



Global Real Estate Report



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Global Real Estate



US Real Estate



UK Real Estate



Saudi Arabia Real Estate

Global Real Estate Market

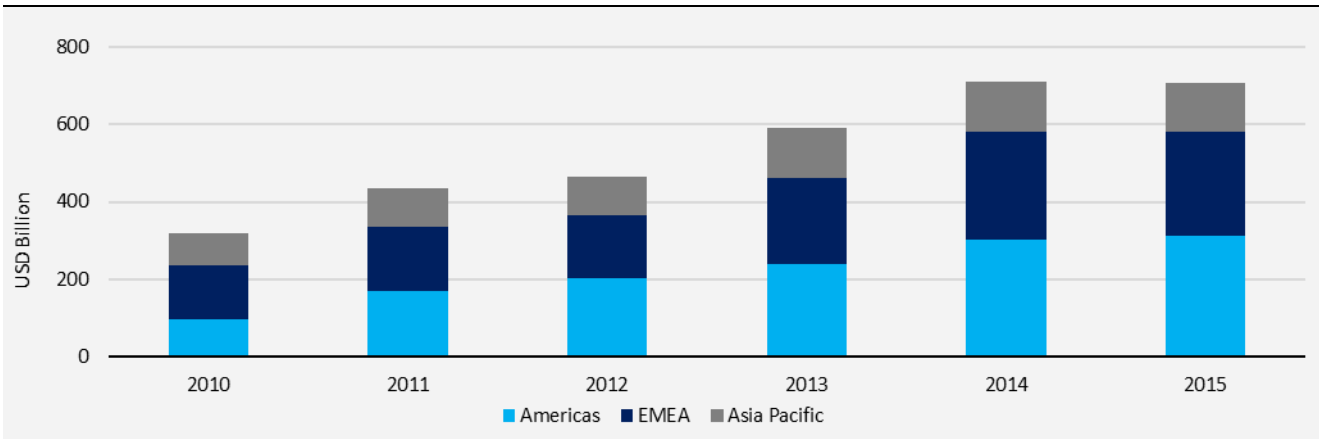
Real Estate Gaining Traction Amid Yield Compression in Financial Assets

Heightened economic uncertainty and stock market volatility have been key features of global financial markets in recent months. Concerns over a slowdown of the Chinese economy, low oil prices and the US Federal Reserve's rate hike plan have dominated headlines across the globe and significantly influenced asset class returns. Added to that, the Bank of Japan treading the European Central Bank's path, pushed interest rates into negative territory. Amid growing concerns over the health of the world economy, investors are increasingly adopting new investment strategies and seeking ways to diversify their portfolios and generate returns.

Real estate is one avenue that is increasingly gaining traction. Real estate which was significantly impacted during the global financial crisis nearly eight years ago has continued its steady recovery, with investments in both, residential as well as commercial sectors, improving notably in recent years. Most of the residential market investments (excluding multifamily) came from private wealth, while investments from corporate or institutional investors were primarily directed towards the commercial real estate segment.

On the commercial real estate front, post the 2008 financial crisis, stringent lending standards and economic uncertainty resulted in tighter supply while occupier demand improved. Investments in commercial properties came in at USD 704 billion in 2015 and were marginally lower than in the preceding year. However, investments in real estate are now approaching pre-crisis levels of about USD 758 billion in 2007. Prospects for the global real estate market also appear bright, with projections from CBRE- a Real Estate Investment Management Company, indicating that investments in commercial property are expected to surpass the USD 1 trillion mark this year.

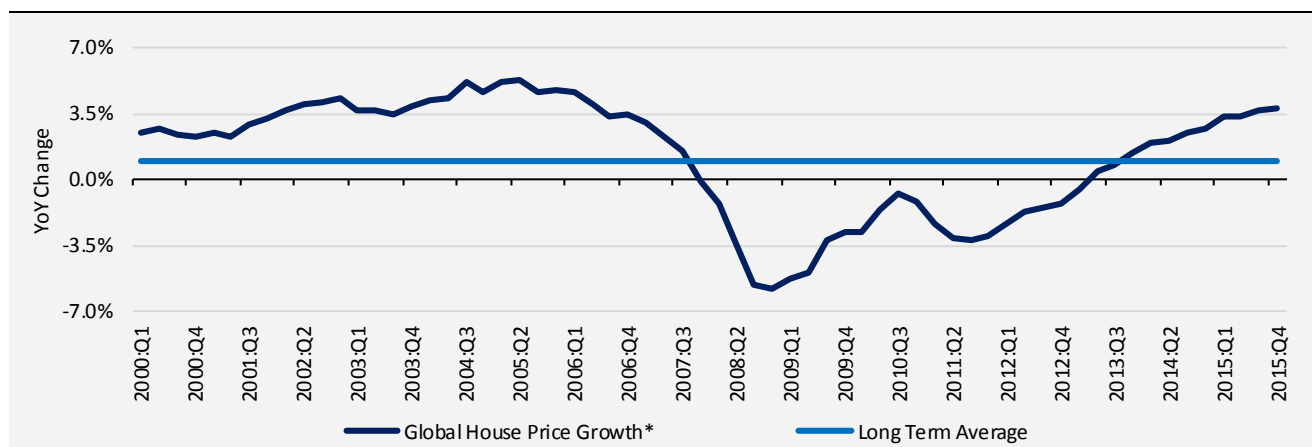
Steady Increase in Direct Commercial Real Estate Investment Volumes



Source: JLL

Residential markets have also recovered significantly since the 2008 financial crisis, with house prices showing robust signs of picking up. According to CBRE, global house prices increased about 3.7% YoY in 2015, the strongest pace since the crisis. Although differences in price growth were apparent across countries and regions, house prices have been rising in most parts of the world.

Global House Price Growth



Source: Federal Reserve Bank of Dallas, * Real House Price Index Growth

On a regional basis, the Americas region has recorded the highest levels of investment activity over the years. Investments in the region surged to new highs last year, with New York witnessing its strongest year on record and Los Angeles receiving significant investor interest. Commercial and housing markets witnessed a surge in cross border investments, especially from Chinese investors. Western Europe has also been a popular destination for investment, with London and Paris being the preferred cities among investors. Nordic countries, especially Norway and Finland, have witnessed a pick-up in investment activity in recent months. In the Asia Pacific region, the highest levels of commercial real estate investment volumes have been observed in Tokyo and Sydney. The Australian housing market also witnessed a flurry of investments in 2015.

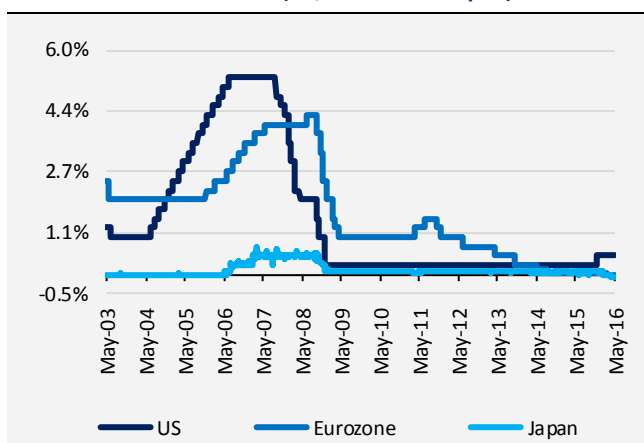
On the whole, the real estate sector has exhibited strong growth in recent years, and though 2015 saw a marginal decline in commercial real estate investments, we expect the industry to continue its positive momentum. Having said that, regional trends will differ and influence the overall sector. We remain reasonably optimistic about real estate as an investment class and anticipate a growing number of investors to consider it as a diversification tool.

In this report, we have discussed the reasons why we expect investment allocations towards real estate to increase, which key markets will be the preferred investment destinations and why certain sub segments are likely to outperform. We have also analyzed in detail the real estate markets of Saudi Arabia, UK and the US. Additionally, we have also developed an in-house methodology to assess different markets, based on the key factors influencing real estate markets.

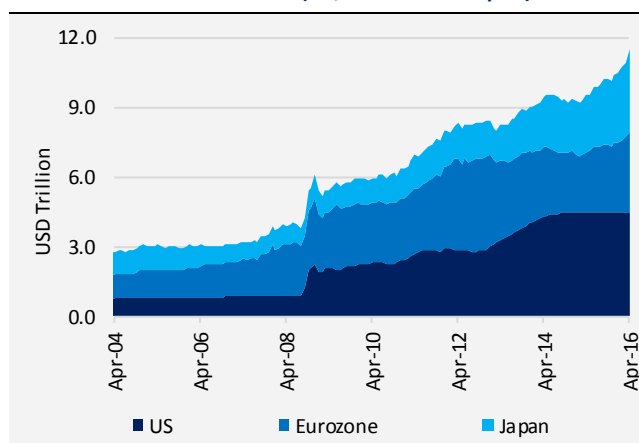
Why Real Estate is an Attractive Investment Avenue?

Accommodative Global Monetary Policies Will Support Real Estate Growth

Global monetary policies have remained accommodative since the financial crisis. Record low interest rates and ample supply of liquidity have resulted in increased asset prices. Central Banks of Eurozone, Japan and UK remain committed to maintaining a sizable asset purchase program. Additionally, central banks of Sweden, Singapore, China, South Korea and many other countries have lowered their policy interest rates. Although, the US Federal Reserve unwound its asset purchases and is on path to increasing benchmark interest rates, we expect the hike in interest rates to be gradual. At this juncture, while we do not expect additions in asset purchases by central banks, any weakness in economic data could compel such a move. Moreover, with inflation still hovering close to record low levels, we expect interest rates to remain low. In this backdrop, the global demand to invest in real estate has been increasing.

Benchmark Interest Rates (US, Eurozone & Japan)

Source: Bloomberg

Central Bank Balance Sheet (US, Eurozone & Japan)

Source: Bloomberg

Quest for Steady Returns will Drive Investments in Real Estate Markets

Traditional investment assets in the past few years have failed to offer reasonable returns to investors. The introduction of negative interest rates in some economies have weighed on fixed income instruments, while volatility in the stock markets have kept many investors off limits. On the other hand, accommodative policies of central banks across most advanced economies has resulted in increased liquidity. In this backdrop, real estate investment is one avenue that is increasingly being considered as an alternative investment asset class. The steady recurring nature of rental income not only provides a stable stream of cash flow and diversification benefits, but also exhibits a low correlation to traditional financial assets.

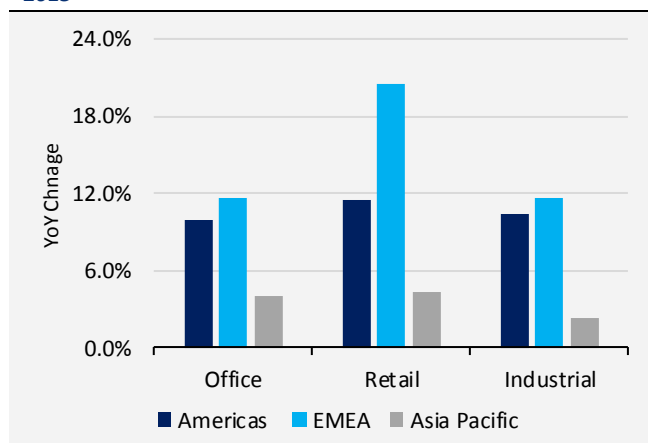
Real estate investments historically have performed better than most other asset classes. According to figures from Green Street Advisors, the US office sector offers more than 370 basis point premium over yields from 10-year government bonds. Long term investors such as the pension funds which strive for higher rates to meet their investment return targets have shown a keen interest to invest in this asset class.

Annualized Asset Class Returns as on 31 December 2015

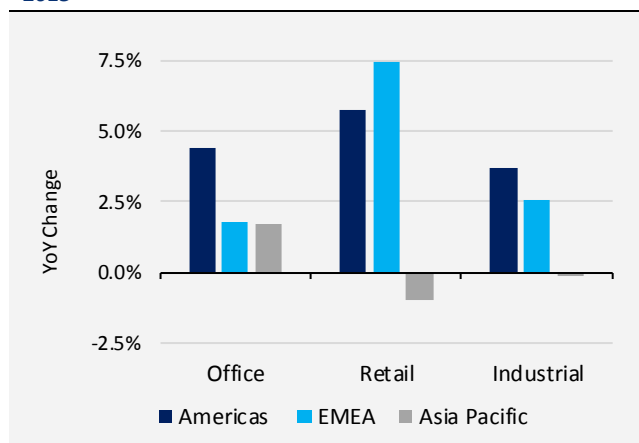
	1 year	3years	5 years
Global Equities	-4.3%	5.5%	3.8%
Corporate Bonds	-4.7%	0.8%	4.5%
Government Bonds	-2.5%	-2.3%	0.1%
Global Commodities	-17.3%	-13.5%	-7.5%
Global Real Estate	-2.4%	2.8%	4.1%

Source: Bloomberg

Note - Global Equities: MSCI All Country Gross World Total Return Index; Corporate Bonds: Bloomberg Global High Yield corporate bond Index; Government Bonds: Bloomberg Global Government Bonds Index; Global Commodities: Bloomberg Commodities Index; Global Real Estate: MSCI World Real Estate

Capital Growth in Commercial Real Estate (Prime Markets), 2015

Source: CBRE

Rental Growth in Commercial Real Estate (Prime Markets), 2015

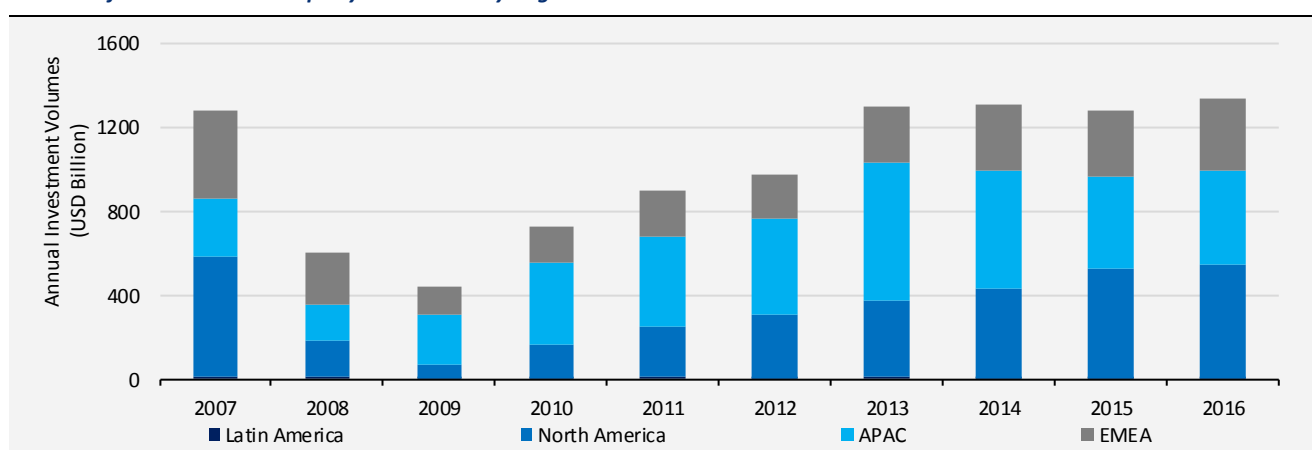
Source: CBRE

CBRE's Global Investor Intentions Survey for 2016 revealed that most investors were optimistic about increasing allocations to the real estate sector. The planned investment in the real estate segment this year is expected to surpass USD 1 trillion, increasing by almost 6% compared to 2015. Easy liquidity and better yields are expected to support returns from real estate assets.

Cross Border Investments in Real Estate Expected to Surge

Monetary policy divergence has been a key feature of global financial markets over the past year. After seven years of near-zero interest rates, the US Federal Reserve hiked its benchmark rate towards the end of 2015 and has also emphasized its plan to initiate further rate hikes, though at a gradual pace. On the other hand, the European Central Bank (ECB) and the Bank of Japan (BoJ) have continued to maintain accommodative monetary policies to support their economies. This has resulted in major currency movements and influenced cross border investments in real estate and prospects of carry trade. Cross border investments in property markets of US, Canada, Australia, UK and Singapore are seeing a flurry of investor activity.

Outlook for 2016: Global Property Investment by Region



Source: Cushman & Wakefield - Atlas Outlook 2016

According to global real estate services provider Savills, about 20% of real estate deals in 2015 were cross-border, compared to 17% in 2009. Cross-border volumes surged from USD 65 billion to USD 217 billion over the same period, highlighting the trend of relatively cheap money combined with the quest for rental growth. Global real estate investments saw an increased participation from the Chinese, Middle East and Japanese investors. According to a study by the Asia Society and Rosen Consulting Group, Chinese investments in US real estate which reached more than USD 110 billion in the five years to 2015 is expected to nearly double to USD 218 billion in the second half of the decade¹. Anbang insurance group's USD 2 billion deal to acquire the Waldorf Astoria hotel in New York last year and its

¹<https://www.theguardian.com/business/2016/may/16/chinese-pour-110bn-into-us-real-estate-says-study>

unsuccessful USD 14 billion bid for the Starwood group in March 2016 have made headlines. Volatility in home markets, concerns about slowing domestic growth and devaluation of the Renminbi has also resulted in many Chinese investors investing in real estate markets in the UK, Canada and Australia, where experts believe that property prices have risen partly due to a surge in Chinese property investments. Likewise, Japan's negative interest rates have fueled investments in Australia's property segment. The search for better returns has also prompted a large number of wealthy Middle East buyers to invest in real estate abroad with about 90% of the overall investments coming from the GCC economies. Bahrain-based Investcorp, an alternative asset manager in the Gulf region, invested about USD 400 million in eight multi-family properties across the US in October 2015.

Investors Should be Mindful of the Warning Flags

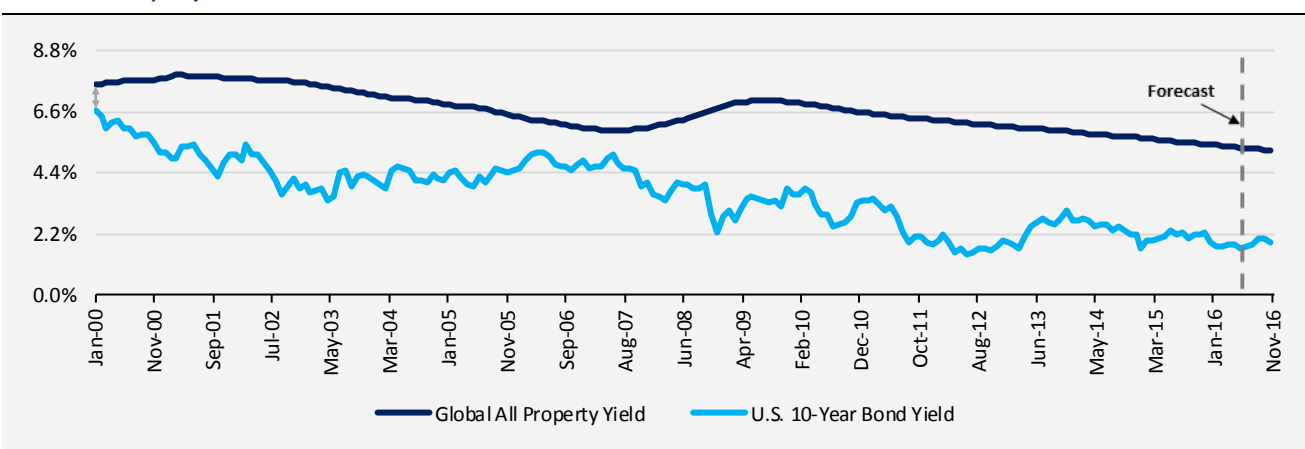
Interest rate hikes in the US and possibly in the UK could not only weigh on foreign capital flows but would also have an impact on currency exchange rates. Investors with short term investment horizons or investments funded by high levels of short-term debt, could be impacted by currency fluctuations. Moreover, real estate markets that offer a small spread over government bond yields would be susceptible to market movements. Tighter interest rate policy in the US could expose the financial vulnerabilities of emerging market economies. Foreign currency debt, denominated largely in US Dollars, has increased considerably in recent years in emerging markets. Increased borrowing costs and pressure on debt servicing capacity could lead to liquidation of real estate assets. Concerns of a hard landing in China, geopolitical risks in Middle East and the UK exiting the European Union could have a short term impact on the real estate markets. On the other hand, economies pursuing ultra-loose monetary policies will see banks being pressurized to lend money. Cheap money is likely to be diverted to real estate investments despite expensive stretched valuations in several markets. We recommend investors to exercise caution and undertake intensive due diligence.

Key Trends in Real Estate Investing

Real Estate Investing will Become Increasingly Competitive; Expect Yield Compression

Increased liquidity in global markets has resulted in investors allocating more funds towards real estate markets. Property prices have been on an upward trajectory in the past few years as investment volumes are rising and investors vie for a limited pool of assets, resulting in yield compression. Post financial crisis, prime property yields have compressed by an average of 25 basis points every year². According to Colliers, yields in prime office markets of London, Hong Kong, New York, and San Francisco which witnessed robust investment flows, are near the below pre-crisis levels. We expect downward pressure on prime yields to continue as real estate transactions are anticipated to increase. Nevertheless, spreads over long-term sovereign bond yields will remain more elevated than the pre-crisis levels when interest rates were higher. Moreover, interest rates will continue to remain at record lows in most countries.

Global All Property Prime Yield & U.S. Government Bond Yield



Source: Prudential Real Estate Investors

Investors should invest in real estate markets that have higher rental growth potential. Furthermore, though yields are anticipated to face pressure, they will likely remain attractive compared to other asset classes.

