PwC-Immospektive

Interpretation of the FPRE real estate meta-analysis for February 2021
References to FPRE graphics in our text are marked with “[1]” etc.

BIP forecast is 3.2% for 2021 and the estimate of catch-up effects is rather sober again

19 February 2021

At the start of the year, the mood in the Swiss economy deteriorated further, but the outlook for 2021 remains mostly positive. Real estate as an asset class is still attractive in the low interest rate environment and yield requirements have fallen again in many sub-markets. After a year of weak sales in 2020, the construction sector is expecting further declines and for this reason is slowing down the increase in the supply of space. Residential rents and prices for residential investment properties are trending upwards. However, office rents are down on the previous year, with central locations likely to become even more attractive compared with peripheral locations as a result of the pandemic. There is still considerable demand in 2021 for logistics properties and owner-occupied homes.

Anticipated return to pre-crisis level by spring 2023

The KOF Economic Barometer fell to 96.5 points at the start of the year due to recent developments and is at its lowest since June 2020.[1] As supply chains have remained intact compared with spring, the economy is expected to be impacted to a lesser extent this time round by the renewed lockdown measures.[2,3] Although considerably higher than the long-term potential growth of 1.6% to 1.8% [9], the consensus for the 2021 GDP forecast with 3.2% growth is rather sober and catch-up effects are not expected to be as pronounced as in the previous quarters (autumn: 3.9%, summer: 4.5%) [8]. Depending on the success of the vaccine roll-out and the length of time the lockdown measures remain in place, GDP should return to pre-crisis levels between the start of 2022 and the start of 2023.[4] That said, forecasts are still subject to great uncertainty.[3] Swiss economic experts are currently forecasting stable GDP growth of 3.3% for 2022 [8].

It is no surprise that both the employment indicator and consumer sentiment regressed at the start of the year.[5,6] For this reason, job losses and numerous company bankruptcies are expected in the coming weeks.[2] As the vaccination roll-out progresses and the weather gets warmer, there are increased hopes that the situation will stabilise. This should motivate companies in the spring to boost business activity again and catch up on delayed investments.[7] The export goods industry should continue to recover thanks to well-functioning supply chains.[1,7] As a result, experts anticipate unemployment will rise further at the start of the year, but are more optimistic about the unemployment rate in 2021 (3.6%) compared with November (4.2%) [8]. The pace of consumption remains positive, although it is subdued for now due to continuing uncertainty. The low growth in wages and a slight decline in immigration [12,13,14] are having a dampening effect on consumer sentiment.[8]

1 Konjunkturforschungsstelle (KOF), Medienmitteilung vom 29. Januar 2021: KOF Konjunkturbarometer
2 Swiss Life Asset Managers, Perspektiven Konjunktur / Februar 2021
3 Schweizerische Nationalbank (SNB), Quartalsheft 4 / 2020 Dezember
4 KOF, Konjunkturanalyse: Prognose 2021/2022. Zweite Welle lastet auf dem Arbeitsmarkt
5 KOF, Medienmitteilung vom 1. Februar 2021: KOF Beschäftigungsindikator
6 Staatssekretariat für Wirtschaft (SECO), Medienmitteilung vom 4. Februar 2021: Konsumentenstimmung verschlechtert sich leicht
7 SECO, Konjunkturprognose / Winter 2020
8 Credit Suisse, Retails Outlook / Januar 2021

Unchanged low interest rate environment

Because consumption and the employment market have weakened, fiscal and monetary policy measures are still important. The SNB is still pursuing an expansive monetary policy and the base rate remains unchanged at –0.75%. Against the background of the weakened economic situation, the SNB has lowered its inflation forecast for 2021 to 0.0%.[3] However, the consensus is for an anticipated recovery in 2021 and the inflation forecast for the year has been raised from 0.1% to 0.3% [8]. In 2022, inflation is expected to remain stable and low (0.4%).

