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Cluttons Middle East, part of the Savills Group

Dubai, Spring 2018

PROPERTY MARKET OUTLOOK

RESIDENTIAL MARKET

Values continue to recede
During the first three months of 2018, the decline in average residential values across Dubai appeared to gather pace, falling by 2.5%.

This comes hot on the heels of the 1.5% fall during Q4 2017, which resulted in an overall contraction of 5.6% last year. The latest change during Q1 means that average home prices are 7.2% down on this time last year.

The sharpest correction has taken place at the Green Community, where average villa prices fell by 12%, or about AED 91psf, to AED 675 psf. In absolute terms however, villas on the Palm Jumeirah (down AED 117psf) registered the largest drop during Q1 2018.

The market's behaviour continues to be underpinned by pricing and affordability, with homes priced above AED 2,000 psf seeing a persistent deterioration in values, while those priced below AED 1,000 psf, remain virtually unchanged, as has been the case for apartments in submarkets such as International City, Discovery Gardens, IMPZ and Motor City.

-2.5%

Fall in residential capital values during Q1 2018

Source: Cluttons

AED 1,209 psf

Average residential capital values as at the end of Q1 2018

Source: Cluttons

Price sensitivity persists

This behaviour continues to underscore the price sensitivity amongst buyers, who have faced a myriad of financial pressures ranging from the introduction of VAT and the subsequent rise in inflation, to the removal of fuel and energy subsidies, which have driven up the cost of living sharply, trimming disposable income levels. Furthermore, the UAE Central Bank continues to mirror US Federal Bank interest rate movements, which will undoubtedly impact on the affordability of mortgages for many households, particularly as further rate rises are expected this year.

On an annual basis to the end of March 2018, across the emirate's residential investment areas, prices fell by AED 94 psf, or about 25 fils per day, driving average prices to 33.9% below their Q3 2008 peak level.

The Burj Khalifa (AED 2,400 psf), which we consider a standalone submarket due to its iconic global status, remains the city's weakest performer, with values falling by 11.1% over the last 12 months, leaving them a distant 72.3% lower than the last market high in 2008. Although more affordable areas such as International City, or Discovery Gardens, stand out as bastions of stability in the face of continuing headwinds for the market, it is worth noting that values in these areas are some 30% to 40% lower than they were in Q3 2008.

Oversupply likely to remain a barrier to recovery

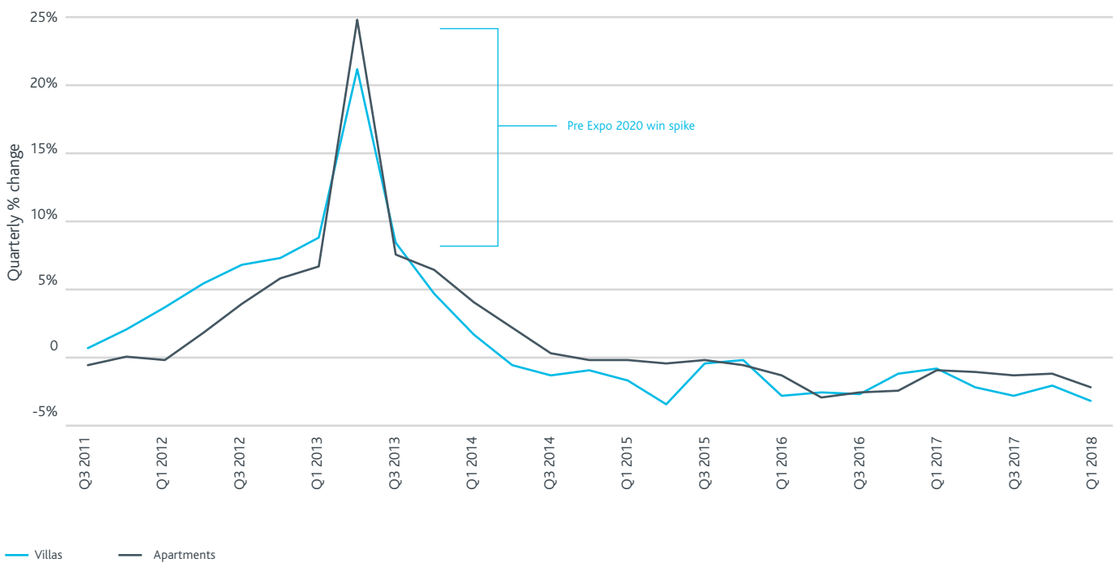
Affordability aside, one of the key factors that has likely contributed to the stability in values in Dubai's more affordable residential areas is the distinct lack of new supply in these markets. Across the rest of the city however, the story is very different.

