

Branded residences and rental pool arrangements in Dubai

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Investment into branded residences with rental pool arrangements is becoming an increasingly popular investment vehicle in Dubai.

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This investment option has a number of advantages when compared to a traditional lease, in particular the fact that the investment is fully managed. However, a rental pool arrangement is not a simple contractual arrangement. Indeed the concept of a managed and serviced apartment, or branded residence, incorporates different, and sometimes even conflicting, interests of its stakeholders being: the branded Operator, the Developer, and the Residence Owner.

While negotiating a rental pool arrangement, the Developer and the Operator usually require a fixed term and on occasions may state that remaining in the “rental pool” is mandatory for the Residence Owner. A mandatory rental pool gives rise to issues for both the Owner and the Operator, as under the law any Owner may, where circumstances justify the same, be entitled to withdraw its unit from the rental pool and actually reside in the unit. Conversely, if an Owner cannot rent out its unit to a third party, it may be held captive within the rental pool and obliged to accept the terms the Operator offers.

In view of such risks, the Operator may want to restrict the Developer from selling all the units in the development, and indeed may require the Developer to remain the owner of a particular number of units as a guaranteed source for the Operator’s business in future, regardless of the rental pool. In certain cases the branded residences sit alongside a Hotel component owned by the Developer, which is also a guaranteed source for the Operator’s business.

In this article we consider in more detail how the interests of all stakeholders can best be aligned. We do this in the context of the following, common rental pool schemes:

- the development consists of a hotel component and branded fully furnished units for sale with a “mandatory” rental pool. The branded residences will be managed by the Operator as serviced apartments (“*Hotel + Serviced Apartments*”); or
- the development consists of branded fully furnished units, part of which will be sold to private investors with a “mandatory” rental pool, another part will form a guaranteed number of units for the Operator’s management regardless of the rental pool. Sold branded residences will be managed by the Operator as serviced apartments to the extent and as long as these are kept in the rental pool (“*Serviced Apartments*”).

Alignment of interests

In order to create a suitable contractual structure it is important to first analyze in detail the interests of each stakeholder in the rental pool, and then to align them on an equitable and transparent basis.

In the table below we set out the relevant interests and steps that can be taken to align the stakeholder’s interest.

<i>Operator's interests and concerns</i>	<i>Residence Owners' interests and concerns</i>	<i>Developer's interests and concerns</i>	<i>Measures to be taken to accommodate all parties' concerns</i>
<i>Aspect No.1: Preservation of the Operator's right to operate and manage the property</i>			
The Operator is willing to operate and manage the Serviced Apartments (forming part of the rental pool) to the maximum extent possible in order to increase the overall revenue stream and, consequently, its remuneration.	The Residence Owners wish, on the one hand, to invest in a promising project with a reputed Operator, and on the other hand, to ensure the transparency of cost allocation and profit distribution.	The Developer is willing to sell the branded residences on its preferred terms to the maximum extent possible, for which reason accommodation and balancing of both Operator's and Residence Owners' concerns is the Developer's priority.	The Operator's right to operate and manage is ensured via: – Management Agreement signed with the Developer/Hotel Owner; – constitutional documents under JOP laws [1] – the Jointly Owned Property Declaration. Also it is important to ensure transparency in relations with the Residence Owners. For this purpose acknowledgement of the Operator as the branded operator of the Serviced Apartments (to the extent and as long as the residence unit is kept in the rental pool) should be clearly stated in the lease agreement to be signed with each Residence Owner ("Lease-Back Agreement"). The transparency of cost allocation and profit distribution is ensured throughout the rental pool documentation, as stipulated below. Such overall transparency will strengthen the parties' relations and will leave less room for possible misunderstandings and disputes.
<i>Aspect No.2: Multiple participants to the rental pool structure</i>			
The Operator is not willing to deal with numerous Residence Owners. Indeed the Operator is willing to deal directly and exclusively with the Developer (including, in terms of funding of working capital, the guarantees of Operator's indemnification and protection of brand etc)	The Residence Owners will be acting through an Owners' Association as per the JOP laws. To the extent and as long as the residential unit is kept in the rental pool, the power to vote at the General Assembly of the Owners' Association will be delegated to the Developer/Hotel Owner acting as a tenant under the Lease-Back Agreement. However, the Residence Owners should be at all times able to withdraw the unit from the rental pool if treated unfairly. In this respect the clear contractual regulation of the parties' rights and obligations is the key to success.	The Developer is willing to accommodate the Operator's concerns.	In order to comply with the JOP laws and accommodate the parties' concerns, the Developer (or its wholly owned subsidiary) will be acting as intermediary between the Residence Owners, Owners' Association and the Operator. In legal terms this can be achieved through the following contractual structure: – the Developer/Hotel Owner will be a tenant of the branded residences kept in the rental pool, and will be voting on behalf of the Residence Owner at the General Assembly of the Owners' Association; – the Developer/Hotel Owner or a related entity will be appointed as the Owners' Association manager to manage the day-to-day aspects related to common areas of the branded residences sold to the Residence Owners; – the Developer/Hotel Owner or a related entity will be appointed as the facility manager to maintain the common areas of the branded residences sold to the Residence Owners; – the above agreements allow the Developer to subcontract such services to the Operator; – all the above arrangements are clearly defined in the Management Agreement signed between the Developer/Hotel Owner and the Operator.
<i>Aspect No.3: Preservation of branded residences in the rental pool</i>			

