CAPITAL STANDARDS
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Kuwait Real Estate Industry

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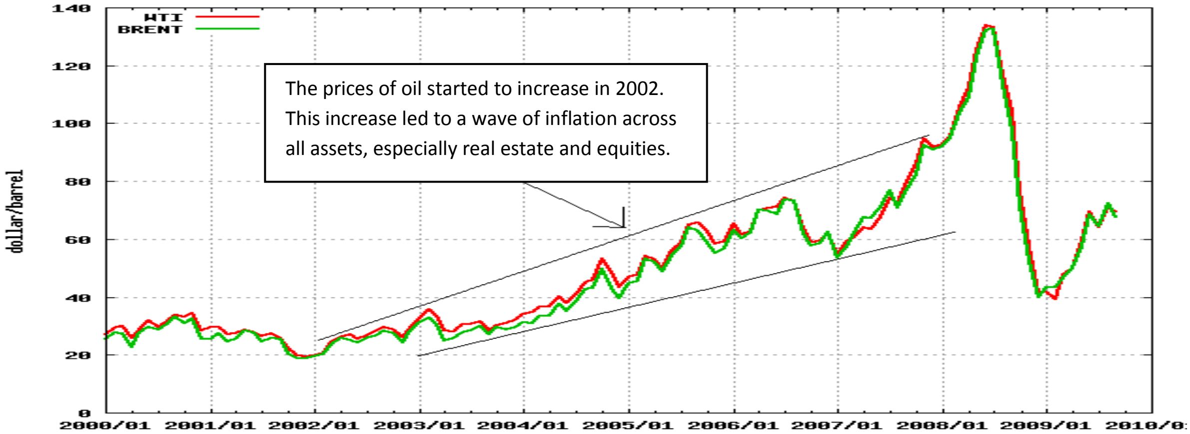
Industry Overview

- The value of the real estate and construction projects in the GCC region has declined by 13.5% from Nov-08 to Nov-09
- The biggest contributor to the On-Hold Projects (OHP) is the UAE with a 78% of total OHPs
- Real Estate comprises 8.5% of the Kuwait's GDP (average of 2001-2007)
- The real estate sector in Kuwait lags the stock market in almost every move
- Nature of real estate companies in Kuwait is to finance long-term assets with short-term debt
- At least 20% of listed assets are exposed to UAE
- In Kuwait, loans extended for real estate purposes comprised 49% of the total loan portfolio in Kuwait (6-year average 2004-2009)
- The residential property transactions have increased significantly in November 2009 (by 52.4%).
- The rental income of investment properties in some areas fell by 5.9%-8% and this led investment properties prices to decline
- Kuwait witnessed overwhelming attention from investors to the commercial property segment in 2007/2008
- The real estate sector is a highly volatile sector with a beta of 0.9
- The sector enjoys high liquidity with average daily volume of 85.7 mn shares constituting 23% of the average total daily volume
- The average return on the index (2005-2009) is -53%

The GCC Economy

The world has been through a tough economic crisis that evaporated billions of dollars of economic value. One of the major effects the crisis had was on the prices of crude oil which is considered the major source of income for the GCC countries. The significant increasing trend in oil prices that started in 2002 fueled real estate price inflation to levels which are considered abnormal. After the financial crisis, these all-time highs suddenly collapsed; as they were mainly not supported by the concept of demand and supply, but speculation.

Figure 1: Historical Oil Prices



After the significant decline in real estate prices over the GCC countries, some of the Government owned conglomerates in Dubai defaulted on a USD 100 bn worth of debt. Real estate development and construction was one of the core segments of these companies and this had a negative effect on the real estate market in the region.

