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IN FOCUS: ZÜRICH, SWITZERLAND

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Highlights



Zürich remains an important financial centre; however, the global financial crisis took its toll and the corporate market, especially, has become much more price-sensitive, affecting hotel rates and meeting and events revenue. Unpegging the Swiss franc from the euro in January 2015 made the country instantly more expensive, which not only had repercussions on the tourism industry but also the competitiveness of its export economy.



With the exception of 2009, Zürich consistently grew airport passenger numbers, tourism arrivals and accommodated bednights. Growth was particularly good in 2015 and year-to-July 2016 in light of the strong appreciation of the Swiss franc, albeit the growth was mostly driven by the domestic market. While visitation from Germany recorded the largest net decrease, interest from the BRIC countries is still rising.



After numerous failed attempts, Zürich is still without a large convention centre. The decision has now been made to refurbish the existing Kongresshaus and Tonhalle at a significant cost, while private investors are constructing an event venue in Stettbach and hoteliers are hopeful for the realisation of The Circle, a large mixed-use scheme at Zürich Airport.



The Circle project is expected to generate renewed interest in Zürich from both a leisure and a corporate perspective. Office construction is also abundant; however, demand for new office space is lagging behind, leading to falls in rents. Planned hotel supply for Zürich is substantial as investors are seeking better returns; some 1,400 new hotel rooms are expected to enter market before the end of 2019, with a further 680 rooms in the planning stage.



Aggregate hotel performance data for Zürich show a stable occupancy level with small decreases in average rate in 2014 and 2015, most likely linked to the currency exchange rate dynamics.



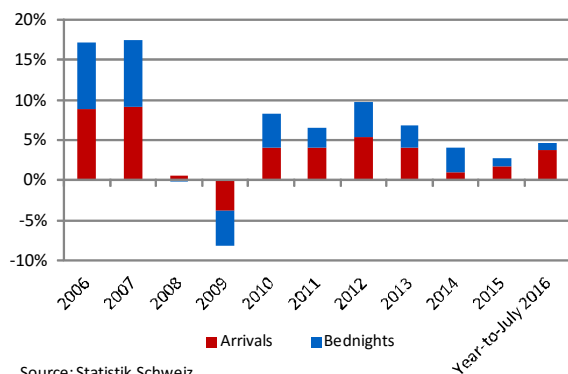
Zürich is still dominated by owner-operated hotel properties and its investment market remains relatively illiquid and opaque. However, branded properties in particular have attracted some interest recently.

Market Characteristics

Tourism

International tourism arrivals make up 75% of total visitation to Zürich; hence the city's tourism success is strongly linked to the airport operation in Kloten, which in 2015 reached a new record in passenger numbers of 26.3 million – 8.5 million more than in 2004. SWISS remains the dominant carrier, transporting some 55% of all passengers; the most popular routes to and from Zürich in 2015 included London (four airports), Berlin, Vienna, Amsterdam and Düsseldorf. Understandably, the vast majority of passenger numbers (98%) was tied to international routes.

FIGURE 1: % CHANGE IN ARRIVALS AND BEDNIGHTS IN ZÜRICH

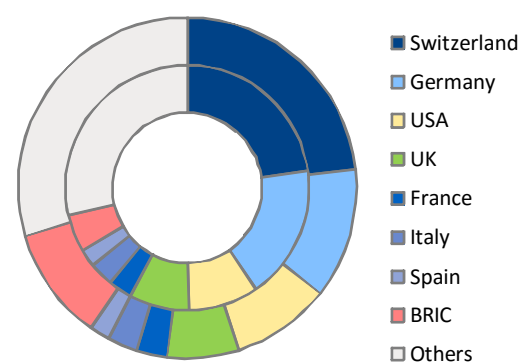


Mirroring the airport operation, tourism arrivals and accommodated bednights in Zürich recovered quickly from the global financial crisis in 2009. In 2015, another record was achieved by the tourism industry with 1.6 million arrivals and 2.9 million overnights; nevertheless, growth slowed down significantly, owing most likely to the effect of the drastic appreciation of the Swiss franc against the euro after the Swiss National Bank lifted its peg of SFr1.20 in January 2015. While year-to-July 2016 figures show an increase, this was mostly driven by the domestic market with April and July recording the largest year-on-year growth.

