Gulf property market: a never ending boom?

Dr Mohamed A. Ramady

Al Raha, UAE - August 04, 2008 - A worker at dusk in Al Raha. Construction of new villas is attracting more families to relocate to the Al Raha Beach area. Nicole Hill / The National

The sub-prime mortgage market crash was the first salvo in a global jitter concerning the health of the property market. Economies that had registered record property price rises are now reporting successive monthly falls, adding to general unease and uncertainty.

In the UK, where more prudent mortgage lending practices were supposed to be in operation, the news on the property front is grim. Over the past six months, UK house prices have dropped at an annual rate of 11.4 per cent, and over the past three months at an alarming 16.1 per cent. The spectre of the crash in the early 1990s looms and even Alistair Darling, the chancellor of the exchequer, has forecast a 30 per cent fall in house prices before things get better.

What has gone wrong? Are markets in different geographic locations and going through different economic cycles, immune from real estate price tremors in other parts of the world? The key is a perception on whether a particular real estate market has reached a critical asset price “bubble”. Bubbles burst at some stage, but it is the exact point of the impact that is uncertain, as well as the consequent speed of a fall in prices.

In the Gulf, there is no sign yet that real estate prices have fallen, but there are also signs that the massive infrastructure and housing construction boom is beginning to face supply bottlenecks. With steel and cement prices rocketing, some projects are being quietly delayed, while others in the drawing stage are being shelved. While each of the Gulf countries has its own real estate market cycle, a reversal in the fortune of one Gulf market might have a knock-on effect on others.

There is some merit for a pause in any upward march in real estate prices. In the western economies, a gentle collapse in the housing market bubble can be socially beneficial. When prices were rising sharply, it was the younger and generally poorer people in society who were left out of the property ownership ladder, while older and richer people, who already owned houses, became better off. In the Gulf, a similar phenomenon was beginning to emerge but, unlike the West, it was based on resource allocation to different real estate projects. Younger Gulf nationals wishing to buy their first homes were suddenly being outbid by rising prices, as construction resources were channelled to more lucrative penthouses, second homes or cost-plus government infrastructure projects.

In the West, the housing market began to feel some strain when the ratio of earnings to house prices deteriorated. In the final analysis, it is the share of a household's income that is taken up paying off the mortgages – even at low interest rates – and the ability of young first-time buyers to get such mortgages, that determines purchasing-power ability. When house prices are rising more than 30 per cent a year, this makes buying a home out of reach to many. What saves some markets is the infusion of liquidity from external sources. London property, for example, was boosted by different waves of buying from Americans, Arabs, Asians and east Europeans.

Similarly in the Gulf, one cannot talk about a homogeneous market. For whom are the different real estate projects being built? Construction in some Gulf states is trying to attract buyers from other Gulf states which have either more purchasing power or a shortage of supply. As such, if economic circumstances change in these countries, or their own construction sector starts to generate enough supply, then these states will be left with a massive over capacity and the beginning of a price-bubble burst.

Demographics is a key factor regarding which Gulf property market will flourish and which will ease off. For countries such as Saudi Arabia and Oman, with larger and a younger growing population, there is a genuine need for affordable first-time homes, rather than luxury second homes or penthouses. For such countries, natural demand exists and it is up to imaginative and cost-conscious construction companies to meet this viable long-term demand. Other Gulf countries with smaller population bases seem to construct real estate projects and then create demand after the fact through slick marketing and an appeal to different "lifestyles".

There is a limit to this type of demand creation, though. At some stage supply will outpace demand and prices will ease unless a new round of external investors and "new" demand is generated to take up the slack of "older" demand. Again, for some Gulf countries, the marketing of a lifestyle, with free sunshine all year round thrown in, has tapped non-Gulf expatriates, ranging from movie stars to football players, but the supply of these VIPs is limited, unlike the less glamorous but larger home-grown population demand of other Gulf countries. Should expatriates also begin to feel the chill of economic recession back home, and declining property values, then prospects of a second home in the Gulf becomes less attractive. Economic globalisation has a price.

The Gulf is helped by government-led infrastructure projects, with Saudi Arabia taking the lion's share in the form of various economic mega cities. Such initiatives will take up the slack from private sector projects, and reduce the effects of a slowdown. In the long run, even such mega projects are at the mercy of oil price fortunes and government budget surpluses. Should such factors coalesce – foreign purchases slowing, high commodity prices, high inflation and a higher cost of borrowing – then the Gulf property boom will start to ease back.

Dr. Mohamed Ramady is a former banker and Visiting Associate Professor, Finance and Economics Dept. at King Fahd University of Petroleum and Minerals, Saudi Arabia.