CREDIT SUISSE

INVESTMENT SOLUTIONS & PRODUCTS
Swiss Economics

Real Estate Monitor Switzerland

Q2 2018

Movement on the mortgage market

Mortgage volumes
Decelerating momentum

Page 5

Mortgage loans
Spoiled for choice

Page 9

Rental apartments
Neither one nor the other

Page 12

Impressum

Publisher
Burkhard Varnholt
Vice Chairman IS&P
+41 44 333 67 63
burkhard.varnholt@credit-suisse.com

Fredy Hasenmaile
Head Real Estate Economics
Tel. +41 44 333 89 17
E-Mail: fredy.hasenmaile@credit-suisse.com

Copy deadline
24 May 2018

Publication series
Swiss Issues Immobilien

Visit our website at
www.credit-suisse.com/immobilien

Authors

Fredy Hasenmaile
+41 44 333 89 17
fredy.hasenmaile@credit-suisse.com

Thomas Rieder
+41 44 332 09 72
thomas.rieder@credit-suisse.com

Dr. Fabian Waltert
+41 44 333 25 57
fabian.waltert@credit-suisse.com

Brice Hoffer

Editorial

Dear readers

Change is the only constant. The Greek philosopher Heraclitus expounded on this in ancient times. But it is increasingly also true for the real estate and mortgage markets, where digitalization is providing fresh impetus. Nearly two dozen providers now have mortgage products that can be processed partially or wholly online. Applications of digital technologies are also shaking up the structure of the mortgage market. More and more, individual credit processing steps are being unbundled, making them easier to outsource. This creates market potential for both new and established providers. After all, thanks to the era of low interest rates, mortgages have also become interesting for investors, who may not possess the necessary processing capacities and would prefer to use those of a third party. At the same time, stricter bank regulations mean that established mortgage lenders are aiming to reduce their balance sheets, and seeking third-party investors (page 7).

Change is also affecting the factor with the greatest impact on the mortgage market, namely interest rates. The phase of ultra-low interest rates is drawing to a close. This raises the question: what is the optimal hedging strategy? Since this question can only be addressed in a close examination of each mortgage borrower's individual financial situation, there is no across-the-board answer. Nonetheless, there are guides to help determine the right individual strategy. One such aid is a comparison of long-term Fix mortgages with a hypothetical trend in money-market mortgages, that would ensure that both variants generate the same interest costs. Given this specific interest-rate development for money-market mortgages, borrowers can easily determine whether they anticipate higher interest rates and would thus be better off with hedging (page 9).

Although – or perhaps precisely because – the long phase of falling interest rates is ending, real estate continues to be in high demand. This applies specifically to the year 2018. The necessity of finding alternatives to bond investments, which barely yield a positive return in the current environment, should be most acute this year. Accordingly, we expect demand for real estate to remain high, despite the advanced stage of the property market cycle, and we foresee ongoing growth in prices as well as brisk construction activity. This development results in rising vacancies and a need to align the supply as closely as possible to demand. Our analysis of the three-room apartments currently under development (page 12) reveals that this process is not always optimal, and that it makes little sense to blindly copy the behavior of other investors.

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

Fredy Hasenmaile
Head Real Estate Economics

Contents

Mortgage volumes

Decelerating momentum

Switzerland has one of the world's highest debt ratios for private households. It is particularly worrisome that the figure is continuously increasing. Lately, however, the growth rate of the debt ratio has been below average.

Swiss households with highest levels of debt

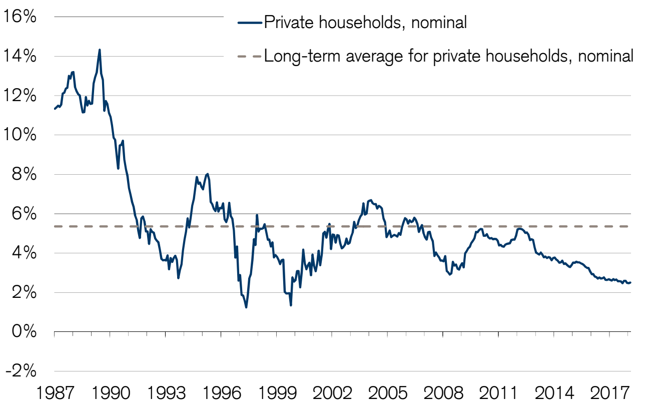
The level of debt carried by Swiss households has been a concern for some time now. In an international comparison of gross household debt relative to gross domestic product (GDP), Switzerland regularly tops the rankings – along with Australia, Canada, Norway and Sweden. In all of these countries, mortgage debt, which makes up 75%–97% of total private household debt, is responsible for this situation. So a certain amount of apprehension is justified. International analysis shows that long phases of unusually generous bank lending are often followed by major crises. A high level of indebtedness increases an economy's vulnerability to market distortions such as stress in the banking system or a severe collapse in consumption. Switzerland had its own uncomfortable experience with a real estate and banking crisis in the 1990s. Borrowing is generally conducive to long-term GDP growth, but only up to a certain level of debt, after which the relationship inverts.[1] With a total mortgage debt ratio corresponding to 146% of GDP, Switzerland is already well beyond that threshold.

Growth in mortgage volumes has leveled off

The steep growth in mortgage debt has to do with certain characteristics of the Swiss market. These include high prices for real estate, the great significance of the rental apartment market, half of which is owned by private individuals, as well as the local tax system, which provides incentives for indebtedness. When the owner-occupied housing market threatened to overheat between 2010 and 2012, politicians reacted by tightening regulation. The federal regulator FINMA raised capital adequacy requirements and the Swiss National Bank introduced an anti-cyclical capital buffer. Another particularly effective brake on growth in mortgage borrowing was the intensification of self-regulation by the banks. The self-regulation measures that were introduced in summer 2012 and heightened in autumn 2014 tangibly reduced the number of households that could overcome the financing hurdles for homeownership. Since then, annual growth in mortgage volumes for private households (cf. Fig. 1) has halved from more than 5% at the beginning of 2012 to 2.57% by the end of 2017.

Fig. 1: Weak growth in mortgage volumes

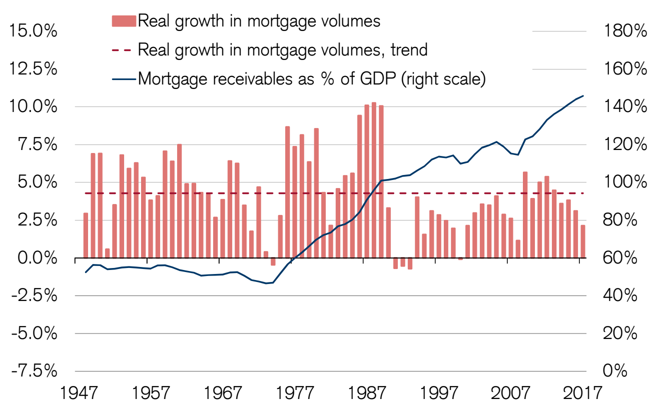
Nominal growth in mortgage volumes for private households



Source: Swiss National Bank (SNB), Credit Suisse

Fig. 2: Growth in mortgages well under trend

Real growth in mortgage volumes (private and corporate) and debt ratio as % of GDP



Source: Credit Suisse, SNB

[1] See research by Cecchetti and Kharroubi (2012), Arcand et al (2015) and the International Monetary Fund (2017)

This puts nominal growth in mortgage volumes well below the long-term average of 5.36% since 1987. Growth has decelerated due to not only higher capital requirements, but also the tougher amortization guidelines, which aim for a more rapid reduction in the loan-to-value ratio to two-thirds of the collateral value.

CHF 1 trillion in mortgage debt by the end of 2018

In addition to mortgage volumes for private individuals, there are also those for companies, although these make up just one quarter of all outstanding mortgages. In total, the mortgage volumes on banks' books are likely to exceed CHF 1 trillion by the end of 2018. Despite the reduced momentum in mortgages, the debt ratio, which compares mortgage debt to domestic value creation as measured by GDP, has continued to rise. In some circles, this fact has been repeatedly criticized, with reference to the above-mentioned risks. However, it is no new phenomenon for mortgage volumes to outpace value creation as measured by GDP – this has been the case since 1975 (cf. Fig. 2). In the meantime, mortgages as a percentage of GDP have risen continuously, from 47% to 146%. Determining the level where the debt ratio is still unproblematic and where it tips to become threatening is no simple task. For example, in Switzerland, unlike the other countries with high levels of private household debt, most mortgages have fixed interest rates, which considerably reduces exposure to interest-rate risk.

