

SC order puts interests of homebuyers above that of banks in the event of a real estate firm defaulting on a loan

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Legal experts say the order would shield homebuyers from fraudulent practices of real estate developers who often fail to repay debt, leading to lenders taking over incomplete projects and auctioning them to recover their dues

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The Supreme Court of India. A recent order by the top court would provide much-needed protection to homebuyers who invest their life's savings in a home and are awaiting delivery and possession.

Homebuyers, especially those paying both equated monthly instalments (EMIs) to repay their loans even as they pay rents for the residences they are living in, have been caught between banks and builders in cases where there is little hope of the builder giving them possession of the homes they had booked. That's because when a developer defaulted on debt, the lenders would take possession of the unfinished project and auction it to recover their dues, leaving would-be homeowners in the lurch since it inevitably meant further delays in getting their flats.

However, a recent Supreme Court order has put the interests of homebuyers above that of banks in the event of a real estate builder defaulting in repayment of bank loans and handing over possession of the unit.

The apex court also said that in case of a conflict between the Real Estate (Regulation and Development) Act and recovery proceedings under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), the former will prevail.

This order, say legal experts, would provide much-needed protection to homebuyers who invest their life's savings in a home and are awaiting delivery and possession but get entangled in the tussle between creditors and builders.

Dismissing an appeal by Union Bank of India against a Rajasthan High Court ruling that complaints against banks can be filed before the state Real Estate Regulatory Authority ([RERA](#)) if bank had taken possession of the project following default by the builder, the apex court said it is in "complete agreement" and that complaints against banks can be filed before RERA in cases where the such proceedings have been initiated by homebuyers to protect their interests.

In the Rajasthan High Court case, the bank had alleged that RERA did not have any jurisdiction over the bank as lenders do not fall under the definition of "promoter" for the purpose of the real estate Act and that the authority cannot cancel the bank auction or halt recovery proceedings of the bank.

"Very often, homebuyers find themselves in a position where the concerned project (on which a charge has been created by the developer) is auctioned, and the allottee/buyer becomes dependent on the new promoter for completion of the project and in turn for delivery of his flat/unit. Therefore, the apex court has held that the buyer shall have the right to file a complaint against the bank as it will step into the shoes of the promoter," explained Sunil Tyagi, senior partner, Zeus Law.

The Rajasthan High Court judgment against which the appeal was made to the Supreme Court by Union Bank of India held that the bank would be considered as a "promoter" under the Act and that RERA has jurisdiction to entertain a complaint against a bank if the bank has taken over a project to recover its dues under the provisions of the SARFAESI Act.

The high court further held that in the event of conflict between RERA and SARFAESI Act, the provisions of RERA would prevail as RERA is a subsequent enactment, said Tyagi.

It would also be relevant to mention here the earlier judgment of the Supreme Court in the matter of Pioneer Urban Land and Infrastructure Ltd and another vs Union of India & Others wherein it was held that remedies that are given to allottees under the Consumer Protection Act, 1986, RERA and the Insolvency and Bankruptcy Code, 2016 are concurrent remedies and RERA is to be read harmoniously with the code and that only in the event of conflict would the code prevail over RERA.

Keeping in view the spirit of RERA, by its recent order the Supreme Court has upheld the Rajasthan High Court order and ensured that the interest of homebuyers is protected and has preference over the interest of banks.

However, the high court judgment does not expressly state what happens when the bank auctions the project, whether the bidder would require consent of the two-thirds of the allottees of the project for a change in promoter status or whether it would automatically become the assignee and be deemed promoter as in the case of a bank, pointed out Tyagi.

By virtue of this judgment, interests of the homebuyers will get priority over that of banks, and aggrieved homebuyers will get the opportunity to approach the appropriate statutory forum (RERA) that can specifically address their concerns. The Supreme Court has also [directed](#) the Union government to inform the court, within a period of two months, on how the rules and conditions on RERA are being implemented by various states.

This directive should prod the central and state governments to take necessary steps for proper implementation of RERA, said Rakesh Warriar, partner, JSA, a law firm.

Venkat Rao, an insolvency expert, told Moneycontrol that the order is significant, especially with regard to the issue of funding for the real estate sector.

SARFAESI is a mechanism whereby banks have the liberty to enforce security without any intervention from anywhere, including the court. After this Supreme Court order, banks will no longer be able to take recourse to subsection 4 of Section 13 of the SARFAESI Act by default. Banking institutions will now come under the purview of RERA which can pass orders to protect the rights of the allottees.

The process of enforcing the security mechanism may no longer be an automatic mechanism but would be subject to regulatory approvals. It would now have to go through a stringent process, Rao explained.

The Rajasthan High Court ruling had also made it clear that the moment the bank or financial institution takes recourse to the measures available under Section 13 (4) of the [SARFAESI](#) Act, RERA would have the jurisdiction to entertain the complaint filed by an aggrieved person.

What this means is that the moment the bank enforces its security to recover the loan amount, it would now have to inform the concerned RERA authority and update the information on the website that it is stepping into the shoes of the promoter. There will now be a mechanism in place wherein the bank would have to communicate to the allottees that it intends to auction the land. The process will not take place by default, Rao explained.

“There will be an intervention going forward. The regulator will get involved. Banks may have to give an undertaking that the interests of the homebuyers will be protected if the property is auctioned. The security of the banking institution will become subservient to the homebuyers’ interests in case there is an agreement in existence,” he said.

Having said that, the order would impact bank recoveries. “It would make liquidating assets and recoveries difficult. Bank NPAs (non-performing assets) may increase,” he said.

Homebuyers welcome the order.

“This is a very crucial ruling by the Supreme Court to protect homebuyers’ interests as their claim will now be given priority over banks’ claim despite the bank being a secured creditor,” said Abhay Upadhyay, president of the Forum for People’s Collective Efforts (FPCE), and member of the Central Advisory Council.

It is also worth pointing out that the real estate Act has a provision under Section 11(4)(h) where such protection has been given to homebuyers and this ruling reaffirms that, he said.

According to the provision, the promoter shall after he executes an agreement for sale for any apartment, plot or building, as the case may be, not mortgage or create a charge on such apartment, plot or building, as the case may be, and if any such mortgage or charge is made or created then notwithstanding anything contained in any other law for the time being in force, it shall not affect the right and interest of the allottee who has taken or agreed to take such apartment, plot or building, as the case may be.

“This will certainly go a long way in giving relief to homebuyers as they will not have to fight two-front battles, i.e., one with the builders and another with banks,” he added.

A setback for banks

Legal experts also point out that the Supreme Court ruling will be a major setback for banks.

“It will affect their right to possession in the event of a default. If homebuyers claim interest in the builder’s property, banks will be hampered,” said Sonam Chandwani, managing partner, KS Legal & Associates.

When it comes to lending to developers, banks must exercise greater caution. If builders fail to complete projects and pay dues, there is a good risk that homebuyers may file a claim for rights/interest in the property. This judgment is something that homebuyers have been waiting for years since if a project is delayed, their entire investment is stuck, and this will provide them confidence and protection if the project is delayed for whatever reason, she added.

The courts and the regulatory authorities have largely adopted a pro-consumer approach in recent times and this decision of the Supreme Court is in line with such an approach. However, while this could be hugely beneficial to consumers, it could put more stress on the Indian banking sector, which is already struggling with NPAs, said MP Srivignesh, counsel, AnantLaw.