EFG - Hermes

Hot Market Begins to Cool

24 September 2007

United Arab Emirates (Dubai) | Real Estate

CONTENTS

• **Maturing Property Market:** Over the past nine months, the residential property market in Dubai has continued to mature, with the four strongest signs of change being: i) a lower rate of price appreciation, ii) improvements in the legal framework, iii) an increasing level of activity in the secondary property market, and iv) a reduction in the number of new project launches.

• **Slow Pace of Project Handovers Affects Supply Forecasts:** Due to the slower pace of completed project handovers being witnessed this year, with approximately only 11,000 units of the expected 57,000 units coming on stream year-to-date, supply continues to lag far behind demand. This supply lag has prompted us to revise our housing unit supply forecasts for the next three to four years, with estimates of 25,000 housing units for the whole of 2007, 64,000 in 2008, and 68,000 in 2009.

• **Strong Demand for Dubai Property:** Demand for housing continues to rise as the population grows, mostly due to immigration. We maintain our assumption that the population of Dubai will rise to almost 1.9 million by 2010, up from 1.4 million today, implying a CAGR of 7.9%. We have revised our demand forecasts, which now call for demand of 45,000 to 50,000 units per annum.

• **Prices Begin to Fall in 2009:** Assuming that supply in 2007 is constrained, with the peak year of supply will be in 2009, the downturn will occur later than we had originally assumed. Our current forecast is for a rise in average prices of 10-15% in 2007 and a rise of 5-10% in 2008. We expect prices to peak in 2H2008 as more supply hits the market. We expect prices to start declining in 2009, which is now assumed to be the peak supply year, with a cumulative decline of 15-20% by 2011.

• **Price Correction will Encourage Stronger Demand:** Whilst we believe that there will be excess supply in 2008, we see this being absorbed by the pent-up demand of earlier years (2005-2007). We believe that the extent of the price correction that we are forecasting in 2009 will depend primarily on: i) The pace at which new units are delivered, and ii) the price elasticity of demand. We believe that demand is price elastic, and that once prices begin to come down from their highs, this will increase demand.

• **Rental Rates Look Set to Decline:** The rate of increase of rents has begun to slow. We expect the decline in the pace of rental rate growth observed in the first eight months of this year to be sustained into early 2008, with rents starting to decline in 2008 as new housing comes onto the market.

Sana Kapadia
+971 4 363 4007
skapadia@efg-hermes.com

Stefan Schürmann
+971 4 363 4013
sschurmann@efg-hermes.com

Philip Khoury
+971 4 363 4002
pkhoury@efg-hermes.com

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EXECUTIVE SUMMARY

Over the past nine months, the residential property market cycle has continued to mature, with the four strongest signs of change being: i) slower price appreciation, ii) improvements in the legal framework, iii) an increasing level of activity in the secondary market, and iv) a reduction in the number of new project launches.

Price Stability and Legal Improvements Underscore Increased Maturity of Residential Property Market

An in-house index that we have created to track properties in key areas across Dubai indicates that, overall, prices have increased by 13.9% in the eight months to August 2007. The relative muted level of price appreciation (by Dubai standards) is one of the strongest factors supporting our view that the cycle is maturing. The legal improvements that have occurred this year, including: i) the passing of a broker's law, ii) the passing of an escrow law, and iii) the creation of the Real Estate Regulation Authority (RERA) which is a public sector agency established to unify and regulate all property market-related activities established to unify and regulate all property related activities are helping to increase confidence in and the transparency of the Dubai property market. The initiatives being undertaken by the government are allowing Dubai to move towards incorporating international best practices and legal standards, helping to put both domestic and foreign buyers more at ease.

Slower Than Anticipated Delivery of Supply - We Revise our Supply Estimates

Another change this year is the slower pace of completed project handovers, a development that is delaying the surge in residential units supplied. Of our initial expectations of supply of 57,000 units (assuming project delays) to be handed over in 2007, we estimate that approximately 11,000 units have been handed over so far. By year end we expect no more than 25,000 units to have been delivered over the full year. These delays stem from: i) a lack of qualified contractors and labor, ii) increasing costs of construction and iii) an insufficient supply of construction machinery and equipment.

This slower pace of deliveries has prompted us to revise our expectations of the number of units that will come on stream over the next three to four years. We now believe that supply will be staggered, such that in any given year, 50-60% on average, of announced units will actually be handed over. In addition, we anticipate that the delivery of supply delayed in one year will cascaded onto the two subsequent years. Thus, for 2008, we estimate 64,000 units will come on stream. This figure comprises of two-thirds of the supply we had originally estimated to be delivered in 2008, with the remainder representing the estimated spillover from 2007. We now expect the peak year of supply to be 2009, with 68,000 units being delivered. Like our new 2008 supply estimates, this is made up of the bulk of supply announced for 2009 being delivered as expected, in addition to the spillover from 2007 and 2008.

Strong Demand Continues - International Interest is Increasing

Demand for housing continues to rise as the population grows, mostly due to immigration. Robust economic fundamentals, high and rising oil prices and increasing wealth has washed the region with liquidity. Given the market's increasing sophistication and maturity, we have refined our assumptions, as we did with our supply estimates, and revised our forecasts for the demand for Dubai housing units. We maintain our assumption that the population of Dubai will rise to almost 1.9 million by 2010 from 1.4 million now, implying a CAGR of 7.9%. Using this as a base, we then segmented the market into local, expatriate and foreign demand and made assumptions about each group's propensity to buy homes in Dubai over the coming few years.

We arrive at an average demand of 45,250 units per annum. Local and expatriate demand, reinforced by a constant flow expatriates into the city and by existing residents seeking to buy their own residences, makes up the majority of our forecast demand. We also assume demand to be price elastic, such that demand will increase once prices fall from current levels due to increased supply.

Freehold Residential Outlook

We now expect the year of price correction to be 2009 rather than 2008. Whilst we believe that there will be excess supply in 2008, we see this being absorbed by the pent-up demand of earlier years (2005-2007). We forecast a rise in average prices of 10-15% in 2007 and a rise of 5-10% in 2008, with the peak being reached in 2H2008. Finally, we expect prices to start declining in 2009, with a cumulative decline of 15-20% by 2011.

However, it is crucial to note that our assumptions and estimates entail a strong degree of subjectivity and potentially produce a wide range of potential price decline outcomes. The most important factor to bear in mind is that the extent of the correction will vary depending on whether the project lies in the low, mid or high segment.

Residential Rental Market - Looks Set for Near-Term Correction

On average, Dubai residential rents across Dubai increased by 16% in the first eight months of 2007 versus 30% for the whole of 2006. We believe this trend of slowing rental rate increases stems from i) delays in expected supply coming on stream, ii) relief from the 7% rent cap for 2007 which has capped expectations, and iii) end-user demand for mid-income housing being higher than that for luxury housing, which has dominated delivered supply to date. Our expectation is that the rent cap for 2008 will most likely be reduced to 5%. Therefore, we expect the decline in the pace of rental rate growth observed in the first eight months of this year to continue into early 2008, with rents starting to decline in 2008 as new housing comes onto the market.

Commercial Property Segment - Rents and Prices Continue to Rise due to Capacity Limitations

As Dubai continues to attract businesses from across the globe, we have seen continued pressure in terms of both rents and selling prices of commercial property over the past 8 months. Vacancy rates of around 1%, in addition to pent-up demand from existing businesses and new tenants wishing to upgrade office premises has allowed rents to rise 40% YTD on average. Prices for freehold office space have risen 17% YTD. This trend of a sustained increase both in terms of rents and selling prices stems from a prolonged lag in the completion of new commercial supply. Most of the commercial space additions are expected to hit the market in 2008 and 2009 and we expect to see a marked decline in rents. As a result, we expect to see Dubai commercial property yields sliding back gradually toward the international average.

