Industry Focus

EMERGING MARKETS

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MENA Real Estate

Building Value Among the Wonders

- **Government Developer Privilege** — In most MENA markets the government influences demand and supply via its policy decisions and direct ownership of companies in the real estate value chain. This influence may be sufficient to delay project completion and avoid periods of over supply. We expect delays to impact non-government developers more than government developers.

- **Sustainable Demand Drivers** — While governments may be able to reduce the risk of excess supply on a short-term basis, sustainable demand is necessary for the long-term health of the real estate sector. Population growth (through immigration and indigenous births), economic growth (the reinvestment of the oil surplus) and social change should drive long-term real estate demand growth in the region.

- **Hotels Relative Concern** — We are indifferent between exposure to office, residential and retail real estate because they have common drivers of value. But we are relatively concerned on the hotels segment. Tourist growth is out pacing the global average which is an absolute positive. But hotels compete across countries more than the other real estate segments and governments are unable to regulate supply outside their borders (raising the risk of regional over-supply).

- **Dubai Should Pass Over-Supply Fear Test** — Office space per capita is on track to top emerging markets at 50 sq ft. But this drops to 25 sq ft (similar to Kuala Lumpur, well below Frankfurt) after increasing the population denominator for census omissions, commuters and immigration (in turn, fuelled by economic policy, regional political instability, "quality of life" migration and critical mass). We are similarly confident on residential, retail and (pre 2010) on hotel.

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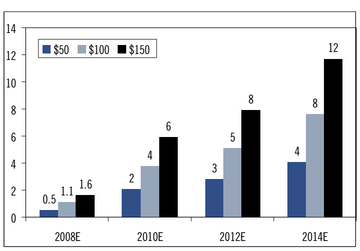
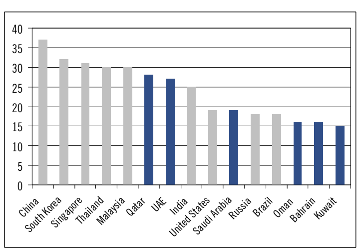
Figure 1. Gulf Wealth ($trn) Gain From Oil Price



Source: BP, McKinsey and Citi Investment Research

Figure 2. Last 10yr Investment/ GDP % is Low



Source: Global Insight and CIR

See Appendix A-1 for Analyst Certification and important disclosures.

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Contents

Summary

Government Influence

In most MENA markets the government influences both demand and supply via policy decisions (covering economic development targets, regulation, taxation, population, tourists, employment and planning permissions) and via its direct ownership of companies involved in real estate (developers, utilities, lenders and raw materials). Government influence may be sufficient in these markets to smooth potential cyclical volatility by delaying project completion. During periods of supply delays we would expect smaller, non-government owned developers to suffer relative to government-owned developers.

Sustainable Demand

Even in markets where the government exerts a powerful influence and should be able to reduce the risk of excess supply on a short-term basis, sustainable demand is necessary for the long-term health of the real estate sector. Reinvestment of recently accumulated oil surpluses, following many years of underinvestment, is sparking growth in MENA real estate. Sustainable demand growth thereafter should be driven by population growth (in turn, driven by immigration and/or youthful demographics) and social change (i.e. need to create employment opportunities, fragmenting family sizes, desire for leisure facilities and more tolerance for foreign visitors).

Hotels (Relative) Concern

We are indifferent between exposure to office, residential and retail real estate given the commonality of value drivers, but we are relatively concerned on the hotels segment. Tourist growth is outpacing the global average, which is positive on an absolute basis. But hotel real estate competes across countries more than the other segments, and governments are less able to regulate cross-border supply, thereby raising the risk of regional over-supply.

Dubai Should Pass the Over-Supply Fear Test

Dubai is growing its office space faster than any other city globally both in percentage and absolute terms. Indeed, it is due to add more than Chennai, Jakarta and Shanghai combined. Office space per capita is on track to be by far the highest in global emerging markets (c50 sq ft). However, adjusting the population denominator for omissions in the last census, commuters from neighbouring Sharjah and ongoing population growth bring this figure down to nearer c25 sq ft: still c10% higher than the next emerging market city, Kuala Lumpur, but a long way off global “leader” Frankfurt. In this report, we run through a similar analysis of residential, retail mall and hotel demand-supply.

The key long-term driver in Dubai which balances demand-supply is immigration and this should continue, driven by: Dubai government real estate evolution of the regulatory framework built on freehold title for residents and freezones for corporates, the staff growth of “Dubai Inc” companies, continuing regional political instability which makes Dubai attractive for neighbouring white collar and affluent population segments, “quality of life” trades by western European immigrants, and the attainment of critical mass (people want to move Dubai because it is already big).

Government Influence

Controlling the Value Chain

Government impacts supply-demand, directly and indirectly

We feel most analysis of real estate markets like Dubai places too much emphasis on demand-supply estimates and too little on the role of the government. The question of whether there is sufficient ongoing demand to soak up all the current real estate projects which are planned is, of course, an important one (we think there is and we address it in a separate section). But, in our view, the government's influence across the real estate supply chain is sufficiently strong that it has the potential to systematically affect the balance between demand and supply both in the short and long term.

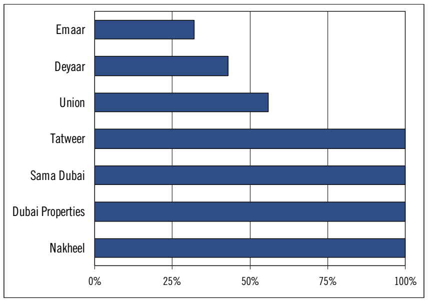
In this section we use the term government to refer to the ruling family, government administrative bodies and companies in which the government is an influential shareholder. Using the example of Dubai we identify the following points of influence.

Supply Side

- Land allocated for development is owned by three "master developers": Nakheel (100% owned by Dubai World), Dubai Properties (100% owned by Dubai Holdings) and Emaar (32% owned by the government of Dubai). Master developers hold considerable sway on how quickly individual plots are released for sub developers with requisite "improvements" (e.g. drainage, compaction and water breakers if reclaimed land).
- Local cement manufacturer capacity is owned c30% by the government.
- Electricity, water and telecom utilities are owned 60-80% by the government.
- Local mortgage lenders and banks (project finance, secured loans, mortgages) are owned 15-56% by the government.
- Government developers account for a substantial portion of planned supply of finished units and these developers are fairly open about their ability to manage supply in line with demand. For example, Emaar's own investor presentations have, in the past, referred to use of supply scale in the context of the Dubai residential market[1].

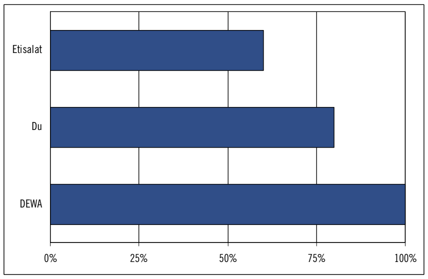
[1] Emaar Investor Presentation, DFM London Conference, May 2007

Figure 3. Government Ownership of Developers



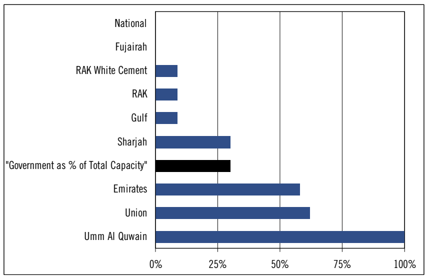
Source: Company Reports

Figure 4. Government Ownership of Utilities



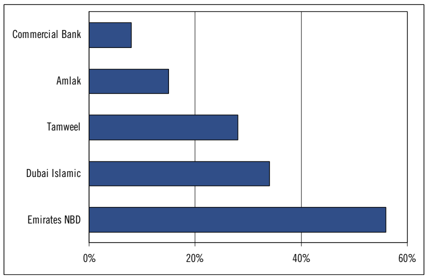
Source: Company Reports

Figure 5. Government Ownership of Cement



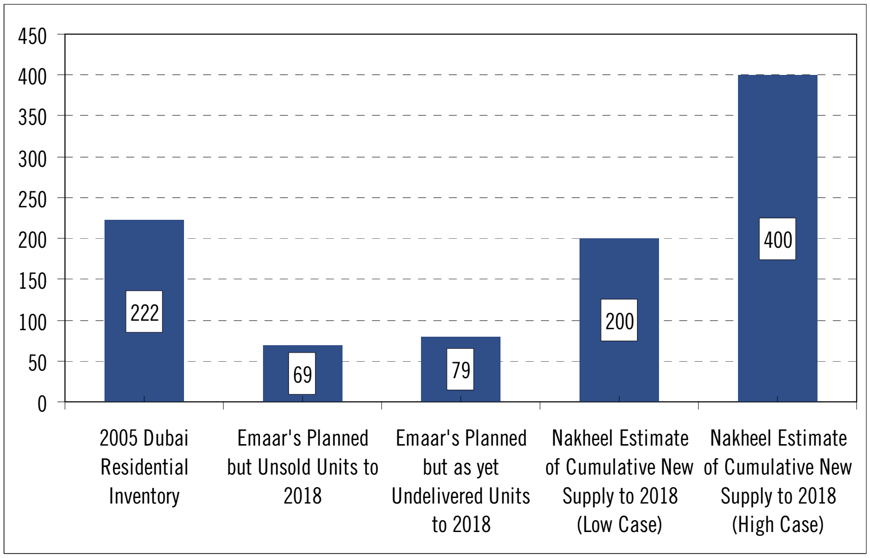
Source: Company Reports

Figure 6. Government Ownership of Finance



Source: Company Reports

Figure 7. Emaar Share of Cumulative Freehold Residential Supply to 2018 (17% to 35%)



Source: Company Reports and Citi Investment Research. Dubai 2005 Inventory is the average of Dubai Chamber of Commerce and Industry Dubai Housing Report, published October 2007, and UAE Ministry of Economy 2005 Census, published in December 2006. Emaar figures are as of September 2007, source: Investor Presentation to Citi MENA Equities Conference. Nakheel figures and estimates as of September 2007, source: from interview with Robert Lee, Executive Director of Nakheel Investment Projects, published on Reuters on 19 September 2007. Emaar data not on a proportionate, equity share basis.

Information

The government enjoys an asymmetric information advantage in terms of real time data on visas (population immigration), business permits and pricing of new and used properties hitting the market.

