CLUTTONS

Dubai property market overview

Fourth Quarter 2009

Overview Since the introduction of freehold property in 2002, Dubai's real estate market has been under an aggressive expansion across all sectors. The freehold law, placed in the context of a diversifying economy and rapid population growth, stimulated massive investment in the Emirate's property market. However, with the impact of the global financial crisis, the subsequent tightening of credit markets, followed by falling employment levels, the local economy started to falter in the middle of 2008 and in the property market, particularly. What followed was a significant reversal in the last quarter of 2008 and through the first three quarters of 2009. Unfortunately, the continuation of a sluggish recovery in the global economy was exacerbated by a hit in market confidence during the recent prospect of Dubai World's possible default. This has and will undoubtedly continue to cast a shadow of uncertainty over Dubai's property market in the foreseeable future, in otherwise, what looked to be a stabilizing fourth quarter. Time will tell.

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research

The economy Despite the current economic climate, there are fundamental reasons to be hopeful that Dubai will recover, and possibly faster than the world's developed economies. Dubai has served throughout its history as a regional centre of trade and commerce. This has been true prior to its discovery of oil and prior to the recent property boom. This trait is unlikely to change and may serve to insulate Dubai from further difficulties, while paving the way for its future recovery and growth. More specifically, these attributes include:

- A strategic geographical location
- Modern transport and communications infrastructure;
- A stable system of governance;
- A relatively tax-free environment; and
- A relatively open and expatriate-friendly society.

These are the fundamentals precipitated by the introduction of freehold property opportunities for foreigners that drove Dubai's economic growth between 2003 and 2007, averaging 6.4% growth per annum over this period. During this time, however, it should be noted that the market in Dubai, not unlike elsewhere around the world, was characterized by an overabundance of cheap bank credit and, what seemed like, endless investment opportunities. This led to an over-exuberance, which although allowed Dubai to grow its base economy, also produced an unhealthy speculative trend in real estate investments, particularly towards off-plan properties. These off-plan properties have suffered immensely, with a significant proportion having either been cancelled or endanger of remaining on-hold indefinitely.

Although, the financial crisis began affecting Dubai markets in the middle of 2008, it is important to recognize that 2008 did conclude positively with a 7.4% growth rate. Although no official numbers have been released for 2009, average forecasts for 2009 placed the growth rate between 0% - 3%. Very few estimates actually predicted a contraction. Currently, the property market and the economy in general continue to remain cautious with a subdued appetite for risk across much of the commercial and industrial sectors. However, those with ready cash are seeing opportunities, conveying an underlying belief that Dubai has the potential to shift towards recovery. Although, we recognize these opportunities presently, we believe there are continuing downside risks to the value of property, as we brace for the next series of debt repayments in 2010. The next major debt obligations to be paid from developers include Limitless and Nakheel. Limitless's loan of $1.2 billion is due on March 31st and Nakheel is set to pay $980 million bond on May 13th.

According to the government of Dubai, the Emirate puts its total debt at $80 billion. However, Morgan Stanley has estimated that Dubai's public debt, when including quasi-governmental entities, totals over $108 billion. While this will instill further apprehension towards the market, if similar economic 'shocks' can be avoided, these downside risks will slowly be eroded by more positive market conditions over the next 12 to 18 months.

Downside risks to the economy include:

- Oversupply in the office and residential property markets;
- A lack of liquidity;
- Loss of market confidence in the wake of Dubai World's debt issues;
- A stagnation and possible decline in the numbers of foreign tourists;
- Expatriate population decline

Residential market The Dubai residential market has, in the past, been characterised by rampant price speculation driven off ambitious project introductions and extreme market confidence. However, in the last two quarters of 2008, confidence in the market was massively affected by the global credit crunch, driving down demand and prices. Many projects were put on hold and some cancelled as the market came to grips with over supply and falling demand for residential property.

