CLUTTONS
Cluttons Middle East, part of the Savills Group

Abu Dhabi, Spring 2018

PROPERTY MARKET OUTLOOK

RESIDENTIAL MARKET

Rate of capital value declines slows
The first quarter of 2018 has recorded a slowing in the rate of capital value declines across Abu Dhabi's residential freehold investment zones. While values receded by 1.7% in the three months to the end of March 2018, the annual rate of decline slowed to -6.2%, following the 6.9% fall in residential values during 2017 overall. The latest price falls mean that average values, which stand at AED 1,090 psf, are now at levels not seen since the end of 2013.

Apartments in Al Reef Downtown emerged as the weakest performer over the last 12 months, with values falling by an average of 14.7%, leaving them at AED 725 psf.

The surge in the number of recent simultaneous completions, coupled with static, but weak, buyer demand has added to the pressures in this submarket.

Al Reef Villas were the next weakest performing market, with average capital values receding by 11.8% over the same period.

Villas at Al Raha Gardens, Golf Gardens and apartments at Al Ghadeer were the only locations to see no change in prices over the twelve months to the end of March. All other residential investment submarkets recorded varying degrees of price corrections over the same period.

-6.2%

Change in residential values in the 12 months to Q1 2018

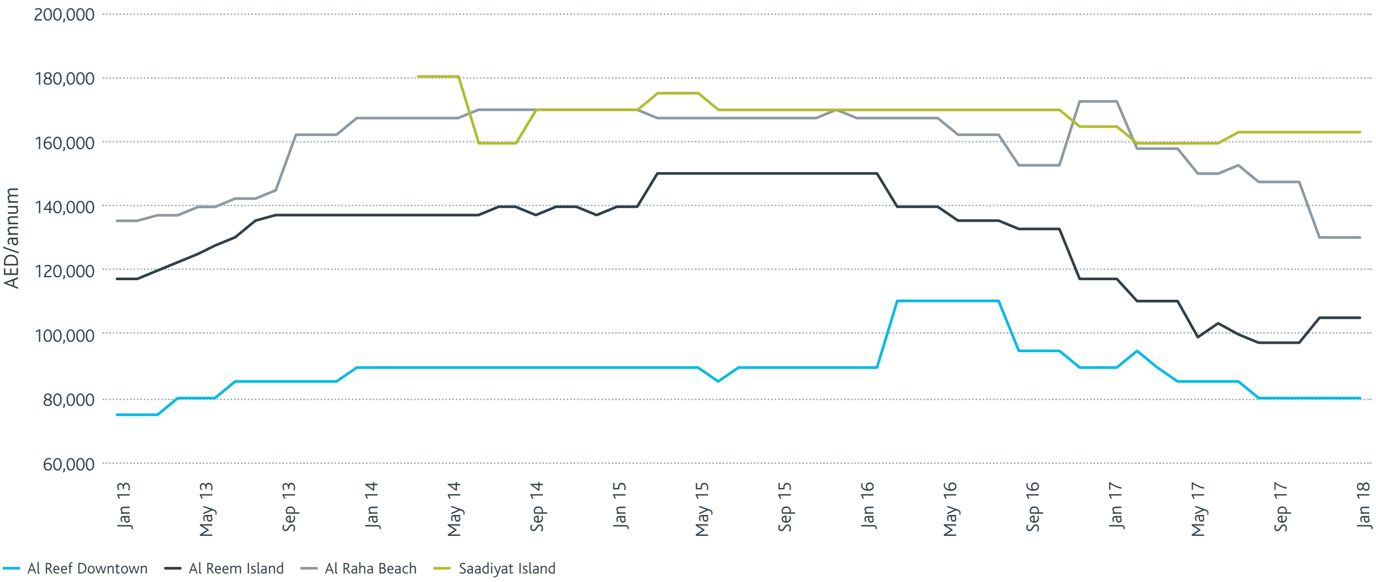
Source: Cluttons

-11.5%

Change in residential rents in the 12 months to Q1 2018

Source: Cluttons

Residential rental value performance across Abu Dhabi's key areas



Source: Cluttons

Opportunity for tenants and corporates

While the market continues to meander through this challenging period, we have noted an increase in the number of bulk residential corporate leases that are ending abruptly. Organisations that secured long term residential leases at a time when demand outweighed supply two to three years ago are now back on the market, hoping to obtain better quality accommodation for their staff, while also making cost savings. This marks the first rise in bulk corporate lease requirements in over 18 months. Such opportunistic behaviour is commonly observed in markets which are at, or near, the bottom of their property cycle.

