MAZAYA
AIM TO LEAD

The Monthly Real Estate Report

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Al Mazaya: UAE and GCC construction sector's prospects strong in 2015, despite oil price falls

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Al Mazaya: UAE and GCC construction sector's prospects strong in 2015, despite oil price falls

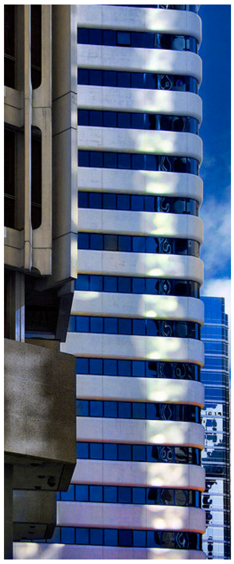
The declining oil price will likely affect the region's construction sector negatively, putting the brakes on some government short-term and long-term infrastructure and real estate spending. Also, non-government real-estate players will stay on the sidelines over the coming months as falling oil prices inevitably mean falling costs of construction materials. The market will wait, naturally, for the cheapest prices. While the prospect of a correction hangs over the industry, it is normal that it will slow – buyers, in particular, will wait to see if better value can be found tomorrow.

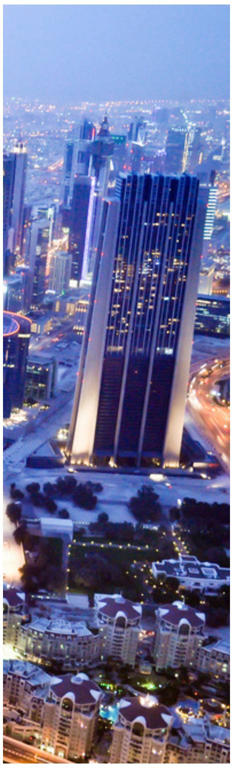
Al Mazaya Holding weekly report points out that while the construction sector slows during the downward movement in the price of oil – and diesel – cheap prices will in time prove to be good news, spurring developers and buyers alike into action while prices are cheap. While costs – of materials and diesel – are low, profit margins can be high.

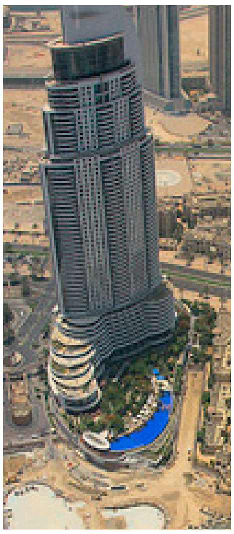
It goes without saying that profitability depends on demand remaining strong during the current period, and indications suggest this is the case. Consequently, we expect the region's construction companies to deliver strong profits during this quarter and the next. In fact, we believe the current prices of materials better reflects the reality of the market than did the prices in 201314/, when high oil prices inflated costs artificially.

Al Mazaya Holding weekly report states the value of construction projects – government and private – in the United Arab Emirates underway at the present time is AED660bn, according to official figures. Despite the declines in the price of oil and the knock-on affect to government spending plans, we believe the construction sector in Dubai will grow by some 5.8 percent in 2015. In 2014, construction contributed 9.1 percent to GDP, an amount we consider sufficient to insulate the industry from any upcoming public sector spending reviews. Construction remains too important to Dubai's long-term economic diversification plans to be slowed significantly – indeed, this year we predict the government will increase its spending on construction by five percent.

Likewise, we expect the construction sector in Abu Dhabi to experience further growth during the current year due to the continuing commitment of the government to state-funded projects intended to play a strategic role in strengthening the economy for the long-term. We do not expect the declining oil price to have any effect on the government of Abu Dhabi's plans to build airports, ports, factories and other important infrastructure edifices over the coming years, with the goal of generating long-term returns. It is worth noting, all of these projects will create demand for housing in the emirate.







