Post-pandemic plans for concrete recovery

Prospects for the Dubai real estate and hospitality sectors

July 2020
The Covid-19 pandemic is proving an enormous challenge for our societies and healthcare systems; the consequences for the global and local economies are both unprecedented and unpredictable. Many economists are convinced we are heading for a significant economic downturn and remain unsure as to how long a recovery will take. However, responses from governments and regulatory bodies have been prompt. In the UAE, at the federal and emirate levels, a variety of measures have been taken to support the economy and its citizens.

Based on KPMG’s experience in the real estate and hospitality sectors, and conversations with stakeholders, we have analyzed the current situation. As a product of our research, this document seeks to offer insight into the challenges faced within the residential, office and mall segments of the real estate market, as well as the hospitality industry.

We would like to thank those who provided invaluable insight, while rising to the challenges we are all currently experiencing.

Please feel free to contact us with any comments or queries.

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EXECUTIVE SUMMARY

Although felt by all, the impact of Covid-19 varies by segment. Businesses that are more heavily reliant on travel and human interaction are the hardest hit, while those which are indispensable (for example, pharmacy and food retail) and/or aid business continuity (for instance, essential services) are relatively resilient.

- A significant reduction in personal and business travel is impacting the sector with occupancy and revenue per available room severely affected. While some locations have closed, other have opted to promote staycation packages in order to cut losses.
- Hotel operators in Dubai believe that their FY 2020 revenue may contract significantly.
- A key component of the local economy and lifestyle, bricks-and-mortar retailers have been heavily impacted, as consumers turn to e-commerce. Some stakeholders have attempted to use technology to remain connected to their customers.
- Certain sectors have been able to adapt, such as food and grocery delivery, and even cinemas: drive-in movie theaters were established as a result of social distancing protocols.
- Increased acceptance and promotion of remote working is expected to become a permanent feature of corporate culture in the future.
- Softening of the residential sales and rental markets is expected to continue.
- Future handovers will be impacted by the duration of the pandemic, buyer sentiment, easing of restrictions and supply chain issues.
- The Central Bank of the United Arab Emirates’ incentives include a 5% increase in the loan-to-value ratio for first-time home buyers and a 50-basis point reduction in the benchmark interest rate. It is hoped that these measures will spur market activity. Major developers are also offering attractive payment plans for properties sold off-plan, enabling buyers to pay a minimal down payment during construction.

- How deeply the sector is affected will largely depend on travel restrictions and traveler sentiment. Hotel operators, the airline industry and governments will play a key role in re-establishing confidence.
- As the weather gets warmer and most people refrain from travel in the near future, the immersive Dubai shopping mall experience may again become a key part of daily life for residents, assuming consumers are positive about being with large crowds.
- Dependent on the sector, some businesses will likely require less dedicated space per head due to a shift towards hot-desks and remote working. This may be balanced out by social distancing requirements (externally or internally imposed) in the short to medium term.
In the Gulf, revised real GDP growth projections show decline across all markets for 2020, with a likely resurgence in 2021. Economic revival is, however, dependent upon a number of factors, including when and how restrictions are lifted and general sentiment among travelers as these will directly affect the real estate and hospitality sectors.
Real GDP growth projections (April 2020)

<table>
<thead>
<tr>
<th>Country</th>
<th>2019 GDP</th>
<th>Projected 2020</th>
<th>Projected 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAE</td>
<td>1.3</td>
<td>-3.5</td>
<td>3.3</td>
</tr>
<tr>
<td>Oman</td>
<td>0.5</td>
<td>-2.8</td>
<td>3.0</td>
</tr>
<tr>
<td>KSA</td>
<td>0.3</td>
<td>-2.3</td>
<td>2.9</td>
</tr>
<tr>
<td>Kuwait</td>
<td>0.7</td>
<td>-1.1</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Note: As of 30 June, the IMF revised its GDP forecast for the GCC, predicting a 7.6% contraction for 2020. This is compared with April’s forecast of a 2.7% downturn in the region.


Globally, air traffic fell 90% due to widespread lockdowns and border closures and tourism numbers are expected to decrease by 60-80% in 2020. According to an International Air Transport Association (IATA) survey, 40% of potential passengers do not plan to travel for at least six months (as of April 2020). In the UAE, this could have a significant impact on the economy, as aviation and tourism account for 13% of GDP. At the date of publication, Dubai plans to reopen to tourists by July, and health precautions will be central to the government’s phased approach.

Returning to travel after containment announcement

<table>
<thead>
<tr>
<th>Waiting Period</th>
<th>February survey</th>
<th>April survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not wait at all</td>
<td>22%</td>
<td>18%</td>
</tr>
<tr>
<td>Wait 1 month</td>
<td>45%</td>
<td>47%</td>
</tr>
<tr>
<td>Wait 6 months</td>
<td>23%</td>
<td>24%</td>
</tr>
<tr>
<td>Wait 1 year</td>
<td>7%</td>
<td>4%</td>
</tr>
<tr>
<td>Not travelling for the foreseeable future</td>
<td>3%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: International Air Transport Association (IATA) April 2020 survey

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</table>

Source: International Air Transport Association (IATA) April 2020 survey

Fluctuations in oil prices and economic indicators

A plunge in global oil prices is exacerbating the economic strain – particularly among members of the Gulf Cooperation Council (GCC). Given a certain dependency on oil in the region, fluctuations in supply and demand are a major concern. Prices plummeted due to falling global demand and rising supply, which in turn triggered a breakdown of the OPEC+ agreement in March 2020. As oil exports may decline by more than USD 250 billion, budget deficits could exceed 10% of GDP in countries across the region.

