

The housing market: its weaknesses and how they can be overcome

by Denis H. Camilleri, Eur. Ing, A&CE

This is the first part of an article identifying the main weaknesses in the local housing market and putting forward possible solutions

THE CLASSIFIED section of *The Sunday Times* in the past weeks has highlighted weaknesses in our local housing market. Interesting articles have appeared dealing with the effect of foreign buyers, housing policy, homelessness, affordable housing together with the rental market discussion spilling over into the correspondence pages.

This neo-forum on housing has been instrumental in the creation of pressure groups due to the lethargy of various governments to right a wrong, while encouraging an inefficient property market to function, instead of altering the antiquated emergency rent laws.

Rental matters

Below is a table giving the equated yields for properties leased out at an initial yield of 4%, with indexation of rental values occurring over various specified periods. This indexation is calculated according to the index of inflation and/or the income profile of both the occupants and the investors. The present tendency is for the inflation rate over the years to average 2.5%, while the median earnings/employee percentage growth rate has averaged 4.8% over the period 1980-1994 and 8% over the period 1988-1994.

However, a slowdown in wage inflation has been in evidence since 1996, despite the acceleration in nominal GDP growth – this growth has fallen from 7% in 1996 to 4.4% in 1998. As rental value is linked to the income profile, a mechanism would have to be established depending on the median income growth and inflation rate to arrive at an index-linked rent.

These equated yields are to be compared with the present 5.9% medium-term Government bonds. Only at an assumed inflation growth of 2% is the assumed yield from

rentals, less than the safe Government bonds too. As a form of incentive, Government ought to regulate that income from rentals be free from income tax and capital gains.

Housing Authority rental incentives

The Housing Authority has issued two schemes to stimulate the private rental market. The first is aimed towards the tenant, while the second is aimed towards the owner of vacant properties.

The first scheme, dubbed *R*, is a subsidy on rents to private residences totalling Lm315 p.a. It is open to unmarried people living alone, single or separated people living with a direct relative, a person living with brothers or sisters and married couples who already have a written agreement with the owner of the dwelling.

The annual income of applicants must not exceed Lm5,000 in the case of families of five or more. In the case of married couples who both work, half the income of the lower will not be considered. Income from social benefits is excluded.

For single people an accommodation space area of 60 sq m should suffice.

Valuing such a residence at Lm14,000, at 4% rental value works out at Lm560 p.a.

So tenants earning less than Lm5,000 p.a. would have to fork out (Lm560-Lm315) Lm245 p.a., approximately Lm20 monthly. From the 1995 census a total of 7,462 single people exist, being 15% of the total households, of whom 57.3% are below the poverty line, the majority being women in the ratio of 1.5:1. These people would not be able to afford the required shortfall of Lm20 monthly and would have to go for sub-standard accommodation.

A family of five would require an accommodation space of 105 sq m. Valuing such a premises at Lm21,000, at 4% rental value, works out at Lm840 p.a.

So a family earning about Lm5,000 p.a. would have to fork out (Lm840-Lm315) Lm525, approximately Lm45 monthly. From the 1995 census 24% of households are below the poverty line at Lm2,000 p.a., while 62% earn below Lm5,000, increasing to 78%, for those families earning below Lm7,000.

Considering the present family expenditure necessary for ordinary expenses excluding house rent and hire purchase installments to be Lm275 monthly, then the above family of five would have to earn a minimum of Lm350 monthly, Lm4,200 p.a., to fork out the rent differential.

Regarding the census "Distribution of Maltese households by Income", it is known that gross understatements of household income exist. Considering the present housing situation, it has been calculated that the median wage for a family with a three-bedroom apartment is at Lm8,000, while with a two-bedroom apartment it is Lm5,000, as compared to the census value of Lm4,700.

These figures could give an indication of the amount of the informal black economy amongst the median wage earner. Considering that the modal house type at 42.54% of total dwellings is the terraced house, with a high price/earning ratio of 12.6 as opposed to the median apartment with a price/earning ratio of 7.6, the problem escalates further.

The Planning Authority has found that since 1993 out of the 4,000 dwellings approved annually most types are apartments, with the maisonette type increasing in importance over the years, while the terraced house has declined substantially over the same period. As the number of households is only increasing by an average of 1,500-2,000 households, a surplus of 2,500 dwellings annually is being provided.

It is most probable that the under-declaration of income is greater in the multi- than in the single households, where the majority are below the poverty line. A system has to be worked out whereby Government benefits really go to the households in need. Stefan Buontempo in his article appearing in *The Sunday Times* of March 14 made a point regarding local homelessness quoting the 1995 census with 7,731 sub-standard or inadequate housing constituting 6.5% of the permanent residences occupied all year round. He then mentioned 360 separated persons who for reasons beyond their control still share the same

dwelling with their separated partner, 900 extended families who still share a dwelling with others, and over 1,100 persons in institutional facilities who would like to have a home of their own.

