INDEX & Cie

Thematic Research

July 2019


The Nasser Rashid Lootah Building, the first skyscraper on Sheikh Zayed Road, viewed facing DIFC, early 1970s

Residential skyscrapers amid morning mist, Dubai Marina, 2019

# A view on Real Estate in Dubai

## Update on the residential property market

**INDEX & Cie**
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*"Historia vero testis temporum, lux veritatis, vita memoriae, magistra vitae, nuntia vetustatis"*
*(In truth, History is witness of times, light of truth, life of memory, teacher of life, messenger of ancient times)*

**Marcus Tullius Cicero**
Roman consul, philosopher, lawyer, orator

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# Executive Summary

Over the past 26 years the residential property market in Dubai grew at an average 8% annual rate in residential unit built. Since the opening of the market to foreign ownership in 2005, the average residential price in the Emirate evolved in two large cycles, affected both on the rise and on the fall by the 2008 global financial crisis and more recently by a considerable growth in supply.

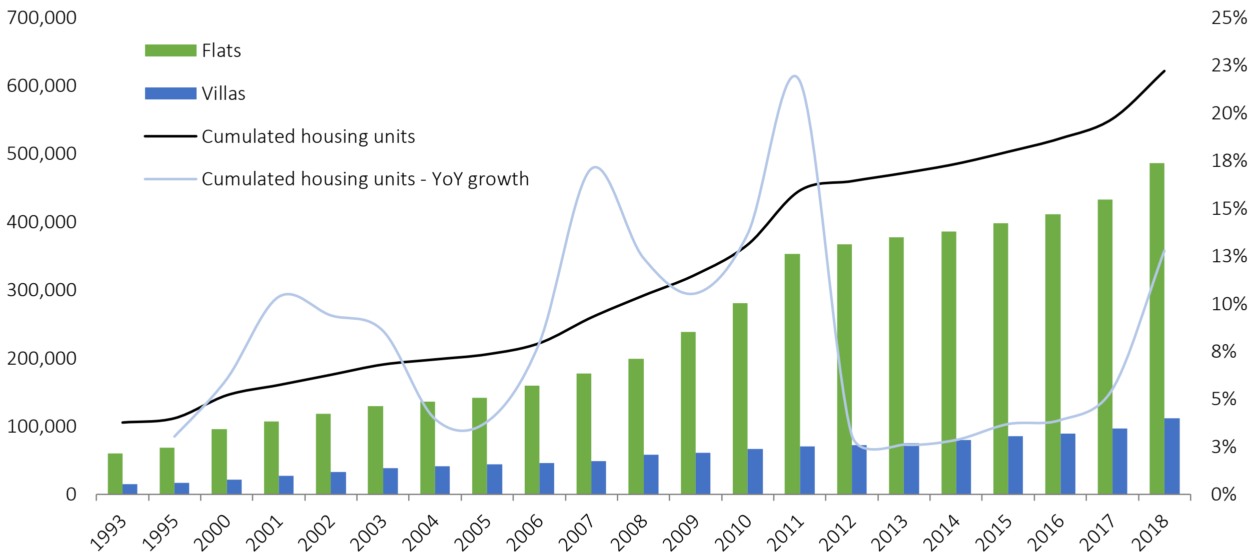
Based on the limited amount of available data and on empirical observation, our June 2019 update on the state of the Dubai property market highlighted the following points and trends:

- **Household income** – Households with less than USD 100,000 of annual income compose 55% of the Emirate's population since 2002, while only 15% is composed of household with an income of more than USD 250,000 annually, showing that the vast majority of residents have relatively limited purchasing power;
- **Purchasing power** – There has been a 28% decrease in purchasing power for the average household since 2014, due in part to a steady increase in house-related expenditure, increasing from 23% in 2013 to today's 36% of disposable income – coupled with a general rising cost of living observed empirically, this finding suggests the appetite from the average resident might be for properties valued at a more affordable price point;
- **Inventories –** The amount of square meters completed in 2016, 2017 and 2018 marked a new historical high beyond numbers seen during the pre-global financial crisis of 2009 and 2010;
- **Construction** – Judging by the current number of square meters under construction, and on the basis that this number is a proxy for future supply, then the next three years will see an unprecedented amount of supply – square meters under construction are delivered in a 3-year cycle with a 40-35-25 percentage distribution;
- **Prices** – The average residential price reflects the present state of oversupply and has steadily decreased since 4Q 2014 at an average rate of 5.6% quarterly, placing Dubai in 41st place among most expensive cities by property, right below Chicago, US and above Warsaw, Poland;
- **Building permits** – The amount of square meters permitted in 2018 are as low as those in 2013 and lower than those in 2009, suggesting that 2018 saw a peak in planned construction;
- **Off-plan sales** – Q1 earning results from EMAAR and a handful of developers show that off-plan sales have increased almost 8% YoY, have surpassed secondary market sales by more than 10% in volume, but accounted for only 50% in value of the secondary market sales, all signs that market activity is definitely not slowing down;
- **Immigration developments** – Demand for property might be boosted via the two newest immigration initiatives of the long-term resident visa (up to 10 years) and the retirement visa (up to 5 years), both of which require the un-mortgaged ownership of at least AED 5 million and AED 2 million worth of property, respectively;
- **Currency strength** – The strength of the US Dollar, and therefore that of the pegged UAE Dirham, does not seem to be strongly correlated with property prices in Dubai – the most recent hike in prices came in an environment of rising US interest rates, which made the Dollar appreciated accordingly against a basket of major currencies.

# Supply

Since our initiation report in May 2016, the supply or residential units in Dubai has substantially increased, posting growth of 3.9%, 5.5% and 13% in 2016, 207 and 2018, as shown below.

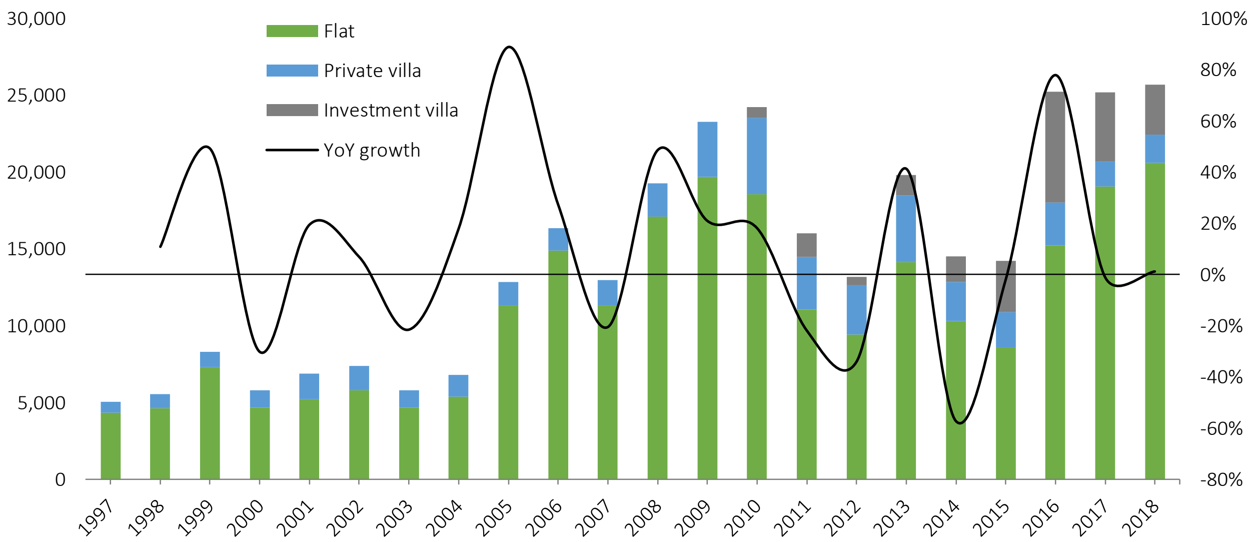
**Cumulated inventory of housing units**




Source: Dubai Statistics Center, Dubai Land Department

From a year-on-year perspective, the pickup in deliveries in completed units tells a story of increased activity among developers. Deliveries in years 2016, 2017 and 2018 have all surpassed the highest point in 2010, the year the global financial crisis hit the UAE.

