CB RICHARD ELLIS
MarketView

Kingdom of Bahrain

www.cbre.bh/bh_en/research

Q2 2010

Quick Stats

	Change from	
Lease Rates	**Q2 09**	**Q1 10**
Residential	↓	↘
Sale Prices	**Q2 09**	**Q1 10**
Residential	↓	↘

Hot Topics

- The EDB forecast real GDP growth of 4% in 2010, rising to 7.2% p.a. by 2015 although independent forecasts remain less bullish.
- Work on the creation of a national public transport network continues although delays continue on the Bahrain-Qatar Friendship Bridge.
- Local Class A office rental rates continue to come under pressure from new supply while typical tenant requirements have moved to smaller spaces than the peak of 2008.
- Residential rental rates continue to decline albeit at slower rates than in 2009 and the number of sales transactions remain at historic lows.

OVERVIEW

In its first annual Economic Review, the Economic Development Board (EDB) announced expectations of 4% growth in Bahrain's real GDP during 2010.

The EDB also pointed to real GDP growth of over 70% during the past decade, an increase in exports of 116% and increased Bahraini employment of 39% with an average increase in wages of over 50% during the same period.

There are genuine hopes that a corner has been turned and that the Bahrain economy has strong potential, although Business Monitor International suggest that economic growth will be around 1.5% in 2010.

The Bahrain economy has been under the microscope due to its reliance on the troubled banking sector but so far the Kingdom has managed to chart a course through these difficult waters.

Despite this, there remains some suspicion that the problems of the banking sector have not yet been fully resolved and that there may be issues ahead that will continue to stunt investor interest in the Kingdom in the short term.

Add to this the difficult conditions across almost all sectors of the real estate market and it would be prudent to apply caution to macroeconomic forecasts. However, it should be pointed out that risk is now priced into the market in all sectors and the market could easily outperform expectations.

Traffic congestion is an increasingly pressing issue, particularly in commercial office districts and access is now directly impacting rental and occupancy rates for all sectors.

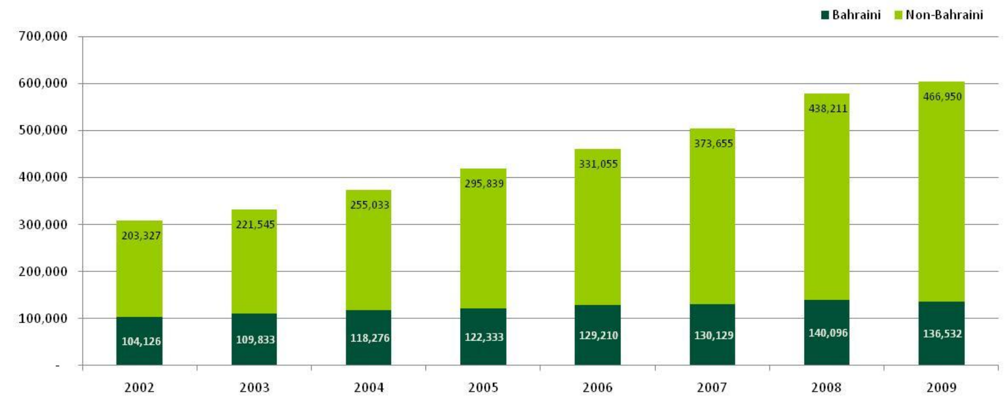
In an effort to address this issue, the Government is pursuing the implementation of a public transport network comprising Light Rapid Transport, a monorail, trams and Bus Rapid Transport.

Whether the estimated US$8 billion investment in this network will solve the current problem is open to question, especially when it could more simply be addressed in the short term by an urban planning approach focused on sustainable, mixed-use development.

In June 2010, press reports indicated that the long-planned Bahrain – Qatar "Friendship Bridge" project had been put on hold amid escalating costs and political tensions. This was strongly denied in the press the following day by a representative of the Bahrain-Qatar Causeway Foundation who stated that the project is in "full swing" albeit delayed.

The project remains a high priority and is likely to have a significant economic impact for Saudi Arabia, Bahrain and Qatar, directly linking the capital cities of all three by both road and rail.

