COVID-19: Boom or bust for PropTechs?

Swiss PropTech Report 2020 | June 2020

Swiss PropTech Report 2020
Acid test for PropTechs

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Three PropTechs portraits

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Imprint

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Copy deadline
June 15, 2020

Publication series
Swiss Issues Immobilien

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Editorial

Ladies and Gentlemen,

The profound change underway in the real estate sector, driven by the digital transformation, would have continued even without the COVID-19 crisis. However, the effects of the pandemic will accelerate this change because the pressure to resolve costly operational inefficiencies and to make data-driven decisions that minimize risk in the global environment has become even more acute.

PropTech companies must play a vital role in these urgent transformation processes. But, like in many other industries, the PropTech sector, too, is suffering as a result of postponed funding rounds.

This study examines what crisis-related impacts await PropTech companies and what opportunities and risks exist. Will the lockdown inject new momentum into the PropTech industry?

In light of the COVID-19 crisis, it is more worthwhile than ever to approach the future open-mindedly and to identify the opportunities offered by the altered environment.

We hope you enjoy reading this study.

Christoph Schumacher
Global Head Real Estate

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CDO Global Real Estate

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COVID-19: Acid test for PropTechs

COVID-19 has been something of a double-edged sword for PropTech companies: Over the long term they are likely to benefit from greater awareness of digital solutions, but in the short term they are threatened by project delays, difficulty in acquiring clients, and financing bottlenecks.

COVID-19 dominates the agenda

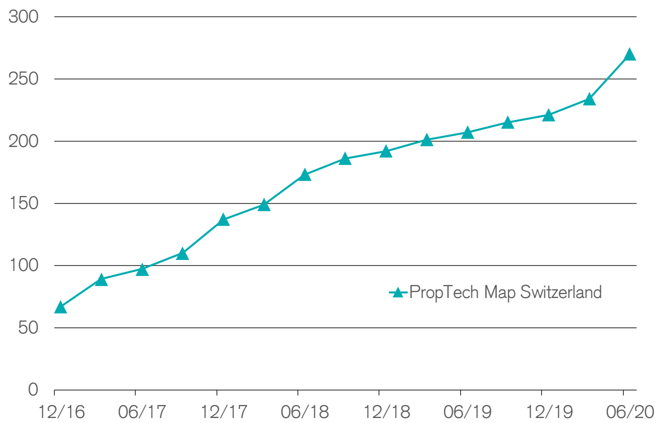
COVID-19 has had the effect of pushing reports on PropTech companies – just like so many other topics – into the background. Whereas the state of the real estate market and its protagonists was already being analyzed and discussed on a broad front shortly before the outbreak of the pandemic, namely in various publications and by online panels organized at short notice, the PropTech sector has barely earned a mention. With this report we are looking to close that gap and provide this key industry with the visibility it deserves. The PropTech sector may still be young, but it is already facing its first acid test. Because although COVID-19 will go down in history as the event that finally forced the world to embrace digitalization, that does not automatically mean that the providers of digital solutions will be among the winners. This much is apparent, for example, from the business situation of the IT industry as surveyed by the Swiss Economic Institute of ETH Zurich ("KOF"), which is currently assessed as being almost as bad as during the financial crisis. Since all key customer industries of IT providers have been hit by the repercussions of the coronavirus crisis, confidence levels in the IT sector have likewise taken a battering. So is this now the case for the PropTech sector too? Will COVID-19 lead to consolidation, and have confidence levels also slumped in this sector? In this year's report we seek to answer these questions.

Consolidation apparent even before COVID-19

COVID-19 struck the PropTech sector at a time when the wave of founding euphoria had already receded and given way to a certain degree of consolidation. In Europe, for example, the number of rounds of PropTech financing recorded a year-on-year decline in 2019 for the first time ever. This process of consolidation was also apparent in Switzerland. According to the PropTech Map Switzerland, the growth figures for PropTechs started to flatten off as early as the second half of 2018 (Fig. 1). A few of the smaller players decided to walk away from the market, and there was general evidence of a certain degree of saturation in the solutions offered in the PropTech sphere. WeWork crashing into the wall of reality in the fall of 2019 was just the most visible sign that the period of relentless expansion had come to an end. Since then the emergence of a new kind of awareness has become apparent: PropTechs are no longer pursuing growth at any price. A number of companies felt the need to make certain corrections and reduce headcount, such as the highly successful pioneer Allthings in the German-speaking world, for example, and the US firm Katerra, a global leader in prefabrication.