²Prudential Real Estate Investors

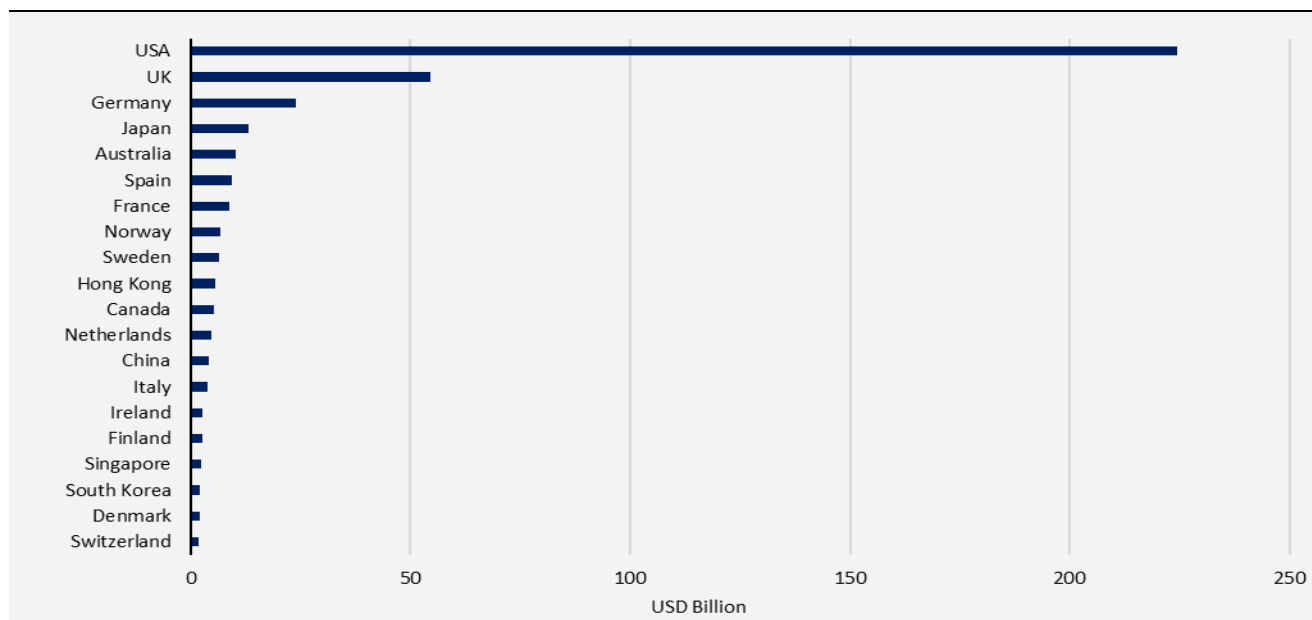
North America and Western Europe will be the Preferred Investment Destinations

The US economy has emerged as one of the major bright spots across developed economies. Compared to other G7 nations, the US is projected to be the fastest growing economy, with overall activity remaining supported by robust housing and labor markets. A robust economy augurs well for commercial real estate investments. The perceived status of the US as a safe haven has resulted in increased flight of international capital into the US real estate market. Moreover, the transparency of commercial real estate in the US is also a key reason for the increased levels of investments compared to some of the other economies. The US was ranked as the second most transparent real estate market in Jones Lang LaSalle's (JLL) Transparency Index in 2014, which cited the nation's leadership in tracking real estate market data and time series data at the submarket level across property types, thereby providing investors with a clear view of the prevailing market conditions.

Recent regulatory changes in the US are expected to result in added inflows into the country. The tax burden imposed on international investors is now likely to be substantially lighter as the government has eased restrictions on the 35-year-old tax on foreign investments, by bringing in changes to the Foreign Investment in Real Property Tax Act (FIRPTA) in late 2015. The share of publicly traded stocks that an overseas investor may hold without incurring FIRPTA withholding and tax upon sales of stock has been increased from 5% to 10%. In addition to exempting foreign pension funds from this legislation, taxes on certain gains on the sale of REIT stocks and capital gain distributions from REITs are also exempted. This is likely to fuel overseas investors' appetite for REIT holdings and facilitate the flow of foreign capital into the US real estate market.

Investment activity is also witnessing an uptick in the Western European countries. Quantitative easing in the Eurozone and negative interest rate policy will support real estate investments. However, the looming uncertainty of UK's future in the European Union has led to a decline in investment volumes in the first quarter of 2016, reflective of the cautious sentiment in the market. Investments from Asian funds in Malaysia, Singapore, China and Taiwan have seen a sharp increase in allocations towards European commercial real estate in 2015. Investors are now broadening focus from key markets of London and Paris to other cities such as Berlin, Munich and Frankfurt.

Top 20 Markets by Total Commercial Real Estate Investment



Source: CBRE, H1 2015

Office Markets will be Favored Over Other Commercial Real Estate Investments

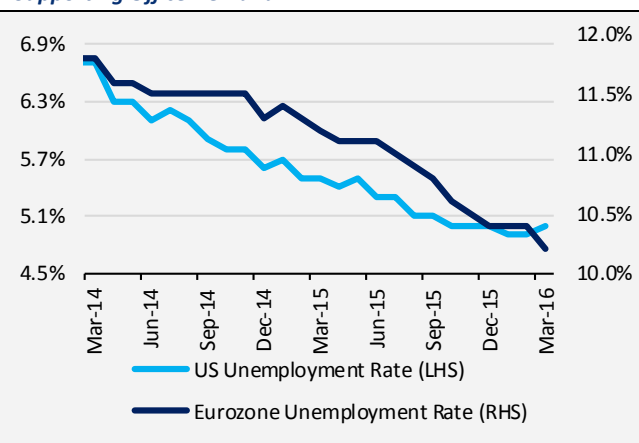
Fundamentals in office markets across most major regions of the world showed signs of tightening in 2015, with the JLL Global Office Index registering an annual 3.7% rise in 4Q15, the strongest annual growth pace in four years.³ Although

political and economic concerns weighed on sentiment, the uptrend in office market rentals continued amid strengthening labor market metrics across most nations.

In the US, additions in nonfarm payroll were above 200K for 20 out of the last 27 months, while in the Eurozone, the number of employed people has continued to rise at an ascending rate for the past eight quarters till 4Q15. Prime office rentals across 95 key markets covered by JLL increased at a stronger pace of 1.3% QoQ in the last quarter of 2015 from 1.2% in 3Q15. Stronger rental growth in the Asian Pacific and MENA region was seen with rents climbing 1.3% and 7.4% QoQ in 4Q15, respectively, compared to 0.6% and 1% in the prior quarter, respectively. Meanwhile, America and Europe lagged, where rental growth in both regions slowed to 0.8% in 4Q15 from 1.6% and 1.5% in the preceding quarter, respectively.

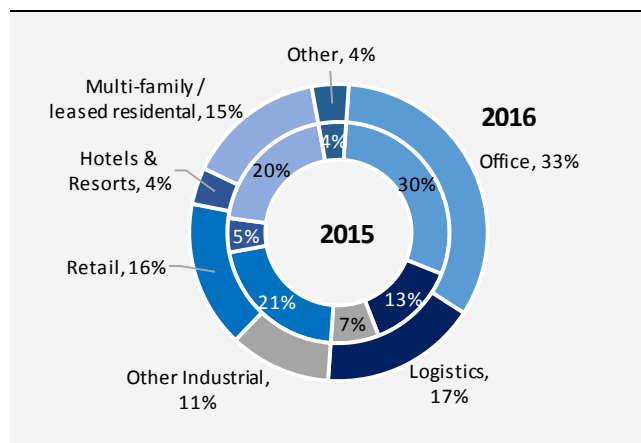
We expect office market fundamentals to further strengthen as corporate demand for new space would continue to exceed supply and push vacancy rates lower. According to JLL, global office leasing volumes are expected to advance 5% and rentals are estimated to grow by 4% in 2016. Occupier demand has been strong while supply has failed to catch up, especially after the financial crisis. In Asia Pacific, office leasing volumes are expected to increase by another 15% in

Robust Labor Market Growth in Key Economies has been Supporting Office Demand



Source: Bloomberg

Investor Preference for Real Estate Investments



Source: CBRE—Global Investor Intentions Survey 2016

2016, after posting a 19% rise in 2015. In Europe, an expected recovery in demand alongside the central bank's stimulus measures could result in office rental growth of between 2% and 3%. In America, despite a tightening policy cycle in the US and a slowdown in the commodity heavyweight Latin American countries, the regional JLL office index is anticipated to witness a 6% YoY growth in 2016. A majority of demand for new office space is expected to come from the US, where stable economic recovery and a well-diversified labor market growth is expected to bring unemployment levels below 5% and increase occupancy levels. However, in the MENA region, rent in prime areas is anticipated to remain steady, amid expectations of a large amount of new upcoming supply.

Warehousing is Emerging as a Promising Investment Potential, Performance to Vary Across Different Regions

An encouraging pace of demand in the global warehousing segment, especially with improving occupiers' activity in the American and European regions, helped rentals in the world's industrial market register a healthy rental growth of 6% in 2015.⁴ CBRE Group's 'Global Prime Logistics Rents Report' highlights a strong global demand for e-commerce fulfillment centers and distribution centers. Growth is especially witnessed in US coastal markets that are close to urban population centers. Apart from the US, higher demand from Canada, particularly in Toronto and Vancouver, and from Mexico, is expected to support rental growth across the American warehousing segment during the year. The US industrial segment, which witnessed its twenty-third straight quarter of positive absorption rate, has been a key market to boost global warehousing demand. Strong demand from the e-commerce sector helped vacancy rates in a few regional US markets to reach between 3% and 5% and assisted average asking rents across the nation's warehousing sector to grow 5.5% in 2015, according to JLL. In the European region, demand from the e-commerce industry kept absorption rate in the warehousing segment supported. According to JLL, absorption volumes in the region stood at a record high level of about 16 million square meters in 2015. However, supply in the sector also remained elevated, with

³<http://www.propertywire.com/news/global-news/global-office-markets-rents-2016030711643.html>

⁴<http://www.wsj.com/articles/warehouse-rental-rates-jump-as-industrial-capacity-is-squeezed-1459371952>

the construction of new warehousing space in 1Q16 at its highest level since 2008. Additionally, constraint of modern warehousing space and difficulty in finding suitable land across the growing European markets could weigh on regional occupiers' activity. We expect rentals in the region to remain steady or to witness modest growth for 2016. In the Asia Pacific region, warehousing demand came majorly from e-commerce and third party logistic companies. Although the region's rentals remained broadly unchanged for 2015, leasing performance was regionally diverse in 2015. While performance across the Hong Kong and Australian markets was subdued, Beijing markets registered the highest rental growth during this period. On similar lines, for 2016, rentals in the region are broadly anticipated to remain steady, amid limited growth in exports and retail sales.⁵

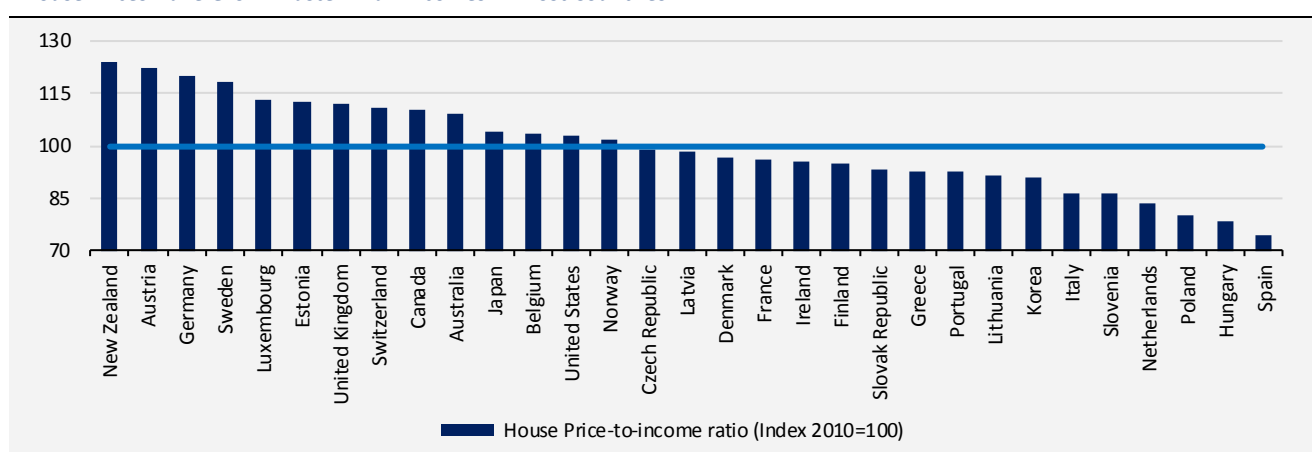
Growth in House Prices Can See Some Signs of Moderation, Investment Activity will Stay Supported by Robust Rentals

House prices saw a robust growth in the past few years driven by the pent up demand for housing which had stagnated in the aftermath of the financial crisis, and low mortgage rates in most countries. Improved job markets, increased urbanization and a growing middle class in emerging economies aided demand for housing and in turn an increase in house prices.

Residential markets in Canada, Australia, the UK and the US saw a surge in foreign investments and demand from the 'buy to let' segment resulting in the heating up of property markets. Although we expect house prices to increase, price growth could witness a moderation in the medium term, particularly considering that large upcoming residential supply is expected in many major markets going forward. Moreover, many governments in the past few months have started intervening by imposing various measures such as taxes and fees to halt the pace of price growth. A select few housing markets of Hong Kong, Moscow and Singapore are showing signs of strain and could weigh on the overall price growth. Home prices in Singapore continued to decline in the first quarter of 2016, marking 10 straight quarters of decline as tighter mortgage controls curbed demand in Asia's second-most expensive housing market.

The rising house prices are also taking a toll on affordability, deterring first time home buyers to enter the market and causing rentals to surge. For instance, in the US, home ownership rates have declined from 69% in 2004 to 63.7% in 2015, while rentals as a percentage of household income have increased to 26% in 2015 from 24% in 2009. Demand from the 'buy to let' segment is expected to remain buoyed by growing rentals. Investors in the 'buy to let' segment especially in the US, UK and Canada can also tap newer avenues such as student housing.

House Prices Have Grown Faster Than Incomes in Most Countries



Source: IMF, Global Housing Watch Report - April 2016

⁵ <http://www.jll.com/gmp/market-perspective/warehousing>

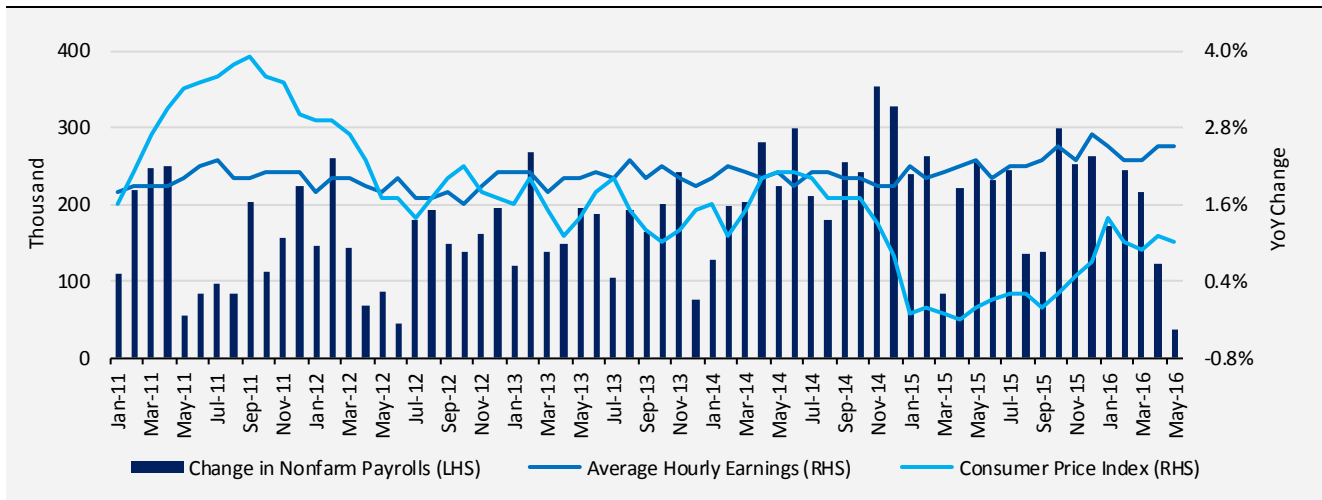
Analyzing the Real Estate Markets of US, UK & Saudi Arabia

US Real Estate Market

Economy Overview

The US has stayed on a robust path of economic growth, despite global headwinds and weakness in commodity prices. Even though the IMF recently downgraded 2016 growth forecasts for the US economy, the country is still expected to outperform other G7 member countries in terms of GDP expansion this year. Hiring pace in the US has remained fairly robust, with nonfarm payrolls registering an increase of more than 200K for 20 out of the 27 previous months. Average wage growth amongst domestic employees has also continued to grow, well above the consumer price inflation, boosting real incomes of residents. Moreover, the Conference Board's reading on US consumers' morale has remained above the 90-mark for an eighteenth straight month, well above the post-recession lows.

Domestic Hiring Pace Continues to Stay Robust, Real Income amongst Locals has Picked Up



Source: Bloomberg

Citing the healthy labor market growth and improving confidence among domestic consumers, the US Federal Reserve (Fed) Chair, Janet Yellen, has hinted at prospects of more rate hikes this year. However, the central bank is likely to maintain a cautious approach and increase interest rates moderately, as the US economy faces headwinds from turmoil in other economies. Amid marginal increases in interest rates we expect higher borrowing costs to have a limited impact on the real estate segment's growth.

The US real estate market has enjoyed a high inflow of investments over the past few years. Direct commercial real estate investments in the US, during the 2006 to 2015 period, were nearly double the global average range of 0% to 5%, according to JLL. Going forward, the recent relaxation of the taxation policies for foreign real estate investors could drive up demand for US properties in the future. Moreover, the recent turmoil in global equity markets could increase demand for alternative investment opportunities, causing investors to park their funds in the US real estate segment which is considered a safe haven in the property market.

The US Residential Market

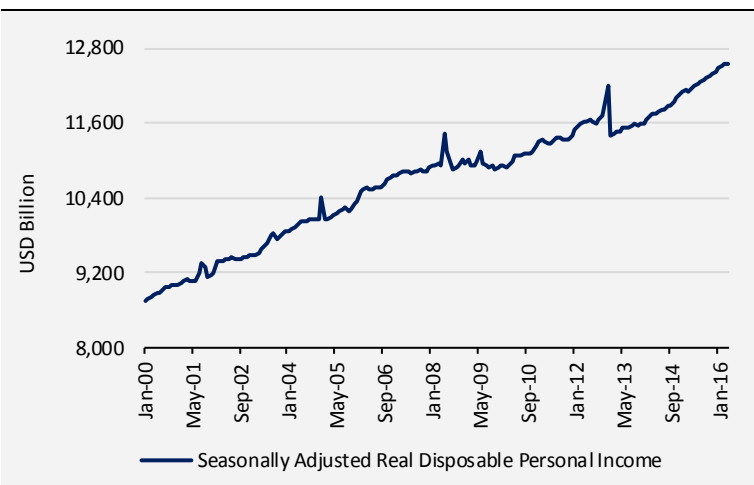
Executive Summary

The US housing market has staged a healthy recovery from the contraction witnessed during the 2007-08 crisis. Markets witnessed a broad uptrend in US home sales, house prices and construction activity. Going forward, we anticipate the US housing demand to stay supported as household formation, which had stagnated in the aftermath of the financial crisis, starts increasing encouraged by a robust labor market. Moreover, we anticipate that a housing supply deficit will continue to fuel price growth. We expect price growth to be largely location driven, with few states exhibiting stronger price increases. Demand from the 'buy to let' segment is envisaged to increase at a higher rate while demand from first time buyers will increase more gradually over the medium term. Stringent credit rating norms after the subprime mortgage crisis, burden of student debt and rising house prices are weighing on affordability levels, resulting in a notable portion of the local populace opting for rentals over ownership.

Buoyant Labor Market and Low Borrowing Costs will Support Demand for Housing

A healthy pace of growth in US nonfarm payrolls has brought the country's unemployment rate to 5% in March this year from a peak level of 10% in October 2009. Moreover, growth in average wage earnings has continued to outpace inflation of late, as low commodity prices have kept a lid on inflation, resulting in an improvement in domestic consumers' real incomes. The real disposable personal income among locals has continued to register a growth of above 2% for more than two years. With a robust hiring pace and a falling unemployment rate, signs of tightening in the US labor market are in sight, amid which domestic wage growth is unlikely to slow.

Rising Domestic Real Income has been Trending Higher



Source: Federal Reserve Bank of St. Louis



Meanwhile, the Fed is on a tightening policy cycle, but the trajectory of rate hikes is anticipated to be more gradual compared to earlier predictions. It is unlikely that this gradual change will affect mortgage rates substantially. In fact, 30-year mortgage rates have actually dropped following the December rate hike in the US. Furthermore, market participants do not expect an increase in longer term yields to have a major impact on mortgage amounts. According to a report by TD Economics, a rise of 20 basis points on a 30-year mortgage on an average priced US home would increase mortgage payments by only USD 25 a month. With average wage growth anticipated to remain at current levels, we believe that the housing market would be able to weather the impact of higher interest rates going forward.

US 30-Year Mortgage Rates



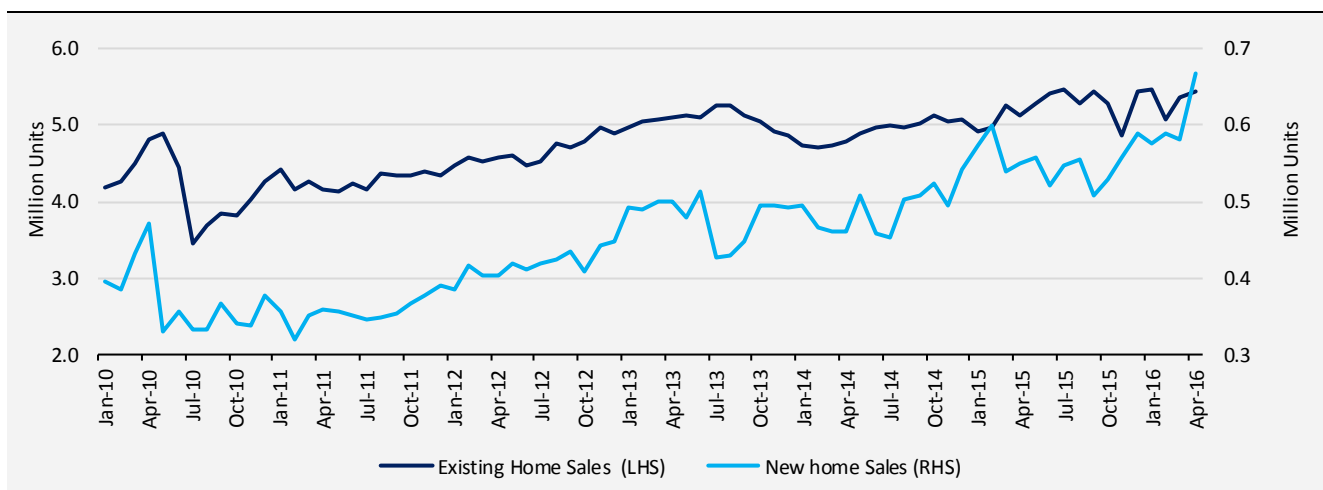
Source: Bloomberg

The improving job market has boosted consumer confidence and supported housing demand. According to reports, Americans bought roughly 5.26 million homes in 2015, a 6.5% increase over 2014. Also, new home sales and existing home sales climbed 15.9% and 7.1% YoY in April, respectively, reinstating views that growth in the US housing market has not lost its upbeat momentum.

In the long run, demand from Millennials (ages 18-34 in 2015) who now outnumber the Baby Boomers- the country's largest living generation, will drive demand for housing as household formation is expected to increase. Household formation rate in the US has slowed in recent times, as the proportion of young people (aged between 25 and 34 years) moving back with their parents increased by 5% over the past five years. We expect young adults who are currently delaying home purchases mainly due to burden of student loans, will enter the markets once finances improve.

