COMMERCIAL RESEARCH

ABU DHABI OFFICE MARKET REVIEW Q3 2018

Key findings

Abu Dhabi's GDP grew by 1.5% in the year to Q2 2018 with both the oil and non-oil GDP registering year-on-year growth.

Prime office rents in Q3 2018 registered at AED 1,720 on average (sq m/p.a.), down 11.5% from Q3 2017.

Over the same time period we have seen Grade A rents register the steepest declines with rents falling by 15.8%, with a significant reduction in rents from Q2 to Q3 contributing to the large annual decline.

Citywide rents have also softened, with year-on-year rents to Q3 2018 falling by 10.0%.

MATTHEW DADD

Partner, Occupier Services and Commercial Agency

"Over the course of the third quarter of 2018 we have seen demand continue to trend towards smaller floor areas, where almost 79% of enquiries were for space requirements below 500 square metres."

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

Rental rate declines are expected to begin moderating in Abu Dhabi's Prime and Grade A market on the back of lower levels of supply and increased demand from the hydrocarbon sector.

Macroeconomic overview

Abu Dhabi's GDP grew by 1.5% in the year to Q2 2018 with both oil and non-oil GDP registering year-on-year growth. The oil sector's growth of 1.0%, has been driven by higher levels of production and by the higher oil price, which has risen to US$80.5 per barrel in October 2018 (average price for the month), up from US$57.6 a year earlier. Growth in the oil sector is likely to have underpinned Abu Dhabi's non-oil sector, which in the year to Q2 2018 recorded growth of 2.0%.

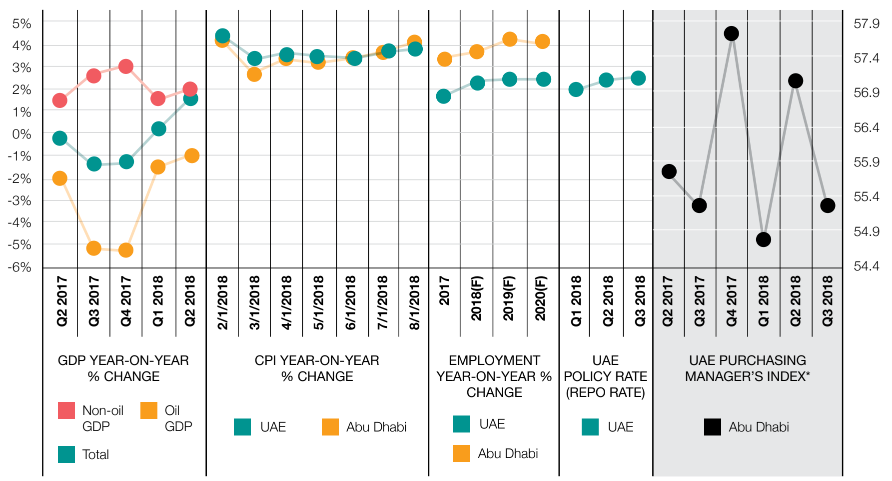
Whilst there are some tentative signs of economic recovery in Abu Dhabi, any significant slowdown in global economic growth may impact the recovery. However, recent forecasts from the IMF indicate global economic growth is likely to continue its steady expansion with growth forecast at 3.7% in both 2018 and 2019, down only marginally by 0.2% from the previous forecasts. Despite this slight downgrade in global growth forecasts, the IMF has revised up the UAE's GDP growth forecasts for both 2018 and 2019 from 2.0% to 2.9% and 3.0% to 3.7% respectively.

Business sentiment across the UAE reflects this cautiously optimistic outlook, with the Purchasing Managers' Index showing mixed results. Whilst the headline number stood at 55.3 indicating a stable rate of expansion, subsets of the index show a slightly lower level of employment compared to previous months and relatively unchanged levels of inventories. With a host of changes in regulation due to be enacted in 2019, designed to reduce business expenses and increase the ease of doing business, firms are likely to be adopting a wait-and-see approach before committing any major expansion plans. Indeed, 62% of those surveyed expect output to be higher in a year's time.

Overall, we remain optimistic that Abu Dhabi's economy will continue to strengthen given higher oil prices, the easing of regulations and the implementation of the AED 50 billion (USD$ 13bn) stimulus package over the three year period to 2021.

