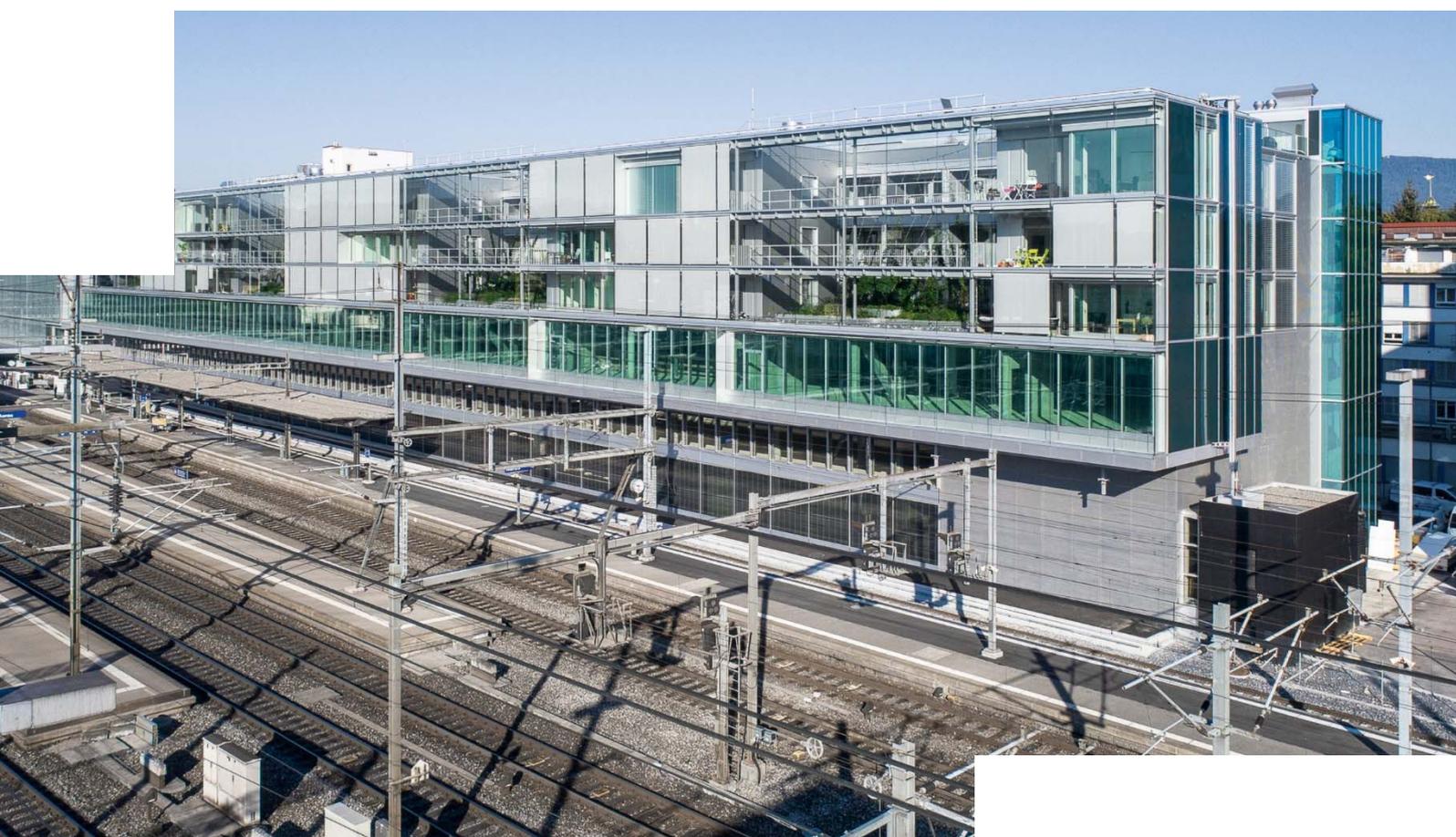


# Never-ending cycle

Swiss Real Estate Market 2020 | March 2020



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Workplace  $\neq$  place of residence  
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# Imprint

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Building: Gleis 0, Aarau. Directly next to Aarau railway station: this residential and office building sets ecological, economic and social standards.  
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# Never-ending cycle

Negative interest rates are dominating the interest landscape. Central banks are showing no sign of pulling back from their ultra-expansive monetary policy. Moderate rates of inflation are giving them room for maneuver here. As a result, investors must brace themselves for further years of negative interest rates. At the same time, the asset thresholds at which savers are being hit with negative interest rates are falling. Investors are therefore looking for strategies and ways to generate a real positive return without taking on unacceptable levels of risk. As the real estate market is an obvious option, the investment pressure is going up another notch and facilitating the umpteenth extension of the super-cycle.

### **Buy-to-let** Page 7

#### **Risk or return?**

In their quest for secure investments, private investors have been following the example of more financially powerful investors and buying properties with a view to renting these out. As multi-family dwellings are hardly affordable in the current environment, condominiums and in some cases single-family homes are the targets of this investment drive. Thanks to low mortgage rates, investors can generate handsome returns in this way. Since the outbreak of the financial crisis, the proportion of new mortgages accounted for by such buy-to-let financings has risen to 17%. More than a half of all buy-to-let properties are located in urban centers or their immediate agglomerations, where the demand for rental apartments is strong. However, positive returns cannot be generated with buy-to-let properties in every location. The decisive factor is the ratio of local residential property prices to locally achievable rents. In highly sought-after locations, residential property is so expensive that only a very low return is obtained. In addition, owners of such properties face interest rate and vacancy risks that could lead to problematic situations. Despite such risks, the increasing tendency of the banks to pass on negative interest rates will drive even more investors into the arms of buy-to-let in the future. However, since buyers are subject to rigorous financing regulations and just under 90% of borrowers possess only one such property, the systemic risks have been within acceptable limits so far.

### **Owner-occupied housing** Page 11

#### **Not enough residential property available**

The running costs of residential property have declined further thanks to low mortgage rates. The potential demand for owner-occupied housing is therefore substantial. On the other hand, rigorous financing requirements for first-time buyers pose a significant hurdle. On average, more than five annual incomes are required to obtain a condominium in Switzerland, and more than seven for a single-family home. In the cheaper regions, just under four annual incomes would suffice; in the most expensive regions, by contrast, more than ten are needed. Passing the “imputed affordability” test is becoming ever more difficult, hence residential property is currently out of reach for the average household. That said, the limiting factor in the residential property market is not demand, but supply. For real estate developers, the construction of rental apartments is ultimately easier and more lucrative, as institutional investors are queuing up to buy into such developments due to negative interest rates. The corollary of all this is a shortage of residential property, and indications of scarcity are becoming apparent. For this reason, property prices will rise again moderately in 2020.

### **Workplace ≠ place of residence** Page 18

#### **A nation of commuters**

The distance between home and workplace is becoming ever greater. Specialization and the modern division of labor on the one hand and the expansion of transport networks on the other have led to employees accepting ever longer distances to work. Every weekday, this gives rise to mass movements of people as more than 3 million commuters leave their municipality of residence to travel to work or a place of education. These highly mobile commuters are thereby alleviating the pressure on Switzerland's urban property markets, and supporting the absorption of vacant property in urban agglomerations. The analysis of growing commuter flows can provide developers with valuable findings in respect of the geographical distribution of demand for accommodation. Com-muter data paints an accurate picture of the strength of regional labor market poles and their “suction effect” on workers in the surrounding areas. Furthermore, they provide developers with important insights into the potential demand for office space in regional labor market poles.

## Rental apartments

Page 24

### Negative interest rates stoke imbalances

Demand for apartments has strengthened recently thanks the positive economic situation and stabilization of immigration. However, it is difficult to discern any new growth stimuli. Quite the opposite: The decline in economic momentum can be expected to slow the absorption of vacant rental apartments this year. The new influx of rental apartments will therefore exceed the market's power of absorption going forward. As a result, we are expecting a renewed rise of vacant apartments and an unchecked rise in the vacancy rate. This in turn means that new rental apartments – which already have relatively long advertising periods – will be on the market for even longer. Interestingly, the highest vacancies are evident not in old or brand-new apartments, but in properties just a few years old. This is a problem in particular for rental apartments aged between three and six years whose initial tenants have moved out, but which are still expensively positioned. Apartments with fairly compact rooms are less exposed to this risk. For buildings aged up to six years, these apartments have much lower vacancy rates. In the case of older apartments, by contrast, this phenomenon is not evident. Rents can be expected to come under even greater pressure due to the resurgence of vacancies. Only in the five large centers and a few mid-sized centers, where a scarcity of supply is still apparent, should rents once again rise slightly.

## Parking spaces

Page 31

### Significant rental income losses on parking spaces

Switzerland is a country of parking spaces. According to expert estimates, the country is home to more parking spaces than residents. The high number of parking spaces is a consequence not just of the dense concentration of vehicles in Switzerland, but also local legislation. In almost all cantons, laws regulate the minimum number of parking spaces that must be created as part of any building project. For a long time, the principle of "one parking space for every apartment" held sway. But with mobility patterns having changed, the mandatory requirement to build parking spaces looks increasingly illogical. In Switzerland's heavily urbanized regions, the degree of motorization is already declining. It is therefore no surprise that an increasing number of parking spaces are empty and dragging down the return on capital of property owners. Contrary to what one might expect, however, vacancies are highest not in cities themselves, but in their wider agglomerations. Losses in rental income are most pronounced for vacant garage parking spaces located outside of the large centers, where the figures run into double-digit percentage territory. In large centers, commuter demand for parking space means somewhat lower vacancy rates. Admittedly, when set against total rental income, landlords are on average losing just 0.6% of their overall income as a result of unused parking spaces. Nonetheless, in an era of growing apartment vacancies, stagnating rental price development, and low net yields, even lost revenues of this magnitude are painful. For landlords, minimizing the number of parking spaces that have to be built should prove the best strategy in many cases. Municipalities have some freedom of maneuver here. They should exploit this leeway, particularly as autonomous vehicles can be expected to usher in a further fundamental change in parking space requirements in the future.

## Office property

Page 37

### Consolidation of recovery

Despite the robust labor market situation, employment growth and the resulting additional demand for office space should slow over the course of 2020. Since the volume of planned new office space is declining in the majority of large and mid-sized centers, the office property market recovery is likely to continue, particularly in the large centers of German-speaking Switzerland, despite weaker demand. However, the gap between city center and peripheral office space markets is set to widen, something that is true for both vacancies and rental price levels. Why? Because despite livelier demand, the volume of office space being advertised across Switzerland has increased slightly once again. The office market therefore presents two contrasting faces: In the city centers, office space is often in short supply, while the supply of space in peripheral office property markets continues to rise. Plenty of construction activity is also still taking place in the major centers of French-speaking Switzerland, and here Geneva and Lausanne stand out with their dramatic expansion of space. These two office markets in "Suisse Romande" now also have the highest supply rates. However, while demand is relatively stable in Lausanne, a temporary lull in demand in Geneva is coinciding unfavorably with a number of development projects that have been triggered by realization of the Léman Express railway project.

## Modular commercial space

Page 42

### Market niche with potential

Many commercial properties on the market in Switzerland are the wrong size, difficult to access, or not at ground level. Often it is simply a case of the price being too high. This market niche has caught the attention of a number of providers. They have responded with an offering of small, simple, and cost-effective modular premises with a good basic infrastructure outside of expensive large centers, available for either rent or sale. This concept allows small and medium-sized enterprises (SMEs) and private individuals to become owners or tenants of small commercial premises with floor space of 60 to 65 m<sup>2</sup> at an attractive price. These modular commercial "workboxes" –

as they are sometimes referred to – are becoming increasingly popular. One reason for this is their great flexibility: The units in question can be fitted out and equipped any way the occupant chooses. Thanks to the modular nature of the concept, a number of units can be combined to form larger premises if required. The demand for commercial workboxes is very broad and multifaceted, and extends far beyond the circle of traditional tradespersons and light industrial enterprises. For example, they can be used by artists, graphic designers, photographers, small-scale retailers, professional consultants, training companies, local associations, or indeed start-ups. The concept has already been tested at more than two dozen locations in French-speaking Switzerland, and has recently branched out into German-speaking Switzerland. As long as it is rigorously implemented, this concept should carve out an interesting market niche both there and in Italian-speaking Switzerland. However, if cheap prices per square meter are to be achieved, developers will have to source readily accessible sites of a certain minimum size with low land prices.

## **Retail property**

Page 44

### **Retailers find it tough going**

Revenues in the retail trade are stagnating, with business continually migrating to the online channel. The stationary clothing business is suffering in particular, having seen its revenues decline by a quarter over the last five years. Further growth of online shopping is a given, even if only demographic changes are taken into consideration. The stationary business therefore remains under pressure and must scale back its volume of retail space. The losers in this process of structural change are above all landlords. In the United Kingdom, significant writedowns on real estate values have already become a painful reality. The process of downsizing is already under way in Switzerland, where the market is characterized by use conversions and rental price declines.

## **Shopping streets**

Page 47

### **High noon for high streets?**

Switzerland's "high streets" are likewise feeling the effects of structural change. But unlike the retail market as a whole, the top shopping streets of Switzerland's large urban centers have a number of important USPs. Their unique locational qualities guarantee high footfall and high visibility. The latter is of crucial importance to retailers and the manufacturers of brand products. Stores on high-end shopping streets can meet the new challenges facing the stationary trade, and can be expected to see a pickup in tenant demand in the medium term. In the future, off-line shopping will be concentrated first and foremost in the top shopping streets – albeit in smaller stores than today, and with a more diverse tenant mix.

## **Investment outlook in Germany**

Page 50

### **German office market rides wave of momentum**

Despite having similar characteristics, real estate investments in Germany offer a healthy degree of diversification for holders of similar investments in Switzerland. As the German office property market cycle is out of sync with Switzerland's, the correlation between these two markets is astonishingly low. Thanks to a modest expansion of office space, vacancies are declining in Germany's top seven cities, and rents are now on a stable upward trajectory. Moreover, the current economic dip is insufficiently pronounced to halt the trend of higher net income. While net yields do look rather low at prime locations, they are still some 70 basis points higher than their Zurich counterparts. Momentum is therefore favorable, making another few years of above-average returns likely.

## **Indirect real estate investments**

Page 53

### **Security has its price**

Investors are not expecting the negative interest rate environment to end any time soon. As a consequence, indirect real estate investments are continuing to attract investors willing to assume a reasonable level of risk. While the dividend yields of real estate funds may be declining due to high valuations and the pressure on rental income, the yield premiums relative to 10-year government bonds are still well above the long-term average at 290 basis points. Moreover, declining rental income will be offset by rising net asset values. Even in the event of slight rises in long-term interest rates, these valuation gains are likely to persist for quite a while. The reason for this is the sluggishness with which the discount rates relevant to property valuations respond to changes in interest rates.

## **Direct real estate investments**

Page 55

### **Mid-sized centers: Better than just middling?**

In an environment characterized by increasing indications of oversupply in the rental market, real estate investments with secure income streams are coveted. Mid-sized urban centers offer an attractive alternative to investments in the fiercely competitive markets of the large centers. A number of these have profiles that are comparable with large centers from the perspective of locational quality and rents, while others offer interesting rental income growth potential.

# Buy-to-let: risk or return?

**Homeowner property used by a third party (“buy-to-let”) allows private investors to participate in the real estate boom. The current interest rate environment is giving a boost to this investment type, which accounts for a sixth of all homeowner mortgages.**

## Buy-to-let in focus

Condominiums and single-family homes rented out by the owner, also called buy-to-let properties, have been attracting increasing attention in recent years. In their quest for secure investments, private investors have been following the example of more financially powerful investors and buying properties with a view to renting these out. Because multi-family dwellings are hardly affordable in the current environment, private investors are instead buying up smaller properties, typically condominiums and in some cases single-family homes. The Swiss National Bank and the Swiss Financial Market Supervisory Authority (FINMA) have been observing this trend with concern, increasingly pointing to the risks of such buy-to-let financing. Although financings of this kind are exempted from the new self-regulatory measures that apply to investment properties, FINMA is nonetheless advising the banks to tighten lending requirements in this area. But what does buy-to-let actually mean? What are the opportunities and risks of this type of investment? In the absence of any official data in this area, we have analyzed our own data in our search for answers.<sup>1</sup> However, depending on the feature analyzed, the results are not necessarily representative of the market as a whole.

## Almost one in six new homeowner properties rented out

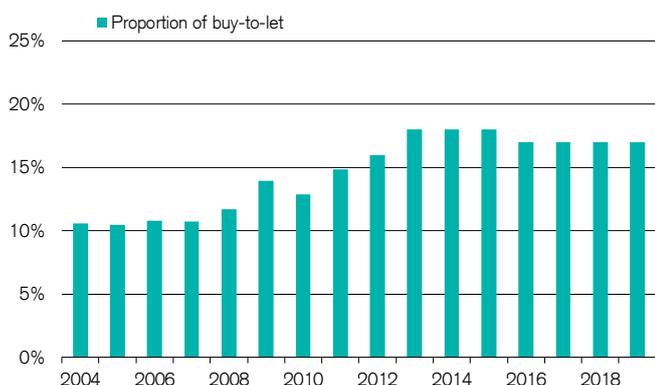
Condominiums and single-family homes rented out by the homeowner accounted for 17% of all new residential property mortgages by volume in 2019 (Fig. 1). Over the last few years, this proportion has declined slightly, which is above all likely to be attributable to the more rigorous financial requirements that apply in the area of mortgage lending. Over the last 15 years, however, the proportion of buy-to-let mortgages has risen sharply. Back in 2004 it stood at just 10.6%, but as Figure 1 shows it then began to grow following the outbreak of the financial crisis in 2008 and the ensuing low-interest environment. Buy-to-let mortgages are mainly taken out on condominiums, which account for more than two-thirds of such financings.

## Negative interest rates as driver of demand

The main drivers of the popularity of buy-to-let mortgages are the negative interest rate environment of recent years and the gap in yield between real estate and other investments. Many investors prefer direct real estate investments, as these give them complete freedom of determination. For the great majority of private individuals, however, even a small apartment block is beyond their financial capacity. By contrast, the purchase of a condominium for investment purposes is more affordable and hence the usual route chosen by private investors. The increasing transfer of negative interest rates from banks to savers, who are now threatened by asset erosion as a result of this phenomenon, is likely to drive even more investors into the arms of buy-to-let in the future.

**Fig. 1: Buy-to-let mortgages account for considerable market share**

Buy-to-let financings as a proportion of total new mortgage conclusions by segment, in CHF

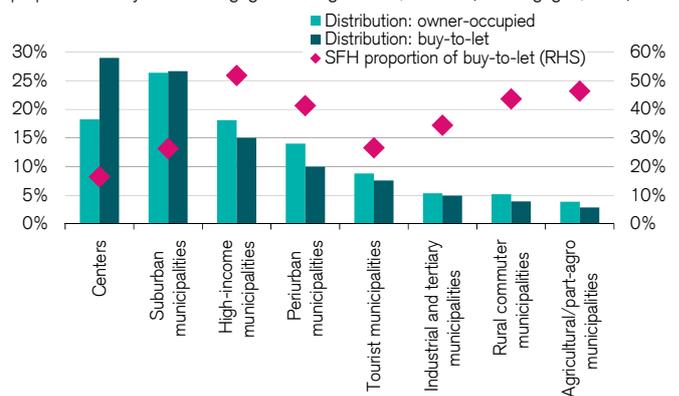


Source: Credit Suisse

Last data point: 2019

**Fig. 2: Buy-to-let more common in urban centers**

Financing of owner-occupied and rented-out residential property by municipality type; proportion of buy-to-let mortgages relating to SFH, in CHF (all mortgages, RHS)



Source: Credit Suisse

Last data point: Q3/2019

<sup>1</sup> Data on usage is recorded when the mortgage is first taken out. Possible later adjustments to usage cannot be evaluated.

## Other drivers of demand

There are also a number of other reasons for investments of this kind, such as when a condominium is purchased with retirement in mind but the purchaser still intends to live in his single-family home for a few more years yet. Some individuals also acquire apartments for their children. In addition, tourism in combination with the digitalization process in large cities and tourist regions is increasingly likely to become a driver of demand: In the modern age, a number of buy-to-let investments are made with a view to renting out a property on Airbnb.

## Unexpected competition

The buy-to-let phenomenon is increasingly motivating institutional investors to reverse the traditional order of marketing for major construction projects, i.e. advertising the rental apartments first and the apartments for sale only thereafter. Under the previous model, institutional tenants were increasingly finding that they were competing with buyers of condominiums, who were immediately putting their acquired property back on the rental market.

## Characteristics of buy-to-let properties

### Buy-to-let phenomenon most prevalent in urban centers and nearby municipalities

When measured against the total inventory of owner-occupied property, buy-to-let financings account for just 14.8%, a bit less than their proportion of all newly concluded mortgages. Buy-to-let properties are most commonly found in urban centers. As the demand for rental apartments is high here and the vacancy rate in many cases low, it is hardly surprising that an above-average number of homeowner properties are rented out in such locations. Furthermore, properties situated in central locations have also recorded the highest increases in value in the past. The concentration is above all evident when a direct comparison is made with the presence of owner-occupied property in urban centers (Fig. 2). A slight degree of overrepresentation can be discerned in suburban municipalities. However, the greater the distance from an urban center, the more likely buy-to-let properties are to be relatively underrepresented.

### Below-average proportion in rural municipalities ...

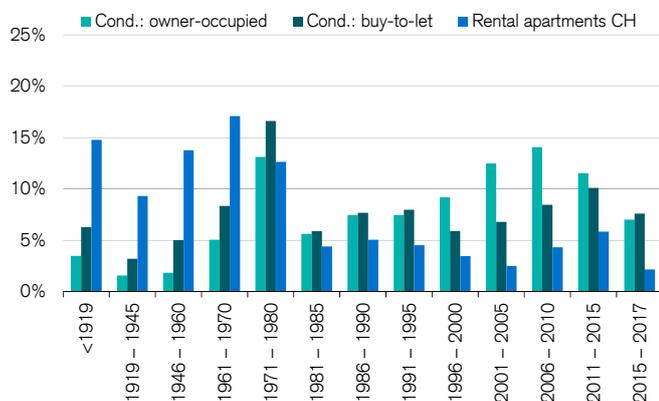
By contrast, in rural regions the share of total properties accounted for by the buy-to-let segment is below the national average of 14.8%. Bearing in mind that home ownership ratios are typically much higher outside of urban centers and their agglomeration municipalities, the number of buy-to-let mortgages here is striking, however. High-income municipalities, which are frequently located in close proximity to major centers – such as Zurich’s Gold Coast – likewise exhibit a below-average proportion of buy-to-lets. In addition, it is notable that (unlike in other municipalities) it is often single-family homes that are rented out in rural and high-income municipalities. Here single-family homes account for between 41% and 52% of all buy-to-let mortgages (Fig. 2).

### ... and tourist municipalities

However, the low proportion of buy-to-let properties in tourist communities is likely to be mainly attributable to the fact that many owners of second homes use their vacation apartments themselves, and do not rent them out. That said, managed second homes are likely to become more frequent in the future due to the Second Homes Act. Even then, however, managed vacation homes are likely to be occupied by their owners at certain times. Such properties should therefore not be viewed as classic buy-to-let properties, which are typically 100% rented out.

**Fig. 3: Owner-rented condominiums are younger than rental apartments**

Share of apartments by property age, by segment (Cond.: Condominiums)

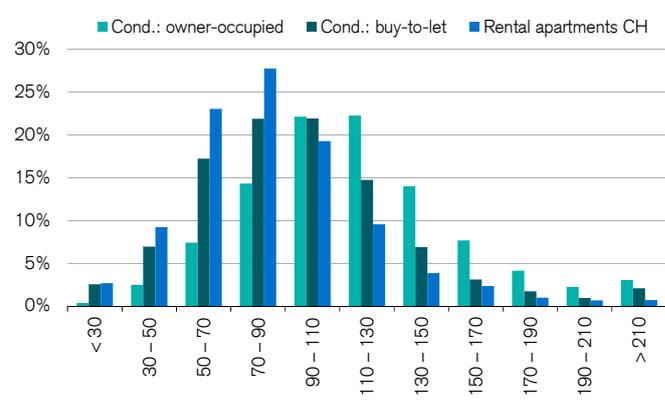


Source: Credit Suisse, Swiss Federal Statistical Office

Last data point: 2017

**Fig. 4: Owner-rented condominiums are larger than rental apartments**

Share of apartments by floor space in m<sup>2</sup>, by segment



Source: Credit Suisse, Swiss Federal Statistical Office

Last data point: Q3/2019

### Higher fit-out standard as differentiator

Whereas single-family homes available for rent are likely to be a sought-after niche in many areas, condominiums put on the rental market by the owner are competing first and foremost with conventional rental apartments. It is therefore important that such properties are competitive in terms of both location and characteristics. For that reason, the fit-out standard of condominiums put on the rental market is frequently higher.

### Buy-to-let properties – larger and more modern

The distinguishing features that really stand out are building age and apartment size. Rented-out condominiums, for example, are typically more modern than conventional rental apartments. 33% of all buy-to-let condominiums were built after 2000, while the equivalent figure for conventional rental apartments, many of which were built between 1946 and 1970, is just 14.9% (Fig. 3). As a result, buy-to-let properties are frequently not just more modern, but also larger. Accordingly, their floor plans and room sizes are more in keeping with modern tenant preferences (Fig. 4).<sup>2</sup>

### Buy-to-let apartments must meet tenant preferences

In a comparison with owner-occupied condominiums, however, buy-to-let properties tend to be older and smaller. This is likely to be attributable to the fact that condominiums are less suited to the requirements of their owners as they age, or they have been inherited or sold and are consequently more likely to be put on the rental market. Indeed, almost one in every two condominiums built before 1960 is rented out as a buy-to-let property. Furthermore, buy-to-let condominiums have to be rather smaller in order to be affordable for the limited budgets of many tenant households.

### Is buy-to-let worth it?

### Example calculation in a negative interest environment

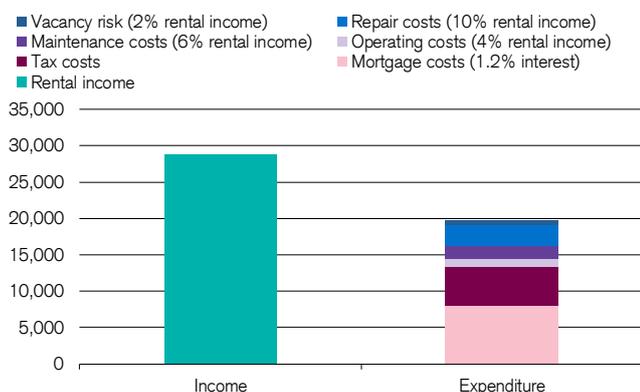
Figure 5 provides a simplified case example of income and expenditure for a possible buy-to-let investment in the municipality of Dietikon (ZH). Here we are looking at an average 4.5-room new-build apartment with 110 m<sup>2</sup> of floor space and a purchase price of CHF 1 million. For a similarly large average newbuild rental apartment, the monthly rent charged (according to Wüest Partner) would be CHF 2,400. In reality, the above-mentioned condominium would be likely to achieve a slightly higher rent given the typically higher fitout standard of buy-to-let properties. Even with this conservative calculation, the owner would be left with an annual profit of just over CHF 9,100 after the deduction of mortgage interest (66.7% debt financing, interest rate 1.2%), tax costs (household income of CHF 250,000), operating costs (4% of rental income), maintenance costs (6% of rental income), and repair costs (10% of rental income), as well as additionally factoring in the vacancy risk (2% of rental income). When measured against the invested capital of CHF 333,000, this would equate to a return on equity of 4.3% (2.7% after taxes) in the current negative interest environment. However, this does not factor in the potential increase in value that could be expected over the long term given Dietikon's proximity to a major urban center.

### Returns can differ sharply depending on location

However, a positive return would not be generated with a buy-to-let property in every location. The decisive factor is the ratio of local residential property prices to locally achievable rents. In highly sought-after locations, residential property is so expensive that only a very low return would be generated. So if they want to avoid negative returns, private investors would be well advised to scrutinize local market conditions closely.

**Fig. 5: Sample calculation buy-to-let**

Simplified case example for the municipality of Dietikon (ZH), in CHF per year

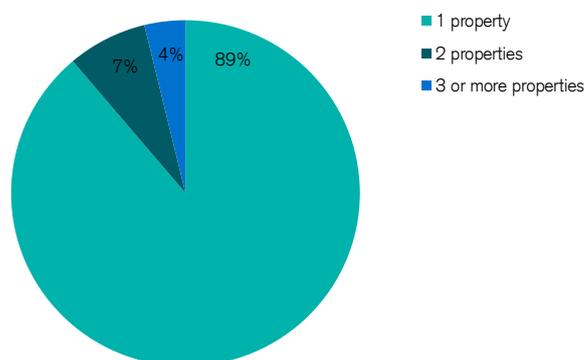


Source: Credit Suisse

Last data point: Q3/2019

**Fig. 6: Very few borrowers own more than one property**

Number of buy-to-let properties per investor



Source: Credit Suisse

Last data point: Q3/2019

<sup>2</sup> The proportion of modern conventional rental apartments is also overestimated, as official statistics for rental apartments also include buy-to-let properties. The same applies for the assessments of floor space and room size.

|  |  |
|--|--|
| <b>Rising interest rates as greatest threat</b>                                | Although the above example looks attractive at first glance, potential investors should be clear that it represents only a “snapshot” picture. In particular, future rises in interest rates could have a serious negative impact on the potential profit (or even result in an overall loss), depending on the investor’s financing situation. If interest rates were to rise, the landlord would come under pressure from two sides: Losses in property value would be possible due to falling prices, yet the freedom of maneuver to pass costs onto the tenant would be limited. Under existing Swiss rental law, rents are pegged to a so-called reference interest rate. In other words, rents can only be increased if this reference interest rate – which is very sluggish to react – rises, and if the future market situation actually permits such an increase. As there can hardly be an economist in Switzerland who expects interest rates to rise at the moment, this is a hypothetical risk for now. However, investors would be well advised to take this risk seriously given the great amount of financial damage it can do – particularly as significant potential for price correction has built up in the real estate market due to ultra-low interest rates. |
| <b>Concentration risks</b>   | 89% of holders of buy-to-let properties own just one such property, whereas 7% own two and just 4% have a portfolio of three or more (Fig. 6). Accordingly, such properties are widely distributed in the market. There are nonetheless certain concentration risks here, even though these properties tend to be situated in good, central locations and can frequently be differentiated from conventional rental apartments from a quality standpoint. For example, any vacancy would immediately lead to a complete discontinuation (or at least a serious interruption) of rental revenues and therefore immediate income problems. Moreover, the problem of a lack of geographic diversification is also evident, which makes buy-to-let investors more exposed to regional imbalances than real estate companies or real estate funds.  |
| <b>Owner occupation or sale as additional options</b>                          | If an apartment cannot be rented out, the owner has two obvious options – sell the property or move back in as an owner-occupier. In many parts of Switzerland, the demand for residential property slightly outstrips the available supply. As long as mortgage rates do not rise significantly, homeowner properties are likely to remain scarce, thereby reducing the sale risks.   |
| <b>Liquidity risk</b>  | The sale of a property takes time and costs money, however. Even in a healthy market environment, a condominium or single-family home can rarely be sold in a matter of days or even weeks. The liquidity problem would be even more pronounced in the event of a sharp deterioration in the market environment. In such situations, real estate is renowned for being impossible to sell quickly – unless of course the investor is prepared to unload it at a significant discount.  |
| <b>Condominium not a sole ownership situation</b>                              | Another risk that is often underestimated is the fact that condominiums come with an element of shared ownership. Any construction adjustments or renovations require the consent of other condominium owners within the building. Conflicts of interests can result in tedious decision-making processes, and in a worst-case scenario to an inability to act for many years.   |
| <b>Never underestimate the time and costs involved</b>                         | Investors should also not underestimate the workload that comes with the ownership of a rented-out property. Although they can have the property externally managed, such an approach is typically not worth the cost, which is why the management and rental of property is typically handled by the owner. In addition, the problem of a maintenance backlog/renovation can become more of a challenge as a building ages. This is particularly problematic if the investor does not have sufficient funds put aside, or if no tenant can be found due to the state of the property.   |
| <b>Treated as owner-occupied property from a technical lending perspective</b> | Despite the threats that exist, rented-out homeowner properties are treated differently by lending institutions in terms of risk compared to conventional rental apartments. Specifically, when calculating (imputed) affordability, it is not just rental income that is factored in, but also the personal income of the owner – as is the case for owner-occupied residential property. In other words, a buy-to-let property should be effectively affordable for the owner even in the absence of the rental stream. Lending regulations have also been repeatedly tightened with a view to preventing excessive risk accumulation.   |
| <b>Demand to remain high – despite rising market risks</b>                     | Buy-to-let mortgages will remain popular over the next few years. While regulatory pressure should remain high or even tighten further, the acquisition of residential property for income-generating purposes will remain attractive while the low-interest environment persists. As oversupply in the rental apartment market is likely to increase further however (see “Rental apartments” section, p. 24), potential investors must have a clear picture of the risks involved and pay careful attention to the marketability of their desired purchase.  |

# Low interest rates fuel demand

**The parameters for owner-occupied property remain attractive. But in 2020 too, the financial requirements for purchasing a home will remain the big hurdle for first-time buyers.**

## Servicing costs of residential property fall further

For existing homeowners, the market situation remains attractive. The average interest rate on all outstanding mortgages has declined again over the last 12 months, namely from 1.47% to 1.39% (Fig. 7). According to our estimates, the average owner-occupying household therefore had to pay mortgage interest of just CHF 4,930 last year. Although the saving in 2019 compared to 2018 was modest at just CHF 186, as interest rates were already very low, the debt servicing burden has declined by more than 50% since 2008, which equates to a saving of more than CHF 5,000 a year.

