

# Real Estate Outlook

Switzerland – Edition 2H21



Approaching normality.



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**Persisting low interest rate environment** remains supportive of real estate investment.





We expect economic recovery to progress in the coming quarters despite the resurgence of COVID-19 cases. At the same time, the inflation dynamic is likely to remain modest and the Swiss franc should show strength compared to the euro. This indicates a continuation of the negative interest rate policy led by the Swiss National Bank in the near-term outlook.

## Macroeconomics

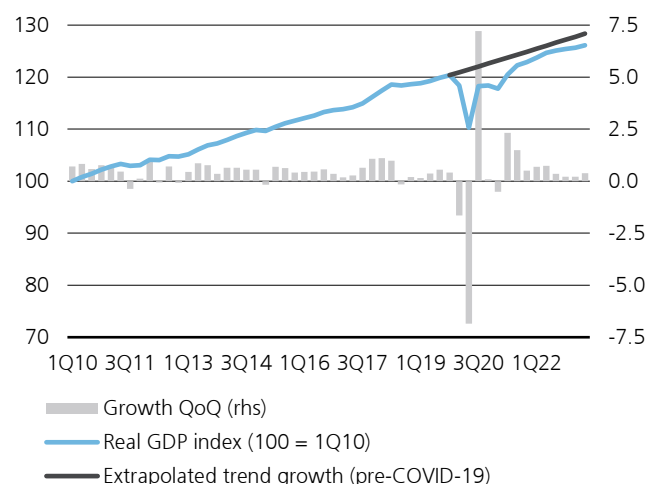
# Low yield foundations still in place.

### Economic rebound expected to continue

The Swiss economy rebounded sharply in the second quarter of 2021 as lockdown measures were gradually lifted, with an expected 1.8% growth QoQ in real GDP. Despite the resurgence of new COVID-19 cases, we expect economic recovery to keep progressing in the coming months as many economic players have already adapted to the long-lasting nature of the pandemic. Consumer sentiment and leading economic indicators such as the Purchasing Managers' Index (PMI) are currently at very elevated levels. This indicates a strong confidence in both the industry sectors and the consumer market. Thus, we expect the Swiss economy to get back on its pre-COVID-19 growth trajectory at the end of the year (see Figure 1).

**Figure 1: Real GDP data and prospects**

(quarterly, %)



Source: Oxford Economics; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021

### Inflation dynamic remain modest

While inflation remains strong in the US, the Swiss inflation dynamic persists at a subdued level. The local Consumer Price Index (CPI) rose by only 0.9% YoY in August 2021, despite important base effects from 2020's data. According to Oxford Economics, the momentum is likely to peak in the fourth quarter of 2021, with an expected inflation rate of 1% YoY, before gradually cooling down in the course of 2022. The inflation dynamic of the eurozone is likely to follow a similar path, but at a substantially higher level (forecast for 4Q21: +3.0% YoY).

### Swiss franc regains strength

After a period of relative depreciation at the beginning of the year, the Swiss franc started to regain strength compared to the euro in 2Q21. At the end of August 2021, the euro / Swiss franc-exchange rate traded at around CHF 1.08 per euro – the lowest level since early January 2021 (see Figure 2).

The strengthening of the Swiss franc is likely to continue in the coming months, as public debt in Switzerland remains at modest levels compared to many other developed economies. And as mentioned earlier, the current dynamic of Swiss inflation is very modest compared to its European peers. However, renewed forex interventions from the Swiss National Bank (SNB) could impact this outlook.

**Figure 2: Swiss franc's exchange rates**

(CHF / foreign currency)



Source: Refinitiv; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021

### Government bond yields to continue at a very low level

In light of a modest inflation dynamic and the strengthening of the Swiss franc, we expect the SNB to stick to its negative interest rate policy in the coming quarters. Therefore, Swiss government bond yields are expected to continue at very low levels in the near-term. After an upward reaction triggered by the shock of the pandemic in 2020, the yield of the 10-year Swiss government bond gradually retreated during the summer 2021 and currently plateaus deep in negative territory. A -0.4% level was reported at the end of August.

