

Off-Plan in the Kingdom of Saudi Arabia

Daniel Goodwin
d.goodwin@tamimi.com

March 2014

Maintaining a Strong Market

The great property upswing of the past few years followed by the recent downturn, has caused legislators in the Kingdom of Saudi Arabia ("KSA") to take note, and, as a result, beneficial lessons have been learned. To safeguard against future downturns, KSA has put a framework in place intended to protect both consumers and sophisticated buyers, increase confidence in off-the-plan sales and allow developers to finance projects with draw-downs from payments by buyers. It is hoped that a solid legal foundation will sustain long term growth in the already growing KSA real estate market.

In recent years KSA has taken a number of significant and practical steps to regulate the sale and marketing of units off-the-plan (or "on-a-map") through the Ministry of Commerce and Industry ("MoCI"). The objectives of this regulatory action are to:

- protect the rights of buyers and developers;
- raise the level of transparency of quantities of supply and demand;
- discourage property speculation (and prevent real estate bubbles);
- reduce the cost of ownership of real estate units; and
- increase the supply of developed real estate throughout KSA.

Along with the recent Real Estate Mortgage Law, the regulatory changes allow a system where local and foreign-owned developers (who are subject to foreign investment requirements not addressed here) are able to sell off-the-plan and receive progress payments from buyers in order to finance development projects, subject always to a system of checks, balances and supervision by the regulator.

Licence Requirements

The Regulations for the Sale of Real Estate Units on a Map implemented by Ministerial Decree No.983 on 2/2/1431H corresponding to 18 March 2010 ("Off-the-Plan Regulations"), require a developer to apply for a licence for each project prior to announcing any marketing or commencing sales of any commercial, industrial, office, service, tourism or residential units in KSA.

An application for a licence requires the regulator to examine (among other things) the developer's:

- safety record;
- feasibility study for the project;
- forecast costs to complete (including marketing costs);
- sales contract forms;
- development permits and approvals; and
- agreements with accountants, auditors, building contractors and the consulting engineer.

Operation of Escrow Account

The developer must provide a copy of each sale contract with a buyer to MoCI within 10 days after the contract is signed.

Whether natural persons or bodies corporate, the Off-the-Plan Regulations contemplate that buyers will usually make payments by instalments during construction. All payments by buyers must be paid into the escrow account for the project together with any financing received.

Monies can only be released from the escrow account to make progress payments to the principal contractor or other consultants (including marketing and sales), provided certain conditions are met and sign-off for the payment is given by the developer, the consulting engineer and a chartered accountant.

Checks & Balances

Once a licence for the project has been issued, MoCI registers a marginalisation instrument (similar to a caveat) over the land to prevent dealings such as the sale, lease or mortgage of the base development land parcel. That instrument is to be released by MoCI at the completion of the project, and before the settlement of units.

Additionally, during the project the consulting engineer must:

- provide quarterly reports on the progress of construction against the programme;
- provide forecasts of the costs to complete to MoCI; and
- certify each progress claim with a certificate of achievement.

The chartered accountant must submit quarterly audit reports on the receipts and expenditures and the records of the escrow account to MoCI.

In addition to reviewing the audited accounts, bank statements and construction progress and costs, MoCI also carries out site inspections of works across KSA, to ensure all is running smoothly on each project.

In the event of failure of the project, including an inexplicable failure to commence construction, a lack of seriousness in implementation by the developer or if it considers it necessary, MoCI has the right to step in and take control of a project, either bringing it to completion or liquidating it and returning funds to buyers.

Sales & Marketing

A developer can only “launch” sales and marketing and open the escrow account once it obtains a licence for a specific project.

Whilst it is an offence to carry out real estate brokerage without holding a licence under the Regulation for Real Estate Offices, it is also an offence under the Off-the-Plan Regulations to carry out marketing or brokerage (in whole or in part) of any residential, commercial, industrial, office, service or tourism units off-the-plan without a licence.

It should be noted that whilst the Regulation for Real Estate Offices does not expressly prohibit “marketing”, it is expressly prohibited under the Off-the-Plan Regulations unless a licence has been issued for the Project.

Prohibitions & Penalties

Although there is a policy intent to discourage people from “flipping” property off-the-plan (i.e. by on-selling it prior to completion), there is no specific prohibition against this in the Off-the-Plan Regulations.

As you would expect, fraud, false reports to MoCI, embezzlement or collusion to deceive another, are all subject to criminal penalties, as is engaging in marketing or sales off-the-plan without a licence.

Other Regulations

The Off-the-Plan Regulations are intended to apply until “the issuance of a Draft Law of Account for Real Estate Developing Security”. Whilst it is not clear when it may be released or exactly how it may add to the Off-the-Plan Regulations, it does give MoCI the opportunity to make necessary amendments to integrate with recent real estate financing (and other) legislation, where necessary.

If an off-the-plan sales contract permits, or the developer allows completion of the sale to occur prior to the final payment being made by a buyer, developers must take care to ascertain whether the Law of Sale by Instalment (and its regulations) need to be complied with. A separate licence may be required for any such vendor-finance arrangements.

Conclusion

It is now widely known that developers in KSA must be licensed to carry out sales and marketing of off-the-plan developments, and that a separate application is required for each project.

Adequate time should be included in the project programme to achieve sales and marketing licensing, though some activities will obviously run concurrently with the application. Developers should take care in providing representations to MoCI in relation to feasibilities, costs and estimates of the programme to achieve project milestones. Similarly, developers would be wise to include in their contracts of sale an ability to extend their estimated timeframes.

Developers intending to use off-the-plan sales to finance projects will be keen to include progress payments by buyers under their purchase agreements as permitted by the Off-the-Plan Regulations.

Real estate laws in KSA continue to develop in sophistication. Safeguards now in place increase confidence and certainty for both developers and buyers off-the-plan for all real estate asset classes in the Kingdom of Saudi Arabia.