CAPITAL STANDARDS
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Kuwait Real Estate Sector

Report Contents

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Summary

After the financial crisis of 2008, the adversely affected Gulf Cooperation Council's (GCC) real estate sector has started its journey to the recovery phase. The increase in housing loans in Saudi Arabia and the announcement of the Madinat Jumeirah city in UAE (United Arab Emirates), indicate positive growth sentiments in the real estate sector. Additionally Qatar's hosting of 2022 World Cup together with the upcoming real estate development projects, are also expected to bring growth in the Qatari real estate sector. Nonetheless, it is very important to note that the GCC investors are highly attracted to real estate investments in Turkey, which expects a USD 100.00 bn trade in the next five years.

Kuwait's real estate sector, following the recovery norm of the GCC region, has also shown signs of growth since the beginning of 2012, with positive future prospects. The key segment that contributed to the total growth is the residential segment as of 1H2012 and it has always been the largest contributor. Conversely, the commercial segment could not come out of the aftermaths of the financial crisis as it continued to see an imbalance between its supply and demand. On the other hand, the investment segment performed well in the 1H2012 which is mainly attributed to lower returns from other investment opportunities such as Kuwait Stock Exchange (KSE).

CSR believes that the Kuwaiti real estate sector is cyclical and is influenced by interest rate changes, availability of credit facilities and also by population growth. These factors have influenced the industry statistics of the Kuwaiti real estate sector. CSR also believes the industry to be highly leveraged, as the industry average of net debt/ equity is 94.11% as of 1H2012.

Furthermore, there have been positive initiatives for the growth of the real estate sector such as: Kuwait Investment Authority's (KIA) announcement to set up Real Estate Investment Authority, and the KWD 1.00 bn fund to be managed by Kuwait Finance House (KFH). Also, KIA has signed a contract with Markaz, for the management of a real estate investment portfolio of KWD 250.00 mn. In addition, the expected increase of KWD 0.03 mn in housing loans, by February 2013 from the Savings and Credit Bank (SCB) may also positively impact the residential segment. These initiatives are expected to revive the real estate sector of Kuwait, which will in turn aid to boost Kuwait's economy.

GCC Real Estate Market

The GCC real estate market is showing signs of recovery after the financial crisis of 2008, which penetrated the real estate bubble in Dubai. The real estate segment of the UAE is now stabilizing with the increased demand of commercial property as compared to the past four years. Further the Real Estate Development Fund (REDF) of Saudi Arabia has approved a total of 10,380 real estate loans, which is expected to boost the housing segment of the Saudi Arabian real estate market.

The demand of the real estate sector is closely associated with the population of the respective country. The local Saudi Arabian population (native Saudi's) represents 73% versus only 32% in Kuwait and 18% in the UAE. This implies a more sustainable organic demand in Saudi Arabia for housing over the long term. Also Saudi Arabia enjoys a more solid primary scenario for growth in the real estate sector when compared to UAE and Kuwait. The more favorable Saudi Arabian economic landscape is also a benefit to the growing real estate sector of the country. However, there are major constraints related to the structural, legislative and affordability limitations, which may be mitigated by the enactment of the new Saudi Arabian real estate mortgage law.

Moreover, UAE and Saudi Arabia are better positioned to attract new businesses, which will have a positive impact on the oversupplied office segment in all three countries (UAE, Saudi Arabia & Kuwait). CSR also expects that with new businesses coming up, population may also increase, generating more demand for housing and also enhancing consumer spending.

Further, the fourth phase of Madinat Jumeirah expansions have been announced by UAE, which will cost Dhs 2.50 bn. The Jumeirah expansions will add new hotels, villas and shops for rental as well as investment purposes. This will in turn add up to the real estate sector's growth prospects in UAE. Upcoming projects such as the world's largest mall and the development of the huge garden (larger than London's Hyde Park), are also expected to boost the UAE real estate sector.

Qatar's real estate sector is also growing mainly due to hosting the 2022 World cup, with an improved development in the real estate projects in the pipeline. The demand for Qatar's residential segment is expected to increase further in the short term. Owing to the implementation of the National Development Strategy plan for the World Cup, and consequently the number of foreign workers in Qatar is expected to increase in the upcoming years.

