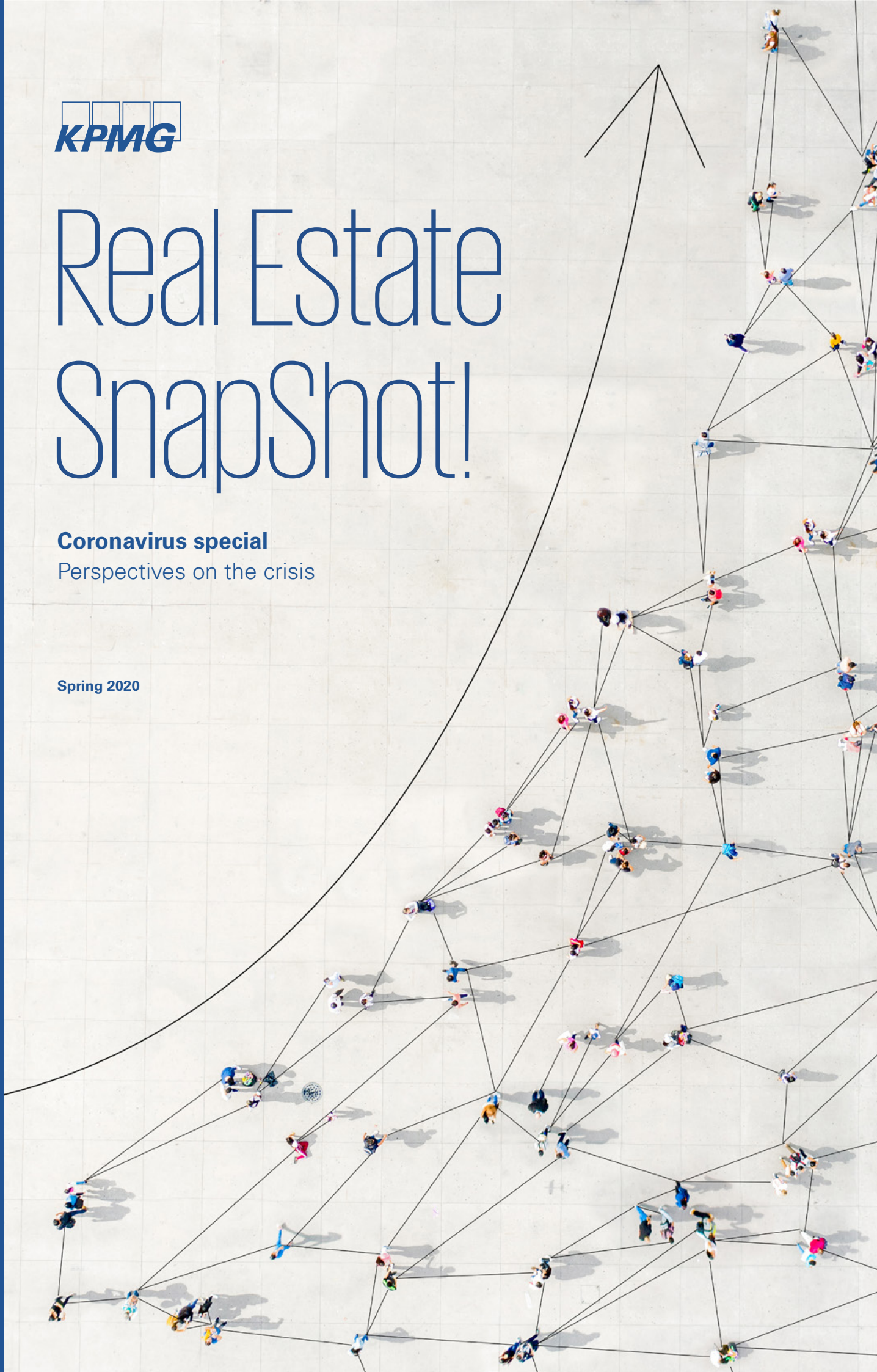
KPMG

Real Estate SnapShot!

Coronavirus special

Perspectives on the crisis

Spring 2020



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Dear reader

Coronavirus has changed our world. Around the globe, decisions have had to be made in extraordinary circumstances based on sparse evidence. Most governments responded to the pandemic by imposing drastic restrictions on public life. At this point, we can only begin to estimate the economic consequences of these measures – but it is certain that they will affect us for some time to come.

It remains to be seen how we will emerge from the recession. Besides stability, Switzerland has so far shown resilience, i.e. by taking swift and focused action based on political consensus and a highly connected society. So we look to the future with confidence.

All decisions put health first, prioritizing people and our lives together. That's why we've decided in this special edition of SnapShot! to share personal experiences and perspectives on the crisis. We spoke to KPMG specialists and industry insiders about the situation. The interviews were conducted in mid-May 2020 and reflect the information available at that time.

Changes to the overall framework conditions cannot be ruled out – as has been the case since the beginning of this pandemic.

We hope you enjoy reading our publication. Stay healthy!

YOURS SINCERELY

Ulrich Prien
Partner, Head of Real Estate Switzerland

Beat Seger
Partner, Real Estate M&A

A conversation

WITH GUESTS **MID-MAY 2020**

Angelo Credenza
UBS Fund Management (Switzerland) AG,
Dept. Head Acquisition & Disposition

Hendrik David
Avadis Anlagestiftung,
Head of Real Estate Switzerland

Christian Wyss
Swiss Life Asset Management AG,
Head Real Estate Acquisition

1

How have you experienced the last two months? How did you and your teams deal with the unusual situation? And how has the lockdown affected your business?

Hendrik David: When the lockdown measures were introduced, we switched to working from home. After Easter, we returned to the office in split teams alternating from week to week between working in the office and from home. We realized that our company's infrastructure was already well prepared for this mode of working and we were able to switch to working from home without interruption. At the end of the day, people have an extraordinary ability to adapt: when we put our minds to it, we can respond faster than any virus. We dealt with infrastructural challenges pragmatically and enabled the temporary relocation of hardware to home offices.

Christian Wyss: We actually started using the split office model on 13 March. On 16 March, we took the next step and extended remote working so that only the essential on-site functions were in the office.

We found the switch to working remotely seamless, despite suddenly having to communicate through technology platforms that we had never really used before.

Since 11 May, we have been gradually returning to the office based on a split teams concept, which means that we alternate each week between working in the office and working from home.

Angelo Credenza: Since the lockdown, we have mainly been working from home. Thanks to our resilient IT infrastructure, our standard processes have not been affected. Having said that, we are noticing a lack of personal contact with colleagues and business partners – after all, this is a people business. In response, we have spent a lot of time on the phone in order to cultivate our business and client relations. This interaction also helps us to better assess market activity despite the mandatory social distancing.

One way we are managing the situation is by setting up various task forces covering all levels of our business. These task forces have helped us quickly introduce and communicate the right measures.

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What about activities on the transaction market, how have they developed during the lockdown?

CW: We found that the usual wave of offers that we expect to see in March was somewhat weaker this year. On the whole, however, business remains at the usual level. Especially in the residential segment, the intensity of competition remained high, as if nothing unusual had happened. In the commercial sector – and particularly in the retail segment – we have already felt a certain reticence.

HD: Viewings have become a bigger challenge. In particular, home viewings have become a sensitive issue, which has led to delays in the timing of certain transactions. But despite all that, we continued to buy and sell properties during the crisis. In terms of prices – both for residential properties and core assets – we have yet to see an impact from COVID-19.

