PwC-Immospektive

Interpretation of the FPRE real estate meta analysis Q3/19
References to FPRE graphics in our text are marked (1) etc.

Labour market buoyed by strong Q1/2019

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The Swiss economy posted another robust performance in Q1/19, and this momentum has trickled through into the labour market. Global uncertainties will start to have an adverse effect on the Swiss domestic economy, however. Its strong currency and expansive monetary policy are driving down government bonds well below 0 % and continue to favour real estate investments. There is therefore still plenty of upside price potential for residential properties, while rents are on the decline, especially in peripheral locations. Office rents have risen sharply on the back of the good employment figures, and low vacancy rates have made downtown areas a renters' market.

Uncertainties abroad will start to curb the strong economy in Switzerland

The Swiss economy posted an unexpectedly strong performance in the first quarter of 2019, up 0.6 % (Q4/2018: 0.3 %). This growth was primarily attributable to investment activity and above-average consumer spending.[1] Although this had the effect of normalising the slowdown in growth at the end of 2018, players are sticking to their low GDP forecast for 2019 of 1.4 % [8]. This still puts it below the long-term potential growth target of 1.6 %-1.8 % [9].

Global uncertainties will start to have an adverse effect on investment activity in Switzerland. Interest on the part of foreign investors in Swiss products is tending to decline due to the weak economy abroad.[2] This, combined with the appreciation in the Swiss franc, will hamper Swiss exports.[3,4] While experts assume that economic growth will pick up again in 2020, their outlook is slightly less optimistic than it was last quarter (1.8 % versus 1.9 %) [8].

Employment is currently riding the uptick from the first quarter, albeit at a slightly slower pace than the quarter before [10]. The expected unemployment rate remains low and is forecast at an average of 2.4 % for 2019 [8] (previously: 2.5 %). The global economic downturn will only be reflected in the key data subject to a delay.[2] While experts anticipate slightly higher unemployment in 2020, at 2.5 % [8], this forecast has been lowered versus the previous quarter (previously: 2.6 %).

Consumer sentiment will remain above the long-term average for the time being.[5,6] Domestic consumption is currently being stabilised by low interest rates and the healthy labour market, yet various indicators point towards a slowdown. According to experts, export output and investment activity will no longer be able to sustain the performance achieved in the first half of the year. In addition, immigration was down in the second quarter, sinking to its lowest half-year value in the last ten years at around 8,000 people [12,13], which will likewise dent consumer output.[1]

Government bond yields have recorded a further decline

Prices abroad tend to rise more sharply than in Switzerland. This leads on the one hand to an appreciation in the Swiss franc versus the euro, while on the other the increase in consumer goods prices triggers an upward correction in the

1 SECO, Konjunkturtendenzen, Sommer 2019
2 SECO Medienmitteilung vom 13. Juni 2019: Schwächere Weltkonjunktur bremst auch Schweizer Wirtschaft
3 SNB, Quartalsheft 2/2019 Juni
4 Swiss Life Asset Manager (SLAM), Perspektiven Konjunktur Juni 2019, Juli 2019
5 SECO Medienmitteilung vom 3. Mai 2019: Konsumentenstimmung leicht schlechter
6 Wüest Partner, Immobilienmarkt Schweiz 2019/2

inflation forecast.[3,7] The SNB has revised this significantly upwards for the current year to 0.6 % (0.3 % in the previous quarter) [11].[8] Inflation is expected to remain practically unchanged for 2020 (0.7 %); for 2021, an increase to 1.1 % is anticipated [11]. The situation on the forex markets coupled with economic developments are forcing the SNB to maintain its expansive monetary policy.[3]

Inflation forecasts are becoming more volatile

The SNB benchmark rate, which replaced the 3M Libor effective June this year, stands at -0.75 % (current 3M Libor: -0.8 %; previous quarter: -0.7 % [21]).[3] Capital market interest rates of 5-year and 10-year government bonds, by contrast, fell much more sharply. 10-year government bonds stood at -0.7 % in June (April: -0.3 %) [21], in line with developments in several large national economies [70]. This trend is not expected to reverse anytime soon given the global economic risks.[9] The forecast yield of 10-year bonds also decreased quarter-over-quarter, both for the current year (from -0.1 % to -0.3 %) as well as for 2020 (from 0.1 % to 0.1 %). The medium-term expectation for Libor performance also contracted from an average of -0.6 % to -0.7 % [20]. A short-term brake was placed on the negative trend for mortgage interest rates, however. The interest rates for variable and 5-year terms are at the prior-year level, whereas those for 3-year and 10-year terms are -0.1 % lower [23].

