UBS Swiss Real Estate Bubble Index

Swiss real estate market

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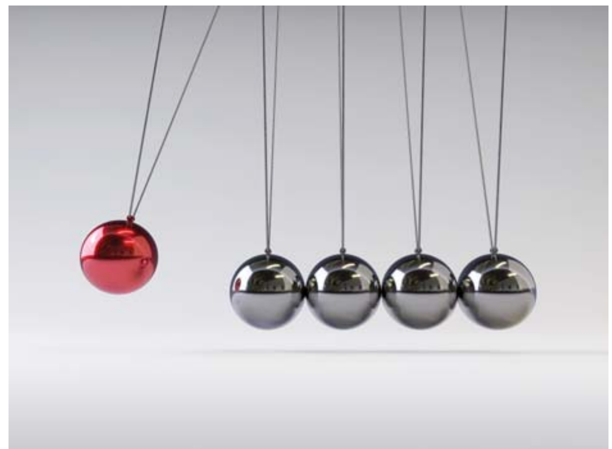
- The *UBS Swiss Real Estate Bubble Index* fell slightly in the first quarter of 2023 to 1.49 points. This means that the market for owner-occupied homes remains overvalued in relation to historical developments.
- There are two main reasons for the fall in the housing bubble index. First, growth in outstanding household mortgages was unusually low, and, second, property prices, adjusted for inflation, fell by 1 percent quarter-on-quarter.
- The greatest imbalance exists in the urban regions, where purchase prices remain inflated compared with rents. The buy-to-let segment in particular represents a substantial risk should mortgage rates continue to rise.



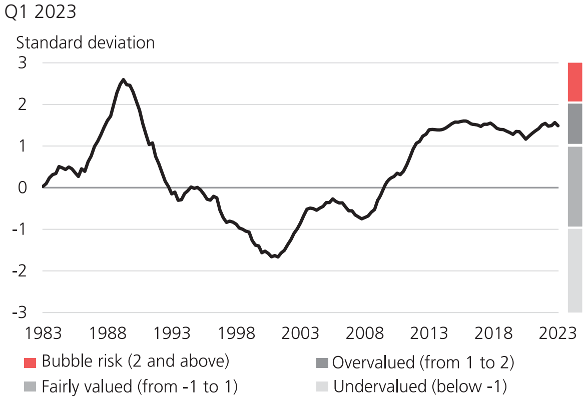
Source: Shutterstock

After a slight fall, the *UBS Swiss Real Estate Bubble Index* currently stands at 1.49 index points. Nominal owner-occupied housing prices rose by 0.5 percent in the first quarter of 2023, only half as much as the 2022 average, and the volume of outstanding mortgages also increased more slowly than in previous quarters. However, it was mainly the strong rise in inflation in the first quarter that contributed to the decline in imbalances in the owner-occupied housing market.

Nevertheless, the index level is significantly higher than before the pandemic and suggests a clear overvaluation of the local housing market. The sub-indexes and the risk map on the following pages show where the risks currently lie in the real estate market.

UBS Swiss Real Estate Bubble Index

Q1 2023

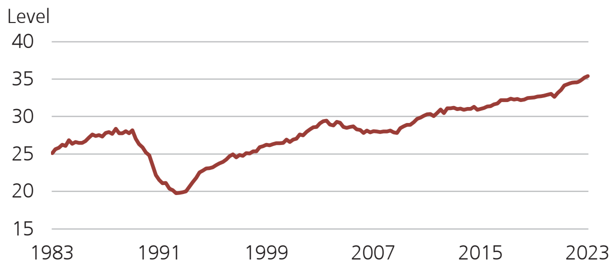


Source: UBS

Sub-indexes

Home prices relative to annual rents

An above-average buy-to-rent ratio indicates a high dependency on sustained low interest rates or implies expectations of future price increases.



