Unitas Consultancy (A GLOBAL CAPITAL PARTNERS GROUP COMPANY) Q1 2016

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Dubai: All the Returns We Cannot See

REIDIN Emerging Markets Real Estate Information

GCP GLOBAL CAPITAL PARTNERS

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Executive Summary

- Returns from a real estate investment is derived from two basic components (i) capital appreciation and (ii) rental returns. Over the last two real estate cycles investors have focused on the out-sized returns generated from capital appreciation compared to rental yields. However, in the long-run the latter can account for 40% of the total returns, making it an essential component of the return matrix. During up cycles, capital appreciation always accounts for the bulk of the total returns; it is in periods of downturn that rental returns dominate, and in this cycle, dominates throughout the entire cycle to date.

- On a city wide basis, capital appreciation since 2009 has been a mere 16%, whereas the total returns including rent during the same period have been close to 70%. Conventional market wisdom for the investor psyche is that low-end properties are a yield product, whereas premium assets are a longer-term capital appreciation play. A segment wise analysis of various apartment communities reveal that prime properties have incurred a 26% higher price appreciation rate to affordable housing. However, due to the superior rental yields in the affordable housing segment, when a total return analysis is conducted, this gap is narrowed to 10%.

- In the villa segment, it appears as if the return distribution is even more skewed towards rent in the current cycle, with rental returns accounting for nearly 90% of the total returns that have accrued to the investor. This is in consonance with empirical experience in the villas which have virtually flat lined in terms of price appreciation in the current cycle.

- Another popular misconception within the real-estate ecosystem is to buy off-plan properties for greater price appreciation, as when they come closer to completion a higher premium can be commanded compared to the rest of the market. However, an analysis of two off-plan projects against their communities indices reveals, if you hold till completion, that the community index has been at par or out-performed the individual off-plan project.

- Lastly, when dealing with rental income it is important to factor account for fees, as usually there is a 25% difference between net and gross returns. Typically, prime properties charge a higher service fees accounting for 17% of the gross rent, whereas in affordable communities it is only 12%. This difference further widens the gap between the net and gross yields for each segment.

- We opine that the change in the structure and composition of of total returns is partly due to the underlying tectonic shift underway in Dubai's economy towards a more end user dominated market. We expect that this trend will continue.

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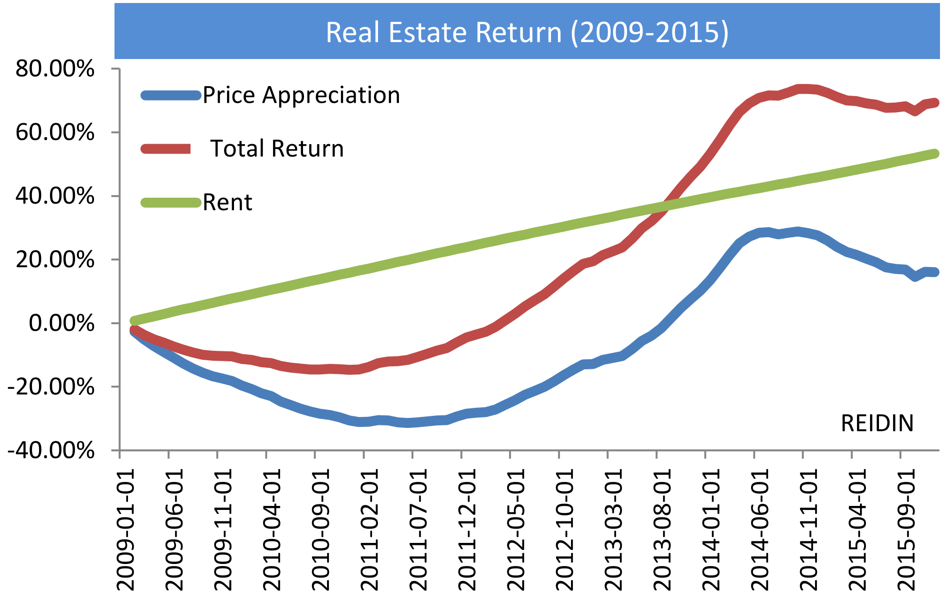
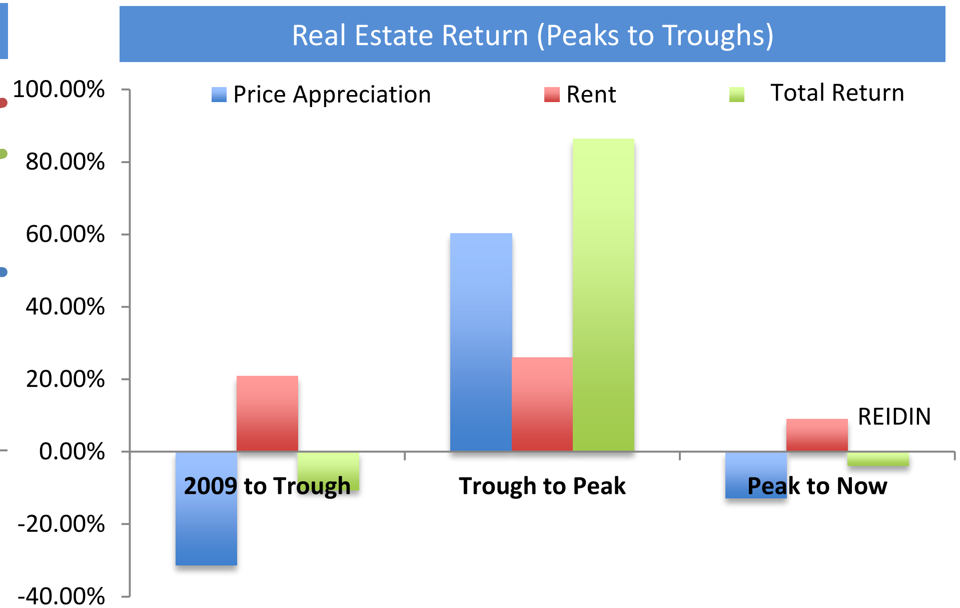
Total Return Analysis: Villas and Apartments

