

Real Estate House View

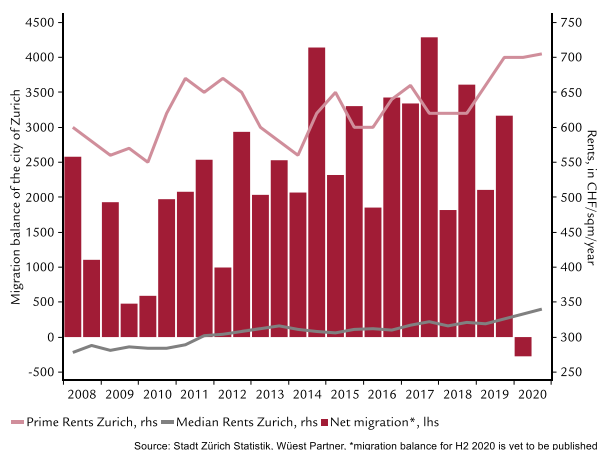
Switzerland

First half of 2021

Key takeaways

- **Cautious long-term outlook for real estate investors:** in the short term, the environment remains unchanged. However, difficulties and challenges stemming from changes in human behaviour (such as new ways of working and shopping) are ahead of us that are not influenceable by the industry.
- **Residential sector potentially under pressure:** multi-family residential assets still provide benefits to investors. In the medium term, vacancy rates are therefore expected to increase further, which will lead to decreasing rental income.
- **Changes in office space:** we expect companies to review their office costs and implement new ways of working. Owing to increasing difficulties letting space and tenant requirements concerning space conversion, rents will also have to respond.
- **Retailers forced to reinvent:** the polarisation between locations increased further in 2020. Retailers are having to adapt even more to consumer trends such as online shopping.

Chart in focus



The current resilience of the Swiss real estate market largely stems from its focus on the residential sector. As rents are not directly impacted by the lockdown measures, investors are therefore focusing on this “safe haven”. Tenant demand is determined by economic growth and largely by immigration, both of which suffered in 2020, particularly the latter. As can be seen from the chart on the left, net migration in Zurich was negative in H1 2020 – for the first time since 2004 (not shown). However, it also appears that rents in Zurich have not responded accordingly. Nevertheless, a more volatile reaction still remains possible in the future and needs to be factored in by investors.

Newly available high frequency data suggest that Swiss GDP stagnated in Q4 2020 despite renewed restrictions for the service industries at home and abroad. Activity in manufacturing was strong, supported by intact global supply chains and steady demand from abroad. Small and medium-sized companies have so far been more affected by the second pandemic wave compared with large export-oriented corporations and Switzerland's large financial sector. As vaccination programmes have started, Switzerland is on track to see its GDP returning to pre-crisis levels in the second half of 2021. Nevertheless, lagged effects of last year's recession have yet to materialise. As a record number of people are actively seeking work, we expect the unemployment rate to rise from 3.4% at present to around 4.0% by Q2 2021.

2021: more of the same

The pandemic has shaped the low interest rate environment for an indefinite period. The environment for investors therefore remains more or less unchanged, although uncertainty about future income has increased and needs to be taken into account when analysing potential transactions. We accordingly expect investors' behaviour in 2021 to be comparable to the preceding years. In the long term, further difficulties and challenges stemming from changes in human behaviour (e.g. new ways of working and shopping) lie ahead that are not influenceable by investors. A strong business case spanning up to 20 years is therefore more important than ever – especially also in view of the costs of readapting assets for future use.

All for residential

The multi-family residential sector is still top of the list for Swiss investors. Residential assets are perceived as good quality investments, not least because they are not immediately affected by the measures taken to combat the pandemic. This has led to a further fall in net initial yields to 1.4%. Although the demand side in central locations is supporting this development, we expect tenant demand to be negatively impacted in the medium term by lower population growth, economic uncertainties and an increase in unemployment. Consequently, the already increased vacancy rate is expected to rise further in the coming years, thereby pushing down average rents across the country.

Needs of employees and employers

The pandemic will have a lasting impact on the office market. However, the effects of working from home only form part of this. We also expect companies to review the costs of space again and wherever possible to reduce space. The other side of the coin is the long-term effect of economic developments: we expect unemployment and bankruptcies to increase with a time lag across many businesses that occupy space. Moreover, developments already visible prior to the pandemic, such as the gradual reduction of bank staff, are set to continue. However, all these developments will take time as contracts are still running and will not all expire at the same time. It will also take some time before the developments are reflected in market rents. A lot of incentives have recently been needed to keep headline rents at their current level. In view of increasing difficulties letting space and more discerning tenants in terms of space conversion, rents will also have to respond at some point, particularly in the secondary markets. We expect tenant demand to focus on prime locations offering employees an attractive office environment, as we see the future role of the office as a place to meet, socialise and innovate.

Never ending retail

Although the retail sector has partially recovered from the first lockdown, it is not set to see an end to its struggle any time soon. Online shopping will undoubtedly remain elevated and concerns (such as trust in the payment system) have receded markedly. This also holds true for supermarkets, which are currently considered winners within the losers. Even Coop only reported a stable turnover for 2020, with an increase of about one third in online shopping, which is of no benefit to retail space. Also, for the first time, the local high street location has not proven advantageous as these locations usually also benefit from their proximity to business districts and workers going shopping on their way home. The polarisation between locations has increased further, with retailers being forced to adapt to consumer trends. According to Wüest Partner, rents will decrease by 3.1% in the current year – a trend expected to continue beyond 2021.

Chart 1: Vacancy rates across sectors in Switzerland

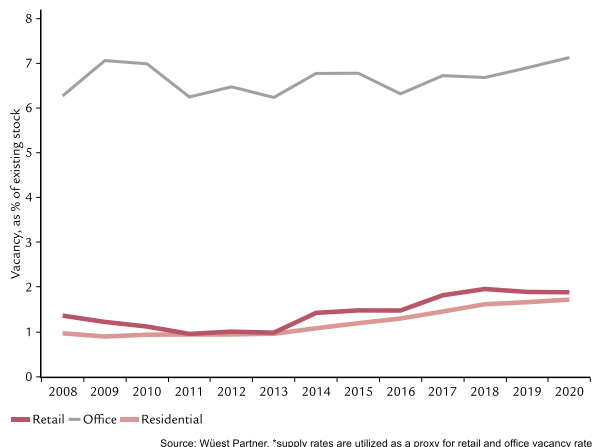
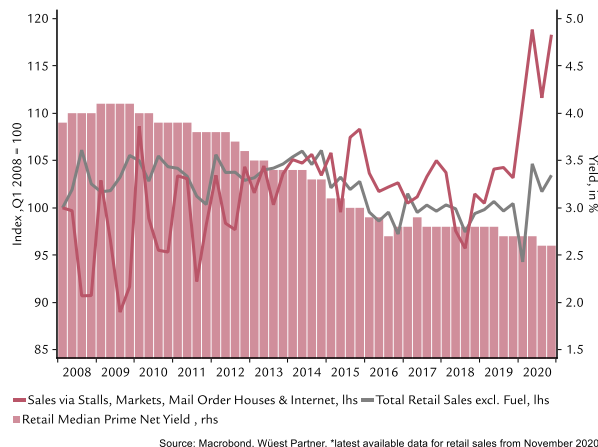


Chart 2: Falling prime net yields in retail as a result of expanding online retail trade?



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