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Abandoned Housing Projects in Malaysia and the Prospect of DP: An Overview

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Abstract

Owning a house is a dream that every individual cherishes. In Malaysia, both the banking sector and the government have expended relentless efforts to ensure Malaysians have access to financing and affordable houses. These efforts are however being derailed by alarming cases of abandoned housing projects (AHPs) that have affected a substantial number of house buyers. Several reasons have been cited for the AHPs. The issues of the Islamic banking debt based home financing products have remained prominent. The literature argues that these products such as BBA and *Tawarruq* have embedded features of transferring risks and liabilities to home buyers. This problem becomes acute in cases of AHPs. *Musharakah Mutanaqisah* or Diminishing Partnership (DP) is suggested as the superior option for Islamic home financing schemes. However, there is hardly any work that has investigated the extent to which DP can provide remedy to address the problem of abandoned housing projects. The present paper adopts content analysis and it shows that DP has a bright prospect of mitigating the problem of abandoned housing projects. The paper is concluded with suggestions for future research.

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Keywords: Diminishing partnership; abandoned housing; Islamic banking

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1. Introduction

"Home sweet home" is a feeling that comes from deep inside of a person. Getting tired of a day at work; looking for some peace and tranquility with the loved ones is the solution. It is a feeling, just like a dream, of owning a house that every individual cherishes. Today, owning a house is not a luxury, but a necessity. Fortunately, the home financing schemes provided by both conventional and Islamic banks has made access to house ownership becomes easier especially to the middle income earners. In addition to the banking sector, the government of Malaysia too has always given priority to the housing industry. The government budget allocation has reached the highest record of RM 1.9 billion from the 2013 budget to build 123,000 affordable houses in different strategic locations in the country.

Despite the easily available banking home financing facilities and the strong willingness of the Malaysian government to develop the housing sector, there are still spillovers which are causing a recurring problem for the nation. One of the most niggling enigmas is the growing issue of abandoned housing project (Dahlan, 2006). For example, as shown in Table-1 below, as of May, 2015 alone, a huge number of 17,987 families were affected from 157 abandoned housing projects. The figure for affected families was even bigger with 24,018 in 2014.

Table 1: Abandoned housing project annual statistics (Peninsular) from January, 2011 to May, 2015.

Year	Total No. of Projects	Abandoned projects	Affected house units	No. of affected families
2011		235		
2012		-		
2013		204		
2014	3548	165	32,582	24,018
2015	35,92	157	25,492	17,987

Source: Ministry of Urban Wellbeing, Housing and Local Government (MHLG)

Therefore, for some, the sweet dream of owning a house becomes a nightmare. There are cases of house buyers took financing from banks and bought houses under construction, but these houses were later declared "Abandoned". The developer failed to complete the housing project and declared for bankruptcy. There are also more extreme cases where the contractors abscond and are neither traceable nor contactable. The poor house buyer is now left with an unfinished house and a huge debt to repay. Worst still, the debt based structure of both the conventional and Islamic home financing products provide the banks with justifications to shy away from assuming any liabilities.

The literature has identified several issues related to the abandoned housing projects, such as lack of strict regulation by Ministry of Urban Wellbeing and Housing andLocal Government (MHLG) in giving license to developers, poor managerial capability, ignorant buyers and lack of due diligence on part of the banks for not properly scrutinizing the developers before giving the loan, among others. However, the issues related to the debt based nature of Islamic banking home financing products remain critical. As a result, several studies have critically discussed on the Islamic banking home financing products such as *al-Bay' Bithaman Ajil* (BBA) and recently *al-Tawarruq* (Commodity Murabahah). It is argued that the features of these products insulate Islamic banks and transfer risks and liabilities to the house buyers. The problem becomes critical in cases of abandoned housing projects. The structures of such products go against the fundamental principle of *Iwadh* in Islamic Muamalat where the bank is supposed to share risk and liability. On the other hand, quite a number of studies have argued that Islamic banking home financing products such as *Musharakah Mutanaqisah* or Diminishing Partnership (DP) could be a superior option for home financing schemes compared to the debt based products. However, there is hardly any work that has investigated the extent to which DP can provide remedy in addressing the problem of abandoned housing project.

