Swiss real estate market

UBS Swiss Real Estate Bubble Index - Q1 2015

Matthias Holzhey, economist, UBS AG
matthias.holzhey@ubs.com

Claudio Saputelli, economist, UBS AG
claudio.saputelli@ubs.com

- The *UBS Swiss Real Estate Bubble Index* stood in the risk zone at 1.31 points after a slight increase in the first quarter of 2015.
- Housing market risks picked up slightly in the face of rising real home prices and continued strong investor demand for residential real estate.
- We expect prices to drop slightly and mortgage growth to slow down further in the quarters to come. Weak price growth lowered regional risks in the first quarter of 2015.

The *UBS Swiss Real Estate Bubble Index* was in the risk zone in the first quarter of 2015 at 1.31 points. It had risen a slight 0.03 points compared to the previous quarter. The rise was driven by an upswing in real home prices of 3.1 percent year-on-year and, more importantly, resurgent demand for condominiums as investment properties (up to 19.4 percent of total loan applications). Property market risks, on the other hand, were kept in check by (still) robust income growth and a relatively moderate increase in mortgage volumes of around 3.5 percent year-on-year.

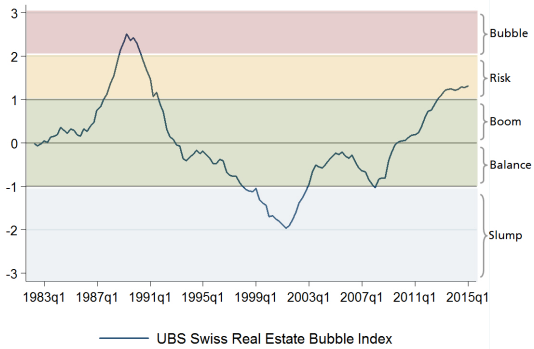
We expect mortgage volume growth to slow down even more. Negative interest rates on low risk investments such as government bonds and meager compensation for riskier investments have made debt service increasingly unattractive. Many higher-earning households will likely prefer to pay down existing mortgages instead of investing in the financial market.

Methodology

The UBS Swiss Real Estate Bubble Index comprises six sub-indices that track: the relationship between purchase and rental prices, the relationship between house prices and household income, the relationship between house prices and inflation, the relationship between mortgage debt and income, the relationship between construction and gross domestic product (GDP) and the proportion of credit applications by UBS clients for residential property not intended for owner occupancy. The UBS Swiss Real Estate Bubble Index is calculated as the average of trend-adjusted and standardized indicators weighted using a principal component analysis. The index level shows the deviation in standard deviations from the average, which is normalized to zero.

The index value is categorized into one of five levels: slump (below -1), balance (between -1 and 0), boom (between 0 and 1), risk (between 1 and 2) and bubble (above 2).

UBS Swiss Real Estate Bubble Index



Source: UBS

Index performance

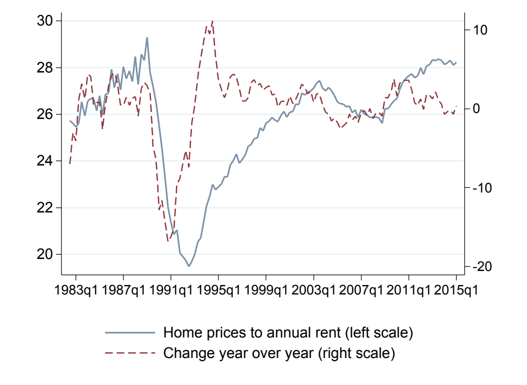
		Index
2012	Quarter 1	0.74
	Quarter 2	0.76
	Quarter 3	0.90
	Quarter 4	1.02
2013	Quarter 1	1.11
	Quarter 2	1.22
	Quarter 3	1.23
	Quarter 4	1.25
2014	Quarter 1	1.21
	Quarter 2	1.24
	Quarter 3	1.29
	Quarter 4	1.28
2015	Quarter 1	1.31

Source: UBS

Sub-indices of the *UBS Swiss Real Estate Bubble Index*

Owner-occupied home prices relative to annual rent payments
Purchase prices rose 0.9 percent quarter-on-quarter in nominal terms, while rents increased a mere 0.4 percent. The price-to-rent ratio thus went up slightly in the first quarter of 2015 and currently stands at 28.2. The indicator has been in a sideways movement for more than two years. However, it currently stands well above the long-term equilibrium of about 25.

