Clause for concern

By Andrew Yule, Carol Gougoulas and Arsalan Shaikh

Dubai's real estate sector has been through difficult times since late summer 2008 and through 2009. However, since the turn of the new year, increasing numbers of analysts are hopeful of change for 2010, commenting on various signs of stability and recovery that are sprouting into view.

The marketplace has been thoroughly altered by the economic conditions and the general preference of investors has swung from units in projects that existed only on paper towards units in projects that are complete or visibly under construction. Additionally, investors are finding they have greater strength in comparison with pre-credit crunch times.

The increased confidence of investors is perhaps most keenly evident in relation to the composition of the sale and purchase agreement (the "SPA") for off-plan properties, the document that governs the purchase by an investor of a unit from a developer.

Whereas previously developers would not contemplate revisions to the SPA, now investors are increasingly finding that there is flexibility, and consequently ,developers showing the greatest flexibility are often the developers attracting the most business.

The purchase price will be at the front of the investor's thoughts, and, in line with RERA recommended policy, the investor should check whether the payment schedule in the SPA is linked with construction milestones.

Two real estate laws of particular importance in relation to the SPA are Law No. 13 of 2008 and Law No. 9 of 2009. These laws govern the developer's right to terminate an SPA for an off-plan unit in the event that the investor falls into default, setting out (i) a termination procedure to be followed and (ii) the monies that may be retained by the developer in the event of termination.

Law No. 9 explains that the greater the completion of the project, the more monies that the developer may retain. Law No. 9 expressly states that it applies to SPAs signed before 30 April 2009. To avoid any question of Law No. 9's application to SPAs signed on or after 30 April 2009, investors will often request an express statement in the SPA to this effect.

Law No. 13 of 2008 provides that if the as-built area of the investor's unit exceeds the area mentioned in the SPA, the developer is not permitted to increase the price, whereas if the as-built area of the unit is less than the area mentioned in the SPA, the purchase must be decreased accordingly (except where the difference is "minimal"). The investor will often look to ensure there is no contradictory wording in the SPA.

In the fallout from the credit crunch, investors are increasingly aware that many projects experience difficulties leading to delays and seek comfort that the SPA is not a commitment to purchase a unit with no foreseeable construction completion date. To provide that comfort, the SPA will often contain (i) reference to an "anticipated" date of completion, with the developer retaining some freedom to push the date backwards if events beyond the developer's control do delay construction and (ii) reference to a date beyond which, if the unit is not complete, the investor has the option of terminating the SPA and having monies returned to him.

Of course, not all investors are buying direct from developers, many investors are instead seeking out lucrative deals on the secondary market. In that event, where an investor buys from a seller, the sale and purchase agreement between them is often called a memorandum of understanding ("MoU").

There are no definitive rules as to whether the investor or the seller should prepare the MOU, indeed it will often be provided by the broker or agent involved in the deal. Both the investor and the seller should carefully review the MOU and obtain independent legal advice before signing.

At an early stage, the investor will want evidence that the seller is indeed the owner of the unit and is entitled to sell. When the seller originally purchased the unit, he may have done so with the help of a mortgage. The investor, therefore, must be careful to ensure the mortgage is discharged before the purchase price is paid.

The investor will want to register his purchase at the Land Department, either in the Interim Real Estate Register (if the unit is incomplete) or in the Real Estate Register (if the unit is complete). Depending on the nature of the deal and the bargaining power of the parties, the payment of the purchase price may be linked to or conditional on the completion of registration.

To permit registration, though, the investor will need to exhibit a No Objection Certificate ("NOC") from the developer. The developer is likely to require all service charges to be fully paid up to date before the NOC is granted. The investor should take care to ensure there are clear provisions in the MoU as to who will obtain the NOC and at whose cost. Similarly, a registration fee is payable at the Land Department for the registration process and the MoU should apportion this between the seller and investor.

Often the deal will involve the payment of a deposit by the investor on signing of the MoU. The parties should review the MoU wording, explaining who will hold the deposit and in which circumstances the deposit must be released and to whom. If the parties wish greater comfort, they could look to have the third party holding the deposit also signing the MOU.

Even with his increased strength, the SPA and the MoU can be a potential minefield for the unwary investor. Each document should be thoroughly inspected before being signed and all parties should seek appropriate independent legal advice in order to be fully informed of the obligations into which they are entering.

The above information is not legal advice and is neither intended to create nor creates a lawyer-client relationship. Neither the writers nor Afridi & Angell are responsible for anyone relying on the above information. You are recommended to take independent legal advice.

Andrew Yule (ayule@afridi-angell.com), Carol Gougoulas (cgougoulas@afridi-angell.com) and Arsalan Shaikh (ashaikh@afridi-angell.com) are Associates at the law firm of Afridi & Angell.