Debt ratio now increasing at a below-average rate

One possibly relevant measure is trend growth. From an absolute perspective, growth in mortgage volumes is well below the long-term average in both nominal (cf. Fig. 1) and real terms (cf. Fig. 2). Absent some context with economic activity, however, the absolute growth rates are not particularly meaningful. This is why it's worth taking a look at the debt ratio. It has also been in a rising trend since the mid-1970s: each year, the debt ratio has increased by an average of 2.3 percentage points. Contrary to expectations, the rise in the debt ratio in recent years has exceeded this long-term average, despite reduced growth in mortgage volumes. This was a by-product of weak economic development. Last year was the first time trend growth in the debt ratio slipped back below the average. This is likely to be the case more often in the future, since the gradual return to increasing mortgage rates is likely to be a serious brake on growth in mortgage volumes and thus aid in limiting the danger of an explosion in credit volumes.

Mortgage market

Digitalization provides fresh impetus

Mortgage lending in Switzerland remains largely in the hands of banks. However, digitalization and the environment of negative interest rates have produced a growing number of new and innovative market players in recent years.

Banks dominate mortgage lending

Traditionally, mortgage credit in Switzerland is handled mainly by banks. At the end of 2017, Swiss banks had outstanding mortgage volumes of CHF 973.9 billion. But insurance companies and pension funds are also active in this market. With respective volumes of CHF 36.7 billion (insurance companies, as at 2016) and CHF 14.4 billion (pension funds, as at 2016), however, these are only niche players compared to banks, with market share of just 5.1% at the end of 2016.

Insurers and pension funds are niche players

There are various factors responsible for the low profile of insurance companies and pension funds in this business. One is that issuing mortgages involves a great deal of administrative effort, for example in risk assessment and processing. For many years, issuing mortgages was not an attractive business below a certain minimum amount, especially for smaller and mid-sized pension funds. Only in the recent environment of low interest rates have insurance companies and pension funds rediscovered the mortgage market, from which they had steadily distanced themselves in the past. In the hunt for yield, investors increasingly appreciate mortgages as an attractive alternative to bonds. While insurance companies had already jumped on the band wagon in 2014 (cf. Fig. 3), it took pension funds a little longer. Currently, both types of niche providers are reporting significantly higher growth rates than the banks.

Digitalization reaches the mortgage business

Over the last few years, digitalization has brought fresh impetus to the Swiss mortgage market. For one thing, traditional providers began to digitalize their processes, allowing for faster and more efficient progress along the entire mortgage chain. In addition, digital transparency meant that customer segments outside the usual market could suddenly be reached. Accordingly, competition among traditional providers has risen. At the same time, the advance of digitalization opens doors for new players in the market, which is particularly evident in the fast-growing brokerage business. Besides traditional brokers, such as architects and real-estate promoters, there are now digital platforms that serve the same purpose. Some of these come from existing providers, such as online real-estate marketplaces or associations, but some are young, innovative start-ups. The result: a rapid increase in online mortgage volumes to CHF 4 billion last year (as estimated by the Institute of Financial Services Zug IFZ of the Lucerne University of Applied Sciences and Arts, cf. Fig. 4), as well as forced greater transparency among the established providers, that are more likely to collaborate with, and in some cases, acquire a stake in, such brokers today. However, new providers do not only concentrate on brokerage, but find their way into new niches too. One example is crowd-lending, where many (small) investors take on the role of lender; another is brokering secondary mortgages in a peer-to-peer approach.

Traditional providers also enter the brokerage business

Given the advance of digitalization and the intensifying competition, established providers are under growing pressure to optimize and expand their business models. As a result, even traditional providers are acting as brokers, for example by bundling mortgage receivables and selling them to third parties. Pfandbrief instruments have provided this type of securitization for decades. In recent years, however, larger banks have begun approaching investors directly. Along the lines of a division of labor, they offer their processing competences to third parties and connect owners of investment properties directly with investors. This development has been encouraged by the stricter liquidity and equity regulations forcing banks to offload credit volumes from their balance sheets and develop new business models.

New investment vehicles with specialized providers

Given the increased broker activities and as a result of heightened investor interest in mortgages, new offers have emerged such as investment vehicles with mortgage loans. Besides traditional mortgage providers, who bring their extensive know-how in risk assessment, object valuation, and processing, there are also new players in the market, who offer outsourcing services. Today, there are already providers who allow investors such as mid-sized pension funds to offer mortgages themselves through "white labeling". However, the entire lending process is handled by the specialized broker, who remains in the background. So the process of issuing mortgages is likely to become even more standardized and automated in the future – with the goal of being able to detach the entire process chain quickly and simply as required.

Opportunities and risks when unbundling traditional mortgage services

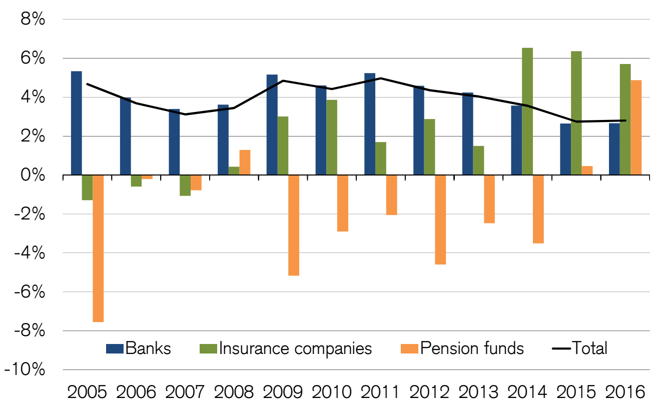
This development presents both opportunities and risks to traditional mortgage providers. On the one hand, they have well established teams and processes so that they can efficiently offer services such as risk management and administration. This makes it attractive for traditional players to complement their range of services with such "white labeling" opportunities. However, in this constellation, Corporate Governance must exercise particular prudence, so that misguided incentives do not arise. This applies to both traditional as well as pure outsourcing service providers. For example, it is intended that investors themselves will be able to select mortgages from a pool, or that the bank will continue to participate in the credit risk by having its own tranche. On the other hand, the current developments heighten the risk of greater competitive pressure. If the division of labor in mortgage processing continues, competition in the individual process steps is likely to increase. This is because the barriers to entry are considerably lower for individual process steps than they are for the entire process chain from advisory services to risk assessment to refinancing. Moreover, there is a risk for new providers that many investors may turn to other asset classes once mortgage rates rise in a lasting way. Then it will be evident which of these new ideas and products will succeed over the long term.

Regulation makes for stable markets

The changing credit environment also raises regulatory questions. Over the last few years, close discussions with regulator FINMA have resulted in banks agreeing to strict self-regulation. One objective of this move is to prevent speculative exaggeration with its far-reaching consequences, such as those observed in the USA during the sub-prime crisis. As an increasing number of providers emerge, the question arises whether and in what form the new players will have to adopt the existing self-regulatory measures.

Fig. 3: Niche players make a comeback

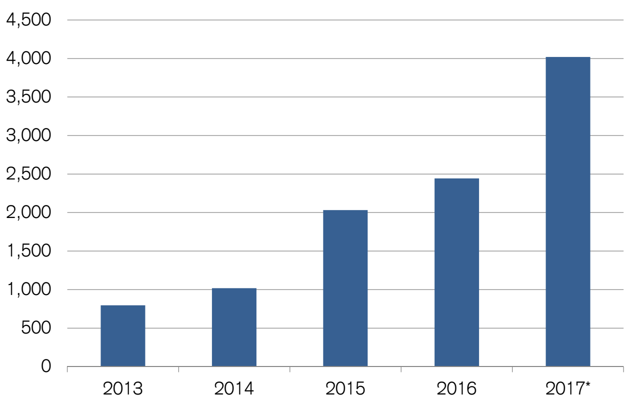
Nominal growth in mortgage volumes with the major provider groups



Source: SNB, Swiss Financial Market Supervisory Authority FINMA, Swiss Federal Statistical Office (SFSO), Credit Suisse

Fig. 4: Online mortgage volumes, 2013–2017

Volumes in CHF m (*2017: estimate)



Source: e-foresight, Institute of Financial Services Zug IFZ

Mortgage loans

Spoiled for choice

Now that mortgage rates have begun to inch upwards again, mortgage borrowers should be thinking proactively about their interest-rate strategy. Besides financial considerations, personal needs and preferences play a decisive role.

