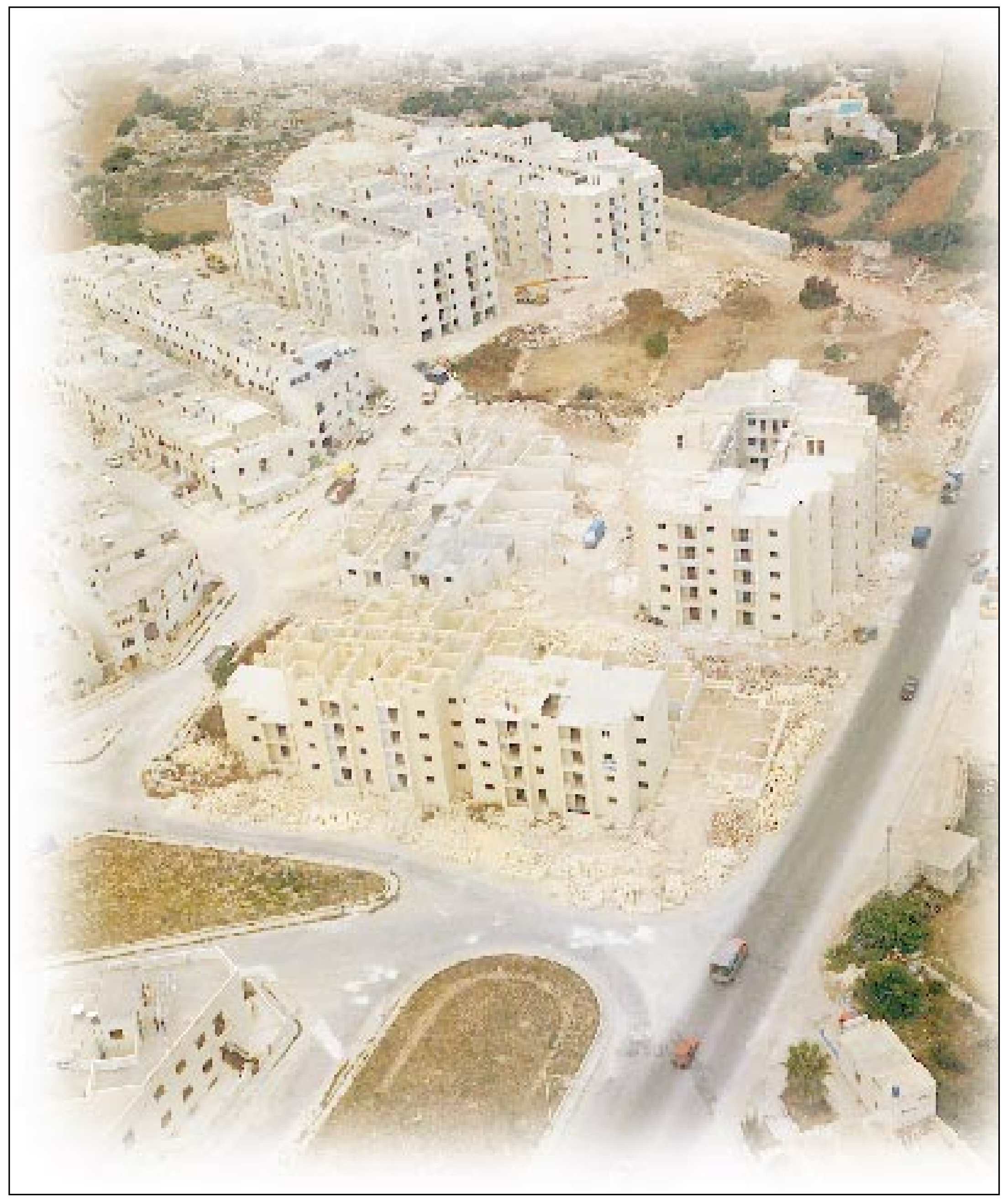


Housing affordability in the Maltese Islands

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

This is the first part of an article on the main findings on improving housing affordability in Malta, as listed in the MCB University Press Internet Conference on Housing Affordability sponsored by the Journal of Property Valuation and Investment, hosted from September 1 to December 15, 1998. Further explanations of these findings may be obtained from the discussion papers or postings to the conference, referenced to by date order, obtainable from Web site www.mcb.co.uk/sevices/conferen/sept98/ha/. This conference evolved from feedback obtained from the article "Housing affordability in Malta" carried in The Sunday Times of November 9, 1997.

