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THE PROPERTY REPORT

UNITED ARAB EMIRATES | 2017

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WEAKER ECONOMIC GROWTH BECOMES THE NEW NORMAL

As we approach the third anniversary of the spectacular collapse in oil prices, they remain 50% to 60% below their USD 100 plus per barrel levels last seen in mid 2014. The implications for the UAE have been varied, with emirates such as Abu Dhabi and Sharjah that rely on oil revenues to spur economic growth, seeing growth rates trimmed as the fall out lingers, curtailing expansion across almost all sectors. For Dubai, where oil income forms a fraction of total GDP growth, the impact, while delayed, has also been marked, primarily due to the slowing growth in surrounding Gulf economies, rather than any underlying weakness in Dubai itself.

Conflicts elsewhere in the Middle East, the Qatari diplomatic crisis, the messy Brexit negotiations now unfolding and the unpredictable nature of the Trump presidency in the United States are all weighing on global growth and continue to limit the UAE economy's ability to register double digit GDP growth.

With the uncertain global economic climate expected to persist, Oxford Economics has forecast that UAE GDP growth by the end of this year will be lower than 2016, rising by 1.7%; the slowest pace of expansion since 2010. Conditions are being exacerbated by the low oil price environment which will drive further consolidation in the sector. This forecast is far more conservative than the UAE Ministry of Economy's own forecast of 3% growth in 2017. The International Monetary Fund has however made two revisions to its growth forecast for the UAE, with the latest 2017 prediction in early July standing at a mere 1.3%; down from a January estimate of 3.3%. Emirates NBD, Dubai's largest lender, meanwhile has forecast GDP growth of just 2% nationally this year, down from an earlier estimate of 3.4%.

OIL PRICE WEAKNESS STILL WEIGHING ON GROWTH

While the weak oil sector continues to act as a drag on overall expansion, the non-oil sector is expected to help drive growth through the second half of 2017. In fact, following the weakest monthly performance in six months at the end of May, the Emirates NBD UAE Purchasing Managers' Index showed a turn around in the rate of growth in the non oil sector. The index rose from 54.3 in May to 55.8 in June, positioning it above the long run average of 54.5; a figure above 50 indicates expansion. While the growth in the number of new orders was reported to have risen, the rate of job creation ebbed to an eight month low.

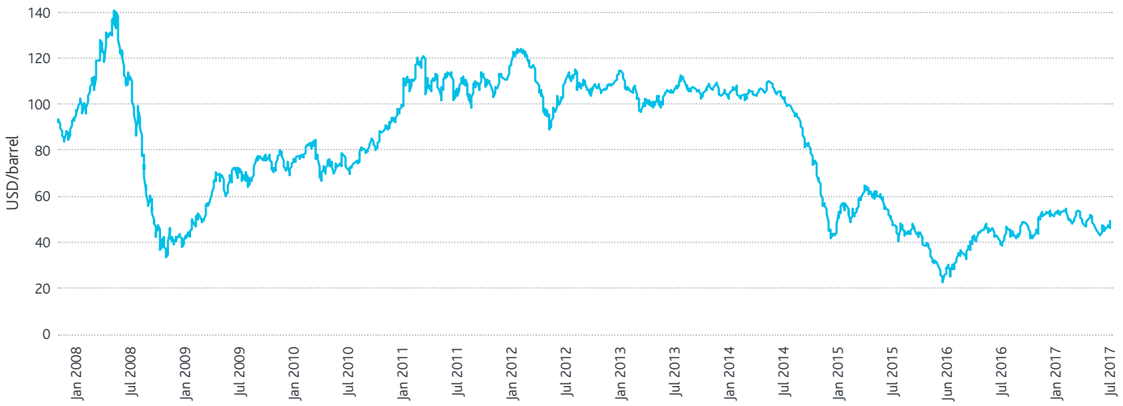
2018 and 2019 are expected to see an increase in the rate of economic expansion, underpinned by higher spending levels, particularly in Dubai, in the lead up to the 2020 World Expo, with 3.3% and 3.6% growth forecast, respectively (Oxford Economics).

On an emirate level, GDP expansion in Dubai slowed to 2.7% last year, down from 4.5% in 2015, according to the Government of Dubai. 2017 is forecast to register growth of 3.1%. Slower global growth has hampered local economic conditions in the emirate. This is also reflected in the sluggish Emirates NBD Dubai Economy Tracker Index, which shows growth having accelerated in June, with new business orders continuing to rise for the 16th consecutive month. However, job creation rates have eased in the all important tourism, travel and construction sectors, while business confidence has retreated to a 12 month low. The increasingly stagnant conditions are reflective of the faltering health of the global economy.

Elsewhere, the Bank of America Merrill Lynch (BoA) announced that GDP growth in Abu Dhabi slowed sharply to 2.8% in 2016, from 5% a year earlier. Abu Dhabi's Department of Economic Development has however forecast a rebound in economic activity, which will translate into growth of between 3.5% and 3.7% this year. The BoA has projected that ongoing fiscal consolidation as a result of the oil price collapse will drive the budget surplus in the emirate up to 10%, with spending likely to slip by 6.2% by the end of 2017.

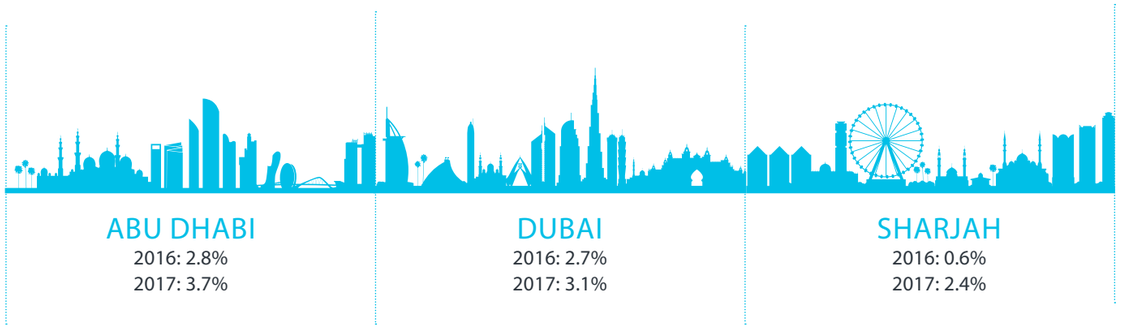
Meanwhile, in Sharjah, Standard & Poor's (S&P) expects GDP growth to average 2.4% per annum between 2017 and 2020. S&P earlier announced that 3.5% growth was registered in 2015, which Moody's Investor Services believes slowed to just 0.6% last year as weak oil prices took their toll on overall investment activity in the country's third largest emirate.

Performance of oil prices



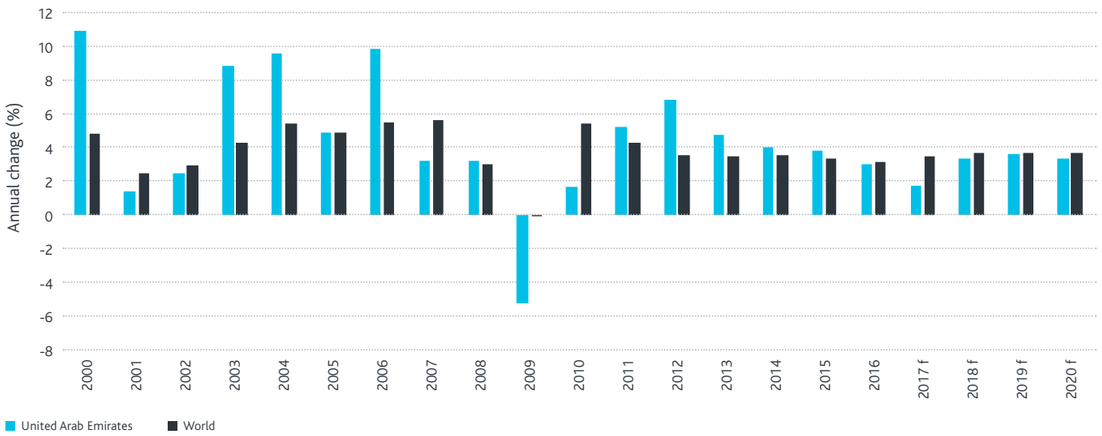
Source: OPEC

GDP growth



Source: Oxford Economics, Abu Dhabi Department of Economic Development, Government of Dubai, Bank of America Merrill Lynch, Standard & Poor's

UAE GDP growth forecast



Source: Oxford Economics, IMF

VAT LOOMS

As we have mentioned previously, the GCC Governments' plan to introduce a formal tax regime, as part of smarter fiscal policies designed to reduce the reliance on hydrocarbon incomes, now looms. We view this as a tremendously positive step in the right direction as the Governments of the region cement much needed alternative revenue streams.

The formal Value Added Tax (VAT) regime begins on January 1, 2018, with the initial rate of VAT set at 5%. In recent months, some GCC member states have already implemented varying degrees of VAT on some goods. Saudi Arabia has for instance implemented a 50% tax on soft drinks, in addition to a 100% tax on energy drinks and tobacco.

In the UAE, VAT regulations continue to be drip fed to the market, with the Ministry of Finance announcing in early July that companies with annual revenues of over AED 375,000 would be liable for VAT. Meanwhile, it has also been clarified that no special arrangements will be made for small and medium sized businesses.

When it comes to property, commercial leases will be charged a 5% VAT, while residential rental property is expected to be exempt from any taxation.

The new VAT regime is clearly expected to fuel inflation, squeezing household budgets further and stalling economic expansion. It is likely to take up to 12 months for the markets to absorb the change, before we see signs of a resumption in growth.