Dubailand (6,400 units) is likely to see the largest number of apartment completions this year, followed by Jumeirah Village (5,400 units) and Dubai South (3,000 units). In total, some 51,000 units are expected to be delivered this year, followed by 53,500 next year and 29,400 completions in 2020. This translates into about 134,000 unit deliveries between now and the end of 2020. Over the same period, the city's population growth should result in the addition of 77,500 households, according to our calculations. Based on past performance, it is likely that there will be some slippage, with circa 20% to 30% of the forecast deliveries being delayed for various reasons. Still, the growing mismatch between supply and demand will continue to act as a strong drag on the market.

Furthermore, segmented analysis of the projected home deliveries over the next three years suggests that most new homes will fall in the AED 1,200 psf plus price bracket (circa 42%), while just 35% are priced under AED 800 psf. Our expectation is for demand to remain firmly centred on the latter as affordability issues take centre stage in the market.

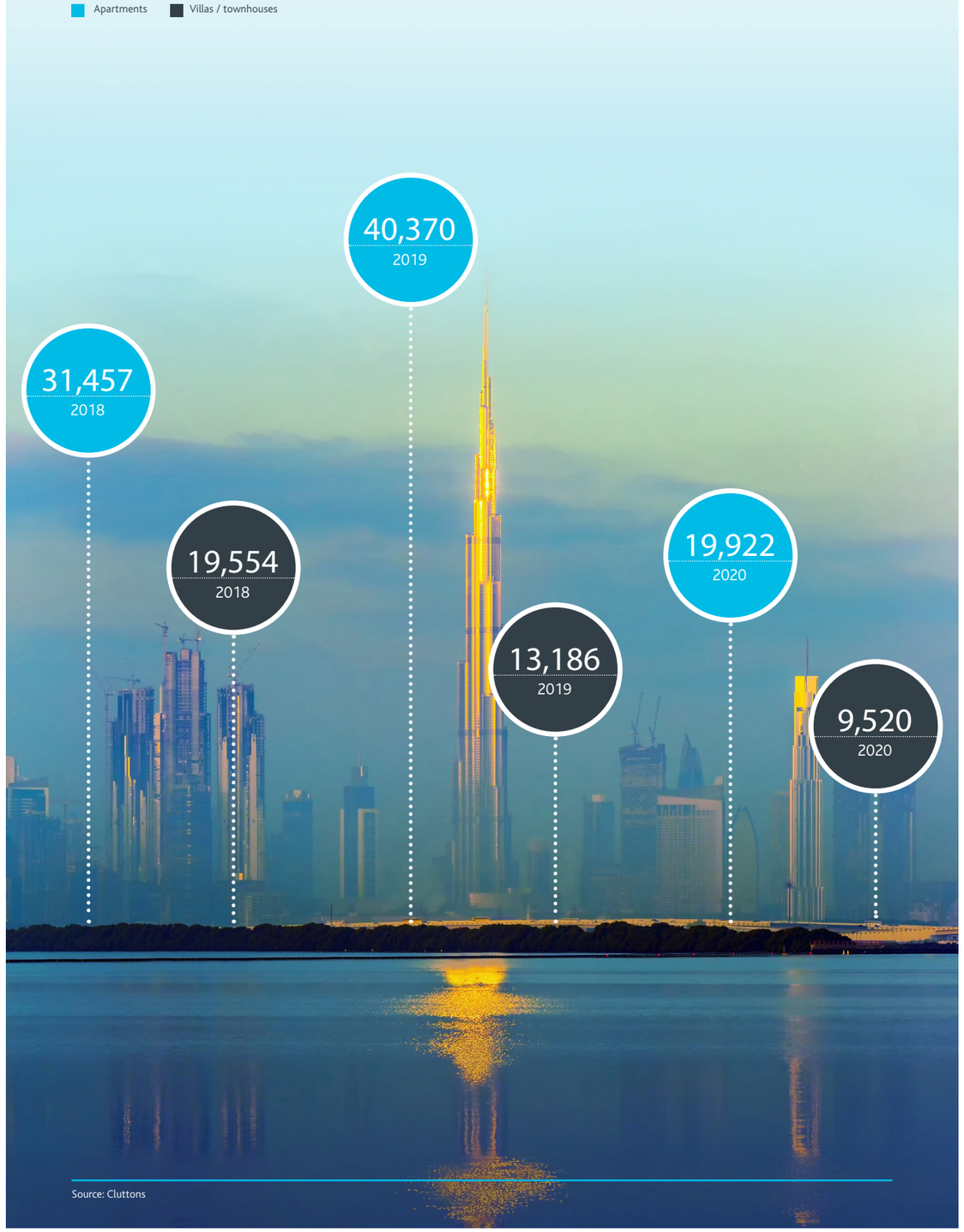
As has been the case historically, most of the population growth will take place amongst low-mid income households, who will continue to home in on the city's more affordable locations. So while the slowdown in the rate of handovers in 2020 may allow the market some respite from the strengthening supply pipeline, the rate of absorption of new units will dictate when the market recovery is likely to begin.

