

Real estate investment in Switzerland – from a lawyer's perspective

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Switzerland is considered an attractive area for real estate business. Relevant factors are in particular the comparably low taxes for businesses and for individuals, administration authorities who in general are service-oriented as well as high degrees of legal certainty and political stability.



The following article looks at key topics of the Swiss real estate market. It starts with a brief overview of the market situation and latest developments, followed by certain legal topics relevant for investors into Swiss real estate.

Swiss real estate market at a glance

Well-weathered crisis of 2008

Over the last years, the Swiss real estate market remained stable, despite the financial crisis of the year 2008 and in contrast to other European countries and the US. Lessons learned from a severe real estate crisis in the early nineties and relatively moderate price increases are just two of the reasons for this stability.

Growing demand – leading to a bubble?

The demand for real estate investments in Switzerland is still growing. Investors explain that the Swiss real estate market is benefiting from a solid Swiss economy with low indebtedness, low unemployment, exceptionally low interest rates and a strong inward migration of qualified workforce with promising economical perspectives. Also, in difficult times on the international financial markets, real estate offers interesting opportunities.

Despite warnings of the Swiss National Bank of an overheating of the real estate market in the residential sector, numerous analysts share contrary views and do not perceive a risk of a nationwide housing bubble. They argue that market fundamentals are unlikely to change in the foreseeable future in a way that could result in a countrywide housing bubble. Certain hotspot areas, however, show signs of overheating. In August 2011, the federal government decided on first measures to prevent an overheating of the market and tightened the rules on the capital support of mortgages. In September 2011, not with a focus on the domestic real estate market but in order to prevent a further strengthening of the Swiss franc, the Swiss National Bank announced measures to maintain a minimum exchange rate of the Swiss franc against the euro. Some analysts express concerns that in the medium term, this step could increase the danger of a real estate bubble.

Increasing institutional investments

Institutional investments in real estate are constantly increasing. Approximately 75% of institutional real estate assets in Switzerland are currently held by pension funds and insurance companies. Institutional investments are likely to grow further in the upcoming years since contributions to pension funds are constantly rising. Also, investment funds and real estate stock became more popular over the last years.

Latest projects and trends

Reported construction projects and the volume of building applications indicate that investments are growing also in 2011. Building activities concentrate on certain regions, in particular urban, suburban and touristic areas, where significant and large-scale projects are being realised.

With regard to commercial real estate, the market shows considerable investment volumes in the three major sectors office space, medical care facilities and tourism. Also, demand for retail floor space remains strong and benefits from constant growth in retail turnover. With regard to office space, there is a trend to move from the city centres to the outskirts. Therefore, in certain cities the market for office space comes under pressure. As for residential premises, the demand for rental apartments remains strong with average prices but significant regional differences. At the same time, the residential market sees an increase of owner occupied flats whereas single-family homes become a less dominant form of residential property.

In some areas, the continued development and building activities lead to a shortage of building land. The creation of additional building land by expanding residential zones into green and agriculture zones requires lengthy procedures, if such expansion is possible at all. Therefore, the preferred approaches are high density construction and re-zoning of land within built-up areas.

Another clear trend is the increasing demand for ecological and energy efficient buildings that comply with specific standards such as Minergie® or LEED®. This demand is supported by federal and cantonal

subsidies for such buildings and for measures that increase real estate sustainability.

Key topics worth knowing

The following key topics are worth knowing for potential investors into the Swiss real estate market.

Investment vehicles

With regard to the investment vehicles used for real estate investments in Switzerland, we observe a general trend towards indirect real estate investments. The most popular indirect investment vehicles on the local financial market are real estate funds, followed by real estate stocks. Real estate investment trusts (REITs) are not used in Switzerland. This is mainly because Swiss tax law does not provide for specific benefits for REITs.

As an alternative for direct investments into specific objects, the use of special purpose vehicles (SPVs) offers a number of advantages. A tailor made SPV can reflect the investor's particular needs, especially with regard to capitalisation, place of incorporation as well as corporate governance and control. In practice, we often set up specific structures with SPVs for domestic and for international investors into local real estate.