Head of Research
Philip Khoury
+971 4 363 4002
+20 2 33 32 1150
pkhoury@efg-hermes.com

Head of UAE Brokerage
Seif Fikry
+971 4 363 4085
seif@efg-hermes.com

UAE Institutional Sales
Amro Diab
+971 4 363 4086
adiab@efg-hermes.com

UAE Retail Sales
Reham Tawfik
+971 4 363 4418
rtawfik@efg-hermes.com

US/UK Sales
Mohamed Ebeid
+20 2 33 32 1054
mebeid@efg-hermes.com

Gulf Sales
Ahmed Salem
+20 2 33 32 1078
asalem@efg-hermes.com

Introduction

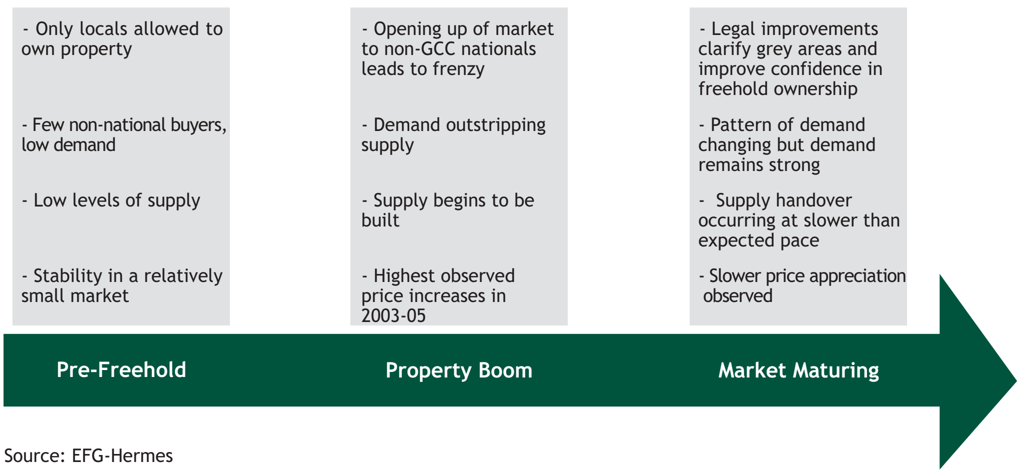
In our previous update on Dubai real estate (Dubai or Not to Buy, dated 18 December 2006), we wrote that the property market was beginning to become mature, with buyers becoming more selective, property prices appreciating less rapidly and sales increasing in the secondary market. Given the demand and supply forces at the time, our view was that property prices would begin falling in 2008, when significant supply was expected to hit the market for the second year in a row, with a majority of pent-up demand already having being absorbed in 2007. We were also careful to point out that the extent of this correction would depend largely on the speed with which supply would come on stream. Moreover, we suggested that the increase in new housing units would directly affect the rental market, with rents increasing at a moderate pace in 2007 then falling in 2008 as new supply was delivered.

Since the report was published approximately nine months ago, the residential property market has seen the following changes: i) prices have risen, but more slowly than before, ii) the legal framework has improved, iii) the secondary property market continues to be more active, and iv) the number of new project launches has fallen. At the same time, a correction in the stock market has made real estate investments more appealing to some buyers, while strong economic fundamentals and abundant liquidity continue to buoy the sector.

I. FREEHOLD MARKET UPDATE

The residential property market has calmed down, with the frenzy of the boom being replaced with a wider and rapidly growing base of buyers, less dramatic changes in price, a reduction in speculative behavior - by both developers and buyers - and, finally, advancements in the legal and regulatory environment that have increased the level of confidence and transparency in the market.

Figure 1.1: Changing Features of the Residential Property Market



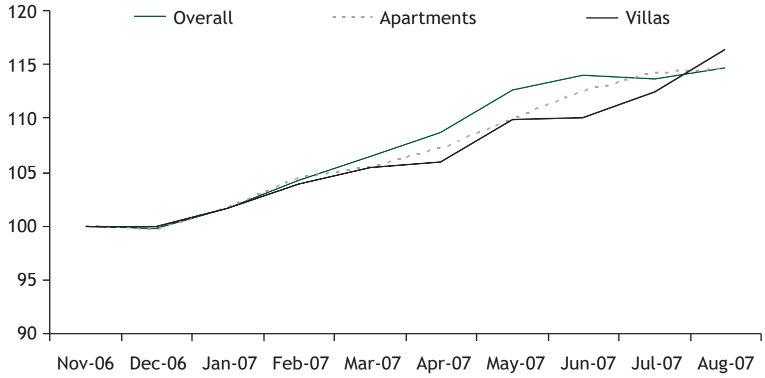
Source: EFG-Hermes

A. Price Stability

Selling prices continue to stabilize...

Among the strongest evidence that the Dubai property market has matured is the slowdown in the rise of selling prices. We have created our own index to track property prices (refer to Appendix 1 for index methodology). The overall index increased by 13.9% in the eight months to August 2007. The index for villas rose by 16.4%, while that for apartments by 12.8%. During 2007, apartments made up a majority of the supply handed over, with these being concentrated in luxury developments such as Burj Dubai, Palm Jumeirah and Dubai Marina. It is interesting to note that the handover of units in these developments has created strong momentum in asking prices over the past few months.

Figure 1.2: EFG-Hermes Dubai Price Index



Sources: Data from Better Homes Property Listings and EFG-Hermes estimates

... but location and desirability lead to price appreciation in 'sweet spots'

The increasing correlation between the price of a particular project and its location, the track record of its developer, attention to design detail, quality of the finished unit, etc, suggests that buyers have become more discerning. Today, there are examples of keenly priced properties that have seen prices remain constant or sometimes even fall due to a lack of one of the above characteristics as buyers have become more selective.

Narrowing premiums to launch price on apartments reflect increasing maturity

Within the luxury segment, prices are still at a premium to their price at launch, which in most cases was two to three years ago. On average, as at the end of August, high-end properties were being sold at a 30% premium to their launch prices. This premium for luxury developments has fallen from 60% (end 2006 prices vs. launch prices). The narrowing of realized premiums reflects the fact that developers are leaving less money on the table for launch buyers. The same conclusion is true for middle-income projects which have seen premiums shrink (end of August 2007 versus launch prices vis-à-vis year end 2006 prices vs. launch prices) from 30% to 20%.

...while villa prices continue to remain in the high range

With demand for villas remaining high, average prices have risen by around 16.4% YTD according to our estimates. Limited supply expectations for the number of villas coming on stream over the next few years, remains one of the major reasons for price appreciation. Another is that the handover of units and a buyer's ability to see the tangible end product has drawn attention to certain projects and thus led to a rise in values. This has happened for example with Palm Jumeirah. Also, larger family homes continue to benefit from strong capital appreciation as indicated in Figure 1.4.

Fig. 1.3: Current Average Prices for Villas and YTD Appreciation

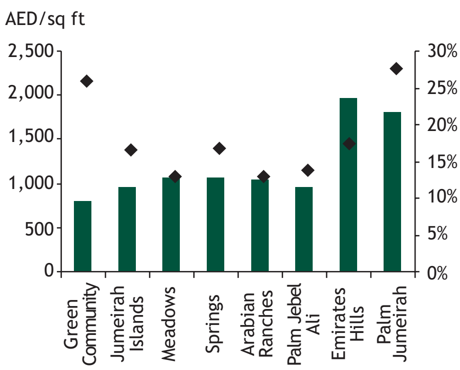
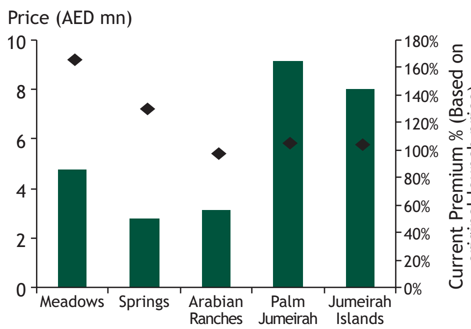


Fig. 1.4: Secondary Market Prices for 4+ B/R Villas in New Dubai



Sources: Better Homes and EFG-Hermes

B. Legal Improvements

Over the past eight months, the introduction of new laws and increased legal clarity have provided support to the Dubai property market. These new elements include: i) the passing of the broker's law, ii) the establishment of the escrow law, iii) and the creation of the Real Estate Regulation Authority (RERA).

	Broker's Law	Escrow Law	RERA
Salient Features	- All brokers must be registered with Land Dept - Training and certification to be enforced	- Developers to deposit off-plan sales funds into a guaranteed account - Funds to be released in line with % of completed construction	- Responsible for overseeing operations of developers, brokers, property financiers etc - Institute rent caps - Provide information on the property market
Implications/ Benefits	- Will help to weed out untrained, unqualified brokers - Buyers can be assured that they are dealing with licensed and certified professionals	- Ensure that buyer funds are being utilized for specific project - With 10% of funds being held for 1 year, ensures defects at handover are repaired - Extends to overseas developers as well - Incentivises developers not to fall behind schedule	- Unify all property-related activities - Act as a forum for disputes - Encourage the adoption of international best practices - Develop mechanisms to deal with unfair practices
Drawbacks	- Time lag between licensing of brokers and public disclosure of above - Training has to commence for brokers	- Only applies to new developments or those yet to be launched- not retroactively - No clarity on use of funds, while held in guaranteed account - No guidance on whether withdrawals can be made to pay for land costs, marketing, sales etc	- Process of integrating the various functions and responsibilities will be arduous

