COMMERCIAL RESEARCH

DUBAI OFFICE MARKET REVIEW Q3 2019

Key findings

Despite this challenging economic backdrop, data from the Ministry of Human Resources and Emiratisation shows that Dubai has added 90,304 net new jobs in the year-to-date June 2019 compared to 74,108 in the same period a year earlier, representing a 21.9% increase.

The continued lack of demand and drive from occupiers to lower costs has seen rental rates fall on average by 8.4% in the year to Q3 2019.

Grade A rents witnessed a period of moderation in rental declines in the year to Q2 2019, however in the year to Q3 2019, the rate of decline has increased to 5.9%.

Citywide office rents fell by 9.2% in the 12 months to September 2019 to AED 110(sq.ft/p.a.).

MATTHEW DADD

Partner, Occupier Services and Commercial Agency

"With the premium between entry level Prime office space and average Grade A buildings closing, firms are much more open to considering relocating in Dubai to Prime office buildings. Particularly as Prime office space offers dual licencing, something which not all Grade A office space offers."

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

An uncertain economic backdrop alongside regulatory changes and weaker levels of occupier demand have led to rents continuing to soften in Dubai's office market. However, in the long-run, regulatory changes will ensure Dubai appeals to a larger cohort of firms looking to open and expand operations across the wider Middle East region.

Macroeconomic Overview

Following the slowdown registered in Dubai's GDP growth, where GDP grew by 1.9% in 2018, down from 3.1% a year earlier, business confidence in Dubai has eased in the first two quarters of 2019. Dubai's composite business confidence index fell from 126.2 in Q4 2018 to 114.9 in Q2 2019.

However, the Dubai Purchasing Managers' Index (PMI), which tracks private business activity, has seen a slight uptick in September 2019 with the index rising to 52.9. Whilst this may point towards some business confidence returning, the average reading for the third quarter was the lowest recorded since Q1 2016.

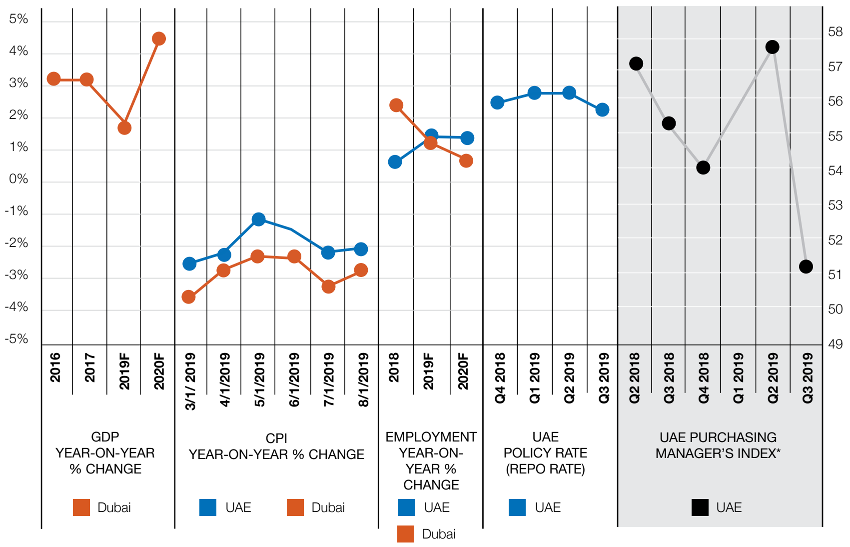
Sub-indices of the PMI show that new order growth has slowed in Q3 2019 alongside selling prices, which registered lower values compared to the first half of the year. This indicates firms are operating below capacity and discounting despite input prices not falling equally. As the index remains above the neutral 50 level, it shows that Dubai's private sector continues to grow, albeit at a slower pace. Firms remain cautiously optimistic in their outlook with 60% of firms expecting their output to be higher in a year's time.

Despite this challenging economic backdrop, data from the Ministry of Human Resources and Emiratisation shows that Dubai has added 90,304 net new jobs in the year-to-date June 2019 compared to 74,108 in the same period a year earlier, representing a 21.9% increase. However, Dubai's private sector employment saw a quarter-on quarter increase of only 0.6% in Q2 2019.