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Brent crude oil price (USD)

Source: International Air Transport Association (IATA) April 2020 survey

<table>
<thead>
<tr>
<th>Month</th>
<th>Brent Crude Oil Price (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
<td>60</td>
</tr>
<tr>
<td>Feb</td>
<td>55</td>
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<tr>
<td>Mar</td>
<td>50</td>
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<tr>
<td>Apr</td>
<td>45</td>
</tr>
<tr>
<td>May</td>
<td>40</td>
</tr>
<tr>
<td>Jun</td>
<td>35</td>
</tr>
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</table>

Source: MacroTrends

Note: As of 30 June, the IMF revised its GDP forecast for the GCC, predicting a 7.6% contraction for 2020. This is compared with April’s forecast of a 2.7% downturn in the region.

### Fiscal breakeven oil prices (USD per barrel)

<table>
<thead>
<tr>
<th>Country</th>
<th>Projections</th>
<th>Fiscal breakdown oil price¹</th>
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</thead>
<tbody>
<tr>
<td><strong>UAE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>62</td>
<td></td>
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<tr>
<td>2018</td>
<td>64.1</td>
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<tr>
<td>2019</td>
<td>67.1</td>
<td></td>
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<tr>
<td>2020</td>
<td>69.1</td>
<td></td>
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<tr>
<td>2021</td>
<td>60.6</td>
<td></td>
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<tr>
<td><strong>KSA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>83.7</td>
<td></td>
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<tr>
<td>2018</td>
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<td></td>
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<tr>
<td>2019</td>
<td>82.6</td>
<td></td>
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<tr>
<td>2020</td>
<td>76.1</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>60.0</td>
<td></td>
</tr>
<tr>
<td><strong>Kuwait</strong></td>
<td></td>
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<tr>
<td>2017</td>
<td>45.7</td>
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<td></td>
</tr>
<tr>
<td>2020</td>
<td>61.1</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>60.3</td>
<td></td>
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<tr>
<td><strong>Oman</strong></td>
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<td></td>
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<tr>
<td>2019</td>
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<tr>
<td>2020</td>
<td>86.8</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>79.8</td>
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</tbody>
</table>

1. Kuwait’s fiscal breakeven oil price in before compulsory 10 percent revenue transfer to the Future Generations Fund including investment outcome.
2. The oil price at which the fiscal balance is zero.

### Stimulus measures

**The Emirate of Dubai**

- The Government of Dubai’s economic stimulus package (AED 1.5 billion) seeks to enhance liquidity and cushion the potential impact of the current economic situation. As of May 2020, the package included various initiatives aimed at reducing the cost of doing business and simplifying procedures – especially in the commercial, retail, external trade, tourism and energy sectors.

- **Actions include:**
  - 10% reduction in water and electricity bills, including those charged in the residential, commercial and industrial sectors, for a period of three months
  - Reduction of municipality fees imposed on sales at hotels by 50% for 90 days
  - A refund of 20% on customs fees imposed on imported products sold locally in Dubai markets
  - Commercial licenses can be renewed without mandatory renewal of lease contracts

**The Central Bank of the United Arab Emirates**

- The CBUAE’s economic stimulus package (AED 250 billion) includes measures that aim to help the real estate and hospitality sectors (among others):
  - AED 50 billion from the Central Bank’s funds through collateralized loans at zero cost to all banks operating in the UAE
  - AED 50 billion of funds freed up from banks’ capital buffers. Banks can use the funding to grant temporary relief to private sector corporate customers and retail clients for a period of up to six months

- **Actions include:**
  - Municipality fees imposed on sales at hotels are reduced from 7% to 3.5%
  - Companies are exempted from fees charged for postponement and cancellation of tourism and sports events scheduled for the year 2020
  - Freeze on fees for the rating of hotels
  - Halt to fees charged for the sale of tickets, issuance of permits and other government fees related to entertainment and business events
  - Companies will be exempted from permits for new sales and offers
  - Cancelation of the 25% down payment required for requesting installment-based payment of government fees
  - Reducing the amount of capital banks have to hold for their loans to small and medium-sized enterprises (SMES) from 50% to 25%
  - Increasing the loan-to-value (LTV) ratios applicable to mortgage loans for first-time home buyers by 5 percentage points. Currently LTVs stand at 75% for non-UAE nationals and 90% for UAE nationals
  - Increasing the maximum exposure that banks can have to the real estate sector from 20% to 25%, contingent on holding more capital

**Source:** IMF
This year, the sector has experienced a significant drop across multiple indicators. According to a Dubai Chamber of Commerce & Industry report, 96% of real-estate businesses surveyed experienced a decrease in sales/turnover in Q1 2020. Looking ahead to Q2, 62% expect an additional decline of 75% or greater, compared with Q1 2020.7

Changes to the share prices of real estate companies listed on the stock exchanges in the UAE also highlight the impact of Covid-19. During the period of 20 February 2020 to 18 March 2020, their share prices witnessed a decline of 23% to 49% before experiencing a gradual upswing. Comparing Q1 2020 results with Q1 2019, combined profitability of Aldar, Damac and Deyaar declined by 64%.

Real estate is considered an essential sector, given its contribution to Dubai’s GDP, a total of 7.4% in H1 2019. The emirate’s real estate sector witnessed year-on-year growth of 2.1% in the first half of 2019, compared to the same period in 2018.6

Daily share prices

Source: Investing.com
In 2019, close to 35,000 residential units were delivered in Dubai, bringing total stock to 555,000 units – a record year. Completed projects included those executed by Emaar in Downtown, Dubai Creek and Dubai Hills. Residential supply in the emirate is expected to reach 671,000 units by 2021, even taking into account the economic crisis induced by the pandemic.

