

Subject : UAE Real Estate Sector

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Date : January 2009

Global Investment House – Kuwait – UAE Real Estate Sector- For the past five years, the GCC region has enjoyed an unprecedented property boom. Construction projects planned or under development in GCC have crossed the US\$ 1 trillion mark, and around two thirds of these mega projects are concentrated in the UAE. The real estate sector in UAE has been shooting up by double digit growth rates on a year on year basis and contributing around 15% to the country’s GDP. After five years of unrelenting growth, the global financial crisis has casts its shadows over the much debatable UAE property sector. For the first time in years, the UAE property market is slowing down as credit tightens, projects are scaled down, jobs are cut, and prices fall following the global credit crunch in September 2008. Total credit extended to the real estate sector has been growing at double digit growth rate. The latest published figures revealed that real estate mortgage loans stood at AED87.5bn in June 2008 growing by 49% compared to AED58.8bn at the end of 2007. However, the recent credit crunch forced UAE banks, and lending institutions to toughen their lending criteria. HSBC lowered its loan to value ratio to 70%, down from 85%. Lloyds TSB has stopped loans for purchase of apartments and dropped its loan to value ratio on villas in the UAE to 50%.

Credit to Real Estate Sector

(AED mn)	2004	2005	2006	2007	Jun-08
Total Credit	246,953	353,139	474,161	647,482	818,940
Real Estate Mortgage Loans	10,604	17,224	31,016	58,859	87,574
Share of Mortgage Loans to Total Credit	4%	5%	7%	9%	11%
Credit to Construction Sector	31,681	41,897	54,344	68,417	84,812
Share of Construction Sector Loans to Total Credit	13%	12%	11%	11%	10%

Source: UAE Central Bank

Sector Performance and Outlook

Dubai

Residential Segment

Dubai has been the center of attention and attracting most of the expatriate workforce. Sales and rental prices have appreciated by double digit growth rates for the past five years. However, since the start of Q4 2008, we witnessed a slowdown in growth in line with the recent developments in global markets and the credit crunch. Despite the decline witnessed in Q4 2008, the increase in the first three quarters resulted in an average growth of 6% in apartment prices in 2008 according to a recent report published by Asteco property consultants. However, the degree of decline varied across different developments. Projects which were launched originally at high price levels were affected the most, whereas more affordable housing projects were less affected. Downtown Burj Dubai apartment prices have decreased from AED3,750 per sqft in Q3 2008 to AED2,700 per sqft in Q4 2008 recording a 28% decline. Dubai Marina rates have also declined by 18%, from AED2,200 per sqft to AED1,800 per sqft in Q4 2008.

The Villa segment on the other hand fared better than the apartment segment with an average growth of 13% in 2008, also with varying trends across different developments. Concerning the freehold market, it is important to distinguish between sales of finished or nearly completed properties, off-plan sales and the sales in the secondary market. It has been reported that prices of off-plan sales and sales in the secondary market have been hit the most. However, it all depends on the location. Projects that were announced in 2008, and launched outside the CBD radius (5 km radius from Burj Dubai) have been affected the most. Properties in the secondary market have fallen as deep as 40%. Looking ahead in 2009, we expect to see further price correction for freehold properties in the range of 15% to 30%, however, completed or nearly completed projects in prime locations will fare better than other projects.

As for the rental market, after years of double digit growth rates, the rental market in Dubai has started to cool-off in 2008. The global financial crisis had little effect on the rental market which was almost stable in Q4 2008. Nevertheless, the stiff credit conditions, and the shortage in mortgage financing have forced many potential buyers to turn into the lease market. Unlike the freehold market which witnessed a lot of speculative activity in recent years, the rental market is more demand driven.

Likewise, we expect rents in Dubai to decline in 2009 due the lack of demand in line with the economic slowdown which forced many Dubai firms to downsize or halt their expansion plans which will likely result in a decline in the number of expatriates in Dubai who form around 90% of the emirate's population. However, we expect rental rates to be more resilient to the downturn than the prices of freehold properties. Accordingly, we expect rents to decline by 15% to 25% in 2009.

Office Segment

Dubai's office market have been growing at double digit growth rates since the start of the property boom driven by the economic boom and the influx of foreign business into the country. Vacancy rates in Dubai office market did not exceed 2%, reflecting the demand-supply gap in the market. In Q4 2008, there was a dramatic shift in the market in light of the recent credit crunch and the global economic slowdown which forced many businesses in Dubai to either downsize or put a hold on their expansion plans in the current market conditions. According to Asteco, Dubai office rents have dropped by 11%-16% in the last quarter of 2008. The free zone developments Sheikh Zayed Road, Bur Dubai, and Deira business district were the mostly affected. We expect further correction in office rents in the range of 10% to 25% as businesses downsize and hold their expansion plans.

