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Cluttons Middle East, part of the Savills Group

Muscat, Spring 2018

PROPERTY MARKET OUTLOOK

ECONOMIC BACKDROP

GDP improvement tempered
GDP growth in Oman for 2017 is estimated to have been a marginal 0.2%; down from the previous estimate of 0.4%. While a recovery in 2018 still appears likely, the expectation is that 2018 will see the economy expand by 3.6%, rather than the 5.2% forecast late last year. The slower than predicted rise in non-oil activity is the key reason for the downgrading in growth (Oxford Economics).

Government income and foreign exports rise
While there is likely to be a slower than anticipated return to growth this year, government figures show that its revenues grew by 20% to OMR 6 billion between Q1 and Q3 2017 in comparison to revenues of OMR 5 billion during the same period in 2016, driven primarily by a 35% increase in net oil revenues.

In the same period, total merchandise exports grew by 22% from OMR 7.5 billion in 2016 to OMR 9.1 billion in 2017. The most significant contributor was an increase of almost 30% in oil & gas exports, underpinned by the ramping up in production at the Khazzan gas facility. Encouragingly, non-oil exports grew by over 30% from OMR 1.8 billion in 2016 to OMR 2.4 billion in 2017.

Buoyed by higher oil prices, the economy is showing a good recovery from the lows of 2016 and this should have positive impacts across the real estate sector if this growth is sustained in the longer term.

0.2%
Forecast GDP growth in 2017

Source: Oxford Economics

3.6%
Forecast GDP growth in 2018

Source: Oxford Economics

GDP growth forecast

Source: Oxford Economics

Positive outlook for the tourism sector
Away from the oil and gas sector, the Sultanate's tourism sector remains one of the most vibrant segments of the economy with arguably the highest untapped potential. In fact, The Travel & Tourism Economic Impact 2018 Oman report by the World Travel & Tourism Council projects a bright future for the tourism sector in Oman, with the country being ranked 18th globally for its potential for tourism growth to 2028.

The report states that the direct contribution of the tourism sector to Oman's GDP amounted to OMR 0.85 billion (3.2% of total GDP) in 2017. This is forecast to grow by 6% in 2018 and then by an average of 5.9% per year to 2028 when the direct contribution of tourism will be OMR 1.6 billion (4.3% of total GDP).

The wider contribution of tourism and all related sectors to Oman's GDP amounted to OMR 1.8 billion (6.6% of total GDP) in 2017. This is forecast to grow by 6.3% in 2018 and then by an average of 5.9% per year to 2028 when this total will be OMR 3.3 billion; 8.9% of total GDP. We view this projected improvement as a seismic shift in the fundamental make up of the Sultanate's economy and certainly one that puts the economy on a path to more widespread diversification.

In parallel, inbound tourist numbers are projected to rise to 4.8 million and corresponding expenditure is set to expand to OMR 2.1 billion by 2028. Growth to 2028 is projected to be primarily focussed on inbound, leisure tourism which bodes well for the hotel sector in Oman.

Improving air connectivity
This projected increase in tourist arrivals is expected to be supported through the successful opening of the new airport terminal at Muscat International Airport in March, which will go some way to boosting to Oman's tourism sector by making entering and exiting Oman a more pleasant and efficient experience, while the increased capacity could attract new airlines to include Muscat in their networks.

The impetus of Oman's tourism sector is illustrated by the growth of Oman Air which primarily flew domestically and regionally until 2007 but has since developed an international network of 45 destinations. The company will introduce flights to/from Istanbul, Casablanca and Moscow during 2018, while we understand that it is also investigating the reopening of routes to/from Beirut, Singapore, Chittagong, Dhaka and the Maldives.