ABU DHABI

Etihad Towers

THE PROPERTY REPORT | ABU DHABI

RESIDENTIAL MARKET

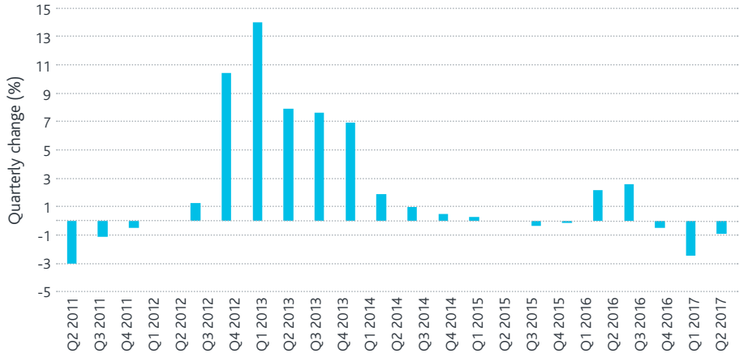
RESIDENTIAL VALUES REMAIN UNDER PRESSURE

The first six months of 2017 have seen a continued lacklustre performance of residential values in Abu Dhabi's main residential investment areas, with values overall dropping by 0.9%. This of course does mask a far more complex picture. The seemingly slower rate of declines has improved the annual change to -6.3% in the 12 months to the end of June, from -7.5% at the end of Q1. This latest change now leaves average residential values standing at just a little over AED 1,150 psf.

Apartments posted larger corrections in the six months to the end of June of -1.4%, compared to just -0.3% for villas. On a submarket level, the three weakest performers all came from the luxury end of the property spectrum, with high end apartments on Al Raha Beach (-3.3%) and Saadiyat Island (-3.3%) being joined by Al Reef Villas (-2.9%).

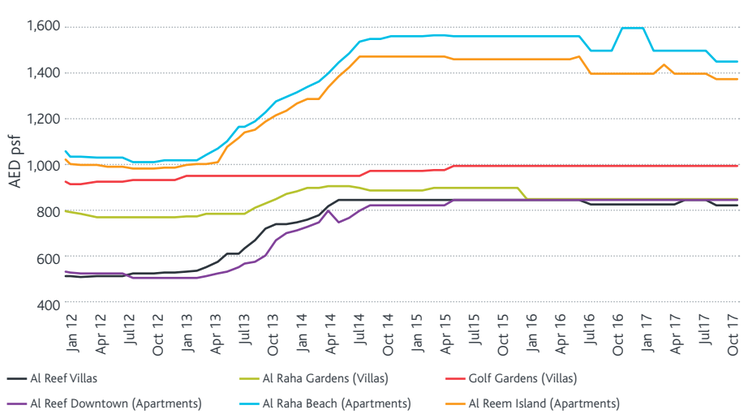
This theme has prevailed over the course of the last 12 to 18 months, not only in Abu Dhabi, but across the rest of the UAE and many other major global markets as well, with investors shying away from committing to luxury home purchases, which is where we continue to record the most severe declines. In fact, sea view villas on Saadiyat Island emerged as the weakest performers in the market, with values declining by 22.2% over the last two years. Over the past few months, there does however appear to be some stability returning here, with values firming at about AED 1,750 psf.

Performance of Abu Dhabi's residential capital values



Source: Cluttons

Performance of residential capital values in Abu Dhabi's key residential submarkets



Source: Cluttons

On an annual basis however, mid-range apartments on Al Reem Island have come under the most pressure across Abu Dhabi's residential investment areas, with averages prices dipping by 15.4%, or AED 100 psf, to AED 1,100 psf. Reem Island did enjoy a resurgence in demand and activity in the first half of 2014 as a community feel began to emerge due to the rapid completion of a number of schemes in unison, however this also forced values up to the AED 1,350 mark, positioning it line with some of the most exclusive residential areas in the city and so it was only a matter of time before house prices in this submarket normalised and settled.

The submarkets enjoying the greatest degree of stability are still those that are perceived to offer the greatest value for money and where prices are amongst the lowest to be had in the city. Al Raha Gardens (AED 850 psf), Al Reef Downtown (AED 850 psf), Ghadeer apartments (AED 950 psf) and Golf Gardens (AED 1,000 psf), have all seen values remaining firm over the last 12 months, underpinned by their relative affordability.

WEAKER UNDERLYING FUNDAMENTALS

Abu Dhabi's economy remains intrinsically linked to the hydrocarbon sector, which has, as we have stated previously, been a critical engine of growth for a range of supporting and related economic segments, each of which plays a key role in creating fresh demand for both residential and commercial property in the emirate. The impact on the economy is best illustrated by the contribution of oil to overall GDP. According to the Statistics Centre Abu Dhabi, overall GDP output slipped from AED 910 billion in 2012, to AED 730 billion at the end of 2016. At the same time, oil revenues declined from 516 billion (or 57% of GDP) to 201 billion at the end of last year (or 28% of GDP). Clearly, the Government's diversification efforts have helped to buffer against the collapse in oil revenues, but there remains a challenging road to recovery ahead.

Since the start of the year, there has been a notable decline in the depth of demand we have been recording for the purchase of residential property, linked in part to diminished buyer and investor confidence as economic headwinds continue to drive an ongoing softening in values.

The weaker confidence levels have been exacerbated by a scaling back in public sector spending, as evidenced by the growing list of project delays. Ratings agency Fitch claims that Government spending declined by 10% last year, following an 18% decline in 2015, which slowed non-oil GDP growth to 3.5% in 2016, from 7.6% in 2015.

Meanwhile, Middle East Economic Digest (MEED) estimates that projects worth at least AED 297 million have been put on hold, while projects totalling AED 253 million are progressing. Cultural icons for the Emirati capital such as the Guggenheim and the Zayed National Museum are yet to be tendered, while the Louvre has had its opening date pushed back. Furthermore, the new Midfield Terminal at Abu Dhabi International Airport is now expected to open in 2019, instead of this year, as originally planned. This is expected to curb Etihad Airways' expansion.

For would be buyers and investors, while residential property priced at between AED 800 psf to AED 1,000 psf remains a particular sweet spot, developers are wary of affordability challenges. We have already seen TDIC move to launch the first phase of Saadiyat Lagoons, with two-bedroom homes priced at AED 2.4 million (or AED 1,123 psf), making it the most "affordable" development on Saadiyat Island to date. Saadiyat Lagoons is expected to eventually house 4,000 homes. Aldar too demonstrated the strong appetite for more affordable homes through the record sales of units in three of the six towers at The Bridges on Al Reem Island when they were launched earlier in the year, with prices starting from AED 450,000.

Still, the depth of overall demand has been tempered by wide ranging redundancy programmes in the public and private sectors. Furthermore, the ongoing erosion of food and energy subsidies, combined with a looming VAT regime and higher inflation levels, which have hovered around the 2% mark so far this year, has put households under tremendous financial pressure. Oxford Economics believes the new 5% VAT could add some 2% to overall inflation levels next year. There is also the risk of rising borrowing costs if the US raises interest rates further, given that the UAE Central Bank largely mirrors US fiscal policy.

RENTAL SUPPLY GROWING

These factors have pushed the home ownership dream further away for many, while some remain nervous to commit due to job security concerns. Indeed this cautious behaviour has had a clear and direct effect on the rental market as well.

While rising household costs, for the reasons outlined above, may mean that some decide to abandon home ownership altogether, there are those who remain committed to building deposits and remaining in rented accommodation, possibly for longer than initially planned. The overall impact of this apparent strengthening in demand for rented property has been undermined by rising supply levels of rental property.

This has been particularly evident on Reem Island, where a sudden surge in completions and the emergence of a number of 'accidental landlords' has kept rents in this submarket under pressure. Buyers and investors have experienced an 11.9% drop in capital values in this market in the 12 months to the end of June and have, unsurprisingly, transferred homes to the rental market to generate incomes. This extra supply, combined with slower economic growth, has caused rents on Reem Island to decline by 8% over the same period.

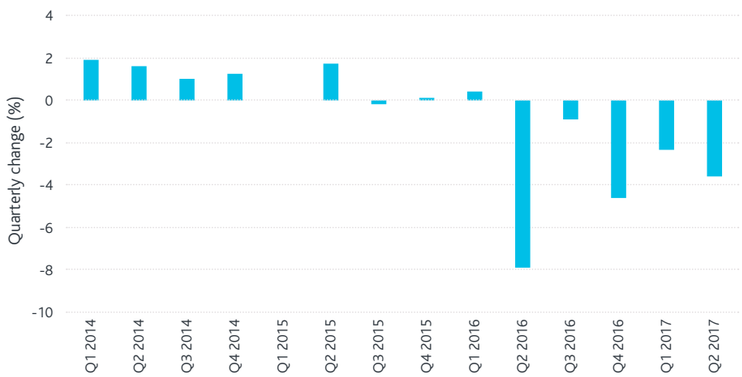
RENTS CONTINUE TO CONTRACT

Rising rental supply levels and slower economic growth have together sustained the downward pressure on rents we have been reporting for the past 18 months. The diminished number of requirements for full-building corporate lets that the market had become accustomed to has added to the overall malaise.

With job security fears stemming from economic weakness and financial cost pressures growing for households, it comes as no surprise that locations perceived to offer the best value for money remain high on tenants' wish lists.

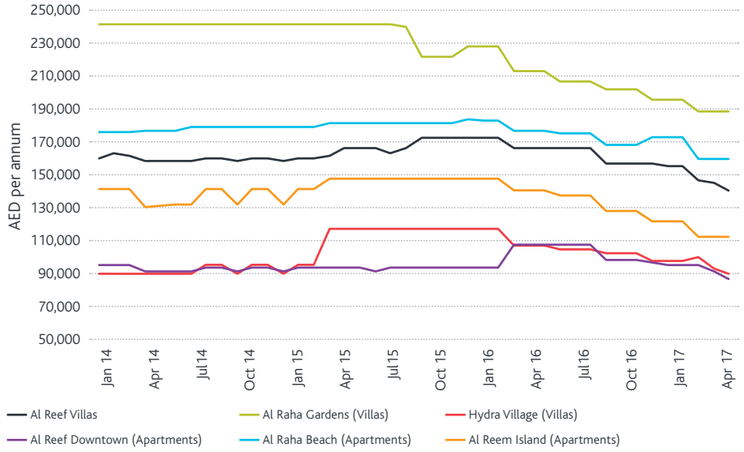
For now, rents across Abu Dhabi's residential investment areas declined by a further 3.6% during the second quarter of 2017, taking the annual rate of change to -11%. This has left average rents just shy of AED 170,000 per annum. Apartments (-12%) have led the declines, while villas have recorded a 10.1% decrease in rental rates over the same period.

