Securities and Collateral for Education Financing in Dubai & Abu Dhabi

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Financing of educational institutions (i.e. schools, kindergarten and to a certain extent universities) is on the rise in the UAE. Foreign educational institutions (e.g. schools, kindergarten and universities) either explore local bank funding (i.e. UAE banks) or seek the assistance of their home county banks or financial institutions to fund either establishment or expansion of such educational institutions in the UAE.

Whilst educational financing is being widely used in the UAE, banks and financial institutions struggle in zeroing in on effective security. Bank struggle primarily due to the complex corporate structure and supporting infrastructure of educational institutions. In this article we seek to identify (and where possible clarify) the nature of securities and collateral available to banks and financial institutions (in the Emirates of Dubai and Abu Dhabi) to secure such financing arrangements.

Security Over Movable and Immovable Assets

In the Emirate of Dubai, private schools must obtain an Education Services Permit (Permit) from the Knowledge and Human Development Authority (KHDA). If the school is in the UAE mainland, the limited liability company ("LLC") that will own and operate the school should have one or more UAE national partner whose share in the capital should not be less than 51%. This is based on the minimum Emirati shareholding prescribed for a LLC by the Commercial Companies Law. This creates a need for foreign investors and school operators to enter into nominee arrangements with UAE entities (wholly owned by UAE nationals) or UAE nationals (in their individual capacity) in order to incorporate the LLC, and to apply for and obtain the Permit from the KHDA in its name.

As the assets of schools (including the land on which the schools are built), are usually owned by the LLC, any security to be provided over the assets of a school requires the involvement of the 51% UAE national shareholder (Nominee). In typical school financings, this has resulted in the need to involve the Nominee as an active participant in the financing arrangements. Due to restrictions of foreign ownership of immovable property in Dubai (except designated areas where land be owned by foreigners), the Nominee is usually the sole owner of the school property and as such must be involved in any land mortgage to be granted over the school premises and registered with the Department of Land and Properties, Government of Dubai.

In the Emirate of Abu Dhabi, problems arise when the financier is looking for security over the associated real estate rights, especially when the educational institution is established outside the 'investment zones'. In our past experience, real estate rights in Abu Dhabi were secured by an assignment of the leasehold interest or "musataha" in favor of the financier. The landlord would typically be the Abu Dhabi Education Council (ADEC), and would agree to assign its leasehold interest in the land provided: (a) it was for financing the educational institution to which the lease related; and (b) ADEC consented to the assignment by way of an acknowledgment. Once this security was fully executed by the assignor, assignee and ADEC, it would be noted in the books of ADEC, but not registered with the any land department or municipality. In order to enforce such security the financial institution would have to rely on the cooperation of ADEC in its capacity as the landlord.

Since the inception of Abu Dhabi Law no. 3 of 2015 it is possible to create security over the real estate right, when the educational institution is built on land that belongs to the Emirate of Abu Dhabi. This form of security would be in the form of a mortgage over the registered leasehold / “musataha” interest. Such mortgage is usually over the rights of the educational institution under the lease / “musataha” entered into by the Department of Municipal Affairs (acting on behalf of Government of Abu Dhabi) and the educational institution, in accordance with the applicable law. Difficulty arises when the educational institution (outside any Investment Zone in Abu Dhabi) is not completely owned by UAE nationals i.e. the shareholding pattern of such institution involves foreign ownership. In these cases it is not possible for such institutes to enter into a lease with the Department of Municipal Affairs with respect to land outside the Investment Zone in Abu Dhabi and thereby create a mortgage over it and hold it on behalf of the educational institution. In such situations, it is advisable for the local shareholder of the educational institution to enter into the lease and mortgage such lease in favor of the financier.

It is also important to note that all real estate security can only be created in favour of a UAE Central Bank licensed bank or finance company. Therefore when the foreign educational institutions seek funding from their home country banks (not licensed by UAE Central Bank) it is common for them to appoint a UAE bank the security agent to hold such security which adds to the cost of creating such security.

It is also common for education financiers to take security over the current movable assets of the educational institutions by way of a pledge. Unlike other project assets, such assets are of low monetary value which depreciate over a period of time.

Security over the Income Stream

A common form of security available from educational institutions stems from the applicable fees, which is the primary source of income for any such institution. As such, school or university fees can be assigned to a bank and can be payable from the student body directly to an account of the bank or an account of the school maintained with the lending bank. Where school fees are paid by credit card, the school is able to assign the point of sale receivables to the lending bank by entering into a separate security assignment with the merchant bank providing such point of sale arrangement to such educational institutions. There is a challenge with ‘start-up’ schools that typically takes 1-2 years after set up for enrolment of students and receipt of school fees. As the set-up process for schools is fairly capital intensive, the need for financing arises from the very initial stages, when the income stream is not available to be secured. Lending banks typically must rely on a contractual undertaking from the school to assign the school income when such income (in the form of fees) materialises.

Promoter Guarantees

Apart from the various securities available to banks, banks usually also obtain guarantees of the promoters of the school. This allows the banks to be able to attach the personal assets of the promoters or take security over other personal assets of the promoters (which are independent of the educational institution).

Conclusion

It is important for banks and financial institutions to carefully structure their loans and security in order to safeguard themselves and make mitigate themselves against the issues and risks discussed in this article. As education financing becomes increasingly prevalent, it is essential financial institutions develop a clear understanding of the security structures available to be able to effectively secure themselves from any risks associated with lending to financial institutions.

Al Tamimi & Company’s banking team regularly advises both lenders and borrowers on financing offered to educational institutions. For further information, please contact Mamoon Khan (M.Khan@tamimi.com) or Sakshi Puri (S.Puri@tamimi.com).