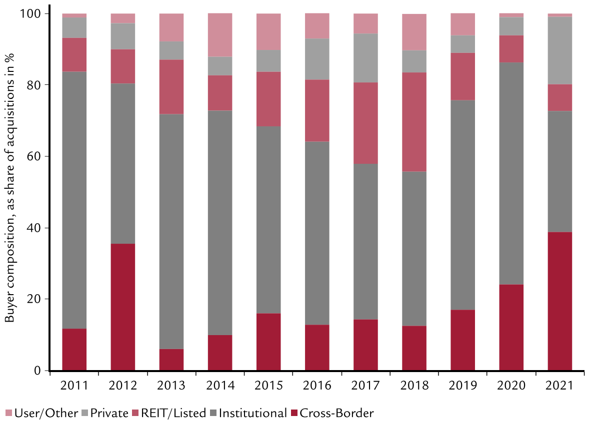
Real Estate House View
Switzerland

Second half of 2021

Key takeaways

- **A solid foundation:** The economic recovery to pre-crisis levels as well as negative interest rates support the attractiveness of the real estate industry for investors. Investors need to consider changes in human behaviour that are impacting the respective real estate sectors and occupiers' demand.
- **Residential – strong:** Homeownership is becoming more expensive and pushing households into renting. The high share of households renting, an even further increasing population, and the enlargement of catchment areas put the sector on firm occupier ground, leading to increasing demand from investors and raising capital values.
- **Office – partly strong:** Changes in office space requirements are leading to a polarisation between assets in prime locations and secondary locations. Rents and prime yields will react accordingly: while rents and capital values of core properties are expected to go north, their less attractive counterparts ought to see figures pointing south.
- **Retail – could become strong again:** The market is still undergoing structural changes, and polarisation between locations continues in 2021. Retailers need to react to consumer trends and offer multi-channel solutions to emerge stronger from the crisis.

Chart in focus



Source: RCA, 2021 data as represented by H1 2021

The Swiss real estate market is traditionally characterised by a dominant domestic investor structure: their ten-year average share (2011-2020) accounts for 84%. Over the years, the stability of Swiss real estate has continuously attracted more and more foreign investors. Since 2013, the share of cross-border capital has increased from 6% to 39% in 2021. However, for one of Switzerland's most attractive sectors – residential that accounts for roughly a third of investment volumes – the Lex Koller rule applies, which restricts the purchase of real estate by foreign nationals.

The Swiss economy recovered quickly from the pandemic, and its GDP had returned to pre-crisis levels by mid-year 2021. A positive surprise is the rapid decline in unemployment since the beginning of this year, which bodes well for the real estate market. The procyclical impetus from monetary and fiscal policy in the western economies will have a longer-lasting positive effect on Switzerland's export economy. Even if the pandemic causes a fourth wave, we expect the economic damage to be lower again than in the period between October 2020 and March 2021. Representatives of the Swiss National Bank (SNB) recently made it clear that the rise in inflation rates will not lead to a change in the SNB's monetary policy. Instead, inflation in Switzerland is expected to remain reliably within the target range of 0% to 2% in the next few years. Following four deflationary phases since 2008, the SNB has thus achieved its objective of price stability.

Residential: an almost safe bet

In an environment where investors seek safety, sectors with intact fundamentals – like Swiss multifamily residential – are in demand. Though working from home (WFH) has shifted occupier demand towards larger flats in medium-sized centres and rural areas, there is no reversal of the urbanisation trend. In the top five markets, median rents increased by 1.4% (Q1 2021 y-o-y), and vacancies remained stable at 0.7% in 2020. Rather, the catchment areas for rental units are expanding. This trend is supported by rising homeownership prices. Nationwide, the median price of a condominium increased by +8% as of Q1 2021, y-o-y, whereas the respective median rent decreased slightly (-0.5%). As the Swiss population is projected to steadily increase by 1% p.a. in the coming years, the Swiss rental residential market stands on solid ground and is attracting investors. As a result, prime yields in 2020 in the top five markets decreased by 20 bps. All those five markets generate prime yields below 2%. At these levels, investors should assess if properties in core markets are still generating the yields they seek, or if properties in medium-sized or rural areas that also exhibit occupier demand could be a better choice.

