Dubai: A High Rise, Then a Steep Fall

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DUBAI -- As financial crisis roiled much of the world in October 2008, the head of Dubai's biggest state-owned developer unveiled his latest megaproject: a $38 billion development that would include a tower nearly two-thirds of a mile tall.

"I'm sure most of you are asking why we're launching this, and you'd be mad not to question it," said the executive, Chris O'Donnell, at a news conference. Though there would be economic ups and downs in the years needed to build the tower, he told listeners, demand would continue to outstrip supply.

"The fundamentals in the market are too strong," he said. "There won't be a crash."

Since then, residential real-estate prices in Dubai have slumped by almost 50%. Developers have slashed jobs and scrapped projects. Groundbreaking on the tower was long ago put on hold. The yearlong retrenchment culminated in last week's surprise announcement that Dubai would seek to restructure $26 billion of debts owed by Dubai World, the holding company for many of the government's port, infrastructure and real-estate businesses.

Behind this jolt was one of the world's most concentrated property bubbles. Some $430 billion worth of construction projects have been scrapped across the United Arab Emirates, a desert country with a population of just 4.5 million and an area smaller than South Carolina. The majority were slated for the emirate of Dubai, according to estimates by the Middle East Economic Digest, a regional projects tracker.

The boom was fueled by easy credit, a poorly regulated market overrun by speculators, and cheerleading from Dubai officials -- including the hereditary ruler, Sheik Mohammed bin Rashid Al Maktoum.

His vision for the city -- a tolerant, modern metropolis open to the world, its many faiths and some of its excesses -- has long rankled conservative Arab neighbors, including some officials in Abu Dhabi, the buttoned-down capital of the U.A.E. But for others, Dubai became a symbol of what a modern Arab state might achieve if it embraced the West and its financial system. President Barack Obama, in a June speech to the Muslim world in Cairo, singled out Dubai as a place where economic development worked.

“ Humans are really the same everywhere, subject to the same hopes and delusions and will participate in a mania wherever it crops up...Bubbles are great if you get in early enough. Just don't stay long! ”

— *James Morrison*

Dubai's soaring skyline is a symbol of pride here. At a National Day parade this week, men dressed in traditional Arab garb pushed floats consisting of scale models of the city's iconic buildings. There were models of the Burj Dubai -- the world's tallest skyscraper, due to open next month -- as well as the sail-shaped Burj Al Arab hotel and the Mall of the Emirates, which houses an indoor ski slope.

"Our leaders have been able to achieve all of this," said Ahmed Al Hammadi, watching the parade. As for the current debt crisis, "we will come out of it stronger," he said.

Officials and developers justified the breakneck pace at which these were built by touting Dubai's proximity to both Asia and Europe, its tax-free and tolerant way of life and its position as the region's business hub. Foreign executives, architects and real-estate brokers flocked here for the seemingly limitless scope to pursue big projects. International debt and property investors bought into the dream, too, until global financial markets seized up and much of the world plunged into recession. Then, buyers began to bail out, employers shed staff and companies put expansion on hold.

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The result is a jaw-dropping real-estate overhang. "To Let" signboards adorn the facades of dozens of recently finished buildings along Sheikh Zayed Road, the superhighway that cuts through the city's canyon of skyscrapers. Office vacancies in new buildings run at 41%, according to international property agency Colliers International.

After taking markets by surprise last week with a request to delay debt payments at Dubai World by six months or more, the government here said early Tuesday it would begin a multiphase restructuring effort aimed at the company's debt, including $6 billion related to lending by the state-owned property developer, Nakheel. It said the restructuring would include the assessment of "deleveraging options," including asset sales. Dubai World said it had started discussions with its banks and these were proceeding on a "constructive basis."

International securities markets recovered their poise after a scare, but the effects aren't just financial. The debt announcement appeared to open a fresh rift between Dubai and U.A.E. capital Abu Dhabi. Federal officials there were livid at being left in the dark by Dubai's decision to seek a debt standstill, say people familiar with the situation. The rift has the potential to unsettle an important U.S. ally in the Persian Gulf, because Dubai, as a re-export hub and offshore financial center for Iranian businesses, is seen as key to U.S. efforts to isolate Iran.

Dubai and Abu Dhabi officials have underscored unity in recent days. But while the U.A.E. federal government orchestrated a $10 billion bailout earlier this year for Dubai companies, it hasn't stepped in to offer assistance to Dubai World.

Dubai's growth began in the early 1980s when Sheik Mohammed and his father pushed to diversify the economy in the face of dwindling oil. Dubai built luxury beachside hotels to lure wealthy visitors from India, Asia and the Middle East, plus package tours from Europe and Russia. In 2002, Sheik Mohammed opened the door to foreign ownership of property in certain developments. With little

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more than a brochure and a floor plan, buyers began to slap down deposits on townhouses, apartments and villas that wouldn't be ready for years.

Aarti Chana was living in the U.K. in 2004 when Nakheel pitched a project called Palm Jebel Ali to prospective buyers. As the second piece of a spectacular development jutting out in the sea in the shape of a palm tree, Palm Jebel Ali would include homes built on stilts, forming a 7.5-mile chain spelling out an Arabic poem written by Sheik Mohammed. "It takes a man of great vision to write on water," the poem reads in part.

Many units would be ready for occupancy by December 2009, Nakheel said. Ms. Chana, now 38 years old, put 10% down on a $780,000 five-bedroom beachfront villa and, making plans to settle here, sold her house near London. "I believed in the Dubai story," she says.

