

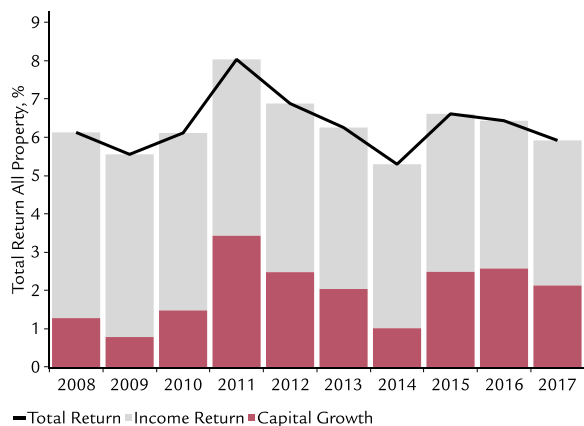
Real Estate House View Switzerland

Second half-year 2018

Key takeaways

- The Swiss real estate market benefits from the economic upswing. This is strengthening demand on the letting markets and supporting the absorption of the current high construction activity which was stimulated by the high pressure to invest capital.
- Swiss real estate investments are still attractive in relative terms for domestic investors, given the low interest rate environment. We expect capital flows into the market to continue.
- In the residential sector, the high level of construction activity is expected to lead to a continuing oversupply of apartments throughout the country, particularly in peripheral areas. Demand for apartments in major cities and their agglomerations remains strong.
- The positive economic outlook will strengthen the office markets in Switzerland but letting activities remain challenging due to the relatively high availability of space. In addition, the market is undergoing structural change, above all the desire for more flexible space requirements, which is reflected in the rapid expansion of co-working facilities.
- The retail sector continues to face structural changes, which is demonstrated by increased vacancy rates combined with lower and/or changing demand for space.
- Investors, owners and tenants will have to remain flexible to adapt to the changing environment.

Chart in focus



Source: MSCI

Total returns have decreased two years in a row, and were 5.9% in 2017. This is slightly lower than expected and lies below the 10-year average of 6.4%. As pricing is expected to soften and rents are trending downwards, total returns are forecast to be slightly lower again in 2018.

With the Swiss franc's external value having fallen by 6% in 2017, a growing number of employers are ready to invest and hire at home rather than outsource production. The unemployment rate fell from 3.3% in March 2017 to 2.6% in May 2018. Retail sales have recovered since mid-2017 due to the improving labour market and lesser incentive to shop abroad given the strengthening of the euro. Due to the weaker Swiss franc, inflation will rise to 1.1% in 2018, a rate not seen since 2010. As global growth is gradually slowing, Switzerland's business cycle has reached its peak. Annual real GDP growth is set to slow from 2.1% this year to 1.2% in 2019. With the relatively large export exposure to China, an intensifying global trade dispute presents a notable risk with regard to the outlook for corporate activity in Switzerland.

Supportive economy

The economic upswing is very well timed for the Swiss real estate market. The ongoing expansion of supply, the resultant increase in vacancy rates and squeeze on rents have created a challenging environment, but there is hope that an improved economy will ease some of this tension by stimulating demand for labour. Investor appetite is still significant, which is reflected in the high sales prices achieved. With interest rates remaining low, the attractiveness of real estate should not change anytime soon, thus maintaining pressure in the investment market.

Construction ongoing

The low interest rate environment continues to drive construction activity in the residential sector. So far there has been no slowdown in response to the increased vacancy rate. We expect vacancy rates to increase further over the second half of 2018 as the economic stimulus will remain weak in the short term and lower immigration keeps demand subdued. It is important to note that vacancy is highest in peripheral areas, whereas in city centres vacancy rates are still very low. In regions such as Solothurn, construction activity is high despite a growing vacancy rate. Generally, apartments that are large in relation to their number of rooms are in rather low demand. Since tenants have a greater choice of apartments, rents are expected to decrease by about -1%. Given the high vacancy rates, this decrease in rents is moderate. Owners are reluctant

to reduce rents and are stimulating demand through other incentives such as rent-free periods. An increasing vacancy rate means the importance of clearly defining a target group is key. In particular, understanding the location is crucial. Our analysis of more than 3000 contracts in 2017 found that 59% of people remain within 3km of their previous apartment. This confirms what previous studies have concluded – namely, that it is important to analyse the demographics of the micro-location when defining target groups.