Similarly, we are seeing tenants shopping around for savings, while also trying to upgrade the quality of their homes. This flight to quality is expected to intensify as the bottom of the market nears.

For new landlords to the market, this also presents an opportunity to ensure their expectations match market realities as tenants are likely to remain in the driving seat for the short term and quality will continue to emerge as a key differentiating factor; newly completed homes have a clear advantage over more secondary stock in this regard.

Stability by year end?

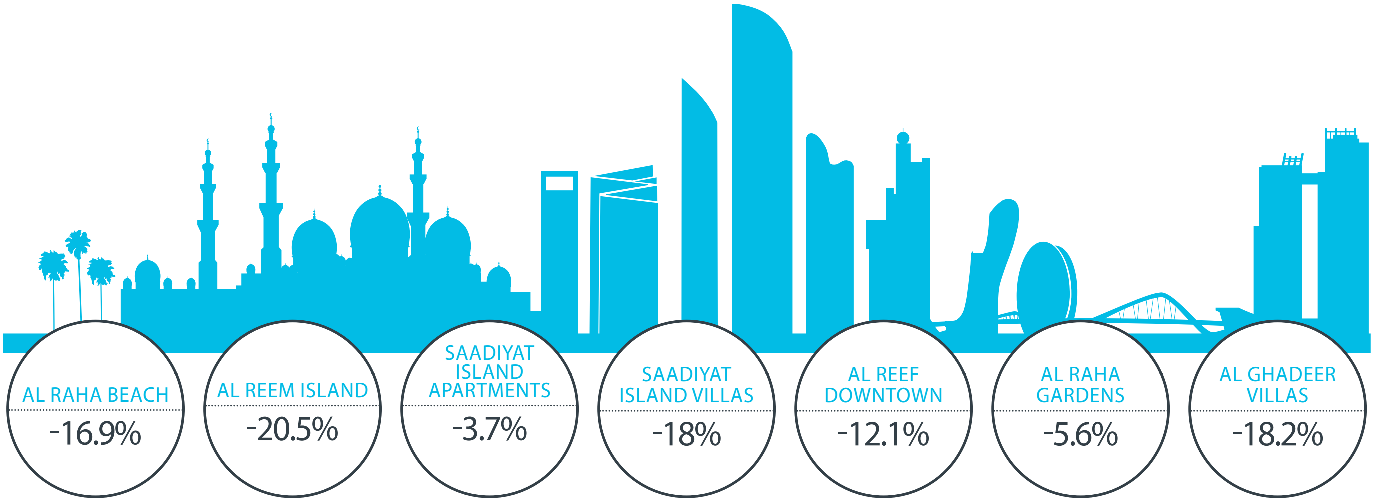
Abu Dhabi's residential market has been caught in near perfect storm conditions for almost three years, fuelled by the collapse in oil prices, which has stifled demand and dampened overall confidence levels in the market. While there is no doubt the impact of the low oil price environment has been exacerbated by rising living costs, 2018 looks set to be a better year for the UAE economy as a whole, with GDP expected to expand by 2.6%, from a seven year low growth rate of 1.7% last year (Oxford Economics).

This is in turn expected to help support more stable rates of job creation and increased government confidence. In fact, following the announcement by ADNOC at the end of last year to spend AED 400 billion over the next five years to boost growth, we expect to see further infrastructure project announcements this year as the government moves to bolster economic growth.

With this in mind, it is our view that the residential market has the potential to start stabilising by the end of 2018, but until then further softening is expected to persist. The additional declines will be catalysed by rising levels of property handovers in locations such as Yas Island and Al Raha Beach by Aldar, which will curtail chances for a quicker recovery.

