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SINGAPORE'S HOUSING DILEMMA: WHAT ARE THE BROADER IMPLICATIONS?

In the past year and a half, the issue of the 99-year leases on Housing & Development Board (HDB) flats has triggered off much debate. Now might be a good time to step back and examine what exactly has changed as a result of this debate and what the broader implications are. In fact, this issue could be a major game changer in many areas. Certainly, housing market dynamics will change, there could be shifts in savings behaviour and we are also likely to see major policy changes over time. These are big changes and it is important that Singaporeans have a clear understanding of these implications.

What has changed?

In March last year, the government clarified that when the 99-year lease on an HDB flat ends, the flat will revert to the HDB with zero value left for the owner of the lease. You might think that this was stating the obvious but to many people it seemed to be a bit of a surprise. Clearly, the market in Singapore is not perfect, since it appears that there was a degree of myopia in how many Singaporeans viewed the HDB lease. This myopia had also been evident in the case of the 60-year leases on some houses in Geylang - when the government advised owners that the lease would run out in 2020 and the properties would revert to the government, some owners were taken aback. So, the first change is that this widespread misunderstanding about the lease has been resolved: lease owners know what to expect and must therefore change their economic behaviour accordingly.

The second change is that the government has signalled that there is not much it can do to somehow magically create value for owners of the lease as it reaches its expiry date. National Development Minister Lawrence Wong explained that the Selective En-bloc Redevelopment Scheme (SERS) was only practicable for a tiny fraction of all HDB flats. Thus, SERS, which many had assumed would be extended to most HDB flats to help overcome this fall in lease value to zero, is now known clearly to not be a solution.

But how lease owners should adjust their behaviour is complicated by the third change which is the greater uncertainty they are labouring under about important aspects of housing in Singapore. Just to mention a few examples: what will the trajectory of home values be over time? And, what further policy changes are in the offing and how exactly will these policy adjustments affect lease owners? The government has floated a number of ideas on policy changes such as the Voluntary En-bloc Redevelopment Scheme (VERS) and an offer of more upgrading when the flat reaches 60 and 70 years of age. But the details have yet to be worked out. At best, schemes like VERS will help create some liquidity for lease owners seeking to sell but they will not substantially alter the big picture - that the lease owner's value of the HDB flat will go to zero when the lease ends.

A fourth change is that prices of HDB flats appear to have started to adjust in response. Anecdotal evidence from property agents suggests that owners are finding it harder to sell older flats and prices of flats considered old have fallen.

Fundamental issues have been raised by this debate - and they have no easy solution

The debate has also uncovered a fundamental difficulty that has to be addressed. Homeowners have multiple objectives in buying an HDB flat and some of these conflict with each other. Moreover, their objectives and those of the government's may not be fully aligned.

People buy homes for a number of reasons. The obvious one is to have a secure roof over their heads: ownership means they are not at the mercy of landlords who may raise rents or end tenancies unreasonably. A second objective is to invest in an asset many Singaporeans think will just keep appreciating. Finally, most people have some kind of emotional objective – a bequest motive, to give something to their children after they pass on. They also form an emotional attachment to the home in which they raised their children and so quite often, while happy to see the value of their flat rise, they are not always ready to liquidate the asset and move to another location.

Second, in contrast, the government has a different set of reasons why it has promoted home ownership. One is to build a home-owning society which gives citizens a physical stake in their country. This is something which the government believes makes for a more stable and harmonious society. Another objective is to give Singaporeans the opportunity to invest in an appreciating asset which can be liquidated when needed to fund the home buyer's retirement needs, thus obviating the need for costly social welfare programmes such as a tax-funded state pension which is prevalent in most developed economies.

… which means that deeper rethink may be needed

So, this debate tells us that it is time to fundamentally rethink some policies which we have held to be sacrosanct.