The present paper fills in this research gap. It examines to which extend the DP can be useful in mitigating the problem of Abandoned Housing Project (AHP). To achieve this aim, the paper is structured into five sections. After the introduction, section two consists of a brief review of the related works. Section three focuses on Islamic home financing products, while the fourth section discusses the prospect of DP for mitigating the problem of abandoned housing projects. Last but not least, section five will conclude the study.

2. Review of Related Literature

AHP is defined differently by the stakeholders of a housing development project. For instance, in the case where the developer has been winding up, AHP is defined as the project which had stopped due to financial problems, or the developer of that project had disappeared (Dahlan, 2011). Furthermore, from the planning point of view, the term 'abandoned project' refers to a project in which the construction work has been postponed, even though planning permission has been granted to the developer. According to Dahlan (2011) a housing project will be declared abandoned based on several conditions. Firstly, the construction activities on the site of the housing construction project have consecutively stopped for six months or more. Secondly, the project has reached the expiry date of the Sale and Purchase Agreement (S&P) that was executed by the developer and finally the purchaser or the developer has been put under the control of the Official Receiver or the developers admit in writing to the Housing Controller that they are unable to complete the projects and the project is endorsed as an abandoned housing project by the MHLG pursuant to section 11(1)(c) of the Housing Development (Control andLicensing) Act 1966 (Act 118) (MHLG Official (2011).

The definition of abandoned projects by the Ministry of Urban Wellbeing, Housing and Local Government (MHLG) is more detail and comprehensive. According to the MHLG, a housing project is abandoned when the projects are not completed within or later than the delivery date stated in the first Sale and Purchase Agreement and no significant activity is noticed at the construction site for six (6) continuous months, or petition for winding up has been registered in the High Court under Section 218 of the Companies Act 1965 or other related laws, or the licensed housing developer is wound up and placed under Receivership, Liquidator or the Malaysia Department of Insolvency (MDI),or licensed housing developer is notified in writing to the Housing Controller that they are unable to continue further with the development of the project; and lastly if certified by the MHLG under Section 11 (1) (c) of Housing Development (Control and Licensing) 1966 (Act 118) that the housing project is an abandoned project.

2.1. The Causes of Abandoned Housing Projects in Malaysia

A construction project involves many parties on both side of the supply chain. The abandonment of one project has negative financial effect on many (Ng, 2009a). These include suppliers of construction materials, transportation companies, manufacturers of plant and machinery and other factors. Moreover, the victims of these projects are under unbearable sufferings. Some have spent their life's savings or under the burden of huge debt repayment. The blame, if we carefully analyze goes to different stakeholders of AHP.

The literature survey revealed a very limited number of researches conducted on the causes of abandoned housing project. The investigation conducted by Dahlan (2006 & 2009), just point out few reasons behind the problem. In pointing out the reasons of AHP projects, he did not conduct any survey or interview rather consolidated the work of some master's thesis. The consolidated work revealed that, the lack of adequate financing in the process of construction management leads to severe liquidity crisis. As a result, developers failed to meet the construction cost and to repay loan which ultimately leads to abandonment of the project. Inappropriate legal provisions and loose approval and monitoring on the part of government machinery found to be the second issue leading to AHP. MHLG seems to be very lenient in providing license to the house developers. So far there is no legal requirement to get necessary endorsement and verification from the purchasers, no legal requirements for obtaining housing development insurance. On the other hand, there is lack of legal provision regulating loan and repayment of loan which allows lenders to abuse and misuse their power to the detriment of the borrower developers. Lastly, the report also revealed that mismanagement, conflicts and insufficient coordination between developers and authority are also the major causes of AHP.

