

New Abu Dhabi Real Estate Laws – Laying the Legal Foundations for Institutional Investment

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The years since the global financial crisis of the last decade have witnessed a significant increase in institutional investment (for instance, by pension funds, sovereign wealth funds and insurers) into global real estate. This trend appears set to endure, as institutional investors continue to increase the percentage of their portfolios targeted for allocation to real estate¹.

The Emirate of Abu Dhabi has of course played a leading role in this, through funds such as those managed by the Abu Dhabi Investment Authority which have made major investments in landmark real estate assets in the US, UK and other global markets. However, whilst there have been major capital flows outwards from Abu Dhabi over recent years, in comparison only small amounts of institutional money have historically been invested inwards into the Abu Dhabi real estate sector, and the majority of this has come from regional (i.e. GCC and other Middle Eastern) investors. There are various reasons for this, but one of the principal ones may be the perception that the legal framework needed to be updated in line with the requirements of institutional investors.

Against this backdrop, two new sets of laws have been introduced over the last year, which have radically altered the legal framework governing the real estate sector in Abu Dhabi and which have put the Emirate on a more level playing field with its neighbour Dubai in this regard. Collectively, these new laws create a more stable, robust and transparent (and thus “de-risked”) legal platform for owning, investing in, developing and financing real estate projects in Abu Dhabi.

Whilst certain hurdles to institutional investment inevitably remain, the introduction of these new laws is a vital step towards laying the legal foundations necessary to facilitate increased institutional investment into Abu Dhabi real estate, both from regional and non-regional investors.

¹ See Cornell University’s Baker Program in Real Estate and Hodes Weill & Associates LP, “2015 Institutional Real Estate Allocations Monitor”. This states (p. 8) that the average target allocation to real estate amongst the 242 global institutional investors it surveyed was expected to be 9.85% in 2016; up from 9.56% in 2015, 9.3% in 2014 and 8.9% in 2013.

What are these New Laws?

The two new sets of laws referred to above (collectively, the “**New Laws**”) are:

- The Property Regulations 2015 and the Strata Title Regulations 2015, which came into force on 14 June 2015, and which apply to real property within the geographical area of the new offshore financial freezone known as the Abu Dhabi Global Market (the “**ADGM**”) which currently comprises the whole of Al Maryah Island (the “**ADGM Laws**”); and
- Abu Dhabi Law No. 3 of 2015 Concerning the Regulation of the Real Estate Sector in the Emirate of Abu Dhabi, which came into force of 1 January 2016, and which applies to real property within the Emirate of Abu Dhabi but which (with certain limited exceptions) has no application to real property within the ADGM (the “**Onshore Law**”).

How have these New Laws created a more robust legal framework?

Collectively, the New Laws create a more stable, robust and transparent (and thus “de-risked”) legal platform for owning, investing in, developing and financing real estate projects in Abu Dhabi. Whilst a discussion of the minutiae of the New Laws is beyond the scope of this briefing, we have summarised some of the headline features below:

- **Application of English law in ADGM** – in similar vein to the DIFC and other jurisdictions such as Hong Kong and Singapore before it, the ADGM has adopted English law (including the principles of equity) as the basis for its legal framework, including with respect to the ownership and registration of real property. The intention is to create a legal regime for real estate that international investors know, trust and are familiar with, and which has stood the test of time.
- **Enhanced industry regulation** – under the Onshore Law, it is now mandatory for all developers and other key industry participants (brokers, surveyors, valuers, auctioneers and co-owners’ association managers) to be licensed by the Department of Municipal Affairs and Transport (“**DMAT**”) before carrying out any business activities. Such licenses must be renewed annually and applicants must, if required by DMAT, undertake compulsory training courses in order to obtain and/or renew their licences. Persons who carry out business activities without the requisite licenses are liable to fines (of up to AED 2,000,000) and, in some cases, imprisonment. Although the Onshore Law is not generally applicable within the ADGM, we understand that the ADGM is in practice requiring developers (and other key industry participants) to register with and be licensed by DMAT before carrying out any activity within the ADGM. Accordingly, the ADGM has signed a Memorandum of Understanding with DMAT pursuant to which DMAT is confirmed as the competent authority for registering developers (and other key industry participants) who wish to carry out business activities within the ADGM.
- **Strata title** – the New Laws introduce a legal framework for strata title and ownership in Abu Dhabi, similar to that already in force in Dubai. Developments in Abu Dhabi (both in the ADGM and onshore) are now capable of being subdivided both vertically and horizontally and sold to multiple investors on a “freehold” basis (with common parts being held communally by a co-owners’ association, or in certain circumstances being retained by the developer). Developments can also be subdivided on a “volumetric” basis into different use components, with some components (e.g. residential or office space) being subject to strata ownership but with other components (e.g. a hotel or a shopping mall within the development) being subject to single ownership and thus capable of being sold to a single investor with distinct title.
- **Mandatory escrow accounts** – the New Laws introduce mandatory escrow account provisions to protect off-plan purchasers, similar to those already in force in Dubai. Going forwards, developers of projects in Abu Dhabi (both in the ADGM and onshore) that involve off-plan sales must, by law, establish an escrow account into which must be paid all proceeds from those off-plan sales and also from bank finance relating to the project. These proceeds are then ring-fenced for exclusive use in relation to the project. Payments out of the escrow account to the developer are only permitted in certain pre-defined circumstances linked to construction progress. Under the Onshore Law, there is an outright prohibition on any monies (whether from off-plan sales or bank finance) being released to the developer until the project is at least 20 percent complete; meaning that, in practice, projects outside the ADGM will need to be self-funded as to the initial 20 percent of their cost. Following practical completion, the escrow agent is required to retain a minimum amount of the proceeds in escrow for a minimum period of time, as security for the repair of latent defects.

