RESEARCH

Knight Frank

DUBAI COMMERCIAL OVERVIEW

Q1 2017

IMPROVING MARKET SENTIMENT IN A CHALLENGING GLOBAL ECONOMY

Despite subdued market performance in 2016, the commercial market in Dubai has demonstrated partial recovery in Q1 2017, with sentiment continuing to gain momentum as international occupiers remain committed to Dubai as a regional commercial hub.

Market overview

- The commercial market in Dubai saw weaker performance in 2016 triggered by the volatility in oil prices and global economic uncertainties. As such, many corporates looked to minimise their capital expenditure and consolidate their operations or renew their leases rather than expand.
- Responding to these conditions, 2016 saw landlords offer greater incentives and flexibility in lease terms as the market dynamic shifted in favour of occupiers. Initiatives to attract and retain tenants included rent reductions, offering fitted and furnished offices with utilities included in the service charge, and longer initial rent-free periods.
- In terms of performance, TECOM Free zone (namely Dubai Internet City/Media City) and the Dubai International Financial Center (DIFC) maintained high rental levels as occupancy levels remain strong; Their Freezone status, quality of space, developed surrounding infrastructure and proximity to amenities such as retail and F&B continue to work in their favour.
- Meanwhile the performance of up and coming areas such as the Dubai Design District (D3) stabilised as rents increased substantially following a period of strong occupancy levels. This marginalised many occupiers and resulted in weaker demand.
- Occupancy of Grade B strata owned assets particularly in Business Bay, where the infrastructure remains underdeveloped, continued to drop, as demand for these remains low.
- However despite subdued performance, Dubai's commercial market remains the most resilient in the region. This stems from the emirates strong appeal amongst international occupiers and their commitment to Dubai as a regional hub for their operations. This is reflected in the fact that occupiers such as HSBC are pressing ahead with build-to-suit office schemes.

"Responding to these conditions, 2016 saw landlords offer greater incentives and flexibility in lease terms as the market dynamic shifted in favour of occupiers."

MATTHEW REASON
Surveyor

CURRENT MARKET TRENDS

Location matters

- Location remains one of the main drivers behind occupiers' choice of office space with the Dubai International Financial Centre (DIFC) and Sheikh Zayed Road being the primary preferences, based on the number of enquiries in Q1 2017 (27% and 20% respectively). Commercial towers along SZR provide easy access and are serviced by metro stations, making them popular among local and international corporates.
- Since its inception the DIFC has served as the ideal platform for international and local businesses and financial institutions looking to operate within a transparent regulatory and legislative framework. The DIFC also benefits from its offshore/free zone licensing status, in addition to boasting a variety of world-class amenities including restaurants and sports facilities.

Build-to-suit

- The lack of availability in Grade A office buildings is pushing occupiers to seek build-to-suit opportunities. This evolving trend enables corporate occupiers to build according to their specifications. Key examples of this include the HSBC building and Standard Chartered building in Downtown. We expect this trend to continue as international organisations continue to build and develop their regional presence in Dubai.

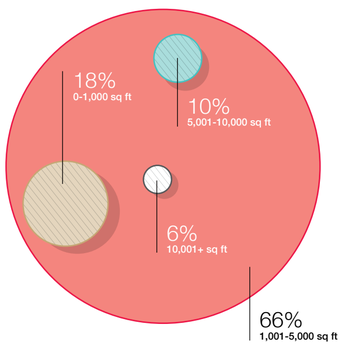
Strong growth in enquiries from healthcare & pharmaceuticals

- While office enquiries from the general trading services remains the most active, 2016 saw growth in enquiries from the healthcare & pharmaceuticals industry. This comes as the emirate aims to achieve a world-class healthcare system and feature as a leading destination for medical tourism.

Medium size office space in demand

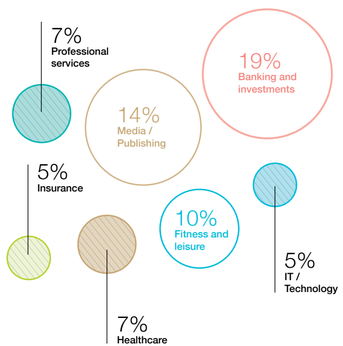
- Under restrained market conditions, the majority of office demand in 2016 was confined to spaces between 1,000 – 5,000 square feet. It is our view that this reflects occupier caution in the face of challenging economic conditions. In turn, Q1 2017 saw an increase in enquiries for 1,000 – 5,000 sq ft of office space which confirms current sentiment.

FIGURE 1
Dubai size requirements



Source: Knight Frank Research

FIGURE 2
Key demand by sector, Q4 2016 - Q1 2017



Source: Knight Frank Research

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

FUTURE MARKET TRENDS

Growth of commercial REITs

- The growth of REITs as a commercial investment vehicle is expected to bring further liquidity to the real estate market in Dubai and is likely to attract global investors as it signals market maturity. Despite housing some international Grade A properties, Dubai's commercial market remains under supplied in terms of quality investment grade products. REITs could therefore present an attractive opportunity for investors looking to diversify their portfolios and hedge their risk.
- The launch of the UAE's first REIT (Emirates REIT) with a seed portfolio of AED 418 million was a welcome step for the sector. Then earlier in March 2017, Emirates NBD Asset Management listed a REIT on Nasdaq Dubai which raised USD 105 million.

