



Building Cycles: Growth and (In)stability

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Executive Summary

- Real estate price cycles have four distinctive phases (i) recovery, (ii) expansion, (iii) hyper supply and (iv) recession. Given the supply/demand metrics at play we opine that Dubai is currently in the recession phase of its second cycle and is expected to enter its recovery phase by late 2016. Although, real estate price cycles are an indication of future price movements, they are governed by underlying fundamentals of supply and demand, capital flows and business activity.
- An analysis of the peak of the first price cycle reveals that villas out-performed apartments by more than a factor of 2. This led to a flurry of new developments flooding the villa segment in the second construction wave creating an over-supply, consequently leading to the villa segment underperforming apartments by 15% in this cycle.
- A paradigm shift that has occurred during the two cycles has been the shortage of affordable homes. As Dubai's population continues to grow between 5-7% with the middle-class comprising of the bulk of the population, the need for affordable homes has been reflected in the second price cycle. Mid-income housing communities such as International City and Discovery Gardens have fallen by half to that of prime communities such as Dubai Marina and Jumeirah Islands in the third and fourth phase of the price cycle.
- When measuring price falls and rises, indices are a good indication of the general direction and health of the market, however they fail to reflect the realities on the ground. Using a Min-Max analysis, although having its own limitations, helps show the highs and lows of the market. A comparison between two indicators across four communities, reveals that the drop using the min-max analysis is more than twice relative to the indices. This drop is not a reflection of the entire market but helps show new levels of price discovery in the form of distress sales.
- The strength of the US Dollar has had a significant impact on real estate prices; this has been natural given that non dollar currency related inflows into the market accounted for nearly half of all investments made in the last three years. The tapering off of foreign inflows has had an impact on declining prices.
- Given the shape shifting dynamics of the current price cycle alongside the demand for affordable housing against the backdrop of an expansionary fiscal policy implies that further price declines may be nearing an end, and that an inflection point is on the horizon.



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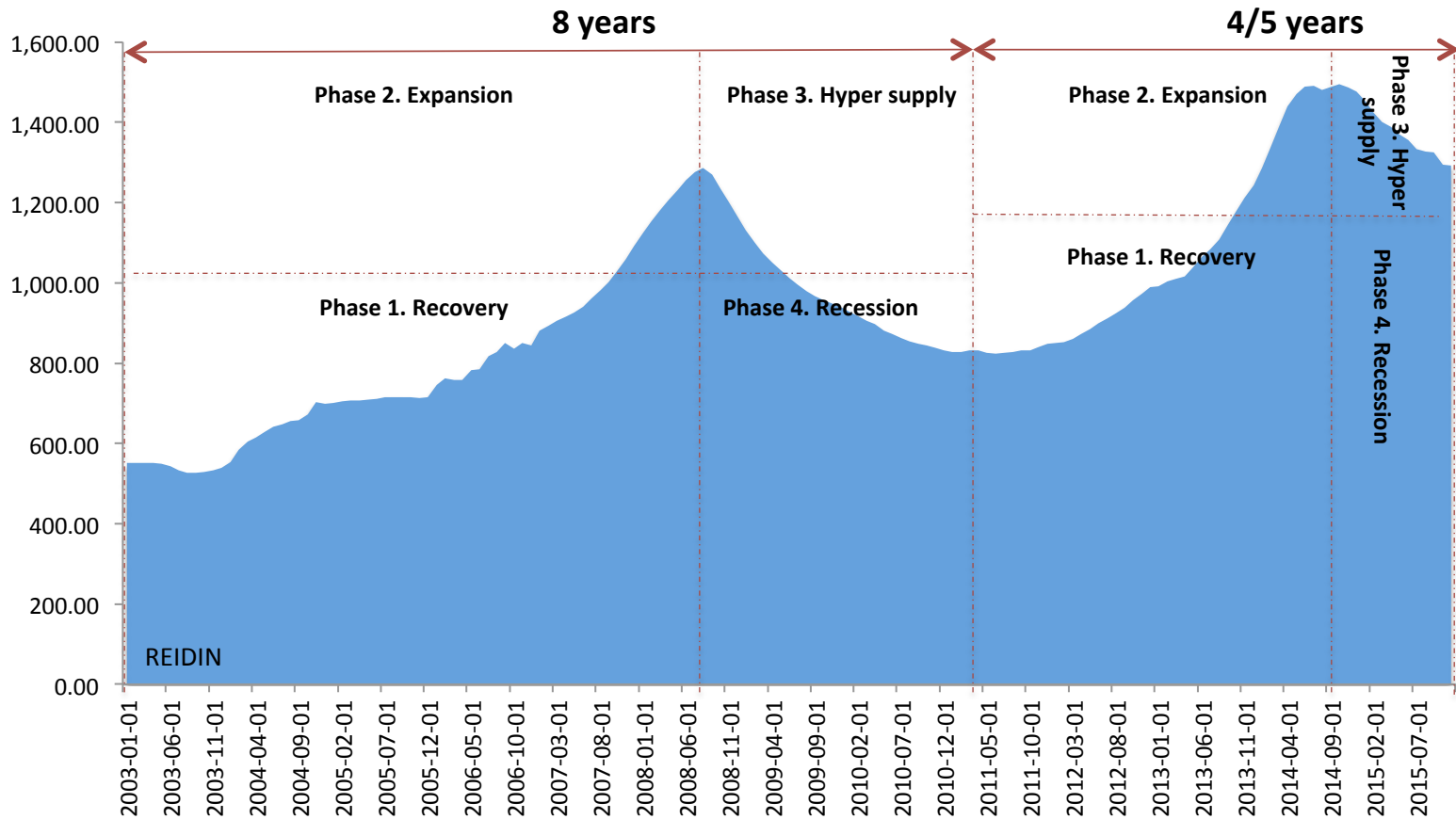
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Price Cycles



