Better Homes
# Commercial REview

Quarterly update

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**Commercial REview is researched and compiled to provide the reader a complete overview of the commercial property market in Dubai. It contains upto date market data and highlights all key trends and market movements.**

## OVERALL REAL ESTATE MARKET

As Q3 drew to a close, the Dubai market continued its blistering pace of development. The rising stories of the Burj Dubai, the centerpiece of the ambitious Downtown Dubai development, served as a continuous reminder that the construction boom is still very much underway. Escalating rents across all sectors continued into the 3rd Quarter, with office rents increasing 15% in prime CBD locations.

- **Commercial office space** continues to experience healthy demand with both regional and multinational companies finding it strategically important to be situated in Dubai. Q3 office rents are now trading as high as AED225-250 per sq. ft and 150-170 per sq. ft for prime and secondary locations respectively. Free zones, in conjunction with heavy investment in infrastructure, continue to provide an impetus to investors and end users alike to look to the Emirate for their business needs.

- **Retail space** continues to perform well, buoyed by both consumer's voracious appetite for consumer goods, from fashion to high-end technology, and the Summer Surprises Festival. Q3 retail rents continue to increase, with showroom space along Sheikh Zayed Road (Interchange 5) trading at AED200 per sq. ft with space closer to the downtown Central Business Districts (Interchange 1) trading as high as AED450 per sq. ft. The Deira side of the Creek has seen rates move from 250 to 450 per sq. ft over the past year, though over Q3 they have not moved significantly. The levels of increase in retail rates depends very much on the location and build quality of retail space, such as Mall of The Emirates, that segments its retail space pricing on a number of criteria such as proximity to major retailers. With new state-of-the-art shopping malls planned or under construction, existing shopping malls are being refurbished in order to retain shoppers in an ever-maturing, competitive retailing landscape.

- **Industrial space**, as well as labor camps, continue to be highly sought after due to Dubai's sustained economic growth. Leasing rates are highly dependent on the area and build quality of particular industrial buildings. With high lease rates for most industrial space, many companies are opting to build their own warehouses to better suit their needs. High demand for labor camps is fuelled by a sustained construction boom which is showing no signs of slowing down. This is further compounded by a recent push by the Dubai Municipality to clamp down and evict groups of bachelors living in 'family-designated' apartments and homes, who often live with many to a room.

### Jumeirah Lake Towers: Jack of all trades, master of one

Though the lights are still out as contractors do their last minute wiring, there is not much that can dampen the glow of Jumeirah Lake Towers (JLT) as it is poised to become Dubai's first non-industry specific free zone. The JLT freezone will be open to all industries with the exception of general trading businesses, and its tenants will be able to enjoy all the rights and privileges attached with being in a designated free zone. JLT will also be home to one of the most prestigious industry-specific clusters, the Dubai Metals & Commodities Centre (DMCC). Currently, there are 800 companies registered within the DMCC. This number is expected to go up sharply once the free zone is fully operational and developed over the next two to three years.

# Economic Eye

- Inflation: 17-23% (annual, est.)
- No. of new trade licenses issued: 1,963 (Q2, 2006, excludes free zones)
- Vacancy: 1%
- Cement: +6.9% ▲
- Steel (re-bar): -3.2% ▼
- Aluminum: -1.08% ▼
- Copper: +7.0% ▲