The outlook for Dubai's GDP remains positive with GDP growth in 2019 expected to strengthen from 1.9% in 2018 to 3.6% in 2019 and 4.2% in 2020.

FIGURE 1

Economic indicators



Source: Knight Frank Research, Oxford Economics

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

Market review

The vast majority of activity in the market continues to stem from firms consolidating, with activity from new incoming occupiers remaining very limited in the first three quarters of 2019. Consolidation activity is particularly driven by blue chip corporates who are facing increased cost pressures, given the weaker local and global economic backdrop. As a result, we have witnessed further pressure exerted on rents.

This is despite net business licence issuance increasing by 8.9% in the first half of 2019 when compared with the same period a year earlier. Net commercial licence issuance over the same period increased at a slower rate of 3.8%.

The continued lack of demand and drive from occupiers to lower costs has seen rental rates fall on average by 8.4% in the year to Q3 2019.

Prime rents on average registered at AED 225 (sq.ft/p.a.) as at Q3 2019, down 8.9% compared to the same period a year earlier. Prime office vacancy remains relatively low compared to the wider market, which currently stands at 19% as at Q3 2019.

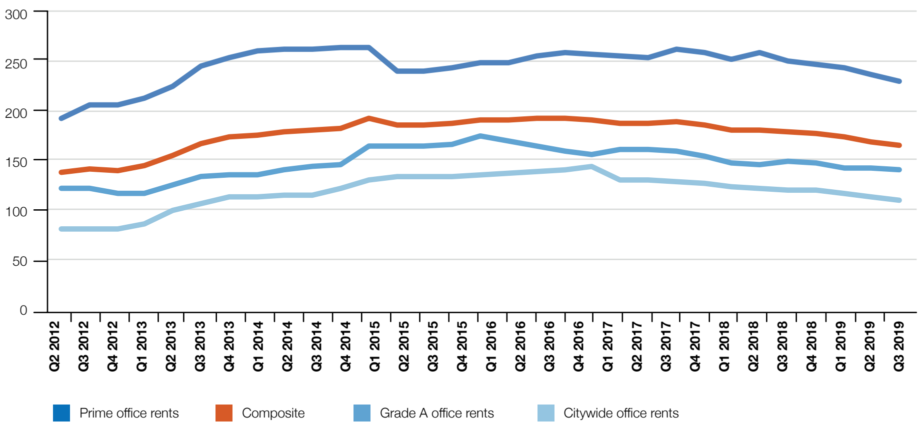
Grade A rents witnessed a period of moderation in rental declines in the year to Q2 2019, however in the year to Q3 2019, the rate of decline has increased to 5.9%. Currently, average Grade A rental rates are AED 140 (sq.ft/p.a.). With the premium between entry level Prime office space and average Grade A buildings closing, firms are much more open to considering relocating in Dubai to Prime office buildings. Particularly as Prime office space offers dual licencing, something which not all Grade A office space offers.

Citywide office rents fell by 9.2% in the 12 months to September 2019 to AED 110 (sq.ft/p.a.).

Given these market conditions, Knight Frank data shows that demand for floor space remains towards floor space below 5,000 square feet. With 72.5% of enquiries looking to lease space in this segment, down from 75.0% six months earlier.

FIGURE 2

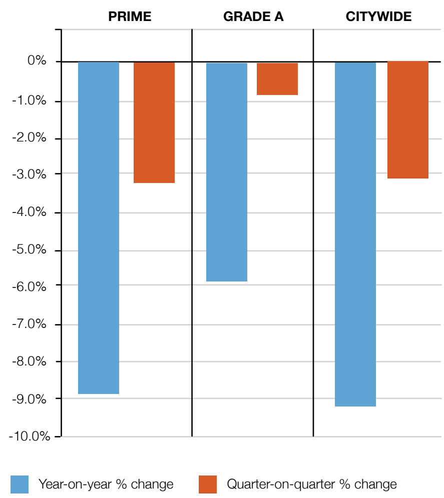
Dubai average office rents (AED/ sq ft/ p.a.)



