

# Gulf Bank Insight Report

Economic Research Unit

SEPTEMBER 2021



## RESIDENTIAL REAL ESTATE IN KUWAIT

### KEY HIGHLIGHTS

- Housing is a crucial building block of the economy. As per the latest available estimates, real estate, renting, and business services have contributed to about 9% of Kuwait's GDP. Lending for housing promotes financial market development through avenues such as securitization.
- Growth of Kuwait's residential real estate sector is supported by population growth, government housing program, and investment demand driven by high rental yields and constrained supply.
- Amidst the COVID-19 pandemic, the residential segment has been the key driver of overall real estate activity in Kuwait as investment and commercial segments have been facing the pressure of increased vacancies and falling rents.
- With a residential price to income ratio of 16.5, Kuwait's housing affordability is lower than other markets such as Dubai, Abu Dhabi, Riyadh, and London.
- Overwhelmed state housing program, restriction of private sector participation, and lack of financing options are some of the challenges facing the residential real estate segment.
- The new mortgage law, opening up of markets for banking players, securitization, and increased PPP could aid in tapping the potential of Kuwait's mortgage market. Additionally, overcoming challenges such as lack of yield-curve for pricing and regulatory caps on pricing would also help in the development of a healthy mortgage market.

#### 1. Housing and its Economic Significance

Housing, one of the basic requirements in the hierarchy of human needs, plays a big role in the economy. At a macro level, it boosts the construction sector, promotes investment in related infrastructure and other amenities, and aids in job creation. For example, in the U.S, housing's share of GDP was 17.5% in 2020.<sup>1</sup> In Kuwait, the construction sector had contributed to 5.1% of non-oil GDP in 2019 and 2.9% in 2020.<sup>2</sup> Real estate, renting and business services had contributed to about 9% of GDP in 2018.<sup>3</sup> Being a key consideration in the migration of labor, the availability of affordable housing options in a country facilitates labor mobility. Ensuring adequate housing facilities would aid in retaining the local labor force and attracting foreign talent. Lending for housing promotes financial market development through avenues such as securitization. Homeownership benefits individuals as well through capital appreciation in the long term and provides secure collateral against inflation and market fluctuations.

#### 2. Growth drivers of Residential Real Estate

##### a. Population growth

Kuwait's population has grown at a CAGR of 4.1%, and the number of nationals has grown at 2.3% from 2005-2020.<sup>4</sup> The country's population is estimated to be 4.5million in 2025 and 5.4million in 2050.<sup>5</sup> The annual rate of growth has slowed to 1% in 2020 and is estimated to slow to 0.34% by 2050.<sup>6</sup> However, with a relatively high population density of 232 people/sq. km, the estimated growth in population would support the demand for residential real estate.<sup>7</sup>

