

Swiss Finance Insight

SEPTEMBER 2014

New Developments in the Swiss Real Estate Market



Martin Hoesli, SFI Professor of Finance at the University of Geneva, gives us his insights on the Swiss real estate market.

How do you see the Swiss housing market evolving over the next few years?

It is important to look at the main sectors of the market separately. There have been some concerns recently especially about the housing markets in Zurich and Geneva as well as in the high-end mountain resorts – and rightly so.

Price increases are now more moderate and some segments have even experienced price declines. Transaction volumes have declined and time on the market increased – partly due to higher down payment requirements.

Clearly, increases in house prices over the past years have exceeded increases in households' income levels, suggesting that at some point, the two will realign by prices going down. The question is when. I believe this will happen when interest rates increase – which doesn't seem likely anytime soon. Also, more loans today have longer maturities and this will mitigate the effect of any rate increases.

What about the non-housing real estate market?

Supply and demand appear to be well aligned in the retail market, so I don't anticipate large price changes in the years to come. In contrast, a lot of construction has taken place in the office market, leading to an imbalance between supply and

demand. This will cause prices to decline in that market.

Any research questions you believe should be addressed?

At least three areas would benefit from more research. One question is what method can best assess whether or not there is a real estate market bubble. My team and I are currently working on this. Derivatives on real estate are another interesting topic. Despite the benefits of such derivatives, volumes are very limited, and it would be useful to analyze the factors preventing a proper development of these products. Finally, it would be important to measure the economic impact of political decisions on the real estate market at a more regional level.

New SFI Education Offer in Real Estate Finance

Donato Scognamiglio, Professor of Finance at the University of Berne and a partner at real estate consulting firm IAZI, talks to us about the newly-launched SFI Certificate of Advanced Studies (CAS) in Real Estate Finance (offered in German).

For whom is the SFI CAS in Real Estate Finance designed and what is the program's main focus?

The program is designed for experienced professionals in the Swiss real estate business. The focus is on real estate valuation, real estate portfolio management, and real estate financing.

Why is there a need for such a program at the moment?

The dynamic development of the Swiss real estate market and the everchanging regulatory landscape requires an in-depth knowledge of real estate valuation, financing, and calculation. The program also leverages the synergies that already exist between the financial industry and the real estate branch.

What features make this program stand out compared to others already running in Switzerland?

To my knowledge, this is the first CAS in Real Estate

Finance offered in Switzerland. The program combines theory with discussions, working projects, and an attractive e-learning tool. This will allow participants to design their own learning rhythm, while profiting from a lively exchange among different real estate professionals.

For detailed information about the SFI CAS in Real Estate Finance, please visit www.SFI.ch/casref

SFI NEWS

Over 100 practitioners attended the SFI Industry Forum in Lugano on August 29, a one-day event specially designed for senior managers wanting to gain new insights into thought-provoking academic research and best business practices. The podcasts of all talks are available at: bit.ly/IndustryForumPodcasts

Professor Paul Embrechts, SFI Senior Chair at ETH Zurich, has been named Fellow of the American Statistical Association on August 5 at The Annual Joint Statistical Meetings in Boston, Massachusetts.

More info available at: www.sfi.ch/downloads

The 9th SFI Annual Meeting will be held at the SFI Credit Suisse campus in Bocken (near Horgen, ZH). The half-day event will tackle the topic of "People versus technology? Where to invest for the future of Swiss banking?"

More info available at: www.SFI.ch/AnnualMeeting

Upcoming Events

October 9, 2014 – Zurich
Bitcoin: A virtual currency here to stay?
SFI Breakfast Seminar with Aleksander Berentsen, Professor at the University of Basel.

October 27, 2014 – Zurich
Swiss banking transformation testimonials.
SFI Evening Seminar with Pierin Vincenz, CEO at Raiffeisen Gruppe.

October 29, 2014 – Zurich
Household finance innovation.
SFI Lunch Seminar with Peter Tufano, Professor at the University of Oxford.

For more information on upcoming events: www.SFI.ch/Events

Housing Finance in Switzerland

Putting the Swiss Housing Market in an International Perspective



Switzerland did not experience soaring house prices in the 2000s as other countries did, and only recently have prices started to slightly decrease. An SFI study discusses the main aspects of Switzerland's housing market that might explain why.