Demand Side

The government acts to indirectly stimulate demand for real estate through a wide range of policy, legal, regulatory and institutional levers. Examples include:

- Immigration policy;
- Freehold title areas (where foreigners can own property);
- Economic free zones (where businesses in a specific industry can be established with a regulatory regimes specific to that industry);
- Regulation on construction (tariffs on raw materials, rules on environmental impact of buildings) and labour (visa regime, minimum wage);
- Regulatory bodies for real estate which arbitrate in case of disputes and protect owners rights (RERA and Strata Law);
- The government can directly influence demand for real estate in its role as a major domestic employer. As government companies expand so does the demand for the real estate to employ, house and entertain their staff. Government companies across the UAE employ about 280,000 staff on our estimates.

Implications for Investors

In MENA real estate markets with well-managed government, demand-supply policy can compensate for the risk of low indigenous demand (i.e. reliance on expatriate driven growth). In these markets, government developers should fare particularly well (their interests are aligned with those that determine many of the underlying drivers of demand-supply and the rules by which the market is governed).

Domestic Projects

The risk of cyclical mismatch of supply and demand is mitigated by the central role of the government in the real estate value chain. The main mechanism for controlling supply intermittently (if need be) is to delay project completion. Private developers which lack government backing may well bear the brunt of such supply management (their projects end up being delayed) assuming all other operational factors (e.g. competence of management) are equal. Well-run government developers should benefit both from the overall management of the market and from the competitive advantage of government support.

International Projects

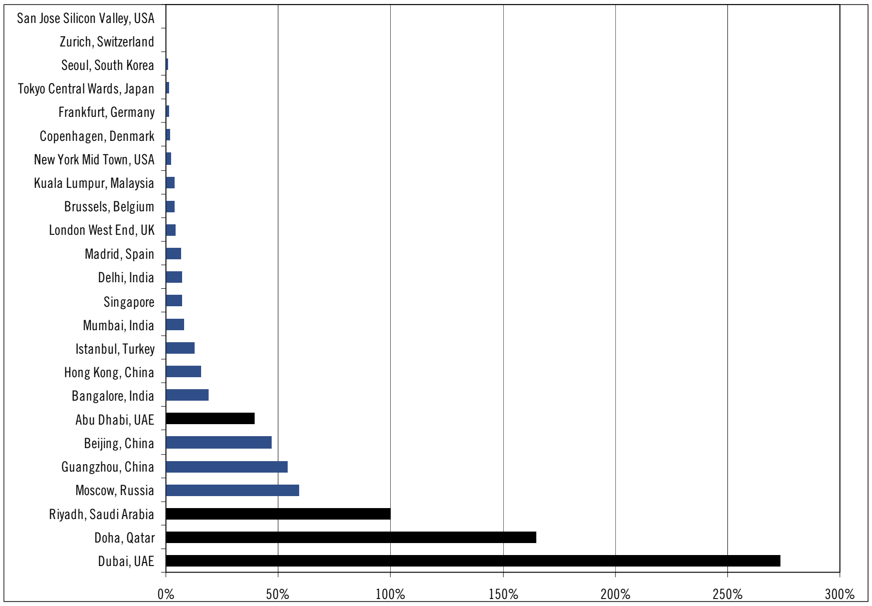
While enjoying all the benefits of government backing in the “home” market, developers expanding internationally still need to establish leading edge industry execution capabilities. In the absence of direct government backing the onus on pure operational expertise (urban planning, construction management and marketing to end customers) is arguably greater overseas. Without the government safety net the risks are greater and the need to get to markets early (before land concessions become hotly contested and prices are bid up), or achieving good M&A valuations for assets in mature markets, becomes more important.

Office

Dubai's Test Case for Oversupply Fears

We take the Dubai office space market as a test case for investors' worst fears of irrational build plans and looming oversupply. On the basis of announced plans, Dubai is expanding office real estate faster than all other large cities globally over the next few years. Figure 8 below illustrates.

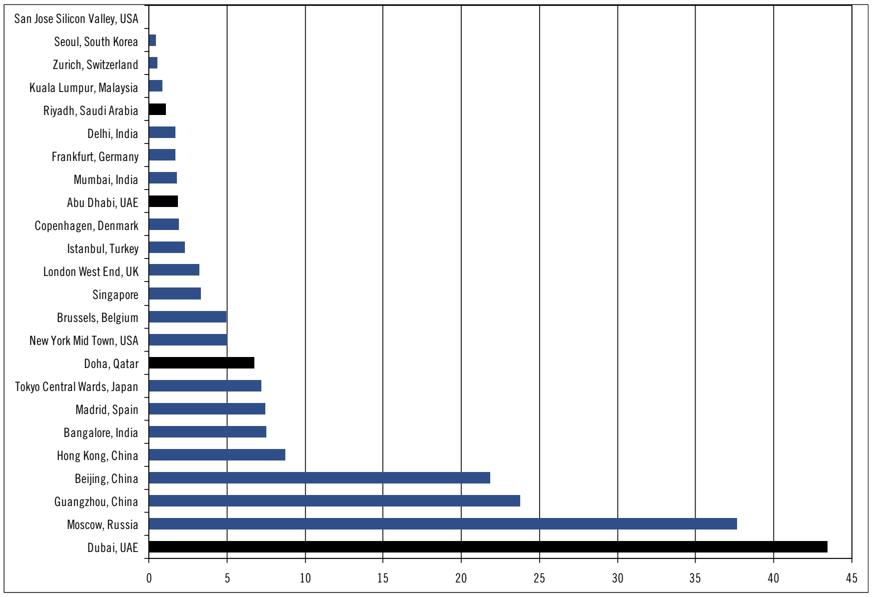
Figure 8. Percentage Growth in Office Space Implied by Planned Construction



Source: Colliers and CIR

Indeed, Dubai is adding more office space *in absolute terms* than any other major global city. Dubai is planning to add office space equivalent to Shanghai, Chennai and Jakarta combined. See Figure 9 below.

Figure 9. Absolute Increase in Office Space According to Planned Construction (Square Feet m)



Source: Colliers and CIR

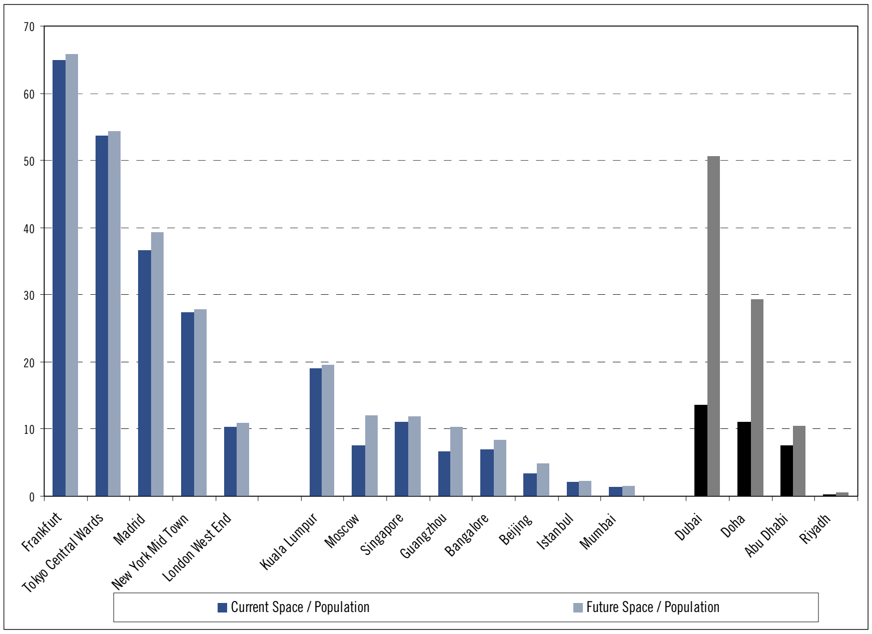
Value chain controls of course

Earlier in this report we argued that in markets like Dubai the government exerts a powerful influence on supply (by influencing the availability of land for development, raw materials, financing, utility connections) and demand (by creating freezones, encouraging immigration and acting as a direct employer). This argument holds true for Dubai office space but in this section we concentrate on why we believe there should be sufficient demand for this planned office space absent any government supply-side intervention.

Determining the office space consuming population

In order to understand whether there is ultimately sufficient demand for all of Dubai's office space plans we benchmark a spectrum of global city office build plans and population. As Figure 10 below illustrates, Dubai is heading from 14 square feet per capita to c50. It is clearly an outlier in the emerging market sample (with cities like Mumbai planning for 2 sq ft per capita and Kuala Lumpur 20). Indeed, Dubai office space per capita plans put it behind only Frankfurt (c66) and Tokyo Central Wards (c54).

Figure 10. Current and Planned Office Space Per Capita



Source: Colliers and CIR

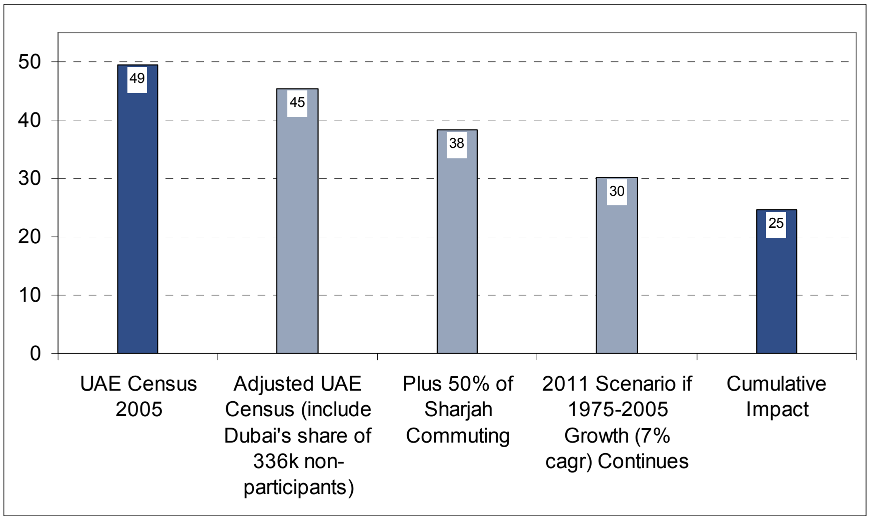
However, we believe that when appropriate adjustments are made to the population denominator, the Dubai planned office space per capita drops from 50 sq ft to nearer 25 sq ft. In the chart presented above the population of Dubai is 1.171m. We advocate three changes:

1. The last UAE Census excluded 336k "non-participants" and we allocate a portion of this to Dubai on a pro-rata basis (ie population weightings for each emirate).

