THE GCC REAL ESTATE MARKETS: AN INITIAL INVESTIGATION INTO THEIR ATTRACTIVENESS TO GLOBAL REAL ESTATE INVESTORS

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As globalisation of investments increases, global real estate investors might have to consider other emerging markets apart from those of East Asia, Latin America and Eastern Europe. There is, therefore, the need to start developing a better understanding of other markets like those of the Gulf Cooperation Council (GCC) in the Middle Eastern region. And as a first step, this paper aims to explore the key cross-border barriers and the attractiveness of such real estate markets to global real estate investors. The paper is part of an ongoing research project investigating investment decision-making and strategies adopted by global real estate investors when venturing into emerging markets, particularly, the GCC region. Primary data collected through interviews with practitioners in the real estate industry in Europe, specifically the UK and Luxemburg, as part of a pilot study and secondary data are presented and discussed. The analysis shows that global real estate investors are determined to invest in different attractive parts of the region particularly, Saudi Arabia. However, the decision to invest in the region is affected by various factors like lack of transparency, difficulties associated with finding appropriate local partners and lack of knowledge about the local GCC property markets.

Keywords: global real estate investors, GCC real estate markets.

INTRODUCTION

In recent years, national economies in all parts of the world have become more closely linked by way of a growing volume of cross-border transactions, not only in terms of goods and services but even more so with respect to investments of all kinds (Bartram and Dufey, 2001). Reduced regulatory barriers between countries, lower cost of communication as well as travel and transportation have resulted in a higher degree of market integration (Bartram and Dufey, 2001). As globalisation of investments increases, global real estate investors might have to consider other emerging markets other than East Asian, Latin American and Eastern European markets. In particular, they may have to start developing a better understanding of markets such as those in the Gulf Cooperation Council (GCC) (that is, Kuwait, UAE, Saudi Arabia, Qatar, Oman and Bahrain).

The economies of the member states of GCC have attracted increasing attention over recent years (Sturm *et al.*, 2008). They have become important as global investors and trade partners through their Sovereign Wealth Funds (SWF's), and play a crucial role

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in global energy markets (Sturm *et al.*, 2008). With a nominal GDP of 1.5% of the world total, comparable to South East Asia countries (DB, 2008b), and from a global perspective, the GCC is considered as a small but a key player.

Whilst most of the region's financial markets have significantly declined as a result of the current 2008/2009 global financial crisis, so far the impact on the real economy has been relatively limited (ILO, 2009). This is due to the following reasons: (i) the GCC region benefited over the past few years from windfall incomes derived from high commodity prices; (ii) GCC countries managed their financial assets prudently; and (iii) beyond exporting commodities, GCC economies are rather weakly integrated into the global economy (ILO, 2009).

GCC countries depend on oil as a major source of its economic development, financing the various economic activities in the industrial, commercial and real estate sectors. However, special attention is paid to the real estate sector due to its close link to growth and economic development as well as population growth (JLL, 2009). GCC markets demonstrate a tripling and quadrupling in investment volume (JLL, 2008c) and their real estate markets are estimated to be the fastest growing in the world (McKinsey, 2008).

Despite the fact that the growth of GCC real estate markets appears to be strong and that global real estate investors have been exploring investment opportunities in emerging markets like Asia (Newell and Kamineni, 2007), latest data from Property Funds Research (PFR) (as of April, 2009), show only 21 real estate funds are established in the whole Middle Eastern region including the GCC, with an estimated Gross Asset Value (GAV) of no more than US$ 3.2 bn. compared to 256 funds with GAV of US$ 135 bn. in Asia and 65 funds with GAV of US$ 15 bn. in Latin America. Furthermore, latest data from Jones Lang LaSalle, providing 'inter-regional' investments worldwide reveal only US$ 0.8 bn. have been invested in direct commercial properties for the whole Middle Eastern real estate markets including Turkey in H1 2008 (JLL, 2008d).

In addition, a recent study conducted by Baum (2008) (Table 1) shows that the biggest market in the region is lacking real estate investments; using population and GDP per capita as the main drivers for investments; outliers have been identified for those countries which viewed investment that did not fit with predicted investment.

