Q4 2013 Overview

The fourth quarter saw a number of positive developments for the Kurdistan Region, albeit overshadowed somewhat by the terrorist incident of 29th September 2013. In reality we saw relatively few side effects as a result of the bombing: heightened security for two to three weeks then business as normal. At grass roots level there was no apparent reduction in demand for companies to open up for business in the region, helped by the substantial confidence in the local security and intelligence forces to prevent future terrorist acts and the fact that the incident in question was seen as a “one off” event.

The launch of Emaar’s Downtown Erbil project on 27th October 2013 was viewed as a tangible demonstration of Erbil’s regional pull as a dynamic investment destination. The project is reported to be valued at USD3bn including over 540,000 m² mixed use development. The initial phase (Clarin Towers) comprises only 276 residential units which is currently being sold off-plan at average sales rates of over USD2,400 per m², making it the most expensive residential developments in the city to date.

Coinciding with the Emaar launch, Prime Minister Nechirvan Barzani released details on a plan to improve the quality of future property developments across the Kurdistan Region through wide ranging measures including the implementation of building regulations and an active building control department. We see this as a hugely positive and much needed step forward.

In December, the pipeline connecting Kurdish oil fields to the Turkish port of Ceyhan was finally opened. This gives the KRG an independent route to market but puts it at odds with Baghdad who are demanding all exports must be through SOMO (State Organisation for the Marketing of Oil). This has yet to be resolved but the development of this key infrastructure is regardless seen as a step forward in monetising oil production.

Erbil is the Arab Tourism Capital for 2014; the fourth quarter of 2013 saw reenergised hotel construction with several previously slow projects making significant progress such as the Hilton Doubletree Best Western and Marriott Hotels. The Hilton Hotel and Resort being developed by Mihtab on 100m Road also broke ground and has made very fast construction progress. Whilst we do not envisage the aforementioned hotels being completed in 2014, the tangible reinvigoration of this sector is compounded by high levels of interest from many of the major hotel brands to operate in KRI, typically under management agreements.

The quarter also saw an increase in the number of investors in the retail and food and beverage use classes. The most active investors are generally from the Levant and GCC regions. We are also seeing major international brands such as Burger King and Starbucks starting to penetrate the local market and expect more international retailers to follow.
Retail

Market Overview

- The historic heart of Erbil’s on-street retail is centred around the Citadel within the Bazaar. As the city grew towards the South and East retail tended to agglomerate on specific streets: Stationary Street, Computer Street, Furniture Street etc. The on-street retail premises are typically on the ground level of low-rise mixed-use buildings.
- Erbil has an immature retail market with a lack of modern retail space. Domestic and regional retailers form 95% of tenant mix.
- There is limited local Mall culture; local people tend to shop in the Bazaar or the older shopping districts in the centre of the city. Anecdotal evidence suggests that the expatriate community and the younger Kurdish generation provide the main spend within the Malls.
- Since 2009 with the completion of Majidi Mall 1 there has been rapid development of shopping centres within the city. There are presently ten existing malls in Erbil of which only four can be described as approaching international standards. Overall existing shopping centres are poor quality and offer poor retail mix.
- In part, poor retail mix is due to a number of units within shopping centres being sold off-plan to individual investors to fund development. A contributing factor is the lack of international brands that have penetrated the Iraqi market to date, although we understand that several of the regional retail franchise stables are expanding offerings.
- An obvious deficiency in the majority of existing shopping centres and those under construction is the lack of parking provision. In a city where public transport is virtually non-existent, we see this as a major oversight.
- Other common shortcomings include lack of sufficient goods loading bays (and access), service corridors, vertical integration and basic property maintenance.

Supply

- We estimate that current built supply of shopping centres is approximately 268,000 m² of Gross Lettable Area (or 0.2 m² per capita).
- Current supply is low quality with the exception of four examples which are approaching international standards.
- Both current and future supply includes shopping centres within which the developer has pre-sold retail units to fund construction. Sofy Mall and Galleria Mall are such examples; the former being used for either offices or travel agencies and the latter with a substantial leasing void.
- There are currently no Outlet Malls in Erbil; we understand that one is planned in a mixed use development in the Northern area of the city.
- Future supply is difficult to assess due to the number of partially constructed centres and large number of neighbourhood/community malls planned as a component within the larger mixed use developments. We conservatively estimate the cumulative supply of shopping centre retail space is approximately 745,000 m² by year-end of 2017.
Major projects included in the pipeline (yet to be launched publicly) include a 100,000 m² (GLA) mall on 100m Road in close proximity to the airport and a 90,000 m² (GLA) mall on Gulan Street.

