APRIL 2021

MEDIA BRIEFING

Key trends driving commercial real estate in the UAE

Flexible leases, tenant incentives and a differentiated offering are some of the key occupier considerations in this evolving market

Owners and occupiers must work together to meet the interests and ensure the sustainability of both parties, particularly due to the changing circumstances that have been brought about by the Covid-19 pandemic, says one of the UAE's leading real estate finance advisers.

With increased commercial pressures as a result of the pandemic, occupiers are seeking more value out of their properties, says Zain Qureshi, managing director and global head of real estate finance and advisory at Mashreq Bank.

TRENDS

- Property trends can be very asset and location-specific
- The pandemic has accelerated trends that were already evident pre-Covid
- Contract renegotiations have been evident across all property segments
- Environmental, social and governance (ESG) factors have been growing in demand and in importance
- It is important to alleviate any strains in landlord-tenant relationships and instead pursue ways of working together for mutually beneficial solutions
- While domestic demand within the UAE bounced back once restrictions were eased, international demand needs to return in a more significant way for a more meaningful recovery moving ahead

Trends such as hybrid working, flexible leases, collaborative spaces and a generally enhanced offering are expected to be important influences on the development and repositioning of commercial property in the UAE.

The impact of Covid-19

Covid-19 and the resulting health crisis has forced many companies to rethink their spatial requirements.

"While businesses are increasingly returning to their physical workplaces, the pandemic has served as an opportunity to reassess the amount of real estate they need, and whether a combination of remote and physical working better suits their business model", says Qureshi.

Consequently, many landlords in the UAE are taking steps to support their tenants' changing needs.

Existing tenants are being given the opportunity to scale down their premises until market conditions improve, alongside incentives such as rent deferment and renegotiation of leases and step-up clauses. Prospective tenants are being incentivised to an even greater degree.

"We've seen certain situations, especially in new office buildings, where landlords have reserved spaces in the building for a defined period of time, to allow prospective tenants to expand into these reserved, adjacent spaces once market conditions improve," explains Qureshi.

"This incentive is over and above more typical rent-free periods and fit-out contributions."

Rising demand for flexible space

Similar to a number of other trends such as the rise of e-commerce and food delivery, the demand for flexible space has also accelerated as a result of the pandemic.

The supply of flexible office in Dubai has gradually grown at a compounded annual growth rate of 20 per cent, from 50,000 square metres (sqm) in 2014 to 160,000sqm in 2020, according to data from consultant JLL. This supply is now expected to increase at a greater pace.

The growth in the demand and supply of flexible office space has been driven by freelance workers, entrepreneurs, start-ups and now even some prominent firms that are seeking short term solutions due to looming uncertainties.

According to Qureshi, the trend of co-working or shared spaces will continue to grow, buoyed by supportive initiatives by the UAE government.

"Many companies, startups and freelancers want to avoid being locked into leases and find co-working spaces as a suitable alternative for the foreseeable future," he says. "Initiatives such as freelance and remote-working visas in Dubai are further supporting this trend."

Changing attitudes and preferences

In addition to location, environmental, social and governance (ESG) perceptions of business premises are increasingly significant factors in shaping the appeal of a property to corporate tenants.

Despite being completed in the midst of the pandemic in 2020, ICD Brookfield Place, an office tower at the Dubai International Financial Centre (DIFC), is on target to achieve an occupancy level of 50 per cent of the 100,000sqm of leasable area in the coming weeks.

Qureshi notes that in addition to its DIFC location and prestige factor, the fact that it is the tallest and largest office building to receive a LEED Platinum rating in the region has contributed to the increase in attractiveness of the building. Its design enables flexible office layouts, air filtration systems smart building technology and green spaces along with the experience of being part of a wider, multi-purpose ecosystem as opposed to a standalone office building.

"Developers and landlords need to come up with spaces that are more flexible, experiential, tech-enabled and energy efficient," he says. "This will increase demand and asset value and thus generate greater returns for the owners."

He stresses that office spaces aren't simply going to die out, but a new model and new preferences are emerging, and different grades of the assets will perform differently.

Strengthening the landlord-tenant relationship

Increasing supply along with the broader macro-economic headwinds were already exerting pressure on the retail market prior to Covid-19.

The subsequent lockdown, distancing and lower footfall levels over the course of 2020 and even at present has resulted in many tenants unable to cover rents and operating costs.

The solution lies in landlords and tenants working together in the best interests of both parties. Landlords recognise that higher vacancy levels render malls more unattractive and therefore tenant retention is important, even if the landlord's profitability is temporarily impacted.

Qureshi notes that there is already evidence of a relatively greater reliance on turnover-based rent models as opposed to high, fixed, base rents. This model enables a better level of sustainability in a downturn while landlords could benefit from an equity-style uplift when sales improve.

One limitation to this model is that landlords would need to participate in strategic initiatives and in attracting footfall at a greater degree since their own revenue and profitability is directly linked to the performance of their tenants. This will also give tenants the breathing space in terms of getting their operations back on track, as footfall gradually ramps up again.