<sup>1</sup> Congressional Research Service, 2020

<sup>2</sup> Central Statistical Bureau (CSB), 2019

<sup>3</sup> CBK – Latest Available

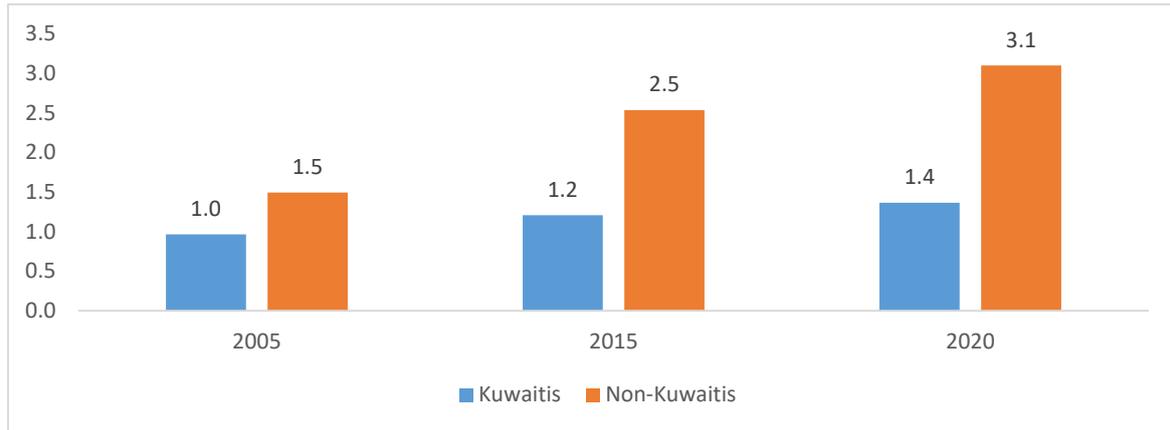
<sup>4</sup> CSB Estimates

<sup>5</sup> World Population Prospects, 2019

<sup>6</sup> World Population Prospects, 2019

<sup>7</sup> World Bank, 2018

**Figure: Population of Kuwait (in millions)**

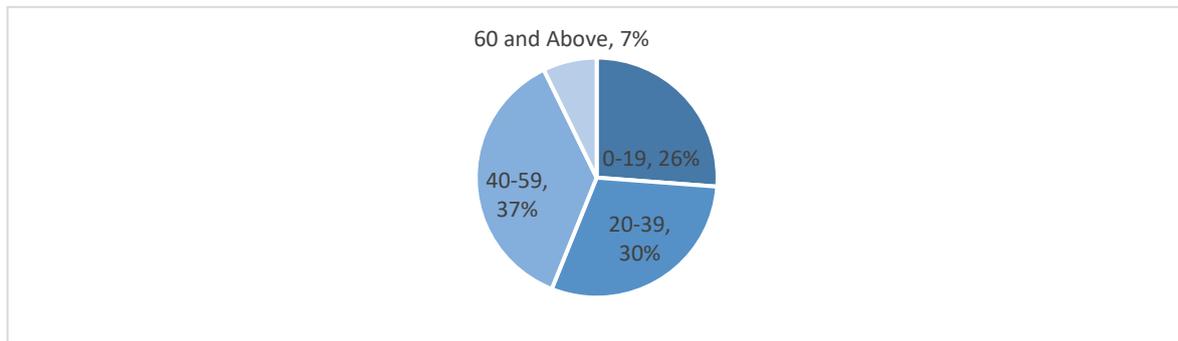


Source: Central Statistical Bureau

**b. Demographic Profile**

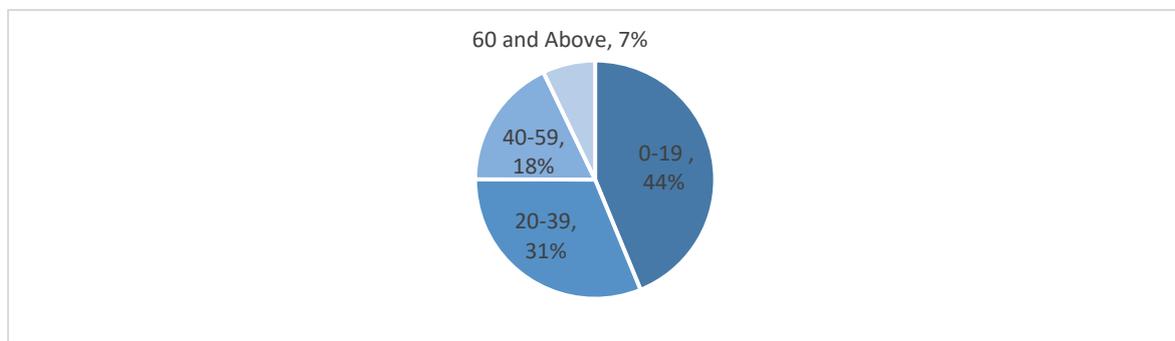
With over 50% of the total population (nationals and non-nationals) and 75% of the Kuwaitis below 40, Kuwait's young demography is favorable for real estate demand. Although recent policies focussing on reducing expat numbers would present some downside, policy reconsiderations such as the review underway for work permits to expats over 60 and sustained demand for high-quality residential spaces from Kuwaiti nationals would support residential real estate.

