

COST OF DOING BUSINESS AND IMPACT ON CONSTRUCTION INDUSTRY

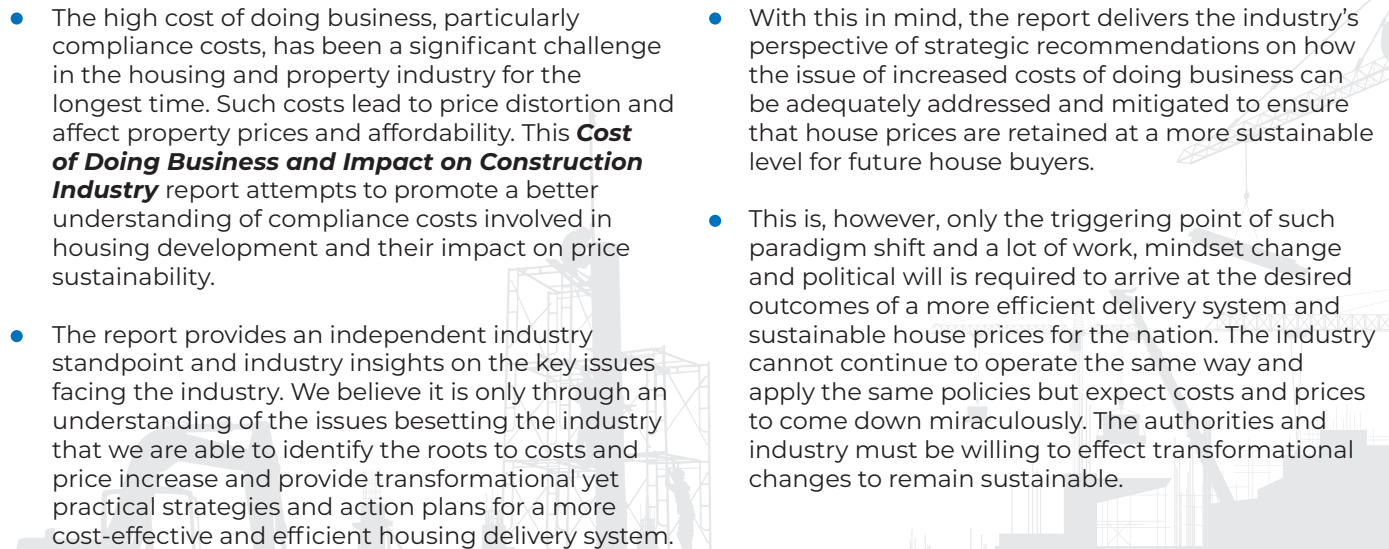


RESEARCH COLLABORATION:





01. INTRODUCTION

- The high cost of doing business, particularly compliance costs, has been a significant challenge in the housing and property industry for the longest time. Such costs lead to price distortion and affect property prices and affordability. This ***Cost of Doing Business and Impact on Construction Industry*** report attempts to promote a better understanding of compliance costs involved in housing development and their impact on price sustainability.
 - The report provides an independent industry standpoint and industry insights on the key issues facing the industry. We believe it is only through an understanding of the issues besetting the industry that we are able to identify the roots to costs and price increase and provide transformational yet practical strategies and action plans for a more cost-effective and efficient housing delivery system.
 - With this in mind, the report delivers the industry's perspective of strategic recommendations on how the issue of increased costs of doing business can be adequately addressed and mitigated to ensure that house prices are retained at a more sustainable level for future house buyers.
 - This is, however, only the triggering point of such paradigm shift and a lot of work, mindset change and political will is required to arrive at the desired outcomes of a more efficient delivery system and sustainable house prices for the nation. The industry cannot continue to operate the same way and apply the same policies but expect costs and prices to come down miraculously. The authorities and industry must be willing to effect transformational changes to remain sustainable.
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02. KEY ISSUES



