CUSHMAN & WAKEFIELD | CORE

DUBAI OFFICE MARKET SPOTLIGHT

2017

This publication

This document was published in May 2017. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document. The future supply figures quoted may change due to phasing or delay in deliveries.

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Market overview

Dubai's office leasing market has been relatively flat with lower level rents displaying continued resilience, while upper level rents have dropped across most areas - with an exception noticed in a few prime submarkets.

We have witnessed a 12% spike in overall enquiry levels when compared to Q1 2016. However, average enquired size has contracted significantly by 22%, indicative of a cautious stance exercised by firms towards expansion. Occupiers, particularly for smaller spatial requirements are favouring fully-fitted offices in order to reduce occupation timelines.

A growing trend of footprint optimisation is also emerging, as corporate tenants look to streamline services and operational costs by consolidating multiple offices across the city into a single space, saving on transaction and renewal fees. Furthermore, in the wake of softening rentals, better options are increasingly becoming available for relatively equivalent rents or marginal premiums in central areas that were once considered expensive.

Prime office markets

The polarisation between prime and secondary markets continues to amplify, also reflected within individual submarkets amongst Grade A and Grade B products. For example, core Gate Buildings in DIFC are witnessing high occupancy while peripheral buildings face relatively slower absorption, trading at lower rents and much lower occupancy levels. The upcoming 150,000 sq. ft. 'The Exchange' in Gate Village 11 is reportedly fully pre-leased, indicative of the strong demand for prime office space in this district.

Similarly, Tecom Group's Dubai Media City, Dubai Internet City and Dubai Knowledge Park are also seeing high occupancy levels. We expect strong demand for the upcoming Innovation Hub, a business cluster of communications and technology facilities spanning 1.8 million sq. ft., strategically located in the heart of the area; the first phase of 350,000 sq. ft. is announced to be delivered by the end of 2018. This proposed stock is already witnessing strong pre-leasing traction. Tecom also welcomed prominent global occupiers such as Facebook and Snapchat earlier this year, reflective of continued demand from the technology sector. We foresee many tenants, reaching the end of their long-term lease agreements, to look for newer premises or purpose-built facilities within this district, or to migrate to upcoming freezones – albeit, many being developed by the same master entity.

Dubai Design District (D3), with near full occupancy in its first phase, has seen the gap between upper and lower rental ranges diminish on the negligible supply that is still available. Dual licensing, continued demand for Grade A stock, along with the momentum gained by the success of Phase 1, underpins the way for D3's Phase 2 - an additional 1 million sq. ft. development expected to be delivered by 2019.

One Central, situated in the Dubai World Trade Centre district, delivered its first office tower in 2016 and is poised to complete offices 2 and 3 by the end of 2017, bringing nearly 745,000 sq. ft. of additional office space to the market. Office 1 is reportedly at 100% occupancy while both upcoming office buildings 2 and 3 are seeing steady pre-leasing activity. We are also witnessing a higher demand for the freezone license options, despite the marginal premium in rentals. Interestingly, some occupiers are operating out of both the freezone and onshore areas within the development, taking advantage of the dual licensing option, for example, Regus Business Centre.

Downtown Dubai displayed nominal variance in its average rents. With HSBC's new purpose-built headquarters under construction, their existing office in Emaar Square remains the only significant second-hand supply coming to market within this district.

