

STRICTLY CONFIDENTIAL



## Dubai: Price, Premia, and Profit

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# Executive Summary

- A look back at Dubai's supply pipeline since the advent of freehold reveals that government sponsored developers (GSD) and private sector developers (PSD) contributed nearly evenly to the housing stock. However, in the current construction boom that is underway PSD's will contribute more than 70% of the total number of units by 2020 in monitored areas. This shift of supply towards the private sector highlights its greater roll in the development of Dubai.
- The initial property launch prices in 2002 of off-plan units were extremely low with an attractive yield, enticing investors and speculators to enter the market, sparking the first property boom. In order for developers to charge such low prices, they had to sacrifice net margins. However, as Dubai picked up momentum and prices began to accelerate, developers started charging a higher launch shifting the benefits from the investor to the developer. A timer series analysis of developer margins reveals that since 2002 to date, margins have almost doubled.
- Liquidity premium theory stipulates a flight to safety in times of market crisis. This was evidenced in 2008-2010 when investors flocked towards GSD developments and transactions in the private sector dropped precipitously. However, there appears to have been a shift in the market structure since then, as evidenced by communities in International city Business bay and even Palm Jumeirah, where private sector development price performance have outpaced government sponsored developments, mirroring their increasingly dominant share of current and future supply. We opine that this trend will continue in the freehold space and that the liquidity premium embedded in price will be arbitraged away.
- Price action and return performance for the future will be a function of launch prices, and it is highly probable that developer margins will reduce as they cater to the more affordable developments, as well as a continued arbitraging away of the liquidity premium in areas where both GSD and PSD developments exist. This implies that in the premium space, prices will drift lower as developer margins compress, both in the ready and off plan space.



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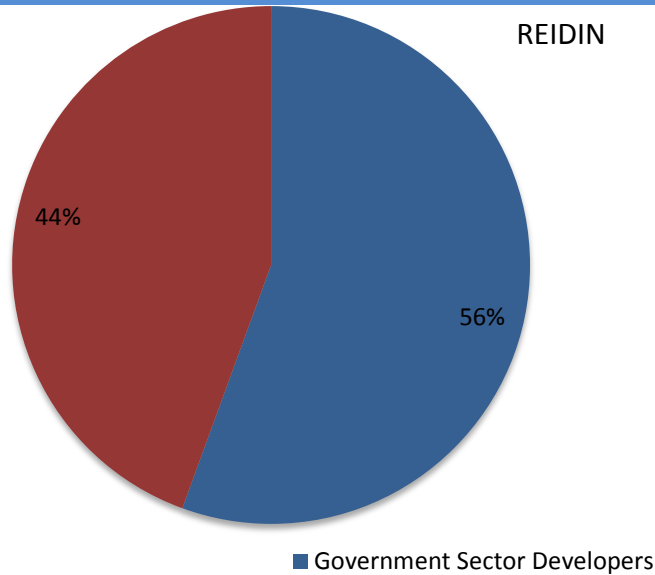
## Who has built what?



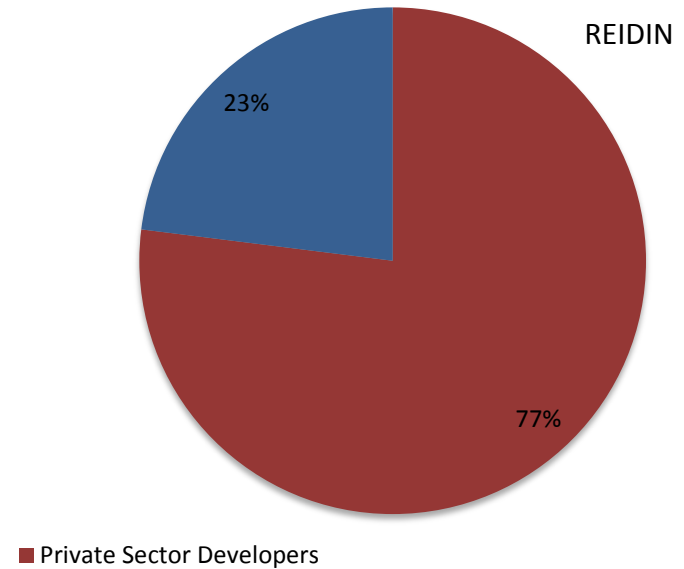
“Competition always makes you stronger and better. Competition is feared only by the weak.”  
— Mohammed bin Rashid Al Maktoum

# Private Sector will Dominate the Building landscape in the Future

Current Supply Structure (2002-2015)

