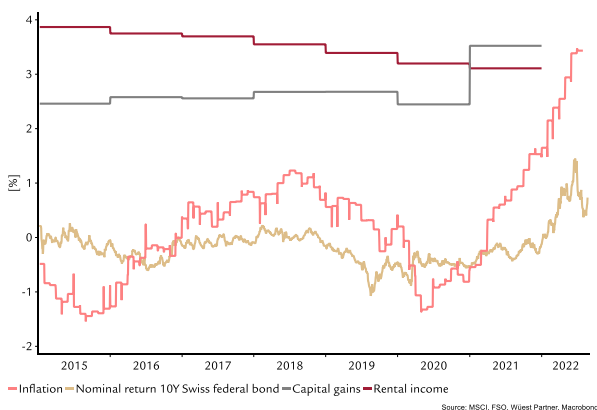


Second half-year 2022

Key takeaways

- **Challenging market environment:** Following historically high capital gains on real estate investments of +3.5% in 2021, these are likely to be lower as the interest rate environment normalises again.
- **Prime yields in Q1 persistently low:** The yields of cities and sectors largely moved sideways in Q1 2022. The lowest net prime yield amounted to around 1.2% for residential in Zurich. However, cash flow returns remain attractive due to partial inflation protection and robust occupier demand.
- **Immigration supports rental and occupier market:** Apartments and high-quality office space are set to remain in demand. An important driver is immigration: between January and May 2022 it was more than 30% above the average of the last eight years. Employment in the services sector rose by 2.2%, and the number of jobs advertised was up 64% compared with the prior-year period, speaking for more office take-up.
- **Construction and financing costs rising:** The largely import-driven prices in construction are at a historic high and have increased by 8.1% year on year in 2022. Fixed-rate mortgages for ten years came in at between two and three percent. The reference mortgage rate will accordingly have bottomed out and could already go up in 2023, thereby facilitating higher rental income.

Chart focus



2021 was a special year for the Swiss real estate market: according to MSCI, for the first time in 20 years total capital gains (3.5%) on real estate investments exceeded the cash flow returns from rental income (3.1%). This was due to the persistently high willingness to pay in the low interest environment, although a turning point is to be expected in 2022: the nominal interest rates of risk-free investments are around 100 bp above the average since the start of the negative interest phase. However, an abrupt reallocation at the expense of direct real estate investments does not appear opportune due to the ongoing negative real yields and partially inflation-protected cash flow returns.

The index of weekly economic activity of the State Secretariat for Economic Affairs (SECO) shows that economic momentum accelerated further throughout the entire second quarter of 2022 following an initial downturn in March. The services sector, as well as the leading export sectors, are in robust condition. The sharp rise in interest rates setting in at the start of the year is only exerting a sporadic impact, particularly in the form of increased mortgage interest rates. This, and the continued long delivery times, are dampening the outlook for the construction industry. Although inflation in Switzerland has reached its highest level in almost 30 years, the loss of purchasing power for the average Swiss household is less marked than in the rest of Europe. However, if our scenario of a recession in the USA and Germany were to materialise, Switzerland would also sustain a significant economic slowdown. The franc could then come under further appreciation pressure against the euro.

Immigration supporting demand for housing

The current figures of the State Secretariat for Migration are positive from the perspective of real estate investors: immigration from January to May was 44% up on the previous year. Around 31% more people migrated to Switzerland in the same period compared with the average of the last eight years. In the cantons of Zurich, Geneva, Vaud, Basel-Stadt and Berne, where more than half of all migrants settle, growth compared with the long-term average lies between 19% (Berne) and 53% (Vaud). Regarding the job and employment growth in Switzerland, this momentum is set to continue, with immigration from abroad reaching between 70 000 and 80 000 people (Figure 1). This is having an impact on the housing market: according to Wüest Partner, the number of rental apartments on offer now amounts to fewer than 147 000 and is therefore below the long-term average. The upward trend in residential rents will accordingly continue. An end to the prolonged sideways movement for advertised rents is therefore also to be expected in Vaud and Lausanne.

Polarisation in the office market

According to Wüest Partner, the advertised rents in the overall office market were down 2.4% on the same

quarter of the previous year. However, prime rents in the centres made one to two-digit gains. This suggests that the polarisation between urban office locations and those outside is continuing. According to CBRE, at 3.1% the availability rates in the cities at the end of 2021 were significantly lower than in the suburbs, where they amounted to 8%. Higher take-up can be expected since 64% more jobs were advertised in the services sector in Q1 2022, and employment growth stood at 2.2%. According to CBRE, take-up in the second quarter was already 27% up year on year.

Bifurcation of retail space

The bifurcation of the rental market is also continuing in the retail sector: while advertised rents of retail space fell by 5.3% year on year in Q1 2022, they rose by between 7% and 20% in the prime segment. In Geneva, Lausanne and Zurich, they were 6%, 8% and 14% respectively above the average of the last five years in Q1. Meanwhile, the prime yields have moved sideways and only declined on the same period of the previous year in the cities of French-speaking Switzerland. The average across all five of Switzerland's large cities is currently around 2.4%.

Higher construction and capital costs

The environment is becoming more challenging for construction and development projects. Compared to consumer price inflation, construction prices reacted strongly due to the high share of imported materials: the cost increase in construction reached +8.1% in Q1 2022 compared with the previous year. In addition, market players are facing challenges due to the sharp rise in mortgage interest rates, which are around one percentage point higher, reaching levels last seen in 2014. The latter also bodes well: the mortgage reference interest rate should have bottomed out. An increase from 2024 is conceivable without any major interest surges (see Figure 2). Where applicable, staggered rental income increases of around 3% per interest rate hike can be expected.

Figure 1: Significantly higher immigration in 2022 (permanent foreign resident population)

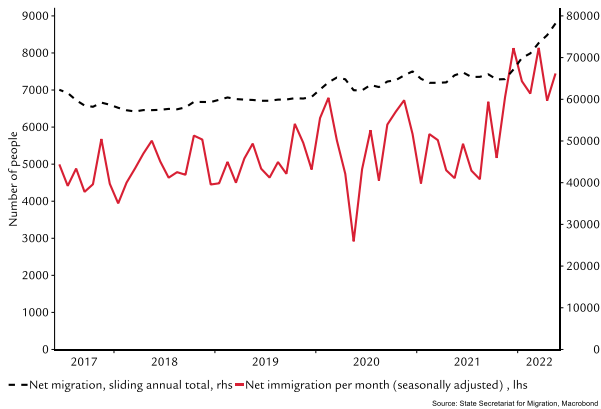
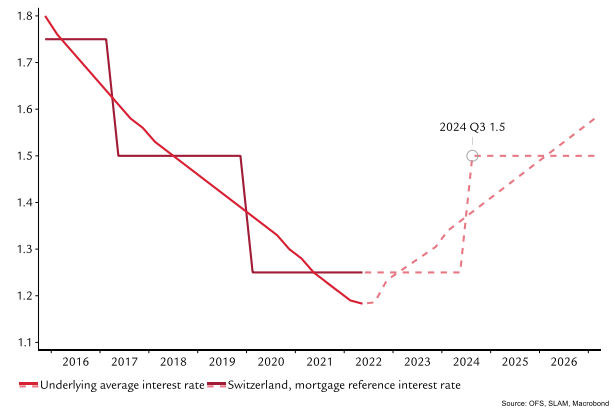


Figure 2: Bottom reached – the reference interest rate for rental agreements should rise again



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