Performance of Abu Dhabi's residential rental values



Source: Cluttons

Performance of rental values in Abu Dhabi's key residential submarkets



Source: Cluttons

The four weakest performing rental submarkets between January and June have been Al Reef Villas (-10.6%), Al Reef Downtown (-10.3%), Al Raha Beach (-8.6%) and Al Reem Island (-8%). Interestingly Al Reef Downtown had emerged as one of the strongest performers last summer, registering double digit rental value growth as demand began to outstrip supply, with tenants drawn in to the area by relatively low rents, easy access to central Abu Dhabi and the emergence of a community feel as more schemes began to complete. As rents here began closing in on rates in other residential investment zones, such as Reem Island, tenant demand shifted to other more affordable locations.

Still, with average annual rents for one- and two-bedroom apartments in Al Reef Downtown standing at AED 75,000 and AED 90,000 respectively, they are still some AED 30,000 to AED 40,000 cheaper than the average rates for the emirate overall. The recent softening of rents in this location may well aid its overall competitiveness going forward.

MORE CORRECTIONS TO COME

While the prospects for any sudden rebound in oil prices appear unlikely during the second half of 2017, the Government's economic diversification efforts, have, to an extent, been curbed by the faltering global economic conditions. It is worth noting that oil giant BP has forecast oil prices to remain below USD 55 per barrel until the end of 2018.

In the short term, we expect demand for residential property to be supported by expansionary activity in the hydrocarbon and public sectors. And while these two crucial elements in Abu Dhabi plc remain weak, requirements for residential property for rent will likely remain subdued, at least over the course of the next six to twelve months. With this in mind, it is our expectation that average rents will end the year 8% to 10% down on 2016.

Similarly, the weaker overall sentiment prevailing in the market, combined with lower rates of job creation, are expected to limit the sales market's ability to stabilise, at least during 2017. So while investors remain in a holding pattern and institutional funds struggle to find substantive investment opportunities, we expect capital values to end 2017 5% to 7% lower than 2016.

The risks to our forecast remain skewed to the downside, with wider global macro issues topping the list of our concerns. On the regional front, the main risk to our forecasts stems from the Qatari diplomatic crisis. While it has the potential to cause a spike in oil prices, should the situation escalate further, it also has the ability to deter investment activity across the whole region.

COMMERCIAL MARKET

OFFICE RENTS FALTER

Earlier in the year we reported on the deteriorating rents in the city's office market. After prime office rents demonstrated greater resilience than their secondary and tertiary counterparts, they too have begun to experience downward pressure.

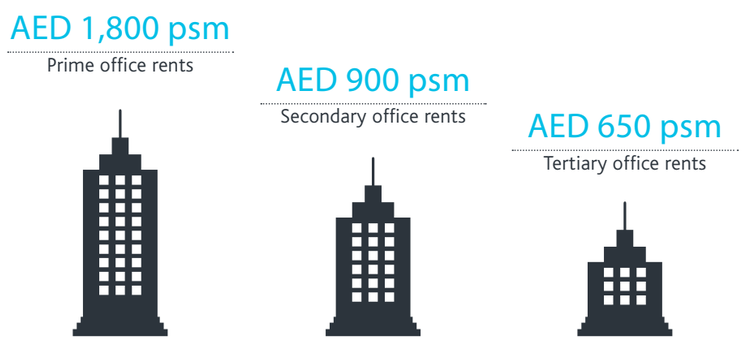
As outlined above, the importance of the public and oil sectors cannot be stressed enough. These two segments of the emirate's economy have historically been the backbone of demand in Abu Dhabi's office market. And with both segments on the back foot, we continue to witness a deteriorating level of requirements from occupiers. What is worth noting however is the upturn in requirements from public sector entities seeking to cut costs through office space consolidation. We are for instance aware of requirements of this nature that range from 3,400 sqm, rising to 24,000 sqm.

The liquidity squeeze faced by the public sector as a result of the fall in oil revenues has resulted in the cancellation, or delay, of a multitude of high profile projects across the emirate. As a result, we understand that a number of businesses reliant on public sector spending are being forced out of the market due to a lack of lucrative contracts, which is adding to the diminished number of enquiries and requirements.

Most enquiries we continue to receive are spawned from the requirement of businesses to have a commercial presence in the emirate in order to do business. Therefore, more often than not, requirements are for a small amount of token space, typically in the region of 150 sqm to 350 sqm.

A key emerging feature of the market is lease flexibility. Corporates are increasingly demanding this both at renewal and for new leases, often citing economic uncertainty as the chief reason.

Average office rents in Abu Dhabi



Source: Cluttons

As a result of the persistent weakness in demand, average prime office rents slipped by AED 50 psm to AED 1,800 psm at the end of the second quarter, 10% down on last summer. Similarly, secondary rents (AED 900 psm) are 25% lower than the summer of 2016, while office rents for more tertiary space have registered a 19% fall in the last 12 months and currently stand at an average of AED 650 psm.

Interestingly, the city's schemes perceived to be in the super prime category, namely Etihad Towers (AED 2,250 psm), International Tower (AED 2,050 psm) and the Aldar HQ Building at Raha Beach (AED 1,900 psm), remain amongst the most sought after office addresses in the city and continue to command the city's highest rents, although here too vacancy rates are creeping up. In addition, rent free periods are increasingly common, and continue to lengthen even at the top of the market, as are rent reductions for existing occupiers at renewal.

LANDLORDS ADJUSTING TO CONDITIONS

While there remain some landlords who are reluctant to adjust rents and are unfazed by the prospect of rising void periods, particularly in core non-freehold areas, there are a number of landlords in the market keen to temper expectations to match market conditions. So while rents in the city's most prestigious prime buildings, such as Etihad Towers (AED 2,000 psm), for instance, appear to have remained steady during Q2, rents on an annual basis have retreated virtually across the board.

Of the prime buildings we track, the three weakest performers over the course of the last 12 months have been Capital Gate (-32.4%), Addax Tower (-30.0%) and International Tower (-19.5%), where rents at the end of Q2 stood at AED 1,250 psm, AED 700 psm and AED 1,650 psm, respectively.

While prospective occupiers may view the declines as an opportunity to capitalise on the weak rents and lock in long tenancies, rents in a few key buildings are still higher, or in some cases equal to rates recorded three years ago. This is particularly important for occupiers who are on the verge of ending three year tenancies as they are unlikely to benefit from the declines registered over the last 18 months. A good example of this is Etihad Towers where rents are 5.3% higher than the summer of 2014, while rates at the Aldar HQ Building and Capital Gate Tower are virtually unchanged on June 2014.

Still, landlords are, for the most part, demonstrating a great degree of flexibility and while headline rents appear to be relatively stable so far this year, net effective rental rates are on the decline as incentives such as rent-free periods and fit-out free periods continue to mount.

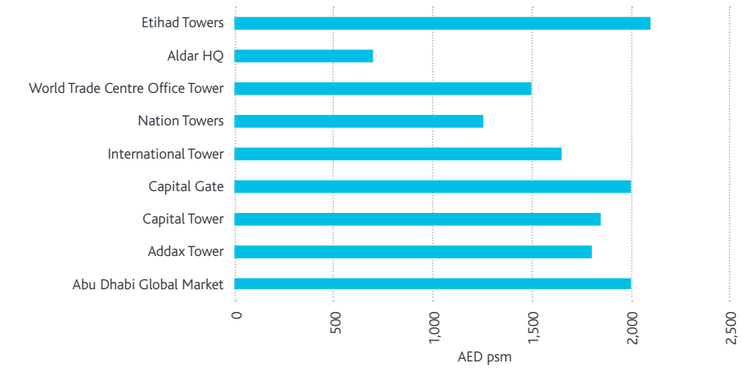
FURTHER RENT MODERATION EXPECTED

Clearly the rising vacancy rates and falling rents are creating a golden opportunity for occupiers to cherry pick from locations they may have previously been priced out of, whilst also remaining firmly in the driving seat during rent negotiations.

We have in fact noted a rising number of public and quasi Government organisations capitalising on market conditions by downsizing or consolidating their operations; private sector occupier requirements are close to historic lows.

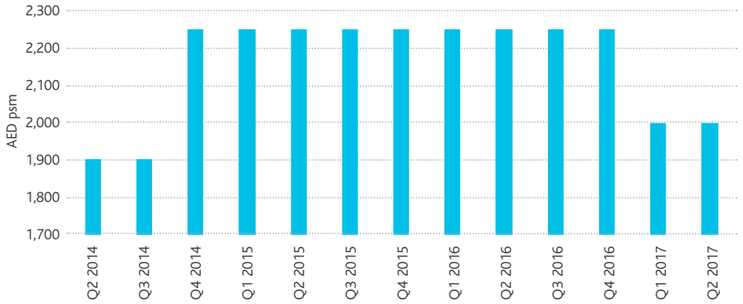
With this in mind it is our view that rent corrections of between 5% to 10% are likely across the board by the end of 2017 and the market's performance will remain hinged on the ability of the economy to shake off the drag generated by the low oil price environment.