Performance of capital values – villas and apartments



Source: Cluttons

Dubai's residential supply pipeline



Source: Cluttons

Transaction levels holding steady
Deal levels however appear to be holding steady, with the 11,200 transactions last year representing a marginal 1.08% fall over 2016. However, as outlined above, the strengthening supply pipeline is likely to hinder the market's ability to stabilise. Interestingly, developers are increasingly targeting new international markets such as South Korea, in addition to the usual roadshows held across India and China in the search of new buyer pools. Developments with unique lifestyle offerings, or specific leisure related facilities, have continued to perform well in both the domestic and international markets.

While it is positive to see transaction volumes holding steady, the majority of sales appear to be taking place amongst international investors, who for the most part are likely to return the properties to the sales market prior to completion, or indeed attempt to rent them out after handover. The growing glut of homes available to rent as a result of this is already evident in the rental market and is likely to continue intensifying. Indeed, for those unable to sell their off plan purchases for a profit on completion, the renting out of their units is likely to be an attractive option, which will in turn add to the downward pressures in the rental market.

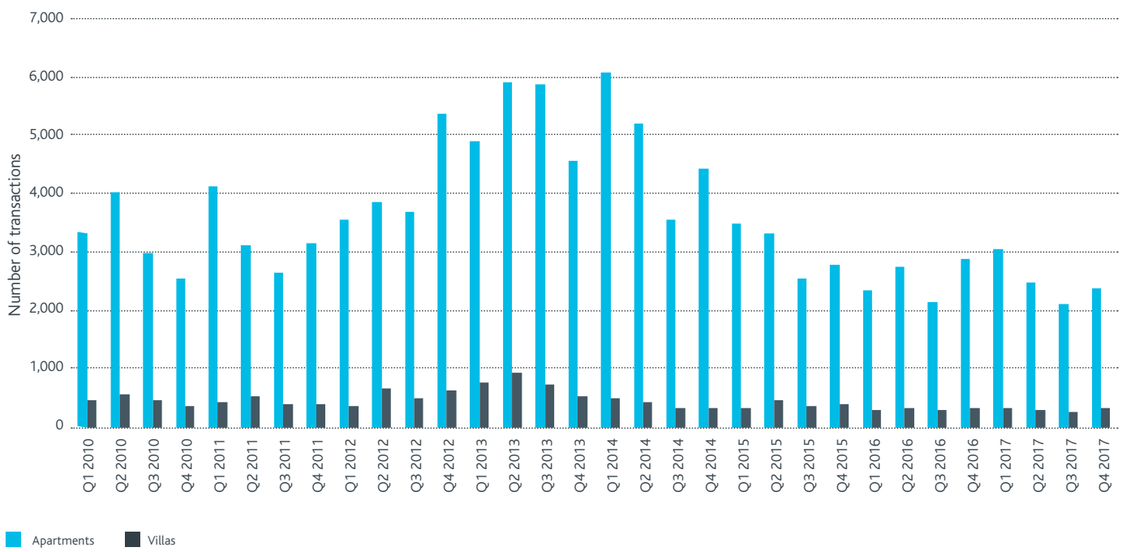
New off plan law to help market
The authorities appear to be zeroing in on this issue however, with plans recently being announced to restrict off-plan sales until projects are at least 50% complete. This comes on the back of VAT rebate rules on the cost of construction materials, which developers are eligible to claim provided they sell out developments within three years from completion.

Should this law be enacted, it is likely to curtail off plan sales activity, which has remained surprisingly resilient, despite a cooling in demand levels for secondary market property over the last three years. Furthermore, the strong upturn in the volume of buy-to-rent homes flowing into the city's rental market will also see a subsequent slowdown.

Undoubtedly, developers, particularly smaller ones, will be pressured into a radical overhaul in their growth strategies, with smaller, more phased development likely. Development financing is also likely to become challenging and developers will need to complete detailed due diligence before bringing schemes through as financial viability will take precedence over the previous 'build it and they will come' mentality. At the end of the day, such rules are designed to protect buyers and preserve, or enhance, the city's reputation as an investment hub, especially as new international markets are increasingly being targeted by developers.

