Global Issues Real Estate
June 2015

Global Real Estate Monitor – Q2 2015

Commercial real estate continues to rise in value

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Boom in Australia: The next steps

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Regional Focus

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Switzerland

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Editorial

Dear Readers,

Until a few weeks ago, real estate values were being boosted by the inexorable fall in interest rates. Interest rates in some countries actually went into negative territory, giving even more of an impetus to the flight to real estate. A large number of central banks used the leeway given to them by low inflation to cut interest rates once again. This year alone, central banks worldwide have lowered their key interest rates more than 40 times. This includes countries such as Canada, Australia and Sweden, which are suffering from overheating real estate markets and for which the renewed cuts in interest rates are tantamount to playing with fire. Firstly because this encourages speculative developments, which can lead to price bubbles on housing markets. Secondly, the real estate market rallies sparked by quantitative easing and cuts in interest rates are treading on thin ice if the fundamentals do not follow suit with a positive trend.

This is particularly true if worries about an end to monetary support measures start doing the rounds. Thus in the euro zone we have recently seen a return to the pronounced selling of listed real estate companies, while in China too the sustainability of the recent upward momentum in prices cannot yet be regarded as firmly established. The more ultra-expansive monetary policy reaches its limits around the world, the greater the degree of price fluctuation we can expect. By contrast, values in the likes of the UK and increasingly Japan too are on solid ground thanks to the robust fundamental data of real estate markets. This prompts us to overweight both markets in a global portfolio (see page 11).

Interest rate cuts and expansive monetary policy in general are not without consequences for the development of exchange rates. The sharp fall in the value of the yen might be an extreme example, but it does show the big impact that changes in interest rate conditions have on exchange rates. Even though the central banks cite the battle against deflation as the reason for cutting interest rates, their secret aim may be to weaken their currency in order to boost exports and therefore domestic economic growth. The current, substantial fluctuations in exchange rates are having a considerable impact on the overall returns on real estate investments. This brings us to the subject of currency hedging. For some – though not all – anchor currencies, the hedging of currency risk is recommended in order to reduce the volatility of returns (see page 8).

On behalf of the authors, I hope you find our publication informative and insightful.

Fredy Hasenmaile
Head of Real Estate Research & Regional Research

Overview

Direct Real Estate

Boom in Australia: The next steps

Australia's housing market has seen strong price growth in recent years. Given record-low interest rates and persistently strong demand, this trend is likely to continue in the coming quarters – even if the risks are increasing. In the commercial sector, the sharp divergence in developments in regional terms is becoming increasingly clear.

Sydney and Melbourne have shown the strongest price growth of late

House prices in Australia have risen by 93% in real terms since the start of the year 2000. Activity on the part of real estate purchasers is concentrated in Sydney and Melbourne in particular. Although the growth in prices slowed slightly last year, the nominal annual growth rates for Australia's two largest metropolitan areas in 2014 were around 13% and 5% respectively (see Figure 1). The recent slightly weaker pace is also reflected in the transaction data. During 2014, the annual growth in monthly sales figures slowed from well into double-digit territory to the low single digits.

First-time buyers often purchase with the intention of letting

A glance at the buyers shows that the proportion of purchasers from abroad has risen sharply since 2011. According to a survey by National Australia Bank (NAB), this section of buyers accounted for 16% of new homes at the end of Q1 2015 and nearly 8% of existing properties. What's more, in both categories one in every four transactions is a first-time purchase. It is worth noting that approximately 40% of these first-time buyers purchase the property with the intention of letting it and therefore view it purely as an investment. If we add in buyers from abroad, the section of buyers acquiring residential property for investment reasons accounts for 26% of the total demand for new properties (18% in the case of existing properties). Even though investment by these sections of buyers is not necessarily attributable to speculative activities, the high proportion nevertheless constitutes a degree of risk. If the outlook for the housing market deteriorates, these two groups are likely to review their investments and may opt to sell again quickly.

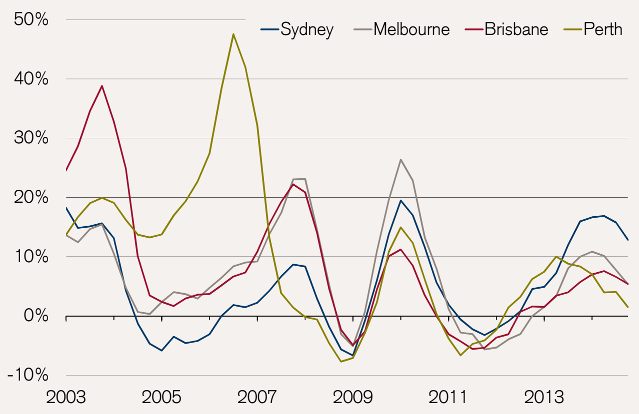
Affordability is increasingly a problem for home buying

Additional risks include affordability as well as the level of debt among private households. Thus the ratio of house prices to disposable per-capita incomes is markedly above the long-term average. Indebtedness among private households has also risen sharply. The ratio of debt to disposable income climbed from 94% at the start of 2000 to 154% at the end of 2014 (see Figure 2).

Figure 1

House prices rising fastest in Sydney

House prices in four largest cities, annual growth in %

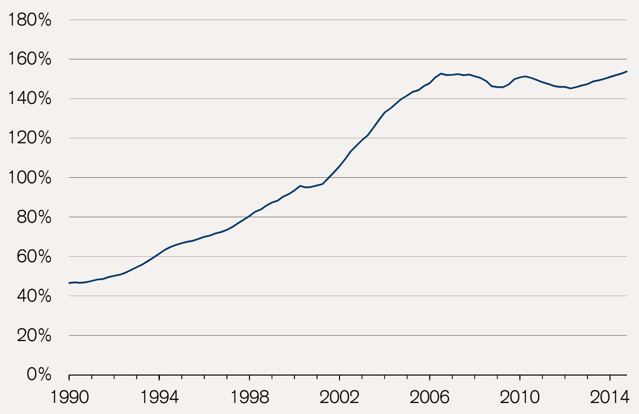


Source: Australian Bureau of Statistics, Datastream, Credit Suisse

Figure 2

Sharp rise in debt among private households

Household debt as percentage of disposable income, in %



Source: Reserve Bank of Australia, Datastream, Credit Suisse

Continued high demand likely to ensure further growth in house prices

Despite the recent slightly slower momentum, there are currently no signs of the demand for home buying in Australia fading any time soon. Asked whether now is a "good or a bad time to buy a home," a majority of survey participants recently chose the former response. NAB survey data also point to continuing, positive underlying sentiment on the real estate market. Thus sentiment has improved in all areas with the exception of Western Australia. The Australian central bank is likely to have played no small part in this by cutting interest rates to a new record low in May this year, thus keeping mortgage interest rates at a low level. Despite increasing risks, we therefore expect continued moderately positive growth in house prices for the quarters ahead.

