Swiss Real SnapShot!

In extra time

Current developments in the Swiss real estate investment market

Autumn 2017
Content

04  Macroeconomic Overview

06  Office Property Market

08  Retail Property Market

10  Residential Property Market

13  Direct Property Investments

15  Indirect Property Investments

16  New territory for provident institutions – the property share deal
Dear Sir or Madam

KPMG Swiss Real SnapShot!, published every 6 months, provides you with an overview of the current developments in the Swiss real estate market and its influencing factors.

The Swiss real estate market is a heterogeneous and strictly segmented structure. Thus, KPMG Swiss Real SnapShot! limits itself to global observation, without addressing regional deviations in detail.

KPMG Real Estate has both, Swiss specific and global expertise in the real estate markets. Our extensive data pools in local markets along with competent and in-depth consultation generate added value for our clients in all areas connected to real estate.

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We wish you a pleasant and informative reading.

With kind regards,

Ulrich Prien
Partner, Head of Real Estate Switzerland

Beat Seger
Partner, Real Estate M&A
In extra time

In the second half of 2017, the global economic cycle was on an upward path. Impetus from abroad has also led to growth in demand for Swiss products and services. The State Secretariat for Economic Affairs (SECO) expects GDP to grow by 0.9% in 2017.

During the first three quarters of 2017, there has been a positive trend in Swiss exports. In Q3 2017, exports rose by 2.5% (nominal) compared to the same quarter last year. Compared to Q3 2016, the strongest growth was in textiles, clothing and shoes, at 26.9%, and metals, at 12.1%. As in previous years, chemicals and pharmaceutical products accounted for the most significant share of Swiss exports, at 45% of total sales. Whilst the balance of trade lost some momentum in the third quarter when compared with the surplus of CHF 10.5 billion in the first quarter, at CHF 8.5 billion it still recorded a significant surplus. The consensus forecast reflects confidence that economic activity in Switzerland will continue to increase, and projects GDP growth of 1.8% for 2018.

Against this background of economic expansion, but also slower population growth, the situation on the Swiss labor market is easing. The unemployment rate is expected to fall to 3.2% in 2017 (2016: 3.5%). The federal economic experts forecasting group assumes that employment will grow by 0.3% this year and 0.8% in 2018. The unemployment rate could therefore fall further by 2018.

A slight upward movement in the Consumer Prices Index is expected, with an increase of 0.4% for 2017 as a whole. According to the Federal Statistics Office (BFS), the main reasons for this are increases in rents and higher prices for petroleum products.

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The International Monetary Fund’s economic growth forecast for industrialised countries, of 2.2% for 2017 and 2.0% for 2018, is slightly more positive than it was even in October 2016. From the mid-point of the year, the strong economic situation in the Eurozone has led to a partial correction of the Euro. The ECB doesn’t manage to reach its inflation target of just under 2% with its monetary policy. In spite of the economic growth, the EU’s quantitative easing will not be halted just yet. The ECB has extended the programme until September 2018, but from January 2018 the volume of monthly purchases is to be reduced from EUR 60 billion to EUR 30 billion. In the USA, the government is pushing for reductions in business taxes and wants to increase domestic infrastructure spending, which could lead to a new impetus in that sector. For these reasons, the IMF anticipates solid GDP growth of 2.2% for 2017 and 2.3% for 2018 in the USA. This autumn, the Fed confirmed its intention to continue with the cycle of gradual interest rate increases. Interest rates in the Eurozone and Switzerland are likely to follow this course over the medium term.

Global GDP growth

Due to the economic upturn in the major European immigration destinations, a continued fall in immigration figures can be expected in Switzerland over the short to medium term. In 2016, net immigration was lower than in the previous year for the third year in a row since 2013 when it reached its most recent high point. According to the State Secretariat for Migration (SEM), net immigration for the year to-date (January-September 2017) stands at 37,000. If immigration remains at this level for the remainder of the year, the net figure will have reached around 49,000 by the end of 2017, a reduction of 11,000 compared to 2016.