US Housing Market Deficit will Continue to Fuel Price Growth

US Home Sales (Annualized)

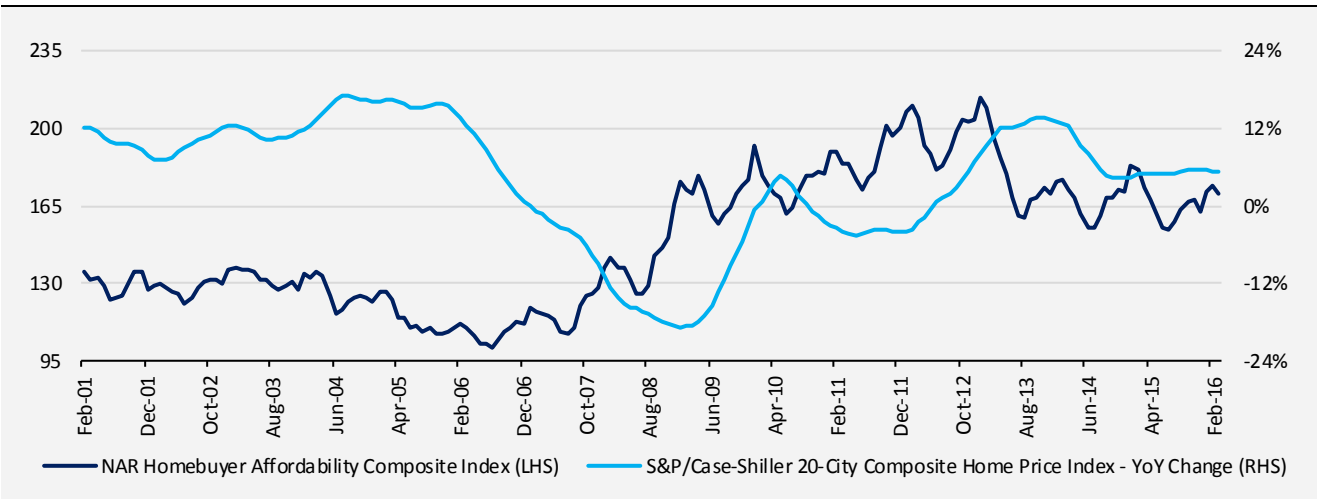


Source: Federal Reserve Bank of St. Louis

A demand-supply mismatch continues to plague the US residential segment. According to UBS, the combined single-family and multi-family housing market deficit stood at around six million units as of the third quarter of 2015. This deficit has continued to keep home prices buoyed, pricing out a certain segment of customers and compelling them to rent homes rather than purchasing them. The S&P/Case-Shiller 20-City Composite Home Price Index which reflects the house price growth of 20 major US metropolitan areas has continued to stay in the positive territory since mid-2012. According to the index reading for February 2016, US house prices have jumped more than 30% from the levels seen in April 2009.

Although the sales of new homes have picked up from the levels seen during the post-recession era, the supply of new

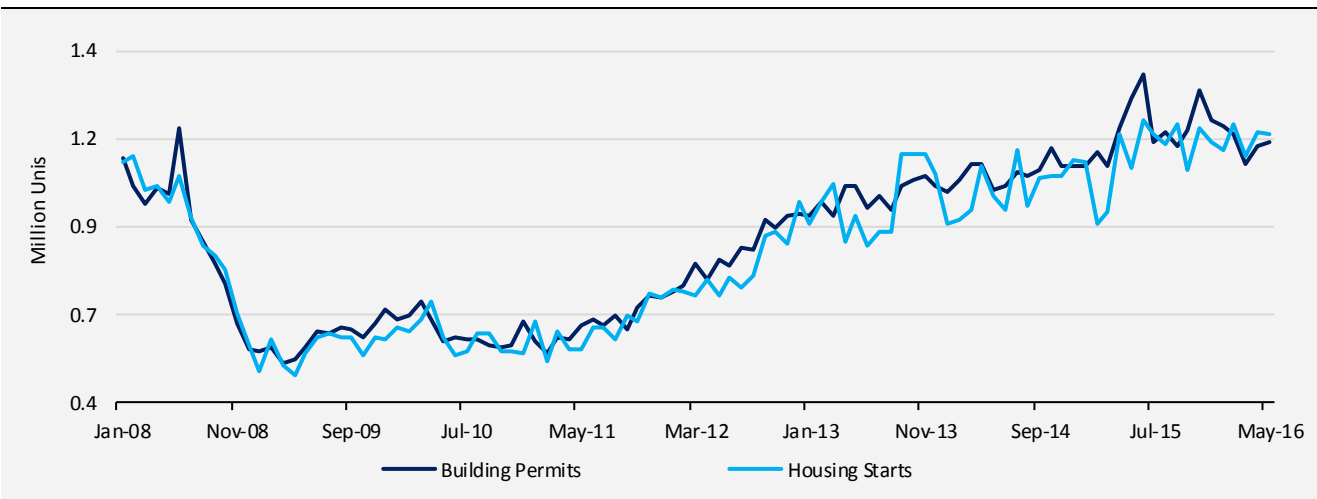
Strong House Price Growth Continues to Weigh on Affordability Levels



Source: Bloomberg

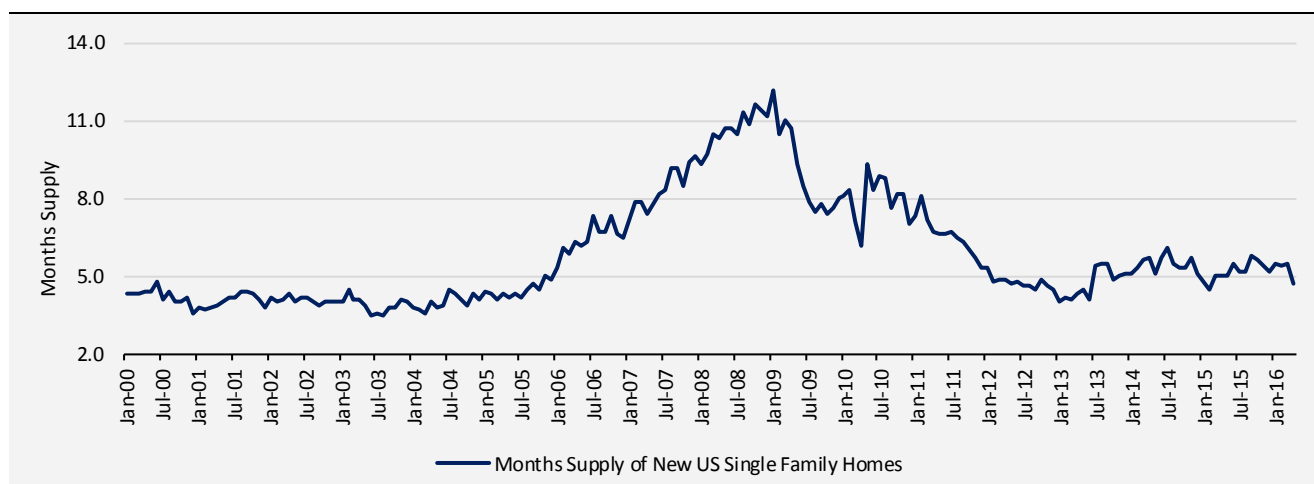
houses has been relatively small in absolute terms. While construction activity in the US has picked up and the housing starts and building permits have witnessed a broad uptrend the most recent data showed that building permits for future home construction hit a one-year low in March 2016.

Building Permits and Housing Starts have Continued to Trend Higher



Source: Bloomberg

Inventory levels in the US residential market, the ratio of homes for sale to actual houses sold, continue to remain well below their pre-recession peaks, highlighting the fact that the shortage of houses is unlikely to wane off soon.

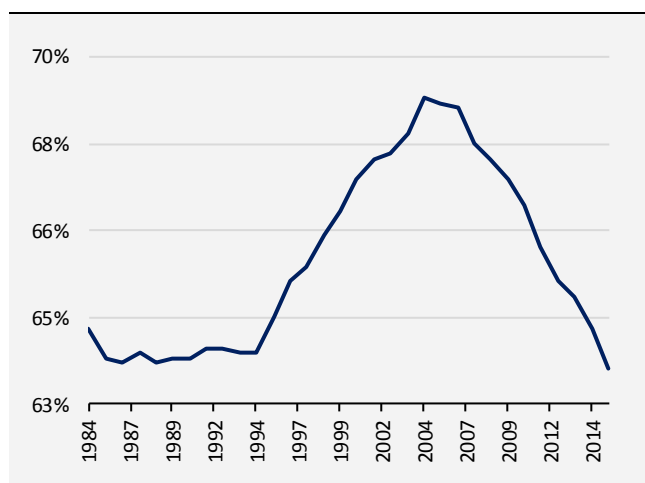
Housing Inventory- Months Supply

Source: US Census Bureau

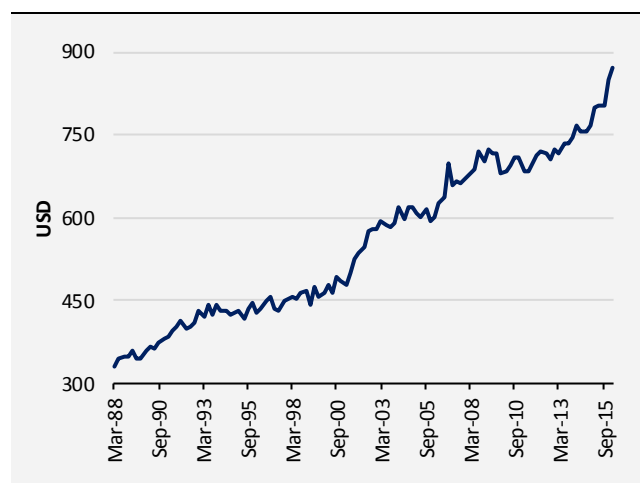
Demand for 'Buy-to-Rent' Properties is Expected to Remain Robust as First-time Home Buyers Face Headwinds

In the past few years, US home prices have increased at rates higher than the growth in income levels, resulting in affordability challenges to first time home buyers. Moreover, stringent credit rating norms and student loans have made house purchases very difficult especially for the millennials who are generally the first time home buyers. In addition, high rents have made it difficult to save for a down payment. Median rents in the US residential segment reached USD 850 in the last quarter of 2015, its highest level on record.

Home ownership rates have dropped from 69% in 2004 to 63.7% in 2015. According to the National Association of Realtors, in the middle of 2006 and 2014 more than 9 million mortgages were foreclosed or underwent a major credit event. Many home owners resultantly shifted to rentals during this period and the stained credit ratings impacted these individuals' abilities to return to owning a house.

US Home Ownership Rate

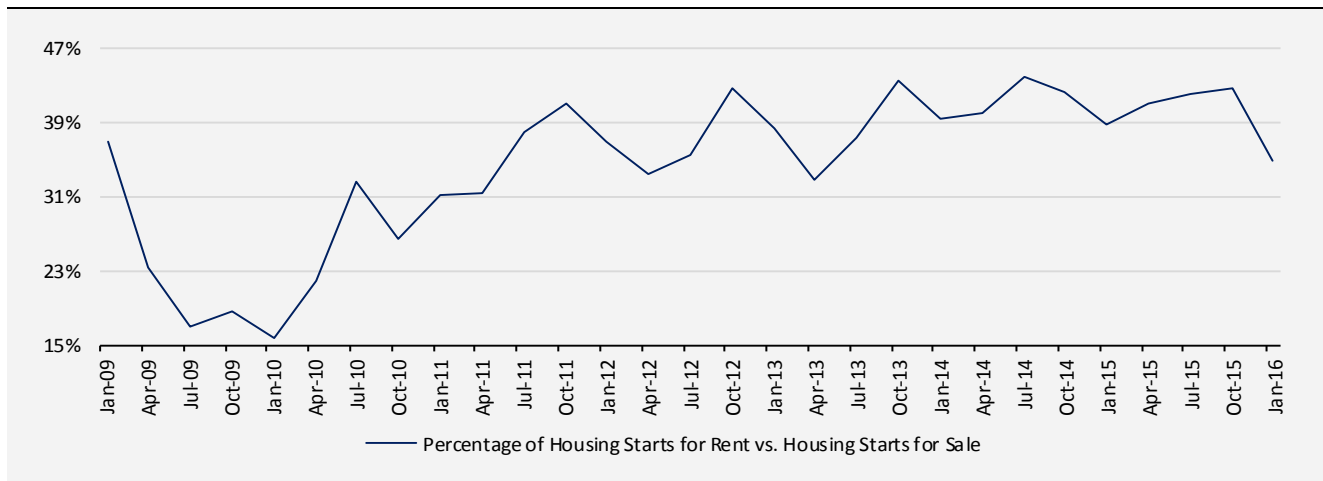
Source: Bloomberg

Median Asking Rent In the US Residential Segment (Monthly)

Source: Bloomberg

Rising rentals have continued to weigh on consumers' pockets, with rents as a percentage of household income continuing to exhibit a strong growth since 2009, making it challenging to save for a down payment. According to UBS, rents as a percentage of household incomes increased to more than 26% in 2015 from less than 24% in 2009, as an increase in the renters' demand continues to outpace growth in the number of rental properties. According to a CoreLogic report, rental vacancy rates are near their lowest level in 30 years. The demand for developing residential properties for the purpose of leasing has increased significantly in the US. Looking forward, we believe that these positive attributes in the rental market coupled with the historic constraint of home supplies would continue to buoy demand for 'Buy-to-Rent' properties in the US residential segment.

The Proportion of Houses being Developed for Renting has Increased Since 2009



Source: Federal Reserve Bank of St. Louis

Price Growth in the US Housing Market will be Largely Location Driven

We expect price growth to be largely location driven, with few states exhibiting stronger price increases. Data released by Zillow showed that home prices in Colorado, Oregon, South Dakota, Nevada and Washington exhibited a growth between 10.3% and 13.2% on a YoY basis in March 2016. Meanwhile, house prices in some states such as Connecticut, New Jersey, Alabama and Mississippi witnessed a growth in the range of 0.3% to 1.1%. A number of factors such as demographics, economic activity, and current house prices can be attributed to price variations. For instance in San Francisco, where the supply is more constrained and the tech boom is supporting demand, the ratio of home prices to household income is 9:1 and home prices to yearly rent is 20:1. Meanwhile, in Detroit and Pittsburgh the ratio of house prices to the median household income is 2:1.

Also, in the leasing segment, rents across the East Coast states have witnessed a stronger growth during the past year. Rental growth across key states such as Oregon and Colorado was more pronounced, up by 9.3% and 7.5%, YoY respectively, in March. Rents across states in the East Coast such as Maine, New York and Massachusetts also increased at a robust rate during the same period. This can be mainly attributed to low home ownership rates in the latter states, where home proprietorships dropped more than the average 5.3% drop seen nationally since 2004. Home ownership rates in Miami fell by 13.8%, while Philadelphia, Boston and New York witnessed a drop between 7% and 10%. Rents across these metropolitan regions have exhibited strong growth, hovering 10%-20% above their pre-recession highs. However, with rental growth notably higher than the growth in home prices, we believe that consumers could strive for ownership, which would be a more feasible proposition, and thereby drive price growth in the East Coast markets.

US Commercial Real Estate

Executive Summary

Amid a strengthening US economy and improving labor market metrics, rental growth across various non-residential real estate segments in the country has stayed upbeat. In the office market, strong fundamental demand, evidenced by a robust hiring pace, continued to lower vacancy rates and fuel rental growth in the first quarter of 2016. In the multifamily segment, though rentals remained steady near peak levels, rental growth is anticipated to ease going forward amid expectations of large new upcoming supply in the segment. In the retail market, rental growth across various locations remained divergent, with secondary markets outperforming primary markets in terms of investment inflows. The industrial segment which witnessed a robust rental growth in 2015, mainly on the back of strong warehousing demand from the e-commerce industry, is anticipated to see a moderation in rental growth amidst reports of large speculative constructions.

Multifamily Apartments Market

Multifamily Rental Growth to Moderate as More Supply Enters the Market

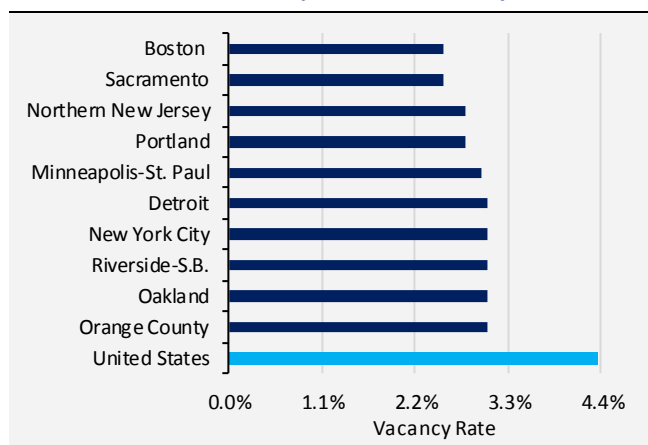
The multifamily housing market has been witnessing a robust demand over the past few years, with vacancy rates dropping to multi-year lows and rentals hovering close to record high levels. As discussed in the residential market section, the US home ownership rate is close to a 48-year low, as an increasing number of households are tilting towards renting, favoring the multifamily market segment. Renter households have increased, as first time buyers have been unable to access finance amidst tight lending standards and as the continuously rising house prices have made house purchases unaffordable to first time home buyers.

Robust demand resulted in average vacancy rates in the multifamily market to decline from over 7.0% in 2009 to about 4.3% in 2015, resulting in a 'landlord's market'. Although there was an uptick in supply (completions) in the latter half of 2015, the pent up demand easily absorbed new inventory entering the market. According to data from New York City-based research firm, Reis Inc., developers opened 200,142 new apartments¹ over the last 12 months, the highest number of new apartments offered in any 12-month period since 1988. Nevertheless, the fourth quarter of 2015 marked the eight consecutive quarter of healthy absorption. However, rental growth in the last quarter of 2015 slowed to 4.3% on the year from the 5.1% YoY growth recorded in the third quarter of 2015. We expect the pace of rental growth in the multifamily segment to moderate over the next few years as more supply of multifamily homes is expected to hit the markets.

¹<http://nreionline.com/multifamily/demand-apartments-slowing-down>

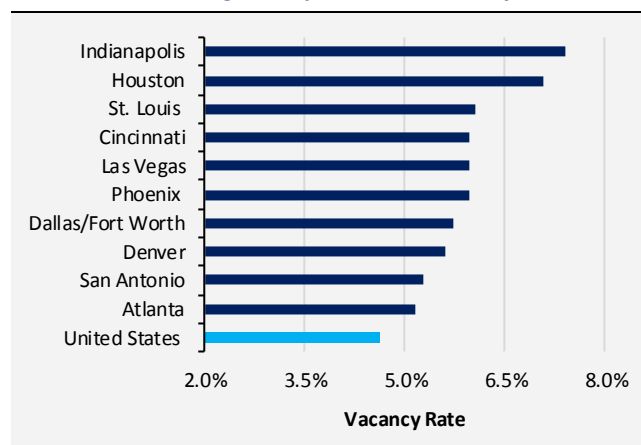
According to Freddie Mac's latest Multifamily Outlook Report, multifamily supply will enter the market at a pace not seen since the 1980s. Housing starts for the multifamily segment, a leading indicator for future supply surged 13.9% to a 373,000-unit pace in April 2016, whilst multifamily building permits rose 8.0%. However, with vacancy levels still below the historical average we expect the multifamily housing market will largely be able to absorb most of the supply in 2016. Few geographic areas based on demand-supply imbalances and high-end rentals (Class A) however could face headwinds from increased supply.

Markets with the Lowest Expected 2016 Vacancy Rates



Source: JLL

Markets with the Highest Expected 2016 Vacancy Rates



Source: JLL

In the long run, an expected improvement in labor market will boost household formations while record high rentals will prompt a transition from renting to homeownership, impacting demand for multifamily apartments to some extent.

On the whole, although the near-term outlook for the apartment market is expected to remain firm, particularly in the markets having strong fundamentals where supply is lagging demand, this segment is likely to be affected by higher supply in the long term. If the current pace of construction activity continues, about 300,000 multifamily units could be expected to be added every year beyond 2015. Increasing supply of multifamily units will weigh on rental growth, as vacancy rates will start heading north.

Student Housing & Senior Housing Are Emerging as a Potential Investment Avenue

Student housing and senior housing, are emerging sub-segments of the real estate sector that can be seen as a potential investment avenue. Although these sub segments are relatively less known compared to the mainstream commercial real estate sectors, the underlying demographic factors offer a compelling investment opportunity. These sectors are experiencing high levels of demand in the US, with investors increasingly foraying in these segments.

The US, owing to its reputation as a hub for quality education, attracts the highest number of foreign students than any other nation. According to a report published by the Institute for International Education, overseas students enrolled at US colleges and universities rose 10% in 2015 and reached an all-time record of nearly a million students, with growth largely driven by increasing Chinese and Indian students. This has now resulted in one in 20 students enrolled at US schools being an overseas student. The jump in foreign students has fueled a surge in demand for housing accommodation, drawing private equity investors to the sector. Even during the financial crisis, while property prices were tumbling, average prices per bed for student housing properties remained robust. While properties with proximity to campuses are the most valuable, the strong demand for student housing presents opportunities even if the properties are located at a short distance away from campuses.

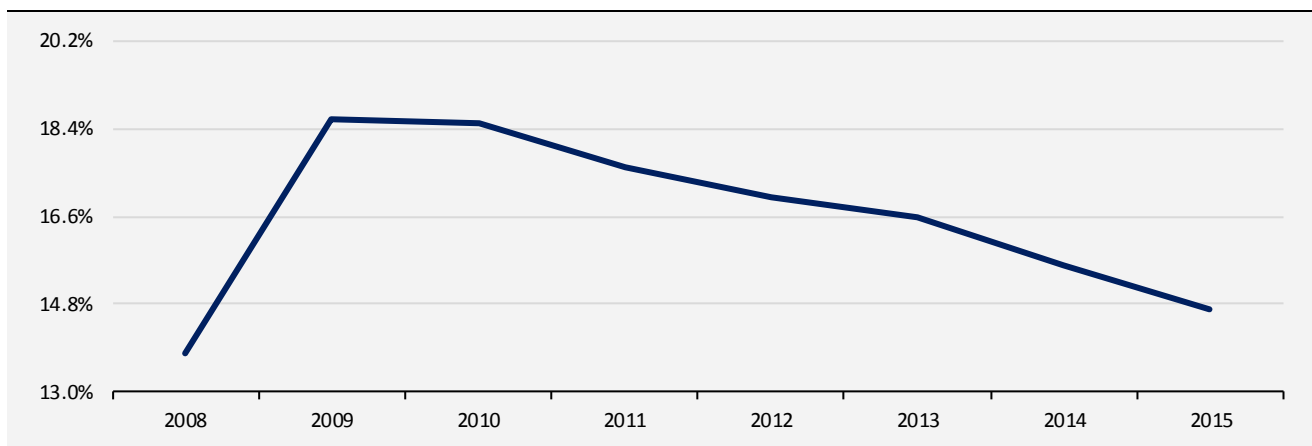
Senior housing is another sector that could provide sustainable and attractive investment opportunities for investors. According to the US Census Bureau, the number of Americans aged 65 and above is projected to grow from 47.8 million in 2015 to 79.2 million over the next 20 years, increasing at four times the rate of the overall US population. Moreover, one in five Americans is projected to be 65 and over by 2030. With a large share of the overall US population aging and living longer, demand for senior housing is expected to accelerate. Occupancy rates in senior houses have also remained high. According to National Investment Center for Seniors Housing & Care, average seniors housing occupancies rose to 90.5% in 2014, moving closer to their pre-recession peak.