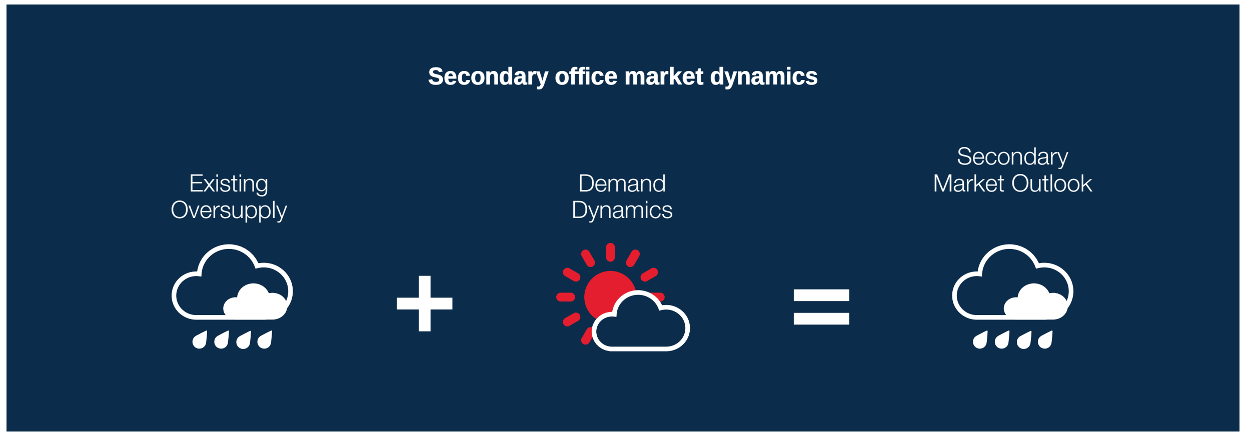
Secondary office markets

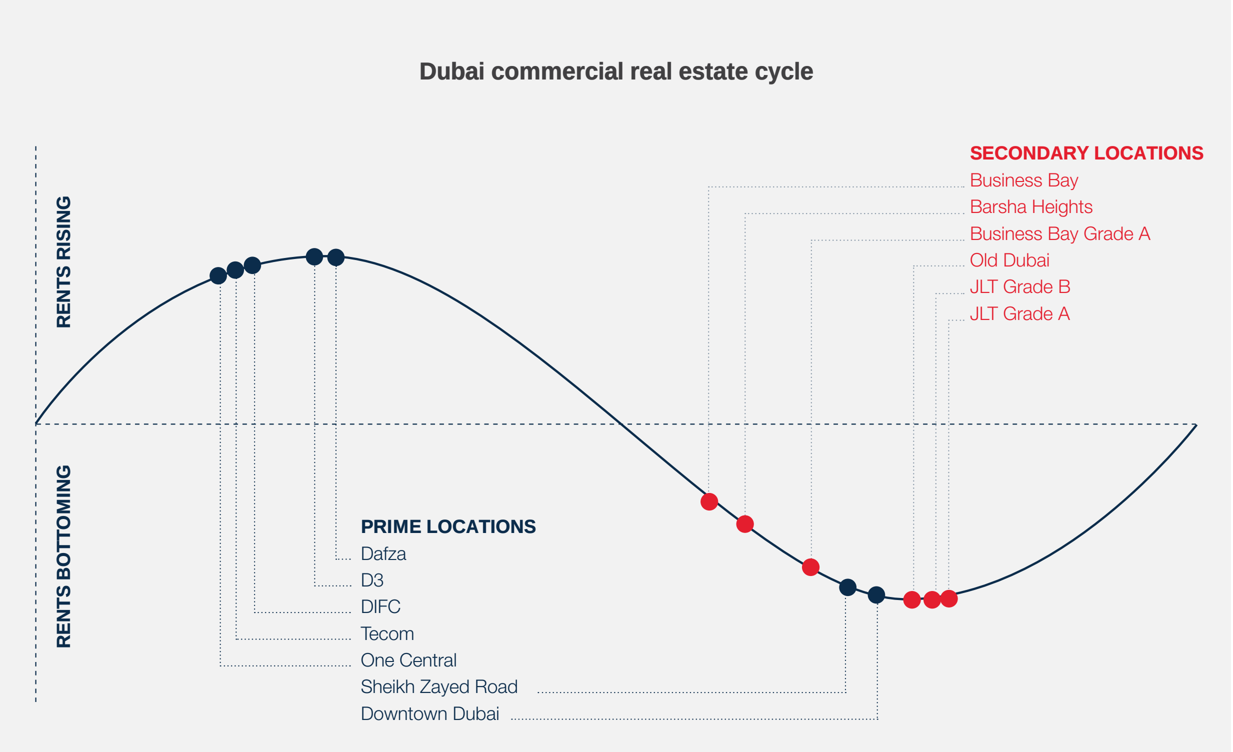
Business Bay, the leading strata-driven office district, has shown significant growth in occupancy levels from the initial low of 55%, to 63% over the last year. Landlords marketing their properties at the higher end have adjusted their rents down to realistic levels, while more affordable units have been readily absorbed leading to a consolidation in headline rental range. Completed infrastructure improvements are providing relief to commuters and the overall development of the district is triggering a surge in tenant interest. Dunkin Donuts, which relocated their headquarters from Sharjah to Business Bay, was amongst the prominent new occupiers in the district. Nonetheless, with over 1 million sq.ft. arriving in the area this year, downward pressure on both average occupancy levels and rents is expected.

JLT's performance remained unchanged, with lower level rentals holding on at AED 60/sq. ft./annum over the last few quarters. Mazaya Business Avenue, typically at lower rental levels within the district, has benefited from attractive entry points with steady absorption and rising occupancy levels across all three buildings, from 60% to over 70% year-on-year. We have observed the upper rental range drop in most buildings except for Almas Tower, which continues to see high rents for its limited, premium fitted offices between AED 210-230/sq. ft./annum.

Sheikh Zayed Road (from the first to the third interchange) is seeing a burgeoning delivery of low-rise offices which are witnessing increasing tenant interest, particularly from clients with higher spatial requirements as they provide large single floor plates, stand-alone buildings, higher visibility and access. Co-working firm Our Space took 20,000 sq. ft. in the Lamborghini building, representing the growing demand from international co-working brands and business centres. However, movement from large corporate firms occupying this district has been limited as these occupiers prefer premium grade stock located within core office districts - areas that have gained enough critical operating mass.