Zürich's tourism industry is hopeful that 2016 will prove to be another exceptional year, given the three-month long Manifesta 11, a

European biennale of contemporary art hosted by Zürich in 2016, running from 11 June until 18 September. The overall theme of this year's Manifesta 11 is 'What People do for Money', which is hardly a coincidence given the city's image as an important financial centre in Europe. The 100th anniversary of Dadaism, an art form created in the city, is also expected to attract increased interest in 2016.

FIGURE 2: MAIN FEEDER MARKETS TO ZÜRICH – 2008 (INNER RING) AND 2015 (OUTER RING)



Source: Statistik Schweiz

Figure 2 shows the proportion of the main feeder markets in 2008 and 2015. While the domestic market has not materially changed, Germany's share has decreased significantly and arrivals from the BRIC countries grew by a factor of 2.6 within seven years, albeit from a low base. German and Spanish visitation dropped by 10% and 16%, respectively between 2014 and 2015, indicating that these markets may be generally more price-sensitive. It will not be unlikely to see a decrease in arrivals from the UK in the future, the fourth largest feeder market, since the pound sterling depreciated by 16% against the Swiss franc after the UK's vote to leave the European Union in June 2016 (Brexit).

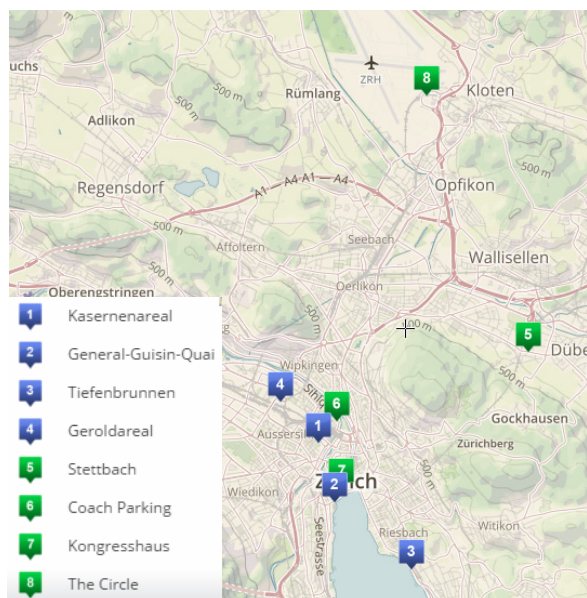
Convention Market

Zürich's inherent weaknesses is that it does not have a large conference centre such as other cities in Switzerland (Geneva or Basel), and hence accommodating lucrative international conventions is challenging. This holds the city back, as large research institutions such as the ETH (Swiss Federal Institute of Technology) would be able to

attract substantial business, as shown by the success of the recently opened Swiss Convention Centre in Lausanne next to EPFL, the french-speaking counterpart of ETH. While everybody seems to be aware of this problem, project after project has failed. Possible locations included the Kasernenareal, the General-Guisan-Quai at the lake shore (rejected by public vote in 2008), Tiefenbrunnen at the lake shore (rejected because of location factors) and Geroldareal (no agreement reached with the owner of the site in 2013); after this frustrating process, the city concluded in June 2016 that the existing Kongresshaus and Tonhalle, dating back to 1939, should instead undergo a complete renovation, costing some SFr240 million. No temporary venue has been considered for the three-year long renovation.

Meanwhile, things are moving on the private investment side: a large event and convention space is currently under construction in Stettbach near Dübendorf, to be finished at the end of 2016. Additionally, discussions about a new convention centre on the coach parking area near the main train station, which was historically dismissed owing to planning restrictions, have been resumed.

FIGURE 3: MAP OF REJECTED (BLUE) AND PLANNED (GREEN) CONVENTION CENTRE SITES



Zürich ranks 44 in a worldwide comparison with 70 International Congress and

Convention Association (ICCA) classified events, with the majority comprising smaller events mostly held in hotels.

Real Estate Overview

With the successful revitalisation of Hürlimann Areal, New Oerlikon and so forth, Zürich proved its ability to successfully transform inner city industrial areas into modern, value added neighbourhoods. The redevelopment of Zürich West, formerly the industrial quarter, was recently completed. As a result, the working population increased by 10,000 to some 30,000 people within ten years. The most prominent building is the Prime Tower, housing offices and restaurants, and until 2015 it was the tallest building in Switzerland at 126 metres high.

