REAL ESTATE INVESTOR SENTIMENT SURVEY – INSTITUTIONAL EDITION
Middle East and North Africa
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Jones Lang LaSalle®
Real value in a changing world

MENA Missing Out on Global Capital Flows

Real Estate Investor Sentiment Survey – Institutional Edition

Across the Middle East and North Africa, 2011 will be remembered as a year of change. Adapting to a rapidly adjusting marketplace, we have launched a new edition of our Real Estate Investor Sentiment Survey. Instead of surveying the broader real estate market, we identified a core group of regional – primarily institutional – investors to ascertain their views on the prospects for regional real estate. The sample also includes some international investment groups with regional exposure to add a global perspective.

The results once again indicate active buyers outnumber sellers in the region. Although the general sentiment indicates declining capital values, nearly 70% of respondents were actively seeking investment opportunities in MENA. This suggests that investors are adopting long term investment strategies and may even see markets selectively stabilising.

Another key theme to emerge was the notion of 'backyard investing'. Investors are focussing on markets they understand and within their perceived sphere of influence. Even though other emerging markets are consistently perceived as having higher growth potential, relatively few investors are deploying capital in those distant markets. Mature markets, like Europe and the U.S., also featured highly in terms of investor interest.

Global real estate capital flows experienced phenomenal growth over the past two years, a trend we expect to continue. However, only a negligible portion of international capital flows is directed into regional real estate. The following report analyses the reasons why the MENA region is missing out on foreign institutional investment. Critical factors include availability of suitably priced product and transparency concerns that are compounded by transactional behaviour. Regional real estate assets are often marketed to a small set of local investors and transacted behind closed doors, which restricts the pool of assets available to international investors and can also prevent those sellers from realising full market value.

Real estate investors and developers are re-structuring their corporate strategies and portfolios to focus on stable income generating assets, but finding assets remains a challenge. There is a shortage of commercial assets in prime locations with high occupancy and strong tenant covenants and, more importantly, owners rarely want to dispose of such assets.

In summary, investors want to increase regional exposure (especially to office assets) and have the capital in place, but remain constrained by product availability. In the absence of such opportunities, investors are heading abroad – mainly to Europe and the U.S. – to find the right risk-return balance and fill the investment void.

We maintain that the MENA market has the potential to capture a higher portion of global real estate capital flows, but the restricted product offering and opaque market processes continue to inhibit transactions and delay market recovery.

We hope you enjoy the report and, as always, we welcome your feedback.

Andrew Charlesworth
Head of Capital Markets – MENA

Key Findings

- Interest in the MENA real estate market remains limited to investors located in the MENA region. Interest from overseas investors is limited by:
    - Pricing;
    - Lack of suitable, investment grade product;
    - Regional economic and political uncertainty;
    - Limited visibility of investment offerings with distribution constrained to a small number of local buyers. Overseas investors have limited access to tenable opportunities.
- Buyers outnumber sellers in all markets with a distinct polarisation occurring between those countries perceived as stable, like the UAE and KSA, and those still characterised by political uncertainty.
- In the prevailing atmosphere of risk aversion, factors like political stability and security of income are at the forefront of investment decisions.
- The majority of respondents indicated plans to increase investment in the MENA real estate market over the next 12 months and stated that the requisite financing in many cases is already in place. Actual transaction activity will remain constrained by the lack of suitably priced product.
- In terms of yield spread, the lack of differentiation between cities and asset classes suggests investors are focussed on achieving a specific return threshold and thus are focussed on the strength of the tenant covenant rather than the asset risk.
- Driven primarily by supply concerns in almost all sectors, investors anticipate further capital declines in many MENA markets.
- Office assets remain the most attractive investment class for this investor base, but this preference is not necessarily in line with short term market conditions.

Backyard investing leads investment demand

In terms of investment strategy, MENA is the geographic focus with 67% of respondents planning to acquire regional assets over the next 12 months. The majority of respondents are regionally based and favour 'backyard investing,' thus it is not surprising that investment strategies focus on areas where investors have greater market knowledge and broader influence.

Jones Lang LaSalle View – Polarisation of Sentiment and Transactional Activity

- In the short term, investment decisions will be dominated by the political instability sweeping the region. Although the Arab Spring was unfolding in specific countries, real estate activity across the region was impacted. The turmoil increased regional uncertainty and the market risk premiums, dampening regional activity in H1 2011. Going forward, we anticipate greater polarisation of both sentiment and activity with investors favouring those markets deemed most stable, like the UAE and Qatar.

