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# Real estate

## Real Estate Outlook – Switzerland 2H24

Market momentum







# Swiss real estate market picking up pace

The turnaround in interest rates has brought greater momentum back to the Swiss real estate market and led to a stabilization of yields and a normalization of the risk premium. The residential segment in particular is attracting great interest from investors thanks to sustained growth in demand and increases in rental price.



# Macroeconomic environment

## Troubled waters

### **Global economic environment experiencing ups and downs**

The macroeconomic environment in recent years has been characterized by great volatility. The pandemic and the resulting economic slump were followed by inflation, interest rate hikes and the associated fears of recession as well as geopolitical upheaval, which significantly increased uncertainty in global trading markets.

Although the figures on the US labor market published at the beginning of August 2024 caused some uncertainty on the financial markets, the US economy remains stable with annualized growth of 1.4% in the first quarter and 2.8% in the second quarter of 2024. The eurozone economy is growing more slowly, particularly in manufacturing-heavy northern-European countries. Growth in the service-oriented southern economies is more robust. The weakness in the manufacturing sector is particularly evident in Germany, where – after a slight improvement in the first quarter - the gross domestic product fell again by 0.1% in the second quarter of 2024.

### **Slightly above-average growth in the second quarter for the Swiss economy**

The volatility of the global economic situation is also reflected in the mood of Swiss economic players. As Germany is one of Switzerland's most important trading partners, the weakness of the German industry is affecting the manufacturing sector here too. This is clearly illustrated by the Purchasing Managers Index (PMI), which has been continuously below the growth threshold of 50 points for industry since January 2023. With a range of values of between 43 and 57 points since January 2023, the PMI in the service sector paints a somewhat less gloomy picture than the industry index, but at the same time its volatility expresses increased uncertainty.



Despite the lack of tailwinds from abroad, the Swiss economy recorded slightly above-average growth of 0.5% in the second quarter, following growth of 0.3% in the first quarter (SECO).<sup>1</sup> This is a surprising result given the weakness in the PMI, the lack of growth in Germany and increasing concerns about headwinds from a strong Swiss franc. However, a closer look reveals that the positive result was primarily driven by pharmaceutical exports, which are not very sensitive to economic developments, while growth momentum is otherwise rather subdued.

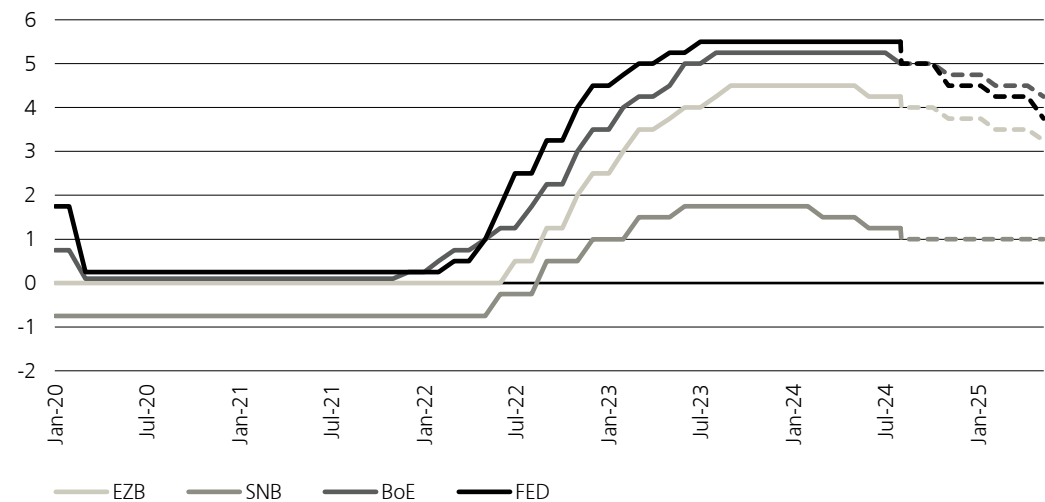
Growth in the labor market is not in line with growth in the Swiss economy. Following the significant employment growth of 77,200 full-time equivalents (FTEs) in 2023, employment growth in the first half of 2024 was relatively moderate at 26,900 FTEs. Similarly, the unemployment rate has risen in the year to date from 2.2% in January to 2.5% in August (FSO).

