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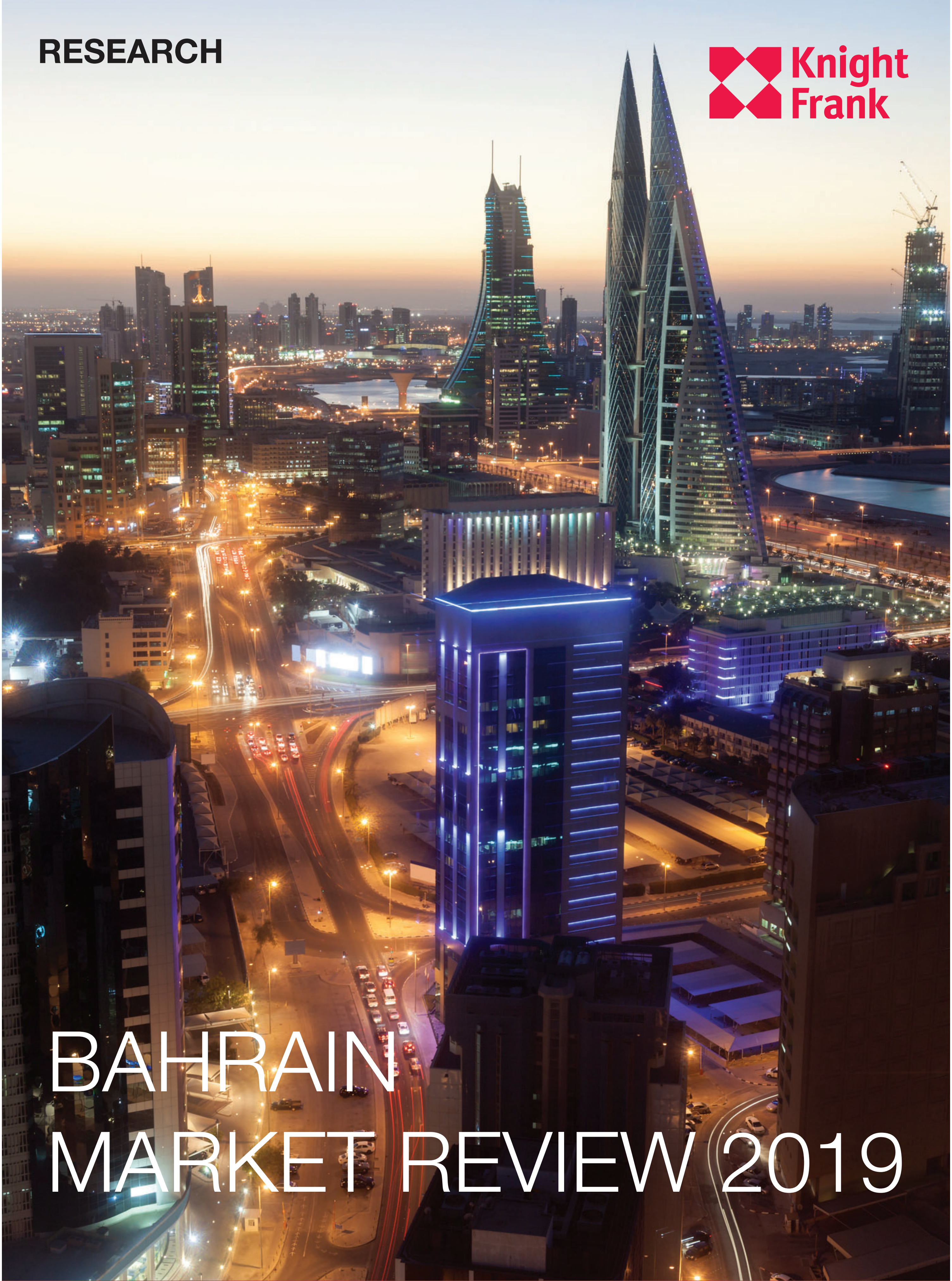


BAHRAIN MARKET REVIEW 2019

RENTAL RATES STABILISE THROUGH 2018 • OVERSUPPLY CONTINUES TO WEIGH ON MARKET PERFORMANCE • OCCUPANCY RATES STAND AT CIRCA 40%

BAHRAIN MARKET REVIEW 2019

Key findings

On the back of reforms, easing of regulations, continued investment in large scale projects and higher oil prices, GDP growth is expected strengthen to 2.8% and employment is expected to expand by 2.5% in 2019.