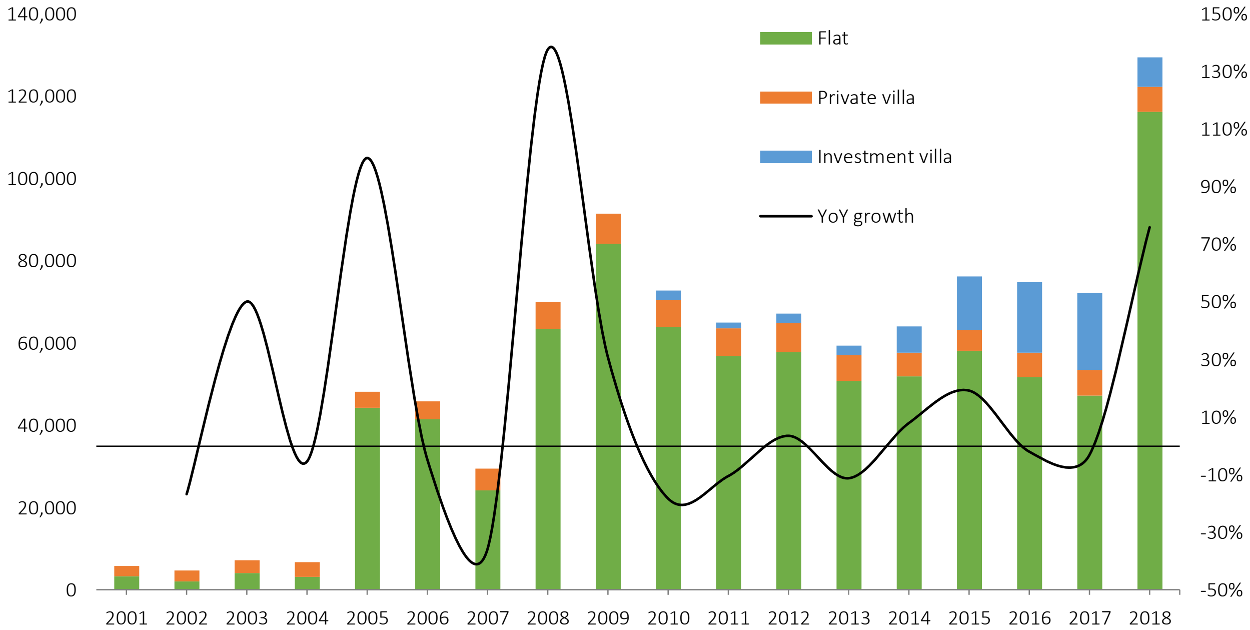
**Completed units**




Source: Dubai Statistics Center, Dubai Land Department

The trend of deliveries is definitely not set to diminish in 2019 and onwards, since the units under construction in 2018 have registered a staggering 76% increase versus 2017, the highest point ever in the construction planning in Dubai.

Units under construction




Source: Dubai Statistics Center, Dubai Land Department

If the units under construction evolution is an approximate forecasting tool of units soon to be completed, then 2019 and 2020 will be years of unprecedented increase in supply within the residential segment – flats take about 90% of 2018's under construction units.

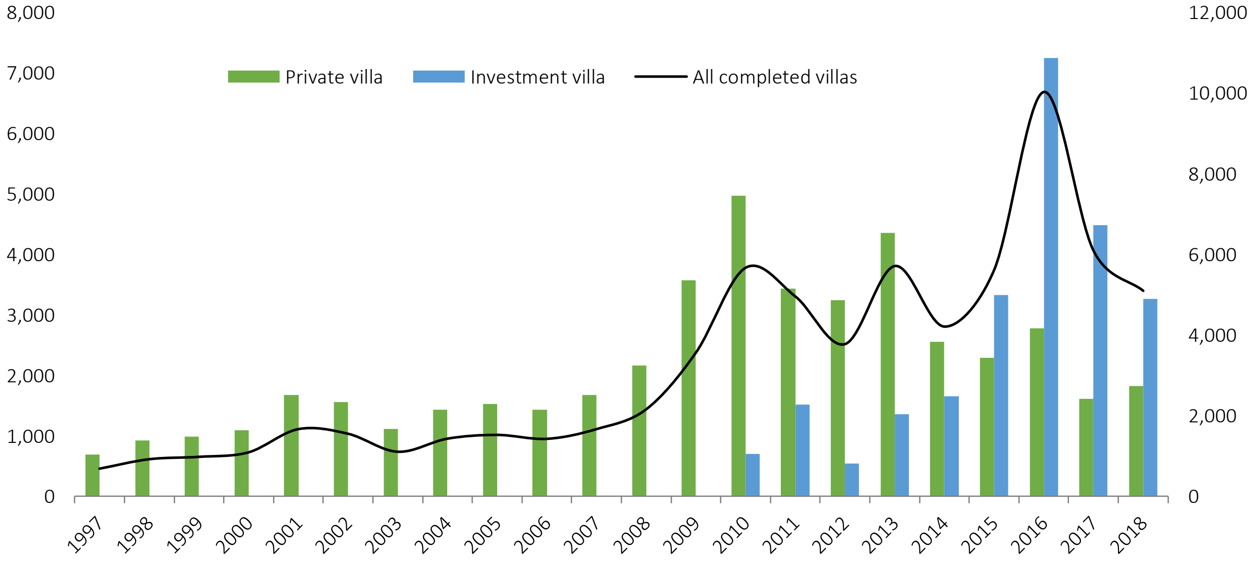
## Villas

Although still representing a minor part of the overall flat-dominated residential market, villas have grown up to account for between 20% and 45% of total units completed. Before diving any further, it is useful to refresh our reader's memory on how the Dubai Statistics Center breaks down the villa group, as follows:

- *Private villas*: a structure consisting of one, two and three storeys, *intended for residence* and occupied by one or more family connected by a staircase, surrounded by a fence, often with a garden. The villa and its annex are considered as one residential unit unless the annex is occupied by another family different from the one living in the villa. The type of possession of the private villa is ownership, lease, or work accommodation. Palaces are considered as private residential villas. Governmental and social houses financed by the government are also considered as private residential villas;
- *Investment villas*: one- or two-storey buildings intended for residential use by one or more families. A unit or building might contain a group of investment villas located on one plot of land or several plots surrounded by one fence and is *usually offered for rent for investment purposes*. The type of investment villa possession may be ownership, rent or work accommodation.

While it is unclear to us how the Statistics Center practically manages to distinguish a private villa from an investment one – a task that would ideally depend on the villa owner specifying the destination of the residential unit – it emerges from the graph below that the number of investment villas delivered has more than doubled that of private villas in 2016, 2017 and 2018, a trend further verified in the record of units under construction for that year, shown previously.

