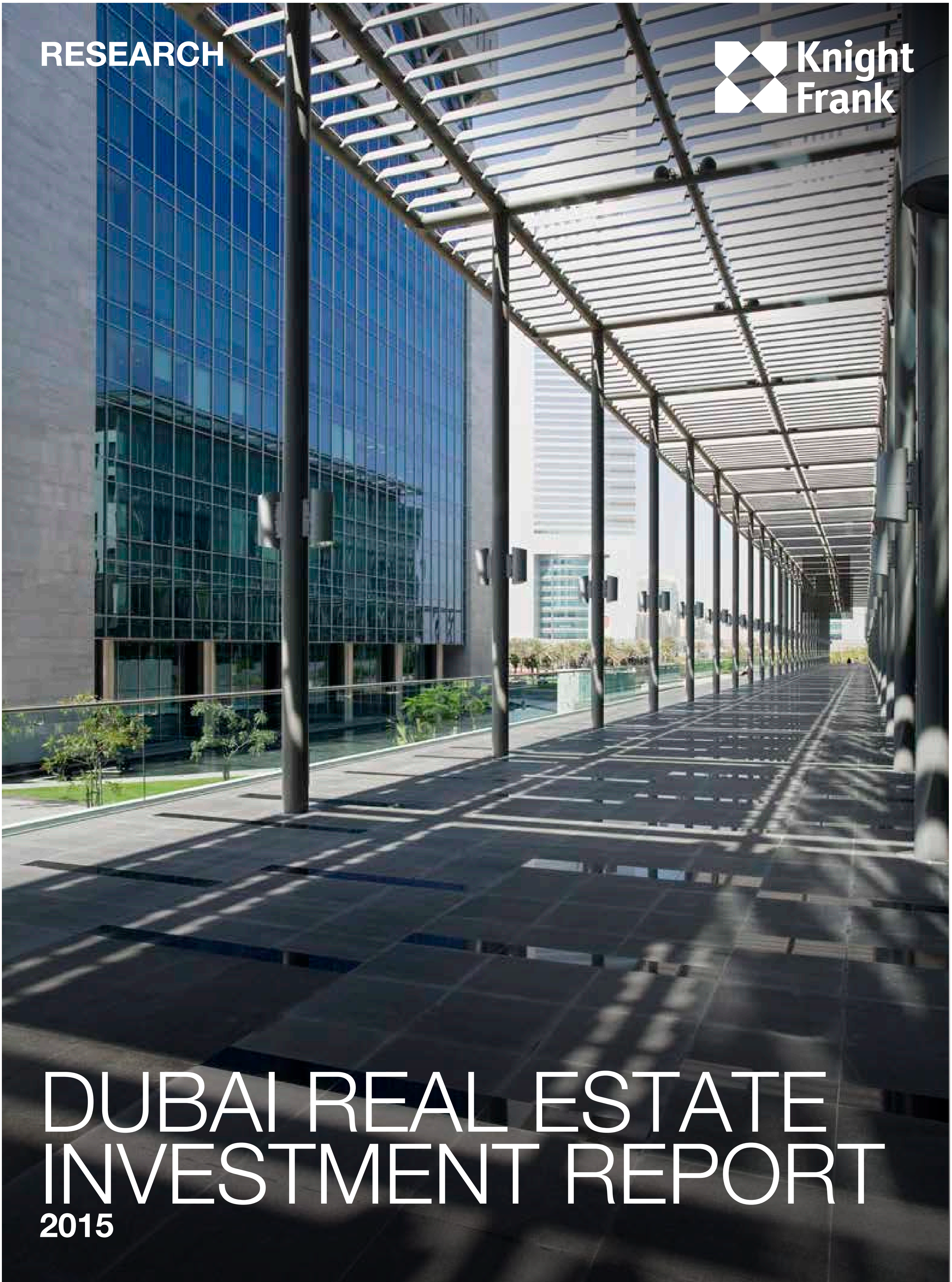
RESEARCH



DUBAI REAL ESTATE INVESTMENT REPORT 2015

INVESTMENT SENTIMENT | YIELD PERFORMANCE | INTERNATIONAL TARGET MARKETS

UAE ECONOMIC PERFORMANCE AND DUBAI REAL ESTATE INVESTMENT OVERVIEW

Survey data pointed to slowing economic growth in the United Arab Emirates at the beginning of 2015, with the strength of the US dollar and lower oil prices hitting both consumer and investor confidence. The HSBC Purchasing Managers Index (PMI) – which tracks non-oil private activity in the federation – slipped to an average of 57.9 in Q1 2015, suggesting a weaker pace of expansion compared to the preceding three months (59.3). *(See Figure 1)*

