LENDING TO UAE FOUNDATIONS

SPRING 2024

gsb

EXECUTIVE SUMMARY

In the last 5 years, the UAE has witnessed the *"Rise of the Foundations"* – a modern world class wealth structuring tool providing flexibility, control and security. An exponential number of ultra-high net worth individuals ("**UHNWI**"), high-net-worth individuals ("**HNWI**"), family businesses, and entrepreneurs are adopting UAE Foundations to consolidate and hold substantial wealth for predominantly legacy planning and asset protection reasons. Despite their impressive increase in popularity, lending to Foundations is not yet commonplace.

This is a missed opportunity. Banks can benefit from significant revenue potential from interest margin, arrangement fees and management fees for assets under management ("**AUM**"). Founders[1] can benefit from easy access to financing to leverage their considerable wealth consolidated under a Foundation.

Educating banks on Foundation structures, client profiles and access to recourse is key to enabling banks to design a sophisticated lending product to service the needs of Foundations. This will benefit lenders, founders and the entire wealth structuring ecosystem.

> ***There is significant value in bringing banks up to speed with Foundations.***

[1] Founder is the term given to the person who establishes a foundation.

UAE FOUNDATIONS IN NUMBERS

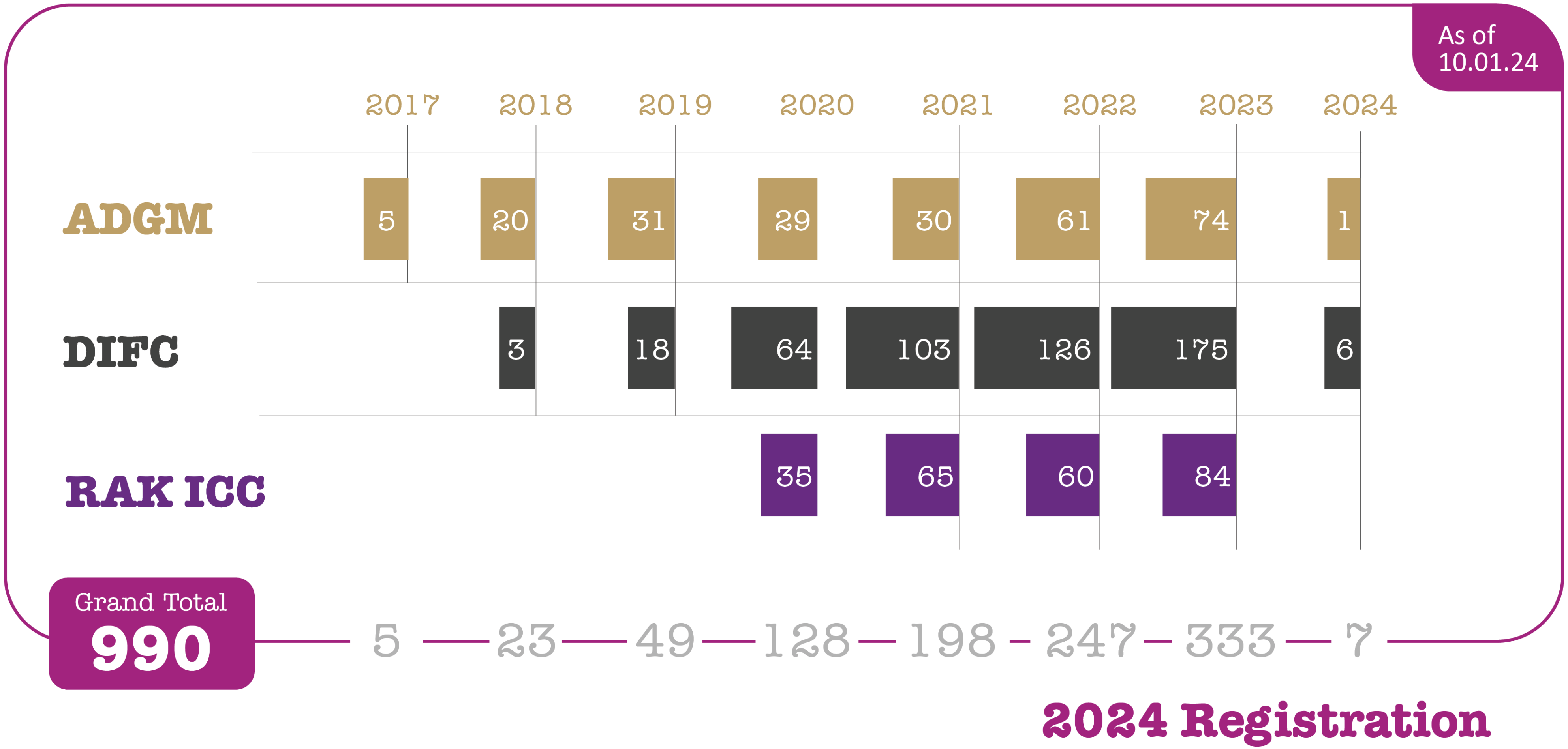


Figure 1.0 - ADGM, DIFC & RAKICC Foundations TImeline

THE ISSUE

As of January 2024, there are **990 Foundations incorporated in the UAE**, all established with the puspose to protect assets, guarantee business continuity, and plan for future generations. This number is **projected to grow by 25-30% yearly.**

Foundations have attracted the attention of UHNWI, HNWI, family businesses, and entrepreneurs who typically have significant pools of assets and streams of revenue (both local and international) requiring consolidation and asset protection under a framework providing legacy and succession planning.

