buildings that have been certified as fit and safe to be occupied by human will be given a CFO by a local authority. In issuing a CFO, the local authority will carry out inspection on the building to ensure that it is safe to be occupied and comply with current local construction law. The introduction of BTS concept will mean that house-buyers will be spared from this dilemma (Kasi, 1992). This is due to the fact that under the BTS concept, the buyers will be handed over the completed unit together with the CFO issued by respective local authority. This problem have been faced by buyers in Taman Desa Tebrau, Johor Bahru, whereby the house has been delivered to them in April 1999, but the CFO was only issued in September 1999 (five (5) months later).

Housing features mismatch

In a purchase of an uncompleted project, house-buyers do not have the chance to view or inspect the real or completed house while purchasing them. What they can see is a show house or what they can imagine through architect's drawings and model houses. There are some aspects such as traffic flow, the eventual environment of the housing scheme and the gradient of the road which they probably will fail to understand through a drawing or model house. Indeed, this is the crucial aspect that should help them in making their decisions. However, through BTS concept, the buyers or potential buyers can have real view and experience of the house and its surrounding since it has been completed before sale or earlier.

PROJECT FUNDING

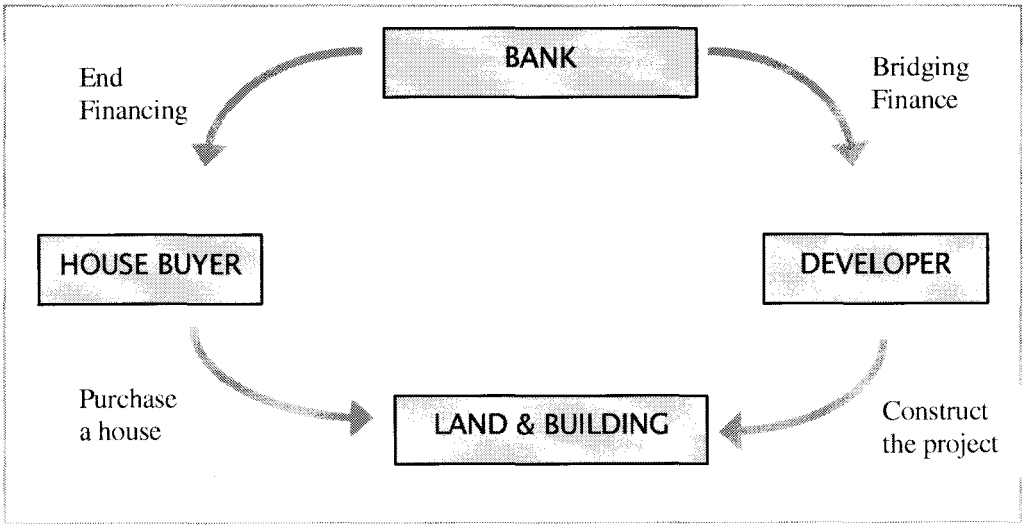
Under the STB approach, there are several sources that a developer can raise his working capital for development projects. According to The Association of Banks in Malaysia (1992), the developer can raise their fund through:

i. Its own capital fund
ii. Financing from banks, financial institutions or building societies such as Malaysian Building Societies Berhad (MBSB) and Borneo Housing Mortgage Finance Berhad (SHMFB) through bridging finance
iii. Credits from suppliers (contractors or material suppliers)
iv. Progress payments from house buyers and end-financiers.

Payment from house buyers or end-financiers is the main and the biggest source of funding for a housing development project. According to MHLG, a developer can sometimes raise up to sixty five percent (65%) of the total development cost from the house buyers or end-financiers. The balance (35%) could be raised either from the developer's own capital or through bridging finance from financial institutions. As a result, the developer can save its development cost from the interest payment to banks or financial institutions. Unfortunately, under the BTS concept, the developer can only raise the fund through the first three sources but not progress payments from the house buyers. In this circumstance, the developer has to either "back-up" its development cost through his own capital fund or increase the margin of bridging finance from financial institutions. In other words, bridging finance from the banks or financial institutions could be increased to about 80% to 90% of the total development cost, depending on the developer's working capital.

This, however, will increase the risk borne by the developer. This is the main reason why REHDA is against the idea of BTS, because it will increase the developer's burden on interest. In other words, interest payable to banks or financial institution is relatively higher compare to STB approach. A relationship among bank-developer-house buyer in financing a housing development scheme is shown in Diagram 2.1.

