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The Creek in Deira, 1960

Dubai Marina, 2016

# A view on Real Estate in Dubai

Focus on residential and hospitality markets

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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

## Exceptional economic set-up, similar development path

History shows that the economic development of almost all land-rich countries begins from a socially organized and systematic form of agriculture, which in turn creates the basis for further ways of growth through manufacturing, trade and services. Before crude oil was discovered, Dubai was known as a trading post for goods and services with a pearl-fishing market; when crude oil sale receipts began flowing through in 1969, the Emirate's government took the decision to first expand its trade-focused infrastructure, i.e. the small and shallow commercial port Rashid. Since then, Dubai developed into what today is a major global hub for tourism, trading of goods and services, logistics and more recently financial services.

The very nature of a trading hub has been gradually exposing Dubai to forces typical of an increasingly interconnected global economy. As a result, and regardless of the different industrial set-up, many sectors of Dubai's economy have been developing, and are expected to keep developing, in a similar way to what these sectors have done in comparable countries.

In this paper, we analyze the historical evolution of the residential and hospitality markets; we focus on the former because it represents the largest part of the Emirate's real estate market, and on the latter because it is the expression of a highly dynamic and relevant part of Dubai's economy, i.e. tourism. In the residential market case, we used analogies with peer cities in an attempt to establish possible paths of evolution for the Emirate's market. Our analysis takes into consideration the causes and trends in both markets; it also shows that a change in investor's profile is taking place, signaling an adjustment to the changing nature of the economic environment.

## Residential Market

### Current situation

Dubai's real estate residential market is still in its initial phase of development and, in its ten years of history of being open to external investors' influence, prices have immediately been subject to the large swings of the real estate-based bubble of 2008 and 2009.

Our historical analysis shows that the ups and downs of Dubai's residential prices might be explained by the occurrence of the **2008-2009 global financial crisis**, the **sharp decline of crude oil** price since late 2014 and the **substantial devaluation of G7 currencies** seen in the last 16 years. Coupled with the development of Dubai's trade- and service-based economy, these external factors went on to influence the internal market dynamics. From the **demand side**, it seems that smaller sizes of both flats and villas are being bought, perhaps because investors perceive them as more liquid and better value holders, which might constitute a shift in attitude as opposed to pre-2009, luxury-driven investment preferences. From the **supply side**, while it would be interesting to see data around what kind of *flat* average size is offered by developers, we can establish that the

*villas* offered are seeing an increase in average unit size, which is somewhat in contrast to what the market seems to want. Such apparent discrepancy could be partially reconciled by the planned economic development measures the government has been applying to the supply side, effectively timing delivery of new units and limiting sale transactions – similarly to what other economies have done for the past 500 years.

### Forecasts

The predictability of the residential market evolution depends on both global trends and local government decisions. On one hand, we believe there is visibility on the following points:

- The **planned economic development measures** will remain in place for a while, as the government seeks to induce an organic and positive growth in residential prices, in line with the 70-year price growth trend observed in Hong Kong, Singapore, Geneva and Monaco;
- **Crude oil** will likely consolidate towards higher levels than those seen in late 2015-early 2016, since such lows seem to have triggered a production capacity cut among oil producers, which in turn will expose the industry more to supply-driven shocks than to demand-driven ones. The probable price adjustments upward would in turn reduce the headline risk associated with investing in Gulf economies, where Dubai enjoys the strongest positioning.

These points should provide support to prices, making them unlikely to reach 2011 lows again.
On the other hand, we believe there is not enough visibility on **foreign exchange evolution**. This is because G7 currencies have been undergoing an artificial devaluation since 2008, whereby the major recipient of the opposite appreciation has been the Chinese Yuan, now the fifth most used currency in global trade settlements. As China gradually devalues its currency and in doing so seeks to further overtake the US as the next global economic power, we do not feel there is enough visibility on G7 currencies appreciation level, which in turn leaves uncertainty around changes in foreign investors' buying power.

## Hospitality Market

### Current situation

Tourism is one of the major contributors to the Emirate's economic growth; at 20% of GDP, this industry is **expected to expand at 7-9% annual rate until 2020, with a target of 20 million visitors**.
A **massive infrastructural effort** is at the root of the past and future growth in the tourism industry. The two airports currently serving Dubai, DXB and DWC, have contributed substantially to the current Emirate's status of a global hub – DXB is now the world's number 1 international airport for passenger traffic, having overtaken London Heathrow in 2014. Furthermore, the Etihad Railway project is expected to connect the city and DWC to neighboring emirates. The 2020 target of 20 million visitors will be further encouraged by the EXPO 2020, a historically powerful advertising tool for global awareness and future business opportunity creation.
Considering the original positioning of the Emirate's tourist proposition, **the hospitality industry is still dominated by 5-star hotels** (70% among luxury, upper upscale and upscale categories). Estimates are of a continued dominance of such segments until 2020, with 70% of new supply in

these categories. The weak Euro, declining oil prices and regional disruption will likely produce 2016 results lower than those of 2015; however, Dubai has been consistently outperforming all other destinations in MENA and annual growth estimates are of 10% annually to 2017.

## Forecasts

The global hospitality industry has undergone significant consolidation in the last few months. The recent acquisitions by Accor Hotels in the MENA region will give the group an 8% share of the worldwide hotel inventory. Furthermore, Marriott is set to become the world's largest hotel group, which will account for up to 15 % of the global hotel supply. These global deals are expected to significantly impact the Dubai hotel market, given that more than 90% of the Emirate's market are affiliated with both international and locally-grown players.

An historical analysis of the rise of hotel brands in the Western markets shows that **institutional investors became increasingly active in the acquisition of hotel portfolios**. As of today, the global hotel ownership industry continues to be dominated by private equity and investment funds, which represented 28% of the total global transaction volume in Q1 2016 and are expected to account for 50% of total global transaction volume by year end.

Consistently with the global setting, the **hotel real estate market in Dubai is largely driven by domestic funds and private investors**. This is a direct consequence of both the limitations on freehold foreign ownership and the perceived risk profile of hotel investment which, until now, did not fit the local banks' lending matrix. Furthermore, a weak oil price, contracting yields and a general negative sentiment on Western tourism destinations are expected to push **Middle Eastern sovereign wealth funds to direct investments towards the domestic property markets**, providing additional dynamism and improved structure, especially in preparation for the EXPO 2020.

We expect the profile of the real estate investors in Dubai will resemble that of other established international markets as the UAE become a mature, international real estate investment market. Institutional investors will still dominate local transactions in the future, providing individual international investors with a platform to actively participate in the hotel ownership landscape.

# Residential Market

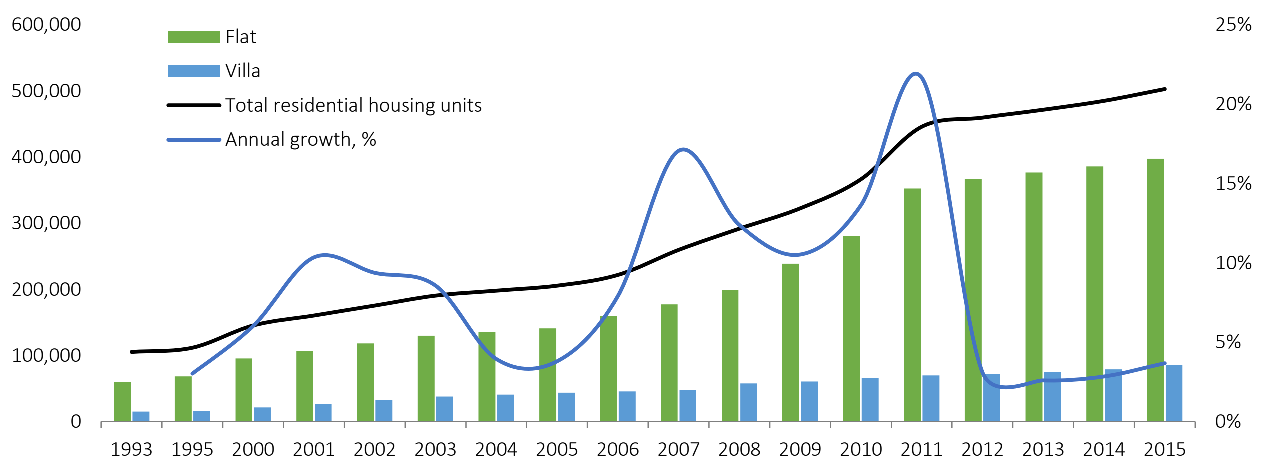
## I. Supply

The real estate market in Dubai remained exclusively accessible to locals and GCC nationals since its very beginning in 1950's until the government announced its intention to open freehold ownership to foreigners in early 2002, a law that came into effect in March 2006. This was the major step of a normalization process towards an increasingly efficient real estate environment, which effectively brought Dubai closer to other cities that enjoy similar socio-economic characteristics.

Field observation of the early-stage real estate evolution suggests that the residential segment has been developed via waves of construction in dedicated areas, in a similar fashion to any other city in its early days and increasingly exposed to global trade and investments. These waves were and still are masterminded and executed by top developer EMAAR, which began the development of Emirates Hills in 1997, Dubai Marina, Arabian Ranches and the Dubai International Financial Center (DIFC) in 1998, Downtown in 2000, the Burj Khalifa in 2004 and is now working on the massive Dubai Hills project in joint-venture with Meeras, another UAE-based prominent developer.

The historical evolution of the residential inventory in Dubai shows what we believe is a wave of strong growth from 2005 to 2011. However, from 2011 onwards the growth in housing units available seems to have plateaued at ~4% onwards; this could signal a period of relatively low delivery from developers, as more projects are expected to come online in stages in Business Bay, Mohammed bin Rashid al Maktoum City and Dubai Hills, in this sequence.

Cumulated inventory of housing units



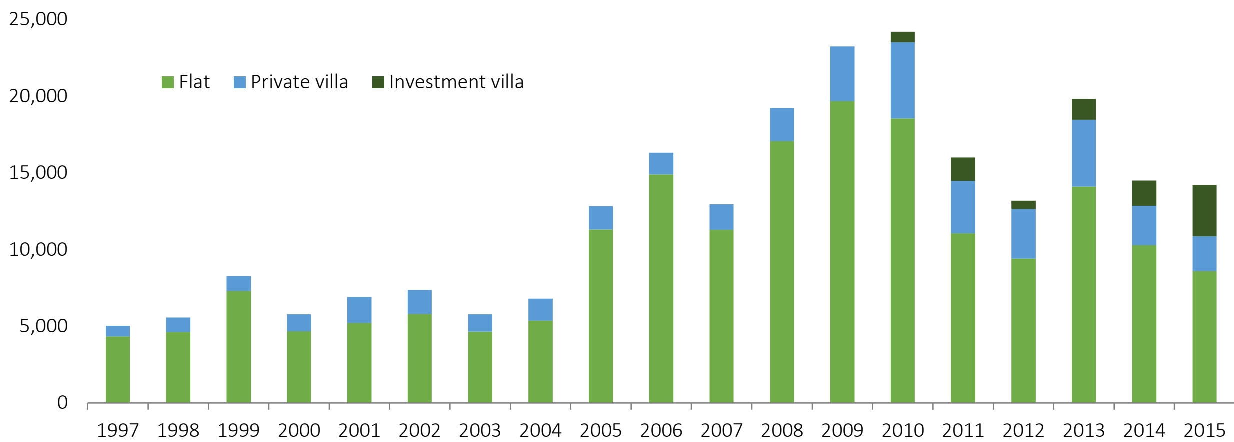

Source: Dubai Statistics Center, Dubai Land Department

Historically, EMAAR's construction efforts were rapidly joined in by a number of other developers, which added inventory in the surrounding areas. For instance, as EMAAR began construction in Marina in 1998, Dubai Properties kicked off the development of Jumeirah Beach Residences in 2002 (completed in 2010) and Dubai Walk (completed in 2014), while Nahkeel followed suit

developing Jumeirah Lake Towers (completed in 2011) and Palm Jumeirah in 2001 (completed in stages from 2008); similarly, EMAAR's Downtown project gave way to Business Bay's development by Dubai Properties, a project that is in an advanced development stage now, and Mohammed bin Rashid al Maktoum City just behind Business Bay by Meydan and Sobha groups.

From a year-by-year perspective, the recent development of the residential market shows a lower number of total units coming online since the peak of 2009; the graph below shows how the number of completed flats in 2015 decreased to the lowest level since 2004, while villas have shown a positive growth trend in numbers from 2012 lows – a phenomenon that remains secondary to the predominance of flats in the residential space.

