INVESTING IN THE UNITED ARAB EMIRATES
Property tax & market insight
Introduction

Cluttons has partnered with Trowers & Hamlins to produce a guide to investing in the United Arab Emirates (UAE), specifically looking in detail at the property markets in Abu Dhabi, Dubai and Sharjah.

This has been a cross team effort, working with Trowers & Hamlins in the UAE to simplify the obligations for those investing in the UAE’s diverse property markets, covering both the residential and commercial sectors.

The document also includes an update on the residential and office markets in Abu Dhabi, Dubai and Sharjah and aims to provide a quick and easily digestible resource for all investors and purchasers.

As the surprise collapse in oil prices in 2014 continues to impact the performance of the various emirates across the UAE, we wanted to delve into the tax obligations for buyers, in particular those that are looking to invest in the UAE’s property markets, attracted by its dynamism and global profile.

Enshrined in the commonly quoted English translation of the UAE Federal Constitution, private property is respected and it is stated that: “no-one shall be deprived of his property except in circumstances dictated by the public benefit and in accordance with the provisions of the law and in consideration of a just compensation.”

In accordance with the Constitution, individual Emirates legislate for the treatment of real estate that lies within their boundaries. In Dubai, the body that oversees the real estate sector is the Dubai Land Department, and in Abu Dhabi and Sharjah that role is undertaken within various departments of their respective Municipalities.

Free zones are independent areas within the UAE, where restrictions on the ownership of companies are relaxed. These are the only places in the UAE where businesses can be incorporated without any local shareholding. There are two free zones in the UAE that have their own real estate laws: the Dubai International Financial Centre (DIFC); and the Abu Dhabi Global Market (ADGM).
Investing in the United Arab Emirates – Property tax & market insight

Abu Dhabi property market snapshot

Oil price decline still impacting property market

Abu Dhabi’s economy remains intrinsically linked to the hydrocarbon sector, which has historically been a critical engine of growth for a range of supporting and related economic segments, each of which plays a key role in creating fresh demand for both residential and commercial property in the emirate. The impact on the economy is best illustrated by the contribution of oil to overall GDP. Clearly, the Government’s diversification efforts have helped to buffer against the collapse in oil revenues, but there remains a challenging road to recovery ahead.

The first six months of 2017 have seen a continued lacklustre performance of residential values in Abu Dhabi’s main residential investment areas, with values overall dropping by 0.9%. This of course does mask a far more complex picture. On a submarket level, the three weakest performers all came from the luxury end of the property spectrum, with high end apartments on Al Raha Beach (-3.3%) and Saadiyat Island (-3.3%) being joined apart with Al Reef Villas (-2.9%).

Indeed, this cautious behaviour has had a clear and direct effect on the rental market as well. While rising household costs, for the reasons outlined above, may mean that some decide to abandon home ownership altogether, there are those who remain committed to building deposits and remaining in rented accommodation, possibly for longer than initially planned.

The overall impact of this apparent strengthening in demand for rented property has been undermined by rising supply levels of rental property. This has been particularly evident on Reem Island, where a sudden surge in completions and the emergence of a number of ‘accidental landlords’ has kept rents in this submarket under pressure.

Residential rental supply levels rising

As outlined above, the importance of the public and oil sectors cannot be overstated enough. These two segments of the emirate’s economy have historically been the backbone of demand in Abu Dhabi’s office market, and with both segments on the back foot, we continue to witness a deteriorating level of requirements from occupiers. What is worth noting however is the upturn in requirements from public sector entities seeking to cut costs through office space consolidation. We are for instance aware of requirements of this nature that range from 3,400 sqm, rising to 24,000 sqm.

Most enquiries we continue to receive are spawned from the requirement of businesses to have a commercial presence in the emirate in order to do business and are therefore, more often than not, for a small amount of token space, typically in the region of 150 sqm to 350 sqm.

