

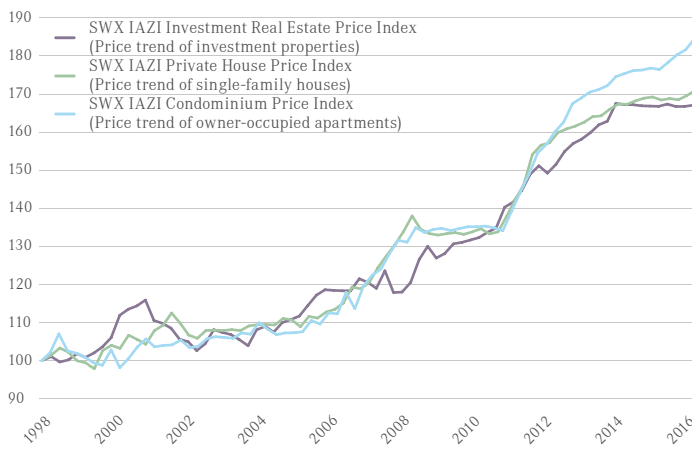
# INVESTMENT THEME

March 2017

## Swiss real estate market – never-ending price rises?

Rising vacancy rates for rental apartments and decreasing migration to Switzerland amid persistently brisk construction activity and an uncertain outlook for interest rates: the Swiss real estate market is continuing to experience a boom phase despite these negative factors impacting demand for real estate. The SWX IAZI price index (see chart below) shows a 2.7% increase for single-family houses and owner-occupied apartments in Switzerland in 2016. In particular, the rise in prices for owner-occupied apartments (+3.9% in 2016) clearly reflects the strong and enduring appeal of condominium property.

### Swiss real estate indices



Source: IAZI AG

This is due to the lower price level of apartments (both relative to single-family homes and in absolute terms), disposals of single-family houses as baby-boomers retire, and the fact that some single-person households and private real estate investors are purchasing condominium apartments. All the same, prices of single-family houses likewise rose in 2016 – by an average of 1.5%.

Prices for multi-family dwellings are flatlining, however, despite the fact that a large number of institutional investors are continuing to enter the real estate market due to yield considerations and a dearth of investment alternatives. New construction projects are also being undertaken in areas where demand still needs to be created and infrastructure has yet to be fully developed (transport, schools and retail opportunities). A large number of rental apartments in these places are thus remaining vacant for longer: the marketing process is long and drawn out, and in some cases potential tenants are having to be lured by the prospect of free accommodation for months at a time. A glimpse into the future shows no sign of a trend reversal: a large number of building permits continues to be granted for multi-family dwellings, posing a corresponding risk to prices. If, against this backdrop, the fall in the number of migrants to Switzerland were to be accompanied by a hike in interest rates, there would be a risk of a (significant) fall in prices.

Should real estate be purchased in the present environment? Private individuals requiring accommodation for their own use are not primarily focused on capital growth; they are investing for the long

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haul. If the bank's mortgage financing requirements are met, they may buy. Caution is the order of the day in the high end of the market, on the other hand. A price correction is under way here, while in the multi-family dwellings market much depends on the future course of interest rates. Private investors in particular should be wary here, given the current high level of asking prices and hence low yields – unless they are expecting a "Japan scenario" of deflation over a lengthy period. In this situation, holding real estate would be even more favourable, but the risks of a future correction correspondingly greater.

## **What buyers need to know when choosing a property**

What points need to be borne in mind when choosing a property? Basically, long-term real increases in rents and property prices are only possible if there is a structural housing shortage – in the case of Switzerland this mainly refers to urban areas. Buyers should in any case always try to buy a property in the best possible location. The price risks in "B and C locations" – i.e. in less attractive areas – have significantly increased in the current environment.

Another point to clarify at an early stage is the planned purpose of the property purchase. No one would dispute the desirability of acquiring a property at the best possible price, but the criteria applied to investment properties, i.e. rented apartments and houses, in terms of location, price and potential rental income should be much more stringent than those applied to owner-occupied homes. In the case of the latter, the buyers' emotional enthusiasm for their dream home should not lead them to overlook the appropriate price or any likely future expenses or restrictions – for example in the case of historic properties. It is also advisable to look into the relevant land-use plans and any potential changes to adjoining plots (new buildings, roadbuilding projects, etc.).

## **Property financing calls for risk awareness**

On the financing side, prospective buyers should make sure that they can afford the property. This can be done by applying an affordability calculation which should not only factor in the assumed interest payments, but also the amortisation and the cost of maintaining the property. Buyers who take out large mortgages should also be aware that the property does not belong to them, but to the bank. Mortgages come with conditions and over time paperwork will need to be submitted on the borrower's income and the condition of the property. It is also highly advisable to run through all the possible eventualities. The main risk in terms of affordability is divorce, assuming a couple has financed the property jointly. However, unemployment, loss of earning capacity or insolvency – in the case of those who own their own business – can also pose

serious threats for property owners. And those withdrawing a proportion of their pension savings to put toward the purchase of their own home should make sure they consider the impact this will have in terms of reducing their future retirement pension. Prudent financial planning will be needed to ensure that the purchase remains affordable in retirement.

