



SWITZERLAND 2015

OVERVIEW

IN-HOUSE Q&A

PRACTICE AREA REVIEWS

LEGAL MARKET ANALYSES

PROFILES

DIRECTORY

CONSTRUCTION & REAL ESTATE REVIEW 2014

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OVERVIEW OF MAJOR ACTIVITY IN SWITZERLAND IN THE REAL ESTATE MARKET OVER THE LAST YEAR

The Swiss real estate market is still very healthy, particularly when compared to the rest of the world, but from the point of view of an investor it is far removed from the peak form shown a few years ago.

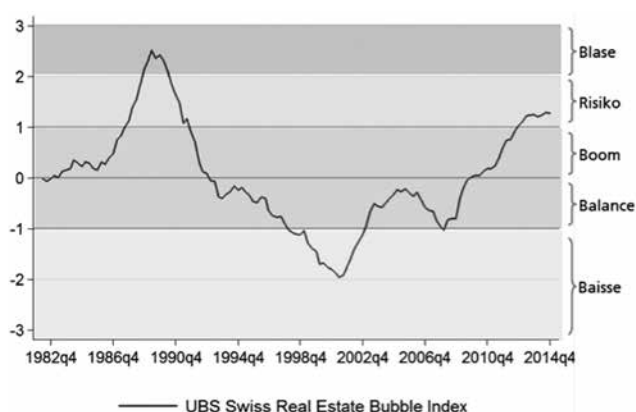
In 2014, the market cooled off slightly in almost all areas, in spite of the fact that Switzerland still has historically low interest rates. On the other hand, these low interest rates also mean that prices have been relatively high since the beginning of last year. The price increases that were still seen in 2014 were generally smaller than in 2013. In some sectors and regions of the real estate market, prices actually started crumbling in 2014 compared to the previous year.

For example, the office market was faced last year with slightly falling prices, growing vacancy rates and lower rents in some areas. Although employment growth was still positive, the new office space added to the market clearly exceeded this growth.

Price increases also slowed down in the residential sector of the market. Within the residential sector, prices for condominiums levelled off more sharply than for single-family homes. From a regional perspective, the slowdown in the increase of prices for residential property was most pronounced in the Zurich and Bern metropolitan areas and the Lake Geneva region.

The cooling of the residential property market is also reflected in the slight rise in vacancy rates. Vacancy rates mostly increased in expensive suburbs in the city centres and conurbations. In an international comparison, Switzerland still did very well in 2014 and vacancy rates are still very low overall.

Despite these developments, the UBS Swiss Real Estate Bubble Index rose from 1.24 to 1.29 in Q3 2014 and to 1.28 in Q4 2014, thereby dropping into the risk zone. UBS writes that this rise was seen in five of the six sub-indices [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]. UBS concludes that "The increase in risks for the Swiss economy stands in contrast to the now-subdued price behavior for owner-occupied homes, although it does reflect the even weaker performance of incomes, consumer prices and rents."



Source: UBS AG

Performance of UBS Swiss Real Estate Bubble Index

		INDEX
2011	Quarter 1	0.19
	Quarter 2	0.24
	Quarter 3	0.37
	Quarter 4	0.60
2012	Quarter 1	0.74
	Quarter 2	0.76
	Quarter 3	0.90
	Quarter 4	1.02
2013	Quarter 1	1.11
	Quarter 2	1.22
	Quarter 3	1.23
	Quarter 4	1.25
2014	Quarter 1	1.21
	Quarter 2	1.24
	Quarter 3	1.29
	Quarter 4	1.28

Source: UBS AG

OVERVIEW OF LEGAL AND REGULATORY FRAMEWORK IN THE REAL ESTATE PRACTICE AREA AND ANY RECENT OR PROPOSED CHANGES

The Swiss regulatory framework

The Swiss real estate regulatory framework is based on transaction law, rental law, planning and zoning law and construction law. There have been many changes to this regulatory framework recently, including in the areas of environmental law and planning and zoning law, and we expect legislator activity to persist in the future.

Amended Environmental Protection Act

Background

According to a recent amendment to the federal Environmental Protection Act (EPA), polluters may be required to provide appropriate security for the costs of cleaning up a contaminated site. Since 1 July 2014, the sale or parcelling of certain contaminated sites has been subject to approval by the competent cantonal or federal authority.