However, despite the increasing uptake of Foundations, founders have experienced challenges obtaining financing or other forms of credit from lenders. This has obstructed founders from realizing the full potential of their Foundation structure and moreover, suggests a disconnect between the UAE's blossoming wealth structuring infrastructure and the staid mindset of lenders.

M-HQ partnered with GSB Private Finance to conduct a survey among local and international banks and lenders to understand:

a. who in the market has appetite to lend to Foundations (both directly and against assets/income streams ultimately held/controlled by Foundations); and

b. what the current barriers are for those who don't lend (or lend on conservative terms).

A total of 60 surveys were distributed by email to a combination of local UAE and international banks and lenders. The survey was based on a **case study.** The survey and case study are outlined in **Annexure A.**

> ***"The Banking Industry is yet to catch up with the needs of clients who want easy access to financing to leverage their considerable wealth consolidated under a Foundation.***

THE RESULTS

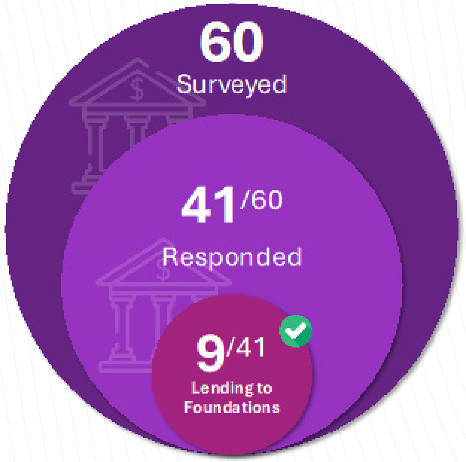


Figure 2.0 - Financing Foundations | Source: GSB & M/HQ survey 2023

Of the **60 banks/lenders** that were **surveyed, 41 responded.** Despite the healthy response rate, only **nine (9) of the 41 banks/lenders confirmed that they would lend to Foundations.** The response from a clear majority of foreign banks showed that lending to Foundations in any form is not part of their lending strategy. With this bare data alone, **it is clear that there is a missed opportunity.**

This was further underscored by the finding that only seven (7) of the nine (9) positive Foundation lenders would lend to a Foundation holding UAE property.

> ***There is a general lack of understanding of Foundations, what they are, how they are structured and how they should be treated.***

Of the seven (7) banks that reported that they would lend to Foundations holding UAE property, six (6) were UAE mainland universal banks and one (1) was a DIFC registered foreign bank. This indicates that aversion to lending against UAE real estate is not solely a foreign bank phenomenon.

