EFG - Hermes

Dubai or Not to Buy?

18 December 2006

United Arab Emirates (Dubai) | Real Estate

CONTENTS

We are publishing this piece as a base for a number of notes that are due to be issued shortly on companies that are dependent, to varying degrees, on the outlook for the Dubai real estate sector.

• The Dubai property market has become more mature, in our opinion, with buyers becoming more selective, developers building less on a speculative basis, property prices becoming relatively stable and sales in the secondary market increasing. At the same time, however, demand for housing shows no sign of slackening. In 2006, rents for residential units, driven by soaring demand, increased by c40%, making rental rates the main concern of the year.

• Demand for freehold housing has far outpaced the speed at which new residential properties are being delivered, a trend that has pushed up prices and whetted the appetite of developers. Development plans announced to date will double the number of residential units by 2010. Our estimates indicate that the number of units will double to 530,000 by 2010, with the bulk of deliveries coming in 2008.

• The major driver of demand is population growth which, in a city like Dubai, depends on the natural increase in population and an influx of expatriates. Strong population growth indicates that the current strong demand for residential units is sustainable. Assuming the population of Dubai rises at a 2006-10e CAGR of 7.9% to almost 1.9 million by 2010, we expect additional demand for residential units in the range of 40,000-50,000 units per annum.

• The freehold market is maturing, with prices probably beginning to fall in 2008, with the magnitude of the drop depending on how much additional supply actually hits the market. Given our industry supply-demand forecasts, we expect an oversupply in housing units starting in 2008.

• The increase in new housing units will directly affect the rental market, which will lag somewhat behind the freehold market, in our opinion. We expect the rental market to be quiet in 2007, with rents increasing at a moderate rate. In 2008, however, rents are likely to begin falling, providing the bulk of new units are delivered as expected.

• Demand for commercial property has likewise been far outpacing supply, sending rents soaring. This is reflected in abnormally high rental yields (current rents to off-plan freehold prices with units due to be delivered on average in 2008) that now average 27%, a huge premium to the global average. The market is changing, however, with supply forecast to triple and demand expected to remain strong in the short and medium terms at least. We believe that by 2009, rental yields will revert to par with the global average or carry only a slight premium to it.

Latest Developments and Outlook for the Dubai Residential Freehold and Rental Markets

Latest Developments in Freehold	Latest Developments in Leasehold
- Signs of increased market maturity - Rising sales in the secondary property market - High demand level with strong influx of expatriates - Buying grows as an alternative to leasing, with rental yields higher than mortgage rates	- Rent rates increasing by an average of 30% in 2006 - Sharjah and Ajman becoming havens for escaping rents for the low and middle income segments - More aggressive rent increases in New Dubai area, rising by more than 30%
Freehold Market Outlook	**Leasehold Market Outlook**
- 2007 will be a quiet period with no major price movements, however M-o-M fluctuation - Units' supply starting to outpace demand growth in 2008 - An oversupply in the market resulting in selling prices correcting across the board - Extent of the downturn will depend on actual supply inflow and the secondary market activity	- A laggard to the developments in the freehold - Moderate rent increases in 2007, with a proposed 5% rent cap - Start of a correction in rates correction in 2008 - Lower rents may discourage some buying - Rent yield gradually adjusting to reach the global averages beyond 2008

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EXECUTIVE SUMMARY

Dubai's freehold market has become more mature in the past year, in our opinion, with buyers becoming more selective, developers building less on a speculative basis, property prices becoming relatively stable and sales in the secondary market increasing. At the same time, however, demand for housing shows no sign of slackening. Expatriates continue to flow in, incomes are rising, several projects have offered off-plan sales, and subsequently been met with a positive response and rental yields are still higher than mortgage rates, all signs that any softening in the real estate market may come gradually rather than all at once. Moreover, encouraged by the recent stability in market conditions, expatriates have begun looking at the freehold market as an alternative to renting homes. Mortgage finance has become more available, and in March 2006 a freehold law that allows foreigners to register properties in designated areas received final approval. In the rental market, soaring demand has driven up rents at a time when the arrival of new units to the market has been plagued by a series of delays.

Freehold Residential Supply - Set to Double by 2010

Demand for freehold housing has far outpaced the speed at which new residential properties are being delivered, particularly in the past two years, a trend that has pushed up prices and whetted the appetite of developers. Development plans announced to date will double the number of residential units by 2010. We have now raised our estimate of the number of new units that are expected to be delivered by 2010 to 270,000, up from our previous estimate of 195,000, after taking into account announcements to end-November 2006, new project announcements, amendments to master plans and delays in the delivery of units scheduled for 2006. This would double the total number of units in Dubai to 530,000.

Most of the new residential units will hit the market in 2008, according to our estimates, although a significant number, estimated at 69,000, are likely to arrive in 2007. We feel comfortable with this number, given that c75% will be handed over by large developers, primarily Nakheel, Emaar and Dubai Properties, that have a good track record of delivering on time or that have extended the delivery dates of projects currently in a very advanced construction phase to beyond the original 2006 delivery date. The remaining c25% being developed by smaller private companies is also likely to be delivered on time.

We feel less confident about 2008, when an estimated 139,000 units are due to be delivered. Our main concern is that schedules will slip and that only a slice of the total anticipated units will be delivered on time because: (i) mass developers are supplying only 14% of the total units expected (vs. 75% in 2007e), thus leaving a greater role to be played by smaller, less-experienced private developers, and (ii) the construction schedules of several of the planned developments are relatively tight, compounded by the fact that ground hasn't even been broken on some.

The huge supply due to come on stream targets a number of different income groups (low-cost housing, units targeting the middle-income segment and units targeting the high-end segment), each with its own market forces. We expect most of the new supply to fall into the middle and high segments, almost equally between the two. All Dubai property developers are targeting at least one of the two segments, though in differing proportions.

Freehold Residential Demand

Demand is the most difficult part of the Dubai real estate market to work out, where the major concern is whether it can absorb a supply that is set to double in the next four years. Population growth is the main demand driver, with Dubai depending not only on a natural increase in population, but also on an influx of expatriates.

Strong population growth suggests that the current strong demand for residential units is sustainable. We have assumed that the population of Dubai will rise to almost 1.9 million by 2010 from 1.4 million now, implying a 2006-10e CAGR of 7.9%, compared to a 2000-05 CAGR of 8.6%. Assuming such an estimated growth in population, we expect additional demand for residential units in the range of 40,000-50,000 units per annum.

Freehold Residential Oulook

The Dubai freehold property market is maturing, with prices probably beginning to fall in 2008, depending on the actual proportion of forecasted supply that will realistically hit the market and on how high demand is. Thus, we have conducted two scenarios for the anticipated supply of housing units. The first includes all announced developers' plans with their expected delivery schedules, indicating that the bulk of supply will come in 2008. The second scenario assumes some delays in deliveries, which is a more realistic scenario, in our view. The major risk is in 2008 supply, where we have assumed that only 50% of the supply will actually enter the market. Although this may seem an aggressive assumption, we believe that it is highly likely in our view, given the associated risks that small developers carry. We expect the same delay in the delivery dates in 2009 and 2010. Therefore this scenario assumes that an average of 62,000 units to be added annually between 2007 and 2009, instead of a huge supply hit that the first scenario assumes.

Given our industry supply-demand forecasts, we expect an oversupply in housing units starting in 2008. Despite the fact that supply in both scenarios is higher than estimated demand in 2007, we believe that pent-up demand will be able to absorb the majority of additional supply during the year. However, the magnitude of the oversupply is huge should all supply come at the scheduled time, which in our view may accelerate the severity of the market correction. On the other hand, assuming our more realistic gradual supply inflow, the oversupply in 2008 will be relatively limited making the downturn more gradual.

Residential Rental Market - Same as Freehold but with a Lag

The increase in new housing units will directly affect the rental market, which will lag somewhat behind the freehold market, in our opinion. We expect the rental market to be quiet in 2007, with rents increasing at a moderate rate despite the planned supply of new units coming onto the market beginning in 2007. In 2008, however, rents are likely to begin falling, provided the bulk of new units are delivered as expected.

We believe that there are several factors affecting the long term industry outlook, which may result in developers losing interest in further overloading the property market with more supply. These include: (i) a limited number of contractors may push deliveries further down the line, (ii) the remaining land bank lies in the hands of few, (iii) the possibility of defaulting on mortgages and (iv) a slowdown in economic conditions. Although these factors are negative in the absolute, they may have a positive impact on the industry in the long term, in our view.

Commercial Property - High Rents But Low Off-plan Freehold Prices

Another distinct segment of Dubai property market is the commercial segment. Dubai has quickly established itself as one of the Middle East's prime business cities and as a hub for regional economic growth. The region's growing economic presence, supported by high oil prices and huge government expenditure plans, has encouraged more foreign companies to establish footholds in the Middle East, often choosing Dubai for their first step.

Soaring demand for office and commercial space, in a market where supply is currently limited to an estimated 24 million square feet, has resulted in an acute shortage. Office and commercial occupancy rates have reached a high of 99% in traditional business areas, with rents in Old Dubai rising by 26% on average and in New Dubai by almost 40%.

Despite the rent increases, the selling prices of commercial space have remained relatively stable so far this year as plans for new projects in this segment are regularly announced: The imminent supply increase makes it difficult for developers to raise prices. This in turn has resulted in abnormally high rental yields, which have reached an average of 27% (current rents to off-plan freehold prices with units due to be delivered on average in 2008) compared to the global average of 8%. We believe that the abnormal yield is of a temporary nature, given the current severe supply shortage, which in turn is placing severe pressure on rent rates.

However, the commercial market is changing. The amount of commercial space is forecast to triple to an announced 75.3 million square feet by 2010. Most of the commercial space additions are expected to hit the market in 2008 and 2009, with major deliveries in Jumeirah Lake Towers, Business Bay and DIFC. In 2007, only 7.3 million square feet are expected to be delivered.

We expect demand to be strong in the short and medium terms at least, given the number of companies expanding in Dubai. Variables that will help fuel growth in demand for office space, in our view, include: (i) continued regional economic growth, (ii) sustained improvement in the business environment and (iii) lower expected living costs, encouraging businesses to expand. However, we believe the current planned additions in commercial space are more than what the market can absorb.

Once the new supply begins to pour onto the market in 2008, however, rent rates should begin to fall and yields begin sliding gradually back toward the international average, with the speed of the decline depending on how quickly that supply arrives and the strength of economic and business activity going forward.

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I. RECENT DEVELOPMENTS IN THE FREEHOLD MARKET

Dubai's freehold market has undergone a number of key developments since our previous in-depth analysis of the real estate sector in December 2005 ("Dubai Real Estate - Planting Too Many Seeds - 15 December 2005"). The market has become more mature, in our opinion, with buyers becoming more selective, developers building less on a speculative basis, property prices becoming relatively stable and sales in the secondary market increasing. At the same time, however, demand for housing shows no sign of slackening. Expatriates continue to flow in, incomes are rising, several projects have offered off-plan sales, and rental yields are still higher than mortgage rates, all signs that any softening in the real estate market may come gradually rather than all at once.

Encouraged by the recent stability, expatriates have begun looking at the freehold market as an alternative to rental. Mortgage finance has become available, and in March 2006 a freehold law that allows foreigners to register properties in designated areas received final approval.

Figure 1.1: Summary of the Latest Developments in the Freehold Market

Increased Signs of Maturity

- Less building on speculative basis
- Increased choice for consumers, with more supply
- Customers more willing to hold off on purchases until the project is partly or fully completed
- Recent relative stability of property prices
- Rising sales in the secondary property market

Demand Driven Growth

- Strong influx of expatriates, rising income levels
- Off-plan sales, with some projects selling in few days
- Buying grows as an alternative to leasing, with rental yields higher than mortgage rates
- Speculators' share in investor (buyer) base decreases

FREEHOLD MARKET

Availability of Mortgages

- Availability of debt financing fuels property boom
- Number of mortgage providers increases
- Greater variety of innovative products
- Changing demographics of property buyers drives increased activity
- Gaps still exists in the mortgage financing industry

Legal Advances

- Designation of freehold zones for foreigners allows property registration and boosts investor confidence
- Grey areas remain
- Condominium property law is soon to be finalized
- Brokers' Law announced and expected to be instituted by year end

Property prices have gone up only c20% YTD, compared to 50% a year ago

Apartments continue to be overpriced, but villas have not reached their peaked as of yet

Source: EFG-Hermes

Increased supply allows consumers to have greater choice...

With the number and variety of properties soaring, freehold housing is becoming more of a buyers' market, with many potential buyers holding back until a project is at least partly or even fully completed. End users have begun to demand better quality and are willing to pay a premium for properties that are delivered on time.

...forcing developers to respond to consumer needs

Given the escalating cost of construction, it is no longer economical for developers to build projects on a speculative basis then sell units upon completion. They must now study the market carefully before even starting construction. Developers have begun paying more attention to the design, quality and finishing of units to match consumer demand. This trend was reinforced after several recent deliveries fell short of the quality expected.

Developers have also begun to compete for the attention of buyers by improving their customer relationship management and by teaming up with banks and finance companies to provide mortgages and easy payment terms. This has encouraged competition not only among developers, but also among mortgage providers, who now must fight for market share. As a result, repayment no longer begins until construction is complete and rental rates are guaranteed on delivery. Buyers are receiving other benefits as well (see details in Box I in this section).

Selling Price Stability Indicates Signs of Market Maturity

The strongest point supporting our argument that the Dubai property market is maturing is the increased stability of selling prices, albeit with occasional minor price corrections. No official property price indices exist in Dubai. Although we have created an (unpublished) index of our own in November 2006, we have opted to use an index that Standard Chartered Bank created a year ago so as to get a longer perspective on market trends. The Standard Chartered index tracks villa and apartment prices in a number of Dubai areas.

The overall price index (which includes both villas and apartments) increased by 18.8% in the 10 months to October 2006. The index for villas alone rose by 30.1%, while that for apartments rose by only 10.1%. Despite the apparently strong rise, property selling price increases were significantly less than those of 2004 and 2005, when they were around 50% and occasionally as high as 100%.

Fig 1.2: Standard Chartered Property Price Index Shows that Villas Outperform YTD...

