COMMERCIAL RESEARCH

DUBAI OFFICE MARKET REVIEW Q1 2019

Key findings

Average office rents across Dubai fell by 4.3% in the year to March 2019, with the quarter-on-quarter percentage decline increasing from 1.2% in Q4 2018 to 2.1% in Q1 2019.

Rents in the prime sector of the market as at Q1 2019 registered at AED 240 (sq.ft/p.a.), down 3.6% in the year to Q1 2019.

Grade A rents, which fell 5.1% in 2018, have seen the rate of decline moderate with rents falling by 3.3% in the year to Q1 2019.

Take-up activity remains limited from new occupiers with new licence issuances falling by 2.7% in 2018. Renewal of existing licences remained relatively flat with only a 0.1% increase witnessed in 2018.

MATTHEW DADD

Partner, Occupier Services and Commercial Agency

"Given the current subdued conditions, landlords are actively offering favourable terms to new and existing occupiers. Rent free incentives, both to existing and new tenants, are becoming a more common practice, in order to maintain and attract key corporate occupiers within their portfolios."

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

Weakened demand and increased supply are driving Dubai's office rents lower in the first quarter of 2019. Despite tougher trading conditions firms are not willing to relocate to secondary locations in order to reduce costs, prime and Grade A office locations still remain most desirable.

Macroeconomic Overview

Dubai's GDP grew by 1.9% in 2018, down from 3.1% a year earlier, according to data from Dubai Statistics Centre, the slowest rate of growth witnessed since 2010. A slowdown in the annual percentage growth rate in 12 out of the 19 broad economic sectors in Dubai has contributed to the overall rate of growth slowing. The only two sectors which have recorded negative annual growth rates are the manufacturing and mining and quarrying sectors, these sectors account for 9.2% and 1.6% of Dubai's total GDP respectively. On a more positive note, three out of the five largest sectors have seen their annual rate of growth increase in 2018 compared to the year prior.

Overall, business sentiment remains fragile across Dubai. This is despite the Emirates NBD Dubai Economy Tracker Index (DET) recording a reading of 57.6 in March 2019, the highest reading since May 2018. As this is above the neutral 50 level it indicates a relatively strong expansion in the non-oil sector.

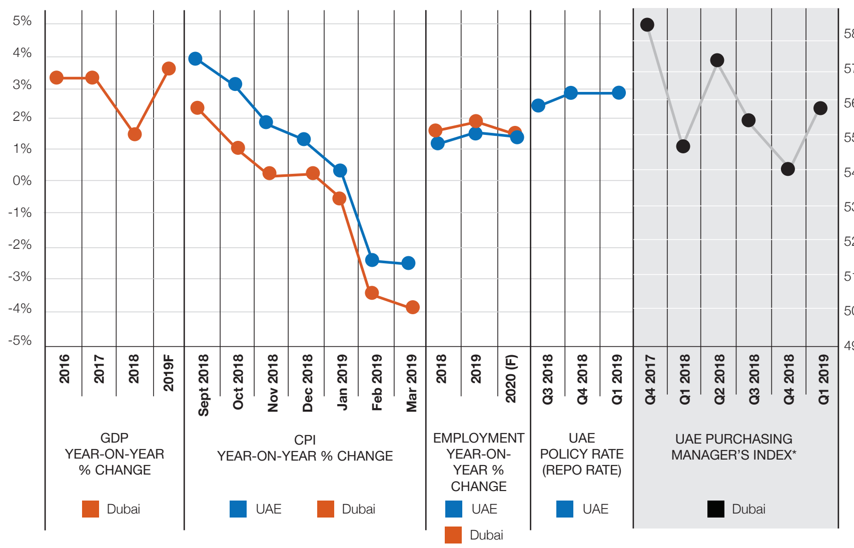
However this more positive backdrop is as a result of firms discounting prices, particularly in the wholesale and retail trade sector, with selling prices declining at the fastest rate since December 2018.

Furthermore, as input costs are rising, firms are seeing their margins continue to be squeezed. This state of affairs leads to pressure to control or reduce costs, as a result only 3% of firms surveyed in March reported increased hiring activity whilst 1% of firms reported lower head counts in March 2019. Looking ahead, firms are optimistic about output in the coming year with 75% of those surveyed expecting output to be higher in a year's time.

The outlook for Dubai's GDP remains positive with Dubai's GDP growth in 2019 expected to strengthen to 3.6% and to 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 chnage, above or below representing growth or decline respectively*

Market review

Dubai's office market continued to witness limited demand in the first quarter of 2019, this has meant that pressure on rents has been sustained over this time period, leading to further softening in the market.

Take-up activity remains limited from new occupiers with new licence issuances falling by 2.7% in 2018. Renewal of existing licences remained relatively flat with only a 0.1% increase witnessed in 2018. Finally, cancellations of licences increased by 22.4% over the same time period.