<p>The Operator is willing to operate and manage the Serviced Apartments (forming part of the rental pool) to the maximum extent possible in order to increase the overall revenue stream and, consequently, its remuneration.</p>	<p>The Residence Owner may wish to withdraw its unit from the rental pool and actually reside in the development</p>	<p>The Developer has to create such rental pool structure, which will incentivize the Residence Owners to keep the branded residences in the rental pool.</p>	<p>The following measures can incentivize the Residence Owners to keep the branded residences in the rental pool:</p> <ul style="list-style-type: none"> – transparent and equitable allocation of cost and expenses attributable to the Serviced Apartments and profit distribution process (as specified below); – transparent budgeting process (as specified below); – notification procedure in case of unilateral termination of Lease-Back Agreement by the Residence Owner (at least 6 months prior notice, but in any case effective from the 1st January of the ensuing year to ensure continuity of budgeting processes, cost allocation and profit distribution between the Residence Owners). – Termination fee (liquidated damages amount) that shall be payable by the Residence Owner to the Developer as a tenant (to be transferred to the Operator in full amount as compensation of its loss of source of business) in case of withdrawal of the branded residence from the rental pool.
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Aspect No.4: Control over shared facilities (spa, gym, pool etc)

<p>The Operator is willing to maintain control over the shared facilities and enjoy peaceful possession and management of same in accordance with its brand standards. The Operator wishes to have exclusive power to define the level of services, prices and tariffs for using same by the guests of the Hotel and Serviced Apartments kept in a rental pool.</p>	<p>The Residence Owners wish to have the right to avail of the shared facilities where they reside in their own branded residence for any period during calendar year as prescribed in the Lease-Back Agreement (usually up to 1 month) and in case they decide to withdraw their respective branded residences from the rental pool.</p>	<p>The Developer has to create such rental pool structure, which will exclude the shared facilities from the Owners' Association's exclusive authority.</p>	<p>Provided the same is clearly disclosed to the Residence Owners before they purchase their units, such shared facilities may be placed in the title or under the control of the Developer/Hotel Owner yet the facilities may also be available for use by the Residence Owners and the costs apportioned fairly through an easement or building management statement. Such "Common Elements" as they are termed, would be overseen by a group composed of a duly appointed representative of the Owners' Association and the Developer/Hotel Owner. It is important to distinguish between "Common Areas" which are controlled by the Owners' Association and Common Elements which are in the title of the Developer/Hotel Owner and may have different rights and obligations attached.</p>
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Aspect No.5: Sharing the cost of management and maintenance of the Serviced Apartments

