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Trend reversal in housing market

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Monitoring the effects of coronavirus

The Swiss apartment market is generally viewed as inert – more critical observers would describe it as boring. But the coronavirus pandemic has well and truly shaken up this key segment of the real estate market. In addition to a trend reversal in vacancy rates, there is also evidence of interesting shifts in demand in the housing market.

Housing vacancy rates experience trend reversal

The imminence of a trend reversal in the number of vacant apartments in Switzerland has recently become apparent to attentive market observers. For some time now, the volume of planning applications in the area of rental apartment construction has been losing momentum, reflecting not just greater reticence on the part of investors but also a paucity of available land on which to build. Nonetheless, the magnitude of the trend reversal is a surprise.

The pandemic and its special effects

This surprising result is likely to be first and foremost attributable to the pandemic. On the one hand, the coronavirus crisis had the effect of increasing net migration (including movements by the Swiss) by more than 13,000 persons last year, above all because many people thinking of moving abroad decided to stay put given Switzerland's relatively stable labor market situation. But the supply side too is likely to have contributed significantly to the sharp fall in the number of vacancies. For example, the pandemic protection measures and various building material shortages are likely to have led to delays in the completion of some housing projects.

Interesting shifts in demand in the housing market

The appeal of Switzerland's major urban centers has suffered disproportionately from pandemic-related restrictions. It is thus not surprising that fewer households than usual have decided to move to a major center. Some of these are probably just postponing this decision until life in the city has once again fully normalized. However, many households believe that much of the "new normal" will remain as a result of the pandemic – such as greater freedom to work from home – and have therefore turned their backs on the city for good in the last year. In addition, there has also been greater residential mobility within urban centers. Many households appear to have used this time to optimize their housing situation by moving elsewhere in the city, or indeed by giving up their *pied-à-terre*. This also might explain why apartment supply rates have risen further, most notably in the urban centers, whereas the time on market of vacant apartments has remain unchanged or even fallen.

Construction economy on recovery trajectory, …

The coronavirus pandemic has also left its mark on the construction economy. That said, this sector has managed to keep the damage inflicted by the crisis within limits, and is now on the road to recovery. Although building activity is not yet back to pre-crisis levels, the current trend provides grounds for optimism. In particular, the upward trend looks set to continue in residential and commercial construction thanks to strong order pipelines. In the medium term, however, the volume of building permit issuance indicates few stimuli for building construction. For the last three years or so, there has been a decline in rental apartment newbuild activity, and this trend looks set to even intensify in the coming months. On the other hand, other areas of the construction economy – such as hospital and data center construction, as well as the growing conversion and refurbishment area – should act as a counterweight, keeping building construction volumes fairly stable.

… but still faces challenges

In addition to the decline in planning activity in the apartment construction area, the scarcity of certain key building materials is the major current risk factor for the construction economy. Bottlenecks in global supply chains have resulted in a shortage of building materials and are reflected in rising construction prices and the risk of delays. Building companies therefore find themselves confronted by the challenge of having to pass on additional costs to their clients, despite fierce competition, in order to prevent erosion of what are already low profit margins.

Content

Surprisingly strong decline in housing vacancies

The housing vacancy rate has declined from 1.72% to 1.54% this year. This is due to astonishingly robust demand for apartments and a decline in building activity, the latter having probably been accentuated by COVID-19. Pandemic-related effects have led to a decline in vacancies, above all outside of the urban centers and for larger dwellings.

Vacant apartments decline by some 7,500 units

The number of vacant apartments in Switzerland as recorded by the Swiss Federal Statistical Office (SFSO) has declined this year for the first time since 2009. As of June 1, 2021, there were just 71,365 vacant apartments across Switzerland, equating to a vacancy rate of 1.54% (Fig. 1). In other words, the Swiss housing market has experienced a trend reversal – even if the vacancy rate remains above its long-term average (1.11%). This phenomenon has occurred recently because demand has hardly been affected by the pandemic, whereas the construction of apartments has slowed further. Nonetheless, the extent of the decline in the number of empty dwellings (–7,467) is a surprise.

Decline in building activity …

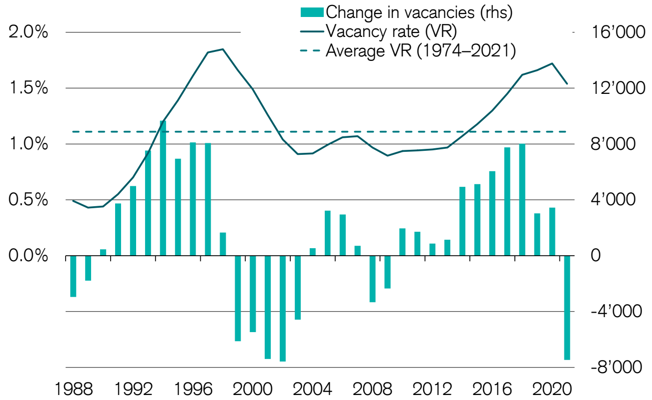
A major factor in the fall in vacancies has been the development of construction activity, with the high level of apartment construction activity in previous years having resulted in a decoupling from tenant demand. A combination of the quest for yield and the paucity of available building land led some investors to turn their attention to peripheral municipalities and rural regions, including those where potential demand is limited. However, the construction of rental apartments has now passed its peak. For the last three years or so, building permit issuance has been exhibiting a declining trend, which despite a temporary counter-movement looks set to persist this year (cf. p. 11). Overall, 5% fewer rental apartments were approved for construction over the last two years compared to the preceding two years.

… further exacerbated by coronavirus effects

In fact, the number of newly built apartments is likely to have declined even more strongly than construction approval figures suggest. On the one hand, coronavirus measures and supply shortages of key building materials have led to a number of delays on building sites. For example, according to statistics produced by the Swiss Contractors' Association, this resulted in a 16.3% decline in residential construction sales in 2020 (cf. p. 8). On the other hand, a growing proportion of residential construction projects – particularly in the major centers – are replacement newbuilds. In other words, only a very few additional apartments come onto the market when these projects complete. Furthermore, a number of major residential construction projects, primarily in urban areas, have recently been suspended by legal disputes relating to noise pollution.