**Figure: Distribution of Total Population in Kuwait by Age Group, 2020**



Source: Central Statistical Bureau; includes nationals and non-nationals

**Figure: Distribution of Kuwaiti Population by Age Group, 2020**



Source: Central Statistical Bureau

### c. State Housing Program

Kuwait's housing program consists of the following options:<sup>8</sup>

1. A government house built on a minimum 400 square meter plot or a minimum 400 square meter apartment provided by the PAHW at nominal value, plus a monthly rent allowance of KD 150 during the waiting period.
2. A minimum 400 square meter plot of land provided by the PAHW at nominal value. A long-term, interest-free loan of KD 70,000 and building materials worth KD 30,000 at a subsidized price are provided by the Savings and Credit Bank for the construction of the house. During the waiting period for allocation, a monthly rent allowance of KD 150 is paid to the applicant.
3. A KD 70,000 long-term, interest-free loan from the Savings and Credit Bank, to buy an apartment or house with a minimum area of 360 square meters, or to build a house if the citizen already owns land. Along with the loan, KD 30,000 worth of building materials is provided by the bank for construction or renovation.

**Table: Government Housing Program for Citizens**

	2015	2016	2017	2018	2019
<b>Submitted Requests</b>	7,950	7,316	7,286	6,199	6,029
<b>Cumulative Requests</b>	97,399	100,018	90,445	96,906	88,632
<b>Distributed Residential Units</b>					
Houses	2,555	0	0	0	0
Plot	370	0	4,430	3,368	0
Apartment	345	0	35	0	0
Total	3,270	0	4,465	3,368	0
<b>Planned Distributed Residential Units</b>					
Houses	-	0	0	0	0
Plot	13,311	12,500	9,719	6,437	8,986

Source: CSB, PAHW

**Table: Value of Loans Approved by Kuwait Credit Bank (KD million)**

	2015	2016	2017	2018	2019
Building	176.18	134.12	265.16	188.56	126.18
Purchase	19.28	18.00	26.15	27.23	27.44
Expansion & Renovation of Private House	1.71	1.04	1.25	1.43	1.33
Expansion & Renovation of Government House	24.97	44.32	20.49	11.87	12.98
Concrete Houses Loan	0.05	0.03	0.05	0.02	0.02
<b>Total</b>	222.20	197.50	313.10	229.10	167.95

Source: CSB

The government's expenditure on rent allowance for FY 2020 stood at KD 2.9 billion.<sup>9</sup> Though a new mortgage law is being proposed, a continuation of the state's aid in housing would be a growth driver for residential real estate.

<sup>8</sup> Right to Housing in Kuwait -LSE, 2013, PAHW

<sup>9</sup> ArabTimes/PAHW

#### d. Investment Demand Underpinned by Attractive Rental Yields

The current low-interest-rate environment has resulted in a search for investment opportunities with higher returns. Kuwait's real estate presents one such alternative. For example, the annual rate of return on investment properties had ranged from 6.9% to 8.4% in Q3 2020.<sup>10</sup> Measures are taken to handle the impact of COVID-19 such as sharp reduction in interest rates and postponement of debtor instalments had contributed to an increase in demand in private residences with their prices increasing by 8.2% y-o-y in Q3 2020.<sup>11</sup>

#### e. Supply Constraints

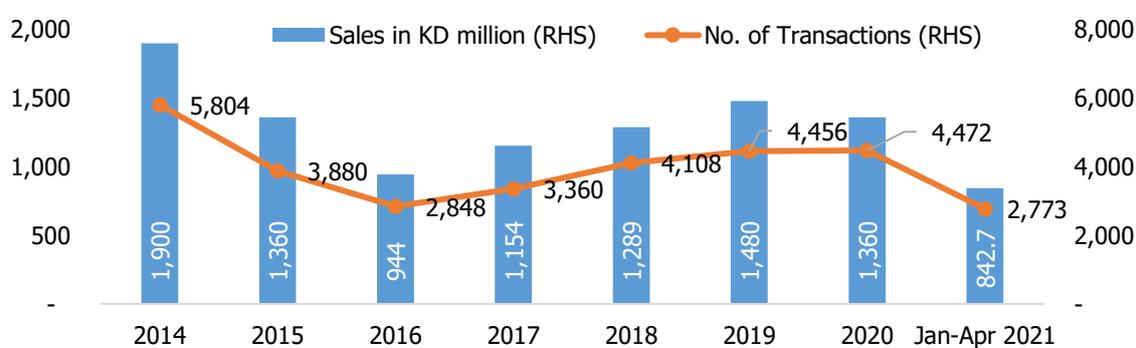
Residential zones comprise around 10% of Kuwait's area.<sup>12</sup> In a 2013 study by the Real Estate Association, the vacant land parcels had stood at 14,079 against 108,288 pending applications for housing with the PAHW. While measures such as allocation of funds towards housing as part of government development program and increased offerings in emerging areas such as Sabah Al Ahmad and new projects such as Jaber al-Ahmad residential city scheme are aiming to increase supply, delays in construction and preference for spacious villas seem to contribute to the constraints in supply.<sup>13</sup>

