

Office markets reviving from the inside out

Swiss office property market 2019 | December 2018



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On track for recovery

Positive market environment for office property

Thanks to a surge in economic growth, the market environment for office property appears to be in much better shape. The recovery is at different stages, depending on location. This applies not only to our three-ring model, in which we differentiate between the central business district (CBD) and the middle and outer business districts, but also as relates to each individual major and medium-sized center. The office market in Lausanne, for example, appears to be in much better condition than the Geneva market just a few kilometers away. One thing all markets have in common is that the recovery originates in the CBD and spreads from the inside out.

Economic upturn reactivates demand for office space

As a result of the economic upturn, employment growth surged, stimulating demand for office space. The expansion is driven by the tertiary sector, particularly by business services, IT, the public sector and the reinvigorated industrial sector, where there is also increasing demand for office space. The digitalization process ensures solid additional demand, since the share of desk jobs is rising in all sectors. The robust 596'000 m² increase in demand forecast for 2018 should be followed by further, albeit somewhat more moderate, growth in 2019.

Providers must adjust to changing demand

At the same time, important office tenants, such as banks, insurance companies, telecommunications companies, and wholesaling, are facing structural change and are not driving demand. So the remaining demand is more hybrid in nature, on a smaller scale, and less stable. This means that a flexible office layout has greater appeal. The need to use office space as a service – rapidly, flexibly, and with the fewest possible binding contracts – is increasing, which is also manifest in the trend towards coworking spaces. This transfers risk to the provider and/or the operator of such services.

Recovery still limited to the core office markets

In the CBDs of the major centers, the office space available for lease has already declined by nearly one fifth. Meanwhile, in Geneva and Zurich, the recovery has reached the middle business district. Nonetheless, most net supply rates have increased further, because in the outer business districts – except for Lausanne's – there has been little sign of a recovery yet. Low interest rates have encouraged construction activity in the agglomerations, so that by now, depending on the major center, 50% to 80% of the available office space is located in the outer business districts. This leads to vacancies and, as a result, up to one sixth of the space available for lease is no longer advertised regularly on the large platforms.

Production of office space continues at a moderate pace

Depending on the location, the recovery will either be encouraged in the medium term by a more modest production of office space (Zurich, Bern) or delayed by more expansive activity (Basel, Geneva, Lausanne). In general, ever since the surge of projects in 2011/2012, investments in office buildings have never been substantially below the long-term average. Thus, the impetus for an extensive recovery will have to come from the demand side. This also explains the remarkable differences between the major centers in Western Switzerland; while the sector mix in Geneva is confronted with structural upheaval, the more broad-based market in Lausanne profits disproportionately from the general economic upturn.

Mid-sized centers offer investment alternatives

With few exceptions (Schaffhausen, Lugano), the mid-sized centers report reasonable supply rates and a modest increase in office space. The mid-sized centers should similarly benefit from jobs growth and the trend toward more office jobs. However, to be successful here, investors need local expertise.

No compromises on locational quality

In the mid-sized and major centers, investors should not make any compromises in terms of locational quality. It remains to be seen whether the economic upturn will be strong enough to absorb the large supply of office space available in the outer business districts. Meanwhile, shortages are likely to begin emerging in good locations, resulting in a return to rising rent prices and a widening gap in rents between the CBD and the periphery.

Shifting demand

Mini-boom for the Swiss economy

The Swiss economy is in the midst of a mini-boom: in annualized terms, growth in the second quarter of 2018 was at 2.9%, well above potential. The manufacturing industry profits especially from robust foreign demand and is making significant gains. All major categories of export goods are in a positive trend and enjoying broad-based growth. Moreover, in nearly all industrial sectors, capacity utilization is well above the average.

Normalization of high growth rates ahead in 2019

We expect a certain cooling of the Swiss economy in 2019, accompanied by a normalization of the current high growth rates. The Purchasing Managers Index (PMI), which serves as a good leading indicator, recently dipped slightly, but continues to signal growth (fig. 1). And the Credit Suisse Export Barometer, which measures foreign demand for Swiss products, also edged down as a result of the uncertainties surrounding Italy's government budget and global trade tensions. However, it is still above its 20-year average and clearly in the growth zone. Industrial turnover should thus continue to rise in 2019, albeit at a considerably slower pace. At the same time, the business cycle appears to have passed its peak. The outlook for the Swiss economy nonetheless remains bright.

Strong economy stimulates employment

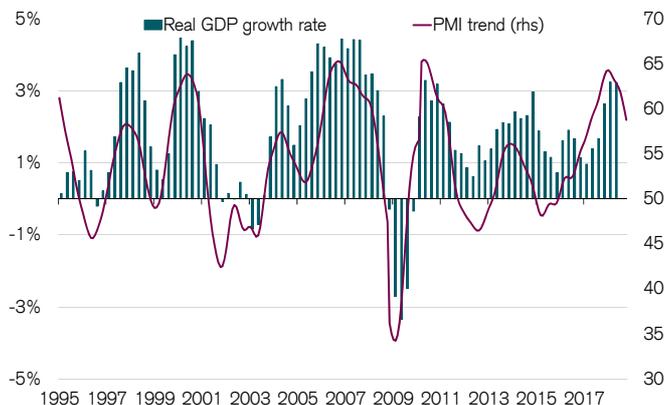
A strong economy creates jobs, after a certain delay, and thus ultimately stimulates demand for office space. The forecast rise in employment was actually initiated in the first half of 2018: total employment rose 2% compared to the previous year (fig. 2). Employment growth has not been this high since the end of 2012, before the EUR/CHF minimum exchange rate was scrapped. In addition to the recovery in industrial sectors, the rise in employment across Switzerland was stimulated primarily by the creation of new jobs in business services, healthcare, and information technology (IT).

Employment surge in the IT sector

Over the last 12 months, employment in the tertiary sector (services) rose 2.2%, more than in the secondary sector (industry and construction), which registered a 1.4% increase (fig. 3). The latter is nonetheless an unusual result, especially since growth in this sector has not been this high since 2008. In services, the IT sector particularly stood out with its marked growth of 7.5% year-on-year (+6500 jobs), mainly attributable to increased digitalization efforts. Besides the IT sector, the corporate management/consulting and architects/engineers segments especially drove demand for new office workspace (+7500 jobs) and thus for offices.

Fig. 1: Leading indicator signals further growth

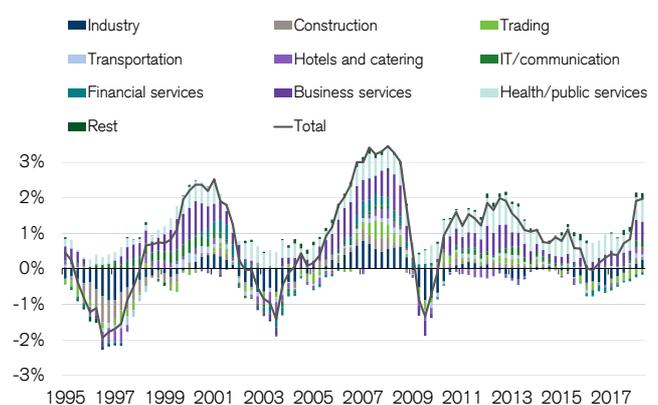
Annual GDP growth rates and trend growth in the PMI



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

Fig. 2: Change in total employment

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



Source: Swiss Federal Statistical Office (SFSO), Credit Suisse

Declining employment in traditional office sectors

These growth drivers for office workspace are contrasted by four sectors (banks, insurance, wholesaling, and telecommunications) with large inventories of office space, since the number of jobs in these sectors has fallen by more than 10'000 over the last 12 months (fig. 3). On balance, therefore, the additional demand for office space in the current cycle is lower than in previous growth phases. The banks, in particular, are exposed to persistent structural change and have slashed their staffing by 3.2% over the last year. The main drivers of this phenomenon are digitalization, collapsing margins and rising regulatory costs. The planned repatriation of bank jobs, especially in IT, might be able to stop or even reverse the negative employment trend. Longer term, the financial sector could actually profit from digitalization, especially since Switzerland has great potential as an innovation driver in the fintech business.

Broader demand for office space

The telecommunications sector, similar to the banks, is suffering from emerging digital competitors and a saturated market. In the insurance sector, employment is back in a declining trend, after a temporary phase in which the sector had been considered very promising. Demand for office space is thus less dependent on a small number of influential traditional users, and more driven by a variety of sectors that report greater need for office workspace.

Office staff replace industrial workers

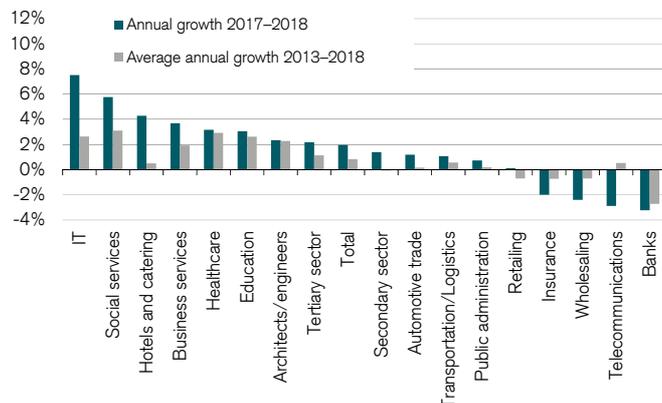
The greater need for office space stems from cyclical employment growth, but also from structural changes. In many sectors, the share of office staff relative to industrial workers or craftsmen is steadily rising. In manufacturing, for example, this is because companies now sell not only machines and equipment, but also increasingly the services that complement them. Besides material goods, a firm may also offer maintenance work with the assistance of sophisticated apps, online services for products, or digital analysis of production processes. Our calculations indicate that the share of office workplaces in manufacturing has been on a continuous rise from 38% to 43% between 2010 and 2017. Not only in industry, but in nearly all other sectors, the share of office workplaces needed is increasing. In information and communication, for example, the share rose from an already high 84% to 89% in the same period.

Companies again seeking more office space

The above factors ultimately result in greater demand for office space. While demand for additional office space was rather weak with only 215'000 m² in 2016 and only 325'000 m² in 2017, a robust 596'000 m² increase in demand is foreseen for 2018 (fig. 4). Structural effects, as well as the high demand from the business services sector (responsible for 43% of total additional demand last year), were more than able to offset the diminished demand from financial services and trading. We forecast somewhat lower, but still respectable, additional demand of 403'000 m² in 2019. The slight decline is due to the anticipated normalization of the currently booming Swiss economy.

