

# PwC-Immospesktive

Interpretation of the FPRE real estate meta analysis Q1/18  
References to FPRE graphics in our text are marked "(1)" etc.

**"The economy is expected to grow further in the future"**

## Dynamic Swiss economy

With the global economy thriving, domestic markets continue to recover as well. GDP growth climbed to 2.5% during the third quarter of 2017, marking the strongest increase in economic output since 2014. Some business sectors once again managed to post gains, the economic growth was however mainly fueled by the processing industry. The depreciation of the Swiss franc as well as the surge in foreign output led to an increase in exports. Switzerland's economic dynamism is expected to continue with low interest rates as its main driver.<sup>1</sup> For the upcoming years, experts anticipate an elevated GDP growth of on average 2.0% in 2018 and 1.9% in 2019. BAK's economic researchers are the most optimistic with their forecast of 2.4% for the coming year 2018. (8, 9)

Based on the prosperous economy, a slight improvement on the labor market is emerging. At the end of 2017, the unemployment rate was 3.2%. Business cycle researchers expect it to decrease to 3.0% on average in 2018 and 2019. (8, 9, 10) They also predict a higher employment growth (2018: around 1.2%, 2019: around 1.0%). Job vacancies have especially opened up in the financial and real estate sector lately.

16 February 2018

*The dynamic Swiss economy had a positive impact on the labor market and the retail sector which for many years now has been ailing. The Swiss National Bank (SNB) raised its short-term inflation forecast. The historically low interest rate levels are generally expected to rise moderately throughout the coming years. Conversely, over the same period, rents for rental apartments and office spaces decreased while prices of owner-occupied properties moved sideways. The regional excess supply in the rental housing market led to an increase in vacancies to 2.4% on average and could potentially cause record high vacancies in the near future. An imbalance is also becoming increasingly noticeable in the office market and the current construction activity does not cause hope for improvement.*

The strong economy and the increase in employment growth are met by historically low immigration. Net immigration has increased by 16,400 during the fourth quarter of 2017, which was by far the lowest over the last ten years. (12)

## Interest rates will increase – gradually

Despite their still limited potential to rise, interest rates will gradually increase in the nearer future. This is on the one hand attributable to the central banks' growing

caution towards monetary policy and, on the other hand, to elevated inflation expectations. In December 2017, the SNB lifted its inflation forecast to 0.7% for the year 2018.<sup>2</sup> (11) The reasons behind this are the flourishing Swiss economy as well as higher import prices. The projections have also been adjusted to 0.5% (previous quarter: 0.4%) for the recently completed year. (11) These developments indicate that retailers and service providers are aware of their improved economic situation and taking advantage of their pricing power.<sup>2</sup>



<sup>1</sup> SNB, Quartalsheft, 4/2017 Dezember

<sup>2</sup> SwissLife, Perspektiven Konjunktur, Februar 2018

---

## **“Interest rates are expected to rise mildly in the short and medium term”**

---

In December 2017, the long-term interest rates (yields on ten-year government bonds) once again dropped to -0.1% before climbing back up to over 0% in January 2018. (21, 22) But as inflation has been rising simultaneously, real interest rates remain in the negative.<sup>1</sup> In the short to medium term, a slow increase in the interest rate level is forecast. Experts predict a moderate rise in the long term rates from 0.1% to 0.3% for 2018 and a possible further increase from 0.4% to 1.1% in 2019. (20)

Mortgage rates are having a delayed reaction to those trends. They are all consistent with last quarter's levels in 2017, except for the ten-year rate (reduction to 1.6%). (23) Banks predict a slow increase in mortgage rates over the next few years. Primarily the five- to ten-year fixed rates are expected to rise. Libor mortgages are however expected to remain stable. For Libor mortgages, banks are thus expecting an ongoing low interest rate environment.<sup>3</sup>