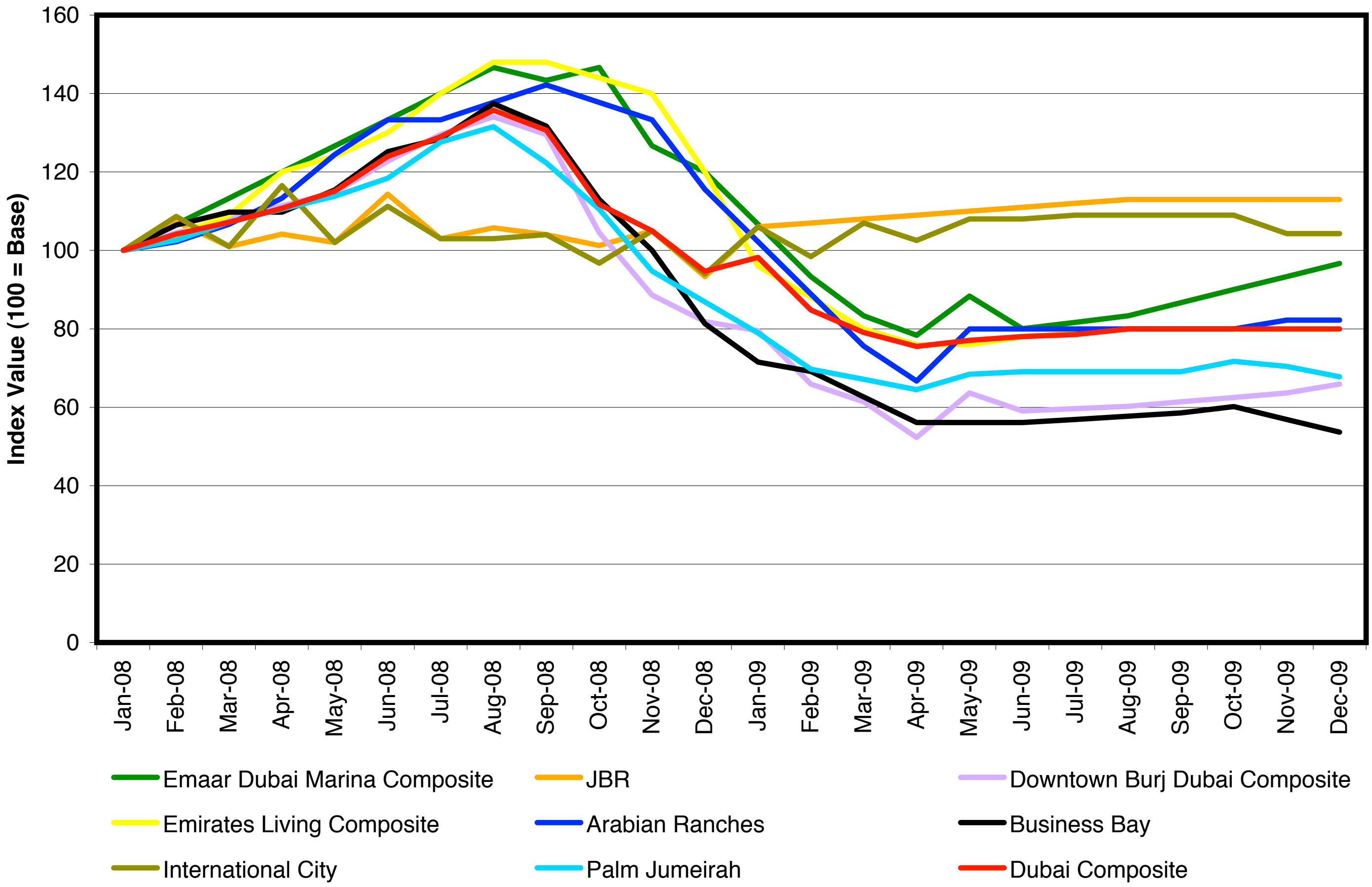
In the last six months, however, the residential market has started to stabilize with month to month sales showing some traction. Transactions, however, remain largely within the purview of cash buyers, and average prices in Dubai have remained level in the past two quarters, overall. Although sales volumes have started to gather some momentum, what continues to become more pronounced is the concentration in demand for particular areas in Dubai which are ready-built with a reputation for good quality. Conversely, there has been a continual flight from low quality properties. Established, residential communities such as in the Downtown Burj Dubai, the Arabian Ranches, and Emaar's Dubai Marina have benefited from marginal price increases, while other areas have either remained unchanged from the last quarter, or have continued to drop, like in Business Bay and International City.

