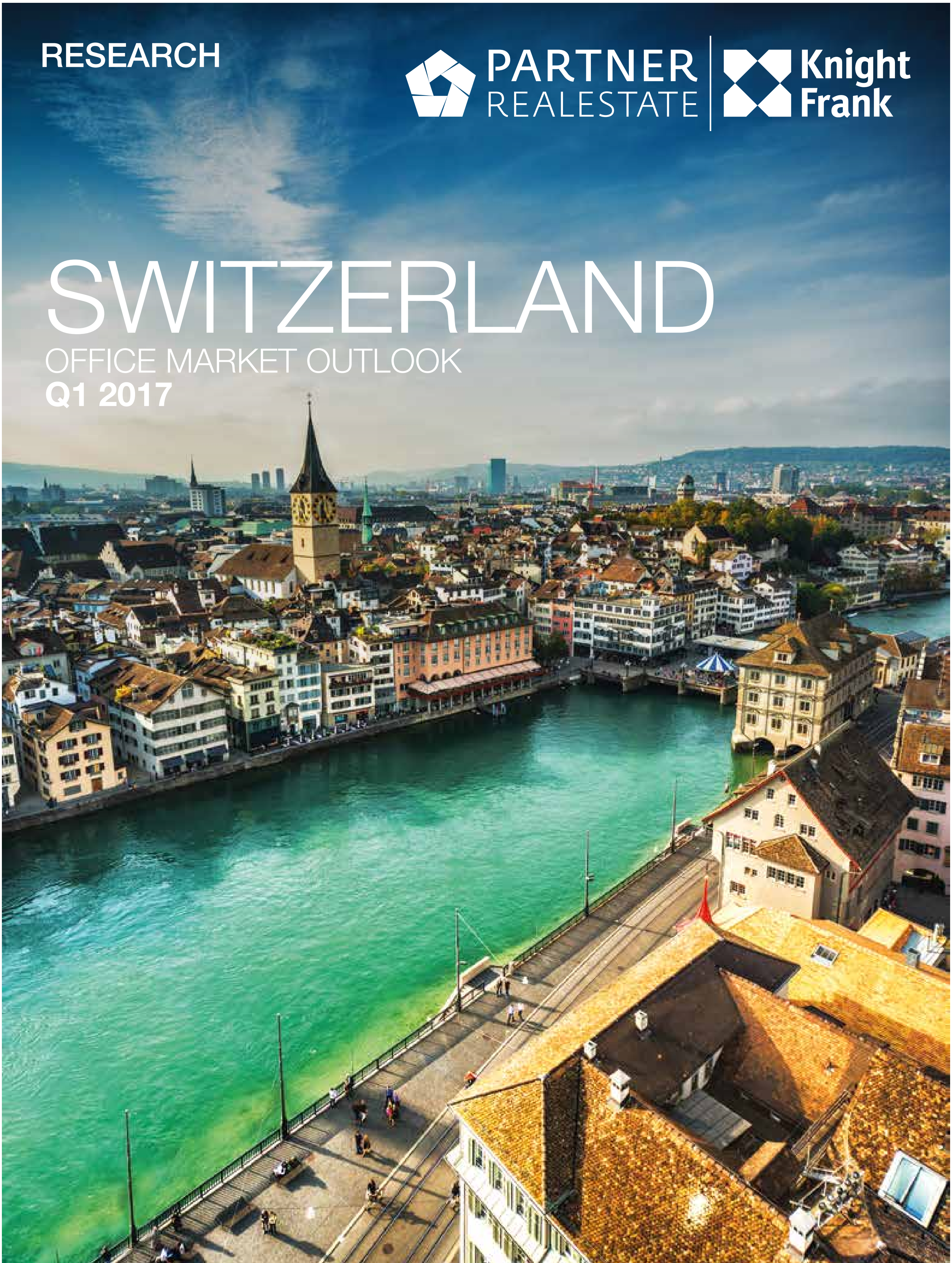
RESEARCH



SWITZERLAND

OFFICE MARKET OUTLOOK
Q1 2017

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

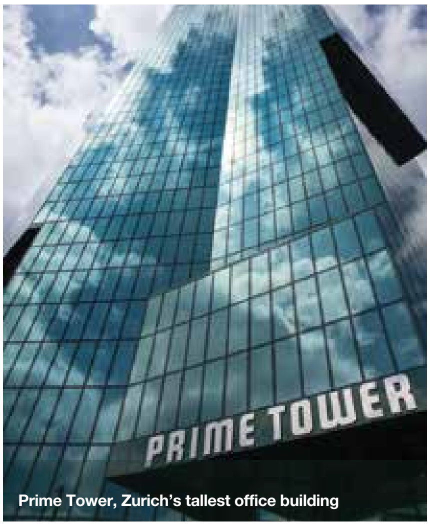
KEY FINDINGS

Occupier consolidation has featured prominently in both Geneva and Zürich with relocation and cost-optimisation strategies at work.

