Intra Legem

EMANCIPATION OF FDI IN REAL ESTATE SECTOR

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Introduction

It is ironic that in spite of having a meager 2.01% of world population, Russia covers 12.5% of world land and Canada comprises of meager 0.5% of world population against 6.1% of world land area while India being the second most populous country in the world nurturing 17.6% of world population, has only 2.4% of world land. Of this 2.4% land, nearly one-half is for agricultural purposes or waste land and the other topographical area comprises of dessert, glacier, valleys, rivers, mountains etc. Hence, in India, it becomes more pertinent to use land scrupulously for commercial as well as residential purposes. To club with that is the Indian ambition of no longer being the third world country but a "*Developed Nation*". And for both of the above we need external assistance. [1]

1. The information set out in this paragraph is collected from, or based on, the following links–
(i) https://en.Wikipedia.org/wiki/List_of_countries_and_dependencies_by_population
(ii) http://blogs.telegraph.co.uk/news/jamesdelingpole/100020126/climategate-goes-serial-now-the-russians-confirm-that-uk-climate-scientists-manipulated-data-to-exaggerate-global-warming/
(iii) https://en.wikipedia.org/wiki/Population_of_Canada
(iv) http://world.bymap.org/LandArea.html
(v) https://en.wikipedia.org/wiki/List_of_countries_and_dependencies_by_population
(vi) https://indiavisa.travisaoutsourcing.com/about-india

As prophetically stated by Mr. Ratan Tata "…*But there is not a shred of doubt in my mind that when you open an economy you should do it in totality. Foreign investment adds a sense of competition; we should see this as a wake-up call to modernize and upgrade.“*[2]

While the Indian economy first opened up with the advent of the New Industrial Policy in 1991 and foreign direct investment ("***FDI***") being permitted as a part of the one of the reforms introduced by the New Industrial Policy, it took 14 years for the Government of India ("***GOI***") to permit 100% FDI in construction development projects, subject to certain conditionalities. [3]

Thereafter, it took the GOI, one whole decade (2005-2015) to comprehend the significance of liberalizing the real estate sector for the purpose of FDI.

2. http://www.tata.com/article/inside/KmqN8d384OM%3d/TLYVr3YPkMU%3d
3. Press Note 2 of 2005 dated March 3, 2005 issued by the Department of Industrial Policy and Promotion ("***DIPP***")

Evolution of Liberalization in Real Estate

Prior to 2005 while NRIs and PIOs were allowed to invest in the housing and the real estate sectors, foreign investors other than NRIs, were allowed to invest only in development of integrated townships and settlements either through a wholly-owned subsidiary or through a joint venture company along with a local partner.[4]

The year 2005 showed a slack of private equity in the real estate sector but on the contrary it also saw a new dawn of 100% FDI being permitted in townships, housing, built-up infrastructure and construction development projects

4. Press Note 2 of 2000 dated February 11,2000 read with Press Note 4 of 2001 dated May 21, 2001 issued by DIPP

albeit subject to the conditionalities of minimum area to be developed, minimum capitalisation and lock-in period. Thus, while the GOI did open up the real estate sector for FDI, the conditionalitise were quite burdensome, dampening the liberalization introduced in the real estate sector, some of which included (i) minimum land area of 10 hectares for serviced housing plots, (ii) minimum built-up area of 50,000 square meters for construction projects, (iii) minimum capitalization of $10 million for a wholly owned subsidiary and $5 million for joint ventures, (iv) the requirement of completing 50% of a project within 5 years, (v) the need to sell developed plots with infrastructural back up, (vi) the requirement of obtaining approval from the Foreign Investment and Promotion Board ("***FIPB***") for repatriating original investment. Nonetheless, something is always better than nothing!

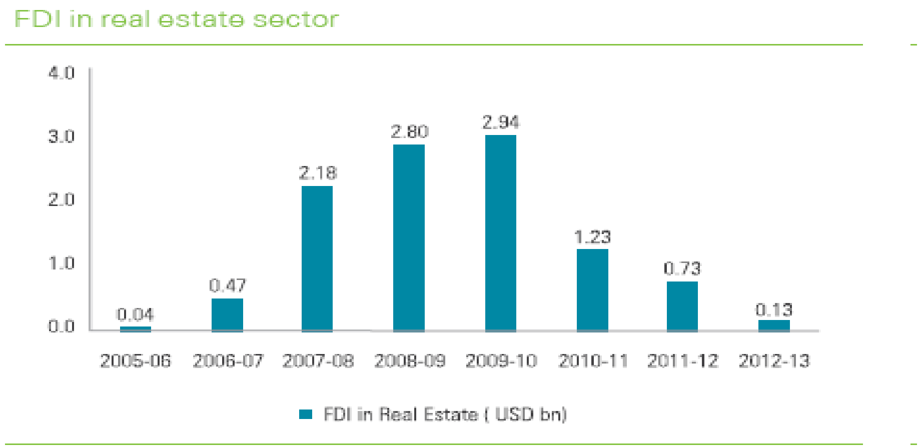
The respite was the exemption granted to the (i) Special Economic Zones ("***SEZs***") and establishment and operation of hotels and hospitals which continued to be governed by Press Note 4 (2001 Series) and Press Note 2 (2000 Series) respectively and (ii) NRIs, from the applicability of the aforesaid conditionalities prescribed by Press Note 2, 2005.[5]