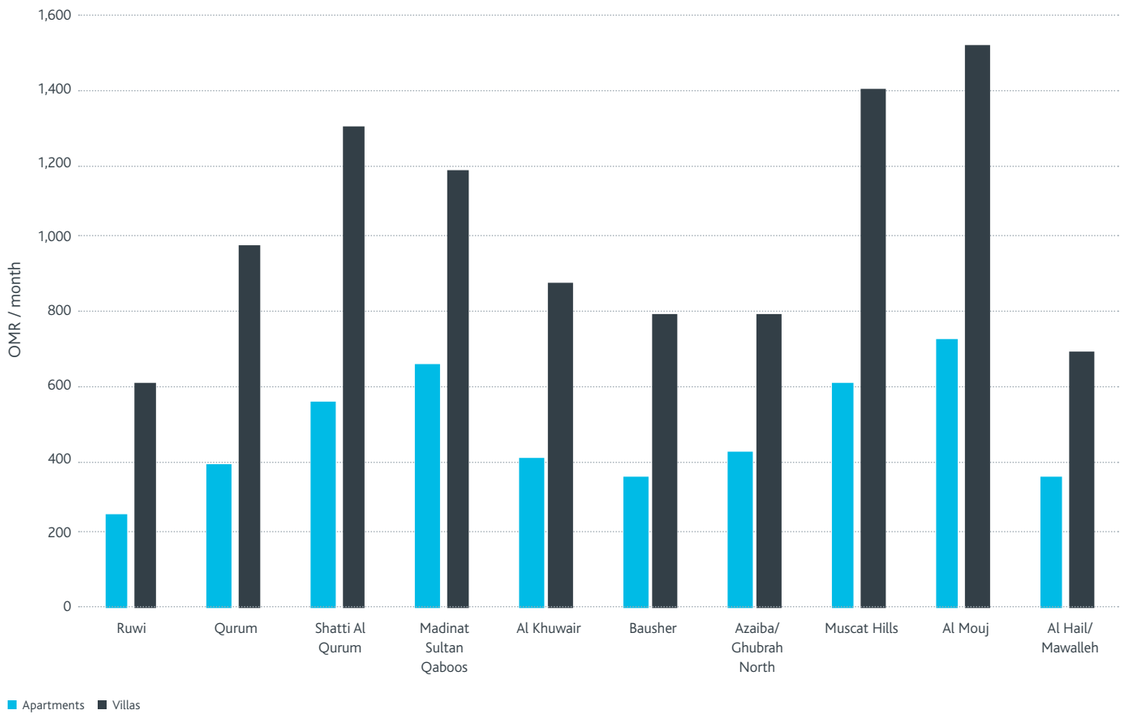
RESIDENTIAL MARKET

Rents stabilise for first time in two years
Undoubtedly, the improving economic profile for the Sultanate has filtered through to the property market as well. Following the sharp corrections in residential rents over the last two years, in the aftermath of the oil price drops, rental rates in Muscat appear to have stabilised, with a marginal 1.1% decline in average rates in the three months to the end of March. This follows on from a 0.9% rise during Q4, which lifted the annual rate of change to 0.6%, the first positive increase in rents since 2014. The slight drop in rates during Q1 however has pegged the annual rate of change back to -0.5% and leaves monthly average rents at OMR 714.

The weakest performing markets during the first quarter were Azaiba / Ghubrah North (-4.6%), Muscat Hills (-1.6%) and Madinat Sultan Qaboos (-0.4%). While the declines were marginal in Madinat Sultan Qaboos, we have noted a fall in the number of enquiries from tenants for this submarket. The increased level of congestion and rising level of construction activity is likely to undermine rents here further through the course of 2018.

Bausher (4.5%), Shatti Al Qurum (2.8%) and Qurum (0.6%) were the only locations to register a rent rise during Q1, while all other locations recorded no change in average rental rates.

Average residential rental values by submarket – Q1 2018



Source: Cluttons

Visa rule changes to lead to a reduction in the number of expatriates?
Although the total number of expatriate workers in Oman grew from 1.35 million in February 2014 to 1.85 million in February 2018, the last two years have seen the number of expatriate workers with further/higher education qualifications decline by 7.5% due to challenging economic conditions.

A further hurdle for the market has arisen following The Ministry of Manpower's decision in January to temporarily ban the issuance of work permits to expats in 10 key sectors, covering 87 job types: sales, administration, marketing, insurance, HR, media, airports, engineering, marketing and technical professions. The temporary ban is likely to result in a further drop in the number of professional expatriates, particularly if it is extended beyond its current six month period and/or is widened to cover a greater range of professions.

