# The brokers are to blame for the real estate bubble!

**... if you only take a superficial look at the complexities of the market, you might draw this mistaken conclusion.**

**The facts on the real estate market - and why there is no real estate bubble. In the following discussion, we explain a few facts on the current real estate market. It is our considered opinion that there is no „bubble," and therefore, we are not on the perilous brink of a bursting real estate bubble.**

**1. We need our living space: Use of newly created housing / net migration to Switzerland**

Switzerland continues to have a positive migration balance, or in other words: more people are immigrating to Switzerland than emigrating from it. Certain business sectors downright depend on the migration of foreign labor into Switzerland. Moreover, there are still a number of wealthy Europeans who for various reasons (mainly security and taxes) settle in Switzerland. These individuals need a place to live – a commodity that is very limited in Switzerland right now. This factor, combined with the population gravitating more and more to „single-only" households and the trend toward more living space per inhabitant, forms the bedrock of a very robust real estate demand. Newly constructed properties are finding buyers, which in industry lingo is referred to as „take-up."

**2. We can afford it (at the moment): the Housing Affordability Index as key measurement figure**

The Housing Affordability Index (HAI) indicates how much of one's disposable income is used for housing. The Index is used by banks too, to regulate the portability of mortgages. Normally, not more than 33 % of income is spent on residential needs. The HAI is currently at a nadir of 20 % – 25 %, according to a study by Credit Suisse Economic Research. In addition, according to this study, nearly 80% of mortgages are already firmly committed.

Thus the market is shielded from interest rate increases for an extended period of time: even as interest rises, the HAI is not going skyrocket overnight. According to the study, one can safely assume that the HAI will only exceed the golden rule of financing (33 % of available income used toward housing) when interest rates start hitting 4.5 %.

The HAI is influenced by two key indicators: the cost of interest and available income. Currently, the index is so steep because income in Switzerland has progressed favorably, despite the financial crisis. At the same time, the costs of interest have declined, and have hovered at historic lows for quite a while now. However, this can change rapidly if that available income drops (e.g., as unemployment increases). When the real estate bubble burst in the USA, the HAI equaled roughly 50 %. Americans speculated on the notion that they could pay back delinquent bank interest by waiting for the value of their real estate to rise - and then making a profit on the sale of it. This speculation turned out to be wrong and ultimately led to the collapse.

**3. There is little speculation in the Swiss real estate market**

Real estate markets often suffer from a monstrous wave of speculation, which runs ahead of a market crisis. In the USA, just before the real estate speculation bubble burst, everyone worked as an intermediate broker. Additionally, people showed up as property buyers, lured into buying by nefarious real estate and mortgage brokers, without putting the money in a „safe investment.“ These buyers had no need for the housing, and had no clue about investing. Voracious real estate developers additionally created the ostensible supply for this speculative demand. In Spain as well – thanks to corruption, deceptive market appraisals and the benign assistance of improvident banks – real estate was erected that neither satisfied a use nor reflected a buyer‘s needs. Dubai epitomizes speculation at its pinnacle. Here, properties had already changed hands three to four times by the construction phase - and each time at a profit, tax-free.

Thankfully, the Swiss real estate market is not built upon such unbridled speculative activity. Indeed, market actors also speculate on increasing prices, especially promotional companies that are planning new condominiums, and that have had these projects on their books for up to three years each. Yet the projects can only be erected if at least one-half or two-thirds of the units are sold. This way, the banks that are financing the loan can put a stop to it, preventing the projects from getting started unless they reach this stage.

For the short-term holding of real estate, the property gains tax in the majority of cantons is progressive, so speculation with standing property investments is not feasible in the short term. If business is brisk, those who pursue such endeavors anyway are promptly taxed as professional real estate brokers. These activities come with additional tax problems (direct federal taxes and „AHV“ or publicly-mandated old age/survivor‘s insurance), which are often a nightmare for speculators. In a few cantons, the tax on earnings for assets with short holding periods even exceeds the speculative profit.

**4. The Swiss economy is robust**

The Swiss economy coped with the financial crisis relatively well. This can also be seen in today‘s strong franc, which is synonymous with the performance and the security of the economy. Since significant assets of a national economy are tied to the real estate market, a real estate market crisis is often the trigger for a national economic crisis. According to the Credit Suisse study, the ratio of private loans to GDP rose from about 70 % (for 1997) to levels in excess of 100 %. At the same time, the percentage of home ownership has risen from approximately 33 % to 40 % today.

