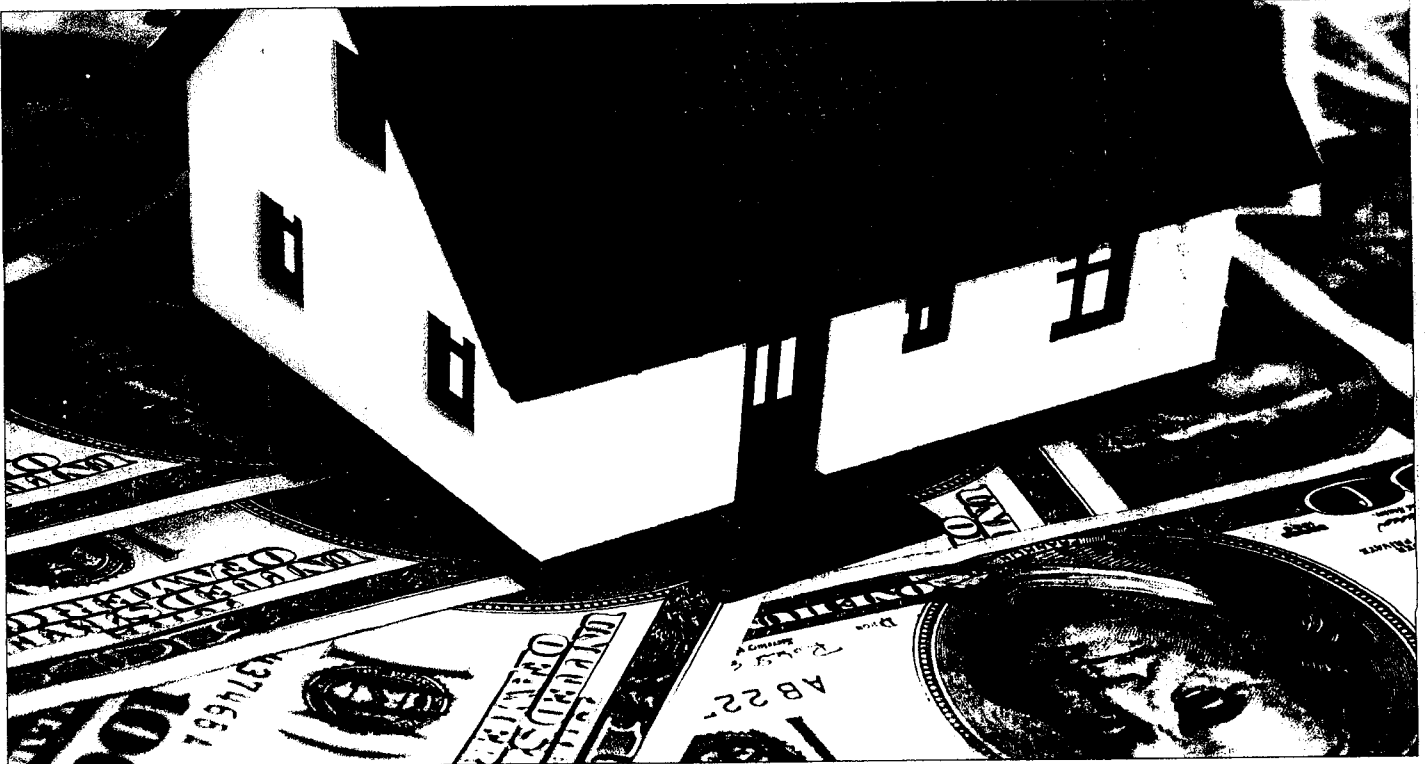


ESCROW ACCOUNT LAW WILL HELP INCREASE INVESTOR CONFIDENCE IN DUBAI



■ The Escrow Account Law will serve to attract more foreign investment in Dubai's real estate sector, especially from certain real estate funds and institutional investors



ON JULY 26, Dubai promulgated the Escrow Accounts of Real Estate Developments (Number 8 of 2007) which contemplates the registration of developers with the Land Department and the mandatory use of escrow accounts for construction by developers.

The Escrow Account Law has been long awaited by developers, investors and residents. Although there has been some discussion among the business community as to the burden of escrow accounts, the general perception is that it is a most welcome development that serves to further increase confidence in the real estate market.

As a result of the Law, many institutional investors, real estate funds, corporate investors and individuals will now look much more closely at investing or

investing further in Dubai. Many such investors had been inquiring and closely watching over the years but were reluctant to invest given the risk that was involved with purchasing property in the existing legal framework.

Such investors primarily consisted of more risk-averse investors. For example, most institutional investors, real estate funds and corporate investors have shareholders or ultimate owners to answer to when investing.

Therefore, and wholly apart from the financial market risk of the investment, they must be able to legally justify an investment by pointing their shareholders and ultimate owners to an existing Escrow Account Law or other similarly protective laws.

