

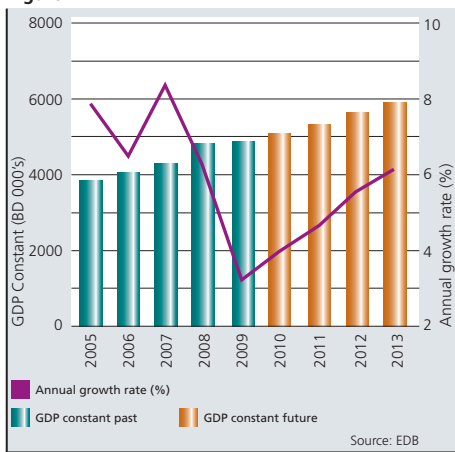
# Bahrain property market update

April 2010

**Comment** Following the global economic downturn that hit the economies of the West in 2007 and those of the GCC in 2008, the first quarter of 2010 has seen signs of a recovery in Western markets as assets regain value, whilst the GCC economies continue to be affected by a reduction in liquidity and corporate profitability.

## EDB predicts GDP growth from 2010

Figure 1.1



	Past		
	2008	2009	2010
GDP Constant: 2001 (BD mn)	4734	4885	5081
Growth (%)	6.3	3.2	4
GDP Current: (BD mn)	8235	7692	8380
Growth (%)	18.6	-6.6	8.96

	Future		
	2011	2012	2013
GDP Constant: 2001 (BD mn)	5320	5612	5955
Growth (%)	4.7	5.5	6.1
GDP Current: (BD mn)	9063	9586	10240
Growth (%)	8.2	5.8	6.8

**The economy** Over the past six months, markets such as London have witnessed a slight recovery as a result of a compression in prime yields. This renewed confidence has been fuelled by the need of institutional investors to allocate capital, coupled with a lack of available prime stock. It is unclear exactly how long this mini recovery will last but commentators expect it to be short lived due to the ensuing lack of liquidity in the wider banking sector and the lack of correctly priced prime stock.

The absence of what can be termed institutional investors in Bahrain accounts, in part, for the lack of a similar mini recovery within the local investment market. In the boom years, the main investors were generally either high net worth individuals or banking institutions. For differing reasons, neither of these parties are currently investing in the local property market.

In the Middle East, markets have been watching Dubai carefully following the partial default on debt payments by Dubai World in late 2009 that resulted in a forced restructuring of its finances.

The Central Bank of Bahrain (CBB) has stated that Bahrain's banks have only a small exposure to Dubai World but it is unclear as yet what the wider effects on general confidence in the regional economy will be resulting from the problems in Dubai. It is however clear that Bahrain has been affected by the fall out resulting from the global economic downturn, not least due to its large banking sector and its extensive development market.

The latest report from the Economic Development Board (EDB) has stated that throughout 2009 Bahrain witnessed a slowdown with a reduction in GDP (constant) growth from 6.3% in 2008 to 3.2% in 2009. Primarily, this stemmed from a decline in the property and construction industry as expectations of future demand were scaled back as well as a reduction in bank lending as the finance sector contracted.

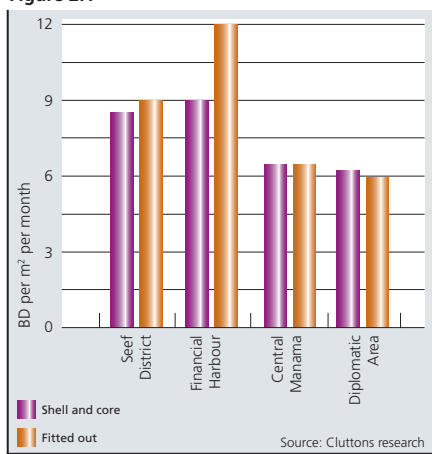
The report predicts that Bahrain will benefit from a recovery throughout 2010 mainly as a result of resilience in the manufacturing and logistics industries as well as the expansion of investment in the oil and gas industries.

The downturn in the world economy has slowed the progress of Bahrain, however, the significant strides made by the country in encouraging diversification through sectors such as finance, industry and business tourism potentially stand the Kingdom in good stead when global markets recover.

**Office** The commercial office market in Bahrain has fared better than other sub sectors, resulting from continuing demand from existing companies wishing to expand their office space or new companies wishing to open offices on the island. In this respect Bahrain has benefited from its pro business environment as companies look to service their business needs in the Gulf from the island.

