

**Swiss Real Estate Funds –
A Tried-And-Tested Asset Class**

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EDITORIAL



Dr. Matthäus Den Otter



Markus Graf

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. Outside Switzerland, it is a similar story, with real estate funds accounting for six of the 25 oldest funds in the world.

Despite their successful track record stretching back many years, real estate funds were overlooked as wallflowers in Switzerland at the end of the 1990s. This has changed markedly in the meantime, and in recent years Swiss investors have discovered real estate funds as an efficient instrument for diversification and an attractive investment. This should come as little surprise given the wide range of advantages this fund category has to 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. For example, the borrowing ratio of real estate funds cannot exceed 50% 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 of around 5%.

Some CHF 20 billion was invested in real estate funds in Switzerland as of the end of June 2008. 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.

The Swiss Funds Association SFA (SFA) wants to inform investors in Switzerland about real estate funds under Swiss law and their specific characteristics. This brochure, which was written in close cooperation with the SFA's Real Estate Funds specialist committee, will give you a concise overview of the key facets of this fund category, and we hope you will find it interesting reading.

Yours

A handwritten signature in black ink, appearing to read 'D. Den Otter'.

Dr. Matthäus Den Otter,
CEO of the SFA

A handwritten signature in black ink, appearing to read 'M. Graf'.

Markus Graf,
Chairman of the SFA's Real Estate
Funds specialist committee

POSSIBILITIES FOR REAL ESTATE INVESTMENTS

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

History

Swiss private investors essentially have three avenues open for investing in real estate in Switzerland: real estate funds, listed real estate companies or direct investments. Institutional investors have a further investment option, namely investment foundations. Listed real estate companies are a relatively new phenomenon. It was only in spring 2000 that a number of significant real estate companies made their way onto the SWX Swiss Exchange, now the SIX Swiss Exchange. Listed real estate companies' profile features higher risks and returns, not least due to their higher average degree of leverage and their focus on commercial property. There are also increased risks for private investors in the case of direct investments, as these require more capital and as a result preclude participation in large, diversified real estate portfolios.

Further differences

There are other differences between real estate funds and 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. Both real estate fund units and real estate equities can also be traded on exchange at any time. Furthermore, most real estate funds invest primarily in residential property, whereas listed real estate companies concentrate heavily on commercial premises. Hence an investment in real estate funds can be expected to have a more stable performance than in the case of real estate companies, given that renting out apartments is much less sensitive to the economic cycle than offices or selling space. In addition to this, real estate companies 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 also do not engage in any other activities, such as general and total contracting. The leverage of listed real estate companies can exceed 50%, while in the case of real estate funds the borrowing ratio is limited to a maximum of 50%. As a rule, levels are between 10% and 30%. Funds are also subject to the regulations of Switzerland's Collective Investment Schemes Act (CISA) and come under the supervision of the Swiss Federal Banking Commission (SFBC). Investors have the respective prospectus and simplified prospectus as the main information documents. The latter contains all the key information in a readily understandable format, and unlike in the EU is also compulsory for real estate funds in Switzerland. All listed real estate funds can be found at www.swx.com/marketpulse. The unlisted real estate funds can also be found on the website of Swiss Fund Data AG.

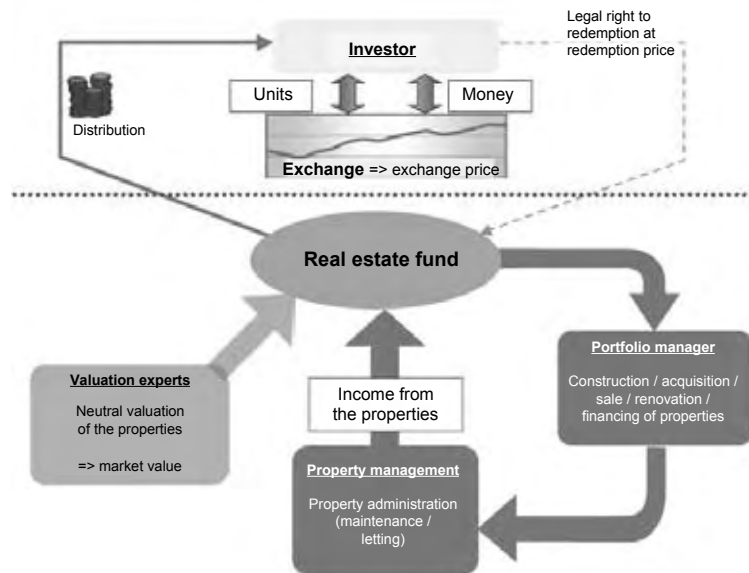
HOW A REAL ESTATE FUND WORKS

Simple and efficient

A common pot

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 a team of specialists covering different disciplines and are invested in various properties. In so doing, the team must adhere exactly to the provisions of the fund contract and the CISA.

