CUSHMAN & WAKEFIELD | CORE

DUBAI OFFICE MARKET UPDATE

2018/2019

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DUBAI OFFICE MARKET UPDATE

Dubai's office market saw an increase in relocation and consolidation activity over 2018, with many international occupiers consolidating their portfolio either into purpose-built facilities or more competitively priced office premises, exerting downward pressure on prime office occupancy levels and net absorption.

We foresee a marginal uptick in the UAE's job market, backed by sustained oil price growth, government accelerator plans and output, focusing on infrastructure, smart government initiatives and energy. However, many new job postings are now a result of corporate restructuring, rather than net positive new job growth.

Despite job growth gradually gathering momentum, we anticipate a pause on spatial expansion for most firms, as near-term resource growth is expected to be managed within existing portfolios, or by consolidating multiple offices into a central location.

This publication

This document was published in October 2018. 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.

Supply

Supply growth continued to visibly outpace demand, led by the completion of a number of large commercial developments including The Opus, The Exchange, Motorsport Business Park and Innovation Hub Phase One, adding 1.3 million sq. ft. to the market and bringing total existing stock to 100.83 million sq. ft.

With retention an ongoing concern for Landlords, supply of secondary units to the market will mechanically increase over the year with a number of relocations across key districts.

Downtown Dubai, in particular, will see an increase in secondary stock vacancy levels due to Marriot International's move from Emaar Square to Central Park Towers DIFC, and HSBC's relocation from Emaar Square to its new built to suit office building.

New additions to Dubai's office market supply this year are largely concentrated in the Grade A segment. These additions are expected to alleviate some of the pressure seen in prime office districts, which currently see prohibitively high rents due to limited supply. Prior to completion, The Exchange DIFC has been 100% pre-leased by several large occupiers including Nasdaq Dubai, indicating new supply will absorb steadily.

Nevertheless, as a number of occupiers are likely to relocate from buildings within neighbouring areas, occupancy levels remain somewhat stagnant.

Tenants continue to prefer fitted, 'plug & play' options, citing reduction in capital expenditure allows for agility and flexibility. Landlords are now addressing the shift in occupier preferences by adding flexible solutions to their portfolio. Central Park and Index Tower for example, are presently converting more floors into fitted space, adapting to occupier preferences.

Given the supply of prime space is projected to increase over the next two years, with large developments such as ICD Brookfield Place coming onto the market, lease rates are likely to soften in this segment. Undoubtedly, this signals a positive shift for the market, given supply side expansion will contribute to lowering business operational costs, and increasing the city's attractiveness for new market entrants.

