

Investment theme

Favorable basic data speaks for Swiss real estate market

Real estate Switzerland

Lead analyst
Claudio Saputelli
 claudio.saputelli@ubs.com

Overview

In Switzerland, as in other countries, the global credit crisis has resulted in individual adjustments of real estate values in the transaction market. Still, this trend was significantly less pronounced than in foreign real estate markets, which are still struggling. The value adjustments observed in the transaction market were particularly caused by (foreign) investors whose inflationary approach made use of a very high proportion of borrowed funds; these investors have meanwhile retreated entirely from the Swiss real estate market. The increased risk premiums and debt financing costs on one hand and the upward movement of the Swiss franc on the other have put an abrupt end to the attractiveness of this aggressive financing method. Nevertheless, the Swiss real estate market remains interesting for moderately debt-financed investors with long-term strategies. This can be seen from the favorable basic data. It appears that the price increase potential for real estate projects has not yet been exhausted in some premium locations. The picture looks different for properties in less attractive locations, where slightly lower demand is expected due to saturation trends and the imminent economic downturn. However, the fact that the increase in supply has already slowed down to some extent should have a supporting effect on the prices.

- Rental housing market:** Though faced with ever-growing competition in the form of condominiums, the future looks bright for the rental housing segment. Dynamic population growth is expected to continue generating a solid demand and hence stable rental income in the years to come.
- Residential property market:** The Swiss residential property market is much more attractive than many of its overseas counterparts. Despite substantial price increases since 2000, residential property remains affordable. Measured by household income and debt financing costs, the prices are currently approximately 30% lower than at the peak of the real estate boom in the early 1990s.
- Office space market:** The current situation in the Swiss office market is cautiously positive. Stable rental income, rather moderate ratings, and virtually no financing difficulties in connection with mostly unassertive strategies (moderate lending amounts) support the market. In Switzerland as a whole, rents are expected to move in a lateral direction due to the high vacancy rate.

Asset class: real estate

Economic forecasts for Switzerland

Prior year comparison in %, real	2007	2008	2009
Gross domestic product	3.1	2.3	1.4
Building investments	-2.9	-0.3	-0.7
Inflation	0.7	1.8	1.4
3 month LIBOR CHF ¹⁾	2.8	2.3	2.0
Yield 10 y. federal bonds ¹⁾	3.0	3.0	3.0

Source: UBS WMR | ¹⁾ End of year

Forecast

Sector	Rents	Rental yield	Prices
Condominiums			→
Single-family homes			→
Rental apartments	→	→	→
Office space	→	→	→

Source: UBS WMR

Rental housing market

Temporary divergence between existing rents and inflation

From 1993 to 2003, the indicators for existing rents (rents for ongoing leases) and inflation, both of which are calculated by the Swiss Federal Statistical Office, developed at virtually the same rate. Since then, however, existing rents have slightly diverged from inflation, though it must be taken into consideration that existing rents account for a substantial part (approximately one fifth) of the basket of commodities on the basis of which inflation is calculated. The main reason for the difference in the two trends is that, in recent years, Switzerland regularly reported extremely low annual inflation of about 1%, while the increase in existing rents regularly exceeded the 2% threshold due to increasing mortgage interest rates. Thus, lessors enjoyed a real growth in rental income. However, the discrepancy between the growth rates of these two indicators has slightly diminished since the beginning of this year, i.e. inflation has, unfortunately, adjusted to the higher growth rate of existing rents. Nevertheless, it seems that for the time being, due to the expected downturn of the domestic economy and the associated relaxation on the interest front, both growth rates have passed their zenith.

