

Pricing flats according to their value

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by Mah Bow Tan

The prices of HDB flats are always a subject of much public interest. In my conversations with young couples, a common question I hear is: "Why are HDB flats so expensive? Prices today seem much higher than what our parents paid in the 1970s and 1980s!"

I can understand these concerns, especially from those looking to buy their first homes. Yes, flat prices have increased over the years. But, in this article, I will explain why this has happened and, more importantly, why rising flat prices, if supported by economic fundamentals, is in the overall interest of everyone - homeowners and homebuyers.

PROVIDING A HOME AND ASSET

Home ownership versus rental: Governing is about making choices and tradeoffs. Which policy will bring greater benefit to the people? What are the implications and costs to taxpayers? In public housing, governments have to make a fundamental choice between home ownership and rental. Most countries have chosen the rental model. Tenants pay subsidised rents, but own nothing.

Singapore decided early on to promote home ownership. We subsidise public housing so that each family can own, rather than rent, its home. The flat becomes a store of value that can appreciate over time as the country develops. We are the only country in the world that has made affordable home ownership a major pillar of its public housing policy.

Resale at market versus cost - Unlocking value: Having chosen home ownership, we must then allow the true value of the flats to be recognised and realised.

Again, we have a choice: Do we require the flat to be sold back to HDB at a fixed price, or do we allow it to be sold on the open market? We have chosen the latter. We let the market determine prices but keep a close watch to temper excessive exuberance, where necessary.

Today, every HDB flat has an open market value which its owner can realise, after staying in it for a minimum period. The values of HDB flats today reflect Singapore's growth and prosperity since the 1970s and 1980s.

While owners may be happy that the value of their flats has gone up, what about first-time buyers? How do we fulfil our commitment to provide an affordable home for them? We do so in two ways: One, by giving them housing grants to buy resale flats; and two, by building new flats which are sold at subsidised prices - within the reach of various income groups.

Hundreds of millions are spent each year to subsidise first-time buyers. That is why the home ownership rate among young Singaporeans is so high, unlike many other cities in the world.

ENSURING FAIR PRICING OF NEW FLATS

For resale flats, we have allowed the market to determine their prices based on value. How do we set the prices for new flats? Broadly, there are two options: Price according to market value or price according to cost.

Fairness for all buyers: In the early years, HDB adopted a zonal pricing system, where the price of each new flat was fixed according to geographical zones. Pricing largely took into account the cost incurred in building the flats and the same price was charged for a given flat type within the zone, regardless of its actual location and attributes. A flat on the 10th floor was priced exactly the same as one on the second floor. Back then, there was practically no open resale market.

However, as we allowed the resale market to develop in the 1980s, buyers showed that

they clearly valued different flats differently, depending on factors like location, view, and design.

They were willing to pay much more for a top-floor flat commanding the best view, compared to a lower-floor one facing the bin centre. HDB could no longer price a top-floor unit the same as one lower down.

To do so would be most unfair to the lower floor buyers. Therefore, HDB started moving towards market-based pricing.

New flats are now priced based on what professional valuers assess similar flats would fetch in the open market, but discounted with a substantial subsidy. This is fairer for two reasons. First, all buyers would get the same public subsidy that they can encash, if the flat were sold in the resale market. Second, buyers would pay for what they get, in terms of location, direction, view, etc.

Fairness across generations: Some have argued that land specifically should not be valued at market levels, since some plots had been compulsorily acquired in the past at low cost.

If we follow this logic, we should price a flat built on reclaimed land in, say, Punggol much higher than a flat in Tanjong Pagar built on land acquired by the state. Surely, this is not fair for the Punggol flat buyer, when the Tanjong Pagar flat clearly has a higher resale value? More importantly, we need to recognise the true market value of land, so that the precious limited land we have is used prudently and optimally. If land is undervalued, we will use up more land now at the expense of future generations.

Affordability to buyers: If market-based pricing is fairer, why do some people argue for cost-based pricing? Perhaps they believe that cost-based pricing means cheaper flats. But this is not true. To ensure affordability, HDB gives extensive subsidies below market value. As a result, market-based prices can be below cost. For example, for Punggol Spectra and Fernvale Crest - two recent Build-To-Order (BTO) projects - the average development cost per flat was \$220,000 to \$240,000, while the average selling price was \$160,000 to \$200,000, or \$40,000 to \$60,000 below cost.

HDB flats are generally priced below their development costs. Over the last three years, the average annual loss on the sale and development of HDB flats was around \$600 million. If we include other housing subsidies, such as the Additional Housing Grant and the CPF Housing Grant, HDB's total annual deficit would be about \$1 billion.

Housing affordability can be achieved under any pricing system. It all depends on the level of subsidy given. I know some first-timers worry that market-based pricing leaves them entirely at the mercy of market forces. Let me assure them that HDB reviews its subsidies regularly to ensure affordability for first time homebuyers. I will discuss this issue in greater detail in my next article.

RECOGNISING VALUE IN PRICING

Today, we have built a unique public housing system that is based on home ownership. It offers Singaporeans not only shelter but also a store of value. Singaporeans generally understand and are prepared to pay for value. This is why some of the higher-priced, premium HDB flats attract more buyers than the more affordable, standard flats. For example, there were 13 applicants per flat for the Punggol Waterway Terraces, compared to four to seven applicants per flat for standard BTO projects launched there this year.

We must price new HDB flats such that the public subsidies that can be realised on resale are fairly distributed across buyers. As the custodian of public wealth, the Government must also use its resources wisely, including land, regardless of how they were acquired, so that the needs of current and future generations of homebuyers can be met.

Recognising the value of the flat in its pricing is a key part of this.

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