Total Employment by Citizenship, Bahrain 2002 - 2009



Source: LMRA

Quick Stats

Change from

Lease Rates	Q2 09	Q1 10
Office	↓	↘
Sale Prices	**Q2 09**	**Q1 10**
Office	N/A	N/A

Hot Topics

- Local Class A office rental rates continue to come under pressure from new supply while typical tenant requirements have moved to smaller spaces than the peak of 2008.
- International standard Class A space has been more difficult to let than local Class A space due to ongoing price-sensitivity of the Bahrain market.
- The CBD (Diplomatic Area) remains unpopular with potential tenants due to problematic traffic access and parking issues.

OFFICE SECTOR

The local Class A commercial office sector in Bahrain continues to be subject to a demand/supply imbalance that is more noticeable at the top end of the price spectrum than on lower rungs. The small selection of international standard Class A buildings in Bahrain have significantly lower occupancy rates than in the remainder of the "Class A" market but a mix of factors continue to cloud the issue.

The three main issues for potential tenants in Bahrain continue to be (in no particular order) traffic access, parking and pricing. The market remains price-sensitive but where traffic access and parking are fully addressed, rental rates have remained reasonably firm and in particularly favoured areas (Seef District in particular), completely unsuitable apartments are being let as office space at rental rates exceeding those of purpose-built Class A office space in areas with significant access and parking issues.

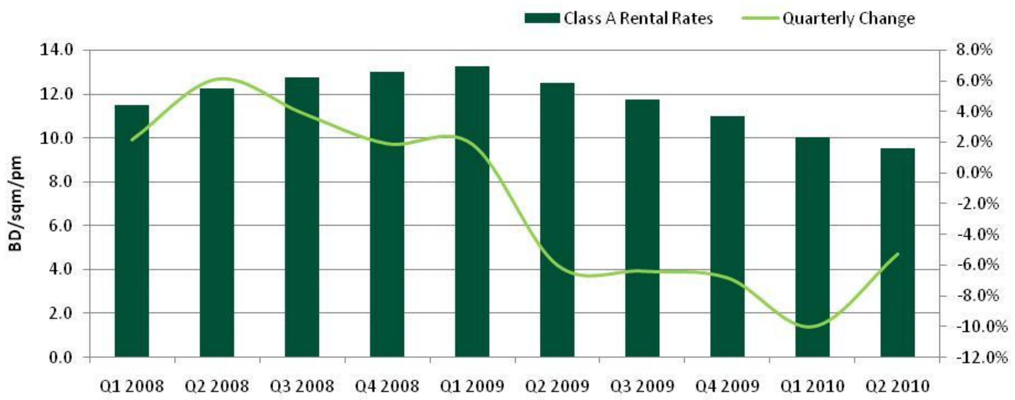
The Kingdom's international standard Class A space is located in areas where traffic access and parking remain an issue and as a consequence both rental rates achieved and occupancy levels remain disappointingly low for buildings built to such a standard.

Tenant's typical spatial needs have also shifted significantly since the peak in 2008, with a return to the 100 to 150 square metre requirements, that have been the historic "norm" in Bahrain. In 2008, Class A office spaces were increasingly being sought in sizes of between 300 and 400 square metres but this is no longer the case as major corporates and banks wait to ride out macroeconomic uncertainties before making major commitments.

The mismatch in supply and demand is only evident if the total supply of local and international Class A office space is aggregated. When considering the local Class A space in Seef District for example, the office space market would appear to be reasonably close to an equilibrium position (hence the use of unsuitable and inefficient apartments for small offices) although new supply in the development pipeline will eventually cause any existing imbalance to worsen.

Development of Class A office space has slowed in the past 18 months and many projects have been placed on hold. It is hoped that this approach will moderate the impacts of reduced demand for office space over the next year or two although it is likely that there will be some significant completions that will be difficult to let in the short term.

Average Class A Office Rents, Bahrain - 2008 to 2010



Source: CB Richard Ellis

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Quick Stats

Change from

Lease Rates	Q2 09	Q1 10
Residential	↓	↘
Sale Prices	**Q2 09**	**Q1 10**
Residential	↓	↘

Hot Topics

- Very few residential sales transactions taking place with price falls sharper in apartments than villas and townhouses.
- Residential rental rates also experiencing downward pressure but again, this has been more marked in the apartment sector than private villas or compounds.
- Complete structural disconnect between the levels of debt that can be serviced by mid to low-income Bahrainis and the ability of developers to construct villas and townhouses at "affordable" prices.

RESIDENTIAL SECTOR

There continues to be a mismatch in the supply and demand of residential units in Bahrain. However, it is a complex issue with a variety of mismatches separated by category into imbalances with the *types* of housing, the *location* of housing and the *price* of housing.