2. A high proportion of neighbouring emirate, Sharjah, live in households where professionals commute daily too Dubai. In the data used above, we note the population of London is considered c21m. This is much higher than London's "night time" population and reflects the "day-time" commuter population. In our view, Dubai merits similar adjustment.

3. Between 1975 and 2005 Dubai's population grew with a c7% CAGR. The law of large numbers likely rules out a continuation of this high growth rate, but it should get pretty close due to the combination of government pro-immigration and pro-freezone policies and demand side factors such as the desire of skilled white-collar workers from politically unstable neighbours (e.g. Lebanon, Pakistan, Iran) to find employment opportunities, the search from white-collar workers from mature Western European countries (UK, Holland, Germany) for quality of life improvement and (relatively) tax free incomes, and the choice of Dubai by multinational corporates as their regional hub for MENA markets (in turn, due to the relative ease of attracting white collar labour, rule of law and ease of setting up a business).

Figure 11. Adjusting "Population" Denominator in Dubai Planned Office Space Per Capita Metric

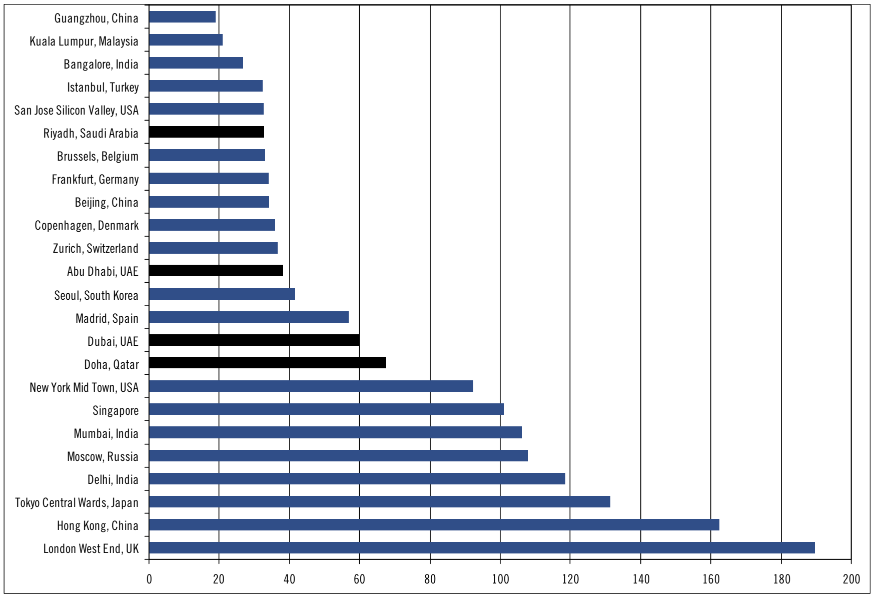


Source: UAE Ministry of Economy and Citi Investment Research

Dubai Office Space Price Check

Dubai has near zero office vacancy, rents are up over 500% cumulatively in the last five years and in 2007 alone, office rents increased about 40% (sources: Colliers, CBRE and Better Homes respectively). Despite these price increases, Dubai is still 40%-70% cheaper than Singapore, Hong Kong and London.

Figure 12. Office Space Annual Rent for "Class A" Space (USD per square foot)



Source: Colliers and CIR

Implications for Investors

The office build plans in Dubai appear to be without global parallel in terms of their relative growth and absolute scale. However, the underlying drivers of population should provide sufficient demand and a medium-term collapse in pricing is unlikely.

Residential

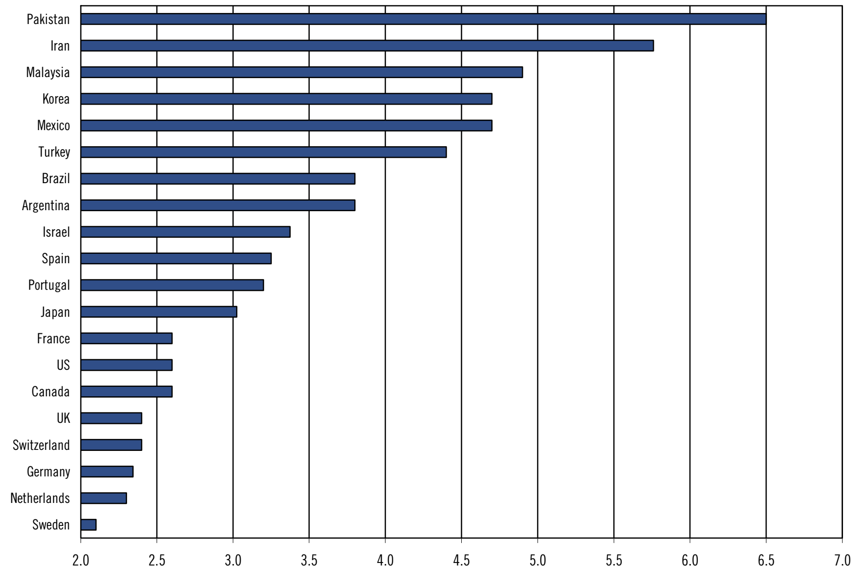
Growing Populations, Shrinking Households

Across MENA residential household size is high relative to global benchmarks, populations are growing and demographic profiles are youthful. These factors drive a healthy demand-side picture of residential real estate.

Household size

Average household size in developed countries ranges from 2 to 3.5 and in emerging countries from 4 to 6.5. See figure below.

Figure 13. Global Benchmarks for Household Size (Inhabitants Per Residence)

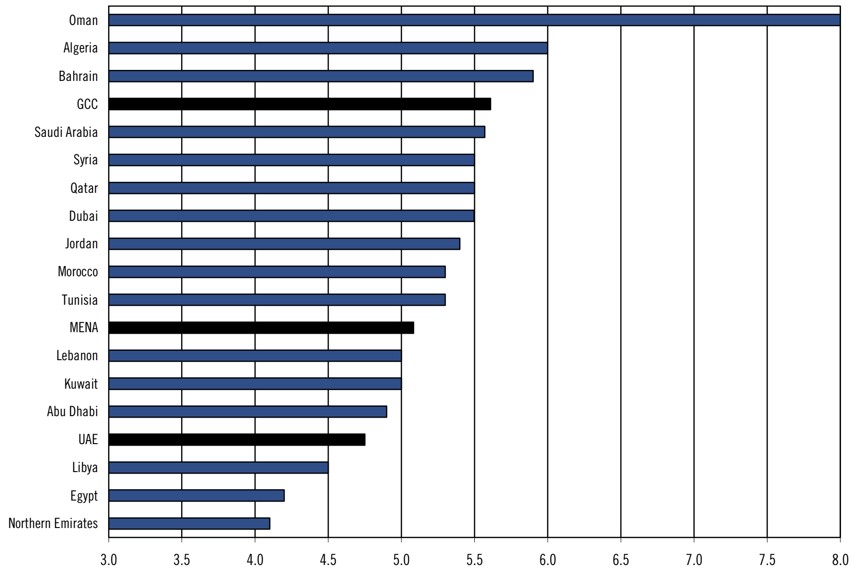


Source: UN Statistics (2001 Household Survey) and CIR Estimates

MENA average household size varies from 4 to 8, with a weighted average of 5. Three of the most populous MENA countries, Algeria (c33m population), Morocco (c31m) and Saudi (c23m), have average household size of 5 to 6.

The largest MENA country, Egypt (c70m), has smaller household size (4) but housing stock is notoriously old, particularly in the larger cities, e.g. Cairo. See Figure 14 below.

Figure 14. MENA Household Size (Inhabitants Per Residence)



Source: Oxford Business Group (Real Estate 2007)

Household size should shrink as MENA societies mature. We expect traditionally large family units to subdivide in the larger, indigenous population countries (e.g. Saudi and Egypt), driven by newlyweds and urban population growth. And in the ex-pat countries (e.g. UAE and Qatar) we expect small, young immigrant families to drive population growth.

Population growth

Our MENA population growth forecasts are summarised in Figure 15. We regard these as conservative given that we model decelerating growth in all countries and a peak in 2020.

Figure 15. MENA Population Estimates (millions)

