



CONSTRUCTION & REAL ESTATE REVIEW

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

The Swiss real estate market is still healthy but from the point of view of an investor it is far removed from the peak form shown a few years ago.

In 2015, the cooling-off of the market in almost all areas continued in spite of the fact that Switzerland still has historically low interest rates. These low interest rates also mean that prices have been relatively high in 2015. This is particularly true for foreign investors of the eurozone given the fact that the Swiss National Bank has abolished the minimum exchange rate of 1.20 Swiss francs per euro as per 15 January 2015 resulting in a strengthening of the Swiss franc. It comes at no surprise that Switzerland is currently not the premier investment destination for international investors and that many have sold their Swiss properties.

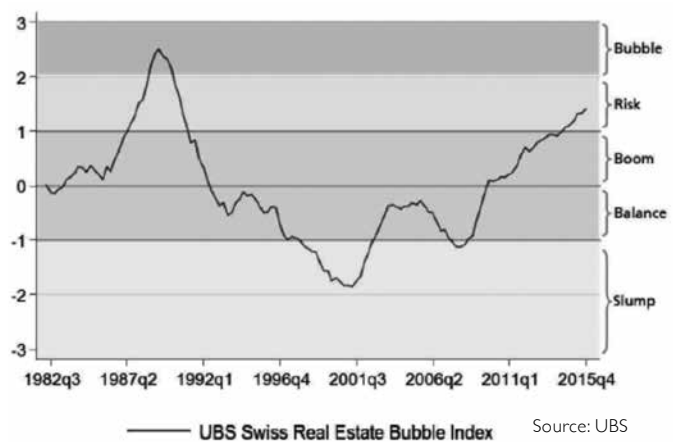
The price increases that were still seen in 2015 in some sectors of the real estate market were generally smaller than in 2014. In some sectors and regions of the real estate market, prices actually started and/or continued to crumble in 2015 compared to previous years. For example, the office market in certain CBDs was faced last year again 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. According to a recent UBS study asking prices for condominiums rose by only 1.5 per cent and for single-family houses by 2 per cent nominally in 2015. However, prices for condominiums and single-family homes in the high-end prime sector went down rather sharply. From a regional perspective, the slowdown in the increase of prices or the decrease, respectively, for residential property was most pronounced in the Lake Zurich gold coast area 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.

The UBS Swiss Real Estate Bubble Index rose from 1.20 in Q4/2014 to 1.41 in Q4/2015, and thus remained in the risk zone. UBS writes:

Household mortgage debt was 3.2% higher than in 2014. Although debt growth slowed in the fourth quarter to its lowest rate since 2008, it was the highest relative to household income in the last five years. We estimate that the disposable income of all households declined last year by around 0.5%.

UBS SWISS REAL ESTATE BUBBLE INDEX



OVERVIEW OF THE 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 second homes (Lex Weber) and environmental law, and we expect legislator activity to persist in the future.

Lex Weber

By adopting the second home initiative on 11 March 2012, Swiss voters came out in favour of limiting the construction of second homes.

However, there was still some legal uncertainty in this regard in spite of the Federal Council's transitional ordinance which entered into force on 1 January 2013 and the guiding decisions taken by the Federal Tribunal in the interim, and the market for second homes has since been plagued by noticeable uncertainty.

The Federal Council now adopted a new Ordinance on Second Homes at its meeting on 4 December 2015. At the same time the Federal Council decreed that this Ordinance and the Federal Act on Second Homes adopted by Parliament will enter into force on 1 January 2016.

The Federal Act on Second Homes adopted by the National Council and the Council of States on 20 March 2015 implements the constitutional article on second homes (Art. 75b of the Federal Constitution) that was approved by the people and the cantons on 11 March 2012 when voting on the

popular initiative called “An end to boundless construction of second homes!”. The legislator primarily implemented this constitutional article by determining that no new second homes may be approved in municipalities where the percentage of second homes is more than 20 per cent. It remains possible to build “first homes”, ie, apartments inhabited by people who have their primary place of residence in the relevant municipality. It is also possible to build apartments that are treated on the same footing as first homes, ie, apartments acquired for training or commercial purposes.

New apartments meant to provide accommodation to tourists may also be built. Tourist apartments may be built as part of a structured lodging facility, which includes hotels and residential units managed as a hotel (the term “structured lodging facility” is defined more precisely in the new Ordinance on Second Homes). According to the Federal Act on Second Homes, people who live in such a municipality may also build a granny flat in their house. In both cases these apartments must permanently and exclusively be offered to guests as short-term accommodation at market conditions. This should ensure that “warm beds” are built.

What is termed “old-law apartments”, ie, apartments that existed or were granted a final permit before 11 March 2012 may be freely put to a new use and renovated, converted or rebuilt within the limits of the previous usable space. Within urban construction areas, the usable space may even be expanded by up to 30 per cent, provided that no additional apartments are built.

In municipalities where the percentage of second homes is more than 20 per cent, apartments without any use restriction may only be built if this is intended to cross-finance a hotel project or if listed or hallmark buildings within the building zone cannot be maintained in another manner.

Environmental law

Revision of Water Protection Act from 1 January 2016

On 1 March 2014, parliament approved an amendment to the Water Protection Act (GSchG) which entered into force on 1 January 2016.

This allows for the financing of equipment to introduce an additional treatment stage to remove trace substances from waste water at some 100 large sewage purification plants (out of around 700 sewage purification plants country-wide). This targeted expansion should make it possible to remove around 50 per cent of the trace substances from the water and considerably improve the water quality of many polluted watercourses.