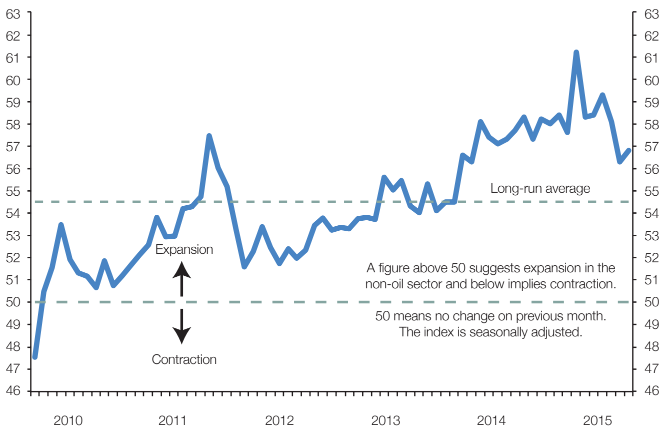
The Royal Institution of Chartered Surveyors' (RICS) Commercial Property Investment Sentiment Index hit 0 in Q1 2015 after posting positive net balances in each of the 11 preceding quarters. This signalled a stabilisation in sentiment across the office, retail and industrial property sectors when compared to Q4 2014. *(See Figure 2)*

At 7.1%, prime all-property net yields for Dubai were flat in the first three months of this year; indicative of pent-up investor demand for well-let real estate in the emirate. *(See Figure 3)* The figure remained stable despite upward pressure from residential yields for whole buildings, which inched up for the third consecutive quarter in Q1 2015 (driven by small falls in capital values and broadly stable rents). Across the commercial property sectors, yields have been flat over the past year, after having trended down in the four years preceding it. *(See Figure 4)*

A number of factors have contributed to the downward trend in yields in recent years. After the global economic crisis, Dubai saw a significant oversupply of commercial office space, with market-wide

FIGURE 1

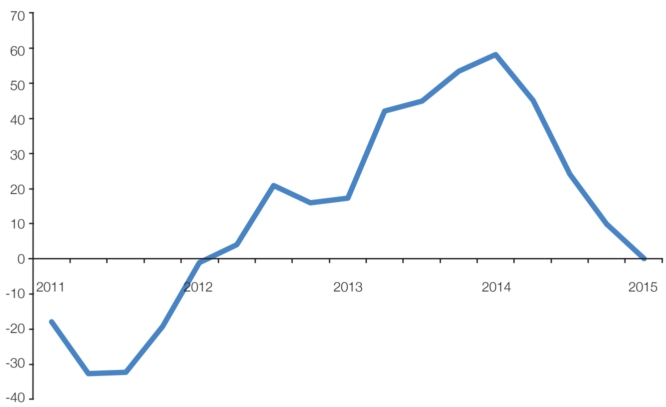
UAE Purchasing Managers Index



Source: HSBC/Markit

FIGURE 2

UAE Commercial Property Investment Sentiment Index, Net Balance (%)



Source: RICS

vacancy rates climbing above the 55% mark (albeit Grade A space accounted for a relatively small proportion of overall availability). The subsequent recovery in confidence across international markets led larger corporates to return to Dubai and provided existing tenants the impetus to consolidate and expand. That in turn has assisted in reducing the emirate's prime vacancy rate and applied upward pressure on Grade A office rents. *(See Figure 5)*

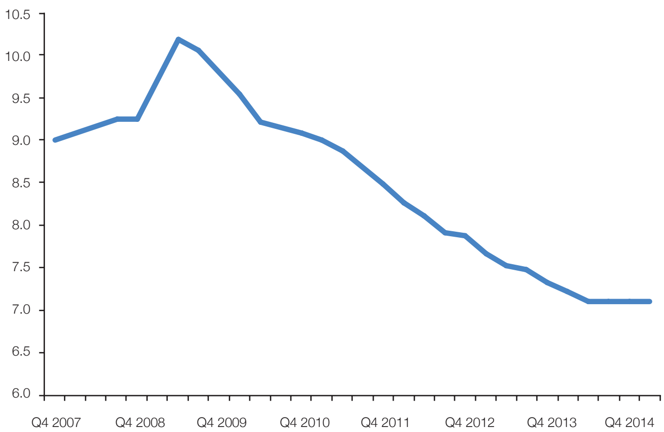
Against a backdrop of low interest rates globally, the flow of capital into real estate has continued. Indeed, whilst we have witnessed a significant amount of equity move from the Middle East into more mature real estate environments (such as the UK and USA), demand for institutional quality assets across Dubai and other key GCC centres continues to rise, partly as yields remain relatively high in context of other global cities. *(See Figure 6)*

