Jones Lang LaSalle

Real value in a changing world

/pulse/

MENA House View – December 2010

MENA Industrial Market On the Rise

Key Findings:

- Real estate markets across MENA will see a significant shift in emphasis over the next few years, with far greater attention being focussed on the light industrial/logistics market. This is consistent with government initiatives to expand the volume of trade which forms an integral component of efforts to diversify the region's economic base from the oil and gas sector.
- Light industrial/logistics will be one of the best performing sectors of the real estate market across MENA over the next few years. This sector has not witnessed the same level of speculative construction as the residential, commercial and hotel sectors of the market. There remains strong underlying demand for quality light industrial and logistics units. This demand will be enhanced by continued investment in major new transport infrastructure including seaports, airports and important new rail initiatives across the GCC.
- Given its strategic significance to the overall economy, the light industrial/logistics market has been tightly controlled by individual governments in the MENA region. While there are increasing opportunities for private sector investment in this sector, the barriers to entry remain higher than in other sectors of the real estate market.
- There has been increased interest in this sector from a range of regional and international investors and developers over the past two years. Despite the difficulties in accessing this market, Jones Lang LaSalle expects this interest to be reflected in higher levels of sales activity in this emerging class.
- Investor interest is likely to be strongest for those properties securely leased to major international occupiers on long-term leases. The light industrial/logistics market offers more opportunities for investors looking for secure, long-term income producing assets than other sectors of the real estate market.

Introduction

Trade and the movement of goods have long been at the heart of the development of the MENA region. In recent decades, governments across MENA have sought to build upon the region's strategic location to develop the trade and import/export sectors of their economy. Most noticeable in this regard has been Dubai, with Sheikh Rashid's economic vision for the Emirate based upon an expansion of trade through major investment in its seaport and airport capacity.

Efforts to broaden the economic base of the region away from its dependence on oil and gas have involved initiatives in many different sectors over the past few years (including tourism, finance and real estate). The global financial crisis of 2008 – 2010 is likely to result in a return to the traditional focus on trade as a key component of the drive to diversify regional economies over the next few years.

The industrial sector has developed less rapidly than the residential, commercial and hotel sectors where most of the development activity was focussed. The industrial sector has however evolved significantly being increasingly characterised by light industrial, logistics, distribution, and warehousing.

Jones Lang LaSalle expects the industrial sector to be one of the strongest performing sectors of the real estate market across MENA, attracting increased interest from both regional and global real estate developers and investors. As the sector continues to evolve, government incentives and initiatives to stimulate demand will create opportunities in areas such as scientific research, information technology, communication and other light industrial activities.

With industrial being one of the most closely aligned sectors to the ongoing drive to diversify and expand the region's economic base, it is an opportune time to release a report on this '**Cinderella Sector**'. This report covers three major topics:

1. Key drivers of occupier space selection for light industrial/ logistics real estate
2. Major industrial real estate markets in the MENA region
3. Emergence of industrial investment market

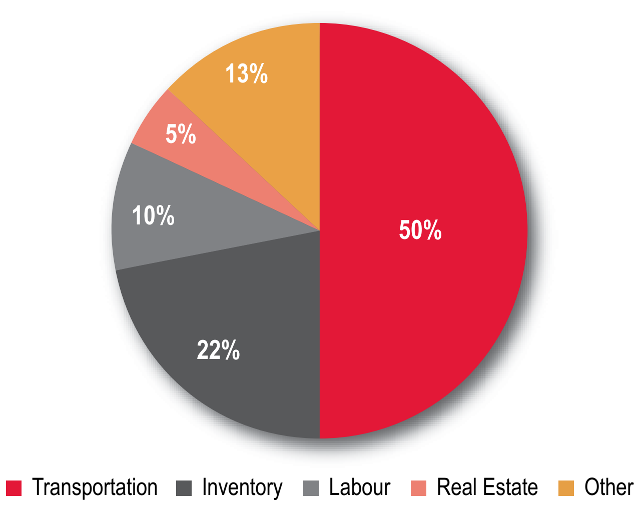
Key Drivers of Occupier Space Selection

Four major factors are expected to drive future occupier selection of light industrial and logistics real estate in the MENA region. These are:

1. Total Operating Costs

Today's market conditions command a greater focus on more immediate challenges, with cost reduction being a priority in remaining competitive. Research on the cost structure of light industrial and logistic operators reveals the three largest costs are typically transportation, inventory and labour (see Figure 1).