Diagram 2.1: Relationship between Bank-Developer-House buyers in financing Housing Development Scheme



Source: Raymond, 1981

Bridging Finance

Raymond (1981) defined bridging finance as a manner that a corporation can use revolving credit loans to make progress payments on new construction. After the construction is completed, the corporation sells common stock of long-term bonds and uses the proceeds to pay off the revolving credit loans. There are two advantages of bridging finance. First, the corporation borrows only as much money as required. Second, the financing is not obtained until needed. This financing strategy thus allows the corporation to avoid rising too much or too little in the way of long-term funds. Other definition of bridging finance refers to short-term financing, usually to cover a gap in time between someone's expenditure and funds for a house and that person's later receipt of funds, often from the sale of his or her house (Michael *et al.* 1984).

Bridging finance is utilised to supplement the upfront funding of the project, for example, land cost, preliminary expenses such as conversion fees, consultancy fees and costs of construction. Disbursements are normally calculated based on the value of work done supported by relevant architect's or quantity surveyor's certificate. The margin of advance on the certificate of claim depends on the agreement stated on the Sale and Purchase Agreement signed by the developer and the house buyer. The amount of finance required

varies depending on the developer's financial strength but generally bridging finance represents thirty to thirty five percents (30% - 35%) of the total project cost.

The formula of interest rate payment for Bridging Finance is:

$$\frac{1}{3} A \times \frac{1}{2} B \times C$$

Where, A = Total Development Cost
B = Development Period
C = Banks Interest Rate

Repayment period is normally timed to expire on the proposed completion date of the project. During the interim period, the developer is expected to service the monthly interest payment. Principle payment can be in the form of bullet payment or gradual redemption of titles (normally from end-financing as and the houses are sold).

End Financing

End Financing refers to the funding provided (or payment made) by the house buyers and their bankers to the developer. Upon signing the S&P, the house buyer would pay a sum of 10% of the purchase price as down payment and usually, finances balance of the purchase price through loans from financial institutions. The loan amount approved together with the difference between the loan amount and the balance of purchase price will be paid progressively to the developer in accordance with various stages of construction work. Hence, once the moment the sale is secured, the construction of the house is self-financing. The end financiers are placed with the burden to disburse the approved loan progressively. They are duty-bound to ensure the loans disbursed are for work performed by the developer and they are usually supported in the form of Architect's Certification.

RESEARCH METHODOLOGY

QUESTIONNAIRE DESIGN

The questions was structured and piloted with a small group, to ensure participants would be clear about the response needed. This included a small number of open ended questions to elicit a broad range of views. The length of questionnaire was also limited so that it would not take too much time to complete. Respondents were advised that comments would remain confidential and would be averaged so that no individual response could be identified. There will be two sets of questions which have been asked to two different groups of respondent, namely housing developers and house-buyers or potential house-buyers. Questions on set A will be asked to a group of twenty developers while set B questions will be asked to a group 100 house-buyers which have been randomly selected.

RESEARCH SURVEY ANALYSIS

1. Response from the developers

Respondent's background

For the purpose of this research, 20 developers were randomly selected comprising six small scale companies; nine medium scale companies and five big scale companies. All of them records of being fully aware of the build then sell concept. However, only 40% of the respondents mentioned that they would prefer the BTS concept while the other 60% claimed that they would prefer the STB concept. Amongst them, only two who had actually experienced the build then sell projects.

Willingness to adopt BTS Concept

25% of the respondents claimed that they would be willing to adopt the build then sell concept, 45 % were not willing whilst the other 30% were not sure whether or not they would implement such a concept in their projects. This showed that, the developers were still

worried about the success of this concept. Furthermore, only 25% of the respondents claimed that the percentage of their readiness to implement such concept was more than 50%. The rest claimed that they were less than 50% ready to implement it.

Possibility of implementing BTS Concept

25% of the respondents pointed out that it would be impossible to implement the build then sell concept in Malaysia in the near future whilst 35% claimed that it would be possible to implement the concept with support from the government and market. Five respondents (25%) claimed that the main obstacle in implementing build then sell concept was the financial capability. Most of developers in Malaysia are small scale and medium scale company. Therefore, they can't afford to bare the construction or project cost using their own money. By implementing build then sell concept, it would mean that they have to bare 100% of the project cost without the help of financial institutions. Under current practice, about half of the project cost is financed by commercial banks with the rest paid by buyers through progress payment. 15% stated that the concept would be possible if implemented on small or medium scale projects.

Government supports

40% of the respondents indicated that the concept would be more attractive if the government offered tax relief as this would help to reduce their financial burden. Another 25% claimed that fast approval would help to make the concept succeed while 20% pointed out that less bureaucracy in the development approval would also help. At the same time, most of them agreed that they would also need support from financial institutions in order to make the concept possible to be implemented.

2. Response from the house buyers
Respondent's background

76 percent of the respondents were those who had bought a house whilst 24 percent had yet to buy a house. When being asked about their awareness of build then sell concept, all of them claimed that they were aware about the concept. However, 4 of them confessed that they did not really know what the concept was all about.