Geneva and Zürich are unlikely to see any rental growth due to relatively subdued occupier conditions and an increasing development pipeline.

Despite ongoing currency limitations, commercial investment in Switzerland reached approximately CHF3.9 billion in 2016, down 12% on 2015 but marginally above the long-term average.

Investor demand for Swiss core assets will remain unabated due to the ongoing dearth of decent investment alternatives, placing further downward pressure on record-low yields.



Prime Tower, Zurich's tallest office building

OCCUPIER MARKET

Occupiers have the upper hand as the occupational markets of Geneva and Zürich remain muted.

Switzerland's economic outlook remains positive even if the "Swiss franc shock" – the lifting of the exchange rate ceiling – may continue to weigh on the country's export sector. Diminishing employment opportunities are having a negative impact on net immigration. Unemployment has also risen marginally to 3.3%, and although very low by international standards, is poised to increase in the longer term. A return to a booming economy is therefore unlikely, although economic indicators do point to a lift in economic growth over the next two years.

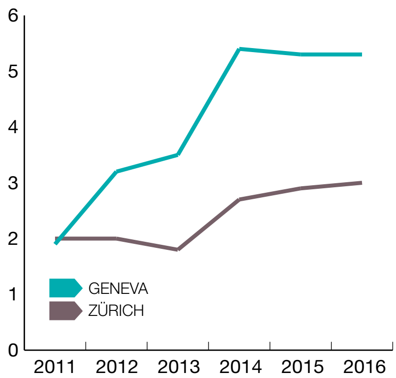
The macroeconomic environment resulted in relatively subdued occupational conditions in Geneva and Zürich throughout 2016. Occupiers were firmly in consolidation mode, and this was particularly evident in the finance sector where smaller leases accounted for a notable share of net absorption. As the market has continued to favour tenants, relocations have featured prominently and new conglomerates establishing operations in Zürich or Geneva have been scarce. Tenants will continue to have the upper hand in the market. This will place landlords under increased pressure to adapt to market conditions and provide occupiers with incentives and/or invest in capital works in existing secondary assets.

Over the last two years, office construction has stagnated and only limited new office supply has been delivered. Demand has also softened as occupiers have increasingly been diverting their attention from Geneva and Zürich to second-tier markets such as Bern and Basel, where lower rents and occupancy costs are more favourable. This has led to the city-wide vacancy rate in both Geneva and Zürich remaining stable at 5.3% and 3.0% respectively (Figure 1). Although low in a European context, the vacancy rate remains high when compared to previous lows witnessed before the financial crisis. More so, there is still a great deal of secondary stock availability in the city, which due to the clear flight to quality, has been challenging to lease.

The outlook for construction activity in 2017 is relatively muted, but from 2018 onwards, several new projects are scheduled for completion in Geneva and Zürich. Zürich's development pipeline is notably larger, with major developments planned in the Glattpark neighbourhood, and the area surrounding the Oerlikon railway station and Zürich Airport. While in Geneva, the Quarter de l'Etang is one of the largest projects scheduled for completion post-2020.

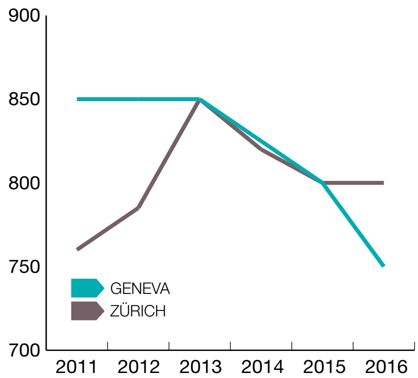
Prime office rents in Geneva and Zürich remain the highest of the major Swiss cities, at CHF750 per sq m per annum and CHF800 per sq m per annum respectively in Q4 2016 (Figure 2). Rents have remained relatively stable, and particularly due to increases in supply, are unlikely to witness any rental growth over the short term.

FIGURE 1
Vacancy rate
%



Source: Knight Frank Research / Partner Real Estate

FIGURE 2
Prime office rents
CHF per sq m per annum



Source: Knight Frank Research / Partner Real Estate

INVESTMENT MARKET

Over recent years, the Swiss market has been facing a dearth of investment stock, leading to intense competition among investors for core properties. As the occupational outlook points to weaker conditions, investors are becoming more selective about the office sector. The appetite for low-risk office buildings generating steady income streams has been relentless, evidenced by sharp yield compression. By contrast, investor interest for riskier assets has fallen considerably.

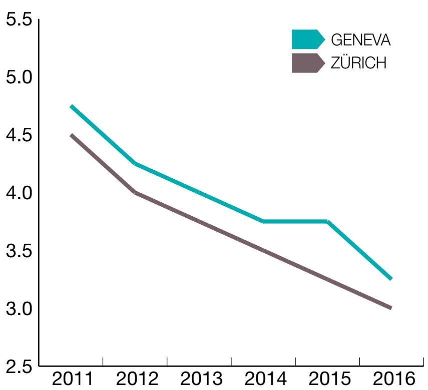
Property yields in Switzerland are below nearly all European cities. In Geneva, prime office yields maintained stability at 3.25% during 2016 and in Zürich fell by 25 basis points to 3.0% over the same period (Figure 3). As the monetary policy environment remains accommodative, investors continue to face investment pressure, placing downward pressure on prime office yields. But despite record low property yields, negative government bond yields continue to make commercial real estate an attractive value proposition.

