RESEARCH

UAE INDUSTRIAL & LOGISTICS

MARKET REVIEW **H1 2018**

THE UAE'S INDUSTRIAL AND LOGISTICS SECTOR CONTINUES TO MATURE DESPITE CHALLENGING MARKET CONDITIONS

UAE INDUSTRIAL & LOGISTICS MARKET REVIEW H1 2018

Knight Frank

Headlines

Grade B stock across both Abu Dhabi and Dubai's industrial and logistics zones have seen the most significant falls in achieved rents over the course of the 12 months to Q1 2018.

Rents in quality Grade A zones have bucked this trend in certain locations such as Jebel Ali Free Zone and Dubai Investments Park where rents increased by 16.7% and 6.7% over the year to Q1 2018.

In Abu Dhabi we have seen similar trends with locations such as KIZAD and Al Markaz remaining resilient relative to the wider market, albeit with rental rates still softening over the last year.

TAIMUR KHAN
Research Manager

"The tepid global and national economic backdrop has put pressure on industrial real estate in Abu Dhabi and Dubai. This is as a result of businesses which operate in this area succumbing to the weaker business and consumer demand, which has struggled to show meaningful signs of growth despite the resurgence in oil prices."

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

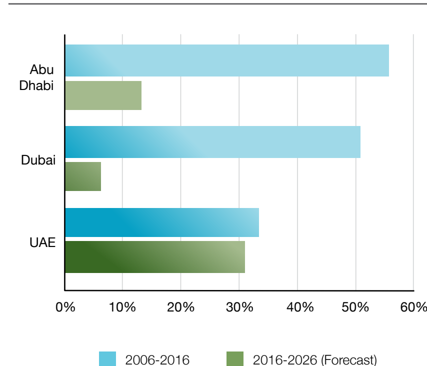
Macroeconomic and sector overview

As part of the UAE's economic diversification plan UAE Vision 2021, Abu Dhabi Economic Vision 2030 and Dubai's Industrial Strategy 2030, the development of the industrial sector is seen as a strategically important goal for sustained long term success of the national economy. The diversification initiatives are beginning to pay dividends, albeit slowly; as at 2016 the manufacturing and transport and storage industries were the fourth and fifth largest industries in the UAE respectively, contributing a combined 16.1% to GDP (production approach), up from 14.6% in 2010.

Over the 10 years to 2017, the UAE's industry sector (which consists of the extraction, manufacturing, utilities and construction sectors) has grown by 31% and is forecast to grow a further 34% in the next 10 years to 2027, according to data from Oxford Economics. Over the same 10 year period to 2027, Abu Dhabi's industry sector is forecast to grow 56% and Dubai's by 51%, up from 13% and 6% over the decade to 2017 respectively. Presently this sector employs over two million people which accounts for around a third of total employment within the UAE.

Given the strategic location of the UAE - which provides access to over three billion people within the MEASA region and up to five billion people within an eight hour flight time - aided by the country's modern infrastructure *(Figure 2, The Knight Frank Hub Report also provides a more in-depth benchmarking report of the UAE's industrial sector)*. It comes as little surprise that many multi-national firms are continuing to use the UAE as their regional supply and re-distribution gateway *(Figure 3)*.

FIGURE 1
Industry, gross value added, % growth



Source: Knight Frank Research, Macrobond

For many global industrial and logistics firms, the traditional entry point to the market has been through the various Free Zones which have been set up in Abu Dhabi and Dubai *(Figure 3)*. These have allowed firms to keep 100% ownership alongside other benefits such as tax advantages and exemptions from customs and excise duties. However, there are some limitations of operating purely in a Free Zone (offshore) namely that offshore firms are limited to operate only within the Free Zone boundaries - that is they are not able to trade with mainland UAE firms or bid for government contracts. The alternative is to set up an onshore business, however this requires an Emirati partner to hold majority ownership within this business, something which most global firms are still not comfortable with.

To try and overcome the barrier, we have seen the introduction of dual licencing which allows firms to operate onshore (with an Emirati partner for this portion of the business) as well as offshore without the requirement of onshore business premises. Whilst we have seen this practice introduced in the likes of Abu Dhabi Global Market, Dubai International Financial Centre and Dubai Airport Free Zone, it has not become widely available in the other industrial and logistics Free Zones. The more rigid structure may have contributed to the tame growth rates we note above, compared to growth rates witnessed in other business sectors. For example, the business and financial services sector's growth registered at 46% over the last decade compared to the aforementioned industry growth of 31%.

