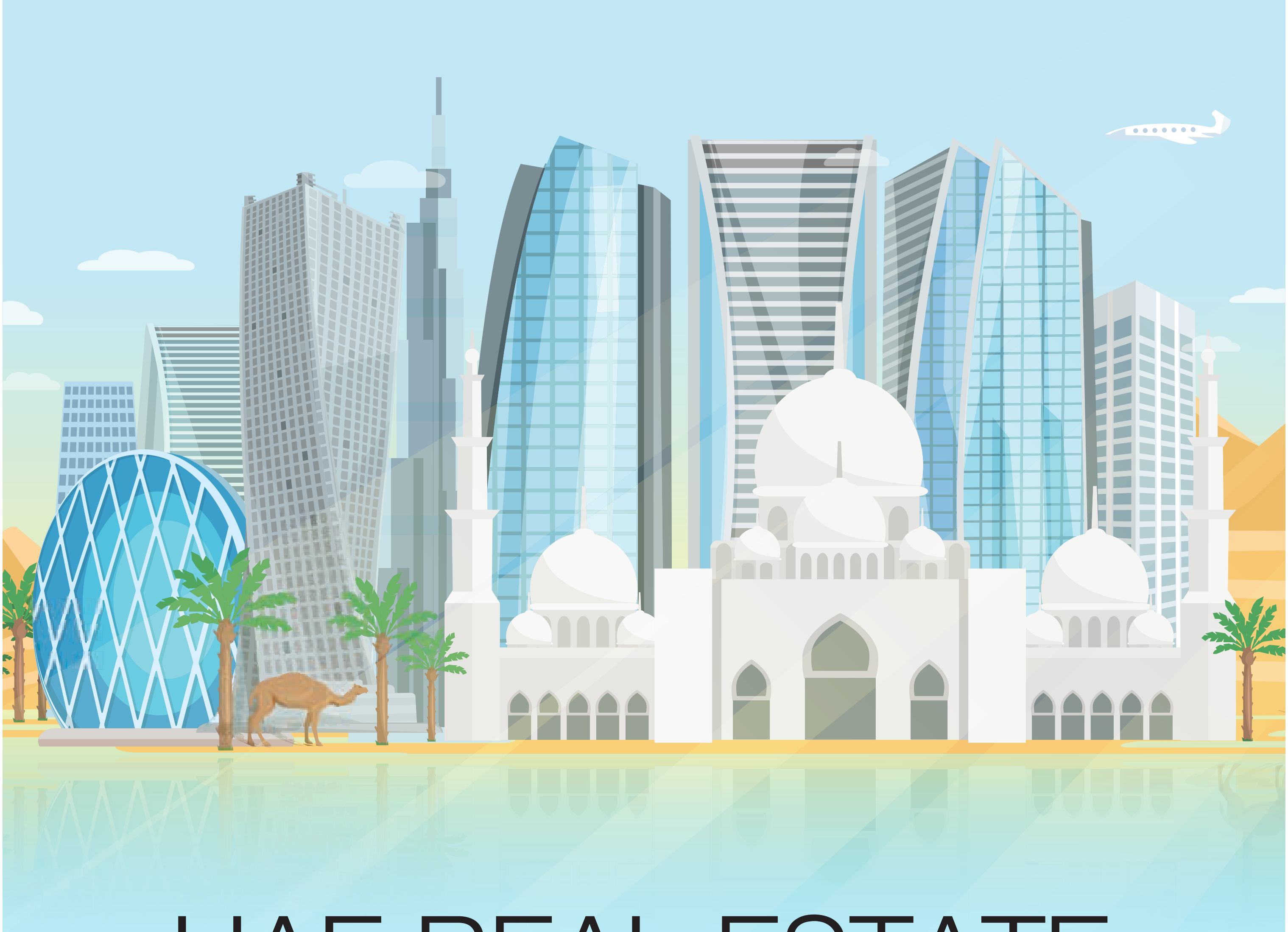
RESEARCH



UAE REAL ESTATE

2016 MID-YEAR MARKET REVIEW

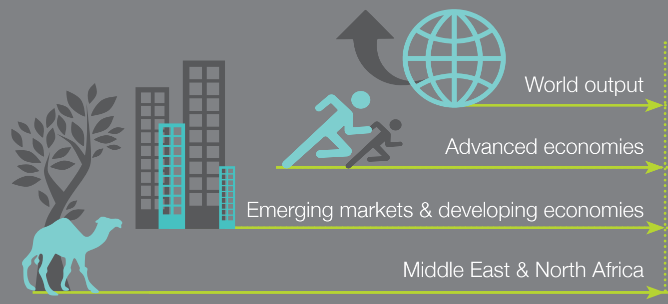
ABU DHABI & DUBAI REAL ESTATE SECTOR REVIEW

OVERVIEW

What's happening on the global and local macro level?

In its World Economic Outlook titled 'Too Slow for Too Long' (April 2016), the International Monetary Fund (IMF) reduced its global growth forecasts to 3.2% (from 3.4% in January 2016). Despite that, growth forecasts remain higher than 2015 levels (3.1%) and are projected to increase to 3.5% in 2017. While growth is forecast to strengthen, the slowdown in China, further declines in commodity prices, and the slowdown in investment and trade continue to represent downside risk to global growth.

FIGURE 1
Global growth levels (%)



	2015	2016F	2017F
World output	3.1	3.2	3.5
Advanced economies	1.9	1.9	2.0
Emerging markets & developing economies	4.0	4.1	4.6
Middle East & North Africa	2.3	2.9	3.3

Source: IMF, April 2016

On the local level, the impact of lower oil prices resulted in the revision of government budgets, reprioritisation of spending and removal of energy subsidies. These changes have resulted in sizable shifts in relative prices since 2011, with headline inflation rates increasing from 0.8% in 2011 to 4.0% in 2015. Coupled with the appreciation of the US dollar, household disposable income tightened and purchasing powers reduced.

How has the local real estate market been impacted?

Against this backdrop, the real estate sector in the UAE witnessed sluggish growth during the first half of 2016. The slowdown in transactional activity continued to weigh on the performance of the residential market, with sale prices softening further in Dubai and stabilizing in Abu Dhabi. While hotel occupancy rates remained healthy, average daily rates and revenues came under pressure on the back of softening demand.

Meanwhile, the retail market saw no noticeable increases in average rents as a strengthening US dollar and high inflation rates impacted tourist and domestic spending respectively. Similarly, growth in the commercial market (office and industrial) was muted as corporates and industries continued to scale back expansion plans amid increasing economic uncertainties.