In Abu Dhabi, some 48 real estate projects worth AED99bn are underway. In general, the health of the UAE's construction sector (we have seen mega-projects that were halted at the onset of the global financial crisis resumed) has supported the wider industry in the region. In the first half of 2014, for example, construction contributed eight percent to Dubai's GDP and we expect this figure to rise over the coming years as mega-projects are announced in the build up to the World Expo 2020, which the emirate will host.

In the last quarter of 2014, five major international construction exhibitions were held in the UAE, demonstrating the support the sector enjoys internationally, both in the UAE and the GCC. Sales of building materials at these conferences were believed to be up on the previous year by as much as twenty percent, and more deals are likely to be done at 2015 exhibitions as a result of recent and upcoming mega-project announcements. The UAE's construction sector, thanks to the excellent infrastructure, particularly in Dubai, that facilitates the transport and import of materials, is optimally placed to thrive. As the government looks to increasingly work with private sector developers in the creation of new centres of commerce and economic cities, we expect the industry to go from strength over the coming decade, supported by beneficial legislation and strong liquidity.

Throughout the GCC, the construction sector relies on GDP growth and infrastructure spending by government for stability and growth. Prospects, therefore, are good, even though the oil price has weakened: AED800bn of projects are expected to be announced over the coming five years throughout the region. Although it is inevitable the industry will face the challenges to which it has become accustomed – typically, caution over lending by banks, fluctuations in the costs of materials, recruiting skilled manpower and competition from overseas construction firms – it is expected the industry will thrive while remaining competitive.

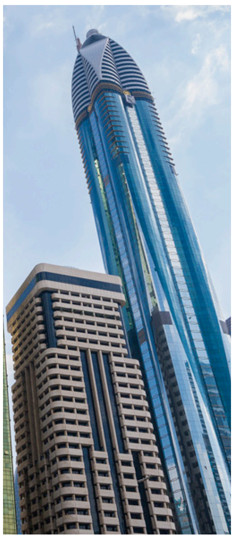
The UAE's economy is forecast to grow by 4.5 percent this year, compared to four percent in 2014, despite difficult global financial conditions. Likeweise, we expect the economies of most other GCC states to perform well. The prospects, then, for the construction sector throughout the region, and particularly in the UAE, are very good, in the opinion of Al Mazaya Holding weekly report.

Al-Mazaya: oil price declines will likely affect Gulf developers' appetite to bring units to market in 2015.

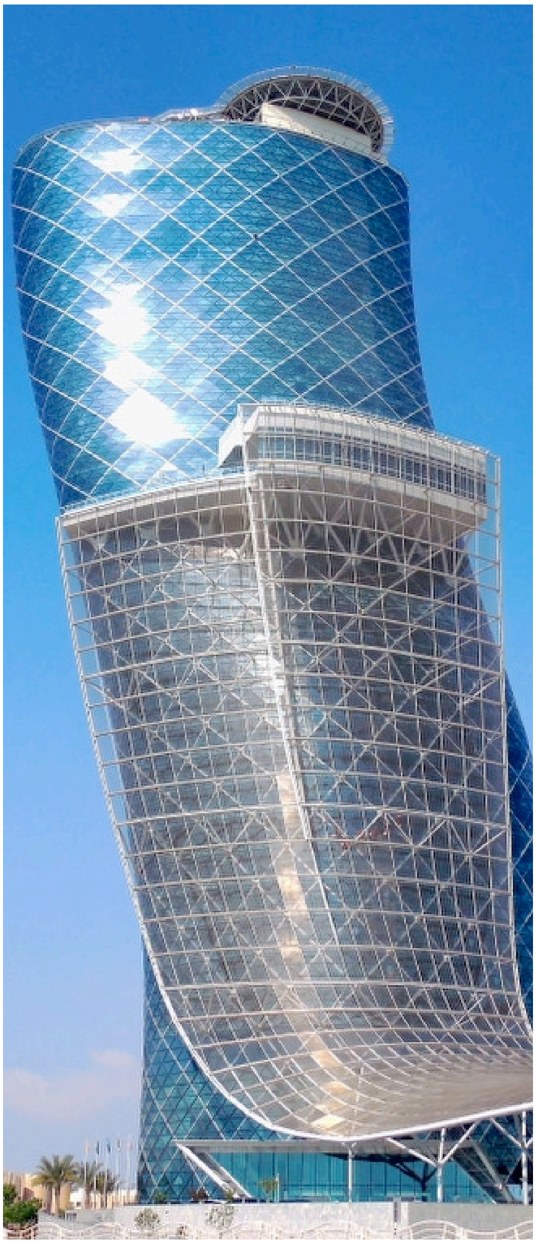
Fluctuations in the oil price are not always driven solely by the supply versus demand ratio – currently, there are other, geopolitical, forces at work that are affecting the price. These forces are by nature temporary, and in time we will see the price stabilize and more accurately reflect market realities post global economic crisis.