Source: JLL

In terms of transactions, the Dubai market witnessed a 22% year-on-year increase in residential sales in 2019. Off-plan sales comprised 60% of overall transactions and enjoyed a 34% increase over 2018, while the volume of ready property transactions was up by 8%. Flexible payment plans, lower prices and various government measures attracted investors and end-users.

Source: JLL

Although 2019 was a record year for deliveries, Dubai’s residential market continued to face headwinds and subsequent rent softening. Apartment sales prices and rents declined by 5% and 8% year-on-year, respectively. Villas witnessed a decline in sales prices and rent by 11% and 7% respectively, compared to 2018. Sales prices were down by over 27% in 2019 as compared to 2014 levels. Rental yields, however, continued to be attractive: at the end of 2019, apartments and villas provided a yield of 6.9% and 5.5%, respectively.

Over the past several years, Dubai’s residential market has been over supplied. The government has taken steps to address the issue, overseen by the Higher Committee of Real Estate. Based on these measures, it is possible that a substantial number of new projects, scheduled for launch in 2020, will be postponed.
COVID-19 IMPACT
The emirate’s residential supply continues to grow, despite softening market conditions. The pandemic significantly disrupted transactions at the end of Q1 2020. Attractive prices and terms, however, may prompt residents and stakeholders to explore investment opportunities.

Sales transactions and rent pressure
High sales transactions in 2019 carried over into 2020, as Dubai-based developers offered attractive payment plans with the aim of turning tenants into owner-occupiers, and banks offered competitive interest rates. As a result, there was a 10.4% increase in the number of sale transactions registered in Q1 2020 compared with the same period last year.

While the number of transactions increased, sales and rental prices (apartments and villas) declined by 1.5%-2.4% and 1.4%-1.8%, respectively, in Q1 2020. The trend of softening prices – witnessed over the past few years – is expected to continue through 2020 due to Covid-19. Therefore, we expect Dubai to remain a buyers’ and renters’ market.

Number of real estate sales transactions

In the current environment, uncertainty looms among both investors and end-users. As a result, the residential market will continue to face a period of contraction in terms of volumes and prices.

Starting in April 2020, the emirate’s lockdown and sanitization drive significantly restricted movement and the number of registered sales transactions dropped by 42% in April. In June, sales have picked up marginally. Both value and volume were higher compared with April and May. As per JLL, over 12,000 residential units were delivered in Q1 2020 in Dubai. While delivery of 83,000 units was expected in 2020, a delay in handovers is anticipated. Deliveries will be impacted by the duration of the pandemic, buyer sentiment, easing of restrictions and supply chain issues affecting contractors’ ability to execute projects according to schedule.

Incentives announced by the CBUAE in March include a 5% increase in the LTV ratio for first-time home buyers and a reduction in the benchmark interest rate by 50 basis points. It is hoped that these measures will help to spur market activity to an extent. Economic contraction due to the pandemic will largely result in a ‘wait and watch’ approach among buyers. This is partially attributable to pressure on disposable income.

On the rental side, some tenants may look for better-quality assets at reduced rates and may, therefore, choose to relocate. Conversely, tenants affected by salary reductions and job cuts are likely to be looking to downsize and move to more affordable locations. This will increase vacancies in affected properties and apply additional downward pressure on market rents.

Mortgages
Dubai’s mortgage market performed well in Q1 2020, as the number registered increased by an impressive 104% compared with Q1 2019. This was followed by a 60% drop between March and April 2020 – mainly as a result of Covid-19.

Number of mortgages registered

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Leveraged capital structures
Developers with significant debt may be particularly at risk of default and struggle to maintain liquidity if their working capital management is not sound. Balance sheets with significant exposure to financing and payment commitments in the short-term will be especially vulnerable. There may be a potential mismatch between cashflows and outstanding commitments, due to the current economic environment.

As a result, immediate negotiation between developers and lenders – with the aim of utilizing CBUAE measures – will be key. Dividend payments should also be considered. For example, one of the entities listed on Dubai Financial Market has not proposed dividends against its 2019 financial results. Developers will need to carefully manage shareholders’ expectations and cash flow for the remainder of the year.

Projects under construction
While construction has continued, the pace has slowed due to various Covid-19-related safety measures. The pandemic has posed various challenges not only to developers, but also to contractors as cash flows and margins were already strained. Any potential project delays will further impact contractors’ execution cost, in addition to supply chain disruption, enhanced safety costs and reduced productivity.

Developers will need to carefully manage obligations, as there is an expectation that contractors will now have to enter price renegotiations. However, it is unlikely that many will agree, due to low margins and existing commitments to sub-contractors. Some contractors are also of the view that delays in contractual completion of projects may result in claims and litigations, if not settled amicably. In the current market environment, it would not benefit either party to begin protracted negotiation of claims and counterclaims. It is in developers’ best interest that contractors survive the current crisis. Without financially-sound contractors, successful project execution would become difficult.

Risk of default
Post 2008, the Government of Dubai established measures to regulate the property market, establishing clear guidelines on repossession of units in case of default. In addition, regulations regarding execution and delivery apply to developers.

In the current market environment, risk of default by homeowners may well increase. Developers may need to take proactive corrective measures to ensure they do not end up with reposessed units due to default, leading to inventory pile up. Homebuyers may, on a case-by-case basis, require support from developers, including deferral of instalments and non-levy of interest, which would ultimately enable them to meet their payment commitments.

Developers may also need to consider best-fit business strategies for the long term. While offering attractive payment terms with single-digit down payments may increase sales in the short term, such an approach could lead to heightened risk of default. It may be difficult to judge a buyers’ financial position based on a plan with an extremely low down payment.
The effect of the coronavirus on the working environment cannot be overstated. In January this year, it would have seemed unimaginable for large numbers of employees to be working from home. The pandemic could change not only how offices are used, but also the whole dynamic of commercial real estate in the UAE.

