Unitas Consultancy (A GLOBAL CAPITAL PARTNERS GROUP COMPANY) Q3 2014

STRICTLY CONFIDENTIAL

Dubai: The "New Normal"

REIDIN Emerging Markets Real Estate Information

GCP GLOBAL CAPITAL PARTNERS

Office No. 103, The Palladium, Plot No. C3, Jumeriah Lake Towers, Dubai, UAE, info@unitasconsultancy.com

Executive Summary

Interest rates have a profound impact on real estate prices and rental yields as it effects the capital-flow (the supply and demand for capital and investor's required rates of return on investments), thus influencing the ability of home-owners and investors to purchase assets. Both these variables share an inverse relationship as witnessed historically in the United States. When mortgage rates were at its peak (18%) in 1976, property prices were close to an all time low.

The recovery of Dubai's property market has lead to a flurry of new developments, sparking a construction boom. However, unlike the last boom cycle, the injection of supply is more gradual in both the residential and commercial segment. A supply analysis shows that there is a 25% and 50% drop in the average supply of units in 2014-15, compared to the last 10 years, in the residential and commercial segment. Additionally, it has taken a long-term view on its mega projects, such as MBR City, DWC, and the Mall of the world.

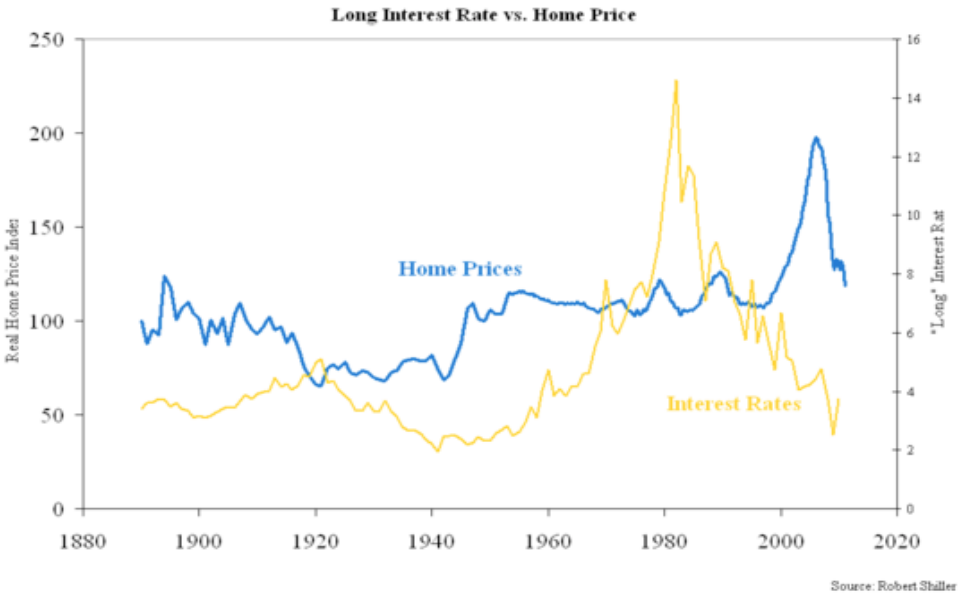
The cooling measures by the government have been effective in slowing transactional activity leading to a stagnation of price growth. Although, transactional activity has been a leading indicator in determining price action, there is another key factor that is prevalent in more mature communities, which is the 'home-ownership' effect. Communities that have a higher mortgage rate, such as Springs and Greens, are considered to be owner-occupied compared to investor driven, causing the supply to be absorbed. Over a period of time, these communities will exhibit higher price growth rates, even though transactional activity will continue to fall, reflecting a higher absorption rate. This phenomena is apparent when comparing the nature of transactions of International City (Investor driven) versus Springs (owner-occupier).

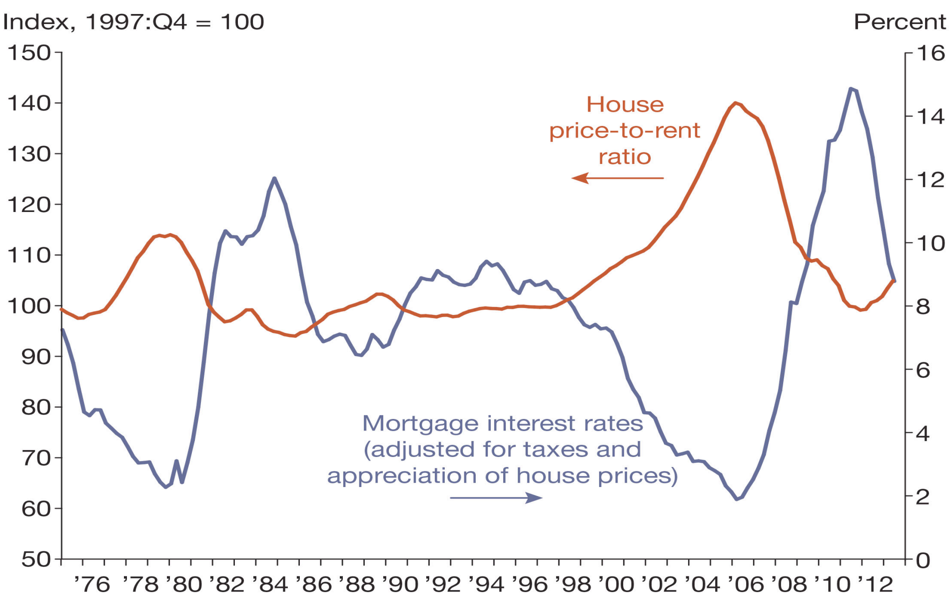
Table of Contents

Correlation: Interest Rates and the Property Market

"Compound interest is the eighth wonder in the world. He who understands it, earns it … He who doesn't .. Pays it" – Albert Einstein