Australia's office markets drifting further apart

In the commercial real estate sector, the end of the investment boom in the mining sector and collapse in commodity prices are having a noticeable impact on the highly commodity-dependent cities in particular. Thus the office markets in Sydney and Melbourne are drifting apart from those in the highly commodity-dependent cities of Brisbane and Perth in terms of rental growth and vacancies. While vacancies in Sydney fell from 9.2% to 7.7% in the 12 months to the end of Q4 2014, Perth showed a rise from 9.0% to nearly 14.0% in the same period (see Figure 3). Although the actual growth in rents is fairly sluggish in general, there are big differences here too. Sydney and Melbourne showed positive annual growth of 8% and 4% respectively to the end of Q1 2015. By comparison, Brisbane and Perth suffered sharp falls of –8% and –23% respectively.

Expansion of supply in Brisbane and Perth also a negative factor

Further rises in vacancy rates and negative rent increases are expected for Brisbane and Perth as a result of the sharp expansion in the supply of office property in the period to end-2016. Independent international real estate researcher PMA expects the vacancy rate in Perth to rise to more than 20% by the end of 2015 before falling back again to 16% by the end of 2017. The fact that supply and demand are relatively balanced in Sydney and Melbourne, on the other hand, should therefore ensure further rental growth in the short term. Added to that, demand in both these centers has historically been relatively broadly diversified across the various sectors.

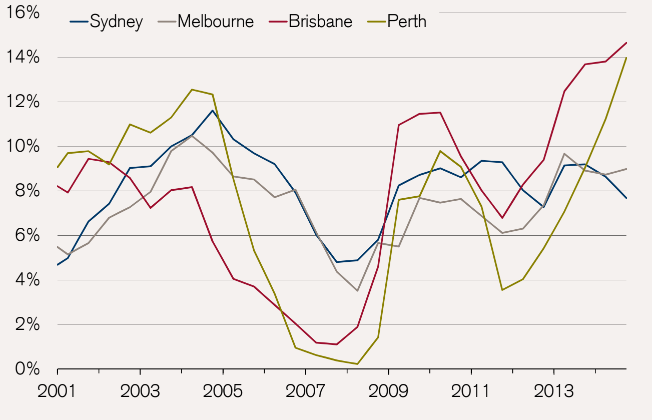
Australia remains attractive to commercial real estate investors

Real estate investors that are aware of the regional differences within the country will consequently be able to continue benefiting from stable and relatively high total returns. These have consistently averaged between 9% and 11% in the last five years for both retail and office properties (see Figure 4). According to our model, the capital growth return – one of the two components of the total return – is likely to fall slightly over the coming years; consequently, a total return of between 7% and 8% can be expected.

Figure 3

Office markets: Vacancies on the rise in Brisbane and Perth

Office vacancy rates in %

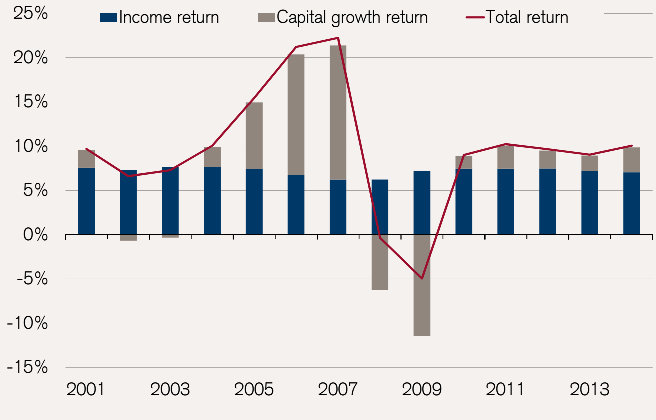


Source: PMA, Credit Suisse

Figure 4

Office properties offer stable total returns

IPD office income returns, capital growth returns and total returns in %



Source: Investment Property Databank, Bloomberg, Credit Suisse

Direct Real Estate

Commercial real estate set for new records

The trend toward rising capital values for prime office space is likely to continue in the coming years. Capital values in most markets will likely exceed their pre-crisis peak levels by the end of 2017; this will be mirrored in a fall in initial yields to new historic lows.

Prime office property likely to continue increasing in value in the years ahead

Investor interest in commercial real estate has continued unabated in recent years, causing capital values to skyrocket in many places. In 23 of the 59 most important markets worldwide, capital values for prime office space at the end of 2014 exceeded their peak levels for the 2005–2008 period by more than 5%. This trend will continue in the years to come, with forecasts from PMA suggesting this number will increase to 37 by the end of 2017. Future capital values are expected to be more or less on a par with their previously observed peak levels in eight markets, while in 14 markets they will be more than 5% below these levels. The two top spots are taken by Beijing and San Francisco. There, capital values are likely to more than double by the end of 2017 compared with 2008 and 2007 respectively. The two German cities of Stuttgart and Munich are also among the leaders in terms of capital growth. Bringing up the rear are the markets in Brisbane and Perth as well as Moscow, all of which are in a state of upheaval.

Initial yields falling below pre-crisis levels in many places

The picture is similar for initial yields: In 39 of the 59 office markets observed, initial yields at the end of 2017 are expected to have fallen to more than five basis points below their trough levels for the 2005–2008 period. Exceptions include the peripheral countries of Europe, which were distinctly overheated prior to the real estate crisis. In the major office markets of Italy, Spain and Ireland, but also in some cities of Eastern Europe (Budapest, Warsaw and Moscow), forecasts for initial yields at the end of 2017 are 20 to 90 basis points above their pre-crisis levels.

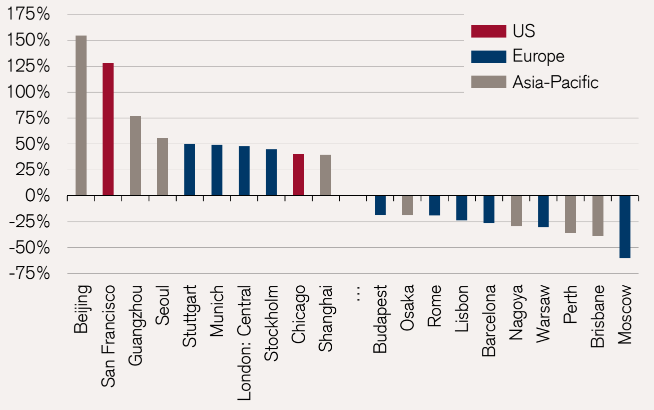
Major volatility differences in total returns

For investors, income returns play a major role alongside the growth in capital values. The resulting total returns for individual markets have varied sharply in the past, not only in terms of absolute levels but also with regard to volatility. A historical comparison shows that markets in the US in particular tend toward higher volatility. Seven of the 11 US office markets included in the calculation can be found among the 20 office markets with the highest standard deviation in total returns. The traditionally highly dynamic markets in Singapore and Hong Kong also show relatively high standard deviation. By contrast, total returns in a large number of continental European markets were relatively stable.