01

OVER REGULATION ADDS TO COST BUT NOT NECESSARILY VALUE OF HOUSES

02

OVERZEALOUS PLANNING REQUIREMENTS REDUCE SELLABLE LAND

03

CROSS SUBSIDIES CREATE PRICE DISTORTION

04

LENGTHY PROCESS OF APPROVAL – UNPRODUCTIVE, COSTLY DELAYS AND UNCERTAINTIES



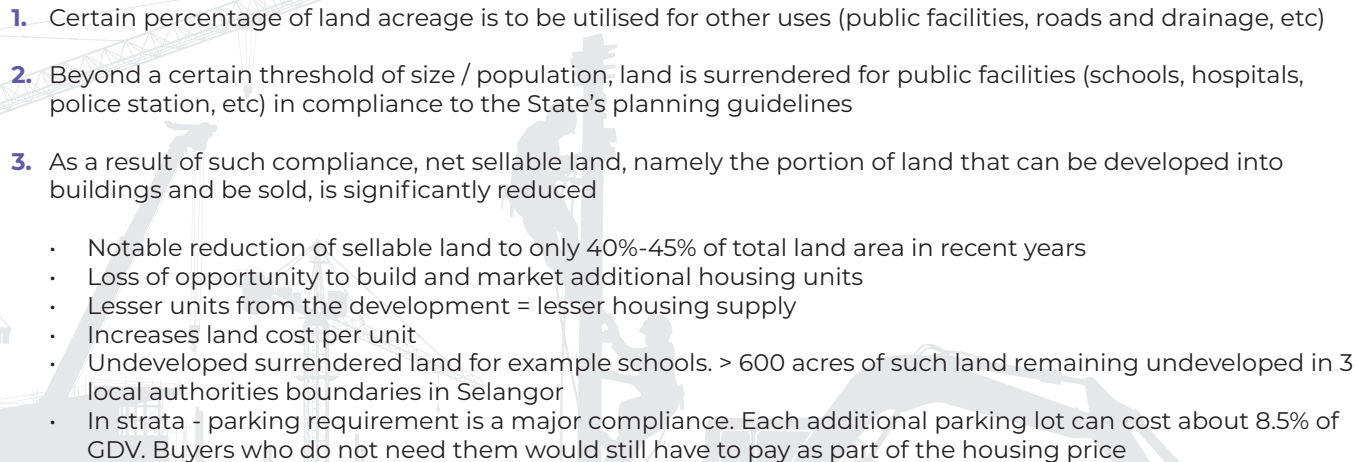


01. OVER REGULATION ADDS TO COST BUT NOT NECESSARILY VALUE OF HOUSES

1. The Malaysian housing industry is highly regulated by various laws, policies, guidelines and standards
2. Regulations add to costs, limit supply and creates inflexibility to adapt to market changes
3. New compliance are imposed by separate agencies through separate laws, policies, standards, etc
4. The overall increase in compliance can be quite substantial when added up
5. Does not necessarily add productively to the value of the house, for example cross subsidies, holding costs and etcetera
6. Main compliances include; land conversion and development (both towards land use change), housing policies, capital contribution charges to utilities service providers, loss of sellable land, holding costs, payment and charges
7. Do regulations constitute a barrier to development? Depends on how important housing affordability is compared to other social objectives. Cost/benefit analyses of these regulations can be useful to assess whether the benefits outweigh the costs to the public (increased cost and reduced housing affordability)



02. OVERZEALOUS PLANNING REQUIREMENTS REDUCE SELLABLE LAND

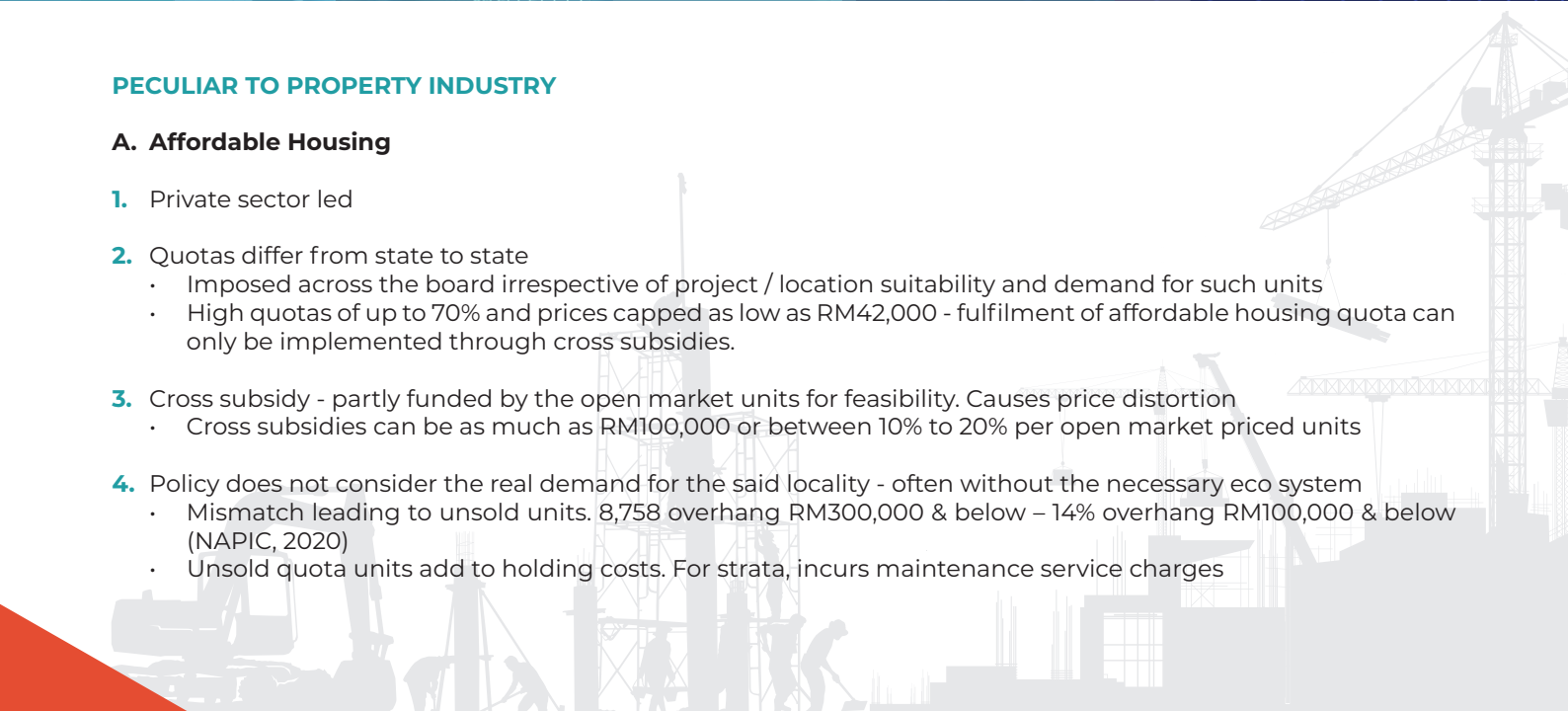
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1. Certain percentage of land acreage is to be utilised for other uses (public facilities, roads and drainage, etc)
 2. Beyond a certain threshold of size / population, land is surrendered for public facilities (schools, hospitals, police station, etc) in compliance to the State's planning guidelines
 3. As a result of such compliance, net sellable land, namely the portion of land that can be developed into buildings and be sold, is significantly reduced
 - Notable reduction of sellable land to only 40%-45% of total land area in recent years
 - Loss of opportunity to build and market additional housing units
 - Lesser units from the development = lesser housing supply
 - Increases land cost per unit
 - Undeveloped surrendered land for example schools. > 600 acres of such land remaining undeveloped in 3 local authorities boundaries in Selangor
 - In strata - parking requirement is a major compliance. Each additional parking lot can cost about 8.5% of GDV. Buyers who do not need them would still have to pay as part of the housing price