### **Construction activity outlook 2018 stays positive – for the moment**

While it fell by two points to 145 points during the last quarter of 2017, the Construction Index remained in clear positive territory with a plus of 12% compared to the previous year. (17) The marginal decline was mainly due to a decrease in underground engineering. At the same time, construction activity is receiving mixed signals for the coming year 2018. The bullish expectations concerning economic growth might primarily fuel the demand for owner-occupied as well as office properties which would have a positive impact on the construction industry. A possible interest rate rise by the SNB would have a contrary effect, especially for residential construction. Overall, predictions remain positive for 2018 but one should not expect any other price runs.<sup>4</sup>



---

## **“Building industry slightly derailed at the beginning of the year”**

---

### **Prices in the owner-occupied housing market move sideways**

During the fourth quarter of 2017, FPRE AG observed a continuing lateral price movement for owner-occupied properties. Prices for single-family homes declined (-2.1% quarter on quarter) (4, 46, 48), while those for owner-occupied apartments rose slightly (+1.4% quarter on quarter).<sup>5</sup> (3, 52, 54)

By the end of the year, the price increase was mainly noticeable in the middle segment (+3.8% quarter on quarter). (54) This rise covered all regions. (55, 56) Prices in the upscale segment moved contrarily and concluded slightly below (-0.8% quarter on quarter).<sup>5</sup> (54)

Single-family homes recorded a price decline across all regions with major drops in the Jura (-4.2% quarter on quarter) and the southern part of Switzerland (-3.5%

quarter on quarter). (49, 50) The biggest decrease appeared in the upscale segment (-3.1% quarter on quarter).<sup>5</sup> (48)

Low mortgage rates led to operational costs of private homes currently being 15% lower on average than rental costs of comparable properties. Prices for owner-occupied properties thus registered a mild increase in 2017. For the coming year, UBS is expecting prices to rise moderately for single-family homes (+0.5%) and to remain stable for owner-occupied apartments as they face challenges due to sinking rents.<sup>6</sup> (7, 30, 51, 57)

---

## **“Signs remain slightly positive for the owner-occupied housing market”**

---

### **Record level of vacant rental apartments expected**

As a result of investment pressure, the supply of rental apartments is almost completely detached from demand. The

---

<sup>3</sup> NZZ, Für Hauskäufer wird es bald knifflig, 22.12.2017

<sup>4</sup> Baukostenindex der Credit Suisse und des Schweizerischen Baumeisterverbandes Q4/2017

<sup>5</sup> FPRE, Transaktionspreis- und Baulandindizes für Wohneigentum, Datenstand 31. Dezember 2017

<sup>6</sup> UBS, Real Estate Focus 2018, Eigenheime (Auf immer weniger Bodenfläche), 11. Januar 2018



---

## ***“The supply of rental apartments is nowadays widely detached from demand”***

---

growing supply is negatively impacting rents. Residential rents have continued to fall at the end of 2017 (-1.7% quarter on quarter) following a mild recovery during the third quarter. Year on year, a considerable decline (-3.8% year on year) can be observed. New buildings in particular have recorded a strong decline in rents of 5.2% compared to the previous year.<sup>7</sup> (25, 26, 27)

The competition for the owners in the rental apartment market is becoming increasingly intense. The current average vacancy rate of 2.4% might not yet have reached its peak according to UBS. Prolonging construction activity paired with low immigration numbers could lead to record high vacancy rates through to 2019, surpassing the current record level of 2.8% (1998). Such vacancies would have serious consequences for

quoted rents. Further rent corrections are therefore expected to happen in 2018. According to UBS forecasts, quoted rents will decrease by 2.5% in 2018 (5), and by 2020, UBS predicts a fall of more than 10%.<sup>8</sup> WP is more optimistic with its prognosis with a decrease of only 1% in 2018. The strongest declines are to be expected in the southern and northwestern part of Switzerland (-1.7% and -1.3%).<sup>9</sup>

### **Persistent imbalances in the office market**

The rents for office spaces are continuing to post heavy losses. Rents recorded in the finalized contracts are lower by more than 20 index points in comparison to the quoted rents. This is evidence of a significant detachment between quoted and actual rents in the office sector. There is a considerable rent decline observable across all regions. The fall is most pronounced in the South (-5.5% quarter on quarter) and the Lake Geneva region (-5.0% quarter on quarter and -20.4% year on year).<sup>7</sup> (34, 35, 36, 37)

First signs of a surplus of supply in the office market were already notable back in 2013. Long-term growing vacancies and declining rent revenues were the results.

