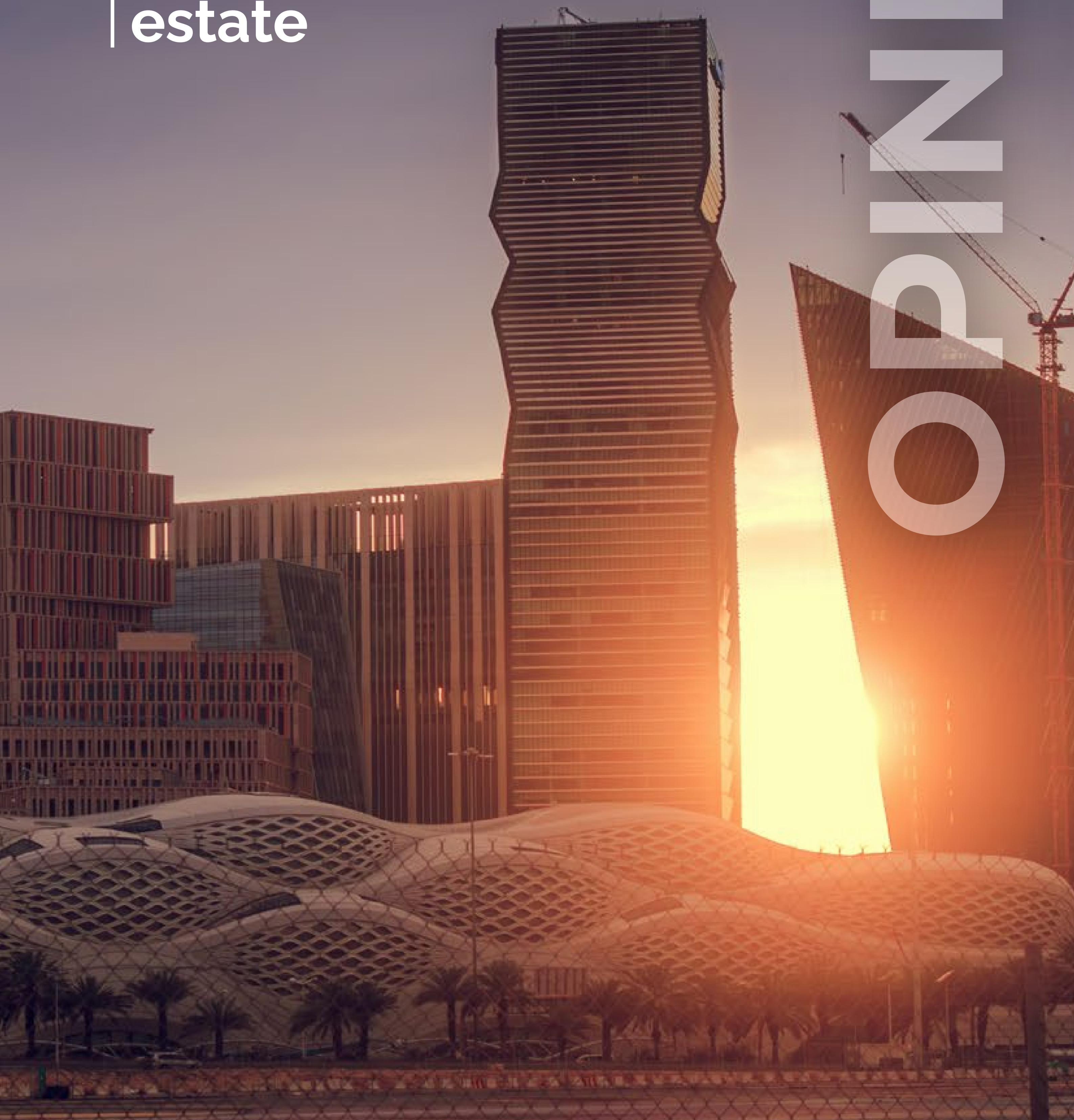
Cavendish Maxwell

OPINION

The significance of Gulf IPOs for real estate



IPOs have come back into fashion

In the Gulf, they have done so in spectacular fashion. 2021 was itself a record year for IPOs globally, but in contrast to the slowing global IPO market the tempo did not let up this year in the region. Ernst & Young reported that MENA IPO markets saw fifteen IPOs during Q1 2022.[1] In Q2 2022, there were nine IPOs This made the half-year total five times more than in 2021, whilst 'Total proceeds raised by MENA IPOs during H1 2022 were approximately US$13.5b, marking an increase of 2,952% compared with H1 2021'.[2] To put these figures in perspective, these IPOs represent more than 14% of the entire global value of IPOs in the first half of this year.[3]

The rest of the year may well prove much more subdued, with geopolitical issues raising perceptions of risk and many of the key planned IPOs now already away. Judging by what is already starting to happen on Gulf markets, the IPO window of opportunity is already narrowing.[4] Nevertheless, these are highly significant figures, placing the Gulf at the epicentre of global IPOs for fast-growth companies, energy companies and even real estate that started during the pandemic[5] and have continued apace thereafter[6] , as attention focused on IPO events and publications across the Gulf demonstrates.[7]

Why have IPOs revived here?