However, the effect of the oil price on the Gulf real estate sector is certainly real, lowering the cost of materials and transportation costs, and we can expect to see more downward pressure on construction costs over the coming months, especially as increased residential unit supply comes onto the market in some Gulf countries where construction activity has recently been high.

Looking at the residential units to be offered in the real-estate market this year, it is evident they surpass the demand forces across the regional market. This is the nature of real estate construction: market forecasts must be long-term in outlook but it is hard to accurately forecast the variables that will affect demand and supply costs accurately. As a result, the sector is often exposed to the consequences of extreme fluctuations.



No less than 20,000 residential units will come onto the market in Dubai in 2015, exerting downward pressure on sale prices and lease rates. In 2014, leasing rates in Dubai improved by some seven percent on 2013 rates, which in turn improved by 24 percent on 2012 rates. The lease rates in 2015 are expected to prove less attractive to investors than the 2013 rates, though the market will remain active, servicing local demand for sales rather than bringing in large numbers of external investors.



In Sharjah, 175 real-estate projects were launched in 2014 and we expect to see some 3,000 further units brought to market in 2015.

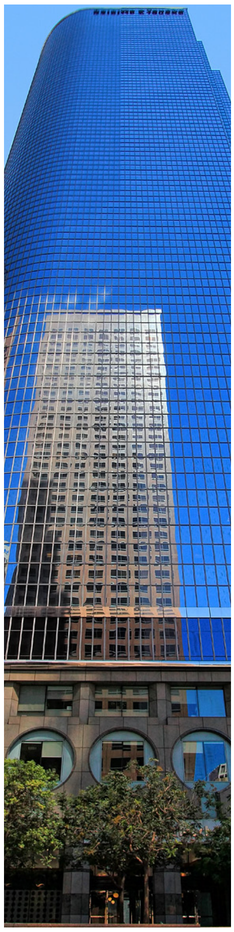
In Saudi Arabia, construction activity is high on the residential side as the government looks to provide sufficient quantities of homes to keep pace with a rapidly growing population. Investment into residential supply is expected to be some SR82bn in 2015, and more than 750,000 units will be finished. A significant proportion of the financing costs for such large-scale construction will be met by the Saudi Real Estate Development Fund, while the rest will likely emanate from the private sector.

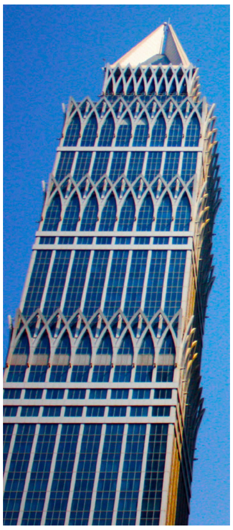
It is expected that, as a result of the new residential unit supply, prices for homes in much of the country will face pressure – currently, market demand is sufficient only to absorb 25 percent of supply. Already, prices in Saudi Arabia for completed homes have weakened by between five and fifteen percent since the start of the year, while land prices have dropped by as much as nineteen percent. As a result, investors are content to wait on the sidelines for further falls before entering the market.

