SFAMA
Swiss Funds & Asset Management Association

Real Estate Funds

The Swiss Funds & Asset Management Association SFAMA (SFAMA), which was established in 1992 with its registered office in Basel, is the representative association of the Swiss fund and asset management industry. Its members include all the major Swiss fund management companies, many asset managers, and representatives of foreign collective investment schemes. Among SFAMA's members there are also numerous other service providers operating in the asset management sector. SFAMA is an active member of the Brussels-based European Fund and Asset Management Association (EFAMA) and the International Investment Funds Association (IIFA) in Montreal. For further information, please visit www.sfama.ch. You can also follow us on Twitter @SFAMAinfo.

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EDITORIAL

Tried-and-tested Swiss real estate funds

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Tradition

Real estate funds can look back on a lengthy history, and are in fact the oldest investment funds in Switzerland: Swissimmobil Series D was launched in 1938, followed just five years later by Foncipars. The latter still exists to this day. It is a similar story outside Switzerland, with real estate funds accounting for six of the 25 oldest funds in the world.

Tried-and-tested asset class

Despite their successful track record stretching back many years, real estate funds were long overlooked as wallflowers in Switzerland. This has changed markedly in the meantime, and in the past decade Swiss investors have discovered real estate funds as an efficient instrument for diversification and an attractive investment. This is unsurprising given the wide range of advantages they offer, such as the high stability and resilience of the investments held by the funds and good performance, as well as low correlation with other asset classes and thus also lower risk. The borrowing ratio of real estate funds may not exceed 33%, for example, and they represent a less risky investment. They are best suited for investors with an investment horizon of at least five years. Over the past five years, real estate funds have posted an average annual performance (price gains and distributions) of around 6%.

Steady growth in volumes

Some CHF 30 billion was invested in real estate funds in Switzerland as of the end of 2015, with volumes thus having doubled over the past ten years. In addition to this, Switzerland's big banks have set up real estate funds abroad with internationally focused investment policies, and also distribute these products successfully outside Switzerland.

Information

This brochure, which was written in close cooperation with SFAMA's Real Estate Funds specialist committee, will give you a concise overview of the key facets of this fund category, and we hope you find it interesting reading.

Sincerely yours

Markus Fuchs
SFAMA Managing Director

Roger Hennig
Chairman of SFAMA's Real Estate Funds specialist committee

Real estate funds, listed real estate companies, investment foundations, direct investments

History

Swiss private investors have three avenues open to them for investing in real estate in Switzerland: real estate funds, listed real estate companies, and direct investments. Institutional investors have a further option, namely investment foundations. Investment companies and listed real estate companies are a relatively new phenomenon. In 2000, a number of significant real estate companies made their way onto the SIX Swiss Exchange (SIX).

Direct investments

Direct investments in real estate entail an increased risk for private investors in that they require more capital and as a result preclude participation in large, diversified real estate portfolios.

Listed real estate companies

The profile of listed real estate companies features higher risks and returns due to their higher average degree of leverage, which can be more than 50%, and their focus on commercial property. In addition to this, they tend to be exposed to a certain degree of equity risk and react with greater volatility than funds to fluctuations on the stock market.

Real estate funds

Meanwhile, real estate funds have lower leverage, focus mostly on existing properties (no development projects), and have a weaker correlation to the financial markets. They can thus be expected to provide a more stable performance than listed real estate companies. With a real estate fund, investors can redeem their units at the net asset value (see glossary) subject to one year's notice to the end of the fund's financial year. These funds also do not engage in any other activities, such as general contracting. Added to this, they are subject to Switzerland's Collective Investment Schemes Act (CISA) and come under the supervision of the Swiss Financial Market Supervisory Authority FINMA. The main information documents for investors are the prospectus and simplified prospectus. All listed real estate funds can be found on the SIX website (www.six-swiss-exchange.com). Swiss Fund Data AG (SFD) also includes the unlisted real estate funds on its website (www.swissfunddata.ch).

