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EVALUATING THE FACTORS AFFECTING REAL ESTATE INVESTMENT DECISIONS IN THE UNITED ARAB EMIRATES

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Abstract

Analyzing the influence of socioeconomic factors and behavioral components on investment decisions, particularly on the estimation of cognitive biases and heuristics, remains undervalued. This is especially the case given the potential offered by the UAE real estate market to diversify the UAE's economy, along with its lucrative profitability. One of the most advanced markets in the UAE is Dubai, which offers facilities for overseas investments. The value of real estate in the region is considered a basis for global real estate investments. Probing the investment behavioral peculiarities in the international real estate markets, Dubai offers a unique case study of behavioral real estate. Within the UAE, as well as globally, the behavioral components and patterns of investments in the UAE's real estate market exhibit a combination of rational and psychological biases driven by government investment policies, the influence of overseas investments, and the thought patterns of investors involved. Supplementing the behavioral real estate discourse, the study provides a detailed examination of investment patterns in the property markets of emerging markets, specifically in the UAE, through an overarching behavioral finance lens. This study highlights that behavioral biases such as loss aversion, overconfidence, and herding significantly influence investment decisions in the UAE real estate market, often leading to suboptimal outcomes. Investors can benefit from setting clear goals, conducting thorough analyses, and enhancing their financial literacy to mitigate these biases. The findings provide practical insights for investors, managers, and policymakers, bridging gaps in the literature and enhancing real estate investment practices.

Keywords: Real Estate, Behavioral Finance, Investment Decisions, UAE, Heuristics, Risk Perception

Introduction:

Traditional finance bases its valuation on wealth maximization and risk minimization, assuming all investors act rationally (Cutler et al., 2024; Abdul Kareem et al., 2023). However, behavioral finance argues that irrational decisions in investments can stem from psychological factors, personality traits, and biases, such as overconfidence, herding, anchoring, and mental accounting (Kaban & Linata, 2024; Jain et al., 2023; Karki et al., 2024). Individual investors exhibit a significant portion of speculative trading, characterized by under-diversification and risk underestimation, which can vary depending on interacting demographics, including age, gender, and wealth (Liu et al., 2024; Mushtaq et al., 2024). Although risk perception fluctuates, attitude toward risk remains constant, and biases such as the disposition effect and herding can lead to market inefficiencies, even if rational arbitrage exists (Rashid et al., 2022).

The rapid expansion of the UAE real estate market, driven by government incentives and the participation of expatriates, presents a unique and significant situation, as it also holds considerable economic importance (Mordor Intelligence, 2024; Khan et al., 2022). Investors in this market are influenced by a myriad of factors, including behavioral biases, risk appetite, financial literacy, and demographic characteristics such as gender, income, and nationality (Ali et al., 2023; Anis & Soegiharto, 2023). While men, on average, tend to exhibit higher financial literacy and are more willing to take risks, specific attributes, such as personality and marital status, appear to have little effect. Prior studies have identified several significant unexplored areas, particularly in understanding the integrated influence of multiple biases in developing economies, such as the UAE (Cutler et al., 2024). This study aims to rectify this by examining the impact of behavioral biases, risk perception, and financial literacy on investment decisions in the UAE real estate market.

Literature Review

Real Estate Concept

Real estate encompasses land—and the buildings and infrastructure that occupy it—regardless of whether it is developed or undeveloped (Abdul Kareem et al., 2023). Legally, it consists of a spatially defined piece of land and associated buildings, which are recorded in the land registries (Abideen et al., 2023). The sector encompasses a range of property types, including residential, commercial, industrial, and historical. Each of these presents unique complications in terms of valuation and investment. The motivations of investors also vary. They may buy properties to use personally, earn rental income, speculate on value changes, or keep them under a preservation order.

The intricacies of the real estate industry stem from the different meanings it holds in various branches of study. Socially, culturally, and politically, it interacts in realms broader than those of a "cash flow machine" (Anis & Soegiharto, 2023). One of the definitions is an asset with built and outdoor structures used under various constraints for commercial, trade, or service purposes, as well as consumption (Haddad, 2023). Real estate has gained recognition as an interdisciplinary field since the 1990s, although some scholars still contend that its detachment from traditional economics is insufficient (Bihari et al., 2022).