Table 1: Value of Real Estate Projects in the GCC Region

Country	Value in Nov-08 USD bn	Value in Nov-09 USD bn	% Change	On-Hold Projects in Nov-09 USD bn
Kuwait	298.8	271.5	(9.1%)	41.04
Bahrain	57.7	68.3	18.3%	9.1
Saudi Arabia	606.5	609.4	0.5%	39.2
Oman	106.4	104.6	(1.7%)	6.7
Qatar	216.9	204.8	(5.6%)	7.9
UAE	1,228.2	915.9	(25.4%)	368.2
GCC Total	2514.5	2,174.5	(13.5%)	472.1

Source: Istockanalyst

The value of projects in the GCC has declined by 13.5% from Nov-08 to Nov-09 and this was mainly due to the large amount of projects that were put on hold. The biggest contributor to the On-Hold Projects (OHP) is the UAE with a 78% of total OHPs. This could be explained by the default of some Government Related Entities (GREs) in Dubai. The liquidity crunch in the GCC was mainly due to the decline in oil prices which meant thinner surpluses for the Council's countries, therefore less money is available to spend on mega projects. Another reason is the large corporations in the region are exposed to large amounts of debt and were affected by the Dubai corporate default which blocked their way to expand and made them focus more on debt service. Foreign investor confidence also declined after what happened in Dubai which may, again, fuel the liquidity crisis.

After the stabilization of the oil prices at a range of USD 70-80 per barrel, the GCC countries are implementing different strategies to support their economies. Countries like Saudi Arabia and Bahrain are investing in Affordable Housing Projects to control real estate prices while providing reasonably priced and affordable properties for people. Another factor that encourages demand is the decline in prices of cement, concrete, steel and other building material which will, in general, help to balance the supply and demand to achieve a steady real estate market. In Kuwait, the amendment of laws 8 and 9 which allows Islamic Banks to trade in residential properties and allows the construction in seven residential new areas in Kuwait which is expected to create some positive activity in the market. In the medium term, real estate prices may continue to fall slightly, then stabilize before a new round of inflated prices.

Real Estate in Kuwait

Overview

Kuwait is an oil producing country with its GDP mainly comprised of income from oil. Real Estate and construction had been an important sector in the Kuwaiti economy since it covers 8.5% of the country's GDP (average of 2001-2007). The real estate sector was negatively affected by the global financial turmoil and the liquidity crisis.

In Kuwait, the real estate and the stock markets are the choice of most of investors (individuals and firms) with excess funds. These two markets are positively correlated with the economy; however, the real estate sector lags the stock market in almost every move. This may be due to the fact that the trading process in the real estate sector is significantly longer than the stock market. Therefore, the economic variables take extended periods of time to be fully reflected in the prices of real estate.

The amount of loans extended to the real estate sector in Kuwait for 2007 was KWD 9.5 bn; however, the contribution of the real estate sector to the GDP for the same year was only KWD 1.9 bn. This indicates that almost 80% of the loans funded for real estate purposes may be spent on several aspects; for projects outside Kuwait, for purposes other than real estate and construction and for purchasing properties that already existed. This huge difference between the two figures indicates that the majority of the loans extended did not create significant economic value, therefore fueling inflation.

KD mn	2001	2002	2003	2004	2005	2006	2007
GDP at market prices	10,700.0	11,590.0	14,267.2	17,516.6	23,593.2	29,494.5	31,841.0
GDP growth rate	(7.5%)	8.3%	23.1%	22.8%	34.7%	25.0%	8.0%
Construction	262.6	312.0	349.3	401.9	437.0	533.8	581.8
Real Estate	873.7	969.8	1,062.0	1,094.8	1,208.4	1,325.2	1,361.8
Total Real Estate and Construction	1,136.3	1,281.8	1,411.3	1,496.7	1,645.4	1,859.0	1,943.6
Growth Rate	1.7%	12.8%	10.1%	6.1%	9.9%	13.0%	4.6%
Contribution to GDP	10.6%	11.1%	9.9%	8.5%	7.0%	6.3%	6.1%

Source: Central Bank of Kuwait (year 2008 was not available)

Regulations

The real estate market transactions are regulated by the Kuwaiti Commercial Law and documented by the Ministry of Justice (MOJ). New laws (Law 8 and 9) have been implemented to prohibit commercial entities to trade and finance residential real estate to achieve a market that is governed by demand and supply with no speculations. However, Islamic Banks were excluded from this law and they can trade and finance residential real estate. This may incite conventional banks to oppose this law and demand equal rights.