At the end of October, the Purchasing Managers’ Index closed at 62.0, its highest level since February 2011, and 7.4 points higher than at the end of January 2017. The robust industrial situation in particular means that the PMI now stands well above the growth threshold of 50 points. This trend can also be seen from the KOF economic barometer, which is above its long-term average, at 105.8. Therefore, the outlook for the Swiss economy is promising, and positive growth rates can be expected over the short to medium term.

Purchasing Managers’ Index, KOF economic barometer and EUR/CHF exchange rate
Office Property Market

Capital continues to flood into office developments. In the first half-year (H1) of 2017, the total volume of office buildings approved over the preceding twelve months exceeded its long-term average of CHF 2 billion. Figures from the Federal Statistics Office show that office employment fell by 0.5% over the same period. Demand has not grown as much as the projected increase in supply.

The main reasons for the stagnating office employment figures are the headcount reductions in the ICT sector (-1.4%) and the miscellaneous business services sector (-1.9%). At the start of 2017, the number of full time equivalent office jobs remained around 1.2 million.

Vacancy levels remain a challenge in the office market. In fact, in 2017 the vacancy rate increased indeed further only in Basel (+9.4%), and it fell in Zurich (-9.7%), Geneva (-12.9%) and Bern (-7.1%). However, with total office space supply of around 460,000 sq. m in these four cities, vacancy is still high in absolute terms.

In recent years, Switzerland as a business location has faced numerous challenges because of the exchange rate situation as well as political and regulatory developments. Whilst the Swiss Franc has recently weakened again following the abolition of the minimum Euro exchange rate in 2015, it is still seen as overvalued. Nonetheless, in 2016 around 265 businesses were set up in Switzerland as a result of the federal inward investment programme (2015: 264 businesses), resulting in 1,005 new jobs (2015: 1,082). Despite the political and economic uncertainties, the Conference of Directors of the Cantonal Economies is talking of a solid year. Despite some reductions in vacancy in the major cities, with demand remaining relatively unchanged, high vacancy rates must be expected in the office sector in 2018 across the whole of Switzerland.

According to the analyses in the Swiss Real Estate Sentiment Index (sresi®), there has been a reduction in political uncertainty in Switzerland. According to the cantonal promotion agencies, positive indicators can be detected mainly in the Basel economic region and Greater Zurich. The upturn has yet to reach western Switzerland.

The stable overall performance of the Swiss economy can be explained by the stable political situation (by international standards) and also by favourable infrastructure conditions and the high levels of education. One example of the successful arrival of a foreign company is Google. It already employs 2,000 people in Zurich and wishes to set up a further 3,000 jobs by 2021. The reason given by Google for its expansion in Zurich is a better environment compared to other European locations. Zurich offers the company a central location and ideal infrastructure, and the proximity to the Federal Institute of Technology (ETH) promises them networking with a highly qualified workforce. Tax considerations are likely to be important too. However, some American companies are hesitant about setting up
abroad, partly because of recent tax reforms and the domestic focus of US economic policy, which could lead them to rethink their strategic position.

Firms establishing themselves in Switzerland: breakdown by sector

- Financial services: 23%
- Trade and raw materials: 19%
- ICT: 23%
- Head office functions: 9%
- Light engineering; electrical and metalworking industry: 9%
- Life sciences: 6%
- Clean/green technology: 4%
- Other: 7%

Source: Conference of Directors of the Cantonal Economies and KPMG

The office market is being affected by an advancing structural transformation. As well as new workplace models such as co-working space, new demands will be placed on workspaces and workplace models as part of the continuing digitisation of the economy. In the analysis in KPMG’s 2017 Swiss Real Estate Sentiment Index, 58% of respondents expect a reduction in demand for office space as a result of technological developments. This also suggests that the pressure on premises in older buildings is likely to increase further, in favor of better-quality and more flexible space in new buildings. The market situation continues to favour tenants, making it possible for many tenants to negotiate better terms for their existing leases. Asking rents are increasingly reflecting this trend. In the first half-year of 2017, they fell by 1.1% in Zurich, whilst they stagnated in Bern (-0.4%), Geneva (-0.3%) and Basel (-0.2%).