AC: When the lockdown started, we did notice a drop in the number of offers we were getting. Talks with various market participants have shown that some players have shifted to a wait-and-see stance. Meanwhile, however, there are numerous investment opportunities in the market again.

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Can you recall what it was like before the crisis? How is the overall situation affecting your expectations for the year?

AC: The year began with the usual market activity. Various investment opportunities arose, some of which led to early closing opportunities.

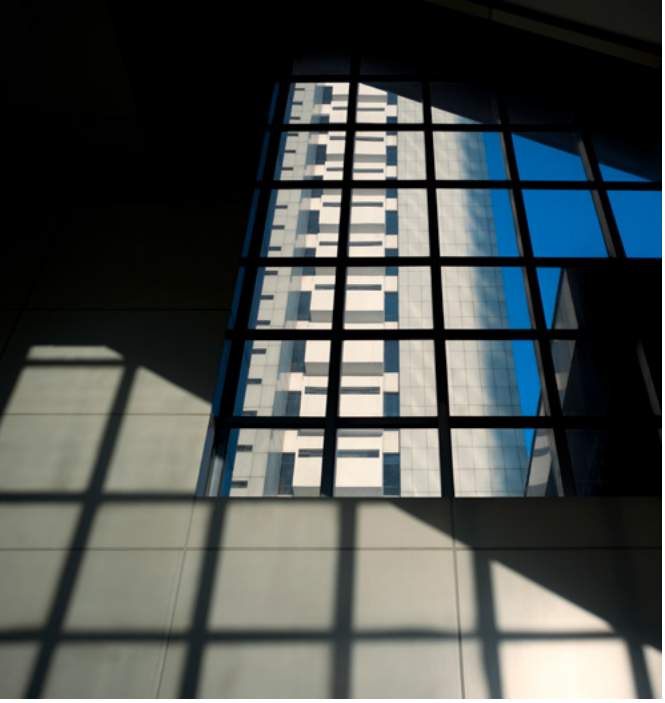
Our expectations for the remainder of the year are essentially based on our experience and activities last year. Our business horizon is geared toward a sustainable, long-term strategy. So short-term adjustments don't make such a big difference.

CW: That's how we see it, too. Our targets for 2020 remain unchanged. We got off to a fairly slow start in January and February. Although that was also the case last year, which was a good year. We have not noticed any significant changes over the last eight weeks. We expect the pipeline of offers to replenish from the third quarter onward, and that the transaction market will be very active toward the end of the year. I also agree that a few turbulent months do not justify reworking the entire strategy.

HD: Our expectations as to the long-term development of Switzerland's real estate market have not changed as a result of COVID-19. Rather, the ramifications are acting as a catalyst for longer-term trends we have been observing for some time such as digitalization, market segmentation and increasing government intervention in the market.

We, too, have observed catalyst effects. For years, people have been slow to move toward the paperless office of the future; COVID-19 has triggered the change from one day to the next: remote work, virtual meeting rooms, digital signatures – all of it is fully up and running and suddenly it's no longer a big deal. To be fair we do have to put things into perspective. As far as I can tell, project-related work – for us, that's mainly construction and transaction projects – is suffering as a result of people working from home because we have lost the ability we had in the office to quickly coordinate finer details.

I think we will see further changes in standardized work processes and services that can be planned in the long term. In many industries, I believe that many jobs could increasingly be done from home even after the crisis, though this depends on the complexity of the service and extent of value added. Employers will certainly reflect on this closely and consider the workplaces they will provide in their own offices in the future.



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What lessons have your learned personally from this extraordinary time so far?

HD: We have been forced to find quick solutions to operational problems, such as organizing ways of collaborating virtually. Personally, however, I suspect it is going to take a while before our industry feels the true impact as the coming recession and its repercussions unfold. Other sectors, like tourism for example, have been directly affected from day one and have endured a brutal impact in some cases.

CW: This extraordinary situation has made it clear to me that humanity ultimately is not in control over everything that happens on this planet and that we must remain adaptable. With regard to real estate, I don't see home offices replacing company offices as a permanent solution. As I see it, there is no substitute for close interaction in the office when it comes to exchanging information.

AC: Being mindful and interpersonal relationships have become all the more important, both in our private and professional lives. It is important that we concentrate on solving problems and that we pursue solutions consistently. So I view this crisis as an opportunity and I am confident that, with this attitude, exciting opportunities will continue to emerge in the future.

5

Now that conditions are beginning to ease, how is the transaction market shaping up at the moment in your view, and where do you see the major challenges?

HD: I feel a sense of new beginnings in daily life as restrictions start to ease. That's a good thing, as long as people stay disciplined and infection rates remain low.

AC: We have noticed a certain degree of normality returning to the transaction market since the beginning of May. Properties are being visited again, with the necessary protective measures, and the number of properties offered is increasing. Market participants are signaling that the majority of investors are still showing a keen interest in real estate of appropriate quality. Momentum has clearly picked up in the market and sellers are going ahead with their planned transactions.

HD: Like I said earlier, we have not actually noticed any interruption in transaction activity with residential properties, except with respect to site visits, which are now taking place again with appropriate precautions.

In the commercial real estate segment, various parties are currently trying to adapt to the new situation. Due to the low interest rate environment, we are not currently sensing any pressure to sell. It remains to be seen whether anything will shift on the price front. Some investors are waiting and watching.

CW: The real estate investment market is late-cyclical and comparatively steady. As a result, we have suffered less from the crisis so far than other sectors. In the medium and long term, real estate continues to be an attractive asset class, with quality increasingly gaining in importance.

6

Could you hazard a guess as to what lies ahead in the next 12-18 months?

CW: We will have to learn to deal with this situation. Life might only really return to normal once a vaccine is available. People tend to quickly forget and move on. That said, we will have to acknowledge that Switzerland is not immune to global problems and that we have to be prepared to deal with comparable crisis situations in the future. In fact, it's only a matter of time before the next crisis hits.

HD: It is not possible to make any reliable long-term epidemiological predictions; we just don't know enough yet. From an economic point of view, the consensus seems to be that we will feel the effects of the pandemic in the coming months in the form of increasing numbers of insolvencies in a recessionary economic environment.

I am confident that people will continue to adhere to the federal government's guidelines, which would allow measures to be relaxed further. This would be of enormous help to several industries, especially the hospitality sector, as they can barely operate profitably under the current restrictions. Unfortunately, I believe that restrictions on the free movement of people and mobility behavior will have to remain with us for longer.
I am very positive about the medium to long-term prospects and I believe that we will find a good way out of this situation in Switzerland, both for society and for the economy.