In 2003, the government restricted construction and building in new areas where the infrastructure and services are not completed. Recently, seven new areas where excluded from this restriction and this added to the level of supply of residential real estate.

Real Estate Loans in Kuwait

The total loan portfolio (banks in Kuwait) over the period of 2004-2009 focused almost half of the funds towards the real estate and construction activities (average of 49.17% for 2004-2009). The real estate loans witnessed significant growth over 2004-2007 until the 2008 economic crisis, which slowed down loan growth over 2008 and 2009. The slowing growth of loans contributed to the already existing liquidity crunch in the real estate market, especially considering that the value of real estate assets dipped while the value of loans remained unchanged. Many real estate companies borrow to purchase real estate assets to develop and then sell for a profit. However, the repayment of those loans became more difficult due to the depressed asset values.

The real estate sector is a cyclical sector with volatile property prices, therefore, banks should be careful not to over-finance the real estate and construction sector in times of economic prosperity. On the other hand, they should also be careful not to restrict funding to the sector in times of economic difficulties, thereby worsening the effects of the crises.

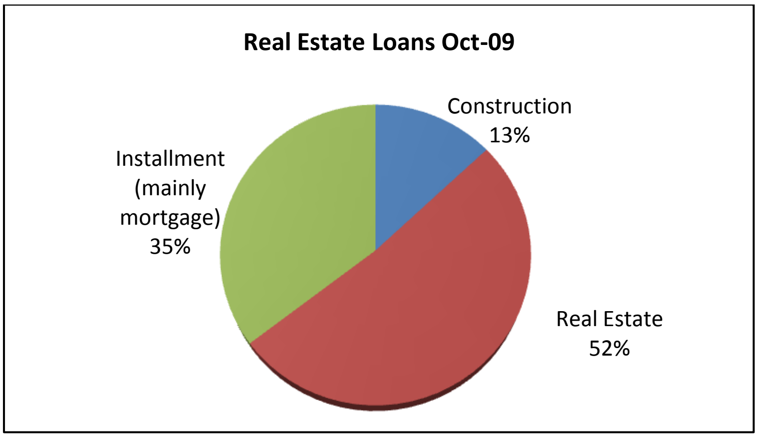
Table 2: Loan Portfolio in Kuwait

KWD mn	Oct-04	Oct-05	Oct-06	Oct-07	Oct-08	Oct09
Total Lending by Banks in Kuwait	9,831.9	11,186.1	14,313.1	18,998.7	23,222.9	24,913.8
Total Lending to Real Estate	4,314.1	5,648.0	7,178.7	9,485.2	11,442.8	12,727.8
Growth rate	-	30.9%	27.1%	32.1%	**20.6%**	**11.2%**
Real estate loans as % of total Loans	43.9%	50.5%	50.2%	50.0%	49.3%	51.1%

Source: Central Bank (Capital Standards' Analysis)

As of October 2009, the real estate loans where distributed for three purposes; Real Estate transactions at an amount of KWD 6.6 bn, Installment Loans (for purposes of restoring and purchasing private residence) of KWD 4.5 bn and loans for Construction Projects of KWD 1.7 bn.

Figure 2: Real Estate Loans



Source: Central Bank of Kuwait

Real Estate Transactions

Table 3: Real Estate Transactions in Kuwait

Transaction Type	Jul-09		Aug-09		Sep-09		Oct-09		Nov-09	
	Value KWD mn	No. of Contracts	Value KWD mn	No. of contracts	Value KWD mn	No. of Contracts	Value KWD mn	No. of Contract	Value KWD mn	No. of Contracts
Residential Property	64.18	352	64.05	306	44.17	190	69.44	324	105.80	451
Investment Property	88.55	115	39.37	96	22.88	94	42.62	130	162.21	170
Commercial Property	5.16	11	5.36	4	3.00	4	44.60	6	41.35	8
Warehouses	0	0	2.76	2	0	0	2.15	3	1.42	2
Total	157.89	478	117.54	408	68.43	284	158.81	463	310.78	631

Source: Ministry of Justice

Residential Properties

The residential properties are the core of the real estate market in Kuwait (average of 47.4% of total transactions for the period of (Jul-09 – Nov-09). The residential properties values differ from one area in Kuwait to another, in the sense that in some areas the prices are more stable than others.