"The secondary office market is not moving forward towards a recovery in its real estate cycle, due to strong headwinds faced from the large amount of existing and upcoming stock, despite marginal improvements in demand"





Source: Cushman & Wakefield Core Research

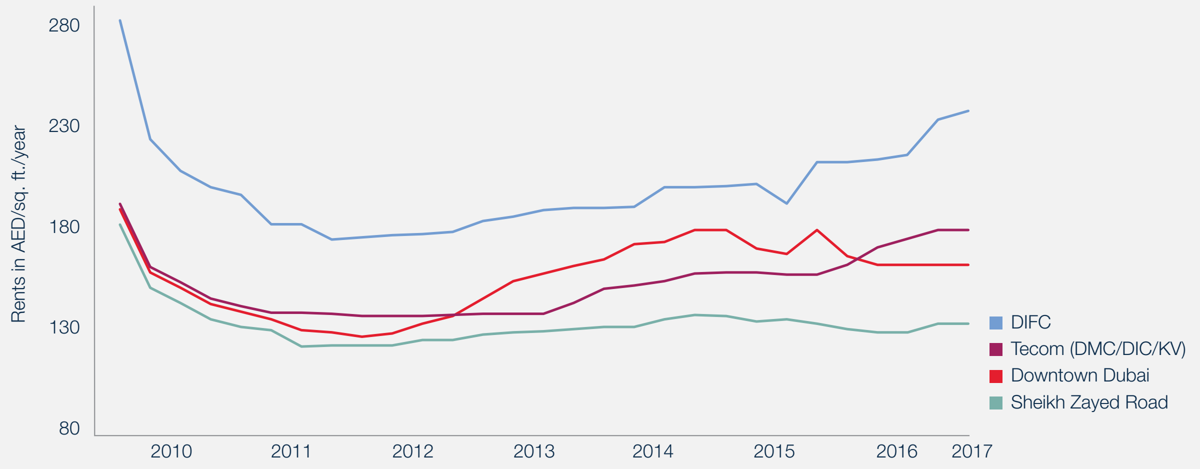
Even with an optimistic hypothesis on demand, we estimate that it will take over 1.5 years for half of the total vacant stock to be absorbed. Out of a total of 94 million sq. ft. of office space in Dubai, 71% or 67 million sq. ft., is estimated to be of Grade B or C quality. This segment has seen a lot of new supply coming over the past 5 years with low levels of absorption, leading to high vacancy rates, above 30% on average. As macro-economic indicators start improving and demand for Grade B & C office space starts increasing again, we still expect a significant lag in absorption for the existing vacant stock. For this reason, we are very cautious about any chance of an upward movement in secondary market rents in the next 12-18 months.

Strata vs single-owned stock

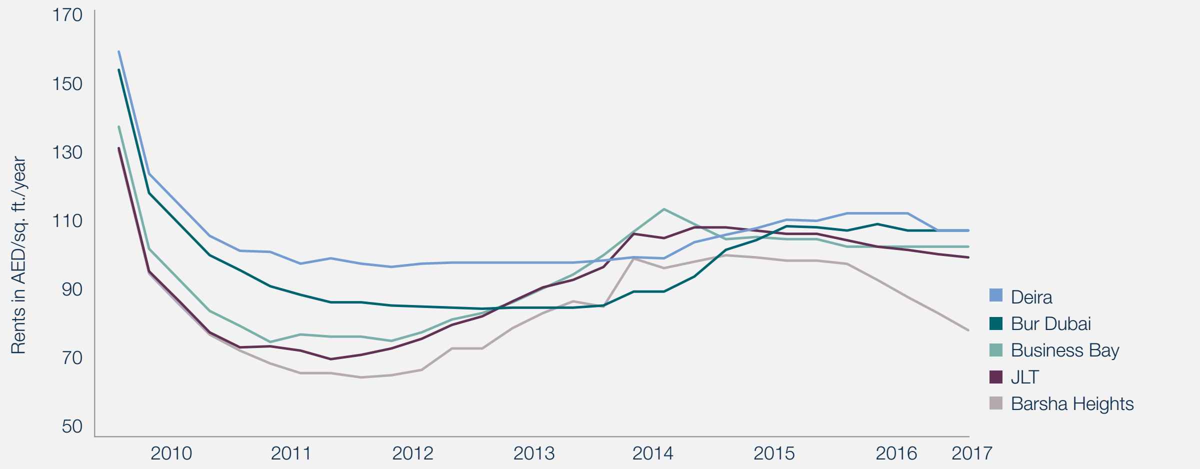
Despite the ongoing debate amongst market players about strata stock underperforming to single-owned stock, these two segments cannot be compared with the same parameters, as both stocks largely cater to different occupier sectors. Districts with higher strata inventory tend to see lower spatial requirements and higher leasing volumes while maintaining demand from smaller firms and start-ups - unsurprisingly driven by divergent tenant drivers compared to prime districts. Landlords are evolving to adjust to changing requirements and responding with increased flexibility in lease terms, in order to generate income and manage risk. The average lease transaction size remains between 1,000 to 3,000 sq. ft. for these districts with a dominant preference for plug-and-play, or partially-serviced offices, to keep operational costs low. We have in fact seen smaller occupiers often prefer strata buildings over single-owned, clearly for the room of negotiation on offer.