First increase in benchmark rates indicated for 2019

The Swiss economy is humming along again. We forecast economic growth of 2.2% for the full year. The most important growth driver is the dynamic world economy. Moreover, the softening of the Swiss franc against the euro has provided a substantial tailwind for Swiss companies. And inflation has been benign so far too. Long term though, the Swiss National Bank expects inflation to rise above its target, suggesting that tighter monetary policy is ahead. As long as the economic situation in the euro area does not deteriorate unexpectedly, we forecast an initial increase in Swiss benchmark rates from –0.75% to –0.50% in March 2019.

Fix mortgages are already rising

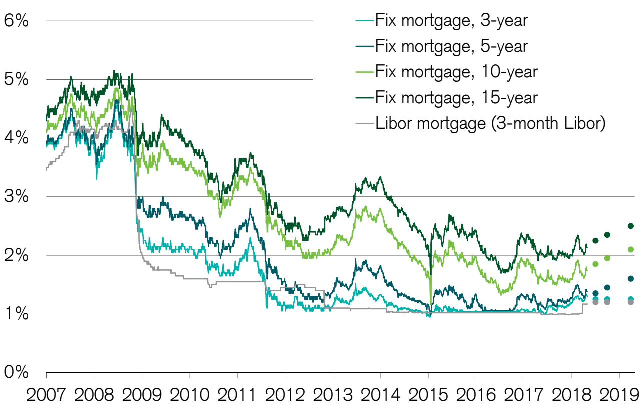
Since the Libor rate will stay in negative terrain after an increase of this size, interest rates on Flex-rollover mortgages are unlikely to rise in the next 12 months, but should stay at their ultra-low levels. In contrast, we expect interest rates on Fix mortgages with medium and long maturities to rise by another 30–50 basis points in total over the next 12 months (cf. Fig. 5). As in the past, the further track will be marked with both upward and downward volatility.

Financially, Fix mortgages are rarely cheaper than Libor mortgages

Even if interest rates on Fix mortgages stay low in historical context, despite a rising trend, mortgage borrowers should take time to consider whether a Libor mortgage or a Fix mortgage makes more sense in the years ahead. A historical comparison shows that with few exceptions, Fix mortgages are more expensive than Libor mortgages over the entire term of the loan. For example, a 5-year Fix mortgage was only cheaper than a Libor mortgage between 1986 and the end of 1989, and again briefly in 2004 and 2005 (cf. Fig. 6). A 10-year Fix mortgage would also have been the better choice at the end of the 1980s though not in 2004 and 2005. So from a purely financial perspective, a Fix mortgage only makes sense at a few particular times, and even then the right maturity must be selected.

Fig. 5: First increase in benchmark rates indicated for 2019

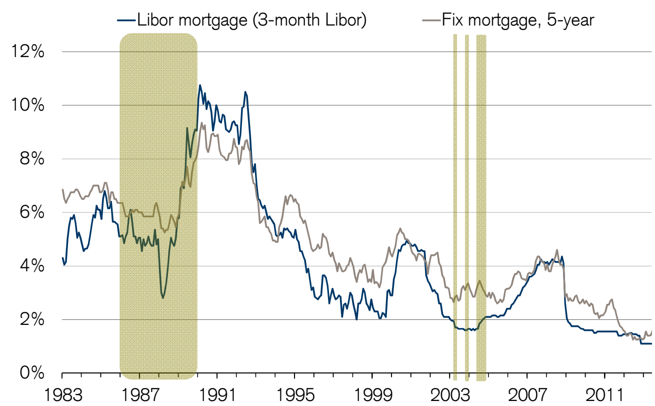
Mortgage rates with forecasts (Q2 2018) for three, six and 12 months



Source: Credit Suisse

Fig. 6: Libor mortgages are usually cheaper

Periods in which a 5-year Fix mortgage was cheaper than a Libor mortgage over its entire term



Source: Credit Suisse, Datastream

Fix mortgages can act like insurance

Nonetheless, there is some justification for Fix mortgages. The trend at the end of the 1980s illustrates this amply. Borrowers with a variable-rate mortgage, at that time the most common product, were confronted with a rapid and massive increase in interest rates of nearly 8%. So variable and Libor mortgages always come with the risk of substantial volatility in interest rates. Not every borrower wants to, or can, financially handle such sudden and sharp increases, to say nothing of the nerve-wracking stress that such a burden brings with it. In this respect, Fix mortgages can act like a kind of insurance, offering protection from financial stress in exchange for a premium.

Does a Fix mortgage make sense today?

Today's situation, in which the premium for a 10-year hedge is historically low, it could certainly make sense to switch temporarily into a Fix mortgage. As part of a break-even analysis, we observed to what extent Libor mortgage rates would have to rise in order to make a Fix mortgage with a term of ten years the cheaper financial option (cf. Fig. 7). If Libor mortgages rise earlier or higher, or fall later, than depicted in the chart below (indicating a stronger economic recovery and/or higher inflation), choosing a 10-year Fix mortgage would be the better strategy. In contrast, if Libor mortgages increase later or slower, or fall earlier, than depicted in the chart (indicating a weaker economic recovery and/or inflation), then a Libor mortgage would be the better choice over the next ten years. Depending on their own assessment of interest-rate developments, mortgage borrowers can decide for themselves, based on this comparison, which strategy is best suited to their needs.

If opting for a product change, don't wait too long

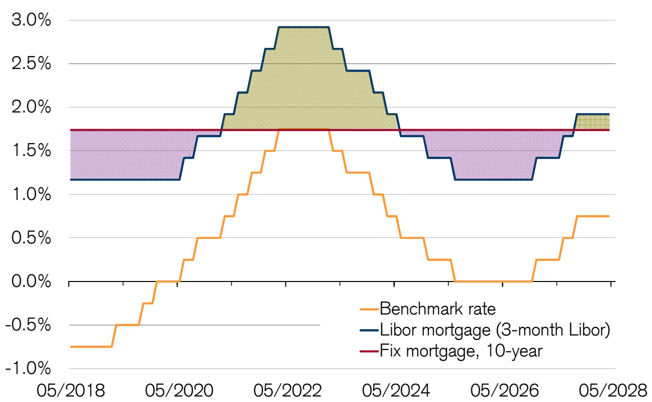
In the current environment, any switch into a Fix mortgage should not be postponed too far into the future. Interest rates on Libor mortgages should remain at their very low levels for some time to come, because only when benchmark rates break above zero will this work through to higher rates on Libor mortgages. Meanwhile, however, interest rates on Fix mortgages will continue to rise (cf. Fig. 8). At the beginning of May 2018, the difference between a Libor mortgage (3-month Libor) and a 10-year Fix mortgage was just 0.57 percentage points, very low from a historical perspective. Our current forecasts suggest that this spread will widen to 0.93 percentage points by April 2019. If Libor mortgages subsequently rise, as our scenario suggests they will in spring 2020, the spread to 10-year Fix mortgages would widen further to 1.43 percentage points. So if borrowers wait too long to change products, the risk increases that the original savings from staying in a Libor mortgage will be wiped out by the following higher interest rate on Fix mortgages.

The optimal combination of security and flexibility

Since the choice of a mortgage depends not only upon financial aspects, but also upon the borrower's specific personal needs and preferences, it is vital to review these personal requirements and needs with a mortgage specialist. In the current environment, and given the uncertainties surrounding the future course of interest rates, it makes sense to combine various mortgages and terms in order to optimize the mix of security and flexibility.