The Circle, a large mixed-use development, is currently under construction next to Zürich Airport's terminal. The Circle will provide event space for up to 1,500 people along with offices, residential units and two Hyatt hotels. The first phase is expected to be completed in 2018.

Europaallee is the revitalisation of land owned by the Swiss Federal Railways into a mixed-use scheme, offering offices (Google will soon relocate there), education facilities, residential units and a hotel (25hours). Four plots have been completed between 2012 and 2016 with a further four envisaged to be finalised between 2017 and 2020.

Looking ahead, the Kasernenareal, centrally located in district 4 with extensive green spaces, will become vacant after the police departments' move in 2020. Alternative uses are currently being analysed for the listed buildings.

Low interest rates and the search for better yields is driving a building boom in office space in Zürich. According to JLL, some 220,000 m² of office space is currently under construction with a further 65,000 m² also likely to come onto the market. The demand side looks different, however, as new take-ups are mostly due to firms relocating within Zürich rather than new companies coming to

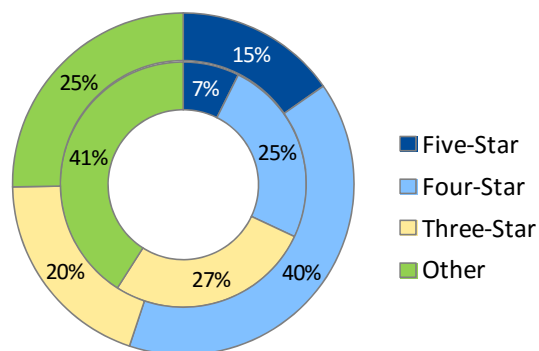
the city. The overall supply rate in Zürich stood at 5.4% in the second quarter of 2016, but locations with poor transport connections are struggling: Glattbrugg-Opfikon, between the airport and the city centre, had an availability rate of 33.4% in the same period with many of the newly planned schemes located in that area. Prime rents are starting to come down, most likely a result of the supply and demand equilibrium.

While experts agree that Switzerland remains a safe haven for investments and that interest rates are not likely to increase in the near future, they also agree that price levels for office and residential assets in particular are starting to come down. Furthermore, recent initiatives such as Secondary Home¹ or Mass Immigration² could potentially have negative implications for the real estate market.

Zürich Hotel Market

By the end of 2015, Zürich had 122 hotels (approximately 8,000 rooms), which is arguably small in comparison with other European cities of similar size (Lisbon 19,900 rooms, Dublin 21,100 rooms, Copenhagen 17,300 rooms and Geneva 9,500 rooms).

FIGURE 4: NUMBER OF HOTELS (INNER CIRCLE) AND HOTEL ROOMS (OUTER CIRCLE) IN ZÜRICH



Source: Statistik Schweiz

We note that the region around the airport (the municipalities of Rümlang, Opfikon and Kloten) is not included in the above figures.

¹ Limits the number of secondary homes in a municipality to 20% of total homes.

² In 2014, the Swiss people decided to limit immigration; however, it is not clear how this should be done.

This region has almost 3,000 additional hotel rooms. Ten out of the 17 hotels in the region are affiliated with an international brand and provide on average 250 rooms, substantially more than the 66-room average in Zürich, making them highly dependent on volume business (group or crew), often at the expense of rate.

Although most of the major international chains have hotels in and around Zürich, the city remains dominated by independent or owner-operated properties. Alternative accommodation providers such as Airbnb are not to be neglected and serviced/furnished apartments (short-term rentals) are suitable for corporate clients staying on an extended basis. Nevertheless, this is a vastly fragmented market with many independent and regional operators

Zürich boasts some of the highest average rates in a European comparison and, according to PricewaterhouseCoopers' European Cities Forecast, is projected to remain in third place in 2016 and 2017, after Paris and Geneva. Occupancy rate remained stable in 2015 with small drops in average rate in 2014 and 2015. The summer months are usually the busiest period in terms of occupancy, but at a discounted rate. Weekends are generally quieter, given the large corporate base in the city.

