COMMERCIAL RESEARCH

DUBAI OFFICE REVIEW Q2 2017

FRAGMENTED MARKET PERFORMANCE CONTINUES IN DUBAI

Key findings

On average office rents across Dubai fell 4.5% in the year to Q2 2017, with the performance of prime and secondary markets continuing to diverge

Dubai's GDP growth is expected to strengthen in 2018, bottoming out in 2017 at 2.2% Y-o-Y and strengthening to 2.5% Y-o-Y in 2018

The US Dollar has depreciated rapidly in the first seven months of 2017 (6%), this is likely to provide further support for economic growth

Employment is forecast to grow in Dubai by 1.63% in both 2017 and 2018

Macroeconomic Overview

Dubai's GDP increased by 2.9% in 2016, down from 4.1% in 2015. Lower oil prices, higher interest rates and a strong US Dollar have underpinned the slowdown in GDP growth. As the economy adjusts to the new norm in oil prices and diversifies in line with Dubai Plan 2021, the slowdown in GDP growth is expected to bottom out in 2017 and begin to strengthen in 2018.

Employment is forecast to grow 1.63% in both 2017 and 2018.

Business sentiment remains upbeat with the Purchasing Managers Index remaining positive at 55 *(figure 1)*.

Market Review

Dubai's commercial occupier market saw lacklustre performance in 2016 as a result of slower economic growth. The strong US Dollar since May 2014 has proved to be a strong headwind for Dubai's economy.

However, despite interest rate hikes by the Federal Reserve, the US Dollar has depreciated rapidly in the first seven months of 2017 (6%), this represents the longest period of depreciation since 2010. Given Dubai's reliance on foreign consumer spending, this is likely to provide a boost to economic growth and may encourage firms to resume capital expenditure. This in turn may lead to increased employment which would translate into additional demand for commercial offices.

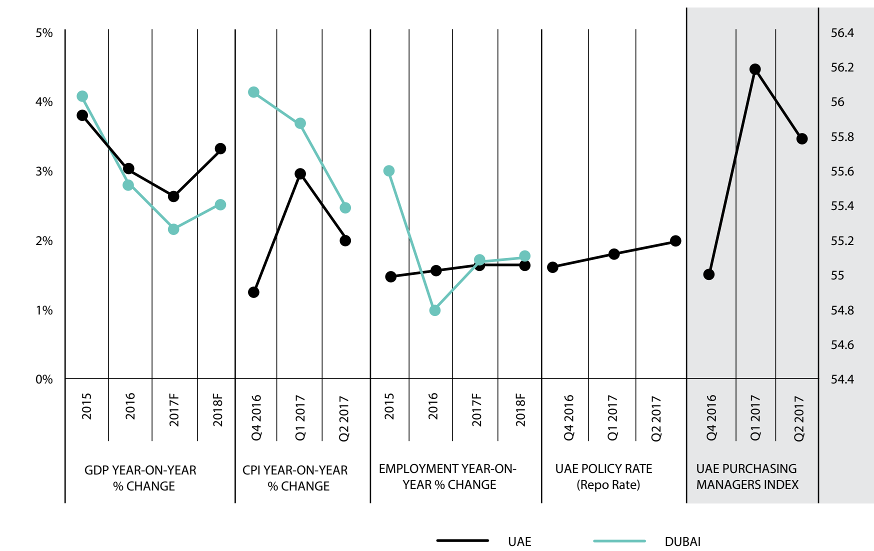
Market activity has remained relatively subdued in the first half of the year. On average, office rents across Dubai fell 4.5% in the year to Q2 2017, with the performance of prime and secondary markets continuing to diverge over the same period.

TAIMUR KHAN
Senior Analyst

"Prime rental performance remained relatively stable with average rents shifting 1.3% higher in the three months to June 2017."

Please refer to the important notice at the end of this report.

FIGURE 1
Economic indicators



Source: Knight Frank Research / Oxford Economics

Note: Purchasing Managers Index: A reading of 50 equates to no change, above or below representing growth or decline respectively

Prime rental performance remained relatively stable with average rents shifting 1.3% higher in the three months to June 2017. Demand in these locations remains high due to limited new supply, Freezone status, international regulatory standards and the quality of local infrastructure.

Vacancies in DIFC remain low with DIFC phase I registering vacancy at 1% as at Q2 2017. However, even within these prime locations, for periphery offerings (DIFC Phase II) absorption rates remain low. Although, as the master plan continues to evolve we expect absorption to steadily increase as the "core" expands. This trend may be further heightened with the move towards mixed use developments which encourage urban living by linking business, cultural and lifestyle environments

Grade A office market rents, which include the following areas; Downtown Burj Dubai, Sheikh Zayed Road and the Trade Centre District, fell 4.4% year-on-year and 2% over the last three months. Increased levels of supply and lower levels of demand have contributed to the fall in rental values, either via landlord rental concessions or headline rates.

In the city-wide market *(figure 2)*, the spectrum in quality of product has led to varying rates of both market performance and occupancy levels. On average rents fell 7.5% in the citywide market in the year to June 2017 and 0.7% over the three months.

Key locations where demand from occupiers is centred such as Internet City, Media City and Knowledge Park have maintained low vacancy rates ranging from 2-3%, and therefore rents have remained relatively stable.

