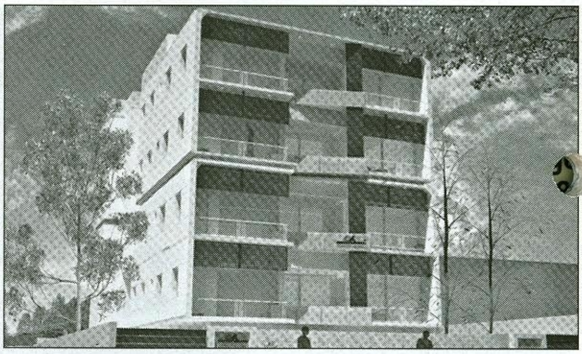
Need to plug loopholes

A foreign investment-friendly regime in the real estate sector holds the key to development of adequate infrastructure for inclusive and sustainable economic growth and there is every need to plug the loopholes afflicting the sector, say Sunil Tyagi and Santosh Singh.

Ever since 2001, when the gates of real estate were first thrown open to Foreign Direct Investment (FDI), the Real Estate sector has seen sweltering growth of around 30 per cent and emerged as one of the most appealing areas for investment by domestic as well as foreign investors. According to the UNCTAD report on world investment prospects titled 'World Investment Prospects Survey 2009-2011', India ranked third in global FDI in 2009 and will continue to remain among the top five attractive destinations for international investors during 2010-11.

India's real estate sector was not fully open to FDI through the Automatic Route till February, 2005. Foreign investors were allowed to invest in integrated townships and settlements either through Wholly Owned Subsidiaries or through joint ventures with local partners. The Press Note No.2 (2005 Series) ('PN 2/2005') further opened up FDI in townships, housing, built up infrastructure and construction-development projects (which include hotels, resorts, hospitals, residential and commercial complexes, educational institutions, recreational facilities, city and regional level infrastructure) ('Real Estate Development') which was brought under the Automatic Route, subject however to the qualifications, prescriptions and conditions laid in respect thereof. Consequently, Persons Resident Outside India ('Foreign Investors') are permitted to invest upto 100% in an Indian entity involved in Real Estate Development sector in the country without seeking prior permission of the Government of India or the Reserve Bank of India (RBI) or the Foreign Investment Promotion Board (FIPB) or the Ministry of Finance subject to complaince with the guidelines prescribed. However, FDI is not allowed in pure / retail real estate business i.e., buying and selling of real estate. Further, investment by Foreign Investors in agricultural sector continues to be prohibited.



Guidelines with respect to FDI in the Real Estate Development sector in India are provided in the Consolidated FDI Policy (effective from 1st April, 2010) (FDI Policy) and Master Circular on FDI in India released on 1st July, 2010 (Master Circular). The following are the highlights of conditions / stipulations currently applicable to investment in the Real Estate Development sector in India.

- Minimum area

FDI Policy prescribes the minimum area requirements for different kinds

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of projects involving FDI which are as follows:

a. In case of serviced housing plots, minimum land area to be developed is 10 hectares;

b. In case of construction-development projects, minimum built up area has to be not less than 50,000 square meters;

c. In case of a combination project, any one of the above two conditions must be satisfied.

Since the term "builtup area" is not defined anywhere under the FDI Policy and the real estate sector uses different terms such as 'built-up area', 'super built-up area', 'carpet area' etc. with no authoritative and uniform definition to be found anywhere, this has lead to ambiguity and confusion. Consequently, calculation of what qualifies as built-up area may vary up to 50%, causing a major variance for the purpose of computation of permissible investment. Since, different connotations of the terminology used can have a strong bearing on developers and investors alike, terminology such as 'Floor Space Index' or 'Floor Area Ratio' ought to be used.

- Minimum capitalization

The investments by Foreign Investors are further subject to minimum capitalization requirements. For Wholly Owned Subsidiaries of foreign companies, the minimum capitalization requirement is US$ 10 million. In case of a joint venture with an Indian partner, the minimum capitalization requirement is US$ 5 million. The ambiguity here is with regards to the computation of value of minimum investment. It is unclear whether investment is to comprise only the face value of securities or also includes the premium charged upon issuance of the same.