Oman's real estate sector has also demonstrated strong signs of growth as the traded value of properties and volumes increased substantially, by 59.70%, in the first five months of 2012, compared to the same period last year. In CSR's view, standout real estate markets for 2012 are the Saudi Arabia's residential sector, and the hospitality-related industries, notably in Dubai's real estate markets.

Gulf Increasing Investment in Turkey's Real Estate...

CSR observes that the GCC real estate investors are notably increasing investments in the real estate sector of Turkey. As for tourism, Turkey is considered the sixth largest tourism destination in the world, with 31.50 mn visitors reported in 2011, where Arab visitors accounted for 1.40 mn during the same period. Tourism is immensely increasing in Turkey and mainly in Istanbul. The UAE's Jumeirah Group has assumed management of the Istanbul's Pera Palace Hotel by the end of 1Q2012, and now it is also exploring new opportunities in Turkey.

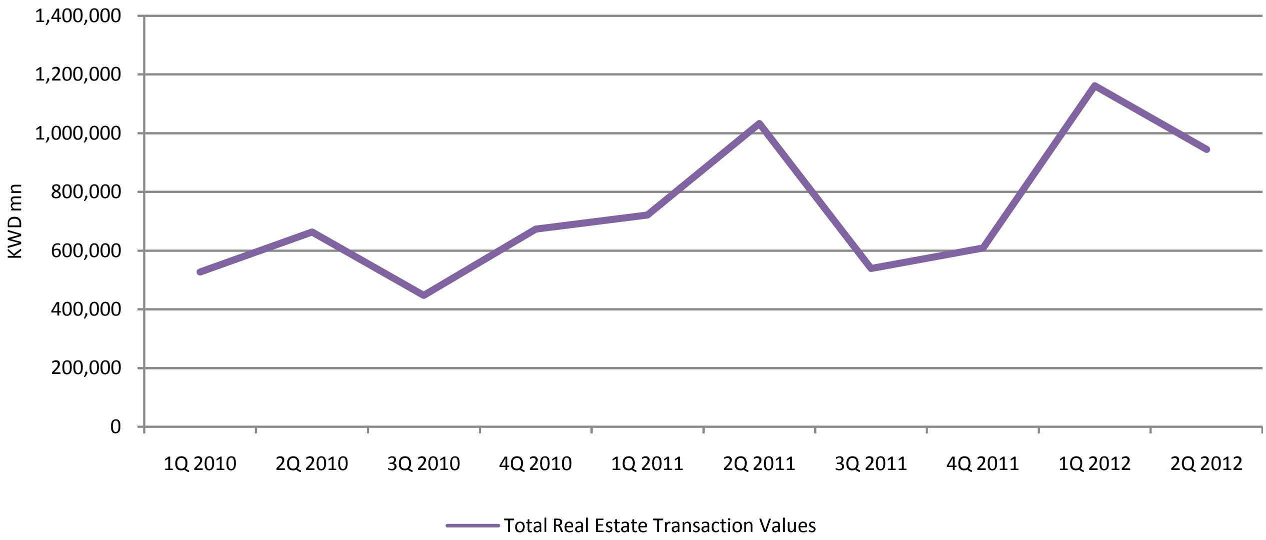
Further, GCC countries have recently invested around USD 10.00 bn in Turkey. The trade between the Gulf countries and Turkey has reached USD 32.00 bn in 2011, of which 11.00% was by the UAE, according to the undersecretary of the UAE Ministry of Economy. Also, Saudi Arabia's My Tuana has already announced investments in the Rotana hotels of Turkey.

Turkey is currently targeting a USD 100.00 bn trade from the Arab countries in the next five years. With a booming economy growing at 8.5% (2011), and relatively cheap real estate prices in Turkey, there is definitely a potential for investor attraction.

Kuwait Real Estate Sector

Kuwait's real estate sector contributes around 3.30% to Kuwait's GDP as of 2010 (according to the Central Bank of Kuwait (CBK)). The Kuwaiti real estate sector has shown signs of growth since the beginning of 2012. The total trading transactions grew by 92.70% in the 1Q2012. However, this trend was not consistent in the second quarter mainly due to the decrease in investment transactions of the sector. The decrease in the investment transactions can be related to the early summer break this year, which was due to the month of Ramadan starting in July. Nonetheless, CSR believes that the overall growth of the sector is dependent on its key segments, which will be discussed further in the report. The legal environment concerning the regulations of the real estate sector also plays an important role in its performance.

