“Move in Now, Pay Later” Developer Incentives in Dubai

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In recent years, Dubai-based real estate developers have offered various incentives to encourage buyers to purchase their product. Readers will be familiar with advertisements promising extras such as free cars, furnishing packages and holidays to buyers.

Over the last 24 months, as developers have come under increased competition and supply pressure, these additional incentives have become relatively standard in the market, including developers offering to pay Dubai Land Department fees and offering buyers extended payment terms.

Typically, such ‘deferred sale’ arrangements will require a buyer to pay a small percentage of the purchase price on signing, a further proportion on handover of possession of the unit and the balance over an extended period (say, five years) by equal monthly or quarterly instalments. The title deed (i.e. legal ownership) of the property does not transfer until the buyer achieves 100 percent payment.

Deferred sale arrangements help developers sell surplus stock and also make real estate more accessible to buyers who may otherwise have insufficient equity to enter the market (e.g. due to the loan-to-value restrictions that may prevent such buyers procuring finance in the short-term). However, it is important to recognise that while deferred sale arrangements offer potential positives, there are a number of issues that both developers and buyers should consider in deciding whether offering/purchasing a product on a deferred sale basis is appropriate for them.

Buyer Considerations

By its nature, a deferred sale arrangement results in the developer receiving the purchase price over an extended period (and after the buyer receives possession). For ‘off-plan’ sales in particular, as the bulk of the purchase price is often only paid after completion and handover of possession to a buyer, there is a potential cash flow risk during the construction phase of the development.

Buyers therefore need to carefully consider (as far as possible) their chosen development and seek comfort from the developer that it has sufficient capital to complete the development. To that end, buyers would generally be advised to evaluate the developer's prior track record for delivering similar projects.

This risk is obviously mitigated in the case of built real estate sold on a deferred sale basis.

Where buyers are taking advantage of a deferred sale arrangement to enter the market (i.e. without sufficient equity to secure financing for the balance), there is also a risk that a tightening of lending criteria may leave the buyer exposed at the point in time when the balance payment is due.

Developer Considerations

On the developer side, there are numerous more issues and include both practical and legal risks.

Buyer default

If a buyer defaults on its payment obligations, the developer may wish to terminate the sale and purchase agreement. This becomes more problematic in a practical sense if possession of the property has already been handed over to the buyer. There are a number of strategies that developers can put in place to mitigate against this risk, in particular by ensuring that the payment plan is appropriately structured and appropriate security is provided.

The procedure for termination of the sale and purchase agreement also presents some issues (although these are not specific to deferred sale arrangements). While the 'off-plan' scenario is relatively straightforward, with the developer able to avail itself of the termination procedure set out in Law No No. 13 of 2008 (as amended by Law No. 9 of 2009) ('Interim Registration Law'), a developer who sells constructed units on a deferred sale basis must bring a claim for termination to Dubai Courts. This can be a costly and time-consuming exercise.

Re-taking possession of the property

Following any such termination, the developer may still be confronted with the practical difficulty of evicting a buyer who refuses to leave the property (either via personal physical occupation, or by leaving their possessions in the property). This would generally require the assistance of the Dubai Courts and relevant authorities and leads to additional time and cost for the developer.

Additionally, the condition of the property may have suffered from wear and tear or damage, requiring the developer to spend additional funds in order to make the property fit for sale. Again, the developer can minimise this risk by using appropriate contractual obligations and security structures. The developer may also be able to insure against material damage.

The developer may also be left to deal with various unpaid charges, such as service charges or DEWA charges that need to be cleared in order for the developer to resell the property.

Tenant in possession

The risks associated with re-taking possession are further complicated if a buyer has leased the property to a third party. In that scenario, if the developer terminates the sale and purchase agreement, it is now left with a property that is encumbered by a lease. Further, the tenant may have already made rent payments directly to the buyer.

Whether or not to permit leasing (and if permitted, the manner in which that leasing occurs) is a crucial issue to which developers must give serious consideration. Some developers may prefer to restrict deferred sale arrangements to owner-occupiers (although that will not be practical in all cases) and many developers would not wish to exclude buyers looking to purchase investment properties. If buyers are permitted to lease their units prior to payment of the full purchase price, ideally contractual arrangements and other procedures would be put in place to provide as much protection as possible for the developer.

Compensation

For ‘off-plan’ sales, the Interim Registration Law prescribes the amount of any instalment payments that a developer is entitled to retain in the event of termination of a sale and purchase agreement. Where ‘off-plan’ units are sold pursuant to a deferred sale arrangement, developers should consider how their instalment structure may impact their instalments under the Interim Registration Law.

For ‘completed’ property sales, the law does not provide any specific regime for calculating the amounts to which a developer is entitled. The issue would generally be left to a contract, subject to the Courts’ discretion to adjust the amount of any compensation to reflect the actual loss suffered.

Cash flow

Developers offering ‘off-plan’ units on a deferred sale basis should also consider the cash flow implications against their capital requirements for the development.

The Way Forward

The above ‘developer’ risks can generally be mitigated against by putting in place appropriate contractual and security structures. The deferred payment plan itself may also be structured in a way that best balances the developer’s desire to sell the property, while providing a level of protection against the risks inherent in such sales. In particular, developers that are considering selling existing completed stock on a deferred sale basis should seek advice as to the appropriate methods for protecting against the ‘buyer default’ scenario and the need to bring a claim before the Courts.

Similarly, buyers can put themselves in the best position by undertaking appropriate due diligence on the developer and the development project and, if required, clarifying the likely lending conditions ahead of time.

It will be interesting to see where the market for developer incentives goes from here. Deferred sale arrangements have become relatively market standard and developers are likely to be creative in order to differentiate their offerings. Readers will appreciate that any such incentive is likely to have practical (and legal) consequences and developers should seek advice on those issues to ensure that their interests are best protected.

Al Tamimi & Company’s Real Estate team regularly advises on deferred payment arrangements and managing their inherent risks. For further information please contact Andrew Balfe (a.balfe@tamimi.com).