Fig. 7: Many reasons to choose a fix mortgage at present

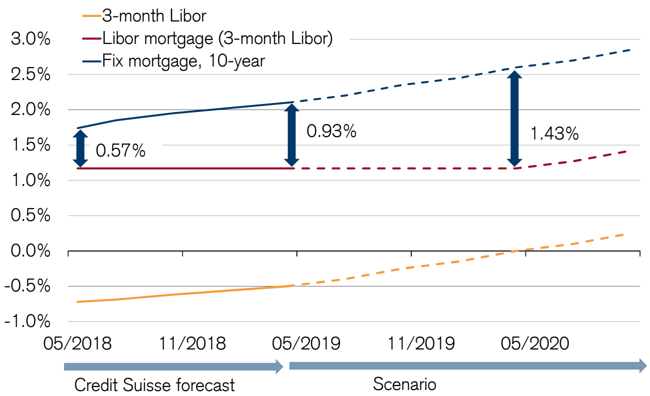
Break-even scenario, in which the cost of a Libor mortgage is equal to that of a newly signed 10-year Fix mortgage



Source: Credit Suisse

Fig. 8: Planning a switch to Fix? Don't wait too long

Spread 10-year Fix mortgage to Libor mortgage; 05/2018 – 04/2019: Credit Suisse forecast; from May 2019: scenario



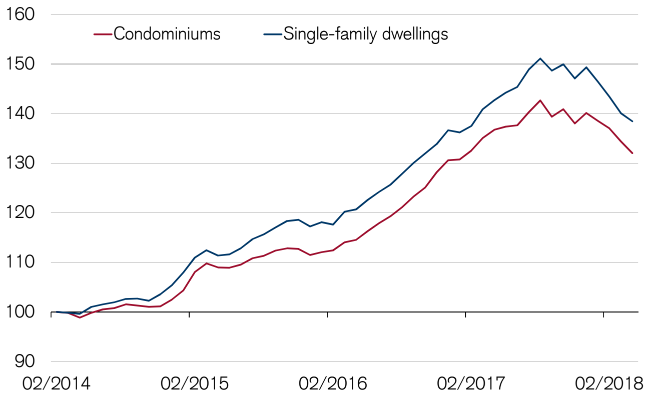
Source: Credit Suisse

Owner-occupied housing

Demand somewhat cooler but still high

Demand for condominiums and single-family dwellings has leveled off since the beginning of the year. This is probably due to the gradual rise in interest rates on Fix mortgages as well as the recent increase in prices for owner-occupied housing. Higher prices narrow the field of potential buyers due to the tougher imputed financing requirements. Compared to previous years, however, demand remains at a high level. Thanks to economic acceleration and mortgage rates that are still very low in a historical context, demand should remain strong over the course of the year.

Fig. 9: Demand index for owner-occupied housing
Index, February 2014 = 100

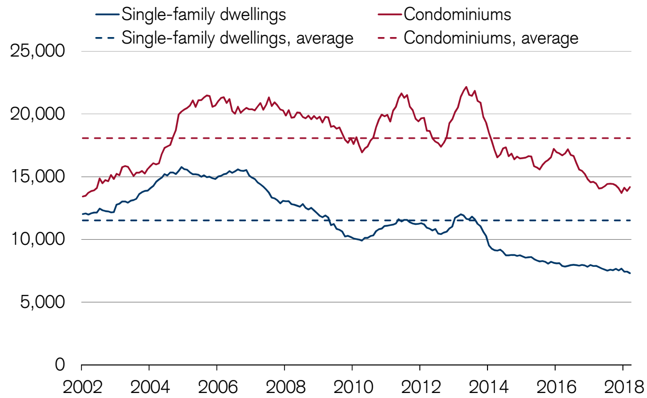


Source: Realmatch360

Project pipeline remains sparse

The number of building permits issued for owner-occupied housing units has fallen further year-on-year. Over the last 12 months, permits to build nearly 14'200 condominiums (–2.0%) and 7300 single-family homes (–7.4%) were issued. In both segments, the increase in the supply has been well below the average since 2002. For condominiums, at least, the number of building permits has stabilized over the last half year. Nonetheless, this is unlikely to work through to the number of finished objects before 2019. Hence the supply of new condominiums remains below current potential demand.

Fig. 10: Building permits for owner-occupied housing
Building permits in number of units, moving 12-month sum

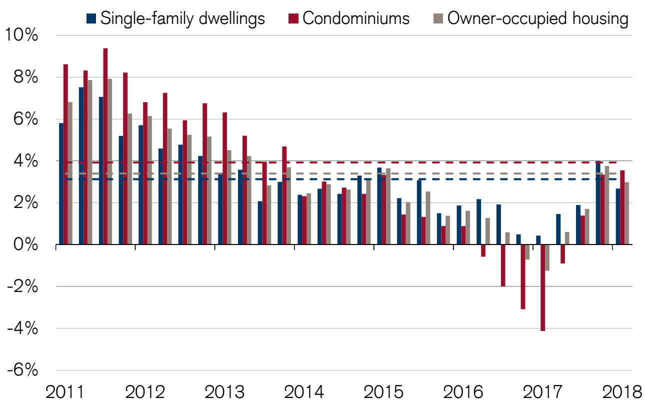


Source: Baublatt, Credit Suisse

Solid growth in prices for owner-occupied housing

Prices for owner-occupied housing stagnated in the first quarter of 2018. Compared to the previous year's quarter, however, they show a solid plus of 3.6% for condominiums and 2.7% for single-family dwellings. The revived price momentum thus remains below the average rate of price growth since 2000. Prices rose most sharply around Zurich as well as in the catchment areas of Lucerne, Basel, Bern and Lausanne. Thanks to healthy economic conditions, ongoing low mortgage rates and a decline in new building activity, we expect prices to continue to head north in the coming quarters. Nonetheless, the pace is likely to be somewhat slower than in the recent past.

Fig. 11: Price trend for owner-occupied housing
Annual growth rates; dotted lines: average 2000 – 2017 p. a.



Source: Wüest Partner, Credit Suisse

Rental apartments

Neither one nor the other

Smaller apartments are the focus of investor interest. In particular, apartments with three rooms are favored by planners and developers. However, the apartment size that is widely considered the golden mean may not be the perfect solution after all.

Rental difficulties force re-assessment

Once, there was eager demand for whatever was built in the rental apartment market; those days are gone. Rising vacancies testify to a growing oversupply. So investors are making efforts to better align the supply of apartments to the market and current tenant needs. Given the generally acknowledged trend towards smaller households, investors had shifted their focus to smaller apartments, as evidenced in a construction emphasis on two- and three-room apartments (cf. Fig. 13). Since 2013, the number of smaller housing units brought to market has increased steadily, and accelerated further in 2015. Most investors lack the courage to deliberately break away from established patterns and reconsider the current focus on three- and four-room apartments. However, since they still want to offer smaller apartments, they are increasingly concentrating on three-room flats since this appears to be a good compromise.

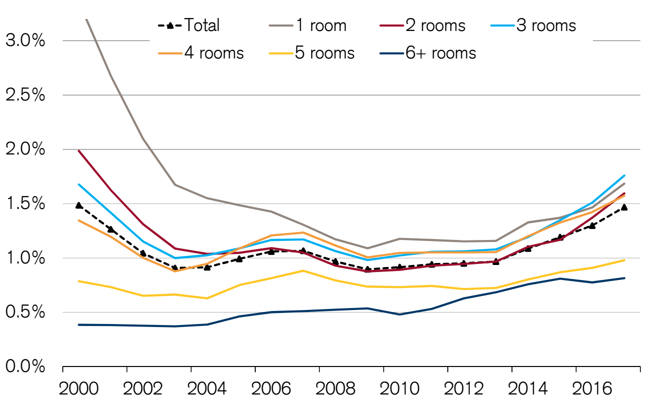
Three rooms – the most common apartment size

As production of rental apartments remains at a very high level, there are many three-room flats currently under construction. In purely numerical terms, the three-room has overtaken the four-room as the most-produced apartment size. More than 30% of new objects are currently three-room flats. However, this may be near the limit. in the belief that three-room apartments can meet the needs of small households as well as households of several persons, many planners and developers began to orient their projects towards this apartment size.

