Terms of agreement in a collaboration

In a joint development between builders and owners, both parties should pay special attention to stamp duty and registration fee considerations...

Sunil Tyagi

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In Delhi, transactions between owners of a residential plots and developers are commonplace – these are usually referred to as joint development or collaboration arrangements. Of course, the specific understanding and commercial terms between the owner and builder vary from case to case, but these transactions relate to sharing of property.

The owner hands over his property to the builder, so that the builder can undertake the redevelopment and reconstruction of an entirely new building on the plot. The new building is constructed at the builder's expense, including cost of obtaining requisite permissions and approvals from competent authorities, construction material and labour. In such arrangements, the owner receives some floors in the newly constructed building and may also receive some consideration money. Ownership of other floors of the new building along with undivided rights and interest in the plot rests with the builder. The builder usually sells/leases out the floors to third parties. In addition to capturing ownership rights in the new building, the parties also set out other important terms such as payment timelines, construction schedule, specifications of the new building, penalty on delayed construction, etc in the joint development or collaboration agreement.

Stamp duty: As high value immovable properties are involved in such joint development arrangements, stamp duty and registration fee implications also arise. To curb the pernicious practice of parties routinely executing these agreements on stamp papers having value of as little as ₹100, the Government of Delhi had issued a circular as far back as May, 2006. On the aspect of stamp duty payable under Indian Stamp Act, 1899 as applicable to Delhi, the circular states that the proper stamp duty payable is the same which would be payable on a sale deed. The underlying rationale given in the circular is that though the nomenclature of the agreement may be joint development or collaboration, the underlying essence of the entire transaction is that of a sale/conveyance of immovable property.

The consequences of non-payment or inadequate payment of stamp duty are harsh as it can lead to impounding of the document and can attract a hefty penalty of up to ten times of the applicable stamp duty. The circular clearly states that deficient stamp duty would entail prosecution for intentional evasion.

Registration fee: The circular further stipulates that these agreements are required to be compulsorily registered under the provisions of the Registration Act, 1908, as such documents create rights, title and interest of the parties in immovable property. Registration of a legal document, wherever required to be compulsorily registered by law, makes them admissible in evidence in courts. Not registering a document that otherwise requires compulsory registration renders it inadmissible in evidence in the courts of law. As a consequence, the parties would find it difficult to enforce the terms of the agreement, thus endangering their rights.

The author is senior partner, ZEUS Law Associates, a corporate commercial law firm. One of its areas of specialisation is real estate transaction and litigation work

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htestates LAW BOOK
Sunil Tyagi

I had given my property on lease for a term of two years. The term expired around three months ago. The lessee assured me that he would vacate the property as soon as he finds an alternative accommodation. However, he is yet to vacate the property. Although we have not executed any written documents, I am worried whether that by accepting rent from him in this interim, the earlier lease deed stands renewed in his favour for another two years. How should I proceed?

–Simar Sikka

In the absence of execution of a lease deed which has been duly stamped and registered, the lessee cannot claim creation of tenancy for a further term of two years in his favour. Rather, the tenancy under the earlier lease deed executed in his favour stands terminated now. However, as you have been accepting monthly rent from the lessee even after expiry of the term under the earlier lease deed, a month-to-month tenancy stands created in the lessee's favour. Such a month-to-month tenancy may be terminated by either party at any time by giving prior written notice of 15 days.

My brother and I are planning to invest in a fully constructed residential property. My brother will purchase the ground floor and garden area whereas I will purchase the first floor and terrace area. Who will have the right to keep title documents of the entire property?

–Sitara Shah

The buyer who is purchasing the portion having greater value will be entitled to receiving the chain of title documents of the entire property.

However, such buyer/prospective owner is bound to furnish the title deeds of the entire property upon reasonable requests made by owner of the other portion having lesser value.

I want to purchase a flat which is jointly owned by a couple. The wife is unable to travel to execute sale deed in my favour. Being the spouse as well as joint owner, can the husband execute the sale deed of the entire property in my favour?

–Amrita Singh

As the property is owned by both husband and wife who have joint and undivided ownership, the sale deed in your favour shall be valid only if it has been executed by both. However, the wife may execute a power of attorney in favour of her husband, authorising him to execute the sale deed in respect of her undivided share in the property, on her behalf. Before execution of the sale deed in your favour, you may ensure that such a PoA has been duly stamped and registered.

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htestates CHEQUE BOOK
Harsh Roongta

I am 26 years old working in a private company for last two years with an annual income of ₹6 lakh. I require a home loan of ₹35 lakh, but don't have funds for down payment. Can I get a home loan?

- Piyush Kalra

Banks can grant loan up to a maximum limit of 80% of the agreement value of the property as a home loan. This means that your down payment will have to be minimum 20% of the agreement value of the property in addition to other costs such as stamp-duty and registration charges, etc.