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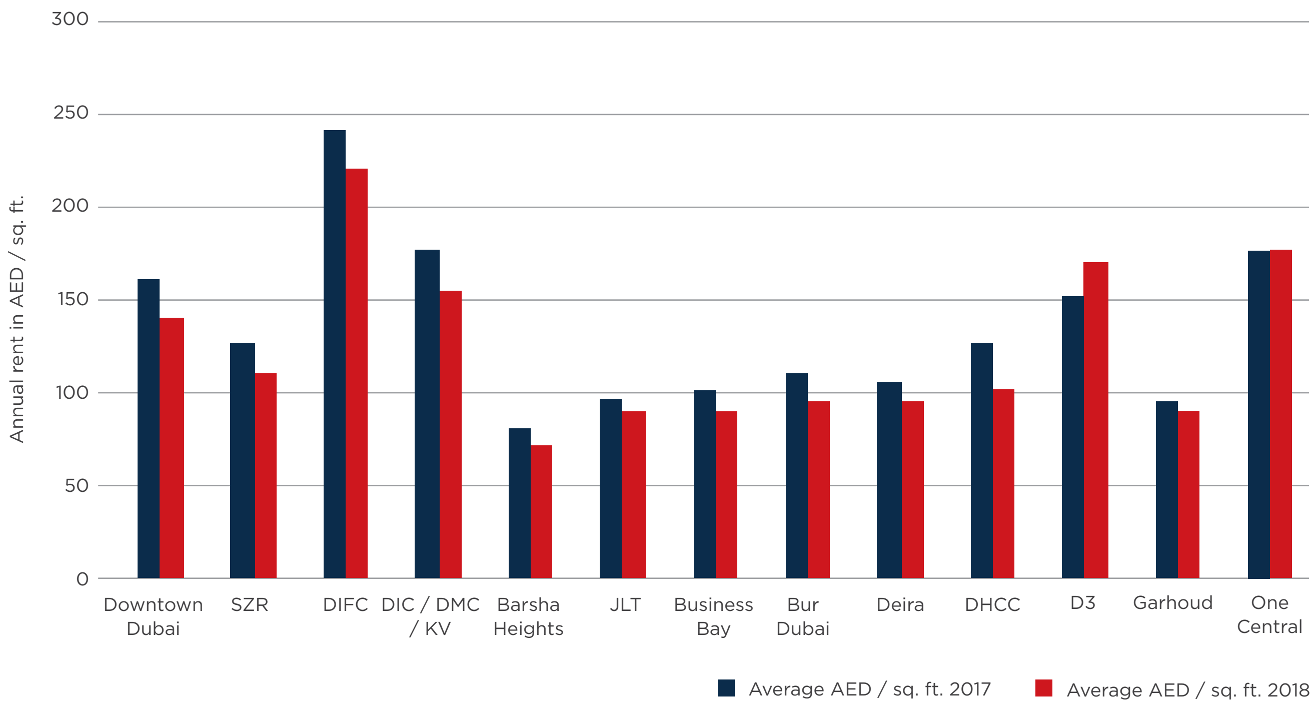
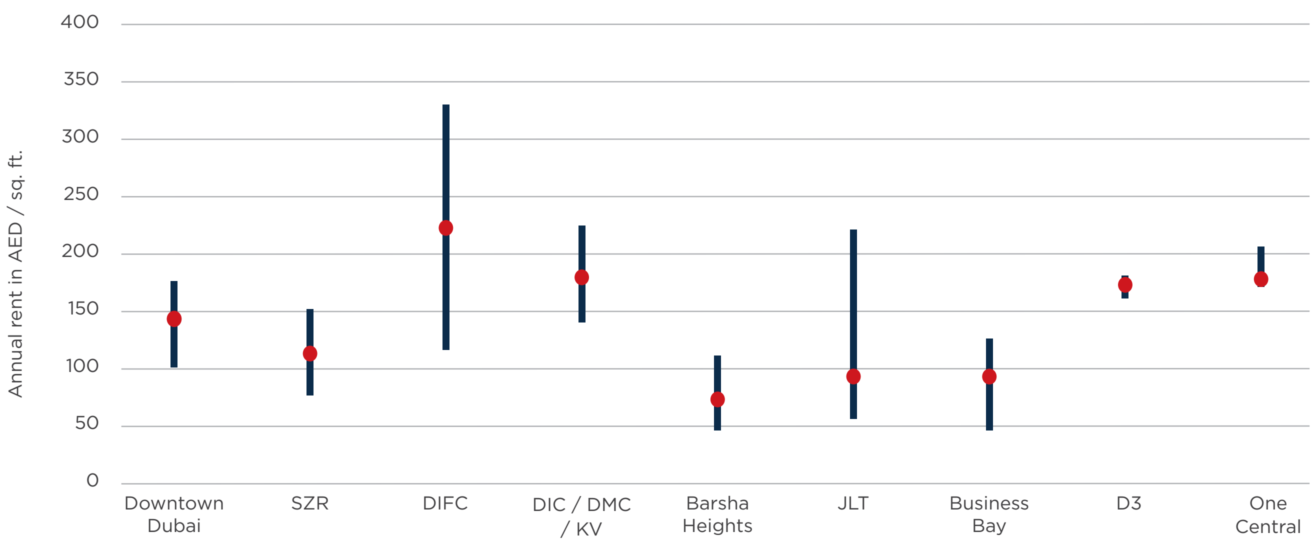
Change in Dubai office rents 2017- 2018

