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Are property or stocks more lucrative?

Michael Ferber

Property prices in Switzerland have soared over the past 25 years.

Many Swiss people have become wealthy through home ownership in recent decades. The massive price increases on the Swiss property market have driven this. But this path to prosperity is an option for fewer and fewer people.

A study conducted by the major bank UBS at the beginning of April examined who in Switzerland can still afford a 110-square-metre apartment with an initial loan-to-value ratio of 80 per cent. The bank's economists came to the conclusion that even for a household with an above-average income of CHF 200,000, barely half of the properties advertised at the time were still financially viable.

For many Swiss people, buying their own home was a kind of gold standard in their retirement provision – with the side effect that they built up a considerable fortune. If this is no longer possible for many, it raises the question of whether asset accumulation with equities is a viable alternative. Investors have also achieved high returns with equities in recent decades. They allow investors to participate in the market with smaller sums and avoid the concentration risk of tying up wealth in a single asset such as a home. Property and equities, however, each have their distinct advantages and disadvantages.

Carouge beats all the rest

As data from property experts show, the increase in the value of owner-occupied homes in many regions in Switzerland has indeed been massive in recent decades. According to Donato Scognamiglio, Chairman of the Board of Directors of the consultancy firm Iazi, the Iazi Private Real Estate Index, a barometer of Swiss residential property prices, has risen by around 130 per cent since 2000. The index is based on actual paid transactions and not on advertising prices, Scognamiglio explains.

An Iazi analysis also shows that the rise in property prices in some Swiss towns and municipalities has been even more extreme. Only towns and municipalities with over 10,000 inhabitants were considered.

According to the survey, prices in Carouge, one of the most sought-after residential areas in the canton of Geneva, have more than quadrupled since 2000. "A house that cost 645,000 francs there in 2000 is now worth around 2.87 million francs," says Scognamiglio. If the mortgage interest paid is taken into account – the property expert uses the average interest rate of 2.5 per cent over the last 25 years – the result is an impressive 1475 per cent increase in the value of the equity capital invested. With the originally invested equity of 129,000 francs – i.e., 20 per cent of 645,000 francs – a profit of around 2 million francs was achieved in the example.

The mortgage as a risk factor

"However, this only works as long as property prices continue to rise", says Scognamiglio. And anyone who uses a lot of borrowed capital for investments must be aware that leverage magnifies losses in a downturn. "High mortgage debt can also act as an accelerant in a crisis," he says.

Fredy Hasenmaile, Chief Economist at Raiffeisen Switzerland, is also in favour of home ownership as an investment. In a study from November last year, he puts the average return on equity of Swiss residential property at 7.2 per cent annually since 1988. This includes the Swiss property crisis of the 1990s, and yet the return still falls only slightly behind equities, he says. A pure Swiss equity portfolio achieved a return of 8.1 per cent in the same period – albeit without leverage.

The calculation of the return on equity for residential property in the Raiffeisen study is complex. All kinds of factors were taken into account for the analysis. These include the rent saved, the interest costs of the mortgage, the maintenance costs, the effect of home ownership on income taxes and the change in value of the property. In addition, the burden of the imputed rental value for the homeowner was factored in. Furthermore, the study takes into account the fact that homeowners can claim around 30 per cent more deductions for maintenance than the actual expenses incurred, says Hasenmaile. In addition, the property gains tax and the leverage effect of the mortgage are considered when calculating the return.