Those financing property purchases with a Libor mortgage should be cautious. Libor mortgages are currently attractive, but the interest rate risks are correspondingly high. Buyers with tight financing budgets should calculate the potential impact of rising interest rates and take careful note of the contractual provisions governing any switch to a fixed-rate mortgage.

Falling property prices are even more of a risk than rising interest rates, however. For property buyers, this may mean that the bank suddenly makes margin calls. In the 1990s, Switzerland suffered a severe property crisis which saw prices fall significantly after a period of overheating. Another very important point is the need to carry out a thorough survey of the property from the basement to the roof and give some thought to the service life of fixtures and fittings such as the heating system, the kitchen and the bathrooms. Where applicable, the cost of renovation work and customizing features to meet your own additional requirements may need to be considered.

## **Property as part of the asset allocation**

In asset management, asset classes are weighted according to the client's risk profile. Property investments will be assigned a larger or smaller weighting depending on individual risk preference. Risk-return assessments and investment objectives should therefore take account both of owner-occupied housing and any rented properties. This is the only way to ensure that holdings of, for example, cash, equities, bonds, alternative investments and real estate can be invested on an individually optimised basis. In the case of the latter, the next question is what form the investment should take: indirect investments (funds) or direct investments (home ownership and/or investment properties). These issues can be discussed in detail in personal consultations with our client advisors as well as our specialists and defined according to the client's preferences.

## **What sellers need to know**

In general, when selling property two key points need to be considered: putting the property on the market at a realistic price and the tax implications of the sale, particularly with regard to property gains tax. The marketing material should give a clear and concise

overview of the property's location and other points in its favour. A comprehensive and attractively presented sales documentation may be instrumental in deciding whether buyers will be interested in the house or apartment and therefore whether they make an initial approach. Exaggerations or indeed false claims would be ill-advised as a viewing appointment would quickly reveal the true facts, undermining any sense of trust.

Current market conditions are very positive for sellers. Many stand to make handsome gains, depending on when they bought the property. Capital gains on property are subject to cantonal property gains taxes, which are handled differently from canton to canton. The longer the seller has owned the property, the lower the property gains tax will be. In some cantons the period of ownership is calculated in years, while in others it is calculated in months. In the canton of Zurich, the duration of residence is calculated in whole years. If someone has lived in a property for twenty years, the property gains tax reduces to half the standard rate (canton of Zurich). When you sell your own home and buy a new one at the same time, this is classed as a replacement purchase, which has the effect of deferring your liability to property gains tax. If the tax office of the municipality where you have been living so far is given written notification of your planned replacement purchase in good time, the tax will not be due immediately. The municipality will merely assess your tax liability. A replacement property does not need to be purchased immediately: to qualify as a replacement, the period between the sale and the subsequent purchase must not exceed a certain limit, usually set at two years. If the replacement purchase takes place within this period, the property gains tax will be permanently deferred at the amount of the reinvested gain on the property sale. In principle, it is always advisable to obtain binding information from the relevant authorities in good time.

### **Unbiased property advice independent of financing**

As part of its comprehensive asset management offering, one of the services Maerki Baumann & Co. AG provides for its clients is "real estate advice - independent of financing". Independent of mortgage financing as such, the offering also covers advice before buying or selling a property.

As explained above, assessing the property market and what purchase or selling price the property could fetch plays an important part in this. It is therefore advisable to have an unbiased sparring partner to reflect on the decision of whether to buy or sell and to choose the right market approach. Our specialists also undertake the task of coordinating with other selected expert professionals.

Knowledge of the regional and local property markets is an essential part of this real estate consulting expertise. The services we offer at Maerki Baumann are therefore focused on the Greater Zurich area. This area covers the cantons of Zurich, Zug, Lucerne, Schwyz, Aargau and Schaffhausen.

### **Tasks we can help you with**

- Assessment of the property market
- Evaluation of the feasibility of a transaction, for example, in terms of a maximum purchase price or a realisable selling price
- Joint meetings with developers, potential buyers or sellers
- Joint viewing appointments
- Advice on the right marketing approach, incl. placement of advertisements
- Preparation of documentation
- Contact person with coordination of parties interested
- Involvement of specialists such as valuers, construction specialists, tax experts etc.
- Review of contracts and other relevant documents
- Processing of the transaction from a payment perspective, incl. drafting promises of payment, or reviewing these in the case of a sale
- Introducing potential buyers and sellers within our network

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## Summary

- The Swiss real estate market is mainly dominated by steadily rising prices.
- Now more than ever, buyers need to exercise caution while sellers must arrive at a realistic valuation of their property, as the prices offered do not always justify the value of the property.
- Unbiased property advice can help you to take the right steps when selecting properties to buy or when selling a property, and can ultimately help you take the right decision.

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## MAERKI BAUMANN & CO. AG

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