

Real Estate Update

February 06, 2015

FOREIGN INVESTMENT NORMS IN REAL ESTATE CHANGED

- 3 year lock-in restriction removed
- Criteria for 'affordable housing projects' relaxed
- Whether investments are now possible in brownfield real estate projects?

In line with the announcements in the Finance Minister's budget speech for 2014, the Union Cabinet in a recent press release issued pursuant to its meeting dated October 29, 2014 ("**Press Release**"), proposed certain relaxations for Foreign Direct Investment ("**FDI**") in 'construction-development sector'. This was followed by press note 10 of 2014 ("**Press Note**") on December 3rd, 2014 and an RBI circular dated January 22, 2015 to formally notify the relaxations. Though most of the changes proposed in the Press Release have substantially been incorporated in the Press Note, there are certain differences in the Press Note as against Press Release. For a detailed analysis of the Press Release, please refer to our previous hotline '*Foreign investment norms for real estate liberalized*'. In this hotline, we are covering only the differences in the Press Note as against the Press Release.

CHANGES

Lock-in restriction

The Press Release proposed that a foreign investor can exit from its investment only on (i) the completion of the project, or (ii) *completion of three years from the date of final investment*, subject to the development of the trunk infrastructure, i.e., roads, water supply, street lighting, drainage and sewerage. The Press Note has done away with the requirement of 3 (three) years from the date of final investment, and hence, an investor can now exit from the project once it is completed or after the development of the trunk infrastructure.

Analysis

No minimum lock-in period: As per the earlier FDI Policy, each tranche of investment was locked in for a period of 3 years. Though this was intended to provide some long term commitment to the project by a foreign investor, even if the project was completed, some later tranches of foreign investment, especially the last mile funding could still be locked-in. By removing the 3 year (three) lock-in now, the government has encouraged foreign investments in shorter projects (also applicable as the minimum area requirements have now been relaxed), and removed deterrence for a foreign investor to provide subsequent funding in case of longer projects.

Ambiguity in exit from multi-phase projects: Previously if a project was developing in phases, a foreign investor could exit from the project upon completion of the initial phase, provided the 3 (three) year lock-in period had expired. However now, since the exit is linked to either project completion or development of trunk infrastructure, it is unclear whether a foreign investor can exit (whether partly or completely) upon completion of any phase of the project, when the trunk infrastructure for later phases is not developed.

Affordable housing project

The Press Note has relaxed the criteria for determining 'affordable housing projects' than as proposed in the Press Release. As per the Press Release, 'affordable housing projects' were defined to mean projects which allot at least 60% of the floor area ratio ("**FAR**") / floor space index ("**FSI**") for dwelling units of carpet area not being more than 60 sq. meters, and out of the total dwelling units, at least 35% should be of carpet area 21-27 sq. meters for economically weaker section category.

Press Note defines 'affordable housing projects' as projects where at least 40% of the FAR / FSI is for dwelling unit of floor area of not more than 140 sq. meters, and out of the total FAR / FSI reserved for affordable housing, at least 1/4th (one-fourth) should be for houses of floor area of not more than 60 sq. meters

Analysis

This relaxation is a welcome move, since projects which qualify for 'affordable housing' will not be required to comply with certain conditionalities like minimum area requirements and minimum investment requirements. Having said the above, since the area requirements is relaxed to as high as 140 sq. meters (approx. 1510 sq. feet), and only 1/4th of the affordable housing portion needs to be 60 sq. meters (approx. 645 sq. feet), whether the purpose for which this relaxation is introduced will be met or not is not clear.

Combination project

The Press Release retained the provision that in case of combination projects (mix of serviced plots and construction

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development), either of the condition for minimum area requirement can be satisfied. However, since now the minimum area restriction (being 25 acres) for 'serviced plots' has been removed, to avoid any misuse, the concept of combination projects has been removed in the Press Note.

Grandfathering

The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Sixteenth Amendment) Regulations, 2014, dated December 8, 2014 ("**Amendment Regulations**") which amends the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 to include the changes introduced by the Press Note, provides that (i) the Amendment Regulations shall be deemed to have come into force from December 3, 2014, and (ii) no person will be adversely affected as a result of the retrospective effect being given to the Amendment Regulations.

CONCLUSION

The changes introduced by the Press Note are expected to provide a much need fillip to the 'real estate sector'. The relaxations in the minimum land area requirements will bring a lot of projects under the FDI compliant fold, especially in Tier I cities, where project sizes are typically small. Having said the above, there are two issues which may cause a concern:

- 1. as now it has been clarified that the minimum investment will have to be infused within 6 months of 'commencement of the project' i.e., *the date of approval of building plan / lay out plan by the relevant statutory authority*, and not 6 (six) months of 'commencement of business', which was understood to mean *the date of investment agreement with the investor or the date of first infusion by the investor*, it appears that investment in brownfield projects may be a challenge, which could be a major dampener. This may also hinder investments in under construction projects which are stalled due to funding requirements; and
- 2. though, the government has relaxed the capital account restrictions in real estate sector over the last few years, certain changes have created hindrance in exits for existing foreign investments; for instance, press note 2 of 2005 permitted a foreign investor to exit upon completion of 3 (three) years from the date of investment, which was then later extended to 3 (three) years from the date of each tranche of investment. So, if an investor made a subsequent investment in the 4th (fourth) year from the date of initial investment, its 4th (fourth) year investment got suddenly locked in for another 3 (three) years, which the investor had not contemplated at the time of making investment. Also now, the Press Note prescribes that an investor can exit only on completion of the entire project or development of the trunk infrastructure. To that extent, in the absence of grandfathering, existing investors who had completed 3 (three) years and could have exited, are now left high and dry. It remains to be seen if they will now be given approvals for exit prior to completion or development of trunk infrastructure.

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You can direct your queries or comments to the authors

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