Fig. 1: Trend reversal after 11-year rise in vacancies

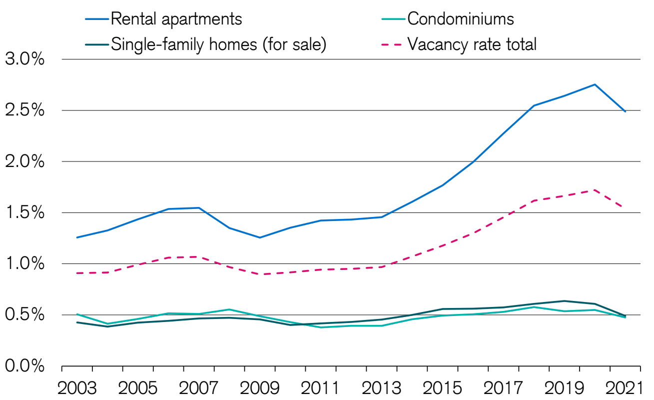
Change in vacancies and vacancy rate (VR); as per June 1 in each case



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 01.06.21

Fig. 2: Fewer vacant apartments in all segments

Apartment vacancy rate by segment, as % of respective housing stock



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 01.06.21

Housing demand not tied back by the pandemice

At the same time, demand has not been tied back by the pandemic. Indeed, net immigration in 2020 actually increased in a year-on-year comparison (from 53,200 to 66,500, including Swiss citizens), because the number of people leaving Switzerland fell more strongly than the number of immigrants. Only the net number of short-term residents (not taken into account in the above figures) recorded a sharp decline. Thanks to the economic recovery this year, the number of immigrants is once again on the rise; hence net migration in 2021 can once again be expected to be higher than before the pandemic (cf. p. 11), albeit without quite reaching the high figure of 2020. In addition, domestic demand likewise appears to have suffered under coronavirus only slightly at the start of the pandemic, when uncertainty was running high. Thanks to short-time working and fiscal support for companies, the pandemic barely had any negative impact on the purchasing power of many households. Indeed, many households were even able to increase their savings thanks to reduced spending on mobility, gastronomy, and leisure. Furthermore, the increased use of home working triggered a rise in demand for living space (see below).

5,500 fewer vacant rental apartments

A significant portion of the decline in the number of empty apartments (equivalent to 5,500 units) was recorded in the rental apartment segment. Nonetheless, the rental apartment vacancy rate remains high in a long-term comparison at 2.49% (Fig. 2). This is explained by the fact that developers focused on investment properties for many years, and ever fewer new single-family homes and condominiums came onto the market (cf. p. 10).

Property to buy in short supply

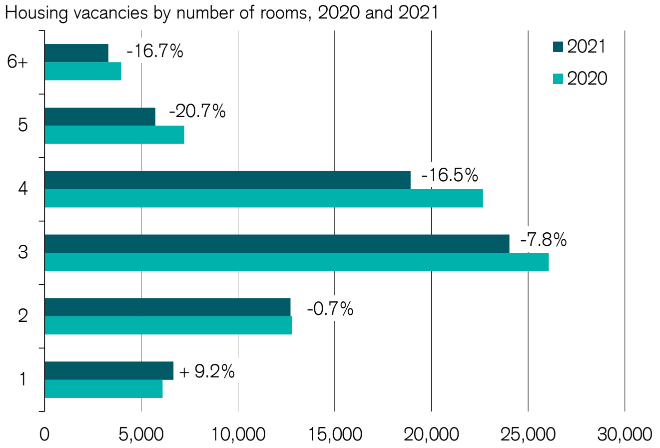
In contrast to the rental apartment market, the market for owner-occupied housing has faced problems with scarcity of supply for years. Although the high level of prices and more rigorous regulatory requirements for the granting of mortgages have reduced the pool of potential first-time buyers, there has nonetheless been an increase in demand for residential property in recent quarters. The majority of people spent a great deal more time at home during the pandemic. In many cases, this will have strengthened the desire to possess one's own four walls. Moreover, the shift toward greater home working has increased the willingness of potential buyers to look for homes further away from their place of work. And with this greater search radius has come an increase in the chance of finding a suitable property that meets the household budget. A combination of higher demand and declining production has fed through into rising prices in the owner-occupied housing area (Q2 2021: +6.6% YoY). At the same time, vacancies have declined by 16% (1,900 apartments); in both the single-family home and condominium sub-segments, the vacancy rate now stands at just under 0.5% (Fig. 2).

Shift in demand toward larger apartments

A further consequence of the coronavirus crisis is the shift in demand toward larger apartments. Many a household is likely to have added an additional room to their property search with a future home office in mind. And this trend is reflected in the structure of vacancies (Fig. 3), which are now more in evidence for smaller apartments than for those with three or more rooms. However, this is not just the result of the pandemic and the associated change in living requirements. Construction activity has been heavily geared around smaller apartments for a number of years now, and this is now clearly reflected in vacancy figures.