Challenges for developers
The risk of course with the planned legislation is to the quality of construction, which may suffer. Developers may move to contain construction costs by cutting corners, which would ultimately impact on investors' confidence in off plan developments. While this may clearly be an issue, it does present the government with an opportunity to introduce more substantive building regulations around the quality of construction, with a view to raising the warranty offered on newly completed homes, which currently stands at just one year, compared to other international markets, where it is much higher.

Residential transaction volumes in Dubai



Source: Cluttons, Reidin

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Dubai Property Market Outlook, Spring 2018

A slowdown in the level of developer demand for new land parcels as a result of this legislation will also likely depress land values, which will again be positive for the market, making affordable property developments more viable. The market would benefit tremendously given the swelling backlog of demand for non-luxury homes from domestic buyers.

That said, for emerging submarkets, such as Jumeirah Village Circle, a curtailing in construction activity as a result of the new law may delay the emergence of a completed community feel, slowing infrastructure investments and also deterring investors from stepping into new neighbourhoods.

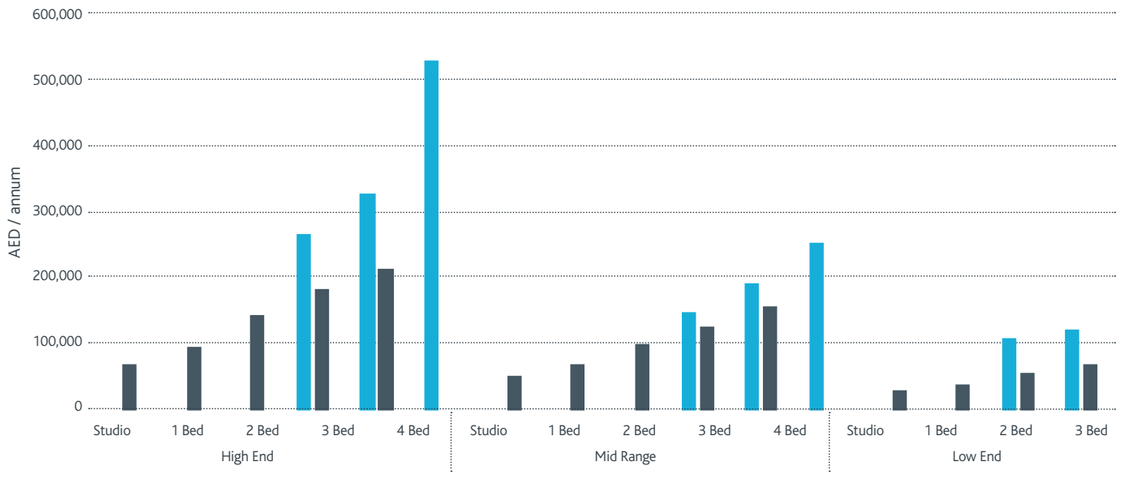
Rental market stabilising?
Away from the sales market, rents across Dubai registered no change during Q1 2018, which helped to improve the annual rate of change to -3.1%, from -7.7% at the end of last year. This marks the first stable quarter for rents in the emirate in over two years. On an annual basis, the worst performing segment of the rental market was high end apartments in Downtown Dubai, Dubai Marina, The Palm Jumeirah and the DIFC, where rents are down 4.8% on this time last year. Unsurprisingly, there are a growing number of landlords willing to accept rental payments in multiple cheques.

It is worth noting that although rents have declined by about 18% over the last three years, to a large extent, the savings for households have been negated by high inflation levels and the introduction of VAT, which have together raised the general cost of living in the city.

While the rental market has shown signs of stabilising, the growing volume of off plan investment stock destined to be made available for rent after handover is likely to pose challenges in the future, particularly if all delivery timelines are met as currently specified. The ability of the rental market to absorb a high volume of new stock will likely be tested over the next three years.

It is our view that newly completed rental properties will command the attention of tenants, while older and perhaps tired more secondary property registers rent falls. This flight to quality phenomenon will likely result in the creation of a very distinctive two tiered market.

Average rental values during Q1 2018



Villas
Low End - The Springs, Jumeirah Village, Al Reem, Falcon City, The Villa
Mid Range - Meadows, Arabian Ranches, The Lakes, Cedre Villas, Up Town Mirdiff, Victory Heights
High End - Palm Jumeirah, Jumeirah Islands, Hattan at The Lakes, Hattan at Arabian Ranches

Apartments
Low end - International City, IMPZ, Discovery Gardens, Jumeirah Village Circle, Jumeirah Village Triangle, Sports City, JLT, Dubai Land 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

Further corrections ahead for residential market
The residential market continues to face a wide range of dampening factors, ranging from affordability issues and the lack of appropriately priced stock to a projected supply overhang and a raft of new legislation around affordable housing provisions and the sale of off plan homes. Together, these complex factors, when combined with wider regional and global macroeconomic and political issues, continue to hold the residential market in a position that is slightly worse than stagnating.

