Investment Strategy & Research

GCC Real Estate Update July-2023

Pockets of late-cycle opportunities remain

Report Highlights:

This report analyzes GCC real estate fundamentals in 2023. 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:

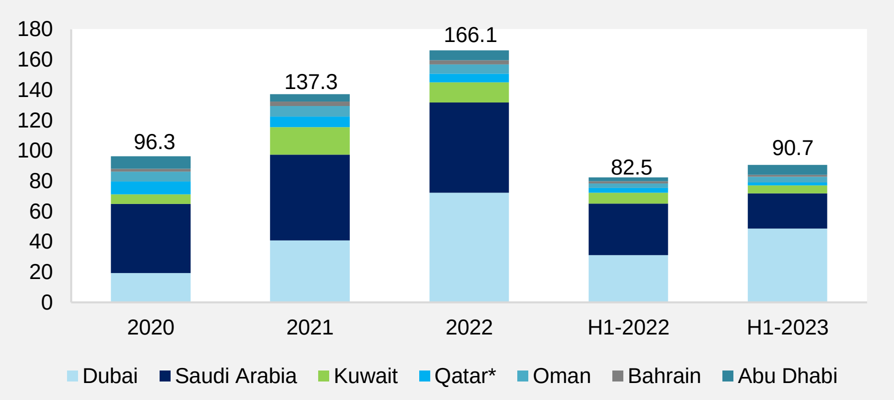
- *Late-cycle disparities emerge – Dec 2022*
- *Divergent cap rate narratives in 2022 – Mar 2022*
- *Pinning hopes on a 'Resi'lient recovery - Aug 2021*
- *Cyclical or Structural Conundrum – Dec 2020*
- *Déjà vu or Different this time? – May 2020*

Investors to cherry-pick RE sub-segments and markets in typical late-cycle trends: The combination of strong pricing and lower transaction volumes prevalent in the GCC at the end of H1-2023 should keep developers cautious of bringing significant supply to the market in our view, and therefore project launches are likely to cater to a more normalized demand environment going forward. Further, we believe the strong late-cycle pricing achieved for quality assets in most of GCC's real estate sub-segments over the last 12-18 months now leaves fewer pockets of opportunities for investors. We believe residential developers in Dubai & Riyadh who possess dominant brand equity, an attractive product mix, and market sensitive payment plans should achieve sell-through of their new launches build-to-sell (BTS) portfolio going forward. Separately, most office markets in the GCC are expected to remain strong as new Grade-A office space supply from developers remains limited. For retail, best-in-class super regional malls in key markets will return as late-cycle favorites, as they should continue to achieve higher occupancy rates and should mitigate tenant portfolio risks adequately.

Dubai carries GCC RE transacted value higher y-o-y in H1-2023; Resi rents in Saudi & UAE trend higher: Real estate sale transactions in the GCC over H1-2023 reached USD 90.7 Bn, up 9.9% y-o-y from USD 82.5 Bn in H1-2022, based on our estimates. Dubai's transactions contributed 54% of the region's total transacted value and was able to offset the decline of the other key markets such as Saudi, Qatar* and Kuwait. RE value transacted in Dubai increased almost 57% y-o-y in H1-2023 based on data from DXB Interact. Key drivers were strong pricing and demand for luxury properties for both single-family and multi-family homes, while the affordable property segment also witnessed healthy gains. Going forward, we expect the pace of price and rental growth across residential key markets to moderate further in H2-2023, as typical late-cycle stabilization is witnessed, and supply calibrates to more normalized demand. Further, the trajectory of mortgage rates and rental affordability should impact end user ownership trends especially in markets such as UAE & Saudi Arabia and determine the future course of residential transaction activity, in our view.