	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Abu Dhabi	1.54	1.61	1.68	1.75	1.83	1.90	1.98	2.06	2.13	2.20	2.27	2.33	2.38	2.42	2.46	2.48
		4.5%	4.4%	4.3%	4.2%	4.1%	4.0%	3.9%	3.6%	3.2%	2.9%	2.5%	2.2%	1.8%	1.5%	1.1%
Dubai	1.54	1.65	1.76	1.88	2.00	2.12	2.25	2.38	2.50	2.61	2.71	2.79	2.87	2.93	2.97	2.99
		7.1%	6.9%	6.6%	6.4%	6.1%	5.9%	5.6%	5.0%	4.4%	3.8%	3.2%	2.6%	2.0%	1.4%	0.8%
Northern Emirates	1.54	1.62	1.70	1.79	1.88	1.96	2.06	2.15	2.24	2.33	2.41	2.49	2.56	2.62	2.68	2.73
		5.2%	5.1%	5.0%	4.9%	4.8%	4.7%	4.6%	4.2%	3.9%	3.5%	3.2%	2.8%	2.5%	2.1%	1.8%
UAE	4.62	4.88	5.15	5.42	5.71	5.99	6.29	6.59	6.87	7.14	7.39	7.61	7.81	7.97	8.11	8.21
		5.6%	5.5%	5.3%	5.2%	5.1%	4.9%	4.8%	4.3%	3.9%	3.5%	3.0%	2.6%	2.1%	1.7%	1.2%
Qatar	0.82	0.89	0.95	1.01	1.07	1.12	1.17	1.22	1.26	1.30	1.33	1.36	1.38	1.40	1.41	1.42
		7.9%	7.2%	6.5%	5.8%	5.1%	4.4%	3.7%	3.3%	2.9%	2.5%	2.1%	1.7%	1.3%	0.9%	0.5%
Saudi Arabia	23.11	23.69	24.30	24.93	25.59	26.29	27.01	27.77	28.47	29.10	29.65	30.13	30.53	30.83	31.05	31.18
		2.5%	2.6%	2.6%	2.7%	2.7%	2.8%	2.8%	2.5%	2.2%	1.9%	1.6%	1.3%	1.0%	0.7%	0.4%
Kuwait	2.99	3.15	3.32	3.51	3.70	3.92	4.15	4.39	4.62	4.83	5.02	5.18	5.31	5.40	5.46	5.47
		5.4%	5.5%	5.6%	5.7%	5.8%	5.9%	6.0%	5.3%	4.6%	3.9%	3.2%	2.5%	1.8%	1.1%	0.4%
Bahrain	0.734	0.749	0.77	0.78	0.80	0.82	0.84	0.86	0.88	0.90	0.92	0.94	0.96	0.97	0.98	0.99
		2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.4%	2.2%	2.0%	1.8%	1.6%	1.4%	1.2%	1.0%
Oman	2.57	2.599	2.63	2.67	2.70	2.75	2.79	2.84	2.88	2.93	2.97	3.01	3.05	3.08	3.11	3.14
		1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.6%	1.5%	1.4%	1.3%	1.2%	1.1%	1.0%	0.9%
Egypt	72.9	74.2	75.63	77.21	78.93	80.82	82.86	85.09	87.11	88.93	90.51	91.86	92.94	93.77	94.31	94.58
		2%	1.9%	2.1%	2.2%	2.4%	2.5%	2.7%	2.4%	2.1%	1.8%	1.5%	1.2%	0.9%	0.6%	0.3%
Syria	18.3	18.9	19.53	20.18	20.86	21.57	22.31	23.08	23.78	24.41	24.97	25.43	25.80	26.07	26.25	26.31
		3.3%	3.3%	3.3%	3.4%	3.4%	3.4%	3.5%	3.1%	2.7%	2.3%	1.9%	1.5%	1.1%	0.7%	0.3%
Algeria	32.9	33.4	33.92	34.47	35.05	35.65	36.28	36.94	37.54	38.07	38.54	38.93	39.25	39.49	39.66	39.75
		2%	1.6%	1.6%	1.7%	1.7%	1.8%	1.8%	1.6%	1.4%	1.2%	1.0%	0.8%	0.6%	0.4%	0.2%
Tunisia	10.07	10.17	10.28	10.40	10.54	10.69	10.84	11.02	11.18	11.34	11.48	11.62	11.75	11.87	11.97	12.07
		1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.5%	1.4%	1.3%	1.2%	1.1%	1.0%	0.9%	0.8%
Morocco	30.5	30.9	31.32	31.76	32.23	32.71	33.22	33.76	34.27	34.75	35.21	35.64	36.03	36.40	36.73	37.03
		1.3%	1.4%	1.4%	1.5%	1.5%	1.6%	1.6%	1.5%	1.4%	1.3%	1.2%	1.1%	1.0%	0.9%	0.8%
Jordan	5.48	5.55	5.63	6.00	6.18	6.37	6.58	6.79	7.00	7.19	7.36	7.51	7.65	7.76	7.86	7.93
		1.3%	1.4%	6.6%	3.0%	3.1%	3.2%	3.3%	3.0%	2.7%	2.4%	2.1%	1.8%	1.5%	1.2%	0.9%
Libya	5.85	5.97	6.10	6.24	6.38	6.54	6.71	6.88	7.06	7.23	7.40	7.57	7.73	7.89	8.04	8.19
		2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.6%	2.5%	2.4%	2.3%	2.2%	2.1%	2.0%	1.9%
Lebanon	3.65	3.7	3.75	3.81	3.88	3.95	4.02	4.10	4.17	4.24	4.31	4.37	4.42	4.47	4.51	4.54
		1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	1.8%	1.7%	1.5%	1.4%	1.2%	1.1%	0.9%	0.8%
GCC	**34.84**	**35.95**	**37.11**	**38.32**	**39.58**	**40.89**	**42.25**	**43.67**	**44.99**	**46.20**	**47.28**	**48.23**	**49.02**	**49.65**	**50.12**	**50.41**
		3%	3%	3%	3%	3%	3%	3%	3%	3%	2%	2%	2%	1%	1%	1%
MENA	**214.49**	**218.74**	**223.28**	**228.40**	**233.62**	**239.18**	**245.07**	**251.33**	**257.11**	**262.37**	**267.06**	**271.15**	**274.60**	**277.37**	**279.45**	**280.81**
		2%	2%	2%	2%	2%	2%	3%	2%	2%	2%	2%	1%	1%	1%	0%

SourceUAE Ministry of Economy, Saudi Central Statistics Department, Central Bank of Egypt, Economist Intelligence Unit, IMF and Citi Investment Research Estimates

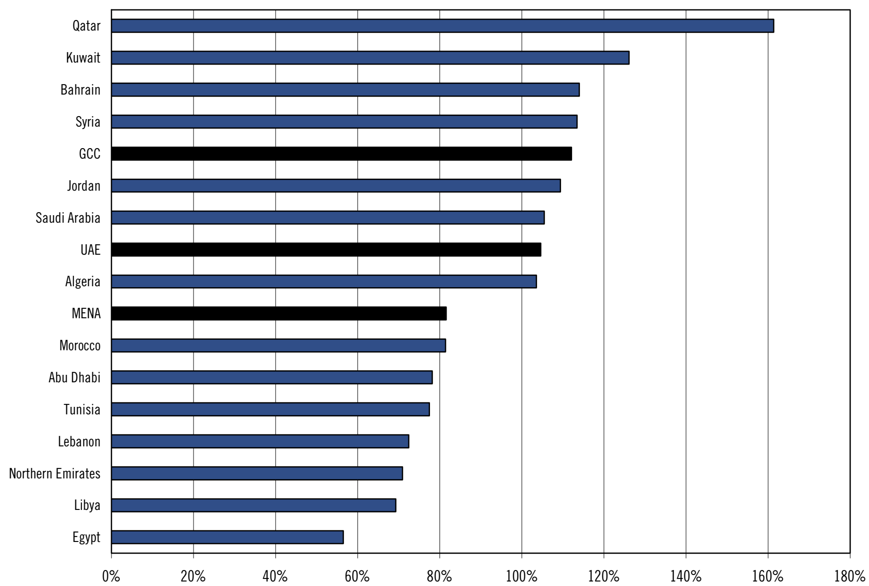
Residential unit demand as MENA "matures"

We estimate that there will be demand for MENA household units to approximately double over the next 20 years (i.e. by 2028) on the basis of the following assumptions across MENA:

- Average household size shrinks from 5 to 3.5
- Population continues growing but at a decelerating rate and peaks in 2020.

The split of this growth forecast by country is illustrated in the figure below.

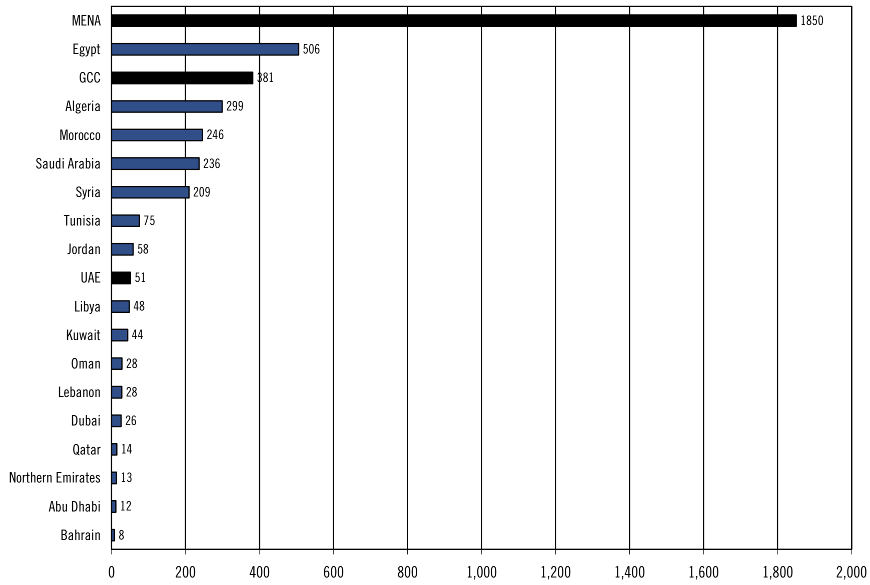
Figure 16. Percentage Increase on Existing Residential Stock by 2028E



Source: Citi Investment Research

In absolute terms this forecast translates into almost 2m incremental per annum unit demand for the next twenty years in MENA and 380k in the GCC alone. See Figure 17.

Figure 17. Annual Incremental Residential Unit Demand ('000)



Source: Citi Investment Research

Back to Dubai

In Dubai our forecast scenario implies average per annum incremental unit demand of 26k. This compares with, for example, a 2007 study published by Dubai Chamber of Commerce and Industry which contained estimates of cumulative announced residential build plans of 130k units. Assuming these units are delivered over 4-5 years implies a range of annual delivery of 26 to 33k units. Note that Nakheel estimates that merely 20k units were delivered in 2007: this implies that at least 6k to 13k units are already behind schedule.

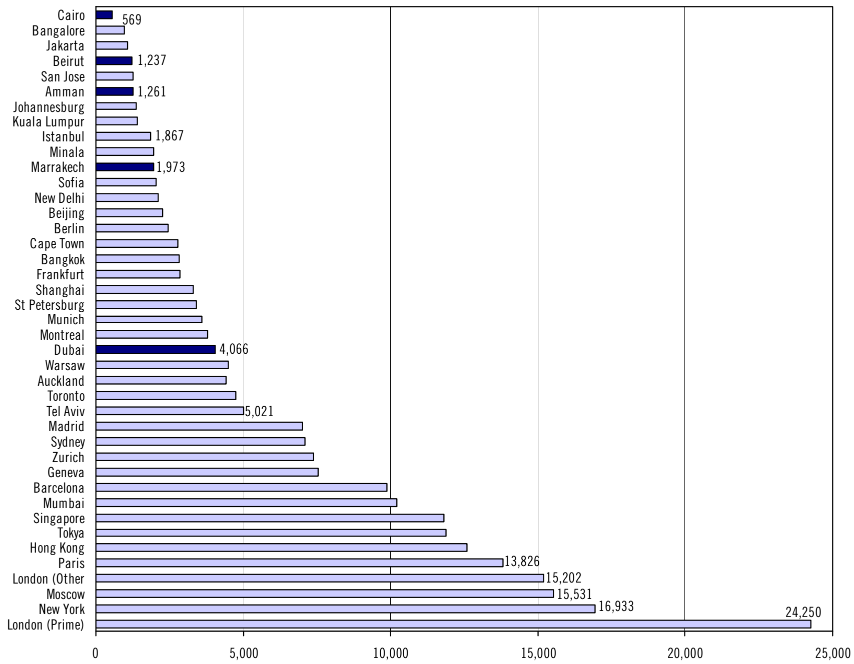
Our confidence that there is unlikely to be any material excess supply in Dubai is driven by four factors:

1. Government supply-side controls on project completion;
2. Upside risk to our population (immigration) estimates;
3. Dubai's specific attractions (relatively liberal social and economic regime) as a second home for regional very high net worth regional population;
4. Pent up demand resulting from historic under-supply.