This increase partially explains the expansion of the credit volume in Switzerland. A vast mortgage market, however, makes the national economy more vulnerable to interest fluctuations. In the USA, the real estate industry held major importance before the crisis, since it made up 6.3 % of gross domestic product (GDP). Following the burst of the real estate bubble, as economic performance lagged, so too did the importance of the real estate industry – to 2.4 %

**Our market forecast (2011)**

As real estate brokers, we are no prophets. Still, we do allow ourselves to make a few comments on today‘s market, and issue a forecast on the future development of the Swiss property market:

- Every market is cyclical. This is as true for the real estate market as it is for stock markets or the markets for cotton, orange juice, or gold.
- It is not important when you buy a property, but rather when you sell it - or have to sell it. The times in which you can rake in real estate profits without a care, or without price increases, do not last forever.
- Since the last real estate crisis in 1992/93, prices have steadily increased in Switzerland. No downturn is on the immediate horizon, yet basic conditions will continuously change - and not always in favor of the real estate market.
- At the latest, when continuing inflation becomes measurable in Switzerland, interest rates will increase and negatively influence the real estate market.
- With a moderate-level increase in interest rates that comes at a gradual pace, you can assume the market will make a „soft landing“. In our eyes, this is the most likely scenario over the medium term. In this case, price increases will slow down, and consolidate at a high level.
- If basic conditions change swiftly and sharply, especially the health of the national economy (income, unemployment), then the landing will turn out to be markedly less „soft.“

of GDP. According to Swiss National Bank, in the year 2005 the ratio of the construction industry to the nation‘s collective economic value creation equaled roughly 6 %, and its ratio to employment was at roughly 9 %. Even more impressive are the facts that pertain to inventory sizes. Thus, the value of the total inventory of buildings in 2005 equaled approximately CHF 800 billion, and thus made up around 60 % of the total real capital inventory of Switzerland.
The real estate market could implode from the problems it created itself. Yet even external factors could exert a negative influence on the real estate market or, if a bubble is present, cause it to collapse. These factors include unemployment, an overinflated currency, declining wages and assets or new taxes. At the moment, few signs are evident in Switzerland which indicate any acute threat to the real estate market by external factors. Indeed, the assumption of the fair taxation initiative at the end of November 2010 in and of itself could have had a negative influence on the prices of high-end luxury properties, and on wealthy foreigners continuing to settle in Switzerland.

**5. The market is intact: Supply and demand are determining prices**

In the USA, the market has been totally inefficient since the real estate bubble burst. The banks do not trust the market, and are issuing no more financing. Consequently, the banks are nipping any viable demand in the bud. The

**COUNTERPOINT**

**Swiss National Bank warns of a potential real estate bubble**

In various reports, Swiss National Bank warned of the developments in the real estate market. On the one hand, it analyzed the market, but also held interviews with banks. The following is a brief summary of the most salient points on the real estate market that Mr. Philipp M. Hildebrand made during a presentation in Ticino on October 28, 2010:

- Generally speaking, only moderate price increases of 1 % to 4 % p.a. have been identified in Switzerland; however, there are a few „hot spots“ where appreciable price increases have been detected.
- Inflation has been particularly sharp in locations with high vacancy figures (Zurich, Geneva).
- From a historical perspective, a longer expansive monetary policy elevates the risk of unfavorable or aberrant development.
- Swiss National Bank believes in the theory that bubble-like price inflation is often followed by severe but fundamentally justifiable price increases. It said that this had been the case in the USA until 2004.
- Mr. Hildebrand advised caution when granting mortgages. A survey of banks indicated that real risks were building up on the mortgage interest front.
- A few banks stood out for their slightly too incautious approach to granting mortgages. It was stated that these banks‘ mortgage commitments often failed to meet their own lending criteria.
- Still, Swiss National Bank contends that there is no reason for panic. The price increase over the last few years can be explained, with few exceptions, by population trends and income development. The exceptions are understood as warning signals, though. The risks are attributed foremost to the mortgage lending business.

In sum: Swiss National Bank‘s warning primarily pertained to the mortgage market, and it determined that the regulations crafted by the banks were apparently no longer being upheld. If this is truly the case, then the warnings are understandable. A too expansive monetary policy of the National Bank, with an expansive lending policy of domestic banks, is an explosive mixture, and when combined with increasing interest, these factors can swiftly lead to a market imbalance.

bonanza of foreclosure sales – which constitutes up to 40 % of all sales – is expanding the supply side even further, as price instability looms on the horizon. Finding a way out of this maelstrom is no easy task; indeed, it is a long-term undertaking. After the collapse of the real estate bubble in the early 1990s, a similar situation was observed in Switzerland. Although we have long since had an intact market in Switzerland, both in terms of supply and demand, that could swiftly change. After the end of the dot.com bubble in 2001, and at the beginning of the financial crisis in 2009 (2nd quarter), deflationary tendencies were palpable among buyers in the market. They speculated on plummeting property prices. Fortunately for the real estate market, it was able to catch itself; however, one could sense how little it takes for homebuyers to gauge their purchase decisions emotionally, and hold off for just another day if prices are allegedly declining.

**Author: Claude Ginesta**

Claude A. Ginesta is a federally licensed real estate fiduciary (registered with the SVIT, the Swiss Federation of Real Estate Fiduciaries) and owner and CEO of Ginesta Real Estate AG. The company was founded in 1944 and specializes in the sale of properties in the Zurich and Grisons markets. With offices in Küsnacht, Horgen and Chur, the company operates as real estate broker throughout Switzerland for properties located across the country.

**Publisher of the “Illusions” series**
Ginesta Real Estate AG, www.ginesta.ch