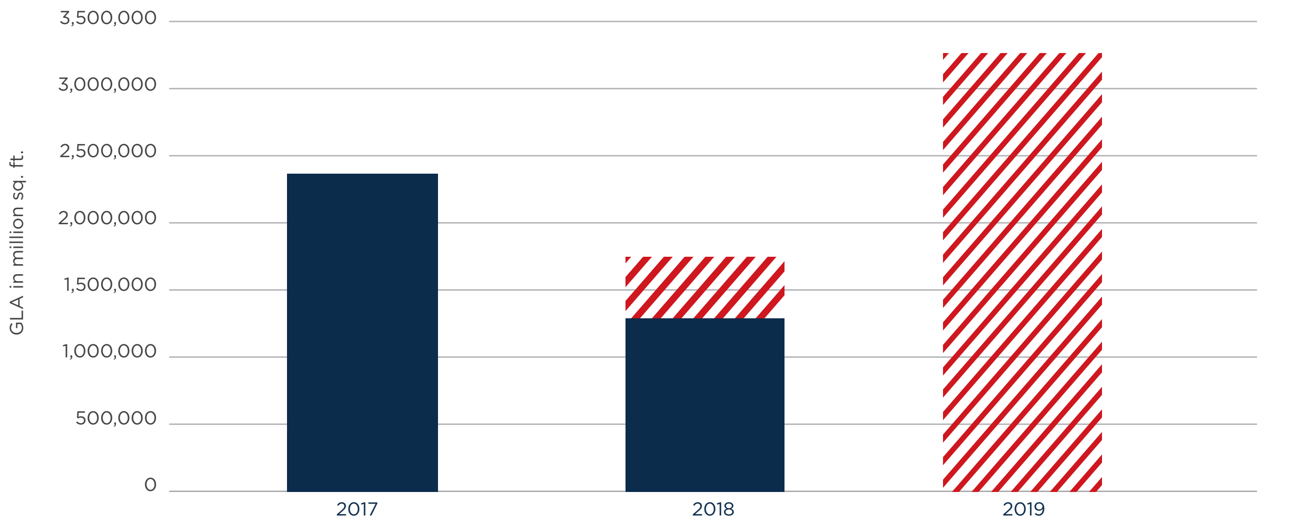


Dubai office rents 2018



Source: Cushman & Wakefield Core Research — Rental Range, Average Rent

Dubai new office supply



Source: Cushman & Wakefield Core Research — Built, Expected

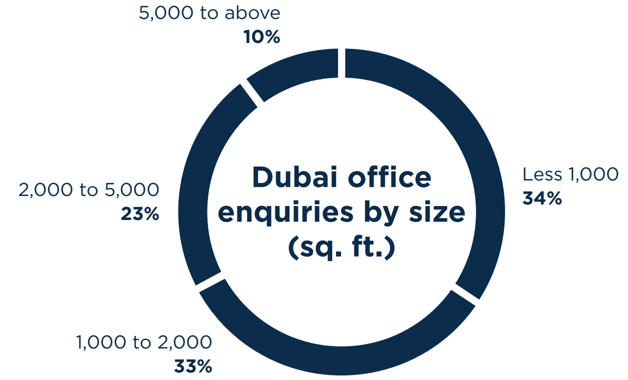
Demand

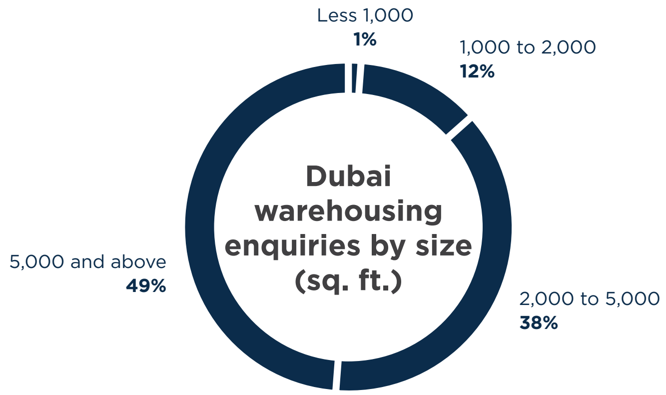
Although the first few months of the year did see slightly weaker enquiries and transaction volumes, VAT implementation had marginal impact on the office market. The effect of VAT was mostly absorbed, as landlords and tenants adjusted to the administrative requirements of tax. The absorption of VAT by the market was most likely accelerated as any increases in business costs were levelled off by a decline in rents.