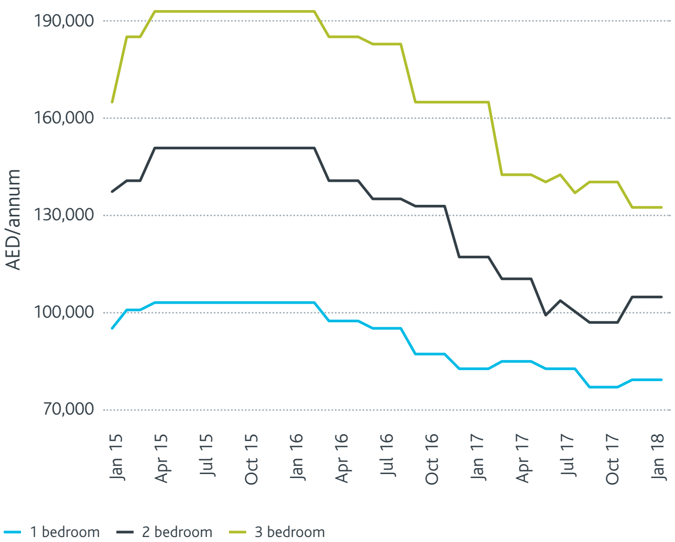
Our forecast is for a decline of a further 5% to 7% for both rents and values during 2018.

Change in residential values since Q1 2015



Source: Cluttons

Residential rental value performance on Al Reem Island



Source: Cluttons

Net effective rents still falling

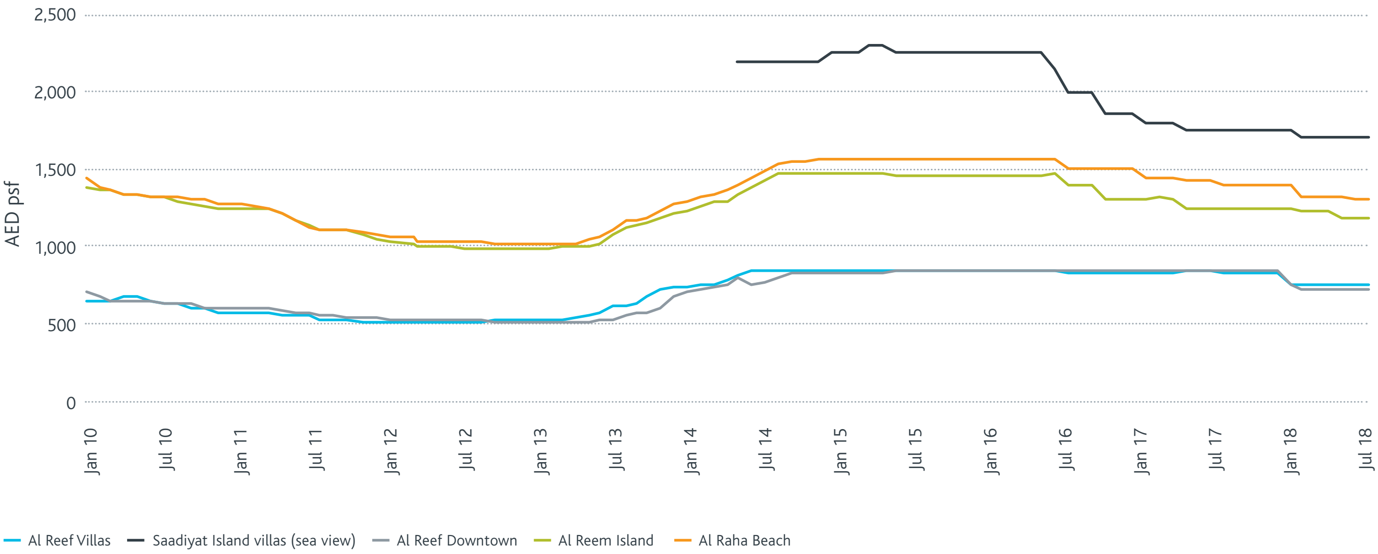
The falling rents in the city are reflective of the lingering weakness in overall requirement levels. Like the sales market, nervousness linked to job security and the reduction, or removal, of housing allowances is continuing to stymie demand. The reduction in housing allowances reflects ongoing cost cutting measures being implemented by companies, while others are lowering allowances to ensure they are commensurate with the overall decline in rents in the wider market.

