



## Construction Costs and Housing Prices: Impact of Goods and Services Tax

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### ABSTRACT

It was expected that construction capital costs and housing property prices will increase following the implementation of goods and services tax (GST) in Malaysia on 01 April, 2015. Therefore, this study examines the impact of GST on the construction capital costs and its influences towards the housing developers and housing property prices. This study also aims to highlight the developers' point of view regarding GST and the housing prices. Moreover, the discussion on future proposal of initiatives for benefits of developers and consumer. The findings are obtained from a survey where 36 housing developers and an experienced property consultant under the employment of Henry Butcher (International Asset Consultant) in Penang, Malaysia are the respondent. It was concluded that building materials and land acquisition are the major construction capital costs affected by the GST implementation. Subsequently, capital flow turnover is the post and significant consequence that developers now face which led to an increment of housing property prices. Hence, the end buyers are the ones who feel the impact of price increment and the government plays the central role in this scenario.

**Keywords:** Construction Cost, Goods and Services Tax, Housing Prices

**JEL Classifications:** L74, R31

### 1. INTRODUCTION

The introduction of goods and services tax (GST) aims to increase the government's revenue and reduce the fiscal deficit of Malaysia since nearly 30 years ago and Malaysia had only facing a budget surplus which is in 1992 to 1997. The GST implementation is part of the government's tax reform programme to increase the capability, effectiveness and transparency of tax administration and management. Malaysia implement GST on 01 April, 2015 with the rate of 6% to replace the current practice of tax system which is the sales taxes (10% and 5%) and services tax (6%) that has been used in the country for several decades (Minister of Finance and Economic Planning, 2014).

It is a known fact that there is a relationship between properties and price. According to Dato' Subromanium Holasy, the Custom Department of GST, the construction cost will only increase to

maximum 2% only where the housing price of properties will drop as the biggest construction cost component which is the land acquisition for housing purpose is subjected to exempt tax (Isabelle, 2014).

However, this statement is doubt by Williams Talhar and Wong, the property consultancy that the implementation of GST in Malaysia is actually had increased construction cost to 5% (Hisyam, 2015). Furthermore, Rusnani et al. (2014) also stated that the price of the housing input will increase accordingly with the introduction of GST as exempt taxes policy disallow developer to claim of input credits.

With regard to the case of Sweden as stated by Englund et al. (1995), GST had increased the building materials to 12% and hence corresponds to a 9.4% of increase in total construction capital costs. Besides, as mentioned by the Chairman of Construction

Industry Forum, Mr. Eric Lee stated that the GST implementation would increase the new residential building cost in Guernsey at least 5% (GST Would Put Building, 2015). According to Philip (2012), GST is an indirect, broad-based consumption tax. In many others countries especially in Europe, it is also known as value added tax (RMCD, 2015). Although the name of tax is difference, but the concept, principle and operation of taxation are the same.

Yet, the increase of building cost is not the only issues for the construction developers. The member of construction developers expressed fear and worry on the exempt tax on housing property. Dato' Neoh Soo Keat, the managing director of Trinity Group Sdn Bhd responded that while housing property is exempted from GST, it does not means that cost of supplying these properties namely constructing, developing and selling will not be affected by GST. This is because, developers still had to pay the tax on nearly all areas involved, especially the materials to construct housing (Eva, 2015). Due to GST exemption on housing property, the developers nowadays were not able to pass on the higher input costs to the buyers directly (Ooi, 2015). Succinctly, developer needs to pay the GST on all the building goods and services that had been charged by supplier on them. Yet, they cannot claim or impose the charged GST on end housing buyers. Hence, the cost of total production will increase, because the supplier is not subjected as exempted tax (Nurul, 2014).

Since 2000, Australia is with 10% of GST, Gold Miles give a prospective that the price of housing property will increase as same value with the GST rate, which is 10% (Australia Competition and Consumer Commission [ACCC], 2000). Additionally, Real Estate and Housing Developers' Association Malaysia (REHDA) also stand with the above point of view that once implementation of GST and exemption tax on housing properties, it will cause developer into financial hardship circumstances. Meanwhile, according to The 2013 Benchmark Survey on GST, 58% respondent believes that GST had brought a negative cash impact to their business. In addition, developers are already being taxed an average 2.75% of stamp duty on the land and property transaction currently (REHDA Property Outlook, 2014).