In 2006, Sheik Mohammed consolidated a handful of government businesses into the Dubai World holding company, with Sultan Ahmed bin Sulayem as its leader. To head Nakheel, Mr. Sulayem, in turn, plucked Mr. O'Donnell from Australia, where he headed a fast-growing property fund.

Messrs. Sulayem and O'Donnell declined to comment for this article. A spokesman for Nakheel didn't respond to emailed questions, nor did a spokesman for Dubai's ruler.

Nakheel was on a roll, preparing to open the first of the palm developments, Palm Jumeirah, and planning the next two. In September 2006, at a separate, 914-acre residential community called Jumeirah Park, villas starting at $654,000 sold out in a day. International banks and local lenders offered loans for up to 97% of the purchase price.

To help finance all this construction, Mr. O'Donnell turned to the bond markets. An investor presentation in November 2006 called Dubai a "vantage access point" that would draw in businessmen from a wide swath of the greater Middle

East, from India to Egypt. It projected that Dubai's population, then just under 1.2 million, would grow by two million in 14 years.

Investors rushed to buy a piece of Nakheel's Islamic bond, known as a sukuk. Swamped by demand, the borrower increased the issue's size to $3.5 billion.

That year, Dubai's real-estate sector raised $4.9 billion through bonds and syndicated loans, according to data provided by Thomson Reuters. Real-estate borrowing soared in 2008 to $30.4 billion.

In 2007, a Dubai World affiliate bought the Queen Elizabeth 2, unveiling plans to moor the ocean liner at the Palm Jumeirah and turn it into a luxury hotel.

By then, cracks in the real-estate market were forming. Officials had put few regulations on development that might limit the speculation. Now, concerned that the market had grown overheated, they did so. And in early 2008, authorities embarked on a series of high-profile corruption investigations at some big real-estate and finance firms.

But police, courts and the companies themselves disclosed little about the probes. As a result of the lack of transparency, the crackdown on corruption, instead of comforting investors, spooked them.

"There is a complete distrust by investors in the system," said Michael Diaz, a Miami-based attorney with offices in Dubai. Dubai and U.A.E. officials say they have made efforts to improve the legal system.

In April 2008, police detained the Lebanese-American chief executive of one of Dubai's top developers. The company didn't disclose the arrest until after it was reported in the press. He denied wrongdoing

A string of other detentions followed at some of Dubai's biggest companies, including Nakheel. A Nakheel spokesman didn't answer emailed questions about

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the probe.

Typical was the case of British developer Arthur Fitzwilliam, an affable 58-year-old polo fan from London. He had lived in Dubai for two decades, dabbling in real estate and other ventures. In 2004, he inked a deal to develop a 14.5 million-square-foot plot of desert acquired from a government-controlled company.

The Plantation Equestrian and Polo Club would have air-conditioned stables for 800 horses, four polo fields, facilities to host horse shows and a five-star hotel. Mr. Fitzwilliam sought partners to help finance the project. A British banker agreed to provide financing, in exchange for a 30% stake, Mr. Fitzwilliam said in an interview.

But in June 2008, authorities detained Mr. Fitzwilliam, the banker and one other. Then in September, Dubai Islamic Bank, or DIB, foreclosed on the land for the project. It also seized more than 100 polo ponies, Mr. Fitzwilliam said. For almost a year, he sat in jail before charges were filed. In March 2009, authorities charged seven men with scheming to defraud DIB, according to a bill of indictment filed by Dubai's public prosecutors. Mr. Fitzwilliam was accused of aiding the scheme.

Last month, he was transferred to a Dubai hospital to undergo tests for cancer. Four Dubai police officers stood guard outside his room.

Mr. Fitzwilliam denied any wrongdoing, as did the British banker he was working with. "I want a fair trial, and I'm prepared to go with the system," he says, shackled to his hospital bed. "Anyone who knows the case knows I'm not guilty."

A spokesman for the Dubai prosecutor's office didn't respond to requests for comment.

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Amid the uncertainty surrounding the arrests, the crisis roiling the rest of the world was catching up with Dubai. When global credit markets froze up in late 2008, international investors stopped buying Dubai property. Some who had already bought stopped making installment payments. Nakheel and others shed staff and scrapped or delayed dozens of projects.

Last February, the troubles touched Ms. Chana's plan for a new home in Dubai. Nakheel halted work on the Palm Jebel Ali. Though dredging had been done, little construction had.

Ms. Chana says she has sunk about $550,000 into her still-unfinished home. Earlier this year, she flew to Dubai to try to salvage the investment. She is living in a hotel-apartment with her daughter, helping to organize other investors and petition Nakheel for rebates. "I just won't let this drop," she says. "It's become my obsession."

In October, Nakheel proposed that Jebel Ali investors transfer their contracts to property elsewhere that is already finished or close to it.

Simon Murphy bought a $240,000 ground-floor apartment in the Palm Jumeirah in 2002 and moved in five years later. He is now a "resident representative" to Nakheel, like being part of a homeowners board. He says that in recent weeks, Nakheel has cut back on maintenance, including tree trimming.

Since Dubai's debt-standstill announcement, Mr. Murphy says, many apartment residents have stopped paying management fees, typically around $700 a month. Nakheel declined to comment. "Most people fear that their money will go into the bottomless pit of Nakheel debt," Mr. Murphy says.

—Andrew Harrison and Maria Abi Habib contributed to this article.

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