Fig. 1: Development of the Swiss PropTech landscape

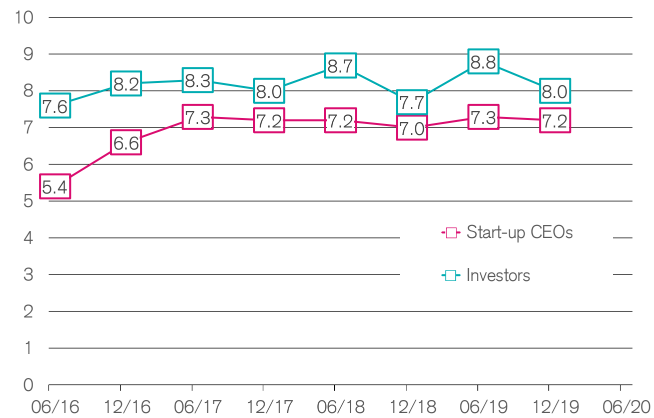
Number of PropTechs according to PropTech Map Switzerland



Source: proptechnews.ch, Credit Suisse | Last data point: 06/2020

Fig. 2: Global PropTech sentiment remains positive

Global PropTech Confidence Index; values >5 indicate confidence



Source: MetaProp, Credit Suisse | Last data point: 12/2019

Nonetheless plenty of confidence before COVID-19

Despite this consolidation, which was viewed by a number of investors as a healthy process of normalization, the PropTech industry continues to benefit from a decent tailwind. In particular, the real estate sector continues to generate highly attractive returns, which is why investors are still shifting capital to this asset class. To this extent, it is not surprising that the number of PropTechs in Switzerland continues to rise. Indeed, the rate of increase is even accelerating at the moment, although this is primarily due to the incorporation of start-ups from the construction area into the PropTech Map Switzerland. Compared to the summer of 2019, the level of confidence worldwide has declined slightly according to the Global PropTech Confidence Index, although this remains at a high level (Fig. 2). Both investors and the CEOs of start-ups remain optimistic over the technological future of the real estate world. It will be interesting to see where the index ends up at the mid-year point, i.e. the extent to which COVID-19 has managed to undermine this confidence.

Repercussions of COVID-19 for the real estate industry

Just like every other sector, the Swiss real estate industry was taken completely by surprise by COVID-19. It may not have been one of the worst-affected sectors, but there was no way of escaping the pandemic's effects: The hotels & catering and retail segments were particularly hard-hit. In the short term, the majority of real estate companies were focused on protecting their workforces and adapting their operating activity to the new official guidelines issued. In addition, many companies had to deal with a completely unprecedented wave of inquiries from tenants. For investors, meanwhile, the first phase was about guaranteeing liquidity, not being infected by the temporary panic in the markets, and analyzing the new situation carefully. As a result, many real estate companies have been heavily preoccupied by “crisis management” over the last few weeks and months, and therefore presumably much less receptive to projects and ideas coming from the PropTech world.

Structure of PropTech industry

Sector characterized by mix of start-ups and established companies

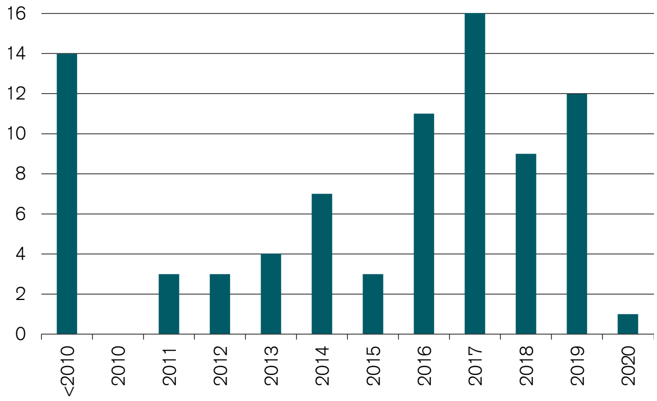
Before we look at the repercussions of COVID-19 for the PropTech sector, we should briefly explain who actually took part in the underlying survey. With 88 fully completed, anonymous questionnaires, more than a third of the Swiss PropTech sector participated in the survey at the end of May. The results are therefore likely to be representative of the industry generally, which can be broken down into two camps. On the one hand there are the pioneers, which were founded prior to 2010, before the term PropTech even existed (Fig. 3). These companies are now the industry's established players, and in many cases face rather different challenges to those confronting the “wild young things” that entered this market rather later. The former have typically secured the necessary financing for their business activity, which makes issues such as sourcing investors or rounds of financing much less important.