### Low inflation allows the Swiss National Bank to lower interest rates

In contrast to other European countries and the US, inflation in Switzerland has remained within the target range of the Swiss National Bank (SNB) of between 0 and 2% for more than a year now. In August 2024, inflation was 1.1% compared to the same month of the previous year. Imported goods in particular have had a deflationary effect since November 2023. However, the year-on-year rate of change for domestic goods also no longer exceeded the 2% mark in 2024. In view of the stable inflation trend, the SNB initiated a turnaround in interest rates on 21 March 2024 and lowered the policy rate from 1.75% to 1.5%, followed by a further rate cut in June to 1.25%. The SNB is thus playing a pioneering role in the international environment with its early interest rate cuts (see Figure 1). A further interest rate cut of 25 basis points is currently expected in Switzerland for the remainder of the year.

**Figure 1: Swiss National Bank leads the way in the interest rate reduction cycle**

Policy rate and forecast (%) of selected central banks



Source: Refinitiv; UBS IB, August 2024, forecasts as of 30 August 2024

<sup>1</sup> Non-adjusted for sport events, the Swiss economy grew by 0.5% in the first quarter and 0.7% in the second quarter.

# Investment market

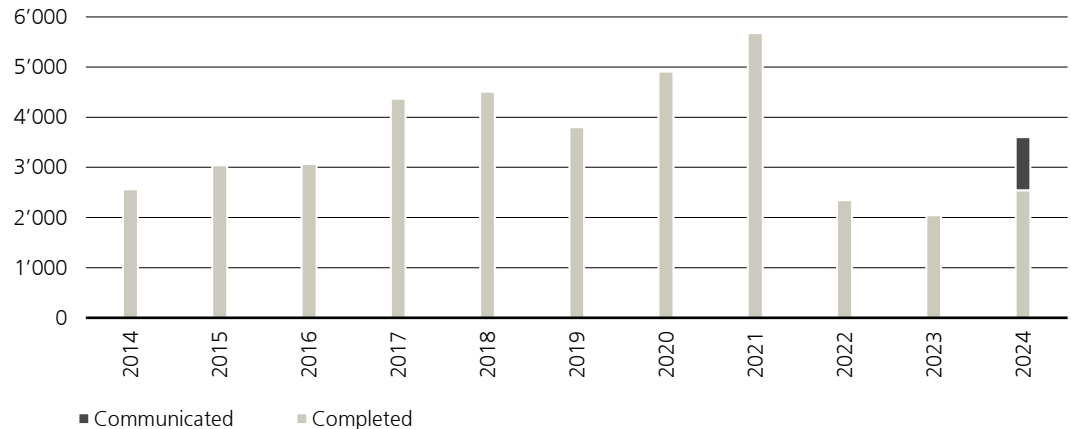
## Picking up speed

### Capital market gearing up

After Swiss real estate investment lost some of its attractiveness over the past two years, investor sentiment has now improved again. The brightening in sentiment becomes clear when comparing this year's capital market transactions with those of the past two years. With CHF 2.5 billion raised capital (debt and equity), total capital market transactions in 2024 already exceeded the total of the two previous years by the end of August (see Figure 2).

**Figure 2: Capital market transactions pick up speed**

Capital market transactions (debt capital and shareholders' equity) on the Swiss real estate investment market (CHF million)



Source: J. Safra Sarasin; UBS Asset Management, Real Estate & Private Markets (REPM), August 2024. **Past performance is not a guarantee for future results.**

The increasing optimism is reflected in the fact that the capital market transactions were very well absorbed in the market. The premiums of listed Swiss real estate funds have risen since the beginning of the year from an average of 14% to 23% (as of 31 August 2024). Of the 41 active listed funds, only eight were still at a discount at the end of August, compared with 15 products at the beginning of the year.