The concern with lending to a Foundation against UAE real estate was explained by one DIFC registered Swiss bank with DIFC booking capabilities as *"..a perceived lack of recourse against UAE domiciled assets (real estate and illiquid financial instruments)..."*

This concern was also shared by a local UAE bank/lender who said that recourse against UAE assets was a big factor - even in circumstances where a facility is secured by a 1st legal charge over UAE real estate assets, a charge over Foundation income and a pledge against potential investments that would be reinvested.

Of the seven (7) banks/lenders who reported that they lent to Foundations holding Dubai real estate, all required the real estate to be freehold. Otherwise, the terms of such lending were reportedly and evidently variable and determined on a deal-by-deal basis; they **did not have a specific policy or procedure for lending to Foundations.**

Variable conditions/terms included:

- Maximum LTV of 75%.
- Maximum term of 10 years with renewable terms of 1 or 2 years.
- Margin of 3% (plus 3 months EIBOR) would apply to the lending.
- Equity release was possible provided that 100% of proceeds remained on the balance sheet with the lender in the form of AUM.

- Minimum AUM of USD5 million.
- Arrangements fees ranged from 0-2%, with the specific fee being determined on a deal-by deal basis.
- Interest only was the only repayment strategy available.

> ***The grounds for concern were cited as a lack of recourse against UAE domiciled assets and holding.***

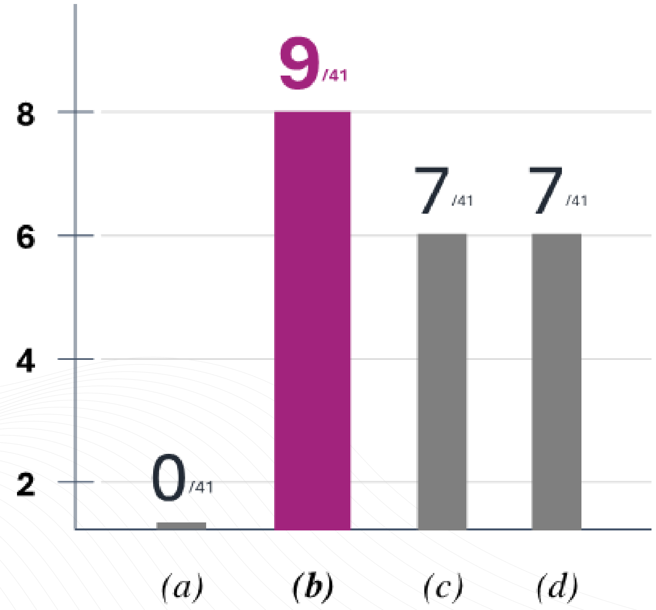
Survey responses and subsequent conversations with industry professionals and investors indicated that there is a general lack of understanding of Foundations, what they are, how they are structured and how they should be treated.

A good example of this was highlighted by one survey participant who commented that *"Foundations are not fully understood by banks, government agencies....They are treating Foundations as a commercial license holder."*

Indeed, it was apparent from the survey responses that a Foundation is often mis-categorized as a business or limited liability company rather than a wealth structuring legal person. The consequence of this is that Foundation lending is often dealt with by the corporate/commercial parts of the bank, rather than the private bank division leading to **confusion among bankers and credit underwriters as to how to manage the lending.**

Overall, our survey results identified a latency in the banking system locally and internationally to develop products to address the financing needs of Foundations more competitively. This appears to stem from:

1. **A lack of general understanding** of what a foundation is and how it is structured;
2. **Confusion** as to which banking department should service a Foundation; and
3. A lack of understanding of Foundations from an enforcement standpoint leading to a **perceived lack of recourse.**



a.	Banks with formal structured lending product [lending guidelines, policies] for Foundations
b.	Banks lending to Foundations
c.	Banks lending to Foundations holding prime Dubai real estate
d.	Banks lending to Foundations holding prime Dubai real estate - freehold only

Figure 2.1 - Financing Foundations | Source: GSB & M/HQ survey 2023

KEY TAKEAWAYS

There is significant value in bringing banks up to speed with Foundations. With the exponential adoption of Foundations as a wealth structuring tool, UHNWI, HNWI, family businesses, and entrepreneurs are looking to banks for an equally sophisticated lending product to leverage their Foundation's considerable consolidate wealth.