Over recent years Manama's office market has become favoured towards tenants. As a result of the more tepid economic backdrop we have seen subdued demand, with rents across all market segments seeing significant declines. In 2018 we have witnessed rents remain relatively stable.

Bahrain's hospitality sector has traditionally attracted regional GCC visitation, particularly from Saudi Arabia via the King Fahd Causeway. As a result of Bahrain's overnight stay sources, its hospitality market has historically had challenges in relation to driving occupancy rates.

Looking ahead we may begin to see international visitation from outside the region increase as the country's national airline expands its network alongside Bahrain International Airport's expansion.

MATTHEW DADD
Partner, Occupier Services and Commercial Agency

"Bahrain continues to be an attractive and cost effective location for firms looking to setup a base in the GCC. Particularly as the region's largest economy, Saudi Arabia continues to open up, Bahrain will increasingly be considered as a hub location given its direct access to Saudi Arabia."

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

Macroeconomic overview

Across the GCC nations a range of economic diversification efforts are starting to pay dividends, with sectors such as business and financial services, Fintech, industrial and manufacturing starting to become integral to regional economies.

This pivot was required post 2014, where the collapse in oil prices exposed weaknesses in the economic structure of many GCC countries. From 2011 to 2014 the average annual GDP growth rate of GCC nations stood at 5.0%; post the collapse, in the period from 2015 to 2018, we have seen average GDP growth slow to 2.2%. As most GCC nations relied on revenues from the hydrocarbon sector as the main source of funds for government spending, the resulting impact on spending and debt to GDP ratios has been profound.

This has been the case for Bahrain more so than any other GCC nation, where the gross general government debt increased from 44% of GDP in 2014 to an estimated 88% in 2018. More so, as a result of this indebtedness raising additional debt has become more challenging. These factors have had a marked impact on economic activity, with GDP growth expected to have slowed again in 2018. Initial estimates expect Bahrain's GDP growth rate to register at 2.6% in 2018, down from 3.8% a year earlier.

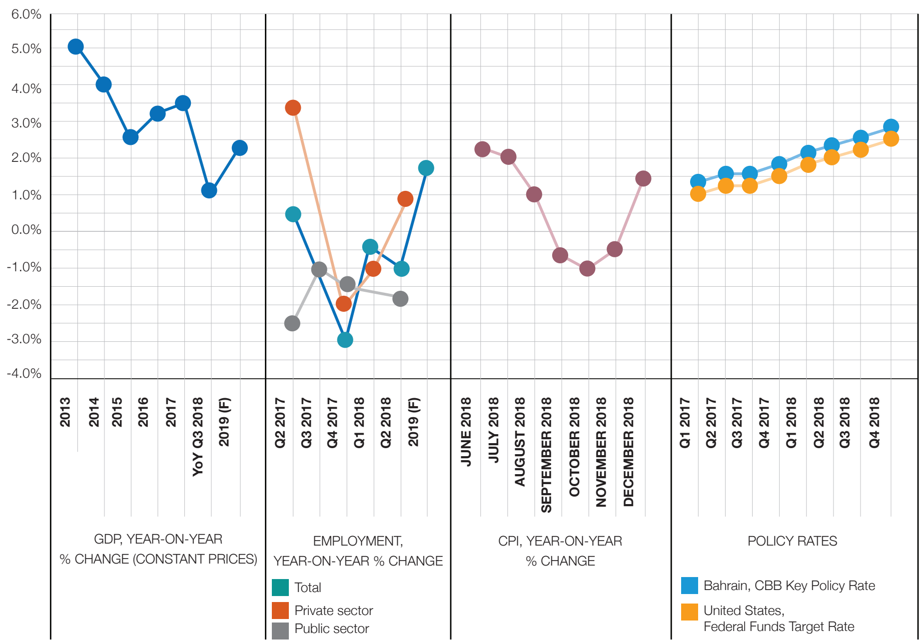
Given the strong challenges the Kingdom faces, Kuwait, Saudi Arabia and the UAE stepped in to provide a US$10bn aid package in late 2018. The money will support a new fiscal program designed to eliminate the country's sizeable budget deficit by 2022.

