Residential property

Financing and protection

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Editorial

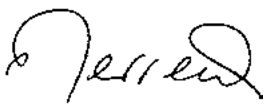
Dear reader

Are you planning to buy a house or apartment for your family? And are you also thinking about how to finance your new home in the most reliable way over the long term? Maybe you're also considering making an advance withdrawal of savings from your pension fund? And, if so, have you thought about the effect this will have on your eventual pension and on the plans you have for your retirement?

I'm delighted that you've been thinking about these questions, because it shows you are taking a serious and prudent approach to these key aspects of buying your own home. Buying your own home means giving careful thought to personal and economic events which could jeopardize the whole project: health problems, losing your job, sharply rising interest rates, an accident or divorce.

At AXA we have set ourselves the task of helping you think through all the important decisions and events in your life and plan for your financial security. Our aim is to give you the freedom to spend time with your family and to pursue your passions and goals without being constantly worried about the future.

When it comes to financing, saving and planning ahead, it is essential to understand your individual situation thoroughly. AXA's specialists will be delighted to offer you personal advice and help identify the best long-term solution for you. I would like to thank you for the trust you have placed in AXA and wish you every happiness in turning your dreams into reality.



Antimo Perretta
CEO of AXA Winterthur

Making dreams affordable

For many people, rising rents and falling mortgage interest rates make the prospect of buying their own home a realistic alternative. Nevertheless, a thorough affordability calculation is absolutely essential if you want to be sure that your dream doesn't become a nightmare.

Affordability calculation

An affordability calculation is the basis for granting a mortgage. The processes used by banks and insurance companies are practically identical. Even though interest rates are currently low, a long-term average rate of between 5 % and 5.5 % is generally used when calculating the maximum mortgage. The purpose of this professional pessimism is to protect prospective homeowners against putting too much strain on their finances and to take account of difficulties that may arise from changes in the market environment.

Tried and tested principles

The 20/80 rule

At least 20 % of the value of the real estate should be covered by your deposit, and at least 10 % must be "real" savings which do not come from your Pillar 2 pension. The remaining maximum 80 % can be financed using borrowed capital. The value of the real estate is made up of the purchase price plus the pro rata costs for building, conversion or any necessary renovation. If a lender has the property appraised and the estimate turns out to be lower than the asking price, then this lower value will apply. The difference will also have to be covered out of your own assets.

Maximum of ⅓ of housing costs

A maximum of 33.33 % of gross income is regarded as affordable. Housing costs include not only the interest on borrowed capital but also capital repayments and ancillary costs.

At least 1 % ancillary costs

Ancillary costs are often underestimated and are added to the housing costs as at least 1 % of the value of the real estate. This may seem a lot at first sight. However, when you consider the outgoings for energy, fees, building insurance premiums, maintenance work, reserves for renovation and replacement appliances, the amount is realistic. Estimated ancillary costs for old properties should be even higher.

Deposit

As a rule, the higher the deposit, the lower the interest rate burden and the better the affordability. However, it's vital not to tie up all your liquid assets in the property because you may need these funds in an emergency. You can't go wrong if you do your calculations right. And it's always possible to invest more of your own money in your home at a later stage if you so wish.

Many people forget that their deposit also comes at a price. The interest and securities income that could have been generated by this money is lost if it is invested in your home. This could easily amount to a few thousand francs a year. Tax should also be a consideration. By increasing your deposit you will pay less interest, and this in turn means that you will be able to deduct less from your tax bill.

When does buying become cheaper than renting? Use the online calculator at www.hev-schweiz.ch

Borrowed capital

The borrowed capital generally comes in the form of a mortgage. Usually this is divided up into a first and a second mortgage.

- The first mortgage normally covers 66.67% of the property's value (resale value) and is not subject to capital repayment.
- The second mortgage normally covers 13.33% of the purchase price and must be repaid within 15 years or at the latest by your 60th birthday.

Special cases

Variable income (bonus, commission)
Many financial institutions recognize at least part of any bonus or commission as income, in which case they will take an average figure from recent years. On the other hand, regular secure income, child allowances and alimony payments are recognized in full.

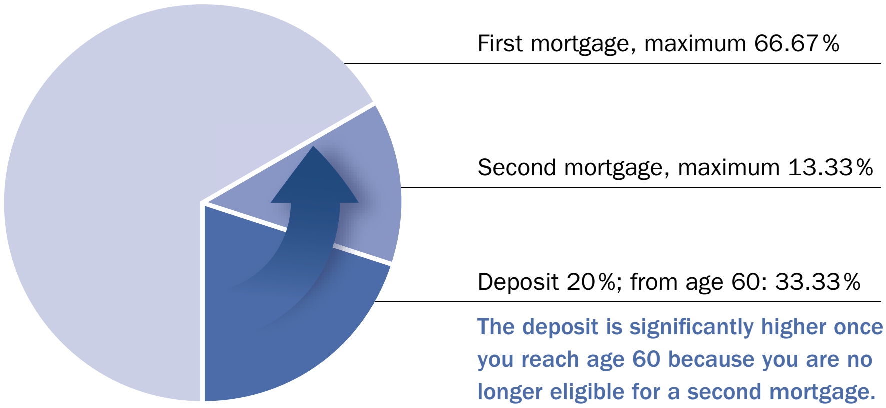
Double incomes
If a single income proves insufficient to meet the affordability criteria, part of the second income may be included or higher capital repayments may be required. However, second incomes are recognized only if both individuals become jointly liable for the debt.