### 3. Kuwait Residential Real Estate Performance

Kuwait's Residential market has been on the uptrend since 2016, with transactions increasing on an annual basis both in terms of volume and value. The effect of COVID-19 pandemic was felt in the real estate market during the initial phase of 2020, with a recovery following towards the end. The residential sector witnessed pent-up demand in the last two quarters of 2020, which resulted in Annual volumes and values reducing only mildly. Residential Real Estate sales in the first four months of 2021 have been strong with sales peaking during March.

Adequate liquidity, low job losses for citizens and the measures taken by the government to contain the COVID-19 pandemic such as stringent lockdown followed by a cautious phased re-opening, imposition of curfews as required, allocation of KD 500 million to support efforts to curb the spread of COVID-19 and vaccination drives have ensured the recovery of demand in the residential sector after a dip in the first two quarters in 2020.<sup>14</sup> Monetary policy support measures such as postponement of loan repayments, increase in loan-to-value limits by 10% for purchase of residential land, and purchase or construction of houses also lent support to residential real estate's recovery. The Public Authority for Housing Welfare (PAWH) has been executing and delivering several projects lately. There has been an increase in residential offerings from emerging areas such as the Sabah Al Ahmad, Saad al Abdulla, and Jaber Al Ahmad in recent quarters. Increased offerings from these relatively active but less saturated areas have kindled investor interest and has been a key driver of demand in recent quarters.

#### Kuwait Annual Residential Real Estate Transactions



Source: Ministry of Justice

<sup>10</sup> KFH

<sup>11</sup> KFH – Q3 2020

<sup>13</sup> Bloomberg

<sup>14</sup> IMF

The residential segment has been the key driver of overall real estate activity in Kuwait, as investment and commercial segments have been facing the pressure of increased vacancies and falling rents due to the COVID-19 pandemic. Investment Real Estate sales fell by more than 50% in 2020, compared to the previous year.

In terms of pricing, Kuwait's residential prices have bounced back after bottoming out in Q3 2018. Kuwait's Residential Home Price Index exhibited a rising trend during 2019 and peaked during Q1 2020 before the pandemic. On a year-on-year basis, the residential price index has registered growth in all of all quarters between Q4 2018 to Q3 2020.

#### Kuwait Residential Home Price Index (Rebased 2016 end =100)

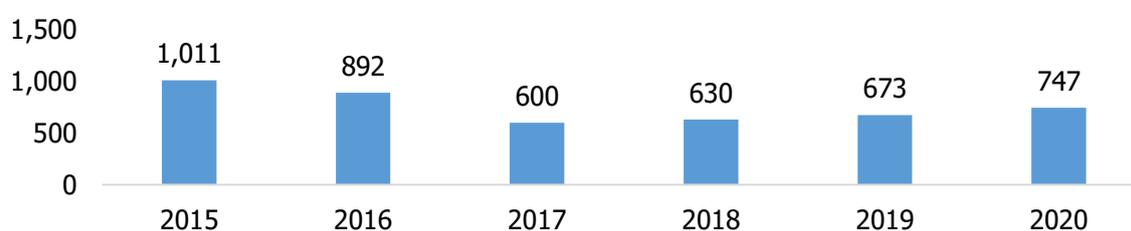


Source: Ministry of Justice, Marmore Estimates

#### 4. Affordability of Residential Real Estate

The average price of residential real estate has picked up after bottoming out in 2017. There was a steep correction in prices since the oil price crash of 2015. Residential prices have recovered since then, with 2020 witnessing the highest growth rate at 11%. The rebound in demand has led to an increase in prices.