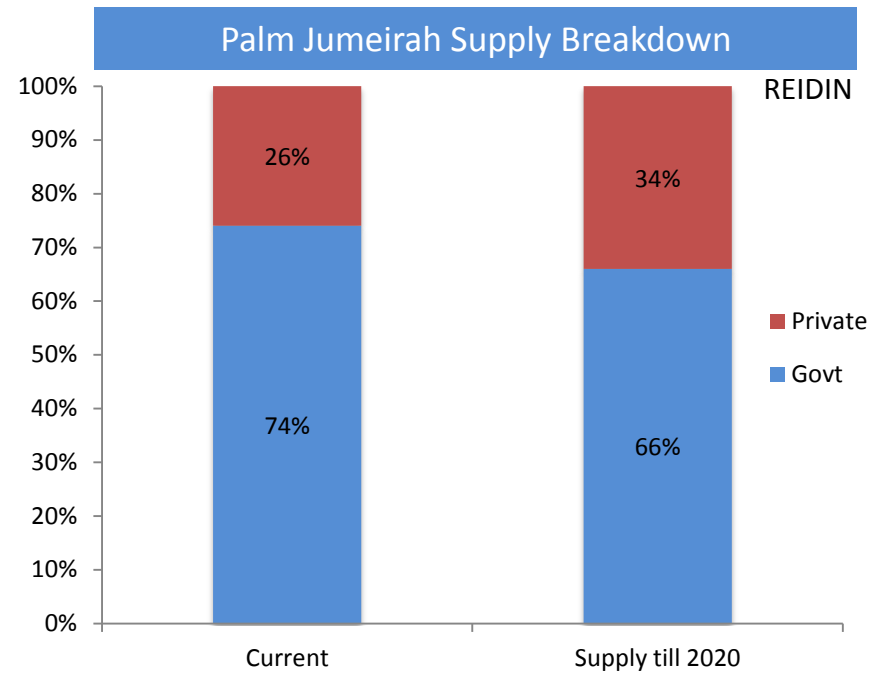
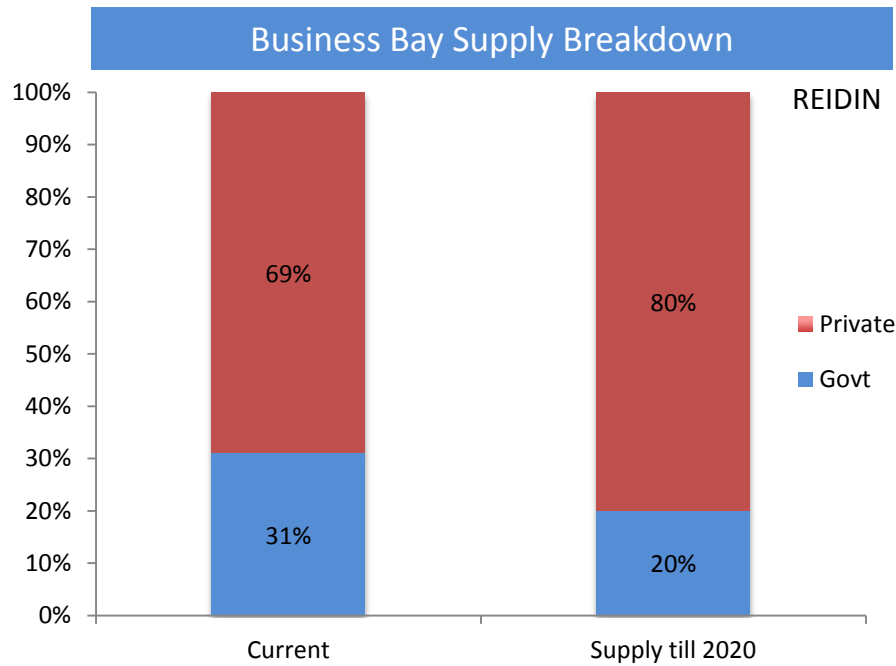


Expected Supply Structure (2002-2020)



A dissection of Dubai's freehold supply in monitored areas reveals that till now, PSD's and GSD's have contributed nearly evenly to the skyline of Dubai. However, going foreword the landscape will change, to where the majority of units will be from the private sector developers.