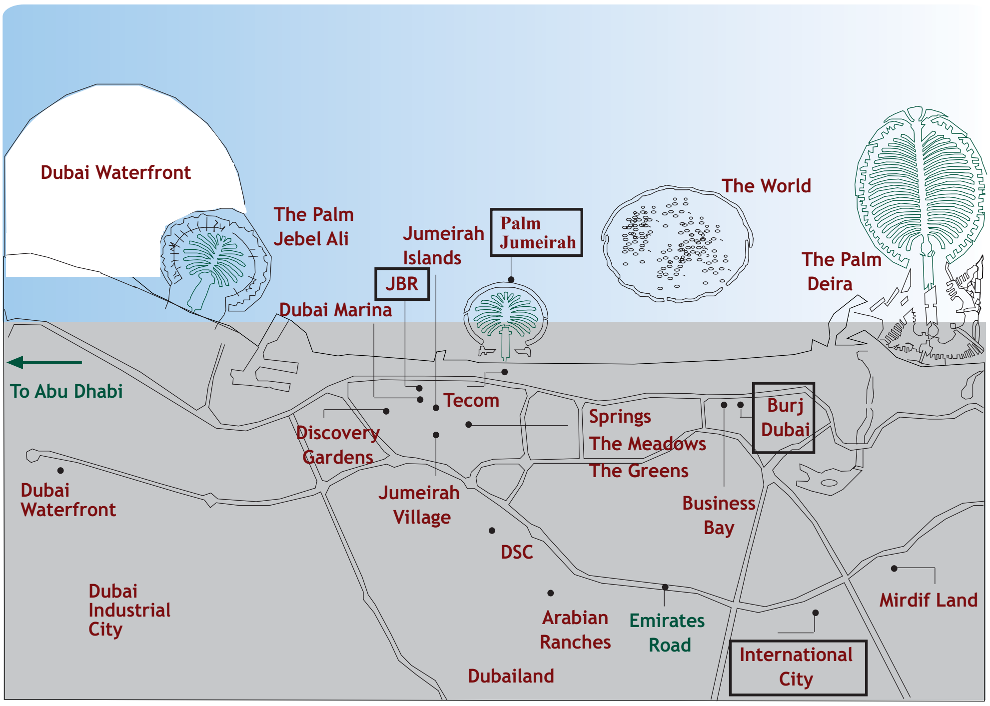
Source: EFG-Hermes

These legal changes are encouraging improvements that reflect the government's commitment to a sound and loophole-free legal structure to govern the fast growing market. At the same time, there are still issues that need resolution, including: i) the yet-to-be-approved Condominium Law, which will govern the rights and obligations of homeowners in tower-style developments, ii) the absence of a mortgage law or any kind of legal framework to govern the rights and obligations of mortgage providers and holders, and issues related to mortgage defaults and repossession, and iii) the lack of clarity on inheritance. Thus, while Dubai moves towards incorporating international best practices and legal standards, it is unlikely that we will see loopholes such as the lack of foreclosure laws tested until more end-users begin to occupy their homes. At the same time, we believe that the RERA in particular is a key strength for the Dubai market.

C. Effect of Handovers on The Property Market

Activity in the secondary market has been increasing as properties are handed over: i) End-users are more comfortable buying a home they can actually see, and ii) many original owners, hoping for maximum returns, had been holding onto unfinished homes until they were close to completion or were completed. However, the fact that the pace of project handovers is not occurring at the expected pace is reducing available supply and thus continues to put upward pressure on prices.

Figure 1.5: Map of Freehold Market - Boxes Indicates New Handovers YTD



Sources: UAE Official Gazette and EFG-Hermes

- International City (IC): This large-scale affordable housing project was expected to provide much needed relief to the mid-income segment once handed over in 2007. Only 10% of the 20,000 units expected to come on stream in 2007 have been handed year-to-date and occupancy remains low. International City's lack of proximity to central Dubai and the fact that shops, restaurants and other amenities are still under construction has meant that it has been slow to fill up, a trend that we expect to reverse as more units are delivered.

- Jumeirah Beach Residence (JBR): The handover at this 36-tower development in Dubai Marina began in April after a delay of more than a year. Of its 6,500 apartments, fewer than half have been released to date, with the remainder expected to be delivered by year-end. As with IC, actual occupancy is not at expected levels. We believe this is a function of both high rents due to its location on the seafront and of the tendency of certain landlords to hold on to properties in the hope that prices will rise further. Rutted roads caused by nearby construction and limited social infrastructure to date has also deterred potential tenants.

- Palm Jumeirah: After a delay of more than 15 months, Nakheel has begun the handover of the first phase of properties (both apartments and villas) on Palm Jumeirah. Most owners appear content with their homes, helped by the handsome price appreciation they have enjoyed, but others have complained about quality and finishing. The fact that rents are at a significant premium to other areas of Dubai may explain why most units remain vacant. But more importantly, it would seem to illustrate that demand is skewed towards affordable, and not luxury, apartments.

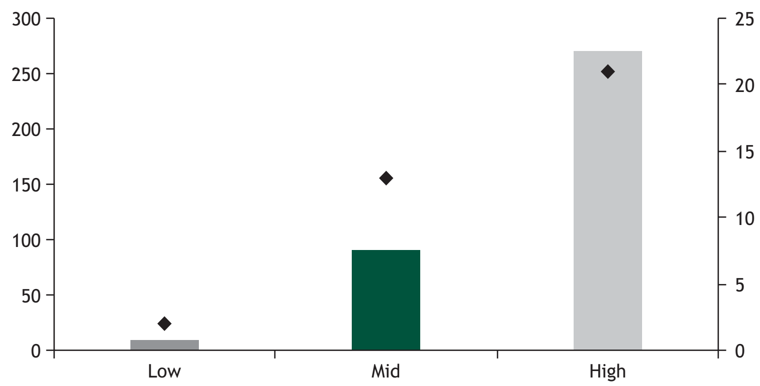
- Burj Dubai: Of the units handed over, high rents are being commanded for this project, primarily due to the central downtown Dubai location and the fact the Burj Dubai is to be the world's tallest tower, and is hence keeping occupancy rates moderate. Some buyers, in the expectation they will be able to sell them later at higher prices, are holding onto their units without renting them out, while other owners live abroad and use their apartments as holiday homes or have no urgency to rent their flats out.

While slower-than-anticipated pace of deliveries has caused house price to increase, the low occupancy rates among delivered homes (which are mostly at the luxury end) would seem to suggest that most demand is for affordable housing. This type of demand is coming from mostly expatriates working and living in Dubai, who are now considering the option of buying a home to live in, as opposed to renting.

D. Impact of New Project Launches

It is interesting to note that there have been relatively few new project launches over the past eight months, and those that have been launched have targeted specific markets. YTD, there have been around 35 new launches with four on average per month, which compares to more than 70 project launches in 2006 according to our estimates. The new launches are targeting mainly the mid-income or luxury segments. Some projects, such as golf course homes, have been oriented towards lifestyle communities. Recently, developers have also turned towards all-villa type projects in keeping with the high demand for spacious family homes.

Figure 1.6: Cumulative Number of Projects (LHS) and New Project Launches by Project Type (RHS) in 2007



Source: EFG-Hermes

Not only have fewer new projects been announced, but the observed price appreciation of new developments from the time of a launch is decreasing. We have selected three new project launches to explore this assertion. These are described in Table 1.7.

Table 1.7: Description of Selected New Project Launches

Segment	Name of Project	Description
Mid-Income Segment	Seasons Community-Jumeirah Village	- Is an apartment and townhouse development located in Jumeirah Village
		- Slated for completion in 2009
Luxury Segment	Centro Towers-Burj Dubai	- Consists of 2 high-rise residential towers
		- Slated for completion in 2008
Lifestyle-Oriented	Lime Tree Valley Villas	- Luxury tailor-made villas located within Nakheel's Jumeirah Golf Estates development
		- Due for completion by 2009

Sources: Developers' brochures and EFG-Hermes

The sales of these projects have met with different levels of success, given that they appeal to different segments of the market. All three projects are 80-90% sold out. Prices for undelivered units (first offered for sale over the course of the past 8 months) have increased by an average of 18% according to our estimates.

Units with a closer delivery date, quality finishing and other distinctive characteristics tend to carry a premium as well. For example, units in Emaar's Centro Towers (see description in Table 1.7), where development was more than 50% complete when they were offered for sale and where the delivery date is 2008, saw price appreciation of around 25% since the launch in April 2007, which is higher than the observed average.

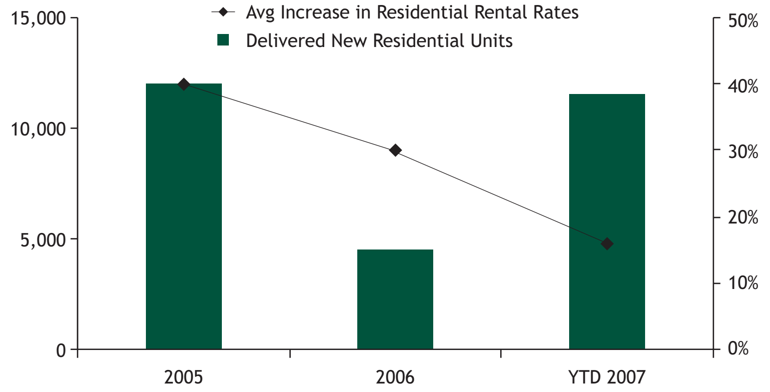
This would seem to suggest that buyers are become more discerning and are willing to pay a premium for project that is unique in its offering. Moreover, it also implies that new project launches are priced in keeping with market trends, rather than discounted rates- which was initially the trend in the early stages of the property boom- as part of efforts to encourage investment.