Quoted rents: slightly attenuated price trend

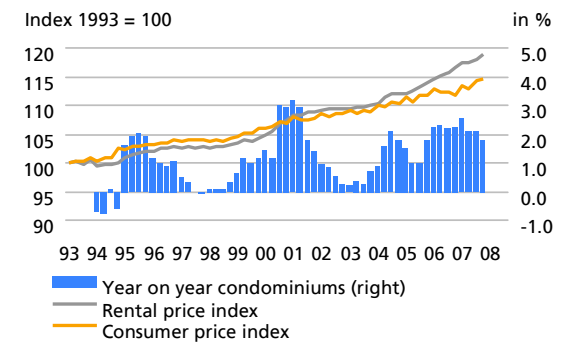
While the quoted rents (rents for re-letting, initial or new letting) for new buildings in 2007 merely exhibited a slight increase (+0.5%), the quoted rents for old buildings maintained their upward trend (+2.0%), which started at the turn of the millennium, albeit more moderately than in previous years. Despite the increased focus on building rental housing over the past two years, the extra demand – part of which was triggered by the free movement policy – could not be met. This applies especially to the Lake Geneva region, where supply is virtually incapable of keeping pace with the extremely heavy demand. Accordingly, the prices in this region have continuously moved upwards for many years. This trend continued in 2007, during which all quoted prices (old and new buildings) once again increased by more than 5%. All in all, quoted rents have increased by more than 50% over the past 8 years. In the new building segment, the increase has even exceeded 80%.

Outlook

A drastic expansion in supply can be expected, especially in regions experiencing a shortage of rental housing. In particular, this applies to northwestern Switzerland and the Lake Geneva region, where measures already initiated to relieve this situation are being pursued. In other regions, the situation is far less critical. This is also evident from the latest changes in quoted prices, which only increased moderately or even receded in these regions in 2007. Due to saturation trends, supply will most likely only expand slightly. In 2008, we expect both existing rents and quoted rents in Switzerland as a whole to increase at a similar rate as in the prior year, i.e. by 2 to 2.5%.

Existing rents and inflation

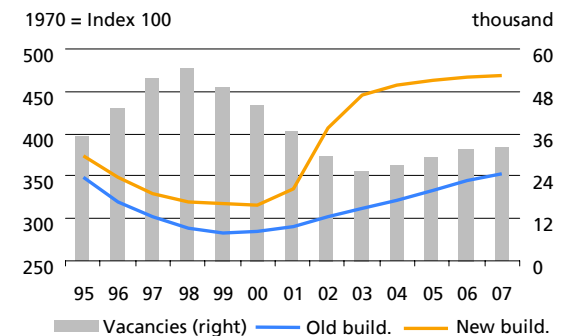
The gap is growing



Sources: BFS, UBS WMR

Rental housing: quoted prices and vacancies

Older buildings: no trend reversal in sight



Sources: Wüest & Partner, BFS, UBS WMR

Quoted prices for rental housing

Increase in 2007 and average increase over the past 5 years

	Old buildings		New buildings		Total	
	2007	Last 5 y	2007	Last 5 y	2007	Last 5 y
Switzerland	2.4%	3.2%	0.7%	2.9%	2.6%	3.3%
Zurich	1.3%	2.7%	0.6%	1.7%	1.4%	2.6%
Eastern Switz.	2.0%	2.0%	-1.3%	2.3%	2.3%	1.9%
Central Switz.	-0.3%	3.1%	-0.4%	1.5%	0.0%	3.2%
Nordw. Switz.	2.8%	2.5%	2.1%	4.7%	2.9%	2.3%
Berne	1.7%	2.0%	1.7%	2.1%	1.9%	2.1%
Southern Switz.	1.4%	3.1%	4.3%	1.5%	2.1%	3.4%
Lake Geneva	5.2%	6.6%	9.6%	4.7%	5.4%	7.1%
Western Switz.	3.4%	3.5%	-4.0%	-0.8%	3.1%	3.8%

Sources: Wüest & Partner, UBS WMR

Residential property market

Condominium property: end of the flattening off of the price curve

2007 witnessed the ninth consecutive increase in quoted prices for condominium property. The increase in Switzerland as a whole amounted to 2.1%, which was somewhat surprising in view of the brisk building activity in this segment and last year's flattening of the price curve. With the exception of central Switzerland (-2.0%), quoted prices increased in all regions, most prominently in the regions of Lake Geneva, Zurich, and southern Switzerland. While the first two regions benefit from the city bonus, the prices in southern Switzerland are mainly driven by the tourist areas. As in the prior year, price development remained virtually consistent in terms of apartment size, though in recent years, large apartments (4+ rooms) accounted for 80% of all apartments built. Nevertheless, absorption, which, by definition, also includes demand, is much more important for price development than merely how much is on offer. The more or less consistent price development for different apartment sizes indicates that absorption is about the same for all sizes in the real estate market. This would appear to indicate that, as a whole, supply is keeping pace with demand, and no speculative supply surplus has formed in the real estate market.