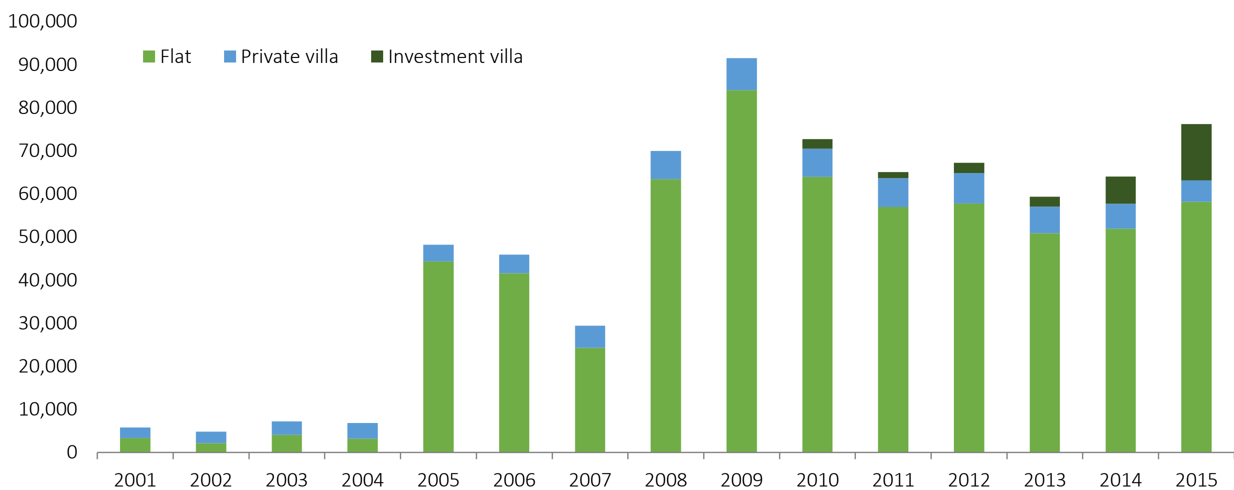
**Completed units**




Source: Dubai Statistics Center, Dubai Land Department

As previously mentioned, the construction activity strongly increased from 2005 onwards, coinciding with the freehold ownership granted to foreign investors.

**Units under construction**




Source: Dubai Statistics Center, Dubai Land Department

## Focus on villas

Although still representing a minor part of the overall flat-dominated residential market, recent developments in villas deserve a mention in light of the emerging "investment" category. In particular, it seems developers have been delivering increasingly more private and investment villas compared with a progressive cooling trend seen in flats.

Before diving into the villa segment, it is necessary to understand that the Dubai Statistics Center defines private and investment villas 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 has overtaken that of private villas in 2015, 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

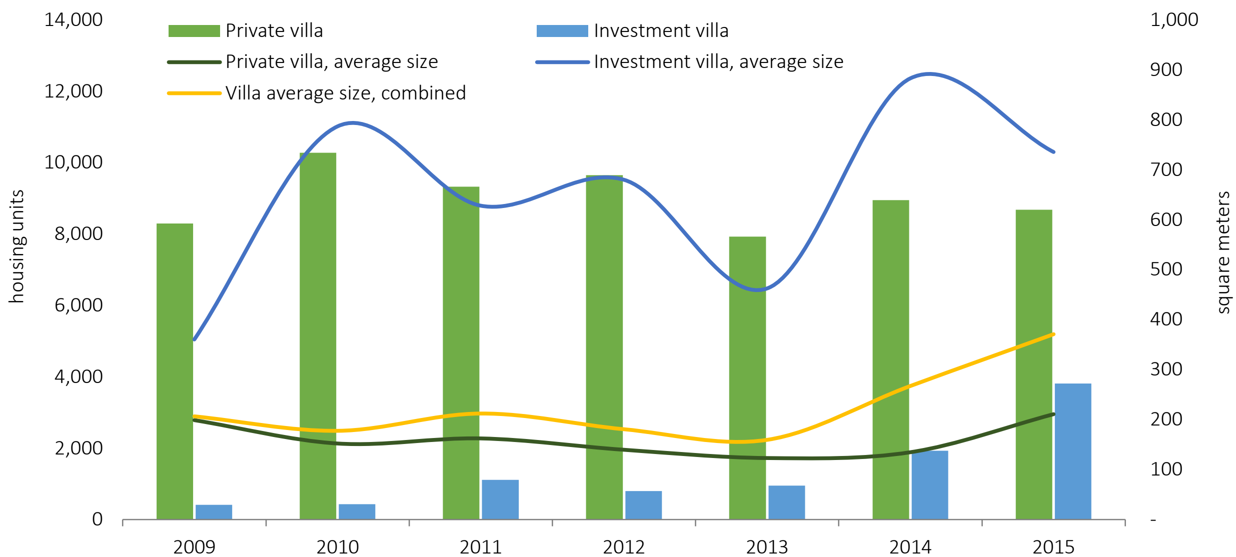
It appears developers have delivered an increasingly higher amount of investment villas since 2012, whose numbers have overtaken private villas in 2015. While it is difficult to exactly pinpoint the reason or origin of this trend, the numbers might suggest there is heightened interest from developers to offer investment type of villa in addition to the more traditional private villas.

Units under construction

Source: Dubai Statistics Center, Dubai Land Department

Furthermore, the history of building permits shows that the average size of the still predominant private villas have almost doubled from 2014 to 2015, which compares similarly to the average size registered in 2009. Investment villas have instead experienced a decrease in planned average size, which is nevertheless approximately in line with the growth observed since 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.

## Planned economic development measures, consistent with history

Our primary research suggest that the largest developers, being an extension of the Dubai government, have been and are currently timing delivery to the market of finished units, while issuing NOCs (no objection certificates, required from developers when units transfer from one owner to the next one) only after a certain number of years of holding period for first-time owners. Indeed, such measures are intended to make the initial phase of real estate development

smoother, financially self-sustainable, socially stable and consistent with an organic growth in resident's spending power.

In other words, these market practices are intended to "nurse" a young market into a mature state, when the government is in fact managing its development by controlling the supply lever according to the perceived level of demand. While this practice does not fall into the classical interpretation of protectionism – which implies high import tariffs on goods, establishment of national monopolies, denial of technology export, subsidies and so on – it does indeed recall a similar underlying purpose, i.e. to nurture a market.

In particular, the "infant industry" definition coined by Founding Father and first Treasury Secretary of the newly independent United States of America sounds distantly pertinent to our case: governments should treat their economies as parents treat their children. In other words, governments that protect their economies in the initial phases of development, by investing in the learning process and technological advancement until they reach maturity, are doing a similar job to that of parents who send their children through schooling in order to access high-paying jobs, instead of sending them, while still young and without an academic education, through employment in lowly paid jobs that require minimal intellectual skills.

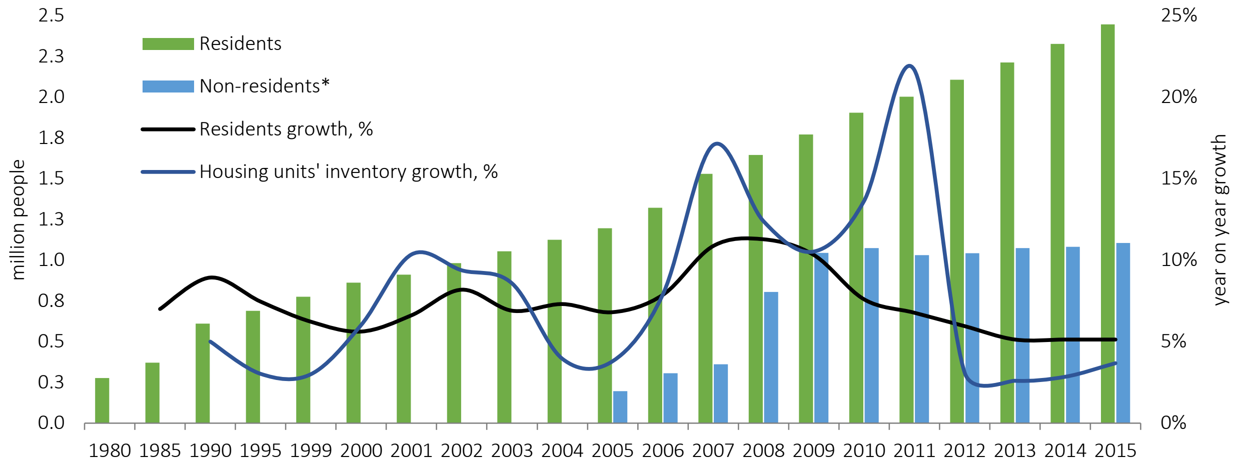
The greatest economic empires seen in the last 500 years were shaped on the basis of this principle; examples of one nation's economic supremacy over rivals by way of strongly protecting its own markets and companies are found in (1) the Tudor family of the British Empire, which established in 1570 high import tariffs and granted monopoly of trade and navigation to the East India Company (EIC) – penalty for British sailors caught trading without a license from the EIC was beheading, as the story of the now global conglomerate Jardine Matheson demonstrates, (2) the newly independent United States in late 1700, freshly separated from the British Empire, which found in the Founding Father and first Treasury Secretary Alexander Hamilton a promoter of protectionist manufacturing policies and high import tariffs, (3) Frederick the Great of Prussian Germany also in late 1700 and then the governments of unified Germany throughout 1800 and early 1900, (4) Japan after the Meiji Restoration in 1868, which adopted quite the same industrial and manufacturing protection measures of Germany, both countries sharing the ultimate goal to finance their expansionistic plans in their respective regions, (5) Northeast Asia, including Taiwan, South Korea (under Japanese influence in first quarter of 1900) and China, all of which adopted similar protectionist policies on manufacturing and industrial businesses in the aftermath of WWII.

While there remain many fundamental differences in the adopted industrial policies between the mentioned countries and Dubai – whose economy did not develop along the traditional sequence of agriculture, manufacturing, trade and services phases – it is evident that the Emirate's government has interest in making the initial phase of the real estate market development as smooth and stable as possible, which will ideally and ultimately translate into an organic, positive growth of prices as much as it happened for comparable cities (discussed in the Valuation chapter).

# II. Demand

In an attempt to identify the major growth drivers of residential housing demand, we examined the evolution of the residential population and of the workforce in Dubai. A comparison between growth trends in the residential market and in the resident population shows that the two rates are indeed different in magnitude but positively correlated.

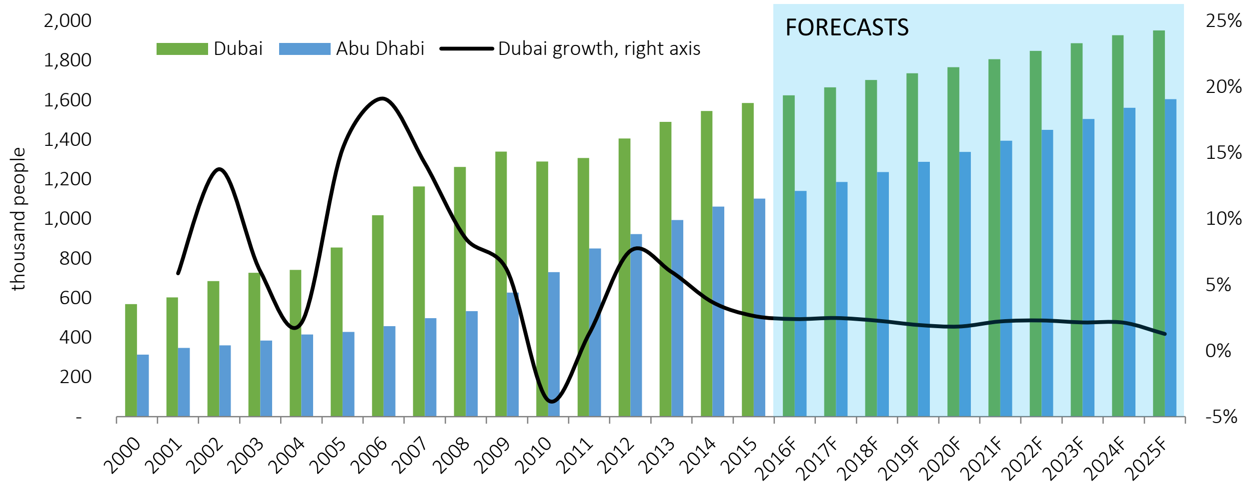
Population and housing units' inventory




* People residing outside Dubai, plus the average of tourists and sailors

Source: Dubai Statistics Center, Dubai Land Department

Total people employed

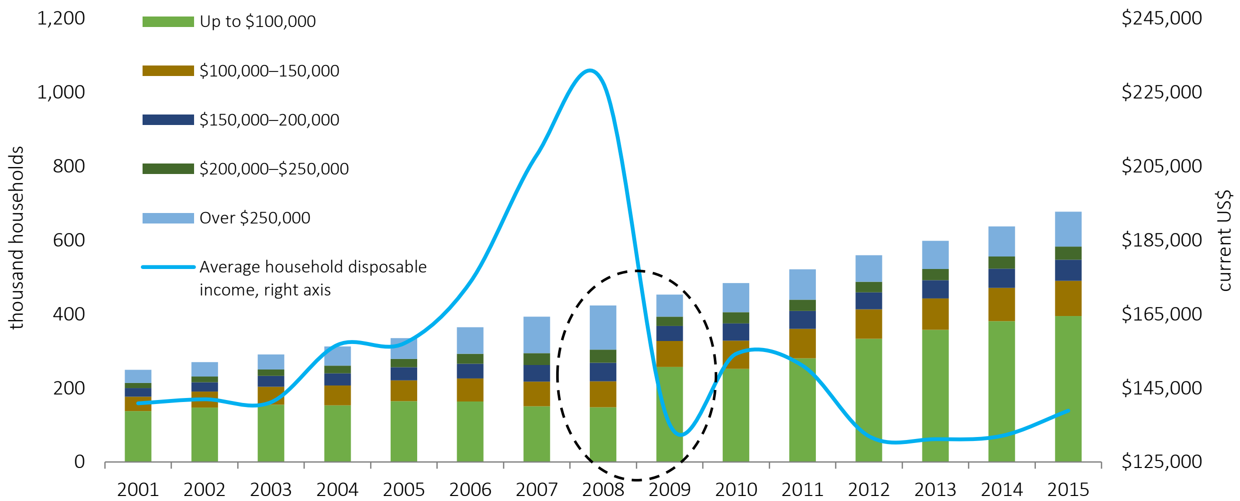



Source: Dubai Statistics Center, Oxford Economics forecasts

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 cooled since 2012 onwards to a substantially lower level, ~5%, when compared to an average of 12-15% between 2000 and 2012. We believe this is only a natural evolution of the supply side, as 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.