II. LEASEHOLD MARKET UPDATE

Rental Rate Increases are narrowing...

Rent increases in the leasehold market have begun to soften. Figure 2.1 illustrates that, according to our estimates, the average YTD increase in residential rates in Dubai is 16% versus 30% in 2006, and 40% in 2005.

Figure 2.1: Rise in Rental Rates (RHS) Versus New Units Delivered (LHS)



Source: EFG-Hermes estimates

...with the rent cap providing some relief

The government rent cap has limited increases, but because it does not apply to new contracts, some landlords continue to renew leases at higher than allowed levels. Dubai has set up a rent committee to deal with the problem, but not all cases get heard. Some landlords have also begun adding hefty maintenance charges to the annual rent that are in essence undeclared rent increases. We continue to divide the leasehold segment into: i) low-cost housing, ii) units targeting the middle-income segment, and iii) units targeting the high-end segment. According to our estimates, low and mid-income housing units have seen average rental increases of 14.2% and 15.3% respectively since the beginning of this year, down from 28.8% and 25.1% in 2006. The smaller rental increase seen in the mid-income housing segment in 2007 can be explained in part by people moving to less expensive areas further from the center of the city, such as International City, and in part by the fact that the rental increases of last year were from a relatively low base.

Fig. 2.2: YTD Rent Increases in Low Cost Units

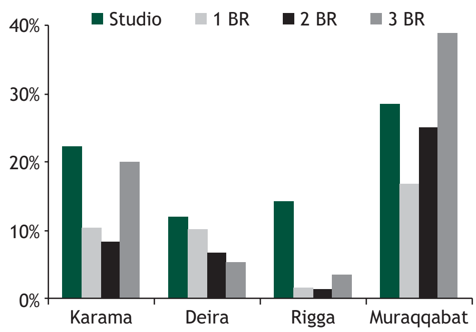
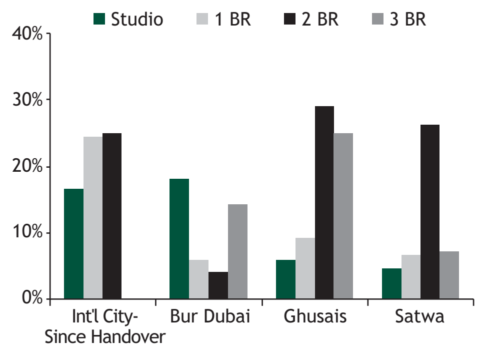


Fig. 2.3:YTD Rent Increases in Mid- Income Units



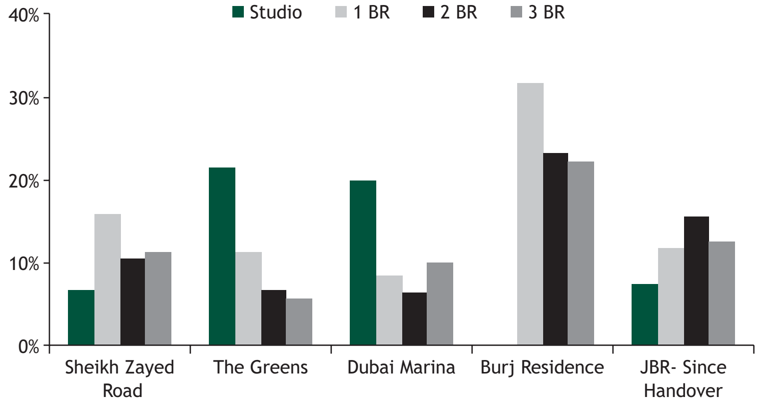
Sources: Asteco and EFG-Hermes

Demand continues to be strong for studios and one-bedroom apartments, with the highest rental increases over the course of 2007 of 22% for studios and 24% for one-bedrooms. This strong demand for these unit types continues to be driven by the inflow of expatriates, especially blue collar and lower level white collar employees who are either young and therefore single or cannot afford to bring their families to live in the UAE.

High-end community developments are preferred...

In terms of the high-end market, our estimated YTD rental increases of 13.5% are much lower than the 30.6% increase observed in 2006. Rents in community style developments such as the Greens have increased YTD by 11%-15% on average, down from around 36% the year before. Rents at Dubai Marina have increased at a slower pace due to a surge of new supply in developments such as JBR and the Palm Jumeirah. Demand for more spacious two, three and four bedroom apartments, which appeal to high-income expatriates, remains strong. Demand continues to outpace supply, leading to further increases in rents.

Figure 2.4: YTD Rent Increases for Areas Targeting the High-End Segment



Sources: Asteco and EFG-Hermes

... with demand for villas remaining high

Villa rents are increasing at a fast pace. Further price escalation is likely given that demand for villas seems to be increasing much faster than supply. On a YTD basis, villa rents have risen c20% in both old and new areas of Dubai, and price increases are expected to be sustained.

Fig. 2.5: YTD Rent Increases for Villas in Old Dubai

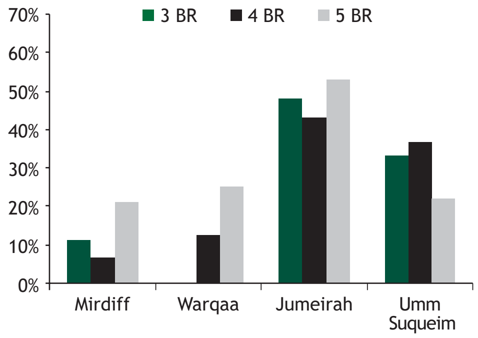
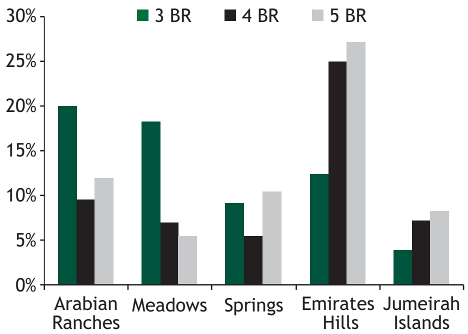


Fig. 2.6: YTD Rent Increases for Villas in New Dubai



Sources: Asteco and EFG-Hermes

Housing demand has soared on the back of strong population growth, robust economic fundamentals, high oil prices and increasing wealth, but because the actual number of units handed has not kept pace for a third year running, rental rates continue to rise, although more slowly than before.

III. RESIDENTIAL MARKET OUTLOOK

A. Freehold Supply

In our December 2006 update on the Dubai real estate sector, we estimated that 270,000 housing units would be added to the market between 2006 and 2010. Given that a number of large-scale projects are at an early stage of development and are going to take longer than expected to build, in addition to the fact that details are limited on how much supply they will add, we have excluded them from our supply forecasts. We have added new projects that were announced over the past eight months, a step that has raised our estimate of announced supply through to 2010 to around 277,000 housing units. The projects announced this year in most cases are slated for delivery in late 2009/mid 2010 at the earliest.

2007 supply has not panned out as expected...

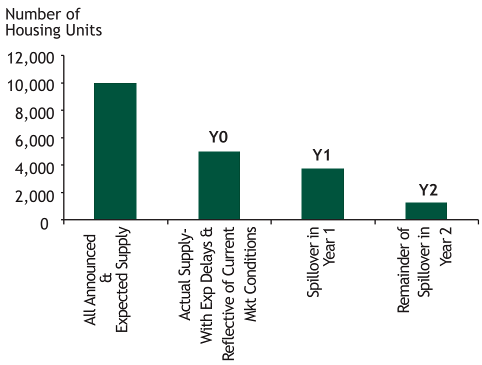
A sizeable proportion of project handovers were due to begin in 2007, with some of them set to define future market trends in ways that would affect the freehold and leasehold segments differently. Among these projects were International City (IC), Jumeirah Beach Residence (JBR), Palm Jumeirah, Discovery Gardens, various towers around the Marina and surrounding areas, Burj Dubai and towers along Sheikh Zayed Road. Of the supply of 57,000 units that in December 2006 we had expected to be handed over in 2007 (after assuming some project delays), we estimate that approximately 11,000 have been handed over by the end of August. There have been greater delays in handovers than previously anticipated due to problems with infrastructure, the availability of utilities, amenities, defects upon handover, etc.

