INDEPTH

RESOLVING PROBLEMS IN DUBAI'S COMMERCIAL PROPERTY SECTOR

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DUBAI Resolving problems in Dubai's commercial property sector

BY PAULINE RENAUD

The once booming real estate sector in Dubai has been hit particularly hard by the global financial crisis. Illustrating this is the fact that, since last November, struggling conglomerate Dubai World has been seeking to restructure about $22bn after calling for a standstill request on its debt. The group's huge financial difficulties have resonated throughout the UAE – especially in Abu Dhabi, which bailed out one of Dubai World's companies. As it stands, the best the Dubai commercial property sector can hope for is stability until liquidity conditions improve. Nonetheless, there is still optimism among market players, many of whom believe that the rest of 2010 will bring recovery. A few weeks ago, Dubai World put its debt plan to lenders in order to restructure the business, a sign that things may already be getting better.

Dubai, like many other property markets, has felt deeply the impact of the global recession. Investors in the sector remain unsettled. But things are slowly starting to improve and favourable income returns may still be available. "Dubai has faced nine months of decline but the latest Property Beat report by HC Securities and Investments reveals that the property market stabilised at 1 percent in January and 6 percent in February," confirms Hélène Mathieu, a barrister at Hélène Mathieu Legal Consultants. "The property market, and particularly the commercial sector market, is beginning a phase of stabilisation, which is a positive indicator. However, the demand/supply balance should not be undervalued. Dubai's commercial property investors may face some insecurity." She adds that while some projects may be announced, others will be postponed or cancelled, largely due to valuations issues. However, occupier demand and fair valuations are expected to strengthen as soon as the global economy recovers. Overall, several factors have contributed to the stabilisation of the Dubai commercial property market, not least the steps implemented by the government to avoid a collapse of the sector.

Recent initiatives taken by the Land department – the real estate registry for the Emirate for registering built and un-built property and for consulting on real estate legislation – have contributed to the introduction of laws aimed at solving investors' issues and improving their confidence. Specifically, the introduction of law no. 9 has reassured both private and institutional investors by clarifying the process to be followed by developers regarding defaulting purchasers, as well as the rights of developers to retain purchaser monies upon cancellation. "The Dubai Government also issued a decree in early March 2010 regulating ownership of industrial and commercial plots granted to UAE nationals," says Ms Mathieu. "As per the decree, the United Arab Emirates nationals will be able to freely own these properties and act on them legally. These lands were previously constrained to some extent as per government regulations. The decree will help boost confidence among investors, as it opens up industrial and commercial plots for investment." The Land department is also considering introducing a real estate investor protection law to outline grounds upon which a property investor may demand cancellation of a purchase, refund or replacement issue.

Furthermore, the Dubai courts have played a substantial role in stabilising the property market by using clear and efficient guidelines when assessing the nature of defaults and remedies available to those concerned. Also, about a year ago, Dubai started to reduce public debt and limit state-owned companies' exposure to the debt market by implementing the Public Debt Law, which regulates government entities' borrowing requirements. Other recent legal and regulatory developments include the creation of the Dubai Financial Support Fund (DFSF) and Dubai's Supreme Fiscal Committee (SFC). "The constitution of these new institutions clearly demonstrates the government's commitment to provide financial support and liquidity to government-related entities," explains - Sunil Thacker, a senior lawyer "The DFSF had made clear its intentions of paying off the Nakheel bonds – sukuks – long before the bonds were actually paid off. The DFSF had also clarified the stand on Nakheel's unsecured Ijara Club facility by stating that the holders will receive 100 percent of principal and accrued interest or profits through a new debt facility with any existing third-party credit support remaining in place."

In addition, the Dubai government has taken steps to directly tackle issues surrounding struggling conglomerate Dubai World. It announced that one of Dubai World's flagship companies, Nakheel Properties, would be recapitalised in an attempt to take it off the hands of the conglomerate and place it with the government. Furthermore, the emirate injected about $9.5bn into Dubai World to help it restructure its operations, as the group struggles with heavy debts. Last year, it announced it would delay repaying $26bn in liabilities linked mainly to property units Nakheel and Limitless World, a move which dramatically resonated through markets worldwide. But the conglomerate's total debt is estimated at about $60bn. A few months ago, Dubai World presented a plan to restructure $23.5bn of debt to its creditors, including converting $8.9bn of debt into equity. According to experts, these various measures have been essential to prevent Dubai World from collapsing. However, some issues still need to be addressed, such as the legal rights of investors in the Emirate. As a result, more regulations can be expected going forward. This is particularly important as more opportunities are currently emerging for bullish investors targeting capital-growth investments.

A slow recovery

Short and long term investment hotspots are on the rise. According to experts, local businesses are still being established, while some multinationals are relocating their operations to the UAE, creating a high demand for commercial space. Meanwhile, the Business Bay and the Dubai International Financial Centre (DIFC) bring increased supply to Dubai's commercial property sector. While the economic downturn persists, lowering valuations, investors have a chance to take advantage. "It goes without saying that the future wealthy investors will make their decision to buy properties during the recession," points out Mr Thacker. "Therefore, investors desirous of investing must exercise a reasonable degree of care and caution before making any decision. It is important that they seek proper legal and financial advice, ensure that the title deeds are registered in their name, investigate seller's position before the Land department and have their contracts reviewed." Valuations are generally stable and fairly reasonable, and performance prospects for the commercial property market seem promising. Nonetheless, modern valuations can be complex, and Mr Thacker believes the Dubai government should take steps to regulate property valuations using appropriate models and the expertise of qualified professionals.

Another area that requires caution is liquidity. The global recession, valuation concerns and sustainability are all impacting liquidity conditions. "The supply/demand imbalance may be one of the main issues to increase liquidity, taking into consideration the massive volume of new supply either completed or expected, combined with minimal levels of demand," says Ms Mathieu. "Therefore, there is an increased need for transparency on the part of all persons involved in the real estate market – developers, brokers and investors; the market has been speculative and shall become real and fair. The support of the government and related initiatives from financial institutions remain a prevailing force within the local real estate market." Government intervention, along with the Central Bank and courts, can play a significant role in improving liquidity. Similarly, experts recommend that banking regulations applicable to the security and funds industry, investment trusts and REITs should be introduced as early as possible to contribute positively to liquidity conditions.

More measures may be needed so the Emirate can emerge from the financial crisis and repair damaged investor confidence. "These are challenging times, but there may be a silver lining," notes Mr Thacker. "Recovery will be gradual until market sentiments are completely restored, valuations are fair, and further regulations are issued in a timely manner. The government of Dubai must continue to take decisive action to address challenges arising from the global recession and build a foundation for strong and balanced future development. The effectiveness and timing of decisions of the newly constituted tribunal remain to be seen." Generally speaking, optimism now prevails, whereas just a few months ago, most were expecting the Emirate to collapse financially, as Argentina did about 10 years ago. Hopefully, only projects based on solid demand credentials will be launched from now on. Commercial properties should be sold to buyers who can actually maintain these assets. Such changes should contribute to making Dubai a stronger market. In the meantime, experts say that improvement in mortgage facilities by banks, combined with the offset of over-commitments by the major mortgage houses Tamweel and Amlak, should also help improve liquidity in the Dubai commercial property market going forward. ■

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