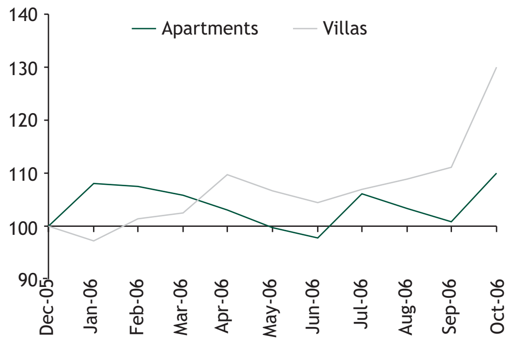
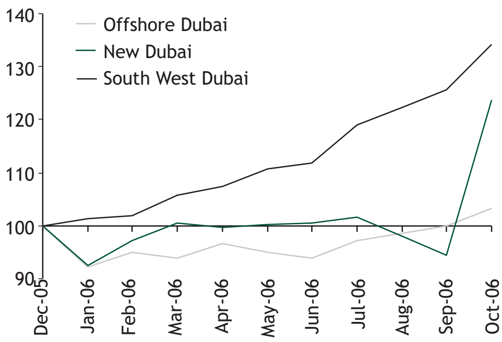


Fig 1.3: ...And Properties in South West Dubai Outperform YTD*



*The data used to build Standard Chartered Bank's residential property index is taken from Better Homes Property Listings magazine and the indices are based on AED per sq ft. The index focuses mainly on buildings still under construction or recently completed. The three zones covered in depth are 1) Offshore Dubai: The Palms, The World and Maritime City, 2) New Dubai: Dubai Marina, Springs, Meadows, Gardens, Lakes, Jumeirah Islands etc and 3) South West Dubai: Arabian Ranches, the Investment Park, Sports City, Green Community

Source: Standard Chartered

Selling price fluctuations point to softening prices

Despite the overall increase in property selling prices so far this year, several months have seen some signs of weakening. The index indicated that apartment prices in September remained largely unchanged from those observed in December 2005 and that for several consecutive months in 2006 they actually fell. The YTD increase was due primarily to major price jumps in two separate months rather than to a clear upward trend. This indicates that prices may be about to soften, in our view.

Villa selling prices, on the other hand, have soared. We believe this is due to: (i) villa price increases having underperformed those of apartments in 2004 and 2005, (ii) the relatively good quality of the villas delivered, built mostly by large, well established developers, compared to recently completed apartments whose construction was considered shoddy, and (iii) the huge supply of apartments relative to villas due to come onto the market in 2007 and 2008.

Property prices performed differently in different areas. Standard Chartered has divided Dubai into three main areas. Prices in southwest Dubai rose faster than elsewhere due to a concentration of villas in Arabian Ranches, Green Community and other developments in the area.

Fears of further price drops…

Over the past 12 months, prices in the secondary market have dropped from their peaks. We recently created a price index (unpublished) that tracks more than 2,500 apartments and villas offered in the secondary market. We compared current average prices per square foot in key locations across Dubai with the lowest and highest average prices observed during a project's existence. The index indicates that prices have dropped from their highest observed level by varying degrees. The most severe drops have been for apartments targeting the high-end segment, with prices in several areas dropping to less than half the highest observed price since the launch of a project. Prices on average are nonetheless still at a c60% premium to the lowest observed prices since the launch of a project. Prices in the more luxurious Dubai Marina and Burj Dubai areas have seen the sharpest drops.

Prices for units targeting the middle-income segment, on the other hand, have dropped at the much more moderate rate of 20% on average. This is due primarily to the market's perception that the supply of inexpensive housing will decline going forward and that demand will continue to outpace supply.

Fig 1.4: Aggressive Price Drops in the High End Segment…*

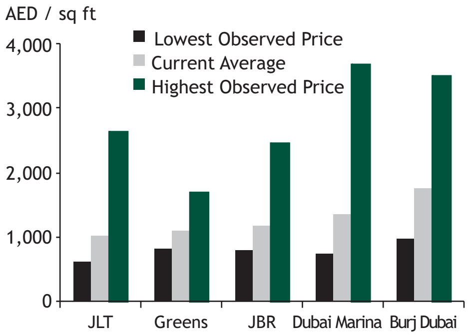
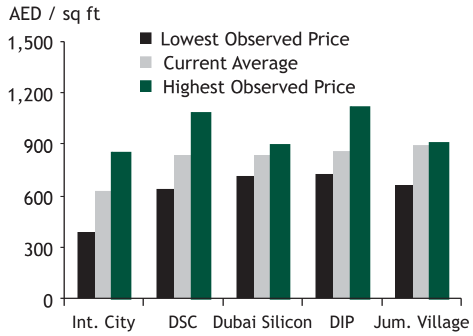


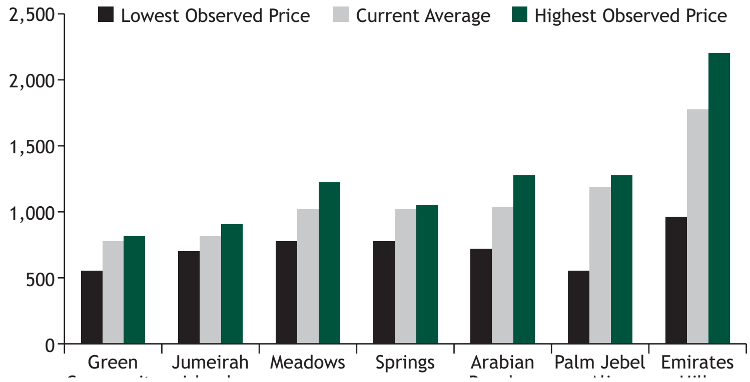
Fig 1.5: …However More Moderate Drops In the Mid-Income Segment*



*JLT: Jumeirah Lake Towers and JBR: Jumeirah Beach Residence, DSC: Dubai Sports City, DIP: Dubai Investment Park
Sources: Better Homes Real Estate and EFG-Hermes

The drop in villa prices has been relatively slight, with current prices at a discount of about 10% to the highest observed price since the launch of a project, which on average is more than 50% above the lowest observed price since the launch of a project. This implies that villas, unlike apartments, have not seen their peak yet and that prices may continue to appreciate in some developments.

Figure 1.6: Prices for Villas Still in the High Range



Sources: Better Homes Real Estate and EFG-Hermes

...have increased activity in the secondary market

The relative softening in property prices and the huge expected inflow of supply have led many home owners to sell their properties in the secondary market for fear prices will fall. The secondary market also grew more active in 2006 due to: (i) a huge appreciation in the price of properties offered for sale at the start of the property boom that encouraged owners to sell properties to realize capital gains, and (ii) higher incomes that have prompted many homeowners, both national and expatriate, to sell in order to buy homes that are newer and better. The secondary market appears to be ready for a further spurt of growth as newer properties hit the market and entice yet more people to upgrade. This will help to deepen the Dubai market and make individual sellers a more potent force.

Prices of recently launched units see moderate appreciation

The prices of units in new projects recently offered in the market are also growing more slowly than before. The price of units in projects built at the start of the property boom has since risen significantly. For example, the price of a one-bedroom apartment in the Greens that was first offered for sale in 2003 for AED288,000 has now more than doubled. In residential communities such as Arabian Ranches, Springs and UpTown Mirdiff, the prices of units, especially villas, have jumped by an average of c70% in the secondary market since they were first offered for sale.

However, prices for undelivered units first offered for sale in the past 12 months have increased by an average of only c15%. Units with closer delivery dates carry a premium. The prices for units in Emaar's Old Town, for example, where development was around 50% complete when they were offered for sale and where the delivery date was 2007, appreciated more than those in units with later delivery dates.

Fig. 1.7: Enormous Price Appreciation on Old Projects Launched

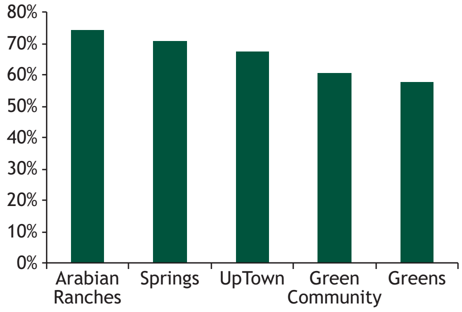
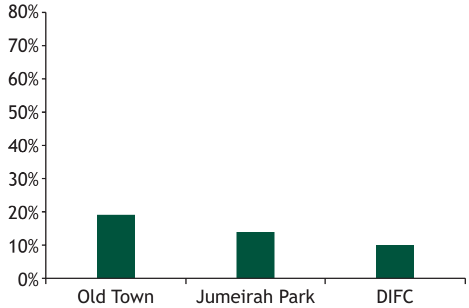


Fig. 1.8: New Launches have Witnessed Moderate Price Appreciation



Sources: Developers' Brochures, Better Homes Property Listings and EFG-Hermes

Market conditions have encouraged expatriates to enter the freehold market

The buyer base, previously dominated by speculators and high net worth individuals, has widened in the last two to three years. Recent market developments have encouraged many of the expatriates who have flocked to Dubai to view freehold less as a long-term investment than solely as an alternative to leasehold property. Rents have increased by 40% or more (detailed in the next section "Recent Developments in the Leasehold Market") at a time when property prices have remained relatively stable. Since the freehold law was issued (see details in Box II of this section), expatriates in the mid- to high-income tranche have increasingly begun to buy homes. Though data is hard to obtain, it appears from interviews with industry experts that around half of all buyers now live in the homes they buy, rather than rent them out as an investment.

The demand for units offered for sale in the primary market has also been strong. Emaar's Old Town Tajer Island development, for example, sold out within two weeks and Nakheel's Jumeirah Golf Estates within two days. Increased demands for quality, timeliness and amenities indicate that much of the demand comes from people actually seeking homes and not simply from speculators.

New trends add flavor to the market

As the market advances, a number of trends are adding color and dimension to the market. These include timeshare, rental guarantees and short term leasing.

1. Timeshare: This is a new concept for Dubai that involves renting out a property for a certain number of weeks each year to tourists and business travelers. The owner is allowed to reside in his home only for a limited number of weeks. With the number of tourists, business travelers, conference attendees and other professionals visiting Dubai expected to rise, the potential for property owners renting out their homes to earn money appears immense.

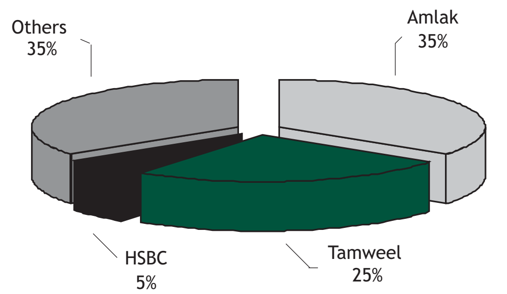
2. Guaranteed rentals, or rent-backs: Under this plan, a developer builds then sells units to interested buyers with the commitment that it will rent the units back from the buyer at a fixed rate each year, maintain them, then buy them back when the buyer decides to sell. So far this rent-back model is being offered by only a single developer of a property in Dubai Marina. Yet it has proved popular and could well spread to other developments.

3. Short-term leases: Although leasing is very active in Dubai, the lease periods tend to be relatively long, with contracts usually of a minimum of one year. Short-term leases are still new to the market, with only a very few units offered in this way.

BOX I: INSIGHT INTO THE MORTGAGE FINANCING MARKET

Market Structure and Players: While still at a nascent stage, mortgage finance has grown in the UAE over the past few years. Amlak was an early pioneer, followed by Tamweel, which entered the market in 2004. Both companies offer their customers a wide variety of innovative home finance products that are compliant with Sharia, or Islamic law, and have gained a strong foothold in the UAE. Commercial banks have also begun to enter mortgage finance in a strong way, with 10 to 12 now offering fixed, floating or adjustable mortgages.

Figure 1.9: Estimated Market Shares for Various Market Players



Sources: Industry and EFG-Hermes estimates

New Innovative Products: Mortgage providers have fueled growth by offering a variety of products to attract customers. These take into account individual needs, interest rate and arrangement fees, prepayment penalties and increased transparency of charges. Newer and more innovative products are also being introduced tailored to customer needs, among them a fixed-rate mortgage product linked to the US Fed rate that Lloyds TSB plans to introduce soon.

Table 1.10: Examples of Currently Available Mortgage Financing Options

Provider	Available For	Tenure	Interest Rate	Maximum Loan Amount
Conventional Banks				
Abu Dhabi Commercial Bank	UAE nationals, expatriates	25 yrs for UAE residents, 10 yrs for non-residents	Ranges from base plus 2.5%/3%/3.5%	As much as 90%
HSBC	UAE & non-UAE residents	Up to 20 yrs	Up to 70% : 7% variable, 70-80% : 7.75% variable	Up to 80%
Mortgage Financing Companies				
Amlak	UAE residents and non-residents, GCC residents	25 yrs for UAE residents, 20 yrs for non-residents	For 70% : 8.75% variable, 70-80% : 9% variable, 81-90% : 9.25%	90% maximum with some promotions of 100% financing
Tamweel	UAE & non-UAE residents	25 years	7.9% floating, 9.5% 5 yrs, 10.5% for 10 yrs 10.85 for 10 yrs	Usually 80% however 90-97% on some projects

Source: Money Works Monthly UAE Mortgage table as of November 2006

Industry Prospects: Dubai's growing property market and the changing demographics of homebuyers ensure that the mortgage finance base will continue to widen. An increasing number of newer entrants, for example, are end-users who use mortgages to buy homes of their own, a group that was not well represented before.

The average loan-to-total-value ratio on most mortgages hovers around 70%, with mortgage recipients weighted toward mid-income expatriates, who generally have limited personal resources and capital. Anecdotal evidence suggests that c25% of properties purchased in the UAE are currently being financed by mortgages, with the figure expected to rise substantially in the next three to four years. The recent introduction of areas in Dubai where foreigners can own freehold property has boosted confidence and sparked additional interest in mortgages.

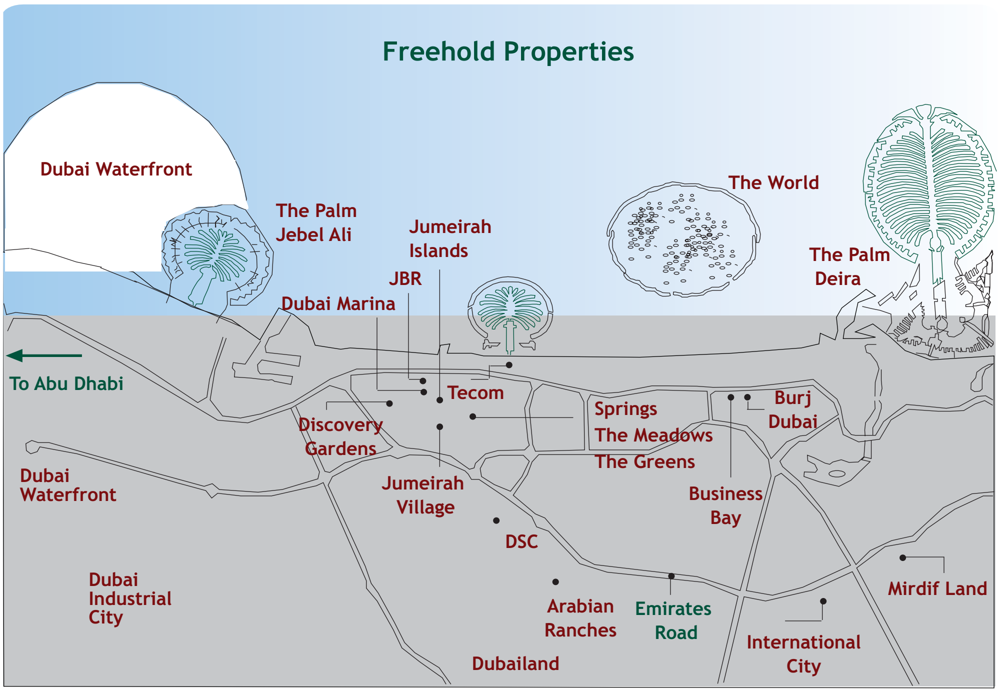
Challenges: Just as there are gaps in the Dubai property market, there are also flaws in mortgage finance. First, no regulatory body governs the administration of mortgages, the rights of mortgage holders and providers have not been spelled out, and no clear-cut treatment exists for title transfers, repossessions after payment defaults or other legal rights and obligations.