Single-family houses: viable property is rare

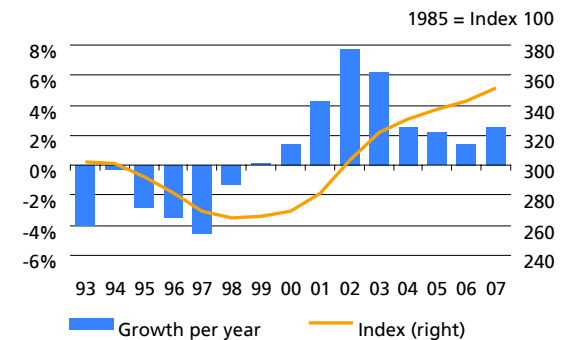
Owing to the fact that the Swiss economy is (still) strong, the demand for single-family houses has also increased, especially since income, and therefore the affordability of available property, has improved considerably. The increased demand is also reflected in the quoted prices, which picked up by another 2.0% in 2007, a figure that is only slightly below the five-year average. In general, two trends are evident in the single-family housing segment: While top property in premium locations often fetches excessive prices due to the meagre supply, outdated single-family houses that no longer meet the quality expectations of prospective buyers increasingly suffer the opposite fate.

Outlook

In 2007, the population in Switzerland grew by 1.1%, substantially surpassing the rates of previous years. Migration, due to the favourable economic situation and freedom of movement accounts for approximately 80% of this figure. The solid demand will most probably continue to support the prices in both sectors, especially in view of the slightly abated expansion of supply according to the latest figures on building permits issued for housing. Moreover, as the long-term financing conditions are still attractive, we expect a price increase of just under 2% for Switzerland as a whole.

Quoted prices for condominium property

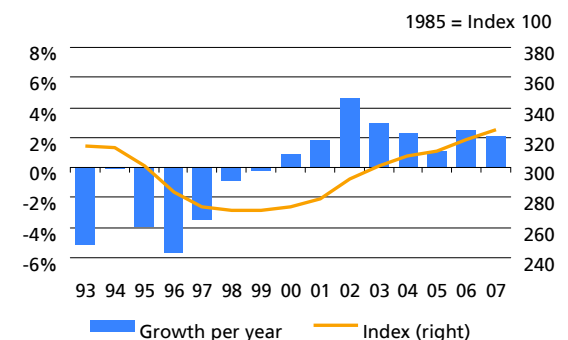
Further price increases despite saturation trends



Sources: Wüest & Partner, UBS WMR

Quoted prices for single-family houses

Higher income promotes demand for single-family houses



Sources: Wüest & Partner, UBS WMR

Quoted prices for residential property

Increase in 2007 and average increase over the past 5 years

	Condominiums		Single-family homes	
	2007	Last 5 y	2007	Last 5 y
Switzerland	2.5%	3.0%	2.1%	2.2%
Zurich	3.4%	2.5%	1.8%	2.2%
Eastern Switz.	1.0%	1.9%	0.4%	1.0%
Central Switz.	-2.0%	1.9%	-0.2%	1.6%
Nordw. Switz.	1.2%	2.4%	2.0%	1.8%
Berne	3.6%	2.5%	2.1%	2.3%
Southern Switz.	4.1%	5.1%	-1.1%	3.0%
Lake Geneva	6.0%	7.3%	12.8%	8.1%
Western Switz.	3.8%	4.4%	1.4%	2.7%