Wave of company foundings abates only a little

On the other side sit the PropTech start-ups, which were founded from 2011 onward and now have an average age of four years. For the majority of these companies, the founding and validation phase is now a thing of the past. The most recent vintages are well represented in the survey. The numerous start-ups clearly show that the wave of company foundings that began around 2014 has so far slackened only slightly. The majority of PropTechs were founded in 2017, as is also reflected in our survey. Many PropTechs are therefore confronted by a genuine economic crisis (in the form of COVID-19) in their very infancy.

Fig. 3: Company founding boom abates only a little

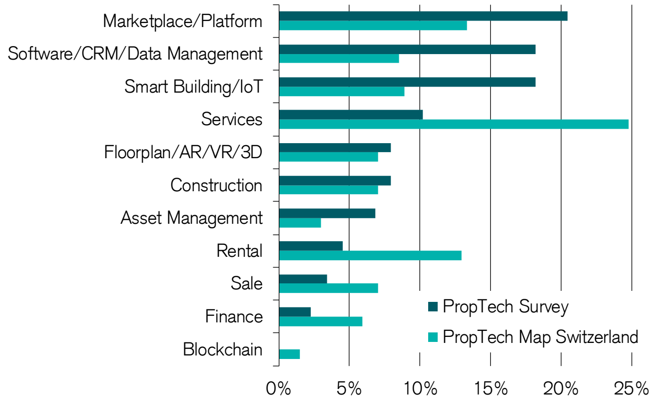
Founding year of surveyed PropTechs



Source: Credit Suisse PropTech Survey 2020 (N = 86)

Fig. 4: Breakdown of PropTechs by various categories

Based on breakdown of PropTech Map Switzerland



Source: Credit Suisse PropTech Survey 2020 (N = 88)

Broad coverage of the various PropTech categories

The surveyed PropTechs cover the entire breadth of the offering spectrum, with the exception of the blockchain category (Fig. 4). Companies from the categories of marketplaces/platforms, software/CRM/data management, and smart building/internet of things (IoT) appear to be overrepresented in the survey. However, this is likely to be explained by the fact that a number of companies assigned to the services category in the PropTech Map Switzerland do not really feel that they fit this collective category. Overall, the more technology-heavy categories appear to be more strongly represented in the survey.

How badly has COVID-19 affected the PropTech sector?

COVID-19 has also hurt PropTechs

The negative fallout of COVID-19 lockdown has also spread to PropTechs (Fig. 5). Only a very small number were not affected by the lockdown measures at all (8%). Overall, however, PropTechs can hardly be said to have been badly hit by this phenomenon. Almost a half of respondents provided answers ranging between 1 and 3 of the impact scale of 1 to 10. Nonetheless, the fact that the average figure works out at 4.3 is somewhat surprising. This shows how widely COVID-19 is affecting areas of the economy that one might have assumed to be barely affected – or even not affected at all. The impact on PropTechs was more marked in the categories of asset management, construction, services, and (in some cases) marketplaces. By contrast, PropTechs in the categories of software/CRM/data management, finance, and floor-plans/augmented & virtual reality/3D (AR/VR/3D) were less affected.