Figure 1: Breakdown of Operating Costs for Logistic Companies



Source: Exchange, Inc.

Although the real estate cost typically comprises just 5% to 10% of total operating costs, it directly impacts and is important in optimising the link between other cost factors. The correct choice of industrial real estate therefore has a major impact on operating cost. Choosing a strategic location close to major ports and other large infrastructure developments will ultimately reduce operating costs, and more specifically those related to transportation/inventory turnover time. In current market conditions, occupier activity is increasingly driven by the need to reduce logistics costs.

Figure 2: Why Real Estate Matters

Source: Jones Lang LaSalle

2. Location

Location is considered the second most important driver of occupier decisions in respect of industrial real estate. The closer the industrial operations are to customers and the more accessible they are to multimodal transport infrastructure, the greater the likelihood that logistics costs are reduced. This rationale for example is most clearly illustrated in older areas of Dubai that cater to local markets and are therefore able to command premiums on real estate, although they offer an inferior product and less sophisticated infrastructure systems. Industrial occupiers will typically assess an area's linkage to the overall transportation network and how it influences their ability to connect with customers when reviewing real estate options.

3. Infrastructure

Major regional and national transportation projects undoubtedly influence the development of the industrial sector. Projects such as the Al Maktoum International Airport in Dubai World Central, the GCC Railway, Khalifa Industrial Zone Abu Dhabi (KIZAD) and the King Abdullah Economic City Port will have a significant impact on the industrial landscape of the region by creating major logistical synergies and enhancing overall connectivity. Infrastructure also refers to the internal and external transportation network that is readily accessible within an industrial development and its connectivity to other major industrial areas. Industrial areas that offer internal connectivity within the site itself, as well as good external connectivity through direct links with major infrastructure networks will generate the most interest.

Dubai is the regional leader in the logistics sector, given its more sophisticated and advanced transportation infrastructure network, which has attracted multiple international players to the market. Moreover, because Dubai's infrastructure systems are already largely in place, it is recognised as the regional hub.

4. Quality of Real Estate Product

High quality real estate increases the attractiveness of an industrial project. It is interesting to note however, that while quality is an important factor, its influence is actually quite subdued when compared to other major factors such as cost and location. Premium developments reflect the quality of the physical premises (with buildings offering multipurpose, large efficient spaces), as well as the overall package offered by the industrial estate such as the availability of ancillary office space, staff/labour accommodation and support retail, which effectively enhances the product's synergies and creates a 'one stop shop' solution.

Major Industrial Markets in MENA

Dubai

Based on the factors mentioned above, Dubai is at the forefront of the industrial market in the region, and is home to nearly a dozen industrial areas. There is currently a total of approximately 65 million square meters of industrial stock in Dubai, comprising two distinct submarkets that are defined as free zones (with 100% ownership being the primary advantage) and non free zones. The free zones contribute approximately 27.5 million square meters of stock to the total, while the remaining 37.5 million square meters is in the non free zone areas. Older areas in Dubai are able to achieve nearly full occupancy, largely because of their early establishment during Dubai's period of prime economic growth. A shift towards the newer industrial areas is likely over the medium term because of several factors such as better infrastructure systems, better quality real estate products and proximity to major infrastructure projects. This could also potentially be facilitated by legislation.

