

# Leasing in the Kingdom of Saudi Arabia

by Jeremy Scott - j.scott@tamimi.com - Dubai International Financial Centre

Andrew Balfe - a.balfe@tamimi.com - Dubai International Financial Centre

Mohammed Negm - m.negm@tamimi.com - Riyadh

May 2019

## Landlord and Tenant Relationships in the Kingdom of Saudi Arabia

### *General overview*

There are limited decrees or regulations in the Kingdom of Saudi Arabia ('KSA') that relate to leasing. What regulation is in place, is principally aimed at the licensing of real estate brokers, restricting commissions and the establishment and use of Ejar, the Ministry of Housing's ('MOH's') electronic services platform.

Landlords and tenants are therefore generally free to contract on such terms as are acceptable to them, provided that any agreed terms are not inconsistent with Sharia principles.

General principles of Sharia are consistent with commonly understood contractual principles. As leasing is predominantly a contractual exercise, landlords and tenants therefore have considerable flexibility as to the nature of their lease.

This freedom of contract as well as the developing nature of the KSA has seen a wide variation in the nature of leasing contracts. There has also been a tendency to adopt short-form contracts particularly in residential contracts.

Office, retail and other commercial arrangements are not uniform and may therefore require more sophisticated and bespoke contractual terms in order to clarify the parties' intentions.

### **Unified Lease Contracts**

The MOH has also issued template leases (known as 'Unified Contracts') for both residential and commercial premises. We understand that the MOH may also implement unified contracts for other asset classes (e.g. industrial and agriculture) in due course.

Use of the Unified Residential Contract ('URC') is mandatory in order to facilitate registration on the Ejar system. In addition, the Ministry of Justice issued a circular in January 2019, which stipulates that unregistered lease agreements (residential and commercial) may not be considered by the Courts.

The implications of this are wide ranging. For example, it could be argued that an unregistered lease agreement may not be capable of enforcement before the Courts. To the best of our knowledge however the circular has not been considered by the Courts. Given the implications of the circular we would expect the Courts or the MOH to broker a solution that allows the Courts to adjudicate on the terms of the lease in question.

Registration on Ejar also has benefits in that it affords the landlord expedited enforcement of the URC as an executory deed.

## **Analysis of the URC**

The URC is comprehensive and addresses usual lease obligations, such as the payment of rent and utilities, delineates each party's responsibility for maintenance, imposes restrictions on the tenant's use and any alterations and sets out the tenant's yield up obligations at the end of the term.

On the whole, we consider that the URC will be sufficient for the majority of residential (villa and apartment) leases.

The URC also permits additional terms to be added. Landlords should consider what additional terms may be appropriate for their particular needs (if any). Issues that landlords may wish to address may include:

1. linking the tenant's repair obligations to:
  1. a condition report, prepared at the commencement of the lease; and
  2. an asset list, where the premises are let in furnished condition.
2. setting out a regime for the landlord to call on the security deposit to remedy a breach; and
3. more detailed 'use' obligations, for example:
  1. relating to the use of shared facilities/common areas;
  2. compliance with any building/community rules; and
  3. restrictions on the number and identity of occupants.

It is not clear whether parties may agree additional terms that contradict the URC.

## **Analysis of the UCC**

More recently, we have seen an increase in the use of more sophisticated commercial lease contracts in the KSA. This is particularly the case for bespoke and/or higher end asset classes (e.g. retail malls) and bespoke tenancies such as cinemas. It has also been driven by the increase in international investment into the KSA as well as the emergence of institutional landlords such as real estate investment trusts ('REITs').

Readers will appreciate that the UCC may not be ideally suited to all commercial transactions and it remains to be seen whether the MOH will require the compulsory use of the UCC in order to procure registration in Ejar.

If that is the case, then in due course we would anticipate that landlords may be required to:

1. seek the MOH's approval for the registration of the landlord's template lease (on an exception basis) and in place of the UCC; or
2. develop an addendum of additional terms to the UCC; or
3. execute the UCC as a side agreement to their own template commercial lease.

## **Leasing to Government Entities**

In addition to the URC and the UCC, a law issued by a Royal Decree No (M/61) 18/09/1427 dated (11 October, 2006) and Finance Minister Resolution No. (3347) dated 16/9/1437 AH (13 September 2016) also imposes certain restrictions and parameters on leasing by Government entities. These include:

1. a requirement to use the approved government lease template, issued by the Ministry of Finance ('MOF');

2. an initial advertising and tendering process, with submissions to be considered by a committee;
3. restrictions on the maximum term, rent and rent increases (subject to certain thresholds, these may be approved by the relevant Government body, or must be escalated to the MOF for approval); and
4. detailed requirements for handover on expiry and payment of any compensation on account of damage.

## Dispute Resolution

The most common forum for resolution of contractual disputes in the KSA remains the Courts. For the majority of leasing transactions, the Courts are likely to be adequate.

That said, Royal Decree No. M/34 of 16 April 2012 ('Arbitration Law') and the recently established Saudi Centre for Commercial Arbitration modernised the regulatory framework for arbitral proceedings in the KSA and signalled the Government's endorsement of arbitration as an alternative and viable dispute resolution mechanism.

As such, arbitration may now offer a preferable alternative dispute forum, particularly in respect of complex leasing arrangements (such as built-to-suit transactions). For foreign investors it may have other advantages, for example, the ability to have the arbitration conducted in English and the ability to choose arbitrator(s).

## Conclusion

Whilst the majority of leasing contracts are likely to be of a short-form nature in the near future, the KSA leasing market is also maturing and adapting to the requirements of international tenants and institutional landlords. In addition, arbitration along international lines is now possible and may be the preferred route for complex leasing matters.

The MOH has also provided a useful template for residential leasing which, once registered in Ejar, means landlords can take the case immediately to the execution courts in the event of tenant default. The MOH commercial lease template may not be suitable for all leasing transactions but is not mandatory at present and may be able to be amended or supplemented. Having said that, both landlords and tenants should be mindful of the circular of the Ministry of Justice (mentioned above) and the risks involved in not registering their lease in Ejar.

Landlords leasing to government tenants also need to be aware of the special requirements applicable in that case.

*Al Tamimi & Company's [Real Estate team](#) regularly advises on landlord and tenant matters in the Kingdom of Saudi Arabia. For further information please contact [Jeremy Scott](#) ([j.scott@tamimi.com](mailto:j.scott@tamimi.com)).*