

## Reviewing the Impact of Liquidity on Real Estate: An International Comparative Study

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**Hajer R. Al Ameri**

*British University of Dubai (BUID)*

*United Arab Emirates, Abu Dhabi*

[dr.Hajer.AIAmeri@Outlook.com](mailto:dr.Hajer.AIAmeri@Outlook.com)

### **Abstract**

After battling significant losses due to the global financial crisis of 2008 and the COVID-19 pandemic, the UAE real estate market has seen new highs in 2021 and 2022. The uptrend of this sector is likely to continue into the next few years, with the money of foreign investors pouring in and the persistent increase in oil prices. Innovative policies and initiatives have made the UAE a haven for investors while Europe and some other countries deal with a liquidity crunch. As per our observations, property purchase in the UAE seems to be a very sound long-term investment, which is probably one of the safest in the uncertain world we are living in today.

This paper aims to study how liquidity affects the performance of the real estate market in the UAE and other countries. The findings reveal that the UAE is an ideal real estate investment destination in times when many countries are facing tightening financial conditions, with some on the brink of deep economic crisis. UAE Government policies like the Golden Visa Scheme and zero property taxation welcome more expats to invest in UAE properties and settle in the country. Foreigners are attracted by the country's sound capital markets, excellent infrastructure, economic stability, and perceived absence of systemic corruption. The credit fundamentals of UAE banks are strong for the coming years, with high oil prices supporting liquidity. The findings also suggest that Dubai real estate will continue to thrive despite the fear of global recession. However, investors should be prepared for a possible increase in property prices and annual rents in the coming years as the UAE real estate market continues its upward trajectory in line with the rising oil prices and foreign direct investments.

**Keywords:** Real estate, liquidity, property market, real estate prices, oil prices

## **1. Introduction**

Liquidity is defined as the ease with which you can convert an asset into cash without compromising its monetary value or market price. It is a driving factor in most investment decisions and is founded on the rationale that liquid assets tend to deliver quick returns. With respect to the property market, assets such as real estate are widely regarded as relatively illiquid compared to equities.

When discussing liquidity, it is crucial to mention market liquidity. Market liquidity is measured as the extent to which you can buy or sell assets in a given market at a stable and transparent price. For instance, one of the most attractive characteristics of the stock market is that it tends to have high market liquidity. There are two variables that are considered here. The first is the bid price of the asset. This is the price that a buyer is offering to pay for the asset. The second is the ask price. As the term suggests, this is the price that a seller is willing to accept when selling the asset. If the bid price and the ask price are close in terms of their value, the market is considered liquid because sellers or investors can sell an asset without incurring potential losses due to low bid prices. When the bid-and-ask phenomenon is applied to the real estate market, it is seen that this market is less liquid than the securities market. This indicates a wide spread between the bid and ask prices, and investors may struggle to realize high capital gains on the sale of a real estate investment property.

With respect to the real estate market, this market also goes through hot and cold periods. (Krainer, 2001) Discusses these market trends and describes cold markets as those where real estate prices are falling and the liquidity of the market is low. Sellers are reluctant to drop their prices during this period to counter the declining price trends, and as a result, the volume of sales tends to decline. Marketing times also get extended. (Weintraub, 2021 )Further explains this concept, stating that serious sellers are often willing to negotiate in a cold real estate market and may even agree to pay some or all of the closing costs when they can't afford to leave their property on the market for months or years. As a result, buyers can get a home for less than the list price, enjoying an easier and more relaxed experience. When fewer buyers are in the market, the closing numbers go down and the market sees a decline in median sale prices.

In comparison, hot markets exhibit characteristics such as a rapid rise in real estate prices and quick sales with shorter marketing periods. They are also known as the seller's market because serious buyers are often willing to pay more than the list price. As a result, properties get sold quickly and for more profit. When more buyers are interested in purchasing homes, the closing sale numbers go up, and there is an overall increase in median sale prices. Accordingly, (Krainer, 2001) presents a theory on real estate liquidity where he suggests that the liquidity of the residential real estate market is dependent on the value of the housing service flow. This can ultimately serve as a reflection of the aggregate state of the economy. He has tested this theory by examining real estate trends in San Francisco, United States. As per his findings, fluctuations in the value of the housing service flow can result in a fluctuation of liquidity as well. High housing service flow results in higher liquidity and vice versa