RE equities outperformance could get narrower in H2-2023: The Refinitiv GCC Real Estate Total Return Index gained by 15%, driven by strong performances from Saudi Arabia (+32.2%), Dubai (+16.9%) and Abu Dhabi (+15.9%) RE equity indices. Qatar (-3.6%) and Saudi REITs index (-2.3%) were major decliners in the regional real estate listed space. The outperformance of the UAE and Saudi equities indices is ascribed to the strong growth in pricing that real estate developers have been able to achieve in their respective markets for their products, with incremental demand outstripping new supply. Going forward, we expect the rally to be significantly narrower, and skewed towards companies that possess stronger balance sheets that enable them to achieve higher IRR projects and opportunistic M&A activity. Moreover, headwinds such as higher interest rates and normalizing future growth could potentially impact the broader sector in our view.

GCC RE Transactions Breakdown – USD Bn



*Source: Kamco Invest Research, Govt Sources , *Qatar transactions from Jan-May 2023*

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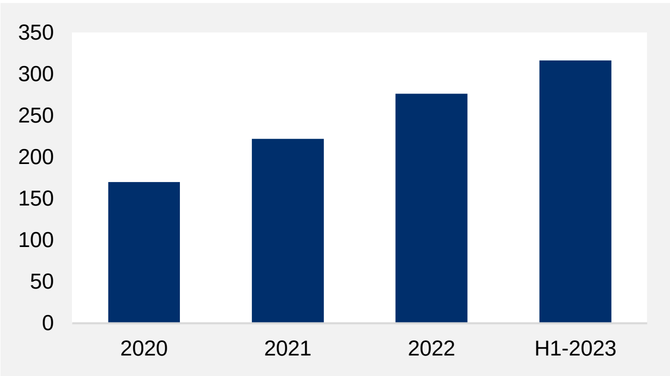
Dubai carries GCC RE transacted value 9.9% higher y-o-y in H1-2023

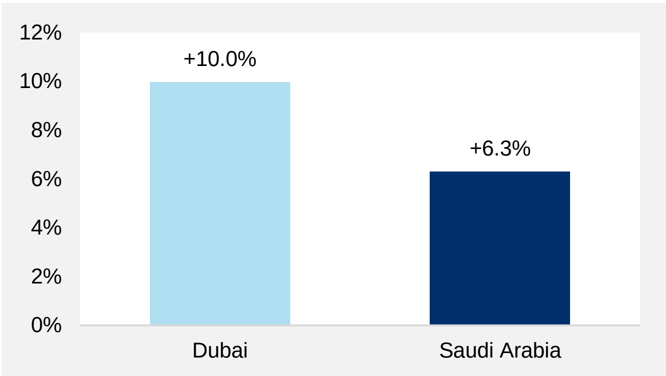
Real estate sale transactions in the GCC over H1-2023 reached USD 90.7 Bn, up 9.9% y-o-y from USD 82.5 Bn in H1-2022, based on our analysis of available official estimates. Dubai's transactions contributed 54% of the region's total transacted value and was able to offset the decline of the other key markets such as Saudi, Qatar and Kuwait. RE value transacted in Dubai increased almost 57% y-o-y in H1-2023 based on data from DXB Interact, mainly driven by strong pricing and demand of luxury properties in both single-family and multi-family homes, while the affordable property segment also witnessed healthy gains. The number of transactions in the GCC however declined by 8.4% y-o-y over H1-2023 to 286,610 deals, despite a jump of over 42% witnessed in Dubai's RE transactions, as other markets such as Saudi, Qatar and Kuwait witnessed lower activity as compared to the same period in H1-2022.

