Muscat, Spring 2017

PROPERTY MARKET OUTLOOK

RESIDENTIAL MARKET

Rents show signs of stability
During 2016, average rents across Muscat receded by 10.1%, in line with our forecasts. During the final quarter of last year, rents declined by 4.2%, leaving average monthly rents just shy of OMR 700.

2017 has however got off to a more stable start, with rents during the three months to the end of March declining on average by a marginal 0.6%. The limited movement has improved the year on year change to -7.0%; the best annual performance in 18 months, suggesting some locations may be starting to show signs of bottoming out.

Eight of the 12 submarkets we monitor registered rent declines during Q1 2017, with Al Hail / Mawaleh (-4.6%), Madinat Qaboos (-3.9%) and Maabela (-2.6%) recording the strongest rental corrections. No submarkets posted any increase in average rents.

Reduced tenant requirements
The rent falls experienced across the market have been symptomatic of a rapid deterioration in tenant requirement levels over the last few years as the economy recoiled in the wake of the shock oil price collapse three years ago. Hydrocarbon receipts have fallen, while the government deficit has widened and in fact stood at 21% of GDP in the 11 months to the end of November 2016, according to Oxford Economics.

The government has taken a number of positive steps over the last couple of years to manage the evolving conditions, however, overall spending has continued to recede, falling by 7.5% last year (Oxford Economics).

The reduction in spending and the weaker economic conditions have taken a toll on the rate of job creation, which has filtered through to the property market in the form of weaker demand levels.

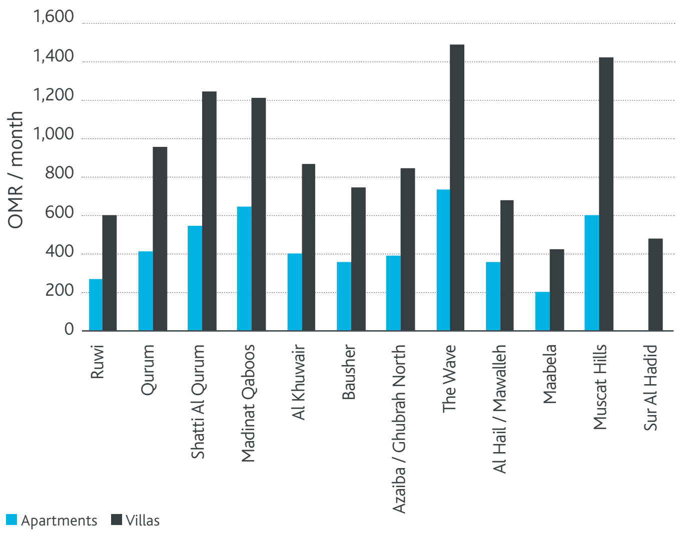
This has challenged the status quo, with some landlords navigating the challenging conditions through increased flexibility and to an extent, a degree of innovative thinking.

-10.1%
Decline in average residential rents during 2016

-0.6%
Decline in average residential rents during Q1 2017

Source: Cluttons

Average residential rental values by submarket during Q1 2017



Source: Cluttons

Flexibility is key for landlords

Tenants are aware of the market conditions and are very much in the driving seat. They are gravitating towards larger, well managed residential schemes with facilities which are considered to offer both a desirable lifestyle and good value for money. Examples of developments which have been able to maintain high occupancy levels despite the quieter conditions include Al Assalah Towers, Hatat Complex, The Greens and Meydan Al Azaiba.

Occupancy levels in a selection of Muscat's key residential buildings

Scheme name	Occupancy level estimates
Al Assalah Towers	>95%
Hatat Complex	>95%
The Greens	100%
Meydan Al Azaiba	80% - 85%

Source: Cluttons

Pricing has clearly been central to the ability of these developments to retain high occupancy levels. However, unlike elsewhere in Muscat, landlords in the above developments have been able to maintain strong occupancy levels without significant reductions in rental values. This is being achieved through the provision of units suited to market requirements, in addition to good property management and communal facilities.

Elsewhere, some landlords have also been willing to work with individual tenants, adjusting lease rates according to their personal circumstances, which has historically been rare in the Muscat market.

Where landlords have been slow to move on rents, or refused to lower rents, occupancy levels continue to decline. On average, buildings that fall in this category have vacancy rates of around 25%.

We have worked with a number of large scale landlords to help maximise their income streams in the low demand environment and as outlined above, tenants who are in the market are generally looking to make a saving, whilst also securing what is perceived to be an upgrade in accommodation. This has, for instance, helped to drive interest at the 615 unit Taminat Complex by the Public Authority for Social Insurance, where 15% of the units available were leased within three weeks of coming to market.

Mute outlook

Overall, with GDP growth forecast to slow to 0.4% this year, from 1.5% last year (Oxford Economics), the prospects for a sudden surge in job creation rates and subsequent increase in the level of requirements for rented accommodation remain low. That said, the slowing rate of rental declines in the first quarter suggests we may at last be starting to see the first signs of the market gradually bottoming out.

It is perhaps too early to call the current conditions entirely stable as the weak signs of stability may be quickly upset by any shocks to the global economy, or indeed the local economy. For now, our baseline view is for rents to dip back by between 5% to 7% during 2017, which assumes little change in rents over the next three quarters.

