Default and Dubai

PETER WILLIAMS LOOKS AT STANDARD & POOR'S LATEST ANALYSIS OF THE ISSUES FACING DUBAI'S GOVERNMENT-RELATED ENTITIES.

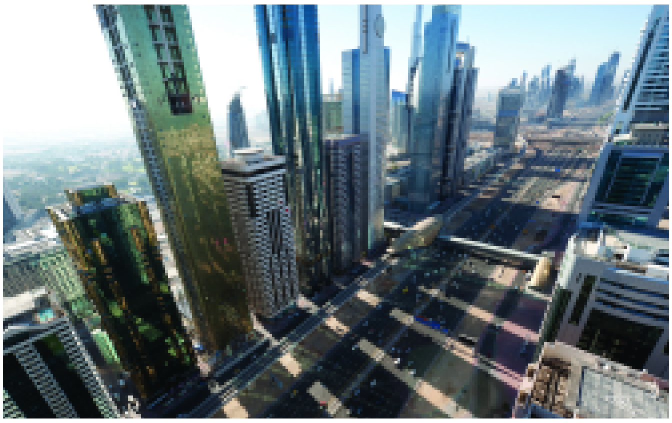
Despite Dubai's economy starting to rebound, the country's government-related entities (GREs) rated by Standard & Poor's face significant risks. According to the credit rating agency's analysis published in early 2012, these risks – a weakening global economic outlook, the Arab Spring, and volatile equity and bond markets – raise concerns because Dubai's GREs face large debt maturities and refinancing in 2012.

According to S&P, the biggest risk facing Dubai-based GREs (see Box 1) is refinancing. Issuers such as DIFC Investments and Jebel Ali Free Zone carry large short-term maturities and are likely to struggle to refinance without some form of government support.

Given that the Dubai government has been involved in various debt restructuring exercises over the past three years, S&P says that the main issues is which GRE the government is likely to support and whether this support will be timely and sufficient to avoid a default. Recent examples of where the Dubai government has stepped in (with the support of the Abu Dhabi government, Abu Dhabi-controlled banks and the UAE Central Bank) include Dubai World and Dubai Holdings in 2009 and 2010.

Sheikh Ahmed bin Saeed Al Maktoum, chairman of Dubai's Supreme Fiscal Committee, recently indicated that the government had no plans to restructure the GRE debt that falls due in 2012. However, according to S&P, he has said that the Dubai government would consider refinancing the GREs' financial obligations when necessary.

It is sometimes difficult to ascertain when a debt restructuring – often carried out by entities in distress – is tantamount to a default. The restructuring of debt obligations can take the form of exchange offers or buybacks, which inevitably offer creditors less than the promise of the original securities. While such a restructure offer may not be good news for a creditor, it is usually a better alternative than a conventional default, where investors stand to fare worse. S&P says an exchange offer is tantamount to a default when the investor will receive less value than the promise of the original securities and the offer is distressed rather than purely opportunistic.



Box 1: Dubai-based GREs rated by S&P

S&P rates five Dubai-based companies that it considers to be GREs: Dubai Electricity and Water Authority, DP World, Emaar Properties, DIFC Investments and Jebel Ali Free Zone. S&P assesses the likelihood and extent of any extraordinary support that the Dubai government would provide to these GREs in the event of their financial distress.

Box 2: Review of growth drivers

After the S&P report was published news came of a move to strengthen economic performance and the financial system in the UAE. The Ministry of Finance and the Dubai Department of Economic Development signed a memorandum of understanding to co-operate in supporting institutions and private sector companies in the UAE and exporters. The memorandum includes a review of the experience of the regional and international development partners of the federal government.

As part of its assessment of GREs, S&P also compared the default probability on bonds and sukuk with that of bank loans and trade-related liabilities. Under most insolvency regimes, it is sensible to assume that financial creditors with equal claims face the same probabilities of default and recovery rates. However, this may not be the case with S&P-rated Dubai-based GREs.

Dubai World met its sukuk obligations on time and in full, renegotiating its bank loans and trade liabilities. In the Dubai World debt restructuring, a specific law was passed – Decree 57 – that set out a special administration process for the company. In essence S&P reasons that Decree 57 gave the government greater control over the administration process for Dubai World.

S&P says because there has been restructuring of bank loans and trade liabilities rather than sukuk defaults, its ratings generally reflect its perception of the probability of default on bank loans.

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