Thereafter FDI in real estate sector witnessed a growth of 80% from 2005 to 2010. While during 2005, FDI in real estate sector was recorded a mere Rs.171 crores, during 2009-2010, it had soared to Rs.13,586 crores.[6]

The above statistics reflect the hearty trust of the foreign investors in India as a growing hub for investment in real estate sector. Nevertheless, the credit crunch of 2008, shook the whole world and hence the industry took a "U“ turn. The real estate sector in India then experienced a terrible slow-down with a steep rise in property prices and unsold inventory, and developers facing a major liquidity crunch. Delayed project approvals and significant

5. Press note 2 of 2006 dated January 16, 2006 read with Press Note 4 of 2006 dated February 10, 2006 issued by DIPP.
6. http://timesofindia.indiatimes.com/business/india-business/Realty-check-FDI-grows-80-times-in-5 years/articleshow/6389923.cms

changes in the legal framework were the principal cause of sufferings of the developers which resulted in a cascading effect on home buyers with real estate prices remaining high. As a consequence, construction activities were either completely stalled or slowed down, thereby creating a feeling of insecurity within the community of realty investors and home buyers.



Source: FDI Statistics, DIPP

The figures above (*in the bar diagram*) depict the ups and downs in the real estate sector during the period commencing from 2005 till 2013.

Some Leg Room

"*More money has been made in real estate than in all industrial investments combined*"- Andrew Carnegie.

However, in order to restore the lost faith and confidence of the investors and to revive the cash trapped real estate sector, the GOI in 2014 introduced a host of reforms for FDI in the construction development projects including the following – (i) dispensing with the minimum area land requirement for serviced plots, (ii) reducing the minimum floor area requirement from 50,000 sq.mts to 20,000 square meters for construction-development projects, (iii) reducing the minimum capitalization requirement from US$10 million to $5 million, (iv) despensing with the 3 year lock in period requirement, (v) providing for exit to the foreign investors on completion of the project or after development of trunk infrastructure and (vi) providing for (a) repatriation of funds or (b) transfer of stake from one non-resident to another non-resident before completion of project with prior approval of FIPB.[7]

7. Press Note 10 of 2014 dated December 3, 2014 issued by DIPP

REITs as an Energy Charger

In order to get things rolling for the Indian realty, the Securities and Exchange Board of India participated in the bandwagon along with the DIPP and the Reserve Bank of India by introducing the Real Estate Investment Trust ("***REITs***") with the hope of assisting the developers in raising funds for the stalled construction activities.

				Amount in Rs.crore
Sr.no	Sector wise	2013-14	2014-15	2015-16*
1.	Service sector	13,294	27,369	9,404
2.	**Construction Development**	**7,508**	**4,652**	**516**
3.	Computer software and hardware	6,896	14,162	19,504
4.	Telecommunications	7,987	17,372	4,238
5.	Drugs and Pharmaceuticals	7,191	9,052	1,441
6.	Automobile Industry	9,027	16,760	9,318
7.	Others	22884	50789	21355
*for quarter ended September 2015				

But no!

Inspite of the reforms introduced by the GOI to revive the real estate sector, there still is a sharp decline in the FDI proceeds coming in for the construction development projects in India. While the overall FDI has increased considerably from $36 billion in the year 2014 to $44.9 billion in the year 2015, the downward trend in case of FDI in the construction development sector continues with a drop in the FDI being recorded from Rs.7,508 crores in the year 2013-14 to Rs.4652 crores in 2014-15.[8]

A watershed for revival of Indian realty

Considering the existing slow-down in the Indian realty sector and with the hope to boost foreign investments in the real estate sector, the DIPP has, by way of Press Note 12 of 2015 issued on November 24, 2015[9] ("***Press Note 12***"),