Demand
- With an average population growth in Erbil of approximately 3% per annum, rising GDP per capita, a growing young (under 20 year old) population, increasing expatriate demographic and evolving tastes of the overall population we expect to see increasing demand for retail.
- Prime shopping centre vacancy rates lie at approximately 5% with some low quality centres experiencing vacancy of up to 60%.
- Footfall for one of the top Erbil shopping centres is a reported 30,000 per day however we believe that conversion rate is low.

Rents
- In Figure 3 we demonstrate an emerging three tier mall market: prime retail rents apply to the top four shopping centres in terms of quality, with attractions such as cinemas and kid’s fun zones and better than average retail mix and parking, driving significant footfall as described above; the secondary market is generally the older and smaller shopping centres with limited retail mix; the tertiary market consists of shopping centres generally sold off-plan with no retail mix and significant vacancy.
- Rents quoted in Figure 3 are exclusive of service charge which are generally USD10 – 20 per m² per month.
- We see evidence of some shopping centres structuring rent on the basis of base rent plus turnover provision. Turnover provisions applied depend on size and retail use.

Outlook
- International retail brands will show increasing interest in the Erbil retail market; although international brand penetration is limited, we are aware of major global brands in the process of acquiring space in both shopping centres and mixed-use commercial towers.
- A growing middle class and consumer demand for better quality retail coupled with population and GDP per capita growth will underpin demand however we believe the estimated 275% increase in shopping centre supply over the next four years will pressurise rental growth and retail space absorption.
- We believe that future supply will include international standard destination shopping centres that create more of a consumer experience than just shopping. One such project will break-ground by the end of Q1 2014 in a super-prime location in close proximity to the airport. Other components in the mixed use project will include two international branded hotels, offices and apartments.
- With the evolution of destination type centres in Erbil in the future and similar to other emerging markets, shopping centres will become a place for the young to gather socially. We expect attractions such ice rinks, bowling, amusement arcades, cinemas, fun zones etc to be included in designs for new centres.
- "Big box" type outlet malls are planned for the future. Currently there are only a few major standalone stores in Erbil.
- There is planned large scale development “Neighbourhood Malls” in most of the larger master planned residential developments; in most cases these will be the last phase of development.
Industrial

Market Overview

- The Erbil market is characterized by a lack of quality space with mushrooming low quality speculative developments, a large proportion of which are outside of industrial/logistics zoned areas.
- There are currently four dedicated industrial zones in Erbil (as described in detail below) however a huge amount of industrial and logistics facilities have been constructed outside of these zones on agricultural zoned land. This is potentially detrimental to security of tenure for the tenants.
- Four major new industrial areas are planned for the future.
- Erbil is experiencing increased demand as a logistics centre for distribution to the local market and forwarding to locations in the South of Iraq.

Supply

Industrial Land

- There are currently four industrial zones in Erbil: North Industrial Zone of 761,000 m², South Industrial Zone of 554,000 m², “Polluting” Industrial Zone of 960,000 m² and Timar Industrial Zone of 15,854,928 m².
- The North Industrial Zone is primarily a light industrial area dominated by car repair workshops. The South Industrial Zone is a mix of light industrial units, car showrooms and warehousing. The “Polluting” Industrial Zone currently has 57 factories, including asphalt, ceramic, block and batching plants. Lastly, Timar Industrial Zone has a mix of factories including some chemical mixing plants.
- Four new industrial areas are in the process of being surveyed and land compensation being finalized for the current incumbents (typically the government will compensate between 3% to 12% of the total land area being re-zoned depending on form of title held). The new industrial zones are the Heavy Industrial Zone of 17,213,113 m² (See Figure 5, No. 1); the Agro-Industrial Zone (See Figure 5, No.2); Hawler Industrial City (See Figure 5, No.3) and the Petrochemical Zone (See Figure 5, No.4).
- Land title and relevant zoning remains a contentious issue as many industrial and logistics facilities have been constructed illegally on agricultural zoned land. We understand farmland remains at risk of being compulsorily taken back by the government.
- We have recently seen the allocation of 275,000 sq m of industrial land for oil and gas related services. This is proving attractive to major international tenants due to security of tenure.