Inverse Relationship Between Interest Rates and the Property Prices

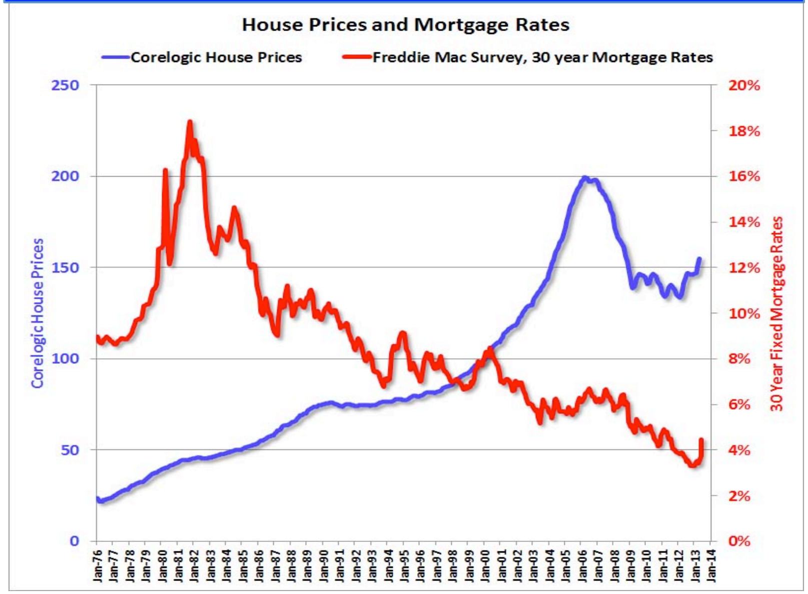




An interest rate analysis and its impact on real estate prices in the USA since 1880 reveals a startlingly high inverse correlation between interest rates and the rate of increase in real estate prices; more importantly, data suggests that during periods of high and rising interest rates, the rate of return generated by real estate assets is *predominantly* in the form of rental yields. According to Robert Schiller, during the past 100 years, there were three periods of secularly rising interest rates, and in all of these periods (lasting for up to a decade) 70% of the rate of return in real estate assets was in the form of rental yields and not capital gains. That trend changed completely starting from 1982, when the US entered into a period of secularly declining interest rates. A rolling interest rate analysis of the past 30 years indicates that during this time, more than 75% of the return generated was in the form of capital gains, as the opportunity cost of capital started to decline and asset prices moved higher, resulting in increasingly lower rental yields

A Glance into Dubai

USA: Property Prices Vs. Mortgage Rates



Dubai Real Estate Return (2003-2013)

Time Period	Rental Return	Price Appreciation	Total Return
2003 – 2005	21%	30%	51%
2006 - Oct 2008	21%	85%	106%
2009-2011	24%	-24%	0%
2012-2013	14%	44%	58%