# A Closer look into Business Bay and Palm Jumeirah



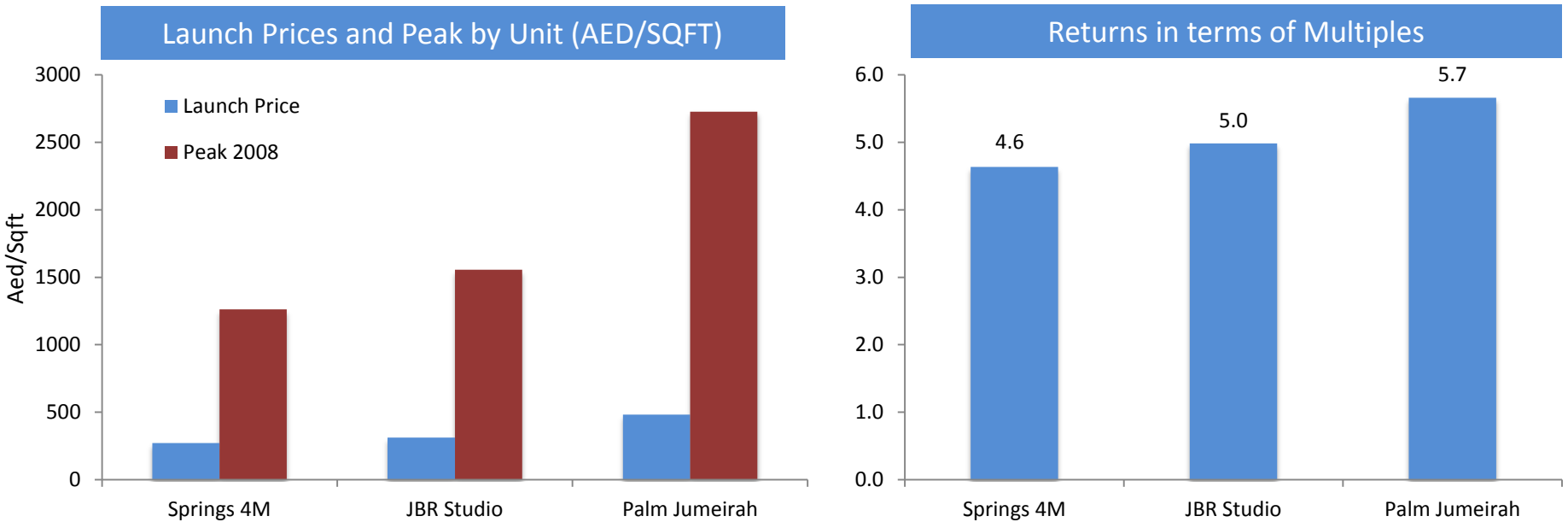
A closer look into Palm Jumeirah and Business Bay, two communities that are rapidly expanding, reveals that in both instances Private sector developers will contribute a higher percentage to the overall supply in the future.

## A Transfer of Wealth



“We were about to see the greatest transfer of wealth in history, and we found that everyone was focused on the wrong thing” – Ken Dyctwald

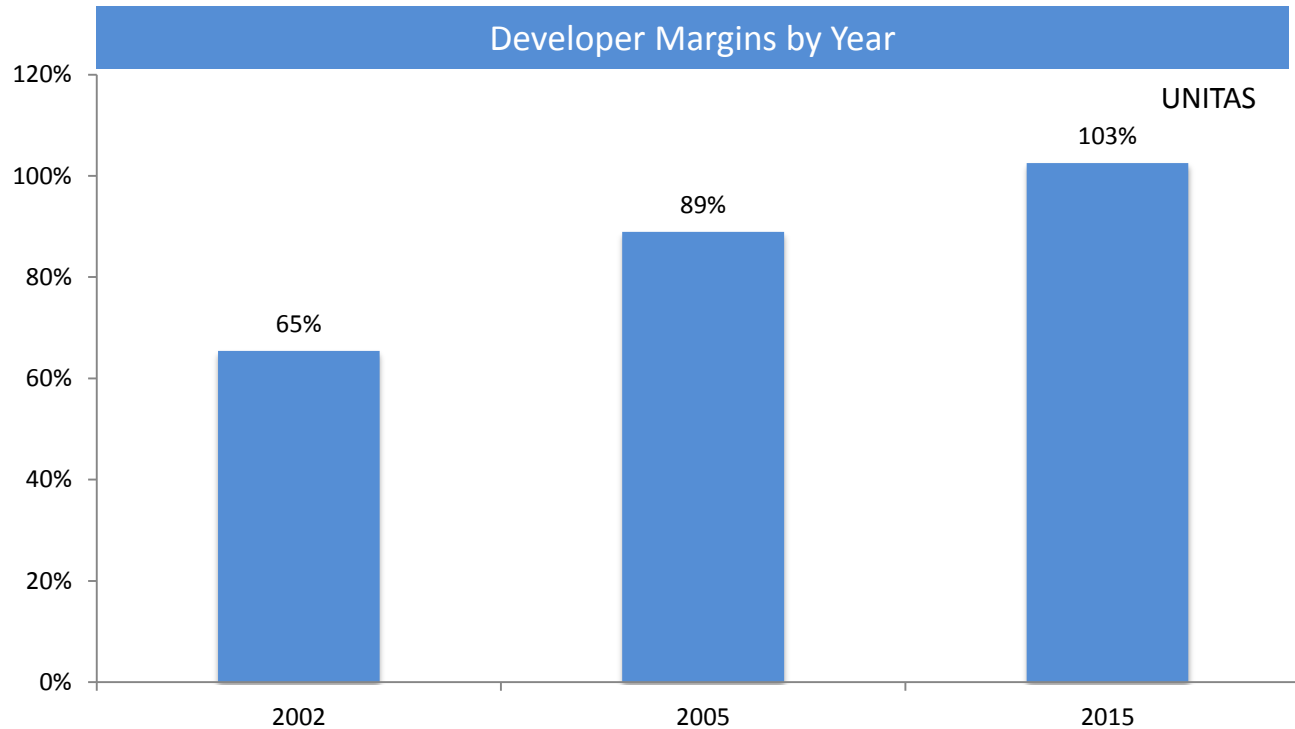
# Lower Launch Prices Resulted in Higher Appreciation Rates