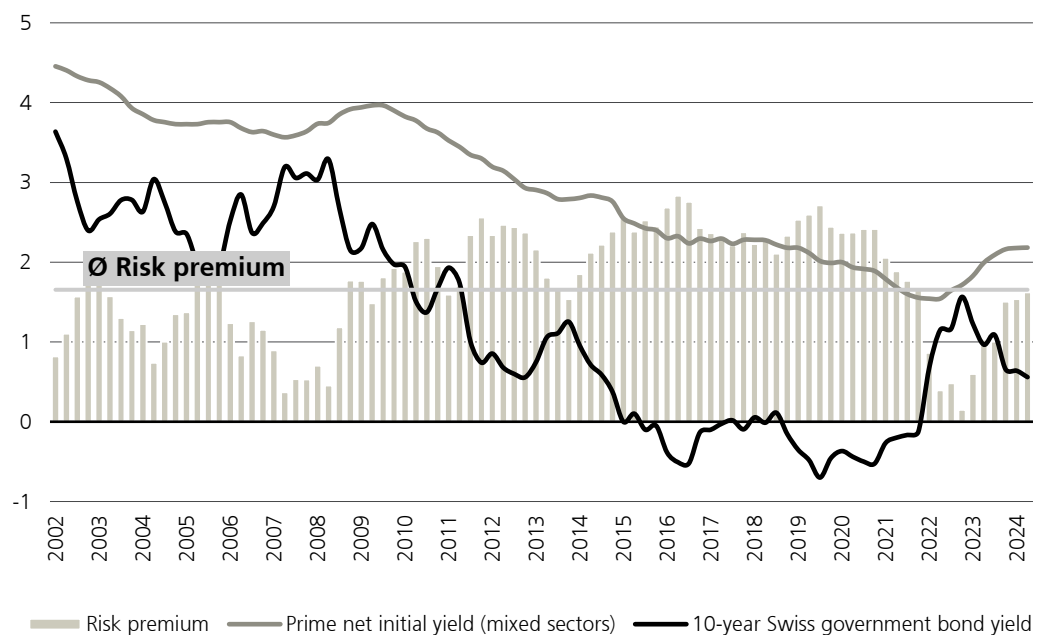
### Risk premiums move toward the long-term average

In addition to the interest rate cuts by the SNB, the significant fall in the yield of 10-year Swiss Confederation bonds in particular is also likely to have boosted the momentum of real estate investments. The risk premium for indirect investments has climbed again to around 230 basis points with an average distribution yield of 2.85%.

The risk premium for real estate investments on the direct market has also risen significantly again and, at around 160 basis points, is now back at the level of the long-term average (see Figure 3). In addition to the reduction in government bond yields, the corrections in real estate yields over the past 24 months have had a positive effect. Compared to the peak in the first half of 2022, prime yields in the residential segment have risen by a total of 65 basis points and in the retail segment by 53 basis points. The comparatively low corrections in the retail sector can be explained by the lower compression of yields in this segment during the pandemic due to the boom in online retail. Residential properties, on the other hand, experienced strong yield compression during this period, which resulted in a somewhat stronger correction after the interest rate turnaround. In addition to the changed conditions in the capital markets, structural change is putting additional pressure on the office property segment. As a result, office properties have suffered the sharpest corrections worldwide in the past two years. At 70 basis points, top offices in Switzerland have experienced the most significant correction, although this remains moderate by international comparison.

**Figure 3: Risk premium back to long-term average**

Yield on 10-year Swiss Confederation bond, net initial yield on prime real estate and resulting risk premium (%)



Source: Wüest Partner; Swiss National Bank; UBS Asset Management, Real Estate & Private Markets (REPM), August 2024.  
**Past performance is not a guarantee for future results.**

Yields have recently stabilized again across all segments. In the first half of the year, only the peak net yields of retail and office properties in Geneva rose by 5 basis points. In the housing market, which is supported by a strong increase in demand, yields in 14 of the 15 (sub)markets monitored by Wüest Partner have been stable again since the fourth quarter of 2023. Basel city center is an exception. However, this outlier is likely to be at least partly explained by the residential protection law (Basler Wohnschutzverordnung) that came into force in Basel in 2022, which is dampening investor interest there and thus putting pressure on prices.