What are the key factors of influence that will drive the market forward?

Please refer to the important notice at the end of this report.

OFFICE MARKET

The office market in Dubai remained relatively subdued during the first half of 2016. The slowdown in the economy and consequent cutbacks in the job market impacted demand for office space. In turn, rents remained flat across the majority of locations in Dubai, particularly for lower quality buildings in less developed locations.

Performance in select areas with freezone status continues to be strong (e.g. Dubai Media/Internet City). Likewise, Grade A buildings continue to command strong rental rates as demand for quality space in central locations such as the Dubai International Financial Center (DIFC) remained robust. The established infrastructure, ease of accessibility, availability of parking space and developed amenities (F&B /retail) continue to play a key factor in corporates' choice of office space.

Elsewhere in Dubai we see a pick-up in demand for office space in the Dubai Design District (D3). The availability of quality space, dual licensing system (operating as both free zone and non-free zone), and proximity to Downtown Dubai has seen global and local designers, artists and creative entrepreneurs commit to the development. As such, D3 registered occupancy rates of 75% and saw an AED 45 per sq ft increase in rents over Q1 2016 (to reach c. AED 180 per sq ft).

The occupier market in Abu Dhabi continues to struggle as falling oil prices led to the restructuring of many Oil & Gas companies and Government Related Entities (GRE's); traditionally the largest occupiers of office space in Abu Dhabi. This has in turn impacted rental rates across the Emirate.

Asking rents in Abu Dhabi's prime commercial district, the Abu Dhabi Global Market (ADGM), maintained their levels at approximately AED 2,500 per sq m. Elsewhere across Grade A buildings in Abu Dhabi, landlords have maintained their asking rents given limited available quality stock and reduced supply completions. Meanwhile Grade B rents have declined on the back of weakened demand.