US Office Market

Office Rentals Expected to Grow in the Medium Term as Demand Continues to Outpace Supply

The US office segment has continued to witness robust growth of late, as a healthy economic recovery and strong hiring pace has caused absorption rate in this sector to outpace the rate of new upcoming supply. Despite the addition of more than 44.2 million square feet (msft) of new office supply in 2015², the highest since 2009, occupancy levels, absorption as well as asking rents increased in 2015, suggesting a strong demand for office space. According to JLL, tightening conditions in the US office sector led to vacancy rates in this segment falling to 14.7% in 2015, close to the pre-recession trough of 13.8%. Suburban vacancy rates stood at 16.3% in the first quarter of 2016, higher than vacancy rates of 12.1% in the central business districts.

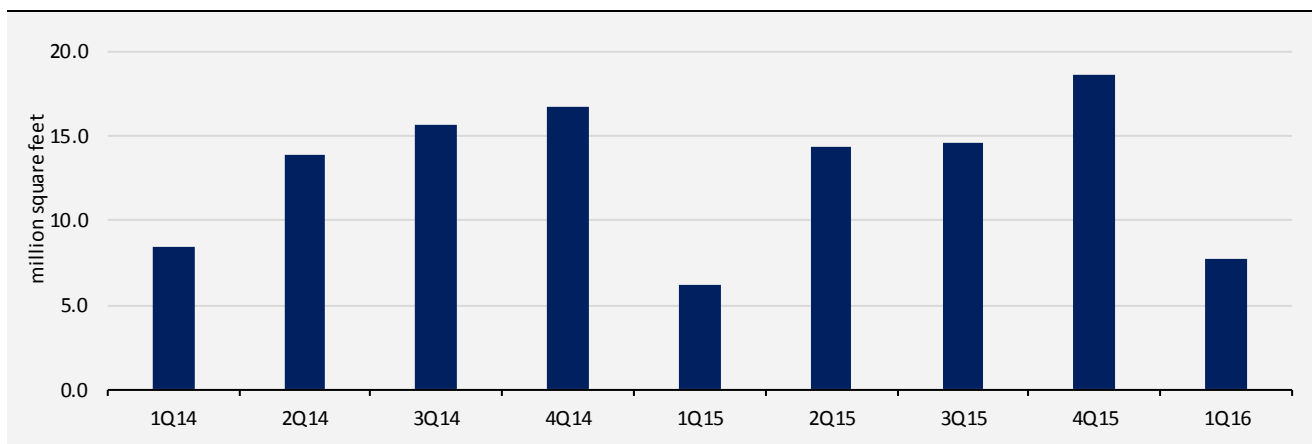
US Office Vacancy Rates



Source: JLL

Overall, rental rates registered a quarterly growth of 3.2% in the first quarter of 2016, with rents in the central business districts as well as the suburban areas trending higher. Rental growth in the Class A properties in the central business districts continued to outpace the national growth rate. Rental rates for average Class A properties in central business districts were about 59.1% higher than those in the suburbs by the end of 2015. With demand continuing to outpace supply, the spillover effect caused rentals in Class B office spaces and suburban Class A offices to also increase by 6.3% and 5.5%, respectively, on an annual basis in 1Q16. There is a possibility that new tenants might opt for suburban offices to cut costs, especially considering the high rents in central business districts. This could help lower vacancy rates in the suburbs and fuel rental growth in these areas.

US Office Absorption Rate



Source: JLL

The healthy hiring pace in the US economy is indicative of the trend that demand for offices will continue to remain buoyant. Monthly job additions in the US have been above the 200K mark for 20 out of the previous 26 months. Considering that upbeat trend in the US labor market is unlikely to slow in the near term, demand for new office space

²JLL

is expected to remain robust, thereby continuing to support rental growth in the office market. Moreover, office rentals at the end of 2015 were still about 10.2% lower than the 2008 peak level when adjusted for inflation, indicating that there is scope for an upside in office rentals. Furthermore, we expect rental growth to remain in positive territory in the medium term, as a large amount of premium office supply is expected to enter markets and landlords would raise rents amid tightening conditions in this segment.

However, in the long run, we believe that rental growth in the office segment could moderate as overall supply is expected to increase in the US office market. In 1Q16, the total number of construction starts jumped 31.8% QoQ, bringing the total development pipeline to a multi-year high of 96.8 million square feet.

Secondary Markets Outperformed in Terms of Investment Growth, Fundamentals Still Favorable

Meanwhile, growth in investment sales volumes in the primary US office markets moderated in the first quarter of 2016, to 1% YoY, after registering a growth of 16.5% to USD 140.9 billion in 2015. Albeit volumes during the first quarter stood at USD 35.4 billion, second highest in the past five years. This moderation was mainly led by cautiousness among investors on concerns over global economic growth and shortage of quality asset classes in the office space. On the other hand, investment activity in the secondary markets reached new highs in 1Q16, led by large portfolio and entity level purchases. The secondary market accounted for 37% of the total investment volumes in the office segment, according to JLL. Also, foreign activity in the secondary markets in 2015 almost tripled and overall investment sales growth in the secondary markets was registered at 76%, higher than a 46.6% growth in the primary markets, amid strengthening leasing conditions in the US.

In terms of fund flow, the US real estate market continued to enjoy its safe haven appeal and attract investors from Europe, Middle East and Asia. During the first quarter of 2016, Germany and Qatar replaced Canada and China as the largest investors in the US office segment. Going forward, considering the ongoing economic and political concerns in Asia, Middle East and Europe, the US office segment could benefit from capital flight from these regions.

Secondary markets also outperformed in terms of fundamentals, as demand for offices in these markets remained buoyed by relocation of firms to more cost-effective and business friendly areas. Particularly, a number of tech firms shifted their offices to secondary markets such as Atlanta and Texas, to reduce their overall operational costs. A number of popular brands such as Google, Apple, Dropbox and Oracle also expanded their new business activity in Texas. Resultantly, cap rates in a few secondary markets compressed at a pace stronger than that in the primary markets. According to the 1Q16 JLL report, cap rates in primary markets compressed by 39 basis points in the last 12 months, lower than the cap rates compression of 60 basis points seen in a few secondary markets, such as Nashville, Minneapolis, Salt Lake City, Phoenix and Charlotte.

Healthcare Sector to Lead Demand for Office Space While Demand from Energy Sector will Slowdown

The US healthcare industry has notably been a key sector in driving demand across the country's office segment. This sector added approximately 270K jobs annually from 2008 to 2015, and is expected to keep demand for medical offices supported, considering the expected change in domestic population dynamics in the future. The number of Americans aged 65 and above is projected to grow from 47.8 million in 2015 to 79.2 million over the next 20 years, increasing at four times the rate of the overall US population, which would strengthen demand for medical offices and support growth in the office segment. Meanwhile, on the downside, in this low oil price era, the energy sector's subdued performance weighed on the US office segment's activity. Markets in Houston, where there is a high concentration of energy companies, witnessed an increase in vacancy rates from 17.8% in 4Q14 to 23.2% in 4Q15³. This is also notably higher than a vacancy rate of 14.7% seen nationwide. A number of companies have resorted to sub leasing, causing the sublet space availability in the city to rise to 7.6 msft in the 4Q15 from 4.5 msft in 4Q14. A sustained period of low oil prices, we believe, would lead to job cuts and cost reduction measures across energy companies, keeping rentals across markets with a large concentration of oil companies under pressure.

³<http://oilprice.com/Latest-Energy-News/World-News/Houston-Feels-The-Oil-Price-Pinch-As-Office-Space-Vacancies-Grow.html>

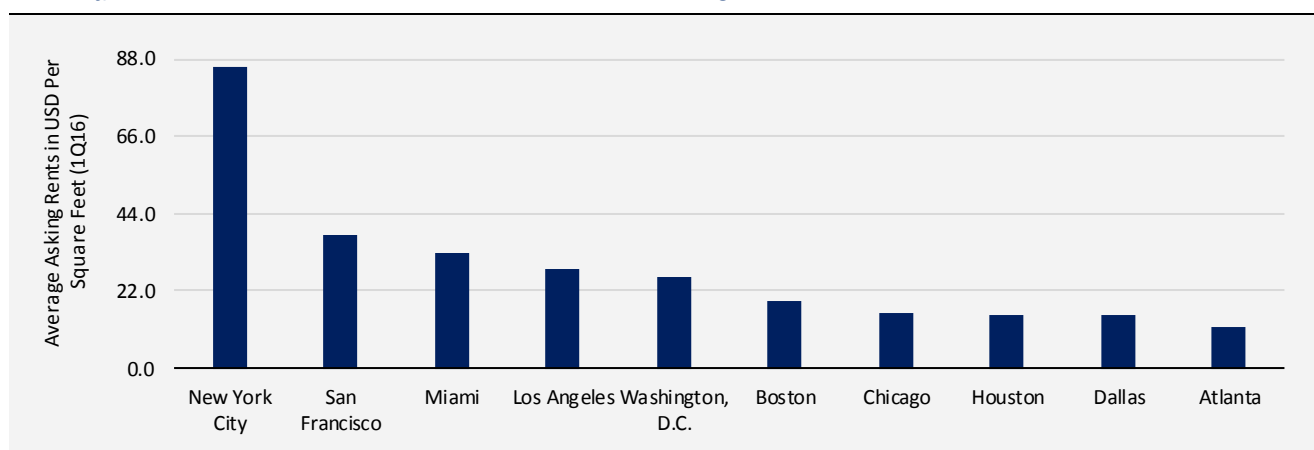
US Retail Market

Low Retail Space Supply will Support Rental Growth in the Medium Term; Rental Growth to be Selective and Location Driven

A broad recovery in the US housing market and wage growth has resulted in an improvement in domestic consumers' morale and a pick-up in retail sector's activity. Vacancy rates in the retail segment dropped to 5.6% in 1Q16 from 6.0% in the same period earlier year, as supply continued to lag demand growth. Availability rate, the ratio of available space to total rentable space, also dropped to 11.2% in the first quarter of 2016 from 11.4% in 1Q15 and is notably lower than the peak rate of 13.3% in 2011.⁴ Amid these signs of a tightening market, rental growth in the US retail market remained in positive territory, registering a rise of about 2.6% YoY in the first quarter of 2016.

While development activity has shown signs of a pick-up recently, we believe that over the medium term, demand is expected to broadly outpace supply in the retail market which would support nationwide rental growth. Performance of the US retail market is not expected to be uniform, with well positioned retail spaces relatively attracting higher demand and enjoying stronger rental growth.

Price Differentials in Rentals across various Retail Markets Remains High in 1Q16



Source: JLL

Among retail segments, the US lifestyle & mall segment, where recovery, after the 2008 crisis, started sooner than that in power centers⁵, has not lost its growth momentum. Data from UBS showed that revenue growth across power centers was around 3.2% over the four quarters ending in September 2015, while the same in lifestyle & malls was about 3.7% over the same period. Performance of power centers has been relatively weaker, but the segment has shown signs of stabilization in recent quarters. Demand has been persistently outpacing supply and has brought vacancy rates in the power center segment to near pre-recession lows, however, rentals in this segment are still lower than pre-crisis levels. According to JLL, rentals across power centers in 2015 were approximately 19.4% lower than those in 2008, suggesting that there is upside potential in this segment's lease rates.

As far as performance of malls is concerned, the overall portion of retail investments towards malls increased from 11.2% in 2014 to 17.2% in 2015, with investment volumes for malls jumping 33.3% to USD 10.4 billion during the year, according to JLL. Around 77% of absorption in the US malls occurred in the 10 major markets, where market participants also opted for portfolio and partial-interest transactions to increase exposure to retail malls. Class A malls continued to outperform, amid lower vacancy rates and a constraint in the availability of such malls. Looking forward, we expect a similar trend where investors would continue to opt for retail space in malls across premium areas, where demographic metrics are favorable.

Meanwhile, in the long run, we expect demand for retail space especially from apparel and department stores to face headwinds from growth in online sales format, as increasing number of consumers shift to online purchases. According to research from Green Street Advisors, sales per square foot fell from USD 200 in 2006 to USD 165 in 2015. However,

⁴<http://www.cbre.com/about/media-center/CBRE%20Q1%20Retail%20Release>

⁵Power Centers- An unenclosed shopping center with a typical range of 250,000 sqft to 600,000 sqft of gross leasable area that usually contains three

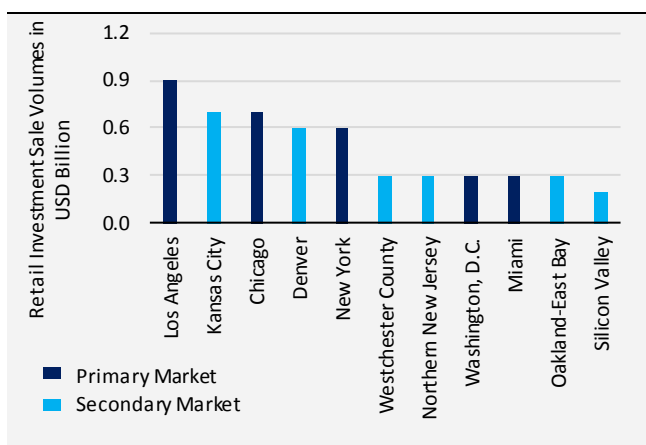
demand for retail space from grocery-anchored centers and small format chains such as dollar stores is likely to remain robust going forward.

Investors' Demand is Expected to Pick-up, Secondary Markets to Outperform

The first quarter of 2016 was not very positive in terms of investments, as retail investment activity witnessed a decline of 25.8% YoY. Market participants refrained from investing due to volatile macroeconomic trends in the US and global headwinds. However, activity is expected to pick-up in the remainder of 2016, as the recent increase in domestic development activity would provide more investment opportunities.

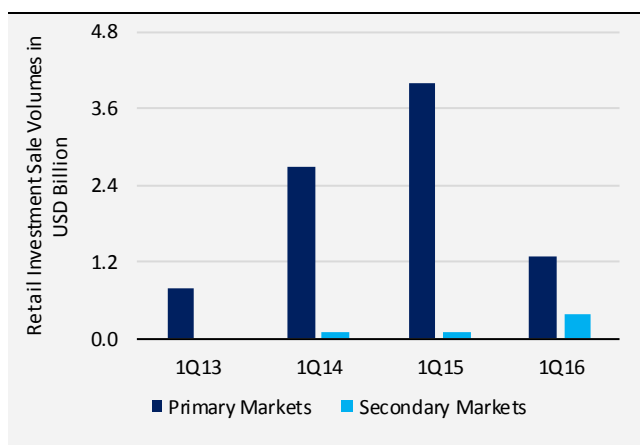
Meanwhile, as per the current trends, a shift in investors' attention could be seen as urban retail investment volumes in primary US retail markets plunged 68.6% YoY to USD 1.3 billion and in secondary markets soared 186.7% YoY to USD 388.7 million in the first quarter of 2016. Amid high disparity in price differentials of primary and secondary retail markets, investors opted for urban properties in secondary markets over those in the primary markets. Secondary markets with healthier population and job growth garnered higher interest among investors. According to JLL, Kansas City, which has a population growth of about 3%, saw growth in investment volumes of 192% YoY in 1Q16. Also, Denver, where job growth was 2.7%, witnessed increased investors' attention during the first quarter of 2016. Even amongst primary markets, investors refrained from a few key oversaturated primary markets such as Miami and New York, while their attention was drawn towards less saturated markets with positive rental growth, such as Los Angeles and Chicago. Going forward, we expect retail investors to continue preferring less saturated markets, and investment growth in secondary markets would outperform that in the primary markets.

Secondary Markets with Favorable Demographics Attracted More Retail Investments in 1Q16



Source: JLL

Overall Investment Sales Volumes in the Retail Market Plunged 60.4% in 1Q16



Source: JLL

US Industrial Market

Supply Shortage in the US Industrial Segment to Wane amid a Pick-up in Construction Activity and Cap Rental Growth, Warehousing to Continue Driving Demand Growth in the Sector

In tune with the trend seen in various segments of the US real estate market, developments in the industrial market remained positive throughout 2015. The net absorption rate in this segment picked up from 225 million square feet (msft) in 2014 to 252.3 msft in 2015 and comfortably outpaced the new supply of 201.9 msft that entered the US industrial market during 2015.⁶ This brought vacancy rates in the industrial segment to a multi-year low of 6.3% at the end of 2015, according to JLL data. Asking rents for 2015 climbed 6.2% to USD 5.39 per square feet, close to a pre-recession high of USD 5.63 seen during the second quarter of 2008.⁷

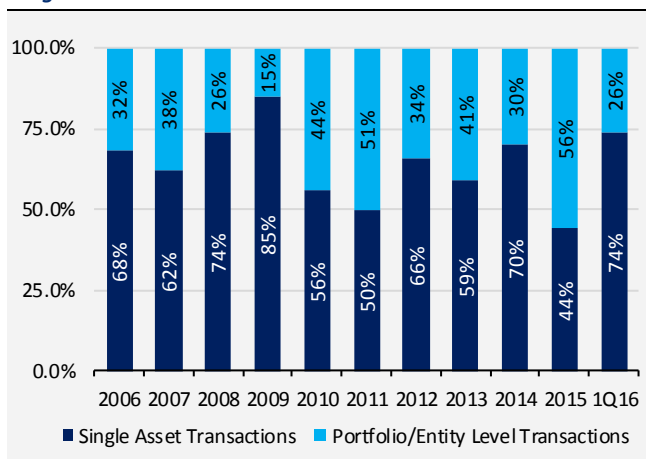
This robust trend in the US industrial market continued through the first quarter of 2016, with vacancy rates dropping further to a 16-year low of 6.2% and net absorption gaining for a twenty-fourth straight quarter, according to JLL numbers. Rentals grew at a moderate but healthy rate of 3.2% in 1Q16 as demand continued to outpace new supply. While investment volumes declined in the industrial segment due to uncertainty in the economic environment, the fall

⁶Colliers – 4Q15 Industrial Report

⁷Colliers – 4Q15 Industrial Report

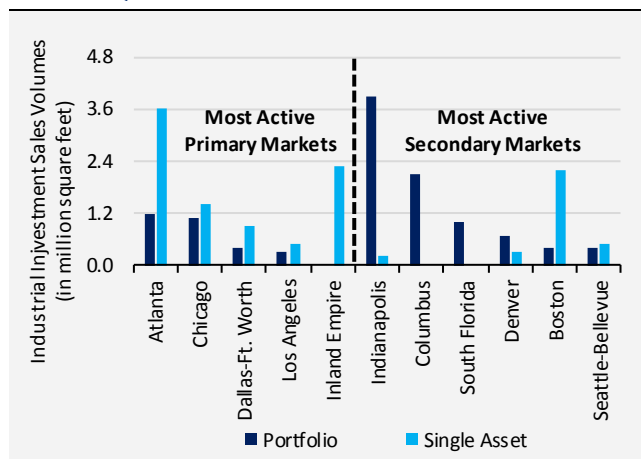
was accentuated by a shortage of large-scale portfolios which restricted major investment activity to single-assets. According to JLL, most transaction values remained in the range of USD 20 million and USD 150 million and investment volumes plummeted 52.5% YoY during the first quarter of 2016. However, investment volumes were down only by 11.4% on an annual basis during the quarter, if the largest ever investment in the US industrial segment that occurred in 1Q15 were not to be considered.

The Proportion of Single-Asset Transactions in 1Q16 Reaches Highest Level Since 2009



Source: JLL

Higher Single Asset Investments in Primary Markets were Seen in 1Q16



Source: JLL

Meanwhile, on the supply side, the construction of industrial space without any formal commitment from the buyers, also typically known as speculative construction, has been increasing of late, mainly in the tight markets of Atlanta, Central Pennsylvania and Dallas. Other key industrial markets are also expected to witness similar supply dynamics in the near future, which we believe could lead to a moderation in rental growth in the near term. Also, considering that construction developments in the industrial segment are relatively quicker than other sectors, the degree of vulnerability of this segment to new supply is higher in the medium term.

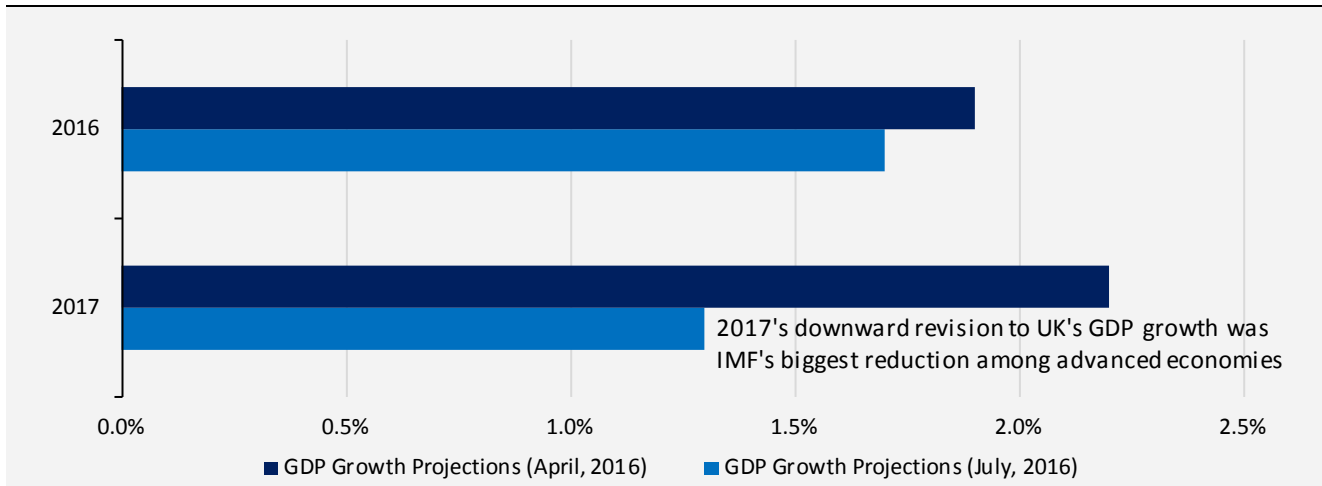
Nevertheless, an emerging sub-segment in the industrial real estate space that is garnering traction is warehousing or distribution centers. Robust growth in e-commerce sales and increasing retail companies adopting online sales format is driving demand for warehouses for faster delivery turnaround. Demand for warehouses in the fourth quarter of 2015 outstripped supply for the 23rd consecutive quarter and JLL expects this trend to continue in the medium term. According to CBRE, rental rates for prime warehouse space in the US surged 9.9% in 2015. CBRE further indicated that six of the fastest growing logistics markets in the world are in the US with Oakland and California in the top slot. In 2015, Oakland and California posted rental growth in the range of 28% to 30% on the year, almost double the rental growth of 15% in New Jersey; another prime warehousing market. Demand for modern warehouse facilities near population centers is expected to attract attention of international investors. Singapore's sovereign-wealth fund through its group company, Global Logistic Properties, last year acquired LA based warehouses - Sorenson Industrial Distribution and Bell Gardens Industrial Park for USD 43 million and USD 37.1 million, respectively. Looking ahead, considering the vast potential in the e-commerce industry, we expect warehousing to drive demand growth in the industrial segment.

