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BRIEFING

UAE REAL ESTATE UPDATE

MAY 2018

- LEASE-TO-OWN SCHEMES FOR OFF-PLAN PROJECTS
- CONSIDERATIONS FOR DEVELOPERS OFFERING DEFERRED PAYMENT PLANS
- REITS EXPECTED TO GAIN POPULARITY IN THE UAE

The Dubai real estate market, especially when it comes to off-plan projects, has seen another tough year in 2018 with challenges in oversupply, a tightening of regulations and a lack of liquidity in the financing sector. Developers and industry stakeholders have been forced to explore new ways to stay ahead of the game in an extremely competitive and ever-changing market. In this briefing, we share some thoughts on initiatives that could help revive the market.

Lease-to-own schemes

Lease-to-own schemes (also known as rent-to-own in other jurisdictions) have been used in other markets to enable a tenant to lease a property with an option to purchase in the future. A portion of the rent paid under the tenancy will often be applied against the purchase price of the property. Lease-to-own schemes launched in the UAE have been largely unsuccessful in converting tenants into purchasers – which is ultimately the end game for a developer. This was partly due to the contracts being too tenant-friendly coupled with a significant downturn in property prices – tenants simply walked away and left developers holding large amounts of unsold property. Valuable lessons can be learned from this experience.

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From a developer's perspective, lease-to-own contracts should aim to mitigate the risk that a tenant will not proceed with the purchase of the property and ensure that the developer can control the process. Some key components to incorporate in the documentation are:

- Comprehensive sale and purchase terms and conditions including a mechanism to determine the purchase price. Uncertainty on the purchase price may deter a purchaser because of the uncertainty on how binding the contract is;
- An automatic trigger allowing the developer to commit the tenant to the purchase of the property after a certain date; and
- Tailored financing options from a mortgage lender to fund the purchase price.

"A PORTFOLIO OF PROPERLY STRUCTURED LEASE-TO-OWN CONTRACTS COULD SERVE AS ATTRACTIVE ASSETS FOR REITS TO INVEST IN."

Deferred payment plans

We have seen a recent trend of developers offering more attractive payment plans and effectively financing purchasers by deferring up to 70% of the purchase price payable in instalments post-handover. This has allowed purchasers to use their property from handover with the benefit of paying off the balance purchase price without recourse to mortgage finance. Obviously this presents a potential cash flow issue for a developer as well as a number of inherent legal and commercial risks associated with handover of a property prior to receiving the purchase price in full.

It is critical that the sale and purchase agreement is well drafted and sets out the conditions attached to the sale including the deferred instalment payment plan. Some further considerations for the developer in this scenario are:

- Whether to retain title for the property in the name of the developer until the full purchase price is paid;
- Offer a formal financing scheme to purchasers. Given that developers would need to be licensed by the UAE Central Bank to provide traditional mortgage finance, there are specific Islamic financing models that may be deployed in this scenario; and
- Collect post-dated cheques for the deferred amount of instalments payable after handover as a form of security.

REITs and securitisation of lease-to-own portfolios

We expect REITs to gain more traction in the UAE with a number of new REITs preparing for launch as a way to diversify real estate portfolios and achieve greater participation from investors and in turn more liquidity.

REITs traditionally invest in income generating assets such as long leases of property (or interest/profit derived from the financing of property), in order to secure a stable income stream over a longer period.

A portfolio of properly structured lease-to-own contracts could serve as attractive assets for REITs to invest in. The lease-to-own portfolio of completed properties may also be attractive to traditional lenders and alternative financiers who may be interested in securitising the developer's lease-to-own portfolio.

The above initiatives seek to explore new territory for the UAE real estate market and present some interesting opportunities for developers to create more innovative and sophisticated structures and documentation. We would be pleased to hear your thoughts and feedback.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

MOHAMMED KAMAL
Partner
Dubai

T +971 4 278 2320
mkamal@wfw.com

AMY JONES
Associate
Dubai

T +971 4 278 2326
ajones@wfw.com

Publication code number: 62175393© Watson Farley & Williams 2018

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