Commercial investment volumes in 2016 reached CHF3.9 billion, reflecting a 12% decline from the previous year. Yet volumes marginally exceeded the long-term average (Figure 4). However, as the Swiss market is relatively opaque and many transactions do not get disclosed, it is difficult to assess the true performance of the market. The office sector has traditionally been dominant and last year accounted for 57% of the overall transaction volume.

Over the years, Swiss institutional investors in the insurance and pension sectors have been the primary protagonists in Switzerland's core market. The higher return requirements of publicly traded companies and Swiss real estate funds have made these investors less active in the market. Historically, cross-border investment has been low, although German fund Deka Immobilien made its first acquisition in Switzerland of the Utoschloss building last year.

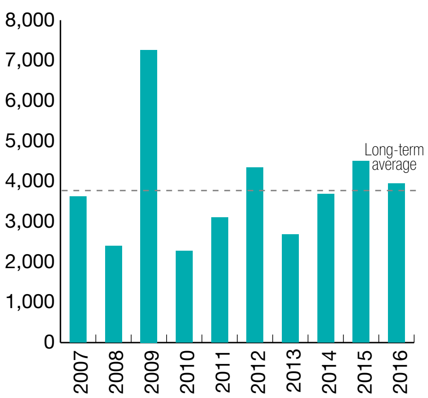
Investment prospects in the Swiss markets for 2017 are sound suggesting that the long-standing reputation for stability is highly regarded by investors who see uncertainty elsewhere in Europe. As Switzerland remains one of Europe's most expensive office markets, the investor profile is unlikely to change dramatically, although with increased political uncertainty across Europe, cross-border investors may expand their search further afield and look to Switzerland for investment opportunities.

FIGURE 3
Prime office yields
%



Source: Knight Frank Research / Partner Real Estate

FIGURE 4
Switzerland commercial* investment volumes
CHF million



Source: Knight Frank Research / Real Capital Analytics

*Office, retail, logistics and hotel

Key office investment transactions in 2016

City	Address	Seller	Buyer	Approximate price (CHF)
Zürich	Hardturmstrasse 101	Carbages AS	PSP Swiss Property	148.50
Geneva	Boulevard de Saint-Georges 16	Si Saint-Georges Center SA	Baloise Vie SA	141.25
Geneva	Rue de La Confederation 3	Credit Suisse	Swiss Life	93.00
Zürich	Thurgauerstrasse 130	Hochtief	Acron AG	N/A
Geneva	Avenue de Champel 8C	Unigestion Holding	Summit Champel 8 Sarl	60.90

Source: Knight Frank Research / Partner Real Estate / Real Capital Analytics

KNIGHT FRANK VIEW

Over the next few years, transport network expansion and the completion of the CEVA rail line and its accompanying projects will pave the way for new office sites. The area surrounding Lancy-Pont-Rouge train station may establish as the new sub-centre alongside the city's CBD, making it increasingly difficult to lease office space in non-CBD locations.

As Zürich's office market has expanded beyond its city boundaries, it has been exposed to the fierce competition between and within sub-centres, and this will intensify, ensuring that Zürich remains a tenant favourable market in 2017.

Interest rates and Swiss bond yields are set to remain in negative territory throughout 2017. Subsequently, Swiss investors are facing a number of challenges and will maintain their focus on commercial real estate and investor demand for real estate will continue unabated.

EUROPEAN RESEARCH

Matthew Colbourne, Associate
International Research
+44 20 7629 8171
matthew.colbourne@knightfrank.com

Vivienne Bolla, Senior Analyst
International Research
+44 20 7629 8171
vivienne.bolla@knightfrank.com

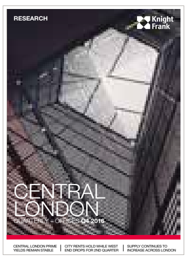
SWITZERLAND – PARTNER REAL ESTATE

Robert Curzon Price, Geneva
CEO & Partner
+41 22 322 2270
robert.curzon@prekf.ch

Abi Pranjes, Zürich
Partner
+41 44 266 6858
abi.pranjes@partnerrealestate.ch

Knight Frank acknowledges the assistance of Wüest & Partner with research for this report.

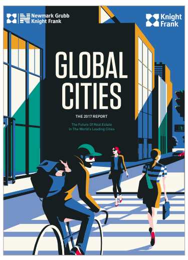
RECENT MARKET-LEADING RESEARCH PUBLICATIONS



Central London Quarterly Q4 2016

The London Report 2017

European Property Outlook 2017



Global Cities Report 2017

Knight Frank Research Reports are available at **KnightFrank.com/Research**