"Experts often possess more data than judgment" - Colin Powell

Total Return Analysis: Apartments

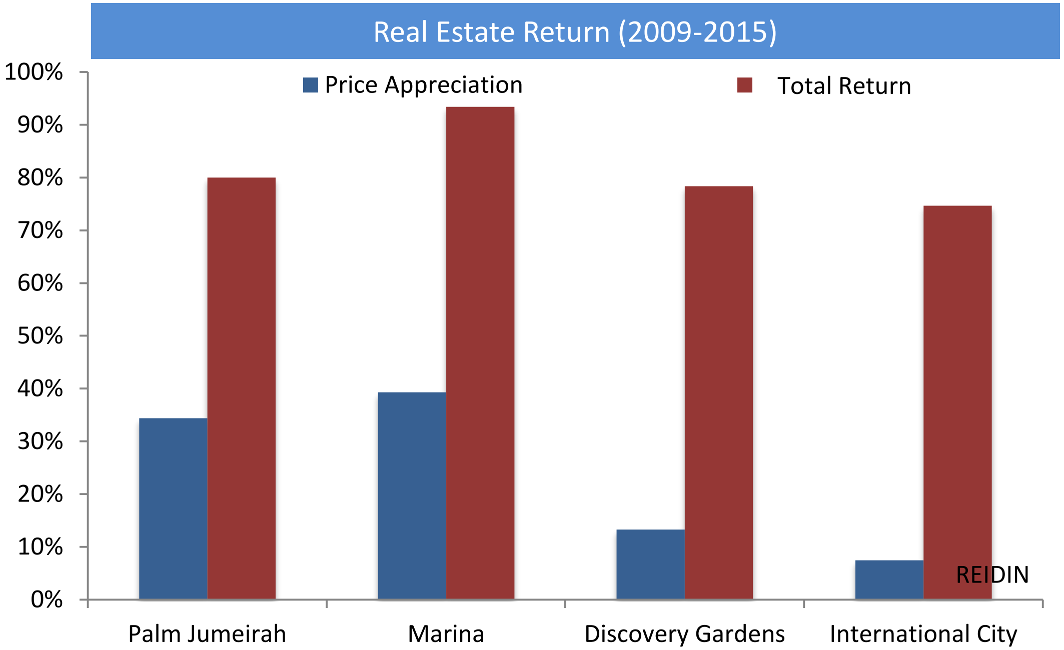


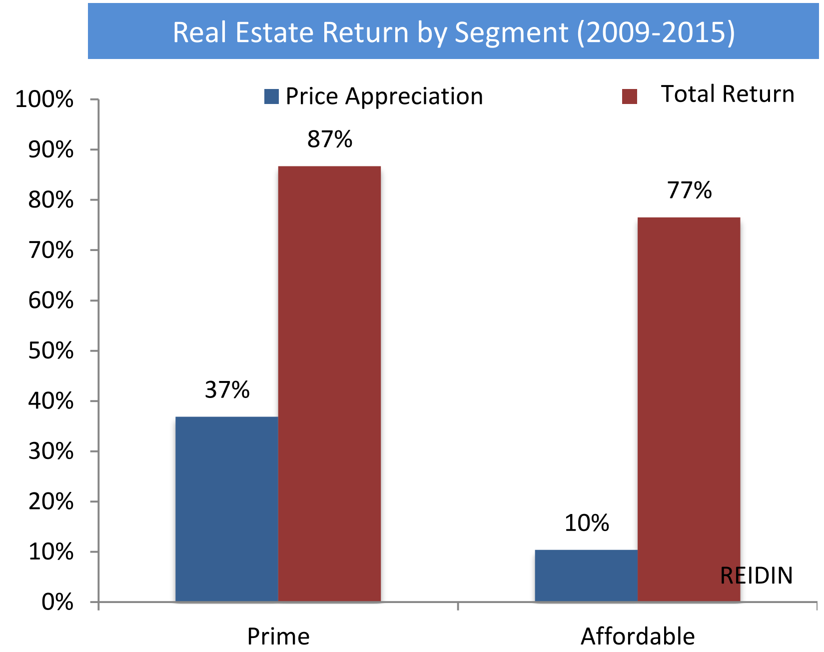


On a city wide basis, capital appreciation since 2009 has been a mere 16%, whereas the total returns including rent during the same period have been close to 70%, indicating that rental income have accounted for 81% of the overall returns that have accrued to the investor. This shape shift pattern distribution has been completely different from the first cycle, where capital gains accounted for approximately 75% of overall returns. This structural shift has been due to a number of factors, predominant among them being the underlying transformation of the market towards more of an end user and mid income focused market.