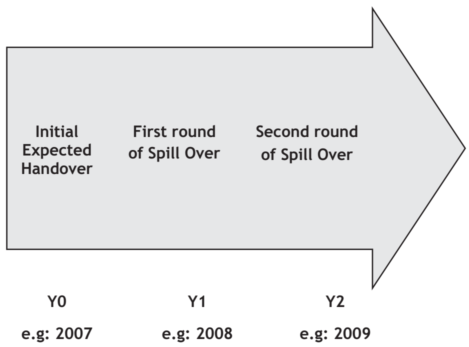
Based on current guidance from developers and our own expectations, we now believe that around 25,000 units will be handed over by the end of 2007. Delays have been creating a supply lag. These delays stem from both a lack of qualified contractors and labor and an insufficient supply of construction machinery and equipment.

... allowing us to adjust supply forecasts in light of current market conditions

Given the slow handovers and the consistent delays, we believe it is useful to break down supply using the following framework:

Figures 3.1 and 3.2: Breakdown of Supply (number of units are for illustrative purposes only)





Source: EFG-Hermes

Figure 3.1 illustrates the following (number of units are for illustrative purposes only): The first column represents announced supply for year Y0, the second column a realistic estimate of actual supply year Y0 taking into account delivery delays or supply delays, with the third and fourth columns representing the spillover from year Y0 into years Y1 and Y2 respectively. The pattern of deliveries cascading into subsequent years versus original estimates helps to provide support to prices in the near term.

Fig. 3.3: Expected Annual Supply 2007-12

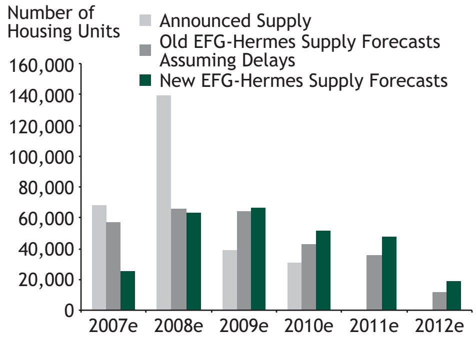
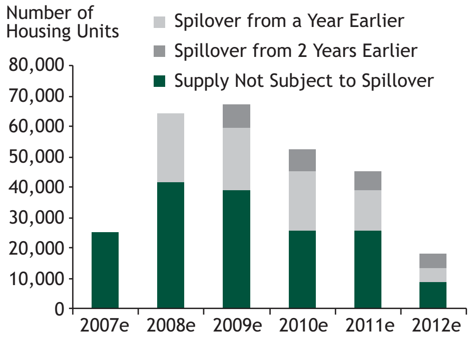


Fig. 3.4: Breakdown of Supply 2007-12



Source: EFG-Hermes estimates

2008 supply includes spill over from 2007...

Our old no-delays scenario estimated 2008 supply at about 139,000 units - a scenario in which we had limited confidence in due to the fact that the bulk of supply to be handed over (c80%) was being undertaken by private developers. Thus, we went on to assume that only 50% of planned 2008 supply (68,000 units) would actually be delivered. We further revise our expectations, adopting our new framework for estimating supply which accounts for delays and assumes supply spillovers into subsequent years. Our new estimate for 2008 supply is only slightly down from our previous estimate, at 64,000 housing units. This comprises of two-thirds of the supply we had originally estimated to be delivered in 2008, with the remainder representing the estimated spillover from 2007. The change in our estimates is illustrated in Figure 3.3, with the breakdown between "original" supply and "spillover" supply illustrated in Figure 3.4.

... with the forecast supply peak shifting from 2008 to 2009

We now expect the peak year of supply to be 2009, with 68,000 units being delivered, up from our previous estimate of 64,000 units. As with 2008 supply, this foresees more than half of estimated 2009 supply being delivered on time, with the remainder accounted for by the spillover from additional deliveries which we had previously forecast for 2007 and 2008. We expect the trend of delays, with actual deliveries cascading into later years than previously forecast, to continue, with spillovers declining by 2012.

B. Freehold Demand

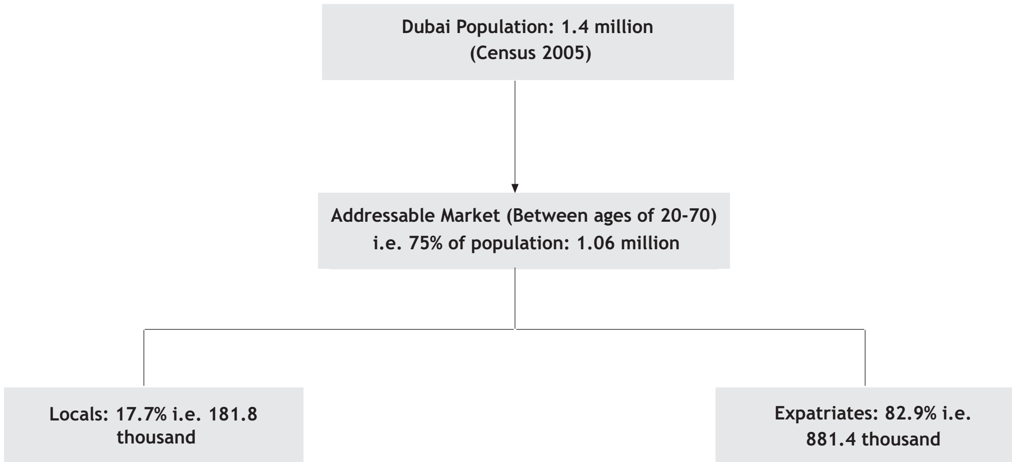
While there are no official statistics for demand, we believe the addressable market of potential homebuyers in Dubai continues to expand, due both to expanding interest in Dubai as a 'destination' city as well as an increase in the number of expatriate residents. With the GCC region as a whole in the grip of a sustained economic expansion and the fact that property prices, while they have risen significantly, are still reasonable compared to global big city property markets, there is a high level of foreign participation in the Dubai property market.

Limited hard information on the profiles of buyers, the degree of leverage used in transactions, the degree of end vs. speculative buying, the degree of non-resident vs. resident participation and other features of the market make demand one of the hardest areas to ascertain. However, the nature and level of demand remains fundamental in ascertaining the impact the surge in supply will have on prices.

In our December 2006 update on the sector, we segmented demand into different types of buyers and based our demand assumptions on population growth - both the inflow of expatriates and the strong growth rate of the national population. We maintain our assumption that the population of Dubai will rise to almost 1.9 million in 2010 from the current level of 1.4 million people, implying a CAGR of 7.9%. However, we have since refined our demand forecast for housing units to make the assumptions more robust and to better reflect the proportion of international buyers.

Addressable Market Assumptions:

i) Segmentation of resident population in terms of expatriates and nationals (80:20 split)
ii) Population segmentation by age
iii) Income factor - the use of cash versus mortgages
iv) International demand - over and above demand from resident population



Sources: Dubai Municipality and EFG-Hermes estimates

- The first cut-off point that we have established is to exclude persons under the age of 20 and over the age of 70.

- We then segment the addressable population into nationals and expatriates.

- For expatriates, we exclude low-income blue collar workers, i.e., the vast bulk of construction workers currently residing in the emirate.

- For each of the ensuing segments of nationals and expatriates, we have estimated the number of those available and willing to purchase a home in Dubai, whether through a mortgage or with cash.

- Finally, we have added a factor on top of this potential demand to account for international demand.

This analysis allows us to fine tune our demand forecasts, allowing us to split out demand forecasts into two major classifications: i) resident and ii) non-resident demand. Resident demand that we have arrived at is 40,000 to 45,000 units per annum (based on expected natural population increases as well expected immigration). We have estimated international demand of c13,000 units in 2007. From 2008 onwards, we forecast a decline in this demand due to a softening in global real estate price appreciation and a tightening in the availability of credit in developed markets that is expected to have a knock-on effect on the ability of buyers originating in developing markets to acquire properties in Dubai. We also believe demand from residents to be price elastic, suggesting that should prices fall in 2009, when we expect supply to peak, we believe there could be a corresponding increase in demand from residents.

