Indirect real estate investment

Asset class fact sheet

This document informs you about the characteristics, advantages and risks of indirect real estate investments and is designed to help you make your investment decisions. If you have any questions, please do not hesitate to contact your client adviser at any time.

Real estate constitutes an attractive alternative to other investment classes as a long-term financial investment. It is characterised by high value retention, can offer tax advantages and may even provide good inflation protection. Its real strength, however, is in generating regular, steady and calculable income. The return on a real estate investment comprises two components. On the one hand, there are ongoing returns in the form of rental income, while on the other there is the possible rise in the value of the property.

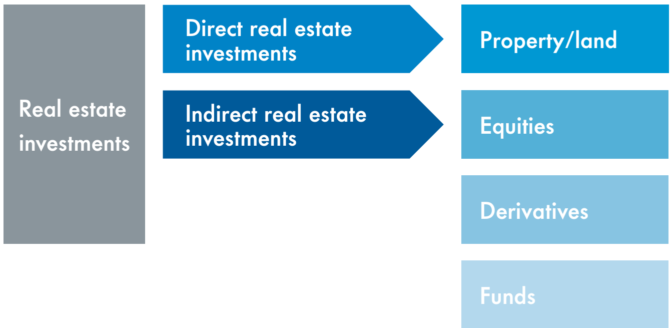
Indirect real estate investment means the acquisition of participation rights through the main or pre-market, over the counter (OTC) or off-exchange, where the investor has an interest only in the real estate shares or indirectly in so-called “listed real estate”. The investor makes their capital available to a professional manager, who then invests the capital in different investment instruments such as real estate funds or real estate stock corporations. Investments can be made in indirect real estate assets with relatively small sums.

Difference between indirect and direct investment

Indirect real estate investments offer investors a number of advantages over direct investments. These can include lower transaction costs, higher liquidity and transparency. In addition, investments can be made in real estate even with a modest capital deployment.

Forms of indirect real estate investments

Indirect real estate investments include equities/participations, derivatives and funds that are linked to real estate.



Premium

The market price at which the investor acquires the real estate fund is normally higher than the net asset value (NAV, value of all real estate properties in the portfolio). The following plays a role in this conjunction:

- The effect of diversification and risk distribution across regions and sectors, as the fund invests in more than one property.
- The liquidity and investor protection that collective capital investment funds provide, unlike direct investments in real estate.
- The latent liquidation taxes that are not incurred if the fund is maintained for a long period but that need to be taken into account in the NAV.

Benefits

Diversification
In contrast to other product classes, the performance of real estate investments is less dependent on the general performance of stock markets and interest rates. This may even be positive if equity markets move sideways or edge downwards. As a consequence, the inclusion of real estate investments can make the assets less dependent on specific market developments.

Inflation protection
Rental income constitutes a largely foreseeable and continuous source of revenue. Inflation can be offset by raising the rental charges. Some tenancy agreements make it possible, for example, to adjust rents in line with the consumer price index. In addition, £real estate prices often adjust to higher price levels.

Steady returns
In addition to the opportunity to secure a long-term increase in value, real estate generates regular income in the form of rent.

Risks

Market risk (interest change risk)
The investor bears the risk that changes in interest levels could have a negative impact on the value of the real estate. Investments in real estate respond inversely to interest rate changes. In the event of sinking interest rates, mortgage loans become cheaper, i.e. the investor can generate higher returns.

Liquidity risk
Real estate purchase or sale transactions take time to complete, mostly two to three months or even longer. On the other hand, investors have a liquidity risk arising out of the limited fungibility of the acquired indirect real estate investments, such as fund units or participations.

Foreign exchange risk
In the case of an indirect real estate investment, the investor may be exposed to a foreign exchange risk if underlying assets are traded in a currency that differs from that in which the instrument is traded, or if the financial instrument is denominated in a currency other than the domestic currency of the investor.

Further risk aspects
The investor may be exposed to further risk aspects.

- Cyclical risk: Real estate markets are dependent on economic cycles and may be subject to strong fluctuations within a cycle. For this reason, the timing of investments and divestments needs to be considered carefully.
- Rental and local market risk: Potential rental income is dependent on the local supply and demand situation. An excess supply of real estate properties can have a negative impact on the rental income of real estate investments.
- Environmental risk: Real estate and in particular plots of land should be checked before acquisition for possible environmental risks (e.g. historical contamination). These may be discovered only later, however, causing substantial clean-up costs, which can have a negative influence on the value of the real estate or plot of land.
- Changes in the legal framework: Potential future changes in the law, regulations and practices of public administrations, in particular in the fields of tax, rental, environmental and construction law, may have wide-ranging consequences on real estate prices, costs and revenues.