During up cycles, capital appreciation always accounts for the bulk of the total returns; it is in periods of downturn that rental returns dominate, and in this cycle, dominate throughout the entire cycle to date.

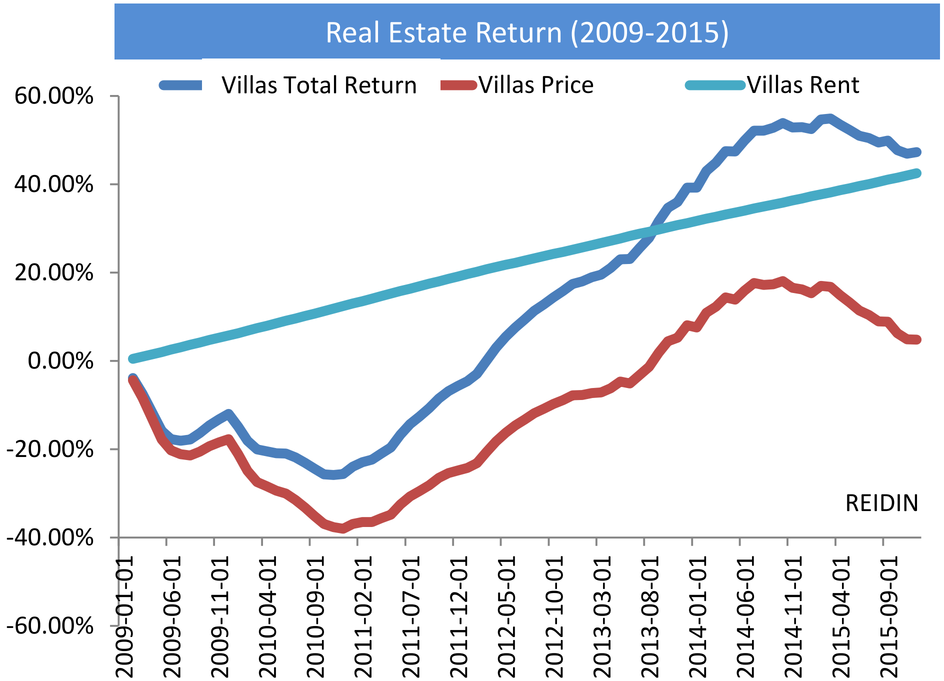
Total Return Analysis versus Price Appreciation: Apartments

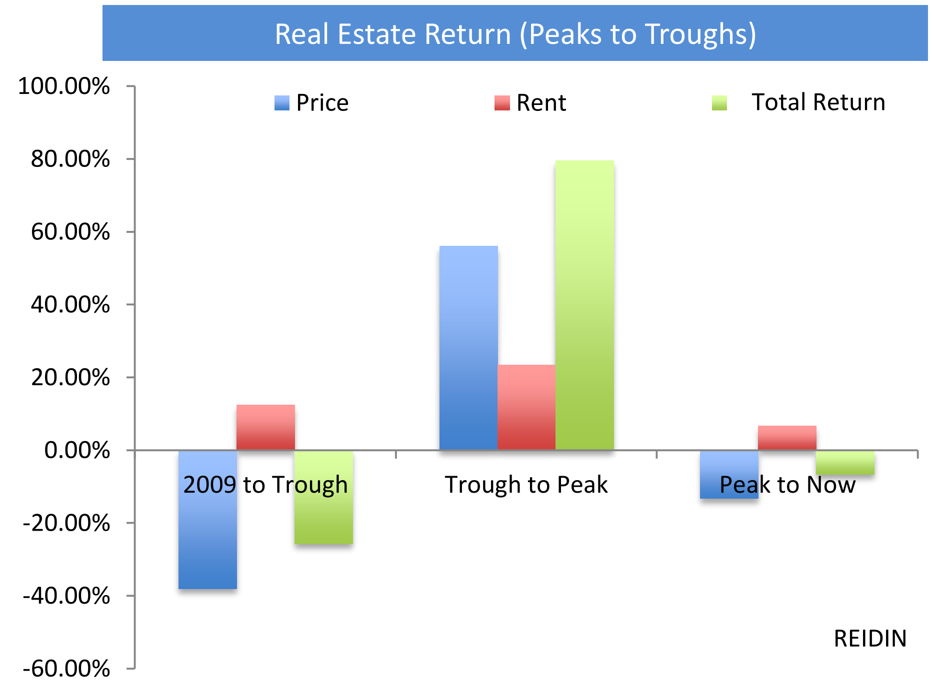




A segment wise analysis of various apartment communities reveal that prime properties have incurred a 26% higher price appreciation rate to affordable housing from 2009 to 2015. However, due to the superior rental yields in the affordable housing segment, when a total return analysis is conducted, this gap is narrowed to 10%. This surprising conclusion runs contrary to the popular zeitgeist embedded in the local real estate market of prime properties being the highest return potential. In point of fact, it is only the structure of returns that have been different; overall returns in this cycle have been virtually identical.