## Debt servicing burden likely to decline in 2020 too

The low level of living costs for homeowners is hardly likely to change this year – indeed, the average mortgage interest burden is likely to fall further. While we are expecting a slight year-on-year rise in the average new mortgage agreement, homeowners whose long-term fixed mortgage is expiring can for the most part expect to benefit from lower mortgage rates in the case of an extension than a couple of years ago. As a result, owner-occupied property will remain cheaper to finance than rented accommodation, even when all costs are taken into account. The desire of the Swiss to own their own four walls is therefore likely to stimulate demand in the coming year too.

## Negative effect of economy as overlay

Unlike the attractive interest rate environment, the economy is hardly supportive at the moment. Growth in 2019 was only around a half of its latent potential. The slight growth acceleration predicted for 2020 is attributable to a greater number of working days and the inflow of licensing revenues for international sports organizations headquartered in Switzerland, so is hardly likely to be tangible. Nonetheless, expansionary monetary policy and the hitherto astonishingly robust development of employment are likely to keep any recessionary tendencies at bay. On the other hand, a soaring trajectory away from the current modest growth path is likewise hardly on the agenda. Household incomes can thus be expected to grow less strongly than last year. However, this economic backdrop is playing only a secondary role at the moment, with the dominant factors being suppression of demand through strict regulation on the one hand, and favorable interest rate developments on the other.

## Affordability not a problem in itself, ...

Despite rising real estate prices, the effective burden on income of an acquisition of residential property has declined once again. The purchase of an average newbuild apartment last year would have cost the average earner just 14.5% of his or her income for mortgage, amortization, and maintenance costs (average 1996 – 2019: 15.8%). The equivalent burden for a single-family home would have been 20.5%, likewise below the long-term average of 23.2% (Fig. 8).

**Fig. 7: Low financing costs for existing homeowners**

Mortgage interest costs per residential unit in CHF; average mortgage interest rate as per September 30 of corresponding year

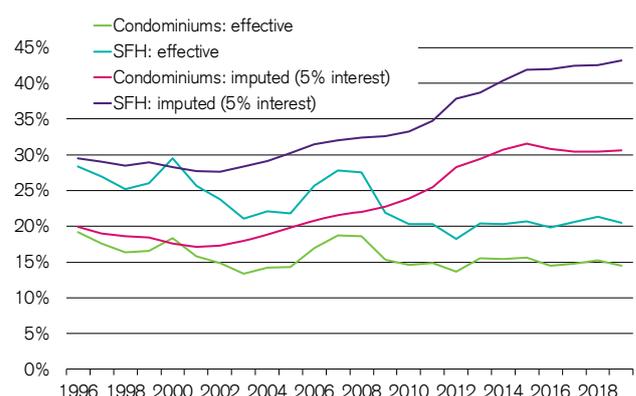


Source: Credit Suisse, SNB, BWO

Last data point: 2019

**Fig. 8: Imputed affordability the major hurdle**

Affordability for average household as % of income (assumptions: newbuild, 1% maintenance, 80% loan-to-value, amortization on 2/3 within 15 years)



Source: Credit Suisse

Last data point: 2019

**... but imputed affordability is a different matter**

Despite the lower effective burden, the demand for residential property is ultimately limited, as the regulatory capital requirements for acquiring such property are high. As things stand, the average-income household has to spend an imputed 43.2% of that income to acquire a new single-family home of an average standard (Fig. 8). This figure is well above the critical threshold of 33%, which explains the low demand for single-family houses. In the case of apartments, the equivalent is 30.6%, just below the 33% threshold. Consequently, however, even a condominium is out of reach for a significant proportion of households. Viewed across Switzerland as a whole, the imputed affordability of residential property (condominiums and houses) is above the threshold in 63 of the 106 Swiss regions.

**Housing Affordability Index reaches new high**

The strong price rises of recent years and their repercussions on demand potential are reflected in the Housing Affordability Index (HAI). This indicator shows how many annual incomes would be required to purchase residential property without a mortgage. As a national average, the HAI now stands at 5.6 annual incomes for a condominium and 7.6 annual incomes for a single-family home (Fig. 9). By way of comparison, the corresponding values for these two figures back in 2001 stood at just 3.3 and 5.2 respectively.

**Residential property in many regions twice as affordable as in top regions**

Figure 10 illustrates the HAI for owner-occupied apartments in Switzerland's 106 regions. In many places along the lake shores of Zurich, Zug, and Geneva, the average condominium will cost more than eight times annual income. A similar situation applies in many tourist regions. By contrast, the number of incomes required in many regions of Switzerland's Mittelland is significantly lower. For example, 5.1 annual incomes would suffice at the moment in the Aarau region. And in places like the Jura or the Thal regions, just four annual incomes would do the trick.

**Demand momentum strongest in low price segment**

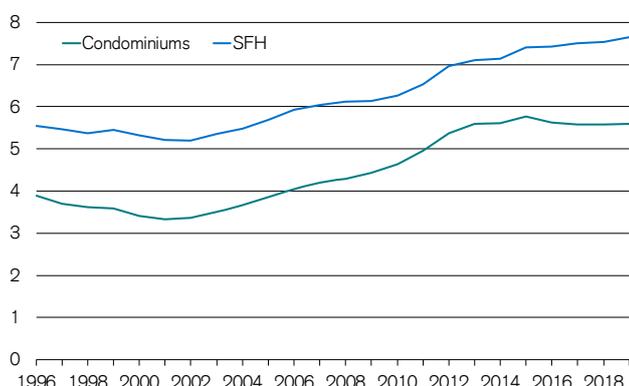
Due to the high financial requirements that apply to the purchase of residential property, it is not surprising that demand is developing most dynamically in the low price segment. Analysis of the search subscriptions on the various online platforms by RealMatch360 shows that momentum is strongest in the low price segment, both for owner-occupied apartments and single-family homes. By contrast, the number of search subscriptions in the upper price segment has declined for both types of property.

**Outlook for 2020: little change in demand**

In 2020, residential property is likely to be just as coveted as it was last year thanks to favorable interest rates. However, with inflated financing requirements – due to the high level of prices – having a dampening effect to a similar degree, we are anticipating demand to be virtually unchanged compared to the previous year. Given steep prices in and around the major conurbations, many households can be expected to increasingly focus their attention on municipalities with good transport links situated some distance away from these costly regions, where residential property remains fairly affordable.

**Fig. 9: Housing Affordability Index deteriorates**

Number of annual incomes required to purchase own home

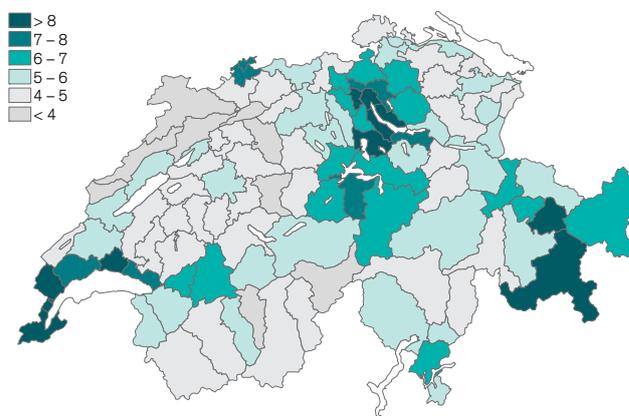


Source: Credit Suisse

Last data point: 2019

**Fig. 10: Significant regional differences in affordability**

Number of annual incomes required to purchase an apartment



Source: Credit Suisse

Last data point: 2019

# Negative interest environment stems supply

**Construction activity in the owner-occupied housing sector will decline further over the coming year. The pronounced focus on rental apartment construction is leading to smaller ownership building projects and greater construction activity away from central locations.**

## Construction activity declines once again in 2019

Construction activity in the owner-occupied housing sector continues to decline. At just 7,000 units, the net number of new single-family houses coming onto the market fell once again in 2019. When measured against the available housing inventory in this segment, the increase amounted to just 0.7%. By contrast, the construction of condominiums destined for ownership occupancy stabilized in a year-on-year comparison. Over the last year, some 14,000 additional condominiums came onto the market. This equates to an expansion of 1.2%. Unlike in the single-family home segment, however, it would be wrong to flag up weak construction activity as the driver here, as this has simply normalized steadily in recent years, falling back from a high level.

## Slower decline in SFH construction activity expected

In view of the modest level of construction activity, there is no reason to expect any trend reversal over the coming year. Quite the opposite: Over the last 12 months, the number of approved single-family homes (SFH) has declined again – this time by 15% to some 5,900 units (Fig. 11). This figure is now 47% below its long-term average. The rate of decline should slow somewhat going forward, as the current level of SFH planning applications is trending sideways. That said, this is not likely to feed through into new market supply until 2021.

## Further decline in condominium construction activity

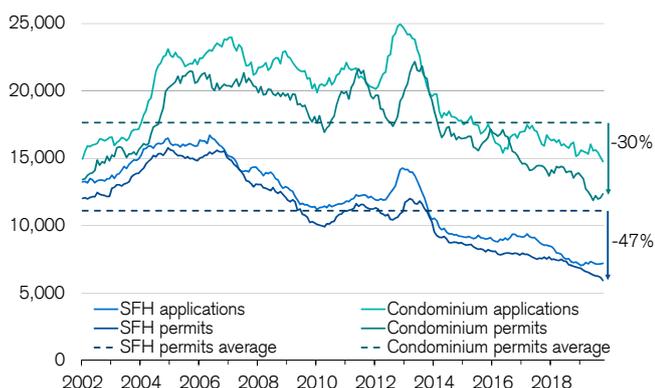
Over the same period, just under 12,400 condominiums were approved for construction. However, at 8.7% this decline was less pronounced than the equivalent for single-family homes. Moreover, the growing gap between applications and permits suggests that various projects have been delayed at the approval stage. Building applications for new condominiums remain on a downward trajectory, however. The number of new condominiums is therefore likely to decline through 2020 and beyond.

## Negative interest environment favors construction of rental apartments

With mortgage interest rates still extremely low and fueling the desire for residential property purchases, the sharp decline in construction activity in the condominium sector is something of a surprise. However, the negative interest environment is not only a positive for potential homeowners: It also has the effect of making residential property more expensive, and single-family homes in particular unaffordable. As things stand, the construction of multi-family dwellings for rental apartments is both simpler and more lucrative for developers, as investors are queuing up to invest in such projects, thereby relieving developers of the laborious task of selling individual condominiums.

**Fig. 11: Construction activity continues to slow**

Planning applications and building permits: no. of residential units, 12-month total

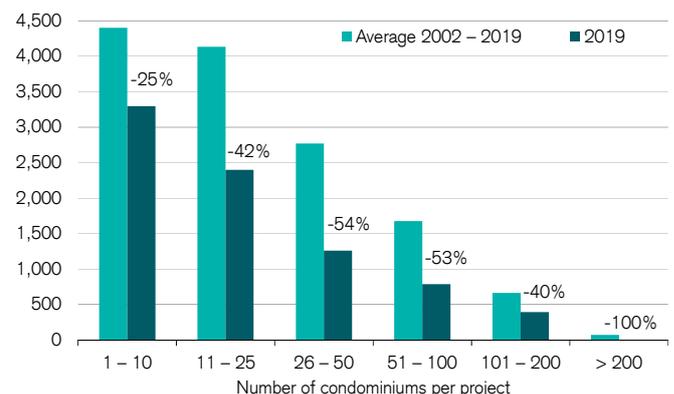


Source: Baublatt, Credit Suisse

Last data point: 11/2019

**Fig. 12: Dwindling number of large projects**

Condominium building permits in number of units, by project size



Source: Baublatt, Credit Suisse

Last data point: 11/2019

**Condominium projects increasingly on smaller scale**

It is therefore not surprising that large condominium projects for homebuyers are becoming less popular. At the moment, 41% of all condominiums are springing up in projects involving no more than 10 apartments, and in many cases the project owners are private rather than professional developers. The equivalent figure back in 2010 was just 27%. Admittedly, the number of condominiums being built as part of projects with ten or fewer residential units is 25% lower than the long-term average, but the number of major projects has declined even more sharply (Fig. 12).

**Fewer condominium projects in central locations ...**

The increased shift of construction activity from owner-occupied to rental apartment segment is also apparent in a regional view. As a consequence, construction activity for homebuyers is steadily shifting from Switzerland's large and mid-sized centers to their wider agglomerations in periurban and rural municipalities, where owner-occupied housing projects have less competition from the rental apartment side. Projects for the owner-occupied segment now account for just 9% of all approved residential units in the large and mid-sized centers (Fig. 13). A further 27% of apartments are springing up in the agglomeration municipalities of the centers. The equivalent figures back in 2002 were 13% and 38% respectively.

**... as these projects are shifting to the countryside**

By contrast, the proportion of condominium projects in rural communities has gradually increased: Whereas it stood at just 9% back in 2002, it has now more than doubled to 21%. In contrast to other municipality types, even the absolute number of approved condominiums is slightly higher than the long-term average here. The equivalent figure for periurban municipalities has also risen, namely from 23% to 30%. In other words, the Swiss are increasingly having to accept longer distances from large and mid-sized centers when purchasing their own home. Commuting times can therefore be expected to increase further (cf. Commuting section, p.18).

**Similar picture in SFH segment**

A not dissimilar picture emerges from the data on single-family dwellings. Here too, the number of new approvals has shifted from more central locations to rural areas. Whereas 31% of newly approved single-family homes were planned in large and mid-size centers or their agglomerations, the equivalent figure now is just 25%. However, in terms of absolute numbers, single-family home approvals have declined in rural communities too.

**Construction of ownership properties focused on Mittelland and away from centers**

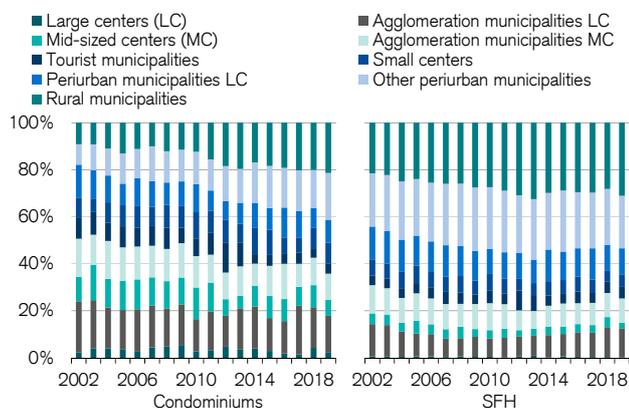
Figure 14 shows the planned expansion of owner-occupied housing for 2020 by region. In 52 of the 110 regions, construction activity is likely to be lower than last year. A comparatively high increase is first and foremost evident outside of central locations. However, there is also the occasional region – such as Canton Aargau – where significant expansion is set to continue close to an urban center. By contrast, construction activity in mountainous areas remains at a very low level due to restrictions on the construction of second homes.

**No trend reversal in sight**

Some real estate companies that have distanced themselves from the promotion of owner-occupied housing in recent years say they are now looking to become more involved with this segment again. This intention may also be driven by a desire for greater diversification in view of the further rise in rental apartment vacancies. But as long as the negative interest environment persists, the preference for investing in rental apartment projects will remain.

**Fig. 13: Owner-occupied housing projects shift to peripheral locations**

Building permits by municipality type, proportion in %

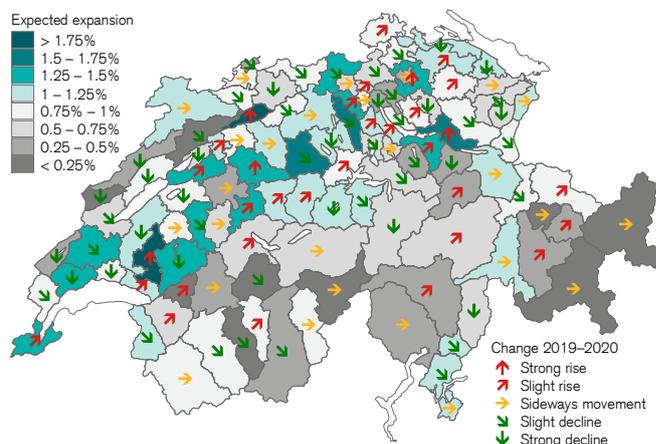


Source: Baublatt, Credit Suisse

Last data point: 11/2019

**Fig. 14: Lower planned expansion in central locations**

Planned expansion of owner-occupied property 2020, as % of housing inventory



Source: Baublatt, Credit Suisse, Geostat

Last data point: 11/2019

# Moderate price growth

**The demand for owner-occupied property contrasts with a low level of newbuild activity. Prices are therefore likely to rise further, albeit modestly.**

**Demand overhang in owner-occupied segment**

The market for owner-occupied property remains influenced by negative interest rates, as the desire for home ownership has increased again thanks to attractive mortgage rates. This desire is only tempered by the mixed economic outlook and above all high financing requirements. All in all, demand remains similar to last year, with continuously declining newbuild supply lagging behind. The scarcity of supply in the owner-occupied housing market is therefore likely to become even more accentuated.

**Advertising period continues to decline**

The decline in marketing effort in connection with owner-occupied housing confirms the demand overhang. The duration of advertising – i.e. the number of days in which a property is advertised online – has shortened further. For a medium-sized condominium this amounts to an average of 83 days, compared to 78 days for a single-family home (Fig. 15). Accordingly, marketing expenditure is now back at the nadir recorded at the end of 2014, before the intensification of self-regulatory measures curbed demand and resulted in considerably longer marketing periods.

**High-price segment remains more challenging**

In the high-price segment, the marketing situation has improved steadily in recent years, but remains much more challenging than before the introduction of regulatory measures. The marketing of properties priced 30%-50% above the regional average lasts (on average) 13 days longer in the case of condominiums, and 17 days longer for single-family homes. The equivalent figures for properties priced more than 50% above the regional average are as much as 42 and 33 days respectively.

**Central locations most sought after**

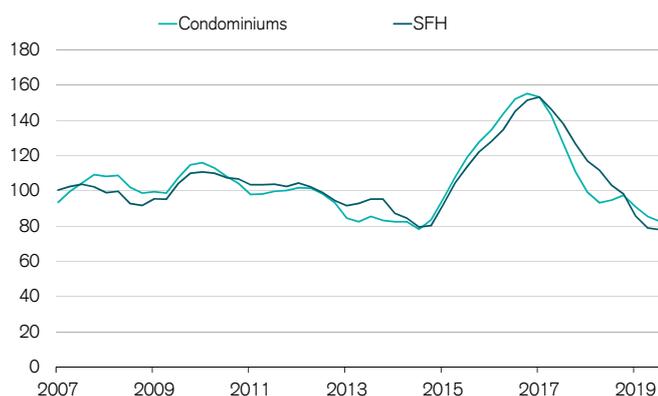
Properties that are centrally located are snapped up the most quickly. The shortest duration of advertising is found around Zurich and Winterthur. For example, a condominium in the city of Winterthur will be advertised for just 42 days on average, and in the surrounding municipalities for just 48 days. By contrast, greater marketing persistence is needed in many mountainous regions.

**Slight decline in vacancies in owner-occupied segment**

In contrast to rental apartments, vacancies in the owner-occupied housing market are declining. Overall, the number of owner-occupied properties standing vacant has declined by 72 units. This figure conceals contrasting developments, however: Condominiums have recorded a decline of 412 units, while single-family homes have recorded a rise of 340 units. The much steeper price growth in the single-family home segment in recent years therefore appears to be taking its toll. That said, overall ownership vacancy rates are extremely low in both cases, namely 0.53% for condominiums and 0.64% for single-family homes. In other words, a vacant home for sale remains a rarity in much of Switzerland, particularly in the major centers and their agglomerations (Fig. 16).

**Fig. 15: Marketing period for owner-occupied property declines**

Duration of advertising for single-family homes and condominiums, in number of days

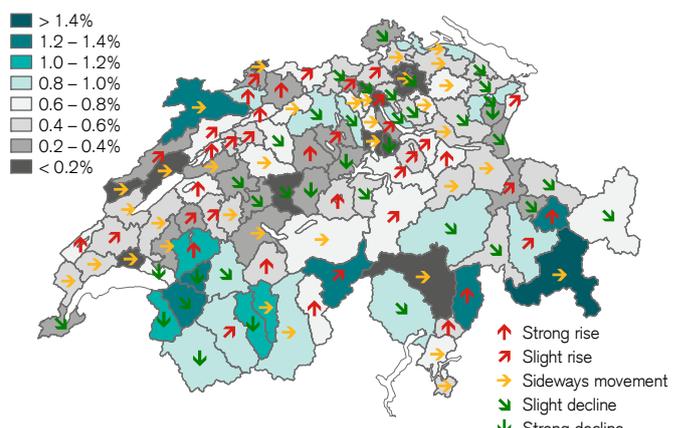


Source: Meta-Sys AG, Credit Suisse

Last data point: Q3/2019

**Fig. 16: Vacancy rates for owner-occupied property mostly low**

Vacancy rates for condominiums and SFH, as % of housing inventory



Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 06/2019

**Much higher vacancy rates in mountain regions**

The highest vacancy rates of all – both for condominiums and single-family homes – are to be found in the Jura and in the Alps. Although vacancy rates in mountain regions are falling, the over-supply that built up before the new provisions on second homes kicked in has only partially been whittled down.

**Vacancies likely to record further slight decline in 2020**

In view of the slight demand overhang and the resulting scarcity of property for sale, a phenomenon that is only likely to become more pronounced this year, we are expecting another slight decline in vacancies in the home ownership segment. However, as vacancies are already low this decline should be modest, with considerable regional differences apparent just like last year.

**Supply scarcity reflected in positive price growth**

The insufficient level of supply is also reflected in price developments. Over the last 12 months, prices in the medium segment have risen by 2.1% for condominiums and 2.4% for single-family homes (Fig. 17). In both segments, price growth has lost some of its momentum recently, which we view as consolidation of the previous, somewhat excessive increase in prices. With a few exceptions, property prices rose last year in almost every region (Fig. 18). Moreover, in regions with declining prices, declines are of a modest nature.

**Owner-occupied housing prices to rise in 2020 too**

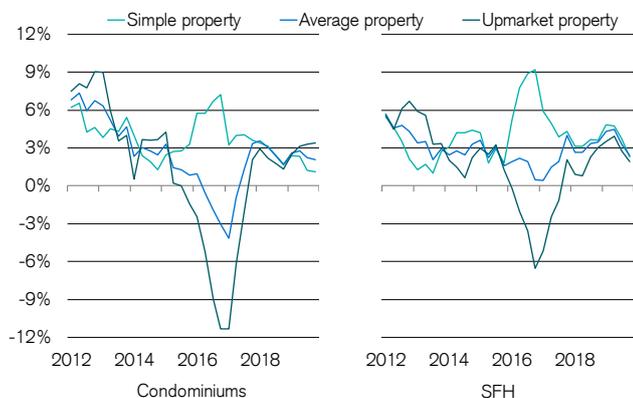
We are expecting the price of purchasing a home to rise in 2020 too. A combination of low mortgage rates and declining newbuild activity should result in positive price growth of around 2%. Significantly higher increases are not expected given the regulatory brake in place. By segment, the prices of condominiums (+1.5%) should rise less strongly – just like last year – than the prices of single-family homes (+2.2%).

**Slight rise in imbalances**

Price development and income development have diverged to a greater degree over the last year, primarily driven by the dynamic rise in the prices of single-family homes. Following the slight improvement in 2016, and at least no further widening of the gap in 2017/2018, it therefore appears that the long-term imbalance between price and income developments has once again increased somewhat. This trend is unlikely to be halted while mortgage rates languish at their current lows. Regulatory measures can mitigate much of this divergence, but cannot prevent it altogether.

**Fig. 17: Rising prices in all segments**

Annual growth rates by price segment

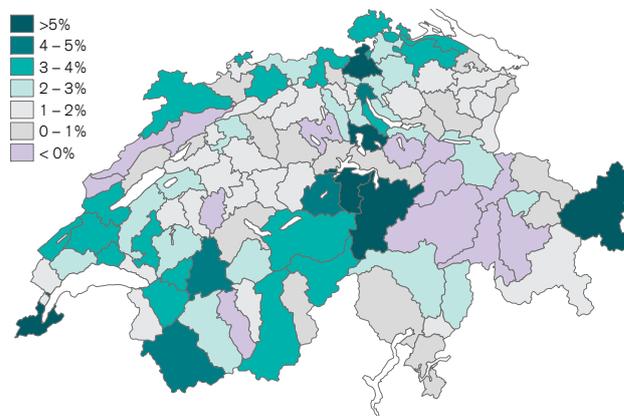


Source: Wüest Partner

Last data point: Q4/2019

**Fig. 18: Most regions record a rise**

Annual growth rates, owner-occupied housing (medium segment)

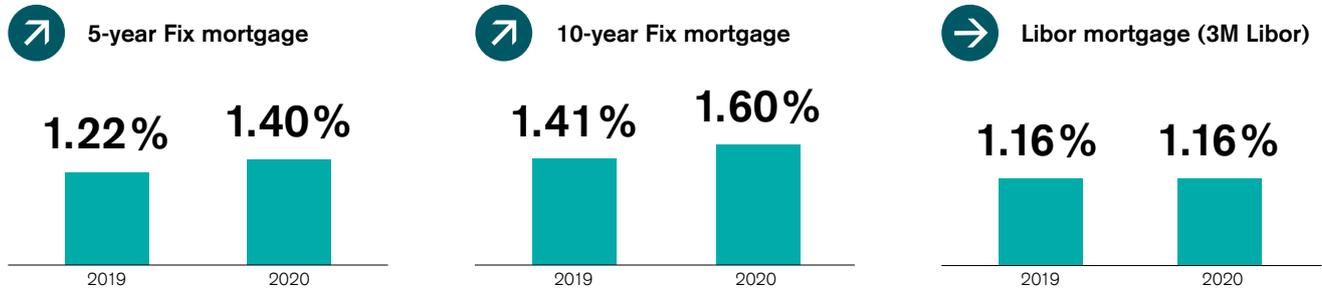


Source: Wüest Partner, Credit Suisse, Geostat

Last data point: Q4/2019

# Not enough residential property

## Mortgage interest rates



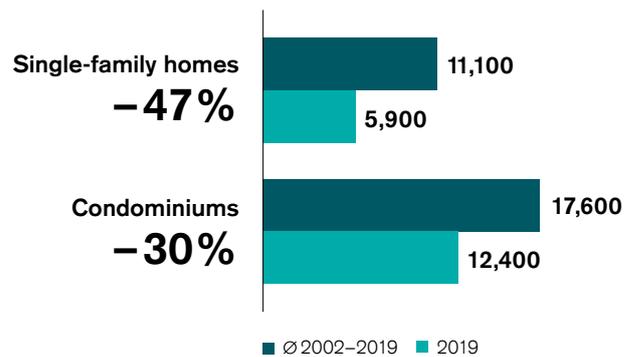
## Demand



- Lower mortgage rates fuel demand
  - High price levels and strict regulation hold back demand
- 2020: Demand stimuli will be largely neutralized**

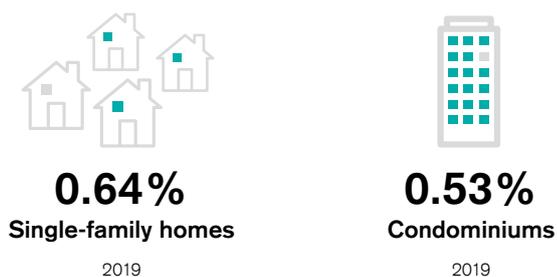
## Supply

Building permits in number of housing units



## Vacancies

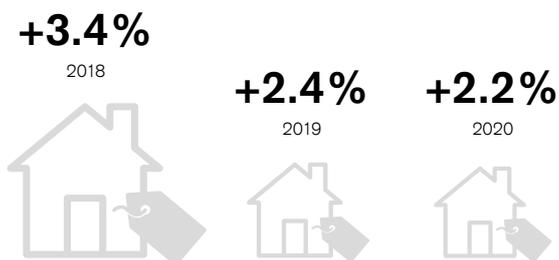
- Unchanged demand meets shrinking supply
- 2020: Vacancies decline slightly**



## Price growth

Growth in transaction prices in %

### Single-family homes



### Condominiums



# A nation of commuters

**An ever-increasing number of Swiss do not work close to where they live. These highly mobile commuters are therefore alleviating the pressure on Switzerland's urban property markets, and supporting the absorption of vacant living space in wider agglomerations. By analyzing commuter flows, developers can gain a fascinating insight into the geographical distribution of demand for accommodation.**

## Separation of place of work and place of residence

The growing division of labor and degree of specialization that are heralded as the drivers of increasing prosperity in modern economies are the cause of increased commuter flows. Increasing specialization not only makes job requirements ever more specific, it has the same impact on the profiles of jobseekers themselves. The more these two aspects coincide, the easier it is for workers to maximize both remuneration and motivation, albeit typically at the cost of a longer journey to work. However, better transport infrastructures allow commuters to mitigate the negative personal consequences of a growing geographical gap between place of work and place of residence.

## Commuters take steam out of residential property prices in urban centers

Commuter flows are dictated by the clusters of companies and jobs in major conurbations. The more a society limits residential density – and therefore also the supply of urban living space – through urban planning measures, the greater the resulting commuter streams. For commuters, the benefits of superior quality of life and lower rents away from major centers outweigh the disadvantages of more time and money for the daily commute. In this way, commuters alleviate the pressure on population density in the major conurbations. Indeed, in the absence of commuting, real estate prices in the cities would truly explode.

## Interesting conclusions to be drawn for real estate investors

The analysis of the commuting phenomenon provides a fascinating insight into the “pull effect” of labor market poles, the size of catchment areas, and the efficiency of transport infrastructures. This information can be used to optimize demand estimates for construction projects involving both office and residential properties. Municipalities situated within commuting distance of labor market poles benefit from the earning power of commuters, for whom the key draw of a place of residence is not geographical distance but transport connections, i.e. the time it takes to commute between home and work. Commuters have the effect of promoting regional equilibrium, since the higher salaries earned in conurbations then finance taxes and consumer spending in the surrounding residential communities. The residential preferences of commuters lead to the gradual spread of urban centers into their surrounding areas – a development known as “suburbanization”. As this phenomenon then extends to municipalities in the outer belts of urban areas, it is described as “periurbanization”.

## Growing commuter flows

## A million more commuters since 1990

In Switzerland, 90% of workers – or just under 4 million people – have a fixed place of work outside of the building in which they live. In transportation statistics these people are classified as commuters. Their number has increased by one million people over the last three decades. In this study, the term “commuting” describes both intermunicipal commuting between different municipalities and intramunicipal commuting within the municipality of residents. A further 0.8 million Swiss commute for training purposes. In other words, the only workers not designated commuters are those who work at home, such as farmers, and people who have no location-specific workplace.

## Intermunicipal commuting on the rise, ...

At the moment, more than 2.6 million workers – or 71% of all commuters – leave their residential municipality when they go to work. Three decades ago, this figure stood at just 1.7 million, or 59%. But while *intermunicipal* commuting has recorded a dramatic rise since 1990, the absolute number of *intramunicipal* commuters in this period has actually declined slightly (Fig. 19). 1.1 million Swiss, or 29% of all commuters, still travel to work without leaving their municipality. However, depending on the size of the municipality of residence, their journey to work may well take them longer than a commuter traveling between two municipalities.

**... but the majority remain within cantonal confines**

Although the great majority of commuters have to leave their home municipality to get to work, as many as 80% remain within their home canton. That said, cantonal boundaries are gradually losing their significance: Whereas only one commuter in eight crossed a cantonal boundary in 1990, that proportion is now down to one in five. This development is also a sign of the ever-widening geographical distance between home and work.