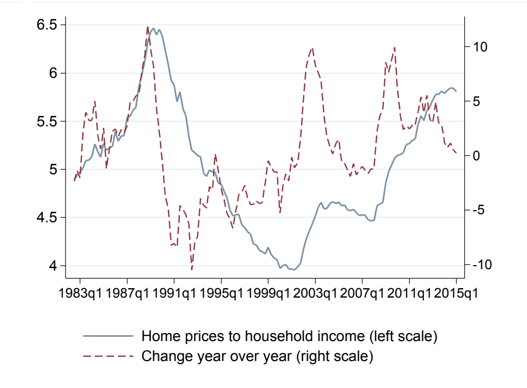
Home prices relative to annual rent
Level and change year-over-year in percent



Source: SNB; UBS

Owner-occupied house prices relative to household income
In the first quarter of 2015, growth in owner-occupied home prices did not quite keep up with growth in household incomes. Approximately 5.8 annual household incomes were needed to purchase a home in the medium price segment. The long-term average is five annual incomes. The indicator will probably rise again in future quarters as incomes are likely to stay more or less flat for now due to the expected cyclical downturn.

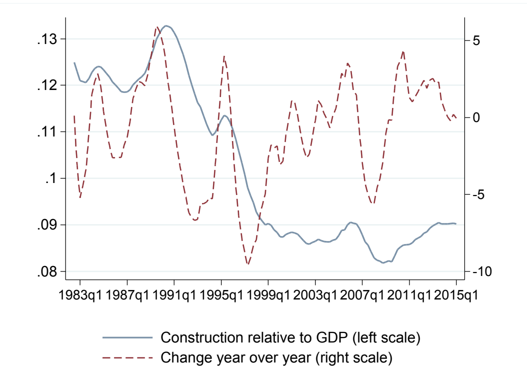
Home prices relative to household income
Level and change year-over-year in percent



Source: SNB; FSO; UBS

Construction relative to gross domestic product (GDP)
Construction investment declined slightly in the first quarter of 2015 and thus underperformed the overall economy. The construction industry's contribution to gross domestic product nonetheless remained steady at nearly 9.0 percent. The long-term average value lies at 10.3%.

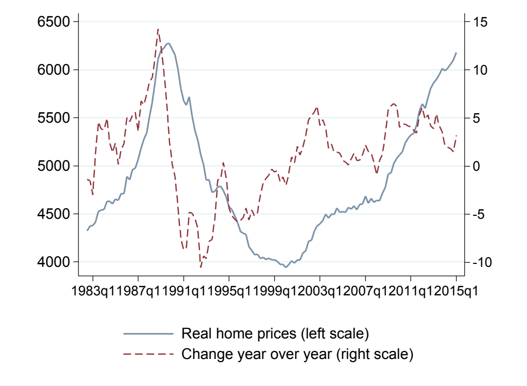
Construction relative to gross domestic product
Level and change year-over-year in percent



Source: seco; FSO; UBS

Owner-occupied home prices relative to consumer prices
Real home prices, as the average value of prices for single-family homes and condominiums, rose 1.3% compared to the previous quarter and 3.1% compared to the previous year. The indicator is just under 1.5% below the price peak of the last real estate bubble in 1990.

