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FAB
First Abu Dhabi Bank

UAE Real Estate Update Q2 2018
''Foundations for Optimism'

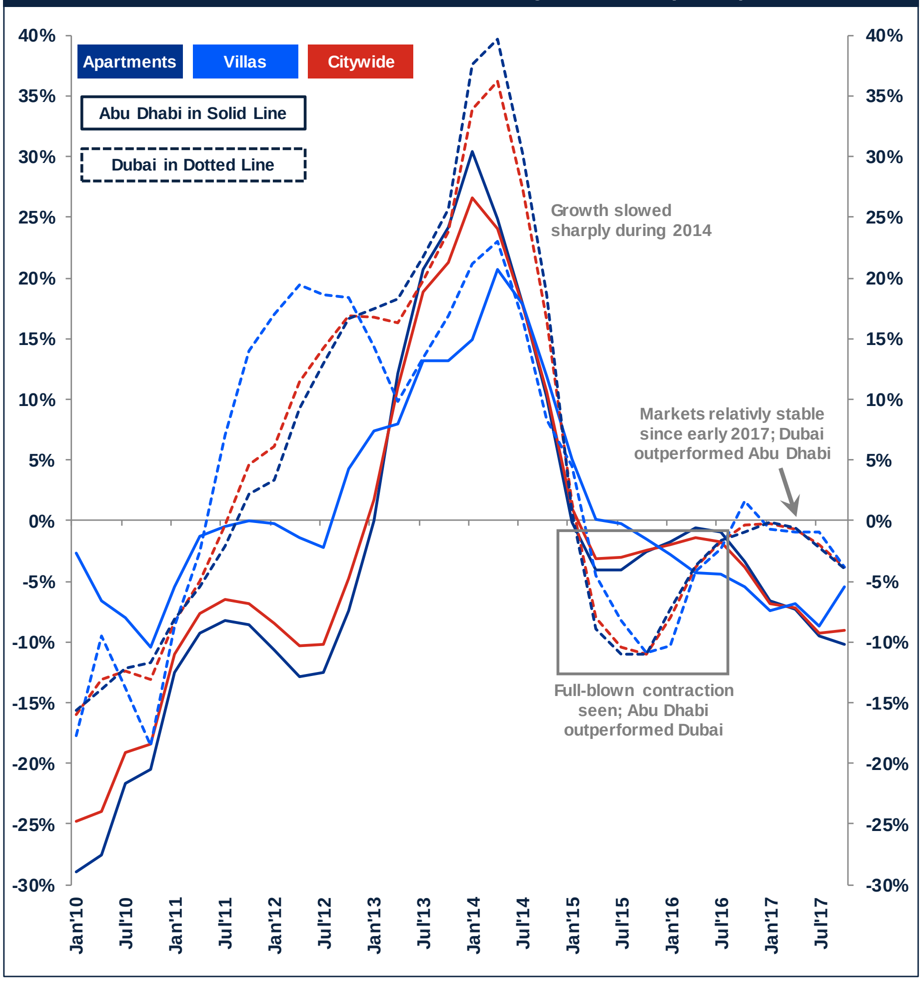
Pricing trends across the region retain a soft bias, although after the correction seen in real estate prices during 2014/2015 the market is now showing some encouraging signs of underlying price support.

Residential price growth slowed sharply during 2014, before the full-blown contraction (negative growth rates) that the market experienced in 2015. Price growth remained negative for much of 2016, albeit an improving (less negative) rate. Relative stability has characterized the market since early last year, although land activity remains sluggish.

Sentiment has been dampened by corporate mergers and companies downsizing, both of which have dented demand. As a result average apartment and villa rental rates across the UAE are estimated to have declined 17% and 12% respectively, since end 2015, with sales prices 13% and 8% lower.

The introduction of 5% VAT on commercial property in January may dent near-to-medium term demand and pressure rental/sales prices, albeit in the context of improving UAE macroeconomic fundamentals longer-term.

