

# The New Abu Dhabi Property Law: An Overview for Property Financiers

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The Law No. 3 of 2015 on the Regulation of Real Estate Sector in the Emirate of Abu Dhabi (the "Property Law") will take effect from January 2016.

The Property Law retains many existing core principles of existing Abu Dhabi real property law, such as the requirement for all dealings in property to be registered, and confirms much of the procedural market practice, for example, the information required in respect of mortgage registration.

However, its scope has been expanded to many aspects which were previously either unclear or unaddressed. The Property Law now tackles many issues which had previously been of concern to property financiers and mortgagees within the Abu Dhabi market, particularly in the areas of off plan financing and mortgage enforcement.

This article provides a brief overview of the Property Law relevant to property financiers.

## **Financing Of Off Plan Units**

Prior to the Property Law, there was no clear legislation to safeguard property financiers lending on off plan sales in Abu Dhabi. As a consequence, whenever financing the purchase of off plan property, lenders had to accept the credit risk of the property developer in addition to that of the end buyer. Lenders were dependent on the developers maintaining an accurate interim registry to register the real estate rights in the property, without the involvement of an independent third party or supervisory authority. Further, lenders were also reliant on the contractual agreements by the developers to register the off plan property upon completion, leaving the lenders in a position where they were contractual mortgagees but without the benefit of rights in rem over the financed property pending registration of their mortgage. Another source of concern was the limited statutory safeguards for property financiers against the delay, non-completion or defects of the property.

The Property Law introduces stringent supervision over property developers, including various requirements to be complied with by a property developer before consent is granted by the Department of Municipal Affairs ("Department"), the regulatory and supervisory authority over property developers, for a property developer to be licensed and for a particular project to be approved.

The law introduces the requirement for the maintenance of an escrow account prior to approval being given for a property developer to commence a project and make off plan sales. Escrow accounts are to be operated by a bank or a financial institution that has been approved by the Department. Therefore banks / financial institutions intending to act as escrow agents may need to enter into agreement with the Department, confirming the terms of their appointment.

There are limitations on circumstances in which withdrawals by the property developer may be made from the escrow account, including the condition that the developer must have first met a 20% milestone in the development project. In case of failure by the developer to complete a project, the escrow account bank is obligated to safeguard the depositors and ensure the successful

completion of the project within a specified period (including, if necessary, the appointment of another developer), failing which property financier and end buyers are granted priority (after the deduction of the account trustee's expenses) to the funds in the escrow account. A notable development that further strengthens the position of financiers of off plan units is the establishment of the Initial Real Estate Register. This register shall record all dispositions over units sold off plan, aimed to cover the construction period. The Property Law confirms that dispositions over off plan units shall not be binding on any of the parties involved or be valid with respect to third parties unless they are registered in the Initial Real Estate Register in accordance with the Property Law. All such disposals related to real estate units sold off the plan which have been made before the enforcement of the provisions of the Property Law shall be entered into the Initial Real Estate Register within six (6) months of the date of its commencement, which period may be extended by Department.

The purchaser of a real estate right may also mortgage his contractual right on the real estate unit, sold off plan, in order to pay the price of the real estate unit, provided that the real estate unit is registered in the Initial Real Estate Register and that the mortgagee shall pay the loan amount directly to the escrow account.

The Property Law has also imposed an obligation on the developer to inform the lender/mortgagee in the event of a default by the purchaser/mortgagor under the sale and purchase agreement, so that remedial actions may be taken by the lender/mortgagee to avoid termination of the sale and purchase agreement by the developer due to the purchaser's/mortgagor's default.

Under the previous regime, developers had a contractual right to impose fees for registering a mortgage or transfer over property, the cost of which can be prohibitive to the debtor. The Property Law has abolished the right of developers to collect fees other than administrative expenses paid to third parties (subject to a maximum set by the Department).

It is encouraging to note that the developer is now obliged to transfer the real estate units sold off plan to the purchasers registered in the Initial Real Estate Register to the Real Estate Register, provided that the purchasers shall have paid the full purchase price of their units to the developer (or as per agreement) and in accordance with the procedures issued by the Department. Previously, this was not an automatic right, but something to be negotiated with developers.

It is also pertinent to note that the Property Law makes it a material breach by a developer not to link purchase price payments to construction progress. Such a material breach allows the purchaser of the off plan unit to terminate the purchase contract between it and the developer. Consequently, it is preferable for a financier to link the drawdown of a facility to construction milestones, which makes linking of payment to construction an important factor in determining the amount of each drawdown by the debtor.

