

New rent cap law in Dubai: The balance of power has shifted

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February 2014

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Decree No. 43 of 2013 on Determining the Increase in the Real Estate Rentals in the Emirate of Dubai ("the New Decree") was issued on 18 December 2013 and is now in effect. As the name suggests, this is the new rent cap law in Dubai. The focus of this article is on the application of the New Decree, identifying a shift of balance of power in favour of the landlords, and outlining some practical steps for landlords and tenants to be better prepared with the implementation of the new rent cap.

Tenancy Law - historical rent control

Most landlord and tenant relationships in Dubai are regulated by Law No. 26 of 2007 Regulating the Relationship between Landlords and Tenants in the Emirate of Dubai (as amended by Law No. 33 of 2008) ("the Tenancy Law"). When the law was introduced in 2007, it contained an absolute restriction on rental increase for the first two years of the tenancy. This protection for tenants (or restriction on landlords) was removed with the introduction of Law No. 33 of 2008.

With the removal of the two-year rent increase restriction, landlords have been permitted to increase rent annually but only to the extent regulated by some later rent cap laws, being Decree No. 62 of 2009 and Decree No. 2 of 2011.

Application of New Decree

The New Decree came into effect on 18 December 2013. It applies to landlords from the public and private sectors and to all leases in Dubai, including leases in special development areas, free zones as well as the Dubai International Financial Centre ("DIFC").

Article 1 of the New Decree provides a rent cap layered structure setting out the maximum percentage increase in rent permitted when a lease is renewed. The application of the rent cap is dependent on the variance between the property rental value and the average market rental rate for properties in a specific area in Dubai. The average market rental rate is set according to the rent index produced and regularly updated by the Real Estate Regulatory Agency ("RERA").

The layered structure of the new rent cap is summarised below and illustrated by some examples.

If the existing rent is:

1. Less than 10% below the average market rental rate – no rent increase is permitted.
2. Between 11% and 20% below the average market rental rate – maximum 5% rent increase is permitted.
3. Between 21% and 30% below the average market rental rate – maximum 10% rent increase is permitted.
4. Between 31% and 40% below the average market rental rate – maximum 15% rent increase is permitted.

5. More than 40% below the average market rental rate – maximum 20% rent increase is permitted.

Example 1:

The average market rent for a one bedroom apartment in area X is AED 100,000 per year. A tenant is paying AED 95,000 per year, being 5% below the average market rental rate. On renewal of the lease, the landlord is not permitted to increase the rent in accordance with the New Decree.

Example 2:

The average market rent for a commercial office in area Y is AED 2,000,000 per year. A tenant is currently paying AED 1,500,000 per year, being a 25% below the average market rental rate. On renewal of the lease, the landlord is permitted to increase the rent by up to a maximum of 10% (being AED 150,000) in accordance with the New Decree. The new rent cannot therefore exceed AED 1,650,000.

RERA has in the past provided an online Rental Increase Calculator (“the Calculator”) which assisted landlords and tenants in determining the permissible rental increase in accordance with the earlier rent caps introduced in 2009 and 2011. It is understood that the Calculator has recently been updated to be in line with the New Decree. At the time this article is being prepared, the specific area list in the Calculator does not include DIFC. Considering the New Decree applies to DIFC, we suspect RERA will also be updating its rent index and the Calculator accordingly in that respect.

The Calculator can be viewed at www.dubailand.gov.ae/English/eServices/RentalIncreaseCalculatorEN.aspx. As a starting point, landlords and tenants are encouraged to use the Calculator as a tool to determine the level of rent increase permitted (if any) under the New Decree.

Balance of power shifted

The concept of a rent cap layered structure under the New Decree is similar to the previous rent cap structure under Decree No. 2 of 2011 (“the Old Rent Cap”). However, rent increases now kick in under the New Decree on lease renewal and as soon as rent for a property is 11% below the average market rental rate, as compared to the 26% required under the Old Rent Cap. There is a 15% drop in the benchmark for rent increase under the New Decree, shifting the balance of power from tenants to landlords, and allowing landlords to increase rent at a lower benchmark on lease renewal.

The shift of balance of power in favour of the landlords is illustrated in the diagram below.



Such a shift in the balance of power may be met with controversy between landlords and tenants. On one hand, tenants may argue that the benchmark for permitted rent increase has been drastically reduced which could potentially result in an increase by up to 20%. On the other hand, landlords may consider the reduction in the benchmark as appropriate considering the rent for some properties in Dubai has not been adjusted since the economic downturn. This article is not intended to analyse the justification for the shift in the balance of power, rather it is intended to ensure both landlords and tenants are aware of the new rent cap so they can be better prepared when their leases are due for renewal.

Practical steps for landlords and tenants

Landlords and tenants should consider the practical steps set out below to ensure the proper application of the new rent cap:

Step 1: Identify lease renewal date

As rent increase is permitted on lease renewal, landlords and tenants must identify their lease renewal

dates.

Step 2: Other rent adjustment arrangements in lease

It is not uncommon, particularly in commercial leases, for parties to agree to a fixed rent or fixed rental increase on renewal. Under such circumstance, the contractual arrangement prevails and the agreed fixed rent or fixed rental increase will apply on lease renewal.

Step 3: Determine rent increase under new rent cap

If step 2 does not apply, landlords and tenants should discuss possible rent increase in advance before the lease renewal date to avoid any surprises going forward. The Calculator would be a good tool to determine if rent increase is permitted and by how much. This would then allow the landlord and tenant to attempt to agree the appropriate rent increase through amicable negotiation.

Step 4: Resolving rental disputes

If a landlord and tenant disagree on the appropriate rent increase, the dispute should be referred to the Rental Dispute Settlement Centre established under Decree No. 26 of 2013. The filing fee for a claim is 3.5% of the rental and cannot be less than AED 500 or more than AED 20,000.

Some disputes are not suitable for the Rental Dispute Settlement Centre, for example if they fall within a free zone that has its own judicial committees or special courts (such as the DIFC), or the rental dispute is in relation to a long term lease. Such disputes must be referred to the appropriate judicial committees or special courts. What constitutes a long term lease is not defined in Decree No. 26 of 2013 and this remains to be clarified over time. However, it is suspected that a lease with a term of more than 5 years may be considered as a long term lease, as this has been the practice of the Dubai Land Department when dealing with lease registration under the Ejari system.

Conclusion

Notwithstanding the controversy that the New Decree may be met with due to its favouring of landlords, it is now in place and both landlords and tenants are encouraged to understand its implications and to be better prepared when their leases are due for renewal.