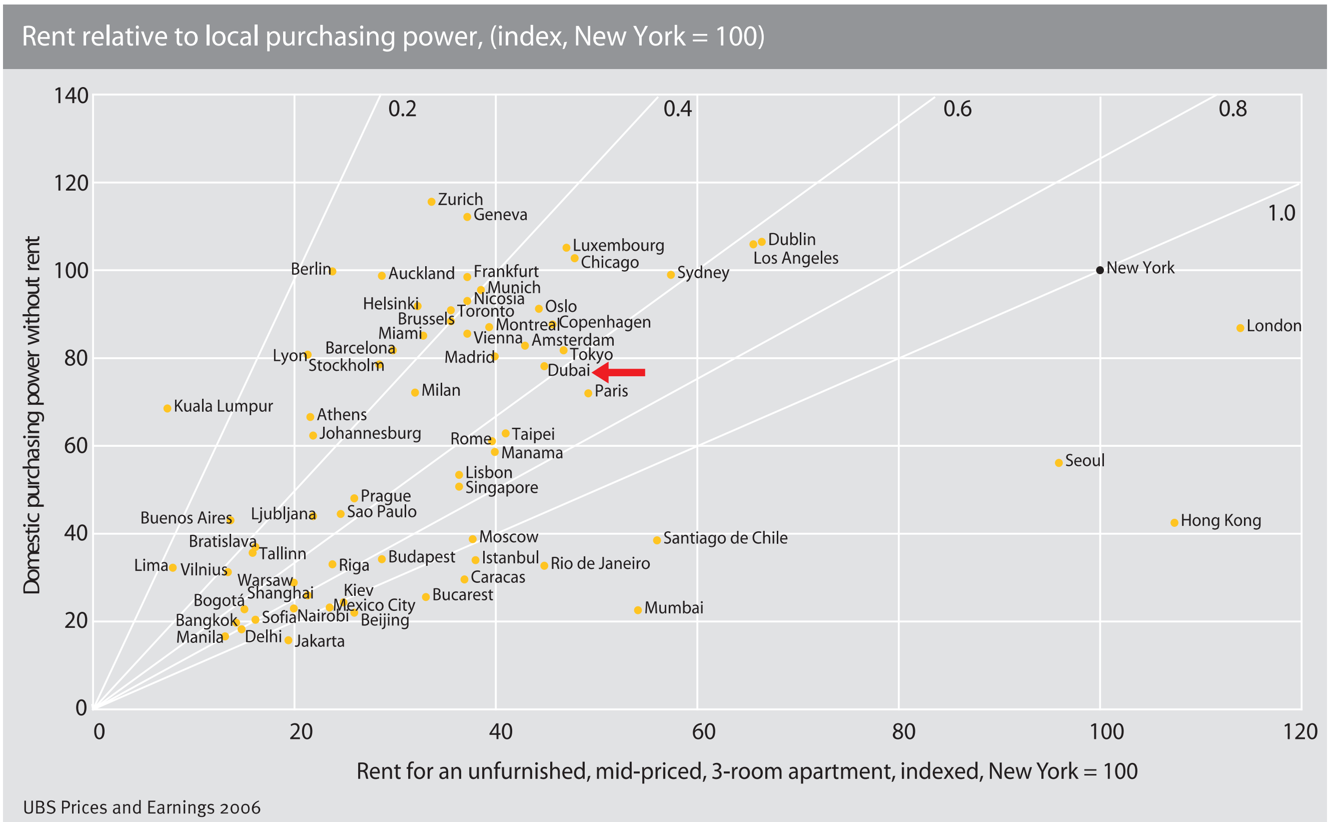
## Geopolitics and the Market

The Israeli-Lebanese conflict does not seem to have significantly affected the Dubai economy or trade in the region. However, it is anticipated that Dubai will be competing with Beirut for construction raw material inputs such as cement, driving up prices. The spillover effect of refugees relocating to the UAE, in addition to regional businesses relocating their offices to the Emirate, undoubtedly strained an already tight residential and office supply, though it is too early to tell if this will be a short-term problem.

A significant amount of Lebanon's infrastructure was destroyed, with some analysts predicting the war has set Beirut's recent “renaissance” back at least 10 years. UAE-based companies have over AED10 billion worth of investments in Lebanon, of which roughly AED8.5 billion was committed to the real estate sector. These companies had particular exposure to sectors such as hospitality, tourism and financial services.

Construction costs also continued to rise, with companies often re-pricing their construction rates on a monthly basis. Re-pricing is fuelled by an increase in raw inputs such as cement and copper coupled with a shortage of qualified labour. However, aluminum and steel prices have marginally retreated. On average over the past twelve months steel prices have risen, although this has trended slightly lower in the last quarter. On average, construction costs have more than doubled since 2002. Though there is very little consensus on exact costs, the construction costs for high grade office is now estimated at more than AED325 per sq. ft. The sky-high costs of construction material and labour continue to be a concern for developers as they can no longer rely on stable rates over the course of their development build. Many are concerned that their financial returns will be adversely affected as they are forced to absorb contractors passing on the rise in their raw material costs. In addition, as much of Dubai's labour force is sourced from South Asian countries, in particular India, Dubai will have to compete with this emerging giant, which is currently experiencing 8-9% growth in GDP per annum.