Figure 1

Capital growth: 10 strongest/weakest markets

Deviation in forecast capital values* from pre-crisis levels** in %

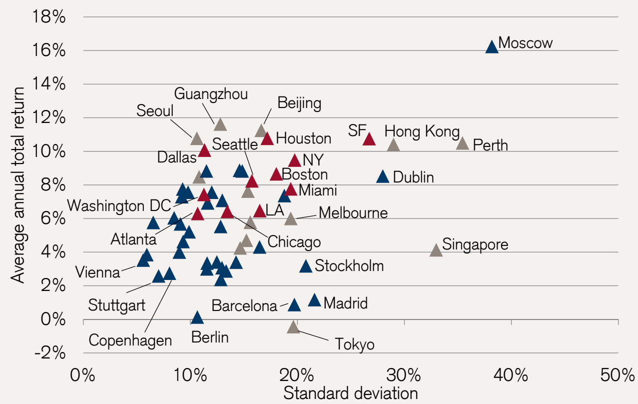


Source: PMA, Credit Suisse. *To Dec. 31,2017; **Maximum 2005–2008

Figure 2

Risk/return comparison for prime office space

Historical* annual total returns and standard deviation in %



Source: PMA, Credit Suisse. *Since 1991; Moscow: 1998; Beijing, Shanghai, Guangzhou: 2004; Osaka, Nagoya: 2002; Seoul: 2000

Direct Real Estate

FX influences on global real estate investments

Fluctuations in exchange rates exert a considerable effect on the performance of international real estate investments. Where the EUR or CHF is the anchor currency, the hedging of currency risk is recommended in order to reduce the volatility of returns.

Exchange rates have a strong influence on the returns and volatility of international real estate investments

Fluctuations in exchange rates affect the risk/return profile of international real estate portfolios in both the short and long term and should therefore be incorporated into investment decisions. Figure 1 illustrates the impact of fluctuations in exchange rates on the total return of a fictitious, globally diversified portfolio of prime office properties. After stripping out currency effects, i.e. in local currency, this portfolio achieved an annualized return of nearly 6% between 1990 and 2014 on volatility of 11.8%. This raises the question of whether the currency risk associated with investment countries should be hedged. With hindsight, a USD investor, for example, would have been able to forgo currency hedging. As the USD weakened during this period, the portfolio returned 6.2% p.a. in USD without hedging; based on hedging costs, the return would have been lower with similar risk.

Hedging is worthwhile in the case of hard anchor currencies

With the EUR as anchor currency, the return after hedging is likewise slightly lower than on an unhedged basis. However, the currency hedge caused a significant reduction in the risk profile; the return is therefore significantly higher in relation to the risk. The benefits of hedging are clearest where the anchor currency is the CHF, which has strengthened over the last decade in particular. As a result of hedging, the investor enjoys a higher return on lower volatility. Even though historical developments typically do not recur, this shows that in the case of harder anchor currencies (i.e. more disciplined fiscal and exchange-rate policy) the hedging of currency risk is recommended. This tends to result in an improvement in the risk/return profile of the real estate portfolio.

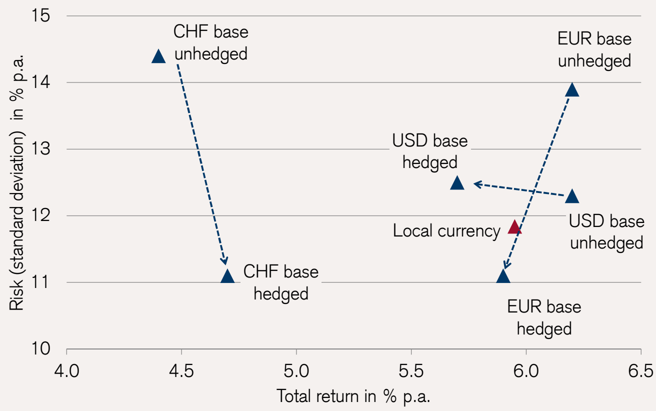
Interest rate differentials need to be considered in investment decisions

A further conclusion is that local initial yields or income returns should not be considered in absolute terms but from the perspective of the respective anchor currency. As Figure 2 illustrates, this can lead to different investment decisions depending on interest-rate differentials. For example, the recent introduction of negative interest rates in Switzerland resulted in Swiss real estate becoming more attractive from a hedged perspective – especially for US-based investors – despite its lower yield levels. In the case of professionally managed global real estate investment vehicles, these currency influences and interest-rate differentials are directly incorporated into the investment process. They are a major factor in the choice of investment properties that are required to meet minimum requirements in terms of distribution yields and internal rates of return.

Figure 1

Office portfolios: Risk/return profile

Synthetic portfolio (40% US, 30% euro zone, 10% each for UK, Australia and Japan)

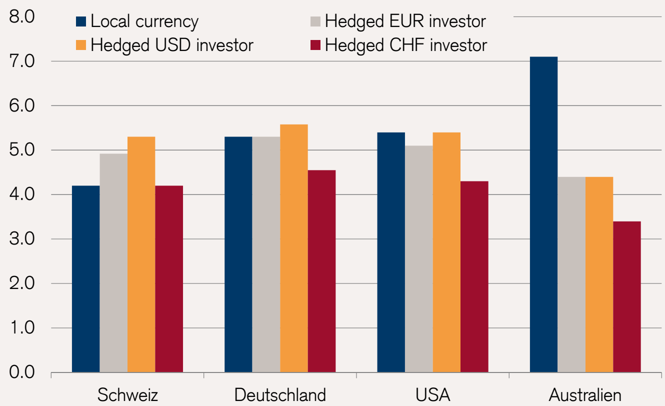


Source: PMA, Datastream, Credit Suisse

Figure 2

Real estate returns from an anchor-currency perspective

Income returns (%, end-2014) adj. for 3-mth. int.-rate differentials (as at May 19, 2015)



Source: IPD, Datastream, Credit Suisse

Direct Real Estate | Overview

Transaction volumes close to all-time high

Transaction markets for commercial real estate are running at full steam, driven by yield-seeking investors that are eager to buy. Capital values are continuing to rise as a result. Rather than a trend reversal, we expect a slowdown in the development of market values and at the same time a rise in rents.