Mainstream Residential Price Change in the UAE (YoY %)



Source: Knight Frank / FAB

19 April 2018

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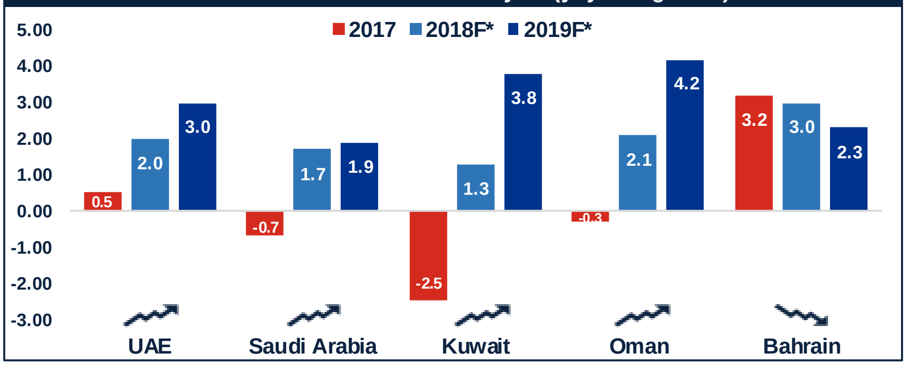
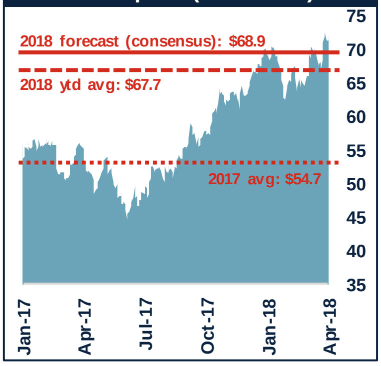
Key to the relative stabilization of the UAE real estate market over recent months is the recovery in oil prices. The latter has been a result of OPEC and non-OPEC oil production cuts over the past year, which has helped to buoy the macro outlook for the UAE and the broader GCC region. From GDP growth of 0.5% last year in the UAE, forecasts are for a recovery to +2.0% this year and +3.0% in 2019, an economic scenario that we believe should continue to lend support to real estate prices.

IMF's GDP forecast for next two year (yoy change in %)



Brent price (US$/barrel)



*Source: *IMF forecast / Bloomberg / FAB*

Moreover, mainstream real estate transaction volumes in the first nine months of 2017 rose 10% compared to the same period a year earlier, according to Knight Frank. The total value of transactions over this period registered at AED36.86 billion (US$10.04 billion) up 12% compared to a year earlier.

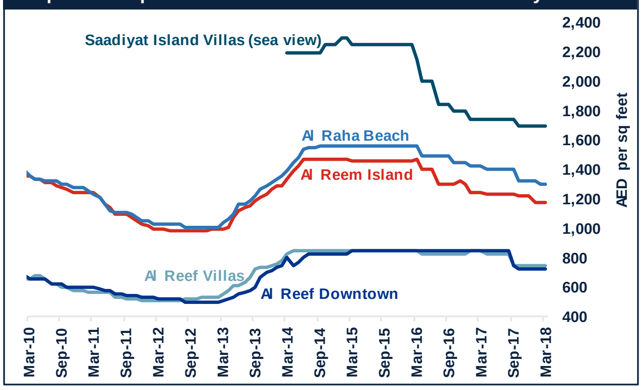
Overall therefore, a soft, but nonetheless cautiously optimistic tone continues to characterize the UAE property market. After the correction seen in real estate prices during 2014/2015 the market is now showing some encouraging signs of underlying price support, although with evidence of extensive incentives being used by landlords to retain incumbent tenants or entice new ones, market conditions are still far from strong. Moreover, we would suggest that with the visible evidence of meaningful new residential supply coming on line in both Abu Dhabi and Dubai over the coming quarters, pressure should continue to be felt on rental prices across most communities.

