Newsletter on home ownership

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UBS immo *news*

Home ownership: *secure financing* and smart retirement planning.

For many Swiss people, owning their own home is a dream come true. It makes sense for homeowners to think about protecting themselves against risk early on so that they are well-equipped to face crucial financial situations.

Owning private residential property, whether a condominium or house, is an investment that is geared to the long term. Consequently, it is important for there to be a solid financial basis for this investment. Neither the cost side nor the income side should be underestimated. According to the feasibility calculation commonly applied today, interest payments, mortgage repayments, maintenance costs and ancillary costs together should not amount to more than one-third of the available gross income. The interest rate applicable for this calculation is not the current, extremely low interest rate, but a long-term average rate of five percent.

To make sure you benefit from the best possible financial advice over the longer term, how you finance your home should not be looked at in isolation, but should be an integral part of your overall personal financial planning. Elements that are important here include the structure of your assets for achieving further financial goals, the protection you have in place and tax aspects.

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UBS

Editorial

Roger von Mentlen
Head of Private Clients Switzerland

Dear Reader,

Owning their own home is a dream for many Swiss people and one which more and more people want to turn into a reality. Life is not always straightforward, however, and not everything can be planned right down to the last detail: unforeseen events can have unexpected financial consequences.

In the current edition of UBS immo news, you can find out how to protect yourself and your loved ones against risks, how to repay your mortgage astutely and what role your retirement cover can play.

How you finance your residential property – now and in the future – should be integrated into your overall financial planning. Your client advisor can help you put together a "roadmap" tailored to your individual financial possibilities, your life goals and your need for protection.

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Does it make sense to use *long-term* fixed-rate mortgages?

Yields on ten-year Confederation bonds doubled from their record low of 0.4 percent in December of last year to 0.8 percent within the space of a month. This shows that long-term interest rates can rise rapidly if markets become willing to take on more risk.

Extremely accommodative monetary policies around the globe are holding back a more substantial increase for the time being, however, so it is not much of a surprise that yields have come back down again slightly. They stood at 0.6 percent at the end of April. The fact is that interest rates remain at a record low. To give a clear basis for a comparison, yields on ten-year Confederation bonds were over two percent as recently as mid-2011.

Over the past 20 years, Libor financing has constantly remained cheaper than longer-term fixed-rate mortgages. Given that interest rates cannot move much lower, this is not a situation that can go on forever. In order to weigh up the costs and risks associated with mortgage financing properly, it is important for mortgage borrowers to take a long-term view. While our main scenario assumes that interest rates will gradually return to a more normal level, we are also envisaging high and low interest rate scenarios in order to map potential risks. Long-term financing thus appears to represent the safest strategy in the current environment. However, given that we expect money market rates to remain at zero until mid-2015, the costs of the various financing strategies are roughly on a par with one another.

Our scenario analysis nevertheless shows that the ten-year fixed-rate mortgage offers the most attractive profile (see UBS Research report on interest costs for mortgages, available in German and French). When comparing scenarios, possible savings with a mortgage of one million Swiss francs amount to a total of around 65,000 Swiss francs with an extremely low interest rate backdrop and Libor mortgages, contrasting with potential additional costs of around 190,000 Swiss francs. Consequently, a short-term financing strategy can only be recommended when taking a pessimistic view of longer-term economic developments.

The analysis also shows that switching from a Libor to a long-term mortgage when interest rates are rising generates significant extra costs. In the example given above, borrowers who switch to a ten-year fixed-rate mortgage when the Libor starts to rise (from mid-2015 according to our forecast) will pay a total of around 50,000 francs more than if they switch to long-term financing straight away. In order to reduce the refinancing risk, however, long-term fixed-rate mortgages should always be combined with a variety of mortgage terms.

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What happens if you are unable to work?

Being unable to work as a result of illness or an accident means that substantial financial gaps have to be filled. In Switzerland, all employees are insured against being unable to work following an accident up to an annual income of 126,000 Swiss francs under mandatory accident insurance (UVG). Being unable to work through illness, however, results in greater shortfalls. Let's take the example of Mr. and Mrs. Smith, who have bought a house for 700,000 Swiss francs. To finance their purchase, they took out a mortgage of 500,000 Swiss francs. Imputed costs amount to around 37,000 Swiss francs per year. Most of the household's income comes from Mr. Smith, who has an annual gross income of 110,000 Swiss francs. As a mother and housewife, Mrs. Smith earns 8,000 Swiss francs from a part-time job. As things stand, income and fixed costs for interest payments, mortgage repayments, building maintenance and ancillary costs are well balanced. But all that would change if Mr. Smith became unable to work (see table).

The financial shortfall would be even greater if the main breadwinner were to die as a result of illness. Widow's and orphan's pensions from AHV and pension funds are generally insufficient to allow the household to carry on in the same financial circumstances as before and to cover the cost of being a homeowner at the same time. For this reason, Mr. and Mrs. Smith are investigating options with their client advisor. One solution would be to protect the family against financial risk by taking out a life insurance policy to cover the risks of death and/or disability.

