COMMERCIAL RESEARCH

DUBAI OFFICE MARKET REVIEW Q3 2018

Key findings

Average office rents across Dubai softened by 5.8% year-on-year to Q3 2018.

Prime office rents in Q3 2018 registered at AED 246 (sq ft/p.a.), down 4.9% in the year to Q3 2018.

Vacancy in core prime assets remains as low as 1%.

Grade A rents fell 8.9% in the year to Q3 and now stand at AED 145 (sq ft / p.a.) on average.

Whilst demand has been subdued in 2018, after a strong start to the year, we believe that due to the easing of regulations, freezing of government fees, economic stimulus packages, and continued introduction of dual-licencing in Free Zones, demand is likely to tick up over the short term to medium term.

MATTHEW DADD

Partner, Occupier Services and Commercial Agency

"Whilst current activity remains subdued, there is a reasonable level of pent-up demand which is being restricted currently."

Due to increasing supply and a slowdown in new market entrants, Dubai's office market performance continues to soften in 2018. This has created an opportunity for existing occupiers, who are looking to take advantage of favourable market conditions.

Macroeconomic overview

Dubai's GDP grew 2.8% in 2017, down from 3.1% from a year earlier, according to data from Dubai Statistics Centre. A slowdown in the annual percentage growth in three out of the five largest economic sectors within Dubai has led to the overall growth rate slowing. On a broader level we have seen that of the 20 broad economic sectors in Dubai, 12 have seen the rate of growth slow in 2017. On a more positive note, all sectors, bar financial and insurance activities which registered a flat growth rate, have grown over the year.

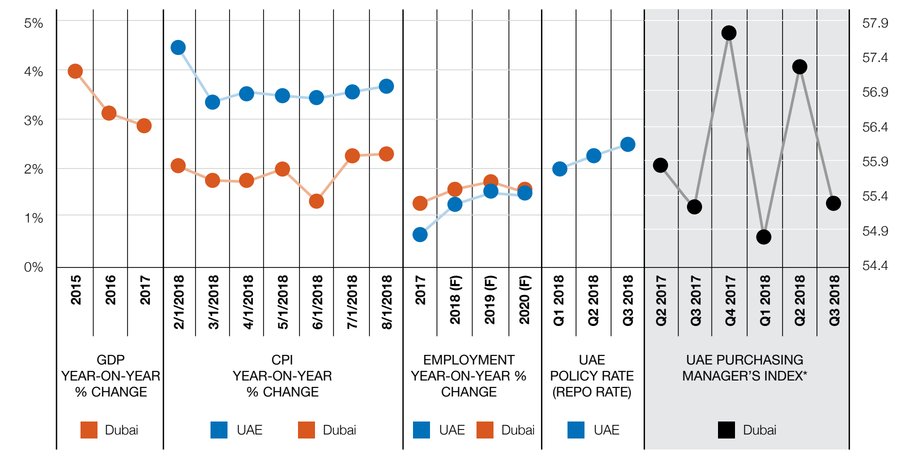
The outlook for Dubai's GDP in 2018 remains positive on the back of a strong global growth forecast by the IMF which stand at 3.7% for both 2018 and 2019. Furthermore, whilst Dubai is not effected as adversely by a slowdown in the regional hydrocarbon sector due to its diversified economic structure, the slowdown has impacted ancillary businesses which service this sector from Dubai given its regional hub and leading financial centre status. Therefore the increase in oil prices to an average of US$79.0 as at September 2018, up from US$55.4 a year earlier will help underpin economic growth this year.

Business sentiment somewhat reflects this more positive backdrop, the Emirates NBD Dubai Economy Tracker Index (DET) stood at 54.4 in September 2018 which is above the neutral 50 level indicating a relatively strong expansion in the non-oil sector. However, despite this the DET shows that employment fell slightly in September. More so, consumer demand remains weak with the selling price in Dubai's private sector declining for the fifth consecutive month, this is despite rising input costs, suggesting firms are having to cut margins in order to support demand.

Overall there is cautious optimism for Dubai's economy with GDP growth forecast at 3.5% and employment growth forecast to increase by 1.6% in 2018, up from 0.7% in 2017. The announcement of a host of changes to ease investment and residency laws alongside broad ranging stimulus packages will provide further support to these forecasts.

FIGURE 1

Economic indicators



Source: Knight Frank Research, Oxford Economics

**Note: A reading of 50 equates to no change, above or below representing growth or decline respectively*

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

Market review

Dubai's office market continues to see performance softening as a result of subdued market activity which has led to the market remaining tenant favourable.

In Q3 2018, we have seen limited activity from new corporate occupiers, with new licence issuances falling 9% year-on-year in the year to Q2 2018 according to data from Dubai Statistics Centre. The primary source of activity has come from firms looking to consolidate their commercial real estate portfolios or occupiers looking to downsize. On a positive note, these market conditions do provide opportunity for occupiers looking to take advantage of softer market conditions and as a result of this activity, landlords who actively manage their assets have fared better.