THE FIGURES for 2007 were assumed taking into consideration Malta's prevailing high inflation rate and low unemployment rate as compared with those prevailing in the EU together with assuming Government's commitment to reactivate the dormant private rental market. Sustainable home ownership in advanced economies is being assumed at 71% over the next decade.

Affordability is generally considered from the household's perspective, but if the required increase in housing supply is to be forthcoming then housing also has to be profitable from the builder's point of view. Very low-priced housing may improve affordability, but if the price implies losses to the builder, no new homes will be built. By definition, sustainable owner-occupancy has to be consistent with both affordability and profitability.

Table 1 – % type of tenure for the Maltese Islands

Year	1948	1957	1967	1985	1995	2007
Owner-occupied	23.1	26.1	32	53.9	68	74
Rental	76.9	73.9	68	46.1	32	26

Table 2 – Market value rates in Lm/m² for the median Maltese apartment (in-house valuations) in areas sought by first-time buyers

Year	1982	1987	1992	1997	2007
Rate	70	91	150	220	448

From regression analysis the growth rate over the 1982-1997 period has been calculated at 7.9%. This growth rate is for affordable apartments; other types of exclusive property may be assumed as yielding higher growth rates. Affordable apartments are assumed to increase by 108% in the next 10 years at a reduced growth rate of 7.2% a year, if adequate housing policy adopted over this decade.

Gross Housing Return
7.9% (growth) + 4% (rent) - 0.65% (maintenance and depreciation) = 11.25%.
On decapitalising purchase charges this goes down to 10.7%.
Net Housing Return 10.7%-4% (inflation rate) = 6.7%

Comparatively, this net rate of return over the 15-year period outperforms most investments on the international market. Equities averaged a net return of 9.58%, but are considered a high risk. Housing is seen as a low-risk investment. Comparisons should also be carried out with the local listed securities, most of which have been in existence for less than five years.

When borrowing is considered on house purchase, the following rates of return are obtained.

Table 3

Year of purchase	Mortgage rate	Property return	50% gearing	80% gearing
1982	8%	11.25%	11.87%	12.33%
1997	6% (subsidised)	11.25%	16.50%	32.25%

The higher the initial rate of gearing, the higher the rate of return, confirming that borrowing to purchase property raises the rate of return on the capital invested; however risk increases with the greater amount of borrowing.

As an example consider a venture with a 10% expected return, however with the actual return rising by 100%.

Cost of venture	Lm100	expected at 10% =	Lm10 actual return	Lm20
Borrowing	Lm70	interest at 8% =	Lm5.60	Lm 5.6
Profits			Lm4.40	Lm14.40

With the return from the venture rising by 100%, the equity income, namely Lm14.40, has risen by 227%, from the previous Lm4.40 return. Thus are fortunes built. But the obverse is also true and thus are bankrupts made.

Housing Affordability Index (HAI)

This is the ratio of median family income to the income required to qualify for a loan on a median-priced existing family residence. Qualifying income is a function of the mortgage interest rate, mortgage terms and lending requirements. It is assumed that a family may spend not more than 25% of its monthly income on housing payments.
An HAI = 100, signifies that a median family just qualifies for a median residence.
An HAI > 100 signifies that the family may purchase a residence more expensive than the median home.
AN HAI < 100 signifies that the median family has to do away with other necessities.

Table 4

YEAR	MORTGAGE monthly payment		MEDIAN family income	QUALIFYING monthly income		RATIO qualifying family income		HAI	
	3-bed/r	2-bed/r	3-bed/r 2-bed/r	3-bed/r	2-bed/r	3-bed/r	2-bed/r	3-bed/r	2-bed/r
1982	Lm60	Lm42	Lm167	Lm240	Lm168	1.45	1.00	70	100
1987	Lm69	Lm49	Lm211	Lm276	Lm196	1.30	0.95	76	108
1992	Lm108	Lm72	Lm266	Lm432	Lm288	1.65	1.10	61	92
1997	Lm165	Lm106	Lm301	Lm660	Lm424	2.25	1.40	46	71
2007	Lm340	Lm241	Lm565#	Lm1363	Lm965	2.45	1.70	41	58

The earnings/employee percentage growth rate is taken at 6.5% over the next 10-year period

