



Success doesn't come easy

There was a lot of speculation last month about how Dubai was faring with its debt repayment commitment. At the core of it was property, and the market suffered.

Manjula Menon investigates where the Dubai property market is headed now.

The passage of the foreign property ownership law in March 2006 heralded a period of unprecedented and unexpected inflow of money into the real estate sector in Dubai. Supported by low mortgage rates, as the UAE monetary policy is a de facto copy of the US Fed policy, the property market flourished, achieving prices and rents beyond normal supply and demand mechanisms, ultimately leading to unhealthy and unsustainable levels. The large

external exposure of the UAE (especially Dubai) did not help, as the global meltdown triggered a collapse of the local real estate market.

Quo vadis?

Despite early signs of stabilisation, property prices in Dubai might not have bottomed out yet. After the distressed selling in the first half of 2009, the third quarter of the year saw renewed investor interest in projects, from

phone enquiries to actual visits and investors exploring new opportunities in the real estate market. However, the vast majority of investors have held back from making actual investments, hoping to enter at the first signs of a revival, which still seems some distance away. The talks and speculations around the debt restructuring of Dubai World and other entities is also not working in favour of the market.

Property investing in Dubai has

fact, the rule has become more of an impediment than an incentive for investors to engage in the property market, experts note.

Demand and supply

A recent UBS report released in November 2009 predicted a further 20-30 per cent drop in Dubai property prices over the next 18 months, on top of the 50 per cent decline from the 2008 peak levels. The report expects Dubai's residential property market to be oversupplied by nearly 25 per cent by the end of 2011. The number of existing vacant units and planned further units, against the backdrop of a declining population in the emirate, will invariably result in a further drop in prices, according to the report. UBS also indicates that a significant portion of non-performing loans is yet to find its way into banks' books, further dampening the outlook of the property sector.

Boston Consulting Group does not foresee a turnaround in the sector in the near future. The global consulting firm notes that the shaky confidence of banks, combined with stringent financing rules and higher financing costs, will place hurdles for investors who wish to enter or re-enter the real estate sector.

Experts also argue that the level of distressed property assets in 2009 will prompt smart investors to focus primarily on tier-one developments that display favourable characteristics in terms of location, high quality construction and finishing, as well as predictable revenue streams.

In the rental lease market, overall population growth will be the single-most important driving factor. An expatriate-led population outflow from the country will put major pressure on the housing market and is likely to keep its growth potential to a minimum for some time to come. Contradictory figures



come a long way since the heydays of the early years of this decade, when speculators made hay as the sun never set. The market has since become better regulated, but some of the changes that came along the way in regulations actually hurt the flow of money into the emirate, including the uncertainty of the visa rules.

Experts say there are still concerns around transparency in property ownership in the emirate, while changing visa regulations for owners, a tenuous legal system and weak enforcement of existing rules are making it much harder to attract much-needed international

investors. Experts explain that a decisive factor that induced many expatriates to invest in the UAE real estate market was the government's promise of a three-year residency visa for freehold property owners, even the jobless. But, after a period of uncertainty, this promise was replaced last May by a rule that entitles only those owners who have a minimum fixed income of AED10,000 and a minimum property holding of AED1 million to a six-month multiple entry visa. This rule has excluded a number of owners who do not fulfil the criteria and is a significant dilution of the original regulation. In

and reports are out in the market about whether the ramifications of the financial crisis have resulted in a net inflow or outflow of Dubai residents at this point. The need of the hour is credible and transparent official data, without which predictions about the property market's movements are doomed to remain pure speculation.

The other important factor is supply. Consensus estimates of the peak-to-trough drop in Dubai property prices vary from 40-60 per cent. Most do not see any recovery before 2011. They also see 90,000-140,000 units hitting the market between 2009 and 2011. With this major oversupply in different sectors of Dubai, it is hard for investors to see good chances for their target return on investment.

Occupancy levels have already been driven down, prompting the rental decline to be more pronounced than the price correction. According to Landmark Advisory, apartment rents fell by 17 per cent in the third quarter, with the agency predicting that these are likely to keep falling due to weak supply fundamentals. Developers and homeowners who find it difficult to sell their properties are being forced to offer their units for rent, thus pushing up the supply of rental units even further. For high-end units, there is a

visible oversupply in Dubai, which makes it difficult to achieve full occupancy.

According to Global Property Guide's third quarter 2009 housing report, the magnitude of the UAE real estate market's fall has been as spectacular as its rise. While property prices rose 61.5 per cent in the UAE in the third quarter of 2008 compared to the year before, they dropped more than 48 per cent year-on-year in the third quarter of 2009. This is a stark contrast compared to most other real estate markets worldwide, where changes on a year-on-year basis have been much more moderate. For example, Australia had a year-on-year house price change of -3.45 per cent in the third quarter of 2008 and a +4.91 per cent change in the third quarter of 2009. Canada had a change of -1.07 per cent in the third quarter of 2008 and a -2.14 per cent change in the third quarter of 2009. Even Spain, where the housing market had taken a severe thrashing, had much lower adjustments. The country saw a -4.31 change in the third quarter of 2008 and a -7.00 per cent change in the third quarter of 2009 (refer to tables).