Abu Dhabi

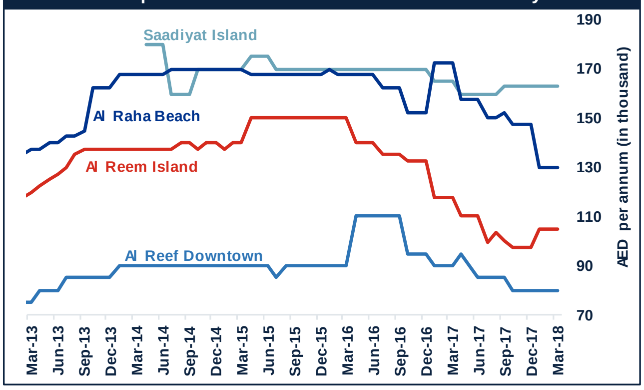
As mentioned above though, aggregate real estate price trends remain fragile, with a cautious sentiment now well embedded across the market. According to real estate agent Cluttons in their Abu Dhabi, Spring 2018 Property Market Outlook, the agent notes a slowing rate of capital value decline in AD's residential freehold investment zones. It calculates that while values fell by 1.7% in Q1 this year, the annual rate of decline was a more modest -6.2%, versus the -6.9% fall witnessed through 2017 as a whole. Moreover, Cluttons adds that average residential values are now at levels not seen since the end of 2013.

Apartments in Al Reef Downtown are cited as the weakest performer of the past 12 months, with residential values having fallen by 14.7% on average. Al Reef Villas saw the next weakest price performance (-11.8%). All residential areas in Abu Dhabi registered some degree of value correction, with the exception of Al Raha Gardens (villas), Golf Gardens and Al Ghadeer (apartments) where values were unchanged.