**Commuting distances and times have barely increased in recent years**

The average Swiss commuter takes 30.6 minutes to get to work (Fig. 20). Extrapolated over an entire year, a full-time commuter could instead have watched 157 football matches during this time, for example. The average one-way journey is around 15 kilometers. Although commuting times and distances have risen since the relevant survey began back in 2000, the rise since 2010 has been modest.

**Switzerland in an international comparison**

According to a study produced by Dalia Research, the average Swiss commuting time puts the country in mid-pack in an international comparison.<sup>3</sup> Austrians more or less mirror the Swiss, taking just one more minute a day to get to work, whereas German commuters save a full 9 minutes every day by comparison. By contrast, British and American commuters take 4 and 10 minutes longer respectively to get to work.

**Commuting is typically radial, ...**

When broken down by municipality type, commuter flows reveal the strong pull of urban centers. Only large, mid-sized, and small centers, and tourist municipalities exhibit a positive commuter balance (inward minus outward commuters). Leading the rankings by a considerable margin is the city of Zurich with a positive balance of almost 170,000 workers. In second place, albeit with a positive balance of only around half Zurich's figure, comes the city of Bern. Figure 21 shows how heavily commuter flows are skewed toward large urban centers. In total, these centers are involved in 60.7% of all intermunicipal commuter movements (as either place of work or place of residence). This so-called radial commuting therefore accounts for the majority of all cross-municipal commuter flows.

**... but tangential movement is growing strongly**

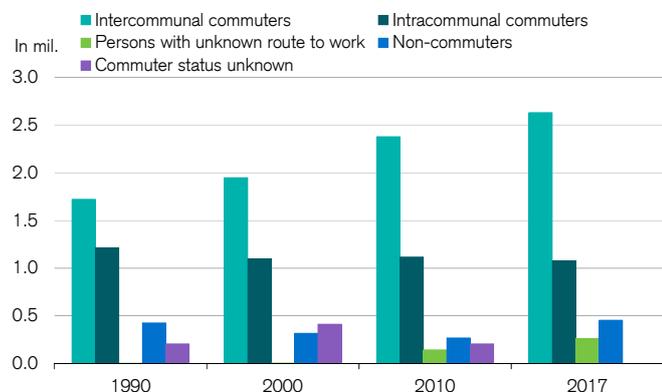
However, so-called tangential commuter movements – i.e. those that do not touch the urban centers – have risen significantly in recent decades. Today, almost as many intermunicipal commuters work in the agglomeration municipalities of the large centers as they do in the centers themselves. In three out of every five cases, these commuters live in a different agglomeration municipality of a large center. For example, almost 1,000 residents of Dietikon travel to nearby Schlieren for work purposes. Just over 600 workers do the reverse commute.

**More workers in agglomeration municipalities**

A major reason for the rise of tangential commuting is the increased significance of Switzerland's agglomeration municipalities as places of work. The decline in employment growth was by far the highest in the agglomeration municipalities of the large centers between 1995 and 2008. Since 2011, growth dynamism has increasingly shifted to the agglomeration municipalities of mid-sized centers. This therefore testifies to the growth of employment markets of the expanded centers.

**Fig. 19: More commuters between municipalities**

Commuters by status, absolute figures since 1990

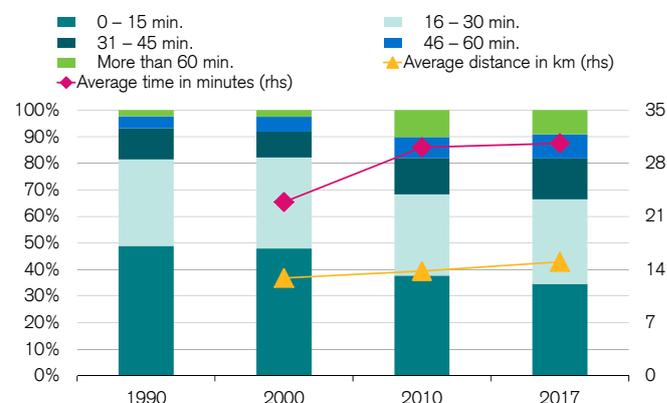


Source: Swiss Federal Statistical Office

Last data point: 2017

**Fig. 20: Longer commuting times and distances**

Commuters by distance to work (one-way) and average time in minutes



Source: Swiss Federal Statistical Office

Last data point: 2017

<sup>3</sup> This study selected a survey method that deviates from that of the Swiss Federal Statistical Office, which is why the results are not comparable.

**Commuters continue to favor the car, ...**

In Switzerland, 54% of resident commuters use a private motor vehicle (typically a car) to get to work. This figure was the same back in 1990. 31% now use public transport (PT) as their main mode of transport, up from 28% in 1990. On a relative basis, PT has therefore become only slightly more popular. The share of pedestrians and cyclists has declined over the same period.

**... but only for journeys of less than 50 kilometers**

While personal motorized transfer may be the most popular for short and medium journeys, the majority of commuters opt for PT for journeys of more than 50 kilometers (Fig. 22). As many PT networks are heavily focused on urban centers, radial commuters are likely to be more frequent PT users than tangential commuters. In recent years, however, increasing efforts have been made to improve the PT interlinking of outer urban municipalities, e.g. in the Zurich area with the Glattalbahn railway and indeed the Limmattalbahn railway, which is currently still in construction.

**Significant rise in cross-border commuting to Switzerland, ...**

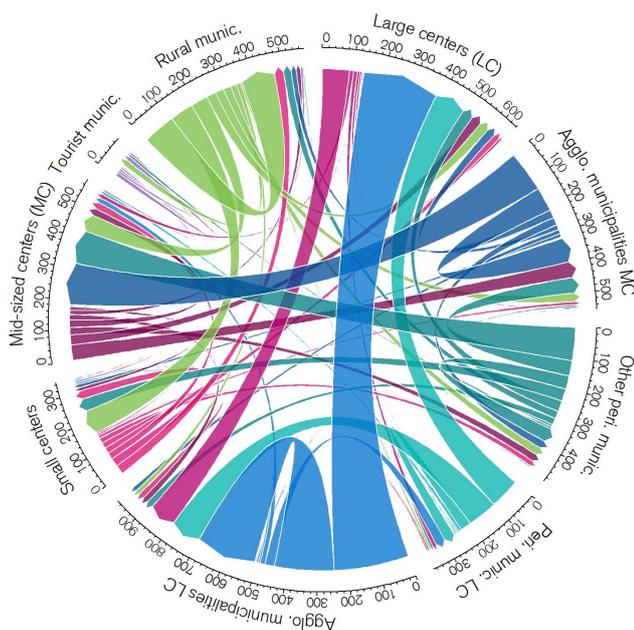
Our analysis up until this point has ignored people commuting to Switzerland from neighboring countries. These workers cross national borders as well as municipal boundaries on their way to work, and are hence termed cross-border commuters. Their number has doubled from 163,000 at the end of 2002 to 325,000 today (Fig. 23). The majority come from France (177,000), followed by Italy (77,000) and Germany (60,000). Without including these significant cross-border movements, commuter flows to Geneva (85,000 cross-border commuters), Ticino (68,000), Basel (34,000), or Vaud (32,000) cannot be adequately captured. The drivers of the growing number of cross-border commuters are lower unemployment and higher wages in Switzerland, as well as the Schengen Agreement (2008), which has greatly facilitated cross-border travel. According to a study produced by Ecoplan, the reintroduction of border controls would reduce the number of cross-border commuters by between 27% and 62%.<sup>4</sup>

**... but very little outwardly from Switzerland**

Swiss workers also commute abroad. However, at less than 26,000, their numbers are dwarfed by those traveling in the other direction. Just like other commuter flows, the influx of cross-border commuters alleviates pressure on accommodation in Swiss conurbations. For example, the scarcity of living space in Geneva or Basel would be significantly higher without the cross-border commuter traffic taking the pressure off the local real estate market. However, these commuter flows do put an additional burden on the transport system. For this reason, local cross-border transport networks are to be further expanded in future. Only last December, for example, the most important international suburban railway network in Europe was opened in Geneva in the form of the Léman Express. The so-called “three countries triangle” with Basel at its heart has long been known to cross-border PT routes, such as the tram connection to Weil am Rhein (DE) and the link to Saint-Louis (FR). However, the cross-border planning of such connections is a drawn-out process and typically proceeds slowly.

**Fig. 21: Commuters sucked in to the major centers**

Commuter flows by municipality type, absolute figures in thousands

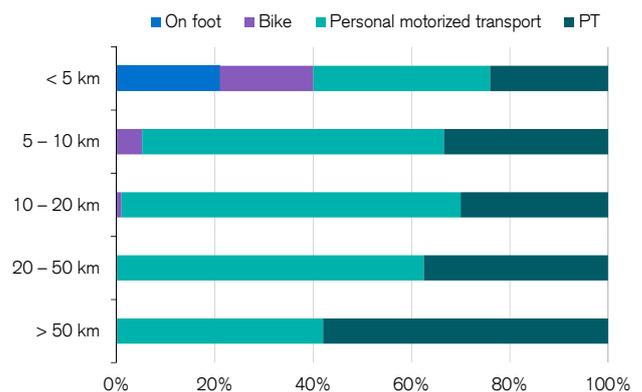


Source: Credit Suisse, Swiss Federal Statistical Office

Last data point: 2014

**Fig. 22: Public transport (PT) preferred for long distances**

Proportion of main forms of transport by route length, in %



Source: Swiss Federal Statistical Office

Last data point: 2016

<sup>4</sup> Ecoplan: Volkswirtschaftliche Auswirkungen eines Wegfalls der Schengen-Assoziierung der Schweiz [“Economic repercussions of a discontinuation of Switzerland’s Schengen association”], Bern, 2017

## Drivers of the commuting phenomenon

### Commuting boosted by changes in world of work

The increasing number of commuters has a strong correlation with changes in the world of work over recent decades. Companies nowadays seek to concentrate their workforce at as few locations as possible. While this promotes knowledge exchange and the ability to innovate, it also results in longer commutes. Although flexibilization of working times – including the rise of the “home office” – can reduce the number of necessary commuter movements, the ultimate reduction potential is limited. And even in professions where working from home is possible in principle, only certain employees will actually do so, as the benefits of personal interaction at the central workplace are too great. The changing nature of career paths likewise exerts an influence: Frequent changes of job within a career are no longer a rarity nowadays, which reduces the incentive to move house. Moreover, it is now typical for both partners in a family to work, which in many cases will mean that at least one party will not have the same place of work and place of residence. And indeed, the proportion of women commuters has also increased, from 39% in 1990 to 48% in 2017.

### Importance of maintaining social ties

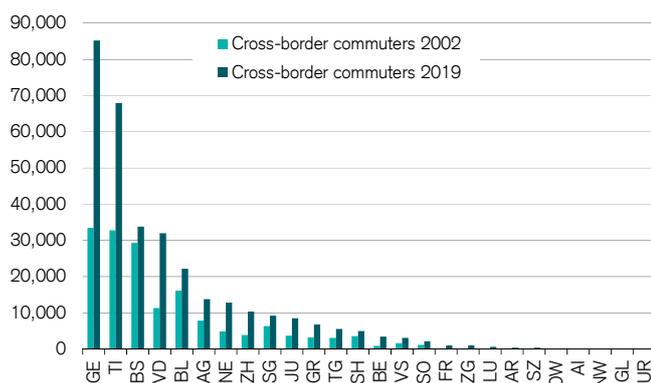
Younger generations attach greater importance to a work-life balance. This also extends to pursuing social activities in the vicinity of their home. In order to maintain social networks, many workers would rather put up with commuting than repeatedly move house. Ironically it is therefore commuters, who subjectively consider themselves to be the most mobile, who are actually the most sedentary grouping in society.

### Scarcity of accommodation boosts the commuting phenomenon

Living space in the major conurbations is a scarce commodity. The consequences of this scarcity are high rents and high property prices. Additional living space in Switzerland is currently springing up outside of the main centers (see “Owner-occupied housing” and “Rental apartments” sections). People looking to buy their own homes therefore feel forced to seek out areas outside of the major centers and their wider urban municipalities. Figure 24 shows how the prices of residential property fall dramatically in keeping with distance from the city of Zurich. In Zurich itself, the price of an average newbuild apartment with 110 m<sup>2</sup> of floor space is currently CHF 1.73 million. But if prospective buyers are prepared to commute for 30 minutes by PT, they will pay an average of just CHF 950,000 or so – such as in Mettmenstetten or Wangen SZ, for example. If they are prepared to commute for as much as an hour, the same type of home will cost just CHF 700,000. Workers on very high salaries can also afford to take into consideration the local tax burden, as in Switzerland considerable tax savings can be made depending on the choice of municipality.

**Fig. 23: Strong increase in foreign commuters**

Number of cross-border commuters domiciled abroad, Q3 in each case

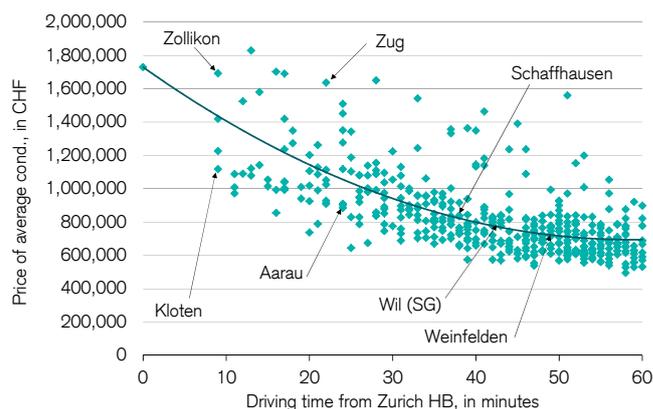


Source: Swiss Federal Statistical Office

Last data point: Q3/2019

**Fig. 24: Commuting times impact negatively on real estate prices**

Price of a newbuild condominium (cond.) with 4.5 rooms in CHF and travel time from Zurich main station (HB)



Source: Wüest Partner, Credit Suisse

Last data point: Q3/2019

### Other influencing factors

A number of different parameters can encourage or discourage the commuting phenomenon. For example, the tax deductibility of commuting costs was recently capped at CHF 3,000 at federal level. At cantonal level, there is still a huge degree of variation in this respect. By contrast, discussions over the eligibility of travel time toward working hours are likely to work in favor of commuters. For example, government employees have been permitted to deduct all commuting time from their working hours since the start of the year – as long as their line manager permits it. But the commuting phenomenon is also likely to be enjoying a boost simply from the increasing ability of commuters to execute certain working tasks while on the go. Moreover, the more meaningful way

in which commuting time can be used thanks to technological advances should reduce the negative effects of commuting. A number of studies have flagged up drawbacks to health and negative impact on individual life satisfaction levels, particularly for long-distance commuters. So in many respects we are actually underestimating the true costs of commuting.

### Internalization of external costs?

The true costs of commuting also include the external costs borne by the wider public, such as traffic congestion and overcrowding, environmental pollution, and ongoing urban sprawl. Discussions over the level of subsidies for public transport are gaining in importance, not least due to sustainability considerations. It is likely that consistent internalization of external costs would lead to a noticeable reduction in commuter flows.

### Commuter flows as indicator for development projects

#### Commuter flows and the real estate market

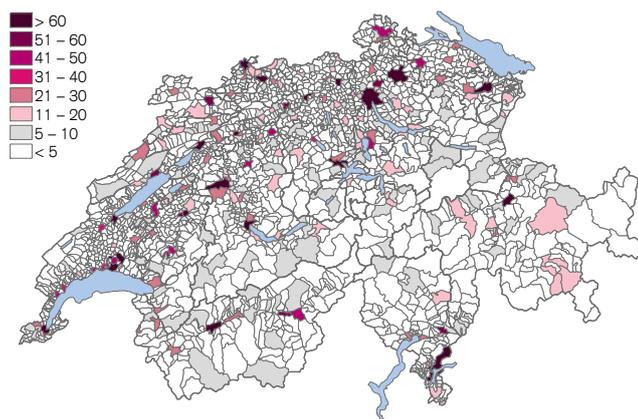
The magnitude, direction, and change in commuter flows can provide developers with valuable indicators when estimating likely demand. Detailed data on the number and origin of inward commuters and the number and destination of outward commuters exists for every Swiss municipality. This allows a relatively precise picture to be drawn in respect of labor market poles and the suction effect they exert in surrounding areas. Builders of office properties, for example, can determine the magnitude of the suction effect of the regional center (as labor market pole) by analyzing commuter balances, the size of the catchment area, or simply the number of surrounding municipalities in which the number of outbound commuters headed toward the regional center accounts for more than 5% (Fig. 25).

### Suction effect of supra-regional centers

For example, in central Switzerland the city of Zug (45 municipalities with outbound commuter proportions >5%) may have less of a suction effect than supra-regional center Lucerne (96), but Zug lies at the heart of a highly competitive network of other labor market centers, including the municipalities of Baar (29), Cham (12), and Risch (11). Strong labor market poles are in turn guarantors of solid property demand for builders of residential developments – as long as the direct transport links are efficient enough. In addition to the large centers, other supra-regional centers with large catchment areas include the cities of St. Gallen, Winterthur, Fribourg, Biel, and Chur. A network of labor centers is now also evident in the vicinity of major center Lausanne (307), with its satellite centers of Le-Mont-sur-Lausanne (41), Renens (35), Ecublens (32), and Morges (48).

**Fig. 25: Labor market poles in Switzerland**

Locations by number of commuter origin municipalities with an outward bound commuter share > 5%

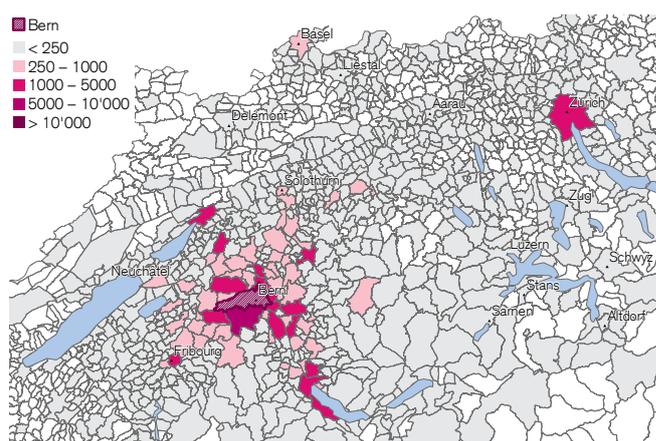


Source: BFS, Credit Suisse, Geostat

Last data point: 2014

**Fig. 26: Bern's large commuter catchment area**

Number of commuters to Bern



Source: BFS, Credit Suisse, Geostat

Last data point: 2014

### A tool for identifying real estate demand

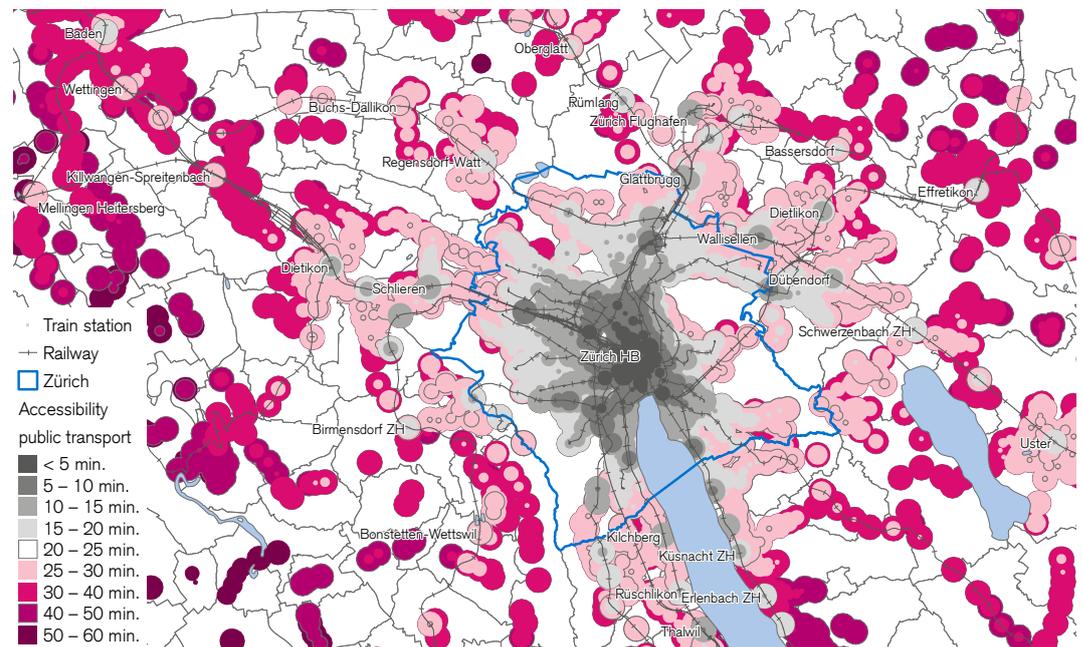
When planning a new residential property, developers can use the commuting intensity of the local residential municipality to estimate potential demand for the corresponding living space from local residents who work in a major conurbation. The commuter catchment area of the main center (Fig. 26) supplements this information, and shows how the residential municipality fits hierarchically into regional commuter interrelationships, as well as which other locations could be competing with an intended building project. It is currently all too common for developers to only find out about unwelcome competitor projects once construction is under way. Figure 26 shows where the workers of Bern actually live, which agglomeration municipalities are easily accessible, and how far commuters are prepared to travel in the Bern region.

## Commuting time as factor in choice of residence

Renters and property owners can also use commuter data to inform their choice of residential area. While the duration of the commute may not be the critical factor when it comes to choosing a place to live, it is certainly an important criterion. The place of work is in most cases already a “known” when it comes to selecting an area to live. If workers then set a ceiling on the amount of time they are prepared to commute, this will then narrow down the number of potential municipalities in which they can settle. Figure 27 shows the travel times from Zurich main station for every hectare in the Zurich metropolitan area. One surprising finding, for example, is that residents of Baden in Canton Aargau can reach the center of Zurich just as quickly as residents of certain districts of Zurich itself, such as Seebach and Höngg. Two other municipalities offering very competitive commuting times are Stettbach and Wallisellen, where plenty of residential space is currently under construction. Anyone living in close proximity to the railway stations of these municipalities will be able to travel to Zurich’s main station just as quickly as residents in some parts of the city center.

**Fig. 27: Good public transport (PT) accessibility is crucial**

Travel times from Zurich HB, down to the precise hectare



Source: Credit Suisse, SBB Open Data, Geostat

Last data point: 12/2019

# Weaker growth stimuli

**Demand for apartments has strengthened recently thanks to a good economic situation and the stabilization of immigration. However, it is difficult to discern any new growth stimuli.**

## Immigration stable

Despite a clear deterioration of the economic situation over the course of last year, the demand for rental apartments remains robust for now. A still healthy employment growth rate of 1.1% (as at Q3 2019) and an intact labor market have underpinned domestic demand. A total of 69,000 people migrated to Switzerland for employment reasons in 2019 – a figure not exceeded since 2015. At the same time, however, there was a significant decline in the number of families moving to Switzerland in their wake. This can be viewed as a delayed reaction to the comparatively low immigration of recent years. However, with net migration of some 53,000 persons (2018: 51,400), the stabilization of immigration – a trend that first became apparent in 2018 – has continued (Fig. 28). This is partly because the number of people emigrating did not rise further for the first time since 2014.

## Less demand from southern Europe

Immigration from the “old” European countries (EU-17 and EFTA) once again proved weak. In 2019, these countries accounted for just 39% of net immigration. The last time a lower figure was recorded was in 2002 – years before the entry into force of the full free movement of persons. In 2019, the decline was attributable in particular to the migration balance of Italian and Portuguese nationals. Due to the return migration of Italians, Ticino actually reported net emigration for the first time since the late 1990s. Attracted by the buoyant economy in their native country, Portuguese citizens continue to leave Switzerland in large numbers (net migration in 2019: -2,800), which is above all feeding through into the net migration figures of French-speaking cantons such as Valais and Vaud.

## Net migration higher in German-speaking Switzerland

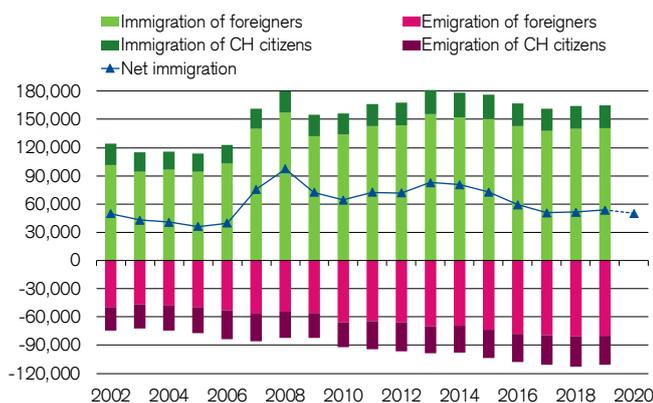
In a mirror image, the number of immigrants from the “new” EU countries has climbed to a record high. This is attributable to the expiry of the safeguard clauses with Bulgaria and Romania at the end of May last year. As a consequence, net immigration from these countries recorded a year-on-year rise of 2,800 persons or 133%. The beneficiaries of this influx were primarily the larger German-Swiss cantons such as Bern and Zurich.

## 2020: immigration to weaken slightly

The Swiss economy appears to have found its feet at the current lower growth level. That said, the 1.4% increase in gross domestic product expected for 2020 is artificially inflated by certain special effects, and should only be viewed as meaningful to a limited degree. Employment growth can therefore be expected to slow this year to 0.9%. We are accordingly expecting a slight slowdown in net immigration to some 50,000 persons (Fig. 28).

**Fig. 28: No new boost to immigration in sight**

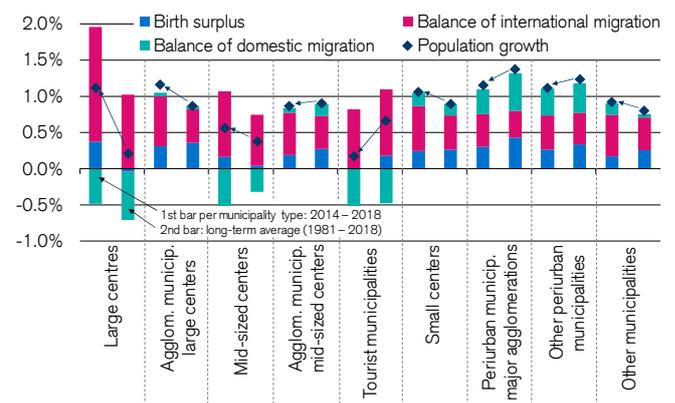
Net immigration of permanent resident population (excluding registry corrections); 2019: estimate/extrapolation; 2020: forecast



Source: SEM, Federal Statistical Office, Credit Suisse Last data point: 12/2019

**Fig. 29: Population growth shifting to urban centers**

Population balance by municipality type: annual average 2014 – 2018 and long-term average 1981 – 2018; as % of residential population



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 2018

## A renaissance at the heart of the city ...

Despite the latest stabilization, there is no sign that immigration rates are set to return to the high levels recorded between 2007 and 2015. This gives renewed significance to potential domestic demand, which is shaped by a number of structural trends. A key trend is “reurbanization”, i.e. the renaissance of Switzerland’s cities, which are becoming more attractive (Fig. 29): Between 2014 and 2018, Switzerland’s five largest cities recorded average population growth of 1.1% p.a. – much more than the long-term average (0.2%). They have seen a strong increase in foreign immigration in particular. By contrast, the large centers continue to lose residents to their surrounding areas, albeit fewer than before. Moreover, families living in cities also appear to be increasingly content with their lot.<sup>5</sup> The birth surplus in Switzerland’s large centers, which was negative on average for a long time, was higher than in all other municipality types between 2014 and 2018.

## ... slowed only by a scarcity of apartments

At just under 1.2% annually, the inner agglomeration ring of Switzerland’s large urban centers is growing even more strongly than the agglomeration core itself. In addition to immigrants from abroad, these suburban municipalities are providing new homes to people moving out of the core cities, but are in turn losing residents to municipalities on the agglomeration periphery, the so-called periurban municipalities. The classic “suburbanization mechanism” is therefore still in place, driven overwhelmingly by the major gulf in apartment rents, which is in turn caused by the scarcity of supply in agglomeration cores. However, this mechanism has lost some of its potency recently when compared to the reurbanization trend evident in the large centers. Switzerland’s small and mid-size centers (cf. page 55) have likewise exhibited more dynamic population development, albeit not to the same degree.

## Demographic effects holding back demand for apartments

Another structural driver of rental apartment demand is demographic and social change. The decline in the birthrate, rising life expectancy, declining marriage numbers, and the rise in the age at which people get married have all brought about a significant change in the structure of private households in the last few decades. The single-person household has been the most numerous type of household in Switzerland ever since the late 1990s. According to the reference scenario of the Swiss Federal Statistical Office, the growth of small households (one to three persons) is set to flatten off over the next few years, which should mean rather fewer new households being created in the coming years (Fig. 30).

## Growth slump from 2030

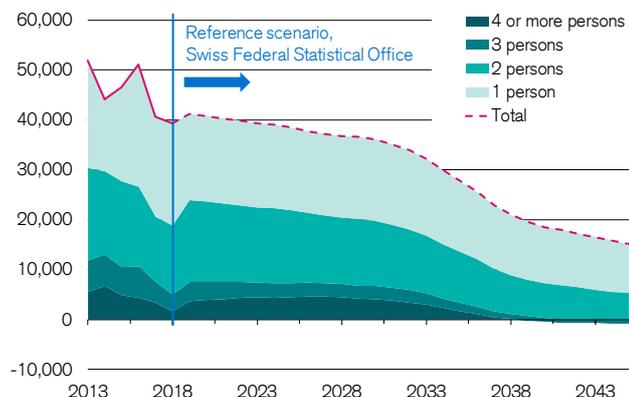
In the long term, household growth should decline sharply from the 2030s onward, as the baby boomers will then reach the age at which mortality rates are much higher. Whether or not the annual additional demand for rental apartments will then in fact slump dramatically ultimately depends not just on the development of immigration, which is difficult to predict, but also on the number of people choosing to purchase property. Either way, however, the current overproduction evident in the rental apartment market urgently needs to be curtailed before this growth slump occurs.

## Conclusion: virtually no growth stimuli in short term

Overall, we are expecting a slight decline in rental apartment demand in 2020, due to a modest fall in immigration and a gradual deterioration of labor markets. Absorption is likely to decline by between 1,000 and 2,000 residential units (Fig. 31). The reurbanization trend will probably persist and provide a powerful boost to demand in the cities. The key challenge where the latter is concerned is the provision of adequate supply.

**Fig. 30: Fewer households likely to be created longer term**

Annual change in number of private households;  
2019 – 2045: reference scenario, Swiss Federal Statistical Office

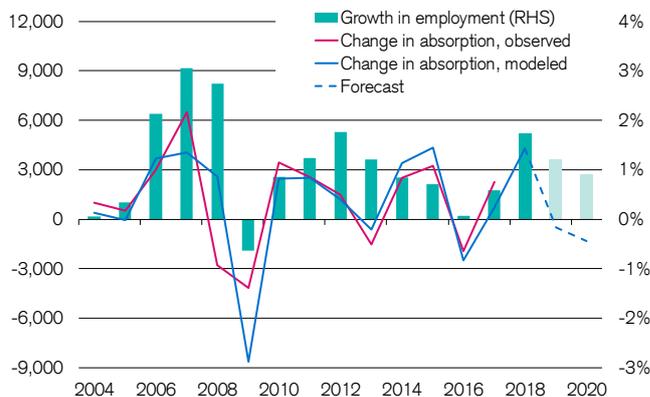


Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 2018

**Fig. 31: Decline in demand for rental apartments expected**

Annual change in absorption of rental apartments and employment growth (full-time equivalents), 2019/2020: estimate/forecast



Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 2018

<sup>5</sup> See “Families discover the city” article in “Swiss Real Estate Markets 2019: Location, location, floor plan”, Credit Suisse, pp. 25 et seq.

# Construction out of step with demand

The developers of residential investment properties have taken their foot off the accelerator for now. But buildings are still springing up in excessive numbers, as well as in the wrong place.

**Far fewer rental apartments approved for construction, ...**

Supply has exceeded demand in the Swiss rental apartment market for many years. A correction to the volume of construction is overdue, but has long been delayed by negative interest rates. In 2019, the number of rental apartments approved for construction declined by 2,300 units (-8.4%). The start of a longed-for correction or just a pause for breath? The sharp fall is actually deceptive, as the number of planning applications declined by just 900 residential units (Fig. 32).

**... but buildings are still springing up in the wrong place**

The problem of excessive apartment construction is exacerbated by their locational distribution. Above all, there has not been enough of a shift of construction activity to address the strong rise in demand in Switzerland's large centers. While the proportion of city center building applications rose somewhat in 2019, it was just 11.7% over the course of the last three years (long-term average: 14.3%). By contrast, the proportion was high over the same period for rural and periurban municipalities – the areas with the highest vacancy rates (Fig. 32). That said, there are a large number of major projects planned for urban agglomerations, and some of these have yet to receive approval. We can therefore expect to see a return to increased building permit issuance over the course of this year.

