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Mountains of Butter, Lakes of Milk, Mountains of Apartments

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Marco Müller

Editorial

Dear readers

After mountains of butter and lakes of milk in years past, we now face a mountain of apartments. The glut has expanded by the equivalent of a ghost town of 8000 homes. In contrast to the agricultural overproduction of the 1980s, however, the mountain of empty apartments was not caused by disastrous government subsidies, but purely by actions in the private sector. The investors who continue to tirelessly build rental apartments are actually acting rationally: they are locking in the attractive net yields offered by real estate investments. In an environment where it is increasingly difficult to generate positive returns with limited risk, real estate investments represent an interesting alternative. Although rising vacancies are exerting pressure on rental income, they are not in fact dimming the bright yield outlook (page 5).

This does not mean that misguided incentives do not exist. The accommodative monetary policy pursued by international central banks is keeping interest rates low. Too low for a nation like Switzerland, which, despite posting economic growth that is above potential, must go along with international interest rate dictates. Because of this, the central banks ultimately share responsibility for the dangerous bubbles that have formed (e.g. in high-yield bonds) and for over-investments such as those now observed on the Swiss real estate market.

The force of the economic revival was underestimated in Switzerland for some time, at least as it appears in the statistical record. Only now, much later, does the data reveal that the Swiss economy is in full bloom, growing well above potential, and outpacing even the strong economy of Europe. The figures for gross domestic product (GDP) dating back to 2016 are being revised sharply upward, shedding a rather different light on the economic performance of that period. If you would like to gain early insights into economic developments in Switzerland, I recommend that you consult our leading Purchasing Managers Index (PMI). This index has been heralding the robust upturn – reliably, as always – since the beginning of 2016. Demand for real estate will doubtless benefit from this upswing. However, the impetus on the market for rental apartments is unlikely to be sufficient to close the gap between supply and demand (page 7).

The effect of the upturn is likely to be most pronounced on the market for office space. Demand from office tenants is much more volatile than, say, demand for housing. This should underpin the current trend shift on the office market and could help to absorb the new office space coming onto the market in 2019/2020 (page 12).

On behalf of our authors, I hope you find our publication informative and inspiring.

Fredy Hasenmaile
Head Real Estate Economics

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Full speed ahead

The Swiss economy is currently in full bloom. The economic outlook is bright. So the real estate markets can count on greater demand, particularly for office space. Still, in the medium term, real estate investors in Switzerland will have to prepare for a phase of navigation without a tailwind.

Economy at a peak

The Swiss economy is experiencing a mini boom. Economic growth in the second quarter was well above potential at 2.9% (annualized). The greatest growth driver is currently the manufacturing industry, which is profiting from high demand from abroad. All major categories of goods are reporting a positive export trend. Capacity utilization is above average and employment growth has shifted into high gear since the beginning of the year and is now at 2% compared to a year earlier.

GDP growth likely to flatten off in 2019

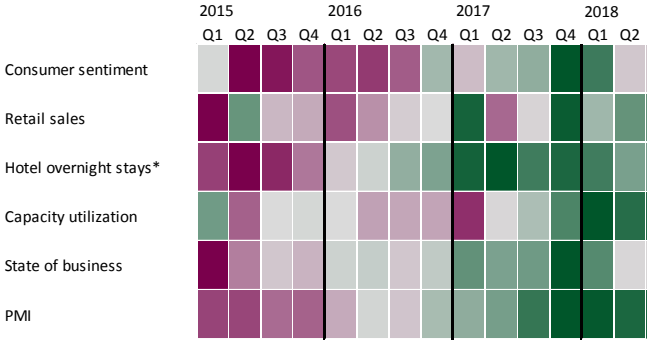
The outlook for the Swiss economy remains upbeat. Our export barometer, which measures the economic performance in the purchasing countries of the Swiss export industry, remains well above its 20-year average. The purchasing managers index (PMI) signals further growth ahead, with readings between 60 and 65 in recent months. The strapping industrial economy should further stimulate investment activity and raise staffing levels, consequently having a benign effect on the labor market. Nonetheless, the economy has probably topped out. For 2019, we expect the global economy to gradually return to normal after a period of strong growth, which would mean decelerating economic momentum in Switzerland as well.

Normalization of interest rates to begin in 2019

The robust state of the US economy reassures the US Federal Reserve that it is on the right track with its program of gradual normalization of interest rates. Higher US interest rates also lift long-term rates in Switzerland, albeit to a much lesser extent, since Switzerland has closer ties to the level of European interest rates. Moreover, the European Central Bank (ECB) has indefinitely postponed an initial increase in interest rates. At the same time, the return of the Swiss economy to a robust growth track heightens the pressure on the Swiss National Bank (SNB) to tighten its accommodative monetary policy, especially since the inflation rate is approaching its long-term average and the franc is now less severely overvalued. The recent market turbulence owing to political uncertainties in Italy, and the crisis in the Turkish lira, have amply proven that any softening of the Swiss franc can be quickly reversed. So an increase in key rates is not to be expected before autumn 2019, and interest rates are likely to stay in negative territory until 2020 at the earliest.

Figure 1: Many signals remain green

Overview of leading indicators

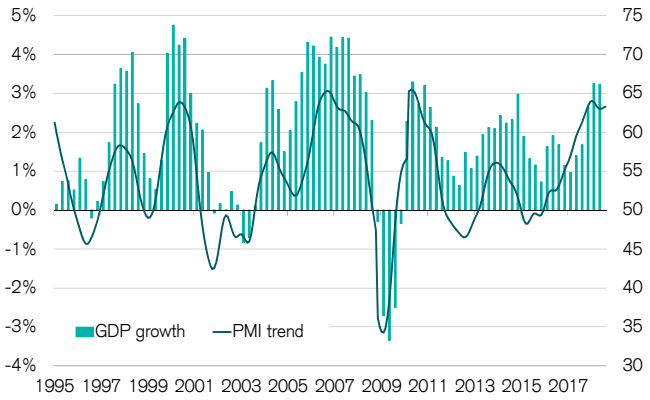


*by Swiss guests

Source: Bloomberg, Credit Suisse

Figure 2: PMI signals further growth

Annual GDP growth rates and trend growth in the PMI



Source: State Secretariat for Economic Affairs (Seco), procure.ch, Credit Suisse

Inflation will determine the course of interest-rate normalization

To date, the ECB has done everything in its power to keep interest rates as low as it could. Given the still unresolved debt problem in Europe, ECB President Mario Draghi's successor will also keep the normalization process as gentle as possible, if inflation rates warrant such a policy. So inflation is still the key factor to observe. Despite the strong revival of the global economy and, in some places, record-low unemployment, inflation has risen only gradually so far. At the moment, core inflation – which excludes volatile energy and food prices – in the euro zone is moving sideways at around 1%. The same is true for core inflation in Switzerland, which is approximately 0.5%.