---

## ***“Office market rents in the Lake Geneva region dropped by more than 20% compared to the previous year”***

---

Marketing conditions remain challenging and investors need to accept revenue losses on their office property as demonstrated by the renewed rent adjustments in 2017. Nevertheless, a slight recovery is predicted for the office property market. The hopes are primarily based on 2018's expected economic upturn in Switzerland which would lead to growth in employment and ultimately demand for space. But the supply is still expanding. The construction of office spaces continues due to the ongoing investment crisis and the cheap debt financing options. These new office spaces could aggravate the imbalances on the office market even further, considering the high availability (38) and the low demand.<sup>10</sup>

---

<sup>7</sup> FPRE, Marktmieten- und Baulandindizes von Renditeliegenschaften, Datenstand 31. Dezember 2017

<sup>8</sup> UBS, Real Estate Focus 2018, Mehrfamilienhäuser (Nicht mehr um jeden Preis), 11. Januar 2018

<sup>9</sup> WüestPartner, Immobilienmarkt Schweiz, 2017/4

<sup>10</sup> Credit Suisse, Büroflächenmarkt Schweiz 2018



## Slight recovery in the retail sector

After two challenging years, the retail sector managed to escape the downward trend and made a slight recovery at the end of 2017 with overall sales growth of 0.1% being achieved. Credited for this improvement were primarily Switzerland's overall economic situation, which continues to prosper, the depreciation of the Swiss franc and the recovery in consumer sentiment. The appreciation of the Euro further reduced potential shopping tourism. The food industry recorded a nominal revenue gain of 0.3% whereas the non-food segment's nominal revenues remained outside of the growth area with -0.1%.<sup>11</sup>

Even though the numbers have improved, the situation for retail space owners stays tense. There currently is an excess supply of retail areas in Switzerland. Moreover, the trend is moving towards smaller retail

areas. This causes further competition in the retail market, thereby enabling tenants, who have held the upper hand for years, to negotiate even more favorable conditions at the expense of the owners. In extreme cases deals are closed solely based on turnover rent. This again signifies higher risk for the property owner.<sup>12</sup>

Shopping centers close to the euro zone must break new ground as exhibited by "Stücki Shopping" in Basel. After eight demanding years, the office area is being reduced by 70% to 10,000 m<sup>2</sup>. The focus is shifting towards health and wellness accompanied by an expansion of gastronomical services. Inspired by the neighboring business park, four new office and laboratory buildings with a total of 1,700 new workplaces are being erected.<sup>13</sup> The "Stücki" can therefore be considered a forerunner which could serve as an example to other shopping centers.

---

***"The sound economic situation, the weaker Swiss franc and the consumers create a better mood"***

---

## Authors

**Kurt Ritz**  
+41 58 792 14 49  
kurt.ritz@ch.pwc.com

**Marie Seiler**  
+41 58 792 56 69  
marie.seiler@ch.pwc.com

**Samuel Berner**  
+41 58 792 17 39  
samuel.berner@ch.pwc.com

**Real Estate Advisory**  
PwC, Birchstrasse 160  
CH-8050 Zürich

<sup>11</sup> Credit Suisse, Retail Outlook 2018, Januar 2018

<sup>12</sup> Immobilien Business, Eigner müssen mehr ins Risiko, 11/2017

<sup>13</sup> NZZ, Das Stücki in Basel wird bald kein Shoppingcenter mehr sein, 15.11.2017