

THE FUTURE IS ALL REIT

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In this briefing, we take a look at the Real Estate Investment Trusts (“REITs”) landscape in the United Arab Emirates (“UAE”), Kingdom of Saudi Arabia (“KSA”) and the wider GCC and take some soundings on the future development of this emerging and undeveloped asset class from real estate industry players.

REITs have been a recurring theme in the Middle East since 2014 when the first one was launched on Nasdaq Dubai. They have recently gained traction with a number of new entrants into the market amidst challenging conditions in the real estate sector across the Middle East.

REITs are essentially corporate vehicles that are typically deployed to invest in income producing real estate assets across a number of sectors. Strict regulations and criteria will commonly govern the way a REIT operates and the type of assets it can invest in. Effective asset management is a key feature of any REIT and through this it can enhance the capital value of a portfolio and optimise revenue.

Since 2014, Abu Dhabi, Saudi Arabia, Bahrain and Oman have all brought in regulatory frameworks to support REITs and there are now eighteen listed REITs across the GCC including:

- **Dubai** – Emirates REIT and ENBD REIT;
- **Saudi Arabia** – Riyadh REIT, AlJazira Mawten REIT and Jadwa REIT Alharamain Fund with an additional twelve REITS being listed on Tadawul in 2018 alone;
- **Bahrain** – Eskin Bank Realty Income Trust; and
- There are an additional three private REITs in **Abu Dhabi** – The Residential Reit, the Logistics Reit and Etihad

According to recent media reports, there are number of new REITs planned to launch including: Manrre REIT by Dubai based Palmon Group which is expected to be listed by 2020; a mixed-use REIT by Dubai Investments subsidiary Al Mal Capital which is set to launch on the Dubai Financial Market; and more imminently, the Shari’ah compliant GII Islamic REIT by Gulf Islamic Investments which is aiming to launch this year and plans to pay out monthly dividends to its investors, unlike the majority of other REITs which tend to pay out dividends quarterly or bi-annually.

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Regulations require REITs to pay out the majority of their annual income as dividends to investors: in the UAE the requirement is for 80% of annual income to be paid as dividends, while in Saudi Arabia and Bahrain that requirement is raised to 90% in line with the usual minimum requirement imposed on REITS in North America and Europe.

There are a number of benefits to REITs. Most notably, they:

- Provide an opportunity for investors to invest in diversified pools of income- producing real estate without exposure to the risks of owning property directly;
- Enable investors to gain exposure to real estate without large capital expenditure;
- Often provide higher yields compared to other equities and investments;
- Provide a steady stream of income and enable investors to spread risk across a number of sectors such as office, leisure and retail; Offer a higher degree of liquidity as they are traded on a stock exchange; and
- Are subject to stringent corporate governance and regulation – REITs are well established in other jurisdictions with a long track record of success.

REITS IN THE UAE

Looking at the UAE REITs regime, to date there has been very little legislation that specifically governs and recognises the concept of REITs onshore in the UAE and we would need to look to the Financial Freezones of Dubai International Financial Centre (“DIFC”) and the Abu Dhabi Global Market (“ADGM”) for REIT specific legislation.

However, it has been reported this week that the Dubai Financial Market (“DFM”) has published a set of rules for the listing and trading of REITs onshore, which are expected to be implemented in the next few months.

To be compliant, a DIFC REIT must:

- Be closed-ended;
- Invest no more than 30% of total assets in property under development;
- Not borrow in excess of 70% of the net asset value of the fund; and
- Be a public fund that is listed and traded on a recognised exchange.

In Abu Dhabi, an ADGM REIT must:

- Be closed-ended;
- Invest no more than 30% of total assets in property under development; and
- Not borrow in excess of 65% of the total gross asset value of the fund and its SPVs.
- There is no requirement for an ADGM REIT to be

MARKET OUTLOOK FOR REITS IN UAE & KSA

Where many REITs have diversified portfolios across multiple real estate asset classes we are starting to see further diversification with both ENBD REIT and Emirates REIT investing in educational facilities over recent years, predicated on the demand for schools in the region.

It is likely that as the market matures we will see further diversification of the asset

classes that the local REITs have traditionally invested in – for example, Dubai-based Five Holdings launched a Dh2.1bn hospitality-focussed REIT last year which is regulated by ADGM.

It is notable, that the Healthcare sector remains untapped by REITs. This is likely to be due to the high capital expenditure required to construct hospitals and procure medical equipment. However, with the healthcare market alone expected to grow by 60% by 2021, this may well be set to change.