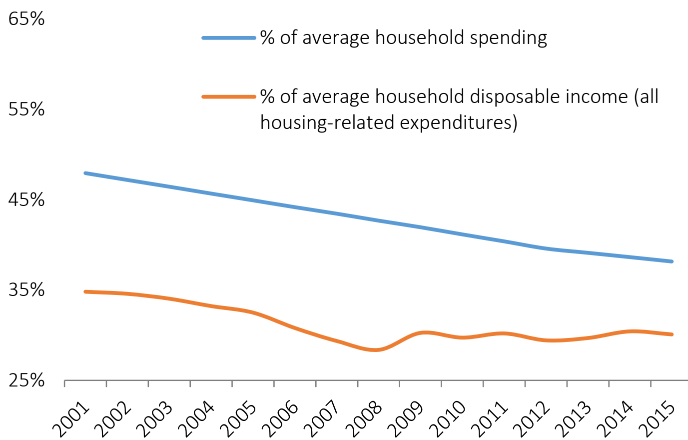
#### Households and disposable income




Source: Dubai Statistics Center, Oxford Economics

It appears as if the crisis had a particularly hard effect on the higher-earning portion of households, which considerably shrunk from 2008 to 2009 both in absolute numbers and in comparison with the segment <$100,000. Consequently, the average disposable income adjusted to lower levels, which now seems to be stable around $140,000 per household.

#### House-related expenditure for households

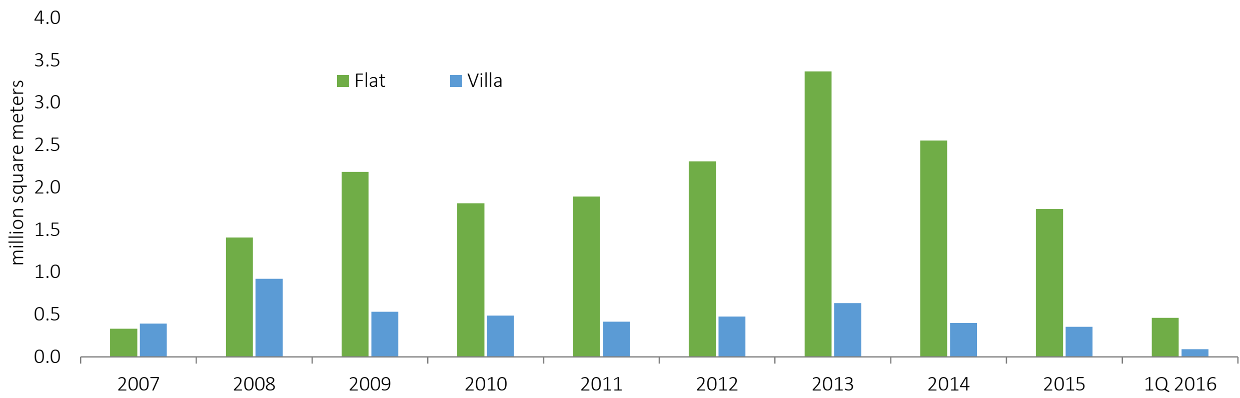



Source: Dubai Statistics Center, Oxford Economics

A closer look at the impact of house-related expenditure reveals that, despite a diminished average disposable income in the past 15 years, today households spend on average about 30% of their earnings on rent (a proxy for mortgage payments), utilities and maintenance in comparison to ~35% in 2001. Forecasts are of a further reduction below 25% by 2025, meaning housing is expected to become more affordable as wealth grows – another sign of normalization.

When looking at the sales history of residential units, it emerges that the actual demand has substantially decreased since 2013, a fact that might be attributed both to the reduced supply from developers and to the deterioration of purchasing power in light of sharply rising prices post-2011 (see next chapter on valuation).

Square meters sold

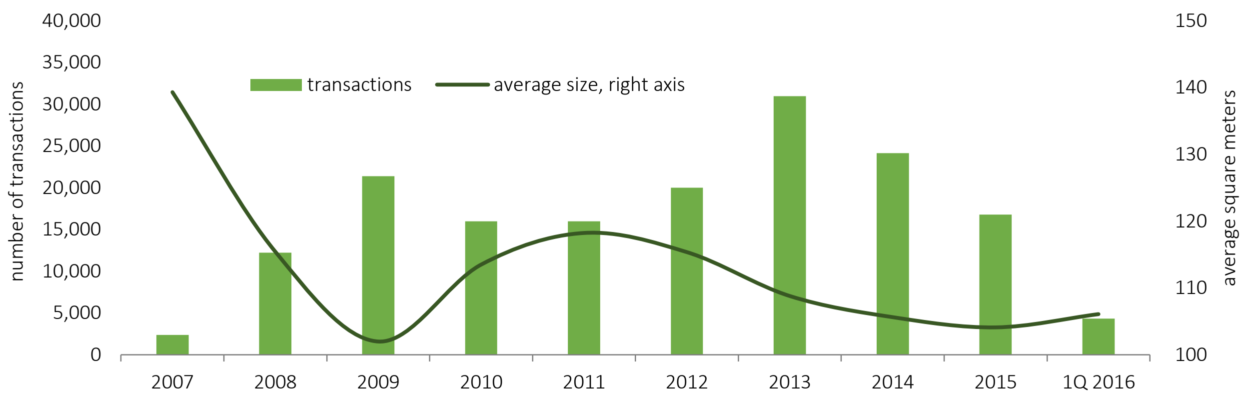



Source: Dubai Land Department

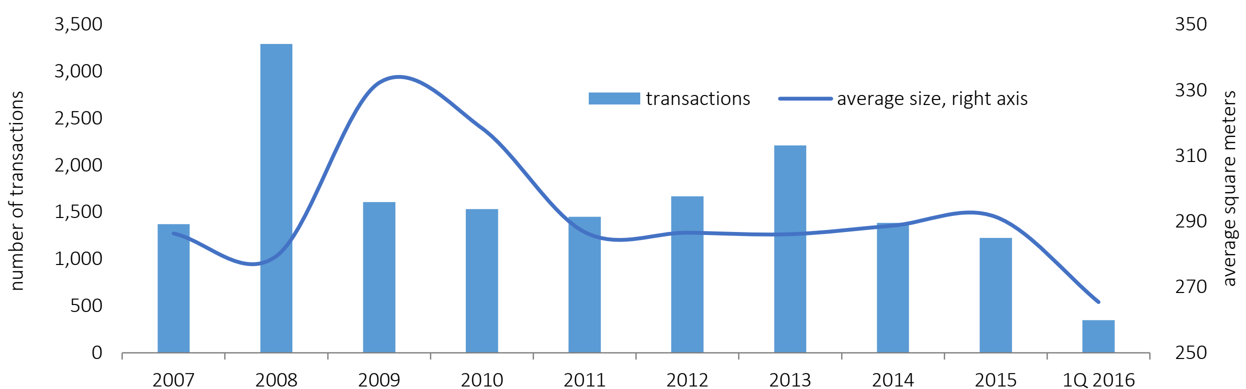
In addition, data on residential transactions suggest an adjustment in average size is taking place in both flats and villas. This could be the result of a change in the typical profile of investors in the residential space, where the average size of flats is normalizing around 105/sqm per unit while villas are diminishing in average size.

Units sold and average size

Flats




Villas




Source: Dubai Land Department

Such development could be a sign that property buyers are on average and increasingly attracted by smaller sizes in both flats and villas, perhaps because they perceive them as 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.

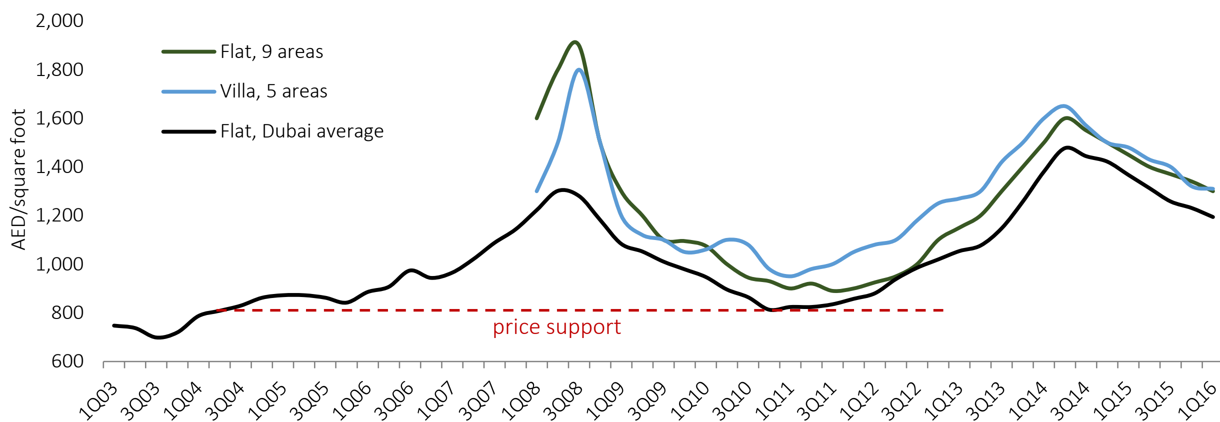
With reference to the average size of villas offered, it seems developers have been predicting a constant or rising appetite for larger units since 2009; the average size that encountered customers' appetite has instead been decreasing since 2009, with the first quarter of 2016 pushing the average even lower. It should be noted that the dataset we have is too short in time to be statistically useful in our effort to imagine the future of the villa segment in Dubai; also, readers should be reminded that villas are still a minor part of the residential housing inventory in Dubai (~28%) and are on average more expensive both in purchase price and maintenance cost – therefore catering on average to one part of the resident community, i.e. families.

# III. Valuation

## Dubai

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 flats' average prices retraced almost 50% from those seen during the third quarter of 2008; 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.

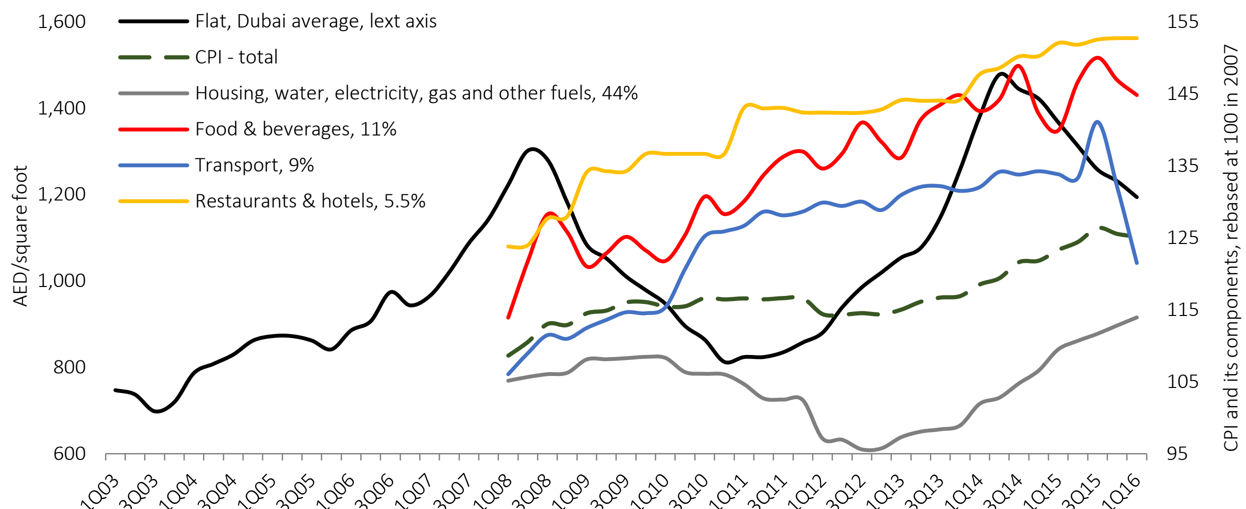
**Prices per square meter in selected areas and city-wide**




Source: Dubai Land Department, Phidar Advisory, Index & Cie Research

In order to have an approximate idea of how the real estate prices influenced overall consumer prices in Dubai, we plotted the flats' average against major contributors to the CPI, as per below.