The story in Abu Dhabi is somewhat different from Dubai, with a number of deep-pocketed expatriates having moved to the capital and putting further pressure on the undersupplied rental market. Market fundamentals there are favourable, with Mubadala's subsidiary Abu Dhabi Finance estimating undersupply to jump up to 100,000 by 2015, a housing shortage caused by financing difficulties, delay and cancellation of projects and investor caution. Clearly, property owners are blessed in this situation, while those seeking to rent are in a bit of a soup. In line with equilibrium laws, however, oversupply of residential units in one emirate and undersupply in another will lead to spill-over effects and create distortions in both the Dubai and Abu Dhabi real estate markets in the medium term, with demographic movements expected to gravitate towards the more affordable Dubai area.

Owners' cartel

Some experts attribute the recent premature price improvements in Dubai rents to two phenomena. The first, they say, is property developers and consultants painting a positive picture of prices and talking up rents. The other reason lies with homeowners' behaviour. Landmark Advisory's third quarter 2009 report entitled "Delaying the inevitable: Owner behaviour preventing rent floor" blames the illogical recent price movements on distortions in owner behaviour, as well as relocation of tenants from other emirates seeking to benefit from lower rents in Dubai. The report argues: "Assuming that landlords are exiting the market due to lower rents, this behaviour will prevent Dubai's leasing market from reaching a rent floor. The momentary respite in the rent correction process, caused by supply distortion, is only temporary and will reverse as soon as those properties come back onto the market. Real rents will be determined by what Dubai residents are willing to pay."

An unknown number of property owners are also holding back from renting out, as they are unwilling to let their property at the going rates or sell it at a drastically discounted price. By taking their listings off the market, however, they are just postponing the bottoming out of the rental market, as the drop will inevitably

House price change (Inflation adjusted)				
Country	year-on-year (%)		q-o-q (%)	
	2008 Q3		2009 Q3	2009 Q3
Israel	-3.79	↑	10.15	0.68
Australia - 8 cities	-3.45	↑	4.91	3.19
Switzerland	2.22	↑	4.28	1.33
China-Shanghai	18.01	↓	3.97	2.66
Hong Kong (RVD)	13.22	↓	3.60	9.19
Hong Kong (HKU)	16.82	↓	3.08	11.12
Norway	-6.56	↑	2.00	1.78
New Zealand	-9.02	↑	1.98	0.60
Portugal	-7.60	↑	1.48	0.30
Finland	-4.04	↑	0.92	2.02
Sweden	-2.42	↑	0.78	2.93
Indonesia-14 cities	-8.34	↑	-0.86	-1.02
Canada	-1.07	↓	-2.14	0.17
US (FHFA)	-11.22	↑	-2.18	-0.45
Germany	-2.97	↔	-2.78	0.59
UK (Nationwide)	-14.44	↑	-4.34	3.40
Netherlands	-0.39	↑	-5.34	-0.33
Spain	-4.31	↑	-7.00	-0.49
South Africa	-7.73	↘	-7.10	0.55
Ireland	-13.75	↑	-7.20	-2.93
US (Case-Shiller)	-20.74	↑	-7.45	1.19
UK (Land Registry)	-9.90	↘	-10.02	2.09
Singapore	1.62	↓	-10.96	14.30
Thailand	-3.13	↓	-13.18	-6.10
Slovakia	14.12	↓	-15.28	-1.23
Russia	6.42	↓	-19.47	-3.76
Iceland	-8.95	↓	-21.21	-4.18
Bulgaria	13.01	↓	-28.66	-3.91
UAE	61.50	↓	-48.05	n.a.
Latvia-Riga	n.a.		-59.70	-6.75

↑ = more than 1 percentage point increase in house price change
 ↔ = less than 1 percentage point increase in house price change
 ↘ = less than 1 percentage point increase in house price change
 ↓ = more than 1 percentage point decrease in house price change compared to same period of last year

Source: Various series, data descriptions and sources here

occur at a later point in time. This artificial undersupply of units naturally ends up in overestimating rent projections. There will, however, be a time and budget limit as to how long property owners refuse to rent out, as maintenance of vacant property and unfunded mortgage payments will eventually increase the opportunity cost of holding back versus renting out at current levels.

