UBS

Swiss real estate market

UBS Swiss Real Estate Bubble Index 3Q 2017

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- The *UBS Swiss Real Estate Bubble Index* declined somewhat in the third quarter of 2017 and is currently in the risk zone at 1.38 index points.
- A slight fall in prices and a lower increase in mortgage volumes than in the previous quarter reduced imbalances.
- The demand for buy-to-let investments saw a marginal drop, but is at a level that is not sustainable in the long term.

The *UBS Swiss Real Estate Bubble Index* fell slightly in the third quarter of 2017 and is currently in the risk zone at 1.38 index points. The revised value of the previous quarter is 1.41 index points. The decline in the Real Estate Bubble Index is due to several factors: First, the price of owner-occupied homes fell slightly; second, the growth in mortgage debt was again weaker than in the previous quarters; and third, the demand for buy-to-let investments declined somewhat.

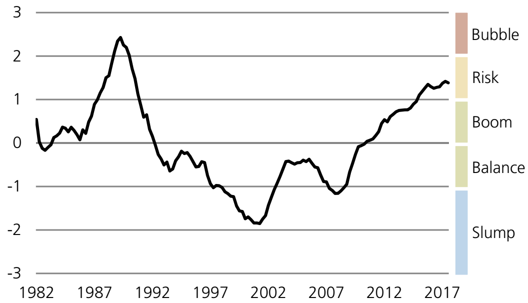
Buy-to-let as a macroeconomic risk

Condominiums for investment purposes still represent a significant proportion of all acquisitions. The proportion of loan applications relating to properties intended for let has fluctuated between 18 and 20 percent since the end of 2012. This contributes to the existing imbalances in the housing market. An economic crisis or a large increase in interest rates is likely to affect this part of the market considerably more than the owner-occupied segment. The low net returns of two to three percent offer hardly any buffer against increasing interest rates, vacancy or falling rents. Investors with low diversification are highly likely to suffer significant wealth outflows in a crisis. In addition, a buy-to-let property is more quickly sold than an owner-occupied home if a household gets into financial difficulties. In summary, this can increase offers in the market in a correction phase and thus increase price pressure.

Demand for residential property remains dynamic

Condominium prices fell in third quarter 2017 for the first time since the start of the real estate boom in the year 2000. Adjusted for inflation, properties saw a price drop of 1.4 percent in comparison to the same quarter of the previous year. However, UBS CIO expects an upbeat end to the year and is not anticipating further price falls in the current quarter. Generally, next year will see an acceleration in the economy and thus also income growth. Moreover, long-term interest rates are expected to rise very little before the end of 2018, meaning that demand for residential property – both for own use and for investment purposes – should remain strong.

UBS Swiss Real Estate Bubble Index



Source: UBS

	Index		Index
2014-Q1	0.76	2016-Q1	1.30
2014-Q2	0.81	2016-Q2	1.26
2014-Q3	0.89	2016-Q3	1.28
2014-Q4	0.96	2016-Q4	1.29
2015-Q1	1.10	2017-Q1	1.38
2015-Q2	1.18	2017-Q2	1.41
2015-Q3	1.27	2017-Q3	1.38
2015-Q4	1.35		

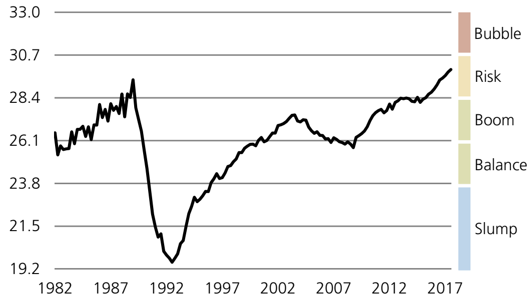
Source: UBS. Owing to data revisions and varying weightings of the sub-indices, slight adjustments can be made to the index values every quarter.

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

Owner-occupied home prices relative to annual rent payments

- An above-average buy-to-rent ratio indicates a high dependency on sustained low interest rates or implies expectations of future price increases.
- The long-term average is 26.1 annual rents. In March 1989, the indicator peaked at 29.3.
- In the third quarter of 2017, it took 29.9 annual rents to purchase a comparable home. The indicator thus increased for the twelfth quarter in a row.

