Al Jazeera - Are Dubai's debt storm clouds gathering again?

By Mark Townsend 06 February 2015
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Action by a state-owned company and the fall in oil prices has placed Dubai's $140bn debt load under scrutiny.
Dubai's debt burden is once more the focus of attention after the state-owned investment firm Dubai World invoked legislation to push through a deal to reschedule $14.6bn in debt. It is the second restructuring in four years through Decree 57, a provision allowing Dubai World to seek ratification at a special tribunal after garnering the support of more than 66.67 percent of creditors by value, the trigger point for a deal.
The move, seen by some as controversial, permits the company to impose a deal on creditors in a process known as "cramdown". Analysts say the development may undermine confidence, but Doug Bitcon, head of fixed income funds at Rasmala Investment Bank, believes there was little choice.
"The composition of creditors has changed over time," Bitcon told Al Jazeera. "Some may have agendas which are not conducive to a rapid conclusion of the restructuring process. It is not surprising [Dubai World] enacted Decree 57."

Under the terms, Dubai World will make an early repayment of $2.92bn due in September and extend payment of debt that would become due in 2018 to 2022. In January, the company said it had reached an agreement with a "substantial majority" and "made a voluntary arrangement notification under Decree 57" that included increased pricing and additional collateral.

The Dubai World tribunal was created to administer the first restructuring under the jurisdiction of a Dubai International Financial Centre court. Ahmed Shaheen, the associate director of fixed income sales and trading at Exotix Partners, was critical of the deal.

"The Dubai World restructuring has been forcefully implemented. This is the second round of restructuring and although returns have marginally improved, this improvement comes from a very low base," Shaheen told Al Jazeera.

"My belief is that creditors should enjoy some form of equity participation on the second round, having borne the brunt of an aggressive restructuring the first time."

In 2009, Dubai World convulsed global financial markets after seeking a standstill on $25bn in debt. Shortly afterwards, Abu Dhabi, in the guise of the UAE central bank and Abu Dhabi-owned financial institutions, threw it a lifeline of $20bn. Even so, the ambitious emirate has racked up more than $140bn in debt, according to the Institute of International Finance - fuelling a real-estate bubble that burst in 2008 causing prices to tumble by 50 percent.

Dubai has since worked hard to rebuild trust, putting in place governance reforms and improving transparency to international norms. Its economy has also bounced back, buoyed by its perceived status as a safe haven and benefiting from a boom in trade, logistics and tourism.

Nevertheless, investor sentiment is being tested after another state-owned firm, Limitless, missed a repayment of $400m, due at the end of 2014. It is in talks to restructure $1.2bn in debt and is seeking the backing of 100 percent of creditors. Credit default swaps, a financial instrument for swapping the risk of debt default, rose to 250 mid basis points (bps) following the Decree 57 announcement after trading at 170 bps towards the end of 2014, according to data from S&P Capital IQ CDS.

The trouble for Dubai is that its debt position is not helped by the fall in oil prices, which have more than halved since June. Although it does not rely on oil revenues, it is indirectly exposed as state-backed companies, known as government related entities (GREs), depend heavily on fees generated from corporate activity, which is susceptible to the decline in oil prices.

Local press in the UAE recently reported that 150 real-estate projects were listed as cancelled. In an alert published in December, Capital Economics noted: "The longer oil prices remain low the more likely it is that GREs will struggle to repay their debts."

In its last assessment, the International Monetary Fund estimated Dubai GREs had a total of $54bn in debt, due between 2015 and 2018, but early repayments have reduced that by around 25 percent, Capital Economic estimates. "Although the debt repayment schedule may now be less arduous at more than 50 percent of Dubai's GDP, GRE debts are still large," it added.

Low oil prices could also deter Abu Dhabi from coming to the rescue of Dubai Capital Economics claims, although that looks unlikely given its substantial reserves. There is an expectation that Dubai will seek further borrowings for hosting Expo 2020, which Standard Chartered estimates will cost between $8bn and $9bn.

The government says it expects to draw 25 million visitors, placing it far ahead of major tourist destinations such as London and Paris.

But Dubai's debts are onerous in relation to the country's gross domestic product, according to Giyas Gokkent of the Institute for International Finance. "Total debt including GRE's is over $140bn, equivalent to about 132 percent of GDP. Dubai World obligations, which are not direct Dubai government obligations, stood at about $30bn."

The institute describes a debt-to-GDP ratio of more than 70 percent as "very high indeed". With an uncanny ability to shake off previous downturns in the economy, Dubai will nevertheless have to manage its debt strategy carefully, fundamental to which is maintaining the support of creditors. Exotix's Shaheen says the recent events may have soured opinion.

"The application of Decree 57 is an indication of Dubai World's reluctance to incentivise minority creditors, preferring instead to rely on the support of its core base of local bank lenders to cramdown any holdouts," Shaheen said. "That might serve the company's interests today and get the deal done, but sets a poor precedent for the future restructurings of Dubai World subsidiaries."