Respondent's Preference

100 percent of the respondents claimed that they would prefer the build then sell concept since it would help to reduce buyer's risks. In addition, it would also reduce the risk of the project being abandoned. Some of them commented that house buyers were the parties who had to bare the financial cost once the project was abandoned. This would totally burden the house buyers whereby a dream to own a house suddenly changed to a nightmare.

The house buyers were also asked about the problems with current delivery system of sell then build. 43 percent of them claimed that the main problem with current practice was abandoned project. Another 40 percent highlighted the late delivery problem, 10 percent said that the project faced a high risk of being in-completed while the another 7 percent claimed that poor quality of houses was one of the problems caused by the current system. Some of the respondent did comment that the main reason why BTS concept is failed to be implemented in Malaysia was because of the developers' attitude. The developers were not willing to bare the burden of financing the project using their own money. As a result, it is the buyers who had to faced or take the burden. They added that the government should give some incentive to the developers who are willing to adopt the BTS concept. At the same time, cooperation or support from the financial institution would be crucial in order to make the concept possible to be implemented.

SURVEY DISCUSSION

The survey revealed that the build than sell concept was possible to be implemented in

Malaysia. All parties agreed that it was the best solution to overcome housing problems caused by the current system. However, a thorough study needed to be carried out in order to find the best way that could be implemented. The advantages offered by the BTS concept include: a ready product, better quality houses, overcome problem of abandoned projects and protecting the buyers' interests. On the other hand, this concept was not being implemented by the majority of housing developers in Malaysia because of their lack of capital and financial capability due to their small scale. As a small company, they are not financially strong enough to undertake such concept. In order to make it possible to be implemented in Malaysia, the writers would like to make some recommendations as follow:

a) Developers could form a joint venture company to undertake BTS project.
b) Developers could form a consortium or syndication amongst small scale developers, so that small developers can be weeded out.
c) Developers could initiate the concept on a small/medium scale project.
d) Developers could use this on low/ medium cost houses.
e) The government could give tax incentive to the developers who practiced BTS concept.
f) Developers could collect some amount of money (i.e. 10 – 15%) which would be kept by third party/when the Sales and Purchase Agreement was signed as a booking fee.
g) The government could give incentive to the financial institutions who support the implementation of such concept.

CONCLUSION

Private sector developers have played a dominant role in assisting the government to provide sufficient dwellings to the social community under the conventional STB method. This research has tested the viability of the BTS concept. The BTS concept was determined to eliminate the differences in opinion between the buyer and producer about the quality and price paid for the product as the buyer would be able to see, feel and touch what they were paying for.

From the research, it can be concluded that the new concept sounds possible to be implemented in Malaysia. However, the concept of BTS applied in the UK cannot be fully imitated in Malaysia due to different market condition in both countries. It is totally impossible to move from STB to BTS concept within a short time period because of the existing housing development in Malaysia. If the BTS was to be enforced, the general consensus is that a lot of smaller and poorly managed developers would fail which would prevent the government providing sufficient housing for the social benefit. In order to avoid this, two procedures need to be addressed. Firstly, "Minimal Deposit System" which is implemented in Australia should be used.

Under this system, developers are allowed to collect certain amount (10% to 15%) of selling price from purchasers as a commitment to the development project. The advanced payment can also be considered as an initial deposit on new houses. This system not only reduces the developers' risks by assuring the feasibility and viability of the project, but also helps them obtain a small amount of finance from the purchasers. In addition, the commitment will also help developers in getting loans more easily from the financial institutions.

Secondly, the government should encourage developers to practice BTS concept with some assistance and incentives. Since the Housing and Developers Act (Control & Licensing) 1966 has clearly stated that BTS-practiced developers could enjoy the exception from

having any Housing Development Account and the developers are more flexible in using their own capital, the government could also assist the developers with other benefits. The government could assist developers in obtaining the financial assistance with the support from National Bank of Malaysia (BNM). In addition, the government could use money from the Abandoned Housing Projects Fund to help developers in raising their working capital instead of funding the projects that have been abandoned.

Furthermore, the government could ensure that CFO was issued at an earlier stage. For example, the developers would be allowed to sell their units after 80% of the total construction works had been completed, in order to reduce the holding cost bear by the developers while waiting for the house buyers to purchase the units. As the house buyers, they can enjoy the advantages by having extra two years to accumulate capital and could probably settle the balance of their deposit by selling their existing property before moving into new ones. The government should undertake a thorough study to examine, scrutinise and analyse the concept's abilities and limitations, after giving good thoughts and consideration to the present and future housing development scenarios

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