- Over the medium term, we expect institutional investors will continue to monitor regional markets, but abstain from direct investment until the risk-reward opportunity improves.

- Meanwhile, regional real estate investment – especially in the GCC – will continue to be dominated by locally based investors.

- Overseas investors tend to favour the purchase of government bonds over direct real estate acquisition to gain exposure to MENA.

Chart 1: Investment Area of Interest

Source: Jones Lang LaSalle

Compared to regionally based investors, those based outside the region are much less active in MENA. Only a handful expect to be active over the next 12 months.

Lack of interest among non-regional investors stems from:

- Relative pricing – with a perception that real estate markets in more mature economies currently offer more attractive level of risk adjusted returns;
- Lack of income-producing assets in MENA markets;
- Political instability in the region that creates uncertainty among international investors;
- Lack of transparency with investment offerings which tend to be directed primarily towards locally based investors.

Investors within MENA are also becoming more active in mature markets, like Western Europe and North America, as evidenced by the following recent investments:

- Qatari Diar Real Estate made a significant investment in the U.S. property market, with a deal to build a US$ 700 million; development in Washington DC's city centre;
- Abu Dhabi Investment Authority recently announced the acquisition of a 5-star hotel on the Champs-Elysee in Paris, France;
- Investcorp, an investment bank based in Bahrain, acquired a shopping centre in Coral Springs, Florida.

Investors based outside the MENA region are also focussing on markets like Western Europe and North America.

In terms of emerging markets, Asia Pacific maintains the highest investor sentiment, while Africa and South American command relatively low levels of interest.

Buyers outnumber sellers across the region

In almost all MENA markets, the number of buyers exceeds sellers. This supports analysis and conclusions drawn from previous reports; transaction activity is primarily constrained by a shortage of suitably priced investment product, not by a lack of investors.

While buyers outnumber sellers across the region, there is a marked divergence between markets that are perceived as secure and stable (eg: Abu Dhabi, Dubai, Qatar, and KSA) and other markets where political uncertainty lingers (eg: Bahrain, Egypt, and Syria).

According to the survey results, there is investor interest for all asset classes in Abu Dhabi, but appetite is strongest for the residential sector. In Abu Dhabi and the broader region, investors anticipate opportunities in the middle income housing segment.

The residential market in Cairo was the only regional asset class where sellers are expected to outnumber buyers over the next 12 months. Following the recent events and transfer of political power, this market is facing continued uncertainties. Unresolved legal challenges to the validity of title granted in several major residential projects in Cairo are inhibiting investor interest and sales activity.

Jones Lang LaSalle View – MENA Missing Out

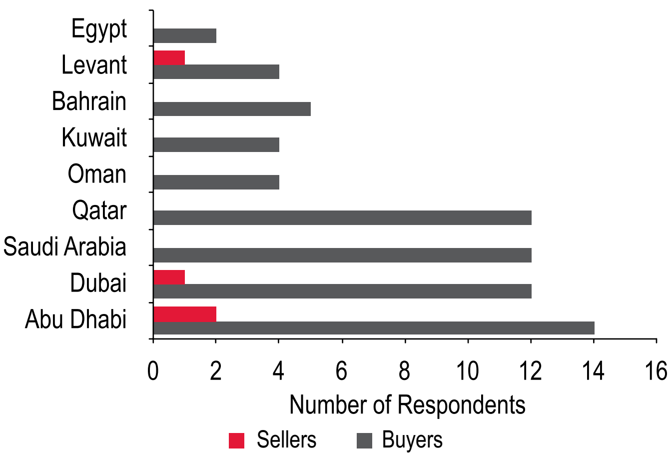
- Investor demand is largely concentrated on a select sub-set of properties within the identified markets. Well located, high quality assets with strong tenant rosters on medium to long term leases remain the most sought after product, and we expect this trend will continue. To date, we have not registered significant interest for secondary properties or those assets with shorter leases in place.

- The narrow offering for direct real estate investment leads to strong bidding competition around the limited investment grade product available in prime locations.

- According to the survey, potential buyers of real estate assets outnumber sellers, but this alone will not induce transactions. Until more product is offered at realistic prices, the MENA region will forgo capital flows in 2011. Meanwhile, transaction activity in mature markets and emerging markets in Asia Pacific is expected to continue on the upward trajectory established over the past two years.