03. CROSS SUBSIDIES CREATE PRICE DISTORTION

PECULIAR TO PROPERTY INDUSTRY

A. Affordable Housing

1. Private sector led
 2. Quotas differ from state to state
 - Imposed across the board irrespective of project / location suitability and demand for such units
 - High quotas of up to 70% and prices capped as low as RM42,000 - fulfilment of affordable housing quota can only be implemented through cross subsidies.
 3. Cross subsidy - partly funded by the open market units for feasibility. Causes price distortion
 - Cross subsidies can be as much as RM100,000 or between 10% to 20% per open market priced units
 4. Policy does not consider the real demand for the said locality - often without the necessary eco system
 - Mismatch leading to unsold units. 8,758 overhang RM300,000 & below – 14% overhang RM100,000 & below (NAPIC, 2020)
 - Unsold quota units add to holding costs. For strata, incurs maintenance service charges
- 



03. CROSS SUBSIDIES CREATE PRICE DISTORTION (CONT'D)



B. Bumiputera Quota

1. Quota can be as high as 70%
2. 5%-7% discount on a 30% quota translates to a 1.5%-2% cross funding by open market
3. Industry's main concern - release of unsold quota units
 - Unsold quota units do not get fast release
 - Approval for release application is subject to various eligibility criteria and approved only in stages
 - No standard release mechanism and depends on respective state's policies and developers may be charged with levy for release of such unsold units
 - The approval for release, however, is not transparent and automatic; and developers are not guaranteed of full release over a specific time period
 - This mechanism creates uncertainty and adversely affect project marketing and cash flow planning
4. Ties up resources and also attract additional holding costs, both in the case of Affordable Housing quota and Bumiputera quota
5. In addition to tied resources, holding costs on unsold Bumiputera quota units can come up to 0.6% of GDV and could be higher if percentage of quota and/or percentage of unsold units are higher and held longer

03. CROSS SUBSIDIES CREATE PRICE DISTORTION (CONT'D)

B. Bumiputera Quota (cont'd)

6. Based on a RI's survey, out of 6,121 unreleased units held by a sample of 136 developers, 30% of such units have been tied up for more than 5 years

Aging Range	Units	% units
0 - 12 months	1,256	21%
13 - 24 months	1,105	18%
35 - 36 months	891	15%
37 - 48 months	668	11%
49 - 60 months	335	5%
Beyond 60 months (beyond 5 years)	1,866	30%
TOTAL	6,121	100%