Fig. 3: Apartments with three or more rooms in greater demand

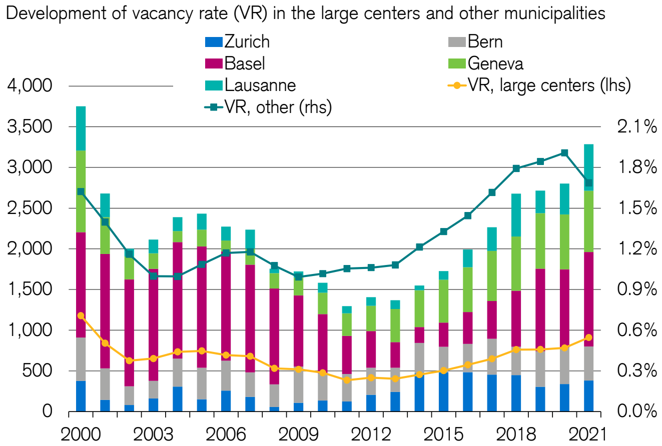
Housing vacancies by number of rooms, 2020 and 2021



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 01.06.21

Fig. 4: Slight narrowing of urban-rural divide

Development of vacancy rate (VR) in the large centers and other municipalities



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 01.06.21

Easing of supply tensions in large centers

Contrary to the general Swiss trend, apartment vacancy figures have increased sharply in the major urban centers (+17.3%). The largest rise of all was recorded by Lausanne (+50.5%), with only the city of Bern exhibiting a slight fall in its apartment vacancy rate (–6.5%). Overall, the vacancy rate of the large centers rose from 0.47% to 0.55% (Fig. 4). The city of Zurich continues to have by far the lowest vacancy rate (0.17%), whereas apartment-seekers are likely to have a rather easier time of it in the city of Basel (1.10%). The easing of supply tensions in the large centers is probably also partly the result of a recent increase in construction activity in the cities. However, coronavirus played an important role too: At the height of the pandemic, urban cultural and leisure offerings were greatly restricted, and the benefits of proximity to the workplace lost their significance due to the widespread shift to home working. As a result, the city lost its relative appeal compared to the country. This is also strikingly apparent in domestic migration movements: A net 14,200 people left the large centers in 2020 – 77% more than in 2019.

Sharp vacancy rate decline in tourist and periurban regions

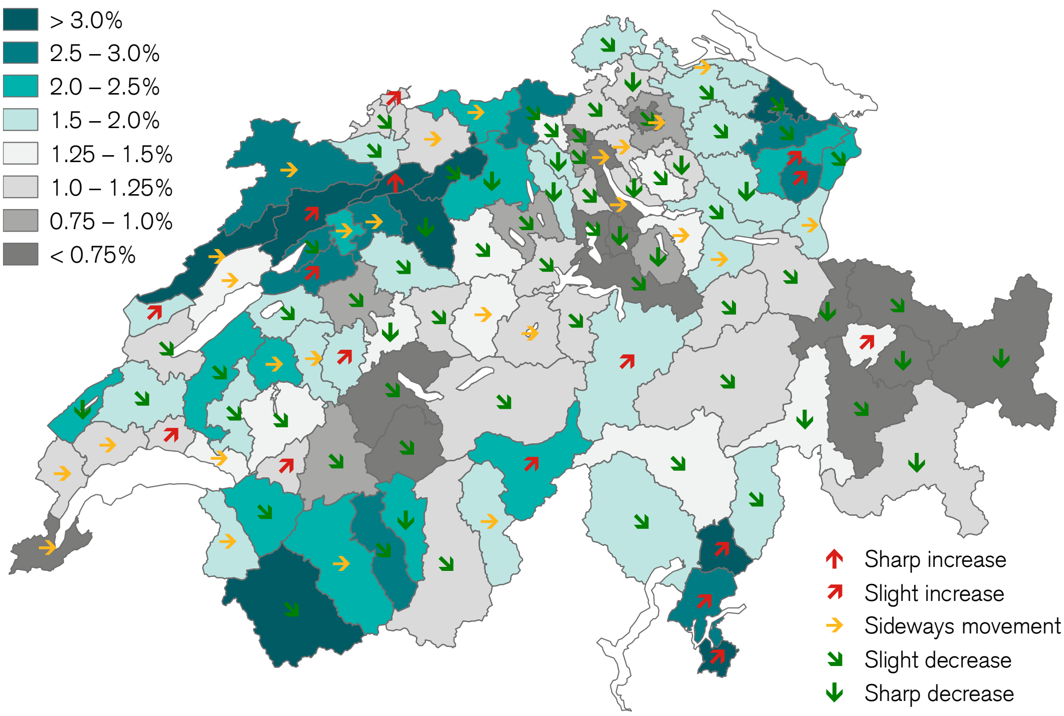
Viewed regionally, there are still four clusters exhibiting significant vacancy levels: northeastern Switzerland, northwestern Switzerland (notably Aargau and Solothurn), Valais, and Ticino (Fig. 5). The easing of supply tensions in Switzerland's urban centers described above is largely limited to the large centers. In the medium-sized centers, by contrast, the vacancy rate has declined slightly from 2.03% to 1.98%. A clear majority of Switzerland's economic regions (68 out of 110) recorded a vacancy rate decline. In particular in periurban municipalities further outside the cities, significantly lower vacancy rates were recorded overall (–19.4%). But in many rural-peripheral regions too, fewer apartments were vacant on June 1, 2021 than a year earlier. In Alpine municipalities with a strong tourist industry, the decline in the number of vacant apartments declined by as much as 25.2%.

Conclusion: Has coronavirus been a trend accelerator – or even a "game changer"?

The turning point in the vacancy rate trend has therefore occurred earlier and proved more pronounced than expected. Once again, the coronavirus pandemic has acted as a trend accelerator, accentuating the anticipated decline in residential construction and stimulating demand for accommodation. That said, the decline in the vacancy rate is unlikely to continue at its current tempo. Although there is evidence of a declining trend in the volume of planning applications being submitted, the order books of construction companies remain well-filled, and construction activity could rise again in the meantime once pandemic-related production restrictions are removed fully. Furthermore, residential property remains coveted by investors, particularly as there is no sign of the low interest rate environment changing any time soon. The extent to which the pandemic could even prove a "game changer" remains to be seen. This would require the recently observed trend toward larger apartments to endure outside of the large centers. However, there are plenty of reasons to suggest that this structural trend could weaken once again against the backdrop of a widespread return to the office and the removal of pandemic-related restrictions.

