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14 January 2016

News Release

UBS Chief Investment Office WM publishes property market study UBS Real Estate Focus 2016: home prices are expected to fall for the first time in 17 years

Since mid-2014 buying a home has been cheaper on average in Switzerland than renting. But the share of households that can finance a home purchase has fallen by half since 2008. Peripheral areas and condominiums have benefited from this trend. Investors should purchase multi-family dwellings in prime locations only if they believe interest rates will remain low over the next 15 years.

Zurich, 14 January 2016 – Last year, asking prices for condominiums rose by a nominal 1.5 percent and by 2 percent for single-family homes. Even though home prices have risen for the last 16 years, the costs of owning a home have been lower than renting a comparable property since mid-2014, for the first time in 15 years. The number of households wanting to purchase a home has therefore expanded.

But it is becoming increasingly difficult to buy one, as incomes have failed to keep pace with the rise in prices. The affordability guidelines of banks restrict the maximum mortgage loan to five to six times a household's annual income. Back in 2008, half of Swiss households would have received financing for 80 percent of the value of a newly built home with 120 square meters. Today, it's only a quarter.

Homes in peripheral areas are gaining popularity

Potential home buyers have been forced to shift their focus from high-priced regions to areas with affordable housing. As a result, the steepest rise in housing prices last year was in eastern Switzerland and German-speaking Central Plateau. In addition, many households are rethinking exactly how much space they need. Condominiums are benefiting the most from this trend, as they require less of a down payment. Condominiums could increasingly replace single-family homes as the property of choice even in outlying locations.

Although operational costs remain low, the price of owning a home is unlikely to rise this year. Widespread loan restrictions, rising vacancies and stagnant incomes are limiting the scope for price rises even in peripheral areas. The average offer prices for single-family homes across Switzerland are likely to stay unchanged this year, while condominiums may even fall by one percent.

Reducing interest rate risk in multifamily dwelling investments

Multi-family dwellings are the star among Swiss investments in the current low interest rate environment. They are one of the few remaining investments with secure and positive cash flows, and are therefore in demand. However, investments in multi-family dwellings could be hit with sharp losses if long-term Swiss government bonds yields were to rise to two percent. From a total return point of view, income-producing real estate in prime locations beats cash investments, despite negative interest rates, only if the low interest rate environment continues for at least another 15 years. So it makes sense to reduce interest rate risk at this time and prefer outlying areas rather than city centers – despite the greater risk of rental losses.

There is only little potential for higher rents, even if interest rates rise. One reason is that rising vacancies for rental units is limiting the potential for increasing rents. In addition, rents have not decreased much in recent years despite a falling reference interest rate, leaving only limited potential for rent increases if interest rates reverse. Finally, rents on new units are currently excessive compared to the market rents for older buildings. As a result, market rents are expected to fall modestly in 2016.

Two-tiered market for office space
Prime initial yields are at 2.5 percent, a record low for the office market. In contrast to the housing market, purchase prices for office properties in less desirable locations have barely risen in recent years due to the vacancy risks. If the number of office workers continues to increase as it has over the past few years, then the market situation should stabilize. From an investment point of view, office properties in B or C locations should offer some opportunity, as the yield difference to top locations is likely to narrow over the medium term. The most attractive area for investing in office space is currently central Switzerland. For Switzerland as a whole, however, this year vacancies are still expected to rise and rents to decline further.

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The UBS Real Estate Focus 2016 property market study is available here:
www.ubs.com/realestatefocus-en.

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