Rents in Abu Dhabi's key office schemes during Q2



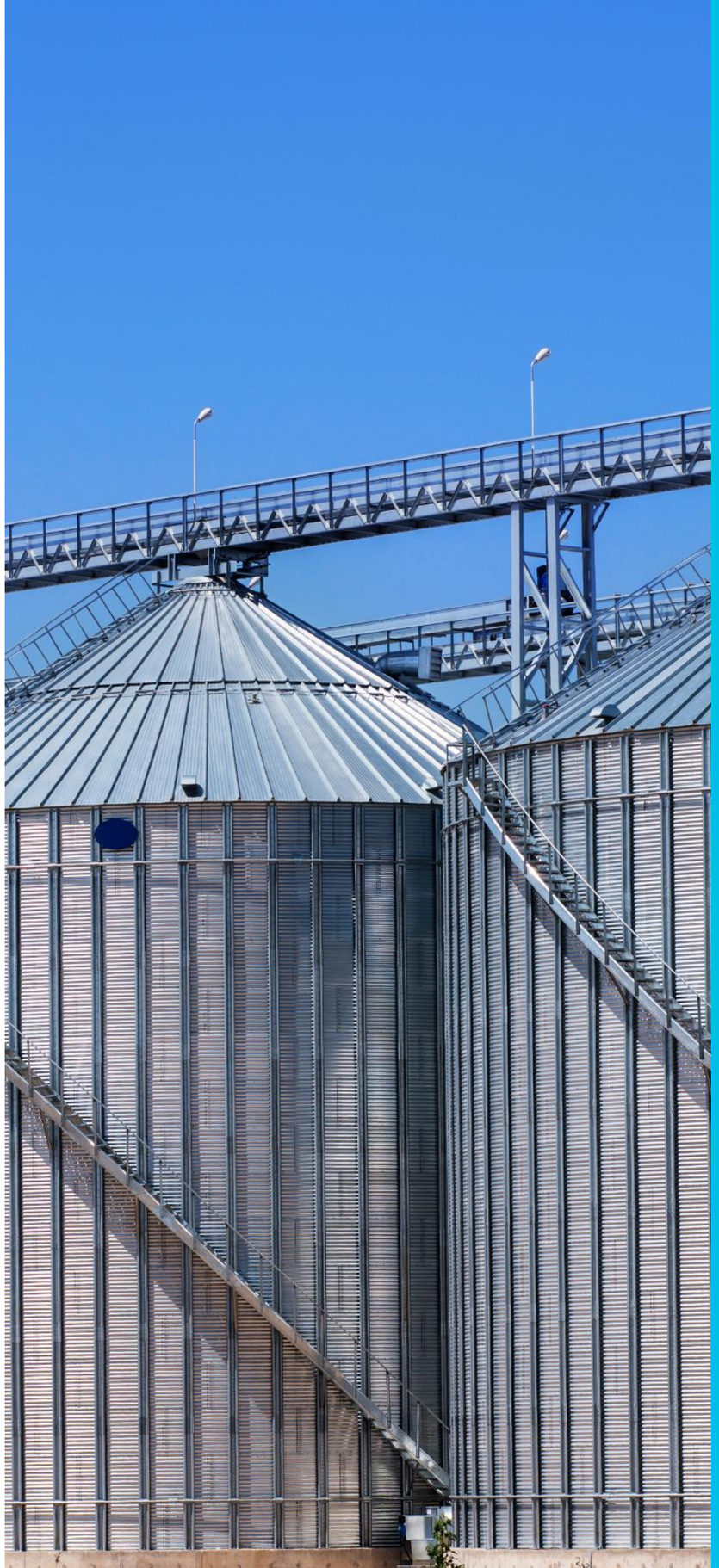
Source: Cluttons

Performance of rents in Etihad Towers



Source: Cluttons

"Rising vacancy rates and falling rents are creating a golden opportunity for occupiers to cherry pick from a range of locations".



STABILITY IN INDUSTRIAL WAREHOUSE MARKET PERSISTS

The brightest star in the city's property market has been the industrial sector, where rents have held steady for the last three quarters. This has been underpinned by robust demand for industrial space and a genuine lack of surplus stock to upset the delicate supply-demand equilibrium.

However, in recent months, economic weakness, combined with rising stock in submarkets such as Mussafah, has meant that rents are increasingly coming under pressure, with a growing number of deals closing below headline asking rates.

In Mussafah, second generation stock has seen an AED 50 psm decline in rates over the course of the last nine months to AED 450 psm, as modern speculatively developed warehousing continues to entice existing occupiers away from older warehouse facilities. This is likely to drive a two-tiered market in this submarket in the short to medium term.

KIZAD remains the nucleus of overall industrial activity in the emirate, with international logistics firms vying for a presence in the UAE's largest free zone. In fact, KIZAD announced a 100 sq km expansion earlier this year.

China's COSCO Shipping Co.'s recent AED 2.7 billion commitment to build and operate a new container terminal, its first in the Gulf, comes quick on the heels of Al Dahra Holdings' AED 140 million rice factory that opened in December 2016 and Schmidt Middle East Logistics' AED 20 million Gulf HQ, which was inaugurated in February.

Furthermore, Emirates Aluminium Rolling (Emiroll) has plans to develop a AED 440 million factory on a 84,000 sqm plot, while Neopharma has announced its intention to expand its production facilities at KIZAD through an investment of over AED 367 million, taking its total land holdings in the free zone to over 160,000 sqm.

Looking ahead, while stability in rents is expected this year, should the economic weakness persist into 2018, headline rents are likely to begin dipping slightly.

DUBAI

RESIDENTIAL MARKET

SOFT PRICE CORRECTIONS PERSIST

Values across Dubai's residential investment areas continued to moderate during Q2 2017, dipping by an average of 1.5%. This leaves the annual rate of change at -5.8% and marks the 12th consecutive quarter of price declines, during which time prices have moderated by 14%. The latest change means that average house prices stand at AED 1,284 psf, nearly 30% below the Q3 2008 market peak.

Apartments continue to fare better than villas, with prices decreasing by an average of 1% during Q2, compared to a 2.2% drop in villa values. Interestingly, however, since the last market peak in Q3 2008, there are only two villa submarkets where prices have recovered to within touching distance of their previous highs. Jumeirah Village and villas at Motor City are both 2.6% and 3.6% down on their Q3 2008 market highs, respectively. Meanwhile, villas on the Palm Jumeirah remain about a third cheaper than they were during the 2008 price boom. Apartments on the other hand remain well below the 2008 peak, averaging between 20% and 71% lower than they were previously. The Burj Khalifa has seen the least amount of price recovery over the last nine years, with prices down 70.6% to AED 2,250 psf, compared to nearly AED 8,700 psf in Q3 2008.

Despite the seemingly slow climb in values when compared to 2008 levels, the market has demonstrated characteristics of maturity, even though it is just 15 years since Dubai opened up its property market to international (non GCC) investors. This is reflected in the fact that price drops have average 1% per quarter over the last 12 quarters.

Clearly improved regulation around off-plan resales, the introduction of Federal Mortgage Caps, the doubling of property registration fees and more stringent controls around developer financing and the protection of investors' funds through the mandatory requirement of escrow accounts have all contributed to the market's stabilising growth profile in recent years.

The ongoing soft correction in the market appears to be nearing an end, with many locations starting to show signs of bottoming out, as we have previously reported. In fact, during the first six months of 2017, just seven of the 32 submarkets we track in the emirate registered price falls, with all other locations seeing no change in values. The weakest performing market was Motor City (AED 900 psf), where villa values receded by 8.2% over the same period, leaving them 12.6% lower than a year ago.

Rounding off the top five weakest performing markets during H1 2017 were Jumeirah Islands (-6.3%), Hattan Villas at Arabian Ranches (-5.6%), the Burj Khalifa (-5.6%) and villas on the Palm Jumeirah (-4%). Aside from Motor City, where values average AED 900 psf and Jumeirah Islands (AED 1,200 psf), prices in the remaining weakest submarkets average between AED 1,600 psf and AED 2,400 psf, putting them well above the average for the city as a whole.

AFFORDABILITY ISSUES STILL UNRESOLVED

Affordability remains a challenge for Dubai's residential market. With household incomes strained by rising living costs, underpinned by inflation levels of over 2% and the looming new VAT regime, like Abu Dhabi, the dream of home ownership continues to drift further away for many. Average incomes remain at around AED 200,000 per annum for expat households across the UAE, based on the Ministry of Economy's last income survey. With an average mortgage multiplier of three to four times annual income, most households would be hard pressed to purchase a "family home" for between AED 600,000 to AED 800,000 anywhere in the emirate.

Performance of residential values since Q3 2008 peak

-19.2%

Average villa prices

-35.7%

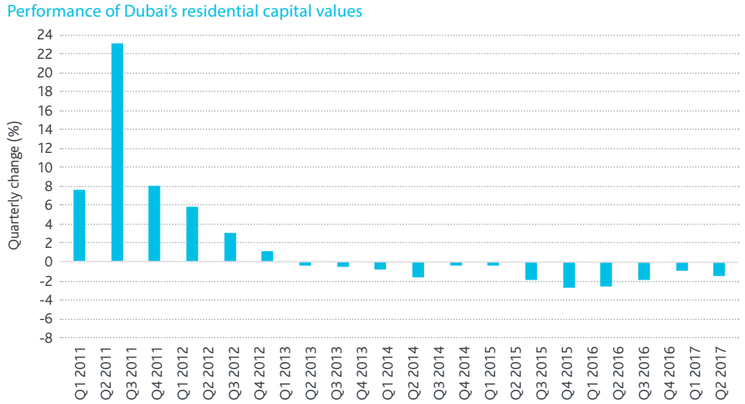
Average apartment prices

-29.8%

Average residential values

Source: Cluttons

Performance of Dubai's residential capital values



Source: Cluttons

The number of "affordable" housing districts in the city remains primarily limited to well known areas such as International City and Discovery Gardens, which together house some 120,000 residents, spread across circa 48,000 units. The limited supply in the affordable segment of the market, coupled with steady, but robust demand, has helped to hold values relatively steady over the last 12 to 18 months.

DWINDLING NEW HOME LAUNCHES, WHILE SUPPLY PIPELINE REMAINS STRONG

Elsewhere, while the housing supply pipeline remains robust, the vast majority of stock being brought to the market does not fall under the "affordable" bracket and threatens to undermine Dubai's ability to continue attracting workers of all skill and earnings levels, whilst also putting the city on a potential path to experiencing the affordability emergencies faced in well established, mature global metropoles such as London, or New York. As it stands, some 12,500 units should be handed over this year, rising to over 21,400 in 2018 and a further 26,000 units in 2019.