8. http://dipp.nic.in/English/Publications/FDI_Statistics/2015/FDI_FactSheet_JulyAugust September2015.pdf
9. issued on November 24, 2015

introduced some path-breaking amendments in the Consolidated Foreign Direct Investment Policy effective from May 12, 2015 ("***FDI Policy***"), for FDI in the construction development projects. The salient amendments introduced by Press Note 12 as applicable to FDI in construction developments projects have been listed below:

- Each phase of construction development project will be considered as a separate phase for the purpose of FDI Policy;
- Minimum floor area requirement of 20,000 sq.mts and minimum capitalisation requirement of USD$ 5 million have been totally dispensed with;
- Exit of foreign investors and repatriation of foreign investments will now be permitted under the automatic route before the completion of a project subject to completion of 3 years lock-in-period from the date of receipt of each tranche of investment;
- Transfer of stake from one non-resident to another non-resident without repatriation of investments will now be permitted without being subject to any (i) lock-period or (ii) government approval;

- The requirement of atleast 50% of the project to be developed within a period of 5 years from the date obtaining all the statutory clearances has been dispensed with albeit subject to certain conditions;
- Conditions of lock-in period will not apply to (i) hotels and tourism resorts hospitals, (ii) special economic zones, (iii) educational institutes, (iv) old age homes, and (v) investments by non-resident Indians;
- 100% FDI is now permitted under automatic route in completed projects for operation and management of townships, malls/shopping complexes and business centres;
- Transfer of ownership and/ or control of the investee company from residents to non-residents is now permitted under certain conditions;

- A clarification is inserted in the definition of "Real Estate Business" that earning rent/income on lease of the property (not amounting to transfer) will not be considered as real estate business;
- Definition of 'Transfer' has been clarified and is in line with Section 2(47) of the Income Tax Act, 1961.

Additional Reforms introduced by GOI

Soon after the DIPP issued Press Note 12 of 2015, the Union Cabinet approved the Real Estate (Regulation and Development) Bill, 2015 (the "***Real Estate Bill***") on December 9, 2015.[10] The Real Estate Bill, among others, aims to provide a uniform regulatory environment to ensure speedy adjudication of disputes and orderly growth of the real estate sector. The Real Estate Bill aims at restoring confidence of the investors by institutionalising transparency and accountability in the real estate and housing transactions, which in turn, will encourage both domestic and foreign investments in the Indian realty sector.

In addition to approving the Real Estate Bill, the Government in its Union Budget of 2015-2016 gave its nod to the ambitious target of developing 100 smart cities and 500 cities under the Atal Mission for Rejuvenation and Urban Transformation [AMRUT] by the year 2020 which will invite investment of Rs.2 trillion in the next five years. Funds have been allocated from the Centre: (i) Rs.4,800 crore for the smart cities, (ii) Rs.50,000 crores for the 500 cities under AMRUT, (iii) Rs.100 Crore for each city every year from the Centre for the next 5 years. Apart from these, the state government will allocate incentives and special incentive packages for mega projects. There are separate incentives for developing SEZ/EMC’s/other sectoral clusters and Electronic Manufacturing Clusters.[11]

10. Press Release dated December 9, 2015, issued by the Press Information, Government of India, Cabinet.

11. http://www.makeinindia.com/sector/construction

Our views on Press Note 12

The changes introduced by Press Note 12 including dispensation of the minimum area and minimum capitalisation requirement will not only encourage FDI in smaller construction developments projects involving a floor area of less than 20,000 sq.mts but will also offer greater flexibility to the foreign investors in structuring their investments. The exit of foreign investors from the investee company before the completion of the projects without obtaining prior approval of FIPB, subject to completion of 3 years from the receipt of each tranche of investment, will offer relatively smoother exit to the foreign investors thereby encouraging investments.

Further, permitting 100% FDI under automatic route in completed projects for operation and management of townships, malls/ shopping complexes and business centres and insertion of a clarification in the definition of the term "*Real Estate Business*" that earning rent/income on lease of the property (*not amounting to transfer*) will not be considered as real estate business, will also provide an impetus to increase investments in such projects.

All in all, Press Note 12 will pave way for the much needed boost to a flagging real estate sector and assist in initiating the process of revival of the real estate markets in India.

Contributed by:
Nishtha Mehta, Associate: nmehta@rajaniassociates.net
Zil Shah, Associate: zshah@rajaniassociates.net
Rashi Rajani, Associate: rrajani@rajaniassociates.net

Contact Us

Rajani Associates
Advocates & Solicitors

Krishna Chambers
59 New Marine Lines
Mumbai 400020, India
t: +91 22 4096 1000
e: intralegem@rajaniassociates.net
w: www.rajaniassociates.net

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