During the first cycle, launch prices of developments were at or near replacement value, which sparked an asset boom, leading to appreciation rates that were outsized as the above graph reveal. These gains were accrued by the investors and end users, which mostly benefited from the real estate boom.



# Developer Margins Close to Double over the last 15 years



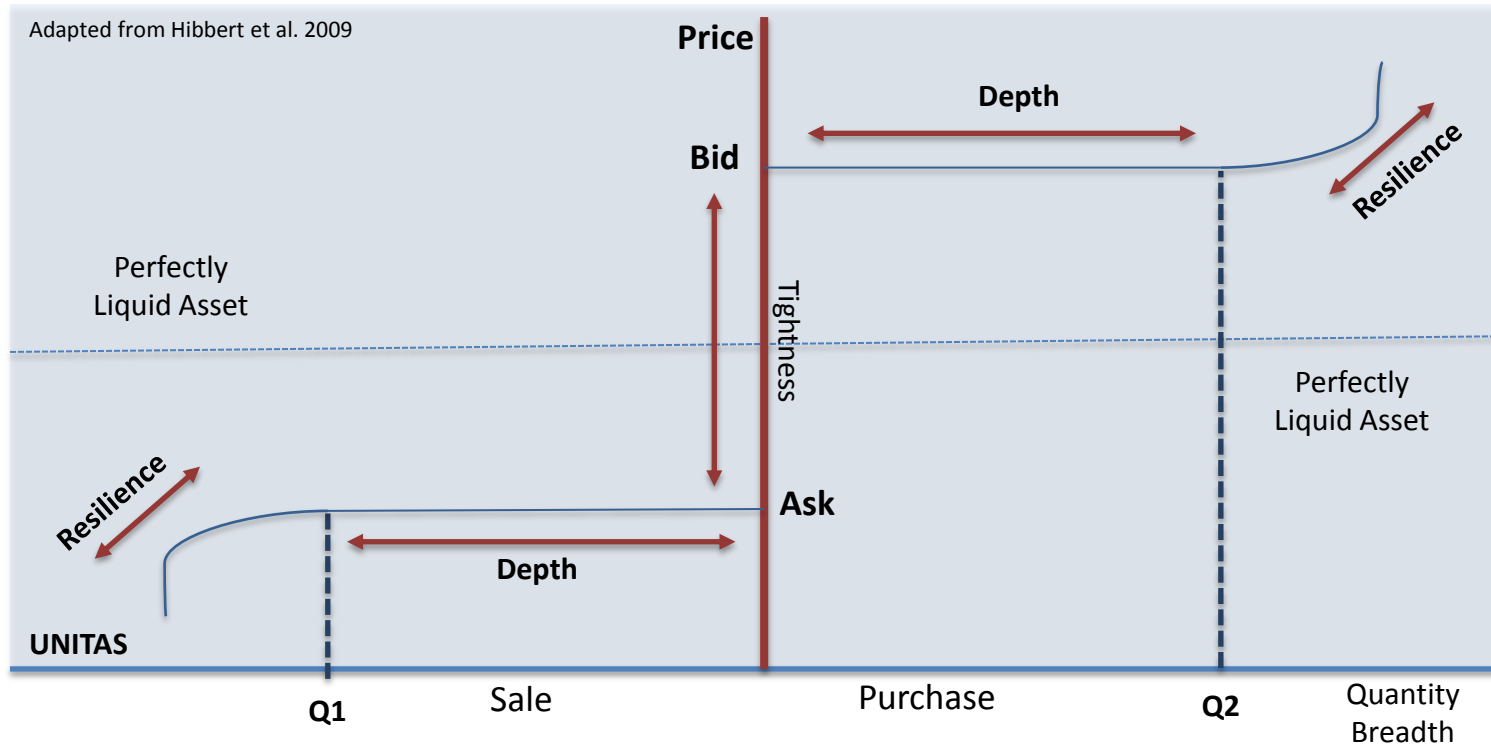
As the above graph reveals, developer margins have nearly doubled from 2003 levels, as developers responded to the asset price boom by increasing their launch prices. This has effectively led to a “transfer of wealth” from the investor to the developer; consequently, even as prices in the current cycle reached and in some cases, even surpassed levels seen in 2008, investors have not seen the same gains accrue to them in percentage terms, as those that were witnessed during the first cycle.