# Rental market

## Growing demand in the housing market drives up asking rents

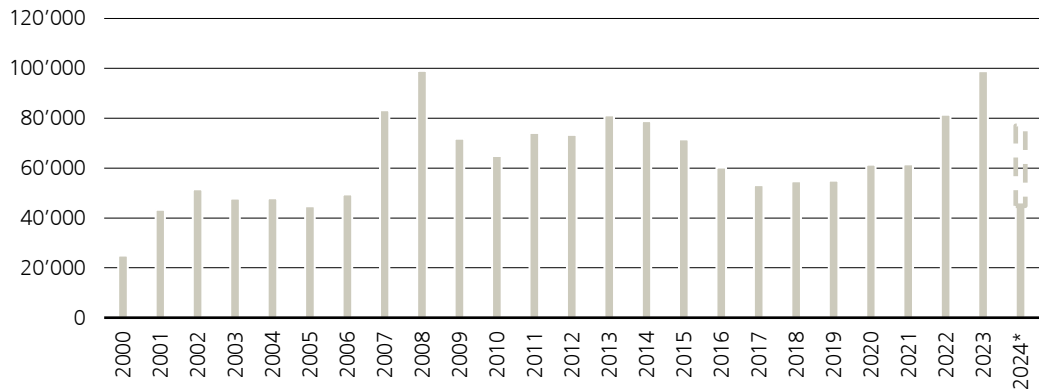
### **Demand for rental apartments in Switzerland remains high**

The Swiss rental apartment market continues to be characterized by strong growth in demand. In 2023, the permanent resident population in Switzerland grew by 146,900 people (+1.7%). According to the Federal Statistical Office (FSO), the Swiss population thus grew almost twice as much in 2023 as in 2022 (+0.9%) and more significantly than at any time since the beginning of the 1960s. The strong population growth was driven in particular by a high level of immigration. In 2024, this has indeed fallen slightly compared to the previous year to date, but it remains at a persistently very high level with net migration of 44,900 up to and including July 2024. Extrapolated to the end of the year, this would correspond to net migration of around 77,000, which is slightly below the level of 2022 (see Figure 4).

In addition to the high level of immigration, the demographic trend toward smaller household sizes is further increasing the demand for rental apartments. Since 1970, the number of single-person households has almost quadrupled, and the number of households where couples without children live has doubled (FSO). This has led to a disproportionate increase in demand for housing in relation to population growth. Most recently, the rise in interest rates in 2022 and 2023 has led to increased demand for rental apartments due to the resulting shift from the owner-occupier to the tenant-occupier market. While there are no signs of a significant trend reversal in terms of demographic factors, the shift in demand away from the owner-occupied market is likely to slow or even reverse. With the recent significant fall in mortgage interest rates, the financial advantage of renting over buying has fallen significantly again.

**Figure 4: High net immigration leads to high demand for housing**

Net migration in Switzerland (permanent population)



Source: State Secretariat for Migration, July 2024

\* 2024: Jan–Jul + extrapolation (dashed line)

### Slight increase in construction activity

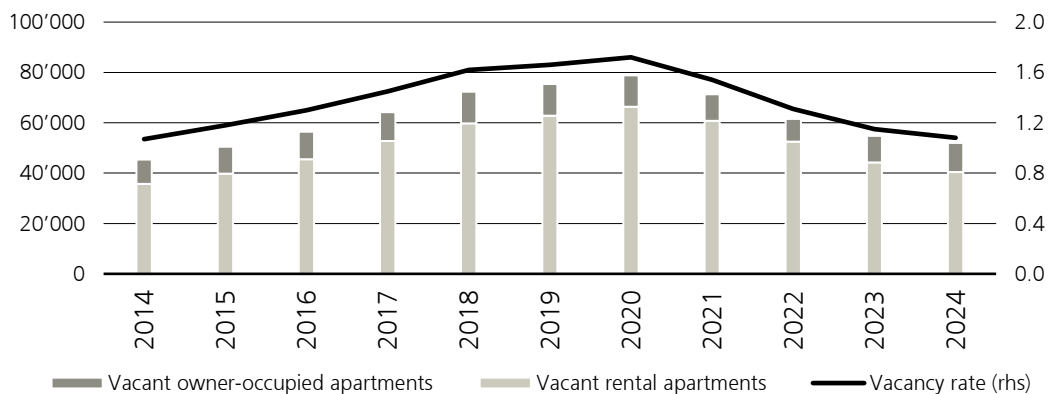
Despite the high growth in demand for housing in recent years, construction activity has fallen steadily. In the past 12 months, around 38,000 residential units were approved for construction. Although this represents a year-on-year increase, it is still at a low level by long-term comparison. There are many reasons for the low level of construction activity: construction prices have risen sharply since the outbreak of the coronavirus pandemic. Although price growth has recently calmed down considerably, the total cost of building a multifamily unit rose by 15.5% between April 2020 and April 2024, according to the FSO. This was reinforced by higher financing costs, which has also begun to ease. Nonetheless, it is likely to take some time before the easing of the situation translates into increased construction activity or even higher supply. This is particularly true as the low building land reserves and increasing urban density are often cited as crucial reasons for the low level of construction activity.

