REPORT

Savills Research

BAHRAIN RESEARCH 2020

The Property Report

Foreword

The Kingdom of Bahrain has adopted a strategy to diversify its economy and empower the private sector to play a bigger role in achieving the country's Economic Vision 2030. The economic reforms adopted as part of the strategy has yielded positive results for the country. The overall GDP more than doubled between 2002 and 2017, with growth in the non-oil sector increased by an average of 7.5% annually.

Under the broader economic reforms, the government also launched the National Planning Development Strategy 2030 and established the Real Estate Regulatory Authority (RERA). This is now helping the nation to achieve an integrated approach towards urban development, increase transparency, promote investments while protecting the rights of consumers. Numerous labour market regulatory programme have also been introduced, key among which is the Flexible Worker System, which permits foreign workers to live in the Kingdom of Bahrain without a sponsor and work in several fields with multiple employers on a full or part-time basis. These factors have contributed towards creating a business-friendly environment in Bahrain and making it a preferred choice for expatriates to live and work.

However, government revenues especially in the non-oil sector have not kept pace with the overall diversification strategy. Successive budget deficits in recent years saw public debt reach 80% of GDP in 2018 compared to 13% in 2008. To address the issue, the government introduced the Fiscal Balance Programme (FBP) with an aim to achieve a balanced budget by 2022. The introduction of VAT and the USD 10 Bn in financing from neighbouring GCC countries are critical milestones in effect towards achieving the targets set out in the FBP.

The onset of COVID-19 pandemic, however, has now undone a lot of progress made under the FBP. The situation has been exacerbated by the dramatic drop in oil prices earlier this year. Consequently, in the first half of this year the budget deficit nearly doubled to BD 798 mn (USD 2.1 Bn), up 98% year-on-year (y-o-y). As a result of this, the timeline of achieving the targeted fiscal balance by 2022 is now likely to be pushed back.

According to recent data released by the Ministry of Finance and National Economy (MoF), during the first half of this year, overall government revenues fell to BD 910 million (USD 2.4 Bn), down 29% compared to the same period last year while oil revenues (in particular) were down by 35% for the same period. The non-oil sector was also affected, albeit less severely, with revenues down 13% year-on-year (Y-o-Y).

Similar to the country's economic landscape, the real estate sector has been under pressure for the last few years and this is now likely to continue for the foreseeable future given the challenging global economic landscape. Despite the diversification strategy, the intrinsic connection between Bahrain's economy and the oil & gas industry means that the recent price fluctuations have created increased pressure on investments, employment and consequently on the real estate sector. The longer-term trends across the sector are still evolving, but, we anticipate a subdued real estate market over the coming twelve months.

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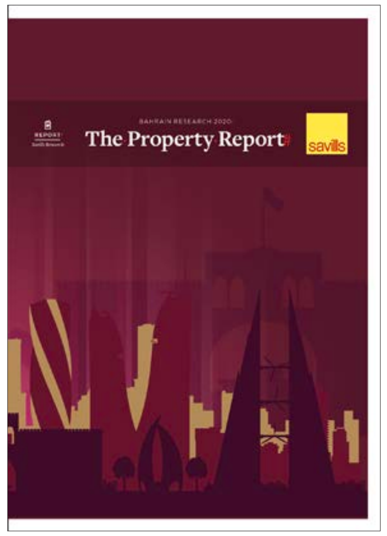

