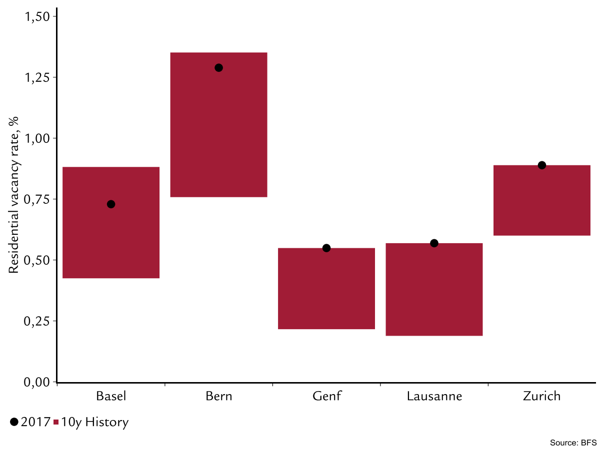
Real Estate House View
Switzerland

First half of 2018

Key takeaways

- After a rather good real estate year in 2017, we are expecting to see more challenges arising in the next years as all sectors are experiencing structural changes, especially in the retail sector but also to some extent in the residential sector.
- Markets in all sectors have become tenant-favourable markets and landlords as well as owners need to make more concessions.
- The imbalances between supply and demand in the residential sector continue to grow. In some peripheral regions supply outstrips demand and we expect vacancies to increase further.
- In the office sector, vacancies have been stable in the major cities, but rents have been decreasing slightly in the course of 2017. As there is more supply in the pipeline, we expect rents to decrease in 2018.
- Movement in the retail sector reflects ongoing caution: yields have increased since last year and, with the exception of Basel, rents have decreased in all major cities.
- It remains to be seen how structural changes will affect the Swiss real estate market. Fundamentals (low interest rates, improving economy) favour steady demand for property in Switzerland, but the market has to be able to adjust to new circumstances.

Chart in focus



The vacancy rate in the residential sector reached a record 1.47% in 2017. But vacancy rates in the large city regions are low compared to the whole of Switzerland. Zurich in particular remains a stable anchor in this regard – a figure that shows people's desire to live close to work and leisure amenities.

Swiss manufacturers continue to benefit from the global upswing. At home, retail sales stabilised in the second half of 2017, with signs of accelerating dynamics. While retailers continue to suffer from online offerings, cross-border shopping has become less attractive given the Euro's 10% appreciation since April 2017. As the weaker currency plus favourable winter sports conditions are boosting the alpine tourism regions, hotel overnight stays are rising again. Consumer price data reveal that some retailers and service providers, such as restaurants and hotels, are testing their price-setting power in the light of accelerating economic dynamics and rising import prices.

Full pipeline

In the last ten years, major cities such as Zurich experienced strong decentralisation. Larger companies relocated in sub-centres with excellent access to public transport. After a long period of limited supply, this movement made office space in the city centres suddenly available for new companies, but also leading to historically high vacancy rates on a Swiss comparison. As there is more supply in the pipeline, the office market will face more challenges in the future. In general, we expect to see the newly added office spaces leased out within a reasonable period of time since they tend to be in good locations, feature exciting architecture and have appropriate marketing budgets. However, existing office space that is already vacant will suffer the most from the additional supply and will face long tenant search periods, making the markets increasingly tenant-friendly. We expect these developments to go on in 2018.

