$US 1 billion Dubai Global Sukuk

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This case describes the basic structure of the Dubai Sukuk. It is intended to be used as the basis for class discussion. Answers are not provided. It is expected that the course leader will guide participants accordingly.

Case Abstract
A sukuk has economic characteristics similar to those of a conventional bond, but is structured so as to be compliant with Shari’a law enabling them to be sold to Islamic investors who are prohibited by Shari’a law from investing in conventional debt securities. The sukuk issued by the Government of Dubai in October 2004 had the typical structure of a sukuk al ijara, that is a sukuk combined with the sale and leaseback of the assets being financed. In the transaction, the assets in question were land and buildings at Dubai International Airport (the Sukuk Assets) which were owned by the Department of Civil Aviation of the Government of Dubai (the Government).

‘Those who take riba (usury or interest) will not stand but as stands the one whom the demon has driven crazy by his touch.’

Qur’an Sura 2:275-280
Islamic bonds – a fast-growing market

Islamic bonds (sukuk) are rapidly gaining in popularity. The first international sukuk was issued by the Government of Malaysia in August 2002. In 2003 global sukuk issuance totalled approximately $1.9bn and this increased to approximately $6.7bn in 2004.

The Shari’a

A suk (the singular of sukuk) has economic characteristics similar to those of a conventional bond, but is structured so as to be compliant with Shari’a law and can be sold to Islamic investors who are prohibited by Shari’a law from investing in conventional debt securities. The Shari’a is a body of Islamic law drawn from various sources including the Qur’an which includes a number of principles relating to financial transactions. The Shari’a is not a codified body of law and is subject to development and sometimes conflicting interpretation. However, the major Islamic financial institutions have a Shari’a Supervisory Board on which Islamic scholars sit, and in practice these Boards determine whether a proposed transaction being arranged by the institution is compliant with the Shari’a.

The most well-known principle of Shari’a law is the prohibition on riba, which is generally described as being a prohibition on “usury” or the earning of interest by lending money. Any return which is based solely on the time value of money (as opposed to the use of an actual asset) is susceptible to being caught by the prohibition on riba however it is described. If however an Islamic financier has an ownership interest in the financial asset then it is allowed to benefit from the return generated by that asset.

The nature of sukuk

Sukuk are structured to comply with these principles. In a traditional bond issue, the investor holds a certificate of debt under which the issuer typically agrees to make payments of interest and principal. With sukuk, by comparison, the investor holds a certificate which represents a beneficial ownership interest in an underlying asset. The yield is linked to a return on that asset, most typically generated by the rentals under a Shari’a compliant lease (ijara) of the asset.

The Government of Dubai sukuk

The sukuk issued by the Government of Dubai in October 2004 had the typical structure of a sukuk al ijara, that is a sukuk combined with the sale and leaseback of the assets being financed. In the transaction, the assets in question were land and buildings at Dubai International Airport (the Sukuk Assets) which were owned by the Department of Civil Aviation of the Government of Dubai (the Government). The basic structure of the transaction is set out in Figure 1 and its key elements are:

- A special purpose vehicle, Dubai Global Sukuk FZCO (the Issuer), was incorporated in Dubai Airport Free Zone.
- The Government conveyed title to the Sukuk Assets to the Issuer pursuant to a purchase agreement.
- The Issuer issued trust certificates (the equivalent of the bonds in a normal bond issue) to the investors (the Certificate holders). Each trust certificate (Certificate) represented a share in the beneficial ownership of the Sukuk Assets. The proceeds of the issue of the Certificates were used by the issuer to pay the purchase price of the Sukuk Assets to the Government.
• The Certificates were held in the European clearing systems of Euroclear and Clearstream and were listed on the Luxembourg Stock Exchange and the Dubai Financial Market.

• The Sukuk Assets were leased back to the Government by the Issuer. This was structured as an agreement to enter into 10 consecutive leases each of six months under a Master lease agreement in order to allow payments of rental to be calculated by reference to LIBOR for each period.

• The rental payments paid by the Government to the Issuer for the use of the Sukuk Assets are to be used to make periodic distributions to the Certificate holders (the equivalent of interest paid under a conventional bond).

• The Government entered into a purchase undertaking whereby it agreed to repurchase the Sukuk Assets at the scheduled redemption date of the Certificates or in a default situation. The amount paid by the Government to repurchase the Sukuk Assets is to be used by the Issuer to repay the principal amount of the Certificates to the Certificate holders.

• Upon a total loss of the Sukuk Assets the Issuer will have recourse to the proceeds of the insurance policies. If these are not sufficient to allow the Certificates to be redeemed in full the Government will be obliged to make up the shortfall.

• Under Shari'a law the Issuer is required to retain responsibility for major maintenance and structural insurance of the Sukuk Assets. However, under a servicing agency agreement the Issuer appointed the Government as its agent to carry out these activities.