The real estate market serves as the framework for the buying, selling, leasing, and mortgaging of real estate, as well as for the brokerage of these transactions. The state upholds the legality and transparency of these transactions (Kaban & Linata, 2024).

Real Estate Scenario in Dubai and Other Emirates

The United Arab Emirates (UAE) is a federation of 7 emirates. The emirates utilize the oil and gas revenues generated from Abu Dhabi, while the other emirates, primarily Dubai, have expanded into various ventures, including real estate, trade, tourism, and investment (Rashid et al., 2022). Foreign nationals may obtain property ownership, but through legal

frameworks that define ownership through usufruct, residence and use rights, and Musalaha rights under Sharia law (Anis & Soegiharto, 2023).

UAE and GCC nationals may obtain freehold ownership. However, foreigners from non-GCC countries are granted freehold ownership rights only in certain designated areas (Abdul Kareem et al., 2023). In Ajman, non-GCC foreigners can usufruct or hold freehold rights for 50 years, while Fujairah and Ras Al Khaimah restrict full ownership to nationals (Khan et al., 2022).

The Dubai Land Department (DLD) oversees real estate governance activities in Dubai. Its subdivisions also perform governance activities in different sectors. RERA performs governance activities in real estate regulations and land provisioning (Mushtaq et al., 2024). RERA also oversees the licensing and protection of escrow accounts, as well as regulates real estate brokerage and development activities. Emaar, DAMAC, and Aldar are the leading players in the UAE residential property market (Liu et al., 2024). The Dubai property market has rebounded post the 2014 oil crisis and the subsequent oversupply challenges. The market has been buoyed by government reforms such as the 10-year golden visa policy and remote-work residency permits (Mordor Intelligence, 2024).

Motivations for investment vary across different nationalities. Europeans and UAE nationals tend to hold more social and emotional values, whereas Arabs and Asians are more financially and structurally motivated (Rehmat et al., 2023). The Dubai market is inherently volatile and has an active oversupply, creating challenges for the market. Investors also struggle with determining the present and future value of the property due to the uncertain investment cycle, nearby developments, and macroeconomic conditions (Ahmed et al., 2022).

Dubai's status as a cosmopolitan center is primarily attributed to its appeal to overseas investors and visitors, following the enactment of Law No. (7) of 2006 on Real Property Registration in Dubai, the return on investments in real estate increased considerably. A well-

researched market evaluation helps participants understand prospects and balance risks (Haddad, 2023).

Traditional Finance Theory (Classical Theory)

Traditional finance theory is grounded in the assumption that investors act rationally, markets are efficient, and decisions are made based on unbiased and readily available information. Within this framework, investors are expected to maximize wealth by objectively assessing risks and returns, while market forces ensure fair valuation of assets. Four assumptions are central to this perspective: investors behave logically, markets operate efficiently, portfolios are constructed according to mean-variance optimization, and expected returns depend solely on systematic risk, as captured by the Capital Asset Pricing Model (Jain et al., 2023). While these principles provided the foundation for modern finance, they are limited in their ability to explain real-world anomalies, particularly in markets such as real estate that are less transparent and more heterogeneous than financial markets.

The Efficient Market Hypothesis (EMH), formulated by Fama (1970), is one of the pillars of traditional finance. It argues that asset prices reflect all available information, meaning it is impossible to outperform the market consistently except through luck. According to EMH, prices move randomly as new information emerges, making them inherently unpredictable. While empirical evidence supports the weak form of EMH in developed markets, critics argue that it oversimplifies investor behavior by ignoring irrationality and psychological biases. Real estate markets in particular challenge the EMH, as property valuation often reflects localized conditions, cultural influences, and investor sentiment rather than purely rational assessments (Haddad, 2023).