High street changing

The structural change in the retail sector has been ongoing in Switzerland as well. Whereas shopping tourism is expected to stabilise at a high level, e-commerce is also taking its toll. Although it is not as developed as in other countries such as the UK, we expect ongoing growth as the Swiss are very prone to technological trends. It is not only online shopping that is to blame, however, but also the competitiveness of each and every retailer. The structural change is driven by the consumer trend towards more online shopping and also by the growth of "experience retailing", so retailers find themselves faced with a dual challenge. We expect the food and leisure sector to make its way more and more into Swiss high streets, leading to gyms and healthy food corners being located next to showrooms for fashion and furniture. These changes are reflected in the development of rents: they have contracted further in 2017 and are expected to continue shrinking in 2018. In poorly accessible rural regions in particular, rents are expected to fall whereas inner-city prime locations will be stable or even slightly positive

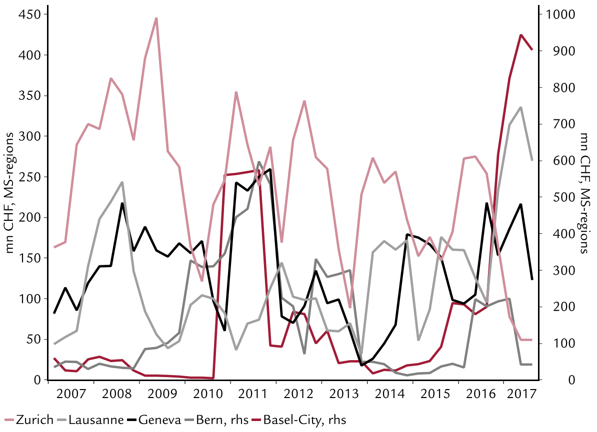
Increasing vacancy rate

The imbalance between supply and demand continues to grow in the residential market. Especially in rural regions, large apartment projects are entering the market. Meanwhile, there is no corresponding population growth to absorb this capacity. The resulting overcapacity puts pressure on existing properties in the vicinity whose fit-out standards are not in line with market requirements. The vacancy rate in the rented accommodation sector has reached a record 1.47% in Switzerland and is likely to rise further next year. 53,327 of the 64,893 vacant apartments are in the rented accommodation sector, i.e. 82%. Nevertheless, vacancy rates in the large city regions are at a low level when compared to the whole of Switzerland. Zurich in particular remains a stable anchor in this regard, with a vacancy rate of around 0.2%. Vacancies in the large cities are often linked to apartments in the high-price segments. We expect this pattern to become even more visible in the near future since changes in the structure of immigration towards non-EU citizens will probably contribute to flagging demand in the high-price segment. Moreover, some of the more prosperous residents have left the rental segment to become home-owners.

Incentives to catch tenants

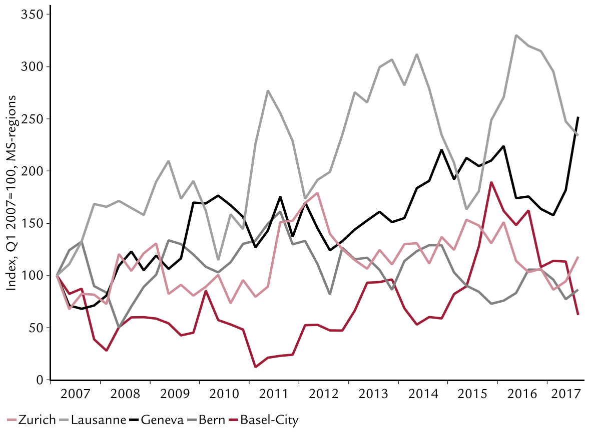
While rents for existing properties were stable or increased slightly last year, quoted rents trended downwards – and we expect this trend to continue. However, property owners are resisting rent reductions and are trying to enhance the marketability of flats in other ways. Thus, residential property owners are increasingly providing incentives such as rent-free periods, contributions to removal costs or other "goodies" to attract and retain tenants. These measures, which used to be limited to office markets, are now bearing fruit.

Chart 1: Building applications office



Source: Wüest Partner

Chart 2: Construction permits residential



Source: Wüest Partner

Authors

Francesca Boucard, Swiss Life Asset Managers
Economist Real Estate
francesca.boucard@swisslife.ch

Martin Warland, Livit
Project Manager Research & Data
martin.warland@livit.ch

Marc Brütsch, Swiss Life Asset Managers
Chief Economist
Marc.bruetsch@swisslife.ch

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