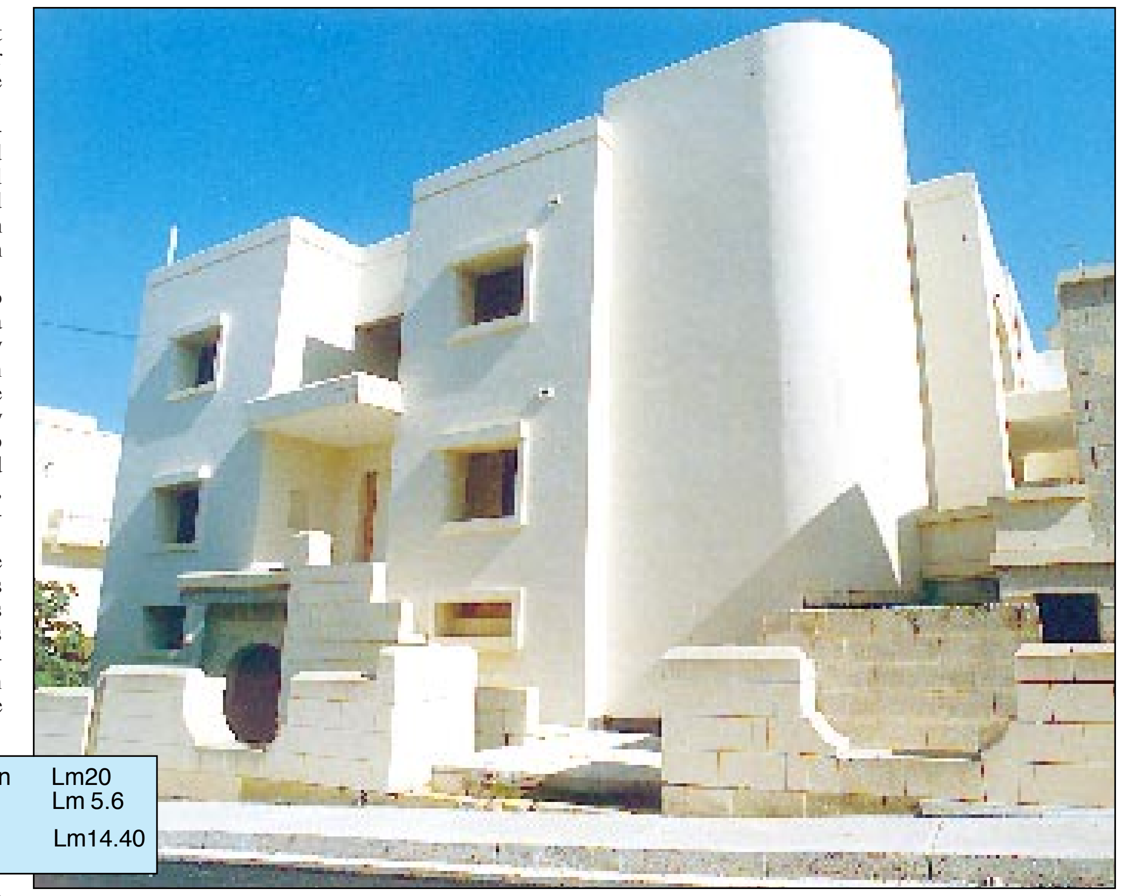
For a three-bedroom apartment, this index has slid from 70 down to 46, while forecast that over the next ten-year period, it will drop further to 41. The ratio only showed signs of improvement between the five-year period 1983-1987 with an increase from 70 to 76.

For the two-bedroom apartment, this index also slid from 100 down to 71, while forecasting that over the next ten-year period, it will drop further to 58. The ratio again showed signs of improvement between the same period, 1982-1987, with an increase from 100 up to 108. It appears to be the only period under which two-bedroom apartments were affordable for first-time buyers.

It is strange how the only improvement obtained in the HAI occurred during an economically depressed period for Malta, when a wage and overtime freeze was in operation in Malta and jobs reserved for the main bread winner.

The property market had reacted to this depressed period, causing a reduction of demand for property by lowering prices. This reduction in property prices was also aided by the prevailing Housing Subsidies, mainly the provision of home-ownership plots at nominal prices and reduced interest rates for home borrowing, depending on the income of the individual

Recently the Association of Estate Agents (Malta) stated that there has been a 14% slump in property sales since 1993. This statement confirms the above in the decline of HAI figures. And the relationship between house prices and transactions is to be noted.