Positive overall economic outlook for 2015

The performance of the world's economy is largely positive for commercial real estate markets. There is increasing evidence of a gradual recovery in the euro zone, while the US is likely to see a rapid return to its modest growth trajectory after a difficult first quarter. The outlook for the emerging-market countries, on the other hand, is mixed. China is currently experiencing a bout of weakness, although we think monetary policy easing measures will be successful at stabilizing the economy. Rents on real estate markets are therefore likely to respond to these developments with a slight time lag.

Real estate remains a popular asset class

Real estate investments retain their popularity among investors amid a continuing dearth of investment opportunities. Transaction volumes in the US reached a new peak in Q1 2015 according to RCA – a peak only exceeded (in nominal terms) by the first half of 2007. Transaction volumes are also at high levels in some European countries such as Italy. Initial yields for office property in Europe have continued to fall in overall terms, although the pace is leveling off to some extent. The peak so far was in Q4 2014, when yields eased by more than five basis points on a quarter-on-quarter basis in 23 out of the 35 cities observed. This was still the case in 16 cities in Q1 2015. Only in Moscow have yields risen considerably again, and now stand at 9.6% for prime office properties.

Low mortgage interest rates are supportive to the owner-occupied residential market

The situation in owner-occupied residential markets varies from country to country. Despite the sharp rise in long-term interest rates in April and May, borrowing costs remain very low in historical terms and are continuing to push up prices. Some countries whose price growth has been extremely worrying for a number of quarters now still show no signs of calming down. They include Sweden (+10.3% year-on-year) and Norway (+7.2% year-on-year), but also Australia and Hong Kong.

Outlook for direct real estate markets over next 6-12+ months — **Jun. 2015**

Region	Rating*	Submarket	Office market	Retail market	Housing market**
North America	Positive	USA	Positive	Positive	Positive
Europe (excl. UK, CH)	Positive	Germany	Positive	Positive	Positive
		France	Negative	Neutral	Negative
		Spain	Positive	Positive	Neutral
		Italy	Neutral	Neutral	Negative
UK	Positive		Positive	Positive	Positive
Switzerland	Negative		Negative	Negative	Neutral
Asia Pacific	Neutral	Japan	Positive	Positive	Positive
		Singapore	Neutral	Neutral	Negative
		Hong Kong	Neutral	Neutral	Neutral
		Australia	Positive	Positive	Positive
Emerging markets	Neutral	China	Neutral	Neutral	Negative
		India	Neutral	Neutral	-
		Brazil	Negative	Negative	-
		Russia	Negative	Negative	-
		Poland	Neutral	Neutral	-
		Turkey	Neutral	Neutral	-

* Overall rating only for commercial real estate markets (i.e. without housing); ** Owner-occupied housing

Source: Credit Suisse / IDC

Indirect Real Estate

REITs yield spreads remain substantial

Yield spreads between indirect real estate investments and benchmark bonds are an important yardstick for the attractiveness of REITs. A historical comparison shows that these yield spreads are attractive in the key countries of the universe that we cover, and are also likely to remain so.

Yield spreads are an important valuation indicator in a historical context

Bonds and real estate investments are to some extent substitutes due to their relatively high yields. For cash flow-oriented investors, comparison of the distributions yields of different vehicles is therefore an essential valuation indicator. To analyze whether REITs are "expensive," we look not only at the yield spread but also at three other valuation indicators: the dividend yield, premium to NAV and current market price as a multiple of funds from operations (FFOs). Where current values or forecasts deviate significantly from normal historical values, this may be a buy or sell signal.

Yield spreads are high by long-term standards

Yield spreads versus government bonds in the main countries of the FTSE EPRA/NAREIT global index are high in historical terms. Dividend yields in the US, for example, are around 4.0% (expected dividend for next year divided by current price), while 10-year bonds are yielding 2.1%; this gives a differential of 1.9% (see Figure 1). Spreads on US REITs have therefore returned to their 2012 levels. Only in the period between the end of 2008 and mid-2009 were they higher, when a sell-off occurred in real estate equities. The picture is very similar in the other countries of the index (see Figure 2). Since the start of 2014, yield spreads have widened again in the five most important countries. This is despite the fact that dividend yields – except in the case of Japan – have fallen due to last year's extraordinarily good performance.

Spread versus corporate bonds persists in the US

Distributions by US REITs also currently exceed those of corporate bonds and are accordingly attractive (see Figure 1). In the period between 2007 and 2012, this spread was only positive during the period of greatest market turbulence.

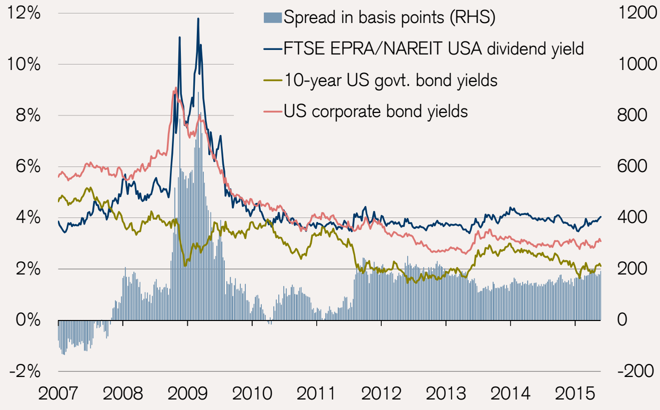
Yield spread likely to come under pressure

The spread versus government bonds is likely to narrow in the key countries going forward, although this is unlikely to be a smooth process. Both components are likely to contribute to a narrowing of the spread. First, we expect higher yields on government bonds. Second, investment pressure is likely to put slight pressure on dividend yields for real estate investments. Yield spreads are nevertheless expected to remain above-average in historical terms in the years ahead.