Mortgage finance in Dubai is vulnerable to downturns in the global and domestic economies and to changes to USD interest rates, to which AED rates are closely tied. Another pressing problem is that mortgage providers have largely been shielded from defaults because rental yields are currently higher than mortgage rates. This could change as calm descends on the property market and rents decline.

BOX II: MORE INSIGHT INTO THE FREEHOLD LAW

Until recently, no legal framework has governed property ownership in Dubai. A freehold property law that was issued in March 2006, however, has boosted the market by making it legal for foreigners to own freehold land and property in designated areas (see map).

Figure 1.11: Map Showing Freehold Areas Across Dubai



Sources: UAE Official Gazette and EFG-Hermes

Although the freehold law had long been expected, its actual promulgation has boosted confidence. Buyers are now assured that they can register their properties in their own names and preserve their titles. Mega developers such as Emaar and Nakheel are now registering titles in the names of the owners of properties bought before the law's issue. Once a unit is paid for, the developer applies for a residence visa for the person whose name appears on the title, thus making the developer the homeowner's legal sponsor. Under this type of visa, which does not extend to families, homeowners are not allowed to work in the UAE.

Even with the new law, however, there are still legal issues surrounding land ownership, the maintenance of common properties, inheritance, mortgage registration and other areas.

Table 1.12: Caveats in the Freehold Law

Caveat	Challenges
Land Ownership	· The wording the law does not clearly state that the property ownership includes the land upon which the property stands on
Residence Visa Issues	· The issuance of the visa requires full payment of the property value
	· No agreement currently between Dubai Land Department and the Naturalization and immigration & Residency Department on the issuance of a permanent residence visa for expatriates who buy property anywhere across the UAE
Maintenance Issues	· Limited guidance concerning the responsibility of maintenance of properties
	· No mechanism regarding the collection of maintenance fees
Inheritance Issues	· No clarity regarding the issue of inheritance. Since the property can pass to anyone of the expatriate's choice, people also have the right to seek the inheritance laws of his/her country of origin
Mortgage Registration	· No clarity regarding the registration of mortgages for freehold properties
99-year Leased Properties	· No clarity regarding 99-year leased properties, such as if the building collapses or comes up for demolition before the expiry of 99-year lease

Sources: UAE Official Gazette and EFG-Hermes

The elimination of these grey areas in the legal structure would instill further confidence in the property market and reduce investor risk. The current freehold property law, for example, does not address the rights and responsibilities of tenants and landlords in high-rise towers and apartment-style developments. Dubai's Land Department is now working on a condominium law that should more clearly define the relationship of homebuyers with the developers of freehold apartment buildings and with each other. No legal structure will govern the rights of homeowners in tower-style developments until it comes into effect. Another planned law to govern real estate brokers will require that brokers be licensed and will specify their rights and obligations.

Table 1.13: Expected Laws to be Passed

Law	Descriptions
Condominium Property Law	· The Dubai Land Department is working on a law that will clarify the relationship between investors and developers in freehold apartment buildings
	· Expected to be finalized by December 2006
	· The law is expected to cover issues such as the maintenance of common areas, the legal rights of renters, the role of the developer after handover, service charges and matters related to the transfer of property
	· Until this law comes into effect, homeowners in tower-style developments will continue to have no legal structure governing their rights and obligations
Real Estate Brokers Law	· Currently, there are multiple rogue brokers in the market who are not registered with agencies and who have tended to distort property prices
	· As a results the Dubai Government is in the process of issuing By- Law No 85 of 2006, or the Real Estate Brokers' Law, which will include a list of all licensed real estate brokers and their rights and obligations
	· In November 2006,the Dubai Land Department annonced a regulation allowing only certified brokers to operate in Dubai. All broker will have to be issued a licence by the Department, be properly qualified and hence certified

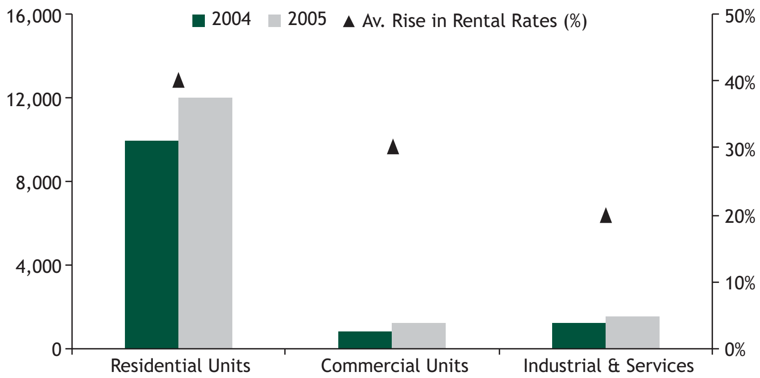
Sources: Industry sources and EFG-Hermes

II. RECENT DEVELOPMENTS IN THE LEASEHOLD MARKET

Demand far outstripping supply pushes up rental rates

The leasehold market has experienced important developments, with rental rates becoming the hot issue. Rents for residential units increased by 40% on average in 2005 and by a further 30% so far in 2006. The rise in rents, with a number of developers and landlords demanding double-digit increases, has been driven by demand increasing faster than supply. The shortfall has been aggravated by a series of delays that have plagued new units being brought to the market. The rent hikes have not been limited to residential units: Increased business activity has boosted demand for commercial, industrial and service units as well, with rents soaring at double digit rates in 2004, 2005 and 2006. However, in this section we focus on developments in the residential market, analyzing the factors that have led to the rent hikes and recent market trends.

Figure 2.1: Rise in Rental Rates (RHS) versus New Units Added (LHS)



Source: EFG-Hermes estimates

Government intervenes to dampen rising rent rates

The increase in rental rates has far surpassed the increase in household incomes, thus raising the ratio of accommodation costs to total household income. This prompted the government in April 2005 to increase the pay of UAE nationals working for the government by 25% and that of expatriates working for it by 15%. A number of private companies also raised salaries, while others began to review their compensation packages. As a result, income levels have increased across the UAE, with employers having to match salary levels with the rising cost of living. Interestingly, although all sectors experienced pay rises in 2005 and 2006, remuneration in banking & finance, construction and real estate rose the most, reflecting the strong growth in these sectors. An amendment to the UAE labor law moreover now allows expatriates to switch jobs provided their current employer approves, ending a system that banned job leavers from working in the country for a specific period of at least six months when they left their jobs. The ability to move more freely between jobs has strengthened the ability of employees to negotiate salary increases.

The government announced yet another, more direct, intervention toward the end of 2005. It issued a decree capping rent increases at 15% in 2006. Although the permitted increase seems generous by the standards of mature markets, it appears less so in Dubai, where rents have been increasing by more than 40% a year in some areas. Some landlords, however, seem to have been able to get around the cap and increase rents by much higher rates by refusing to renew lease contracts and forcing tenants to negotiate higher rents or look for alternative accommodation. In order to avoid further strife on behalf of tenants, the Dubai Rents Committee is currently reviewing the rent cap for 2007. A new directive is expected to be passed by the end of this year, with indications pointing to a possible 5% rent cap. Other landlords, including large developers such as Emaar and Union Properties, have kept their rent increases at reasonable levels, thus maintaining good landlord-tenant relationships that may stand them in good stead should rents slacken later on.

Rents increasing at double digit rates all across Dubai

Rental rates across all areas of Dubai have increased by at least 25% over the past 12 months. Here we have opted to divide the leasehold market into:

i. low-cost housing
ii. units targeting the middle-income segment
iii. units targeting the high-end segment

This market segmentation corresponds more or less to geographical segmentation, with Old Dubai (Deira, Karama, Rigga, Muraqqabat, Ghusais and Satwa) being the preferred and affordable residential areas for the low- and middle-income segments. New developments in New Dubai and a few other areas cater to the high end of the market. These include areas in the Sheikh Zayed Road, Dubai Marina and Umm Suqueim. Other developments by Emaar, Dubai Properties and Union Properties, including the Greens, Arabian Ranches, Springs, Meadows, Green Community and Mirdiff, also fit into this segment.

An inflow of blue collar workers pushes up rents in Old Dubai…

The increase in the number of expatriates, especially blue collar workers, has led to a dramatic increase in demand for low cost housing that has not been met by a proportionate increase in supply. Rents for low-cost housing or other locations in Old Dubai have increased by an average of 30% over the past 12 months. Because of their low base rate in 2005, rent increases in both the Rigga and the Muraqqabat districts outpaced increases elsewhere. Rents in 2005 in both areas were at a c15% discount to those in other areas that cater to the same market segment.

…with demand for units highest in the Karama district

The Karama district seems to be the preferred place for low-cost housing. Huge demand has boosted rents to levels similar to those of units that target the middle-income segment and even of units in New Dubai that target the high end. The densely populated district, in the centre of Old Dubai, houses most of the city's population.

The middle income segment is diminishing!

The middle-income segment tends to comprise of workers residing in the Bur Dubai, Ghusais and Satwa areas. Soaring demand for low-cost housing has pushed rents almost as high as those of units that target the middle-income segment, where increases have been less pronounced. The middle-income segment as a result seems to be diminishing as lower-segment rents increase, reducing the market segmentation more or less into two main layers in terms of rent rates. Demographically, however, the market continues to have three segments.

Both segments prefer small sized units

A clear trend in both the low and middle segments is that the rental rates of studios and one-bedroom apartments had the highest increase overall. The jump in rates can be attributed to the large number of single expatriates, especially blue collar and lower level white collar workers, who prefer not to bring their families to avoid the UAE's high living costs. Many workers have opted to live in groups/ share the same housing unit to lessen the individual rent burden. Also, a relatively limited supply of studios and one-bedroom apartments in these area has also helped push up prices.

Fig. 2.2: Rent Increases for Low Cost Housing Units*

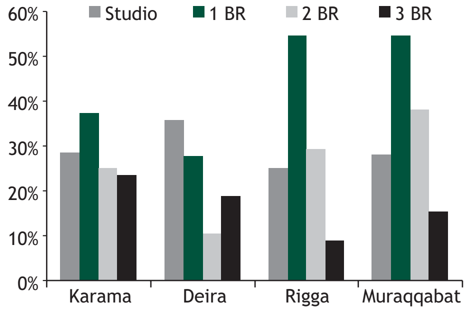
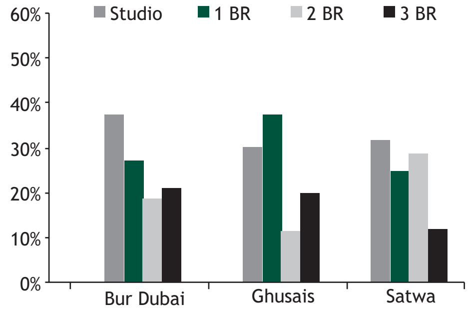


Fig. 2.3: Lower Rent Increases in the Middle Income Bracket*



*Over the past 12 Months
Sources: Asteco Property Management and EFG-Hermes

Sharjah and Ajman: havens for escaping rising rents

The high rents in Old Dubai have pushed many people into the nearby emirates of Sharjah and Ajman, where rents have historically been lower. Because of a limited supply of apartments, however, the new demand has pushed up rents in both emirates phenomenally. Rents in some Sharjah districts, such as Al Rolla and Al Qulaia, have risen by as much as 55% during the past twelve months. The increases were even more pronounced in Ajman, where rates historically were low compared even to Sharjah. Rents have doubled in several areas of the emirate. Yet even with the increases, rates are still at a 50% to 60% discount to those in Dubai. We expect this trend of workers moving out of Dubai to continue until the rent rate gap narrows.

Fig. 2.4: Rent Hikes in Various Areas in Sharjah*

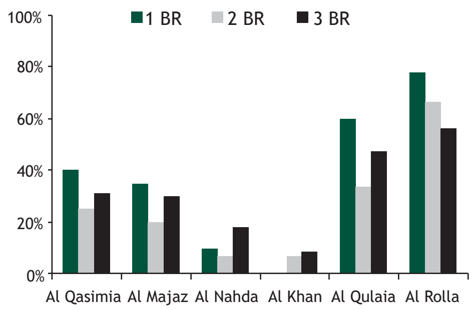
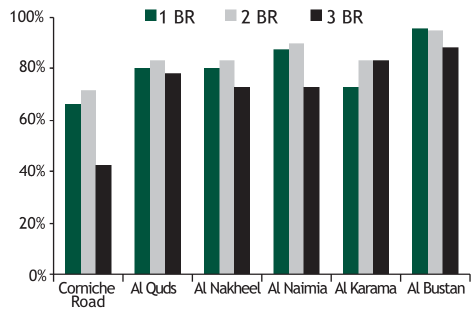


Fig. 2.5: Rent Hikes in Various Areas in Ajman*



*Over the past 12 Months
Sources: Asteco Property Management and EFG-Hermes

Dubai Marina: hot spot for the high-end segment

Rents in the high-end segment have increased even more than in the other segments, with rates climbing by more than 30% in the past 12 months. Within the high-end segment, rents in the Greens residential community and the residential towers in Dubai Marina, both developed by Emaar, increased the most for units of all sizes. This was due to the well established market position of the two developments, which were brought to market in 2004 and 2005. What is interesting is that even though Dubai Marina has only been on the market for about a year, the rents of its exclusive apartments have risen by almost 40% as demand has increased. A supply lag in the Marina, where only about 30 of the anticipated 200 towers have been completed, has further inflated rents. Rates within the area itself vary dramatically depending on location, the view and the facilities provided.

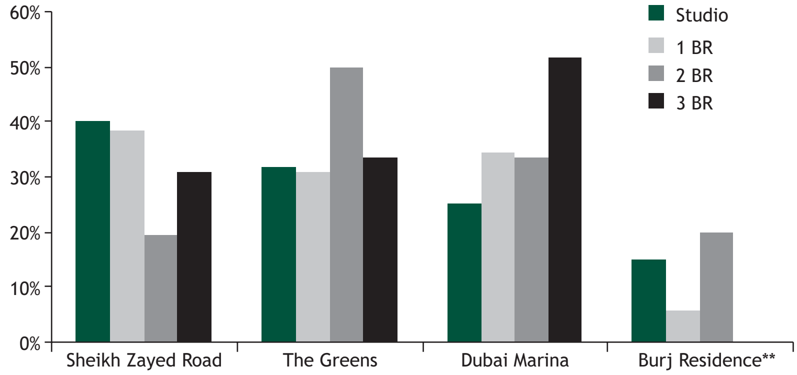
Burj Residence: a new development that is gaining attention

The Burj Residence apartments newly delivered by Emaar also seem to be gaining popularity among tenants. The project's relatively late delivery, with some units being brought to market at the beginning of 2006, has hardly given tenants a chance to move in and as a result rents have increased more slowly than elsewhere. Rates for units of all sizes have nonetheless increased in the past few months.