# The Liquidity Premium



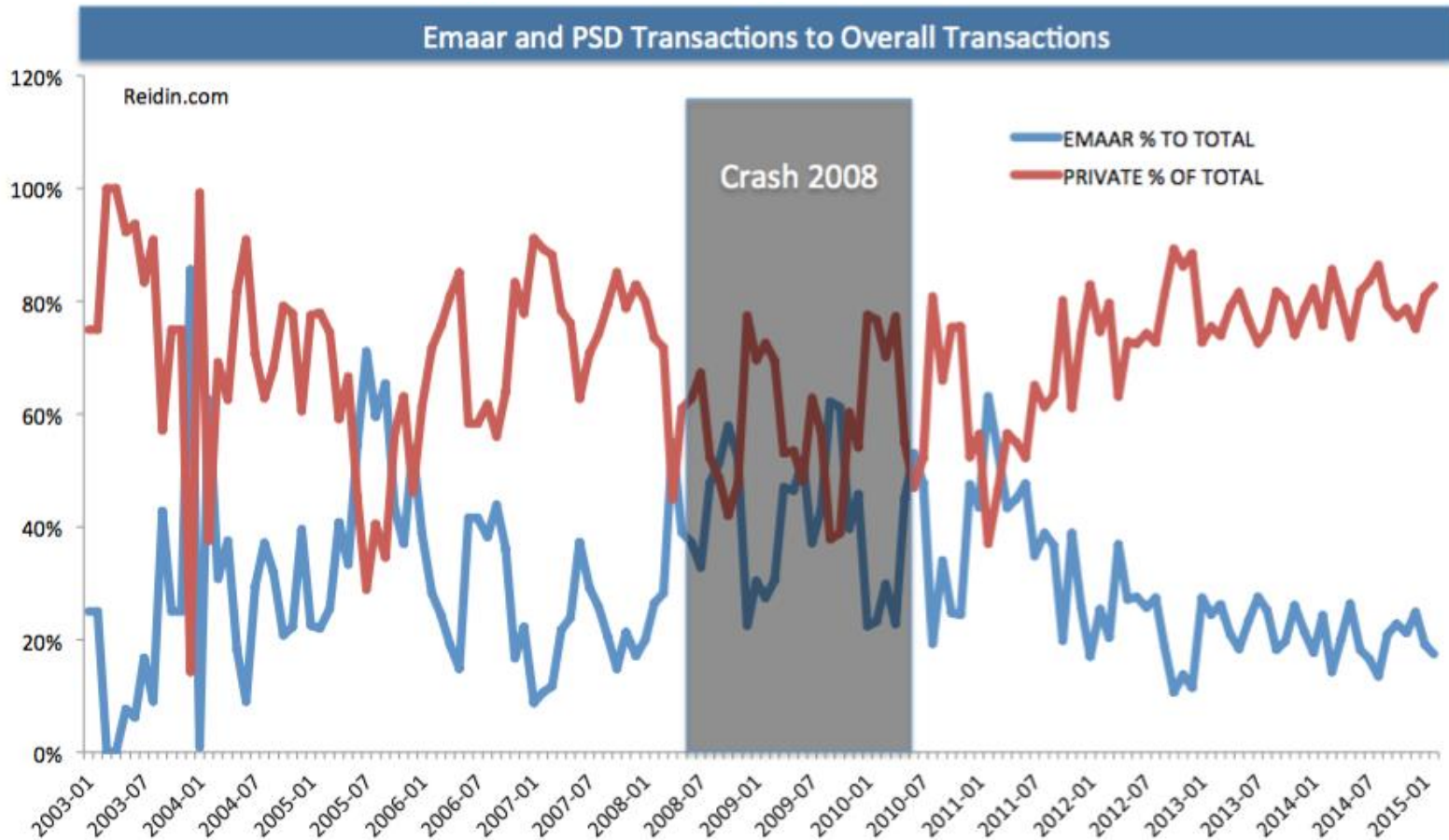
“The destruction of the inducement to invest by an excessive liquidity-preference was the outstanding evil, the prime impediment to the growth of wealth, in the ancient and medieval worlds”  
– John Maynard Keynes