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Swiss residential property with high returns

Municipalities with large increases in the value of residential properties over the past 25 years

Canton	**GE**	**GE**	**ZG**	**ZH**	**ZH**
Name of municipality	Carouge	Geneva	Zug	Zurich	Zollikon
Population 2024	22’311	206’635	31’995	433’989	13’570
Price for House 2000	645’044	764’970	892’621	976’279	1’053’173
Own funds 20%	129’009	152’994	178’524	195’256	210’635
Mortgage 80%	516’035	611’976	714’097	781’023	842’539
Cumulative interest 25 years at 2.5% p.a. without amortisation	322’522	382’485	446’310	488’140	526’587
Price for house 2025	2’871’000	2’922’000	3’303’000	3’309’000	3’412’000
Increase in value of house	345%	282%	270%	239%	224%
Increase in equity (excluding amortisation and depreciation)	2’032’443	1’927’539	2’142’593	2’039’837	2’042’875
Return on equity taking into account interest paid over 25 years	1’475%	1’160%	1’100%	945%	870%

NZZ/feb.

The economist cites several advantages of home ownership over equities. The return on property is achieved with fewer fluctuations, he says. In addition, the illiquidity of residential property forces owners to remain continuously invested – even in times of crisis. “This ensures optimal investment behaviour”, says Hasenmaile.

However, the risks of home ownership should not be underestimated. “If the value of the property falls sharply, the leverage effect of the borrowed capital can wipe out all or even more of the equity invested.” If the buyer can no longer service the mortgage, there is also a risk that they will have to sell the property at a particularly unfavourable time.

“Many potential buyers currently doubt whether residential property will continue to generate a high return on equity in the future”, says Hasenmaile. However, he assumes that this will continue to be the case. Immigration and the fact that property is a scarce commodity in Switzerland, for example, speak in favour of this. In his view, it would take “a massive collapse in confidence” for the prices of Swiss residential property to fall.

Meanwhile, Zug-based asset manager Pirmin Hotz is taking up the cudgels in favour of equities. According to calculations by Bank Pictet, Swiss equities have achieved an annual nominal return of 7.7 per cent since 1926, and 5.6 per cent after adjusting for inflation. “That beats every other asset class”, he says.

The asset manager is less euphoric about property returns, even in Switzerland. “Many property owners tend to overestimate the return on their investment,” says the asset manager. If an annual budget of 1 per cent of the property’s value is allocated for maintenance and ancillary costs, this is not enough in the long term because it does not adequately reflect one-off expenses and provisions for renovations and refurbishments.

What’s more, many homeowners think they are wealthier than they actually are. They do not base the return on the current market value – as is common with equities – but on the original purchase price of their property, says Hotz. “That would be like Novartis shareholders basing their dividend yield not on the current market price of the shares, but on the low entry price from 10 or 20 years ago.”

The asset manager is also critical of calculations of property returns based on the equity invested rather than the total property value. “If you want to meaningfully compare the total return on equities with that on property, you have to base it on the risk-bearing capital on both sides; otherwise you’re comparing apples with pears.” After all, equity returns are not achieved with borrowed capital.

Hotz estimates the net return on property at between 4 and 5 per cent, equivalent to a real return of 2.5 to 3 per cent. “This makes property the second most attractive asset class after equities.” For even higher returns, it would take “an explosion in land prices,” says Hotz. The houses and flats on the property lose value over time.

“Historically low interest rates have fuelled property prices over the past two decades, particularly in preferred locations”, says Hotz. “In such an environment, buyers of residential properties accept gross returns of 2 per cent or less.” Upon closer examination, this results in a net return approaching zero.

A long spell of calm

According to Hotz, the risks of property are underestimated because the last major property crisis in Switzerland was almost three decades ago. At that time, prices for residential and office properties plummeted by 30 to 50 per cent as a result of drastic interest rate hikes. “Since then, there has been a long period of stability on the Swiss property market,” says Hotz.

In the Swiss property sector, debt-to-equity ratios of 50 to 80 per cent are not uncommon. “It doesn’t take a crystal ball to predict that many homeowners, property companies and lending banks would be in trouble if interest rates were to rise sharply to, say, 4 or 5 per cent”, says Hotz.

Ultimately, there are many ways to accumulate wealth – property and equities are both very suitable options. The choice between these two forms of investment depends not only on financial means, but also on personal preferences and risk tolerance.

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