Dubai's Real Estate Market: Another Boom?

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Also available in Arabic

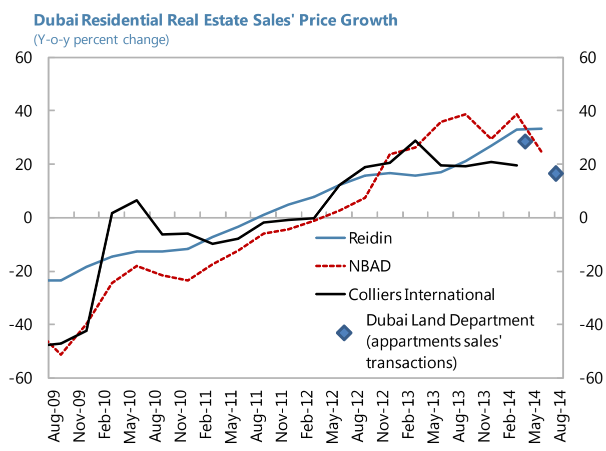
Following a real estate boom in 2002-08, the real estate market in the UAE turned to bust, in part linked to the global financial crisis. But more recently, the situation has changed again noticeably.

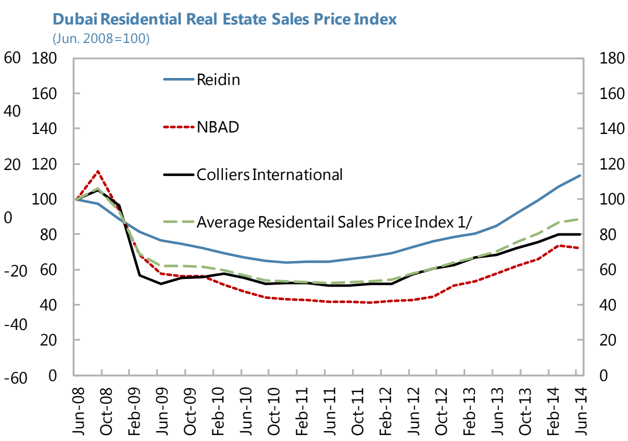
Since mid-2012, residential property prices and rents in Dubai have been increasing quickly, thanks to returned confidence in the real estate market and also the successful bid for the Expo 2020.

A quick recovery of the real estate sector in the United Arab Emirates (UAE), especially in the Dubai residential market, has undoubtedly benefited economic growth. But can it also lead to a situation when housing prices rise too quickly and then, at some point of time, collapse? Here, a new IMF study looks at the real estate market in the UAE, and possible policy measures to contain real estate boom and busts.

Strong recovery

Available data show that real estate prices in Dubai have reached their 2008 peak levels in nominal terms. Earlier this year, the rate of price increase reached 30 percent year-on-year before moderating to about 17 percent in August. Prices have also risen in Abu Dhabi's residential market, though the upswing started much later than in Dubai.





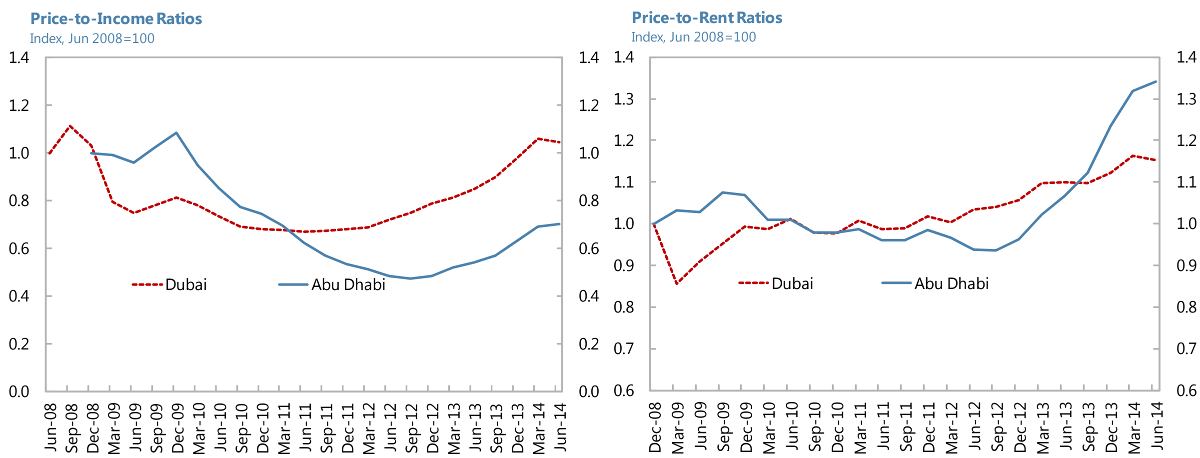
Sources: Dubai Land Department; Colliers International; National Bank of Abu Dhabi; Reidin; and IMF staff calculations.
1/ Average of Colliers International, National Bank of Abu Dhabi, and Reidin residential sales indices.