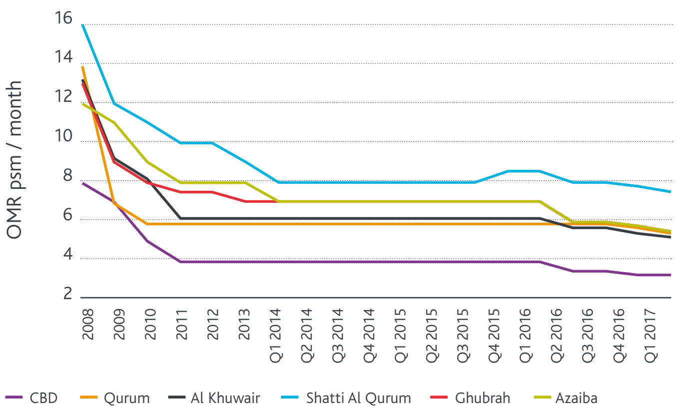
OFFICE MARKET

Office rents fall to fresh lows as demand retreats

The weaker economic activity and subsequent reduction in overall requirements in the market have continued to undermine office rents across Muscat, with areas in the Central Business District (CBD) (-18.8%), Ghubrah (-17.9%) and Azaiba (-17.9%) emerging as the weakest performers in 2016. In fact, the CBD now offers some of the most competitive office rents in Muscat, with average rates standing at OMR 3.25 psm.

Rents across the markets we monitor continued to recede during the first three months of 2017, with lease rates in Al Khuwair (OMR 5 psm), declining by 4.8%, positioning it as the worst performer. Across the board, rents currently sit at fresh historic lows and are roughly 60% down on the market peak of 2008.

Performance of office rents across Muscat's key submarkets



Source: Cluttons

Unsurprisingly, larger shell and core units are registering the sharpest drops. In some instances, this has been up to 10% during the first quarter alone, as demand for space in excess of 800 sqm has all but dried up. Furthermore, economic pressures mean that many businesses are consolidating operations and downsizing, which is driving up the number of requests we are receiving for smaller amounts of space.

While some landlords are receptive to the weak conditions and are willing to work with tenants in order to retain them in the longer term, others are reluctant to drop rates in order to retain tenants or entice demand and are experiencing rising void periods as a result.

Further corrections ahead
It is our view that landlords who are slow to respond to the weak conditions are likely to register the steepest rent drops over the course of 2017 as they will likely end up chasing the market down. The short term prospects for the office market are certainly very weak, with rent corrections on average of 10% to 15% likely this year.

The added complications around the potential impact of the 1 January 2018 implementation of a GCC wide Value Added Tax (VAT) at a rate of 5% are too early to assess as its exact impact on the property sector is still yet to be fully understood. Demand for office space could be further dampened due to increased operating costs for tenants in the event that office rents are netted by the new tax.

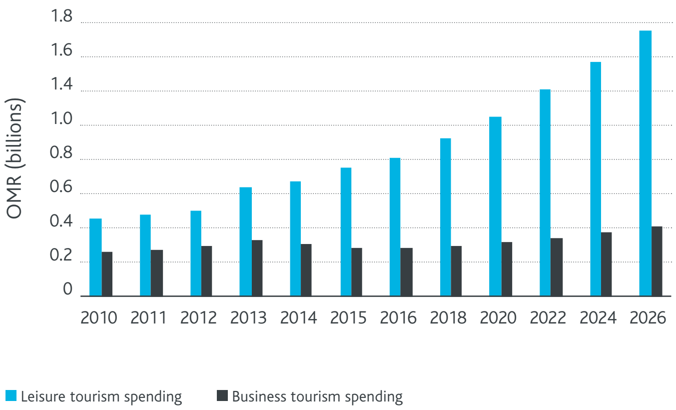
Over the medium to long term, high state spending levels on transport and energy infrastructure and job boosting ventures such as the USD 6.4 billion Liwa Plastics Industrial Complex, slated to commence operations in 2020, will likely filter through to the property market in the form of a boost to confidence. This in turn is expected to drive up overall activity levels as a result of the 12,000 new jobs it is forecast to create.

HOSPITALITY MARKET

Tourism remains on a strong growth curve
Away from the office market, the hospitality sector appears to be going from strength to strength and is likely to remain the star performing asset class in Oman's real estate landscape for the next few years. The recent Economic Impact 2016 report by the World Travel & Tourism Council states that the direct contribution of travel & tourism to Oman's GDP was OMR 0.697 billion in 2015 and that this is forecast to have risen by 6.6% to OMR 0.743 billion in 2016. The outlook is for the direct contribution of travel and tourism to grow by 6.1% per annum over the next 10 years to OMR 1.344 billion by 2026.

The report also forecasts that inbound tourism spending is projected to have reached OMR 0.68 billion in 2016 (an increase of 5.4% from 2015) and that this is expected to grow by 7.5% per annum to OMR 1.481 billion in 2026. The outlook for inbound tourist numbers is equally positive, with a prediction that they will rise from 1.81 million last year to 3.34 million in 2026.

Leisure and business tourism spending in Oman



Source: World Travel and Tourism Council

New airport to spur development
Muscat's new international airport, which is scheduled to be fully operational by year end, is expected to help facilitate greater tourist arrivals. The International Air Travel Association forecasts that passenger numbers across the Sultanate will rise from 8 million at the end of 2015 to 21 million by 2035, equating to an annual growth rate of 5.2%. In addition, the completion of the landmark USD 1.8 billion airport in the Omani capital is expected to spur development activity on the airport fringes, whilst also lifting overall economic sentiment.

Statistics from the World Tourism and Travel Council indicate that the business tourism sector has been set back by current economic conditions, but will start to demonstrate a meaningful recovery over the coming years.

Conversely, the statistics indicate that the impact of current economic conditions on the leisure tourism sector has been limited, with the council projecting that leisure tourism spending will continue to show strong growth and will account for almost 80% of all tourism spending in Oman by 2026.

The overall projections indicate that the outlook for the tourism sector in Oman is very positive. It is our view that this will help to drive the continued development of the hospitality sector across the Sultanate, particularly for facilities with a strong leisure tourism focus.

Our view is that landlords who are slow to react to the weak conditions are likely to register the steepest rent drops during 2017

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