### Vacancy rate continues to fall

The combination of steadily rising demand and declining construction activity has led to a significant fall in the vacancy rate in Switzerland since 2020. From a peak of 1.7% in 2020, the average vacancy rate across Switzerland fell to 1.08% in 2024. The decline was once again driven by rental apartments, where the vacancy rate fell by 8.6% (3,800 apartments), while an additional 1,000 vacant owner-occupied housing units (+9.5%) were recorded.

**Figure 5: Vacancy rate continues to fall**

Vacant apartments (total) – lhs; as a % of stock – rhs



Source: Federal Statistical Office (data as of June 2024), September 2024

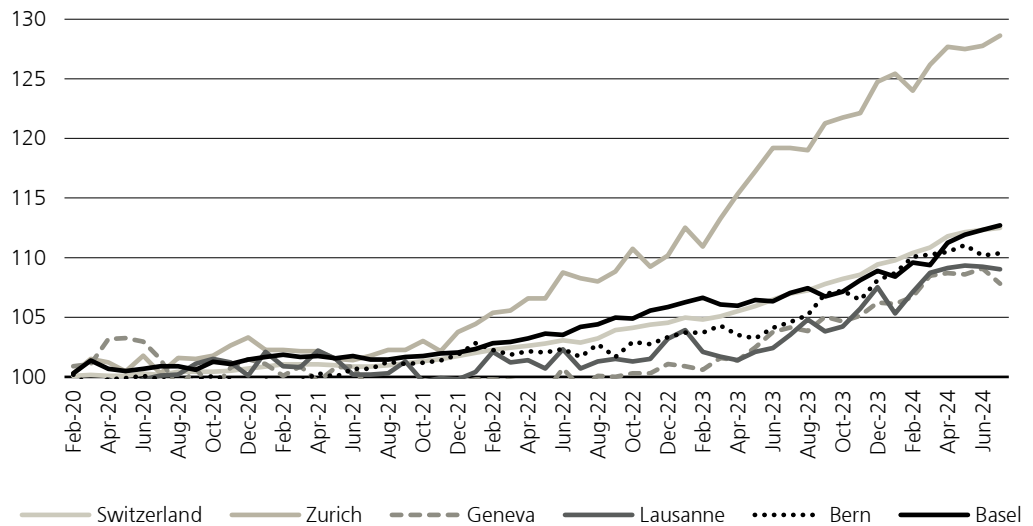


In city centers, vacant apartments are still much rarer than the national average. However, with the exception of Basel, the vacancy rate in the five major centers did not fall any further year-on-year. In the city of Basel, the vacancy rate fell from 1.06% to 0.77% in 2024. The four other major centers, where the vacancy rate has been below 1% for some time already, recorded stable vacancy rates: Zurich: 0.07% (2023: 0.06%), Bern: 0.44% (2023: 0.45%), Geneva: 0.54% (2023: 0.52%), Lausanne: 0.62% (2023: 0.61%).

**Asking rents continue to grow strongly**

The housing shortage continues to drive up rents: according to the Homegate Index, asking rents across Switzerland in July 2024 were 5.1% higher than in the previous year. Since the beginning of 2020, there has been an increase of 12.5% (see Figure 6). Rents have risen particularly sharply in the city of Zurich: in July 2024, rents were 7.9% higher than a year ago and 28.6% higher than at the beginning of 2020. The other German-speaking Swiss cities were around the national average, while growth in Geneva and Lausanne was slightly below average. Given the low level of construction activity, the strong rental growth is unlikely to change in the short term.

**Figure 6: Rental price growth in largest Swiss cities** (asking rents, indexed, Jan 2020 = 100)



Source: Swiss marketplace group/homegate, data as of July 2024

Last year, existing rents were raised (in addition to the increase in asking rents) in the rental apartment market due to two increases in the mortgage reference interest rate of 25 basis points in June and December 2023, respectively. The reference interest rate is based on the volume-weighted average interest rate of outstanding mortgages in Switzerland. Therefore, no further increase in the reference interest rate is expected due to the current fall in mortgage interest rates. However, due to the high proportion of fixed-rate mortgages, interest rates continue to rise for part of the total mortgage portfolio depending on the term and time of refinancing and despite interest rate cuts by the SNB.

