Switzerland's office market

A new report by Colliers International

At first glance, it would seem that the recession had little impact on the Swiss office market. The availability rate in 2010 remained unchanged at 4.3%. The average rental price persisted at the previous year's level of 234 francs per m^2 p.a. However, taken alone, these figures would be misleading. The aftermath of the recession is clearly palpable. Marketing office space is currently arduous. Nonetheless, there is a light at the end of the tunnel. The situation has eased slightly, and the market showed some signs of life at the end of 2010.

There have been significant developments in the market. Nearly all major tenants are pursuing office consolidation and optimisation projects. Generally, this means that several locations are being consolidated into one new office building, leaving office space empty, often in good locations. Medium and small firms are seizing the opportunity and filling these vacancies as they arise.

In 2010, the newly completed buildings increased the supply of office space: It rose nationwide by 43,000 m^2 to 1.64 million m^2. The combination of newly completed office properties and those that are planned or under construction means that a new generation of A-class properties is developing in the large and medium-sized markets. There is a high demand for these buildings. Not only do they support modern work processes optimally, but they also satisfy prestige requirements. Furthermore, because they are usually centrally located and well-connected to public transport, they satisfy the needs of the workforce.

Between 2011 and 2013, many new projects will be completed and occupied. On the demand side, the growth in jobs is expected to be stable but by no means above average. This will increase the market inventory and supply. Consequently, the pressure on rental prices and conditions will continue to rise, and incentives will be increasingly important. For owners, this means there will be greater marketing efforts and a need to invest in developing new sites. Older properties will need to be repositioned and alternative solutions sought for the many existing B- and C-class properties.

Positive outlook for Switzerland

In Switzerland, the expected growth of 1.4% is close to its potential. Therefore, unemployment will not increase. The national debt is less than half that of the surrounding countries and the same applies to the current budget deficits. In the coming years, unlike in the neighboring countries, companies and individuals in Switzerland will therefore be spared the additional costs of higher taxes and reduced infrastructure services. The resulting increase of attractiveness to foreign companies and employees will support the influx of new businesses to Switzerland.

During the 10 years up to 2008, the demand for office space grew by around 3% annually. Due to the financial crisis, this rate fell significantly, but it is now expected to rebound to typical levels in the coming years. The high and balanced growth of the real estate industry appears stable. The macro-economic environment for Swiss real estate remains favorable. However, potential rent increases will be limited, at least as far as commercial buildings are concerned.

In 2010, the more stable economic environment led to a modest recovery in the Swiss transactions market. Still, many investors failed to reach their target volumes. Despite the lack of attractive opportunities, parking capital is less and less of an option. So, rather than earning no capital returns at all, many investors are willing to pay higher prices and accept lower yields. Thus, the long-term liquidity surplus is starting to eat into portfolio performance.

Attractive investment performance

Compared to other investment classes, the performance of the Swiss real estate market was stable during the recession, attracting a lot of investor attention. Several foreign investors who withdrew during the financial crisis reappeared in 2010. Rather than trying to make a quick profit, investors are looking for long-term returns. The overall performance in terms of net cash-flow yield is still the decisive factor. Thus, interest in real estate investments has increased significantly.

The favorable conditions for financing are also having a positive effect on demand. Mortgage rates have reached historic lows. With the yields on government bonds and real estate investments diverging, the appeal of the latter has increased. In addition, property investments offer long-term protection against inflation.

Newly constructed or sustainably renovated buildings that are leased long-term to tenants with superior credit ratings are particularly sought after. Although prices for such objects are high and their rent and capital appreciation potential is modest, the actual cash-flow returns are attractive. The large market demand has caused declining yields, especially for commercial A- and B-class buildings. Top-class commercial properties are selling at net returns of 3.5%, while the average for A-class buildings is 4%.

The illiquidity of the investment market is prompting various institutions to increasingly seek value-added investments. This is done, e.g., through early investment in development projects or the acquisition of development sites. Other options are to optimise one's own portfolio through more effective rental and vacancy management and the exploitation of existing revenue potential through the conversion, renovation or development of suitable properties.

At present, the winners in the investment market are found among the owners and portfolio restructurers who are willing to sell. They are the beneficiaries of the investment pressure. Older properties in good locations with development potential are the most promising. Institutions that cling to traditional structures or investment rules will face a tough time going forward.

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