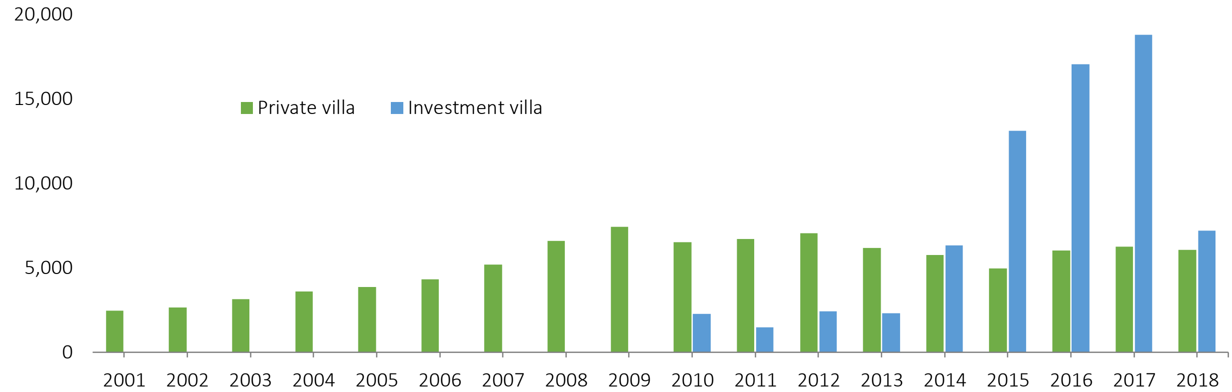
**Completed units**




Source: Dubai Statistics Center, Dubai Land Department

Major developments inland, such as the EMAAR project Dubai Hills Estate and the Mohammed Bin Al Maktoum Rashid City – District One by Meydan Sobha, have contributed in increasing substantially the number of villas both already delivered and to come in 2019, as shown in the following graph.

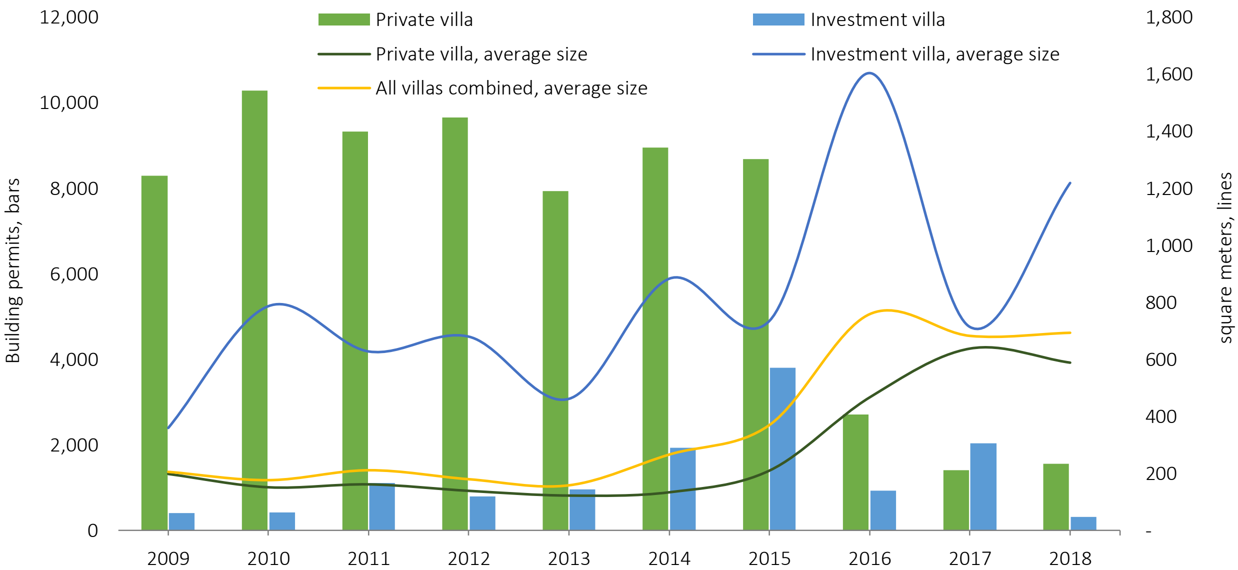
Units under construction




Source: Dubai Statistics Center, Dubai Land Department

From a building permit perspective, the future projects offering villas are expected to decrease, perhaps since an already large quota of both private and investment villas has been either delivered or is about to be through the projects mentioned. Notably, the average size of villas has almost doubled from 2016 to 2018, substantially higher than that in 2009.

Building permits



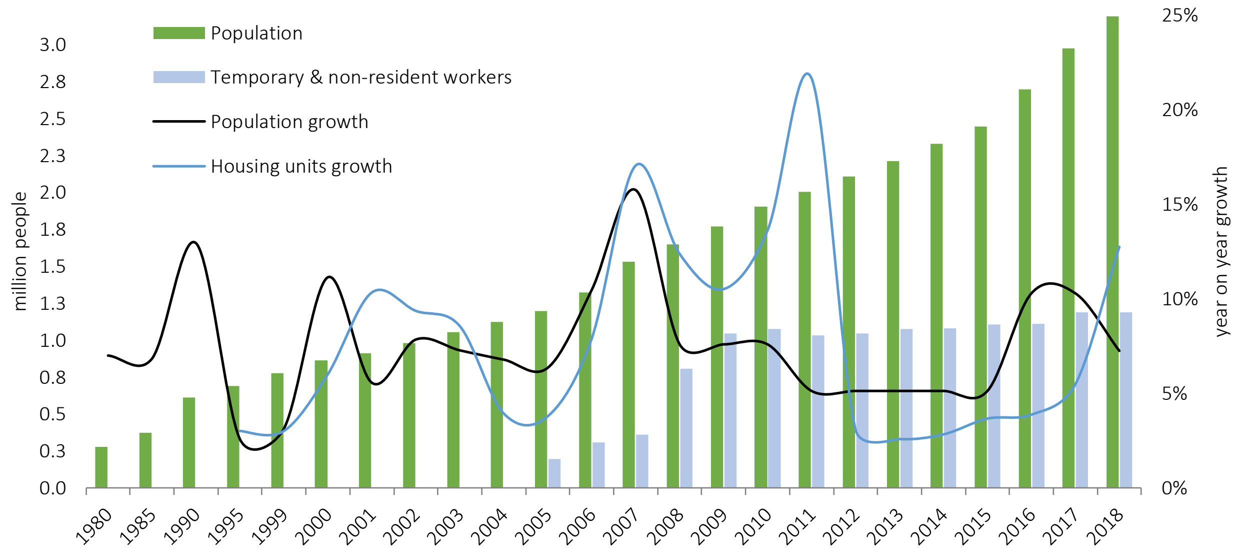

Source: Dubai Statistics Center, Dubai Land Department

It is indeed possible that the observed trends in planned average sizes offered reflect the developers' view of customers' future preferences; however, this is only one side of the story, as these findings should be viewed against the average sizes purchased over time, which shows where the historical appetite of investors in terms of size was.

# Demand

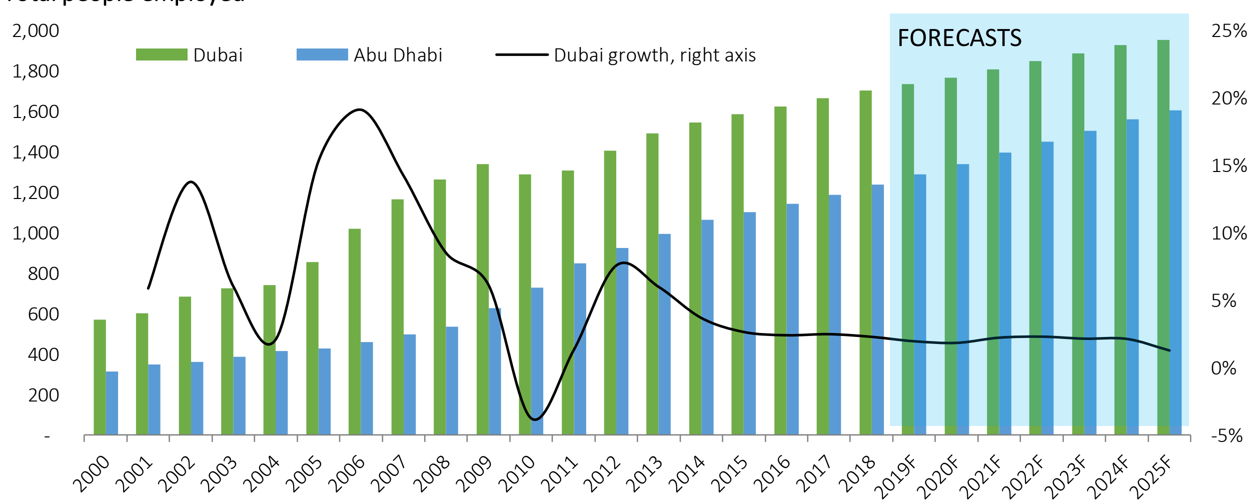
Growths in resident population and in the residential segment of real estate are indeed correlated, usually with the latter amplifying the former in the initial stage of development. This is exactly the case for Dubai, which is facing a rapid growth in its initial expansion phase.