The residential property transactions have increased significantly in November 2009 after the cabinet's decision to allow construction in seven new areas in Kuwait; Jaber Al Ahmed, Saad Al Abdullah, Sabah Al Ahmad, Al Maseelah, Al Sideeq, Al Funaytees and Abu Futaira. This created more supply for the market, with more demand brought by the contribution of Islamic banks through mortgages, leading the residential activity to pick up. Residential properties in some areas (mostly areas close to the city) will hold their values or witness a slight increase over H12009 as the supply is backed by enough demand. However, we might see some volatile movements in the prices of residential real estate in some new areas.

In the beginning of 2009, the number and value of the Savings and Credit Bank (SCB) approved loans have been declining. This factor also contributed to the declining prices of residential real estate, however, the number of approved loans by SCB increased by 24.5% in October 2009 (17% increase in value), thereby adding demand in the market.

Investment Properties

The second largest portion of the real estate transactions is the investment properties segment, comprising an average of 40.4% of total transaction (average for Jul-09 – Nov-09). According to a 'Kuwait Finance House' real estate report, the rental income of investment properties in some areas fell by 5.9%-8% and this led investment property prices to decline. The decline in rental income is mainly due to the effects of the financial crisis and the drop in demand on investment properties by expatriates.

The average price per transaction witnessed a decline over Jul-09 – Oct-09, however, it significantly increased in Nov-09 by 188% and this may be an indicator of a slight increase in liquidity. This unsustainable increase in liquidity is not a clear sign that the worst is behind.

Commercial Properties

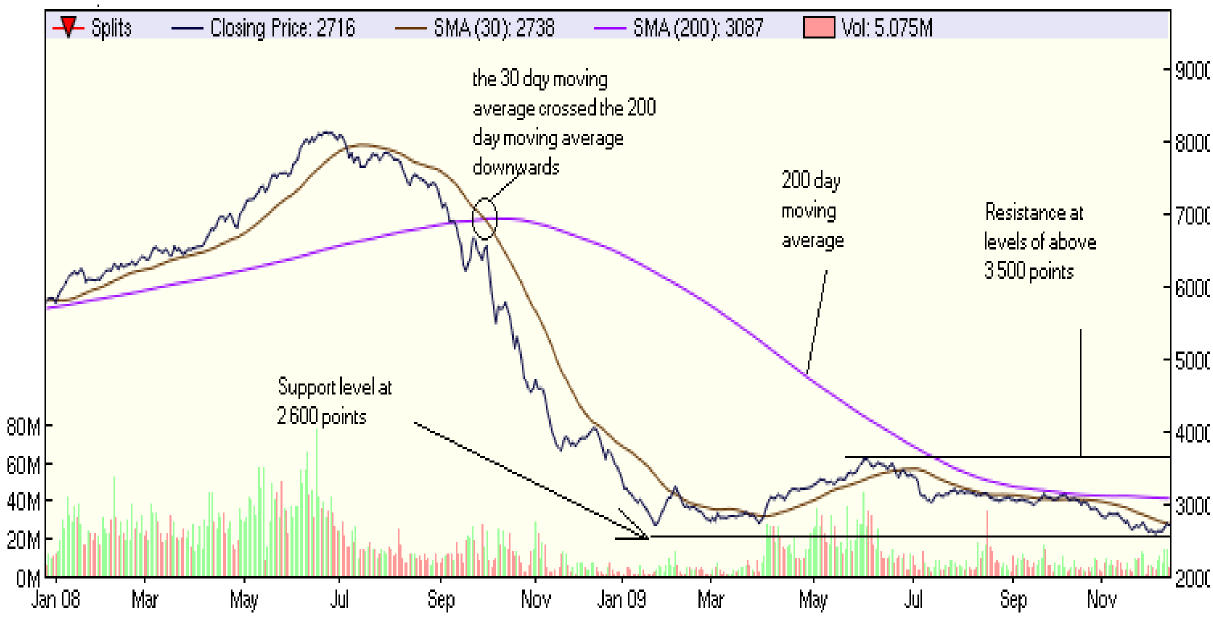
The country witnessed an overwhelming attention from investors to the commercial property segment in 2007/2008, thereby adding a large amount of supply to the market. This attention was the reason of increasing rental rates and prices of commercial properties which attracted large amounts of investors. However, after the surfacing of the effects of the economic crisis, the demand on retail and office building declined sharply which led to a drop in rental rates in late 2008 and early 2009. This factor, along with weak access to funds, resulted in a decline in value of commercial real estate. According to figures from a Kuwait Finance House real estate report, the decline in commercial property started in the fourth quarter of 2008, when many real estate companies needed liquidity and started to sell off their properties. In Q42008, the average decline in commercial property around all Kuwaiti governorates was 10% – 10.5%, followed by a deeper decline in Q12009 by an average of 24.1%. in Q22009, the prices declined at a lower rate of 3.2% – 6.2%, followed by an average decline of 1% - 5.6% in Q32009. the trend shows that the commercial property market may, to some extent, be supported going through Q42009 and Q12010.

