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UAE Real Estate Update (August 2018)

Remaining Selective as Macro Backdrop Firms

- **As the regional macro backdrop improves, the sentiment toward UAE real estate is likely to remain selectively optimistic**
- **Property prices and yields may still have room to weaken further, but the pace of decline appears to be slowing**
- **Upcoming supply remains the greatest threat to sector performance, but new off-plan sales law may offer some structural support**

Further to our analysis of the UAE real estate environment entitled 'Foundations of Optimism' published back in April, we have recently received 1H 2018 data. While the direction of travel for residential and commercial property (sales and rental) prices in 2018 remains downward, data suggests that the pace of weakening is steadily slowing.

The outlook for the UAE real estate sector in 2H 2108 and into 2019 should be buoyed by an improving macroeconomic environment and as a result of the recent upward trend in regional inflation data.

After UAE GDP increased by only a disappointing 0.8% in 2017, as a result of the well-documented OPEC/NOPEC oil production cuts, we expect regional economic growth to rebound this year and next, in part due to the recent recovery in the oil price. This macro optimism forms the basis for our cautiously constructive outlook for the region's property market.

Indeed, UAE GDP growth is expected to register around 3.3% in 2018 and then 3.6% in 2019. As a further reflection of improving (expanding) macroeconomic metrics, we also note that UAE inflation remains above the long term average; inflation data for June came in at +3.29% YoY, albeit down from +3.48%, but still well above its 5 year average of 2.57%

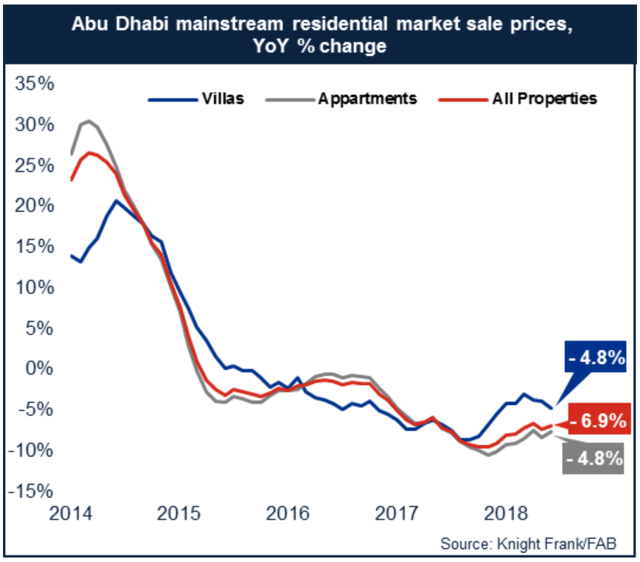
The key positive economic metric for the region though is obviously the recovery in the oil price. Brent crude, currently priced around $72.00/bbl traded as high as $79.01/bbl in late May, a far cry from the low of $48.33/bbl of June 2017. Ramifications of a higher oil price reach further than just government revenues and infrastructure investment; they tend to drive a more buoyant outlook for economic activity as a whole, including that of real estate.

Conversely of course, any near-term reversal in the oil price's fortunes would tend to quickly dampen our expectations for the macro outlook and, by extension, that for the real estate sector.

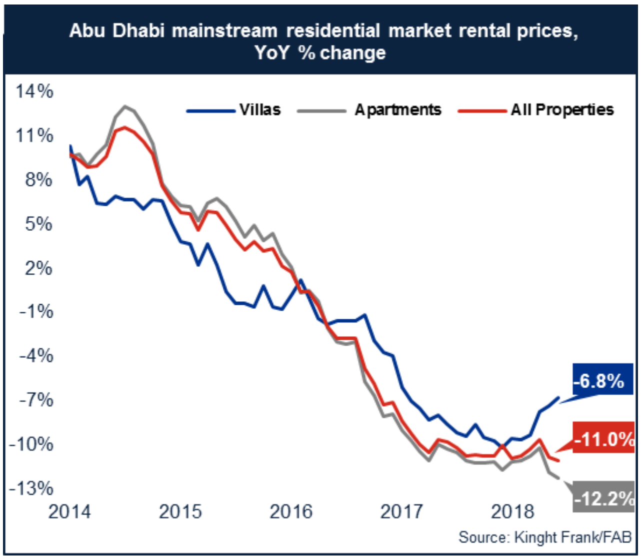
For now though, we would interpret robust credit and deposit growth (+1.9% and +6.0% respectively YoY as of June 2018) as positive lead indicators for real estate fundamentals over the coming quarters. This has been is the fastest rate of credit growth in 11 months.

