

Mixed use of Developments incorporating hotel and residential features

Jeremy Scott - Partner - Real Estate
- Dubai International Financial Centre

Katrine Kofoed
k.kofoed@tamimi.com

Consider the shared systems and services in an integrated building such as this, including, fire systems, lifts, and the exterior. Consider also the levels of service and corresponding costs that a residential apartment building may find desirable compared to that required by a hotel.

Thankfully, many potential compromises will exist in order to balance these tensions for any development, the exact nature of which forms much of the focus of a lawyer's craft. Of course individuals may disagree as to whether a fair compromise has been reached and for this reason it is important to emphasise (once again) the importance of developers clearly disclosing to all investors the compromise and structures chosen for their developments.

Such developments are regulated pursuant to Law No 27 of 2007 on Ownership of Jointly Owned Properties in the Emirate of Dubai ("JOP Law") and the Directions to Law No 27 of 2007 which are implemented by RERA ("Directions").

Such "simple" schemes of joint ownership however have come close to being the exception in Dubai and many other cities in the Gulf where mixed use developments are common. A mixed use development will usually possess more than one "uses" for example; residential apartment, office, hotel and retail uses. The volumetric area comprising each such "use" is generally termed a "Component".

All mixed use developments present certain challenges in terms of management. Consider for example the case of a residential and retail building. Perhaps the residential Component has a swimming pool and gym as part of its facilities. Should the retail Owner(s) be responsible for the costs of these facilities? Conversely would the residential Owners want the retail Owner(s) and potentially their clients using the swimming pool and gym?

Generally speaking retail Owners would have no interest in such facilities and would not want to pay for the same. Such issues would therefore need to be resolved through the constitutional documents (for example the "Jointly Owned Property Declaration" as it is termed in Dubai) for the development.

The above however represents a fairly simple situation, where the interests of the parties are clear. There are however numerous occasions where more complex issues arise both by virtue of the areas and services in question and the nature of the building. There is no better example of this than in the case of mixed use developments incorporating a hotel, residential and other Components.

To illuminate the issues, let us consider Diagram 1 (below) where area "A" is a singly owned Hotel Component and area "B" is a jointly owned Residential Component. Area "C" represents an area shared between the two Components.



Let us say that area "A" (the "Hotel Component") and Area "B" (the "Residential Component") are relatively self contained with each retaining its own entrance lobby and mechanical, electrical and plumbing infrastructure. Area "C" in this example comprises a shared leisure area comprising a swimming

pool, gym area and spa area ("Facilities").

Both Components may have a legitimate interest in the use of the Facilities however the following issues arise:

1. Who should control the management of the Facilities?
2. To what standard should the Facilities be maintained and operated to? The standard required of the Residential Component or the standard required by the Hotel Component?

The answer from the Owner of the Hotel Component has to be that these areas must remain in their control as the Hotel Component Owner will need to be able to promise to its Operator, control over such areas in order that the Operator can maintain its "brand standards" and customer service levels.

Let us therefore consider the following management possibilities for Area "C":

1. The area becomes a Common Area and an Owners Association be formed having jurisdiction over Area "C"; or
2. Ownership over Area "C" passes to the Owner of Component "A" (the Hotel Component")

Let us consider in more detail each management possibility:

Option 1 - Area "C" is Common Area and an Owners Association is formed.

Under this option the following needs to be considered:

1. Decisions of an Owners Association are made either by the General Assembly or by the Board.
2. Decisions of the General Assembly usually relate to constitutional issues such as rule formation and the appointment of the Board.
3. Decisions on constitutional matters may depend on the number of votes of the voting "entitlement" the relative Components have.
4. Decisions as to who the Board may comprise may depend on the number of Owners in each Component and also the number of votes or voting "entitlement" held.

It will be apparent from the above that to leave decisions as to who manages such areas strictly to the JOP Law and Directions can be arbitrary and risks an ongoing political struggle for control of such Facilities.

Option 2 - Ownership of Area "C" passes to the Owner of the Hotel Component.

Under this option the following needs to be considered:

1. Ownership would entitle the Owner of Component "A" to exclude all Owners in the Residential Component "B" (the Residential Component).
2. The Owners of Component "B" would be required to pay for the costs of the maintenance and repairs and all other services in connection with the Facilities.
3. The above factors would mean that transparency as to the costs of the Facilities may be unlikely, and could lead to a situation where the Owner of Component "A" simply names its price for the use of the Facilities.

Option 2 would appear the optimal solution for the Hotel Component Owner, however in many cases the developments may have been designed such that such Facilities were intended for the use of both Components. In other cases the developments may have been sold on the basis of shared use (to have sold on a "user pays" basis may have reduced the sale price of the Residential Units).

The astute reader may well have gathered that either Option 1 or Option 2 may work provided appropriate mechanisms are put in place to protect the respective Owners' interests. The other important point

(though not the focus of this article) is that any mechanisms need to be disclosed to investors prior to the sale of Component A or Units in Component B.

Let us consider some potential mechanisms for resolving this Hotel/Residential mixed use scenario:

Option 1 - Area “C” is Common Area and an Owners Association is formed.

Within the constitutional documentation for the Owners Association the following needs to be clarified so as to bind the Owners Association, as well as the Owner of the Hotel Component and Owners in the Residential Component:

1. The standards of maintenance and repair and provision of the Facilities needs to be that required by the Owner of the Hotel Component.
2. Owners within the Residential Component would need to accept heightened charges for the Facilities due to the higher standards required, or at least a cost split agreed up front.
3. If the Owners in the Residential Component dominated at the General Assembly or could control the Board then there would need to be a means of curtailing such rights to ensure 1 and 2 above were achieved.

Option 2 - Ownership of Area “C” passes to the Owner of the Hotel Component.

For this option to add value to the Owners in the Residential Component there would need to be an agreement (commonly called a “Building Management Statement”) setting out the rights and obligations of the Owners of the Components in relation to Area “C”.

Typically a Building Management Statement would:

1. Specify that Area “C” would fall within the Hotel Component;
2. By a separate plan designate that rights would be granted over Area “C” to the Owners in the Residential Component;
3. By the Building Management Statement and usually a schedule (commonly called a “Building Management Schedule”) designate the rights and obligations of the Owners in the Residential Component in relation to Area “C” including:
 - a. that the Owner of the Hotel Component would have the right to appoint the contractors;
 - b. by the Building Management Schedule, setting out the level of costs that the Owners respectively would have to share in relation to Area “C”.

Neither Option 1 nor Option 2 represents a perfect solution for both parties. Each requires consideration in order to reach a balance that is attractive to both parties.

Option 1 would require the Owner of the Hotel Component to become subject to the jurisdiction of an Owners Association with its associated procedures and mechanisms which may be considered onerous and more capable of dispute in a situation where Operators may want clarity, simplicity and control.

Option 2 however would lack transparency from the point of view of an Owner in the Residential Component. In particular, how could the Owners in the Residential Component be confident that the contracts and costs incurred by or on behalf of the Owner of the Hotel Component were procured in a fair and transparent fashion?

At this juncture, readers may also like to consider Diagram 2 where Area “A” once again is the Hotel Component, Area “B” is the Residential Component and Area “C” represents the shared car-parking, lobby and foyer areas and pool gym and recreational areas.

