Thursday - July 13 2006 The announcement by the Deputy Prime Minister on the Government&#65533;s decision to adopt the 10:90 model for housing delivery alongside the existing Sell-Then-Build model seems to have put paid to much of the controversy surrounding the issue. &#65533; For one, there was unanimous support from the House Buyers&#65533; Association (HBA), Rehda, Fomca and the general community. The big question is what does it take to make the new proposed system work? &#65533;Build Then Sell (BTS)&#65533; The BTS system essentially means the developer completes the houses before he starts selling them. The financing of the project would be entirely borne by the developer and his banker. The risk is now shared between the banker and the developer only.&#65533; How much financing would be given to such a development would depend on the criteria set by the individual bank and the bank&#65533;s risk appetite. &#65533; For a &#65533;very viable&#65533; project, a developer may obtain a higher financing package, a &#65533;less viable&#65533; one may get lower financing. &#65533; There are no clearly spelt-out guidelines in deciding the level of financing a project gets. Unless banks can come out with a transparent set of guidelines, it is purely guesswork how much financing a project is going to get under the BTS model. &#65533; The level of bank financing for the project will determine how much equity the developer has to fork out. It could range from a 70:30 to a 30:70 risk sharing formula between the banker and the developer, respectively, depending on the viability of the project. &#65533; For the bank, there is no spread in the risk. Once the financing formula is agreed upon, and if the developer has the balance of equity, the project can be completed.&#65533; A higher premium will be attached to the price of houses under the BTS model due to higher opportunity cost, interest and holding costs. &#65533; In recent years, a few developers have experimented with the BTS system. If these projects are any indication, the premiums could well be 30% to 50% more. However, these BTS pioneer projects are small in terms of the number of housing units built, and they are in very prime locations so that the risk of poor take-up is mitigated.&#65533; 10:90&#65533; Under this proposed model, the house buyer pays a 10% deposit to a trust account upon signing the Sale & Purchase Agreement (SPA). The developer and the banker would have no access to the money. The balance 90% of the purchase price is paid upon the completed housing unit being handed over to the purchaser. The financing and equity sharing formula for the 10:90 model is very similar to that of BTS.&#65533; The potential danger of this model is buyers reneging on their agreements during market downturns, thereby creating a domino effect of projects failing in midstream. &#65533; To prevent such an eventuality, some changes need to be made to existing legislation. This should include a &#65533;lock in' clause in the SPA where buyers cannot renege on the agreement, and are as equally bound to specific performance clauses as the developer.&#65533; Sanctity of contract cannot be assumed, as experience has shown that house buyers will find loopholes and the flimsiest of excuses to get out of a down market, even in more mature markets like Australia where a group of buyers successfully reneged on their contracts, citing unacceptable colour tone. &#65533; This caused the Australian government to step in to review the system to avoid a major debacle. Unless there is a lock-in clause to prevent buyers from reneging under the 10:90 model, there is no comparative advantage to adopt the 10:90 model.&#65533; And when projects stall, be they under the 10:90 or the current Sell-Then-Build system, the complexities of vested interests involved are the same. Banks would have to get purchasers&#65533; consent for any arrangement to work, unlike the BTS model where banks have only to deal with the developer.&#65533; The cost of delivering houses will be higher under the 10:90 model. Bridging finance interest is estimated to be

generally 2% to 3% higher than end-financing. &#65533; Again a higher risk premium will have to be factored in. At this moment in time, it is difficult to ascertain the quantum, as no precedent has yet been set. Much still needs to be discussed and resolved, especially between the banks, Bank Negara, the Ministry of Housing and Local Government, Rehda and other stakeholders.&#65533; Sell Then Build (STB)&#65533; The current STB model is based on a formula of shared risk among three main parties- the developer, the house buyer and the financier. &#65533; The house buyer pays 10% upon signing a standard sale and purchase agreement regulated under the Housing Act. As the building works progress, there will be progressive billing for the duration of the standard SPA until the unit is completed and handed over to the purchaser. &#65533; The banks will fund the end financing for the purchaser who will make instalment payments to the bank in accordance with the terms of the loan agreement.&#65533; This tripartite formula of risk sharing under the STB model has been a very successful and efficient system in helping the nation in housing delivery for the last 40 years. &#65533; This system has been extremely effective in providing adequate and affordable housing to the rakyat, especially low-cost houses. It has also helped to subsidise bumiputra home ownership and modern infrastructure such as electricity supply networks, sewerage treatment plants, water reticulation systems and roads.&#65533; What has been the bane of the STB system is that when it fails, all parties involved &#65533; the buyers, the banks and developers &#65533; are affected, especially the buyers. &#65533; There is also the issue of house buyers having to accept shoddy workmanship, although it is debatable whether there will be significant improvement in workmanship under the 10:90 or BTS systems, given the prevailing challenges and constraints faced by the construction industry in terms of skilled labour.&#65533; Going FORWARD &#65533; Can the three systems coexist? I believe they can because the three systems offer a genuine competitive choice for buyers, bankers and developers. But the critical question that remains is which is the most effective system to achieve the goals and housing targets as spelt out in the 9th Malaysia Plan &#65533; to provide 709,400 units of houses to the rakyat, of which 68% are in the medium-cost range and below.&#65533; The STB model has been a tried and tested one, enabling the nation to deliver 3.6 million homes that are still affordable to buyers. Unfortunately, the 2% or so failure rate of this system &#65533; in the form of abandoned housing projects &#65533; has generated so much bad publicity that it has occluded the overall merits of the current STB model.&#65533; Can the 10:90 or BTS systems on their own deliver the numbers and meet the targets of the nation&#65533;s housing needs? I sincerely think not. &#65533; Rehda earnestly believes that based on the 9th Malaysia Plan targets, the STB model with improved evaluation and monitoring is the key to housing delivery and affordability. Stringent viability requirements and sound project financing arrangements can help prevent abandoned projects.&#65533; For buyers looking at affordable housing, it is still the STB option, where the cost savings arising from the lower risk premium to both bankers and developers is passed on to buyers. &#65533; This may suit most buyers who are not in a hurry to buy a house and need time to build up their financing capability. Buyers under STB have to accept some level of risk, although under the current tighter regulatory provisions of the amended Housing Act, buyers are given further protection.&#65533; For bankers, the viability of the project and the financial capability of the developer will determine which of the three systems will best suit their risk appetite. &#65533; Banks may be prepared to fund projects under BTS or the 10:90 systems despite the higher risk cost and premiums if it can be demonstrated that there is high demand for these projects. &#65533; This is where good market information is needed for risks to be kept in

proper perspective and rationalised.&#65533; The industry awaits concrete announcements from the Government on the packages of incentives for the BTS and the 10:90 systems because the incentives must be attractive and tangible enough for developers to migrate wholesale from the STB to the 10:90 or BTS systems. &#65533; This would certainly include a bigger role by the banks in providing the necessary project financing packages. But judging by the deafening silence from the banking industry on the matter to date, it would take great resolve and determination on the part of the Government to bring all the key players to the table before serious discussions can start on how we are to move forward on the 10:90 or BTS schemes.&#65533; Meanwhile, the decision to allow the three systems to run parallel until a more structured package of incentives is agreed upon is a wise move . &#65533; Rehda is keen to see an end to the problem of abandoned housing and has called on the Ministry of Housing and Local Government to get banks and developers together to look at the parameters for financing each of the individual systems. &#65533; It should be an exciting two years ahead before the parallel systems come up for review. &#65533;   Datuk Eddy Chen Lok Loi is the trustee of the Rehda Institute and Deputy President, EAROPII Malaysia.&#65533;