Fig. 5: Fewer housing vacancies in many agglomeration municipalities and rural regions

Vacancy rate as per June 1, 2021, arrow: year-on-year change



Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 01.06.2021

Recovery trend apparent despite obstacles

The construction economy has managed to keep the damage inflicted by the coronavirus crisis within limits, and is now on the road to recovery. However, there is now evidence of an increasing shortage of certain key building materials, which could threaten the recovery – at least in the short term.

Storm weathered relatively well

The construction sector has weathered the coronavirus storm relatively well. Unlike other sectors, it was affected only for a limited period and in certain places by building disruptions (building site closures in the first semester of 2020 in Ticino and a few regions of French-speaking Switzerland). Nonetheless, the pandemic has not passed the construction economy by: A combination of coronavirus containment measures and presumably a certain degree of uncertainty on the part of developers led to productivity declines and a sales decline of 5.8% in the main construction trade in 2020. According to the quarterly statistics of the Swiss Association of Master Builders, residential construction sales fell by as much as 16.3%.

Well-filled pipelines

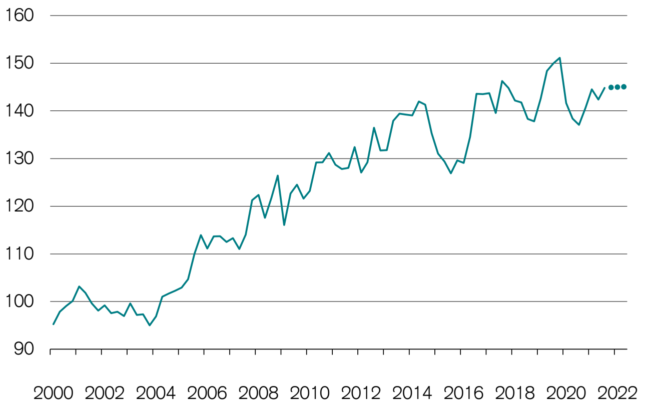
Although building activity is not yet back to pre-crisis levels, the current trend provides grounds for optimism. For the third quarter of 2021, we are expecting a sales increase of 5.7% year-on-year in the main construction trade (Fig. 6). The recovery is likely to persist in residential and commercial construction in particular (+11.1% and +13.5% respectively). Both segments are currently exhibiting well-filled order books – among other things, because a backlog is likely to have built up as a result of restrictions and productivity slumps during the pandemic.

Decline in rental apartment construction increasingly apparent

In the medium term, however, the volume of building permit issuance promises few stimuli for building construction. Although approved construction volumes have stabilized recently, the level of building permit issuance over the last 12 months was 6.4% below the average of the previous six years (Fig. 7). The key driver of this decline is the level of newbuild activity for rental apartments in multi-family dwellings, which has exhibited a declining trend for some three years now (cf. also p. 11). It is estimated that rental apartment construction has accounted for around a quarter of all sales in the main construction trade over the last decade. On the other hand, in the longer term there are grounds for optimism thanks to the latest rise in newly submitted planning applications, which brought the most recent projections for construction volumes back into line with the average of the last five years. However, this increase is not down to activity in the residential segment, but relates to other areas of building construction (e.g. hospital and other public building construction, data center construction), as well as to conversion and refurbishment projects.

Fig. 6: Building economy picks up steam once again

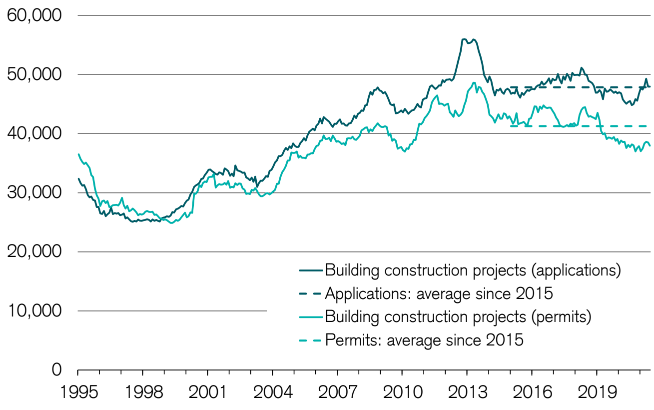
Forecast sales development in main construction trade, nominal; index: Q1 1996 = 100



Source: Credit Suisse, Swiss Contractors' Association   Last data point: Q2/2021

Fig. 7: Planning activity in building construction has picked up recently

Planned building construction volumes in CHF mn, moving 12-month total



Source: Baublatt, Credit Suisse   Last data point: 06/2021

Conversion and refurbishment an increasing focus, …

Over the last ten years, the average annual volume of planning applications submitted for conversion, finishing, and refurbishment work has amounted to around CHF 12 bn. In the first half of 2021 the equivalent figure had already reached CHF 6.6 billion, which equates to a high proportion of 27% of all newly planned construction volumes (Fig. 8). A key driver of this development is likely to be the trend toward energy-related refurbishment, which is expected to continue in the longer term despite the rejection of the fully revised CO_2 Act by the Swiss electorate. The likelihood is that this will benefit not just the main construction trade, but above all the finishing industry and construction suppliers that deliver products such as heating solutions, room ventilation regulation technology, photovoltaic equipment, windows, and insulation.

… particularly in rural regions

A further driver of the conversion trend is likely to be a consequence of the coronavirus crisis. In the wake of the pandemic, demand for owner-occupied housing rose, while at the same time the search radius of many buyers will have widened due to the greater prevalence of home working. As the supply of newbuild properties is limited, however, many investments are likely to have been in existing stock, as can currently be observed in certain parts of the northwestern Mittelland and the Jura region, for example. This effect is even more pronounced in a number of tourist regions, where the Second Homes Act restricts the supply of newbuild property. To some extent, this is also reflected in the strong growth of owner-occupied property prices. In a number of regions of Canton Graubünden, for example, price rises have exceeded 10% over the last 12 months.