Since each case is different, a client's specific needs in terms of protection must be judged on an individual basis. In certain cases, it makes sense to take out a term insurance policy on a large part of the mortgage volume. Survivors would thus be left with less mortgage debt to pay off and would be able to continue financing their home despite the lower income, thanks to survivor benefits. UBS offers appropriate tailored insurance solutions here with products from Swiss Life.

Benefits and income in the event of inability to work through illness

The calculation below is a sample calculation; actual pension benefits can vary depending on individual situations. Basis: Mr. and Mrs. Smith, one child.

Pillar 1	
Husband's disability (IV) pension	CHF 28,080
Disability child's pension	CHF 11,232
Pillar 2 (pension fund)	
Disability (IV) pension	CHF 30,000
Disability child's pension	CHF 7,500
Pillar 3	
Disability pension	–
Disability lump sum	–
Total pension benefits	**CHF 76,812**
Wife's gross income earned	CHF 8,000
Required for own home (feasibility calculation)	CHF –111,000
Shortfall	**CHF –26,188**

Source: UBS Financial Planning

Smart mortgage repayments

Financial planning has to factor in and envisage further events, such as a drop in income following a change in job, unemployment, an addition to the family or a divorce. Alongside protecting yourself, therefore, it is important to pay off your mortgage sensibly. Homeowners who have spare funds available in periods of low interest rates are well advised to build up some reserves. Depending on the mortgage chosen, extraordinary repayments are also possible, and this can help reduce the particularly high burden of paying back a mortgage in the first few years. In accordance with the self-regulation of banks introduced in 2012, mortgages have to be reduced to at least two-thirds of the market value within 20 years.

From a financial and tax perspective, indirect mortgage repayments are the best bet. Here, the repayments made are not used to pay off the mortgage debt directly, but are paid instead into a pillar 3a account, for example. Tax deductibility thus remains intact in respect of the mortgage interest, which is advantageous from a tax point of view. Added to this is the fact that deposits into a 3a account are fully deductible from taxable income up to an amount of 6,739 Swiss francs per year (for people with a pension fund). When making indirect repayments, the assets in the pillar 3a account are pledged to the bank and used to repay the mortgage debt at the latest upon retirement. Any surplus funds or funds remaining in the account are then paid out to the client.

UBS offers various instruments for this option:

- UBS Fisca account: for tax-privileged saving in a restricted retirement savings account (pillar 3a).
- UBS Fisca custody account: building up retirement savings via investments in securities, with six investment funds to choose from.
- UBS unrestricted retirement account and custody account 3b: additional savings and investment options for your private retirement planning.

"Withdrawing pension assets early can shrink pension benefits."

Good to know

The savings built up in a tax-privileged pillar 3a account can also be put towards owner-occupied residential property at a later stage, if major renovation work is required, for example, or if you are looking to pay off your mortgage completely. The investment rates of interest within pillar 3a may be higher than the currently low level of mortgage interest rates, taking into account the tax advantages involved. You thus save twice over and create scope for reducing your mortgage later on if interest rates rise.

Interview with René Knoblauch, financial planning expert at UBS

René, for most people, buying their own homes is one of the "big" moments in their lives. Isn't it difficult to combine financial planning, retirement planning and the consequences of possible disability into advisory services all at the same time?

René Knoblauch: Financing comes at the very start of the advisory process. Where the equity comes from, the choice of financing strategy and financial feasibility: these are the cornerstones of the process. Today, for example, buyers have to put in at least ten percent of their own money and this money can't come from a pension fund. If pension assets are being withdrawn, you always have to be aware that the tax due has to be paid from freely available assets and that gaps could arise in your pension cover. Depending on the pension scheme involved, pension benefits could be reduced if the person insured were to become disabled or die.

Is the situation for single people or childless couples different from that of families with children?

There is, of course, a big difference, and the advice provided is different depending on the individual circumstances involved. If a family with children lives primarily on the income from one breadwinner, the consequences would be drastic if this person were to become disabled or die. The financial consequences for a couple who both work full-time and who have no children would clearly be less significant.

Is retirement planning primarily an important issue for families and young first-time homebuyers, or is it important for other client segments too?

Retirement planning and financial planning can be just as important at another stage in life and in another specific situation. Questions such as "How will I make my payments?" or "How am I going to finance my retirement?" have to be looked at on a regular basis. Pension funds are under pressure, and this could result in lower BVG retirement pensions in the future. People who have withdrawn pension assets to buy their homes have to make sure they take steps to close the subsequent gaps in their pension cover. For example, if there is a shortfall of 200,000 Swiss francs when a person retires, this results in a life-long annual pension loss of 13,600 francs with a pension conversion rate of 6.8 percent.

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