Scientific Society of Advanced Research and Social Change

SSARSC International Journal of Geo Science and Geo Informatics
ISSN 2349-6975
Volume 1 Issue 1, March 2014

FDI in Real Estate - Investment & Repatriation of Original Investment

C.S. Awaneesh K.Srivastava
Vice-President-Finance& C.S.
Mantri Realty Limited,
New Marine lines,Mumbai -400020
Email: kmr_srivastava@yahoo.co.in

Abstract :

Indian Real Estate Market,despite its opportunities has seen sharp drop in foreign Investment (FDI) in last few years due to many reasons and in future Global Investors may be more cautious to Investment in India because of ambiguity in regulations, delays in clearances from local authorities and conflicting provisions of Companies Act, Consolidate FDI Policy and RBI regulations governing to it. For a number of private equity investors who invested between 2006 and 2008, returns have been subpar from what they had hoped and been promised many expect to lose money because many projects have not taken off and many others are stuck in litigation with their investee companies because of conflict on exit route provided so far.

Basic Objective of this research paper :

The basic object of this research paper is to highlight the practical difficulties which arises during the transaction which happen for Investment in the Real Estate Sector e.g. at time of capitalisation of Inflow of Foreign Money , repatriation of Income/ sale proceeds by way of dividend when there is still ambiguity on withholding tax rates , the confusion arises because of difference in nature of transaction which either not covered in the regulation or skipped to put it in detail and at time of repatriation of Capital Investment after completion of Project/ locking period. Another Confusion on exit to the Investor when Project is half completed or at start up stage and locking period is over.

There are many loop holes in laws which governs the buy-back of shares of Foreign Investors which includes the conditions precedent in the Share Subscription Agreements, Companies Act, 2013/1956 and FDI Policy /Press Note 2 of 2005

Limitations :

There may be different view on the interpretation of provisions of Laws / Regulations because some of the cases where exit is not provided to the Investors, has been referred to the Arbitrators, High Court of respective states, but still conflicting judgments/opinions are there. The objective of this research paper is also based on the facts and findings of practical cases which are still in the process of negotiation for settlement hence the name of parties can't be disclosed.

Introduction:

The real estate sector is a critical sector of our economy. It has huge multiplier effect on the Economy and therefore, is a big driver of economic growth. It is the second-largest employment-generating sector after agriculture, growing at a rate of about 20% per annum and this sector has been contributing about 5-6% to India's GDP. Not only it generates a high level of direct employment but it also stimulates the demand in over 250 ancillary industries such as cement, steel, paint, brick, building materials, consumer durables and so on.

The Indian real estate industry has been on a roller coaster ride since 2005. Consequent to the Government's policy to allow Foreign Direct Investment (FDI) in this sector, there was a boom in Investment and developmental activities. The sector not only witnessed the entry of many new domestic realty players but also the arrival of many foreign real estate investment companies including private equity funds, Foreign NBFCs and development companies which entered in the sector lured by the high returns on investments. The real estate sector has been riding through many highs and lows since then. The industry achieved new heights during 2007 and early 2008, characterized by a growth in demand, substantial development and increased foreign investments. However, in third quarter of year 2008, the effects of the global economic slowdown were evident here too, and the industry took a 'U' turn. FDI inflow into real estate dropped significantly and what had emerged as one of the most promising markets for foreign investments experienced a Down Turn.

FDI Policy For Real Estate Sector :

The Foreign Direct Investment (FDI) Policy is laid down in the Consolidated Policy of 1st October 2010. (The policy has been there for the past few years. It is just that every 6 months, the Government comes out with a Consolidated FDI Policy which replaces the earlier Consolidated FDI Policy.) The FDI Policy has to be read with FEMA Regulations. The original policy was laid down vide Press Note 2 dated 3rd March 2005. In the new Consolidated FDI policy reference has been given of the original press note or FEMA regulations as per relevance

Non-residents are permitted to invest in Real Estate Development activity through Indian companies. Investment through partnership firms, branch, or any in any other manner is not permitted. Direct business by non-residents is not permitted. The investment is subject to few conditions discussed in subsequent paragraphs.