Disruptions to supply chains the biggest current risk

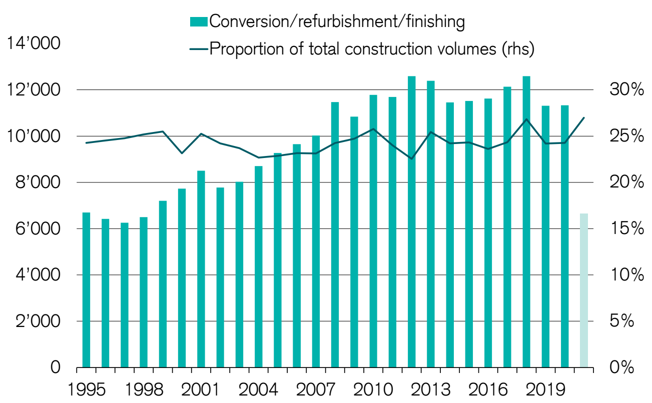
The scarcity of a number of key construction materials remains the greatest risk factor for the construction economy. This risk is likely to continue to hover over the industry given that global supply chains continue to face restrictions and demand has picked up sharply as the post-pandemic recovery continues. Moreover, the temporary closure of the huge container port of Ningbo in China has further exacerbated the situation. According to the survey of the Economic Research Unit of the Federal Institute of Technology in Zurich (KOF), a majority of construction companies (58%) reported a shortage of building materials in June 2021. This is now also feeding through into construction prices, which according to the Federal Statistical Office have recorded a 1.2% year-on-year rise following almost a decade of stagnation – with the rise being even higher in areas such as timber construction (Fig. 9). As the situation has recently become even more problematic, the trend of higher costs and construction delays is likely to continue for now. This presents building companies with the challenge of passing on these additional costs to avoid further erosion of what are already low profit margins, despite fierce competition.

Recovery can be expected to slow

As long as there are no widespread closures of building sites over the next few quarters, the persistently high order backlog is likely to ensure the continued recovery of the construction economy, even though the tempo of that recovery should gradually slow. The industry can also draw confidence from the negative interest rate environment, which is set to continue and lead to persistently high demand from investors. The greatest opportunities for the construction trade in the longer term include not just conversion and refurbishment, but also infrastructure, as there is significant need for this in Switzerland, and much of the necessary long-term funding is ring-fenced.

Fig. 8: Conversion work supports demand for building construction

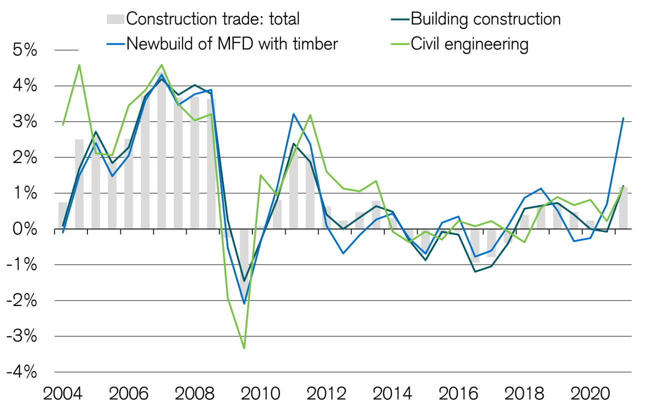
Planned building construction volumes as per planning applications, in CHF mn; 2021: H1



Source: Baublatt, Credit Suisse Last data point: 06/2021

Fig. 9: Construction prices rising after years of stagnation

Semi-annual construction price index, annualized growth rates (MFD: multi-family dwellings)



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 04/2021

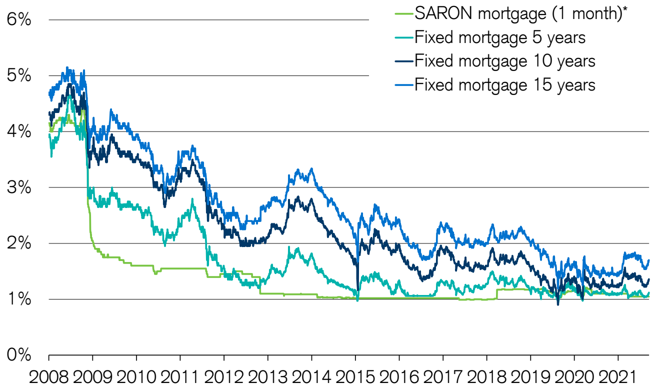
Owner-occupied housing

Low interest phase extended

Since inflation should remain below the 1% threshold, we are anticipating a continuation of the negative interest environment. As such, there is no reason to expect any rise in policy rate until the end of 2022 at the earliest. The interest rates on SARON mortgages are therefore likely to remain at, or close to, their lows over the next 12 months. By contrast, as long as the economic recovery continues, we are expecting fixed mortgage rates to trend slightly higher over the coming 12 months. As before, this development is likely to be accompanied by limited upward and downward movements. The historically very low interest rate environment will therefore remain in place over the next 12 months.

Fig. 10: Mortgage interest rates for different terms

Interest rates for new mortgages, in %



* SARON mortgage interest rate from 21.9.2020 on. Earlier historic interest rate: Flex rollover mortgage (3-month LIBOR).

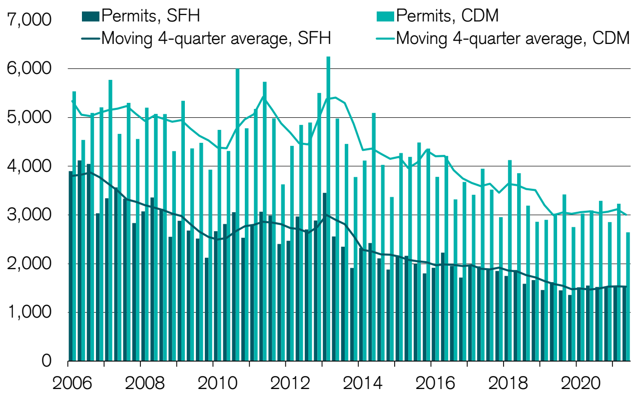
Source: Credit Suisse — Last data point: September 14, 2021

Newbuild activity still too low

The volume of building permit issuance for condominiums and single-family homes has stabilized recently. Over the last 12 months, 12,017 condominiums and 6,120 single-family homes were approved. In other words, owner-occupied housing construction activity is still at a nadir, despite the urge to own residential property still being extremely strong. Not much is likely to change quickly here given that planning applications remain at low levels. While the volume of applications for condominiums continues to decline, the volume of applications for the construction of single-family homes has risen only slightly (+5.0%). Given the persistently negative interest rate environment, the focus of construction activity is likely to remain in the rental apartment area.