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- **Enhanced protections for off-plan purchasers** – alongside the new escrow provisions, the New Laws also introduce greater general protections for off-plan purchasers. For instance, the Onshore Law introduces certain protections for off-plan purchasers where projects are delayed or cancelled, as well as termination rights in certain predefined circumstances, including where the unit delivered substantially differs from the specification set out in the SPA, or is unusable due to fundamental defects in construction.
 - **Clarity around mortgage enforcement** – the New Laws give greater clarity to the procedures that a mortgage lender must follow when taking enforcement action following a borrower default. In the case of real property within the ADGM, mortgage lenders now (as is already the case in the DIFC in Dubai) have a wider array of potential remedies than is available onshore, such as the power to sell the property by way of private contract (rather than by public auction, which is the usual method of enforcement in the UAE), the power to enter into possession and receive the rents and profits from the property, and the ability to appoint a receiver. Over time, this may give rise to a secondary “loan to own” market, at least for property within the ADGM, whereby distressed real estate can be acquired indirectly through buying and enforcing on mortgage debt attached to it.

Why is this good news for institutional investors?

Whilst there have been major capital flows outwards from Abu Dhabi into global real estate assets over recent years, only small amounts of institutional money have historically been invested inwards into the Abu Dhabi real estate sector (with the vast majority of that money coming from regional investors who already know and understand the region). The same is largely true of Dubai (although institutional activity levels there have tended to be slightly higher than in Abu Dhabi).

Various reasons have been cited for this by market commentators, such as lack of investment grade product; a shortage of willing sellers coupled with the long term “hold” strategy favoured by local investors; limited liquidity; the fledgling nature of REITs and investment markets in the region; and restrictive foreign ownership laws². However, another factor inhibiting institutional investment into Abu Dhabi in the past has been the perception that the legal framework governing the real estate sector needed to be updated in line with the requirements of institutional investors.

The reforms brought about by the New Laws have radically altered the legal framework governing the real estate sector in Abu Dhabi and have put the Emirate on a more level playing field with its neighbour Dubai in this regard. Collectively, these laws create a more stable, robust and transparent (and thus “de-risked”) legal platform for owning, investing in, developing and financing real estate projects in Abu Dhabi, which is more capable of supporting investment by (and more likely to be attractive to) institutional investors.

Conclusion

The New Laws are a significant step forwards for the real estate sector in Abu Dhabi.

We are still very much in the early days of the implementation of the New Laws. As is the case when any major new laws are introduced, there has inevitably been an initial “road testing” period, whilst the New Laws are being assimilated into the market and the processes for implementing them are being rolled-out by the relevant authorities.

Looking to the future, the introduction of the New Laws is undoubtedly a key part of the process of repositioning the Abu Dhabi real estate sector so that it is more attractive and more marketable to institutional investors. This is not to say that levels of institutional investment are going to increase overnight, as this is of course also dependent on market forces and other external factors. However, over time, the hope is that the New Laws will facilitate an increase in levels of institutional investment into Abu Dhabi real estate (both from regional and non-regional investors), with Abu Dhabi also taking a larger share of the overall institutional investment coming into the region (the majority of which is currently being allocated to Dubai).

² See CBRE, “In and Out: Middle East 2015”, p. 9.

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