Abu Dhabi Office, Residential & Hospitality Q3 2016

Job losses and slower economic growth drive office and residential rentals lower

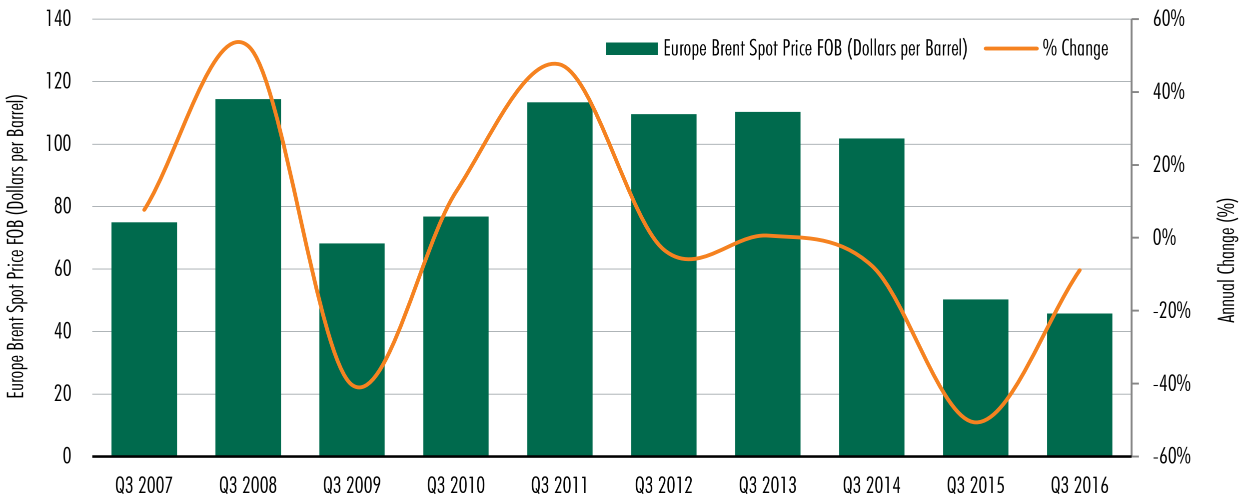
Hotel RevPAR 12.5% (year to date from Sep-15)

Hotel Occupancy 2% (year to date from Sep-15)

Average Apartment Rent 5.0% y-o-y

Secondary Office Rent 2.0% q-o-q

Figure 1: Average Crude Oil Prices (2007 – Q3 2016)



Source: Energy Information Administration (www.eia.gov)

- According to the Statistics Centre – Abu Dhabi (SCAD), the Emirate's inflation rate averaged around 2.4% during August 2016, slightly lower than the 2.7% observed during H1 2016. The housing, power, water and fuel group remained the highest contributing group, with 91% of the overall increase in the CPI.
- Brent Crude oil hovered around US$46/barrel during Q3 2016, down more than 61% from the US$118.50/barrel average achieved during Q1 2012. On a quarter on quarter basis, prices have dropped by 9% from US$50.25/barrel observed during Q2 2016, but remain up on Q1 2016 performance.
- Secondary office rentals continued to fall with a drop of 2% during Q3 2016, translating into roughly a 9% decline from the same period last year.
- Despite the general softening of housing rentals, there were still cases of rental uplifts being recorded, albeit at a minimal growth levels, with the mid-market segment continuing to outperform the wider market.

OVERVIEW

According to EIA during Q32016, Brent Crude oil averaged US$45.79/barrel, down by more than 61% from Q1 2012. On a quarter on quarter basis, average oil prices dropped by 9% from the US$50.25/barrel observed during Q2 2016.

Amidst the sustained weak performance of the hydrocarbon sector and the multi-faceted impacts on the local economy, rating agency Standard and Poor's (S&P) has given Abu Dhabi an "AA/A-1+", highlighting the overall stable outlook for the Emirates. The Emirate's sizeable fiscal reserves continue to provide the financial capacity and flexibility to follow through with planned Government projects and maintain services despite falling oil revenues.

According to the Statistics Centre – Abu Dhabi (SCAD), the Emirate's inflation rate hovered around 2.4% during August 2016, slightly lower than the 2.7% observed inflation level during H1 2016. The housing, power, water and fuel group remained the highest contributory group, with 91% of the overall increase in the CPI. Earlier this year, the Abu Dhabi Distribution Company (ADDC) announced a new set of utility tariffs following the Government's move to cut energy subsidies.