Fig. 3.5: Estimated Demand for Housing Units

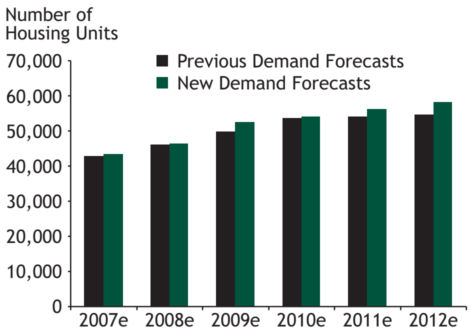
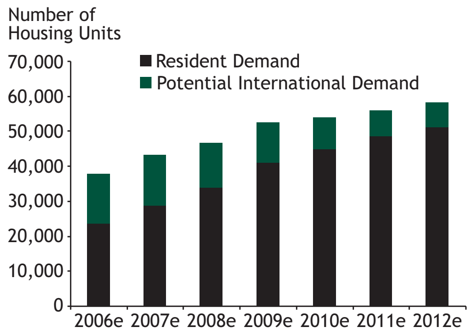


Fig. 3.6: Resident versus Non-Resident Demand



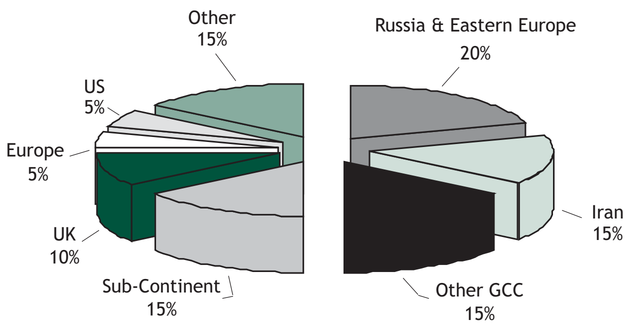
Source: EFG-Hermes estimates, based solely on anecdotal evidence

Anecdotal evidence suggests that there continues to be very strong international interest in property not only in Dubai, but also in the UAE in general. We believe this is because Dubai (and the UAE) offers a wide variety of properties, suitable to different types of buyers. However, Dubai continues to harness most of this interest. Other emirates are more niche in their offerings, focusing either on the middle-income or the holiday home segment, for example.

Strong Levels of International Demand Prevail

Dubai continues to be a pioneer in terms of developing a liberal property market, with its initiatives towards improving the legal framework as well as market data increasing international interest. Real estate agents have also suggested that this revived interest has been helped by the handover of properties such as Palm Jumeirah, JBR and other Emaar projects (i.e. units in the Downtown Burj). The fact that Dubai real estate prices are on average competitive compared to those in major developed cities has helped spur demand. Because of a lack of documented data on the breadth of international demand, we have estimated foreign interest based largely on anecdotal evidence (Figure 3.7). Buyer interest has largely been concentrated towards luxury or holiday homes, but more recently it seems that international investors are looking at certain types of Dubai property as good investment properties as well.

Figure 3.7: Breakdown of International Demand



Source: EFG-Hermes estimates, based solely on anecdotal evidence

We believe that there still exists a layer of speculative demand. While speculation has decreased as the pace of price appreciation has slowed, it is still substantial, helped by the delay in supply, and the implicit leverage built into off-plan payment programs. Figure 3.8 summarizes our expectations of how the levels of interest of the various residential property buyers will evolve over the coming few years. As described earlier, we believe demand to be price elastic. Should prices fall in 2009, when we expect supply to peak, we believe there will be a resulting increase in demand - especially stemming from mid-income expatriates - looking for homes to buy and live in.

Figure 3.8: Forecast Levels of Interest by Different Buyers in the Dubai Property Market

Investor Base	Level of Participation		
Nationals	High	Moderate	Maintained
Expatriates - High Inc.	High	Moderate	Maintained
Expatriates - Mid Inc.	Low	Increasing	Increasing
Non-Residents	Moderate	Declining	Maintained
Property Market Phases	2003-06 (Boom)	2007-08 (Stability)	2009 (Start of a Downturn)

Source: EFG-Hermes estimates

There also appears to be a mismatch between types of property on offer and demand. Market talk suggests that foreign demand is mostly concentrated towards luxury homes, lifestyle-oriented projects and holiday homes, while local demand is skewed mostly towards affordable housing and villas/family homes. With the current availability of luxury homes, there continues to be strong international demand, which may increase helped by the new regulation. The current supply/demand mismatch for affordable housing will be eased by a lot of middle-income supply coming on stream in 2008 and 2009, absorbed in our view by increased demand for this type of housing from expatriates. There is also a healthy level of demand for villas/family homes, a need that supply is not expected to meet in the short to medium term.

We believe that there are pockets of value within the Dubai market, with some projects still relatively overlooked. In our view, should market prices correct a new wave of buyers would enter the market. In the short term, however, supply continues to dwarf demand, and a mismatch seems unavoidable. The economic fundamentals are strong, and if Dubai continues to maintain its position as the region's hub for the financial, media and tourism sectors, we should continue to see sustained interest in the market - even in the case of a market correction.

C. Freehold Market Outlook

We believe that handovers in 2007 have continued to fall short of demand for a third straight year. However, as is illustrated in Figure 3.9, we now estimate that some 23% of total estimated supply for the period of 2007 to 2012 is expected to be delivered in 2008 and 24% in 2009 (in 2007, we estimate this to be 9%). We now expect the year price correction to be 2009 rather than 2008. Whilst we believe that there will be excess supply in 2008, we see this being absorbed by the pent-up demand of earlier years (2005-2007). We believe that the extent of the price correction will depend primarily on both the pace at which new units are delivered and the price elasticity of demand. We believe that demand is price elastic, and that once prices begin to come down from their highs, this will increase demand for Dubai property. This is reflected in our earlier demand estimates.

Fig. 3.9: Supply & Demand Expectations 2007-12*

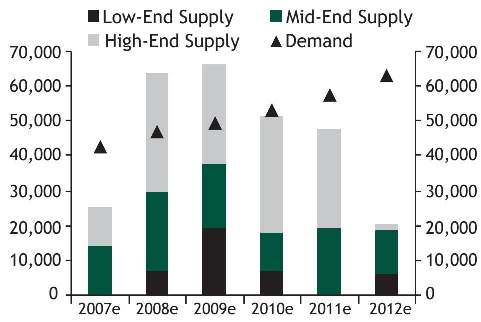
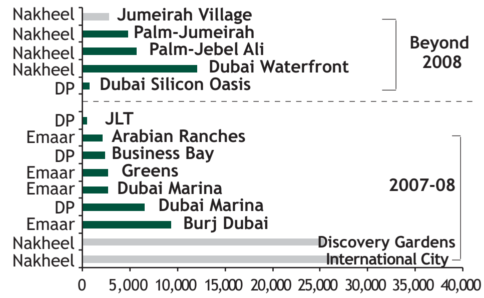


Fig. 3.10 : Main Project Delivery Date/Units*



*Number of housing units
Source: EFG-Hermes Estimates

Figure 3.9 illustrates that supply is biased towards the mid- and high-end segments. Demand is harder to segment, but we believe it is skewed towards those looking for affordable housing alternatives. This apparent mismatch, with a disconnect between what people want to buy and available units for purchase, could lead to an earlier correction in freehold prices than expected.

Extent of Forecast Price Correction
Our current forecast is for a rise in average prices of 10-15% in 2007 and a rise of 5-10% in 2008. We expect prices to peak in 2H2008 as more supply hits the market. We expect prices to start declining in 2009, with a cumulative decline of 15-20% by 2011. It should be noted that our assumptions and estimates involve a strong degree of subjectivity, with a consequent impact on our conclusions.

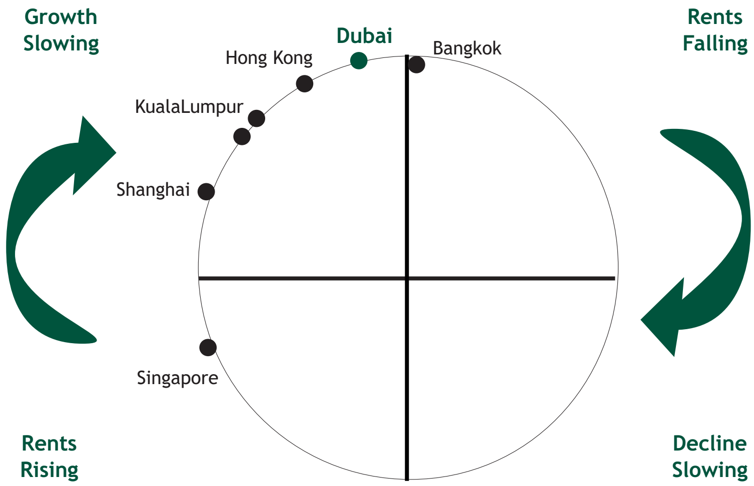
The anticipated correction is expected to affect low, mid and high income segments differently. Given that the bulk of supply is for luxury apartments, we believe property values in this segment will fall sooner and further than in other segments. Since villas are expected to account for only 10% of total new housing units, we do not expect to see meaningful declines in prices in this segment. We also expect certain key developments such as those in central locations (e.g. Burj Dubai and DIFC) to hold on to their values in the face of a market correction.

D. Leasehold Market Expectations

Our previous expectation was that rents would correct later than freehold prices (i.e. in 2008). Several things have changed since the end of December: i) As mentioned earlier, there have been delays in the expected supply coming on stream which is positive for rents, ii) there has been a slowing of rent increases, due primarily to the 7% rent cap for 2007, likely to be 5% in 2008 and providing tenants multi-year fixed rents, and this has capped expectations, and iii) end-user demand for mid-income housing has been higher than that for luxury housing, which has dominated delivered supply to date

We expect the decline in the pace of rental rate growth observed in the first eight months of this year to continue into early 2008, with rents starting to decline in 2008 as new housing comes onto the market.