Figure 1

Substantial spread vs. govt. bonds in historical terms

EPRA USA dividend yield; yields on 10-year government and corporate bonds



Source: Bloomberg, Credit Suisse

Figure 2

REITs yield spreads more attractive than at start of 2014

FTSE/EPRA NAREIT country indices for five most important countries in the global index

	US	UK	Japan	Hong Kong	Australia
Average since 2007					
EPRA dividend yield	4.5%	3.8%	1.9%	3.4%	6.6%
10-year govt. bond yield	3.0%	3.2%	1.1%	2.3%	4.6%
Yield spread	1.5%	0.5%	0.8%	1.1%	1.9%
Values at start of 2014					
EPRA dividend yield	4.4%	3.3%	1.5%	3.9%	6.0%
10-year govt. bond yield	3.0%	3.0%	0.7%	2.3%	4.3%
Yield spread	1.4%	0.3%	0.7%	1.6%	1.7%
Latest value					
EPRA dividend yield	4.0%	2.8%	1.7%	3.2%	5.0%
10-year govt. bond yield	2.1%	1.8%	0.4%	1.4%	2.7%
Yield spread	1.9%	1.0%	1.3%	1.8%	2.2%

Source: Bloomberg, Credit Suisse

Direct Real Estate | Overview

Volatile time for REITs

Following a strong start to 2015 for REITs and other real estate equities, volatility has increased sharply of late. This has led to a correction in some regions. In light of persistently high dividend yields compared with government bonds, REITs remain attractive for investors.

US and euro zone REITs have corrected since the end of Q1 2015

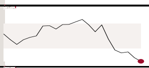
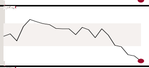
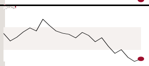
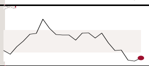
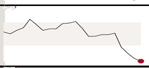
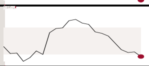
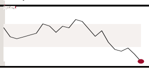
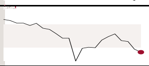
After an impressive Q1 2015, REITs have not shown such strong across-the-board performance of late. US REITs recorded the biggest losses, with a fall of nearly 6% in April this year. So far, they have failed to recoup the ground lost. Even though the recovery on US real estate markets continues unabated in fundamental terms, the outlook is clouded by an imminent hike in key interest rates. The euro zone is also among the big losers with a drop of 10.1% since the end of Q1 2015. Reasons include the sharp rise in 10-year government bond yields in the euro zone since April 2015 as well as renewed uncertainty about the stability of the single-currency bloc. The recent correction makes the relatively high valuations of euro zone REITs look more attractive again. In overall terms, we are retaining our neutral weighting for the US and the euro zone.

We recommend overweighting the UK and Japan

The convincing victory by the Conservatives in the UK parliamentary elections in May this year also boosted UK REITs. Having temporarily risen to nearly 6% above their end-April level, REITs were still holding on to price gains of +2.7% at the end of May. The fundamentally solid real estate market and improved picture in terms of technical analysis contribute to our recommendation of an overweighting of UK REITs. Japanese REITs posted a very solid performance in April and May. They are benefiting from the ongoing recovery in the commercial real estate market, which is also increasingly permitting rent increases for existing tenants at prime locations in Tokyo. The outlook is supported by the central bank's J-REIT purchasing program and the changed investment structure of the world's largest pension (GPIF), which among other things is favorable to REITs.

China: Rally in April

Chinese real estate companies recorded a 25% increase in share prices in April. This was due to a sudden improvement in market sentiment. In fundamental terms, there has not been any material improvement in the situation on the real estate market. Although the fall in prices in the residential segment has slowed, the supply overhang remains.

Global Real Estate Equity Indices[1]								
	Market data			Key data				View[3]
	Last 30 days	10.06.2015	YTD %	Div Yield	Spread[4]	P/B	12M fwd P/E	Relative
World		2504	6.6	3.9	144	1.5	23.0	Benchmark
USA		5548	-4.9	4.2	172	2.3	37.3	Neutral
Eurozone		4464	7.6	4.3	335	1.3	18.1	Neutral
UK		3239	9.9	2.9	72	1.1	29.8	Outperform
Developed Asia ex Japan		1930	3.1	4.2	170	0.9	16.8	Neutral
Japan		4210	3.0	1.8	128	1.9	32.0	Outperform
Emerging Markets		2649	14.4	4.1	-98	1.1	11.2	Neutral
Swiss Listed Real Estate[2]								
Real estate stocks		1891	4.4	4.4	415	1.1	20.9	Neutral
Real estate funds		332	3.0	2.9	265	26	n/a	Underperform

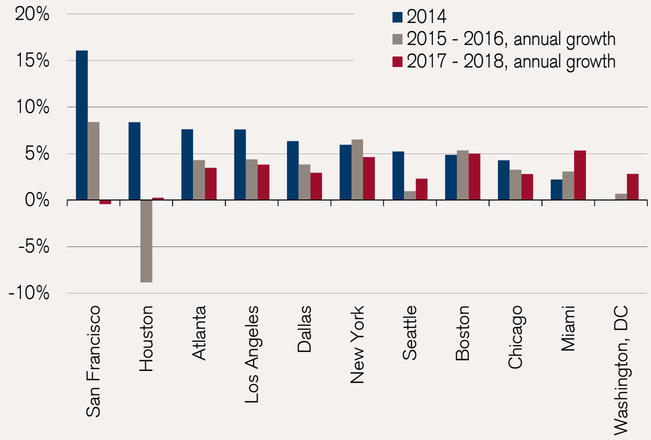
Data as of market close of 10/6/2015, with band representing +/- standard deviation from period average
1) FTSE EPRA/NAREIT indices, 2) SXI Real Estate Shares / SXI Real Estate Funds (price-to-book ratio is measured by agio, dividend yield by distribution yield)
3) Overall view of Investment Committee for 3-6 months, relative to benchmark world
4) Spread between dividend yield and 10-year government bond in basis points. For USA, Asia ex-Japan, World: US-Treasuries; Rest: local government bonds
Past performance is not an indicator of future performance. Performance can be affected by commissions, fees or other charges as well as exchange rate fluctuations.
Source: Datastream, Bloomberg, Immobilienbrief, Credit Suisse/IDC

Commercial real estate: Regional disparities remain

The recovery on the US office market is continuing. Rents in the country's 11 largest markets rose by an average of 6.2% in 2014. Strong technology-driven demand in San Francisco has resulted in an 84% increase in rent levels in the last four years. Owing to the expected expansion in the supply of space, a significant cooling is expected in the medium term. Other markets are at a less well advanced stage in their real estate cycle. Bottom-of-the-table Washington seems to be only just on the point of starting to turn the corner. The vacancy rate was at an all-time high of 17.2% at the end of Q1 2015. Solid average yearly growth in rents of 5.6% and 5.2% is expected for New York and Boston respectively in the period to end-2018. In Houston, however, the outlook is clouded to a considerable extent by the slump in oil prices and expected, substantial addition of new office space.