Sources: Wüest & Partner, UBS WMR

Market for office space

Vacancies still abound despite decline

Currently, the local office space market is drawing on the positive impulses from the economy. The sound growth of the gross domestic product – since 2004, it has been growing above its long-term potential – is accompanied by a considerable improvement in the employment situation. This, in turn, has helped to bring some life into the office space market, though this has only been noticeable since 2006 and predominantly in the city centers of economic metropolises, where office space has become rather scarce. In contrast, the situation in Switzerland's 20 largest agglomerations has only relaxed slightly. According to Collier's office market report 2008, the availability rate in 2007 still hovered at 4.3% (2006: 4.9%) despite the reduction of 6 month availability by approximately 8.6% to 1.6 million square meters. The quoted rents, which have remained virtually unchanged for years in Switzerland, also show that a profound recovery has not yet begun in the office space market. Following the nominal lateral shift and real descent from 2003 to 2006, their nominal decrease averaged 4.4% in 2007. The last time quoted rents were as low as today was just after the turn of the millennium. Since the massive slump in quoted rents in the early 1990s – back then, rents were about 50% higher than today on average – the longed-for pick-up never materialized in the office space market.

Subprime crisis: financial metropolises particularly exposed

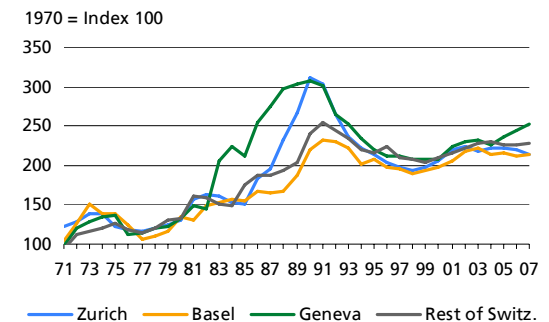
With 275,000 employees (in full-time equivalents), the MS region Zurich has the largest employment market, followed by the MS regions Geneva, Berne, Basel-Stadt, and Lausanne ("MS" stands for "mobilité spatiale", the regionalization concept of the Swiss Federal Statistical Office). The proportion of employees in the service sector is especially high in these regions. In Zurich, for example, it tops 88% (CH: 70%). Geneva, Berne, and Lausanne, too, have a rate of just over 80%. However, the employment structure rather than the employment volume is what counts for the analysis of the effects of a potential spillover of the US mortgage crisis to Switzerland. The current economic situation shows that the financial sector in particular is affected by the credit crisis, with the financial center Zurich having by far the highest exposure. More than 16% of all employees or about two thirds of the employees in growth sectors work for the financial sector in Zurich. The predominance of employment in financial institutes is also evident in Geneva and Lugano. But at least these two cities are somewhat better diversified. For instance, Lugano benefits from the relatively strong electronics and engineering industries, and Geneva draws on the watch industry (heavily export-oriented).

Outlook

Provided that the US mortgage crisis does not spill over to the Swiss office space market, it is reasonable to expect that as a whole, rents will remain stable and – thanks to a reduction of the still abundant vacancies – rental income will grow. Thus, the demand for investment property would persist at a high level, which would help to counter major markdowns on office property.

Quoted prices for office space in Switzerland

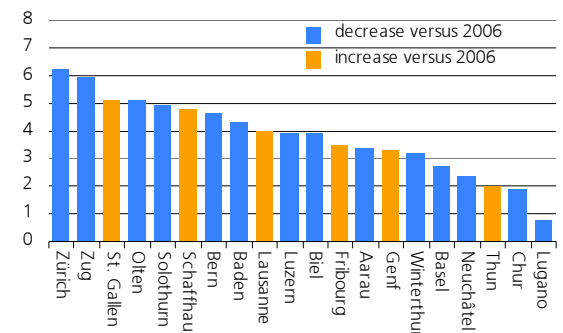
Nominal development since 1970



Sources: Wüest & Partner, UBS WMR

Office vacancies in Switzerland's 20 largest agglomerations

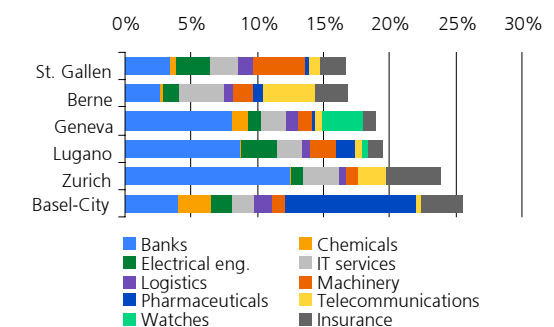
Office space available within 6 months in %