Like in many other countries, there is a considerable number of polluted sites in Switzerland. The Federal Council plans to investigate, monitor and rehabilitate these sites until 2025 for around 5 billion Swiss francs. According to the EPA, the responsible person (ie, the polluter) must bear the cost of the measures required to investigate, monitor and rehabilitate polluted sites. If two or more persons are responsible, they are to bear the costs according to their share of the responsibility. The first to bear the cost is the person who, through his or her conduct (the *Verhaltensstörer*), caused the measures to be required. Anyone who is responsible simply as the proprietor (the *Zustandsstörer*) of the site bears no costs if, by exercising the required care, that person could not have had any knowledge of the pollution. However, if a polluter cannot be identified or cannot pay, the authority concerned has to pay for the costs. In 2009, a parliamentary initiative was filed to tighten liability for polluted sites. There was criticism in particular that legal entities could easily escape legal responsibility and clean-up costs, and consequently the authorities concerned would have to bear these costs. To address this issue, two amendments were made to the EPA.

Security for clean-up costs

Since 1 November 2013 the competent authority may request the polluter to provide appropriate security to cover its probable share of the costs for investigation, monitoring and rehabilitation if the site is expected to cause harmful effects or nuisances.

The obligation to provide security for probable clean-up costs applies to any polluter, not only the current owner of the property. Also, the property does not necessarily need to be listed in the Register of Contaminated Sites. On the other hand, the listing of a property as a contaminated site does not automatically trigger an obligation to provide security.

The amount of security is determined by the extent, nature and intensity of the pollution. It is adjusted from time to time as knowledge of the situation regarding the pollution improves. The EPA does not specify the form of security – insurance policies, bank guarantees and other equivalent forms of security (eg, cash

deposits) are acceptable. Hence, the required form of security will vary from canton to canton.

Approval requirement

Since 1 July 2014 a sale or parcelling of a site that is listed in the Register of Contaminated Sites is subject to approval by the competent authority. Without this approval, the new owner or the parcelled lots may not be registered in the Land Register. If any transactions are planned, it is therefore advisable to check the publicly available Register of Contaminated Sites at an early stage and involve the competent authority as soon as possible. Generally, the cantonal authorities are competent to enforce regulations regarding polluted sites and will grant the required approval. In specific cases and based on special legislation, one or several federal authorities may be competent (eg, the Federal Office of Civil Aviation or the Federal Department of Defence, Civil Protection and Sport).

The competent authority may only approve the sale or parcelling of a polluted site if one of the following conditions is fulfilled:

- the relevant site is not expected to cause harmful effects or nuisances;
- security for the investigation, monitoring and rehabilitation has been provided; or
- there is a prevailing public interest in the sale or parcelling.

If the site is not expected to cause harmful effects or nuisances, the applicant has a right to obtain approval. In this case, the competent authority has no discretion and must grant approval. However, if the land is expected to cause harmful effects or nuisances, approval may in principle be granted only if appropriate security has been provided or there is a prevailing public interest in the sale or parcelling.

The amount of the costs to be secured is estimated on the basis of the available knowledge and is adjusted periodically. Since the EPA does not apply the principle of joint and several liability for polluted sites, it is unclear whether or not a site owner who is not the sole polluter may generally be obliged to provide security for the total amount of the clean-up costs. Rather, in view of the purpose of the new provision – to prevent the owner from avoiding liability by selling or parcelling the site – the owner may be obliged to secure only its own probable final share of the costs. The approval requirement for the sale or parcelling of the site seems to be an inappropriate way to oblige the site owner to secure the total amount of clean-up costs (ie, including the shares of other polluters).

There is a prevailing public interest, for example, if public infrastructure is constructed or if the sale itself will be used to fund environmental rehabilitation measures.

Prior to these new federal regulations, the prohibition to parcel sites that have been registered as polluted sites was already applied in several cantons. With the amendment of the EPA, the approval requirement for selling or parcelling polluted sites now applies in all cantons. This puts the competent authorities in all cantons and the federal authorities in a position to prevent the owner of a polluted site from avoiding liability by selling or parcelling the relevant site.

Implementation by the cantons

The implementation of the EPA's new provisions lies with the cantons. Cantonal laws determine the competent authorities as well as the details for the implementation. Unless the cantonal laws provide for different rules (like, for example, in the canton of Zürich), specific approval is required for the sale of any site listed in the Register of Contaminated Sites. In the canton of Zürich, the competent authority (the Office of Waste, Water, Energy and Air (AWEL) issued a general ruling and a circular letter on the implementation of the new federal approval requirement. The Zurich cantonal rules can be summarised as follows:

- The rules contain a general approval for the sale and parcelling of certain sites. The general approval covers sites that are registered as polluted sites but are not expected to cause harmful effects or nuisances and are not subject to monitoring or clean-up. The general approval is limited to the sites explicitly defined in the federal Contaminated Sites Ordinance.
- For all other sites that may cause harmful effects or nuisances or qualify as requiring assessment, monitoring or rehabilitation, individual approval is needed for each sale and parcelling. If, in a particular case, individual approval is required in the canton of Zürich, it must be available at the latest when the transaction is registered in the Land Register (not necessarily, however, when the public deed for selling or parcelling the property is signed). Nevertheless, the notary public must check the Register of Contaminated Sites and, if the property in question is listed, inform the parties and include appropriate wording in the public deed.