Figure 3: Change in employment by sector

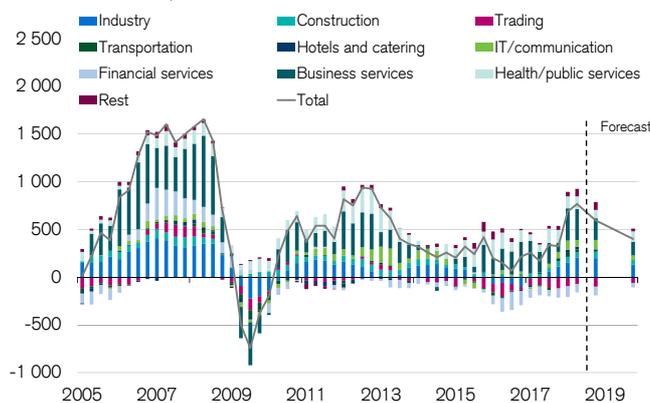
Annual growth in selected services, full-time equivalents



Source: SFSO, Credit Suisse

Figure 4: Additional demand for office space

Estimated additional demand compared to the previous year's quarter in 1000 m²; Forecasts for fourth quarter 2018 and 2019



Source: SFSO, Credit Suisse

Here to stay

Coworking is a new way to work

The coworking trend began in the USA after the turn of the millennium, and reached Europe and Switzerland several years later. The rise of coworking as a new way to work can be attributed mainly to the individualization and mobility of today's workforce, but also, in some cases, to an oversupply of office space. Technological progress and the burgeoning number of young entrepreneurs lent additional momentum to the trend. The amount of coworking space around the world has surged over the last decade. In contrast, the supply of coworking space in Switzerland has increased noticeably only in the last few years.

Community is key

Compared to traditional office work, the focus of coworking is the collaboration among members. In this sense, coworking spaces differ from traditional business centers, which also offer flexible workspace as a service (including various other services), but do not emphasize social exchange and collaboration. In coworking spaces, on the other hand, proximity to other tenants is a defining characteristic. The community aspect is often reinforced by collaborative events. Particularly for young people, flexible leasing of coworking spaces can be attractive. It offers, first, a less risky alternative to a fixed working space, and second, the opportunity to develop a professional network. As a rule, coworking spaces can be rented by the hour, day, week, or month. Many coworking spaces are organized according to the "plug and play" concept, in which the entire infrastructure is made available to tenants (internet, desks, chairs, printers, coffee). In order for this service to be possible, a certain spatial flexibility of the office furnishings is a must.

Coworking is not for everyone

Coworking spaces are not equally suitable for all types of workers. Most of them offer little privacy, which can be problematic for confidentiality and data protection. Moreover, the premises tend to be noisy, and the amount of space available to each worker varies widely depending on the provider. Today, different ways of working are increasingly mixed, so that traditional offices and open coworking spaces can be combined in the same location. Flexible or fixed workspaces, and even private offices, can be leased. Pilot projects in this style have been launched by Swisscom and Axa insurance, among others. The major coworking providers, such as the International Workplace Group (IWG), are expanding globally at a fast pace, which presumes strong growth in membership numbers. So the boom in recent years might be followed soon by a consolidation phase, since smaller coworking spaces may be squeezed out of the market by larger providers.

Rising demand for flexible workspace

Coworking in Switzerland has grown exponentially in recent years. According to the Coworking Switzerland association, as of July 2018 there were 155 official coworking locations in the country. Most of the providers are private individuals who usually have another professional activity besides operating a coworking space. The Swiss market of coworking providers is thus sharply fragmented and dominated by small players; institutional providers remain the exception. For most operators, the community aspects have a higher priority than the economic aspects. This may be one reason why, according to estimates, only about half of the locations are profitable. Gradually, however, large international providers are entering the market, such as Spaces, a subsidiary of IWG. Their objective is to realize large-scale projects such as Ambassador House in Opfikon or The Circle at Zurich airport. Thanks to the increasing plans of major providers to enter the market, demand for flexible office space is likely to increase in the years to come.

Minor share of the total office market

The share of coworking spaces compared to the total Swiss office market is currently very small. However, a precise estimate is difficult to make, because on the one hand there are a large number of very small coworking spaces, and on the other, coworking and traditional office spaces are often mixed at the same location. Moreover, there are spaces that are dedicated to coworking only on an interim basis, and subsequently disappear from the market. One example is the Office Lab in the Mythen Schloss in Zurich, previous home of Swiss Reinsurance, which is slated to be demolished in 2019. We expect coworking space as a share of the total office market to grow further in the coming years, provided the institutional providers continue to expand their influence.

Coworkers prefer city centers

Most coworking spaces are located in the two urban centers of Zurich and Geneva. And in these two locations, the first institutional providers also set up shop some time ago. In the rest of the major centers, such as Basel, Bern and Lausanne, most coworking spaces are, in contrast, operated by private individuals. These differ quite sharply in terms of size and number of workspaces from the coworking spaces run by institutional providers. Most coworking spaces can be found in

the center of a financial district, usually in the inner city (fig. 5 and 6). The most important aspects here include the attractive working environment and the connections available with public transportation. Larger operators, such as Spaces or Impact Hub, offer coworking spaces in Zurich as well as Geneva. The network of workspaces between these financial centers will increase in future and expand to new locations across Switzerland. According to media reports, Spaces intends to broaden its network to up to ten coworking locations.

Here to stay

Regardless of a possible medium-term consolidation, the new coworking spaces phenomenon is a trend that providers of office space must take seriously. Digital platforms and a largely automated administration have sharply reduced the costs related to operating flexible spaces, and allow for the offer of “space as a service” in the first place. On the demand side, the trend to project-based work and a growing number of freelancers also spur demand for flexible workspace and an inspiring working environment. In an era of rapid change, coworking spaces offer companies new possibilities to use flexible space and adjust costs rapidly. In larger developments, coworking spaces can serve as overflow for anchor tenants, which enhances the appeal of the standard office space for potential tenants. The new worlds of work will not be limited to coworking spaces for long. Certain elements, such as contract modalities or office layout, should soon be replicated in traditional workplaces too. In this way, the coworking trend in the Swiss office market is sure to make a lasting impression.

Figure 5: Coworking locations in Zurich

Coworking locations by area, in m²

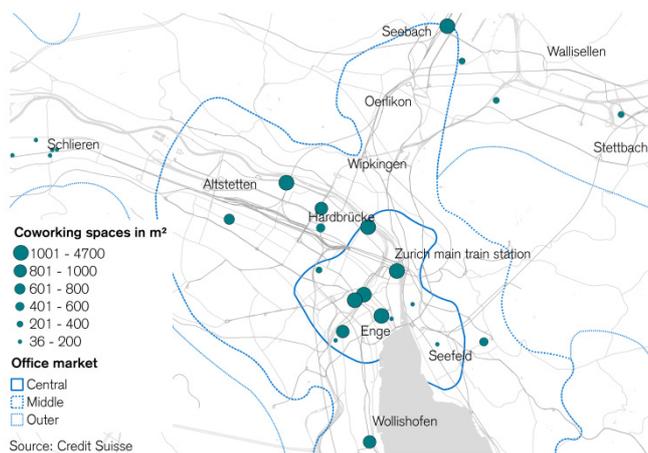
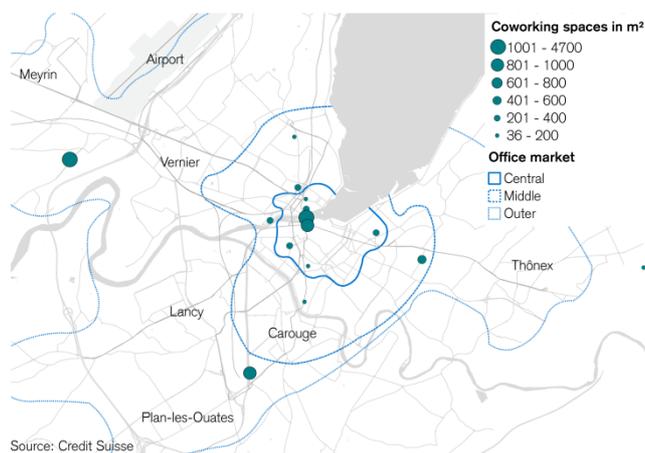


Figure 6: Coworking locations in Geneva

Coworking locations by area, in m²



Supply of office space is growing moderately

Volume of new construction permits is back below the long-term average

Developing real estate, including office space, remains an attractive investment due to persistently low interest rates, low financing costs, and the limited investment alternatives. As a result, approved construction volumes for rental apartments have sprung from one record to the next in recent years. In contrast, new construction permits for office property were slightly lower than the long-term average of nearly CHF 2 billion from 2014 to mid-2017 (fig. 7). This reflects a somewhat more cautious investor stance in recent years, as lower demand and high levels of vacancies exerted pressure on the office market. The jump in approved new building projects in the summer of 2017 reflects the construction of Roche Building 2 in Basel. Because this development no longer features in the 12-month total of new building permits, the volume of approved permits has fallen to the current CHF 1.8 billion, and has thus slipped back below the long-term average. On average, however, since the sharp expansion in 2011/2012, investment volumes have only fallen to the level of the long-term average, not substantially below it. Thus a recovery in the office market can only come from the demand side, especially since several large-scale projects that were approved back then, such as The Circle at Zurich airport, are about to be completed and bring additional office space onto the market.

Decline in office investment in the centers

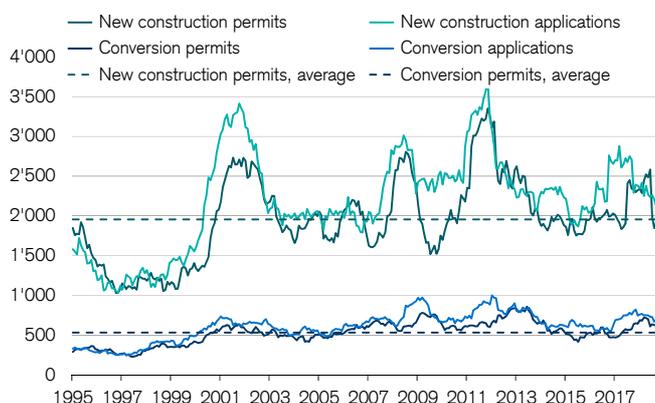
The volume of building permits in the five major centers (Zurich, Basel, Bern, Lausanne, Geneva) has been below the historical average in recent years, provided Roche Building 2 is excluded (fig. 8). In Zurich, in particular, investors have been steadily scaling back new construction activity over the last few years. In recent quarters, investment volumes have also receded in the six largest mid-sized cities (Winterthur, Lucerne, Zug, Aarau, St. Gallen, Lugano). This has been the case even longer in the other centers and suburban municipalities. Project totals there are currently at a level well beneath the long-term average. In contrast, construction activity in peripheral areas appears to be increasing. The relevant building permits have meanwhile risen to a high CHF 753 million, surpassing the total for building permits in the five major centers (CHF 696 million).