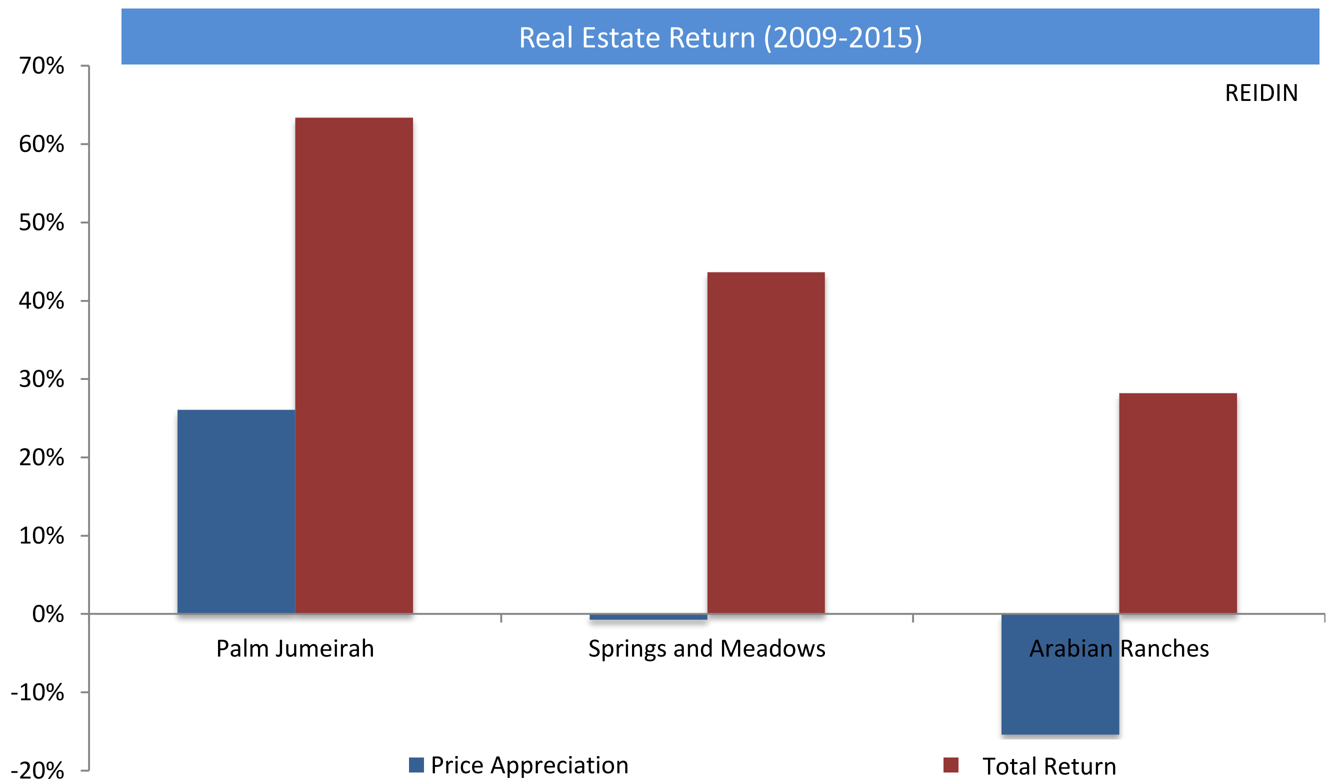
Total Return Analysis Versus Price Appreciation: Villas





In the villa segment, it appears as if the return distribution is even more skewed towards rent in the current cycle, with rental returns accounting for nearly 90% of the total returns that have accrued to the investor. This is in consonance with empirical experience in the villas which have virtually flat lined in terms of price appreciation in the current cycle.