Based on the regular observations by the Ministry of Urban Wellbeing, Housing and Local Government ('MHLG'), there are seven identified causes of abandonment of the projects. These factors are the weakness and problems faced by the developers in respect of (i) Finance; (ii) Administration and management of the developers(iii) Insufficient technical expertise on the part of the developers, warranting the abandonment of the projects (iv) Contractors (v) Land owners(vi) Illegal squatters; and,(vii) Marketing and sales.Hoe (2013) conducted

semi-structured interview of the stakeholders of AH projects which include, developers, contractors, government officials, bankers and customers. His findings revealed that financial problem, abuse of government incentive for small contractors, mismanagement and inefficiency of management team and last but not least the role of government has major implication towards AHP. Figure-1 below has summarized the findings of the studies regarding the reasons of AHP. Financial, Management and Government policy problems and other issues have been highlighted as the main reasons that lead to AHP. The literature survey confirms that, lack of proper financing is a major issue that requires significant attention to mitigate the problem of AHP. The later part of this paper will focus on the issue.

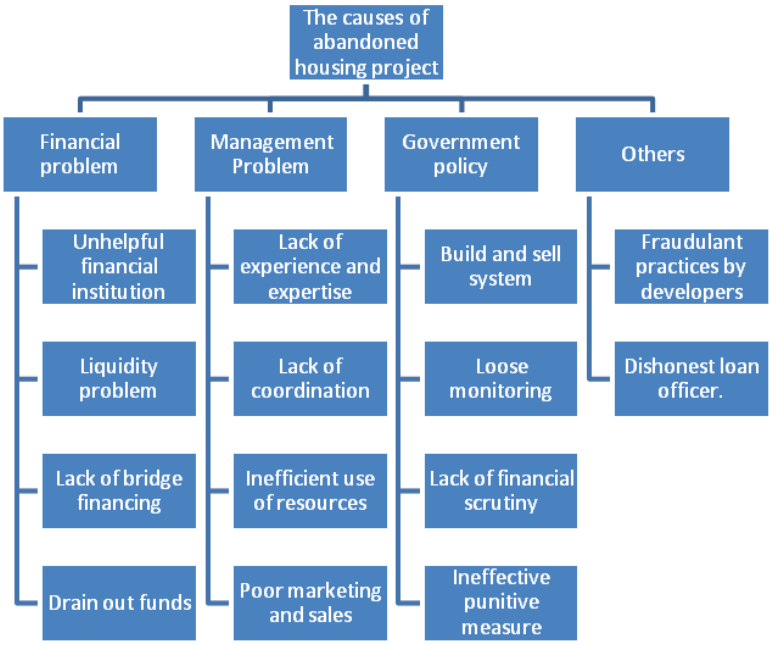

Figure 1: Reasons for abandoned housing projects.
Source: HOE (2013), p.98

2.2. *The Effects of AHPs on Consumers*

The AHP has resulted in multiple adverse consequences to the economy, society and environment. The house buyers are the one that are being victimized first and suffer the most. The sufferings are twofold: even though the houses will not be completed the buyers of those incomplete houses have to service bank loan (NST online 2008; Ng, 2011; Rahman, 2012) and to stay, they have to rent a house (Chang, 2009; Ng, 2009b). They also suffer losses for being unable to reap the benefit of appreciating property value and rental collection (Chow, 2009). Some of the house buyers are even black listed because they fail to repay the loan (Yip, 2009a; Yip, 2009a). On the other hand, they are also unable to buy a new house unless they pay back their loan (Yip, 2009b).

The relevant authorities are found to be less nimble in extending help to the victims. As a result, they have to go through the tedious process of forming a committee to deal with the developer and the authorities (Ali, 2011; Chang, 2009; and Chow, 2009). There are instances where the process of settlement took so long that some owners have even passed away (Chang, 2009). The AHP projects that reach a settlement might carry a disproportionate compensation to the actual loss suffered by the house owners (Lim, 2009 and Yip, 2009a).

3. Islamic Home Financing Products

Among the basic necessities of descent living, shelter ranks only next to food and clothing (Hasan, 1997). In Islam, even though the fulfillment of basic needs, including housing is the individual's own responsibility, government should intervene when deficiency is acute (Hasan, 1997). The government therefore, should take proper initiative to provide affordable housing through internal management and also by supporting other institutions like banks. Islamic financial institutions also have a big role to play towards mitigating the issue. Islamic banks around the world, offer home financing schemes to cater for the need of prospective home owners. Unlike the conventional banks, Islamic banks have to offer *Shariah* compliant financing. The objective is to provide financing which is free from *Riba*(usury), *Gharar*(excessive uncertainty) and *Maysir* (speculation). According to Imam Al-Ghazali (1937), the prime objective of the Shariah (*Maqasid al Shariah*) is to promote the welfare of the people, which lies in safeguarding their faith, life, intellect, posterity and wealth. One of the goals of Islamic economics is to ensure equal distribution of wealth by removing disparity created through mass exploitation of resources to obtain maximum profit.