Meanwhile, the subdued residential market conditions have curbed developers' appetite to bring forward new schemes, with just over 1,600 units announced so far this year, according to our estimates, against a little over 34,000 last year. The danger of such a sharp slow down in new unit launches could potentially drive a price spike in the medium to long term given the population and jobs growth predictions in the lead up to the Expo 2020 and beyond.

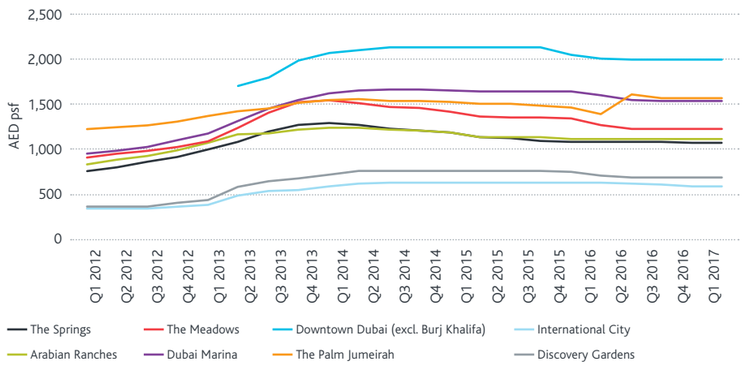
In fact Standard Chartered expects 300,000 new jobs to materialise between 2018 and 2021, directly as a result of the Expo 2020. By the end of 2017, some AED 11 billion worth of construction and infrastructure contracts will have been awarded in the city. This will help to drive up demand for both residential and commercial property in the next six to nine months, suggesting that the bottom of the current market cycle may finally be on the horizon. Meanwhile Dubai Municipality predicts that the emirate's population will nearly double from 2.8 million today to five million by 2030, effectively suggesting the need for a doubling in the city's housing stock in order to accommodate the expected growth.

The fact that over 58,000 units are scheduled to enter the market between 2019 and 2020 may offset any population surge linked to the World Expo in 2020; however, as is the case with most project-linked jobs, the vast majority will be in the lower to middle income bracket and with little evidence to suggest this demographic is being catered for in any meaningful way, house price spikes in more affordable communities are almost inevitable in the medium to long term.

2018 LIKELY TO BE A YEAR OF STABILITY AND MARGINAL GROWTH

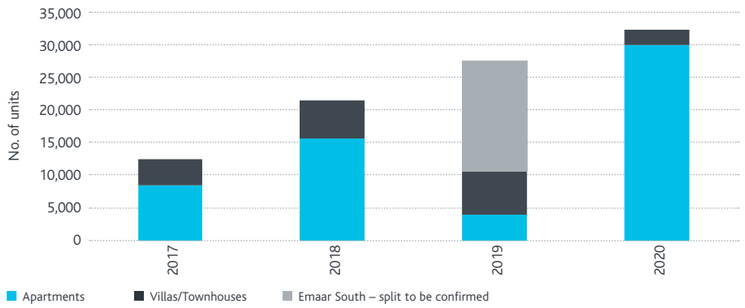
The support provided to the house prices as a result of the dynamics outlined above continues to influence our forecasts for the market, with stability likely to bed in more widely across the city's residential investment areas before the year is out. However, it is still our view that values will end the year 4% to 5% down on 2016, on average. 2018 is likely to see values starting to show their first positive, albeit weak growth, in over three years as the 'Expo effect' starts to influence demand levels and overall sentiment.

Performance of residential capital values by submarket



Source: Cluttons

Dubai's residential supply projections



Source: Cluttons

RENTS TO RECOVER BEFORE CAPITAL VALUES?

Average annual villa rents in Dubai stand at a little over AED 245,000, while apartment rents come in at just a little over AED 100,000 per annum. Average annual household incomes in the UAE stand at AED 200,000, which makes villas unaffordable for most households, while those that live in apartments need to spend an average of 50% of their earnings on accommodation. By comparison, in London, which is often ranked amongst the world's most expensive places to live, our data shows that average rents for apartments hover around AED 216,000, with annual incomes coming in at the same level as those in the UAE (AED 200,000 p.a.). This positions London as being a far more expensive location.

So while the medium term projections suggest households may be forced to rent for longer before transitioning to home ownership, the shortage of affordable rental accommodation is expected to drive a quicker turn around in rents. In fact, during Q2 2017, rents receded by a nominal 0.3%, on average, lifting the annual rate of change to -8.4% at the end of June, compared to -11.8% at the end of March and we expect this trend to persist in the second half of the year. It is worth noting that the only segment to register a rent fall during the first six months of 2017 was three-bedroom villas at The Springs, Jumeirah Village, Al Reem, Falcon City and The Villa, which collectively posted a 7.7% drop; all other locations have seen rents remain flat so far in 2017.

While the short-term prospects appear relatively subdued, our view is that the rental market's fortunes remain tied to the looming 2020 World Expo. At this stage, the mega event is one of the primary upside risks to our outlook, especially as we expect it to drive up the rate of job creation and tenant demand, but this is not expected for another one to two quarters at least.

However, before the 'Expo effect' ripples through the market, we expect that rents will continue moderating during 2017. We forecast rents to end the year 5% to 7% lower than 2016, but like the sales market there is growing potential for a more stable picture to emerge, as the Expo effect starts to filter through.

Villa rents are forecast to end the year 10% down on 2016, while apartments are expected to demonstrate greater stability, with virtually no change in average rates when compared to 2016.

2018 will be an interesting year for the residential market not just in Dubai, but across the UAE as VAT comes into effect. Newly completed residential property will likely be exempt from VAT for three years. Clearly off plan sales transactions may see a boost when the new tax is implemented.

Dubai's residential transaction highlights for H1 2017

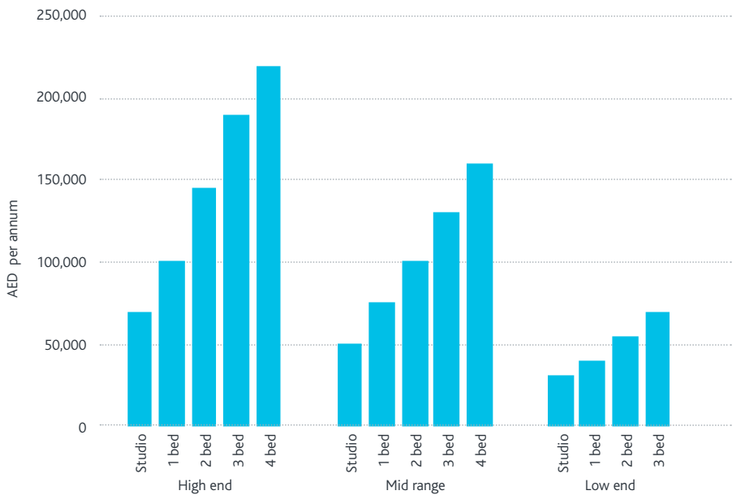
6,058
residential transactions

6.39%
rise in residential transactions (against H1 2016)

AED 10.44 bn
worth of residential transactions (Up 9% on H1 2016)

Source: Reidin

Performance of residential rental values in Dubai



Low end – International City, IMPZ, Discovery Gardens, Jumeirah Village Circle, Jumeirah Village Triangle, Sports City, JLT, DubaiLand apartments
Mid Range – Business Bay, The Views, Greens, Dubai Marina, JLT, Green Community-DIP
High end – Downtown Dubai, Dubai Marina, Palm Jumeirah, DIFC

Source: Cluttons

IMPACT OF QATARI CRISIS ON DUBAI'S PROPERTY MARKET

An outside risk to our sales market forecast is the political rift unfolding in the Gulf, with Qatar at its centre. While we have seen political spats in recent years, the deepening crisis between various Arab states and Qatar has the potential to dramatically cause a seismic shift in property investment capital flows emanating from the state of Qatar, both at an individual and sovereign level.

Any impact is however likely to be a slow burn, rather than an overnight change. Although, that said, there may be some retaliatory divestment within the Gulf, should things deteriorate further in the coming weeks and months. This is unchartered territory and any such response would be unprecedented.

Cluttons 2016 Middle East Private Capital Survey, carried out in partnership with YouGov, found that London was ranked the number one global property investment destination last year by Qatari high net worth individuals (HNWI). Gulf-based HNWI have however nudged the British capital into second place for 2017, favouring Dubai instead. London may well usurp Dubai if the current political stand off intensifies, or lingers.

London of course remains a particular favourite property investment destination for Qataris, with the Government's sovereign wealth fund amassing a mammoth AED 190 billion property portfolio in recent years. Should the political climate continue to remain unfavourable, Qataris may turn their attention away from regional markets, such as Dubai, where they regularly feature in the top three largest GCC investors by nationality. According to the Dubai Land Department, Qatari nationals pumped an estimated AED1.9 billion into the Dubai property market last year. Should these funds be forced to look elsewhere, London is likely to emerge as an obvious alternative alongside other known global property targets for Qataris like New York.

This scenario does not however sit within our central forecast and we expect any impact to be minimal and overshadowed by the overwhelmingly positive Expo 2020 effect now building in the background.

COMMERCIAL MARKET

OFFICE RENTAL MARKET PERFORMANCE REMAINS PATCHY

The sluggish global economic conditions have also filtered through to the city's office market this year, with international blue chip occupiers becoming increasingly cost conscious, whilst also putting expansion plans on hold and some even consolidating operations. This has been a key feature of Dubai's office market so far this year and has not been restricted to one sector in particular, but instead has been something our teams have observed across the board.

In terms of rental performance, lower limit rents in Deira receded by AED 10 psf to stand at AED 50 psf at the end of June, positioning it as the weakest performer during Q2 and during the first six months of 2017.

Elsewhere, competition in Business Bay remains fierce and deals are often concluding at below asking headline rents and inclusive of service charges in some cases, making Business Bay a weaker submarket than the figures would imply.