03. CROSS SUBSIDIES CREATE PRICE DISTORTION (CONT'D)

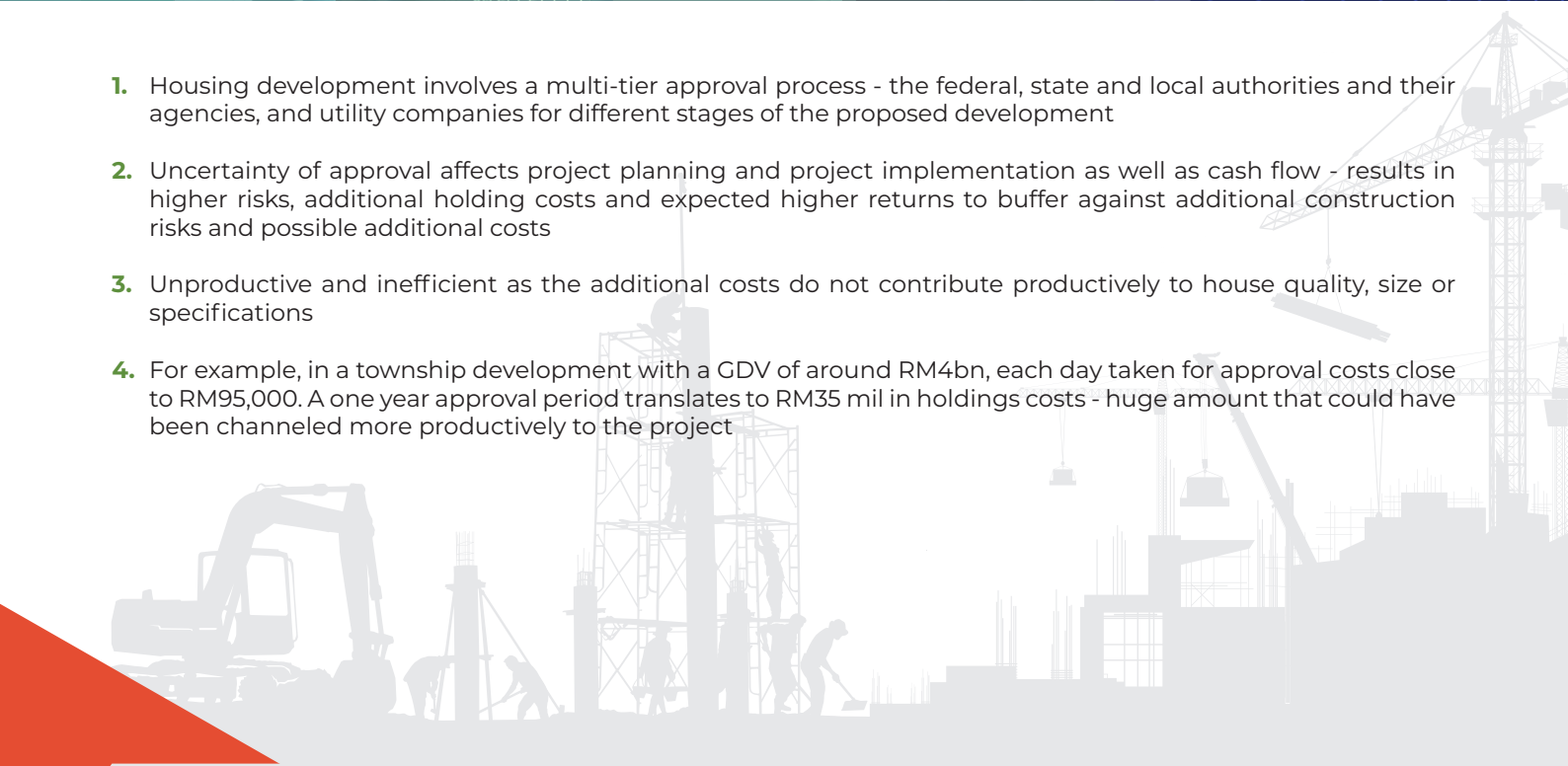


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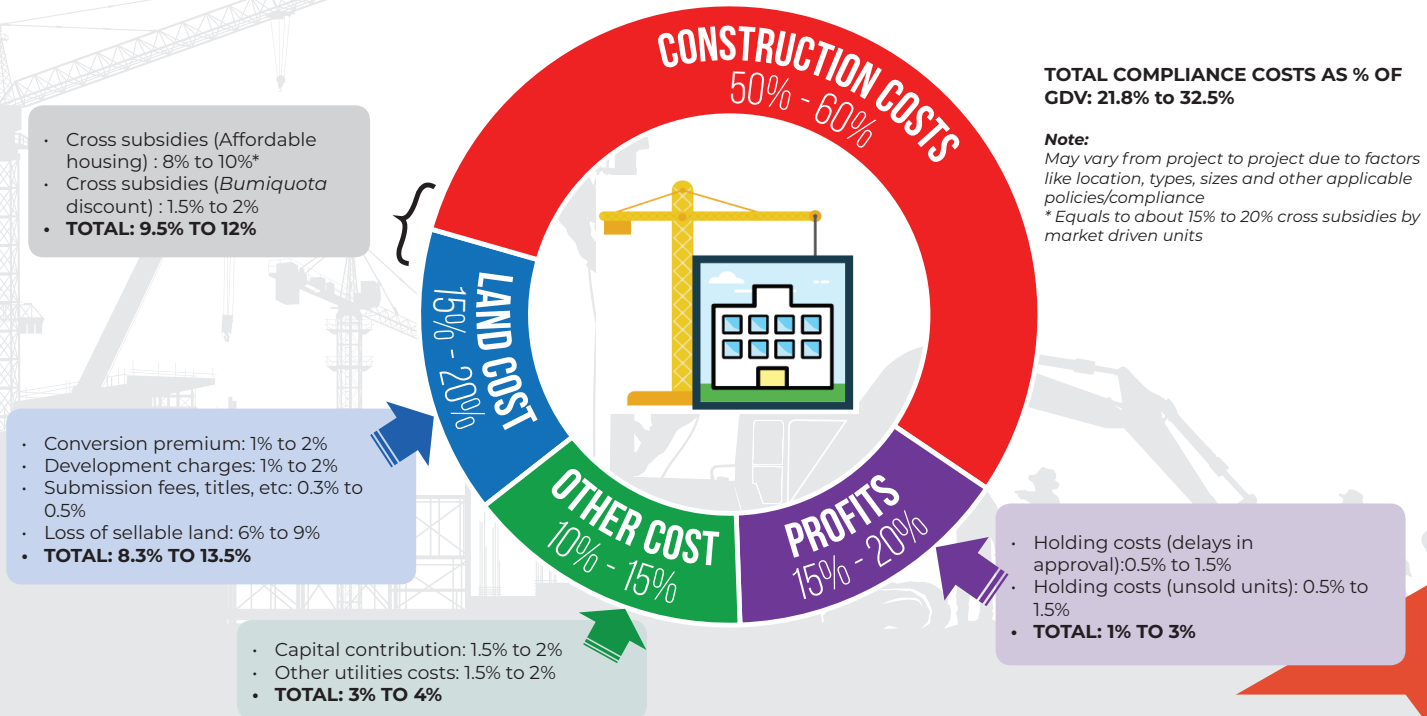
04. LENGTHY PROCESS OF APPROVAL – UNPRODUCTIVE, COSTLY DELAYS AND UNCERTAINTIES

1. Housing development involves a multi-tier approval process - the federal, state and local authorities and their agencies, and utility companies for different stages of the proposed development
 2. Uncertainty of approval affects project planning and project implementation as well as cash flow - results in higher risks, additional holding costs and expected higher returns to buffer against additional construction risks and possible additional costs
 3. Unproductive and inefficient as the additional costs do not contribute productively to house quality, size or specifications
 4. For example, in a township development with a GDV of around RM4bn, each day taken for approval costs close to RM95,000. A one year approval period translates to RM35 mil in holdings costs - huge amount that could have been channeled more productively to the project
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03. COMPLIANCE COSTS AND IMPACT



COST COMPONENTS OF HOUSING DEVELOPMENT & COMPLIANCE COSTS





SUMMARY OF COMPLIANCE COST IN PROPERTY DEVELOPMENT

Details of Compliance (Township)	% to GDV
Conversion Premium	1% to 2%
Development Charges	1% to 2%
Capital Contribution	1.5% to 2%
Other Utilities Costs	1.5% to 2%
Loss of Sellable Land (60% surrendered)	6% to 9%
Cross Subsidies - Bumiputera Quota Discounts	1.5% to 2%
Holding Costs - Unsold Bumiputera Quota Units	0.5% to 1.5%
Holding Costs - Delays in Approvals	0.5% to 1.5%
Submission Fees, Titles etc	0.3% to 0.5%
SUB TOTAL	13.8 % - 22.5%
Cross Subsidies - Affordable Housing (Land, Building & Other Costs)	8 - 10%*
TOTAL	21.8% - 32.5%