Little repurposing of offices into residential space

The volume of planning applications and building permits for conversions is currently disproportionately high. The increase in vacancies is forcing many owners to take a forward strategy and renovate, in order to stay competitive. Over the last few years, there has also been greater discussion about repurposing vacant office properties.

Figure 7: Planned increase in office space

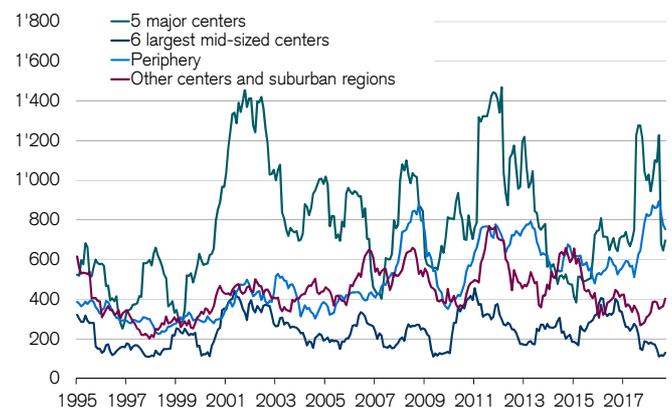
Building permits and planning applications, moving 12-month total, in CHF million



Source: Baublatt, Credit Suisse

Figure 8: Planned increase in office space by city type

Building permits, moving 12-month total, in CHF million



Source: Baublatt, Credit Suisse

Given the intact demand for rental apartments in the centers, repurposing into housing is a recurring idea. Our analysis shows, however, that aside from several individual cases, only very few office properties are repurposed. In all the planning applications of recent years, only some 18'000 m² p.a. appears to concern conversions of office space into housing. Although this figure may not include all repurposing projects, the volume of conversions is nonetheless insignificant, given the total office space of over 2.6 million m² in Switzerland. One important reason for the low amount of repurposing from offices to residential space is the daunting cost of around CHF 2000 per m².

Nonetheless, repurposing nearly doubled since 2015

For this reason, repurposing is only undertaken where housing rents are much higher than office leases, or in cases where years of vacancy make repurposing necessary. Interestingly, the volume in our sample suddenly jumped by more than 50% from 2015 onwards, when vacancies had risen to the peak of earlier cycles. In individual cases, repurposing can certainly offer a solution for offices that become too difficult to lease. However, even in their entirety they have very little weight.

Higher supply of office space

The total amount of office space advertised for rent online in the second quarter of 2018 had risen to 2.65 million m² (fig. 9) within a year. The resulting supply rate of 4.9% is based on total office space available for lease in Switzerland. On balance, the pick-up in demand so far appears too weak to keep pace with the volume of available offices. The revival on the demand side comes at just the right time to counter this trend, and not just stabilize the amount of available office space, but actually reduce it.

Center cities recovering – periphery awash with space

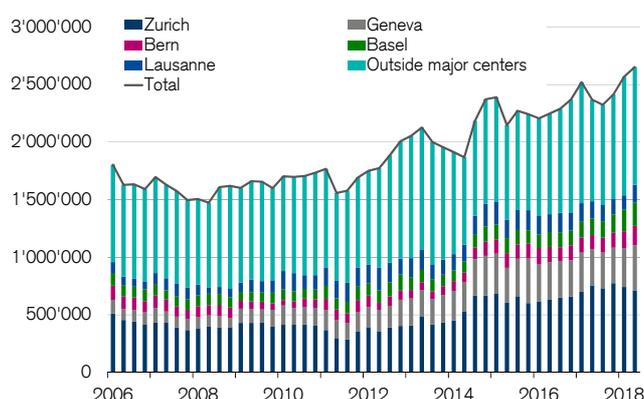
In contrast, volumes of advertised office space have decreased compared to a year earlier, especially in the towns of the major agglomerations. Available office space has declined by around one fifth in the central business districts (CBD) of the five major centers (fig. 10). The only exception to this clear trend is Basel, where the supply of office space in the CBD is higher than it was a year ago. The opposite trend is evident in the outer office markets: increasing amounts of office space are available for lease, and in many cases vacant. Many of the large-scale construction projects in recent years were realized not in the center cities, but further out, in some cases even on the periphery of the office markets, where development land is still available. Marketing these offices is hard work. Success in one location means vacancies in another, so that a change in tenant is often a zero-sum game for real estate agents. The tenants, however, can enjoy new office space at better conditions.

Growing shadow market for office space

In light of high vacancies, an increasing volume of available office space is no longer advertised on the major real estate platforms. To avoid the stigma of a shelf-warmer, these properties are not listed continually, but only at certain times; and usually it is only a fraction of the available space that is advertised. There has been little recent demand for particularly large spaces of 2000 m² or more. Throughout Switzerland, there are at least 430'000 m² that are being advertised very selectively and through alternative channels (individual internet sites, real estate agents, business promoters, etc.).

Figure 9: Offices available for lease

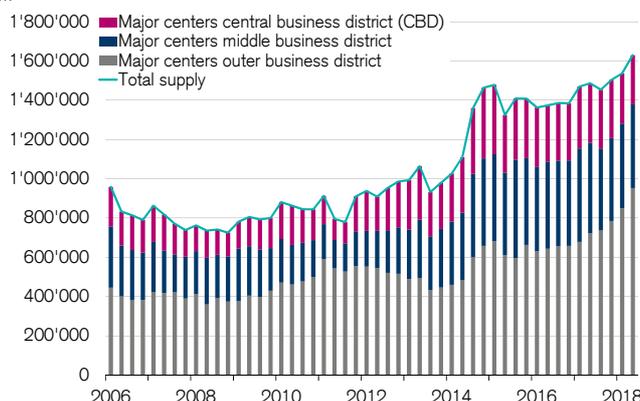
Total office space advertised for lease each quarter* (existing and new buildings), in m²



Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Figure 10: Supply of office space in major centers, by proximity to center

Total office space advertised for lease each quarter* (existing and new buildings), in m²



Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Mixed market results

Vacancies falling in nearly all centers

Thanks to the economic revival and the subsequent heightened demand for office space, the office markets in the centers are recovering. In the city of Zurich, vacancies fell in 2018 for the fourth consecutive year and are now around 36% below the 2014 peak (fig. 11). Meanwhile, in the city of Bern, vacancies fell for the second consecutive year and are now 19% below the all-time high posted in 2016. In the city of Lausanne (including the Lausanne West district), vacancies also declined and were most recently 23% below last year's peak, while vacancies in Basel-Stadt fell only slightly and now stand 36% below the record set in 2012. The picture is different in the city of Geneva, where after declining last year, vacancies are on the rise again. The trend in vacancies thus confirms that the central office markets are on track for recovery.

The further away from centers, the higher the vacancies

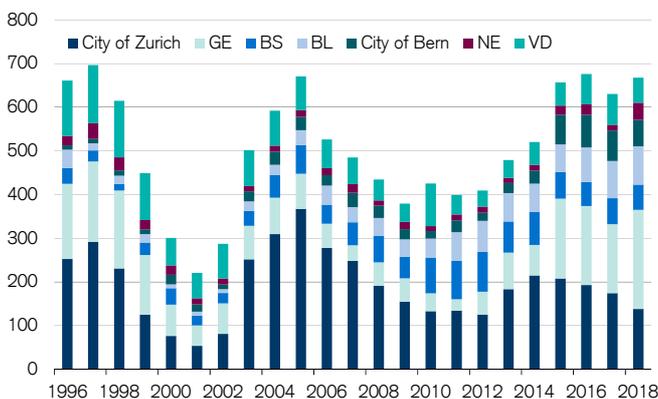
Wherever vacancy measurements also include the middle and outer business districts, conditions look very different. Vacancies in cantons Neuchâtel, Basel-Landschaft and Geneva, for example, have risen. In Geneva, sharp increases in Meyrin, Vernier and Plan-les-Oates have pushed vacancies for the canton as a whole to a new high that is actually 23% above the record set in the 1990s. Only in canton Vaud did vacancies decline year-on-year for the canton as a whole. Because the vacancy situation in canton Geneva has deteriorated considerably, the total amount of vacant office space in Switzerland did not fall again, as it did last year (fig. 11). On the contrary, the total amount of vacant space in the partial survey, which covers around 44% of the national office market, actually rose 6% compared to the previous year, which is almost entirely due to locations outside central business districts.

The decrease in rent prices should soon end

After a phase of sideways movement, rent prices based on leasing contracts are now trending slightly lower again in most regional markets. The sharpest decline was registered between April 2017 and April 2018 in the region around Lake Geneva, where rent prices fell 5% (fig. 12). In the city of Geneva, rents fell 8% during this period, bringing the correction since mid-2013 to a total of 17%. Given the spike in vacancies in Geneva, rent prices will probably continue to decline. In the Zurich region (-0.3%) and in the regions around Basel (-2.5%) and Bern (-1.4%), all rents edged down compared to a year earlier. One exception is the city of Zurich, where rent prices rose slightly (+0.6%). In the medium term, cyclical demand stimulus in most regions should put an end to the decline in rent prices.

Figure 11: Vacant office space

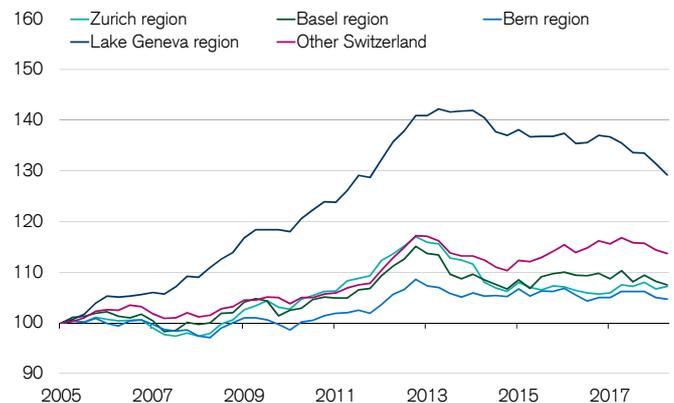
In 1000 m²; partial survey covering around 44% of the Swiss office market



Source: cantonal statistical offices, Credit Suisse

Figure 12: Regional rent prices

Hedonic rent price index based on leasing contracts, index: 2005 = 100



Source: Wüest Partner, Credit Suisse

Mid-sized and major centers

The situation on the market for offices in individual mid-sized and major centers is much less homogeneous than, say, that on the market for rental apartments. Figure 13 depicts the individual office markets in two dimensions. The supply rate on the horizontal axis describes the availability of space and/or the current extent of the oversupply. The vertical axis shows the expected increase in office space based on the investment amounts that have been approved in the last 24 months. Office markets positioned in the positive percentage area enjoy a level of investment that is above the long-term average.

Major centers act as investment focal points...