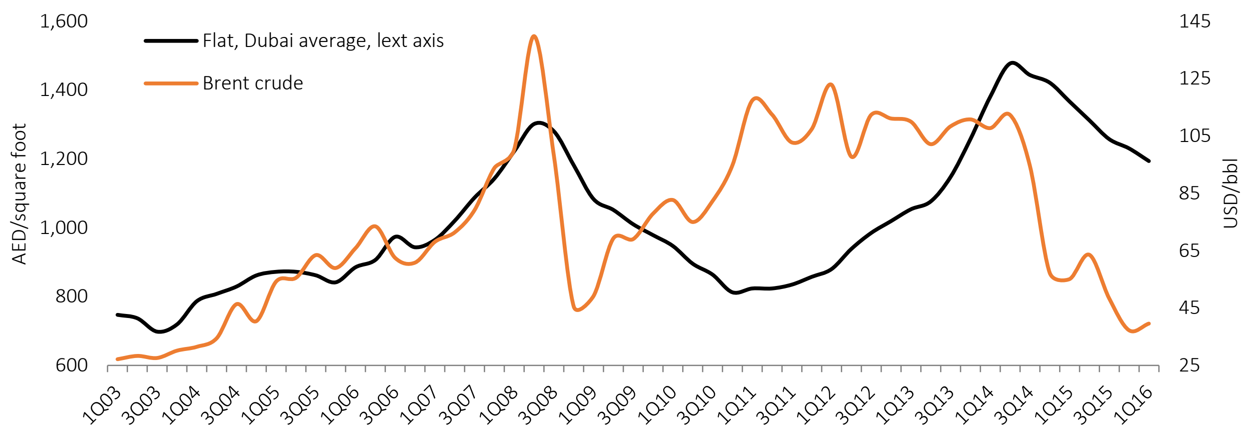
**Residential prices and consumer price index, by major contributors**




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

The housing, utilities and fuels category contributes almost 50% to the CPI, where the housing part consists of rent and could be considered as a proxy for mortgage payments; in other words, the CPI does not take into consideration sale transaction prices, but ongoing costs such as rent and mortgage payments. In the 2008-2012 timeframe, this component had the effect of maintaining approximately flat the overall CPI in a macroeconomic environment where crude oil price and all the other CPI components also increased markedly (see next graph for crude oil comparison). In addition, **the 2008-2009 sharp decline in sale prices affected housing-related ongoing costs with a 2-year time lag, while the more recent slump in prices does not seem to have exerted any effect on rents yet.** Field observation and our conversations with brokers show that so far rent levels have not adjusted to the correction in sale prices that took place since the third quarter of 2014.
We then turned to probably the most relevant headline variable to Dubai's real estate market and its overall economy: crude oil.

Residential prices and crude oil



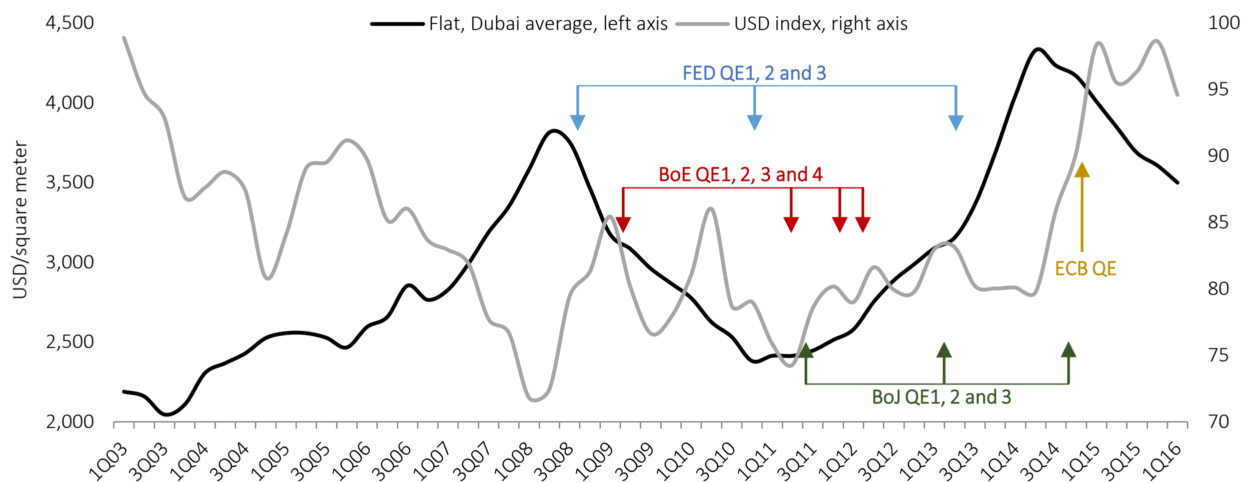

Source: Dubai Land Department, Bloomberg, Index & Cie Research

Despite the fact that Dubai has achieved probably one of the highest degrees of economic independence from oil among Gulf States, it is hard not to notice that there is a more than casual correlation between crude oil and residential prices over the past 13 years. In this context, we believe that the 2008-2009 "black swan" type of economic and financial shock should not be considered similar to the more structural slowdown in global growth observed in 2015 and currently undergoing; in other words, since 2015 we have been approaching the end of an expansionary credit cycle that fuelled corporate growth for decades now, which in turn follows the end of a commodity growth cycle dominated by the post-Mao, aggressively growing China. Therefore, we feel the real estate price adjustment seen since 2015 in Dubai is definitely more regionally-based and correlated to oil and to the buying power of USD-, EUR- and GBP-based investors than it was back in 2008 when the subprime crisis triggered a concerted collapse in real estate prices across the world.
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 as US Dollar per square meter.

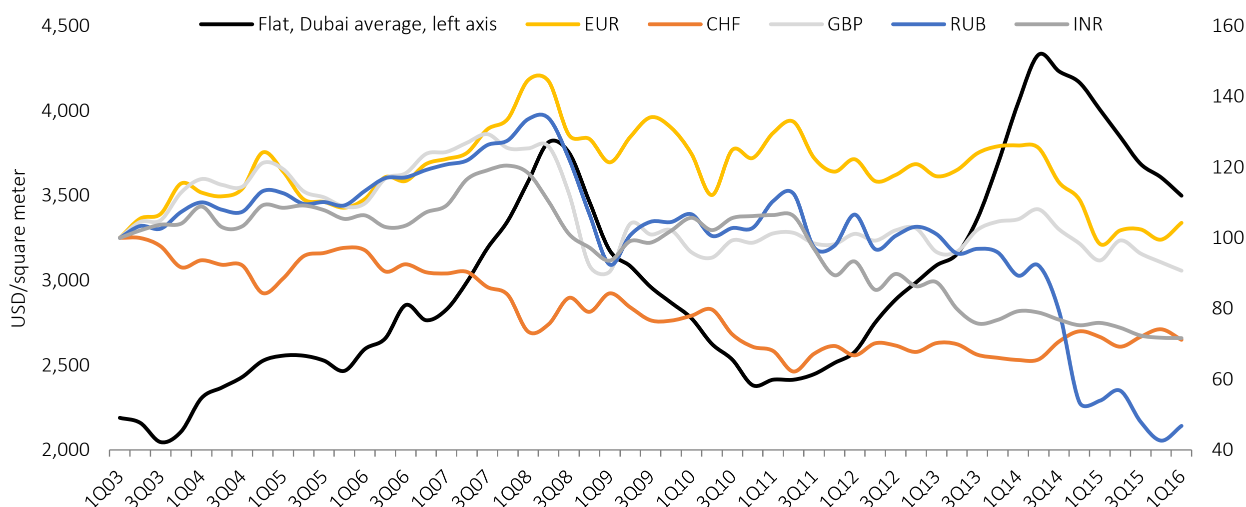
**Real estate prices vs currencies**

US Dollar index* and quantitative easing programs, by country




* Euro 57.6%, Japanese Yen 13.6%, Pound Sterling 11.9%, Canadian Dollar 9.1%, Swedish Krona 4.2%, Swiss Franc 3.6%

Selected currencies relative to the US Dollar, rebased at 100




Source: Dubai Land Department, Bloomberg, ICE, Index & Cie Research

When considering single currencies, it seems logical to expect the cause-effect relationship between Dubai residential prices and foreign investors' buying power to be more direct since 2015 than it was around the 2008 global financial crisis. In other words, the events of 2008 impacted all financial and real assets in a dramatic, negative way across geographies and sectors; instead, the

residential prices correction seen in Dubai since 3Q 2014 might have been due in part to sharply declining oil prices, the quantitative easing program by the ECB and the cessation of the one in the US, the last two resulting in a sharp appreciation of the US Dollar. Notably, the Russian Ruble also greatly depreciated as the Ukrainian crisis kicked in in late 2013, hitting at one of the most present nationalities in Dubai's real estate investment and tourism markets.

### Dubai and its closest peers

Our study of history and investment experience show that human behavior develops according to a hierarchy of needs, whose general structure Abraham Maslow theorized in 1943 and which applies to all individuals across civilizations. When the various manifestations of human development are represented as cycles through time and are compared on an absolute time scale, it emerges that business activity, creation of wealth and consumption develop in the long run in a uniform and similar way across countries. This is all the more true nowadays where the global economy is more connected than ever before.

Because of this anthropologic reality, we believe in the predicting power of analogies. Taken a set of similar situations – be they cities, companies or industries – the average historical development provides a useful insight into the future evolution of any early-stage situation. Since we believe Dubai will continue to be subject to socio-economic forces similar to those that affected comparable cities in the past, it follows that the residential market will also likely converge to its own long-term mean as it happened for its peers in their own times. Of course the challenge lies in finding the correct peers by a set of adequate characteristics, as Dubai displays rather unique features from many points of view.

Since 1969, Dubai rulers made a number of forward-looking, open-minded and business-oriented decisions around infrastructural, economic and investment set up, which were instrumental to create the competitive advantage that the Emirate has relative to other Gulf cities, States and the whole Middle Eastern region. The relativity is the key-point in this case and the basis for analogies with Singapore, Hong Kong, Geneva and Monaco. As observed in the past, an only marginally more secure environment for business and protection of wealth has been the origin of a long-lasting competitive advantage for the following cities:

1. *Hong Kong* – From 1842 to 1997 the city was under British control as a colony of the Crown, which developed the fishing village from a safe harbor for trading ships heading to China to a safe haven for business headquarters and wealth. China experienced deep social and economic turbulence since the early years of 1800 up to 1978, in a time sequence that saw the fall of the Celestial Empire, the years of aggressive Japanese invasion, the struggle for power between Chiang Kai-Shek's nationalists and Mao Zedong's communists and the profound social disruption brought by Mao's communist reign; all these created the base for Hong Kong to become the favorite harbor for those seeking protection for themselves and their wealth. Businesses were relocated in the colony and wealth was massively expatriated, especially as China plunged into the violent Cultural Revolution in 1949; even when Deng Xiaoping inaugurated the Open Door policy in 1978, investors' and business community's perception of China did not radically change or improve, and Hong Kong remained the base

for whomever wanted to do business with the Mainland and in general Northeastern Asia. This is still relatively true, although the city has been formally returned to China in 1997, is facing growing industrial and economic competition from neighboring Shenzhen and from a rapidly evolving national financial center in Shanghai;

2. *Singapore* – Since 1819 the British Empire began developing a small Malaysian fishing village belonging to the infighting Johor Sultanate into one of the busiest ports in the world, in the process building infrastructure and business under the protection of a strong rule of law. This happened during the colonial era when other European powers had already established their operating naval headquarters in the region (especially the Dutch in Malacca and the Portuguese in Macau), which meant that the British literally had to create a trading port from scratch. When the British had to gradually open the colony to self-rule after WWII, a democratic period began that lasted about 15 years during which the People's Action Party (PAP) of Lee Kwan Yew emerged as the strongest political choice of the population. Since 1959, the man managed to make Singapore one of the most business-friendly sites for Western companies that wanted to manufacture goods at lower cost and closer to larger, emerging markets. Progressively, Singapore became the safe haven of Southeast Asia, where wealth was safely parked and regional headquarters set up away from turbulent Indonesian, Malaysian, Filipino and Thai regimes, a feature that lasts well into our days;
3. *Geneva* – The Switzerland we know today became an independent state from the Holy Roman Empire in 1648, while its neutrality was re-affirmed in 1815 during the Congress of Vienna, after the devastation of the French Revolutionary Wars. Since then, the growing and belligerent Europe experienced centuries of conflicts that had high human and financial costs; countries sought to finance wars through higher taxation, confiscation of enemy's assets and printing money, thus triggering hyper-inflation. In this environment, neutral states like Switzerland with their relatively more stable fiscal and monetary policies and safety from foreign-asset confiscation became natural safe havens. However, it is only during the two World Wars that Switzerland experienced the kind of capital and wealth inflow that contributed to create some of largest banks on earth. The commercial, geographic and cultural proximity with Germany made Switzerland more important for wealth concentration and trade than for territorial expansion during WWII; therefore, the country managed somehow to stay neutral despite the unusually aggressive and expansionist German National Socialist government, effectively functioning as a vault for European wealth escaping racial laws, confiscation and destruction. The Swiss Banking Act of 1934 was approved in the wake of the National Socialist surge to power, with the idea to ensure banking secrecy by replacing account names with numbers; this feature was initially designed to protect certain clients' wealth from National Socialist confiscation; it is beyond our scope to establish whether this initial intention was practically upheld during and after WWII, a fact investigated by the Bergier Commission from 1996 to 2002, but it is evident that the Swiss banking industry owns its fortunes almost entirely to the wealth accumulated during those tragic years of European history. Geneva and Zurich were the reference cities and cemented their reputation as guardians of wealth up to recent times – if we disregard the breach of banking secrecy caused

by the multi-year, tax-evading conspiracy that embroiled some of the largest Swiss banks in 2009, 2014 and 2015, which in some cases led to admission of wrongdoing and to revealing client names;

4. *Monaco* – Established in 1289 by the Grimaldi, a guelf family fleeing power struggles in the Republic of Genoa, the city-state became officially independent from foreign domination in 1489 and was put under the protection of Charles VIII, King of France, against the claims of the then Reign of Sardinia. Since 1800, the principality of Monaco was long known as a primary holiday retreat in Europe, but it was only since Prince Charles III took control in 1856 that the city began seriously building its competitive advantage around elite tourism – via the government holding company Société des Bains de Mer – and gambling – through the Casino of Montecarlo. In 1949 prince Ranieri III, also known for marrying American actress Grace Kelly, improved the city's economic standing by encouraging financial and real estate expansion, thanks to Aristotle Onassis' restructuring work of the Société des Bains de Mer. The result of centuries of elite tourism made a high concentration of wealth and politically relevant people possible in the very geographically limited, 2km$^2$-wide city; this condition, coupled with more than 50 years of favorable tax treatment for residents, made the real estate development of Monaco comparable to no other in any other city in modern history, thus representing a superior limit to price growth.