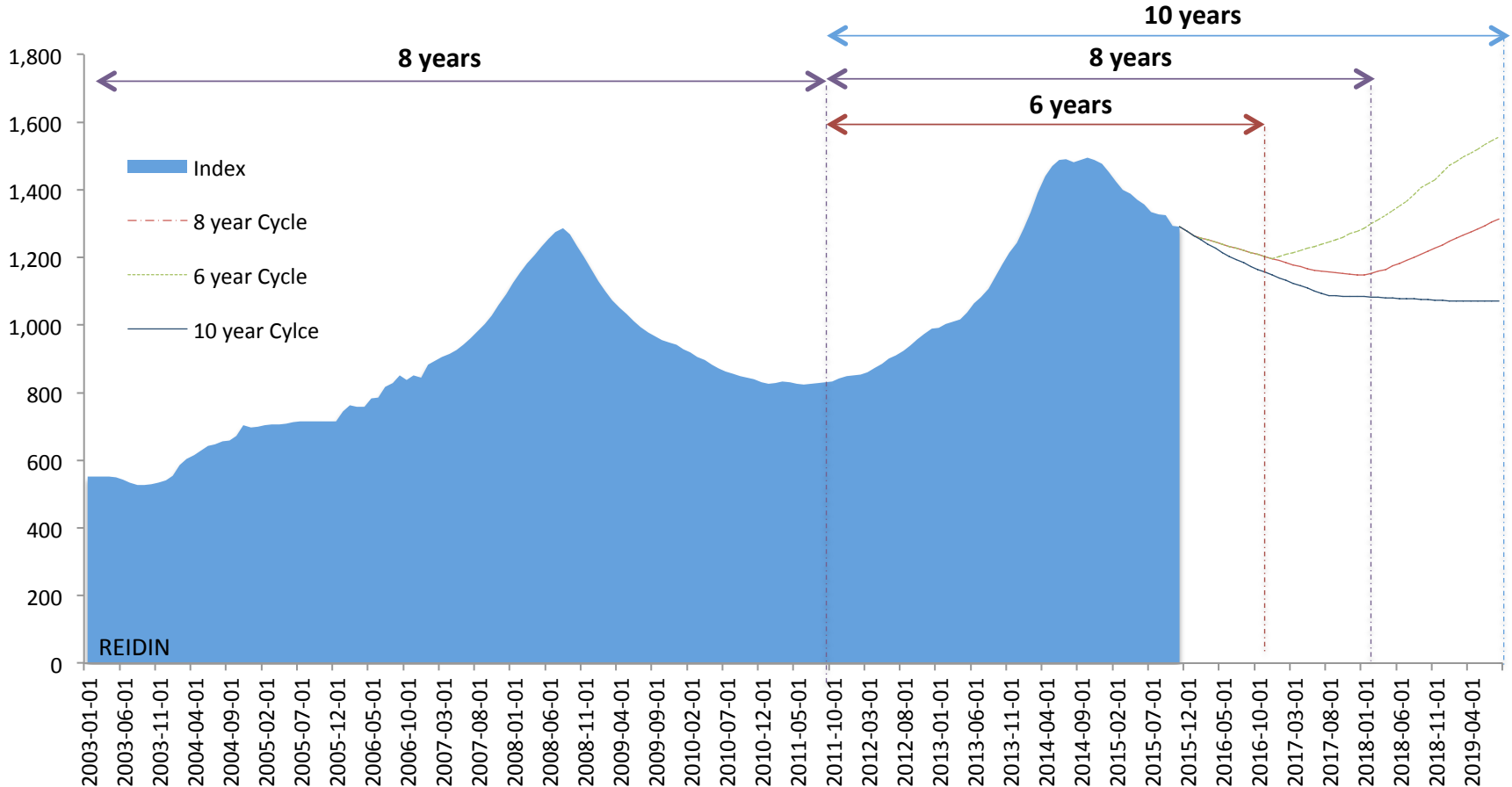
“Behold, there come seven years of great plenty throughout all the land of Egypt. And there shall arise after them seven years of famine; and all the plenty shall be forgotten in the land of Egypt” – King James Bible

