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Dubai: Shocks, Shifts & a Return to First Principles

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Executive Summary

- Recent exogenous shocks in the oil and currency markets have led to concerns about the resultant ripple effects that already have and will continue to reverberate throughout the real estate market. Undoubtedly there has been a correlation between the oil and the real estate market, as well as the stock markets; this implies that the recent sell off will have an adverse impact on real estate prices, especially in the trophy segment, as Russian buyers were predominantly purchasing at the higher end of the spectrum.
- A longer term correlation between oil and real estate prices is much lower, implying that historically there has been very little carry through from impacts in oil prices. With the equity markets, the longer term correlation remains high, suggesting that unless equity prices recover in the near term, there is likely to be softening in the real estate markets (by approximately 15-20%), again particularly at the higher end of the price range.
- Correlations between real estate and other currencies (Euro and GBP) have also been high, especially for the Euro and recent dollar strength reaffirms our analysis that cash flow returns from real estate will dominate over capital gains as the market has entered "The new Normal".
- A Return analysis of major asset classes over an 8 year cycle reveals that real estate has significantly outperformed other asset classes, including gold. Given the recent turmoil and the correction that is already underway, investors would be well advised to return to first principles by looking at the longer term fundamentals that remain firmly in place.

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Dubai Real Estate and Other Investment Instruments



"Know what you own, and know why you own it." - Peter Lynch

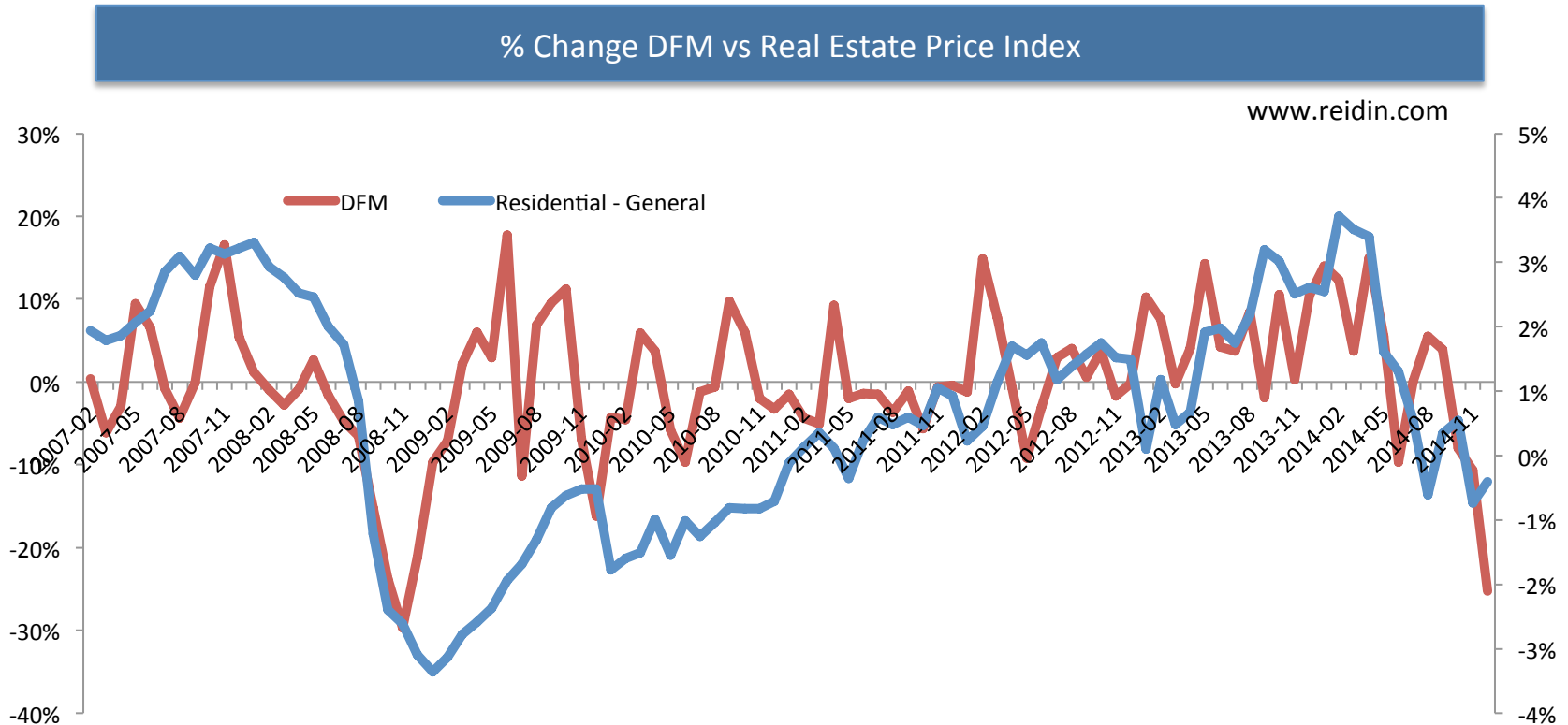
Correlations Between Price Appreciation of Real Estate Assets and Other Investment Instruments