UAE Residential

Abu Dhabi: In the year to Q2 2018 average sale prices in the capital fell 6.9%, according to Knight Frank data. Similarly, Cluttons saw Abu Dhabi residential values lower by 6.2% in the 12 months to Q1 2018. Villa prices have fallen by 4.8% and apartments prices by 7.6% year-to-end June. At same time though, we are encouraged by the fact that the data generally shows price falls having moderated in each of the last four quarters.

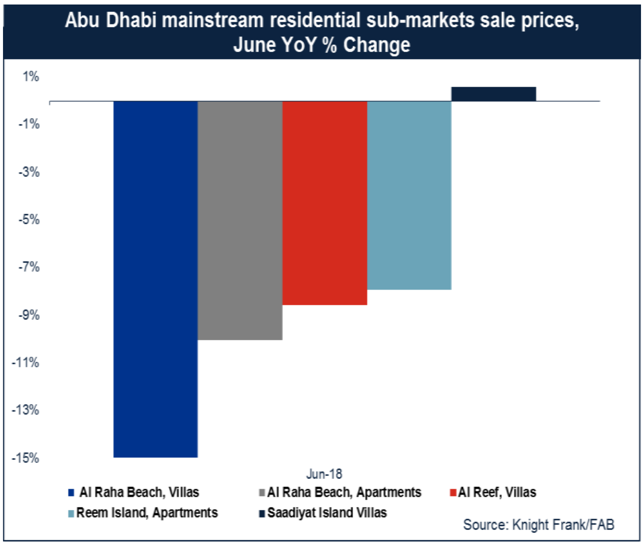


Abu Dhabi mainstream residential market sale prices, YoY % change

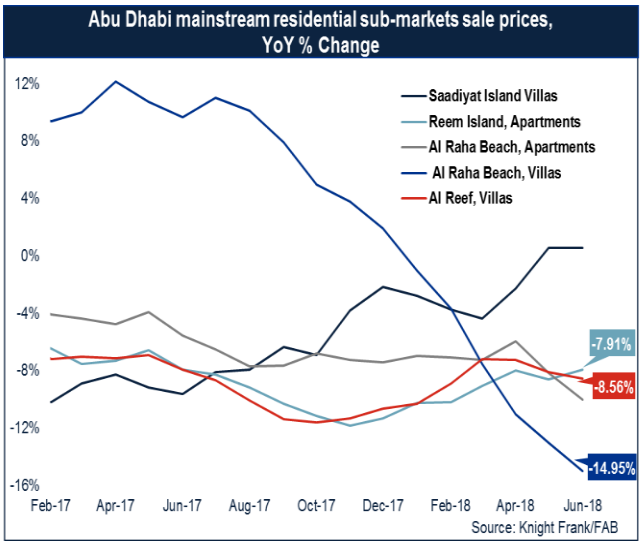


Abu Dhabi mainstream residential market rental prices, YoY % change

At the same time, the rental market continues to seek a floor in prices. Rental rates across Abu Dhabi fell on average by 11.1% in the year to Q2 2018, with apartment rents falling by 12.3% and villa rents by 6.7% over the same period. Rents have fallen consecutively for 25 months in Abu Dhabi, according to Knight Franck, weighed down in part by supply. In this respect prices are expected to remain under pressure with circa 6,500 new units likely to be delivered in 2018, according to Knight Frank.



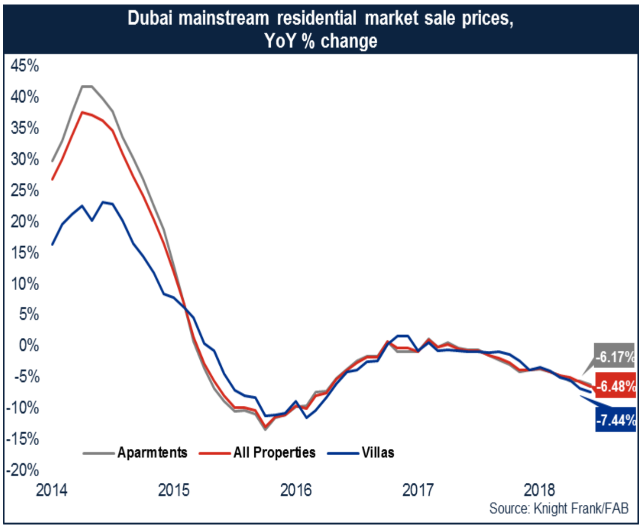
Abu Dhabi mainstream residential sub-markets sale prices, June YoY % Change