Potential buyers are aware of an economic shock before sellers, since the direct effect of a shock has an immediate impact on the budget constraint of buyers, while the asking prices of sellers are not flexible and tend to be backward looking in a slow market.

However no homelessness exists in Malta, it seems evident that dependent children are well looked after, (schooling, clothes together with the other requirements), so one really has to conclude that the median family wage is really the qualifying family income.

Table 5 – median family wage for 1997

For a **3-bed/r** this works out at Lm660 × 12 months, i.e., **Lm8,000**
For a **2-bed/r** this works out at Lm424 × 12 months, i.e., **Lm5,000**

In the 1995 Malta census, from the distribution of Maltese households by income, the median annual income is calculated at Lm3,932, with the poverty line assumed at half this value. Only 35% of families are said to earn over Lm5,000, while only 19% are said to earn over Lm8,000.

Again, from the census only 18% of households live in apartments; the majority living in better accommodation, with the Maltese model house being the terraced house at 47%. This means that, on extending the housing affordability principle further, it is very true that potential understatements exist to the quoted household incomes, and should be used carefully.

What must be addressed is the falling quality of life for the Maltese family, to survive by modern standards, two and a quarter median jobs currently are being required for a median priced 3-bed/r apartment, with one and three quarter jobs required for a 2 bed/r apartment.

A real work culture has evolved which could eventually erode all principles. Couples will postpone marriages or decide to co-habitate, and decide to have children later due to housing commitments, together with other social problems ensuing.

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Housing social policy

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A housing policy with a human face – to leave the right to shelter to an anonymous market – would not be right, nor correspond with the UN recommendations. In Malta those living on the poverty line have to be identified since they require housing subsidies, while Government intervention is required to achieve sustainable housing tenure for improvements to be gained in the Maltese family's quality of life,

A study from the US census of 1993 on the effects of policy changes on affordability of a modestly priced home, with current fixed rate 30-year mortgage being 5% down, a 7.17% interest rate and no subsidy, revealed that the percentage of renters who could afford to buy were as follows:

Surprisingly, decreases in the mortgage interest rate of less than 3%, compared with the prevailing rate, had no significant effect on the number of renters, who would have qualified for a mortgage. A more effective option is a down payment subsidy. Renters are considered at the bottom of the property ladder, as whereas only 11% could afford to purchase a modest house, in the case of home owners, 73% could afford to relocate to a modestly priced house.

Malta's apartment accommodation area at 135 m^2 for a three-bedroom and 90 m^2 for a two-bedroom appears oversized compared to other countries, except for the US. Social housing in Germany provides for one person – 45 m^2, two persons – 60 m^2, three persons – 75 m^2, four persons – 90 m^2, and 15 m^2 each for additional persons.

More realistic space standards for future social housing development would help to improve the HAI.

Utilisation potential of vacant dwellings

From the 1995 Malta census only 77% of dwellings are occupied, with the other 23% either partially used or vacant. Further subdivision classifies these vacant dwellings into partially used (summer residences) at 8.4% and vacant at 14.7%. Of these, 29.5% are defined in need of substantial repairs and 9.5% as derelict, which are likely to be of sub-standard size.

From previous studies on vacant dwellings, it is assumed that that number of dwellings that may be made available to be placed on the housing market approximate to 4.1% of 155,202 (number of total dwellings) = 6,363 dwellings.

The present Malta population, as at the 1995 census, is given at 378,132, with an annual intercensal growth of 0.9% over the past 10 years. If the population growth rate over the next period is taken at 0.75%, then the expected population in 2007 is expected to be 413,603.

If the model family size in 2007 is taken at 2.8 persons, then the number of households in 2007 is estimated at 413,603/2.8 = 147,715 households (from 1995 census given at 119,479, which gives an increase of 28,236 households by 2007). Assuming 98% of these future households are to be housed in single households, then the number of dwellings required in 2007 is estimated at 147,715 by 0.98 = 144,760 dwellings.

According to the 1995 census, the total number of dwellings available stands at 155,202, with 35,723 vacant or partially used. The occupied dwellings currently work out at 119,479. Of these 32,862 are rented out, an additional approximately 3,000 households on a free rent with the remaining 83,617 dwellings owner-occupied.