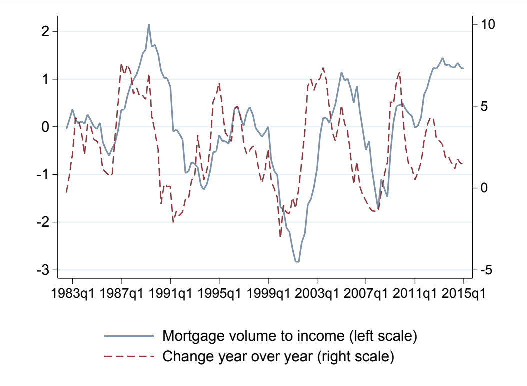
Home prices relative to consumer prices
Real home prices (CHF/m²) and change year-over-year in percent



Source: SNB; FSO; UBS

Mortgage volume relative to disposable household income
Mortgage volumes rose 3.5% year-on-year in the first quarter of 2015, which is slightly faster than in previous quarters. However, the indicator still declined compared to the previous quarter as household incomes rose relatively rapidly.

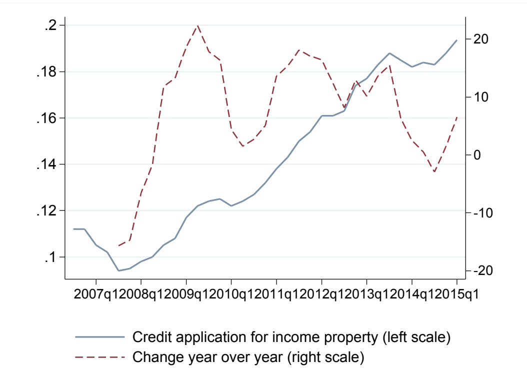
Mortgage volume relative to income
Mortgage debt of private households relative to income (detrended series) and change year-over-year in percent



Source: SNB; FSO; UBS

UBS loan applications for real estate intended for leasing
The number of loan applications for non-owner-occupied properties has reached a new all-time-high. In the first quarter of 2015, 19.4% of all credit applications were for properties not intended for self-occupancy. Negative interest rates should initially sustain demand for condominiums as investment properties.

Credit applications for residential property not intended for self-occupancy
Share of total and change year-over-year in percent



Source: UBS

Regions with risk potential for the residential real estate market

Prices stagnated or declined in three-quarters of all Swiss economic regions in 2014. This trend has changed the risk map. Martigny has been downgraded from a risk region to a monitoring region. The Linth region and Gros-de-Vaud are no longer considered monitoring regions, due to a significant cool-down in price dynamics.

Methodology

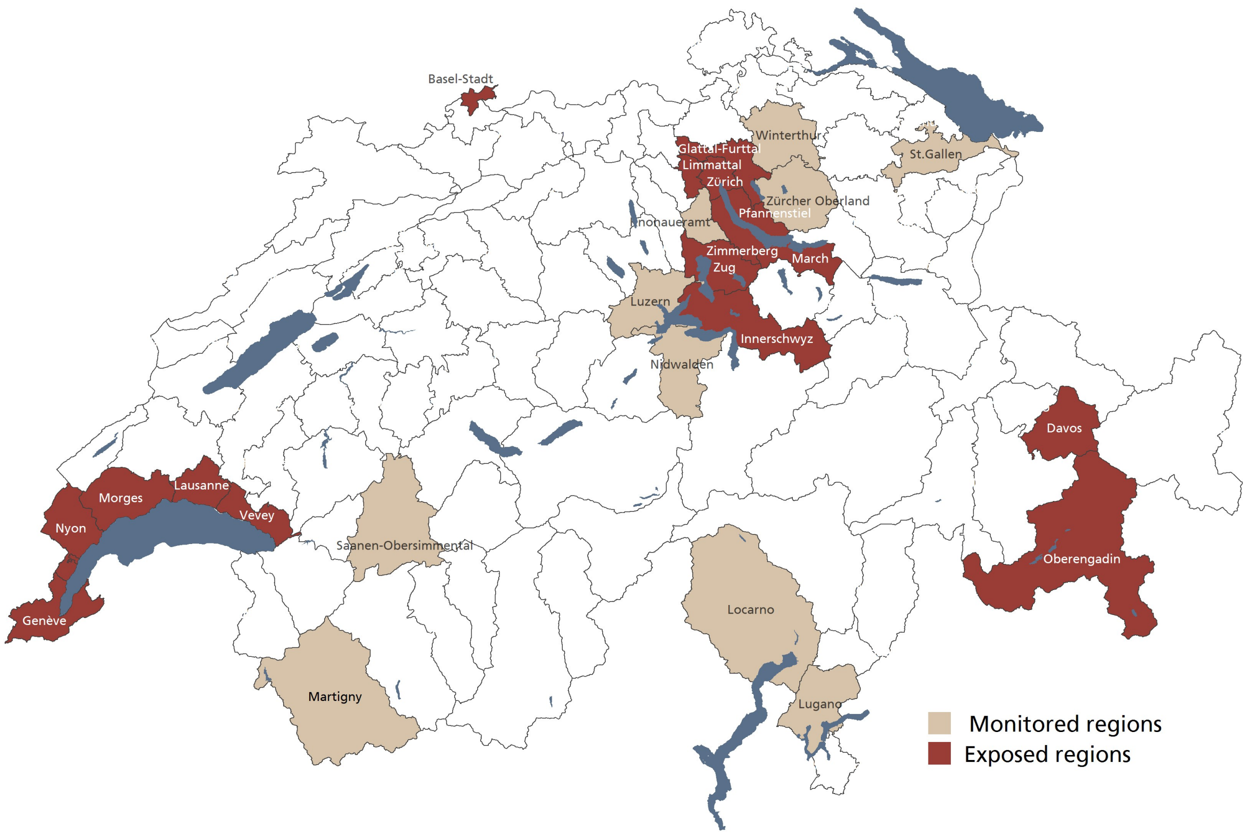
Our selection of exposed regions is tied to the level of the UBS Swiss Real Estate Bubble Index and is based on a multi-level selection process utilizing regional population and property price data (see appendix).