The office market in the UAE remained under pressure in 2019, as demand for space was subdued. Landlords sought to address this by offering competitive terms, including rent-free periods, early exit clauses and reduced lease rates to manage and increase occupancy, as tenant retention is a factor in sustaining long-term revenue.

Commercial working space supply in Dubai is expected to increase to 9.18 million m² by 2021 (5% growth from 2019), according to JLL. Prominent new projects include office blocks in ICD Brookfield in DIFC and Mashreq Bank in Downtown. Softer market conditions have prompted some tenants to consider relocating, potentially upgrading. As a result, pick-up of new space may be driven by relocation, rather than new entrants to the market. This will likely continue to put pressure on existing office stock in the medium term. In 2019, the vacancy rate increased to 14% and average office rent decreased 13% to AED 1,358 per m² annually.

Commercial working space GLA (m² millions) In recent years, the UAE government has undertaken a number of initiatives with the goal of attracting businesses, generating employment and spurring demand for office space. These include long-term visas, reduced costs and changes in ownership laws for companies. However, Covid-19 has added unexpected variables to the market situation.

The future of work Remote and/or working from home (WFH) practices have become dominant during the Covid-19 crisis. In the UAE, since the latter half of March 2020, most employees began either working from home or in small groups at alternative locations. The sudden onset of Covid-19 provided little time to adopt the infrastructure necessary to support this large-scale shift.

Fortunately, many public and private sector entities in Dubai have embraced digitalization and invested heavily in automation. Therefore, the transition to WFH was relatively smooth for many – operations and customer servicing was largely uninterrupted. For companies which had not previously invested in technology, the pandemic has forced management to re-evaluate their IT strategy. Digital transformation is no longer an option – it has become a critical business need.

On the back of WFH practices, many companies are realizing that, given the right technology, not all employees need to work in an office full-time. Some businesses are analyzing their existing office footprint to determine how much space will be required in the future, which may impact lease arrangements. Although large-scale WFH policies could be an interim arrangement for some, they may have a far-reaching impact on future utilization. The near-certain shift from physical to digital is an industry-defining moment for the office sector. As Dubai-based businesses gradually return to their offices, companies are ramping up employee safety measures, including adequate spacing between workstations. While short-term precautions require certain protocols (including lower occupancy, supported by WFH policies), the medium-term, post-Covid-19 reality of working will likely include a reduced number of employees per square meter. Organizations will also need to think about flexible and collaborative space planning. This may entail limiting access to office space, potentially restricting occupancy to client meetings and other, similar events.

It is important to note that the WFH concept may not be sustainable for all industries. For example, client-facing staff and businesses are likely to continue working primarily from offices. Additionally, there may be psychological effects of WFH, as some staff feel isolated, which can have an impact on productivity. Conversely, other employees may find themselves to be more productive for a variety of reasons. There is no one-size-fits-all solution: each organization must determine its own requirements and adapt accordingly.
Rent and occupancy

The immediate impact of the pandemic is being felt by organizations, some of which are re-thinking their expansion plans. This may result in reduced demand for leases in the short-term, as businesses ‘wait and watch.’ The market will likely see a fall in leasing activity as a result. Some landlords are finding that when tenants are renewing leases, they are requesting reduced leasable area due to downsizing. Landlords also believe that tenants will push hard for rent reduction while renewing leases, as businesses look to cut costs wherever possible.

Short-term leases may become more vulnerable as some companies look for more favorable terms and alternative options. Landlords, including entities owned by the Government of Dubai, have been proactive, engaging with tenants and offering short-term support. This will help to ensure tenant retention while long-term occupancy and income is protected. Several free zones and landlords in the UAE announced support measures in the form of rent freezes, abatement and deferment.

Although businesses will continue to require office space, price and quality will be key determining factors going forward, as organizations face considerable economic pressure in the short to medium term. The pandemic has created greater awareness of increased safety and hygiene in the work environment. This will further encourage tenants to demand improved facilities, greener and open spaces and improved building infrastructure. Older buildings which cannot offer improved facilities may suffer higher vacancy risks and rental pressures.

The pandemic has created greater awareness of increased safety and hygiene in the work environment.
SHOPPING MALLS

The UAE’s malls are not only a key component of the local lifestyle and tourism experience, but also make a substantial contribution to GDP. Across the emirates, retail GLA has increased year on year and, pre-Covid-19, was expected to further expand with several large malls under construction. Dubai’s total GLA is forecast to be 5.43 million m² by 2021 (up 35% from 2019), according to JLL.

Shopping mall GLA

As a result of various factors, the UAE retail market has faced challenging times: bricks-and-mortar expansion has slowed, and stores have been consolidated to increase operational efficiency. Mall rentals witnessed year-on-year decreases in 2019. As a result, landlords offered rental discounts, depending on the location and type of mall.

In 2019, average vacancy in Dubai malls was approximately 20% (up from 18% in 2018), while average rents have decreased by 14% to 23%, according to JLL. Malls with lower turnover have been impacted most severely. Landlords have offered various incentives, including rent-free periods, to support retailers, reduce vacancy rates and maintain or increase footfall.

Online shopping has grown significantly over the last few years, and the UAE boasts the highest e-commerce sales in the Middle East, estimated at USD 16 billion in 2019. Despite challenges, including the growth of online platforms, it is evident from the current GLA that the UAE market continues to be concentrated in bricks-and-mortar locations. Most malls are destinations, providing a variety of entertainment options, as well as shopping. However, as online options are often cheaper, easier and faster, the traditional shopping mall experience will need to evolve to meet ever-changing consumer behavior and co-exist with e-commerce concepts.

