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SWISS PROPERTY SUCCESS STORY

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Following on the last edition's interview with Shaftesbury, we speak to PSP Swiss Property, one of Switzerland's leading real estate companies, known for a very specific business model. CEO Luciano Gabriel gives us his views on the Swiss market and how the company keeps their portfolio in great shape, demonstrating the listed sector's commitment to regeneration.

ONE Why invest in PSP Swiss Property?

"PSP Swiss Property is a transparent 'pure play': we invest in one sector and one country only - commercial properties in Switzerland. We focus on offices in prime locations and, to a lesser degree, in high street retail. Investors know what they get and they appreciate our specific business model. Furthermore, we pursue a long-term strategy aimed at optimising net asset value and earnings per share. Also, since our Company's IPO in 2000, we have consistently raised the dividend payout. In other words, we generate a continuous stream of smoothly increasing dividends for our shareholders. This year, on 6 April, we paid out CHF 3.30 per share for the 2015 business year, corresponding to a dividend yield of nearly 4% in relation to the year-end share price of CHF 88. This is remarkable considering the current low to negative interest rate environment in Switzerland. In terms of value generation for investors, our shares have outperformed their European counterparts since they were first listed in 2000."

TWO Have you ever considered investing outside Switzerland?

"This is a strategic question we regularly pose ourselves. The answer has always been that it's better for us to focus on our home market, which we know best. Going beyond Switzerland would undermine our business model. We keep focusing on the office markets in Switzerland's main business centres, where we expect growing demand for commercial space over the long-term. Most of our properties are in locations with dynamic labour markets, because this is where companies are set up and expand due to the talent and labour pool they can pick from. This is mainly the case in Zurich, Switzerland's engine of growth, as well as Geneva and Basel. While demand in Bern, the country's capital, is stable, it's not really a growth market. In the rest of Switzerland, we take a cautious case-by-case approach."

THREE What's the growth story for PSP?

"Overall the Swiss economy will expand by around 1% this year and probably in the foreseeable future as well. While this growth rate may be slightly higher than in neighbouring countries, it remains modest. As a result, demand for office space is unlikely to increase. We expect the rental market overall to move sideways or slightly downwards in the next three to five years. Currently, we are in a situation with overlapping weak economic cycle and long-term structural change of the demand for commercial space. However, this is not really a problem for PSP Swiss Property. In such a sluggish environment, the prime locations and the quality of our buildings represent a clear competitive advantage. Also in a stagnant market we have a great opportunity to attract tenants from elsewhere to move to our new or newly renovated properties in their preferred locations. Many commercial properties on the market today are outdated; when larger companies decide to move or to centralise in one place, they clearly prefer new buildings. Often, these decisions are related to changes in management, collaboration or communications models within a company. Here, our strength is really showing. We have built up a competitive edge over the past years by pursuing a strategy that focuses on the quality of our properties and not on the size of our portfolio. The vast majority of our buildings are in great shape; some properties, however, which are located just outside the central business districts, no longer meet today's requirements. Here, we opt for total renovations or even the demolition to replace older buildings with new constructions offering everything modern tenants expect. We invest in improving the quality of what we already own instead of competing with pension funds and insurance companies simply to expand our portfolio – and paying prices which we consider inappropriate."

FOUR What is the outlook for interest rates, the economy and the exchange rate.

"If we were convinced that the Swiss National Bank would continue its current policy for years and years, we would start buying aggressively. However, we don't think that we are in a stable financial equilibrium. It's just a matter of time until there will be some serious disruption on the markets. But, of course, nobody knows exactly what will happen and when. That's why we keep leverage low and remain cautious in everything that we do. Our priority is to optimise the value of our properties with a long-term view." >

Office space

PSP Swiss Property transformed the old Hürlimann Brewery site into mixed-use development for offices and leisure, including the office of Google.

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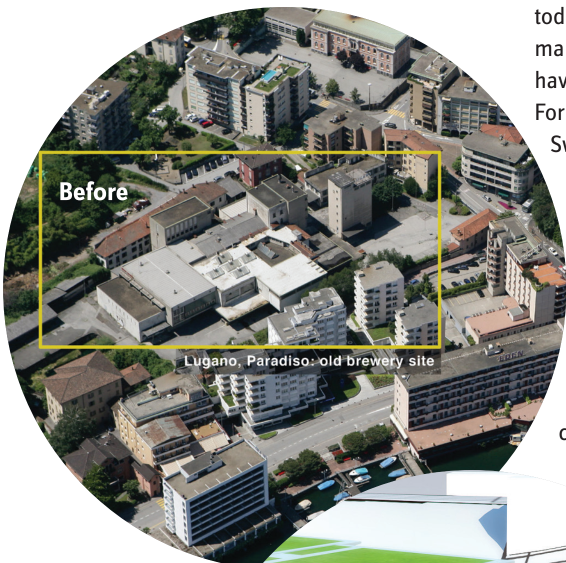
Urban Living

When finalized, the old industrial brewery site in Paradiso, on the shore of Lake Lugano, will be transformed into build for-sale apartments.



