Investment Strategy & Research

GCC Real Estate Update Dec-2022

Late-cycle disparities emerge

Report Highlights:

This report analyzes GCC real estate fundamentals in 2022. We analyze demand-supply drivers and examine trends in transactions, prices and rents that drive the outlook for real estate in the region. Segments covered in the report include:

- *Residential RE*
- *Commercial Office RE*
- *Retail RE*
- *Industrial RE*
- *GCC RE Equities*

Access previous reports:

- *Divergent cap rate narratives in 2022 – Mar 2022*
- *Pinning hopes on a 'Resi'lient recovery - Aug 2021*
- *Cyclical or Structural Conundrum – Dec 2020*
- *Déjà vu or Different this time? – May 2020*

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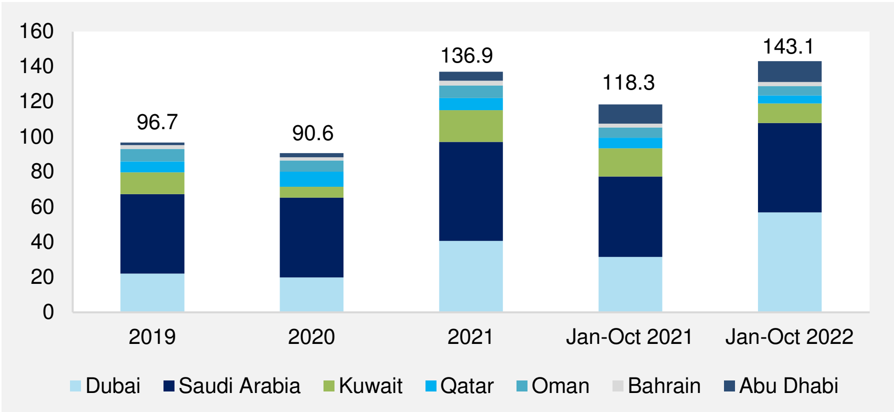
Strong NOI growth pushes select sub-segments into late-cycle: All RE sub-segments in the GCC performed better y-o-y in 2022, even as commercial spaces witnessed idiosyncratic journeys of growth. In the office segment, supply continues to be tailored towards newer sources of demand such as robotics, IT, and healthcare as these sectors drive faster take-up of such spaces. We reiterate that 2022 will be the new base year for the office real estate demand for both new and existing stock of office spaces. Separately, temperature-controlled spaces, chilled centers and bonded warehouses continue to command premiums of at least 25%-30% at the top end of the industrial warehouse market. Within the retail RE market, mall space developers are focusing on the benefits of cross-shopping relationships and its impact on footfalls and consumer spending, when planning and choosing retailer mix. The strong NOI performance across sub-segments combined with the twin risks of further interest rate hikes and a prolonged period of high rates could potentially have pushed real estate assets in certain geographies into a late-stage expansion phase, in our view. Nevertheless, developers remain cautious of these trends, and are expect announce project launches that are likely to cater to a more normalized demand environment going forward.

Dubai lifts Jan-Oct 2022 GCC RE transactions; Resi strengthens in 2022: Real estate sale transactions in the GCC over Jan-Oct 2022 reached USD 143.1 Bn, eclipsing the full year figure of 2021 (USD 136.9 Bn) based on our analysis of official estimates. UAE (Dubai and Abu Dhabi combined) contributed to over 48% of the aggregate value transacted, while Saudi added 35.6% to the region's transactions over Jan-Oct 2022.The higher transaction activity was driven by value transacted in Dubai that increased almost 81% y-o-y over the period. Strong demand and price gains were witnessed by luxury residential properties, while the affordable segment also witnessed healthy gains. Investors are likely to gauge the residential market more carefully in 2023 due to the higher prices prevalent in the market, which could potentially lead to RE transactions run-rate plateauing going forward. Price growth could also cool-off in our view, driven by more realistic IRR expectations, and with rising mortgage rates.