Non-residents can invest upto 100% of the equity capital of the Indian company

Investment is permitted on automatic basis.

Investment can be in equity shares, or Fully and Compulsorily Convertible instrument (preference shares or debentures).

Each project of Real Estate development should comply with the specified conditions relating to area and Investment ;

1- Project conditions:

1.1 **Minimum area to be developed:**

Minimum area to be developed under **each project** should be as under:

- In case of development of **serviced housing plots**, minimum land area should be 10 hectares.
- In case of **construction-development projects**, minimum built-up area should be 50,000 sq.mts. (In the Recent budget of 2014 this is reduced to 20,000 sq. mts.)
- In case of a **combination project**, any one of the above two conditions should be satisfied.

1.2 The meaning of **serviced plots** has been explained in the Press note. It means where *roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have been made available*. This infrastructure should be provided and a **completion certificate** from the concerned local body/service agency should be obtained before selling the serviced housing plots. Unserviced plots cannot be sold.

1.3 At least 50% of the project must be developed within a period of five years from the date of obtaining all statutory clearances.

1.4 **Other Conditions:**

1.4.1 The project should conform to the norms and standards as laid down in the applicable building control regulations, and all rules regulations of the State Government/Municipal/Local Body concerned.

1.4.2 The investor/investee company will be responsible for obtaining allnecessary approvals under applicable rules of the State Government/ Municipal/Local Body concerned.

1.4.3 The State Government/ Municipal/ Local Body concerned, which approves the building / development plans, would be required to monitor compliance of the above conditions by the developer.

2. <u>Key Issues:</u>

2.1 **Built up area:**

The built up area should be 50,000 square meters (now 20,000 sq. Mts.) . How does one calculate the area? There are different areas mentioned by the builders. It is clear that salable area is not to be considered.

Will the area be calculated as?

- ✓ the plinth area – length x breadth x floors.
- ✓ built-up area which includes the inner walls of the premises & upto outer wall of the premises.
- ✓ Carpet area.

Will it include the following?

- ✓ Parking space.
- ✓ Open areas.
- ✓ Balconies.

3- Investment conditions:

3.1 **Minimum Capitalisation:**

The non-resident investor should invest a minimum of US$10 million (Now reduced to USD 5 Million in recent budget) in wholly owned subsidiaries, and US$ 5 million for joint ventures with Indian partners. The funds have to be brought in within six months of commencement of business of the Company.

If joint venture partners are all non-residents, the minimum investment to be brought in US$ 10 mn. If there are Indian partners, then the minimum capitalisation is US$ 5 mn.

Issues:

- What is "joint venture" has not been explained. One has to give a normal commercial meaning. If the Indian partner is investing say only 1%, will it be sufficient to say that he is a joint venture partner? It certainly cannot be said that he is a joint venture partner. One has to look at the whole joint venture – how much is the Indian partner investing, how much is his contribution, what are his responsibilities as a partner. Then one can take a decision whether the Indian partner is a bonafide partner or not.

- Should the minimum investment comprise of face value of shares, or can the investment include premium? The investment can include premium. Here the minimum investment is the amount of funds which should be invested in the Indian company.

4 . **Lock-in period:**

4.1 **Original investment** cannot be repatriated before a period of **three years** from completion of minimum capitalisation. Say the first installment of investment of US$ 2 mn. is brought in on 30th September, and the balance investment of US$ 3 mn. is brought in on 1st January. Assume that the investment is in a joint venture with an Indian partner. The lock in will apply for 3 years from 1st January.

Beyond the minimum investment, the lock-in period of three years applies from the date of receipt of **each installment** of FDI. Thus later of the two applies – date of achieving minimum capitalisation or the date of investment of installment.

