

A strong performer

Dr Alexander Vogel and Dr Wolfgang Müller of meyerlustenberger outline some recent developments in the healthy Swiss real estate market

The Swiss real estate market has been very robust over the last two years, in particular the housing market where apartment prices according to market specialists went up by roughly 5% in 2009, 10% in 2010 and another 2-3% in the first half of 2011.

Despite the worldwide financial turmoil and the economic outlook remaining highly volatile, bargain hunters have had a hard time in Switzerland's real estate market in recent years: this is especially true in areas that had already experienced a substantial increase of price levels in the past five to 10 years (such as the Zurich or Geneva region). Even during the economic crisis in 2009, hardly any significant price corrections occurred, which was clearly below what had been predicted by real estate experts and feared by some real estate owners.

As a result, over the last 15 years Swiss property has appreciated in value by an average of 2.67% per year and has made investments in Swiss real estate in good locations the most stable investment class over prolonged periods of time. Probably the best performing property market in Switzerland in recent years, the Lake Geneva area, experienced a rise in values of more than 100% (an average of roughly 7% each year) in that time, which is still relatively modest compared to the enormous increases of price levels in some of Europe's hot spots. London, for example, saw an aggregate increase of about 270% (roughly 18% per year on average) in the same time, while in Paris there was an aggregate increase of approximately 190% (about 12.5% per year). Even prices for office space in attractive locations remained quite stable, although there were significantly more changes in tenants and although the demand for office space declined moderately in 2009.

There are several factors behind this relative strength of the Swiss real estate market. First, the Swiss economy is relatively stable, was less affected by the economic crisis in 2009 than other economies and further rebounded quickly after the recession, with about 2.5% growth in GDP in both 2010 and 2011 which had boosted the Swiss housing market and also maintained a steady market demand for commercial property, at least for good locations.

Secondly, the Swiss residential market is directly affected by the still relatively high levels of inflow of well-qualified foreign employees and their families in view of the attractive labour market in Switzerland. Thirdly, interest rates in Switzerland for mortgages remain at rock-bottom levels and there are no concrete signs yet of any imminent rise: due to the strong Swiss franc, the Swiss National Bank is unable to raise interest rates in the coming months.

The Swiss National Bank has kept cautioning against any imprudent rush into investments in real estate based on historically low interest levels and repeatedly expressed its worries of the beginning of a quickly expanding real estate bubble in view of the still increasing number of residential properties in Switzerland being completed or still under construction at the end of 2010. In view of these current trends, no short term changes are expected regarding real estate development projects, even though the number of building permits decreased again slightly in the last quarter of 2010, particularly in the main urban centres.

The turmoil in the currency and equity markets, and the fact that investors continue to see Switzerland as a safe haven, has pushed the Swiss Franc up to historical peaks against the Euro

“International investors desiring to acquire residential real estate in Switzerland are faced with a strict regime”

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and the US-dollar which in turn forces the Swiss National Bank to continue its very expansive monetary policy. This is seen as an assurance against any short-term increases of interest rates.

In addition, at least some of the funds moved into the Swiss Franc and to Switzerland will flow into the real estate market which will – together with the continuing domestic demand also fuelled by investors fed up with the unstable equity markets and low interest rates – support real estate prices at current levels.

Switzerland has so far been able to maintain its image of an attractive jurisdiction equipped with a stable and favourable taxation system providing for relatively moderate tax rates. It offers, besides a central location in Europe, political, social and economic stability combined with reliable and efficient public services, a first-class infrastructure and a healthy environment.

International investors desiring to acquire residential real estate in Switzerland, however, are faced with a relatively strict regime aimed at restricting purely speculative investments in the housing market in Switzerland. This has led to a fairly restricted residential housing market for foreign investors without a permanent residence permit, both individuals and corporate bodies. Conversely, restrictions regarding the acquisition of purely commercial real estate by foreign individual investors or foreign entities are quite limited.

As a result, there are interesting investment and tax planning possibilities for foreign investors or foreign entities wishing to invest in Swiss commercial real estate either directly or through a Swiss legal entity. Further, since April 1 2005, shares of companies (and/or units of investment funds) holding residential property may be purchased without permit by foreign investors if such shares are listed on a Swiss stock exchange.