FIGURE 2
Dubai office supply

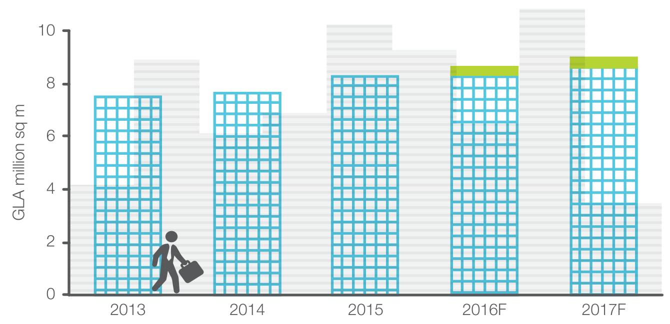
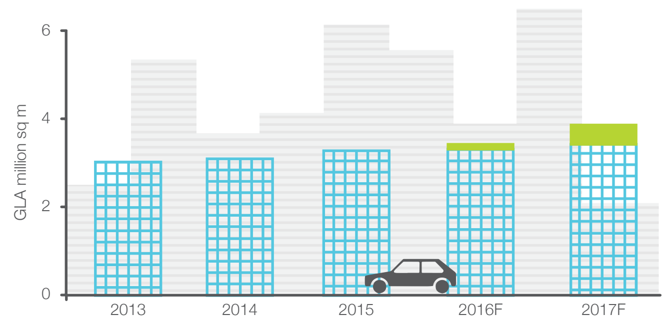


FIGURE 3
Abu Dhabi office supply



Source: Knight Frank Research

Existing supply · Under construction stock

Viewpoint

The performance of the office market in Dubai and Abu Dhabi is likely to remain muted for the remainder of the year as corporates scale back on expansion plans under the current global economic conditions.

In Dubai, we expect to see marginal declines in asking rents across Grade B buildings, while rents in grade A office space maintain their stability. In the medium-to-long term, the delivery of more quality space (e.g. ICD-Brookfield Place tower in the DIFC, Dubai World Trade Center - DWTC) is expected to exert downward pressure on the performance of Grade A space.

In Abu Dhabi, the short-term impact of the economic slowdown is likely to be offset by delays in the delivery of office space, which in turn will keep rents stable. In the long run however, rents are expected to soften as landlords strive to attract occupiers, and more space is released to the market (in addition to build to suit developments).

INDUSTRIAL MARKET

Performance in the industrial sector remained flat over the first half of the year, as occupiers postponed new purchases and expansion requirements on the back of a slowdown in global trade volumes. The sector also witnessed increased supply as some occupiers, namely those in the Oil and Gas industry, have downsized and consolidated their space.

There continues to be a flight to quality from traditional industrial areas such as Al Quoz, to newer locations such as Dubai Investment Park (DIP) and Dubai Industrial City (DIC). These latter locations benefit from more developed infrastructure and services, greater connectivity, and longer leasehold tenures. As a result, rents have remained relatively stable, as occupancy rates are high.

Bonded free zones such as Dubai South and Jebel Ali Free Zone (JAFZA) remain popular areas, as demand for new and quality stock remains high. Infrastructure improvements to Jebel Ali Port and Al Maktoum International airport have also assisted in attracting more occupiers to the area.

Occupier demand in Abu Dhabi is also shifting from older industrial areas such as Musaffah and Mina Zayed, to newer locations offering quality services. We understand that locations providing quality European specified warehousing, such as Abu Dhabi Airport Free Zone, have attracted a lot of interest from logistics providers, with occupancy rates registering approximately 90-95%.

