Buying within your means

A much better indicator of housing affordability is the ratio of ‘house price’ to ‘lifetime income’.

For a 30-year-old earning $5,520 a month with savings of $189,900, affordable homes would be an HDB executive flat or lower, using a cut-off ratio of about 30%.

Present value (DPV) of their earnings, over their remaining working life.

Using survey data collected by the Department of Statistics, we can decipher predicted income profiles by birth cohorts for different income groups over the working ages of 20–64. We now have data only for three income levels: lower (25th), middle (50th) and upper (75th) percentiles.

Since our focus is on young homebuyers, the accompanying table presents estimates of the DPV of household income for households headed by 30-year-olds. By adding their own accumulated savings to the income figures, young homebuyers can obtain an estimate of their lifetime income. They can then divide the price (including the transaction cost) of the house they are buying by their estimated lifetime income to see what percentage of their lifetime income will be consumed by the property.

The rest of the table provides illustrative computations of housing affordability for the three income groups referenced. Accumulated savings (including interest earnings) were estimated from household expenditure survey data, and transaction costs were estimated using current rates on stamp duties and other fees and charges. Property taxes and costs of home insurance and maintenance were not included.

Some general observations that emerge from this table are worth highlighting:

- First, when the mortgage rate goes up, homebuyers have to spend a higher percentage of their lifetime income on housing, and affordability goes down.
- Second, given that current mortgage rates are above 5 per cent, and if we use the 2.5 per cent cut-off rule, HDB resale flats of four rooms and above are not affordable for low-income groups.
- Third, at current mortgage rates, HDB resale flats are well within the affordable range for middle- and upper-income groups.

Fourth, private properties are obviously high-income groups. Still, even for those in the 75th income percentile, private residential properties at median prices are not within the affordable range at current mortgage rates.

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