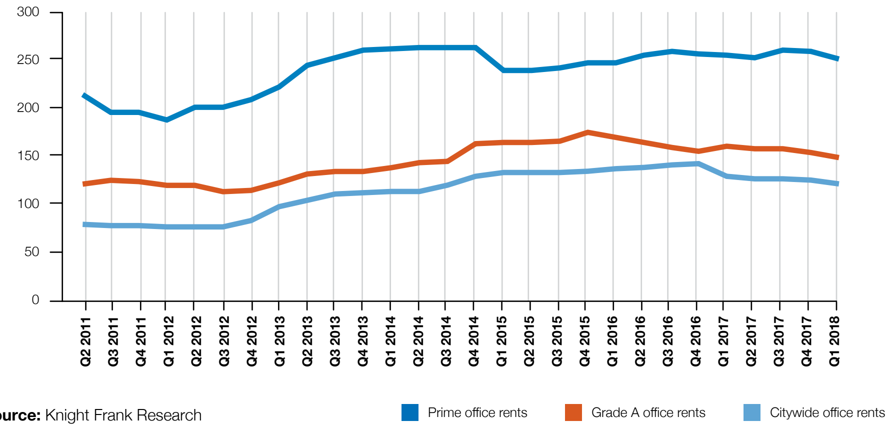
Whilst current activity remains subdued, there is a reasonable level of pent-up demand which is being restricted currently. This is as a result of two initial factors, first due to the restrictions in transferring licences from one Free Zone to another; the demand for which is increasing due to the continuing roll out of dual-licencing in Free Zones. Secondly, whilst some occupiers are willing to undertake these moves, many are in long term contracts which further restricts demand. Additionally, in the case of the prime sector, even if occupiers are able to overcome the aforementioned challenges, the lack of prime office product with the correct floor plate configuration is further limiting market activity.

As a result of these demand conditions, both institutional and private landlords have continued to be more proactive in sourcing and retaining clients. These landlords are continuing to offer rent free periods, delayed rent escalations, free parking and fit-out contributions on top of the lower market rents on offer.

More so, given this subdued market activity, we have seen rents soften across all segments of the market. Average office rents across Dubai softened by 5.8% year-on-year to Q3 2018, up from the 4.3% decline witnessed in Q1 2018.

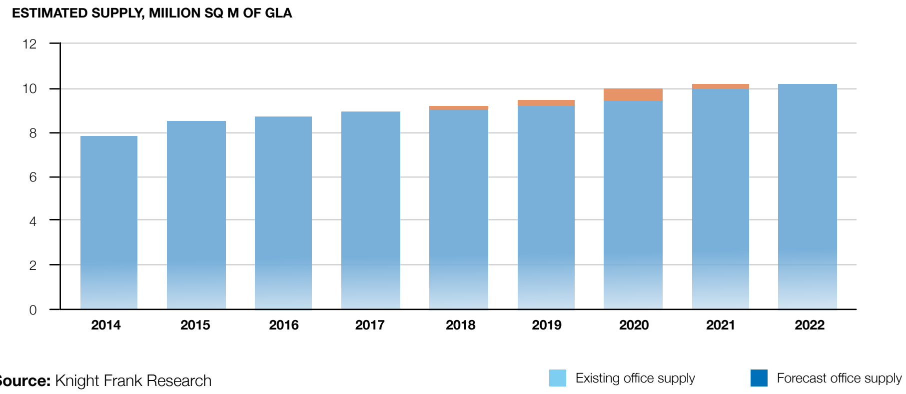
Prime office rents in Q3 2018 registered at AED 246 (sq ft/p.a.), down 4.9% in the year to Q3 2018. Vacancy in core prime assets remains as low as 1%, however

FIGURE 2
Dubai average office rents (AED/ sq ft/ p.a.)



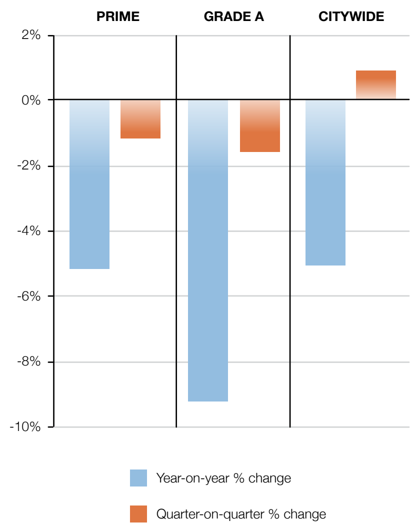
Source: Knight Frank Research

FIGURE 3
Dubai office supply



Source: Knight Frank Research

FIGURE 4
Dubai office market performance, to Q3 2018



Source: Knight Frank Research

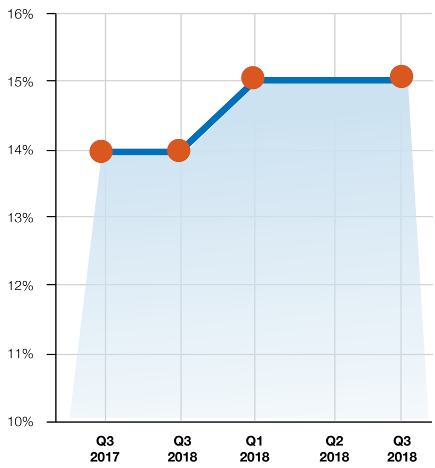
as you move towards the outskirts of these projects we are seeing this rate shift higher. As the Gate Avenue project nears completion we are likely to see the "core DIFC" expand and therefore this spread in vacancies fall.