Self-employed persons
The average income over the previous three years is generally used as the basis.

Extraordinary obligations
Fixed obligations, such as leasing payments, personal loan payments, alimony payments and costs for vacation homes, are deducted from income for the purposes of calculation.

Older persons
For individuals who are approaching retirement age, the calculation is based on retirement income from AHV and Pillar 2 pensions rather than on their current earned income. In addition, financing often covers only 66.67% of the property's value instead of the usual 80%. The amount above this portion is subject to additional guarantees or a shorter repayment period.

Financing for owner-occupied property



You can work out your negotiating position

A correct assessment of your financial situation strengthens your hand when dealing with lenders. It's best to know exactly where you stand.

The more comfortably you meet the affordability criteria, the easier it is to get a loan approved. This also puts you in a strong position when it comes to negotiating terms with lenders.

If you are struggling to meet the affordability requirements, additional conditions (e.g. having to repay the second mortgage more quickly) will be imposed. If you cannot meet the criteria, you will either have to provide a larger deposit or look for a more affordable property.

Sample affordability calculations

Value of property (in CHF)	400 000	600 000	800 000	1 000 000	1 200 000
Financing					
Deposit (20%)	**80 000**	**120 000**	**160 000**	**200 000**	**240 000**
First mortgage 66.67%	266 680	400 020	533 360	666 700	800 040
Second mortgage 13.33%	53 320	79 980	106 640	133 300	159 960
Total costs					
Interest on first mortgage 5.0%*	13 334	20 001	26 668	33 335	40 002
Interest on second mortgage 5.5%*	2 933	4 399	5 865	7 332	8 798
Repayment of second mortgage (15 years)	3 556	5 332	7 109	8 887	10 664
Ancillary and maintenance costs, 1% of the property's value	4 000	6 000	8 000	10 000	12 000
Total annual costs	**23 823**	**35 732**	**47 642**	**59 554**	**71 464**
Total monthly costs	**1 985**	**2 978**	**3 970**	**4 963**	**5 955**
Affordability					
Required gross income	**71 473**	**107 207**	**142 940**	**178 680**	**214 413**

* Affordability is calculated using predicted long-term interest rates, not current interest rates. These calculation principles are used in almost exactly the same way by all lenders (banks and insurance companies).

For your personal calculations you can use interactive mortgage calculator from www.axa.ch/hypothekarrechner

Is the deposit hurdle too high?

The amount of money required as a deposit is often the biggest obstacle on the path to owning your own home. So it's good that there are other options when you don't have sufficient savings.

Purpose

Homeowners must be aware that they alone bear the risk of any loss in value – in the form of their deposit. The 20% deposit hurdle is intended to ensure that the lender does not lose any money. Even if a property loses value or it becomes necessary at some point in the future to sell the property at a loss, it must be possible to repay the full amount of the loan. From the owner's perspective, however, the capital he invests is intended primarily to reduce the interest burden. This may be true as long as he remains the long-term occupier of the property.

Residential property as retirement saving

Since owner-occupied property is similar in some ways to classic retirement provision, the law allows buyers to withdraw pension savings from Pillars 2 and 3a prior to retirement under certain conditions. This capital can be used to acquire, construct or renovate residential property, to make capital repayments against a mortgage, or to acquire shares in a housing cooperative or similar investment. In contrast, pension savings may not be used to cover normal maintenance costs or pay mortgage interest.

Raising the deposit

There are several options for coming up with the deposit:

- Your own savings in bank accounts and investments
- A gift or an advance on an inheritance
- Personal loans (however, mortgage lenders must include the associated interest and repayments in the affordability calculation)
- Policy loans or the surrender of life insurance policies
- Pledging of life insurance policies
- Advance withdrawal or pledging of Pillar 2 or 3a pension assets under the homeownership promotion scheme (WEF)

Advance withdrawal or pledge of pension fund assets

Under the home ownership promotion scheme (WEF), would-be buyers are permitted to pledge or make advance withdrawals of assets from occupational pension schemes in order to finance the purchase of their own home.

Pledge

In the case of a pledge, the pension fund assets are provided to the lender as additional collateral. In return, the lender may provide a larger mortgage. The capital therefore remains in the pension fund, continues to attract interest, and there are no reductions in benefits. The disadvantages are higher interest and capital repayment costs, because a smaller deposit means a larger mortgage. If the buyer fails to honor the obligations set out in the pledge agreement, the pledge is realized. The pledged assets are realized on the relevant due date, which means that the pledged pension or lump sum is forfeited.