Price Check

Within MENA, Dubai is the most expensive location (7x Cairo for example). However, Dubai is cheaper than Tel Aviv, Mumbai, Singapore and Moscow. Global "ceilings" such as Paris, London and New York are 3-6x more expensive than Dubai. See Figure 18.

Figure 18. Prime Comparable Apartment Prices (USD per Square Metre)



Source: Citi Investment Research

Implications for Investors

MENA residential real estate growth should be driven by population growth and shrinking household size as large, traditional family units fragment. Pent up demand, resulting from historic shortages, and youthful demographics reinforce these drivers.

Prices remain well below global benchmarks even in the most expensive MENA city, Dubai. This suggests that the recent history of significant price rises should not, in isolation, give cause for concern.

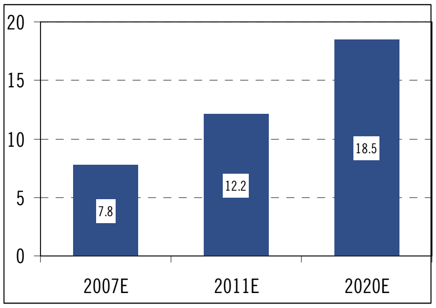
Retail Malls

Retail Space Expansion

According to Retail International, mall space (measured in gross leasable area or GLA) is on track to expand by about 140% in the GCC over the next decade, with most of this coming from Dubai and Abu Dhabi. (These estimates are illustrated below.)

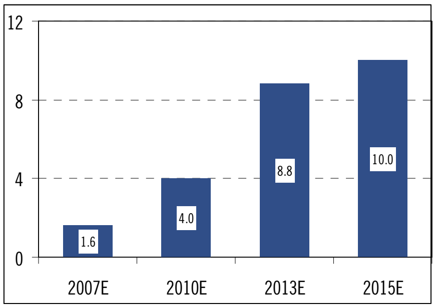
We suspect that the contribution from other GCC countries is underestimated, which would suggest an even greater proportionate expansion across GCC.

Figure 19. GCC Retail Space (Sq Metres)



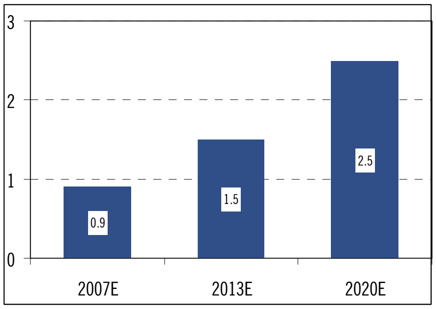
Source: Retail International

Figure 20. Dubai Retail Space (Sq Metres)



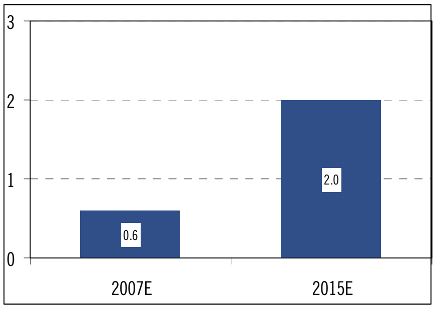
Source: Retail International

Figure 21. Abu Dhabi Retail Space (Sq Metres)



Source: Retail International

Figure 22. Egypt Retail Space (Sq Metres)

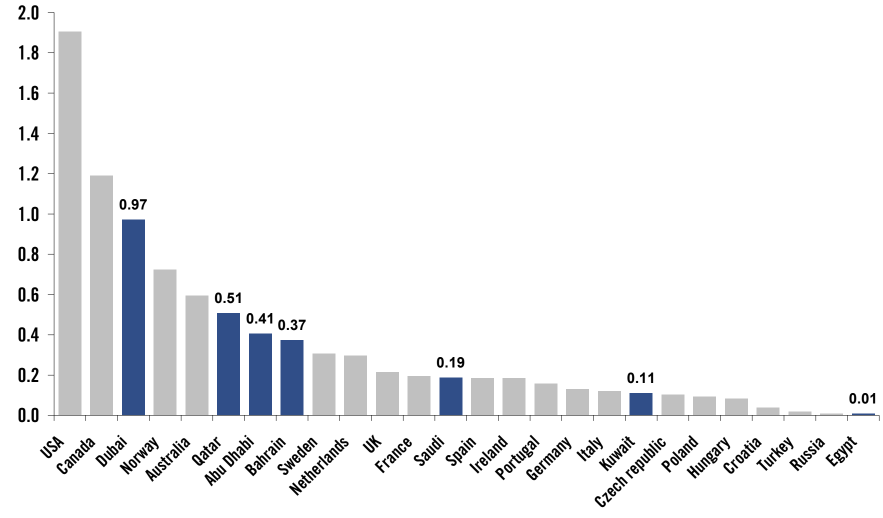


Source: Retail International

High GLA Per Capita By Global Standards

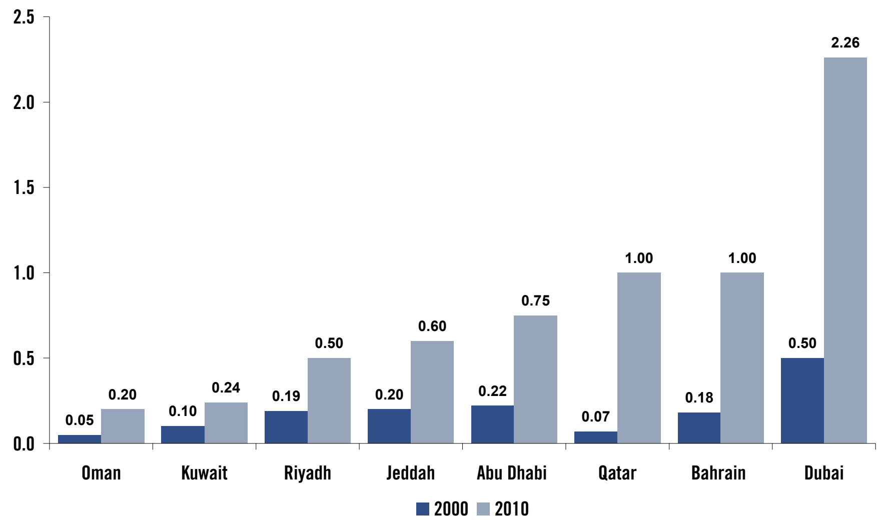
- GCC countries already rank highly alongside global benchmarks in terms of GLA per capita. Elsewhere in MENA we have only come across data for Egypt, which ranks very low.
- GLA per capita in the GCC (ex-Dubai) is heading towards a range of 0.2 to 1.0 square metre by 2010, according to Colliers forecasts (see chart below). This is above most international benchmarks from 2005, with the exception of the US and Canada.
- Dubai is heading towards 2.3 square metres, which is well beyond the US 2005 benchmark of 1.9.

Figure 23. Global Retail Space (GLA) Per Capita (Square Metres)



Source: MAF Group Chart from Dec 07 FT Gulf Property Conference (Cushman & Wakefield, Retail International, ICSC, Colliers) and CIR

Figure 24. GCC Historic and Forecast Retail Space (GLA) Per Capita (Square Metres)



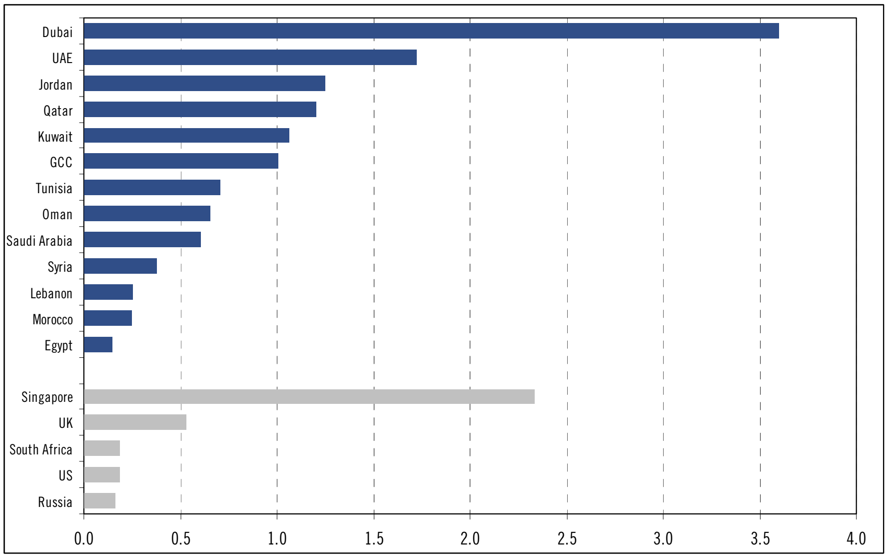
Source: Colliers and CIR

The Case for High GLA Per Capita in MENA

We believe mall space in MENA should be higher than global benchmarks for a number of reasons:

- Absence of leisure facilities suitable for extremely hot climate underpin the case for multi-purpose malls (with children's play areas, cinemas, theme parks, ice rinks, restaurants etc);
- Plentiful space (developed country and other emerging market cities tend to have limited green field space given higher population density);
- Duplication in conservative countries such as Saudi where there is a need for segregated areas for women and families;
- Branded retail tourist destinations; this is particularly relevant in cities and countries where tourist visitors are significantly greater than the resident population (e.g. Dubai, see chart below).