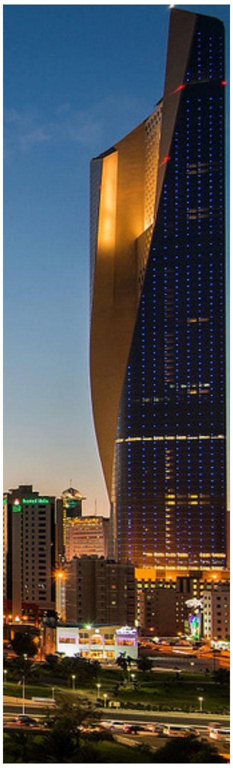
In Jordan, we see some momentum in the market for small apartments – in January of this year alone, some 863 small apartments were purchased, up eighteen percent on January, 2014. However, demand for larger apartments has fallen off significantly, by as much as 21 percent in January 2015 versus a year previously. Investor hesitation as prices decrease and high levels of bureaucracy are deterring construction companies from pushing ahead with planned projects. While the market continues to experience downward pressure, we expect the real estate sector to seem less attractive than it has previously to potential investors.

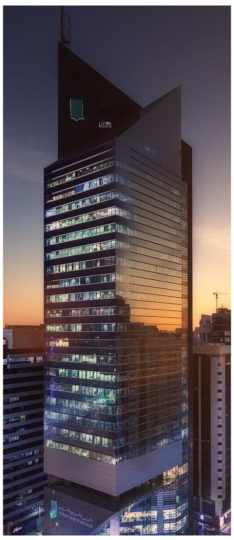
In Qatar, we expect to see 25,000 new residential units come onto the market in 2015, and some 100,000 by 2020. Current projections show demand is sufficient to absorb this level of supply – and lease rates are likely to remain stable and attractive to investors. It is expected that government calls for the construction of increased numbers of affordable homes for low-to-middle income families will see considerably more low cost residential units completed over the short-term future.

Lease rates in Qatar have surged in recent years, up by between seventy to eighty percent between 2011 and 2014, as a result of the increased price of land. We expect strong demand for residential units over the coming five years will support a further ten percent strengthening of lease rates.



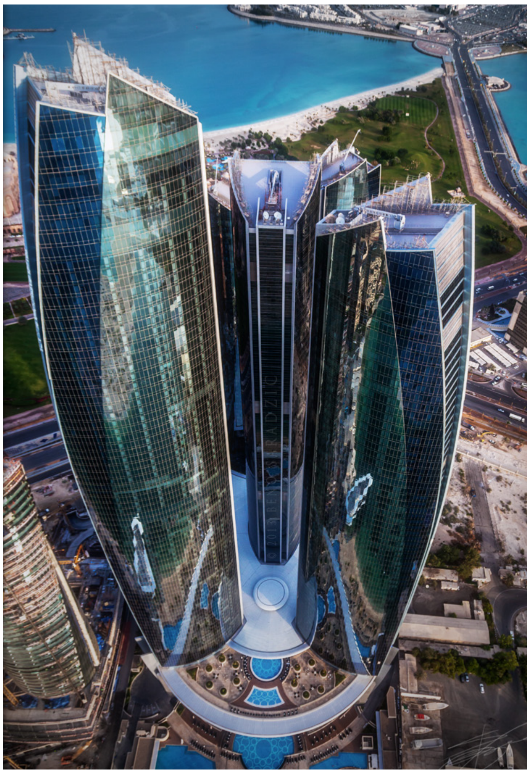






In Bahrain, we expect to see 40,000 residential units delivered, largely driven by a Bahraini Ministry of Housing Social Housing initiative to meet projected demand, especially towards the lower-income end of the market. We expect to see demand grow by between five and seven percent, and we are confident the construction sector in Bahrain will enjoy significant momentum as a result of well-supported mega-project announcements and investment drives.