(Wong, Yiu, & Chau, 2012) Also explain liquidity and information asymmetry in the second-hand real estate market. Information asymmetry is when one party has more or better information than the other in a transaction. Due to this imbalanced information, markets become inefficient and buyers and sellers face moral hazards and monopolies. As stated by (Hagerty, 2021), property owners have immense power in initial negotiations because they are the only ones who know the state of their assets and the market conditions. Buyers must tour the location and assess the property to collect information, but it takes time. When more details are revealed upon the hashing out of a deal, offers change accordingly. Development and leasing professionals keep new deals, prospective information,

and new tenants under wraps and obfuscate their actions until they are nearly complete. This makes information asymmetry a structural issue, which undermines the liquidity of the real estate market. For several years, properties and some industry players have benefited from the market being opaque, but big global investors with experience want transparency and liquidity in real estate markets. Information asymmetry was one of the primary factors that caused the housing market crash that triggered the 2008 financial crisis. It causes quality commodities to lose value and deals also take more time to close because of the need for additional vetting. This practice became even more common during the COVID-19 pandemic when building owners removed unrented spaces from the market to inflate occupancy artificially as rents decrease. Lucrative concessions like free rent and expansive tenant improvement allowances allowed them to lower effective rent while maintaining the publicly posted rates.

These findings suggest that liquidity is a primary driver of real estate activity in most property markets. Understanding the extent of its impact on UAE real estate in current times is particularly important as it allows us to account for a key variable that can influence returns on real estate investment amidst the fear of global recession. Accordingly, this paper explores the impact of liquidity on the real estate market in the UAE real estate and how it can create positive and negative outcomes for real estate investors, buyers, and sellers. It also sheds light on the performance of the real estate markets in other countries for a comparative analysis.

The remainder of this paper has been arranged to offer a theoretical background, the materials and methods used to investigate the issue, the results, the discussion, and the conclusion.

## **2. Theoretical Background**

Although the real estate market in the UAE is still on its road to recovery after suffering significant losses in the aftermath of the global financial crisis, where property values dropped by 20% to 50% as per (Al-Malkawi & Pillai, 2013) as well as the pandemic-driven slowdown, the performance of the real estate sector is a topic of great concern to the stakeholders because of the increasing indication of a global recession in 2023.

The UAE's real estate market outlook remained positive for the most part in 2021 and 2022. With the country's economy bouncing back in 2021 after the opening up of trade and travel sectors, the previously ailing property sector gained significant strength, as confirmed by (Markaz, 2021).

A large part of the credit goes to the surging liquidity in the UAE. The same phenomenon applies to global real estate markets. Evaluating how liquidity shapes the future of the UAE and the global real estate market is essential for investors, buyers, sellers, tenants, and landlords alike.

In response to the testing times during the COVID-19 pandemic, the Targeted Economic Support Scheme (TESS) was introduced in the UAE to help banks manage liquidity. According to (Markaz, 2021), 95% of banks had already surrendered from the scheme in 2021 since they did not need the support. This was because their provisions for bad loans were reversed in 2021 and the net profits increased. In March 2021, it was reported by Abdulhamid M. Saeed Alahmadi, the Governor of the Central Bank, that the liquidity in the banking system had returned to the pre-COVID levels (Scaria, 2021).

Liquidity was also supported by high oil prices flowing into the sector, weak credit demand, and strong business conditions. In light of the global supply issues, oil prices have increased significantly, which is a huge support for UAE banks' funding and liquidity. According to (Estate, 2022), the state of the banking sector is critical, as mortgage lending is one of the major drivers of real estate development. As expected, after the 60% annual increase at the end of 2021, the bank's profitability

in the UAE increased in 2022. One of the main reasons for this growth was the increase in lending interest rates associated with the lending interest rate growth in the US. This happened after the UAE Central Bank connected the interest rates movement to their change by the Federal Reserve System in the US. In 2022, the bank reserves of the financial institutions in the UAE also remained stable, as high oil prices promoted liquidity and offset the costs of financing the economy.

(Reuters, 2022) Mentioned that the UAE Central Bank sees GDP growth at 3.9% in 2023. Economic growth will attract more foreign investment and boost economic confidence, like in February 2022, when one of the world's largest alternative investment managers, Apollo Global Management, signed a commitment to invest \$1.4 billion to drive the growth of Aldar Properties.

As highlighted by (Darasha, 2022), Dubai's population growth year after year is also credit positive because it will contribute to balancing the supply and demand in the residential market. According to (Ratings, 2022), these factors, in combination with the rising interest rates and stable economic conditions, will support the credit fundamentals of the UAE bands in 2023, supporting the steady growth of the property sector.

The outcome of this impact on the real estate industry has already been evident. Property prices in the UAE demonstrated a strong recovery in 2021. In fact, the real estate market has been going through record-breaking momentums over the past year and a half. The 25,972 transactions in the first quarter of 2022 was the highest number reported for a single quarter since 2010, as highlighted by (Government., 2022), is proof of the market uptrend.