Prime locations remain in high demand

- The DIFC is expected to maintain its strong appeal among corporate occupiers, particularly with the delivery of ICD Brookfield Place. The USD 1 billion development consists of 54 storeys of Grade A office and retail space. The top three floors of the tower are being built as Sky View suites with internal gardens and the project has been designed with a view to achieving LEED Gold certification.
- In addition the DIFC is set to benefit from the biggest single infrastructure project it has launched since its inception. The Gate Avenue (previously known as The Spine) will link the main Gate and Village districts in the north of the DIFC to the other commercial and residential towers including Index Tower and Burj Daman. The Avenue will comprise 660,000 sq ft of built-up area including retail, leisure & dining, a mosque and social green spaces.

Expanding logistics landscape is set to support future demand for office space

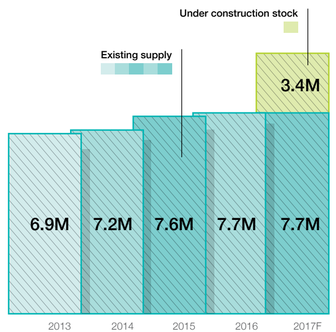
- As Dubai continues to push towards diversifying its economy and attracting talent, enquires for office space stemming from the industrial and logistics market is expected to increase. Demand is also likely to come from the Fast Moving Consumer Goods (FMCG) general trading sector

Breaking new grounds

- As mega projects such as the expansion of Al Maktoum International Airport and the planned Red Line metro extension (Route 2020), demand for commercial office space in and around Dubai South is expected to gain traction.

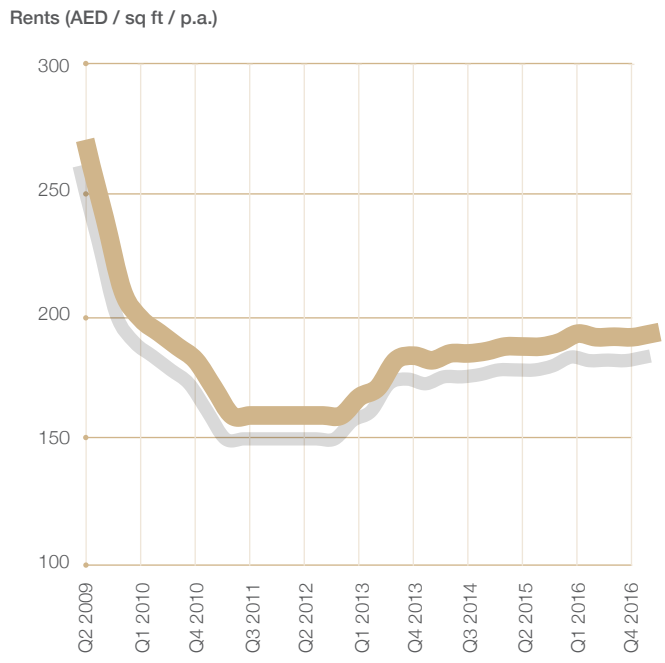
The Dubai metro

FIGURE 3
Dubai office supply, GLA thousand sq ft



Source: Knight Frank Research

FIGURE 4
Dubai Grade A office rents



Source: Knight Frank Research

Market Outlook

- Our outlook for Dubai remains positive in 2017 as oil prices are expected to regain some of the losses previously recorded. This is expected to boost government revenues and increase spending particularly on infrastructure and development projects. In light of this, preparations for the Expo 2020 are likely to go ahead in full steam, with investments focused on the expansion of the metro, airport and roads network along with tourism facilities and real estate. Investments in these sectors are expected to support the overall growth of the economy.

- 2017 is expected to hold many possibilities for tenants, but is likely to be a challenging year for landlords. With the recent stabilisation in oil prices and strong commitment to government investment, occupier sentiment has improved and companies are now starting to resume their office searches capitalising on greater landlord motivation.

- Stock levels are expected to increase in 2018, with developments such as ICD Brookfield, Gate Village 11, One Central and HSBC Headquarters all coming online. This will bring a welcome addition to the current limited levels of international grade A quality space available in Dubai, and is expected to attract further demand.

- We remain cautious of external challenges which may hinder economic growth. Any decision by the US Federal Reserve to increase the interest rates further will strengthen the USD and consequently the UAE Dirham. This will likely put pressure on the cost of living and challenge the competitiveness of the UAE. In addition, on-going global political uncertainties are likely to impact the performance of financial markets, which in turn will dent sentiment.

- As the market awaits further details, the introduction of VAT in January 2018 will undoubtedly impact costs.

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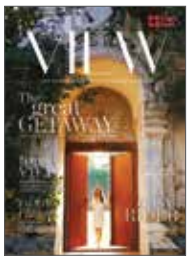

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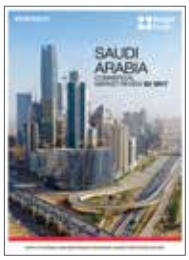

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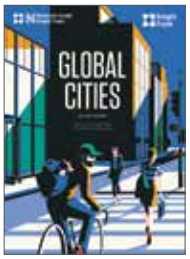

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