Evaluating future GLA supply in the UAE, existing assets appear to be under pressure. To a certain extent, large malls will likely continue to attract demand as tourism, shopping and entertainment destinations. Malls without entertainment offerings (cinemas or children’s play attractions) or access to public transport may struggle to compete, however.

COVID-19 IMPACT

The retail sector witnessed a significant downturn due to Covid-19 restrictions. On 25 March 2020, the UAE announced the closure of malls, in line with preventive measures declared by the Ministry of Health and Prevention and the National Emergency Crisis and Disaster Management Authority. All non-essential businesses were instructed to remain closed, except grocery stores, supermarkets, cooperative societies and pharmacies.

On 23 April, the Government of Dubai permitted malls, high-street shops, souqs and wholesale outlets to operate at 30% capacity for 10 hours a day. Certain amenities, such as cinemas, common prayer rooms, changing rooms and family entertainment, remained closed.

As of 27 May, the Emirate of Dubai further eased restrictions on personal movement and business operations allowing 50% capacity. As of 18 June, the majority of restrictions have been lifted.

The overall response to Covid-19 is fundamentally changing retailers’ operational reality. This experience will likely have a dramatic and long-term impact on how consumers access, shop, dine and entertain in malls. In addition, travel and working restrictions will likely result in heightened operational and financial risks in the short to medium term, including business continuity, cash-flow management and health and safety requirements, among others.

As malls reopen, they are entering new territory. Many economists agree that, even in the recovery phase, retail spending is likely to be significantly depressed. Spending within the retail sector will likely flow through digital channels, as e-commerce adoption accelerates.
In summary, the retail sector, due to increased supply across the UAE alongside an evolving e-commerce market, faced headwinds. Although Dubai’s 2019 tourist numbers were healthy (it was the fourth most visited city, globally), a strong dollar continued to dampen tourist spending patterns and therefore strained the retail market.

**Footfall: what is the new normal?**

As malls restart operations, it will be a substantial challenge to attract pre-Covid-19 levels of footfall in the short to medium term. Thus far, it appears that a portion of consumers do not feel comfortable visiting crowded spaces including, physical stores. In China – where stores opened in mid-March – anecdotal findings suggest that retail foot traffic may be down by as much as 50% compared with last year. It is advised that retailers and mall owners work together to win consumer confidence by maintaining optimum hygiene and safety standards, as prescribed by government directives.

For the past few months, most retailers have been forced into a reactive position: initially responding to the crisis, working to stabilize the business and establishing resilient day-to-day operations. With malls across Dubai now operating at near-full capacity, footfall is expected to gradually rise as residents gain confidence. As the weather gets warmer and many people choose to avoid overseas travel, this is expected to increase.

However, the absence of tourists, due to current travel restrictions, will hinder growth in footfall and retail sales in the summer months. Spending pattern is also critically important, considering Dubai is a hub for luxury fashion, jewelry, watches and accessories. Current consumer sentiment has resulted in reduced spending, which has negatively impacted revenue for both mall owners and retailers.

In our view, mall owners will need to continue to work with retailers in the current crisis, as many are starting to think about ‘next steps.’ The immediate recovery phase includes refining and activating roadmaps after initial reopening. In parallel, retailers should also consider the next phase – the ‘new reality’ – and how they will adapt. As a result, some will require support from mall owners in the medium term.

**Vacancy costs: potential increase**

Despite reopening and various support measures provided by mall owners, some retailers will possibly postpone new store openings and expansion plans. It is likely that such measures will become more widespread if footfall remains stagnant, particularly given the anticipated dearth of international tourists. This risk is likely to be more acute for smaller retailers, who may not have the size or scale to navigate the crisis. Almost all (96%) of operators in the wholesale and retail trade industry experienced a decrease in turnover in Q1 2020 and 65% stated they expect to go out of business in the next six months, according to a survey conducted by the Dubai Chamber of Commerce & Industry. While dependence on residents’ spending power will significantly increase (due to lower visitor numbers), their inclination to save more as an outcome of ongoing uncertainty, will likely impact purchasing power in the short term. In the current circumstances, it is critical for retailers to carefully manage operating costs in order to compensate for reduced footfall, which could otherwise increase vacancy costs for mall operators.
Cash-flow management
Many retailers have requested a review of existing rental agreements. A majority of rent payments due during the shutdown period are being deferred as part of a “temporary waiver,” depending on how long business is suspended/reduced. Various mall operators have come forward with packages to provide rent relief. For example, Majid Al Futtaim, Meraas, Aidar, Al Futtaim and Nakheel have already announced their support schemes. Emaar Malls has also released policies to support affected tenants, including turnover (or percentage) rent. Some retailers have requested support beyond the shutdown period and are renegotiating rental agreements, as it will take time for the market to pick up again. Tenants’ cheques due in March and April have been deferred for one quarter by some operators to help retailers manage cash flow.

Supporting retailers is critical in the current circumstances. Relief measures, in combination with the challenges in achieving optimum footfall, will have an impact on mall operators’ liquidity. Short- to medium-term commitments, covenant compliance and credit ratings will likely come under pressure as operating cash flows are strained due to rent abatement, deferral and significant reduction in turnover rent. Expo 2020 was expected to result in increased footfall and abatement, deferral and significant reduction in turnover rent. Under-construction shopping malls: back to the drawing board?

Several malls are under construction, including Dubai Hills Mall, Meydan One and Al Khail Avenue. The feasibility of some projects will likely be revisited, which could result in delayed construction and phased openings. In addition, owners of malls still under construction will likely face renegotiation of lease terms and increased lead time to sign new leases, creating a period of uncertainty. The feasibility of some projects will likely be revisited, which could result in delayed construction and phased openings. Large malls under construction in Dubai include Dubai Hills Mall, Meydan One and Al Khail Avenue.

