FDI IN CONSTRUCTION AND DEVELOPMENT SECTOR IN INDIA

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Prior to 2005 while NRIs and PIOs were allowed to invest in the housing and the real estate sectors, foreign investors other than NRIs, were allowed to invest only in development of integrated townships and settlements either through a wholly-owned subsidiary or through a joint venture company along with a local partner.

The year 2005 showed a slack of private equity in the real estate sector but on the contrary it also saw a new dawn of 100% FDI being permitted in townships, housing, built-up infrastructure and construction development projects though subject to the conditionalities of minimum area to be developed, minimum capitalisation and lock-in period. Thus, while the GOI did open up the real estate sector for FDI, the conditionalitise were quite burdensome, dampening the liberalization introduced in the real estate sector, some of which included

(i) minimum land area of 10 hectares for serviced housing plots,

(ii) minimum built-up area of 50,000 square meters for construction projects,

(iii) minimum capitalization of $10 million for a wholly owned subsidiary and $5 million for joint ventures,

(iv) the requirement of completing 50% of a project within 5 years,

(v) the need to sell developed plots with infrastructural back up,

(vi) the requirement of obtaining approval from the Foreign Investment and Promotion Board ("FIPB") for repatriating original investment.

The respite was the exemption granted to the (i) Special Economic Zones ("SEZs") and establishment and operation of hotels and hospitals which continued to be governed by Press Note 4 (2001 Series) and Press Note 2 (2000 Series) respectively and (ii) NRIs, from the applicability of the aforesaid conditionalities prescribed by Press Note 2, 2005.

The real estate sector in India then experienced a terrible slow-down with a steep rise in property prices and unsold inventory, and developers facing a major liquidity crunch. Delayed project approvals and significant changes in the legal framework were the principal cause of sufferings of the developers which resulted in a cascading effect on home buyers with real estate prices remaining high. As a consequence, construction activities were either completely stalled or slowed down, thereby creating a feeling of insecurity within the community of realty investors and home buyers.

However, in order to restore the lost faith and confidence of the investors and to revive the cash trapped real estate sector, the GOI in 2014 introduced a host of reforms for FDI in the construction development projects including the following – (i) dispensing with the minimum area land requirement for serviced plots,

(ii) reducing the minimum floor area requirement from 50,000 sq.mts to 20,000 square meters for construction-development projects,
(iii) reducing the minimum capitalization requirement from US$10 million to $5 million,
(iv) despensing with the 3 year lock in period requirement,
(v) providing for exit to the foreign investors on completion of the project or after development of trunk infrastructure and
(vi) providing for (a) repatriation of funds or (b) transfer of stake from one non-resident to another non-resident before completion of project with prior approval of FIPB.

Considering the existing slow-down in the Indian realty sector and with the hope to boost foreign investments in the real estate sector, the DIPP has, by way of Press Note 12 of 2015 issued on November 24, 2015 ("Press Note 12"), introduced some path-breaking amendments in the Consolidated Foreign Direct Investment Policy effective from May 12, 2015 ("FDI Policy"), for FDI in the construction development projects.

The salient amendments introduced by Press Note 12 as applicable to FDI in construction development projects are as under:

- **Each phase of construction development project is to be considered as a separate phase for the purpose of FDI Policy**
- **Minimum floor area requirement of 20,000 Sq.Mts. and minimum capitalisation requirement of USD $5 Million have been totally dispensed**
- **The requirement of atleast 50% of the project to be developed within a period of 5 years from the date obtaining all the statutory clearances has been dispensed with, subject to certain conditions such as government approval etc.;**
- **Conditions of lock-in period will not apply to (i) hotels and tourism resorts, hospitals, (ii) special economic zones, (iii) educational institutes, (iv) old age with; homes, and (v) investments by non-resident Indians;**
- **Exit of foreign investors and repatriation of foreign investments will now be permitted under the automatic route before the completion of a project subject to completion of 3 years lock-in-period from the date of receipt of each tranche of investment;**
- **Transfer of stake from one non-resident to another non-resident without repatriation of investments will now be permitted without being subject to any (i) lock-period or (ii) government approval;**

- **The requirement of atleast 50% of the project to be developed within a period of 5 years from the date obtaining all the statutory clearances has been dispensed with albeit subject to certain conditions;**
- **Conditions of lock-in period will not apply to (i) hotels and tourism resorts, hospitals, (ii) special economic zones, (iii) educational institutes, (iv) old age homes, and (v) investments by non-resident Indians;**
- **100% FDI is now permitted under automatic route in completed projects for operation and management of townships, malls/shopping complexes and business centres**
- **Transfer of ownership and/ or control of the investee company from residents to non-residents is now permitted under certain conditions;**
- **A clarification is inserted in the definition of "Real Estate Business" that earning rent/income on lease of the property (not amounting to transfer) will not be considered as real estate business;**
- **Definition of 'Transfer' has been clarified and is in line with Section 2(47) of the Income Tax Act, 1961.**

Soon after the DIPP issued Press Note 12 of 2015, the Union Cabinet approved the Real Estate (Regulation and Development) Bill, 2015 (the "Real Estate Bill") on December 9, 2015. The Real Estate Bill, among others, aims to provide a uniform regulatory environment to ensure speedy adjudication of disputes and orderly growth of the real estate sector. The Real Estate Bill aims at restoring confidence of the investors by institutionalising transparency and accountability in the real estate and housing transactions, which in turn, will encourage both domestic and foreign investments in the Indian realty sector.

In addition to approving the Real Estate Bill, the Government in its Union Budget of 2015-2016 gave its nod to the ambitious target of developing 100 smart cities and 500 cities under the Atal Mission for Rejuvenation and Urban Transformation [AMRUT] by the year 2020 which will invite investment of Rs.2 trillion in the next five years.

The changes introduced by Press Note 12 including dispensation of the minimum area and minimum capitalisation requirement will not only encourage FDI in smaller construction developments projects involving a floor area of less than

20,000 sq.mts but will also offer greater flexibility to the foreign investors in structuring their investments. The exit of foreign investors from the investee company before the completion of the projects without obtaining

Prior approval of (Foreign Investment Promotion Board) FIPB, subject to completion of 3 years from the receipt of each tranche of investment, will offer relatively smoother exit to the foreign investors thereby encouraging investments.

Further, permitting 100% FDI under automatic route in completed projects for operation and management of townships, malls/ shopping complexes and business centres and insertion of a clarification in the definition of the term "Real Estate Business" that earning rent/income on lease of the property (not amounting to transfer) will not be considered as real estate business, will also provide an impetus to increase investments in such projects.

All in all, Press Note 12 will pave way for the much needed boost to a flagging real estate sector and assist in initiating the process of revival of the real estate markets in India.