Conclusions for real estate investors

Demand for floor space is pro-cyclical. Since economic momentum exceeds expectations, it should stimulate demand for residential and commercial space. In the market for office space, the economic revival has already contributed to turn the trend in vacancies. To be sure, this is largely limited to the inner cities and adjacent business areas at present, but if the upturn persists, it should extend to the peripheral business areas too. The decline in rental prices has decelerated significantly almost everywhere, and should continue to stabilize. In contrast, the gap between supply and demand on the market for rental apartments is so wide that the economic upturn can only moderate the growing oversupply, not reverse it. So the issue of vacant rental apartments will continue to challenge real estate investors for years to come. Some investors have already reacted to the enhanced relative appeal of the office market, and are increasingly channeling funds into commercial properties. This can be observed in the agio spreads between commercially oriented real estate funds and pure residential property funds. The agio spread in favor of residential property funds has fallen from 20 to 11 percentage points in recent quarters.

Navigating without a tailwind

Medium term, real estate investors will have to navigate under more difficult conditions. The driving factors to date (waves of immigration, phase of low interest rates, economic upturn) will be played out by then, and it will be no easy feat to simply pull the next driver out of a hat. In such a case, diversification is the order of the day, so as to reduce dependency on specific market segments. A portfolio that is broadly diversified in terms of geography, use, target group and price segment is the best safeguard against the unknown. Investors can certainly consider extending the geographical spectrum beyond the Swiss border. Moreover, since net cash flow yield will deliver a much greater contribution to total yield in future, it is more important than ever to secure rental income, generate additional revenues and keep costs under strict control.

Accelerated rise in housing vacancy rate

At 1.62%, the housing vacancy rate is at its highest level in 20 years. Once again, the majority of new additions to vacant housing are rental objects. Meanwhile, the inventory of vacant owner-occupied housing has also risen by 8.7%.

Vacant housing tops 70'000 units for the first time

The surge in the inventory of vacant homes over the last few years has continued into the current year. The latest reading indicated 8020 vacant homes, a greater increase than in any of the preceding 20 years, as we had predicted. The inventory of vacant homes has thus more than doubled over the last nine years. As of June 1, 2018 it had touched a new absolute high of 72'294 housing units. This puts the housing vacancy rate, which represents the number of vacant homes as a percentage of total housing, at a high 1.62% (figure 3).

Vacancy rate for rental apartments is 2.5%

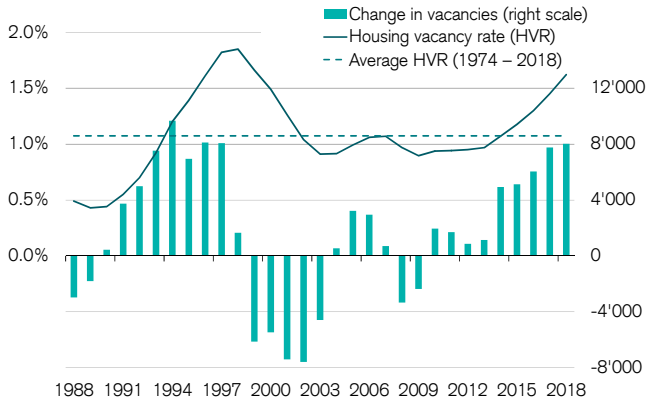
The sharp increase in the housing vacancy rate stems primarily from overproduction in the rental apartment segment (page 11). Although demand has been declining for more than four years, mainly due to decreasing immigration from the European Union, residential properties are still attractive investment objects. This in turn can be attributed to the ongoing environment of negative interest rates, in which real estate generates attractive cash flow yields compared to bonds. However, the high demand has severely depressed initial yields for good objects in central locations. Thanks to the decline in yield and the sparse availability of development land in urban centers, investors are shifting focus to conurbations and rural regions – including some in which demand potential is limited. Within the space of one year, the vacancy rate for rental apartments rose from 2.24% to 2.51% (figure 4). This means that rental apartments account for 82.6% of the current inventory of vacant homes.

Vacancies in owner-occupied housing also increasing

Vacancies are considerably lower in owner-occupied housing (figure 4). The vacancy rate for single-family dwellings has barely changed (from 0.41% to 0.43%). The rate for condominiums, however, is somewhat higher (from 0.87% to 0.94%). Given the continuous decline in production (page 10), this increase of around 1000 vacant homes was somewhat unexpected. It indicates a significant decline in demand in certain regions, which can be explained by the high level of prices and strict financing requirements.