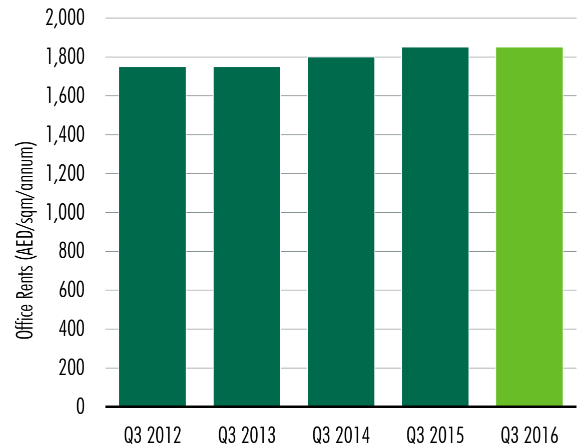
During the quarter, the Abu Dhabi Executive Committee approved a number of projects including the construction of roads, infrastructure, services and education facilities across the Emirate, whilst also confirming that a number of high profile developments would also continue, including the construction of the Guggenheim museum on Saadiyat Island. The multiplier effect of these large public expenditures cannot be under estimated and will ultimately help to stimulate local market activities, whilst also minimising the adverse impacts of the softening economy.

OFFICE MARKET

Office rentals continued to slide amidst weakening demand levels, a trend which was underlined by news of further job cuts in the Capital, with ADIB's cost optimisation measures resulting in the loss of 200 jobs across its UAE operations. This comes at a time when a growing number of businesses appear to be considering actions to streamline business operations, including staff reductions, office downsizing, and sub-leasing of excess accommodation, which is adding further pressure to already high vacancy rates.

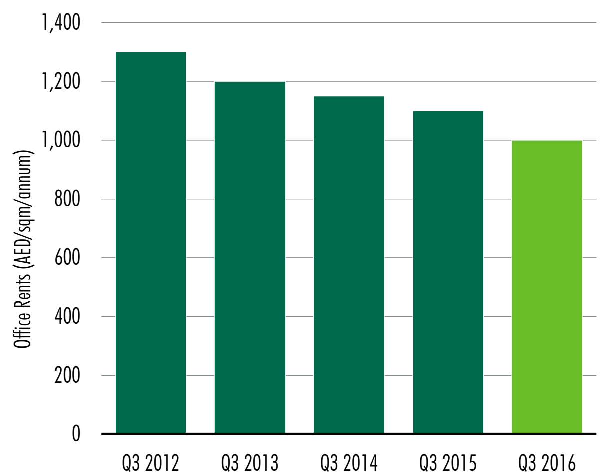
Secondary office rentals continue to slide with a drop of around 2% observed during Q3 2016, which translates into a 9% decline from the same period last year. This trend has been accentuated by a development pipeline that is heavily orientated towards inferior quality products and locations.

Figure 2: Prime Office Rental Rates (Q3 2016)



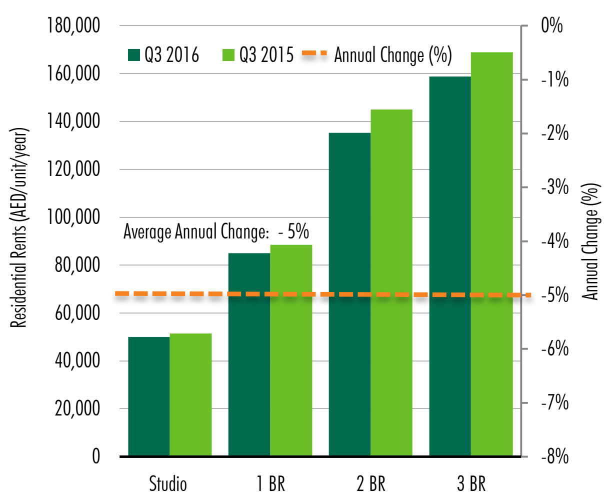
Source: CBRE Research

Figure 3: Secondary Office Rental Rates (Q3 2016)



Source: CBRE Research

Figure 4: Average Apartment Rentals Rates (Q3 2016)



Source: CBRE Research

OFFICE MARKET (CONTINUED)

Shell and Core office units within prime Grade A accommodations remain priced at an average of AED1,850/m^2/annum. Whilst these rates have been stable in recent quarters, there are signs that market pressures may soon result in deflation of Grade A rentals, although the lack of available high quality office product for lease is helping to insulate performance far better than in the overexposed secondary market.

