MENA Real Estate: Demand builds up

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- **Despite earlier fluctuations and the effects of the pandemic, Egyptian real estate is expected to make a comeback by the end of the year.**
- **The real estate market in the UAE, which was fighting sluggish conditions even before COVID, is set for a long climb back. We expect, however, that the mismatch in supply and demand will be narrowed, mainly via the housing market.**
- **The UAE's recent loosening of foreign ownership restrictions could help create momentum across the sector.**

Egypt: Recovery on the horizon

Despite unfavourable market condition and relatively slower demand in the economy on the back of the pandemic shock, Egypt's real estate sector is picking up. It is mainly being driven by strong market fundamentals and actions by the Central Bank of Egypt (CBE). We expect continued gains this year, particularly in the housing market, as consumer demand continues to grow.

- Undoubtedly, COVID-19 presented new challenges to the real estate sector. The shutdown and lockdown measures resulted in a working-from-home economy which disrupted the flow of business and drastically decreased consumer demand and investment spending.
  - The postponement of Cityscape Egypt, an annual marketing exhibition held in March, in which real estate developers and property professionals showcase their projects, was a setback to the sector's 2020 deals.
- But while sector sales in Q1 fell by nearly 30% YoY, they have since been recovering. In August, the Aqarmap Egypt Index showed sales growing by 12% MoM [3].
  - The index in Q1 fell by 29.5%, reaching 1,936 points, the lowest value recorded in the last 5 years.
  - Demand growth appears to have returned, but we note that the 2,671 point rise in August still leaves the index 19% below the same period in 2019.
- The residential market has performed comparatively well on an annual basis. Q2 saw the completion of one residential project, bringing the total stock to 159,000 units with around 35,000 additional units expected to be completed by the end of the year. We expect some residential unit completions to be pushed out to 2021/2022.
  - To curb future excess supply, the government suspended the issuance of construction licences for new projects for the next six months. We do not see this boosting residential prices drastically, however, given the downward pressure earlier in the year.
  - In Cairo, residential house prices fell sharply in Q1 (by nearly 30% QoQ) as consumers became cautious about conducting major transactions under the pandemic threat.
  - The rental market maintained its strength with the market favourable to landlords. In New Cairo, one of Cairo's new cities, there was a 23% YoY increase in rental rates in Q2.

Figure 1 – Egypt's GDP Composition, by sectors[1]

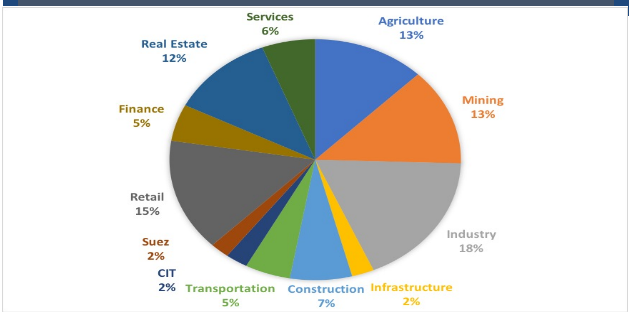
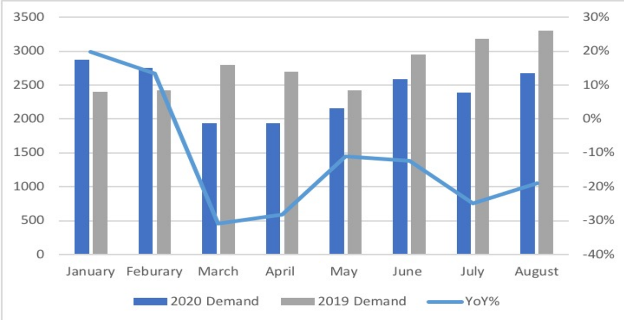


Figure 2 – Egypt's Real Estate Demand Index[2]



- There is high demand for office space, but this market is two-tiered, and likely to remain that way until at least early 2021.
  - Demand for smaller, fitted primary office spaces is outpacing that for secondary office spaces[4], which suffer more from online retail competition. In Q2, primary office rents across Cairo grew by 7% YoY.
- Despite the easing of pandemic measures and a gradual return to working in offices, we expect that market uncertainty will still subdue demand for office space and that sales will remain relatively flat until mid-2021.
  - This is primarily the result of weakened demand from SMEs and start-ups, where the working-from-home trend is continuing.
- The sector is crucial to Egypt's economy: real estate and construction account for more than 12% of GDP, with an average annual growth of 4.2%. The sector employs more than 8% of the total labour market.
  - Egypt is forecast to see GDP rise by 2% this year, far lower than the 5.6% expansion seen in 2019, but still rare growth in the pandemic year.
  - The outlook is also positive: growth is expected to recover in FY 2021/2022 to 6.5% as Egypt benefits from newly implemented reforms and IMF aid.
    - The IMF is providing a newly approved 12-month stand-by arrangement worth USD 5.2B on top of a USD 2.8B emergency loan to support Egypt's balance of payments.
    - The CBE in March reduced interest rates by 300 basis points -- its largest rate cut on record -- setting the lending rate at 10.25%, and the deposit rate at 9.25%, both of which are the lowest since early 2016.
    - The latter, together with the CBE's decision to keep the rates unchanged, has safeguarded the real estate sector from the ripple effects of the downturn. It has also encouraged

[1] Arabia Monitor; General Authority for Investment.
[2] Arabia Monitor; Aqarmap Index.
[3] An index which monitors Egypt's property market since 2013. The calculation is based on the company's search engine, which contains more than 100,000 real estate units and accounts for over 1 million site visits that occur each month.