Retail Segment

The successful marketing of Dubai as global leisure and shopping destination had its impact on Dubai's retail scene. The recent addition to Dubai's retail's scene was Dubai Mall which opened in 2008 with a total GLA of 344,000 sqm. Another large scale development which is scheduled to launch in 2010 is Mall of Arabia (Phase 1), which will add an additional GLA of 400,000 sqm. We expect the forthcoming retail supply which will likely hit the market in 2009, and 2010 to result in an oversupply situation which will likely push rental rates downwards in 2009, coupled with the general global economic slowdown which will likely lead to a decline in footfall and spending.

Abu Dhabi

Residential Segment

Unlike Dubai which has been experiencing a real estate boom since 2002, the real estate market in Abu Dhabi is somewhat in a different stage of the real estate cycle, and still lags that of Dubai. The residential market in Abu Dhabi is deeply undersupplied, with a population of 930,000 at the end of 2007, and only 180,000 units available as estimated by the Urban Planning Council at the end of 2007. According to Colliers the supply of residential units is expected to increase by 213,000 by 2010. An additional 140,000

units are expected between 2011 and 2013 following the completion of residential components within Al Raha Beach and Al Reem Island mega projects. With the addition of new residential units to the market, we expect the residential market in Abu Dhabi to stabilize with the new supply coming from mega projects such as Al Reem Island and Al Raha beach in 2009.

Office Segment

The office market in Abu Dhabi is under supplied especially the primary office space. Office rental rates have appreciated by 14% between Q4 2007 and Q4 2008 according to Colliers international, with vacancy rates of almost 1%. Rents in the Central Business district range from AED2,500 to AED4,000 per sqm in Q4 2008. According to Colliers, the upcoming supply between Q4 2008 and Q4 2010 will be concentrated in Abu Dhabi Island, and then will be gradually fragmented to different locations including ADNEC Capital Center, Al Raha Beach, and Al Reem Island. According to Asteco, the office segment has witnessed an increase of 11% in prices in Q4 2008. We do not foresee any decline in Abu Dhabi's office rental rates in the medium term. However, a slowdown in the rate of growth is expected due to the lack of demand in line with current financial crisis and the slowdown of economic activity.

Retail Segment

Unlike its neighbor Dubai which turned into a major shopping destination, the Abu Dhabi retail market is mainly driven by Abu Dhabi residents and not tourist inflows. Shopping mall supply in Abu Dhabi is expected to increase from the current GLA of 820,000 sqm to 1.4mn sqm by 2010 according to Colliers. According to Plan Abu Dhabi 2030, retail space in Abu Dhabi will spread across the city evenly, with the existing downtown, Al Reem Island, Capital District, Sadaiyat Island, and Al Yas Island being key retail areas. Given the lack of supply, we do not foresee a softening in rental rates in Abu Dhabi's retail market in the short term until new space is delivered in 2010.

Sector Outlook

The UAE property boom was fuelled to an extent by speculators who helped inflate property prices to skyrocketing levels through purchasing the property off-plan with minimum down payments, and then flipping it within a short period of time in order to achieve higher returns. Those speculators, encouraged by cheap and available liquidity, have drove the prices of off-plan or un-built properties to the levels of completed properties or properties near completion. Now the tables have turned, and off-plan sales which used to witness the largest hikes are also the ones who are experiencing the greatest hit.

It is worth noting that the magnitude of the effect of the credit crunch on the UAE property market has been more severe with off-plan sales. Partly since the same speculators who were rushing to enter the market are now rushing to get out and are driving off-plan sale prices down, a trend known as "Panic Selling". We expect panic selling to continue to drive prices down, however, the prices of projects towards completion are not expected to witness sharp drops as those seen in off-plan sales. However, as mentioned earlier the trends will be different across the Emirates. The outlook for Abu Dhabi property market remains stronger than Dubai. Unlike Dubai, the property market in Abu Dhabi and other emirates seems to be more resilient.

Given the lack of financing in light of the recent global financial crisis, we expect the slowdown in the market to continue in the short term in line with the economic slowdown which will result in project cancellations or delays. The emirate's finance department lowered its previous gross domestic product growth targets of 11% a year to 2015 to a more modest 4% to 6%. The slowdown in economic activity will likely result in lower expatriate population growth and therefore lower demand on both residential and commercial properties. Developers who will weather the storm are those with solid branding, good track record, and available financing.

On the upside, project cancellation and delays will increase the pent up demand as supply is delayed. Nevertheless, the market correction will allow buyers who were previously deterred by high prices, to enter the market at more affordable prices. Accordingly, going forward, we expect the UAE property market to be dominated with end users rather than speculators especially with the government's commitment to introduce legislations regulating the market.

We expect the government to continue supporting the market, and inject liquidity when needed. Therefore, we believe that despite the recent downturn in the market, the outlook is still positive in the long term supported by strong fundamentals, and proactive government policies which will drive away speculators and stabilize the market. Once the market stabilizes, opportunities will arise for investors with long term perspective who are willing to pay higher down payments and settle for lower returns than those achieved in the boom period.