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THE REALITIES OF GOVERNANCE AND REGULATION IN THE UAE REAL ESTATE SECTOR

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Introduction

The emergence and rise to prominence of the United Arab Emirates (UAE) real estate sector has been unprecedented, with reports indicating that real estate prices rose by 21.8% in 2013 (HSBC Holdings plc, 2014). While many investors and speculators made incredible returns on their investment over relatively short periods, there have been real concerns about the level of accountability, transparency, regulation and governance in the sector. These concerns appear to have been proved correct in the light of the negative sentiments and impact in the UAE market, in response to the last global financial crisis. There are suggestions that the sudden and unprecedented fall in the market[1] was due to the lack of transparency and weaknesses in the regulatory and reporting systems. The real estate market is back on the growth path, and the IMF and other renowned international financial institutions have issued warnings about the need for the Emirates to maintain a close eye on the real estate market (HSBC Holding plc 2014). In particular, these institutions call for a proper governance and regulatory framework in the run-up to Expo 2020 given the scale of planned real estate expansion. This is to avoid a bubble burst soon after the Expo (HSBC Holding plc 2014). In all, the indication from these international financial institutions is that there is a need to ensure that the market is built on a solid governance structure based on policies that assure sustainability, accountability and transparency.

In late 2000, the UAE real estate sector was thrown into a major crisis, which could be traced to two sources – first, a crisis of confidence due to a number of reported cases of corruption and embezzlement in the sector; and secondly, the impact of the global financial crisis and credit crunch. The most visible results of the crisis was the slump in property values and the market value of real estate development

[1] For an in-depth discussion of the Dubai real estate market collapse of 2008, see Renaud (2012).

and related companies, as well as near-total halt of economic activities in the real estate sector. It was suggested that the industry, at that point, was plagued by the lack of accountability and transparency, and that given the speedy development in the sector, proper corporate, regulatory and governance structures were not yet fully installed. While the industry gradually recovered to pre-financial crisis levels, questions still persist about the optimal governance structure and mechanism for the industry. This study investigates current governance structure and public policies in the UAE real estate sector with the aim of proposing robust structures and mechanisms based on the ethos of sustainability, accountability and transparency in line with international best practices.

Existing research suggest that crisis in the real estate sector have significant impact on a country's economy as a whole, as it exposes banks and sovereign wealth funds to asset write downs (Woertz, 2008). The first part of our study employed a combination of archival and empirical research techniques, starting with the tracing and documentation of the history of real estate development and associated governance structures and practices in the UAE, including the key milestones in its evolution and rise to prominence. This will be followed by an in-depth empirical study of the financial reporting practices, and corporate governance structures and mechanisms of key players in the UAE real estate sector. From the results of our analysis, we established the prevailing practices in the sector, and generated outcomes that will be of use to UAE policy makers in the areas of governance, accounting, market performance, regulation, and real estate investor confidence and participation. We believe these outcomes should make the UAE real estate sector better-prepared for future global financial and economic shocks and crises.

Brief Literature Review

Extant research has confirmed a link between the real estate sector and other constituent parts of a country's economy (Hofmann, 2001). Further proof of this could be gleaned from the recent global financial crisis, whose roots could be traced largely to the slump in the US housing market. While there is a deepened culture of research on issues and the impact of the real estate sector on other sectors of developed and established western economies (Barras, 1994; Hilbers et al.; Borio and McGuire, 2004; Adair et al, 2006), there is precious little empirical study on the UAE real estate sector. This is partly due to the emerging nature of the sector, and its speed of emergence. One exception is the study by Abdelgalil (2007), which examined the relationship between the Dubai real estate sector and its financial sector. He not only found empirical evidence of a relationship between the two sectors at both the macro and microeconomic levels, but also found that the real estate sector has been the prime driver of the financial sector in Dubai. Another publication in this area, Al-Roumi et al (2004), documents the role and contributions of the real estate sector to the economy of Dubai. It reported that the sector contributed 9 percent of Dubai's total GDP in 2003, with the distribution of activities among real estate enterprises as brokers 75 percent, leasing and management 58 percent, and sale and purchase 43 percent.

It has been suggested that the UAE real estate sector, prior to the global financial crisis of late 2000, was plagued by the lack of accountability and transparency, and that given the speedy development in the sector, proper corporate, regulatory and governance structures were not yet fully installed. While the body of literature on corporate governance and accountability in the UAE has been growing in recent times, studies addressing the issue with specific reference to the real estate sector are almost non-existent. This is despite the significant and growing importance of the sector to the UAE economy. Recent studies examining governance in the UAE include Aljifri and Moustafa (2007), Hassan (2011), Hassan (2012), Mubarak (2012), Baydoun et al (2013), Adawi and Rwegasira (2013), and Khan and D'Silva (2015).