It also means that the **lock-in applies to the entire investment**, and not just the minimum amount required to be brought in.

The policy clearly provides that the lock-in period applies to the "Original investment". Original investment means the entire amount brought in as FDI.

4.2 Thus in essence, if the conditions of press note 2 of 2005 are satisfied, then the non-resident can acquire the shares.

Real estate and non-real estate business:

i. A company may have real estate and non-real estate business. Can a non-resident investor invest in such a company?

ii. The non-resident investor can certainly invest in such a company. However it is necessary that each project of the company is FDI compliant. If any project is not FDI compliant, the investment cannot be made.

iii. There may be some practical difficulties. For example, the non-resident will not be able to sell the shares before the lock-in period (even though for non-real estate business there is no lock-in). To take another example, the lock-in period may be over, but conditions of the real estate project-are not fulfilled. Then also, the non-resident will not be able to sell the shares.

5. Purchase of shares:

5.1 The non-resident investor can purchase shares from Indian resident investors. It is clear that if the company has FDI compliant projects, shares can be purchased.

The funds will go to the Indian shareholders and not to the company. In this situation, will minimum capitalisation norms apply?

The guidelines are silent. As per the policy, the non-resident investors should bring the minimum funds as required as per capitalisation norms. In case of doubts, it will be better to apply to FIPB.

5.2 Joint Venture at project level / or Company level:

The joint venture has to be at the company level and not the project level because investment has to be made through equity instrument/ Compulsorily convertible hybrid instrument

6. Exit from the project:

The main conditions to be complied with before the non-resident can sell the shares are:

- the lock-in period of 3 years should be completed from the date of investment or minimum capitalization norms, whichever is later.
- at least 50% of the project should have been developed within a period of 5 years from obtaining statutory clearances.

May take an approval from FIPB.

7. Key challenges/ Issues to be addressed by Ministry/ RBI :

7.1 What about the case when all the conditions has been complied with viz. minimum capitalization and BUA of 20,000 sq. meter and Project could not take off due delay in getting statutory approvals, whether the Investor can ask company/shareholder/promoter of company to buy-back its shares ?

If buy back is by company and since the project could not take off, how the company shall provide exit to foreign Investor if it doesn't have general reserve?

7.2 **Development:**

Assume that the project is 95% complete. However no unit is fully ready to be handed over to the buyers. Can the non-resident sell the shares in the company?

Take another example. The project comprises of five buildings of 500 flats. Three buildings are ready. For two buildings, construction has yet to commence. Out of the 300 flats in the three completed buildings, only 100 flats have been sold. Can the non-resident sell the shares?

Conclusion :

Foreign Direct Investment in Real Estate Sector is much needed because of its positive impact on the growth of GDP and employment generation, hence the Government / ministry /RBI should give a serious thought to address all the issues mostly in one time by inviting the suggestion on key issues from all the stakeholders and professionals who are part to it . Since In India the return on Investment in real estate project is very high in comparison to global real estate market therefore it has high potential to attract inflow of foreign investment in this sector.

BRIEF INTRODUCTION OF AUTHOR

C.S. Awaneesh K. Srivastava has rich experience in both Corporate Sector and Academics. He is Associate Member of Institute of Company Secretaries of India, having Master Degree Finance & Control, Bachelor degree in Law and Post Graduate Diploma in Business Management. He is actively involved in professional development of buddy company secretaries through Navi Mumbai Chapter of ICSI and holding the position of Vice-Chairman of Navi Mumbai Chapter. He has varied interest in Corporate Laws,Corporate Finance, Corporate Restructuring and FEMA/ RBI Regulations.

References:

1- Foreign Exchange Management Manual-Taxman Publication
2- www. Rbi.org.in
3- www.ficci.com
4- Consolidated FDI policy 2010 & Press Note 2 of 2005