GCC average value per transaction



Sources: DLD, Kamco Invest Research

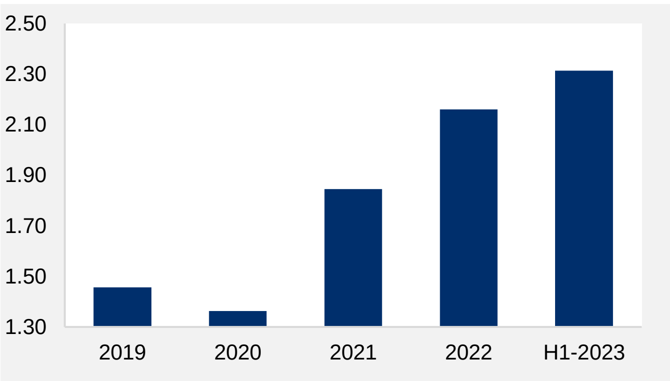
Average value per transaction y-o-y in H1-2023



Sources: MOJ, Kamco Invest Research

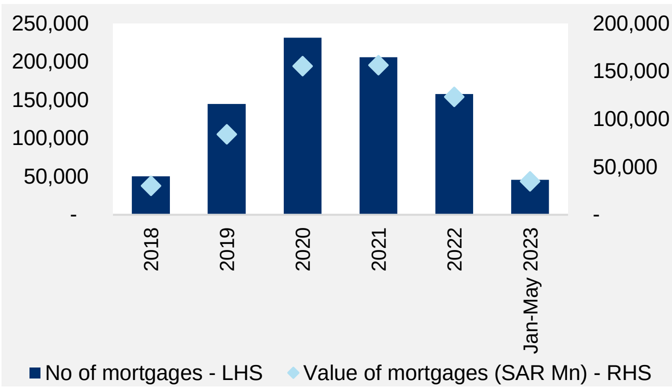
Nevertheless, the average value per transaction achieved over H1-2023 for GCC real estate was up by 20.1% y-o-y, pointing towards significant investment demand and strong pricing. The average value per transaction in GCC in H1-2023 (~USD 316,400) also surpassed the 2022 average (~USD 276,600). However, it is hard to estimate whether GCC's full year 2023 transacted value potentially surpasses 2022 estimates, as it will depend on: 1) Key markets such as Saudi, Kuwait and Qatar witnessing higher transaction volumes and transacted value in H2-2023. 2) UAE markets and mainly Dubai keeping the current pace of H1-2023 transaction activity.

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



Sources: DXB Interact, Kamco Invest Research

Total Saudi residential new mortgages from banks & finance companies



Sources: SAMA, Kamco Invest Research

In Dubai, off-plan transactions continued their momentum with off-plan volumes jumping by over 73% y-o-y in H1-2023, while registering a healthy 7.1% increase in average off-plan value per transaction from end -2022. Separately in Saudi Arabia, mortgage activity continued to trend downwards due to higher mortgage rates and higher pricing of residential products. Going forward, we expect the pace of price across key residential markets to moderate further in H2-2023, as typical late-cycle stabilization is witnessed and supply calibrates to more normalized demand, while investors and end users should remain cautious about higher interest rates and affordability. The trajectory of mortgage rates and rental affordability should impact end user ownership trends especially in markets such as UAE & Saudi Arabia and determine the future course of residential transaction activity, in our view.

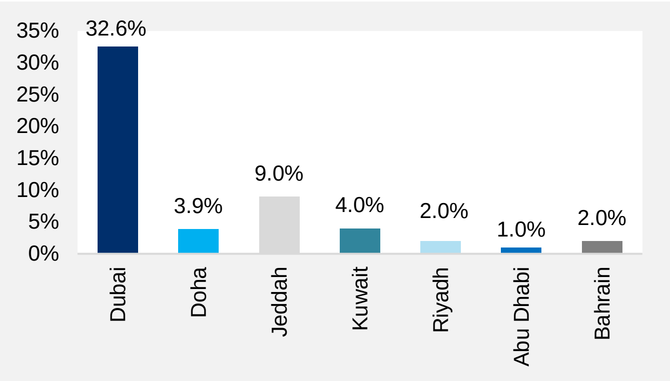
Pockets of late-cycle opportunities remain in GCC's RE landscape

