Is now the right time to put your hard-earned money into a new property? Leong Chan Telk looks at the impact of the relaxed financing regulations

IT'S easier now to borrow money for a house but there has been no let-up in its cost, to the return of the property mania of the 1990s. The current high note was wannee buyers have flocked to showrooms to ooh and ahh, but they didn't plonk money down in a hurry.

Then came reminders by banks that interest rates continue to rise, which may "take the wind out of the sails" for property launches, said a recent UOB Kay Hian Research report.

Thousands of DBS, HSBC and Standard Chartered clients were notified of a further hike.

It's something many have braced themselves for. Singaporeans are now more financially discerning, having learnt precious lessons about money management and the perils of property speculation during the 1990s economic crisis.

The new financing rules will make them look hard at what it all means for their pockets, especially over the long run.

The news seems a godsend, especially to new private homebuyers. They now need just 5 per cent cash for the down payment; CPF savings can cover another 5 per cent, before they need 10 per cent cash and 10 per cent CPF. A lower down payment extends to HDB flat purchasers too. The cash portion is now 4 per cent, but will rise to stay at 5 per cent from next year.

But there is pain in the gain from easy financing. Consider:

» You pay higher interest costs which will balloon later;
» You can't make other investments as the money went to interest charges, for say, a $750,000 home, instead of a $500,000 one.

Burden of higher interest costs

GONE are the days when an HDB flat cost, say, $100,000, and a terrace house, $300,000.

With many properties costing $600,000 or above, a 20 per cent down payment means a much higher interest cost, as a 60 per cent loan is needed. That's why Associate Professor Benedict Koh of the Singapore Management University and co-author of the book Personal Financial Planning says: "I often joke to my students that many Singaporeans are potential millionaires. "But they don't actually become millionaires as they hand most of their money to the bank."

On a $450,000, or 70 per cent loan, the sum would be $136,341.

Apart from interest costs, do note that a 50 per cent loan does not provide a bigger buffer against the danger of negative equity, says certified financial planner Dennis Ng of Leverage Holdings.

Negative equity is when your outstanding loan exceeds the value of the property. It's not a negligible risk as economic cycles are getting shorter.

If you have a problem servicing your monthly repayments, you can't hope to sell your property and downgrade.

"Your bank may not allow you to sell unless you are able to top up with cash that you still owe after handing over the sale proceeds," says Mr Ng.

If you are unable to pay, your home will be seized, and you will be made a bankrupt.

For now, if you're a fresh private home buyer, a 5 per cent cash down payment allows you to buy a home earlier.

To at least partially protect yourself from mortgage rate hikes, you can take up schemes offered by several banks that raise your savings interest rate as the mortgage rate rises, suggests Mr Tan Chia Seng, the business director of Citibank Singapore's secured assets group.

He adds that such schemes can help you to pay off your mortgages earlier.

"Another idea: Squirrel money away regularly so as to repay part of the loan capital in later years."

That's what Ms Rosa Tan, 34, a financial controller, has done. In the three years since buying her terrace house in Choa Chu Kang, she has saved five such repayments.

What also saves her hefty interest charges is her decision to take a 10-year loan, instead of a 30-year one.

"People should relook their loan tenure. Do they need to stretch it to the maximum?"

"Half of their monthly instalments would go towards repaying the interest," she says.

Another strategy doesn't apply if you are a savvy investor, rather than someone who parks most of his savings in an account earning a paltry 1 per cent in interest.

If you can invest at a rate of return far higher than the mortgage rate, you should do so, says Mr Wong Sui Jau, the research manager at unit trust distributor Fundsupermart.

"I've stretched my home loan to 30 years. I'm not in a hurry to pay up the capital as my investment return rate is higher than the mortgage rate," he says.

Earlier depletion of CPF pool

CPF rules introduced in 2002 govern how much of your CPF savings you can use to pay off your mortgage. The intent is to ensure that a larger portion of your CPF savings is set aside for retirement.

The limit on CPF usage for mortgage purposes bought this year is $138,000 of their valuation.

After the limit is reached, you will have to dig deep into your pockets for cash every month.

The pain will kick in after 23 years and six months if you take out a 30 per cent loan repayable over 30 years, based on calculations made by Mr Leong Sze Hian, the vice-president of the Society of Financial Service Professionals.

This assumes your mortgage payments are serviced entirely by CPF savings.

For a 70 per cent loan, D-Day will arrive at the tail-end of your loan period: 28 years and seven months, based on current interest rates, says Mr Leong.

Whatever loan package you choose, it all will arrive earlier if interest rates rise as your CPF pool will drain faster.

For people who buy their homes in a few years' time, D-Day will become even earlier.

CPF funds allowed for mortgage repayment will shrink progressively until the limit hits 120 per cent of the valuation for homes bank loans.

Then, D-Day will arrive after 20 years, positing a tough cash flow challenge.

"How many will be able to serve their housing loans entirely with cash from the remaining 10 years?" asks Mr Leong.

Opportunity costs of funds being tied up

UNDER the new financing rules, whatever cash you had set aside for the down payment, for that same sum, you can now buy a property that costs 1 1/2 times your salary, says property consultant DTZ Research.

For example, instead of buying a $500,000 condo with an 80 per cent loan, you can now opt for a $750,000 dream home with a 90 per cent loan. This assumes your household income is at least $10,000 a month.

The loan amounts would be $700,000 and $675,000, respectively.

The mortgage repayments for the former are to be $2,400 and $4,000 a month, respectively.

However, instead of spending more on a house, investment professionals will tell you to consider equity investment.

Sure, sometimes stocks stink, but Mr Wong of Fundsupermart says that, historically, unit trust invested in global equities have notched up 8 to 10 per cent a year.

Says economist Mamu Bhaskaran, who is a partner at Centennial Group, a consultancy firm based in the United States: "Young people should think very hard before buying a private property instead of an HDB flat.

"By opting for the latter, which costs less and comes with a government subsidy, they can build up their savings very quickly."

This is especially so if they invest the money, and the gains compound over many years.

The compounding effect is very powerful," he adds.

If they soak away $500 every month in an investment that grows at 5 per cent a year, they will have about $777,000 at the end of 10 years.

If you are thinking of buying a property for investment, beware of low rental yields.

Fund manager David Laiang estimates, for example, that a three-bedroom apartment on Killiney Road rented out at $2,100 a month nets a rental yield of merely 2.25 per cent, assuming an 80 per cent loan and 3 per cent interest rate.

Cashflow-wise, as a landlord you will be paying rents each month for your property — in maintenance, interest, tax, capital repayment and the like — than what you collect in rental.

Says Mr Bhaskaran: "I really don't think that most classes of property in Singapore are good for high-end properties, where the fundamentals favour higher prices."

Published: The Straits Times
Date: 31 July 2005
Headline: Take a cold hard look