Exhibit 1: Trading Activity in the Kuwaiti Real Estate Sector –Quarterly transaction value analysis



Source: Kuwait Finance House & CSR

Legal Environment of the Kuwaiti Real Estate Sector

Kuwait's real estate sector has seen leaps and bounds in the past, mainly in 2008 due to the financial crisis which adversely affected the world's economy. Also, the demand and supply in the Kuwaiti real estate sector was significantly affected by the new regulations imposed on the sector. Post the financial crisis; the government regulations had constrained the immediate recovery of the real estate companies as the new laws imposed controled the demand and supply of the sector.

Moreover, the real estate mortgage laws have imposed challenges for the real estate sector, as it restricts the mortgage of the private residential units. In addition, the approved modifications of the BOT (Built-Operate-Transfer) system have greatly contributed to the decline of the sector when these laws were promulgated in the last quarter of 2008.

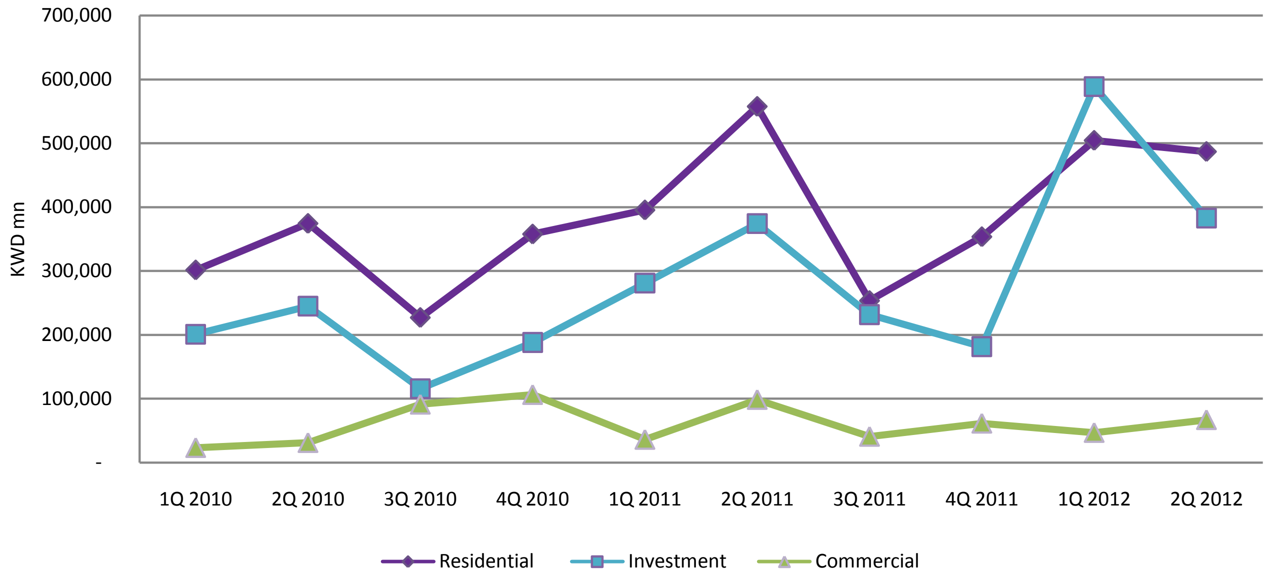
As a result of the lack of supply in the land/property in Kuwait, there have been several laws presented by the Parliament to limit the company's role in real estate development and mainly to provide prime located homes to the locals of Kuwait. By law, the lands in Kuwait cannot be owned by companies or foreigners, only local Kuwaiti's can own lands. Further, it is mentioned in Law no. 8 and 9 that it is prohibited for any company to invest in land in any residential area of Kuwait. These laws had an effect on the supply of land in Kuwait, mainly in the non-residential areas. The decreased supply to companies resulted in an increase in prices for the prospective investors. However, this law was exempted for Islamic banks, as they have different business models compared to other conventional companies.