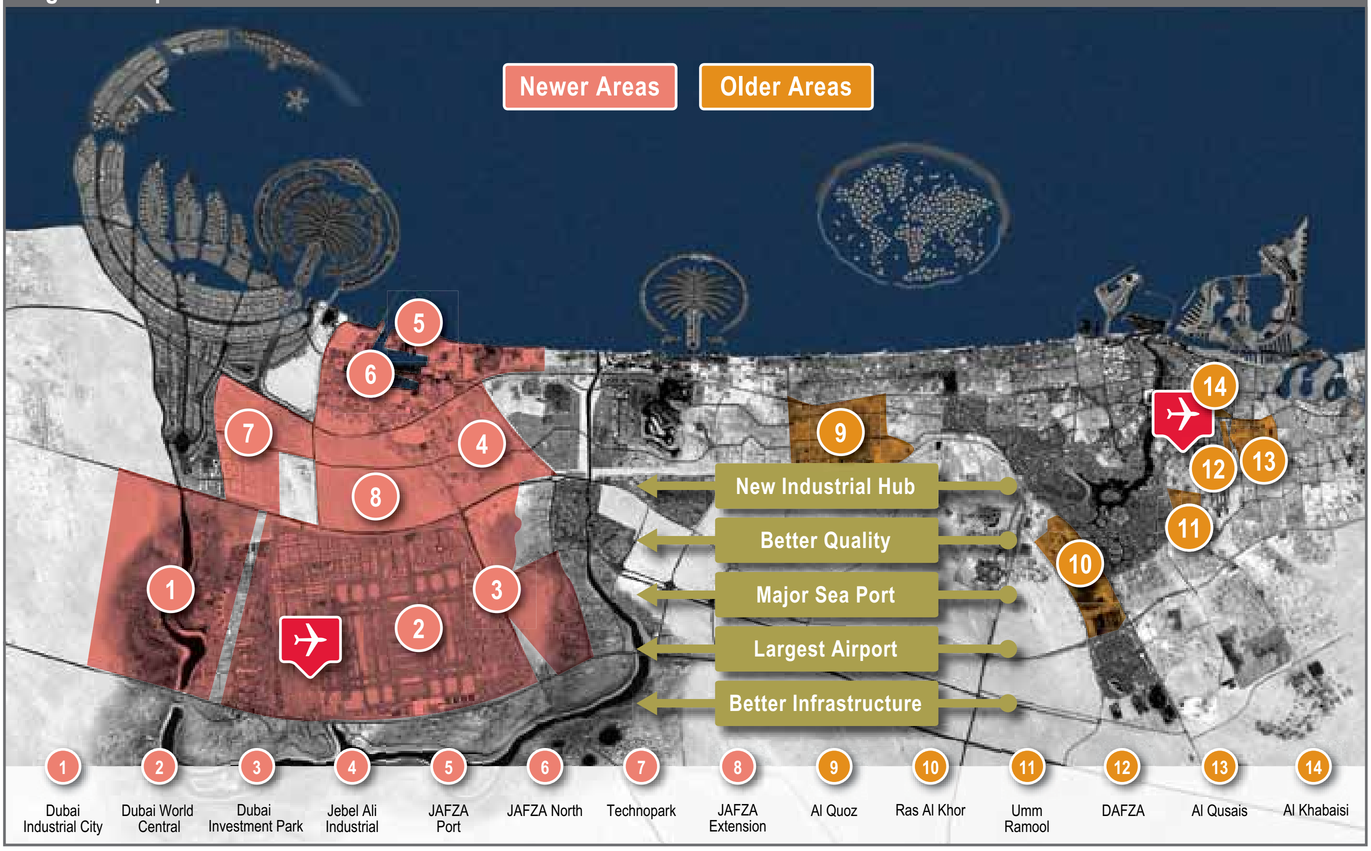
Rental rates in Dubai currently vary significantly from one area to another, mostly because there is no real standardisation of logistics facilities. Higher rental levels are found in some of the older and more established areas, despite their congested nature and the poorer quality of premises available. This is primarily because they benefit from proximity to their base markets and customers.