RE equities pricing in more normalized demand: The Refinitiv GCC Real Estate Total Return Index gained by 1.2% driven by the strong performance of Abu Dhabi (+16.7%) and Dubai (+14.3%) RE indices, while outperforming the MSCI GCC index (-1.4%) over Jan-Nov 2022. Key decliners in listed equities space came from Saudi Arabia, as both the Saudi RE developers and the Saudi REITS indices declined by 14.1% each. While fundamental KPIs of real estate sub-segments have improved substantially in select markets, recent headwinds such rising interest rates and normalizing future growth could impact the stock prices of developers and REITs going forward, in our view. Having said that, we continue to expect specific equity stories to continue to outperform broader indices as higher IRR projects are announced, opportunistic M&A activity is executed, and specific product types such as data centers are acquired as alternative investments.

GCC RE Transactions Breakdown – USD Bn

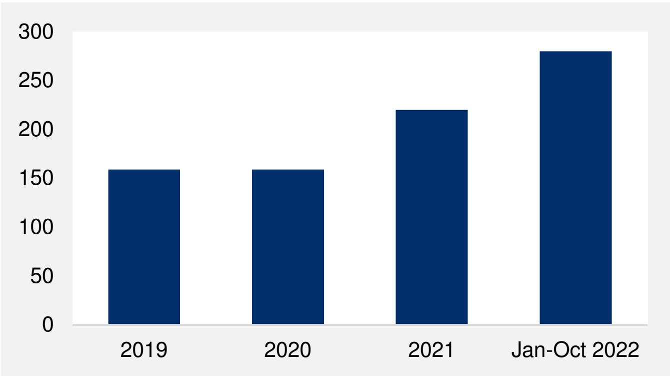


Source: Kamco Invest Research, Govt Sources

Dubai lifts Jan-Oct 2022 GCC RE transactions past full year 2021 figure

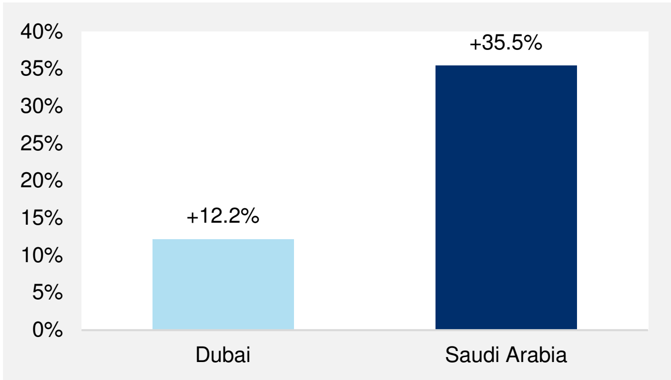
Real estate sale transactions in the GCC over Jan-Oct 2022 reached USD 143.1 Bn, eclipsing the full year figure of 2021 (USD 136.9 Bn) based on our analysis of official estimates. The aggregate figure for the region was also almost 21% higher on a y-o-y basis compared to Jan-Oct 2021, as RE transactions from Dubai almost single-handedly drove the increase. RE value transacted in Dubai increased almost 81% over the period, mainly driven by the increase in demand and price of luxury properties, while the affordable property segment also witnessed healthy gains. The number of transactions in the GCC however declined by 6% y-o-y over Jan-Oct 2022 to 511,239 deals despite a jump of over 61% witnessed in Dubai, as other markets such as Saudi, Qatar and Kuwait witnessed lower activity as compared to the same period in 2021.

GCC average value per transaction



Sources: DLD, Kamco Invest Research

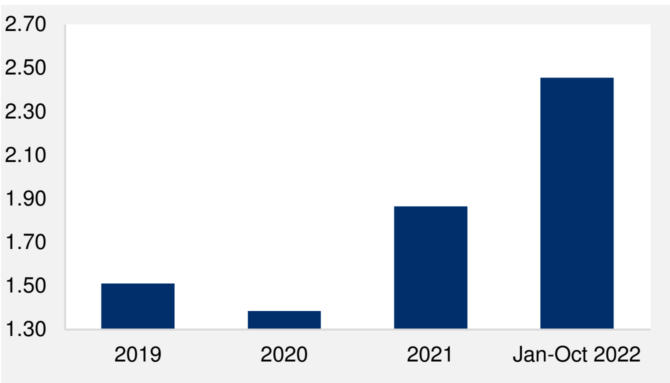
Average value per transaction y-o-y in Jan-Oct 2022