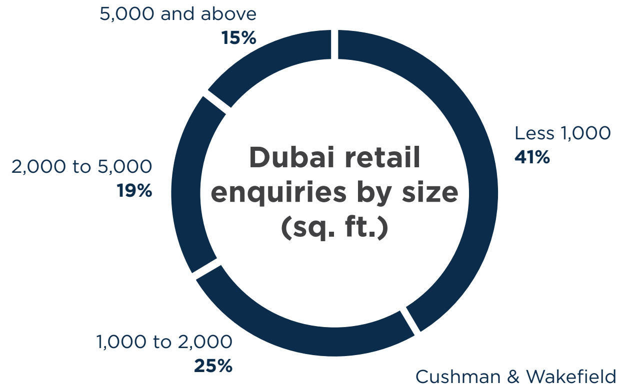
On the other hand, upcoming secondary and tertiary tier stock is likely to continue to weaken rents, while maintaining slow absorption. In response, landlords are gradually increasing incentives to attract new tenants inline with more mature office markets, resulting in a significant number of cyclically opportunistic occupiers.

Going forward, market sentiment is expected to improve given the implementation of various policy initiatives to reduce business costs and streamline business processes, such as the Dubai Municipality reducing market fees for businesses by 50% (from 5 % to 2.5% of annual rent).

A number of freezone authorities have also introduced 'dual licensing' capabilities, allowing companies to be registered (with distinct legal entities), in both off-shore as well as onshore jurisdictions, while also reducing fees and charges to attract new business. DAFZA, for example, reduced the registration, license and staff visa fees for new investors by 65%, 33% and 20%, respectively. Other associated fees have also been reduced or waived entirely.