Past and future expected growth in rents

Annual growth in rents for prime office space in %



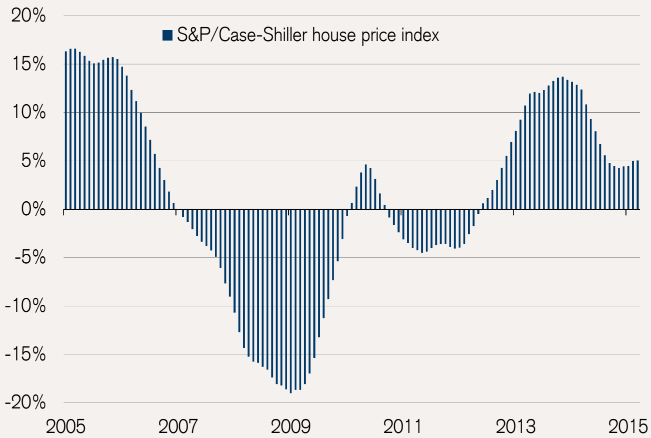
Source: PMA, Credit Suisse

Residential real estate: More traction again of late

The owner-occupied residential market has attracted attention thanks to positive data. After a relatively weak Q1 2015 due to the bitter winter, key construction activity data in April proved better again. The number of seasonally adjusted, annualized housing starts was up 9% on the previous year. Whereas April sales figures for new residential units improved significantly (+6.8% month-on-month), those for existing units disappointed (–3.3% month-on-month). Reasons include the relatively limited number of houses on sale on the market, plus higher price levels. Growth in house prices has accelerated again of late after a noticeable cooling toward the end of 2014. The latest data are an indicator that the recovery on the residential market is gaining speed again.

Annual growth rates for US house prices

S&P/Case-Shiller house price index for 20 metropolitan regions, annual growth in %



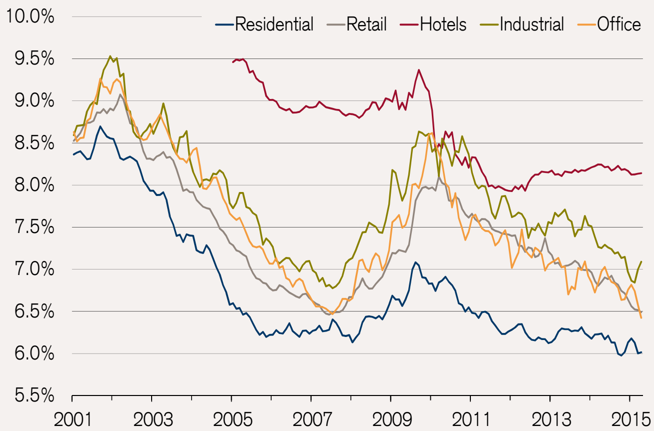
Source: Bloomberg, Credit Suisse

Hotel properties: Positive outlook in future too

2014 was a good year for the US hotel industry. Revenue per available room (RevPAR) rose by 8%, while average occupancy improved to 64.4%. Investors have also been showing increased interest. According to RCA, the volume of transactions in the hotel sector in the first four months of 2015 increased by 68% year-on-year, while prices were up 33% year-on-year at the end of the first quarter. The outlook is also positive. Besides modest expected growth in space, positive employment growth is supportive to the demand for overnight accommodation whether from business or vacation travelers. According to CBRE, the negative impact of the strong USD is evident above all in the high-end segment as well as in gateway cities such as New York and Miami. However, these markets currently show record occupancy ratios and should therefore be able to cope with a degree of softening.

Development of initial yields in commercial sector

Initial yields by sector, in %



Source: RCA, Credit Suisse

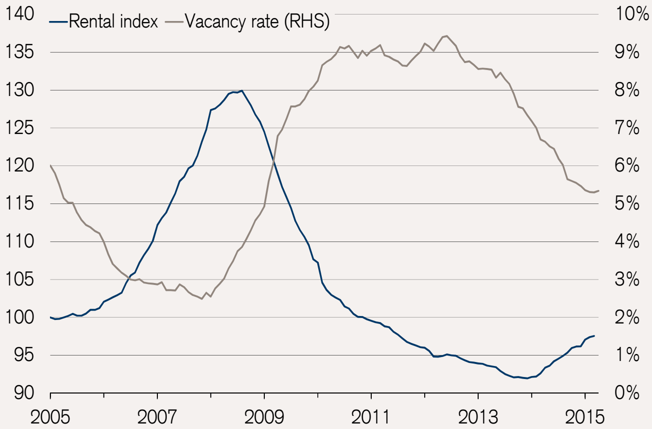
Region: Asia-Pacific

Commercial real estate: Still not much momentum

Office markets in Asia are already at a relatively advanced stage in their real estate cycle in many instances, with the result that modest average growth in rents of 1.5% and 3.0% is expected for the key cities in 2015 and 2016 respectively. Tokyo ranks as one of the most dynamic office markets. Here the vacancy rate has fallen from more than 9% in mid-2012 to 5.3% in April 2015, with the annual growth in rents having risen to 4.9%. The construction industry has responded with a corresponding expansion of its activities. Additional new office stock of between 1.5% and 2.0% is expected to be added on an annual basis from 2016. While Tokyo remains among the world's top destinations for overall returns in the short term, weaker growth in rents and stagnating vacancy rates are expected in the medium term.

Tokyo office market: Rents and vacancy rates

Office space: Rent index (Q1 2005 = 100), vacancy rate in % (RHS)



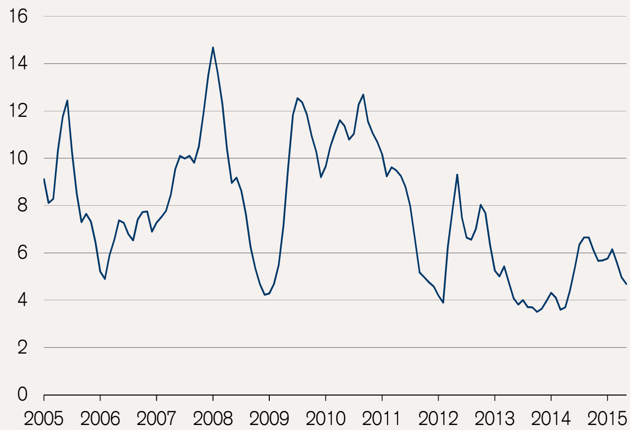
Source: Miki Shoji, Datastream, Credit Suisse

HK residential real estate: New measures to cool market

The Hong Kong owner-occupied residential market has once again been drawing attention to itself due to its volatility. Annual growth in prices has surged from 1.6% to 19.6% (March 2015) within a year. In February 2015, the regulatory authorities therefore took further measures to dampen down the real estate market. They include a lower loan-to-value ratio for mortgages on residential properties with a value of up to HKD 7 million as well as a reduction in the proportion of income that can be used for debt servicing in relation to purchases of second homes. Monthly transaction figures subsequently slumped from more than 6,000 at the start of 2015 to just over 4,000 in March and April. Sales in May returned to over 5,000. In Singapore, prices for owner-occupied residential real estate fell for the sixth time in succession in Q1 2015 (–1% quarterly growth). Prices are expected to fall further this year.