Sources: MOJ, Kamco Invest Research

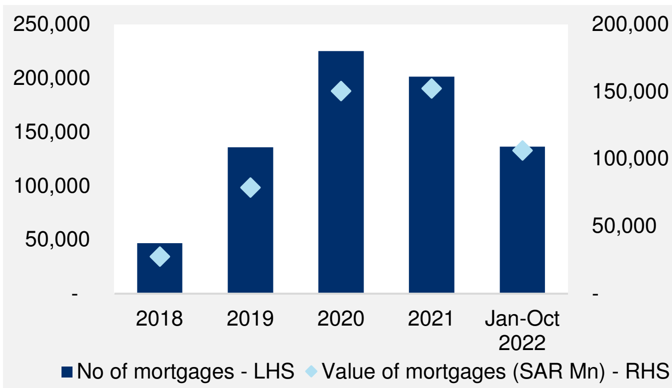
Further, the average value per transaction achieved over Jan-Oct 2022 for markets such as Saudi Arabia (+35.5%) and Dubai (+12.2%) was significantly higher, pointing towards strong end-user demand and investment appetite. The average value per transaction in GCC in 2022 (~USD 280,000) also surpassed 2017 average (~USD 223,000). At the current annualized pace, sales transaction volumes are on course to reach one of its highest levels ever recorded, with strong demand for both off-plan and completed residential assets. Value transacted in Saudi Arabia and Dubai combined reached USD 107.8 Bn over Jan-Oct 2022 and could potentially reach close to full year figures of the entire GCC from 2021. In Dubai, after registering strong demand for off-plan properties and a significant jump of over 32% in average off-plan value per transaction in 2022, price growth could cool-off in our view, driven by more realistic expectations from investors and with rising mortgage rates. Investors are likely to gauge the market more carefully in 2023 due to the higher prices prevalent in the market, which could potentially lead to RE transactions run-rate plateauing going forward.

Dubai off-plan value per transaction average (AED Mn)



Sources: DLD, Kamco Invest Research

Saudi residential new mortgages from banks



Sources: SAMA, Kamco Invest Research

Saudi's residential sector's demand will continue to be driven by Vision 2030's target of increasing home ownership to 70% by end of the decade, and as of mid-2022 the Saudi Real Estate Refinance Company estimates home ownership to have reached above 60%. However rising interest rates resulted in lower offtake of mortgages, as the number of mortgages over Jan-Oct 2022 declined almost 17% y-o-y.

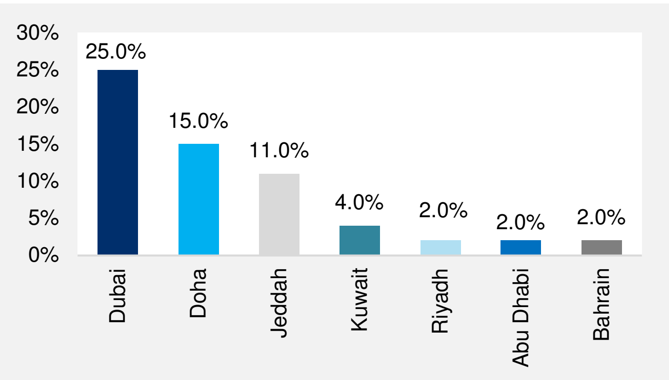
Late-cycle disparities emerge amongst RE sub-segments

All real estate sub-segments in the GCC have performed better in 2022 than in 2021 with residential and quality industrial warehouses witnessing strong price and rental increases. Office supply tailored towards newer sources of demand such as robotics, IT and healthcare will continue to see faster take-up of such spaces. The strong NOI performance across sub-segments combined with the twin risks of further interest rate hikes and a prolonged period of high rates could potentially have pushed real estate assets in certain geographies into a late-stage expansion stage, in our view. Nevertheless, developers remain cautious of these trends, and are expected to announce project launches that are likely to cater to a more normalized demand environment going forward.