Fig. 11: Quarterly building permit issuance for owner-occupied housing

Number of residential units, single-family homes (SFH) and condominiums (CDM)



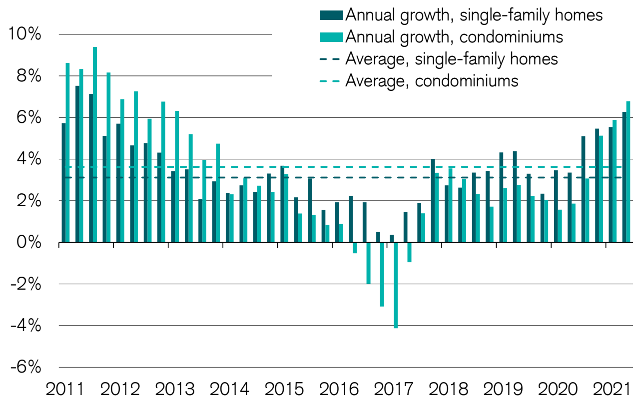
Source: Baublatt, Credit Suisse — Last data point: Q2/2021

Price growth accelerates further in owner-occupied housing segment

As a result of the COVID-19 pandemic, the desire to own residential property in Switzerland is at a scarcely imaginable level. But as supply is too low, price momentum has gradually gathered steam over the last few quarters. The prices of single-family homes have risen by 6.3% within a year. For condominiums the price growth has been even stronger, namely 6.8%. These are the highest growth rates recorded since 2011/2012. That price growth has not been even higher is likely to be primarily due to Switzerland's rigorous regulatory financing requirements. These will limit upside price potential in the future too.

Fig. 12: Residential property price growth, mid-range segment

Annual growth rates; dotted lines: average 2000–2020



Source: Wüest Partner — Last data point: Q2/2021

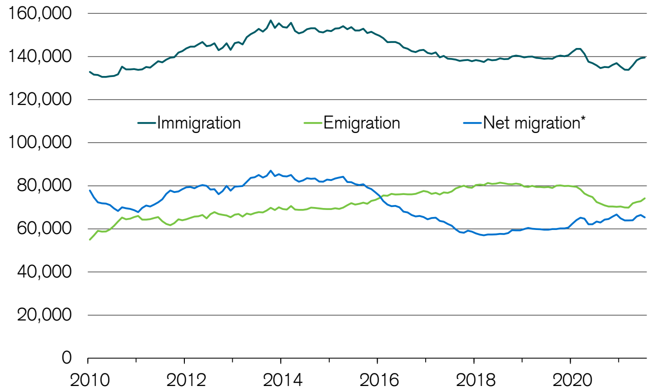
Rental apartments

Demand for rental apartments immune to crisis

Net migration was high in 2020, despite a decline in people moving to Switzerland, as fewer people emigrated. In 2021 too, net migration will support the rental apartment market. By July, the net immigration of foreigners was some 5.1% higher than in the pre-crisis year of 2019. Although net migration is likely to weaken compared to the strong previous year once a high level of Swiss emigration is taken into account, the figure is unlikely to be down on that of 2019. Furthermore, domestic demand for rental apartments can be expected to increase significantly on the back of the economic recovery. According to the State Secretariat for Economic Affairs, following a temporary slump, consumer sentiment in July 2021 was significantly higher than its pre-crisis level.

Fig. 13: Net migration of foreign residential population

Moves to/from Switzerland and net migration: moving 12-month totals



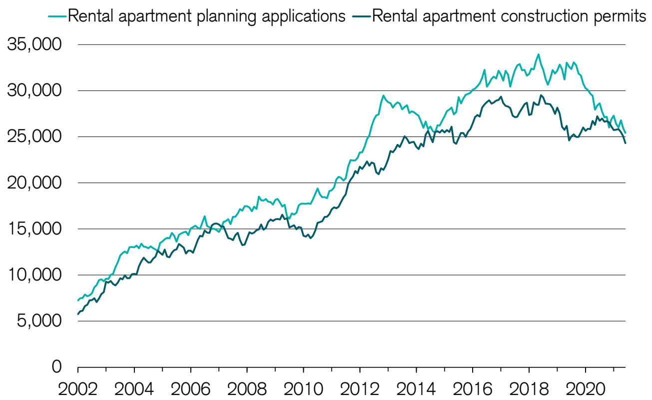
* Net migration, not taking into account registry corrections
Source: State Secretariat for Migration, Credit Suisse Last data point: 07/2021

Accelerated trend reversal in rental apartment construction

Rental apartment construction activity has been increasing steadily for years – driven first by the additional demand coming from immigrants, and later by the wave of investor interest due to interest rate developments. But a combination of higher market risks and declining initial yields has now resulted in real estate developers becoming more circumspect. Since peaking three years ago, the volume of planning applications for new apartments has declined by around a quarter. As a consequence, construction activity is likely to be scaled back significantly over the next two to three years. A similar outcome is also suggested by the number of apartments approved for construction, which has declined by 11% over the last 12 months.