**High demolition rate reduces net addition in urban centers**

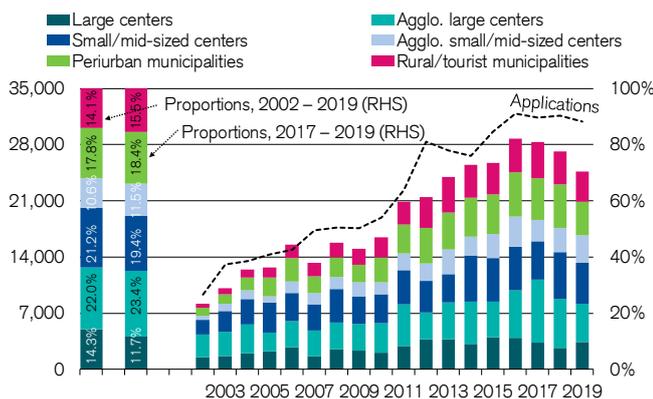
But hopes of an improvement in Switzerland's hotspots are also being thwarted by the scarcity of building land reserves. And in certain areas – e.g. the city of Zurich – many existing brownfield sites have already been converted into new residential districts recently, so a rising number of construction projects are replacement newbuilds. These are typically denser than the original developments. Nonetheless, the actual number of net new apartments being created is less than the number of approved units would suggest. In major centers, the share of apartment projects being built on "green fields" was just 17% between 2015 and 2017 (Fig. 33). 44% of investment was channeled into replacement newbuild projects, 39% into the upgrading of existing properties.

**Conclusion: reduction in oversupply still a long way off**

The number of rental apartments approved for construction should stabilize again this year, and fresh supply will continue to outstrip the market's absorption capacity outside of the major agglomerations. Whereas the shortage of supply is set to persist only in the major centers and Canton Zug, the vacancy problem can be expected to become more acute above all in regions such as southern Ticino, the southern part of Canton Fribourg, Canton Solothurn, and the Jura arc.

**Fig. 32: Construction activity: too much, and in the wrong place**

Building permits for rental apartments by municipality type, number of housing units

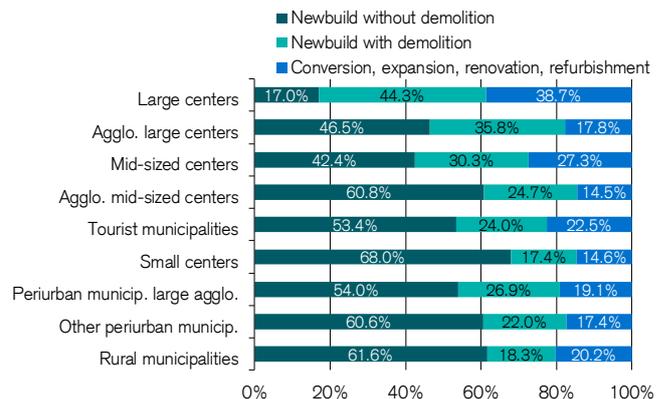


Source: Baublatt, Credit Suisse

Last data point: 11/2019

**Fig. 33: Building redevelopment dominates in major centers**

Building investment in multi-family dwellings and buildings with partial residential use: Building redevelopment versus building "on green fields", 2015 – 2017



Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 2017

# Modernity no protection against vacancy threat

**Outside of city centers, the marketing of rental apartments is challenging – and for newbuilds too. The properties in demand right now are those with compact floor plans.**

**Tenants need not hurry when looking for an apartment**

In many Swiss regions, apartment seekers can currently choose from a bountiful spectrum of properties. At the end of 2019, 5.3% of the rental apartment inventory across Switzerland was on the market – with this figure considerably higher in some areas of the Mittelland, home to so many rural and periurban municipalities. Home hunters can afford to take their time in these regions, where rental apartments are on average advertised for 40 days, 50 days, or even more (Fig. 34). By contrast, in urban centers such as Zurich, Geneva, and Zug, advertisements are on average withdrawn from circulation after less than 25 days.

**One in every ten newbuild apartments vacant**

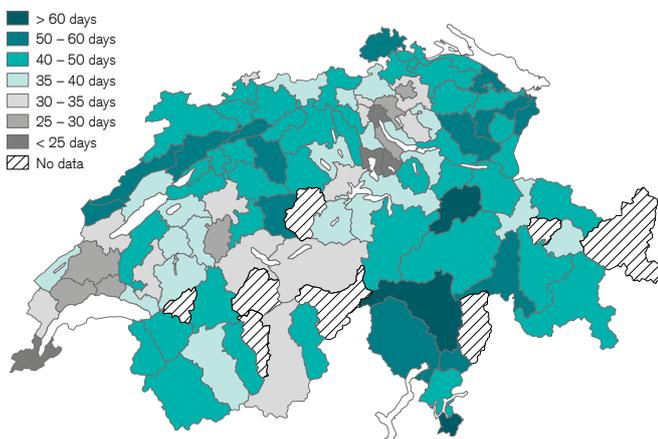
The current market environment is particularly challenging, and not just for landlords looking to fill individual apartments, but also when new tenants need to be sourced rapidly for a glut of apartments in one of the numerous newbuild blocks that are springing up. Since 2012, the vacancy rate for all Swiss residential properties (rental and owner-occupied) has continuously risen from 0.95% to 1.66%. However, if the view is restricted to newbuild apartments that have come onto the market in the two years prior to the reference date of the vacant apartment survey, the vacancy rate rises from an estimated 5.4% to 10.1%. As a consequence, an average of one in every ten apartments is vacant for the first two years following completion. If only properties available for rent were taken into consideration, this proportion would likely work out even higher.

**What divides the wheat from the chaff?**

New apartment marketing has become more challenging as a result. This makes the question of what distinguishes success and failure all the more important. In last year's study,<sup>6</sup> we showed that location is a key factor. The greater the proximity to an urban center and the better the micro location within the municipality, the lower the vacancy risk. But what impact do individual property characteristics have? In online property searches, the key filter criteria applied along with geographic location are size (floor space, number of rooms) and price. If a certain price level is exceeded or a minimum floor space is not met, a property will not even make it to the next selection stage. Consequently, these characteristics are likely to have a decisive impact on a property's market chances.

**Fig. 34: Patience required when marketing**

Duration of advertising for apartments on the market, 2019

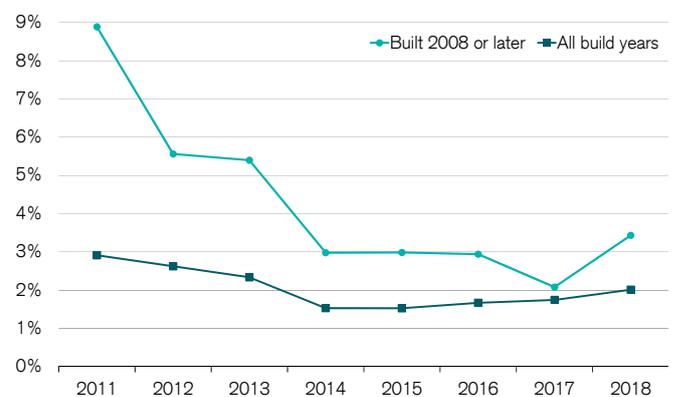


Source: Meta-Sys AG, Credit Suisse, Geostat

Last data point: Q4/2019

**Fig. 35: Newbuilds typically do not find tenants overnight**

Loss of rental income as % of gross expected rental income for a constant portfolio of 1,100 investment properties (predominantly residential use) between 2011 and 2018



Source: REIDA, Credit Suisse

Last data point: 2018

<sup>6</sup> See "Quality prevents vacancy" article in "Swiss Real Estate Market 2019: Location, location, floor plan", Credit Suisse, pp. 28 et seq.

### Higher vacancies even several years after initial occupancy

Using the data of the Real Estate Investment Data Association (REIDA), a data pool fed from the portfolios of various institutional investors, the pattern of rental apartment vacancies can be scrutinized in greater detail for the above-mentioned criteria. The performance of 1,100 predominantly residential investment properties can be tracked over the entire period 2011–2018. In order to determine how vacancies in newbuild properties have developed over time, we compared the lost rental income for all 1,100 properties with those of 28 properties built in the years 2008–2010 (Fig. 35). What emerges is that it takes a while for newbuild apartments to be absorbed. In 2011, the income loss in the newbuild sub-portfolio was 8.9%. Only three years later did this figure stabilize at 3.0%, thereby converging with the income loss on the portfolio as a whole.

### Vacancies highest in apartments that are no longer brand new

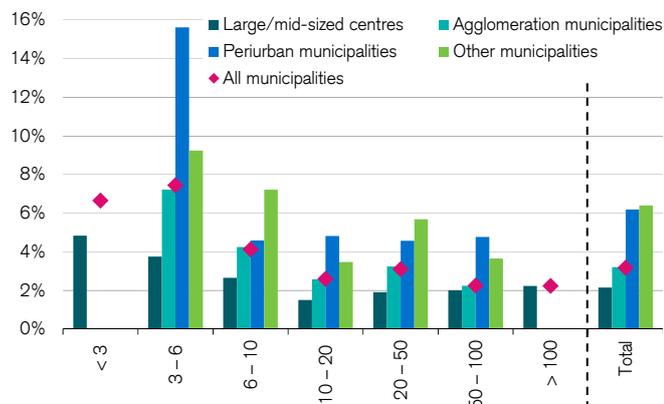
In many cases, a certain amount of patience is therefore required before a newbuild property is fully let. However, absorption periods vary greatly from case to case and depend on a number of factors, including location: Analysis of just under 100,000 rental agreements from the REIDA portfolio for a two-year period up to Q3 2019 reveals an income loss equivalent to 3.2% of expected rent (Fig. 36). The lowest income losses are to be found in large and mid-sized centers (2.1%), while the highest are recorded in periurban and rural municipalities (6.2% and 6.4% respectively). For newbuild apartments less than three years old, the income loss is also much higher in the large centers (4.8%), albeit still lower than the total for all newbuild apartments (6.6%). Income losses are higher for properties aged between three and six years, whereby the city-country gap is particularly striking in this case. One possible explanation is that re-letting is particularly difficult for apartments that are three to six years old, which were originally positioned in the market rather expensively. It appears that the willingness of many tenants to pay the kind of premium that was achievable for the initial occupancy is no longer so high, despite the relatively low building age.

### Small-scale newbuild apartments in vogue

Another factor likely to have a significant impact on the absorption chances of new apartments is room size, as this correlates closely with the rental price. Whereas the income losses in the analyzed REIDA portfolio amounted to 6.6% of expected rent overall for apartments less than three years old, this figure drops to just 1.1% for the smallest 20% of apartments (measured in terms of floor space for the given number of rooms) (Fig. 37). This phenomenon no longer applies when the analysis switches to apartments aged ten years old or more. Apartment-seekers appear to have a fundamental preference for newbuild properties, and are prepared to forgo a certain amount of space in order to meet their budget restrictions. Net rents for newbuild apartments amount to CHF 274 per m<sup>2</sup> on average, which is 24% higher than the level of net rents for the overall portfolio. If only rental agreements with a term of less than three years are taken into consideration (to approximate the rents of new agreements), the difference declines to 10%. This premium for newbuilds is offset by tenants forgoing 10% of floor space for their given budget.

**Fig. 36: Higher vacancy rates for newbuilds in urban centers too**

Loss of rental income as % of expected rent, by building age in years and municipality type; period: Q3 2017 – Q3 2019

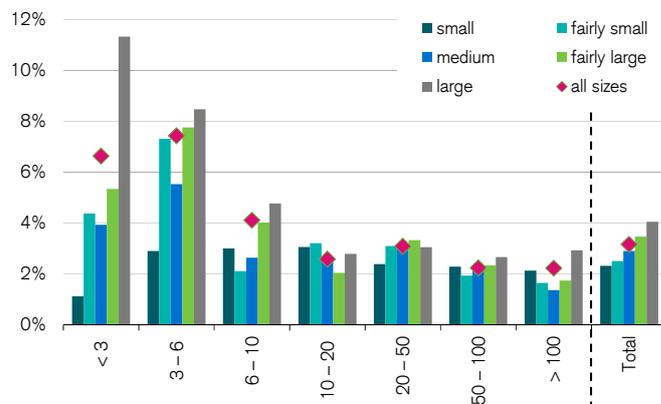


Source: REIDA, Credit Suisse

Last data point: Q3/2019

**Fig. 37: Compact floor plans in demand**

Loss of rental income as % of expected rent, by building age in years and apartment size (quintile per number of rooms); period: Q3 2017 – Q3 2019



Source: REIDA, Credit Suisse

Last data point: Q3/2019

### Rental prices likely to come under even more pressure

The growing number of vacancies in recent years has led to persistent pressure on rental prices. However, the rise in the number of vacancies in 2019 (a further 3,100 rental apartments) was much less pronounced than just the previous year (6,600 apartments), thanks to the previously healthy economic situation and the stabilization of immigration. The pressure on rents has therefore slowed somewhat for now (Fig. 38). According to Wüest Partner, the annual growth rate in offered rents amounted to -0.9% in the fourth quarter of 2019, an improvement on the prior-year equivalent of -2.1%. Contractual rents even recorded a rise of 1.6%.

### Gulf between market rents and existing rents

Since the beginning of 2009, contractual rents in Switzerland rose by 12.3% on average, and by as much as 15.4% in urban centers. At the same time, the reference interest rate declined from 3.5% to 1.5%. Tenants who concluded rental agreements ten years ago and consistently claimed their reduction entitlements would have reduced their rents by 16.8% over this period. An original monthly rent of CHF 2,000 for an apartment in a major urban center would therefore have declined to CHF 1,663. If these tenants were to conclude a new agreement for an identical apartment today, their rent would suddenly leap to CHF 2,308, equivalent to an additional rental burden of 38.8%.

### The rise of the furnished apartment

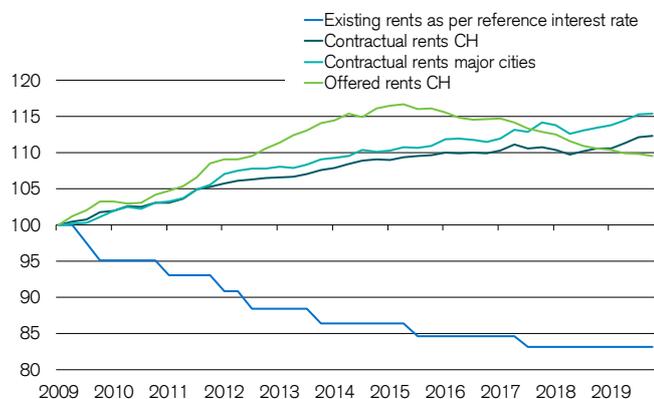
The above example illustrates that long-term tenants have little incentive to relinquish their existing apartments – other than in response to a major life development such as job relocation or starting a family. One consequence of this “lock-in effect” is that many tenants, particularly those based in highly-priced urban centers, choose to sublet their apartment when not using it for a prolonged period of time, e.g. when moving abroad temporarily. Along with the growing number of serviced apartments, this phenomenon is another reason why an increasing number of furnished apartments are advertised on property platforms, particularly in city centers (Fig. 39). In the city of Zurich, for example, furnished apartments accounted for some 24% of all advertised apartments in 2019. Similarly high figures were recorded in the wider Geneva (14%) as well as in the regions of Lausanne, Basel-Stadt and Lorzenebene/Ennetsee (11% each). This shows that furnished apartments and the “serviced living” model are functioning particularly well for landlords. In addition to urban centers, numerous tourist municipalities also offer a spectrum of furnished apartments.

### Conclusion: downward trajectory likely to steepen again

The downturn in the rental apartment market has slowed somewhat over the last year. However, a lack of growth stimuli on the demand side should prove more potent this year than the slight improvement on the supply side. We are therefore expecting to see an addition of between 4,000 and 5,000 vacant rental apartments (previous year: 3,100). As demand remains strong in the major urban centers in particular, we are not expecting rental apartment markets to weaken significantly here. By contrast, vacancies in certain regions already characterized by an oversupply problem, such as Ticino and Canton Solothurn, can be expected to rise further. The pressure on rental prices is also likely to increase further in more rural areas in particular. On average, we are expecting offered rents across Switzerland to decline by some 1.0%–1.5%. Sitting tenants will also benefit from falling rents due to a further reduction of the reference interest rate to 1.25%.

**Fig. 38: Gulf between market rents and existing rents**

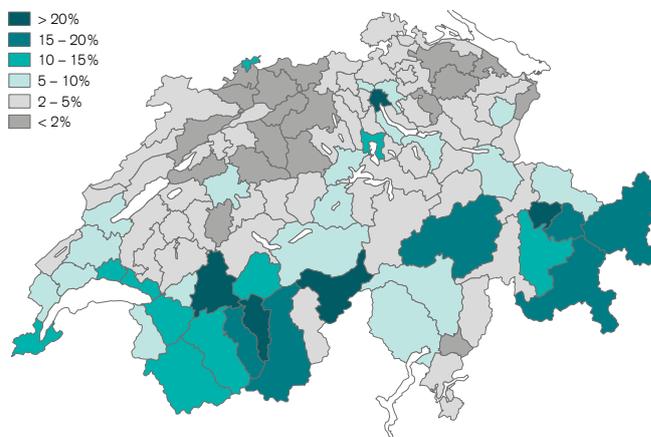
Rental price development\*, indices: Q1 2009 = 100



\* Existing rents: hypothetical development if all reduction entitlements claimed, minus 40% accrued inflation and 0.5% general cost increase annually. Source: Wüest Partner, SFSO, BWO, Credit Suisse Last data point: Q4/2019

**Fig. 39: Many furnished apartments in urban and mountain regions**

Furnished apartments as proportion of total advertised apartments, 2019



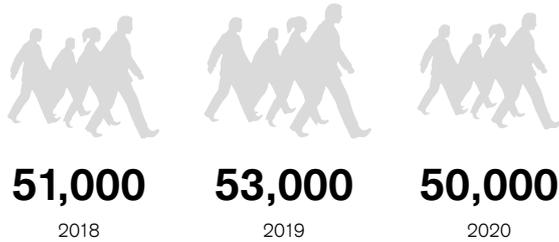
Source: Meta-Sys AG, Credit Suisse, Geostat

Last data point: Q4/2019

# Interest rates foster imbalances

## ↘ Demand

### Net immigration



- Net immigration expected to decline by around 5%
- Lack of growth stimuli from the economy

**2020: Demand declines by 1,000 to 2,000 residential units**

## ↘ Supply

### Planning applications



### Building permits

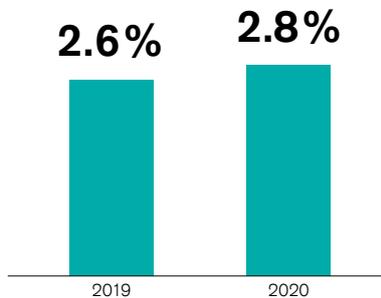


- Number of approved apartments declined
- Still no lasting decline in construction activity expected

**2020: Construction activity to decline by around 1,000 units**

## ↗ Vacancies

As % of rental apartment inventory

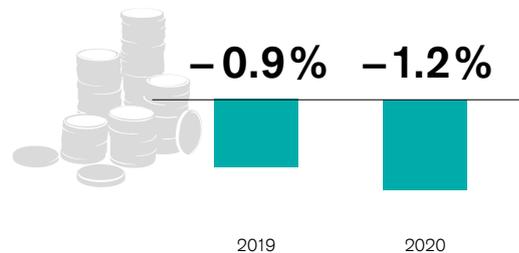


- Wide gap between supply and demand remains
- 2020: Another 4,000–5,000 apartments vacant

**Vacancies surge once again**

## ↘ Rental price growth

Increase in rents offered in %



- Prices decline mainly in rural areas and on urban periphery
- Market remains overheated in the large centers

**Pressure on rents increases further**

## ↗ Supply rate

As % of rental apartment inventory



- Rise in supply rate to as much as 6%
- Average since 2006: 3.8%

**Search for tenants a challenge away from urban centers**

## ↘ Performance

Total return on residential investment properties



- Slight increases in value remain possible in centers
- Average net cash flow yield of 3.5%

**Investment pressure remains high due to interest rate environment**

These forecasts are not reliable indicators of future performance.

# Significant rental income losses on parking spaces

**Vacant parking spaces diminish the returns on capital employed. In this context, residential investment property owners find themselves caught between changed mobility behavior and declining demand for parking space on the one hand, and official requirements that are failing to keep pace with this development on the other.**

## Switzerland – a country of parking spaces

Switzerland is a country of parking spaces. According to expert estimates, the country is home to more parking spaces than residents. The high number of parking spaces is a consequence not just of the dense concentration of vehicles in Switzerland, but also local legislation. In almost all cantons, laws govern the minimum number of parking spaces that must be created in building projects. In some cases, however, these laws date back to the 1980s. For a long time, the principle of “one parking space for every apartment” held sway.

## Up-to-date needs assessment can prevent inefficient use of capital

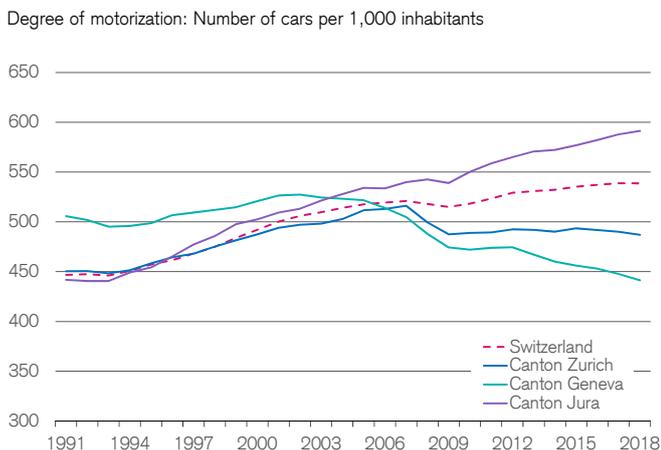
A growing number of voices assert that this formula is no longer fit for purpose, and parking space requirements have now been watered down in a number of regions. The proportion of car-free households has been increasing for several years now. In the big cities in particular, up to a half of households no longer own a car. Nonetheless, our analysis shows that parking spaces are more likely to be unlet in urban agglomerations. For property owners, therefore, forward-looking and circumspect planning of the number of required parking spaces is an important factor. The construction of parking garage spaces is costly, and during their operational lives the landlord is exposed to the risk of changing parking space needs. However, if landlords can estimate this need as accurately as possible, they can avoid the inefficient use of capital and instead offer more reasonable apartment rents, which would be a competitive advantage in the current market environment.

## Changing mobility behavior

## Higher vehicle ownership levels in rural communities

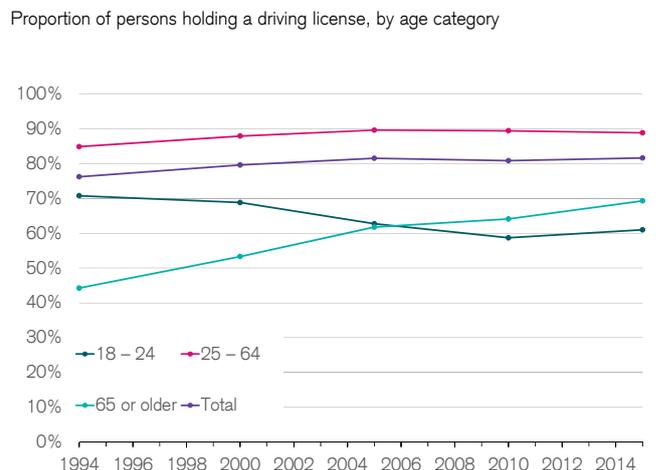
Households in rural areas possess significantly more cars than those based in major urban centers. Thanks to superior access to public transport and shorter journeys, urban households are less reliant on a car. This is also reflected in the number of public transport season tickets held per household, which is significantly higher in urban centers and their agglomerations. By contrast, inhabitants of more rural areas typically have to travel much greater distances, both to work and in the pursuit of their leisure activities. Interestingly, however, they spend more or less exactly the same amount of time traveling as urban households, since motorized private transport does not involve regular stops, and rural areas are less afflicted by traffic jams.

**Fig. 40: Declining level of motorized private transport in urban areas**



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 2018

**Fig. 41: An increasing number of young people do not hold driving license**



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 2015

### **Declining degree of motorization in urban areas**

In 2018, the degree of motorization in Switzerland amounted to 539 cars per 1,000 inhabitants (Fig. 40). This figure has stagnated since 2017, but has risen from the level of 447 back in 1991. The degree of motorization differs from canton to canton. Urban cantons such as Basel-Stadt, Geneva, and Zurich exhibit lower – and declining – vehicle ownership rates. In Canton Geneva in particular, where the roads can be heavily congested, the number of cars per resident is declining sharply. In Canton Zurich, the proportion of residents owning a private vehicle has been declining since 2016. By contrast, vehicle ownership levels continue to rise in rural cantons, as is clear from Figure 40 and the steady rise in Canton Jura.

### **Young adults increasingly not bothering to learn to drive**

The mobility behavior of the Swiss has been changing for a number of years now, which should result in an ongoing change in demand for parking spaces over the next few years. For the younger generation, a car no longer has the same cachet that it once did. Figure 41 shows that the proportion of people holding a driving license in the youngest age category (18 – 24) declined from 71% to 59% between 2000 and 2010. This proportion has now settled at just under 61%. The ongoing expansion of public transport networks and the different values of the young – who attach more importance to issues such as environmental protection and sustainability – are likely to be the key drivers of this change. As a result, the need for parking spaces among young adults is already declining.

### **Contrasting trend among over-65s**

Among the oldest age group, precisely the opposite is happening. Between 2000 and 2015, the proportion of over-65s holding a driving license increased from 53% to 69%. This is likely to be attributable first and foremost to the fact that cars first became an affordable everyday product for the baby boomers – not until this generation did women become almost as likely as men to hold a driving license.

### **Expansion of public transport and “sharing economy” reduce demand for parking**

But even for people who do hold a driving license, the appeal of owning a vehicle is gradually losing its luster. Particularly in cities and the surrounding agglomerations, the quality of public transport has improved greatly in recent decades, and further expansion will come. For example, Lausanne only opened its metro system in 2008, while in Geneva the largest cross-border urban rail system in Europe – the Léman Express – did not commence operations until the end of 2019. Moreover, the “sharing economy” concept has now also extended to car journeys in Switzerland thanks to the Mobility scheme. Between 2002 and 2018, the number of Mobility customers rose from 52,000 to more than 197,000. As a result, car ownership can be expected to become even less prevalent going forward, particularly for urban dwellers, which should gradually feed through into lower demand for parking spaces.

### **Major regional differences in legislation**

#### **Mandatory parking provision in most cantons**

When renovating, rebuilding, or expanding properties, building owners cannot just decide on the number of parking spaces based on estimates of current and future demand, as they must observe local cantonal legislation, which in almost all cases sets out minimum requirements for the number of parking spaces to be provided. The exceptions are the cantons of Zug, Basel-Stadt, Ticino (residential buildings only), and Graubünden, none of which have provisions of this kind enshrined at cantonal level. Zug, Ticino, and Graubünden leave such laws entirely to their municipalities, while Canton Basel-Stadt has no parking provision requirement other than a maximum ceiling.

#### **Responsibility for determining specific number of parking spaces typically lies with municipalities**

In practice, most cantons delegate the responsibility for the specific determination of the permissible minimum number of parking spaces, as well as how any deviations are dealt with, to their municipalities. However, the cantons are responsible for determining parameters and prerequisites, and often point to Standard 40 281 of the Swiss Association of Road and Traffic Professionals (VSS), which describes the processes for determining parking space supply along with detailed guideline figures. Only the cantons of Appenzell Innerrhoden, Schwyz, and Uri do not in principle allow their municipalities to permit any deviations from the mandatory parking provision requirement. Where deviations arise, the owner of the plot is obliged to pay a compensation charge. The corresponding revenues must then typically be earmarked for parking expenditure.

#### **Five different zones in the city of Zurich**

One canton that essentially gives its municipalities a free hand when it comes to drawing up legislation is Canton Zurich. The city of Zurich exercises its decision-making authority by breaking down its cluster of municipalities into five different zones on the basis of objective criteria. This enables the number of parking spaces to be much better managed.

### Three examples as illustration

This model has come to be applied by many other municipalities as an exemplary way of adapting legal requirements in this area. Figure 42 shows how differently statutory provisions on the construction of parking spaces are designed in different cantons. Here we compare the situation in Zone B of the city of Zurich with the rules that apply in Reinach (AG) and Stans (NW).

**Fig. 42: Mandatory parking place creation: examples for a residential property in three municipalities**

Property specification: Residential property with 20 apartments and floor area of 2,000 m<sup>2</sup>

|   | Reinach (AG)   | Stans (NW)   | Zurich (Zone B)   |
|---|--|--|---|
| <b>Density of population</b>                                    | 893 residents per km <sup>2</sup>  | 759 residents per km <sup>2</sup>  | 4,654 residents per km <sup>2</sup>   |
| <b>Address</b>  | Titlisstrasse, 5734 Reinach  | Buochserstrasse, 6370 Stans  | Kanzleistrasse, 8004 Zurich   |
| <b>Public transport quality</b>                                 | C – moderate access  | C – moderate access  | A – very good access  |
| <b>Legal provisions</b>   | <ul style="list-style-type: none"> <li>Building Code: Cantonal Building Code, lays out parameters for responsibilities of municipalities</li> <li>VSS Standard 40 281: Applies in Canton Aargau for the definition of the number of parking spaces that must be built</li> </ul> | <ul style="list-style-type: none"> <li>PBG: Cantonal Planning and Building Act, regulates construction requirement and responsibilities</li> <li>PBG implementing decree: Specifies the minimum number of parking spaces to be built, maximum only for visitor parking for businesses</li> </ul> | <ul style="list-style-type: none"> <li>PBG: Cantonal Planning and Building Act, regulates construction requirement and responsibilities</li> <li>Parking Space Ordinance of the city of Zurich: Specifies minimum and maximum number of parking spaces to be built</li> </ul> |
| <b>Minimum number of mandatory parking spaces for residents</b> | One parking space per 100 m <sup>2</sup> of floor area or one parking space per housing unit:<br><b>20 parking spaces</b> (for residents)  | One parking space per 100 m <sup>2</sup> of floor space (at least one parking space per housing unit)<br><b>20 parking spaces</b> (for residents)  | 1 parking space per 120 m <sup>2</sup> of floor space, in Zone B reduction factor of at least 25%:<br><b>4 parking spaces</b> (for residents)   |
| <b>Maximum number of mandatory parking spaces for residents</b> | Can be restricted by the municipality council.   | No provisions  | 1 parking space per 120 m <sup>2</sup> of floor space, in Zone B reduction factor of maximum 45%:<br><b>7 parking spaces</b> (for residents)  |
| <b>Visitor parking spaces</b>                                   | 10% on top of total for residents:<br><b>2 parking spaces</b> (for visitors)   | 1 parking space per 2 apartments:<br><b>10 parking spaces</b> (for visitors)   | 10% of minimum number of parking spaces reserved for visitors: <b>0 parking space</b>   |
| <b>Waiver of parking space construction requirement</b>         | <ul style="list-style-type: none"> <li>Upon submission of a Mobility concept (from 25 apartments)</li> <li>In exchange for payment of compensation charge to municipality (if the number of parking spaces is reduced)</li> </ul>  | <ul style="list-style-type: none"> <li>In locations with good public transport connection (decision of local council, new PBG)</li> <li>In exchange for payment of compensation charge to municipality if construction or rental/purchase is not possible</li> </ul>                             | <ul style="list-style-type: none"> <li>Upon submission of a Mobility concept, including annual check</li> <li>In exchange for payment of compensation charge to municipality if construction or rental/purchase is not possible</li> </ul>                                    |

Source: Cantonal and communal laws (as cited in table), Credit Suisse

### Major differences in minimum number of mandatory parking spaces

Of the three municipalities illustrated in our example (Fig. 42), a residential property in Stans has to provide the highest number of parking spaces. The fact that many fewer spaces are required in a major center like Zurich (with its outstanding public transport connections) is hardly surprising. But the other two examples show very clearly that the minimum number of mandatory parking spaces can vary dramatically even when major urban centers are excluded. A total of 30 parking spaces are required in Stans – 36% more than in Reinach (AG).

### Parking spaces account for significant proportion of lost rental income

#### Municipalities do not have recourse to the necessary information

Against a backdrop of changing mobility behavior, the question arises as to whether the strict regulation of the minimum number of parking spaces is still appropriate in the modern era. In practice, the supply of parking spaces is out of kilter with demand in many areas, with reports of half-empty underground garages being commonplace. Municipalities lack information on the actual usage of the private parking spaces of residential properties. We have therefore tried to create a picture of the current situation on the basis of data on price levels and vacancies. Here we have relied on the data of the Real Estate Investment Data Association (REIDA), which relates above all to properties of institutional investors.