PropTechs refrain from taking drastic measures

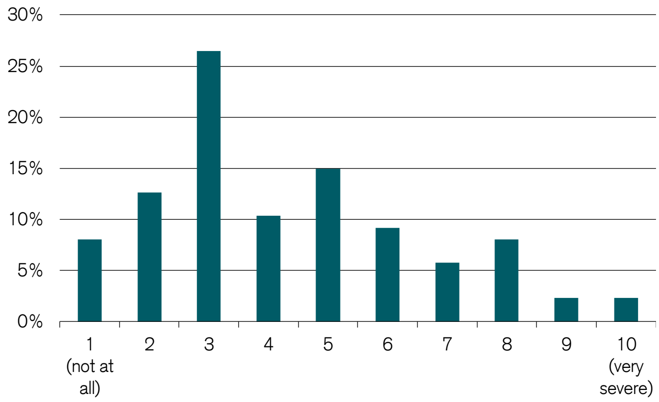
The impact on the sector can also be viewed to some extent in the measures taken by PropTechs in the face of the pandemic (Fig. 6). Just 6% of companies reported that they had not felt the need to take any measures at all (other than protecting their own employees). The remaining 94% responded to the pandemic in some form or other. Only a tiny minority were forced to take drastic measures such as implementing redundancies (1%). A number of companies resorted to recruitment freezes (5%) and short-time working (8%), however. A similar number also initiated cost-cutting measures (8%). In addition, measures to raise funds were cited more often: These include applications for loans guaranteed by the Confederation (11%) and the procurement of additional funding (5%), while greater attention was also paid to communicating with investors (10%). Most widely resorted to of all were the intensification of selling activities (16%), intensified communication with employees (14%), and a greater focus on core clients (13%).

More mature PropTechs better placed

PropTechs that have already managed to build up a solid client base and can boast a number of projects already under way are likely to feel the repercussions of the pandemic less directly than companies that are heavily reliant on the acquisition of additional clients, pilot project launches, and network expansion. As the pandemic presented a serious challenge to both management and the operating units of many real estate companies, leaving little time to engage with future themes, the acquisition of new clients can be expected to be quite a challenge at the moment. Generally speaking, it is more difficult to build up new relationships in an era of social distancing. Furthermore, due to the absence of events, trade fairs, and conferences, it has become much more difficult for PropTechs to raise their profiles. As an additional factor, media attention is focused almost exclusively on COVID-19 issues right now, whereas information on the new, technology-oriented solutions offered by PropTechs is likely to be relegated to the back pages at best, and completely suppressed at worst.

Fig. 5: Not so badly affected by the lockdown

Responses to question on impact of COVID-19 lockdown



Source: Credit Suisse PropTech Survey 2020 (N = 87)

Fig. 6: Measures taken as a result of COVID-19

Citations as proportion of all answers (multiple citations possible)

Source: Credit Suisse PropTech Survey 2020 (N = 88)

Heightened risk of failure

As a consequence, the sales of many PropTech services and products have slowed and new projects have been delayed, whereas costs have continued to be incurred. For numerous PropTechs, this is not an easy situation. Start-ups are typically not in a position to finance themselves through their own business activity. Put simply, they burn through more cash than they generate. They therefore live from one financing round to the next, or consume the funds made available to them by their founders and partners. As the coronavirus pandemic has extended the period of time that will elapse before such companies become self-supporting, as well as delaying rounds of financing, the risk of young PropTechs failing has become that much greater.

Significant long-term opportunities

However, not all PropTechs find themselves in such a predicament right now, particularly as the pandemic has underlined how important digitalization is. PropTechs are particularly well-placed to benefit from this. One of the lessons learned from the shutdown is that many more things must be digitalized in the future. In the long term, this could unleash considerable stimuli for PropTechs. Indeed, many real estate companies wish they had invested more heavily in digital solutions in the past. As things stand, those who have already done so consider this money well spent, and will hence continue along this path. The PropTechs that help real estate players work in a location-independent way are already directly benefiting from the lockdown. These include, for example, digital document managers, providers of digital access systems, and providers of digital communication solutions between landlords and tenants. In addition, the pandemic can also be expected to open up opportunities for providers of smart building technologies and AR/VR solutions.