Another law, which prohibits the holding of large property (5000 square meters) for more than 3 years, was also exempted for Islamic banks, due to their nature of business, which held the property for long term for other than trading purposes. The cautious lending strategy adopted by most of the banks in 2009 had slowed the credit growth to 6.90% in 2009. This created difficulties for the real estate firms that were trying to adhere faster growing trading activities. Nonetheless, regulation for the credit growth of the country, the interest rate, is also one of the important elements in the legal environment of the Kuwaiti real estate sector.

On 1st December 2012, Kuwait had parliamentary elections which were boycotted by the opposition. However, the formation of a new government is expected to show stability and have a significant positive effect on laws governing the real estate sector and ultimately on the sector's performance in the coming years.

Segmental Analysis of the Kuwaiti Real Estate Sector

Exhibit 2: Performance of Key Segments of the Kuwaiti Real Estate Sector



Source: Kuwait Finance House & CSR

Investment Segment

The investment segment was the major contributor to the total transactions of the real estate sector in 1Q2012. The segment is showing significant improvement in trading values compared to its performance in 2011. The segment has recorded a sales value of KWD 382.98 bn in 2Q2012. During the first half of 2012 the segment was booming and the transactions increased to contribute around 40.87% to the total transactions in the sector. This increase may be mainly attributed to the weak performance of KSE, which diverted the investor attention to other investment horizons. Consequently it had aided in the revitalization of the segment's performance during the first half as many of the investors, in pursuit of stable income generation with security of capital, were attracted to the investment segment. However, the slight decrease in the transactions in the 2Q2012 may be attributed to the month of Ramadan (July) which leaded to early summer break for most of Kuwait's population.

From the year 1999 to 2012, the price paid per square meter rose on average by 10.00% and 7.00% annually, for buildings and plots of land respectively. However, prices in the Kuwait City area have been to some extent more volatile. After the financial crisis of 2008, the investors mainly shifted to less costly and less risky investments, such as vacant plots or individual apartments. The increased activity in the investment segment of the real estate sector compared to 2011 could also be attributed to the general belief that real estate investments may be less risky.

Growth in performance of Residential Segment

The residential segment is the largest part of the Kuwaiti real estate sector, as it consists of properties under the government housing project known as Public Authority for Housing Welfare (PAHW). The residential segment recorded KWD 486.82 bn valued transaction in the 2Q2012, a marked 37.68% improvement from the low transaction values in the 4Q2011. The residential segment is facing a growing demand from the local market of Kuwait. The increased demand is subject to a few reasons prevailing in the local Kuwaiti market at present such as:

i. The loan grant approved for widows between 21 to 40 years of age, who do not possess a property more than 200 sq. meters. Also, low cost housing will be available for the widows as described by the law.
ii. Population growing at 2.17% (5-Yr average).
iii. Decline in interest rate by Central Bank of Kuwait by 50 bps in October, 2012.

However, the recent tax law may have a negative impact on the demand of houses and villas according to the local news agencies. Furthermore, the increased demand for the residential segment is over ruled by the investors moving towards the investment real estate segment, mainly owing to the smaller investors entering the market. The shift in investor's interest has led to a decline in the residential real estate segment's contribution to the total transactions of the Kuwaiti real estate sector to 43.70% compared to 51.95% by the end of 2011, yet it is the highest contributor.

Over supplied Commercial Segment

The Kuwaiti commercial segment is suffering from the aftermaths of the financial crisis of 2008. The corporate sector had been cutting costs significantly during the financial crisis, leading to an oversupply in the commercial segment. This resulted in an increase in vacancy rates reaching up to 70.00% in March 2012, according to the local news agencies. The total transactions of the commercial segment had declined by 23.60% in 1Q2012 compared to 4Q2011 amounting to KWD 47.12 bn. The trend took a slight rise in 2Q2012, where the transaction values for the commercial segment increased to reach KWD 67.24 bn. The segment is facing a sluggish demand which may also be attributed to the current political turmoil in Kuwait, which impedes the upcoming business opportunities in Kuwait. The high rise towers of Kuwait built with more than 50 floors have contributed to the increased supply of the commercial segment. The current situation for new business opportunities is very skeptical due to the issues between the government and the parliament; however the recent elections of 2012 may bring more stability in the country with a regulatory environment which could attract more businesses, improving Kuwait's private sector. This may support the commercial segment to create a balance between its demand and supply.