This brief historic excursus of each city shows how the respective competitive advantages were mostly established by creating a business-friendly environment in unstable regions and often during violent shifts in economic and political balances. The push towards a fast modernization of Dubai began in 1969, as oil receipts started coming in after the discovery of the Fateh oil field in 1966. The vision conceived by Sheikh Rashid bin Saeed Al Maktoum in those days was determinant for Dubai to develop its present relative competitive advantage; the business and legislative environment friendly towards trade and tourism through freezones, the busiest airport in international passenger traffic in the world and the busiest commercial port in the Indian Ocean, made the Emirate the commercial trading and aviation hub between West and East. Today, Dubai is the relatively safer place in a region where Iraq saw wars for 17 years since 1990 and still is in a civil war, Iran was subject to various trade and investment sanctions led by the US, Europe and the United Nations since 1995, the Arab Spring protests began in 2010 and involved at various degrees 18 countries in North Africa, Levant and the Gulf, Syria is in a civil war that involves an impressive number of participants since mid-2011 – a situation not too dissimilar to that of Libya since early 2011 – and Yemen is under a coup d'état-led civil war since mid-2014. Aside the religious, ethnic, social and political reasons at the historical roots of this regional unrest, it is clear these kind of events contribute to accentuate the relatively safer environment for business and wealth protection that Dubai, and in general the UAE, provide in the Middle East.

While these cities seem to share a rather similar positioning in their respective regions, when looking at them from a more real estate- and tax-focused level the differences are more pronounced, as shown in the table below.

Population density, taxation and freehold ownership

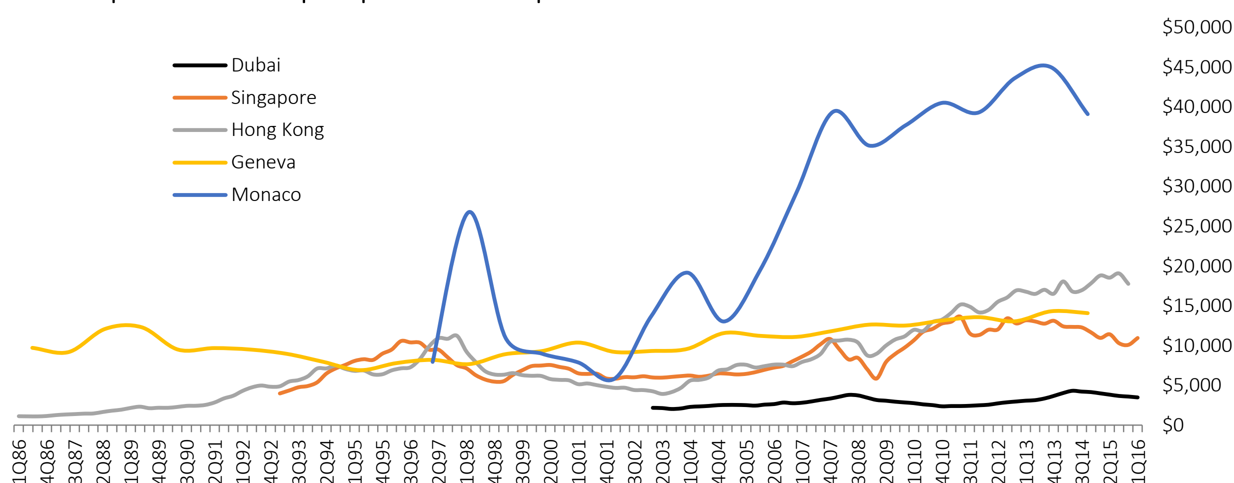
| | Density, people/km² | Population, people | Land area, km² | Resident Income tax | Corporate tax | Value-added tax | Capital gain tax | Freehold ownership for non-nationals |
|---|---|---|---|---|---|---|---|---|
| Dubai | 453 | 2,446,675 | 5,401 | 0% | 0% | 0% | 0% | yes, other than the coastal area from Marina to Sharjah |
| Hong Kong | 6,560 | 7,241,700 | 1,104 | 2%-17% | 16.5% | 0% | 0% | no, only 99-year leasehold |
| Singapore | 7,606 | 5,469,724 | 719 | 0%-20% | 17% | 7% | 0% | yes, except HDB |
| Geneva | 12,424 | 197,916 | 16 | 40% | 17.9% | 8% | 40% | yes |
| Monaco | 15,555 | 31,109 | 2 | 0% | 33% | 20% | 0% | yes |

Source: Dubai Government, IRAS (Singapore), Inland Revenue Department (Hong Kong), Swiss Federal Tax Administration, Ministry of Finance (Monaco)

The first thing that catches our eye is the density difference between Dubai and the rest of the group; this is indeed the result of a wider land area relative to its population, in comparison to the next peer, i.e. Hong Kong, but it is important to keep in mind that the Asian capital has only ~20% of buildable land area, which makes the density value in certain areas such as Central and Causeway Bay considerably higher than the reported average of 6,560 and considerable lower than that in mountainous areas towards the New Territories. In this sense, Singapore is a more telling example of a possible evolution of Dubai, albeit in a very far and optimistic future scenario. The two Asian cities are half way in density if compared to their European peers, which are far more concentrated, territorially smaller and less populated.

The final effect on residential prices of all this is shown in the graph below.

Residential prices – US Dollar per square meter comparison

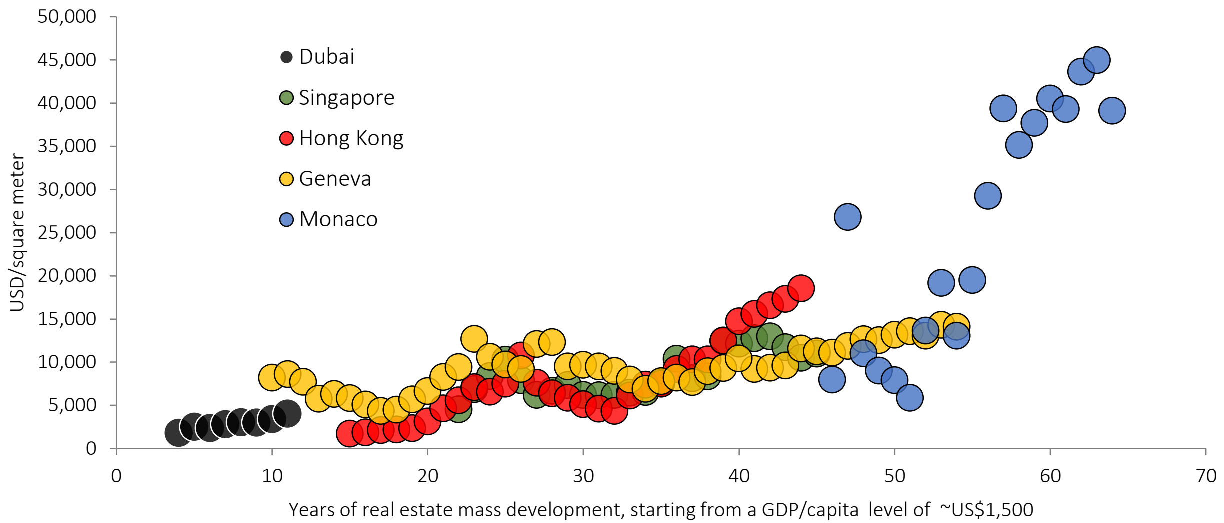



Source: Dubai Land Department, Urban Redevelopment Authority (Singapore), Singapore Department of Statistics, Housing and Development Board (Singapore), Rating and Valuation Department (Hong Kong), Swiss National Bank, Institut Monégasque de la Statistique et des Études Économiques, Index & Cie Research

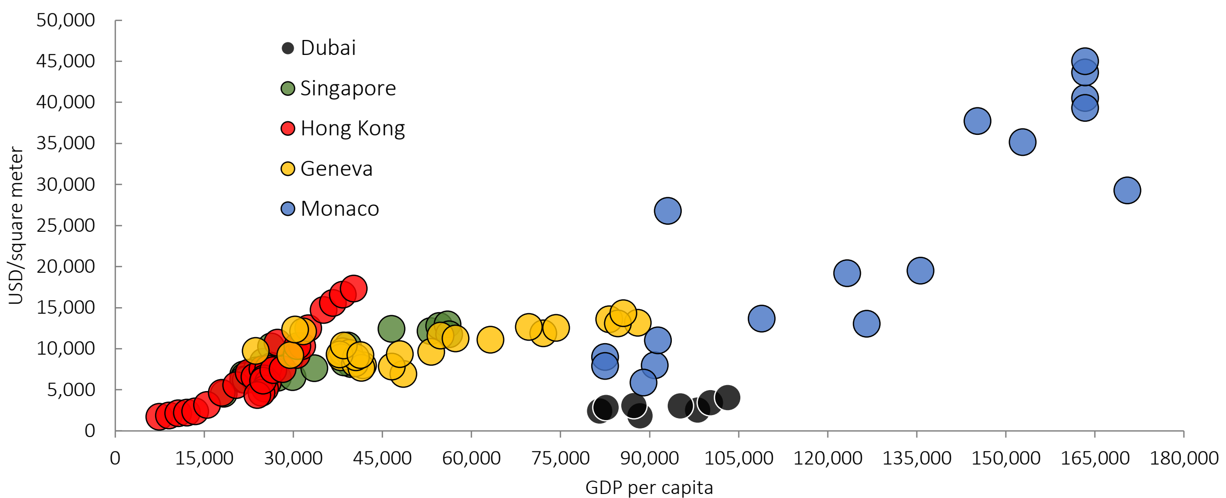
In order to put the historical evolution of prices in perspective, we plotted it against what we believe was the beginning of mass development for the real estate industry in each city – comparison starts from a GDP per capita level of ~US$1,500 to simulate a leveling of the buying power – and against the historical evolution of GDP per capita levels.

**Historical price evolution of Dubai and its peers, by years of real estate development and GDP per capita**

By years of real estate development




By GDP per capita




Source: Dubai Land Department, Urban Redevelopment Authority (Singapore), Singapore Department of Statistics, Housing and Development Board (Singapore), Rating and Valuation Department (Hong Kong), Swiss National Bank, Institut Monégasque de la Statistique et des Études Économiques, World Bank, Oxford Economics, Index & Cie Research

It is important to remember the GDP per capita data is not available for Dubai before 1970, and in 1971 it comes at US$28,000; this is due to both the sudden creation of wealth right after oil receipts came in in 1969 and to the lack of reporting by the World Bank or any other local authority on the years prior to 1969. Without a similar GDP per capita level, in Dubai's case we set the beginning of a real estate mass market in 2003-2004, which is halfway between the government announcement in 2002 of the intention to change property laws and the effective grant of freehold ownership of flats and hotels to foreign investors in March 2006.

Two things emerge from the graphs above: (1) Dubai is aligned to a similar upward-sloped price curve as its peers, and (2) Dubai is priced at a large discount to its peers compared to its per capita spending power. Even without considering the clear outlier Monaco, Dubai clearly falls into the emerging market category, which is understandable when keeping in mind that the whole country comes from an unparalleled wealth creation history – a condition only found among the Arabic Gulf States and in Brunei.