Neither fish nor fowl

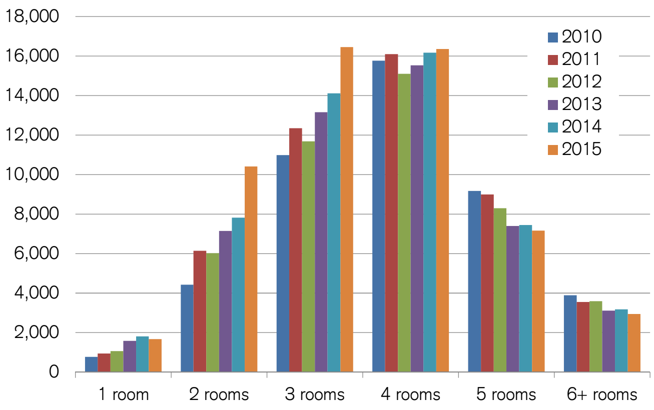
But is an apartment with three rooms really the ideal solution? Isn't it rather the case that this apartment size does not meet the needs of a family seeking a roomy home, nor the desire of a young couple to rent a flat for the most affordable price? Wouldn't a mix of two- and four-room apartments be a better alternative? Or perhaps a strict focus on small apartments with one and two rooms in the major agglomerations? After all, for a family with two children, a three-room apartment is generally one room too small, and for small households, such a flat is often too expensive, especially in urban areas where prices are high.

Fig. 12: Highest vacancies reported in three-room flats
Vacancy rates by number of rooms (rented and owned)



Source: SFSO, Credit Suisse

Fig. 13: Construction activity shifts to small apartments
Net increase by number of rooms, 2010 – 2015



Source: SFSO, Credit Suisse

When considering how many three-room apartments may be needed, developers seem to be consistently over-estimating the market's absorptive capacity. Three-room flats are not moving as well on the rental market as one could wish. Not only are vacancies highest for this category, they are also increasing most rapidly (cf. Fig. 12).

Highest vacancies in three-room apartments

In 2016, apartments with three rooms already had the highest vacancy rate. Last year, the vacancy rate rose to 1.76%, further widening the gap to the average vacancy rate for all sizes of apartments, which stands at 1.44%. A reversal of this trend is nowhere in sight. A sample of some 3000 rental apartments under construction reveals that the share of three-room apartments here is 39%, even higher than the percentage of recently finished objects. An increasing number of investors are apparently betting on this apartment size and have not yet noticed the problems in finding tenants. Outside major centers, in particular, three-room flats function less well. In institutional investor portfolios, these apartments cause the greatest shortfall of rental income outside the major cities. Difficulties in renting these flats are also becoming more obvious in marketing efforts. In virtually all of the construction projects in our sample, the occupancy rate was lowest among three-room apartments – and usually by a wide margin. Rising vacancies in flats with three rooms are thus inevitable, even though smaller apartments would be expected to move more quickly. In contrast, the two-room flats, which were the second most common size in the sample, are doing well on the market. So real estate investors would be well advised not to blindly copy existing apartment mixes.

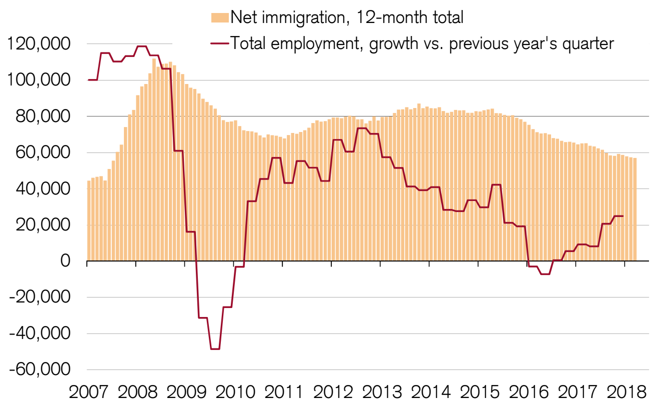
The original German article first appeared in the April 21, 2018 edition of the *Neue Zürcher Zeitung.*
Reprinted with permission of the *Neue Zürcher Zeitung.*

Rental apartments

Still no trend reversal in immigration

The robust economic environment is timely for the rental apartment market, since a better employment outlook should give a boost to demand, which has been fading in recent years. Net immigration continued to decline in the first quarter of 2018 – partly because the economy in the European Union (EU), the largest source of immigrants to Switzerland, is also solid and the unemployment rate in the EU is falling. Compared to the previous year's quarter, net immigration fell by around 10%. While immigration was largely stable (–1.1%), emigration increased significantly (+7.0%).

Fig. 14: Net immigration and jobs growth
In number of persons; employment in full-time equivalents (excl. primary sector)

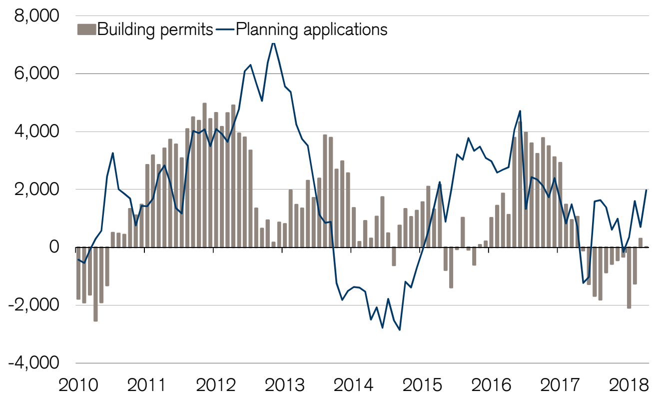


Source: State Secretariat for Migration, SFSO, Credit Suisse

Planning applications for a record-high 33'700 rental apartments

Last year's slightly lower figures for planning applications and building permits suggest that even in the rental apartment market, the sky is not the limit. The planning applications submitted in the first quarter of 2018 illustrate, however, that investors are not about to abandon investment properties. The number of planned rental apartments over the last 12 months is now 2000 housing units higher than at the same time a year ago. Over the last 12 months, planning applications for around 33'700 rental apartments were submitted – a new record high.

Fig. 15: Planning for rental apartments in year-on-year comparison
Building permits and planning applications, number of housing units, 12-month total

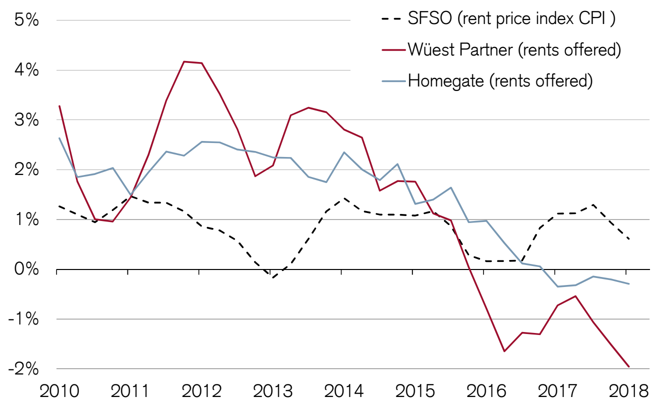


Source: Baublatt, Credit Suisse

Rent prices remain under pressure

The continued surge of construction activity against the backdrop of depressed demand is exerting increasing pressure on landlords in many regions outside the centers. Concessions on rental prices are more often required to avoid longer-term vacancies. The index of rents offered showed negative annual growth rates again in the first quarter of 2018, ranging from –0.3% (Homegate) to –2.0% (Wüest Partner). The increase in the rental price index from the SFSO, which depicts the average rent costs for Swiss households, recently slackened a bit (still +0.6%). This most likely reflects the cut in the reference interest rate to 1.5% as of June 1, 2017.

Fig. 16: Rent prices
Annual growth rates; CPI: Consumer Price Index



Source: Wüest Partner, Homegate, SFSO, Credit Suisse

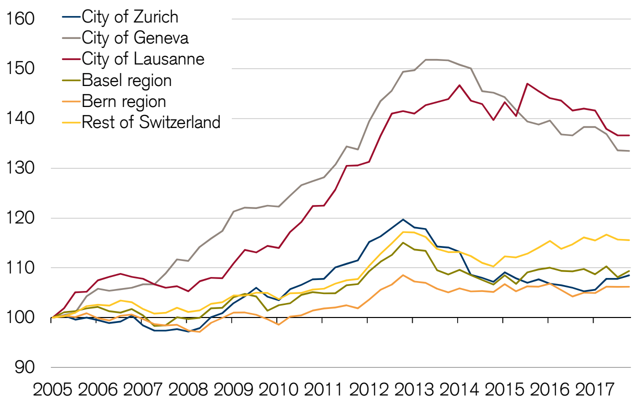
Commercial real estate

Office property: Rent prices stabilizing

The stagnation in the office space supply at the end of 2017 and the pick-up in demand as a result of the broadly supported economic upturn in Switzerland have helped to ease the marketing environment. This easing is expressed in a sideways movement in office lease prices in the markets of the major centers in the fourth quarter of 2017, for example in Zurich (+0.6% quarter-on-quarter) and Geneva (–0.1% quarter-on-quarter). Given the ongoing positive economic conditions, which will continue to stimulate demand for office space, the stabilization of the Swiss office market should continue throughout the coming quarters.