How a Swiss real estate fund works



Capital preservation and value growth

With real estate funds, investors participate in a broadly diversified, professionally managed real estate portfolio in proportion to the investment made. The two key criteria here are capital preservation and value accretion, with active portfolio management being a significant factor in investment success on the real estate market. As a rule, investors can expect a fund to generate steady income, which is reflected in the distribution. The properties are valued by independent experts. This ensures that the assessment is independent and in line with the market, an important point for investors.

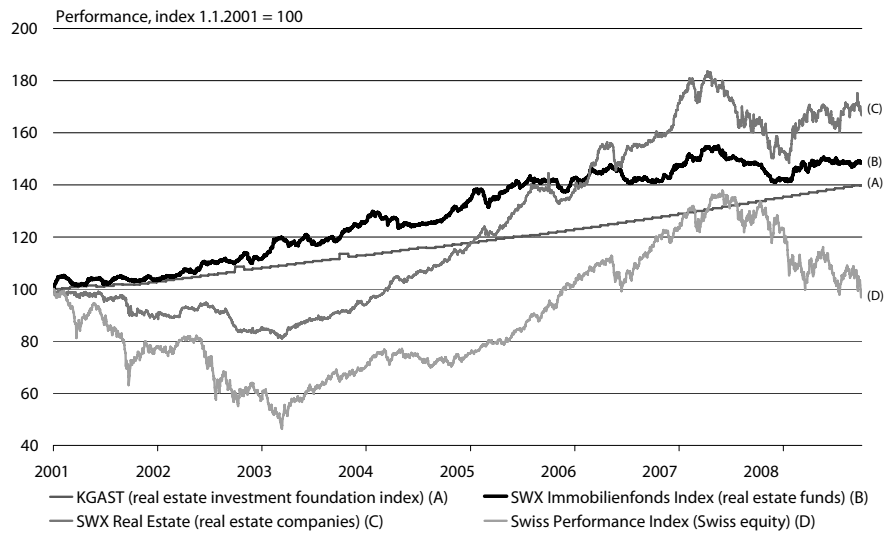
REAL ESTATE FUND RETURNS

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. On average over the past 30 years, Swiss real estate funds have generated a dividend yield of over 3.5% and an overall performance (distribution plus price gains) of more than 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.

Performance



ADVANTAGES OF REAL ESTATE FUNDS

Characteristic qualities

Portfolio enhancement

Real estate funds are ideal building blocks for wealth creation and preservation. Investors can thus add them to their securities portfolio and profit from the following characteristic features of real estate funds:

■ **Steady income and attractive distributions**

The rental income of a 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 some 1–1.5 percentage points higher than the average yield on Swiss Confederation bonds (as of September 2008).

■ **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 the risk and stabilizing the returns of an overall portfolio.

■ **Low entry level**

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

■ **High flexibility, liquidity and transparency**

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 in connection with the acquisition and administration of properties (development, 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

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.
- You are looking for an addition to your securities portfolio that has relatively low correlation with the financial markets.

CLEAR REGULATIONS

Real estate funds made comparable

Duties and key data

Since 2005, there have been clear regulations on real estate fund companies' duties of loyalty, due diligence and disclosure vis-à-vis their investors in the form of the SFA guidelines (see www.sfa.ch), which have been recognized by the SFBC 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 disclose information, fund management companies are obliged to regularly publish key data on their funds, among other things. 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 operating expense ratio (TER_{REF})
- return on equity (ROE)
- dividend yield
- payout ratio
- premium/discount
- performance
- investment return

VALUATION OF REAL ESTATE

Discounted income value approach

Discounted cash flow

The uniform valuation of properties is a key issue for the SFA. 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

SFA Guidelines for Real Estate Funds

Pursuant to Art. 88.2 CISA, Art. 92 and 93 CISO and the SFA Guidelines for Real Estate Funds (see: www.sfa.ch), the properties held by a fund must be valued regularly by independent valuation experts recognized by the SFBC 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 in the interests of the fund. This can lead to differences compared with the valuations.

REAL ESTATE FUNDS AND TAXES

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 fund are subject to tax on income and capital. In addition to this, investors are taxed on the distributions.

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 half 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 is referred to as cash flow, and 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 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 return	The investment return 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 positive premium means that the market views the product as being attractive, and that investors are prepared to pay extra. In the case of a negative difference – which is known as 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.

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