Contrarily, blue chip corporations largely look to operate out of prime single-owned, well-managed stock, preferably on one large floor or across contiguous floors for streamlined operations and security, along with the ability to negotiate lease terms with a single entity. Supply catering to such demand remains limited in Dubai and has led many occupiers to opt for purpose-built facilities: for instance, HSBC in Downtown Dubai, along with MasterCard and Huawei in Dubai Internet City. Albeit, the upcoming One Central, D3 Phase-2 and ICD Brookfield Place are expected to bridge this gap.

Dubai prime office rental trends

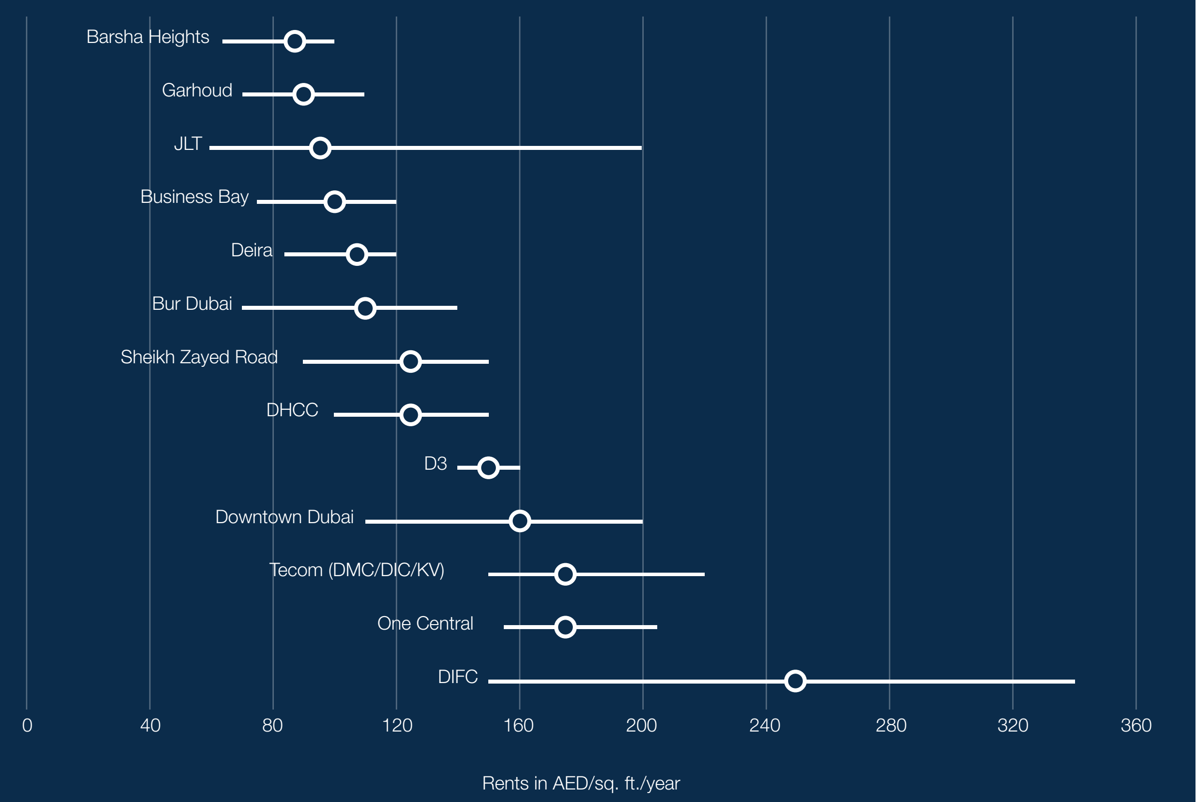


Dubai secondary office rental trends



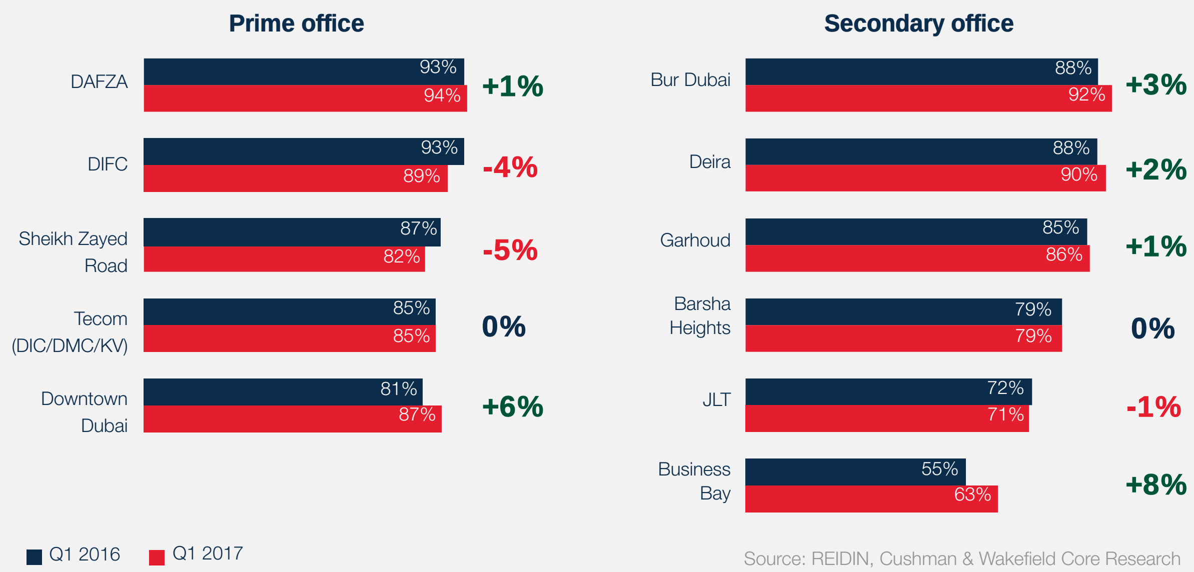
Source: Cushman & Wakefield Core Research

Dubai office rental range - Q1 2017



Source: Cushman & Wakefield Core Research

Office occupancy levels Q1 2016 vs Q1 2017



Source: REIDIN, Cushman & Wakefield Core Research