The combination of strong pricing and lower transaction volumes prevalent currently should keep developers cautious of bringing significant supply to the market in our view, and therefore project launches are likely to cater to a more normalized demand environment going forward. Further, we believe the strong late-cycle pricing achieved for quality assets in most of GCC's real estate sub-segments over the last 12-18 months now leaves fewer pockets of opportunities for investors. We believe residential developers in Dubai & Riyadh who possess dominant brand equity, an attractive product mix, and market sensitive payment plans can achieve sell-through of its new launches build-to-sell (BTS) portfolio going forward. Separately, most office markets in the GCC are expected to remain strong as new Grade-A office space supply from developers remains limited. For retail, best-in-class super regional malls in key markets will return as late-cycle favorites, as they should continue to achieve higher occupancy rates and should mitigate tenant portfolio risks adequately.

Residential RE prices in Dubai & Saudi trend higher in 2023; Yields expansion has many catalysts

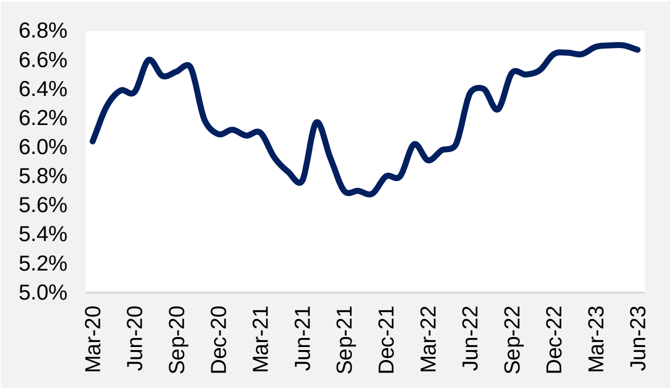
Growth in residential real estate prices in key markets continued into H1-2023, albeit slower than trends witnessed in 2022, driven by investment demand and slower completion of the supply pipeline., In Dubai, prices rose 11.7% in Q2-2023 y-o-y, as per ValuStrat, driven mainly by higher demand for single-family homes and luxury villas, while incremental supply for those products continue to remain limited. As a result, prime villas reportedly witnessed price gains of 16% y-o-y, while luxury villas at the end of Q2-2023 surpassed mid-2014 prices by 8.8% according to data from ValuStrat. Registered prices of off-plan properties increased by 6% in Q2-2023 from the end of 2022, after witnessing a price growth of 17% y-o-y in 2022. Developers look to improve specifications and continue to tweak post-completion plans of their new launches to keep price momentum going, while mortgage lenders can lend upon projects reaching 50% completion rates as against the 80% previously, which is likely to keep demand for such properties buoyant.

Residential rents performance: H1-2023 (y-o-y%)



*Source: Kamco Invest Research, ValuStrat, REMI, JLL, * Riyadh & Jeddah are from Q1- 2023*

Dubai apartment yields performance



Source: Property Monitor, Kamco Invest Research

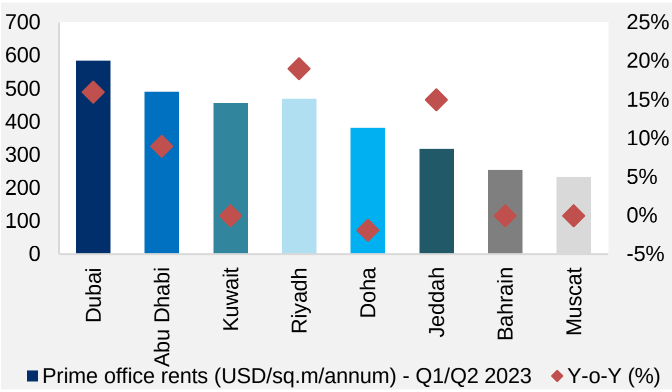
In Abu Dhabi, residential price growth was muted at 1% y-o-y at the end of Q1-2023 as per JLL, as residents reportedly preferred to relocate to new developments located on the new islands offering modern amenities, as against the older projects on the main island. Contrary to trends witnessed in Dubai, sales prices of villas (+5% y-o-y) in Riyadh lagged corresponding price increases of apartments (+10% y-o-y) in Q2-2023 based on Knight Frank estimates, as home buyers preferred the relative affordability of apartments in the current backdrop of rising interest rates. Developers are also reportedly increasing supply to smaller single-family homes and apartments as a result. Jeddah on the other hand reportedly witnessed lower price growth of 1%-2% y-o-y, as per Knight Frank, as demand was impacted by lower affordability, while supply consisted of the higher contribution of Ministry of Housing projects in the affordable segment. In terms of rents, Dubai reportedly witnessed a 32.6% y-o-y jump in average residential rents as per ValuStrat, as investors continued to raise rents to maintain gross yields which are around 6.5%-7%.