After years of bullish activity throughout the 2000s and until the 2007/8 financial crisis, many housing markets around the world experienced significant price declines in the immediate years after that. The US is a clear example: the main national housing index rose 100% from 1996 to 2006, then declined by 29% from 2006 to 2009. The situation was different in Switzerland, where house prices had not risen on average at a faster rate than fundamentals such as demographics and disposable household income would imply. The subsequent decline was also quite moderate.

Another interesting feature of the Swiss housing market is the very low homeownership rate. Swiss authorities often mention an increase in the rate as one of their objectives, but only limited efforts are made to provide the political and tax means to achieve this.

In a recent study, SFI Professor Martin Hoesli (University of Geneva) and his co-authors Steven Bourassa (Florida Atlantic University) and Donato Scognamiglio (University of Berne) discuss unusual aspects of the Swiss housing market, in an attempt to explain why house prices have not exhibited the same boom-and-bust cycle as in other countries and why the homeownership rate remains so low.

Swiss real estate price developments

From 2000 to the third quarter of 2008, the Swiss real estate price index computed by the consulting firm IAZI rose by 32% - a much lower figure than the corresponding 100% for the US. The housing market in Switzerland appears to have peaked in the third quarter of 2008, with a small drop in prices during the last quarter of 2008 (2%) and only a trivial decrease during the first half of 2009.

There was, however, significant geographic variation in house price appreciation in Switzerland, with the canton of Geneva, for example, seeing single-family house prices rising by more than 60% between 2004 and 2008. This suggests that there might have been price bubbles in some regional Swiss markets.

In general, the contained house price increase during the 2000s can be attributed to stringent lending practices by Swiss banks. A 20% down payment is required when purchasing a property and the debt service cannot exceed one-third of the household's income.

Key Concepts

Hedonic pricing: Pricing method according to which the price of a property is determined by the characteristics of the house (e.g. year of construction, number of rooms) as well as the characteristics of the neighborhood (e.g. proximity to schools and retail, level of water and air pollution).

Another moderating factor has been the use by many lenders of hedonic valuation models for underwriting purposes. The hedonic method is based on a set of property and locational characteristics and, compared to other valuation methods, leaves less room for appraiser subjectivity. Hence, estimated values are less prone to being inflated excessively in rising housing markets.

Home ownership in Switzerland

Switzerland has always had one of the world's lowest home ownership rates. It currently stands at 37%. Few other countries have rates below 50% and most have rates above two-thirds.

While governments of countries such as the US actively promote home ownership, Swiss authorities - as the study explains - have maintained a more ambivalent attitude. The tax system, for instance, is not designed to encourage home ownership. Imputed rent (net of housing expenses) is taxed, so are housing wealth and some capital gains. In contrast, rental housing has been the subject of various subsidy programs by both federal and cantonal governments.

Geneva and Vaud are examples of cantons with well-developed subsidy schemes. Tenants in both cantons simply need to satisfy income requirements to occupy a subsidized apartment. Zurich has a similar scheme whereby rents can be reduced by granting loans to landlords at below market interest rates or even without interest. In Geneva and Vaud, the proportions of

“While governments of countries such as the US actively promote home ownership, Swiss authorities have maintained a more ambivalent attitude.”

households benefiting from subsidies are 20.9% and 8.6%, respectively; in Zurich, it's 3.4%.

Consistent with the country's low ownership rate, the authors find that renting a place in Switzerland does, indeed, tend to be less expensive than owning one. Besides the tax matters mentioned above, residential real estate prices are high compared to household income. This is mainly due to the scarcity of building land and high construction quality standards.

Links

- Bourassa, S., Hoesli, M., and Scognamiglio, D. (2010), *Housing finance, prices, and tenure in Switzerland*, *Journal of Real Estate Literature*, 18: 263-282: <http://ares.metapress.com/content/y4375126p35p5600/fulltext.pdf>
- Prof. Martin Hoesli: www.SFI.ch/Hoesli
- IAZI: www.iazicifi.ch

Impressum

SWISS FINANCE INSIGHT is published online by the Swiss Finance Institute, Bd. du Pont d'Arve 42, Geneva 4 - Switzerland insight@sfi.ch
T +41 (0)22 379 84 71