# The Liquidity Premium Theory



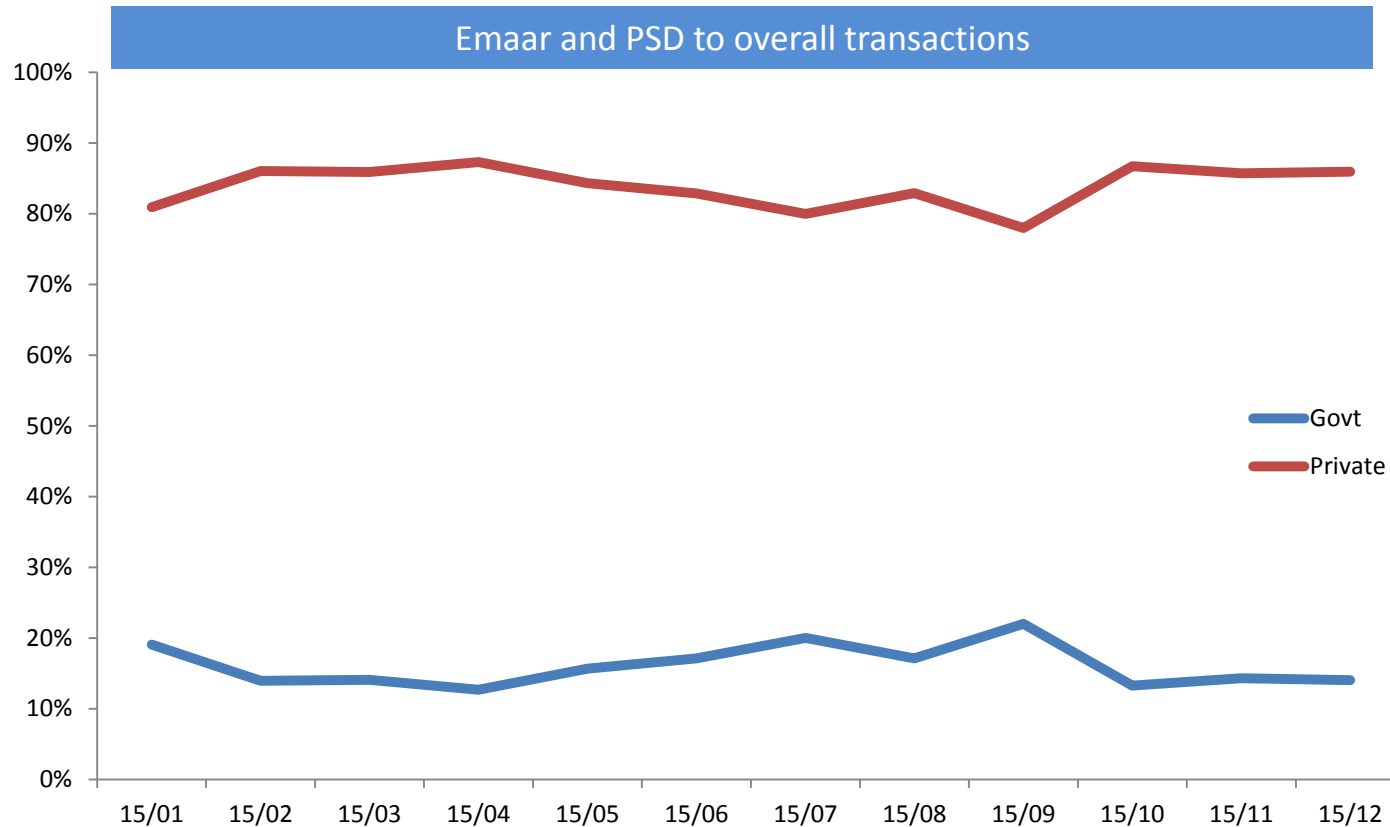
Liquidity premium posits that as there is a “flight to safety” phenomena, there is a premium paid for assets that are more easily liquidated. First coined by Keynes, it has been observed throughout capital and asset markets whenever there has been periods of stress. As the above construct reveals, the closer the asset is treated as a perfectly liquid asset”, the higher the price that it trades at. This price equilibrium is not only a function of the bid/ask spread, but also a function of the transactions that are carried out.