Price sensitivity amongst buyers will continue to shore up the performance of more affordable locations, while the top of the market will likely continue to see values ebbing over the next 12 months. On the plus side, the recent weakening in the strength of the US dollar and therefore the UAE dirham, is likely to result in more domestic investment activity as investors look to reorganise portfolios, rather than exiting the market in search of more attractive opportunities.

Still, our expectation is that values will slip by up to 5% or 7% this year. It is quite likely that this trend will persist well into 2019, catalysed by the buoyancy of the supply pipeline, before there is the potential for stability in 2020 once the supply pipeline starts to diminish.

For the rental market, the dearth of stock resulting from off plan homes bought with the intention of renting them on completion suggests that further corrections are likely once the rate of handovers gathers pace over the next 12-24 months. It is therefore our view that rents will slip by up to 5% or 7% during 2018, with similar declines in 2019.


Dubai Marina

"Price sensitivity amongst buyers will continue to shore up the performance of more affordable locations, while the top of the market will likely continue to see values ebbing".

OFFICE MARKET

Office rents hold steady
Like the residential rental market, office rents across the 24 submarkets we track in Dubai have remained largely unchanged during Q1, with just eight submarkets registering falls in upper limit rents of between AED 5 psf to AED 20 psf. On an annual basis, Bur Dubai (-21%) has registered the steepest correction in upper limit rents, leaving them at AED 110 psf, or AED 30 psf lower than this time last year.

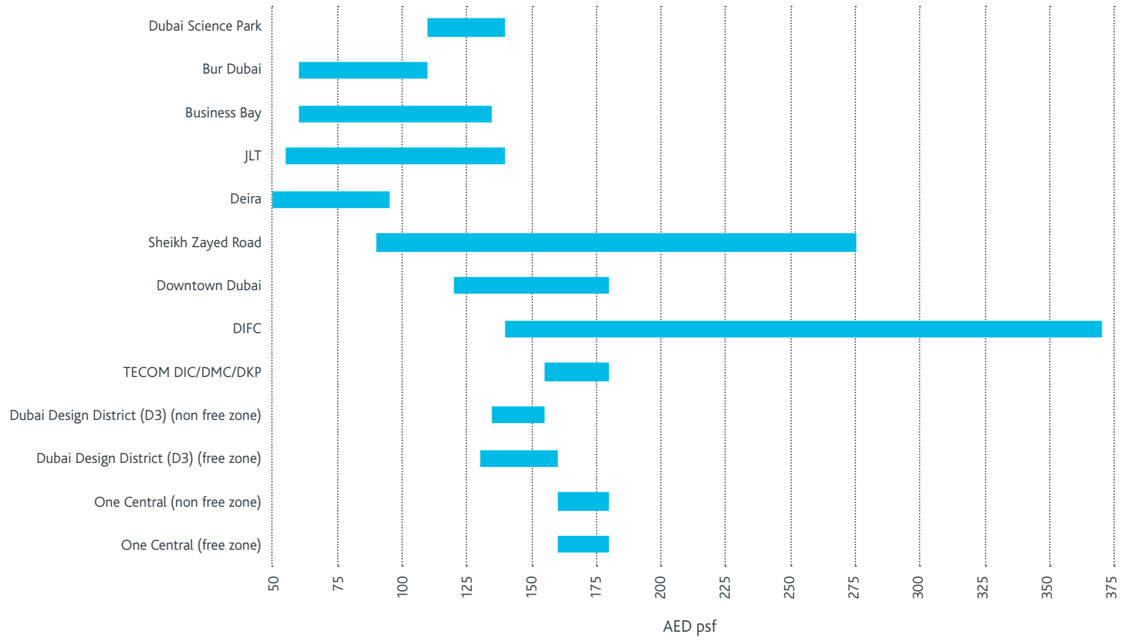
Elsewhere, the city's free zones continue to command the lowest vacancy rates in the emirate, which has helped rents in core locations such as Dubai Internet City, Dubai Media City, Dubai Knowledge Park and the DIFC remain stable. However, we are watching these markets closely as significant new stock is due to be delivered across many of these free zones in 2018 and 2019, including Innovation Hub in Dubai Internet City, Brookfield Place in DIFC and Silicon Park in Dubai Silicon Oasis. We expect these developments will likely exert downward pressure on rents to some extent in these areas.