Sources: Colliers, UBS WMR

Employment share in growth sectors

Percentage of the respective total stock



Sources: BFS (company census 2005), UBS sectoral trends

Listed real estate investments

2007: easy come, easy go

In 2007, the listed real estate investments started off with gains similar to those that had closed the previous four years. By the end of the first third of the year, real estate shares achieved a total return (sum of distribution amounts and price changes) of 7.2%, and real estate funds achieved 5.2%. The heightened expectations associated with rising interest rates could be absorbed effectively by the simultaneously anticipated rent growth. Subsequently, however, the real estate securities, too, were caught in the vortex of the credit crisis. Due to the global upsurge in risk premiums, real estate share prices fell by as much as 25% and real estate fund prices by as much as 15%. Like the rest of the financial market, the real estate sector, too, failed to recover by the end of the year. The result was a negative balance for 2007 for both asset classes, putting an end to several years of excellent performance: -10.9% for real estate shares and -3.4% for real estate funds.

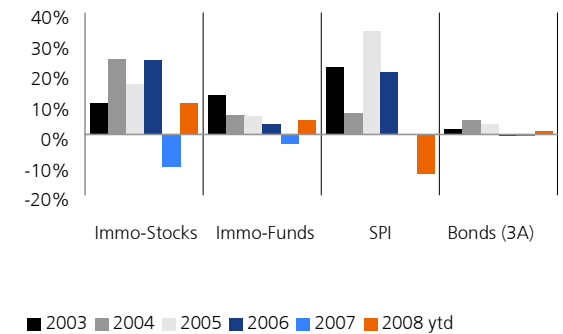
Meanwhile, fears of a global economic downturn have started to surface in addition to the simmering international credit crisis. Yet, this has not impressed real estate investors so far. A glance at the YTD performance reveals that though the SPI has already lost 13% since the beginning of the year (as of April 11, 2008), real estate shares have gained a remarkable 10%, while real estate funds have gained almost 5%, on average. The main reason for the recent value recovery lies in the reversal of interest rate expectations, which again point downward due to the current economic situation. Nevertheless, the basic data of the Swiss real estate sector is strong enough to promise investors further price increase potential in the long run.

Outlook

A massive global economic downturn accompanied by a US recession would inevitably impede the local economy, too. The office space market, which is currently recovering in business metropolises in particular, and real estate shares that are largely invested in office and commercial property would suffer most. In addition, borrowed capital, the cost of which has risen recently, is used much more intensively for real estate shares than for real estate funds. In the event of a merely temporary economic slackening, the scope for further price corrections on real estate shares could be confined. The fact that current rents are not excessively high would provide support in this case. On the other hand, a liberal monetary policy of the Swiss National Bank (SNB) could reduce refinancing costs, thereby opening the door to new investment opportunities. Despite the elevated market risks, favorable basic data are instrumental in retaining the attractiveness of the Swiss real estate funds and real estate shares sector for cash-flow-seeking investors with a long-term approach. The risk is more than adequately compensated by above-average distribution yields.

Performance of Swiss real estate investments

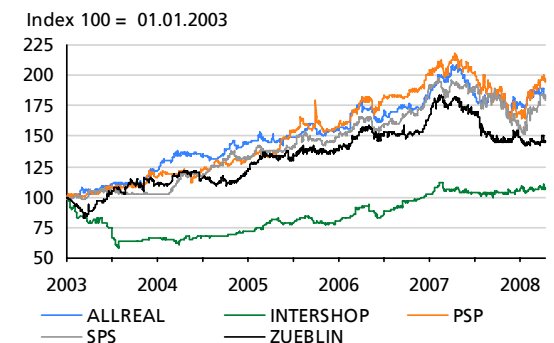
Real estate investments started off well in 2008