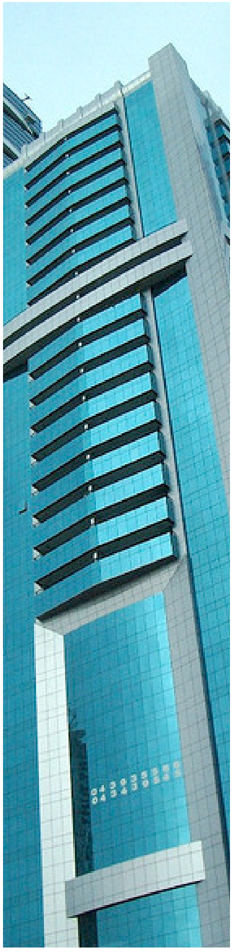
Despite the large amount of residential units forecast to come onto the Gulf market in 2015, Al Mazaya report does not predict a supply glut. Instead, and perhaps controversially, we expect declining oil prices to temper developers' enthusiasm to complete projects on schedule, delaying completion of final phases until prices and lease rate have strengthened. As a result, we do not predict the occurrence of real estate bubbles similar to those we have seen in the recent past. Supply will naturally realign itself to a level at which the prospect of meeting demand is, in most cases, realistic.

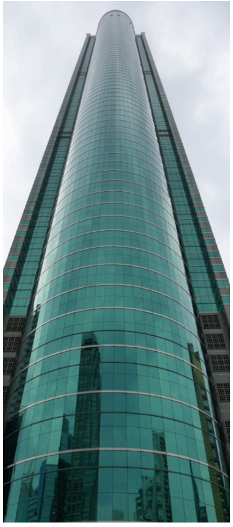


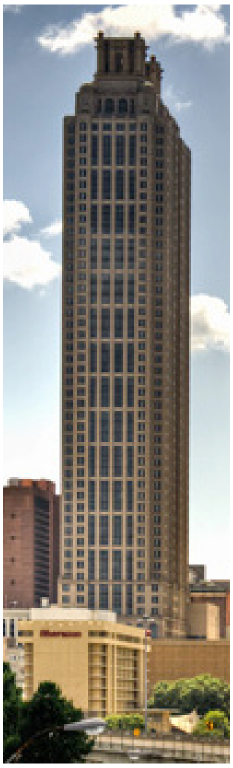
Increases in Real-Estate and Land Prices do not correspond to Free Economy Standards

Considering the financial and economic mechanisms pursued within this region and worldwide; their relatedness to the plans and objectives of individual economies is unfortunately unable to well define or manage the negative impacts resulting from existing market conditions. The regional and global financial and economic mechanisms are not tailored to cope with the strengths and weakness of the local economy. It is quite evident now that current trends push the need to necessitate applying micro rather than macro holistic systems; this is because some sectors operate following open market systems, while others follow direct governments, yet other sectors will follow free ownership systems, while some will follow public-private participation systems etc. All systems operate without arriving at a unified model that guarantees achieving mid-to-long term objectives under the umbrella of an overall perspective suitable to potential, current and future strategic plans of each country.

As such, pursuing those current approaches will never end up achieving an actual full-scale development strategy, especially given the difficulties hindering efficient utilization of resources and maximizing returns.