**Population and housing units' inventory**




Source: Dubai Statistics Center, Dubai Land Department

**Total people employed**

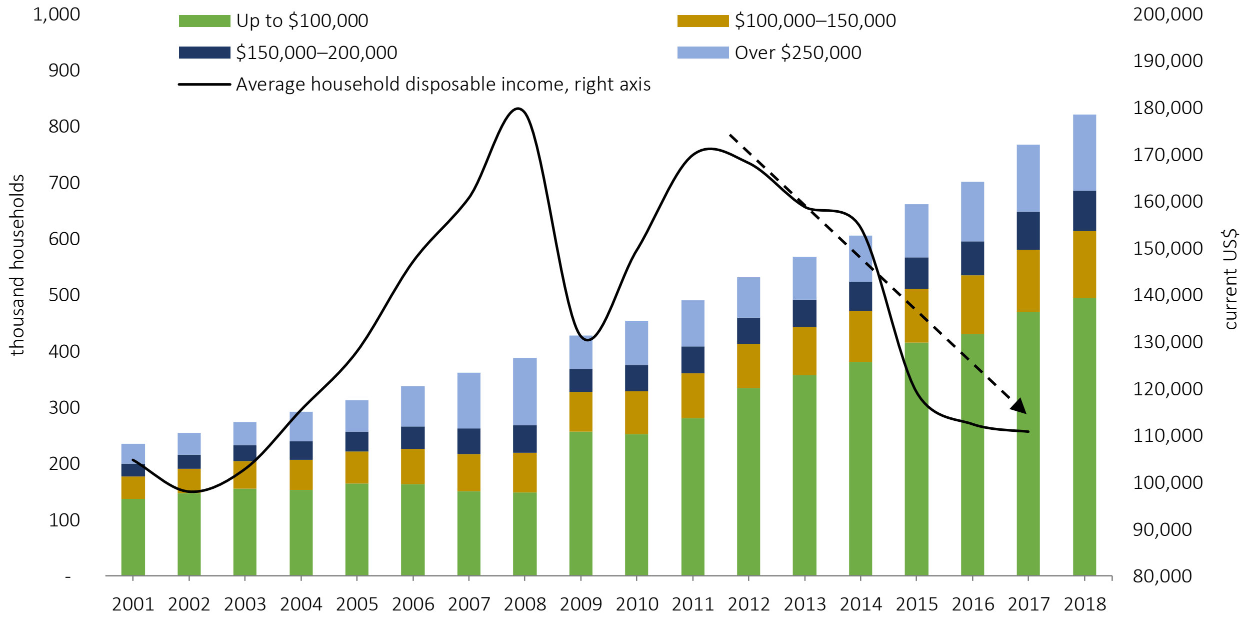



Source: Dubai Statistics Center, Oxford Economics forecasts

As expected, the growth rate of the resident population is normalizing after years of spectacular economic development, as it emerges evidently from the number of people employed since 2000; the housing units' inventory growth has instead spiked in 2017 and 2018, now reaching levels observed before the 2008 global financial crisis. We are somewhat perplexed of such growth in the housing supply, since field observation suggests that the supply of units probably exceeds the current potential demand.

Furthermore, the earning power breakdown of households provides additional evidence of the evolution in the composition of Dubai's households, as shown in the graph below.

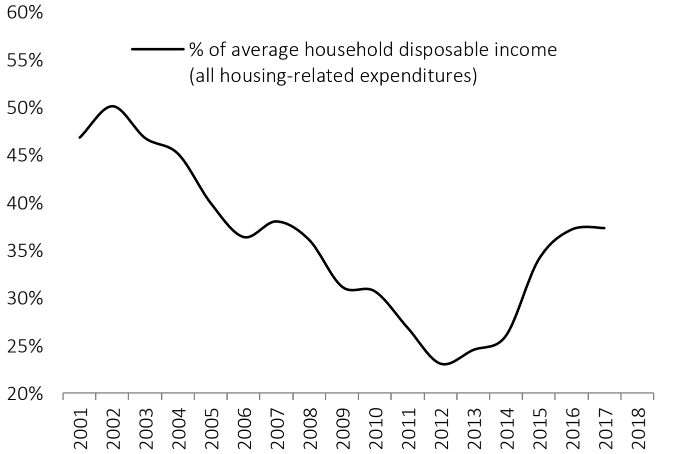
**Households and disposable income**




Source: Dubai Statistics Center, Oxford Economics

The most notable trends were (1) a major expansion of the lower income bands when compared with those beyond $150,000, and (2) a substantial decrease in average disposable income, now standing at just above $110,000 per household.

**House-related expenditure for households**

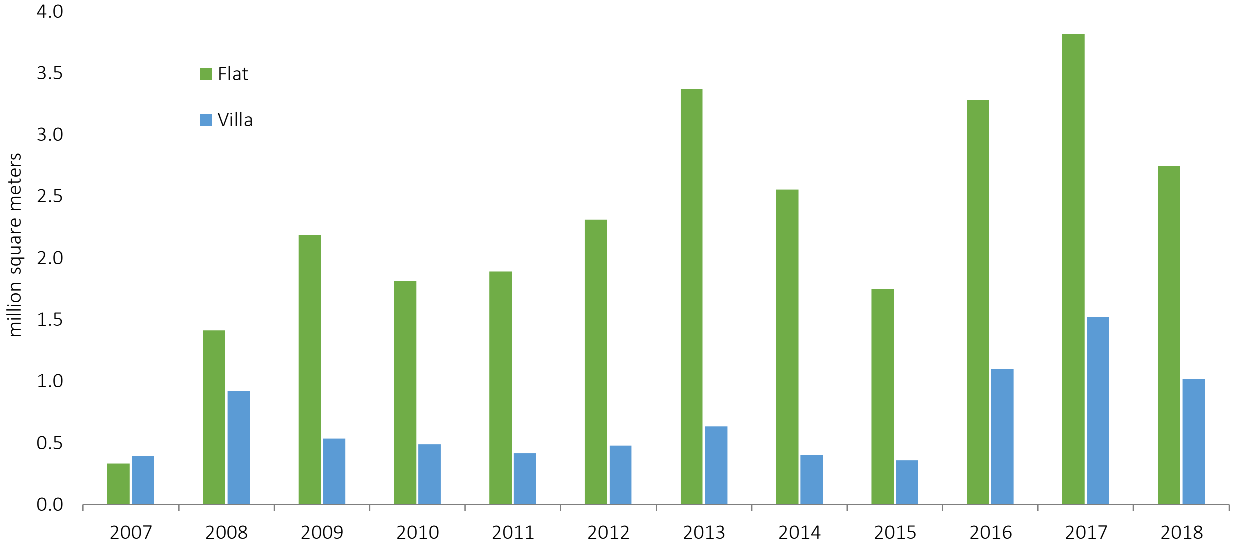



Source: Dubai Statistics Center, Dubai Government, Oxford Economics

A partial explanation of the substantially lower average disposal income comes from the increased impact that all housing expenditures have on the average household. As it usually happens in emerging economic sectors of young nations, forecasts are only an indication of what the future might look like. In Dubai's case, we observe that the impact of housing costs as also substantially increased for the average household, now taking away 37% of the disposal income.