Residential real estate strengthened in 2022; yields expand on faster NOI growth

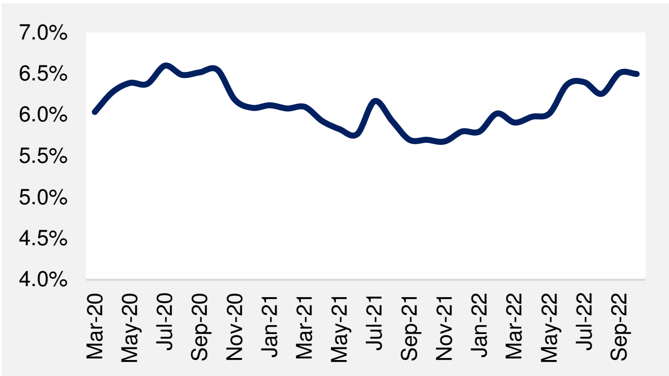
In our previous GCC RE update: Divergent cap rate narratives in 2022 – Mar 2022, we highlighted that segment fundamentals could push the residential market to a late-stage recovery phase in the real estate cycle. Investor sentiment gained momentum in 2022 and resulted in opportunistic buying in select GCC markets and residential product types, similar to trends witnessed in 2021. As a result, prices rose y-o-y across markets such as Dubai (+9%) and Jeddah (+20%) at the end of Q3-2022, as per JLL. Developers continue to provide more flexible payment plans with lower down payments and post completion plans to attract off-plan and first-time buyers, while catalysts and product demand differed across various GCC markets. Abu Dhabi witnessed a surge in demand for both off-plan and developed villas within established communities in 2022, with certain developments witnessing double-digits gains y-o-y in percentage terms. The rising interest rate environment also pushed mortgage buyers to come earlier to the market to lock-in fixed rates for the longest tenure possible across the UAE. Rents increased by around 20%-25% y-o-y in Dubai by the end of Q3-2022 based on real estate consultant data, as landlords looked to capitalize on strong market trends. As result, gross rental yields in Dubai expanded by around 70bps by Oct-2022 from the start of the year despite rising prices based on data from Property Monitor. The consultant further mentioned that yields for apartments was reportedly at 6.87%, while average townhouse and villa yields were at 5.97% and 5.12%, respectively.

Residential rents performance: Q3-2022 (y-o-y%)



*Source: Kamco Invest Research, ValuStrat, REMI, JLL, * Kuwait and Bahrain are as of Dec - 2022*

Dubai apartment yields performance



Source: Property Monitor, Kamco Invest Research

Rents across all key residential markets moved up as Doha (+15.0%), Jeddah (+11%), and Kuwait (+4%) followed Dubai in terms of y-o-y increases at the end of 9M-2022. Saudi's residential sector's demand will continue to be driven by Vision 2030's target of increasing home ownership to 70% by end of the decade, and as of mid-2022 the Saudi Real Estate Refinance Company estimates home ownership to have reached above 60%. However rising interest rates resulted in lower offtake of mortgages, as the number of mortgages over Jan-Oct 2022 declined almost 20% y-o-y. Moreover, an increase in total employment has driven sale prices of apartments and villas in Riyadh higher by 20%-30% on average y-o-y at the end of Q3-2022, while similar price rises were witnessed in Jeddah due to constrained supply of high-quality residences.