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Foreign investments in Swiss real estate

Restrictions on ownership

The acquisition of Swiss real estate by non-residents (so-called persons abroad or foreigners) is restricted according to the Swiss Federal Act on Acquisition of Real Estate by Persons Abroad (the so-called Lex Koller). The implementation and administration of such act, however, is delegated by the federal government to the cantons, specifically the canton where the particular real estate is located is in charge of enforcing the relevant provisions.

Thus, to acquire real estate for which prior authorisation is required, a request for authorisation must be filed with, and authorisation obtained from, the appropriate cantonal authority; it is the cantonal authority which decides both whether a transaction requires authorisation and whether an authorisation is granted, provided, however, that authorisations may only be granted in the cases explicitly provided by the Lex Koller and, if applicable in certain cases, by the implementing legislation of the canton in charge.

Real estate transactions are covered by the Lex Koller if the acquirer (or the beneficial owner of the acquiring entity) is a person abroad within the meaning of the Lex Koller (see below for details) and if the acquisition object qualifies both with regard to its use (non-commercial) (see below for details) and type of right to be acquired as real estate within the meaning of the Lex Koller (see below for details).

With regard to the requirement to obtain an authorisation and the granting of an authorisation, the fact that the real estate to be acquired is already held by a person abroad is irrelevant. The same is true for the transaction structure employed and/or the legal basis of the acquisition: the requirement to obtain an authorisation is independent of the fact whether the transaction is structured as a straight sale/acquisition, indirect acquisition by way of acquiring the shares of an entity holding such real estate, exchange of real estate, gift, acquisition of assets and liabilities of a business or the restructuring of an existing entity by way of merger, demerger, asset transfer etc. However, there are certain exceptions regarding the acquisition of real estate by way of inheritance and certain privileged exchanges of real estate (see below for details).

Persons abroad

The Lex Koller defines individual persons abroad as being either individuals resident or domiciled abroad, or individuals living – temporally resident – in Switzerland but who are neither nationals of EU/EFTA member states nor holders of a valid permanent residence permit (the C permit).

Thus, in particular nationals of EU/EFTA member states resident in Switzerland, independent of their residence permit (that is EU/EFTA nationals holding a permanent residence permit, a limited residence permit (so-called B permit), or, possibly, a short residence permit), as well as nationals of other foreign countries holding a C permit and both de facto resident in Switzerland, are exempt from the



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authorisation requirements under the Lex Koller. Conversely, and different from other jurisdictions, the acquisition of real estate in Switzerland does not entitle a foreign national to obtain a residence permit.

Legal entities are considered persons abroad if they are either domiciled abroad (in this case irrespective of whether or not they are controlled by persons abroad, and even if entirely controlled by persons with permanent residence in Switzerland) or are controlled by persons abroad.

Control of a legal entity by persons abroad can be exercised by different means and is assumed by law if persons abroad either hold (or control, whether directly or indirectly) more than one-third of the respective entity's equity capital or of the respective entity's voting rights or provide significant amounts of debt capital to such entity. The relevant amount of debt capital triggering foreign control depends on the balance sheet structure of such entity and is equal to 50% of the difference between the company's assets and its debts with respect to persons that are not subject to the Lex Koller.

Qualifying real estate

The Lex Koller requires persons abroad to obtain a permit from the authorities in charge in order to acquire Swiss real estate unless such real estate serves as permanent business establishment for the exercise of an economic activity. Economic activities in the sense of the Lex Koller include industrial production, trading or service activities.

Further, real estate pertaining to a permanent business establishment may, as an exception, include residential property, for example (i) if such residential property is necessary for the business, such as a caretaker's flat; (ii) if a separation from the business is impossible or unreasonable; or (iii) if such residential property is mandatory pursuant to housing unit quotas under planning or zoning regulations. The mere building, sale or rental of residential property does, however, not qualify as an economic activity in the sense of the Lex Koller.

Moreover, persons abroad may purchase commercial real estate with land reserves without permit as long as such land reserves do not exceed one-third of the property

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surface. Land for development purposes may be acquired by persons abroad provided construction works on buildings to be used for economic activities begin within approximately one year. Also, a person abroad may acquire residential property by way of acquisition of, or a merger with, a company whose main business purpose is not the acquisition, holding and sale of residential property and provided the value of the residential property amounts to less than 30% of the company's assets.