Further, AWEL clarifies that not only sales and purchases but all transactions leading to a change of ownership, as well as transactions that fundamentally diminish the value of a site, are subject to approval. On the other hand, however, the establishment of a right of pre-emption, purchase or repurchase does not require approval, but the subsequent exercise of a right of pre-emption, purchase or repurchase is again subject to approval.

Comment

The new approval requirement for the sale or parcelling of a contaminated site can considerably delay a transaction. It is therefore advisable to plan the transaction accordingly and to check the Register of Contaminated Sites and involve the competent authority at an early stage.

Also, buyers should pay attention to the seller's obligation to provide security for probable clean-up costs.

Planning and zoning law

Swiss laws control or limit the development, construction, and use of real estate and protect existing structures under a detailed planning system on the federal, cantonal and municipal levels. A detailed zoning regime on the municipal level determines the possibilities of development and construction (in certain cases replaced by a specific planning process).

The Land Use Planning Law that has been in force since 1 May 2014 aims to ensure compact settlement development, the

improved use of uncultivated areas and the reduction of outsize building zones. The key concept is densification (*Verdichtung*). The technical implementation of this densification is quite complicated and will cause many a headache in future.

Lex Koller

The Swiss Federal Act on Acquisition of Real Estate by Persons Abroad (the Lex Koller) restricts the acquisition of Swiss residential and other non-commercial real estate by foreign (ie, non-Swiss) persons. In recent years, and in particular since 2007, it has been heavily debated whether the Lex Koller should be abolished altogether on the one hand, or made even stricter on the other. It is widely recognised that the Lex Koller is the only effective measure to reduce demand for Swiss residential properties.

Following the 2014 summer session of the Swiss parliament, it is clear that the Lex Koller will remain in force without accentuation for the time being. In June 2014, two motions were dismissed by the Swiss parliament that aimed to strengthen the Lex Koller and, again, apply it to commercial properties and ban non-Swiss persons from acquiring shares in Swiss real estate funds and listed real estate companies.

As a consequence, the acquisition of residential premises by non-Swiss persons remains restricted, while the acquisition of business premises is, as a rule, unrestricted under the Lex Koller. However, the debate regarding the Lex Koller is expected to continue.

Lex Weber

Background and objective of the Lex Weber

On 11 March 2012, the Swiss population voted in favour of an initiative promoted by Mr Franz Weber that aimed to freeze further development of second homes or secondary residences in municipalities where these residences already exceeded 20 per cent of all residences. On 9 February 2014, the Swiss Federal Council issued a draft law on secondary residences (the Lex Weber) to be submitted to the Swiss parliament for debate and approval. The debate is still ongoing and major changes are still possible.

The draft Lex Weber generally prohibits the construction of new secondary residences in Swiss municipalities where the portion of secondary homes already exceeds 20 per cent. In municipalities where secondary residences exceed 20 per cent of all existing residences, new housing properties may be built only if the property will be used as a main residence or for tourist accommodation (ie, hotels and guest houses). The draft law also sets out to what extent existing secondary and main residences may be modified.

Properties existing prior to 11 March 2012

A secondary residence existing prior to the adoption of the initiative (ie, 11 March 2012) can be renovated, transformed and rebuilt within the borders of the previously occupied land area without any further limitations under the Lex Weber. Such existing properties can be used as principal or secondary residences, with no limitations.

An existing property, as defined by the draft Lex Weber, is a property that was either legally built prior to the adoption of the initiative or is still benefitting from a final building permit granted prior to 11 March 2012.

The land area occupied by existing properties can, in principle, only be enlarged if the property owner registers the residence as a principal residence or tourist accommodation (ie, a hotel or professional tourist lodging house).

New secondary residences – limited exceptions

In municipalities where the portion of secondary homes exceeds 20 per cent, new secondary residences can no longer be built. However, some exceptions may apply:

- New secondary residences may only be authorised on protected sites or monuments if: this does not affect the protected value of the property, the preservation of such building cannot be guaranteed in any other manner, and this is not contrary to any other predominant interest. Protected sites and monuments are protected by ad hoc Swiss laws and, as such, are rare properties that demand a case-by-case approach.
- Under certain conditions, the draft law also authorises the construction of new secondary residences for rent through “organised housing companies”. In short, this should only be possible if: the housing company can prove that this is the only viable business model for the company, the business proceeds will be used to finance the company itself, new secondary residences do not exceed 20 per cent of the entire housing areas, and architectural and functional unity can be ensured, unless monuments or nature protection interests prevail.
- A housing company running a hotel or similar tourist resort may fully convert its property into secondary residences if it has existed for at least 25 years and cannot be economically exploited any longer. However, this is not possible if the manager or owner of the housing company is responsible for this situation.