A multifaceted market
Gauging the overall health of the office sector is challenging in a fragmented market like Dubai. We continue to record a range of activity across the board, ranging from companies expanding to some who are consolidating operations, while there is a wide range of new market entrants and some are attempting to regear existing leases. This depth of activity is characteristic of a normal market where rents are neither rising nor falling rapidly and is indicative of a market that is healthy and mature.

Whilst our teams have seen activity stemming from the aviation, legal and technology-media-telecoms sectors, there appears to be a more complex dynamic at play beneath the surface, even amongst these active segments of the economy. We have reported on global macro economic trends as having a direct impact on the office market, given the emirate's high concentration of global blue chip firms, but Brexit in particular seems to be having quite a unique influence on occupiers' behaviour. Some British occupiers, for instance, appear to be coming under pressure to make cost savings and many are attempting to do this at lease renewal. We are seeing evidence of this across several submarkets. This behaviour likely stems from the uncertainty in their 'home market' due to the Brexit divorce proceedings.

In contrast, US companies do appear to be more positive in their outlook and this could be due to strong economic conditions in their home market. Unsurprisingly, we continue to see a good level of new US entrants setting up shop in the city.

Office rent ranges in Dubai's key submarkets during Q1 2018



Source: Cluttons

Flexibility amongst landlords
The somewhat static conditions overall mean that landlords are keen to demonstrate flexibility for the right occupier. Contributions to fit out costs, fitting out space to beyond just CAT A (raised floors and suspended ceilings) and agreeing to rents below the headline asking rate, depending on the length of tenure and the strength of the covenant, are, for instance, now a common occurrence.

Interestingly, we are seeing landlords considering contributions to fit outs to help occupiers with lower capital expenditure budgets, particularly where they might be relocating or downsizing, in order to reduce costs. Some of these occupiers are willing to have any contributions to fit outs amortised for the duration of the lease, which may well signal the start of a new trend as landlords work harder to drive up relocation activity levels.

It is worth noting that there are occupiers in the market who are being motivated to relocate purely on the basis of cost, as well as the perception of getting better value for money. Business Bay for instance, has been the recipient of many occupiers departing from Deira and Bur Dubai over the last 18-24 months who have been drawn to this submarket by the attraction of letting relatively more modern and recently completed space.

Benefits of relocating
However, it is our view that in some parts of Business Bay, where transportation and pedestrian infrastructure is still playing catch up, the advantages of relocation may be negated by traffic issues as well as the lack of gravitas associated with a more established central business district. The latter of course comes with the added benefit of extensive street level retail and food and beverage outlets, which give rise to a vibrant and desirable place to work. This may well change with the opening of Marassi Business Bay and once the area reaches a certain level of office occupancy.

For now, Business Bay is still dogged by strata owned space, which is suitable for SME's and continues to be shunned by larger international occupiers due to the complications linked with negotiating with multiple landlords and this, we expect, will linger for a few years yet, given the high proportion of completed, but yet to be occupied stock. That said, it is an attractive market for international occupiers who perhaps established themselves many years ago in the traditional Central Business District in Old Dubai and are now looking at Central Dubai locations. Some parts of Business Bay do offer good value, especially in its good quality single ownership stock, such as Ubora Tower, for instance.

The decision to relocate for cost savings is both complex and challenging. Often, regearing existing leases, making more efficient use of existing office space, or simply renewing in situ on 12 month or three year leases, with flexible break options, may be more beneficial in the long run.

Flat conditions likely to persist
Given the complexities of the market discussed above, we expect that the flat conditions will likely linger through 2018, with any rent falls likely to be contained between AED 5 psf to AED 20 psf. Free zone areas will continue to buck the trend as their position as the most desirable submarkets for most new occupiers remains unchanged and unchallenged.

Later this year, or during early 2019, conditions may well improve, with requirement levels outpacing supply as the Expo 2020 effect starts to filter through. Organisations servicing infrastructure and construction projects linked to the mega event are likely to boost their presence, with a rise in recruitment and office requirements likely to follow suit.


Sheikh Zayed Road and the DIFC

INDUSTRIAL MARKET

Rents slip further
Elsewhere in the city's commercial property landscape, industrial rents have continued to drift, following on from a challenging 2017, which saw the market being hampered by an excess amount of speculatively developed supply. This overhang of warehouse stock still remains across all submarkets and is likely to put rents under more pressure as the year progresses.

