Development finance in the UAE

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With that in mind, we thought that a reminder of some of the key legal issues in development finance in the UAE would be of interest to our readers.

Although the UAE is undoubtedly a development-friendly jurisdiction there are a number of regulatory measures and licensing requirements to consider. In addition, clearly defining the roles and responsibilities of the parties and ensuring that correct and sufficient security is available and in place at the appropriate times are also of paramount importance and should be treated as a priority in the structuring stage.

There are three themes to our analysis of the relevant issues:

- Due diligence;
- Roles and responsibilities; and
- Regulation and licensing.
- Due diligence

In the early stages of any development finance transaction, the parties should be considering the type of project, its revenue sources, how any finance will be serviced and the potential market for the project. Each of these will be important in identifying how the lenders can best protect their position, while ensuring that the financing solution offered to the borrower meets their short and longer term commercial needs.

Alongside these project-related due diligence streams, the underlying land and other project assets should be assessed, including a review of the title itself, to confirm what type of title it is and whether security can be granted over it. Although it sounds rudimentary, it is of course crucial to ensure that the ownership interests and assets reflect the parties' expectations and are suitable for the type of financing and/or security proposed. It is also important to understand the borrower's group structure and identify which companies will be providing security and which will form part of the covenant package in the finance documents.

Increasingly, we are seeing longer term facilities being offered in development finance transactions, rather than borrowers relying on shorter term funding arrangements which do not match the project term and would have to be renegotiated or refinanced periodically. While this move to longer term facilities makes sense from a development perspective, when the background of increasing capital adequacy requirements is overlaid, there are some pertinent issues to consider around pricing and how any costs associated with changes in the banking world's regulatory framework should be allocated between the borrower and the lenders.

Similarly, understanding the cashflows of the project is key to defining what account structure is appropriate to the project and the timing and quantum of repayments to the lenders. The revenues and cash flows will also be important in identifying what security over the project accounts should be granted and also what cash waterfall between the project accounts is most appropriate. Time spent understanding these issues at an early stage will save headaches further down the line when specifics are to be drafted into the documents.

Based on the due diligence and the borrower's requirements, the financing structure can be settled, with both Islamic and conventional structures being available. Any requirement of the borrower to ring fence the project, assets and liabilities should also be communicated at an early stage and agreed with the lenders. If acceptable to the lenders, this would benefit the borrower by limiting cross contamination between projects. This is increasingly relevant where companies will be running several developments, each of which will have its own financing arrangements, and given that the use of special purpose vehicles remains limited.

Roles and responsibilities

In summary, the key roles in a development finance transaction are:

- The developer, which will undertake the development. There may be local ownership requirements depending on the nature of the project and the Emirate, which should be considered at an early stage.
- The land owner – if this is not the same party as the developer, the land owner will (usually) enter into an agreement with the developer to develop the project. This development agreement should be carefully reviewed by lenders to understand the implications of a default under the facility and to ensure that the lenders have appropriate remedies in the event of a breach of the development agreement or the facility agreement. This is often by way of a cure period during which the lenders can remedy a breach by the parties to the development agreement or, in the case of a breach of the facility agreement, a right to step into the development agreement and replace the defaulting party. These underlying agreements can also dictate who needs to be a party to the finance documents.
- The project consultant – this consultant is appointed to oversee the technical aspects of the project. There may be more than one project consultant if the lenders have also appointed their own specialist advisor who will, for example, approve payment of development costs and sign off completion certificates.
- The master developer – there maybe a master developer, who will run the large site within which the project is located. Often the master developer and developer must enter into agreements as to how the project will be set up, run and progressed. It is also prudent to review the original document under which the land owner obtained the land for any unepected or unusual provisions.
- The lender/s – the lenders in a development finance transaction will usually expect to be more closely involved in the project, with varying degrees of rights to approve and oversee in respect of the project. One of the most important areas is of course in relation to deviations from the project budget.
- The contractors – the contractor for the project, the documents under which they are appointed and any performance security to be provided by a bank on their behalf should all be reviewed. Not only to ensure the lenders are comfortable with the appointed contractor, but also to inform the security package and extent to which the contractor will need to enter into agreements with the lenders.
- In the case of hotels or residential complexes there will also usually be management companies who need to be wrapped into the financing structure. Direct agreements between the lenders, the developer and these management companies are often required, so the early engagement of these parties in the financing process is sensible.

The project itself will involve multiple stakeholders, from those noted above to subcontractors and the banks providing any required performance security. The lenders' position and rights will usually need to be overlaid into these (often pre existing) relationships and it can take some time to identify which rights and responsibilities are fundamental to each party and how best to protect the lenders' position while not smothering the stakeholders' ability to operate the project in a sufficiently flexible way.

Given the number of interested parties, it is clear that one of the keys to successfully implementing financing arrangements for developments is early engagement between the project's stakeholders. The intention of this engagement should be to clarify what each of them can expect from the others and what each of them is required to do for the others. The negotiations with third parties who are involved too late in projects are almost always more difficult than those where the relevant third parties have been prepared and involved in the project financing.

Regulation and licensing

Given the federal nature of the UAE, it is important to assess and understand the regulatory regime where the project is to be established. For example, in Dubai there are mandatory requirements to maintain an escrow account in respect of off plan sales and rules regarding termination by developers of sale agreements whereas in Abu Dhabi there are currently no such rules (although a raft of new regulation is expected soon, which is expected to include escrow requirements similar to those in place in Dubai). By way of further contrast, Ras Al Khaimah has similar escrow requirements to those in Dubai, whereas in Sharjah the law provides that a bank guarantee for a percentage of the project cost must be provided, rather than having escrow requirements.

Other examples of differences between the Emirates are (i) the availability of the interim register in Dubai for offplan properties, which is not currently an option in other Emirates and (ii) the eligibility to own real estate in each Emirate, which vary from eligibility being limited to UAE and GCC nationals to lesser restrictions on ownership by foreign nationals provided that the property is in certain designated zones, as is the approach in Abu Dhabi, Dubai and Ras Al Khaimah.

As we have seen with the introduction of the recent mortgage regulations, reported on in this issue by my colleague Ravi Gill, many expect further real estate regulation in coming years, in addition to the proposed new laws in Abu Dhabi.

At present, the main areas under this theme which a lender should consider are whether the land owner is eligible to own the land in question, whether the developer has the skills, expertise, licenses and approvals necessary to carry out the project in question and whether the project has been or is reasonably likely to be successfully registered in the relevant Emirate. The applicable rules can differ between the Emirates quite considerably and so early enquiries should always be made.

Some of the differences between the Emirates have been noted above. One of these key differences is the escrow arrangements which the Dubai Lands Department requires to be established with an approved bank. These requirements can be confusing, particularly where funding is required to acquire the land and where off plan sales have also been made. In our experience, the relevant authorities can show flexibility in respect of the escrow requirements where the business case for such exceptions has merit, is sensibly presented and the consumer protection motives behind the relevant rules are still respected.

Conclusion

We expect the number of development finance and infrastructure projects to rapidly increase over coming years, as a result of the increasing economic optimism, Dubai’s successful bid to host Expo 2020 and the well-placed confidence in the UAE market. We hope that this article was of interest. Should you wish to discuss any of the issues outlined in this article, please feel free to contact the author or any member of the Banking and Finance team.