Demand in the office market will continue to be largely characterised by this dynamic environment. The structural transformation means that there may be changes in the way people think about using office space. A greater weight might be attached to possible interim uses and vacancy management. The market remains open and expansive, and thus subject to a lot of competitive pressure. Generating added value through flexibility and the provision of services is increasingly becoming a factor for success.
Retail Property Market

The transformation in Swiss retailing also continues to forge ahead. In August 2017 alone, retail sales, seasonally adjusted and in real terms, decreased by 0.3% compared to July. Things currently look better on the consumer side. Since Q2 2017, consumer sentiment has risen by 5 points to -3 points. The index is therefore above its long-term average of -9 points. The anticipated recovery of the Swiss economy and the improved labor market situation are having a positive impact on consumer sentiment.

Retail sales and consumer sentiment index

![Chart showing retail sales and consumer sentiment index]

Source: GfK and KPMG

Whilst according to GfK retail sales fell again by 1.5% in 2016, online and mail order retailing again grew significantly last year by 8.3%. Faster growth has been seen only in 2012/2013 (9.7%), when it started from a lower base. This takes online and mail order retailing to a share of 6.9% of the overall Swiss retail market, with a volume of CHF 8.1 billion. As before, online retailing is experiencing growth primarily in the non-food sector. Where in the non-food sector online and mail order retailing made up 15.3% of total sales in 2016, the equivalent figure in the food sector was just 1.9%.

Overall B2C online and mail order market by product area

![Chart showing overall B2C online and mail order market by product area]

Source: GfK and KPMG

The major players in retailing are also ahead in Swiss online sales. In 2016, Migros again enjoyed the highest turnover, with sales of CHF 1.6 billion. The most significant share of these sales was generated by its subsidiary Digitec/Galaxus, at around CHF 700 million. The e-commerce sales of the Coop group (including Siroop) stand at around CHF 1.4 billion. Both companies again recorded growth in the 2016 reporting year (Coop: +5.2%, Migros: +1.2%), and there is potential for more.

In contrast to the falling sales elsewhere in bricks and mortar retailing, filling stations and convenience shops are increasingly enjoying a growth in popularity. These outlets are characterised by their central locations and ease of access. The trend towards a denser, more quickly accessible sales network with smaller store formats is continuing. GfK Switzerland estimates that turnover in small-format retailing reached CHF 5.25 billion in 2016 (+1% compared to 2015), across 1,794 filling stations and convenience shops nationwide.

In 2016, the food/near-food sector achieved marginal growth of 0.3%, whereas the non-food sector was faced with a drop in sales of 2.7%.

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2 Including CHF 1.3 billion of Swiss purchases from foreign retailers
The challenging retail environment is also reflected in the retail premises market. Existing anchor tenants are undergoing a strategic reorientation and withdrawing from some regional markets. This in turn is leading to less passing trade and lower sales for neighbouring retail premises. Apart from lower rental income, for property owners it also means higher tenant turnover and increased demands in terms of property management.

According to the cities’ statistics offices, retail vacancy rates rose in 2017 in all four of the principal centres. The most marked increase was recorded in Zurich, with a rise of around 7,000 sq. m to 10,000 sq. m. Moreover, according to the City of Zurich, this striking increase was attributable not to one large property but to various small to medium-sized properties across large parts of the city area. But vacancy has also increased significantly in Basel (+13%), Bern (+4%) and Geneva (+13%). The market for retail tenants is also putting pressure on asking rents and existing rents in relation to new lettings and lease extensions. Falling margins mean that increasingly, lease negotiations are also being started whilst existing leases are still running. In the first half-year of 2017, asking rents for retail space in the principal centres recorded another fall compared to the previous half year (Basel: -4.5%, Bern: -2.4%). In Zurich and Geneva, asking rents for advertised retail space are almost unchanged, at +0.1% and +1.0% respectively.