#### Garage parking space rental prices highest in large centers

Across Switzerland as a whole, the median annual rent for a garage parking space stands at CHF 1,560, more than twice that of the average outdoor parking space (CHF 720). However, there are significant regional differences in rental prices. As is clear from Figure 43, rental prices are lower for garage parking spaces in commercial properties located in municipalities situated further from an urban center. For residential properties, the highest annual rental prices are currently found in large urban centers (CHF 1,800) and their agglomerations (CHF 1,500), whereas rental prices in mid-sized and small centers, their agglomerations, and rural communities are all more or less at the same level (CHF 1,440).

#### Virtually no rental price differences outside of large centers

For outdoor parking spaces too, the most expensive rents are to be found in the large centers (Fig. 44). For this category of parking space, higher sums are demanded by commercial properties than by residential properties. Where the latter are concerned, it should be stressed that a price premium is only demanded for major urban center locations (CHF 960), whereas rents for all

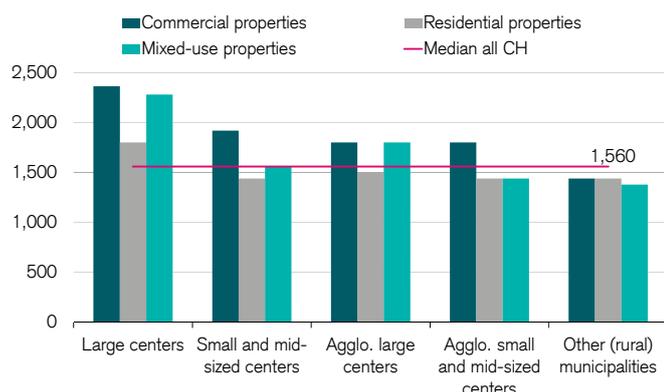
other municipality types are more or less at the same level (CHF 600). This exception to the typical city-country divide could indicate a higher level of vacancies in urban agglomerations.

### Parking spaces account for 5.5% of all rental income

Viewed across all types of property, parking spaces account for 5.5% of total rental income. As far fewer mandatory parking spaces have to be provided in urban areas, the rental income accounted for by parking spaces in major urban centers is just 4.2% for all property types, despite higher rental prices. In mid-sized and small centers, the equivalent proportion is 5.7%. And in the urban agglomerations of large, mid-sized, and small centers, as well as in other (rural) communities, parking spaces account for between 6.3% and 6.7% of rental income. The significance of parking space revenues is therefore limited. But equally it should not be dismissed as negligible.

**Fig. 43: City-country price differences for parking spaces**

Median annual rents of garage parking spaces, in CHF

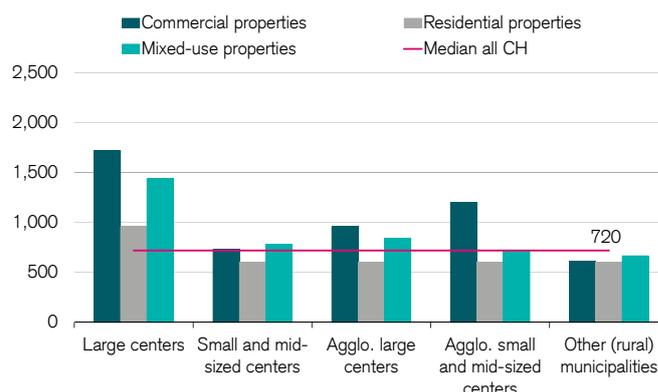


Source: REIDA, Credit Suisse

Last data point: Q3/2019

**Fig. 44: Virtually no price differences away from major urban centers**

Median annual rents of outdoor parking spaces, in CHF



Source: REIDA, Credit Suisse

Last data point: Q3/2019

### Losses in rental income from garage parking spaces in double-digit percentage territory

Our analysis reveals that existing vacancies – measured through lost rental income – are significantly higher for both garage and outdoor parking spaces of residential property than they are for living space vacancies (Fig 45). The lowest losses on parking space income are to be found in the major urban centers. Here the better utilization levels are above all attributable to the much lower supply of parking spaces. A second reason is the large demand for parking spaces from commuters who work in major urban centers. Nonetheless, in percentage terms the level of vacancies (lost income) is three to four times higher than for living space. Vacancies are highest for garage parking spaces. Outside of the major urban centers, the associated lost revenues amount to between 11% and 13% of rental income.

### Rental problems greater in suburbs

So when people talk about the difficulty of renting out parking spaces in cities, they are not wrong. However, the parking space rental problem is much greater in the suburbs than it is in major urban centers. As a rule, vacancies (= lost income) are lower for outdoor parking spaces than they are for garage spaces. Partly the exception here are rural communities, where roadside space is less in demand, more public parking spaces are provided, and greater land reserves are available to accommodate outdoor parking.

### Same picture for commercial property – but even more pronounced

A similar picture emerges for commercial properties, where lost rental income due to vacant parking spaces is likewise higher away from large centers. In major urban centers, the loss in rental income for all parking spaces stands at 9%, but just 6% in mid-sized and small centers. By contrast, the rental income lost on commercial parking spaces outside of urban centers is a heady 18% – an unmistakable sign that the available supply far outstrips existing demand here.

### Wide bandwidth of vacancies in the individual regions

Overall – i.e. across all properties, irrespective of their use or geographical location – parking space vacancies account for a high 11.0% of potential rental income. However, the vacancy situation differs dramatically from region to region (Fig. 46). For example, while the loss in rental income amounts to just 5% in the Lorzenebene/Ennetsee region of Zug, the equivalent figure for the Glattal region stands at 24.5%, with garage parking spaces on commercial property sites being the largest contributor to this statistic.

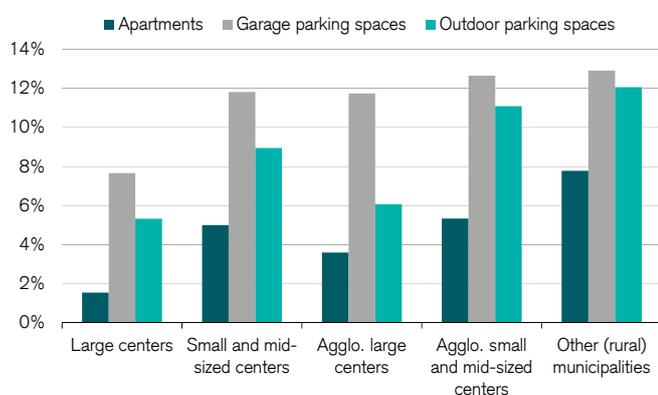
### Tolerable as proportion of total income

In terms of total rental income, landlords are on average losing just 0.6% of their overall income as a result of unused parking spaces. In the major urban centers, parking space vacancies account for as little as 0.3% of total potential income, whereas in the agglomerations of the large,

mid-sized, and small centers, as well as in other (rural) municipalities, they account for 0.8%-1.0%. Nonetheless, in an era of growing apartment vacancies, stagnating rental price development, and low net yields, even lost revenues of this amount are painful. Moreover, high vacancies put pressure on parking space rents, which is likewise not conducive to a healthy income situation. Efforts to minimize the number of parking spaces required for newbuilds are therefore intensifying.

**Fig. 45: Higher loss of rental income in rural areas**

Loss of rental income on apartments and parking spaces, residential properties, in %

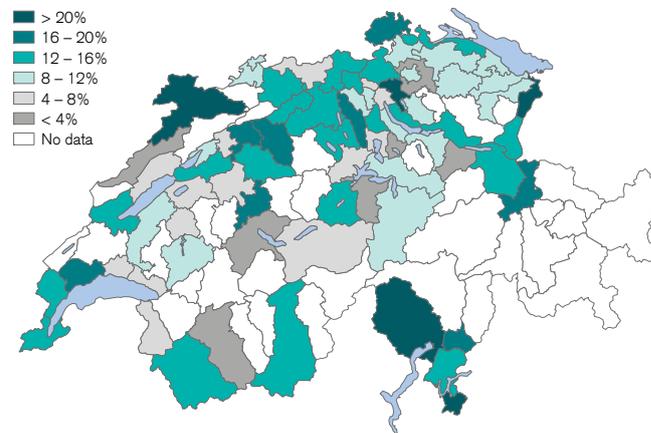


Source: REIDA, Credit Suisse

Last data point: Q3/2019

**Fig. 46: Significant differences in regional rental income losses**

Loss of rental income on garage and outdoor parking spaces in properties



Source: REIDA, Credit Suisse

Last data point: Q3/2019

## How to deal with uncertain future need for parking spaces?

### Great uncertainty over future need for parking spaces

Investors should expect the need for parking spaces to continue to decline. In view of increasing environmental awareness and more rigorous regulation to achieve the ambitious climate-related targets of the Paris Agreement by 2050, personal vehicle ownership levels are likely to be more closely scrutinized in the future. In the medium to long term, even greater shifts can be expected due to technological advances. The introduction (and spread) of autonomous vehicles will have a significant impact on human mobility behavior, vehicle ownership, and therefore the need for parking spaces. Property owners are therefore going to be confronted with considerable uncertainty when it comes to the future need for parking spaces.

### Autonomous vehicles – the game changer

Whether it takes ten or as much as twenty years for self-driving vehicles to become a regular feature of our roads remains to be seen. But the key point is that transportation behavior will change before the end of the lifecycles of parking spaces being built today. According to our estimates, which were drawn up in 2019 on the basis of a very detailed (and hitherto globally unique) study produced by the Federal Institute of Technology (ETH) in Zurich<sup>7</sup>, mobility is set to become dramatically cheaper. Due to the financial benefits and great appeal of self-driving cars, mobility volumes are set to increase sharply. Contrary to widely-held expectations, private vehicle ownership will not disappear, as its costs are very much comparable to other (including automated) modes of transport from a user perspective. What we should actually expect is that many people will invest in a self-driving vehicle that can be used not just to drive them around, but also execute a number of procurement tasks (“pick-ups”).

### Autonomous vehicles do not need to be parked on the doorstep

A prototype of an autonomous parking garage was recently developed in Germany. According to estimates, autonomous parking should lead to a space saving of up to 20%. Furthermore, autonomous driving could lead to even greater changes for the world of parking spaces in particular. It is only reasonable to assume that the proximity of a parking space will no longer be a major issue, given the ability of autonomous vehicles to move themselves. So parking spaces based a few minutes away from either starting point or destination are very much “in the game” as parking alternatives. This will free parking spaces from their direct, tied locations, which in turn means that availability and price will be the two key criteria in the future. Autonomous vehicles will therefore seek out cheap parking spaces in non-central locations nearby. Sharing models could also contribute to reducing the overall number of parking places required in the future, as multiple occupancy plays an optimizing role here.

<sup>7</sup> Institute for Transport Planning and Systems, ETH Zurich, 2019: Induced traffic through autonomous vehicles: an appraisal

**Best strategy – minimize new parking space creation**

Thanks to greater flexibility with respect to the distance between apartment and parking space, existing parking space capacity can be much better utilized. Depending on the local situation, and in view of the already large number of vacant parking spaces, the need for newly created parking spaces is likely to diminish considerably. In many places, the best strategy for property owners in the long term is likely to be the avoidance of parking space creation altogether, or the provision of just the bare minimum. Of help here is the fact that, with a few exceptions, Swiss municipalities have considerable freedom of maneuver when it comes to deviating from mandatory parking space requirements, which are for the most part imposed by their cantons.

**Fewer mandatory parking spaces thanks to Mobility concept**

A number of municipalities are already allowing property owners to undercut the number of mandatory parking spaces if they can present a convincing Mobility concept in return. This concept must set out how future residents will be able to manage without a car, or how the corresponding need can be covered through the use of other parking spaces. In view of the costs of an underground parking space, which are estimated to be in the region of CHF 35,000-42,000, the savings are likely to be most keenly felt in major development projects. In the case of small building projects, the costs of the Mobility concept and any compensation charges will have to be weighed up against the possible savings, and the former may not look attractive in every case.

**Renting the required parking spaces elsewhere**

One strategy that has already been partly implemented is for the parking spaces required for new-builds – or at least a proportion of them – to be rented elsewhere in the neighborhood for the long term, rather than created by the developer. On the one hand this saves on the construction costs of parking spaces, while on the other what are often existing vacancies can be at least partly reduced. For example, visitors to the Kalkbreite site in Zurich can use five visitor parking spaces in the garage of the neighboring Lochergut complex, while visitors to the replacement newbuild of Altstetten's "am Salzweg" complex will be able to park their cars in the nearby garage of the Raustasse development in future.

**Flexibility through pooling and modular parking space developments**

Above and beyond these developments, parking spaces are likely to be increasingly pooled in future. This approach was also part of the concept that enabled "PLANAR AG für Raumentwicklung", together with Ammann Albers Stadtwerke, to win the project competition for the Eschenbühl site development in Uster, which has to meet the requirements of the "2000-watt society". For both economic and environmental reasons, an above-ground parking garage is part of the design plan. In the event of the parking spaces no longer being needed in the future, the above-ground building can be more easily repurposed than an underground garage. Furthermore, the parking spaces can be constructed much more cheaply, and the car park can be expanded in a modular way if local parking needs require it. In this way the parking space offering can be flexibly geared to demand.

**Summary: Investors should exploit options for reducing number of parking spaces**

From today's standpoint, how the number of vehicles and the number of parking spaces needed for properties will develop in the long term is anything but clear. By contrast, it is not disputed that human mobility behavior is changing for environmental reasons, and that autonomous vehicle technology will reach maturity. Despite these uncertainties, investors would do well to avoid sticking to the status quo, as the above-mentioned analysis shows that the number of available parking spaces is already demonstrably too high, leading to not inconsiderable losses in rental income. For investors in building developments, it is therefore important to consider innovative, flexible, and modular solutions. This will enable them to save costs during construction, optimize yields thanks to lower vacancies, and potentially realize later reconversions more efficiently.

# Demand momentum wanes

**The powerful Swiss economy clearly weakened in 2019. Although the labor market situation is still robust, employment growth – and therefore also additional demand for office space – has slowed.**

**Employment a prop, but losing momentum**

The labor market situation remains robust at the moment thanks to the powerful growth of the Swiss economy in 2018. Indeed, it has been more than ten years since Switzerland’s unemployment rate was at such a low level. However, the high growth rates for Swiss employment have normalized over the last few quarters. Whereas employment grew by 2% at times in 2018, year-on-year growth as per the third quarter of 2019 amounted to just 1.1%. However, this figure is still higher than the average over the last five years (0.86%). This development is attributable to the above-average employment growth evident in the secondary sector (Fig. 47). Overall, however, there are still more new jobs being created in the tertiary sector than in the secondary sector.

**Growth driver “corporate services” loses momentum**

Corporate services continue to be the largest contributor to growth, even if annual growth in this sector did decline sharply from 3.4% in the first quarter of 2019 to 1.4% in the third quarter. This decline is primarily attributable to a reduction in headcount in the temporary positions segment. It is typical for this area to be the first to suffer from an economic slowdown. By contrast, there has recently been a sharp resurgence in employment in the IT industry and in wholesaling, two key sources of demand in the office property market. At the same time, an increasing number of teaching jobs have been cut. In addition, the situation in retailing remains challenging, as rising volumes of online purchases are leading to a reduction in headcount in shops.

**Less gloomy situation in wholesaling, insurance, banking, and telecoms**

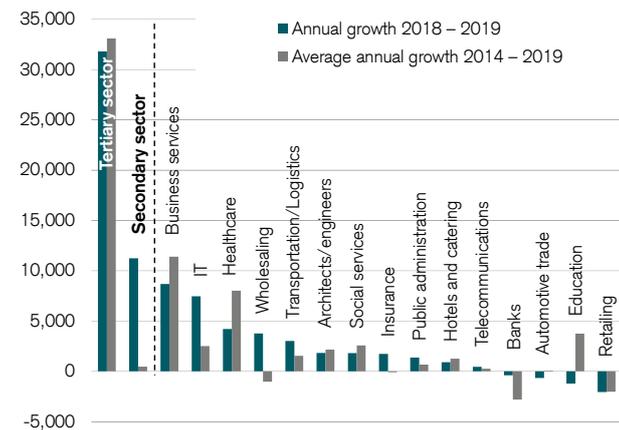
On the other hand, the negative employment trend clearly evident in last year’s “problem” sectors, which in addition to wholesaling also included banking, insurance, and telecommunications, has not continued (Fig. 47). In the banking sector, which has suffered for years from shrinking margins, employment declined only minimally over the last twelve months. In the insurance and telecom sectors, by contrast, employment numbers recorded a clear rise.

**Additional demand for office premises should decline further**

The strong surge in office employment led to a temporary situation of very dynamic additional demand for office space. The greatest year-on-year increase was recorded in the second quarter of 2018, when additional demand for office space amounted to some 775,000 m<sup>2</sup> (Fig. 48). The level of additional demand has receded ever since, in keeping with the decline in employment growth. We estimate additional demand last year to have been at the still very high level of 489,000 m<sup>2</sup>. While employment growth should weaken further this year, it is still likely to remain in positive territory. By the end of 2020 we are expecting additional demand to stabilize at around 250,000 m<sup>2</sup>.

**Fig. 47: Growth driver “corporate services” weakens**

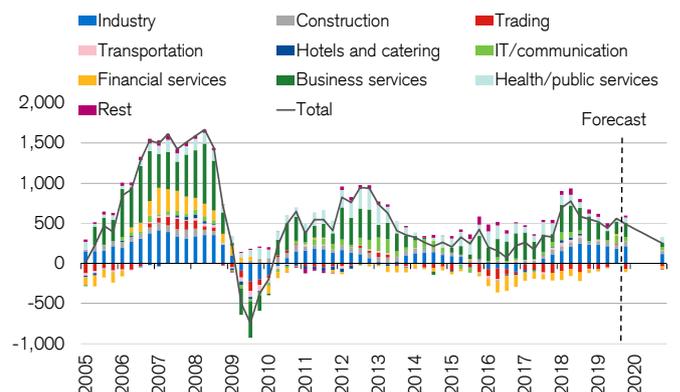
Annual headcount growth (per Q3) of selected services sectors on a full-time basis



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: Q3/2019

**Fig. 48: Decline in additional demand for office property**

Estimated additional demand compared to prior-year quarter in 1,000 m<sup>2</sup>; Q4 2019 and 2020: forecasts



Source: Credit Suisse, Swiss Federal Statistical Office Last data point: Q3/2019

# Gulf between city center and periphery

**Despite stronger demand for office space, the total volume of office property advertised for rent across Switzerland has once again risen slightly. The office market is currently presenting two contrasting faces: In the city centers, office space is often in short supply, whereas the supply of property in the periphery continues to rise.**

## Coexistence of oversupply and scarcity of supply

The total volume of office space advertised online recorded a year-on-year rise of 163,000 m<sup>2</sup> in 2019 to a new total of 2,814,000 m<sup>2</sup> (Fig. 49). The supply rate, which reflects the availability of space as a proportion of the total office space market, therefore rose to 5.2%. This result would appear to be rather at odds with the clear recovery of office property markets that has accompanied the economic upturn since the end of 2017. Our survey, which takes into account not only advertisements on leading real estate platforms but also office property advertised through other channels (individual websites, development agencies, etc.), reveals a very clear divide between Switzerland’s city centers and their peripheries. Whereas office space absorption rates in city centers are high and scarcity of supply is already becoming apparent in places due to weak construction activity (above all in Zurich, Bern and Basel), the oversupply in the outer business districts of all Switzerland’s major centers has risen further (most strongly in Geneva and Lausanne; Fig. 50).

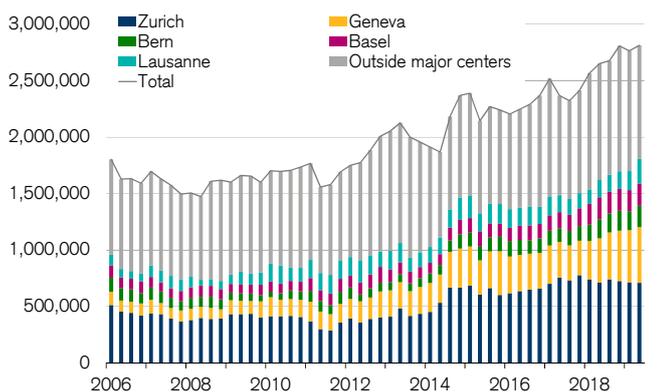
## Higher construction activity inflating supply rates in French-speaking Switzerland

It is interesting to note that apart from the ubiquitous gap between city center and periphery, the individual office markets of Switzerland’s five major cities are exhibiting very different developments. Whereas the total amount of advertised space in Zurich and Basel – and in some parts of Bern – is virtually unchanged compared to the previous year, Geneva and Lausanne stand out with their significant rises in office space supply. These two office markets of French-speaking Switzerland now also have the highest supply rates, with Lausanne having recorded a year-on-year rise from 5.8% to 8.2%, and Geneva from 9.5% to as much as 11.9% (Fig. 52). Whereas demand in Lausanne remains relatively intact and the supply of available space is being fueled above all by significant construction and planning activity, the problem in Geneva is stagnant demand coinciding disadvantageously with various development projects.

## Mid-sized centers typically exhibit low supply rates

In the mid-sized centers and outside of the major conurbations, the demand for office space is less dynamic, as well as being difficult to predict. For this reason, construction projects involving office properties are rarely initiated without an anchor tenant in place or high pre-leasing rates. The majority of mid-sized centers therefore exhibit low supply rates (Fig. 52). The only mid-sized centers with a supply rate of more than 5.0% are Baden (5.4%), Lugano (5.7%), and Zug (7.4%). Whereas the supply rate in both Baden and Zug is being driven up by individual office projects (“Duplex” building complex and “Quadrolith” project in Baar respectively), market supply in Lugano is being fueled by a large number of small office premises of less than 1,000 m<sup>2</sup>.

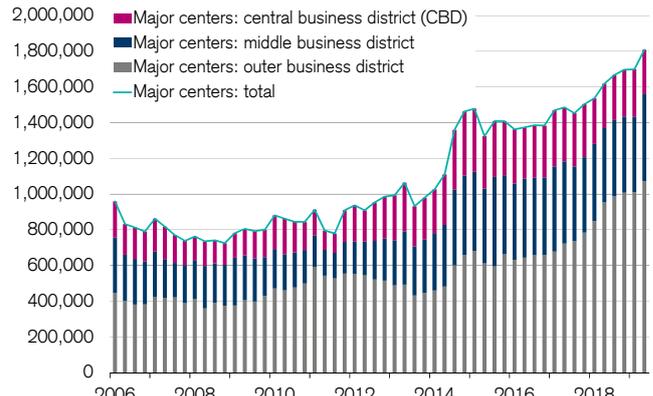
**Fig. 49: Supply of available office space rises further to 2.81 mn m<sup>2</sup>**  
Total of quarterly (online) advertised space (existing stock and newbuilds), in m<sup>2</sup>



Source: Meta-Sys AG, Credit Suisse

Last data point: Q2/2019

**Fig. 50: Supply rises above all in outer business districts**  
Quarterly (online) advertised space in major centers (stock and newbuilds), in m<sup>2</sup>



Source: Meta-Sys AG, Credit Suisse

Last data point: Q2/2019

# Brakes applied to construction activity

**Construction activity is declining in the majority of large and mid-sized centers. This should ensure a continuation of the office market recovery, despite weaker demand.**

**Building permits at lowest level since 2000**

The investment volume of construction approvals (as expressed in the number of building permits issued) has very rarely fallen below its long-term average in recent years. Office construction activity has accordingly been relatively high, particularly given the rise in vacancies since 2013. The key drivers of this development were the persistently low interest environment, low financing costs, and limited investment alternatives. However, the volume of building permits issued has now fallen noticeably (Fig. 51). The annual investment volume of newbuild approvals recently stood at CHF 1,387 million, or 29% below its long-term average. The last time the figure was this low was back in 2000. This reflects the more cautious stance of investors, who are responding above all to high vacancy rates in the outer and peripheral office space markets.

**Low construction activity likely in the major centers**

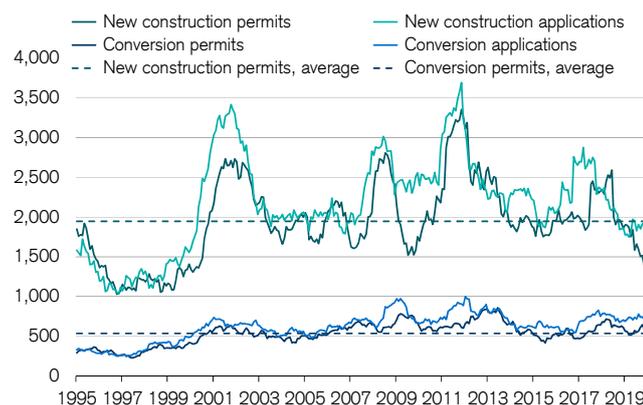
The individual office markets of the mid-sized and large centers are illustrated in Figure 52. The vertical axis illustrates the anticipated expansion of space in the future, whereby the percentage values indicate the extent to which construction approvals over the last two years lie above or below the long-term average. Lausanne stands out in particular with its significant expansion of office space, this being the result of major site developments with integrated office space planned in this part of French-speaking Switzerland (e.g. in Bussigny). Until a short time ago, Basel has also been notable for its above-average investment in office space. Only recently has the volume of building permits here fallen below its long-term average. Once the construction projects that are currently in the implementation phase (such as the “Roche Tower 2”) reach completion, construction activity in Basel is likely to decline. The same applies to Geneva, where the volume of building permit issuance has likewise only recently fallen below its long-term average. In Zurich and Bern, by contrast, projected new office space has been relatively low for a number of years.

**Lower investment also likely in mid-sized centers in the future**

For quite a while now, the volume of investment in office space has also been stuck at below-average levels in the majority of Switzerland’s mid-sized urban centers. The exceptions here are Neuchâtel and Olten, where building permit issuance over the last two years is more than 100% above the long-term average in both cases. In Neuchâtel, the high volume of projected activity is attributable to a new office and commercial park. In Olten, a new office building was approved on the Usego site, while an enlargement of the main bus station in Wangen bei Olten (including a vertical expansion of the administration building) was also approved. By contrast, planning activity in Lucerne and Baden has experienced quite a slump. In these mid-sized centers, the volume of building permit issuance over the last two years has been some 70% and 80% respectively below the long-term average.

**Fig. 51: Planned expansion of office space records sharp decline**

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

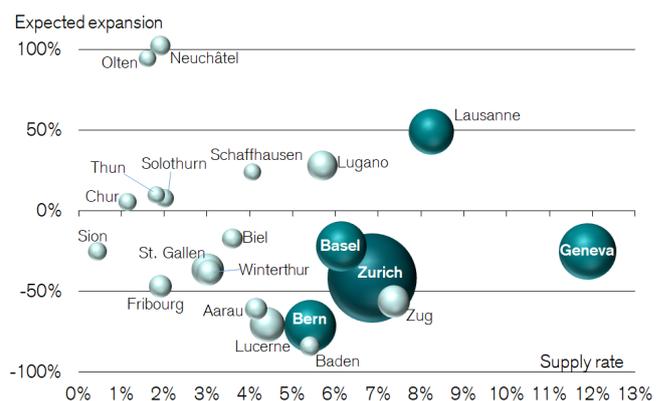


Source: Baublatt, Credit Suisse

Last data point: 11/2019

**Fig. 52: Higher supply rates in the major centers**

Scope of data: total office space; expansion: building permits 2018/2019 compared to long-term average; supply rate as % of total space 2019



Source: Credit Suisse, Meta-Sys AG, Baublatt

Last data point: 11/2019

# Consolidation of recovery

**As a result of the vigorous demand for office space over the last few quarters, office vacancy rates have declined in most regions. There are also signs of a turnaround in rental prices, which are developing positively again overall.**

## Office vacancy rates are for the most part falling

It required strong demand for office property in 2018 to bring about a trend reversal in the amount of office space standing empty. Official figures for vacancies, which above all cover the central and middle business districts of the major cities, have declined by some 10% in 2019, thereby reflecting the positive development of the market in more central locations (Fig. 53). This time the trend reversal is likely to persist, as the lower expansion of space going forward is likely to counteract any imbalances as a result of waning demand momentum. The sharpest declines in vacancies have been recorded in Canton Neuchâtel (-68%), in the city of Bern (-39%), and in the city of Zurich (-22%). The dramatic fall in the vacancy rate in Neuchâtel was due to an outlier surge in the equivalent figure for 2018. Nonetheless, it is still 7% below the figure recorded in 2017. Bern recorded a fall in its vacancy rate for the third year in succession, resulting in an overall decline from 75,000 m<sup>2</sup> back in 2016 to 37,000 m<sup>2</sup> in 2019. In the city of Zurich the office vacancy rate has virtually halved since 2014, namely from 215,000 m<sup>2</sup> to a current level of 109,000 m<sup>2</sup>. In Canton Basel-Country it declined by 6% last year, thereby breaking a trend of steady rises dating back to 2015.

## By contrast, vacancy rates rise slightly in Geneva, Vaud, and Basel-City

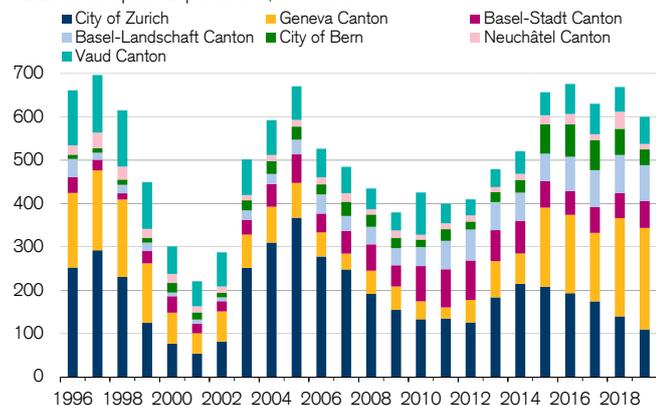
By contrast, a slight deterioration in the vacancy situation is apparent in the cantons of Geneva, Vaud, and Basel-City. Following a dramatic rise of 44% in vacancies in Geneva in the previous year, last year saw another small rise of 3% to 234,000 m<sup>2</sup>. Basel-City was unable to repeat the decline in vacancies recorded the previous year, this time reporting a rise of 6%. The rise in Vaud amounted to as much as 9%, which was above all attributable to major vacancies in the Nyon and Morges areas. In the Lausanne region, by contrast, vacancies declined by 5% due to a sharp fall in the Ouest lausannois area (-25%).

## Office rental prices recover

The strong demand for office space has also had a positive impact on office rents (Fig. 54). Following a prolonged sideways movement, the strongest rise in office rents in 2019 was recorded in the Bern (+7.6%) and Basel (+7.5%) regions. The trend of rising rents has also resumed in the city of Zurich (+5.8%). In the major centers of French-speaking Switzerland, where rents declined by 18% (Geneva) and 10% (Lausanne) between 2013 and 2018, a clear trend reversal has also become evident recently. Over the last year, rents have increased by 7.2% in the city of Geneva and by 4% in the city of Lausanne. In view of the differing developments in the central and outer business districts of the major centers, we are expecting the gap in rental prices between very central and more peripheral locations to increase.