The high-end segment prefers more spacious apartments

More spacious two and three bedroom apartments attract higher income expatriate couples who can afford to bring their families to Dubai. Demand for these units has outpaced supply, pushing rates up. Rents for two bedroom apartments have jumped by an average of 31% (vs 26% for low-cost housing and 20% for the middle-income segment) and for three bedrooms by about 40% (vs 14% for low-cost and 18% for middle-segment housing).

Figure 2.6: Rental Rate Increases for Areas Targeting the High End Segment*



*Over the past 12 Months
**Increases for Burj Residence is for the past six months, since the launch of the project
Sources: Asteco Property Management and EFG-Hermes

Villas are even scarcer than apartments

While the number of villas constructed and offered for rent has definitely increased in the last 10 years, the number of new villas coming onto the market is less than one-tenth that of apartments. In 2005 for example, fewer than 3,900 villas but more than 45,000 apartments were being built in Dubai. With supply limited, the prices and rental rates of villas have inevitably risen. Villas, which generally offer more than two bedrooms as well as gardens and perhaps a pool, have always been considered more luxurious, and their rents have always factored in a premium. Villa rental rates have risen in both Old and New Dubai, but to varying degrees.

Fig. 2.7: Rent Rate Increases for Villas in Old Dubai*

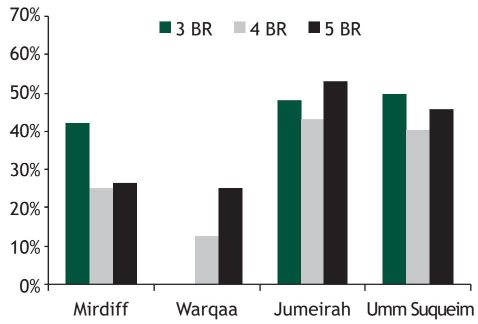
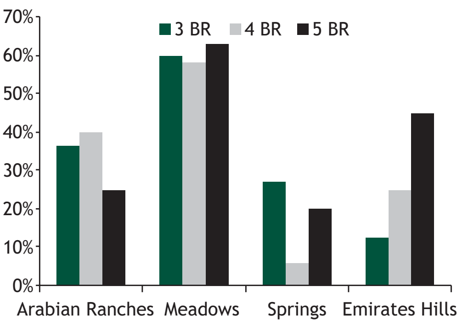


Fig. 2.8: Rent Rate Increases in Residential Communities in New Dubai*



*Over the past 12 months
Sources: Industry Consensus and EFG-Hermes

Emaar's developments are popular among tenants

The villas in Emaar's developments seem to be attracting the attention not only of potential home buyers but also of tenants seeking to lease. The homeowners, speculators and real estate agencies who have snapped up freehold villas to rent out have been doing so successfully at a premium to the villas on offer in Old Dubai. Most of these newer villas are being rented out to the higher income tranche of expatriates who are attracted by the community-style areas, landscaped and self-contained compounds, ample playing areas for children and amenities such as golf and polo. The high underlying demand for these villas has allowed landlords to keep prices high. This has been helped by more features such as pools, gyms, maids rooms that have been added. Annual rents for the same type of villa can increase by as much as AED10,000 within the course of even a few months.

Table 2.9: Current Annual Rent Rates for Villas (AED mn)

Location	3 Bedroom	4 Bedroom	5 Bedroom
Mirdiff	130-150	140-175	180-250
Al Garhoud	110-150	160-220	200-270
Umm Suqueim	135-170	200-320	280-400
Jumeirah	120-180	240-350	320-450

Table 2.10: Current Annual Rent Rates for Villas Developed by Emaar (AED mn)

Location	3 Bedroom	4 Bedroom	5 Bedroom
Springs	115-140	145-180	190-250
Emirates Hills	180-200	250-280	370-400
Arabian Ranches	135-170	150-170	180-270
Meadows	135-195	215-250	260-320

Sources: Industry Consensus and EFG-Hermes

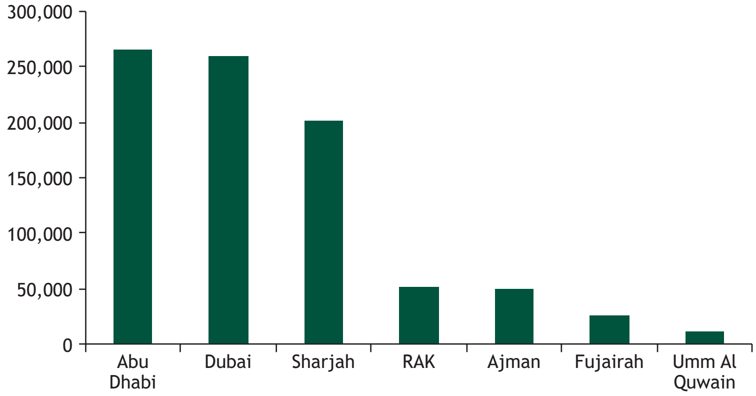
III. SUPPLY IN THE RESIDENTIAL PROPERTY MARKET

The recent developments detailed in the previous two sections are adding maturity to and increasing the sophistication of Dubai's residential property market, whether freehold or leasehold. Frenzied growth in demand, particularly in the past two years, has far outpaced the speed at which new residential properties are being built, a trend that has pushed up prices and whetted the appetite of developers. Development plans announced to date will double the number of residential units by 2010. Indeed, the number of new units could triple within 10 years, given the number of recently announced, large-scale projects, among them Dubai World Central, Dubai Waterfront, Arjan, Liwan and Majan, of which the precise number of units has yet to be confirmed.

Dubai has 30% of total units in the UAE

The UAE had an estimated 863,860 housing units as of end-2005, with the majority concentrated in the Abu Dhabi, Dubai and Sharjah emirates, according to a Ministry of Economy census. Although the numbers are 12 months old, we believe that they still reflect the country's current housing structure, given the small number of units added in 2006. In Dubai, for example, which had 260,000 units in 2005, or 30% of all the UAE's units, less than 10,000 units were added in the first 11 months of 2006, a relatively insignificant change.

Figure 3.1: Residential Units in Various Emirates*



*According to the latest 2005 census
Source: Ministry of Economy and EFG-Hermes

A. Supply Expected to Double by 2010

In our December 2005 update on the Dubai real estate sector, we estimated that 195,000 residential units would come onto the market between 2006 and 2010. In light of new project announcements, amendments to master plans and delays in the delivery of units scheduled for 2006, however, we have now raised this estimate to 270,000 units, a number that takes into account announcements to end-November 2006. Our estimates indicate that the number of units will double to 530,000 by 2010, with the bulk of deliveries to begin in late 2007 and 2008.

Villas are only 10% of total supply

Of the large stream expected in the next four years, villas represent only 10% of the total. We estimate some 26,650 will hit the Dubai market between 2006 and 2010, with the bulk expected in 2008 and 2009. The largest developers, Nakheel, Emaar Properties and Union Properties, have begun building a number of villa-type residential communities, such as The Palm, Palm-Jebel Ali, Green Community-West, Green Community-Motor City and new units in Arabian Ranches.

Fig. 3.2: Major Supply of Apartments Hits the Market in 2008

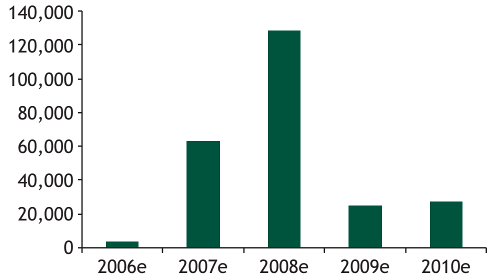
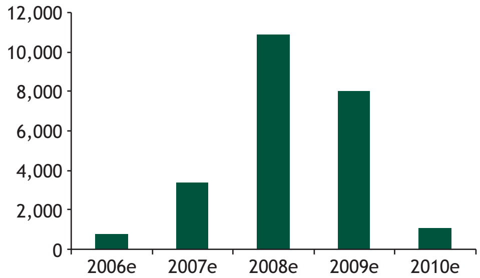


Fig. 3.3: Major Deliveries of Villas in 2008 and 2009



Sources: Industry and EFG-Hermes estimates

Planned unit deliveries in 2007 are highly probable...

Most of the new residential units will hit the market in 2008, according to our estimates, although a significant number, around 69,000, are likely to arrive in 2007. We feel comfortable with this number, given that c75% will be handed over by large developers, primarily Nakheel, Emaar and Dubai Properties, that have a good track record of delivering on time or that have extended the delivery dates of projects currently in a very advanced construction phase to beyond the original 2006 delivery date. The remaining c25% being developed by smaller private companies are also likely to be delivered on time.

The biggest single release in 2007 will be that of Nakheel's International City development that will make up 40% of the year's total deliveries. Nakheel is also set to deliver phases of its Discovery Gardens project, beginning 2Q2007, which will further boost the supply of units. Emaar and Dubai Properties will also hand over a number of towers at Dubai Marina, Jumeirah Lake Towers and Jumeirah Beach Residence.

Fig. 3.4: The Three Mass Developers Delivering c75% of 2007 Units' Supply

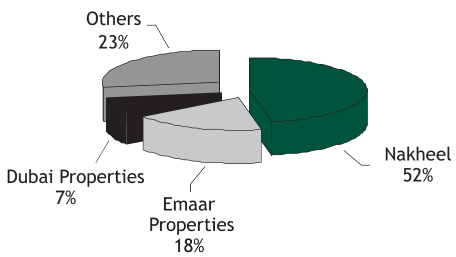
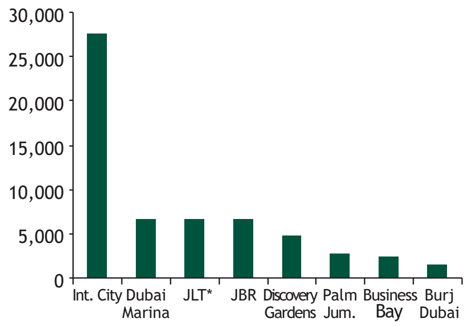


Fig. 3.5: Major Developments Expected to be Delivered in 2007



*JLT: Jumeirah Lake Towers
Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

... however 2008 will be a year of challenge for the sector

We feel less confident about 2008, when an estimated 139,000 units are due to be delivered. Our main concern is that schedules will slip and that only some units will be delivered on time because: (i) mass developers are supplying only 14% of the total units expected (vs. 75% in 2007e), thus leaving a greater role to be played by smaller, less-experienced private developers, and (ii) the construction schedules of several of the planned developments are relatively tight, compounded by the fact that ground hasn't even been broken on some. We expect that small developers may face a hard time finding qualified contractors, who generally prefer to work with large developers because: (i) the contracts are generally larger, which tends to improve margins, the work is steadier with a greater possibility that they can add to their backlog, and (ii) the risk of payment defaults is smaller, especially should the market slow. Although 2008e supply is spread among a diverse group, the supply is nonetheless concentrated primarily in five geographic locations: Dubai Land, Festival City, Dubai Marina, Discovery Gardens and Jumeirah Lake Towers. The other areas include Business Bay, Dubai Investment Park, Burj Dubai amongst others.

Fig. 3.6: Mass Developers' Contribution to Deliveries Falls Significantly in 2008

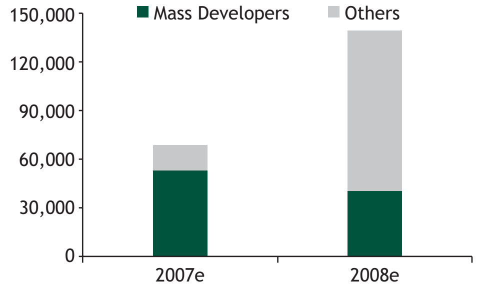
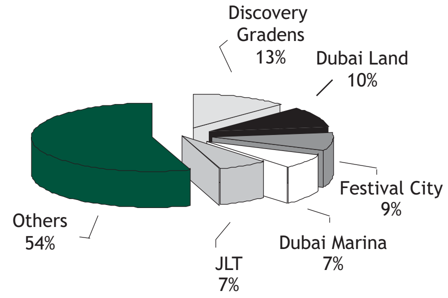


Fig. 3.7: Five Areas Dominate c50% of Total Deliveries in 2008



Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

B. Risks Facing the Supply Side

Although a doubling of residential units is alarming in a city as small as Dubai and could potentially herald a sharp drop in property prices, a number of factors that could slow the expected inflow of supply make the picture appear less negative. These include:

- Extended delivery dates: We expect that this trend of delayed deliveries will continue due to the enormous size of planned developments, an increase in the number of small players and the scarcity of qualified contractors. A year ago, it was estimated that around 50,000 units would be delivered in 2006, but as at end-November, actual deliveries were less than one-tenth of that. Contractors face a shortage of workers, both skilled and unskilled, escalating building material costs and scarce construction machinery. With 25% of the world's cranes already on the ground in Dubai, it seems unlikely the emirate will be able to attract further cranes needed to complete all the announced projects over the next five years. In addition, several developers have not been keeping up with their payments, making it hard for contractors to meet their own financial commitments on time. The region's construction boom has overstretched the small number of qualified contractors, putting them in a strong negotiating position, we believe, when developers tender new contracts over the next 18 months.

- Failure to deliver projects: Although for the sake of caution we excluded what we regard to be unfeasible projects from our supply estimates, we believe that even some of those that we did include may not be delivered at all. Our main concern is the small size and lack of experience of many of the developers. Smaller market entrants that were encouraged by buoyant industry conditions and abnormally high profits may be less excited should the market stall.

- Changing scope of projects: There is also the potential that some large-scale projects will change their scope to meet changes in demand. Many mixed-use mega developments are at very early stages of development, with only their broad master plans drawn up. This makes it possible for their developers to readjust apartment, villa, retail space and office numbers in response to customer needs.

Despite the steady stream of new projects over the last three years, the market could still be subject to yet more supply inflow by current or new developers. Large developers such as Emaar and Union Properties, however, have realized that the Dubai residential property market is oversupplied and have been exploring other growth venues. Emaar, for example, has begun to expand internationally and has announced a number of projects across the region.