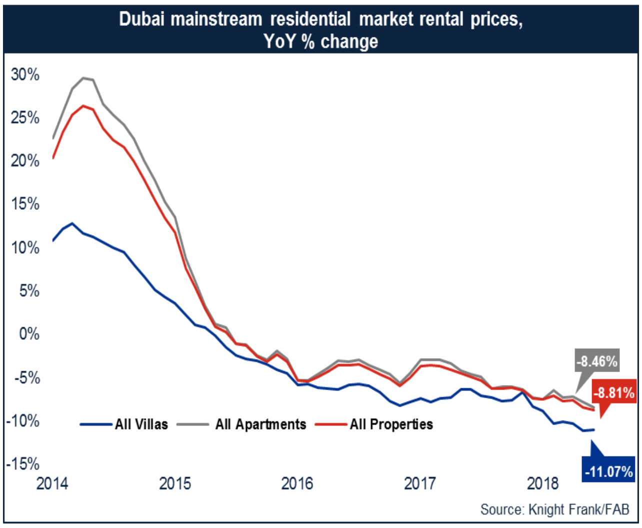


Abu Dhabi mainstream residential sub-markets sale prices, YoY % Change

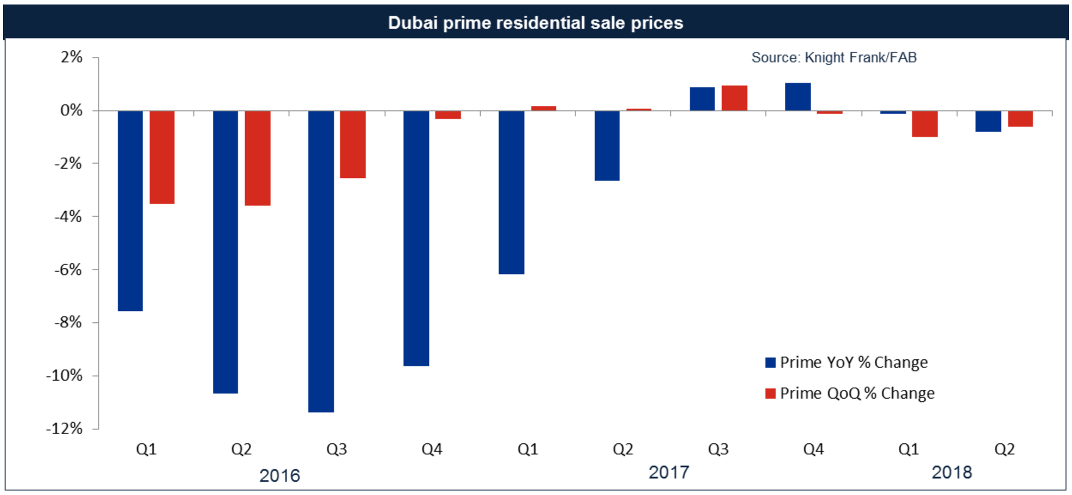
Looking at key sub-markets, prices have fallen across almost all markets and property types on an annual basis, although the fall varies by geographic area. In this respect we note that Al Raha Beach villa prices registered a near-15% YoY decline as at June 2018. Meanwhile, Saadiyat Island villas saw a small price increase, reflecting, in our view, investors' perception of relative value in the higher echelons of the real estate market of more attractively priced properties. It should, however, be remembered that Saadiyat Island villas were among the sectors of the market to see the most severe price correction during the 2014/2016 downturn.

Dubai: Mainstream residential sales prices fell by 6.5% over the year to Q2 2018, according to Knight Frank data. Over the same time period prices for apartments are said to have fallen by 6.2% and for villas by 7.4%. Rents have also continued to trend down with villa rental declines outpacing the wider market (All Properties: -8.8%, Apartments: -8.5% and Villas: -11.1%). Prime prices in Dubai fell by 0.8% in the year to Q2 2018 and a 0.6% fall was recorded in the last quarter. Supply again is the key constraint on price performance; expected to remain under pressure with circa 33,000 units are likely to be delivered in 2018.





Indeed, this was very much the concern aired by Cluttons in their 'Dubai, Property Market Outlook, Spring 2018'. In this publication the agent highlights the growing volume of off-plan investment stock and the fact that much of it is expected to be used as rental property after handover. Such new stock volumes are seen by Cluttons as likely to weigh on rental market yields over the next three years.