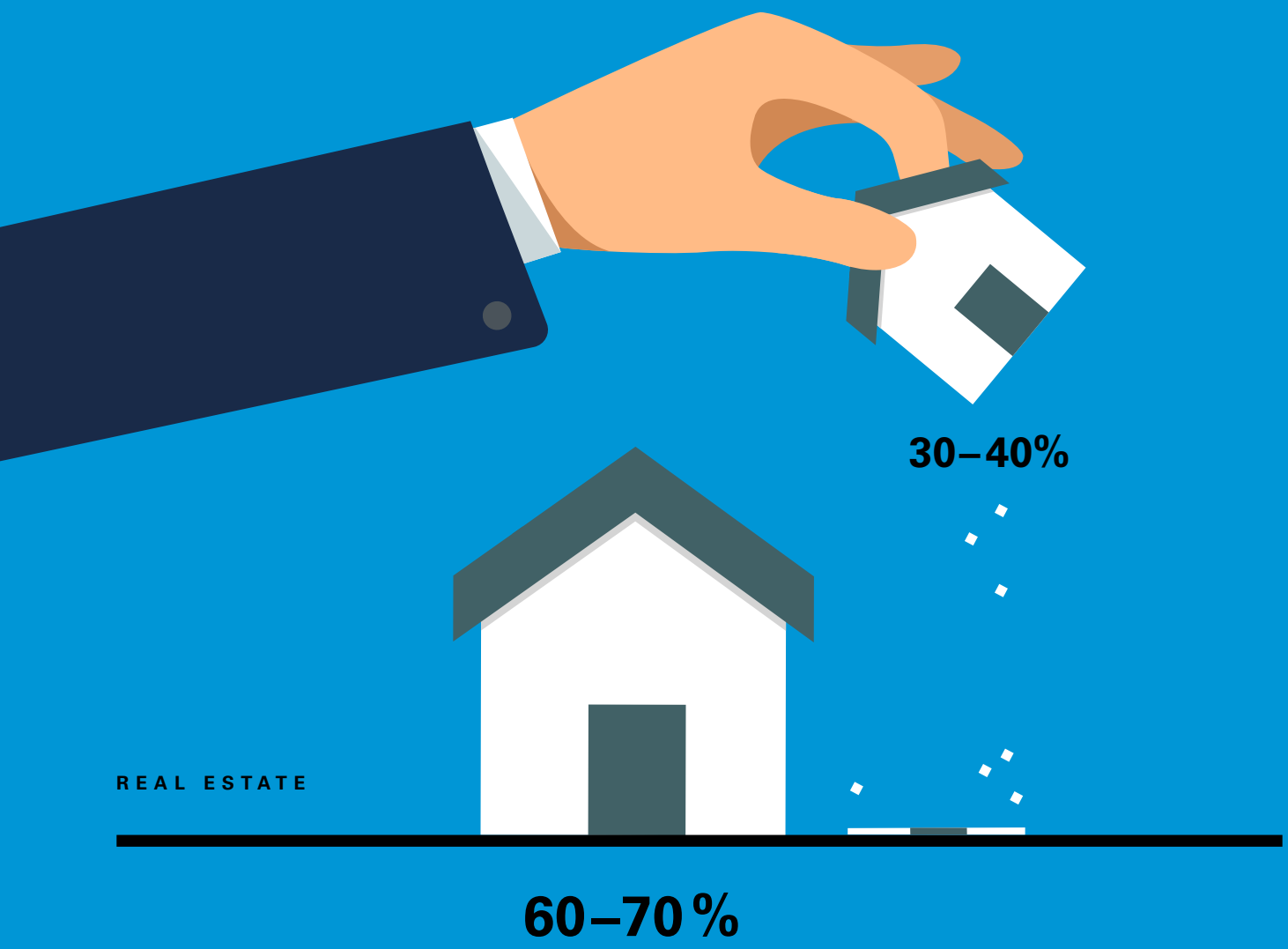
AC: The transaction market in Switzerland, especially for properties in the core segment, is likely to remain competitive and will continue to attract the interest of investors. Fundamental factors, such as the low interest rate environment, the investment pressure, and the stability of cash flows continue to speak in favor of investing in Swiss real estate. This outlook is confirmed by listed real estate funds, which have seen the market stabilize with a return to healthy demand expected. However, the current environment could lead to pronounced corrections in the real estate transaction market in highly exposed sectors or to isolated distress sales. Such an environment may offer interesting investment opportunities, both for private and institutional investors.

Gentlemen, thank you very much for taking the time for this remote conversation. I look forward to seeing all of you again soon and I'll keep my fingers crossed that it will be in a functioning and exciting market environment.

Beat Seger
Partner, Real Estate M&A

Around 30-40% of structurally weak companies will not survive the crisis.

Peter Dauwalder
Partner, Head of Markets and
Head of Restructuring



What does the crisis mean for companies?

Peter Dauwalder / Head of Markets and Head of Restructuring

KEY TAKEAWAYS

The crisis will act as an accelerator in industries already suffering from structural problems. Around 30–40% of structurally weak companies will not survive the crisis. The real estate sector will not feel the effects until a second phase, as it is mainly affected indirectly by falling sales. Robust cash flow planning is essential – it needs to hold up to the peaks and troughs in businesses' individual liquidity curves.

In your view, what are the key points in the coronavirus crisis?

Companies – especially but not only those operating in the retail and tourist industries – are facing massive problems. These sectors were already in a state of upheaval before COVID-19; the virus now acts as an accelerator. An estimated 30 to 40% of existing companies will not survive the crisis.

In the hotel and gastronomy sector, much depends on how quickly companies are able to get back to business properly. As they face full costs as soon as they start up again, many restaurateurs have put off reopening for now. They don't believe they can operate at a profit while observing the government's guidelines. For the tourist industry, it depends on whether the borders are fully open in time for the summer season, and whether Swiss tourists choose to stay in the country this summer.

Companies that were already deeply in debt before the crisis have gained a little extra time thanks to the government's measures, but this doesn't reduce their problems. For most, the government measures simply postpone the inevitable: notifying the court of balance sheet overindebtedness. As loans above CHF 500,000 are only granted after a comprehensive check by the bank, it has become more difficult for such companies to access liquidity. Given the current situation, banks are even more careful in assessing where they are prepared to take risks.

In the real estate sector, landlords will soon face difficulties much like their tenants. As potential new tenants for commercial space become scarce, the landlord's success is closely linked to the success of the tenant. For retail space there is also a mismatch between the rent level and the achievable margins. This, together with falling demand, will give tenants the opportunity to negotiate temporary and long-term rent reductions.

Most tenants of commercial and production space have already approached their landlords. For production space in particular, landlords have few alternatives at short notice and the costs associated with a change in tenant are very high. In light of this situation, I expect sales-based rents to grow in importance for commercial and production spaces.

2

Where are the biggest challenges?

Participants in the Swiss real estate market won't be affected until the second phase. Initially, it will mainly be tenants that are impacted. Only once the tenants experience payment difficulties will real estate owners see an effect on their own income. Landlords will become the most important stakeholders, and some will have to take part in creditors' committees. There is no way around the fact that both parties will have to engage more in dialogue with each other. This will also help owners in assessing the expected cash flow so that they can secure the required liquidity and develop some room for maneuver at their own companies. For some tenants, revenue will not recover to pre-crisis levels despite the government restrictions being lifted.

If companies with liquidity problems own real estate, they may struggle to secure an acceptable disposal price for their properties. When liquidity is an issue, owners are often forced to sell as quickly as possible, which is reflected in the achievable price.

3

What are the possible solutions?

Professional business leaders today need to adopt short to long-term cash flow planning which stands up to turbulence. Specifically, they should consider the peaks and troughs of their own liquidity curve to find out where the company has room for maneuver and where they need to go over the books again.

Landlords should sit down with their most important tenants and work out realistic scenarios. They can then develop solutions to stabilize or restructure companies that have become distressed. In the current situation, insolvency is likely to damage both parties. So it's vital to engage in dialogue and seek solutions that work for both sides.

Professional investors should be prepared to make counter-cyclical or late cycle investments. Market opportunities will appear but it will take courage and not least swift action to seize them.