Over the past 18 months or so, the spread between all-property yields and the Dubai government bond has widened beyond its long-run average. *(See Figure 7)*

Although this was almost entirely down to the receding "risk-free" rate, going forward this gap should close as the difference falls back in-line with historical norms – this takes into account the possibility that the US Federal Reserve may well raise interest rates in the near-term (the UAE Central Bank usually follows moves made by US policymakers).

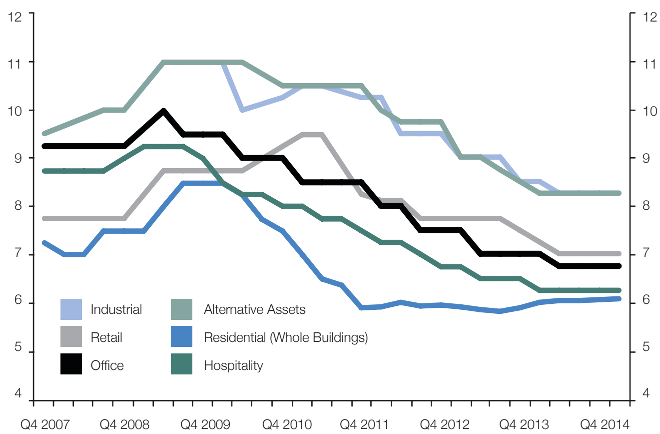
Moreover, given that forecasters expect the economic climate in Dubai to improve this year, it is difficult to see the gap between all-property and government bond

FIGURE 3
Prime All-Property Yield, Dubai (%)



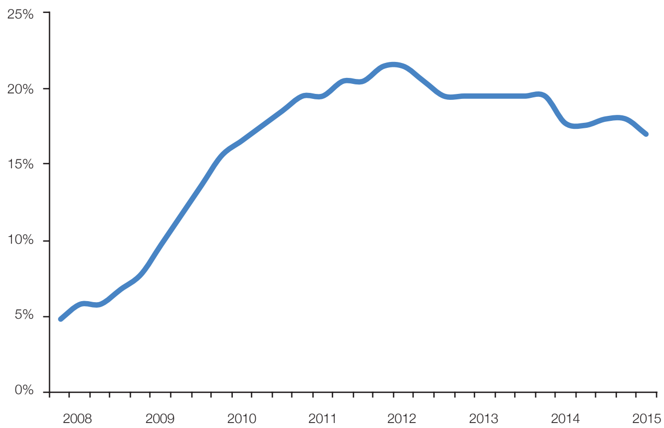
Source: Knight Frank

FIGURE 4
Prime Property Yields, Dubai (%)



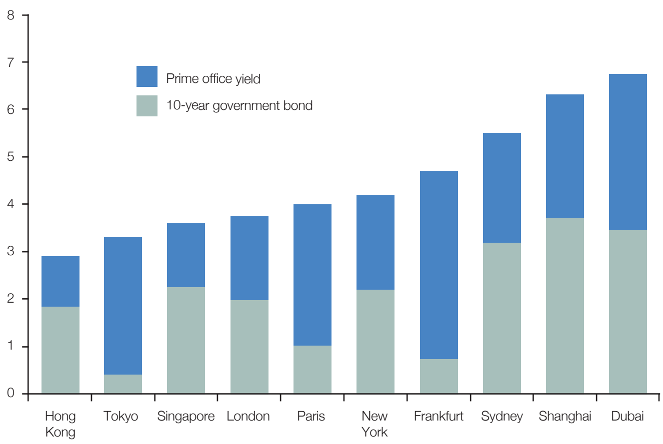
Source: Knight Frank

FIGURE 5
Prime Office Vacancy Rate, Dubai (%)