Closely linked to EMH is the Market Equilibrium Theory, which explains that the interaction of supply and demand determines prices. Value is perceived differently by producers and consumers, and the price serves as the mechanism that balances these

perceptions (Cascão et al., 2023). In real estate, equilibrium is affected by factors such as income, capital investment, inflation, population growth, and government policies (Kamoune & Ibenrissoul, 2022). Although this framework captures the economic forces behind price fluctuations, it neglects the behavioral dynamics that shape investor decisions under uncertainty.

Other theories from the classical tradition also contribute to understanding financial decision-making. The Theory of Reasoned Action (TRA) and the Theory of Planned Behavior (TPB) emphasize how individual intentions influence decisions, connecting them to attitudes, social influences, and perceived control over resources (Ajzen, 1991; Khan et al., 2022). Although these theories originated in psychology, they have been applied to finance to demonstrate that market data do not solely determine investment choices but are also influenced by internal motivations and external constraints, such as time, resources, and social pressures. Risk-related frameworks also enrich traditional finance. Bounded rationality, as proposed by Herbert Simon, suggests that investors make decisions within the limits of available information and cognitive capacity rather than optimizing perfectly. Risk aversion theory and risk homeostasis theory further emphasize how individuals evaluate uncertainty, showing that people adjust their risk-taking based on perceived safety or vulnerability (Owusu & Laryea, 2023).

Finally, the Behavioral Portfolio Theory (BPT), although emerging from critiques of traditional finance, is often linked with this body of work. Unlike Modern Portfolio Theory, which assumes investors seek only to maximize return for a given level of risk, BPT suggests that investors structure portfolios to satisfy multiple goals, such as protecting against losses while also striving for gains. In real estate, for example, investors may choose properties not only for expected financial returns but also for emotional satisfaction, social prestige, or security for future generations (Rehmat et al., 2023). Taken together, these classical approaches

establish the foundations of financial decision-making, though they remain limited in capturing the irrational and emotional aspects that increasingly dominate investment behavior.

Behavioral Finance Theory

Behavioral finance appeared as a new branch of finance due to the shortcomings of the traditional finance model. The integration of psychology, sociology, and economics makes behavioral finance a more realistic and comprehensive approach to understanding financial decision-making. The concept of a rational investor is dismissed by behavioral finance, which argues that biases, emotions, and the use of heuristics do, in fact, break rationality. One of the leading paradigms is that markets are inefficient, investors' reasoning may not be rational, and the prices of financial assets do not accurately reflect their fundamentals but are somewhat influenced by distorted rationality, emotions, and sentiment (Cutler et al., 2024).

The behavioral finance branch was built on the work of Kahneman and Tversky and their Prospect Theory (1979). This work laid the foundations of finance by arguing that people do not evaluate outcomes in absolute terms, but rather relative to a given reference point. People are risk-averse in situations involving potential gains but gain-seeking in situations involving potential losses. This was referred to as loss aversion. This is particularly true in real estate, where investors often do not dispose of a losing real estate investment. Loss recovery is hoped for. This was the first work to emphasize the importance of perception and framing in the decision-making process, and the irrationality that was a core assumption in traditional finance was exposed.

Heuristics play a crucial role in behavioral finance. Representativeness, availability, and anchoring are examples of mental shortcuts that can lead to erroneous decisions by investors. When appraising property, an investor may assume that the property's price trends will continue (representativeness), rely on available information, such as recently published data, to assess risk, and overestimate the property's purchase price (anchoring). Although these

heuristics are beneficial in dealing with uncertainty, they can lead to systematic errors (Owusu & Laryea, 2023).

There are several biases prevalent in the context of finance and real estate, primarily overconfidence and the disposition effect. Overconfidence bias leads investors to overestimate their ability to predict the market and their own knowledge, resulting in more trading and decreased returns (Liu et al., 2024). The disposition effect is the emotionally driven tendency for an investor to sell winning assets too quickly, while retaining losing assets. Herding, that is, imitation of other people's decisions, is another bias that leads to speculative market bubbles, particularly in real estate. These and many other biases explain the anomalies that classical theories of finance have failed to account for, such as overpricing, excessive market volatility, and delays in adjusting to and responding to new information.