When looking at the history of sold residential units, it emerges that the demand has substantially increased in 2016 and has remained quite high in 2017 and 2018 compared to the past trend, a fact that might be attributed partially to the increased supply from developers and from the decreased unit size, which in turn might have increased affordability, as shown in further graphs below. In particular, 2017 saw the record highest sale of flats calculated in square meters.

### Square meters sold – mortgage and sales

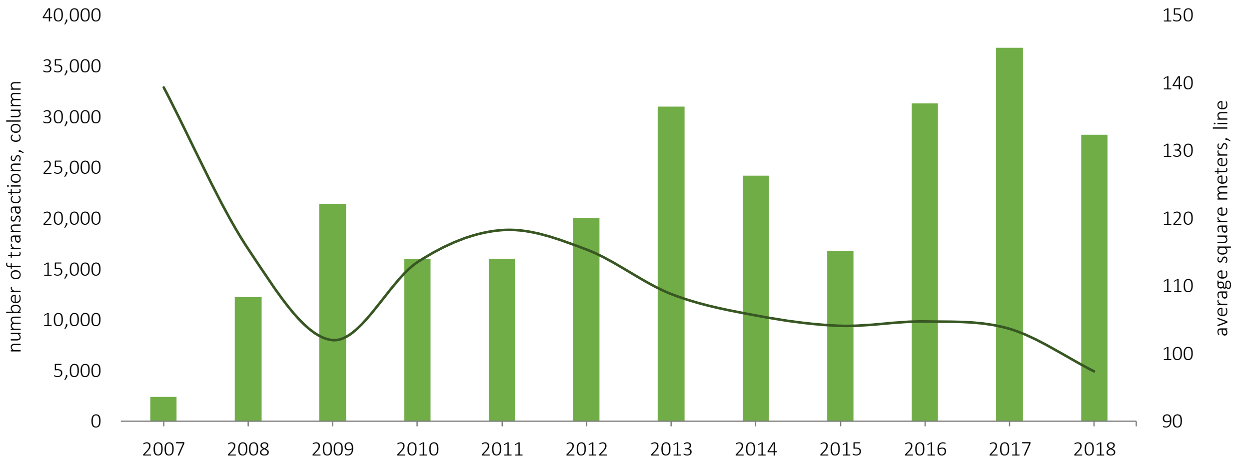



Source: Dubai Land Department

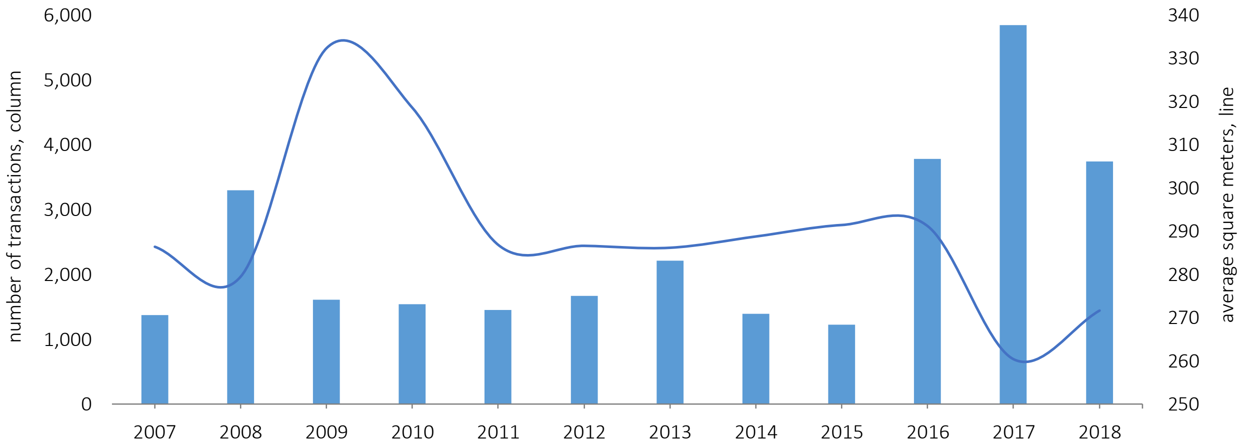
The evolution of the average flat and villas surface has further developed, as shown below. Today, a flat is about 97 sqm large, while a villa stands at 272 sqm.

### Units sold and average size

Flats




Villas



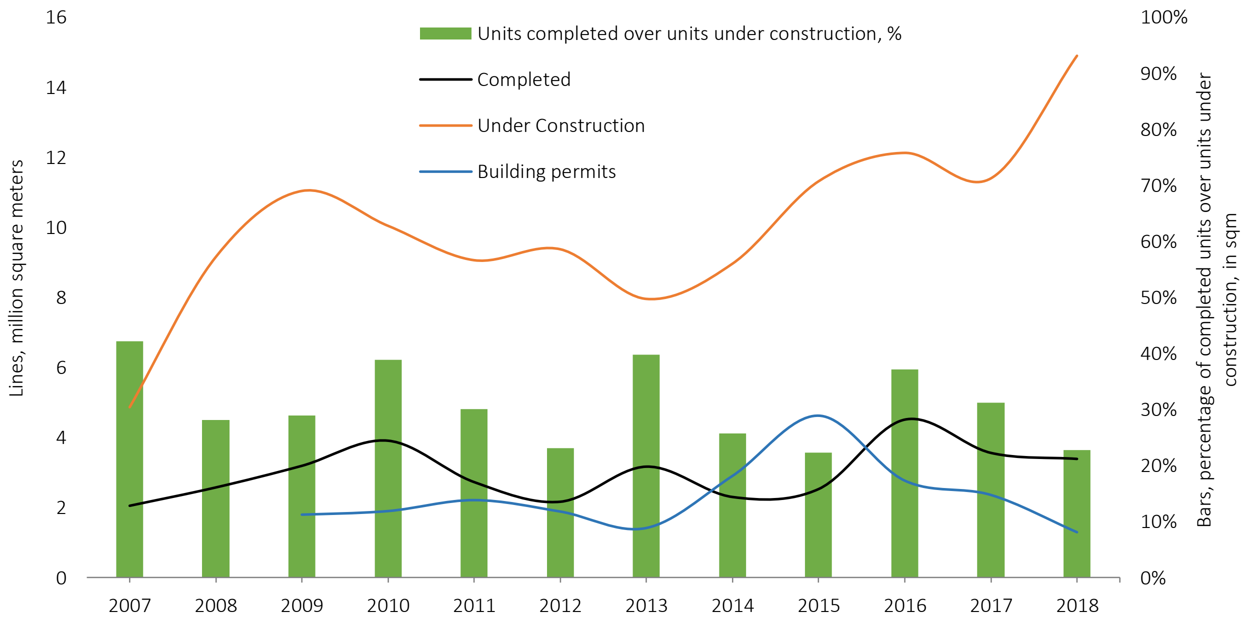

Source: Dubai Land Department

As we thought in our initiation report in May 2016, such development could be a sign that property buyers are on average increasingly attracted by smaller sizes in both flats and villas, perhaps because they perceive them as more affordable, more liquid and better value holders. This rising attitude is in contrast to pre-2009 investment preferences, when investors might have been attracted by larger properties, perhaps perceived more in line with the luxurious image of Dubai persistently offered by developers to this day.

With reference to the average size of villas offered, it seems developers have been predicting a constant or rising appetite for larger units since 2009; the average size that encountered customers' appetite has instead been decreasing since 2009, with years 2017 and 2018 pushing the average even lower. Considering the short period of life of the open market in Dubai, these datasets reveal the effort to gauge demand sensitivity to price and size[1].

In an attempt to put things in perspective, the historical average sizes of villas and apartments have been used in the graph below to run a comparison of different phases of the residential property market: completion/delivery, under construction and building permits, in square meters.