Correlation	2013-Date	2007-Date
DFM	0.54	0.40
GOLD	0.22	-0.05
OIL	0.59	0.19

A correlation analysis reveals that there is a strong relationship between real estate prices and the DFM, both in the short and the long term. This relatively stable relationship implies that unless equity prices recover, real estate prices are expected to soften from further levels. For oil, a longer term time series analysis shows a weak relationship between the two, implying that recent oil price dislocations will not pass through real estate prices.

A Correlation analysis between real estate and gold reveals that there is no relationship over the longer term.

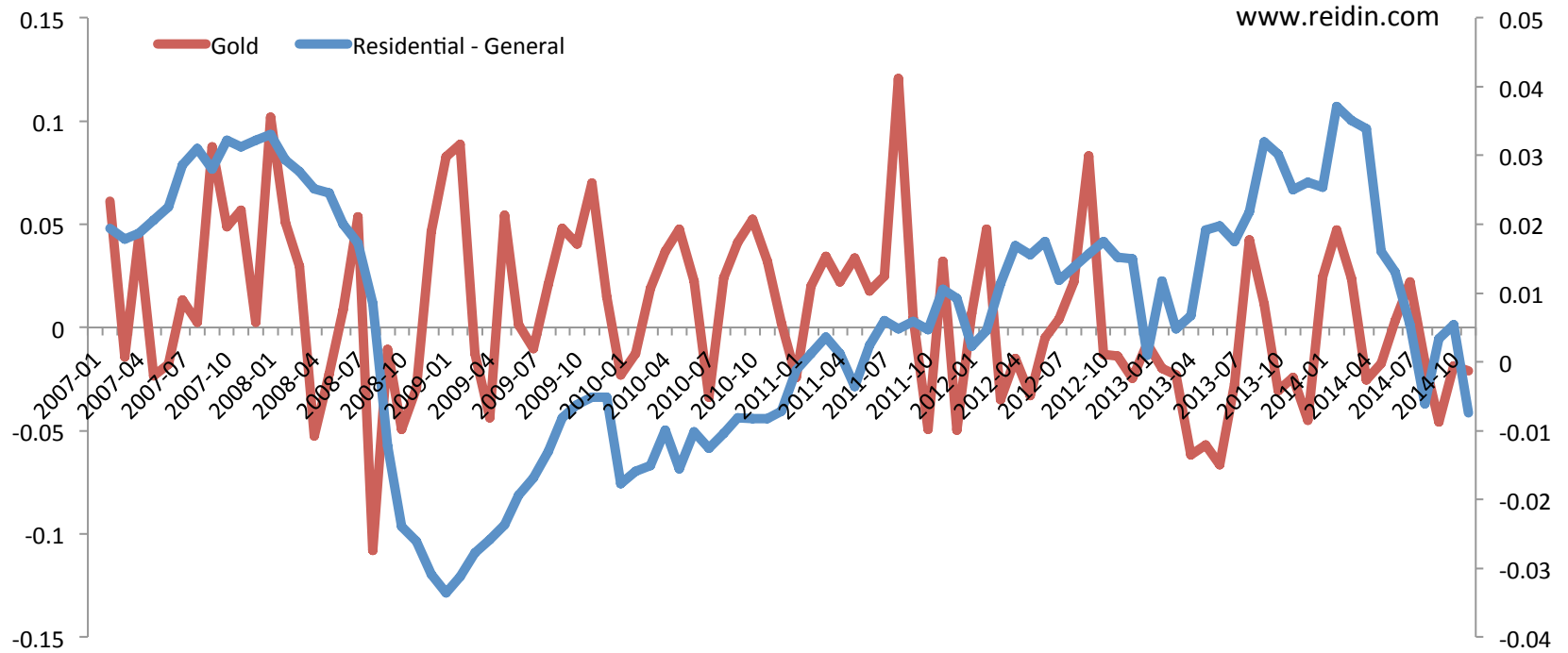
Dubai Financial Markets and Dubai Real Estate