In addition to this, the government of Bahrain has enacted a range of reforms to help ease the fiscal burden and help diversify the economy. These reforms range from the implementation of Value Added Tax (VAT) at 5%, public sector reforms to reduce the wage bill burden, long-term investor visas and legal reforms to help reduce the cost of doing business.

Outlook

On the back of these reforms, easing of regulations, continued investment in large-scale projects and higher oil prices, GDP growth looks set to strengthen to 2.8% and employment is expected to expand by 2.5% in 2019. Additionally, the fiscal situation is likely to improve given the introduction of VAT alongside

FIGURE 1
Economic indicators



Source: Knight Frank Research

fiscal consolidations. Finally, whilst the introduction of VAT is likely to increase the rate of inflation, we do not expect this to be a substantial increase given the relative consumer friendliness of the VAT regime in Bahrain compared to other GCC nations.

Regional competitiveness

Bahrain continues to be an attractive location for firms looking to setup a base in the GCC. Particularly as the region's largest economy, Saudi Arabia, continues to open up. Bahrain will increasingly be considered as a hub location given its direct access to Saudi Arabia via the King Fahd causeway.

International firms are attracted by Bahrain's favourable business environment, which offers effective regulations, lack of Free Zone restrictions alongside a favourable tax regime.

Figure 2 highlights the competitiveness of doing business in Bahrain, where in the World Bank's Ease of Doing Business rankings Bahrain ranks 62nd out of 190 countries, up from 66th in 2018. Bahrain's trading across borders and protecting minority investors scores have also improved over the last year. Starting a business, dealing with construction permits, registering property, trading across borders and getting electricity are all areas in which Bahrain scored well. With the broad range of reforms enacted in 2018, we expect Bahrain's ranking to continue its ascent.

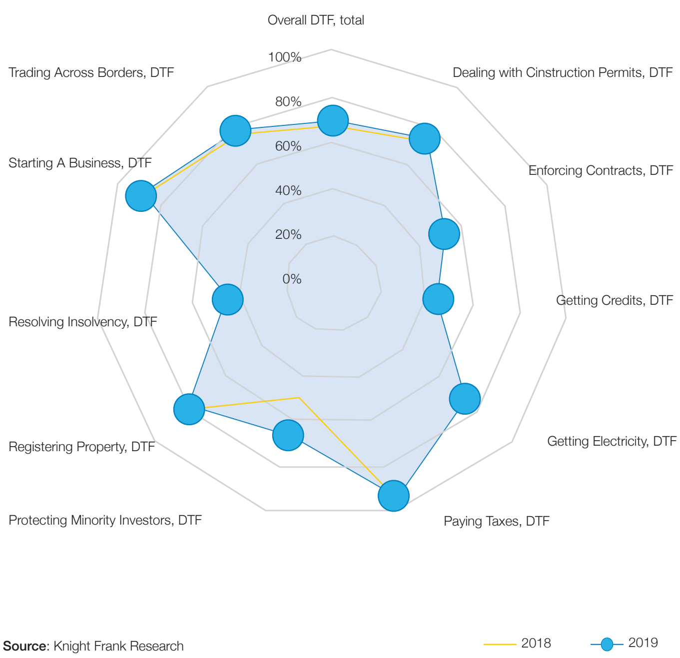
The main areas where Bahrain must continue to develop in the future are the areas of resolving insolvency, getting credit and enforcing contracts – the World Bank has highlighted that performance in most of these areas has already begun to improve since 2016.