Yields on government bonds fell again, but expectations are slightly higher for 2021

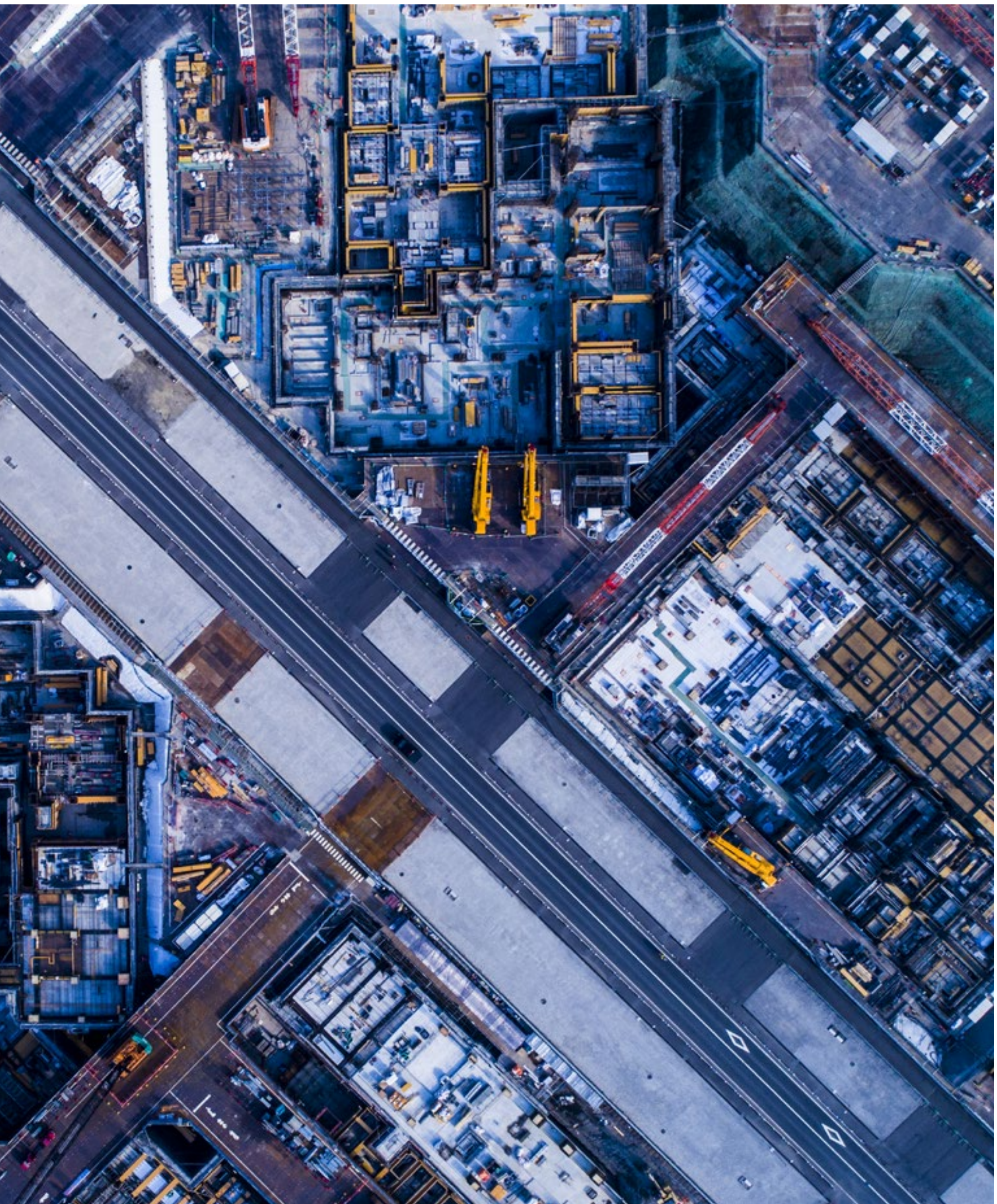
Low inflation, an expansive monetary policy and subdued economic momentum are drivers for persistently low interest rates and yields.[9] The yields on 1, 5, and 10-year German government bonds fell once more between October and the end of the year (–0.8%, –0.76%, and –0.55%). Expectations were slightly higher for the new year but have since also fallen overall to between –0.5% and –0.3% for 10-year government bonds (November: –0.5% to 0.0%) [20,22]. Mortgage interest rates initially remained stable in the fourth quarter. The yield on a 10-year fixed-rate mortgage was 1.25% in December (1.23% in September), while that of a 3-year mortgage was 1.03% (September: 1.04%) [23].

