Real Estate House View
Switzerland

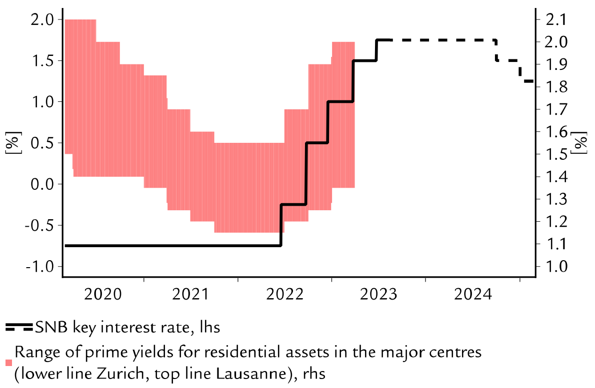
Second half-year 2023

Key takeaways

- **End of rate hike cycle:** The Swiss National Bank raised the key interest rate to 1.75% in June. We now expect the hiking cycle to come to an end, with a total increase of 225 basis points. Nominal interest rates on government bonds rose less in comparison, and we expect them to fluctuate around 1% next year. We expect to see the first key interest rate reductions by the end of 2024.
- **Gap between price expectations closes:** With the interest rate situation more clear, the period of pricing uncertainty amongst buyers and sellers is also coming to an end. Demand remains strongest for residential properties that are not in need of renovation. Other commercial sectors are also of interest, but only high-quality assets in well-connected locations.
- **Market rents continue to rise:** A resilient labour market and persistently high immigration, combined with a reduction of construction activity is driving demand for space and pushing asking rents higher.
- **A greater focus on refurbishments for the construction industry:** Due to tightening decarbonisation targets, investors are likely to shift away from new builds and focus on improving energy-efficiencies of existing buildings. Experts expect a capacity utilisation of 70% for the construction workforce for refurbishments, which will be restrictive of new supply.

Chart in focus

Central bank base rates and prime yields



Macrobond, Swiss Life Asset Managers

With the rate hike cycle winding down, an end to rising real estate yields is also in sight. Given the record-high demand for residential properties, scope for a rise in yields and potential valuation adjustments remains limited. Prime yields for residential property in the major cities recently moved upwards between 20 and 40 bps, reaching between 1.35% (Zurich) and 2.00% (Lausanne) in the first quarter of 2023. Although the cycle is not yet over here, more entry and buying opportunities are beginning to emerge.

We are now seeing increased financing costs in the real economy. The purchasing managers' indices for manufacturing and SMEs have recorded values below the growth threshold. High-frequency data on economic momentum in Switzerland, such as SECO's index of weekly economic activity (WEA), has indicated a stagnant trend towards zero growth since the beginning of the second quarter. In Switzerland, we expect real gross domestic product to grow by 0.7% this year and by 1.3% in 2024. Generally speaking, the current recession in the Western world will only have a minor impact on labour markets. We expect an annual average unemployment rate of 2.0% for Switzerland. In terms of the central banks' inflation targets, the fall in demand is now having the desired effect. This, along with the elimination of supply bottlenecks following the pandemic, has meant that inflation rates have been falling steadily since the second half of 2022. In Switzerland, the inflation rate has now returned to 1.7% and is thus within the Swiss National Bank's target range of 0% to 2%. This is likely to bring the cycle of interest rate hikes to an end.

Safer bets

After the interest rate turnaround, many investors are currently wondering which sectors and macro locations they can confidently invest in again. Residential investments should be mentioned first, due to low structural uncertainties. At 57%, net immigration to Switzerland from the start of the year to May 2023 was above the average of the past eight years. Meanwhile, at around 40 800 units, the moving annual total of all newly constructed housing units approved at the end of the second quarter is as low as it was almost 20 years ago. As a result, the increase in asking rents is exceeding expectations: according to the Homegate/ZKB rental index, rents rose by 3.3% across Switzerland in June 2023. The situation is different for commercial space. Due to structural changes, investors need to differentiate strongly by location. Investments are only economically viable in areas where companies and retailers are choosing to retain or expand their premises. This is primarily the case in cities that favour a concentration of rental space due to high-quality infrastructure, transport connections and public services. This is also confirmed by current market data.