In principle, IPOs are just another way of financing a company, and by no means the least expensive one. Companies, it is said, ought to imbibe bank debt before they turn to external equity, and even when they do, the IPO route is said to be slow, often expensive, and fraught with problems along the way. When governments seek to exit from established businesses and promote local capital markets at the same time, however, as they have done in the UAE,[8] and Saudi Arabia,[9] with e.g., the Abu Dhabi Ports, ADNOC Distribution, ADNOC Drilling, Borouge, DEWA and Fertiglobe IPOs, the motivations for exit are. Felicitously, the attractions of high dividends amidst a stable regulatory background in the region are evident to investors, including global private equity players such as Blackrock, Fidelity and Vanguard; the result has been oversubscription, spectacularly so with the retail tranches.[10]

That vibrant real estate markets work in tandem with succcesful IPOs is intuitively highly plausible; research suggests that FDI, as measured by urban economic openness (UEO), the degree to which a certain region or urban area within a country is integrated with foreign countries is a common factor for both.[11] But what does this two-way traffic mean for real estate markets when IPOs accelerate? It is good news, but the effects occur in three different ways.

Benefits for the housing market

The short-term connection between successful IPOs and local housing markets has been frequently observed worldwide, e.g., the IPO of Alibaba was followed by soaring housing prices at its headquarters city, Hangzhou,[12] whilst in the USA the housing market in Silicon Valley has been closely correlated with local IPOs as as function of wealth effects. What has however become clear is that these effects are highly localised, piling on house price increases in congested and/or low-affordability areas,[13] all of which demonstrates the need for the kind of data that facilitates analysis at a granular level.[14]

Economic benefits for commercial real estate

Longer term, commercial real estate as an asset naturally depends on the health of the overall economy, and residential real estate, especially mid-market, also benefits from the acceleration of job opportunities that listed companies can deliver.[15] Both benefits emphasise the importance of what kind of IPO: the benefits accrue from firms such as Al Nahdi Medical Co, which raised US$1.38b in the Kingdom's biggest IPO since Saudi Aramco's listing in 2019, and digital security firm, Elm Information Security Company, which are major users of commercial space. To the extent that IPOs provide them and those that follow with the opportunity for consistent growth, this is of obvious benefit to commercial real estate, especially in Jeddah and Riyadh where they are respectively based.[16]

Raised opportunities for real estate companies

The second type of benefit is less well-documented, but equally valid. IPOs provide opportunities for real estate companies themselves. The diversification of listed Exchanges in the Gulf, with now - despite the rise of REITs in the region - only 18% of the market taken up by real estate companies compared to more than twice that a decade ago, entails a more relaxed environment for potential listing by developers or investors.

This is not to suggest that taking advantage of these opportunities is easy. It is hard to disagree with Paul Go's assessement that going forward 'Investors are refocusing on companies with resilient business models and profitable growth, while embedding ESG in their core business values'.[17] Preparations for any IPO are necessarily extensive,[18] A successful initial public offering (IPO), whether on a Gulf Exchange or elsewhere, a difficult choice in itself, involves sustained planning and effort, both to deliver the IPO and then to adhere to the regulations of a public company thereafter. including undoubtedly the need for accurate valuations, whether of existing assets or work-in-progress. Moreover, the increased sophistication of investors places additional requirements on companies to make strategic choices that as private entities they can avoid, such as sectoral and geographic focus. Hence the temptation of the freewheeling SPAC route where these requirements can be circumvented: there is now a framework in place for the ADX, and there may be more across the Gulf.

Conclusions

The Gulf real estate market does not depend on the success of IPOs, any more than it does on rising stock market prices generally, but the two work successfully together. Just as the indirect local market effects of individual IPOs are very localised, however, and critically dependent on flotations by new, growth companies, real estate companies need to judge their timing for their own flotations very carefully. The need for expert advice, financial transparency and above all clarity of strategy purpose has never been clearer.

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