To address this barrier which may be stifling foreign investment and to encourage further investment from multi-national firms, the UAE Cabinet has approved a range of legislation which will ease investment laws in all of its seven Emirates. Announced by HH Sheikh Mohammed bin Rashid Al Maktoum, the

Vice President and the Prime Minister of the UAE and Dubai Ruler, the changes of note include allowing 100% foreign ownership of firms within the UAE outside of dedicated Free Zones.

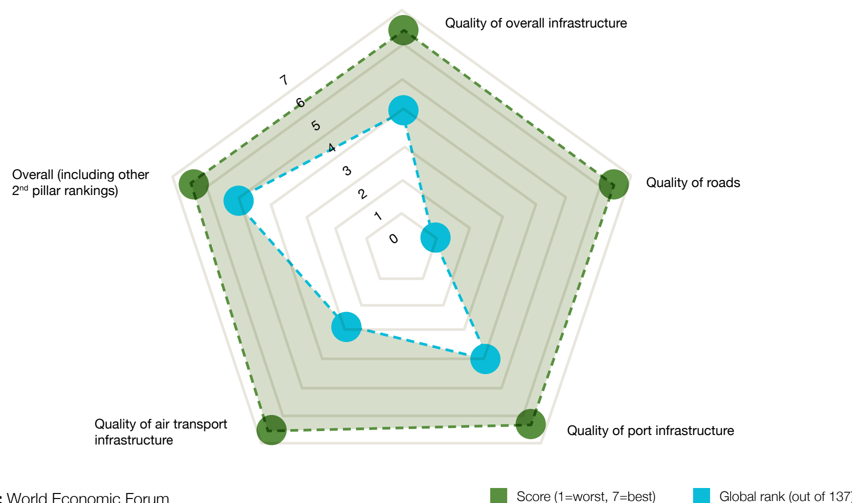
Whilst the details of the proposed legislation are still to be released, such as the industries which are likely to receive 100% onshore ownership permissions, there are indicative signs that it is fairly likely that the industrial and logistics sector will be chosen as one of the selected sectors. Given the UAE's status as a global hub and overall business friendly environment, alongside the continued growth of the industrial and logistics sector both regionally and globally where the UAE is ranked first in the World Bank's ease of doing business survey across the Middle East and Africa. These changes are likely to fuel demand for multi-national firms to set up a regional operations to service not only the GCC countries, but also the wider MEASA region, particularly in the e-commerce sector as trends shift more towards online retailing.

Whilst the above factors have impacted the sector, it is important to note that there have been other factors which may have also contributed to this slower than expected growth rate. Given the sharp fall in commodity prices from 2014 to early 2016 and lacklustre global economic and trade growth over the same time period demand for industrial and logistics facilities was particularly sparse. Most existing occupiers adopted a wait-and-see approach before committing to any expansion plans.

However mid-2017 seems to have been a turning point for the global economy which in turn has underpinned the growth in global trade volumes. This positive economic climate looks set to continue on the back of stronger global growth forecasts by the IMF, up 0.2% to 3.9% for both 2018 and 2019. This combined with 100% foreign ownership legislation, recent fiscal stimulus packages in both Abu Dhabi and Dubai, easing of business regulations and reduction in government fees for businesses, easing of residency and investment laws in the form of visas up to 10 years may mean we will see an increase in demand from residents and foreign investors. We expect to see this reflected in longer lease term commitments as a result of companies and investors committing to the region owing to the more generous visa opportunities for certain sectors. In turn, this will allow for mature investors such as REIT's and funds to look more seriously at the region. As a result GDP growth for 2018 for the UAE is forecast to register at 3.3% up from the estimated 1.7% registered a year earlier. This is likely to

FIGURE 2

UAE, World Economic Forum, Global infrastructure rankings (2nd pillar)