Fig. 17: Office leases

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



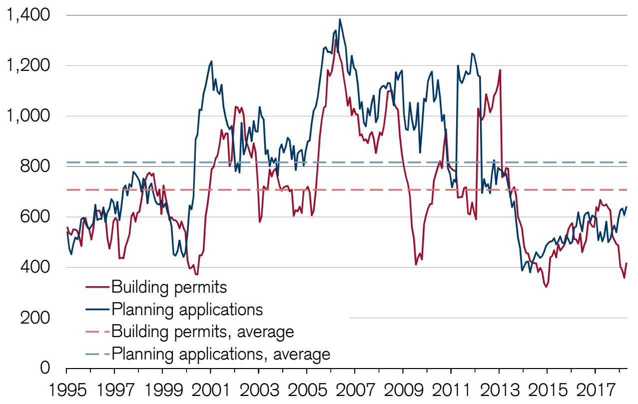
Source: Wüest Partner, Credit Suisse

Retail property: Ongoing low planning activity

Despite improved consumer sentiment, the situation for Swiss retailers is very challenging. The far-reaching structural change resulting from the growth of e-commerce weighs on margins for bricks-and-mortar retailers and reduces demand for retail space. The resulting crisis in the Swiss retail market has made investors cautious. Since the end of 2013, planning activity for new retail space has been well below the long-term average. Due to ongoing difficulties in this market, we do not anticipate any new stimulus for the construction industry in the near future.

Fig. 18: New retail projects

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



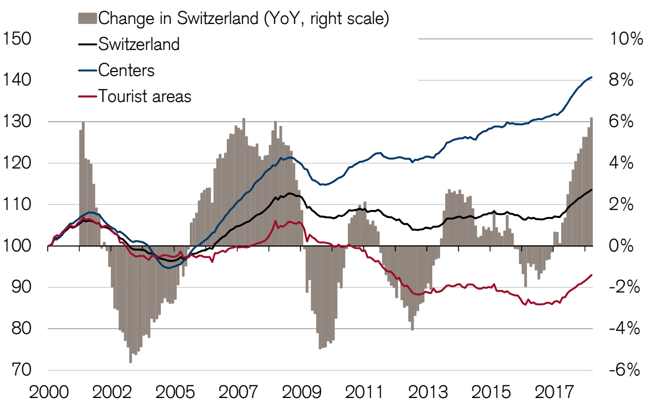
Source: Baublatt, Credit Suisse

Hotel business: Demand is on the rise again

After a long phase of stagnation, the number of overnight stays in Switzerland has been headed north again since the beginning of 2017. The appreciation of the euro makes Swiss hotels more attractive to European tourists, a key demand segment in this business. In previous years, the strong franc had heavily impacted overnight stays in mountainous areas, while there was an increase in overnight stays in the centers thanks to city tourists and business visitors. At present, both markets are profiting from the recovery in demand: in the centers, overnight stays increased by 6.5% year-on-year and in the tourist areas by 7.8% year-on-year (March 2018).

Fig. 19: Overnight stays in hotels and spa resorts

Number of overnight stays and year-on-year (YoY) change



Source: SFSO, Credit Suisse

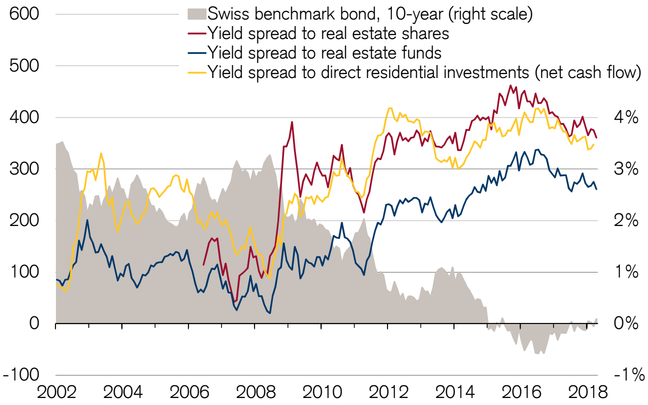
Real estate investments

Returns on real estate investments still attractive

Despite interest rates inching up at the longer end, Swiss real estate investments remain an essential portfolio component given their attractive returns compared to other investment alternatives. At the end of March, the yield spread between direct investments in investment properties and 10-year government bonds was just below 350 basis points (bp). Among indirect investments, Swiss real estate funds display excess yield of 260 bp and real estate shares a full 360 bp. Since the first domestic increase in benchmark rates is unlikely to occur before the first quarter of 2019, Swiss real estate investments should remain attractive for the near future.

Fig. 20: Yield spread between real estate and government bonds

Real estate investments: Dividend yield; yield spread in basis points



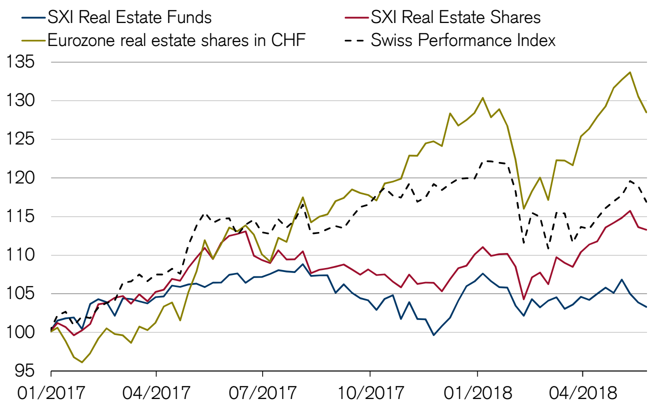
Source: IAZI, Datastream, Credit Suisse

Real estate shares leave real estate funds in the dust

After posting a relatively disappointing performance in 2017 (+10.1%) compared to real estate shares in the eurozone (+28.4%) or the Swiss Performance Index (SPI, +19.9%), Swiss real estate shares have seen solid growth since the beginning of 2018. Total returns of 2.7% exceed those of European real estate shares (0.0%). The latter had a significantly sharper reaction to rising long-term interest rates at the beginning of the year. On the other hand, Swiss real estate funds have lost some ground over the year to date (–3.3%). The outlook for higher interest rates is likely to dampen investor enthusiasm for these products due to their bond-like nature. On top of that is the pressure on rental income, which is increasingly shifting from commercial space to the residential segment.

Fig. 21: Performance of indirect investments

Total performance, index: January 2017 = 100



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

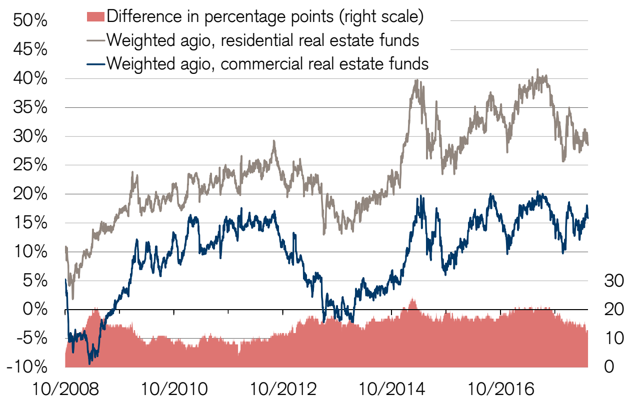
Source: Datastream, Credit Suisse

Commercial real estate funds more attractive again

After a correction at the beginning of the year, agios on Swiss real estate funds have stabilized at a high level (24.3% at May 11, 2018). In terms of the risk-return profile, the appeal of commercially oriented real estate funds has increased – chiefly due to stabilization on the market for office space that coincides with increasing challenges in the rental apartment market. This shift of risks is expressed in a declining agio spread between products with commercial focus and residential property funds. While this spread widened to over 20 percentage points at times in 2017, it now stands at some 12.6 percentage points.

