Dubai real estate

Stronger economy unlikely to lead to a rapid rise in property prices

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- **After stabilizing in 2016, residential property prices in Dubai drifted lower in 2017, thanks to a combination of moderate demand and rising supply as new developments hit the market.**
- **Further substantial supply increases are expected in 2018, meaning that the stronger economic growth forecast for this year may not translate into a rapid property market recovery.**

Fresh downward pressures on residential property prices in 2017

Dubai's residential property market shows few signs of bouncing back quickly from a now three-year downturn. Having stabilized in 2016, prices saw renewed declines in 2017 as housing supply far outpaced demand. According to property firm Asteco, the prices of apartments and villas fell by 7.8% y/y and 5.6% y/y respectively in 4Q17, the fastest drop for several quarters. (Chart 1.) Prices are down 16-19% from their peaks of over three years ago.

These trends are confirmed by other data sources. Reidin, another real estate property tracker, shows villa and apartment prices down 1.9% y/y and 3.5 y/y respectively in Q4. (Chart 1.) Latest data on Phidar Advisory's Dubai 9/5 House price Index also points to softness in Dubai's residential real estate market.

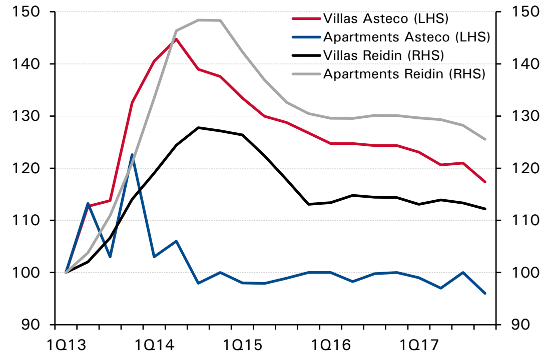
Alongside lower prices, rents have also been falling. According to Asteco, rents were down 11.1% y/y for apartments and 9.6% y/y for villas in Q4, with accelerated declines from earlier in the year. (Chart 2.) Similar to sales prices, rents are down 19-20% from their previous peaks. This may even understate market pressures, with some of the adjustment coming from non-price factors such as better payment terms or rent-free periods. With rents falling faster than sales prices, yields on property investment have become more compressed.

Tighter regulations helped dampen speculative pressure

Dubai's property market has been on a rollercoaster ride for more than a decade. Residential prices fell by around half in the years following the 2008-09 financial crisis, but rebounded from 2013, helped by the return of confidence linked to the swift rise in oil prices back above $100 per barrel. Indeed, the market was likely driven by speculative buyers hoping to cash in on Dubai's economic recovery. The emirate's award as host of the Expo 2020 event in 4Q13 also saw a spike in the number of buyers entering the real estate market. This pushed apartment prices up by a staggering 60% y/y that quarter, with villa prices up 35% y/y.

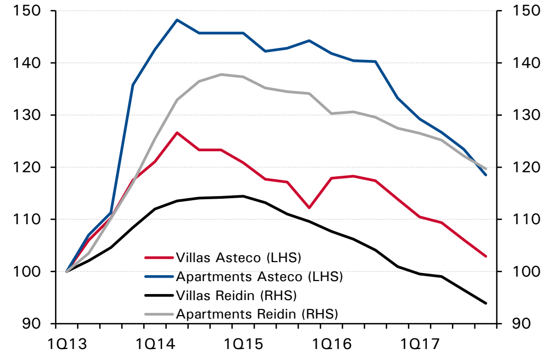
To prevent a repeat of the boom-bust cycle in property prices that had plagued Dubai's economy before, the authorities tightened regulations. They doubled the land registration fee to 4% and introduced tighter loan-to-value ratios to help mitigate risks to banks' balance sheets, rein in speculative activity and gear the market more towards end-buyers. This had an almost immediate impact. Growth in apartment prices slowed from 41% y/y in 1H14 to 19% y/y in 2H14, while villa prices slowed from 20% y/y to 8% y/y during the same period.

Chart 1: Dubai residential property sales prices
(index)



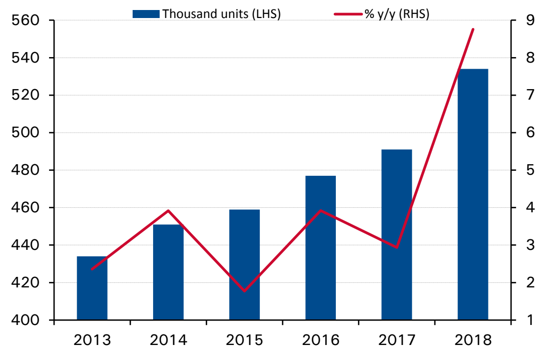
Source: Asteco, Reidin

Chart 2: Dubai residential property rents
(index)



Source: Asteco, Reidin

Chart 3: Dubai housing supply



Source: Jones Lang LaSalle

Prices in 2017 were pressured by rising supply

Growth in supply has been a key factor in recent price weakness – and a legacy of the long lead times in bringing large real estate projects to market. According to Jones Lang LaSalle (JLL), a property consultant, growth in housing supply slowed slightly from 3.9% y/y in 2016 to 2.9% y/y in 2017. (Chart 3.) With population growth possibly in the range of 1-2% y/y, occupancy rates continued to remain low, adding further downward pressure on prices.