Comparison of real estate phases, in square meters




Source: Dubai Land Department, Dubai Statistics Center, Index & Cie Research

The following interesting patterns emerge:

1. Square meters under construction are rising much more than either the completed and permitted ones, a fact suggesting that either supply or inventories are destined to increase in the immediate future;
2. Completed/delivered square meters are never more than 40% of the under construction ones in any given year, suggesting that square meters under construction are delivered in a 3-year cycle with a 40-35-25 percentage distribution;
3. Square meters permitted are as low as during 2013 and lower than those in 2009, suggesting that 2018 saw a peak in planned construction.

[1] It should also be noted that villas carry a different and much higher cost of maintenance and utilities than flats, which in turn changes their liquidity, value and eventually appeal.

## Immigration new policies[2]

Recent developments around immigration policies are currently contributing in further opening the country to foreign long-term contribution, in a similar fashion to the Singapore and Hong Kong set up. The two main measures – long-term visas and a new retirement law – will effectively provide an attractive long-term residence and investment option in the UAE for non-natives.

The two measures are effective starting from January 2019 and develop along the following lines:

1. **Long-term residence visas** – The new system enables foreigners to live, work and study in the UAE without the need of a national sponsor and with 100% ownership of their business on the UAE's mainland. These visas will be issued for 5 or 10 years and will be renewed automatically.

   Eligibility for a 10-year visa without a sponsor

   a. *Investors in public investments of at least AED 10 million* – conditions:
      i. A deposit of at least AED 10 million in an investment fund inside the country;
      ii. Establishing a company in the UAE with a capital of not less than AED 10 million;
      iii. Partnering in an existing or a new company with a share value of not less than AED 10 million;
      iv. Having a total investment of not less than AED 10 million in all areas mentioned, on condition that the investment in sectors other than real estate is not less than 60 per cent of the total investment;
      v. The amount invested must not be loaned;
      vi. The investment should be retained for at least three years;
      vii. There should be a financial solvency up to AED 10 million.

   b. *Persons with specialised talents* – conditions:
      i. Scientists must be accredited by the Emirates Scientists Council or holders of the Mohammed Bin Rashid Medal for Scientific Excellence;
      ii. Creative individuals in culture and art must be accredited by Ministry of Culture and Knowledge Development;
      iii. Inventors must obtain a patent of value, which adds to the UAE's economy – patents must be approved by Ministry of Economy;
      iv. Exceptional talents must be documented by patents or a scientific research published in a world-class journal;
      v. Executives must be owners of a leading and internationally recognized company or holders of a high academic achievement and position;
      vi. Doctors and specialists must meet at least two of the following conditions:
         - A Ph. D. degree from one of the top 500 universities in the world;
         - An award or certificates of appreciation in the field of the applicant's work;
         - Contribution to a major scientific research in the respective field of work;
         - Published articles or scientific books in distinguished publications in the respective field of work;
         - Membership in an organisation related to the field;
         - A Ph. D. degree, in addition to 10-year professional experience in his field;

[2] Source: https://government.ae/en/information-and-services/visa-and-emirates-id/residence-visa/long-term-residence-visas-in-the-uae

- Specialisation in areas of priority to the UAE.

Eligibility for a 5-year visa without a sponsor

c. *Investors in a property in the UAE* – conditions:
    i. The investor must invest in a property of a gross value of not less than AED 5 million;
    ii. The amount invested in real estate must not be on loan basis;
    iii. The property must be retained for at least three years.
d. *Entrepreneurs* – conditions:
    i. Must own an existing project with a minimum capital of AED 500,000, or those who have the approval of an accredited business incubator in the country;
    ii. The entrepreneur is allowed a multi-entry visa for six months, renewable for another six months. The long-term visa includes the spouse and children, a partner and three executives.
e. *Outstanding Students* – conditions:
    i. Outstanding students with a minimum grade of 95% in public and private secondary schools;
    ii. University students within and outside the country having a distinction GPA of at least 3.75 upon graduation.

Long-term visa includes families of the outstanding students.

2. **Retirement visa for UAE residents** – In September 2018, the UAE Cabinet approved a law to provide retired residents over the age of 55 a long-term visa for a period of 5 years, with the possibility of renewal, if eligibility criteria is met.

    Eligibility for a 5-year retirement visa

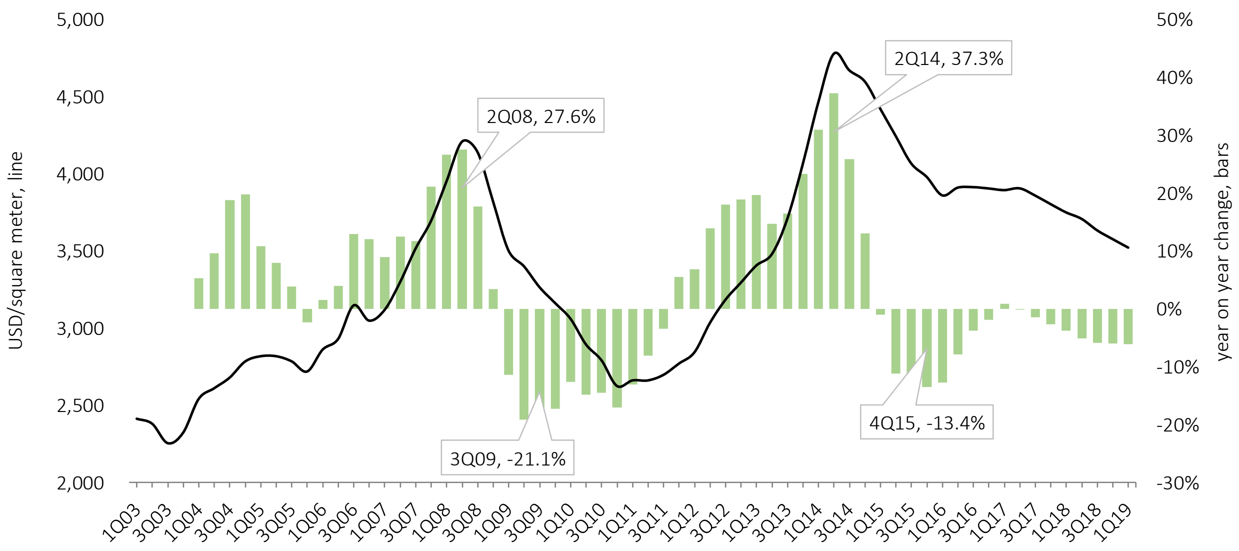
    For a retiree to be eligible, he must fulfill one of the following criteria:

    i. Invest in a property worth AED 2 million;
    ii. Have financial savings of no less than AED 1 million;
    iii. Have an active income of no less than AED 20,000 per month.

# Valuation

Prices of residential units in Dubai have experienced much volatility in the past 13 years due both to the only recent opening to foreign investments, to an unprecedented level of highly levered speculation – the average equity down payment was just 5% pre-2008, compared to today's 20%-35% – and to the 2008 global economic crisis. In hindsight, there could not have been a more challenging time to open a real estate market in its early stage to non-domestic influence, as the impact on valuation clearly shows. The graph below reveals that the residential units' average price retraced about 50% from the peak of the 2008 third quarter to the first quarter of 2011; the low seen in 2011 brought the valuation to the pre-2006 domestic-limited ownership years, which also reveals where a price support existed for the first, important test for Dubai's residential properties.