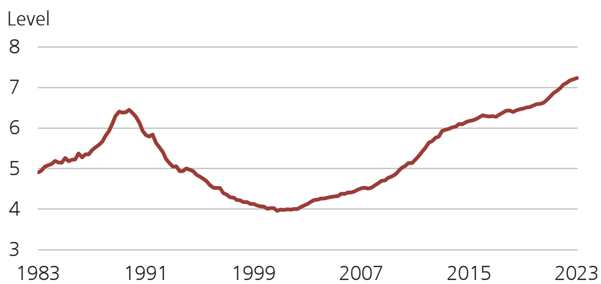
Sources: Wüest Partner, IAZI, FPRE, FSO, UBS

Prices and rents no longer in line with interest rates

Due to low interest rates, purchase prices have decoupled from rental prices over the past decade. Despite the rise in interest rates in the meantime, there was still no sign of this trend changing in the first quarter of 2023. At the same time, the ongoing costs of residential property (assuming debt financing of 80 percent) rose by 45 percent compared with 2019, while rental prices hardly increased at all. A reversal of this trend is overdue, in our view.

Home prices relative to household incomes

If the price development in the market for owner-occupied homes is not supported by a change in household incomes, this can be interpreted as a signal for interest rate risks.



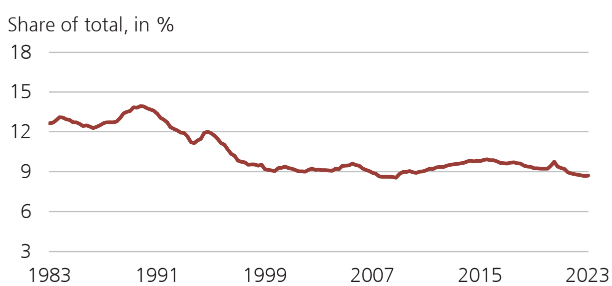
Sources: Wüest Partner, IAZI, FPRE, FSO, UBS

Purchasing power continues to decline

Income per household is likely to have stagnated in the first quarter of 2023, and the purchasing power of the average household in the owner-occupied market continued to decline accordingly. On average in Switzerland, the purchase price is already more than eight times the disposable household income. At the current level of mortgage interest rates, however, homes are still affordable, but the financial costs have risen markedly.

Construction relative to gross domestic product (GDP)

If the construction sector gains weight within the national economy, this can imply an overheating of the real estate market.



Sources: SECO, FSO, UBS

Construction activity not picking up

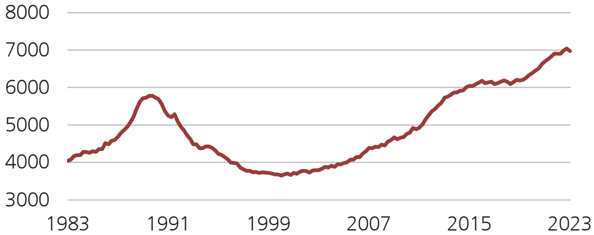
Real construction investment is continuing its downward trend, something we have seen since 2020. The macroeconomic importance of the construction sector is thus further eroding, and the low number of new-builds is likely to counteract a long-term price slump.

Sub-indexes

Home prices relative to consumer prices

If owner-occupied home prices rise faster than construction costs and general inflation for a long time, this can be a warning of a possible correction.

Real owner-occupied housing prices (CHF/m2)



Sources: Wüest Partner, IAZI, FPRE, FSO, UBS

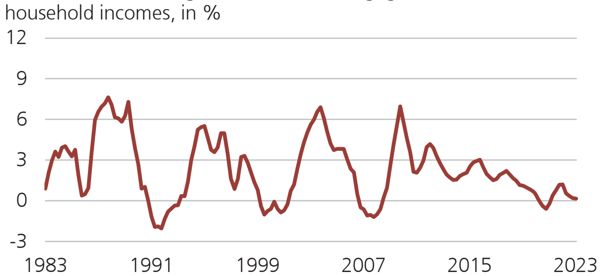
Inflation reduces imbalances

In a year-on-year comparison, housing is still showing a real increase in value, but in the first quarter of 2023, home prices fell by 1 percent after adjusting for inflation. In the coming quarters, too, we believe the prices of consumer goods and services are likely to rise by at least the same rate as residential property prices, and this will help mitigate the risk of value corrections in the medium term.

