RESEARCH

PARTNER REALESTATE | Knight Frank

SWITZERLAND

OFFICE MARKET OUTLOOK

Q1 2018

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

KEY FINDINGS

Occupiers in Geneva and Zürich remain focused on undertaking cost-optimisation strategies.

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

Commercial investment in Switzerland reached approximately CHF3.9 billion in 2017, down 26% on 2016 but only marginally below the long-term average.

Investor demand for Swiss core assets will remain robust as prime office yields continue to offer an attractive yield spread over government bonds.

OCCUPIER MARKET

The occupational markets of Geneva and Zürich are set to remain tenants' markets.

Switzerland's economic outlook remains positive, with real economic growth expected to near 2% in 2017. According to the Swiss National Bank, the Swiss franc remains high but is no longer significantly overvalued. Unemployment at 3.0% is very low by international standards, and is poised to decline further in the longer term. Hence, all economic indicators point to a lift in economic growth over the next two years. Demand for office space is expected to increase in 2018 against this backdrop.

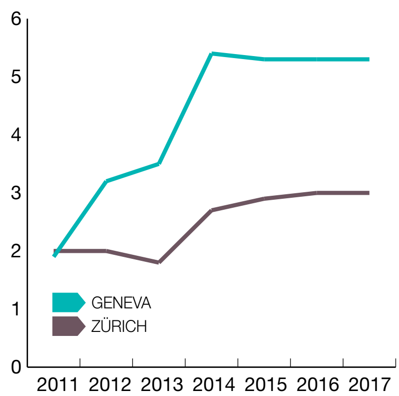
Occupational market fundamentals in Geneva and Zürich are improving. While office space consolidations continue to feature in the market, this has been occurring to a much lesser extent. Flexible work arrangements including co-working, desk sharing and working from home, have reduced tenant demands for large office premises. Instead, demand for smaller office space in the CBD has been dynamic.

The city-wide vacancy rate in both Geneva and Zürich has remained 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 both cities, which due to the clear flight to quality, has been challenging to lease. The office landscape is unlikely to change from a tenant's market over the next two years. Landlords have been under increased pressure to adapt to the market circumstances and provide occupiers with incentives and/or invest capital works in existing secondary assets.

Office construction has stagnated and only limited new office supply was delivered to Geneva and Zürich in 2017. Several new schemes and refurbishments are scheduled for completion during 2018 and 2019. Zürich's development pipeline is notably larger, with major developments planned in the Glattpark neighbourhood, and the area surrounding the Oerlikon train station and Zürich Airport.

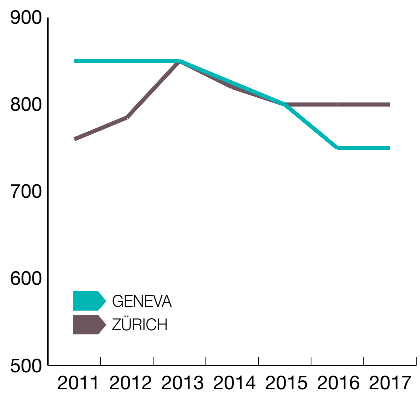
Prime office rents in Geneva and Zürich remain the highest of the major Swiss cities, at CHF750 per sq m per annum and CHF800 per sq m per annum respectively in Q4 2017 (Figure 2). Rents have remained relatively stable, and particularly due to increases in supply, are unlikely to witness any rental growth over the short term.

FIGURE 1
Vacancy rate
%



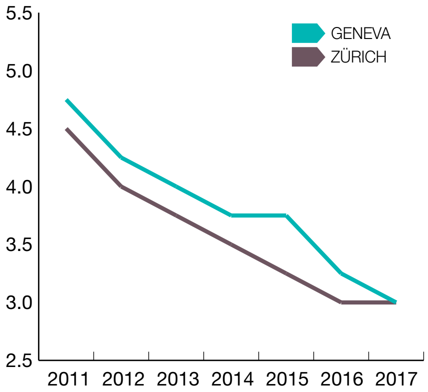
Source: Knight Frank Research / Partner Real Estate