HOW A REAL ESTATE FUND WORKS

Simple and efficient

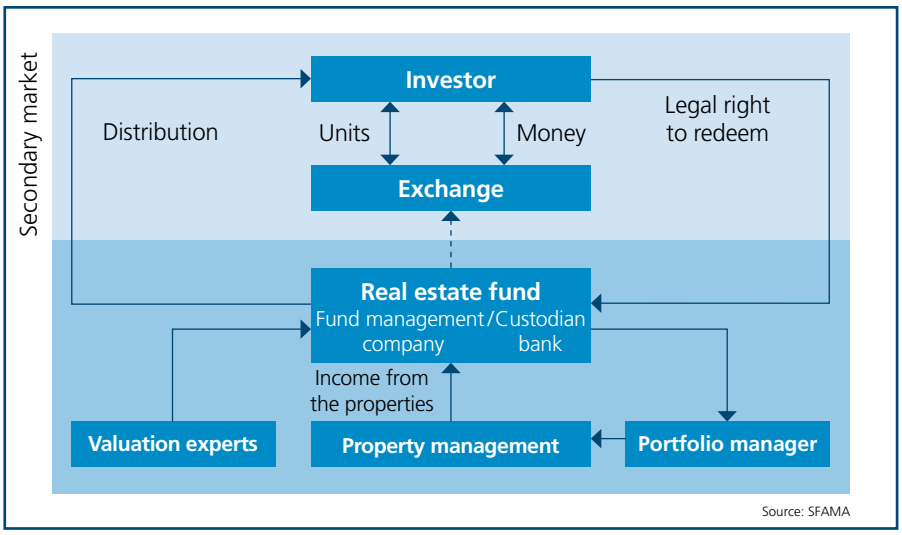
Pooled assets

A large number of investors, acting independently of each other, place money that they have available in a common pot – the real estate fund. The total assets amassed in this way are managed by the fund management company. A team of experts covering a range of disciplines invests the assets in different properties – ensuring diversification in terms of developed and undeveloped plots, type of property, and geographic location – with the key criteria being capital preservation and appreciation.

Clear allocation of tasks

Real estate funds are open-ended collective investment schemes, and take the form of either contractual funds or investment companies with variable capital (SICAVs). Real estate funds are approved and supervised by FINMA, which also authorizes and supervises the fund management company and custodian bank. The fund management company performs the key tasks relating to a real estate fund itself, or delegates them to a third party in accordance with the CISA. Decisions on the purchase or sale of properties, as well as on construction and renovations, lie with the portfolio manager. Once the properties have been acquired by a fund, the property manager handles maintenance, letting etc. and transfers the income from the properties (e.g. rent) to the real estate fund. The income generated by the properties is distributed to investors annually. If the market value of the properties has to be determined for the valuation of the fund assets, this is carried out by independent valuation experts. Given that a fund's assets are valued only once a year, the fund management company must ensure that the units are traded on an exchange (secondary market). This means that real estate fund investors can buy and sell units on the exchange at any time, while also retaining their statutory right to return their units directly to the fund management company for redemption. However, such direct redemptions are subject to a 12-month period of notice to the end of the fund's financial year.

How a Swiss real estate fund works



Source: SFAMA

Positive performance over several years

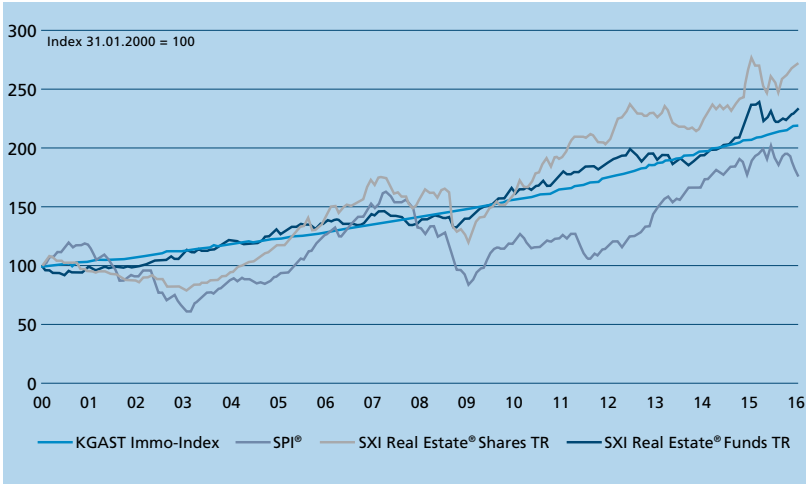
Less risk

The performance of the real estate markets is to a certain extent independent of the financial markets and, as a rule, also subject to less pronounced fluctuations. Thanks to these characteristics, real estate funds can be used to lower the overall risk of a securities portfolio and improve the risk/return profile.