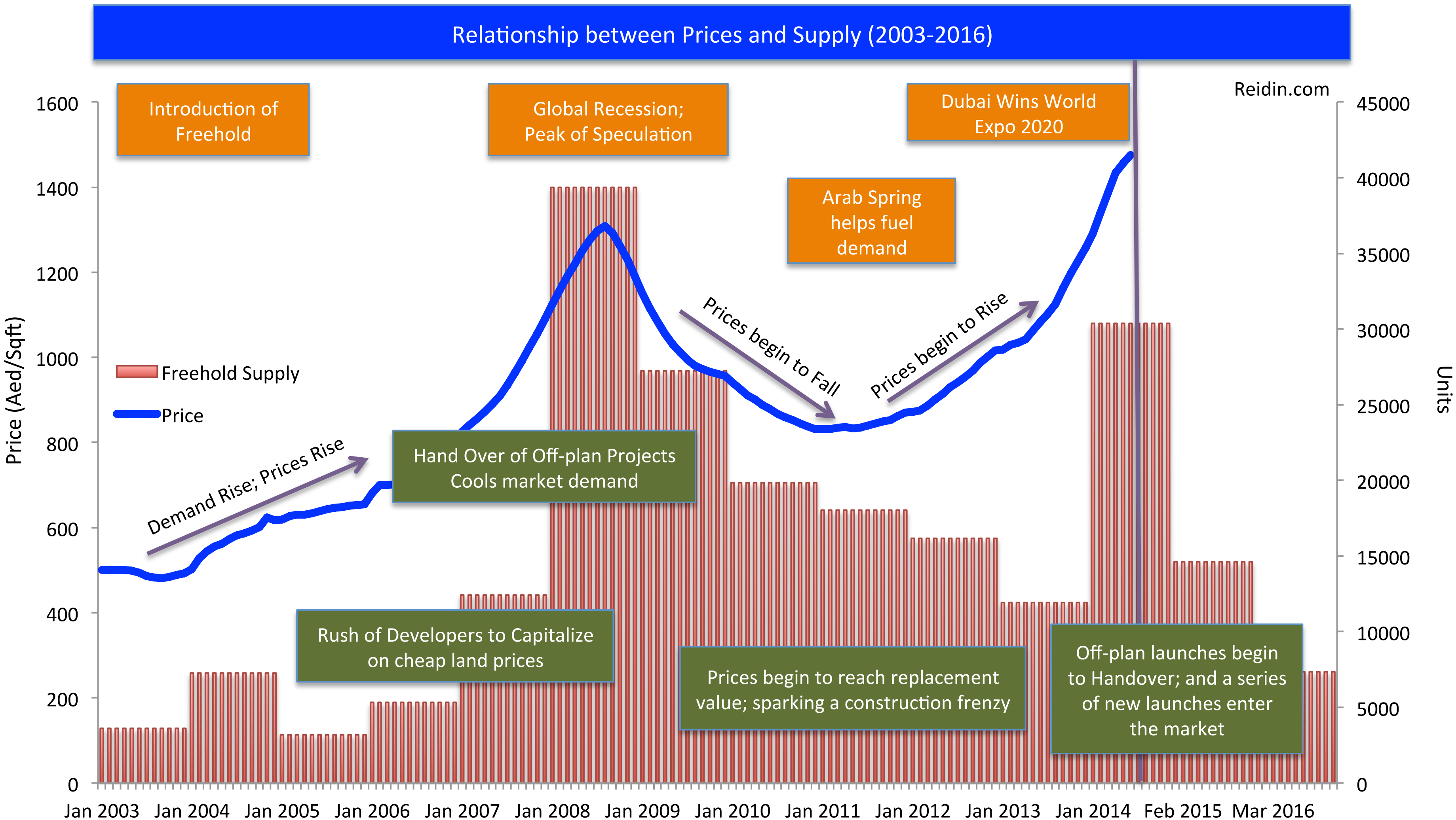
Reidin.com

In Dubai, since the announcement of freehold in 2002, rental yields have accounted for less than 33% of the cumulative gains that have been generated by real estate assets, mimicking the trend that was observed in the USA. Interestingly enough, even during this time, it is pertinent to note that during 2003-2005, when interest rates were on the ascent, rental returns accounted for nearly 50% of the annual gains that were witnessed in the market, indicating the sensitivity of asset returns to interest rates. Given that there is a near consensus on the fact that interest rates are likely to move higher in the coming year, it comes as little surprise that both transactional activity and capital gains have paused; and whilst many believe that the bullish trend of rising prices will resume imminently, it appears as if this period of price consolidation at the macro level may indeed be a more longer term phenomena.

Its Not a Sprint; it's a Marathon

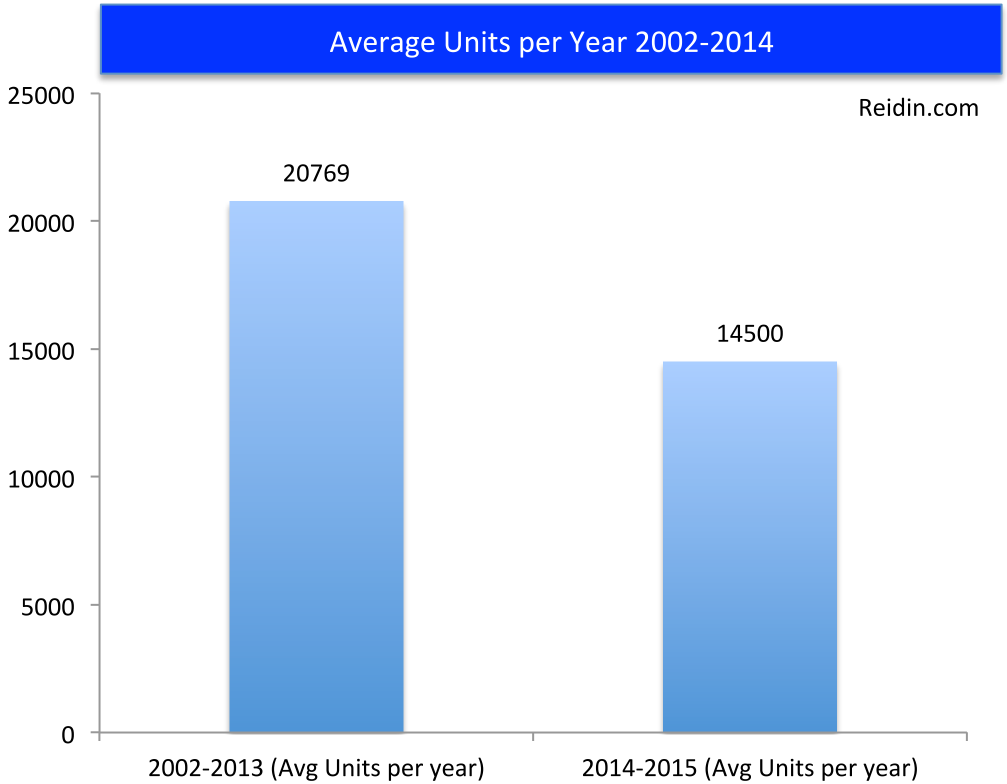
"But you can build a future out of anything. A scrap, a flicker. The desire to go forward, slowly, one foot at a time." - Lauren Oliver

Supply has a Lag Effect on Price!