Source: World Economic Forum

FIGURE 3

Key multinational industrial and logistics firms operating in the UAE

DUBAI

Al Quoz	Al Qusais	Ras Al Khor	Al Rashidiya	JAFZA	Jebel Ali Industrial Area	Dubai Industrial Park	Dubai South
Belhasa Motors Co. LLC	Caterpillar	Nissan/Infinity	Emirates Post	Dubai Petroleum Company	Landmark Group	Unilever	IKEA
Masafi Co. (LLC)	TNT	Geekay Group	Gulf Transport Co.	Shell	Al Tayer Motors	Al Naboodah	Nestle
United Foods Company (PSC)		JBC		Airlink International	Jumbo Electronics	Boschmann Electronics	Lufthansa Technik
ANC Holdings				DP World		Penguin Engineering	Execujet
Fed Ex				Siemens		UPS	Amazon
Pepsicola				DHL		Kanoo Group	
				Fed Ex			

ABU DHABI

Mussafah	Industrial City of Abu Dhabi	Abu Dhabi Airport Freezone
Samsung Service Centre	Gemini Technical Industries	First Abu Dhabi Bank
Dulsco	Spinneys	Etihad
Ford service centre	DUCAB	Fedex Express
Pharma Link		Royal Jet
Audi Service Centre		

Source: Knight Frank Research

be further supported by higher oil prices which reached up to US$80 in May, the highest level since November 2014.

Regional competitiveness

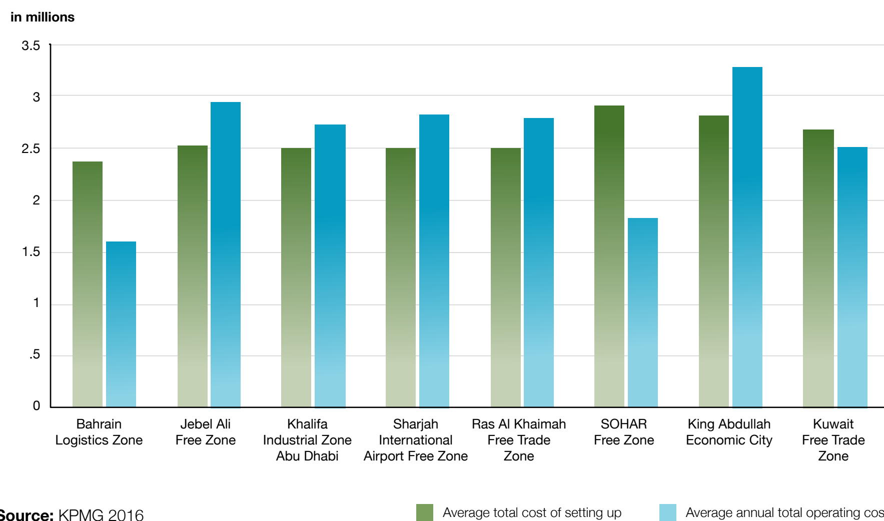
Whilst the UAE has very much cemented its position as the regional hub for global businesses to set up a base to service the MEASA region, we are seeing a range of reforms in other GCC countries which has led to the opening up of these economies.

Part of these reforms have been aimed at either the creation or easing of regulations in existing logistics and industrial Free Zones. As a result multinational firms are more open to considering these locations for their operations.

Using data from KPMG's *Cost of Doing Business Report 2016*, which focuses on typical costs associated with setting up and operating a logistics business across key logistic centres in GCC countries, we briefly analyse the differences in cost below for key locations and note overall that due to the opening up of markets in the region, the industrial and logistics sector is becoming more competitive than ever. Therefore respective authorities must now carefully analyse the implications of fees such as set-up fees, governmental fees, visa costs and ports and customs fees. The culmination and significance of these costs will have a marked impact on the final decision for multinational firms. Previously the availability of existing real estate stock had been a much more important factor but as ownership rules are relaxed and built-to-suit options of an institutional specification become the norm, overall operating costs are becoming much more attractive. Should the proposed visa changes include the manufacturing and logistics sectors, multi-national occupiers will be able to look more realistically at potential longer term commitments to the region which is a key consideration on their initial fit-out costs