May vary from project to project due to factors like location, types, sizes and other applicable policies / compliance

** Equals to about 15% to 20% cross subsidies by market driven units*

Details of Compliance (Strata Less Than 10 acres)	% to GDV
Conversion Premium	1% to 2%
Development Charges	1% to 2%
Capital Contribution	1.5% to 2%
Other Utilities Costs	0.5% to 1%
Car Park Requirements (every 1 basement / elevated car park for strata)	4% to 8%
Loss of Sellable Land / GFA (Open space, setbacks, reserves, facilities etc)	2% to 4%
Cross Subsidies - Bumiputera Quota Discounts	1.5% to 2%
Holding Costs - Unsold Bumiputera Quota Units	0.5% to 1.5%
Holding Costs - Delays in Approvals	0.5% to 1.5%
Submission Fees, Titles etc	0.3% to 0.5%
SUB TOTAL	12.8 % - 24.5%
Cross Subsidies - Affordable Housing (Land, Building & Other Costs)	#
TOTAL	12.8% - 24.5%

May vary from project to project due to factors like location, types, sizes and other applicable policies / compliance

Depending on policies

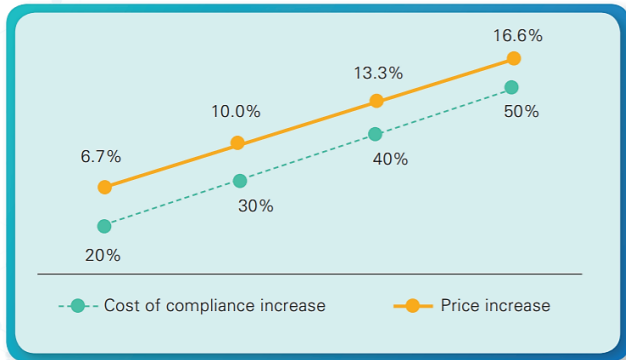


COMPLIANCE COSTS AS % OF GDV (CASE STUDIES OF ACTUAL PROJECTS)

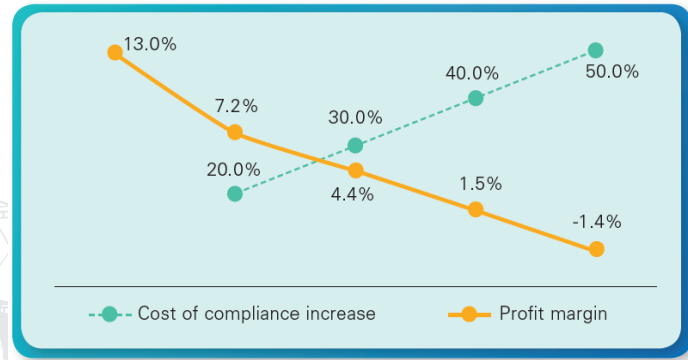




IMPACT OF INCREASED COMPLIANCE COSTS ON PRICES



IMPACT OF INCREASED COMPLIANCE COSTS ON PROFIT MARGIN





IMPACT OF VARIOUS COMPLIANCE COSTS

1. BUMIPUTERA QUOTA

Unsold Bumiputera Quota units still not released as of June 2020 (a sample of 136 developers)

Total units	= 6,121 units
Tied resources	= RM3.8 billion
Holding costs	= RM3.8 billion x 0.07 p.a x 3 years
(average 3 years)	= RM4.6 billion
Total holding cost	= RM4.6 billion

3. APPROVAL TIMELINES

Example : Township Development

Each day taken = Holding Costs
= RM95,000

One year approval timeframe
= RM 35 million in holding costs or 1% of GDV

2. SEWERAGE CAPITAL CONTRIBUTION (SCC)

Average Annual Housing Production	= 138,900 units
Malaysia's All House Price	= RM432,111
Annual GDV	= RM60 bn
SCC @ 1%	= RM600 mil p.a

4. REDUCED NET SELLABLE LAND

1990's Sellable Land	55%-60%	} Loss of additional 20%
2020's Sellable Land	40%-45%	

For each 100 acre development, loss of 20% land equals to:

- 20 acres of land loss due to additional land surrender
- RM10mil in land value
- 1,200 units of houses (loss of opportunity and lesser housing supply)
- An estimated RM540 mil in additional GDV (at RM450,000 per unit)
- Increased land costs per unit



04. CASE STUDIES

REDUCED COMPLIANCE TOWARDS LOWER DEVELOPMENT COSTS - CASE STUDIES OF DEVELOPMENT COSTS OF AFFORDABLE APARTMENTS

FIVE (5) CASE STUDIES:

CASE STUDY	STATE
Case study 1	Selangor (Rumah Selangorku)
Case study 2	Penang (Island - Private CSR Affordable Housing Project)
Case study 3	Wilayah Persekutuan Kuala Lumpur (RUMAWIP)
Case study 4	Wilayah Persekutuan Kuala Lumpur (RUMAWIP) includes low cost
Case study 5	Selangor (Rumah Selangorku)



