SAUDI FINANCIAL MARKETS ADAPT TO NEW REGULATION

The government of Saudi Arabia has recently passed new financial laws that it hopes will boost its real estate markets. But the country must continue to strive for improvement.

A place to call home

While Saudi Arabia is a comparatively wealthy country, the level of homeownership is tiny in contrast to Western economies, says Chaoul. “It is obviously a very rich country, yet if you look at the home ownership here it is extremely low. Depending on the studies, you’re getting a number of around 25 percent, but that means about 75 percent of people do not own their homes.

Homeownership is an integral part of building a strong community, says Chaoul, as otherwise people do not take care of their immediate surroundings. “When I think about home ownership, I think of what Larry Summers… said: ‘In the history of the world, no one has ever washed a rental car.’ The fact of not owning your house has an amazing social ramifications. It’s not only economic implications. It’s only with homeownership that people start taking care of their immediate environment.”

One of the ways in which the level of homeownership can be improved is by reforming mortgage laws, and so Chaoul welcomes these latest reforms by the government: “They’ve seen at what happens around the world, and homeownership is highly correlated with mortgage markets.” The mortgage penetration in Saudi Arabia is only two percent, but it is 70 percent in the US and 72 percent in the UK. So they have enacted these laws to allow commercial banks to offer mortgages, have clearer foreclosure rules, and so on.

Despite the clear progress that has been made, Chaoul believes that the country must not be complacent with the reforming strategy, and must continue to reshape the regulatory environment so that the market can really take off. “The problem in this region is that sometimes they announce the laws and think that the job is done,” he says.

Internationally, you see that actually enacting the laws may just be the first step; it is followed by a number of policies and framework build up and it can take up to 10 years for those laws to have an impact on the market. The financial institutions have a mismatch between their deposits, which have little incentive to call home.

A new regulatory environment

Creating this secondary market will only be achieved by the provision of liquidity in the market and making it worthwhile to develop. “You can’t create a secondary market by only allowing finance companies to hold securities in that market,” says Chaoul, “you have to provide the liquidity for that market. That is something that they haven’t done yet in Saudi Arabia.”

“It also doesn’t stop at just the secondary market. You have to have public policy. You have to be able to provide subsidised housing. You have to provide support and incentives to developers, because the land is very expensive in Saudi Arabia. All the oil revenues went into land, and so prices are now extremely high. You ask a developer to build lower-middle income housing and he’ll ask if you’re out of your mind. So you have to provide incentives. Until you start doing that, you’re not going to solve the supply side of the housing crisis. And this is not all. You have to have all the remaining industries that are satellites to the housing industry: title insurance, mortgage insurance; standardised evaluators; electronic databases for land ownership. And so on and so forth.”

Chaoul says an overarching framework needs to be put in place so that there is a true incentive for investors to operate in. “Today, every time you want to hold security you have to go to the regulator to get her approval for every single security. There’s no overall framework that is regulating that activity, so that every time that wants to go and issue a security can do it in a standardised way.”

He is encouraged by the move towards a new regulatory environment, and hopes that this reform agenda is maintained in the long-term. “You have to start somewhere, and I commend and respect the government for introducing these rules. The problem today is that everyone now says the problem has been solved, and that is a mistake. By the time they realise that that is not the case, it’s another five years.”

Aside from real estate, private equity is also beginning to show interest mostly of opportunities, which Chaoul describes as “a blank canvas across all sectors.” Part of the reason for this is the Saudi people’s desire to own physical assets. “Private equity has landed on the shores of the Middle East lately, and obviously there’s a lot of interest in it,” says Chaoul. “People in this part of the world are keen on physical things. They have in their psyche the idea that real estate and private equity are safe investments. They do not view the illiquidity as a huge risk factor. If you look at the concentration of wealth, in real estate and private equity, and compare it on a global basis, you will find that it is extreme in this part of the world.

Private equity firms are also likely to benefit from the large number of family businesses that might be going through structural changes. “We’re seeing a generational change taking place,” says Chaoul. “There are a lot of family businesses that are transitioning, or there are expansion opportunities, or they need capital. People in this part of the world have the resources, andprivate equity is by itself a natural candidate for the region.”

Community and environment

Another aspect of Chaoul’s strategy is its advertising to sharia-compliant banking methods. Chaoul says that much of this form of banking has the same structure in the aspects of Western style finance: “When you think about Islamic finance, the way it is practiced is really ethical finance. The world already has a phrase for it: corporate social responsibility (CSR). If you look at CSR, it is not very different to the tenets of Islamic finance. Everyone will have their own particularities, and everyone will have their own sharia lawyers. But there are many similarities in the two.”

While Malaysia has led the way in developing Islamic finance, there is clear potential for it to take off across the Middle East, he adds. “The market is still in its infancy. There’s still a significant amount of penetration to be made. If you were to take the penetration seen in Malaysia and apply it to the rest of the Islamic world, the sky is the limit.”

Alkhabeer’s plans for the coming years are based around strengthening its core business, while looking to grow across the region, says Chaoul. “We have three legs of the stool: real estate, private equity, and capital markets alongside an investment banking and advisory business. Over the next few years we’re looking to strengthen those legs of the stool. We have about eight or nine funds out there today between real estate, private equity and capital markets.”

Alkhabeer’s presence stretches internationally in both real estate and private equity, with a development fund in London and plans to secure a number of transactions in the US this year. One of its private equity funds, which closed in December, also has underwriting assets in the UAE. Chaoul adds that over the next few years the firm wants to develop its capital markets offerings, and will be aggressively marketing it across Saudi Arabia and the region, while he also expects the company to expand its presence into different parts of the country. His primary ambition is to become the expert for the region in all of those areas. “We want to be seen as the go-to people for anyone who wants to invest in the region,” says Chaoul.