The increment price of housing property is due to housing developer entrepreneur's objective that sole objective of business firms is to maximization of profit and the only legitimate corporate purpose (Dwivedi, 2012). Therefore, profit maximization will be the prior consideration for developer; meanwhile reduced profit gain will be the last option that developer will regard. It is very clear that, the building cost and exempt taxes plays an important element in determine the impacts towards housing developer and the housing price.

Following the implementation of GST in Malaysia, the primary group affected due to this broad-based consumption tax are the consumers (Godsell, 2013). According to the Malaysian Deputy Finance Minister, living costs will not increase but instead decrease logically as those items being charged 10% of sales and service tax (SST) will then be subjected to a lower 6% of GST only (BERNAMA, 2014). However, the adoption of GST had increased the price level as illustrated by Burgess (1998) in Figure 1. In fact,

the construction sector faced a scenario similar to it in which the introduction of GST influences the price of building input and thus affects the developer's profit and eventually the property value. The cascade effect brought about by GST regarding the construction capital costs, developers and housing properties in the construction industry is tabulated as a flow chart in Figure 2 (Zainal et al., 2015).

## 2. GST VERSUS CONSTRUCTION COSTS

Table 1 shows the typical main components for a building that is summarised from AIA (2013), Dell'Isola (2003), Farid and Othman (2009), CIDB (2011), CIDB (2015), AECOM (2010), Hansen (2006), Alaghbari et al. (2012), and Jenkins (2013). According to Andrew (2012), a real estate developer is an entrepreneur. For a real estate entrepreneur, the developers seek to create and sell entirely new product in the hopes of earning a much larger profit (Brown, 2015).

Building material costs are the major components in construction development costs while GST implementation has been identified to have inflated the construction material prices within a year of implementation (Warsame, 2006; Daliae, 1990; Englund et al.,

Figure 1: Goods and services tax cycle Burgess (1998)

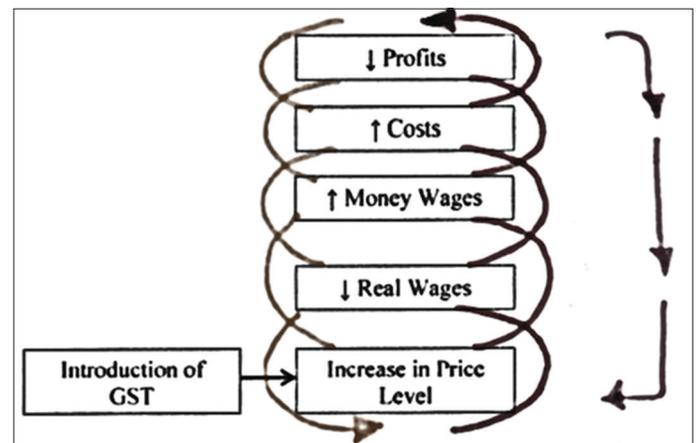
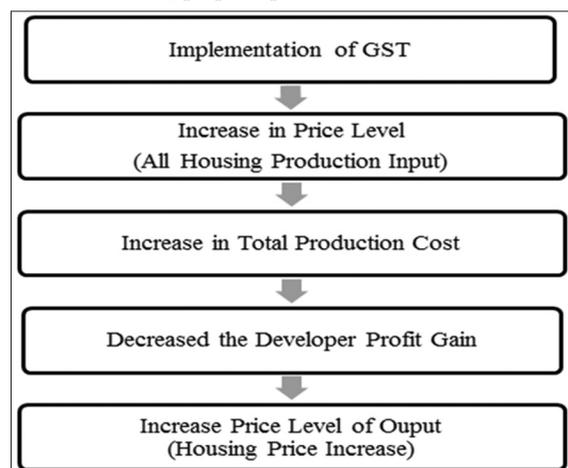