DEVELOPMENT COSTS

ITEMS	CASE STUDY 1	CASE STUDY 2	CASE STUDY 3	CASE STUDY 4	CASE STUDY 5
A. IBS	RM136	RM212	RM61	RM115	RM113
B. Non IBS Items			RM75		RM8
A+B = Building Costs	RM136	RM212	RM136	RM115	RM121
C. Other Costs <ul style="list-style-type: none"> • Earthwork • Substructures (Piling, Pile Cap, Ground Beams) • Statutory Contribution (IWK, water TNB, ISF etc) • Road, sanitary, plumbing, TNB infrastructure • Preliminaries & other costs (application fees etc) • Foundation, carpark • Other Ancillary buildings (common facilities eg Surau, dewan etc) • Other costs (Finance charges, marketing, project operations etc.) 	RM98	RM66	RM95	RM67	RM67
A+B+C = Total Construction Costs	RM234	RM278	RM231	RM182	RM188
D. - Land costs <ul style="list-style-type: none"> - Conversion premium - Development Charges 	RM14	RM24	RM73	RM55	RM26
A+B+C+D = Gross Development Costs	RM248	RM302	RM304	RM237	RM214
E. Developer Profit Margin (PBT)	(RM48)	RM28	RM46	RM35	RM34
A+B+C+D+E = Selling Price psf	RM200	RM330	RM350	RM272	RM248
Selling Price per house (Controlled Prices)	RM170,000	RM300,000	RM283,500	RM217,600	RM244,000



ANALYSIS

Based on the previous case studies, the following are observed:-

- i. Subject to location of project which is a determinant factor of land costs, **the minimum cost per unit for the industry to develop a 800-900 sq ft private affordable housing apartment unit is around RM214 to RM304 per sq ft on a break even basis**, namely not inclusive of any profit margin.
- ii. **Building cost for most projects are around RM136 and above per sq ft.**
- iii. In cases where Government controlled prices are lower than development costs, **losses are absorbed by the development through a cross subsidy element, thus making a stand alone all affordable units development not feasible for the private sector.**
- iv. **Land costs per sq ft / per unit can be reduced if affordable housing is undertaken on government land.**
- v. **Land costs per sq ft / per unit will also reduce should the development be given higher density / plot ratio.** Assuming Case Study 1 is given a density of 120 units per acre instead, the land costs per unit would have reduced significantly by about 50% per sq ft / per unit basis, thus reducing overall development costs.



ANALYSIS (CONT'D)

vi. **Controlled pricing could lead to a loss and such loss will have to be cross subsidised by other open market segments of the development** (if it is not an affordable units only type of development), thus pushing prices of other units higher.

E.g. in Case Study 1, the losses of RM40,800 per unit will be funded by other housing segments (non price controlled units), within the same development, if any, or within other phases / developments or absorbed accordingly by the developer

vii. Capital contribution to utility service providers account to 1.5% to 2% of GDV. If price per sq ft is RM330 as in the case of Case Study 2, such contribution accounts to RM5-RM7 psf. It is noted that in Case Study 3, similar number, namely RM5 psf is recorded as statutory contribution. In addition, other utilities infrastructure imposed on the development also add to costs at additional 1.5% to 2% of GDV. **Any reduction in capital contribution / statutory contribution will help ease cost pressures.**

viii. Respondents also indicate that whilst use of **BIM will result in faster approval, the impact on GDV may be minimal.** For example, saving of timeline by 3 months over 48 months construction period translates to 0.3% reduction as a result of savings in administration/operations expenses. Correspondingly, Certificate of Completion and Compliance (CCC) must be speedily issued, otherwise time saving obtained would go to waste as vacant possession cannot be delivered.



REDUCED DEVELOPMENT COST (MINUS LAND & STATUTORY CONTRIBUTION)

ITEMS	CASE STUDY 1	CASE STUDY 2	CASE STUDY 3	CASE STUDY 4	CASE STUDY 5
A. IBS	RM123	RM194	RM61	RM115	RM113
B. Non IBS Items			RM75		RM8
A+B = Building Costs	RM123	RM194	RM136	RM115	RM121
C. Other Costs (a)					
• Earthwork	RM98 (-) RM5	RM66 (-) RM6	RM95 (-) RM5	RM67 (-) RM4	RM67 (-) RM5
• Substructures (Piling, Pile Cap, Ground Beams)					
• Statutory Contribution (IWK, water TNB, ISF etc)					
• Road, sanitary, plumbing, TNB infrastructure					
• Preliminaries & other costs (application fees etc)					
• Foundation, carpark	RM93	RM60	RM90	RM63	RM62
• Other Ancillary buildings (common facilities eg Surau, dewan etc)					
• Other costs (Finance charges, marketing, project operations etc.)					
A+B+C = Total Construction Costs	RM216	RM254	RM226	RM178	RM183
D. - Land costs (b)					
- Conversion premium	RM0	RM0	RM0	RM0	RM0
- Development Charges					
A+B+C+D = Gross Development Costs	RM216	RM254	RM226	RM178	RM183
E. Developer Profit Margin (PBT) (c)	RM24	RM28	RM25	RM20	RM21
A+B+C+D+E = Selling Price psf	RM240	RM282	RM251	RM198	RM204
% of Reduction of Selling Price psf	(20%)	15%	28%	27%	18%
Selling Price per house (Controlled Prices)	RM204,000	RM254,000	RM203,000	RM160,000	RM190,000