For now, the weakest performing market during Q1 was Class B space in JAFZA, where rents dipped by AED 2 psf, or 8.3% to AED 22 psf. This makes Class B space at JAFZA the most affordable in the city. Class A rents at Dubai Industrial Park (formerly Dubai Industrial City) posted a drop of AED 5 psf over the last 12 months, leaving rents at an average of AED 40 psf, making this the weakest performer overall.

Flight to quality to persist
The supply overhang from last year is fuelling a flight to quality as occupiers are tempted to upgrade ageing facilities for modern, purpose built stock. This trend is expected to persist during 2018, fuelling the emergence of a two tiered market.

Meanwhile, other occupiers are pursuing build to suit options. The LuLu Group, for instance, have struck a AED 300 million deal with Dubai Wholesale City to establish a purpose built logistics and distribution facility, which will be built across a 1.3 million sq ft land parcel. Dubai Wholesale City, which sits within Dubai Industrial Park, offers the added advantage of being able to offer large onshore land plots. Virtually none remains at Dubai Investments Park for instance, which is likely to help boost demand at Dubai Industrial City going forward. Although here too, a number of speculatively developed light industrial units remain vacant and have been slow to let.

Logistics and distribution operators still very active
In general, logistics and distribution operators continue to expand operations, homing in on locations in and around Dubai South. News in March of the resumption in works linked to the UAE's Etihad Rail project will no doubt add further impetus to the attractiveness of being relocated next to what will arguably become the world's largest and most significant integrated logistics and transport hub.

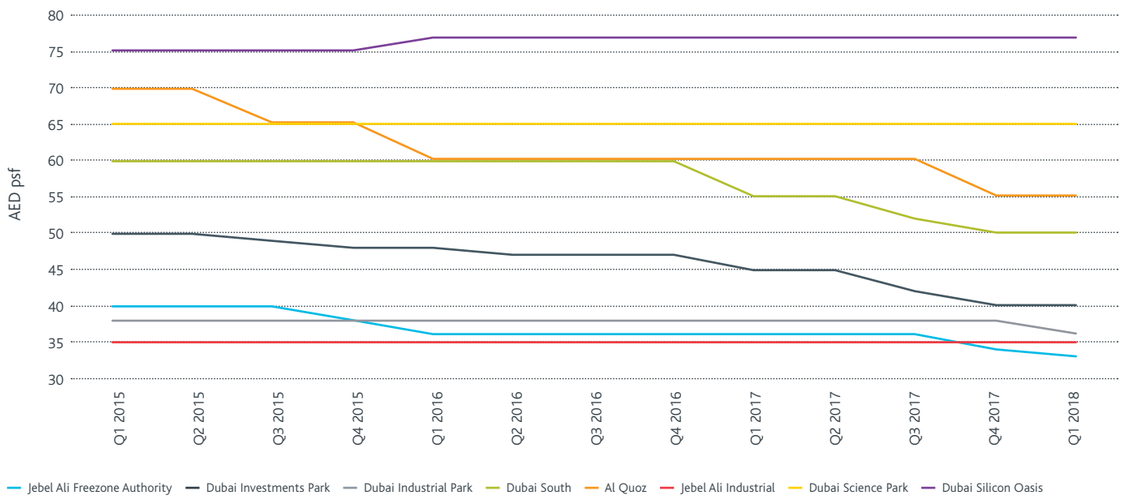
The incorporation of JAFZA, Dubai World Central and Etihad Rail terminals will be a game changer for logistics operations in the UAE and so the appeal of a base around Dubai South will likely intensify over the short term.

Similarly, e-commerce, which remains in its infancy in the region, continues to expand rapidly, with a high level of interest in locations such as Dubai Commer-City, along with Dubai Investments Park, which also remains a hive of activity.

Mixed outlook for 2018
The main challenge for the city's industrial landscape remains the supply overhang from last year, combined with poorly maintained, older facilities. The market is currently going through a period of normalisation, with occupiers being drawn to more modern, newly completed stock. Once we work our way through to the end of this upgrade cycle, rents for older stock are likely to continue slipping, which will probably catalyse redevelopment of historic warehousing.

Until we get to that stage, rents are likely to slip by up to 5% this year, with any declines contained between AED 3 psf and AED 5 psf.

Performance of Class A industrial rents in Dubai



Source: Cluttons

HOSPITALITY MARKET

Sector firmly in expansion mode
One segment of the property market in Dubai that stands out due to its robust expansion and positive outlook is the city's hospitality sector.