Content

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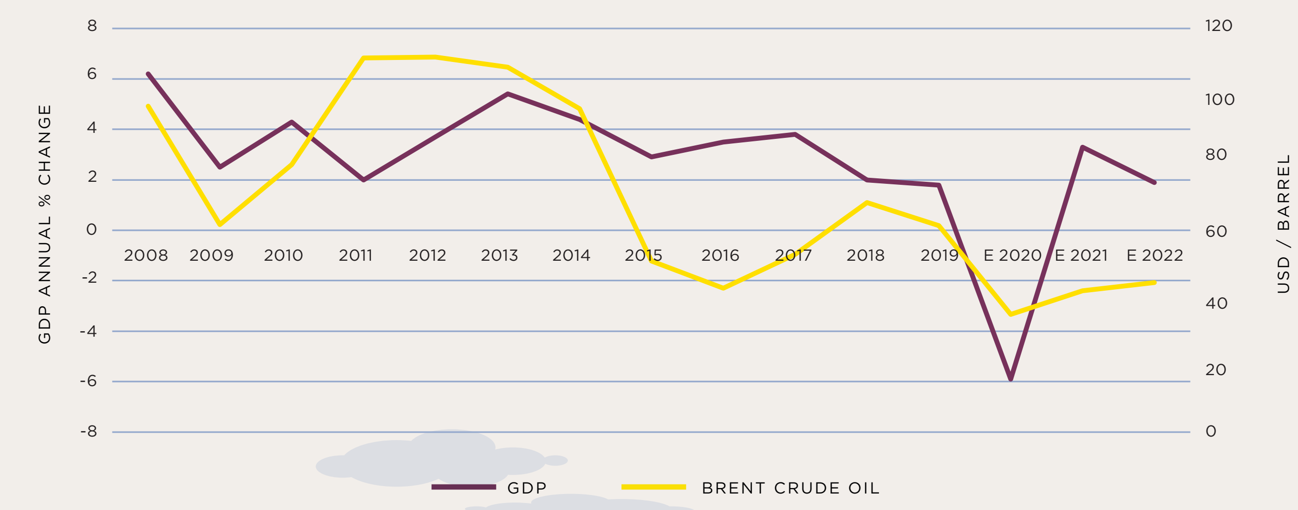
Significant economic decline due to the pandemic

The COVID-19 pandemic has severely disrupted the economic landscape in Bahrain. The country was already under significant economic pressures as persistent large fiscal deficits have raised public debt from 42% of GDP in 2013 to close to 79% in 2019. With the onset of the pandemic straining government finances and a drop in oil prices, the fiscal position continues to remain precarious. It is projected that the government revenues are set to drop by 8.5% in 2020, compared to a 2.5% growth recorded in 2019. This will push the overall debt to 103% of the GDP in 2020.

Overall economic output is also expected to significantly slowdown in 2020 with the GDP projected to decline by 5.9% in 2020 after a 1.8% growth last year. Non-oil GDP is likely to contract by 5.1% y-o-y while the oil sector economy is set to decline by 9.9% in 2020. According to ratings agency Moody's, interest payments on general government debt now account for 20% of government revenues as the debt is running at a little over 100% of the country's gross domestic product (GDP).



GDP TREND

SOURCE OXFORD ECONOMICS, KNOEMA, SAVILLS RESEARCH

However, fiscal consolidation measures under the FBP should lower the deficit in the coming years with initiatives such as the introduction of VAT, and with USD 10 Bn in financing from other GCC countries also helping the improvement.

BAHRAIN HAS CONSISTENTLY RANKED HIGH ON VARIOUS PARAMETERS MAKING IT AN IDEAL BUSINESS DESTINATION

- The high-speed regional connectivity and a road link to the largest market in the region and another planned causeway in the pipeline.
- Most sectors enjoy 100% foreign ownership
- Tax advantages including no corporation tax
- Ranked 1st for regulatory framework and shariah governance in the 2019 Islamic Finance Development Report
- Operating cost advantages including up to 43% lower logistics costs, up to 33% lower manufacturing costs, up to 35% lower financial services costs and up to 20% lower ICT costs compared against other GCC cities
- Skilled competitive local workforce with high proportion of bilingual speakers
- Consistently ranked highly in expat satisfaction surveys

THE BAHRAIN GOVERNMENT MOVED VERY SWIFTLY TO PUT IN PLACE A PACKAGE TO SUPPORT THE HARDEST HIT SECTIONS OF SOCIETY. THIS INCLUDED:

- Salary assistance for Bahraini nationals in the private sector
- Paying the utility bills of all citizens and residents
- Deferment of loan payments for nationals
- Waiving of municipality fees and tourism levies
- Waiving of rent for government-owned industrial land
- The setting up of a liquidity support fund
- Central Bank of Bahrain creating additional loan facilities for retail banks

The support provided by the government throughout this period has reinforced that Bahrain is business friendly and a great start up location for international players planning to enter the GCC market.

Savills has compiled Bahrain's first property market indices. This covers the office sale and rental market as well as the residential sale and rental market and is tracked quarterly, with further real estate segments to be added at a later stage. Our basket of properties include projects from the low to high-end segment across the most popular geographies in Bahrain.