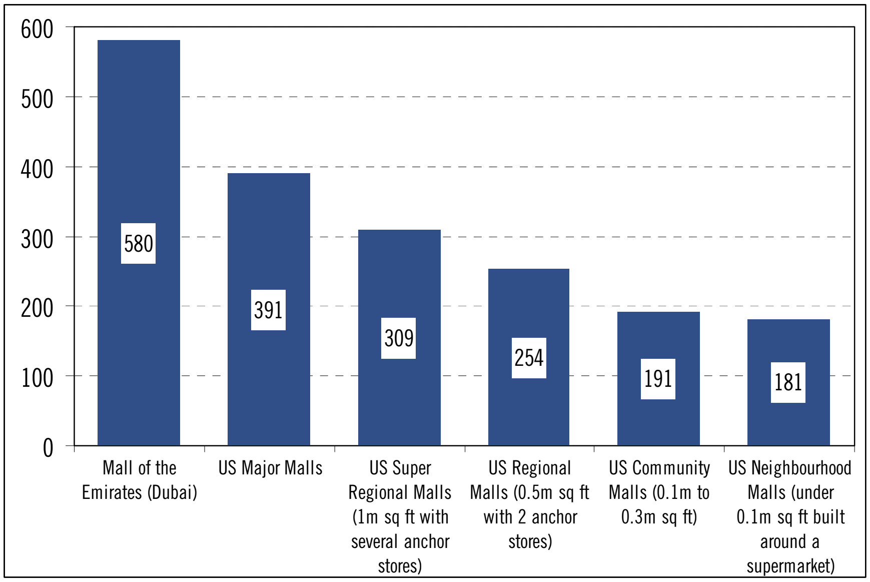
Figure 25. 2007 Tourist Arrivals Divided by Resident Population



Source: WTTC, EIU, IMF and Citi Investment Research Estimates

Figure 26 below compares retail sales per square foot in Dubai's most successful mall, Mall of the Emirates, owned and operated by Majid Al Futtaim Group, with malls in the US. Mall of the Emirates performs significantly better. Of course, we acknowledge that Dubai's tourist industry (hotels, Emirates Airlines) plays an important contributory role and that many malls in the GCC will likely fail to match Mall of the Emirates' stellar performance. But this provides an insight into how the addressable market for mall space in the GCC may be larger than global precedents would suggest.

Figure 26. Shopping Mall Retail Sales Performance (USD Per Square Foot of GLA)

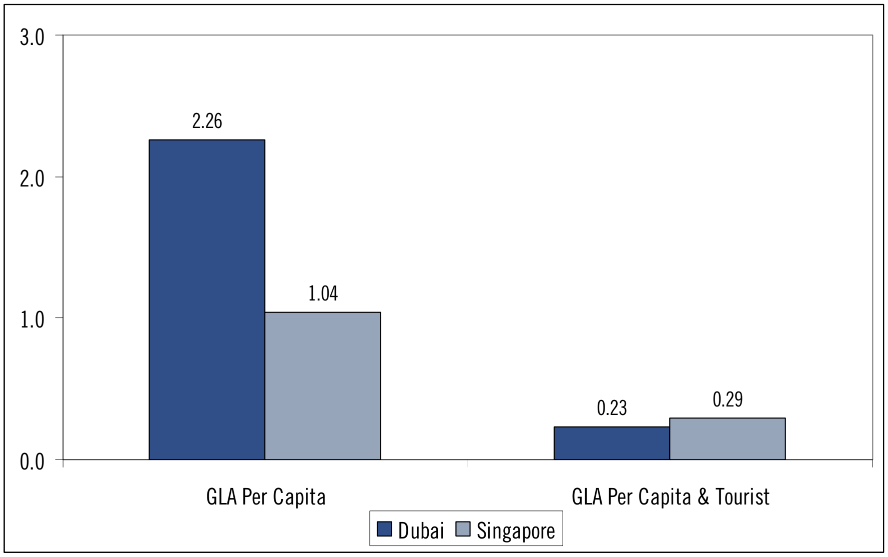


Source: Newspaper Association of America, International Council of Shopping Centres, MAF Group and CIR

Back to Dubai

- Dubai planned expansion retail mall space is going to take its GLA per capita statistic to the highest that we can find globally.
- Retail mall space should be benchmarked to tourist visitors as well as resident population. We note that Dubai already has one of the highest proportions of tourist visitors to resident populations globally. Singapore is one of the closest peers we can find on this metric.
- If Dubai achieves its target of 15m tourist visitors (hotel guests) by 2010E (2007A of c6m-7m plus, depending on data source[2]) then planned retail mall per capita *and* tourist will fall to a level below Singapore.

Figure 27. Cumulative Planned Retail Mall GLA Per Resident (Capita) and Tourist in 2010E



Source: Colliers, EIU, IMF, Dubai Department of Tourism and Commerce Marketing, Dubai Public Authorities Report and Citi Investment Research Estimates

Implications for Investors

In some MENA cities, retail mall GLA is undeveloped and there is likely pent up demand. In most MENA cities, the extreme summer climate and the absence of well established leisure facilities means that retail mall GLA per capita should rise higher than many global benchmarks. Rising GDP per capita helps too, of course.

In cities such as Dubai, where there is such a high proportion of tourist visitors to residents, there is a case for even higher retail mall GLA per capita. The example of very high retail mall sales performance from the Mall of the Emirates in Dubai supports this.

[2] Dubai Department of Tourism and Commerce Marketing estimate 5.9m hotel guests in 2007 whereas Dubai Public Authorities Report estimates 6.4m in 2006.

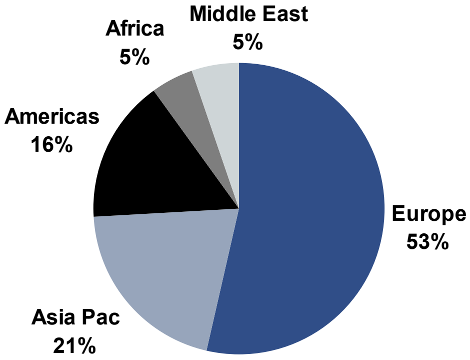
Hotels

Absolute Positives

Tourist Growth

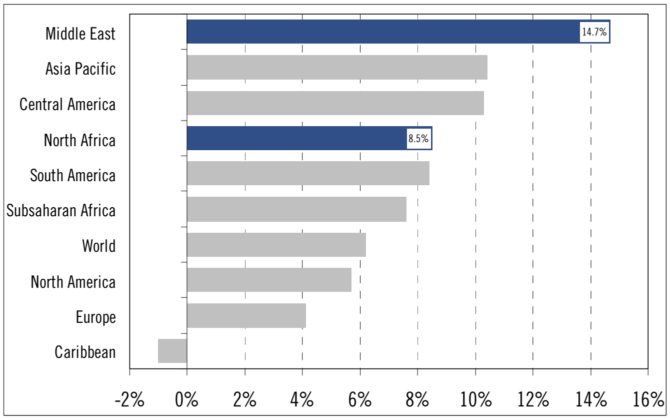
Tourist arrival growth is healthy in MENA (outpacing the global average). This is a positive for the hotel sub-segment on absolute basis. See chart below.

Figure 28. Percentage of Split c900m Global Tourist Arrivals in 2007



Source: UNTWO and Citi Investment Research

Figure 29. Tourist Arrival yoy Growth in 2007 (Percentage)



Source: UNTWO and Citi Investment Research

Healthy Occupancy Rates and RevPar Growth

Across most of MENA occupancy rates are healthy (with Beirut an understandable exception in 2007) and, equally importantly, revenue per average room is growing significantly. See table below.

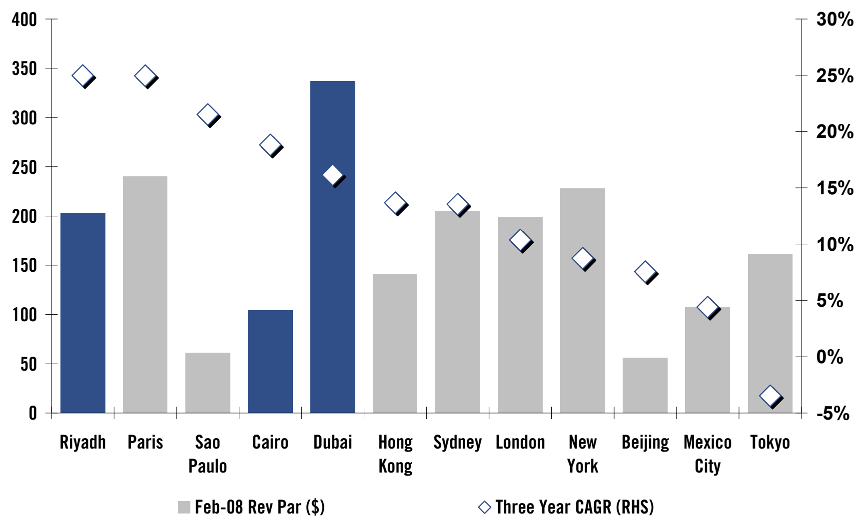
Figure 30. MENA Hotel Occupancy, Average Room Rate, RevPar (2007)

	Occupancy %	Average room rate (US$)	RevPar (US$)	RevPar change (%)
Beirut	36.8	115	42	20.5
Amman	54.5	129	83	37.1
Taba	68.1	36	25	107.7
Alexandria	71.4	80	57	44.7
Manama	72.1	231	166	21.9
MENA	**74.3**	**181**	**134**	**19.4**
Hurghada	76.2	45	34	23.3
Doha	77.3	274	212	1.8
Riyadh	82.8	249	206	22.9
Cairo	83.0	125	104	31.3
Muscat	84.2	275	232	35.4
Abu Dhabi	86.7	291	252	24.4
Dubai	88.6	356	315	12.5

Source: Emirates Business 24/7 May 08 and CIR

Relative to global benchmarks, the growth in RevPar is healthy in the 3 MENA destinations represented in the data illustrated below (Riyadh, Cairo and Dubai).

Figure 31. RevPar Levels and 3-Year CAGR, Global Benchamarks



Source: HotelsMag.com, Deloitte Survey Data and Smith Travel Research and Citi Investment Research

Relative Concerns

More Direct Competition

Our central thesis in MENA real estate is that the government plays the key role in preserving tension between demand and supply. *Relative* to other segments of real estate (e.g. office, residential and retail) we are concerned on hotels: competition between tourist destinations extends across national boundaries but government influence does not.

In tourist destinations, more than other segments of real estate, we believe there is a need for individual properties to distinguish themselves. Compared to other segments of real estate, tourist holiday destinations are transient by definition and arguably more interchangeable. Cities develop their own culture and critical mass. Offices, in particular, cater for specific clusters of commercial or government activity (e.g. regional finance, shipping and media in Dubai, petrochemicals and finance in Doha, trade and finance in Jeddah).