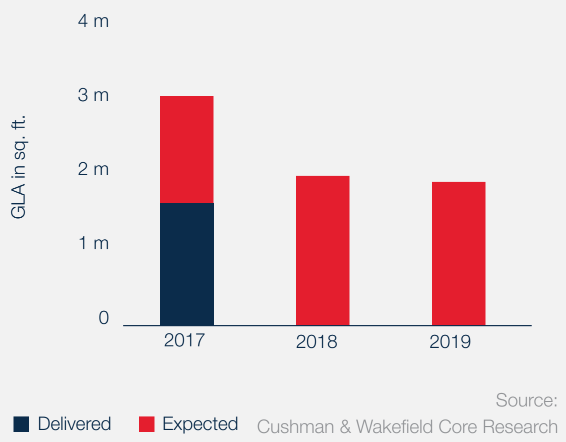
Supply forecast

The supply delivery in Q1 2017 has been rolling, with over 1.6 million sq. ft. of office stock coming to the market. Major developments being handed over were The Onyx 1 and 2 in The Greens, and the Tamani Arts Tower in Business Bay.The remainder pipeline for 2017 looms at 1.4 million sq. ft, including One Central's Offices 2 and 3 spanning more than 745,000 sq. ft.

In 2018, One Central's remaining Offices 4 and 5, phase 1 of Innovation Hub along with Amesco Tower in JLT are expected to be handed over, topping nearly 1.8 million sq.ft altogether. Other large developments under construction include D3 phase 2 and ICD Brookfield Place, announced to be delivered by 2019.

We have also noticed several upcoming mixed-use projects adjusting their asset portfolio, accommodating more residential or retail instead, marginally affecting office supply estimates.