Fig. 14: Rental apartment building permits and planning applications

Number of housing units, moving 12-month total



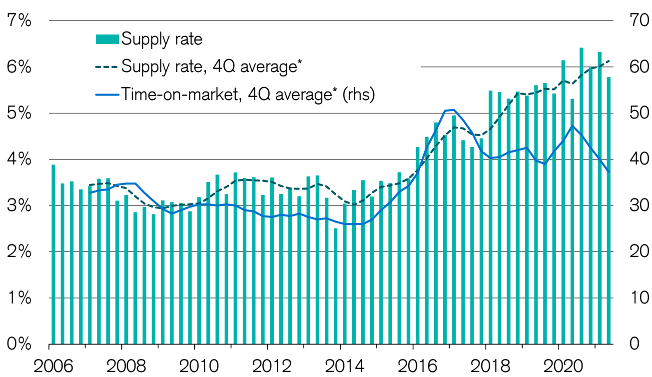
Source: Baublatt, Credit Suisse Last data point: 06/2021

Pandemic stimulates re-evaluation of housing situation

A significantly higher number of rental apartments have been advertised since the lockdown-related slump in the second quarter of 2020. Over the last four quarters, the supply rate has worked out at a high average of 6.1%. This increase is largely attributable to the large and medium-sized centers. Many households are likely to have been prompted by the pandemic to re-evaluate their living situations and to move to a larger apartment outside of the city, for example, or relinquish their *pied-à-terre*. The positive overall development of demand is evident from the average time-on-market of apartments, which has fallen sharply over the last few quarters. As a consequence, the downward pressure on rents can be expected to slacken over the coming quarters.

Fig. 15: Supply rate and time-on-market of rental apartments

Supply rate as % of existing housing stock, time-on-market in number of days



* Moving average over four quarters
Source: Meta-Sys AG, Credit Suisse Last data point: Q2/2021

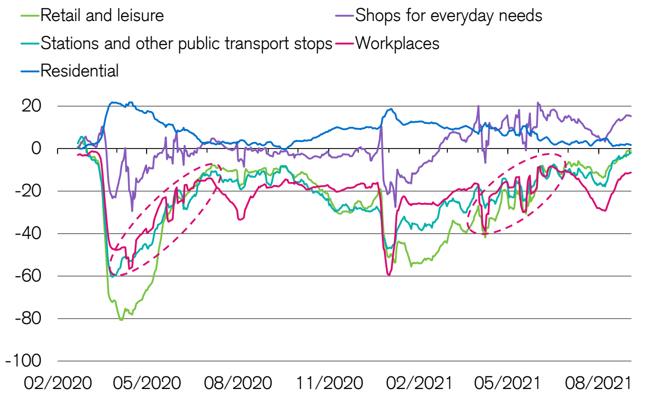
Commercial real estate

Slow but steady return to the office

The easing of the coronavirus containment measures and above all the repeal of mandatory home working have resulted in a slow but steady return to the workplace, including the office. Before the summer vacation period, the number of workers at their office workstations was still 11% below its pre-pandemic figure. After the expected dip in the summer vacation period, the figure was still 12% lower at the end of August. Nothing is likely to change here in the short term given the ongoing social distancing rules in place. And as an increasing number of companies will allow their employees to work from home – at least in part – after COVID-19 too, commuter movements going forward will remain lower than before the pandemic.

Fig. 16: Swiss mobility data

Moving seven-day average; 0 = reference value prior to pandemic



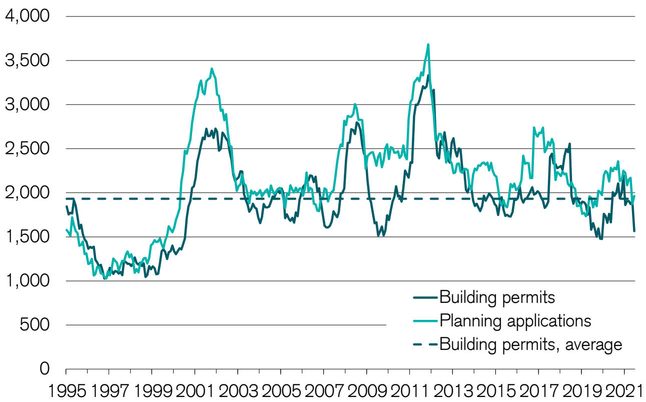
Source: Google | Last data point: September 2,2021

Office space planning responds to weak demand

Over the last 12 months, the investment volume of building permit issuance for office space amounted to some CHF 1,565 mn. This is well below the most recent high of last November, and as much as 19% below the long-term average since 1995. Fewer offices are being planned, and in the office property markets of the large centers in particular. This decline is welcome, especially as demand is likely to remain subdued due to the increased prevalence of home working. However, the anticipated decline in office space production will only impact on the supply of space in the medium term, hence there is a likelihood of rising vacancies and declining rents over the coming years.

Fig. 17: Planned expansion of office space

Building permits and planning applications, moving 12-month total, in CHF mn.



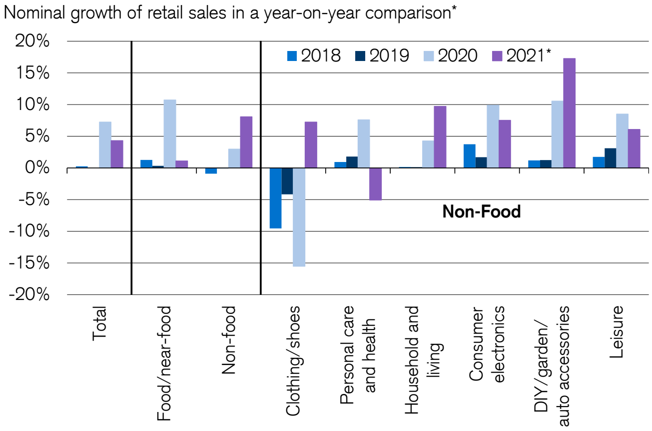
Source: Baublatt, Credit Suisse | Last data point: 06/2021

Retail sales growth surprisingly strong

In the first seven months of the year, retail sales recorded a year-on-year rise of 4.3%. Whereas the food segment recorded a rise of just 1.1%, the non-food segment enjoyed strong growth of 8.1%. This is at least partly explained by catch-up effects. Accordingly, the clothing and shoes segment busines also performed strongly this year, rising 7.2% (2020: -15.5%). Another positive factor is that "shopping tourism" has yet to get back to pre-crisis levels. The current growth is deceptive, however, as these shifts in consumer behavior are unlikely to persist after COVID-19. An additional headache for bricks-and-mortar retailers is that the majority of sales lost to online traders during the pandemic are unlikely to be regained.