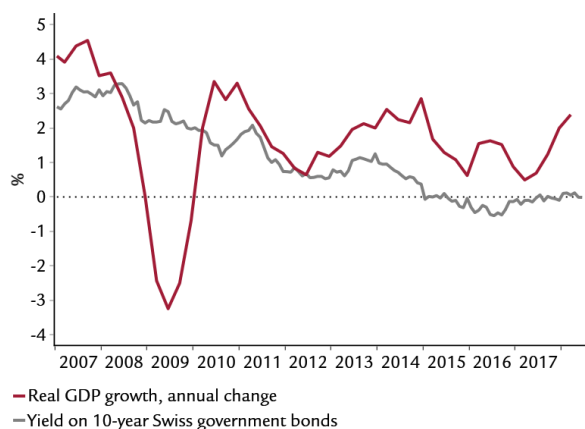
Accessibility is key

The sound economic outlook will support office markets, but the occupational market remains challenging and letting space has become more difficult. In addition, the office market is undergoing structural change, driven by increased automation and the rapid expansion of co-working facilities. For instance, IWG, the company which operates Regus and Spaces (among others), wants to expand from 28 to 40 locations by 2018 and to 100 over the next four years. This shows that operators believe in the sustainability of the trend. At the same time, there is a risk that vacancies in the buildings run by these operators will be hidden. Overall, we expect the challenges to persist and rents to be roughly stable in 2018. In this environment, public transport access is key. Office space that is not within walking distance of a well-frequented public transport station incurs much higher marketing costs. In locations with poor public transport access we expect to see more conversions from office to other commercial uses such as sports facilities or day-care centres, as these depend more on accessibility by car than public transport.

Retail sales up

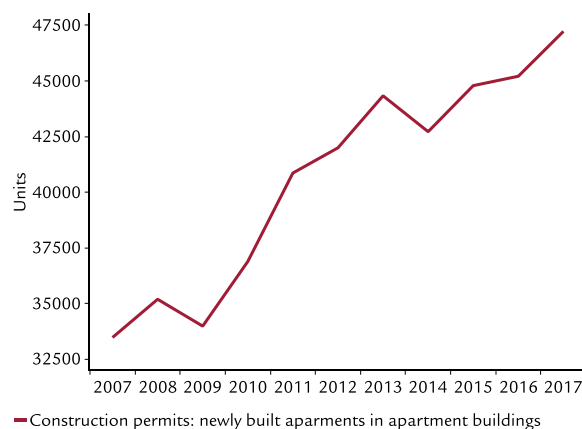
Structural changes in the retail market are ongoing. Yet in 2017 retail sales were stronger than expected due to the good economic environment, weakening of the Swiss franc and positive consumer sentiment. Online sales also increased further. We still expect high streets to do reasonably well, but current rental levels may not be sustainable. Lower demand due to uncertainty and the increased availability will probably bring down rents in the medium term.

Chart 1: Favourable macroeconomic environment



Source: Macrobond

Chart 2: Construction of residential apartments on-going



Source: Wüest Partner AG

Authors

Swiss Life Asset Managers

Francesca Boucard

Economist Real Estate

francesca.boucard@swisslife.ch

Marc Brüttsch

Chief Economist

marc.bruetsch@swisslife.ch

Livit AG

Martin Warland

Project Manager Data & Research

martin.warland@livit.ch

Do you have any questions or would you like to subscribe to this publication?

Please send an email to: info@swisslife-am.com.

For more information visit our website at: www.swisslife-am.com/research



Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich

Swiss Life Asset Managers may have acted upon or used research recommendations before they were published. The contents of this document are based upon sources of information believed to be reliable but no guarantee is given as to their accuracy or completeness. This document includes forward-looking statements, which are based on our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements.

France: This publication is distributed in France by Swiss Life Asset Management (France), 7 rue Belgrand, F-92682 Levallois-Perret cedex and Swiss Life Real Estate Management, 153 rue Saint Honoré, F-75001 Paris to its clients and prospects. **Germany:** This publication is distributed in Germany by Corpus Sireo Real Estate GmbH, Aachenerstrasse 186, D-50931 Köln and Swiss Life Invest GmbH, Zeppelinstrasse 1, D-85748 Garching b. München. **UK:** This publication is distributed by Mayfair Capital Investment Management Ltd., 2 Cavendish Square, London W1G 0PU. **Switzerland:** This publication is distributed by Swiss Life Asset Management Ltd., General Guisan Quai 40, CH-8022 Zurich.