FIVE How has PSP's portfolio changed over time?

"We made our first big acquisition in 2001, buying a CHF 409 million portfolio from Swisscom. But the biggest step was in 2004, when we merged with REG Real Estate Group, a former Swiss brewery. In fact, most of our development sites are former brewery sites. We acquired a CHF 1.2 billion property portfolio, consisting predominantly of very well located investment properties. We thus became the owner of properties that would hardly be available on the Swiss market today – not least because the investment market is so illiquid. Since the merger, we have made very few individual acquisitions. For quite some time now, competition from Swiss institutions such as pension funds and insurance companies has been so strong that we have not been able (and willing) to make any larger scale acquisitions. Conversely, we sold quite a number of properties in peripheral regions. But, as I mentioned before, our focus has been on improving the existing portfolio anyway with significant capital expenditures on selected individual properties."

SIX Do you expect market conditions in Switzerland to change to create investment opportunities?

"In the Swiss market, there is a buy-and-hold mentality. The real estate capital gains tax is just too high for short holding periods. As a result, property investors hold on to their investments for years. It's also a market with relatively low leverage, which means that forced sales are rare. Most investors are equity investors – pension funds, insurance companies, companies with surplus cash or

> *...most of our development sites are former brewery sites. We acquired a CHF 1.2 billion property portfolio, consisting predominantly of very well located investment properties*

wealthy families. If you don't have investors who have to exit the market in difficult times, supply remains small. In the rental market, the overall demand for commercial space is stagnant and rents are declining slightly. On the other hand, property prices are going up, because institutional investors have nowhere else to go in this low to negative interest rate environment. As a consequence, the investment market is very, very competitive and it's difficult to find good assets at reasonable prices. In Zurich, for instance, we are talking about net initial yields significantly below 3% for the few opportunities available on the market. In addition to accepting such low net initial yields, it is often unclear how you should be able to sustain even this level, taking into account upcoming lease contract renewals or renovation costs to keep existing tenants. We think certain investors are a little too aggressive when it comes to pricing. In short: we do not expect any substantial changes in the market in the short run."

SEVEN What does PSP spend each year to keep your buildings fresh and attractive for tenants?

"In a normal year, we invest around CHF 50 million in our investment portfolio. This does not include demolitions and redevelopments of individual buildings and sites; this amounts to a total of around CHF 300 million combined in 2016 and 2017. This is one of the reasons why we allow our overall vacancy rate to rise – we voluntarily give up some rental income in the short term for the prospect of lower vacancy rates and higher rental income in the medium term. Some-times it is obvious that we will not be able to gain a new tenant when an existing large one leaves, unless we carry out a radical renovation. Clearly, it makes sense to keep a building vacant for a while and invest the necessary time and resources to enhance its appeal and marketability."

EIGHT How do you approach developments and what part do residential assets play in your strategy?

"Developments represent about 8% of our portfolio. We develop exclusively sites that we already own. We don't buy land for building. In Switzerland, land is just too expensive compared to the value of the finished development. And there is also a considerable downside risk during the planning and construction phase. As to rental housing, it is a strictly regulated market in Switzerland that does not really offer great upside potential. Consequently, residential assets are not a major strategic option for us and we will not invest in residential property for the long-term. When we develop one of our existing sites, we focus on achieving the highest potential value for a specific location. If the answer lies in residential use, we usually build for-sale condominiums. This is the case, for example, at our planned project in Lugano/Paradiso and the residential part of our ongoing development project in Rheinfelden. Indeed, the construction of condominiums on our own land was part of our success story in the past."

Luciano Gabriel
PSP

Luciano Gabriel joined PSP in 2002, initially as its Chief Financial Officer before becoming CEO five years later. Prior to this, he spent four years in charge of corporate finance and group treasury at Zurich Financial and 14 years at UBS in various roles in London, Milan and Zurich. Mr Gabriel is the current Chairman of EPRA's Board of Directors.

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