Exposed regions	Monitored regions
Zürich	Knonaueramt
Glattal-Furttal	Zürcher Oberland
Limmattal	Winterthur
Zimmerberg	Saanen-Obersimmental
Pfannenstiel	Luzern
Innerschwyz	Nidwalden
March	St.Gallen
Zug	Locarno
Basel-Stadt	Lugano
Davos	Martigny*
Oberengadin	
Lausanne	
Morges	
Nyon	
Vevey	
Genève	

** in the previous quarter classified as exposed region*

Regional risk map - Q1 2015

Exposed and monitored regions for the Swiss residential real estate market



Source: UBS

Appendix: Regional analysis

We utilize an adjusted relative market growth matrix to measure regional risks and risk accruing to the Swiss economy in relation to the situation of the overall market.

First, every region is assigned to one of four categories on the basis of population and population growth (outer matrix):

- *Star Markets* – densely-populated regions with high population growth
- *Developed Markets* – densely populated regions with low population growth
- *Evolving Markets* – small regions with high population growth
- *Marginal Markets* – small regions with low population growth

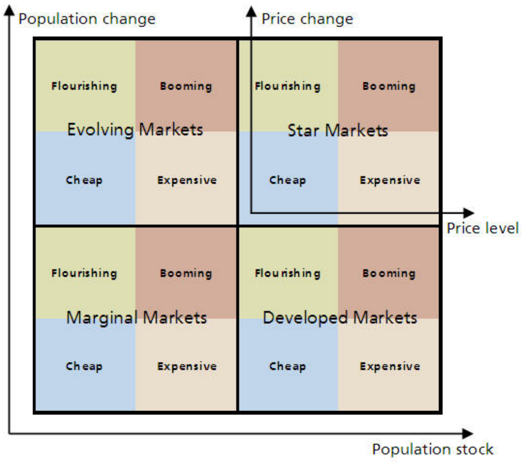
Secondly, the regions are assigned to one of four further categories (inner matrix), irrespective of their categorization described above, based on price levels and housing price increases:

- *Booming* – expensive regions with above-average price increases
- *Expensive* – expensive regions with below-average price increases
- *Flourishing* – cheap regions with above-average price increases
- *Cheap* – cheap regions with below-average price increases

Thirdly, the relative market growth matrix is linked to the UBS Swiss Real Estate Bubble Index, rendering the selection criteria dependent on the current index level. The higher the index level, the less (relatively) restrictive the selection of regions is.