FIGURE 4

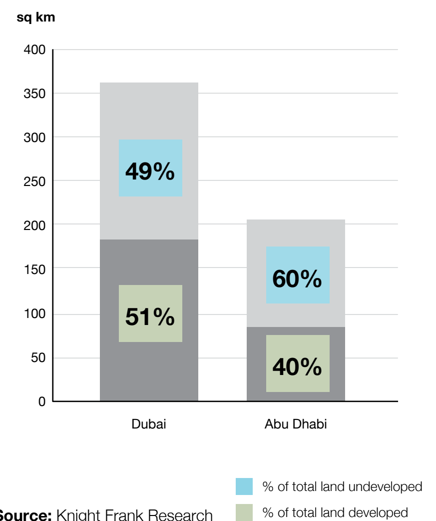
Indicative cost of doing business in GCC countries, in USD (2016)



Source: KPMG 2016

FIGURE 5

UAE's Industrial area development, sq km



Source: Knight Frank Research

FIGURE 6

Abu Dhabi and Dubai free zones overview

DUBAI

Location	Dubai Airport Free Zone	Al Quoz	Al Qusais	Ras Al Khor	JAFZA	Jebel Ali Industrial Area	Dubai Industrial Park	Dubai Investment Park	Dubai South	Dubai Maritime City
Established	1996	1973	1975	1976	1985	1995	2004	1997	2006	2007
Status	Free Zone	Non Free Zone	Free Zone	Non Free Zone	Free Zone	Non Free Zone	Non Free Zone	Non Free Zone	Non Free Zone / Free Zone	Non Free Zone
Total area (sq km)	0.7	27	8	12	56	22	32	23	146	2.3
Time to airport	Located next to DXB	25 minutes to DXB	15 minutes to DXB	18 minutes to DXB	25 minutes to DWC	15 minutes to DWC	20 minutes to DWC	15 minutes to DWC	Located next to DWC	20 minutes to DXB

ABU DHABI

Location	Mussafah	Industrial City of Abu Dhabi	Khalifa Industrial Zone Abu Dhabi (KIZAD)	Abu Dhabi Airport Free Zone
Established	1998	2004	2010	2006
Status	Non Free Zone	Non Free Zone	Free Zone	Free Zone
Total area (sq km)	N/A	40	100	12
Time to airport	17 mins to AUH	15 mins to AUH	30 minutes to AUH & DWC	Located next to AUH

Source: Knight Frank Research

DXB - Dubai International Airport / DWC - Al Maktoum International Airport / AUH - Abu Dhabi International Airport

Key findings

- Bahrain Logistics Zone ranks lowest for both setup costs and annual operating costs and as a result is the cheapest location among GCC countries.
- SOHAR Free Zone has the highest set up costs however ranks second lowest for annual operating costs.
- King Abdullah Economic City currently ranks highest for annual operating costs.

An evolving landscape—build to suit: National Industries Park case study

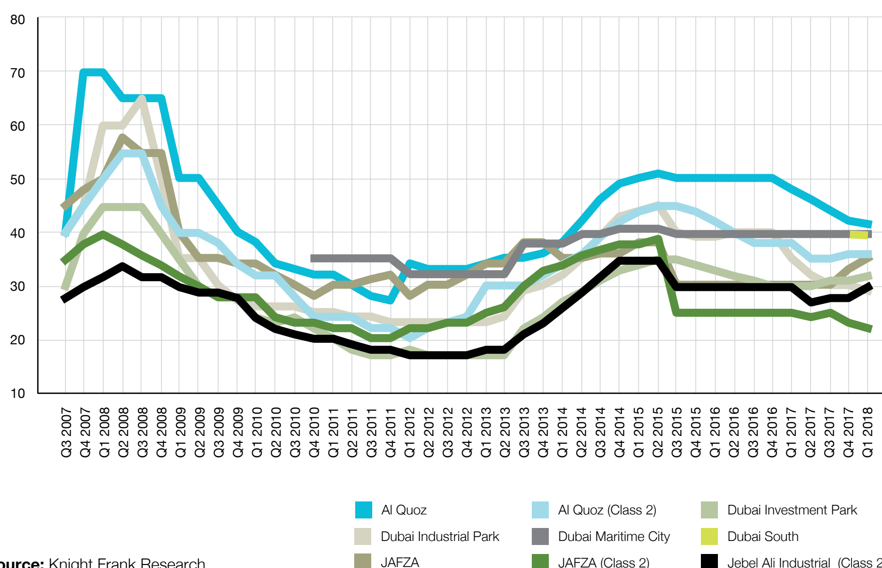
National Industries Park (NIP), formerly known as Dubai Techno Park, is an industrial park comprising of over 230 million square feet of land and is located within Dubai's industrial area aimed at international company formation across a variety of sectors.