Since the shock caused by the rise in the Franc, consumer sentiment seems to be recovering because of the improving labor market. It remains to be seen how far retail sales will benefit from the anticipated economic upturn. Competitor pressure remains strong in retailing in any case, and it is reflected in the pressure on margins to which many sellers in bricks and mortar retailing are subject. The increased product transparency means that selling goods on the sales floor contributes less to premises costs. Sellers are therefore increasingly pursuing hybrid marketing strategies. This gives rise to increased flexibility in demand for space and, overall, to a reduction in space requirements. Property owners must come to terms with these far-reaching structural changes and make the space on offer more dynamic.
Residential Property Market

In the current low interest rate environment, real estate investment is largely focused on the residential sector. However, in various regions the continuing development of new properties is now exceeding demand, resulting in increased vacancy rates. As at 1st June 2017, the empty dwellings rate across Switzerland rose for the sixth time in a row, to 1.47%. This means that around 65,000 homes are vacant, representing an increase of 15% year-on-year (8,400 homes). The greatest increase is seen in relation to rental homes. Over the last four years, the number of empty rental homes has grown by an average of 14.3%. The average rise in the number of empty homes for sale stood at 6.5%. Vacancies have been rising first and foremost in the rental sector.

After reaching a high point in 2016, with planning consents for 29,000 rental homes, the number of planning consents for the twelve months ending in Q3 2017 has dropped to 26,600 homes. However, over the same period, the number of planning applications submitted for rental homes was 31,400, above the 2016 level. This means that availability, and therefore also vacancy rates, are not expected to reduce over the short term. Moreover, net immigration has been falling consistently since 2014 (see: net migration p. 5). In recent years, immigration has been an important prop underpinning housing demand. Around half of the total growth in the number of households in 2016 was made up of foreign households. From January to September 2017, net immigration stood at 37,000. For the same period in 2016, the net migration figure published by SEM was 44,000. Therefore, year-on-year the figure has fallen by 17%.

Since the start of 2017, rents in Switzerland have been on a downward trend. Across Switzerland as a whole, the homegate.ch rental index fell by 0.3% (October 2016–October 2017). In Zurich, the index remained steady at +0.2% (August 2016–August 2017). Conversely, after a downward phase from November 2015 to April 2017, quality-adjusted asking rents in the Cantons Geneva and Vaud are now rising again. In October, the index climbed by 2.0% (October 2016–October 2017). Elsewhere, asking rents recorded a slight increase only in Lucerne, of +0.1% (October 2016–October 2017). The most marked fall in rents was in Canton Ticino, where they dropped by 2.0% compared to 2016 (October 2016–October 2017). Falling immigration and continuing housing construction have together resulted in a loosening of the rental market across Switzerland.

Quality-adjusted asking rents

(source: homegate.ch und KPMG)
In June 2017, the reference mortgage interest rate was reduced to 1.5%. A reduction of 0.25 percentage points in the reference interest rate entitles tenants to a 2.91% reduction in rent. However, according to the Federal Housing Office only around 20% to 25% of households are requesting a reduced rent. Financial market analysts assume that initially mortgage interest rates will remain low, even if they rise slightly, over the short to medium term. According to SNB data, in July 2017 the average interest rate for fixed-interest mortgages with terms between seven and ten years reached its highest level for the year so far, of 1.38%.

Changes in reference interest rate

SNB target range (right axis)
Mortgages 10-year fixed rate (left axis)
Mortgage reference interest rate (left axis)
Yield on 10-year federal bonds (right axis)
3-month Libor (right axis)

Source: SNB and KPMG
Midway through 2017, it was announced that Libor (the London Interbank Offered Rate) will be phased out in 2021. Not only does the SNB use Libor to set its target range for its monetary reference interest rate, Libor also determines the interest rate for financial products such as mortgages. The SNB is promoting SARON (Swiss Average Rate Overnight), which is based on actual market transactions and prices, as a possible successor to Libor as a benchmark for secured loans. With SARON, counterparty and liquidity risks are negligible. Moreover, SARON is based on data from the secured money markets and, according to the SNB, is less volatile in times of turbulence. It is not yet clear what effect a possible switch to SARON will have on the calculation of the reference interest rate for leases. However, while the practice of using bands to set the reference interest rate is retained, SARON’s lower volatility should be reflected in the reference interest rate.