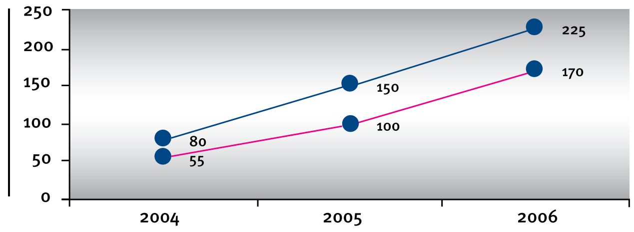
### Rent relative to local purchasing power, (index, New York = 100)



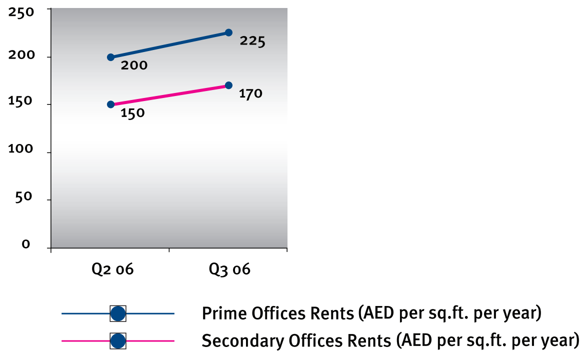
The Dubai stock market continues to struggle as weary investors look elsewhere for attractive returns after the market's dismal performance over the past year. Although property continues to be a favorite, this sector comes with its own risk as delivery delays and rising construction costs may adversely affect expected returns. Despite hiccups in the local market, the DIFC continues to push ahead on its ambitious objective of becoming a world-class exchange comparable to New York, London, and Hong Kong.

It is well known that the cost of accommodation continues to be a problem among many Dubai residents who spend a significant portion of their salary on their housing requirements. Though Dubai's workforce enjoys high wages and tax-free status, many find it difficult to spend what they perceive is a disproportionate amount of their disposable income on rent. A recent study by UBS captured 'rent relative to local purchasing power' and shows that despite this sentiment, apartments in Dubai are almost half as much to rent as in New York when compared to purchasing power.

Office Rents (2004 - 2006)




Office Rents
(Last 2 Quarters)




## Market Moves

### a) Office Product

By the end of 2007 it is estimated approximately 7.3 million sq. ft of office product will be ready for hand-over. With occupancy levels close to 100%, developers are scrambling to bring product to the market that will both satisfy this demand as well as supply that is expected make Dubai the premier business hub in the Middle East.

One office development in particular seems poised to take advantage of demand for the immediate need for high grade office space. Jumeirah Lake Towers (JLT), a mixed-use development, that is available on a freehold basis with an estimated 5.6 million sq. ft net leasable area of office space. This development will be delivered over the next 6 to 26 months, with sales prices ranging from AED 750 – 1100 per sq. ft. JLT is particularly unique as it is the one free zone in Dubai that is not restricted to a specific industry. Although it will house the Dubai Metals and Commodities Centre – including the prestigious Dubai Gold & Commodities Exchange and Dubai Diamond Exchange – it will have nearly 70% of its space available for businesses wishing to locate in a free zone. However, since the office space will be owned by independent landlords, the tenancy terms and rentals are likely to vary.

Consensus among real estate professionals is that office rents continue to increase, with lease rates in the last quarter up 13%. As per the graph below, annual rents for both Prime and Secondary office climbed upwards from AED200 to AED225 per sq. ft for prime and AED150 to AED170 per sq. ft for secondary office locations. There are pockets of relief such as Dubai Festival City which has offered more tenant friendly, longer term leases to hedge against a possible market correction. Though the anticipated supply of office space is expected to increase substantially with Business Bay, Jumeirah Lake Towers, and DIFC, this supply will not be released onto the market for the next three to five years, supporting the current high rental rates.