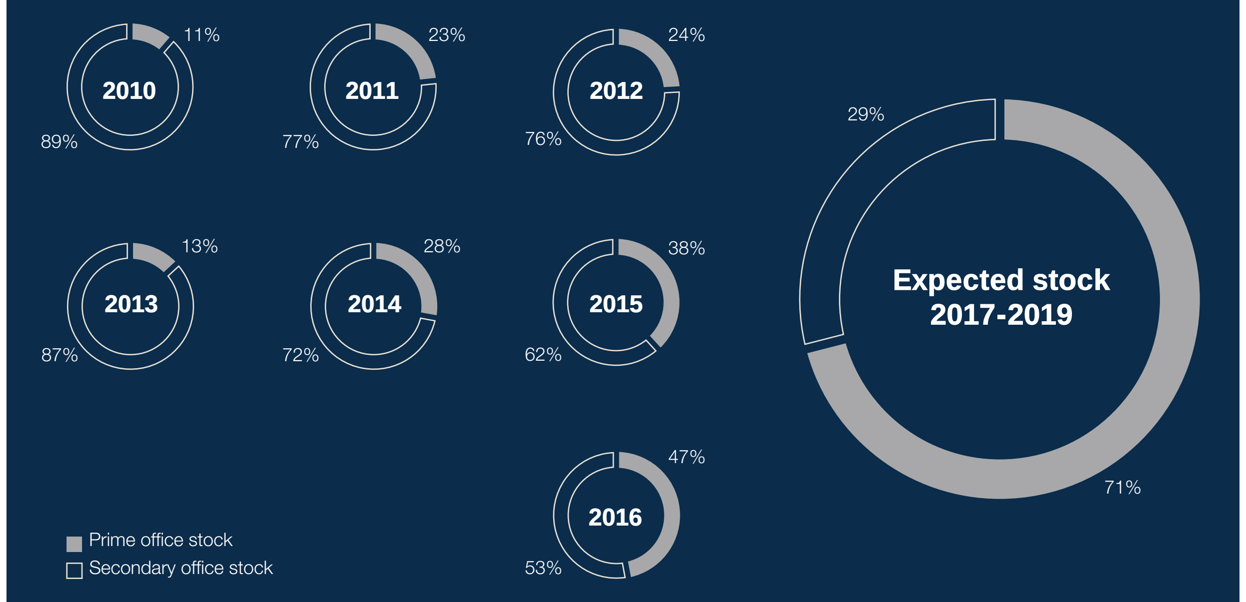
Expected office supply 2017-2019



Source: Cushman & Wakefield Core Research

"The Dubai office market seems to be gradually self-adjusting with new prime stock expected to exceed new Grade B supply for the first time in the last 10 years. Developers have recognised the need for quality office space where demand has consistently exceeded available supply in the past, while the recent surge of Grade B & C delivered stock is finally anticipated to slow down"

Evolution of new office supply in Dubai



Source: Cushman & Wakefield Core Research

Demand trends

Diversity remains key

Apart from the oil and BFSI (Banking, Financial Services and Insurance) segments, occupier demand is spread across most sectors – a strong endorsement of the diversified Dubai economy. These include technology, service industries, logistics and transportation. Furthermore, the enduring demand for business centres persists, highlighting the supply gap for smaller fitted spaces and aligning the needs of startups, SMEs and new corporate entrants. International operators along with regional names are increasingly addressing this gap.

Upcoming trends

A cross segment between retail and commercial space is emerging with gymnasiums and fitness centres rising in demand. The growing interest for bona fide mixed-use developments and adoption of the live-work-play philosophy for millennials (the next generation of occupiers), requires integrated services like fitness centres in a pedestrian ecosystem, within close proximity to offices. This has led to a spike in enquiry levels for retail within office buildings, bolstering rents in prime areas. Boutique workout studios, conveniently located within commercial buildings, usually offer innovative and intense workout classes in a structured 45 minutes format such as spin, HIIT or bootcamp sessions, facilitating lunch break workouts for employees.

The studios are able to derive value from prime retail strips as they require smaller spaces (1,000 sq. ft. or less) than their bigger competitors with fully-fitted gymnasiums, who require more room to fit training equipment. This works to their advantage, making it easier to reach full occupancy, as they do not need to rely on a big number of memberships to cover relatively high rental rates.

Bigger gyms may only be profitable if they are paying approximately up to AED 100 per sq. ft. compared to a boutique brand that could afford up to AED 300 per sq. ft., making the latter a more viable option for landlords leasing prime retail space in commercial districts.

Furthermore, D3, with its investment grade offices, ateliers and retail outlets, blurs the edges between spaces of work and play. Regeneration activity across older industrial areas such as Al Quoz is also leading to quirky warehouse-based art centres, start-up incubators and gymnasiums mushrooming in the district – for example Alserkal Avenue.

Through the development of these pockets of commerce, art, design, music and sport, integrated with retail and F&B, Dubai is learning to use urbanism as a powerful tool, enhancing public interactions through open and mixed-use spaces.

Tenant-friendly market

Lease terms favouring tenants are increasing in districts such as Business Bay and JLT, where the bulk of the stock is strata. We have noticed that landlords are attracting tenants with incentives and even contributions, specifically in utility bills and fit-outs (or amortisation of fit-out over the lease term), to ease large initial capital expenditure. Rent-free periods are also increasing up to 6-9 months from the previous standard of 3-4 months, particularly for longer lease terms.

However, this trend is not reflected throughout the entire market. For example, D3 and Gate Buildings in DIFC which are witnessing near full occupancy, continue to favour landlord-friendly lease terms.