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Residential Market

Rental

The past few years have seen a readjustment of living patterns following an increase in energy costs which resulted in a shift from larger to smaller units. This is largely limited to the villa segment and even more so for those rented on an exclusive basis (utility costs not included). Further, the occupier movement has been observed given the increase in supply by approximately 3,500 apartment units in a short period. This is set to be further intensified with a supply of 4,322 units over the next four years when Golden Gate Towers, Oryx Bahrain Bay, The Views, Layan, Paramount Tower, Harbour Row, Canal View, Spiral Orchid Residence, Harbour Heights, City Centre Towers and Amwaj Gateway are handed over.

Residential rents are now facing further downward pressure as supply outstrips demand. New units in Janabiyah/Atrium Towers start from BD 250 per month inclusive (utility costs included) and rents in Harbour Heights for a new 2-bedroom unit starts from BD 500 per month inclusive (utility costs included). which is only a slight increase in developments that were delivered over 10 years ago such as Abraj Al Lulu.

During Q3 2019, apartments experienced an average year-on-year rental price decline of 6.1% against villas which recorded a decline of 4.3%. The low-end of the market fared worse with year-on-year declines of 10% and 9% for apartment and villa segment respectively. Surprisingly, the high-end of the market has experienced the lowest movement year-on-year with decreases of 2.6% and 5.3% for villa and apartment projects respectively.

We assume that residential rental rates will continue to decline for the remainder of this year across apartment and villa projects with the high-end segment facing the most pressure as households tighten their budget on the back of subdued economic outlook, uncertainty surrounding employment in the private sector, and salary reductions. For many, working from home has been a positive experience, even leading to claims of increased productivity. For some people, being able to control, create and craft their working environment at home has benefits; for others, the experience has led to feelings of boredom, loneliness and reduced learning and development without face-to-face interaction with their peers. However, we believe this may lead to a rise in tenants looking for extra space for home offices and an increased focus on communal areas, which was historically not been a priority. This is somewhat true across all segments where there is a flight towards quality.

Also, residential locations such as Saar, Janabiyah and Hamala which are preferred by employees working in the Eastern Province of Saudi Arabia may be negatively impacted. The temporary closure of the King Fahd Causeway has left many based in Saudi Arabia for the period of the lockdown and not being able to access their residential unit for a few months. This could have a more permanent impact on the market dynamics both from an employer and employee perspective with a requirement to be located in the Eastern Province, causing a further supply and demand imbalance in the western areas of Bahrain.

Sale

A high volume of freehold apartments has entered the market over the past three years with a further 7,500 units expected in the next five years, worsening the supply/demand imbalance. Historically, investors would buy an entire residential floor to rent it with yield expectations of more than 8%. However, given the lack of demand in the rental market, there has been a consequential impact on the freehold off-plan sales market.

However, in terms of capital values, villas fared worse year-on-year during Q3 2020 with an average decrease of 5.2% compared to 4.4% for apartments. High-end villas faced the steepest drop with a year-on-year price drop of 8.3% whereas mid-end villas decreased the least by 0.5% for the same period. In the apartment market, the low-end fared the best with a minor price decrease year-on-year of 0.7% compared to drops of 3.9% and 4.8% for mid and high-end apartments respectively during Q3 2020.