However, with the huge amount of supply for commercial real estate, especially office buildings, it is expected that neither rental rates nor prices would see an increasing trend any time soon. The effects of the economic crisis on liquidity and the weak access to funds are the biggest contributors supporting these expectations.

Kuwait Stock Exchange

Industry Performance

Figure 3: Real Estate Index (KSE)



The performance of the real estate industry in the Kuwaiti Stock Exchange has been bounded in a tight range of approximately 1000 points (2,600 – above 3,500). The index came down from high levels of 8000 in late May and early July of 2008 driven by the effects of the crisis and the deterioration of the real estate industry as a whole. The index found the 2,500 points to be a hard support and the 3,600 to be a resistance mark. The volume levels declined in July – November until the index reached the support boundary where volumes increased and the index picked up to close at 2,723 points as of December 14 2009. For the index to break the support or the resistance, a large trading volume and some positive (to break resistance upwards) or negative (to break the support downwards) information is needed to support the task. The annual results for the financial year 2009 along with the results of the first two quarters may have significant effects on the real estate sector.

Table 4: Market Statistics

	Banking	Investment	Real Estate	Services	Non-Kuwaiti	Food	Industry	Insurance
Index Volatility	24%	30%	27%	18%	20%	23%	22%	12%
Average Daily Volume	24,598,968	127,408,826	85,674,870	87,018,390	24,389,303	4,029,386	22,961,729	366,715
Beta	0.82	0.96	0.89	0.92	0.82	0.81	0.91	0.62
2005-2009 Return %	14%	(57%)	(53%)	(17%)	(2%)	(5%)	(5%)	(8%)
Average % Share of Total Volume	7%	34%	23%	23%	6%	1%	6%	0%

Source: Capital Standards

The real estate sector is a highly volatile sector with a beta of 0.9 which reflects the correlation between the index and the market. The sector enjoys high liquidity with average daily volume of 85.7 mn shares constituting 23% of the average total daily volume. The average return on the index (2005-2009) is -53% which is the second lowest performance in the market.

Sample Analysis

Performance 2007 - 2008

Table 5: 2007-2008 Performance

	Rental Income			Property Trading Income			Loans			Projects under Construction		
	2008	2007	% Change	2008	2007	% Change	2008	2007	% Change	2008	2007	% Change
NREC	8.03	7.67	4.69%	0	0	-	163.37	117.84	38.64%	235.42	38.21	516.12%
Tamdeen	11.67	11.62	0.43%	36.26	3.73	872.12%	119.25	105.45	13.09%	179.67	69.45	158.70%
Al-Tijaria	7.07	6.83	3.51%	0.15	13.99	(98.93%)	149.07	85.2	74.96%	79.03	52.61	50.22%
United	13.38	11.81	13.21%	0.90	1.40	(35.71%)	95.42	103.67	(7.96%)	25.48	15.21	67.52%
Average	10.04	9.48	5.83%	1.05	7.70	95.14%	131.78	103.04	27.89%	129.9	43.87	196.10%

Source: Capital Standards

There are 36 listed real estate companies in Kuwait Stock Exchange. Together, their assets totaled KWD 5.16 bn by the end of 2008. National Real Estate Company (NREC), Tamdeen, Al-Tijaria, and The United Real Estate Company are the four largest listed real estate companies, and together they comprise more than 30% of the assets of all the listed Kuwaiti real estate companies. Their significance among listed companies can have serious implications for the entire real estate sector in Kuwait. Analyzing these four companies can give us insight into the general condition of the sector in 2008.