### b) Retail Product

The retail sector continues to perform well, buoyed by both consumers' appetite for consumer goods, from fashion to high-end technology, and the Dubai Summer Surprises Festival. In addition to new, state-of-the-art shopping malls planned or under construction, existing shopping malls are being refurbished in order to retain shoppers in an ever-maturing, competitive market. Most notably is Al Ghurair City, which will inject approximately AED 2.0 Billion into its expansion and re-branding.

In contrast, a recent interview with the leasing manager of a more modest neighborhood mall revealed this mall's own plans for both internal renovations and an external makeover. This will include upgrading its elevators and escalators, the replacement of its floors and ceilings, and the improvement of its exterior façade. This neighborhood mall is home to about 50 stores, averaging 800 sq. ft per store, and serves primarily the local neighborhood.

In Q3, the Mall of the Emirates, with Ski Dubai, continued to solidify its position as one of the strongest performing malls in the Emirate. It currently has a long waiting list (estimated at over 55 companies). The arrival in late summer of heavyweight retailer H&M at Mall of the Emirates brings this trendy and affordable Swedish retailer to the Dubai masses, which has let approximately 16,000 sq. ft of retail space in two locations within the mall. Deira City Centre enjoys consistent popularity due to its prime location, though it remains hard-pressed to accommodate further growth due to limited parking space.

The main challenges facing new retail is to create a well designed, well balanced and top quality retail mix that provides an accessible and unique experience. Malls from major developers, such as the Al-Futtaim Group have tested the retail waters by developing Dubai Festival City's marina side, a 'fusion' of restaurants, nightlife, shopping and canal promenades. In addition, Emaar is developing The Dubai Mall that will have the world's largest mall aquarium amongst other attractions. Together these two malls will set the bar for retail in the region for years to come. Smaller developers are also looking to capitalize on developing projects for this visibly hot market, most notably Five Star Group with its Zabeel Mall. The retail market in Dubai continues to expand, with unique selling points, parking and accessibility continuing to be the name of the game in Dubai.

According to the major developers the retail horizon appears bright, provided that the projection of 15 million tourists visiting Dubai by 2010 can be realized and that population growth continues.

A recent AC Nielsen online consumer confidence survey of over 42 countries revealed that 30% United Arab Emirates' respondents are recreational shoppers - those who shop at least once a week for "something to do" or for "entertainment", and is second only to Hong Kong. This is likely due to Dubai's mall culture, prompted by the extreme summer temperatures, the Dubai Shopping Festival (cancelled for 2006) and Dubai Summer Surprises, which increase consumer spending in malls by up to 50% for their duration. The demand from the resident population could be impacted by the sharp increases in the cost of living which will have an impact on consumer spending.

The competitiveness of the retail market suggests excessive retail rents, with base asking rates for premium retail space shooting up approximately 80% over the last 12 to 18 months to AED450/sq.ft. The popular Spinneys retail chain has publicly lamented that high rents are limiting its expansion plans to small store openings and is not prepared to commit to long-term contracts at current rates.

## c) Industrial Product

Industrial real estate in Dubai continues to be a much sought-after product as businesses and factories continue to demand space to support their local and regional operations. Nevertheless over the past quarter, industrial rates have for the most part remained unchanged. Most landlords in this sector are waiting for indications of increased demand after the Ramadan holiday before they decide to re-price their industrial holdings. Depending on the type of Industrial space required and its location and quality, product is currently trading at approximately AED27-28/sq.ft with 'Jebel Ali Industrial' commanding rates in the AED30-plus range. Industrial activity has long been the backwater of Dubai's more attractive real estate sectors, which have enjoyed center stage. There has however been significant activity and new development in this area, with most new product located in Dubai Investment Park. This area is anticipated to be the industrial future of Dubai. The neighboring cargo airport will spur future demand for industrial space as businesses will look to strategically locate as close to the periphery of the airport as possible.

The expansive master-planned Dubai World Central (DWC) airport and logistics hub will further raise the appeal of the industrial sector, realizing Dubai's aspirations to be a top global trade and logistics hub. Agents are already dealing with companies looking to locate in proximity to DWC. Indeed industrial uptake at Dubai Investments Park has been so strong that it now has a waiting list and rental rates for land have increased from AED1.50/sq.ft to 2.50AED/sq.ft since January of this year.