## Investment market

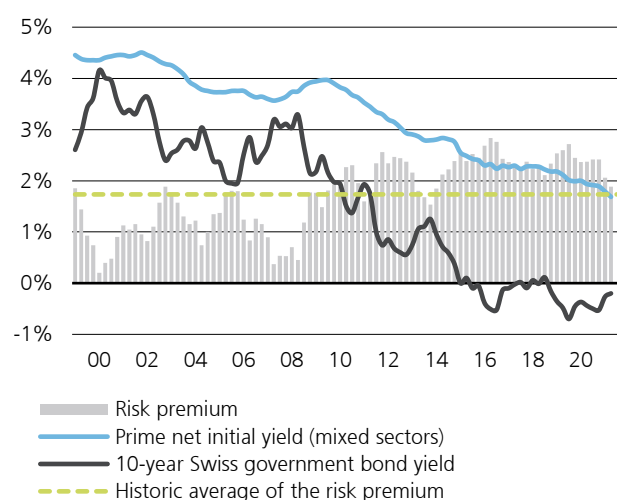
# Prime initial yields compressing in all sectors.

### Direct market: Strong investment pressure in 1H21

Persisting negative interest rates create a very challenging investment environment for investors. With this in mind, Swiss direct property investments remain very appealing for investors seeking alternatives to negative money market returns and yields at subdued levels in the bond asset class. This strong investor interest recently led to an acceleration of the net initial yield compression in the prime sectors of the Swiss property market. The momentum has been particularly strong in the residential market, with a 18 bps retreat in the first half of 2021 – according to data from Wüest Partner. Surprisingly, investor demand has been particularly strong for prime office properties as well, with a 33 bps compression despite some uncertainties related to the pandemic. Net initial yields compressed also in the prime retail property sector, but only by 10 bps.

Despite increasing transaction prices and retreating initial yield levels, the risk premium offered by direct property investments remains substantial (see Figure 3). At the end of 2Q21, the spread between the net initial yield of a prime property acquisition and the 10-year government bond yield reached 1.9%. This is still slightly above the historical average (1.7%). As the low bond yield environment is likely to continue (see page 4), we expect the property transaction market to remain very competitive in the coming quarters.

**Figure 3: Risk premium of direct property investments**



Source: Wüest Partner 2Q21; Oxford Economics; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021. Past performance is not an indication for future results.

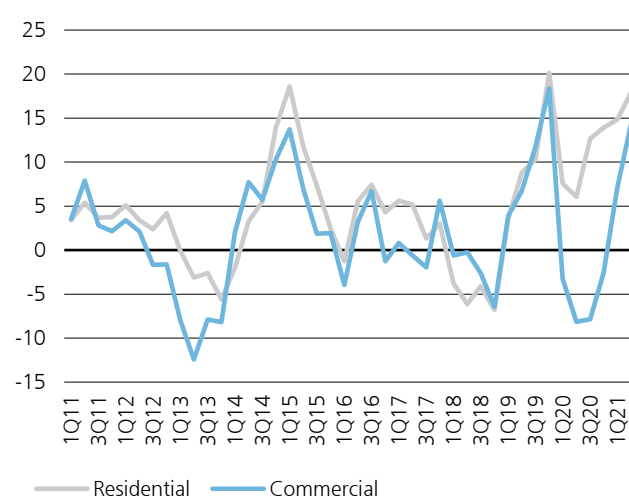
### Elevated dynamic in the indirect sector too

Investor interest for Swiss property investment is also observable in the data of the indirect market. According to Safra Sarasin 2021, the indirect market is so far the most dynamic it has been in the last four financial years, with over CHF 3 billion of capital market transactions YTD – both equity and debt raising – reported in the sector (as of the end of August 2021).

The pricing dynamic remains very strong in the listed fund market, with an average agio reaching around 42% of NAV in the overall market as of 31 August 2021. The residential sector continued to progress with a positive trend in the first half of 2021, with an increase of the average price index of 14.8% YoY in 1Q21 and 17.9% YoY in 2Q21 (see Figure 4). This indicates that investors seem to keep favoring the income stability of multifamily investments in the current environment.

However, the commercial sector also started to rebound once the pandemic situation started to improve. The commercial sector showed strong price index returns in the first half of the year, with a 7.1% YoY increase in 1Q21, and 14.3% YoY in 2Q21. In our view, commercial products are likely to continue to catch-up in the coming months, particularly as they benefit from base effects of the sharp retreat of 2020 triggered by the COVID-19 outbreak.

**Figure 4: Price return of listed Swiss real estate funds (% YoY)**



Source: Refinitiv 2Q21; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021. Past performance is not an indication for future results.