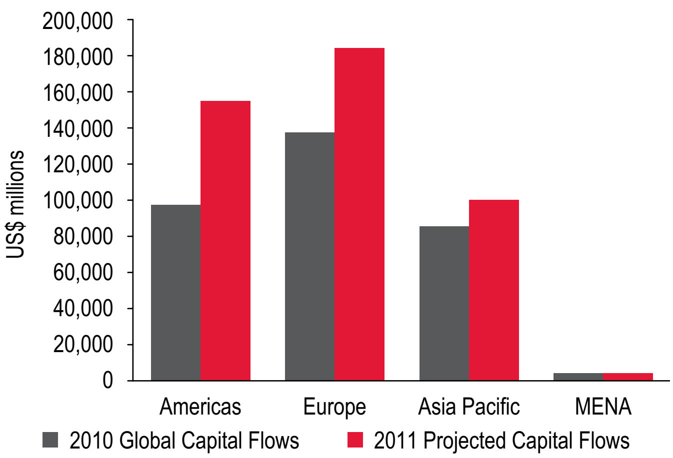
- Even with the challenges emerging over the past two years, banks have largely refrained from forcing defaulters into asset disposal. Unlike mature markets, MENA countries have largely untested and often limited mechanisms to compel disposal, which effectively obliges the bank to negotiate work outs with borrowers.

Chart 2: Investor Intentions, Buy – Sell



Source: Jones Lang LaSalle

Chart 3: Global Capital Flows



Source: Jones Lang LaSalle

Risk aversion on the rise

Jones Lang LaSalle View – Corporate re-positioning and emergence of new investment strategies dominate

- As regional markets mature, trends identified in earlier investor sentiment surveys continue to evolve. Previously focussing on development activity, many real estate entities are still in the process of repositioning their businesses around asset management to generate recurring income.

- The main constraint for these entities trying to reposition is the lack of suitable investment product offering long term stable revenue streams. In the short timeframe, condensed development activity and rental volatility led landlords to sign annual lease agreements that allowed greater flexibility to adjust rents in a highly inflationary market. Additionally, the strata regime and the resulting prevalence of jointly owned office buildings – especially in Dubai – has excessively fragmented ownership for large portions of supply. The result is a shortage of single ownership assets in prime locations with strong tenant covenants, which is the expressed investment target of institutional investors.

- In the now tenant favourable environment, occupiers anticipate additional declines and request break clauses in lease agreements. Even if commercial landlords want to create investment grade product, the uncertainty associated with such clauses disintegrates the stable income model.

- Buyers and sellers arrive at an impasse: real estate entities want to reposition their business models around stable income-generating assets, but sellers are unwilling or unable to restructure their product to appeal to investors. Consequently, negative capital flows emerge for real estate investment:

    - Regional investors focus on global markets to find investment opportunities;
    - Unable to find suitable investment opportunities, overseas institutions forgo regional investment.

- An emerging trend is the creation of new regional investment vehicles, particularly more liquid investment vehicles like REITs. Although still a novel concept in the region, we anticipate more such vehicles to emerge in the coming years.

The single most important factor determining investment decisions is risk, which encompasses security of rental income and political instability. Risk is closely followed by the lack of appropriately priced product. Compared to previous surveys wherein respondents indicated that investment decisions were predominantly driven by transparency and the cost and availability of finance, respondents now rank these factors as least important.

In terms of investment strategies, the majority of respondents indicated ‘Core’ or ‘Passive’ as the preferred strategy. Again, this indicates low risk, uncomplicated investment preferences.

The second preferred investment strategy was ‘Core Plus,’ which includes properties requiring active management or offering value add through repositioning, renovating or expanding.

Unsurprisingly, higher risk investment options – like development – were least popular. Although most investors prefer completed projects, the few investors considering development opportunities tend to prefer niche asset classes like affordable housing, education and logistics.

Chart 4: Factors Affecting Investment Decisions

Source: Jones Lang LaSalle

Increased pool of potential capital

Almost 75% of respondents said they were planning to increase their level of investment in the MENA real estate market over the next 12 months (compared to just 7% who were planning to decrease their level of exposure).

According to the survey, respondents aim to invest up to US$ 6 billion in the real estate market over the next year. However, this may be inflated because many funds may be trying to tap the same capital sources.