Figure 3: Sharpest increase in vacant homes since 1997

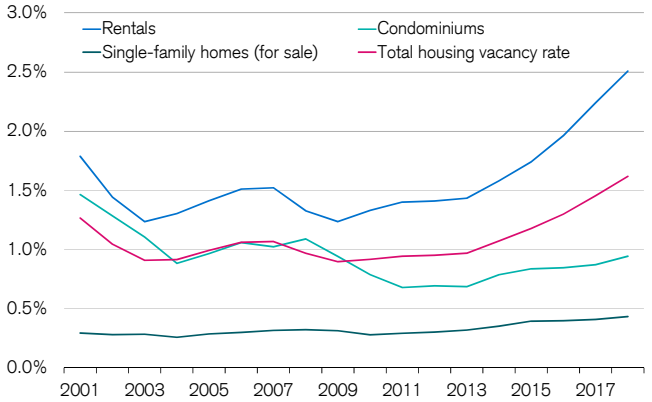
Housing vacancy rate (left scale) and increase in vacant homes



Source: SFSO, Credit Suisse

Figure 4: Every 40th rental apartment stands empty

Housing vacancy rate by segment, as % of the relevant housing inventory



Source: SFSO, Credit Suisse

High vacancies in rural areas and around smaller centers

The rise in vacancies remains a broad trend that spans the regions. The housing vacancy rate has increased in 67 of 110 Swiss economic regions (figure 5). While the increase has been especially notable in Northeast Switzerland and Canton Ticino, the rate also rose markedly in many regions of the Western Mitteland where vacancies were already elevated. In general, regions that are far from city centers, and regions around small and mid-sized centers, are hardest hit by vacancies. In Oberaargau, for example, 4.7% of homes are standing empty, and in the region around Olten the figure is 3.6%.

Only partial easing in major centers

There is no question of oversupply in the major centers, where demand continues to exceed supply. While the situation in general has again eased slightly, with the housing vacancy rate for the five major centers inching up from 0.39% to 0.46%, the picture looks different in the individual centers. Three have continued to trend towards easing – Geneva (0.62%), Basel (0.69%) and particularly Lausanne (from 0.38% to 0.67%). However, the housing vacancy rate declined slightly in Zurich (0.20%) and Bern (0.45%). In Zurich, developers have increasingly shifted their activity into suburban regions such as the Glatttal, the Limmattal and the Zurich Unterland. So a significant easing in the City of Zurich's housing market is not on the horizon.

Vacancies poised to rise further in 2019

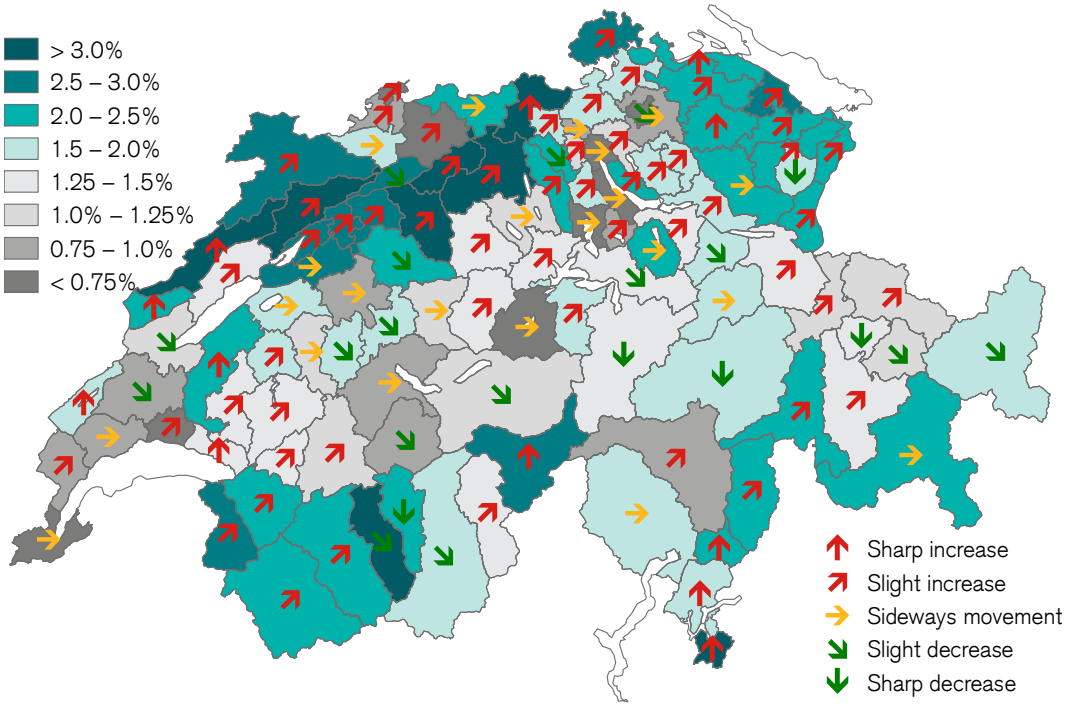
For the coming year, we expect housing vacancy rates across Switzerland to rise further. However, the increase should be less pronounced, given the evidence of stronger economic growth, no further decline in immigration, and the relatively stable trend in building permits (page 11). At the same time, there is no sign that the trend may reverse to falling housing vacancy rates. The project pipeline remains full to bursting, and the economic environment continues to support demand for real estate investments. Moreover, the latest appreciation of the Swiss franc has lessened the likelihood that the SNB will abandon its policy of negative interest rates, which indirectly stimulates construction activity, in the near future.

Market analysis is a factor of success

Vacancies in newly built homes have hardly risen (+1.0%), despite brisk construction activity. This underscores the fact that project development can be successful even in this challenging market environment. However, for a building project to succeed, it must be oriented specifically to the needs of prospective residents in terms of, for example, location, floor plan, housing mix and price segment. Accordingly, careful analysis of the market and location is an increasingly vital key to success.

Figure 5: Vacancies increase most in Northeast Switzerland and Ticino

Housing vacancy rates 2018, arrows: year-on-year change



Source: SFSO, Credit Suisse, Geostat

Prices up nearly everywhere

Prices for owner-occupied housing continue to rise, but as expected, the trend recently lost some momentum. Thanks to ongoing excellent market conditions, we expect prices to climb further in the coming quarters.

Price momentum decelerating

Prices for owner-occupied housing have risen further. In the second quarter, prices for condominiums were up 3.0% compared to the previous year's quarter (figure 6). The increase for single-family dwellings was only slightly lower at 2.6%. Thus momentum has decelerated somewhat, as expected, compared to the level at the beginning of the year, slipping below the average for 2000–2017 despite its still respectable level. Meanwhile, increases have been posted for the last five quarters, lifting prices for condominiums nearly back to the level of early 2016. Single-family dwellings, which lost hardly any value in 2016/2017, are already significantly more expensive than at that time.