Mortgage volumes relative to household incomes

An acceleration in household debt that is not accompanied by income growth is a signal of an overheating of the real estate market.

Difference of annual growth rates of mortgage volumes and household incomes, in %



Sources: SNB, FSO, UBS

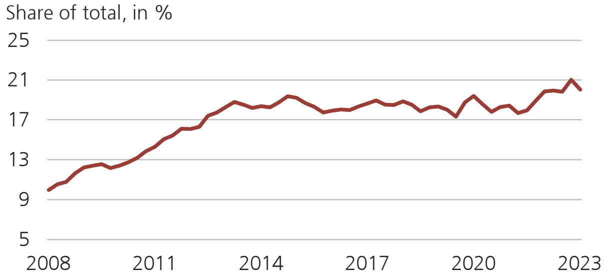
Slowdown in household debt

The volume of outstanding mortgages increased at a much slower pace in the first quarter of 2023 than in 2022, with the growth rate more than halving. This is likely due to fewer transactions and an increased propensity to amortize. Household debt thus developed at a below-average rate, which argues against a heightening of risks in the housing market.

Credit applications for buy-to-let properties

High demand for residential property for the purpose of leasing (buy-to-let) indicates greater speculative demand.

Share of total, in %



Sources: SNB, UBS

Buy-to-let (still) avoiding slump

In general, rental income from highly leveraged buy-to-let (BTL) investments no longer covers costs, yet loan applications for BTL remain at a high level. The first quarter of 2023 has seen a slight fall in BTLs, but sales of BTL properties due to a lack of liquidity are not likely to become an issue until mortgage rates exceed 3.5 percent, in our view.