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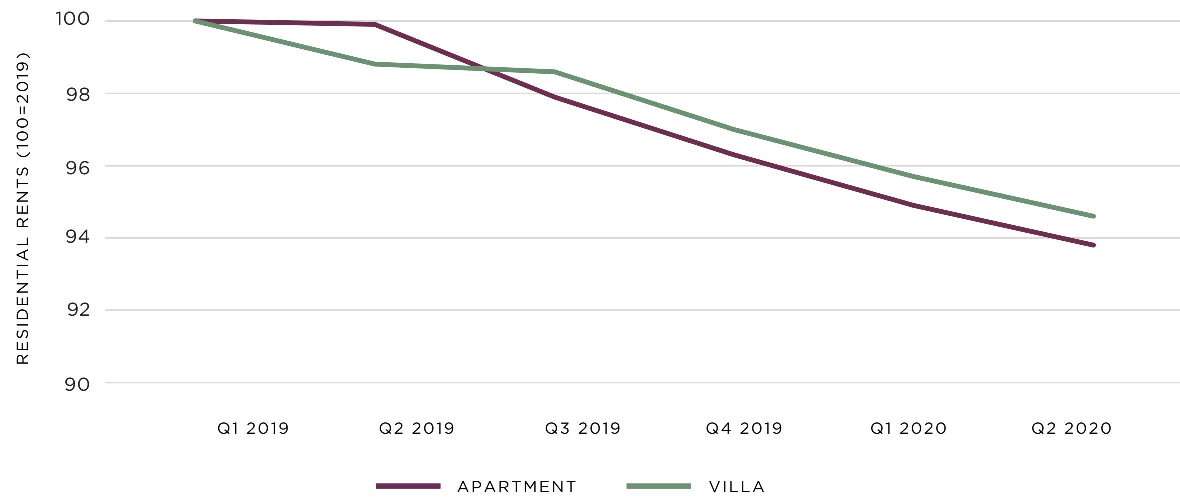
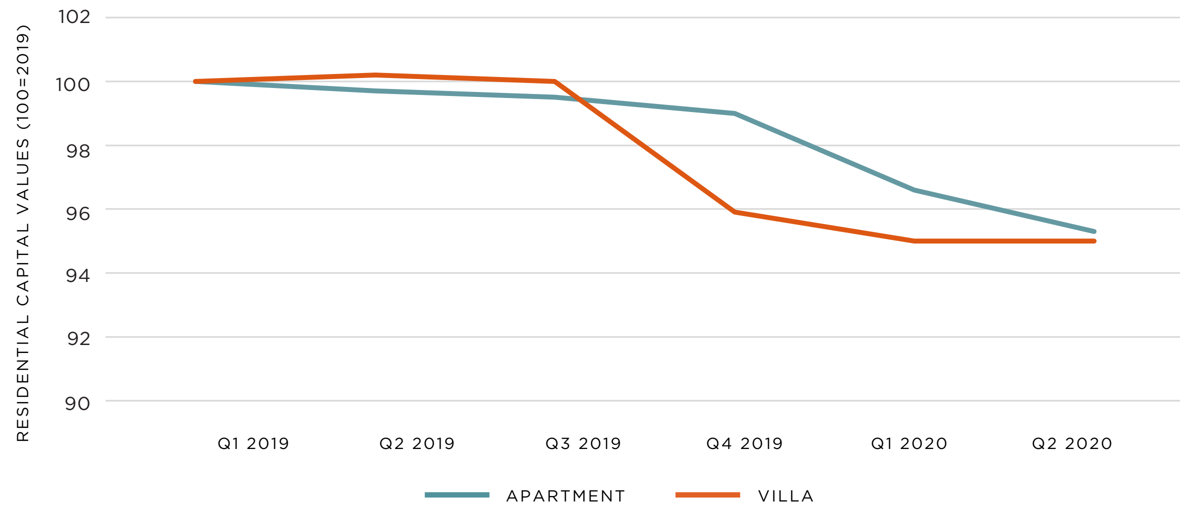
“A high volume of freehold apartments has entered the market over the past three years”



RESIDENTIAL RENTAL VALUE INDEX — **SOURCE** SAVILLS RESEARCH



RESIDENTIAL CAPITAL VALUE INDEX — **SOURCE** SAVILLS RESEARCH

Office Market

Rental

Despite an oversupply which has stretched for several years, several newer developments have come online over the past couple of years such as United Tower and the AXA Building. Consequently, occupancy and rental rates have been under pressure.

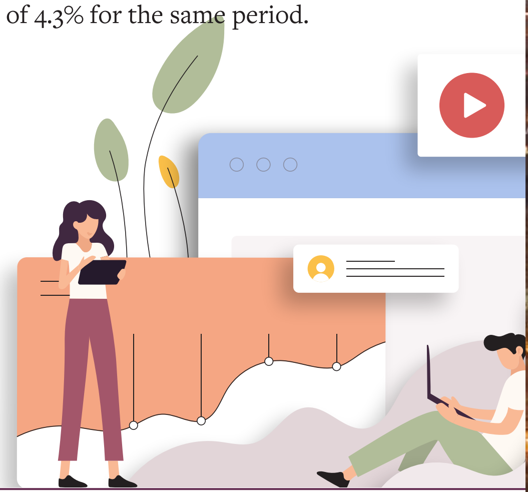
While it is too early to draw any robust conclusions on productivity on home working, it is clear that the global pandemic has stimulated discussions that challenge the traditional office working formula which may further impact the market dynamics. Over the coming year, we expect occupiers to analyse their office requirements with a strong probability of downsizing as more flexible working conditions are offered to employees. We have already started seeing these trends emerge globally with companies such as Twitter and Fujitsu allowing staff to work from home or the office dependent on their convenience. Similarly, outsourcing firm Capita is to close over a third of its offices in the UK permanently as it shifts towards a more flexible style of working.