Reference is also to be made to Fr Charles Cini's articles, the case studies in which really drive the point regarding homelessness in Malta.

Caritas together with *Discern* are carrying out a study of the various forms of poverty found in Malta. It would be helpful if this survey could highlight housing and poverty, as an in-depth study is required in this area.

The second scheme, *T*, subsidises improvement works on vacant properties, where the owner decided to rent them for at least 10 years to Maltese people. When the applicant is the owner, the Housing Authority may give a grant of up to Lm1,800 and a loan of up to Lm5,000 at an interest rate of only 3.5% p.a. When the applicant is the prospective tenant, he will be eligible for a grant of up to Lm2,500.

Good return on capital

The approximate calculated refurbishment costs for an old derelict premises of 115 sqm floor area at Lm45/sq m is Lm5,175. Government is thus covering approximately 45% of the required refurbishment costs, an appreciable amount. From the above table of equated yields the average return from rent earnings approximates to 7.25%. Developers by availing themselves of the Housing Authority's Scheme *T*, would thus be earning a higher return.

Considering the additional capital annual growth of affordable housing at 7.9%, this type of investment ought to be considered also from institutional investors who would be getting a good return on their capital invested, while at the same time showing a humane understanding to a present social problem. The legal framework needs to be overhauled to entice new investors into this emerging market.

The chairman of the Housing Authority has mentioned the social housing problems as having a bottomless pit. Applicants request alternative accommodation instead of repairs being carried out to their substandard and even dangerous accommodation. If people are moved out of old buildings, these same buildings will get squatted by another family, knowing that the quickest way to be reallocated is to live in substandard or dangerous housing.

The problems in the Valletta/Cottonera

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Table of equated yields with a 4% initial yield

Inflation/Income growth rate	Rent review frequency (years)		
	3	5	7
2%	5.92	5.8	5.78
3%	6.89	6.7	6.66
4%	7.85	7.71	7.59
5%	8.82	8.65	8.47

Housing Authority must give the example

(Continued from page 1)

regions are not just urban decay but also social decay. The problem cannot be solved wholly by the Housing Authority, but a holistic approach is required involving the Social Services Department and the police force.

Regarding the amount of floor areas dished out by the Housing Authority, a policy must be set up whereby a family obtains accommodation depending on its requirements.

The Housing Authority must give the example thereby influencing the private developers that we have to be sparse in the utilisation of our scarce land availability.

The apartment layout submitted in the chairman's article of April 11, is too generous on floor areas,

thus being uneconomical on land use, and further worsening the affordability problem, due to high rental or capital values. The Housing Authority is now to market 20% of its developments, as one- or two-bedroom units.

From the 1995 census the following information is obtained regarding the 35,723 vacant dwellings.

From this table it is noted that only a fifth of the vacant premises of which over two-thirds require repair or are in a bad condition, are found in the Inner Harbour Region, where all types of social problems co-exist.

Ignoring the Northern and Gozo Regions, as a high percentage of vacant dwellings here are summer residences, a third of the vacant dwellings are in the Outer Harbour,

South-Eastern and Western regions.

These regions being close to the Inner Harbour Region should offer suitable alternative accommodation to families in depressed areas. The number of dwellings excluding summer residences in these regions totals 9,285 dwellings of which a third are newly constructed.

A total of 6,500 dwellings requiring some form of repair should be sufficient to provide annually the extra 400 dwellings quoted to service a rental market. Developers ought to identify such areas which satisfy housing requirements for a depressed sector of the population, while at the same instance obtaining a decent return on their investment.

(To be concluded)

Region	% of total	% newly constructed	% good state of repair	% require repair	% bad condition	% summer residence	% non summer residences
Inner Harbour	21.17	8.88	18.43	36.99	38.63	3.83	31.12
Outer Harbour	15.23	13.24	15.19	17.61	15.37	5.52	20.79
South Eastern	12.47	10.51	13.83	12.35	9.36	15.50	10.74
Western	5.91	4.96	4.50	9.15	10.36	0.50	9.02
Northern	28.20	41.10	32.20	8.54	10.75	50.86	15.21
Gozo	17.00	21.29	15.83	15.34	15.51	23.89	13.07
	100.00	100.00	100.00	100.00	100.00	100.00	100.00

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Property yields and costs

THE ASSOCIATION of Estate Agents is promoting more affordable housing in the Lm18,500-Lm22,500 range, in what were previously considered summer resorts like Bugibba, Marsascala and Birzebbuga. They are rightly advocating better up-market two-bedroom developments, not a hybrid resembling a stretched out three-bedroom. The market value rates for average floor areas in these localities averages out at Lm230/sqm, just above the median market rate for the Maltese Islands at Lm220/sqm. The buyer has to decide on the amount of floor area that suits his/her requirements. However if s/he decides that a 50 sqm two-bedroomed apartment suits his/her purpose, for such a small area the market rate would average Lm320/sqm, as for small premises the linear relationship between floor area and market value rate does not hold.