Total Return Analysis versus Price Appreciation: Villas

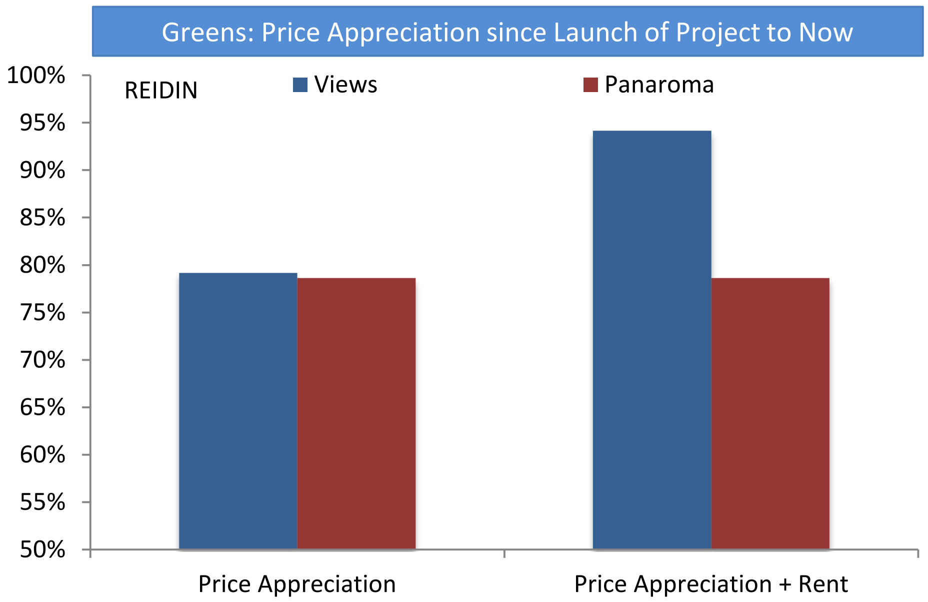


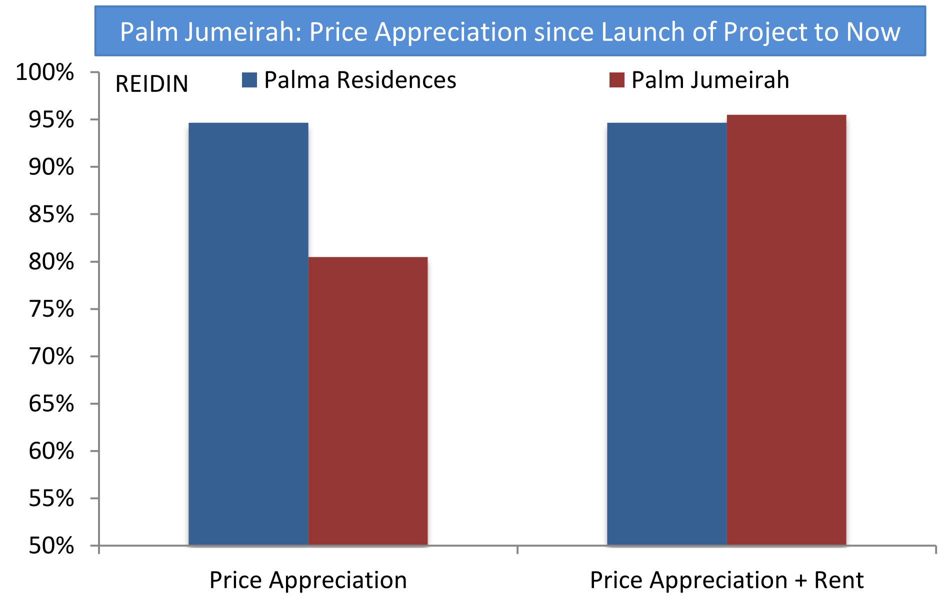
A segmentation analysis in villas does indicate that prime properties still outperform the mid to high income segment even in this cycle. This is logical as the villa space has not catered to the mid income segment thus far; with recent offerings that are still off plan, we expect this trend to converge towards the experience of apartments as more affordable options are released.

Total Return Analysis: Off-Plan VS Ready

"The single biggest problem in communication is the illusion that it has taken place" - George Bernard Shaw

Off plan versus Ready: A Report Card For the Long Term Investor





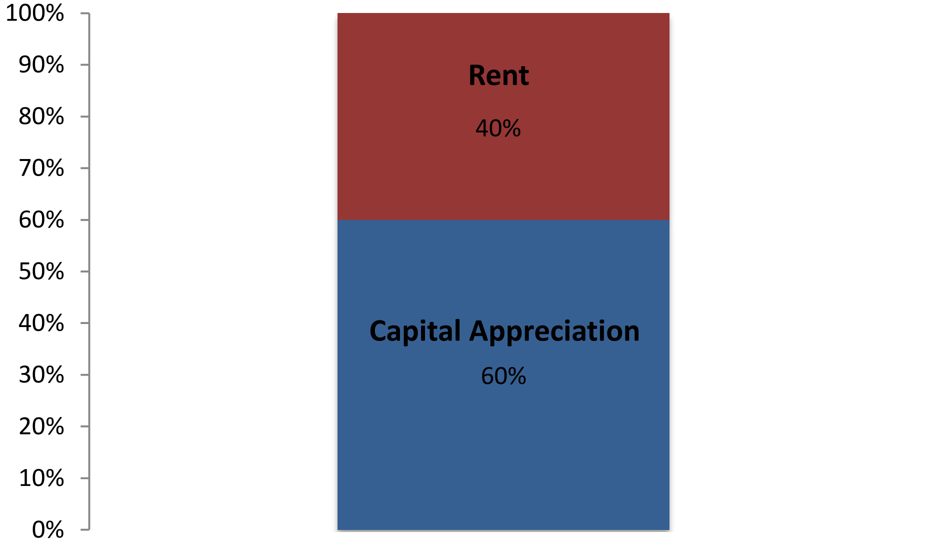
A popular misconception within the real-estate ecosystem is to buy off-plan properties for greater price appreciation, as when they come closer to completion a higher premium can be commanded compared to the rest of the market. However, an analysis of two off-plan projects against their communities indices reveals, if you hold till completion reveals, that the community index has been at par or out-performed the individual off-plan project. This implies that off-plan investment price action whilst volatile in the short term, has little attractiveness for the long term investor.