<p>The Operator wishes to ensure that the Serviced Apartments are managed in compliance with its brand standards, and for which purpose respective costs and expenses are borne by the Residence Owners and the Developer. After sale of the branded residences to the Residence Owners and putting them back into the rental pool, the Residence Owners shall share the operating and non-operating expenses attributable to the Serviced Apartments (including marketing, salaries of staff, replacement and repair of FF&E, minor repairs and capital repairs etc). In case the branded residence is withdrawn from the rental pool, then the Residence Owner shall share the cost of maintenance of shared facilities and common areas of the branded residences sold to the Residence Owners.</p>	<p>The Residence Owners wish to see a transparent and equitable cost allocation.</p>	<p>The Developer has to create such rental pool structure, which will be transparent and equitable in order to obtain RERA approval and to incentivize the investors to buy the branded residences and further keep them in the rental pool to the maximum extent possible.</p>	<p>Allocation of operating and non-operating expenses of the Serviced Apartments (either in a form of fixed % or as % of cost apportioned pro rata to the sq.f. of each unit) shall be regulated in the Lease-Back Agreement and shall apply to the extent and as long as respective branded residence is kept by the Residence Owner in the rental pool. In addition, the Residence Owner's obligation to share the cost of maintenance of shared facilities and common areas after withdrawal of the branded residence from the rental pool, will be regulated via the Unit Sale and Purchase Agreement, Facility Management Agreement and Building Management Statement. Each Residence Owner will be obliged to share such cost pro rata to the aggregate area of its respective unit, regardless of actual usage of shared facilities.</p>
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Aspect No.6: Protection of Brand

<p>The Operator wishes to ensure that: – its brand is fully protected from competitors; – the Developer and the Residence Owners comply with its brand standards.</p>	<p>The Residence Owners wish to avail of the Operator's brand as it is one of the key prerequisites for success of the project and return on their respective investments.</p>	<p>The Developer is willing to accommodate both parties' concerns.</p>	<p>As long as the branded residences are kept in the rental pool the Operator's brand is protected to the maximum extent possible based on the Management Agreement signed with the Developer. In order to ensure protection of the Operator's brand in case of withdrawal of the branded residence from the rental pool, the Unit Sale and Purchase Agreement, Facility Management Agreement and Building Management Statement shall provide for the following restrictions: – the Residence Owner is restricted from appointing an operator for management of the branded residence, which is the Operator's competitor; – the Residence Owner is restricted from creating competition to the Operator and thus, may not rent out the branded residence to a third party for a period of less than 1 year; – the Residence Owner undertakes not to interfere with the Operator's management of the rest of the Serviced Apartments and shall not in any way compromise the Operator's brand standards.</p>
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Aspect No.6: Operator's remuneration and distribution of profit

<p>The Operator wishes to ensure that it receives its remuneration on the same terms and conditions as provided in the Management Agreement signed with the Developer/Hotel Owner.</p>	<p>Since the Residence Owners wish to avail of the Operator's brand, they agree to pay the Operator the requested remuneration, provided, however, that the Operator maintains transparent budgeting and spending policy.</p>	<p>The Developer is willing to accommodate both parties' concerns.</p>	<p>Transparency of budgeting, cost allocation and profit distribution will be regulated in the Lease-Back Agreement. As such, the Residence Owners will be entitled to the net operating profit after deduction of all cost and expenses attributable to the Serviced Apartments, as well as deduction of Operator's fees, less service charges for maintenance of common areas. In such a way the Operator ensures that it is getting its remuneration from the operating account before respective net profit is remitted to each Residence Owner.</p>
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As one may see from the above, the rental pool arrangement is a complex structure involving different stakeholders with different and sometimes conflicting interests. In order to ensure the success of the project and protection for all participants, it is highly important to establish and disclose an effective rental pool structure with very detailed allocation of rights, obligations and remedies.

[1] Dubai law No.27 of 2007 "On Ownership of Jointly Owned Properties in the Emirate of Dubai" and respective RERA's "Directions" to the JOP law