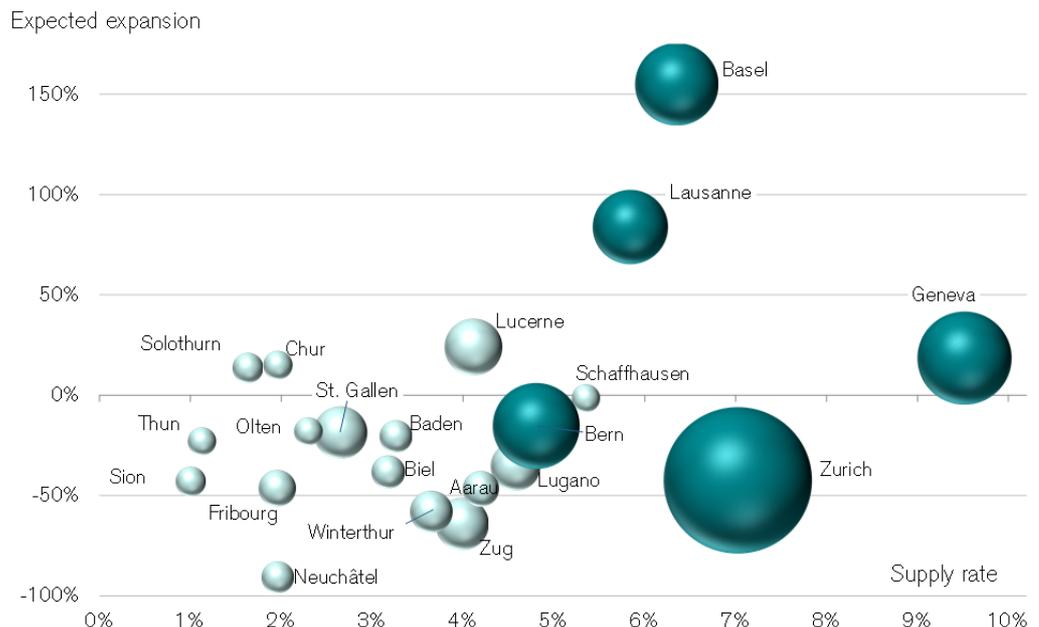
Around 40% of investments in office space are typically concentrated in major centers. At the moment, the two centers of Western Switzerland stand out with high investment totals, as does Basel, due to the construction of Roche Building 2. To the west of Lausanne, and in various locations in Geneva, large-scale developments are pending, most of which include office space. In contrast, after a phase of high investment, development activity in Zurich and Bern has tapered off again.

...and are thus more liquid

One thing all the major centers have in common is that the recovery emanates from the central business district (CBD). There, the amount of office space advertised for lease has declined by around one fifth within the span of a year. In some cases, the pick-up in demand has already caused tangible improvement in the middle business districts. However, the available space in the outer business districts has risen further, in some cases substantially, in all major centers except Lausanne. Weak demand for office space in recent years, and cheap financing, were ultimately responsible for the surge in supply rates to the current high levels. This is particularly the case in Geneva, where the supply rate is nearly in the double-digit percentages. In Lausanne though, the only market where the recovery has already reached the outer business district, intact absorption forces ensure that the supply rate is headed towards lower values in future. This should apply to Bern and Zurich as well, in terms of the expected increase in office space.

Figure 13: Supply rate and increase in office space in major and mid-sized centers

Expansion based on building permits issued in the last two years compared to the long-term average, supply rate as % of inventory



Source: Credit Suisse, Meta-Sys AG, Baublatt

Modest increase in office space in mid-sized centers

The large office markets, in particular, are traditional tenant markets. This is evident in the fact that 61% of all space available for rent in Switzerland is located in the major centers, 42% in Zurich and Geneva alone.

As for the mid-sized centers, only Lucerne and some smaller centers are expected to report above-average increases in office space in the near future. Demand is strongly shaped by the companies located there. The settlement of companies plays a particular role in locations that pursue a deliberate low-tax strategy (Zug, Lucerne, Schaffhausen). Demand is thus less dynamic in the mid-sized centers and is difficult to forecast. As a result, the supply rates are consistently – with the exception of Schaffhausen – lower than in the major centers, because office projects are rarely initiated without a high pre-lease quota.

Figure 14: Existing offices and those available for lease in the largest office markets

Offices available for lease (existing and new) in m² per Q2 2018, existing space as of end-2016, area-weighted average rents (net) in 2018 in CHF/m²; expected expansion for 2019

Major centers	Inventory of office space	Space available	Supply rate	Expected expansion	Average rents
Zurich	10'146'117	7'13'279	7.0%	↓	292
Geneva	4'102'089	390'616	9.5%	↑	380
Bern	3'493'741	168'198	4.8%	↓	221
Basel	3'218'140	204'364	6.4%	↑	178
Lausanne	2'607'336	152'516	5.8%	↑	225
Mid-sized centers					
Lucerne	1'539'188	63'405	4.1%	↑	227
St. Gallen	1'320'596	35'022	2.7%	↓	196
Zug	1'306'898	52'027	4.0%	↓	216
Lugano	1'134'601	52'000	4.6%	↓	240
Winterthur	834'321	30'533	3.7%	↓	219
Fribourg	641'524	12'593	2.0%	↓	203
Aarau	603'432	25'364	4.2%	↓	191
Biel	520'595	16'572	3.2%	↓	137
Baden	498'209	16'217	3.3%	↓	189
Neuchâtel	486'393	9'492	2.0%	↓	194
Solothurn	434'568	7'047	1.6%	↑	150
Sion	422'623	4'242	1.0%	↓	173
Chur	390'159	7'651	2.0%	↑	178
Schaffhausen	370'197	19'803	5.3%	→	141
Oltten	369'914	8'520	2.3%	↓	161
Thun	367'978	4'165	1.1%	↓	175
Switzerland	53'565'172	2'650'734	4.9%	↑	231

Source: Credit Suisse, Meta-Sys AG, Baublatt

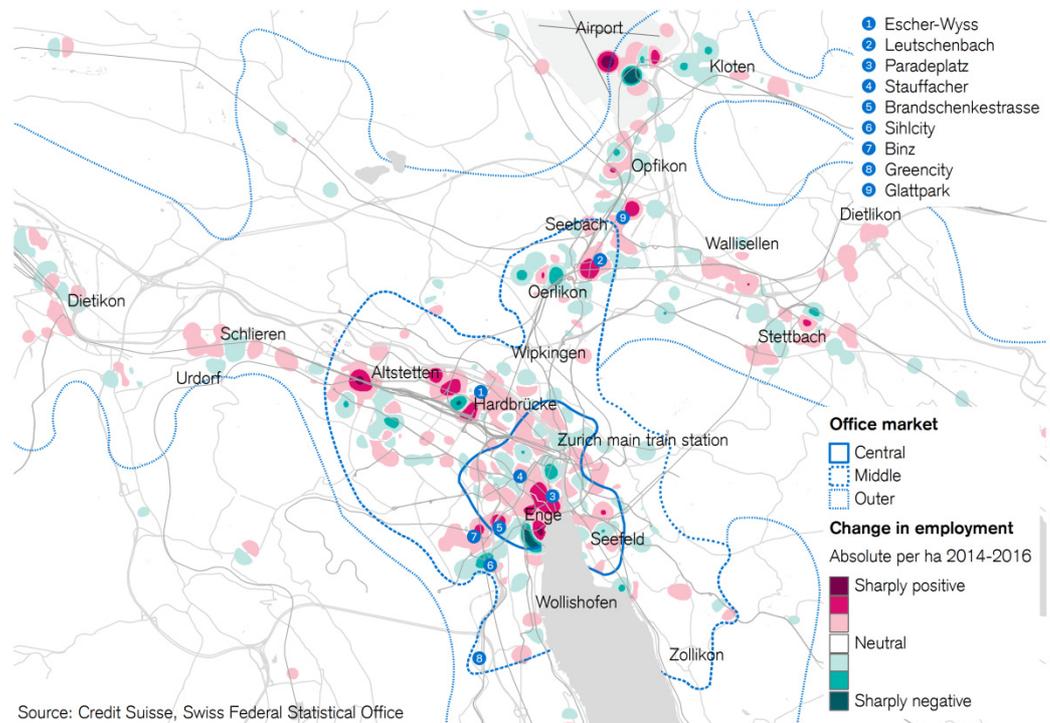
Explanation of supply rate:

We define the supply rate as the sum of all space listed for rent that would be suitable for use as offices and is clearly quantified, divided by the total inventory of office space, in a particular quarter. The amount of time the space has been on the market is immaterial, since only the available space itself influences the market. Our survey is based on all offers accessible on the internet that were advertised in a particular quarter. These listings are not limited to real estate portals, but also include other publicly accessible sources, such as individual websites. In terms of area, the supply rate applies to the entire office market of a major or mid-sized center. The illustrative maps of the major centers on the following pages provide information on the borders of the markets, for which we use a hectare grid.

Zurich

Figure 15: Spatial trend in office employment: Zurich

Change in office employment, absolute per ha, 2014 – 2016



Source: Credit Suisse, Swiss Federal Statistical Office

Banks and insurance companies account for one fourth of all jobs

Zurich remains a banking center, despite the healthy consolidation in the market. Banks dominate employment in the office market, with 14% of total jobs. Combined with the similarly important insurance companies, this sector's result (24.0%) nearly matches that of the sector aggregate for business services (26.2%). The public sector (11.8%), information technology (7.9%), and wholesaling (5.8%) are also key pillars of Zurich's economy.

Business services and IT drive growth

Sectors contributing to the increase in employment are IT, as well as legal, fiscal and corporate consulting, and education. These businesses kept jobs growth in Zurich relatively stable at around 0.8% p.a. from 2011 to 2016, and the rate recently accelerated to nearly 1%. The aforementioned growth sectors thus offset the loss of jobs in the banking and insurance sector. Between 2011 and 2014, insurance companies created some 1300 jobs, but three quarters of these were eliminated again between 2014 and 2016. Hopes for future growth are also pinned largely on IT and business services, since neither the wholesaling nor the financial services sector is expected to return to a trend of positive growth in employment.

City center makes a comeback

Over the last few years, employment growth has again been concentrated at well connected locations in the middle business district. New jobs sprang up mainly around the Altstetten and Hardbrücke train stations (fig. 15). The Escher-Wyss-Geviert and Leutschenbach neighborhoods have also proven to be emerging quarters. A trend reversal was observed in the central business district (CBD). This innermost ring, which includes the old town, suffered for several years from the shift of back office jobs to less expensive locations, and only began adding a significant number of new jobs from 2014 onward. Especially between Enge and Paradeplatz, space was leased after an unusually high level of city center vacancies in the preceding years. Led by legal offices and corporate consultants, a broad mix of businesses has refilled the empty offices in attractive central neighborhoods. Renovations and, in some cases, price concessions were necessary to make this happen. The lease of the former headquarters of private bank Coutts on Stauffacher, the Caleidos building in Seefeld, and various offices on Brandschenkestrasse are further examples of this revival in inner city locations.