Factors Influencing Kuwaiti Real Estate Sector

a) Kuwait Economy

Kuwait's economy is largely dependent on its abundant oil reserves, which enabled the country to attain a budget surplus of KWD 13.20 mn in the year 2011-12. The oil sector is 49.23% of Kuwait's GDP as of 2010 (according to CBK). The IMF (International Monetary Fund) anticipates a decline in the GDP growth from 8.2% in 2011 to 6.6% in 2012 and a further decline of 1.8% is expected in 2013. In Kuwait, the majority of large real estate projects still depend on the approval from the government. The increasing income from oil revenues may aid the Kuwaiti real estate sector to see growth in the short term, mainly attributed to the Kuwait Development Plan (KDP), which includes Silk City, a major container harbor, railway and metro system. Nonetheless, the IMF has highlighted risks of KDP implementation delays. Further, Kuwait's government may get a significant portion of the investment for major construction projects raised through Public-Private Partnership (PPP) initiatives. Such measures may have a positive impact on the growth of the Kuwaiti real estate sector as it is cyclical in nature.

b) Interest rate changes

CBK is continuously seeking an expansionary monetary policy, which may help in boosting the non-oil sector's economic growth. The interest rate has reached 2.00% in October 2012 due to a decrease of 50 bps, by CBK. This will have an impact on the liquidity of the Kuwaiti market. More loans and credit facilities at lower rates will be available to the general public, corporate and other institutions. Increased liquidity and lower cost of loans may boost trading in different sectors and also in the real estate sector. The residential sector is expected to reap benefits from the low interest rates. It is considered to be a positive initiative by the CBK to increase lending in Kuwait, which may increase business activity and perhaps have an effect on demand of the commercial real estate segment as well. However, the political uncertainty in Kuwait could be threatening the growth in the coming months.

c) Available Credit facilities

The available credit facility agreements for Kuwaiti residents, particularly for the real estate sector, amounted to KWD 106.20 mn as of August 2012 (according to CBK). This indicates that the local banks have facilities available to grant the real estate sector. It is also important to mention that Kuwaiti banks are ready to lend provided there are appropriate projects and plans. Currently 10% of banks total loan portfolio is towards real estate sector as per the IMF.

In 2011, Kuwait saw a sluggish 1.60% credit growth with an increase of KWD 407.00 mn in loans. However, 2012 is seeing improvement in the credit growth reaching 3.00% in 1H2012, with an increase of KWD 750.00 mn of lending. While the increase in 2012 is not very high, however amid the challenging environment for companies along with banks in the past, this growth has been a positive improvement. Loans provided to the real estate and the construction sector exclusively grew by KWD 79.00 mn to reach KWD 8.60 bn in 1H2012. Most of the loans were given to new construction projects, which is common in Kuwait. The increase in residential sectors demand is evident from the slight increase in loans being extended by the SCB, which showed a 1.8% YoY increase in the same period.

d) Population growth

Population is a very important factor that has a positive correlation with the real estate sector's growth, mainly in the residential segment. Kuwait's population has been increasing at an average rate of 2.17% for the past 5 years. The increasing population with the mix of locals and expatriates from different regions of the world tend to influence both the residential and the investment segments of the Kuwaiti real estate sector. The sector observes an increasing demand of the rental apartments, which could be due to the increasing expatriate population in Kuwait. Local Kuwaitis also tend to increase their investments in the residential buildings and houses with the intent to generate stable recurring income for the future. Thereby, population growth is an essential factor influencing the overall growth in the real estate sector.

Financial Snapshot of Real Estate Players in Kuwait

There are 49 real estate companies listed on the KSE (according to Zawya), that have a business model of real estate management, consultancy and BOT. In order to highlight the current scenario of the real estate industry in Kuwait, the following industry statistics show the financials of the industry players.