A key emerging feature of the market is lease flexibility. Corporates are increasingly demanding this both at renewal and for new leases, often citing economic uncertainty as the chief reason.

Performance of Abu Dhabi’s residential capital values

Considerations for investing in Abu Dhabi

UAE nationals and companies wholly owned by them can own any land anywhere in Abu Dhabi. These rights are also held by the UAE Government; the Governments of the other Emirates; entities wholly owned by the Abu Dhabi Government; and individuals or companies specified by the Executive Council (although this power is used very sparingly).

Citizens of other GCC states and corporate entities wholly owned by them are able to hold freehold properties in areas designated as ‘Investment Areas’.

Non-GCC nationals and companies can only hold land in Investment Areas, but their interests are limited to leases of floors in buildings (but not the land itself). usufruct rights lasting up to 50 years or a musataha of not more than 50 years renewable.

It is imperative that the ownership, transfer and mortgage of all property in Abu Dhabi is recorded with the Municipality.

In Abu Dhabi, the Municipality charges a transfer fee of 2%, up to a maximum fee of AED 1,000,000 per transaction. Although it is intended that the buyer and seller will each pay 1%, in practice the buyer tends to pay the whole transfer fee. Other ancillary fees may also be payable.

ADGM

In the ADGM, nationals and companies from any GCC country are entitled to freehold titles for land.

The term of any lease may be renewed or extended, provided that in no event shall the aggregate term of any lease (inclusive of all such renewals or extensions) exceed 198 years. ADGM also recognises the concepts of life interests and future or reversionary interests and musataha and usufruct interests are recognised as leases.

Registration of any dealing in the property is recorded on the ADGM’s register. The fees for registering a property transaction are also 2% of the value of the transaction, although unlike outside of the ADGM there is no cap on the amount payable.
Dubai property market snapshot

Soft price corrections persist

Values across Dubai’s residential investment areas continued to moderate during Q2 2017, dipping by an average of 1.5%. This leaves the annual rate of change at -6.6%. The latest change means that average house prices stand at AED 1,284 psf, nearly 30% below the Q3 2008 market peak.

Despite the seemingly slow climb in values compared to 2008 levels, the market has demonstrated characteristics of maturity, even though it is just 15 years since Dubai opened up its property market to international (non GCC) investors. This is reflected in the fact that price drop has averaged 1% per quarter over the last 12 quarters.

Clearly improved regulation around off-plan resales, the introduction of Federal Mortgage Caps, the doubling of property registration fees and more stringent regulations issued from time to time. In the mandatory requirement of escrow accounts have all contributed to the market’s stabilising growth profile in recent years.

The ongoing soft correction in the market appears to be nearing an end, with many locations starting to show signs of bottoming out. In fact, during the first six months of 2017, just seven of the 32 submarkets we track in the emirate registered price falls, with all other locations seeing no change.

Affordability challenges

Affordability remains a challenge for Dubai’s residential market. With household incomes strained by rising living costs, underpinned by inflation levels of over 2% and the looming new VAT regime, like Abu Dhabi, the dream of home ownership continues to drift further away for many. Average incomes remain at around AED 200,000 per annum for expat households across the UAE, based on the Ministry of Economy’s last income survey. With an average mortgage multiplier of three to four times annual income, most households would be hard pressed to purchase a “family home” for between AED 600,000 to AED 900,000 anywhere in the emirate.

The number of “affordable” housing districts in the city remains primarily limited to well known areas such as International City and Discovery Gardens, which together house some 120,000 residents, spread across circa 48,000 units. The limited supply in the affordable segment of the market, coupled with steady, but robust demand, has helped to hold values relatively steady in recent quarters.

Expo 2020

Looking ahead, Standard Chartered expects 300,000 new jobs to materialise between 2018 and 2021, directly as a result of the Expo 2020. By the end of 2017, some AED 11 billion worth of construction and infrastructure contracts will have been awarded in the city. This will help to drive up demand for both residential and commercial property in the next six to nine months, suggesting that the bottom of the current market cycle may finally be on the horizon.