- Commencement of business

It is also stipulated that foreign funds have to be brought in within 6 months of 'commencement of business' of the Company. The concern raised here is what would be tantamount to 'commencement of business' of any Company, especially in the case of a Foreign Investor. Some opine that it should be the date on which the Joint Venture Agreement or such similar agreements are executed between the Foreign Investor and Indian Company. In common parlance, the date of commencement of business of a Company is the date on which the Company is duly incorporated under Indian laws. The Federation of Indian Chambers of Commerce and Industry has also highlighted the issue in its survey report on Foreign Direct Investment in real estate in the following terms:

"…..the problem arises when the FDI is brought in an existing company which is operational for more than six months before the date of signing agreement with FDI partner, which date should be considered as date of commencement of business of the company? The Government should clearly spell out the implication of the term 'commencement of business'. It needs to be clarified that the 'date of commencement of business' is the date on which the joint venture agreement or joint development arrangement or any other form of agreement for development activities in India is signed by the Foreign Investor or the date of incorporation of a company, as the case may be. This ambiguity must be clarified in

FDI in Housing and Real Estate

Year	In Rs (crore)	In US$ (million)
2005-06	170.52	38.04
2006-07	2121.11	46734
2007-08	8749.34	2179.13
2008-09	12,621.24	2801.17
2009-10	13,586.41	2844.11
April, May 2010	737.87	162.65

Country	Projects
Mauritius	625
USA	230
Cyprus	230
UAE	69
Singapore	66
NRIs	46
UK	42
Total (32 countries)	1614

Note: Investments have also come in from Sudan, Kenya, Italy, Nigeria, Sit Kitts and Nevis, Japan etc.

Courtesy: Times of India

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subsequent legislations or administrative notices."

- **Repatriation of funds**

The FDI Policy further stipulates that the 'original investment' is not to be repatriated before a period of 3 years from the completion of minimum capitalization. However, early exit is possible with prior approval from FIPB.

The issue that arises here is what actually comprises 'original investment'? Is it the amount of first instalment or the first tranche (in case the investment is being remitted in tranches) or entire corpus of the minimum capitalization? What happens to the returns that accrue to the investor during such lock-in period? Is an investor entitled to repatriate the returns in totality that does not form part of the original investment? The stipulations must clearly state what exactly is meant by the term 'original investment'. Such clarity would allay apprehensions of investors and provide a more conducive and investor-friendly regime for foreign investments in Real Estate Development sector.

- **Completion norms and compliance with local laws**

Development of at least 50% of the project has to be completed within a period of 5 years from the date of obtaining statutory clearances. Further, the project must comply with local, municipal and state rules and regulations and conform to all applicable norms and standards relating to land use, construction, provisions of amenities, etc. Since the actual implementation of projects takes place at the State level and each State has different sets of rules, bye-laws and regulations applicable, there is a need to simplify the procedures and have in place an expeditious approval mechanism to make this sector more attractive to foreign players. An institutional set-up is required for getting various clearances for FDI projects from both the Central and State government within a stipulated time frame.

The conditions and qualifications detailed in PN 2/2005 are not applicable to Non Resident Indians ('NRIs') and Persons of Indian Origin (PIOs) investing in real estate (both development as well as retail sectors). NRIs and PIOs may invest upto 100% in housing, commercial and other real estate projects across the country other than agricultural land, plantations and farm houses subject to the acquisition, transfer regulations and repatriation norms under the applicable Master Circular 15 of 2010.

Also, Foreign Investors are permitted to invest upto 100% in the hotel and tourism related real estate industry, hospitals and Special Economic Zones (SEZs) and the aforesaid conditions do not apply to investment in these sectors. Nevertheless, investment in SEZs is subject to the SEZ Act, 2005 and SEZ policy of Government of India.

The importance of foreign investment in real estate development is undisputed as the ever-increasing demand for housing, commercial space, townships and infrastructure in India can be effectively catered to with foreign investment in this sector. Foreign Investor participation also brings in much-needed professionalism into the sector as real estate development in the country takes gigantic strides. The Central Government recognizes this fact and amends its regulations from time to time to ease Foreign Investors' entry into this sector. However, the ambiguities in the FDI Policy and concerns highlighted need to be addressed if the FDI route is to continue being an attractive mode of investment for Foreign Investors. Further, the local laws and approval mechanisms require a major overhaul, bureaucratic obstacles need to be minimized and procedures simplified so as to reduce hurdles faced by Foreign Investors during implementation of projects undertaken and achieve more FDI realisation. A Foreign investment-friendly regime in the real estate sector holds the key to development of adequate infrastructure required for inclusive and sustainable economic growth in our country.

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