The inception of NIP is aimed at addressing the undersupply of Grade A quality industrial and logistics units within Dubai, particularly stock which provides good accessibility to land, freight, shipping facilities and good quality infrastructure.

The bulk of existing facilities for many new entrants are no longer fit for purpose. As more sophisticated businesses decide to enter the market we have seen the requirements for industrial and logistics real estate change rapidly. Much of the existing stock is either below par in terms of quality, is made up of smaller multi-tenant units, lacks connectivity and the dual licence structure – which is vital for industries such as e-commerce. More so, even where lessees have space which may be good quality stock, the significant surcharges on subleasing often discourages this practice from occurring.

As a result we are seeing new areas such as NIP attracting new market entrants via the build-to-suit route with typical unit sizes being above 10,000 square metres. Existing firms are also choosing to relocate to these areas consolidating their various facilities and reducing their overall space utilisation as a result. This trend is not a surprising one, as noted in Knight Frank's *Future Gazing Logistics Report*: real estate product ultimately

FIGURE 7
Average Dubai Industrial Rents, AED per sq ft, per annum

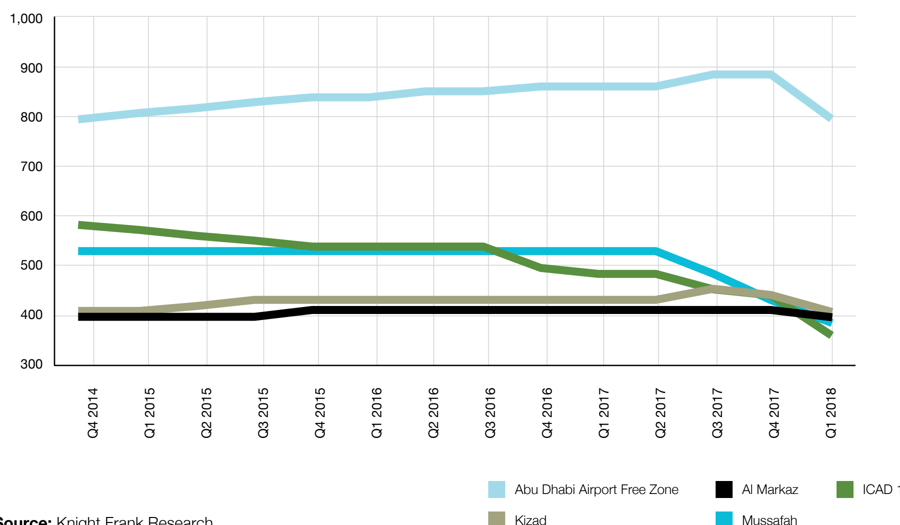


Source: Knight Frank Research

TOM SWALLOW
Senior Surveyor, Occupier Solutions Commercial Agency (OSCA)

"The bulk of existing facilities for many new entrants are no longer fit for purpose. As more sophisticated businesses decide to enter the market we have seen the requirements for industrial and logistics real estate change rapidly. Much of the existing stock is either below par in terms of quality, is made up of smaller multitenant units, lacks connectivity and the dual licence structure – which is vital for industries such as e-commerce."

FIGURE 8
Average Abu Dhabi industrial rents, AED per sq m, per annum



Source: Knight Frank Research

needs to reflect the requirements of the end user. As technology takes hold in a variety of ways particularly in automation of occupier operations, there will be a divergence of occupier requirements that will be difficult to satisfy speculatively. As industrial real estate becomes more of a source of strategic and competitive advantage, occupiers will be prepared to work in partnership with the developers and landlords and make long-term commitments to product that suits their operational requirements and has the required levels of future proofing. As a result the next phase of the industrial property cycle in the UAE is mimicking the one we are seeing globally where bespoke product that is leased is typically constructed to an institutionally acceptable standard that can then be altered to suit individual occupier requirements.