"It's a win-win situation for both," says Qureshi. "Retailers don't default on fixed rent payments if the business struggles, and the landlord gets to retain the tenant as well as prevent vacancies and closures."

While this solution may not work for all landlords due to revenue transparency or even for certain tenants that do not prefer sharing revenue, a hybrid model may be adopted based on mutually agreeable negotiations.

Hospitality to experience selective stability

While still under considerable pressure due to international travel restrictions and consequently lower arrivals figures, the UAE hospitality sector has been able to adapt to market conditions to a reasonable degree.

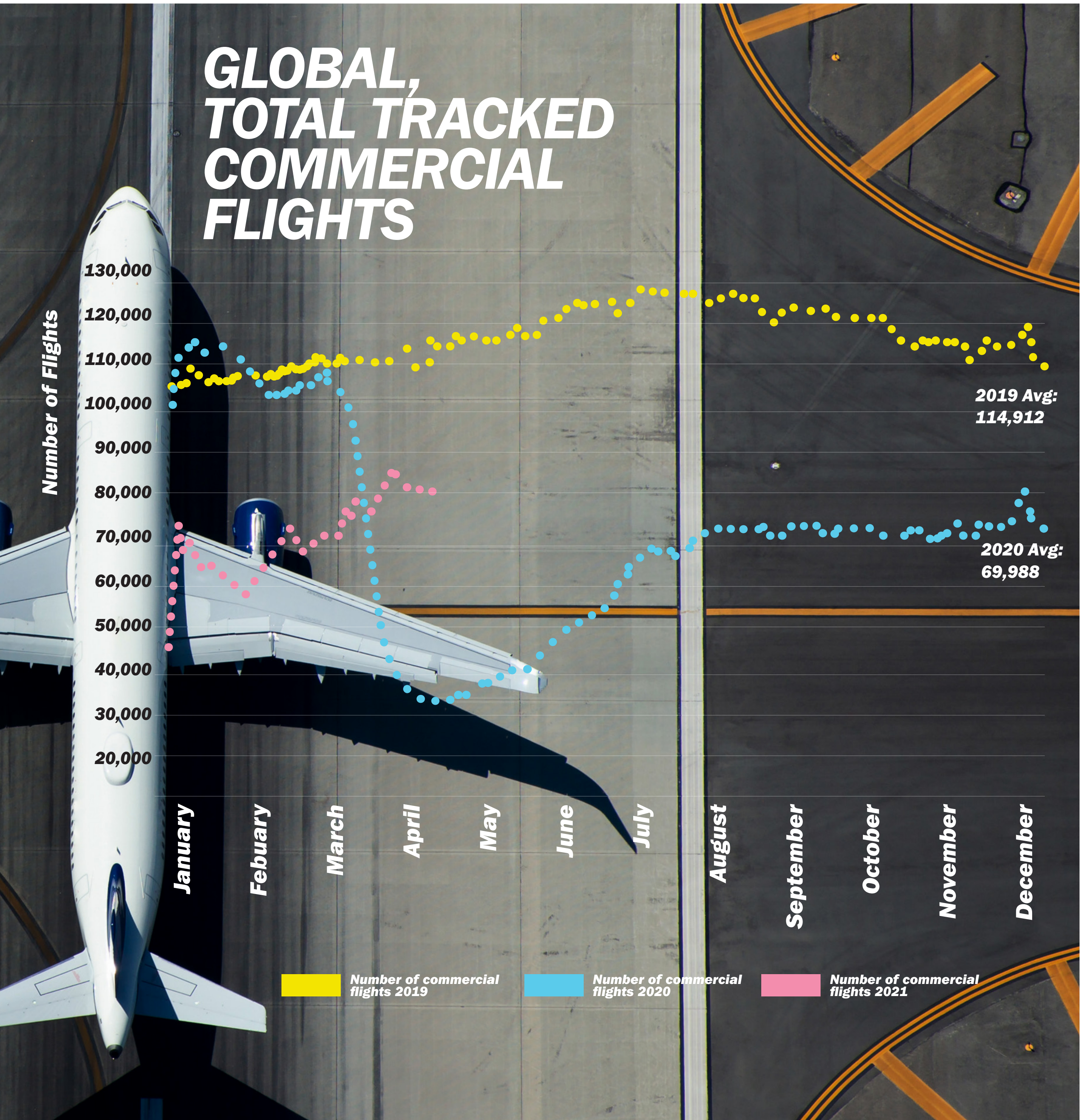
Staycations contributed to a partial recovery once the initial lockdowns were eased in the UAE, and particularly in Dubai and the Northern Emirates.

This was followed by the ever-busy November to January months that witnessed high occupancy levels as visitors flooded Dubai.

While hotels have to a great degree been able to rationalise operational costs over the course of 2020, business hotels have been far harder impacted compared to beach and leisure oriented hotels such as those on Palm Jumeirah, in Dubai Marina and in Ras al-Khaimah.