Owner-occupied home prices relative to annual rent payments
Value

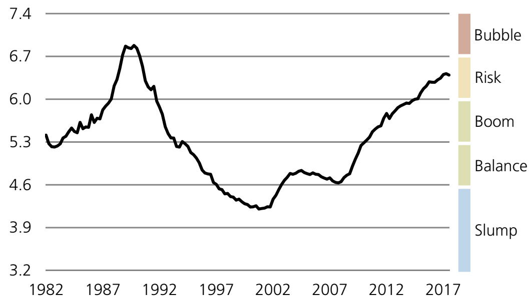


Sources: SNB; UBS

Owner-occupied housing prices relative to household income

- The indicator shows whether the price behavior of the owner-occupied housing market is supported by changes in household income. A decoupling of prices from average household income can be interpreted as a sign of interest rate risks.
- In terms of a long-term average, it takes 5.3 annual incomes to purchase an owner-occupied home in the medium price segment.
- In the third quarter of 2017, it took around 6.4 annual household incomes to purchase an owner-occupied home in the medium price segment. Compared to the previous quarter, the index remained unchanged.

Owner-occupied housing prices relative to household income
Value

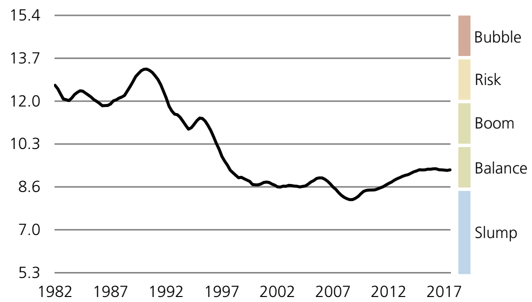


Sources: SNB; FSO; UBS

Construction relative to gross domestic product (GDP)

- If the construction sector gains weight within the national economy, this can signal an overheating of the real estate market.
- The current values are significantly below the peak values of the 1980s.
- Nominal construction investment increased slightly in the third quarter of 2017. In a year-on-year comparison, it saw a rise of 1.6 percent. The contribution of construction investment to gross domestic product stayed steady over the year at 9.3 percent.

Construction relative to gross domestic product
Share of total

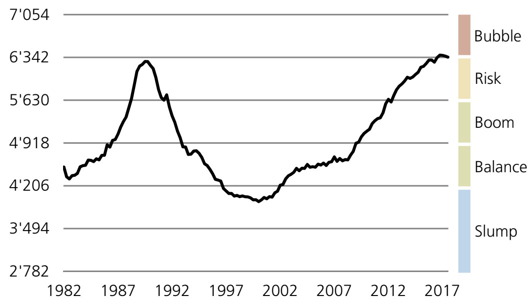


Sources: SECO; FSO; UBS

Owner-occupied home prices relative to consumer prices

- In the long term, owner-occupied housing prices are likely to be oriented towards the development of construction costs and general inflation. A sharp and lasting increase in inflation-adjusted owner-occupied housing prices is thus a warning signal for a possible correction.
- After adjustment for inflation, owner-occupied housing prices are now barely above the high of 1989.
- Prices for owner-occupied homes fell 0.3 percent, with this being attributable to the considerable decline in asking prices for condominiums of over one percent. By contrast, the consumer price index remained unchanged in the third quarter of 2017.

Owner-occupied home prices relative to consumer prices
Real owner-occupied housing price behavior (CHF/m²)

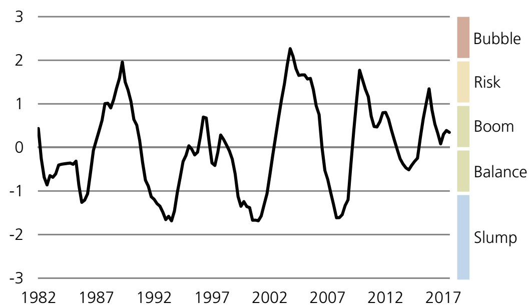


Sources: SNB; FSO; UBS

Mortgage volume relative to disposable household income

- A sharp growth in mortgage debt is a clear indication of the owner-occupied housing market overheating. In the event of an increase in interest rates or a correction in owner-occupied housing prices, high household debt increases the negative consequences for the national economy.
- The volume of outstanding household mortgages rose only 2.6 percent compared to the previous year. This is the lowest value since 1999. On average over the last 10 years, outstanding mortgage volumes have risen 3.8 percent per year.
- The sharp slowdown in household debt growth dampened the development the Real Estate Bubble Index in the last few quarters.

Mortgage volume relative to income
Mortgages of private households relative to income (trend-adjusted, standardized)

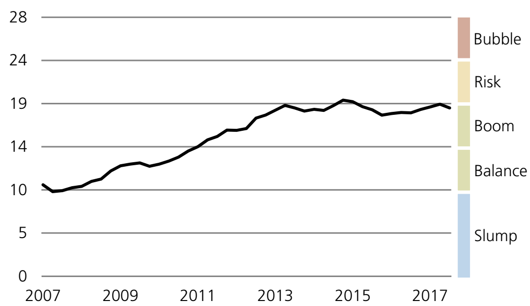


Sources: SNB; FSO; UBS

UBS loan applications for real estate intended for leasing

- High demand for residential property for the purpose of leasing (buy-to-let) indicates speculative demand.
- However, the current value remains below the record high in 2015.
- The number of loan applications for non-owner-occupied properties declined slightly in the third quarter of 2017. Buy-to-let nevertheless appears to remain a popular investment strategy, accounting for 18.2 percent of all loan applications.