Figure 4
Dubai industrial rents

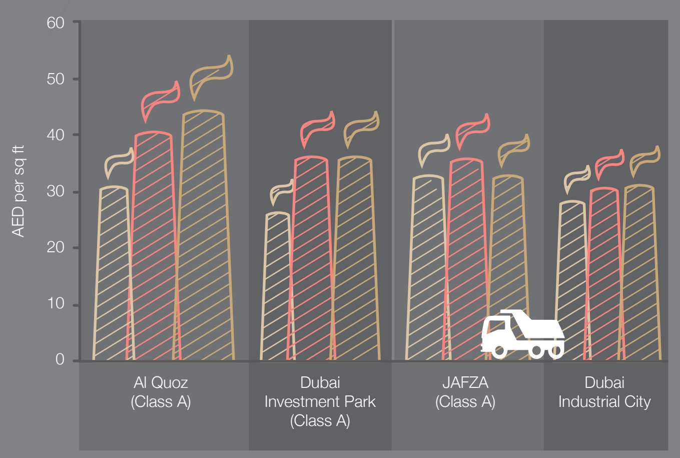
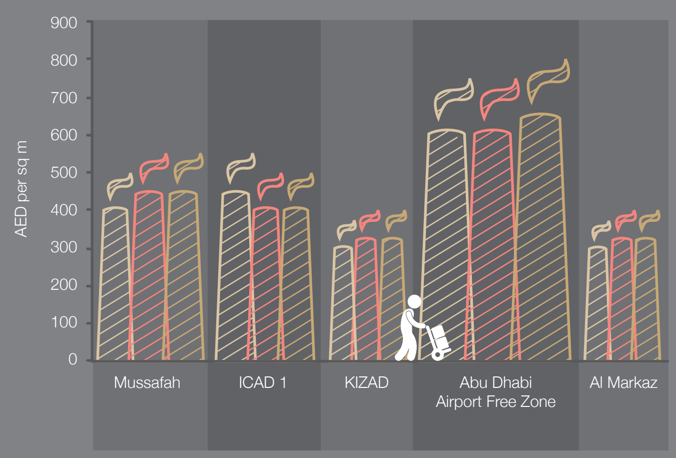


Figure 5
Abu Dhabi industrial rents



Source: Knight Frank Research

Q1 2014 Q1 2015 Q1 2016

Viewpoint

According to the World Trade Organization (WTO), growth in the volume of global trade is expected to remain subdued in 2016 (2.8%). Further slowdown in the Chinese economy, financial market volatility and sharp exchange rate movements are expected to impact the performance of the sector in the short-to-medium term (WTO).

With the industrial and logistics sectors being a main pillar of Dubai's non-oil economy, the sluggish performance of the global trade market is likely to reflect on the performance of the sector in the short-to-medium term. Consequently, rents are expected to remain stable as occupier demand softens. In Abu Dhabi, while demand has slowed significantly on the back of the decline in oil prices, the limited supply of quality industrial space is expected to keep the market stable.

In the long-term, the UAE's commitment to diversifying its economy through continued investment in developing the sectors' supporting infrastructure (e.g. Jebel Ali Port & KIZAD) and enhancing legislation is likely to boost the industry further.

HOSPITALITY MARKET

Dubai's hotel market sustained strong occupancy rates in Q1 2016, registering 85%. While down from the rate recorded over the same period in 2015, this was still the highest in the region by a considerable margin.

Facing a more cash constrained guest profile however, hotels have had to offer more attractive packages in order to maintain market share. As a result, average daily rates (ADR) in the emirate dropped 12% in Q1 2016 compared to the same period in 2015, resulting in a 13% decline in revenues per available room (RevPar).

In Abu Dhabi, occupancy rates maintained their stability recording 78% in Q1 2016. Meanwhile ADR's and RevPar's dropped 15% to USD 138 and USD 108 respectively over the same period. Given its heavy reliance on corporate demand, the hospitality market in Abu Dhabi suffered on the back of the slowdown in economic growth and subdued corporate activity.