Building construction is on shaky ground and the outlook remains gloomy

The forecast for the construction sector is positive overall, yet building construction is losing momentum. Although the Credit Suisse construction index gained again in the second quarter (+4 % quarter-over-quarter [17]), the positive earnings expectations are primarily attributable to civil engineering, with declining revenue expected in building construction (-2 % versus the previous quarter [17]).

Residential construction is marring the outlook for building construction

Residential construction is the culprit for the downtrend in building construction. 12 % fewer housing building permits were issued last year than the year before. Since the backlog of orders is still high, however, this decline will not have an immediate impact on revenue in residential construction. Nevertheless, earnings expectations are down 4 % year-over-year [17]. Earnings expectations for new office builds (commercial construction), by contrast, are seeing a continual rise, although again only minimal growth potential is forecast in this sector over the long term. The main opportunities in building construction are currently in the area of renovating, expanding or redeveloping existing buildings. Accounting for almost one-third of all building permits issued in building construction, the share of these kinds of projects is the highest it has been in the past 25 years.[10,11]

The owner occupation market is slipping out of equilibrium into a shortage

Demand for owner-occupied properties continues to be fuelled by market performance, while supply remains scarce. The most recent reduction in mortgage interest rates and the strong economic growth in 2018 further propped up demand. By contrast, building permits for single-occupancy houses contracted by 14 % last year, and those for owner-occupied apartments by 13 %.[11] This imbalance is expected to continue to drive up the price of owner-occupied properties in 2019.9 Although prices for single-occupancy houses advanced only slightly in the second quarter, up just 0.3 % after an increase of 1.9 % in Q1, the forecast for the year as a whole is solid. Prices are currently 7.2 % above the prior-year level (+4.6 % in the mid-range price segment [47, 48]). Prices of owner-occupied apartments rose to a similar extent, climbing 7.7 % year-over-year (+3.2 % in the mid-range price segment [53, 54]).