Advance withdrawal

Assets that are withdrawn in advance from the pension fund are used directly for the deposit. The burden of interest and capital repayments is reduced because the deposit provided is larger and the mortgage correspondingly smaller, but there is a significant downside. The advance withdrawal of pension fund assets will reduce the individual's retirement pension and, depending on the pension fund, may also result in reduced disability or death benefits. To prevent abuse of the purpose of the pension, the pension fund ensures that a sales restriction is entered in the land register. If the conditions for an advance withdrawal are no longer met (e.g. if the property is sold), the amount that was withdrawn must be paid back to the occupational benefits institution.

Preconditions for advance withdrawal

Minimum amount
- CHF 20000
- There is no minimum amount for purchasing shares in building cooperatives.

Maximum amount
- Maximum vested benefits amount.
- From age 50 onward, the maximum in vested benefits at age 50 or half the vested benefits currently available, whichever is greater.

Restrictions
- Advance withdrawal: every five years at the most.
- No later than three years before regular retirement.
- Amounts from additional benefits purchases may not be withdrawn for three years.

Conditions
- Processing may take up to six months.
- Pension funds often charge a fee.
- In the case of married couples, the spouse must provide written consent.
- If the property is sold, the withdrawn capital must be paid back to the pension fund.
- If the withdrawn amount is not repaid, it will no longer be possible to purchase pension fund benefits.

Example of advance withdrawal of pension fund assets (WEF withdrawal)

(All figures in CHF)	With advance withdrawal	Without advance withdrawal	Difference
BVG retirement benefits on regular retirement (age 65)			
Retirement capital	290 000	390 000	-100 000
Retirement pension	**19 700**	**26 500**	**-6 800**
BVG benefits on disability			
Disability pension	16 000	20 000	-4 000
Disabled person's child's pension	3 200	4 000	-800
	19 200	**24 000**	**-4 800**
BVG benefits on death			
Partner's pension	9 600	12 000	-2 400
Orphan's pension	3 200	4 000	-800
	12 800	**16 000**	**-3 200**

Example: male, aged 42, gross income: CHF 110 000, BVG minimum benefits, WEF withdrawal: 100 000, BVG conversion rate 6.8%

Replacement risk insurance

The shortfall in risk coverage following an advance withdrawal should be made good in all cases by taking out private insurance. You can also fully restore your retirement provision by repaying the advance withdrawal at a later date. Additional saving within the Pillar 3 framework may well be necessary if you want to be certain that you can afford to stay in your own home in old age.

Which is better?

At first sight, housing costs will be considerably reduced after an advance withdrawal because the mortgage and hence the interest and repayment amounts will be lower. However, if the resulting tax burden and pension situation are taken into account, the balance can quickly shift in favor of a pledge. The fact that interest can be deducted from income tax should also be considered when comparing housing costs.

Another important factor is the reduction in benefits in the case of a pledge. On the one hand, a regular amount should be set aside to make up for the reduced retirement benefits. On the other, insurance premiums will need to be paid to provide coverage in the event of disability or death. Which option is best for you therefore depends entirely on your personal pension and tax situation.

Comparison of advance withdrawal / pledge

Advance withdrawal	Pledge
⊕ You have more capital at your disposal. This means you'll need a smaller mortgage ⊕ Thanks to the smaller mortgage your interest and capital repayments will be reduced. ⊕ You pay less tax on the capital you withdraw from your pension fund. The capital is not withdrawn all at once (at retirement) or as pension income and therefore attracts lower tax rates (progression).	⊕ Pension fund benefits remain unchanged. Benefits on disability, old age or death remain the same. ⊕ Your entire pension fund capital continues to bear interest. ⊕ You can continue to pay into your pension fund and deduct these amounts from your tax. ⊕ You can enter the mortgage interest in your tax return and thereby reduce your income tax.
⊖ The retirement benefits from your pension fund, in other words the pension or lump sum, will be reduced. ⊖ Depending on the pension fund, your risk coverage in case of disability or death will be reduced. ⊖ You can declare less mortgage interest in your tax return.	⊖ The larger mortgage loan will mean higher interest and capital repayments. ⊖ The financial institution may require higher capital repayments.

Challenges in financial consultations

“You should never take low interest rates for granted.”

Otto Balmer has been advising clients and corporate clients at AXA's general agency of Pensions and Assets in Basel since 2010.

Low interest rates, a robust economy, and a booming real estate market: ideal conditions for becoming a home-owner.

Otto Balmer: Demand for mortgages is very strong at present. Paradoxically, this is one of the things that can make advising clients problematical. Clients often come here expecting to be able to take out a mortgage easily and at a low rate. However, the lending criteria are the same now as when interest rates are high, and this can lead to disappointment. Furthermore, many properties on the market at the moment are overpriced. In this case, financial institutions won't finance the full asking price and will only consider the lower estimate from the survey. Clients must therefore come up with a larger deposit than they had expected.

How do clients react when they realize that the financing they were hoping for isn't possible?

They usually understand once they realize that the affordability criteria are there to protect them. Often clients figure out a way to come up with a higher deposit so that they can still buy the property they really want. When that's not possible, they can become frustrated. Often they will try to obtain finance from a different financial institution, but they will have much the same experience wherever they go.