Factors such as changes in the reference interest rate or low-cost new-build housing could lead to rents for existing leases stagnating or even falling. In terms of asking rents, the downward trend will persist because of the continuing expansion of supply and net immigration. Thus, prospects both for rents under existing leases and for asking rents are generally negative. It can be assumed that the dynamics of the market will lead to a closing of the gap between the two indices.

The saturation of parts of the residential property market is intensifying. Developers and investors need to take care. At present, there are absorption risks only in peripheral areas. A continued high level of construction activity and changes in migration may mean that rents in the conurbations of the principal centres also come under pressure.
Direct Property Investments

In recent years, developments in the Swiss property market have been determined largely by the low interest rate environment. Low yields on the capital markets have led many investors to look to property as an alternative to fixed-interest investments. Other alternative investments such as private equity, hedge funds or even commodities have a less favorable risk-reward profile and a different allocation profile for long term investors, such as provident institutions.

As well as quoted funds, the largest property investors also include provident institutions. Over 23% of the invested assets of Swiss pension funds is held in property investments (direct: 10%; indirect: 13%). Most pension funds limit their activities to the domestic market. At 0.3% of total invested assets, direct investments in foreign property are comparatively rare. An evaluation of pension fund book values forming part of the 2017 KPMG Real Estate Pension Fund Benchmark reveals an average gross yield of 5.4% across all properties in the pool of properties under review.

Weighted average net yields achieved by provident institutions by segment and location

<table>
<thead>
<tr>
<th></th>
<th>Residential</th>
<th>Mixed/commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>3.6%</td>
<td>4.1%</td>
</tr>
<tr>
<td>2014</td>
<td>4.1%</td>
<td>4.6%</td>
</tr>
<tr>
<td>2015</td>
<td>4.6%</td>
<td>5.1%</td>
</tr>
<tr>
<td>2016</td>
<td>5.1%</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

Source: KPMG

The strong demand for property as an asset class is reflected in rising transaction prices and thereby in falling initial yields in certain segments. Between 2016 and 2017, the median net initial yield fell from 4.0% to 3.1% for residential properties and from 4.5% to 3.4% for mixed/commercial properties. There was less of a reduction in the case of office premises, where net initial yields fell from 4.6% to 4.5% over the same period.

Initial yields by use category

<table>
<thead>
<tr>
<th></th>
<th>30th percentile</th>
<th>Median</th>
<th>70th percentile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Gross yields</td>
<td>4.1%</td>
<td>4.6%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Residential Net yields</td>
<td>3.6%</td>
<td>4.1%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Office Gross yields</td>
<td>3.9%</td>
<td>4.4%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Office Net yields</td>
<td>3.4%</td>
<td>3.9%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Mixed use Gross yields</td>
<td>4.8%</td>
<td>5.3%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Mixed use Net yields</td>
<td>4.3%</td>
<td>4.8%</td>
<td>5.3%</td>
</tr>
</tbody>
</table>

Source: REIDA, SIV and KPMG

Because of the present macroeconomic situation, direct property investments remain attractive. In view of the low yields on fixed-interest loans, property investments are still generating an attractive yield differential compared to bonds, despite the drop in net yields. However, the rise in vacancy (residential vacancy rate +15% between 2016 and 2017), combined with falling gross yields, point to an increase in risk in this asset class.
The overview is limited to the data source of Real Capital Analytics (RCA). The data from RCA provides a good indicator of the most important transactions on the property investment market but it does not claim to be complete.