The companies were still benefitting from the aftereffects of the economic boom in 2008 as their Rental Income grew by an average of 5.83%. This may be a direct result of projects completed in 2008 that began to realize income or it could be a result of rent increases that lagged the economic downturn and therefore did not fully reflect declining economic conditions. The characterization of rent as a “sticky price” supports the latter result.

Property Trading Income is a good indicator of the effects of the economic downturn on the sector. On average between Al-Tijaria and United Real Estate, from 2007 till 2008, income from property trades fell by 86.35%. Tamdeen grew its income from property trading in 2008, however this occurred in the first half of 2008, and therefore does not fully reflect the economic downturn. Al-Tijaria and United Real Estate did not suffer losses while trading property; rather, they stopped trading entirely. The companies may have not seen profitable opportunities to trade property, which may be true for the entire market at the time as property prices plummeted during end the of 2008. This is a better indicator of how the economic downturn impacted the real estate sector as its effects were immediate rather than lagging.

Table 6 shows that all four of the sample companies increased Projects under Construction by at least 50% by 2008. Average Projects under Construction in 2008 reached KWD 129.9 mn, almost equal to the average 2008 growth in loans to KWD 131.78 mn. Construction was not completely financed by loans, as loans in 2008 for the individual companies do not match their respective Projects under Construction in 2008. For example, Al-Tijaria's 2008 loans almost doubled their 2008 Projects under Construction and United Real Estate's 2008 loans more than tripled their 2008 Projects under Construction. This indicates that although many companies continued to expand and build in 2008, the projects may have not been entirely financed by loans. Borrowed funds not used for Projects under Construction may have been used for other purposes, such as maintaining financial flexibility and meeting payments due during the period for completed developments and projects.

Most Recent Performance & Changes

Table 6: Quarterly Performance

	Cash			Rental Income			Profit on Property Sales			Projects under Construction		
	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change
NREC	15.13	15.52	(2.51%)	6.46	5.98	8.03%	0	0	-	255.80	47.13	442.75%
Tamdeen	17.13	10.97	56.15%	8.12	8.99	(9.68%)	0	36.26	(100.00%)	210.20	173.21	21.36%
Al-Tijaria	1.16	0.44	163.64%	4.79	5.23	(8.41%)	4.96	1.8	175.56%	58.56	69.42	(15.64%)
United	7.57	7.91	(4.30%)	10.6	9.91	6.96%	0	0	-	0	0	-
Average	10.25	8.71	17.65%	7.49	7.53	(0.46%)	1.24	9.515	(86.97%)	131.14	72.44	81.03%

Source: Capital Standards

Table 7: Quarterly Performance

	Net Profit			Investment Properties			Due to Banks & Loans			Stock Price		
	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change	3Q 2009	3Q 2008	% Change
NREC	20.56	20.54	0.10%	69.11	66.43	4.03%	189.05	149.01	26.87%	350Fils	325Fils	7.69%
Tamdeen	2.01	35.42	(94.33%)	47.61	66.70	(28.62%)	220.94	183.37	20.49%	300Fils	395Fils	(24.05%)
Al-Tijaria	18.12	27.75	(34.70%)	158.54	129.80	22.14%	158.65	113.79	39.42%	132Fils	168Fils	(21.43%)
United	1.86	7.37	(74.76%)	187.54	120.92	55.09%	94.16	94.23	(0.07%)	83Fils	142Fils	(41.55%)
Average	10.64	22.77	(53.28%)	115.70	95.96	20.57%	165.70	135.10	22.65%	216Fils	258Fils	(16.02%)

Source: Capital Standards

Table 7 shows that by the third quarter of 2009, the economic downturn significantly impacted real estate companies. The average Rental Income for the four companies only decreased by 0.46% over the year, however this was mainly because Investment Properties grew by an average of 20.57% allowing the companies to generate Rental Income from a larger volume of properties. The growth in Investment Properties distorts the actual impact of the economic downturn on Rental Income. Without the addition of Investment Properties from the fourth quarter of 2008 until the third quarter of 2009, Rental Income may have significantly declined on average, properly reflecting the entire real estate sector.