Office space available in CBD is as low as in 2012

The trend reversal in the city center is also reflected in the development of office space available for rent (fig. 17). One would have to flip the calendar back to 2012 to find a lower supply of available office space in the CBD. The same is true for the official register of vacant offices, which has particularly declined in Districts 1 and 8. The Seebach neighborhood made the greatest contribution to reducing vacancies in the city, reporting a total of 138'000 m² of newly leased office space, one fifth of the total. In Leutschenbach, in the middle business district, several marketing successes were reported.

Brisk movement in the middle business district

Consequently, the trend of space available in the middle business district is also headed in a positive direction. Although new space continues to come onto this market, the volume available has decreased slightly. The areas along the Hardbrücke are performing well; the Prime 2 building on the Welter-Furrer-Areal and the new Allreal building near Escher-Wyss-Platz are almost fully leased. Marketing for the Manufakt8048 commercial building near the Altstetten train station and the Atmos reconstruction project by PSP on Hardturmstrasse / Förrlibuckstrasse is off to a good start. Successful leasing efforts are also reported in Zurich South around Sihlcity, as well as in Binz. The third construction phase of Greencity has begun after certain adjustments were made to the concept, and the Pergamin II office building now has an anchor tenant with a connection to the sought-after cluster theme Health & Care. Persistent vacancies in less well connected locations of Altstetten, challenging marketing of space at the Oerlikon train station, and the discontinuation of marketing efforts for projects well into the planning phase are all signs that the situation nonetheless remains challenging.

Situation remains thorny in the outer business district

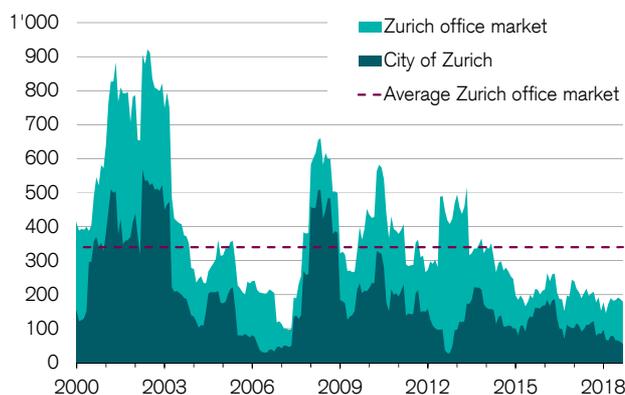
Things are even more difficult in the outer business district. Much of the vacant space there is no longer listed on the major real estate portals. Compared to a year earlier, the total amount of vacant offices has risen further. Reports of successful leases are rare, and many offices have been standing empty for years. Moreover, once their long-term leasing contract expires, tenants are increasingly taking advantage of their negotiating power. But marketing is not only challenging in Glattpark: Schlieren, Dietikon, Urdorf, Wallisellen, Kloten, and other suburban municipalities also have large inventories of offices available. Thus, on balance, the supply rate of 7.0% on the Zurich office market has not declined, despite the recovery in the city center.

Expansion since 2014 well below the long-term average

The recovery in Zurich's office market should also continue because the planned expansion in office space has been well below the long-term average of CHF 340 million p.a. for around four years (fig. 16). This should provide the easing in the medium term that would be required for the market recovery to spread beyond the center and its bordering neighborhoods, to include Zurich's entire office market. This would allow rents, which have already bottomed out in the city, to begin rising in the outer business district as well.

Figure 16: Approved construction permits for office space

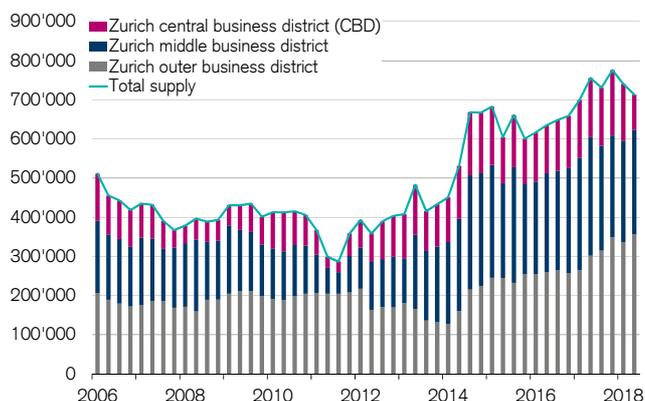
12-month total and long-term average on the Zurich market, in CHF million



Source: Baublatt, Credit Suisse

Figure 17: Supply of office space

Total office space advertised for lease each quarter* (inventory and new buildings), in m²

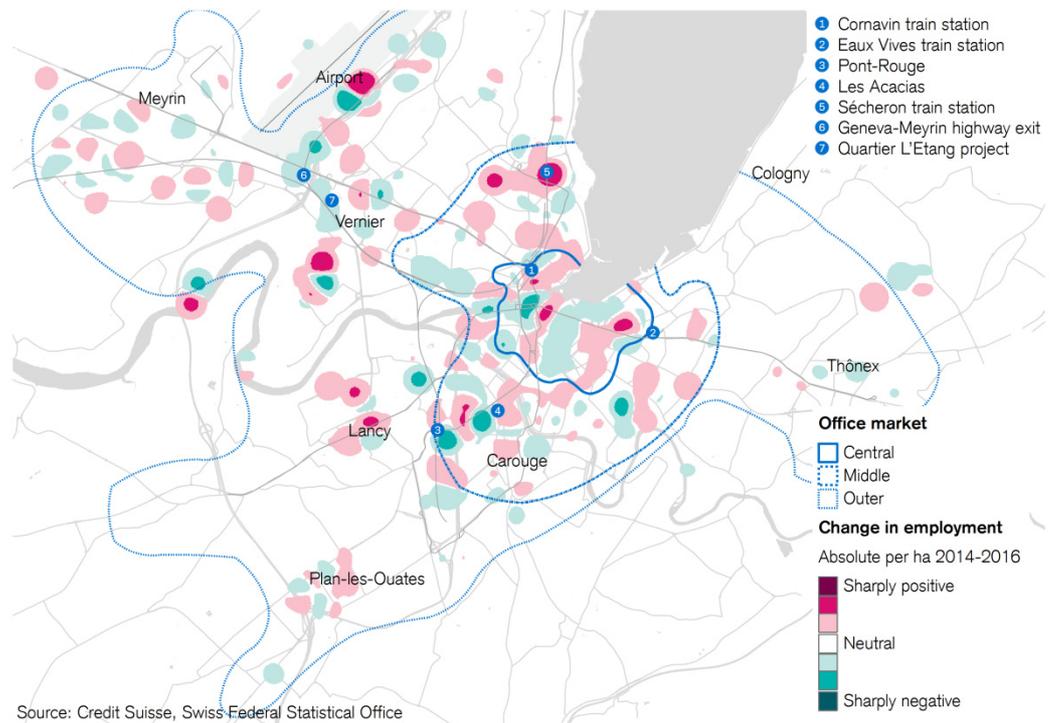


Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Geneva

Figure 18: Spatial trend in office employment: Geneva

Change in office employment, absolute per ha, 2014 – 2016



International organizations, banks and commodity trading buoy the economy

Aside from international organizations, which account for approximately 10% of all jobs in Geneva, banks dominate the employment scene in Geneva with 21.2%. In contrast to other major Swiss centers, insurance companies play a very minor role. However, thanks to Geneva's position as a commodities trading hub, wholesaling accounts for 7.4% of jobs there – more than in any other Swiss economic center. Legal and tax advisory services follow close behind with 6.8% of jobs. This is the largest segment of the sector aggregate for business services (24.9%), which provides a wide range of services, predominantly for the over 1000 multinational companies in Geneva. The public sector is also a significant employer, accounting for 14.1% of jobs.

The perfect storm in Geneva – until recently

From 2011 to 2016, total employment in Geneva rose by 0.56% p.a., only about half the pace of expansion in Lausanne, for example. A number of factors in recent years have affected precisely the sectors that are most heavily represented in Geneva. Structural change, triggered by the financial crisis and a new fiscal transparency, has hit the banking business hard. Of course the financial sector's falling share of value creation affects not only Geneva, but all of Switzerland, but Geneva is uniquely exposed and suffers disproportionately. Meanwhile, the appreciation of the franc proved to be a heavy burden for international organizations, as it sharply boosted their costs. Commodity trading firms were also impacted, and are simultaneously confronted with increasing supervisory and regulatory demands. Most recently, tax reform and related uncertainties have complicated the process for companies settling here, further aggravating the difficult situation.

Jobs leaving the CBD

In terms of space, the central business district (CBD) has felt the keenest effects of structural change. The number of jobs in the CBD fell by more than 1% p.a. from 2011 to 2016. Only the streets around the Cornavin train station and in the eastern CBD around the Eaux Vives train station were able to sidestep this trend. This was an early sign of a new spatial hierarchy in which locations near highly frequented train stations, especially, gain locational quality. In the more recent period from 2014 to 2016, this shift continued, albeit at a somewhat weaker rate. The middle business district was the main beneficiary, where additional jobs were created in the Pont-Rouge/Les Acacias area and around the Sécheron train station (fig. 18).

Supply rate at a new peak

Since 2016, employment growth in the entire Lake Geneva region has picked up significantly. At the end of the second quarter of 2018, the momentum had reached 3.3% over 12 months, the highest of all the major regions of Switzerland. Nonetheless, structural change and the corresponding weak demand for offices in recent years left traces in the real estate market. The supply rate of all listed space, including space that is not yet built, climbed to 9.5%. As elsewhere, leasing problems are clearly greatest in the outer business district. Listed space in the CBD has not risen further in 2018, and in the middle business district it has actually fallen (fig. 20). The surge in the outer business district was powered mainly by the already available and additionally planned space in Plan-les-Ouates, around the Geneva-Meyrin highway exit, and in the rest of the Meyrin municipality.

Shelf-warmers and newly renovated buildings boost vacancies

Space that has become impossible to lease inevitably winds up in the vacancy figures. This is what happened in 2018, when listed office vacancies in Canton Geneva skyrocketed. The responsible municipalities were the same as those contributing to the supply rate: Vernier, Meyrin and Plan-les-Ouates. Compared to the previous year, it is predominantly the long-term vacancies (three years and more) and recent vacancies (less than three months) that rose. They make up more than 90% of the increase. The first suggests an oversupply, and that vacancies will continue to rise in objects that in terms of age and condition no longer meet modern standards and/or are barely marketable. The latter refers to buildings that were temporarily off the market for extensive renovations, then relisted as available, as well as newly built office space that needs longer periods of time to find tenants.

