Abu Dhabi, Spring 2016

PROPERTY MARKET OUTLOOK

RESIDENTIAL MARKET

Further weakness in sales prices
In the 12 months to the end of Q1 2016, the value of villas across Abu Dhabi's residential investment submarkets fell by 1.4%. This decline has pushed the average price of an Abu Dhabi villa to approximately AED 1,250 psf. While villa values for the most part have stagnated, we have witnessed a steady decline in prices for luxury homes. For example, sea view villas on Saadiyat Island registered a 4.4% decrease, deflating average values to approximately AED 2,150 psf.

In contrast, apartment prices remained largely unchanged in Q1 2016. Despite this, there has been further compression in the annual growth rate, which has slipped to 0.8%, from 1.1% at the end of 2015.

-1.4%

Annual change in villa values in the 12 months to Q1 2016

0.8%

Annual change in apartment values in the 12 months to Q1 2016

Source: Cluttons

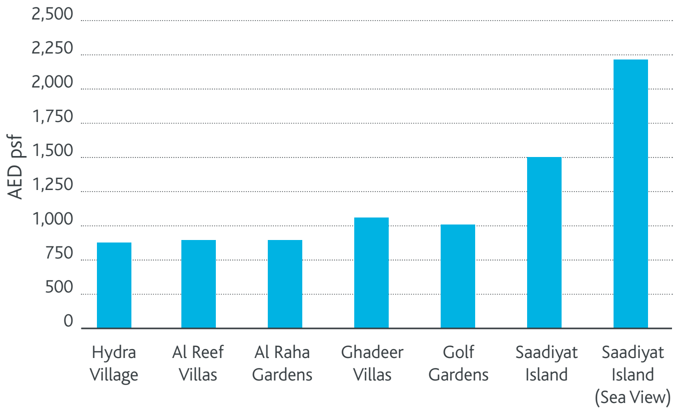
The shift in residential values reflects growing caution in the market, which is being exacerbated by low levels of housing requirements. This latest phase in the market's cycle comes quick on the heels of the Federal Mortgage Caps, which have curbed the appetite to purchase high end luxury accommodation.

A buyers' market?
Furthermore, with Abu Dhabi's economic growth still intrinsically linked to the hydrocarbon sector, buyers remain conscious of the squeeze on government revenues and the subsequent drag on economic growth. Unsurprisingly, in a sentiment driven market like Abu Dhabi, house hunters are increasingly taking a 'wait-and-see' approach as the market transitions into a buyers' market.

Despite this weakness, new job starters continue to trickle in from the education, hospitality and leisure sectors. And for those households on three to five year contracts, purchasing provides greater stability through fixed payment plans, which may in some instances be cheaper than renting. However, for these groups, demand is centred on what is perceived to be affordable. In contrast, submarkets like Saadiyat Island have experienced a sharp slowdown in demand.

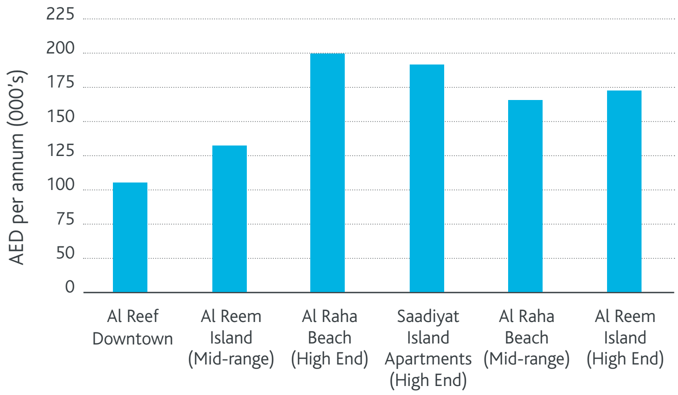
Outlook softens further
For the most part, Abu Dhabi retains its appeal among the UAE HNWI community, as evidenced by the results of the first part of our 2016 Middle East Private Capital Survey in partnership with

Performance of residential sales market in Abu Dhabi in Q1



Source: Cluttons

Average apartment rents in Abu Dhabi's key submarkets in Q1



Source: Cluttons

YouGov, which saw the city emerge as the Middle East's second most preferred investment location, behind Dubai.