Repercussions of COVID-19 for demand

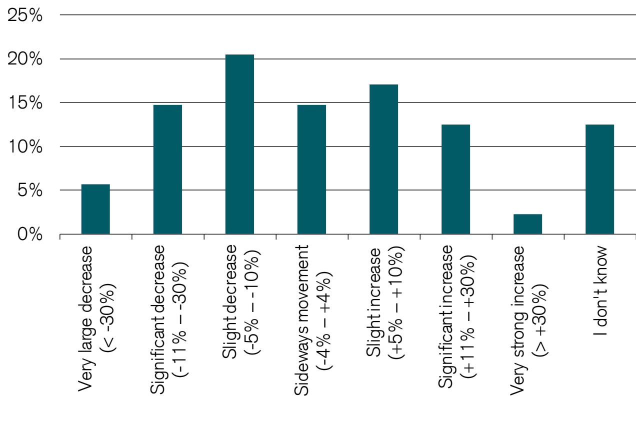
Figure 7 shows that COVID-19 has had very different repercussions for the PropTech sector, and that this sector has a highly heterogeneous setup. Around 15% can discern neither an increase nor a decrease in demand for their products and services as a result of COVID-19. 41% report a decline, but only in a very few cases does this exceed the level of 30%. By contrast, 32% of the surveyed PropTechs report an increase, in most cases of between 5% and 10%, but in a few cases as much as 30%. According to the survey, digital marketplaces and PropTechs from the software/CRM/data management category in particular have benefited from higher demand. Overall, there were slightly more negative than positive responses. 13% of respondents could not (yet) provide any view of the repercussions of COVID-19 for their demand.

Opportunities predominate

COVID-19 has done nothing to quell the spirit of optimism within the PropTech sector, however. The surveyed PropTechs view the pandemic much more as an opportunity than as a risk (Fig. 8). Despite some companies reporting significant short-term repercussions, not a single survey respondent classified COVID-19 as a major risk (responses of 1 to 2 on a scale of 1 to 10). However, the risks are rather more apparent to the older PropTechs than to the younger ones, which may be attributable to the fact that the former have already built up a much higher fixed cost base and are much more reliant on sales revenues, which could potentially be threatened by the market dislocations. The most positive of all are PropTechs from the categories of finance, floor-plans/AR/VR/3D, and software/CRM/data management. By contrast, PropTechs in the categories of asset management and construction tend to be rather more skeptical.

Fig. 7: Repercussions of COVID-19 for demand

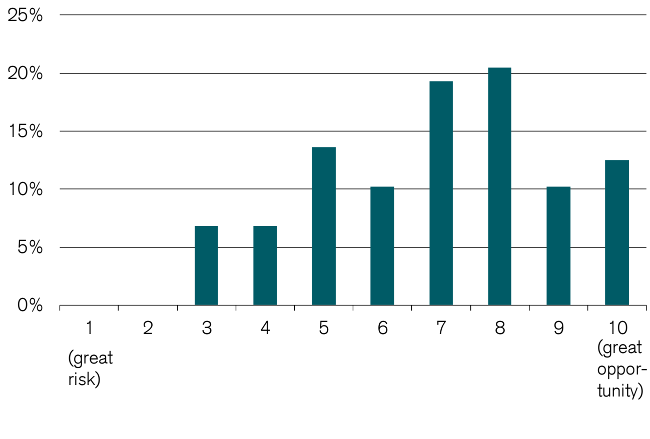
Responses to question on the development of demand since COVID-19 outbreak



Source: Credit Suisse PropTech Survey 2020 (N = 88)

Fig. 8: Opportunities outweigh the risks

Evaluation of opportunities and risks after the coronavirus pandemic



Source: Credit Suisse PropTech Survey 2020 (N = 88)

Real estate players becoming more open to PropTech solutions

The outbreak of the coronavirus pandemic has also brought some benefits for the technological pioneers of the real estate industry. Compared to last year's survey, interest in PropTech solutions appears to have increased (Fig. 9). 11% of PropTechs (compared to 7% the previous year) discern a strong increase in receptiveness to PropTech solutions on the part of real estate companies. 70% (compared to 56% the previous year) record a "certain" degree of receptiveness to their solutions. It is hardly surprising that PropTechs from the floorplans/AR/VR/3D category report a high level of receptiveness, particularly as, among other things, they offer solutions to temporary restrictions on physical property visits. But heightened interest was also perceived by PropTechs from the areas of software/CRM data management, marketplaces, and smart building/IoT.

Will COVID-19 usher in phase of consolidation?

As mentioned at the beginning, a certain degree of consolidation had become evident in the PropTech industry even before the onset of the coronavirus crisis. According to the "Hype Cycle" published by the consultancy firm Gartner, the steep rise in public awareness often witnessed at the start of a new technology could now be leveling off. It may well be that COVID-19 is now acting as a catalyst, accelerating the descent into the "Valley of Disappointment" before a gradual renewed rise to the "Plateau of Productivity" kicks in. In response to the question of whether COVID-19 will usher in a phase of consolidation in the PropTech sector, the industry appears split (Fig. 10). For 40% of respondents this appears to be rather unlikely (responses between 1 and 3). On the other hand, 24% (responses between 8 and 10) anticipate consolidation and less competitive pressure in the future. Opinions are split on this issue not only in the wider sector, but also within certain PropTech categories. This is particularly apparent in the marketplaces and smart building/IoT areas. In both of these categories, as well as in the software/CRM/data management area, PropTechs believe consolidation is more likely than not.