The effect of institutional investors, real estate funds and corporate investors coming to the Dubai real estate market in large numbers should not be underestimated. Although on the face of it they are just another category of investor, they represent billions of dirhams of sophisticated capital which is not easily spooked by fluctuations in market price.

They generally represent a dispropor-

tionately large percentage of investment capital and invest for the medium to longer term. As a result, such investors can bring quite a bit of stability and depth to a market. They can also have the effect of maturing a market to the next level.

Review of certain important provisions of the Escrow Account Law

I review and discuss below certain important provisions of the Escrow Account Law.

Certain Important Definitions

The 'developer' is defined as a natural or corporate person licensed to carry on property development business in the emirate, including a main developer or a minor one.

The 'escrow account' is defined as one in which sums paid by buyers of units off-plan or by financiers of developments are deposited. Hence, it is contemplated that all funds from third-party purchasers as well as mortgage financing proceeds be deposited in the account.

'Property development' is defined as 'projects involving construction of multi-storeyed buildings or compounds for

residential or commercial purposes'.

Registration of Developers

One important development that the new Law brings with it is the registration of developers. Similar to the Real Estate Brokers Law, the Escrow Account Law now requires the registration of developers at the Land Department.

Article 4 states that 'a Register of Developers shall be prepared at the department to register names of developers licensed to carry on property development in Dubai. No developer may carry on such business in Dubai unless it is registered in the register'.

Article 5 also states that 'a developer shall not advertise in local or foreign media, or participate in local or foreign exhibitions, for promotion of sale of units or properties off-plan or in the process of construction in Dubai, unless such developer has obtained the written permission of the Land Department'.

Hence, no marketing of units can occur until approval has been granted by the Land Department. One major issue that arises is that many developers in Dubai are non-GCC nationals. Hence,

such foreign developers cannot be licensed by the Department of Economic Development as developers as such a license is only available to GCC nationals. It is important that this issue be clarified or exemptions granted to foreign developers so that developments in freehold areas are not interrupted.

Article 3 also states that 'the provisions of the Escrow Account Law are applicable to all who sell units off-plan in Dubai's property developments that are not yet completed, whether under or in the process of construction, and who receive payments from buyers or financiers against such units before completion of the developments'.

Therefore, it appears that the intention of the Escrow Account Law is that it will apply to all developments that have not yet begun or are under construction. Media reports and inquiries with certain industry personnel seem to indicate that the Escrow Account Law shall only apply to those projects that have not yet been launched as of the announcement of the date of the Escrow Account Law. Further clarification is required in this regard from the Land Department.

Escrow Account

Article 6 requires that 'a developer desiring to sell units off-plan shall apply to the Land Department to apply for the opening of an escrow account' and enclose related project documents.

Article 7 confirms that such an escrow account shall be established according to a written agreement between a developer and the Land Department whereby sums paid by buyers of units (or paid by financiers) shall be deposited in such escrow account, opened in the name of the development at an ap-



proved bank.

The escrow account shall be managed by a Land Department approved, experienced and qualified auditor (Article 8). A developer may apply to the auditor for a withdrawal from the escrow account by submitting a certificate issued by the engineering/architectural consultant of the development describing the extent of its completion.

The auditor will in turn report to the Land Department as to the details and balance of the escrow account (Article 11). Thereafter, within seven days of re-

quest or completion of submission of required documents, the auditor shall disburse payment as requested by the developer (Article 12). The Land Department shall ensure that 10 per cent of the value of the development is retained in the escrow account (ie, a holdback) for a period of one year after the issuance of the certificate of completion for the development (Article 13).

Market Reaction

Although there is some confusion as to some of the provisions and practicalities

of the Escrow Account Law, most market participants have welcomed it and view the outcome as a positive development. Based on feedback from many of our clients, it is anticipated that real estate prices will increase as a result of the additional administrative burden and costs related to the implementation of the Escrow Account Law by developers.

Delays in completion may also be exacerbated given such additional burden. Moreover, many anticipate that smaller developers or those operating on thin margins may be pushed out of the market as a result of the fiscal and regulatory discipline required to develop using such an escrow account.

Certain issues that arise: What will happen to bank guarantees for construction that have already been issued as security by certain developers?

Certain master developers such as Nakheel have alternate escrow arrangements using banks such as HSBC. What will happen to such arrangements? Will they be replaced or exempted?

Can the price of land be withdrawn from the escrow account? Can a certain amount of profit be withdrawn? What about marketing or sales costs?

Conclusion

The Escrow Account Law will serve to increase investor confidence and attract more foreign investment, especially from certain real estate funds and institutional investors. However, successful and sustainable implementation of such law will depend upon the speedy and practical resolution of the developer registration issue and other issues discussed above.

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