Table 1: Market Performance – Dubai

	Rents (AED/sqm/pa)	Land Lease (AED/sqm/pa)
Older Areas	300 – 400	50 – 80
Newer areas (excluding JAFZA/DAFZA)*	250 – 350	25 – 40
JAFZA/DAFZA	500 – 600	70 – 110

* Jebel Ali Free Zone/ Dubai Airport Free Zone

Figure 3: Map of Dubai Industrial Areas



Abu Dhabi

There is currently a total of approximately 16.5 million square metres of industrial space in Abu Dhabi, comprising two major industrial areas including Mussafah, which is older and more developed, and Industrial City of Abu Dhabi (ICAD), which offers large amounts of currently undeveloped industrial land. ICAD is operated by ZonesCorp, a government backed corporation responsible for the establishment, management and operation of specialised economic zones across Abu Dhabi.

In November 2010, the Abu Dhabi Ports Company received approval to establish the Khalifa Industrial Zone Abu Dhabi (KIZAD) which will be the first industrial free zone in the area, and is strategically located halfway between Abu Dhabi and Dubai. Khalifa Port will be the development's flagship and is surrounded by industrial land estates as an effort to stimulate industrial activity, especially foreign investment. KIZAD is expected to be operational by the 4th Quarter 2012 and by 2030, is expected to contribute 15% to Abu Dhabi's non-oil GDP.

Abu Dhabi average industrial unit rents are around 25% to 30% higher than Dubai, driven primarily by the higher industrial rent rates in Mussafah. In the medium to long-term better quality product, integrated developments and more advanced infrastructure will be required to attract sophisticated tenants and create investment grade product. The required transformation and evolution of the market has been recognised in Abu Dhabi and great strides have been made in establishing the new industrial areas ICAD and KIZAD.

Table 2: Market Performance – Abu Dhabi

	Rents (AED/sqm/pa)	Land Lease (AED/sqm/pa)
ICAD	350 – 400	15 – 30
Mussafah	400 – 550	80 – 110*

* Refers to secondary lease rates as primary leases from government are virtually unavailable.

Riyadh

Although Riyadh currently does not have proximate access to major infrastructure projects, its industrial development is probably one of the most advanced in Saudi Arabia. Projects such as the Saudi Landbridge Railway, which aims to link the main ports of Jeddah, Riyadh, Dammam and Jubail through a developed network, will allow opportunities for more advanced transport routes/trade flows, and represents one of the government's most ambitious expansion plans. The government has also implemented a new land use plan in an attempt to cluster industrial areas to the south of the city. Additionally, a plan has been approved to double the industrial sector contribution to GDP from approximately 10% in 2009 to 20% by 2020.

While Saudi's industrial market has traditionally been characterised by heavy industry supporting the oil and gas operations, there is an increased focus on light industrial development in an effort to diversify the economy and enhance the competitiveness of Saudi's industrial sector.

Table 3: Market Performance – Riyadh

	Rents (SAR/sqm/pa)	Land Lease (SAR/sqm/pa)
Faisaliah	200 – 250	50 – 80
Suley	150 – 200	10 – 15*

* Lease rates refer to large parcels (200,000 square meters or more).

Unlike the UAE, the industrial market in Riyadh has little or no design built developments and most local conglomerates prefer to keep warehousing and distribution inhouse, although we anticipate there will be a shift to outsourcing in the long-term.

Jeddah

The industrial areas in Jeddah are situated as feeder areas to other source markets within the Kingdom, and most developments currently offer relatively poor quality real estate assets. Industrial areas in Jeddah are currently scattered across the city, with no real defined areas for industrial development. Most of the demand for space in Jeddah is from Saudi companies servicing the local market with relatively little interest from multinational companies. It is anticipated that the infrastructure planned for the Jeddah region, including the new port within the King Abdullah Economic City, will play an important role in spurring industrial growth in Western Saudi Arabia. Jeddah will benefit from this trend and is expected to define appropriate new areas for industrial development to showcase a more cohesive approach to developing this important market segment.