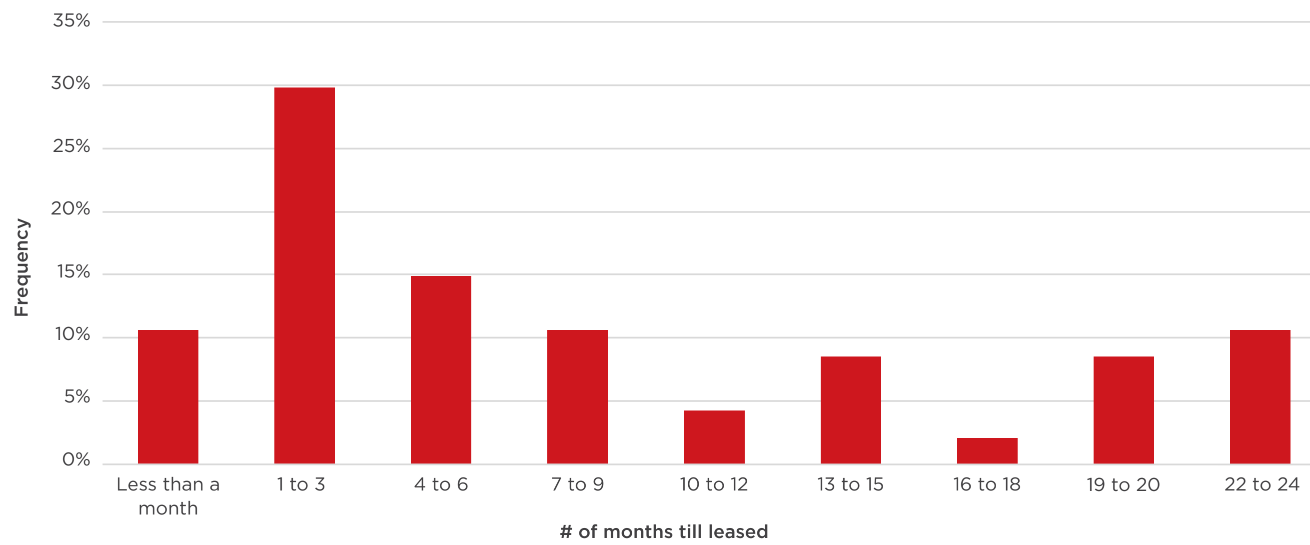




Source:
Cushman & Wakefield Core Research

"We have seen spatial requirements for new enquiries contract, with over 67% now below 2,000 sq. ft., while only 10% were requirements over 5,000 sq. ft. This underlines a preference, particularly from occupiers with smaller spatial requirements for fitted, furnished, plug & play offices with immediate occupation timelines."

Months a property is listed before being leased (H1 2017 to H1 2018)*



* All Cushman & Wakefield Core office listings across the Dubai market (freezones and onshore areas)

Source:
Cushman & Wakefield
Core Research

Current market conditions continue to be tenant favourable across most grades, particularly in the Grade B & C segment.

The decline in rents across key districts has had an impact on initial yields, forcing strata landlords to choose between leasing at lower rents, or incurring opportunity cost for extended vacancy periods.

Although office transactions take longer to execute than residential transactions, over 11% of office listings are leased within the month, and an additional 30% of the units are leased within the one to three months, noticeably in contrast to most major international markets.

This robust absorption figure represents the significant supply of strata stock in the Dubai market, with characteristically smaller transaction sizes and higher volumes, and landlords who are progressively adapting to the market conditions.

We continue to see landlords of Grade A space deliver CAT A conditions, with most Grade B and C premises being partially or fully fitted to aid faster absorption. Core and shell units unsurprisingly have seen slower take-up, higher discounts or incentives from landlords, including capital contribution.

Sweeping changes in regulations to impact the office market

A number of policy initiatives have been announced by Dubai and UAE Federal Government to attract more investment into the city and drive economic growth, including a 10-year visa for specialists and exceptional students. The system will grant up to 10-year residency visas for scientists, innovators, entrepreneurs and specialists in medical, scientific research and technical fields. This initiative aims to further cement Dubai's position as a preferred destination for global talent within the region.

IFRS 16-Another major change to the international financial reporting standards by the International Accounting Standards Board (IASB) is IFRS 16. Effective January 2019, occupiers will be required to account for all leases on their balance sheets.

At present, many analysts adjust financial statements to reflect lease transactions that companies hold off-balance sheet. For the first time, analysts will be able to see a company's own assessment of its lease liabilities, calculated using a prescribed methodology that all companies reporting under IFRS will be required to follow. That is, all companies that lease major assets will see an increase in reported assets and liabilities. This will affect a wide variety of sectors, the larger the lease portfolio, the greater the impact on key reporting metrics.

We expect this regulatory shift to drive occupiers into more agile leases, with proclivity for shorter terms (less than 1 year) and flexible workspace, or companies with a longer view (depending on the business requirements) acquiring office assets despite potentially negating accounting benefits realised in sale-leaseback structures.

We also see rising competition amongst freezones, as barriers to entry based on the sector are increasingly blurred. Freezones now are offering very competitive licensing structures with many giving an option of dual licensing. We have also seen 100% ownership to foreign investors in some specific onshore business sectors, for example, Apple.

Flexible Workspace - agility to rethink the traditional office

It is no surprise that when a proportion of workforce progressively becomes predominant, the occupier preferences and attitudes of that workforce, determine building design and asset manager's strategy. Such is evident with the generational shift toward millennials, expected to represent 35% of the global workforce population by 2020.

So why would an investor include flexible workspace as a part of their asset mix? And why would an occupier include flexible working as part of their portfolio?

The answer - An organisation's most important assets are its people.