## Achieved rents continue their downward trend

Figure 2.1



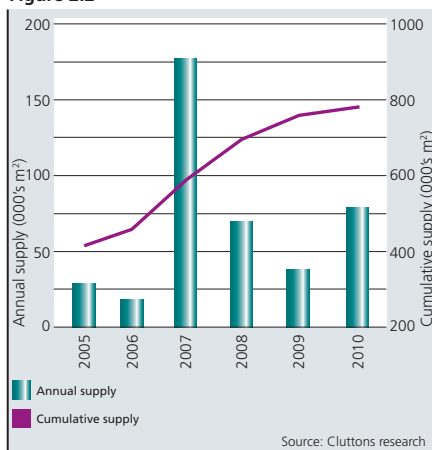
Despite the apparent resilience of the commercial office market, it must be borne in mind that within prime office buildings, lettable area has more than doubled between 2006 and 2010 rising from around 400,000 square metres to in excess of 800,000 square metres.

The dramatic increase in prime space was mainly due to the development of the Dual Towers, the GB Corp Building and Harbour House at Bahrain Financial Harbour which alone increased existing supply by approximately 30%. Despite there being some liquidity in the market, this over supply has resulted in a downward pressure on rental values as tenants seek to secure good quality space at a discount.

Figure 2.1 shows the variance in achieved rents in the four major commercial areas of Bahrain split between shell and core space and fitted out space. The prime areas of Seef and Bahrain Financial Harbour are commanding a premium for fitted out space as tenants are becoming increasingly unwilling to take on the capital cost of fitting out new premises.

On the other hand, achieved rents for fitted out space in the Diplomatic Area and Central Manama are often lower than shell and core space as a result of the age and quality of the fitted out space being let.

Figure 2.2



Despite average asking rents only reducing by approximately 3% year on year, achieved rates have fallen between 20% and 30% with brand new, poorly located grade A office space seeing the largest falls. This has created the potential for tenants to vacate their current premises and take leases in better buildings in terms of space, access and parking requirements at a lower rent.

Excluding future supply in the Diplomatic Area and the Seef District, there is a further estimated 500,000 square metres of pipeline commercial office space within the master planned developments of Bahrain Financial Harbour and Bahrain Bay. This equates to a 60% increase in supply which, if built out within a short timescale, will further depress commercial rental values.

As a result careful management of this future supply is vital to ensure that a further reduction in rental values is avoided.

**Hotel** The hospitality market in Bahrain has undergone rapid expansion over the past five years, mainly as a result of growth in the tourism industry and the corporate sector.

## 4 & 5 star hotel supply set to increase by 200%

Given its relaxed and business friendly environment, Bahrain has benefited from an increase in tourist arrivals, approximately 60% of which are from GCC nations. Of particular importance to the hospitality sector is the proximity of Eastern Province, Saudi Arabia, which is joined to Bahrain via the King Fahd causeway.

The number of visits to Bahrain increased from approximately 5 million in 2003 to 7.8 million in 2007 when tourism accounted for 7.5% of GDP. Through the Vision 2030 document, the EDB has earmarked the tourism sector as a major source of growth over the coming years as it looks to continue the diversification of Bahrain's economy.

Traditionally Bahrain has benefited from a strong meetings, incentives, conferences and exhibitions (MICE) sector which, in the Gulf, is worth approximately BD 3 billion per annum. According to Oxford Business Group, Bahrain is actively seeking to boost its market share of this sector which currently attracts over a million business travellers on an annual basis.

The Bahrain hotel stock currently comprises 65 hotels rated between two and five stars. Of these 11 are designated as five star which provide approximately 2,500 rooms equating to 910,000 five star hotel nights per annum.

Like most of the real estate markets across the region, the hotel sector has suffered as a result of the global downturn. With corporate profitability down and a reduction in leisure spending both on a national and GCC level, the hotel sector continues to be affected by the current economic climate. This will be compounded by the introduction to the market of a number of master planned developments across the island, each including further hotel supply.

Within the next four years we have estimated that an 19 additional four or five star hotels will be launched, the majority of which are within master planned developments. This will add approximately 5,900 rooms to the existing stock which equates to an increase of 2.1 million room nights.

As a result of this increase in stock, we believe that the hotel sector will suffer from an over supply in the short to medium term. This pipeline of four and five star hotel rooms amounts to an increase of over 200% on current stock which, if built, will lead to a reduction in average daily rates (ADR) and a slow down in the sector as a whole as the market attempts to absorb the new stock.