Relative market growth matrix

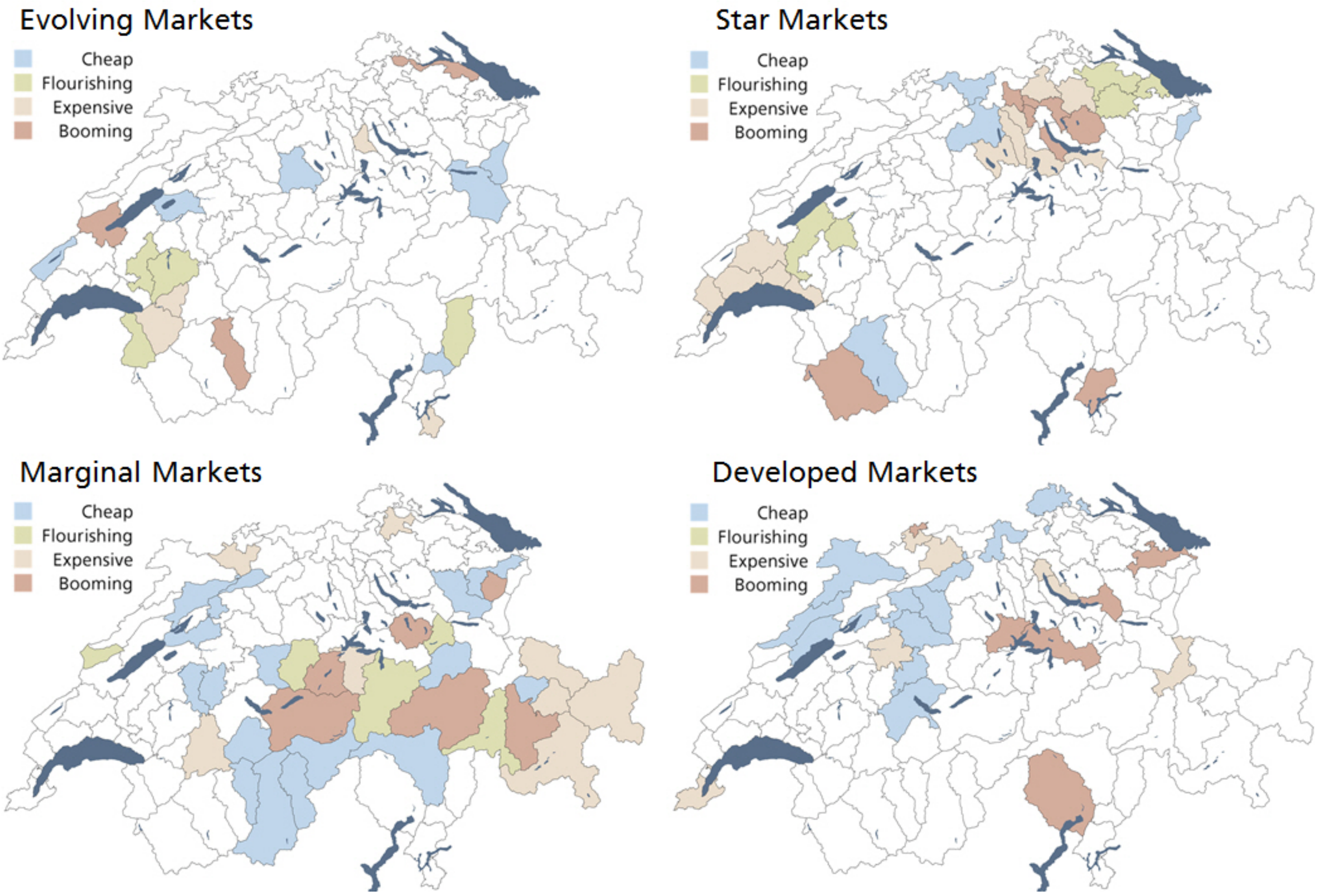
With population and prices as variables



Source: UBS

Example: The upper right quadrant – Star market, booming – contains all regions with both above-average population growth and price increases and that are among the most populated and expensive regions.

Categorization using the relative market growth matrix – overview



Source: UBS

Appendix