[4] Primary spaces are properties located in major commercial centres with public transport accessibility, energy efficient, and have financially strong tenants. Absent any of these criteria, property will be ranked as a secondary space.

  - mortgage financing and allowed developers to obtain loans.
- Notwithstanding the unavoidable contraction in sales across the sector in H1, we expect strong recovery by the end of the year. Egypt has a growing population of over 100 million and a general appetite for investing in real estate as a relatively safe and reliable asset.

UAE: New drivers for residential demand

With structural shifts boosting demand, we expect the existing supply-demand imbalance in the UAE's real estate sector to narrow. This longer-term outlook will be boosted by the residential housing market, given it is expected to regain competitiveness by early 2021 as government initiatives begin taking effect.

- The combined shock of low oil prices and the coronavirus pandemic has prompted the IMF to forecast a 3.5% contraction in the UAE this year, following on from lacklustre growth that averaged 2.3% over the previous five years. While the non-oil private sector is showing signs of recovery, growth will be slow and anaemic. This is expected to ripple across the emirates' key sectors and make for a tough recovery in the overall real estate sector this year.
- This will have an economic impact: real estate is a key contributor, accounting for around 14% of GDP in 2018 -- a 50% increase from 2017.
  - In Dubai, the real estate sector contributes over 7% of GDP, registering an annual average growth of nearly 2% over the last three years.
- With sale prices declining on average, however, we do see the residential market regaining some demand by the end of the year. It may even present an unparalleled opportunity for investing.
  - Prior to the pandemic, transaction volumes for residential properties were posting significant growth rates, with strong momentum continuing into the start of 2020. In February, transaction volumes had the strongest start to a year since 2017, recording an increase of 24% across the UAE.
  - Though transaction activity has certainly slowed, the depth of the contraction in the residential market has been relatively limited considering the severity of lockdown measures. In H1 of 2020, transaction volumes in Dubai decreased by 14.4% YoY.
  - In value, Q2 brought in slightly less than USD 2.7B, reflecting a 40% YoY contraction. The volume of transactions has improved since then, particularly during the summer period.
    - In August, nearly 2,500 properties, worth over USD 1.2B, were sold, marking a 2.2% increase from July and 11.3% YoY growth. Sale transactions for villas and townhouses alone reached over 490 -- the highest number for this segment in a single month.
  - The demand for mortgages in recent months has risen. According to Dubai Land Department, in July mortgage take-up grew three times more than in the previous month with over 1,150 transactions, reaching a value of USD 3B. This is also over three times higher than the same period in 2019.
  - All this reflects an improvement on the demand side. If the working-from-home economy continues, we expect to see a continued upward trend for larger properties.

Figure 3 - Dubai's Real Estate Transactions (units)[5]

- Residential prices across Dubai, which on average fell by 5.6% in H1 of the year, are likely to remain under considerable pressure this year, given the excess supply.
  - Prices in the Dubai and Abu Dhabi residential markets have declined by 23% and 18% respectively since 2018.
  - So far, in Dubai nearly 8,500 units have been completed in 2020 and over 43,000 residential units are scheduled for completion over the remainder of the year. We expect some will be pushed out into 2021.
    - Most of the supply will be apartments and villa properties.
    - For comparison, in 2019 there were around 23,000 new housing completions. Most of the new supply was in the form of standalone residential towers.
  - Meanwhile in Abu Dhabi, residential sales fell on average by 8% in Q2 this year. Over this period, average prices for apartments fell by 8.5% and rental prices to date declined by 4.7%, compared with an 8.8% decline in 2019.
- We expect rental rates across the UAE to soften further by the end of the year, but to rebound towards mid-2021 as employment contracts and market sentiment improve. (If the deployment of stimulus packages continues, the rent bounce back may come earlier.)
- More recently, the weakening of the US dollar over the past fourth months, is expected to encourage the sector even further, as investments become more attractive for overseas investors.
  - In 2018, of the USD 44B real estate deals, 18.5% came from overseas investors, with Indian (6.7%), and UK (2.7%) buyers taking the lead after Emiratis.
- With the UAE authorities enacting favourable legislation and providing more flexibility, the long-term fundamentals underpinning demand for residential property are expected to be strong.
  - As part of the Central Bank of the UAE's stimulus package, loan-to-value ratios have increased for first-time buyers by 5% for all property purchases. This, in addition to flexible payment terms and rent-free periods currently being offered by landlords, should lift demand.
  - Compared with 2016, where around 45% and 40% of the total payments were required on completion and during construction, respectively, have currently decreased to 35% and 28%.
  - Coupled with this, the introduction of the freehold law in Abu Dhabi that allows foreigners for the first time to own land within the emirate's investment areas on a freehold basis, is expected to further improve the balance between supply and demand in the residential market.
  - The introduction of the golden visa residency scheme in 2019 will also help increase foreign interest.

[5]Arabia Monitor; Dubai Statistics Center.

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