Grade A rents fell 8.9% in the year to Q3 and now stand at AED 145 (sq ft/p.a.) on average. This rate is likely to continue to slide given a range of Grade A office supply due to enter the market and existing vacancy.

Citywide office rents fell 4.9% in the year to Q3 2018 to AED 123 (sq ft/p.a.), however in the citywide office market we are seeing fragmented market performance continue. Single-ownership assets continue to outperform strata owned stock which has underperformed, due not only to lack of quality but lack of demand for this type of space due to its long term disadvantages as businesses grow.

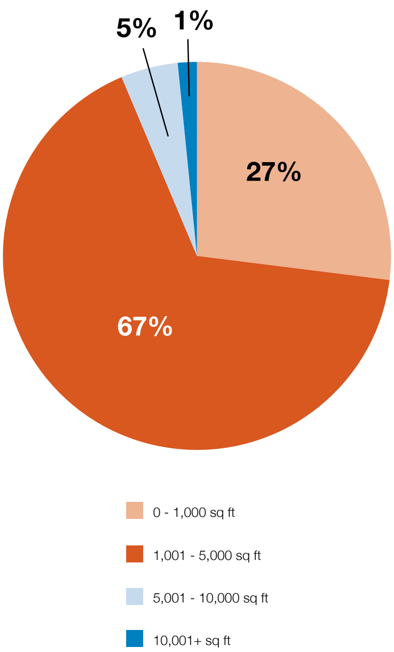
Healthcare firms were the single largest source of demand with 18.8% of demand coming from the sector. Finance, general trading and IT/ Technology firms accounted for the next three largest sources of demand with a share of 12.5% each of total enquiries. Furthermore, we are also continuing to see size requirements from clients continue to decrease, with 94% of space requirements being below 5,000 square feet.

FIGURE 7
Dubai vacancy rate



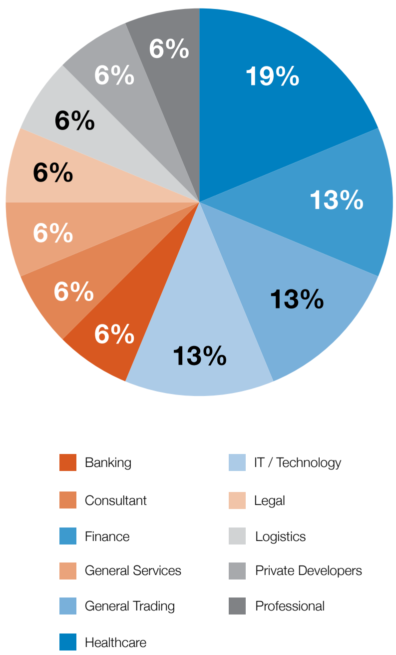
Source: Knight Frank Research

FIGURE 5
Proportion of enquiries by size (%), Q3 2018



Source: Knight Frank Research

FIGURE 6
Demand by sector (%), Q3 2018



Source: Knight Frank Research

TAIMUR KHAN
Research Manager

"Single-ownership assets continue to outperform strata owned stock which has underperformed, due not only to lack of quality but lack of demand for this type of space due to its long term disadvantages as businesses grow."

Outlook

The short to medium term outlook for Dubai's commercial market remains negative with rents expected to continue to decline across all market segments. This trend is likely to be primarily driven by the delivery of additional supply *(Figure 3)* which we expect to total at over 400,000 square metres by the end of 2019. However, the vast majority of this supply is concentrated in the Grade A and Citywide office market. As a result we expect that prime market rents are likely to be less impacted by the influx of new supply in the medium term.

Whilst demand has been subdued in 2018, after a strong start to the year, we believe that due to the easing of regulations, freezing of government fees, economic stimulus packages, and continued introduction of dual-licencing in Free Zones, demand is likely to tick up over the short term to medium term from both existing and new market entrants. However, there will naturally be a lag between the implementation and pick-up from corporate occupiers.

Definitions *(With guidance from the Best Practice Standards for Office Developments (2015 V2.0) by the Middle East Council for Offices (MECO):*

Prime: The Prime segment represents the average rent of the top 5% of all lettings in the market

Grade A: This segment of the market represents offices which are adjacent to the city centre, with rents on average higher than those in the citywide market

Citywide: This segment represents the broader city offices market, outside the 'core city', where usually a significant of office buildings are grouped

Composite: The composite data represents is an average of all aforementioned markets

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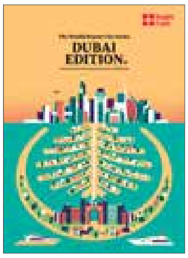

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