



CONSTRUCTION AND DEVELOPMENT

C.A Niki Shah BCA Study Circle 12th January, 2017



WHY FDI IN REAL ESTATE SECTOR.

Realty reforms has boosted offshore funds optimism in construction and development sector, even though the clouds of uncertainty shroud the sector, the drivers to the optimism can be:



- a. Liberalisation of the conditionality's for the sectors
- b. Relaxation for raising foreign debt
- c. SARFAESI benefit now available to offshore funds
- d. RERA act to be effective from March 17

These regulatory changes are likely to imbibe ethical behaviour and streamline the market to large and serious players - an environment most conducive to offshore funds

FDI POLICY ON CONSTRUCTION AND DEVELOPMENT

Construction Development: Townships, Housing, Built-up Infrastructure



Sector/Activity	%% of Equity/ FDI Cap	Entry Route
5.2.10.1 Construction-development projects (which would include development of townships, construction of residential/commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships)	100%	Automatic

Each phase of the construction development project would be considered as a separate project for the purposes of FDI policy. Investment will be subject to the following conditions:

(A) (i) The investor will be permitted to exit on completion of the project or after development of trunk infrastructure i.e. roads, water supply, street lighting, drainage and sewerage.

(ii) Notwithstanding anything contained at (A) (i) above, a foreign investor will be permitted to exit and repatriate foreign investment before the completion of project under automatic route, provided that a lock-in-period of three years, calculated with reference to each tranche of foreign investment has been completed. Further, transfer of stake from one non-resident to another non-resident, without repatriation of investment will neither be subject to any lock-in period nor to any government approval.

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(B) The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/Local Body concerned.

(C) The Indian investee company will be permitted to sell only developed plots. For the purposes of this policy “developed plots” will mean plots where trunk infrastructure i.e. roads, water supply, street lighting, drainage and sewerage, have been made available.

(D) The Indian investee company shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government/Municipal/Local Body concerned.

(E) The State Government/Municipal/Local Body concerned, which approves the building/development plans, will monitor compliance of the above conditions by the developer.

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Note.



- It is clarified that FDI is not permitted in an entity which is engaged or proposes to engage in real estate business, construction of farm houses and trading in transferable development rights (TDRs).
 - ✓ “Real estate business” means dealing in land and immovable property with a view to earning profit there from and does not include development of townships, construction of residential/commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships. Further, earning of rent/ income on lease of the property, not amounting to transfer, will not amount to real estate business.
- Condition of lock-in period at (A) above will not apply to Hotels & Tourist Resorts, Hospitals, Special Economic Zones (SEZs), Educational Institutions, Old Age Homes and investment by NRIs.
- Completion of the project will be determined as per the local bye-laws/rules and other regulations of State Governments.

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- It is clarified that 100% FDI under automatic route is permitted in completed projects for operation and management of townships, malls/ shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and/or control of the investee company from residents to non-residents is also permitted. However, there would be a lock-in-period of three years, calculated with reference to each tranche of FDI, and transfer of immovable property or part thereof is not permitted during this period.
- "Transfer", in relation to FDI policy on the sector, includes,—
 - ✓ the sale, exchange or relinquishment of the asset ; or
 - ✓ the extinguishment of any rights therein; or
 - ✓ the compulsory acquisition thereof under any law ; or

FDI POLICY ON CONSTRUCTION AND DEVELOPMENT (CONTD...)



- any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882) ; or
- any transaction, by acquiring shares in a company or by way of any agreement or any arrangement or in any other manner whatsoever, which has the effect of transferring, or enabling the enjoyment of, any immovable property.

SALIENT FEATURES



- **FDI can be made in phases of a Project.** Each phase of the construction development project would be considered as a separate project for the purposes of FDI policy
- **Exit.** An investor will be permitted to exit on completion of the project or after development of trunk infrastructure
- **Completion of the project :** It will be determined as per the local bye-laws/rules and other regulations of State Governments.
- **Trunk infrastructure.,** mean roads, water supply, street lighting, drainage and sewerage.
- **Restriction on transfer before completion of the Project. Lock in period.,** An investor will be permitted to exit and repatriate foreign investment before the completion of project under automatic route only after the completion of lock in period of 3 years.
 - ✓ Calculation of amount of Lock in: Each tranche of Foreign investment has to complete the lock in conditions
- **Transfer of stake from NR to NR.** transfer of stake from one NR to another *without repatriation* of investment will neither be subject to any lock-in period nor to any government approval.