Many of the above aspects were previously determined through contractual arrangements or cooperation agreements between the banks and developers, leading to a large variance in approach. The Property Law now ascertains the accepted position, which should provide consistency to banks lending for off plan properties in the future.

## **Development Finance**

For financing the development of a project a developer is generally prohibited from mortgaging the project land or any real estate right related to it unless the mortgage is granted for the purpose of financing the building of the project and provided that (i) the loan amount is to paid directly into the escrow account; (ii) the developer informs the purchaser(s) about the mortgage through notification in the sale and purchase agreement; and (iii) the developer and mortgagee undertake to release the mortgage over the sold unit(s) once fully paid.

## Mortgages

The Property Law sets out the requirements and formalities of a mortgage, which are mostly in line with the current practice.

The Property Law confirms that if the mortgagee is a bank, finance company or financial institution, it has to be duly licensed registered with the Central Bank of the United Arab Emirates (the “Central Bank”) to engage in real estate financing in Abu Dhabi. This implies that an entity that is not a bank or financial institution may also act as mortgagee (as the law only introduces the condition for a Central Bank licence for financial institutions, it does mandate that a mortgagee must be a licensed financial institution). This, however, would be a departure from usual practice and may not be accepted by the Department in reality.

Any mortgage not registered in the Real Estate Register or Initial Real Estate Register, as the case may be, in accordance with the procedures prescribed by the Department, including any agreement to such effect, shall be void. In-kind surety mortgages (i.e. those granted by third party’s in support of the primary debtor’s obligations) are expressly permitted.

The priority of mortgages has been clarified (in order of the time and date registered), although interestingly, if multiple mortgage applications are received at the same time, the mortgage is to be assigned the same serial number and the relevant creditors are to rank equally amongst each other. This could prove useful where financiers agree to share security in respect of a project providing an alternative to the usual security agent/intercreditor arrangements.

The Property Law allows for the transfer or assignment of a mortgage to another creditor subject to the consent of the mortgagor. The transfer must be recorded in the original deed of title and registered. This diverges from the current practice that a mortgage cannot be transferred to another creditor, save by way of cancellation of the current mortgage and registration of the fresh mortgage, and it is anticipated to be welcomed by the banks.

The Property Law now clearly specifies that the mortgagor shall have the right to use and administer his mortgaged property and collect its yield and revenue until it is foreclosed and sold at a public auction upon default of paying the debt. However, as a safeguard to the mortgagee, the court can order that the revenue from the mortgaged property be frozen with effect from the date of filing of the action to enforce the mortgage if it finds that the mortgagor is delaying payment of his debt to the detriment of the mortgagee. In the case of early payment, the mortgagee may levy a fee or fine for early repayment, provided that such fee or fine is commensurate with the extra expenses actually incurred by the mortgagee due to early repayment, and subject to the limits specified in Central Bank regulations.

For musataha, usufruct and long term leases, the Property Law permits the creation of mortgage over such rights where they last for a period of 10 years or more, in case of a musataha or usufruct and for a period of 25 years or more, in case of long term lease. In connection with mortgage over musataha and usufruct rights, the Property Law confirms that: (a) such mortgage may be created without prior approval of the owner of the property; and (b) the owner of such property shall not be permitted to mortgage such rights again, without approval of the musataha or usufruct holder (although it is permissible to agree otherwise).

The Property Law generally confirms that a registered mortgage is an execution deed and can be directly executed/enforced before the execution court. A mortgagee must serve written notice to the mortgagor and the guarantor, if any, by registered mail with the acknowledgment of receipt informing them of the default and requiring payment within a period of no less than 30 days from the date of the notice. However the Property Law also provides that enforcement of a registered mortgage starts with an attachment application to be submitted to the competent summary court

after giving notice to the debtor, without having to obtain a court judgment that the debtor owes the debt. It appears that the Property Law considers registered mortgages as execution deeds, but requires mortgagees to enforce such deeds through the summary court (and not the execution court). The Property Law further confirms that mortgage agreements with “self-help” provisions shall be valid, however, the condition of self-help shall be void and therefore not enforceable.

While direct enforcements have been successfully obtained through Abu Dhabi courts previously, the legislative confirmation of this procedure should be well received by financial institutions, both for the resultant time and cost benefits.

### **Final Thoughts:**

The changes introduced by the Property Law provide a much clearer framework for both borrower and lender. Its introduction should likely encourage more lending in the real estate sector in Abu Dhabi accordingly. With the commencement date of the legislation fast approaching, lenders will need to review their documents and processes to ensure conformity with the new law so that they are ready to serve their customers.