Dubai Logistics City (DLC) has recently completed phase one grading operations and tenants are now able to begin construction on the land. Currently more than 85 regional and international companies have reserved land at DLC, totaling in excess of 26.9 million sq. ft. HH Sheikh Ahmed bin Saeed Al Maktoum, Chairman of the Dubai Aviation Corporation anticipates that 64.6 million sq. ft of land will be leased out by 2008.

Renting Industrial space continues to be a "seller's market". Often landlords refuse to negotiate on prices or guarantee leases for more than one year, prompting more and more companies to build their own fit-for-purpose warehouses. Currently there is a big market for pre-fabricated, pre-cast construction, especially for simple structures as required in warehousing and labor camps.

Companies are continuing to be innovative in how they use their warehouse space. Though 'storage' designated industrial space can only be used for holding inventory, 'commercial' designated industrial space allows for 10% of the built up area to be used for office. For businesses requiring more than 10%, permission must be granted by the municipality.

As industrial real estate vacancies diminish and rental rates increase 10% to 15% per annum, tenants are tending to seek the security of longer term leases from between 2 to 4 years.

## d) Labor Camps

The market for labor camps is heating up. The supply of labor accommodation is expected to see significant growth as the construction sector looks to consolidate living spaces for their staff. It is expected that short term demand for leased and ready labor accommodation will continue, though this is an indication that companies, increasingly disgruntled with rent hikes, are looking to secure land leases to construct their own purpose-built facilities.

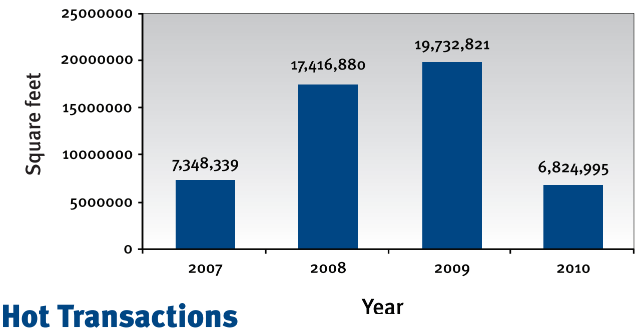
Demand for new, higher quality staff accommodation is also on the rise since the construction sector is under pressure to walk the Dubai Government's line on standards for living conditions. The municipality is clamping down on illegal bachelor housing throughout the city. This policy has been influenced by criticism from a number of international human rights groups.

# Demand & Supply

The demand for space across all sectors remains very strong, especially in office and industrial, with near 100% occupancy recorded. In particular, given the lack of office supply in the market, astute developers have been trying to capitalize on this opportunity by building short stack office complexes with short development timelines rather than multi-storey towers that often take 24 to 48 months to complete. In this way, they reduce the risk that the market will turn before their development is completed. Furthermore, potential tenants and purchasers are in many instances willing to pay premiums for short build/delivery timelines. Generally speaking, short stack office blocks cannot be considered Grade A+ space by international standards but with a growing number international companies establishing a presence in Dubai, there is still a significant requirement for this type of functional, yet prestigious office space.

The following table projects the total new supply of office space coming online, based on announced projects to date. This estimates the amount of mixed use space in Business Bay that will be designated commercial and does not include Dubai World Central.

### Expected Office Supply




### Hot Transactions

- A company in Dubai Media City recently procured office approximately 10,000 sq. ft of office space for AED250 per sq. ft.
- A 10,000 sq ft warehouse in Al Quoz 4 was recently leased to a firm from Saudi Arabia at AED 40 per sq. ft.
- A new commercial tower in Bur Dubai leased approximately 17,000 sq. ft. of office space at AED 260 per sq ft.

# Emerging Trends

### Increased Appetite for Longer Term Leases

Longer term leases continue to be more widely accepted in the Dubai market. Due to rapidly appreciating lease rates over the past four years, driven by an insufficient supply of office space, pricing power remains with landlords. However, landlords are starting to take note of upcoming supply and are agreeing to more three and five year contracts.