Hong Kong: Owner-occupied sales figures

Monthly sales figures, three-month averages in thousands of units



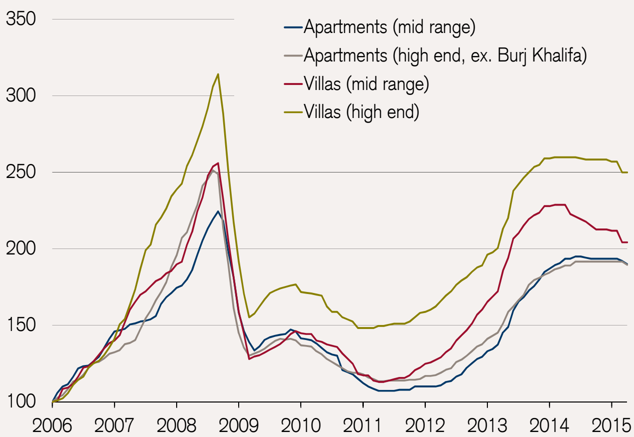
Source: Hong Kong Land Registry, Bloomberg, Credit Suisse

Dubai: Outlook is more subdued

The Dubai residential market has cooled significantly. After sharp price rises in 2013 and in the first half of 2014 with annual growth rates of up to 50%, a downward trend can now be observed. In the mid-market segment, prices for apartments have eased by 1.9% and prices for villas by 10.7% on a year-on-year basis (as at April 2015). By contrast, the prime office market has been relatively stable in the last 12 months. The vacancy rate in the central business district fell slightly to 23% in Q1 2015, while rents rose slightly (+1% annual growth). New additions amounting to 19% of the current prime office stock are expected by the end of 2017. Office rents are likely to fall in 2015 due to the supply overhang and oil price-induced dampening of investor sentiment.

Dubai: Prices for apartments and villas

Dubai price indices (apartments and villas by price segment), Q1 2006 = 100



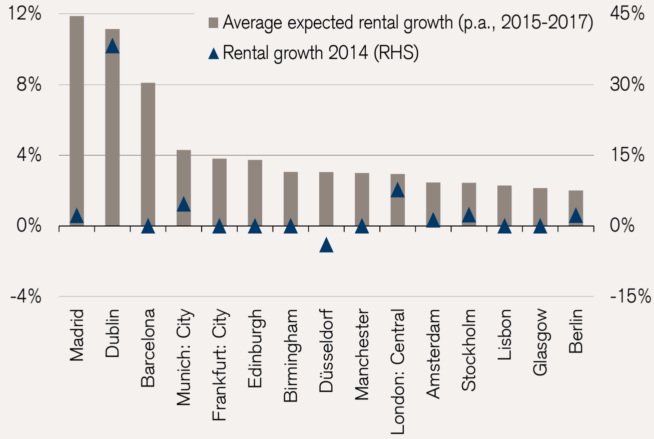
Source: Bloomberg, Cluttons LLC, Credit Suisse

Commercial real estate: Rental growth unevenly distributed

Major investor interest in commercial real estate has caused a downward trend in initial yields for prime office property. Rental trends have provided few grounds for enthusiasm to date. Low single-digit growth rates, stagnation or slight falls were observed in 2014, except in Dublin (+38%), and the outlook is mixed. The rule of thumb is that average expected growth in the period to end-2017 is strongest in those cities where rents have seen a sharp correction in recent years and are well below their historical peak levels. This is particularly the case in Dublin, Barcelona and Madrid. Lower but nonetheless persistently positive growth is expected for German and UK cities. Oslo, Warsaw and Moscow are at the bottom of the table. Oslo is impacted by the fall in oil prices, while Warsaw is continuing to suffer from excess supply.

15 European cities with strongest rental growth

Average expected annual growth in rents for prime office space



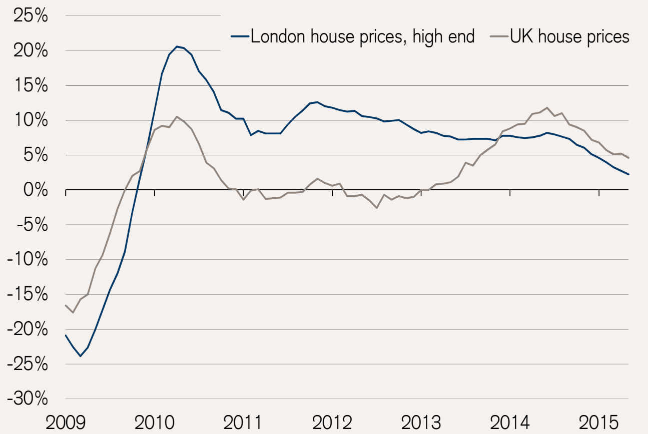
Source: PMA, Credit Suisse

UK housing market: "Mansion tax" now off the table

Uncertainty began brewing in the UK residential market in May 2015 in the run-up to the general election. Many market participants took a wait-and-see approach, as shown by the fall in sales instructions for March and April this year. Annual price growth has continued to slow to 4.6% nationwide and 2.2% for the top market segment in London. With the Conservative victory, demand in the top tier of the housing market in particular is likely to get a boost from the fact that the Labour party's proposed "mansion tax" is no longer on the table. In Germany, the heavyweight among Europe's economies, annual growth in asking prices for existing apartments has accelerated again to 7.1% since September 2014.