UK Real Estate Market

Economic Overview

The United Kingdom (UK) is one of the largest economies in the world and a highly attractive destination for domestic as well as foreign investment. However, its decision to leave the European Union (EU) post the referendum on 23rd June this year has considerably increased economic as well as political uncertainty in the nation, leading the IMF to significantly lower its forecast for UK economic growth for this year as well for 2017. Credit rating agencies such as Moody's, S&P and Fitch have lowered their ratings on the nation following the "leave" vote, while concerns have risen that the UK economy might slip into a recession post-Brexit.

UK's Economic Growth Projections have been Lowered



Source: IMF

On the macro front, the UK's labor market seems to have weathered the initial Brexit uncertainty, with the unemployment rate dropping to 4.9% in the second quarter, from 5.1% in the first. Jobless claimants also declined in the month following the historic leave decision, suggesting that the job market was not substantially impacted, at least in the immediate aftermath of the Brexit vote. Meanwhile, economic activity has taken a hit, with gauges of construction, manufacturing and services activity slowing in July.

The vulnerability of the UK economy to post-Brexit shocks recently prompted the Bank of England to downgrade UK's economic growth expectations as well as cut interest rates to record lows and unveil its largest stimulus package since the financial crisis. However, it is likely that the central bank's move is not expected to have a major impact on the real estate market in the short term.

The UK Residential Market

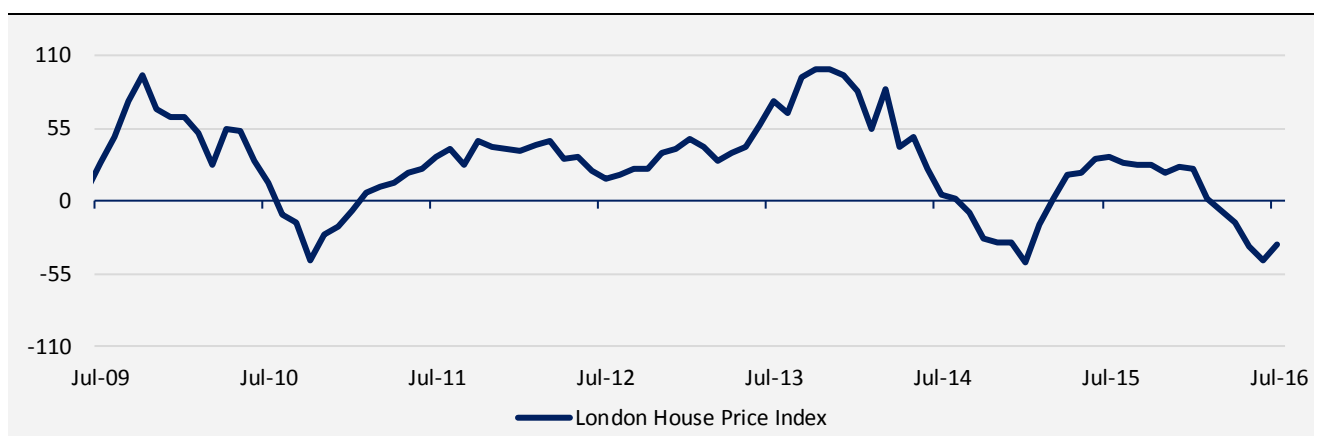
Executive Summary

The UK's decision to leave the EU after more than four decades of membership has created increased uncertainty regarding the nation's real estate sector. Investor sentiment has altered considerably and many surveys have pointed towards declining demand in the housing sector. Meanwhile, increased regulations in recent years have also impacted the real estate market, with second time and buy-to-let property owners being significantly impacted. We expect demand from buy-to-let landlords to be affected by the additional surcharge of 3% that has come into effect from April 2016. On the other hand, lower interest rates and the various government schemes and incentives could potentially reduce the adverse impact of Brexit and support demand from first time buyers. Overall, we expect the price strength in the nation's residential real estate market to slow, especially taking into consideration the ongoing period of economic uncertainty in the fallout of the UK's leave decision.

UK's Property Market Expected to Slow

The UK residential property sector was severely dented during the global financial crisis, when rising unemployment and a significant decline in household earnings spurred a near 20% drop in the nation's average house price. However, years of near-zero interest rates, wage growth and government schemes such as the Help to Buy program fueled a surge in property demand, with house prices exceeding pre-crisis levels. Though housing demand has staged a steady recovery, the pace of growth has slowed considerably in recent months. Economic uncertainty in the wake of the Brexit vote is expected to result in weaker demand for homes, with UK's Nationwide acknowledging Britain's house price outlook to be 'unusually uncertain' following the nation's leave vote. Another survey by the Royal Institution of Chartered Surveyors (RICS) has shown that house price growth in the UK fell to a three-year low in July 2016 as Britain's vote weighed on the real estate sector. The Brexit vote has significantly altered the dynamics of London's property market, with a measure of home-price changes in the capital recording a sharp drop post-Brexit. Moreover, sentiment is anticipated to be further weighed down by potential number of job roles relocating outside the UK.

Home Price Sentiment in London has Worsened in Recent Months



Source: RICS

Going forward, we expect price rise in the UK's property market to slow, with market participants waiting for the underlying trends in the real estate sector to become more evident in the fallout of the Brexit vote. In addition to the slowing pace of house price growth, the Brexit vote has also led to an increase in the number of days taken to sell UK property. Recent figures from UK's property listing portal Rightmove have revealed that the number of days to sell property in London increased by five days between May and July, the most across the UK. Other regions have also witnessed a similar trend affected by the Brexit uncertainty.

Prime Residential Market Impacted by Stamp Duty Increase

In recent years, the UK government has introduced several changes for second-home buyers which have resulted in a shift in overall buying pattern towards smaller towns. While London witnessed strong levels of house price growth till about three years ago, the relative higher cost of properties in the capital has restricted the overall market to wealthy buyers.

Stamp duty changes in particular, have impacted London's residential market. In 2014, the UK government overhauled the Stamp Duty Land Tax (SDLT) by permitting it to be charged on a progressive scale, more in line with income tax. The higher stamp duty in England and Wales increased the cost of expensive properties, leading to a decline in overall transactions. According to independent property advisor Knight Frank, London witnessed the steepest decline in transactions in the first ten months of 2015, compared to other places in England and Wales. The top end of London's property sector (over £2 million) has been the most affected by the changing regulations. Although the general elections in 2015 were expected to boost investor confidence in the prime residential markets, the market continued to adjust to the stamp duty changes. Figures from estate agent Douglas & Gordon indicate that the changes in the stamp duty system spurred a 64% drop in sales of London homes selling for £2 million and above in the last nine months of 2015 against the same period two years ago. Going forward, the London market is expected to be significantly influenced by the expanding pool of properties available to buy in the aftermath of UK's leave vote.

Meanwhile, the additional 3% stamp duty levy from April 2016 has made purchases more expensive for second-home buyers, potentially deterring some investors. While house prices continued to rise in the months prior to the regulation taking effect, the following month saw a sharp dip in transactions, indicating that buyers rushed to acquire properties ahead of the additional surcharge. According to Knight Frank, sales transactions rose by about 50% in March as investors hastened purchases before the stamp duty took effect. In the following month, however, transactions nearly halved, underlining the impact that the stamp duty surcharge had on the property market.

Stamp Duty Rates on Additional Residential Properties

Property Value	Existing residential SDLT rates	New additional property SDLT rates
Upto £125,000	0%	3%
£125,000 - £250,000	2%	5%
£250,000 - £925,000	5%	8%
£925,000 - £1.5 million	10%	13%
Over £1.5 million	12%	15%

Source: HM Treasury

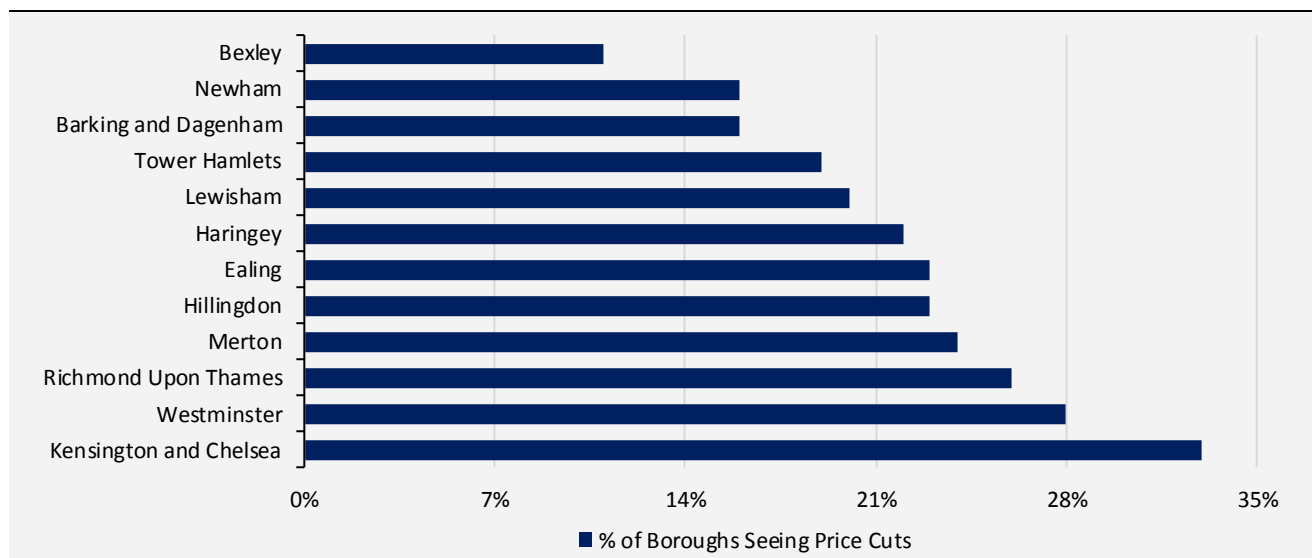
Brexit Compounds Worries for London's Luxury Residential Market

London's luxury residential market, where property prices range generally in excess of £5 million has also been significantly impacted by the Brexit vote in addition to being affected by the stamp duty overhaul and outgoing foreign capital, especially from buyers in China, Russia and the Gulf region. Price growth has slowed and a number of properties are being sold at a discount, with vendors lowering their initial asking prices by more than 10% in certain cases¹. In the first quarter of 2016, highest levels of price cuts were observed in properties selling for £5 million or more, which received 11.1% less than the initial asking price, according to property data provider LonRes. Britain's vote to exit the EU has led to further declines in high-end house prices in London, as buyers contend with tax increases and post-Brexit uncertainty. Figures from Knight Frank suggested that prices in certain prime neighbourhoods such as Knightsbridge

¹<http://www.bloomberg.com/news/articles/2016-04-07/london-luxury-apartment-sales-slump-triggers-20-bulk-discounts>

and Chelsea witnessed price cuts of more than 7% YoY in July. Other locations have also seen cooling of house prices. Meanwhile, data from distressed property firm, Propcision, revealed that failed sales in London's property market spiked to 8% and 9.25%, respectively, in the two weeks following the UK's leave decision, compared to the weekly average of 5%, indicating the adverse effect of Brexit on the nation's property sector.

London Boroughs Witnessing a Price Reduction



Source: Propcision ([Press Release April 2016](#))

Tax Changes, Central Bank Restrictions to Impact Buy-to-let Landlords

Changes have also been announced for buy-to-let property buyers who face a reduction in some of their tax privileges. From 2017 onwards, the amount that landlords would be able to claim in tax relief on their finance costs would be gradually lowered over four years. Under the new laws, landlords, who account for a significant proportion of property sales, would be able to claim tax relief at the basic tax rate of 20%, instead of 40% or 45% for those at the top level of the income tax bracket. The stricter regulations and changes in tax privileges from next year are likely to impact investor sentiment and influence buying behavior. According to UK's Council of Mortgage Lenders, the total number of new buy-to-let mortgages is expected to decline by 22% to 90,000 by 2017, compared to the levels seen in 2015.

Buy-to-let landlords who accounted for one in five sales in 2015, face prospects of further challenges this year following the Treasury's plan to give additional powers to the BoE over the sector. The central bank has already announced stricter mortgage rules by allowing only 15% of the new mortgages granted by banks to be at multiples higher than four-and-a-half times a borrower's income. BoE officials are also mulling to introduce further controls on the buy-to-let sector, citing it to be a source of risk in the financial sector. Officials have hinted at limiting the ratio of high loan-to-value mortgages given to buy-to-let landlords, or lowering the overall number of loans given to landlords. Though profit margins for buy-to-let investors are expected to increase following the central bank's recent rate cut and no significant change in rental yields, stricter regulations are expected to have an overall adverse impact on these landlords.

Reduction in Interest Rates to Support Demand and Prices

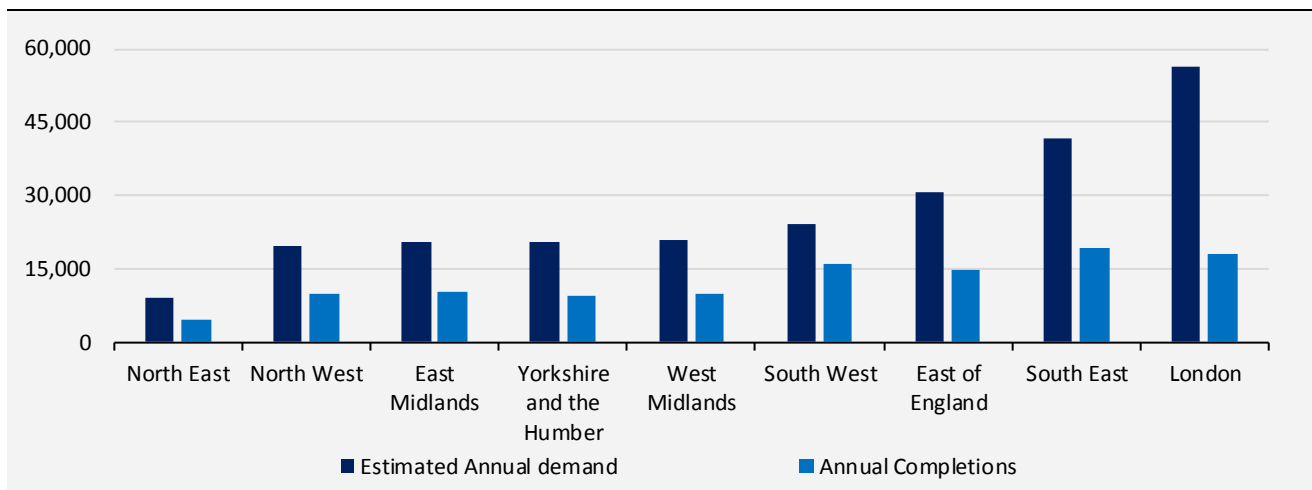
Low interest rates in the UK have been a major support to the housing market following the financial crisis. The BoE's recent slashing of rates to further lows combined with the pumping of stimulus in the economy is now expected to further influence the nation's property market. While few experts remain skeptical of the BoE's move to have a major impact on the real estate segment, we believe that the record-low rates would help to mitigate the impact of Brexit on the housing sector. Lower rates are likely to have a knock-on effect, with monthly costs dropping for those with mortgages tracked to the base rate.

Supply Constraints, Property Location will Continue to Influence Market Performance

One of the factors affecting the residential sector in the UK has been the shortage of houses which has driven increases in house prices over the medium to long term. According to a report published by the Confederation of British Industry (CBI), at the end of 2014, 240,000 new homes were required to be constructed annually in England alone, in order to

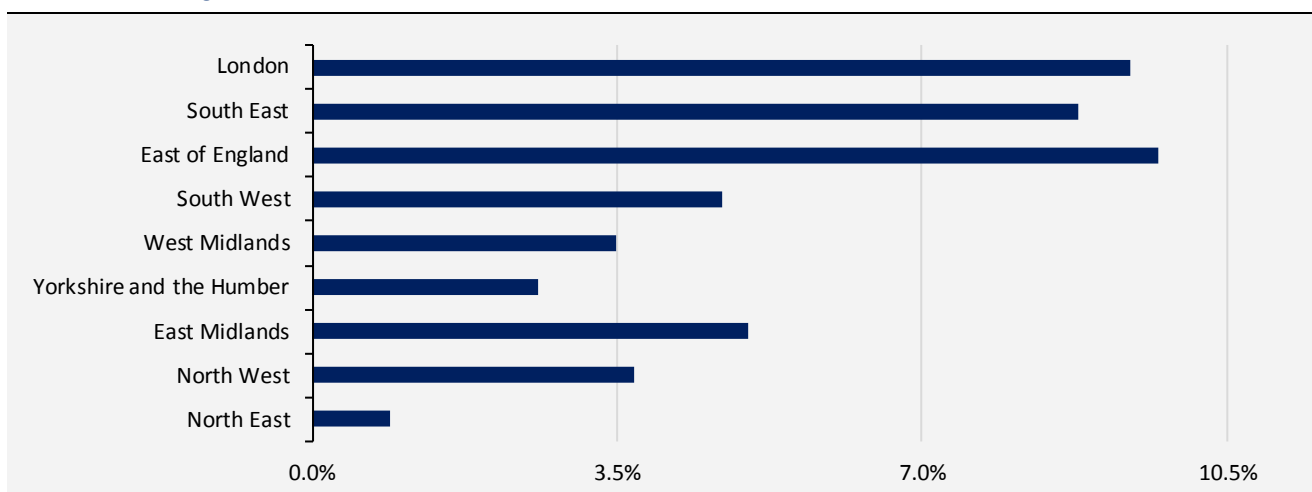
satisfy rising demand. However, more than 200,000 homes were built annually in just four out of the last 14 years, with the highest level of completions attained in a particular year, being 219,000. Shortage of land makes residential development in sought after locations very costly. The UK planning system has been very stringent and has laid emphasis on 'green belts'. Moreover, 'not in my backyard' (NIMBY) behavior has resulted in rejection of proposals for new development, making it very difficult to build new homes.

The Housing Gap in England, 2013-14



Source: House of Commons Library

2015 Annual Change in House Prices



Source: Office of National Statistics

The demand-supply gap has inflated the cost of home purchases and house rents, making affordability difficult for people. The UK government has intervened in the housing market through its Help to Buy program and taken additional measures such as announcing an ambitious target of building one million homes by 2020. Earlier this year, the former Prime Minister, David Cameron, had also announced plans of constructing 30,000 affordable starter homes on brownfield sites across the nation. Though these measures are aimed at reducing the housing shortage, supply constraints could be expected to have a considerable influence on the residential sector in the short term. Moreover, property location would also impact price growth. For instance, the prime London market has been impacted by the stamp duty reform, while the Aberdeen market which has been UK's oil industry hub has witnessed a slowdown amid job losses in the region.

The UK Non-Residential Market

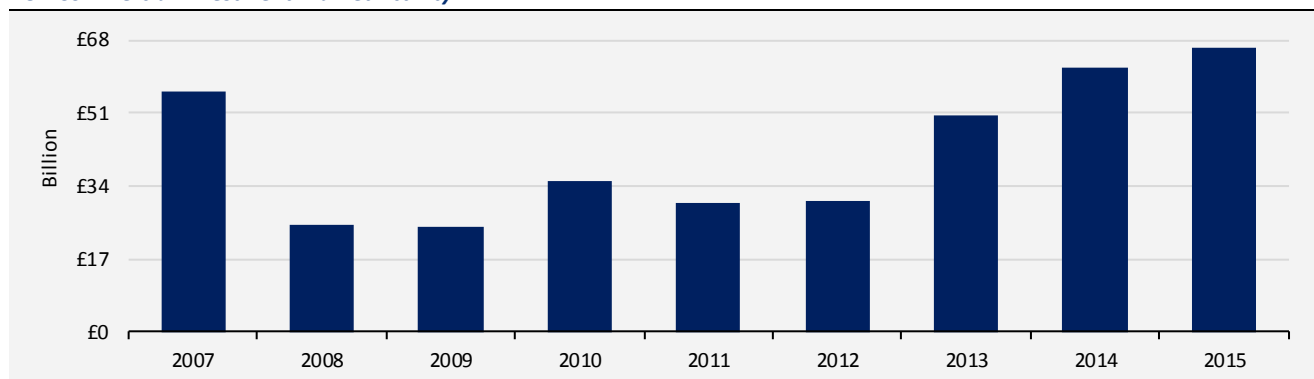
Executive Summary

The non-residential market in the UK has exhibited strong growth in recent years, but is expected to take a hit from the recent decision by Britain to exit the EU. The rising uncertainty surrounding the terms of the deal is expected to impact investment volumes in the UK's commercial real estate segment. In the office segment, demand for new space is anticipated to be negatively impacted as a number of firms are anticipated to relocate their headquarters and cut jobs. Growth in demand is likely to come from companies with limited external exposure, though businesses will eye measures that the UK regulators take to cope with the impact of Brexit. In the hotel segment, a weaker Sterling could improve demand among international tourists, though the number of EU visitors and business travelers could drop. As far as the retail segment is concerned, retail sales have continued to stay buoyed in the post-Brexit era, amidst positive labor market fundamentals and rise in real incomes. However, in light of a challenging macroeconomic outlook for the UK, retailers would adopt a wait and watch approach in making future expansion decisions.

Commercial Property Returns Projected to Moderate

UK's non-residential real estate market has witnessed strong levels of investment in recent years, helped by increasing demand, particularly from overseas investors in the United States, Middle East and Asia. In 2015, a record amount of over £66 billion flowed into UK's commercial market, with inbound capital from foreign investors accounting for around half of the total deals. Apart from London being a favorable destination for foreign investors, shifting trends in the real estate market have seen international investors considering other cities such as Birmingham, Bristol, Manchester and Leeds as potential investment avenues. Foreign investments outside London witnessed a notable increase in 2015, with 35% of transactions involving foreign buyers compared to the historical average of around 15% to 20%.