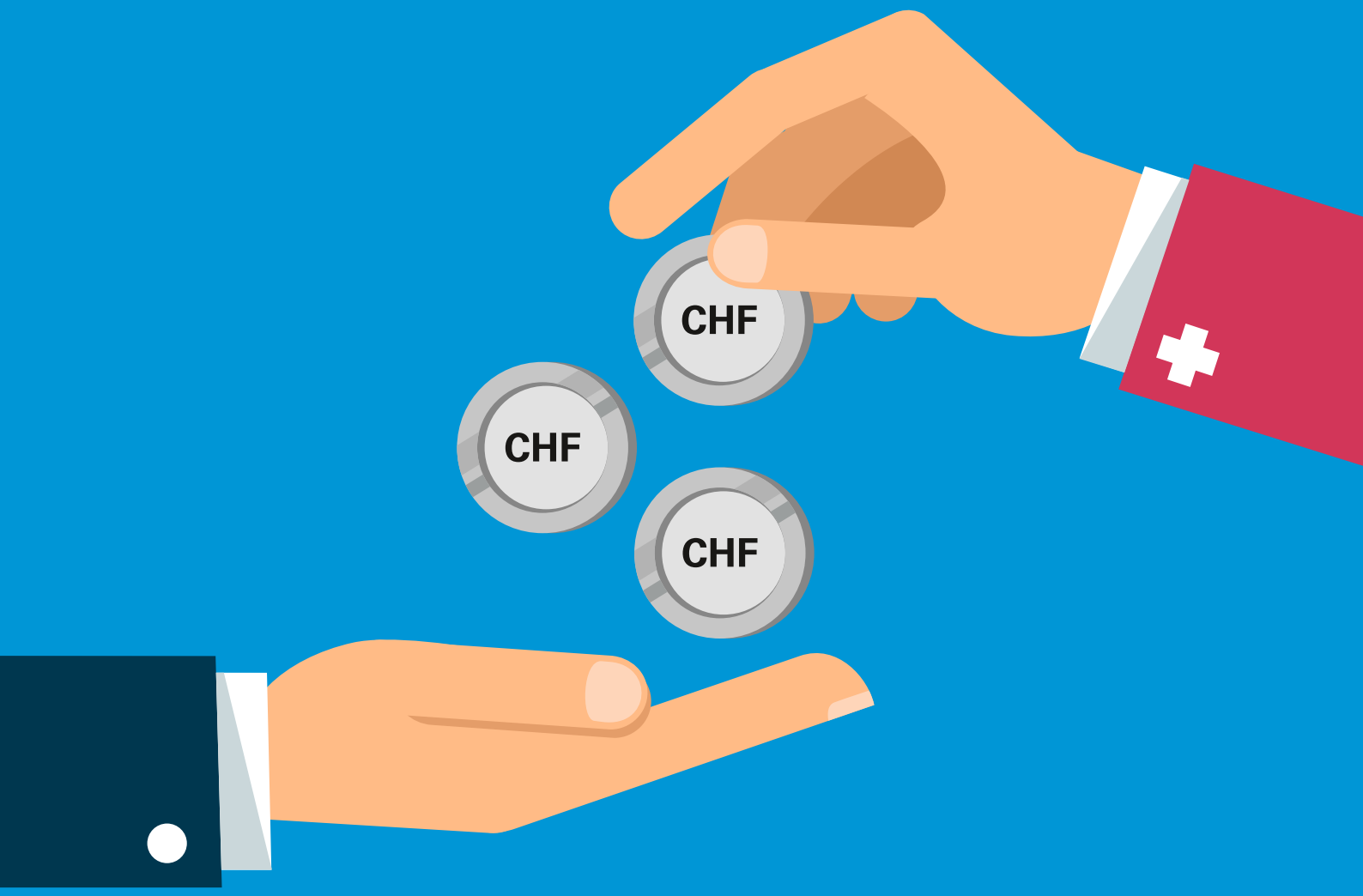
4

Your personal statement?

Most business leaders and managers are about to experience their first major recession. But it's important to keep in mind that every crisis is also an opportunity – so let's use it!

It is interesting to note how many are relying on COVID-19 loans.

JÖRG KILCHMANN
Partner, Head of Legal



A legal perspective on the crisis

Jörg Kilchmann / Head of Legal

KEY TAKEAWAYS

It is interesting to note how many companies have found themselves facing existential problems within a short space of time – and are relying on support such as COVID-19 loans for survival. I believe that these companies will experience difficulties despite the support they've received and we'll see many fold in the coming months.
The Swiss government took swift and pragmatic action, but it is time to take a step backwards and focus instead on creating the right framework conditions. The challenge now is to find a happy medium between supporting the economy and financing the money pledged during the crisis.

1

In your view, what are the key points in the coronavirus crisis?

Switzerland, but also neighboring countries, missed the beginning of the crisis to some extent. Once the potential of the crisis became apparent, the Swiss government – probably influenced by the measures implemented across the border – reacted quickly but with an unusual degree of intervention in its citizens' daily live. This was accepted by the public with astonishing readiness. The Federal Council is now, rightly, stepping back somewhat and focusing on creating the framework conditions. After all, the role of the government in the coronavirus crisis is in principle "only" to ensure that the virus doesn't spread further and that risk groups are protected.

It is interesting to note how many companies face existential problems if their revenue collapses for one or two months. As I see it, temporary revenue dips are part of entrepreneurial risk, although the circumstances triggering the crisis were admittedly somewhat unusual this time. It shouldn't really be necessary for the state to prop up the economy to such an unprecedented extent after just one month.

In the area of real estate, the focus is naturally on what will happen to rent payments. I'm confident that landlords and tenants will manage to agree pragmatic solutions in real cases of need. I think it's safe to say that it would be in the interests of very few landlords to evict their tenants as soon as possible or force them into insolvency. In my view, extending the notice period to 90 days in case of non-payment, as provided in the Ordinance on Mitigating the Effects of the Coronavirus Pandemic on Leases dated 28 March 2020, gives the parties sufficient time to work out solutions without the need for further intervention by the state. At the same time, a legal basis might be advantageous for real estate owners like pension funds who also have to serve the interests of other stakeholders.