House price growth in the UK

House price indices, annual growth in %



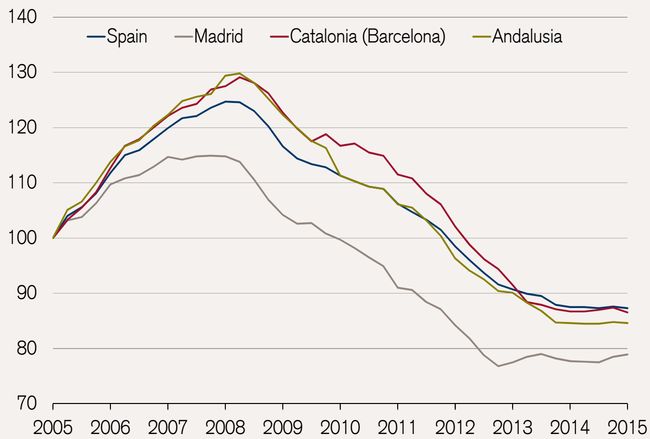
Source: Nationwide Building Society, Knight Frank, Credit Suisse

Spain: Trend reversal imminent on housing market

The Spanish housing market is having a tough time resuming its growth trajectory. Nominal house prices are down by around 30% since their peak in early 2008. Having recorded positive quarterly growth of +0.3% quarter-on-quarter in Q4 2014 for the first time in over six years, prices eased again in Q1 2015. Even though transaction data and credit volumes have thus far remained at their low levels, we expect a slow but steady recovery over the coming quarters. If we compare the euro zone's four largest economies with one another, Spain is expected to see the strongest annual growth in GDP at 2.5% in both 2015 and 2016. The fact that mortgage interest rates remain at historically low levels, combined with low construction activity, should also have a positive impact. Furthermore, the acceleration in income growth is supportive to household balance sheets.

Development of Spanish house prices

Nominal house price indices at national/regional level (Q1 2005 = 100)



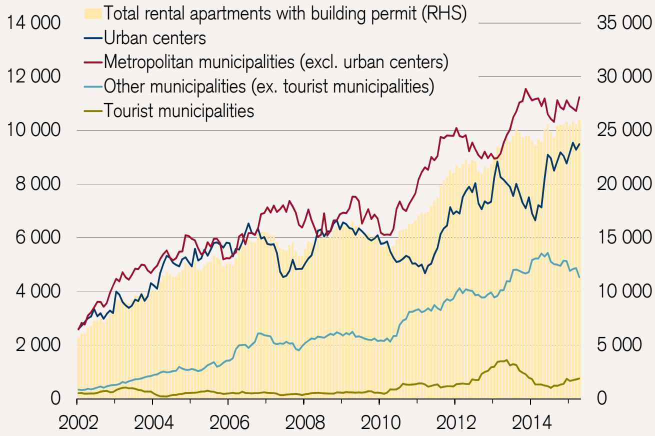
Source: Ministerio de Fomento, Bloomberg, Credit Suisse

Rental apartment output soaring

Due to low interest rates and resulting dearth of investment opportunities, rental apartments have been very popular with investors for several years. Rental apartment approvals have accordingly risen year after year. The total number of rental apartments to have been given a building permit in the last 12 months currently stands at around 25,500 units. In regional terms, the spotlight is on the major urban centers and metropolitan municipalities. However, there are also plans for a large number of apartments in the other municipalities. The introduction of negative interest rates has further boosted the appeal of real estate as an investment because the yield premium versus low-risk bonds has increased. We therefore expect rental apartment planning activity to remain at a high level. By contrast, the demand for rental apartments has fallen from its peak. This is due to lower expected immigration in particular.

Rental apartment approvals (new homes)

12-month moving sum, in residential units



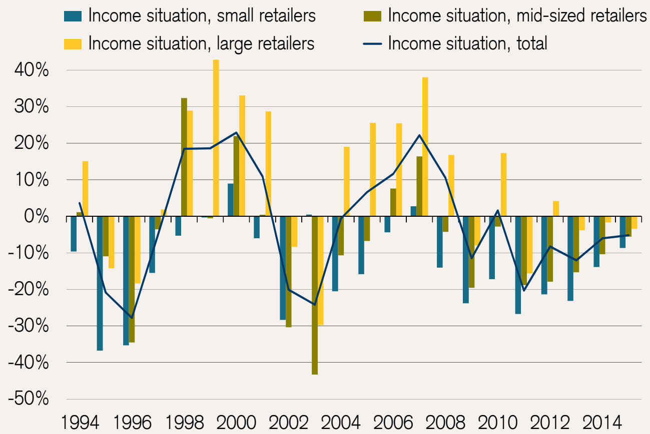
Source: Baublatt, Credit Suisse

Retail: Uncertainty overshadows low interest-rate effect

The retail property market seems to be in a state of shock on the supply side. Large-scale projects have become a rarity and will only be completed – if ever – following a lengthy planning phase. One example is the recently approved Ebnet superstore complex in Sirnach (Canton of Thurgau). This is the first CHF 50 million-plus retail project to have been approved since June 2012. The uncertainties sparked by online trading and the strong Swiss franc outweigh favorable financing conditions; investors are consequently giving the retail market a wide berth at the moment. Since 2011, retailers of all company sizes have been bemoaning the worsening income situation. This represents the longest lean period since 1994. Given the economic hit caused by the Swiss franc shock, we do not expect an easing this year.

Income situation in retailing

Net figure: positive (better) vs. negative (worse) responses on income situation



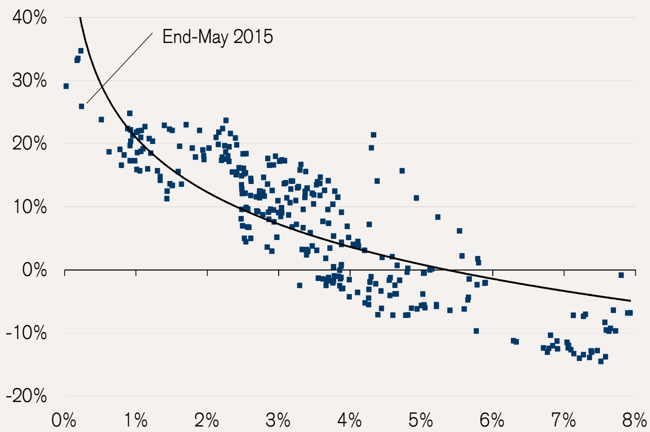
Source: KOF Swiss Economic Institute at ETH Zurich, Credit Suisse

Indirect real estate: A black May for funds

Swiss real estate funds and companies had an excellent start this year because real estate investments became even more attractive at a stroke following the introduction of negative interest rates. The picture has reversed completely since the end of April and is now dominated by losses, with the result that the total return since the start of the year stands at 3.0% for funds and 4.4% for listed companies. This volatility is fairly unusual, but can easily be explained by low trading volumes. One possible reason is that funds were slightly late in reacting to higher long-term interest rates. What's more, capital increases and a new listing in the SXI Real Estate Funds Index are likely to have had a negative influence. Switching to vehicles with lower premiums and foreign products as well as profit-taking are also likely to have played a role.

Premiums and long-term interest rates

Average premium* for real estate funds (y-axis), 10-yr. CHF swap rate in % (x-axis)



Source: Credit Suisse, Datastream; * Premium to net asset value (NAV)

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