### Selected Property Transactions January to October 2017

**Les Roches Campus**
- **Type**: Office
- **Price**: CHF 149m
- **Purchaser**: n/a
- **Seller**: Colony Capital

**Kanton Bern Apt.**
- **Type**: Residential
- **Price**: CHF 61m
- **Purchaser**: Swiss Estates
- **Seller**: n/a

**Walzwerk**
- **Type**: Industry
- **Price**: CHF 54m
- **Purchaser**: SFP
- **Seller**: Sefer Found.

**Apollo**
- **Type**: Office
- **Price**: CHF 50m
- **Purchaser**: n/a
- **Seller**: Mobimo AG

**Park Hotel Weggis**
- **Type**: Hotel
- **Price**: CHF 45m
- **Purchaser**: Dogus Holding
- **Seller**: Martin Denz

**Grütpark**
- **Type**: Retail
- **Price**: CHF 41m
- **Purchaser**: SF Ret. Fund.
- **Seller**: CSA RE Switz.

Sources: RCA and KPMG
Indirect Property Investments

In the middle of 2017, prices for quoted property vehicles reached a record high. At the end of the third quarter, the total return on property funds and property company shares had fallen by around 5 index points (base index: 2016) compared to their highs in July and August 2017. As well as expectations in relation to future interest rate trends, a possible reason for the negative movement in prices is also a revised assessment of risk by market players due to trends in the direct property investment market. However, because of the persistent low interest rate environment, indirect property investments remain attractive to investors even after the correction in the second half of the year.

Even after the price correction which started in August 2017, property funds remain highly valued, with an average premium of 26% as at the end of October. La Foncière and Streetbox Real Estate trade at the highest premiums, of 49% in each case. Nonetheless, at the start of August 2017, the average property fund premium still stood at 37%. It will soon become clear whether the reduction in premiums is due to a market correction or whether it is the start of a new trend.

There is a strong variation in the premiums over the net asset values of the major Swiss property companies. While PSP traded at a premium of 3% as at 1st November 2017, for Intershop the figure at the same date stood at 64%. At the other extreme, Plazza is trading at a discount of 11%.

The current year shows that there is still strong demand for indirect property investments. Their great popularity with investors is reflected in the high levels of capital flowing into the property investment vehicles. By the end of October 2017, they had achieved a cumulative capital inflow of CHF 3.3 billion, an increase of 31% compared to the same period of the previous year (CHF 2.5 billion). A comparatively high level of issues by property funds was seen, with a total volume of CHF 1.8 billion. Property companies were also very active, with issues of around CHF 1.5 billion.

Their ability to attract capital shows that investors still see indirect property investments as a viable alternative to investing in the bond market. As at the end of October, Swiss property funds had recorded a performance of about 3%. 10-year Federal bonds continue to fluctuate between -0.2% and 0%. However, the first indicators of possible changes in headline rates abroad had already affected the performance of property company shares and property funds. Therefore, the future attractiveness of indirect property investments must be viewed with an eye on changes in interest rates.

Performance of listed property investments

Source: SWX, SNB and KPMG
New territory for provident institutions – the property share deal

Property investments, even by private investors, are often structured by way of property companies. A sale of shares in a property company has many advantages for the seller (including in terms of tax).

It is not surprising that, in a seller’s market with attractive income-generating properties, provident institutions find themselves considering whether they want to or can acquire a property indirectly by way of a share deal (i.e. by purchasing shares in a property company). If there are several potential purchasers, being prepared to conclude a share deal can be a decisive advantage for the purchasing party.

Share deal: tax considerations

From a tax perspective, it does not take long to analyse the purchase of a property (sale of a property) by way of an asset deal. Apart from identifying the allowable acquisition costs and the value added tax considerations, generally there are no particular issues. In the case of a share deal, the tax questions are more complex. In the case of a company, its tax history and therefore any possible tax risks must also be taken on, and also the transaction itself and a later transfer of the property into direct ownership can trigger unexpected tax consequences.