## Occupier market

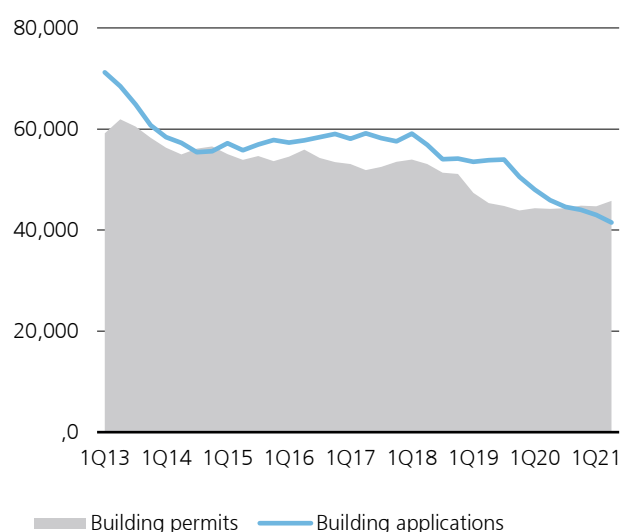
# Resilience of the Swiss market fundamentals.

### Multifamily: On a stabilization trend

The Swiss multifamily market is evolving towards stabilization. On the demand side, net migration reached around 26,000 people in the first half of 2021. Hence, the migration dynamic is on track to reach an annual level similar to the average of the period 2016-2020 till the end of the ongoing year (i.e., around 55,000 people net). On the supply side, planning activity keeps slowing down at a gradual pace (see Figure 5).

The vacancy rate in the Swiss residential market retreated in 2021 for the first time in 12 years, due to calmer construction activity and a pandemic-related absorption boost (i.e. the demand for second homes). With this in mind, the supply / demand-imbalance has not yet fully resorbed in the Swiss multifamily market and offering rents remain widely under pressure according to data from Wüest Partner. However, we observe that the rental level of institutional residential portfolios tends to evolve in a more resilient way due to above-average locations of these types of assets and the quality of invested stock.

**Figure 5: Planning activity in the Swiss housing market**  
(12-month sum, number of dwelling units)

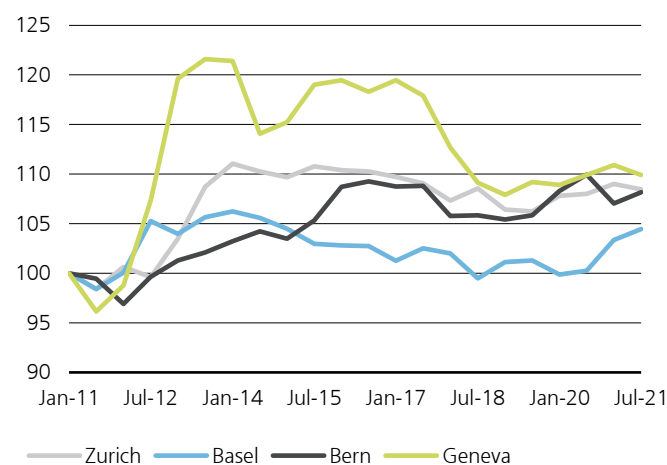


Source: Bauinfo 2Q21; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021

### Office surfaces: Still no clear impact from COVID-19

Recent market data keeps pointing towards resilience in the Swiss office property market. According to JLL, the availability rate of office surfaces experienced a slight retreat in the Zurich and Geneva markets in 2Q21, after having edged up somewhat during the first quarters of the pandemic shock. At the same time, Wüest Partner reports stable trends for the level of offering rents in most of the local markets (see Figure 6). The long-term impacts of sustained working from home still needs to be seen in terms of shifts in the office demand structure. But as of today, Swiss office properties keep showing signs of strength, both from an occupier and investment market perspective.

**Figure 6: Evolution of the offering rents in regional office markets**  
(Index, 100 = Jan 2011)



Source: Wüest Partner 2Q21; UBS Asset Management, Real Estate & Private Markets (REPM), September 2021

### Retail properties: Some light at the end of the tunnel

While the repeated lockdowns caused deep economic stress for many offline shops, the roll out of the vaccination campaign is raising hopes for sustainable recovery in the Swiss retail market. Recent data from Monitoring Consumption Switzerland confirms a marked return of offline shopping over the first half of 2021. Despite this ongoing positive development, negative structural trends such as the long-term progression of e-commerce and retail tourism are likely to remain a drag on retail surface occupiers in the coming years.



## Return forecasts

# Multifamily to outperform in the coming years.

### Performance outlook remains robust

Strong occupier market fundamentals during the pandemic, as well as the positive outlook for transaction market activity has led to a slight upward revision of our 5-year total return forecast compared to [our last paper](#) published in March. Investments in commercial sectors are expected to hold up better than expected, particularly in terms of investor demand and transaction yield compression. We now expect a mixed direct allocation in the Swiss property market to return 4.5% of total performance annually over the 3-year period 2021-2023, without the use of leverage (see Figure 7). Over the 5-year period of 2021-2025, our forecasted total return still stands at 4.1% p.a. on average.