The Property Price Cycle Theory



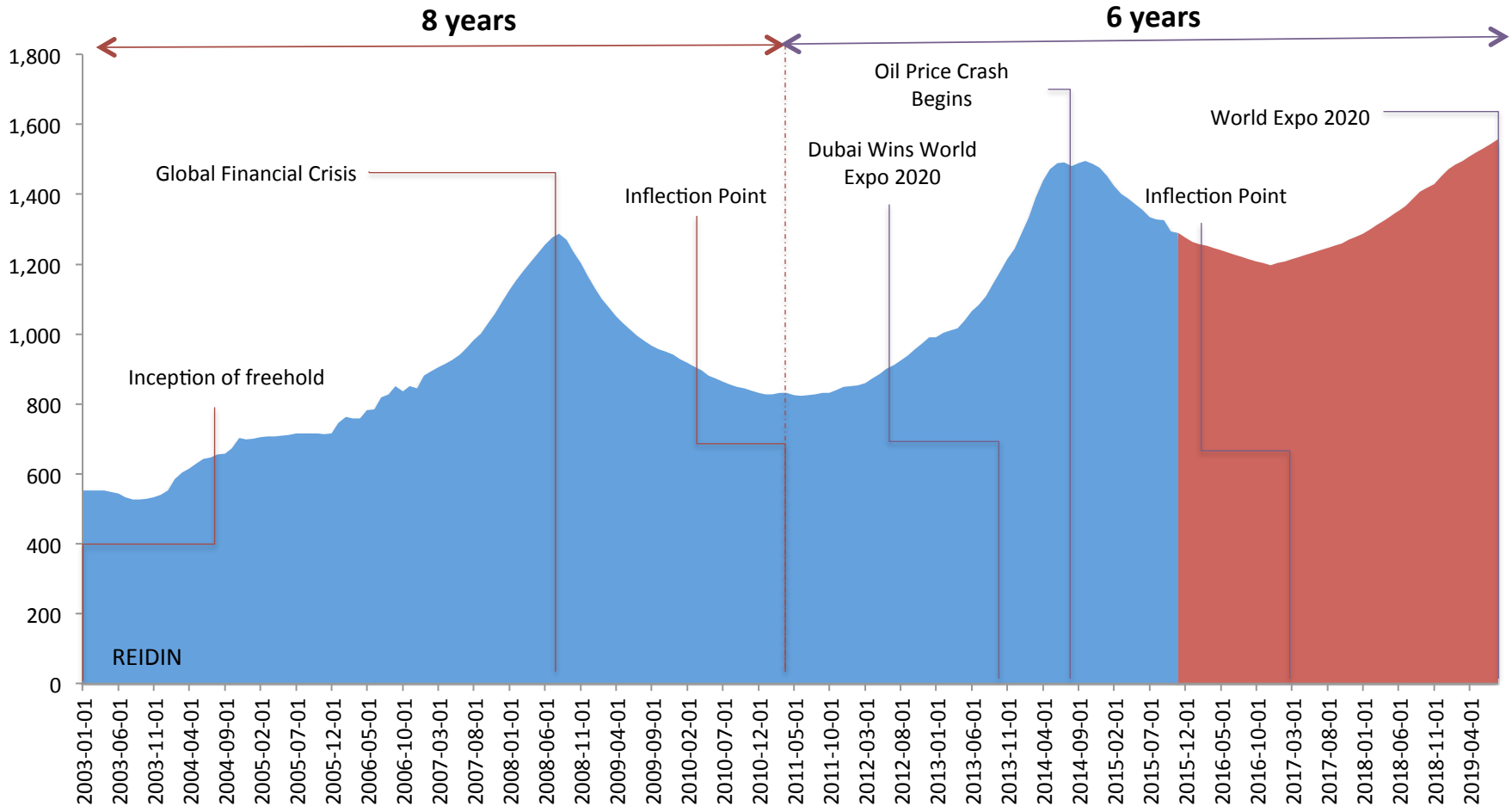
Real estate cycles can be categorized into four distinctive phases; (i) recovery, (ii) expansion, (iii) hyper supply and (iv) recession. These phases are defined by two stages of up trends, when demand outstrips supply pushing prices on an upward trajectory, and two stages of down trends, when supply outstrips demand causing prices to fall. Whilst it is a source of perpetual debate as to which stage of the cycle a any market is at, it appears as if Dubai is currently in its second cycle in phase 4 as prices continue to taper downwards.