- First, if it is indeed the case that the bequest motive is strong, then the notion of the HDB flat as an investment which can be liquidated to fund retirement becomes less workable. Anyway, it is already apparent that this approach is not working. There are too many retiring folks who are unable to put aside the Minimum Sum that the Central Provident Fund (CPF) needs to provide for an annuity. In most cases, too, the annuity from the Minimum Sum will not suffice to fund the retirement needs of Singaporeans.

- Second, one reason for the above is the huge increase in the price of HDB flats in recent years. Since the government reformed housing policy to incorporate market pricing and promote asset enhancement 30 years ago, the price of HDB flats has risen 10-fold. This has diverted the bulk of household savings into a substantial over-allocation to real estate rather than a more diverse allocation across financial assets such as bonds and equities, which is what a conventional approach to retirement planning would require. Home ownership has been achieved at the high cost of putting retirement adequacy at risk.

- Third, one reason why the cost of building HDB flats has soared is that, following the constitutional amendments to establish the elected Presidency, state land is administered by the Singapore Land Authority (SLA) as a component of the national reserves. The SLA is mandated to maximise the returns from this asset. So, SLA sells land at market prices to HDB, inflating the cost of home ownership, not just for HDB flat owners but everyone else. The SLA's mandate seems to conflict with affordable housing and retirement adequacy - as well as keeping Singapore cost competitive.

- Fourth, now that the maturing Singapore economy can no longer grow at the phenomenal rates that permitted huge appreciation in the price of HDB flats, is it even likely that property price increases could provide the returns needed to fund the average Singaporean's retirement needs? In other words, going forward, will even the massive over-allocation of savings to property be enough to provide for Singaporeans in their old age?

What could be done to address the problem?

There are no two ways about it. We need to rethink our approach to home ownership, national reserves management and retirement funding from the ground up.

First, has the emphasis on home ownership been taken too far? Is it optimal to have 90%+ home ownership when most countries have far lower rates of home ownership? A case can be made that it might be better for lower income groups to rent homes rather than be put in a position where they have to put aside so much of their limited savings that other financial objectives such as retirement are compromised. If we have more public housing set aside for rental and combine that with housing market regulations to better protect tenants, we could have a better outcome for the poorer segments of the population.

Second, we may have to shift away from basing retirement funding on the hope that property prices will appreciate sufficiently – now that we may not have price appreciation as we had before. Anyway, it does not seem appropriate to subjects retirement adequacy to the vicissitudes of the property market cycle.

Third, should we review this policy of treating state-owned land as something so sacred that its value must be boosted as much as possible? Should we not take into account the broader implications of such a policy such as the impact it has on pushing up property prices to levels that compromise housing affordability and to a level where Singapore's cost structure is also inflated?

Fourth, it may be time for us to consider a different approach to social safety nets such as retirement funding. Instead of depending on property price appreciation, we should consider having a tax-funded state pension to complement existing schemes. In fact, the World Bank has advised that a good framework for retirement funding should have multiple pillars, not depend disproportionately on one pillar such as CPF savings or property price appreciation.

Near term implications

It will take time for policy changes to be made. In the meantime, we are likely to see some economic fallout from this issue. A few implications are possible:

- As Singaporeans realise that their comfortable assumptions about home ownership and retirement have to be reconsidered, they will change their spending and savings behaviour. Basically, Singaporeans will realise that the present structure of policies, home ownership, rising cost of living and savings management will not meet their retirement needs. They will have to save a lot more to finance a comfortable retirement. But if the savings rate goes up, consumer spending will have to slow to allow that. And that will put a dampener on economic growth.

- Property prices will have to adjust now that it is clear that there is no silver bullet to preserve the value of older flats. There may be a widening gap between prices of older and newer flats.

The bottom line

Clearly, the 99-year lease issue is extremely complex and is interlinked with many difficult issues such as retirement adequacy. And so, the implications for the economy could be far-reaching. All the more reason for a speedy policy response.

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