Still, the SME sector in the city continues to rapidly expand and as we previously forecast, Business Bay has continued to cement its position as an SME hub owing to the smaller, strata owned units in this submarket. The sheer volume of such stock is likely to keep lower limit rents supressed for the foreseeable future, which will in turn aid the area's attractiveness to the SME community.

Furthermore, rising stock levels in this area suggest that rents for space perceived to be more secondary are likely to come under increasing downward pressure over the short to medium term.

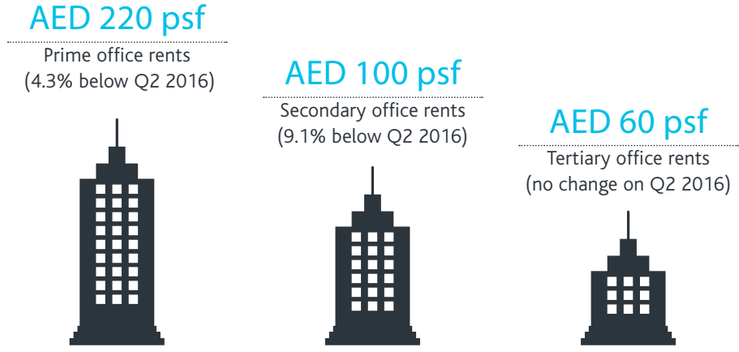
In addition, the new VAT regime will likely be a first for most onshore SME occupiers, many of whom will be facing corporate taxation for the first time, come January 2018. This may stifle demand from this sector for smaller offices and undermine rents in locations such as Business Bay (for onshore entities), or Jumeirah Lake Towers (for offshore entities) in the short term.

OCCUPIER EXPECTATIONS

Through our Corporate Services team, we have tracked a trend this year around the ending of many five-year leases which were initially signed in mid to late 2012. That was when the office market began to improve in the aftermath of the Great Recession in 2009. Occupiers who committed to new tenancies during this period are now faced with new rents that have, on average, risen by 22% across the city, if they intend to relocate, or downsize within prime markets. This rapid uplift in rents occurred during the period of 2012 to 2015 when steep rent rises were a feature of the market.

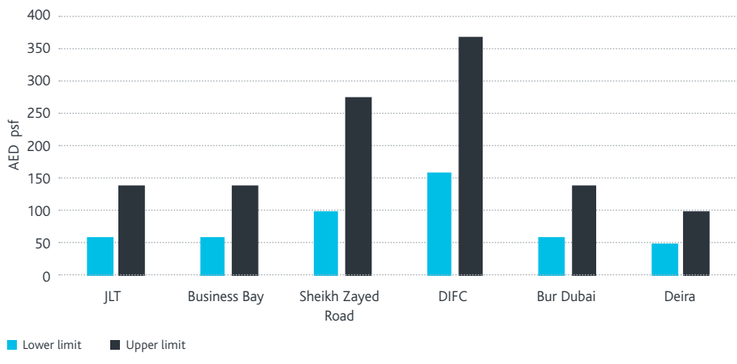
So for cost conscious tenants looking to consolidate operations through savings based relocations, the challenge of balancing a significant reduction in their footprint, capital expenditure for fit outs and moving costs is proving to be challenging.

Average office rents in Dubai



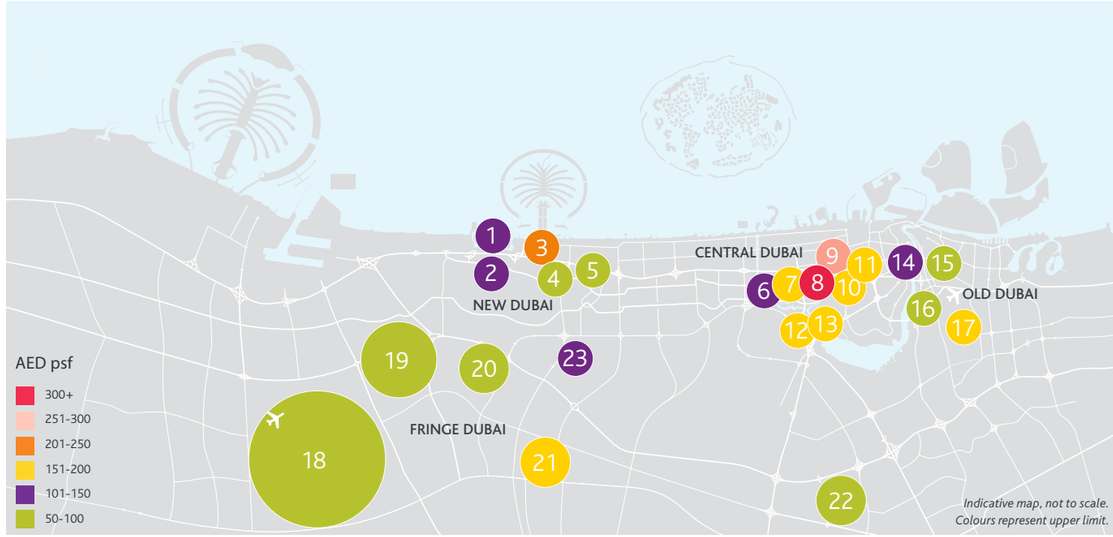
Source: Cluttons

Rents in Dubai's key office submarkets during Q2 2017



Source: Cluttons

Dubai office market heat map (Q2 2017)



		Lower limit (AED psf)	12 month % change	Upper limit (AED psf)	12 month % change
New Dubai	1. Dubai Marina	95	5.6%	130	-7.1%
	2. JLT*	60	0.0%	140	0.0%
	3. Tecom DIC/DMC/DKP*	165	0.0%	220	-2.2%
	4. Tecom	65	-7.1%	90	0.0%
	5. Al Barsha	65	0.0%	90	0.0%
Central Dubai	6. Business Bay	60	0.0%	140	12.0%
	7. Downtown Dubai	120	-4.0%	180	-10.0%
	8. DIFC*	160	0.0%	370	0.0%
	9. Sheikh Zayed Road (Trade Centre)	100	-16.7%	275	-1.8%
	10. One Central free zone*	170	0.0%	200	0.0%
	11. One Central non free zone	150	0.0%	170	0.0%
	12. Dubai Design District (D3) free-zone*	130	-7.1%	160	0.0%
	13. Dubai Design District (D3) non-free-zone	135	0.0%	155	0.0%
Old Dubai	14. Bur Dubai	60	0.0%	140	-6.7%
	15. Deira	50	-16.7%	100	-4.8%
	16. Garhoud	70	-6.7%	90	0.0%
	17. DAFZA*	160	0.0%	180	0.0%
Fringe Dubai	18. Dubai South*	65	-7.1%	70	-22.2%
	19. Dubai Investments Park	45	12.5%	65	-7.1%
	20. IMPZ*	60	0.0%	75	7.1%
	21. Dubai Studio City*	140	0.0%	160	0.0%
	22. Dubai Silicon Oasis*	50	11.1%	90	0.0%
	23. Dubai Science Park	110	-	145	-

Source: Cluttons

*Free-zone

EMIRATES TOWERS BUSINESS PARK IS A GAME CHANGER FOR THE DIFC

In the nearby Dubai International Financial Centre, rents in the DIFC core remain the priciest in the city. With occupancy levels holding at near 100% underpinned by a strong prestige factor, combined with the attractiveness of operating in an internationally regulated free zone, the appeal of a DIFC base has been sustained.

The success of the DIFC in attracting and retaining over 1,600 businesses since its inception in 2004 has prompted authorities to enhance the city's most expensive free zone through the launch of the USD 1.4 billion Emirates Towers Business Park (ETBP) project earlier this summer. The development, which is set to help triple the size of the wider DIFC by 2024, will provide a welcome source of relief to the dwindling supply of Grade A space in the area. Clearly the authorities will need to implement enhanced traffic management solutions in order to retain the attractiveness of the area to international occupiers, particularly as office space density rises in and around the wider DIFC and Trade Centre area, which will soon see the completion of new phases at One Central, for instance.

Still, arguably the most exciting commercial development in the city in over 10 years, ETBP is expected to meet the increasing demand for Grade A office space through low- and high-rise office towers catering to a range of requirements. At the same time, it is expected to complement Dubai's rapid transition from being a regional hub to a global one, while putting the wider DIFC area, including One Central, on a path to rivalling The City in London, or Wall Street in New York.

Furthermore, with DIFC regulation, and therefore free zone status within this premium zone, we expect ETBP to alleviate demand pressures on core DIFC stock around The Gate, Gate Precinct and Gate Village. International corporate occupiers already pay more rent per square foot than any other commercial building in Dubai for office space within the on-shore Emirates Towers office building, which will be at the heart of this new development. And while the picture across the rest of the city is mixed and patchy, with weaker than normal demand, we expect demand and rental levels for space at ETBP to buck this trend.

TECHNOLOGY-MEDIA AND TELECOMS FIRMS UNDERPINNING DEMAND FOR FREE ZONES

Away from Old and Central Dubai, TECOM free zones in New Dubai remain primary targets for many of the city's new market entrants. The persistent demand, predominantly from the ever-expanding technology-media-telecoms (TMT) sector has stoked upper limit rents. In Internet City, Media City and Dubai Knowledge Park area for instance, upper limit rents (including service charges) have crept up to AED 220 psf.

As we previously reported, this depth of demand has resulted in the fast tracking of the 1 million sq ft Innovation Hub, which is reportedly ahead of schedule and due to be completed by late 2018, or early 2019; however much of it is likely to be pre-let, suggesting the upward pressure on rents here will persist.