Imputed affordability hems further price increases

We expect prices to continue to rise in the coming quarters. The robust economic recovery and falling unemployment support demand. Moreover, the long phase of very low interest rates depresses actual financing costs. The number of owner-occupied homes coming onto the market continues to decline, which also supports prices. High capital requirements and regulatory affordability criteria are daunting hurdles that put homeownership out of reach for an increasing number of households. Thus future demand potential is limited, which has a damping effect on further price growth.

Luxury segment on the rise again

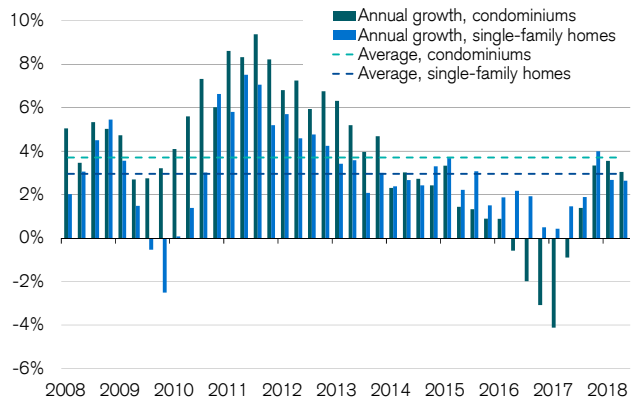
The differences between the segments have lessened noticeably over the last few quarters. Now prices in the luxury segment are rising again, for both condominiums and single-family dwellings. However, since demand continues to focus on the low and mid-price segment, the uptick in the luxury segment is modest, and the marketing effort required to sell luxury objects remains considerably higher.

Only a few regions report falling prices

In regional terms, too, the picture has become more homogeneous. Prices were higher in 96 of 106 regions (figure 7). Sizeable increases can often be found outside the usual high-price regions, for example in Cantons Fribourg, Bern and Lucerne. But prices also climbed in some of the high-price regions. Two notable exceptions here are Zug and Geneva, where the increase was minor compared to earlier readings. Falling prices can still be found, primarily in Canton Valais. Then there are individual regions, such as Mendrisio or Thurtal, where the declines are barely below zero.

Figure 6: Moderate price growth

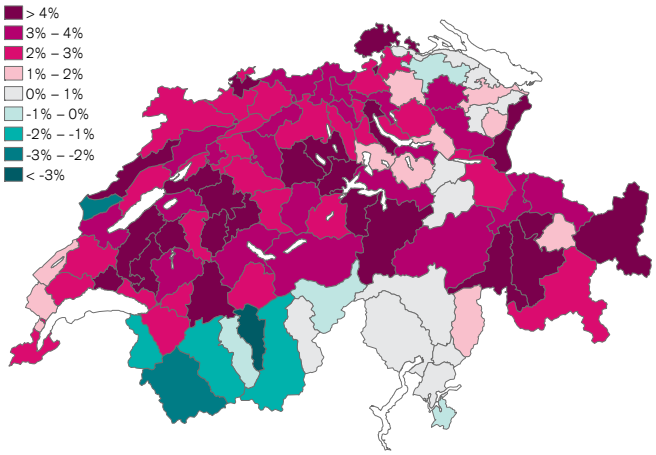
Annual growth rates, mid price segment



Source: Wüest Partner, Credit Suisse

Figure 7: Prices rising in most regions

Annual growth rates for owner-occupied housing (mid range), Q2 2018



Source: Wüest Partner, Credit Suisse, Geostat

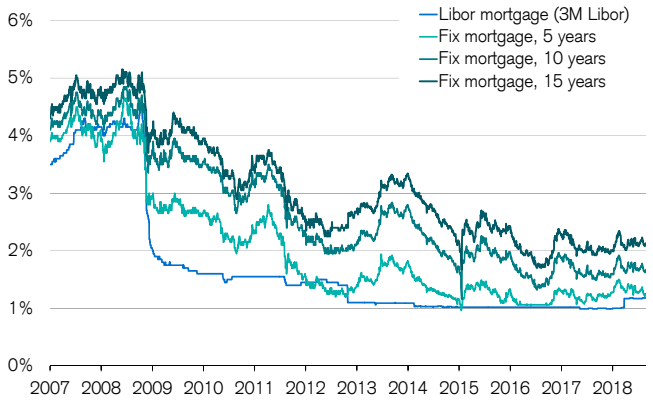
Owner-occupied housing

Mortgage rates still at rock bottom

Interest rates for Fix mortgages have rebounded since their lows in summer 2016 by up to 42 basis points, depending upon the term. However, in historical context, rates are still at a very low level. In the upcoming 12 months, we expect Libor mortgages to remain in a sideways trend. Rates for Fix mortgages with medium and long terms, in contrast, should climb another 20 to 50 basis points. As in the past, the gradual rise in interest rates will be punctuated with both upward and downward volatility, as was the case recently during political turmoil in Italy.

Figure 8: Mortgage rates for various terms

Mortgage rates for new loans, in %



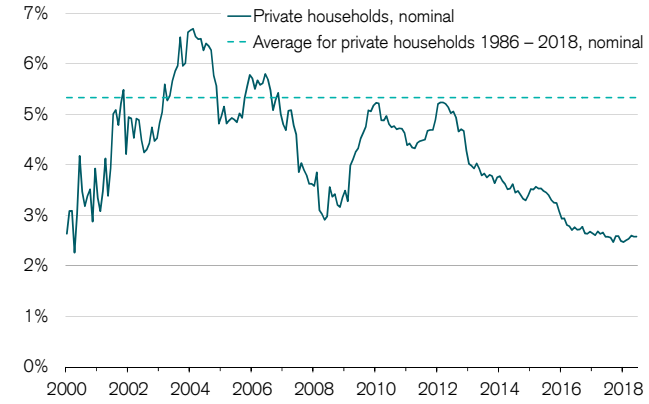
Source: Credit Suisse

Growth in mortgage volumes has stalled

Demand for owner-occupied housing continues to be tempered by the existing regulatory measures. Over the last year, growth in mortgage volumes for private households was only 2.58%, less than half the average growth rate since 1986 (+5.3%). Although strong economic growth and persistently modest mortgage rates continue to encourage the dream of homeownership, the higher financing requirements resulting from higher prices, and strict regulatory measures, act to restrict potential demand for owner-occupied housing.