In contrast, the property sector in most countries witnessed a slowdown. Europe, in particular, saw a significant deterioration in returns in the third quarter of 2022, which signified the worst performance since the 2008 global financial crisis (MSCI, 2022). In light of the looming liquidity crunch, European industry leaders believe that liquidity will decrease further because of the real estate market's low investment volumes, rents, and occupancies (PWC, 2022). In the Emerging Trends in Real Estate®: Europe 2023 report, (PWC., 2022) emphasized that economic uncertainty and political unrest has become top concerns for real estate leaders after the pandemic. As rising energy costs drive inflation, interest rates are also seeing new highs, altering the real estate outlook in Europe for 2023. Although leasing activity held up reasonably well in 2022, experts suspect that the looming recession will result in significant declines of rents and occupancies in the real estate sector. In this light, overall property development and investment prospects for 30 major cities have deteriorated since last year's Emerging Trends in Real Estate® Europe report.

Per the housing market shock model analysis of (Seckute, 2022 ), sharp price corrections in the European real estate sector will deepen and lengthen the recessions. Declining house prices, along with lower liquidity and higher financial stress, will decrease investments. This shock will trigger a reduction in gross fixed capital formation by 2% in 2023 and 1.7% in 2024. His model simulations also predicted a decrease in Eurozone GDP by 0.7% in 2023 and 0.5% in 2024. The United Kingdom, Denmark, Finland, Estonia, Sweden, Germany, and Slovakia are expected to witness the largest GDP losses, explained by the negative cash flow or overvaluation of their real estate markets. In the worst-case scenario, these markets could face longer-lasting recessions amid decreasing investments linked with the financial sector's negative performance in line with the residential real estate markets.

Overall, global commercial real estate returns turned negative in the third quarter of 2022. This happened for the first time since the start of the COVID-19 pandemic (Green-Morgan, 2022 ). Saudi Arabia, however, managed to push its real estate market toward long-term growth despite its contrasting liquidity dynamics with the UAE. While UAE liquidity conditions were more supportive, the Saudi Central Bank stepped up efforts to ease the liquidity crunch and pump money into the

financial system, which, backed by the increase in oil prices, supported real estate market growth (Martin & Omar, 2022).

Currently, there is no other study that has attempted to study the impact of liquidity on the UAE and the global real estate market. This research is significant and can potentially prove helpful for real estate buyers, sellers, and property developers by helping them engage in lucrative transactions in the coming years.

### **3. Methodology**

We have relied on secondary research to review the impact of liquidity on the real estate market in the UAE and other countries. We have compiled existing data sourced from a variety of channels because it provides valuable insights into general industry trends, allowing us to generate new insights from the previous analysis.

All data and research have been sourced from research papers, newspaper articles, books, government websites, and other suitable literature discussing how the real estate market responds to liquidity changes. Reviewing the research that currently exists on the impact of liquidity on real estate markets, along with the latest market news, has enabled us to determine how it may potentially influence the UAE real estate market in the near future and how it compares to the situation in other countries.

### **4. Results**

As per our observations of the real estate market in the UAE, the UAE has taken commendable steps to position itself as a safe haven for investment and used various measures to build confidence among foreign investors. It is clear that due to the rapidly recovering economy and rising oil prices, the UAE banks have strong liquidity. According to (John, 2022), liquid assets have gone up 2 percent since December 2020, reaching 38 percent of total assets in December 2021.

To drive the growth of the UAE property sector, the Dubai Ruler, Sheikh Mohammed bin Rashid Al Maktoum issued a new law called Dubai Decree No. 22 of 2022 for setting up real estate investment funds. This fund is intended to increase and incentivize the money supply in the real estate sector while promoting transparency and regulation. Under this registration mechanism, registered UAE funds can buy and own real estate assets in Dubai areas previously limited to foreign ownership.

With a range of initiatives and policies being introduced by the government, the UAE is attracting a lot of foreign investors in the real estate sector. Below is an overview of these initiatives and policies and how they boost liquidity to strengthen the real estate sector and the overall economy:

#### *Rising Oil Prices*

According to (EIU, 2022), international oil prices will continue to stay high, averaging more than a hundred US dollars per barrel in 2023. Oil production and exports are also expected to increase sharply due to the lifting of the OPEC+ quota restrictions. The UAE will continue to invest heavily in increasing capacity. These developments will promote regional liquidity, which will help sustain business opportunities and investment in the real estate sector as well as leisure and retail industries.