Exhibit 3: Industry Statistics

(Figures in KWD mn)	1H2012	FY2011	FY2010	FY2009	FY2008
Total Assets	5,874.37	5,897.02	6,083.30	6,501.16	6,650.87
Short Term Debt	136.29	199.40	257.85	297.97	304.93
Total debt	2,216.12	2,190.26	2,212.77	2,270.42	2,214.46
Gross Revenues	163.31	438.55	291.26	333.66	594.37
Net Operating Income	38.89	135.11	41.70	87.98	168.96
Payout Ratio (%)	330.28%	54.12%	70.33%	100.40%	250.41%
Return on Average Assets (%)	(3.15)%	(3.51)%	(2.65)%	(2.31)%	1.45%
Net Debt/Equity (%)	94.11%	94.45%	76.51%	77.48%	60.14%
Interest Coverage Ratio (x)	0.42x	1.12x	20.17x	-313.35x	7.29x

Source: Zawya & CSR Research

Based on the available information as of 1H2012, total assets have been on a declining trend in the sector since 2008. A declining trend is observed in the industry's gross revenues as well, which may be attributed to the cyclical nature of the industry. Moreover, due to the same reason, the industry's debt has also shown an increasing trend, however most of the debt is long term. The industry statistics also indicate that the industry has been affected by the aforementioned influencing factors. Nevertheless, the decrease in the interest rate of Kuwait has yet to show an effect by the end of 2012. It is important to note that the industry is already highly leveraged, having a net debt to equity of 94.11% as of 1H2012. At the same time, the industry is unable to cover its interest expense in 1H2012 as indicated by the interest coverage ratio of 0.42x which indicates limited room for further debt.

CSR believes that given the high leverage of the industry and constrained liquidity, real estate companies may face difficulties in acquiring further debt or contract agreements. Thereby, the credit quality of the industry is of immense importance to the market participants. There are four companies in the Kuwaiti real estate sector that have been rated for their credit worthiness (credit ratings). All the rated companies are of an investment grade rating, indicating their adequate credit worthiness as compared to international and national peers.

Exhibit 4: Summary of Credit Ratings of the Kuwaiti Real Estate Sector

Company (Rating Year)	Country	Rating	National Rating[1]	Outlook	Type of Rating	Rating Agency
Salhiya Real Estate Company (2010)	Kuwait	BBB-	A-$_{KW}$	Stable	LT corporate rating	Capital Standards
Commercial Real Estate Company (2012)	Kuwait	BBB+	A+$_{KW}$	Stable	LT corporate rating	Capital Standards
Al ARGAN Real Estate Company (2012)	Kuwait	BBB-	-	Stable	Bond Issuance	Capital Intelligence
United Real Estate Company (2010)	Kuwait	BBB-	-	Stable	USD 100 mn Mashraka Sukuk	Capital Intelligence

Source: Zawya & CSR research

[1] The national scale rating with respect to the country of operation is provided by Capital Standards.

Top 5 players of Kuwaiti Real Estate Sector

The top five real estate companies with respect to revenue are Salhia Real Estate Company (Salhiya), Mabanee Company (Mabanee), Al Mazaya Holding Company (Mazaya), United Real Estate Company (UREC) and Al Argan International Real Estate Company (Al Argan). In 1H2012, Mazaya posted a net loss, while all the other top 5 players of the real estate sector posted net profits. The inconsistency in the profitability of one of the top revenue grossing company, Mazaya, may be due to their business model or otherwise the management strategies.

Exhibit 5: Top 5 players of the industry with respect to gross revenues as of 1H2012

(Figures in KWD mn)	Total Assets	Total Debt	Gross Revenues	Net Operating Income	Payout Ratio (%)	Return on Average Assets (%)	Net Debt/Equity (%)	Interest Coverage Ratio (x)
Salhia Real Estate Company	280.42	138.32	22.23	7.37	93.96%	2.80%	106.98%	1.96x
Mabanee Company	364.54	125.05	19.7	13.49	238.15%	7.22%	65.18%	14.71x
Al Mazaya Holding Company	239.5	52.49	17.23	4.93	-	-4.34%	48.16%	9.56x
United Real Estate Company (UREC)	524.16	194.91	16.27	2.41	26.90%	4.14%	109.19%	0.92x
Al Argan International Real Estate Company	125.6	48.69	9.12	1.18	94.34%	2.29%	60.17%	0.74x

Source: Zawya & CSR Research

Salhia may be leading the sector by the end of 2012, mainly due to their proportion of stable income (55%), which increases their gross revenue, is attributed to the rental income. Further, they have a defensive segment in their portfolio that is the care home, which is considered unique. Nonetheless, Salhiya is considered highly leveraged; yet, the associated risks may be mitigated by its adequate interest coverage ratio which is 1.96x, as of 1H2012.