In Saudi Arabia, residential rents in Riyadh and Jeddah echoed the drive towards affordability as apartment rents grew by 4% and 13% y-o-y respectively in Q1-2023, outpacing overall residential rental increases by 200bps-400 bps over the same period. Other rental markets such as Doha (+3.9%) and Kuwait (+5%-6%) also witnessed marginal increases y-o-y, based on trends from ValuStrat and REMI respectively. Going forward, we expect the pace of price and rental growth across key markets to moderate further in H2-2023, as typical late-cycle stabilization is witnessed and supply calibrates to more normalized demand, while investors and end users should remain cautious about higher interest rates and affordability. The trajectory of mortgage rates and rental affordability should impact end user ownership trends especially in markets such as UAE & Saudi Arabia and determine the future course of residential transaction activity, in our view.

Riyadh remains hottest office space market; BFSI returns as key demand driver

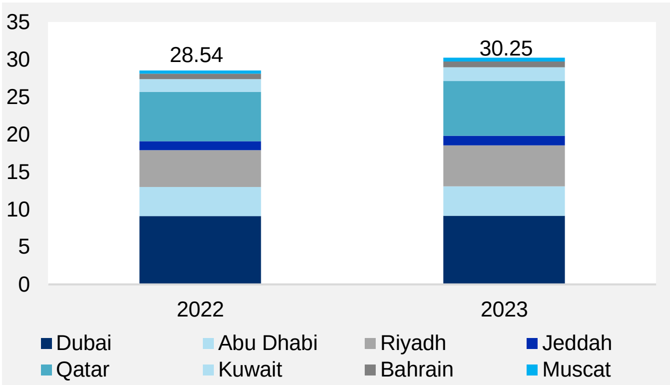
Grade-A office spaces in the region continued to witness strong rental performances, as supply remained tight, while sectors such as BFSI (banking, financial services, and insurance) and O&G (oil & gas) reportedly joined newer sources of demand such as TMT (Technology, Media & Telecom) for additional take-up of quality spaces. Aggregate office space in GCC's key markets is expected to reach 30.25 Mn sq.m by the end of 2023, from 28.54 Mn sq.m in 2022, based on our analysis of consultant data. Further, consultant data showed that prime office rents across most markets increased in Q1/Q2-2023 with Riyadh (+19%), Dubai (+16%), Jeddah (+15%) Abu Dhabi (+9%) witnessing strong increases y-o-y. JLL mentioned that average market-wide vacancy rates in Riyadh have fallen to 1% at the end of Q1-2023, and that corporates have started expanding to Northern Riyadh as spaces comes with better accessibility and better parking. They further mentioned that in Jeddah, market-wide demand is reportedly being led by local companies and family businesses relocating to newer areas towards the north and west, while CBRE estimates occupancy rates to have improved to 88% by early 2023, compared to 78% a year ago.