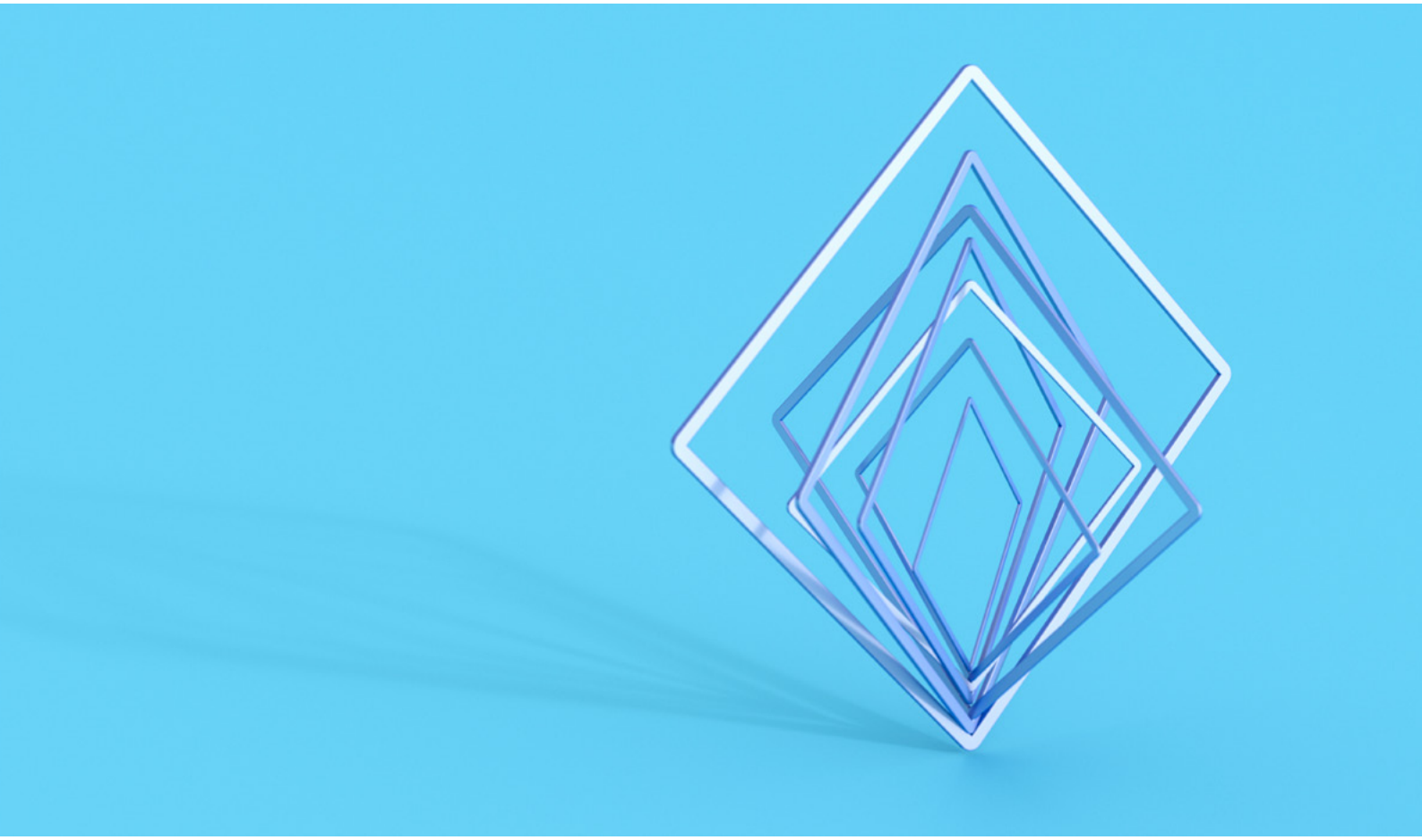
Where are the biggest challenges?

Finding our way back to a new normal will be a balancing act for all involved. Even though it was necessary to intervene heavily in the economy and daily lives of everyone, it's now time to pass responsibility back. Otherwise the public will develop a "fully comprehensive insurance" mentality, which won't help going forward.

This process includes how we deal with the emergency ordinances issued by the Federal Council. They are virtually all based on the Epidemics Act of 28 September 2012 (EA) and not on the authority granted in the Federal Constitution to bypass the legislator, i.e. Parliament and the people, in order to issue emergency ordinances. While the prerequisites and the content of the Federal Council's authority to issue emergency ordinances are defined in the Federal Constitution (limitation on time, proportionality, etc.), this is not quite so clear in the EA. So there will be one or two interesting legal questions.

Ultimately, the emergency ordinances are only valid for a limited period. That means they have to be transferred into a formal law, or they expire. Given the pace that the Federal Council reached in recent months, it's not easy to keep on top of all the applicable emergency ordinances. That's why we've put together an overview of all the emergency ordinances relevant for the real estate sector and their validity periods.

Another challenge will be finding the right approach to tackle the immense debt that has piled up in a short space of time. In recent years, exceptional work has been done and debt was being reduced continuously. Now within just a couple of weeks the development has taken a turn in a completely new direction. It will be interesting to see which solutions are put forward to reduce debt.



Overview of emergency ordinances

ORDINANCE	MAJOR CONTENT	VALIDITY PERIOD
Ordinance on Measures to Combat the Coronavirus (COVID-19) (COVID-19 Ordinance 2 of 13 March 2020) (status as of 3 June 2020)	Emergency ordinance defining measures to combat and reduce the risk of transmission of COVID19, in particular: – Art. 6 Events and businesses – Art. 7 Exceptions – Art. 7d Preventive measures on construction sites and in industry	– Current version valid until 6 June 2020, then amendments applicable from 6 June 2020 – According to Art. 12 (3), the ordinance is valid for a maximum period of six months from the date it entered into force
Ordinance on granting of credits with joint and several federal guarantees as a result of the coronavirus (COVID19 guarantee ordinance of 25 March 2020) (status as of 20 April 2020)	Ordinance on granting of joint and several federal guarantees and the SNB refinancing facility for certain credit claims, in particular: – Art. 3 Joint and several guarantees with simplified requirements – Art. 4 Other joint and several guarantees	– In accordance with Art. 5 of the ordinance, the joint and several guarantee is limited to a maximum period of five years – In accordance with Art. 25 (2) the ordinance is valid for a period of six months from the date it entered into force
Ordinance on insolvency law measures to combat the coronavirus crisis (COVID19 insolvency law ordinance dated 16 April 2020) (status as of 20 April 2020)	Ordinance on temporary relief from the duty to notify the court of overindebtedness in accordance with Art. 725 Code of Obligations, in particular: – Art. 1 Notification duty (waiver of court notification if the company was not overindebted as of 1 December 2019 and if there is a prospect of remedying the overindebtedness by 31 December 2020; no audit of the interim balance sheet) – Article 6 Deferral (debtors with the legal form of partnerships, juridical persons and sole proprietorships can apply for a deferral of a maximum of 3 months if the company was not overindebted on 31 December 2019 or claims to the full extent of the overindebtedness have been subordinated) – Art. 7 Extension and revocation of the deferral	– In accordance with Art. 23 (2) the ordinance is valid for a period of six months from the date it entered into force

3

What are the possible solutions?

In the real estate sector, I would say you have to rely on the common sense of landlords and tenants. I am confident that they will work together to come up with viable approaches, although admittedly private real estate owners will be in a better position to agree quick and straightforward solutions. Other owners such as pension funds and the like have to consider other stakeholders' interests so are not as free. They might be more inclined to welcome legal regulations.

Crises like this one are also always the start of something new. In future, rental agreements will define the risk allocation between the tenant and the landlord in the event of a similar crisis. This makes good sense and is a valuable lesson learned from the current situation.

4

Your personal statement?

The coronavirus crisis has proven an enormous challenge not only for the people but also the government of Switzerland. They did lots of things well, some things extremely well. But now the Federal Council must have the courage to let go of this matter and leave it to the market to find solutions. The government should concentrate on its core tasks; that means focusing on creating positive framework conditions for the economy.

Statutory auditors are currently having to balance more aspects than ever.

DANIEL HAAS
Audit, Head of Accounting Advisory Services Corporates

AUDITORS

What does the statutory auditor need to consider?

Daniel Haas / Audit, Head of Accounting Advisory Services Corporates

KEY TAKEAWAYS

Statutory auditors are currently having to balance more aspects than ever as they consider and implicitly confirm in their audit reports the going concern assumption for the next 12 months. How effectively the statutory auditor works with management and the board of directors could be decisive this year. The extent to which a company is affected by the crisis will depend in particular on whether sales dips reflect a delay or a permanent reduction.

In your view, what are the key points in the coronavirus crisis?