**Fig. 53: Decline in office vacancies likely to persist**

Vacant office space as per June 1, in 1000 m<sup>2</sup>

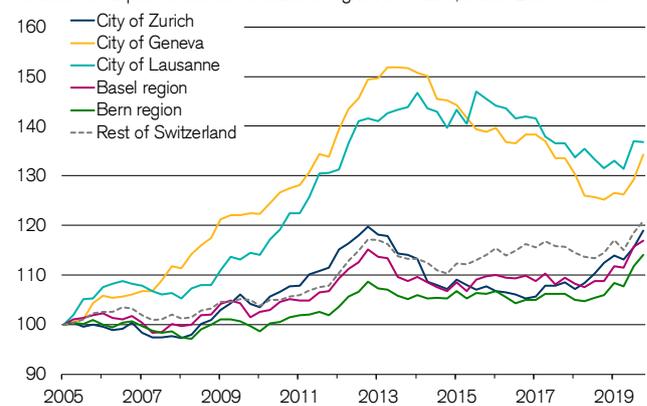


Source: Various statistical offices, Credit Suisse

Last data point: 06/2019

**Fig. 54: Reversal of trend in regional rents**

Hedonic rental price index on the basis of signed contracts, index: 2005 = 100



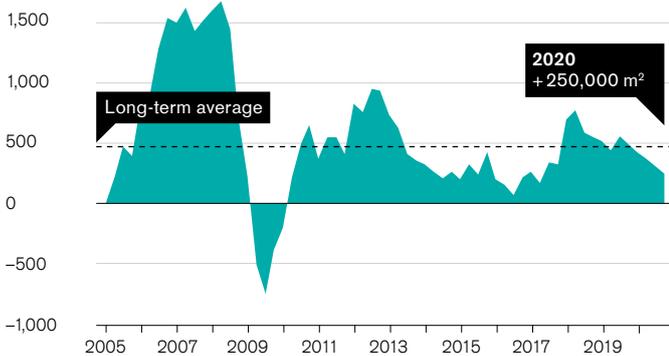
Source: Wüest Partner, Credit Suisse

Last data point: Q4/2019

# City centers on the upswing

## Demand

Additional demand for office space (in 1,000 m<sup>2</sup>)

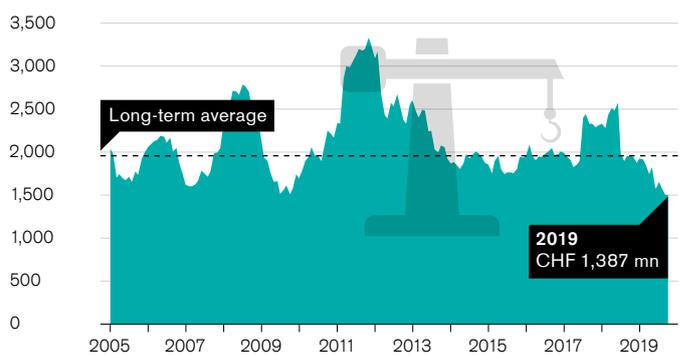


- Moderate economic growth reduces employment growth and additional demand
- Focus of demand on city centers and easily accessible locations close by

**2020: Additional demand positive, but way below long-term average**

## Supply

Building permits for office space (in CHF mn)

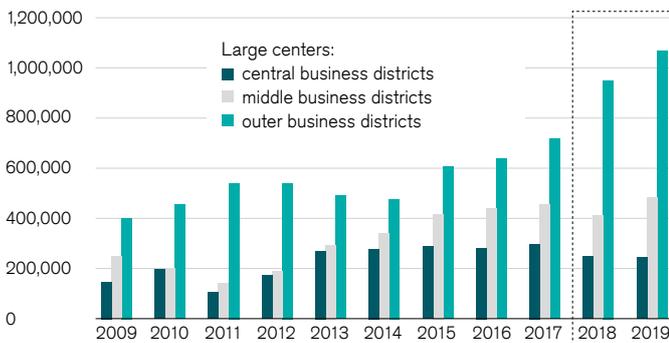


- Sharp decline in building permits
- Synchronous development in all large centers with exception of Lausanne

**2020: Slowing construction activity should ensure (less dynamic) continuation of office market recovery**

## Advertised office space

In m<sup>2</sup>



- Supply rate rises to 5.2%
- Contrasting developments of city centers and urban periphery

**Growing price and vacancy gap between center and periphery**

## Development of office space supply 2019

By degree of centrality, year-on-year

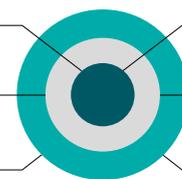
**French-speaking Switzerland**  
(Geneva, Lausanne)

**German-speaking Switzerland**  
(Zurich, Bern, Basel)

**+11%**  
central business districts

**+79%**  
middle business districts

**+22%**  
outer business districts



**-10%**  
central business districts

**-5%**  
middle business districts

**+8%**  
outer business districts

- Decline in supply in German-speaking city centers
- Recovery more sluggish in French-speaking Switzerland due to high level of construction activity

**More rapid recovery in German-speaking Switzerland**

## Vacancies

- Trend reversal: Official vacancies down by 10% in 2019 (reflecting above all situation in city centers)
- Particularly in Zurich and Bern

**2020: Decline in cities, rise outside**



## Rental prices

Contractual rents

- Trend reverses to positive rental price development in all large centers

**2020: Rising rental prices, above all in city centers**



# Modular commercial units as market niche with potential

**Standardized “workboxes” that lend themselves easily to modular use have carved out a market niche. They meet a modern need, and appeal from both a flexibility and price standpoint.**

### **Need for commercial premises**

The supply of commercial premises in Switzerland differs greatly from region to region. Many available premises are the wrong size, are difficult to access, or are not at ground level. Often it is simply a case of the price being too high. This market niche has caught the attention of a number of providers. They have responded with an offering of small, simple (and therefore cost-effective), modular premises with a good quality of infrastructure (sanitary facilities, electricity, heating) outside of expensive large centers, available for either rent or sale. This concept allows small and medium-sized enterprises (SMEs) as well as private individuals to become owners or tenants of light industrial warehousing units with floor space of 60 to 65 m<sup>2</sup>.

### **Standardized “workboxes” as new niche**

This offering of modular commercial premises known as “workboxes” is becoming increasingly popular. One reason for this is their great flexibility: The units in question can be fitted out and equipped in any way the occupant chooses. They come with an intermediate or upper level on which all activities not subject to floor load restrictions (office activities, item displays, etc.) can be carried out. A total of some 120 m<sup>2</sup> of space is therefore available. In addition, every unit comes with large frontal access that facilitates efficient loading and unloading. Users can rent or purchase parking spaces directly alongside. Thanks to the modular approach, several workboxes can be combined to form larger units if required, an approach that permits flexible use and makes them suitable for all sorts of different companies.

### **Wide spectrum of user groups**

The demand for commercial workboxes is very broad and multifaceted, and extends far beyond the circle of traditional craftsmen, tradesmen, and light industrial enterprises. For example, they can be used by artists, graphic designers, photographers, small-scale retailers, professional consultants, training companies, local associations, or indeed start-ups. This selection shows that there are virtually no limits to the possible ways in which workboxes can be used.

### **Demand fueled by powerful trends**

Two key trends are supporting the demand for such premises. Firstly, the internet and modern logistics solutions are enabling micro-companies to offer their products globally and thereby establish a business base. The global export business was once solely the province of medium-sized and large companies, but new modes of distribution are now driving demand for small commercial premises in particular. Workboxes can be used for the production of small batches and essential minimum storage. A second trend evident is the increasing number of people who are able to pursue all sorts of hobbies thanks to growing prosperity and less onerous working hours. Many hobbies can only be practiced at home to a limited extent (model building, vintage cars, creative working, etc.), hence the additional demand for studios or workboxes of this kind. Hobby enthusiasts are prepared to invest significant sums of money to pursue their pastimes. Either alone or in collaboration with like-minded souls, they therefore provide an equally strong source of demand for workboxes, either as tenants or purchasers.

### **Successful niche**

The idea of modular workboxes was the brainchild of a group of companies and architects in French-speaking Switzerland who wanted to promote commercial activities in peripheral areas. They struck a chord with this idea, which has now been implemented at more than two dozen locations with the construction of around 1,300 workbox units. The regional focus remains in French-speaking Switzerland. In June 2017, the offering was expanded to a first site in German-speaking Switzerland, namely Niederbuchsiten (Canton Solothurn). Additional workbox hubs are planned in Würenlingen (Aargau) and Kriens (Lucerne). The success of this concept is now increasingly being copied, notably in Aigle, not far from the original site opened back in 2010. At the beginning of 2017, another provider began advertising 32 similar workboxes in Gretzenbach (Solothurn). All but two of these units are now rented (as at January 2020). A similar concept is

being pursued by a provider in Aadorf (Thurgau), albeit in this case with workboxes of different sizes.

**Cost-effective, flexible, easily accessible, and with good basic build quality**

The fundamental commercial idea of workboxes is to offer flexible premises at very attractive rental and purchase terms. Back in the 1990s, many craft workshops were still located in the centers of major towns. Since then there has been a dramatic increase in the cost of central urban real estate, and small businesses have been unable or reluctant to pay the corresponding prices. They have therefore been looking for cheaper alternatives away from the large and mid-sized urban centers. Modular warehousing units that offer easily accessible commercial premises on the urban periphery meet this need almost perfectly. Analysis of 29 locations of such workboxes reveals that 21 are situated less than nine minutes from a motorway exit. (Fig. 55). Thanks to their modular construction, the development of these units can benefit from significant economies of scale, which – alongside the affordable price of land – is a key to keeping prices at an attractive level for end users. As a rule, the developers of these small commercial units always work with the same suppliers, which facilitates significant efficiency gains: The majority of building parts are completely standardized, with no “frills” of any kind provided. That said, the basic unit provided is of solid build quality.

**Modest prices and limited floor space make workboxes affordable**

Workboxes are on average offered at a cost of CHF 1,183 per month (excluding ancillary costs). This pricing appears to be attractive: The vacancy rate currently stands at 10.1%, and if two locations that have only just started the marketing process are excluded this figure falls to 5.9%. In view of the brisk growth tempo and the price increases witnessed since launch of the concept back in 2010, this is an impressive result. When expressed in square meters, the average rental price of a workbox stands at CHF 129 (excluding ancillary costs). This is no more than the median price of existing commercial space offered across Switzerland, although workboxes are typically newbuilds (Fig. 56).

**A development welcomed by the authorities**

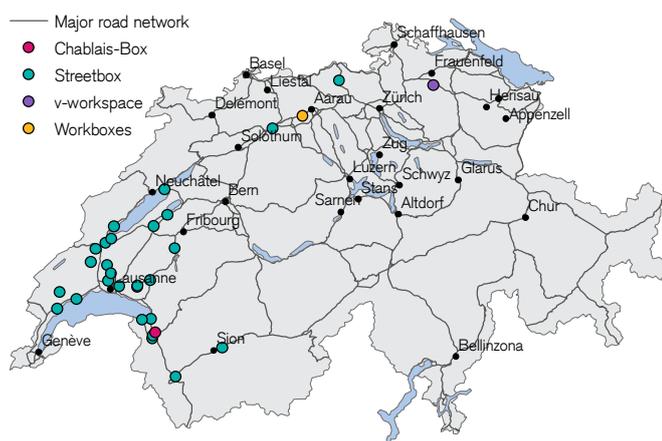
Offerings of this kind are warmly welcomed by local authorities. They bring new life to industrial zones of local municipalities, help to promote innovative business ideas, and have the effect of increasing the local tax base. Furthermore, making the corresponding plots of land available to small companies with limited means ticks a lot of political boxes. Municipal representatives can send out a signal that they are not just pulling the strings to help big companies, but are also sympathetic to the needs of small companies and tradespeople.

**Requirements of a location**

As long as it is rigorously implemented, this concept should also find a market in German-speaking and Italian-speaking Switzerland. This in turn opens up an interesting small niche for real estate investors. However, if a location is to be suitable for workbox use, the price level should not exceed a certain threshold. It should thus lie outside – or at least no closer than the periphery – of a town. This is the only way to keep the cost per square meter at a reasonable level, which we believe to be a crucial USP of this concept, particularly with competition in this segment increasing. Another important factor is easy accessibility from major roads and/or motorways, as this increases the catchment area. Furthermore, to ensure economies of scale the plot of land should have a minimum size of around 4,000 m<sup>2</sup>. At least 40 workboxes should be constructed as a rule, with sufficient external space left over to ensure easy access for inbound and outbound deliveries.

**Fig. 55: Workbox concept developed in French-speaking Switzerland**

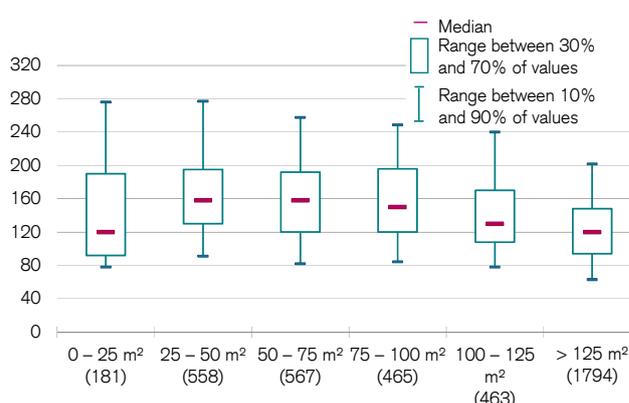
Locations with workboxes in Switzerland (as at January 2020)



Source: Streetbox, Workboxes, Chablais-Box, Credit Suisse

**Fig. 56: Small premises are more expensive**

Net rent per m<sup>2</sup>/year in CHF for advertised commercial and warehouse units across Switzerland, existing inventory and newbuilds (number in brackets)



Source: Meta-Sys AG, Credit Suisse

Last data point: 2018

# Retailers find it tough going

**Revenues in the retail trade are stagnating, with business continually migrating to the online channel. The stationary business remains under pressure and is having to downsize retail space. The losers of structural change are therefore above all landlords.**

## 2019: Stagnation in retail revenues

The nominal revenues of the Swiss retail trade stagnated in 2019, with minuscule growth of an estimated 0.1%, more or less the same as the previous year (Fig. 57). The uncertainty over the trade dispute between the US and China, the seesawing of the Brexit negotiations, and social unrest in a number of countries had an attritional effect on the global economy, bringing to an end Switzerland's previous buoyant economic growth. Real wage growth was initially negative, and only moved into positive territory toward the year-end. The stationary retail business, which faced increasing competition from online traders and a resurgence in the appeal of shopping tourism, derived support only from population growth. Thanks to a robust labor market, however, the weakness of demand in manufacturing failed to dampen consumer spirits.

## Clothing: Revenues down by 25% since 2015

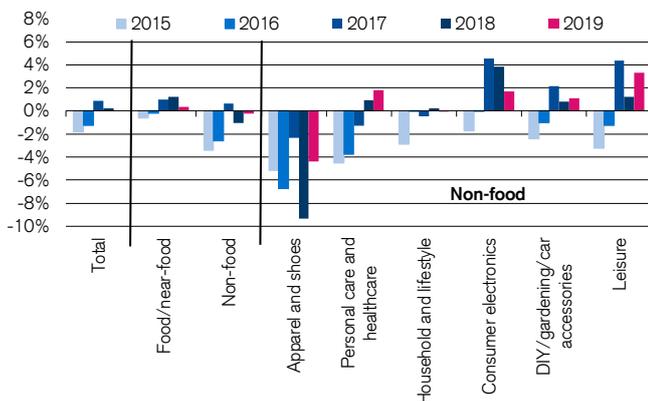
The development of the individual retail segments followed an established pattern. Food and near-food recorded a slight increase in sales compared to the previous year (+0.3%). In the non-food area, the apparel and shoes segment was once again responsible for a slight overall decline (-0.2%). With negative growth of 4.4%, the decline in revenues in the clothing trade was once again severe, albeit not quite as bad as in the previous year. Weather conditions in 2019 broadly played into the hands of fashion retailers compared to 2018. Once again, stationary clothing retailers lost market share to the online channel – and to Zalando in particular. Due to an increase in prices of around 2.2% (driven by higher import prices), real revenues declined by as much as 6.5%. Viewed cumulatively, the clothing business has seen a quarter of its revenues evaporate over the last five years.

## Non-food segments mostly up

The household and lifestyle area once again failed to increase its annual nominal revenues, which languished broadly at the prior-year level. Here too, price increases of 1.9% were not evidence of greater market strength on the part of retailers, but reflected – at least in part – rises in purchasing costs. By contrast, the personal care and healthcare segment built on the positive trend of 2018 (+1.8%), despite an overall fall in the level of prices (-2.0%). The volume of sales is therefore likely to have increased by 3.8% in real terms. Other segments to have recorded nominal year-on-year sales growth include the areas of DIY/gardening/car accessories (+1.1%) and leisure (+3.3%), which also reported slight price increases (+0.1% and +0.0% respectively). The consumer electronics business once again increased revenues last year (+1.7%). However, the growth rate was rather weaker than in the previous two years, and price inflation (-0.1%) was also not as pronounced as in 2018.

**Fig. 57: Retail sales stagnate**

Nominal retail sales growth (adjusted seasonally and for number of sales days)

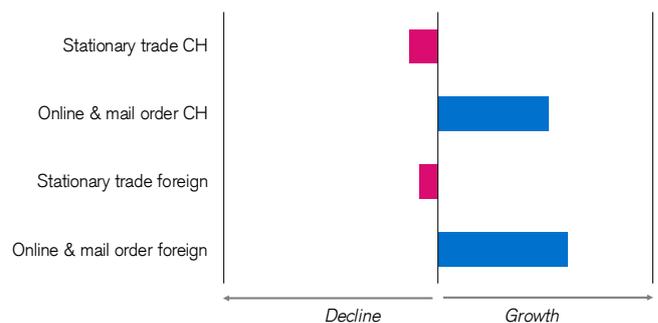


Source: GfK, Credit Suisse

Last data point: 12/2019

**Fig. 58: Development of demand in Switzerland and abroad in 2020**

Year-on-year change in demand from perspective of surveyed providers, n = 174



Source: Fuhrer & Hotz

Last data point: 2019

**Food segment increases margin slightly**

The food/near-food segment made no great advances in 2019, recording an estimated nominal sales increase of 0.3%. However, prices rose by some 0.1% despite a decline in food import prices. This is positive for food retailers, as other costs remained stable, and hence the slight rise in margins. A proportion of the nominal revenue growth is probably attributable to the relatively high growth rates recorded by discounters such as Denner, Aldi, and Lidl. Another driver of business is likely to have been the proliferation of convenience and gas station shops, which have increased sales by more than 36% since 2010.

**Outlook for 2020: Population growth and purchasing power as drivers**

Weaknesses in global manufacturing and a strong Swiss franc will rule out any dynamic economic growth in 2020. However, both population growth (forecast: +0.8%) and a slight increase in purchasing power, which will be boosted by the unusually small rise in health insurance premiums, can be expected to support nominal retail sales and enable them to record a slight increase: (forecast +0.4%).

**Inexorable rise of online shopping**

The stationary retail business continues to lose market share to the online channel, however. Sales of online providers in Switzerland have almost doubled since 2010. Overall, they amounted to an estimated CHF 10.5 billion in 2019, which would represent a repeat of the 10% growth figure booked the previous year. Of this amount, some 80% relates to Swiss providers and the remaining 20% to foreign online traders. In the event of online growth maintaining its anticipated dynamism, this would imply a nominal decline in sales of 0.9% for the stationary trade in 2020. This in turn explains the pessimistic expectations of retailers and manufacturers where the stationary business is concerned (Fig. 58).

**Further growth of online retailing a given**

Neither in Germany nor in Switzerland do the growth rates of the online trade show any signs of losing steam. Among other things, this momentum is supported by demographic developments. From 2020 onward, digital natives will account for the majority of the active Swiss population aged between 16 and 65. Having grown up with digital technologies, it is only logical that these consumers are avid users of them. This is one of the main reasons why growth is primarily taking place in the online channel. As an additional factor, older generations are also discovering the benefits of online shopping. The proportion of people who use the internet on a daily basis, spend more than six hours a week online, and access the internet via their mobile phones is growing most strongly among the over-60s. The strong growth in online expenditure of the "silver generation" can be expected to continue over the coming years. We are also expecting the equivalent proportions to increase in the 30-59 age group too.

**Online sales growth takes toll on retail space**

In keeping with the increase of internet usage in Switzerland, the proportion of the population that has made at least one online purchase over the last three months has likewise risen sharply since 2014. 72% of Swiss made at least one online purchase within three months in 2017. This put Switzerland behind only the United Kingdom as the European country with the highest proportion of online consumers. Moreover, this proportion is likely to have increased even further in the meantime, even if the growth rate is likely to have been less dynamic than in the period 2014-2017. In the UK, 82% of the population now shop online. Online shopping already accounts for more than 18% of all retail sales in the UK, and this figure continues to rise. The stationary retail business is under pressure accordingly: In the UK and the US, the two countries where online shopping accounts for the highest proportion of total revenues, shop closure rates reached new record levels in 2019.

**Fig. 59: Decline in number of retail outlets continues**

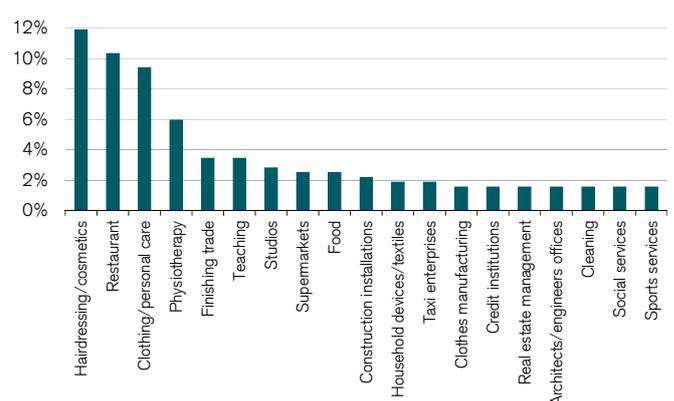
Number of workplaces (rhs), change in % (lhs)



Source: Swiss Federal Statistical Office, Credit Suisse Last data point: 2017

**Fig. 60: Retail space being converted**

Breakdown of new tenants of ground floor premises with mixed use, in %



Source: Meta-Sys AG, Credit Suisse Last data point: 2017

## Writedowns on property values in the UK

In the United Kingdom, the difficulties experienced by retailers are now feeding through into real estate stocks. A number of real estate companies have had to book writedowns on their retail property portfolios due to a sharp decline in rental income. Another unsettling development was the announcement by UK fund company M&G in December 2019 that it was closing a large real estate fund that focused heavily on retail property. In addition to the structural change toward the online business, consumer sentiment in the UK has also been dragged down by uncertainties over Brexit. Moreover, special insolvency procedures allow British retailers to close stores and force through rent reductions, which result in painful income losses for landlords. While the corresponding structures in Switzerland may be rather different, this development is unlikely to bypass *Confoederatio Helvetica* altogether.

## Forced downsizing of retail space supply

The stationary retail trade is trying to limit losses in market share through innovations and new concepts, but in many cases is facing a losing battle. Accordingly, the number of retail outlets in Switzerland has been steadily declining for several years. Whereas there were just under 53,000 retail outlets back in 2013, the equivalent figure by 2017 was only around 50,000 (Fig. 59). Viewed on an annual basis, neither the number of workplaces nor the number of companies in the retail business has recorded a rise since 2014. The structural decline in retail outlets has manifested itself above all in tourist municipalities (-8.7%, urban centers (-6.0%), and high-income municipalities (-4.7%). Good examples of companies with a dwindling number of branches include Vögele Shoes and Ex Libris.

## Use conversion a striking phenomenon

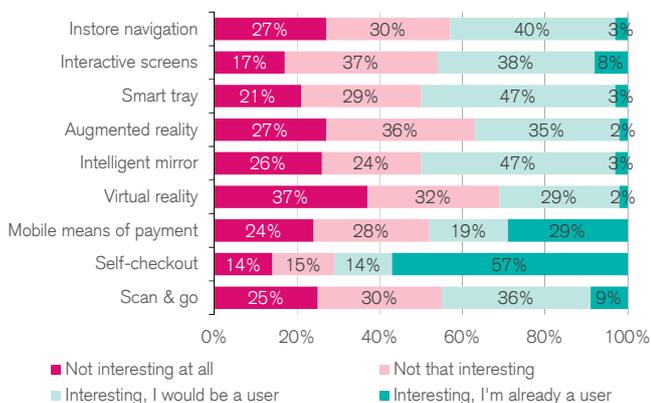
Due to the proliferation of empty retail properties, the phenomenon of use conversion is becoming widespread in much of Switzerland (Fig. 60). By comparing previous advertisements for ground-floor retail premises with current tenant data, we have been able to determine the degree of use conversion recorded in 2017. It emerges that just 20% of advertised space has been re-let to retail tenants. Instead it is above all restaurants and service providers such as hairdressing and cosmetic salons that have moved in. In some cases, retail properties have even been rented out as office space. Credit institutions, real estate management companies, and architects/engineering offices have all expressed interest in former retail properties of this kind, which are often on the market at attractive rental terms. However, use conversion also has its drawbacks for landlords, who must brace themselves for higher costs for converting the properties and for a lower willingness to pay on the part of incoming non-retail tenants.

## Digitization of points of sale

Stationary retailers are currently seeking salvation in the use of new technologies and services, in the hope that these can turn the tide by offering an enhanced shopping experience and superior client service. This idea is currently in the middle of a conceptual and test phase. It appears likely that the various initiatives in this area will be continued or indeed intensified in the future, not least since younger shopper generations in particular exhibit a much greater interest in new technologies than the baby boomers. That said, the acceptance of new technologies by consumers does not exactly mirror the expectations retailers themselves have of digital solutions (Figs. 61 and 62). However, the relentless increase in the share of revenues accounted for by the online channel will at most slow the integration of online and offline technologies, rather than warding it off.

**Fig. 61: Interest in / use of new technologies**

Assessment from consumer perspective as per end 2019 (basis: 513 consumers)

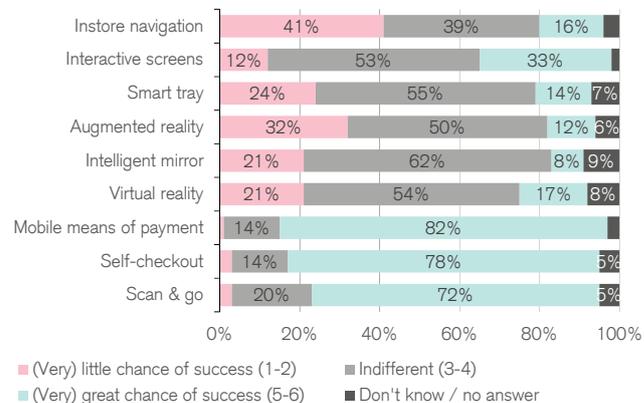


Source: Fuhrer & Hotz / Omni Channel Forum

Last data point: 2019

**Fig. 62: Chances of success from retailer perspective**

Development by 2022 (basis: 76 retail trade experts)



Source: Fuhrer & Hotz

Last data point: 2019

# High noon for high streets?

**Switzerland's main shopping streets are likewise feeling the effects of structural change. But unlike the retail market as a whole, the top shopping streets of Switzerland's large urban centers have a number of important USPs.**

### **High streets: Top end enjoys premier league status**

The top-end shopping streets of Switzerland's retail trade stretch for just a few hundred meters. These "high streets" are home to the very best shops in a city. Just a few years ago, retailers would have had to pay eye-watering sums to secure one of these coveted sites. Fast forward to the present and demand has cooled significantly, because even these upmarket sites have not escaped the wider structural change. That said, the cost of a square meter of retail space in these prized locations has barely changed. Landlords are therefore still enjoying a healthy situation here. According to Cushman & Wakefield, both Zurich's Bahnhofstrasse (5th place) and Geneva's Rue du Rhône (17th) still rank among the most expensive retail locations in Europe.<sup>8</sup>

### **Unique locational qualities**

Switzerland's main shopping avenues have unique locational qualities that cannot be replicated. Their USPs include their enviable location, be it close to a lake shore, at the start or end point of a key public transport hub, as a link between railway station and old city center, or simply the fact that they fulfill a key "corridor access" function. This means they are heavily frequented by both Swiss consumers and tourists, which makes them highly attractive for retailers and manufacturers of brand products. As such, there are virtually no vacancies to be found on the high streets of the major urban centers. According to real estate service provider CBRE, only 1.5% of retail space on these streets was unrented in 2019.

### **The best "visibility"**

However, it is not their outstanding location alone that explains the extremely high footfall evident on these streets. These upmarket parades of shops also benefit from the clustering of famous brands and the glitz and glamor of their best outlets. Zurich's Bahnhofstrasse is now one of Europe's top 14 streets with respect to footfall, which puts it on a par with the larger high-end European shopping streets that can boast more tourist attractions.<sup>9</sup> Indeed, the southern part of Zurich's Bahnhofstrasse ranks in Europe's top 10.

### **Adjustment to tenant mix needed**

The tenant mix of Switzerland's top shopping streets is dominated by international chains. According to CBRE, these chains account for some 50% of Bern's Spitalgasse and Marktgasse, 59% of Lausanne's Rue de Bourg, 66% of Zurich's Bahnhofstrasse, 68% of Basel's Freie Strasse, and 69% of Geneva's Rue du Marché. Between 80% and 100% of these tenants have stores elsewhere in Switzerland. In terms of tenant mix, clothing and shoe outlets account for between 31% and 55% of these shops. In Geneva and Zurich, watch and jewelry stores account for a further proportion of between a quarter and a third. This mix will have to change over the next few years. The closure of Globus' women's fashion store on Bern's Spitalgasse makes the need for adjustment starkly clear. The wider trend is shifting away from fashion into sectors such as food, gastronomy, and healthcare/beauty.

### **The changing role of "bricks-and-mortar" retailing**

In the modern era, where consumers can order anything online at any time, the role of the stationary point of sale has changed. On-site sales are no longer the be-all and end-all. The sales function is receding into the background as the marketing function takes center stage, i.e. customer contact and the customer experience are gaining in significance. As a consequence, the importance of footfall has actually increased further. This is apparent, for example, on the Bahnhofstrasse in Zurich, where the highest rents are now to be found at the northern end of the Bahnhofstrasse, right by the heavily frequented main railway station (Fig. 63). This "Hauptbahnhof" is one of the most heavily frequented railway stations in the world, with some 2,915 train movements a day, and 466,800 rail users arriving or departing every weekday. With this in mind, the visibility of a point of sale has also become more important. Corner sites and large shop window frontages justify higher rents. Property features of this kind are likely to become even more important in the future.

<sup>8</sup> Cushman & Wakefield 2018: Main streets across the world

<sup>9</sup> BNP Paribas: Pan-European footfall analysis 2017 – 2018

## Retail stores evolving into centers of customer experience

Stationary points of sale should be a bridge to the consumer, improving the perception of the brand. Ideally the customer becomes part of a community, similar to the model pursued by Apple. The store becomes a meeting place where products are returned, additional services provided, online purchases picked up, and new products tested. Digitization can provide valuable assistance in creating shopping experiences. To give an example: With its “Nike Live” shop concept in Los Angeles, Nike evaluates the shopping patterns and other data of local Nike app users, and uses the findings it has gained to restock its store on a fortnightly basis with new clothes, shoes and accessories, sometimes of an exclusive nature. Thanks to the information that Nike has compiled, customers can also be given product recommendations that are highly relevant to them personally.

## Upmarket shopping streets sitting pretty

These developments are playing into the hands of points of sale at the best addresses. Whereas consumers previously had to make their way to shops that were often located outside of the city, the shop is now coming to the consumer. This process has already been anticipated by convenience shops. It is not surprising that the specialist retail giants are likewise coming to city centers. IKEA experimented with pop-up stores in city centers at an early stage, and is now investing in smaller but easily accessible premises in central locations. The growing appeal of cities as a place to live or work is also proving conducive to this development. Factors such as employment density are becoming more important for the selection of a site, as they promise high footfall (Fig. 64). However, it is only the top shopping streets that are benefiting from this focus on footfall. Specifically, the large chains are scaling down their branch networks – primarily in small and mid-sized centers. This is reducing the suction effect of the corresponding shopping streets and increasing the pull of the top addresses, thereby allowing the latter to expand their catchment areas.

## Tourism as additional driver

The strong growth in city tourism (+45% since 2006) makes tourists an increasingly significant factor for cities and their shopping streets. Among others, Asian visitors with considerable purchasing power have been a contributory factor to the strong growth. The number of overnight stays has trebled since 2005, with their proportion of all overnight stays rising from 10% in 2005 to 19% in 2018. The main beneficiary of the short stays of many business travelers and urban tourists (average: 1.7 days) is the retail trade, as while these customers typically do not have time to embark on major excursions, they can head out of their hotels to do a bit of shopping.

## Emancipation of manufacturers increases tenant potential

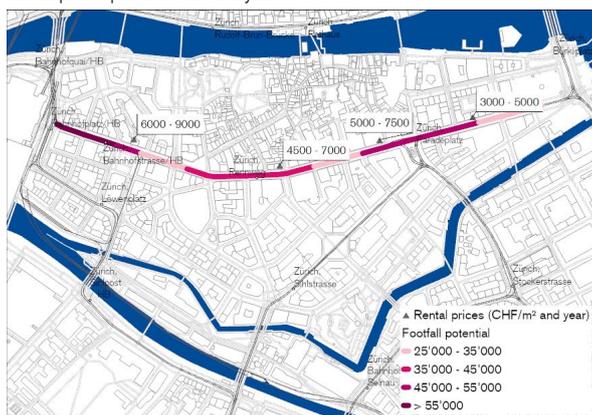
Thanks to the internet and online shops, any manufacturer of a brand product can now establish a direct sales channel to its customers. What they lack is visibility with customers. For this reason, a stationary point of sale in addition to a presence in suitable marketplaces is an appropriate tactical step in the battle for customer attention. For example, a number of shoe manufacturers have recently started opening up their own monobrand stores (Geox, Ecco). Even automotive manufacturers are now trying to establish a presence at the very best retail addresses. In the medium term, we are anticipating increasing tenant demand at these locations. Many international businesses have been heavily preoccupied with building up their online presence in recent times, and as a consequence have devoted insufficient resources to optimizing their branch networks.