FIGURE 6
Key performance indicators (average)

DUBAI

	ADR	Occupancy	RevPAR
Q1 2015	268	86	231
Q1 2016	236	85	200

ABU DHABI

	ADR	Occupancy	RevPAR
Q1 2015	162	78	127
Q1 2016	138	78	108

Source: STR Global

FIGURE 7
Dubai hotel supply

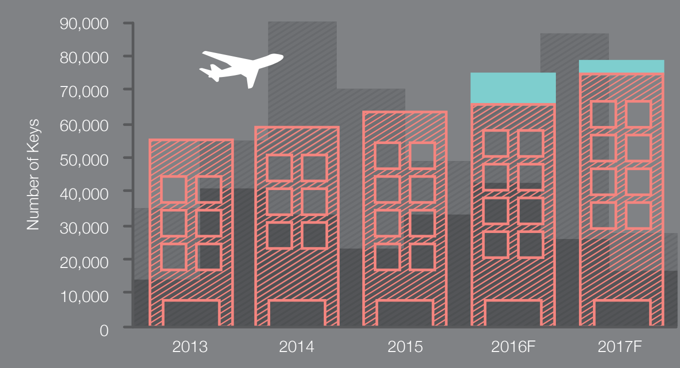


FIGURE 8
Abu Dhabi hotel supply

Source: Knight Frank Research

Existing supply Under construction stock

Viewpoint

Many of the challenges seen in 2015 such as a strong US dollar, lower visitor numbers from Russia & neighbouring CIS countries (which dropped 23% Y-o-Y in 2015 according to DTCM), and slower economic growth in China and the Eurozone are expected to continue throughout 2016, which will invariably impact demand levels – and in turn profitability - in the short term.

However in the medium-to-long run our outlook for the hospitality sector remains positive for both cities, and will be rooted in the delivery of major demand generators that will help drive tourism demand – particularly from the leisure segment. The expected delivery of the theme park complex, Bluewaters Island, the Opera District and major retail destinations in Dubai, along with Abu Dhabi's commitment to developing entertainment and cultural districts of its own, will stimulate visitation and maintain the competitive positioning of both cities. These demand drivers are underscored by the continued investment in airline infrastructure, which will further increase the accessibility of both emirates.

From a supply side, and despite notable recent openings, both markets remain underserved in terms of mid-market and budget hotel offerings. The introduction of more affordable hospitality options will ultimately balance the hotel supply, which is heavily weighted towards the top end of the market in both emirates, and will widen the country's tourist base.

RETAIL MARKET

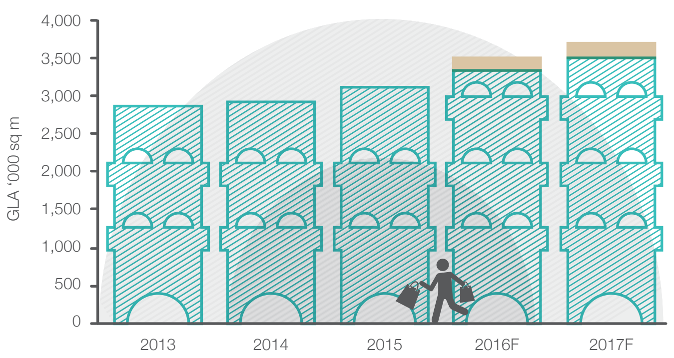
The retail sector in both Dubai & Abu Dhabi saw no noticeable growth over the first half of 2016, as demand remained subdued on the back of a strong US dollar (impacting the purchasing power of tourists from Russia) and slow economic growth in China and the Eurozone. In particular, the lower consumer spending weighed down on the bottom lines of personal luxury brands and high-end retailers, which grew at a slower rate in H1 2016 compared to the same period last year.

Domestically, higher inflation rates saw residents reprioritize and redistribute their spending on necessity goods. A recent report by the Dubai Chamber of Commerce reveals that 41% of the country's consumer spending went to housing in 2014. The next biggest expense was food and beverage (F&B), which accounted for 14% of total expenditure.

In fact, unlike other mall categories, F&B outlets have demonstrated a considerable degree of buoyancy over the past 12 months, as the appetite for out-of-home dining in Dubai has grown. As a result, mall operators have been rigid on lease terms for F&B retailers.