Based on individual transactions, the most common deal size sought was between US$ 20 million and US$ 50 million.

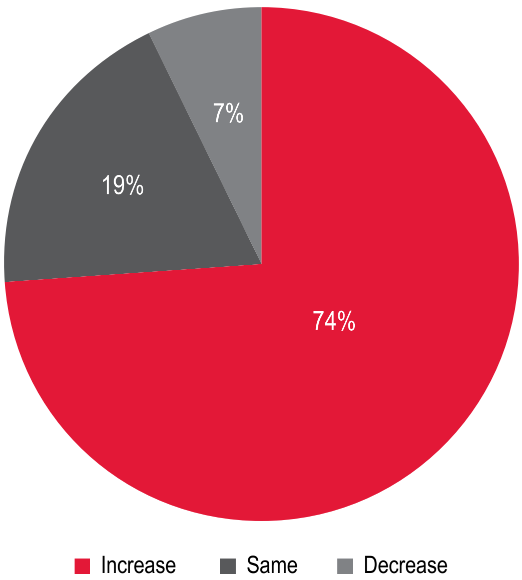
The majority of investors (74%) indicated that they had the financing in place to fund their acquisition plans for the next 12 months. The remaining 26% were planning to use a combination of debt financing and syndicated equity to raise the required capital.

Jones Lang LaSalle View – Increased Capital Will Not Translate into Increased Transactions

- In 2010, there were only four significant open market transactions recorded for the year including the off market sale of a completed, fully leased office building in Emaar Square and the sale of the Ritz Carlton Hotel in DIFC.

- Investor plans to increase their level of investment in the MENA real estate markets suggest that there is relatively widespread availability of capital. Although this capital may support existing prices for the limited pool of investment grade assets, it is unlikely to support prices for second tier assets, which draw little interest.

Chart 5: Real Estate Investment Level Change



Source: Jones Lang LaSalle

Yield expectations the same across all assets

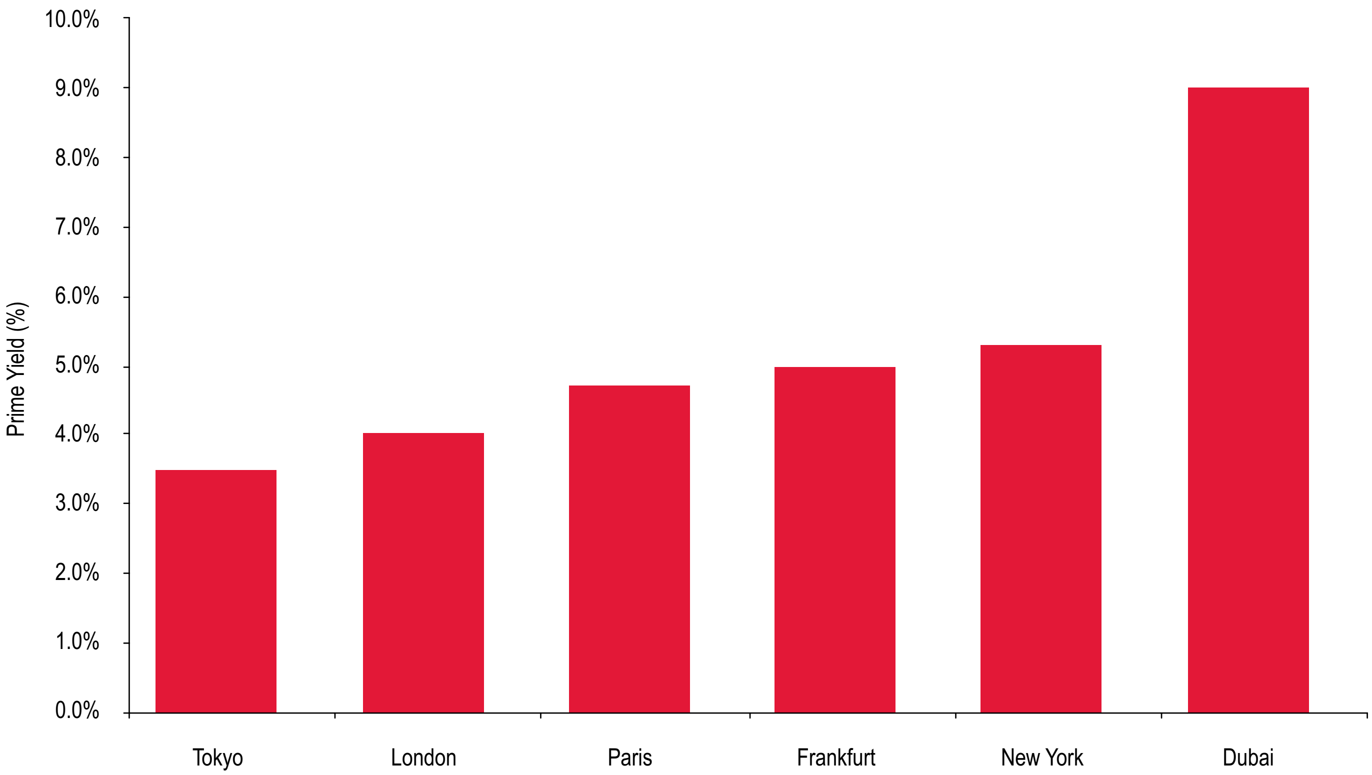
Jones Lang LaSalle View – Mismatch between tenants and landlords