Sources: REIDIN, Knight Frank

FIGURE 6
Prime Office Yield Spreads in Major Global Cities



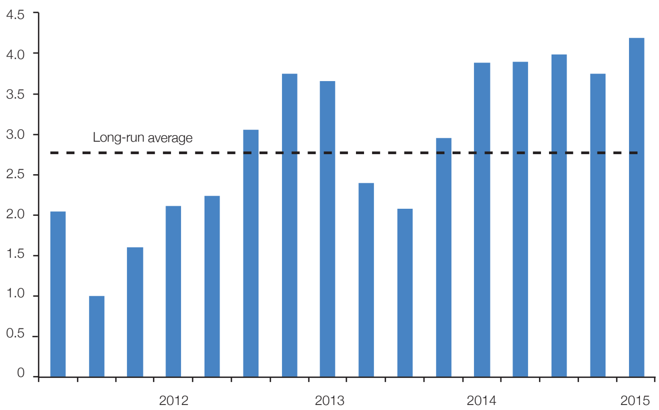
Sources: Bloomberg, Knight Frank

yields closing much as a result of rising government bond yields; it may be that a more material adjustment in all-property yields is likely. After all, if the historical relationship between GDP growth and the movement of all-property yields holds, the improvement in the economic climate should apply downward pressure on yields over the remainder of this year.
(See Figure 8)

That said, compared to history, the US dollar remains strong against the euro, the British pound and the Russian rouble. Since the UAE dirham is pegged to the US dollar then, real estate in Dubai is now more expensive for buyers holding other currencies. On the flip side though, the strength of the greenback has increased most GCC-based investors' buying power abroad.

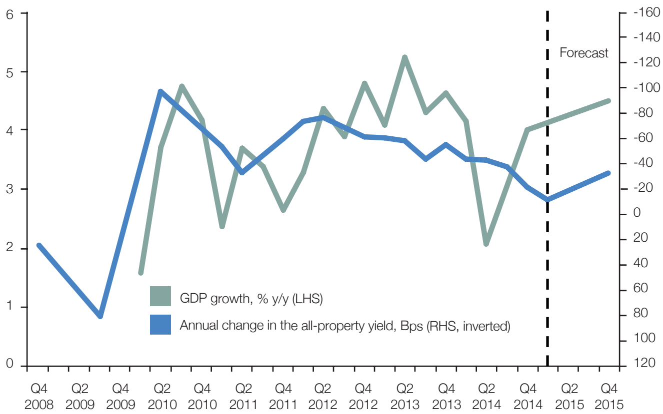
On balance, if the historical relationship between GDP growth and all property yields is anything to go by, the projected improvement in economic conditions in 2015 should provide further scope for prime all-property yields to harden. This in turn should reduce the gap between Dubai government and property yields to bring it back into line with the long-term average.

FIGURE 7
Difference between the All-Property Yield and Dubai 10-Year Government Bond (%)