**Population growth supports commercial markets – despite structural challenges**

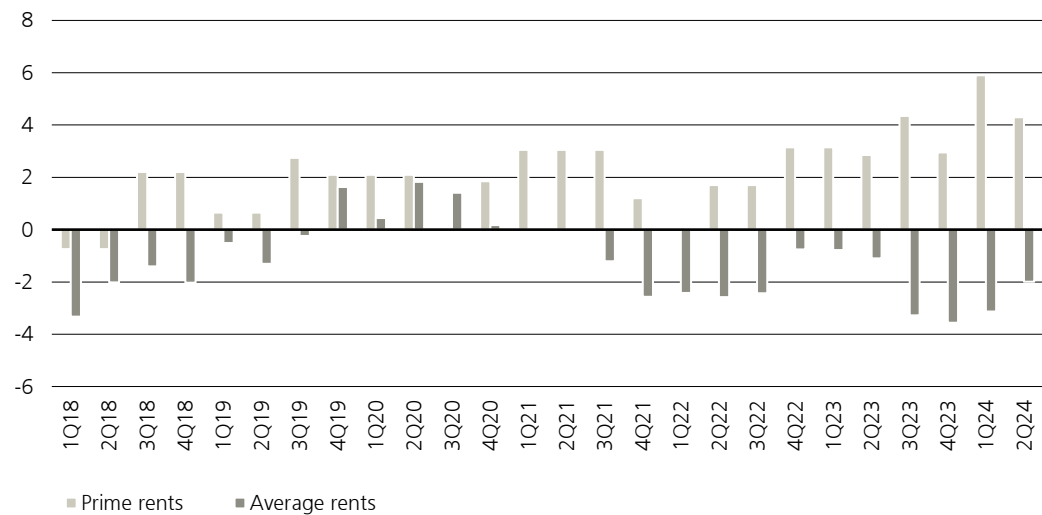
In addition to the turnaround in interest rates, commercial space was also affected by the ongoing uncertainty regarding future space requirements, particularly in light of hybrid working models and the growth of online shopping. Commercial segments in general are inherently more sensitive to the housing market. However, the commercial segments of the Swiss real estate market have been relatively robust, supported by strong population growth.

Employment growth is also having a stabilizing effect on the office market. At around 26,900 full-time equivalents, growth in the first half of 2024 did slow somewhat compared to the strong growth in 2023, but remained positive. According to CBRE, Swiss companies have an above-average office presence by international standards which has supported the overall stabilizing effect on the office market. As a result, the supply ratio in Swiss office locations also remains largely stable. In Zurich, the supply ratio has indeed risen by 0.2 percentage points to 5.1% compared to the end of 2023, but this can be explained by the high level of new construction activity in Zurich in recent years. In Geneva and Basel, the supply ratio has remained constant over the past six months.

What remains clear on the office market is the strong demand for office space in prime locations. While secondary assets are found in increasingly difficult positions in the wake of space consolidations, the rental market becomes increasingly polarized. This is reflected in the development of rents (see Figure 7): while prime rents rose by 4.3% year-on-year in the second quarter of 2024, average rents fell by 2%.

**Figure 7: Prime and average office rents are becoming increasingly divergent**

Rental price growth (% , year-on-year)



Source: JLL; Wüest Partner; UBS Asset Management, Real Estate & Private Markets (REPM), data as of 2Q24

In addition to the shift to online retail, brick-and-mortar retail has also come under pressure in the last two years due to poor consumer sentiment. A brief upswing after the end of the pandemic was followed by a renewed deterioration in consumer sentiment due to inflation-related real wage losses and geopolitical uncertainties. Compared to the low point at the end of 2023, it is true that the indicator has now risen from -49 points to -32. However, retail sales have so far shown little upturn: a month-on-month decline was recorded in four out of six months in the first half of 2024. As a result, the situation for retail properties is rather difficult: according to Wüest Partner, rents for retail space fell by 1.4% in the second quarter of 2024 year-on-year. By contrast, rents in prime locations, which are supported by the return of tourists among other things, have risen significantly year-on-year, particularly in Zurich.

