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 rates imply a premium of just 4%

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IT'S freehold lands are scarce in Singapore, where more than 80 per cent of the lands are leasehold. The government sells state lands with a finite tenure of 99 years to private developers for residential development purposes. The lands, together with any buildings and structures built on the lands, will be returned to the state at the end of the lease.

In highly urbanised Singapore, more buildings that are architecturally sound are retrofitted before the 99-year lease tenure.

The redevelopment process is commonly known as an on-block sale, where individual freehold property owners band together to sell their development rights to developers. Subject to the approval from the planning authorities, the redevelopment process involves bulk condemnation of land use and topping up of lease term.

Unlike leasehold lands that confer owners the right of the property built therein for perpetuity, the 99-year leasehold property has a finite life. Many leasehold property owners are concerned about the depreciating values in view of shortening lease term.

Effects of decaying lease

Freehold properties that are limited in supply command premium premiums over leasehold properties, critics parry— that is, everything else remains the same.

In other words, for properties of the same age and size, with the same number of rooms and the same neighbourhood, a freehold property will be priced higher than a comparable leasehold property. How much will be the price difference between the two properties? Why should there be difference between buying a freehold property or a leasehold property because of the short term nature of the occupation?

However, from a market’s perspective, the length of the lease term matters. Owners of leasehold properties are at risk of not getting the property and collect rents for an indefinite period of time, as long as the building is structurally sound and safe for occupation.

Both leasehold and freehold owners could sell future redevelopment options on the land via an en bloc process to developers.

Developer will buy en bloc and redevelop the acquired on freehold properties into newly entitled leasehold properties, if economic values of the new properties outweigh redevelopment costs and loss of rental revenue during the construction process.

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Valuing long-term interests

There are two possible explanations for the higher prices that the market pays on the very long-term interests in freehold properties.

First, the capitalisation rates selected for the valuation of the land in the market are higher than the risk-free rate.

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