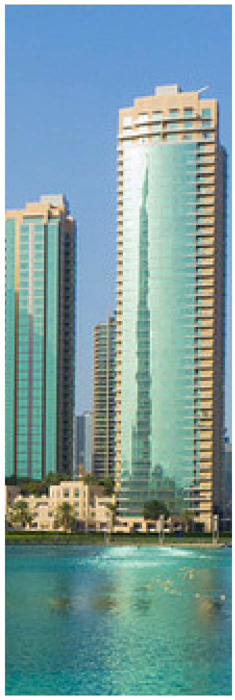


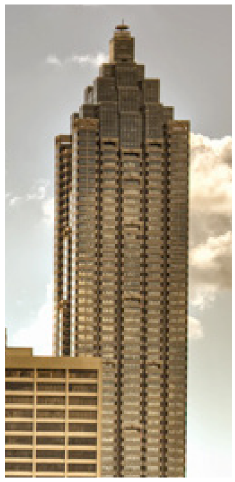
Al-Mazaya Holdings report says the contribution of different economic sectors to GDP varies according to their proportional weight; with the same applying to their negative impacts on the overall economic activities. This eventually adds to the challenges hindering realistic economic accomplishments and disperses the results sought from financial, economic mid-to-long term plans. The real-estate sector is leading the market and investments are enjoying major indicators of success, regardless of the prevailing circumstances. The real-estate sector is also regarded positively when long lasting development objectives are sought from the current development plans within the region. Al-Mazaya report adds that applying supply and demand concepts to the real-estate market in a realistic and comprehensive manner can't accurately be foreseen and involves uncontrollable risks that can't be managed in timely basis. Land – being the base for investment and planning processes is owned, invested in by the Estate through real-estate development companies and allocated to the citizens in accordance with well drafted decisions and plans. Therefore, supply and demand mechanisms are incomplete under such perspectives. That is, supply forces require demand and vice versa. When demand increases, prices go up and the market requires additional spaces to meet the demand. The unjustified hike on prices then arises and the market loses its balance.

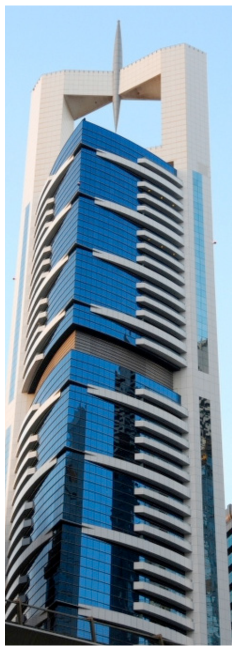
The main activities and indicators currently reflected in the Qatari real-estate sector are elaborated in the Al-Mazaya report in terms of the hiking price of land and real-estate - a leading event amongst the daily developments taking place however, the assessment mechanisms and solutions proposed to overcome such a challenge are varied. The Qatari real-estate market follows free market mechanisms and therefore demand/supply forces are determining the lease rates and land price in light of the lack of upper limits on annual increases on residential lease rates. Lease rates are being mutually agreed upon between the lessor and the leaseholder, while commercial real-estate rates are limited to 10% annual increases aiming to prevent huge hikes in the price of commodities and services, or heading towards limitless inflation rates and uncontrollable negative impacts. These procedures are taken at the times when real-estate figures are striving to assign price rates for land and real-estate attributed to a legal basis – yet aiming to manage real-estate and land prices while avoiding negative impacts affecting investors, landlords or on-going economic development plans.

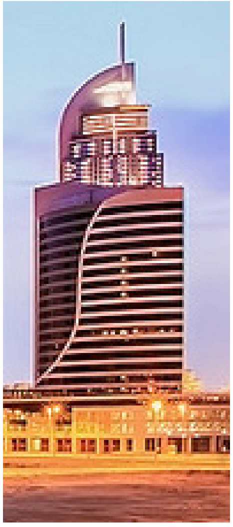
Al-Mazaya Report states the urban large-scale development that the Qatari economy witnesses will enhance production and service activities therefore, naturally increasing prices across all sectors; mainly land and real-estates being the core of all development trends. Specifically, we refer here to the increase in ratios and the terms and range of impacts, as statistics reveal 300% increase on lease rates at some selected locations, while land prices increased by 30% during Q1 the this year, with real-estate transactions amounting to QR 20 billion during the same term. This reflects huge liquidity available to the Qatari real-estate market. Still, such statistics are widely damaging as they are negatively impacting the construction, operation costs and the price to be paid by end users.