Table 4: Market Performance – Jeddah

	Rents (SAR/sqm/pa)	Land Lease (SAR/sqm/pa)
Al-Khomrah	70 – 120	35 – 40
Quwaizah	200 – 250	60 – 80

Cairo

Industrial zones in Cairo are currently dominated by light and medium industrial activities which comprise 93 zones. There are 27 zones identified as heavy industrial. The quality of industrial real estate product typically varies from low to medium, depending on the location and accessibility of the site, although it is worth mentioning that some newer areas integrate mixed-use supporting real estate such as office and retail. Although industrial areas are generally spread throughout the city, some industrial cluster developments such as 6th of October are starting to evolve, and have attracted a number of international tenants. In an effort to promote the industrial sector, the government has also recently established the Industrial Development Authority (IDA) to facilitate registration procedures and stimulate international investment interest. In the long-term, Cairo's location as the gateway to other North African countries and the MENA region, supported by a relatively developed infrastructure base, will attract more global attention and improve Cairo's industrial competitiveness.

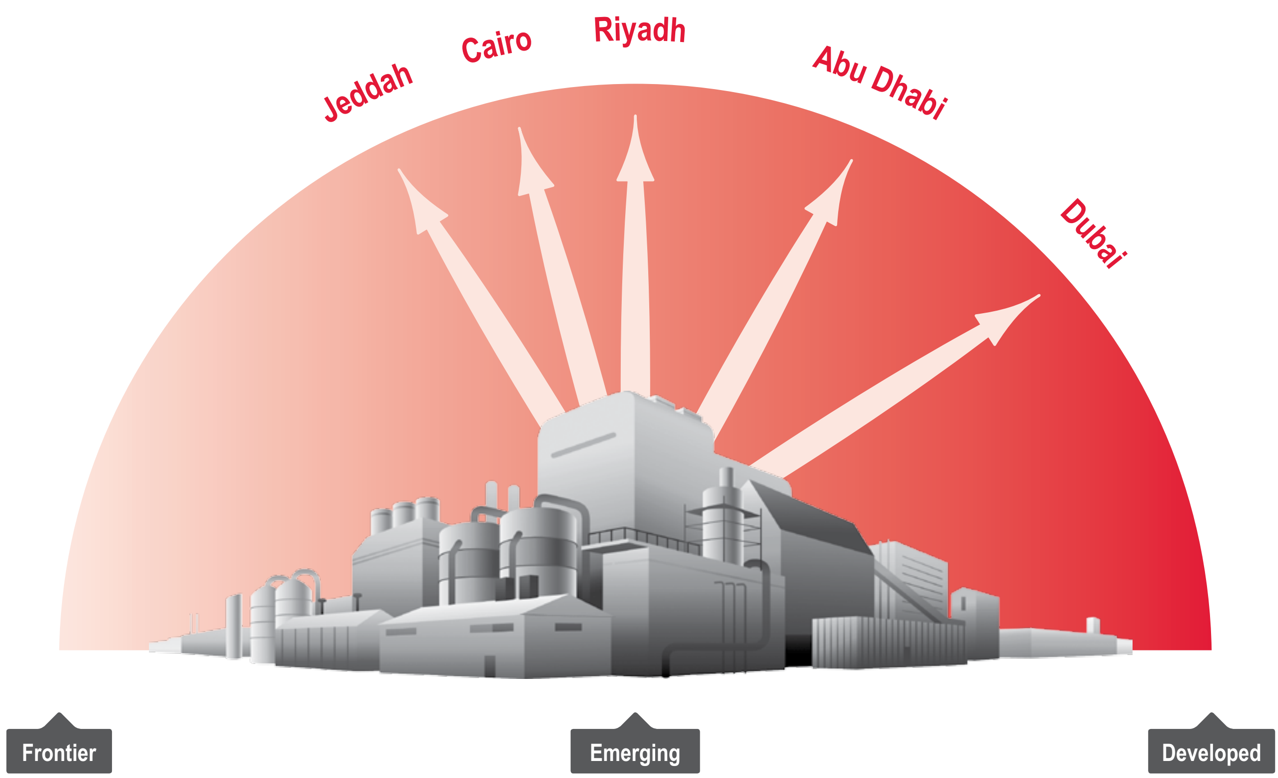
Table 5: Market Performance – Cairo

	Land Sales* (EGP/sqm)
Katameya Industrial Zone (New Cairo)	1,250 – 2,000
6th of October	400 – 1,200

* Cairo's market is dominated by land sales activity. Vacant land leases are unavailable as regulated by Egyptian government authorities. The IDA typically sells land to investors and allows a grace period to initiate building of industrial units after which time investors have the option of renting it out.

Ranking of Major MENA Industrial Real Estate Markets

The graph below illustrates the ranking of major MENA industrial real estate markets based on the four factors influencing the occupier space selection process (total operating costs, location, infrastructure and quality of real estate product).



Emergence of the Industrial Investment Market

The logistics sector has attracted significant interest from real estate investors in recent years and has developed very much into an asset class of its own on a global scale. With increased globalisation, the movement and storage of goods and the management of the supply chain process has advanced significantly. As a consequence, institutional investment in the light industrial and logistics sector is coming from two key sources.

The first of these is local investment groups and funds that are interested in industrial and warehousing product for their own strategic investor base. These groups are seeking mainly income generating assets that provide long-term stable revenue and prospects for future capital gains. In view of the oversupply of space in traditional sectors such as residential, office, and retail, investors are now increasingly seeking new markets and asset classes that were historically overlooked, such as education, logistics and medical. Furthermore, the industrial and logistics sectors generally offer products that adhere to Sharia-compliant investment criteria.