Well filled pipeline prevents rapid recovery

On the demand side, the current economic upturn should eliminate one of the two causes of the oversupply. However, on the supply side, a revival in investment activity, evident in the issuance of building permits since 2015, is likely to prevent the recovery on the Geneva office market from being more dynamic (fig. 19). At the current perimeter, the first commercial buildings for the Quartier de l'Etang project, one of the largest developments in Geneva, are under way.

Correction in rent prices will persist

The record-high supply of office space and vacancies explain why the correction in rent prices in the city of Geneva intensified in 2018. Since peaking in 2013, rent prices based on leasing contracts have fallen 17%. Given the extent of the oversupply, rent prices should continue to correct. Office rents for prospective tenants in Geneva, which remains one of the highest-priced markets in Switzerland, should thus become more affordable. While this means that the challenges will remain substantial for property owners, the trend is nonetheless positive for Geneva as an economic center. The modernization of the supply of office space and the wide choice available create appealing conditions for companies tempted by the many attractions of the Geneva area.

Figure 19: Approved construction permits for office space

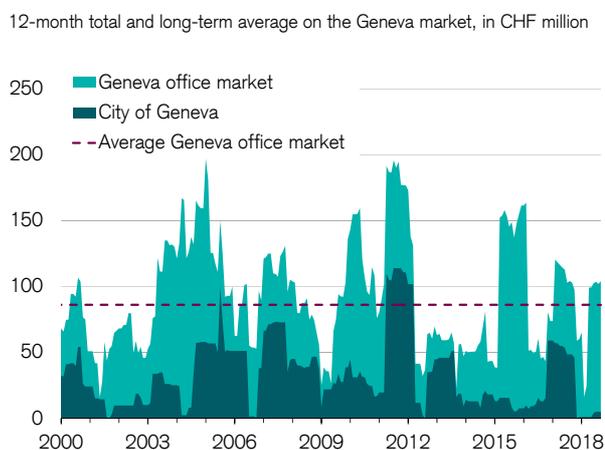
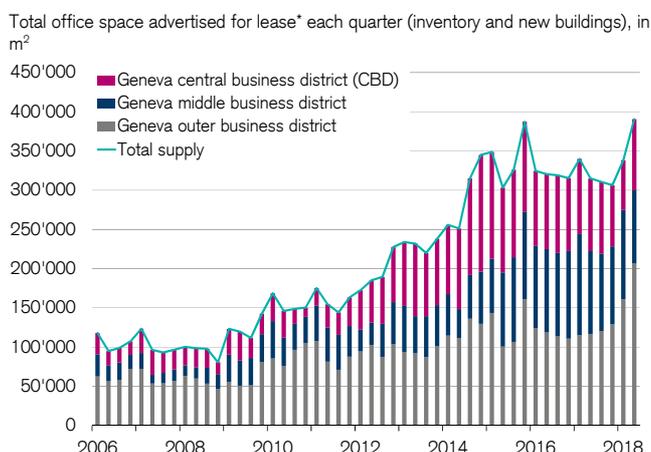


Figure 20: Offices available for lease



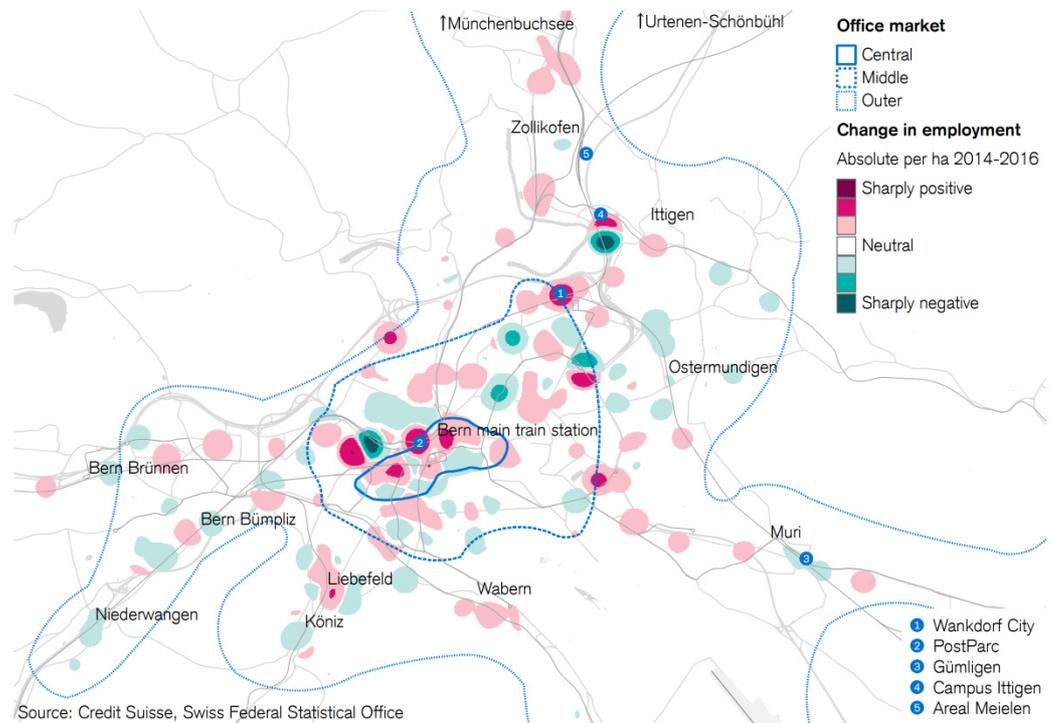
Source: Baublatt, Credit Suisse

Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Bern

Figure 21: Spatial trend in office employment: Bern

Change in office employment, absolute per ha, 2014 – 2016



Public sector impacts the sector picture

In the capitol of the Confederation, the dominant force is the public sector – administration, education and health and social services – accounting for 27% of the employment side of the sector structure. Traditional business services follow with 21.2%, but they are considerably less significant than in the other major centers. On the other hand, the considerable presence of associations and political parties is evident in a disproportionately high share of other services (6.8%).

High growth in employment

Bern, like Lausanne, displayed the highest growth in employment (1.0% p.a.) of all the major centers from 2011 to 2016. In the more recent period of 2014 to 2016, the trend actually accelerated (1.2% p.a.). More than half of employment growth was attributable to the public sector and other services. The remainder stemmed chiefly from business services and the telecommunications sector. The drop in employment in the key IT sector can only be called painful.

Bern's CBD expanding again

Employment growth was evident particularly in the middle and outer business districts and was mainly driven by the federal government's accommodation strategy 2024. New administrative centers in Ittigen, Zollikofen, and Köniz have begun operations in recent years, and have helped to bring steady jobs growth to the outer business district. In the two inner districts, on the other hand, transfers have been taking place. In the middle business district, the first phase of Wankdorf City resulted in impressive growth. Meanwhile, in the central business district (CBD), the number of jobs decreased from 2011 to 2014. However, these were regained in recent years when employment in the CBD was increasing most strongly. The occupation of the PostParc building doubtless contributed to this effect. The preponderance of red shading on the map above highlights the growth in the CBD (fig. 21). In the middle business district, in contrast, neighborhoods with positive jobs growth are more or less offset by those with negative jobs growth.

Absorption still difficult

The solid employment growth in Bern's office market was nonetheless only just enough to keep the supply of listed office space steady at the elevated level of 120'000 m². This emphasizes the trend in space available on the office market (fig. 23). The realization of the next development phase of Wankdorf City, and the planned continuation of the federal government's decentralized accommodation strategy, contribute to the current expansion in office space available. By the end

of the second quarter of 2018, the volume of office space available had risen above 160'000 m², corresponding to a supply rate of 4.8%. Decentralized space was the main contributor to the higher supply. On balance, 81%, or more than four fifths, of Bern's available office space can be found in the outer business district. This includes both existing properties and new projects. Among the new buildings are projects in Urtenen-Schönbühl and Münchenbuchsee. Large tracts of existing office space are available especially in Ostermundigen, Bern-Bümpliz, and increasingly in Gümligen, at the eastern edge of Bern's office market, where there was a recent drop in employment around the train station (fig. 21).

Interim uses and repurposing of office space

The relatively high supply of available offices in Bern has resulted in difficult marketing in some areas, for example in the properties vacated by Swisscom in Ostermundigen or by Losinger Marazzi in Köniz in 2016. Since no tenants could be found, despite years of marketing efforts, these spaces have been made available for interim use, and the owners are considering repurposing the buildings by 2020/2021. Even though these properties are no longer included in the supply statistics, the volume of office space available in Bern has risen sharply again. This trend does not suggest a recent history of brisk demand, especially in the segment above 1000 m². Over the last 12 months, there have been hardly any reports of significant leasing successes.

Falling vacancies downtown

After peaking in 2016, vacant office space in the city fell for the second consecutive year in 2018. This indicates that the office market in Bern's CBD and middle business district is recovering. In the outer business district, for which no vacancy data is available, a contrary development is evident.

Directionless rent prices

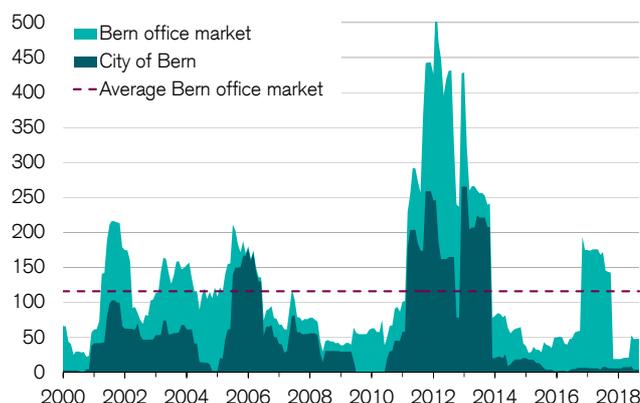
Market rents have been trending sideways in recent years. In 2011/2012, after the office supply fell below the 80'000 m² threshold, rents rose sharply. As a large number of projects were realized from 2011 to 2013, rent prices corrected slightly in 2013 and have been flat since 2014. The greater supply of available office space in well connected locations around the city center will probably limit the potential for higher prices and tend to exert steady pressure on rents.

A burst of second-phase construction

Planning for new office space has been quite moderate in recent years. Only the expansion of the administrative buildings to an entire campus in Ittigen pushed volumes of building permits for offices briefly above the long-term average (fig. 22). In May 2018, a permit was granted for the second phase of the Zollikofen campus of the Meielen area, where the federal government has commissioned a second administrative building for the Federal Office of Information Technology, Systems and Telecommunication. The current construction activity at the Wankdorf City project is also a second phase. By 2020, Wankdorf City II will be completed, comprising the BYTE building, commissioned by the Swiss Federal Railways for its IT division, and the TRIO ensemble, which except for around 4300 m² of office space in the tower will be mostly apartments.