Prices per square meter, Dubai residential average

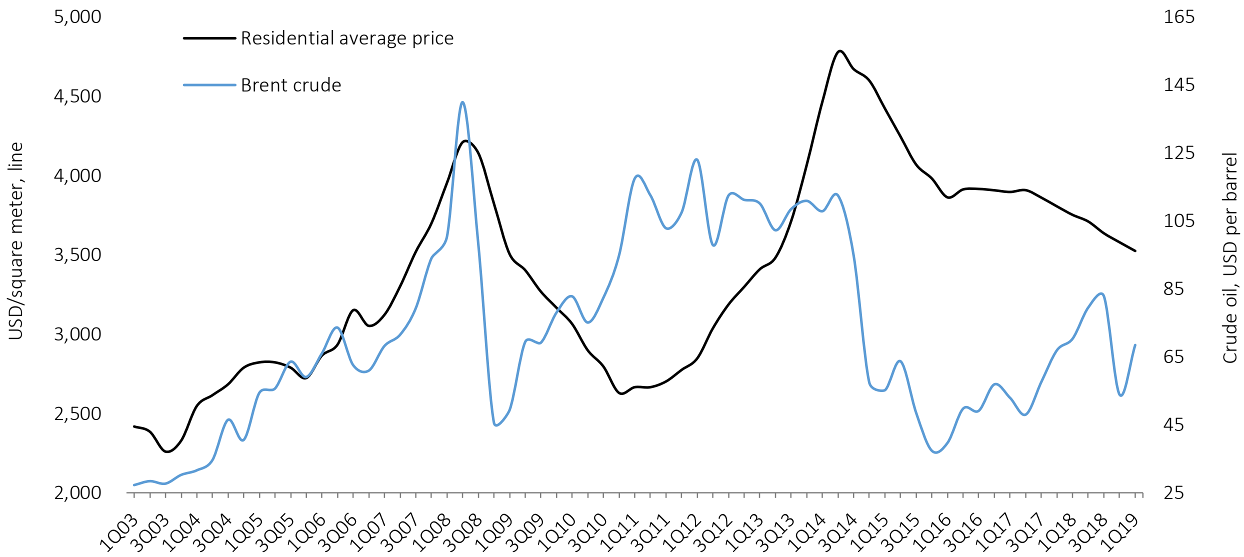



Source: Dubai Statistics Center, Bank of International Settlements, Index & Cie Research

Since 2011, another spike in price in 2014 tested and surpassed the record high of 2008, to then retrace substantially and in a remarkably similar fashion to the post-2008 trend. The lower rate of price decrease seen from first quarter 2016 until today is definitely more dependent on the massive amount of supply brought online by developers, rather than by a panic sale witnessed during the aftermath of the global financial crisis. Overall, the flection in prices is following a rather textbook trend in which an abundance of supply is diluting the monetary value of the average property; from a commercial point of view, much hope seems to have been put on the EXPO 2020 event, which is historically proven to be beneficial for the general economy of the host city – there are multiple examples of such effect, last of which was Milan EXPO 2015 when the city enjoyed a sort a real estate "renaissance" that has lasted until today, among widespread positive economic effects.

An element of further influence on property prices has to be found in crude oil, which has indeed staged a recovery since 2016's lows, but seems poised to remain bound in an US$55-80 price range for a while.

Residential prices and crude oil



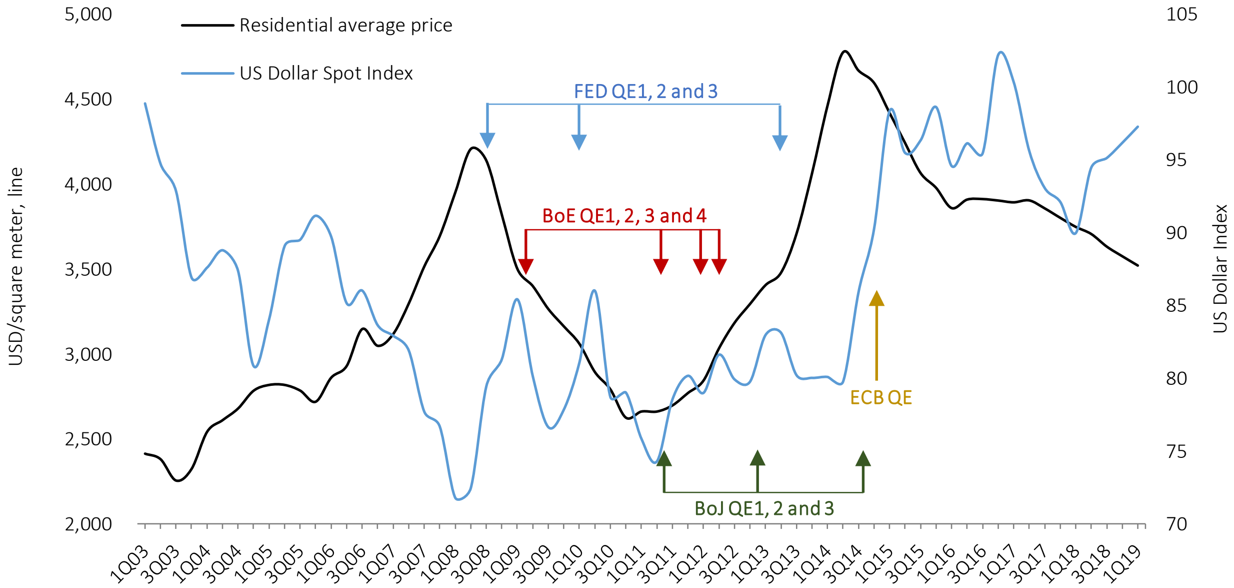

Source: Dubai Statistics Center, Bloomberg, Index & Cie Research

Since our last analysis in 2016, a de-coupling of crude oil and property prices seems to have materialized, in contrast to what we found back then on the price trend being more correlated regionally to crude oil and to the strength of major currencies than it was back in 2008 when the subprime crisis triggered a global collapse in real estate prices. The correlation between prices and internal supply exuberance has increased, while it has diminished with the price of crude oil. If supply is indeed causing this price decrease, further weakness to valuation might be expected as we get closer to EXPO 2020.

We next looked at major currencies against the US Dollar and vice versa, in an attempt to establish whether substantial changes to purchase power can be correlated with sharp rises and falls of the Dubai residential market. It should be noted that the quantitative easing policies promoted by the US, Europe, Japan and the UK since 2008 added a layer of complexity for those who want to understand the global balance in currencies; the hundreds of billions of various currencies that the Western and Japanese banking systems and ultimately their real economies received from central banks were aimed not just at sustaining high levels of both government and corporate debt accumulated in decades of near-zero borrowing rates, but also and most importantly to facilitate earnings growth via exports thanks to artificially devalued currencies. Discussing the global equilibrium among the top 5 currencies is beyond the objective of this paper and might pose serious challenges given the magnitude and reach of the phenomenon; the effect on Dubai residential prices does not seem to show any clearer cause and effect relationship when one looks at the US Dollar index, a gauge of US Dollar strength against a basket of currencies.
Note that the real estate prices are represented in US Dollar per square meter.

Real estate prices vs currencies

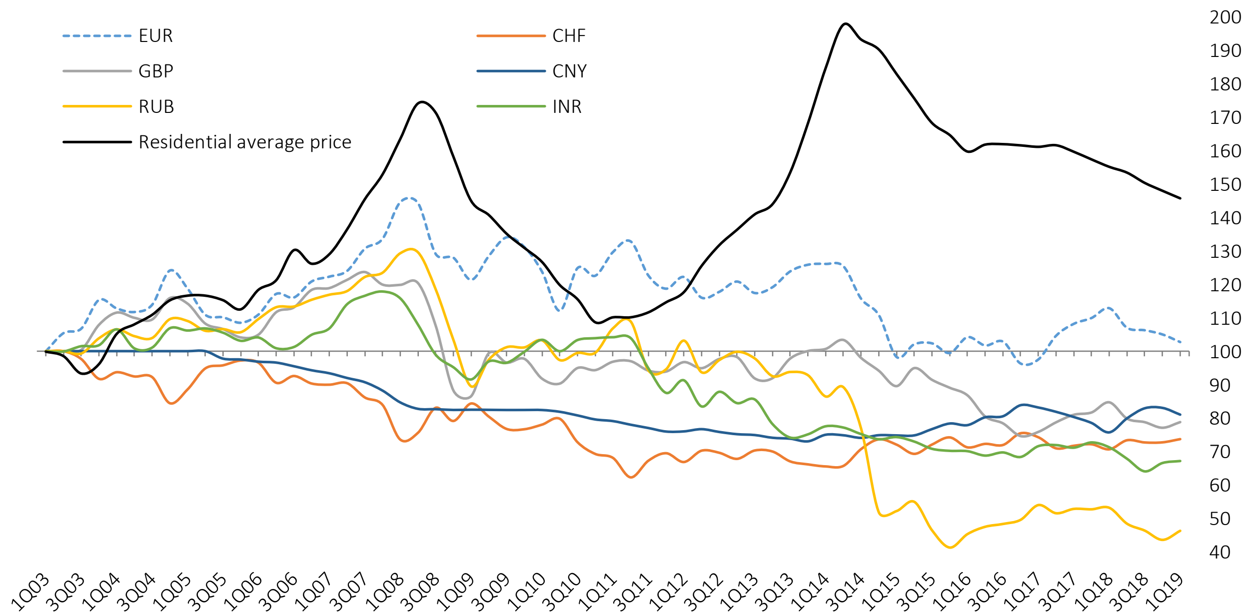
US Dollar index* and quantitative easing programs, by country




