

Dar Al-Arkan sukuk - a vote of confidence

LONDON: The year 2010 could be a landmark year for the Saudi housing sector, and the opportunities for Islamic housing finance - both development and mortgages - could be potentially immense.

Following the recent confirmation by Muhammed Al-Jasser, governor of the Saudi Arabian Monetary Agency (SAMA), that the proposed mortgage law would be adopted within the next few months, the financial market is expectant about the possibilities that such a law would unleash in a market that is under-housed and has a very young demographic profile.

"It will be a qualitative jump in the way we finance housing in the country and in the way we use financial instruments that are linked to the housing market," he explained in a statement in Riyadh in early February 2010.

Equally important is the performance of the housing sector in the Kingdom relative to other markets in the GCC (Gulf Cooperation Council) countries. Saudi Arabia has been much less affected by the real estate bubble that has been the bane of Dubai, Bahrain and to a certain extent Qatar.

Only a few days ago, Dar Al-Arkan Real Estate Development Co. (DAAR), a leading residential real estate developer and provider of Shariah-compliant housing finance, successfully redeemed its inaugural landmark three-year \$600 million sukuk issued in March 2007 by DAAR International Sukuk Company. The repayment was made on schedule.

This was the first sukuk to be issued by a Saudi company in the international capital markets. So overwhelming was the demand for the sukuk that the issuers decided to raise the original target of \$425 million to \$600 million. Financial institutions across Europe, Southeast Asia and the GCC region subscribed to the issuance. Since then, Dar Al-Arkan has become one of the more prolific issuers of sukuk in the Kingdom, with its latest issuance being a \$450 million sukuk which closed in February 2010 its fourth issuance since 2007. This latest sukuk was lead arranged by Unicorn Investment Bank, Deutsche Bank and Goldman Sachs.

Not surprisingly, a confident Yousef Abdullah Al-Shelash, chairman of Dar Al-Arkan, stressed that "the overwhelming response we received from the international financial community when we launched this (first) sukuk represented a vote of confidence not only in Dar Al-Arkan but also in the Saudi economy. We are committed to maintaining our leading role in providing affordable housing solutions that meet international standards to middle income families across the Kingdom."

For Bahrain-based Unicorn Investment Bank, this has been a triumph as the Joint Lead Manager, Joint Bookrunner and Shariah adviser to the sukuk issue. According to Majid Al-Sayed Bader Al-Refai, managing director and CEO of Unicorn Investment Bank, "the ability of Dar Al-Arkan to successfully meet its obligations at a time when a number of sukuk issuers have either defaulted or are seeking restructuring bears testament to the strength of Dar Al-Arkan's business model and the strength of the Saudi economy in general."

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In January 2010, Moody's Investor Service assigned a Ba2 rating to Dar Al-Arkan, the largest developer in Saudi Arabia by market value. Moody's noted that the Ba2 rating is one of the highest industry ratings; the mean rating of global homebuilding companies is Ba3. The Ba2 rating also positions Dar Al-Arkan well above regional peers in the GCC countries. Standard & Poor's Ratings Service has similarly assigned a BB- rating to the company.

A Saudi mortgage law would be a major boost for companies such as **Saudi Homes Loans Company**, an Islamic mortgage company set up two years ago through a venture involving the International Finance Corporation (IFC), the private sector funding arm of the World Bank Group; Dar Al-Arkan; and Arab National Bank, and for the local banks.

The Saudi housing sector, according to a new strategic report launched by the Jeddah Municipality in early March 2010, will need an investment of a staggering \$640 million over the next two decades to build some 5 million new housing units. This is to meet demand from young Saudis coming to the market (some 65 percent of Saudis are under the age of 25); greater migration from the rural areas to the metropolitan areas; and the increasing influx of expatriates into the Saudi economy. Real estate is projected to contribute 7.2 percent to the Saudi economy in 2009, and with the demand dynamics for housing, especially affordable housing, this is set to increase over the next few years. However, mortgages represent only 2 percent of GDP compared with over 30 percent for Malaysia.

Some banks such as Samba Financial Group are not even waiting for the enactment of the mortgage law. They are already providing captive housing financing for selected corporate clients. In fact, earlier this month, Samba Financial Group renewed a housing finance agreement with Saudi Electricity Company (SEC), which was launched in May 2009 to provide mortgage finance facilities for SEC employees who wish to own their own homes. The important aspect of this agreement is that the mortgage finance is Shariah-compliant and has a tenor of 20 years. The monthly payments are deducted at source from the salaries of the employees.

However, Saudi mortgage providers are keenly awaiting the provisions of the proposed mortgage law, especially those covering the more contentious aspects such as defaults, repossessions, passing of the title and deeds in the case of death of the mortgagee, and the issue of mortgage insurance. As for the financial institutions, the choice of Islamic mortgage products effectively boils down to the Diminishing Musharaka (shared ownership with capital repayment and rental component), the Ijara (leasing), and the Murabaha (cost plus financing).