The affordability calculation uses relatively high benchmarks. Why is it then that real estate often has to be sold quickly, or even in a forced auction?

You have to bear in mind that the affordability calculation relates to a specific moment in time. Unfortunate events (e.g. unemployment, divorce, disability or death) may mean that individuals are no longer financially able to remain in their own home. In the case of individuals who have only modest retirement benefits, retirement can mean that they are no longer able to bear the financial burden of owning their own home. I therefore urge my clients to build up their reserves and, where possible, to take out insurance against risks.

Low interest rates help reduce the housing costs of owners considerably. What do you recommend that they do with these savings?

Interest rates have an enormous impact on what an owner can afford to spend on other things. But this also applies when interest rates are high. For this reason it is important to build up reserves regularly during the “good years”, as a way of creating a cushion for when interest rates rise again. You should never take low interest rates for granted. People who spend their excess income and raise their living standard will be forced to scale back when interest rates rise.

Criteria for choosing a mortgage

Private households in Switzerland have accumulated over 700 billion francs in mortgage debt. The average residential property is burdened with a mortgage of almost half a million francs. The choice of mortgage and provider is extremely important.

Very few people indeed have sufficient assets to buy a property outright. Mortgages account for more than 90% of the total financial obligations of private households in Switzerland. This makes the mortgage the most important element in financing the purchase of your own home. The choice of mortgage model can have far-reaching consequences, which means that this decision should be taken very seriously. The range of possible mortgages can be broken down into three main categories:

- Fixed-rate mortgages
- LIBOR mortgages
- Variable-rate mortgages

There are also numerous special offers. However, most of these are simply combinations of the three classic mortgage types; and sometimes an interest rate bonus may be offered in specific circumstances (e.g. start mortgages, eco-mortgages).

Fixed-rate mortgage

Guaranteed interest rate for up to 15 years

With a fixed-rate mortgage, the amount of the loan, the interest rate and the term are all agreed when the contract is signed. Depending on the amount, you can choose a term of between one and 15 years. The interest rate remains unchanged until the end of the agreed term.

A fixed-rate mortgage is therefore ideal for homeowners who want to be able to plan their interest costs over a specific period. The longer the term, the higher the interest rate will be. Especially if affordability is an issue, a longer term makes sense because the borrower is protected against rising interest rates.

▶ A fixed-rate mortgage offers interest rate certainty throughout the term, but there is a risk when the loan matures. If the mortgage ends when rates are high, it will be necessary to agree a new mortgage for the whole amount on less advantageous terms. Borrowers can hedge against this risk by spreading the loan amount across several fixed-rate mortgages with different terms. This, however, has the disadvantage of making the borrower heavily dependent on one mortgage provider. Whenever one tranche of the mortgage matures, there is always another that continues to run. This can make it impossible to switch providers, which is a considerable weakness during interest rate negotiations.

LIBOR mortgage

Hoping that interest rates remain low

The interest rate for a LIBOR (London Interbank Offered Rate) mortgage consists of a basic rate, which is derived from short-term money market rates, plus a client-specific margin. When a borrower signs a contract, the loan amount, client margin and term (between two and five years) are defined. Within this term, individual periods of three, six or twelve months are defined at which the mortgage rate is adjusted to the LIBOR. The LIBOR mortgage is therefore linked to short-term interest rates. Maturing tranches can be re-fixed within the overall term or converted into a multi-year fixed-rate mortgage. Under some models, you can pay extra to protect yourself against interest rate fluctuations by defining a maximum interest rate.

▶ LIBOR mortgages are ideal for homeowners who are looking for flexibility and affordable short-term interest rates but who would also be able to cope with a rise in rates. Most providers only offer LIBOR mortgages above a predefined threshold.

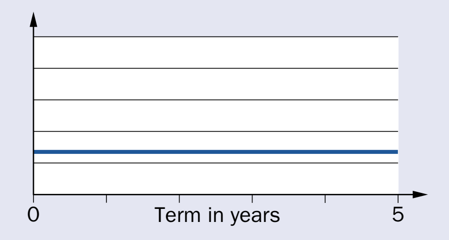
Variable-rate mortgage

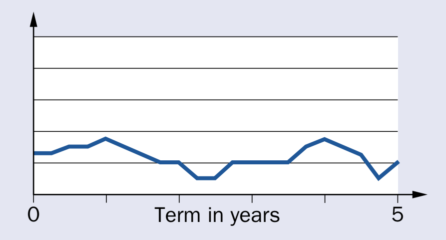
Flexibility without any fixed term

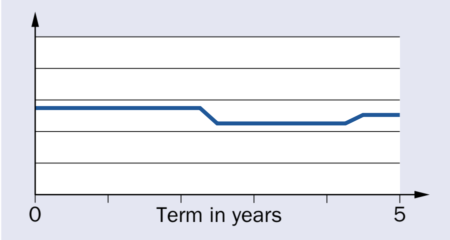
With variable-rate mortgages, the interest rate is linked to events in the money markets and capital markets and can change accordingly. This means that the interest burden will fluctuate. A variable-rate mortgage can be terminated at any time, provided that the notice period is observed.