With demand for property in the UAE stabilising in recent years, the real estate market is facing increasing concerns of oversupply. As more developers enter the market, supply has exceeded demand in the region, particularly in the Dubai residential sector. REITs could assist with this oversupply by providing a new category of institutional purchaser for assets that were traditionally acquired by individuals.

Joseph Morris, Partner of Global Capital Markets at Knight Frank Middle East welcomes the recent REITs activity and commented: *“The addition of transparent, listed real estate vehicles to the market has undoubtedly started to provide much needed further depth to the real estate sector and will assist in bringing a more institutional approach to investment across the region. As the local REIT markets continue to evolve, we envisage prospective managers will start to have a more considered approach to the process of listing, focussing on scale, quality of assets, sector and management track record. We have already started to see regulators take note of these factors, with the CMA in Saudi Arabia recently adapting the requirements for listing, ultimately to protect investors and ensure liquidity. As the markets continue to open up as a result of increased transaction volumes, over time we expect to see the emergence of more thematic REITs focussed on particular sectors, as well as those with differing investment theses and differing targeted risk and return profiles”.*

In both the UAE and KSA, it is fair to say that there is a current shortage of Grade A properties available for institutional investors. Furthermore, investors are being put off by the shorter leasing periods offered at prime commercial locations.

In a recent report on REITs, international property consultancy, Knight Frank note that: *“the quality of the REIT, both in terms of real estate and asset manager will become paramount which will provide more transparency to market participants and will enable investors to accurately deploy funds in line with a set strategy and risk profile”.*

An estimated 120,000 properties could be added to the Dubai market by 2021, with about 30-40% deemed affordable. REIT asset managers could play a key role in enhancing these assets and developing them into grade A investment assets.

Matthew Shaw of the newly formed Invest AD Brookfield Managers gave us his take on the future of REITs in the region: “REIT’s have an important role to play in this region’s real estate landscape by providing institutional and private investors with a diversified and liquid form of ownership in assets of scale which individually they may not otherwise have access to, within defined regulatory frameworks, focussed on income (i.e. low risk) and thus distinct from most other real estate equity options which predominantly have substantial development exposure. The REIT industry in the region is still at a nascent stage, but momentum is gathering. Regulatory challenges exist, but authorities are increasingly supportive to address them”.

FUTURE CHALLENGES FOR REITS

There are of course challenges facing REITs in the region moving forward which include:

- REITs do not avoid the foreign ownership restrictions in the UAE (this is widely viewed as a key reason for the lack of REITs in the UAE market);
- REITs do not currently benefit from any special exemptions on property taxes and registration fees, which is commonly a benefit of investing through REITs in other jurisdictions; and
- Listing on the DIFC exchange does not offer the same level of liquidity as listing on a major international stock exchange or on one of the onshore exchanges (DFM or Abu Dhabi Exchange) and there is no exchange yet in the ADGM.

Without doubt, the regulatory framework will remain a critical priority for investors in the REIT market. Strengthening and adapting regulations to reflect those which have proven favourable in mature jurisdictions will remain a driver for increasing investment through REITs.

Simon Townsend, Senior Director and Head of Strategic Advisory & Consulting at CBRE Middle East also supports the new wave of REITs and told us: “The emergence of REITs within the region have had a positive impact on the investment markets. The funds have added an additional layer of liquidity and increased the demand for quality institutional grade investment assets. The shortage of such assets has resulted in these funds having to evolve and adjust their business plans with this diversification by either sector or type. The ability for investors to access vehicles with the ability to acquire prominent and strong yielding assets has removed several of the barriers to entry into the large scale diversified real estate investment market”.

A key part of this will be to make REITs more cost effective. A potential move by the Land Departments in both Dubai and Abu Dhabi to offer special treatment and exemptions for REITs in the UAE may assist with this, for example, reducing or exempting fees for acquisitions and disposals of assets by REITs. Once a REIT is listed on a stock exchange, it becomes a publicly traded company with similar characteristics to a Public Joint Stock Company (“PJSC”). As it stands, DFM PJSCs are treated as 100% UAE national for the purposes of owning real estate assets onshore outside of the freehold areas in Dubai. It is not clear whether a DIFC or ADGM publicly listed REIT would be treated the same as they are technically offshore. Extending the same treatment to REITs would clarify this and allow foreign national investors to enjoy the economic benefits of an asset that they would not ordinarily be able to own directly and will assist the overall real estate market by enlarging the liquidity pool.

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We see REITs potentially playing an important role in stimulating the real estate market and providing institutional investors with an opportunity to participate in the market through a well-established internationally recognised investment vehicle.

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