Table 1: Countries with fewer funds targeting than predicted

Country	Funds	Predicted	Error
Taiwan	9	43	-34
Saudi Arabia	3	34	-31
Venezuela	0	20	-20
South Korea	44	55	-11
Iran	0	10	-10
Indonesia	4	13	-9
Argentina	7	13	-6
Algeria	0	6	-6

Source: Baum, 2008

The result shows that Saudi Arabia, the biggest real estate market in the GCC, has an error of 31 funds. This means that there is lack of investments in the region, which therefore needs to be further investigated. This paper therefore aims to explore the attractiveness of the GCC real estate markets to global real estate investors and the key cross-border barriers that influence the decisions of those investors to invest in the GCC region. It is, therefore, important to first examine the flow of monies into the GCC real estate markets and the extent to which global investors are involved in real estate investment in the GCC markets. To do this, secondary data was collected from the relevant reports of Jones Lang LaSalle Global Real Estate Capital (JLL), the leading international real estate advisors, and the current database of Property Funds Research (PFR), providing details about real estate funds established in the Middle Eastern region including the GCC region.

Furthermore, primary data was collected through a pilot survey. This was conducted using interviews and the respondents were practitioners in the real estate investment industry in Europe. These practitioners are high level global portfolio/fund managers in large real estate investment management firms who are currently managing portfolios/ funds in emerging markets with similar attributes to the GCC real estate markets. Semi-structured questionnaire was designed and four practitioners were in-depth interviewed. The questionnaire bordered on the key constraints global investors face in the GCC region or regions with similar attributes to the GCC markets as well as the opportunities and potential of GCC real estate markets.

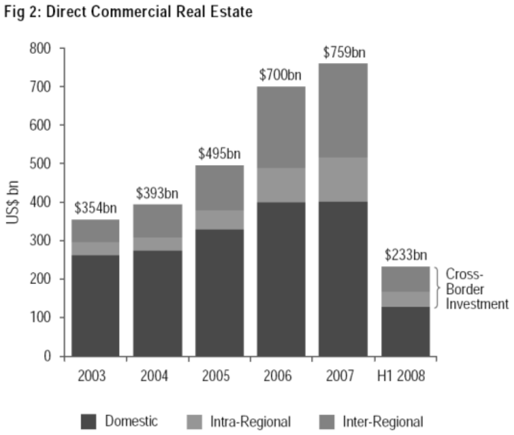
The rest of the paper is organised as follows: The next section presents and discusses the available secondary data on real estate investments in the GCC real estate markets. Section 3 presents the analyses of interviews discussing international property investment in emerging markets as well as the GCC region. The last section deals with conclusion and suggests future direction of this research.

PRESENTATION AND DISCUSSION OF SECONDARY DATA

Jones Lang LaSalle Global Real Estate Capital reports classify cross-border investment as 'intra-regional' and ‘inter-regional’ investment. The former refers to a situation where both purchaser and vendor originate from the region where the asset is located and the latter is the situation where the purchaser, vendor or both originate from outside the region where the asset is located (JLL, 2008d). Figure 4 shows the history of direct real estate investments around the globe. In 2005, it has been estimated that the Middle Eastern region had cross border investments of around US$ 4.7 bn. (JLL, 2006). In 2006, this amount increased to US$ 6.9 bn., while the whole inter-regional capital flows were US$ 201 bn. (JLL, 2007a). In 2007, the Middle Eastern region received a US$ 9 bn. This year-over-year increase could be explained by the shift of regulations towards liberalisation in the whole Middle Eastern region including Turkey (See Figure 5).

However, most recently, and due to the financial crisis, inter-regional investments around the globe have dropped significantly to US$ 65 bn. for H1 2008 (JLL, 2008d), compared to US$ 115 bn. in H1 of 2007 (JLL, 2007b). This also has resulted in a considerable decrease of inter-regional investments into the Middle Eastern region which had cross border investments of US$ 0.8 bn. (Figure 5) from both the Americas and Europe (approximately 1% of total inter-regional investments) (JLL, 2008d).