Although behavioral finance has explanatory power, it has also been subject to criticism. Some argue that it lacks a cohesive theoretical model and that explanations are drawn from diverse and disparate areas of psychology. Other critics argue that the behavioral model places too much emphasis on irrational behavior and does not adequately account for the presence of market discipline (Li, 2020). The 2007-2009 Global Financial Crisis, however, demonstrated the importance of behavioral finance, highlighting the irrationality of exuberance and overconfidence, as well as herding behavior, which were blatant triggers of the collapse (Grable et al., 2019). Behavioral finance captures these elements and presents a far more sophisticated and comprehensive picture of the reality of investor behavior, particularly in the more emotionally charged and longer-term real estate markets, where risk and security are profoundly influenced by perception and psychology.

Behavioral Real Estate

Integrating principles of behavioral finance into real estate acknowledges that both financial and non-financial factors, including psychological and emotional considerations,

influence real estate investment decisions. Investors employ a blend of objectives, external factors, and historical context that is subjective and permeated with biases (Song et al., 2023). For example, an investor may have an articulated goal regarding a specific return, a return-risk balance, or risk reduction; however, other factors, such as legislation, government action, interest rates, taxes, fluctuations in demand and supply, and prevailing economic conditions, will also play a role—success with or failure to obtain an investment goal shapes and conditions memories, confidence, and expectations. Beliefs, emotions, and attitudes, along with heuristics that alter information processing, are also important. Hence, real estate decision-making psychology shapes a cycle of objectives and environmental goals, which also defines a range of objectives and strategies to be followed in the future.

In reality, decision-making in real estate is streamlined into several phases. Investors begin with a definition phase, where they establish their goals, specify anticipated returns, and assess their risk tolerance. This is followed by a planning phase, during which they outline more detailed strategies and investment criteria, including search and evaluation parameters. In the deal phase, they identify and evaluate prospective investment opportunities based on the criteria set in the previous phases. This is followed by the execution phase, during which negotiations are carried out and the investment decision is structured and finalized. Having committed to an investment, they enter the monitoring phase, where the property's performance is assessed against expectations.

In the last phase, optimization, investors decide whether to extend, modify, or prune a property from their portfolio and set new goals for the definition phase (Anis & Soegiharto, 2023). While this order seems neat and well-structured, the reality is that, order notwithstanding, the process is convoluted, lacks clarity, and is significantly driven by subjective factors. For instance, investors make decisions with imprecise risk evaluations, and

the lack of transparency leads to a decision-making process that is unsystematic and more reliant on intuition and personal experience (Abdul Kareem et al., 2023).

Investment Behavior: A Review of Factors

Financial fundamentals and behavioral aspects have shaped factors influencing real estate investments. Behavioral economics considers the psychological factors that influence an investor's decision-making, which rational factors-neutral models often fail to capture. For example, interest rates have direct effects on the demand for properties by influencing the affordability of mortgages. Demand and prices increase when interest rates drop, as borrowing becomes cheaper, and the opposite occurs when interest rates increase (Bihari et al., 2022). Ali et al. (2023) suggest that broader economic factors, including GDP, inflation, and employment, influence real estate markets. Additionally, investment opportunities and risks are shaped by government control of real estate activity through policies, subsidies, tax credits, and legislative changes (Ahmed et al., 2022).

The most important determinant of an individual's ability to invest, understand, and use financial information in a coherent and actionable way is termed financial literacy. Financial literacy encompasses knowledge of financial products and markets, as well as the ability to apply that knowledge effectively. Financial literacy consists of both awareness of financial products and the ability to act on that knowledge. Objective literacy is dissociated from an individual's self-assessed knowledge and is referred to as subjective literacy. Objective and subjective financial literacy together inform one’s willingness to engage in risky behavior and interact with risky financial instruments, such as cryptocurrencies and tokenized real estate. Financially literate individuals are more likely to diversify their portfolios, make informed decisions, and capitalize on new financial opportunities. Conversely, low financial literacy results in overly cautious decisions or suboptimal outcomes (Haija & Lahyani, 2023; Vuković, 2023).