Sources: Datastream, UBS WMR

Selected real estate shares in Switzerland

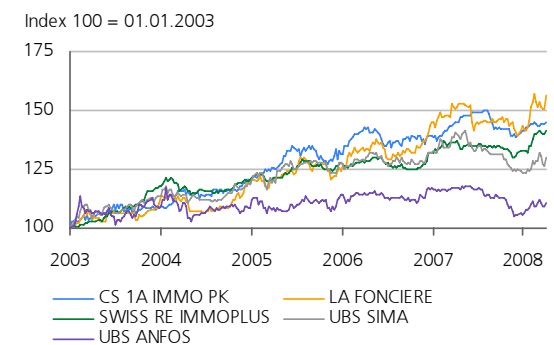
Performance since 2003 (without dividends)



Sources: Datastream, UBS WMR

Selected real estate funds in Switzerland

Performance including distribution amounts



Sources: Datastream, UBS WMR

Appendix

Required disclosures

Analyst confirmation

Every research analyst who bears the main responsibility for a part of this research report or the entire report confirms the following concerning each security or each issuer on which he/she reports herein: (1) The opinions expressed precisely reflect his/her personal views on the respective securities or issuers; and (2) no part of his/her compensation is or will be directly or indirectly related to the recommendations or views expressed by the research analyst in this research report.

Notes (April 11, 2008)

PSP Swiss Property:

In the past 12 months, UBS AG, its affiliates or subsidiaries have rendered investment banking services for this company/this legal entity against remuneration. Within the next three months, UBS AG, its affiliates or subsidiaries expect a remuneration for investment banking services. In the past 3 years, UBS AG, its affiliates or subsidiaries have operated as managers/co-managers for the issue or placement of securities of this company/this entity or its/their affiliates. UBS AG, its affiliates or subsidiaries have issued a warrant whose value is based on one or several financial instruments of this company.

SPS Swiss Prime Suite:

In the past 12 months, UBS AG, its affiliates or subsidiaries have rendered investment banking services for this company/this legal entity against remuneration. Within the next three months, UBS AG, its affiliates or subsidiaries expect a remuneration for investment banking services. In the past 3 years, UBS AG, its affiliates or subsidiaries have operated as managers/co-managers for the issue or placement of securities of this company/this entity or its/their affiliates. UBS AG, its affiliates or subsidiaries have issued a warrant whose value is based on one or several financial instruments of this company.

Intershop:

In the past 12 months, UBS AG, its affiliates or subsidiaries have rendered investment banking services for this company/this legal entity against remuneration. Within the next three months, UBS AG, its affiliates or subsidiaries expect a remuneration for investment banking services. In the past 3 years, UBS AG, its affiliates or subsidiaries have operated as managers/co-managers for the issue or placement of securities of this company/this entity or its/their affiliates. UBS AG, its affiliates or subsidiaries have issued a warrant whose value is based on one or several financial instruments of this company.

Allreal:

In the past 12 months, UBS AG, its affiliates or subsidiaries have rendered investment banking services for this company/this legal entity against remuneration. Within the next three months, UBS AG, its affiliates or subsidiaries expect a remuneration for investment banking services. In the past 3 years, UBS AG, its affiliates or subsidiaries have operated as managers/co-managers for the issue or placement of securities of this company/this entity or its/their affiliates. UBS AG, its affiliates or subsidiaries have issued a warrant whose value is based on one or several financial instruments of this company.

Züblin:

In the past 12 months, UBS AG, its affiliates or subsidiaries have rendered investment banking services for this company/this legal entity against remuneration. Within the next three months, UBS AG, its affiliates or subsidiaries expect a remuneration for investment banking services. In the past 3 years, UBS AG, its affiliates or subsidiaries have operated as managers/co-managers for the issue or placement of securities of this company/this entity or its/their affiliates. UBS AG, its affiliates or subsidiaries have issued a warrant whose value is based on one or several financial instruments of this company.

UBS Securities LLC, an affiliate of UBS AG and UBS Financial Services Inc.