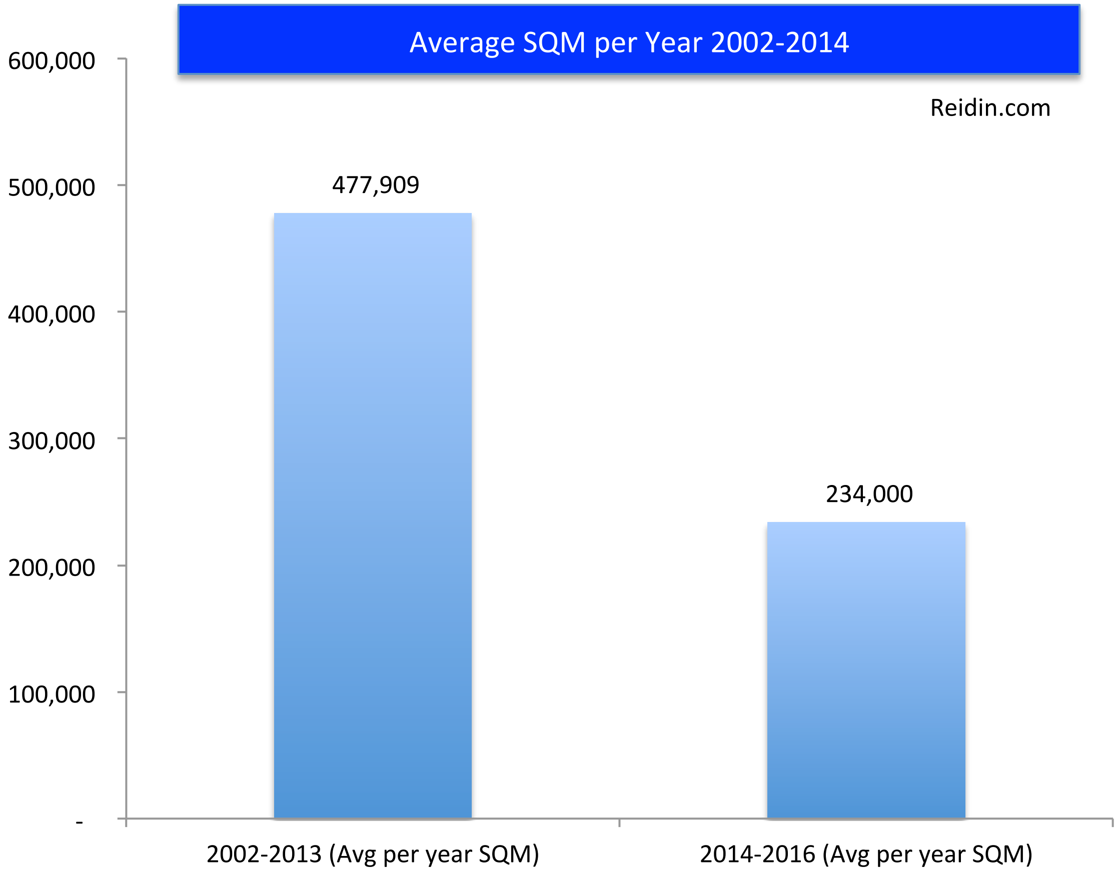
Historically, annual supply peaked in 2008, leading to the bust in property prices as demand nosedived following the global economic contagion. As subsequent levels of annual supply receded, price levels started to rise again, signaling a return to health. Visibility of upcoming supply however, needs to be closely monitored and whilst current levels indicate that there appears to be no dramatic surge, the plethora of off plan projects will need to be scrutinized in terms of their delivery timelines to gauge impact on price levels.

Output of Residential Supply Slows Down Compared to Historical Averages



A look into Dubai's historical supply output, shows that an average of 20,769 units were being injected into the market from 2002 to 2013. However, a look into the future, shows that this average has been scaled back by 25% allowing for a more gradual injection of supply, implying that master developer are more cognizant of graduating the supply pipeline this time around, as they seek to avoid a repeat of the 2008 boom-bust cycle.

Office Supply Experiences Gradual Roll-Out Compared to Historical Averages in Monitored Areas



Area	Existing Supply (sqm) 2002-2013	Upcoming Supply (sqm) 2014-2016
Business Bay	680,000	335,000
Downtown	232,000	-
Tecom-C	200,000	45,000
Jumeirah Lake Towers	750,000	125,000
DIFC	360,000	62,000
Dubai Marina	100,000	45,000
Sheikh Zayed Road	700,000	90,000
Dubai Silicon Oasis	175,000	-
Dubai Internet & Media City	1,850,000	-
Al Barsha	210,000	-

Similar trends are witnessed in the commercial segment of the market. The average SQM of commercial space being supplied per year in the market between 2002-2013 was 477,909 SQM, which is 50% higher than expected in 2014-2015. This dramatic decrease of supply within this segment is following the same trajectory to that of the residential space, indicating that developers are more aware of the demand/supply trends in the market.

Dubai Taking it Easy ....

Dubai's Mall of the World to be built in 10 years

Dh25 billion required to build mega project in the emirate

By Cleofe Maceda
Published: 18:19 July 9, 2014

GULF NEWS

95

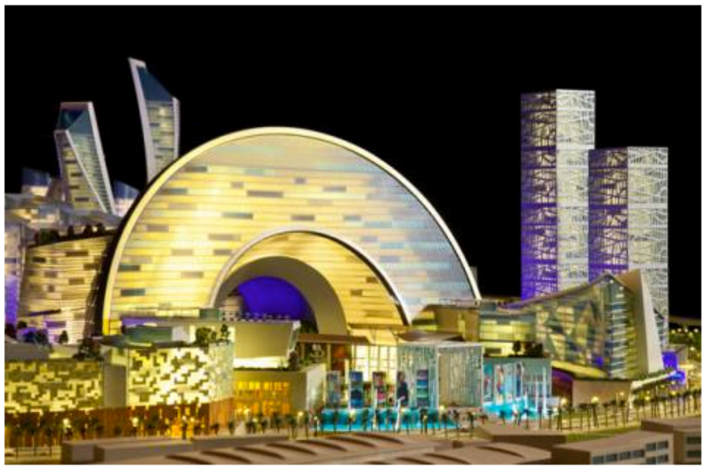


Image Credit: WAM

Artist's impression of the Mall of the World, the world's first temperature-controlled city, which will be built along Shaikh Zayed Road in Dubai. The mall will be capable of receiving 180 million visitors a year.