Performance

On average over the past 30 years, Swiss real estate funds have generated a dividend yield (gross amount as a percentage of the exchange or market price) of around 3%, with the corresponding overall performance (change in price plus any distributions) coming to about 6%. They thus yielded more than the corresponding 10-year Swiss Confederation bonds, and this with only slightly higher risk. The long-term average performance is also only slightly below that of Swiss equities, which entail much greater risk and are subject to stronger fluctuations.

Index performance

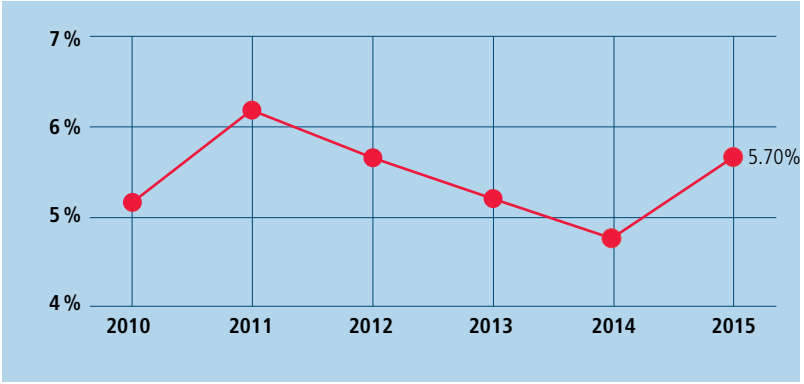


Sources: UBS Asset Management, SIX, KGAST

SFA ARI®

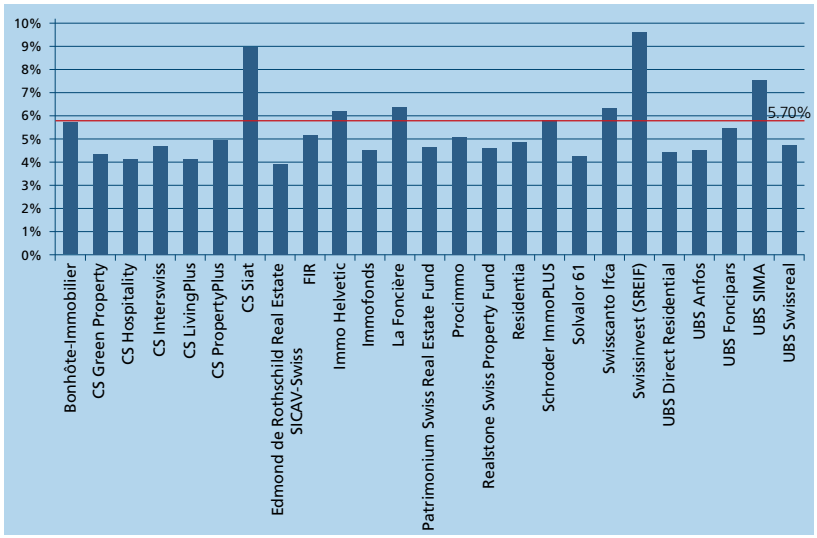
The SFA ARI® investment yield indicator was launched in April 2012 with a view to making it possible to compare the actual yields of listed Swiss real estate funds at the product level. The SFA ARI® is based on the investment yield statistics and is calculated quarterly (in the middle of January, April, July, and October). It is published on the SFAMA and SFD websites. The fund universe comprises all real estate funds listed on the SIX Swiss Exchange that make direct real estate investments in Switzerland, with Switzerland being their sole investment country. Funds of funds and Swiss funds that invest directly outside Switzerland are thus excluded.

Development of the SFA ARI®



Source: SFD

Investment yields of the real estate funds covered (as at end-2015)



Source: SFD

CHARACTERISTICS OF REAL ESTATE FUNDS

Advantages

Portfolio enhancement

Real estate funds are ideal building blocks for wealth creation and preservation. Investors can thus add them to their portfolios of securities and profit from the many features these funds have to offer.

Steady income and attractive distributions

The rental income of a real estate fund's investments is only influenced to a limited extent by changes in land and property prices. Hence, relatively steady income (distributions) can be expected. Thanks to regular rental income from their properties, real estate funds generate attractive dividend yields that are around three percentage points higher than the average yield on Swiss Confederation bonds (as at end-2015).

Broad diversification

Thanks to the diversification across a wide range of properties in different locations – and also in terms of the different usage, e.g. residential or commercial properties – the investment risk is reduced by comparison with direct investments.