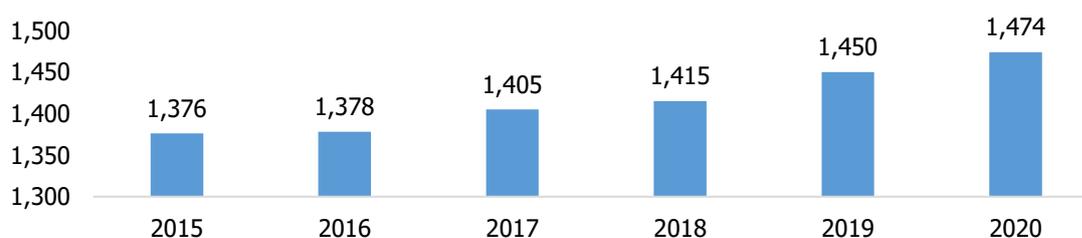
#### Average Price of Residential Real Estate in Kuwait (KD/Square meter)



Source: Ministry of Justice

Although the average salary of Kuwaiti nationals has been increasing every year since 2015. They are broadly in line with inflation, which indicates no major increase in real disposable income since the oil price crash during 2015.

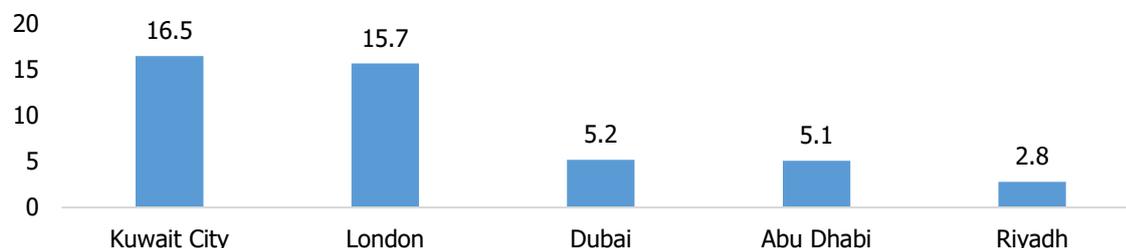
#### Average Monthly Salary of Kuwaiti National (KD)



Source: Labor Market Information System – Kuwait

Compared to other GCC markets such as Dubai, Abu Dhabi, and Riyadh, Kuwait's Residential affordability appears to be low. The residential price to income ratio for Kuwait stands at 16.5, which is approximately thrice that of Dubai or Abu Dhabi. Kuwait's ratio is significantly higher than Riyadh and stands higher than even London.

#### Residential Price to Income Ratio (2021)



Source: Number; Note: Residential Price to Income - Ratio of median apartment prices to median familial disposable income, expressed as years of income. Median apartment size is 90 square meters.

The implication of the ratio is that it takes approximately 16.5 years to repay the financing procured to purchase a residential apartment in Kuwait from the disposable income of an average Kuwaiti national by paying monthly instalments. Kuwait city's average residential price to income is the highest among the GCC, making it one of the least affordable places to own a residence.

### 5. Challenges in Residential Real Estate

#### a. Overwhelmed State Housing Program

PAHW has distributed 67,102 housing units from FY2013/14 to FY2020/2021.<sup>15</sup> This works out to an average of approximately 8,300 units per annum. In comparison, the number of applicants on the waiting list was 91,542, as of December 2020<sup>16</sup>. The waiting time from application to allocation is around 10-15 years, indicating the demand-supply gap in the state housing program. During this wait time, it is difficult for people to buy houses on their own due to the high real estate prices. The land allocated to citizens by PAHW is reportedly farther from the city centre given the constraint in the land supply, making it less preferable.