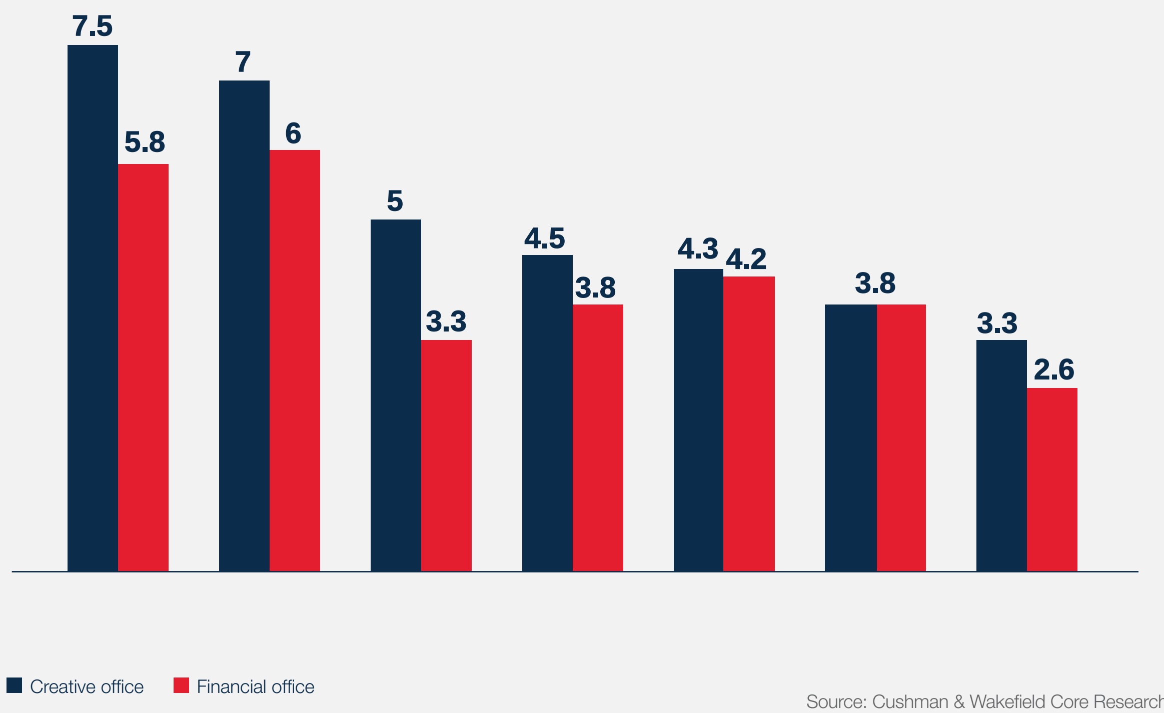
Dubai as a global commercial investment destination

Dubai witnesses high occupancy levels within Grade A office stock, stemmed from strong demand from blue-chip occupiers positioning their regional headquarters. This in the backdrop of one of the lower lease acquisition costs juxtaposed to higher yet steady yields, makes a strong investment case for Dubai's office market. But despite the city's attractiveness, institutional funds are yet to penetrate this market with trading led by smaller individual investors in the strata segment.

This is underpinned by many factors: to begin with, there has been a clear lack of investment grade stock available for sale. Master developers who undertake the development risk of building premium supply, unsurprisingly have deeper pockets to sustain the leasing cycle and want to maximise returns, given the steady yields and relatively lower risk on the back of historically high demand for Grade-A stock. This demand continues to be evidenced by steady pre-and post-leasing and purpose-built activity in prime districts such DIFC, D3, Tecom and One Central, thus authorities and developers continue to hold on to these high performing assets. On the other hand, mid-level developers with Grade B stock have been hesitant to pursue the leasing risk, traditionally preferring an early exit by selling strata. This is predominantly due to the lack of understanding of mature development and disposal strategies, and in some cases, allows to provide monetary injections to a strained construction cash flow.

Secondly, institutional funds prefer investment grade assets that are tenanted by blue-chip occupiers with long-term leases of 15 years and above, a common practice across global commercial hubs. The average lease terms by prime occupiers in Dubai are much shorter, ranging between 5 to 9 years, largely due to the 4% transfer fee applicable on the total lease value for a duration above 10 years, deterring occupiers from considering longer term options.
Furthermore, many office complexes within freehold areas

Gross office yield levels across global cities (in percentage)*



Source: Cushman & Wakefield Core Research

Office rent comparison - Dubai vs global cities

	Financial office	Creative office
Hong Kong	717%	283%
New York	382%	239%
London	312%	186%
Singapore	78%	18%
Paris	58%	100%
Sydney	25%	91%
Dubai rents as baseline		

Source: Cushman & Wakefield Core Research are developed and controlled by the freezone authorities, while land in onshore areas remains leasehold. The lack of long-term tenanted stock, competition between state and private sector in freezones, and limited development avenues available in onshore areas, collectively underplay institutional investment.

International funds aiming to geographically diversify across the globe are increasingly pressed to include Dubai in their portfolio, given the city's dominant rise as an economic hub. This has led many funds to enter the market on the back of REITs (Real Estate Investment Trust). Given the steady performance of Emirates REIT, which allocates over 47% of its portfolio to commercial assets, along with the upcoming Emirates NBD REIT and the announced ADFG's Etihad REIT, institutional investment is expected to progressively gain exposure in this market.

Lastly, the close control of the market is gradually changing, as a few major projects have materialised recently, such as the joint venture between ICD (Investment Corporation of Dubai) and Brookfield Property Partners, the flagship listed real estate company of Brookfield Asset Management. ICD Brookfield's first major project in the UAE will be ICD Brookfield Place, a 1.5 million sq. ft. mixed-use development in Dubai International Financial Centre (DIFC). Other acquisitions include Standard Chartered office building in Downtown Dubai bought by a Kuwaiti sovereign fund and two buildings in Emaar Business Park sold to a regional family investment fund - which indicate a maturing landscape.