Low correlation

Given that the performance of the real estate markets is not solely dependent on the financial markets, real estate funds offer a good possibility for reducing risk and stabilizing the returns of an overall portfolio.

Low entry level

Investors can participate in Swiss real estate funds from less than CHF 100. The transaction costs are also lower compared with direct investments.

Liquid and highly transparent

Units of listed real estate funds can be bought or sold at any time on the stock exchange, or returned to the fund management company for redemption. Specific information on the funds can be found in their annual and semi-annual reports, as well as in regular publications.

Valuable time savings

Real estate funds relieve investors of all the time-consuming tasks involved in buying and managing properties (redevelopment, renovations, letting).

Professional management

The fund managers and their external partners deal with the Swiss real estate market and the properties in their portfolio every day, and are thus experts in their field.

Investor profile

Long-term investment horizon

If the following statements apply to you, real estate funds may also be suitable for you:

- You are convinced of the advantages of a real estate fund over direct investments.
- You want to participate in a broadly diversified portfolio of Swiss properties in a simple manner.
- You are interested in preserving and increasing the value of your investment, as well as in a stable dividend yield.
- You are an income-oriented investor with a long-term horizon (at least five years).
- You are looking for an addition to your securities portfolio that has relatively low correlation with the financial markets.

Differences in taxation

Direct or indirect property ownership

The taxation of real estate funds differs depending on whether a fund holds its properties in direct ownership or indirectly via real estate companies. In the case of direct ownership, taxation takes place only at the level of the fund, while investors are mostly exempt from income and wealth taxes on distributions. In the case of indirect ownership, the real estate companies held by the real estate fund are subject to tax on income and capital. In addition to this, investors are taxed on the distributions.

Lex Koller

Purpose and amendments

One law that is often mentioned in connection with real estate funds is "Lex Koller", which entered into force in 1985. This federal law, which was aimed at countering the rising demand from outside Switzerland at that time for residential properties and above all holiday homes, essentially prohibits people from abroad from buying property in Switzerland. It was subsequently amended in 1997 and 2002 to allow foreign investors to buy so-called real estate for permanent business establishment purposes (manufacturing and service enterprises). Furthermore, the authorization requirement was lifted for all citizens of the EU and EFTA member states resident in Switzerland. Since 2005, indirect investments in real estate – i.e. the purchase of units in real estate funds and participation in real estate companies – have no longer been subject to Lex Koller provided the real estate funds are publicly traded and the real estate companies are listed on an exchange.

CISA, FINMA, and SFAMA

Legislation

Together with securities funds, real estate funds are among the most strictly regulated financial products in Switzerland. The CISA, which entered into force on 1 January 2007 and was revised as of 1 March 2013, governs all aspects relating to real estate funds, from administration and management to safe-keeping and distribution. The detailed implementing provisions are set down in the ordinances issued by the Federal Council (CISO) and FINMA (CISO-FINMA).

Supervision and self-regulation

Real estate funds are approved for distribution and subsequently supervised in Switzerland by FINMA. The service providers involved – i.e. the fund management company, the custodian bank, distributors etc. – also require FINMA authorization. Furthermore, the fund industry has committed itself to a self-regulation regime. SFAMA has issued the following self-regulation documents for real estate funds:

- SFAMA Code of Conduct
- Guideline for Real Estate Funds
- Specialist information factsheet on key figures of real estate funds
- Specialist information factsheet on the issuing of real estate fund units.

Duties and key data

Comparable real estate funds

Since 2005, there have been clear regulations on real estate funds' duties of loyalty, due diligence and disclosure vis-à-vis their investors in the form of the guidelines issued by SFAMA, which have been recognized by FINMA as a minimum standard. As regards the duty of loyalty, the primary focus is on avoiding conflicts of interest. Market values are thus determined by independent valuation experts, for example. As part of the duty to provide information, fund management companies and SICAVs are obliged to regularly publish key data on their real estate funds, among other things (see glossary). This ensures that it is easy to compare funds against each other, which contributes to more transparency. For example, the following key data are published regularly: rent default rate, borrowing ratio, operating profit margin (EBIT margin), fund total operating expense ratio (TER_{REF}), return on equity (ROE), dividend yield, payout ratio, premium/discount, performance, and investment yield.

Discounted income value approach

Discounted cash flow

The uniform valuation of properties is a key issue for SFAMA. Since the end of 2007, all real estate funds must carry out their valuations using a discounted income value approach, e.g. the discounted cash flow (DCF) method. The decisive element with this method is the net income from future revenues and costs. The discounted approach allows the implications of future market and interest-rate developments to be reflected as well as possible.