A minimum premium must always be paid for any type of residential premises, increasing according to the amount of accommodation area provided, although not in direct proportion (another area for a dissertation project to establish an equation for the Maltese property price tag). The buyer could end up purchasing a 70sqm apartment for the same sum.

It is strange how the Central Bank quotes the price/earnings ratios for apartments and maisonettes in shell form. This type of market is easing out due to the erosion of benefits to DIY enthusiasts, as young couples are better off earning hard cash and purchasing completed premises. The savings in the finishings tend to minimise as the percentage amount of finishes in the purchase price has been eroded due to the prevailing high land value. Economies of scale also tend to favour the completion of a total development, in lieu of being worked out on a piecemeal basis. It might be worthwhile for the DIY enthusiast presently to refurbish vacant derelict premises. There should be 400 such premises available annually for sale.

The previously mentioned price/earnings ratio at 12.6 for terraced houses and 7.6 for apartments are too high. Internationally mortgage lenders provide finance up to two or three times the head of household's gross annual earnings. It is expected that average house prices would rarely exceed three to four times the level of average wages. Price/earnings ratios fluctuate from about 2.5 in times of a slump, up to five during a boom. The high price/earnings for Malta indicate that they seem to come out of some other, richer economy with far higher salaries.

Foreign purchasers

It is difficult to arrive at the best measures to be imposed for such real estate sales. A comparison with the Sixties is superfluous due to the changed economic climate, which has made tremendous strides forward. The population in the mid-Sixties stood at 3.14 million, yielding a population density of 995 persons per square km, while in the late Nineties it is at 3.78 million, with a population density of 1,200 per square km.

The annual number of tourists has also increased by over a million. Together with the increased standard of living, the infrastructure is being overstretched. The type of settler that was beneficial to Malta in the Sixties would be different for the new millennium. With the hubbing principle suiting Malta, one cannot afford to dispose cheaply, considering the limitation of land area. The time has come to hide behind exclusivity in real estate, although presently Malta is not yet an exclusive destination. The designs to the proposed new developments at Manoel Island and the Cottonera project and other desig-

In the second and concluding part of his article DENIS H. CAMILLERI, Eur. Ing, A&CE, discusses various facets of the local property market

nated areas are to be way above the normal local standards, to compete for an exclusive market.

The property market works in strange ways as other markets also do. It is not so easy to conclude that the foreign market has not increased our property prices. Markets are nothing more than day-to-day measures of crowd psychology, which applies remarkably well to business cycles and speculation.

In a mass ambience, actions and emotions are so infectious that individual preferences are frequently sacrificed for those of the group. Furthermore, the mass is in a state of perpetual expectancy, rendering it particularly susceptible to influence and can easily be fooled. The mass is unresponsive even to irrefutable logical connections; it does not operate on a sophisticated level. In this age of globalisation, panic seems to travel internationally more through psychological conduits, than through any other source.

The amount and frequency of information available to and impacting on all market participants is far greater than in earlier lower-tech times. In general, both analysts and market participants may do well to look to the masses and behavioural patterns which overlie the real fundamentals in order to gain insight into likely future developments. The number of settlers, having obtained annually less than 500 permits, averaged over the past decade, is not too high, apparently, to affect the local housing market.

This of course misses the point that the perception alone of large numbers of wealthy buyers is quite sufficient to precipitate a boom. The real numbers are of lesser significance than the perceived reality in terms of expected profits and opportunities for speculation.

Regarding the benefits that the Maltese have obtained from foreign settlers, the other side of the coin must also be considered. It is known that a few settlers who purchased their villas in the late Sixties for Lm12,000 sold them in the mid-Nineties for a quarter of a million liri.

Financing costs in housing investment

The property market is unique, for in no other type of investments are loans available up to 80%, 90% or even 100% of the capital value. This high rate of borrowing leads to a volatile market, creating in turn the booms and slumps, characteristic of the property market. The banks' newspaper features on their available house loans do not divulge much more information than what is regularly advertised.