GCC prime office rents & y-o-y declines: H1-2023



*Source: Kamco Invest Research, Knight Frank, JLL, Savills, REMI, ValuStrat, * Riyadh & Jeddah are from Q1- 2023*

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



Source: JLL, ValuStrat, REMI, Savills, Knight Frank, Kamco Invest Research

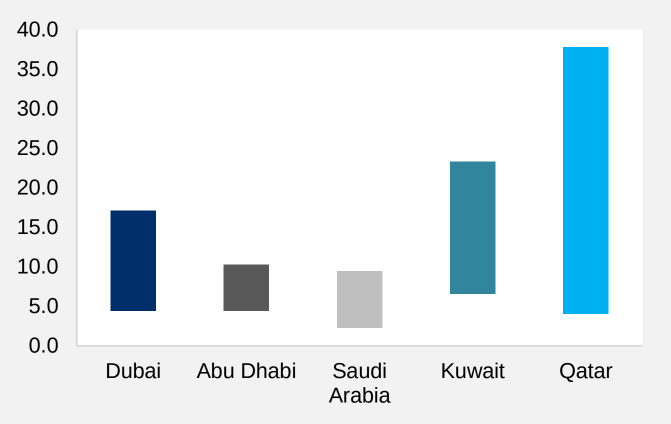
In Dubai, new entrants represented 40% of the enquires at the end of Q1-2023 as per Savills, while consolidation activity and space upgrades continued from corporates. BFSI re-established itself as the key sector driving office space demand within Riyadh, Dubai, and Abu Dhabi, while we expect TMT, AI, Robotics, Healthcare/Pharm and Legal corporates to remain active occupiers, a trend which emerged since 2020. Most markets in the GCC are expected to remain strong as new office space supply from developers remains limited. Further, some of the Covid-19 initiated trends could reverse further going forward, as companies monitor return-to-office mandates and flexible/remote working strategies to remain asset light and cost conscious. Moreover, certain multi-national corporates will continue to prefer sustainable office spaces that are LEED certified, with allocation towards wellness components and better infrastructure connectivity.

Industrial RE disparity widens on suitability

Trends from 2022 continued into the current year as quality industrial warehouse spaces within the GCC continue to witness strong growth in demand, while such spaces remained in short supply. Rents moved higher overall across markets for such spaces, with certain spaces witnessing double digit increases y-o-y in percentage terms. National Industrial transformation plans will remain strongest driver for the segment going forward, which should bring investments from private sector participants such as international logistics players, real estate developers , as they look to capitalize on growth from the major industrial hubs and achieve attractive yields of +8%.

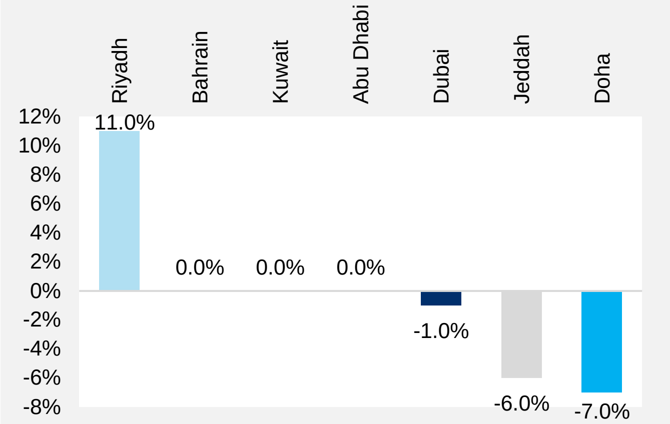
In the UAE, Maersk, the global integrated logistics company, opened its new cold store of over 13,000 sq.m at Dubai Industrial City. Separately, Silver Line Gate Group (SLG) announced in Q1-2023 that they are investing AED 200 Mn in constructing a new manufacturing, warehouse, and corporate offices facility, spanning 1.37 million sq. ft. at Dubai Industrial City, which is set to open by 2025. In Saudi Arabia, the 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. Moreover, the country's aim to increase the number of factories from 10,640 industrial facilities to 36,000 factories should also result in strong demand for industrial warehouse spaces.