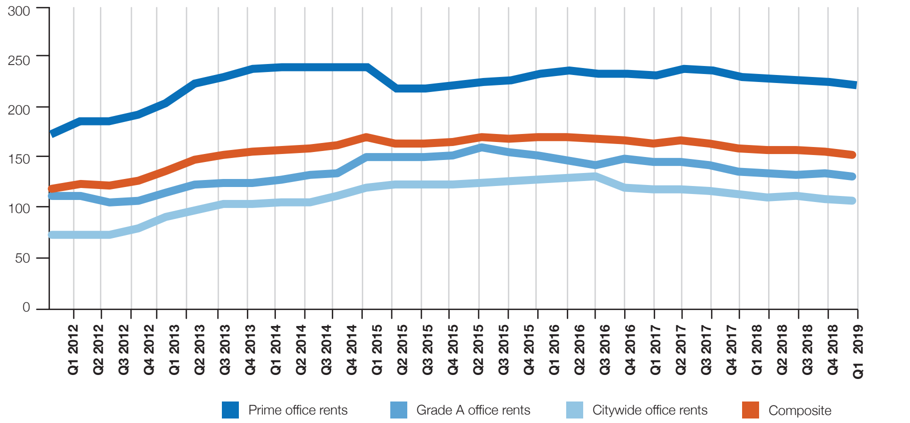
The most significant source of demand remains primarily from firms looking to consolidate their operations, with 75% of current demand recorded by Knight Frank being for floor space of up to 5,000 square feet. Demand is also centred towards product which requires limited capital expenditure.

Given these conditions landlords are actively offering favourable terms to new and existing clients. Rent free periods, both to existing and new tenants, are becoming a more common practice. Furthermore, landlords are willing to concede longer rent free periods and offer contributions to other costs to occupiers willing to sign longer term leases, a practice being received very favourably by global occupiers.

This lack of new demand and drive to lower costs has seen rental rates continue to trend lower across the market. Average office rents across Dubai fell by 4.3% in the year to March 2019, with the quarter-on-quarter percentage decline increasing from 1.2% in Q4 2018 to 2.1% in Q1 2019.

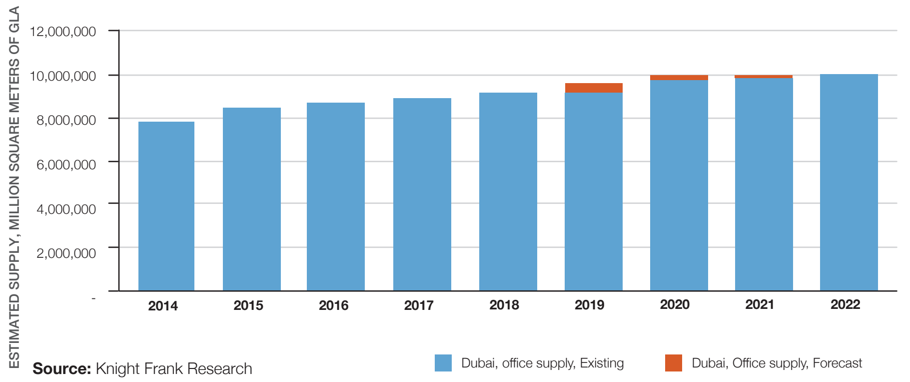
Rents in the prime sector of the market as at Q1 2019 registered at AED 240 (sq. ft/p.a.), down 3.6% in the year to Q1 2019. Vacancy in this sector has remained relatively low compared to the wider market, even to the point where some periphery assets have seen declines in vacancy. This is due to occupiers taking advantage of softer market conditions to upgrade their office space. Much of this flight to quality has originated from tenants who have previously occupied Grade A offices.

FIGURE 2
Dubai average office rents (AED/ sq ft/ p.a.)