In case you find arranging the funds for down payment difficult, you can look for friendly loans from your family members/friends. If that is not possible, then you can look for secured loans against tangible movable security such as jewelry, NSC, bonds, shares, units of mutual funds, or life insurance policy with high surrender value.

If none is possible you should be looking at saving systematically every month to create a down payment corpus. Since you are 26 years of age, banks will normally lend up to 4 – 4.5 times of your gross annual income. With your annual income of ₹6 lakh, you should be eligible for approximately ₹24 - 27 lakh @ 10.25% for 30 years loan tenure. In order to enhance your eligibility, you can either make your earning parents / earning spouse (if married) to join you as co-borrower to the loan or increase the tenure to 30 years.

What is more prudent, transfer my home loan outstanding amount of ₹15 lakh to another bank or convert it to a lower interest rate in same bank? What are the factors to be considered before taking a final call on balance transfer or conversion?

- Pradip Singh

Current (October 2013) competitive rate in the market for a loan amount of ₹15 lakh is around 10.25% and assuming you are paying substantially more than that, you can check if your existing lender is willing to reduce the interest rate to 10.25%. You may have to pay a small fee of up to 0.56%. This will avoid the logistics of transfer of documents from one lender to another. If the lender is not willing to reduce the rate of interest to 10.25% pa, you can evaluate the option of switching your loan to other lender.

RBI has instructed banks not to charge the foreclosure fee in respect of floating loans. So, in case your loan is under floating rate, you will not have to pay any penalty for shifting such loans. However, you may have to pay some processing fee to the prospective lender. In fact most lenders will agree to take over your home loan from an existing bank without any significant processing fees. So, effectively there will be no charge for shifting the loan to another lender. You will need a good track record of payment of your EMI's on time to get an offer from another bank.

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DHANTERAS LOSES SHEEN

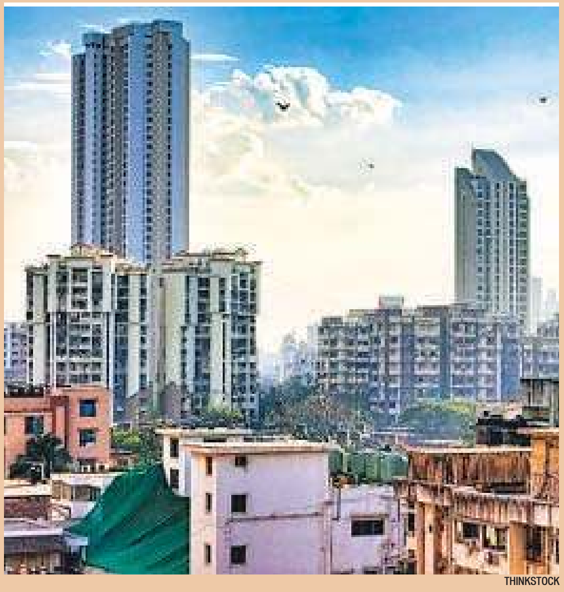
It was predicted that the young prince would die of snakebite on the fourth day of his marriage. His wife on that day piled up her ornaments, gold and silver coins at the entrance of their room. Come evening she also lit several lamps illuminating the place. Singing pleasing songs and narrating stories all night she ensured that her husband remained awake. When the God of death, Yama, arrived in the form of a serpent, his eyes were blinded by the brilliant glare of shining gold and jewels and the lit-up area. Yama slithered atop the heap of jewels and coins and also listened to the stories and songs being told and sung by the prince's wife. Tired, an unsuccessful Yama went away from the room. The prince's wife in all her wisdom managed to save her young husband's life. The day became known as dhanteras and the belief spread that buying gold and silver on that day was not only auspicious but also averted tragedies.

According to another legend, it was on dhanteras when Dhanvantri (the physician of the gods emerged from the sea with a jar when the gods and demons were churning the oceans for obtaining amrit (the nectar of immortality).

India's rental yields higher than in Singapore and Hong Kong

Residential yields in Mumbai are currently around 3.5% and are much lower than those observed in London, Tokyo and New York

Ashutosh Limaye



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Residential rental yields* across Tier I cities in Asia have an interesting story to tell. While yields in India are higher than in Singapore, Hong Kong and Beijing, they are lower than in cities such as Jakarta and Manila. Several factors are responsible for this – the local demand-supply situation, macro-economic scenario, end-user demand, local land-related policies, etc.

Does this yield variation in Asian cities clearly reflect the risk-return trade-off? The World Bank's Registering Property index (part of its Doing Business index) provides some insights.