The DCF valuation has the following advantages:

- transparency with regard to expected income, costs, vacancies, and risks
- risk-adjusted perspective (returns/risk/performance)
- formation of scenarios "What if…"/early warnings
- changes in usage can be modeled (e.g. conversions)
- basis for further analysis (e.g. portfolio analysis)
- uniform parameters.

SFAMA Guideline for Real Estate Funds

According to Art. 92 and 93 CISO and the SFAMA Guideline for Real Estate Funds (see www.sfama.ch - under Self-Regulation & Model Documents - Real estate funds), the properties held by a fund must be valued regularly by independent valuation experts using a discounted income value approach. Properties are valued at the price that would probably be obtained in a diligent sale at the time of valuation. Whenever properties held by a fund are bought or sold and at the end of every financial year, the market value of the properties in the fund's assets must be checked by the valuation experts. The market value of the individual properties represents the price that would probably be achieved in normal business dealings assuming a diligent sale or acquisition. Any opportunities that arise in individual cases – in particular in the acquisition and sale of fund properties – are exploited for the account of the fund. This can lead to differences compared with the valuations.

GLOSSARY

List of terms used

Borrowing ratio

The borrowing ratio shows the extent to which the properties are financed with borrowed capital. In the case of real estate funds, borrowing is limited by law and must not exceed one third of the market value of the properties taken over the average of all properties.

Cash flow yield

The net income before amortization, depreciation, and provisions represents the cash flow generated in the past financial year. The cash flow yield expresses the previous year's cash flow in relation to the current exchange price, and offers information on the earnings power of a fund.

Correlation

Measures the degree of dependency between the price movements of different investment instruments and the performance of a benchmark index.

Dividend yield

The dividend yield expresses the last gross distribution amount per unit or share as a percentage of the exchange or market price.

Fund contract

The fund contract is a comprehensive document containing all the legally required information on the fund, such as the fund's name, the name and registered office of the fund management company and the custodian bank, the rights and obligations of the parties to the contract, the investment policy guidelines, the calculation of the net asset value, the issue and redemption of units, as well as fees and incidental costs.

Fund total operating expense ratio (TER_{REF})

The TER_{REF} (Total Expense $Ratio_{Real\ Estate\ Funds}$) is closely based on the TER of securities funds and is an indicator of the burden placed on the fund by the operating expenses.

Gross yield

Rental income as a percentage of the market value of a property.

Income value

The value of a property calculated on the basis of the rental income. The income value is the most important factor in the valuation of a property.

Investment yield

The investment yield of a real estate fund corresponds to the change in the net asset value of the units under the assumption that the gross amount of any distributions of income and/or capital gains is immediately reinvested without deductions at the net asset value of the units.

Market value

Current value of a property that would probably be obtained in a diligent sale as assessed by independent experts.

Net asset value

The net assets of a fund divided by the number of units.

Net fund assets

The assets calculated at market prices, minus liabilities and deferred taxes. The net fund assets correspond to the equity after liquidation taxes.

Operating profit margin

Also referred to as the EBIT margin. The operating profit margin expresses the operating earnings before interest and taxes (EBIT) in relation to the net rental income. This statistic makes it possible to obtain information on the quality of the portfolio, the efficiency of management, and the cost structure of the company.

Payout ratio

The payout ratio shows the income distribution as a proportion of the generated cash flow.

Performance

The performance of a real estate fund corresponds to the total return achieved on a unit in a given period (change in price plus any distributions). It is expressed as a percentage of the exchange or market price of the units at the beginning of the reporting period.

Premium/discount

Percentage difference between the exchange price and the net asset value (after deferred taxes) of fund units. A premium means that the market views the product as being attractive, and that investors are prepared to pay extra. In the case of a discount, the exchange price is lower than the net asset value adjusted for the distribution.

Redemption price

Price at which real estate fund units must be redeemed by the fund management company subject to the period of notice required by law.

Rent default rate

Also known as the income default rate. The rent default rate is a key indicator of the rental situation. It expresses the rent defaults in relation to the expected net rental income.

Return on equity (ROE)

The ROE indicates how efficiently a company has used the equity at its disposal.

SFA ARI® investment yield indicator

The SFA ARI® is based on the investment yield statistics and is calculated quarterly. It makes it possible to compare the actual yields of listed Swiss real estate funds at the product level.

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