UK Commercial Investment Market Activity



Source: LSH Research

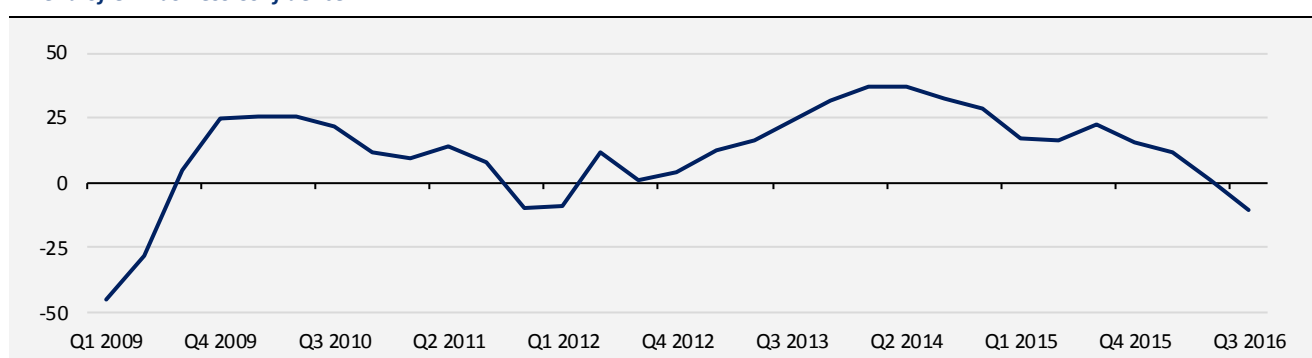
For 2016, we expect investment volumes to be impacted as the outcome of the Brexit vote took a number of businesses by surprise. Moreover, demand will face headwinds from uncertainty surrounding the negotiation process and prospects of a softening economy. According to Savills, the Total Commercial Development Activity Index, a key gauge to measure the performance of the UK commercial property sector, touched an 89-month low of -18% in July. The

Market Construction PMI reading for July dwelled deeper into the contractionary territory to 45.9 from 46.0 in June, with its commercial activity sub-index plummeting to a six-and-a-half year low, suggesting a weak morale among non-residential real estate builders in the nation. The slowing pace of growth in capital appreciation is expected to result in investors focusing on rental growth and income returns. Investors are also expected to supplement these income generating aspects with value-adding strategies such as refurbishment and development.

Office Space Demand to be Impacted as Companies Plan to Shift Operations Post Brexit and Turn Cautious on Expansions Plans

Overall, office rentals across the nation saw strong performance in 2015, with rents in London witnessing a steady increase. According to the Global Financial Centre's Index (GFCI) survey, London overtook New York in 2015 and reclaimed its position as the world's leading financial center. However, the equation is fast changing, with the Brexit referendum resulting in many European companies contemplating to shift their offices outside the UK. Moreover, lack of clarity over the process of UK's exit has resulted in companies further deferring plans of hiring and investing in the UK.

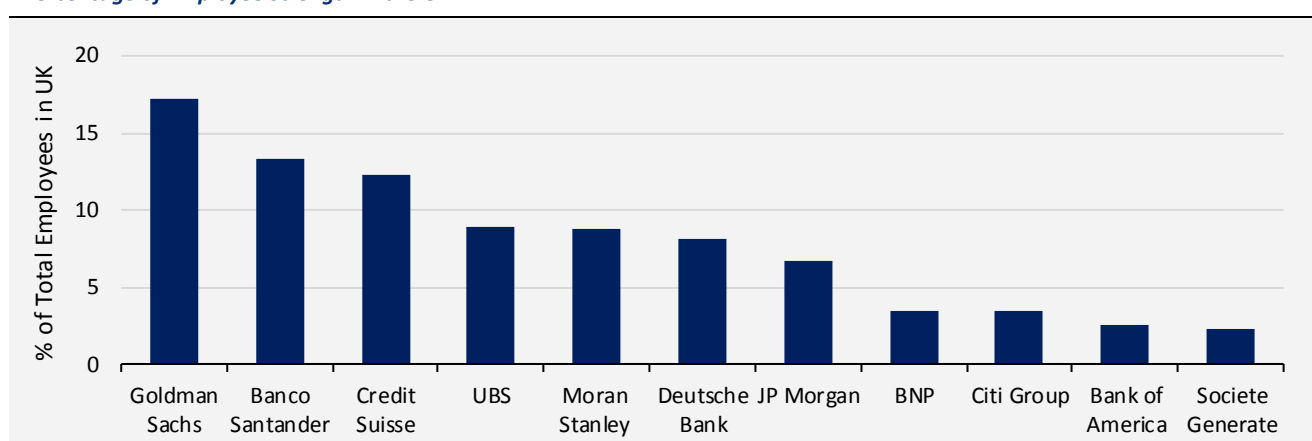
Trend of UK Business Confidence



Source: ICAEW / Grant Thornton

PricewaterhouseCoopers had estimated 70,000-100,000 fewer jobs in the financial services sector and about 950,000 job losses in overall economy by 2020, in event of the Brexit². We expect demand for office space from the financial sector to be the hardest hit post Brexit, as this event is likely to make European banks lose their "passporting" system access, which allowed the UK based branches to directly service clients in the 28 member nations of the EU through their subsidiaries. The financial services segment accounts for about a quarter of the corporate rental market in London. Many US and European banks, including JP Morgan, Citigroup, Morgan Stanley and HSBC have hinted at moving operations outside UK. Companies such as JP Morgan and Goldman Sachs had earlier warned that in the event of UK leaving the Eurozone could result in about thousands of job roles moving from the UK. Nevertheless, speculations also suggest that UK is striving to retain passporting rights for financial services even after Britain leaves the European Union.

Percentage of Employee Strength in the UK



Source: Bloomberg & JP Morgan

²<http://www.cnn.com/2016/07/18/brexit-why-sterlings-plunge-hasnt-made-uk-property-a-bargain.html>

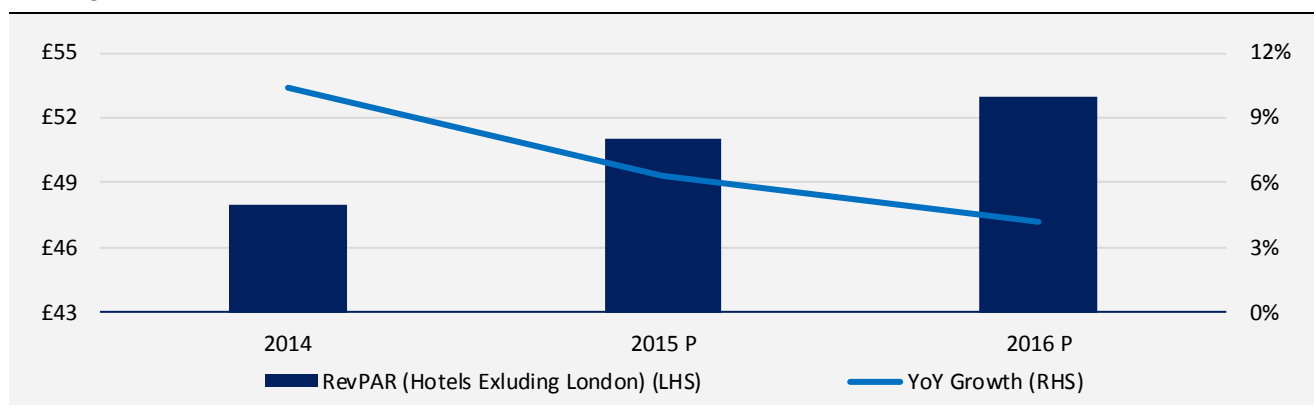
On the other hand, demand from legal & professional firms involved in aiding post Brexit changes is expected to witness an uptick. Likewise, local companies which are less dependent on external investments would be relatively insulated. On the whole, we expect a lower pick up in office space in the short term as companies are likely to take a cautious stance while in the long run, a lot will depend on how the UK government responds to the post-Brexit challenges.

Brexit could Pressurize Hotel Revenues

UK's hotel segment was marked by two distinct halves in 2015. A weaker Euro was a key challenge for hoteliers as it significantly impacted the number of European visitors travelling to the UK in the first half of the year. However, the latter half of 2015 saw a surge in overseas visitors. Nearly half a million fans from across the globe travelled to the UK to witness the Rugby World Cup, fueling a spike in hotel demand.

Looking forward, it would be too early to evaluate the impact of Brexit on the UK's hospitality segment. A weaker Sterling is expected to attract international leisure travelers, while EU visitors could reduce. According to a report by Deloitte the Association for British Travel Agents, 73% of the business visitors are from the EU and 44% of the travel expenditure is from EU nationals, which indicates that a downside in revenue per available room is likely³. On the other hand, the slowing pace of household spending growth in the UK could affect hotel demand from domestic visitors.

Slowing Revenue Growth in Hotels



Source: ICAEW / Grant Thornton

According to CBRE Research, the UK suffered one of the largest declines in the hotel investment market across Europe during 1H16, with year-on-year deals down by 76%⁴. Furthermore, structural changes from the growing presence of shared accommodation platforms such as Airbnb have significantly altered the hotel industry dynamics. The sharing accommodation model has expanded the options for consumers and raised competition for hoteliers. Though the rise of such platforms has the potential to disrupt the hotel industry, its impact is expected to be limited in the near term.

UK Retailers to Adopt a Wait and Watch Approach

Balanced labor market fundamentals and low inflation continued to buoy growth in UK's retail sector. The nation's unemployment rate has remained at a 10-year low and average weekly earnings have displayed signs of a pickup after cooling in the latter months of 2015. Despite Britain's decision to exit the EU, retail sales in the UK rose at a robust pace in July. According to BRC and KMPG, retail sales across all stores in the country climbed 1.9% YoY in July, compared with June where sales increased merely 0.2%⁵. However, sales during July were also boosted by strong promotional activity and warm weather, and market participants would await more economic data points ahead to better gauge the impact of Brexit on UK's retail market. Investments in UK shopping centers reached £1.46 billion in the first half of 2016, a near 27% decline compared to the same period in the preceding year⁶. This decline in investments can be attributed to uncertainty regarding the impact of Brexit on the domestic economy and the recent hike in stamp duty charges. Meanwhile, shifts have been observed in the retail industry due to the rising presence of online platforms. We expect conventional retailers to use additional channels to fulfil customer's shopping experience. Existing retailers and new entrants to the UK market are also anticipated to cautiously await more gauges on consumer confidence, for making decisions on new stores going forward.

³<http://blog.capterra.com/eu-referendum-how-brexit-complicates-the-hotel-industry/>

⁴<http://www.thecaterer.com/articles/368070/uk-hotel-deals-down-76-during-first-half-of-2016>

⁵<http://www.wsj.com/articles/u-k-retail-sales-defy-brexit-vote-1470729717>

⁶<http://www.cushmanwakefield.co.uk/en-gb/research-and-insight/2016/property-times---uk-shopping-centres-q2-2016/>

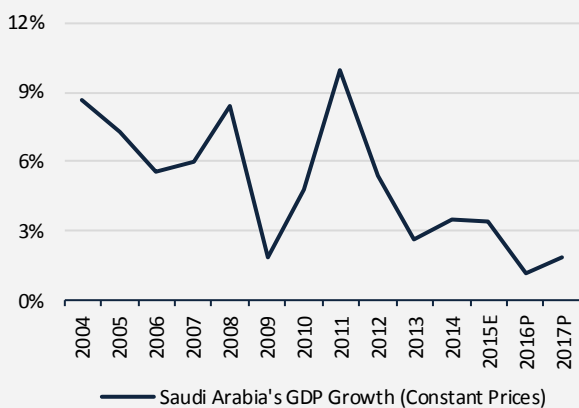
Saudi Arabia Real Estate Market



Economic Overview

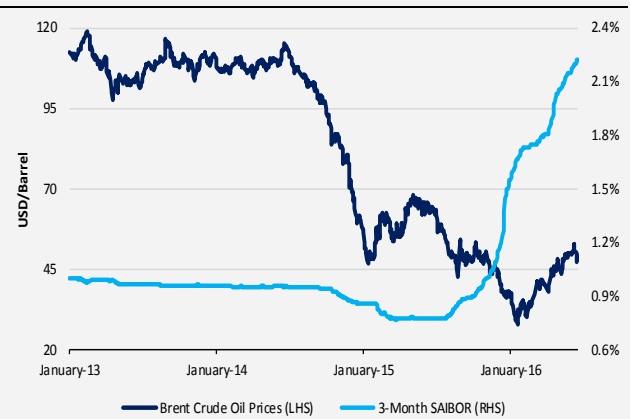
The Saudi Arabian economy has exhibited a strong economic growth (CAGR of 5.5% during the 2004-2014 period) over the past decade, primarily driven by robust hydrocarbon revenues, government spending and private sector activity. However, the scenario is changing with oil prices now hovering close to 12-year lows. The economic growth is expected to more than halve from last year's level. The IMF anticipates Saudi Arabia's GDP to expand by 1.2% in 2016 and by 1.9% in 2017, considerably lower than the reported growth of 3.3% in 2015. The government has implemented a series of reforms such as subsidy cuts and limiting wage growth, in addition to a reduction in 2016 budgeted expenditure and debt issuance, to tackle the impact of lower hydrocarbon revenues. However, the slump in oil revenues, reduced government spending and debt issuance has resulted in a strain on banking sector liquidity. The three-month Saudi Arabian Interbank rate (SAIBOR) is hovering close to 2.22% (as on 17th June 2016), its highest level in about seven years. The challenging economic scenario is expected to weigh on business and investment sentiment in the country.

Saudi Arabia's Economic Growth has Taken a Hit from Low Oil Prices



Source: IMF

Strained Banking Sector Liquidity



Source: Bloomberg

Although the NCB's construction contract index shows that the value of awarded contracts reached SAR 223.4 billion in 2015, an increase of 1.2% from the previous year, value of contracts plunged 25% QoQ in the fourth quarter. Nevertheless, the Kingdom has embarked on a policy of raising local and international debt to cushion the erosion of its fiscal buffers and not immediately cut support lines to any of the current key construction projects. We believe that the government will continue to focus on the crucial infrastructure projects for now and delay a number of projects planned for 2016.

Residential Market

Executive Summary

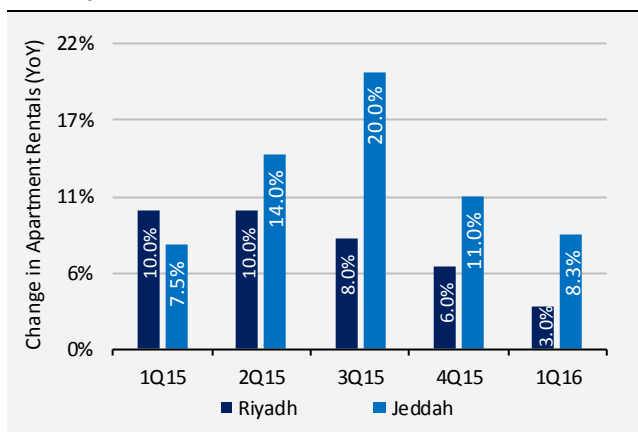
We are positive on the undersupplied residential segment as demand from growing population is expected to keep residential rates supported. Although low affordability among potential home buyers is a concern, recent government initiatives to halve minimum down payment requirement is a positive development. In the near term, we expect rental demand to increase as home buyers are likely to hold back purchases, amid economic uncertainty and expectations that the imposition of white land tax could increase land availability for residential construction and thereby lower prices. However, we do not anticipate a major downward shift in house prices, as the supply constraint and underlying demand growth would continue to support prices.

Positive on the Undersupplied Saudi Residential Market in the Long Run; Housing Finance Reforms will give an Impetus to Demand

High real estate prices and hurdles in accessing finance continued to weigh on domestic affordability levels and caused locals to opt for rentals over owning a house. Also, amid economic uncertainty and expectations that the imposition of white land tax could increase land availability for residential construction, home buyers have held back purchases.

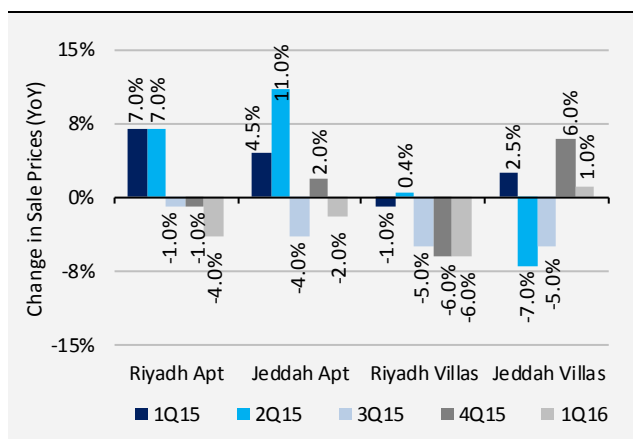
According to JLL, the number of residential transactions in Saudi Arabia fell 5% YoY in the year to November. Meanwhile, average apartment rents in key cities, Jeddah and Riyadh, increased 13% and 9%, respectively, for the same period. The shift in demand towards renting of residential properties compared to a purchase has resulted primarily from the mortgage regulations implemented towards the end of 2014, which mandated the loan-to-value (LTV) ratio at a maximum of 70%, resulting in potential buyers unable to meet the 30% down payment requirement.

Apartment Rents in Riyadh & Jeddah Continued to Grow at a Healthy Rate



Source: JLL

Sale Prices Exhibit a Slowdown



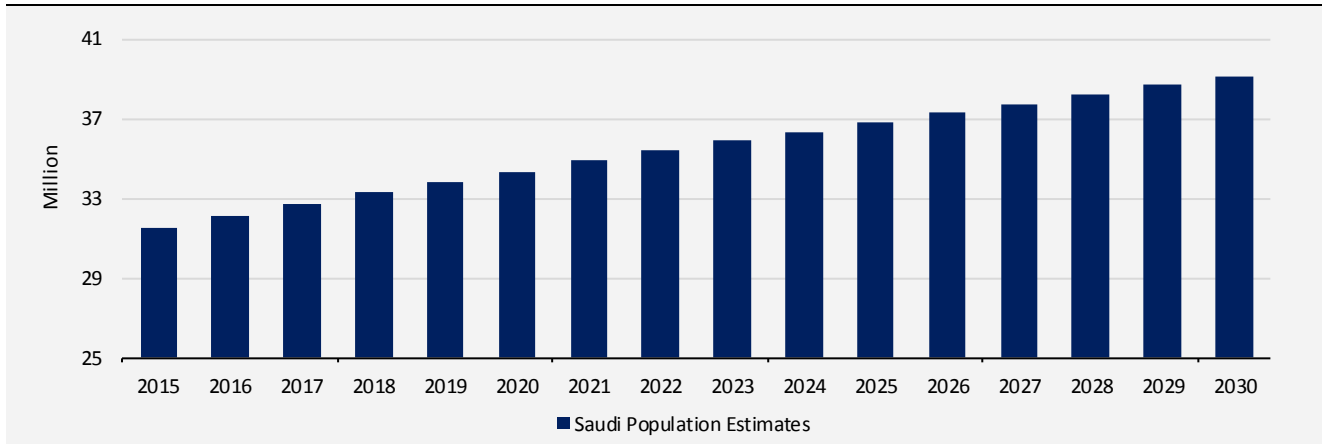
Source: JLL

¹<http://www.arabnews.com/news/451566>

Favorable Demographics will Support Demand across the Already Undersupplied Residential Segment

Growing Saudi Arabian population has been a key factor in fueling demand across the already undersupplied housing market in the Kingdom. According to forecasts, by 2030, Saudi Arabia is anticipated to add more than one fifth to its 2015 population. Moreover, shrinking average household size in Saudi Arabia and higher proportion of youth in the domestic population will translate into more demand for houses. In addition, the Ministry of Municipal and Rural Affairs expects that the Kingdom's urbanization rate would reach 88% by 2025¹ (up from 83% in 2014 according to World Bank data), thereby raising prospects of a continued favorable environment for underlying demand.

Saudi Arabia's Population is Expected to Increase at a Healthy Rate

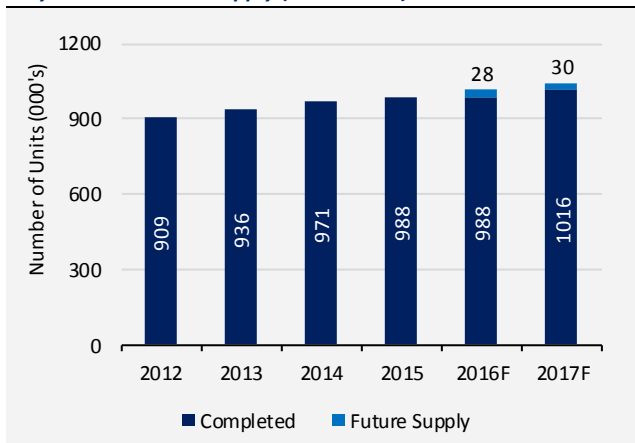


Source: World Bank

Although new supply is expected to enter the market in the near future, the population growth and change in the demographic dynamics might continue to keep the demand-supply mismatch across key cities such as Jeddah and Riyadh in place and support house prices. According to JLL, the shortage in Saudi Arabia's housing segment stands at around 1 million units and at least 200,000 units need to come to the market annually to match demand. In 2015, the Riyadh and the Jeddah markets saw additions of merely 17,000 and 20,000 units, respectively. The consultancy firm forecasts an addition of about 28,000 units in Riyadh this year and about 30,000 units in 2017, however, with a caveat that the actual deliveries could be considerably lower than expected. With limited growth in residential supply and amid anticipation that the supply shortage is unlikely to wane in the near term, we believe that even lower quality residential units could continue to demand premium prices.

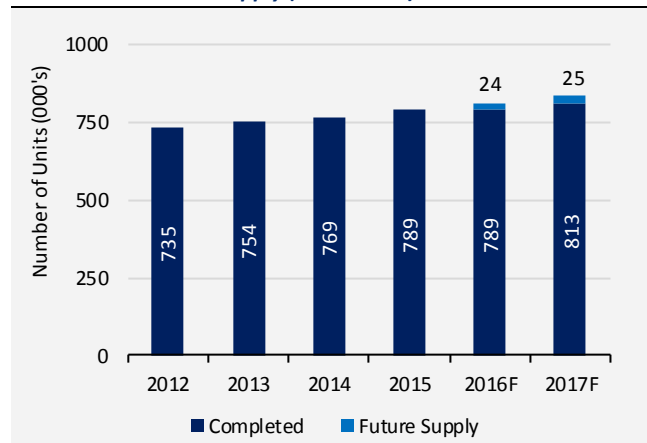
Meanwhile, a shift in demand from conventional villas to high-rise residential luxury apartments has been witnessed. We expect this trend to continue amid lifestyle changes, rising income levels among the richer individuals, and better amenities in apartments, including swimming pools, gyms and sky lounges.