Figure 9: Growth in mortgage volumes

Nominal growth in volumes of mortgages for private households



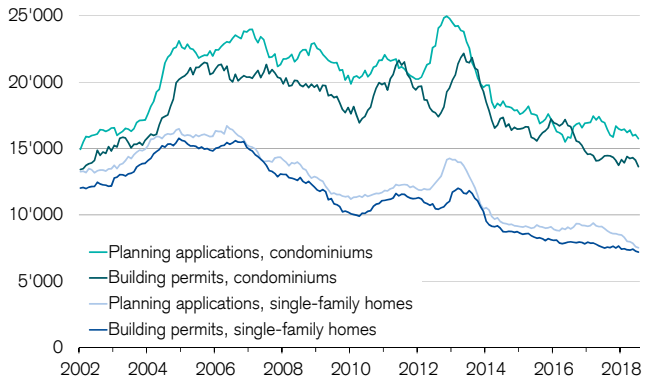
Source: SNB, Credit Suisse

Production of owner-occupied housing at a long-term low

Construction of owner-occupied housing continues to decline, and this is unlikely to change in the coming year. Over the last 12 months, only around 13'600 building permits for condominiums were approved. This corresponds to a 5.6% decline over the year. Since planning applications have also fallen (–7.1%), there is no end to the downward path in sight. The picture for single-family dwellings is similar: over the last 12 months, barely 7200 building permits were issued (–4.1%). In the same period, planning applications plunged 16.1%.

Figure 10: Construction of owner-occupied housing

Number of housing units, moving 12-month total



Source: Baublatt, Credit Suisse

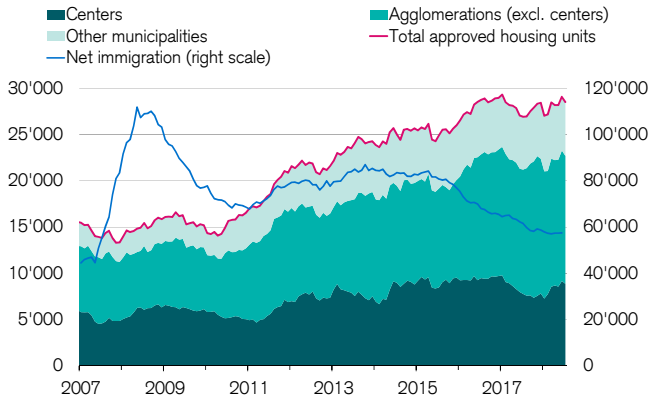
Rental apartments

Supply has decoupled from demand

In recent years, immigration has declined while construction activity has continued unabated, with the result that supply has decoupled from demand in the market for rental apartments. Around 29'000 housing units were approved for construction in the last 12 months. Compared to the average since 2007, there are currently far more rental apartments being approved in agglomerations (+67%) and other municipalities (+68%) than in the centers (+38%). Immigration, on the other hand, is gradually showing signs of stabilization: in the first half of 2018, the net number of immigrants from abroad was just 4.3% below the figure for the previous year's period.

Figure 11: Construction activity and net immigration from abroad

Approved housing units and net immigration; 12-month sum



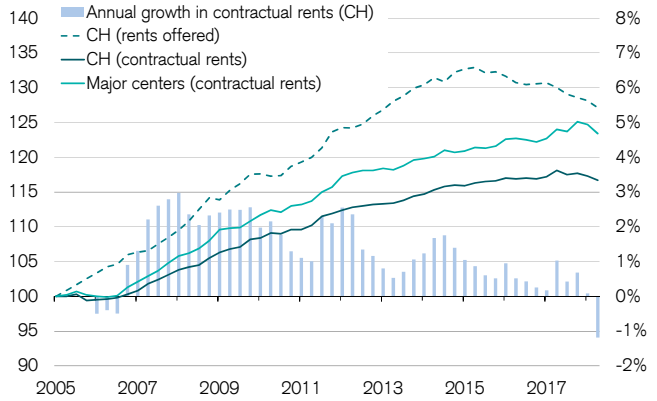
Source: Baublatt, State Secretariat for Migration, Credit Suisse

Downward pressure on rents intensifies

For some three years, we have observed declining rent prices in online advertisements for apartments – a result of the growing oversupply on the market for rental apartments. Meanwhile, the rental contracts actually signed also indicate falling rents. In the second quarter of 2018, contractual rents fell year-on-year (–1.2%) for the first time in nearly 12 years. Still, a tenant signing a rental agreement in Switzerland today must count on paying rent that is around 17% higher than in 2005, on average. In the major centers, the rise in rents is higher, at 23%.

Figure 12: Rental price trend

Contractual rents and rents offered, annual growth rates



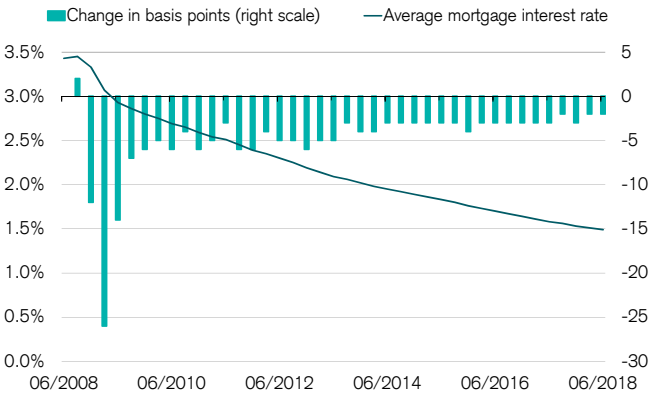
Source: Wüest Partner, Credit Suisse

Rise in reference rates far in the future

In June 2017, the Federal Housing Office announced a cut in the reference interest rate to 1.50%, since the relevant average mortgage rate had fallen below the 1.625% threshold. This average rate, which is calculated as the mean interest rate on all outstanding mortgages, has now dropped to a new low of 1.49%. Interest rates on new mortgages with a short to medium term are generally still below this figure. So the southward trend will likely persist for some time. An increase in the reference rate before 2021 is highly unlikely, even in the case of a first hike in key rates in the coming year.