Meanwhile, demand remained lackluster as the impact of more stringent loan-to-value rules was compounded by the effects of higher interest rates, higher fuel costs, and modest wage and job growth, all of which reduced consumer purchasing power. Transaction levels in 2017 were low compared to earlier years, averaging AED3.5 billion per month, down 6.5% from 2016. (Chart 4.) But they were helped by a shift towards the more affordable housing segment, mainly as a result of a rise in the incidence of cash-strapped and risk averse buyers.

The property market downturn has not been exclusive to Dubai, or to the residential sector. Prices of apartments and villas in Abu Dhabi fell by a steeper 8.0% y/y and 7.9% y/y respectively, on average, in 4Q17, with the market appearing to suffer from the same issue of oversupply. Prices and rents in the commercial property sector are also falling. Meanwhile, other GCC countries are witnessing their own property market corrections.

Prices expected to remain weak through 2018

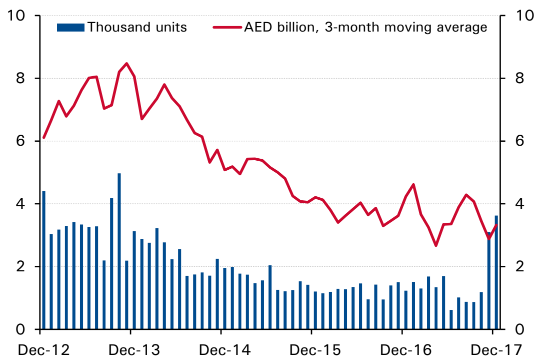
One key factor in recent market weakness – rising supply – is expected to grow over coming quarters: JLL expect supply growth to pick up to 9% this year. The near completion of a number of residential developments, including New Dubai Gate in the Jumeirah Lake Towers district, The Pad in Business Bay, Eagle Heights in Sports City and Serenia Residences on Palm Jumeirah, will likely add 17,000 new apartments to the market in early 2018. Although project launches are expected to ease off in the 2H18, the projected supply increase in 2019, at 8%, is nearly as large.

Rising supply means that the improving macroeconomic climate in the UAE is unlikely to trigger a sharp recovery in property prices. We expect non-oil growth to accelerate to 3.7% this year – the strongest in the Gulf region and up from an estimated 3.3% in 2017 – helped by an easing pace of austerity, stronger regional growth and rising infrastructure spending ahead of Expo 2020. Consumer demand will also be affected by the decline in purchasing power from the new 5% VAT and rising interest rates. A central bank survey suggests that credit standards are still tightening, though at a slower pace than before.

There are, however, some positive factors. One is that supply growth could disappoint relative to forecasts. JLL, for example, state that new supply typically comes in at around 40% of initial projections, suggesting that the supply-demand gap will not end up as large as the raw figures above imply.

Another positive is the cheaper dirham, which will make the property sector more attractive to international investors. The dirham fell 10% versus the euro in 4Q17 due to weakness in the US dollar to which it is pegged. This means apartment prices fell 13% y/y in euro terms in 4Q17 – although some of this was a reversal of the rise in prices due to earlier dollar strength. (Chart 5.) Finally, there may be upsides from the run-up in oil prices to $70 per barrel, which if sustained, would boost investor confidence in the UAE, strengthen the financial climate and improve the fiscal position.

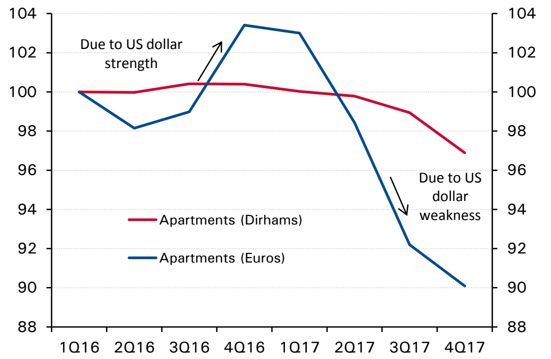
Chart 4: Dubai real estate transactions



Source: Dubai Land Department

Chart 5: Dubai residential property sales prices

(index)



Source: Reidin, Thomson Reuters Datastream

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