Warehousing

- Typical speculative built warehousing is low quality and normally consists of small clusters of 400 – 600 m² warehouses with clear height of between 4 – 6m.
- International tenants tend to lease warehousing on Gazna Road, Kirkuk Road, Makhmoor Road or Mosul Road.
- A large proportion of warehousing has been developed on agricultural land; in our view suitable for shorter term tenancies only as long term tenure is potentially compromised if the government starts to enforce planning regulations.
**Demand**

- Demand is increasing from international companies seeking to set up distribution centers, factories, laydown yards and workshops. Much of this demand is oil and gas related however we are seeing an increase in demand for warehousing for retail, pharmaceutical and food storage sectors.
- Due to a combination of international tenants currently leasing poor quality warehousing which is either no longer fit for purpose or no longer operationally viable due to business expansion, and a change in strategy to a mid/long term view, we see evidence of a large number of upcoming pre-let or built to suit transactions for major light industrial facilities.
- There is growing demand from major logistics and FMCG companies to expand operations in Erbil because of a combination of its security and its position as an important logistics hub for goods entering from Turkey into the rest of Iraq.
- Domestic industry is increasing with new factories being constructed, noticeably in the construction industry related uses.
- From 2006 to end of H1 2013, the Kurdistan Investment Board has sanctioned some 123 industrial investment projects in KRI with a total investment of USD 6bn, on a total land area of 20m²

**Rents**

- Both prime and secondary rental rates for speculatively built warehousing have remained stable for Q3 and Q4 2013 as demand increases in tandem with increasing supply.
- Ground rents vary enormously depending on size of plot, location, zoning, site improvements, access to utilities/infrastructure and length of ground lease. We have seen variance from USD 0.5 per m² per month to USD 2 per m² per month.

**Outlook**

- We anticipate considerable activity from the pre-let/build to suit market as international companies pursue long term strategies in the region.
- International tenants are starting to vigorously assess land title and implications on long term tenure.
- We expect increasing demand from logistics companies for large volume warehousing. Increasing demand for cold storage facilities is leading to planning for a central cold storage facility to accommodate this.
- Large tracts of farmland are in the process of being converted into industrial areas. We do not expect these to be cohesive masterplanned areas in the short term although there is demand for such: we would recommend a public private partnership to properly plan an industrial and logistics zone with the required infrastructure, economic incentives, customs clearance and streamlined company registration and residency processing. The overriding aim should be to facilitate manufacturing and logistics set-up in Erbil. Overleaf is a Case Study on a highly evolved masterplanned industrial zone in Dubai, United Arab Emirates which should be viewed as an example of what the Erbil market requires.

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“We see evidence of a large number of upcoming pre-let or build to suit transactions due to current low grade facilities and evolution of long term occupier strategies.”

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**FIGURE 7**
Average Warehouse Rental Rates

<table>
<thead>
<tr>
<th>Rent</th>
<th>Trending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prime</td>
<td>11</td>
</tr>
<tr>
<td>Secondary</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: IKG Property Research

**FIGURE 8**
Typical Speculative Built Warehousing in Erbil

Source: IKG Property Research
Case Study
Dubai Industrial City

- Dubai Industrial City ("DI") is a 55,000,000 m² masterplanned industrial and logistics Zone in Dubai, United Arab Emirates. It is situated in close proximity to the multi-modal logistics hubs of Dubai World Central and Jebel Ali seaport.

- DI is not a “free-zone” therefore all foreign companies must have a UAE national partner as a nominal 51% shareholder in the entity. As such there are no tax breaks or 100% repatriation of profits as is typical in a free-zone, however the City’s prime focus is to facilitate companies setting up operations in Dubai with the key infrastructure in place and a streamlined government services department to improve set-up efficiency.

- Key infrastructure for the site has been completed including:
  - A 10km 8 lane central spine road;
  - 4 x 132KVA substations with 800MW dedicated for the City;
  - sewerage and water network;
  - Fibre optic cable network for the entire city;
  - Storm water drainage network;

- DI have already constructed 650,000 m² of international standard warehousing ranging in unit size from 460 m² to 930 m². These include offices, driver rest rooms, prayer rooms. We understand these warehouses are almost 100% fully leased.

- Land can be leased long term, areas range from 20,000 m² to in excess of 300,000 m²; power, water, roads, sewerage and telecommunications are all provided.

- DI includes labourer accommodation for in excess of 10,000 workers; facilities include retail areas with supermarkets, shopping facilities, barber shops, internet café, laundry, restaurants and banking facilities, public transportation and taxi services, private health centers, ambulance center, mosques, recreation areas and sports facilities.

- Office accommodation of 27,000 m² in three buildings has been constructed on site, enabling companies to lease good grade offices in close proximity to their manufacturing and logistics facilities.