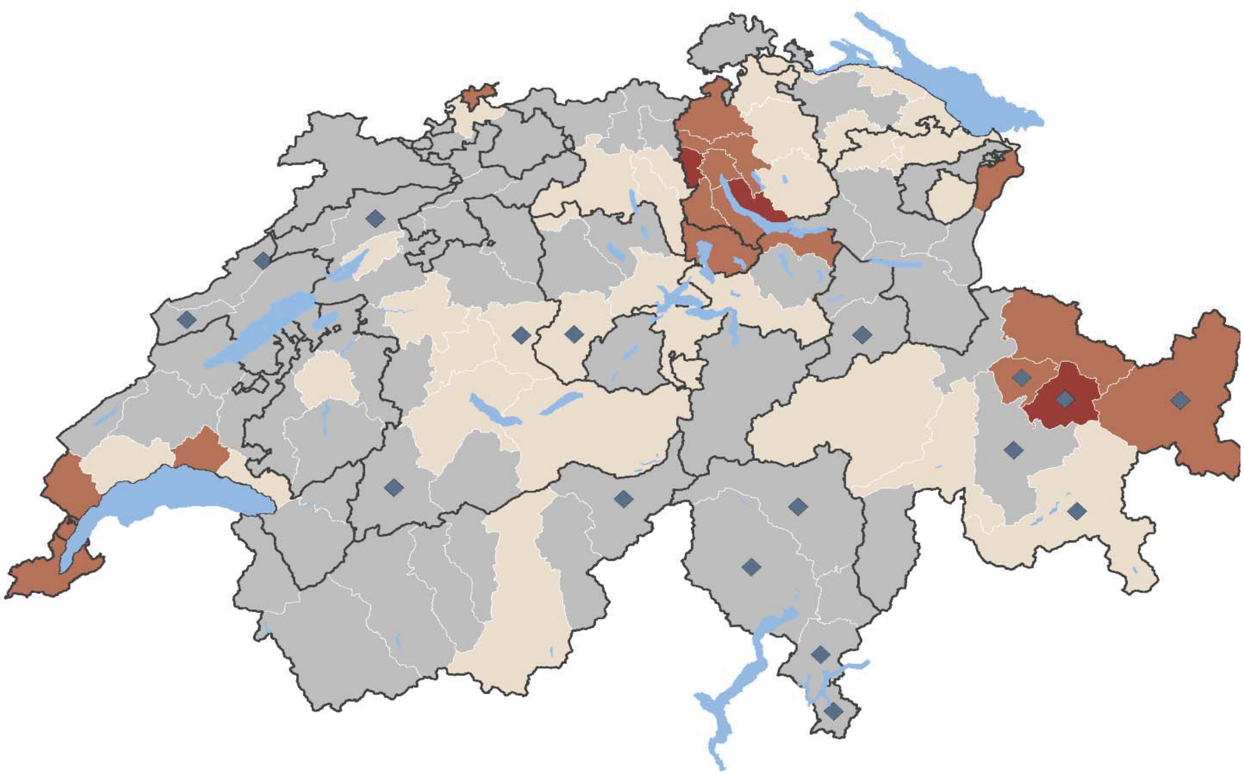
Regional risk map

Risks are particularly high on Lakes Zurich and Geneva and in parts of Graubünden. In these regions, purchase prices have risen significantly faster than market rents over the past five years. The higher the mortgage rates, the faster this imbalance should be reduced. The relative risk in Zurich and Geneva has already fallen from “high” to “elevated” in the past half-year, as local home prices have hardly risen at all while rents have continued to rise.

The regional analysis is based on how the local price-to-rent ratio has changed over the past five years. Regions where this ratio experienced a disproportionately sharp rise have an increased correction risk. In addition, regions with falling population numbers (last three years) are highlighted.

Principles: The trend in rents shows the situation on the housing market. The price-to-rent ratio reflects the interest rate level and expectations about future increases in rental prices. If this ratio experiences a disproportionately sharp rise compared with the other regions, this may suggest that overheated speculation is driving prices in the local owner-occupied housing market. Independent of this, falling population numbers constitute an additional risk for real estate demand.

Regional risk map



Relative risk assessment:
- low
- slightly elevated
- elevated
- high

Regions with falling population numbers

Sources: Wüest Partner, FSO, UBS

Appendix

Index calculation
The UBS Swiss Real Estate Bubble Index represents the weighted average of six standardized sub-indexes using principal component analysis. The index shows the discrepancy, measured in standard deviations, from the mean normalized to zero. The index uses the following classification: Undervalued (below –1), fairly valued (from –1 to below 1), overvalued (from 1 to below 2) and bubble risk (2 and above).

Comment on the adjustment of the index history
Due to adjustments in its methodology and data, the history of the UBS Swiss Real Estate Bubble Index is no longer directly comparable with the numbers in publications prior to the fourth quarter of 2021.

The numbers are now only standardized (recursively) using the data available up to the relevant point in time. For example, the index value in the first quarter of 2015 is calculated using data from 1980 up to the first quarter of 2015. All index values up to and including 2010 are standardized (non-recursively) with data from 1980 to 2010 to ensure there are sufficient data points. That means that the published index values now reflect the imbalances from the perspective of the relevant quarter.

Deviations from the previously published index values can be explained by data revisions—in particular, household incomes according to the FSO—and the switch in price indexes from supply prices to the broader UBS Composite Index (average of all available price indexes) at the beginning of 2020.

UBS Swiss Real Estate Bubble Index
Data series since 2017

Period	Index	Trend*
2017-1	1.47	↘
2017-2	1.52	↗
2017-3	1.52	→
2017-4	1.55	↗
2018-1	1.50	↘
2018-2	1.43	↘
2018-3	1.40	↘
2018-4	1.40	→
2019-1	1.36	↘
2019-2	1.32	↘
2019-3	1.28	↘
2019-4	1.35	↗
2020-1	1.34	↘
2020-2	1.25	↘
2020-3	1.16	↘
2020-4	1.24	↗
2021-1	1.31	↗
2021-2	1.37	↗
2021-3	1.42	↗
2021-4	1.51	↗
2022-1	1.55	↗
2022-2	1.48	↘
2022-3	1.49	↗
2022-4	1.57	↗
2023-1	1.49	↘

Source: UBS.
*Compared to the previous quarter

Appendix

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