Sanctions

In the case of a breach of law and the unlawful use of the property (ie, main residence used as a secondary residence), the authority will give a deadline to the owner to remedy the situation and, if the required proper use of the property is not legally re-established within the given period, the use of the property shall be prohibited by the competent authority and the property sealed. In the case of an intentional breach of law, the draft law also provides for sanctions of imprisonment for up to three years or a fine. Milder sanctions will apply if the breach of law is committed as a result of negligence.

Outlook

The draft law has been heavily criticised by the promoters of the initiative. The law is intended to protect the tourist regions' interests in remaining attractive and prosperous, while complying with the essence of the Weber initiative.

It is still unclear whether major changes will be requested by the Swiss parliament before the law is finally enacted. Also,

depending on the final text of the law, the promoters of the Weber initiative may still decide to challenge the implementation and enactment of the Lex Weber with a referendum, which requires a minimum of 50,000 signatures.

Last but not least, many of the above conditions applying to new residences are still very unclear and, as a result, remain subject to wide interpretation by the authorities in charge of implementing and monitoring the status of secondary homes at the cantonal level. Bearing in mind that the draft Lex Weber states that this monitoring will be carried out by a cantonal supervisory authority instead of a federal one, it is very likely that the different cantons will give different interpretations leading to different results. The promoters of the Lex Weber fear that the tourist cantons will do everything they can to bypass the Lex Weber principles – despite the fact that these principles were originally aimed specifically at such cantons.

Countercyclical capital buffer (CCB) and mortgage loans

Pursuant to the observations of the Swiss National Bank (SNB), the CCB and other measures did not provide sufficient relief with regard to the risks associated with the existing imbalances in the mortgage and real estate market. The SNB was particularly concerned about the continued growth of residential property prices and mortgage loans during 2013. In order to further strengthen the resistance capacity of the Swiss banks and the whole Swiss economy to risks arising from the aforementioned market imbalances, the SNB requested the Swiss Federal Council to increase the CCB from 1 per cent to 2 per cent from 30 June 2014. On 22 January 2014, the Federal Council followed the SNB's request and decided to double the CCB.

As a consequence, domestic banks had until the end of June 2014 to increase the additional capital buffer to 2 per cent of their direct or indirect mortgage-backed risk-weighted assets where the mortgaged property is Swiss residential real estate. This applies to both owner-occupied and investment properties, but only insofar as the mortgages are backed by residential real estate. It does not apply if the mortgaged property is a commercial property.

The Swiss Bankers Association's guidelines on the minimum requirements for mortgage financing for owner-occupied residential property entered into force on 1 September 2014, with transactions initiated prior to this date subject to a transitional period of five months. Under these guidelines, a deposit of at least 10 per cent of the loan value must be paid (with funds that do not come from the second pillar) for new purchases and mortgage increases. If the purchase price is higher than the loan value, the difference must be paid in full with own funds that do not come from the second pillar. The mortgage debt must be reduced to two-thirds of the loan value of the property within a maximum period of 15 years, with repayments made on a straight-line basis starting at the latest 12 months from the date on which the deposit was paid. These stricter regulations concerning own financing should help put a halt to the increase in real estate prices.

INDUSTRIES OR TYPES OF CLIENT THAT ARE PARTICULARLY ACTIVE IN THE REAL ESTATE SECTOR

In the past year we were involved with various facets of very big and exciting real estate development projects. At the same time, we managed large transactions for our clients in the transaction market for logistics properties. The transaction market for residential properties was also relatively active in the past year.

DEVELOPMENTS IN THE SWISS REAL ESTATE MARKET IN THE NEXT YEAR OR SO

Overall, investors in the Swiss real estate market will likely have to accept slightly more modest returns than in the boom period for the foreseeable future. The likelihood of the market quickly recovering its peak form – from the point of view of an investor – is quite small.

After a long boom phase, all signs are currently pointing towards a slowdown. Further regulatory intervention or a

noticeable increase in interest rates could accelerate this development. However, the likelihood of a slowdown is less, at least as far as interest rates are concerned, following the SNB's announcement that it will introduce a negative interest rate.

The central question is therefore whether the successive calming of the market will continue ("soft landing" scenario) or whether the market will accelerate ("bursting bubble" scenario). While the SNB does not yet believe that the risk of overheating has passed and considers the regulatory measures taken to date to be justified, critics fear that regulatory intervention has already overshot the target and could lead to further exaggeration in future. At least it can be said that the Swiss voters kept their sense of proportion with their recent rejection of further restrictions on immigration ("Ecopop initiative") and their acceptance of cantonal tax privileges for certain immigrants (rejection of the initiative to abolish lump-sum taxation).