The concept of financing in Islam differs with that of conventional financing as Islamic economic principles share risk and rewards in wealth creation by means of equity rather than debt. As a result, the society becomes more entrepreneurial and creative. This differs from the modern capitalism where profit maximization is the sole motive and banks are content with interest income on the loan regardless of the financial and social implication on the business. In contrast, the Islamic banks provide financing in adherence with Maqasid al Shariah, which is to ensure overall wellbeing of the society.

Like conventional banks, the Islamic banks in Malaysia also provide financing to cater for various needs of individual customers. According to statistics published by central bank of Malaysia, 31% of the total financing is used to purchase residential and non residential property. The statistics reveals two important issues. First, the contribution of Islamic banking in construction and property development industry and the second issue is huge demand for home financing by the individual consumers. Table -2 and Figure-2 below will illustrate the situation described above.

Table 2: Financing by purpose: November 2014

	Purchase of securities	**Purchase of transport vehicles**	**Purchase of residential property**	**Purchase of non-residential property**	**Purchase of fixed assets other than land and building**	**Personal use**	**Credit card**	**Purchase of consumer durables**	**Construction**	**Working capital**	**Other purpose**
RM, Million	19,841.7	68,620.9	75,879.3	26,276.5	3,121.5	30,355.6	1,969.9	24.4	9,101.3	75,939.6	15,751.8
% of Total	6.07%	20.99%	23.21%	8.04%	0.95%	9.29%	0.60%	0.01%	2.78%	23.23%	4.82%

Source: Annual report. BNM-2014

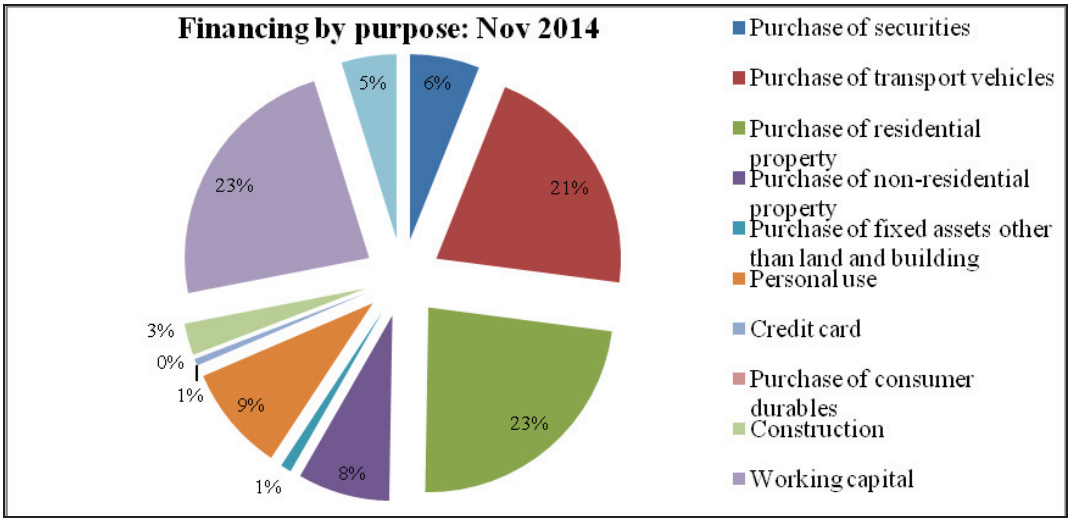

Figure 2: Financing by purpose: November 2014
Source: Annual report. BNM-2014

3.1. Major Islamic Home Financing Products

The following section will briefly describe different home financing schemes offered by Malaysian Islamic banks.