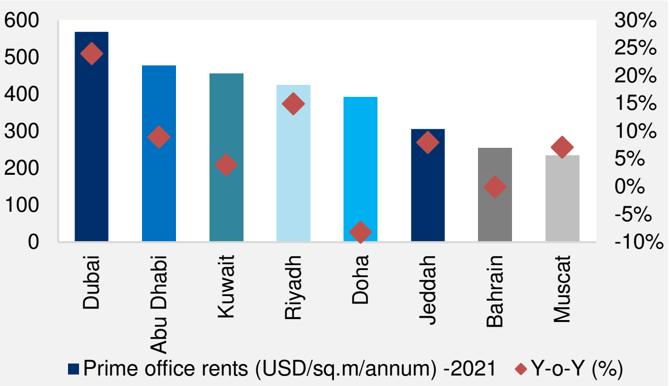
Going forward, we expect to see more normalized demand and price rises in key residential markets, as investors remain cautious due to upcoming supply and rising interest rates, while end-users are likely to focus on affordability. End-user apartment and townhouse prices are likely to witness slower growth as compared to high-end villas, as buyers become more cautious about house price-to income multiplier ratios. Banks are also likely to look at these parameters more stringently when disbursing mortgages. Rental growth is also likely to be more muted than recent trends witnessed, as tenants look for affordability and factor in relocation costs and signing up for new lease rates which are expected to be higher.

Space transformation to capture market share for newer sources of office demand

Grade-A office spaces in the region continued to exhibit strong performances, as supply remained tight and newer sources of demand drove additional take-up of office spaces. Aggregate office space in GCC's key markets is expected to reach 29.06 Mn sq.m by the end of 2022, from 27.31 Mn sq.m in 2021, based on our analysis of consultant data. As a result, prime office rents across Dubai (+24%), Riyadh (+15%), Abu Dhabi (+9%) witnessed strong increases. Kuwait also witnessed a 4% increase in rents for prime office spaces which now average around KWD 11.5/sq.m/month, as supply additions for the top end of the market continues to remain limited.

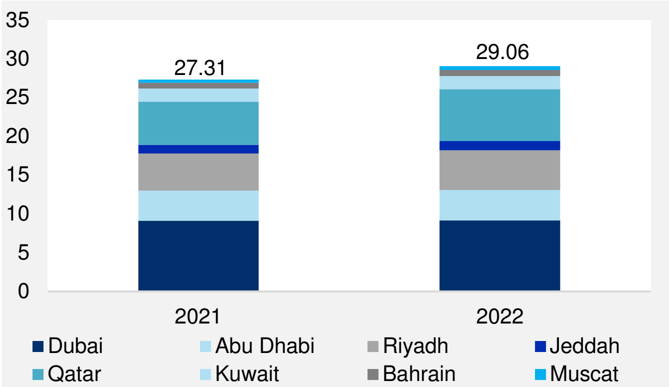
One key trend that was witnessed during 2022 especially in markets such as Dubai and Jeddah was the increase in demand for flexible office space and serviced offices, which pushed office space providers to either setup or expand operations. Abu Dhabi also reportedly witnessed demand for flexible office spaces from private sector occupiers who look at ready-to-move solutions. This drove higher occupancy rates in flex and micro-office spaces as per CBRE.

GCC prime office rents & y-o-y declines: Q3-2022 (%)



*Source: Kamco Invest Research, Knight Frank, JLL, Savills, REMI, ValuStrat, * Kuwait and Bahrain are as of Dec - 2022*

GCC key office markets office supply (Mn sq.m)