Figure 2: Goods and services tax Impact on construction capital costs and housing property prices (Zainal et al., 2015)



**Table 1: Typical components of housing property**

Site cost	Hard cost			Soft cost
	Building materials	Labour	Equipment and machinery	
Land cost	Aggregates	General labour	Excavator/backhoe	Architectural fees
Commissions and fees	Brick	Concreter	Mobile crane	Engineering fees
Title insurance	Cement	Steel bar bender	Bar cutter/bender	Other professional fees
Transfer taxes (RPGT)	Iron/steel reinforcement	Carpenter (formwork)	Concrete mixer	Insurance
Surveys	Ready mixed concrete	Carpenter (joinery)	Power trowel	Marketing
Demolition	Sand	Bricklayer	Concrete vibrator c/w poker	Legal fees
Site works	Glass	Roofer	Marble/Granite polisher	Loan fees/interim
-	Timber	Structural steel worker	-	-
-	Roofing materials	Plumber	-	-
-	-	Plasterer	-	-
-	-	Tiller	-	-
-	-	Painter	-	-

1995). Findings as shown in Table 2 indicate that all building materials set the highest cost increase after GST implementation is not surprising as prior to GST implementation only second schedule materials were being charged 5% of SST. On the other hand, GST had also led to an increment to the land acquisition cost although supply of land for housing properties is exempted from GST. Hence, the argument of Dato' Subromaniam Holsay saying that the "biggest cost components" which is land being exempted from GST would lead to cost saving for housing developers is inaccurate.

Besides, marketing costs has also been raised after GST implementation which may be a result of developers outsourcing marketing agents to help them boost the sales of property while the agents are entitled to as much as 5% of the project's Gross Development Value, leading to higher marketing costs for the developers. Moreover, labour cost as indicated at Table 2 does not get a significant GST impact as neither increase nor decrease.

### 3. GST VERSUS HOUSING PRICE

GST implementations in reality will not directly affect the business profitability but instead affects one's living cost and eventually one's purchasing power (Obst et al., 1999). Due to the lack of purchasing power, it will indirectly lead to a waning sales of property as the development costs is brought up by 6% where the 6% charged is for the price of the final product which is housing property prices.

For a developer, their projects include residential properties and also commercial properties. Sales of commercial properties being charged an additional 6% of standard rate and developers are able to reclaim the 6% from the government within one month. Hence, developer cash flow should not face any issue. However, all of the developers surveyed have not yet received any payback from the government after GST implementation due to the government system being temporarily offline, calculation error and the authorities still in the learning process of the new system.

Although housing properties are exempted from GST, the late tax claim refund from the government for the commercial properties will complicate the organisation's overall cash flow which is the

critical circumstance that all respondents are facing (Breen et al., 2002; Grigore and Gurău, 2013). In order to cover for the losses within the tax claiming time frame, developers will then increase the final property price. As consequences, the housing property prices are then increased due to the limitation of exempted tax and late claims though only <6%.

Once the housing property prices increase due to GST implementation, eventually the end buyers will pay the increase of the property. The main reason is due to developers' entrepreneur objective which aims for profit maximisation. Theoretically, GST is said to be absorbed by housing developers, but in reality, the final housing prices have already increased more than 3.41% and <6%.

In a nutshell, GST does affect housing developers in terms of cash flow (financial tightening) and work overload. Cash flow turnover leads to developer's increasing the output prices while the ones who bear the price increment are the end buyers who are the consumer within a supply chain. Moreover, the complexity of the claiming procedure results in one's work overload and confusion.

### 4. INITIATIVES AND SUGGESTIONS FOR MALAYSIAN HOUSING DEVELOPERS

Transferring all the cost increment to the end buyers is the priority decision among the developers. However such a measure will result in an increment of the housing property prices and thus is unadvisable. The initiative of using in-house sources which is recommended by MCT Executive Director is not an effective solution to soften the GST impact either as professional soft costs are just a small portion in a project. However, such small portioned savings can help an organization to allocate their resources onto other operational fields.