Visually, it appears that the DFM has been a leading indicator to the resultant impact in real estate prices. This implies that unless equity prices recover, there is likely to be a correction in real estate values. The impact of this will be most felt in the higher end of the market as Dubai's residential price index is dominated by top heavy properties, implying a reversion to the mean as prices adjust to falling equity asset values

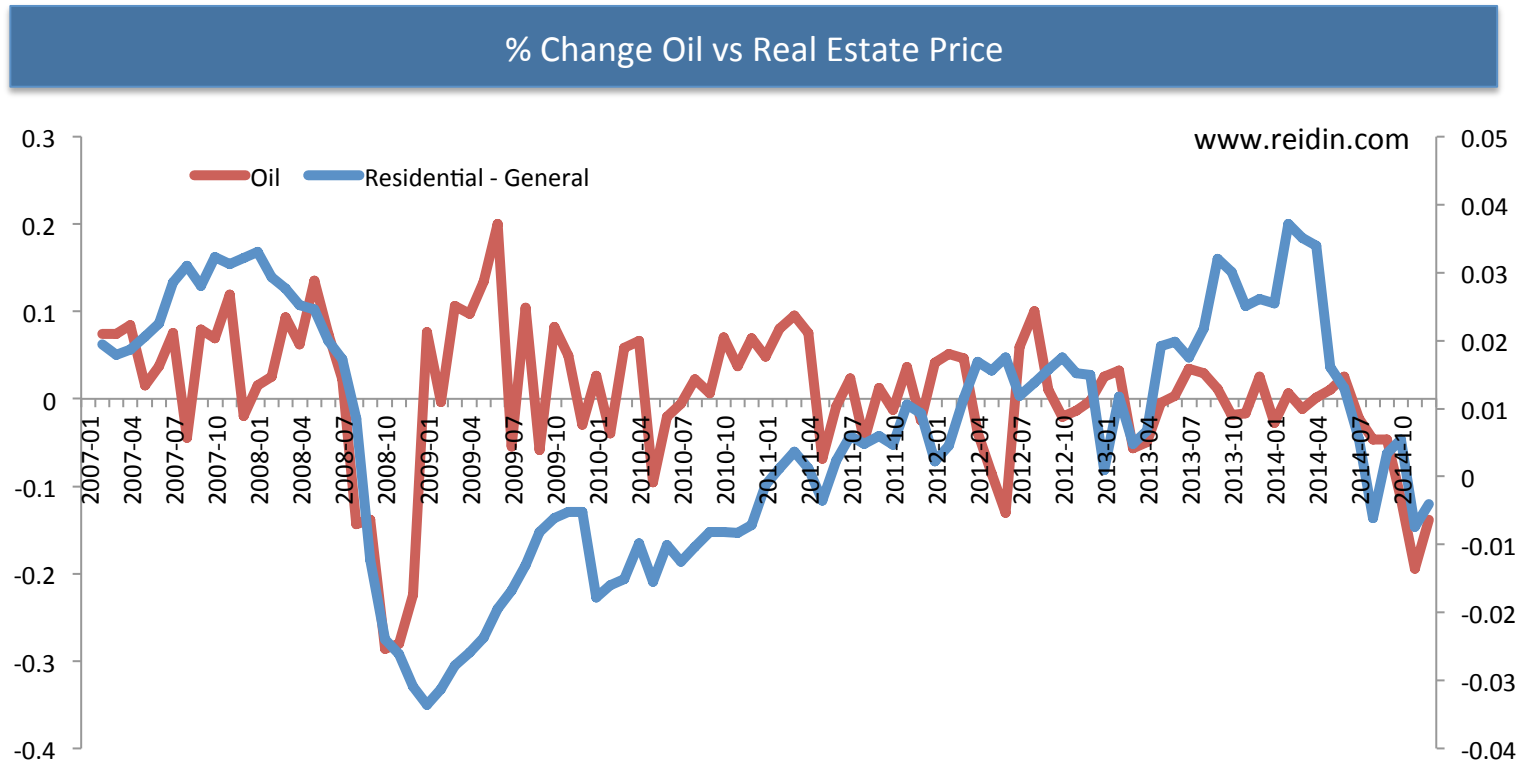
Gold and Dubai Real Estate

% Change Gold vs. Real Estate Price



When gold is looked at in a time series analysis, there appears to be no relationship between the two variables, implying that gold has had no impact on domestic real estate values. Consequently, gold market gyrations are unlikely to exert any effect on the same in the future

Oil and Dubai Real Estate Assets