3.1.1. Bay Bithaman Ajil (BBA)

BBA contract is the widely used home financing scheme practiced in Malaysia. The structure of BBA has embedded buy back (*Inah*) provision. The customer books the house with an earnest money, committing to pay the balance later. The ownership is transferred to the customer that he sold to the bank at cost with a simultaneous contract to buy back from the bank with cost plus profit. The bank then pays the developer and the customer has debt payable to the bank with an agreement to repay in installment. The house remains as a pledge to the bank as collateral. According to Rosly (2005), BBA model has features that favor banks in Malaysia for safety reasons as they face little risk in this structure. In case of default, they are amply covered by the pledge and the down payment may be forfeited. The customers have to pay the remaining debt in full irrespective of the time default. The profit rate they charge converges to the interest based of conventional bank (Meera and Razak, 2009). A deferred installment sale inevitably locks itself in a fixed rate over the duration of a loan. As a result, low market rate makes the BBA expensive and creates a feeling of injustice to the customers of Islamic banks. On the other hand, when the market rate is higher, Islamic banks will suffer loss (Dzuljastri, 2011). The most important issue that is relevant to this research is the rejection of banks to shoulder any responsibility in case of any latent defect. The avoidance of ownership risk and liability is a pure violation of Shariah principles (Rosly 2005, Sanusi 2006) which makes the BBA contract unacceptable to many international scholars (Usmani, 1995, Bendjilali, & Khan, 1995, Rosly, 2005). When the houses in the contracts turn into AHP, the bank does not only reject the responsibility but also charges the full financing amount. This is a clear violation of Islamic law as there is an automatic implied warranty against latent defects in the goods purchased (Mejlle, in Hasan 2012).

3.1.2. Al Ijarah Al Muntahia Bi al Tamleek

With respect to *Al-Ijarah Muntahia Bi al Tamleek*, the contract is basically a lease contract where the financial provider effectively buys the property outright then leases it to the customer, in return for rental payments over a fixed period. *Al-ijarah muntahia bittamleek* usually consists of two contracts, namely, a lease over the lease period and a disposal at the end of the financial lease (Abdul Rahman, 2010) where the bank buys the house from the

owner and pays for the price by cash payment (Engku-Ali, 2010). Later, the bank leases it to the customer for periodic rental payments that would cover the bank's costs and profits. In any case, at the end of the lease period, the bank will transfer the ownership of the house to the customer via a sale contract or a gift. In a contemporary practice, this contract is only made available for houses that are ready for occupancy (KFH Research, 2010).

3.1.3. Tawarruq

Tawarruq technically is the purchasing of a commodity on credit by the *mutawarriq* (seeker of cash) and selling it to a person other than the initial seller (3rd party) for a lower price on cash (Dusuki, 2008). In *tawarruq* house financing contract, the customer first executes a sale and purchase agreement with the developer. Then he/she seeks for house financing with an Islamic bank under *Tawarruq*. After receiving the *Tawarruq* document from the customer, the bank purchases a commodity from commodity broker. The bank then sells the commodity to the customer with a markup on deferred payment basis. At the same time, the bank acts as an agent to sell the commodity to another broker on behalf of the customer. The profit from the commodity is used to settle the property purchased. At the end of the day, buyer of the property owes a debt to the bank.

3.1.4. Diminishing Partnership (DP)

Diminishing partnership (DP) or *Musharakah Mutanaqisah* is relatively a new technique that is not found in classical literature. It is formulated by contemporary Muslim scholars to facilitate investments among Muslims. It is also a financing technique that is relatively very little used by Islamic banks. Even though the mechanism of DP has been approved by the First International Conference on Islamic Banking, which was held in Dubai in 1979, it has not been widely implemented throughout Islamic financial system (Bendjilali and Khan,1995, p. 16). In this section, a review of available literature on DP is provided.

