UBS

Swiss real estate market

UBS Swiss Real Estate Bubble Index 2Q 2016

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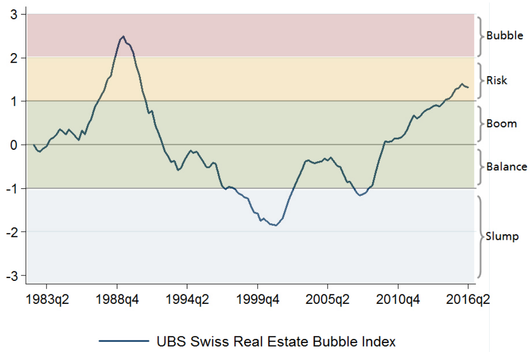
- The *UBS Swiss Real Estate Bubble Index* nudged down in 2Q 2016 to 1.32 points and thus remains in the risk zone.
- This second drop in a row was due to house prices falling in real terms and the declining momentum of mortgage growth.
- Investments in real estate remain popular due to low interest rates.

The *UBS Swiss Real Estate Bubble Index* was in the risk zone in 2Q 2016 at 1.32 index points. The index decreased 0.03 points over the revised figure for the previous quarter. There were two factors behind the slight drop: First, nominal home prices were unchanged compared to the previous quarter. Adjusted for inflation, this corresponds to a decline of 0.6%. On an annual basis, this was the lowest growth rate since 2000. Second, the momentum of mortgage growth also weakened. Private household mortgage debt rose by only 2.7% compared to the previous year – likewise the slowest rate since the turn of the millennium.

Low interest rates are continuing to boost the "buy-to-let" investment strategy. In 2Q 2016, the proportion of loan applications for real estate not intended for owner-occupancy hovered at almost 18%. Real estate investments thus continued to enjoy great popularity, as also confirmed by the figures for building permits. Building permits for almost 30,000 dwellings were granted in the first half of the year, which corresponds to a rise of around 8% compared with the same period of the previous year.

UBS Swiss Real Estate Bubble Index



Source: UBS

Index performance

		Index
2013	Quarter 1	0.80
	Quarter 2	0.84
	Quarter 3	0.89
	Quarter 4	0.91
2014	Quarter 1	0.89
	Quarter 2	0.95
	Quarter 3	1.04
	Quarter 4	1.06
2015	Quarter 1	1.14
	Quarter 2	1.29
	Quarter 3	1.30
	Quarter 4	1.40
2016	Quarter 1	1.35
	Quarter 2	1.32

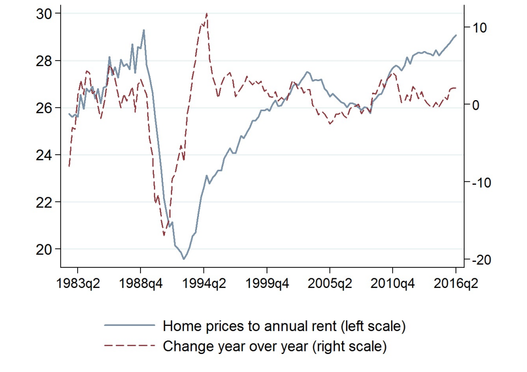
Source: UBS
The index values may be slightly adjusted each quarter as a result of data revisions and varying weights of the sub-indices.

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).

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

Owner-occupied house prices relative to annual rents
While rents declined by a nominal 0.7% year-on-year, owner-occupied house prices were unchanged. This resulted in an increase in the buy/rent ratio. In 2Q 2016, it took more than 29 annual rents to purchase a comparable home. The last time the ratio was higher was in March 1989. The current figure significantly exceeds the long-term average of around 26.

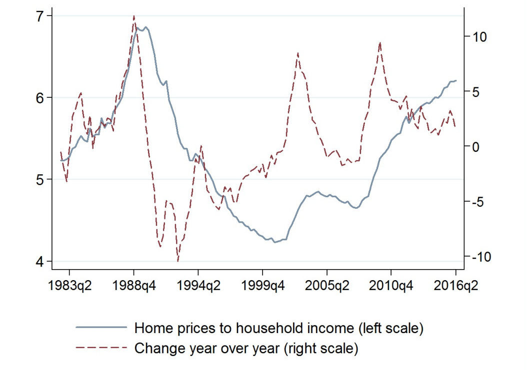
Home prices relative to annual rent
Level and change year-over-year in percent



Source: SNB; UBS

Owner-occupied house prices relative to household income
Nominal prices of owner-occupied homes stagnated in 2Q 2016. Since household incomes fell slightly, the indicator did not go up very much compared to the previous quarter. Around 6.2 annual household incomes were still needed to purchase a home in the medium price segment. The long-term average is 5.3 annual incomes.