If the owner-occupied sector were to increase to a sustainable 74% level by 2007 0.74 of 144,760 = 107,122 owner-occupied dwellings

0.26 of 144760 = 37,637 rented out dwellings, which includes 2000 free rentals, still assumed to exist in 2007.

This entails extra dwellings required as follows 107,122 - 83,617 = 23,505 extra owner-occupied dwellings.

37,637 - 32,862 - 2,000 (free rent) = 2,775 extra rented dwellings.

Once the proper rental climate is in place by the year 2000, an approximate number of rented dwellings of 400 annually would have to be placed on the property market, while for the owner-occupied sector, an additional 2,350 residences have to be provided annually over this ten-year period. This total figure of future dwellings required at approximately 2,750 per annum is close to the figure of 2,920 quoted in the Malta Structure Plan Survey report dated 1990.

(To be concluded)

Table 6 – A study from the US Census 1993

current mortgage requirements	11.4%
2.5% down payment	12.7%
no down payment	14.4%
interest rate 1% lower	11.7%
interest rate 2% lower	12.0%
interest rate 3% lower	12.3%
$1,000 down payment subsidy	12.5%
$2,500 down payment subsidy	14.4%
$5,000 down payment subsidy	25.8%
$7,500 down payment subsidy	32.5%
$10,000 down payment subsidy	36.4%

Table 7

COUNTRY	USA	UK	FRG	GDR	N'LAND	FRANCE
(Flr area – m^2)	149	89	99	63	101	105

THE SUNDAY TIMES
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FEBRUARY 21, 1999

Housing affordability in the Maltese Islands

Reactivating the dormant private rental market

The second and concluding part of an article by DENIS H. CAMILLERI, Eur. Ing., A&CE, on the main findings on improving housing affordability in Malta, as listed in the MCB University Press Internet Conference on Housing Affordability, sponsored by the Journal of Property Valuation and Investment, and hosted from September 1 to December 15, 1998

Table 8

Maltese tenure for 1990

Owner-occupied	60.1%
Private rented	29.2%
Social rented	10.7%

THIS TABLE appears to suggest a healthy private rented market at 29.2% of the total building stock.

Table 9

Rented dwellings distribution by amount of rent paid

Rental value Lm/pa	Up to 30	31-50	51-100	101-150	151-200	200+
% distribution 1995	-	52.8	29.4	6.66	3.3	7.8
% distribution 1990	40.6	17.9	28.6	5.82	2.7	4.4
% distribution 1985	40.1	16.4	28.9	8.20	4.4	2.0

However from above table most of the leases, 58%, are pre-1939 restricted agreements, with only 4% carried out during 1980-1990. The rental income from dwellings is very low, for a three-bedroom median apartment priced at Lm29,700 and for a two-bedroom at Lm19,800, with, as quoted in the 1995 Malta census, only 7.8% of dwellings having a rental value in excess of Lm200 p.a., which has however increased from the previous 2.0% value quoted in 1985 census. At Lm200 p.a., this gives a rental return of 0.67% for a three-bedroom and 1.0% for a two-bedroom.

However the 1995 census further gives 1% of total rentings as being in the Lm500-Lm600 p.a. range, together with a further 1% being within the Lm1,000-Lm2,000 p.a. range. The maximum range specified is within Lm5,000-Lm7,000 p.a. at an insignificant percentage of 0.012%. These increased rental values could be an indication of the changing future society, being not so tied down to the home-owners ideology.

As half the available vacant dwellings are of an undersize accommodation area, they may be rehabilitated for rental purposes for persons who presently may not make it on to the property ladder, however renting would still be seen as a stepping stone to purchase.

In the initial period most of the 400 rented dwellings required annually up to the year 2007 would be obtained from the 6,363 available vacant dwellings, meaning that approximately half of these vacant dwellings would go towards a revival of the rental sector, with the other half for the DIY enthusiasts in the home-owners sector.

It seems likely that investors will prefer to acquire their stock from the lower reaches of the resale housing market. Here capital values are low, yields tend to be higher, and this is where the demand is from new households, where demand for home ownership is currently weak. An investor should be able to acquire such a property and rehabilitate it for 90 sq m × Lm90/sq m = Lm14,400.

Table 10

The following table gives the present rates on returns on furnished apartments.