### Positive stance on multifamily investments

Investor sentiment is very positive for the multifamily sector since its stable income-driven performance remains particularly sought-after in a still uncertain environment. We expect this to persist in the coming quarters, which should contribute to the positive performance of the sector going forward. We forecast an average total return of 5.3% over the next 3 financial years 2021-2023. An important driver of this performance is likely to come from capital value growth driven by further discount factor compressions. By contrast, the rental growth outlook remains rather muted in the near-term.

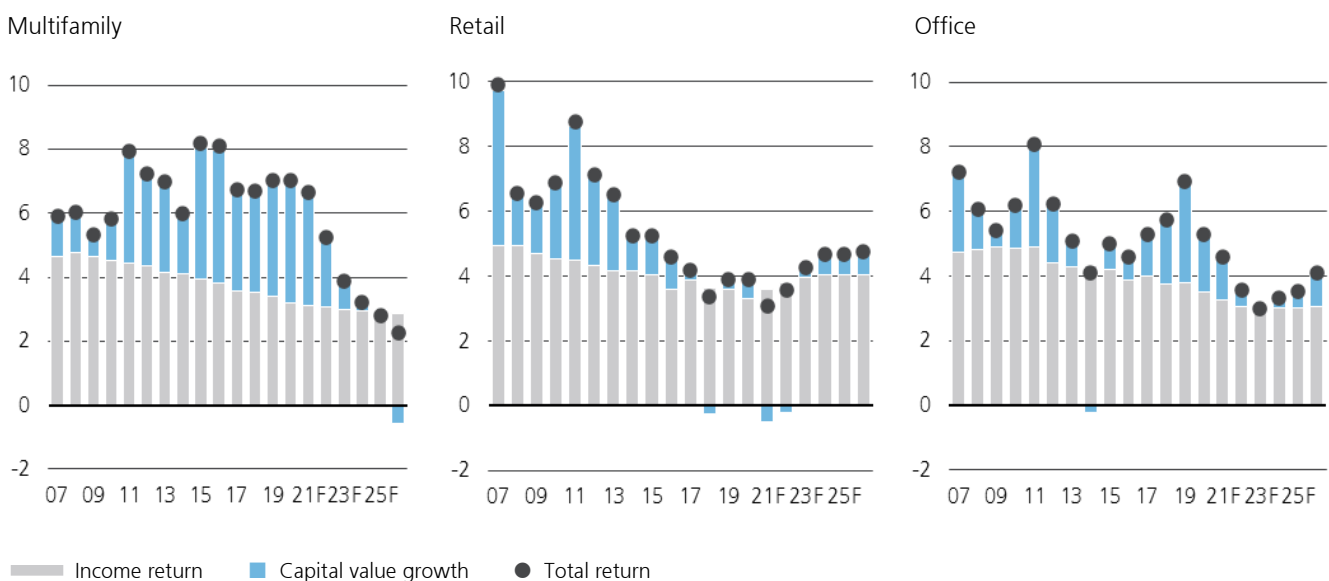
### Office: Expected resilience, but with downward risks

The office sector has proven to remain resilient throughout the pandemic, both from an occupier and investment market perspective. Nevertheless, we expect long-term consequences of the home office trend and the current building pipeline to drag on market fundamentals in the coming years. As a consequence, initial yield compressions and market rent growth are likely to halt in the near-term, with strong differences amongst the subsectors of the office market. On average, we expect an annual total return of 3.7% p.a. over the period 2021-2023 for the overall market.

### Retail: Still at the bottom of the ranking

Despite ongoing recovery in the Swiss retail market, long-term detrimental trends such as e-commerce and retail tourism are likely to keep weighing on occupier demand in the retail property market going forward. This is expected to impact rental growth prospects and investor sentiment negatively in the coming years and explains retail property investment's position in our expected total performance ranking. We expect the average allocation in the Swiss retail property sector to return 3.6% of annual total performance over the 2021-2023 3-year horizon.

**Figure 7: Expected returns in the Swiss real estate market** (on the property level, unlevered)



Source: MSCI / Wüest Partner; UBS Asset Management, Real Estate & Private Markets (REPM), August 2021

Note: Expected / past performance is no guarantee for future results. The presented forecasts have been computed based on the assumption of a persisting low interest rate environment in the near future

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