Outlook		Office districts	2016 recorded	2017 forecast	2018-2020 forecast
Office	Prime districts	DIFC	Bright outlook	Bright outlook	Bright outlook
		Downtown Dubai	Mostly bright outlook with partial deterrents	Mostly bright outlook with partial deterrents	Mostly bright outlook with partial deterrents
		Sheikh Zayed Road (DWTC to interchange 1)	Mostly bright outlook with partial deterrents	Mostly bright outlook with partial deterrents	Mostly bright outlook with partial deterrents
		Tecom (DIC/DMC/KV)	Bright outlook	Bright outlook	Mostly bright outlook with partial deterrents
		D3	Bright outlook	Bright outlook	Bright outlook
		One Central	Bright outlook	Bright outlook	Bright outlook
	Secondary districts	JLT	Mixed outlook, many deterrents	Mixed outlook, many deterrents	Mostly bright outlook with partial deterrents
		Business Bay	Mixed outlook, many deterrents	Mixed outlook, many deterrents	Mixed outlook, many deterrents
		Bur Dubai	Mixed outlook, many deterrents	Mixed outlook, many deterrents	Mixed outlook, many deterrents
		Deira	Mixed outlook, many deterrents	Mixed outlook, many deterrents	Mixed outlook, many deterrents
		DHCC	Mixed outlook, many deterrents	Mixed outlook, many deterrents	Cloudy outlook

Bright outlook | Mostly bright outlook with partial deterrents | Mixed outlook, many deterrents | Cloudy outlook

LEASE TERM

Typical lease length

- Space under 1,500 sq. ft. – 1 to 3 year term plus an option to renew for a term equal or more than the original term
- Space over 1,500 sq. ft. – 3 to 5 year term plus an option to renew for a term equal or more than the original term

Rents quoted in

AED/sq. ft./annum on net lettable area.

May include service charges.

Break options

Landlords will usually require a break clause to be supported by a 3 to 6 months notice accompanied by a period 3 to 6 month penalty.

LETTABLE AREA REPAIR RESPONSIBILITY

Internal

Tenant, in case of minor repairs ranging between AED 500-2,000. Usually a predetermined amount mentioned in the contract. In case of major repairs such as structural or MEP, it comes under the landlord.

Common areas

Landlord. Service charge usually included in rent.

External/Structural

Landlord/Owners Association pays for the repairs to the structure, roof etc. and does not pass the charges onto the tenant.

OPERATING EXPENSES

Service charges typically cover

- Service charges in a Class A building range from AED 25-30 AED/sq. ft./annum
- In the case of a strata title office, the service charges are usually paid by the landlord while in the case of a single landlord office, the rent and service charges are segregated and the tenant pays both

Additional costs that the tenant pays

- The tenant may choose a legal consultant.
- Utility connection and consumption/services, for example IT.

Transaction costs

New lease: Whoever hires the agent generally pays their fees. The landlord typically pays 7.5% of the first year's rent. The tenant typically pays a standard fee of 7.5% of an annual rent

Lease renewal: An administrative fees of around AED 1,000. In case of an expansion, 7.5% of the first year's rent on the additional space.

Sublease: An administrative fees of around AED 1,000

Purchase: Whoever hires the agent generally pays the agent 2% up to AED 100m, over AED 100m usually 1%

RENTAL PAYMENTS

Frequency of rent payable

Usually annual but can vary from 1-4 payments over the year.

Security deposit

- 5% of annual rent in case of shell and core office
- 10% for fitted office

Basis of rent

Rent normally escalates annually in line with CPI. In case of a renewal, rent is escalated in line with the governing authorities rental index regulations.

Frequency of rent review

Usually at the end of contract term.

DISPOSAL OF LEASE

Sub-letting

Subleasing is rare due to short lease terms (except for companies belonging to the group).

Reinstatement responsibility for leased area

Tenant's responsibility. Although removal of tenant-installed fit-out is subject to a mutual agreement between the tenant and the landlord as the fit-out may add value to the landlord.

SPACE MEASUREMENT

Standard

The area quoted is known as net lettable area. This comprises net area excluding walls, structural columns and common areas.

Efficiency

Usually above 75%.

TENANT'S FIT-OUT

Construction

The tenant usually undertakes the fit-out with their contractors and construction workers supervised by the tenant's architect and approved by the local regulatory body.

Fit-out allowances

Some landlords provide fit-out allowances or rent free periods and they range anywhere between 2-6 months depending upon the term of the lease.

HEAD OFFICE
Ground Floor, Building 6,
Emaar Square, Downtown Dubai,
Dubai, UAE

+971 4 245 2100

DMCC OFFICE
Ground Floor, Indigo Tower
Jumeirah Lakes Towers,
Dubai, UAE

+971 4 245 2100

ABU DHABI OFFICE
Office No. RU 04, Abu Dhabi National
Exhibition Centre (ADNEC), Al Khaleej
Al Arabi Street, Abu Dhabi, UAE

+971 2 556 7778