Figure 3.1

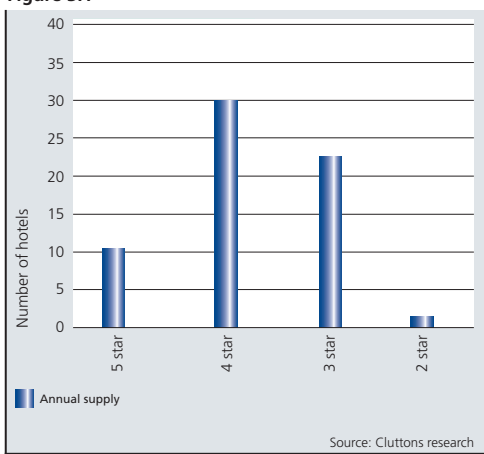
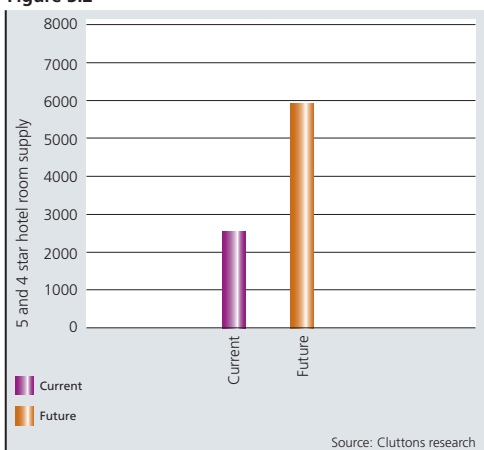


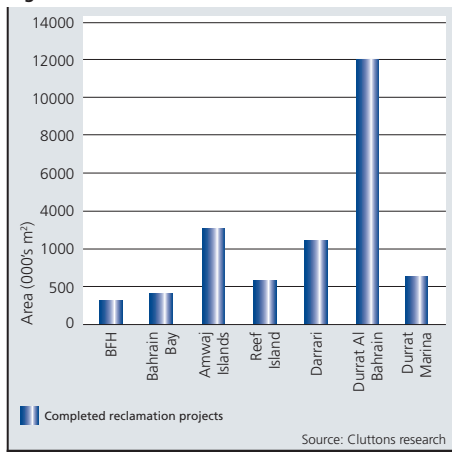
Figure 3.2



**Master planned developments** Since 2003 when the development of Bahrain Financial Harbour began, the growth of reclaimed master planned areas has been considerable.

## Master planned developments underpin construction sector

Figure 4.1



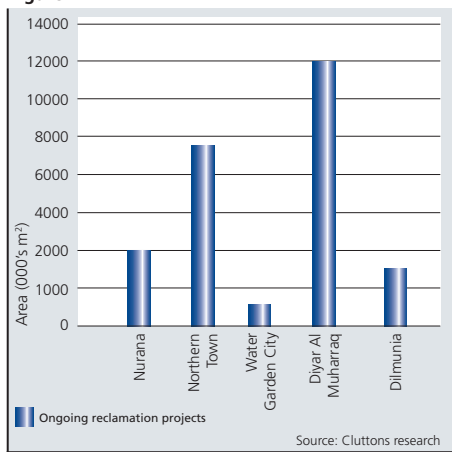
With Diyar Al Muharraq, Water Garden City, Northern Town, Nurana and Dilmunia all in the process of being reclaimed, Bahrain is set to further increase its land mass by approximately 23 million square metres or 3% of its total land mass.

This figure excludes master planned areas that we understand have finished reclamation and marine works such as Durrat Al Bahrain, Darari and Bahrain Bay which are ready to have infrastructure and services provided to their sites which alone extend to a further 14.5 million square metres. Figure 4.1 clearly illustrates the amount of land reclaimed in major projects while figure 4.2 shows the additional land within master planned developments which is due to come on line in the next few years.

Given the amount of land being created and further projects as yet unnamed, Bahrain looks set to create a supply / demand imbalance in the short to medium term. This over supply will become acute if all the schemes that are planned, but as yet have not broken ground, come forward over a short period of time. Such a situation will inevitably further depress the value of development land.

In this scenario, only the best located, well designed and market facing schemes will be successful. As such the supply of serviced development land onto the market must be carefully phased if values are not to fall further.

Figure 4.2



Purchasers have suffered from paying high values for development land at the peak of the market which were unrelated to the income producing capacity of the built asset. With the reduction in commercial office rents and the correction in the residential market, the value of land has reduced significantly, down from a peak of BD 300 psf in late 2008 to highs of around BD 120 psf in the current market.

The large increase of development land in Bahrain looks set to underpin activity in the construction industry for a number of years. However if projects are to be successful the release of this land must be carefully phased to avoid flooding the market and depressing development land values further. Such a situation will result in a corresponding reduction in activity in the construction sector as major projects become unviable.

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