Due Diligence

Tax risks need to be analysed as part of the due diligence exercise ahead of the purchase of the company. Any risks uncovered will affect the purchase price and appropriate provision for them must also be made in the warranties and guarantees in the purchase contract.

Transaction-related tax issues

When shares in a property company are sold, the tax consequences of the change in beneficial ownership vary between cantons. A comparison of the Cantons Geneva (GE), Grisons (GR), Lucerne (LU), Vaud (VD) and Zurich (ZH) shows how much practice can differ:

<table>
<thead>
<tr>
<th>Required shareholding</th>
<th>Property gains tax? Seller: natural person</th>
<th>Property gains tax? Seller: legal person</th>
<th>Step up acquisition costs</th>
<th>Property transfer tax?</th>
</tr>
</thead>
<tbody>
<tr>
<td>GE &lt;50%</td>
<td>Yes</td>
<td>No *)</td>
<td>No</td>
<td>No ****)</td>
</tr>
<tr>
<td>GR &gt;50%</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>LU &gt;50%</td>
<td>Yes</td>
<td>Yes</td>
<td>No **)</td>
<td>Yes</td>
</tr>
<tr>
<td>VD 2 or more shares</td>
<td>Yes</td>
<td>Yes</td>
<td>Property gains tax (***))</td>
<td>No</td>
</tr>
<tr>
<td>ZH &gt;50%</td>
<td>Yes</td>
<td>Yes</td>
<td>Property gains tax</td>
<td>None</td>
</tr>
</tbody>
</table>

*) Subject to retention period
**) Check whether property gains tax can be offset against tax on profits
*** Only in the event of a future sale by way of a share deal
****) Unless a purchase contract is notarised

Source: KPMG

The purchaser needs to be aware of these different tax consequences, in order to be able to evaluate the case for the investment precisely and to have the best possible arguments for the negotiations with the purchaser.

Foreign sellers

If the seller is resident or registered abroad, e.g. a holding company in Luxembourg, the range of tax issues requiring analysis widens further. Whilst the due diligence will centre on a review of the substance of the foreign seller’s business, property gains tax and withholding tax considerations need to be investigated in relation to the transaction (share deal).

Property gains tax

If the foreign seller’s business is sufficiently substantial, a tax benefit may arise in Switzerland as a result, depending on the country. Certain double tax treaties (e.g. with Austria, Germany and Luxembourg) provide that gains from the sale of shares in a Swiss property company are taxable only in the seller’s country of domicile. Therefore, the property gains tax triggered in Switzerland by the change in beneficial ownership cannot be levied. However, depending on the canton, in such cases acquisition costs (so-called step-up costs) can be allowed, so that – even though no property gains tax is levied on the transaction – the profit resulting from the increase in value is never taxed. Accordingly, the purchaser no longer needs to consider deferred taxes on this portion; this will have a positive effect on the investment case.
Withholding tax

However, a foreign seller can also present potential withholding tax risks for the purchaser. Firstly, there is the well-known issue of existing reserves. If there are so-called “distributable reserves not required for business operations” when the property company is sold, they will remain subject to the old withholding tax rate under the new owner.

Example: until now, dividends from a Swiss property company to its French shareholder have been subject to 15% withholding tax. If the new owner, a Swiss investment fund, distributes a dividend to itself from funds which are not required for business operations, it will still be subject to 15% withholding tax.

Another special issue to consider is that of “vicarious liquidation”, a tax evasion measure under which the Federal tax authorities consider not only the tax treatment of the disclosed reserves (existing reserves) but also the hidden reserves. Put simply, and as an example, it is assumed that an investment fund which purchases a property company and later transfers the properties into its direct ownership is liquidating the company on behalf of the seller, in order to avoid withholding tax which would be payable by the seller. The Federal Court has already on several occasions defined the conditions in which there is tax evasion. However, in a seller’s market it can be difficult to identify, particularly when a share deal amounts to an unusual legal structure.