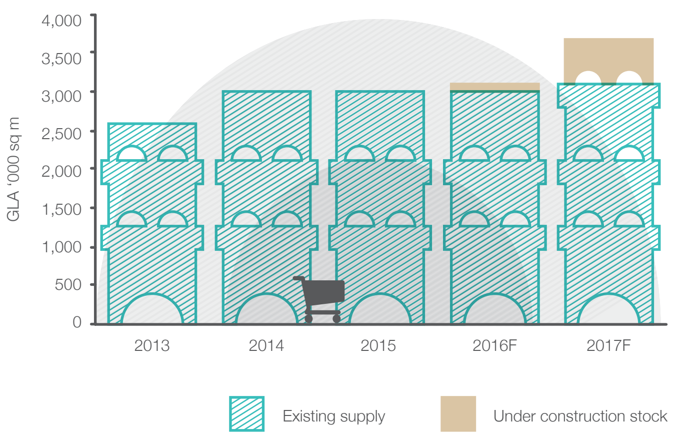
Occupancy rates in well-established malls such as The Dubai Mall and Mall of the Emirates in Dubai, and Yas Mall in Abu Dhabi remain high, indicating strong demand for retail units in the right location. Elsewhere, landlords are re-positioning their malls to meet the changing consumer habits, in order to remain competitive and ensure healthy occupancy rates.

FIGURE 9
Dubai retail supply



Source: Knight Frank Research

FIGURE 10
Abu Dhabi retail supply



Viewpoint

The retail market in Dubai & Abu Dhabi is expected to see slower growth levels over the second half of the year, as economic uncertainty and unfavourable currency exchange rates continue to impact both tourist and domestic spending.

In Dubai, the delivery of extensions to existing super-regional malls is likely to place downward pressure on rents in the short-to-medium term, while the lack of short-term supply completions will keep Abu Dhabi's retail market stable. However landlords are expected to become more flexible on lease terms; offering increased rent-free periods and further incentives to attract and retain the right occupiers to meet their tenant mix strategy.

In the long-term and as global uncertainties begin to ease and confidence in the market picks-up, we expect to witness another growth cycle for the retail market associated with growth in the hospitality and tourism industry. However, we believe retailers will have to diversify their offerings and introduce new products, technologies and marketing strategies to remain competitive in the market.

RESIDENTIAL MARKET

The residential market in Dubai maintained its stability in the year-to-April 2016. Despite an annual 9% Y-o-Y drop across the mainstream market, the General REIDIN sale price index remained relatively flat on a monthly basis, with no noticeable changes in the performance of both apartments and villas.

Dubai's prime market continued to outperform the market average. While the General REIDIN prime price index declined 5% in the YT April 2016 versus YT April 2015, encouragingly prices in the prime segment increased 2% on a quarterly basis between Q4 2015 and Q1 2016. The performance of prime apartments outweighed that of villas, with the index pointing to a 2% quarterly increase over the same period. In turn, prime villas recorded no significant price change.

A number of factors have supported this regulation in prices and are set to support the return of confidence to the market:

- **Government commitment to infrastructure spending.** While it is too soon to estimate the impact of the Expo 2020 on the residential sector, continued government spending on infrastructure projects geared towards the event (e.g. Route Metro 2020, Dubai Parks & Resorts) will promote confidence in the market and is expected to draw further inward capital.
- **Controlled supply.** There is a general consensus among developers of the need to phase out residential projects in line with demand.
- **Strong liquidity.** The residential real estate market in Dubai continues to attract capital from strong liquid markets such as Saudi Arabia and India; two of the traditionally top buyers of real estate in Dubai.

In Abu Dhabi, sale prices remained relatively stable on the back of a shortage in quality residential supply. The General REIDIN sale price index points to a 1% increase Y-o-Y in Q1 2016. While demand has declined on the back of corporate restructuring and cutbacks in government spending, this has been balanced by a slowdown in the delivery of projects, thus keeping the market steady.