## The future of the high street

In the future, physical shopping will take place first and foremost in the most upmarket shopping streets. The latter have the necessary pulling power, as well as the essential footfall. However, retail stores can be expected to become smaller in the future, with 400 m<sup>2</sup> proving sufficient to fulfill their new function. The tenant mix should become more vibrant again going forward, particularly as manufacturers of consumer products will increasingly be competing with the big retail names in their quest to achieve ever greater proximity to the consumer.

**Fig. 63: Footfall potential and rental prices**

Rental prices per CHF/m<sup>2</sup> and year

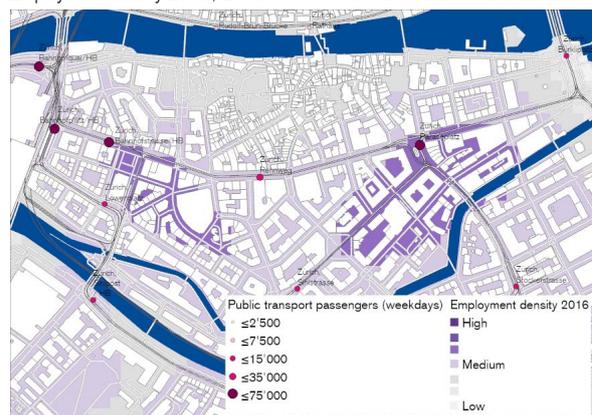


Source: Senozon, Wüest Partner

Last data point: 2018

**Fig. 64: Employment density and Zurich PT commuter density**

Employment density 2016, Zurich PT commuters: number of arrivals and departures

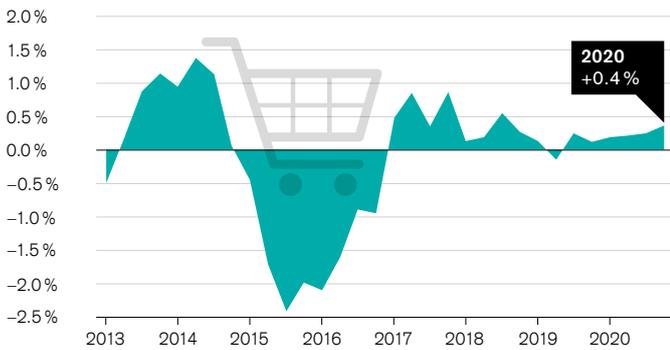


Source: Credit Suisse, Swiss Federal Statistical Office, Zurich Public Transport

# Space reduction is taking place

## Demand

Growth in retail sales, nominal

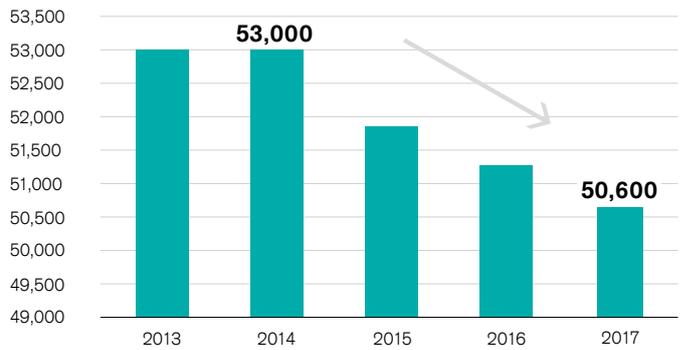


- Population growth and higher purchasing power support consumer spending, strong franc has dampening effect
- Sales decline in stationary trade

**2020: Modest sales increase, negative growth in demand for retail space**

## Supply

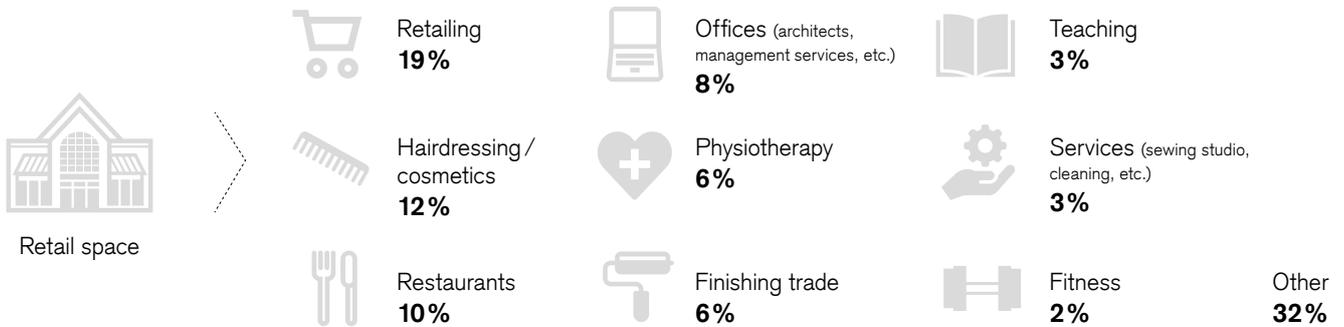
Number of retail outlets



- Ongoing decline in retail outlets
- At the same time: reduction in retail space

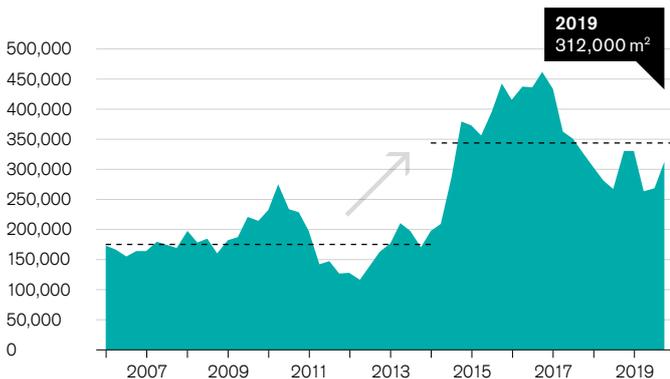
**2020: Continued decline in retail space**

## Use conversion of retail space (ground-floor premises)



## Advertised retail space

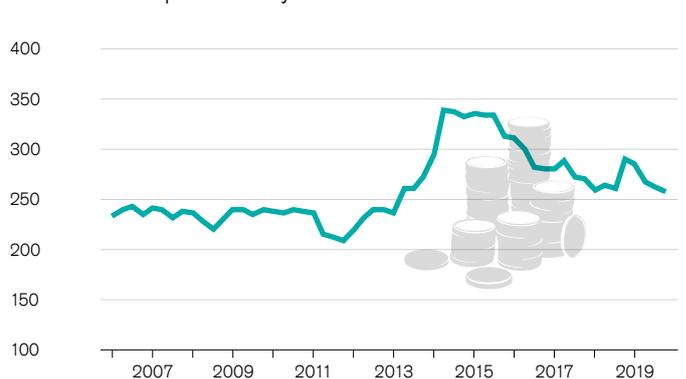
In m<sup>2</sup>



**2020: Supply of space remains at high level**

## Rents offered

In CHF per m<sup>2</sup> and year



**2020: Rents remain on downward trajectory**

# Office market rides wave of momentum

**A broad-based upturn in the rental market and robust risk premiums are supporting the investment outlook for German office property.**

**Need for greater risk diversification**

With the prices of Swiss investment properties increasingly decoupling from their fundamental data Swiss real estate investors are looking for investment alternatives, as well as superior risk diversification. While they are keen to retain the defensive character of Swiss real estate investments, the German market is becoming difficult to overlook. This market is closer for Swiss investors than London or other overseas markets. Core real estate investments in Germany exhibit similar defensive characteristics to their Swiss equivalents. According to the MSCI, total returns in Germany have fluctuated around 3.5% annually since 2002, slightly higher than in Switzerland (0.8% p.a.), but well below globally diversified real estate portfolios (5.5% p.a.).

**Low correlation with Swiss investments**

Despite having similar characteristics, real estate investments in Germany offer a healthy degree of diversification for holders of similar investments in Switzerland. This is particularly true of German office property, which from a cyclical perspective is the most out of sync with Switzerland. The correlation coefficient of total returns for German and Swiss office investments since 2002 amounts to just 0.06. While this still indicates slightly positive correlation, it is astonishingly low.

**German market lagging behind after prolonged phase of weakness**

Due to a construction boom in the late 1990s, the returns on real estate investment in Germany lagged behind those of both Switzerland and globally diversified portfolios for a long time (Fig. 65). However, the German real estate investment market has been enjoying a renaissance since 2014. The logistics segment recorded the strongest performance of all here between 2014 and 2018, with an annualized total return of 11.9%. This segment was followed by rental apartments, office property, and retail property with annual returns of 10.1%, 7.9%, and 7.6% respectively.

**Europe's largest transaction market**

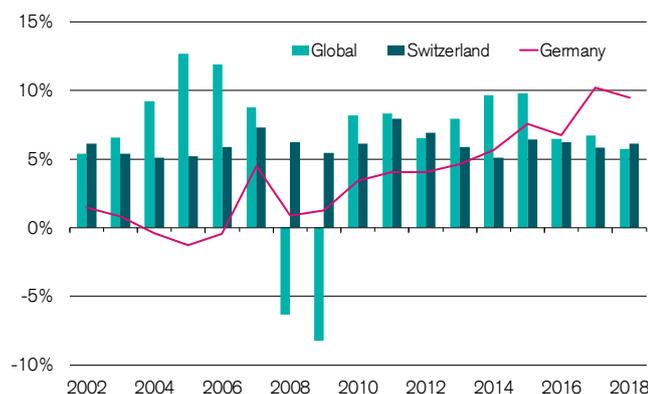
As a result, German real estate investments have also been attracting more attention from international investors. According to Real Capital Analytics, between the third quarter of 2016 and the third quarter of 2019 the transaction volume in the German commercial property market amounted to an average of EUR 17.6 billion per quarter. This has seen Germany overtake the previous market leader (the UK: EUR 16.4 billion) as Europe's largest transaction market.

**Low net yields, but high risk premiums**

The resurgence of appetite for German real estate investments has led to a rise in transaction prices, and therefore by definition to lower net yields (Fig. 66). This development was accentuated further in 2019 due to the lack of investment alternatives in an even more pronounced negative interest environment. However, by the end of 2019 German real estate investments were exhibiting a risk premium of more than 300 basis points over government bonds – a high level when viewed historically and relative to the period before the financial crisis.

**Fig. 65: German real investments exhibit momentum**

Total returns of direct investments, in CHF (i.e. hedged)



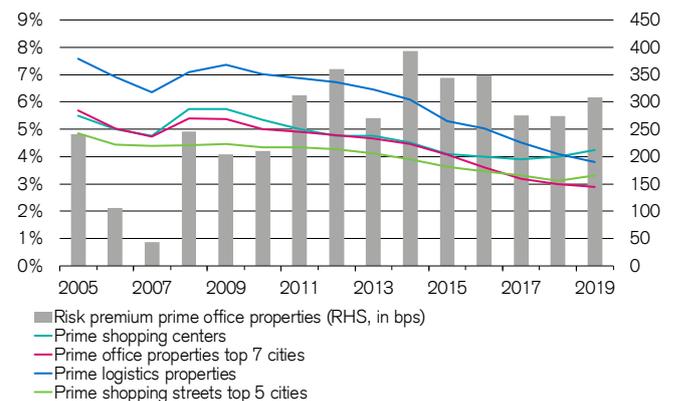
Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: MSCI, Credit Suisse

Last data point: 2018

**Fig. 66: Declining net yields, but stable high risk premiums**

Transaction-based net initial yields of German real estate in %; risk premiums compared to government bonds in basis points (bps)



Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: Property Market Analysis, Credit Suisse

Last data point: 2019

### Higher net yield than Zurich office property market

The trend toward higher online spending is weighing on investments in retail property, while at the same time favoring those in logistics properties. Indeed, the average net yield of top logistic properties in Germany declined to below 4.0% – and hence below the yield of prime shopping centers – for the first time in 2019. As recently as 2011, this figure stood at more than 7.0%. The average net yield on prime office properties declined from 5.0% to 3.0% over the same timeframe. Although this figure appears to be extraordinarily low, prime office properties in Germany still offer a premium of some 70 basis points on their Zurich equivalents.<sup>10</sup>

### Polycentric structure of the German office property market

Any view of real estate returns is incomplete without an analysis of market rents. Due to their higher transparency and liquidity, we are focusing on the office markets of Germany's top seven cities, which according to Savills currently account for four-fifths of all investments in office property. According to Property Market Analysis (PMA), the total office space in these cities amounted to more than 79 million m<sup>2</sup> at the end of 2019. At that point, Berlin was the largest market with 18.2 million m<sup>2</sup>, followed by Munich, Hamburg, and Frankfurt with 14.0, 13.7, and 10.3 million m<sup>2</sup> respectively. By contrast, Cologne, Düsseldorf, and Stuttgart were significantly smaller with 7.6 million m<sup>2</sup> in each case.

### Modest expansion of supply ...

In contrast to Switzerland, where the office property market has witnessed a construction boom, the expansion of supply in Germany has been modest over the last decade (Fig. 67). In 2018, the total amount of newly completed office space here amounted to barely 1 million m<sup>2</sup>, or just 1.3% of the overall market supply.

### ... despite resurgence in demand for cyclical and structural reasons

At the same time, the German office property market has experienced a resurgence in demand. Average office employment growth in the top seven cities amounted to more than 2% per year between 2014 and 2018. Cyclical demand coincided with a structural trend toward flexible office letting. Gross space demand in the top seven cities rose sharply, and has stabilized above the level of 3.5 million m<sup>2</sup> since 2016 (Fig. 68).

### Convergence toward vacancy rates of around 2%

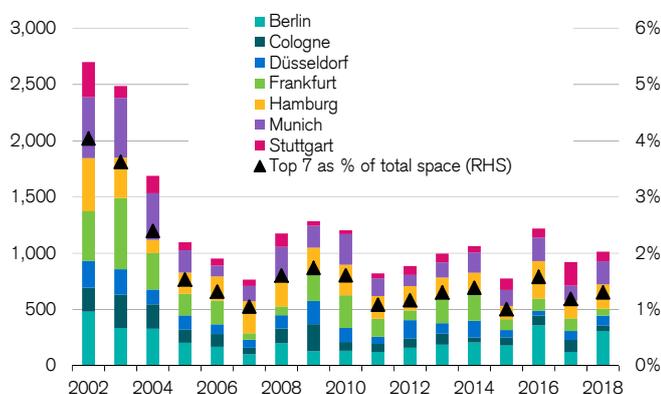
The combination of low supply and higher demand has resulted in a significant reduction in vacancy rates (Fig. 68). Back in 2011, Germany's cities were still characterized by very different vacancy situations. More than 18% of office space was vacant in Frankfurt, whereas Stuttgart had a vacancy rate of just 6%. Fast forward to the third quarter of 2019, and Stuttgart, Munich, and Berlin all had vacancy rates of just 2% or lower. In Hamburg and Cologne too, the vacancy rate is not much higher.

### Rental prices on upward trajectory

For a considerable period of time, the level of rental prices in Germany's top seven cities was held back by the high vacancy rates. Back in 2013, office rents per m<sup>2</sup> were not only among the lowest in a global comparison of cities of similar economic importance, they were also between 10% and 15% lower on average than they had been at the turn of the millennium. The subsequent sharp decline in vacancies has now led to a significant rise in rents in all top seven cities, however (Fig. 69).

**Fig. 67: Modest expansion of space in German office market**

Newly completed office space in mn m<sup>2</sup> per city and aggregated as % of total supply

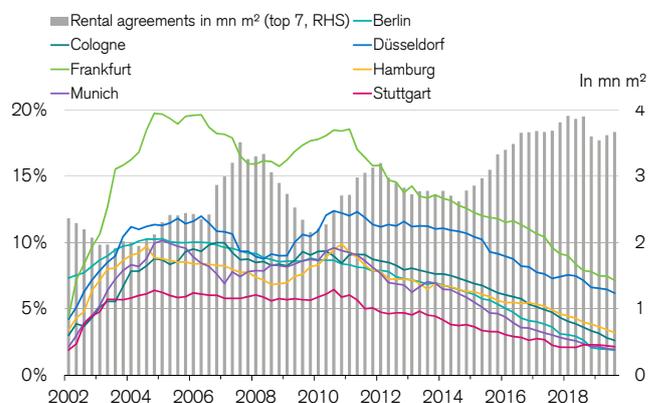


Source: Property Market Analysis, Credit Suisse

Last data point: 2018

**Fig. 68: Robust demand leads to lower vacancies**

Vacant space as % of total available space per city, aggregated rental agreements for the top seven cities in mn m<sup>2</sup> (12-month total, right-hand scale)



Source: Property Market Analysis, Credit Suisse

Last data point: Q3/2019

<sup>10</sup> Historical performance data and financial market scenarios are no reliable indicator of future results.

## Berlin's rise as international technology hub

Of all Germany's major cities, Berlin's development has been the most impressive. Between 2014 and 2018, employment in the segments relevant to the office property market rose by 3% per year, while peak rental prices rose from EUR 24 to EUR 36 per m<sup>2</sup>/month. The German capital has transformed itself from an administrative center into a leading international business hub. The drivers of the dynamism of Berlin's rental market are the technology, communication, biotechnology, and pharmaceutical segments, along with a vibrant start-up scene.

## 2019: Office market defies economic downturn

The German economy slowed significantly in 2019. We are expecting real gross domestic product to have grown by just 0.5% last year, following average growth of some 2.0% annually between 2014 and 2018. The manufacturing sector and the automotive and export industries in particular have cooled substantially, whereas the services segments relevant to the office property market have continued to develop robustly. Despite weaker economic growth, the rental market remained very strong in 2019, and the trend of rising rents has continued.

## Inevitable response on supply side

Given the acute scarcity of supply in a number of markets and the higher level of market rents, it is not surprising that the volume of office space currently under construction is on the rise, as illustrated by Figure 70. Berlin in particular has a relatively large pipeline, but a significant amount of space is currently under construction in Munich too.

## Shortage of supply likely to persist outside of Berlin and Frankfurt

However, the majority of this new space is already pre-let, and the amount of still available space is very modest in Cologne, Düsseldorf, and Hamburg. In Munich, the lion's share of space set to come onto the market in the future is on the urban periphery. Accordingly, the problem of supply scarcity is likely to be alleviated somewhat only in Berlin and Frankfurt.

## Only slight rise in vacancies expected

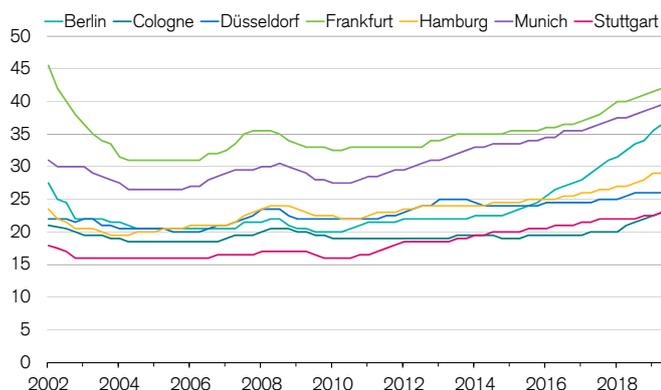
It would take a more pronounced economic slump for vacancies to rise by any significant degree. In keeping with our macro scenario of German economic growth being similarly low in 2020 as it was last year, we are expecting a slight rise in vacancies. In the country's top seven cities, this should mean vacancies remaining at around their current historically low levels. In other words, rents should continue to rise, albeit less sharply.

## Further growth in net income probable

In view of the above, the investment outlook for German office property remains intact. While the already very low net yields pose a risk in the event of interest rates picking up significantly, high risk premiums can be expected to continue to stimulate investor appetite. It is also worth noting that German office rental agreements have an average term of four to five years. Even in the event of market rents stagnating or slightly declining, many of these agreements are likely to be renewed at higher rates over the next few years. As a result, real estate portfolios can expect to enjoy further increases in net income.

**Fig. 69: Rents trending up**

Peak rents for newly leased offices, in EUR per m<sup>2</sup>/month

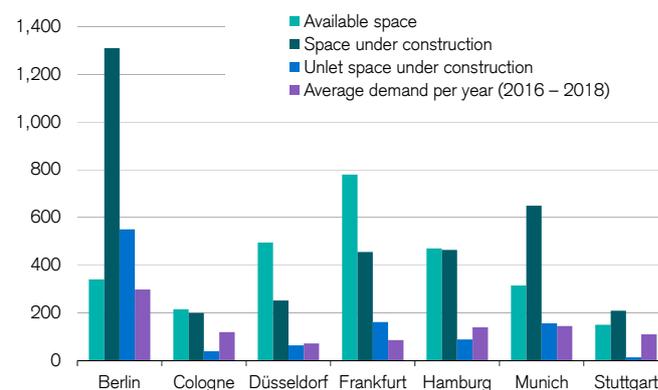


Source: Property Market Analysis, Credit Suisse

Last data point: Q3/2019

**Fig. 70: No end to scarcity of supply in sight**

Comparison of available rental space, office space under construction and net absorption in thousand m<sup>2</sup> per city



Source: Property Market Analysis, Credit Suisse

Last data point: Q2/2019

# Security has its price

**The prices of real estate funds and above all real estate shares rose sharply in 2019. Investors are not expecting the negative interest rate environment to end any time soon. Indirect real estate investments will accordingly remain in vogue.**

**Indirect real estate investments at a high**

With 2019 having been a buoyant year for stock markets, Swiss real estate shares and funds also shone. Indeed, with a total return of 37.0% and 20.7% respectively, they recorded the strongest performance of the last 20 years, clearly outperforming Eurozone real estate shares (16.7%) (Fig. 71).

**Interest rates once again a major prop**

In addition to the generally positive market sentiment, interest rates proved once again the key driver of the outstanding performance of indirect investments. The U-turn in the Fed’s monetary policy stance also had the effect of pushing any normalization of rates in Switzerland into the distant future. Long-term rates reached new lows in the summer as recessionary fears burgeoned, which was temporarily reflected in a decline in the yield on 10-year Swiss government bonds to below -1% (Fig. 71). Although it has normalized somewhat since, this yield can be expected to remain heavily in negative territory in 2020. A combination of low inflationary pressure, the weakening economy, and the threat of upward pressure on the Swiss franc makes any rise in key rates on the part of the SNB unlikely.

**Real estate shares steeply valued**

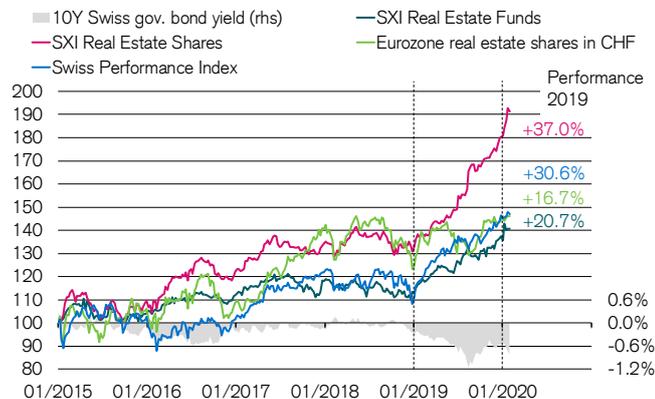
The boom in listed Swiss real estate investments has seen the corresponding premiums rise sharply. The loftiest of all at the end of 2019 were the premiums on real estate shares at 43.2% (Fig. 72). But the premiums on real estate funds relative to net asset values are likewise back at the highs recorded in the years 2015-2017 – despite the fact that there was a significant year-on-year rise in capital increases in 2019 (to more than CHF 1 bn) and three funds were newly listed.

**Fair price relationship between residential and commercial property**

The spread between premiums on residential real estate funds (average premium: 35.5%) and real estate funds focusing on commercial and mixed-use properties (29.4%) has narrowed further. This is primarily due to the ongoing downturn in the rental apartment market and a simultaneous trend of recovery in the office property market. Things have now reached the stage where the price relationship between commercial and residential real estate funds can be once again viewed as balanced. This is also apparent from rental income losses, which in 2019 amounted to 5.1% for residential real estate funds, whereas the equivalent figure for commercial funds rose slightly for the first time since 2015 to 6.1%.

**Fig. 71: High total return thanks to subdued interest rate expectations**

Total performance of indirect real estate investments, index: January 1, 2015 = 100; yield on 10-year Swiss government bonds



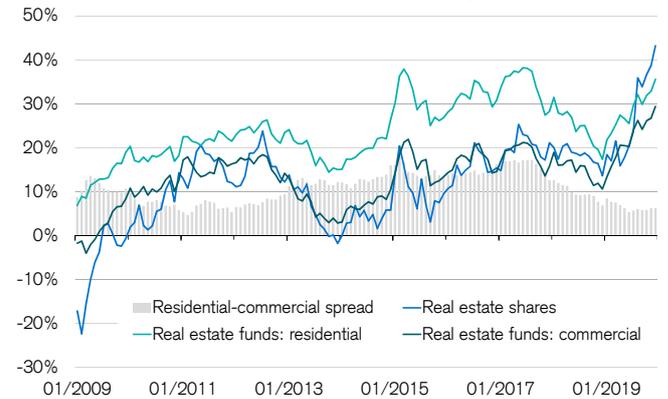
Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: Datastream, Credit Suisse

Last data point: 30.01.2020

**Fig.72: Commercial space once again in demand**

Premiums of listed Swiss real estate shares and funds (weighted by market capitalization); residential/commercial premium spread in percentage points



Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: Datastream, Credit Suisse

Last data point: 31.12.2019

### The older, the more expensive

In the area of residential real estate funds, traditional products are particularly in vogue with investors. The average premium on vehicles set up no later than 1963 stood at a high 39.5% at the end of 2019 (Fig. 73). The younger the fund, the lower the premium: For the latest products to have come on to the market since 2010, the equivalent premium is just 15.4%. The higher premiums for older funds are a direct consequence of their characteristics: They are typically larger and geographically diversified, as well as having a lower risk of income loss due to the lower proportion of newbuilds and above-average location quality. For example, the rental income losses of the oldest group of funds amounted to a relatively modest 4.4% in 2019, whereas the youngest funds were forced to forgo 6.8% of target rental income. Furthermore, many of the older funds have significant appreciation potential over the long term that can be realized through expansion, modernization, or replacement newbuilds. Given these advantages, investors with a more long-term view are more inclined to pay more for such vehicles.

### Moderate risk of correction to fund market

Despite the currently high price levels, there are reasons to believe that indirect investments in the Swiss real estate market remain attractive. Given the corresponding earnings expectations of companies and the increased risk resulting from their high correlation with the stock market, we consider real estate shares expensive. By contrast, we view the risk of a major correction to the real estate fund market to be rather low at the moment. Even if it is highly unlikely that the total returns of 2019 will be repeated, real estate funds remain attractive for investors taking a long-term view. While their dividend yields may be declining due to high valuations and the pressure on rental income, the yield premiums relative to 10-year government bonds are still well above the long-term average at 290 basis points (as at end 2019).

### Stable yield on investment thanks to rising net asset values

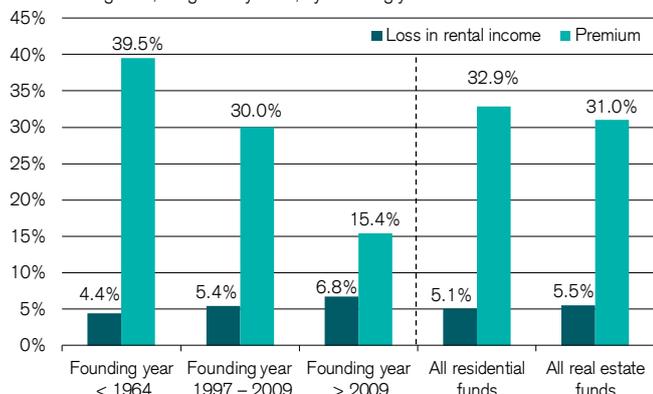
Moreover, declining rental income is being offset by rising net asset values. Over the last three years, low interest rates have seen real estate funds book valuation increases of some 2% annually, resulting in yield on investment of more than 5% (Fig. 74). Even in the event of slight rises in long-term interest rates, these valuation gains are likely to persist for quite a while. The reason for this is the sluggishness with which the discount rates relevant to property valuations respond to changes in interest rates.

### Conclusion: Stability has its price

2019 was an extraordinarily successful year for real estate investors, and not one that is likely to be repeated any time soon. For long-term investors, real estate funds in particular remain an interesting option due to their comparatively stable income streams and quasi-bond characteristics. The larger, established vehicles in particular promise a certain stability, even if this does come at a higher cost. The high price level also offers a good opportunity for switches within a real estate portfolio. One option that real estate investors might want to consider is a switch to foreign real estate markets. This would already appear to be true of pension funds, whose foreign component in real estate portfolios has risen from 6% to 12% over the last year according to the Credit Suisse Pension Fund Index. Investments in growth segments such as logistics properties or serviced apartments could also make a valuable contribution to optimization of the risk/return ratio.

**Fig. 73: Established residential real estate funds highly sought-after**

Rental income losses and premiums of listed Swiss real estate funds with a focus on residential segment, weighted by NAV, by founding year of fund



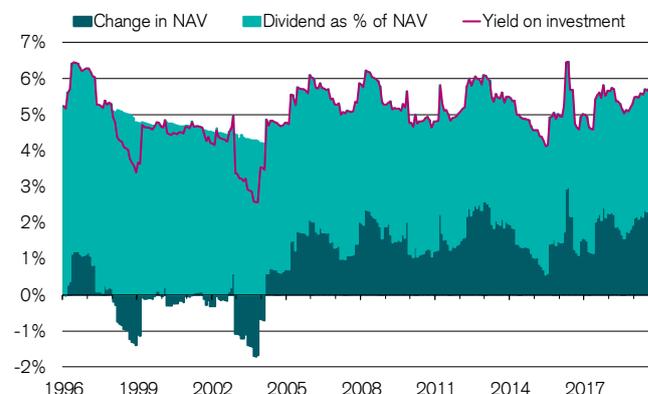
Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: Fund annual reports, Credit Suisse

Last data point: 12/2019

**Fig. 74: Stable yield on investment thanks to valuation gains**

Yield on investment of listed Swiss real estate funds; NAV: net asset value



Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: Datastream, Credit Suisse

Last data point: 31.12.2019

# Mid-sized centers: Better than just middling?

**The high demand for investment properties should remain high for quite some time given current interest rate levels. In an environment characterized by increasing indications of oversupply in the tenant market, secure investments are coveted. For investors, mid-sized urban centers offer an attractive alternative to the fiercely competitive markets of the large centers.**

## 2019: No letup in stampede into real estate

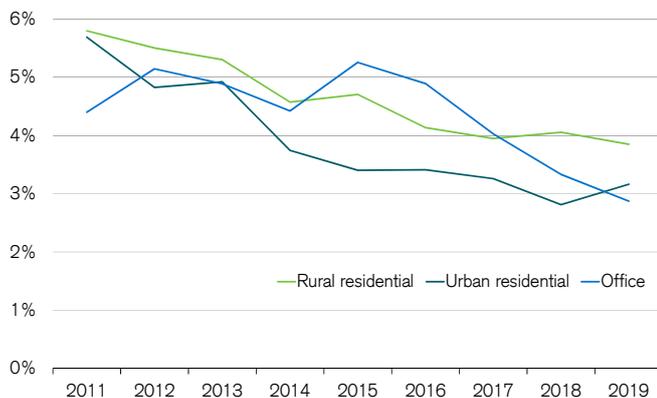
Real estate was coveted by investors last year – the fifth year of the negative interest era. According to the IAZI Investment Real Estate Index, new investors in residential and mixed-use investment properties were able to achieve an average net cash flow yield of 3.4%, which at times represented outperformance of 400 basis points or more compared to 10-year government bonds. The positive economic situation of recent years has temporarily strengthened demand in rental markets and therefore the revenue base – particularly in the office space market. Many market players are therefore continuing to invest heavily in newbuild projects, despite a challenging marketing situation. Although 10% fewer newbuild projects were approved in 2019 than in 2018 – as measured by planned building construction expenditure – newly submitted planning applications reveal the total volume of such projects to be in the region of CHF 35.4 billion, actually 2% higher than the previous year.

## Initial yields on office space decline once again

Persistently strong demand in the transaction market and the associated high level of prices are also feeding through into initial yields (Fig. 75). In the case of office space, this is the fourth annual decline in succession, with initial yields amounting to just 2.9% (gross) in 2019. This development is likely to be driven mainly by demand for urban office space, which was particularly popular due to the stronger recovery of the office space market in central business districts. As a result, the spread between the yields on office and residential property, which had been steadily narrowing in previous years, has now disappeared completely. This reflects the different positions of these two segments in the market cycle. Whereas the recovery is most advanced in office property, particularly in central locations, the rental apartment market remains in decline. Initial yields on urban residential property have increased slightly (from 2.8% to 3.2%). However, this should not be taken as a sign of a change in the price trend in the large centers. The increase appears to be attributable to a few transactions at the start of the year that were concluded in the expectation of an impending reversal in monetary policy. In other urban centers and rural communities, a slight decline in gross initial yields (from 4.1% to 3.9%) was recorded.

