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inBrief

Underperforming real estate: Can REIT (funds) assist developers in the UAE?

By Shahram Safai, Anna White and Elizabeth Brachaniec | 7 July 2020

During these unprecedented times, developers all over the world are actively looking for solutions to deal with underperforming real estate.

For developers in the United Arab Emirates (**UAE**), real estate investment funds (otherwise known as **REITs**) may offer a solution to the problem.

A REIT is a public or private investment fund which is established to invest a certain percentage (as stipulated by law) of its assets in real estate.

REITS are permitted onshore in the UAE under the Emirates Securities and Commodities Authority's framework and in the freezones of the Abu Dhabi Global Market (**ADGM**) and the Dubai International Financial Centre (**DIFC**).

In this InBrief we consider the main advantages of a REIT to a developer through:

a) the developer establishing a REIT; or

b) the developer entering into a joint venture with a REIT.

We will also highlight some of the key aspects of the law governing REITs in the UAE onshore and in the freezones of the DIFC and ADGM.

Option #1 – Developer establishes a REIT directly

For a developer, the main advantage of establishing a REIT is that the REIT will provide a source of funding to the developer which can in turn be used to develop other projects.

The developer achieves this by transferring its existing real estate assets into the REIT and then sells shares in the REIT to investors through initial offerings and follow on offers.

The developer is permitted to keep a certain percentage of the shares in the REIT – as such it does not have to sell the whole of its

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real estate assets to raise funds.

In addition, the developer will benefit from the appointment of professional experts to manage the assets of the REIT which in turn should improve the quality of the assets in the REIT.

Option #2 – Developer joint ventures with a REIT

In the UAE, it has been increasingly common to see developers joint venturing with local UAE land owners as a means of developing real estate. However, an alternative to this more traditional joint venture structure is for a developer to joint venture with a REIT.

From a developer's perspective, a REIT is an advantageous joint venture partner as the REIT must strictly comply with the regulatory requirements in the UAE, and a REIT uses property management teams to professionally manage the real estate assets. Together, these provide for strong governance and enhanced transparency which in turn reduces the risk to a developer when considering a joint venture arrangement with a REIT. Such strong governance and enhanced transparency is also attractive to potential third party investors.

There are two main types of joint venture arrangements that a developer can enter into with a REIT.

The first is a joint venture between the REIT and the developer which has the purpose of constructing a project using funds obtained by the REIT. Under this model, the REIT secures funding through a public offering and then releases some of these funds in phases to fund the development costs of the joint venture partnership between the REIT and the developer to construct the project. Any unused funds from the public offering are usually invested by the REIT in conservative projects (*i.e.* ownership, leasing, management).

The second model is a sale and leaseback between a REIT and a developer. Here, the REIT purchases the underlying land to be developed from the developer and then leases the land back to the developer to construct the project. The developer gets the benefit of the sale proceeds which can be used to fund the construction of the project and the REIT gets the benefit of the income from the annual rental payments under the lease back.

The Law

In the UAE, there are three options for establishing a REIT: firstly, UAE onshore under the Emirates Securities and Commodities Authority's framework; secondly in the ADGM; and thirdly in the DIFC.

For REIT's that are established onshore in the UAE (including onshore Dubai), the Emirates Securities and Commodities Authority's framework is applicable. This is set out primarily in Administrative Decision 6/R.T of 2019 Concerning Real Estate

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Investment Fund Controls, and supplemented by Law 4 of 2000 on Emirates Securities and Commodities Authority and Cabinet Resolution 13 of 2000 Concerning the Regulations of the Functioning of the Emirates Securities and Commodities Authority. Under this framework, a REIT must be a public or private investment fund established to invest at least 75 per cent of its assets in real estate assets for construction, development or re-outfitting in preparation for sale, management, leasing or disposal. A REIT may establish or own real estate services companies, provided that its investment in the ownership of such companies and their subsidiaries does not exceed 20 per cent of the REIT's total assets.

Under the ADGM framework, the Financial Services Regulatory Authority Fund Rules must be complied with. Under these rules, the REIT must be a public property fund which is primarily aimed at investments in income-generating real property; and must distribute at least 80 per cent of its audited annual net income to its unitholders.

To establish a REIT in the DIFC, the DIFC Investment Trust and REITS Rules Instrument 2006 must be complied with. These requirements include the following: an investment company or investment trust must be used as the fund vehicle; the REIT must be a public fund that is listed and traded on an authorised market institution; the REIT must be close ended; the REIT must distribute 80 per cent of its audited annual net income to unitholders; the REIT must not borrow beyond 70 per cent of net asset value; and the REIT may only invest up to 30 per cent of its total assets in property under development.

Conclusion

The Covid-19 pandemic will lead to continued uncertainty in the real estate market in the UAE and worldwide. Developers should be more aware than ever about the advantages of a REIT as an alternative source of funding. ■

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If you require more detailed information, please do not hesitate to contact Shahram Safai at Afridi & Angell at ssafai@afridi-angell.com.