Appendix

Other legal information

This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis. Other than disclosures relating to UBS AG, its subsidiaries and affiliates, all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are subject to change without notice. At any time UBS AG ("UBS") and other companies in the UBS group (or its employees) may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The compensation of the analyst(s) who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of UBS Global Wealth Management and Business Banking as a whole, which includes investment banking, sales and trading services. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein. For structured financial instruments and funds the sales prospectus is legally binding. If you are interested you may obtain a copy via UBS or a subsidiary of UBS. This document may not be reproduced or copies circulated without prior authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law.

Australia: Distributed by UBS Wealth Management Australia Ltd (Holder of Australian Financial Services Licence No. 231127), Chifley Tower, 2 Chifley Square, Sydney, New South Wales, NSW 2000. **Bahamas:** This publication is distributed to private clients of UBS (Bahamas) Ltd and is not intended for distribution to persons designated as a Bahamian citizen or resident under the Bahamas Exchange Control Regulations. **Canada:** In Canada, this publication is distributed to clients of UBS Wealth Management Canada by UBS Investment Management Canada Inc.. **France:** This publication is distributed to clients of UBS (France) SA, 69, boulevard Haussmann F-75008 Paris, R.C.S. Paris B 421 255 670, a duly authorized bank under the terms of the "Code Monétaire et Financier", regulated by French banking and financial authorities as the "Banque de France" and the "Autorité des Marchés Financiers". **Germany:** The issuer under German Law is UBS Deutschland AG, Stephanstrasse 14-16, 60313 Frankfurt am Main. UBS Deutschland AG is authorized and regulated by the "Bundesanstalt für Finanzdienstleistungsaufsicht". **Hong Kong:** This publication is distributed to clients of UBS AG Hong Kong Branch by UBS AG Hong Kong Branch, a licensed bank under the Hong Kong Banking Ordinance and a registered institution under the Securities and Futures Ordinance. **Indonesia:** This research or publication is not intended and not prepared for purposes of public offering of securities under the Indonesian Capital Market Law and its implementing regulations. Securities mentioned in this material have not been, and will not be, registered under the Indonesian Capital Market Law and regulations. **Italy:** This publication is distributed to the clients of UBS (Italia) S.p.A., via del vecchio politecnico 3 - Milano, an Italian bank duly authorized by Bank of Italy to the provision of financial services and supervised by "Consob" and Bank of Italy. **Jersey:** UBS AG, Jersey Branch is regulated by the Jersey Financial Services Commission to carry on investment business and trust company business under the Financial Services (Jersey) Law 1998 (as amended) and to carry on banking business under the Banking Business (Jersey) Law 1991 (as amended). **Luxembourg/Austria:** This publication is not intended to constitute a public offer under Luxembourg/Austrian law, but might be made available for information purposes to clients of UBS (Luxembourg) S.A./UBS (Luxembourg) S.A. Niederlassung Österreich, a regulated bank under the supervision of the "Commission de Surveillance du Secteur Financier" (CSSF), to which this publication has not been submitted for approval. **Singapore:** This material is distributed to clients of UBS AG Singapore Branch by UBS AG Singapore Branch, an exempt financial adviser under the Singapore Financial Advisers Act (Cap. 110) and a wholesale bank licensed under the Singapore Banking Act (Cap. 19), regulated by the Monetary Authority of Singapore. **Spain:** This publication is distributed to clients of UBS Bank, S.A. by UBS Bank, S.A., a bank registered with the Bank of Spain. **UAE:** This research report is not intended to constitute an offer, sale or delivery of shares or other securities under the laws of the United Arab Emirates (UAE). The contents of this report have not been and will not be approved by any authority in the United Arab Emirates including the UAE Central Bank or Dubai Financial Authorities, the Emirates Securities and Commodities Authority, the Dubai Financial Market, the Abu Dhabi Securities market or any other UAE exchange. **UK:** Approved by UBS AG, authorized and regulated in the UK by the Financial Services Authority. A member of the London Stock Exchange. This publication is distributed to private clients of UBS London in the UK. Where products or services are provided from outside the UK they will not be covered by the UK regulatory regime or the Financial Services Compensation Scheme. **USA:** This publication should not be distributed in the USA nor to "US persons".

© UBS 1998-2008. The key symbol and UBS are registered or unregistered trademarks of UBS. All rights reserved.