Still, the overall demand frailty and the continued low oil price environment has and will continue to hamper economic growth and job creation levels in the short term. With this in mind, it is our expectation that average residential values are likely to slip by a further 4% to 5% during 2016, with more affordable areas likely to remain flat, while the top end of the market may see more significant price falls.

Rental market remains flat

Away from the sales market, rents across Abu Dhabi's key residential investment zones have continued to remain stable, with a marginal 0.5% rise being recorded in Q1. This now leaves the annual rate of change for rents at 2.7%.

Al Reef Villas (8.7%) and Hydra Village (25.9%) remain the city's star performers over the last 12 months, as tenants continue to home in on areas they perceive to be more affordable. Anecdotal evidence of redundancies in the city has also spooked some households into a more cautious mind set, with some opting for cheaper rental options as a buffer against sudden job losses.

Affordable housing options remain limited

Furthermore, as companies consolidate headcount, housing allowances are also being adjusted downwards. In the case of the oil and gas sector, the shrinking pool of high-end management grade tenants from this sector, who typically have budgets of circa AED 350,000 to AED 400,000 per annum, has meant rising void periods for properties at the luxury end of the spectrum. Downward rental adjustments in this segment of the market are inevitable and we expect this to materialise before the summer.

At the other end of the spectrum, budgets continue to hover around AED 100,000 to AED 150,000 per annum. By contrast, average apartment rents stand at just over AED 160,000 per annum, rising to almost AED 270,000 per annum for villas. This underscores the need to address the sheer lack of affordable housing options in Abu Dhabi.

In addition, with the education, healthcare, retail, leisure and hospitality sectors increasingly turning to subsidised or bulk housing solutions to improve staff retention rates, households continue to compete with large scale corporate lets. The shortage of stock in this segment of the market is likely to drive strong demand for build to suit solutions in the medium term.

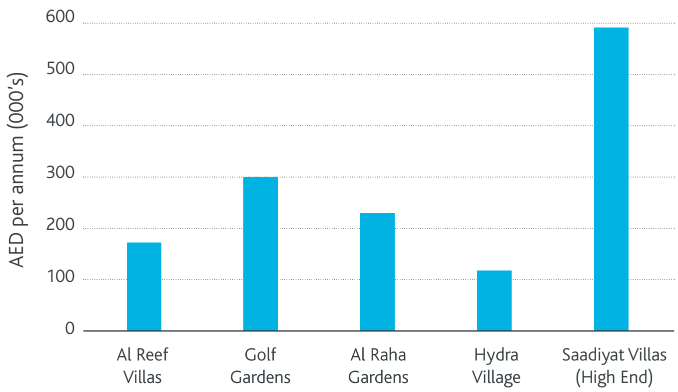
Away from these core sectors, we have noted a reduction in demand from the finance and banking sector, with a handful of requirements being withdrawn altogether in recent weeks.

Incentives unlikely to postpone rent falls

Landlords are increasingly aware of the challenging market conditions and have begun to explore ways in which to entice and retain tenants. On Reem Island for example, not only are some landlords lowering rents, but some are demonstrating greater flexibility in payment terms, with some accepting payment in up to four cheques per annum, up from one to two previously.

Despite the maturing attitude, the market's fundamentals remain frail, with tenant demand for high end luxury homes not likely to stage a turnaround in the near term.

Average villa rents in Abu Dhabi's key submarkets in Q1



Source: Cluttons

Based on the prolonged period of oil price weakness, we now expect slightly stronger rent falls of up to 5%, on average, during 2016. And like the sales market, the top end of the market is anticipated to register stronger declines.

That said, more affordable submarkets such as Hydra Village will remain resilient and are likely to post modest rent rises of around 2% to 3%. We expect areas perceived to be more affordable to continue outperforming the wider market.