Consolidation would help the major players

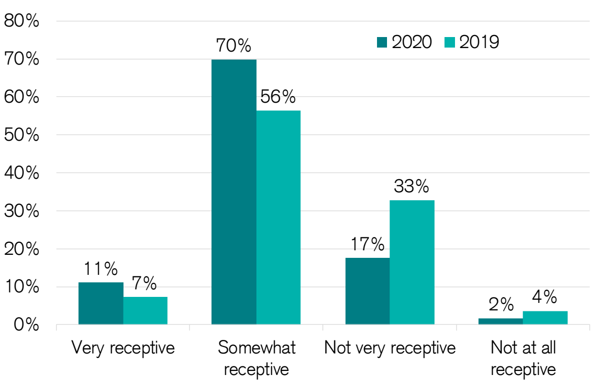
Certain areas would appear ripe for a consolidation. Such a process is already apparent in the marketplaces segment: Whereas there were still 43 marketplaces in this category in 2019, there are now just 36 according to the PropTech Map Switzerland. Platforms no longer in operation or repurposed in some way include newflat, Raiffeisen Casa, coozzy, elocations, and homespeed. In the event of consolidation in the PropTech sector, the big players could find it easier to survive. Size matters when it comes to making it onto the radar of real estate market protagonists. A merger of similar PropTech types would also help to speed up the process of gaining the much-needed attention of prospective clients.

Investors might adopt more selective approach

Investor behavior is something else that might provide a boost to consolidation. During the lockdown and the flight of much of the investment community to liquidity, many investors started to review their portfolios with a view to establishing whether they were fit for the future. This could lead them to be more selective going forward, and refocus their attention on PropTechs offering the greatest opportunities. At any rate, it does not look like the investment taps will be gushing in quite the same way in the future. This applies not just to the PropTech sector, but also to up-and-coming companies generally. After a slew of disappointed expectations, failed IPOs, and headline-grabbing accounting scandals, a more conservative mindset has re-established itself. And as even more PropTech start-ups have forced their way into the market in recent years, the consolidation pressure will remain high in any case.

Fig. 9: Receptiveness to PropTech solutions

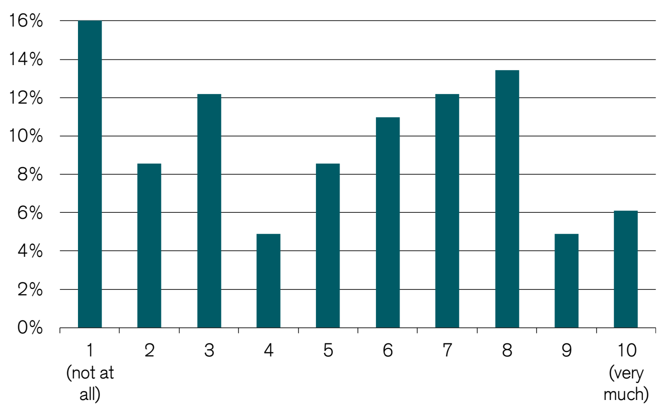
Comparison of responses from 2019 and 2020 surveys



Source: Credit Suisse PropTech Survey 2020 (N = 63), Survey 2019 (N = 55)

Fig. 10: Consolidation as consequence of COVID-19?

Responses to question of consolidation as a result of COVID-19



Source: Credit Suisse PropTech Survey 2020 (N = 82)

Are investors becoming more reticent?

Many PropTechs were unable to give an answer to the question of whether investors had become more reticent since the outbreak of the coronavirus pandemic. Partly this reflects these companies' financing structures, which often do not contain any external investors at all. This is likely to be the rule at least for the smaller PropTechs. Where the other companies are concerned, those with an established circle of investors already in place are likely to have an advantage in the coronavirus era. Given a typical investment horizon of five to seven years in the venture capital segment, the current crisis is unlikely to prompt the corresponding capital providers to suddenly walk away. By contrast, the acquisition of new venture capitalists is likely to be more of a challenge.