* Strength measured against a basket of currencies composed of Euro 57.6%, Japanese Yen 13.6%, Pound Sterling 11.9%, Canadian Dollar 9.1%, Swedish Krona 4.2%, Swiss Franc 3.6%

Source: Dubai Statistics Center, Bloomberg

Selected currencies relative to the US Dollar, rebased at 100




Source: Dubai Statistics Center, Bloomberg

In US Dollar terms, foreign investors' buying power has come down between 20% and 60% since 2003, that is an average yearly depreciation of 2.5%, excluding the Euro, which has appreciated negligibly. It is likely that a stronger US Dollar had an effect on prices, as they are seen coming down in concert with the Euro and Russian Ruble in 2014 and later on in 2018. Dubai residential prices do not seem to be correlated to the Chinese Renminbi, despite the rising push from developers to attract Chinese investments and quite likely due to the fact the currency is under the total control of the Party as an economic lever.

# Going forward

### The past

Similarly to what we concluded in May 2016, we believe the predominant driver of Dubai's real estate market remains the investment needs and purchasing power of the resident population, which seems to have somewhat decreased from only three years ago. However, differently from what previously observed, global economic trends have not affected as strongly the residential prices as they have in the past. Indeed, foreign currency and crude oil weakness have partially and negatively influenced property prices in Dubai, but the main responsibility for such decline since 2016 has to be attributed to the supply side, which has been substantially increased by developers. What we thought was a carefully planned market timing by developers turned out to be a rather unexpected increase in completed units for the years 2016, 2017 and 2018 and a consequent decrease in prices of about 33% from the peak in December 2014 to date. From a construction point of view, 2018 units planned were 76% higher than those in the previous year, which signals that much more supply is coming online in the next three years – as observed, the construction-to-completion cycle takes about three years distributed as 40-35-25 annually.
Noteworthy is the development on villas, which have increased considerably in numbers both completed and sold since 2015, and today account for just below 20% of the total inventory of residential units in Dubai, as of December 2018.

### The future

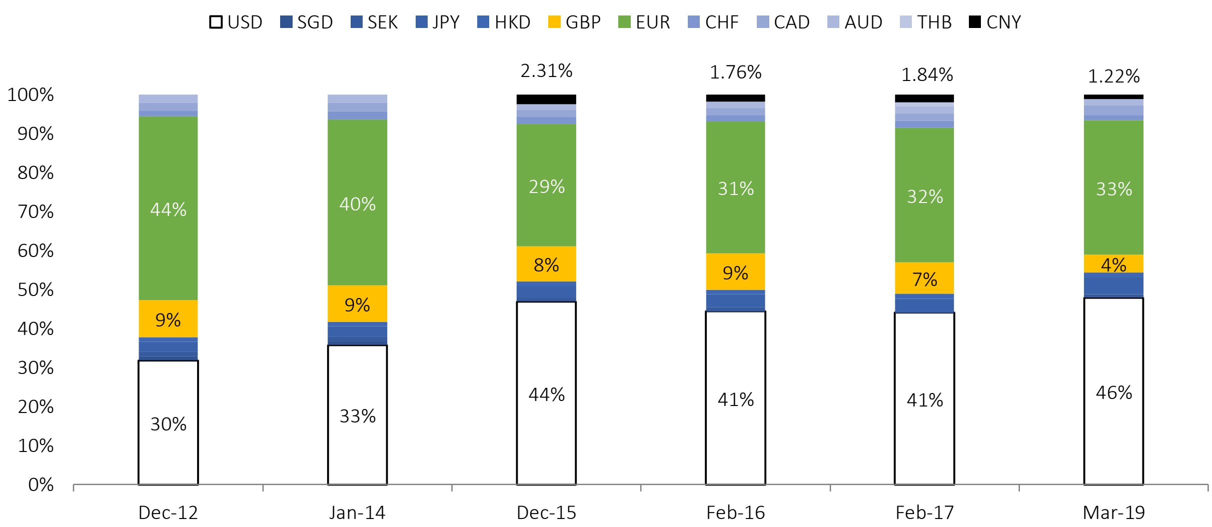
Considering how the past three years went and in this absence of more granular datasets, we believe there might be some more downward pressure for residential prices in 2019 and early 2020, due to an exuberance in internal supply, a fundamentally stable to negative outlook for crude oil price and a continued strengthening of the US Dollar against major currencies – at least until EXPO 2020 kicks in.
First, developers have effectively increased substantially their deliveries to the market to take advantage of high prices around 2013 – 2015, but the record level of completed units coming online had the inevitable effect of depressing prices, even in the most coveted areas of Dubai. While it is true that there is a price bottom for everything on sale, we reasonably expect that the downward pressure on prices will continue throughout 2019 and part of 2020, when the market could be revived by the beneficial effect of EXPO 2020.
Second, our prediction that prices would adjust upward from a low of US$35/bbl in mid-2016 was correct, as a prolonged time of exceptionally low oil prices triggered maintenance and expansion expenditure cuts at producers' level, which saw their profitability decrease for almost four years. Production capacity cuts at OPEC producers, sanctions on Iran and an almost zeroed production in Venezuela helped creating favourable conditions for prices to eventually rise. However, and from a fundamental perspective, prices have not risen and are highly unlikely to ever rise past US$80/bbl simply because there is an immense amount of available reserves in Canadian sands

and American shale, which combined are much higher than the projected global demand until 2050. Because of this fundamental truth, crude oil price fluctuations are 90% dominated by financial speculation rather than by users of the commodity, so that anything that happens to prices is mostly sentiment-driven. Forecasts on the price of a commodity that is globally used, heavily politicized and so strongly influenced by market sentiment are a rather ineffective tool to predict the future of Dubai's residential market, especially when adding to the equation the fact that alternative sources of energy – solar, wind and hydroelectric – are today a real alternative to oil from a $ cost per Kwh produced, even in the oil rich Middle East.

Third, we continue to feel we do not have visibility on exchange rates of major currencies against the US Dollar, despite the fact we expect the Dollar to continue appreciating on the basis of a stronger and more stable economy and higher interest rates than those of the immediate comparable countries (Europe, China). In May 2016 we saw a uniform loss of value at G7 level that took place against the Dollar, as a consequence of quantitative easing programs in major Western economies, which produced a rebalancing in all other world currencies; back then, we pointed to the Chinese Yuan and its moderate depreciation – on the basis of government intervention – to suggest that Chinese investors might become more relevant to the Dubai residential market. However, the past trend in global payments has been patchy in the last three years for the Yuan, as shown in the graph below.

**Share of global payments, by top 10 currencies**

Messages exchanged on SWIFT system, based on value




Source: Society for Worldwide Interbank Financial Telecommunication (SWIFT)

The decrease in use of the Yuan might be partially explained by the recent trade war with the US, where we have seen a clear willingness of the Trump administration to thwart further economic expansion and growth for China. We expect this trend to continue as the civilization clash intensifies.

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# Disclaimer

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