Finally, the island is a firm favourite with expats, with the Expat Insider's 2018 survey ranking it as the best place to live and work for the second year in a row.

TAIMUR KHAN
Research Manager

"The introduction of VAT is likely to increase the rate of inflation, however we do not expect this to be a substantial increase given the relative consumer friendliness of the VAT regime in Bahrain compared to other GCC nations."

FIGURE 2
Ease Of Doing Business: Distance To Frontier Score 2019



Source: Knight Frank Research

FIGURE 3
GCC Countries, Ease of Doing Business Rank

	2015	2016	2017	2018	2019
UAE	32	34	26	21	11
Bahrain	61	66	63	66	62
Kuwait	100	98	102	96	97
Oman	77	69	66	71	78
Saudi Arabia	84	96	94	92	92

Source: Knight Frank Research

2015 2016 2017 2018 2019

Real Estate market overview

Commercial

Bahrain's commercial office market continues to be dominated by weak occupier demand coupled with oversupply, a legacy of the 2001 to 2007 construction boom. This supply-demand imbalance has endured since 2010 when the full effects of the global economic downturn hit Bahrain.

Starting in 2010, Manama's office market become increasingly favourable to tenants with headline rental rates falling by circa 45% to 50% from the peak in 2008. However, 2018 saw the market stabilise with rent falls abating, a sign that the market has bottomed out, though it remains to be seen when rental growth will return to the market due to the elasticity of the supply pipeline.

As a result of the economic backdrop, the rate of completions has slowed dramatically since 2014 which has avoided any compounding effect of the supply-demand imbalance.

Demand for commercial office space continues to be limited and largely centred on small, fitted out units as tenants look to avoid cap expenditure. This trend has been prevalent for the past seven years and looks set to remain in the short to medium term.

Vacancy rates across the market continue to hover around the 40% mark with best in class schemes commanding better occupancy levels. Conversely, older buildings with inefficient floorplates and poor parking arrangements look set to suffer from lower occupancy levels and higher falls in rental rate.

As a result of these market conditions and the lower cost of doing business in Bahrain when compared to other regional financial centres, the Kingdom is well placed to take advantage of new entrants to the market that are seeking access to the GCC.

Using KPMG's cost of doing business in Bahrain (Financial Services) 2018 report it can be seen that on a total costs basis, when looking to accommodate one CXO, two Heads of Department, two Directors, five Managers and 10 Analysts, Bahrain is 35% cheaper than Abu Dhabi Global Market (ADGM) and Dubai International Financial Centre (DIFC). Commercial rents for accommodating these 20 employees are 60% and 61% lower in Bahrain compared to ADGM and DIFC respectively (Figure 6).

Whilst the market has shown signs of stabilisation throughout 2018, this has come as a result of dramatic falls in rental rates. This stability looks set to continue in the short to medium term though it is unlikely to translate into rising rents or capital values in the foreseeable future as the market struggles to absorb existing stock.

FIGURE 4
Key Market Indicators

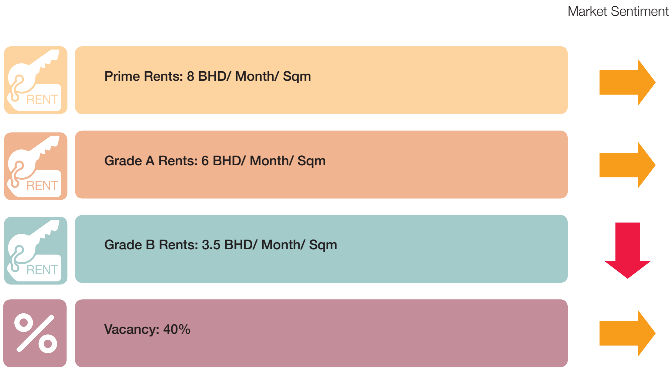
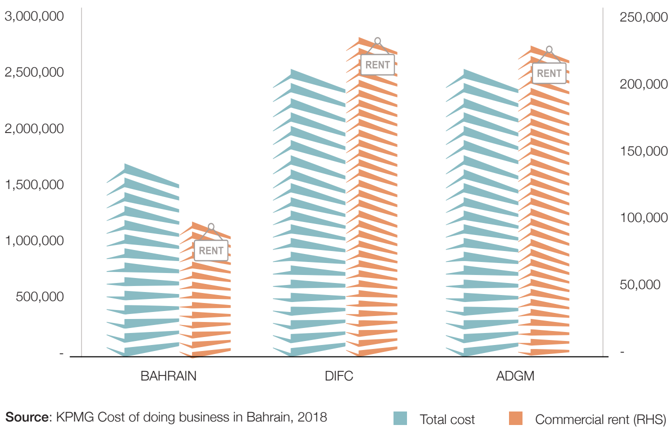