Tenants too remain wary of the threat of job losses and the rising cost of living, associated with the introduction of VAT and a general upward creep in inflation, which has left many household budgets under tremendous pressure. As a result, tenants are negotiating reductions at renewal.

With this backdrop showing no signs of easing, it is perhaps no surprise that landlords are increasingly receptive to meeting the expectations of tenants. In fact, we are aware of a number of instances where landlords are agreeing to close deals below headline asking rates, while some are also offering 13-month contracts, for the price of 12.

Furthermore, there are growing numbers of landlords willing to accept rental payments in multiple cheques; up to 12 cheques are being accepted by new landlords to the market who are eager to generate income streams and minimise voids.

Residential capital value performance across key submarkets in Abu Dhabi



Source: Cluttons

Buyers remain cautious

The persistence of falling values has been underpinned by cautious buyers, who remain nervous about committing to a purchase in a softening market. Compounding matters further is the ongoing threat of redundancies as companies continue to pursue cost cutting strategies, reflecting the slower economic growth as a result of the low oil price environment. Whilst buyer requirements remain low, those on the market appear to be genuine; however, many are looking for 'good deals'.

More positively, the very top of the market appears to be showing signs of stabilising. Sea facing villas on Saadiyat Island for instance, which remain the most expensive residential property type in the capital at AED 1,700 psf, have seen no movement in prices for two consecutive quarters. This is likely to help tempt buyers back into the market especially as we feel the stability is likely to persist. In fact, we have noted a marginal uptick in demand from Emirati buyers predominantly, looking for second homes, or expanding their buy-to-let investment portfolios on Saadiyat Island. Interestingly, of the 13 submarkets we monitor in Abu Dhabi, sea view villas on Saadiyat Island have experienced the biggest price correction since 2015, with prices ebbing by an average of 26.1%.

Elsewhere, high end property continues to stick and is slow to sell. That said, some developers of high end homes appear to be sensing the nearing bottom of the market and are pressing ahead with new schemes, such as the recently announced five-phase Al Fahid Island project. The development, spread across 21 million sqm, will include 301 luxury beach front villas, in addition to 15 townhouses and 652 apartments when complete.

Rental rate declines slow

Rents across Abu Dhabi's residential investment areas decreased by 2.3% during Q1 2018, following the 4.3% drop in Q4 2017. The latest change leaves rents 11.5% lower than this time last year.

The biggest rental declines over the last 12 months have been recorded by high end apartments on Al Raha Beach, where average rents have dropped by 27.4%, leaving them at approximately AED 142,000 pa. The next biggest annual correction has taken place at Hydra Village (-17.9%), with average rents now standing at AED 80,000 pa.

Interestingly, the only market to register a rent rise during Q1 was Al Reem Island, where mid range apartments posted a 3.8% rise in average rents, pushing them to close to AED 92,000 pa. However, it is worth noting that over the last 12 months, mid range apartments on Reem Island (-15.4%) have experienced the third largest rental contraction in the city. The rental drops here appear to be approaching a tipping point and rents are now perceived to be good value, which is likely to help support greater stability moving forward.

COMMERCIAL MARKET

Pressure mounts on headline rents
Like the city's residential market, the office market in the capital is also still facing the pressures of firms that are downsizing or consolidating operations; a trend that began over two years ago, in the aftermath of the oil price rout. While rents across the city's prime office buildings held steady during Q1, deals continue to be concluded below headline asking rates in many cases.

Elsewhere in the market, in more secondary and tertiary buildings, rates have dropped by as much as 30% to 50% over the same period. In some cases, rents in tertiary buildings have fallen to nearly the same level as warehouses.

Landlords become more realistic
These substantial drops do not however accurately reflect the market conditions and are a result of landlords holding out on rent reductions for extended periods of time, before being forced to make drastic adjustments as they chase the bottom of the market. Still, there are some landlords who are increasingly realistic in their expectations and are willing to make concessions in order to secure the right tenant. These concessions are of course entirely dependent on the covenant strength, amount of space being negotiated and crucially, the length of lease being sought.

We are aware of a number of instances where landlords are now also willing to cover agency fees. This is a seismic change in behaviour as up to 60% or 70% of landlords are now willing to do this, compared to almost none two or two and a half years ago. Furthermore, many are also willing to offer increased parking provisions and shorter leases, with increased lease flexibility, particularly on one to three year lease tenures.