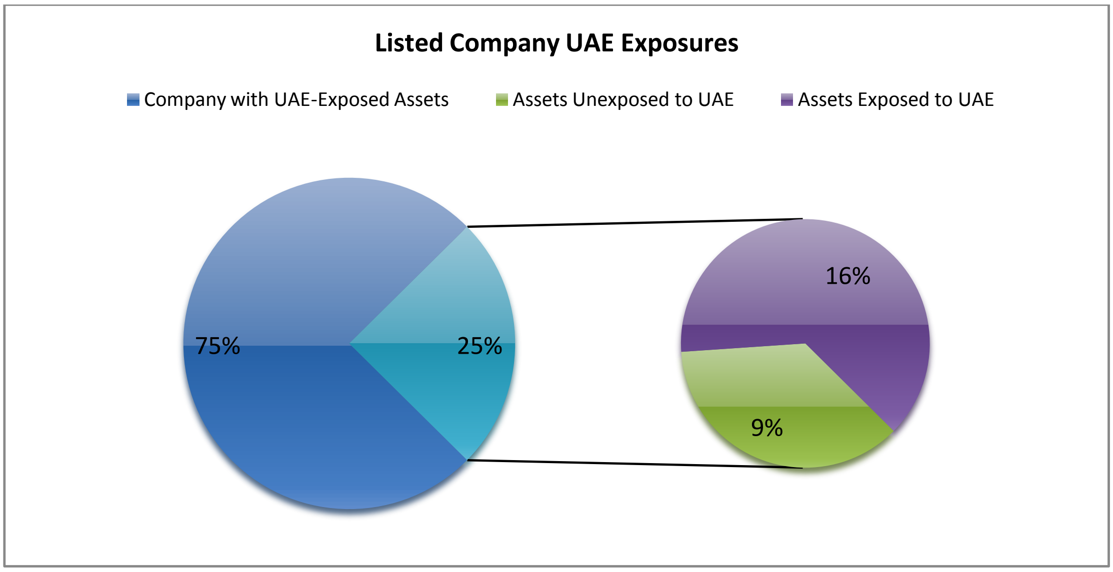
The growth in spending for Investment Properties and Projects under Construction throughout the period (Table 7) indicates that companies may not be as severely impacted by the economic downturn that they cannot continue their plans for growth. Projects under Construction grew by an average of 81.03% over the period, however this is distorted and should be larger since United Real Estate did not consolidate their construction of United Tower, as it is owned by an associate company, and therefore the value of the project is not publicly available. Increased spending may indicate that financially able companies in the market are attempting to capitalize on low property and construction material prices. Projects completed in the present period would take longer to generate significant income as they have only added to a market already saturated in supply.

Table 8 shows that loans taken over the period, for the four companies in the sample, increased by an average of 22.65%. The KWD 30.60 mn increase in loans does not match the average increase of KWD 58.7 mn in Projects under Construction (Table 7) over the year. This is primarily because NREC increased their Projects under Construction by KWD 208.67 mn over the period, skewing the average. Factoring in United Real Estate's unconsolidated project, each of the four company's loans roughly matches or exceeds the value of Projects under Construction. This may indicate that, although companies are still spending to expand and develop projects, they are borrowing to strengthen their financial flexibility and endure the economic downturn.

Overall, the real estate sector, judging from the sample of these four companies, seems to have absorbed the impact of the economic downturn. Companies, however, have continued with their expansion and the development of projects planned before the economic downturn. Increased borrowings have not been used entirely to fund their projects, possibly to maintain their financial flexibility, reflecting the condition of the entire real estate sector.