Source: Knight Frank Research

FIGURE 3

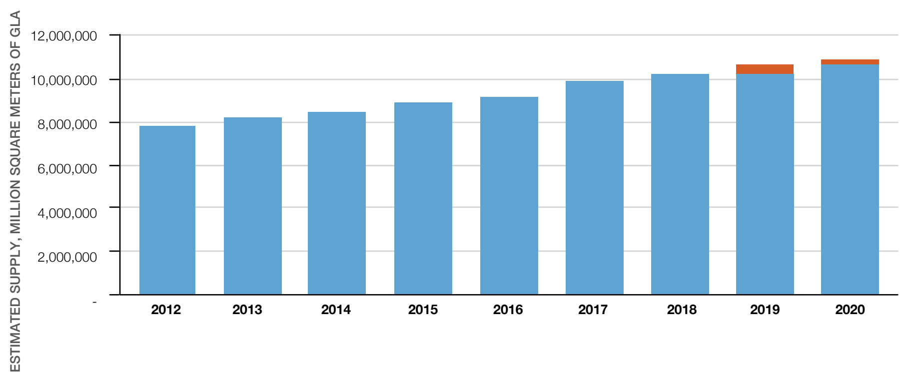
Dubai office market performance, to Q3 2019



Source: Knight Frank Research

FIGURE 4

Dubai office supply



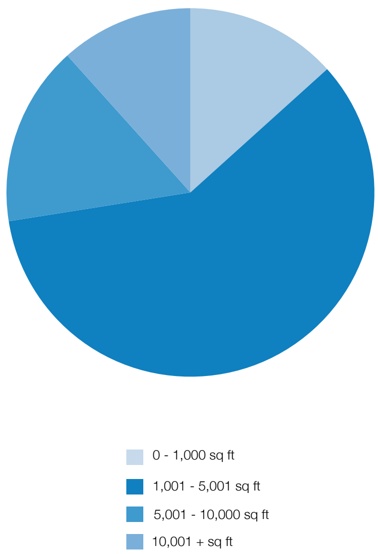
Source: Knight Frank Research

The engineering and construction sector continues to be the leading sector of demand for office space in Dubai, according to Knight Frank data, with 12.8% of demand originating from this sector. IT and technology firms and general services firms are the next two largest sources of demand with a 11.9% and 8.3% share of enquiries respectively. The next five largest sectors of demand are from a range of professional services sectors, which account for 28.4% of total enquiries.

Business Bay and certain TECOM Business Park locations – Dubai Internet City, Dubai Media City and Dubai Knowledge Village – were the areas where office was most demanded in the first three quarters of 2019, with 30.5% and 18.3% of all enquiries listing these as their preferred locations. Office space on Sheikh Zayed Road and DIFC were the next two most demanded areas with 15.3% and 13.7% of enquiries looking for office space in these locations.

FIGURE 5

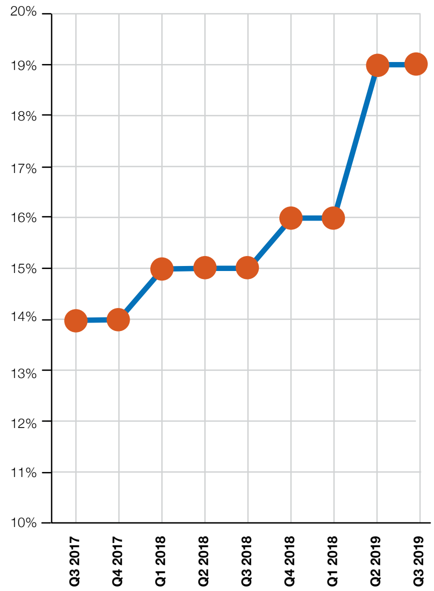
Proportion of enquiries by size (%), Q3 2019