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*

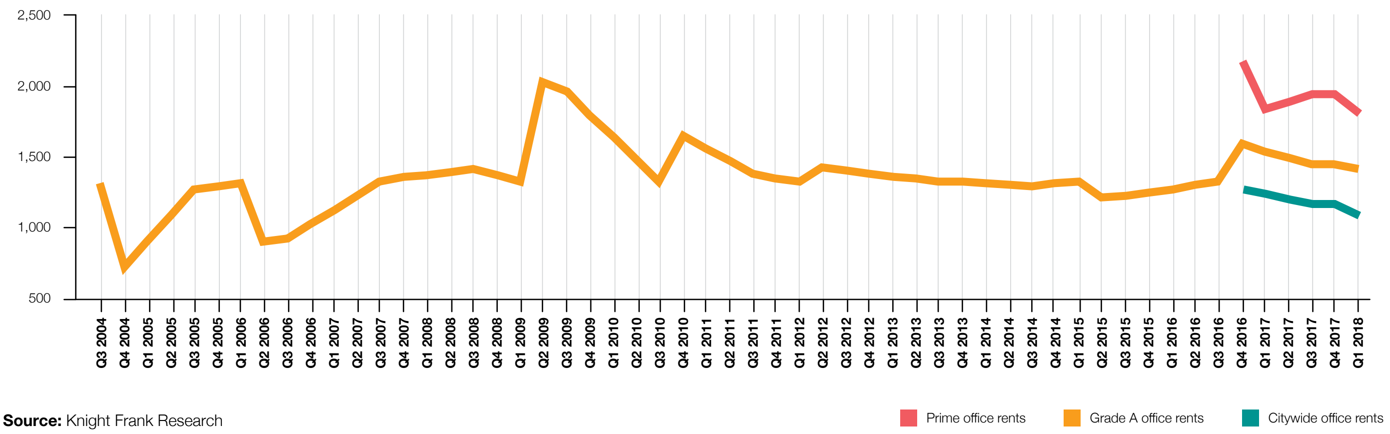
Market review

After a relatively strong start to the year in Abu Dhabi's office market, we have witnessed activity become muted once again over the course of Q2 and Q3 2018. Whilst there is increased activity from certain sectors in the market, there has been a notable slowdown in demand from the general trading and professional sectors. Abu Dhabi's fragile economic backdrop is a likely contributor to this slowdown, as firms are likely to hold off executing many corporate decisions until there is a clearer understanding and implementation of 100% foreign ownership laws and the outcome of proposed mergers in the banking sector.

Prime office rents in Q3 2018 registered at AED 1,720 on average (sq m/p.a.), down 11.5% from Q3 2017. Over the same time period we have seen Grade A rents register the steepest declines with rents falling by 15.8%, with a significant reduction in rents from Q2 to Q3 contributing to the large annual decline (figure 4). Citywide rents have also softened, with year-on-year rents to Q3 2018 falling by 10.0%. Grade A rents registered on average at AED 1,225 (sq m / p.a.) and Citywide rents at AED 1,050 (sq m / p.a.).

In Q3 2018, demand for office space was largely driven by requirements from the oil and gas and technology sectors. Oil and gas firms accounted for over 65% of enquiries and technology companies accounted for almost 21% of total demand according to Knight Frank data. The engineering and construction, financial and general trading sectors accounted for the next three largest pools of demand at 5.2%, 4.7% and 3.7% respectively. With improvements in Free Zone licencing and pro-active leasing, in areas such as the ADGM in 2018, we have seen a significant increase in take up in these areas. In other Free Zones, such

FIGURE 2
Abu Dhabi average office rents (AED/ sq m/ p.a.)

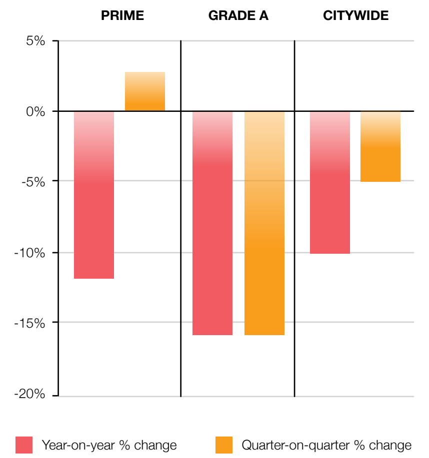


Source: Knight Frank Research

FIGURE 3
Abu Dhabi office supply

Source: Knight Frank Research

FIGURE 4
Abu Dhabi office market performance, to Q3 2018



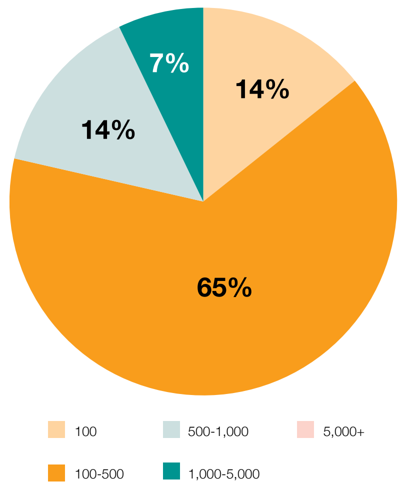
Source: Knight Frank Research

as Masdar there is 100% occupancy and therefore occupier activity remains limited in such Free Zones. Compared to the start of 2018, where demand was from a much broader range of sectors, we have seen demand recede again to a smaller set of sectors. More so, a large portion of this demand is concentrated in dual licenced Free Zones such as Abu Dhabi Global Markets Square.