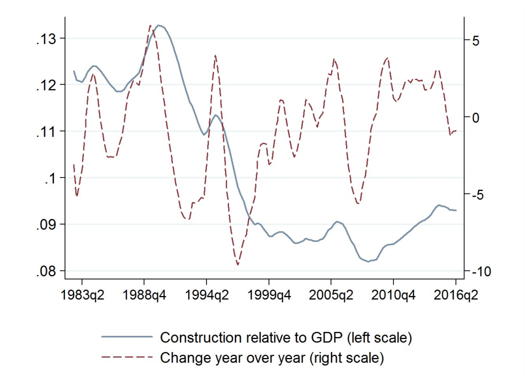
Home prices relative to household income
Level and change year-over-year in percent



Source: SNB; FSO; UBS

Construction relative to gross domestic product (GDP)
Nominal construction investment increased slightly in 2Q 2016. However, investment in the sector declined 0.4% compared to the previous year. In view of the somewhat weaker economic results, construction investment's share of the gross domestic product remained unchanged at 9.3%. The long-term average value lies at 10.3%.

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



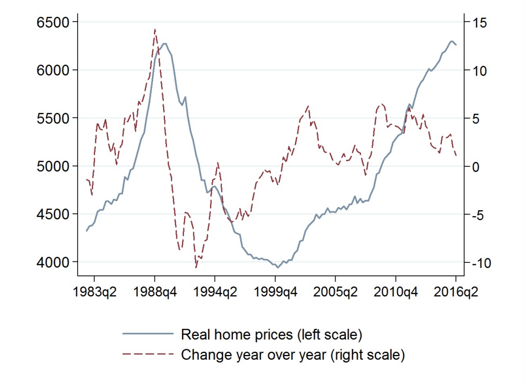
Source: seco; FSO; UBS

Owner-occupied home prices relative to consumer prices

Nominal home prices, as a mean value of prices for single-family homes and condominiums, were virtually unchanged in 2Q 2016 compared to the previous quarter. Due to positive inflation, there was a small price correction for owner-occupied homes of 0.6% after adjustment for inflation. Year-on-year, however, a nominal rise of 0.7% was recorded.

Home prices relative to consumer prices

Real home prices (CHF/m²) and change year-over-year in percent



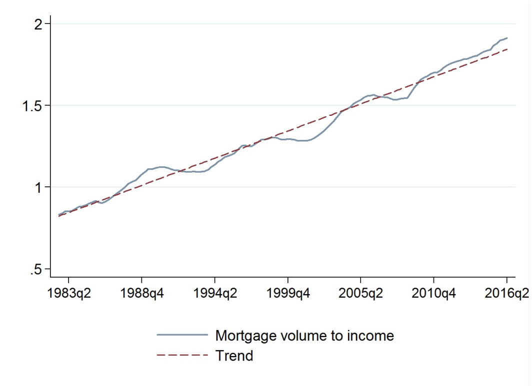
Source: SNB; FSO; UBS

Mortgage volume relative to disposable household income

The momentum of mortgage growth dropped in 2Q 2016 for the fourth time in succession. Mortgage debt only rose by around 2.7% year-on-year. This means that the growth rate fell to its lowest level since the start of 2000. Total debt exceeds disposable income by about 90%.