FIGURE 11
Dubai prime vs. general residential sales index

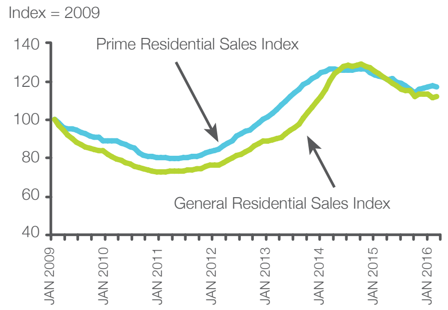
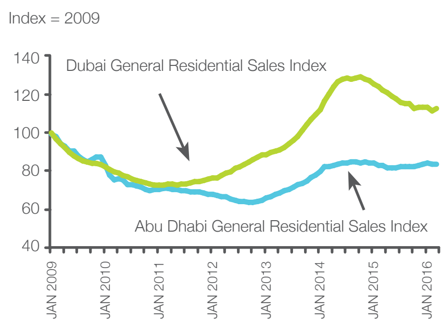
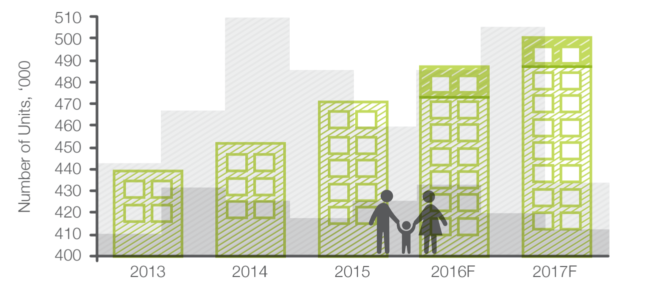


FIGURE 12
Abu Dhabi vs. Dubai general residential sales index



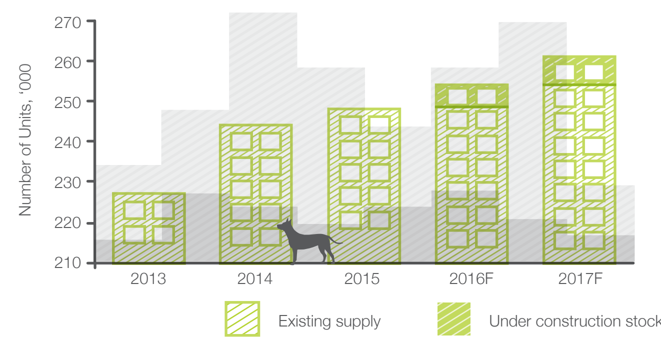
Source: REIDIN

FIGURE 13
Dubai residential supply



Source: Knight Frank Research

FIGURE 14
Abu Dhabi residential supply



Viewpoint

Looking ahead, the residential market in the UAE is expected to soften over the second half of the year. While it's difficult to predict when the next growth cycle will be, we expect the residential market to level out by the end of 2016 before seeing gradual recovery in 2017. On a segment split, we expect prime residential properties will continue to outperform the market average in the short-to-medium term.

Given Dubai's position as one of the top five global cities that matter to private high net worth individuals, based on Knight Frank's global Wealth Report, we expect the emirate to continue attracting investments both regionally and globally. However the outlook for the emirate in general and the real estate sector in particular depends on a number of fundamentals. Further volatility in oil prices, the EU referendum (June 2016), US presidential elections (November 2016) and on-going geopolitical tensions are likely to impact the behaviour of currencies, investor sentiment, and demand for property.

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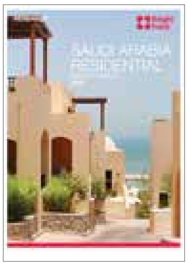

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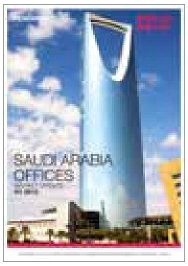

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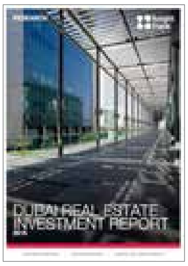

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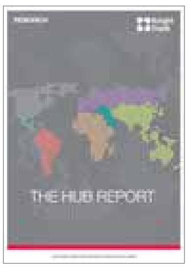

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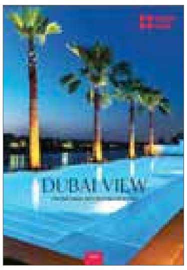
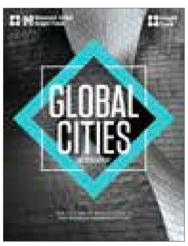


Dubai View 2015

Private View 2015 / 2016



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