Timings of the Cycles



The time periods of real estate cycles can range from 4 years to 12 years, usually with an average of 8 years. The above chart depicts the scenarios that could occur in Dubai given different cycle lengths. In a six-year cycle we can expect prices to rebound in the third-quarter of 2016, as the market enters the recovery phase of its third-cycle. However, in a longer term scenario we can see a rebound in 2018, or even as late as 2020. Although, price cycle theory can be a indication of a rebound, the length of the cycles are governed by fundamentals of supply demand metrics, capital flows and job creation.

Through the Looking Glass...



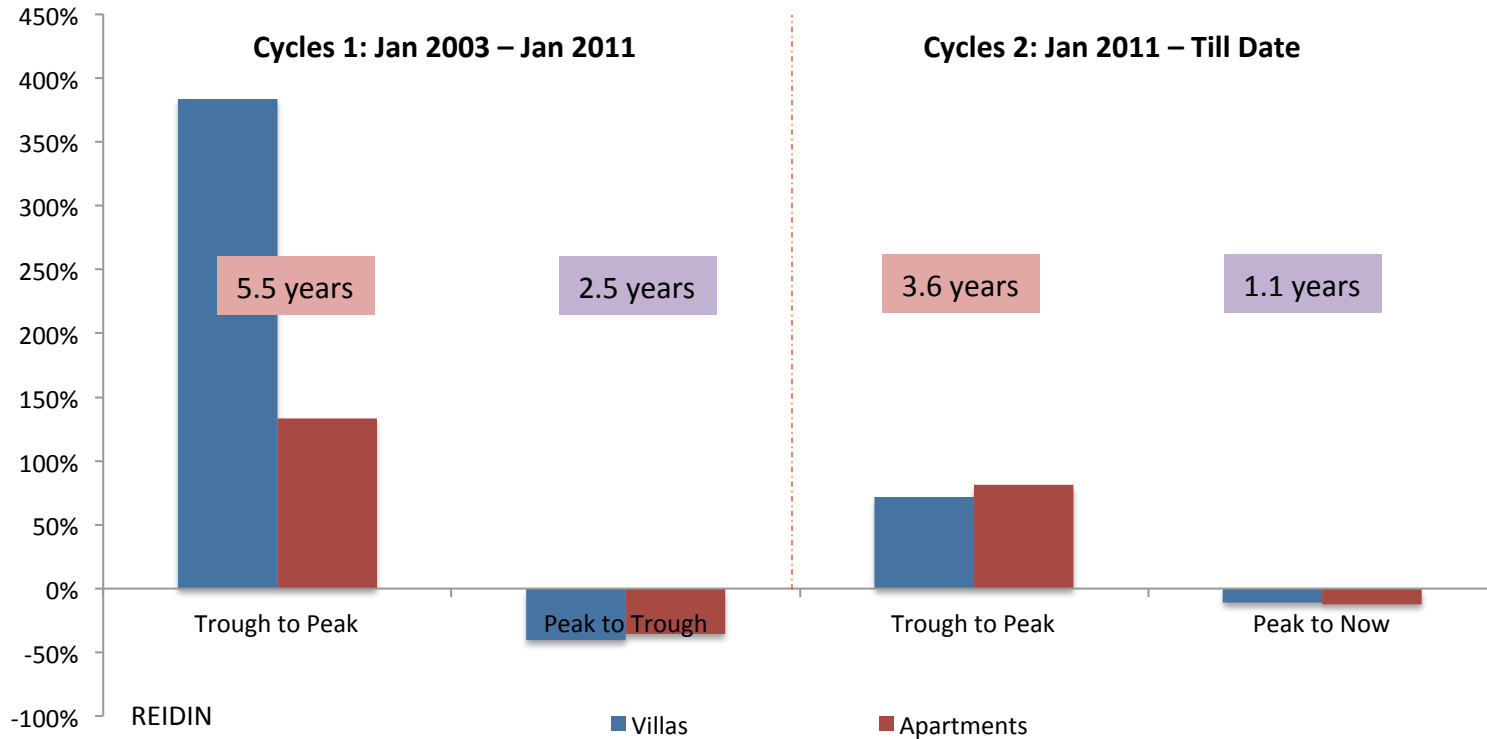
Given the fact that concerns of “hyper-supply” have been abated, and that supply is already dragging far below estimate levels (refer to our presentation the “Tautology of Supply – 2015 Q4”) and the fact that transaction levels has already started to witness an increase in certain communities (refer to our presentation “Follow the Money – 2015 Q4”), it appears as if Dubai’s real estate is following a 6 year life cycle, implying that there will be an inflection point sometime in 2016, as fiscal policy stimulates end user demand on the back of continued job creation.