The introduction of the Dubai Metro has also had a measure of influence on the property market, boosting the perception of Dubai as a modern city. Up and running since September 9th, the Roads and Transport Authority claims that nearly six million passengers have taken the metro in the first three months of operation. Figures released by the RTA show a significant rise in the number of passengers from month-to-month. Approximately, 1.2 million passengers used the metro from September to October, followed by a healthy increase to 1.76 and 1.9 in November and December, respectively. With Dubai's metro up and running, tourist and residents alike are benefiting from easy-access to major destination areas in the emirate. Furthermore, the metro has enhanced the sense of community within nearby residential areas, adding to their prestige value.

In terms of the availability of credit, there seems to be an easing. Lending, however, is still cautious, tailoring towards individual clients. Furthermore, lenders are only willing to offer credit on projects by reputable developers and where construction is visibly progressing, as questions remain over the ability of some developers to complete and deliver their products to market.

Chart 1.1 below show's Cluttons' Indicative Pricing Exercise index, charting the percentage change in median per square foot sales price from January 2008 to December 2009. The chart illustrates a select number of residential areas, as well as, a Dubai composite index for comparison.

Chart 1.1 Cluttons residential indicative pricing exercise index



Source: Cluttons Valuations and Cluttons Consulting and Research

According to the index, residential property prices peaked in the middle of 2008, gaining on average 38% in value between January and August 2008. The best performing areas were Jumeirah Village increasing by 68%, Emaar Dubai Marina (46%), Emirates Living (48%), Arabian Ranches (38%), Business Bay (37%) and Downtown Burj Dubai (34%) over the same period.

These impressive gains were followed by steep losses over the following six months; the Cluttons Dubai composite lost 38% of its value from August 2008 to January 2009. In August 2009, the index was close to 70% below the peak 12 months previous, where it has lingered for the past two quarters of 2009.

We see the market as having some key strengths that should provide it with some upside in the coming quarters; however, there are some severe downside risks that cannot be ignored.

Key market strengths that will underpin the market's recovery and future growth include:
- Improving affordability;
- Wide selection of available stock across different price points;
- Pent up demand for good quality established property;
- Relatively attractive rental yields for investment property;
- Freehold ownership;
- And a new 2008 mortgage law, setting out rules for default, foreclosure and repossession.

Whilst market weaknesses which may impact future recovery and growth include:
- Oversupply potential along with the decreasing rents that would follow;
- Questionable quality in certain developments;
- Questions over the financial viability of real estate developers and their ability to complete their projects
- Concerns over the number of mortgage defaults forecasted in the near future. (Moody's forecasted 12% of the 27,000 residential mortgages to go into default throughout 2010.)
- High service charges due to a lack of enforcement of the strata law, requiring the setup of a home owner's association to oversee the management of the common areas and control cost
- Landlords not paying service charges in absentia, effecting maintenance and upkeep;
- Credit is still expensive and more difficult to obtain;
- Lack of an official legal framework surrounding the buying and selling of property; and
- A significant proportion of the market continues to be investor-driven rather than owner occupier driven;

Commercial market The commercial property market in Dubai has been affected largely in tandem with the residential market. As with the residential market, it has historically been characterised by limited supply and high demand with significant upward pressure on rental rates. This pent up demand and projections of continued demand growth attracted developers and speculators alike. At one point there was approximately 60 million square feet of office space in the supply pipeline due to come to market in the five years to 2013. However in the current economic downturn, the demand for office space has fallen, leading to downward pressure on sales prices and rental rates. New build announcements with large tranches of office space have either been put on hold or cancelled in light of the current circumstances. Furthermore, a number of office buildings in Business Bay are approaching completion this year, which should further depress achievable rental rates in Dubai.

