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Ongoing boost for investment property prices

Given the appealing growth of the Swiss economy and the permanent inflow of immigrants, housing demand is strong and therefore investment in apartment buildings remains attractive. Besides these positive fundamental factors, additional effects like negative interest rates on bank deposits, negative yields on confederation bonds as well as volatile stock markets boost prices for investment properties, resulting in decreasing initial yields.

Today, apartment buildings in urban areas are, whenever possible, converted into condominiums, since condominium prices exceed the capitalised earnings value of investment properties by 50 percent and more. If a big apartment building, not suitable for conversion into condominiums is sold, auctions result in exploding prices even for average properties: Basically, every crude sketch is sold at the price of a “Vincent van Gogh”.

Investors seeking higher yields resort to small and peripheral towns where initial yields are still appealing. Reasons for high yields in the periphery might also be historic, since investment properties were usually developed and owned by “local” capital (see figure 1). These players are used to historically low competition and therefore attractive yields. Especially in the big and mid-sized cities, risk-return analysis by investors with a global scope is much broader. That’s why prices increased first and strongest in the big cities where for over 15 years prices rose and rose because basically no one was really interested in peripheral investment properties. Given today’s low yields in the cities, capital seeks opportunities and resorts first to the outskirts of the big cities and to mid-size cities, then to small and peripheral towns and today even to bigger villages with a certain demand for rental apartments. This effect changes the structure of the property owners in the periphery from owners with a “local investment scope” to owners with a “global investment scope” thus granting yesterday’s owners attractive increases in the value of their properties (see figure 2).

Given a strong long term demand for rental apartments, rental incomes should at least remain stable in real terms. Since no strong positive change of the general situation is expected for the time being, shortage of investment opportunities and especially the negative or very low yields on many types of bonds will lead to high real estate prices. Overall, FPRE in its RESC baseline scenario, expects further increases in real estate values and given the situation in the EU, for the time being there is no trend reversal to be expected. Negative interest rates on bank deposits, negative yields on confederation bonds, shaky stock markets as well as regulations on asset allocation lead to high and stable demand on the real estate transaction market (see figure 3).

In view of the current market situation institutional investors, who usually buy properties of 15 million and above, are today also interested in smaller properties of 3 million and more. Traditionally this segment was generally bought by private investors. Initial yields will most likely decrease again in 2016 and 2017 in the

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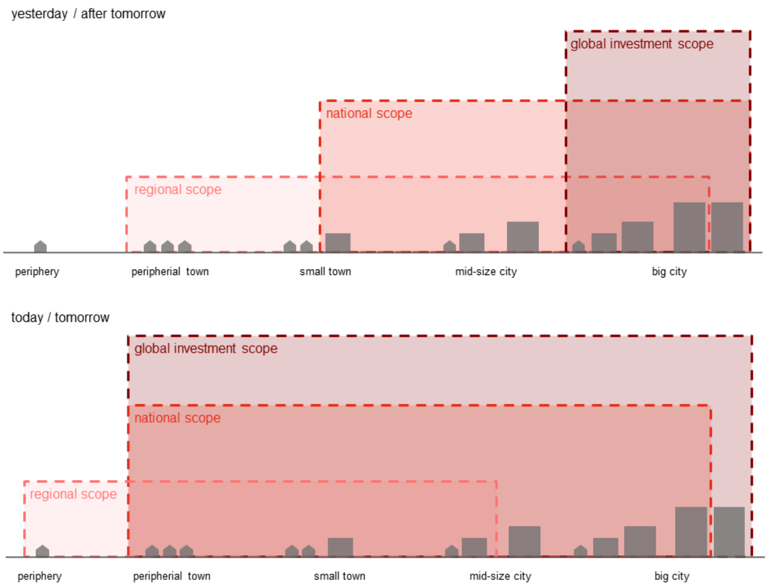
cities, where they are already extraordinarily low, as well as in the peripheral regions where investors buy higher risks at decreasing yields.

This results in a dilution of the existing portfolios; since there is some «air in the system» i.e. valuations do not exactly follow the market but might be up to 20 percent below the market. There is no choice. Hope springs eternal and whenever interest rates begin to rise again increasing existing rents should support the market values. In addition, interest rates are likely to be combined with economic growth and dynamic stock markets. Investors can hope that losses on real estate values will then be compensated by gains on other assets.

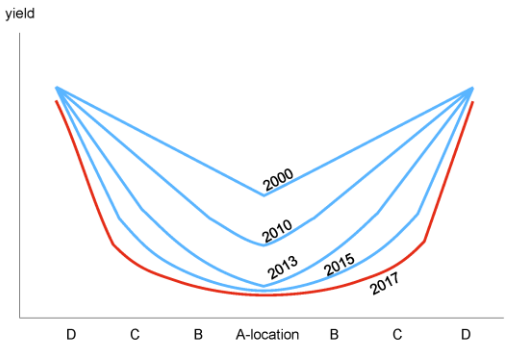
Stefan Fahrländer, FPRE

Abbildung 1: Spatial shift of demand for investment properties of players with different investment scope



Source: Immobilien-Almanach Schweiz 2016.

Abbildung 2: Yields of apartment investment properties by location 2000 - 2017



Source: Immobilien-Almanach Schweiz 2016.

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Abbildung 3: Situation and forecast for apartment investment properties

Apartment building - Switzerland

	Demand		Supply		Cash-flow		Initial yields		Market values	
	2015	2016	2015	2016	2015	2016	2015	2016	2016	2017
Old building	🟢	→	🟢	→	🟢	↗	🟢	↗	↗	↗
New construction average	🟢	→	🟡	→	🟢	→	🟢	↗	↗	↗
New construction upper	🟡	→	🟡	→	🟡	↘	🟢	→	→	→

Apartment building (new construction average) - regional

	Demand		Supply		Cash-flow		Initial yields		Market values	
	2015	2016	2015	2016	2015	2016	2015	2016	2016	2017
Lake Geneva	🟢	→	🟢	→	🟢	↗	🟢	↗	↗	↗
Jura	🟡	→	🟢	↘	🟡	↘	🟢	→	↗	→
Swiss plateau (Mittelland)	🟢	→	🟡	↘	🟢	↘	🟢	↗	↗	↗
Basel	🟢	→	🟡	→	🟢	→	🟢	↗	↗	↗
Zurich	🟢	→	🟢	↘	🟢	→	🟢	↗	↗	↗
Eastern Switzerland	🟢	→	🟢	→	🟢	→	🟢	↗	↗	↗
Alpine area	🟡	→	🟡	↘	🟡	→	🟢	↗	↗	→
Southern Switzerland	🟢	↘	🟢	↘	🟢	↘	🟢	↗	↗	→

All valuations are done from a owner/seller perspective. The circles describe the actual situation: green: unproblematic situation; yellow: some problems; red: problematic situation. Arrows describe the forecast for the following 12 months. ↗: expected improvement; →: stable; ↘: expected aggravation.

Source: Fahrländer Partner.