**Fig. 75: Initial yields on office property at record low**

Transaction-based gross initial yields (median) of institutional investors; urban: large centers including Lucerne, Lugano, St. Gallen, Bellinzona, and Chiasso



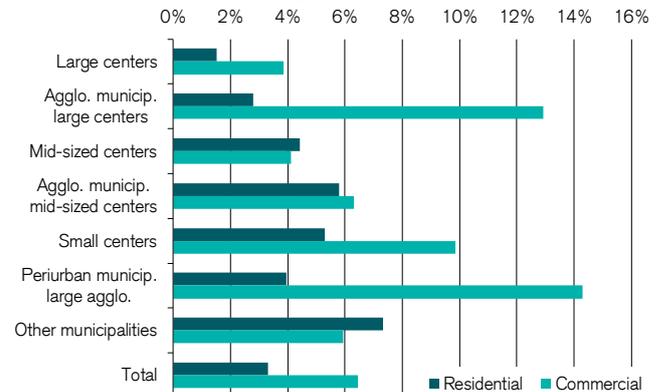
Historical performance data and financial market scenarios are no reliable indicator of future results.

Source: REIDA, Meta-Sys AG, Credit Suisse

Last data point: 12/2019

**Fig. 76: Mid-sized centers exhibit second-lowest vacancy risk**

Losses in rental income as % of target income; period: Q3 2017 – Q3 2019; analysis based on approx. 130,000 rental agreements



Source: REIDA, Credit Suisse

Last data point: Q3/2019

## Risk-averse capital looking for investment alternatives

Monetary and economic developments last year have left market participants in little doubt that negative interest rates will be a fixture of the investment landscape for a long while yet. Accordingly, demand for residential property will persist, and the tenant and investor market will drift further apart. Investors will inject even more capital into real estate, although they are likely to increasingly focus on quality and therefore a certain degree of security when selecting properties. Properties in the large centers are coveted in this context, as they exhibit low vacancy risks and enjoy an assured level of demand.

## Fiercely contested market in large centers

However, the market here is increasingly restricted to existing properties. In the city of Zurich, for example, just 20 plots of land without existing buildings traded hands annually between 2011 and 2018. The equivalent figure in the previous decade was 31. The transaction market is therefore extremely limited, which makes it difficult for individual market participants to invest. A certain amount of liquidity is still being provided by private property owners who have taken advantage of the strong market in recent years to sell their properties at a high profit. However, real estate companies and institutional investors are not only competing with each other in these transactions – over the last few years, the public sector and co-operative housing associations have been expanding their own property portfolios in the city of Zurich, as is clear from cantonal ownership transfer statistics.

## Mid-sized centers as alternative

Due to the negative interest rate outlook referred to above, we can expect to see further investment switches in the future from cash positions or low-risk bonds into real estate. These funds will be seeking properties in good condition in the most risk-free locations available, which accordingly promise strong demand and only low vacancies. Based on the evaluation of data compiled by the Real Estate Investment Data Association (REIDA), institutional investors in Switzerland's large centers suffered income losses of just 1.5% on residential property and 3.9% on commercial property between 2017 and 2019 (Fig. 76). The second-lowest vacancy risk in the residential space market is exhibited by the surrounding regions of the large centers (2.8%). However, for commercial space income losses in double-digit percentage territory were recorded here. By contrast, the mid-sized centers offer a significantly lower vacancy risk for commercial property, and even in the area of residential property the income forfeited (4.4%) due to vacancies is still much lower than in small centers and rural municipalities. Mid-sized centers could therefore offer a logical alternative to the large centers for risk-conscious investors.

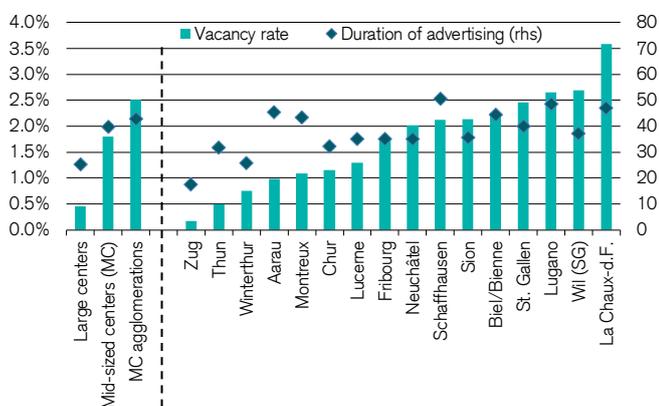
## Real estate investments in Switzerland's mid-sized centers

### Definition of a mid-sized center

The mid-sized centers, which we define here as the core urban centers of agglomerations with more than 50,000 residents, encompass a group of 28 towns ranging from Winterthur, with more than 110,000 inhabitants, to Rorschach with just under 10,000.<sup>11</sup> This heterogeneous group of towns across Switzerland, which are the next largest urban centers after the five main cities, are designated B-towns and C-towns from a real estate perspective.

**Fig. 77: Lowest vacancy risk in Zug, Thun, and Winterthur**

Vacancy rate (rental and owner-occupied) as % of residential housing inventory and average rental apartment advertising period in days

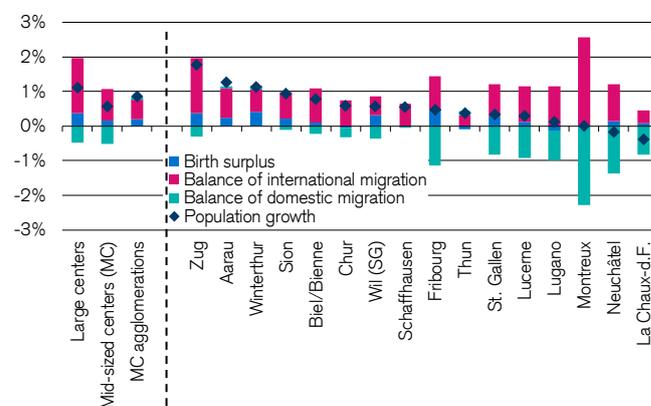


Source: FSO, Meta-Sys AG, Credit Suisse

Last data point: Q4/2019

**Fig. 78: Towns near Zurich exhibiting highest population growth**

Balance of population: annual average 2014 – 2018, as % of residential population



Source: Swiss Federal Statistical Office, Credit Suisse

Last data point: 2018

<sup>11</sup> In the following analysis of individual towns, we focus only on the 16 towns with more than 20,000 inhabitants.

### Scarcity of living space in Zug, Thun, Winterthur

The fact that this group is very heterogeneous becomes clear simply from a glance at vacancy rates (Fig. 77): In towns like Thun, Winterthur, and Aarau, these are broadly in line with the vacancy rates of the large centers. In Zug, where the vacancy rate of 0.17% is only (just) higher than that of Zurich, a scarcity of apartments is clearly evident. At the other end of the spectrum we find towns such as St. Gallen, Lugano, and Wil, where the vacancy rates are far above the Swiss average of 1.66%. In La Chaux-de-Fonds, which has a vacancy rate of 3.6%, a clear oversupply situation is apparent.

### Weak demand in Neuchâtel and Ticino

In recent years, overall demand has developed less dynamically in the mid-sized centers than in the five large centers. Although there are some indications of reurbanization in the former group, this phenomenon is less pronounced than in the big cities. Population growth has accelerated slightly here over the last five years at the cost of the surrounding areas, much as it has in the large centers (Fig. 29, p. 24). In this respect too, the city of Zug stands out with its dynamic development, with its population having grown almost twice as fast as the large centers over the last five years (Fig. 78). Aarau, Winterthur, Sion, and Biemme have also recorded striking growth over the last few years. Population development looks very different in a number of towns that have not benefited from immigration from abroad to the same degree, or which have lost residents to their surrounding areas. Indeed, the two mid-sized centers of Neuchâtel have actually seen their populations decline, with the result that the population of this canton as a whole has shrunk for the last two years. Population dynamics are similarly weak in Ticino and its mid-sized centers, where more deaths than births have been recorded due to the high average age.

### Residential and working city at the same time

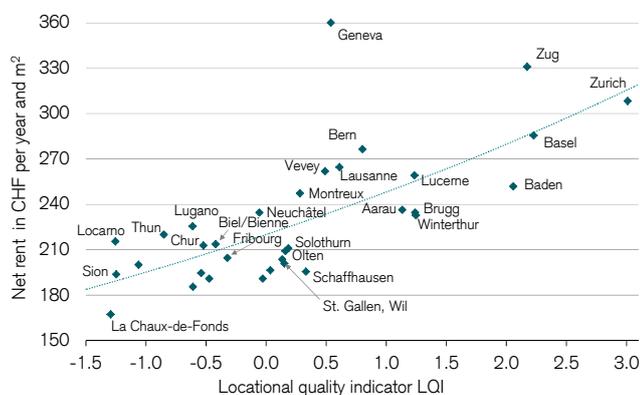
Mid-sized centers have also not quite kept up with large centers when it comes to employment growth. Whereas employment in the big cities increased by 1.1% annually between 2012 and 2017, it rose by just 0.8% in the mid-sized centers (Fig. 81). Some mid-sized centers such as Montreux and Thun are relatively strongly positioned as residential locations, even if they do still exhibit positive commuter balances. Even Winterthur – once a bedrock of Swiss manufacturing – has undergone a transformation into more of a services hub and residential town. Although the commuter balances of these towns are positive, many of their residents commute to the nearby large centers of Lausanne, Zurich, and Bern. By contrast, more people work in the mid-sized towns of Baden, Aarau, and Zug than actually live there. Here the workforce-to-population ratio is even higher than in Switzerland’s major cities. While Baden has recently suffered a loss of jobs in manufacturing, its proximity to Zurich and high locational quality (Fig. 79) gives it every opportunity – unlike La Chaux-de-Fonds, for example – to reposition itself as a services hub and a place to live.

### Good outlook for rental income in Baden and Winterthur

While all five large centers exhibit a degree of locational quality and a rental price level that are well above the Swiss average, the picture for the mid-sized centers is extremely heterogeneous (Fig. 79). A few of these centers, most notably Zug, Baden, and Lucerne, have a comparable profile to the large centers when it comes to locational quality and rents. Indeed, the level of rents in Zug is surpassed only by Geneva. When it comes to locational quality, Zug ranks third nationally – behind only Zurich and Basel.

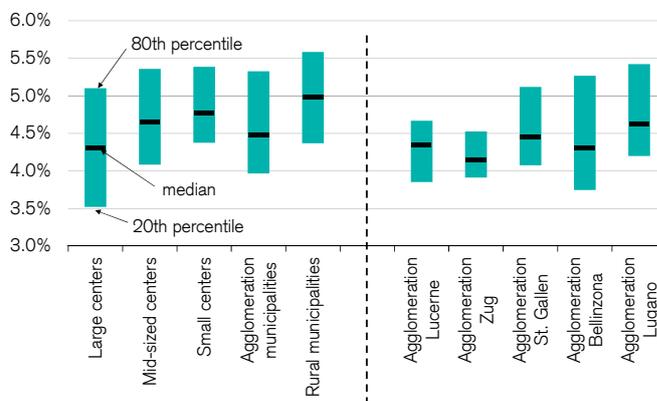
**Fig. 79: Rents in Zug twice those of La Chaux-de-Fonds**

Locational Quality Indicator (LQI) and net rents for an average newbuild property (contractual rents, quality-adjusted)



**Fig. 80: Risk premium on gross yields of mid-sized centers**

Gross yields of 1,700 residential investment properties from the portfolios of institutional investors, 2018



Historical performance data and financial market scenarios are no reliable indicator of future results.

Given their above-average levels of locational quality, towns such as Baden, Winterthur, and Schaffhausen have fairly low rent levels, which suggests there is future growth potential in rental income here. However, in the case of Schaffhausen, Olten, St. Gallen, and Wil, a fairly high level of housing supply is currently preventing any realization of growth potential at the moment. In view of their below-average locational appeal, the towns of Locarno, Lugano, and Thun look fairly expensive. In the urban agglomerations of Ticino, waning demand and rising vacancies have already triggered a correction to rental prices, and this can be expected to persist for some time.

**Higher risk rewarded with higher return<sup>12</sup>**

Ultimately, it is the risk/return ratio that is decisive for the appeal of an investment location. Analysis of the accounting data of 1,700 residential investment properties from the REIDA portfolio (see above) shows that the median gross yield (realized gross rental income as a proportion of market value) is 4.6% in the mid-sized centers, or a good 30 basis points higher than in the large centers, despite the former recording higher income losses as a result of vacancies (Fig. 80). When only above-average locations are scrutinized, the difference in yield is significantly greater. The risk premiums in the small centers (median gross yield: 4.8%) and rural municipalities (5.0%) are higher still. Gross yields in the urban agglomerations of Lucerne and Zug are broadly in line with those of the large centers. Higher yields can be obtained in some parts of the Ticino market, which is currently more risky.

**Conclusion: Mid-sized centers close to Zurich ...**

The partially supply-starved markets and the increasing amount of regulation in planning, construction, and residential regulation in the large centers make it increasingly logical for risk-conscious real estate investors to start looking for alternative investment locations. Switzerland's mid-sized centers are an obvious option here, despite these constituting a very heterogeneous group. Some of these are definitely more than just middling. The city of Zug, for example, offers a comparable risk/return profile to the big cities with its locational quality and economic strength, although as an investment location it has long been an "open secret". With its locational appeal and proximity to Zurich, Baden also offers a high degree of security. Other locations that might be designated "core plus" include Winterthur, Lucerne, and Aarau. These towns also offer high locational quality and a limited vacancy risk.

**...and areas close to Lausanne as first-choice alternatives**

For Switzerland's other mid-sized centers, investors need to factor in a rather higher risk premium. Many of these have potential, but already exhibit signs of excessive supply (e.g. Olten and St. Gallen). Accordingly, there is no obvious reason to expect increases in property valuations and rental income here in the short to medium term. Better prospects in this respect are offered by the likes of Vevey and Montreux, where rents can be expected to rise from today's standpoint. The towns exhibiting the highest risks are the locations with below-average locational appeal, existing indications of oversupply, and few demand stimuli. This is true first and foremost of the urban centers of Ticino, where yields now appear too low to justify the higher risks.

**The riskier the macro location, the more vital quality becomes**

The risk/return ratio of a portfolio can be optimized through diversification across different urban areas. The more investors move away from the "A-cities", however, the more important micro-location and property characteristics become if the risks of income losses and valuation corrections are to be mitigated. This is particularly true of newbuild properties, for which the absorption of the space available can take some time (p. 27 et seq.). Here profound market knowledge is essential if a project is to be optimally aligned with the needs of the regional market.

<sup>12</sup> Historical performance data and financial market scenarios are no reliable indicator of future results.

**Fig. 81: Demographics, economics, and the real estate market in core towns of mid-sized agglomerations**

Market indicators for the core towns of Swiss agglomerations with more than 50,000 inhabitants\*

| Town  | Population 2018 | Population growth <sup>1</sup> | Net immigration from abroad | Net domestic immigration <sup>1</sup> | Employment growth <sup>2</sup> | LQI, 2019 <sup>3</sup> | Expected expansion of MFH <sup>4</sup> | Vacancy rate, 2019 <sup>4</sup> | Advertising period <sup>5</sup> | Net rent/m <sup>2</sup> , Q2/2019 <sup>6</sup> | Expected trend in rents <sup>7</sup> |
|---|-----------------|--------------------------------|-----------------------------|---------------------------------------|--------------------------------|------------------------|--|---------------------------------|---------------------------------|--|--------------------------------------|
| Winterthur  | 111,851         | 1.1%                           | 0.6%                        | 0.1%                                  | 1.1%                           | 1.2                    | →                                      | 0.7%                            | 26                              | 233  | ↗                                    |
| Lucerne   | 81,691          | 0.3%                           | 1.0%                        | -0.9%                                 | 1.1%                           | 1.2                    | →                                      | 1.3%                            | 35                              | 259  | →                                    |
| St. Gallen  | 75,833          | 0.3%                           | 0.9%                        | -0.8%                                 | 1.2%                           | 0.2                    | ↘                                      | 2.5%                            | 40                              | 201  | →                                    |
| Lugano  | 63,185          | 0.1%                           | 1.1%                        | -0.9%                                 | 1.0%                           | -0.6                   | ↗                                      | 2.7%                            | 49                              | 225  | ↘                                    |
| Biel/Bienne:  | 55,159          | 0.8%                           | 1.0%                        | -0.2%                                 | 0.6%                           | -0.4                   | →                                      | 2.3%                            | 44                              | 214  | →                                    |
| Thun  | 43,734          | 0.4%                           | 0.3%                        | 0.1%                                  | 0.0%                           | -0.9                   | →                                      | 0.5%                            | 32                              | 220  | ↗                                    |
| Fribourg  | 38,365          | 0.5%                           | 1.0%                        | -1.1%                                 | 0.5%                           | -0.3                   | →                                      | 1.7%                            | 35                              | 205  | →                                    |
| La Chaux-de-Fonds                                       | 37,952          | -0.4%                          | 0.4%                        | -0.8%                                 | -0.7%                          | -1.3                   | →                                      | 3.6%                            | 47                              | 167  | ↘                                    |
| Schaffhausen  | 36,587          | 0.5%                           | 0.6%                        | 0.0%                                  | 1.3%                           | 0.3                    | ↗                                      | 2.1%                            | 51                              | 195  | →                                    |
| Chur  | 35,378          | 0.6%                           | 0.7%                        | -0.3%                                 | 0.7%                           | -0.5                   | ↘                                      | 1.2%                            | 32                              | 213  | ↗                                    |
| Sion  | 34,353          | 0.9%                           | 0.8%                        | -0.1%                                 | 0.8%                           | -1.2                   | →                                      | 2.1%                            | 36                              | 194  | →                                    |
| Neuchâtel   | 33,489          | -0.2%                          | 1.1%                        | -1.4%                                 | 0.2%                           | -0.1                   | ↗                                      | 2.0%                            | 35                              | 235  | ↘                                    |
| Zug   | 30,542          | 1.8%                           | 1.6%                        | -0.3%                                 | 1.1%                           | 2.2                    | →                                      | 0.2%                            | 18                              | 331  | ↗                                    |
| Montreux  | 25,984          | 0.0%                           | 2.6%                        | -2.3%                                 | 0.7%                           | 0.3                    | →                                      | 1.1%                            | 43                              | 247  | ↗                                    |
| Wil (SG)  | 23,966          | 0.6%                           | 0.5%                        | -0.4%                                 | 0.7%                           | 0.1                    | ↘                                      | 2.7%                            | 37                              | 204  | →                                    |
| Aarau   | 21,506          | 1.3%                           | 0.9%                        | 0.1%                                  | 0.9%                           | 1.1                    | ↘                                      | 1.0%                            | 46                              | 236  | ↗                                    |
| Vevey   | 19,891          | 1.0%                           | 1.9%                        | -1.4%                                 | 0.2%                           | 0.5                    | ↘                                      | 0.8%                            | 34                              | 262  | ↗                                    |
| Baden   | 19,342          | 0.8%                           | 1.0%                        | -0.7%                                 | -0.5%                          | 2.1                    | ↘                                      | 0.6%                            | 33                              | 252  | ↗                                    |
| Bellinzona  | 18,635          | 0.7%                           | 0.5%                        | -0.1%                                 | 0.6%                           | -1.1                   | ↘                                      | 2.7%                            | 56                              | 200  | ↘                                    |
| Oltén   | 18,363          | 1.2%                           | 0.9%                        | 0.3%                                  | 2.1%                           | 0.2                    | ↗                                      | 3.0%                            | 44                              | 209  | ↘                                    |
| Solothurn   | 16,777          | 0.2%                           | 0.6%                        | -0.4%                                 | 1.6%                           | 0.2                    | →                                      | 0.9%                            | 39                              | 211  | →                                    |
| Locarno   | 15,826          | 0.2%                           | 0.7%                        | -0.4%                                 | 0.5%                           | -1.3                   | →                                      | 3.4%                            | 59                              | 215  | ↘                                    |
| Mendrisio   | 14,942          | 0.2%                           | 0.5%                        | -0.1%                                 | 1.1%                           | -0.5                   | →                                      | 3.3%                            | 66                              | 195  | ↘                                    |
| Arbon   | 14,633          | 0.7%                           | 0.7%                        | 0.0%                                  | 0.6%                           | -0.5                   | →                                      | 2.2%                            | 54                              | 191  | →                                    |
| Uzwil   | 12,892          | 0.3%                           | 0.7%                        | -0.6%                                 | -0.1%                          | 0.0                    | ↗                                      | 1.7%                            | 48                              | 191  | →                                    |
| Altstätten  | 11,733          | 1.0%                           | 1.2%                        | -0.5%                                 | -0.3%                          | -0.6                   | →                                      | 1.7%                            | 56                              | 185  | →                                    |
| Brugg   | 11,179          | 0.5%                           | 0.5%                        | 0.0%                                  | 0.5%                           | 1.2                    | ↗                                      | 1.7%                            | 50                              | 235  | →                                    |
| Rorschach   | 9,441           | 1.0%                           | 1.5%                        | -0.8%                                 | -0.4%                          | 0.0                    | →                                      | 2.4%                            | 57                              | 196  | →                                    |
| Total mid-sized centers                                 | 933,228         | 0.6%                           | 0.9%                        | -0.5%                                 | 0.8%                           | 0.2                    | ↘                                      | 1.8%                            | 40                              | 222  | →                                    |
| Total agglomeration municipalities of mid-sized centers | 951,798         | 0.9%                           | 0.6%                        | 0.1%                                  | 1.2%                           | 0.4                    | ↗                                      | 2.5%                            | 43                              | 217  | ↘                                    |
| Total large centers                                     | 1,062,437       | 1.1%                           | 1.6%                        | -0.5%                                 | 1.1%                           | 1.8                    | →                                      | 0.5%                            | 25                              | 304  | ↗                                    |
| Switzerland   | 8,544,527       | 1.0%                           | 0.7%                        | --                                    | 1.0%                           | 0.0                    | ↘                                      | 1.7%                            | 39                              | 233  | ↘                                    |

\* All figures refer to the municipal status as of January 1, 2015; mergers and other municipal mutations after this date are not included.

<sup>1</sup> 2014 – 2018, p.a.

<sup>2</sup> 2012 – 2017, p.a.

<sup>3</sup> Credit Suisse Locational Quality Indicator LQI, CH = 0.0; total per municipality type: weighted average

<sup>4</sup> Including residential property

<sup>5</sup> 2019, in number of days

<sup>6</sup> Contractual rents, quality-adjusted, in CHF per m<sup>2</sup>

<sup>7</sup> Forecast horizon: 2 – 3 years

Source: Swiss Federal Statistical Office, Baublatt, Meta-Sys AG, Wüest Partner, Credit Suisse

Last data point: 2019

# Negative interest rates extend cycle

## **Indirect investments: Persistent support from interest rates**

After an outstanding 2019 for Swiss real estate investments, both real estate funds and shares continued to perform impressively in the first few weeks of the new year, not least because long-term interest rates declined sharply in the second half of January. However, it would be unreasonable to expect this tempo to continue as the year progresses. We now consider real estate shares in particular to be expensive bearing in mind the earnings expectations of the corresponding companies and the valuation of their foreign counterparts. Swiss real estate funds have also recorded impressive price rises. In this case, however, valuations still look appropriate given prevailing interest rate expectations. Further value increases are possible, albeit hardly to the same extent as in 2019. The backbone support from low interest rates can be expected to persist for some time yet. No tightening of the reins of monetary policy is evident in the near future. The upward pressure on the Swiss franc increased in the first few weeks of 2020, with the result that the “Swissie” is now as strong against the euro as at any point since mid-2017.

## **Valuations still have upside**

At the same time, there are no signs of any real inflationary pressure. Investors can therefore count on persistent negative interest rates, which means they will be prepared to pay handsomely for relatively attractive and secure returns. Low long-term interest rates should translate into further increases in net asset values. Investment returns in the region of 5% therefore remain realistic. However, investors are keeping an eye on the real estate market and the situation in the rental apartment market in particular. This is evident from the fact that funds and real estate shares focused on commercial property have again been receiving more attention recently compared to residential property funds. We consider the price relationship between residential and commercial property funds to now be broadly balanced once again. For security-focused investors with a long-term investment horizon, we would recommend mixed real estate funds with good regional diversification and low rental income losses. Investment vehicles available at lower premiums include above all less established funds, although these typically exhibit higher vacancy risk.

## **Direct investments: Market anticipating persistent low interest rates**

Market players in the world of direct Swiss real estate investments are also acting in expectation of persistently low interest rates. The slight slowdown in planning activity – as expressed in the decline in building permits – is therefore hardly likely to persist, and in the rental apartment market too, only a slight decline in the influx of new space should be expected in 2020. At the same time, as few stimuli on the demand side can be expected in property markets, the downward pressure on rental income is likely to rise again slightly. This is the case both for residential property that lies away from the most attractive locations and for the office space markets on the periphery of large centers. The increases in market values that investors have pretty much taken for granted in recent years can be expected to continue for quite a few years yet – thanks to the latest decline in interest rates and the sluggishness of valuation-relevant discount rates. We are therefore anticipating a total return of 4% to 5% in 2020<sup>13</sup> for well-diversified real estate portfolios. In the transaction market, further price increases are possible in urban centers in particular. Investors are looking for the optimum balance between the security of the urban center and the typically higher, but less secure, returns of less central locations. A possible alternative to the expensive large centers is therefore the centers of the mid-sized agglomerations.

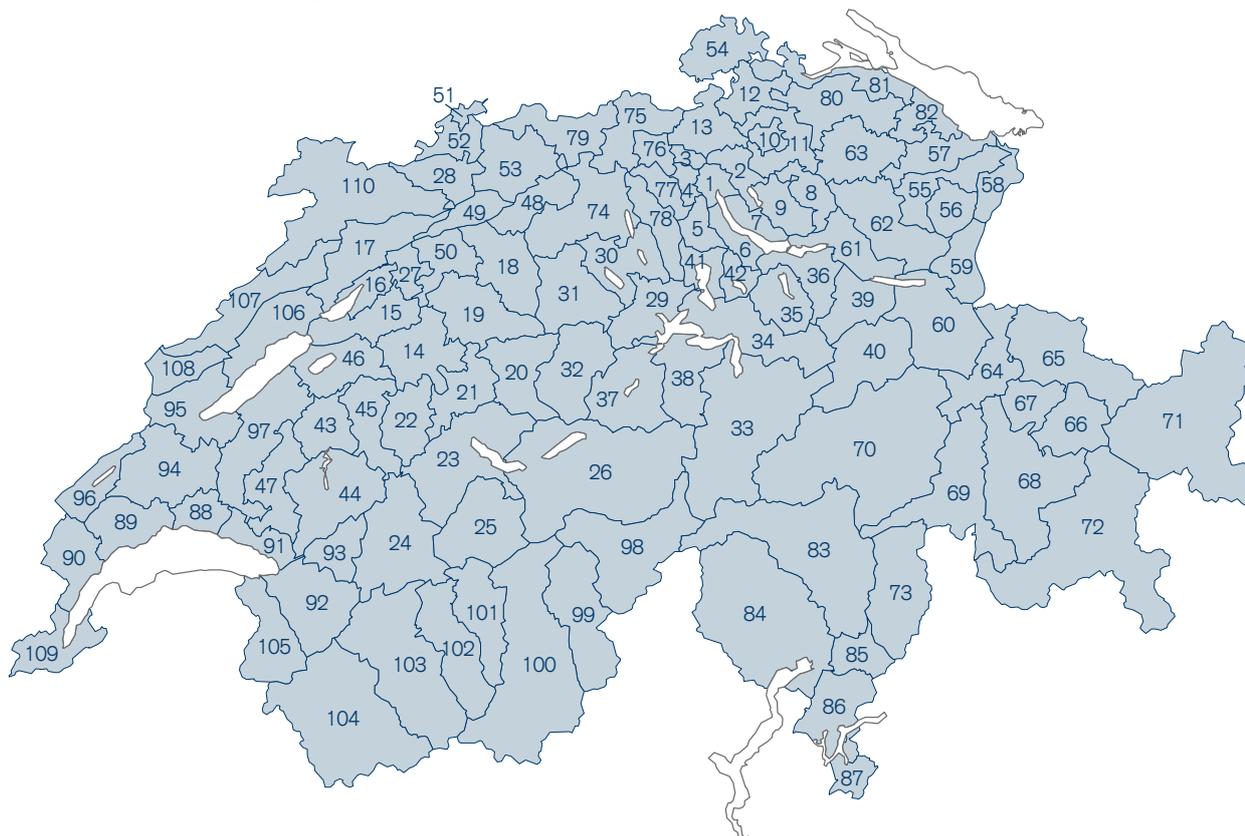
<sup>13</sup> Historical performance data and financial market scenarios are no reliable indicator of future results.



## Appendix : Switzerland's economic regions

Credit Suisse Swiss Economics has defined these economic regions on the basis of the Mobilité Spatiale regions used by the Swiss Federal Statistical Office. Political borders play less of a role in the definitions than economic phenomena, geographical and demographic features, and mobility patterns. Consequently, some of these economic regions straddle cantonal borders.

### Switzerland's economic regions



|                     |                                  |                         |                          |                        |
|---------------------|----------------------------------|-------------------------|--------------------------|------------------------|
| 1 Zürich-Stadt      | 23 Thun                          | 45 Sense                | 67 Schanfigg             | 89 Morges/Rolle        |
| 2 Glattal           | 24 Saanen/Obersimmental          | 46 Murten               | 68 Mittelbünden          | 90 Nyon                |
| 3 Furttal           | 25 Kandertal                     | 47 Glâne/Veveyse        | 69 Domleschg/Hinterrhein | 91 Vevey/Lavaux        |
| 4 Limmattal         | 26 Berner Oberland-Ost           | 48 Olten/Gösgen/Gäu     | 70 Surselva              | 92 Aigle               |
| 5 Knonaueramt       | 27 Grenchen                      | 49 Thal                 | 71 Engiadina bassa       | 93 Pays d'Enhaut       |
| 6 Zimmerberg        | 28 Laufental                     | 50 Solothurn            | 72 Oberengadin           | 94 Gros-de-Vaud        |
| 7 Pfannenstiel      | 29 Luzern                        | 51 Basel-Stadt          | 73 Mesolcina             | 95 Yverdon             |
| 8 Oberland-Ost      | 30 Sursee/Seetal                 | 52 Unteres Baselbiet    | 74 Aarau                 | 96 La Vallée           |
| 9 Oberland-West     | 31 Willisau                      | 53 Oberes Baselbiet     | 75 Brugg/Zurzach         | 97 La Broye            |
| 10 Winterthur-Stadt | 32 Entlebuch                     | 54 Schaffhausen         | 76 Baden                 | 98 Goms                |
| 11 Winterthur-Land  | 33 Uri                           | 55 Appenzell A.Rh.      | 77 Mutschellen           | 99 Brig                |
| 12 Weinland         | 34 Innerschwyz                   | 56 Appenzell I.Rh.      | 78 Freiamt               | 100 Visp               |
| 13 Unterland        | 35 Einsiedeln                    | 57 St. Gallen/Rorschach | 79 Fricktal              | 101 Leuk               |
| 14 Bern             | 36 March/Höfe                    | 58 St. Galler Rheintal  | 80 Thurtal               | 102 Sierre             |
| 15 Erlach/Seeland   | 37 Sameraatal                    | 59 Werdenberg           | 81 Untersee/Rhein        | 103 Sion               |
| 16 Biel/Seeland     | 38 Nidwalden/Engelberg           | 60 Sarganserland        | 82 Oberthurgau           | 104 Martigny           |
| 17 Jura bernois     | 39 Glarner Mittel- und Unterland | 61 Linthgebiet          | 83 Tre Valli             | 105 Monthey/St-Maurice |
| 18 Oberaargau       | 40 Glarner Hinterland            | 62 Toggenburg           | 84 Locarno               | 106 Neuchâtel          |
| 19 Burgdorf         | 41 Lorzenebene/Ennetsee          | 63 Wil                  | 85 Bellinzona            | 107 La Chaux-de-Fonds  |
| 20 Oberes Emmental  | 42 Zuger Berggemeinden           | 64 Bündner Rheintal     | 86 Lugano                | 108 Val-de-Travers     |
| 21 Aaretal          | 43 La Sarine                     | 65 Prättigau            | 87 Mendrisio             | 109 Genève             |
| 22 Schwarzwasser    | 44 La Gruyère                    | 66 Davos                | 88 Lausanne              | 110 Jura               |

Source: Credit Suisse

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