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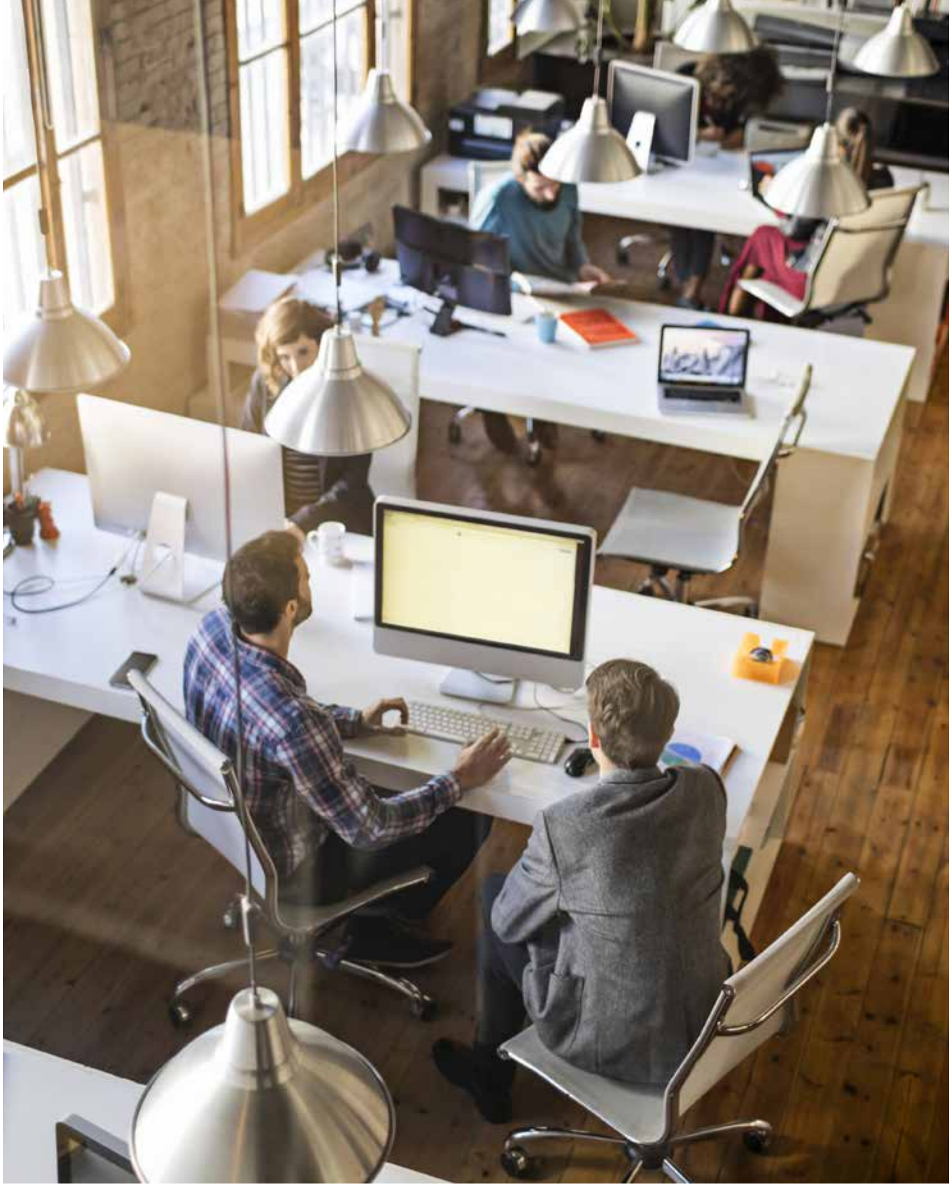
[7] Credit Suisse, Monitor Schweiz Juni 2019
[8] Fahrländer Partner Raumentwicklung (FPRE), Metaanalyse Immobilien Schweiz 2Q/2019, 1Q/2019
[9] Zürcher Kantonalbank (ZKB), Immobilienbarometer 2. Quartal 2019
[10] Credit Suisse, Bauindex Schweiz, 2. Quartal 2019
[11] Credit Suisse, Immobilienmonitor Schweiz Juni 2019



Prices of multiple-family units continue to rise

Investments in multiple-family units remain popular in the current market environment, and the pressure on yields continues unabated. In the second quarter of 2019, the average real discount rate for a new, smaller-sized residential property in a prime location in Zurich was 2.09 % [34]. In peripheral locations, investors have to accept an increased risk of vacancies in exchange for more attractive returns. Longer listing times and falling rents are evident here, accordingly.[9]

Rents for new properties have seen a significant rise since the start of the year

Market rents (transaction rents) of investment properties remained stable throughout Switzerland in the second quarter (+0.2 % versus the previous quarter).[12] Year-over-year, however, rents are down 1 % [25]. This trend is also evident at regional level, with rents declining compared with the previous year in all regions except for Geneva, where they were up +0.4 % on the prior-year value. Rents for new apartment builds proved to be more volatile than those for old apartment complexes. While new builds were down 1.5 % versus the same quarter last year (old apartments: -0.5 %), in the first half of the year they recovered by 0.6 % each quarter. [26] From the point of view of market participants, the general trend of falling residential rents looks set to continue; this conviction is significantly stronger than it was in the last survey six months ago [30]. Conversely, the upside potential of prices for multi-family properties is still considered to be strong due to the limited number of alternative investment options [31].[9]