## Liquidity Preference clearly existed in 2008....



In one of our previous reports entitled, *"Dubai: The Path of Symbiosis Q1-15"*, we highlighted that in Dubai Marina, during the last financial crisis Government Sector Developers were a more liquid asset compared to private sector developments, where GSD assets traded more frequently than PSD developments, even though the former accounted for less than a third of overall supply.

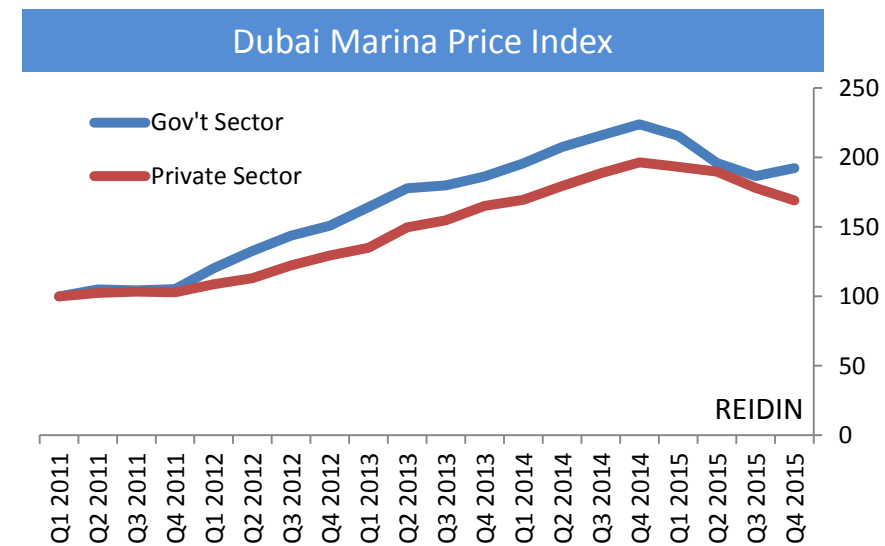
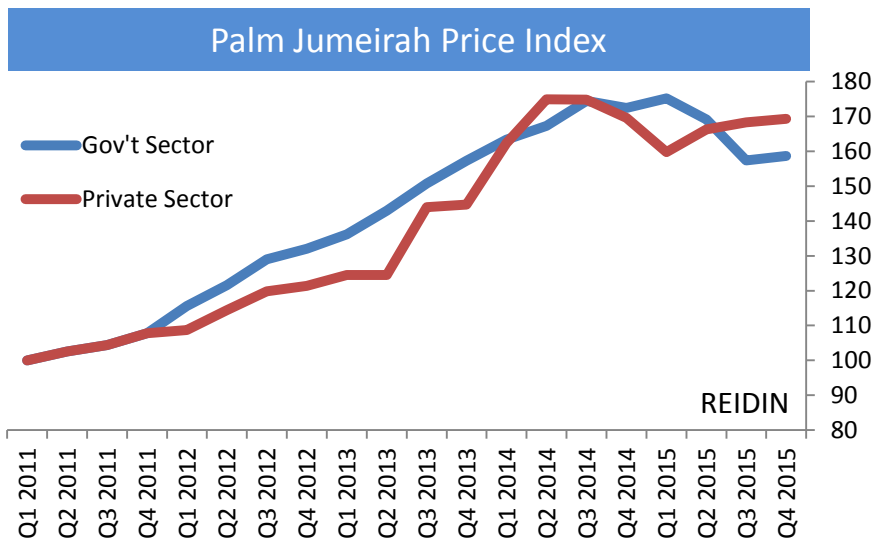
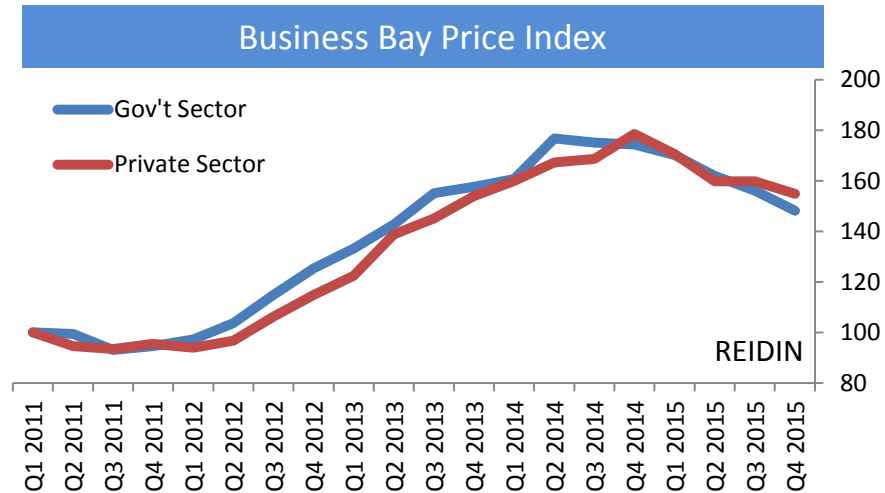
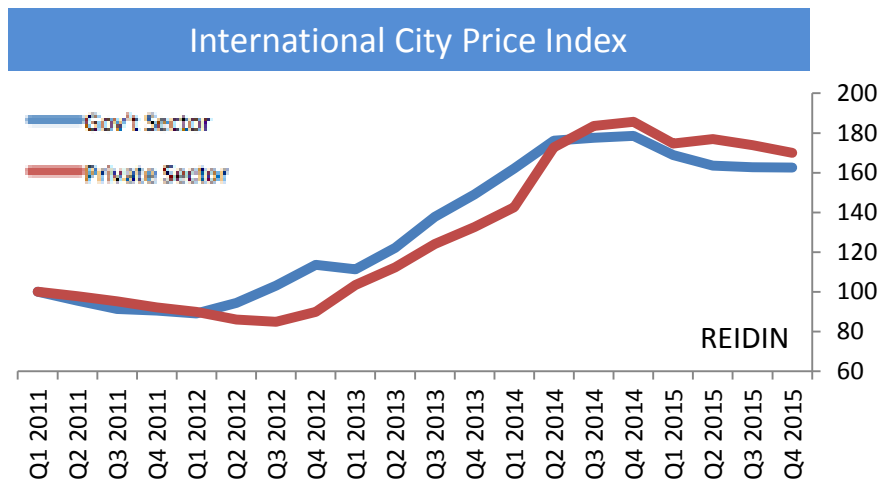
# However, in the current cycle, there is no “flight to safety”