Despite the current negative outlook, there are some positives to be highlighted, the primary one being that office space availability will not be a limiting factor in the future economic growth of Dubai. With existing office space in place, companies wishing to either set up or expand their operations in Dubai will now have a selection across numerous locations. Current rental rates vary by location and quality and range from between AED 55 per square foot per annum in JLT (Jumeirah Lake Towers) to asking rents of between AED 250 and AED 300 per square foot per annum in DIFC (Dubai International Financial Centre). As rental rents have been forced downward, another positive is that the cost of doing business has also declined. As such, we may see many organisations upgrading their offices and moving to properties with higher specifications in better locations and buildings. Indeed, as shown in the table below, although rents have fallen 50% - 70% from 2008 peak rents, depending on the area, the last quarter of 2009 shows that the pace of decline has started to slow, with certain areas with a reputation for top-quality holding their rates, particularly Emaar Square and DIFC.

Table 1.1 below gives an indication of past peak rents and current commercial asking rents.

Table 1.1 Dubai commercial office asking rents

Asking rents per annum (in AED/sq ft)

Location	September 2008 (peak)	August 2009	December 2009
Emaar Square	650	170 – 200	170 – 200
TECOM	250 – 275	130 – 175	75 – 120
SZR	350 – 450	120 – 250	90 – 250
Business Bay	N/A	140 – 160	90 – 120
JLT	250 – 275	55 – 120	55 – 85
DIFC	500	250 – 300	250 – 300

Source: Cluttons Consulting and Research

Like the other property sectors of Dubai, there are some downside risks and weaknesses which will both constrain and slow the market's future recovery and growth. The overall attractiveness of Dubai as a commercial centre will have a bearing on its prosperousness going forward. These qualities include the strength of the planning in commercial areas within Dubai, specifically, in terms of efficiency, infrastructure and business specifications, as well as, the general ease of doing business. In the World Bank's,2010 Ease of Doing Business, what is reflected on the ground here in Dubai is that the emirate suffers, in some aspects, from bureaucratic inefficiencies and in general, a lack of a formal legal framework to cover such topics as contract enforcement, protecting investors, and the dissolution of a business.

In the past, when the pace of economic growth was rapid, there were no immediate incentives to address these issues, but present circumstances require the support of these institutional structures, which will serve to aide in maturing the market and accelerating recovery. For example, in some areas, particularly the free zones, occupancy is restricted to companies with specific trade licenses, whilst in others the local free zone authority has been artificially maintaining rental levels, both to the detriment of occupancy rates. This has started to take its toll on the free zones, which have begun experiencing a departure by companies who have decided that they are able to save costs in either non-free zone areas, or in 'virtual' free-zones, which require no office space and less costs in terms set-up and fees. To begin addressing this issue, at least one free zone, the DMCC (Dubai Multi Commodities Centre, has started to ease the restrictions on the types of business that can be located within its zone, as well as, accelerating registration times.

In other commercial areas in Dubai, piecemeal planning compounded by the fragmented nature of land ownership has meant that some areas have not been developed to their density potential. This has also lead in some cases to completed infrastructure, which though being suitable for the construction phase, has not been up to the required level for servicing completed projects, rendering them essentially unleasable, JLT and Business Bay being primary examples. The result of this is penalty to those sub developers who have taken the initiative to complete their projects on time. With that being said, Dubai continues to progress in making improvements in its business environment. The World Bank has named the UAE as a top 10 reformer in terms of the 'Ease of Doing Business,' and the country has moved from 47th place to 33rd place in its annual report covering 183 countries. Additionally, clients now have more choice than ever when looking for office space, and the upside is that landlords are being forced to consider the quality of their product, as well as, the quality of maintenance and property management in order to attract tenants.