Oil prices (being a liquid barometer) have had a high correlation to real estate prices in the near term; a longer term time series analysis reveals however that the underlying relationship is a weaker one, and will be felt indirectly through other pass through effects. We opine that oil price volatility having a weak impact on underlying real estate price fundamentals in the medium term

Dubai Real Estate and Currencies



"Every once in a while, the market does something so stupid it takes your breath away." -
Jim Cramer

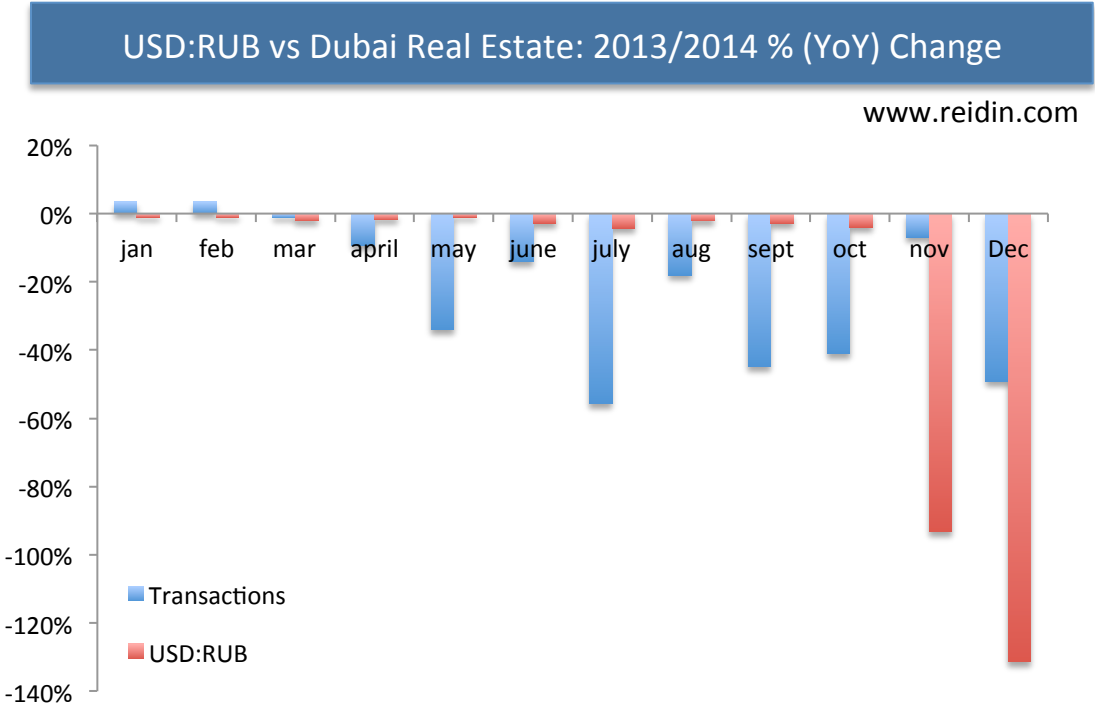
Dubai Real Estate and Currencies

Correlation	2013-Date
USD:RBL	0.21
USD:GBP	0.11
USD:EUR	0.35

Currencies impact real estate prices as well as transactions and recent weakness in the Russian Ruble will have a deleterious effect on transactional and price activity, especially at the higher end of the market.