> ***Despite the impressive increase in the popularity of UAE Foundations, lending to Foundations is not yet commonplace.***

Our survey indicates that while local and international banks have appetite for lending, **their policy and guidelines are nascent**, if at all present largely due to a lack of understanding and knowledge of the foundation as wealth structuring tool.

Education is key to raising awareness and understanding. This should enable banks to develop a sophisticated lending product designed within clear guidelines to be delivered by a private client team or bank to service the needs of these Foundations.

> ***Clients are looking to banks for an equally sophisticated lending product to leverage their Foundation's considerable consolidate wealth.***

NEXT STEPS

1. **Education is the starting point.** Targeting key stakeholders within local and international banks (such as the Head of Credit, Head of Legal, Head of Private Wealth) to educate them on what a foundation is, how it is regulated, how it should be treated and how it can be structured will help banks to build clear lending guidelines or policy.

> *Education is key to raising awareness and understanding.*

2. A **Foundation** should be **serviced by a private banking team** or at the very least, lending should be available to a Foundation through a private bank or the private banking division of a universal bank who classify a Foundation as a wealth structuring tool. A Foundation should not be seen in the same light as trading entities or commercial businesses that typically sit within the corporate/commercial divisions of banks. Treating a Foundation as a wealth management and structuring tool is important to align internal bank communications and assign responsibility for relationship management and lending to Foundations to the private bank team, generally better suited to meet the needs of Foundation clients.

3. Through education, banks (in particular their legal teams) should become more **confident with the enforceability and range of security** that can be provided by a Foundation against financing. Working with banks to design a reasonable security package that reflects their understanding of the Foundation and avenues for recourse will likely lead to increasing confidence in lending to Foundations. This might include the requirement for a charge over shares in an underlying subsidiary, securitization of account receivables (cash flow/portfolio) or a corporate guarantee from an underlying operational entity.

With a better understanding of a Foundation, banks can design a sophisticated and commercially sensible security package that reflects an understanding of the structure and is proportionate to the measured risk of lending to a Foundation.

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M/HQ

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We have extensive experience advising on a broad range of wealth structuring and legacy planning issues. We particularly assist in establishing and servicing **Family- and Group-Holdings, Single- and Multi- Family offices, Foundations** and other asset consolidation/protection and intergenerational wealth management structures.

Headquartered in the UAE, we are an entrepreneurial firm for entrepreneurial clients.

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At GSB Private, we work for you independently, combining long-standing experience in private banking and deep-rooted partnerships with leading private banks, investment houses, lenders and trusted advisory firms. We deliver sustainable returns in the most ethical and responsible ways possible by building transparent, principles-led, long-standing relationships. We take the time to listen and understand your requirements - ensuring all strategies are aligned with your financial goals and future objectives. We operate as an External Asset Manager, ensuring the perfect balance of independence, service, value and accessibility.

THE SURVEY

All participants were presented with the case study below and asked, whether they had lent to a UAE Foundation. If the bank/ lender answered 'yes', then the following questions were asked:

- 'What is the maximum Loan to Value ("**LTV**") you provide to a Foundation?'
- 'What is the maximum term of the loans that you provide to a Foundation?'
- 'What is the interest rate charged for loans to a Foundation?'
- 'Do you have the ability to provide a loan for equity release purposes (and if so, do 100% of the proceeds need to be reinvested with the bank)?'
- 'Are the loans provided to Foundations on an interest only or repayment basis?'
- 'What arrangement fee would typically be charged for a loan to a Foundation?'
- 'Do you have a minimum/maximum loan size to a Foundation (and if yes, what is the minimum/maximum)?'
- 'Do you have any restrictions on the real estate assets within the Foundation that you will lend on (and if yes, what are those restrictions)?'
- 'Would you still lend to a Foundation that held non real estate assets (and if yes, would you have any restrictions on what assets could be held that you would be unwilling to lend against)?'
- 'Would you lend against income streams generated by assets and structures ultimately owned by a Foundation (and if no, why not)?'

For those banks who answered 'no' to the first question of *'Does your institution currently provide loans to UAE incorporated Foundations*', we gave the bank the opportunity to explain why.