Source: JLL, Valustrat, REMI, Savills, Kamco Invest Research

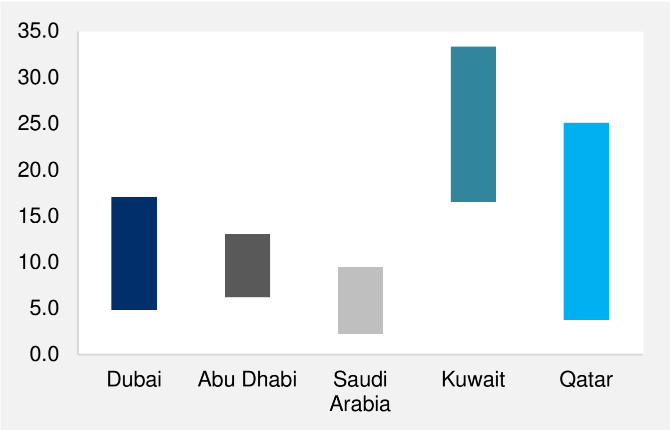
Going forward, tenant migration is expected to continue as tenants look for more appropriate office spaces like sustainable built environments, with a strong preference for buildings that are LEED certified. Space requirements are likely to witness large disparities, as witnessed in 2022. This is largely due to the varying space requirement of newer sources of office space demand across sectors such as AI, Robotics, Technology, Media & Telcom (TMT), Healthcare/Pharm and Legal. Further, certain corporates will continue with a combination of on-premise + flexible/remote working strategies for to remain asset light. This should also shape office space developers in our view to re-look at their upcoming office space supply and cater to these newer sources of demand to help achieve premium rents prevalent in the market. We continue to believe that 2022 will be the new base year for the office real estate demand going forward for both new and existing stock of office spaces. For older office spaces, developers are likely to continue to look to repurpose their office space portfolio to attract demand from alternate sources of demand such as data centers.

Quality Industrial assets witness a higher premium

After witnessing normalizing trends in 2021, quality industrial warehouses spaces within the GCC witnessed strong demand growth in 2022. Rents moved higher overall across markets for such spaces, with markets with lower available supply such as Dubai and Kuwait witnessing strong double digit increases in percentage terms. Tenant incentives remain limited as a result, forcing them to adhere with the terms set out by warehouse owners.

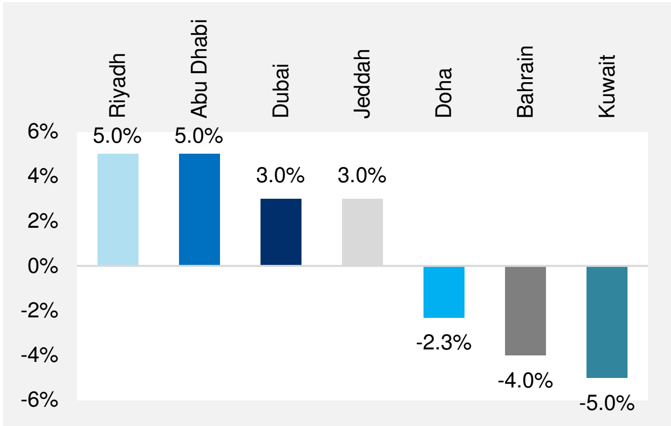
Demand emanating from e-commerce, 3PL, pharma, and FMCG from large hypermarkets is expected to continue for automated built-to-suit, temperature-controlled and chilled centers. Temperature-controlled spaces and chilled centers continue to command premiums of at least 25%-30% at the top end of the market. The addition of bonded zones within logistics parks is also witnessing strong demand especially in Saudi Arabia. Higher footprint of Saudi's bonded zones with proximity to ports increase capabilities to clear, store and re-export to more destinations, and potentially enable the country to become one of the main centers of storage and redistribution in the region. The competition and aspirations of regional ports to become global multimodal transports and national initiatives like Saudi Arabia's National Industrial Development and Logistics Program and UAE's Operation 300bn, should support the industrial real estate segment.

GCC industrial warehouse rents (USD/sq.m/month)



Source: CBRE, Knight Frank, Valustrat, REMI, Kamco Invest Research

GCC retail space rents: Q3 2022 (y-o-y%)



*Source: JLL, Valustrat, REMI, Kamco Invest Research, * Kuwait and Bahrain are as of Dec - 2022*