Extensive literature has outlined the importance of proper governance models for the sustainability of key economic sectors such as the real estate industry. Schulte (2004) highlighted the need for real estate specific corporate governance rules which address identified deficits as "effective means to achieve more transparency and professionalism", and found that 97% of CEOs in the real estate sector identified corporate governance to an issue of importance in the sector, with the subject listed high on their agenda. Recognising the paramount importance of proper governance, accountability and sustainability in the sector, Jones Lang LaSalle and LaSalle Investment Management introduced the first Global Real Estate Transparency Index in 1999, aiming to characterize the relative transparency of key global real estate markets on key issues such as availability of accurate financial and market information, regulatory and legal environment, security of legal title and enforceability of property rights, financial disclosure and governance of listed real estate companies, and zoning and building codes. The 2014 version of the Index, which covered the real estate sector in 102 countries, recognised Dubai and Abu Dhabi as the most and second most transparent out of 16 markets in the Middle East and North Africa (MENA) regions respectively. However, the region is still considered to be one of the least transparent regions in the world (JLL, 2014). Acknowledging the fact that "a fully functioning and well regulated real estate market can be an important factor to enhance the economy of countries", the United Nations Economic Commission for Europe (UNECE), in 2010, established a policy framework to provide guidance and promote sound real estate markets. The Framework documents a set of ten core principles that could serve as guidance for policy action in the real estate sector. The principles covered include good governance, transparency, accountability, fairness and efficiency (UNECE, 2010).

Literature specific to governance in the real estate industry in the UAE is almost non-existent. This is despite the fact that the UAE government recognized the strategic importance of the sector to the economic wellbeing of the country. We can safely conclude that at the moment, there is no systematic body of knowledge on the issues of accountability, transparency and governance in the UAE real estate sector. This is a misnomer, for a sector that has grown to become a critical part of the country's economy. Following the global financial and economic crisis of 2008 and the unprecedented impact on the real estate in the UAE, some studies have emerged on the subject in the literature. Renaud (2012) examined the dynamics of Dubai's real estate bubble and suggested some policy responses required to bring Dubai back to its long-term growth path. He emphasized the strengthening of the real estate governance structures as a major requirement for accelerated economic recovery and sustainability. In this study, we document the current governance structure and recommend improved structures based on global standards.

Key Findings and Practical Implications

The UAE real estate sector has, within a relatively short timeframe, become one of the main fulcrums of the UAE economy. Tremendous growth occurred in the sector from the time the Emirate of Dubai announced its plan to grant freehold rights to expatriates in designated parts of the Emirate in 2002. The extent of growth of the sector was such that, the UAE Ministry of Economy reported that the sector was the fastest emerging contributor to the country's GDP in 2007, with an investment of Dh.25.8 billion (8%) (UAE Ministry of Economy, 2008). The value of property investments in the country also increased at unprecedented rates. Some argued that the speed of development in the sector has meant that the necessary institutional structures to support sustainable growth in the sector were not put in place, and it was therefore not too surprising that the sector crumbled during the global financial crisis in 2008. Given the importance of this sector to the UAE economy, particularly in view of the stated intention of the government to diversify the economy away from oil- to non oil-based sectors, various options were suggested on how to fortify the sector against future economic and financial downturns. We found that the UAE real estate sector was hit on two fronts from late 2000 – first, by a number of alleged cases of corruption and embezzlement in the sector; and secondly, by the impact of the global financial crisis and credit crunch. This resulted in significant slump in property values and the market value of real estate development and related companies. In addition, activities in the real estate sector almost ground to a halt. The speed of development of the sector post-2002 also contributed to perceived lack of accountability and transparency, given that proper corporate, regulatory and governance structures were not yet fully installed. We found an industry that has now almost recovered fully to pre-financial crisis levels, but with questions still persisting about the optimal governance structure and mechanism for the industry.

Preliminary results from our study reveals an industry that has come a long way since its take-off in 2002, and the global economic and financial crisis of 2008. We found basic regulatory and governance structures in place, but shortcomings in the areas of enforcement, uniformity, and awareness. Regulatory authorities struggle to ensure strict enforcement of certain governance and accountability rules and regulation. Lack of uniformity of governance and regulatory structures between some of the Emirates was also found to be an issue. We recommend the enactment of a Code of good behavior by the industry, which should cover issues such as corporate management structure, objectives, suitability and work experience, professionalism, equity and fairness, suitable and competent valuation of real estate assets, establishment and continued development of internal supervision and risk management system, annual account audit and independence and qualification of the auditors, etc. Careful attention also needs to be paid to core principles of good governance, transparency, accountability, fairness and efficiency as identified by UNECE (2010). There is an urgent need to harmonise the set of governance rules and regulations guiding key players in the industry across all Emirates in the country.

Summary and Conclusion

It is clear from our review of the current regulatory and governance framework of the UAE real estate sector that the structure is still in a nascent stage. While a code of corporate governance exists for companies listed on UAE stock exchanges, there are no specific corporate governance framework developed for firms operating in the sector, majority of which are not listed on the stock market. Hence there are no clear regulation or guidelines to guide companies on important governance issues. In addition, it appears that a number of key policy components necessary for a sustainable development of the real estate sector are yet to be implemented in the UAE. Examples include an integrated national legal framework applicable across all Emirates of the UAE that guarantees real right of property ownership, removal of restrictions on buyers/tenants choice of tenure options, development and documentation of financial procedures for real estate transactions, removal of arbitrary restrictions on banks and other regulated lenders engaging in real estate financing, etc. It is important for the UAE to continually update the governance framework policy and procedures in its real estate sector to ensure an overall integrated structure and mechanism that guarantees optimal transparency and accountability within the sector. The framework should be nationally integrated, and harmonised with existing regional and international standards. This is a necessary prerequisite for sustainable real estate sector development and long-term contribution to the economic wellbeing of the country. Addressing these issues should go a long way in ensuring the long-term sustainability of this emerging but critically important sector of the UAE economy. This is a key starting point for establishing a robust governance structure and mechanisms for the real estate sector that is consistent with best international practices for consideration by UAE policy makers.

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