Capital value performance: Abu Dhabi residential across key markets



Rental value performance: Abu Dhabi residential across key markets

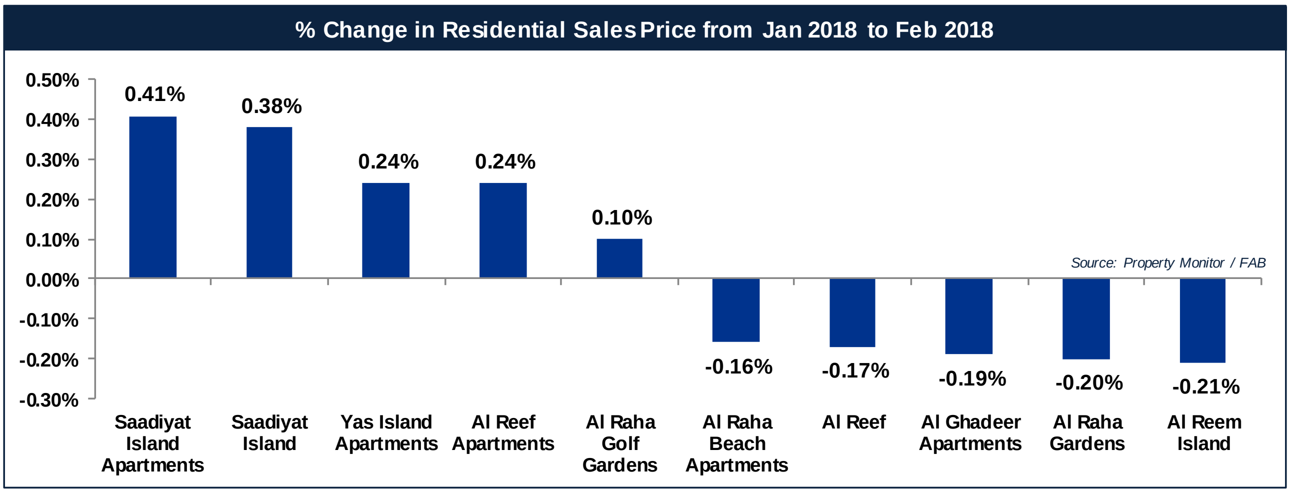


Source: Cluttons / FAB

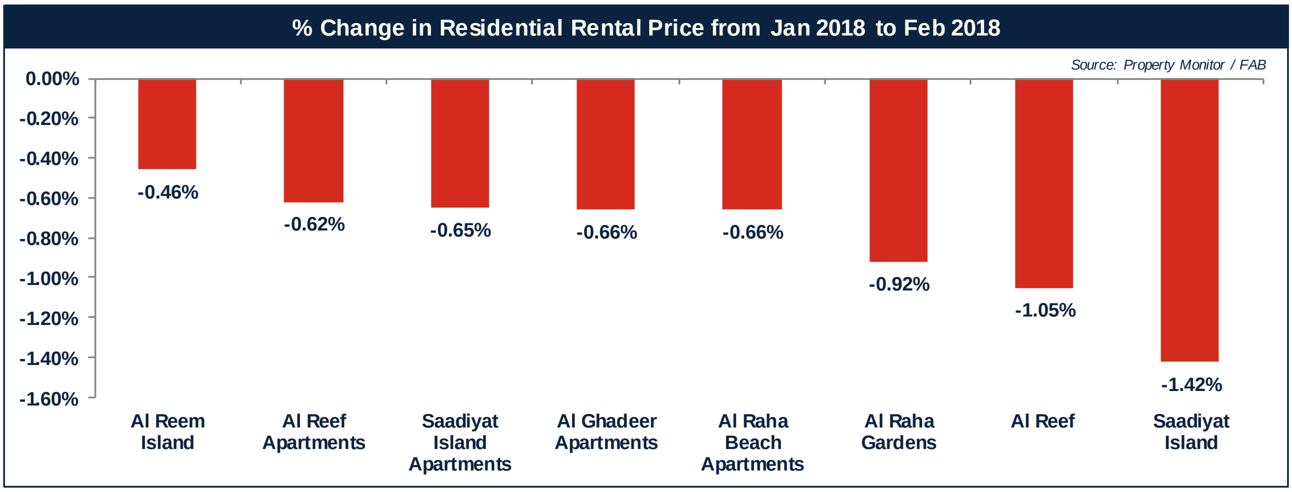
While the decline in values has not been helped by an environment characterized by still generally cautious buyers, reluctant to commit to purchasing, Cluttons does air a degree of optimism in that high-end properties seem to be showing signs of stabilizing. In this respect, sea facing villas on Saadiyat Island, which are among the most expensive Abu Dhabi real estate, encouragingly have now seen no (downward) movement in prices for two consecutive quarters, albeit that this statistic comes from a low base. These properties have seen their values decline by an average 26.1% since 2015. Nonetheless, it is hoped that this relative stability may underpin the sector's outlook and encourage buyers back into the market over the coming months.

Moreover, while high end properties may still be facing soft pricing conditions, there is evidence that some developers are beginning to sense a bottoming to the market and are therefore now moving ahead with new schemes. We would nonetheless still advocate a degree of caution in this regard, noting the importance of buy-to-let investors in many recent development sales. This could create new competitive pressures in the rental market as new developments reach handover stage in the coming months.

Data from Property Monitor meanwhile highlights a mixed picture across Abu Dhabi residential sales prices in the first two months of this year. Saadiyat Island apartments saw the largest price rise (+0.41%), while Al Reem Island, amid all the upcoming supply, was the underperformer (-0.21%).



Property Monitor data also corroborates our belief that the AD residential rental market is experiencing a soft patch as handovers of new accommodation comes on line. Across all Abu Dhabi, rental prices declined between January and February this year.



This said, against a backdrop of heavy competitive supply, we maintain that (off-plan) high quality projects, offering attractive prices and payment options will be key beneficiaries of the underlying depth of real estate demand. Cluttons notes the recently announced 5 phase Al Fahid Island project as evidence of such optimism.

Relative Rental Weakness

But softness in the Abu Dhabi rental sector seems likely to persist as the abundance of new supply comes on stream. In this respect we note some 9,000 residential units could be completed and delivered this year. Two thirds of these will be apartments and the remaining third villas and townhouses. Geographically the supply is concentrated on Al Reem Island, Al Raha Beach and Yas Island. According to Cluttons' data, rents across Abu Dhabi residential investment areas declined 2.3% in Q1 this year, having fallen 4.3% in Q4 2017. The sector currently sits at -11.5% YoY.

Al Reem Island may have been the only area of AD to register a rise in apartment rents during Q1 this year (+3.8% for mid-range units), but this was but a small rebound from the 15.4% price correction seen by the sector over the past 12 months, the third largest rental contraction in the City according to Cluttons.

Indeed, recent anecdotal evidence has shown the relative weakness of the Abu Dhabi apartment rental market during Q1 2018. Between January and March this year, we have witnessed first-hand the decline in rental prices and increased 'negotiability' of landlords. During Q1 2018 and this analyst's search for accommodation, we have not only seen a 13.5% decline in the headline rental price of the same prime 2-bed duplex apartment in the same building in Abu Dhabi, but we have also benefited from a shift to a more flexible pricing plan; from a 1-cheque, to a 3-cheque payment structure.

