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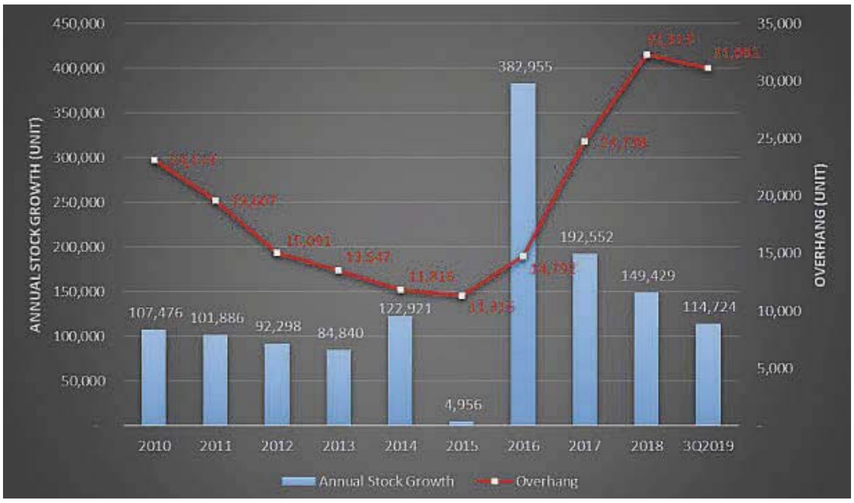
Are houses in Malaysia overpriced?

A review of price developments in the country from 1990 to 2019



Annual stock growth vs number of overhangs, 2010-Q3'2019

MALAYSIAN house prices have been in a continuous upward trend since 1990. This has captured concerns over the country's housing affordability. Understanding the drivers behind these rises is important to obtain a neutral outlook for property prospects in 2020.

The rise of house prices throughout 1990-2019 can be distinguished into three distinct periods based on magnitude and drivers that caused the impact.

From the perspective of house price change, drastic increase during the period of 1990-2000 was mainly ignited by two episodes of housing bubble, both in 1990-1992 and 1994-1996; where extreme movements of house prices were observed, with a rapid rise of about 20% per year for two or three consecutive years, and then falling rapidly in the following two or three years. Houses were likely to be overpriced during this period, causing the deviation of house prices from their fundamentals.

House prices rise in the period of 2000-2010 can be attributed to house price growth that reflects the increase in the fundamental value of property. The increase of development costs such as land, labour, material, and machinery & equipment were built into the value of new housing development, resulting a house price adjustment that was not much deviated from the fundamental house prices. While no discernable housing bubbles were found in this period, the continuous uptrend of prices convinced investors on the profitable return from property investment.

Coupled with the fact that income growth was generally higher than the house prices growth, a buying sentiment among people that helps pushing up house prices was formed. Unsurprisingly, this sentiment was then transformed into a built-up speculative herd instinct that caused house prices escalation after 2010.

Looking back at the last decade of 2010-2019, the year 2015 could be positioned as the threshold of the country's housing market performance, where the market has experienced a bull run in the first half of the decade (2010-2015), and then suffered a slowdown in the second half of the decade (2015-2019), which the impact is still profound until today.

The last episode of skyrocketing house prices in 2010-2015 was driven by the favourable lending policy (initiated in 2009) and the overly optimistic expectations of future house price movements (developed from 2000 to 2010).

Back then, interest rates were low, allowing buyers to get larger amount of loans with a lower monthly payment. Coupled with the implementation of the mortgage interest tax relief (MITR) – a government stimulus program during the subprime mortgage crisis that aimed to increase homeownership in the country by easing the burden of people in purchasing houses – investors tended to treat housing as an investment vehicle that could deliver capital gains far in excess of their ability to earn income from work or from other investment in the real economy.

Buoyed by the confidence of these investors; developers, too, took advantage of optimistic buyer sentiment by introducing the Developer Interest Bearing Scheme (DIBS) to promote property in the primary market. Since purchasing a house with DIBS is marketed as an attractive invest-ment opportunity that buyers are of no obligation to serve their loan payments during the construction period, more speculative activities were encouraged in the housing market.

As a consequence, houses were overpriced and have exceeded the growth rate of consumer prices as well as the growth rate of income, leading to the reduction of housing affordability nationwide.

House prices in the period of 2015-Q3'2019 were not likely to be overpriced, due to various macro-prudential and fiscal measures implemented by the government that have contributed significantly to the reduction of speculation in the property market.

However, developers have become overconfident as they generally believed that property prices will keep increasing as long as demands are generated from the expanding population. As a result, they would just launch anything certain that the market will buy up whatever was offered.

This is evidenced by observing the annual residential stock growth throughout 2010-Q3'2019; where as high as 382,955 units were added into the existing stock inventory in 2016, followed by 192,552 units in 2017, 149,429 units in 2018, and 114,724 as of Q3'2019; with a total number of 839,660 units that far exceeded the combined units of 514,377 from 2010-2015 (*chart*).

Such excessive supply of houses has definitely outstripped the demand for these properties, not to mention the limit of absorptivity at each individual local market. Consequently, overhangs become more critical, with a drastic rising trend since 2016, reaching to its peak at 32,313 units in 2018.

Meanwhile, the weakening currency and trade tensions have badly affected the local economy as well as the purchasing power among mass market buyers; which further translated into the escalation of living cost that caused a decline in demand for properties. High household debts and large number of overhangs remain as the key stumbling blocks for the housing sector's recovery.

Judging from the past experience, should the number of overhangs to be restored back to its lowest level – which is at 11,316 units in 2015 – a reduction of supply in the consecutive years is needed. The housing market is, thus, expected to remain challenging in the following years as the unprecedented large property overhang will take more time for the market to absorb before the housing market could stage a meaningful recovery.

***This** article was contributed by MKH Bhd manager of product research & development Dr Foo Chee Hung.*