C. Market Maturity Has Created a Need for Segmentation

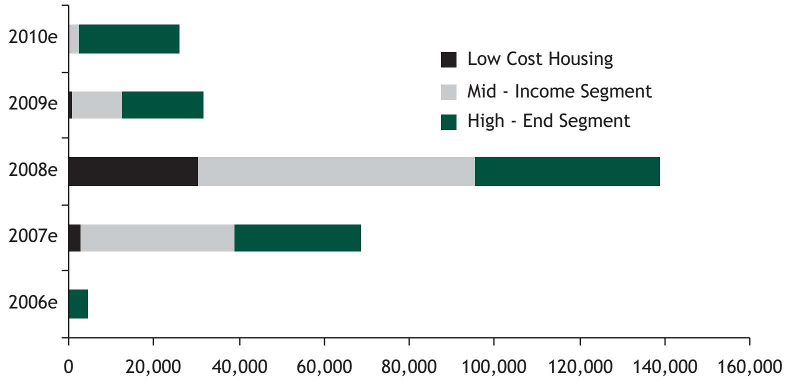
The huge supply due to come on stream targets a number of different income groups, with each having distinctive market forces. For the sake of this analysis, we have thus divided the market into three segments:

(i) low-cost housing

(ii) units targeting the middle-income segment

(iii) units targeting the high-end segment

Figure 3.8: Market Segmentation of Residential Units

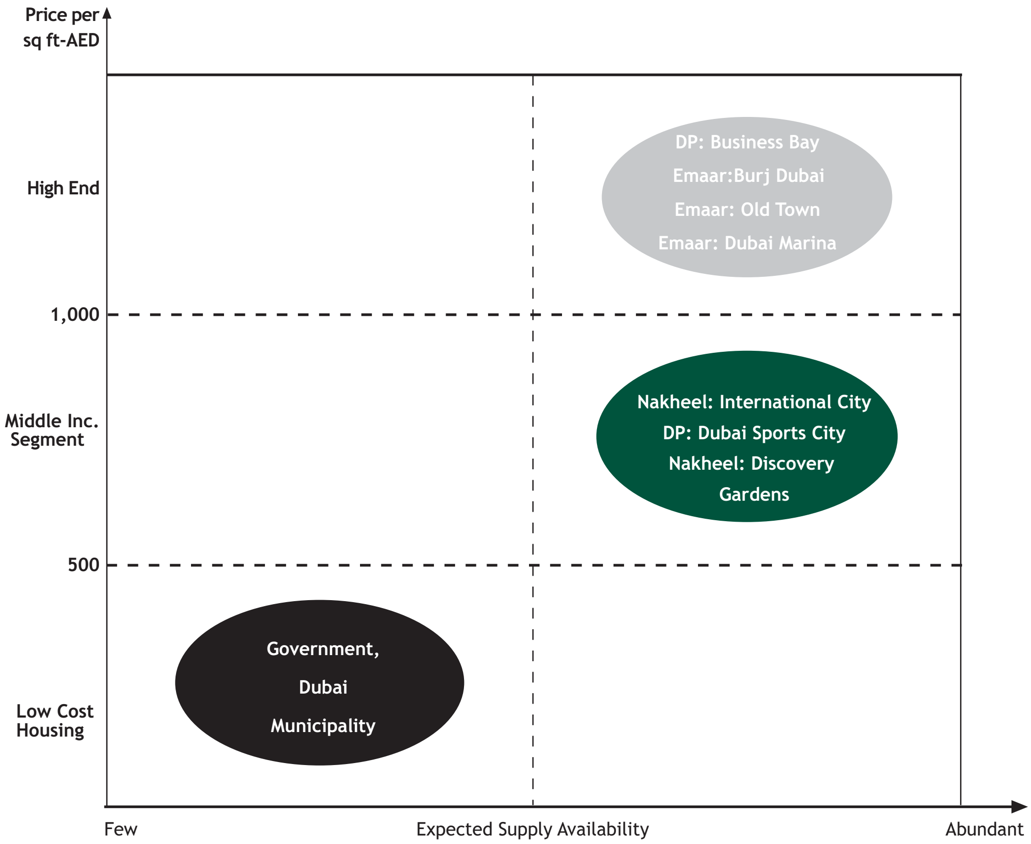


Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

Lacking clear-cut lines between the segments, we have nevertheless chosen to divide them by price per square foot, which in our opinion reflects the market's perception of the differences between segments. Low-cost housing includes units priced below AED500/sq ft (USD135/sq ft). Only projects funded by the government can afford to offer prices this low given the high construction cost.

Middle income housing includes units priced between AED500/sq ft and AED1,000/sq ft (USD270/sq ft), while high income covers everything above that. We expect most of the new supply to fall into the middle and high segments, almost equally between the two. All of the Dubai property developers are targeting at least one of the two segments, though in differing proportions. Despite the high price for high end units, an ample supply is nonetheless scheduled to hit the market.

Figure 3.9: Our Market Segmentation versus Availability of Supply*



*DP is Dubai Properties
Source: EFG-Hermes

D. Developers' Market Presence and Strategies

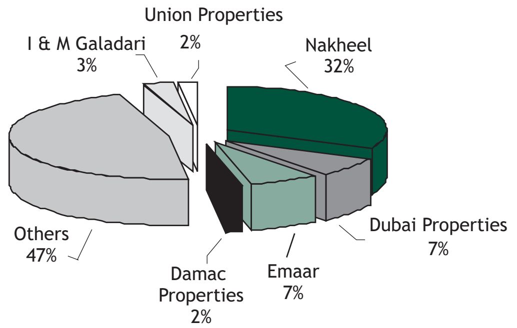
Mass developers dominate slightly less than half of the market

The Dubai property market was previously dominated by the three government-owned mass developers - Nakheel, Emaar and Dubai Properties. These three are expected to account for c49% of planned unit deliveries in the next four years.

Nakheel alone currently accounts for slightly less than one-third of the market, with the developer planning to supply 84,000 units, scattered between the International City, Palm Jumeirah, Jumeirah Park, Palm Jebel Ali and Discovery Gardens, before 2010. Emaar's expected market share in 2006 - 2010 deliveries of 7% has weakened from 2005 due to its shift in focus to the international market.

Dubai Properties' market share has remained more or less steady at 7% to 8%. Most of its developments, however, such as The Lagoons and Dubai World Central, are large and of mixed use. Because they are still at an early stage, they are likely to be modified, making it hard to ascertain the exact number of housing units that will eventually be built. Moreover, Dubai Properties has a range of subsidiaries (including Sama Dubai and Tatweer) which are each developing multiple projects scattered in various areas of Dubai- a part of the company's branding strategy to let each company have its unique identity.

Figure 3.10: Developers' Market Shares for Unit Deliveries (2006-2010e)



Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

Middle income segment supply dominated by Nakheel

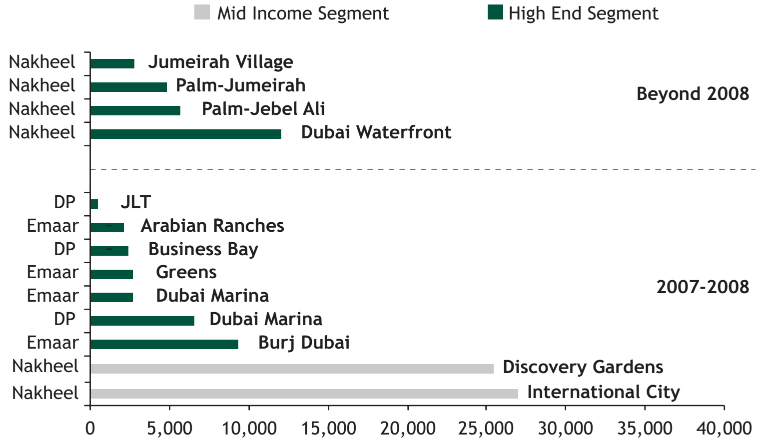
Nakheel is the prime developer in the middle income segment, which it entered with its International City project -- a large residential community targeting both the low and middle income segments. Some 27,000 units in the development are expected to be delivered in 2007. Another of its mega projects directed to the middle segment, Discovery Garden, will contain 25,000 units to be delivered in phases between 2Q2007 and 2Q2008. These units are also geared towards the middle-income segment and will add to the stock of affordable housing, thereby facilitating a downward movement of rent rates.

Nakheel has also travelled to the other end of the spectrum with its foray into several high-end luxury projects. The Palm group of developments on man-made islands off the coast, which include Palm Jumeirah, Palm Jebel Ali and Palm Deira, has delivery dates beyond 2008. The exact dates are difficult to specify due to a late start-up after they were announced and problems the company has since faced in dredging. Nakheel is also developing the World project, which will consist of 300 man-made islands and was originally designed as a low-density highly exclusive project. However, given the market dynamics and the underlying pressures associated with property development, Nakheel has recently announced an initiative to broaden the scope of the World project and make it a more high-density, mixed-use development with a lower entry threshold in terms of pricing.

Emaar and Dubai Properties focus on the high end

Luxury properties continue to flood the market as units are delivered in the Dubai Marina, Jumeirah Lake Towers, Greens, Arabian Ranches, Business Bay, Burj Dubai and Old Town projects, all of which target the high end. Both Emaar and Dubai Properties focus on this market segment and have almost no presence in any major project targeting the middle income segment.

Figure 3.11: Developments by Major Developers

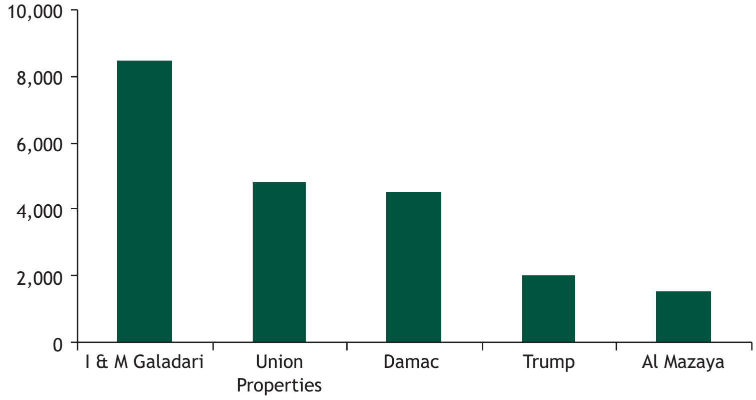


Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

Other private developers increase their presence

As the number of private developers has significantly increased, most of the recent entrants have tended to focus on the high end of the market. Both I & M Galadari and Union Properties are expected to contribute the most to forthcoming supply. I & M Galadari has several residential projects planned in Dubai Land, while Union Properties will focus on projects in the MotorCity and developments in the DIFC in the next two years. Other developers have projects in Dubai Marina, Jumeirah Lake Towers and Dubai Pearl.

Figure 3.12: Private Developers' Expected Units' Deliveries in the Next Four Years



Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

IV. RESIDENTIAL PROPERTY MARKET- DEMAND OUTLOOK

Demand is the most difficult part of the Dubai real estate market equation to work out, where the major concern is whether demand can absorb supply that is set to double in the next four years. The major driver of demand is population growth which, in a city like Dubai, depends not only on the natural increase in population, but also on the influx of expatriates. In addition to the homebuyers themselves, foreign investors, real estate agents, high-net-worth individuals and, to a lesser extent, speculators will all have a role in driving demand.

A. Demand Growth Drivers

Expatriates drive population growth

Local Emiratis make up only 20% of Dubai's population, with expatriates from around the globe accounting for the rest. The UAE's population as of end-2005 was 4.1 million, according to a government census. With approximately 1.3 million people, Dubai was its most second populous city, after Abu Dhabi, as well as its fastest growing city. Dubai's population is very young, with c55% in the 16- to 35-year-old bracket that comprises the city's main workforce and consumer base.

Dubai's population grew by c50% from 2000 to 2005 due to: (i) a 1.8% annual natural increase (births minus deaths), and, more significantly, (ii) an immense influx of expatriates lured to Dubai by a booming economy. The net number of work permits issued in 2005 in Dubai, at 250,000, was equivalent to 20% of the resident population. A large share of the permits was issued to blue collar workers, mainly in construction, who live in work camps. The remainder, who tend to seek more up-market housing, is nevertheless significant.

Fig. 4.1: More than 50% of the Population Base is in the 16-35 Age Group

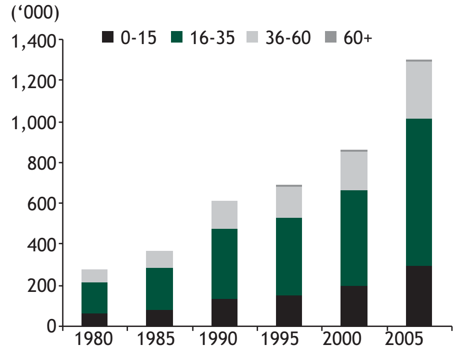
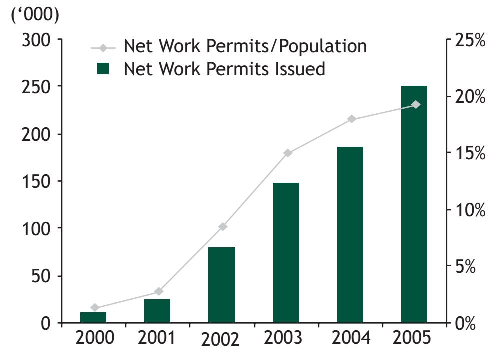


Fig. 4.2: Net Work Permits Issued Represented 20% of the Population in 2005

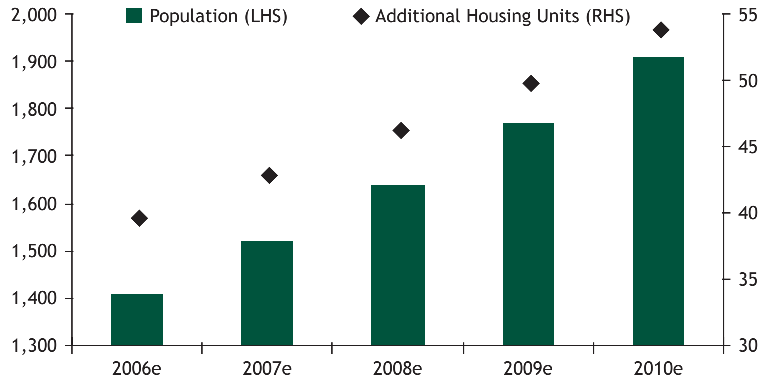


Sources: Ministry of Labor & Social Affairs, Dubai Municipality and EFG-Hermes

Positive demographic factors prevail...

The strong population growth indicates that the current strong demand for residential units is sustainable. We have assumed that the population of Dubai will rise to almost 1.9 million by 2010 from 1.4 million now, implying a 2006-10e CAGR of 7.9%, compared to a 2000-05 CAGR of 8.6%. Assuming this strong forecast growth in population, we expect additional demand for residential units in the range of 40,000-50,000 units per annum.

Figure 4.3: Estimated Additional Housing Units/Annum



Source: EFG-Hermes estimates

...backed by strong economic and business activity

Our expectations for population growth may seem high compared to the global average. Dubai, however, has shown itself deft at attracting a host of international companies as a preferred business city. Some 11,537 new business licenses were issued in 9M2006, up from only about 12,000 for the whole of 2004 and 2005 (see the section "Recent Developments in the Commercial Property Market"). The impact of this growth in business activity will continue to be seen in the coming few years, helping to sustain Dubai's population growth at relatively high rates.

We anticipate a large number of workers entering Dubai to staff finance, industry and tourism, sectors that the Dubai government has been encouraging. Most of these are likely to tend toward the high and middle income brackets, something that should in turn expand the buyer base for residential properties. This compares to the current conditions where a large percentage of expatriates coming into the country is low income workers primarily in the construction sector.

The main risk facing our relatively optimistic population growth scenario is that the region's economy slows, or that increased political risk, unlikely in our opinion, causes business activity to slump.

B. Varied and Growing Investor Base

The property boom that began in 2002 was sustained by investors with different objectives, horizons and backgrounds, many them residing outside the UAE. They include foreign investors, high-net-worth GCC and UAE citizens, high-income expatriates, middle-income expatriates, real estate agencies and speculators. Their roles are likely to change as the market matures. Among the important investors are:

Foreign Investors

Dubai's amenities, including its year-round sunshine, have encouraged investors from the UK, Europe and the US to buy homes, often for use as vacation homes. Most of these investors were early buyers in the property cycle when they snapped up luxury homes in prestigious Dubai areas such as the Palm, the World, Dubai Marina and Burj Dubai. Wealthy Pakistani, Indian and other investors from the sub-continent have also been buying property in Dubai, a place they view as a second home. These foreign investors have had a role, though relatively minor, in driving the property boom of the past few years. Going forward, we believe foreign investors will continue to play a minor role in the market, which will be highly influenced by global economic conditions.