Dubai Ruler inaugurates first phase of Mohammed bin Rashid City mega-project

The National staff
January 29, 2014 *Updated: January 29, 2014 07:48 AM*

Related

- Digital cities the answer as urbanisation spreads
- In pictures: Sheikh Mohammed tours Cityscape Global 2013
- In pictures: Mohammed Bin Rashid City unveiled
- Dubai announces Mohammed Bin Rashid City mega-development

DUBAI // Sheikh Mohammed bin Rashid, Vice President and Ruler of Dubai has inaugurated District One of the Dh30 billion Mohammed bin Rashid City.

A plaque was unveiled to mark the occasion of the promising urban, mixed-use, leisure and sports development which spans more than 54 million square feet of prime freehold land.

Sheikh Mohammed viewed the mega model of the development at the sale centre where he was briefed by Saeed Humaid Al Tayer, Meydan Group Chairman and chief executive, owner and developer of the project.

The city will feature 600 hectares of open and green space of city parkland, waterways, woodlands, water park and the largest crystal lagoon body of water in the world with 7km of stunning lagoons and 14km man-made beaches.

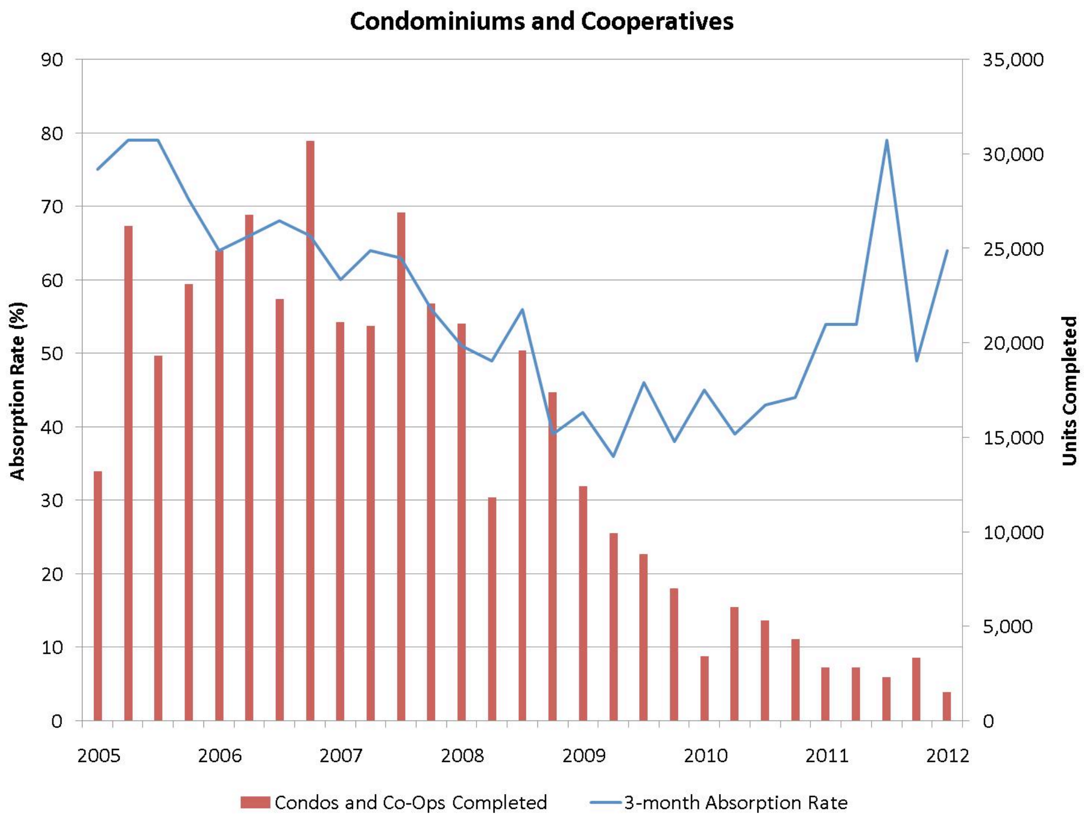
The City is scheduled to be completed in 2018-2019.

Master developers in their announcements are indicating a long timeline for the completion of their projects, unlike the last cycle where there was a rush to completion. This is a healthy indicator for the market, lowering the probability of excess supply being offered in the medium term.