Retail mall space metrics recovers in select markets

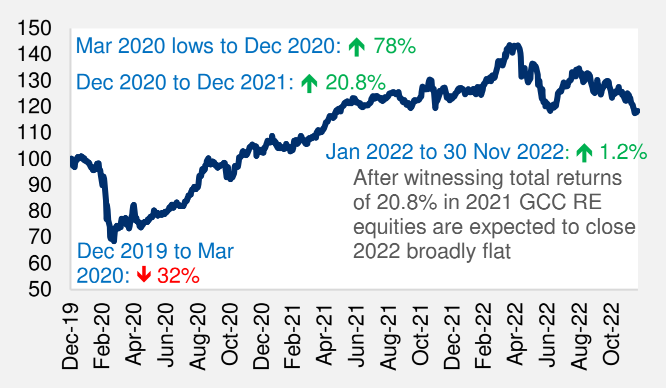
Select retail markets showed a rental recovery in 2022 such as Riyadh (+5%), Abu Dhabi (+5%) and Dubai (+3%) based on consultant data, as mall footfalls recovered, while mall owners continued to focus on increasing their Family Entertainment (FEC) footprint. Nevertheless, retailers continue to look for more strategic locations for their outlets and are willing to pay a premium for better visibility. While retailers would prefer floor plans more suitable for their profitability matrix such as sales/sq.ft and sales conversion rates etc, mall developers on the other hand are likely to still look at potential large format malls to combine social experiences encompassing retail, F&B and entertainment. Consumer spending habits continue to change, while retailers drive expansion plans via omnichannel strategies such Click & Collect, and influencer-driven marketing campaigns to maintain profitability and market share. Mall space owners are also aware of the benefits of cross-shopping relationships and its impact on footfalls and consumer spending, when planning and choosing retailer mix. Retailers are also looking at spaces that can aid them via shared customer base, rather than a one-size-fits-all layout.

In terms of mall sizes, the strategy from operators are more diversified. In markets such as Riyadh, macro catalysts support the launch of such large-format malls, as Saudi Arabia aims to reportedly increase the number of residents in Riyadh from 7.5 Mn in 2021 to 15-20 Mn in 2030, and establishing Riyadh as the regional headquarters for multinational companies. In other markets such as Kuwait and Dubai, mall space developers are looking at smaller format malls to cater to underserved localities. Developers continue to revisit their floor plans for upcoming projects to stay ahead of competition, nevertheless, we believe that brick-and-mortar retail and quality mall spaces will remain important for consumer spending patterns and customer experiences.

RE equities pricing in more normalized demand

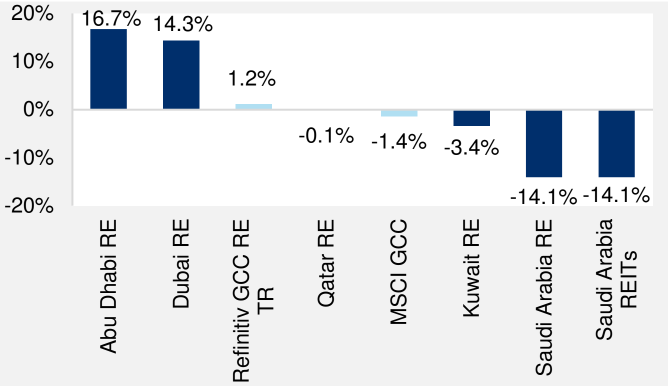
Real estate equity indices in the UAE were the only gainers YTD over Jan-Nov 2022, while the sectoral index in all other markets declined over the period. The Refinitiv GCC Real Estate Total Return Index gained by 1.2% driven by the strong performance of Abu Dhabi (+16.7%) and Dubai (+14.3%) RE indices, while outperforming the MSCI GCC index (-1.4%) over the same period. Key decliners in the real estate listed equities space came from Saudi Arabia, as both Saudi RE developers and the Saudi REITS index declined by 14.1% each.

Refinitiv GCC Real Estate Total Return Index



Sources: Kamco Invest Research, Refinitiv

GCC RE equity indices: Jan-Nov 2022 returns (%)



Sources: Kamco Invest Research, Bloomberg, Refinitiv

While fundamental KPIs of real estate sub-segments have improved substantially in select markets, recent headwinds such rising interest rates and normalizing future growth could impact the stock prices of developers and REITs going forward, in our view. Having said that, we continue to expect specific equity stories to continue to outperform broader indices as higher IRR projects are announced, opportunistic M&A activity is executed, and specific product types such as data centers are acquired as alternative investments.

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