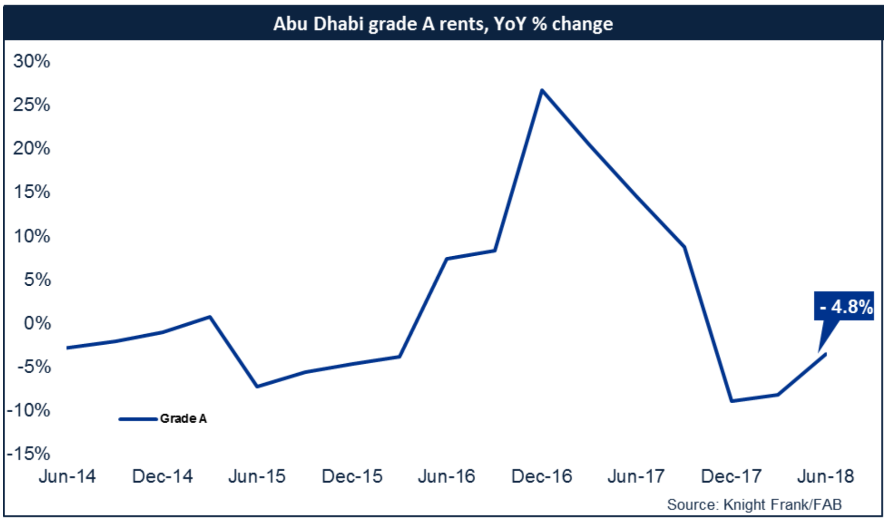
Conversely, in the Dubai residential sales market, it could be a relative lack of current supply that is actually helping to support prices and form a price floor for the sector. Moreover, with affordability likely to become an increasingly important factor for potential purchasers, we would expect higher demand / relative lack supply in mid-price properties to be one of the dynamics of new home sales over the next couple of years. Cluttons notes that a new proposed law concerning the restriction of off-plan sales until schemes are 50% complete, could lend some structural support to residential home prices over the coming quarters.

Conclusion

A firming macroeconomic backdrop across the UAE region should help to create a base of support for the real estate market. Credit growth in the region was the strongest in 11 months as of June this year, which we believe should also be a fillip for real estate sentiment going forward. Encouragingly, we note that residential price falls have moderated in recent months, although a veil of uncertainty continues to hang over the sector in terms of potential new supply that is set to be delivered over the coming 12-24 months.

UAE Commercial
Grade B stock across both Abu Dhabi and Dubai's industrial and logistics zones have seen the most significant falls in rents over the past 12 months to Q1 2018. Rents in quality Grade A zones have bucked this trend in certain locations such as Jebel Ali Free Zone and Dubai Investments Park where rents were +16.7% and +6.7% respectively over the year to Q1 2018. In Abu Dhabi areas such as KIZAD and Al Markaz remain resilient relative to the wider market, albeit with rental rates still net softer overall.

Abu Dhabi: On average, according to Knight Frank, Grade A office rents across Abu Dhabi fell 3.4% in the year to Q2 2018. As at Q2 2018 Prime rents across Abu Dhabi on average were recorded at AED1,678/sqm, Grade A rents at AED1,450/sqm and citywide rents were recorded at AED1,110/sqm.



% Change	3-Months	6-Months	12 Months
Grade A	194%	-0.30%	-3.45

Abu Dhabi currently has stock of around 3.5 million square meters of commercial space and this is forecast to expand to as much as 4.3 million square meters by the end of 2020. However much of this expected stock is owner occupied or is likely to be delayed due to market conditions. Nonetheless, the market wide vacancy rate in Abu Dhabi's commercial real estate market was calculated to be 27% as at Q2 2018.

Conclusion
Looking at the UAE commercial property sector as a whole, we would say that activity levels remain buoyant. Turnover should be driven by companies seeking to expand capacity as the economy picks up as well as those still looking to consolidate operations, make synergies and strengthen balance sheets. At the same time, we also continue to hear evidence of a wide range of new market entrants, all of which appears to be net positive news for this segment of the real estate market.

At the same though, we would advocate a degree of caution, While Prime rents are expected to remain broadly stable over the coming months, we are cognizant of warnings of a significant potential amount of new Grade A stock becoming ready for occupation. Any such deluge of supply would be expected to put downward pressure on rents across the sector. Furthermore, Knight Frank points out that increased supply / weakness in rental prices may then also put pressure on occupancy rates as a result of the implied increase in inventory stock levels. As such, data suggests that the outlook for the sector offers some optimism, but certainly not to the extent of complacency.

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