DP or partnership that culminates in ownership is a recent innovation in Islamic banking industry. It is also known in the literature as "shared equity" and it is used for home financing. DP could be considered as a derivative of original *Musharakah* and *Ijarah* modes of financing. Here, these two modes of finance are combined in order to facilitate asset acquisition. DP consists of three portions. First, one consists of *Musharakah* (partnership) between the customer and the bank. This is done through the contract of *'Shirkat al-milk'*. For example, the customer and the bank buy a house with initial capital investment equals 10 and 90 per cent by both parties, respectively. The second portion is implemented through the contract of *Ijarah* between the customer and bank. Here, the customer rents the house from the bank and pays the rental payment, which is shared between the two based on their percentage of shares. Finally, the customer will continue buy the shares of the bank gradually until the house is fully owned by him. Gradually, the shares of the customer will increase while the shares of the bank will decrease, through the periodical redemption by the customer, until the house is fully owned by the customer. This is carried out through the sale contract (bay).

3.2. Features of DP

The DP or decreasing partnership represents a joint venture between the bank and the customer where they buy the house (or any other asset) together. Once acquired, the house is leased to the customer who pays the rent to the bank for using its shares in the house. Together with the rent, the customer will pay additional amount in order to redeem the shares of the financier. Consequently, the financier's shares will decrease while the customer's shares will increase until the house is fully owned by the customer. This mechanism entails three contracts – according to Usmani (1995) these contracts are:

(1) Establishment of the partnership;
(2) Leasing the shares of financier to the customer; and
(3) Selling the successive shares of the financier to the customer.

It is obvious from the above that DP financing technique consists of three parts, namely: *Musha rakah* (partnership), *Ijarah* (leasing) and *Bay* (sale). All of these contracts are allowed by Shariah and consensus of the ulama. However, some issues arise when it comes to combining of these three contracts under one. It is the general agreement of the Muslim scholars that two contracts combined into one, where one of them is conditional for another, is not allowed by Shariah. Therefore, the *ulama'* put forward several conditions for this mode of finance to be valid from *Shariah* point of view. These conditions can be summarized as follows:

(i) The agreement of joint purchase (*Musharakah*), leasing (*Ijarah*) and selling (*Bay*) the financier's shares in asset should not be combined in one single contract. However, there can be one document joining the joint purchase and the contract of leasing. In this document, the financier may agree to lease his shares to the customer after they jointly purchase the asset.

(ii) Whenever the sale/purchase of new shares is taking place, it must be done through the exchange of offer and acceptance between the financier and the client at that particular time.

(iii) Prices of the units of the financier's shares will be determined according to the market value at the time of sale/purchase. This is more preferable – according to Usmani. However, it is also permissible for the price to be agreed in the promise signed by the client.

Apart from the conditions put forward by Usmani, the following have been suggested by Bendjilali and Khan (1995)

- There should be promise by the bank to put its shares on sale at specific future date.
- The purchase of the shares should not be binding on the customer.
- The prices to be determined at the time of sale

3.3. Practical & Legal Issues

Rosly (2005) believes that DP is one possible solution to the volatility and uncertainty faced by Islamic banks due to their overdependence on BBA financing technique (referring to the case of Malaysia and Bank Negara's proposal for a floating rate option). The objective of the DP is to earn profits through investment, while the object of the investment – he says – is to own a property. Capital contribution by the partners is not fixed and can vary from contract to contract. It is believed that DP, as a mode of Islamic financing, is more efficient, equitable and fairer at the same time (Bendjilali and Khan, 1995, Dzuljastri, 2011). Under the DP, the period needed for the transfer of ownership will be shorter (Bendjilali and Khan, 1995, Meera and Dzuljastri, 2005). Furthermore, Bendjilali and Khan claim that DP could lead to specialization, productivity and alleviation of poverty through redistribution mechanism (Bendjilali and Khan, 1995). In addition to that, DP is also proposed by Rosly (2005) as a solution to the market volatility and uncertainty.

The DP financing technique was one of the modes for house financing discussed and approved during the workshop organized by Islamic Research and Training Institute (IRTI), Jeddah, and Sudanese Estates Bank, Sudan, held in Khartoum in 1991(Mahdi, 1995). Several papers were presented in which various techniques were explained for house financing. Application of these modes by several institutions, such as Jordan Islamic Bank and Al-Baraka International Bank London, were elaborated and explained. Participants of the workshop concluded that the DP, among other modes of financing, is allowed by *Shariah* and can be implemented in house financing. It is also believed that this mode of finance may stand better if compared to *Murabahah*, BBA or interest-based financing since DP plays safe guarding role against inflation.