Industrial market The Dubai industrial market is dominated by several large 'Free Zone' and 'Non-Free Zone' industrial areas. Dubai has invested significantly in its industrial infrastructure over the last 20 years, and today the sector is very well developed and is likely the best placed of all the property sectors. Although, the Industrial areas outside of the main industrial Free Zones are hampered by poor physical infrastructure, this continues to change with massive efforts from the Dubai Government to improve immediate access to these areas.

Dubai is firmly engrained in world trade flows and is considered the main industrial centre in the Middle East. The industrial sector has been impacted by the world wide economic slow down to some degree, however, the growth prospects for the region will support this market moving forward, and the level of development is such that future demand growth can be catered for.

Dubai's industrial market is characterized primarily by a warehousing sector that takes advantage of the emirate's Free Zones, enabling it to act as a distribution hub between Europe, East Africa, Southeast Asian, and Australia. In addition, the sector also comprises of light manufacturing and heavy industry, as they benefit from low labour costs, access to raw materials, and a tax-free environment. Because the construction industry has been the primary driver of the sector's growth most recently, the reduction in construction activity has negatively impacted the sector. Furthermore, the performance of the local industrial market, by its nature, is largely tied to the performance of the world economy. As such, with falling volumes of world trade much of the capacity is currently not required. However, the industrial sector has been able to rely on the recent progress achieved in aviation, ship building and repairs, and this continues to bolster the industry, with Dubai now boasting some of the most capable facilities in the regions.

The total area zoned for industrial uses has expanded exponentially over the last decade as Dubai's position as a place of transit between East and West grows. In 1970 Dubai had approximately 11 million square feet (one million square metres) of industrially zoned land. By 2009 this had increased to approximately two billion square feet (two hundred million square metres) of industrially zoned land. Growth has been driven primarily by the construction of large master planned developments, for example: Dubai Investments Park; Dubai Logistics City; and the Jebel Ali industrial areas.

Table 2.1 below shows the main industrial areas of Dubai and their approximate areas.

Table 2.1: Dubai Industrial Areas

Industrial & Warehousing Area	Est.	Gross Land Area (ft^2)	Gross Land Area (m2)	Developed Land to Date
Al Khubaisi	1965	11,990,169	1,114,328	100%
Umm-Ramool	1969	42,295,871	3,930,843	95%
Al Quoz	1974	197,418,508	18,347,445	100%
Al Qusais	1975	59,351,966	5,515,982	70%
Ras Al Khor	1976	72,165,297	6,706,812	85%
Jebel Ali Free Zone (North)	1985	315,467,254	29,318,518	90%
Jebel Ali Free Zone (South)	2005	339,660,178	31,566,931	40%
Jebel Ali Industrial Area	1995	235,686,222	21,903,924	85%
Dubai Investment Park (DIP)	1997	351,705,126	32,686,350	75%*
Dubai Industrial City (DIC)	2006	359,655,916	33,425,271	2%
Total		**1,985,396,507**	**184,516,404**	

Source: Cluttons Consulting and Research
*Currently publicly released land

Jebel Ali Free Zone (combined North and South zones) is by far the largest of the industrial areas. It is also probably the most developed, with continually improving infrastructure and governance.

Current rental rates for most industrial areas in Dubai typically range from 25 to 30 Dirhams per square foot per annum depending on quality and fit out.

Cluttons offers a comprehensive agency, management and professional service to all owners and occupiers of commercial and residential property throughout the Middle East.

We act for a wide variety of institutional, corporate and high net worth clients and we have connections with all the major lending institutions through our valuation services.

Presented here is a list of our principal activities. We offer you a single point of contact so that you may be directed to the person who will best be able to offer you the right service.

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