PropTech funding needs of a manageable nature

For the time being, the coronavirus crisis has not significantly changed the financing needs of the great majority of PropTechs (Fig. 11). Around a third of PropTechs do not currently see any need for additional funding. For around 40%, by contrast, greater financing needs are apparent (responses between 4 and 10) – for example, because the period of time until breakeven has been extended by the crisis, or because existing backers are no longer on board to the same degree. 10% of PropTechs report much higher financing requirements (responses between 8 and 10). As a rule, PropTechs that have existed for a number of years are more likely to face funding challenges going forward.

Many PropTechs are self-financed

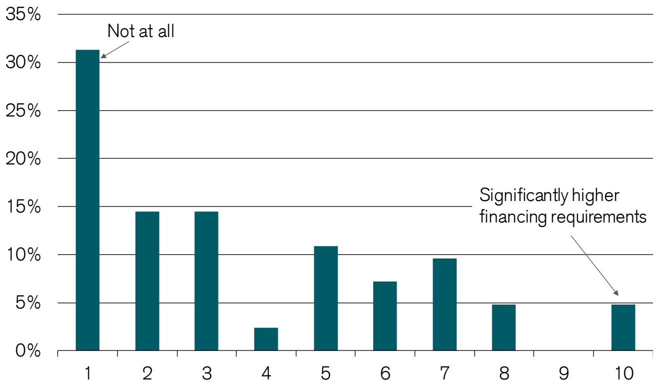
A key reason why the financing needs of Swiss PropTechs look to be relatively manageable overall is the high degree of self-financing in this sector (Fig. 12). Three-quarters of PropTech companies obtain their capital from founders and partners (74%). This result is very robust, particularly since last year's survey delivered almost exactly the same result (76%). In comparison with the 2019 survey, however, the capital proportion of established companies who get involved as providers of capital and often as strategic partners has increased to 10%. This increase has primarily come at the expense of business angels (6%) and venture capitalists (2%). This financing structure explains why many PropTechs still have little contact with professional investors, and why impending financing needs are therefore manageable.

Key question: How will PropTechs ensure long-term survival?

That said, the position of PropTechs when it comes to raising funds is unlikely to be as healthy as it was prior to the coronavirus crisis. Risks have increased overall as a result of the global economic slump – if nothing else because of the increased uncertainty. Strategic investors, who hold a not insignificant stake in fast-growing PropTechs, could themselves find the next few quarters very challenging in the aftermath of the crisis, which could in turn diminish their interest in such holdings. In any case, higher-risk financing has become more expensive to obtain. Founders in search of funds may therefore have to be prepared to make greater concessions to potential investors, with the resulting reduction in the value of their own stakes. On the positive side, the long-term outlook for PropTechs now appears much brighter as a result of COVID-19. However, the key question is how PropTechs will be able to secure their survival over the longer term, particularly with the likely rise in short-term challenges.

Fig. 11: Impact on financing needs

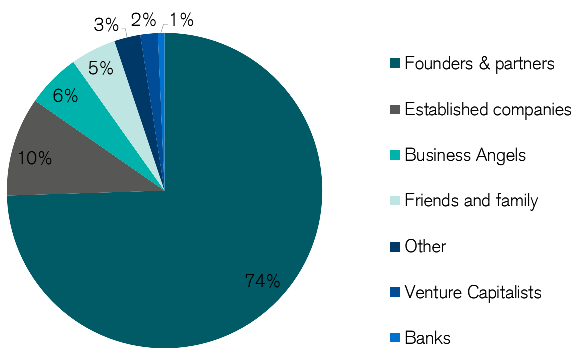
Responses to question as to whether COVID-19 has changed financing needs



Source: Credit Suisse PropTech Survey 2020 (N = 83)

Fig. 12: Financing structure of PropTechs

Financing sources of surveyed PropTechs



Source: Credit Suisse PropTech Survey 2020 (N = 69)

A portrait of three participants in the Swiss PropTech Survey 2020

In order to highlight the multifaceted and vibrant PropTech landscape, we give three participants in the PropTech Survey the opportunity to introduce themselves. Companies that have appeared in previous PropTech reports were excluded from the selection process.

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