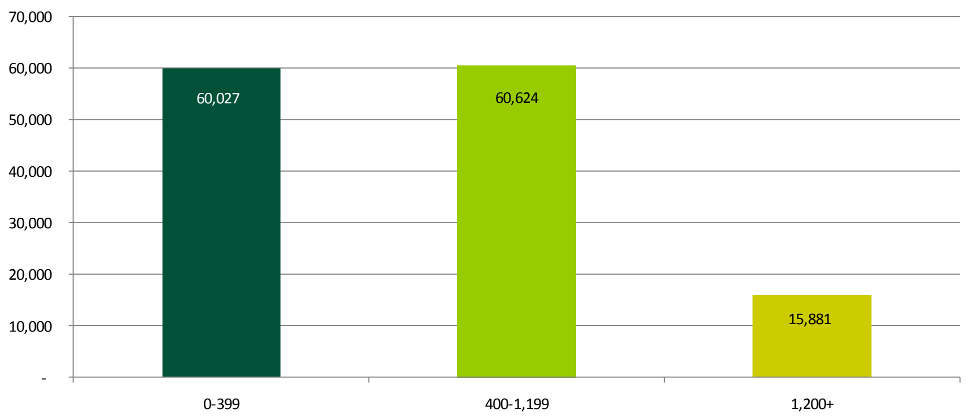
The waiting list for social housing has now reached approximately 53,000 households and is growing by around three or four thousand units per annum. This rate of growth in the waiting list exceeds the rate at which the Government can address the problem and the situation looks set to worsen in the short term. Social Housing is offered to those households earning less than BD400 per month and if the reports are correct, it is extremely disconcerting to discover that 53,000 households fall into this category when the total number of Bahrainis in employment is only around 138,000.

The next category of housing is defined as "affordable" and this category is also fraught with problems for Bahraini households. Recent commentary in the press has put the blame for this firmly at the door of private sector developers, intimating that they are unwilling to address this market sector. This simply isn't true, the problem lies with two key issues. Firstly, the typical Bahraini household prefers to live in, and own a villa or townhouse, on a plot of land owned by them (true Freehold). In an economy where house trading is at an embryonic point in its development cycle, Bahrainis see their first home as also being their long term permanent home.

The second issue lies with the land. Due to the rampant land trading that has taken place in Bahrain in the last few years, prices of land earmarked for low density residential development have risen sharply and in most areas can be found in a range broadly around the BD20/ft² level. Based on a small plot of 225 square metres, the cost of the land alone would be around BD50,000. The subsidised mortgage for mid to low-income Bahrainis offered by the Government only amounts to BD40,000 – not even enough to buy the small plot of land on which a Bahraini household would want to build their house.

When the costs of construction are added in, it is simply not possible for developers to meet the demand for "affordable" housing. There is a structural problem in Bahrain in that the relatively low average salaries of Bahrainis, allied with the availability and cost of finance simply do not allow them to buy the houses that the developers build for them.

Distribution of Income, Bahraini Employees – 2010 (BD/per month)



Source: CIO, GOSI, LMRA and CB Richard Ellis analysis

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RESIDENTIAL SECTOR (continued)

In the meantime, the excessive land trading and spiralling land prices have led developers to pursue their only economic alternative – "luxury apartments" for which the market has now subsided both from investor/speculators and owner-occupiers. The number of transactions taking place in this sector remains at historic lows although the few transactions that have taken place have generally achieved either the original purchase price or small profits for the sellers.

The lack of sales has had a significant impact on developers with cash flow problems forcing many project slowdowns or postponements. Many residential project masterplans are currently being reconsidered in terms of development uses, unit sizes, target markets and much more attention is being paid to the issue of phasing. Many projects in the Kingdom and wider GCC were launched as massive single-phase developments in order to benefit from development cost savings, but as cash flow dried up in late 2008/2009, the bullishness of this approach has resulted in some major project problems.

The problem remains that while developers sit on thousands of part-built residential units, there are thousands of households that require housing. There is a fundamental disconnect between the incomes of the general population, the availability of finance and the sheer cost of providing land and preparing houses to meet their needs. The situation may require a socio-cultural shift as buying and selling houses becomes more widespread, enabling Bahraini households in particular, to see past an apartment as not necessarily their housing solution for life, but merely a short term measure.

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