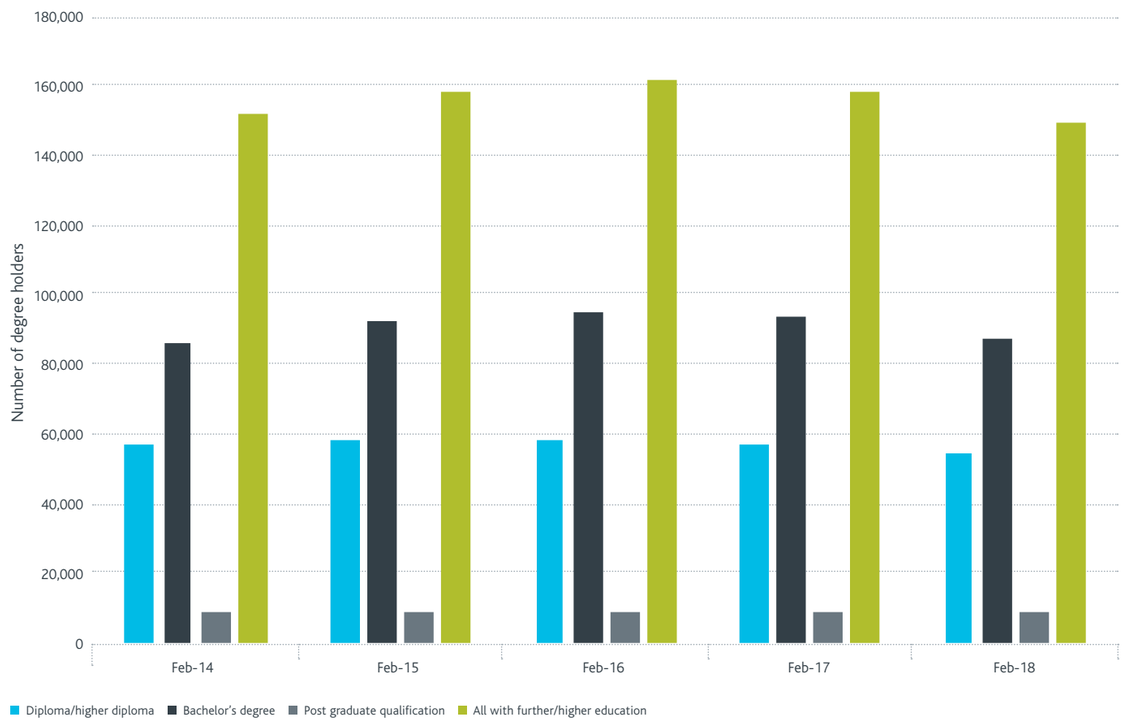
The inevitable fall out from a reduction in the number of new expatriate workers coming to the country for work, coupled with the fact that many may find themselves out of work upon the expiry of their current work permits, is likely to hurt demand in the short to medium term.

Outlook stable for now
At present, all signs suggest that the residential market is at, or near, the bottom of the current property cycle, but while the number of downside risks appears to have diminished, the expat visa ban rule detailed above is currently the single biggest risk to our flat baseline outlook for 2018, which remains unchanged from last year.

Residential rental demand sits at, or close to, historic lows across the city and the current rental stability follows the 21.5% decline in average rental rates over the past four years. While the flatlining rents suggest that a plateau of sorts may be emerging, we consider that the sector remains vulnerable to further downward pressure. Should the visa ban be extended beyond the current proposed six months, it would certainly cause our forecast of stable rental values to unravel and result in further but limited declines in the second half of 2018.

Conversely, if we continue to see gains in oil prices, then this will continue to drive the economy upwards and is likely to result in a boost to the residential market, particularly in terms of demand.

Oman's professional workforce in numbers



Source: National Centre for Statistics & Information

OFFICE MARKET

Rents remain unchanged
The office market in Muscat remains flat, with average headline rents holding steady in the city's key submarkets during Q1 2018. This follows stagnation during 2017, with the exception of the CBD area, where rents dipped by 250 baisa to OMR 2.75 psm at the end of last year. The CBD retains its position as the cheapest submarket to rent an office in Muscat.

Despite this apparent stability, the limited number of deals in the market continue to be concluded below headline asking rates, underscoring the challenges faced by landlords in attracting and retaining high quality occupiers.

Quality still commands attention of occupiers
Even in a market that has faced setbacks in the form of a demand slump following the shock oil price rout four years ago, there remains a handful of occupiers who are drawn to high quality buildings and are committed to upgrading space, despite the uncertain economic conditions that have prevailed over the last four years.