The Registering Property index ranks India at 94 among 185 surveyed countries. China, Hong Kong and Singapore rank higher than India, while Indonesia and Philippines rank lower. Both Indonesia and Philippines are perceived as having relatively weak legal frameworks. This clearly shows that weakness in the legal framework is directly indicative of higher the risk - and therefore higher yield:

This differential in rental yields is a crucial consideration for global investors for whom the diversification of markets is an important criterion. Also, higher yields in Asia might tempt global investors, particularly from the West, to invest while they have access to cheaper funds onshore. Local investors also benefit, because higher yields mean a rising rental value, offsetting moderated capital values - the former rise faster than the latter.

Rental yields - emerging Asian vs developed markets

The intra-regional comparison of various Asian cities reflects a logical differentiation between rental yields. However, the same logic does not seem to apply in developed markets. It is widely believed that emerging Asian countries are relatively more risky for real estate investment than developed economies. Yet, the rental yields in emerging Asia do not reflect the relative risk-return differential.

For example – residential yields in Mumbai, which are currently around 3.5%, are lower than those observed in London, Tokyo and New York. All these cities rank quite high on the World Bank's Registering Property index.

Despite stronger regulations and a better legal framework in the developed economies, comparison with emerging Asian yields reveals a different picture. Lower penetration of financial markets, higher inflation and larger population creating a constant demand for housing could be reasons for this.

Also, households in emerging nations generally prefer to channel a large proportion of their savings into physical assets such as gold and real estate. According to India's central bank data, the country's household investments in physical assets are over 50% of the total household savings. In a country like the United States, the figure is below 30%.

Based on yields, global investors do display a degree of scepticism over investing in Asian residential property markets. However, domestic investors continue purchasing at lower yields purely for the capital appreciation (typically around 10% pa - and definitely higher than inflation) and because of the savings culture.

The question is – how long will this continue? Can the existing yield differential between emerging Asia and developed markets sustain? Over the past few years, rental yields have been on a decline across various Tier I cities in Asia.

So far, it has been the faster rise in capital values over rents across much of Asia that has led to a compression in yields.

In Mumbai, yields have fallen by 50-90 basis points (bps) across various precincts during the period 2007-2Q13. After property prices took a beating during the Global Financial Crisis (GFC), they bounced back quickly, resulting in yield compression. More recently, during 1Q11-2Q13, yields have risen moderately, owing to marginally higher growth in capital values over rental values.

Similar trends have been witnessed in Hong Kong, Singapore and Beijing, where rental yields fell by 50-100 bps during the same six-year period. Manila and Jakarta exhibited a similar trend, though the rates of fall were quite different. While rental yields in Manila fell 30-35 bps, the fall was much sharper in Jakarta at 250 bps. This is attributable to the steep rise in capital values beginning 2Q10, which was the result of escalating cost of transaction and construction material.

Rise in capital values occurred even when economies were slowing down from peak growth rates. Mumbai has seen residential property prices surpass the previous peak of 3Q08, and they continue to remain high despite a slowdown in the Indian economy (FY13 GDP growth fell to 5.0% level after averaging ~8.0% growth during FY10-FY12). This has led to concerns about affordability and overheating of the property market in a scenario wherein job creation and income growth have slowed.

Stemming the tide

Several Asian governments have started taking steps to cool down property prices. In China, the measures have included raising the minimum down payment, raising the interest rate for second home purchase, restrictions on property purchases by non-Chinese buyers, etc. In India, measures to curb speculative buying include the approval and visible fast-tracking of the real estate regulatory bill, which intends to check demand-supply imbalances and bring more transparency to the sector. The Singapore government has introduced similar measures to curb the irrational rise in property prices.

In such a scenario, it is hard to foresee further price escalation unless the economies revive or restrictions ease.

Yields must reflect true investment rationale

In the near term, residential yields in Asian Tier 1 cities will either stabilise or rise marginally as capital value appreciation begins to drag. This is good for the real estate sector in emerging Asia on the whole, since the current prices and yields do not correctly reflect the actual macro-economic scenario. Any or a combination of three possible scenarios could prevail in the near future –

Existing high capital values could instigate authorities to further step up efforts to curtail speculation, resulting in a price corrections - or at least stabilisation. Rentals would probably remain unchanged, thereby halting further yield compression.

Further rise in capital values could boost demand for rental housing, leading to increased rental values. This would stabilise yields if both capital and rental values grow in tandem.

An increasing number of individual investors hitherto focused on Emerging Asia could switch to investing in other regions (especially developed markets), attracted by higher yield and better amenities.

So far, the likelihood of such a sea-change in investor orientation was remote, largely due to the strong cultural preference of Asians for local real estate.

We are now looking at a different scenario.

Though the RBI has now curtailed investment by Indians into offshore property, many HNIs and non-resident locals in other Asian countries have already displayed an increasing preference for investing in properties on foreign shores. In Asian countries other than India, such a trend can still lead to fall in domestic property prices, thus putting a floor to yield compression or fuelling gradual rise in yields.

(*Residential rental yields = monthly rental x 12 months / capital value of the property, or the annual rate of return an investor can earn from his capital invested in a property.)

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