Credit applications for residential property not intended for owner occupancy
Share of total



Source: UBS

Regional analysis

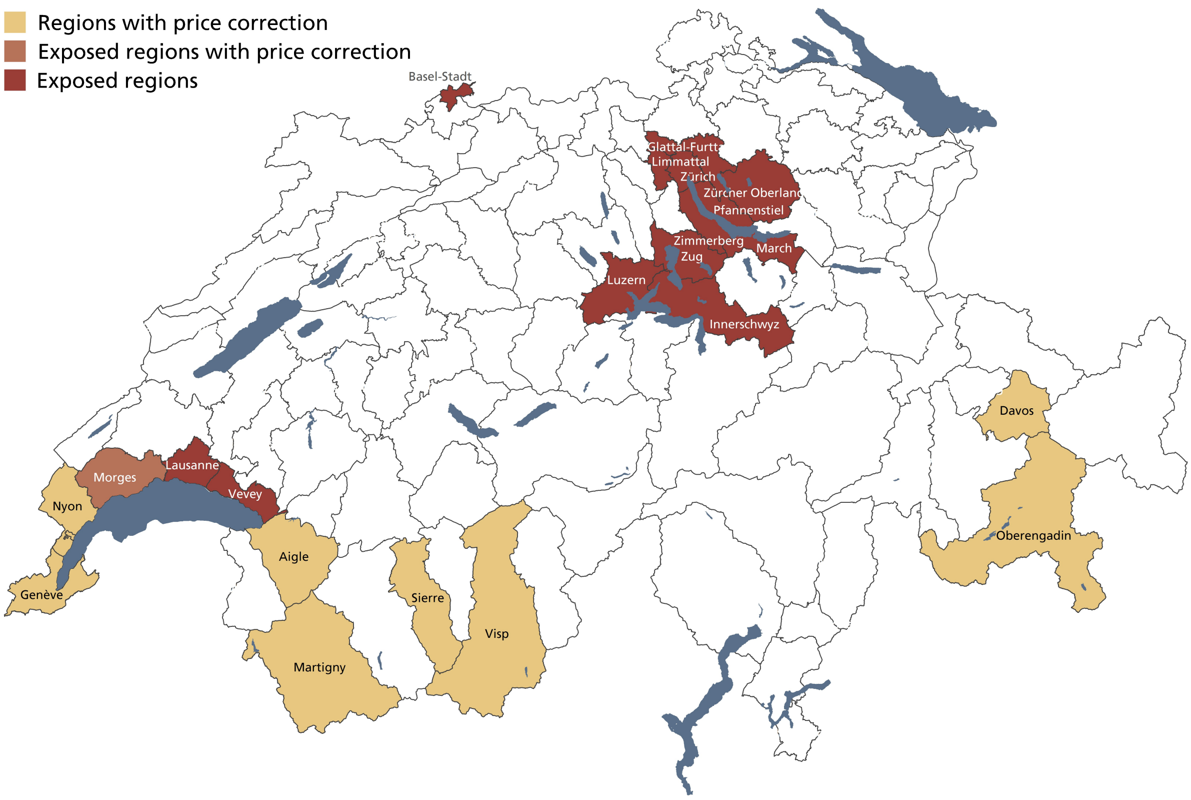
The number of risk regions remained unchanged in 3Q 2017. The Geneva, Nyon and Morges regions are in a correction phase. Local owner-occupied housing markets have already cooled down in these regions. In the past three years, price corrections in the Valais, the Bernese Oberland and parts of Graubünden have led to no tourist regions being on the risk map anymore. The regional risk focus is gradually shifting from Lake Geneva to the regions of Zurich and Central Switzerland.

Methodology

The regional risk map shows those regions posing the greatest macroeconomic risks in the event of a Swiss-wide correction. The analysis is based on the population size, the price level and the price behavior for owner-occupied homes. The selection of risk regions is linked to the UBS Swiss Real Estate Bubble Index. Vacancy or liquidity risks are not taken into account.

Regional risk map – 3Q 2017

Risk regions for the Swiss residential property market and regions with a price correction of more than 5 percent since 2013



Source: UBS

Appendix

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