

Introduction of Leasing Law in DIFC

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The Dubai International Financial Centre ('DIFC') free zone has, over the years, cemented itself as a leading international financial hub and continues to experience strong demand in the rental market.

In 2018, the governing authority of the DIFC, DIFC Authority ('DIFCA') overhauled the previous legislative framework in respect of real estate and introduced a new Real Property Law (DIFC Law No. 10 of 2018) and accompanying Real Property Regulations. The Real Property Law does not include detailed guidance on leasing in the DIFC, although it did foreshadow the introduction of a new leasing law.

The Leasing Law (DIFC Law No. 1 of 2020) and Leasing Regulations have now been issued by DIFCA and came into force on 14 January 2020. The Leasing Law supplements the existing Real Property Law but deals specifically with leasing matters. It provides clarification to lessors and lessees of properties in the DIFC on their respective rights and obligations and is intended to 'further align the DIFC with international best practice in this regard' (DIFC Consultation Paper).

What follows is an high level overview of the key aspects of the Leasing Law.

Application

The Leasing Law applies to all residential, retail and commercial leases in the DIFC, with the exception of:

1. leases of premises that are primarily used for serviced apartments or hotel guest rooms; and
2. leases entered into by parties to a mortgage of the premises in accordance with the terms of the mortgage.

The Leasing Law applies to leases entered into prior to the enactment of the Leasing Law, except where particular provisions of the Leasing Law require compliance with time and notice periods that are

incapable of being applied to such leases.

Statutory obligations on the lessee

The Leasing Law implies into leases the following statutory obligations on the lessee:

1. to not use the premises for any illegal purpose (Article 12(1));
2. to use the premises only for its permitted use (Article 12(2));
3. to not use the premises or common areas in a manner that causes nuisance or interference with other occupiers (Article 13);
4. to pay rent on the dates specified in the lease and, if not specified in the lease, rent is to be paid in advance in quarterly instalments (Article 15); and
5. to pay all taxes and fees in respect of the premises, except for the lease registration fee, amounts payable by virtue of the lessor's ownership and any amounts levied on the lessor by law (Article 16).

Statutory obligations on the lessor

The Leasing Law implies into leases the following statutory obligations on the lessor:

1. to ensure the lessee has quiet enjoyment of the premises (Article 14); and
2. a prohibition on the lessor disconnecting utility services to the premises (in which event the lessee may report the incidence to the police or file a case before the court) (Article 17).

These statutory obligations mean that such obligations no longer need to be explicitly stated in the lease itself.

Specific provisions for residential leases

Security deposit scheme

Security deposits are now not permitted to exceed 10 per cent of the annual rent of the lease.

The Leasing Law clarifies that a security deposit may only be used to compensate the lessor after the expiry or termination of a lease, and only for the following reasons:

1. non-payment of rent;
2. damage to residential premises, excluding fair wear and tear; and
3. damages for breach of contract.

The Leasing Law has introduced a new security deposit scheme whereby security deposits are to be paid to the DIFC Registrar of Real Property ('Registrar') within 30 days of receipt by the lessor. Please note that this does not apply to leases that were in place prior to the enactment of the Leasing Law.

The Registrar will hold the security deposit in an escrow account and administer the release and refund of security deposits. On the expiry or termination of a lease, the lessee and lessor may sign a release form confirming whether the lessee is entitled to a refund of all or part of the security deposit. If the parties do not agree on the refund of the security deposit, the dispute must be notified (by either party) to the

Registrar to be resolved by the DIFC Courts or any specific tribunal that may be established (the DIFC Authority is considering the possibility of establishing a separate arm within the DIFC Courts' Small Claims Tribunal to deal with lower value disputes).

The law does not specify the timeframe in which the Registrar is required to release the security deposit. However, it is recommended that the release form or notification of dispute be lodged as soon as possible after the expiry or termination of a lease, as any security deposit which is unclaimed six months after the termination or expiry of a lease will be forfeited to DIFCA.

Condition reports

The Leasing Law has also introduced a (non mandatory) regime for the preparation of condition reports in order to prove the condition of the premises at the time of handover. Where a lessee is required to pay a security deposit, the lessor may, prior to handover of the premises to the lessee, prepare a condition report specifying the state of repair and condition of the premises. Where a condition report is provided by the lessor, the lessee must sign and return the condition report or provide details of its disagreement with the condition report within 20 days of receipt, otherwise the condition report is taken as evidence of the condition of the premises should any dispute arise between the lessor and the lessee relating to the state of repair and condition of the premises. Any disagreement in respect of a condition report is to be resolved by an independent expert. If a condition report is unsigned the DIFC Courts are entitled to draw their own inferences from the evidence provided at the time of the dispute.

Rent increases

The Leasing Law imposes an obligation on the lessor to give the lessee 90 days' written notice of any proposed rent increases. This corresponds with rent increases relating to renewals in mainland Dubai. However, it is interesting to note that the DIFC has not followed in the footsteps of mainland Dubai in legislating for automatic lease renewals where the lessee remains in the premises after the expiry of a lease.