> Variable-rate mortgages are ideal for the short-term financing of homeownership. This could be the case, for instance, if you intend to sell a property in the near future.

The most important mortgage models







Fixed-rate mortgage		LIBOR mortgage		Variable-rate mortgage	
Advantage	**Risk**	**Advantage**	**Risk**	**Advantage**	**Risk**
The amount in interest due for the whole term can be budgeted right from the beginning. Interest rates can be set for up to 12 months in advance, subject to a corresponding premium.	Early termination will result in additional costs.	You benefit from favorable short-term interest rates and stay flexible.	It is hard to calculate the exact interest burden because of volatility of the rates. Early termination will result in additional costs.	The term is open-ended; conversion into a fixed-rate mortgage or LIBOR mortgage is possible at any time.	It is impossible to calculate the exact interest burden because of the different rates.

Mortgages from AXA

“Attractive terms thanks to our cautious lending policy.”

Daniela Hohenhaus has been advising clients at AXA’s general agency of Pensions and Assets in Winterthur since 2002.

Why do insurers offer mortgages? Aren’t they classic banking products?

Daniela Hohenhaus: Mortgages have been part of AXA’s range of investment instruments for decades. One of the jobs of an insurance company is to manage client assets from mandatory occupational benefits insurance and from the individual life business. We are required to invest these assets long-term, securely and with a view to generating attractive returns. Here, the mortgage business offers attractive investment opportunities, besides real estate and bonds, etc.

What are the differences between an insurance solution and a banking solution?

AXA has a cautious lending policy. When it comes to mortgages, AXA only considers property which will be used as the owner’s main residence and which will be easy to resell. In addition, the borrower must have an excellent credit rating.

In view of these criteria, what are the advantages of choosing a mortgage from AXA?

For financing plans that meet these criteria, AXA can offer very attractive terms. In addition, our clients will benefit from our expertise as an insurance company. I’m thinking here, for example, of providing security for one’s family or optimizing one’s tax position through indirect mortgage repayment.

What is your advice to first-time buyers?

In view of the financial consequences and the complexity of the topic, I recommend that first-time buyers seek in-depth advice. The important thing is to ensure that they are fully aware of the consequences of buying their own home. It helps to discuss the subject with friends or colleagues. It’s also important to take advice on board; first-time buyers shouldn’t insist on realizing the dream of homeownership if the conditions aren’t right.

What do I have to do to get the best possible interest rate?

Some clients tend to focus too much on negotiating the best mortgage rate. Here, I can only recommend looking at a range of offers but, as with other important decisions, you have to be careful not to compare apples with pears. Potential borrowers should look critically at the quotation date, the extent to which it is binding, and the guaranteed payment date.

Repaying the second mortgage

Only the second mortgage has to be repaid, and the way in which it is repaid can be crucial in determining long-term affordability. It therefore makes good sense not to rush into this decision.

Direct or indirect

Second mortgages must be repaid within 15 years or, at the latest, when the borrower reaches the age of 60.

They can be repaid in two ways: directly or indirectly.

- Direct repayment means an agreed amount is repaid every year. While direct repayment gradually reduces the mortgage debt and interest amount, it causes the tax burden to rise.
- With indirect repayment, the money is invested in a pension plan with the aim of building up the required capital. This insurance policy is then pledged to the mortgage lender. When the contract term ends, the capital is used to repay the second mortgage. The mortgage loan and interest, and thus also the tax deductions, remain constant throughout the term. Furthermore, thanks to the integrated insurance cover, borrowers will still be able to meet their payments in the event of disability or death.

Making the right decision

- Tax burden:
  The higher the tax rate paid by the borrower, the more the mortgage interest reduces the tax burden. This positive effect is greater in the case of indirect repayment plans.
- Interest burden:
  If the interest burden is felt to be substantial, it should be reduced through direct repayments.
- Inflation:
  Inflation reduces mortgage debt in real terms. Borrowers who have a large loan and have repaid little of it will benefit more from this effect.

Practical decision-making model

It's often useful to answer three key questions:

1. Do you consider your tax burden to be high?
2. Can you easily afford the mortgage interest?
3. Do you expect inflation to rise?

If you answered "Yes" to all the questions, then indirect repayments are the better solution for you. If you answered "No" to all the questions, then direct repayments make better sense. In all other cases, in-depth analysis is advisable.

Comparing direct and indirect repayment

What are the costs of repayment? (in CHF)	**Direct repayment**	**Indirect repayment**
Installments or premium payments (CHF 6 667 per year)	100 000	100 000
Mortgage interest	16 000	30 000
Tax savings through deduction of debt interest	–4 000	–7 500
Tax savings through deduction of Pillar 3a payments		–25 000
Amount from policy (amount paid out – repayment)		–23 058
Tax on lump sum payment (6 %)		7 383
Total net cost of repayment	**112 000**	**81 825**
Difference in favor of indirect repayment		**30 175**

Advantages of indirect repayment
Cost advantage CHF 30 175 + insurance benefit on death of over CHF 93 508

Sample calculation: Second mortgage of CHF 100 000 is repaid over 15 years. The mortgage interest rate is 2.5 %. The marginal tax rate is 25 %. The Pillar 3a insurance for indirect repayment is combined life insurance which includes a tax-privileged savings component and a lump sum in the event of death (Protect Plan from AXA). Average values for a 45-year-old male with a mid-range bonus forecast.