Figure 4: Direct Commercial Real Estate



Source: JLL (2008d)

In addition, latest data extracted from Property Funds Research database shows that as of April, 2009, 21 real estate funds (see Table 7), with no more than 0.2% of total global Gross Asset Value are being allocated to the Middle Eastern region, compared to 256 funds with estimated GAV of US$ 135 bn. in Asia and 65 funds with estimated GAV of US$ 15 bn. in Latin America. These funds are mostly investing in the GCC region (see Table 8); a sample of the level of global investments into the GCC through real estate funds is depicted in Table 8. It shows that some of these funds (for example, fund # 3) partially targets UK and European investors. Other funds, however, did not specify the target investors.

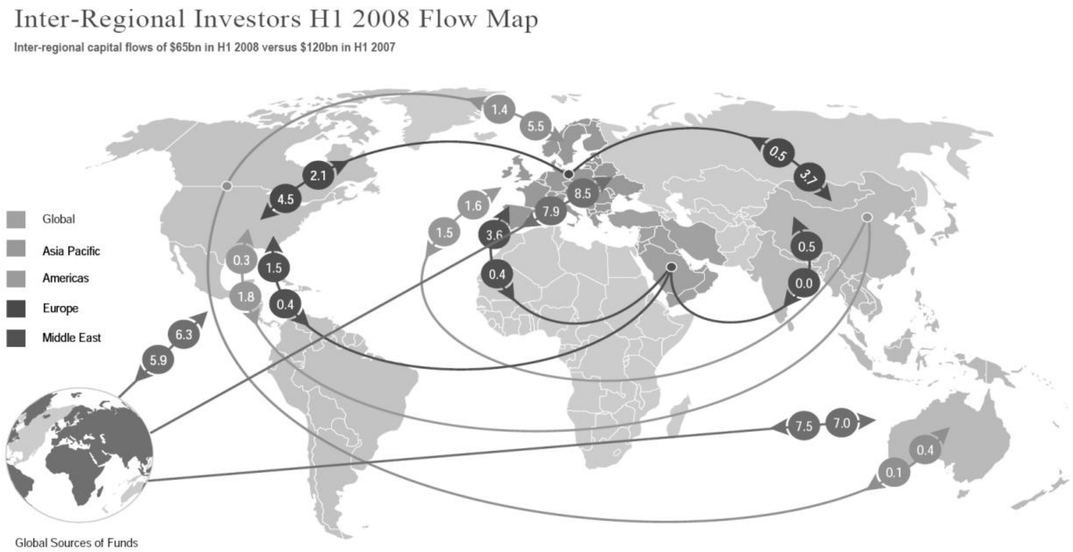


Figure 5: Inter-regional investors H1 2008 Flow Map

Source: JLL (2008d)

Table 7: Property Funds Research current vehicle universe

Source: Property Funds Research database April, 2009

Regional focus	Estimated GAV (US$m)	Number
Europe (ex- UK)	527022.99	835
Global (pan region)	445592.91	276
North America	308818.87	358
UK	164085.53	353
Asia	135281.58	256
Australasia	43839.04	87
Latin America	14956.61	65
Africa	5301.86	19
MENA (including GCC)	3282.99	21
Total	1,648,182.38	2270

Table 5: Sample GCC funds basic information

Source: PFR funds database April, 2009

Fund #	Location focus	Estimated GAV (US$m)	Domestic currency	Domicile	Target investors
1	GCC	699.88	US Dollar	Cayman Islands	Institutional investors
2	GCC	500	US Dollar	Cayman Islands	Institutional and wealthy investors
3	GCC	50	US Dollar	Cayman Islands	UK and European Tax-Exempt investors and HNWI's primarily in the UK, UAE and wider Gulf region

The above data shows that GCC real estate markets cannot be considered as a favourite destination of global source of funds. It is, therefore, necessary to comprehend the reasons for this phenomenon. The interviews conducted with real estate fund managers centred on this. The ensuing sections, thus, present and discuss the data from the interviews.