Risk perception is closely linked to financial literacy. By definition, "risk" involves a consideration of " profit and loss". However, people tend to think of " risk" as a loss. (Sindhu & Dharmendra, 2022). Unlike beginner investors, who are likely to misjudge uncertainty and overvalue returns, experienced investors tend to have a more accurate perception of risk (Rashid et al., 2022). Cognitive and emotional factors, as well as demographics, contribute to the subjectivity of risk perception.

Take, for example, research around gender differences. Most meta-analyses report that males have higher risk tolerance than females, although this conclusion is not universally accepted. Ahmed et al. (2022) provide examples of this. Ali et al. (2023) note that younger individuals in a cohort tend to be more willing to take risks than older individuals, who tend to be more conservative. More recent research has also examined the impact of educational attainment on risk. Although Gupta & Shrivastava (2021) document that research on the direct impact of higher educational levels on risk tolerance has not been universally accepted, there is a consensus that educational attainment is a critical determinant in the more effective evaluation of risk. All other factors remaining constant, the degree of risk tolerance an individual has is the most critical in determining the composition of their portfolio, especially in highly crypto-assets or tokenized real estate, which tend to be more volatile and sought after by people who have a higher risk tolerance for volatile assets in the portfolio (Karki et al., 2024).

Overconfidence Bias

Overconfidence bias refers to an investor's irrational belief that they possess superior skills and knowledge and have access to accurate private information, which leads to reckless investment choices (Ali et al., 2023; Haija & Lahyani, 2023). Ignoring potential threats is often caused by excessive self-estimation, overconfidence relative to peers, and a tendency to take risks (Yuvaraj & Venugopal, 2023; Maman et al., 2022). Overconfident traders will buy and

sell too frequently, believe too strongly in the value of the private information they hold, and overlook public information, which in turn leads to overly optimistic predictions of profit (Cascao et al., 2023). Past overconfidence, driven by experience and personal milestones, can foster a false belief that reliable market trend prediction is an attainable goal (Kamoune & Ibenrissoul, 2022). Some researchers defend the theory of overconfidence in positive investment outcomes (Gupta & Shrivastava, 2021; Rashid et al., 2022), while others argue that it is detrimental to decision-making, leading to reckless risk underestimation and irrational behavior (Rashid et al., 2022).

Herding Bias

Herding bias refers to the tendency of investors to make their own independent decisions by following the majority (Ahmad & Shah, 2020). This tendency is primarily observed in institutional investors and has been noted on many global markets, although it is notably less pronounced in Asia and the US (Song et al., 2023). Almansour et al. (2023) note that herding bias contributes to extreme volatility in stock and real estate prices and can also lead to the mispricing of risks and returns. Bihari et al. (2022) and Mireku et al. (2023) suggest that people imitate others due to the expected payoff, cognitive biases, and a lack of private information. Some of the cues to herding behavior include the amount of capital directed to the investment, overconfidence, and, in particular, the type of investor; individuals are much more likely to herd than institutions (Jain et al., 2023). This behavior reflects inefficient markets, as it can lead to the creation of speculative bubbles and generate market momentum (Bihari et al., 2022).

Loss and Regret Aversion

Loss aversion refers to the phenomenon whereby an individual exhibits a stronger emotional reaction to losses compared to gains of the same value, biasing them towards more conservative strategies and, more frequently, a short-term focus (Kaban & Linata, 2024).

Myopic loss aversion refers to the scenario where short-term loss avoidance takes precedence, resulting in extreme losses and a subsequent loss of long-term value (Shafqat & Malik, 2021). Regret aversion is an emotional bias closely linked to loss aversion, whereby the individual is willing to rationalize the loss; yet, as the time nears an expected loss, the individual irrationally holds onto the position, thinking the value will materialize (Shafqat & Malik, 2021). All three behavioral biases will cross-determine extreme limits in irrational trading, thereby determining the individual's position in terms of profit or loss.

