Taking security over real estate in Dubai and Abu Dhabi: Recap for banks

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Registration of properties and transactions with the relevant authorities is at the heart of such reforms, particularly in Dubai and Abu Dhabi. In Dubai, the Dubai Land Department (the “DLD”) is responsible for recording and keeping track of all acts of disposal over real estate located in Dubai, while, in Abu Dhabi, this task is carried out by the Municipality of Abu Dhabi (the “Municipality”).

From a banking and finance perspective, documenting and registering rights and disposals of real estate is inextricably linked to the types of securities which can be granted (and registered) as a result. In effect, an advanced real estate registration system in which it is possible to register real estate related rights and asset security provides banks with more certainty in terms of reduced litigation risks and enforcement procedures; and reduces potential unauthorised sale or disposal of the secured property. From a borrower’s perspective, the availability of an advanced registration system provides borrowers with a better negotiating position and easier access to financing generally. For both parties, a trustworthy real estate register carries significant benefits.

In acting for UAE banks we frequently assist in creating security structures for financing transactions. During these interactions, the scope and effect of the different forms of security and how each applies to real estate need to be understood in the context of the deal. Below are brief examples of some of the issues that are encountered for security packages involving real estate.

Mortgages versus Conditional Assignments

While registered mortgages over real property (registered with the DLD or the Municipality) are the best type of security which can be obtained in Dubai or Abu Dhabi, this security is often unavailable for properties in Abu Dhabi where titles are yet to be issued, including those under development. In Dubai, the Interim Land Register has provided a solution for this problem by catering for the registration of mortgages over properties which are still under development.

In Abu Dhabi, this issue has not been solved yet and many banks opt for the only “alternative”. This consists of obtaining, usually pursuant to an overarching memorandum of association, a conditional assignment of the sale and purchase agreement (the “SPA”) of the real estate property being developed. The form of assignment agreement is usually imposed by the developers who are often reluctant to negotiate the terms of the assignment. Although we are not aware of any major issues with this “alternative” for properties under development to date, from a purely legal and enforcement perspective, an assignment of SPA does not amount to a mortgage and requires specific conditions to be met for its validity. Both the SPA and the corresponding assignment agreement should be carefully reviewed together to avoid the bank inheriting any of its customer’s unfulfilled obligations under the SPA.

Mortgage of musataha rights

Article 1353 of the UAE Civil Transactions Law No. 5 of 1985 defines musataha as being the right of the musateh (i.e., in effect, the lessee) to build a building or to plant on the land of another (the landlord). According to the same law, musataha agreements may not exceed 50 years. After their expiry, the musateh returns the land to the landlord (including any improvements which may have been constructed or planted thereon). Once vested with musataha rights, the musateh may (for the duration of the musataha agreement) dispose of such rights in any manner he deems fit, which renders musataha agreements attractive for undertaking certain long term projects involving real estate, business or industrial projects. However, any such acts of disposal should not include transfer of ownership (this being impossible as the landlord remains the title holder), the creation of any rights to third parties beyond the term of the musataha agreement, or any act which breaches any specific conditions agreed between the parties to musataha agreement.

It is not possible to create a valid mortgage over a musataha right unless the musataha agreement itself is capable of being registered (with the DLD or Municipality, as applicable). Also, failure to register the mortgage of the customer's musataha right with the DLD or the Municipality would render the mortgage void. In an event of default, the bank would only be entitled to sell (through public auction) the remaining duration of the mustataha agreement to a buyer. It does not step in as the new musateh.

In other words, the commercial value of this security lies in the duration remaining at the date of the auction. For example, if the term of the musataha agreement is for 25 years and a default occurs on year 19 of granting the loan, the potential new musateh would need to be satisfied with a remaining duration of 6 years. Banks should therefore carefully assess the duration of the musataha agreement and ensure that it exceeds the duration of the loan by at least a reasonable period of time in order to attract as many buyers as possible in the event of sale by public auction.

Mortgaging musataha rights versus commercial mortgages

A common misunderstanding that we sometimes come across is a confusion between the scope of a commercial mortgage and the scope of a mortgage over land, including musataha rights. A commercial mortgage does not encompass immovable assets such as buildings or plants. A commercial mortgage only encompasses movables and intangible rights (such as machinery and certain intellectual property rights). This is clearly stated in article 164 of the UAE Commercial Transactions Law. Where the relevant authorities have accepted the registration of commercial mortgage agreements which captures immovable assets, this would not be considered as being legally effective. A mortgage of musataha rights on the other hand does not include any movable property that might be present on the site at the date of returning the land.

Granted Land

As per the implementing order issued by the Ruler of Dubai on 14 May 1996 ("Implementing Order"), granted land in the Emirate of Dubai, whether commercial or residential, that has a separate title deed can be mortgaged in favor of a bank. As per this Implementing Order, mortgages can be registered in relation to such granted land in favor of banks on the condition that the registration of mortgage is against financing granted by such banks to the borrower for the purpose of construction on the granted land and on the additional condition that the value of construction is equivalent to the finance amount. We are not aware of any enforcement precedent in connection with granted land so the consequences of not complying with the Implementing Order, and other Dubai regulations associated with granted land, have not been tested so far. We note however that the Implementing Order specifically approves grant of mortgages over granted lands and therefore such mortgages should be enforceable by law.

In Abu Dhabi, Article 2 of Abu Dhabi Law No. 19 of 2005 Concerning Real Property states that every property granted by the Government to a UAE national shall be that person's property and it is therefore obligatory for the UAE national to register the title to the property. The grantee shall also, within the boundaries of the law, have the right to use, exploit and dispose of the real property. Article 10 of the same law states that UAE nationals may sell and purchase or otherwise dispose of residential, commercial, investment, and agricultural plots of land and buildings established for a specific purpose that have been allocated to them provided that the purpose of allocation is not changed.

Lands granted to UAE nationals for residential purposes in Abu Dhabi cannot be sold unless construction is completed over the granted lands. This position is confirmed by presidential instructions issued in 2007. Also, we understand the practice of the Municipality is to allow the sale of residential land granted only to UAE nationals (i.e. after the issuance of construction completion certificate) and may also require that an approval from the Ruler’s Court is obtained before allowing the title transfer. Considering this, banks should always seek the prior approval of the Municipality in relation to taking a mortgage over residential granted land before committing to financing.

Other issues relating to the above:

- The recent decision of the DLD dated 19 March 2015 sets 30 June 2015 as the deadline for the registration (and payment of related fees) of real estate rights and acts of disposal in the Real Estate Register and/or the Interim Land Register held with the DLD. The decision provides that, among other things, failure to pay any unpaid fees to the DLD shall constitute a financial evasion and may be reported as such to the relevant authorities. The decision also mentions that failure to register a relevant property within the deadline may render its ownership void.
- A standard-form musataha agreement has been introduced for the Emirate of Abu Dhabi where the property is owned by its Government. Financial institutions will need to be familiar with this template when providing lending to projects to be constructed on such land.
- The perfection requirements and type of real estate securities varies from what is described above in some of the free zones located in both Abu Dhabi and Dubai. As an example, the Dubai International Financial Centre has its own register of securities and perfection requirements. Jebel Ali Free Zone offers a hybrid security which allows mortgaging of buildings but without the underlying land. Similarly, it is expected that the Abu Dhabi Global Market will introduce its own rules with regard to taking security over properties located within the free zone.