#### *UAE Visa Reforms*

UAE Golden Visa reform has provided foreign individuals with an incentive to invest in the UAE for the long term, as discussed by (Rawuf, 2022). With more expats planning to live, work and build a future in the country, there has been an evolution in their investment habits. The opportunity to make the UAE their home influences the investment mindset, particularly regarding properties. Previously, people were more interested in investing in a residence in their home countries, but the prospect of building a future in the UAE, along with the current demand and supply equation, is encouraging long-term visa holders to explore the residential market on foreign land. As longer-term residency



options are introduced, more expats will move to the UAE, which will eventually result in a hike in rental prices.

### *Zero Tax Advantage*

Thanks to its oil and trade revenues, the UAE doesn't depend on direct taxation for income, meaning property owners do not need to pay annual property tax, income tax, or capital gains tax. As a 'no tax' country, it entices more international investors to take advantage of the many opportunities presented by its real estate sector. Per the comparison made by the (Finder, 2022) of property tax rates in some large cities, Dubai remains one of the cheapest cities for property investments. It offers an irresistible playground for investors, compared to other cities like Sao Paulo, where people pay as much as 30% taxes on the total property value, especially considering rental yields as high as 8% in Dubai.

### *Increasing Foreign Investments*

(Alshamlan, Fernandez, & Fernandez, 2021) believe that political stability, well-developed infrastructure, geocentric location, stable currency and financial system, crowd-pulling events like Expo 2020, and investor-friendly policies of the government make UAE a top leader in attracting foreign direct investments. The government has passed numerous initiatives, laws, and regulations to attract more foreign investors. As a result, people and entities in the Middle East, North Africa, Sub-Saharan Africa, South Asia, and Central Asia see the UAE as a major trade and investment hub.

In addition to improved regulatory policies, recent diplomatic measures taken by the UAE have welcomed foreign investments and given the real estate market a boost above the global average. In light of the global community's sanctions on Russia, Dubai, in particular, has become a hub for high-net-worth individuals in Russia and other countries. The money continues to flow into the UAE from these affluent people, along with some major institutions in Russia and its neighboring countries. As stated by (Essaid, 2022), the liquidity levels in the UAE reached new heights in the third quarter of 2022 due to the influx of foreign investments.

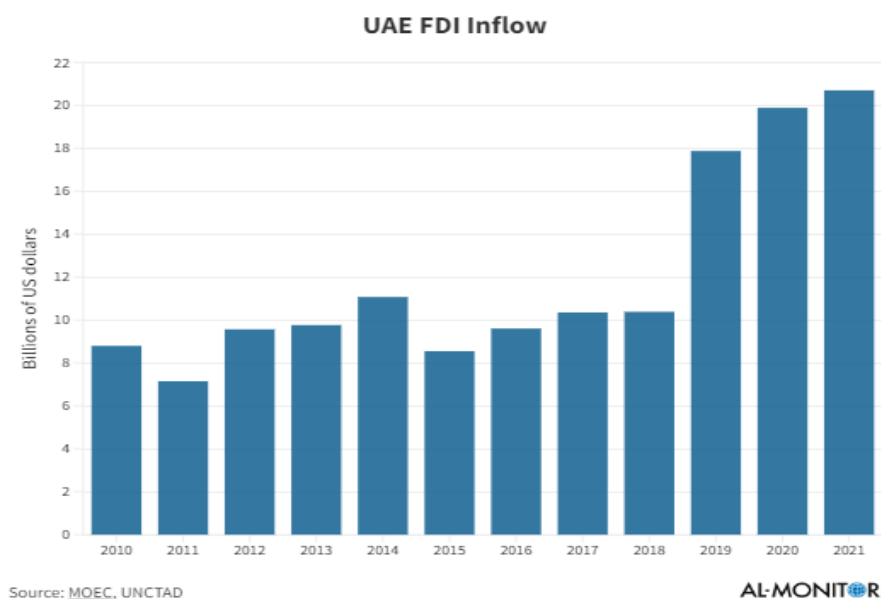


Fig.1 UAE FDI Inflow (MOEC, 2021)

The multi-nationalism of the UAE population and the introduction of policies that welcome people from different nationalities have been major factors in making the UAE real estate market competitive. This trend will continue well into 2023.

These findings also suggest the UAE will see a rise in property prices. This is in line with worldwide inflation and the increase in interest rates, which will also directly impact mortgages and foreign direct investments. Hence, affordability might be an issue for middle-income buyers and renters. However, an oversupply of homes from previous years is currently keeping affordability in check. On the other hand, the luxury real estate sector, which is dominated by high-net-worth individuals and entities, will remain resilient against price surges. Property prices are expected to rise at a slower pace, according to (Chandak, 2022).