Surges and Declines



“Look at market fluctuation as your friend rather than your enemy; profit from your folly rather than participate in it” –
Warren Buffet

Price Surges and Declines



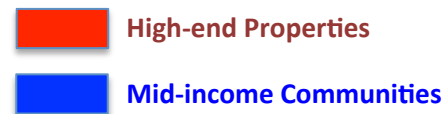
A time series analysis of the peaks and troughs of the first Dubai real estate cycle shows that the villa segment had appreciated more than twice to that of apartments. This shortage of villas can explain the rush of developers into this segment in the second cycle, leading to an oversupply highlighted in our previous report, “Dubai: A closer Look into 2013 (Q1 2014)”. The oversupply became apparent on a relative basis as the apartment segment witnessed higher appreciation rates to that of villas in the second price cycle.

An Analysis of Troughs....

Cycle 2			
	Peak	Now	Change
Jumeirah Islands	1,812	1,508	-16.8%
Dubai Marina	1,818	1,523	-16.2%
Arabian Ranches	1,313	1,102	-16.1%
Jumeirah Golf Estates	1,715	1,459	-14.9%
Downtown	2,574	2,217	-13.9%
Springs and Meadows	1,241	1,078	-13.1%
Greens	1,558	1,360	-12.7%
The Views	1,829	1,600	-12.5%
JLT	1,397	1,227	-12.2%
Jumeirah Park	1,350	1,186	-12.1%
Palm Jumeirah (Apartments)	1,926	1,699	-11.8%
Sports City	1,011	902	-10.8%
Palm Jumeirah (Villas)	2,783	2,500	-10.2%
International City	778	711	-8.6%
DSO	935	855	-8.6%
Discovery Garden	905	834	-7.8%