FIGURE 5: ZÜRICH HOTEL PERFORMANCE (SFR)

Year	Occupancy	% Change	Average Rate	% Change	RevPAR	% Change
2010	72.7%	—	236.0	—	171.6	—
2011	70.9%	-2.5	241.5	2.3	171.2	-0.2
2012	71.1%	0.3	227.6	-5.8	161.8	-5.5
2013	72.4%	1.8	239.5	5.3	173.4	7.2
2014	73.2%	1.1	239.1	-0.2	175.0	0.9
2015	73.5%	0.4	237.1	-0.8	174.3	-0.4
Year-to-July						
2015	72.0%	—	235.4	—	169.5	—
2016	72.3%	0.4	235.6	0.1	170.3	0.5

Source: STR Global

New Hotel Supply

Zürich presents an extensive pipeline given the size of its existing hotel market.

FIGURE 6: ZÜRICH HOTEL PIPELINE

Proposed Property	Number of Rooms	Estimated Opening Date	Location
The Züri by Fassbind	167	Q1 2017	Kreis 5
25hours Hotel Langstrasse	170	Q2 2017	Kreis 4
Motel One Zürich	400	Q3 2017	Kreis 1
Harry's Home	117	Q1 2018	Wallisellen
A-Ja Resort	320	Q4 2018	Kreis 9
Hyatt Place Zürich Airport	300	Q4 2019	Airport
Hyatt Regency Zürich Airport	250	Q4 2019	Airport
Dual-Brand Rümlang	273	Not Confirmed	Rümlang/Airport
Boutique Hotel Rümlang	85	Not Confirmed	Rümlang/Airport
Total	2,082		

Sources: Tophotelprojects; HVS Research

We comment on the new projects as follows.

- The Züri is a conversion from the former Hotel Senator; Fassbind already operates hotels in Lausanne and Bern under the 'by Fassbind' brand;
- 25hours already operates a property in Zürich and this new project will open as part of the Europaallee redevelopment;
- After Basel, this will be the second property in Switzerland for the German hotel brand Motel One – once open, it will be the largest hotel in Zürich and the third largest in Switzerland (behind the Starling and the Kempinski Geneva). The budget positioning could be a substantial draw for leisure tourism to the city, generally perceived to be expensive;
- Harry's Home, an Austrian brand, will operate an aparthotel in Wallisellen;
- Hyatt has two hotels planned in the airport region as part of The Circle;
- Recent announcements include the A-Ja Resort and two hotels in Rümlang, close to the airport.

It is noticeable that supply has increased considerably around the airport – 720 rooms were added in 2014/15 and should the entire pipeline materialise there would be an

additional 900 rooms, making the region extremely competitive.

Hotel Investment Market

Zürich remains a relatively illiquid hotel investment market and one of the least transparent in Europe. We list recent transactions in the city below.

Single Asset

- The 42-unit **Astor Hotel** aparthotel was sold by Credit Suisse Real Estate Fund LivingPlus in December 2015 for SFr14.7 million. It had previously been sold in October 2009 for a similar price;
- The 138-room **MGallery** became subject to a sale-and-leaseback agreement between Accor and private investors. The sale price amounted to €33 million and a commitment from the buyer to carry out €23 million worth of renovations as soon as the transaction is finalised.

Portfolio

- The **Hilton Zürich Airport and its Aparthotel** were part of a pan-European portfolio transaction whereby the majority owner changed to Oman Investment Fund (OIF). Westmont retained the management of the two properties;
- In June 2014, Axa sold an 11-property **Accor portfolio** (1,594 rooms) to Accor for a reported €219 million. Six of the Swiss properties are located in Zürich and operate under the Novotel, ibis, ibis budget and MGallery brands.

In August 2016, the Tschuggen Group, which operates three luxury hotels in Switzerland (Eden Roc in Ascona, Tschuggen Grand in Arosa and Carlton in St. Moritz) acquired a commercial asset with a prime city centre location, next to Paradeplatz, and a conversion into a hotel cannot be excluded at this stage.

Conclusion

Zürich remains a large economic driver for Switzerland, not least owing to its well established international airport. However, the city has been facing some challenges recently as a tourism destination; a drastic appreciation of the Swiss franc against the euro has made Zürich considerably more

expensive to visitors from the Eurozone, and a trend towards an oversupplied hotel market is putting further pressure on average rates. Nevertheless, visitation and accommodated bednight statistics have shown a positive trend and 2016 is expected to record further tourism growth, given Manifesta 11 and the Dadaism anniversary celebrations.





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