"Business hotels will continue to face considerable headwinds for the foreseeable future, as corporates re-assess and limit business related travel unless absolutely necessary," says Qureshi.

He also notes that hotels will generally have to be creative and accommodative to sell those rooms



Source: Flight Radar 24

through initiatives such as half/full board packages, offering complimentary meeting and business facilities, reconfiguring room layouts where possible and being able to offer a variety of on-site facilities.

"Being able to adapt, innovate and present an attractive offering will continue to be important themes over the course of 2021 and while upcoming supply is a concern, Expo 2020 Dubai is expected to relieve some of the pressure temporarily."

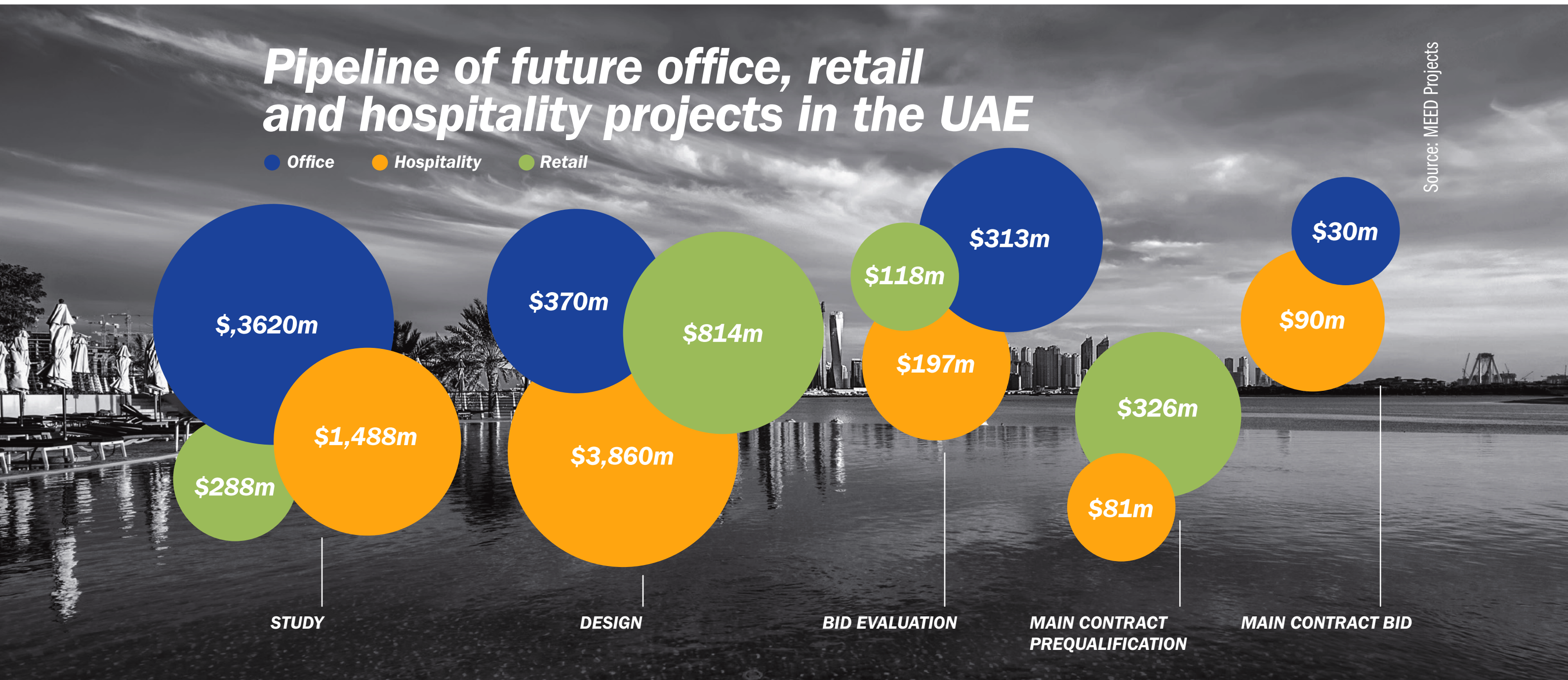
The outlook for the industry

With the dual challenges of Covid-19 and an ongoing oversupply in some segments, the near-term outlook remains challenging with much depending on global vaccination roll-outs, an increase in travel, a curb in some of the supply and more importantly, a change in sentiment.

Data from regional projects tracker MEED Projects indicates that the pipeline for future projects in the commercial, retail and hospitality market remains subdued. The majority of the projects are in the study or design phase, with less than 10 per cent at various tendering stages.

"Property trends are very asset and location-specific to a considerable degree, and can thus vary greatly," says Qureshi. "It is still very much a cautionary and selective approach for the foreseeable future."

Office, retail and hospitality projects planned vs underway in the UAE



This briefing is brought to you by the MEED-Mashreq Real Estate Partnership

Find more insights: www.meedmashreqindustryinsight.com
Write to us on: MEEDMashreqPartnership@meed.com