Figure 22: Approved construction permits for office space

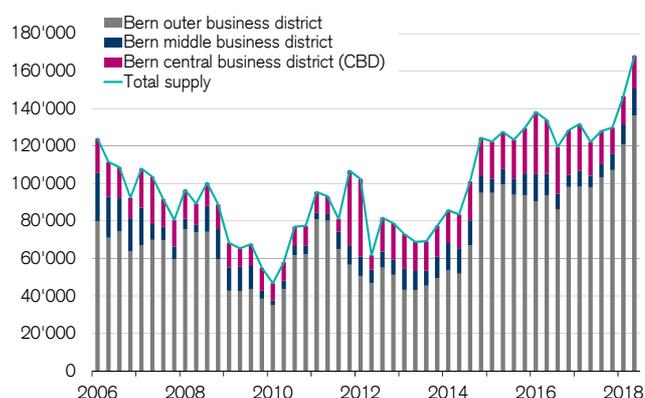
12-month total and long-term average on the Bern market, in CHF million



Source: Baublatt, Credit Suisse

Figure 23: Offices available for lease

Total office space advertised for lease* each quarter (inventory and new buildings), in m²

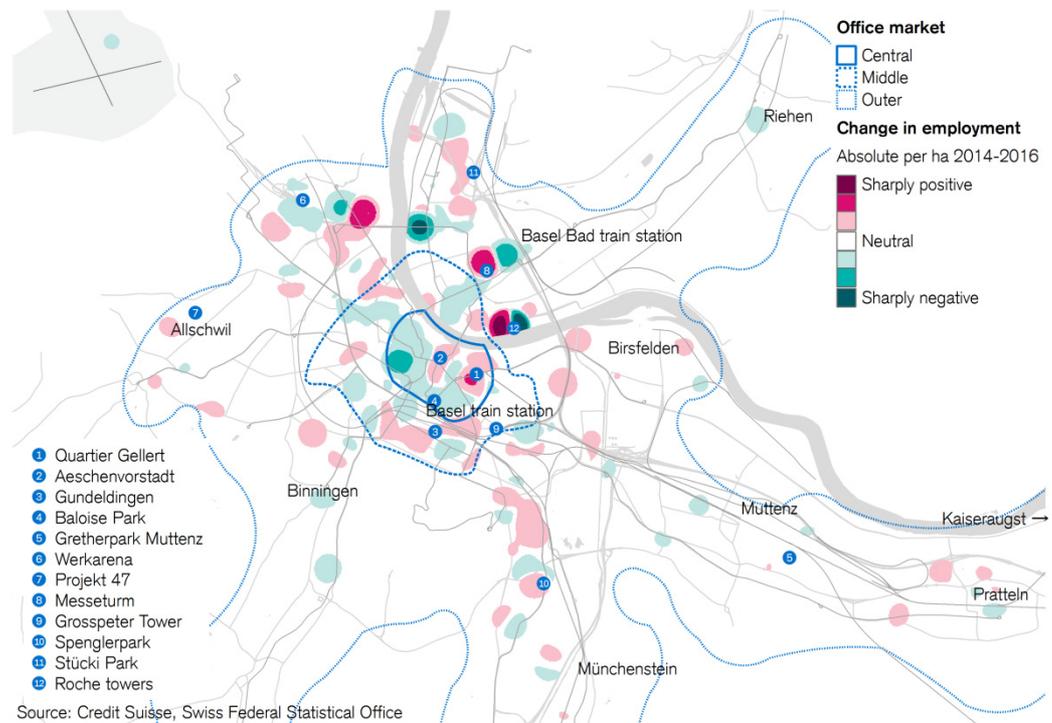


Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Basel

Figure 24: Spatial trend in office employment: Basel

Change in office employment, absolute per ha, 2014 – 2016



Industry's strong position

The sector structure at the perimeter of Basel's office market is dominated by industry. In no other major center does the secondary sector's share of employment exceed 8.5%; in Basel, however, nearly 18.7% of jobs are provided by industry. The pharmaceutical business accounts for nearly 9% of these jobs, complemented by a broad range of other industries. Wholesaling is an important provider with 6.3% of jobs, thanks to the favorable conditions in Basel with the pharmaceutical sector and the transportation links available in the bend of the Rhine. In contrast to other economic centers, Basel thus has a high share of commercial buildings. As is typical for a large economic center and an important banking market, business services (26.5%) and financial services (11.8%) also provide important support to the economy.

Moderate jobs growth between 2011 and 2016

Basel reported the lowest growth in employment of all the major centers from 2011 to 2016, with just 0.56% p.a. These were difficult years for industry as the franc appreciated sharply. So it would seem reasonable to conclude that the weak jobs growth was due to Basel's high dependence on industrial businesses. But this was not the case. Wholesaling, financial services (banks and insurance companies), transportation/warehousing, and chemicals were largely responsible. In recent years (2014 to 2016), in which employment growth was actually negative (-0.36% p.a.), also IT and corporate management/consulting made negative contributions to growth. These are two sectors that, similarly to wholesaling and financial services, are the biggest demanders for office space. This fleshes out the picture of the modest demand for office space observed in Basel until 2016. Meanwhile, the demand situation in the greater Basel area should have brightened since the end of 2016; employment statistics indicate that Northwest Switzerland has gained ground, with growth exceeding 2% at the end of the second quarter of 2018, and now occupies third place, behind Central Switzerland and the Lake Geneva region.

Growth on the edges

During the entire observation period, the pharmaceutical industry has been a reliable support to the employment market. The two big pharmaceutical companies in Basel have been focusing their expansion on their manufacturing facilities for some time now. Since these are located in the outer business district, their activity has helped to boost growth in that segment (fig. 24). In the central business district (CBD), on the other hand, employment decreased nearly across the board from

2014 to 2016. Only in the Gellert neighborhood and around the Aeschenvorstadt were new jobs created. There was no distinct trend in the middle business district, aside from the Gundeldingen neighborhood, which made gains not only as a residential location but also as an employment location.

Higher supply rate, especially in the outer business district

The supply rate on Basel's office market has been relatively manageable at 4.4% until recently, when it surged to 6.4% (fig. 26). This is not primarily attributable to the CBD or middle business district, although the space created for third-party tenants in Baloise Park did raise the supply in the CBD above 11'000 m². Nearly 70% of the supply is located in the outer business district. The expansion is also fueled by space that can be used for both commercial activities and offices. Some of these are existing properties, such as the Gretherpark in Muttenz, some are new developments, such as the Werkarena in North Basel, near the French border, or the fourth office building of Project 47 in Allschwil.

But scattered success stories too

A further contributor is the not yet leased space in the new Prattler Towers. Also Roche is scheduled to move out of the Messe Tower at the end of 2018, releasing more than 7000 m² of space for new tenants. Spaces comprising more than 1000 m² are particularly likely to inflate the supply rate. But there are also some signs of success. The Grosspeter Tower is nearly fully leased, there is for once no space in Spenglerpark listed for rent, and the office space in Stücker Park is enjoying such great demand that the next expansion with office and laboratory space is already in planning.

In contrast, moderate vacancies in the city

The differing availabilities of office space are reflected in vacancies. On balance, these have not changed much in the two half cantons. In the city, vacancies have dropped slightly (-3%) and are now below the average for the last ten years. In canton Basel-Landschaft, on the other hand, the amount of vacant offices rose further and currently stands at its highest level since this survey was launched in 1995.

Expansion above the long-term average

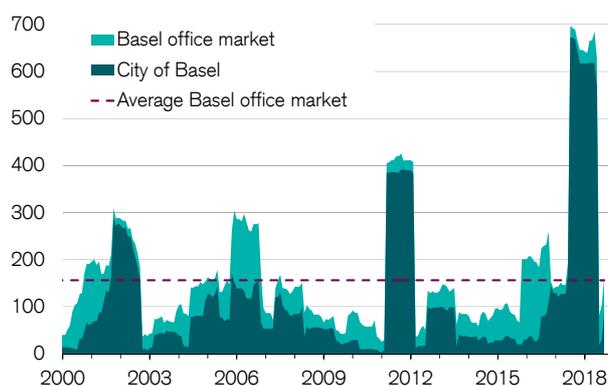
The supply of additional space has been steadily expanded in recent years, which appears to be increasingly working through to the state of the market (fig. 25). There is a certain amount of demand, but it is not very strong. In recent years, the increase in office space, excluding the Roche buildings, corresponded closely to the long-term average. The construction of the two towers, however, pushed it well above the average. The high level of planned development projects suggest that the supply overhang will not subside in the coming quarters, especially since the planned transfer of Roche jobs to Kaiseraugst and, in the medium term, into Building 2, will not help.

Rent prices heading south again

After some two years of sideways movement, rent prices in Basel slipped back into decline in the second half of 2017. This trend accentuated over the course of 2018, in tandem with the higher supply of office space.

Figure 25: Approved construction permits for office space

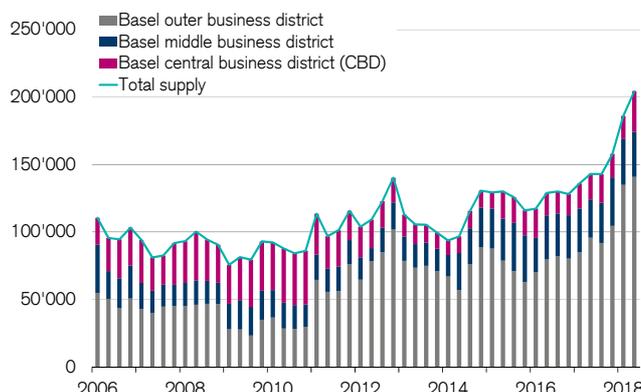
12-month total and long-term average on the Basel market, in CHF million



Source: Baublatt, Credit Suisse

Figure 26: Offices available for lease

Total office space advertised for lease* each quarter (inventory and new buildings), in m²