In city centres, the office market has become a renters' market

Market rents (transaction rents) for office spaces again trended upwards (+2.2 % in Q2/19) and in June 2019 were 12.9 % higher than in June the previous year [35, 36, 37].[12] This upward trend in rental prices can be observed in all regions throughout Switzerland, but especially in urban cantons. Accordingly, office rents in the cantons of Berne, Basel-Stadt, Lucerne and Zurich increased by over 15 % within the space of a year, while in Schaffhausen, Ticino and Schwyz the rise was less pronounced, at 7 %.[12]

After an extended period since 2013 where market players expected office rents to go in only one direction – down, they have now been influenced by the trend of rising margins that has taken hold since 2018 and a small number of market players (about 10 %) said in early summer 2019 that they expect rents to begin rising again for the first time [41].

Market rents for office space up almost 13 % on prior-year level

Although the forecasts for office construction are positive, the actual number of office spaces for which a building permit has been received is down. Current office construction activity is predominantly focused on the agglomerations, with demand for office space in major centres especially high. The supply ratio in large cities will trend downwards as a result, improving the situation for renters [39].[7,13] The declining availability of office space in major centres will persist for the time being. A structural change is also under way in terms of the supply of offices, with large advertised properties becoming rarer and smaller properties becoming available for rent more often. The volatile market environment is putting pressure on small companies, and the share of smaller companies that are renting flexible rather than permanent office spaces is increasing. This is leading to shorter contract periods and more frequent changes in tenants.[13]

On the office investment market, the appeal of investments in office properties has increased due to the overall positive performance and the low interest rate environment. While the returns for A-class investments still stood at around 2.5 % at the end of 2018 [40], recently we have observed a further squeeze on returns on the office space market in major centres towards 2.0 %. Economists expect the price trend to remain stable for 2019 overall before the currently high price level could start to tumble in 2020 [6].

[12] FPRE, Transaktionspreis- und Baulandindizes von Renditeliegenschaften, Datenstand 30. Juni 2019

[13] CBRE, Büromarkttrends Schweiz 2019, 4. Juli 2019

Retail spaces are coming under even greater pressure

Rents for retail spaces continue to contract on the back of declining revenues and pressure from online retailers and shopping tourism. The situation is compounded by the forecast downtrend in economic growth in the quarters ahead, which will likewise have an adverse effect on revenue.[11] In spite of the declining demand for retail space, shopping centres are currently being constructed in several areas, including the region around Lake Geneva and near Zurich Airport.[14] Due to changing shopping patterns and contracting revenues coupled with the current overhang of supply, vacancies are rising and rents are falling in the retail space market.

The revenue generated by train station shopping centres has strengthened in recent years

Operators of retail spaces are defending themselves against current market pressures using various methods, for example by realigning their business strategies or reorganising their retail spaces. In shopping centres, for example, an increased emphasis is being placed on entertainment, wellness or beauty offerings, and the food and beverage offering is being enhanced. Some Swiss shopping centres are now also offering customers the option of ordering clothes online for delivery to the store so they can try them on. It is hoped this will boost visitor numbers. Others, meanwhile, are placing their bets on pop-up stores of unique brands that cannot be found anywhere else. The option that is best suited to increasing sales density depends in particular on a retailer's location, the goods sold and the target audience.[14] For example, during the same period that has seen sales density in shopping centres fall by 10 % (since 2010), in train station shopping centres it has risen by 10 %.[15]

Authors

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

Nicole Strässle
+41 58 792 43 20
nicole.straessle@ch.pwc.com

Rubina Insam
+41 58 792 93 39
rubina.insam@ch.pwc.com

Real Estate Advisory

PwC, Birchstrasse 160
CH-8050 Zurich

PwC, Avenue Giuseppe Motta 50
CH-1202 Geneva

[14] NZZ, Medienmitteilung vom 11. Juni 2019: Trotz Krise entstehen neue Shoppingcenter in der Schweiz
[15] Handelszeitung, Medienmitteilung vom 16. Juli 2019: Verkaufsflächen in der Schweiz stehen weiterhin unter Druck