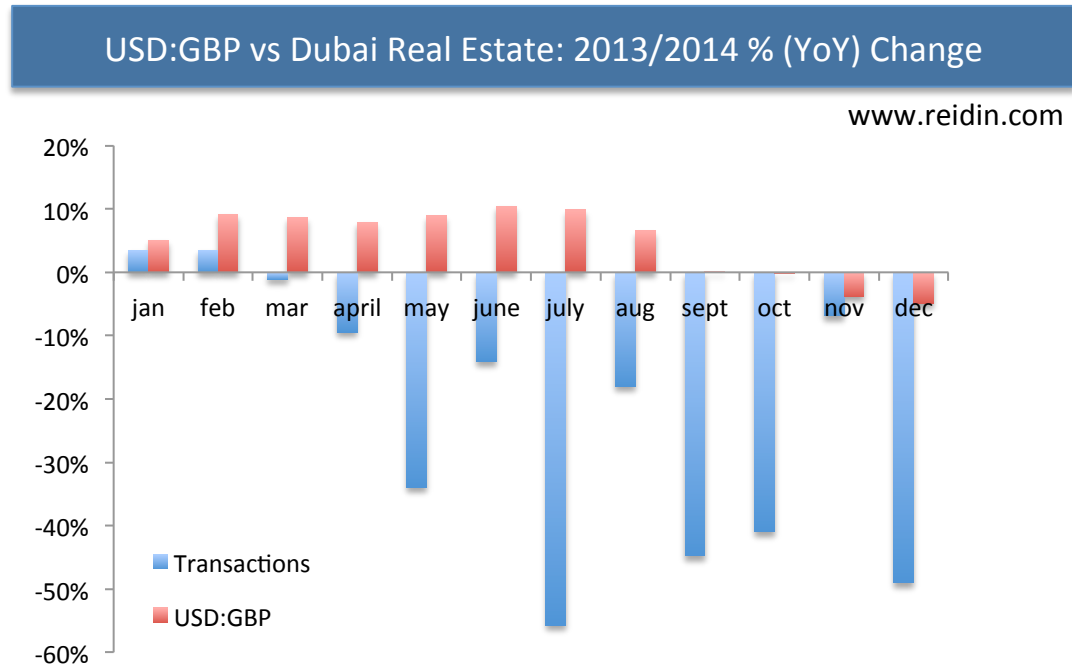
When other currencies are looked at, the Euro emerges with the strongest relationship to real estate transactional activity, implying that euro weakness is likely to spill over to real estate sentiments and impact price action adversely. A weaker relationship has been observed vis a vis the Sterling.

USD:RUB and Dubai Real Estate Asset Transactions



Visually, the decline in the ruble appears to have had a significant contribution towards the decline of transactional activity. We expect this trend to continue and remain for some time now as buyer pattern behavior shifts away from this region.