Landlords are now showing greater flexibility and a willingness to negotiate with major tenants, which has resulted in a more noticeable gap between Landlord's quoting rentals and the actual achieved rentals. This underlines a sustained shift towards becoming a tenant friendly market.

RESIDENTIAL MARKET

Average housing rentals have continued to decline amidst the prevailing weak employment market and softening economy. During Q3 2016, average market rentals fell by around 2% quarter-on-quarter, taking the year=on-year decline to 5%.

Luxury residences within master planned communities, which are highly favoured by blue chip corporate tenants and high-income expatriate residents, have experienced an average rental drop of 3-5% over the last quarter, underlining the negative impacts of ongoing cost optimisation measures which have included resulted in job losses, a tightening of corporate packages, and reduced housing allowances and salaries.

As a result expatriate residents are also becoming more cautious with their spending, which is directly impacting demand for housing. This has translated into declining rentals for larger unit types, but solid fundamentals for smaller and more affordable units as some tenants choose to downsize the property type or select more affordable locations.

On average, annual rentals for studio and one-bedroom units in key mainland locations range between AED25,000-AED45,000 /unit/ annum and AED35,000-AED60,000/unit/ annum respectively. This translates into a minimum 35% gap in rentals as compared to rental levels for low to mid-end properties in the city centre which range from AED40,000 -AED72,000/unit/ annum for studios and AED55,000 -AED120,000 /unit/ annum for one bedroom units.

Despite the overall drop in rents, some affordable yet relatively inferior housing products have still managed to demonstrate modest rental growth, or have remained flat. This underlines a general market shift towards affordability. With expatriate residents most susceptible to deflationary risks and company downsizing, we anticipate further migration of tenants to locations such as Al Reef Downtown, and affordable mainland locations.

However, with limited availability of affordable homes, this segment appears to be well insulated against the current market downturn, meaning mid-market rentals rates are unlikely to see too much fluctuation in the short term.

HOSPITALITY MARKET

Q3 2016 prove to be challenging period for the local hospitality market, with declining revenue performance brought about by sustained deflation of room rates.

In addition to the typically quiet summer period, macroeconomic challenges have added further pressure to the tourism and hospitality sector, resulting in weaker corporate demand, a key component of the Emirate's visitation profile.

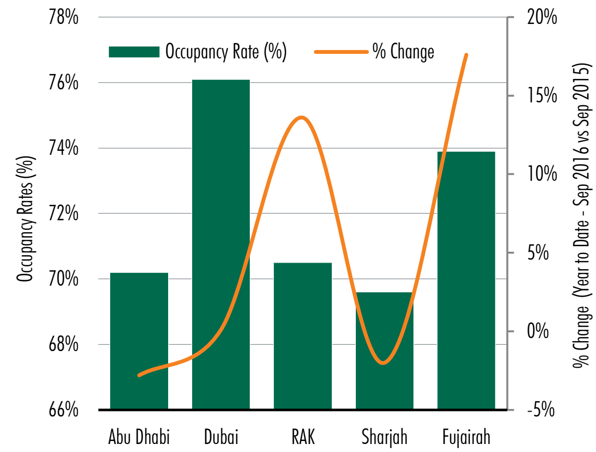
According to data from STR Global, Abu Dhabi's year to date occupancy rate to September 2016 was recorded at 70.2%, down by around 3.0% from the same period last year.

The year-on-year average daily rate (ADR) also dipped, falling from AED488/room/night in September 2015 to AED440/room/night in September 2016. Lower occupancy rates and the continued softening of ADR's, has subsequently pushed down revenue per available room (RevPAR) by close to 12%, as rates fell from AED352/room/night in September 2015 to AED310/room/night in 2016.

Despite ongoing initiatives to diversify and boost Abu Dhabi's tourism and hospitality markets, the Emirate's room demand is still heavily driven by corporate requirements. With the on-going austerity measures observed in both private and Government agencies, weaker corporate demand coupled with sustained growth in room supply has inevitably brought about fresh challenges for the market and consequently impacted hotel performances.

