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Buy or Rent?

Everyone thinks about getting their own property in some stage of their life. Few actually consider the option of renting a place to stay in place of a purchase. Perhaps, it has something to do with our culture. We yearn to have a roof over our head that is ours. In the olden days, the rich and mighty are land and property owners.

There are many reasons we can think of people wanting to buy their own properties. Singaporeans, especially, work their whole life to fulfill their mortgage payments. Many of them have little cash savings or investments left for their retirement because most of them have their wealth in their properties. What has come to be popularly known as “asset rich but cash poor” is a widespread phenomenon.

A typical Singaporean will finish his education, enter the workforce and in a few years time, get married. With marriage, it means a property purchase is imminent. HDB is the most common choice. In the past, buyers used to have to wait for more than 2 years in a queue to get one. Now, you don't have to wait that long. The better endowed will look to acquire a private property or an executive condominium.

There isn't any Singaporean I know, who rents when he can buy. Is there value in being a contrarian? Can one actually be better off renting than buying, especially during this times when “negative equity” is not unheard of. Let's take a closer look at this issue.

First, why do most people decide to buy a house instead of renting one? The answers are varied but pretty obvious. They include

1. Affordable financing scheme from either the CPF or the banks (in the case of private properties)
2. Substantial savings that include one's CPF makes buying a home easy.
3. Asset values tend to grow over time both as a result of inflation and real economic growth. Therefore, buying a house will be a good investment.
4. Having your own roof over your head.
5. No need to put up with the whims and fancies of the owner.
6. A sense of belonging.
7. Governmental campaign

When people decide to rent, the likely reason is because they have no money to buy. I am not counting lifestyle reasons. There must be a few (I have not seen one yet!) who have

rented because they believe they can buy properties at a cheaper price later. However, I wonder if there is someone out there who have chosen to rent instead of buying a house because he finds the return of investment from the property purchase lower than what he can find from other alternative. Perhaps, more importantly, the amount of interest to be paid to the lending institution could be more substantial than the rent itself.

My results could probably concur with what the market already knows but still I aim to seek the truth. To begin, I need to have a hypothetical example:

Alvin and Christine who are about to marry each other, are scouting around for a house to pay. They have decided to settle for a HDB flat at a mature estate in Toa Payoh. They saw an executive apartment that costs about \$400,000. The CPF mortgage rate is currently about 2.6% or 0.1% above the CPF interest rate. They will settle the mortgage over thirty years. They decide to take a loan of \$320,000 and pay \$80,000 from their combined CPF. (Assuming that rates stay constant throughout the entire tenure)

	<u>Installment</u>	<u>Principle</u>	<u>Interest</u>
1st year	\$ 15,373.04	\$ 7,137.70	\$ 8,235.34
2nd year	\$ 15,373.04	\$ 7,325.51	\$ 8,047.53
3rd year	\$ 15,373.04	\$ 7,518.26	\$ 7,854.78
4th year	\$ 15,373.04	\$ 7,716.08	\$ 7,656.96
5th year	\$ 15,373.04	\$ 7,919.11	\$ 7,453.94
30th year	\$ 461,191.35	\$ 320,000	\$141,191.35

At the end of the thirty year, they would have paid out approximately \$141,191.35 to HDB. Every month, both of them would have to pay \$1,281.09 to repay their loan. If they had not used this sum of money to pay for the installment and leave it in the account, they would have accumulated \$685,779.05 in the CPF account, with accrued interest worth \$224,586.65. Therefore, if Alvin and Christine decide to buy the flat, they would have to pay the intrinsic cost of the flat, which works out to be \$365,778.

Then suppose the flat appreciates in value at an average rate of 5% per year. At the end of the tenure, the flat would be worth \$1,728,776.95. Even at a lower rate close to inflation, the flat would be worth \$970,905. As a result, the couple would be better off buying the HDB flat, supposed the projections and assumptions are realized.

Let's take a twist. If Alvin and Christine decide to rent and use their CPF accounts to invest in an index fund that generates about 8% over the long run, what could their results be? In this case, they would invest the installment regularly in the fund. At the end of 30 years, they would receive as much as \$1.742 million dollars. If they have rented, let's assume that over the thirty years and including inflationary effects, their average rental rates for a similar size apartment is \$3,000, they would have paid out \$1,080,000. The net result is an investment return of about \$700,000.

Buy or rent, the answer is not conclusive. Simply because there are many assumptions and projections that I have made, these may or may not materialize. Also, I have chosen

to use a HDB apartment as an example. If they decide to buy a private property where the financing terms are different and perhaps more expensive, the results would be very different.

Having a house continues to be a priority for most people. It is perhaps the biggest real asset they would ever have. Our government wants to see us own houses so that we would have a sense of belonging in the country. Personally, I like the idea of having a house to diversify my investments. It is also because of lifestyle reasons that I want to own my own house.

Economically, it is difficult to predict what the future events will be. For instance, no one will know where the interest rates will head, where the inflation will move and how the property and investment markets will perform.

Given these uncertainties, perhaps your house will give you the shelter, warm and comfort that you badly need to confront the challenges.

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.