Preparing for the unexpected

While it may be possible to resolve financing issues, questions involving risk and the future can sometimes remain unaddressed. Protect yourself against all predictable risks. In this way you can ensure that you are not forced into a situation in which you and your family would have to cope with the additional pressure of selling your home.

If your financial circumstances deteriorate due to unforeseen events (e.g. occupational disability or death) or your income drops following retirement, you may find yourself unable to afford your own home. In this situation the mortgage lender will demand repayment of the mortgage and, in the worst case scenario, the sale of the property. It therefore makes sense to protect yourself against risks of this kind. In fact, more and more financial institutions are refusing to provide mortgages without adequate financial protection.

Occupational disability

Occupational disability due to illness or accident is a risk that is frequently underestimated. It can strike anyone and doesn't only affect those who do hard physical work or make their living in high-risk professions. There are increasing numbers of cases where mental conditions and even minor physical ailments can make it impossible for someone to continue working. Especially in the case of disability due to illness, the available pension, even when combined with disability insurance (IV) benefits, is usually not enough to match the previous level of income. The affordability calculation (see page 4) shows whether someone will be able afford to finance their own home on the remaining income. If it turns out that there is a shortfall, this should be covered by occupational disability insurance.

► Occupational disability insurance ensures that interest and capital repayments can be made by providing regular replacement income.

Death

The death of one wage earner can push the surviving family members into severe financial difficulty because of the lost income. These problems may be complicated by inheritance claims which, according to the law, must be brought by the guardian of any children who have not yet come of age. All this will make it questionable whether the residential property can remain affordable. Difficult times, in which individuals are grieving, are made more difficult by worries about whether they can stay in their own home. Term life insurance provides financial stability at a very reasonable cost. The guaranteed death lump sum is paid out immediately to surviving family members.

► The payment of the lump sum from term life insurance reduces the mortgage debt so that the interest and capital repayments remain affordable, even in the changed situation.

Retirement

As a matter of principle, the second mortgage must be repaid before retirement. Generally this means that outgoings will fall as the retirement date approaches. In some cases, however, the post-retirement drop in income can have drastic consequences – particularly if pension fund capital has been used to finance the purchase of residential property. Even if there has been no advance withdrawal of pension assets, pensions from Old-Age and Survivors' Insurance (AHV) and occupational pension funds generally only make up around 65% of pre-retirement income. Unless an individual has invested in an additional private pension, the affordability of residential property can quickly become a real and pressing issue. This problem is exacerbated by the fact that not only the property owner but also the property itself is aging and that renovation costs are often added to financing costs as retirement approaches.

If it looks likely that there will be a post-retirement affordability gap there are three options:

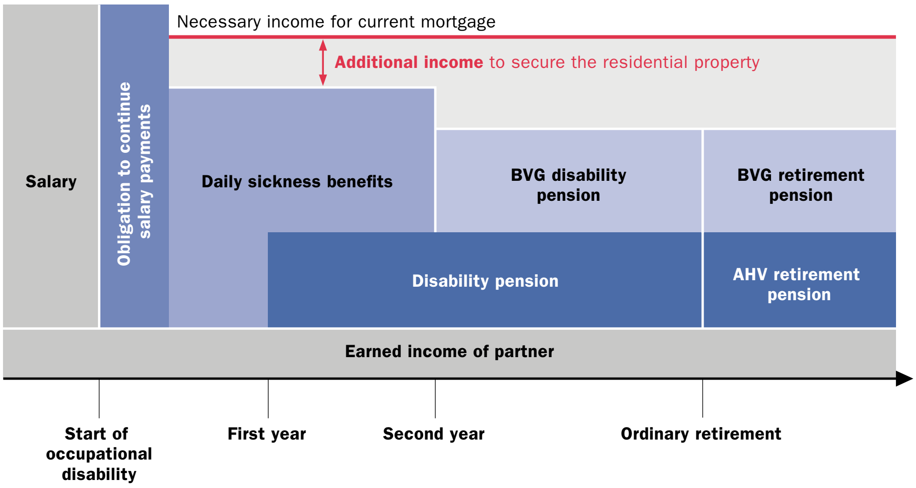
1. Voluntarily repay the first mortgage
2. Increase retirement income by purchasing additional pension fund benefits
3. Buy a life annuity.

The choice of the best option can be left until shortly before retirement. However, the necessary capital will need to have been accumulated much earlier. Pillar 3a insurance policies are an attractive savings option for homeowners.

► Pillar 3a endowment insurance policies combine retirement benefits with the necessary risk coverage, can be used for indirect mortgage repayment, and offer tax advantages.