Mortgage volume relative to income

Mortgage debt of private households relative to income and trend line



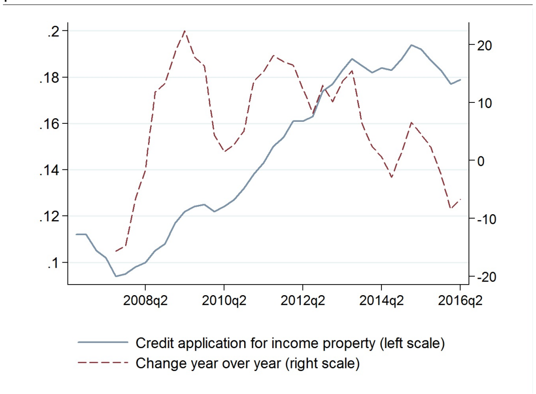
Source: SNB; FSO; UBS

UBS credit applications for residential property not intended for self-occupancy

The number of loan applications for non-owner-occupied real estate rose slightly in 2Q 2016. The figure nevertheless remained substantially below the record high achieved in 2015. Despite historically low long-term interest rates, falling rents and rising vacancies reduced the attractiveness of buy-to-let investments. Buy-to-let nevertheless remains a popular investment strategy, accounting for 17.9% of all loan applications.

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

The risk map has changed to reflect the decrease in the real estate bubble index. The regions Appenzell Innerrhoden, Baden and Thurtal are no longer among the monitored regions. The composition of the exposed regions remains unchanged.

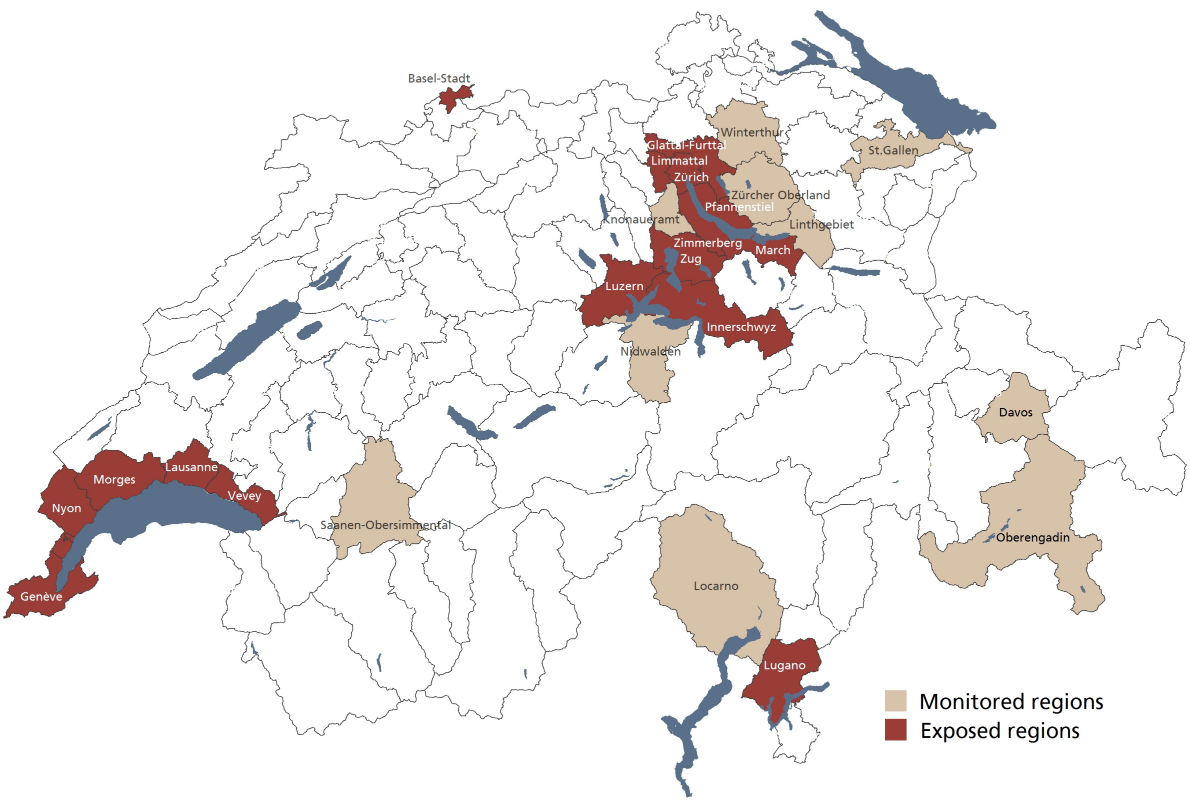
Methodology

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.

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

Regional risk map - 2Q 2016

Exposed and monitored regions for the Swiss residential real estate market



Source: UBS

Appendix