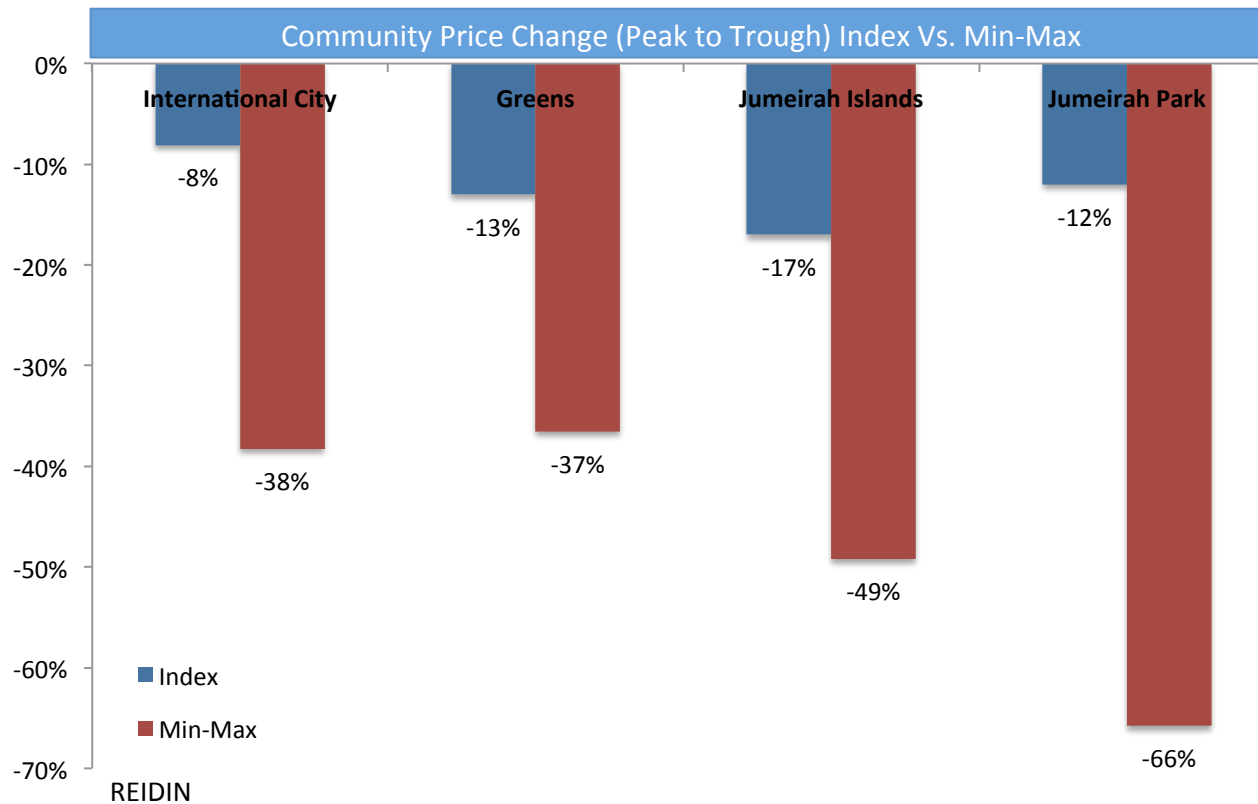
Cycle 1			
	Peak	Trough	Change
Greens	1,634	797	-51.2%
Sports City	1,244	629	-49.4%
International City	733	387	-47.2%
Arabian Ranches	1,456	791	-45.7%
Discovery Garden	846	482	-43.0%
Downtown	2,568	1,480	-42.4%
Palm Jumeirah (Villas)	1,744	1,129	-35.3%
Springs and Meadows	1,261	848	-32.8%
Palm Jumeirah (Apartments)	1,699	1,152	-32.2%
JLT	1,015	700	-31.0%
Dubai Marina	1,292	941	-27.2%

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A comparison between the current and previous real estate cycles reveals that in the last downturn the mid-income housing segment incurred the largest price drop. However, in the second cycle a paradigm shift occurred, due to a shortfall of affordable housing and over supply of high-end units, the mid-income segment has been the most resilient in the downturn.

The Min-Max Effect



Although indices generally give a reasonable indication of market direction, they fail to capture the full extent of peaks and troughs. The above chart shows the drop in prices using an index and a min-max scenario. As we can see that the falls in all communities through the min-max analysis are much larger than the index, highlighting that price declines in these communities have been deeper than the general consensus. This drop is not a reflection of the entire market but helps shows new levels of price discovery in the form of distress sales.

Real Estate Markets and the Dollar



“If in God we trust, then all others must bring data” – W. Edward Deming

The Impact of the Mighty Dollar...