- Considering the potential oversupply in many asset classes across the GCC, current yield expectations do not sufficiently capture market risk.
- Limited yield variance across locations and sectors suggest uniform risk and market performance, but this is not realistic.
- While investors seek assets with long term leases in place to provide security of income, tenants are leveraging weak market conditions to negotiate concessions such as shorter leases and break clauses.

Yield spreads register a narrow range of 9% to 11% for all asset classes. Minimal differentiation between cities or asset classes suggests that yield expectations are determined by the strength of tenant covenant rather than the asset risk.

Compared to stable overseas markets, regional yields are low. Insufficient risk premium is a major barrier to attracting international investment to the MENA real estate markets.

Chart 6: Global Prime Office Yields, Q1 2011



Source: Jones Lang LaSalle

Investors expect further capital value declines

Respondents were asked about capital value expectations for Abu Dhabi, Dubai, and KSA. For all three markets, investors broadly expect real estate values to decline over the next 12 months.

Conservative price expectations could indicate low transaction levels going forward. Unless sellers significantly adjust their expectations, the price gap between buyers and sellers will linger and possibly grow, further restricting sale volumes.

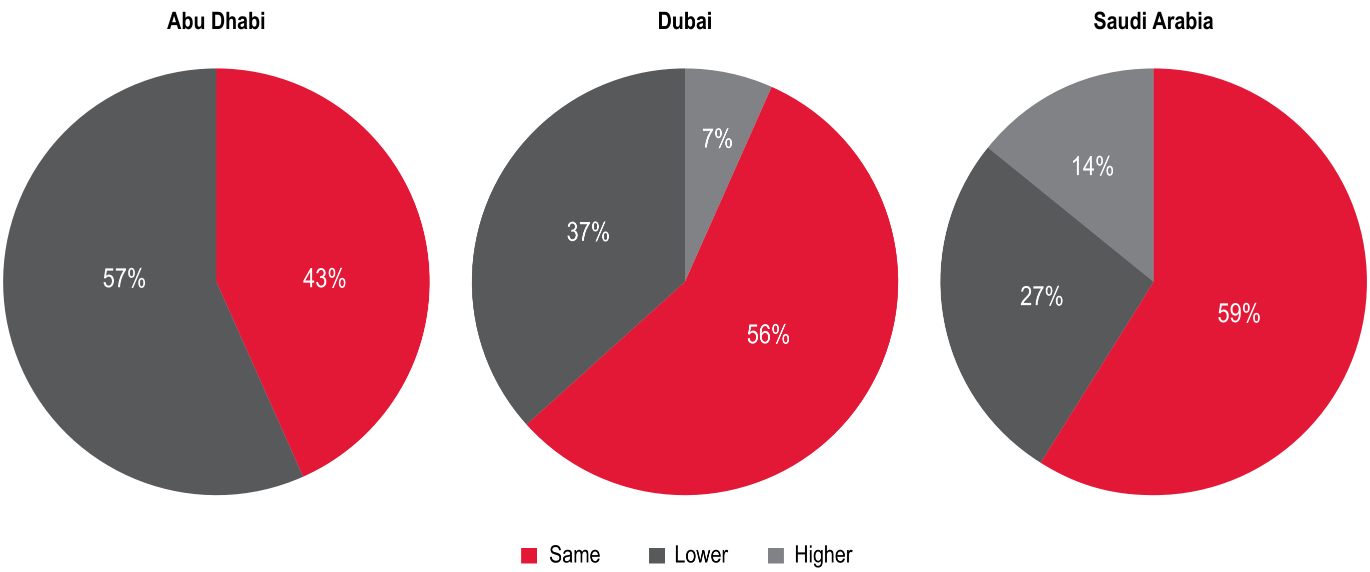
According to the survey, respondents anticipate highest capital value declines in Abu Dhabi, with investors expecting some stability in Dubai values.