House prices bear watching?

Various measures, for example, price-to-income and price-to-rent ratios, can provide guidance on valuation in the real estate market. These measures indicate that Dubai's real estate prices have been growing more rapidly than residents' income and rents. By end-2013, Dubai's price-to-income ratio reached levels last seen in 2008, at the peak of the previous boom. The price-to-rent ratio has already surpassed 2008 levels. While the momentum in house price increases has moderated over the summer, these indicators are worth watching.

The UAE's economy is now more resilient than it was in the mid-2000s: construction accounts for a much smaller share of the economy, residential real estate is much less credit-financed, and the banking system is less exposed to economic and financial shocks.

Anecdotal evidence suggests that speculative activity is not on the same scale as before the 2008 collapse. But large-scale speculative demand in the real estate market could still return. If demand becomes inflated by speculation, developers could again respond with excess expansion of supply. Inflated demand and oversupply could then prove to be key ingredients for an eventual steep fall in housing prices.



Source: Colliers International, JLL, NBAD, Reidin, IMF staff calculations.

Addressing risks

Recognizing this risk, the UAE's government has introduced a number of measures to help reduce speculative demand. One of the most important steps was the increase in real estate registration fees from 2 percent to 4 percent last fall.

Also, the Central Bank of the UAE has introduced regulations that are helping further strengthen the resilience of the banking system and contain credit-financed speculative demand. These regulations include loan-to-value limits for mortgage lending and debt service-to-income limits on loans for individuals (i.e. limits aimed at containing excessive mortgage lending and borrowing).

These measures may have helped moderate the price momentum over the last few months, though it is too early for a firm assessment. If quick price increases resume, the authorities may find it helpful to exercise vigilance and implement further measures to contain speculative real estate demand and support the soundness of the banking system. Such measures could include:

- **Real estate transaction fees** are useful for real estate markets that are largely based on cash transactions, as is the case in the UAE where an estimated 70-80 percent of all real estate transactions are done in cash—that is, out of purchasers' own resources, or financed from abroad. The authorities could also raise real estate transaction fees substantially for properties re-sold within a short time of purchase (similar to what Hong Kong and Singapore did). In addition, imposing different fees for reselling off-plan properties (that is, pre-construction properties), could help further discourage speculative demand without suppressing "healthy" growth.

- **Regulatory measures for the banking system** can reduce the pressure on real estate prices by limiting credit-financed speculation. Some of these measures, as mentioned above, have already been introduced in the UAE. They could, however, be tightened further, if prices resume their quick rise and particularly if real estate lending picks up more strongly. Importantly, these measures can also protect the banking sector from a potentially large drop in housing prices.

There are no "one size fits all" measures to deal with quickly growing real estate markets and their potential consequences. International experience suggests that some countries were successful in preventing the boom by applying the right policies (for example, Singapore). Other countries could not stop the boom, but strengthened their banking systems for the eventual downturn (for example, Hong Kong, Korea, India).