As new floor space comes onto the market and tenants are in a stronger negotiating position, landlords will look to secure cash flow and occupancy over the longer term. Further as the market matures and investment funds look to accrue assets in the market, they will look for properties which are secured with long term tenancy contracts, a common practice in more mature property markets internationally.

Similarly, the retail sector lacks what is considered medium to long term lease transactions, with the majority having 2 to 3 year terms. Upward adjustments are often applied every 12 months in mall destinations with 100% occupancy. It is anticipated that retail space will be the first sector to start signing longer term leases en masse, primarily because of the high fit-out costs associated with setting up a retail space.

Below is a snapshot of transactions to illustrate the changing trend towards longer term leases:

- A new tower development in the Garhoud area has offered three years leases at an average of AED190 per sq. ft for its Grade A office space.
- A law firm took approximately 4,500 sq. ft in DIFC on a five year contract; the exact lease rates have not been disclosed.

Longer term it is anticipated there will be a more balanced leasing market as an increasing supply of offices will make for more equitable leasing rates.

### Hotel demand wanes over the summer season

Tourism figures for Dubai have seen a decline over the summer season with tourist traffic down compared to previous years. According to management at a major hotel chain in the Emirate, the industry has suffered throughout this hot summer season compared to 2005. In early June, one hotel was reported to have seen occupancy drop to 60-65%, compared to the high occupancy levels in 2005 of around 80%.

These occupancy figures are backed up further by a prominent beach front property, which experienced a drop in occupancy from 77% in May to 64% in July, highlighting sharp movement in the market from the end of Q2 to the beginning of Q3. However, this reduction in occupancy rates was lessened by the significant demand for short term accommodation from middle to high income Lebanese refugees who sought safety in Dubai during the recent conflict.

However, despite this mid-summer slowdown, occupancy for the first six months of this year were the highest in the GCC, at 89.9%, boding well for the coming months as cooler temperatures and some of Dubai's popular international sporting events kick into high gear.

# Project Spotlight – Dubai Festival City

### Offices to lease in world class creek-side commercial hub

The first commercial offering, Festival Tower is now leasing. The signature, 30-storey premium office building is offering 530,000 sq ft of 'A' Grade office space. The highlights include;

- Occupation first quarter 2007
- Minimum office space from 2,500 sq ft
- Ample parking
- 12 passenger lifts and 1 goods lift
- Adjacent to Festival Waterfront Centre, a 2.6 million sq ft retail, leisure and entertainment resort with over 550 shops, 90 restaurants and cafés and 150-berth Festival Marina
- Easy access from the soon to open 12-lane Ras Al Khor bridge and Garhoud bridge.
- Just 2km away from Dubai International Airport
- Superior environment - 20,000 luxury homes, Four Seasons Golf Club featuring the 18-hole championship Al Badia Golf Course, two International Schools, Festival Power Centre - 'Big Box' retail and Automotive Park

دبي فستيفال سيتي
Dubai Festival City


The unrivalled business environment at Dubai Festival City will be of benefit to both company executives as well as to all their personnel. The InterContinental and Crowne Plaza with their 800 rooms, suites, apartments and shared convention facilities are all connected to Festival Tower.

Dubai Festival City is the highly acclaimed development by the Al-Futtaim Group stretching over 4 kms along the Dubai Creek.

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# About Us

## Better Homes

Leading the way in Dubai real estate for over 20 years, Better Homes has the finest and most comprehensive listings of property in the region. With the only trained and certified property consultants in the UAE, no one understands property better.

Better Homes' Commercial Advisory offer leasing and sales brokering services for commercial properties. So whether you're searching for an office, retail outlet or industrial space such as a warehouse or labour camp; Commercial Advisory has the most suitable and cost effective solution to allow your business to achieve its full potential.

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## Investment Boutique

Commercial REview has been researched and compiled by Investment Boutique on behalf of Better Homes.

Investment Boutique is a UAE limited liability company, which provides advisory services such as market research, RICS valuations and feasibilities studies; advises regarding syndicate finance and employs niche development expertise in regional property projects.

INVESTMENT BOUTIQUE

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