Meera and Dzuljastri (2005, 2009) compared DP to conventional loans and BBA financing facility. They showed that out of these three, DP is the most efficient in terms of cost incurred by a client. In other words, DP is relatively the most affordable mode of financing. This is because the pricing is based on actual rental rate rather than interest rate as in conventional home financing. As it is based on profit sharing, the duration of financing can be reduced when customers purchase more of the bank's share. Furthermore, it is interesting to note that the balance, at any

point of time, would not exceed the original amount extended by the financier.

Both, DP and conventional loans follow diminishing balance method and therefore the balance, at any point of time, cannot exceed the original amount. On the other hand, balance under BBA facility can be higher than initial contribution by the financier. Being less expensive for the clients compared to BBA, the authors argued that DP may not be attractive to the banks since this may reduce their earnings. Owing to that, the authors suggested its implementation through co-operatives where the funds are provided by the members. Furthermore, the advantage of co-operatives lies in the fact that there will be no money creation as is the case with fractional reserve banking. This will further promote the objectives of *Shariah* (*Maqasid al-Shariah*).

4. The Prospect of DP for mitigating AHP's

Even though there are some issues, the unique features with respect to Shariah compatibility, price and fairness makes DP superior over other forms of house financing loan. The earlier discussion identified the problems that lead to AHP. Presently, the analysis focuses on whether the use of DP as house financing tool can help in mitigating the problem of AHP. However, it is worth mentioning that DP cannot resolve all the problems pertaining to AHP, but the following issues can be addressed by DP:

First and foremost, it was identified that financial problem faced by the developers subsequently leads to the problem of AHP. Here, financial problem means unhelpful financial institutions, liquidity problem, and lack of bridge financing and mismanagement of funds or draining out funds. The developers related to AHP are basically new and inexperienced. As a result, normally it is very difficult for them to acquire loan from financial institutions. They largely depend on sales revenue to complete the project. If sales are slow and low then they find it difficult to complete the project. On the other hand, if the developers have multiple projects, they will be drained out of funds from one project to another. There are also cases of misuse and mismanagement of funds by the developers due to their inexperience and sometimes due to their dishonesty. Therefore, if the banks provide home financing through DP, they will become partners. Banks as a superior market force has the capability to select appropriate developer as a contractor. With their expertise and bargaining power, they can control the developers in a positive way. They can also ensure appropriate use of funds. All these lead to better control and successful completion of project.

The second problem that leads to AHP is the poor management capability of the builders in case of both construction management and financial management. These happened due to lack of coordination and inefficient use of resources. In addition, poor marketing and sales skill have aggravated the issue. If Islamic banks are directly involved as a partner in DP, they will obviously choose those developers that are skilled and well managed in every aspect. This will certainly reduce the risk of the customers falling in the wrong hand and being exposed to AHP.

Last but not least, lack of proper government policy is one of the important reasons that lead to AHP. Among the policy is to allow the prevailing "sell and built" system which one of the important factors that caused the increase of AHP (Khalid, 2010). In case of DP, the banks in most of the cases will invest on projects that are already completed. This will surely reduce the number of AHP.

5. Conclusion

Among the causes of abandoned houses projects, the problem relating to financing is the focus of this paper. The sufferings of the victims of AHP who bought houses through bank financing are twofold. First, the house is abandoned and second, they have to carry the burden of huge debt. Even though the financing was availed from an Islamic bank due to the debt based nature of the contract, the victims have to bear all liabilities in full. For example, the popular home financing products like BBA and *Tawarruq* are debt based product and do not share any risk. The Islamic banks in this case take no responsibility or do not bear any liabilities which go against the core objectives of their establishment which is the fulfillment of *Maqasid al Shariah*.

On the other hand, Diminishing Partnership (DP) when compared to other home financing products is found to be more in line with *Shariah* as it is based on equity partnership. As a result, the banks have to share the risk and responsibility of the investment. Financing, legal management and other issues that lead to AHP can be mitigated if DP can be used as a mode of house financing. However, further empirical research is suggested on the role of DP in mitigating the problem of AHP.

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