

This is an original article written by Philip Loh on 24/01/2006; the edited version appeared in the Business Times 15 February 2006.

A bizarre Singaporean way of viewing property

An Indian friend once told me, “To my parents, the house is sacred. They would never mortgage it, even if it means living from hand to mouth every month or they can choose to downgrade and enjoy a more comfortable retirement.” Remember the days when a comfortable retirement meant buying the biggest house you can afford, paying off the 30-year mortgage and selling the property for 10 times what you bought it for.

My grandmother used to tell me, “Ah Fei, never borrow money. Use what you earn and be contented.” We grow up in a world where debts are frowned upon. Remember the time when you exceeded your credit card limit for your purchases and your mother’s and grandmother’s “advice” just reverberates in your mind.

Most Singaporeans are brain-washed by their childhood experience and form a skewed view of debt and property: they will take a lifetime to repay.

Liquidity should be the number one consideration in a prudent investment. Many Singaporeans believe that home equity (defined as the excess of your property valuation over your remaining mortgage) to be a convenient nest egg which they can tap on when they are in financial trouble. Nothing can be further from the truth. Many have realised it the hard way that home equity is not as liquid as they thought.

Suppose you have a bank mortgage, and you do what many Singaporean do: make an extra lump sum repayment every time you have some spare cash. Then one day, when you find yourself physical disabled or retrenched, you go to your bank and say, “I was faithful all these years in my mortgage payment. Will you let me coast now for a little while since I am way ahead of schedule?” The banker will probably say, “Sorry, you’ll have to fill out an application to see if you qualify to borrow that money back.”

You see, banks are income lenders, not collateral lenders. They associate assets with liens, but their first requirement is that you show your ability to repay. The irony is that you almost have to prove that you don’t need the money before they loan it to you. If you were to take a loan application to a bank during a critical time in your life when you were sick, unemployed or had a financial setback, chances are they would say, “Sorry, come back when you have the ability to repay.”

What I am advocating is not piling up excessive debt but the proper management and utility of debt to enhance your wealth. Most people do not realise that your mortgage interest can be off-set against your rental income by reducing your effective borrowing rate. For example, if your yearly effective mortgage interest rate is 3%, by the rental income off-set, this could be reduced to 2.4%, assuming you are in the 20% incremental tax bracket. If you have a sum of money, the decision of whether to use it to lower your mortgage should be based on whether your money can earn more than 2.4 % if invested. I can assure you even the most prudent financial advisor would tell you 2.4% is not a very difficult mark to beat.

The main purpose of proper home equity management is to position yourself in a situation where you can ACT upon opportunities rather than be forced to react to

situations. When fluctuations in the market occur, the rich truly get richer and the poor often get poorer. For example, in Sept 1997, the Singapore stock market crashed. People who lacked liquidity during that crucial time period were forced to sell. Many scrambled to cover margin accounts. Those who had liquid funds available were able to ride out the short-term market correction.

There are basically 3 types of people in this world:

1. Those who pay interest
2. Those who earn interest
3. Those who pay interest in order to earn greater interest (*just like banks and any major corporations*).

Between 2002 and 2004, Temasek Holdings had been actively trying to increase the leverage of all its subsidiaries. They have been making use of the low interest rate environment to raise funds through bond issues – which is paying an interest to increase earnings.

I was often asked by many of my opinion of the property market in the next few years. My take is if you are buying a place called home, it is never wrong. Fulfilling a lifetime aspiration to own one's dream home is never wrong. However, from a solely financial standpoint, it does not seem to be such a wise move. The residential market in Singapore is simply not going anywhere in the next three to four years. My argument rests on four main areas of concern.

First, the impact of the CPF cut has not been fully felt yet. The greatest impact is not the cut of ordinary account contribution from 26% to 22% but the reduction of CPF cap from \$6000 to \$5500 monthly income and eventually to \$4500 two years from now. A young couple whom I know personally committed to a 20-year mortgage to buy a condo two years back. By next year, they would have to service part of their mortgage payments using cash or choose to refinance their property and stretch their loan repayment period.

Second, the government has identified high business cost as one of the biggest deterrents for new direct investment in Singapore. The money paid to employ one engineer in Singapore could be used to employ more than ten in China. The government has a vested interest to ensure that rental rate, which is a key component of business cost, do not rise to exacerbate the already serious problem.

Third, over the last 20 years, the mean income of the average Singaporean had increased by leaps and bounds. For example, if you work as a road sweeper 20 years ago, you earned probably \$200 per month. Today, if you work as a contract cleaner, you probably earn six times as much. This significant increase in wages for doing the same job provides a pricing support for basic HDB housing which in turn provides a very good platform for up-graders to buy bigger flats or private property. Unfortunately, as I look forward, I do not see an accountant or engineer doing the same job to be earning much more than they do now **years later**.

Fourth, if you are to speak to a private residential property owner between the ages of 45 to 65 and ask them how they plan to finance their retirement, a standard answer usually surfaces: "I plan to sell my existing property in a few years time, downgrade to a cheaper place, and use the cash generated for my retirement." Like most

Singaporeans, they are suffering from the asset-rich-and-cash-poor syndrome. Another way to interpret their cash-poor position is, even if the property market does not pick up in the next few years, they would still have to sell to raise cash. Yet another way of looking at it is that they would need to take advantage of any slightest recovery in the property market to sell there by ensuring that any recovery would be short-lived. Most property analyses that I read look at supply and demand solely from the perspectives of new development units and totally ignoring the supply and demand factors on the resale market which are obviously much bigger.

Conclusion

It is pretty difficult to change the mindset of Singaporeans. I suspect it may take more than one generation before they can view their roof over the head as what it really is – a “roof”.