Locality	Furnished rental value % of market value
Bugibba (internal)	8%
Kappara	6%
Qawra (internal)	8.5%
Sliema (front)	5.5%
Sliema (inner prime)	5.5%
St Julian's	7.5%
Swieqi	7.0%

It is to be noted that where the rentals are more secure, utilised over the whole year, not just over the summer period, the rate of return slid down from 8.5% up to 5.5%.

Considering the above a fair yield for unfurnished premises for an established rental market with incentives should tend towards the international average of 4% yield, giving a rental value of Lm576 p.a., being an amount presently paid by only 3.5% of existing tenants.

However, from the table below, for outright purchase a down payment of Lm3,750 is required, together with purchase expenses at Lm675, and a yearly repayment of Lm900 p.a. for the next 30 years.

However for family earnings below Lm3,000 p.a., a rental amount of Lm576 p.a. would place this family below the poverty line, as the family expenditure for 1997, being the amount of money the family deems necessary for ordinary expenses, excluding house rent, mortgage bills and hire purchase instalments, among others, is assessed at Lm250 monthly. The family income for the above rental amount must be approximately Lm3,600 p.a.

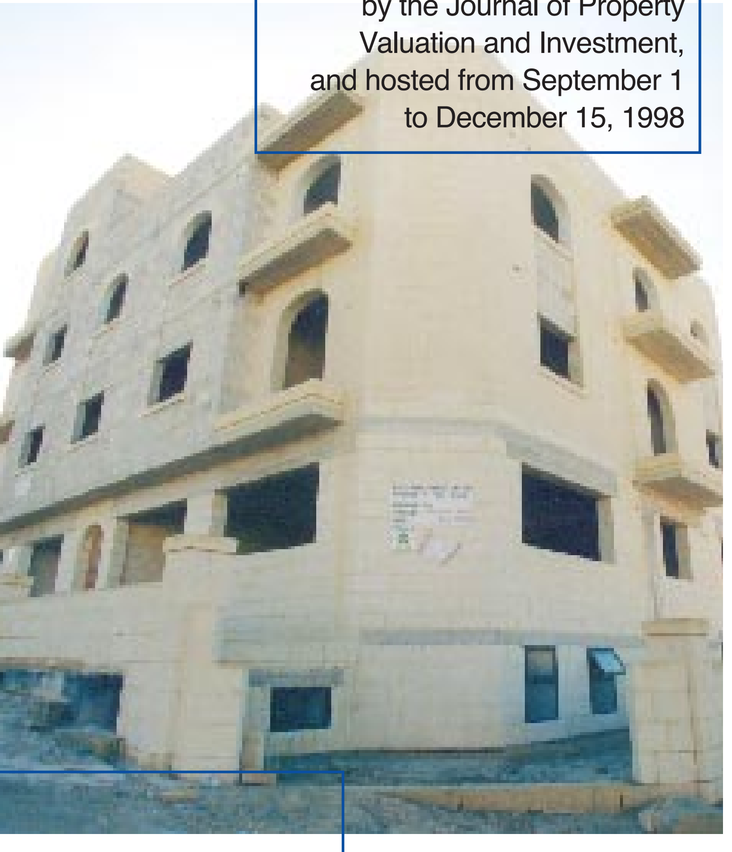

Table 11

Renting vs outright purchase
PURCHASE REQUIREMENTS

Value	Rental amount	Down payment	Expenses	Yearly repayment
Lm15,000	Lm600 p.a	Lm3,750	Lm675	Lm900 p.a.
Lm27,000	Lm1,080 p.a.	Lm6,750	Lm2,580	Lm1,668 p.a.

The rental income yield would depend on the property size/type with an inverse relationship existing. Average yields are higher on flats than on houses and yields decrease as the number of bedrooms increase. Other important factors, such as the potential for capital growth, would also need to be taken into account. The annual capital growth for a house is greater than for a flat.

Different types of owners expect a different yield from their property. In the current market conditions, individual investors are able to accept a lower yield than an institutional investor due to higher fund administration costs, which could add a 1% premium to yield.

The small DIY investor must be encouraged to become a landlord by being given a favourable taxation treatment. To help resource the growth in demand for rented dwellings; provide an exit for existing small landlords; and provide a new source for unwanted stock at the bottom end of the owner-occupied sector, while considering the housing market as the largest capital market in the economy, it is necessary to draw into the housing market the large-scale, professional investors who dominate the other capital markets.