Investors remain optimistic about KSA's market fundamentals, specifically the high liquidity resulting from a strong petrochemical-driven economy combined with the fiscal commitment to infrastructure development. Investors continue to monitor the petrochemical industry and recognise the indirect but significant influence on the real estate market.

Jones Lang LaSalle View – Value Declines Related to Supply Cycles

- In terms of capital values, respondents expectations are largely in line with current market conditions. Although Dubai rents continue to fall, the rate of decline has slowed significantly and indicators show some locations and sectors are either at, or near, the bottom.
- Anecdotal evidence indicates that the population has resumed growth and tourism has improved: schools are full and hotel occupancy has recovered.
- More established residential and commercial areas have experienced price stabilisation and, in select cases, increases. Areas like Palm Jumeirah, Dubai Marina and prime office locations like DIFC and Emaar Square have performed best, while peripheral and less developed areas with limited infrastructure continue to suffer.
- While Dubai is already passed the supply peak, Abu Dhabi is still approaching the peak of the supply cycle. Thus, Abu Dhabi rents and sale prices are expected to continue to decline in the coming year.
- Although KSA's strong fundamentals indicate greater stability, anticipated new supply will depress asset values for certain sectors and locations.

Chart 7: Expected Change in Capital Values during 2011



Source: Jones Lang LaSalle

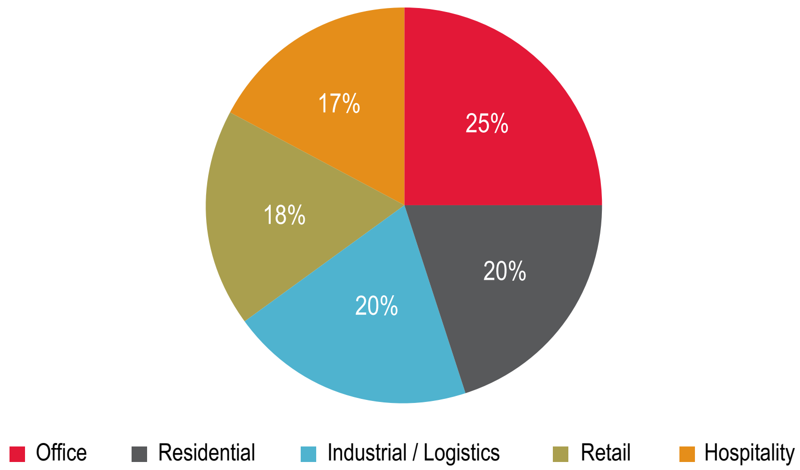
Office is the most attractive sector

Jones Lang LaSalle View – Investor Focus on Completed Product

- Across all sectors, investor interest is focussed on completed and operational properties backed by long term secure income streams. Going forward, the lack of investment grade assets will continue to restrict transaction volumes.

- Although specialist players are showing interest for non-core assets, the market is still focussed on the office sector. This is ironic because, in various markets across the MENA region, burgeoning office oversupply will increase risk in this sector over the short term.

Chart 8: Property Types of Interest



Source: Jones Lang LaSalle

Although there is general interest for all asset classes, office is the preferred sector and this trend is in line with real estate investment strategies of institutional investors across the globe.

The logistics / light industrial sector emerges as another target sector, especially in Dubai and KSA. Less exposed to market oversupply, this sector is projected to be one of the best performing over the short to medium term. However, private investment opportunities are limited due to strong government control over industrial development and industrial zones across the region.

Interest in the hospitality and retail sectors typically stem from specialist investors and various niche players are now specifically seeking opportunities in these sectors.

The residential sector attracts limited, if any, interest from overseas institutional investors. However, MENA-based investors have expressed interested in the residential sector, particularly for low to middle income housing development as this has been neglected during the boom years. More specifically, regional developers and investors see opportunity in partnering with local governments to develop low cost housing.

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