Property prices in Singapore are booming, but is a "buy-and-rent-out" strategy still workable at current rates of rental yield?

If you are intending to invest in a residential property and to rent it out, here are seven costs you should be aware of.

01 **Property tax**

One of the possible oversights of first-time investors in residential property is that the property tax for non-owner occupied properties (10%) is much higher than that for owner-occupied ones (4%).

The tax rate is applied to the “Annual Value” of your property, which is the assessed open-market rental that it would fetch, which may not correspond exactly to the rental collected for a particular property.

This tax is imposed even if the property is not rented out.

In the case of owner-occupied HDB property, rebates are often available (for example it is now at 50% subject to a cap of $120). However, no such rebates are currently applicable for non-owner occupied properties (whether HDB or private).

Therefore, aspiring landlords have to factor an approximate 10% tax on their rental incomes.

02**Furnishing costs**{loadposition advert1}

Although a private apartment usually comes with basic renovations, for it to be in a marketable state, the owner would have furnish it with appliances (such as a washing machine), curtains, etc and thus incur a one time expense that, as a rule of thumb, would constitute one to two months worth of rental income.

Furthermore, while tenancy agreements have clauses for tenants to be responsible for minor repairs (say below $200), the landlord is usually responsible for major repair expenses within the property. It is also normal practice for the interior of a rental residence to be repainted once every 2 to 3 years, just before the commencement of a new lease.

For a fairly new property, furnishing and refurbishing expenses would easily average $500 per month over the initial years, but would increase for older developments.

03**Agent commission and opportunity cost**

Even if a property is newly furnished, it is not uncommon for an agent to take about a month to market it to potential tenants. The property therefore earns no rental in the meantime. An agent is also set to receive one month's rental as his fee for finding a tenant.

04**Condominium management fees**

Condominium apartments, like all property, have to be maintained and management fees are collected monthly for this purpose. The fee varies widely, from as low as $200 per month (for a 2-bedroom apartment without a shared swimming pool) to $800 or more (for a luxury condominium).

Part of the fees collected also goes to a sinking fund, used to pay for major upgrading and repair works.

(Note: Landed properties do not incur management fees, but may incur a similar maintenance costs. HDB apartments would attract Service and Conservancy Charges, which are essentially maintenance fees but are typically less than $100 per month)

05**Fire insurance**

If your property is mortgaged to a bank, you would be required to take up a Mortgagee Interest Policy (MIP). This is generally provided free-of-charge by the bank in the first year, but would have to borne by the owner thereafter.

Fortunately, fire insurance is cheap at as low as $10 per month for basic coverage. It is nonetheless an often-overlooked out-of-pocket expense.

06**Interest**

Interest is not strictly speaking a hidden cost, but many property investors have assumed that that interest rates will continue to stay low.

If global interest rates are to rise, as is widely-expected, the cost of servicing a loan may increase substantially in the next few years.

For example, for a S$500,000 loan to be repaid over 30 years, an increase in interest rate from 2% to 3% will cause monthly repayments to rise from $1,848 to $2,108. Since many properties in Singapore have gross rental yield of around 3% (before deducting expenses), investors would soon need to top up more cash to sustain the investment, if they are not already doing so.

07**Income tax**

Rental income is subject to income tax. The precise amount of tax will depend on the tax bracket (20% maximum) that the owner falls under. The following expenses are tax-deductible

- interest on the property loan
- property tax
- fire insurance
- commission paid on getting a tenant
- cost of renewing a lease
- tenancy works in getting the property ready to be leased out
- maintenance charges

**Worked example**

Consider the real-life example of a fairly new 1,000 square feet District 11 freehold condominium apartment, which costs S$1.5 million. It fetches a rent of about $4,500 per month on a two-year lease. The costs incurred would include:

- Property tax of $450 per month (at 10% of rental)
- One-time expense of $6,000 of purchasing various appliances and furniture, to be depreciated over 24 months
- Monthly management fee of $400
- $4500 agent commission to find a tenant and $4,500 opportunity cost incurred during the search period, to be depreciated over 24 months
- Monthly fire and general insurance fees of $25
- Income tax (assume 10%)

Total monthly expenses thus add up to $1,500, equivalent to a monthly rental income (before income tax and interest expense) of $3,000.

Assuming an outstanding mortgage loan balance of $1.2 million (or 80% of the purchase price), the monthly repayment over 30 years is $4,435 per month at 2% interest. Of this, approximately $1,650 per month goes towards interest payment. The assessable income tax would be 10% of $1,350 ($3,000 subtracted by $1,650 interest expense), or $135 per month. Final net rental income is thus $2,865, which represents a net yield of just 2.29%.

More importantly, the investor is out of pocket by $1,435 per month (i.e. the shortfall between the monthly mortgage payment and the net rental income).

If interest rate rises to 3%, this negative cash flow would correspondingly increase to about $2,000 per month.

(Note: The counter example for a leasehold apartment would show a higher net rental yield and even possibly a positive cash flow. This is because the cost of a leasehold property would be lower than that for a comparable freehold property, while absolute rentals are generally independent of whether the property sits on freehold or leasehold land.)

**Conclusion**

In an exuberant property market, in their hopes for capital gains, investors and speculators may neglect the fact that rental income often cannot fully defray the cost of ownership. All things considered, the effective yield (before deducting interest on the mortgage) on a residential property in Singapore can be surprisingly low. When interest expense is included, an investment in a residential property is likely to be cash flow negative.