The amount to be invested in the expansion of sewage purification plants is approximately 1.2 billion Swiss francs. This will add some 6 per cent to the costs for sewage disposal. Based on the new Art. 60b and 61a GSchG, the federal government will charge a sewage levy of 9 Swiss francs per affiliated inhabitant via the municipalities from 1 January 2016 (for a limited period until 2040 at the latest). Depending on the state of the special municipal funds for sewage, residents will therefore soon have to digest an increase in the annual basic and/or volume prices for waste and sewage disposal.

Revision of Technical Ordinance on Waste

The Technical Ordinance on Waste governs the disposal of waste. To meet the requirements of a modern waste policy, the Technical Ordinance on Waste was revised totally and its name changed to the Ordinance on Waste Avoidance and Disposal (VVEA), which entered into force on 1 January 2016. This involves adjustments to the social, economic and technical changes over the past 20 years. With the revision, increased importance is given to the avoidance, reduction and targeted recycling of waste.

The revised Art. 16 VVEA is of the most practical concern:

1 When doing construction work, the owner must include information on the type, quality and quantity of waste that will be generated and the intended disposal of this waste in the application for a building permit submitted to the competent authority if:

a. the construction waste is expected to exceed 200 m³; or
b. construction waste containing contaminants dangerous to the environment and public health such as polychlorinated biphenyls (PCBs), polycyclical aromatic hydrocarbons (PAH), lead or asbestos is expected.

2 Once the construction work is finished, owners who have prepared a disposal concept pursuant to para. 1 must provide the authority responsible for granting the building permit with proof on request that the waste that was generated was disposed of in accordance with the official instructions.

It is widely known that many buildings constructed before 1990 contain asbestos. In future, owners renovating or converting such buildings will regularly have to submit (rather extensive) disposal concepts to the building permit authorities pursuant to the revised Art. 16 VVEA. This will shift the duty of investigation from contractors to owners.

Model law on the use of the subsoil

The subsoil in Switzerland is already being used for many things, including transport, energy and water infrastructure buildings and the planned but politically very controversial disposal of radioactive waste. The subsoil is also host to many resources (groundwater, thermal water, geothermal heat, hydrocarbons, gravel, sand, ores, etc) and can be used as a storage facility (water, natural gas, CO₂, hydrogen, etc).

Given the limited availability of ore and coal deposits and the fact that no crude oil and/or natural gas reserves have been found, there has not been much interest in Switzerland's deep subsoil to date. Switzerland's subsoil has therefore not been well researched and is not well known. This is likely to change soon as part of the Federal Council's climate policy and the Energy Strategy 2050 as the options for exploiting the subsoil as a store for CO₂ and natural gas and for providing deep geothermal heat are becoming ever more relevant.

There is no single comprehensive law to date that focuses exclusively and definitively on the issues related to the subsoil. The federal and cantonal governments share responsibilities, and the different topics (ownership rights, spatial planning, use, data access) are governed by different laws.

The federal government is responsible for settling matters related to ownership rights, while the cantons are in particular responsible for the rules applying to the use of raw materials. The latter is governed by different cantonal special laws as well as cantonal laws defining ownership to untapped mineral resources and laws of subsoil and subsoil use. Several cantons are currently revising their laws of subsoil, in particular as there is a need to introduce rules regulating the use of geothermal energy.

Upcoming geothermal projects actually served as the driver for these new laws. The cooperation between several cantons of north-eastern Switzerland resulted in a model law on subsoil use being drafted in December 2013. This model law is meant to serve as a basis for implementation in the cantons and regulates the use of the subsoil in harmony with public interests, in particular those concerning profitability, environmental compatibility and safety. The model law makes it clear that each canton is the sovereign of its subsoil, including the mineral resources, and owns all related rights of use and exploitation. Some cantons are currently working on drafting suitable laws that will regulate questions concerning permits and concessions, the related fees and duties as well as liability issues.

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, in particular in the Western part of Switzerland. At the same time, we managed large transactions for our clients in the transaction market regarding, for example, a shopping center and hotels and transactions regarding residential properties, although the transaction market slowed down last year (see our introductory remarks at the beginning of this review). Last but not least, we were involved in various real estate dispute resolution cases before courts in Switzerland, in particular in the areas of construction disputes and landlord-tenant conflicts.

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

Seen overall, returns for investors will remain more modest than in the boom period for the foreseeable future. Due to the situation of negative yields on Swiss government bonds with maturities up to 2017 institutional investors, in particular pension funds and insurance companies, were looking out for assets with positive cash flows such as real estate investments. The heavy investment pressure pushed net initial yields down to a new record low of 2.5 per cent to 3 per cent for prime commercial and residential properties, sometimes even lower. Chances that the market will quickly recover its peak form – from the point of view of an investor – are quite small.

After a long boom phase, the actual calming in many areas of the Swiss real estate market is expected to continue. Further regulatory intervention (such as the lending hurdles for mortgages imposed by the Swiss National Bank (SNB) and, based thereon, the economic viability rules of Swiss banks for mortgage lending) or a noticeable increase in interest rates (which currently does not seem very likely though) could accelerate this development. However, the likelihood of a sharp slowdown decreased, at least as far as interest rates are concerned, following the announcement of the SNB to lower interest rates further (the negative interest rate was adjusted from -0.25 to -0.75 in 2015). The negative interest rate is charged on the portion of the sight deposit account balance which exceeds a given exemption threshold defined by the SNB individually for each bank based on the minimum reserve requirement and aims to ensure that the discontinuation of the minimum Swiss franc-euro exchange rate does not lead to an inappropriate tightening of monetary conditions.

The central question whether the successive calming of the market will continue (“soft landing” scenario) or whether the market will accelerate (“bursting bubble” scenario) is not yet answered. While the SNB still does not seem to believe that the risk of overheating is past and considers the regulatory measures taken to date to be justified, critics fear that regulatory intervention could already have overshoot the target.