FIGURE 2
Prime office rents
CHF per sq m per annum



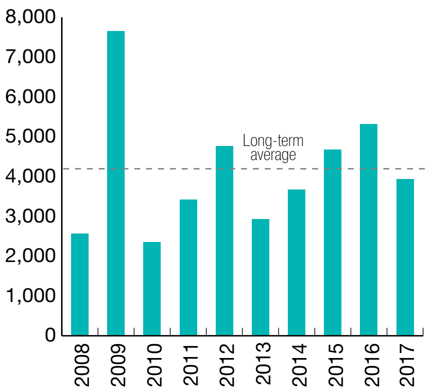
Source: Knight Frank Research / Partner Real Estate

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

INVESTMENT MARKET

The Swiss market continues to face a dearth of investment stock leading to intense competition among investors for core properties. The occupational market outlook has been causing many investors to become more selective about acquiring commercial real estate. The appetite for low-risk office buildings with high occupancy generating steady income streams has been strong. By contrast, investor interest for riskier assets has been less significant.

Property yields in Switzerland are below nearly all European cities. In Zürich, prime office yields maintained stability at 3.00% during 2017, and in Geneva, fell by 25 basis points to 3.00% during the same period, to be in line with Zürich (Figure 3). Despite record low property yields, low Swiss government bond yields continue to make commercial real estate an attractive value proposition.

Commercial investment volumes in 2017 reached CHF3.9 billion (Figure 4), reflecting a 26% decline from the previous year. Yet volumes were only marginally below the long-term average. The office sector has traditionally been dominant and last year accounted for 59% of the transaction volume.

Over the years, Swiss institutional investors in the insurance and pension sectors have been the primary purchasers of Switzerland's core assets. The higher return requirements of publicly traded companies and Swiss real estate funds have made these investors less active in the market. Foreign institutional investors continue to exhibit scant investment activity.

Key office investment transactions in 2017

City	Address	Seller	Buyer	Approximate price (CHF)
Geneva	Chemin du Château-Bloch 11 1219 Le Lignon	SUVA	Credit Suisse Funds AG	80,000,000
Geneva	Rue de la Corraterie 4 1204 Geneva	BNP Paribas (Suisse) SA	Bank J. Safra Sarasin AG	78,080,000
Geneva	Rue François-Diday 3 1204 Geneva	Private	AXA Assurances SA	57,500,000
Zürich	Apollo	Mobimo AG	Private	50,000,000
Zürich	Max-Högger-Strasse 6	Private	Helvetica Property Investors AG	29,000,000

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

Prime Tower, Zurich's tallest office tower

KNIGHT FRANK VIEW

Geneva's office landscape is undergoing transformation driven in part by investment capital and construction of the new CEVA rail line. Well-situated and emerging submarkets, such as the area surrounding the new Lancy-Pont Rouge train station, will make it increasingly difficult to lease office space in non-CBD locations. Incumbent office building sites and obsolete and older stock will also come under pressure. Zürich's office market, on the other hand, has expanded beyond its city boundaries. Continued development in the north from Oerlikon train station to Zürich Airport is further intensifying competition, making it tenants' markets.

Prime office yields continue to offer an attractive yield spread of around 300 basis points over government bonds. A spike in interest rates would put upward pressure on yields, although this is unlikely in the short term. Some investors have begun to exercise caution with their portfolio allocations but with the attractive value proposition, investors will continue to focus on real estate.

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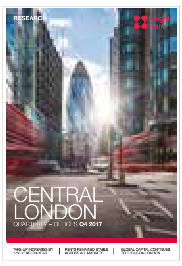

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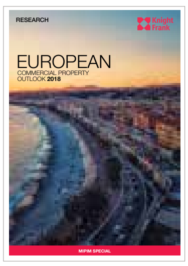

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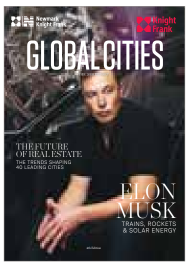

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