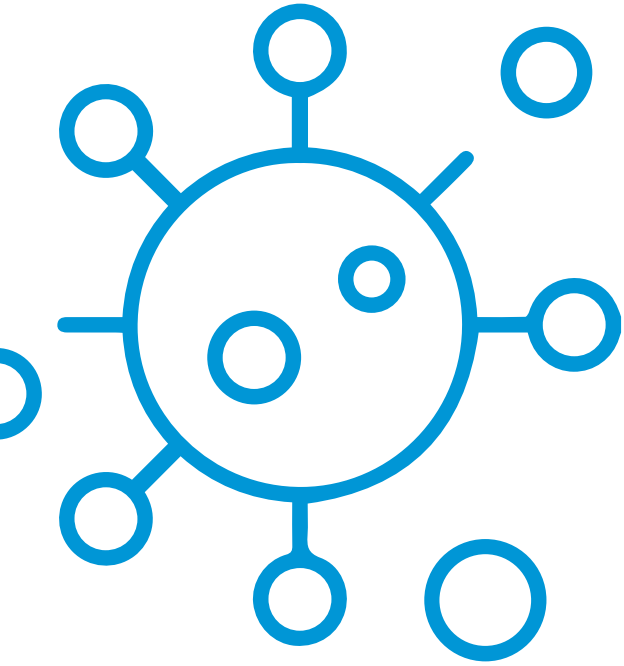
From an accounting perspective, the three critical points are falling sales, liquidity bottlenecks and impairment issues. The crisis began in Switzerland in mid-March – at a time when we had not yet issued our audit reports for some companies. In our audit report, we confirm to creditors and stakeholders that the going concern assumption is valid for the next 12 months. For companies whose reports hadn't yet been issued, it's helpful if robust structures were already in place in the prior year. That way, there's a bit of a cushion to safeguard the company in the current crisis. It's going to be tough for companies whose financial situation was already weak before the crisis. In the worst case, when a company is not able to survive, overindebtedness has to be reported to the court, for example. That's why the interaction between management, the board of directors and the audit team is even more important than ever this year. The going concern assessment and underlying assumptions are key. Turning to the court, as a measure of last resort, needs to be considered very carefully in order to limit the damage to the company and its creditors. As the auditor, it's a huge balancing act and the work is very challenging. In a special COVID-19 ordinance, the Federal Council has made certain relief provisions regarding the duties in connection with affected companies. Now these have to be taken into account.

Max Boemle posited that if profit is the food of a company, liquidity is its oxygen. In other words, a company can survive without profit for a year; without liquidity, however, it will fold very quickly. The crisis acts as a disruptor, depending on the specific industry. In the event or air travel industry, for example, revenue – and also cash flow – may have fallen permanently. Other companies that are up or downstream in the supply chain may also be affected and find themselves facing liquidity bottlenecks. The Federal Council's loan program is a highly pragmatic solution, which probably saved a lot of companies at the last minute. But conditions are attached to these loans and they act as a tight corset for companies going forward. Depending on how the crisis develops, how long it continues and how it impacts a company's business, some may struggle with COVID-19 loan repayments. I believe that tax payers will be dealing with these loans for some years to come.

2

Where are the biggest challenges?

Much depends on whether revenue is delayed, or permanently reduced. A delay has less of an impact on goodwill impairment testing. But if future cash flows fail to materialize, we'll see additional write-downs and impairment of assets. Fashion retailers will have to write down their inventories because the spring/summer collection is unlikely to sell well, if at all. Accounting departments and auditors alike will be discussing impairment of assets, fixtures and inventories over the coming weeks.



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What are the possible solutions?

Good financial monitoring is extremely important, especially key performance indicators and control parameters around liquidity. Companies that had already invested in short and long-term liquidity planning prior to the crisis stand to benefit now. High-quality data and tools enable companies to quickly put together the key facts they need to make decisions. There are various effective and efficient applications available to treasury departments today. It can be helpful to get a neutral perspective from an independent treasury specialist to evaluate which system best fits the needs of the company.

Credit risks have increased massively for traditional real estate companies and landlords. There is uncertainty as to how far the state will go in terms of binding legislation that makes concessions to tenants (e.g. rent reductions, payment postponement). In the interests of sustainable, long-term customer relationships, real estate companies will have to take unfamiliar, customer-centric measures in these unusual times. Assessing the quality of the customer relationship and adjusting customer approaches could become a future success factor.

The crisis also offers opportunities for real estate professionals. Distress sales could trigger a new level of transaction prices. Companies may also be forced for liquidity reasons to engage in sale-and-leaseback transactions. Real estate companies might be able to develop their business as a partner in this area
.

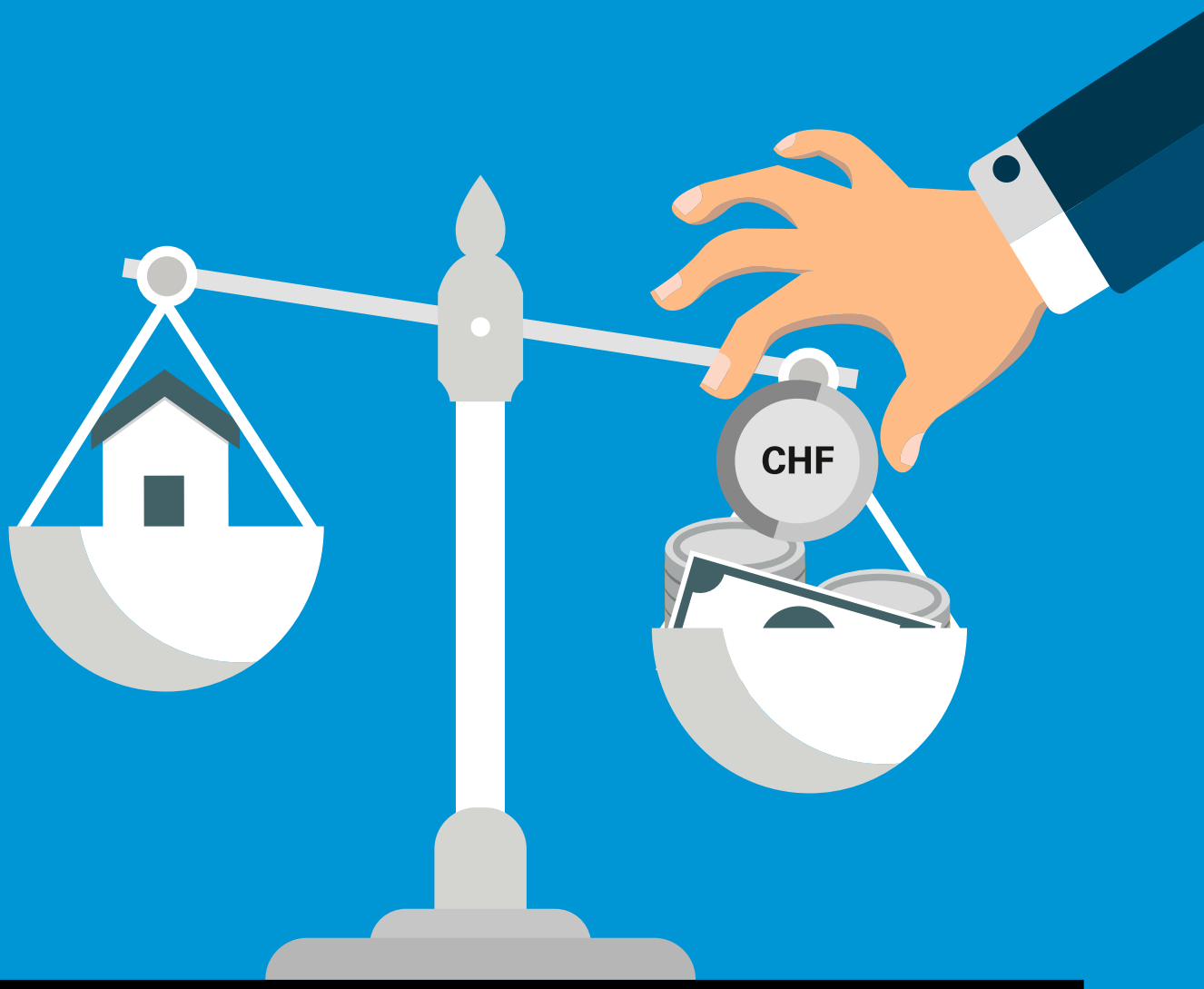
4

Your personal statement?