Health and safety costs
Employee and customer health and safety is a key priority. The related costs are expected to increase due to additional measures either required by the authorities or voluntarily adopted by mall owners. Malls and shopping centers will require around-the-clock cleaning and sanitation. This includes items which have been tried by consumers, such as clothing and jewelry. There are also temperature checks, provision of masks and hand sanitizer and physical distancing requirements. Restaurants and cafes are required to place tables at least six feet apart (or provide screens), to maintain social distancing, and are temperature checks, provision of masks and hand sanitizer and physical distancing requirements. Restaurants and cafes are required to place tables at least six feet apart (or provide screens), to maintain social distancing, in Dubai. Similar precautions are also required in cinemas. Such provisions will have an impact on short and mid-term profitability.

Under-construction shopping malls: back to the drawing board?

Over the years, Dubai has been recognized as a global retail destination. However, contraction of the regional economy due to the pandemic, poses challenges to future growth of the retail market, especially bricks-and-mortar establishments. This is exacerbated by the fact that Dubai’s retail GLA per capita is one of the highest in the world, at 1.21 m². As such, brands risk cannibalizing their own territories in the UAE. Large malls under construction in Dubai include Dubai Hills Mall, Meydan One and Al Khail Avenue.

Although work at a number of sites is progressing, activity has been slowed due to additional labor force safety measures. Any protracted slowdown in construction activity will have a significant impact on contractors’ ability to complete projects on time and without additional cost, in the form of extension-of-time claims to the owners. This will be a critical element, as owners decide to postpone capital expenditure (capex) and/or reduce capital outflows, while also ensuring project costs do not increase.

Shifting consumer preferences
Few (if any) businesses factored the possibility of a pandemic into their business continuity plans (BCP). This is unknown territory for all – the scale and duration of the pandemic’s impact are still unknown. The Covid-19 outbreak has changed the mindset of many UAE shoppers, who traditionally preferred the bricks-and-mortar experience. Due to restricted movement and limited access to stores, dependence on online channels has significantly increased since March. Case in point: Carrefour in the UAE witnessed a 400% increase in online orders and a 59% increase in new customers to its platform.14 As a result, some mall-based stores have explored alternative ways to sell and distribute. For instance, cinema closures did not stop Vox from selling movie snacks to customers via home delivery, while also opening a drive-in cinema at Mall of the Emirates. Likewise, Dubai Mall established a virtual online presence, featuring merchandise from various retailers. The app’s virtual mall atmosphere may help businesses mitigate some losses incurred and also maintain customer loyalty. Mall of the Emirates also launched a new online shopping platform called ‘Trends at Your Doorstep’, which offers merchandise from the mall’s fashion, beauty and luxury brands.

While some operators and retailers are able to shift offerings to online platforms, this is not an option which has been adopted by all. Businesses will need to re-evaluate how they can best navigate the co-existence of bricks-and-mortar operations with e-commerce offerings.
The hospitality sector, a segment of travel and tourism (T&T), is critical to the UAE's economy, given not only its contribution to GDP (approximately 5% in 2019), but also to overall employment (roughly 10%). Underscoring this figure, the city of Dubai ranked third in the world for international tourism spending in 2019 (approximately AED 102.47 billion). Business travel comprises a large segment of the UAE’s T&T revenue. Meetings, incentives, conferencing and exhibitions (MICE) contributed more than AED 20 billion to the Dubai economy in 2019.

Last year, a total of 16.73 million international guests visited the Emirate, a 5% year-on-year increase. India, Saudi Arabia and the UK were the top three source markets, contributing 28% of total visits.
While China is the fourth largest source market, the segment has witnessed profound growth over a five-year period, with a compound annual growth rate (CAGR) of 23%. Russia exhibited the second-highest CAGR (12%) over the same period.

Certain key factors drive growth among these emerging source markets:

- Relaxed visa requirements, such as visa on arrival for Chinese and Russian nationals
- Introduction of additional and direct airline routes to China and Russia
- Government initiative ‘Hala China’ aimed at attracting Chinese visitors

Dubai’s future key tourism growth markets will likely continue to shift towards the East – in particular, welcoming visitors from the Indian subcontinent, China and Russia (including the wider Confederation of Independent States).

In addition to a shift in source markets, Dubai’s T&T sector has experienced a change in spending patterns. Whereas 10-15 years ago visitors tended to wield substantial spending power, today’s visitors’ spending patterns increasingly lean toward the mid-market segment. Given the shift in demographics, as the volume of tourists visiting Dubai increases, spend per capita will likely decrease.

Supply
The Emirate of Dubai holds the majority of room keys in the UAE. In 2019, the sector faced room-rate challenges, despite relatively stable occupancy and an increase in room keys. Noteworthy new openings in 2019 included the Waldorf Astoria DIFC, Address Fountain View, Mandarin Oriental, Taj JLT and Avani Ibn Battuta. Hotel supply in the emirate is expected to grow in 2020, adding 24,000 room keys, to reach a total of 151,000. Upcoming openings include the Royal Atlantis in Palm Jumeirah and the Artesia in Damac Hills.