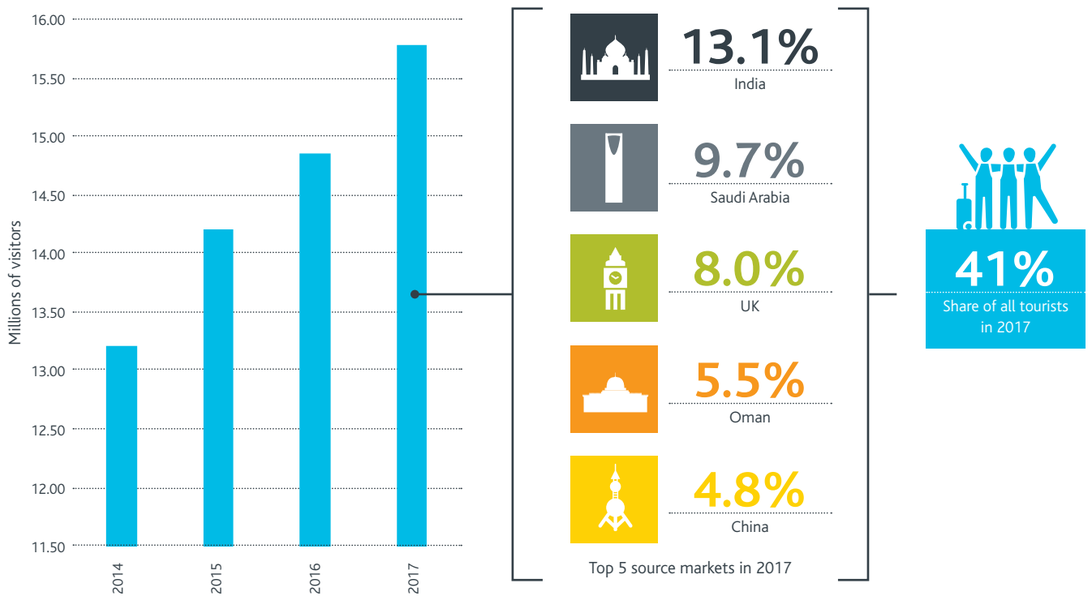
In fact, during 2017, the city saw 10 new hotel properties added to its portfolio, taking the total number of rooms up by 4,854 to a total of 82,733 keys. Overall occupancy levels have also improved, reaching an average of 78% last year; up from 76% in 2016 (Dubai Statistics Centre).

The city appears well on track to meet its vision of hosting 20 million tourists by 2020, with the Department of Tourism and Commerce Marketing reporting a 6.2% increase in the number of visitors last year, pushing the total to 15.8 million. In order to accommodate the projected influx, it is perhaps unsurprising to see the hotel development pipeline continuing to swell, with Downtown Dubai, Business Bay and the Palm Jumeirah remaining key locations for new hotel properties.

Hotel apartment supply rising
Similarly, the hotel apartment sector in the city also remains buoyant, with the number of new properties expected to increase by nearly a third from 24,698 hotel apartments at the end of 2017, to close to 32,000 by the end of 2020. For developers, hotel apartments remain somewhat of a cash cow.

Among the key benefits for developers of a hotel apartment complex in a mixed use development is the ability to use cash flows from presales of units to fund the development, enhancing the viability. The addition of regular apartments to the hotel project can also sometimes result in higher loan to value ratios for construction funding. This structure allows for an enhanced income potential from branding premiums, resulting from the sale of hotel apartment units, and rental income from unsold units, as well as access to cash flows from ongoing hotel operations. This is likely to be behind the surging interest from developers such as Damac (12,500 units) and Emaar (4,900 units), who together account for 50% of the existing, or planned, hotel apartment stock in the city over the next three years.

Dubai tourist arrivals



Source: Department of Tourism and Commerce Marketing

Key hotel accomodation stats for 2017

Source: Dubai Statistics Centre

Some subtle challenges ahead
Although the hospitality sector remains a bright spot in the emirate's property landscape, the rising number of hotel and hotel apartment properties, combined with the rise of Air BnB, is likely to sustain downward pressure on revenue per available room (RevPAR), which has continued to decline in recent months. This is a trend we expect will persist.

Furthermore, there has been a noticeable shift in traditional source markets, with a growing number of Chinese and South Asian tourists visiting the emirate, driven partly by the easing of visa regulations for tourists from China and India.

Hotel operators have been forced to adjust rates and create special packages to accommodate the change in demand demographics.

That said, we do expect that occupancy levels will be sustained as the city continues its aggressive drive to deliver enhanced tourism infrastructure, which is materialising in the form of new theme parks, world class hotel resorts and iconic attractions, such as the recently announced QE2 hotel. The former cruise liner is expected to be docked at Dubai Cruise Terminal at Port Rashid and further details are expected to be announced imminently.

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