High-net-worth GCC and UAE Citizens
Landlords in Dubai have historically been UAE nationals, either of buildings they have developed or of housing units they have bought and rented out. Other wealthy GCC nationals entered the Dubai property market during the property boom, buying blocks of apartments in areas such as the Greens, Dubai Marina, and International City then leasing them or reselling them at high premiums.

We believe the market's current stability will tend to make investing in real estate less rewarding. It will grow even less rewarding if the market slows and prices and rental yields slide. Thus, despite the involvement of this wealthy segment in the property boom, we expect a lower contribution going forward.

High-income Expatriates
The expansion of the country's economy since 2002 enabled many expatriates to amass substantial wealth, which many used to buy homes in Dubai both as investments and as their own residences. Anecdotal evidence suggests these expatriates tended to buy apartments in the Greens and Dubai Marina as investments, owing to the ease of renting them out, and villas in communities like Arabian Ranches, The Meadows and Springs to live in themselves.

We believe the continued influx of high-income expatriates, many of them to work in the service companies that are expanding in Dubai, will increase the group's contribution in the investor base. The share of units bought for investment, however, will tend to decrease as the market stabilizes.

Middle-income Expatriates
Middle-income expatriates are relatively late entrants to the property market. Several factors have encouraged them to buy housing, including: (i) the increasing availability of various mortgage products from both finance companies and commercial banks, (ii) an increase in less-expensive housing at developments such as International City, Dubai Sports City, Dubai Investment Park and Discovery Gardens that specifically target them, and (iii) an improved legal environment ushered in by the freehold law that gives foreigners the right to own properties in designated areas.

We expect this group's share of the market to increase as the market stabilizes and prices begin to fall. In fact, we believe that the middle income expatriates will be the main group driving demand in the coming few years and thus have a major contribution in shaping the property life cycle.

Real Estate Agencies
Like high-net-worth UAE and GCC citizens, real estate agencies have bought blocks of apartments to rent out for substantial profit.

We expect this trend to slow as the market stabilizes. When the market has weakened and prices have fallen, however, real estate agencies may jump in once again to invest in inexpensive properties.

Speculators
Real estate agencies and wealthy investors, long the major speculators in Dubai, have been further encouraged by the growing availability of mortgage finance. The activity of these buyers, especially those who use debt financing to fund their purchases, has pushed up property prices in the secondary market.

The contribution of this group seems to be declining, especially as prices stabilize and show further signs of softening, a trend we expect to continue as the market evolves.

Change in investor base as the market evolves

Figure 4.4 summarizes our expectations of how the role of Dubai's various residential property investors will evolve. High-net-worth individuals, real estate agencies and speculators were the main investors initiating Dubai's property boom in 2003. Going forward, however, their contribution is likely to gradually fall or stay the same at best.

We expect the phase of stability that started in 2006 to continue into 2007, before the start of a downturn. We believe demand will be driven by a different set of investors, with high- and middle-income expatriates buying properties either as an investment or to avoid paying escalating rents. These two income brackets will likewise continue to be the main drivers as the market weakens.

Figure 4.4: Expected Investor Involvement in Buying Real Estate Assets*

High Initial Involvement | Moderate Initial Involvement | Low Initial Involvement

Investor Base			
Foreigns	High	Moderate	Maintained
High Net Worth Individuals	High	Moderate	Declining
Expatriates - High Inc.	Moderate	Increasing	Increasing
Expatriates - Mid Inc.	Low	Increasing	Increasing
RE Agencies	High	Moderate	Increasing
Speculators	High	Moderate	Diminishing
Property Market Phases	2003-05 (Boom)	2006-07 (Stability)	2008 (Start of a Downturn)

Source: EFG-Hermes

V. RESIDENTIAL PROPERTY MARKET OUTLOOK

Demand for housing has soared in the last few years as oil income flowed into the country. A huge supply of new units that developers began building to meet this demand is due to begin hitting the market in 2007, turning into a flood in 2008. As a result, housing prices are likely to begin declining in 2008, with the pace of prices declines governed by the speed at which the new units are actually delivered. The increased supply of housing units will push down rents, too, but at a lag to the price drops in the freehold market, in our opinion. We expect rental rates will continue to increase in 2007, though at a moderate rate, even as new units come onto the market. The increases are likely not to exceed the 5% rent cap that the Dubai Rent Committee is expected soon to introduce, down from the annual double digits increases of the past few years. In 2008, however, rents are likely to begin falling, provided that the bulk of new units are delivered as expected.

Figure 5.1: Summary of Our Expectations for the Residential Property Market

Freehold Market

- 2007 will be a quiet period with no major price movements, however M-o-M fluctuation
- Units' supply starting to outpace demand growth in 2008
- An oversupply in the market resulting in selling prices correcting across the board
-Extent of the downturn depend on actual supply inflow and the secondary market activity

Leasehold Market

- A laggard to the developments in the freehold
- Moderate rent increases in 2007, with a proposed 5% rent cap
- Start of a correction in rates in 2008
- Rent yield gradually adjusting to reach the global averages beyond 2008

DUBAI RESIDENTIAL PROPERTY MARKET

Factors Affecting Long Term Industry Prospects

1. Limited number of contractors may push deliveries further down the line
2. Remaining land bank lies in the hands of few
3. Possibility of defaulting on mortgages
4. Slowdown in economic conditions

Source: EFG-Hermes

A. Freehold Market

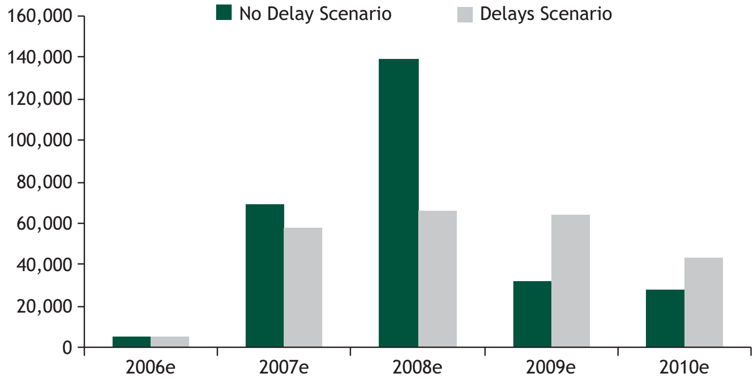
Housing prices in Dubai are currently still rising, an increase that has been sustained in part by continuous delays in the planned deliveries of new units. Going forward, supply will be the main variable affecting prices. Demand will continue to increase as both business activity and the population grow, provided there is no slump in the economy.

Supply is the Major Factor Determining the Extent of the Downturn
We believe the housing boom is already over and that the market has now matured. There is a danger, however, of delays to deliveries at a number of major development projects, and other projects that have been announced may not be built at all. The extent of any shortfalls will determine how quickly and to what extent housing prices decline. To reflect variability in supply, we have drawn up two scenarios for the anticipated supply of housing units.

Scenario One (Default Scenario): A relatively minor 10% of planned deliveries are delayed in 2007 - a year for which most planned units are being built by relatively reliable mass developers - with delivery dates pushed into 2008. The following year, some 50% of planned deliveries are delayed to reflect the fact that many of the units announced for 2008 are being built by relatively less reliable small developers (see the "Supply in the Residential Property Market" section). Similar delays continue for units with planned 2009 and 2010 delivery dates. This scenario assumes that an average of 62,000 units is added annually between 2007 and 2009, as opposed to the huge supply hitting the market in 2008 assumed in the first scenario.

Scenario Two (Alternative Scenario): Developers deliver all announced units by their expected delivery dates (see the "Supply in the Residential Property Market" section). This entails the bulk of the supply coming onto the market in 2008.

Figure 5.2: Two Scenarios for Supply



Sources: MEED, Emporis.com, Developer Brochures and EFG-Hermes estimates

Demand, on the other hand, should remain strong in the short and medium terms, given: (i) expected high population growth, (ii) approval of a freehold law earlier this year that allows expatriates to own their own homes, and (iii) an increase in the number of less expensive units due to come onto the market. We believe that there is minimal downside risk to our demand forecast, which entails 40,000 to 50,000 units being bought each year.

Although in either scenario the number of new buyers seeking homes in 2007 is less than the number of new deliveries, we believe that pent-up demand from earlier years means that most homes will nonetheless find buyers. In 2008, however, the number of deliveries will exceed the number of all potential buyers. Should all deliveries arrive as currently scheduled, as envisaged in our first scenario, the gap would be severe (figures 5.3 and 5.4). Under the second scenario's supply inflow, the gap in 2008 would be smaller, making the downturn more gradual.

Fig. 5.3: Supply-Demand Forces, Assuming All Supply Comes on Time

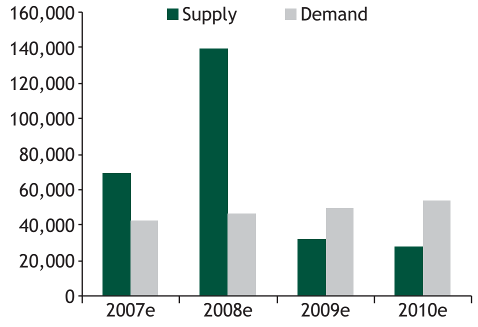
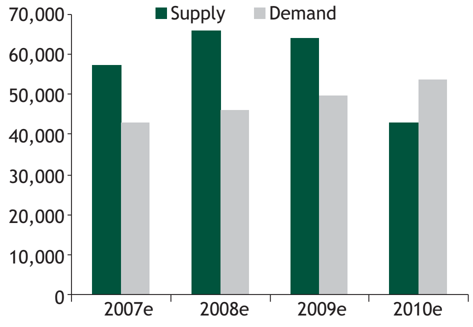


Fig. 5.4: Supply-Demand Forces, Assuming Delays in the Supply Side



Source: EFG-Hermes estimates

Property Prices Begin Falling in 2008

Given that Dubai's property market lacks any previous boom-bust cycles to measure against, we have looked at Singapore's as a pointer to the extent of a likely fall in prices. Although there are a number of differences, the two countries offer a number of similarities: (i) both are financial hubs in their respective geographic locations, (ii) both are prime business cities with similar economic growth drivers dominated by service industries, and (iii) the two have similar population breakdowns, with a skew toward expatriates, that inflate the role of economic factors.

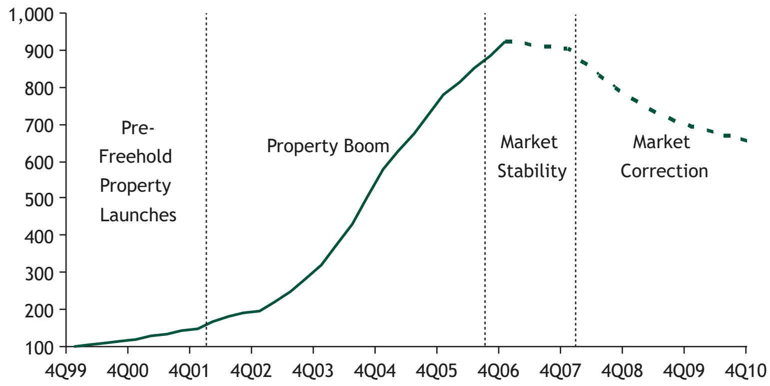
The Singapore property market went through a boom that began at the end of 1998, with property selling prices increasing a cumulative 37% over two years. This boom was followed by a very short period of stability, after which property prices dropped sharply. During the downturn, property prices fell by about 30% from their peaks. We believe the supply-demand forces in Singapore of 2000 to be similar to those of Dubai now. Developers, awash with funds earned during the boom, initiated a slew of new developments, but demand could not keep up given the unfavorable economic conditions at the time.

Figure 5.5: Property Price Cycle in Singapore

Source: Urban Redevelopment Authority

Under Scenario One, and using Singapore as a guide, Dubai's supply-demand forces seem to point toward a period of market stability in 2007, with prices moving in a +/-5% range. After 2007, property prices begin to slide resulting in a cumulative 25% to 30% fall in property values by 2010. Of course, there is a tremendous degree of subjectivity in these estimates and that the range of potential price decline outcomes is very wide.

Figure 5.6: Dubai Property Prices Begin to Slide in 2008, Scenario One*



Pre-Freehold Property Launches	Property Boom	Market Stability	Market Correction
- Limited supply	- Limited supply	- Supply starting to flow	- Supply in all segments hitting the market
- Low demand levels	- High demand Growth rate	- Demand still there	- Slowdown in demand growth
- Few expatriates	- Supply shortage leading to exponential increases in prices	- No major price change on either side, with prices slightly softening	- Oversupply in the market resulting in a price correction starting 2008
- Stability in a relatively small market	- Highest increases in prices seen in 2003-04	- Price fluctuation M-o-M, responding to supply inflow	- Cumulative price correction estimated at 25-30% till 2010

*Pre-2005 price figures have been compiled from various sources
Source: EFG-Hermes

The magnitude of the price drop will differ in various market segments. We expect that prices of villas will fall the least. The price decreases for villas will lag behind those of apartments, including large-sized apartments that are considered substitutes for villas. Prices will also be dependent on qualitative factors such as finishing, location and who the developer is.

We expect the magnitude of price decreases to be similar for apartments that target both the middle-income and high-end segments, because a roughly equal number of new units are due to be delivered in both. This is contrary to the general market view that supply will be concentrated toward the high end of the market (see the "Supply in the Residential Property Market" section).

Scenario Two: a more severe price drop if are on time

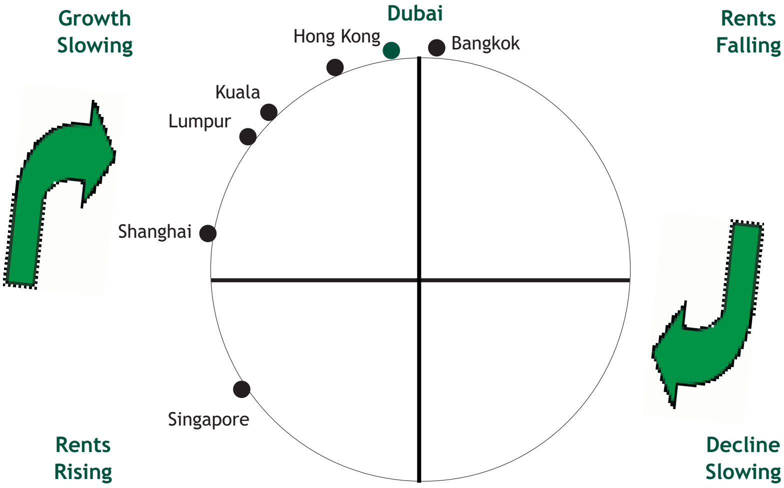
If developers deliver on time, with the bulk of deliveries in 2008 as outlined in Scenario Two, one would expect to see an even sharper drop in prices than under Scenario One. This scenario sees prices falling by significantly more than the 25-30% in Scenario One. They could be driven down even further by second order effects. Of course, as is the case in Scenario One, it must be noted that there is a tremendous degree of subjectivity in these estimates and that the range of potential price decline outcomes is very wide.