Riyadh Residential Supply (Cumulative)



Source: JLL

Jeddah Residential Supply (Cumulative)



Source: JLL

Credit Availability and Affordability Remain a Concern; Move to Halve Minimum Down Payment a Positive Development

Despite favorable demographics, low affordability and limited access to finance might continue to haunt Saudi Arabia's residential real estate market. Real estate prices are high due to inadequate urban planning and an artificial land shortage created by holding for speculative activity. Lenders are reluctant to provide home loans due to opacity on mortgage laws and amid expectations that land and building costs might ease moving ahead. Moreover, the 2014 year end move by the Saudi Arabian government to bring the Loan-to Value (LTV) ratio to 70% has also been detrimental to lending activity for home purchases. Mortgage-loan book grew by SAR 8 billion in 2015 compared with an increase of SAR 18 billion riyals in 2014, marking the lowest growth recorded in the 2009 to 2014 period. Statistics from the Ministry of Justice show that the number of residential transactions have trended lower across key cities such as Jeddah, Riyadh and Dammam. In value terms, real estate deals in the Kingdom have fallen 16% to SAR 367 billion in Year To September 2015 period, from SAR 436 billion recorded in the same period a year ago.



However, we believe that lending activity might pick up pace going forward, especially following the central bank's announcement that the advance payment for home buyers has been reduced to 15% from the earlier 30%. In conjunction, the Saudi central bank, in order to ease tightening liquidity, has also increased the ratio of deposits that commercial banks can lend out from 85% to 90%. On the other hand, the recent rationalization of subsidies is likely to have a short term inflationary effect and impact household budgets negatively.

Tax on Undeveloped Urban Land is Anticipated to Release More Land for Construction and Cap Prices in the Long Term

The Saudi Arabian government recently announced the implementation of a tax on undeveloped land (white land tax), to discourage unnecessary holding of vacant land. It is difficult to presently evaluate the full impact of such a levy, since there is no standard definition for what can be considered as vacant land. Landowners could still find loopholes to avoid taxation, by building temporary sheds or by installing a utility line below the ground. However, the general belief is that such a reform could free up more land for development, thereby reducing pressure for further increases in land & building costs. Also, investors expect that this law could change market dynamics by boosting real estate development and deter the current trend of investments in vacant lands for capital gains. Nevertheless, the impact of this move is likely to boost supply only in the medium to long term and is unlikely to get reflected in the short term.

Government Schemes and Reforms Likely to Promote Affordable Housing

The Kingdom recently implemented new rules to allow off-plan sale of homes, enabling real estate developers to sell houses before they are constructed, particularly after this payment method proved to be a success in Dubai and helped fund construction of thousands of homes in the Emirate. Moreover, the government launched the ESKAN scheme in early 2014, where ESKAN means housing in Arabic. This scheme has been introduced with the aim to break-through bottlenecks such as red-tapism, land availability and aid allocation, and provide subsidized home loans or housing units at subsidized rates to Saudi families. The Kingdom also announced that Saudi Real Estate Development Fund (REDF), the government owned home loan provider to individuals, would be converted into a bank to reduce unnecessary bureaucratic intervention. Furthermore, the government recently entered into a contract with a Korean company to build approximately 100,000 homes near the Riyadh International Airport.



Upcoming Infrastructure Projects will Spur Residential Demand in the Proximity Areas

Haramain High Speed Rail Project



Source: Saudi Railways Organization

There are a number of key ongoing infrastructure projects in Saudi Arabia such as the High Speed rail & Metro projects and the upgradation of airports. The Haramain high speed train, which is currently undergoing test runs between Madinah and Rabigh, has begun its trial run from the main station in Jeddah mid-2016. We envisage an increased demand for residential housing in the proximity of these train terminals as they offer accessibility to the trade centers in the city. In most of the cities, train stations function as nodes in transport networks which would offer better connectivity to residents living in the peripheral areas of the city, where house prices are generally lower.

Delays in Projects Likely to Help Avoid Oversupply

In 2016, low oil prices are expected to keep economic activity in the Kingdom dampened. Apart from a low materialization rate (the rate at which the planned construction projects get delivered), there are several reasons such as lack of credit availability, working capital constraints, inadequate dispute redressal procedures and manpower shortages that could result in project delays. Despite government measures to boost housing supply, project delays could limit oversupply in the real estate market and help avoid any drop in prices.

Subsidy Reforms to Weigh on Disposable Income of Locals

Saudi Arabia has taken a number of reforms, including the recent rationalization of energy subsidies. Such reforms have started to impact the spending capacity of locals and caused households to rationalize their budgets. Growth in point of sale transactions in the Kingdom, a gauge of retail sale transactions, has been declining of late. Budget rationing coupled with higher borrowing costs in Saudi Arabia is likely to weigh on the disposable income and in turn on the loan repaying capacity of domestic consumers.

Office Market

Executive Summary

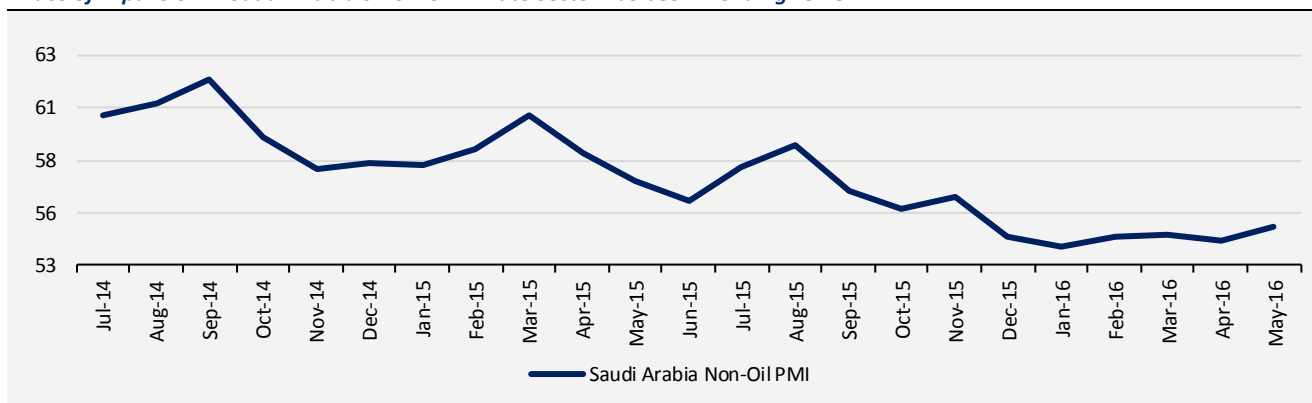
Amid low oil prices, growth in the Saudi Arabian economy is anticipated to slow. Corporates have resorted to cost cutting initiatives and slashed their expansion plans for the near term, particularly amid the government's move to roll back spending in the 2016 budget. Additionally, more office supply is expected to enter the market in 2016 which could increase vacancy rates and weigh on rental yields. Although a set of positive reforms in favor of attracting foreign investments could change our outlook on the office segment, the current challenging scenario does not make us optimistic about this sector. We have a more negative bias on the Riyadh market compared to Jeddah.

Saudi Office Market: Increase in Office Supply to Weigh on Rental Yields

Weak Economic Growth will Deter Corporates' Expansion Plans

A number of Saudi Arabian companies have lowered their earnings forecast for the current year as low oil prices and lower government expenditure are likely to weigh on the performance of the domestic private sector. Corporates are unlikely to undertake aggressive expansion and are likely to cut back their hiring pace. As a result, demand for new office space is not expected to grow at the robust pace seen in the past, complementing the slowdown already visible in the public sector firms. Reports showed that the Kingdom's labor force increased merely by 46,000 in 2015, the weakest pace since records began in 1999², amid a slowdown in the hiring pace of both, public and private sectors. Also, according to the employment sub-index of the Emirates NBD Saudi Arabia Non-Oil PMI reading, the rate of hiring eased to near-stagnation at the end of the fourth quarter of 2015, the weakest in the current 21-month period of expansion. Moreover, rising interest rates are proving to be a double whammy for the Kingdom's private sector performance. The benchmark measure of interest rates, the 3-month SAIBOR, climbed to 2.22% as on June 17, 2016, close to multi-year highs. In order to adjust to the higher borrowing cost, a number of companies have expressed plans to initiate cost cutting measures, which could result in rationalization of real estate facilities.

Pace of Expansion in Saudi Arabia's Non-Oil Private Sector has been Trending Lower



Source: Bloomberg

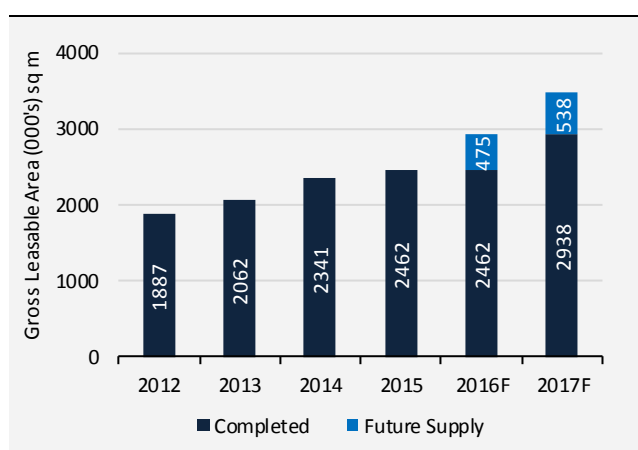
²http://www.arabianbusiness.com/saudi-arabia-s-labour-force-grows-at-slowest-pace-since-1999-623441.html#.Vt06u_l961s

Completion of Large Scale Under-Construction Projects in Riyadh to Weigh on Rents

Rentals in Riyadh have broadly remained stable, as low materialization rates in the office segment has limited prospects of a substantial oversupply. According to JLL estimates, the materialization rate in Riyadh stood at 24% in 2015, with only 121,000 square meters of the planned 500,000 square meters of office space actually being delivered. This kept vacancy rates stable at 16% and restricted any major downside in rentals, despite demand growth for offices slowing. Key office properties in Kingdom Tower, Business Gate and Granada Business Park continued to have occupancy levels of more than 90%.

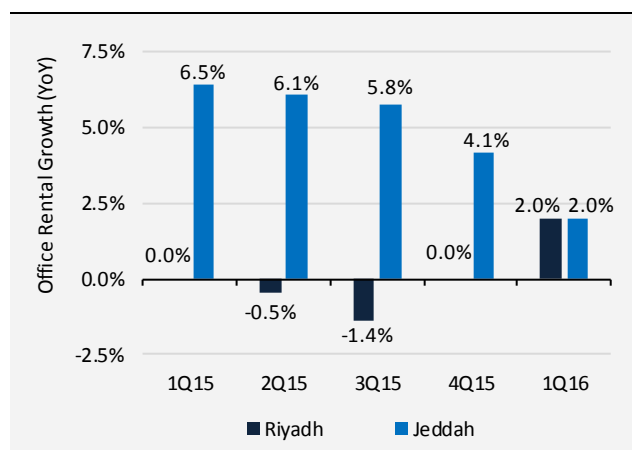
We expect the office market scenario to alter substantially in 2016 as nearly half million square meters of new office space in two under construction projects – the King Abdullah Financial District (KAFD) and the Information Technology Communications Complex (ITCC) will be added, and exert pressure on rentals. The KAFD is expected to deliver about 112 buildings of which about 80% will be used for commercial purpose. KAFD will operate as a financial hub for the country's major financial institutions including the Capital Market Authority (CMA) and Saudi Stock Exchange (Tadawul). However, sources reveal that rentals in KAFD are estimated to be in the range of SAR 2,000 to SAR 3,000 per square feet, much more expensive than the rents in the Central Business Districts (CBD) which are about SAR 1,000 to SAR 1,200 per square feet. On the whole, the feeling is that the ambitious KAFD project will add more space than the local market can absorb resulting in a supply glut. Likewise, the ITCC project which was initiated much before the KAFD project and had a relatively smaller budget of approximately USD 1.65 billion, aims to improve infrastructural facilities for the current IT companies and construct various types of buildings useful to these companies on an area of approximately 0.78 million square meter. With office rentals already remaining under pressure in Riyadh, we believe that the additional commercial space could increase vacancy rates and weigh on rentals going forward.

Riyadh Office Supply (Cumulative)



Source: JLL

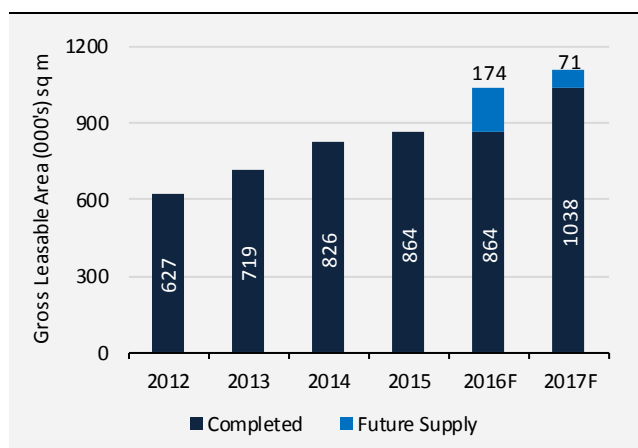
Rental Growth in Riyadh Continued to Underperform the Same in Jeddah



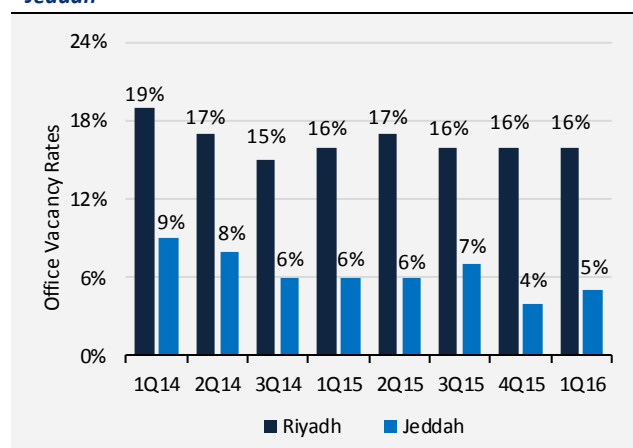
Source: JLL

Downside in Rentals to be Relatively Gradual in the Jeddah Market

The office area in Jeddah, which is the secondary business center after Riyadh, is relatively more fragmented. According to JLL, in Jeddah, only 38,000 square meters of Gross Leasable Area (GLA) was delivered in 2015, with the major portion being small office space. The limited supply in Jeddah resulted in a 4% YoY growth in rentals in the fourth quarter of 2015. However, large supply is expected to hit the market in 2016, with a number of ongoing construction projects on the Prince Sultan Street, King Abdulaziz Road and the Emaar Square part of Jeddah Gate. A total of 33,000 square meters of GLA has been added during Q1 2016. With the upcoming supply in the Jeddah market, we believe that vacancy rates could increase. Nevertheless, the office segment in Jeddah has lower vacancy rates compared to Riyadh, as a result of which rentals in the former are expected to be less vulnerable to the new supply. Moreover, the downside in rentals for Grade A office spaces is likely to be limited, considering the limited availability for such properties in Jeddah.

Jeddah Office Supply (Cumulative)

Source: JLL

Vacancy Rates in Riyadh are Relatively Higher than that in Jeddah

Source: JLL

Free Zones will have a Negative Bearing on Rents across the Central Office Areas

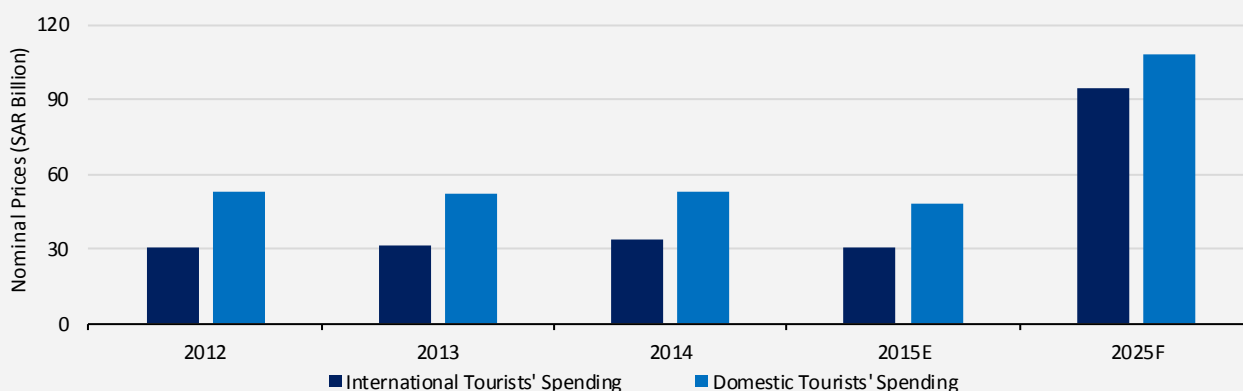
As a part of its long term diversification objective, the Saudi Arabian government plans to set up free trade zones near the airports to attract foreign businesses. The Vice-Chairman of the General Authority of Civil Aviation, Faisal Al Sugair, stated recently that the aviation regulator is in talks with multiple government agencies to set up free zones at the Jeddah and Riyadh airports. These free zones would have more relaxed policies for visa approvals, licensing and taxation, and have large areas to include manufacturing facilities. Although these zones are likely to have a positive economic impact, prospects of massive office supply with relaxed operational policies is likely to cause migration of companies to the free zones and weigh on rentals across current commercial areas. However, we expect a minimum of at least 3-5 years for these projects to come on-stream.

Hotel Segment

Executive Summary

Saudi Arabia's hospitality sector is broadly driven by religious tourism centered around the holy cities of Makkah and Madinah, while Riyadh primarily caters to corporate and leisure visits. We have a positive bias on hotels across Makkah, Madinah and Jeddah which have a higher presence of religious tourists. We expect religious tourism to surge as the government eases restrictions on visa approval amid completion of the holy mosque's expansion projects. Furthermore, Civil Aviation's upgradation initiatives to increase the overall capacity of Saudi Arabian airports to more than 100 million travelers by 2020 and the completion of the Haramain high speed rail links would provide an additional impetus to religious tourist inflows. Although hotel supply in Makkah and Madinah is expected to increase, the rise in religious tourism demand will largely absorb the increased supply. Meanwhile, we are not very optimistic about Riyadh's hospitality sector as corporate and leisure visits are expected to take a hit this year, with companies cutting down on unwarranted travelling expenses and the ongoing subsidy reforms hurting regional tourists' discretionary incomes. We anticipate an increased demand for budget hotels across tourist destinations amid cost-reduction initiatives by the corporate sector and a rise in middle-income tourists.

Saudi Arabia's Tourism Segment is Anticipated to Boom Amid a Surge in Religious Visits



Source: World Travel & Tourism Council

Religious Tourism will Drive Hotel Demand

Expansion of the Holy Mosque and Increase in Umrah Visas is Anticipated to Boost Hotel Demand in Makkah

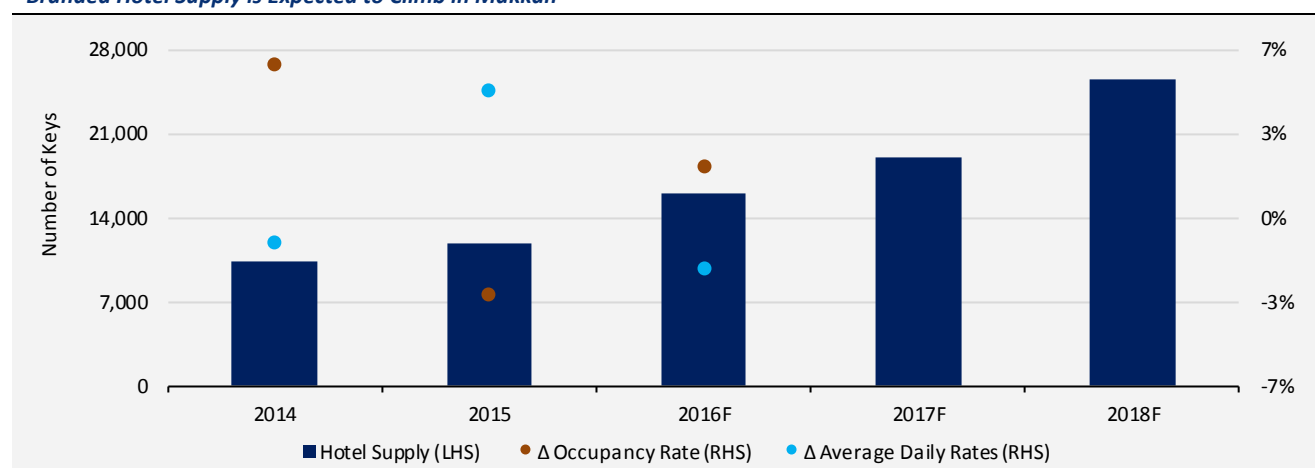
Makkah is the epicenter of Muslim pilgrims globally and the city's hotel segment faces an ever-increasing demand. Over a period of time, the Saudi government has worked towards expansion of the holy mosque in Makkah. Last year, the Saudi Arabian government announced initiation of five new projects as a part of the third expansion plan of the Grand Mosque. These large scale expansion projects will considerably hike the holy mosque's capacity and would help the

Saudi Arabian government lower caps on visa approvals and boost the inflow of religious tourists. According to market estimates, post expansion, the grand mosques will be able to accommodate about 2.5 million worshippers during the peak Hajj season from about 1.5 million worshipers in 2013¹. By 2018, the government also plans to triple visa issuances for Umrah, the off-season religious visits that can be done throughout the year². According to the Hajj ministry's figures, Umrah visas are expected to increase from 6 million issued during 2014 and 2015 to 10 million visas in 2016 and the number is expected to increase six fold to 60 million by 2018³.

Additional Supply in Makkah will be Largely Absorbed by Increased Tourist Inflow

In 2015, average daily rates (ADRs) remained buoyed, despite the ongoing construction activity restricting visa approvals and weighing on occupancy rates. Hotels were able to charge premium rates during the Hajj season, taking advantage of the recent demolition in hotel space. Reports revealed that approximately 26,000 rooms were demolished to accommodate the recent expansion activity⁴. Going forward, branded hotel supply in Makkah is expected to increase at a CAGR of 29% from 2015 to 2018, and more than double the accommodations. However, ADRs are not anticipated to witness a significant downside as a higher expected inflow of religious tourists will largely absorb the new supply and support occupancy rates. Moreover, branded economy hotels are expected to gain popularity as the easing visa restrictions would allow more arrivals of cost conscious customers from populous emerging countries.