Every crisis also has a cleaning effect. The Swiss economy has repeatedly managed to adapt to a rapidly changing environment – just think of the Swiss franc or the financial crisis. So I'm sure the Swiss economy has a good chance of overcoming this crisis too. Maybe we will even emerge from it stronger.

After the temporary payment relief, we can expect a cooler tax climate.

CHRISTOPH FREY
Director, Real Estate Tax



TAXES

Impact on real estate taxation

Christoph Frey / Real Estate Tax

KEY TAKEAWAYS

The focus will naturally shift to taxation as part of efforts to make up for the money being spent now and the anticipated fall in tax revenue receipts as company profits dip. It is likely that the tax authorities will scrutinize debatable matters more closely in future – that's why it's so important to document any extraordinary arrangements being made in the current environment, especially those between related parties. In terms of real estate taxes, we can expect discussions about tax write-downs, (intercantonal) tax loss carryforwards and non-cash benefits

In your view, what are the key points in the coronavirus crisis?

The federal government has provided large sums of money. But it's unclear to what extent these loans will be repaid. The economy is suffering in general, and profits are shrinking for many. KOF, the economic research institute of the Swiss Federal Institute of Technology (ETH), predicts that tax revenue receipts will fall by CHF 25 billion over the coming years. Sufficient tax revenues will need to be generated sooner or later if we are to keep the national budget stable. In addition, as many cantons have cut their tax rates in recent years, we can generally expect the initial phase of crisis-related payment relief to give way to a cooler tax climate in the medium term. The tax authorities are likely to challenge and scrutinize debatable matters more in future.

The Federal Act on Tax Reform and AHV Financing (TRAF) has finally been implemented and we now have a sustainable response to the international tax dispute with the OECD. But the discussion has already moved on. The OECD wants to reform global taxation of multinationals. TRAF didn't impact real estate gains, transfer and other real estate taxes, the tariffs are more or less unchanged. But if new sources of tax revenue are needed to finance the crisis, real estate taxation may appear back on the agenda. After all, it's always been easier to tax immovable assets rather than movable assets and income. While the introduction of a new real estate tax is unrealistic, amendments to the cantonal tax rates are certainly conceivable in the long run. It is also extremely likely that we'll see stricter enforcement of prevailing law with regard to determining real estate profits.

Where are the biggest challenges?

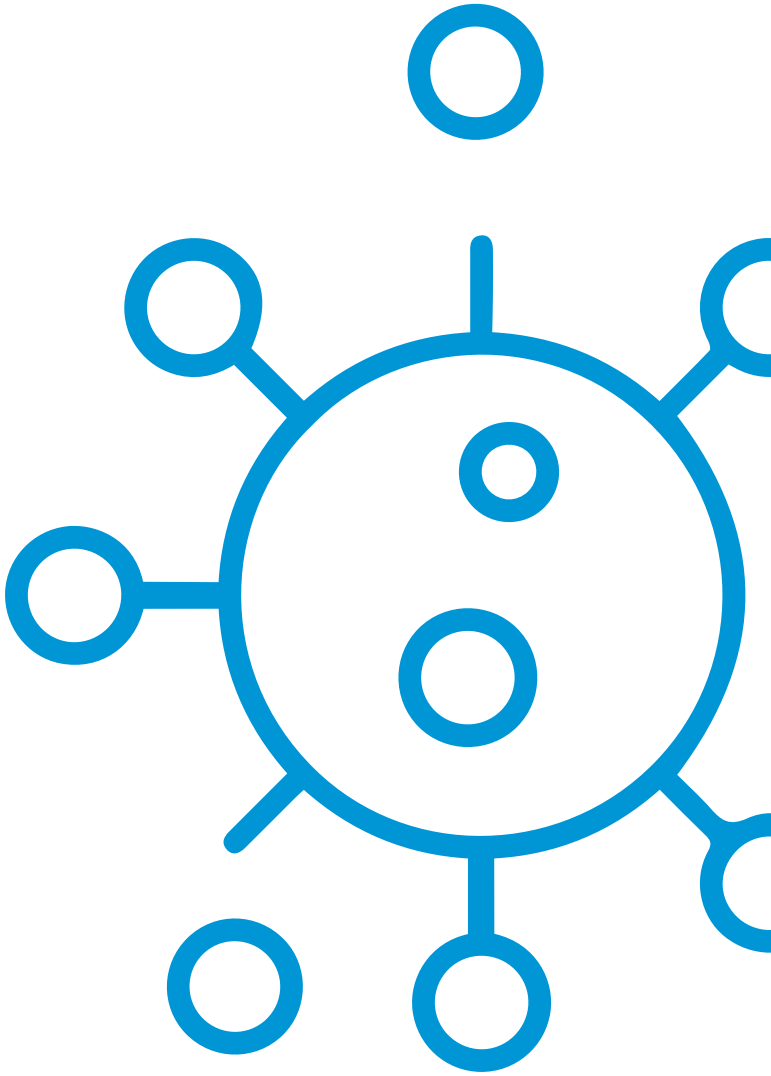
Tax is generally of secondary importance at the moment for companies and private individuals compared to the business and organizational challenges that they are facing. The tax authorities announced various options to delay payments, extend deadlines or waive late payment interest. These are intended to help with liquidity bottlenecks. For example, the federal government decided that no late payment interest would be charged on any direct federal taxes falling due from 1 March 2020 to the end of the year.

In the area of real estate tax, tax challenges will come as a result of knock-on effects. For example, tax authorities expect straight-line depreciation of real estate held in company assets. So they will critically assess any extraordinary write-downs or impairment recorded on commercial real estate in the current environment. This will lead to discussions. It will certainly be helpful if owners maintain solid documentation to justify their decisions. At a minimum, they need to have the property valued. If the amount of the write-down is high, it may be worth getting two independent expert appraisals. Without this sort of documentation, adjustments may be made to taxable income. Even before the crisis, the tax authorities were placing more value on critical assessment of the lower depreciation limits for real estate (see also our blogs on kpmg.ch).

In terms of tax loss carryforwards, the question is who bears the loss – whether from loss of rental income, extraordinary write-downs or loss on disposal. This is especially problematic in the case of companies with intercantonal operations, or when the family silver – a property with real estate income – has to be sold. For companies, it is important that any loss is tax deductible and that they are taxed on their economic capacity to perform. However, there are certainly cases where a tax loss carryforward is not permitted, or is allowed in one canton but not in another. Companies sometimes have to go to court to defend their position, which can be very expensive and time-consuming. Again, for owners I expect more discussion with the tax authorities, as losses are likely to occur more often, and tax authorities will not readily pass up possible tax revenue.