The rental market may soon approach price levels that are perceived as offering (better) value, which could add a degree of underpinning to the sector going forward. Nevertheless, we believe that a soft bias will remain as new supply comes on line.

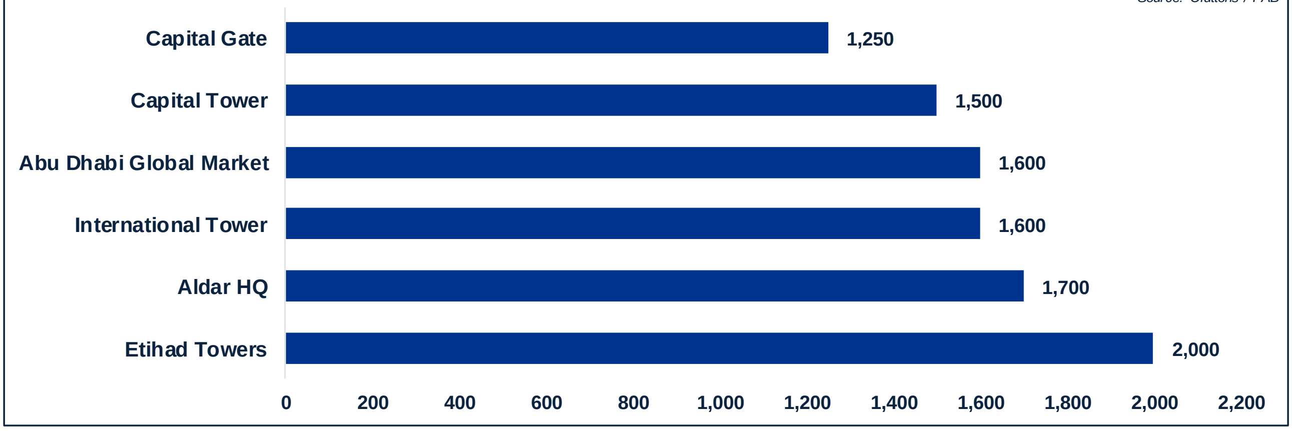
Commercial Property Still Has Work To Do

Meanwhile, the commercial office market in Abu Dhabi is also not out of the woods yet, with continued declines in rents being widely reported, according to Cluttons. Further rental declines are also projected across all quality grades, with vacancy rates likely to increase as companies continue to downsize and relocate to smaller premises. This said, similar to the residential market, there is a feeling that commercial property prices having fallen toward levels last seen in late 2013/early 2014, a degree of relative value may now be returning to the sector.

Even the city's most prestigious buildings are said to have seen rental profiles weaken. Cluttons cites the Aldar HQ building (-2.8%) and International Tower (-3%) as among the commercial buildings to experience headline rent declines in Q3 last year, albeit that the prime office sector as a whole has declined by just 5.4% over the past 5 years. In contrast though, secondary rents are estimated to have fallen 39.3% on average over the same period.

Rental value performance: Abu Dhabi office/commercial rent across key markets (AED per sq metre)

Source: Cluttons / FAB



The recent gains in the oil price should help to support the real estate market outlook, although overall market activity will likely remain muted for some time to come while cost cutting initiatives still characterize the sector. For now, we see little incremental commercial office space requirements from the oil and gas sector.

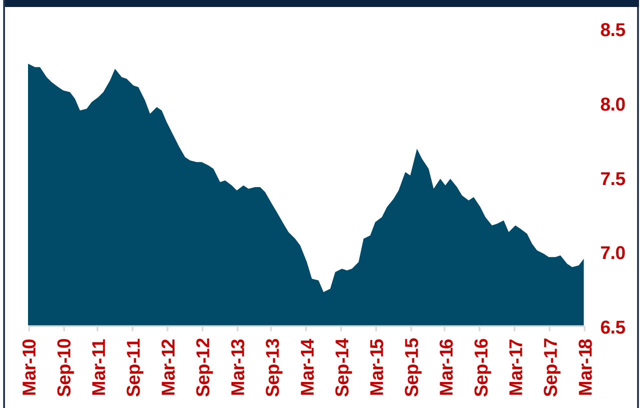
Elevated vacancy levels across the commercial real estate space will maintain near-term downward pressure on rents. This may be particularly relevant among older, 'in need of upgrade' properties. In the latter many landlords are now thought to have adjusted their business models to operate with vacancy rates of up to 30%. In turn, this is creating something of a vicious circle; landlords reluctant to lower rents to entice new tenants, tenants reluctant to view such properties at what are now considered to be overvalued rents. The market may need innovative leasing structures and incentives to break this deadlock and more importantly, will require a more meaningful upturn in the oil price outlook to create more buoyant expectations for commercial real estate this year and next.