The second source of interest is from international logistics developers, owners and operators who are seeking to broaden their global reach and enter into the GCC/MENA market. Given the significant investment in transportation infrastructure, the regional markets offer interesting strategic and geographical opportunities and we are now seeing increased interest from overseas players seeking to gain a foothold in the MENA region. These international logistics specialists are mainly coming from Europe and Asia and seek diversification away from their home markets.

Some of these international groups will be looking to buy existing assets and some development opportunities either solely or on a JV basis with a local partner. Existing JV relationships such as that between JAFZA and Gazely are examples of where international logistics developers have successfully teamed up with local partners as a means of bringing international standards and occupier relationships to the region. Such groups also offer longer term prospects, providing the local partner with access to similar deals in mature markets.

In both cases, investors are focussing on high quality industrial/warehousing assets that are leased on a long-term basis to good quality occupiers. To this extent, sale and leaseback of owner/occupied properties will be particularly valued with deal sizes upwards of US$ 30 million preferred. In addition to the institutional investor segments, there is also a smaller subset of specialist industrial private investors who are mainly price driven and thus chasing yield and value add opportunities.

In spite of the strong appetite for this sector, accessing the MENA logistics/light industrial market from an institutional investor perspective has until now been challenging. The development, operation and ownership of industrial and logistics hubs across the region have typically been the preserve of government backed entities and few speculative developers have emerged. Going forward we see plenty of opportunities for countries in the MENA region to open their markets further and capture the inherent demand for industrial property, although this may require some change in regulations. Changes to the legal framework and strategies of existing industrial zones in terms of their articles of association and objectives and the creation of product aimed at fulfilling demand from the institutional investor segment, will provide significant potential to generate increased sales activity in this market over the next few years.

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Pulse reports from Jones Lang LaSalle are frequent updates on real estate market dynamics.

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