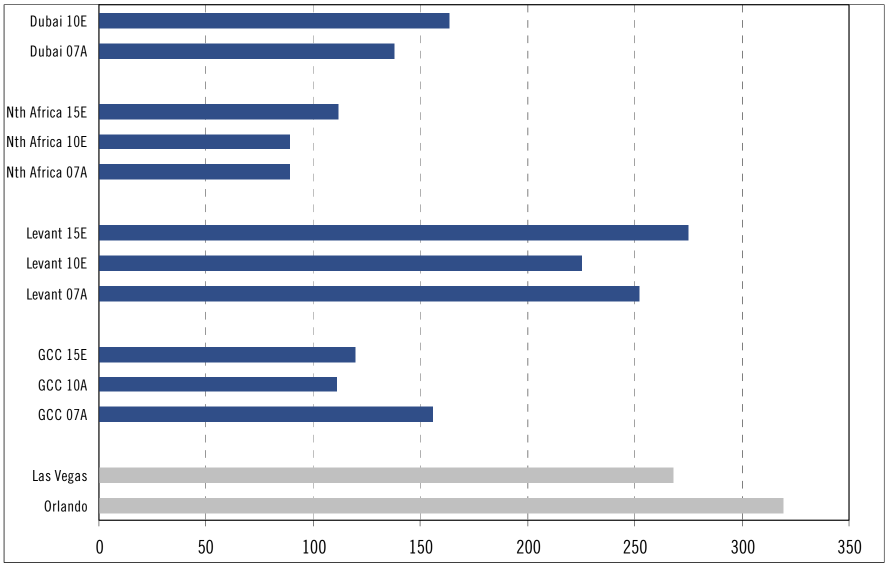
Some tourist traffic flows are very specific to a city: for example, religious tourists to Mecca and Madinah in Saudi and Damascus in Syria or archaeological tourists to Cairo in Egypt or Amman in Jordan. In these cases the rationale for hotel expansion is underpinned by unique characteristics of the destination. But in the market for beachfront hotels catering for the same income bracket, there is a danger that the beachfront aspect becomes relatively commoditised in the absence of any other draws to that particular location. Hence, in Dubai, the MENA city with the highest number of hotel rooms, increasing efforts are being made to differentiate new tourist developments: moving back from the beach front towards office districts, conference venues, retail centres, golf courses and theme parks.

Hotel Demand-Supply

In Figure 32 we consider hotel build plans alongside forecast tourist visitors and benchmark MENA with some US tourist destinations.

- In the GCC, announced plans for hotel construction imply a doubling of rooms by 2015E, with tourist visitors per hotel room expected to decline by about 25%. On this basis, average stay will need to increase in order to maintain occupancy levels.
- In North Africa and Levant, announced plans imply a 20-25% increase to hotel rooms but tourist visitor growth expectations are sufficient to imply an increase of 10-25% in tourists per hotel room.
- Across MENA tourist visitors per hotel room is expected to remain around 130, which is well below the most successful destinations in the US (Las Vegas 270 and Orlando 320).

Figure 32. Tourist Visitors per Hotel Room



Source: Jones Lang LaSalle, World Travel and Tourism Council, Dubai Department for Tourism and Commerce Marketing and CIR Estimates

Back to Dubai

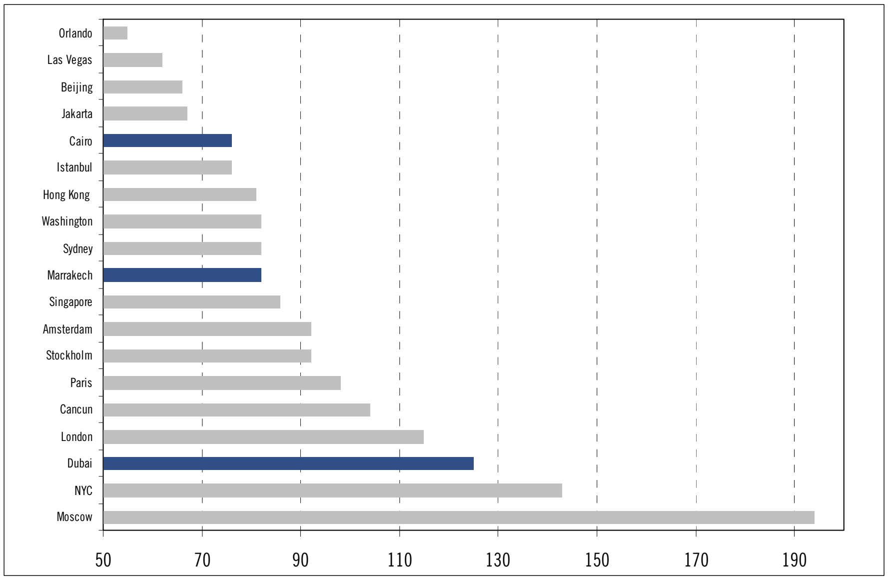
Planned Supply

- In Dubai announced plans imply a 60%increase in the number of hotel rooms by 2010, but tourist visitor growth expectations are sufficient to imply an increase of 20% in tourists per hotel room (see Figure 32 above).
- Note that after 2010E there is a major implied expansion of Dubai hotel rooms (a further c90%), if developments such as Dubailand and Bawadi come on stream as initially planned (source: DTCM).
- Again, we argue that if post 2010 expectations of tourist visitor growth and average stay imply a major over-supply of hotel rooms in Dubai, then the government is likely to bring its influence to bear. Note that in 2007 hotel construction delays meant that merely c3k rooms were added, and a Colliers report quoted in the Gulf News in Oct 07 stated that 30 hotels with a previously stated delivery date of 2007 were not completed.

Price Check

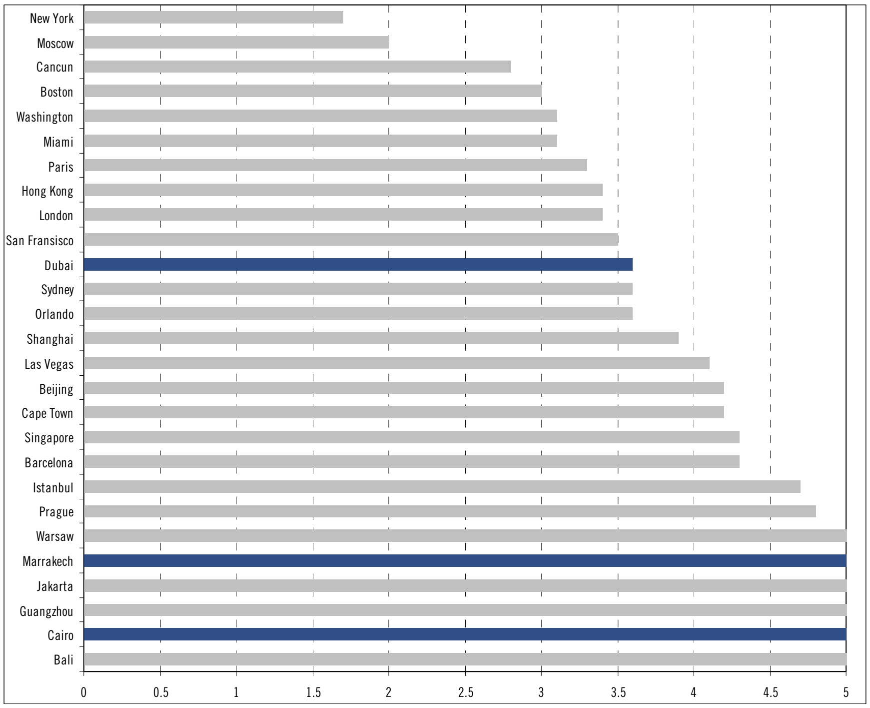
- Dubai average hotel room rates are already amongst the most expensive globally in terms of pricing for top end accommodation and average pricing for all the rooms available. See Figure 33 below.
- However, the purchasing power of a tourist in Dubai is also relatively attractive in terms of the quality of hotel available for comparable price. The standard of room available for the same price is superior in Dubai compared to several other destinations in the top 10 most expensive cities (London, Hong Kong, Paris, New York, Moscow).

Figure 33. Average Price per room night 2007



Source: Hotel.com (The Hotel Price Index UK 2007) and CIR

Figure 34. Star Rating Available for GB Sterling 100 Per Night



Source: Hotel.com (The Hotel Price Index UK 2007) and CIR

Implications for Investors

High tourist growth underpins the case for hotel room expansion in MENA. However, we are wary that unlike other segments of the real estate market, hotels arguably compete more directly across countries and governments are less able to regulate the market when there is a serious risk of regional over supply of generic hotel real estate.

Appendix 1 – Project Plans v Progress

Grand Plans and Cheap Talk

Overspend risk

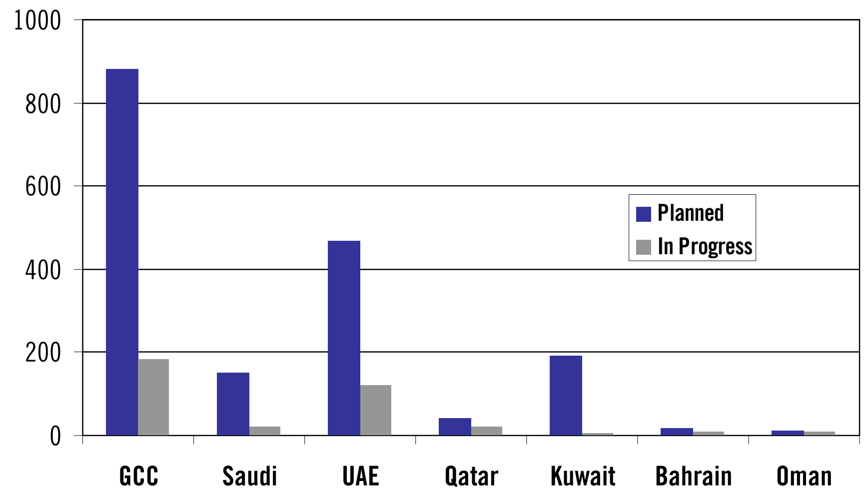
While the reinvestment of the hydrocarbon boom underpins the confidence of many investors in MENA economies, the sheer scale of planned project spend also creates concern on the economic efficiency of those plans, in terms of their long-term stability once the current boom has passed. Will excess liquidity in the region (fuelled by the oil price and negative real interest rates) drive profligate spending and value-destroying construction activities by individual companies? Will MENA end up with many "white elephants"?