Fig. 22: Agios for real estate funds by investment focus

Listed Swiss real estate funds



Source: Datastream, Credit Suisse

Risk warning

Every investment involves risk, especially with regard to fluctuations in value and return. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income.

For a discussion of the risks of investing in the securities mentioned in this report, please refer to the following Internet link:
https://research.credit-suisse.com/riskdisclosure

This report may include information on investments that involve special risks. You should seek the advice of your independent financial advisor prior to taking any investment decisions based on this report or for any necessary explanation of its contents. Further information is also available in the information brochure "Special Risks in Securities Trading" available from the Swiss Bankers Association.

Past performance is not an indicator of future performance. Performance can be affected by commissions, fees or other charges as well as exchange rate fluctuations.

Financial market risks

Historical returns and financial market scenarios are no guarantee of future performance. The price and value of investments mentioned and any income that might accrue could fall or rise or fluctuate. Past performance is not a guide to future performance. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income. You should consult with such advisor(s) as you consider necessary to assist you in making these determinations.

Investments may have no public market or only a restricted secondary market. Where a secondary market exists, it is not possible to predict the price at which investments will trade in the market or whether such market will be liquid or illiquid.

Emerging markets

Where this report relates to emerging markets, you should be aware that there are uncertainties and risks associated with investments and transactions in various types of investments of, or related or linked to, issuers and obligors incorporated, based or principally engaged in business in emerging markets countries. Investments related to emerging markets countries may be considered speculative, and their prices will be much more volatile than those in the more developed countries of the world. Investments in emerging markets investments should be made only by sophisticated investors or experienced professionals who have independent knowledge of the relevant markets, are able to consider and weigh the various risks presented by such investments, and have the financial resources necessary to bear the substantial risk of loss of investment in such investments. It is your responsibility to manage the risks which arise as a result of investing in emerging markets investments and the allocation of assets in your portfolio. You should seek advice from your own advisers with regard to the various risks and factors to be considered when investing in an emerging markets investment.

Alternative investments

Hedge funds are not subject to the numerous investor protection regulations that apply to regulated authorized collective investments and hedge fund managers are largely unregulated. Hedge funds are not limited to any particular investment discipline or trading strategy, and seek to profit in all kinds of markets by using leverage, derivatives, and complex speculative investment strategies that may increase the risk of investment loss.

Commodity transactions carry a high degree of risk and may not be suitable for many private investors. The extent of loss due to market movements can be substantial or even result in a total loss.

Investors in real estate are exposed to liquidity, foreign currency and other risks, including cyclical risk, rental and local market risk as well as environmental risk, and changes to the legal situation.

Interest rate and credit risks

The retention of value of a bond is dependent on the creditworthiness of the Issuer and/or Guarantor (as applicable), which may change over the term of the bond. In the event of default by the Issuer and/or Guarantor of the bond, the bond or any income derived from it is not guaranteed and you may get back none of, or less than, what was originally invested.

Investment Strategy Department

Investment Strategists are responsible for multi-asset class strategy formation and subsequent implementation in CS's discretionary and advisory businesses. If shown, Model Portfolios are provided for illustrative purposes only. Your asset allocation, portfolio weightings and performance may look significantly different based on your particular circumstances and risk tolerance. Opinions and views of Investment Strategists may be different from those expressed by other Departments at CS. Investment Strategist views may change at any time without notice and with no obligation to update. CS is under no obligation to ensure that such updates are brought to your attention.

From time to time, Investment Strategists may reference previously published Research articles, including recommendations and rating changes collated in the form of lists. The recommendations contained herein are extracts and/or references to previously published recommendations by Credit Suisse Research. For equities, this relates to the respective Company Note or Company Summary of the issuer. Recommendations for bonds can be found within the respective Research Alert (bonds) publication or Institutional Research Flash/Alert – Credit Update Switzerland. These items are available on request or from **https://investment.credit-suisse.com** Disclosures are available from **www.credit-suisse.com/disclosure**

Global disclaimer / important information

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject CS to any registration or licensing requirement within such jurisdiction.
References in this report to CS include Credit Suisse AG, the Swiss bank, its subsidiaries and affiliates. For more information on our structure, please use the following link:
http://www.credit-suisse.com

NO DISTRIBUTION, SOLICITATION, OR ADVICE: This report is provided for information and illustrative purposes and is intended for your use only. It is not a solicitation, offer or recommendation to buy or sell any security or other financial instrument. Any information including facts, opinions or quotations, may be condensed or summarized and is expressed as of the date of writing. The information contained in this report has been provided as a general market commentary only and does not constitute any form of regulated financial advice, legal, tax or other regulated service.

It does not take into account the financial objectives, situation or needs of any persons, which are necessary considerations before making any investment decision. You should seek the advice of your independent financial advisor prior to taking any investment decisions based on this report or for any necessary explanation of its contents. This report is intended only to provide observations and views of CS at the date of writing, regardless of the date on which you receive or access the information. Observations and views contained in this report may be different from those expressed by other Departments at CS and may change at any time without notice and with no obligation to update. CS is under no obligation to ensure that such updates are brought to your attention. **FORECASTS & ESTIMATES:** Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. To the extent that this report contains statements about future performance, such statements are forward looking and subject to a number of risks and uncertainties. Unless indicated to the contrary, all figures are unaudited. All valuations mentioned herein are subject to CS valuation policies and procedures. **CONFLICTS:** CS reserves the right to remedy any errors that may be present in this report. CS, its affiliates and/or their employees may have a position or holding, or other material interest or effect transactions in any securities mentioned or options thereon, or other investments related thereto and from time to time may add to or dispose of such investments. CS may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investments listed in this report or a related investment to any company or issuer mentioned. Some investments referred to in this report will be offered by a single entity or an associate of CS or CS may be the only market maker in such investments. CS is involved in many businesses that relate to companies mentioned in this report. These businesses include specialized trading, risk arbitrage, market making, and other proprietary trading. **TAX:** Nothing in this report constitutes investment, legal, accounting or tax advice. CS does not advise on the tax consequences of investments and you are advised to contact an independent tax advisor. The levels and basis of taxation are dependent on individual circumstances and are subject to change. **SOURCES:** Information and opinions presented in this report have been obtained or derived from sources which in the opinion of CS are reliable, but CS makes no representation as to their accuracy or completeness. CS accepts no liability for a loss arising from the use of this report. **WEBSITES:** This report may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the report refers to website material of CS, CS has not reviewed the linked site and takes no responsibility for the content contained therein. Such address or hyperlink (including addresses or hyperlinks to CS's own website material) is provided solely for your convenience and information and the content of the linked site does not in any way form part of this report. Accessing such website or following such link through this report or CS's website shall be at your own risk.