The usual legal forms used for such SPVs are the share corporation (*Aktiengesellschaft*) and the limited liability company (*Gesellschaft mit beschränkter Haftung*). Swiss company law allows the flexible structuring of both types of companies by bespoke articles of association. The incorporation of both types of companies can be achieved within a few days. For SPVs held by several investors, it is common to have a shareholders' agreement governing the exercise of voting rights and other matters relating to the shareholding.

Taxes

In view of the 26 cantonal tax regimes that apply in Switzerland, the following gives a brief overview of the taxes and duties in general levied on real estate transactions and on ownership of real property.

Real estate transactions trigger different types of taxes and duties, mainly property transfer taxes, property gains taxes, notary fees and fees of the land register and possibly VAT. Depending on the parties involved, a transaction can also trigger income taxes and social security contributions. Ownership of Swiss real estate primarily triggers income and property taxes as well as real estate taxes.

Basically, a SPV holding Swiss real estate can be located anywhere in Switzerland, preferably in a canton which levies low corporate income taxes. Despite the location of the legal seat of the SPV, however, the SPV is subject to taxes in the cantons where it operates and where it owns real estate.

Because of such intercantonal tax rules, the best solution is often to have the SPV incorporated in the canton where the real estate is located.

As to dividend distributions by a Swiss SPV, a 35% Swiss withholding tax applies. Swiss based shareholders may reclaim the entire amount of withholding tax. Non-Swiss shareholders may do so if and to the extent provided for by a tax treaty. Thus, the withholding tax is of particular relevance for Swiss SPVs ultimately held by non-Swiss investors or embedded into international groups of companies.

Tenancy law

Tenancy law plays quite an important role in Switzerland as we traditionally have a high rate of commercial and residential tenants. Approximately three out of five households live in rented flats.

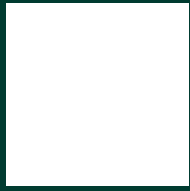
Swiss tenancy law provides for tenant protection in certain situations, which can be contrary to investors' interests. The relevant provisions are mandatory law and relate to commercial and to residential leases. The main features of tenant protection can be summarised as follows:

- (a) Tenancy law protects tenants against terminations of a lease that violate the principle of good faith. Also, under certain circumstances, tenants are entitled to an extension of the lease term. On the other side, the law entitles the landlord to terminate a lease for certain reasons, such as urgent own needs or contract violations (in particular payment default) by the tenant. In practice, tenants who are not willing to accept a termination sometimes manage to delay the end of a lease, in particular by involving conciliation authorities or even the court.
- (b) Landlords are entitled to increase the rent under an existing contract, for instance to reflect general price increases. On the other side, tenancy law protects tenants against abusive rent increases. Jurisprudence sets the threshold of an excessive and therefore unlawful rental income at a rather low level.
- (c) Both notices of termination and notices of rent increases must comply with particular formal requirements and observe particular notice periods and termination dates.
- (d) Landlords may contractually exclude the right to sub-lease and the right to transfer a lease to a third party for certain reasons. An accepted reason is for instance the exclusion of sub-leases or transfers of a lease to a competitor of the landlord.

Environmental law

In Switzerland, many of the contaminated sites are situated in industrial facilities. This goes back to the fact that Switzerland was industrialised as of the 1820s and that, like elsewhere, serious environmental concerns began to develop only in the 1970s.

Today, the cantons register all contaminated sites.