All participants in the survey were given an opportunity to provide further comment and an explanation of their responses.

The survey also included a section aimed at investors, which asked the following questions:

- 'Have you invested in real estate properties in the UAE (and if yes, have you financed the purchase of the real estate property/ies)?'
- 'If finance has been used, has that been through a mortgage (and if yes, would you consider re-mortgaging the property/is)?'
- What was the LTV of your mortgage/s?'
- 'If you have not invested in real estate properties in the UAE, would you consider investing in alternative asset classes (and if yes, which asset class)?'

CASE STUDY

A DIFC Foundation owns AED 200,000,000 worth of residential and commercial real estate, generating rental income of AED 15,000,000 pa.

The founder wants to obtain a debt facility from a lender which would release 50% of equity in the portfolio (resulting in a loan to the Foundation of AED 100,000,000).

Proceeds will be used to re-invest in non-property assets such as equity and bond mandates which the lender would retain as AUM on their balance sheet.

These investments would then be managed by a DIFC based and regulated external asset manager, with the key objective of hoping the Foundation to diversify its overall asset base and income streams.

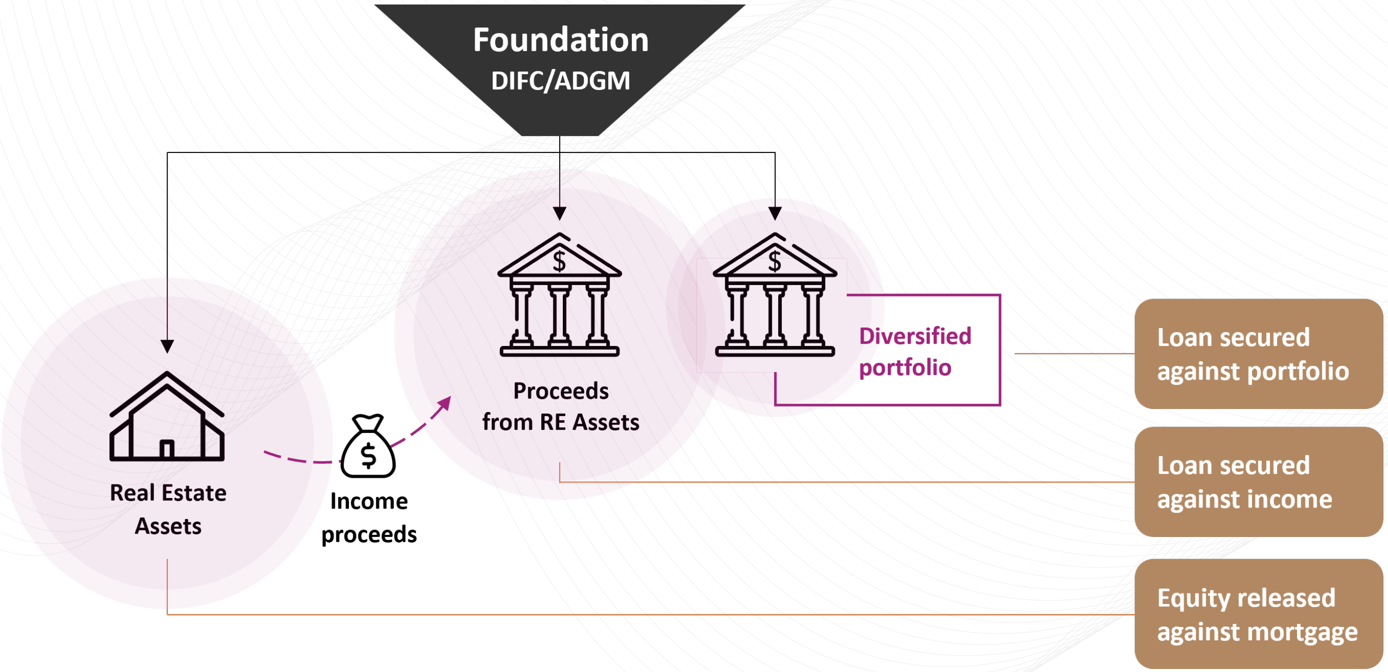

Figure 3.0 - Equity release from under foundations structure

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