In Business Bay, where supply continues to rise, there is a downward trend in rental rates which has led to increased demand for space in strata titled buildings. For the single ownership buildings in Business Bay we are witnessing increasing demand which has helped underpin price stability over the last year.

Outlook

Commercial market activity is expected to pick up in the latter half of the year with rental trends likely to continue at their current trajectory given the embedded supply dynamics in place.

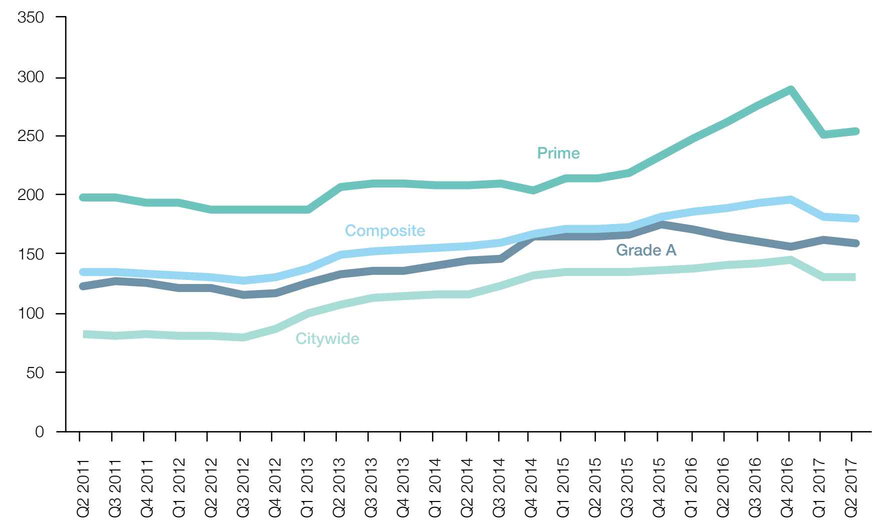
High occupancy in prime offices *(253 AED/sq ft /p.a.)* will continue to support rents, which supports our view that prime rents will rise further this year.

The delivery of additional Grade A stock will off-set any potential upside in rental values. In the citywide sector we expect pockets of outperformance to be sustained due to limited availability of good quality stock in preferred locations, however on average, rental values are expected to continue to fall marginally.

Lastly, whilst Dubai's economy is not as dramatically impacted by swings in oil prices, it is positive news for the region that prices have recently settled at around $50 per barrel, up from lows of $27 per barrel in January 2016.

FIGURE 2

Average Dubai office rents (AED/sq. ft./p.a.)



Definitions *(With guidance from the Best Practice Standards for Office Developments (2015 V2.0) by the Middle East Council for Offices (MECO):*

Prime: The Prime segment represents the average rent of the top 5% of all lettings in the market

Grade A: This segment of the market represents offices which are adjacent to the city centre, with rents on average higher than those in the citywide market

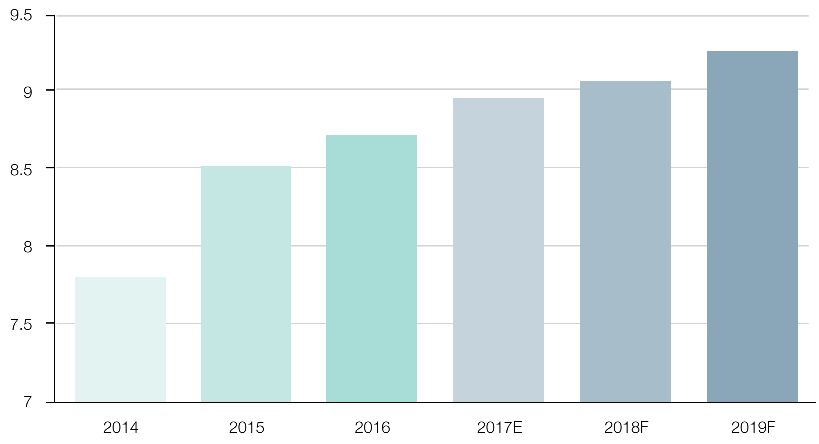
Citywide: This segment represents the broader city offices market, outside the 'core city', where usually a significant of office buildings are grouped

Source: Knight Frank Research

MATTHEW REASON
Senior Surveyor

"Commercial market activity is expected to pick up in the latter half of the year with rental trends likely to continue their currently trajectory given the embedded supply dynamics."

FIGURE 3
Dubai office stock, in square metres (millions)



Source: Knight Frank Research

FIGURE 4
AED's respite
Nominal broad effective exchange rate index The AED's performance against key currencies

Source: Knight Frank Research

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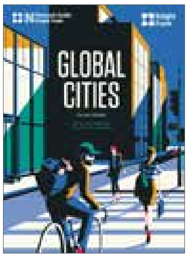

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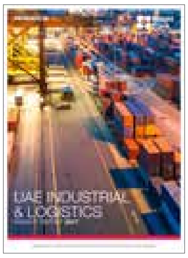

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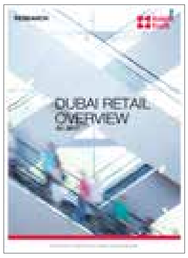

Dubai Retail Overview Q1 2017

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