Market overview

The tepid global and national economic backdrop has put pressure on industrial real estate in Abu Dhabi and Dubai. This is as a result of businesses which operate in this area succumbing to weaker business and consumer demand, which has struggled to show meaningful signs of growth despite the resurgence in oil prices – which at the end of May 2018 stood at almost US$78 per barrel.

Alongside this, as the specification, location and labour elements of industrial and logistics businesses change – the speed of these changes has been amplified by the emergence of new technology - we are seeing that the real estate provisions that industrial and logistics clients require have also changed. A reasonable proportion of the current stock within both Abu Dhabi and Dubai's market does not meet this criteria, therefore it is little surprise that we have seen average rents fall across most markets.

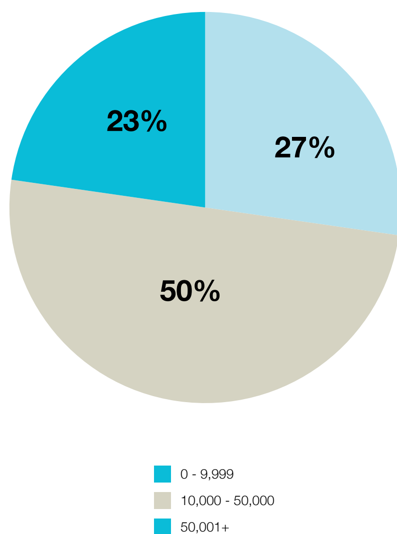
Grade B stock across both Emirates' industrial and logistics zones has seen the most significant fall in achieved rents over the course of the 12 months to Q1 2018, as can be seen in figures 7 and 8. However, rents in quality Grade A zones have bucked this trend in certain locations such as Jebel Ali Free Zone and Dubai Investments Park where rents increased by 16.7% and 6.7% over the year to Q1 2018. In Abu Dhabi we have seen similar trends with locations such as KIZAD and Al Markaz remaining resilient relative to the wider market, albeit with rental rents still softening over the last year.

During this time period we also witnessed a flight to quality with some occupiers using the slower market to negotiate favourable terms which during previous cycle may not have been within their price range. This includes leasing premises with greater eaves height, larger units with more efficient designs and those located in preferential locations.

Demand in the industrial and logistics sector year-to-date 2018 has been witnessed in the majority from Industrial Manufacturing, General Services, Aviation, SMEs and IT/Technology firms. Anecdotally we are also seeing that there is an increasing demand from E-commerce businesses and from food and perishable goods businesses.

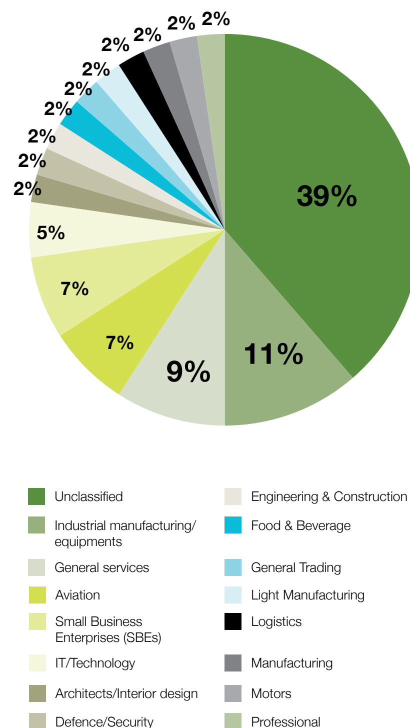
Over 82% of enquiries year-to-date have required space in either JAFZA or Dubai Industrial Park. Dubai South accounts as the third most enquired location.