Fig. 18: Development of retail sales

Nominal growth of retail sales in a year-on-year comparison*



* Seasonally and number-of-sales-days adjusted, 2018–2020: Jan.–Dec.; 2021: Jan.–Jul

Source: GfK, Credit Suisse | Last data point: 07/2021

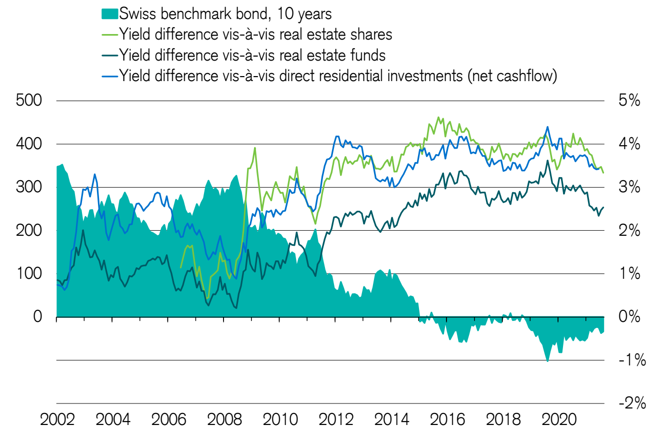
Real estate investments

Real estate yields declining, but still attractive

With their relatively attractive and stable yields, real estate investments continue to be sought after by investors. That said, the yield premium over government bonds has declined slightly over the last few quarters. On the one hand, the yields on Confederation bonds have recovered slightly, even if they are still in negative territory. On the other hand, the downward pressure on real estate yields is persisting – particularly in the case of real estate funds, which have enjoyed strong price rises in recent months. However, valuation gains also need to be taken into consideration alongside distribution/cashflow yields. For the time being, the upward potential of direct real estate investments such as apartment blocks is unlikely to have run its course.

Fig. 19: Yield premiums of real estate investments

Distribution yields compared to 10-year CHF government bonds, in bps (lhs)



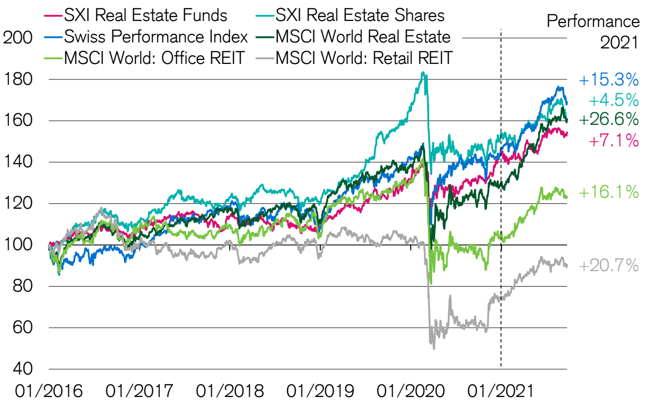
Historical performance data and financial market scenarios are not a reliable indicator of future results.
Source: Datastream, IAZI, Credit Suisse Last data point: 08/2021

Indirect real estate investments remain on growth trajectory

Swiss real estate funds, which once again proved their defensive qualities during the coronavirus crisis, managed to record a further rise this year (+7.1%). A slight upward trend is also apparent for real estate shares (+4.5%), although these have lagged well behind the broad SPI equity index (+15.3%) once again in 2021. A strong recovery trend is evident for real estate investments globally. This has been most pronounced in the segments that were little affected by the pandemic, namely residential (+40.6%) and industrial/logistics real estate (+28.0%), whereas the recovery of Real Estate Investment Trusts (REITs) specializing in hotel, office, and retail property has been weaker, with valuations yet to get back to pre-crisis levels here.

Fig. 20: Total performance of indirect real estate investments

Index: January 1, 2016 = 100



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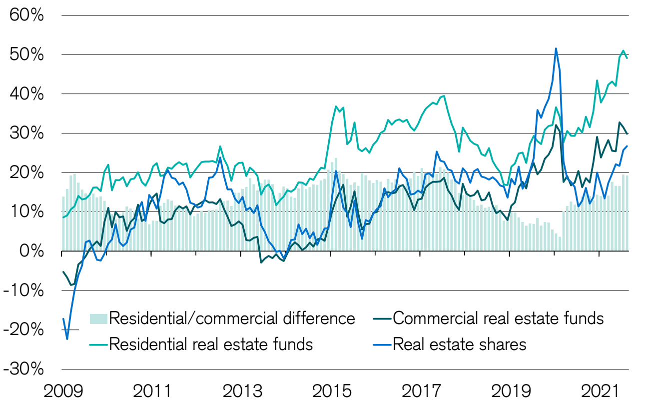
Source: Datastream, Credit Suisse Last data point: September 22,2021

Residential real estate funds buoyant

The defensive characteristics of real estate funds and the negative interest rate environment, the end of which is not yet in sight, have resulted in an even stronger investor interest in funds focusing on the residential segment. Despite a number of capital increases, premiums here have at times risen to more than 50%. The valuations of these funds are therefore extremely high, even taking into account a long-term horizon. The premiums of commercial real estate funds (29.8%) have likewise reached pre-crisis levels, but still lag well behind those of residential real estate funds.

Fig. 21: Premiums of real estate funds and real estate shares

As % of net asset value, excluding mixed real estate funds



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