Branded Hotel Supply is Expected to Climb in Makkah



Source: Colliers International

*'Δ' means Delta which symbolizes change in quantity

*2016 Forecasted Occupancy Rate = 64% & Average Daily Rates = USD 224

Madinah to Benefit from the High Traffic Inflow of Religious Tourists and Key Domestic Infrastructure Projects

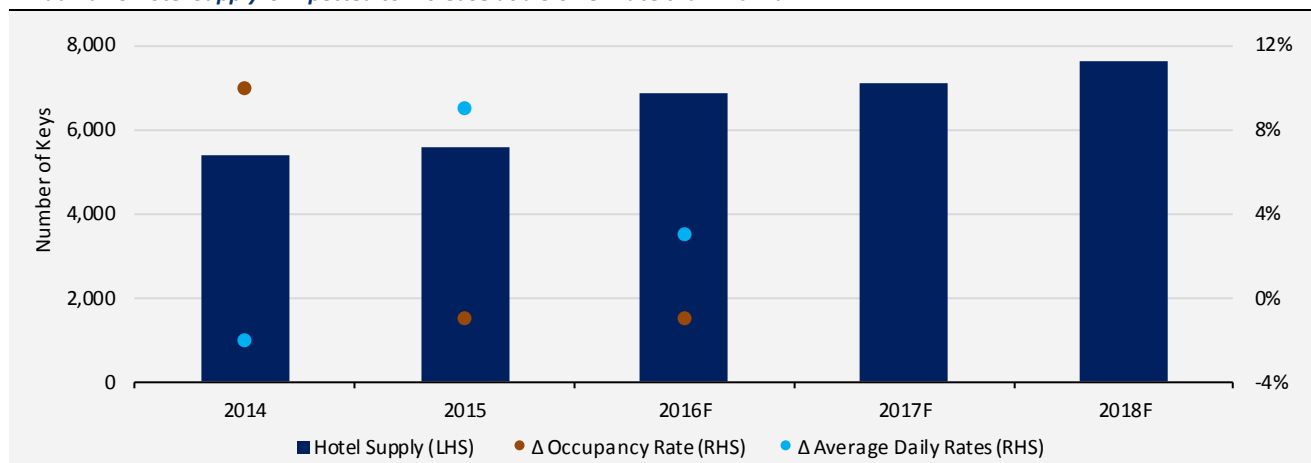
Madinah, the second most important holy city in Saudi Arabia, would also largely benefit from a higher inflow of Hajj and Umrah pilgrims, particularly considering the expansion of Makkah's grand mosque. Furthermore, there are a number of key transportation projects due for completion in the near term. Upgradation of the Prince Mohammed Bin Abdulaziz Airport in Madinah is underway. Also, the Haramain high-speed rail network would connect Makkah and Madinah via the King Abdullah Economic City and the King Abdulaziz International Airport. These train services which would have the capacity to serve approximately 160,000 passengers on a daily basis and more than 50 million passengers annually, could notably boost tourist visitors in Madinah.

¹<http://english.alarabiya.net/en/special-reports/hajj-2013/2013/10/12/Grand-Mosque-expansion-project-s-first-phase-opens-during-hajj.html>

²<http://www.albawaba.com/business/holy-profits-mecca-most-lucrative-hotel-market-worldwide-814022>

³<http://saudigazette.com.sa/saudi-arabia/1-25m-umrah-pilgrims-a-month-from-next-year/>

⁴<http://www.albawaba.com/business/holy-profits-mecca-most-lucrative-hotel-market-worldwide-814022>

Madinah's Hotel Supply is Expected to Increase at a Slower Pace than Makkah

Source: Colliers International

*'Δ' means Delta which symbolizes change in quantity

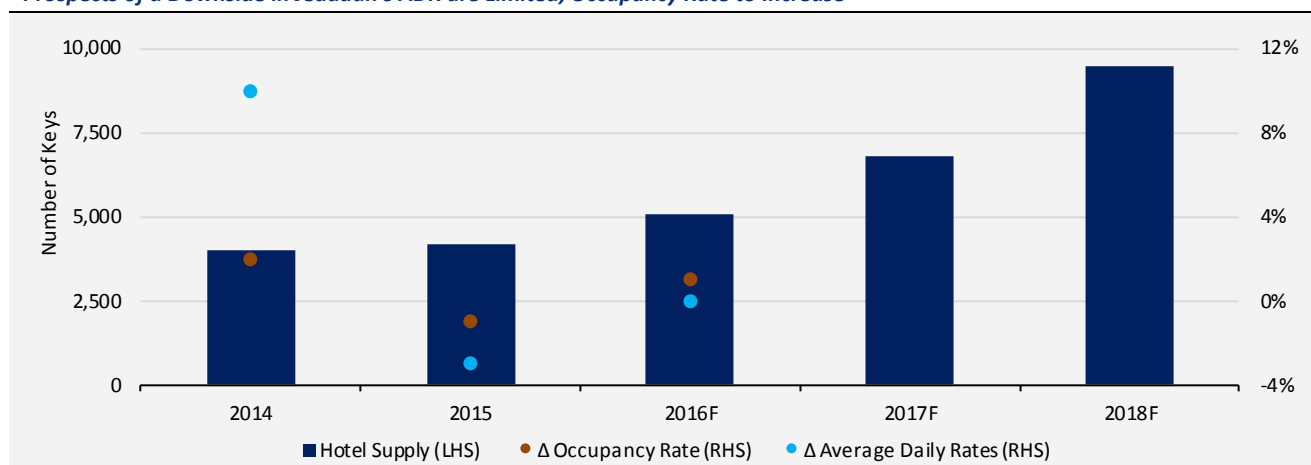
*2016 Forecasted Occupancy Rate = 62% & Average Daily Rates = USD 163

Meanwhile, demolition of a number of hotels to help expand the Prophet's Mosque in Madinah supported ADRs in 2015. ADRs in Madinah rose in 2015 despite a drop in occupancy levels, suggesting that hotels across Madinah could charge premium rates even with the limited number of visa approvals last year.

Branded hotel supply in Madinah is anticipated to grow at a CAGR of 11% from 2015 to 2018, a pace much slower than that in Makkah. The quality of hotel supply is also expected to improve, as old hotels are demolished and new branded supply enters the market. Higher anticipated inflow of religious tourists will cap any prospects of a drop in occupancy levels across Madinah hotels.

ADRs across Jeddah Hotels Likely to be Partially Supported by Religious Tourism

Unlike Makkah and Madinah, hotels in Jeddah attract religious tourists as well as leisure visitors. A slowdown in regional leisure travel could be witnessed as recent subsidy reforms negatively impact pockets of GCC consumers. However, the number of religious tourists in Jeddah hotels are expected to benefit from the expansion of Makkah's grand mosque and partially absorb the lost demand. The city's close proximity to Makkah and seaside appeal of hotels could attract religious tourists looking for premium accommodation. Moreover, a number of infrastructure projects including the upgradation of the King Abdulaziz International Airport are also in progress. The upcoming Haramain high speed railways, which could reduce the travelling time between Jeddah and Makkah from more than an hour to merely 5-7 minutes, would also provide a significant boost to the number of religious tourists in the city.

Prospects of a Downside in Jeddah's ADR are Limited, Occupancy Rate to Increase

Source: Colliers International

*'Δ' means Delta which symbolizes change in quantity

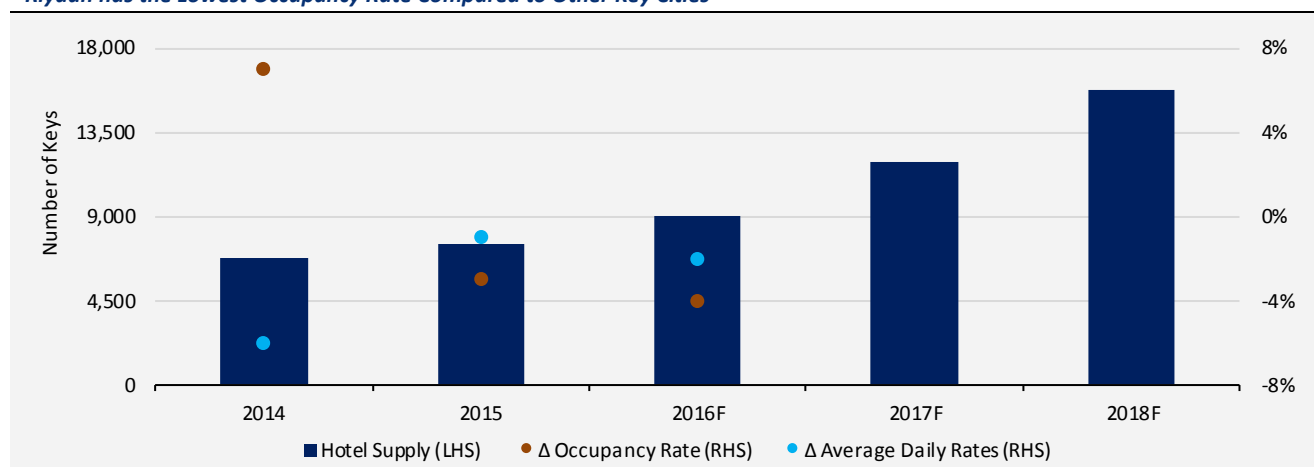
*2016 Forecasted Occupancy Rate = 75% & Average Daily Rates = USD 253

Branded hotel supply in Jeddah is expected to grow at a CAGR of 32% from 2015 to 2018, the highest compared to the other major Saudi Arabian cities. Of this, 5-star and 4-star hotels would constitute about 51% and 31% of the total upcoming supply, respectively. However, the historic trend of delays in hotel openings is likely to continue, considering that there already is a significant amount of backlog already from 2015, which would keep ADRs supported in the near term. Jeddah's hotel segment would be in a better position than that in Riyadh, considering the sector's less reliance on non-religious tourism.

Riyadh's Hospitality Segment is Anticipated to be Most Vulnerable to the Vagaries of Oil

Riyadh is Saudi Arabia's primary business center and mainly caters to business travelers. The impact of lower oil prices, cut down in government expenditures and overall rationalizing of spending plans would weigh on the city's hospitality segment, as companies lower their business travel expenses and as locals in the GCC region cut leisure travel expenses amid subsidy reforms. We believe that demand for mid-market and budget hotels could increase amid cost cutting programs by corporates and growing number of middle-income domestic tourists.

Riyadh has the Lowest Occupancy Rate Compared to Other Key Cities



Source: Colliers International


*'Δ' means Delta which symbolizes change in quantity

*2016 Forecasted Occupancy Rate = 56% & Average Daily Rates = USD 229

In 2015, two key hotel projects, the Movenpick and Doubletree by Hilton, delivered a notable portion of hotel supply. Going forward, Riyadh's hotel supply is expected to grow at a CAGR of 28% till 2018, which would more than double accommodation from the current levels. Although delays in projects are likely to weigh on the hotel segment's materialization rates, 51% of the city's new hotel rooms anticipated to open in 2016 are delayed projects of the previous years. Nevertheless, even if there are delays, ADRs are unlikely to find any support as we expect overall demand in the city to soften and lead to higher vacancy rates going forward. It would be more difficult for older hotels to maintain their historical rates and amid a slower demand from the corporate segment, we believe that hotels in Riyadh might focus more on offering differentiated products to increase their occupancy levels.

Mid-market Hotel Segment Expected to Grow

A key trend that is emerging over the past few years is the demand for mid-market and budget hotels. As discussed earlier in the report, cost cutting initiatives by corporates and higher proportion of price sensitive tourists are likely to result in increased demand for budget hotels. The limited supply and increasing demand will support prices in this segment. According to a report by Germany-based research company Tophotelprojects, many project developers are now focusing on this segment and a large number of rooms are expected to enter the market by 2018. Some of the key projects include 1,433 rooms from Park Inn by Radisson, 1,155 rooms from Hilton Garden Inn, about 1,800 rooms from Four Points by Sheraton. In addition, Starwood's Aloft Hotels, Accor's Mercure and InterContinental Hotels Group's Staybridge Suites are also foraying in this category.



Retail Segment

Executive Summary

Saudi Arabia's retail sector has been one of the high growth sectors of the economy, with the Kingdom boasting of a large growing population and strong per capita income. The country's retail market grew at a robust pace of 11%¹ in 2015, despite lower oil prices weighing on the country's economic health. A recent move by the government to allow 100% FDI in the retail and wholesale businesses is expected to provide a fillip to investments in the sector, with many foreign players having already set plans of expansion in the Kingdom. However, the subsidy reforms have started hurting consumers' spending activity, while higher interest rates are expected to slow expansion activity among retailers. Some estimates indicate that growth in Saudi Arabia's retail segment could slow to 6%-8% in 2016 from 11% in 2015². Furthermore, large retail supply is anticipated to come up in Riyadh and Jeddah, which could result in pressure on rentals going forward.

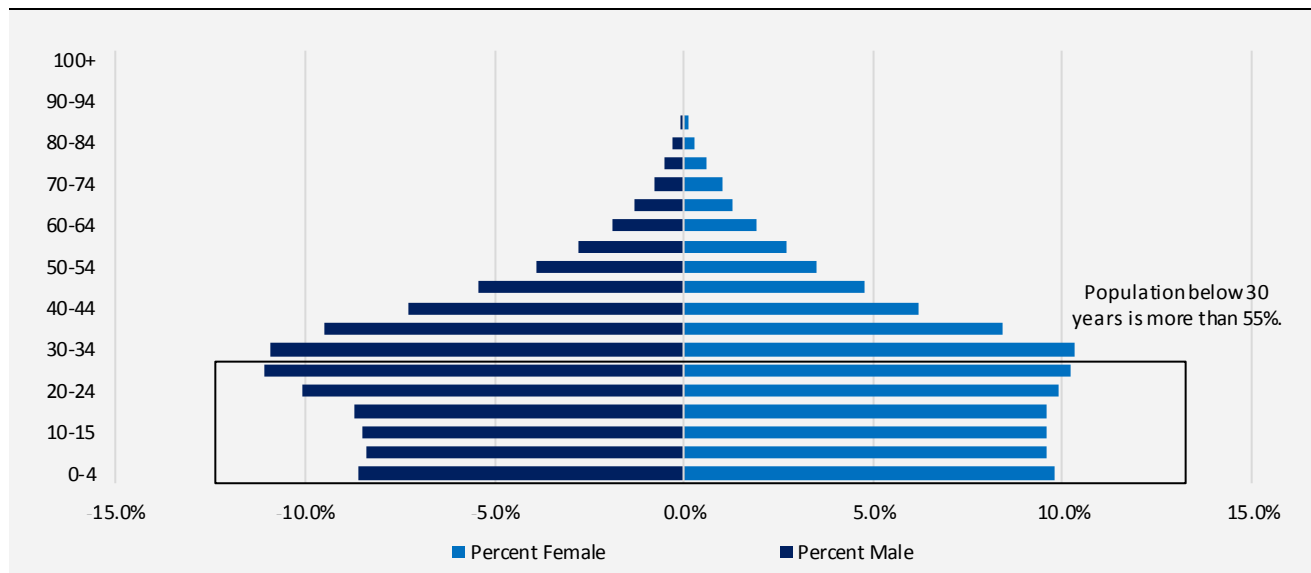
Subsidy Reforms to Weigh on Retail Sector's Growth in the Medium Term

Saudi Retail Sector Set to Grow; Although the Pace is Expected to be Slower in the Medium Term

Saudi Arabia's retail sector has been one of the fastest growing retail sectors in the world. A large consumer base and a rapidly growing young population have continued to drive retail growth. With more than 55% of the local population being less than 30 years old, demand for fashion and beauty products has surged, causing more retailers to open outlets. According to World Bank estimates, Saudi Arabia's total population, which stands above 30 million currently, is expected to grow almost by a quarter in the next 15 years. Rising count of women in the workforce and growing urbanization are also expected to support growth in the retail segment. Moreover, there is a lack of other entertainment sources in Saudi Arabia, which results in malls enjoying higher footfalls and greater leisure spending as families find these places optimal for outings over the weekends. Despite this, retail space per person in Saudi Arabia stands at just about 0.30 square meters, much lower compared to the gross leasable area per capita of 1.1 square meters in China and 3 square meters in the US. This underscores the long term potential of the sector. However, in the medium term the Kingdom's retail segment is expected to take a hit from the recent subsidy reforms. According to Economist Intelligence unit, retail sector growth is expected to slow and be in the range of 5% to 7% over the next few years after clocking in a double digit growth of 11% in 2015. Nevertheless, in the long run, as oil prices consolidate, the pace of activity in the retail sector is expected to pick up.

¹<http://http://www.thenational.ae/business/retail/saudi-retail-sector-is-its-success-story>

A Major Portion of the Saudi Arabian Population is in the Working Age Group (2015 Est.)

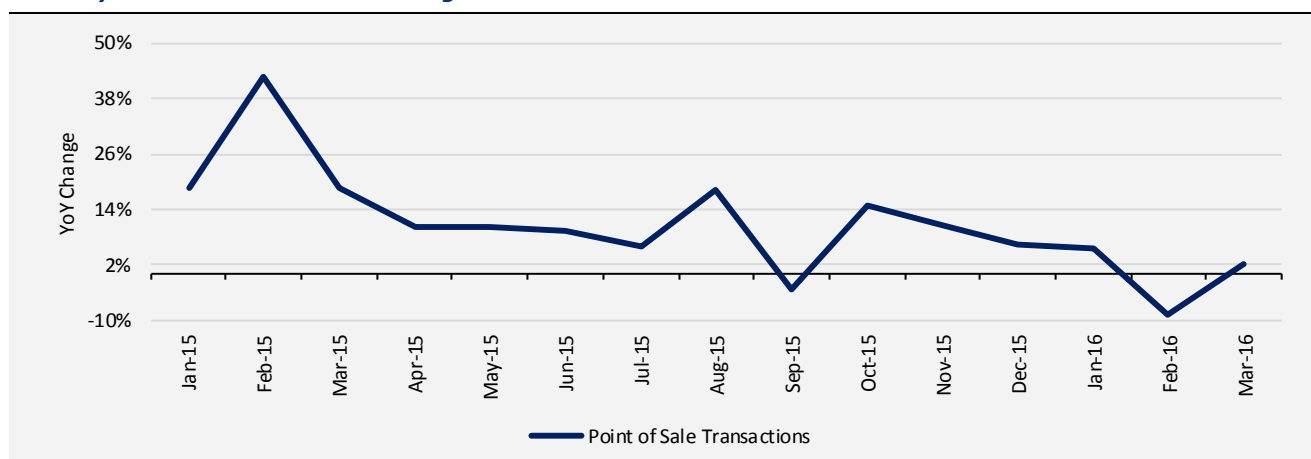


Source: US Census Bureau

Shrinking Discretionary Household Incomes and Higher Costs to Weigh on Retailers' Activity

Historically, high per capita income in Saudi Arabia has been an important driver of growth in the country's retail segment. However, recent reforms introduced by the government have started to weigh on domestic consumers' spending activity. Point of sale transactions (POS), a gauge used to measure consumer confidence in the economy has started showing signs of strain. The latest February 2016 numbers showed that POS fell 9.1% from a year earlier and the cash withdrawals at ATM's fell 8% during the same period. Additionally, a slowdown in Saudi Arabia's private and public sector hiring pace accompanied by a deceleration in domestic wage growth and higher inflation would weigh on the retail demand in the near term. A few Saudi retailers such as Jarir Marketing and Almarai have cautioned investors about challenging conditions ahead.

Subsidy Reforms have Started to Weigh on Retail Transactions in Saudi Arabia



Source: SAMA

Moreover, interest rates in Saudi Arabia are hovering near record high levels. Expectations are that rates could further go up, especially considering the close correlation of the Kingdom's monetary policy with that of the US. Furthermore, the government has announced plans to levy a 5% VAT in 2018, in line with the other GCC nations. Collectively, higher interest rates and tax levies could lower retailers' profit and curtail their expansion activity going forward.

Government Reforms to Boost Demand for Retail Space...

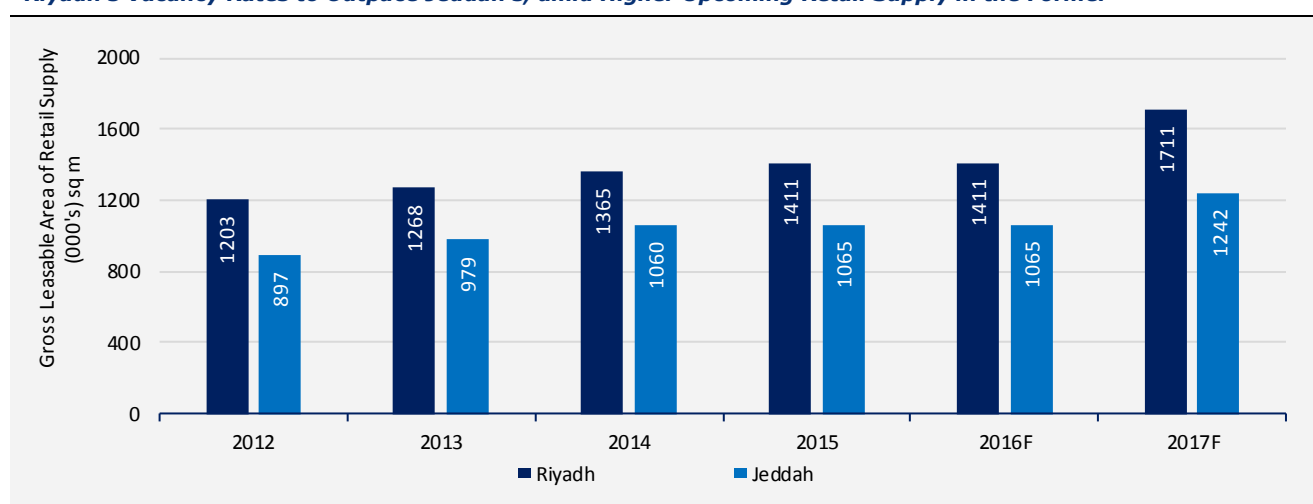
In a move to diversify away from oil, the Kingdom recently eased restrictions to enable foreign investors to own 100% stake in domestic retailing and wholesale businesses. Considering the vast opportunities seen in the USD 45.3 billion Saudi Arabian retail market, this move has garnered notable interest. A number of retail players such as Lulu Hypermarkets, Middle East Centre for Shopping Centres, GMG (the parent of Sun & Sand Sports) and Al Futtaim Group (operator

of Ikea and Marks & Spencer outlets) have stated plans to increase their presence in the Saudi market. UAE-based Lulu Hypermarkets plans to launch four hyper markets in 2016 and six more in 2017. Furthermore, the government is also considering to close down small groceries stores (locally known as bagalas) and give retail permits only to large shops, which is anticipated to boost demand for quality retail spaces going forward.

...Though Large Upcoming Supply is Expected to Pressurize Rentals

Meanwhile, looking ahead, occupancy rates and rentals in Saudi Arabia are expected to come under renewed pressure as the increase in demand is unlikely to absorb the large upcoming retail supply. According to JLL, gross leasable area is expected to climb by 514,000 square meters in Riyadh and by 352,000 square meters in Jeddah through 2017. In Jeddah, most of the upcoming retail spaces are expected to come in the Northern and Eastern regions of the city, which lack quality retail spaces. Meanwhile, the market in Riyadh is expected to enjoy a surplus of quality retail spaces going forward, considering that such supply is expected to increase by 60% over the next five years in the city. Also, the upcoming retail space in Riyadh's community centers is anticipated to increase vacancy rates and weigh on rentals. As a result of a constraint of quality retail space in Jeddah, we believe that rental growth in the city might continue to be stronger than that in Riyadh, after rents grew 7% in Jeddah and 3% in Riyadh, in 2015.

Riyadh's Vacancy Rates to Outpace Jeddah's, amid Higher Upcoming Retail Supply in the Former



Source: JLL

¹http://www.tradearabia.com/news/RET_293625.html