The description above is only a basic summary of the structure of the Government of Dubai transaction. As the sukuk is a relatively new product, each transaction is likely to raise interesting problems for the bankers and lawyers involved.
The following are the key parties in the Dubai Global Sukuk:

**Issuer**

Ownership of the Issuer: The authorised and issued share capital of the Issuer is AED1,000,000 consisting of ten shares with a nominal value of AED100,000 each. Nine of the Issuer’s shares are owned by the Government (acting by its Finance Department) and the remaining one share in the Issuer is owned by Dubai Islamic Bank PJSC.

**Seller**

The Government will convey to the Issuer (as trustee and agent for and on behalf of Certificate holders) title to the Sukuk Assets.
| Lessee | The Government will enter into ten consecutive Leases of the Sukuk Assets with the Issuer pursuant to the Master Lease Agreement during the period of five years commencing. |
| Obligor | The Government will enter into the Purchase Undertaking, pursuant to which the Government will undertake to purchase the Sukuk Assets from the Issuer at the Exercise Price (as defined below) either on the Scheduled Dissolution Date or on the date specified by the Trustee to Certificate holders. |

The following are the key elements of the Sukuk Certificates:

| Form and Delivery of the Certificates | The Certificates will be issued in registered global form only without coupons attached. The Certificates will be represented by interests in the Global Certificate deposited with a common depository for Euroclear and Clearstream, Luxembourg. |
| Clearance and Settlement | Holders of the Certificates may elect to hold their interest in the Global Certificate in book-entry form through each of Euroclear or Clearstream, Luxembourg. |
| Denominations | The Certificates will be issued in minimum denominations of US$10,000 and integral multiples of US$1,000 in excess thereof. |
| The Trust Assets | The Trust is the trust constituted by the Issuer under the Declaration of Trust. The Trust Assets are the Sukuk Assets, all of the Issuer’s rights, title, interest and benefit, present and future. |
| Purchase Agreement | Pursuant to the Purchase Agreement, the Seller will sell to the Issuer the Sukuk Assets. The proceeds received by the Issuer from the issuance and sale of the Certificates |
will be used to pay the aggregate purchase price payable by the Issuer to the Seller for the Sukuk Assets.

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<thead>
<tr>
<th>Sukuk Assets</th>
<th>Certain land, buildings and other property at Dubai International Airport.</th>
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</thead>
<tbody>
<tr>
<td>Master Lease Agreement</td>
<td>Under the terms of a Master Lease Agreement between the Issuer as lessor and the Government, acting as lessee, the Government agrees to enter into ten consecutive leases of the Sukuk Assets (each, a Lease) during the period.</td>
</tr>
<tr>
<td>Use of Proceeds</td>
<td>The proceeds of the issue of the Certificates will be used by the Issuer to purchase the Sukuk Assets from the Government, as Seller, pursuant to the Purchase Agreement.</td>
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<tr>
<td>Listing</td>
<td>Application has been made to list the Certificates on the Luxembourg Stock Exchange and the Dubai Financial Market.</td>
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<tr>
<td>Governing Law and jurisdiction</td>
<td>The Declaration of Trust and the Agency Agreement and the Certificates will be governed by English law and subject to the non-exclusive jurisdiction of the English Courts. The Purchase Agreement, the Master Lease Agreement, each Lease, the Servicing Agency Agreement, the Purchase Undertaking, the Agency Declaration, the Share Agency Declaration, the Certificate Purchase Agreement and the Costs Undertaking will be governed by the laws of the UAE as applied in Dubai. The courts of Dubai have non-exclusive jurisdiction to hear all disputes relating to them.</td>
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Dubai Global Sukuk: Case Study Questions

Following the recent string of successful Sukuk issues, and the fact that they are a relatively new concept in corporate finance, your employer, an Investment Bank, has selected your group to make presentations to the Board regarding the key issues involved.

Your group must consider the following questions and you must present your findings to the whole class. Please be ready to explain any technical concepts to the class. You will be expected to defend your answers.

Remember that “time is money” and that your responses must be succinct and not overly descriptive. In other words – get to the point!!

1. Describe the exact nature of the Dubai Sukuk
2. What Islamic modes of finance underpin the Dubai Sukuk?
3. Describe how these modes of finance work and the exact relationship they have with the Dubai Sukuk
4. What investment considerations are relevant to an investor?
5. Provide an overview of the UAE economy to enable investors to gauge the investment climate.
6. What Sharia Board requirements were put in place?
7. Are issues of corporate governance relevant to this issue?
8. What was innovative about this issue?
9. How was the issue rated and by whom?
10. What risks for investors are associated with investing in sukuk?
11. Was the issue a success?
12. What lessons can be learnt for the issue of future sukuk? How do the critical factors for Dubai Sukuk compare with those for the other Sukuk issued?

Demonstrate with a flow chart the nature of underlying transactions.