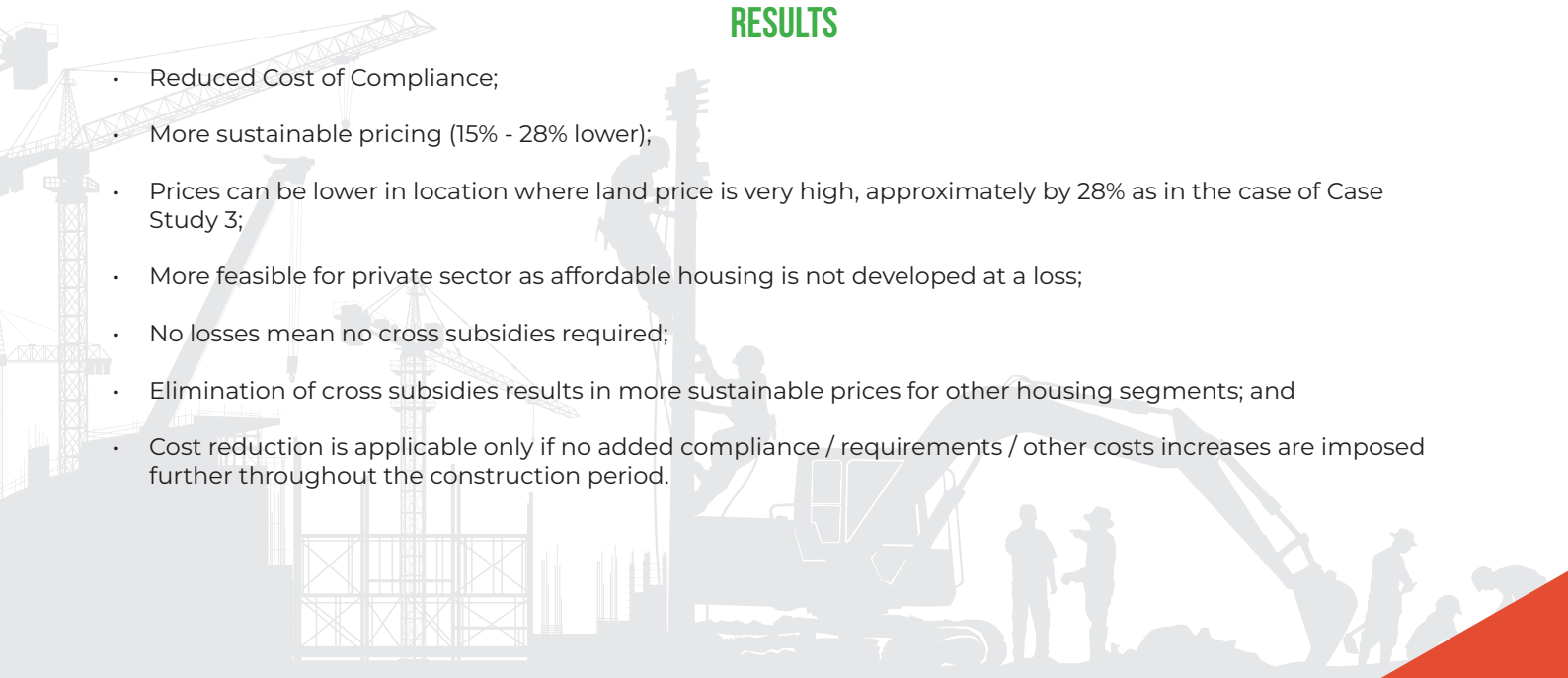
Assumption:

(a) Statutory contributions are reduced to 0; (b) Land costs are reduced to 0; (c) Profit margin at 10% of GDV



RESULTS

- Reduced Cost of Compliance;
- More sustainable pricing (15% - 28% lower);
- Prices can be lower in location where land price is very high, approximately by 28% as in the case of Case Study 3;
- More feasible for private sector as affordable housing is not developed at a loss;
- No losses mean no cross subsidies required;
- Elimination of cross subsidies results in more sustainable prices for other housing segments; and
- Cost reduction is applicable only if no added compliance / requirements / other costs increases are imposed further throughout the construction period.





05. RECOMMENDATIONS

TRANSFORMATIONAL RECOMMENDATIONS

03

THRUSTS

07

FOCUS AREAS

21

PRACTICAL SOLUTIONS



THRUST 1: REDUCE UNPRODUCTIVE COSTS

01

TRANSFORMATION IN TRANSPARENCY, SPEED OF APPROVAL AND STREAMLINING OF PROCESSES

1. Full digital property development system incorporating pre consultation, submission, approval and payment system
2. Local plans to be expedited and gazetted to reduce approval timelines
3. Self regulation - OSC 4
4. Payments - deposits, charges, fees to be made to an online payment centre - fees and charges for the whole process are calculated up front and paid online at the designated times

02

COST BENEFIT ANALYSES FOR PROPOSED NEW COMPLIANCES

5. Cost benefit analyses for all new compliances



THRUST 2: MINIMISE CROSS SUBSIDIES

03 AFFORDABLE HOUSING

6. Provision of affordable housing for B40 and M40 should be undertaken by the public sector – through targeted rental and ownership public housing programmes
7. The private sector may pay contribution in lieu
8. Developers voluntarily building market driven affordable housing units shall be exempted from paying such contribution.
9. Government through State Housing Board, SEDCs to buy existing unsold affordable units

04 BUMIPUTERA QUOTA & DISCOUNTS

10. Bumiputera discounts shall remain, but quota for Bumiputera buyers shall be kept at a maximum of 30%
11. Bumiputera discounts to be capped at specific ceiling price
12. Government to buy existing unsold Bumiputera units