Figure 3.11: Position of Dubai Relative to Other Cities in Residential Rent Cycle



Sources: Jones Lang La Salle, CBRE, and EFG-Hermes estimates

BOX 1: SUPPORT AND RESISTANCE FACTORS FOR THE RESIDENTIAL FREEHOLD MARKET

Support Factors

i) Development of a Solid Legal and Institutional Framework: One of the most important pillars for the stability and continuation of growth of the Dubai property market is a robust legal system. We have seen significant improvements in the legal structure over the past 18 months, as discussed previously. The passing of new laws and the formation of new government entities to control various functions in the market have been helping to establish a more professional legal system for the property market. Once the condominium law and mortgage rules are enacted and other grey areas dealt with, confidence from potential buyers is expected to increase even further.

ii) Increasing Demand: The base of buyers who choose to buy property in Dubai is constantly widening. As the city becomes a destination for more and more tourists (estimated at 15 million in 2010), the economy grows and diversifies, more companies and better qualified labor are relocating to Dubai. Dubai's foreign investments (into stock exchanges for example) and international marketing efforts are also helping to create additional demand for the local property market.

iii) Abundant Liquidity: Economic reforms, supported by high and rising oil prices, have increased Dubai's regional importance. The fallout from the US subprime mortgage crisis, which is affecting global equity and real estate markets, has not had a direct impact on Dubai real estate. This is primarily due to the GCC being a capital exporter and low mortgage penetration levels, with leveraged real estate being a new phenomenon. In fact, the widening availability of debt financing that is expected to take place as the mortgage market deepens, will provide support to the market going forward.

iv) Valuations: At current levels, even after the significant appreciation of recent years, Dubai real estate is less costly than real estate in comparable international cities around the world. This should support Dubai's position as an alternative destination for global real estate buyers.

v) Increasing Cost of Construction: Higher prices for land and for cement, steel and other building materials, as well as a shortage of labor, both skilled and unskilled, are leading to a rise in the cost of construction (which has risen 30% Y-o-Y, according to a report by EC Harris, dated July 2007). The cost of building materials is expected rise by another 1.0% to 1.5% a month over the next 18 months. The higher costs will have the greatest effect on smaller developers, whose access to funding is more limited. This in turn may further dampen supply. Given the implementation of the escrow law, which reduces the ease of access to off-plan sales funds, developers will have further cash flow constraints.

vi) Inadequacy of Infrastructure: The anecdotal consensus is of the view that the pace of construction in Dubai is much faster than what the city's transport system, infrastructure, power and water supply and other networks can handle. Among the main causes of property handover delays have been holdups in the opening of access roads or hooking up of utility and cable connections. Moreover, amenities such as power and district cooling capacity require immense capital investment and entail a lag between build-out and access. This could further dampen the pace at which supply becomes available.

Resistance Factors

i) Affordability and Financing: The early phases of demand for Dubai property were fuelled mostly by cash buyers. The current and coming surges in demand are expected to be driven by end-users. However, there is the danger that the number of potential end-users who can afford to buy a property, given an average purchase price of around AED1 million, is limited even with a mortgage. We believe an important driver will be increased competition among banks leading to extended payment schemes, lower interest rates on mortgages and more innovative home finance products. Unless end-users can afford to participate in the market, the mismatch between the type of supply and type of demand is likely to be greater than originally anticipated.

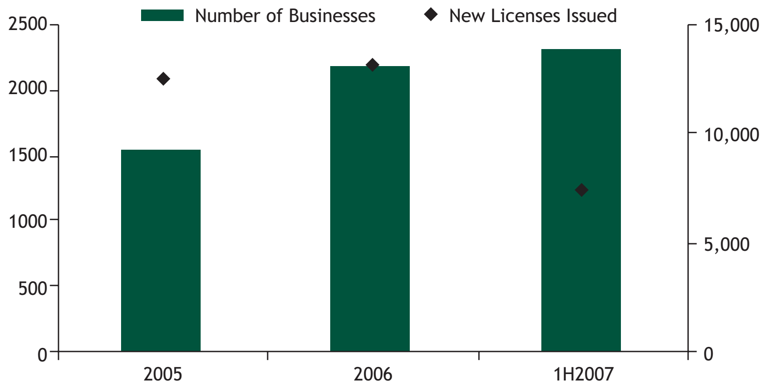
ii) Rising importance of other UAE Emirates: Dubai was the pioneer of the real estate market in the UAE and the first emirate to open its doors to foreign buyers, but others have now followed to varying degrees. Ajman and Sharjah continue to provide affordable housing, with average prices ranging from AED500 to AED800 per square foot. Ras al Khaimah and Fujairah, on the other hand, are poised to become regional tourist hubs, packaging their natural beauty and a "resort-feel" to attract buyers seeking holiday or retirement homes. The major contender for Dubai's position is Abu Dhabi, where the property cycle has only just begun. Property development in Abu Dhabi is being undertaken under 'Masterplan 2030' which ensures that there is co-operation between developers, utility providers, transportation and other municipal authorities, aiming to result in higher sustainability and a better urban environment. Abu Dhabi, however, has more legal restrictions on foreigners owning property and its prices per square foot are already in line with peak prices in Dubai, factors that make buying less attractive for some. Nonetheless, the property being developed in Abu Dhabi is more controlled, and virtually all its developments are community or lifestyle projects. This has attracted much attention from buyers and could absorb some interest away from the Dubai market, especially if ownership restrictions are further removed, and the outer limits of Dubai and Abu Dhabi continue to move towards one another.

iii) Restrictive Legal Initiatives: While much headway has been made in Dubai with regards to adopting best practice in the legal domain, there is the risk of creating an over-regulated framework. The announcement by the newly formed Real Estate Regulation Authority (RERA) that all homeowners will have to seek approval from the agency before renting out properties to buyers and restrictions on the type of tenants (bachelors, families etc) could end up being restrictive rather than helpful and curtail the degree of autonomy landlords currently enjoy.

IV. COMMERCIAL SECTOR UPDATE AND FORECAST

Dubai's popularity as the financial and business hub of the Middle East continues to grow and is being fueled by high oil prices and resulting strong economic growth in the GCC, leading to the establishment and expansion of regional headquarters by global firms and the establishment and expansion of regionally focused small and medium enterprises. This has boosted demand for commercial space to new levels.

Figure 4.1: Newly Issued Business Licenses 2005-1H2007



Source: Dubai Department of Economic Development

Market analysis estimate commercial occupancy rates of around 99% in both traditional and newer areas of Dubai. Our previous update on the sector (Dubai or Not to Buy, 18 December 2006) divided commercial space into grade A, B and C. Grade A represented the most prestigious type of commercial space with the best amenities, while grades B and C were located mostly in older areas of Dubai, locations that were considered secondary, and had basic features.

Commercial rental rates still increasing...

According to our estimates, office rents have risen by almost 40% YTD in both old and new areas of Dubai as demand continues to outweigh supply. Our analysis shows that office and commercial rents in Old Dubai (Garhoud, Bur Dubai and parts of Sheikh Zayed Road) have risen by 36% on average (YTD) and in new Dubai (Sheikh Zayed Road, DIFC, Business Bay, Jumeirah Lake Towers, Internet and Media City) by almost 45% (YTD). The more luxurious Grade A properties in both areas jumped by around 35% on average. Finding office space in the city remains arduous, with companies settling for less desirable locations, renting temporary space in villas, setting up branches or smaller offices or buying rather than leasing office space. Newer areas of Dubai have become centers of commerce, a trend that explains why rental rate increases are not easing in these locations.

Fig. 4.2: Rent per sq ft in Old Dubai

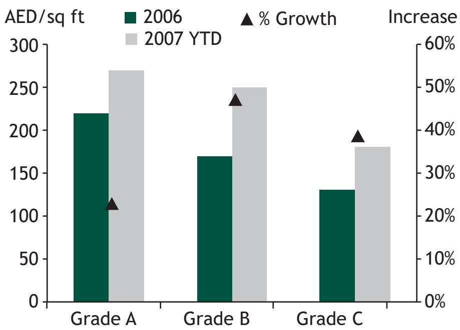
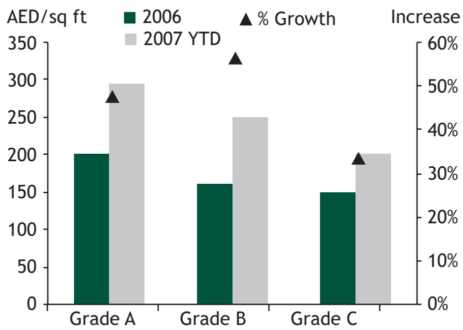


Fig. 4.3: Rent per sq ft in New Dubai

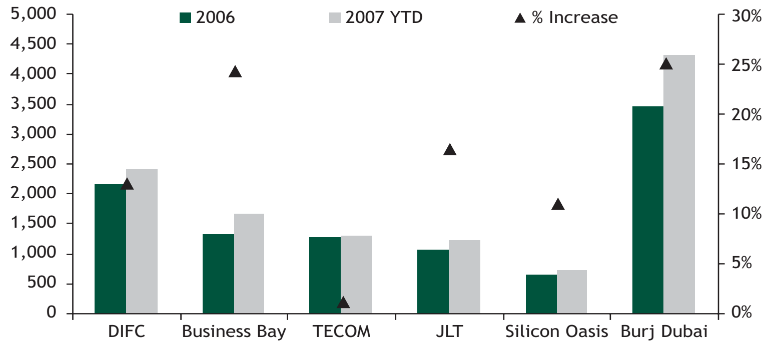


Sources: Better Homes, Asteco and EFG-Hermes

...while limited supply allows for higher selling prices for freehold commercial space

Selling prices for off-plan developments in the DIFC, Burj Dubai and offices in the JLT have increased by approximately 17% over the past eight months due to the desirability of their locations and on expectations of strong yields based on current off-plan prices and expected future rents.