B. Rental Market

The increase in new housing units will also push down prices in the rental market, but at somewhat of a lag to the freehold market. We expect rents to increase at a moderate rate in 2007 despite the arrival of new units onto the market in 2007. The Dubai Rents Committee is currently studying a rent cap for 2007 that may limit landlords to rent increases of no more than 5%, down from 15% in 2006. This compares to rent caps of 7% and 15% in Abu Dhabi and Ras Al Khaimah. We believe that landlords in any case will have less bargaining power when negotiating new contracts, given the market's expectation of an imminent large inflow of supply.

In 2008, however, rents are likely to begin falling, provided the bulk of new units are delivered as expected. In figure 5.7, we chart the positions of a number of cities in the rent life cycle. It would seem that Dubai is approaching the peak of the cycle in terms of rent rates and will soon enter a phase of falling rents.

Figure 5.7: Dubai's Residential Rents Approach their Peak*



*Forecasts for all countries are based on Jones Lang LaSalle reports. Dubai forecasts are EFG-Hermes expectations
Sources: Jones Lang LaSalle and EFG-Hermes

Units targeting the low- and middle-income brackets come on market in 1Q2007

International City, developed by Nakheel, is a large residential community targeting the middle-income segment. Some 20,000 of its studios and its one-, two- and three-bedroom apartments are expected to hit the market in 1Q2007. We think that the influx will push down rents in older areas such as Karama, Deira and Ghusais that serve the same income bracket. Rents for studios and one-bedroom apartments in Karama, for example, are just 13% less than those at The Greens, a residential community that targets the high end of the market.

Developers have also begun to explore building homes that target the low-income segment, the growth of which is expected to surge. Nakheel is studying plans to integrate 'affordable housing' for renters with low incomes into its future developments, according to the company's senior management. Among units in the International City that Nakheel recently said it would offer for rent in 2007 are studios for AED33,000 a year, a steep discount to the current AED55,000 rent for similar units now in the market. Such discounts to the market rate further support our belief that rents will not rise significantly in 2007. We must note, however, that units in the International City should not be a benchmark, given their current relatively high rental yield, estimated at c13% compared to a market average of 8-10%.

Figure 5.8: EFG-Hermes Expectations of Rents in the Middle-Income Segment

2006	2007	2008	Long Term
- Limited supply - High demand growth rate - Supply shortage leading to high rent rates - Rates increasing between 14% and 26%	- 20,000 units delivered in IC - Demand still outpacing supply - Less pressure on rent rates - New developments announced	- Major supply inflow- rest of IC & Discovery Gardens - Demand still there - Correction in rates, estimated at c25%-30%	- Increased units' deliveries, resulting in abundant supply - Slowdown in demand growth - Oversupply resulting in further cuts in rates with rent yields gradually adjusting to global averages

Source: EFG-Hermes

Rents in the high-end segment have increased even more than in other segments, with rates climbing by more than 30% in the past 12 months. We expect the continuous supply inflow in several residential communities and towers to relieve rent pressures in 2007 and actually push down rates in 2008.

Figure 5.9: EFG-Hermes Expectations of Rents in High End of Market

2006	2007	2008	Long Term
- Supply scarcity - High demand growth rate - Supply shortage leading to high rent rates - Rates increasing by an average of 30%	- Delivery of units in 1Q- JBR, Burj Residence etc. - Demand still outpacing supply - Some pressure on leased units, slightly pushing up rates	- Flow of new supply, estimated at 43,000 units, mostly in Dubai Marina and JLT - Demand still there - Correction in rates estimated at c25%-30%	- Increased units' deliveries, resulting in abundant supply - Slowdown in demand growth - Oversupply results in downward adjustment in rent rates

Source: EFG-Hermes

C. Factors Affecting Long Term Industry Prospects

Several factors affect the long term industry outlook, some of which may dampen the appetite of housing developers to bring more supply to market. Although these factors are negative, their ultimate impact on the industry may be positive in the long term, we believe.

1. The UAE's limited number of contractors may delay deliveries in the future
The number of well-qualified contractors now operating in the UAE, local or foreign, is limited. With their tight schedules and the shortage of skilled and unskilled labor and of basic building materials such as cement and steel, it is not surprising that projects scheduled for delivery in 2007 have been pushed back to 2008. Lengthening delivery delays and the failure of some developers to assign their construction work to reliable contractors may cause developers to become less enthusiastic in embarking on new developments. It may also lead us to lower our supply estimates.

2. The remaining land bank lies in the hands of a few
Although the property market has become more fragmented and a number of large developers have divested much of their land banks to private developers, more than 50% of Dubai's remaining land bank is still held by major players such as Dubai Properties and Nakheel. The enormous work backlog of these two companies and the large scale, investment and duration of their projects means they may have fewer resources to begin new property developments. Among the mega projects already in their pipeline are Dubai World Central and the offshore Badawi Resort on Palm Island.

3. Possibility of defaulting on mortgages
Because rental yields currently exceed mortgage rates, there have been few defaults on mortgage payments until now. As freehold property prices fall and rental yields drop, however, mortgage financing companies may find themselves dangerously exposed. Due to cash flow mismanagement, some investors will be unable to meet their payments, while others may seek to sell their properties to minimize costs, leading to possible distress sales.

4. Slowdown in economic conditions
On the demand side, we believe that any slowdown in the economy and in business activity would tend to lower the number of expatriates coming into the country. This would in turn decrease the demand for residential units.

Our overall feeling is that while there are pockets of weakness, the Dubai real estate sector is maturing. When the landing does occur, some market players are likely to get their fingers burnt. But a changing investor profile and the fulfilling of pent-up demand indicate that the market correction that will occur once supply exceeds demand will be not be overly severe.

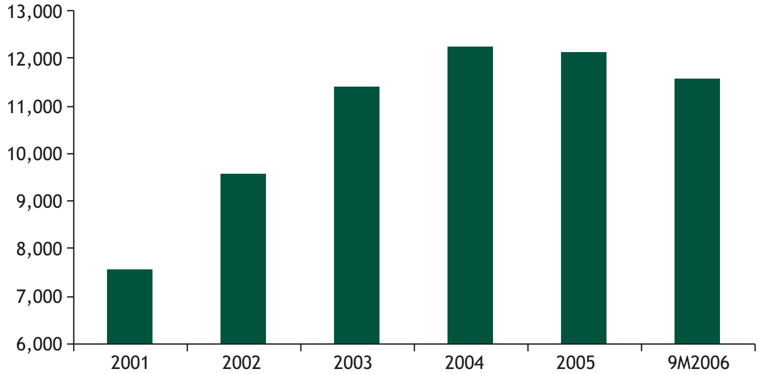
VI. RECENT DEVELOPMENTS IN THE COMMERCIAL PROPERTY MARKET

Dubai is becoming a prime business city…

Since the beginning of the decade, Dubai has quickly established itself as one of the Middle East's prime business cities and as a hub for regional economic growth. The region's growing economic presence, supported by high oil prices and huge government expenditure plans, has encouraged more foreign companies to establish footholds in the Middle East, often choosing Dubai for their first step. In this they have been encouraged by the establishment of free zones such as Jebel Ali Free Zone, Dubai Media & Internet City, Dubai Industrial City and Dubai International Financial Centre (DIFC).

The Business Registration Department at the Department of Economic Development (DED) issued 11,537 new licenses in 9M2006 for various business types (commercial, professional, industrial etc.) compared to only around 12,000 for the whole of 2004 and 2005. At the same time, businesses already in Dubai also expanded and upgraded their premises, creating further demand for commercial space. The highly coveted commercial property market has its own supply-demand forces distinctive from those of the residential segment.

Figure 6.1: New Issued Business Licenses: 2001-9M2006



Sources: Department of Economic Development and EFG-Hermes

…leading to a dearth of commercial space…

Soaring demand for office and commercial space, in a market where supply is currently limited to an estimated 24 million square feet, has resulted in an acute shortage. The boom comes fast on the heels of an earlier boom in Dubai for residential units.

Office and commercial occupancy rates have reached a high of 99% in traditional business areas such as Bur Dubai and Garhoud. Space in other areas such as the Dubai Media & Internet City is now also fully leased out. Sheikh Zayed Road, currently regarded as a key business area, was originally designed to house residential and mixed-use towers, with only 20% allotted to commercial space. Demand for space has boosted rent levels by more than 30% in the past 12 months.

Dubai's commercial property has been divided into a number of specially-designated Central Business Districts (CBDs). We have opted to divide the commercial property market into three segments based on quality, with Grade A representing the most prestigious grade and Grade C the least. This is similar to the low cost, middle segment and high end designations we used for the residential market (as detailed in the "Recent Developments in the Leasehold Market" section). This commercial segmentation corresponds more or less to a geographical segmentation, with most Grade B and C office space located in Old Dubai and most Grade A space located in areas of New Dubai. We describe the different grades and their geographical market segmentation in tables 6.2 and 6.3.

Table 6.2: Commercial Units' Segmentation by Quality Grade...

	Description	Most Prominent Areas
Grade A	Prime location where buildings have a luxury finish, well-designed space, availability of parking and secure IT systems	DIFC, Business Bay, Jumeirah Lake Towers and areas in Sheikh Zayed Road
Grade B	Locations where units are above average quality with some attractive design features	Areas in Sheikh Zayed Road, Bur Dubai and places in Garhoud
Grade C	Spread in less desirable locations, with basic features and amenities	Garhoud, certain pockets in Bur Dubai and Karama

Source: EFG-Hermes

Table 6.3: … And Geographical Location

	Area	Description
Old Dubai	Spans across Garhoud, Bur Dubai and extends until the Defense Roundabout of Sheikh Zayed Road	Traditionally the primary central business district (CBD), still houses long established companies and banks. However, some places are currently regarded as secondary work places
New Dubai	Spans from Defense Roundabout of Sheikh Zayed Road and beyond- including Dubai Media & Internet City, Business Bay, DIFC and Jumeirah Lake Towers	The current primary business district that is attracting most of the demand among multinationals, financial institutions, international professional services firms and industry related firms. The area is promoted for upholding exceptional standards for commercial properties

Source: EFG-Hermes

...and pushing up rents across all segments

Office and commercial rents in Old Dubai have risen by 26% on average and in New Dubai by almost 40%. The more luxurious Grade A properties in both areas jumped by around 35%, with rents pushed up by the variety of amenities offered, the dearth of supply in this segment and the increased presence of international companies. The less well equipped Grade B and Grade C offices in New Dubai, considered more prestigious than similar offices in Old Dubai, increased by 33% and 50%, respectively. Both grades have become substitutes for companies seeking Grade A space but unable to afford it or find any available. Rents for Grades B and Grade C space in Old Dubai, on the other hand, increased at a slower pace, with new market entrants and companies who seek to expand their operations tending to prefer more prestigious developments in New Dubai.

Fig. 6.4: Rent per sq ft in Old Dubai

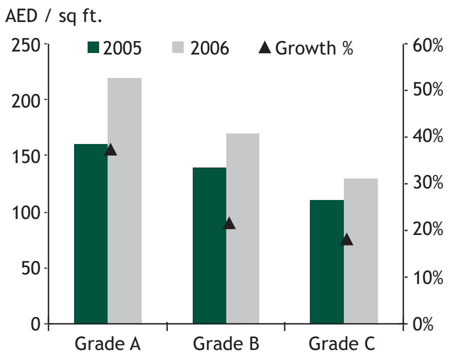
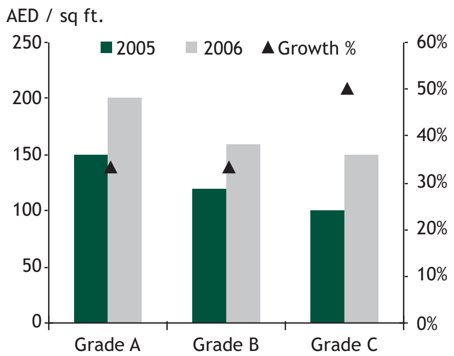


Fig. 6.5: Rent per sq ft in New Dubai



Sources: Better Homes Real Estate Commercial Review and EFG-Hermes

Rent rates for new developments at a premium

Most office space tends to be concentrated in the traditional business districts of Old Dubai, such as Karama, Garhoud, Buteen and Bur Dubai. Recently delivered developments in the prestigious New Dubai district, such as the Jumeirah Lake Towers and projects around Burj Dubai, carry a rent premium of around 50% for the units expected to be ready early 2007, due to the scarcity of supply in prestigious locations.

Stability in selling prices starting to loom

Despite the rent increases, the selling price of commercial space has remained relatively stable so far this year as plans for new projects in this segment are regularly announced: The imminent increase in supply makes it difficult for developers to raise prices. This is a welcome relief to buyers in a market that has seen selling prices rise steadily since 2000 to more than AED2,000 per square foot (in areas such as the DIFC) from an average market low as AED250-400 per square foot. The new commercial space, however, will not begin coming to market in significant amounts until 2008 (with only minor additions in 2007), a delay that has led to a distortion of the rent-to-selling price ratio, or rental yield.

Fig. 6.6: Higher Rent Rates in New Dubai's Developments

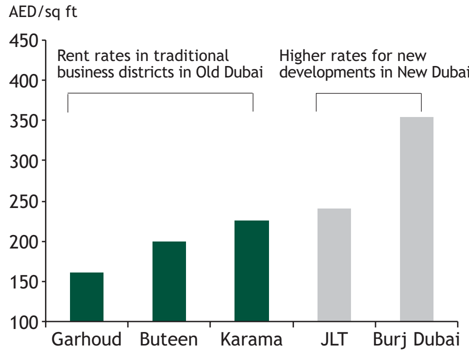
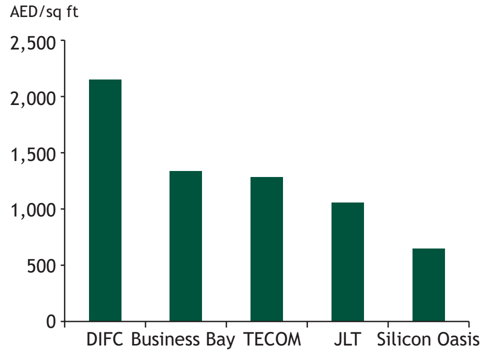


Fig. 6.7: Selling Prices for New Developments



Sources: Better Homes and EFG-Hermes

Current market conditions spurred new market trends

New market trends have emerged in response to the current severe supply shortage and the rise in rents. First, many companies are moving to free zone areas, when space is available, to take advantage of special benefits that include: (i) 100% foreign ownership, (ii) a 100% exemption from corporate, import/export and personal income taxes and commercial levies, (iii) an absence of foreign exchange controls, and (iv) three-year residence visas (subject to renewal) for employees. Second, some companies are opening small corporate offices to house top-level staff and meeting rooms in the more expensive Grade A areas while placing general and administrative staff in less expensive Grade B and Grade C neighborhoods. Third, some companies are moving to low-rise office buildings in New Dubai which, while less luxurious than tower offices, nonetheless provide a number of up-scale amenities and can be built much more quickly. A further trend is a move by companies to squeeze more personnel into existing office slots, sometimes combining senior personnel with general staff, to save costs and take advantage of prime space.

