Promoting homeownership is not entirely risk free

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For twenty years, Switzerland has been promoting homeownership by letting residents draw on their pension fund assets to buy a home. In a recent study, Philippe Thalmann, EPFL professor in economics and architecture, dispels some popular beliefs and sheds light on the consequences for the insured.

It has become common practice to draw on pension fund assets to purchase a home. But this financial instrument, which will be referred to as "promoting homeownership," is becoming increasingly controversial, to the point of being called into question altogether. Does it pose a threat to future homeowners? And was it responsible for the sharp rise in property prices?

In his study, Philippe Thalmann, professor in economics and architecture and president of the Federal Commission for Accommodation, shows that the promotion of home ownership is not to blame for the sharp rise in property prices. However, it can put owners at risk, in particular when the market falters. Here, he responds to some preconceived notions that we put to him.

The Swiss government is seeking to allow a maximum number of people to own the home they live in.

"Indeed, it is a mission that is enshrined in the Federal Constitution. The main argument for this is that Switzerland has one of the lowest home ownership rates among comparable countries. So what? We could just as well highlight the fact that Switzerland is among the countries with the highest proportion of tenants, and leads a small group of countries that came out of the 2008 economic crisis comparatively unscathed. On the other hand, homeowners are often considered to be better citizens because they have stronger ties to their neighborhood and village, and because they supposedly take better care of their homes. There is also a political argument. Simplifying, it can be said that tenants lean left politically, while homeowners lean to the right."

The promotion of homeownership can only be used to reduce the down payment towards a home.

"When you buy a home, you have to make a down payment of at least 20% of the price. Usually, the rest is financed using a mortgage, which is taken up with a bank. Pension assets can contribute to the down payment, but since 2012, only up to a maximum threshold of 10%.

Alternatively, pension assets can also be pledged to replace part of the debt, bringing it down below 80%, which means also means lower interest payments. Although this means that you receive less benefits when you retire, you will have been able to save more leading up to your retirement – at least in principle. This approach is rarely adopted, in particular because debt is so cheap today and minimizing debt has not been a priority for people. The main obstacle when purchasing a home is finding the means to make the down payment."

Promotion of homeownership to purchase real estate is largely risk-free to those that decide to use it.

"The risk lies not such much in the fact of using your pension assets. Rather, it lies in the fact of becoming a homeowner with little financial margin. It's fine if you buy at the right time and the housing market continues to climb. If, however, you buy when the market is strong, and then it collapses, you can be in trouble. The bank may ask you to pay back part of your debt on short notice, given that your property will have lost part of its value. This happened in the 90s when the housing market collapsed. The homeownership promotion scheme is a financial tool that lets people become homeowners without being fully aware of, or underestimating, the risks."

Becoming a homeowner is a good investment and guarantees a more comfortable retirement.

"Over the past years, it has been the best possible investment, with a return on investment that I estimate at 30% per year, due to an average yearly increase in housing prices of 6%.

But what goes up quickly tends to come back down. The rise in housing prices was fueled by sinking interest rates and strong immigration. But now, interest rates can sink no further, and the Swiss population voted against immigration last February. Both phenomena that propped up housing prices have fallen away, which means that they will fall again. Once they begin to drop, the extraordinary returns of the past could become equally extraordinary losses. If you make a 20% down payment towards a home and its value drops by 6%, you lose one third of your down payment.

Additionally, by withdrawing a large part of your pension assets, you significantly reduce your retirement and freeze your wealth in your property. Remarkably, many owners have been forced to seek support from social services to pay for their health insurance. This was obviously not the objective, and social services now consider that things have gone to far. The point was not to give handouts to people that own their homes!"

By promoting homeownership, younger people can afford to purchase a home.

"It is more nuanced than that. The average age at which people become homeowners, which is relatively high in an international comparison (between 35 and 40 years), stays the same, largely because it takes time to save enough to make the down payment and accrue enough money in your pension fund. But it has helped people from lower income classes become homeowners, who would never have been able to do so based on their savings alone. But again, they don't purchase their home any earlier than their peers that do not have to rely on their pension funds.

Over the past decade, pension funds have registered over 400,000 early withdrawals, with the number of homeowners increasing only by 250,000 units. That means that all of the withdrawals are being used to purchase a home.

It isn't quite that simple. Many individuals make multiple withdrawals. Sometimes, both spouses withdraw capital for the same investment. Based on a variety of indicators, I estimate that 210,000 households took advantage of homeownership promotion between 2001 and 2012. But turning to how the capital was used, the number of new owners is much higher than the increase in the number of owned accommodations. Indeed, many people became owners by purchasing an existing home or apartment from someone that lived there previously. Again here, the exact numbers are unavailable and indirect indicators have to be used. I estimate that 640,000 households became owners between 2001 and 2012. That means that the households that used their pension assets only represent one third of the pool of new owners.

Promotion of homeownership led to the rise in housing prices.

"We didn't observe a sudden jump in prices immediately following the introduction of the homeownership promotion scheme in 1995. Instead, the evolution of the prices was progressive and continuous, despite the fact that the number of beneficiaries has been falling since it peaked in 2003. Therefore, it cannot be held responsible for the increase in housing prices that we've experienced over the past decade."

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