FDI and Real Estate in the GCC, Jordan, Iraq and Egypt: Perceptions, Benefits, Challenges and Risks

Research into foreign direct investment tends not to differentiate in any detail between real estate and any other type of foreign direct investment. From a legal perspective however, foreign ownership of and therefore investment in real estate in the GCC, Jordan, Iraq and Egypt is usually the subject of separate regulation.

In this article, we consider:

1. some of the perceptual issues pertaining to foreign direct investment in real estate;
2. some of the benefits of allowing foreign direct investment in real estate;
3. strategies available to mitigate against any concerns regarding foreign direct investment in real estate; and
4. challenges faced in terms of attracting foreign direct investment in real estate.

Perceptions

Amongst the developed OECD countries, the tendency in recent history has been to remove barriers to foreign direct investment and promote equality of treatment and open competition. Barriers to foreign direct investment have, of course, remained in certain strategic areas. In real estate terms, such strategic areas have tended to be areas of historical or cultural significance or land pertaining to strategic industries or infrastructure.

Countries in the GCC region however, have tended to have much broader restrictions on foreign ownership of real estate. The standard position has been to restrict foreign ownership of real estate unless expressly permitted. Permissions have been created through establishing designated areas in which foreigners can own, approving certain types of assets for ownership by foreigners or by approving certain classes of individuals or companies to own.

Whilst the reasons for taking a restrictive approach to foreign ownership are not, in most cases, a matter of public record, we assume the following concerns may play a part:

1. concerns about a form of economic colonisation due to price inflation and crowding out of local ownership;
2. concerns about immigration and a watering down of national identity;
3. concerns that the laws and systems in place are insufficient to regulate foreign ownership;
4. concerns about instability caused by the sudden inflow or exodus of foreign capital; and
5. linking the policy objective of increasing the participation of the local workforce with the need to also reduce foreign ownership .

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The benefits of Foreign Direct Investment in Real Estate

It is worth noting that real estate, in addition to being an important economic sector itself, is an enabler of other economic sectors. Without real estate investment it is likely that supply problems will emerge causing rents to rise or other headwinds that can hinder the growth in other sectors of the economy. As an enabler, real estate investment is also dependent on there being an active market of end users.

Having restrictive foreign ownership laws in relation to real estate can also cause downstream problems for other sectors of the economy opened up to foreign investment. For example, where foreign ownership of businesses is allowed and those businesses own real estate, the business may need to be restructured or divest itself of its real estate prior to allowing any foreign investment.

Many of the concerns regarding foreign direct investment in real estate are particular to the residential sector. It is not the case however, that the right for foreigners to own residential real estate of itself alters the demographics of a country. Such changes would require relaxation of visas and residency rights. It would be true to say however, that having liberal and transparent immigration arrangements would support foreign investment in a residential real estate market.

The right of foreigners to invest in and own residential real estate unlocks far more capital that can be committed to building and owning residential stock. Moreover, foreign ownership could reduce the level of remittances by foreign workers. It would also allow more foreigners to secure finance for SME business purposes by using home equity as security for the bank.

Unlocking foreign investment in real estate is also important for real estate sectors other than residential such as industrial real estate including projects that may be the subject of Public Private Partnerships. This is due to the use of Build-Operate and Transfer models which allow the private partner to finance and benefit from the facility for a period prior to it returning to public sector ownership. Such projects are less attractive where there is uncertainty regarding the ownership and transferability of the real estate interests.

Below we take a foreign investor's perspective in assessing the challenges some regional jurisdictions may have in attracting foreign direct investment in real estate. We also consider how some of the concerns discussed above can be mitigated.

Risks and Mitigation Strategies

Many of the concerns associated with foreign ownership of real estate can be mitigated against. For example, concerns regarding the crowding out of local ownership can be minimised through setting aside areas in which foreigners can own and ensuring there is an abundance of land designated only for nationals to own.

Instability due to capital inflows or outflows can be addressed through adjustable lending caps and transfer fees or taxes in order to dampen price inflation and regulate the market.

As highlighted above, foreign ownership of real estate does not of itself create or cause immigration.

Accordingly, protection of the national identity and alignment of other policy objectives such as local participation in the workforce could be addressed through other policy measures.

Where sensitivities around foreign ownership by individuals cannot be overcome, real estate sectors could be opened up to institutions to participate in foreign investment and ownership such as real estate investment trusts or other fund structures.

Challenges in Attracting Foreign Direct Investment in Real Estate

Notwithstanding the restrictive approach generally taken with regard to foreign investment in real estate in the region, most jurisdictions in the region have been actively promoting foreign investment in general terms including in relation to real estate.

Some of the barriers to attracting foreign direct investment in real estate are the following:

1. failing to have clear and easy-to-follow rules around foreign ownership of real estate including the nature of the interest owned, the succession processes and visas;
2. linking, too closely, the right to own real estate with visas or the business operations of the owner meaning that the owner must divest itself of the real estate interest should the owner's circumstances change;
3. failing to have dynamic and secure land registration systems;
4. uncertainty regarding the ongoing management of strata or jointly owned properties;
5. difficulty in obtaining credit due to unclear or untested mortgage registration and credit recovery procedures;
6. unclear or inflexible rules regarding the types of legal entities that can own real estate;
7. complexities regarding transfer processes and fees; or
8. the inability to recognise or differentiate between different types of ownership such as freehold and registered leasehold interests.

Conclusion

Real estate is an important enabling sector of the economy. Opening up real estate to foreign investment can therefore allow other sectors of the economy to expand more readily. To the extent that foreign ownership of real estate is considered sensitive, a targeted approach to regulation could be adopted to mitigate against concerns and perceptual issues. It is important however, that any regulation and supporting land registration systems meet international expectations in order to attract such foreign investment.

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