The Home-Ownership Effect

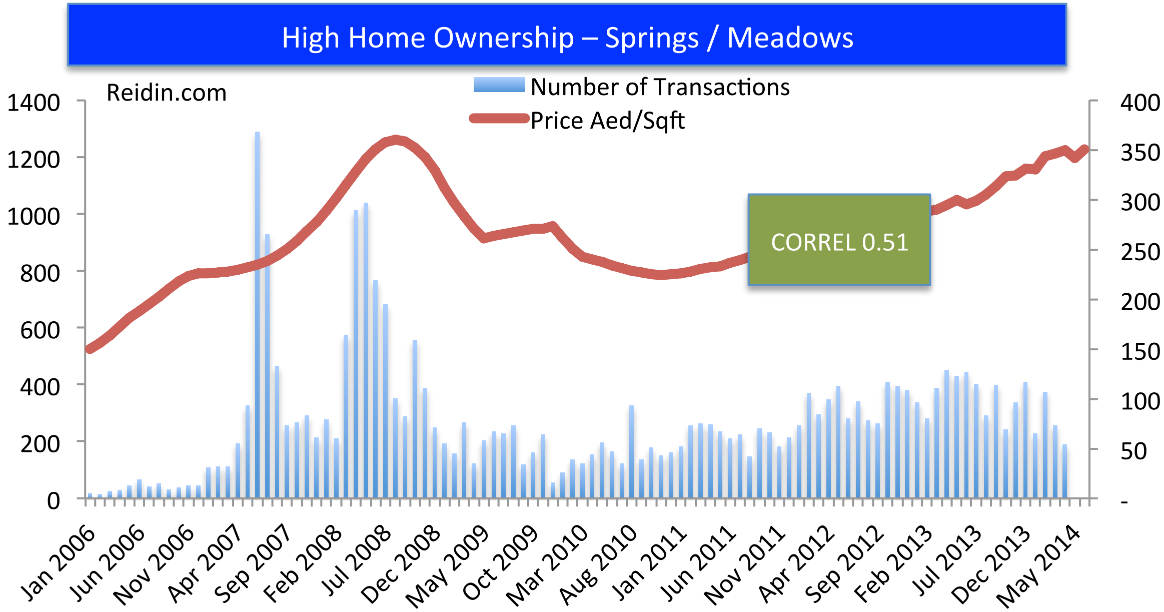
"Funny thing how it is. If a man owns a little property, that property is him, it's part of him, and it's like him. If he owns property only so he can walk on it and handle it and be sad when it isn't doing well, and feel fine when the rain falls on it, that property is him, and some way he's bigger because he owns it. Even if he isn't successful he's big with his property. That is so." – John Steinbeck

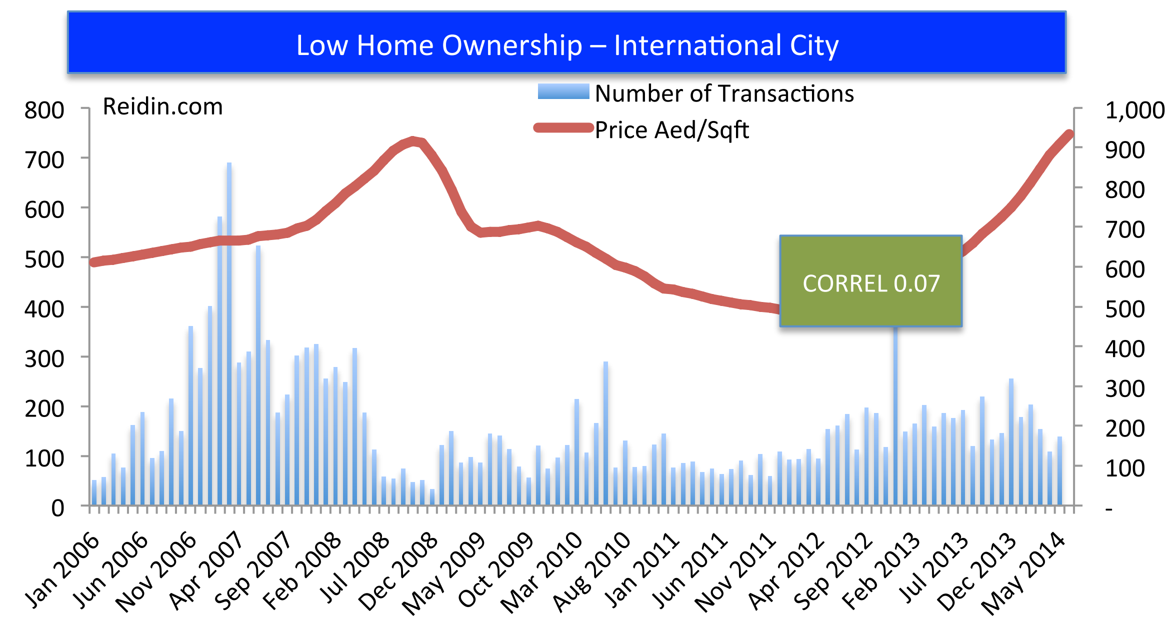
Higher Absorption Rate! Higher Home-Ownership!



When a comparable city in the US is analyzed (Dallas), absorption rates that move steadily higher has a tight knit relationship with the units that are being completed in the area. This implies that the level of speculative activity has receded and end user occupiers dominate the market, as they do in most mature markets. This is the same relationship that we observe in Dubai as well, as the following slides illustrate.