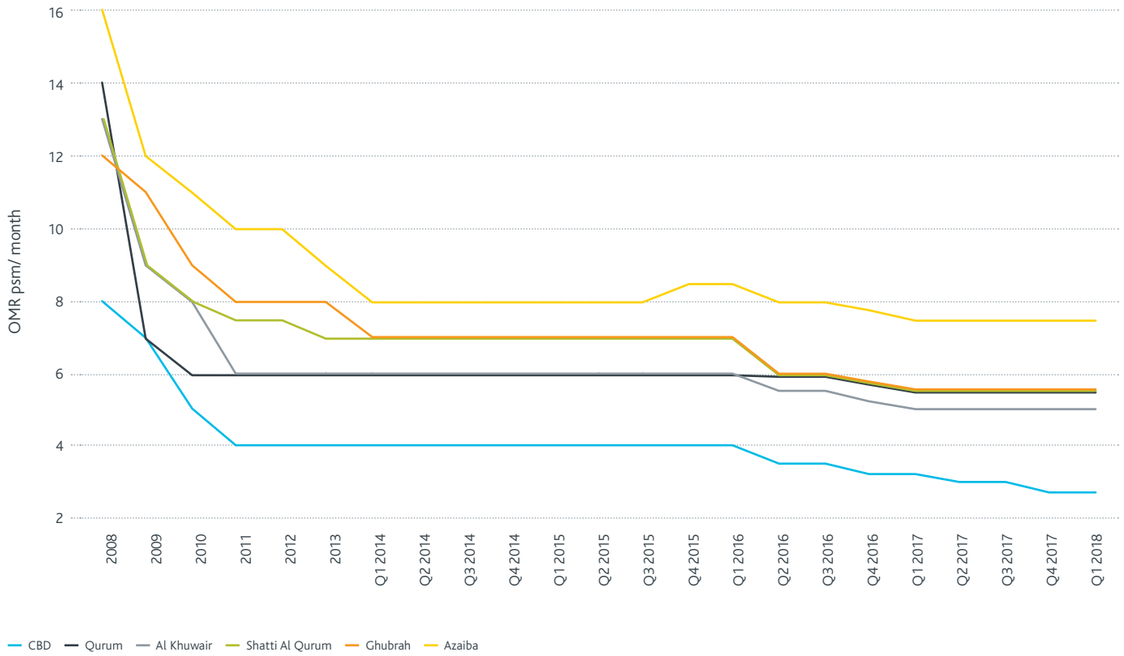
Mixed outlook
Like the residential market, the downside risks to the office market from the expat visa change rule are a concern. Whilst the impact of the low oil price environment has taken its toll on headline rental rates, with markets like the CBD seeing a drop of nearly a third over the last four years and Ghubra and Azaiba seeing rents slip by just over 20%, the effective limitation on recruiting new staff in the professions outlined above may well impact on organisations' growth strategies.

This will inevitably filter through in the form of weaker demand and may cause office rents to slip further from their current historic lows, should the economy weaken as a result of the decision.

That said, for this scenario to play out, the expat visa ban would need to be extended beyond the current proposed six month period, but nonetheless remains a potential barrier on the pathway to the recovery of not only the office market, but the residential market too.

As with the residential market, however, continuing increases in oil prices are likely to add impetus to the sector, particularly in terms of demand, although we consider it highly unlikely that there will be any increase in rental values over the course of this year.

Performance of office rents across Muscat's key submarkets



Source: Cluttons

REAL ESTATE SECTOR ADVANCES

Introduction of Real Estate Investment Funds (REIFs)
Separately, the government is working to boost overall economic growth and this has filtered through to the property market in the form of some very encouraging developments.

For instance, the much anticipated decision to allow the creation of a real estate investment fund (REIF) is now a reality. This follows the Capital Market Authority's Decision 2/2018 (the REIF Regulations) and Ministerial Decision 95/2017 issued by the Ministry of Housing.

REIFs will allow investors to invest in larger scale real estate projects at significantly lower price points and with far greater liquidity in comparison to more traditional real estate investment. The increased ability of both institutions and individuals to invest in income generating real estate assets has the potential to provide a significant boost to the real estate sector in Oman, particularly since the regulations require that at least 75% of a REIF's assets must be invested in the Sultanate.

It will be interesting to see whether, following the introduction of REIFs, Oman follows recent developments in Dubai in the future to allow crowdfunding for real estate. This would further open up opportunities to a significantly wider market interested in investing in real estate at low entry price points.

The challenge for REIFs will of course be around the sourcing of investment grade assets, which, like elsewhere in the region, remain limited. That said, the REIFs law may well be the impetus needed by developers to shift their strategic development focus from local to global.

Khazaen Economic City gains momentum
Elsewhere, a deal was signed in March for Saudi Arabia-based Mohammed Ali Al Swailem Group to act as the master developer for the 51 million sqm Khazaen Economic City project in Barka. Work on the first phase of the project is expected to start later this year. With a focus on logistics and industrial activities, the development has the potential to both become a major new economic hub and to provide a suitable location for the potential relocation of industrial and logistics operators in Ghala, thereby aiding the long mooted redevelopment of this area. Clearly this would be of significant long term benefit to Muscat.

Landlords adapting to challenging market conditions
When market conditions are challenging, both residential and commercial landlords need to be proactive in order to attract and retain tenants. Key issues that should be considered include:

"In testing times, landlords' primary aims should be to generate demand and drive occupancy rather than achieving the highest rental values."

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2071