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Current Status of Foreign Direct Investment in the Real Estate Sector

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Abstract

The Real Estate Sector in India has had major changes over the past few years, changes in policy and prohibition of certain local investment options has created the way forward for Foreign Direct Investment (FDI). The FDI Policy for Real Estate Sector has allowed 100% investment through the automatic route along with relaxation in the compliances and conditions. An opportunity has been presented in India for Foreign Investors to be a part of the fast growing and lucrative Real Estate Sector. An overview of the important regulations along with the Impact of RERA is presented below.

Keywords: *RERA, FDI, real estate sector and real estate business*

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INTRODUCTION

The real estate sector plays an important role in the Indian economy due to its direct correlation with economic growth. Real estate sector holds the power to have a multiplying effect on economic growth and a decline in the sector would certainly affect the economy adversely.

The sheer requirement that India as a country generates is reason enough to generate a large demand and need for Foreign Direct Investment (FDI).

The Complete ban on the use of External Commercial Borrowings (ECBs) and Foreign Currency Convertible Bonds (FCCBs) for raising funds has further piqued the interest of foreign investors as it creates as dearth of local fund. An opportunity has been presented for FDI in Real Estate.

Foreign Direct Investment (FDI) is when Investors from one country start investing in businesses located in other countries, the investor can be an Individual or an organization like a company or a firm. The investor usually holds controlling interests or ownership along with acquiring capital assets in the foreign country [1].

In India 100% FDI is allowed as a part of the automatic FDI channel. The FDI is for Construction and development which includes many activities such as construction of residential, development of townships, roads or bridges, commercial premises educational institutes, recreational facilities, etc.

It is to be noted here that FDI is not permitted when the investor is trying to buy a stake in any “real estate business” directly or for construction related to farm housing projects or in cases of transferable development rights trading [2].

Real Estate Business refers to the dealing in land and immovable property for profits and excludes construction and development of infrastructure such as construction of residential, development of townships, roads or bridges, commercial premises educational institutes, recreational facilities, etc.

It is important to note that profits earned from leasing or renting property built out of FDI is allowed and does not fall under the above-mentioned restriction [3].

APPLICABLE CONDITIONS FOR FDI IN THE REAL ESTATE SECTOR POST RERA

The followings are the conditions required to be satisfied by the Investor for FDI in the real estate sector:

- *Minimum Capitalisation:* There is no threshold in regards to minimum amount of Capital to be invested by the investor, i.e. no minimum capitalization. Earlier to the amends, $5 Million was the minimum capital required to be invested, within 6 months from the commencement of the project.
- *Exit and Lock-in restrictions:* The investor can exit the investment after:

- Three years from the date of initiation of the instalments towards the investment, or
- On completion of the Project, or
- Completion or development of trunk infrastructure.

- *Minimum Land Stipulation:* No Minimum Area Requirement. Earlier, 20,000 sq. Meters was the threshold for minimum area requirement for construction-development projects.
- **Completed Assets:** In completed projects under the automatic route, 100% FDI is permitted for operation and management of township, shopping complexes and business centers. Though a prerequisite of 3-year Lock-in period is attached for an approved investment.
- *Property on Lease:* The rent collected or any earnings from lease of the property, not amounting to transfer is permitted. However, an entity engaged or willing to engage in 'Real Estate Business' is not permitted to invest as FDI.
- Each phase of a project is to be considered as a separate project in itself for the purposes of FDI.
- Both in Transfer of stake by a non-resident investor to another non-resident investor and Transfer of stack from residents to non-residents are permitted under FDI policies but the latter is attached to two prerequisites; Lock-in period of minimum 3 years and no transfer of immovable property during this period.
- The Investments made by the Non-Resident Indian's are not subject to the afore-mentioned restrictions and conditions applicable for FDI. The investments by the NRI's are regulated by the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000, which allows the NRIs to invest in activities in the real estate sector.
- Transfer of control from residents to non-residents above mentioned conditions are not applicable to the investment by the Foreign Institutional Investors (FII), investing in listed companies.
- The Indian Investee company is duty bound to obtain approvals from authorities and to fulfil all the compliances as prescribed by the Local authorities. Also, the investee company can only sell developed plots where the trunk infrastructure is complete.

FOREIGN DIRECT INVESTMENT IN REAL ESTATE SECTOR POST RERA

FDI presents a great opportunity in Real Estates as has been explained in the introduction. FDI has been given the easiest possible route with 100% funding as well as availability of the automatic mode of application. The subject matter of the Investment and its limitations have already been discussed now we shall also examine certain stipulations in FDI that arise post RERA implementation.

Important Stipulations found in the FDI Policy Post RERA regarding project compliances:

- Land use requirements and community and common facility norms must be complied with, as per the applicable laws and standards.
- Each and every phase of the development project will be considered separately.
- The exit of investors shall be allowed upon completion of trunk infrastructure which includes water supply, lighting, roads, sewerage, etc.
- If a lock in period of 3 years has been completed under the automatic FDI route then a foreign investor can repatriate and exit the project.
- The onus of completing the necessary local compliances with Municipal Board or State government such as approvals for building plans is on the Indian investee company.
- The FDI policy has further clarifications regarding the stipulations mentioned above:
- Exemptions for the 3-year lock in period mentioned in (iv) are in development related to Special Economic Zones

(SEZs), investment by NRIs, hospitals, educational institutions, Hotels & tourist resorts and old age homes.
- Further clarification is given regarding the transfer of ownership from residents to non-residents in cases of completed projects. A lock in period of 3 years which is decided upon the nature of FDI in each phase, during this period any such transfer of that immovable property is not permitted.

CONCLUSION

The FDI policy saw a reform in November 2015 when the government further relaxed some of the conditions in the policy.
The Salient points from this amendment are as follows:

- Relaxation of limits for investment and area that can be developed.
- Provision for exit of foreign investor posts the 3-year lock in period.
- Where no repatriation of investment is not required a foreign investor can sell to a non-resident without prior approval.
- For FDI each phase of the project will be considered separately.

These changes and relaxations have proved to be a catalyst in the growth of real estate sector.

All projects no matter the size can now be infused with 100% FDI with the easiest compliances that fall under the automatic FDI route. Such FDI is also permitted in completed projects for operation and management activities, further a completed project can earn profits form rent and lease under this policy [4].

The clarification regarding when FDI can be infused or at which stage can FDI come in is pending as the policy and regulations is silent on this aspect. Since there is no guideline for which stage FDI can be infused at present it is considered as the “construction- development” stage at the latest.

It is the state governments mandate to provide further regulations, the increasing clarity of regulations is instrumental in wooing foreign investors.

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