A Closer look into Singapore

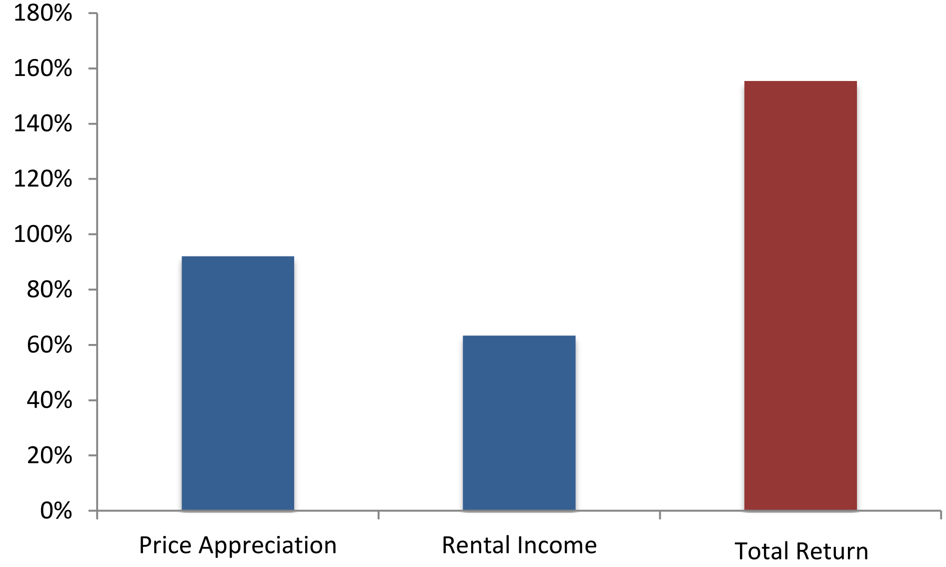
“The only relevant test of the validity of a hypothesis is comparison of prediction with experience” – Milton Friedman

Singapore and Dubai Run Parallel

Return Distribution % (2000-2015) [1]



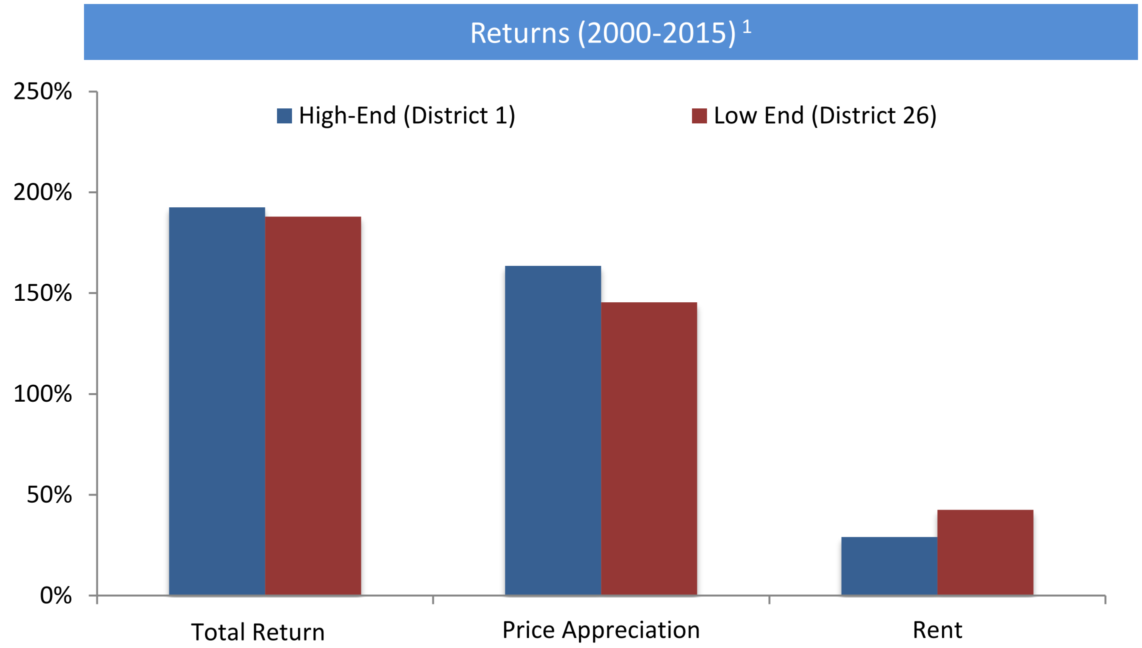
% Returns (2000-2015) [1]



A closer look into Singapore from 2000 to 2015, reveals an identical ratio of the contribution of rents and capital gains to the overall return of the property market, to that what was experienced in Dubai from 2003-till date. This highlights the Singapore's real estate market may well follow Dubai's experience in the years ahead as rental returns start to play a predominantly higher factor in the distribution of overall returns.

www.srx.com.sg[1]

Singapore: A Segment-wise Analysis



Similar to Dubai, in Singapore the gap also narrows for returns between prime properties and low-end areas when rents are factored in the equation. The gap between the price appreciation of high-end and low-end properties narrows in the long-run as the latter has a higher yield.