VII. COMMERCIAL PROPERTY MARKET OUTLOOK

Demand for commercial property has been far outpacing supply in Dubai, sending rents soaring. This is reflected in abnormally high rental yields that now average 27%, a huge premium to the global average. We calculate the rental yield here and in forthcoming mentions as current rent in Dubai divided by the price of an equivalent off-plan property that is not currently available for rental or occupation. The volume of freehold transactions for completed commercial property is still negligible, forcing us to rely on the prices of off-plan sales of properties that will mostly not be available for occupation before 2008.

The market is changing, with supply forecast to triple and demand expected to remain strong at least in the short and medium terms. We believe that rental yields will revert to a par with the global average or carry only a slight premium to it. Figure 7.1 highlights a summary of the current market conditions and our expectations of how new market forces will affect selling prices, rent rates and rental yields for commercial properties.

Figure 7.1: Summary of Our Expectations for the Commercial Property Market

	Rent Yield	=	Rent Rate	/	Selling Price
Current	- A rent yield averaging 27% but reaching +30% in some cases - Significant premium compared to global average		- Escalating rent rates, a reflection of the current severe supply shortage and the huge growth in demand - Higher rates for new developments in New Dubai area		- One of the lowest sq ft selling prices among major business cities - Higher selling prices for new developments whose units are expected to be delivered in ST
Outlook	- Rental yields adjusting gradually - Yields going down, to stand at a slight premium to the global average in the long term		- Rent rates to remain high in the ST and gradually drop thereafter - Premium will remain on some exclusive areas that have limited supply		- Stable selling prices - Continuing price variations, depending on location, quality and developer

Source: EFG-Hermes

Supply Expected to Triple by 2010

Developers increasingly penetrate the commercial segment…

Real estate developers have tended over the past few years to focus on the booming residential market at the expense of commercial property, which has seen only a small flow of supply additions in recent years. Dubai currently has an estimated 24 million square feet of commercial space, most of it spread around Old Dubai. Developers only began to tap into the commercial segment with the construction of new freehold and leasehold towers. They have increased their activity, encouraged by: (i) an acute supply shortage, (ii) abnormally high rental yields, and (iii) an expected oversupply in residential units.

Early in the property boom, Dubai Properties launched Business Bay and the Jumeirah Beach Residence, the latter offering commercial space as well as residential units. Free zones such as the Dubai International Financial Center (DIFC), Dubai Investment Park, Emaar Business Park, Jumeirah Lake Towers have also sprouted across the city. Private developers have likewise entered the commercial real estate segment and have begun to build commercial towers in the New Dubai area that stretches from Sheikh Zayed Road to Dubai Marina, Dubai World Central and even Emirates Road, where many of Dubai's new cities are being built (including Dubai Silicon Oasis, Studio City, Outsourcing Zone, Jumeirah Village, City of Arabia and Falcon City of Wonders). Private developers continue to build in Old Dubai as well, specifically in Garhoud, where Festival City is under construction.

Table 7.2: Major Developments Offering Commercial Properties

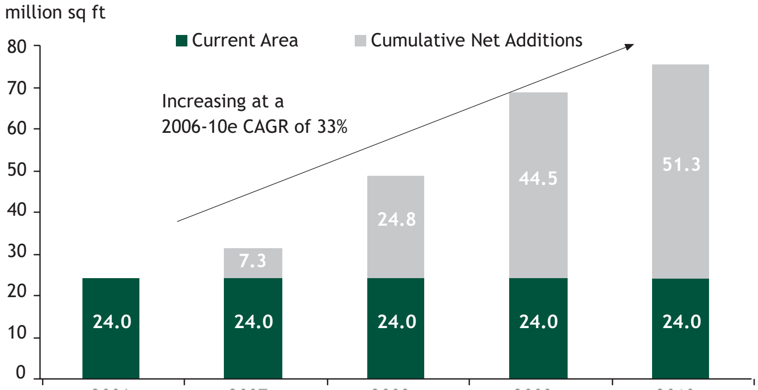
Development	Developer	Expected Date of Delivery	Description
Jumeirah Lake Towers	Master developers: Dubai Multi Commodites Center, Nakheel	End of 2007 & 2008	- Dubai's first non-industry specific free zone that is opened to all industries with the exception of general trading business
			- Hosts the Dubai Multi Commodities Center (DMCC), which currently has 800 registered companies
			- Resident companies will enjoy the benefits of a free zone
Business Bay	Dubai Properties	End of 2007 & 2008	- Located between Ras Al Khor and Sheikh Zayed Road is a mixed - use freehold development that covers 80 million sq ft.
DIFC	Various Developers	End of 2008 & 2009	- The financial business hub,offering over 22 million sq ft of office space, residential and leisure areas
			- Regarded as the most prestigous and expensive business complex

Source: EFG-Hermes

...with immense supply expected to hit the market

That the number of residential units in Dubai will double in four years is hard to believe. That the amount of commercial space will triple to an announced 75.3 million square feet by 2010, equal to a 2006-10e CAGR of 33%, is perhaps even more so. Most of the commercial space additions are expected to hit the market in 2008 and 2009, with major deliveries in Jumeirah Lake Towers, Business Bay and DIFC. In 2007, only 7.3 million square feet are expected to be delivered.

Figure 7.3: Forecast Commercial Supply - 2006-2010e



Sources: Better Homes Real Estate Commercial Review and EFG-Hermes

We believe, however, that some of the developments planned for 2008 and 2009 will not come to the market. As with residential property (see the "Supply in the Residential Property Market" section), the major risk is that delivery dates will be extended. Much of the planned space is being supplied by small private developers who lack a track record, several of the planned developments have relatively tight supply and construction schedules, and on some, ground hasn't even been broken.

New supply is mainly in New Dubai and is primarily Grade A

Dubai's existing supply of commercial space is dominated by the lower quality Grade B and Grade C segments. This is due to: (i) the relatively old age and low-quality amenities of the commercial space in a market that has seen few recent deliveries, and (ii) the concentration of most available supply in the less popular Old Dubai area, the traditional business district.

New space additions tend to fall in the Grade A and, to a lesser extent, Grade B segments and to be concentrated in areas of New Dubai, where new projects offer well-designed office space and world-class amenities such as gyms, restaurants, printing services and even high-tech features such as voice and movement sensors, wireless internet technology and voice over internet protocol (VOIP). The better economic conditions of the last two years have increased the number of companies that can afford higher-quality space.

Will Demand Absorb the Additional Supply?

Even though new companies are coming to Dubai and an expansion in non-oil businesses, including tourism and finance, has increased the potential for further growth, we believe the current planned additions in commercial space are more than what the market can absorb. Among variables that will help fuel the growth in demand for office space are:

- Regional Economic Growth: Middle Eastern economies, boosted by high oil prices, have been growing rapidly. Huge government expenditures and efforts to diversify away from hydrocarbons have created a wide variety of business opportunities. Dubai is in a good position to attract businesses as a base for their first forays into the region.

- Sustained Improvement in Dubai's Business Environment: Dubai's government has been particularly successful in establishing itself as a preferred business city and in attracting international businesses. This has been evident in the increase in Net Foreign Direct Investment (FDI), which has increased ten-fold since 2000 reaching AED5.0 billion (USD1.4 billion) in 2005. The government offers incentives such as a non-tax environment, free zone areas and ease in establishing companies. The government continues to introduce further improvements.

- High Living Costs: A major issue facing companies planning to expand in Dubai is the high cost of living for employees. The huge expected increase in property supply points to a period of rent and price stability, followed by a drop, a trend that should help encourage more businesses to expand in Dubai.

These positive factors indicate that business should remain strong, creating more demand for commercial space. In finance, for example, the demand for more sophisticated and diversified financial services is increasing in the region as a whole. The large international banks and financial institutions that hope to satisfy these demands need a place from which to operate. Dubai, already the region's financial hub, has become even better placed as the Dubai International Financial Exchange (DIFX), which opened in September 2005, gears up its activities. The exchange hopes to become the leading stock exchange between Western Europe and East Asia.

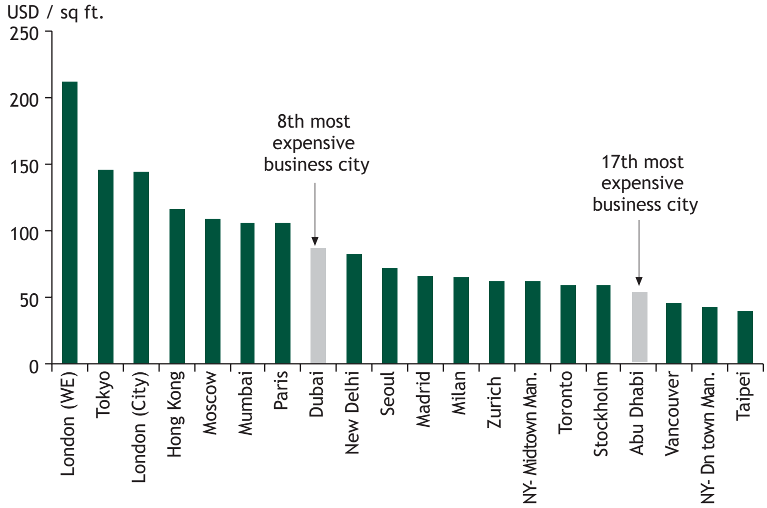
Nonetheless, we believe the emirate is unlikely to be able to absorb all expected supply in such a short time. The vast bulk of commercial space coming onto the market will have to be hooked up to infrastructure such as water and electricity, something that may strain the emirate's resources. Over the short to medium terms, we believe, demand will continue to outpace supply. But once the bulk of the new supply comes onto the market, it will become a buyers' market. The timing will depend on the extent of delays in property deliveries.

What Needs to Happen for Rental Yields to Revert to the Global Average?

Abnormally high rental yield is of a temporary nature

Dubai currently has the eighth most expensive commercial unit rent rates among 20 surveyed cities, making it a more expensive place to do business than well-established business centers such as New York, Beijing, Toronto and Milan. According to a survey published in November, the average rent in Dubai was USD87 per square foot, compared to USD59 in Toronto, USD53 in Abu Dhabi and USD38 in Beijing.

Figure 7.4: Dubai is Among the 10 Most Expensive Business Cities in Terms of Rent



Sources: CB Richard Ellis Global Market Rents Report and EFG-Hermes

Dubai's commercial property selling prices, on the other hand, are at the bottom among business cities. With the exception of Istanbul, Dubai prices are the lowest in our selected peer group, coming in at an average of USD325 per square foot. This in turn has resulted in abnormally high rental yields, which have reached an average of 27% compared to the global average of 8%. We believe that the abnormal yield is of a temporary nature, given the current severe supply shortage, which in turn is placing severe pressure on rent rates. On the other hand, the market is expecting a huge flow of space additions and therefore developers are having difficulty in raising selling prices for new developments.

Fig. 7.5: Selling Prices in Dubai are Among the Lowest Globally...

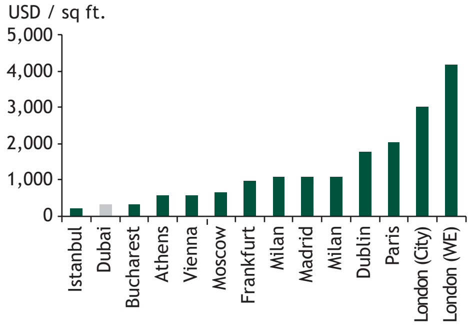
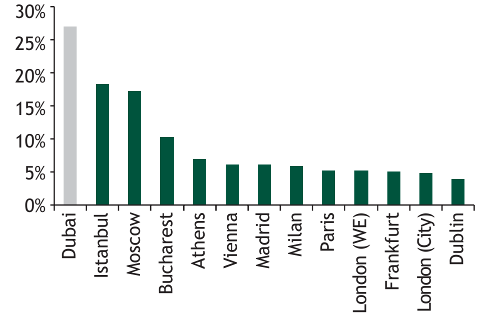


Fig. 7.6: ... Making Rental Yields Abnormally High



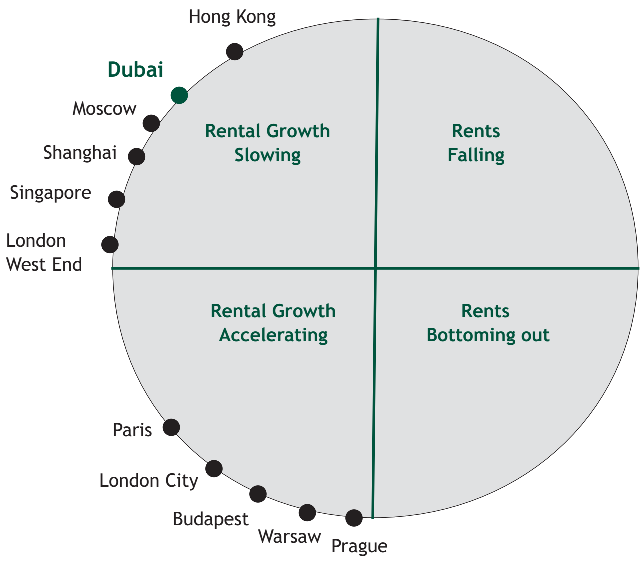
Sources: CBRE and EFG-Hermes

Are rent rates peaking yet?

The trend of strongly rising rents is not only confined to Dubai. Indeed, it is a trend in all major business cities given the growth of the global economy over the past few years. In figure 7.7, we highlight various business cities and where they are in terms of the rent life cycle. It would seem that Hong Kong, Dubai and Moscow are approaching the peak of the cycle in terms of rent rates and will soon enter a phase of falling rents.

We believe that Dubai's supply of new commercial space is unlikely to increase in 2007 at a time when demand remains high, thus ensuring that office rents will not soften. Once the new supply begins to pour onto the market in 2008, however, rent rates should begin to fall and yields begin sliding gradually back toward the international average, with the speed of the decline depending on how quickly that supply arrives and the strength of economic and business activity going forward.

Figure 7.7: Rent Life Cycle for Various Business Cities*



*Forecasts for all countries are Jones Lang LaSalle reports. Dubai forecasts are EFG-Hermes expectations
Sources: Jones Lang LaSalle and EFG-Hermes

Selling prices to stabilize at current levels

On the other hand, we do not expect a similar downward trend in selling prices, at least at the more prestigious new developments, given that: (i) prices are currently low compared to other global business cities as mentioned above, and (ii) demand is expected to remain strong in some areas, such as the 110-acre DIFC, which contains the DIFX.

Speculators flooding the secondary market: is a major concern

The main risk faced by the segment, in our opinion, stems from the secondary market. Much of the trading activity in the commercial space has been speculative, with traders attracted by Dubai's high rental yields. Once the supply of new commercial space approaches the limit of what the market can readily absorb, many of these speculators will be tempted to sell off the properties they have accumulated, flooding the market. The result could be a sharp drop in property prices accompanied by strong downward pressure on rents.

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