The person investing in his/her house, nowadays expects more information. S/he needs to be convinced that home ownership is still one of the best forms of investment available. Nowadays various investment facilities are available from Malta, so the potential home-owner may rightly decide that s/he would be better off investing outside housing. House loans from different banks will soon be competing at the same level, as it appears that the interest rate subsidy from the Housing Authority would be available to all. This all drives towards the point that the banks ought to be more aggressive in marketing their services.

The first point to be mentioned is that studies have shown that as the rates of return on housing improve, the higher the amount of the purchase price borrowed. This remains true provided the return from property is higher than the borrowing rate. This has been shown to be true for a period from 1982-1997 ("Housing Affordability in the Maltese Islands", *The Sunday Times*, February 14) with housing return given at 10.7% and borrowing costs averaging seven per cent. For a purchaser borrowing as much as 80% of the value of the property, the return increases to 16% p.a., as compared to a property purchased outright with no loan facilities availed of, whence the return remains at 10.7%.

Studies confirm that the amount of borrowing adds to the return while at the same time adding to the risks involved. A return of 16% p.a. compares very favourably with the various local investment funds which quote returns received over a minimum of a five-year period rarely exceeding 16%.

A second point regards the purchasing costs, for example a two-bedroomed apartment at Lm15,000. A 75%, 30-year house loan, would involve a total expense including down-payment, purchase fees and interest payments over the years of Lm31,425. At an assumed property growth rate of six per cent p.a., over the coming 30-year period, this apartment would then be assumed to have increased in value to Lm86,000.

Similarly for a three-bedroomed apartment purchased at Lm27,000, the total outlay over a 30-year period totals Lm59,370, while its market value in 30 years' time is assumed at Lm155,000.

A third point to be looked into is equity release for older home-owners. The Maltese population is aging and with growing home ownership, an increasing proportion of older people in the future will find themselves house-rich and income-poor. Again recently the provision of sheltered housing for the elderly has cropped up, against the present old people's home-cum-hotel in their locality.

However, most older people wish to remain at home. This points to the possibility of releasing housing wealth by borrowing against home equity. This scheme applied successfully in New Zealand, where the average age at the start of the equity release was 74, increased the applicants' income by 20%. Before embarking on equity release clients had found life financially difficult.

Further discussions regarding deregulation of banking services is expected. Once Malta joins the EU, mortgage facilities would be available over the Internet where shopping to acquire the most favourable rates would be possible.

Property insurance matters

Now that state pensions in 30 years' time would only help the aged to sustain their bare essentials, private investments are to grow in importance. For most people their major life-long investment will be their home. From above workings by stripping part of their residential asset, in their older age, by moving to a smaller residence, a capital gain of Lm95,630 (Lm155,000-Lm59,370), may be made in 30 years' time,

equivalent to Lm16,500 at today's prices.

If the importance of home ownership as part of a personal portfolio investment is to increase in the coming years, then this investment has to be risk free. Home Insurance policies help reduce this risk.

A feature in the *Classified* Section on March 21 described the cover obtained against natural perils and how to secure against the unexpected. The insurable value of property was defined as composed of rebuilding plus demolition costs as being distinct from the market value. The Association of Insurance Companies should issue easy to follow guidelines whereby an individual may calculate an adequate insurance cover for his/her particular building type, by citing simple properties, such as floor areas. Under-insured premises have a false sense of security, as during a claim the average clause will apply, while no benefits are obtained by over-insuring premises. For the same premium amount, the insured would be better off by insuring for other uninsured perils, hence reducing the risk further.

In future, due to the increased importance of one's residence as an investment medium, other insurance policies may emerge on the market. Such policies could insure property owners against mortgage rate hikes, unemployment or may even safeguard the market value of a property. Such policies would tend to shift the onus of market risk from the property owner onto the insurance company.

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Property management education

From the above, it is apparent how complex property management is for the local market. The discussions have until now only centred mostly on the residential market, although in the correspondence pages reference has also been made to the outdated leasing laws of commercial premises. Up to the present stage, we have managed with half guided professional advice. However, with the advent of globalisation, which is already reaching our shores, together with the evolving hubbing principle, property is an important element of the nation's wealth.

It is opportune for our University to introduce a course dealing in general practice of estate management. The course would be of use to quantity surveyors, property investment consultants, estate agents, housing officers and planning and development officers.

Next, an index covering the whole spectrum of the local property market has to be constructed. This index is to be related to real sales of property occurring compiled by property professionals, having a feel and understanding of the peculiar mechanics of the local and international property market.

The Chamber of Architects and Civil Engineers, aware of the present and past inertia towards Malta's housing problems feels that its contribution towards Maltese society is required. Late in November a seminar dealing with "Malta's Housing Dilemma" is to be organised. For further information send an e-mail to dhcamilleri@waldonet.net.

It is expected that average house prices would rarely exceed three to four times the level of average wages