The virtually identical total returns experienced in Singapore between mid and high income segments further belie the claims that high end properties have outperformed other segments of the markets. In point of fact, given the higher annuity rental yields offered by the mid income sector, the latter is actually *not as risky* as the high end of the market.

www.squarefoot.com.sg[1]

Charges and Yields

"Some people think that the truth can be hidden with a little cover-up and decoration. But as time goes by, what is true is revealed, and what is fake fades away" - Ismail Haniyeh

25% Difference between Gross Yield and Net

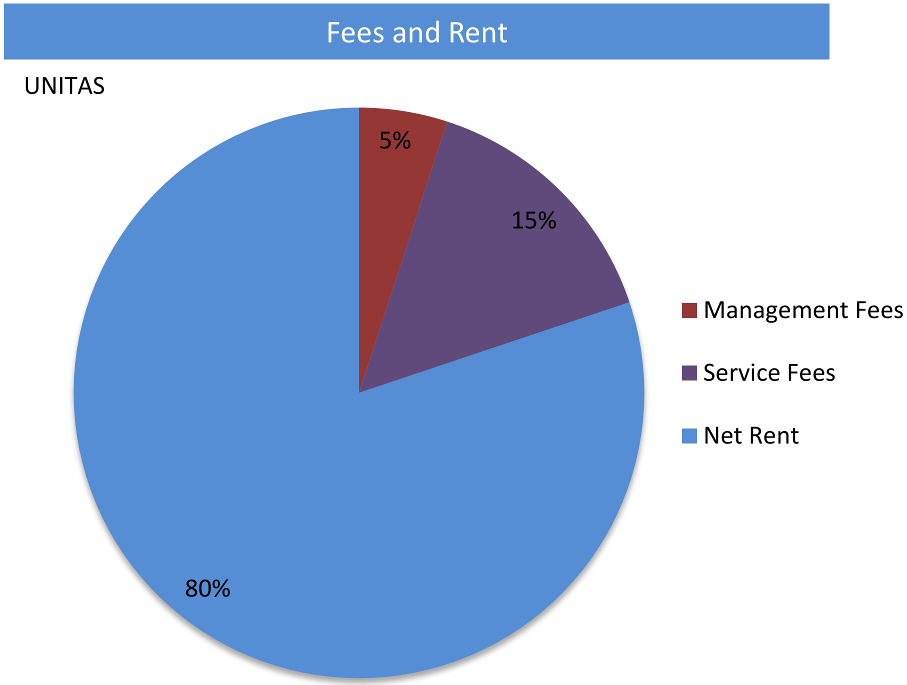
International City	
Sqft	484
Type	Studio
Selling Price	
Net Price	*344,608*
Transfer Fees (6%)	20,676
Trustee Fees	2,000
Noc Fees	1,500
Title Deed Fees	540
Gross Price	***369,324***
Rental Rates	
Gross Rent	*35,000*
Management Fees	1750
Service Fees	4240
Net Rent	***29,010***
Return on Investments	
Gross ROI	10.16%
Net ROI	7.85%
Difference	
22.7%	

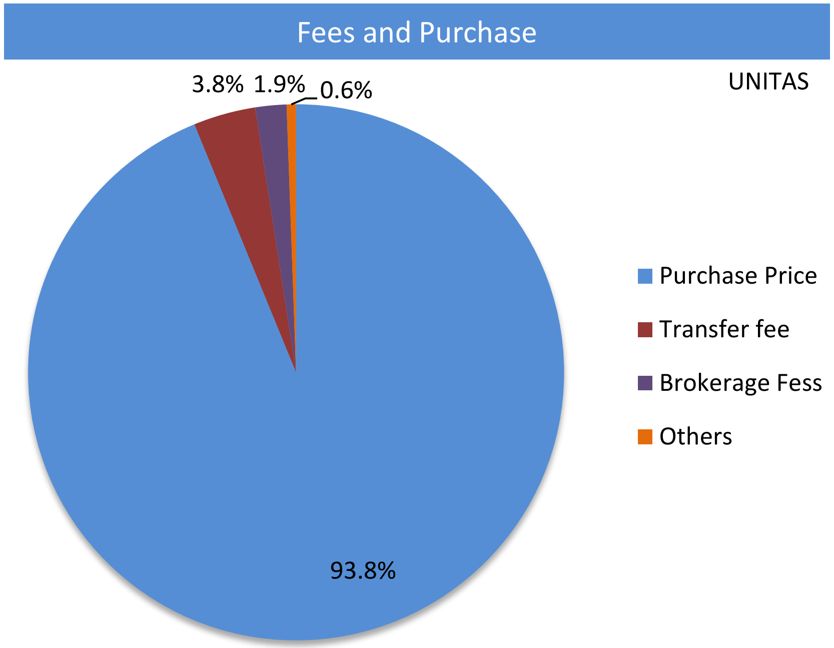
Greens	
Sqft	740
Type	One Bedroom
Selling Price	
Net Price	1,004,920
Transfer Fees	60,295
Trustee Fees	4,000
Noc Fees	1,500
Title Deed Fees	540
Gross Price	1,071,255
Rental Rates	
Gross Rent	82,318
Management Fees	4,116
Service Fees	13,000
Net Rent	**65,202**
Return on Investments	
Gross ROI	8.2%
Net ROI	6.1%
Difference	
25.7%	

Downtown	
Sqft	1384
Type	Two Bedroom
Selling Price	
Net Price	3,382,496
Transfer Fees	202,950
Trustee Fees	4,000
Noc Fees	1,500
Title Deed Fees	540
Gross Price	**3,591,486**
Rental Rates	
Gross Rent	187,836
Management Fees	9,392
Service Fees	30060
Net Rent	**148,384**
Return on Investments	
Gross ROI	5.55%
Net ROI	4.13%
Difference	
25.6%	

An investor should be cognizant of the fact the difference between a gross and net yield in a property investment can vary by 25%. When you factor in the transfer fees along along with the fees associated with the rental component, the gap between gross and net yields is startlingly high, and these transaction costs may well influence investment decision making.