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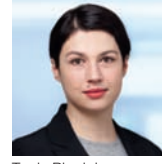
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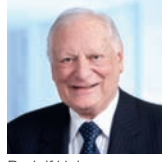
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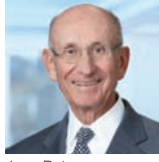
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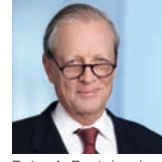
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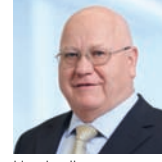
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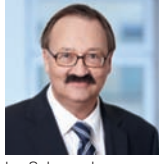
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Estate planning
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Insolvency
Insurance
Intellectual property
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Investment funds
Joint ventures
Licensing & Sponsoring
Litigation
Media
Mediation
Mergers & Acquisitions

New technologies
Patents
Private banking
Private equity
Private international law / Conflict of laws
Product liability
Public procurement
Real estate & Environment
Restructuring & Insolvency
Securities
Sports
Tax
Telecommunication
Trade & Retail
Trademarks
Transportation
Trust & Foundations
Unfair competition
Value added tax
Venture capital
White collar crime

In most cantons, the basic information of these registers is accessible online. This allows making within a short period of time a first assessment as to whether or not a specific site could be critical. Further details about the type, size and age of contamination and about impacts on the environment are usually not accessible online but can be obtained upon written request. It is possible that, for whatever reasons, a contaminated site is not registered. Consequently, in the case of critical or unknown uses of an object in the past, it is recommendable to conduct an environmental due diligence review.

With regard to clean-up costs for contaminated sites, the polluter-pays-principle applies. In this context, Swiss environmental law distinguishes between a temporary and a final cost allocation. Under a temporary cost allocation, it is possible that a possessor, who is not the polluter and who is not the owner of the site, must pay for the examination, monitoring and clean-up of the site. Under the final cost allocation, it is the polluter who must pay for the examination, monitoring and clean-up of a contaminated site. Also, the polluter must compensate the possessor for the costs paid under a temporary cost allocation.

From an investor's perspective, it should be noted that appropriate contracts can protect the acquirer of a site from environmental liability. However, such contracts are binding only upon the parties thereto but not upon the environmental authorities. The contractual protection should therefore focus on compensation claims against the polluter and previous owners.

Foreign investors

Swiss law restricts the acquisition of real estate by foreign nationals (so called 'Lex Koller'). As to non-Swiss citizens residing in Switzerland, the Lex Koller does not treat all foreign nationals equally. Rather, citizens of EU member states actually residing in Switzerland may acquire Swiss real estate like any Swiss national, whereas citizens of other countries may do so only under certain circumstances. The regime for foreign nationals residing abroad is even stricter:

Under the Lex Koller, as a general rule, the acquisition of business premises by foreign nationals is not restricted. In contrast, restrictions apply to the acquisition of residential real estate. Even though the acquisition of business premises is not restricted, it is not allowed to acquire an unlimited amount of land reserve together with business premises. Also, it is not allowed to acquire residential real estate that is part of business premises. Again, some exceptions apply.

The Lex Koller applies to both asset deals and share deals. In both cases, a transaction within the

scope of the Lex Koller does by operation of law not enter into effect before the required Lex Koller approval has been granted. If such a transaction is completed without applying for an approval or before the approval has been granted, then the transaction becomes null and void. As a consequence, the concerned contract is not enforceable. To the extent the contract has already been fulfilled, the parties may claim refund of payments made. In addition, the authorities must correct the unlawful situation by re-registering the seller as the owner of the property or by enforcing the purchaser to sell the property at an auction.

In practice, the parties to a planned transaction often do not know whether or not the transaction is subject to the Lex Koller. In these cases, the purchaser must file with the competent authority a request for a declaratory ruling. The purchaser must do so before entering into the transaction.

Over the last years, various efforts have been made to repeal the Lex Koller. Concerns arose that upon a repeal of the statute, certain regions would suffer from the excessive construction of second and vacation homes. To avoid the negative impacts thereof, the government proposed certain accompanying measures in the area of land use planning. After some back and forth, the federal parliament decided in December 2010 to amend the Federal Land Use Planning Law. As a consequence thereof, the cantons must within three years enact appropriate accompanying measures. Since no formal decision has been taken yet to repeal the Lex Koller and in view of the aforementioned three years period, that statute is likely to remain in force until at least 2014.

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