Figure 4.4: Selling Prices for Freehold Areas and YTD Increases in Price



Sources: Better Homes, Asteco and EFG-Hermes

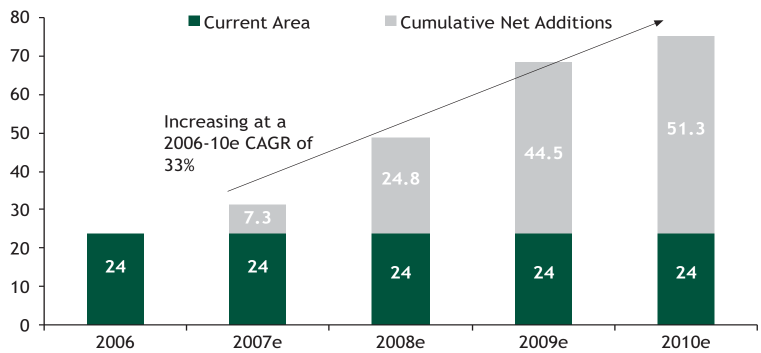
Dubai office rents are among the highest in the world

Dubai is fast becoming one of the most expensive business cities globally, with an average rent of USD89 per square foot. This compares to USD97 in Hong Kong, USD112 in Paris, and USD120 in Moscow. On the other hand, while prices for freehold commercial space have risen, selling prices remain at the bottom end among business cities, coming in at an average of about USD400 per square foot, resulting in rental yields of around 20%, compared to a global average of 6-7% (Dubai rental yields are based on selling prices for commercial stock that is currently being built and is two to three years from completion - there is currently no liquid secondary market for commercial property in Dubai)

Commercial Property Outlook

With demand for commercial property outpacing supply over the short term, rents will continue to rise in our view. Project delays have thus far put a halt on the expected surge of supply this year (estimated at 7.3 million square feet), with only a very small tranche (mostly in Jumeirah Lake Towers, DIFC, Sheikh Zayed and TECOM) expected to be delivered in 2007. This has sustained the trend of rental increases. We also maintain our expectation that the stock of commercial space will triple to 75 million square feet overall by 2010 compared to year end 2006.

Figure 4.5: Annual Deliveries and Stock of Commercial Property



Sources: Better Homes Commercial Review, Colliers and EFG-Hermes

Major supply additions to spur marked decline in rents

Most of the commercial space additions are expected to hit the market in 2008 and 2009 and we expect to see a marked decline in rents. As a result, we expect to see Dubai commercial property yields sliding back gradually toward the international average.

Appendix I: Dubai Residential Property Price Index Methodology

Data Set

- We have used a selection of apartments and villas across different areas in Dubai.

- Apartments: International City, Dubai Marina, Palm Jumeirah, Greens, JBR, JLT, Old Town, Uptown Mirdiff, DIFC, Business Bay, Burj Dubai and Discovery Gardens.

- Villas: Arabian Ranches, Dubai Sports City, Dubailand, Emirates Hills, Green Community, Jumeirah Park, Jumeirah Village, Meadows, Palm Jebel Ali, Palm Jumeirah and Springs.

- Within each of these properties, we have selected a typical home in terms of size, number of bedrooms and other features such as a garden, pool etc that are reflective of the nature of the project.

- Data points are based on **asking** prices for units.

Process

- Our index tracks a data set that begins in November 2006.

- For each property, we note the price at which the unit is first offered.

- If a unit is sold in a given month, we replace it with a similar unit and note the new price of the replacement unit.

- This replacement unit is the unit that carries forward for the next month.

- In terms of the divisor, we adjust the index for units that are sold and thus replaced during a month.

- For example, if a 2B/R villa in the Springs is sold in December, we add a suitable replacement that is carried forward into January.

- The divisor for December adjusts for this transaction by removing the unit that is sold and adds the unit that replaces it.

- Then in January, the index is calculated on the adjusted divisor - which compares prices for the replacement unit - thus making a like-for-like comparison.

- We compare properties using **price per square foot** data.

- We have also assigned a weight to each development, which is a function of size, area, and number of units, and this allows us to arrive at an average appreciated price per square foot.

Appendix II: More Insight into Legal Improvements

Broker's Law

The Broker's Law, passed in January 2007, stipulates that all brokers, both individuals and companies, must be licensed with the Land Department. The department has been assigned the role of training and certifying all brokers to ensure that property transactions are conducted by licensed and trained brokers who are able to provide proper advice and professional service to their clients. Once the department certifies and trains the emirate's brokers, Dubai will be one step closer to having a more efficient and professional property market.

Escrow Law

The Escrow Law, or Law No 8, was passed late in July this year. The law is structured as follows:

Applicable to
- All property developers will be required to set up trust accounts to deposit monies received from customers for off-plan sales.
- The law applies to all developers and declares that only registered property developers are allowed to undertake construction activity.
- The escrow law extends to i) all developments for which off-plan sales are currently ongoing, ii)developments where construction work has commenced on-site and iii) developments that have not yet reached the shoring stage.

Use of Funds
- These funds will then be held in trust accounts that will be offered at banks that are licensed to offer such facilities.
- Funds will only be released to the developer - for the purpose of funding the project - once certain stages of construction are completed.
- An independent surveyor will assess the stages of completion of construction.
- The Land Department will hold 10% of the value of the development in the trust account for one year after handover to act as a warranty.
- The 10% residual will also not be released until all homebuyers have registered their properties with the Dubai Land Department.

The escrow law is an initiative that was long overdue and is thus much welcomed. It will limit unprofessional behavior by developers and increase buyer confidence. The fact that 10% of funds are held for one year after handover in the trust account before being transferred to the developer is a safeguard to ensure that the developer adequately compensates for any defects. Law No 8 works in the favor of local property developers by giving them credibility. In addition, it acts as pre-emptive safety net to prevent fraudulent developers from running off with buyers' money. Finally, developers will have a greater incentive not to fall behind schedule so that they can collect their funds.

Since the escrow law was passed, banks and mortgage providers such as Dubai Islamic Bank, HSBC, Amlak and Tamweel have received approval to offer trust account services to developers. A few private developers have already established escrow accounts. The immediate effect of this law and its acceptance by both finance providers and the developers is a very positive indicator. However, it should be noted that, all other things being equal, it will increase development costs.

Real Estate Regulation Authority (RERA)

Of all of this year's legal developments, the most important was the creation in August of the Real Estate Regulation Authority (RERA). This agency was created as part of the restructuring of the Dubai Land Department.

The RERA's responsibilities include:

- Overseeing operations of property developers, property management companies, financing institutions, brokers and various owner associations.
- Registering and endorsing lease contracts.
- Approving financial institutions qualified to manage escrow accounts.
- Managing and supervising the work of home owner associations.
- Monitoring property advertising.
- Licensing and regulating the real estate brokerage industry.

This agency will allow for the unification and integration of all property-related initiatives and legislation under one roof, a move that will add transparency to the market, and act as a forum for discussion of other improvements and new laws. The RERA has also announced that it will draw up model rental contracts that stipulate tenant and landlord rights, obligations and privileges and, more importantly, lock in rental rates for three to five years. In taking this step, the agency is seeking to limit the impact of rising living costs on tenants. Moreover, the RERA is encouraging the government to build more low-cost housing. Over the next few months, the agency will also be setting up a property arbitration center.

DISCLOSURES

We, Sana Kapadia, Stefan Schürmann, and Philip Khoury hereby certify that the views expressed in this document accurately reflect our personal views about the securities and companies that are the subject of this report. We also certify that neither we nor our spouses or dependants (if relevant) hold a beneficial interest in the securities that are the subject of this report.

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EFG-Hermes (UAE), Level 6, The Gate, West Wing, DIFC , P.O. Box 30727, Dubai - UAE
Tel: +971 4 363 4000 | Fax: +971 4 362 1170 | Website: www.efg-hermes.com
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