#### b. High Capital Costs Associated with Developing Infrastructure

Even as new areas are developed to meet the demand for residential real estate, support infrastructure such as roadways requires high capital expenditure. For example, total construction cost was at KD 500 million for Jamal Abdul Nasser Street Development Project and Jahra Road Project when they had reached 83% and 92% completion rates respectively.<sup>17</sup> KD 30 million has been allocated in FY2021/22 budget for the development of road and other services in Cairo Street project. As these expenditures are dependent on oil revenues, an unfavorable movement in oil prices could affect the spending on these projects.

#### c. Private Players Prohibited from Entering Residential Real Estate Market

The government owns 95% of the land in Kuwait and largely controls residential real estate development through parcelling of land plots and their allocation. Kuwait's laws restrict private companies from buying and trading residential property. While this was intended to control real estate prices and inflation, the efficiency and competition associated with private sector participation could improve supply. To address the concern of increase in prices, alternative measure such as price increase ceiling or increase in supply of buildable land could be considered.

<sup>15</sup> Arab Times/PAHW

<sup>16</sup> Zawya/PAHW

<sup>17</sup> MEConstruction News

**d. Lack of Financing Options/ Immature Mortgage Market**

In addition to the interest-free loans offered by Kuwait Credit Bank, local banks and investment companies in Kuwait offer instalment loans for housing that could be availed for purchase/construction of houses or repairs. However, in this case the house is not mortgaged and the salary of the borrower is considered as security. The loan amount is capped at KD 70,000. In case of house purchase, given the prevailing real estate prices, it would require significant investment from the borrower.

**6. Mortgages**

**a. Potential**

**i. Opening up Markets to Banking Players**

Mortgage loans where the property is offered as collateral, are subject to conditions such as the borrower having other income in addition to salary, the mortgage being availed on the second house, etc. A relaxation in the conditions would open up the mortgage market for banks.

**ii. New Draft Mortgage Law**

Kuwait Credit Bank's capital is dwindling, which according to a recent PAHW report, has enough capital to grant real estate loans for only 12,000 plots a year. A new draft mortgage law is being proposed as an alternative, which if implemented, would open up additional opportunities for banks and financing companies in the mortgage market. The proposed law allows banks and financing companies to extend mortgage loans with the interest being paid by the government to state housing program applicants. The law also allows banks and finance companies to repossess properties in the event of default and alternate housing is to be provided by the state for those who have been evicted.

**ii. Scope for Securitization**

A well-developed mortgage market would improve opportunities for securitization. This would allow banks to transfer assets off their balance sheet to the investors, in turn freeing up banks' capital, which could be productively deployed. In addition to boosting credit growth, these asset-backed securities would deepen financial markets and ease of trading of the securities would facilitate better price discovery.

**v. Increased Avenues for Public Private Partnerships to Augment Supply**

As a means to address the supply gap in housing, PAHW has been adopting public-private partnerships in housing development in recent years such as the USD 495 million deal to build housing development in Jaber Al-Ahmad and Sabah Al-Ahmad districts. This could increase the supply of residential units and in turn support demand for housing loans.

**b. Challenges**

**i. Lack of Yield Curve for Effective Pricing**

By reflecting long-term expectations of interest rates, the yield curve aids banks in the pricing of the loans. This would require active issuances for government bonds in different tenors and an efficient bond market. However, in Kuwait, the farthest expiry is that of a 10 year bond expiring in 2027. The absence of comparable rates for longer term loans impedes effective pricing.

**ii. Regulatory Caps on Pricing**

Interest rates that could be levied on housing loans are capped at a maximum of 3% on the current discount rate. The interest rate changes can be affected for instalment loans only once in 5 years, and these changes should also be within  $\pm 2\%$  of the current interest rate on the loan. Such regulatory caps could tighten credit supply and cause non-interest credit conditions.<sup>18</sup>

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<sup>18</sup> Federal Reserve Bank of Chicago

## **7. Conclusion**

Residential real estate is poised to grow driven by favourable demography, state housing program, attractive yields, and upcoming new residential developments. Faster implementation of projects with increased private sector participation would ease supply constraints and price pressures. Passage of the new mortgage law and additional measures such as availability of yield curve would pave way for a healthy mortgage market in Kuwait.