Figure 13: Average mortgage rate

Average mortgage rate and its change over time



Source: Federal Housing Office, Credit Suisse

Decline in office vacancies

Vacant office and retail space has stagnated or decreased in most regions, with the exception of Canton Geneva. While the market for retail floor space market is still under pressure, the office market appears to be easing.

Regional differences in the inventory of vacant office space

The office market displays divergent trends depending on the geographical region. While vacancies in the two Basel cantons are stagnant at relatively high levels, they have fallen in the City of Bern by 13% and in Canton Vaud by 18%. We also expect a decline in Zurich. This is largely due to the healthy economy combined with a rise in demand for office space. There are gathering signs of stabilization in the referenced markets, and the office market should revive further in the coming quarters. Canton Geneva is an exception. There, office vacancies surged to 226'727 m² (+ 44%, figure 15). The strongest increases were registered in offices that have been without tenants for more than three years, and those that have been empty for just a few months. The constant expansion of office space creates risks for the Geneva market. In contrast to the overall Swiss market, the 12-month total of building permits in Canton Geneva is some 25% above its long-term average.

Investments in the office market remain attractive

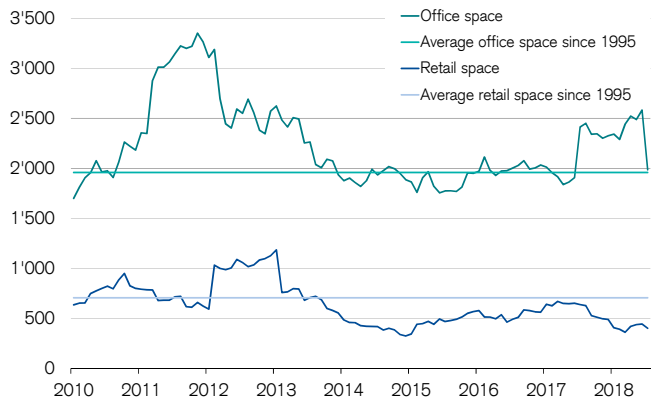
In an environment of persistently low interest rates, modest financing costs and limited investment alternatives, developing office space remains an attractive medium-term option. In July, the 12-month total of all approved new building projects in Switzerland was near the long-term average of CHF 2 billion (figure 14). The recovery in jobs growth (+2% year-on-year) after a lengthy phase of lethargy nourishes hopes that the registered vacancies can be reduced further despite the ongoing additions to the supply of floor space.

Unremitting pressure on the market for retail floor space despite falling vacancies

Similarly, the trend in retail vacancies is not uniform. Vacancies rose 12% in Canton Geneva and 1% in the City of Basel. On the other hand, vacancies fell 11% in the City of Bern and in Canton Basel Land, and an entire 28% in Canton Vaud. However, these figures gloss over the situation on the market for retail space. The major problems in many medium-sized centers are not visible in the statistics. Moreover, retail space that cannot be leased can be quickly re-purposed, and is then no longer reported as retail space. The problems in the market for retail space are reflected in low growth: the 12-month total for building permits for all retail space is reported at CHF 399 million, well below the long-term average (figure 14). As before, a majority of the planned space is located in mixed-use buildings, which combine residential and commercial space. They are a consequence of the brisk construction activity in the rental apartment segment.

Figure 14: Building permits for office and retail space

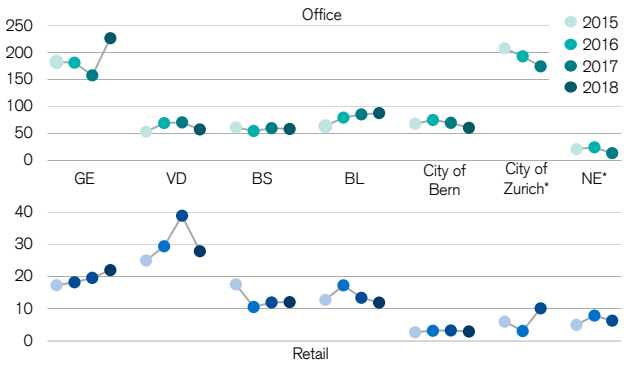
Construction value in CHF m, new build, moving 12-month total



Source: Baublatt, Credit Suisse

Figure 15: Trend in commercial vacancies

Empty office and retail space as of June 1, in thousand m²



* 2018 data not available as of publication deadline

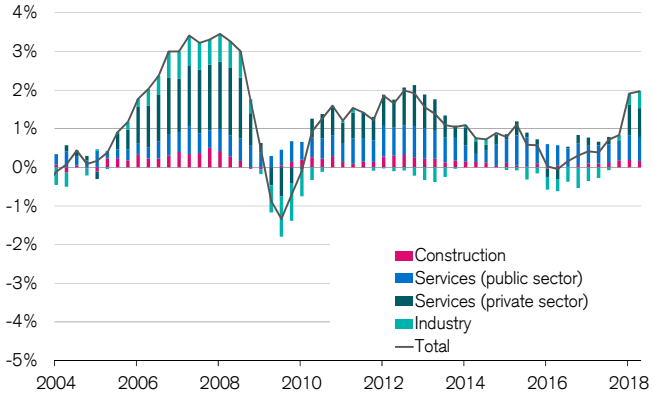
Source: Various statistical offices, Credit Suisse

Office property: Rising demand

Rising demand for office space is predominantly a result of the strong recovery in the Swiss economy. Capacity utilization in manufacturing is above the average level. Besides the recovery in the manufacturing industry, another factor that is stimulating additional demand for office space is increased employment in the IT sector and in corporate services. In contrast, the financial sector is still more likely to be vacating premises than seeking additional office space. The planned repatriation of banking jobs, especially in the IT department, nonetheless nourishes hopes that this trend will soon turn.