Sources: Bloomberg, Knight Frank

FIGURE 8
Change in the Prime All-Property Yield and GDP Growth, Dubai



Sources: Dubai Statistics Center, DED and Knight Frank

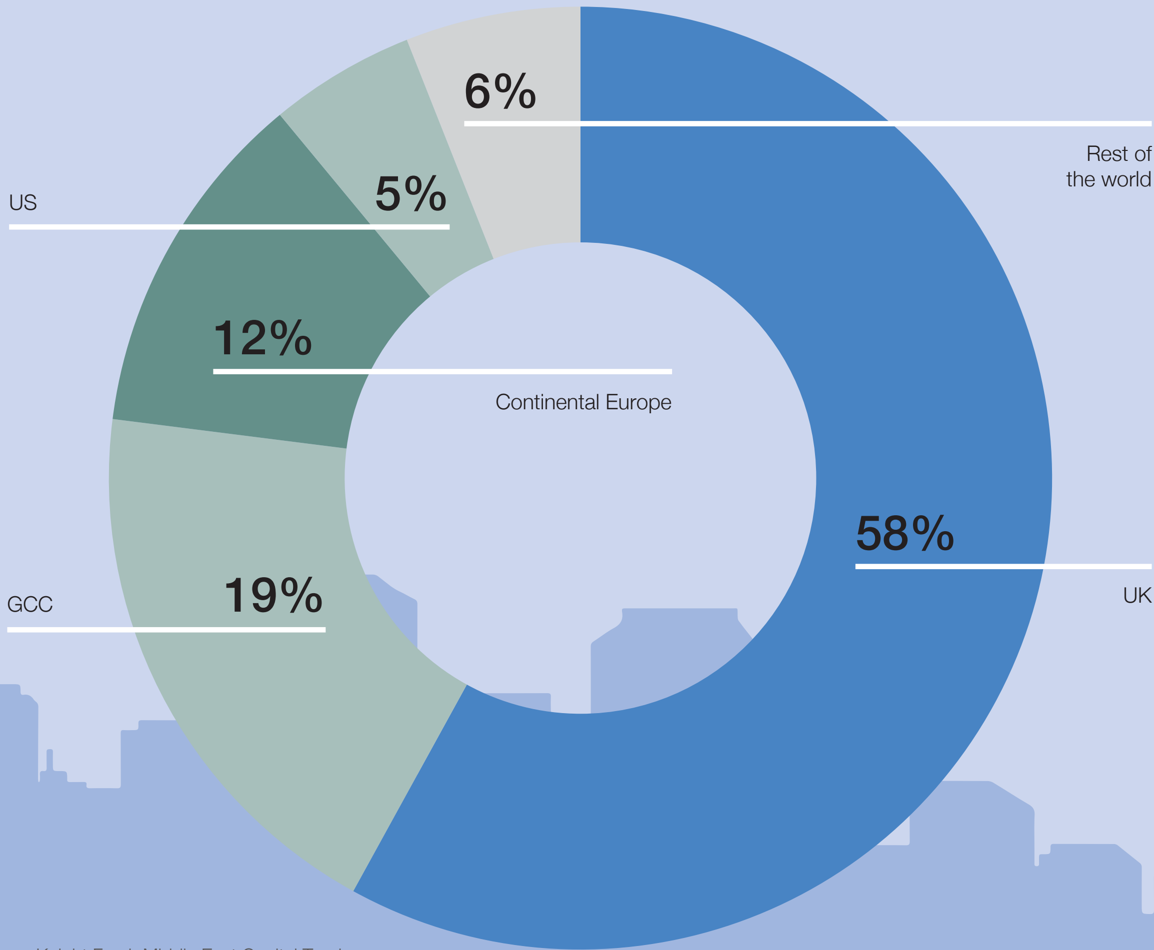
Which markets are real estate investors from the GCC targeting?

Knight Frank's Middle East Capital Tracker monitors real estate investors' favoured global destinations. A broad look at the results shows that the UK remains a firm favourite for almost three-fifths of investors from this region, albeit the GCC and Continental Europe are also important targets. Although the US currently makes up 5% of overall demand, we have seen an increasing number of enquiries for this market. *(See Figure 9)*

Rolex Store, Knightsbridge, London - acquired by a private client of Knight Frank Middle East (Q1 2015)

FIGURE 9

Primary Investment Destinations Being Targeted by Survey Respondents in the GCC



Source: Knight Frank Middle East Capital Tracker

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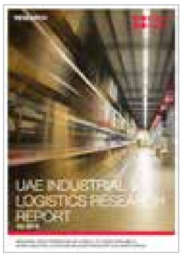
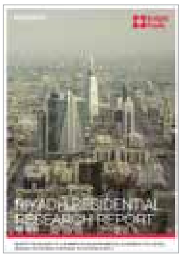
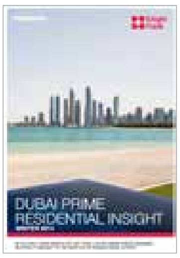
Dubai Offices
Market Update
Q3 2014



UAE Industrial & Logistics
Research Report
H2 2014

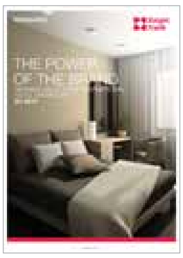


Riyadh Residential
Research Report
H2 2014

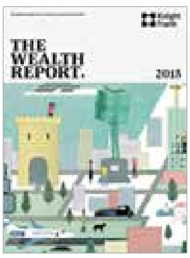


Dubai Residential
Insight Winter 2014

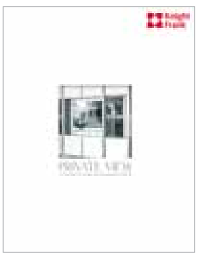
Global Capital
Markets Q1 2015



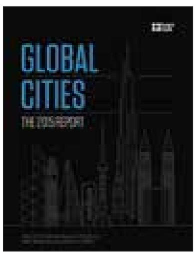
UAE Hospitality Report
Q1 2015



The Wealth Report 2015



Private View 2015



Global Cities
The 2015 Report

Knight Frank Research Reports are available at **KnightFrank.com/Research**

Definition: Indicative prime yields are based upon a hypothetical best in class asset and are net of market level acquisition costs. Prime yields are based on rack rented properties and disregard bond type transactions. This data is provided for general reference purposes only.

Knight Frank

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