Year-end positive momentum in the construction sector due to catch-up effects

After a very poor 2020, the construction sector felt the momentum of a revitalised economy in the last quarter, and performance was positive on a quarterly comparison. The construction index rose by 2.6% in the fourth quarter, with commercial construction even reporting a 7.1% rise [17]. The latter also recorded a 20.5% increase in building permits compared with the previous period. This is due primarily to catch-up effects, but continued moderate order books are expected.[10]

With a 7% decline in sales, 2020 was the weakest construction year since 2015

The pandemic and the resulting uncertainty among investors have caused a noticeable slowdown in the construction industry overall. With a 7% decline in sales over the year, 2020 was the weakest construction year since 2015. The decline is due in particular to structural engineering, where sales expectations were 10% down on the same quarter in the previous year, with residential construction lower by 11.3%. Although civil engineering remains fairly resilient with an index rise of 3.3% in the fourth quarter and a fall of 3.9% compared with the same quarter in the previous year, the pandemic is having a growing impact on the already saturated residential construction sector.[10] A rebound in sales is not expected here initially, although investments in residential development projects nevertheless remain attractive considering the lack of alternatives for investors, which is underpinning the construction sector.[9]



Owner-occupied homes enjoy further growth

Prices of owner-occupied homes continued to rise across the board during the last quarter of the year, with a plus of 2% for single-family homes [4,57,58] and 1.7% for owner-occupied apartments [3,63,64]. As a result, transaction prices were 7.1% (single-family homes) and 2.6% (owner-occupied apartments) above the previous year's levels. By way of annual comparison, prices for single-family homes rallied, especially in the Zurich region (+9.2%) and Central Switzerland (+8.6%), as did properties for owner-occupied apartments in Eastern Switzerland (+3.8%) and Basel (+3.5%). The weakest growth in the prices of single-family homes compared with the previous year was in the Alpine region (+3.2%) and Southern Switzerland (+2.2%). Comparing segments, it can be observed that – conversely to the previous quarter – the prices of properties in the high-end segment rose by 3.5% (single-family homes) and 1.9% (owner-occupied apartments), which was higher than properties in the low- (single-family homes +0.5%, owner-occupied apartments +1.8%) and medium-price segment (single-family homes +0.8%, owner-occupied apartments +1.4%).[11]

[9] Zürcher Kantonalbank, Immobilien aktuell / Dezember 2020
[10] Credit Suisse, Bauindex Schweiz / 4. Quartal 2020
[11] FPRE, Transaktionspreis- und Baulandindizes für Wohneigentum, Datenstand 31. Dezember 2020

Owner-occupied home market is now a seller's market, pushing up prices in turn

The owner-occupied home market thus continues to benefit from the impact of the pandemic, with people spending more of their cash on their own four walls rather than outside the home.[9] With demand rising, the owner-occupied home market is becoming more and more of a seller's market, which is also pushing up prices.[12]

Slight slowdown in the expanding supply of rental apartments

Both immigration and emigration fell during the pandemic, such that net immigration remained stable, despite the crisis, and is still the main driver of demand for rental apartments. [12,13,14] At the same time, supply has further expanded over the last year despite vacancy problems, as investors are finding comparably attractive yields in the rental housing market.[13] The expansion over the last year was more moderate than in previous years, however, as investments are increasingly being made in replacement buildings or refurbishments rather than in new builds.[14] Money is therefore once again being increasingly invested in central locations rather than just in more remote ones, which is creating a balance between the outsized demand in the cities and the oversupply in peripheral areas.[9]

Residential rents stable in fourth-quarter 2020, with discount rates lower again than in autumn

After residential rents (transaction rents) declined across the whole of Switzerland in the third quarter, they remained more or less unchanged in the last quarter (+0.2% compared with Q3/20) [25,26]. The stabilisation is mainly due to recently built flats, however, which rose by 0.9%, while rents for older flats continued to decline, falling by 0.7% in the fourth quarter. In the annual comparison, both recently built and older flats were 1.2% up on the same quarter in the previous year. The Zurich region recorded the biggest growth, with rents rising by 2.2%, while the only regions with declines were Basel (–0.3%) and Southern Switzerland (–0.6%).[15] Despite stagnating rents, the preference for residential investment properties remains high among investors, and yield requirements continued to decline. At the same time, forecasts of rent increases in the next 12 months for multiple-occupancy homes have become more frequent [31]. The minimum real discount rate on a new, mid-sized residential investment property at a good micro location in Zurich fell to 1.89 % in mid-January (October: 1.93%) [34,35].