05 UTILITY SERVICE PROVIDERS TO BEAR OWN COSTS

13. Utility service providers to bear own capital costs



THRUST 3: OPTIMISE LAND/GROSS FLOOR AREA EFFICIENCY

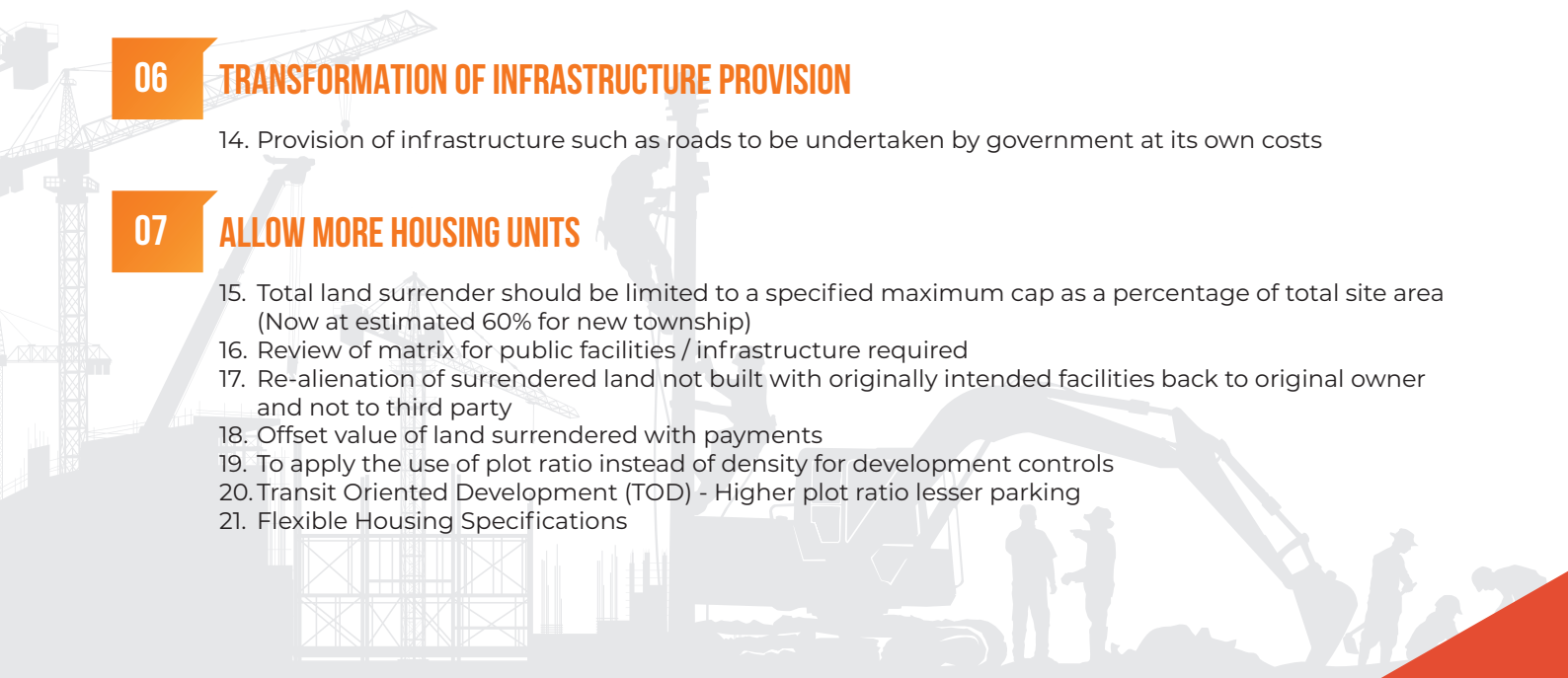
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TRANSFORMATION OF INFRASTRUCTURE PROVISION

- 14. Provision of infrastructure such as roads to be undertaken by government at its own costs

07

ALLOW MORE HOUSING UNITS

- 15. Total land surrender should be limited to a specified maximum cap as a percentage of total site area (Now at estimated 60% for new township)
 - 16. Review of matrix for public facilities / infrastructure required
 - 17. Re-alienation of surrendered land not built with originally intended facilities back to original owner and not to third party
 - 18. Offset value of land surrendered with payments
 - 19. To apply the use of plot ratio instead of density for development controls
 - 20. Transit Oriented Development (TOD) - Higher plot ratio lesser parking
 - 21. Flexible Housing Specifications
- 



IMPACT OF RECOMMENDATIONS

1

A more efficient approval system

2

Transformation towards self-regulation

3

A more sustainable cost increase

4

A halt to increased imposition of new compliance

5

A shift of social housing provision to public sector

6

A more mutually beneficial Bumiputera housing policy

7

A more targeted Bumiputera discount

8

A revised business model for utility service providers

9

A thoroughly reviewed planning requirement

10

Transformation of planning controls

11

Higher density / higher gross floor areas

12

Transit Oriented Development (TOD)

13

Flexibility of smaller sized units

14

A more financially feasible project

02. CONCLUSION



- ◆ **Reduction of overall costs** of doing business in property development will help **lower housing costs** and **sustain prices at a more affordable level.**
- ◆ **Conscious efforts** must be made towards a structural reform to effectively lower costs to ensure more sustainable house prices in the future and such efforts shall include:-

(i)

MINIMISING APPROVAL TIMELINES THROUGH SELF REGULATION VIA CONSULTANTS

Automatic approvals in principle based on preset requirements / compliance of guidelines will improve speed to market, minimise delays and holding costs as well as eliminate elements of corruption. This should apply at all levels of approvals.

(ii)

REMOVAL OF CROSS SUBSIDIES

Removal of cross subsidies will ease the pressure on costs and prices and results in fairer prices for the buyers of market driven housing segments.



06 CONCLUSION (CONT'D)

(iii)

GOVERNMENT MUST BE RESPONSIBLE FOR SOCIAL PUBLIC HOUSING

The role of social public housing provision must be reverted to the Government. This will allow the private sector to focus on market driven products, including market driven affordable housing for the general *rakyat*.

(iv)

SETTING OFF VALUE OF SURRENDERED LAND WITH OTHER PAYABLE CHARGES

Value of such surrendered land is to be set off against other charges payable to the state / local government including conversion premium, development charges, improvement service fund and etc.

(v)

APPLICATION OF PLOT RATIO IN PLANNING CONTROLS

Plot ratio should be the way to go moving forward to ensure a more efficient land use of urban land and at the same time provides the flexibility in terms of sizes and designs to suit market demand.

(vi)

ANY NEW INTRODUCTION OF COMPLIANCE SHALL BE STUDIED AND ANALYSED IN DETAIL

To ensure minimal impact on costs and this shall be undertaken in consultation with industry players



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