Anchoring Bias in Real Estate Investment

Anchoring bias occurs when an investor fixates on a specific piece of prior information, such as previous asset prices and order reference points, when making decisions (Abdul Kareem et al., 2023; Haddad, 2023). This affects valuation, and as a byproduct, an investor making a price level market decision will use past price anchors instead of more relevant contemporary market conditions (Owusu & Laryea, 2023). Anchoring is observable in every auction, or more broadly, in markets where initial bids and prior prices, such as 52-week highs on stocks, serve as anchors in the decision-making process (Ahmed et al., 2022). Evidence from descriptive analytics suggests that gender, as well as level of experience and professional background, directly correlates with the impact of anchoring bias, where females and those less experienced in their field tend to be more strongly affected (Abdul Kareem et al., 2023). The pervasive use of anchors detracts from objective levels in the stock, real estate, and mutual fund markets.

Literature Gaps

Substantial gaps remain within the growing body of literature on the behavioral drivers of real estate investment. For one, most work to date has focused on developed economies, leaving a gap in the understanding of behavioral drivers in emerging markets, particularly in the Middle East. The rapid growth of the real estate market in the United Arab Emirates, along

with the need for contextual empirical investigations into the cultural, legal, and regulatory frameworks that govern investor operations in the region, underscores the necessity for more behavioral research in the region.

Furthermore, although research on behavioral biases is voluminous, the connection between these biases and property decision-making is relatively scarce. For instance, the phenomena of overconfidence and herding have been well documented in stock markets. However, their influence on the formation of real estate market bubbles and investment cyclical patterns is underexplored. Moreover, while the literature acknowledges the influence of demographic factors such as age, gender, education, and marital status, their interaction with financial literacy and cultural norms is underexplored.

The understanding of the impact of financial literacy on investment outcomes has recently gained importance. Still, inconsistencies remain in its measurement and application. The distinction between an individual’s objective financial literacy and subjective financial literacy is often overlooked. The subjective literacy component may potentially cloud one's ability to make informed decisions. This limits our understanding of the impact that financial education has on driving investor resilience and risk-taking within the real estate niche.

Existing investment models, whether traditional or behavioral, applied in the context of real estate, remain disparate. The traditional frameworks tend to neglect the underlying psychological factors, while the behavioral side lacks coherent frameworks and predictive capacity. Knowledge of real estate investing requires the development of a comprehensive model that aligns behavioral and psychological theories with economic fundamentals.

Conclusion

The literature overview indicates that real estate investment involves the integration of financial fundamentals, behavioral biases, and socio-demographic aspects. Rational finance theories provide a solid foundation for understanding the fundamentals of the tradeoff between

risk and return, as well as the principles of market equilibrium. However, they lack the emotional and irrational dimensions of an investor. Behavioral finance addresses this concern by demonstrating how decision-making is influenced by heuristics, cognitive biases, emotions, and irrational behavior, and consequently, explaining anomalies such as bubbles, excessive trading, and loss aversion.

Behavioral finance is particularly relevant in the real estate sector because, in finance, real estate is often complex, opaque, and long-term in nature. Decisions are made based on subjective, rather than solely financial, considerations. Personal financial circumstances, culture, financial literacy, risk perception, gender, age, socioeconomics, and other traditional economic factors shape and influence investment decisions, which are likely to be highly dynamic and irrational.

Harmonizing and complementing behavioral and traditional perspectives enables analysts to approach the study of real estate investment behaviors more holistically than other studies have done. Contextualizing insights within specific markets, particularly in the rapidly evolving and innovatively regulated real estate markets of the UAE, remains necessary. This primarily involves constructing frameworks that bridge the interplay between gaps in financial literacy, demographic variables, and cultural contexts, thereby enhancing the predictive and explanatory capabilities of current models. Thus, it will benefit academic literature and, concurrently, assist decision-making in highly sophisticated real estate markets to developers, investors, and policy planners.

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