

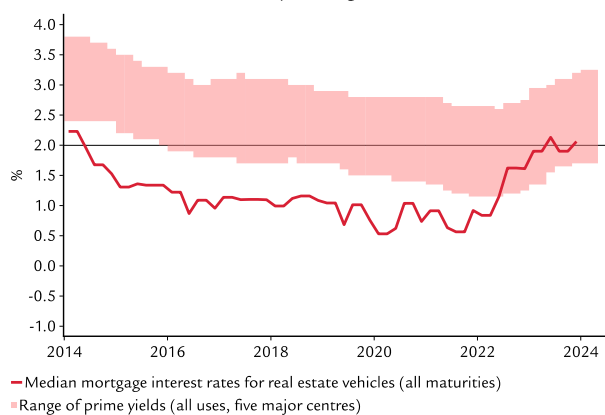
Second half-year 2024

Key takeaways

- **Leverage effect back:** Interest rates have peaked in this cycle. While a return to negative territory is unlikely, financing costs and yields to maturity on alternative investments have already fallen again significantly, thus reflecting the attractiveness of real estate investments.
- **Capital market pricing real estate investments higher again:** The appetite for real estate investments has returned, and there is an increasing willingness to invest. Traded real estate is priced above rock bottom again and will rise again by the end of the year. Discount rates are following suit and have already been lowered again in particular for prime residential properties.
- **Fall in construction costs expected:** Decreasing construction activity, surplus capacities in the construction sector and falling import prices suggest that construction costs in Switzerland are set to fall in the medium term and thus make refurbishments and new construction projects more attractive again.
- **Unexploited potential for existing stock:** Just 43% of municipal land use plans complied with the revised spatial planning of 2014 at the start of 2024. The densification envisaged by this is thus lagging behind. There is therefore all the more scope in the remaining municipalities to achieve targeted planning advantages and increase net income.

Chart in focus

Mortgage interest rates and net initial yields of direct real estate investments in the prime segment



The second key interest rate cut by the SNB in June will enable the downward trend in debt financing costs to continue, although we are not expecting any further cut in interest rates before the end of 2024. One-to-two-year and two-to-five-year mortgages, which are already slightly lower, should all soon fall below the two percent mark. Five-to-ten-year mortgages can be expected to follow suit in the quarters to come. The negative impact of the leverage effect is thus disappearing in most cases, with prime yields on direct real estate investments between 1.7% and 3.2% in the first quarter of 2024.

The Swiss National Bank cut its key interest rate twice in the first half of 2024 and has therefore already implemented the expected normalisation of monetary policy. Economic growth in Switzerland remains subdued and is relying on robust domestic consumption. Favourable financing conditions will have a beneficial impact on corporate investment activity. An upturn in construction activity is being hindered not so much by the rise in interest rates as by the increasing regulation density. The export-oriented industry sector is only recovering sluggishly from the growth dip of the past two years. The loss of China as the growth driver of the global economy and the difficulties of the German automotive industry are weighing on this sector. However, according to a survey by the KOF Swiss Economic Institute at ETH Zurich, the expectations for order intake over the next three months rose in June 2024 to their highest level since July 2021.

Turnaround for transactions

Average discount rates for the valuation of institutional real estate vehicles rose between the 2022 and 2023 reporting years by six basis points to 3.04% after having fallen continuously in the reporting periods since 2009. Lower interest rates regularly have a positive impact on the valuation of real estate. And the turnaround can be observed on the transaction market. Prices for traded residential real estate have already risen again in the third quarter of 2023 (see Chart 1) and were up 3.9% year on year as of the first quarter of 2024. Office properties are likewise catching up again and were 4.0% higher than in the previous year as of the second quarter of 2024. The recovery is thus continuing. The valuation figures available from business reports in the first half of the year confirm this trend: the average discount rate fell to 2.90%. There is even significant positive value change emerging again in the prime segment of residential real estate: according to a survey by Fahrländer Partner, discount rates already fell again from the peak of 2.09% in January to 2.02% in August 2024.

Falling construction prices expected

The long-standing slowdown in new construction promises an increasingly favourable environment for construction investments. Viewed from a historic perspective, the conclusion can be drawn that phases of falling construction activity and excessive capacities in the construction industry are frequently followed by phases of falling construction costs (see Chart 2). These phases were particularly pronounced after 2008 and 2014. This is likely to be supplemented in the current environment by the fact that prices have been driven by temporary effects (supply chain bottlenecks, energy prices). Construction prices rose by 15% between October 2020 and April 2024, while consumer prices only gained 7.7% over the same period. At the same time, building production declined by around 14%, while capacities (measured in terms of employee numbers) rose further. In view of these developments, the current price level does not appear sustainable, and we therefore expect construction prices to fall over the coming quarters.

Densification guidelines falter – this offers opportunities

Implementation of the Spatial Planning Act (SPA-1) in force since 2014 is faltering. Only 43% of municipal land use plans complied with the more restrictive overarching specifications at the end of 2023, while 33% were awaiting a cantonal review or audit. This is impairing progress on the construction side: between 2018 and 2022, 44% of building permits granted were for built-up properties. The reasons for the delay are that the cantons have demanded significantly more time to draw up the overarching (structure) plans and the municipalities have lacked resources. Some of the structure plans were only ready 18 months ago. Owners and buyers prepared to invest accordingly exercised restraint with building applications and plot purchases. However, opportunities are also arising for owners of plots of land for which usage planning permission is still pending, as involvement in the adjustment is possible here and actually desired in many municipalities. The realisation of such planning benefits by means of a plan adjustment will become a more important subtask in the active management and administration of real estate assets.

Chart 1: Average discount rates and transaction prices

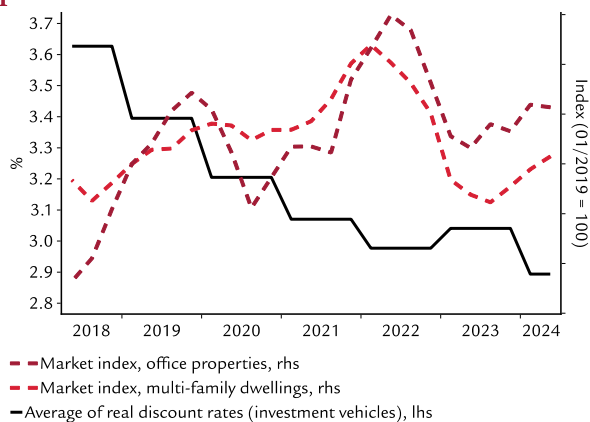
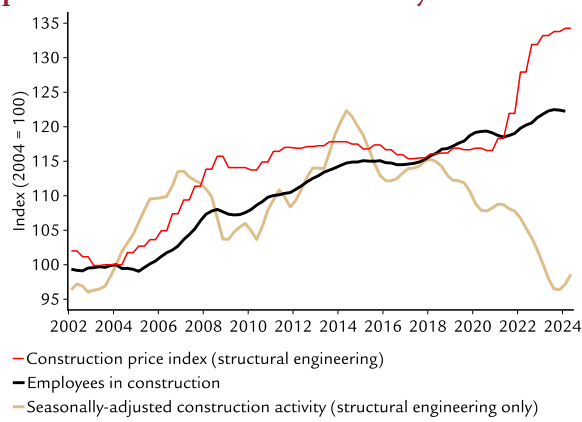


Chart 2: Building production, employees and prices in the construction industry



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