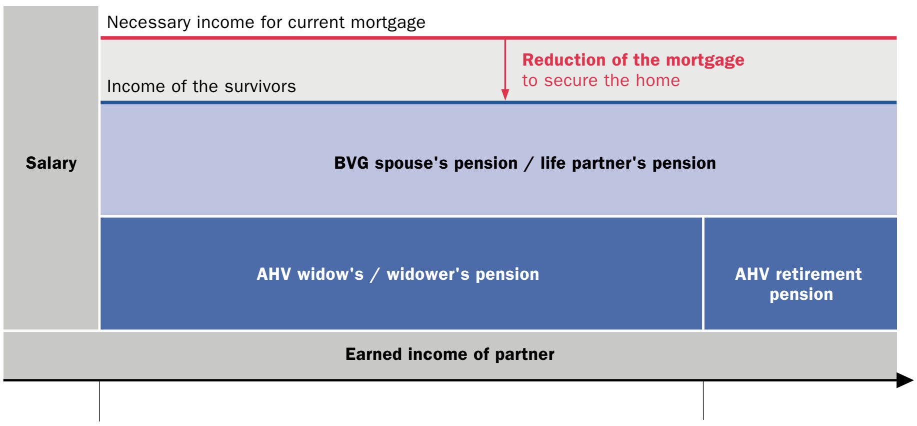
Examples of pension gaps

Lost income in the event of occupational disability due to illness



Individuals who depend on income from Pillars 1 and 2 in the event of occupational disability due to illness or accident are likely to have to make drastic cutbacks. The reduction in income often makes homeownership unaffordable. This income gap can be closed by buying appropriate occupational disability insurance.

Income shortfall for surviving family members in the event of death



The death of a wage earner can often result in the forced sale of the home. This may be because it is no longer affordable or because inheritance claims cannot be met using other assets. The guaranteed lump sum from a term life policy is a cost-effective way of avoiding this problem. This type of insurance is rightly regarded as providing vital cover for homeowners with families.

Ensuring affordability

“Protection against every occurrence is impossible.”

Beat Gyr has over 25 years of experience in insurance has been managing AXA’s sales office of Pensions and Assets in Altstätten since 2012.

Only those who pass the affordability test can be granted a mortgage. So why is it necessary to take further precautions?

Beat Gyr: The affordability test assesses the situation at a given point in time, but it doesn’t consider events such as divorce, unemployment or death. No one likes to think about what may go wrong in life. But you also don’t want to be faced with losing your home when you’re already in a tough situation.

What do you recommend?

In most cases, life insurance provides a relatively affordable form of protection against occupational disability or death. Divorce and unemployment, on the other hand, are more complicated. If the home becomes unaffordable when the borrower reaches old age, he or she will either have to repay the mortgage sooner, which may not be a good choice for tax reasons, or have sufficient retirement capital from other sources.

The second mortgage has to be repaid by retirement age. Won’t this reduce the burden sufficiently?

This varies from case to case. Borrowers are especially likely to run into problems if they’ve made advance withdrawals of pension fund assets. This is the case in almost two thirds of all home purchases today and has a major negative impact on pension income. I therefore urge my clients to draw up a regular savings plan after they’ve made the withdrawal so that they can make up the shortfall.

But doesn’t the mortgage lender have an interest in ensuring that interest payments can be met?

Certainly, and that’s why they not only apply the affordability test but also require borrowers to take out term life insurance. But it’s unusual for them to insist on any other steps.

Estimating taxes and additional costs

If you look at direct housing costs alone, rented property is almost always more expensive than owner-occupied property. However, this comparison fails as soon as you consider your tax bill or have to make a major repair. So it makes good sense to calculate on a realistic basis right from the start.

Substantial additional costs

The total derived from mortgage interest, capital repayments and ancillary costs generally comes in lower than the rent for a comparable property. But when planning their budgets, homeowners will also notice the effect of less obvious items, including:

- Tax (imputed rental value, wealth tax value)
- Reserves for renovation and remodeling
- Life insurance premiums to ensure continued affordability
- Payments into a pension plan (in the case of advance withdrawal of pension assets)

It would also be logical to include the cost of the deposit (in the form of lost interest and dividends). These costs can be substantial.

Ancillary and maintenance costs

Homeowners also have to shoulder the cost of maintaining their property, in addition to standard ancillary costs such as energy and fees, because a house that is not maintained will decrease in value. As a rule, ancillary and maintenance costs are calculated as at least 1% of the property's value. The older the property, the higher its maintenance costs are likely to be.

Experience tells us that the largest portion of expenses is down to operating costs (e.g. chimney cleaning, general cleaning, inspections), insurance premiums, duties, and repairs. Approximately one third needs to be allocated for replacing equipment and major renewal projects, but in reality this won't cover very much.

> ▶ Sample calculation: Given a property value of CHF 800 000, only around CHF 26 600 would accumulate over a period of ten years (one third of 10 x 1%), scarcely enough to renovate a small bathroom.