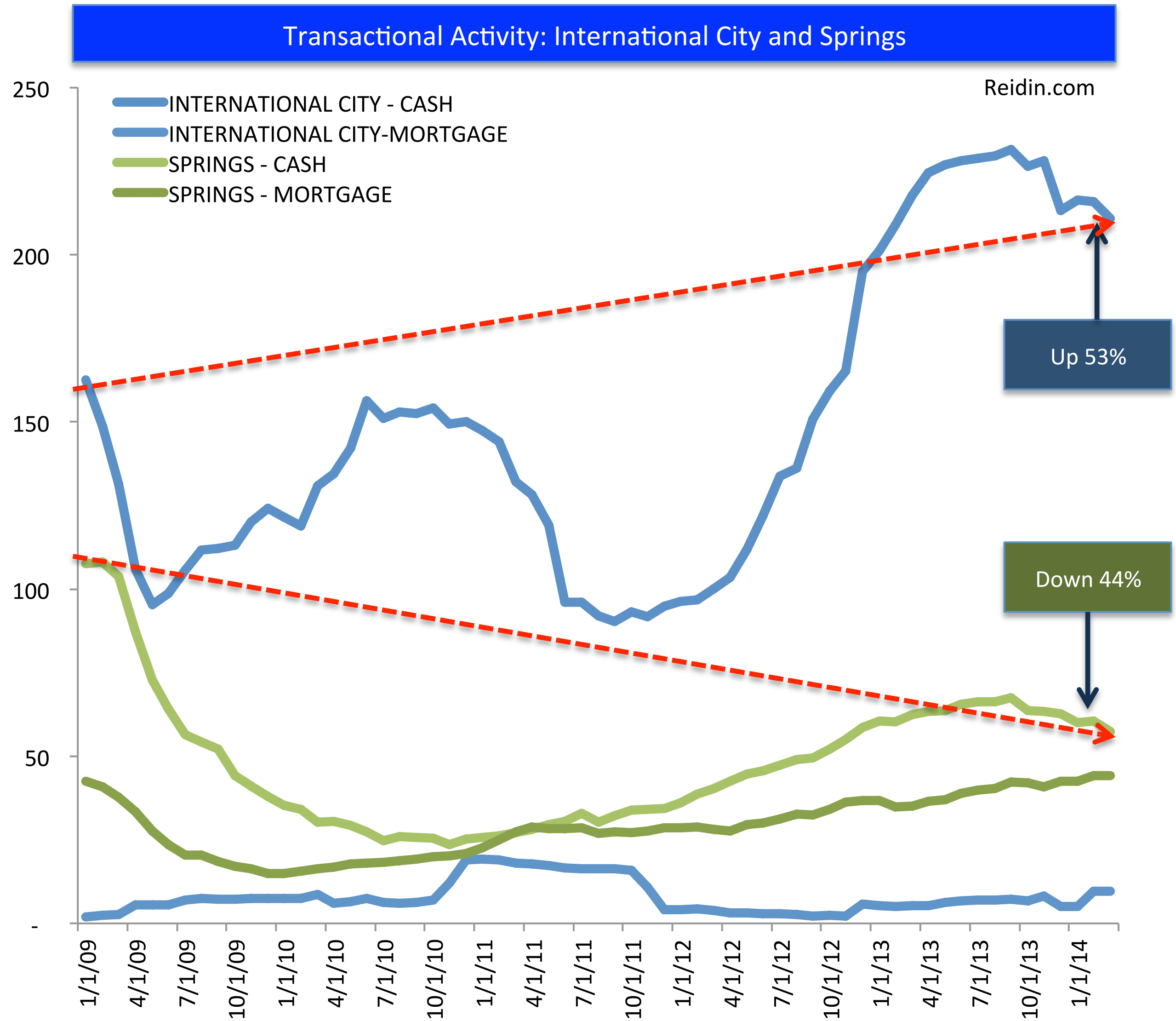
The 'Home-Ownership Effect'!





Interestingly enough, communities that have a high home ownership base (As defined by high levels of mortgage activity) exhibit a higher sensitivity to transactional activity changes than do communities with lower mortgage transactions. This is because the supply of "floating" or available stock is lower, as owner occupier stock is withdrawn from the market. An analysis of two communities in Dubai illustrates this vividly, with Springs/Meadows showing a higher sensitivity to transactional activity change by a factor of 6x than International City. Going forward, this implies that investors should be looking at higher absorption rates as a factor in determining purchase levels.

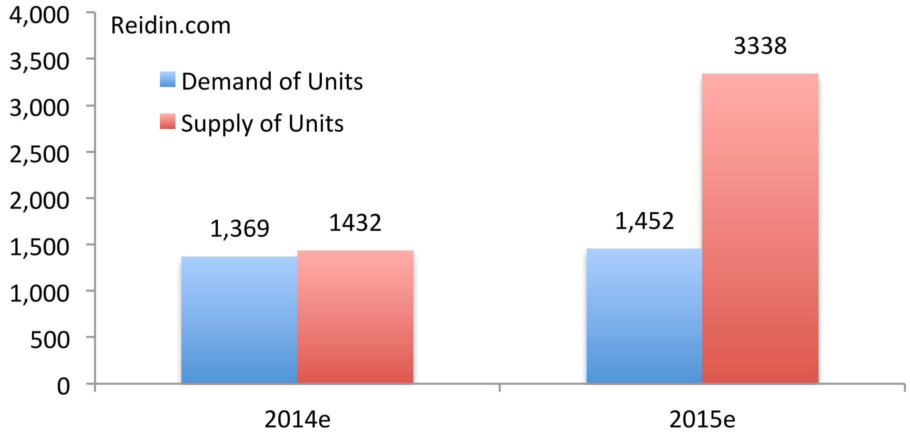
A Closer Look: International City versus Springs