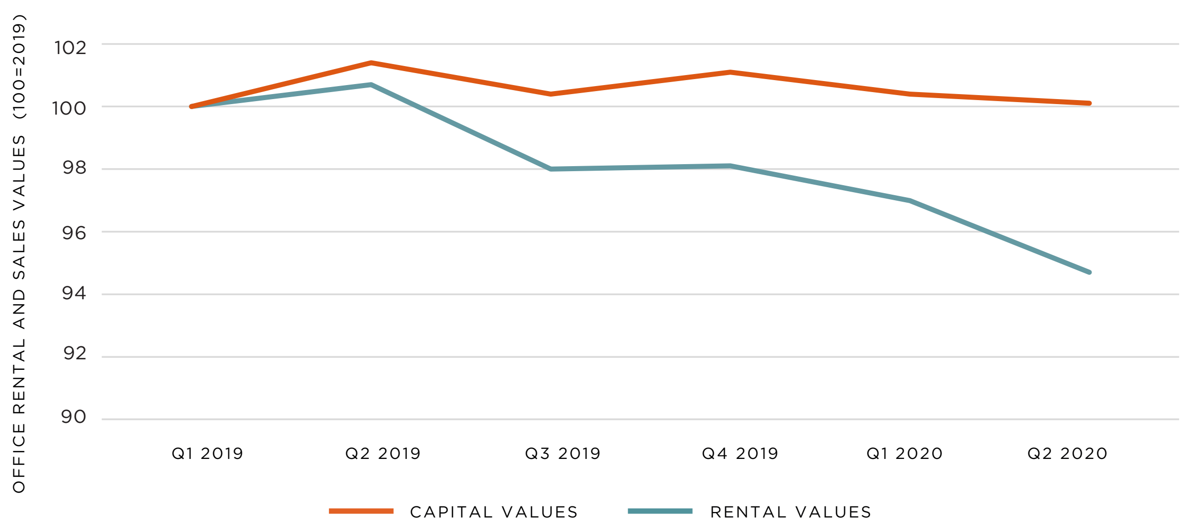
Low-end offices have struggled to compete for the most with a 10.1% rental price decline y-o-y in Q3 2020. It must be noted that the lower end of the market has witnessed rental rates similar to those offered in the industrial market which highlights the stress level the market is facing.

However, offices in the high-end segment remained resilient with a minor decline of 1.4% y-o-y as landlords have remained firm on their rental expectations due to the quality of stock and the type of clientele they attract. Consequently, these Grade A developments such as the Bahrain World Trade Center enjoy high occupancy rates of over 90%.

Sale

The limited number of freehold offices available for purchase has contributed to the stability of pricing in this segment of the market with high-end offices recording a slight price rise of 0.6% y-o-y. Similarly, low-end offices recorded a marginal increase of 0.1% whereas the mid-end segment recorded a price decline of 4.3% for the same period.





OFFICE SECTOR INDEX **SOURCE** SAVILLS RESEARCH

Retail Market

The retail sector was in a period of transformation globally before COVID-19 due to various socio-economic trends and technological advancements. We highlighted the level of disruption to the sector in our recent global reports such as the IMPACTS and Repurposing Retail. With the restrictions imposed on social interactions during the early stages of the pandemic, disruption in retail reached new heights. Several retailers who were already underperforming before the pandemic have been forced to shut shops. Whereas others adapted to create a flexible omni channel retail model which will have a longer-term positive impact on the sector.

While the increase in online shopping has not reached the level of market penetration as other mature markets, it is still having a large impact on the Bahrain retail market. Over the past year, we have noted considerable increases in vacancy rates in prime assets which have enjoyed extended periods of full occupancy such as City Centre Bahrain which now has a reduced occupancy.

While retailers have worked hard to adapt their business models, the loss of footfall has had an undeniable impact. Even as retailers reopen their doors, it may take some time for consumer confidence to return to pre-COVID-19 levels.

Landlords have responded in various ways to assist and alleviate the stress on their retail tenants, with varying degrees of support. We have recommended a pragmatic approach to conversations between landlords and tenants, and where possible advised necessary support, which should ultimately safeguard businesses and stakeholders.