Real Estate Markets Price Change Against the US Dollar						
	Hong Kong	Singapore	UK	Canada	Dubai	US Dollar
2011 Q2	6.1%	2.0%	-0.4%	2.7%	0.0%	-1.9%
2011 Q3	-0.3%	1.3%	1.9%	3.4%	0.0%	5.9%
2011 Q4	-1.7%	0.3%	-1.1%	0.3%	3.0%	1.8%
2012 Q1	1.7%	-0.2%	0.0%	-0.3%	1.0%	-1.7%
2012 Q2	9.2%	0.5%	1.2%	2.3%	4.8%	3.3%
2012 Q3	4.6%	0.7%	1.8%	1.8%	4.6%	-2.1%
2012 Q4	6.7%	1.8%	-0.7%	-0.7%	5.3%	-0.2%
2013 Q1	5.2%	0.6%	-0.1%	-0.7%	1.7%	4.1%
2013 Q2	1.5%	1.0%	1.9%	1.6%	5.7%	0.3%
2013 Q3	1.9%	0.4%	2.6%	2.3%	7.0%	-3.7%
2013 Q4	-0.2%	-0.8%	1.0%	0.3%	8.7%	-0.2%
2014 Q1	-0.4%	-1.3%	2.3%	0.6%	12.0%	0.1%
2014 Q2	1.4%	-1.0%	4.0%	1.5%	7.1%	-0.5%
2014 Q3	5.4%	-0.8%	3.9%	2.6%	0.0%	7.8%
2014 Q4	5.0%	-1.1%	-0.4%	0.4%	-1.1%	5.4%
2015 Q1	5.4%	-1.1%	0.8%	0.1%	-5.1%	8.8%
2015 Q2	3.4%	-0.9%	1.2%	1.5%	-3.0%	-3.0%
2015 Q3	-1.6%	-1.3%	3.0%	0.0%	-2.4%	0.9%
Correlation to US Dollar	0.23	-0.19	0.01	-0.01	-0.44	

The above chart highlights the correlation between the US Dollar and real estate markets. As the table highlights, Dubai's real estate markets appear to have been impacted the most with the rise of the USD (this was referred to earlier in our presentation "The Curious Case of Payment Plans"). This is natural given the fact that non dollar currency inflows into the real estate market counted for nearly half of total investments made in the last three years. The resurgence of the USD has led to a tapering off of foreign inflows consequently leading to price declines.

Conclusions

Real estate price cycles have four distinctive phases (i) recovery, (ii) expansion, (iii) hyper supply and (iv) recession

The time periods of real estate cycles can range from 4 years to 12 years, usually with an average of 8 years

Price Cycles

Given the supply and demand metrics at play we opine that Dubai is currently in the recession phase of its second real estate cycle.

As supply continues to lag and price falls start to taper, Dubai could be entering the recovery phase of its third cycle in late 2016. However, in a longer term scenario we can see a rebound in 2018, or even as late as 2020.

A price analysis of off-plan projects versus ready properties from their launch till their completion, reveals that both appreciate at similar levels.

Real Estate and the Dollar

Dubai has a moderately high inverse correlation between real estate prices and the US dollar strength. When looked across a variety of cities, Dubai has the highest, for example, it is twice to that of Singapore.

This is natural given the fact that non dollar currency inflows into the real estate market counted for nearly half of total investments made in the last three years

The resurgence of the USD has led to a tapering off of foreign inflows consequently leading to price declines.

Surges and Declines

In the first asset boom, villas had superior price growths by a factor of 2 relative to apartments. This caused an oversupply of villas in the second construction wave as developers tried to capitalize on the growing demand. Due to the lopsidedness of supply and demand, apartments experienced higher growth rates in the second cycle.

A similar dynamic transpired between the affordable housing segment and prime properties. An oversupply in the first second cycle of prime properties and a shortage in affordable homes, caused a reversal of roles for price appreciation in the segments.

Conclusion

Although price cycle theory may give an indication of market peaks and trough, the underlying engine is based on fundamentals in the form of supply/demand, business activities, and capital flows.

In a 6 year cycle, we expect a recovery in late 2016, and prices peaking by 2019/2020 in the run-up to the World Expo 2020.

Given these dynamics, we opine that the current discounts available in the market are attractive price points for bargain hunters to capitalize on the bull run in the future.



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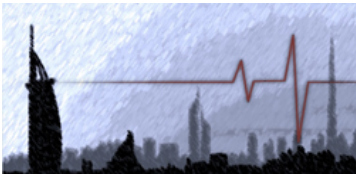
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DOLLARS AND SENSE



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THE CITY ENDS



A CLOSER LOOK INTO
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