Figure 16: Employment trend

Annual change in number of employees, full-time basis, in %



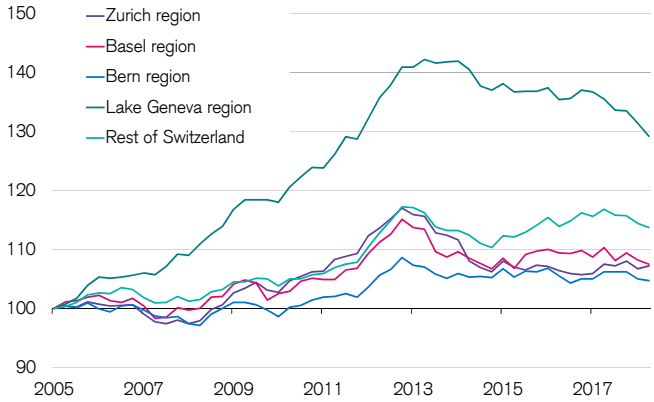
Source: Credit Suisse, SFSO

Office property: End of the decline in rent prices expected

After a short pause, rent prices have resumed a downward track in most regional markets. Only in the City of Zurich have rents registered a mild rise of 0.6% year-on-year. In the overall Zurich region (–0.3%) and in the regions around Basel (–2.5%) and Bern (–1.4%), all rents were declining. The correction was most severe with –8% in the City of Geneva. Rent prices in Geneva are likely to drop further given the sharp rise in vacancies and the high level of construction activity. In most regions, however, we expect the decline in rent prices to be over, thanks to a rebound in demand stimulus.

Figure 17: Office leases

Hedonic leasing price index in various regions: Q1 2005 = 100



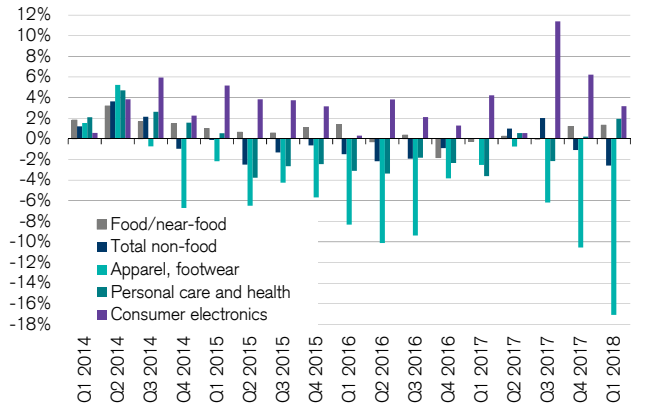
Source: Wüest Partner

Retail property: Negative sales trend in non-food

Retail sales in the food/near-food segment were 1.3% higher than the previous year's figure in the first quarter of 2018. The food/near-food segment is relatively stable compared to the non-food segment. Turnover in non-food fell by 2.6% overall, with a particularly steep drop in sales in the apparel segment. The structural shift from bricks-and-mortar shops to online trade is a particular issue in this segment, which, combined with persistent "shopping tourism", results in lost sales and lower demand for retail space from Swiss retailers.

Figure 18: Retail sales

Real sales by product group, change compared to previous year's quarter, in %



Source: GfK, SFSO, Credit Suisse

More than a niche

Online trade, urbanization and digitalization are currently impacting the logistics business and stimulating large-scale investments in real estate. From an investor's perspective, logistics objects not only offer attractive returns, they also contribute to portfolio diversification.

Logistics is a significant sector of the Swiss economy

The flow of goods around the world is rapidly increasing in the wake of globalization, which boosts the logistics business across the continents. Although Switzerland's high wages and the cost of land prevent it from being an international logistics hub, the local logistics sector handles a significant flow of goods. Export volumes have risen steadily since 1990 to more than 20 million tons, while import volumes have increased to over 51 million tons. According to GS1 Switzerland, the Swiss logistics market has a total volume of around CHF 40 billion. This makes the business a significant sector of the Swiss economy.

Online trade boosts logistics business

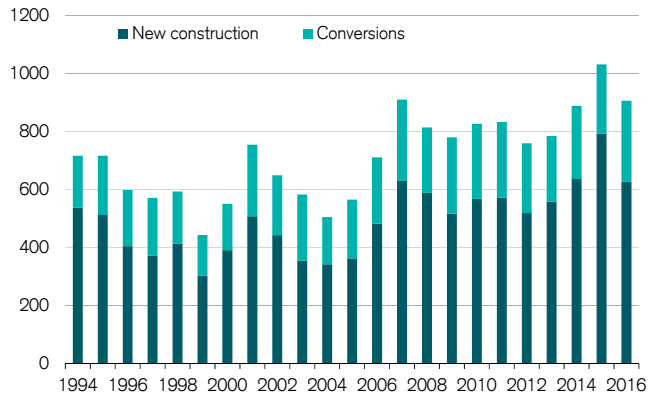
The logistics economy is currently undergoing drastic change. In the process, the greatest influence is the steadily increasing volume of online trade. In online trade, shoppers prefer the provider that offers the simplest and fastest delivery. This preference has elevated logistics from a pure delivery function to a strategically significant service. Online trading volumes in Switzerland have risen by 8.7% annually over the last three years to nearly CHF 9 billion in 2017. A boost in deliveries of small items, taking over delivery along the last mile, and new tasks, such as returns processing, all contribute to a greater need for logistics services. In order to meet these needs, logistics providers and dealers are investing continually in their transport networks and logistics warehouses.

Dynamic trend in construction activity

Over the last 20 years, an average of around CHF 0.7 billion has been invested in logistics properties (new construction and conversions) across Switzerland each year (figure 19). Compared to office space (CHF 3.0 billion) and retail floor space (CHF 1.6 billion), logistics real estate is just a niche market. Nonetheless, construction investments in warehouses and depots surpassed CHF 1 billion for the first time in 2015. In terms of location, current projects tend to focus on urban agglomerations and highway junctions (figure 20). In addition to factors that are specific to particular buildings, such as sufficient floor load-carrying capacity and hall height, the proximity to conurbations and transport infrastructure are the decisive locational factors for logistics real estate. The most important investors here are wholesalers and retailers, as well as the logistics and transport sectors. In contrast to, say, Germany, the USA or the UK, Switzerland does not yet have its own development market for logistics real estate.