FIGURE 5
Bahrain, Indicative Office Rents

Source: Knight Frank Research

FIGURE 6
Average annual cost of operations in USD (2018)



Source: KPMG Cost of doing business in Bahrain, 2018

> "Commercial rents are 60% and 61% lower in Bahrain compared to ADGM and DIFC respectively."

Hospitality

Bahrain's hospitality sector has traditionally attracted regional GCC visitation, particularly from Saudi Arabia via the King Fahd Causeway. From an international perspective, demand has largely been attributable to corporate visitation and the Bahrain Grand Prix, which is the largest inbound demand generator in the Kingdom. Looking ahead we may begin to see international visitation from outside the region increase as the country's national airline expands its network and improvement works are completed at Bahrain International Airport.

Due to the nature of visitation in Bahrain, the hospitality market has historically had challenges in relation to driving occupancy rates. Over recent years we have seen average occupancy decline from 56% in 2014 to 52% in 2018. Over the same period, ADR and RevPAR decreased by 23% and 28% respectively.

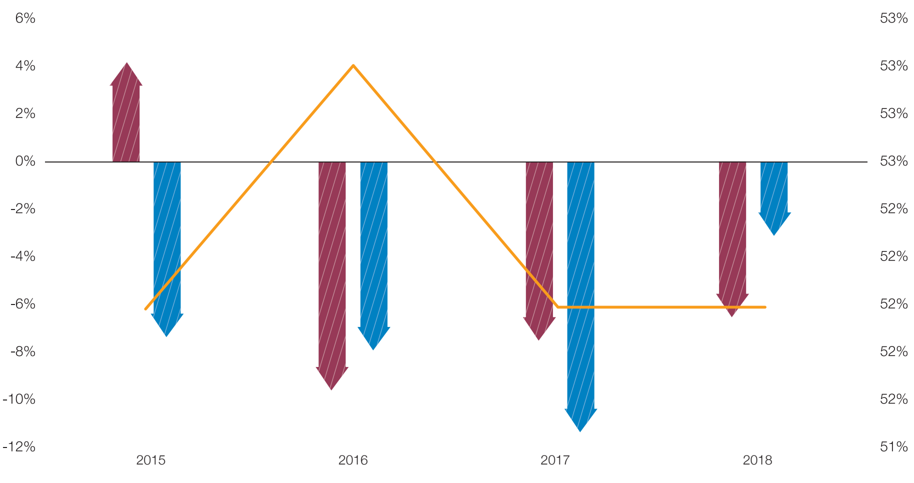
This softening in key performance indicators (KPIs) was attributable to falling oil prices which not only impacted the domestic market, but also the wider gulf economies, which in turn has resulted in subdued corporate demand. Leisure demand has been impacted by the rift between Qatar and Bahrain (among other nations). More so, in the medium to long term we expect demand will be further impacted as entertainment led destinations are delivered in Saudi Arabia.

As of year-end 2018, Manama's hospitality supply consisted of 13,000 keys (11,000 hotel keys and 2,000 serviced apartment keys) primarily composed of 4 and 5 star hotels which account for 40% and 39% of the total room supply respectively.

