MITIGATING THE RISKS OF ANOTHER UAE REAL ESTATE ASSET BUBBLE[1]

THE CASE FOR AN ACTIVE APPROACH TO REAL ESTATE LENDING AND MANAGEMENT

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The UAE, with the Emirates of Dubai and Abu Dhabi in the forefront, are gearing up for a new real estate development boom. New, recently announced projects aim to capitalize on high oil revenues and an influx of people and capital attracted by the UAE's perceived status as a 'safe haven' amidst continuing regional turmoil resulting from the unrest in several Arab countries. That the UAE Central Bank is seeking to introduce new limits on mortgage borrowings suggests the perception of a new property bubble is a key concern for regulators. However, international and local banks remain wary about lending to real estate developments at a time when they have to make continuing provisions against assets that were funded during the last boom.

In a study released last month entitled "GCC Banking: Diamonds in the Rough," AlixPartners stated that a number of regional banks remain crippled by a real estate overhang, asset quality concerns and a post-bubble credit legacy.

However, despite its potential negatives and risks, we believe that a new wave of real estate development could be used to enhance and cement the extremely competitive positioning already reached by the UAE in global finance and international tourism and hospitality. However, in contrast to the boom-bust scenario over 2005-2009, banks should welcome and adopt a more proactive approach to real estate lending, driven by a continuous and relentless attention to value maximization of the assets being built – as derived from both its basic capital value and income generation characteristics.

An active approach to real estate credit management entails:

- The development of a real estate database, to include the main information related to the type, status, location, utilization, commercialization, etc. of the building financed, enabling a thorough and dynamic approach to its financial appraisal;

[1] Op ed in The National 14 January 2013 http://www.thenational.ae/thenationalconversation/industry-insights/property/proactive-approach-can-allay-fears-of-boom-and-bust#

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- The development of "industrial" Key Performance Indicators (effectively, "Early Warning Signals") that should allow the banks' credit managers to anticipate and forecast potential troubles ahead (business, then translating into financial ones);
- The development of a comprehensive monitoring dashboard that would help banks build a more diversified and well-balanced credit portfolio of real estate initiatives, and pricing them on the basis of a more robust, risk-based approach;
- The identification of a set of recurring and robust financial and industrial solutions that should help in addressing the issues arising, just in time before they develop into significant troubles.

Apart from the initiatives of "active (credit) real estate management" that could be undertaken by individual banks, we advocate the build-up of a banking system wide common real estate data set and industrial-driven risk management dashboard. This could be easily developed with the sponsorship and involvement of institutions including the UAE Central Bank (which is keen to monitor real estate exposures), RERA and the main UAE banks. This would act as a macro-prudential tool for real estate risk management, for the benefit of the banking system, the real estate sector and, ultimately, of the UAE economy. Our proposal would stabilize the sector and detect the formation of future asset bubbles, thus reducing the credit costs to the banks and the financing costs to the real estate developers. A system-wide real estate database and risk/ performance dashboard, would improve transparency and help attract back some of the international lending and equity capital that has proven to be elusive after the first real estate development boom and subsequent bust. This should be accompanied by providing the legal and regulatory framework of an active mortgage market.

The outlook for the UAE real estate sector remains challenging. However, the challenge could be turned into a structural advantage, given the vision of renewed strategic, long term development in the region. We need a more systemic, analytic and industrial-based proactive approach, by the banking sector and by regulators alike.