# IV. Going forward

## The past

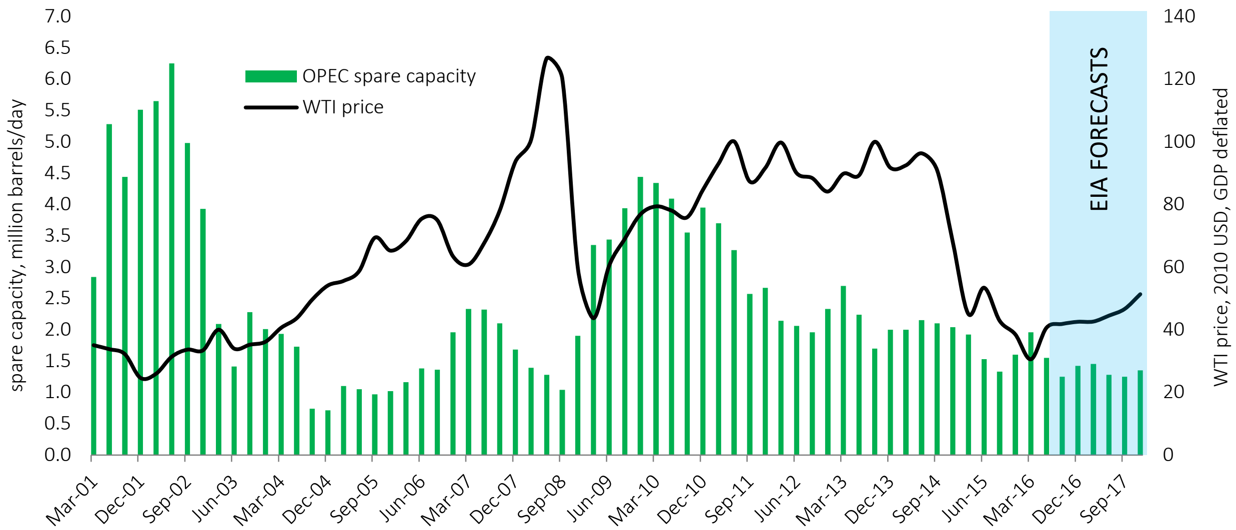
While we believe the predominant driver of Dubai's real estate market remains the investment needs and purchasing power of the resident population, it is clear that global economic trends had an effect on foreign investor decisions regarding investments in Dubai's real estate market; in particular, the decline of crude oil price and the substantial resetting of G7 currency balances seen in the last 3 years might contribute to explain the sharp movements of Dubai's residential prices.
These external factors went on to influence the internal market dynamics, especially the demand side. It seems that smaller sizes of both flats and villas are being bought, perhaps because investors perceive them as more liquid and better value holders, which might constitute a shift in attitude as opposed to pre-2009, luxury-driven investment preferences. While it would be interesting to see data around what average size is offered on flats by developers, we can definitely establish that the category of villas is seeing an increase in unit size – through building permits – which is somewhat in contrast to what the market seems to want. Such apparent discrepancy could be partially reconciled if we consider the market timing game played by developers since the very beginning, which represents a necessary protectionist move in the initial phase of market development, further confirmed by field observation and by our conversations with market participants. In particular, delayed deliveries to the market and obstacles to sell newly purchased properties could in fact be some of the levers developers have to resort to when a downturn in prices threatens their planned revenues and margins, as it is the case since 4Q 2014.

## The future

We believe there is visibility on two out of three factors of influence on Dubai's residential prices.
First, we expect the game of market timing to continue for at least the next 5 to 10 years, especially concerning properties around the Dubai Canal area. The comparison with peers suggests that the Emirate's price evolution is in line with what seems to be a common growth trajectory over the course of 70 years of real estate records, through various variables.
Second, we imagine a situation in which crude oil will consolidate towards higher levels than those seen in late 2015-early 2016, since prolonged times at ~US$35/bbl have indeed triggered a cost-cutting adjustment as oil producers see their profitability decrease. Production capacity cuts at OPEC producers, halts and postponements in capital expenditures for expansion globally are gradually creating the conditions for prices to eventually adjust moderately upwards; in addition, we see a substantially higher probability of supply shocks – both organically and from geopolitical risks in Nigeria, Iraq and Libya – than supply increases, while global demand for oil keeps growing. However, at the same time we do not see prices reaching the past ~US$100 area, since global reserves are at historical highest levels of 1.7 trillion barrels (as estimated by the 2015 BP Statistical Review). Therefore, the probable, mildly upward price adjustments in the future would in turn

have a beneficial impact on the headline risk associated with Gulf economies as an investment region, where Dubai enjoys the strongest position.

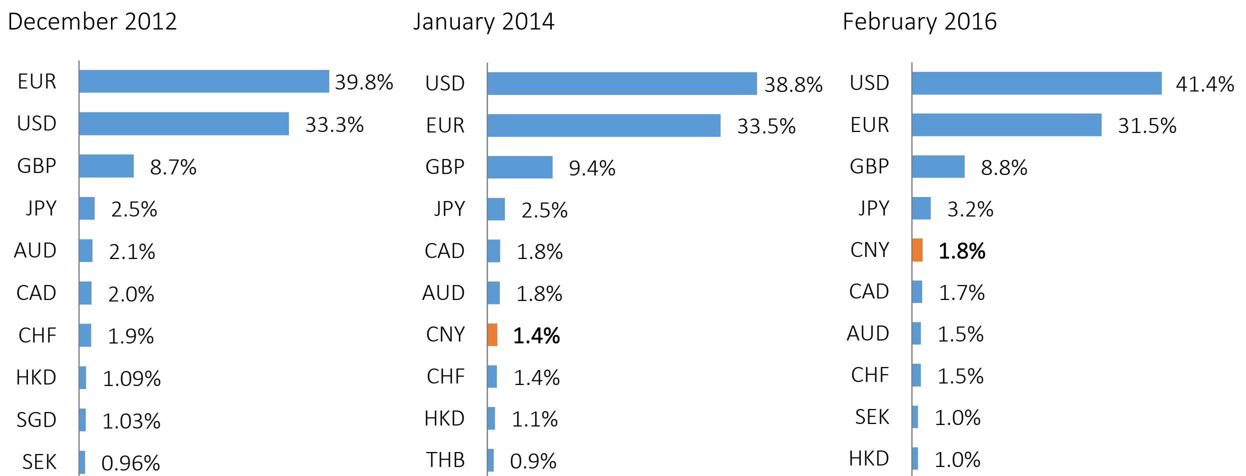
OPEC crude oil spare capacity and EIA price forecasts




Source: US Energy Information Administration (EIA)

Third, we do not feel we have visibility on the exchange rates of major currencies against the US Dollar, since the quantitative easing programs promoted by G7 countries starting from 2008 – and from 2001 in Japan – have sought to revitalize a naturally decreasing and anemic economic growth via the depreciation of national currencies. This uniform loss of value at G7 level has produced a rebalancing in all other world currencies, among which the Chinese Yuan has been the most hit simply because it is the fifth most used currency in global payments, and despite that it is rapidly gaining ground against major currencies.

Share of global payments, by top 10 currencies




Source: Society for Worldwide Interbank Financial Telecommunication (SWIFT)

The gain in presence in international settlements for trade is due to the fact that since the beginning of the 2008 financial crisis China has taken the temporary difficulty for central banks around the world to find USD funding for their own national banks as an opportunity to begin opening its capital account gradually to external influence; this has been done via bi-lateral

currency swaps – mostly central banks – which started as only 3 in 2009 and amount to 31 as of December 2015.

Chinese Yuan swap lines

2009

2015

Source: People's Bank of China news releases, UN Comtrade

This opening is far from being complete since China limits the amount of Yuan swapped so far to RMB3 trillion globally (~US$477 billion), but it should be interpreted as an attempt to gain a predominant position in the global scene of currencies, in a similar fashion to what the United States achieved for the US Dollar with the US$160 billion loans to Europe for the Marshall plan for reconstruction after WWII.

Therefore, we expect these currency shifts to be the largest shifts to world economic power and we feel China has all the intentions to keep devaluing its currency to gain some of the export strength it has lost since 2009.

As we witness these forces rebalancing for the foreseeable future, we do not feel confident in forecasting what the general trend will be in G7 currencies, which in turn will also affect both domestic pricing of residential real estate in Dubai and the buying power of G7-based investors.

# Hospitality Market

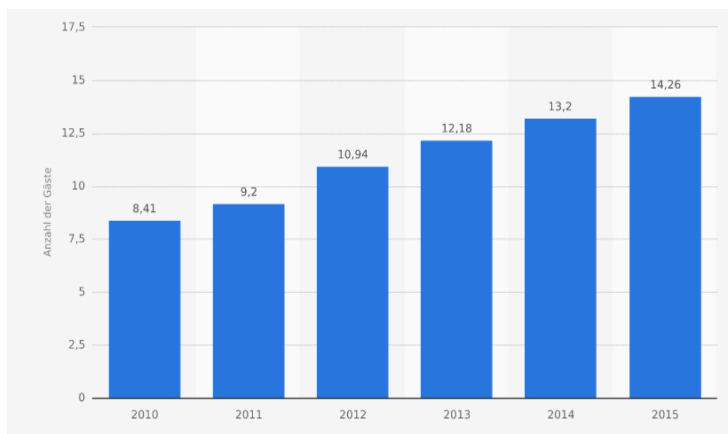
## I. Tourism in Dubai

### Current situation

Over the last two decades, Dubai has risen to become one of the key global tourism destinations. With its breath-taking buildings, white-sand coastline and limitless shopping options, the city attracts people from all over the world to experience something new.

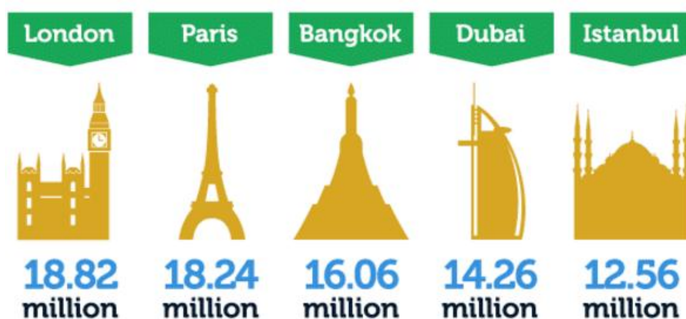
With a total contribution to the local economy of USD 23 billion in 2015, representing 20% of GDP, the tourism industry has become a main driver of the country's economic growth. Its share is expected to grow further as the country's reliance on the oil industry continues to diminish.

Number of international overnight guests in Dubai (million)




Source: MasterCard

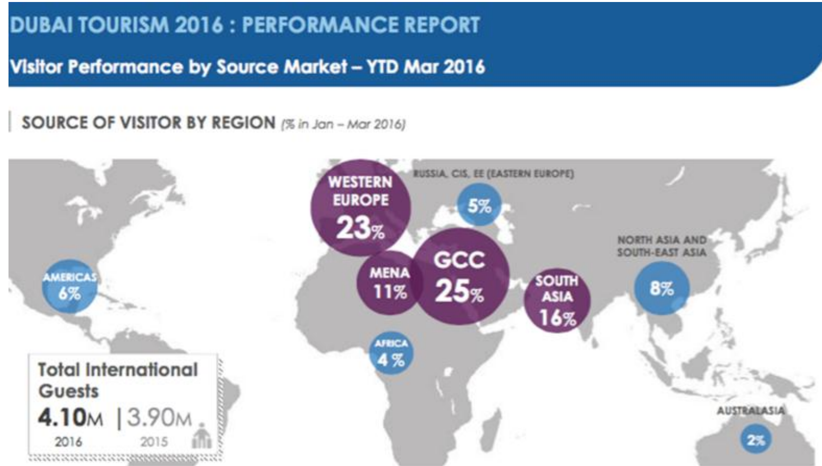
International comparison



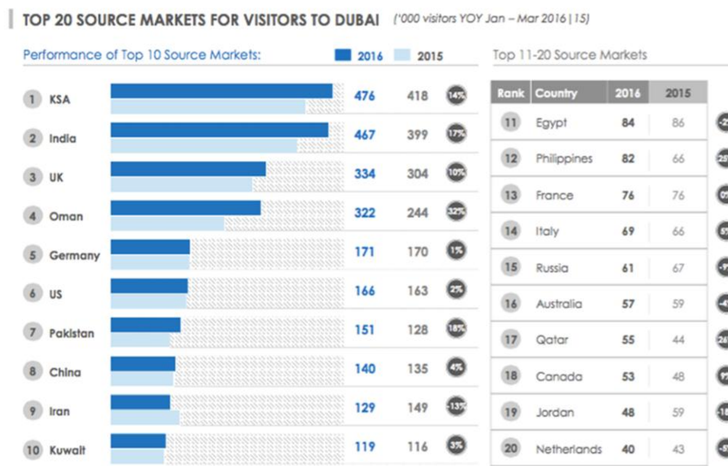

From 2010 to 2015, the number of international visitors staying overnight in Dubai has grown steadily, from 8.41 million to 14.26 million, at a compound annual growth rate of 11%. The development of new tourism attractions and events within the emirate, together with the Tourism Department's increased focus on attracting new markets, is expected to support continuous growth at a rate of 7% to 9% annually until 2020, with the target of 20 million visitors.

With 25% of the total number of visitors, the GCC countries remain Dubai's primary tourist source markets, closely followed by Western Europe with 23%. South Asia and other Middle East and North African countries contributed 16% and 11% of visitors, respectively.

At 8%, North and South Asia is still a minor source market; however, these markets have experienced sustained growth over the past few years on the back of more relaxed visa controls and its share of the total visitation is expected to increase.