Transfer into direct ownership

When properties are transferred into the direct ownership of a provident institution, there are further tax issues to be considered. Whilst a merger between a company and a fund is not possible under the Mergers Act, depending on the canton, a “false merger” is acceptable for tax purposes. Here, all assets and liabilities are transferred to the provident institution and the company is liquidated soon afterwards. Whilst in principle the tax on profits will be accounted for (realisation as provided for under the tax system), normally the transfer will be tax-neutral in terms of property gains and transfer tax (with exceptions in certain cantons).

Conclusion

A property share deal is a more complex transaction for the purchaser, but as well as holding risks, it holds opportunities. Viewed holistically, it can be more financially advantageous than an asset deal.

Just being prepared in principle to enter into a share deal can be sufficient to allow the interested provident institution to make it to the seller’s negotiating table. Compared to an asset deal, the necessary investigations and the subsequent restructuring are more complex. In the case of foreign sellers in particular, tax headaches may arise. However, because these issues can be solved in principle, viewed holistically, the case for the investment can nonetheless be worthwhile.

Table of abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAK Basel</td>
<td>BAK Basel Economics AG</td>
</tr>
<tr>
<td>BFS</td>
<td>Federal Statistical Office</td>
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<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>GfK</td>
<td>Institute for Consumer Research, Market Research Institute of Switzerland</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and Communications Technology</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IPO</td>
<td>Initial Public Offering</td>
</tr>
<tr>
<td>KOF</td>
<td>The Swiss economic research institute of the Federal Institute of Technology</td>
</tr>
<tr>
<td>Libor</td>
<td>London Interbank Offered Rate</td>
</tr>
<tr>
<td>MSCI</td>
<td>Morgan Stanley Capital International</td>
</tr>
<tr>
<td>PMI</td>
<td>Purchasing Managers’ Index</td>
</tr>
<tr>
<td>REIDA</td>
<td>Real Estate Data Association</td>
</tr>
<tr>
<td>SARON</td>
<td>Swiss Average Rate Overnight</td>
</tr>
<tr>
<td>Seco</td>
<td>State Secretariat for Economic Affairs</td>
</tr>
<tr>
<td>SEM</td>
<td>State Secretariat for Migration</td>
</tr>
<tr>
<td>SIV</td>
<td>Swiss Association of Real Estate Appraisers</td>
</tr>
<tr>
<td>SNB</td>
<td>Swiss National Bank</td>
</tr>
<tr>
<td>SWX</td>
<td>SWX Swiss Exchange</td>
</tr>
<tr>
<td>WP</td>
<td>Wüest Partner AG</td>
</tr>
</tbody>
</table>
All-encompassing Real Estate Advisory from one Source

M&A/Capital Market
• Structuring and execution of transactions (Lead Advisory)
  – Asset deals: Acquisition and disposal of properties and portfolios
  – Share deals: Mergers, spin-offs, IPOs, private placements
• Arrangement of indirect investments, such as funds or trusts
• Fund raising for specific projects
• Debt & Capital Market Advisory

Investment Advisory
• Investment advisory for national or international indirect real estate investments
• Structuring of real estate investments within portfolios
• Qualitative and quantitative analysis of investment products
• Monitoring and investment controlling, portfolio performance measurement

Strategy/Organization
• Strategy development and implementation
  – Business planning/business modelling
  – Corporate/public real estate management
  – Asset and portfolio management
• Analysis of organization and processes; organizational development, internal control system
• Performance management/MIS/investment monitoring
• Risk management and financial modelling
• Turnaround and financial restructuring
• Support in digital transformation

Valuation/Due Diligence
• DCF-valuations of properties and real estate portfolios or companies
• Independent valuation reports for financial statements
• Valuations for acquisitions or disposals
• Feasibility studies and valuation of real estate developments
• Transaction-focused due diligence and process management
• Major Project Advisory

We are also pleased to answer your tax-related, legal and regulatory questions regarding real estate and we support you in process and cost optimization as well as solutions for your technological infrastructure.
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Editorial deadline
9th November 2017
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