Conversely, any real estate not qualifying as commercial real estate as described above is subject to authorisation, unless another specific exemption is available. Authorisations to acquire residential property are available to acquire a holiday home or serviced flat. Such real estate must be in an area designated by the cantonal authorities as a holiday resort.

The cantons and tourist municipalities may implement their own restrictions: they may decide on a total ban on authorisations for a specific location, permit acquisitions of condominiums only and only up to a certain quota, limit the annual number of authorisations or only permit the purchase of residences that are already foreign-owned. In practical terms, persons abroad can acquire secondary homes only in designated tourist areas, mainly in the areas adjacent to the Alps and in certain parts around Lake Geneva.

In addition, depending on the authorising canton, apart from zoning law restrictions there are certain restrictions with regard to the size of a secondary home to be acquired by a person abroad (usually not to exceed approximately 200m² and the underlying parcel of land not to exceed 1000m²). In order to obtain an authorisation for a person abroad intending to acquire a secondary home, the application procedure usually takes up to three months, but in certain cases can be faster. Before 2010, there was a yearly quota of authorisations for foreign investors that was – depending on the canton – exhausted fairly quickly.

Qualifying transactions

Besides the direct purchase of real estate, the Lex Koller also covers transactions which give persons abroad de facto control over real estate, for example through lease-



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holds, granting and exercise of a right of purchase, right of first refusal or a right of repurchase or the granting of financing.

The term “acquisition of real estate” thus also includes the acquisition by way of joint ownership or co-ownership (including condominium ownership), or of leasehold, occupancy or usufruct rights to real estate and, most importantly, the acquisition of shares (including non-voting shares) in a legal entity, of an interest in a company without legal personality (such as a partnership) or of a unit of an investment vehicle (including investment funds) whose de facto purpose is the acquisition of real estate.

However, the acquisition of shares listed on a stock exchange in Switzerland or investment fund units if they are regularly traded, even if such trading is off-exchange, does not trigger the obligation to obtain a Lex Koller authorisation. Thus, the purchase of a single share in an unlisted company involved solely or substantially in acquiring or holding residential property or dealing therein requires prior authorisation under the Lex Koller.

A long-term lease agreement with unusual contractual terms may also be subject to the authorisation requirement under the Lex Koller. Examples of such terms are the one off-payment of the rent

in advance or the waiving of consent to fundamental architectural alterations, the linking of a rental contract to a loan agreement with offsetting of rent against interest on the loan, the financing of the purchase or development of the real estate in excess of the usual lending limit applied by Swiss banks (generally 80% of the market value), a construction ban and similar ownership restrictions on neighbouring land.

In such cases, the criterion is not the subjective intention of the parties but solely the objective facts: the objective assessment of the potential results obtainable with the structure implemented by the parties. In line with the above, the transfer of a Swiss company's foreign headquarters holding qualifying real estate will also qualify as a relevant transaction, even when all such company's shares are held by persons permanently resident in Switzerland.

Further exceptions

Further exceptions (situations where no authorisation is required) exist for acquisitions by inheritance and transfers to relatives in straight line of ascent or descent from the person disposing of the property (but not to siblings or other relatives), as well as his/her spouse and his/her registered partner.

In addition, certain other transactions are exempted, such as: exchanges of condominium property in the same condominium complex (but not the acquisition of a second condominium unit); compensation for property transferred to a public law corporation or institution or in the course of an expropriation, land amalgamation, re-allotment of land or rectification of boundary; and transfers in the context of the liquidation of certain real estate holding vehicles to the extent the acquirer held shares in the legal entity corresponding to the real estate (usually an apartment) to be acquired. In addition, exemptions are available for foreign states or international organisations and for non-resident EU and EFTA nationals acquiring a second residence in the area of the place of work in Switzerland.

Moreover, the authorities can also grant a general exemption from the Lex Koller to a certain project or restricted area to further the economic development of such area. The only such exemption granted in recent years was to the Andermatt Swiss Alps project. As a result, interested investors, even if qualifying as persons abroad, are able to acquire and transfer residential property in that development without authorisation until the end of 2030.