Mabanee is mainly concentrated in revenues from the Avenues Mall, which is one of the largest malls in Kuwait. The Avenues Mall is an attraction for the whole population of Kuwait with a diverse target market. This adds to the increasing share of Mabanee's revenue in the Kuwaiti real estate sector. However, the high concentration on one property could be risky. With the opening of Grand Avenues in 3Q2012, it is expected that Mabanee's revenues may further show an upward trend in the short term.

Mazaya is mostly into trading activities along with a 'build and sell' strategy that has been adopted by the management of the company. This strategy may increase its cash flow volatility, as selling is considered to be somewhat stagnant in the current market situation. However, Mazaya has the least net debt/equity among the top 5 companies of the sector, of 48.16% as of 1H2012, indicating a low leverage as compared to peers.

UREC is the real estate arm of KIPCO (Kuwait Projects Company (Holding)). Though they have improved their liquidity last year with a bond placement, yet their debt is considered higher than the industry's average. UREC's net debt/equity stands at 109.19% as of 1H2012, highest among the top 5 players of the industry. However their return on average assets is the second highest among the top 5 companies, indicating their sound profitability.

Al Argan is also considered one of the top 5 real estate companies as of 1H2012. Al Argan has issued a bond in January 2012, which may contribute to improve their liquidity profile. Based on the 1H2012 financials, the net debt/equity is 60.17%, less than the industry average. Moreover, it is important to note that the interest coverage ratio and return on average assets are also the lowest among the top 5 companies in the sector. The ability to pay back the interest and debt may witness risks in the short term, due to the lower profitability levels of the company.

The 5 leading players of the Kuwaiti real estate market are also considered to have a high debt, which may be considered as a norm of the industry. Nonetheless, the interest coverage ratio indicates that UREC and Al Argan have less room to acquire further debt. It is important to note that the Commercial Real Estate company was the highest revenue generating company in the previous Real Estate Sector report (March, 2012-CSR), however now the company has moved down to the 8th position in the sector.

Future Prospects & Conclusion

CSR believes that the future prospects of the Kuwaiti real estate sector are quite positive, provided that the political situation stabilizes in the short term. There is a major portion of Kuwait's land that is unused, which accounts for more than 90% of the total land space of Kuwait approximately. If this land is used for further tourists or development projects, the real estate sector could boost, adding to the overall economic growth of Kuwait.

The Real Estate Union has stated in a local news paper (7th September, 2012) that the real estate sector has performed well in 1H2012. Also, the real estate sector has capitalized on the lower interest rates of bank deposits which will in turn revitalize the performance of the sector. Furthermore, the KIA portfolio is expected to cause improvements in the performance of the commercial real estate segment of the sector.

The announcement by KIA to set up the Real Estate Investment Authority, and the KWD 1.00 bn fund that will be managed by Kuwait Finance House (KFH), together tend to increase growth and bring positive sentiments in the sector. Furthermore, KIA has also signed a contract with Markaz (Kuwait Financial Centre) to manage part of its National Real Estate portfolio. The value of the portfolio to be managed is estimated to be KWD 250.00 mn, which is 28.60% of Markaz's AUM (Assets under Management). This contract will last for 40 years. The management of the national portfolio by Markaz may positively impact the commercial and investment segments of the Kuwaiti real estate sector.

Further, housing loans in Kuwait are expected to be increased from KWD 0.07 mn to KWD 0.10 mn by February 2012 by SCB as per local news agency. The increase is anticipated to encourage construction of housing units in newly established areas. The increasing credit facility in February 2013 may also give a boost to the residential segment of the sector.

Going forward, there is an expectation of 10% to 12% growth in the residential and investment segments respectively. The positive outlook and growth in the future projects may attract investors from all over the world to Kuwait's real estate sector, provided government eases on the restrictions for foreigners to own land in Kuwait. Nevertheless, currently Kuwait's political situation is critical and challenging. CSR looks forward to the new elected parliament of 2012 to prioritize the economic development and push to enhance the economy of the country.

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