One of the most important points to keep in mind is the tax impact of non-cash benefits. If decisions are taken in the current environment on account of COVID-19 that mean a contractually defined payment was not rendered, or was waived, this is particularly problematic between related parties.

For example: A company does not pay the contractually agreed rent to another group company (the owner of the building) for three months. The latter must be able to demonstrate that this extraordinary arrangement would also have been agreed with a third party (arm's length). If this is not possible, the situation counts as a non-cash benefit, which is subject to withholding tax of 35%. It also leads to an adjustment of corporate income tax. There are various legal assessments regarding the duty to pay rent in this extraordinary situation, as we are seeing in the current parliamentary debates on the matter.



The issue is not just limited to rent, however, but also affects any contractually agreed arrangements between related parties. Unusual or poorly documented decisions will trigger more discussion with the cantonal tax authorities and the Federal Tax Administration (FTA). As a precaution, it is important to ensure there is good cause for deviating from contractual arrangements. The agreements, legal basis and rulings of the Federal Council should be taken into account in this process. It's also very important to document precisely any decisions taken in the heat of the moment – subsequently if necessary. It should be made clear that the best realistically available option for both related parties was selected. You will be grateful for this documentation if the FTA decides in three years or so to carry out a tax audit.

3

Your personal statement?

I have been very pleasantly surprised by the willingness of the Swiss population to accept such massive restrictions to daily life in order to protect certain groups. Solidarity in a crisis is a strong indication of a well-functioning society. The straightforward support offered by the government to companies with liquidity bottlenecks is also impressive; the amount pledged is also a big cause for concern, though.

Our view

INTERVIEW PARTNERS

Beat Seger
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What are your thoughts on the way this "extraordinary situation" has unfolded?

Beat Seger: I always try to see the positives of situations like this. We found that many companies are much more advanced in terms of digitalization than previously thought. Virtual networks stood up to the added pressure and various communication tools were ramped up in rapid time. Connectivity has become denser.

In a previous crisis, people were saying that the upswing starts with mindset; and indeed, we have experienced a rapid cultural shift in various business areas. These days, it's become normal to meet virtually, and for everyone to choose the most efficient daily rhythm for their specific needs.

Climate change doesn't care about the virus. Paradigm shifts like the one we're seeing are helpful for ongoing developments in sustainability. Let's just hope that we don't go back on this progress with everyone overburdening the transport system at the same time.

Ulrich Prien: Those are the positive aspects – and the rapid response in introducing monetary and fiscal policy measures. Germany alone agreed budgetary measures worth EUR 350 billion (around 10% of its GDP for 2019) as well as guarantees of EUR 820 billion. The debt ratio in the euro zone is expected to creep past 97% of GDP in 2020. So we're not doing too badly with our figure of CHF 62 billion (around 9% of GDP for 2019). Our debt ratio will rise from 27% to 36% of GDP. So we can afford it (for now).

It will take a long time to reduce the debt level and social disparity will probably increase, as it did after the financial crisis. This won't make appropriate politics without polemics and populism easier, and the battle for budget will be tougher than ever. It's likely that debt will simply remain at a higher level – or at least that's what we've seen in the past.

What about the crisis from the perspective of the real estate industry?

BS: As an industry, our orientation is long term, so we're pretty stable. Ultimately, we provide residential and work infrastructure, and receive a return on the capital invested. Insolvency is rare thanks to a culture of mainly conservative lending – something we inherited from the 90s.

A consensus quickly developed that residential buildings and urban commercial properties are unproblematic, while default on rents can be expected in the area of retail, industry and especially tourism. We're currently all waiting for the predicted insolvency wave. Let's hope that government support has prevented the worst of the turbulence.

Of course, we've noticed that transactions for business properties have been delayed in light of the circumstances and market assessments. But late doesn't mean never.

UP: Some people find real estate boring – but in the current environment, most find it reassuring. This is reflected in the rapid recovery of listed investments following a liquidity-driven draw-down. After all, everyone wants real estate – ideally directly to live in, for private old age provision, or as a stable investment on a balance sheet that has to cover pensions.

Real estate doesn't carry a virus – but there are certain tenants who need to recover from this unexpected shock. This will lead to temporary payment defaults, but substance itself is not impaired. Rather, this phase of unconventional monetary policy is being extended again, which will continue to support the market and drive it to some extent.

Based on today's perspective, how do you expect the real estate market to develop?

BS: Let's forget about COVID-19 for a moment. The stock market had an incredible year in 2019 and most investors closed in a good position. And this is despite trade wars, Brexit and the strong franc. Unemployment was at a record low. What more could you want? And then all of a sudden: lockdown, emergency law and collapse – a cold shower. Then the cash started to rain in. Hesitantly at first – just CHF 10 billion, but then more, and continuously. We're at the beginning of a recession, although the stock market is relying on a rapid recovery. Initial indicators are picking up and everyone shares a strong interest in getting the economy back up to speed quickly. In short, let's stay positive!

The real estate market is late-cyclical and will be affected in a second phase as tenants suffer losses of income. Nobody wants payment defaults and vacant space, but is that the end for an owner with an otherwise strong balance sheet? Hardly.

UP: I agree. This is also where the political discussion starts – and where we have to seek compromises while protecting the principles of our constitution. It's not really liberal – but beggars can't be choosers.

I assume that investment pressure and the structural scarcity on the real estate market will ensure market stability. Finally, the Federal Statistical Office is still forecasting a > 10 million population Switzerland and the crisis could trigger renewed migratory pressure. The divide between investment grade and non-investment grade is set to intensify. Real estate will mainly be purchased as a means against the uncertainty and not in the spirit of assuming entrepreneurial risk. The expected corporate insolvencies will only affect little risk capital in Switzerland, which will lead to price adjustments.

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So, there will be a real estate crisis – for commercial properties?

BS: Perhaps, but probably not. Letting space will be more difficult as people work from home and embrace other new ways of working. And there's the cost pressure felt in a recession, of course. We will have to wait and see what the enduring influence of changing travel and shopping behaviors will be. On the earnings side, big leaps are unlikely. The risk premium rises too – so do investors expect higher returns? I'd say only if investors turn their backs on this segment. But given the investment pressure, that's unlikely to happen. Time will tell, once we know how the coming months develop. But at present we're not seeing any signs that the trend is changing.

UP: I also believe that we won't be able to comment until after the expected insolvencies and any – potentially drawn-out – transactions that follow. Distress sales are certainly not going to make sense for the real estate market overall. It may well be the case that difficult space remains vacant and it is not possible to find a buyer or tenant. Does that constitute a real estate crisis? Only if larger owners and lenders were to start struggling with payments. And we're far removed from that in my view. A change in the real estate market trend will be initiated by interest rates or oversupply. An insolvency wave can trigger such a situation – but in fact it's mainly accelerating the structural clean-out among physical retail outlets and the hotel industry.

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Your personal statement?

BS: An almost total standstill for eight weeks – a previously unthinkable scenario and a new experience. Going forward, I hope that we will take as much innovation as possible from this situation and use it to emerge quickly from the recession.

UP: Before the crisis, Switzerland was known for its stability. Now it's resilience we're known for, i.e. the mix of appropriate action, robustness and solidarity among the population. I think we did that well.

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