With majority of overheads attributable to payroll, it makes sense to attract, invest in and retain (the best) talent by creating a desirable work environment.

The war for talent continues to create innovative and intelligent commercial real estate propositions, that enhance economic sustainability and employee satisfaction. This includes the ability to "work anywhere" and anytime.
Now more obvious than ever, Millennials want to communicate, connect, commute (and work) from anywhere in the world. This includes the increasing number of working parents whose childcare responsibilities are more evenly distributed, particularly in egalitarian, liberal societies.

The flexible workspace impact on productivity and operational efficiency consistently substantiates the cost benefit conclusion - A Met analysis on flexible workspace represents a circa 20% increase in employee productivity and up to 40% cost saving attributable to reducing portfolio footprint, higher retention, commitment and reduced absenteeism.

The downside, flexible working by default creates physical distances between employees within the same organisation, which can lead to problems such as lack of cohesion, more difficulty absorbing company culture and reduced face to face communication, (controversially, Yahoo banned flexible working for this reason in 2014).
It can lead to feelings of isolation for flexi-workers and blur the lines between work and home (working weekends and evenings) creating a work-life balance gap. A paradoxical poison to the talent attraction antidote. Another criticism is a perception of unfairness from non-users of flexible working, as there is typically no discount applied to users, and no add-on incentive for non-users.

These issues are somewhat muted by the benefits of collaborative workplaces, where interaction is encouraged, and organisations can with great precision and fluidity, acquire and dispose of micro-space in line with business growth and contraction. It is no longer just a cashflow hedge for start-ups. Portfolio occupiers make use of trimming dead space whilst allowing proximity to clients in a wider geography of sub-markets.

Research from a global coworking survey found that a social atmosphere, interaction with others and a sense of community were the top three most important drivers to occupier satisfaction. However, the proclivity for traditional brick and mortar fixed workstations persists, as does the private office within flexi-work environments, to ensure confidentiality and security risks are managed. The research shows 44% of occupiers have dedicated workstations compared to flexi-desks, and 82% also work from home in addition to their membership.

The Dubai flexible workplace market has benefited from adoption of the trend by government regulators. The Dubai Department of Economic Development's Mohammed Shael Al Saadi comments at the recent launch of Servcorp's Level 41, Emirates Towers: 'One of the most powerful mega-trends is the shift towards mobile working. We see this not only as a growing factor amongst SMEs, but also for bigger, international businesses, who are now frequently suggesting that their staff can follow this new working model.'

Another Dubai co-working brand Our Space adds: 'With a fast-moving, cutting-edge business community; Dubai demands a higher quality of work space. Add to that the demands and expectations of a younger workforce who want to see everything on tap; from seamless technology to lifestyle comforts, to more dynamic environments; and it's clear that this region will be at the forefront of the coworking movement.'

Tech is key - the platform connecting flexible space together is the technology. Apps facilitate services such as booking meeting rooms or workstations, food and beverage, secretarial, legal and HR services, while creating an online community and portals to coordinate events, training and development and other social initiatives.

Smart buildings that operate within the flexible working sphere synergize the cyclical nature of multiple users of a space with temporal precision. Knowing which member is using the space, their preferences and settings. There is also an opportunity for organisations to capture data with this technology for example, understanding the best use of space by tracking circulation and density. The Edge in Amsterdam occupied by Deloitte is an exemplar in this domain.

A balance is clearly needed. Managers and organisations need clear flexi-work protocols, whilst being able to monitor productivity, ensure coordination, security and communication levels are maintained and risk is managed.

According to the Global Coworking Forecast 2018, there are 15,500 coworking spaces globally as of 31st December 2017. This number is expected to grow to 18,900 spaces by 2018. With a forecasted global membership of 1,690,000 in 2018, this averages 89.42 members per Coworking space.

This is where asset managers create value for investors.

There aren't the conventional spatial restrictions of traditional offices. Because the space is optimized and efficient by means of granting rights through membership and scheduling, it can be leveraged in multiples. SoftBank's $4.4b investment in WeWork indicates so.

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