ANALYSIS OF PRIMARY DATA

Cross-border barriers to GCC real estate markets

In response to a question that bordered on key cross-border barriers in most emerging markets including the GCC real estate markets, all the respondents identified transparency to be one of the most important factors that affect their decisions to invest in emerging real estate markets. One respondent had this to say:

“The keyword here is market transparency.....Transparency could be legal issues” he continues “things like, stability, transparency, corruption also legal security, ...market data accessibility, and any historical data”.

Another respondent observed:

“I think the Jones Lang survey is a good model for transparency, you simply look at the JL transparency data”.

Table 9 confirms the views of the respondents as it shows the transparency position of GCC real estate markets compared to other peer markets based on the latest Jones Lang LaSalle real estate transparency index. Noticeably, there is no any GCC market that is ranked highly transparent (tier 1) or even transparent (tier 2). However, some of GCC markets are now more transparent than those of China tiers 1 and 2 as well as India tiers 1, 2 and 3, which are recently considered as favourite destination of global funds.

Table 9: Transparency of GCC markets

2008 Composite Rank	Market	2008 Composite Score[1]	2008 Composite Tier
32	Dubai	2.78	3
33	Greece	2.79	3
34	Russia Tier 2 Cities	2.83	3
47	Bahrain	3.23	3
47	Philippines	3.23	3
49	China Tier 1 Cities	3.33	3
50	Argentina	3.34	3
50	India Tier 1 Cities	3.34	3
52	India Tier 2 Cities	3.38	3
53	Croatia	3.42	3
54	Abu Dhabi	3.46	3
55	Indonesia	3.51	4
56	Saudi Arabia	3.53	4
57	Macau	3.54	4
60	Oman	3.59	4
61	Qatar	3.64	4
62	Costa Rica	3.65	4
62	India Tier 3 Cities	3.65	4
62	Panama	3.65	4
65	China Tier 2 Cities	3.68	4
66	Kuwait	3.71	4

Source: JLL, 2008c

According to JLL (2008c), the limited availability of reliable property market indices is also a major constraint on the transparency of the GCC real estate markets and remains a threat to global investors. And therefore, disappointingly, it is not possible to assess the performance of these markets or even compare them to other developed or developing markets due to the lack of time series property data. This is an area in which significant improvement is likely to be seen over the next coming years (JLL, 2008c). And as a first step, Mazaya Real Estate (a Kuwaiti listed company) has introduced in early 2007 the Mazaya Real Estate Index - the first of its kind in the Middle East. The index measures the prices of properties across the GCC, as opposed to other indexes which only measure the share prices of property firms listed on the regions' stock exchanges (JLL, 2008c).

In addition, RERA (the Dubai government's real estate regulatory authority) published a new commercial and residential property index in Dubai (JLL, 2008c). These are significant moves in the region's move towards greater transparency

Furthermore, tremendous efforts by international real estate advisors researching into the GCC markets, for example, Jones Lang LaSalle, Colliers International and DTZ, provide details of GCC property markets as well as average yields in some sub sectors. For instance, the most recent study by Colliers International reveals the average yields for the certain markets of the GCC which were between seven and 15% (Colliers, 2009).

Here, respondents were discussing how they deal with this lack of market indices. One respondent state:

"obviously you would like to see what this market al.ready does, ... you would love to see data on the historical markets which we do not get, ...hence derive real estate data out of these data, and that's obviously has an error. I don't know plus or minus 20% or so, huge error margin".

In addition, respondents were discussing other key investment cross border barriers to the GCC region, one respondent stated:

"also a key issue is introducing European banks to Sharia structuring for the financing, a lot of them aren't used to them, a lot of the law firms that we're using in Turkey haven't been really involved in that, so there were quite a big education process for everybody, every European bank we got have to have a lesson in Sharia structuring".

Another respondent observed:

"a big issue we're facing in emerging markets is essentially the lack of sophistication, when you talk about gross yield, let yield, cap rate, they simply don't know what it is, and they simply say the property how much it pay, we saw it even in Dubai, that is supposed to be at the frontline of the Middle East, we've been trying to do institutional lease contract, people didn't understand, they say why do you need a 20 page lease contract, here is the space, here is the rent, period. And that's obviously something that threatening institutional investors"

One respondent added:

"Also when you look at these markets, you need to consider the market size, that's perhaps for very small countries is difficult, because each and every country has different local legislation issues, and it's hard for big companies to drive their forces and say, now we need to understand all issues in so small countries of whatever one, two or four million population, and they speak two or three different languages, I would say forget about it we never go there".