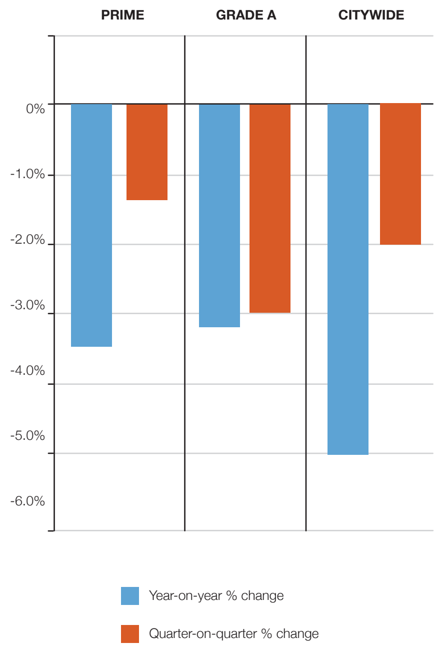
Source: Knight Frank Research

FIGURE 3
Dubai office supply



Source: Knight Frank Research

FIGURE 4
Dubai office market performance, to Q1 2019



Source: Knight Frank Research

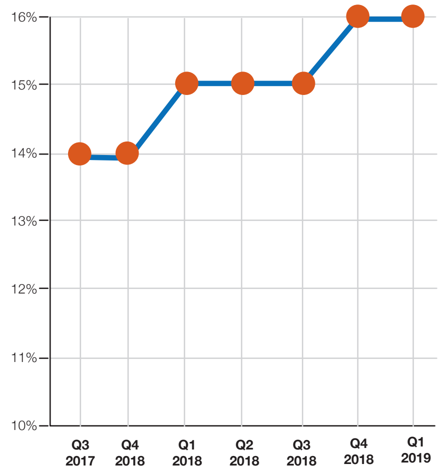
DUBAI OFFICE MARKET REVIEW Q1 2019

Grade A rents, which fell 5.1% in 2018, have seen the rate of decline moderate with rents falling by 3.3% in the year to Q1 2019. We are likely to see the performance of the Grade A market weaken further, as a material portion of new supply due to enter the market over the short to medium term falls within this category.

Citywide office rents fell by 5.0% in the 12 months to March 2019, however this headline figure masks the performance of strata owned stock which has seen rents fall by over 20% in some cases, over the same time period. On average, citywide office rents were recorded at AED 117 (sq. ft/p.a.) as at Q1 2019.

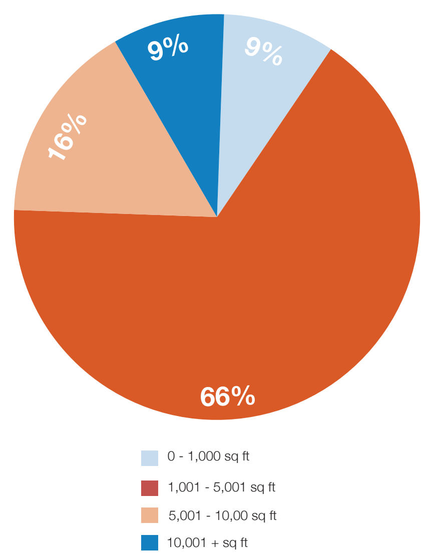
Engineering and construction firms were the single largest source of demand with 13.9% of demand coming from the sector, according to Knight Frank data. General services and real estate were the second two largest sources of demand with a share of 11.1% each of total enquiries.

FIGURE 7
Dubai vacancy rate



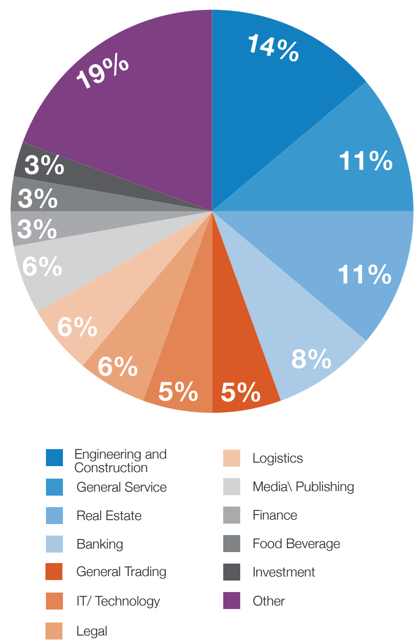
Source: Knight Frank Research

FIGURE 5
Proportion of enquiries by size (%), Q1 2019



Source: Knight Frank Research

FIGURE 6
Demand by sector (%), Q1 2019



Source: Knight Frank Research

TAIMUR KHAN
Research Manager

"Although firms are witnessing tougher trading conditions, they are not willing to relocate to secondary locations in order to reduce costs, particularly given the inherent licencing limitations these locations have."

Outlook

As a result of subdued demand across the market we expect that rents will continue to fall further over the course of 2019. In recent history this has been driven primarily by the surge in supply, which will continue to be the case as we expect almost 490,000 square metres of office space to be delivered this year. However in the short term we expect demand to remain weak which, is likely to put further pressure on rents. One of the factors behind this slowdown has been due to the lack of demand from existing tenants. This is as a result of firms adopting a wait-and-see approach as details of the 100% foreign ownership laws emerge, before committing to any expansion or capital expenditure plans, this includes initiatives such as the proposed common Free Zone licence law amendment announced in May.

Although firms are witnessing tougher trading conditions, they are not willing to relocate to secondary locations in order to reduce costs, particularly given the inherent licencing limitations these locations have. Prime and Grade A office locations still remain most desirable, given not only due to the quality of the product, Free Zone and dual licencing but also due to the amenities these mixed use developments offer. DIFC has always garnered the most interest in this capacity but developing areas such as DWTC are also beginning to pique the interest of occupiers.

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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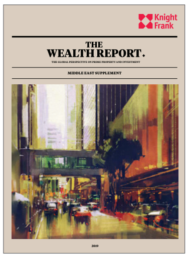

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