# Return forecast

## Slight capital growth expected again in the residential segment

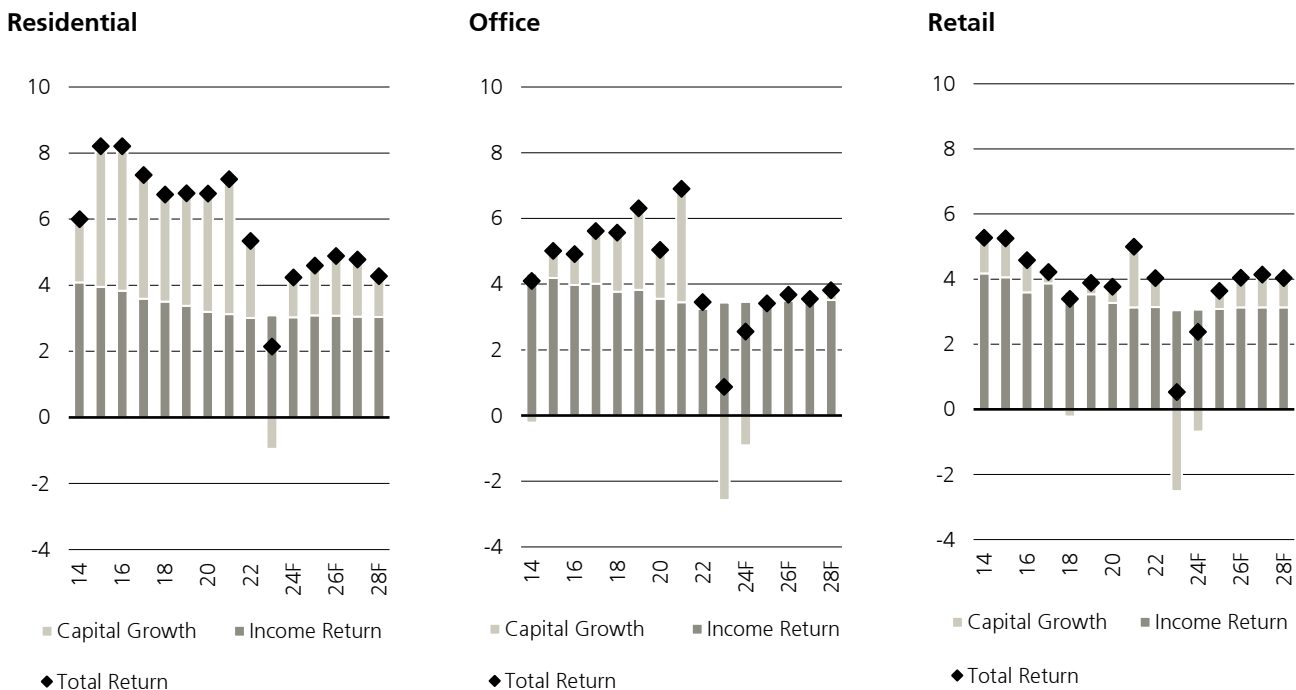
Global real estate markets have suffered significant value corrections in the wake of rapid interest rate hikes over the past two years. In Switzerland, the rise in interest rates has also led to corrections in the real estate market, although these have been very minor by international standards. Supported by strong fundamentals, Swiss residential real estate lost 0.9% in value in 2023, while office real estate lost 2.6% and retail space 2.5%.

Globally, there are now signs that real estate prices are stabilizing, and in Switzerland most of the corrections should be reflected in the books by the end of 2024. However, despite the turnaround in interest rates, value growth (as seen during the time of negative interest rates, which was associated with strong investment pressure), are unlikely in the current market environment. This also means that the income side is gaining in importance.

In the commercial real estate segment, which is experiencing less tailwinds from the user markets than the residential segment, slight corrections should be expected in 2024. However, at -0.9% in the office segment and -0.7% for retail space, these are likely to remain moderate and not jeopardize a positive total return (see Figure 8). For the Swiss residential market segment, we expect that the positive prospects for rent increases and the reference interest rate hikes that are taking effect will lead to capital growth of around 1.2%.

**Figure 8: Focus on income returns**

Income return, capital growth and total return of Swiss direct real estate investments (by segment, in %)



Source: MSCI; Wüest Partner; Oxford Economics; UBS Asset Management, Real Estate & Private Markets (REPM); last data point: 2023; forecasts as of August 2024. **Past/expected performance is no guarantee of future developments.**



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