Figure 19: Rising construction investment in logistics real estate

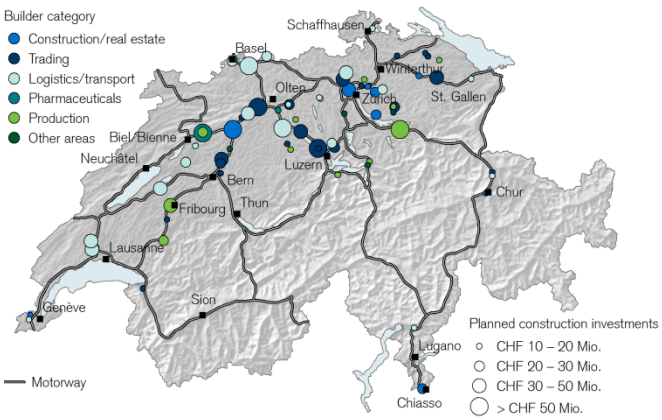
Construction investments in warehouse and depots, 1994 – 2016, in CHF million



Source: SFSO, Credit Suisse

Figure 20: Focus on conurbations and highway junctions

Planning applications for large-scale logistics and warehousing projects, 2013 – 2018



Source: Baublatt, Credit Suisse, Geostat

Attractive yield level, but limited market liquidity

However, logistics properties are gradually attracting the attention of investors in Switzerland too. The high demand for real estate investments that is spurred by low interest rates is exerting pressure on initial yields and cash flow yields in all segments. Purchases of higher-yielding logistics space can counteract falling cash flow yields and enhance portfolio diversification. This is a particularly interesting option for larger real estate portfolios that are oriented towards commercial space, as well as for investors with a longer-term horizon. According to the MSCI index for Swiss real estate, net cash flow yields on commercial and logistics space have been systematically higher – usually by more than 100 basis points – than those on residential, office or retail space for the last 15 years (figure 21). At the same time, investors must accept certain disadvantages, such as limited market liquidity, exacting user-specific demands from tenants, and the necessity of having extensive market knowledge and a long-term investment horizon.

An ideal diversification tool

One recurring argument in support of investing in logistics real estate is its contribution to portfolio diversification. Individual segments of the real estate market are often in different stages of the real estate cycle, since they respond to different drivers. The cyclical drivers most relevant for the logistics market are the developments in exports, consumption, and the overall economy. In the past, total yields for office space have had very little correlation with commercial and logistics space (correlation coefficient: –0.14), while the correlation between the latter and residential space was actually quite negative (–0.51). In this case, some different cyclical drivers are at work than those for logistics space, such as population growth and jobs growth.

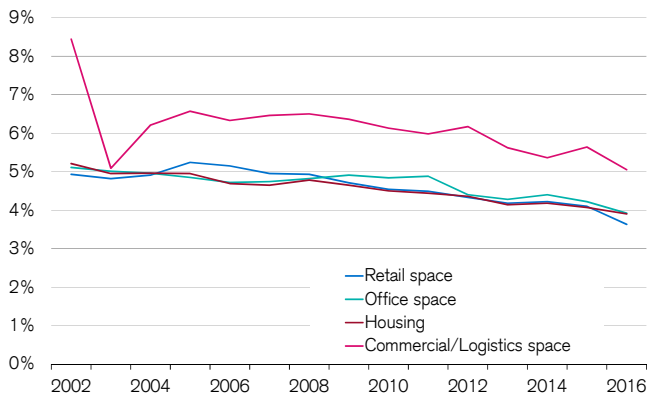
One person's sorrow is another's joy

The cyclical drivers for retail space, on the other hand, are similar to those for logistics space. So the correlation between total yields for logistics and those for retail space was relatively strong for many years. However, while total yields for retail space have been losing ground since 2012, those for logistics space have been in a clear uptrend since 2014. Here, a significant new structural driver entered the picture: online trade has expanded sharply in recent years, exerting pressure on yields for stationary retail floor space, while logistics space has profited from the shift in trade towards online channels (figure 22). On balance, these observations suggest that logistics space can make an important contribution to risk diversification in a real estate portfolio. In past years, this contribution has become even greater since the performance of logistics space has decoupled from that of retail space.

This article is based on the "Logistics Real Estate Report 2018", available at www.credit-suisse.com/realestate.

Figure 21: High cash flow yields on logistics real estate

Net cash flow yields according to the MSCI index Real Estate Switzerland

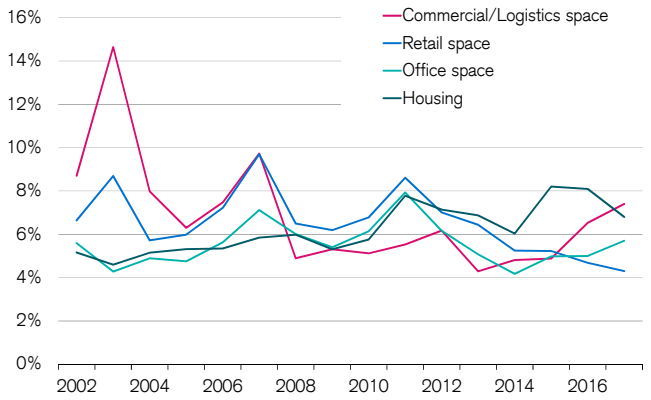


Past performance is no guarantee of future returns. Performance may be affected by provisions, fees and other costs, and exchange rate fluctuations.

Source: Bloomberg, MSCI, Credit Suisse

Figure 22: Decoupling of logistics yields and retail yields

Total return according to the MSCI index Real Estate Switzerland



Past performance is no guarantee of future returns. Performance may be affected by provisions, fees and other costs, and exchange rate fluctuations.

Source: Bloomberg, MSCI, Credit Suisse

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