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**Key nationalities traveling to Dubai, 2014-2019 (‘000s)**

<table>
<thead>
<tr>
<th>Country</th>
<th>2014</th>
<th>2019</th>
<th>% of total visitors</th>
<th>CAGR (2014-19)</th>
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</thead>
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<tr>
<td>India</td>
<td>1,272</td>
<td>1,870</td>
<td>12%</td>
<td>9%</td>
</tr>
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<td>KSA</td>
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<td>1,565</td>
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<td>4%</td>
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<td>989</td>
<td>6%</td>
<td>23%</td>
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<td>1,030</td>
<td>6%</td>
<td>38%</td>
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<td>USA</td>
<td>587</td>
<td>867</td>
<td>4%</td>
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Source: Dubai Tourism 2019: Performance Report
COVID-19 IMPACT

The T&T sector is among the hardest hit by the pandemic. Industry stakeholders face multiple significant hurdles: oversupply, decreasing room rates, postponement of major events, travel restrictions and consumer sentiment, leading to severe liquidity issues.

According to the UN World Tourism Organization, 96% of all worldwide destinations introduced travel restrictions in response to Covid-19.22 In addition, many international events have either been postponed or cancelled, including the Tokyo Olympics, Wimbledon, the Dubai World Cup and Expo 2020 Dubai. As a result, the T&T sector is projected to shed 100.8 million jobs; the segment is forecast to lose 30% in output value (USD 2.7 trillion), worldwide.23

Dubai’s hospitality market has borne the brunt of event cancellations and restrictions. Occupancy rates were relatively healthy in January and February, at 84.6% and 77.1% respectively, according to STR. However, travel restrictions shrank average occupancy in May to 27.7%, a year-on-year decline of 46.1%.

Hotel operators in Dubai believe that their FY 2020 revenue may contract by more than 50% and anticipate it will take 18-24 months to reach pre-pandemic levels of profitability.
Traveler sentiment
The future of the hospitality industry is highly dependent on how and when travel restrictions are lifted, as well as sentiment. Not only will tourists need to regain confidence in modes of travel, but also in hotels’ ability to adhere to the highest hygiene standards. Hotel operators, F&B stakeholders, the airline industry and governments will play a key role in re-establishing a sense of confidence and safety amongst travelers.

Although it is impossible to predict when life and business will return to normal, a prolonged reduction in leisure and business travel is expected. In the interim, occupancy will largely depend on UAE residents’ willingness to spend. Given widespread salary cuts and redundancies, many families will certainly re-evaluate their annual vacation budgets – at least for the foreseeable future.

Bulk segment
As businesses are becoming accustomed to using online platforms, companies may curtail non-essential business travel to reduce operating costs. Dubai has been a regional hub for MICE, which generates group bookings for the hotel industry, contributing to room revenue and bulk occupancy, as well as increased F&B revenue. It is unlikely that demand for event spaces will reach pre-Covid-19 demand anytime soon, due to social distancing and spending constraints.

In addition to leisure and MICE travel, Dubai’s position as a regional travel hub also contributes to the hospitality sector through flight crew layovers in local hotels – another bulk segment absent in the current market. In 2019, Dubai airport recorded 373,261 flight movements, making it the world’s busiest international airport.24

Occupancy and rates
In Q1 2020, the hotel market in Dubai has experienced a significant decline in occupancy, with reduced ADR and RevPAR – specifically from mid-February onwards. Occupancy rates declined to 66% in Dubai compared with 82% during the same period last year. Year-on-year comparison for 1-8 March 2020, shows that hotel occupancy in Dubai has decreased further (to 60.6%), ADR also decreased by 20.4% (to AED 498).

Dubai’s hotels have been forced to manage significant cancellations and refunds to consumers. Because Covid-19 was declared a pandemic by the World Health Organization, all reservations were subject to force majeure clauses. Exacerbating the situation, insurance policies do not necessarily cover these losses – a consideration for future policy negotiations.

Expo 2020 was expected to be the year’s most important event for the hotel industry – it was due to bring 25 million visitors, 70% of which were expected to hail from international markets.25 Many hotel operators believe that the postponement of Expo 2020 will negatively impact Q4 revenue. Further, additional supply, expected in 2020, will increase pressure on occupancy and room rates. As hotels reopen, aggressive room rates, with the goal of increasing occupancy, may negatively impact profitability and diminishing owners’ returns, including valuation in the short to medium term. Hotel operators should be careful to avoid short-term strategies which could be detrimental in future – for example, offering discounted rates which do not cover operating costs.

Source: Cavendish Maxwell and STR Global
Cash flow and operating costs
All (100%) of hotels, restaurants and T&T businesses experienced a decrease in turnover in Q1 2020, according to the Dubai Chamber of Commerce & Industry. Looking ahead to Q2, 56% of hotels and restaurants and 100% of T&T operators expect an additional decline of 75% or greater, compared with Q1 2020. Since mid-March 2020, hotels in Dubai have been operating at significantly reduced occupancy resulting in unsustainable revenue. Hotel operators are therefore focusing on cost reduction, as managing liquidity and operating costs are currently one of their biggest challenges. Many hotel operators have already undertaken measures including paid/unpaid leave, headcount and salary reductions, renegotiation of supplier contracts and providing properties for quarantine facilities. Their primary focus is mainly to save costs and preserve cash.

In order to manage cash flows, some hotel owners have agreed with the lenders to defer principal debt obligations while they continue to service interest. After evaluating current and future commitments, owners and operators are also working with lenders to refinance debt at lower interest rates, which will likely improve their ability to meet existing obligations.

Moving forward, hotel operators will need to use all possible measures to gain travelers’ trust, assuring them that facilities are safe and hygienic. From enhanced cleaning measures, to social distancing in lobbies, common areas and restaurants, to reduced-touch experiences utilizing technology, every possible step must be undertaken to guard the safety and wellbeing of customers and employees.

Implementing safety measures and communicating these to customers will be a key differentiator in future. For example, Abu Dhabi and Ras Al Khaimah introduced stay-safe hotel certification programs, and similar initiatives or guidelines will be implemented in other emirates. No doubt there will be an incremental operating cost due to increased safety and hygiene measures, but owners and operators may not be able to compromise, given the paradigm shift brought about by the pandemic.