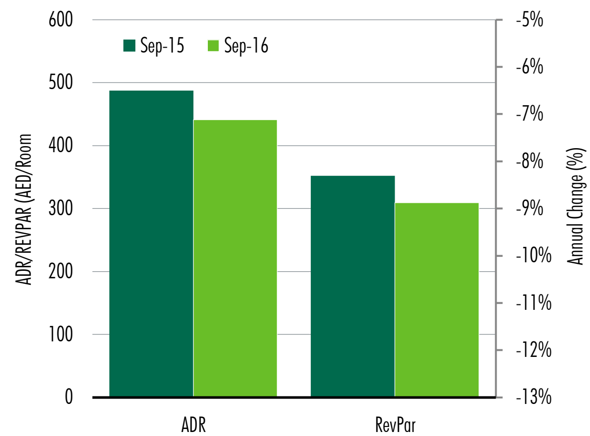
Between 2017 and 2018, close to 2,500 new hotel and hotel apartment keys are scheduled to be completed, raising competition and adding further pressure to hoteliers and hotel owners. The majority of the new rooms will be of 5-Star quality which could lead to a sustained period of lower rates for the upscale and luxury segments.

Figure 6: Comparative Analysis – Occupancy Rates (Sep-2016)



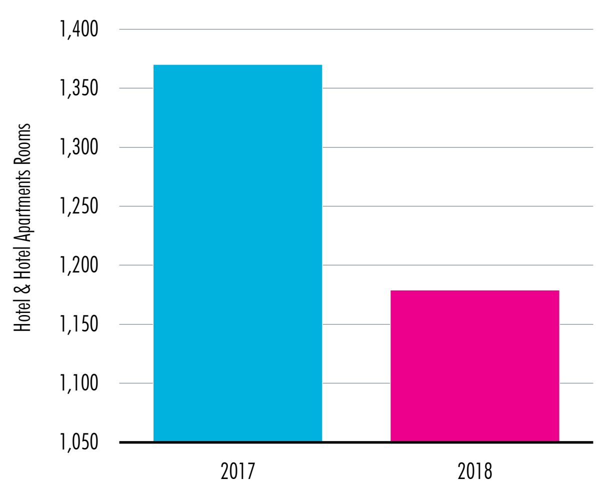
Source: STR Global

Figure 7: Abu Dhabi Hotel Performance (Sep-2016 vs. Sep- 2015)



Source: STR Global

Figure 8: Abu Dhabi Future Hotel Supply (2017 – 2018)



Source: CBRE Research

OUTLOOK

We expect to see further rental declines in the residential sector in the coming quarters, as continued economic uncertainty and downsizing of the workforce culminates in weaker demand fundamentals. We also anticipate further migration towards the Emirate's more affordable residential locations, as consumer confidence is further impacted and tenants consider a range of cost cutting measures to help manage mounting market and economic risks. This is likely to result in a fragmented performance, with high-end apartment products expected to suffer further rental declines, whilst the mid-market will remain better insulated as strong demand for affordable residential units prevails.

For the commercial market, we anticipate a further shift towards a tenant led market, as vacancy rates rise and Landlords battle to maintain occupancy rates in the properties. With secondary stock levels climbing, we expect older and inferior office accommodations to experience further deflationary pressures.

With various events on the horizon as we move into one of the Emirate's peak visitation periods, an improvement in overall hospitality performance is expected during the final quarter. However, the market is likely to experience sustained deflationary pressures on room rates as new supply is delivered and as hotels continue to struggle against the strength of the US dollar and other economic headwinds.

CONTACTS

For more information about this MarketView, please contact:

EMEA RESEARCH

Matthew Green
Head of Research & Consulting, UAE
Strategic Advisory
Middle East Research
CBRE
Dalma Mall | Mussafah – Tarif Highway
United Arab Emirates
Abu Dhabi, UAE
t: +971 2 681 7800
e: matthew.green@cbre.com

Arlene Isito Jimenea
Senior Research Analyst – Research & Consulting
Strategic Advisory
Middle East Research
CBRE
Dalma Mall | Mussafah – Tarif Highway
United Arab Emirates
Abu Dhabi, UAE
t: +971 2 681 7800
e: arlene.jimenea@cbre.com

CBRE OFFICES

Abu Dhabi
Dalma Mall | Mussafah – Tarif Highway
United Arab Emirates
Abu Dhabi, UAE

Dubai
Emaar Square
Building 6, 8th Floor
Dubai, United Arab Emirates

Bahrain
Manama
Enma Mall, Management Office
Um Nassan Av, East Riffa, 925
Manama, Bahrain

Turkey
Istanbul
Suleyman Seba Cad. No:48
BJK Plaza A Blok A1-06
Besiktas, Istanbul

To learn more about CBRE Research, or to access additional research reports, please visit the Global Research Gateway at www.cbre.com/researchgateway.