Looking towards the future, 3,300 keys have been announced to come online by the end of 2022. This represents a supply increase of approximately 25%. As more quality internationally branded properties enter the market, we expect locally operated and less centrally located properties will ultimately lose market share.

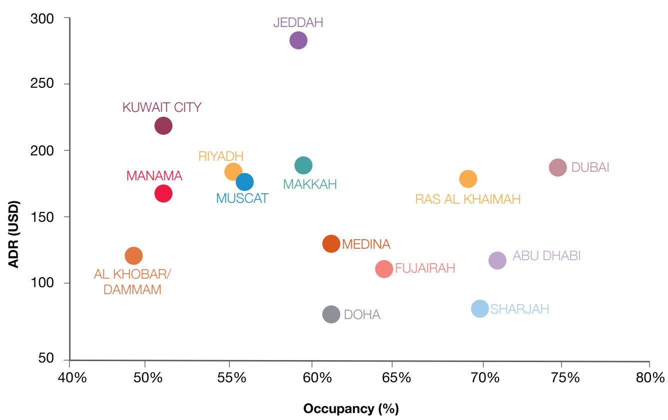
The short to medium term outlook for the market remains subdued as a result of additional supply scheduled to enter the market and the implementation of VAT which is likely to create further pressure on KPIs. The expansion of supply, where the total key count is expected to grow 25% by 2022, is likely to impact the top end of the market most given that the vast majority of additional keys set to be delivered are in either the 4-star or 5-star segment of the market.

FIGURE 7
Key Performance Indicators



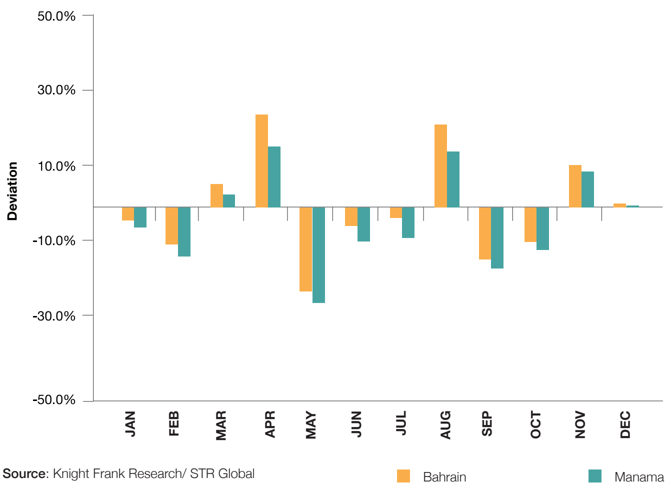
Source: Knight Frank Research/ STR Global

FIGURE 8
Trading performance by GCC City - 2018



Source: Knight Frank Research/ STR Global

FIGURE 9
RevPAR seasonality - 2018



Source: Knight Frank Research/ STR Global

Demand generators

Bahrain is considered to be a well-regarded leisure destination and Manama has been established as a trading outpost for the Middle East since the early 1970's. As the government continues to diversify the economy and promote the location as a credible tourist and leisure destination, it will be able to drive demand beyond its traditional base.

The expansion of supply, where there are several key tourism related projects that have already been completed, are highlighted in figure 10.

FIGURE 10

Bahrain's key demand generators

Source: Knight Frank Research

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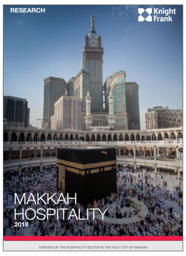
KSA Commercial Market Review 2018



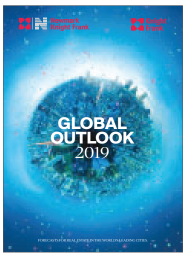
Makkah Hospitality 2018

UAE Real Estate Investment 2019

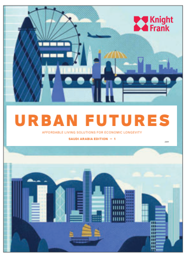
Dubai Office Market Review 2018

(Y)our Space

The Wealth Report



Global Outlook



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