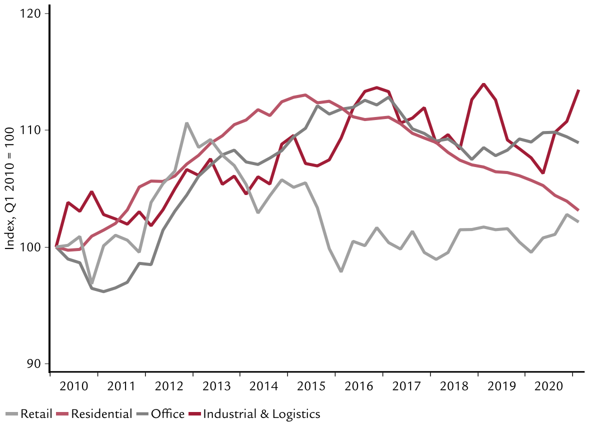
Office: cherry picking

A recent study by Deloitte finds that, post-pandemic, 62% of Swiss employees opt for a mixture of office and WFH. Moreover, many occupiers have not yet decided on their return-to-office strategies and the occupier market is characterised by a wait-and-see attitude. Consequently, the nationwide vacancy rate (6.8%) has increased by 30 bps since Q1 2021 (y-o-y) and prime rents decreased by -2% in 2020 across the top five markets. Investors have shifted their preferences accordingly. Though office remains a key investment pillar, demand focuses almost entirely on core properties in excellent locations with long lease contracts – the fear of vacancy is driving investors to properties with superior location factors, meaning secondary locations are avoided. Due to the oversupply of capital-seeking core properties, prime yields are compressing. In some locations, such as Zurich (Q4 2020: 1.7%, -20 bps y-o-y), yields are at levels where return targets become difficult to reach. However, if the spread to government bonds remains significant, investors will continue to deploy capital in these properties. In the short term, the prospects are positive: for 2021, the 10-year bond yield is forecast at -0.1%, for 2022 it is 0%.

Retail: white knight omni-channel?

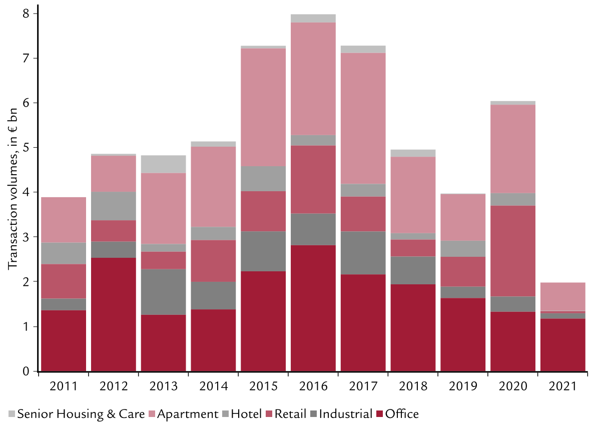
Although a certain catch-up consumption effect is driving the sector in the short run – consumer spending in May 2021 was higher than before the pandemic –, a survey finds that the Swiss are planning to consume less, more consciously and more online – including grocery goods – after the pandemic. According to a recent study from the University of St. Gallen, consumers prefer omni-channel solutions that allow both offline and online contact points. Successful retailers will have to adjust to these changes in preferences. For successful shopping centres, hip anchor tenants are becoming a must, because these tenants generate consumer traffic. As in other sectors, the wait-and-see attitude of market participants results in a rather quiet market, where the respective data does not fully reflect the true situation. The investors that are active are very weary of the quality and security of properties pushing prices in the prime segment. During 2020, the prime yield compressed by 10 bps in Zurich (Q4: 2.3%), Lausanne (2.9%) and Geneva (2.6%). On the other hand, prime rents in all top five markets decreased by 5% in 2020 – mostly in Bern (-13%), the least in Zurich (-1%). The opposition of prime rent and prime yield developments illustrates the uncertainty of the sector.

Chart 1: Swiss real estate sectors asking price index (asking rents) until Q1 2021



Source: Wüest Partner

Chart 2: Transaction volumes in the Swiss real estate markets until Q2 2021



Source: RCA, 2021 data as represented by H1 2021

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