Smaller homeowners who hold on to their properties and do not rent out feel caught in the situation. Even though they still manage to generate cash flow, they view their projected cash surplus as negative, with rentals projected to drop further versus their mortgage obligations. They also expect further supply to hit the market once other owners in a similar situation exit the market. However, given the serious lack of confidence and widespread pessimism in the market, some are of the view that the worst has been discounted in the prices and rents already and that the bottom might be close. These owners prefer taking a contrarian approach to the market.

Is a real recovery in sight?

A prevailing perception among some commentators is that job losses in the UAE are not yet a haunting ghost of the past. Job losses still continue to be a major threat, while salaries could take longer to recover. Combine this with a rise in the supply of units in the months ahead and the quality that is both available and affordable. In fact, this situation could act as deterrence for investors and tenants alike to put their eggs in the Dubai basket. With a strong and attractive real estate market in India and opportunities arising in western markets, albeit at a slower pace, a considerable number of expatriates are reconsidering how to most reasonably allocate their budgets going forward, probably benefiting the more established markets back home. For converting potential interest from end-users and investors in the UAE into action, economic recovery in the country has to be sustainable and laws of residency visas might need to be adjusted to last beyond a 30-day grace period to leave the country, once expatriate residents are faced with unemployment.

Real estate consultancy Colliers International reported a seven per cent increase in the overall value of residential properties in Dubai between July and September 2009, the first increase since the market plummeted in 2008. But the consultancy shied away from predicting any full-fledged recovery.

A Jones Lang LaSalle report in October predicted that the price recovery in Dubai would occur well after the second half of 2010, despite a slight improvement in sentiments. There is also a consensus among experts and consultants that as long as prices and rents do not realistically reflect fundamentals and valuations, it will be an uphill climb for the sector. Some also suggest that in an effort to mainstream and put an end to speculators' dominance that distorts prices in the emirate, the Real Estate Regulatory Authority should support the rental system by temporarily introducing not just recommendations, but actual obligatory ranges for rents, which would be set according to the property's specifications and regularly adjusted to market developments. This might help bring about a much-needed catharsis, they argue.

House price change (Nominal)

Country	year-on-year (%)		q-o-q (%)	
	2008 Q3		2009 Q3	2009 Q3
Israel	1.95	↑	13.65	2.67
Australia - 8 cities	1.36	↑	6.25	4.19
Norway	-2.16	↑	3.78	1.78
New Zealand	-4.43	↑	3.71	1.89
Switzerland	5.26	↓	3.27	0.90
Hong Kong (RVD)	18.48	↓	2.70	8.12
China-Shanghai	24.23	↓	2.63	2.98
Hong Kong (HKU)	22.24	↓	2.19	10.04
Indonesia-14 cities	2.56	↔	1.88	0.23
Finland	0.35	↔	0.17	1.77
Portugal	-4.82	↑	0.00	-0.34
Sweden	1.83	↓	-0.40	2.89
South Africa	2.58	↓	-1.15	2.18
UK (Nationwide)	-10.33	↑	-2.95	4.03
Canada	2.32	↓	-2.98	0.28
Germany	0.01	↓	-3.03	0.81
US (FHFA)	-6.51	↑	-3.76	0.23
Netherlands	2.76	↓	-5.07	-1.23
Thailand	-1.53	↓	-6.88	-6.24
Spain	0.39	↓	-8.02	-0.94
UK (Land Registry)	-5.58	↓	-8.71	2.71
US (Case-Shiller)	-16.53	↑	-8.95	1.87
Russia	22.34	↓	-10.82	-2.60
Singapore	8.31	↓	-10.96	15.75
Iceland	3.86	↓	-12.54	-2.17
Ireland	-10.00	↓	-12.87	-3.91
Slovakia	19.91	↓	-14.27	-1.49
Bulgaria	26.76	↓	-27.98	-4.98
Ukraine- Kiev	24.01	↓	-34.41	-8.48
UAE	80.00	↓	-47.00	7.00
Latvia-Riga	n.a.		-59.07	-8.51

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Overall, the crisis should be an eye-opener for both authorities and market participants that real estate speculation needs containing and balancing with real supply and demand in the economy. One of the lessons from the ongoing crisis is to discourage the quick-profit herd mentality that built into the property market in past years and build a robust long-term strategy for sustainable growth of the sector. Let us also not forget that Dubai opened its property market less than 10 years ago, while other emirates followed it. It needs time to settle down and mature now, as this is the first boom-bust cycle for the market. Some projects may not be viable anymore and investments have gone bad. But nobody is going to take away Dubai's infrastructure and what it has already built.

We must also not forget all of Dubai's incredible achievements over the last five to six years. Once real estate investing finds its footing again, it will undoubtedly be one of Dubai's pillars of strength and a star in the country's quest for diversifying away from an overdependence on oil into viable and sustainable areas of growth. After all, there are costs on the road to success.