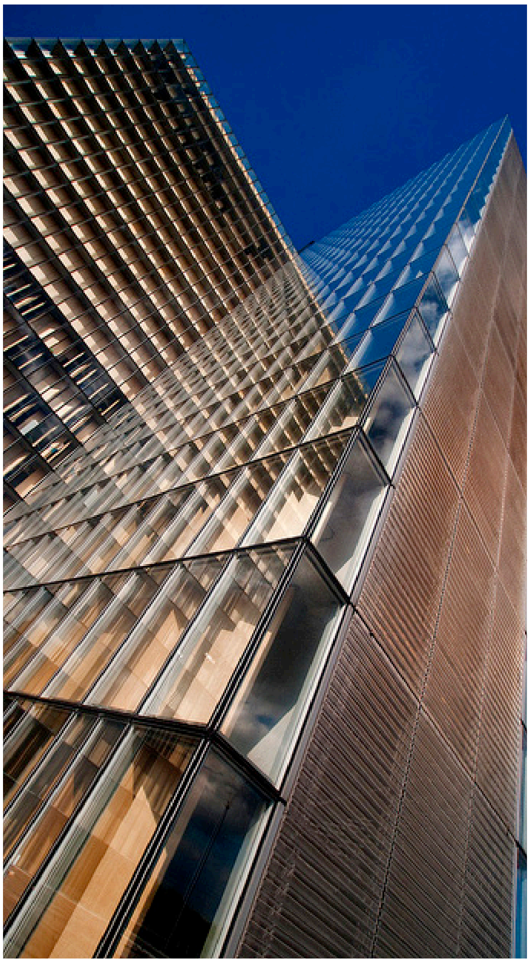
Al-Mazaya report recommends rapid and direct constraints to be imposed on the overall real-estate activities taking place at the Qatari real-estate market in order to avoid a real-estate bubble occurring, or a false demand trend affecting residential and commercial sectors. Amongst the leading constrains to be imposed is the management of liquidity traded in the real-estate market and control of its relevant sources as this is the significant factor mostly deviating and distorting real-estate mechanisms and demand/supply forces. Regulatory resolutions will equally contribute to alleviating the continuous leaps in prices whether in term of allocating more land to development purposes, constructing additional subsidized residencies, expanding the urban borders or the inclusion of additional areas to them. It will be equally worthy to explore imposing various limits that may control the upper margins of land and real-estate as they may hike to from current positions which is thought to harm the economic activities rather than benefiting them. As such, prioritizing the public economic interest requires a scrutinized intervention by related authorities affecting demand/supply mechanisms and alleviating their negative impacts. This approach may not be seen as offensive to the open market economic rules as the goal is to minimize the negative ramifications and maximize the benefits sought from the overall construction rebound.











Al-Mazaya report also refers to the real-estate market in Abu Dhabi following the same pattern recorded at the Qatari real-estate market in terms of the trends and negative impacts. Abu Dhabi, reacted less severely to the overall economic activity, since real-estate activities are better regulated here, not to mention that the current mature stages, while are not yet causing a real-estate bubble, are still considered as chaotic. Abu Dhabi Real-estate market has witnessed great leaps during the past few years increasing by 200% on several real-estate products and locations which took place post to canceling the 5% maximum annual increase. Abu Dhabi real-estate market still lacks the supplementary long-term procedures and regulations necessary to overcome challenges related to the increase on lease rates and lack of supply occurring every now and then, causing more deviations and distortions to the market. It is equally worthy to define official price trends to assign upper and lower lease rates at each location. It is further required to arrive at permanent and final remedies to the un-orderly dealers market from which lease markets in Abu Dhabi has long suffered and still continues to do so.

Al-Mazaya report states the current prices available on land and real-estate in the region exceed the actual values and the anticipated increase trends that should correspond to the economic momentum as well as to the actual demand, while government resolutions issued in this regard are being misused. The report adds that regarding the increasing inflation rates, which may not be responsible for causing these leaps in the market, nor making such increase a non-changing fact, regardless of the prevailing financial and economic conditions. The liquidity available to the real-estate market of the region requires additional regulations to better control the land and real-estate prices. Moreover, it is further beneficial to expand the range of investment opportunities available to individuals and SME’s currently considered as limited in the real-estate and financial markets; a step which opens the door widely to register additional bargaining and development transactions yet without impacting positive or added economic values. Nevertheless, investment in production sectors across the region indicate stability, growth and returning trends given the direct correlation with actual production and long terms investments.