Distributing entities

Except as otherwise specified herein, this report is distributed by Credit Suisse AG, a Swiss bank, authorized and regulated by the Swiss Financial Market Supervisory Authority. **Austria:** This report is distributed by CREDIT SUISSE (LUXEMBOURG) S.A. Zweigniederlassung Österreich. The Bank is a branch of CREDIT SUISSE (LUXEMBOURG) S.A., a duly authorized credit institution in the Grand Duchy of Luxembourg with address 5, rue Jean Monnet, L-2180 Luxemburg. It is further subject to the prudential supervision of the Luxembourg supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), 110, route d'Arlon, L-2991 Luxembourg, Grand Duchy of Luxembourg as well as the Austrian supervisory authority, the Financial Market Authority (FMA), Otto-Wagner Platz 5, A-1090 Vienna. **Bahrain:** This report is distributed by Credit Suisse AG, Bahrain Branch, authorized and regulated by the Central Bank of Bahrain (CBB) as an Investment Business Firm Category 2. Related financial services or products are only made available to professional clients and Accredited Investors, as defined by the CBB, and are not intended for any other persons. Credit Suisse AG, Bahrain Branch is located at Level 21-22, East Tower, Bahrain World Trade Centre, Manama, Kingdom of Bahrain. **DIFC:** This information is being distributed by Credit Suisse AG (DIFC Branch). Credit Suisse AG (DIFC Branch) is licensed and regulated by the Dubai Financial Services Authority ("DFSA"). Related financial services or products are only made available to Professional Clients or Market Counterparties, as defined by the DFSA, and are not intended for any other persons. Credit Suisse AG (DIFC Branch) is located on Level 9 East, The Gate Building, DIFC, Dubai, United Arab Emirates. **France:** This report is distributed by Credit Suisse (Luxembourg) S.A., Succursale en France, authorized by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) as an investment service provider. Credit Suisse (Luxembourg) S.A., Succursale en France, is supervised and regulated by the Autorité de Contrôle Prudentiel et de Résolution and the Autorité des Marchés Financiers. **Germany:** This report is distributed by Credit Suisse (Deutschland) Aktiengesellschaft regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht („BaFin"). **Guernsey:** This report is distributed by Credit Suisse AG Guernsey Branch, a branch of Credit Suisse AG (incorporated in the Canton of Zurich), with its place of business at Helvetia Court, Les Echelons, South Esplanade, St Peter Port, Guernsey. Credit Suisse AG Guernsey Branch is wholly owned by Credit Suisse AG and is regulated by the Guernsey Financial Services Commission. Copies of the latest audited accounts are available on request. **India:** This report is distributed by Credit Suisse Securities (India) Private Limited (CIN no. U67120MH1996PTC104392) regulated by the Securities and Exchange Board of India as Research Analyst (registration no. INH 000001030), as Portfolio Manager (registration no. INP000002478) and as Stock Broker (registration no. INB230970637; INF230970637; INB010970631; INF010970631), having registered address at 9th Floor, Ceejay House, Dr.A.B. Road, Worli, Mumbai - 18, India, T- +91-22 6777 3777. **Italy:** This report is distributed in Italy by Credit Suisse (Italy) S.p.A., a bank incorporated and registered under Italian law subject to the supervision and control of Banca d'Italia and CONSOB. **Lebanon:** This report is distributed by Credit Suisse (Lebanon) Finance SAL("CSLF"), a financial institution incorporated in Lebanon and regulated by the Central Bank of Lebanon ("CBL") with a financial institution license number 42. Credit Suisse (Lebanon) Finance SAL is subject to the CBL's laws and regulations as well as the laws and decisions of the Capital Markets Authority of Lebanon ("CMA"). CSLF is a subsidiary of Credit Suisse AG and part of the Credit Suisse Group (CS). The CMA does not accept any responsibility for the content of the information included in this report, including the accuracy or completeness of such information. The liability for the content of this report lies with the issuer, its directors and other persons, such as experts, whose opinions are included in the report with their consent. The CMA has also not assessed the suitability of the investment for any particular investor or type of investor. Investments in financial markets may involve a high degree of complexity and risk and may not be suitable to all investors. The suitability assessment performed by CSLF with respect to this investment will be undertaken based on information that the investor would have provided to CSLF and in accordance with Credit Suisse internal policies and processes. It is understood that the English language will be used in all communication and documentation provided by CS and/or CSLF. By accepting to invest in the product, the investor confirms that he has no objection to the use of the English language. **Luxembourg:** This report is distributed by Credit Suisse (Luxembourg) S.A., a Luxembourg bank, authorized and regulated by the Commission de Surveillance du Secteur Financier (CSSF). **Qatar:** This information has been distributed by Credit Suisse (Qatar) L.L.C., which is duly authorized and regulated by the Qatar Financial Centre Regulatory Authority (QFCRA) under QFC License No. 00005. All related financial products or services will only be available to Business Customers or Market Counterparties (as defined by the QFCRA), including individuals, who have opted to be classified as a Business Customer, with net assets in excess of QR 4 million, and who have sufficient financial knowledge, experience and understanding to participate in such products and/or services. Therefore this information must not be delivered to, or relied on by, any other type of individual. The QFCRA has no responsibility for reviewing or verifying any Prospectus or other documents in connection with this product/service due to the fact that this product/service is not registered in the QFC or regulated by the QFCRA. Accordingly, the QFCRA has not reviewed or approved this marketing material or any other associated documents nor taken any steps to verify the information set out in this document, and has no responsibility for it. Investors in this product/service may not have the same access to information about the product/service that they would have to information about a product/service registered in the QFC. The product/service to which this marketing material relates may be illiquid and/or subject to restrictions on their resale. Recourse against the product/service, and those involved with it, may be limited or difficult and may have to be pursued in a jurisdiction outside the QFC. Prospective purchasers of the product/service offered should conduct their own due diligence on the product/service. If you do not understand the contents of this brochure you should consult an authorized financial advisor. **Saudi Arabia:** This information is being distributed by Credit Suisse Saudi Arabia (CR Number 1010228645), duly licensed and regulated by the Saudi Arabian Capital Market Authority pursuant to License Number 08104-37 dated 23/03/1429H corresponding to 21/03/2008AD. Credit Suisse Saudi Arabia's principal place of business is at King Fahad Road, Hay Al Mhamadiya, 12361-6858 Riyadh, Saudi Arabia. Website: https://www.credit-suisse.com/sa**. Spain:** This report is distributed in Spain by Credit Suisse AG, Sucursal en España, legal entity registered at Comisión Nacional del Mercado de Valores. **Turkey:** The investment information, comments and recommendations contained herein are not within the scope of investment advisory activity. The investment advisory services are provided by the authorized institutions to the persons in a customized manner taking into account the risk and return preferences of the persons. Whereas, the comments and advices included herein are of general nature. Therefore recommendations may not be suitable for your financial status or risk and yield preferences. For this reason, making an investment decision only by relying on the information given herein may not give rise to results that fit your expectations. This report is distributed by Credit Suisse Istanbul Menkul Degerler Anonim Sirketi, regulated by the Capital Markets Board of Turkey, with its registered address at Yildirim Oguz Goker Caddesi, Maya Plaza 10th Floor Akatlar, Besiktas/Istanbul-Turkey. **United Kingdom:** This material is issued by Credit Suisse (UK) Limited is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The protections made available by the Financial Conduct Authority and/or the Prudential Regulation Authority for retail clients do not apply to investments or services provided by a person outside the UK, nor will the Financial Services Compensation Scheme be available if the issuer of the investment fails to meet its obligations. To the extent communicated in the United Kingdom ("UK") or capable of having an effect in the UK, this document constitutes a financial promotion which has been approved by Credit Suisse (UK) Limited which is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority for the conduct of investment business in the UK. The registered address of Credit Suisse (UK) Limited is Five Cabot Square, London, E144QR. Please note that the rules under the UK's Financial Services and Markets Act 2000 relating to the protection of retail clients will not be applicable to you and that any potential compensation made available to "eligible claimants" under the UK's Financial Services Compensation Scheme will also not be available to you. Tax treatment depends on the individual circumstances of each client and may be subject to changes in future.

UNITED STATES: NEITHER THIS REPORT NOR ANY COPY THEREOF MAY BE SENT, TAKEN INTO OR DISTRIBUTED IN THE UNITED STATES OR TO ANY US PERSON (WITHIN THE MEANING OF REGULATIONS UNDER THE US SECURITIES ACT OF 1933, AS AMENDED).

18C011A_IS

Other publications from Credit Suisse

Monitor Switzerland Q2 2018

The Monitor Switzerland contains analysis and forecasts for the Swiss economy.

June 19, 2018

Swiss Construction Index Q3 2018

The quarterly Swiss Construction Index provides up-to-date information about the economy in the construction industry and contains estimates and background information regarding sales performance in the construction sector.

August 29, 2018

SME study 2018

The annual study canvasses over one thousand Swiss SMEs on their success factors in Switzerland. This year's theme focuses on competitiveness.

30 August 2018

Perspectives on Regional Economies: Cantons Thurgau and Schaffhausen

(available in German)

The regional study addresses current economic themes in the cantons of Schaffhausen and Thurgau.

26 September 2018

2018 NAB Regional Study

(available in German)

The NAB Regional Study investigates current topics concerning Aargau's economy. This year the focus is on the working world of the future.

25 October 2018

Subscribe to our publications directly from your relationship manager.