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



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

GCC retail space rents: H1 2023 (y-o-y%)



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

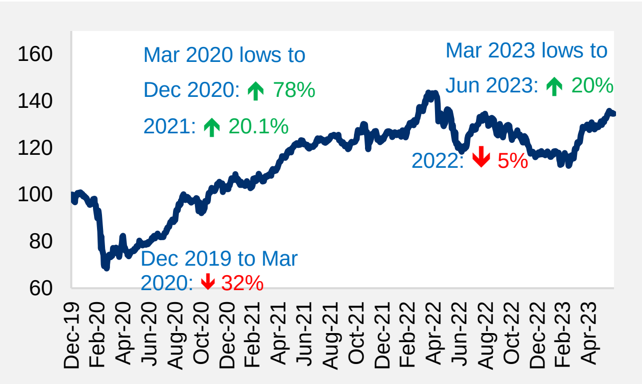
Super-regional malls return as late-cycle favorite

The retail real estate market in the GCC remains supply conscious, with markets that absorbed new supply witnessing softer aggregate trends. This was evident from H1-2023 rental trends, as all markets barring Riyadh (+11%) remained stable or witnessed declines y-o-y, as per consultant data. Mall space owners continue to focus on increasing their Family Entertainment (FEC) footprint to attract footfalls. Retailers are constantly evaluating their mall space expansion plans and the potential impact from increasing omnichannel strategies such Click & Collect, and influencer-driven marketing campaigns to maintain profitability and market share. Nevertheless, we believe the risk of retail ecommerce largely pinning hopes of achieving continuous market share gains from brick-and-mortar retail has considerably receded after Covid-19. Further, mall space owners of best-in-class super regional malls should be able to keep vacancy rates at natural vacancy rates at 4%-5%. Further they should be able to mitigate tenant portfolio risks by monitoring KPIs such as footfalls, tenant sales and occupancy cost ratios (OCRs), which should enable them to achieve contract renewals or tenant rollover at favorable rental rates. In such landmark mall spaces retailers would continue to look for more strategic locations for their outlets and will be willing to pay a premium for better visibility.

RE equities in UAE & Saudi rebound in H1-2023

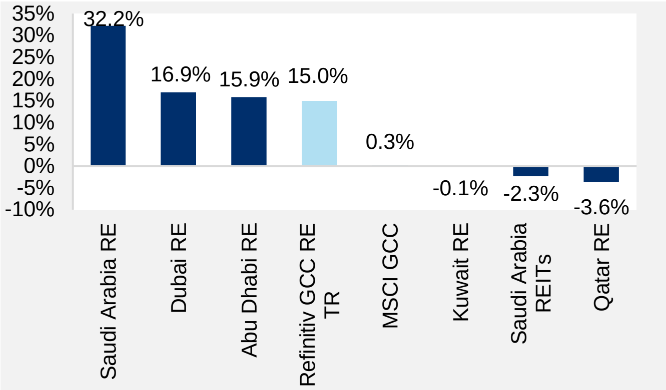
Real estate equity indices in the UAE and Saudi Arabia outperformed the MSCI GCC index (+0.3%) and other regional RE sectoral indices over H1-2023. The Refinitiv GCC Real Estate Total Return Index gained by 15%, driven by strong performances from Saudi Arabia (+32.2%), Dubai (+16.9%) and Abu Dhabi (+15.9%) RE indices. Qatar (-3.6%) and Saudi REITs index (-2.3%) were major decliners in the regional real estate listed space.

Refinitiv GCC Real Estate Total Return Index (Rebased)



Sources: Kamco Invest Research, Refinitiv

GCC RE equity indices: H1 2023 returns (%)



Sources: Kamco Invest Research, Bloomberg, Refinitiv

The outperformance of the UAE and Saudi equities indices is ascribed to the strong growth in pricing that real estate developers have been able to achieve in their respective markets for their products, with incremental demand outstripping new supply. Going forward, we expect the rally to be significantly narrower, and largely skewed towards companies that possess stronger balance sheets that enable them to achieve higher IRR projects and opportunistic M&A activity. Moreover, headwinds such as higher interest rates and normalizing future growth could potentially impact the broader sector in our view.

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