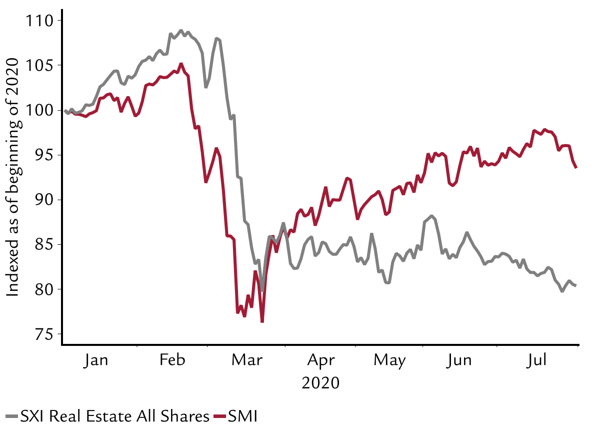
Real Estate House View
Switzerland

Second half-year 2020

Key takeaways

- **Resistant residential property market:** residential market with stable first half-year 2020 performance - investor uncertainty and lower population growth on the demand-side leading to lower rental levels in peripheral regions - tight market conditions within dense metropolitan city centres
- **Acceleration of structural change in retail industry:** shift towards e-commerce at the expense of stationary trade - additional stress for retail locations with lower levels of footfall
- **Office market remains solid but faces several challenges:** sector impacted by a reduction of investor and construction activity – working from home effects and a challenging economic situation expected to result in higher vacancy rates
- **Hospitality under pressure:** COVID-19 causes significant decline in overnight stays
- **Investor uncertainty recognizable in the performance of property shares:** property shares performed significantly worse than the overall market.

Chart in focus



Source: SIX

The SXI Real Estate All Shares Index includes all real estate stocks primarily listed on SIX Swiss Exchange. The SMI tracks the 20 largest listed stocks. The graph illustrates the development of the two indices over the calendar year (indexed as of beginning of 2020). Compared to the SMI, the SXI Real Estate Index showed a delayed reaction in the beginning of the crisis, but consequently underwent a similar price correction at a comparable pace to the SMI. While the SMI appears to be recovering quickly to pre-crisis levels, the recovery of real estate stocks is still sluggish. Investors assume that listed property shares will generate lower cash flows in the future due to the implications of COVID-19.

March to May 2020 reflects Switzerland's worst recession in decades, but domestic activity started to recover by mid-May with the gradual re-opening of the economy. Domestic demand in stationary retail was back to almost normal levels in June, according to unconventional high frequency data. The immediate fiscal policy response with a short-term working scheme and COVID-19 liquidity credit lines provided a safety net for the labour market aiming to limit the risk of a demand shock following the supply shock. Medium-term, the large fiscal room to manoeuvre and a favourable sector composition means that Switzerland is one of Europe's fastest recovering economics from the crisis. Nevertheless, unemployment rates and corporate bankruptcies usually tend to rise over a period of two to three years following a cyclical through. This crisis forms no exception.

Safe haven residential

The multifamily sector remains fairly immune to the effects of COVID-19. However, the challenging economic situation is likely to amplify the residential market imbalance between supply and demand. On the supply side, planning activity was already declining before the crisis and this development was accelerated by investment uncertainty. On the demand side, low population growth is expected, as migration declines due to travel restrictions and an expected reduction of the workforce. The market imbalance in the residential market is therefore likely to continue and weigh on the outlook for rental growth in the coming quarters as it has done so recently. These effects are projected to remain limited within dense metropolitan city centres, as market conditions remain very tight.

Trend accelerator COVID-19 in retail

The COVID-19 shock has led to an acceleration of structural changes in the retail industry, already in place before the outbreak of the pandemic. During the past few years, the prime yield for retail properties has fluctuated at a low level between 2.7 and 2.9 percent. This seems remarkable since the rental level fell during this period and the vacancy rate has remained constant since 2010. The first indicators of a COVID-19 effect can be seen in the rising vacancy rate, the falling rent level and the decreased number of building applications in the first half of 2020. Investors anticipated requiring a higher risk premium when considering an asset with retail exposure. This will likely lead to market repricing, especially for properties in secondary locations.

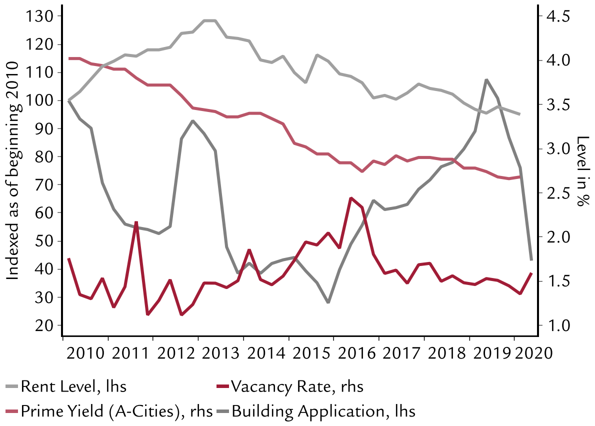
Office markets: Go office or go home?

The office segment is currently subject to public debate due to the growing importance of - and current change to - working behaviour such as working from home. COVID-19 is likely to impact the working environment in the medium and long term and a new flexibility will enable people to work from different places at varying times. Nevertheless, the crisis again evinces to which great extent people appreciate and rely on social interactions. Offices are expected to remain an important workplace function, albeit for a different primary purpose. The office sector has remained stable during the past few months. The lockdown caused a tightening of investor activity and constrained construction output, which will lead to a reduction of office supply. Notwithstanding that, we expect office vacancies to increase due to the challenging economic situation, especially for non-prime locations. On the demand side, pre-crisis trends have been reinforced. High-quality office spaces in prime locations will see increasing demand.

Hospitality damaged by the crisis

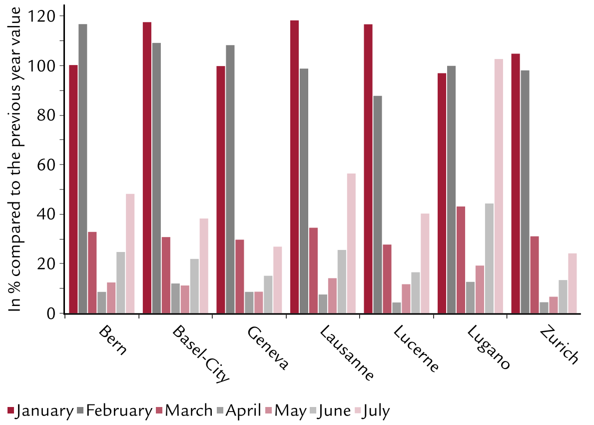
The hotel industry is the sector most affected by COVID-19. Compared to the previous year, the number of overnight stays in major Swiss cities fell by almost 85 per cent (March to May). The differences between urban and rural areas are, however, considerable: while many tourist areas are experiencing a high thanks to limited travel opportunities, urban hotels are suffering from a lack of business and leisure travellers. There is also great uncertainty about restaurants. With the change from summer to winter and thus to closed rooms, the behaviour of customers will have to show itself first.

Chart 1: Key figures of the Swiss retail market



Source: Wüest Partner

Chart 2: Development of the number of accommodations in the Swiss hospitality sector



Source: Federal Statistic Office

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