OFFICE MARKET

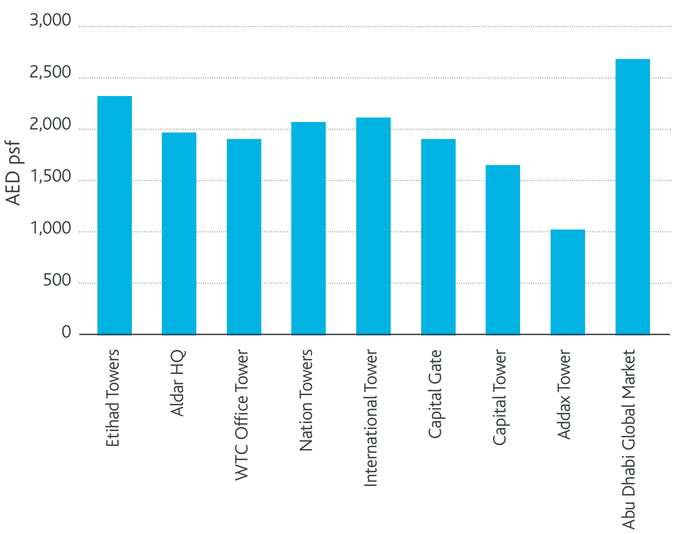
Rents start to decline

After a year of stability in office rents across Abu Dhabi, we have begun to see rents slip in more secondary and tertiary locations, while some previously resilient Grade A schemes have also begun to experience rent declines.

During Q1, average Grade A rents remained unchanged at AED 2,000 psm, while more secondary (AED 1,200 psm) and tertiary stock (AED 800 psm) experienced average rent falls of AED 100 psm, marking the first decline in almost 18 months.

Despite the stability at the top end of the market, a handful of prominent Grade A developments registered downward rental movement. Abu Dhabi Global Market (AED 2,600 psm) and the World Trade Centre Tower (AED 1,850 psm) led the declines, with rents falling by 26% and 8%, respectively. This reflects landlords' acceptance of the challenging environment and it is these landlords that are likely to be best placed when growth eventually returns.

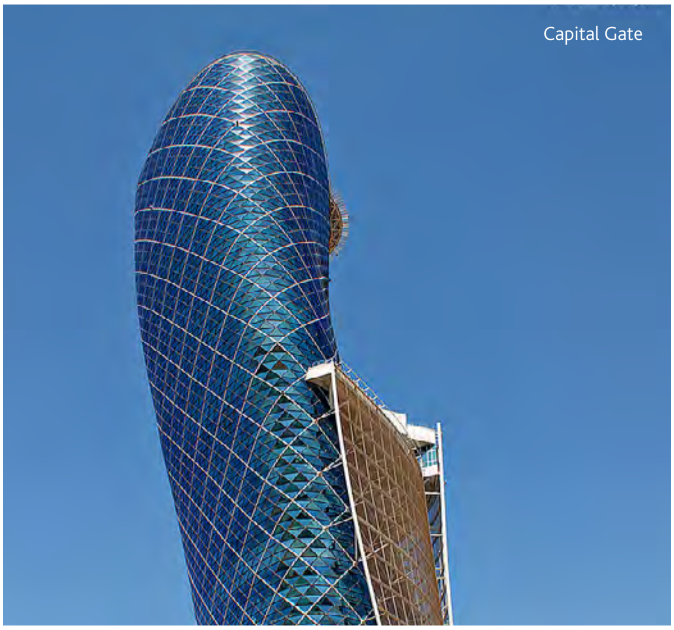
Performance of office rents in prominent office schemes in Q1



Source: Cluttons

Office market weakness unlikely to reverse in the near term

The Grade A office market in Abu Dhabi has been historically small when compared to neighbouring Dubai and this has in part aided the market's ability to withstand the oil price shock and


Capital Gate

the ensuing slowdown in business activity. However, given the importance of the hydrocarbon sector to the city's office market, it is unsurprising that the ongoing global consolidation of space by international oil companies, along with redundancy programmes, has begun to impact rents and take up in Abu Dhabi.

In addition to the ongoing trickle of completions, space is also being returned to the market by oil and gas firms, which is fuelling a supply-demand imbalance. This is of course undermining rents, as outlined above. It is worth noting that Abu Dhabi is not alone in this scenario as this is something we have noted in oil economies' office markets from Aberdeen to Lagos.

It is our expectation that further rent falls of around 5% to 7% are likely before the year is out, in addition to a raft of lease incentives

Given this backdrop, it is our expectation that further rent falls of around 5% to 7% are likely before the year is out, in addition to a raft of lease incentives, unless oil prices stage a major comeback; however this appears unlikely at this stage.

There will of course be exceptions to our forecast, with centrally located, well managed buildings expected to buck this trend, particularly if the rents are perceived to offer good value. An example of this would be the AED 1,850 psm Abu Dhabi World Trade Centre, which is arguably Abu Dhabi's most iconic office building. Asking rents here are well below comparable schemes in Dubai, which is helping to fuel interest in the tower, particularly from firms relocating within the emirate.

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