Dubai

According to data from Knight Frank, the Q1-Q3 period in 2016 saw Dubai average residential house prices decline by 5.6%. However, the same period last year (2017) saw a much more modest price decline of just 0.6%. Moreover, Knight Frank notes positive prime residential price growth between August and September last year.

Rental market weakness is also evident in Dubai at the moment, with REIDIN noting a 6bps fall YoY in rental yields to 5.48% in January. Year-on-year activity levels in Downtown Dubai were also less than impressive in January.

Dubai rental yields (%) experiencing downward pressure



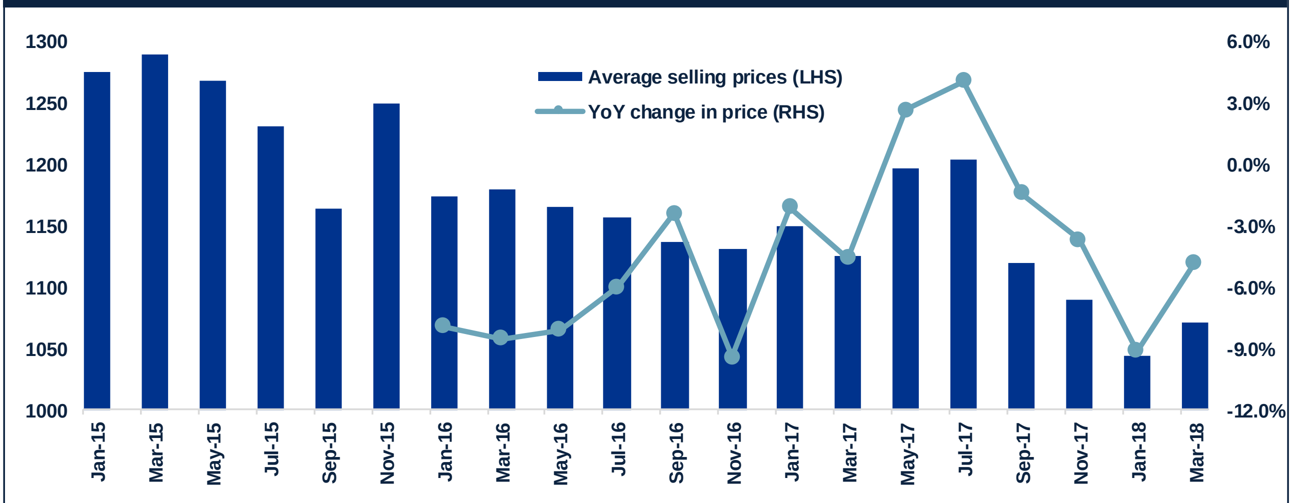
Dubai Downtown: Transaction Value in Top 5 areas (AED mn)

	Mar-17	Feb-18	Mar-18	M-o-M	Y-o-Y
Downtown Dubai	559	213	317	↑	↓
Dubai Marina	424	257	240	↓	↓
Business Bay	439	236	214	↓	↓
Palm Jumeirah	321	192	190	↓	↓
Jumeirah	126	36	133	↑	↑