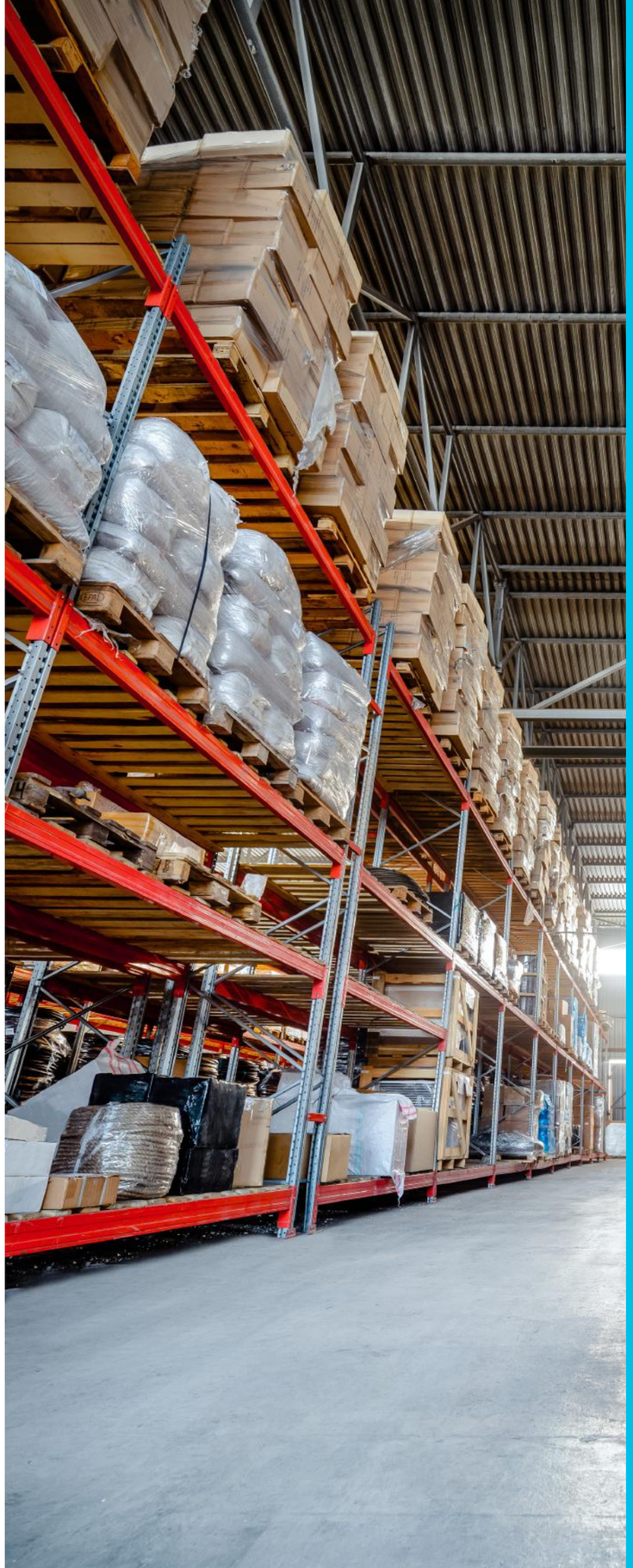
We already have numerous corporate clients vying to get a foothold in Internet City or Media City as they remain amongst the most popular locations for new market entrants, especially those from Europe, or the US.

FLAT OUTLOOK

As has been the case for over 18 months now, Dubai's office market continues to buck the trend being observed elsewhere in the property market, with rents remaining relatively resilient in the face of what are arguably some of the most challenging times for the global economy in almost 10 years.

The relative stability of rents is of course being underpinned by some outward movement in lease incentives, but we attribute the stability more to the fact that rents are perceived to be fair market value by most occupiers, particularly as prime rents, on average, remain some 54% below their Q3 2008 peak levels. Secondary rents are two-thirds lower than they were at the height of the last market cycle.

Our expectation is for rents to largely remain unchanged over the rest of 2017, with any declines likely to be contained at 5%, in a worst case scenario. The looming VAT regime, however, which will see corporate occupiers liable for a 5% tax, based on their annual lease rates, may upset the stability the market has enjoyed recently, particularly in more secondary locations. We do however feel that many occupiers will have begun to price this into their plans for 2018, suggesting that the flat outlook may well persist for a year longer than we had originally anticipated, before the Expo 2020 effect, outlined above, starts impacting demand and improving the rental growth profile of the city's office market.



INDUSTRIAL MARKET SNAPSHOT

Demand has continued to ease throughout 2017, exacerbated at present by the seasonal summer slowdown, with enquiry levels noticeably lower than at the start of the year. The persistence of an unstable global economic outlook which has caused requirement levels to ebb across the city and indeed the region as a whole, a growing amount of speculatively developed warehouse space and increased competition amongst landlords have contributed to the increasingly stagnant conditions.

Headline rents as a whole across all the areas we monitor have largely held steady so far this year, with the exception of rents in Dubai Investments Park (DIP), Dubai Industrial Park and Dubai South, where rents are down by between 4% and 12% over the last 12 months as supply mounts. Despite this, the areas immediately adjoining Al Maktoum International Airport remain a hive of activity as occupiers continue to position themselves adjacent to Dubai's emerging global logistics super node, drawn in by the promised triad of hubs resulting from the development of Al Maktoum International Airport, Dubai's main Etihad Rail terminals and the nearby Jebel Ali Free Zone.

Dubai continues to move forward with its ambitious diversification plans, which have led to the emergence of new innovative businesses as well as the expansion of global players into the local market. Online retail businesses, for instance, are relatively new players in the region and will require distribution centres and other logistics facilities.

We expect to see growing demand from this sector as it develops, particularly around Al Maktoum International Airport and the Expo 2020 site, where the majority of demand is currently centred for industrial space. This is a crucial juncture for the city as its world class logistics facilities move from being regional hubs to global ones. Siemens' announcement in April to establish its global logistics and distribution centre at the Expo 2020 site is a huge boost of confidence for Dubai and clear recognition of the Government's efforts to reposition the emirate on the world stage.

The strengthening pipeline of speculatively developed space is however likely to put rents under pressure, with more secondary stock likely to face sharper corrections over the course of the next six months as activity levels are expected to remain subdued. At Dubai Industrial Park for instance, Phases 1 and 2 enjoy occupancy levels of 95% to 98%, which has prompted the release of a further one million sq ft of highly specced and temperature controlled space in Phase 3. This will likely tempt light industrial manufacturers out of older stock elsewhere in the city. With the rising amount of stock in the market, landlords are expected to lower asking rents to entice relocation activity and we expect occupiers to capitalise on this. With that in mind, it is our expectation that rents may dip on average by up to 5% between now and the end of the year, before there is the potential for increased stability as the Expo 2020 economic boost starts to materialise in early 2018.

SHARJAH

RESIDENTIAL MARKET

VILLA RENTS RECOVER

Sharjah's position as an affordable alternative to Dubai continues to be retained. The emirate's emerging profile amongst the wider expat community, coupled with the strong focus on creating a family friendly destination is boosting its appeal and this is reflected in the level of demand we are recording from tenants. Redundancies, like in Dubai, are still of course an issue as we work our way through a challenging period for the global economy. This has however not had a material impact on overall requirement levels, which remain very robust at most price points.

The villa market in particular continues to offer good value for money when compared to Dubai or Abu Dhabi and households faced with rising living costs due to the reasons outlined above are increasingly seeking out family home options in Sharjah, which has resulted in a turnaround in the performance of the villa market, as demand has now edged ahead of supply.

During the first six months of 2017, average villa residential rents across Sharjah rose by 1.5%, marking a significant departure from the deep corrections we have recorded over the last 12 to 18 months. Average villa rents have now risen to almost AED 112,000 per annum, from AED 100,000 per annum at the end of last year. The latest change has left annual rents nearly AED 25,000 higher than they were at the end of 2011.

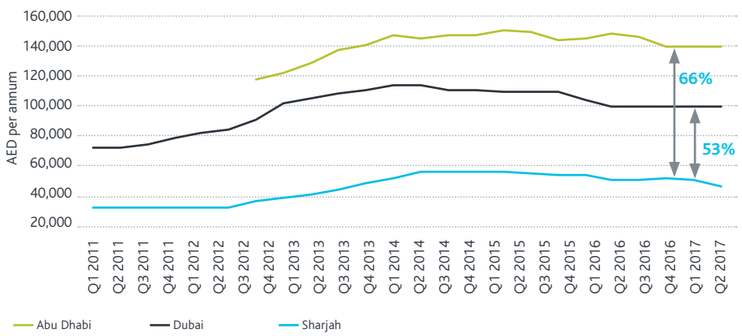
Apartment rents have, in contrast, maintained their downward trajectory, slipping by 7% in the six months to the end of June, building on the 8.1% decline in 2016. In Al Nahda, rents have lost the most ground amongst the markets we monitor, decreasing by 10.9% between January and June. Interestingly, in this submarket, the rate for one-bedroom flats has dropped by almost a fifth so far this year to stand at AED 38,000 per annum, while three-bedroom apartments (AED 70,000 per annum), were the only apartment type to register any growth across the areas we monitor.

VILLAS EXPECTED TO EMERGE AS STAR PERFORMING SECTOR

Demand for villas in Sharjah is likely to continue rising, fuelled by the relative affordability of homes compared to those in Dubai, which in turn will remain a key catalyst behind the multitude of mixed use freehold projects bubbling through. We are already seeing several new villa projects coming to market that provide quality, affordability and accessibility, including communities by Majid Al Futtaim, GIBCA and Faisal Holding. We expect to see continued demand for these developments as they reach completion.

With this in mind, it is our view that rents on average are likely to end the year about 5% down on this time last year, however the villa market will outperform, with growth of 3% to 4% likely by the close of 2017, underpinned by limited supply levels. Apartment rental rates on the other hand are forecast to remain weak, ending the year about 10% down on December 2016.

