

([www.wallstraits.com](http://www.wallstraits.com), published 5 September 2002)

## Money Matters: A Beneficial War

Hell broke loose last month (literally too! It was the Chinese Hungry Ghost Festival) when mostly local banks slashed their mortgage rates in anticipation of strong demand from property buyers and owners after 1<sup>st</sup> September 2002.

Prior to this round of cuts, foreign banks armed with their Qualifying Full Bank license set the stage with many innovative housing loan schemes and packages. Citibank has the Home Savers Account, Standard Chartered has MortgageOne and ABN-Amro cuts home rates drastically.

Then, the government announced a slew of changes that, now, allow property buyers to own their dream homes much more easily. Beginning from 1<sup>st</sup> September, prospective home buyers no longer need to place a cash deposit, equivalent to 20% of the price of property. Instead, they can now pay 10% of the downpayment in cash with the remaining 10% coming from their Central Provident Fund (CPF) account.

Sensing a chance to capture or regain market share and to prop up their bottom line in the current sluggish loan markets, local banks started to jump on the bandwagon. First to fire the salvo was United Overseas Bank who offered home loans at a fixed rate of 1.55% in the first year and 2.80% in the second year. Then Overseas Chinese Bank Corporation offered a fixed rate of 1.50% in the first and 2.70%. Soon, Development Bank of Singapore and even Hong Kong Shanghai Bank Corporation offered their version of cheap rates.

This is what each bank is offering (as of 1 Sept 2002):

Banks	Interest Rates (%)					
	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6 and +
ABN Amro	1.33	2.33	2.33	3.33	3.33	4.00
ABN Amro	1.73	2.33	2.33	3.33	3.33	4.00
Maybank	1.68 (F)	2.50	2.85	4.25	4.25	5.00
StandChart	1.50	2.75	2.85	3.50	3.50	3.50
HSBC	1.65 (F)	2.65 (F)	2.75	3.00	3.00	4.00
HSBC	1.65	2.55	2.75	3.00	3.00	4.00
DBS	1.50	2.70	2.80	4.00	4.00	4.00
DBS	1.50 (F)	2.85 (F)	2.85	4.00	4.00	4.00
OCBC	2.70	2.80	2.90	4.75	4.75	5.50
OCBC	1.50 (F)	2.70 (F)	2.90	4.00	4.00	4.00
UOB	1.55 (F)	2.80 (F)	2.80	4.00	4.00	4.00
UOB	1.55	2.80	2.80	4.00	4.00	4.00

This table of numbers is really daunting. For one, if you think it helps you to select the cheapest rate, you will be disappointed. It does not and it confuses your thought process.

In addition to the rates that you pay, there are other variables to consider as well when it comes to deciding which home loans to take. First, you have to decide if you want to take a floating rate loan or a fixed rate loan, an explanation will be provided later. Second, some of the loan offers come with a full repayment penalty. This means that should you decide to refinance again, especially if rates drop again, before the lock-in period is up, you would have to pay a penalty fee that could be substantial.

Next, you also have to consider if the lending bank would provide you subsidy for your conveyance and legal fees. Finally, some banks include insurance coverage for fire and home contents, provides free valuation and processing fees while some do not provide such an extensive package. In order to decide which home loan package is most attractive to you, you must decide what do you really want and how much is your loan and the loan tenure.

All descriptions and no numbers will dull my readers. However, before I move on to give you several numerical examples on how you may benefit from these current depressed rates; let me explain what a floating rate loan is and what a fixed rate loan is.

A floating rate loan is one where the interest rate charged by the banks or finance company on your loan changes with respect to the rates in the market over the tenure of the loan. In Singapore, banks have board rates. The interest rate on your loan fluctuates with changes to the board rate. There is fixed difference between the loan and the board rate. For instance, if board rate of UOB rises to 6% and the fixed difference is 2.5%, your home loan rate will be 3.5%. Sometime, banks have different fixed differences at different term of the loan.

In the case of a fixed interest rate, the interest rate charged by banks remains fixed throughout the term of the loan. This means that the consumer is immune to fluctuations in the interest rate. The consumer knows his liability per month in advance which remains fixed throughout the term of the loan. This enables better financial planning. Currently, only several banks, mostly local, offer fixed rates. Additionally, these rates are only fixed for the first two years of the loan.

While some current fixed rates may look really attractive to you, there are some downsides to choosing a fixed rate. The obvious disadvantage is if interest rates drop below the levels at which you are fixed. This will cause you to pay more for your loan in the long run.

Before you can decide whether or not you should fix the interest rate on your bond, you need to have an idea of what's generally expected to happen to interest rates over the next year or so.