What has not yet been seen is a move to absorb the extra 5% VAT cost by landlords. In a similar way to occupiers in Dubai, most occupiers in the Emirati capital appear to be taking the VAT costs in their stride. Clearly, absorbing VAT remains a potential bargaining tool for landlords, should void periods become intolerable.

Signs of occupier movement emerging
Like the residential rental market, we feel occupiers are starting to sense an opportunity in the market, given that rates, particularly in many prime buildings, have fallen to levels not seen since late 2013, or early 2014. As a result, there is a growing number of requirements from occupiers who are testing the waters and exploring the market with a view to capitalising on the low rates and upgrading their offices. We have noted this trend from public sector entities and a handful of banks as well as the technology-media-telecoms (TMT) sector.

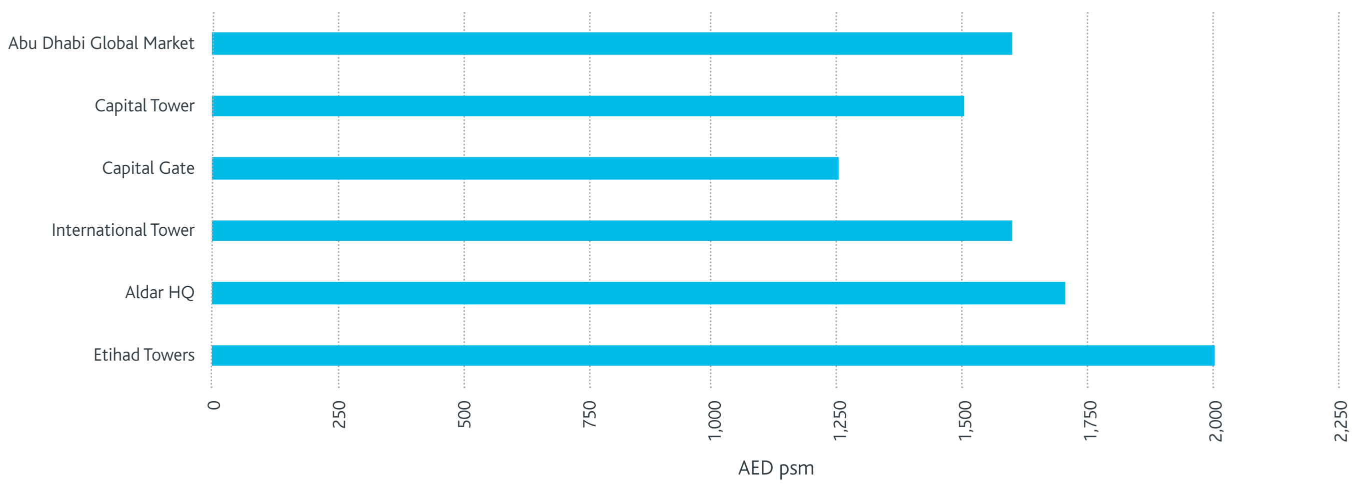
In fact, may occupiers are demanding CAT A fit outs, which include raised floors and suspended ceilings, as standard, while others are asking for contributions to fit out costs and there are landlords who are willing to entertain such discussions for the right occupier.

Clearly, relocation may not be the best solution for all those looking to make cost savings. Our teams have also been recording a rising number of requests for lease regearing assistance, which offers the benefit of remaining in situ, saving on fit out costs and emerging better off, financially.

Outlook for office market still weak
The office market in the UAE capital appears set for at least another 9-12 months of rent declines as the market works through a challenging period. Clearly for landlords there is an opportunity to capitalise on the softer conditions and move to secure the right tenants, while for the latter, the opportunity lies in taking advantage of lower rates to secure better lease terms, or indeed, upgrade to higher quality space whilst still making a saving.

The medium term prospects are slightly more encouraging, with rising public sector spending expected to boost GDP growth, which in turn should aid the return of more robust levels of occupier requirements; however, this is unlikely to materialise for at least another 9-12 months. Until the market approaches that point, further rent drops of 5% to 10% on average, across the board, are likely.

Office rents across key buildings in Abu Dhabi during Q1 2018



Source: Cluttons

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