Source: Knight Frank Research

FIGURE 6

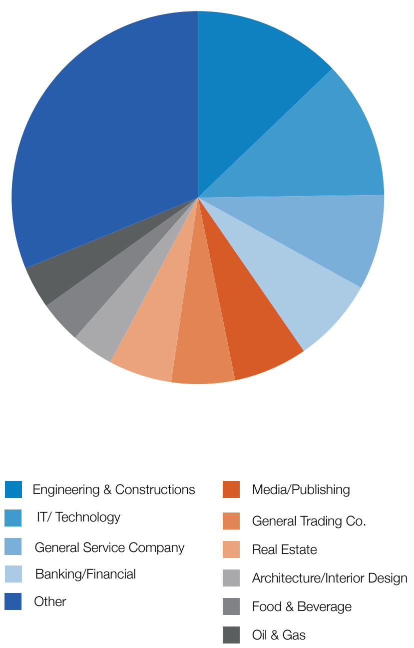
Dubai vacancy rate



Source: Knight Frank Research

FIGURE 7

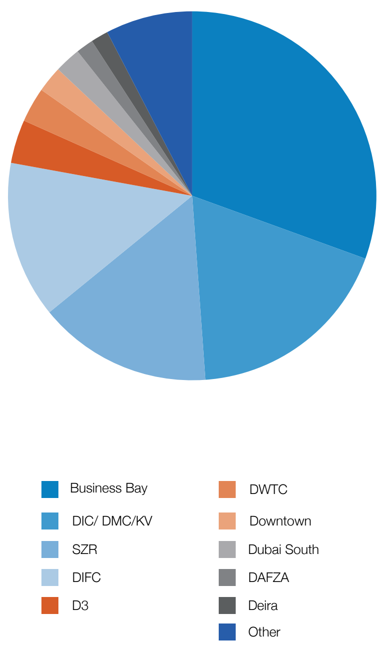
Demand By Sector (%), Q3 2019



Source: Knight Frank Research

FIGURE 8

Demand by Location (%), Q3 2019



Source: Knight Frank Research

TAIMUR KHAN

Associate Partner

"Given regulatory changes such as the introduction of dual licencing and the 100% foreign ownership law, which permits 122 activities across 13 sectors for 100% foreign ownership, alongside subdued demand, we expect rents will continue to fall over the short to medium term. The regulatory changes will drive further consolidation in the market, as firms optimise their real estate portfolios in the UAE. Free Zones offering dual licencing are likely to benefit the most from these changes."

Outlook

Given regulatory changes such as the introduction of dual licencing and the 100% foreign ownership law, which permits 122 activities across 13 sectors for 100% foreign ownership, alongside subdued demand, we expect rents will continue to fall over the short to medium term. The regulatory changes will drive further consolidation in the market, as firms optimise their real estate portfolios in the UAE. Free Zones offering dual licencing are likely to benefit the most from these changes. Whilst in the short run there are negatives for landlords due to these regulatory changes, in the long run these changes will attract new occupiers and provide a better regulatory platform for existing occupiers to expand from.

Alongside these changes, a considerable level of supply is set to enter the market. By 2021, Knight Frank expects almost 793,000 square metres of office space to be delivered. This planned upcoming supply is concentrated in the citywide and Grade A segments and as a result, these two segments of the market are likely to be most impacted. Once again, whilst in the short run this new stock may cause rents to soften, the lack of institutional grade stock in these two segments is likely to be detrimental to the development of Dubai in the long-run.

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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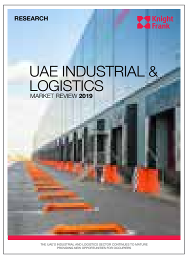

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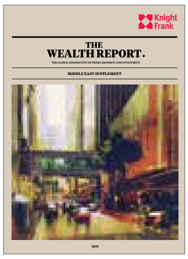

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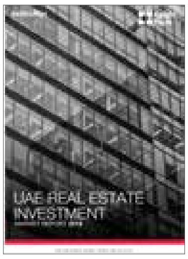

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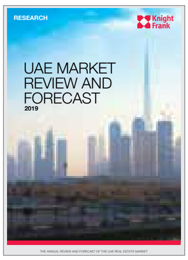

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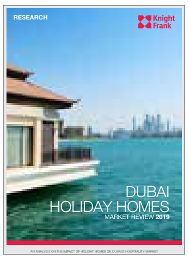

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RESEARCH

Taimur Khan
Associate Partner
+971 56 4202 312
taimur.khan@me.knightfrank.com

OCCUPIER SERVICES & COMMERCIAL AGENCY

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

DEVELOPMENT CONSULTANCY & RESEARCH

P.P. Varghese
Partner
+971 56 1766 588
pp.varghese@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

Thomas Farmer
Associate Partner
+971 56 6116 368
thomas.farmer@me.knightfrank.com

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.

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