Exposures to the UAE

Figure 4: UAE Exposures



Source: Capital Standards

Four companies, different from those previously discussed, represent 25% of all assets listed on the Kuwait Stock Exchange. These four companies alone have an exposure of more than KWD 815 mn to the UAE. This exposure represents more than 16% of the entire market's listed assets. Other listed real estate companies also have major exposures to the UAE that are not publicly available. The economic downturn and the recent default of Dubai World and its subsidiary Nakheel, has severely impacted the UAE's real estate sector depressing prices and rental income. The UAE's real estate sector may be further depressed relative to the GCC's real estate sector, therefore exposing the Kuwaiti market to the UAE's severe decline in real estate value. Some companies with exposures to the UAE have taken measures to reduce their exposure the UAE by cancelling projects that have not begun construction.

Abu Dhabi's recent USD 10 bn payment of Dubai's debt has regained some of the confidence of investors. The default of Dubai's loans may have increased its borrowing costs along with the borrowing costs of its fellow emirates, namely Abu Dhabi, and the other GCC countries. This is especially true for Kuwait because of their high exposure to Dubai's real estate sector. The debt repayment alleviates some of the rising pressure on borrowing costs in Kuwait and stabilizes the falling real estate values they were exposed to.

Maturity Profiles

Table 8: Debt in 2008

	Short-Term Debt	Long-Term Debt	Short-Term Assets	Long-Term Assets
KWD Millions				
Total	444.20	402.21	306.96	1,997.76

Source: Capital Standards

Table 9: Debt Maturity in 2008

Short-Term Debt/Total Debt	Short-Term Assets – Short-Term Debt	Long-Term Assets – Long Term Debt	Long-Term Assets/Long-Term Debt	Short-Term Assets/Short-Term Debt	Long-Term Assets/Total Assets
52.48%	(137.24)	1,595.55	496.96%	69.10%	86.68%

Source: Capital Standards

Seven of the real estate sector's largest companies that comprise almost 60% of the listed real estate companies' assets were evaluated for their debt maturity profiles. Total Short-term Assets covered 69.10% of the companies' Total Short-term Debts. Total Short-term Debt exceeded the companies' Total Short-term Assets by KWD 137.24 mn. This deficit may cause liquidity problems for the companies and restrict their financial flexibility. Short-term Debt is a significant portion of Total Debt at 52.48%, while their Long-Term Assets constitute the majority of their Total Assets. This indicates that the nature of real estate companies in Kuwait is that they finance long-term assets with short-term debt, which may expose them to liquidity risks.

Conclusion

The GCC region witnessed a large wave of project cancellations in 2009 mainly due to the effects of the global financial crisis on the prices of oil. The UAE has 78% of the total On-Hold Projects and we believe that the majority of those projects are located in Dubai. After the default of some large conglomerates in Dubai, many projects were suspended and some were canceled as the Emirate experienced a harsh liquidity crisis.

In Kuwait, the real estate sector is considered one of the largest sectors for investors to invest their funds and gain returns. The local banks strongly support this sector by extending loans for real estate purposes; however, banks tend to tighten credit policies on real estate related facilities in times of economic difficulties. For this reason we find that when economies shrink or experience slowdowns, the real estate sector takes a hard hit due to weak access to funds.

The growth in bank loans to real estate and construction activities as a whole witnessed a significant decline in 2008 and 2009. In these conditions, the real estate sector requires increased attention and funding to stabilize especially large construction projects. In the first half of 2010, banks are expected to ease on provisions and regain their appetite to increase lending to the real estate sector, thereby injecting liquidity into the sector, which may stabilize and possibly increase prices further in Q4/2010/Q12011.

The performance of the real estate index in Kuwait Stock Exchange indicates the uncertainty in the performance of the underlying companies of the index. The index is floating in a tight range of 2,600 – 3,200 since July 2009 (2,600 – 3,600 beginning of 2009) and the market is in a state of anticipation for the financials of December 2009. There may be some changes after the release of the financials of 2009, however investors might need confirmation on the outcome and wait for the quarterly results to substantiate their expectations.

DISCLAIMER