Maintenance of residential premises

The Leasing Law clarifies the respective obligations of the lessee and the lessor in respect of maintenance of the residential premises:

1. the lessee's obligation is limited to taking reasonable care to avoid damaging the residential premises (and any common areas), keeping the premises reasonably clean and notifying the lessor, as soon as practicable, of any damage to the premises (Article 34(1) and (2));
2. the obligation to maintain the residential premises in good repair during the term is placed on the lessor (Article 38(1));
3. a lessee will not be liable for damage to the premises where the damage constitutes fair wear and tear, the lessee took reasonable care to avoid such damage, or the damage was caused by failure of the lessor to comply with its obligations under the lease or the law (Article 34(3));
4. the lessor may serve notice on the lessee in the event that the lessee has failed to comply with its maintenance obligations and the requirements for that notice are set out in Article 35(2). Where the lessee fails to comply with a repair notice, the lessor is entitled to repair the damage and recover the reasonable costs of repair from the lessee (Article 35(3)); and
5. a lessee who disputes a repair notice served by the lessor or the reasonableness of the cost of repair may commence a claim with the DIFC Courts within 20 days after receipt of either the repair notice or the invoice for the cost of repair (as applicable) (Article 35(4)).

Additional statutory obligations on the lessee and the lessor

Below we set out some additional statutory obligations applicable to residential leases:

1. the lessor must ensure that the premises are vacant and in a reasonably clean condition on the agreed handover date (Article 37(1));
2. except as otherwise agreed in the residential lease, a lessee is liable for charges in respect of the supply and use of utilities or a fair and equitable share of utility charges where the premises are not separately metered (Article 32);
3. the lessor is liable for all installation costs in respect of utilities, capacity charges, building service charges and master community service charges (Article 33);
4. a lessee must not install any fixtures in the premises or make any alterations to the premises without the lessor's consent (Article 36(1));
5. the lessee may make urgent repairs (which are the responsibility of the lessor) under certain circumstances and recover the reasonable costs of repair from the lessor (Articles 39-41);
6. Article 43 of the Leasing Law sets out the right of the lessor to enter the premises (in addition to those set out in Article 55 of the Real Property Law) and the lessee's obligation to permit entry under such circumstances. The lessor may enter the premises at a reasonable time and on giving the lessee at least two days' prior notice, or at any time in case of an emergency and where the lessee is not contactable (Articles 42-46); and
7. a lessee may apply to the DIFC Courts for compensation if the lessor causes damage to the lessee's property while exercising such right of entry, meaning that the lessor's usual release may not be enforceable (Article 47).

Specific provisions for retail leases

The Leasing Law prohibits the acceptance of key-money (i.e. payment by a lessee in order to secure the grant or renewal of a lease) or any consideration for the goodwill of any business in respect of retail leases.

Termination of leases

Generally, leases may be terminated before the expiry of the term by written agreement of the parties, or without agreement of the parties or DIFC Court order where:

1. any rent due under the lease is more than 30 days overdue (whether or not formal demand has been made);
2. any other term of the lease has been breached and the lessee fails to remedy such breach within 30 days of written notice from the lessor;
3. the rights of the lessee and lessor become vested in one person;
4. the lessee has died (for residential leases);
5. the lessee has abandoned the premises for a period of more than one month (except residential leases);
6. the premises have been destroyed; or
7. a party exercises its right to terminate the lease in accordance with the terms set out in the lease.

Notwithstanding the above, Article 54 provides that residential leases may only be terminated by the lessor and by an order of the DIFC Courts in the following circumstances, offering greater protection to lessees of residential leases:

1. where the lessee fails to pay rent by the due date and the remedy period stated in the lease has expired (or 30 days where no remedy period is stated);
2. the lessee fails to comply with any other material obligation under the residential lease and the lessee fails to remedy such failure within 30 days of a written notice from the lessor;
3. the lessee has abandoned the premises for a period of more than three months;
4. the lessee uses the premises for an illegal purpose; or
5. the lessee is declared insolvent;

The lessee also has a right to terminate a **residential lease** by order of the DIFC Courts in the event that the lessor has failed to comply with a material obligation under the lease and failed to remedy such failure within 30 days of written notice from the lessee or the residential premises are not fit for purpose or unsafe for occupation.

While it is common for leases to state that the lessor has a lien over the lessee's property left at the premises on expiry or termination of a lease, the Leasing Law now grants the lessor a statutory lien and a preferential claim over the proceeds of sale for payment of any arrears in rent. The process for selling such property depends on whether or not the lessee is insolvent.

Conclusion

The introduction of the new Leasing Law is a welcome development to the rental market in the DIFC. As is the case in any jurisdiction, lessors and lessees should always seek legal advice with respect to their rights and obligations under the law and the current practices adopted by the Registrar.

Al Tamimi & Company's Real Estate team and [International Litigation Group](#) regularly advise on leasing in the DIFC and disputes arising from DIFC leases. For further information, please contact [Mohammed Kawasmi](#) (m.kawasmi@tamimi.com), [Shirley Zhang](#) (s.zhang@tamimi.com), [Rita Jaballah](#) (r.jaballah@tamimi.com) and [Peter Wood](#) (p.wood@tamimi.com).