On the other hand, promotions such as giving discounts between 5% and 10% for those buyers who can pay their installments within a single payment is necessary in order to push up sales rate although developers will still sustain some losses. Additionally, the late claiming issues can be overcome if an organization establishes a GST specialist department to handle all GST related issues. Although investment in a new department may be costly initially,

**Table 2: GST impact on construction capital costs**

Construction cost	Mean score	Frequency	Rank
Construction site cost			
Land acquisition	3.74	High	9
Title insurance	3.58	High	18
Site demolition	3.52	High	29
Transfer taxes	3.52	High	30
Commission and fees	3.42	Medium	34
Feasibility/survey	3.42	Medium	35
Construction hard cost - building materials			
Timber	4.10	High	1
Aggregates	4.03	High	2
Bricks	4.03	High	3
Cement	4.00	High	4
Roofing materials	4.00	High	5
Glass	3.97	High	6
Ready mix concrete	3.97	High	7
Iron/steel reinforcement/bar	3.90	High	8
Construction hard cost - labour			
Bricklayer	3.52	High	24
Tiller	3.52	High	31
Rofer	3.52	High	28
Plumber	3.52	High	27
Painter	3.52	High	26
Concretor	3.48	Medium	32
Steel barbender	3.45	Medium	33
Structural steel worker	3.42	Medium	36
Plasterer	3.39	Medium	39
Carpenter (formwork)	3.39	Medium	37
General labour	3.39	Medium	38
Carpenter (joinery)	3.35	Medium	40
Construction hard cost – equipment and machinery			
Excavator/backhoe	3.65	High	10
Marble/granite polisher	3.61	High	14
Concrete mixer	3.61	High	12
Concrete vibrator c/w poker	3.58	High	15
Mobile crane	3.58	High	17
Bar Cutter/bender	3.55	High	20
Power trowel	3.55	High	23
Construction soft cost			
Marketing fees	3.65	High	11
Insurance fees	3.61	High	13
Legal fees	3.58	High	16
Others	3.55	High	22
Engineering fees	3.55	High	21
Architectural fees	3.55	High	19
Loan/interim fees	3.52	High	25

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however it can provide a positive return in the long run. Yet, all the suggestions above are not the most effective as that particular solution lies within the government's role because government is the one who can ensure that the GST implementation can be ran efficiently. Once everything is proceeding smoothly, then only anything can be settled easily. Hence, for this moment, the most urgent issue which the government should tackle first is to list all the claimable guidelines clearly and make the claiming process faster in order to ensure an organization's cash flow can be proceeded smoothly. However, if the government still proceed

with the GST implementation, then they must at least make housing properties less than RM500k into zero-rated tax items. Moreover, subsidies can also be provided for the developers as the gross development value can be reduced while gross development costs can be decreased automatically. For example, Prima and MyHome projects are the projects receiving subsidies from the federal government.

Meanwhile, the local government can alter certain policies or reduce other taxes such as stamp duty to help in lowering the GST impact (Anthony, 2008). Due to subsidies and increase in population density per hectare of land, housing developers would be able to build more economic houses and thus property prices would become cheaper while the sales rate becomes greater. As a side note from the findings, it was found that Malaysian NGOs within the construction field have no obvious function other than to act as the informer who passes along messages. Moreover, the federal and local governments can directly help in lowering the GST impact on the housing developers. The federal government needs to improve itself and collaborate with the developers to ensure that all related stakeholders can benefit from this tax implementation.

## 5. CONCLUSION

In conclusion, building materials and land acquisition costs are the major construction cost components most affected due to GST implementation. On the other hand, cost increment due to GST and exempted taxes have caused various issues in the developers' business capital flow. Hence, developers have resorted to raising the housing prices in order to maintain profit and cover the risk of losses. Consequently, the end buyers will ultimately bear the price increment. Therefore, the government should wisen up and strives to transform the whole scenario of the developers and housing buyers into a win-win situation.

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