Demand sustained in cities

As mentioned above, we expect the unemployment rate to average 2.0% next year and drive demand for high-quality office space due to ongoing staff shortages. According to the latest JLL office market study, many cities are still undersupplied: the supply rate is 2.2% in Zurich's district 1, 1.9% in Geneva's city centre and 1.5% in Lausanne. The exception is Basel, where the rate reached 7.6% at the end of last year. If entire municipal areas are considered instead of just city centres, the supply rates are usually higher: at the end of the second quarter, the consulting firm Wüest Partner reported a rate of 3.8% for the whole of Zurich and 10.2% for the whole of the city of Geneva. This concentration of prime locations (such as Zurich's middle to upper Bahnhofstrasse and the Rue du Rhône in Geneva) is underlined by the continuing rise in prime rents: according to Wüest Partner, these rents are over CHF 900/m2 p.a., which is above the pre-pandemic level once again.

The major refurbishment cycle

Lower availability of capital, coupled with rising prices is severely hampering the increase of available space through new construction activity; this is at a time when demand in many places is growing unchecked. In the long-term, new construction will come under even more pressure: this is due to the refurbishment cycle and the ambition to make real estate stock more climate neutral. More than half of the buildings in Switzerland are over 50 years old. According to calculations by Professor Thalmann of EPFL Lausanne, around 70% of employees in the construction industry would have to be involved in refurbishment works if the decarbonisation targets for building stock are to be met by 2050. If the approved investment volume is taken into account, the industry is not yet on track: in the second quarter of 2022, around CHF 51 billion per year pro rata was still being spent on new construction across Switzerland, a share of 72% (see Chart 2). In addition, time may be running out: according to the ZKB, it now takes an average of 140 days to obtain planning permission in Switzerland, which is 67% longer than in 2010, and the trend is rising.

Chart 1: Market rent trends in response to excess demand

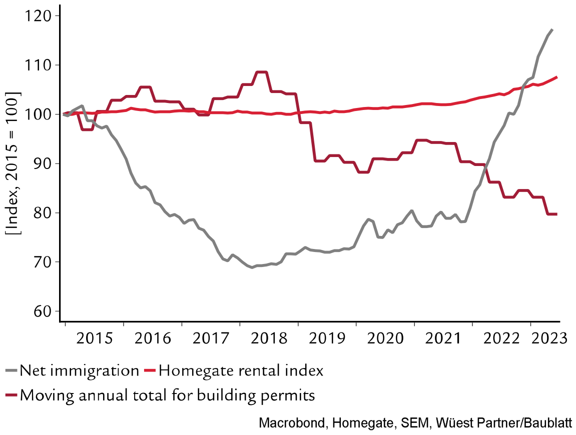
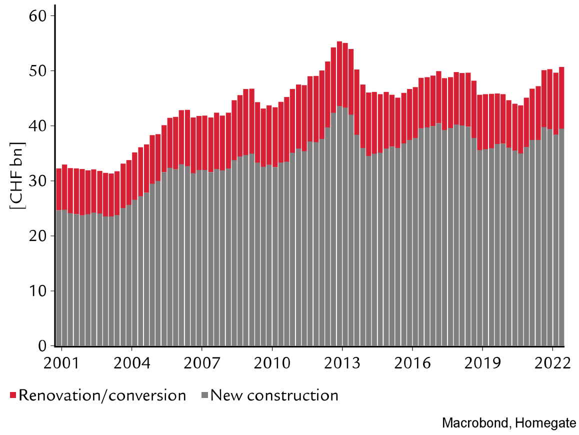


Chart 2: Proportion of construction investments in renovation still low



Authors

Swiss Life Asset Managers

Robert Kuert
Real Estate Research Analyst Switzerland
robert.kuert@swisslife-am.com

Marc Brütsch
Chief Economist
marc.bruetsch@swisslife-am.com

Francesca Boucard
Head Real Estate Research & Strategy
francesca.boucard@swisslife-am.com

Do you have any questions or would you like to subscribe to this publication?
Please send an e-mail to info@swisslife-am.com.
For more information, please visit our website at www.swisslife-am.com/research