Source: Dubai Government



TOP 20 SOURCE MARKETS FOR VISITORS TO DUBAI ('000 visitors YOY Jan – Mar 2016 | 15)

Performance of Top 10 Source Markets:

| Rank | Country | 2016 | 2015 | Change |
|---|---|---|---|---|
| 1 | KSA | 476 | 418 | 14% |
| 2 | India | 467 | 399 | 17% |
| 3 | UK | 334 | 304 | 10% |
| 4 | Oman | 322 | 244 | 32% |
| 5 | Germany | 171 | 170 | 1% |
| 6 | US | 166 | 163 | 2% |
| 7 | Pakistan | 151 | 128 | 18% |
| 8 | China | 140 | 135 | 4% |
| 9 | Iran | 129 | 149 | -13% |
| 10 | Kuwait | 119 | 116 | 3% |

Top 11-20 Source Markets

| Rank | Country | 2016 | 2015 | |
|---|---|---|---|---|
| 11 | Egypt | 84 | 86 | -2% |
| 12 | Philippines | 82 | 66 | 25% |
| 13 | France | 76 | 76 | 0% |
| 14 | Italy | 69 | 66 | 5% |
| 15 | Russia | 61 | 67 | -9% |
| 16 | Australia | 57 | 59 | -4% |
| 17 | Qatar | 55 | 44 | 26% |
| 18 | Canada | 53 | 48 | 9% |
| 19 | Jordan | 48 | 59 | -18% |
| 20 | Netherlands | 40 | 43 | -5% |

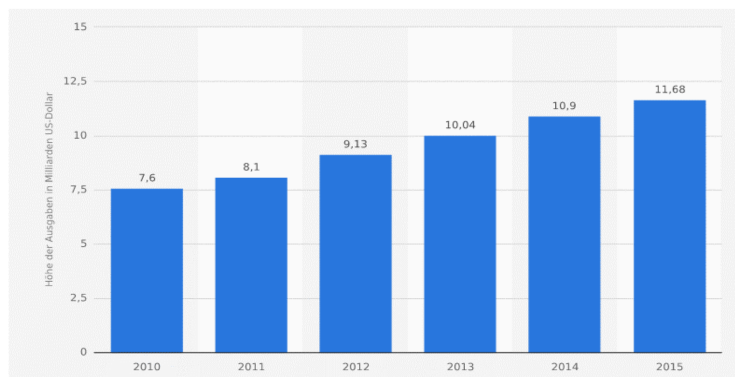
Source: Dubai Government

Statistics of source markets by country show that KSA and India were the Emirate's key feeder markets in Q1 2016, each contributing about 470,000 visitors, growing by 14% and 17% on Q1 2015, respectively. However, the largest increase in visitation was registered by Oman (+32%), showing that visitation from the GCC markets still has room to grow and should remain a key focus of the tourism industry.

As part of the government's efforts in developing the tourism industry in the city, Dubai Immigration provides visa-on-arrival to more than 50 nationalities. However, the process remains challenging for some countries, such as Iran, which has witnessed a decrease in visitation to Dubai of 15% year-on-year.

While slightly below the tourism visitation growth rate of 11% annually, tourism receipts have been growing steadily at a compound annual rate of 9%, with international visitors spending USD 11.7 billion in 2015, compared to USD 7.6 billion in 2010. On a per tourist basis, expenditure has declined by 9%, with an average spend per guest of USD 819 in 2015, versus USD 904 in 2016.

**Tourism receipts in Dubai (in billion USD)**




Source: MasterCard

This moderate decline is to be expected, with Dubai attracting a wider variety of visitors than before, away from the over-reliance on luxury tourism and an improved offering in midscale hotels and resorts.

*Airports & passenger frequency*

Dubai Airport (DXB) – passenger traffic (in million)

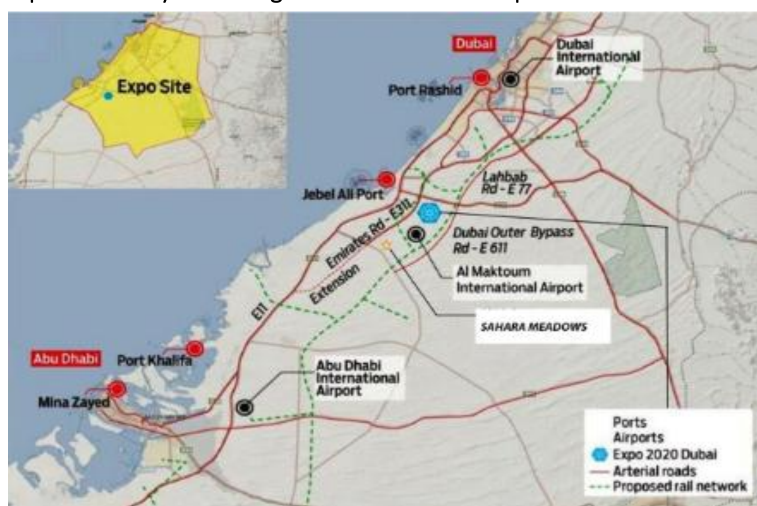
| Month | 2015 | 2016 | % change |
|---|---|---|---|
| January | 6.89 | 7.33 | 6.3% |
| February | 5.97 | 6.38 | 6.9% |
| March | 6.74 | 7.24 | 7.4% |
| **YTD** | **19.61** | **20.95** | **6.8%** |

Source: Dubai Airports

The growth of Dubai as a key player in the international tourism industry has been widely supported by the global connectivity of its international airports. Dubai is now served by two different airports: Dubai International Airport (DXB) and Al Maktoum international Airport (DWC). DXB is now the world's number 1 international airport for passenger traffic, having overtaken London Heathrow in 2014, with 78 million passengers in 2015 versus 70 million in 2014, an increase of 11%. DXB is serving 100 airlines flying to more than 240 destinations worldwide. With the recent opening of Concourse D in Terminal 1, at a cost of USD 1.2 billion, the passenger capacity has increased to 90 million. According to Dubai Airports, passenger traffic is projected to surpass 103.5 million by 2020.

In contrast to DXB, which is located in the heart of the city, limiting its expansion capacity, Dubai's newest airport DWC is situated on the outskirts of the emirate, granting the airport enormous potential for further expansion. DWC is expected to be completed in 10 years and connectivity to and from the airport will be improved with the extension of the metro line. Furthermore, the Etihad Railway project is expected to connect the city and DWC to neighboring emirates.

Airports and key demand generators location map




The map shows the central location of Dubai International Airport (DXB), in the heart of the city of Dubai. The Al Maktoum International Aiport (DWC) is located in "South Dubai" near Dubai Investments Park and the site of EXPO 2020. The land around Al Maktoum International can be easily expanded upon, an important consideration in order to increase the number of passenger traffic in Dubai.

As part of the Dubai Airports Strategic Plan 2020, Dubai Government has committed USD 7.8 billion towards the expansion programs. This is expected to have a significant impact on the growth of the tourism industry in the emirate, therefore positively impacting Dubai's economic growth.

The Dubai Airport Strategic Plan 2020 forecasts a 7.2% annual growth rate of passengers. To support this growth, the airport's floor space will be increased by 675,000sqm, twice the size of Heathrow Terminal 5.

Dubai Airports will continue levering on the central location of Dubai, at the crossroad between Europe and Asia, with 67% of the world's population living within an 8-hour flight radius of Dubai.

Dubai - A Global Hub

Source: Dubai Airports

*Cruise tourism*

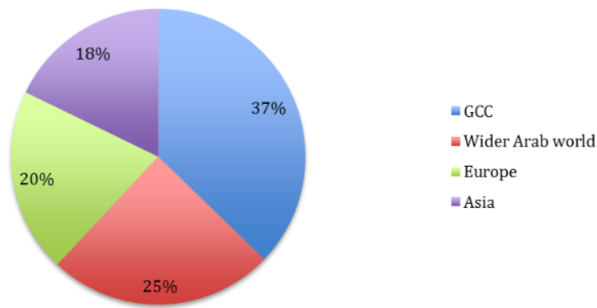
Recently, cruise tourism has been gaining momentum in Dubai with the development of the Mina Rashid Terminal. With a 2020 target of 1 million passengers at the port, the Mina Rashid cruise terminal will undergo several expansion projects, including a second terminal and a marina dedicated to private yachts. Furthermore, the terminals will be connected to the city with a high-tech metro system, allowing for a fast and easy connection to the city centre and the destination's key attractions.

From 2014 to 2015, the port registered an increase of 22% in number of ships, up to 134 vessels, leading to an increase in passengers of 33%, from 373,000 up to over 500,000. Projections for 2016 show an increase in number of vessels to 155 and 650,000 passengers.

*Medical tourism*

In order to support Dubai's aggressive tourism visitation targets, medical tourism has been earmarked as a key demand generator. With the emirate's central location between Europe and Asia and its connectivity to key markets, it is expected that the city will become a regional hub for medical tourism.  Targets for 2020 are to attract over 500,000 international medical tourists by 2020.

Percentage of medical tourists by region




Source: Gulf News

The destination will provide a wide range of services, including wellness, cosmetic and dental services, ophthalmology, orthopaedics and physiotherapy and specialised medical tests, to name few.

The launch by the Dubai Government of the portal www.dxh.ae is enabling international medical tourists to book medical procedures online at any of the 26 private and public hospitals in Dubai along with special discounted Emirates airfares, visa, medical insurance to cover malpractice, hotel stay, leisure activities and Marhaba service for smooth airport to hotel transfer.
Tourism receipts from medical tourism are expected to rise by 13% every year, from its current USD 300 million (2015). As shown in the pie chart above, the feeder markets for medical tourists are well diversified, providing a safety net in case of economic downturn in one particular region.

## Forecasts and trends

A key focus of the government is the development of new attractions, supported by infrastructure, to support the 20 million visitors by 2020 target. The EXPO 2020 is one such event, not only increasing global awareness of the destination but also improving the infrastructure of the city, securing its position as a key global player.

### *EXPO 2020 Dubai*

The 2020 World EXPO in Dubai is expected to have a significant impact on the destination over the next few years. The winning bid of Dubai has received significant international coverage, especially as it is the first time that the Expo is hosted in the MENASA region. With its tagline "Connecting Minds, Creating the Future", Dubai sees the hosting of the event as an opportunity to pioneer new paths of development and innovation, with the city's long term goal of becoming the catalyst in connecting minds from all over the world.
25 million visitors are expected at the Expo, with 70% coming from overseas, the first time in the Expo history that the majority of visitors will come from abroad. The government is already focusing on the long term effects of the Expo on the destination, seeing it as a springboard to a progressive and sustainable vision for the future, providing a steady growth of the tourism sector and leveraging on the increased carrying capacity of the destination with the potential hosting of more international events.

*Infrastructural projects*

The Dubai Government has always prioritized the development of the city's infrastructure to support the growing tourism industry.

| Project Name | Project Sponsor | Project value (US$ Million) | Completion Year |
|---|---|---|---|
| Dubai Metro | Dubai Roads & Transport Authority | 14,352 | 2030 |
| Emirates Roads Master plan | Dubai Roads & Transport Authority | 12,000 | 2016 |
| Etihad railway Network | Etihad Rail | 11,000 | 2018 |
| Aiport Expansion Project | Dubai Airport Authority | 7,800 | 2018 |
| Abu Dhabi Metro | Musanada | 7,000 | 2020 |
| Abu Dhabi Airport Expansion: Midfield Terminal | Abu Dhabi Airport Company | 2,960 | 2017 |

*Source: Meed*

Projects are constantly launched to improve the existing road networks and improving the city's connectivity to the world. These projects are also essential to support the growing population of the country, which is expected to reach 10 million by 2020.

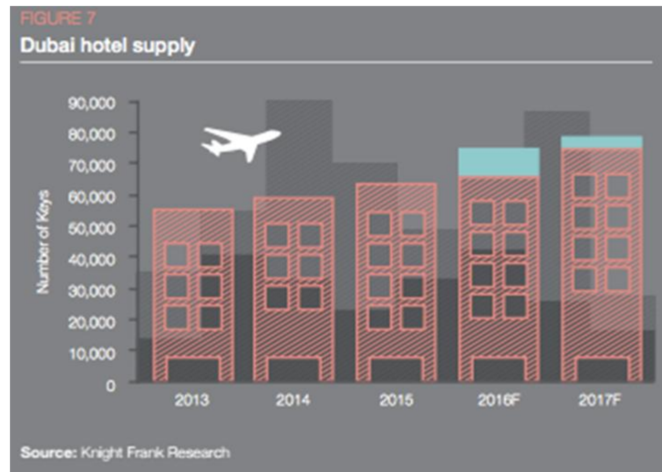
Currently, the Dubai Metro expansion, with a cost of USD 14.35 billion, is the largest project with a targeted completion in 2030. A second project by the Dubai Roads & Transport Authority is the Emirates Roads Master Plan, which will link Ras Al Khaimah to Abu Dhabi, at a total cost of USD 12 billion and is targeted for completion in 2016. The Etihad Railway will be developed in 3 phases at a cost of about USD 11 billion and will connect all 7 emirates to neighbouring countries.

# II. Hospitality Market

## Current situation

*Hotel supply & availability*

The number of hotels and hotel rooms has been growing steadily to support the growth in tourism demand. According to the Dubai Statistics Centre, at the end of Q1 2016 there was a total of 73,700 hotel rooms and 25,249 hotel apartments in the city. The number of hotels and hotel rooms has been growing steadily to support the growth in tourism demand.




According to the Dubai Statistics Centre, at the end of Q1 2016 there was a total of 73,700 hotel rooms and 25,249 hotel apartments in the city. These numbers are expected to rise significantly in the next few years, in line with the numerous hotel projects currently under development.

According to Knight Frank Research, number of keys in the city is expected to reach 80,000 by 2017, representing a growth of 10% on 2016 numbers.