However, during the current downward trend the balance between government and private sector developers remain unchanged. This constitutes the fact that investors flight to safety towards government units is no longer there. This trend we opine will only continue as private sector development dominate the landscape. This not only indicates a trend of market maturing, but is also is a function of PSD assets improving in quality relating to GSD developments.



# The Liquidity Premium Compresses



The above chart shows that three of the four communities measured, private sector developers have had superior price performance, indicating that the liquidity premium for GSD developments has reduced. We opine that this trend will continue, especially as PSD will dominate the future supply trajectory of Dubai.

# Conclusions

*Liquidity premium theory stipulates a flight to safety in times of market crisis*

*Private sector development price performance have outpaced government sponsored developments, mirroring their increasingly dominant share of current and future supply*

## Who has built what?

A dissection of Dubai current supply reveals that the housing stock is split nearly evenly between private sector developers and government sponsored developers

However, as Dubai undergoes its second construction frenzy, the topography of housing units will be highly skewed towards private sector, accounting for more than 70% of total supply.

This structural change in the roll out of Dubai's housing stock, highlights the pivotal role of the private sector in coming years

## Liquidity Premium

Historically, government sponsored developments act as a flight to safety, as witnessed in Dubai Marina. During the World Financial Crisis, GSD units contributed nearly half of all transactions, which otherwise on average accounted for 20%.

In the current real-estate dip we witnessed that the ratio remained the same, signaling a paradigm shift of confidence towards private sector developers.

Moreover, a price analysis between GSD's and PSD's reveals that in three out of four communities PSD's have outperformed, highlighting the shift in the structure of the market.

## Transfer of Wealth

During the creation of freehold, launch prices were extremely low as Dubai went through a price discovery phase.

However, as the asset boom sparked, developers started increasing launch price trying to maximize their margins, consequently shifting the gains away from the investor.

Since the inception of freehold, developer margins have almost doubled. This transfer of wealth has reduced future returns, and it is likely that margins will reduce in the coming years, especially as developers cater to more affordable communities

## Conclusion

In real estate, the liquidity premium phenomena between GSD and PSD developments in Dubai, has reduced, a trend that is likely to continue as quality improvements and future supply is likely to be dominated by PSD.

With a likely compression in developer margins that are expected, it is likely that prices in premium areas will drift lower, both in the off plan and the ready space.

Relative price performance between GSD and PSD assets, is likely to skew towards the latter.



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# Our Aspiration and Motto



“No barrier can withstand the strength of purpose”

HH General Sheikh Mohammed Bin Rashid Al Maktoum  
The Ruler of Dubai and Prime Minister of UAE



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