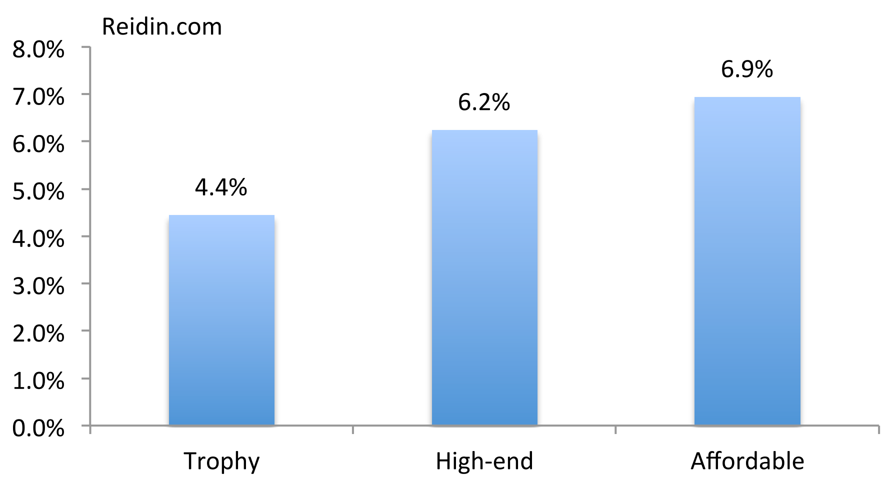
The Springs/Meadows community transactional activity has shown a secular decline over time (-44%); whereas in the International City segment the cash transactions have witnessed alarming volatility (+55%), mimicking the "animal spirits" of investors. Pertinent to note however Is the fact that mortgage transactions in the Springs have in fact risen, implying that as speculative activity has declined, the genuine end user demand has steadily increased. Known as the "absorption rate" this is a variable that investors will need to increasingly focus on as they seek to capture capital gains.

Outlook: 2014-2015

Supply and Demand Metrics: Trophy Segment (2014-2015)



Market-wise Breakdown: Net Rental Yields



Even as homeownership levels continue to rise, data suggests that there is oversupply at the top end whilst rental yields continue to surge at the mid end of the market. Increasing offerings in the off plan segment suggest that both the asset price rise, as well as rental growth will be checked in the coming years, but equally that the structure of returns will increasingly flow from rental yields rather than outsized asset price growth which was the norm in the preceding decade. This will not only coincide with declining speculative activity, but as interest rates move higher, usher in a period of more stable housing market dynamic as behemoth projects will be matched by more rational and mature residential and commercial construction growth. This is a healthy dynamic for it suggests a more sustainable era of growth as Dubai marches on towards its claim to not only being the most visited city on the planet, but also a leading magnet for attracting the best and the brightest from competing world cities.

Conclusions

Interest rates have historically had a high inverse correlation between interest rates and the rate of increase in real estate price.

Master developers in their announcements are indicating a long timeline for the completion of their projects, unlike the last cycle where there was a rush to completion

Interest Rates and the Real Estate Market

An interest rate analysis and its impact on real estate prices in the USA since 1880 reveals a high inverse correlation between interest rates and the rate of increase in real estate prices.

During periods of high and rising interest rates, the rate of return generated by real estate assets is *predominantly* in the form of rental yields

In Dubai, since the announcement of freehold in 2002, rental yields have accounted for less than 25% of the cumulative gains that have been generated by real estate assets, mimicking the trend that was observed in the USA.

It's Not a Sprint; It's a Marathon

Dubai's historical supply output was an average of 20,769 units per year from 2002 to 2013. However, 2014-2015, output has been scaled back 25%, allowing for a more gradual injection of supply.

The mid-income level remains undersupplied, however, the land topography suggests that developers are moving towards providing solutions to cater to this segment.

The commercial segment is following the same trajectory to that of the residential space, indicating that developers are more aware of the demand/supply trends in the market.

The 'Home Ownership' Effect

Homeownership levels have continued to rise in Dubai, however data suggests that there is oversupply at the top end whilst rental rates continue to surge at the mid end of the market.

Moreover, communities that have a high home ownership base (as defined by high levels of mortgage activity) exhibit a higher sensitivity to transactional activity changes than do communities with lower mortgage transaction.

An analysis of two communities in Dubai illustrates this vividly, with Springs/Meadows showing a higher sensitivity to transactional activity change by a factor of 6x than International City.

Outlook

Given that there is a near consensus on the fact that interest rates are likely to move higher in the coming years, it comes as little surprise that both transactional activity and capital gains have paused; and whilst many believe that the bullish trend of rising prices will resume imminently, it appears as if this period of price consolidation at the macro level may indeed be a more longer term phenomena.

Visibility of upcoming supply needs to be closely monitored and whilst current levels indicate that there appears to be no dramatic surge, the plethora of off plan projects will need to be scrutinized in terms of their delivery timelines to gauge impact on price levels.

Unitas believes in in-depth planning and discipline as a mechanism to identify and exploit market discrepancy and capitalize on diversified revenue streams.

Our purpose is to manage, direct, and create wealth for our clients.

Unitas is the author for these research reports

Palladium Tower, No: 103,
Jumeirah Lake Towers,
PO Box 500231 Dubai,
United Arab Emirates
Tel. +971 4 447 72 20
Fax. +9714 447 72 21
www.unitasconsultancy.com

REIDIN
Emerging Markets
Real Estate Information

REIDIN.com is the leading real estate information company focusing on emerging markets.

REIDIN.com offers intelligent and user-friendly online information solutions helping professionals access relevant data and information in a timely and cost effective basis.

Reidin is the data provider for these research reports

Concord Tower, No: 2304,
Dubai Media City,
PO Box 333929 Dubai,
United Arab Emirates
Tel. +971 4 433 13 98
Fax. +971 4 360 47 88
www.reidin.com

Our Aspiration and Motto

"No barrier can withstand the strength of purpose"

HH General Sheikh Mohammed Bin Rashid Al Maktoum
The Ruler of Dubai and Prime Minister of UAE