Government should redress the investor's poor perceptions of the sector, among which are: fear of a future government putting restrictions on tenure rights and rents, lack of liquidity in the sector, lack of information

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Housing affordability in the Maltese Islands

(Continued from page 1)

such as investment returns, and unquantified risk.

To show investors that rented housing could be profitable, Government should make repossession easier, reduce tax on rents to individual landlords, such as capital allowances for expenditure on major repairs and improvements, exemption from capital gains tax and a reduced rate of VAT for repairs.

The institutional investor would prefer initial subsidies and grants to achieve higher initial yields, together with a rebate on capital gains. Rental growth levels are more closely related to household income than to the general inflation. This is to be considered when a legal framework is decided upon, for the indexing of future rent levels.

Shared ownership

A way of helping to get on to the home ownership ladder is by introducing shared ownership schemes. Here part of the property is purchased while the rest is rented. In this kind of ownership lending societies may be prepared to loan out against a lower deposit, due to the security involved. This form of ownership means that if the owner cannot presently partake in the full equity of his property, he can offset some of the costs by renting, while at the same time purchasing a proportion of his residence that he could presently afford.

A 50% shared ownership property can cost as much as 80% of full home ownership considering medium interest rates, however the continuous rise in house prices could make this method more attractive. At the lower end of the property ladder, in current market conditions, the complexity of shared ownership could be overcome for the owner and for lenders if it was replaced by a scheme of subsidised full ownership, together with lending societies accepting a lower down-payment or possibly waiving it totally at the lower end of the property market.

This scheme could possibly involve no additional cost to the government. The Maltese population is aging. With growing home ownership, an increasing proportion of older people in future will find themselves in a situation where they are "house-rich and income-poor". With possible future reduced pension benefits, one way to improve their standard of living is by releasing part of their house equity, unless they decide to trade down to a smaller house. However with most older people wishing to remain in their present home, this points to the possibility of releasing housing wealth by borrowing against home equity.

Conclusions

Sustainable home ownership has to be consistent with the economy's long-run growth rate. Crudely, if we want to raise owner-occupancy rates, then the economy must grow faster. Although subsidies superficially increase affordability, unless they are accompanied by measures to raise housing supply or land, then those subsidies will be capitalised into higher house prices. The important point to stress is that Government stimuli to housing demand are of little value unless there is equal consideration to the supply side of the market.

The role of Government is contentious; subsidies for first time buyers may boost demand initially for such housing, but end up at least partially self-defeating. Indeed any form of state control is delicate, because the volatility of the market makes it extremely difficult to gauge the effect of intervention. Whether policies are in the form of taxation, planning or price controls, they all entail some form of economic or social risk or both.

A tax on vacant properties should be considered very carefully before being implemented. Obtaining approximately 6,000 dwellings from the presently vacant stock does not warrant the imposition of such a tax, which would definitely affect the supply side of the market adversely, further escalating the affordability problem.

Another measure being proposed is that the ceiling for a foreign settler purchasing property in Malta is to be raised from Lm15,000 to Lm50,000. The number of settlers, having obtained an average of 500 permits annually over the past decade, is not too high to apparently affect the local housing market. However the perception that settlers generate a high demand has an impact on prices, considerably greater than the real settler demand should cause.

Mass psychology plays a major role, that the perceived numbers are of lesser significance than the perceived reality in terms of expected profits and opportunities for speculation. It was the foreign settlers which created a building boom in the Sixties. When the ceiling of Lm6,000 was raised to Lm15,000 in the early Nineties, two-bedroom apartments priced at Lm6,000 in the mid-Eighties by the early Nineties reached Lm15,000. Would such a proposed new ceiling rate indicate that two-bedroom apartments, forecast to fetch Lm42,500 in 2007, exceed the Lm50,000 market tag, worsening the housing affordability problem? Any form of price control entails an economic or social risk.

It has been identified that one way to improve the HAI has been by the granting of down payments to offset the initial purchase costs. Providing a subsidy on the abatement of stamp duty or part of to those on the poverty line, should be one of the future packet of subsidies on housing.

Transaction costs tend to generate "lock-in-effects" and reduce the propensity of households to move, encouraging them to postpone a move to future periods.

Further explanations of these findings may be obtained from the discussion papers or postings to theconference, referenced by date order, obtainable from Web site www.mcb.co.uk/services/conferen/sept98/ha/