The fact that over 58,000 units are scheduled to enter the market between 2019 and 2020 may offset any population surge linked to the World Expo in 2020; however, as is the case with most project-linked jobs, the vast majority will be in the lower to middle income bracket and with little evidence to suggest this demographic is being catered for in any meaningful way, house price spikes in more affordable communities are almost inevitable in the medium to long term.

2018 likely to be a year of stability and marginal growth

The support provided to house prices as a result of the dynamics outlined above continues to influence our forecasts for the market, with stability likely to bed in more widely across the city’s residential investment areas before the year is out. However, it is still our view that values will end the year 4% to 5% down on 2016, on average. 2018 is likely to see values starting to show their first positive, albeit weak growth, in over three years as the ‘Expo effect’ starts to influence demand levels and overall sentiment.

Considerations for investing in Dubai

Restrictions on ownership apply across all land in Dubai, including all free zones.

In Dubai, nationals and companies from any GCC country are entitled to own freehold title to land.

Public joint stock companies incorporated in the UAE (including companies listed on the Dubai Financial Market) are also entitled to freehold title irrespective of whether shares are held by non-GCC citizens.

An individual who does not hold a passport for any of the GCC countries; or a corporate entity that is partially or wholly owned by an individual who does not hold a passport for any of the GCC countries, is able to hold real rights over land in Dubai within certain “Designated Areas”. The Designated Areas for foreign ownership of real estate are determined by the Ruler of the Emirate of Dubai by way of decrees and regulations issued from time to time. In these Designated Areas a foreign person may: own the freehold of land and/or (for a period not exceeding 99 years), usufruct (for a period not exceeding 50 years) of property.

Outside of Designated Areas the rights of non-GCC nationals are limited to the grant of short term leases.

Investment by a non-GCC national in real estate situated in Dubai using a corporate structure is, generally, only permissible through two types of corporate vehicles: an LLC incorporated in the Dubai mainland (the shares of which LLC must be owned at least 51% by a local shareholder); or an offshore company that has been registered with the Jebel Ali Free Zone Authority. It is anticipated that, shortly, companies registered in DIFC will be permitted to register their ownership of properties with the Dubai Land Department.

It is imperative that the ownership, transfer and mortgage of all property in Dubai is recorded with the Dubai Land Department.

DIFC

The rules on property ownership in the DIFC are largely similar to a Designated Area in the remainder of Dubai.

Any purchase of property in Dubai is subject to a fee of 4%, which is charged for the registration of that contract at the Dubai Land Department. This is measured against the higher of: the sale price; or the market value of the property (as determined by a registered property valuer). Until this transfer fee is paid, the Dubai Land Department will not issue an updated title deed.

There are other fees that are typically paid by real estate investors, depending on the structure of the transaction and the type of property being purchased. For example: a 2% broker fee that is generally paid by the purchaser; an administration cost of approximately AED 4,000 for the use of the transfer centre; a property valuation fee of approximately AED 3,000; and, for apartments or villas situated in a master community, a fee payable to that master developer to procure his approval for the sale (i.e., his confirmation that all service charge dues are paid up to the date of sale). For buyers with mortgages, there are fees associated to both the procurement of the mortgage and its registration.

Investing in the United Arab Emirates – Property tax & market insight
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Sharjah property market snapshot

Villa rents recover

Sharjah’s position as an affordable alternative to Dubai continues to be retained. The emirate’s emerging profile amongst the wider expat community, coupled with the strong focus on creating a family friendly destination is boosting its appeal and this is reflected in the level of demand we are recording from tenants. Redundancies, like in Dubai, are still of course an issue as we work our way through a challenging period for the global economy. This has however not had a material impact on overall requirement levels, which remain very robust at most price points.