FIGURE 9
Enquiries by size, sq ft



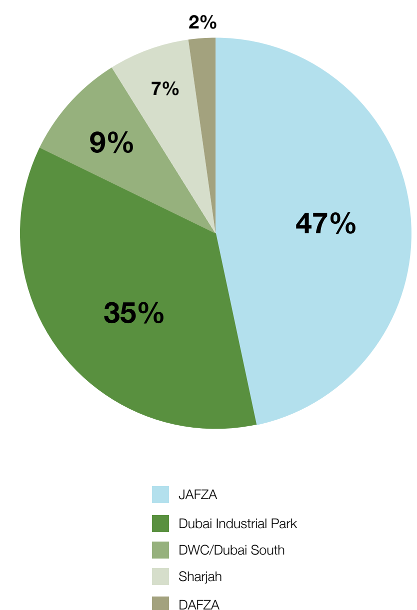
Source: Knight Frank Research

FIGURE 10
Demand by sector, (as % of total)



Source: Knight Frank Research

FIGURE 11
Demand by location



Source: Knight Frank Research

Year-to-date we have also seen that 50% of demand has been for space between 10,000 - 50,000 square feet, 27% of demand has been below 10,000 square feet and 23% of total demand requiring space over 50,000 square feet.

Outlook

Looking ahead we envisage that the fragmented market trends between Grade A and Grade B will continue, with sub-par Grade B facilities continuing to see rental rates decline. As these Grade B units are eventually brought up to similar standards to those seen in Grade A markets – either by refurbishing or demolishing the unit or built-to-suit solutions. As this gap in the class of stock closes, industrial and logistics zones which are located in close proximity to road transport, air freight and port transport networks are likely to be able to demand premium rents even above Grade A rental levels.

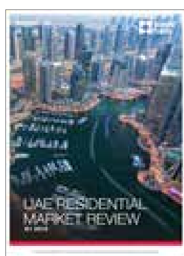
MATTHEW DADD
Partner, Occupier Solutions Commercial Agency (OSCA)

"Due to the opening up of markets in the region, the industrial and logistics sector is becoming more competitive than ever. Therefore respective authorities must now carefully analyse the implications of fees such as set-up fees, governmental fees, visa costs and ports and customs fees. The culmination and significance of these costs will have a marked impact on the final decision for multinational firms".

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Abu Dhabi Office Market Review Q1 2018

Dubai Office Market Review Q1 2018



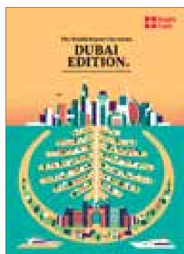
UAE Residential Market Overview Q1 2018

UAE Hospitality Report 2018

UAE Market Review & Forecast 2018

The World's Smartest City - Dubai

The Hub Report 2018



The Wealth Report City Series: Dubai Edition

Knight Frank Research Reports are available at **KnightFrank.com/Research**

Regional offices in:

Botswana • Kenya • Malawi • Nigeria • Rwanda • Saudi Arabia • South Africa Tanzania • UAE • Uganda • Zambia • Zimbabwe

RESEARCH

Taimur Khan
Research Manager
+971 56 4202 312
taimur.khan@knightfrank.com

COMMERCIAL LEASING & AGENCY

Matthew Dadd, *MRICS*
Partner
+971 56 6146 087
matthew.dadd@me.knightfrank.com

Tom Swallow, *MRICS*
Senior Surveyor
+971 56 4542 976
tom.swallow@me.knightfrank.com

DEVELOPMENT CONSULTANCY & RESEARCH

Harmen De Jong
Partner
+971 56 1766 588
harmen.dejong@me.knightfrank.com

VALUATION & ADVISORY SERVICES

Stephen Flanagan, *MRICS*
Partner
+971 50 8133 402
stephen.flanagan@me.knightfrank.com

CAPITAL MARKETS / INVESTMENT

Joseph Morris, *MRICS*
Partner
+971 50 5036 351
joseph.morris@me.knightfrank.com

MEDIA & MARKETING

Nicola Milton
Head of Middle East Marketing
+971 56 6116 368
nicola.milton@me.knightfrank.com

Important Notice

© Knight Frank 2018 - This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank to the form and content within which it appears.

Knight Frank UAE Limited (Dubai Branch) Prime Star International Real Estate Brokers (PSIREB RERA ORN: 11964 trading as Knight Frank with registration number 653414. Our registered office is: 5th Floor, Building 2, Emaar Business Park, PO Box 487207, Dubai, UAE.

Knight Frank UAE Limited (Abu Dhabi Branch) is a foreign branch, with registration number 1189910. Our registered office is Unit 103, West Tower, Abu Dhabi Trade Center, Abu Dhabi, PO Box 105374, Abu Dhabi, UAE.