Average rents for two-bedroom flats in Sharjah vs Dubai & Abu Dhabi



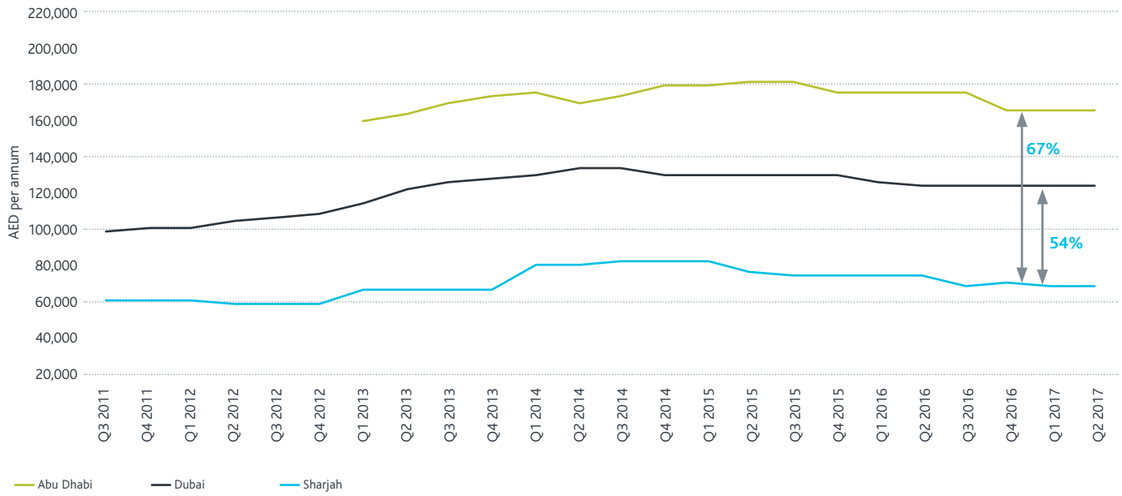
Source: Cluttons

H1 residential market performance in Sharjah

-3.1%	-5.5%	95,000
Decline in average rents	Annualised change in average rents (Q2 2017 v Q2 2016)	Average rent (AED) for a three-bedroom villa

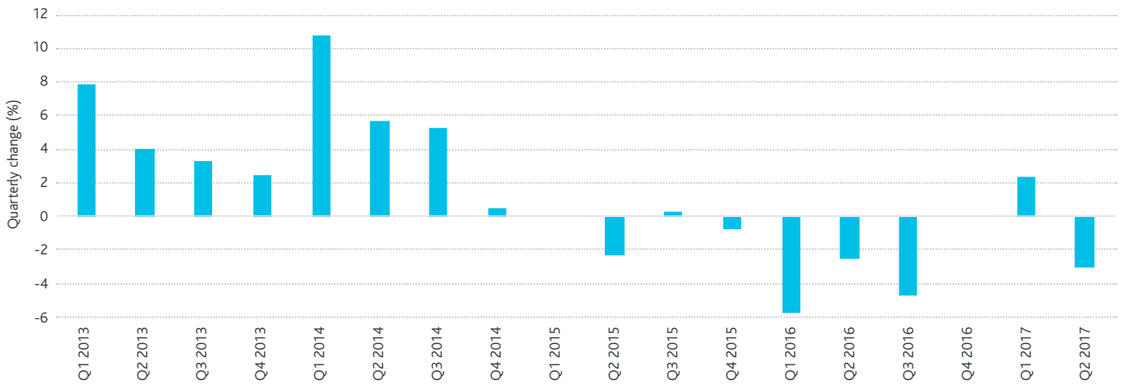
Source: Cluttons

Average rents for three-bedroom villas in Sharjah vs Dubai & Abu Dhabi



Source: Cluttons

Performance of Sharjah's residential rental values



Source: Cluttons

OFFICE MARKET

RENTS FIRM UP

The resilience of office rents in Al Soor and the prime and fringe areas of Al Majaz that began earlier this year has persisted, with rents remaining unchanged during the first six months of 2017. This is in contrast to last year, when rents slipped by as much as 9.3% in prime areas of Al Majaz to AED 68 psf, while Al Soor (AED 60 psf) registered a slightly less severe correction of 7.7% over the same period.

While we have previously highlighted the small size of Sharjah's Grade A office market, this has kept it relatively well insulated from more macro issues compounding global growth, and there remains little in the way of new demand streams aside from the constant requirements from the public sector. In fact, the 2017/18 Government of Sharjah Budget aims to create 1,800 new jobs for Emiratis.

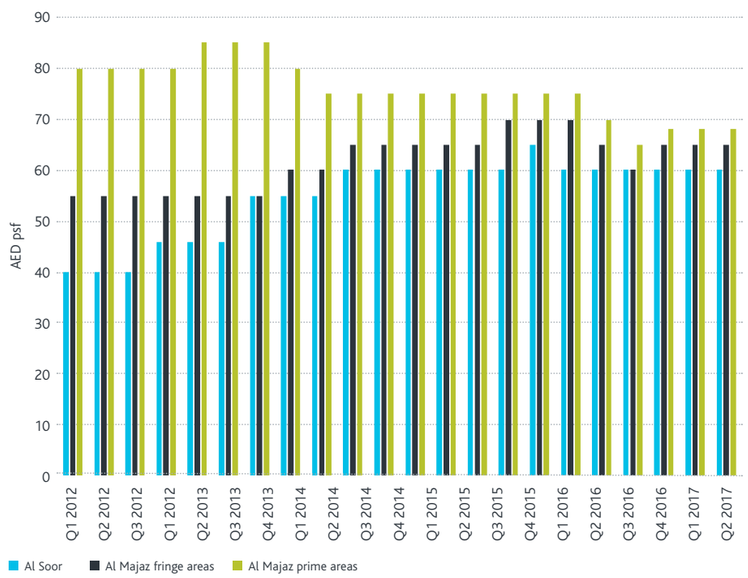
A BUMPY ROAD AHEAD FOR OFFICE RENTS?

Positively, the supply of prime office space remains limited. Historically, the oil and gas sector has been one of the primary domestic drivers of demand for new office space, but as we enter the fourth year of the low oil price environment, this critical source of requirements remains subdued.

Unsurprisingly, the number of overall requirements is markedly down on this time last year, with a limited number of enquiries trickling in from the SME sector and a very small number of larger enquiries from the finance and banking sector.

Our expectation is for further decreases in average office rents in the region of AED 5 psf before the year is out, taking the total decline during to 2017 to about AED 10 psf. These forecasts are of course linked to the way in which Dubai's more affordable office submarkets perform.

Performance of rental values in Sharjah's key office submarkets



Source: Cluttons

Average office rents in Sharjah

AED 60psf

Average rents in Al Soor during H1 2017

AED 65psf

Average rents in Al Majaz fringe areas during H1 2017

AED 68psf

Average rents in Al Majaz prime areas during H1 2017

Source: Cluttons

CONCLUDING THOUGHTS

The challenges posed to the UAE economy as a result of the collapse in oil prices in 2014 continues to play out and has had a direct impact on the ability of the country's economy to sustain the pre-oil price crash levels of job creation, both in the private and public sectors.

The fall out for the property market has been clear in markets such as Abu Dhabi, where a diminished level of requirements from the backbone of economic growth, the oil and gas sector, has resulted in faltering demand in the city's office market, which has put downward pressure on rents. At the same time, consolidation activity stemming from the domestic economic slowdown, combined with global economic sluggishness, has meant that demand for the purchase of homes, particularly at the top end of the market, has been weak. Similarly, the rental market has seen a swing to housing perceived to be more affordable, which has put the luxury end of the residential market under tremendous strain.

For Dubai, the economic diversification efforts by the Government have meant that the oil price collapse has been less relevant; however, after the prolonged weakness in the price of the region's chief commodity, economies around the Gulf remain under pressure, which has filtered through to Dubai in the form of a slowdown in the rate of creation of senior level positions, which has hampered demand for rented accommodation.

On the residential sales front, values are demonstrating greater stability, in part supported by the positivity now building as the World Expo approaches. This underlying sentiment boost is being fuelled by the Government's wide ranging infrastructure investment programme, which is expected to support growth in both the residential and commercial markets through the sheer volume of jobs expected to be created in the lead up to the mega event in three years' time.

In Sharjah, the overall weakness in national job creation rates has curbed demand for residential rental property, but encouragingly the relative affordability of villa rents in the new gated villa communities in Sharjah is attracting the attention of cost conscious households. This has resulted in a turnaround in rental value growth, which we expect to persist. The office market remains subdued, for the same reasons as Abu Dhabi, but Sharjah's saving grace is the limited supply of new office developments, which is helping to keep rents relatively stable.

The property markets in the UAE have faced another tough year, but widespread stability and indeed marginal growth in some segments is expected by the end of 2018.

THE PROPERTY REPORT | UAE REAL ESTATE MARKET

2017 YEAR END UAE PROPERTY MARKET CONSENSUS FORECASTS

RESIDENTIAL RENTAL VALUES – APARTMENTS	RESIDENTIAL RENTAL VALUES – VILLAS	OFFICE RENTAL VALUES
DOWN 8% – 10%	UP 3% – 4%	DOWN 7% – 10%

SHARJAH

RESIDENTIAL CAPITAL VALUES – APARTMENTS	RESIDENTIAL CAPITAL VALUES – VILLAS	RESIDENTIAL RENTAL VALUES – APARTMENTS	RESIDENTIAL RENTAL VALUES – VILLAS	OFFICE RENTAL VALUES	INDUSTRIAL WAREHOUSE RENTAL VALUES
DOWN 4% – 5%	DOWN 4% – 5%	DOWN 0% – 2%	DOWN 8% – 10%	DOWN 0% – 5%	DOWN 0% – 5%

DUBAI

RESIDENTIAL CAPITAL VALUES – APARTMENTS	RESIDENTIAL CAPITAL VALUES – VILLAS	RESIDENTIAL RENTAL VALUES – APARTMENTS	RESIDENTIAL RENTAL VALUES – VILLAS	OFFICE RENTAL VALUES	INDUSTRIAL WAREHOUSE RENTAL VALUES
DOWN 5% – 7%	DOWN 3% – 5%	DOWN 8% – 10%	DOWN 6% – 8%	DOWN 5% – 10%	FLAT 0%

ABU DHABI

"The property markets in the UAE have faced another tough year, but widespread stability and indeed marginal growth in some segments is expected by the end of 2018."

Source: Cluttons

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Cluttons International Holdings (trading as Cluttons Middle East) is part of Savills plc.

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