- DI has a specialist department that acts as an interface between government departments and DI’s tenants. This is a one-stop shop to address all government related issues including licensing, registration, permits and visas. In addition, the DI Permits Department assists companies with their proposals for construction of industrial facilities and commercial developments, a single window approach to expedite developments.

- The Permits Department reviews the architectural designs, permit requests, construction plans and infrastructure requirements for adherence to local and statutory requirements. Upon review, DI provides companies with a no objection certificate (NOC) that facilitates expediting approvals from the concerned government departments.
Residential

Market Overview

- Sales of new residential apartments being offered for sale are typically sluggish - possibly due to considerable new supply of fresh accommodation being offered.
- Rental Yields in Erbil are typically high when compared to more mature markets and are likely to soften. In tandem with a surge of supply of new residential stock being offered for sale coupled with corporates moving out of traditional villa style accommodation into new purpose built office accommodation we anticipate rental rates to weaken, hold firm at the very best.
- The introduction of serviced apartments by some of the larger hotel chains could contribute to decreasing rental rates in tandem with many business occupiers moving out of villa accommodation into purpose built office accommodation.
- Over the next 2-3 years the supply of residential apartments being offered for sale could increase by as much as 700% if all planned developments come to fruition.
- We are beginning to see market segmentation by the introduction of new top end developments and expect transaction prices to adjust accordingly.
- Much of the new product in the mid-tier range is located on arterial routes leading out of Erbil, especially towards the north.

Supply

- We maintain our previous projections that over the next few years if all planned developments come to fruition the size of the apartment for sale market could increase by over 700%.
- There are only circa 2,000 completed apartments (West of City.)
- Many new developments such as Emaar’s Clarin Towers and additional stock at Empire World are beginning to contribute to the studio / 1 / 2 bedroom market - a sector previously not properly catered for.
- Much of the new stock gravitates around the mid-tier range although we shall witness distinct market segmentation when units at Park View are delivered this summer.
- None of the delivered units enjoy proper service charge arrangements. Typical service charge costs are in the region of USD 1.5 to USD 2.0 per m².

Demand

- Typically, non occupiers represent approximately 50% of purchasers with sustained demand from outside of the KRI. Given the continued unstable socio-political background pertaining to regions outside of the KRI we anticipate continued demand from this sector.
- Currently, there is only one bank offering traditional mortgage financing in the KRI. Many developers offer staggered payment profiles but over relatively short terms. Several large international banks have established branches in country but only offer commercial banking facilities with no immediate plans to offer conventional retail mortgage facilities.
Serviced Apartment Market – SNAP

- Serviced Apartments are typically used by business travellers requiring hotel style facilities and services but require larger living areas than found in normal hotels. Although more expensive than private residential accommodation, they provide an excellent medium term housing solution.
- Except a handful of boutique serviced apartment buildings, the Erbil serviced apartment market is still within its infancy stages. IKG Property forecasts less than 300 units will be delivered to the market further to the completion of several new five star hotel developments.
- The current number of business visitors per annum to Erbil is approximately 500,000 and increasing rapidly.
- Using benchmarking data from more mature markets, IKG Property calculates the serviced apartment market could currently soak up approximately 1,500 units, especially as many overseas workers are on rotation programs and in need of short to medium term residential solutions.
- Although regionally dependent, typical rental rates for serviced apartments are in excess of USD 50 per m2 per month, representing a capitalized asset value in excess of USD 3,000 per m2.
- Given the undersupply, IKG Property anticipates many new serviced apartment operators to enter the market.

Case Study

Park View
Gulan Street, Erbil

- Park View is a new residential development offering 962 residential units for sale when completed. This project is one of the most exclusive projects in Erbil, with units being offered for sale between USD 1800-2000 per m2.
- Park View is being developed by a JV Company formed between Salahaddin Holding Company & ILCI. We understand Salahaddin has contributed the land with ILCI being responsible for all development activities.
- The developer is one of the first to deliver a building to international standard, adopting international standards throughout the delivery. It is reported that sales are strong with the first phase nearly sold out.
- The project is a phased development with a total of twelve towers being released in 4 tower tranches at six monthly intervals, supplying 962 units when completed. The first phase is scheduled to be completed this summer.
- The development shall also be one of the first to offer 2 bedroom apartments.

FIGURE 16
Number of Serviced Apartments by Country per ‘000 Business Visitors per year

<table>
<thead>
<tr>
<th>Country</th>
<th>Visitors per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>5.3</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>5.2</td>
</tr>
<tr>
<td>Sydney</td>
<td>2.6</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.8</td>
</tr>
<tr>
<td>London</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Source: IKG Property Research

FIGURE 17
Number of Serviced Apartments by Country

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