Source: REIDIN / FAB

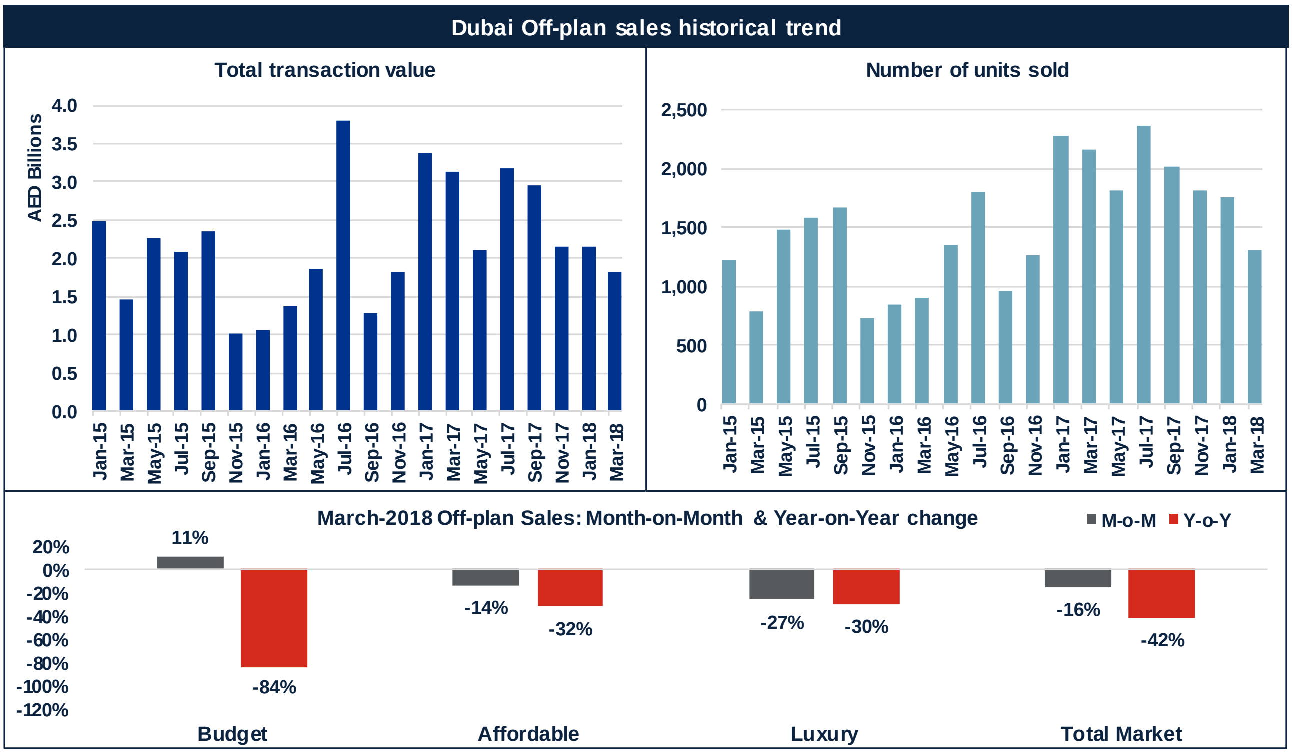
Similarly, Dubai average selling prices were down 5% YoY in February 2018 (2% below the 12m trailing average) according to data from REIDIN. Meanwhile the data for annual rental costs across Dubai also highlight a fairly mixed performance picture on a MoM basis.

Dubai residential average selling price (in AED per sq. ft.)



Source: REIDIN / FAB

That said, we note that in Dubai, off-plan sales were down 58% in value and -46% in volume on YoY basis in February. Indeed, sales fell across all segments according to REIDIN data, albeit up on a month-on-month basis within the luxury and affordable segments, buoyed by activity in Zabeel and Business Bay respectively.



Source: REIDIN / FAB

Al Ain

The Al Ain real estate market is expected to experience a differentiation between low-end and high quality properties during the course of this year, with several projects in the latter category due for completion. A subsequent decline in demand for low-end residential accommodation may trigger moderate declines across rental rates.

Several new residential developments are due for handover this year, with the Asharej and Al Hili areas among the most active.

Meanwhile, the commercial property sector in Al Ain is expected to remain subdued this year, with rental rates biased to the downside, especially among low-quality properties.

Again, we see the implementation of 5% VAT on commercial property as carrying near-term negative implications for the Al Ain commercial property market. The tax imposition may constrain demand over the coming months, although the longer-term economic benefits that VAT should yield remain positive for the UAE fundamentals (growth, employment).

Northern Emirates

The key appeal of the Northern Emirates real estate sector is its position on the affordability scale for middle-income earners.

Infrastructure spending will create jobs and in turn should fuel demand for accommodation and commerce, helping to support residential and commercial real estate prices

Price appreciation in the region (and arguably elsewhere across the UAE) remains limited at the moment though by the prospect of prolific supply in Dubai; especially the case for the southern end of the Northern Emirates (Sharjah, Ajman)

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