Table 11: Key findings on emerging and GCC markets investment barriers

Specific barriers to the GCC region	**Barriers to other emerging markets**
Lack of transparency (i.e. legal issues, corruption, legal security, political stability and finding qualified local partners)	Lack of historical market performance data
Lack of sophistication	Taxation structure
Introducing European banks to Sharia structuring	Currency fluctuations
Lack of research/ knowledge of GCC markets.	Lack of standing investments
Language and cultural issues	
Market size (i.e. Small countries are not attractive to large institutional investors)	

He continues:

"Further into Egypt for example, it's potentially great country, great story, I think population growth is quite high, so there is lot of potential there but in the transparent like anything so would not like to go simply because we couldn't survive, then if you would work there with local partner you would need to trust the local partner to 100%, and what will be missing is to control the local partner by understanding something, but then you suddenly see that the

letters there are in language is different, for example in Turkey, we can understand the letter but in Arabic, there is simply no way, then we need to hire somebody who speaks Arabic but we can't find it so often".

Table 11 summarises the key findings on emerging and GCC investment barriers as experienced by interviewees. The findings confirm what have been covered earlier in terms of cross-border barriers to investment in emerging markets.

Potential of GCC real estate markets

Generally, respondents were positive about the potential benefits of investing in region and especially in the Saudi Arabian market. One of the respondents states

"In Saudi Arabia I think 50% of the population are below 25, and 5 children per capita, there is big big need. Here comes the need for real estate.....the tenancy here is clear".

In addition one respondent observed:

"...And what I am expecting excellent demographic, good GDP growth, high quality of construction" He continues "I'm very interested in Saudi Arabia"

Another interviewee added

"Saudi Arabia would be my favourite, it is a big market, market with a lot of potential, it will be a market where all institutional investors sooner or later will look at"

This also confirms the views of leading real estate companies such as Jones Lang LaSalle and Colliers International and the Saudi based bank NCBC. According to NCBC (2008), JLL (2009) and Colliers (2009) the current market conditions in the GCC region create significant opportunities for equity investors and those who still have access to debt finance.

CONCLUSION

Respondents point out that the region has excellent demographics (particularly in Saudi Arabia), high population growth, good GDP growth and huge need for residential, retail and office real estate, which are good reasons for institutional investors to invest and diversify their portfolios into the region. However, they believe that lack of transparency, introducing banks to Sharia structuring and finding appropriate local partners are the most ineffectual hurdles to further attract global funds into the region, and suggest that further research may assist to develop a better understanding of the GCC local property markets.

Both secondary and primary data confirms that GCC real estate markets are still immature to global real estate investors, as key cross-border barriers prevent global investors venturing into the region. With lack of research, there is limited scope to challenge these perceptions in an effective manner. As a result, it is suggested that there is a need to further investigate the GCC real estate markets as well as address and examine the key hurdles that are of major concern to global real estate investors and ways of mitigating them. In addition, an investigation into the GCC Real Estate Funds industry in terms of fund origination, fund structures, access to local real estate players, etc, is important with a key aim of developing a foreign market entry strategy to the GCC real estate markets on the Fund level.

One way of achieving this is by developing a real estate fund model for potential global investors in the GCC real estate markets. The model should aim provide a better understanding of the GCC real estate industry regarding, for example:

- Rules and regulations in terms of establishing a Foreign Real Estate fund (i.e. The Market Entry Strategy).
- Access to local banks, developers, agents, and all other involved at the fund transactions level.
- Preferred fund structure, ass*et al.*location, compliance, domicile, etc.

Data will be collected from different GCC governmental bodies and key organisations from the GCC real estate funds industry (e.g. Investors, banks, fund managers, real estate developers, legal and financial advisors).

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