If rates are widely forecast to rise, a fixed rate is the better option, and if rates are expected to drop fast, you shouldn't be locking into a fixed rate.

But if interest rates are going to fall slowly, you could benefit from fixing your home loan rate for a short period of time.

Let's take a very simple example for review. Suppose you decide to take UOB's fixed rate loan offer and pay 1.55% on your loan in the first year and 2.80% in the second year. If your loan value is \$1 million dollar, you would pay interest worth about \$15,313 worth of interest in the first year. When you use ABN Amro's floating rate loans, assuming the rates remain unchanged, the interest that you have to pay is \$13,133. This is a saving of about \$2,100. However, since your loan rate has not been fixed, any increase in the general rates would mean that you would no longer be able to enjoy the low interest rate. Depending on the magnitude of the increase, you could be worse off than if you had been in on a fixed rate offer.

In other words, you must take a view when it comes to deciding between a fixed loan rate and a floating one. While a fixed rate loan helps you to plan your financials properly, through removing the uncertainties, you would not benefit when interest rates fall further.

Moving on, I have a couple of examples on how property buyers or owners may take advantage of the current depressed home loan rates.

During the course of my research, I spoke to a friend whose father has taken a loan from local bank two years ago. He had taken a loan with a 5 year lock in period and one that has an interest of 5% each year. Then, the rate was considered very favorable. Two years later, he blamed the bank for making him pay such a high interest rate. What is not apparent is he should consider refinancing. Although he would have to pay a penalty fee for full repayment before the lock-in period is over, his savings by refinancing his loan allows him to achieve substantial savings.

For instance, on termination, he had to pay \$12,000 of penalty (1% of present loan value) Little does he know that by refinancing his loan, say with OCBC, his interest is reduced to \$17,781, compared to \$59,917 if he had continued with the same bank. Let's not forget that he has to pay the \$12,000 penalty fees. This means that all in all, in the first year, he has to pay almost \$30,000 in interest. This is still a very substantial saving in the first year despite having paid the penalty fees. Plus, there is room for further savings.

Understandably, there are many home owners out there who had been servicing their loans for many years already. If you are one of those who continues to be penalized by a high variable rate, this would be a good time for you to take advantage of the low rates and refinance your loan so that you can enjoy a substantial level of savings.

Unfortunately, there are no independent loan consultants who can advise you on the best loan to take as most loan specialists work in their respective banks. However, in the United States, there are many mortgage brokers who advise their clients on the best rates to take without charging a fee, mainly because they earned a referral fee from the financial institutions. In that case, you have to do some homework on your own but more often you are likely to benefit.

Next, for new home buyers, usually you have a choice of the type of loan to take. I am not talking about fixed or floating rates here. Rather, new home buyers have a choice to

classify their loans as “Uncompleted Property Loan” or “Completed Property Loan”. In the case of the former, loan is drawn down on a periodic basis from the lending bank. Borrowers, as a result, pay only a very small installment. The remaining sum will be drawn down when the project is completed.

The advice for new home buyers is to classify their loan as a completed property loan. The reason is if you would calculate the total savings that you can achieve, it would be substantially higher than if you would to classify it under Uncompleted Property Loan. Besides, when your house is finally completed, bank rates may have gone up to higher levels. Then, you would have a larger loan quantum to pay and at a higher interest rate.

Finally, for the eager new home buyers, do you know which bank offer you the best rate? Let me take a hypothetical example: Mr Paul Tan wants to buy the Casablanca executive condominium at Woodlands. He has eyed a unit and intends to borrow \$500,000 from one of the bank.

If he decides to take a fixed rate loan, OCBC bank would offer the best rate because it had the lowest fixed rate for the first two years and the package includes a legal subsidy and free insurance for fire and home contents. It has a two year lock in feature.

If he decides to take a floating rate loan, ABN Amro would offer the best rates for the first two years because its floating rate is current the lowest but there is no legal subsidy. However, borrowers are not subjected to any lock in feature.

This is a very quick and “dirty” way to sieve out the heaps of data. However, home buyers must carefully examine each package offered by the banks to decide on the one that best suits their need.

In conclusion, there probably is no better time for new home buyers to own their dream homes and current home owners to refinance their loans to achieve substantial savings from their interest payments. The slew of measures from the government has encouraged sales in private homes and recent sales figures during the Chinese Ghost Festival have been buoyant. Developers are very optimistic that the buying will continue for the rest of the year. With the economy looking up, barring any upsets such as another Gulf War or a double dip in the global economy, interest rates aren't likely to go down any further. The potential for an upside is far greater than the potential for more downside.

*Don See, a former Research Sage from Wallstrait, has gone to further his studies. He is now a weekly columnist with the site and continues to enjoy writing for the site and for the masses.*