USD:GBP and Dubai Real Estate Transactions

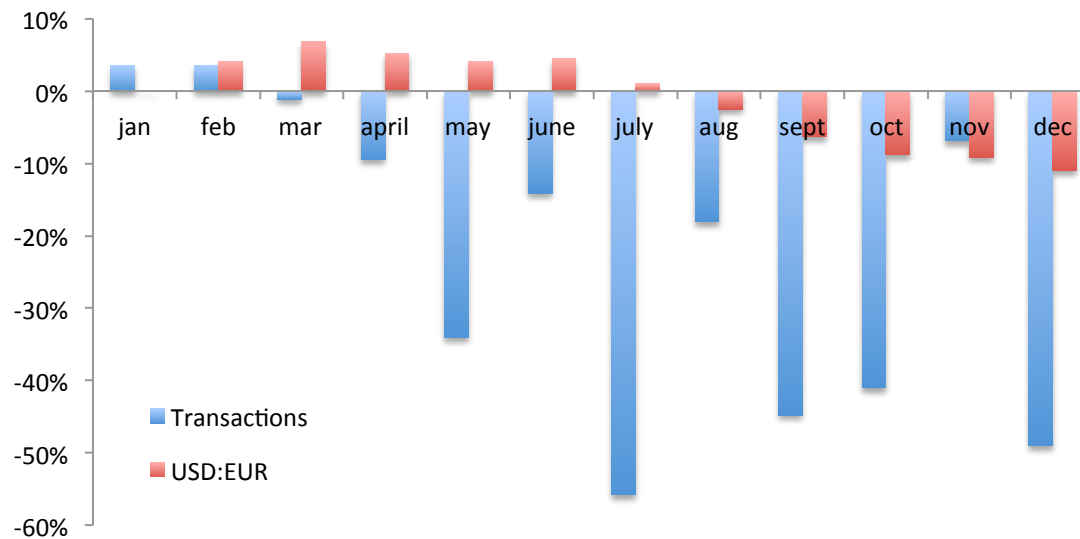


The Sterling appears to exert almost no pressure on transactional activity over the last year, implying that buying pattern here should remain relatively unaffected in light of currency volatility insofar as the latter remains muted, as has been the case for the observed time frame.

USD:EUR and Real Estate Asset Transactions

USD:EUR vs Dubai Real Estate: 2013/2014 % (YoY) Change

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The Euro appears to exert the greatest pressure on underlying real estate investor sentiment. This implies that Euro weakness will contribute towards further weakening of asset values, especially if this trend is expected to continue.

Conclusions

A correlation analysis reveals that there is a strong relationship between real estate prices and the DFM, both in the short and the long term

The Euro appears to exert the greatest pressure on underlying real estate investor sentiment

Real estate and Commodities / Equities

There is a strong correlation between the DFM and real estate prices, where the former is a leading indicator

Historically, oil has had a weak correlation, with real estate asset prices, but however the recent oil crash, has caused a 25% drop in the DFM in the last month, causing a weak sentiment across the board

Performance of Investment Instruments

A comparison between different asset classes such as Dubai real-estate, DFM, Gold, and oil, highlights the superior nature of real estate in both near and long term investing.

A time-series analysis shows that the best performer has been real-estate, followed by gold, DFM, and oil, over the longer term. With fundamentals remaining in place, we opine that this trend will continue

Real estate and Currencies

Currency fluctuations have a strong correlation on transactional activity, influencing buying patterns. In the currencies studied the Euro had the highest correlation, followed by the Ruble and the Pound

With the sudden deprecation of the ruble we expect their to be decrease of demand for high-end properties, as Russian Nationals were a high percentage of the buyers

Outlook

Recent gyrations in the global markets will undoubtedly effect real estate prices in the medium term, as resulting impacts assert themselves through historical correlations, particularly at the higher end of the market

This expected price drop represents an opportune time for investors to return to first principles by focusing on higher yielding real estate assets given the “New Normal” economy that global real estate markets are currently in.

Appendix A: Dubai Real Estate Versus 'Other Investments'



“Lower-income Americans — those living in households earning less than \$30,000 in annual income — preferred gold to stocks, savings accounts and bonds”

“Upper-income Americans are much more likely to say real estate and stocks are the best investment, possibly because of their experience with these types of investments”

Gallup Poll

Real Estate and Stocks Yield Superior Returns

	Real Estate*	DFM	GOLD	OIL
2007-date	118%	-26%	91%	16%
2008-date	66%	-47%	35%	-33%
2009-date	58%	91%	37%	42%
2010-date	83%	82%	8%	-22%
2011-date	98%	91%	-11%	-36%
2012-date	84%	129%	-28%	-47%
2013-date	55%	76%	-28%	-46%
2014-date	19%	-14%	-4%	-44%

*Assumption: 5% rental yield included per annum

Financial Markets have the most Volatile Behavior

	Real Estate*	DFM	GOLD	OIL
2007	37%	39%	29%	71%
2008	11%	-69%	-9%	-56%
2009	-12%	10%	30%	78%
2010	-6%	-3%	25%	17%
2011	10%	-16%	22%	16%
2012	22%	19%	1%	-5%
2013	51%	163%	-27%	-22%
2014	19%	-14%	-4%	-44%

*Assumption: 5% rental yield included per annum



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The Ruler of Dubai and Prime Minister of UAE