The villa market in particular continues to offer good value for money when compared to Dubai or Abu Dhabi and households faced with rising living costs due to the reasons outlined above are increasingly seeking out family home options in Sharjah, which has resulted in a turnaround in the performance of the villa market, as demand has now edged ahead of supply.

During the first six months of 2017, average villa residential rents across Sharjah rose by 1.5%, marking a significant departure from the deep corrections we have recorded over the last six months of 2016. This is in contrast to last year, when rents slipped by as much as 9.3% in prime areas of Al Majaz to AED 68 psf, while Al Soor (AED 60 psf) registered a slightly less severe correction of 7.7% over the same period.

While we have previously highlighted the small size of Sharjah’s Grade A office market, this has kept it relatively well insulated from more macro issues compounding global growth, and there remains little in the way of new demand streams aside from the constant requirements from the public sector. In fact, the 2017/18 Government of Sharjah Budget aims to create 1,800 new jobs for Emiratis.

Office market

The resilience of office rents in Al Soor and the prime and fringe areas of Al Majaz that began earlier this year has persisted, with rents remaining unchanged during the first six months of 2017. This is in contrast to last year, when rents slipped by as much as 9.3% in prime areas of Al Majaz to AED 68 psf, while Al Soor (AED 60 psf) registered a slightly less severe correction of 7.7% over the same period.

Villas expected to emerge as star performing sector

Demand for villas in Sharjah is likely to continue rising, fuelled by the relative affordability of homes compared to those in Dubai, which in turn will remain a key catalyst behind the multitude of mixed use freehold projects bubbling through. We are already seeing several new villa projects coming to market that provide quality, affordability and accessibility, including communities by Majid Al Futtaim, GIBCA and Faisal Holding. We expect to see continued demand for these developments as they reach completion.

With this in mind, it is our view that rents on average are likely to end the year about 5% down on this time last year, however the villa market will outperform, with growth of 3% to 4% likely by the close of 2017, underpinned by limited supply levels. Apartment rental rates on the other hand are forecast to remain weak, ending the year about 10% down on December 2016.

Considerations for investing in Sharjah

Historically, only UAE nationals and companies wholly owned by them were entitled to hold land interests in Sharjah. Later, citizens of the GCC states and companies wholly owned by them were granted similar rights (although they were limited in the number of properties that they could own).

Non-GCC nationals have been granted the right to hold the following interests in properties located in areas that have been designated for foreign investment by the Government of Sharjah (i.e. but not outside of these areas) on the condition that they have a residency visa for Sharjah at the time of purchase (i.e. but there is no requirement to retain the visa after purchase): leasehold up to 100 years; musataha up to 50 years (renovable by mutual consent); and usufruct up to 100 years. These rights do not allow a non-GCC national to own any right to the underlying land.

The ownership of land is registered at the Sharjah Real Estate Registration Department.

Transfer fees are payable for any dealing of property in Sharjah. The fee is 2% for GCC citizens, and 4% for a non-GCC national.

It is the responsibility of the landlord to register any lease or renewal with the Sharjah Municipality. No unregistered lease can be presented in the event of a dispute or for the provision of any service.

Performance of Sharjah’s residential rental values

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Source: Cluttons
Value Added Tax (VAT) in the UAE

The UAE will be introducing VAT on 1 January 2018 at a standard rate of 5%. From this date on, consumers will be charged VAT at the point of purchase on goods and services (except for those goods or services which are exempt).

Whether or not VAT will be payable on real estate will depend on whether the property is commercial or residential.

Residential properties will generally be exempt from VAT. However, to enable developers to recover VAT on the construction of residential properties, the first supply of newly-constructed residential properties will be zero-rated (i.e. taxable but at a rate of 0% for the buyer payable) if they are supplied within three years of their construction. Bare land will also be exempt from VAT.

Commercial properties will be taxable at the standard VAT rate of 5%.