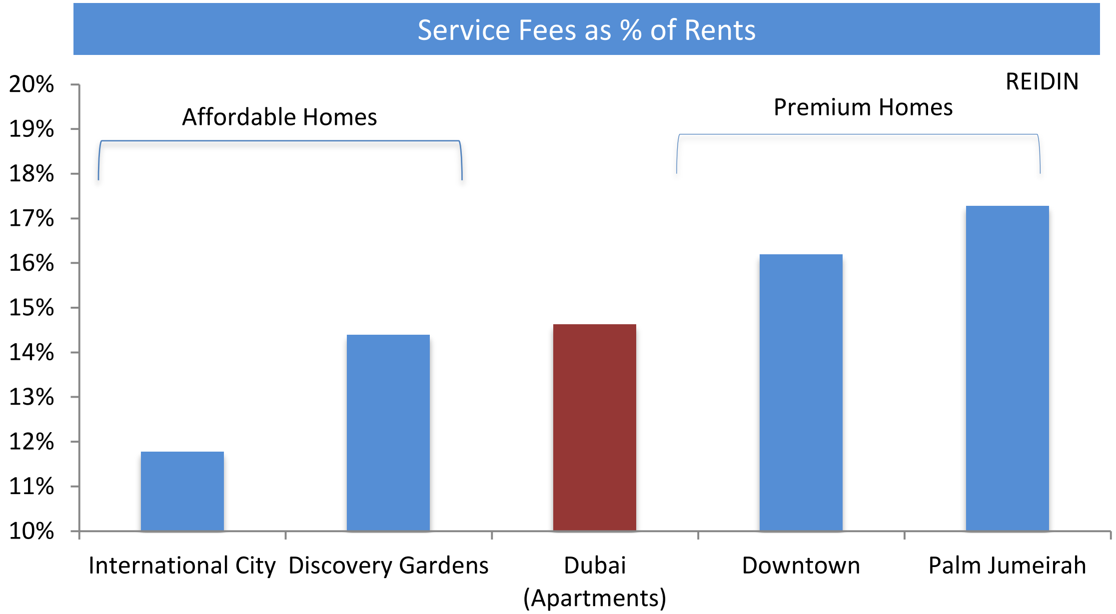
What are the Fees associated with Rents and Purchases





The above graph depicts the different fees associated with the purchase and rent of the property. After deducting the two most common fees in rents (management and services fees), the investor is left with 80% of the gross rent. Whereas in purchasing a property the bulk of the extra fees is associated with the transfer and brokerage fees, which could make the property 7% more expensive than the net price.

Premium Property Owners pay a higher percentage of their rent in service fees



Typically services fees is 15% of the rental value across Dubai, however this amount gravitates higher or lower depending on the segment of the market. In the affordable segment the service fees can account for as low as 12% of rents, whereas in the high-end areas it can be high as 17%. The difference in the service fees can impact the net rental yield to the investor, consequently widening or lessening the gap between net and gross yield.

Conclusions

Returns from a real estate investment is derived from two basic components (i) capital appreciation and (ii) rental returns.

During up cycles, capital appreciation always accounts for the bulk of the total returns; it is in periods of downturn that rental returns dominate, and in this cycle, dominate throughout the entire cycle to date.

Total Return Analysis

A look back at the total returns from a real estate investment, reveals that the rental income contributes a significant portion of the gains. This is especially evident in the last cycle (2009 to now), where rental income accounted for 80% of returns.

In the same a cycle a segment wise analysis of various apartment communities reveals that prime properties have incurred a 26% higher price appreciation rate to affordable housing. However, due to the superior rental yields in the affordable housing segment, when a total return analysis is conducted, this gap is narrowed to 10%

TRA: Off-Plan and Ready

A popular misconception within the real-estate ecosystem is to buy off-plan properties for greater price appreciation, as when they come closer to completion a higher premium can be commanded compared to the rest of the market.

However, an analysis of two off-plan projects against their communities indices reveals, if you hold till completion reveals, that the community index has been at par or out-performed the individual off-plan project. This implies that off-plan investment price action whilst volatile in the short term, has little attractiveness for the long term investor.

A Look into Singapore's TRA

A comparison between the total return analysis of Singapore and Dubai reveals a similar return structure. In the long-run rents in both cities have contributed 40% to total returns.

In addition to this, a similar return pattern exists between high-end and low-end properties. Although, capital gains have been higher in the former, the latter has higher rental rates, lessening the gap between the total return.

Charges and Yields

An investor should be cognizant of the fact the difference between a gross and net yield in a property investment can vary by 25%. This difference is attributed to the various costs included with the rental and purchase components of the investment.

Typically services fees is 15% of the rental value across Dubai, however this amount gravitates higher or lower depending on the segment of the market. In the affordable segment the service fees can account for as low as 12% of rents, whereas in the high-end areas it can be high as 17%.

GCP believes in in-depth planning and discipline as a mechanism to identify and exploit market discrepancy and capitalize on diversified revenue streams.

Our purpose is to manage, direct, and create wealth for our clients.

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"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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