Are buyers overpaying for freehold properties?

IREUS study shows that freehold property here were sold 10.4% higher on average than comparable leasehold properties, yet model ratio implies a premium of just 4%

By Sing Yue Foo and Tan Xin Hong LEW TOON

PRIVATE freehold lands are scarce in Singapore, where more than 60 per cent of the land is state-owned. The government sells state lands with a lease tenure of 99 years to private developers for residential and commercial development purposes. The lands, together with their buildings, will be redeveloped and sold to the public after the lease expires.

In highly urbanised Singapore, many buildings that still structurally remain intact have been redeveloped to meet the needs of the current population. Unlike freehold lands that confer ownership of the entire property, a leasehold property has a maximum of 99 years lease term, subject to renewal.

Different factors contribute to the price difference between a leasehold property and a freehold property, particularly the short-term nature of the occupation.

In the short term, the price of the properties of the same age and size, with the same facilities and number of houses, a freehold property will be priced higher than a comparable leasehold property. How much will be the price difference between the two properties? Who should there be differences between the two?

From a renter’s perspective, he will be indifferent between living in a freehold property or a leasehold property, unless the freehold property is more expensive than the leasehold property.

From an investor’s perspective, the length of the lease term is important. A difference in the tenures of the properties will be crucial in determining the profit of the investor. The properties with longer leasehold tenures will produce higher rental returns for an investor.

From the landlord and freehold owners, they will benefit from the capital gains the property will generate when the lease expires.

Developers will develop and redevelop the acquired ex-leasehold properties and increase the value of the properties by redeveloping the properties into new and usually larger properties. This increase in the value of the properties is translated into revenue generated from the sale of the properties.

While there is no impact of decaying lease on leasehold sites, developments of leasehold properties are concerned with the shorter balance lease term, and will usually pay upgrading premiums to the government to top up the lease tenure to 99 years.

Therefore, it is necessary to review if the 5 per cent premiums used to compute the lease’s top-up premium is still representative.

The difference of the lease term to 99 years will not simply grant the additional rights at the end of the lease, it will also push up the value of the property.

In case of a leasehold land with a balance 75 years tenure, for example, topping up the lease will not just give the leaseholder an additional 25-year lease term at the end of 75 years, it will also have positive impact as the value of the property will increase.

The gross effect of the lease top-up will be a positive one, which not only increases the values of the existing leasehold land. It would also create positive spotlight to neighbouring lands, inducing more redevelopment activities for surrounding older properties.

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