Project spend reality check

In this context, we note that there is a major discrepancy between the projects which have been announced and those that are actually underway. According to oft-quoted MEED (Middle East Economic Digest) data there are plans for nearly $2 trillion of construction projects in the GCC. Less often referenced though are two pieces of telling MEED data:

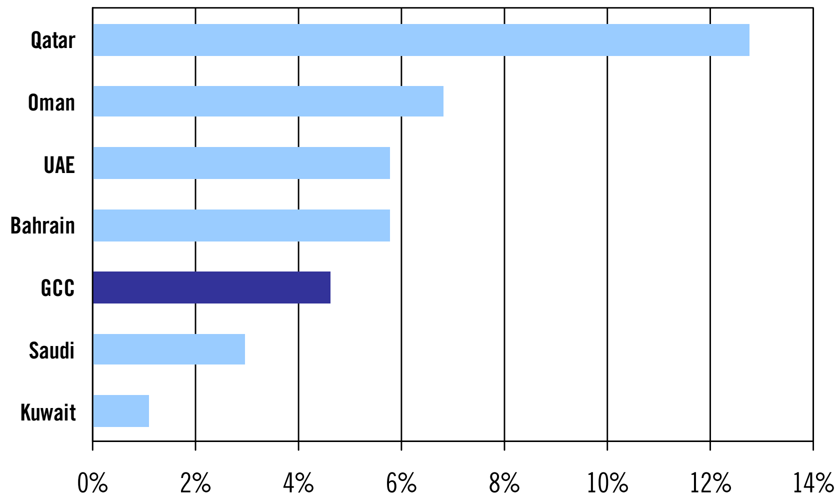
- Merely 20% (by value) of those projects have started.
- The 12-month order books of the largest 50 contractors in the region equate to merely 5% of all announced project value (yet most projects likely have a completion time frame well below 20 years).

Figure 35. Planned v In Progress Construction (USD Billions)



Source: MEED and CIR

Figure 36. Top 20 Contractor Backlogs as Percentage of Planned Construction



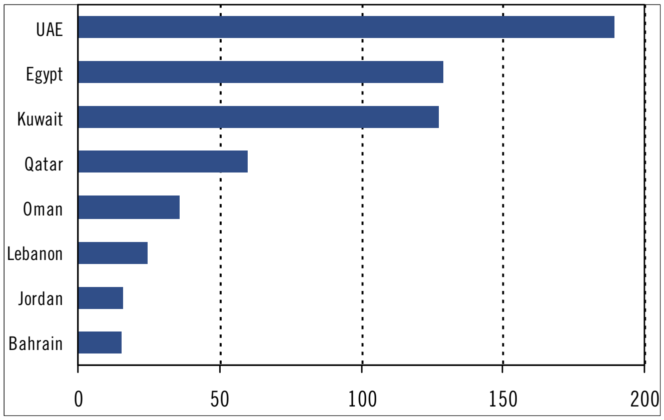
Source: MEED and CIR

Implications for Investors

The discrepancy between announced project spend and actual work in progress may suggest greater value discipline in project planning, rational delays in the face of potential excess supply or, simply, the constraint of high input cost inflation. Whatever the explanation, we argue this data is consistent with the thesis that the region's real estate and construction markets are not rushing into over-supply.

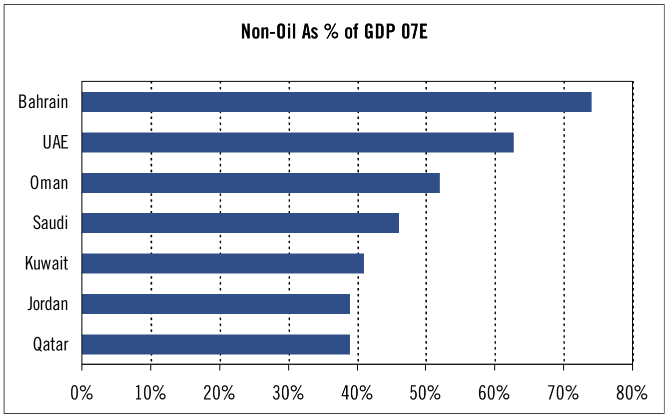
Appendix 2 – MENA Macroeconomic Data

Figure 37. Nominal GDP 07E (USD)



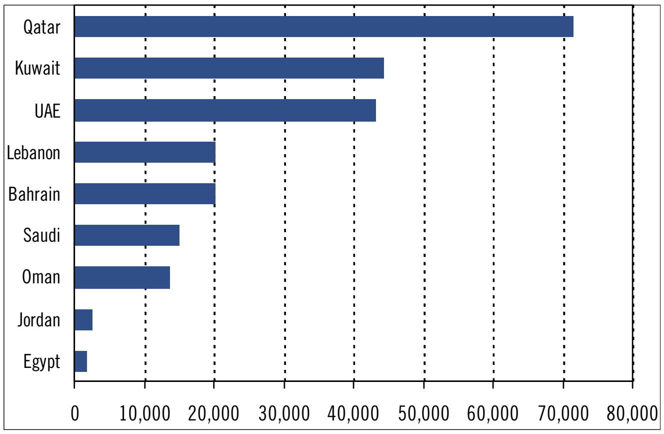
Source: Citi Investment Research

Figure 38. Non-Oil As % of GDP 07E



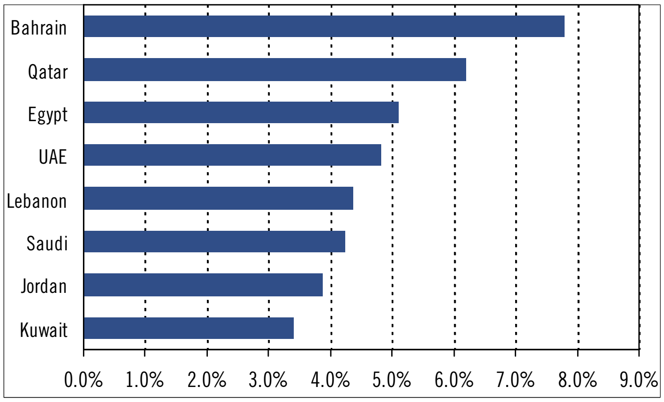
Source: Citi Investment Research

Figure 39. GDP Per Capita 07E (USD)



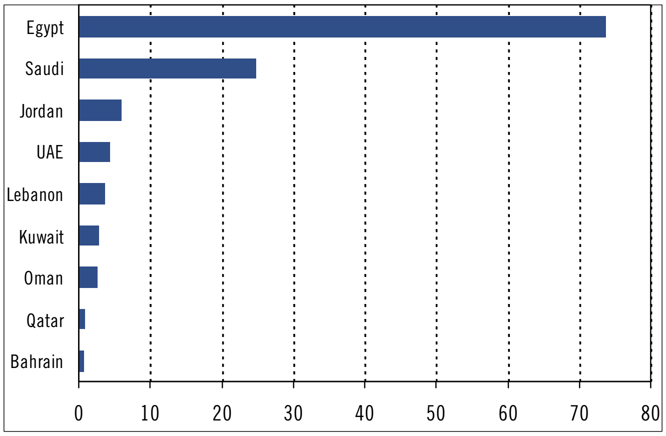
Source: Citi Investment Research

Figure 40. Real GDP CAGR 07E-11E (%)



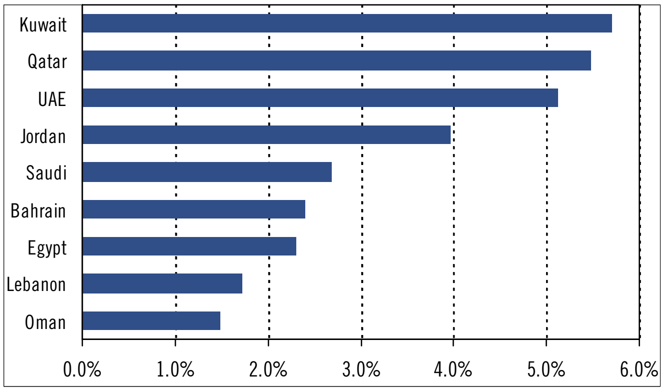
Source: IMF and Citi Investment Research

Figure 41. Population 07E (m)



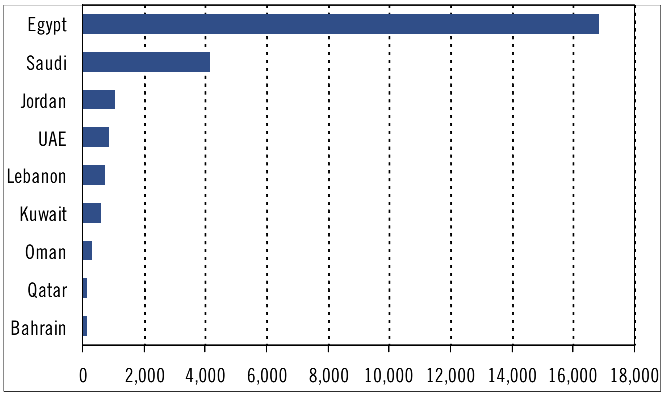
Source: EIU, IMF, National Central Banks and Economics Ministries and CIRh

Figure 42. Population CAGR 07E-11E (%)



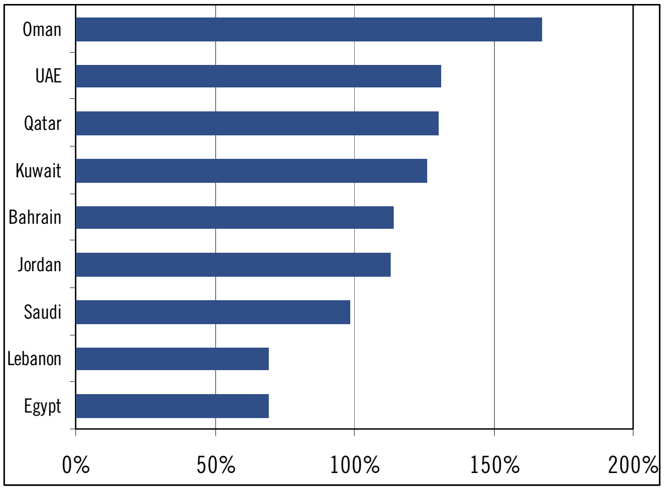
Source: EIU, IMF, National Central Banks and Economics Ministries and CIR

Figure 43. Residential Units 05E (k)



Source: Oxford Business Group, National Census Statistics and CIR

Figure 44. Residential Unit Increase to 2028E (%)



Source: Citi Investment Research Estimates

Appendix A-1

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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