We have witnessed downward pressure on retail rents across Bahrain as supply and demand reach a new level of imbalance. In recent years, there was a flurry of retail development which has led to landlords trying to attract the same pool of tenants by offering incentives such as one-year rent-free and large contributions to fit-out costs. However, retailers are putting expansion plans on hold largely due to the lack of demand and other associated costs.

There may well be a shift towards more community and convenience-based retail. These concepts are currently proving popular with the quick take up of spaces in the new developments of District 1 in Hamala and Janabiyah Square. Further increases in e-commerce and a proportion of discretionary spend on leisure experiences will lead to a change in the way in which we use space. Landlords will be looking at how they may have to adapt. Converting retail into engaging leisure 'experiential' options is one possibility. Rebuilding it as an office or residential space is another. In Australia, for example, mall owners including Vicinity and Scentre are converting shopping centres to incorporate offices, hotels, apartments, transport hubs and even childcare to create an 'all of life' destination. The oversupply of retail in most cases mirrors an exponential rise in internet retailing. The adaptation is not only restricted to the physical spaces but also the rental models being offered by landlords and developers. We have noted an uptick in requests for turnover rents although there is still some resistance from occupiers not wanting to provide full access to their Electronic Point of Sale (EPOS) Systems to their landlords.

We have seen pro-active landlords in Bahrain adopt this approach such as Dana Mall in Sanabis who moved out all tenants except for the hypermarket to make way for a complete renovation including major structural changes. Other landlords are using this time to focus on working with and retaining current tenant relationships.

"Spill over demand from growth in e-commerce and food security driving warehousing demand"

Where the looming global uncertainty has impacted other commercial sectors, resulting in activity being put on hold, industrial / warehousing assets have proved to be more resilient, with an increased demand from tenants by comparison. The industrial sector is set to benefit in the post-COVID-19 era from the exponential increase in demand for online retail services, making it a stable and secure investment asset class.

Regardless of the state of the economy, consumers still spend on food, and with an increasing awareness around food security, cold storage facilities will be in high demand. There is significant appetite for high-quality warehouses. The e-commerce sector has essentially been fast tracked, with the grocery and non-discretionary sector proving strong. A combination of shoppers wanting to shop online as well as supply chain risk, and suppliers wanting greater certainty and holdings of stock, have led to an increase in demand locally.

Outlook

Long Term Real Estate Adjustments

The pandemic may lead to permanent lifestyle changes on many which may have a knock-on effect on the property market. We include a selection of changes we believe will happen over the long-term:

INCREASED

1. Working from home
2. A higher standard of living
3. For apartment projects, increased demand from occupiers to provide recreational space
4. Increased demand for home offices/ studies and larger properties
5. Increased leisure time
6. Collective family living supported by social media/internet
7. Increased reliance on web services for purchases and support to staff working from home office
8. The attractiveness of Bahrain as an entry point for international companies

DECREASED

1. Commuter times and distances
2. Demand for central urban retail and office space
3. Spending on landmark projects space
4. Demand and need for sprawling office suburbs
5. Spending on commercial property
6. Rents and values with consequential declining taxation revenues

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RESIDENTIAL MARKET

1. The residential sale market will experience a further slowdown
2. The supply/demand imbalance is set to worsen as further supply comes online mainly for apartments
3. An increased working from home culture will lead to home offices/ studies rising in the desires of prospective tenants
4. Developers and landlords alike will need to offer further incentives to attract buyers and tenants alike

OFFICE MARKET

1. High-end rents to remain stable for the remainder of the year
2. Downward pressure in the mid to low-end segment to continue
3. Demand to remain subdued in the short-to-medium term
4. Smaller units to remain most popular as businesses look to downsize

RETAIL MARKET

1. Letting periods to extend as tenant pool reduces
2. Occupancy rates under stress as some retailers fall victim to the pandemic
3. Landlords will have to readjust rental rates as shopping behaviours alter
4. Footfall is not likely to return to pre-pandemic levels until mid-2021

Savills Middle East

Working alongside investors, developers, operators and owners, we inject market insight and provide evidence-based advice at every stage of an asset's lifecycle. We have unrivalled reach across the Middle East with extensive market experience in UAE, Bahrain, Oman, Egypt and KSA.

Savills Market Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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