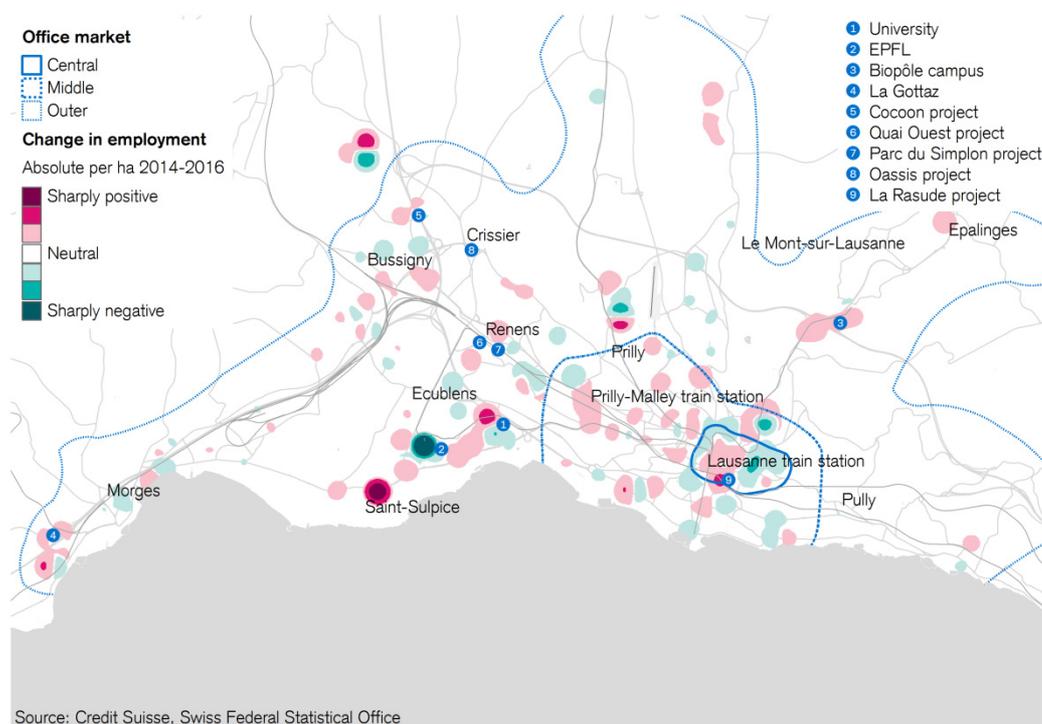


Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Lausanne

Figure 27: Spatial trend in office employment: Lausanne

Change in office employment, absolute per ha, 2014 – 2016



Broadly anchored sector structure

The sector structure in Lausanne is very broad-based; in other words, no one sector is dominant. As is typical for an economic center, business services (26.2%) and the financial industry, comprising insurance companies and banks (13.8%), form the backbone of employment in the office market. They are complemented by the IT sector (5.8%) and wholesaling (5.1%). The public sector has a greater weight than in other economic centers, with 20.2% of employment. This applies to public administration, healthcare and social services, and the education/training segment. The latter is nearly twice as large as in other major centers and includes the University of Lausanne and the École Polytechnique Fédérale de Lausanne (EPFL), which boasts an outstanding reputation at home and abroad.

Growth increasingly to be found in the outer business district

Given the considerable variety of sectors, growth in employment at the perimeter of Lausanne's office market was quite even. Indeed, from 2011 to 2016 it posted slightly more than 1% p.a., the strongest growth of all the major centers, just above that of Bern. Both the CBD and the periphery of the office market contributed to the growth (fig. 27), although the outer business district registered 1.54%, nearly double the 0.82% recorded in the CBD. An explanation may be needed for the fact that employment in the CBD and middle business district was actually slightly declining in the more recent period of 2014 to 2016, especially on the perimeter of the CBD. This is mainly because available space is rare in the CBD. The few offers that come onto the market tend to be absorbed relatively quickly. The same is true for the middle business district, where office jobs were created particularly in the west of the city center between 2014 and 2016. Further growth centers were the areas around the EPFL, the Biopôle Campus in Epalinges and La Gottaz in Morges.

The public sector is a definite driver

Consequently, it was mainly the public sector, especially the education and training segment, that was responsible for the growth. Business services contributed just around one third of the increase. Insurance companies also made a positive contribution to growth, although it could not offset the job losses in the banking segment. Wholesaling and the advertising industry also eliminated jobs in net terms in Lausanne.

High absorption power lowers the supply of office space

Over the last few quarters, intact demand for offices has effected a reduction in available office space. At the end of the second quarter of 2018, the supply rate in Lausanne was 5.8%, the second lowest after Bern (fig. 29). Excluding the major Cocoon development in Bussigny, for which details on the four planned administrative buildings were only available in autumn 2018, the supply rate in Lausanne would have fallen to 4.5%, the lowest value for all the major centers. A majority of the available space, some 75%, is located in the outer business district. This includes, especially, the large developments to the west of Lausanne. The Quai West project at the Renens train station, the Parc du Simplon south of it, the new Oassis quarter in Crissier and the buildings at the Morges train station are already under construction. Another building at the Biopôle Campus is still in the planning phase, although the space is already being advertised.

Recovery taking hold in the outer business district too...

If there were one major center leading the gradual recovery on the Swiss office market, it would be Lausanne. Here, the momentum has already reached the outer office market. This is evident not only in the falling supply rate, but also in vacancies, which have fallen from over 70'000 m² to 57'000 m² at cantonal level. The biggest contributor to this phenomenon was the West Lausanne district, where official vacancies have fallen by nearly half. At both cantonal level and in the Lausanne and West Lausanne districts, the volume of empty office now stands below the average since the survey began in 2005.

...although expansion has accelerated

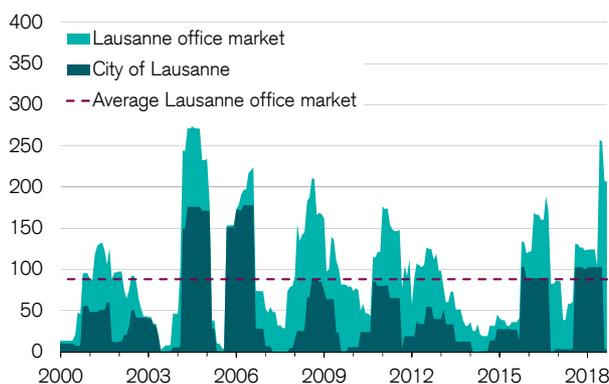
The high absorptive power of Lausanne's office market is even more evident when one considers that the volume of approved construction permits has been above the long-term average since 2004 (fig. 28). There was a lower number of office projects from 2013 to 2015, in reaction to an increasing supply rate, but the pipeline has filled again lately. In Lausanne, the cantonal insurer for fire and natural disasters has commissioned a new headquarters that will unite the service units currently housed in Pully and Lausanne. More recently, the building permit for the Cocoon project ensured that planned construction volumes for offices will remain well above the long-term average. Considering other projects, such as the development at the Prilly-Malley train station or the La Rasude project at the Lausanne train station, construction volumes should remain above the average in the coming quarters.

Rent prices poised to rise again

Rent prices for office space in Lausanne corrected only at the end of 2015, somewhat later than in the other economic centers. Since then, rent prices in actually signed rental agreements have declined by a total of around 8%. However, prices should be ready to bottom out. Given the intact demand and a well filled, but not overfilled, pipeline, we expect the trend to reverse soon with rent prices rising again.

Figure 28: Approved construction permits for office space

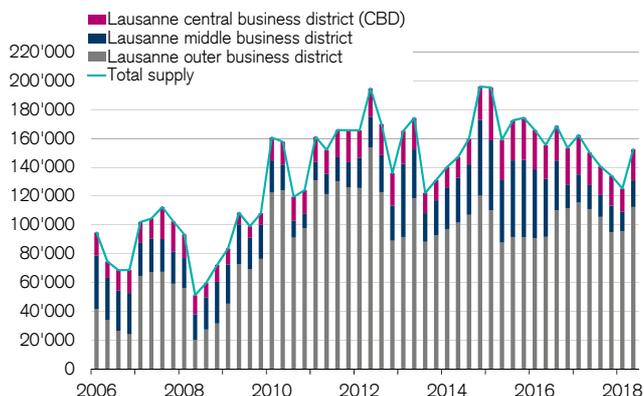
12-month total and long-term average on the Lausanne market, in CHF million



Source: Baublatt, Credit Suisse

Figure 29: Offices available for lease

Total office space advertised for lease* each quarter (inventory and new buildings), in m²



Source: Meta-Sys AG, Credit Suisse *space advertised on the internet

Recovery to what extent?

The market environment for office property appears quite positive at the moment. Demand for space tends to be pro-cyclical, especially as regards office buildings. Recall, for example, the cyclically good years before the financial crisis, when a relatively large oversupply in Zurich was reduced astonishingly quickly. The trend is unlikely to be turned so smoothly this time around – first, because unlike then, negative interest rates have promoted rather too much development of office space, and second, because structural problems limit the absorptive power of demand. Because the former factor has exogenous causes that have little or no connection with the situation on the office market, the questions of whether, and to what extent, the recovery will persist must be answered on the demand side.

Intact economic outlook

The Swiss economy is still humming along, but its high flight appears to be drawing to a close. The export-oriented manufacturing industry is already feeling a headwind from the multitude of political uncertainties. While the Swiss export boom loses some impetus as a result, the situation on the Swiss labor market is more likely to improve. A majority of companies plan to increase their staffing in the coming months. Thus the labor market should remain on track for growth, although the trend has probably already peaked. The unusually high momentum is likely to be followed by somewhat more sober growth rates. Thanks to persistently favorable fundamental factors, we expect to see impressive GDP growth of 1.7% overall in 2019.

Structural developments slow things down

The highly positive influence of cyclical factors on demand for office space is somewhat reduced by structural factors. Sectors affected by structural change, such as banks and insurance companies, wholesaling and telecommunications services, will hardly be able to feature as demand drivers in the coming quarters. On the other hand, we see further growth potential in manufacturing, the public sector, IT, and the wide ranging business services sector.

Demand for offices positive, but limited

Moreover, trouble spots such as unresolved tax reform, the undecided future relationship with the European Union, or the strength of the franc make a rapid trend reversal in companies settling here unlikely. On the other hand, progressive digitalization should contribute to demand for office space since an increasing number of activities in both the secondary and tertiary sector are carried out in front of a screen. On balance, therefore, we can expect substantial demand for office space that is, however, unlikely to match the absorptive power of earlier recovery phases.

Negative interest rates mean the supply will increase further

On the supply side, negative interest rates translate into a steady increase in the supply of office space, which tends to take too little consideration of the existing oversupply. Hence while we can expect a decline in vacancies and the supply rate in the coming quarters, the decrease is likely to be sluggish. This is particularly true for the office markets in Basel and Geneva; in Zurich and Bern, however, we anticipate a faster reduction in vacancies due to less expansion, and in Lausanne, the same but due to high demand.

Ongoing recovery – but also in the outer business district?

On balance, we expect the recovery to persist. As in earlier cycles, this should gradually extend to the middle and outer business districts, at a somewhat slower pace. Since demand is not sufficient to absorb all available space, however, marketing will remain the most challenging specifically in the outer business district. In an environment with a shortage of skilled workers and a dried-out labor market, potential office tenants place a greater value on central city locations. From an investor's point of view, there is thus currently only limited room for compromise in terms of locational quality.

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