Future supply
According to Colliers International, 65% of hotel owners/investors in the region do not plan to scale back on projects currently in the construction or development phase. Whilst a number of hotels are in various stages of construction and scheduled for completion in 2020 (including Marriott The Palm and Paramount Tower Hotel and Residences), actual materialization rates are expected to drop compared with previous years, as a result of the pandemic.

Institutional investors, including sovereign wealth funds, currently hold enough capital to invest in quality hotel assets, now available at attractive prices. However, investors will likely wait for the acute period of uncertainty to pass – specifically, watching how international travel pans out in the coming months. The level of interest in hotel properties, by both lenders and investors, will also determine how much value stakeholders are ready to ascribe to this asset class, post pandemic. This is particularly relevant for hotels under construction, where project execution could come under stress and owners may be forced to actively seek additional or new sources of funding. However, many operators agree that forecasting in the current climate is difficult, making operating and investing decisions more complex.

In the coming months, given current and planned hotel, retail and entertainment offerings, the emirate may need to closely monitor and manage its supply and demand. A risk of oversupply in hospitality and tourism offerings, combined with softening demand in the short- to medium-term, is certainly a scenario to be avoided. Once travel restrictions are eased, tourists will return to Dubai, but actual spending per tourist is likely to grow at a slower rate. These factors should be taken into consideration by stakeholders in the hospitality sector when setting the agenda for the years ahead.
CONCLUSIONS

For shopping malls and hospitality businesses, the pandemic has led to a significant demand crisis. Organizations will need to proactively work with tenants in the spirit of partnership as, for many, it is a question of survival. Malls owners will need to revisit the current leasing options with an aim to share ‘risks’ with retailers by evaluating fixed and turnover rent proportion.

For hotels, hygiene and safety are key factors in generating future demand. This will likely lead to increased health and safety spend; however, hoteliers cannot compromise on these costs if they want to remain in the business.

As real-estate sales slow and hotels witness record-low occupancy rates, businesses are facing severe cash-flow challenges. Organizations that are overleveraged are most at risk. Cash reserves alone may not mean a company is immune, as we simply do not know how long the current downturn will last. Developing a detailed, 13-week rolling cash forecast will help to identify shortages as early as possible.

Organizations should also establish adequate spending freezes and tightened authorization to limit outgoings. In order to manage short-term commitments, mainly with contractors, extended payment terms should be negotiated without compromising timely execution of projects. A few organizations are also considering extending or setting up receivables factoring and reverse factoring programs to manage cash flow.

The financial effects of the pandemic are such that previously healthy businesses are suddenly coming under acute financial pressure. Nearly all local real estate organizations have debt on their balance sheet; servicing interest payments has become a challenge, due to significantly reduced cash inflows. For some, the likelihood of breaching financial covenants or experiencing a funding shortfall in the near term is a further source of concern.

It is imperative for organizations to engage with lenders early on in order to address any expected deficiencies and take appropriate steps. Further, management should monitor covenants of financing activities, simulate stress scenarios for covenant breaches, and define an action list. Engaging with lenders to avail themselves of additional financing options, including those provided/facilitated by the CBUAE, should be a priority.

There is continued uncertainty in the real-estate capital markets, which often lag behind major events, due to the relative illiquidity of the assets. Consequently, valuers will likely rely on market uncertainty clauses as per the Royal Institution of Chartered Surveyors Standards, as transactional evidence dries up. Also, an increasing number of stakeholders are turning to industry anecdotal evidence from brokers and market participants. Investors, shareholders, lenders and boards will seek more clarity on asset performance, which will likely mean more regular valuation reviews.

Greater oversight and scrutiny of the valuation process, by way of valuation management, helps ensure better independence, establishing a barrier between the valuer and the instructing party. The emphasis is on reviewing the valuation output to ensure that the input, assumptions and conclusions are reasonable. Further, ensuring valuation reports are transparent, identifying why the valuer has reached their conclusions despite a lack of transactional data, will be more common than in pre-pandemic times.

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Covid-19 is a global crisis. We are navigating an unprecedented situation which has an uncertain future. Many experts believe the current recession is unlike any that we have witnessed since the Great Depression of the 1930s. Economically, the scale is substantially larger, more international, and the ramifications are likely to persist longer than the global financial crisis of 2008. Changes to behavior and lifestyle will arguably demarcate pre- and post-Covid-19 eras.

Like other markets, the UAE faced challenges during the global financial crisis of 2008. During this period, we saw issues stemming from overheating of the real estate sector and, as a result, the global financial sector suffered. Thanks to UAE government initiatives undertaken at the time, the sector has matured and is more resilient in 2020. However, local economic recovery is expected to be prolonged. Certain segments, such as tourism, aviation and retail, are expected to recover at a slower pace than others. By the end of 2022, however, we anticipate industries to return to pre-Covid-19 levels of activity.

In order to move forward, businesses must accept the new reality and evolve accordingly. For example, consumer demand has taken a significant hit. The co-existence of bricks-and-mortar retail alongside e-commerce offerings will define the future success of mall owners and retailers. Similarly, office sector stakeholders will need to focus on offering top-quality space at attractive prices, as WFH has gained traction. Future success will be defined by businesses’ ability to adopt technological solutions and evolve with changing market needs.

As Dubai gradually reopens, the emirate’s world class infrastructure and emphasis on innovation will continue to attract investors and tourists. This places Dubai in a relatively strong position with investors and consumers, and should strengthen business confidence. Dubai’s real estate and hospitality sectors will overcome the current crisis and continue to play a critical part in the nation’s economic growth. This is a new beginning – a time for us to redefine ‘normal’ and lead the change.
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