Reserves of 1% a year are sufficient to maintain the value of the property, but they won't cover the cost of upgrades to meet new requirements. It's also important to be aware that simply maintaining the same standard over the years will also lead to a fall in value. Improvements in energy efficiency, a new kitchen, putting in a fireplace, adding a conservatory, or other sensible renovations – perhaps because children are growing up or have left home. One thing is certain: the need is sure to arise, often sooner than you think. Projects of this kind are always expensive, and putting money aside regularly to finance them is essential in any realistic budget. One tried and tested method of avoiding this problem is to set up a separate house account with a bank and make monthly payments into it by standing order. Owners of condominium property generally have to make regular payments into a renewal fund, which is used to finance renovation projects for the property in the future.

Exploit the reserve from the affordability calculation

When a mortgage application is being assessed in terms of affordability, the forecast burden on the owner is estimated at a higher level than the actual costs in the first few years. When interest rates are reasonably low, reserves and savings plans can usually be financed by exploiting the difference between the maximum affordable cost burden, as established by the affordability test, and the actual costs.

Taxes

The flip side of all the tax deductions for debt, debt interest and costs for homeowners is the imputed rental value and the asset value. Homeownership can often amount to a tax penalty. It's also important to know that expenditure which results in a permanent increase in the value of a property is not recognized as maintenance costs and is not therefore deductible. The imputed rental value and the value of the property itself will increase the homeowner's tax burden.
At the same time, however, the debt, the associated interest, and the cost of maintenance and administration are all tax-deductible.

The risk of rising interest rates

Every mortgage has to be renewed at some point. Anyone faced with high interest rates at this time is likely to see their housing costs rise sharply. Unlike conversion plans, these additional costs cannot be deferred.

Tax on residential property

Tax burden	Tax relief
Income tax	
Imputed rental value Imputed rental value is the putative income that would be realized if the property were rented out. Calculating the imputed rental value is a complicated procedure that varies from canton to canton. The tax authority will provide the figure in writing, and it must be declared as income in the tax return.	**Deductions for maintenance and administrative costs** Expenditure which is related to property maintenance can be deducted from income. Such deductions are applied either as a fixed amount that varies from canton to canton, or by providing proof of the actual expenditure. The key factor is that the money must be used to maintain the value of the property. Expenditure which results in a permanent increase in the value of the property does not fall under maintenance costs and is therefore not deductible. Examples of maintaining value ■ Repairs and renovation ■ Modernizing kitchens and bathrooms ■ Improvements to doors, windows, heating systems and insulation ■ Garden maintenance Examples of increased value ■ Extensions or conversions ■ New conservatory, lift ■ Installations ■ Luxury fixtures and fittings **Deduction of debt interest** Mortgage interest is tax-deductible.
Wealth tax	
Taxable value The taxable value is calculated by the cantonal tax authorities and must be entered as wealth in the tax return.	**Deduction of loan debt** The mortgage debt is tax deductible.

Effective protection against high claims costs

Depending on whether your home is already set in stone or is still being created on paper, protect your investments and budget against the unplanned financial consequences of unwelcome incidents. Take advantage of professional advice from AXA to choose the optimum insurance package for your needs.

Construction insurance

Builder's risk insurance
Builder's risk insurance covers damage to your own buildings which is caused, for example, by the collapse of a roof or wall.

Builder's liability insurance
Builder's liability insurance covers financial claims brought against the builder or property owner on the basis of statutory liability provisions following personal injury or property damage.

Builder's legal protection insurance
This form of legal protection insurance covers private builder-owners in the event of disputes about hidden defects in the building. In particular, it covers defects which are discovered only after the acceptance protocol has been produced and/or the building has been commissioned and which were not apparent at any earlier stage. Builder's legal protection insurance is taken out as a supplement to construction insurance (builder's risk insurance, builder's liability insurance).

Building property insurance

Fire insurance including natural hazards
Most cantons require buildings to be insured against fire damage through a cantonal buildings insurer. In the other cantons (Geneva, Valais, Uri, Schwyz, Appenzell Innerrhoden, and Ticino), fire risk can be included under a building property insurance policy purchased from a private insurer.

Water insurance
Water damage, other than that caused by high water and floods, is not covered under the natural forces insurance provided by cantonal and private fire insurers. This type of damage includes: water from water pipes, frost damage to water pipes and apparatuses connected thereto; damage from rain, snow and meltwater; backups from sewers; fluids leaking from heating, air-conditioning and cooling equipment; loss of rental income as the result of water damage. Damage of this kind is covered by building insurance.

Earthquake insurance
There are major gaps in coverage here since most buildings in Switzerland are not insured against earthquake damage. Cantonal fire insurers provide insurance coverage in the form of earthquake funds, but this coverage is limited and often cannot be enforced by law. No such solution exists in cantons without cantonal building insurance.

Burglary insurance
All damage resulting from burglary involving shared rooms and facilities can be insured. This type of insurance is especially important for owners of multi-family buildings because they can be held liable for damage that cannot be clearly attributed to one particular resident. In the case of owner-occupied single family homes, this type of damage is covered under household contents insurance.

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