Hotels and hotel keys by category (2016)

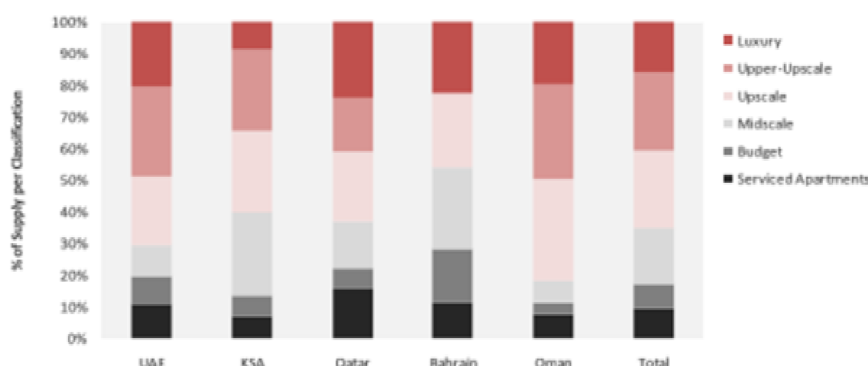
| First Quarter / الربع الأول | | | | | |
|---|---|---|---|---|---|
| Title | المجموع<br>Total | نجوم 3 - 1<br>1 - 3 Star | أربع نجوم<br>4 - Star | خمس نجوم<br>5 - Star | البيــــان |
| Number of Hotels | 462 | 265 | 106 | 91 | عدد الفنادق |
| Number of available rooms | 73,700 | 20,585 | 21,608 | 31,507 | عدد الغرف المتوفرة |
| Average Occupancy % | 85 | 84 | 86 | 84 | متوسط الإشغال % |

Source : Department of Tourism & Commerce Marketing — المصدر : دائرة السياحة والتسويق التجاري

Source: DTCM

By 2020, the DTCM forecasts the number of keys to reach 138,000. While 57% of the city's hotels are in the 1 to 3-star market, the majority of hotel rooms are in the 5-star market, representing 43% of the overall market. Combined with the Upscale category (4-star) this ratio reaches 70% of the overall supply.

Proposed new hotel room supply by category – 2020




Source: HVS

According to HVS, the market will continue to be dominated by Luxury, Upper Upscale and Upscale properties, with 70% of new room supply to enter the market by 2020 in these categories.

*Hotel performance*

Over the years, Dubai has strengthened its position as a regional leader in terms of hotel performance. With an Average Daily Rate (ADR) of USD 236 at an occupancy of 85% in Q1 2016, Dubai is expected to continue out-performing other regional markets by year-end.

In Q1 2016, Dubai's market - wide ADR was USD 236, for an occupancy rate of 85%, leading to a revenue per available room (RevPAR) of USD 201.

MENA market – 2016 forecast

| Country | City | Market | 3 Month Rolling Forecast | | | | Full-Year Forecast | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Occ % | ADR ($) | RevPAR ($) | YoY RevPAR Variance | Occ % | ADR ($) | RevPAR ($) | YoY RevPAR Variance |
| UAE | Dubai | Dubai Creek / Festival City | 66 | 172 | 113 | -10% | 75 | 213 | 160 | -13% |
| UAE | Dubai | Sheikh Zayed Road / DIFC | 63 | 144 | 91 | -10% | 75 | 186 | 140 | -10% |
| UAE | Dubai | Palm Jumeirah | 68 | 311 | 211 | -14% | 76 | 437 | 331 | -9% |
| UAE | Dubai | Dubai Marina / JBR | 69 | 187 | 128 | -13% | 83 | 258 | 214 | -9% |
| UAE | Abu Dhabi | Abu Dhabi City | 60 | 101 | 60 | -11% | 73 | 120 | 87 | -12% |
| UAE | Abu Dhabi | Abu Dhabi Beach | 56 | 162 | 90 | -13% | 68 | 224 | 153 | -9% |
| UAE | Ras Al Khaimah | Ras Al Khaimah | 56 | 138 | 78 | -7% | 74 | 162 | 119 | 5% |
| UAE | Sharjah | Sharjah | 63 | 63 | 40 | -11% | 73 | 72 | 52 | -12% |
| UAE | Fujairah | Fujairah | 55 | 101 | 56 | -7% | 75 | 111 | 84 | 4% |
| KSA | Riyadh | Riyadh | 49 | 216 | 106 | -10% | 53 | 225 | 118 | -12% |

Source: Colliers International

This represents a RevPAR decrease of 13% on Q1 2015, with an ADR of USD 268, at an occupancy of 85%.

The Colliers International MENA Market 2016 Forecast projects non-seasonal 3-month forecast (May 2016 to July 2016) as well as the 2016 year-end forecast show that Dubai will continue to outperform over destinations in the MENA region in terms of occupancy, ADR and RevPAR.

However, 2016 is expected to close 10% behind 2015 performance. This is a continued consequence of the weak Euro, the declining oil prices which have had a significant impact on corporate travel and the general sentiment of insecurity brought by the recent terrorist attacks on key global tourism destinations.

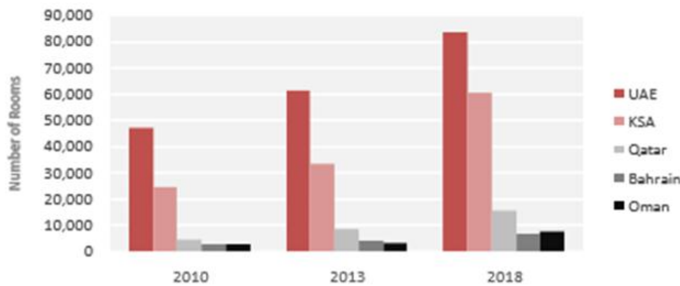
## Development and trends

Over the last few months, the global hospitality industry has undergone significant changes with major consolidation of the market taking place.

In December 2015, Accor Hotels acquired FRHI Holding, the owner of the Fairmont, Raffles and Swissotel brands. The USD 2.9 billion provided Accor with an additional 17 luxury hotels in the MENA region. BY 2020, Accor Hotels is expected to control about 8% of the worldwide hotel inventory.

Changes in branded hotel supply per market

| Country | Branded Rooms Supply in 2010 | Branded Rooms Supply in 2013 | % Change 2010-13 | Branded Rooms Supply in 2018 | % Change 2013-18 |
|---|---|---|---|---|---|
| UAE | 47,000 | 61,300 | 30% | 83,156 | 36% |
| KSA | 24,300 | 33,200 | 37% | 60,084 | 81% |
| Qatar | 4,500 | 8,500 | 89% | 15,441 | 82% |
| Bahrain | 2,600 | 4,200 | 62% | 6,721 | 60% |
| Oman | 2,500 | 3,233 | 29% | 7,522 | 133% |
| Total | 80,900 | 110,433 | 37% | 172,924 | 57% |




Source: HVS, Smith Travel Research

In a USD 13 billion deal, Marriott is set to become the world's largest hotel group, taking over Starwood Hotels and Resorts. By 2020, the company is expected to make up 15 % of the global hotel supply.

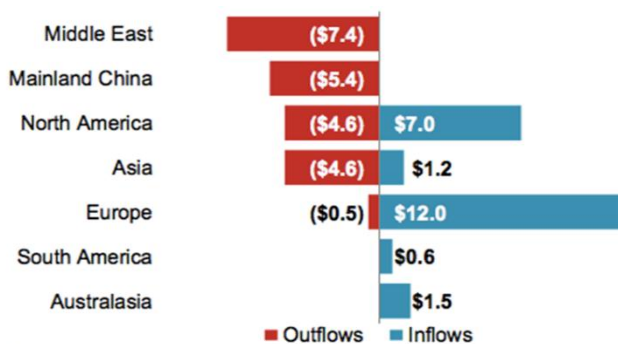
These global deals are expected to significantly impact the Dubai hotel market. Dubai's hotel inventory continues to be brand dominated with more than 90% of the market's hotel rooms being brand affiliated with both international and locally-grown players.

Research undertaken by HVS – Smith Travel Research shows that this trend is expected to continue, with the UAE's branded room supply set to continue growing over the foreseeable future.

## Significant transactions

Even with oil prices depressed and local economies burdened, Middle Eastern investors have not been given an official mandate to rein in spending. Given the relatively smaller investment grade market at home they will continue to have an outbound focus.

Hotel transactions - capital outflows and inflows (USD bn)




Source: JLL

According to JLL, Middle Eastern investors pumped nearly $7.5 billion into hotels globally last year, and even with some decline, 2016 could mark the second or third highest year on record. Even if large institutional funds slow their buying spree, we expect an increase in high-net-worth-tied family offices placing capital in safe havens abroad.

# III. The changing profile of hotel investors

## Current investors - Worldwide

Traditionally, the hotel ownership landscape was highly fragmented, with hotel assets owned and operated by private investors. Hotels were passed on from one generation to the next, and were recognized for their income generating ability rather than their real estate asset value.

The rise of hotel brands had a significant impact on the profile of hotel owners in the US and Europe. The industry consolidation was not limited to the operating brands, with institutional investors becoming more and more active in the acquisition of whole portfolio of hotels. Until now, the global hotel ownership industry continues to be dominated by private equity and investment funds, such as Blackstone, which represented 28% of the total global transaction volume in Q1 2016 and are expected to account for 50% of the total global acquisition volume by year end.

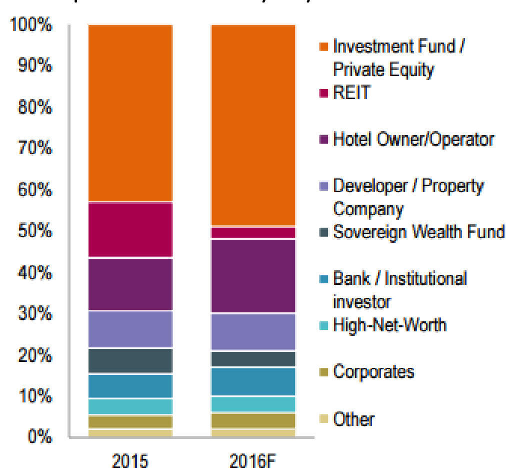
While REITs were the second most important buyer in 2015, they are expected to decrease their activity in 2016, potentially a consequence of investment holding periods, following a couple of years of active fund deployment.

Unlike the trends witnessed over the past few years, where hotel operators were divesting most of their real estate assets and focusing on building brand equity, they are expected to be the second most active buyer in 2016, with 20% of global transactions.

This is a consequence of the continued consolidation taking place at the hotel group level, with the merger between Marriott and Starwood leading the trend.

High Net Worth Individuals' share of total transactions is expected to remain stable at 5% of global transactions, in line with 2015.

Hotel acquisition volume by buyer




Source: JLL

While portfolio transactions represented the majority of deals in 2015, these are expected to drop by 80%, with a renewed focus on single asset deals in 2016, which represented 75% of the total volume in Q1.

Middle Eastern investors still remain eager to acquire. While they are being more cautious, they were able to capture 10% of total transaction volumes within the EMEA region. Capital from the Middle East was primarily invested in the UK and Central Europe, while Asian money, accounting for 4% of EMEA volumes, targeted assets in South-Western Europe.

## Dubai's investors profile

The hotel real estate market in Dubai is largely driven by domestic funds and private investors. This is a direct consequence of the limitations on freehold foreign ownership as well as the

perceived risk profile of hotel investment which, until now, did not fit the local banks' investment matrix.

Furthermore, Middle Eastern sovereign wealth funds traditionally invested surpluses of the oil industry; with the weak oil prices experienced over the past year, it is expected that investments will be redirected to the domestic property markets, providing additional dynamism and structure to the market.

Finally, with global tourism markets in which Middle Eastern funds have traditionally invested (e.g. Western Europe) being negatively affected by contracting yields and general negative sentiment, we can expect Middle Eastern funds to be redeployed in the region, especially in preparation for the EXPO 2020.

As Dubai, and the UAE as whole, becomes a mature, international real estate investment market, the profile of the real estate investors will resemble other established international markets. Institutional investors will dominate local transactions in the future, providing individual international investors with a platform to actively participate in the hotel ownership landscape.

# Authors' Biographies

## Index & Cie

**Tommaso Leodari** is a Vice President of Investments at Index & Cie. Mr. Leodari has 10 years of global experience in investments gathered in major global investment banks, wealth management firms and family offices in London, Dubai, Singapore and Hong Kong.

His career began at UBS Investment Bank, first as a Debt Capital Markets Originator, then as an Economics Analyst, publishing on asset allocation themes and on the state of the global economy during the 2008 global financial crisis. He went on to focus on advising and managing capital with a deep value, conservative and long-term style, mainly for HNWIs and for some of the largest Southeast Asian family offices.

Mr. Leodari obtained his Master in Business Administration (MBA) from HKUST Business School in Hong Kong, during which he specialized in Value Investing while at London Business School. He holds a Bachelor of Arts (BA) and a Master of Science (MSc) from Bocconi University in Milan, Italy.

## Stirling Hospitality

**Marina Pytlak** is a Director of Asset Management at Stirling Hospitality.

Mrs Pytlak began her career as a Corporate Development Manager for the Jumeirah Group, a leading hotel owner/operator based in Dubai.

While with Jumeirah, she completed numerous project analysis assignments including the preparation of project feasibility studies together with asset and deal valuations for multiple hotel and serviced apartment projects globally with a strong focus on Europe, North Africa, CIS and the Americas. Mrs Pytlak was also actively involved in the articulation of the Group's 5-year Strategic Plan encompassing all the Group's brands (hotel, serviced apartment and Spa).

Mrs Pytlak has a Master in Business Administration (MBA) from Columbia Business School in New York, USA, and a Bachelor of Science (BSc) in International Hospitality Management from the Ecole hôtelière de Lausanne in Switzerland.

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