For 12 months until November 2022, there was a price hike of 9.5% in the Dubai residential market. The rates of apartments and villas went up 9% and 12.7%, respectively, according to (Ellis, 2022).

## 5. Discussion

While the world was trying to recover from the aftermath of the COVID-19 pandemic, Dubai was one of the few places that welcomed tourists. Affluent individuals and families from all parts of the world, especially Europe, decided to visit Dubai. Some decided to settle here, while others added it to their favorite holiday destinations. This resulted in a significant increase in property demand, especially in the high-end sector. Afterward, the Expo Dubai 2020, golden visa schemes, and incredibly competitive immigration reforms heightened the popularity of Dubai among people and nations worldwide. Among other competitor nations, Hong Kong lost its appeal after China decided to focus on the Chinese Special Administrative Region (SAR). This reinforced the status of Dubai as the hub of tourism, trade, and financial activities, increasing its market share manifold. Singapore also fell short since it had to keep its borders close for a long time after the pandemic outbreak. Consequently, Dubai gained a competitive advantage (Alajaji, 2022).

As stated by (Adamco, 2022), a beneficial environment will be created when foreign asset managers and global institutional investors are attracted to the Dubai real estate market. As a result, liquidity regarding specialized commercial property segment developments will be promoted, and the market will be accessible to both institutional and retail investors. Since there is a high prevalence of cash buyers in the city, the property sector remains less exposed to interest rate increases (Waind, 2022).

Despite the expected decrease in affordability, property prices may not increase substantially as long as the UAE remains a buyers' market. As a result, affordability may continue for some years until rising interest rates, inflation, and construction costs cut demand for affordable housing. Regarding future growth, the UAE real estate market is expected to benefit from replenishing China's investment in Dubai. In addition, the country is set to welcome a new population to the property demand mix after introducing gaming. Furthermore, as banks continue to lend money and rent prices go up, more people will decide to put their money into UAE properties, contributing to demand growth. With steady growth in borrowing rates, it will be interesting to see mortgage data at the end of 2023 (Alajaji, 2022).

With Dubai breaking all real estate transaction records and setting new highs for luxury properties in 2022, stakeholders should be concerned about the direction the market will take, given the global market slowdown and the fear of global recession. It is natural for investors to be concerned about the future performance of the UAE real estate market, especially because the prices are expected to fall

by 12% in the US in 2023. In the UK, the situation looks even bleaker, with the prices expected to decrease by a whopping 30% by 2024 (Haque, 2022 ). Nevertheless, the real estate scenario in Dubai looks very different from what was witnessed in the 2009 downturn.

It is interesting to note that the global real estate markets performed well at the onset of the pandemic, as people realized the importance of homes, resulting in increased property value. However, the good times halted in 2022, with interest rates skyrocketing due to inflation. Buyers' affordability took a major hit as a result. High interest rates always bring bad news for the real estate sector, and the recent rate increase is the primary reason for the property slowdown across the world. However, Dubai's property market remains less exposed to interest rate increases because it benefits from the higher oil prices and the presence of cash buyers. More than 70 per cent of UAE property purchases are made with cash. This is largely due to the international nature of the market. On the contrary, cash buyers represent 22 and 31 per cent purchases in the US and UK, respectively (Reuters., 2023 ).

The UAE has taken commendable steps to strengthen its real estate market since the outbreak of the pandemic. After positioning itself as an ideal destination for people and investments, it has renewed migrations to Dubai, which will likely fuel the property sector in 2023 and beyond.

## **6. Conclusions**

This study investigates the impact of liquidity on the UAE real estate sector. It discusses how multiple variables have come into play to strengthen the property market and attract foreign direct investments in the country. We have reviewed the existing literature on the impact of liquidity on the real estate market while highlighting its current and potential conditions. Our research reveals that the increase in regional liquidity levels due to rising oil prices, foreign investments, and government policies is driving real estate growth, pushing the UAE to enjoy a position better than the global average.

It is evident that the rising property demand will likely result in a gradual increase in UAE property prices in the near future. The residential property demand trend could also change due to the increasing mortgage rates, rising cost of living, and anticipated new supply. Furthermore, if higher oil prices are not sustained, the UAE's recovery in 2023 may slow down. Buyers and investors must consider this when making investment decisions.

Further research can quantify the impact of liquidity on the UAE real estate market and offer definitive proof of its relationship with this sector's growth. As the current situation indicates, increasing liquidity levels in the UAE can play a vital role in strengthening the real estate market and encouraging more buying and selling activity. This, in turn, can benefit the country's economy and open avenues for foreign direct investment.

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