Over the course of the third quarter of 2018 we have seen demand continue to trend towards smaller floor areas, where almost 79% of enquiries were for space requirements below 500 square metres *(Figure 5)*. As a result of consolidation in the market and low level of uptake, the vacancy rate has increased marginally to 24%.

FIGURE 5

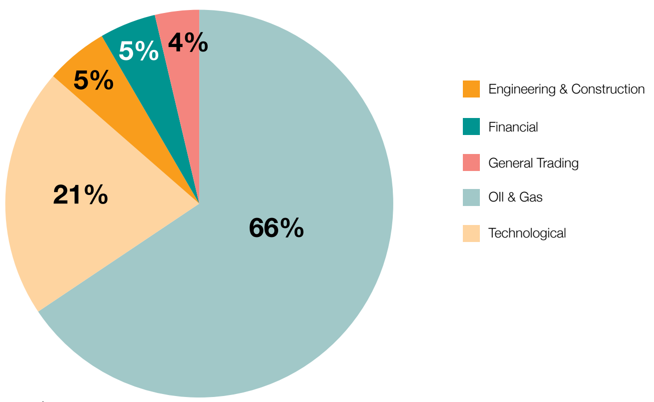
Proportion of enquiries by size (%), Q3 2018



Source: Knight Frank Research

FIGURE 6

Demand by sector (%), Q3 2018



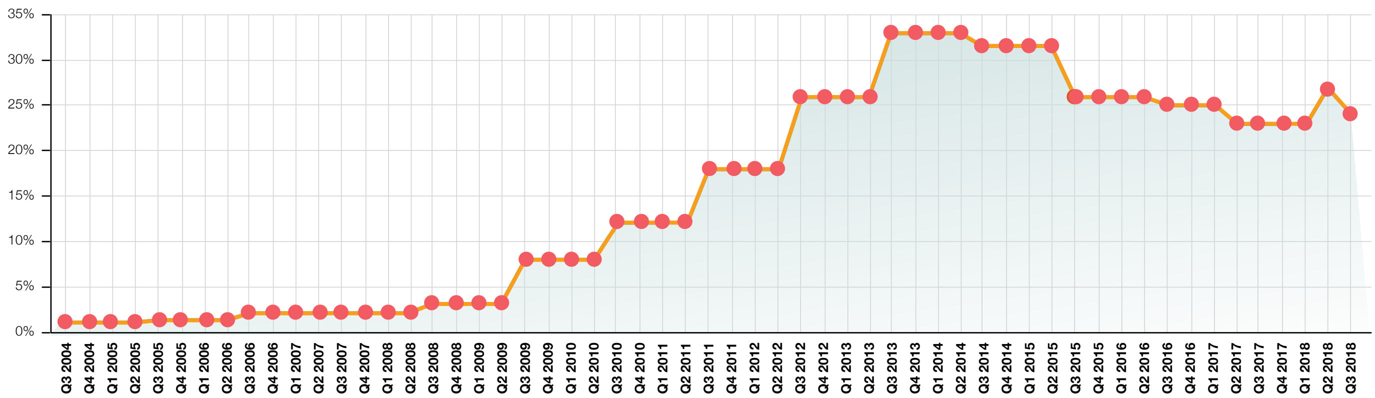
Source: Knight Frank Research

TAIMUR KHAN
Research Manager

"In the short to medium term we expect that market conditions in Abu Dhabi's office sector will remain challenging with rental rates continuing to fall, however we expect that the rate of decline is likely to start to moderate, particular in the Prime and Grade A segments."

FIGURE 7

Abu Dhabi vacancy rate



Source: Knight Frank Research

Outlook

In the short to medium term we expect that market conditions in Abu Dhabi's office sector will remain challenging with rental rates continuing to fall. However we expect that the rate of decline is likely to start to moderate, particularly in the Prime and Grade A segments.

Knight Frank's view is based on limited levels of supply due to enter the market in the Grade A and Prime segments, with the vast majority of the 165,000 square metres of additional supply expected by 2020 being classed as Citywide stock in non-core locations.

More so, a result of renewed activity in the oil sector and the expected benefits of the AED 50bn stimulus packages as well as the easing of regulation, we expect demand to tick up from early 2019.

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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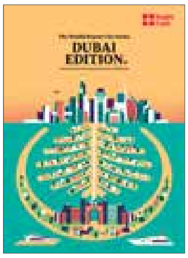

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