Rental price gap between office space in urban centres and peripheral areas is set to widen further

Working from home rather than in the office is still the preferred option during the pandemic. It is difficult to assess today the extent to which this will continue in the world after Covid-19. Companies are monitoring the situation and are initially holding off on expanding their floor space. From today's perspective, Credit Suisse predicts that demand for office space will decline until at least the end of 2021, but solid growth in demand is expected in the medium term due to economic growth and tertiarisation.[16] Despite the rental savings potential and efficiency gains associated with home working, the lack of contact between employees and the sense of belonging to a company are factors favouring a return to office-based working in the long term.[17] This means that the quality of the environment will play an important role in encouraging employees back into the office. As a result, central locations where companies, service providers, restaurants and sports facilities can benefit from each other will become more attractive than the less well-established peripheral areas. This development will further open the rental price gap between central and peripheral locations.[16]

Trend towards declining office rents temporarily halted

In fourth-quarter 2020, office rents (transaction rents) gained momentum and rose by 3.6%. However, on an annual basis the trend in the office segment remained negative. Due to a widespread decline in rental prices in the two previous quarters, by the end of the year rents were 5.1% down on the previous year's levels [2,35]. Exceptions here were rents in the cantons of Zug and Ticino, which reported significant rental price increases of 16.2% and 11.3% respectively compared

[12] Zürcher Kantonalbank, Immobilienbarometer / 4. Quartal 2020
[13] Wüest Partner, Immobilienmarkt Schweiz / 2020/4
[14] CSL, Immobilienmarktbericht 2021
[15] FPRE, Transaktionspreis- und Baulandindizes für Renditeliegenschaften, Datenstand 31. Dezember 2020
[16] Credit Suisse, Büroflächenmarkt Schweiz 2021 / Dezember 2020
[17] JLL, Büromarkt Schweiz 2021

with the same quarter of the previous year. In fourth-quarter 2020, the largest rises for rents were recorded in the same two cantons (ZG: 4.9%, TI: 3.4%), while the worst performance was reported in the cantons of Aargau (–1.8%) and Geneva (–1.6 %) [37]. Considerable price pressure is being observed particularly in the Lake Geneva region. Office rents were down –10.4% in the canton of Geneva and –6.1% in the canton of Vaud compared with the previous year's levels.[15] Considering the transaction prices of office properties, the low transaction volume in 2020 led to declining yields on properties at top locations. These were 2.35% on average for A-class properties, according to a CSL survey in 2020 and are expected to remain stable in 2021.[14] Market participants are still sceptical about the price trends of office rents and office properties in 2021, but the outlook has brightened slightly since the end of 2019 [48,49]. With online shopping dominating the year, logistics properties became more attractive and therefore recently recorded a sharp decline in yields.[14]

To bridge the gap, retail must turn to alternative sales channels

Nationwide, retail sales were less buoyant than in the third quarter of 2020, but the fears that the retail trade would not post positive annual results due to renewed lockdown measures have not materialised. Seasonally adjusted, real sales (excluding petrol stations) at the end of December were 4.7% above the previous year. Stationary retail spaces have hardly benefited from this, however. While a catch-up in consumption played some role in this, the main driver for sales came from the mail order and internet retail trade category (+18.5% compared with the previous year) and the IT and communication technology category (+29% compared with the previous year), with sales of the latter rising by 13.5% in the fourth quarter alone.[18] For the time being, companies are holding back on targeted store closures and floor space reductions in stationary retail. Nevertheless, tenants' solvency has been stagnating for years. Owners are accordingly reducing rents to avoid vacancies. Despite efforts by providers of floor space to adapt, uncertainty regarding the future of stationary retail, falling rental income and rent defaults caused by the pandemic all led to a decline in prices for retail property in the portfolios in 2020. In Switzerland, PwC observed average negative revaluation effects of around –5% for retail businesses.

Desire to survive leading to structural changes among retailers

For retail properties, the location and associated frequency of passers-by are – under normal circumstances – the be all and end all, but with people working from home, the flow of passers-by has moved from central locations to residential areas. In extreme cases, this has led to a doubling of sales for smaller businesses in otherwise second-class locations, while most retail spaces have had to book losses.[9] Widespread store closures (as ordered by the government again in January 2021) make store location irrelevant, however, and alternative sales channels and creativity are becoming more important. Numerous companies said in 2020 that they had stepped up their focus on marketing and communication measures and setting up online shops. More attention is being directed towards the service being offered and less towards the sale. The recipe for surviving is being able to react quickly to the changing market environment. Many new concepts and measures have emerged in the meantime, such as click & collect, home delivery services and contactless payments, driving forward structural changes in the sector.[8]

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[18] Bundesamt für Statistik (BFS), Detailhandelsumsatzstatistik – vierteljährliche Zeitreihen: Datenstand 31.12.2020