SALIENT FEATURES



- **Developed Plots** Indian company is permitted to sell only developed plots.
- **Activities not permitted.** FDI is not permitted in real estate business, construction of farm houses and trading in TDRs
- **Real estate business** means dealing in land and immovable property with a view to earning profit there from and does not include development of townships, construction of residential/ commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships.
- Earning of rent/ income on lease of the property, not amounting to transfer, will not amount to real estate business.
- Transfer has also been defined
- **Exemptions to lock in conditions.** Hotels & Tourist Resorts, Hospitals, Special Economic Zones (SEZs), Educational Institutions, Old Age Homes and investment by NRIs.
- **Completed Projects.** 100% FDI under automatic route is permitted in completed projects for operation and management of townships, malls/ shopping complexes and business centres subject to conditions

CONDITIONS FOR INVESTMENT

- Lock in Period conditions



- Exit Condition

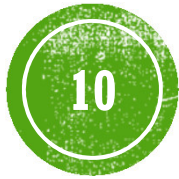


- Completion of Trunk Infrastructure

- Multiple Phases

- Rental Income

- Completed Projects



TRUNK INFRASTRUCTURE & MULTIPLE PHASES OF THE PROJECT

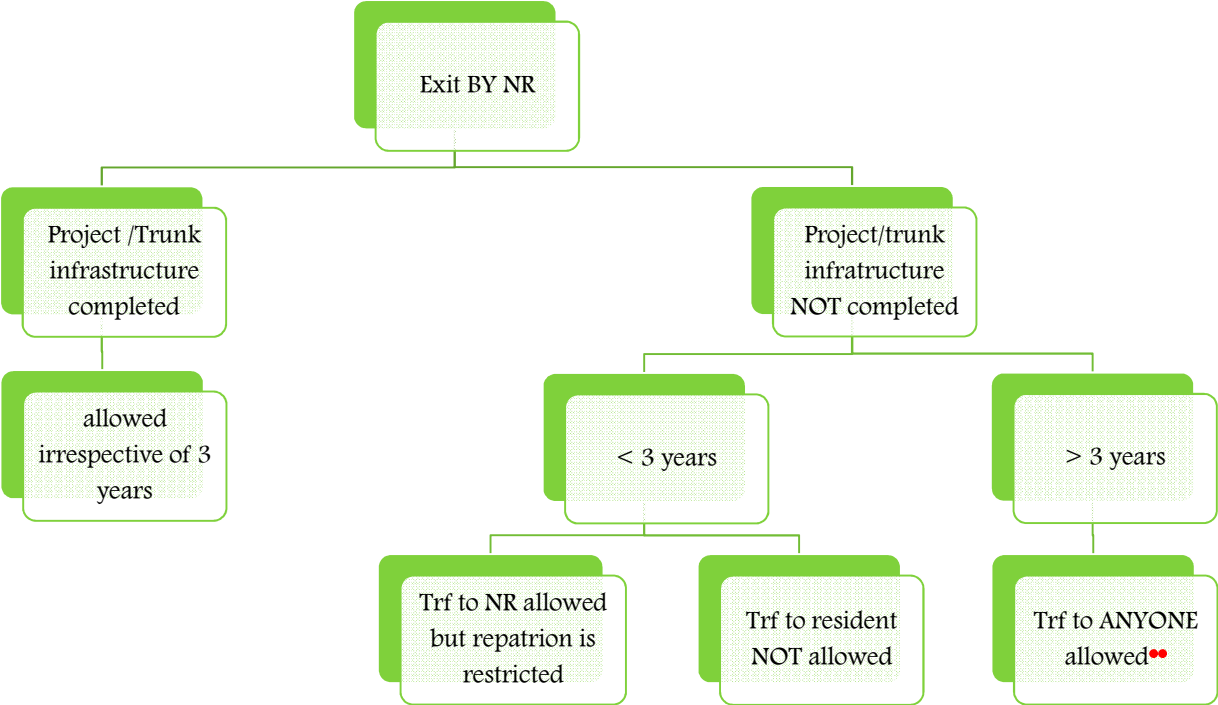
➤ Is FDI investment in a particular phase of a multi-phased project locked-in till 'trunk infrastructure' was developed for all phases of the project?



- ✓ All FDI conditions should be "seen" on phase specific basis and hence so long as the exit criteria for the specific particular phase is satisfied, foreign investor should be allowed to exit from their investment in that particular phase.

EXIT CONDITIONS

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EXIT CONDITION (Contd...)

••Will an Investor be allowed to Exit from the Company wherein the construction and development of the project has not been done at all?

The intent behind the 3 year lock-in is to ensure committed capital which should be used for development purposes. However, the 3 year lock in period should not be read in isolation, and the 'real estate business' restriction under capital account regulations should be adhered to.



Hence, before achieving an exit, foreign investors must put in all possible efforts to ensure that developers have put their best foot forward to utilize the foreign capital for development purposes.

M/s Mordil Properties (Mauritius) Limited

Applicant was not able to complete the development of 50% of the 5 acres of land in Hyderabad for 5 years, without any compelling reason except citing difficulty in arranging for the financing. FIPB rejected the application for sale of shares. (FIPB review 2014)

LOCK IN PERIOD



- Transfer from one NR to Another NR– What should be considered as Lock in period for new investor?
 - ✓ *Case Law: M/s Trinity Capital (Six) Ltd., Mauritius (No.FC.I-263/2013)*
In above case the applicant had applied to FIPB for Seeking approval for non-imposition of fresh Lock-in restrictions, following de-merger of the business. FIPB in its 205th meeting had allowed the non imposition of fresh lock in
- On going Project ;Will lock in condition apply in case of FDI in a project wherein Trunk infrastructure has already been developed and completed????

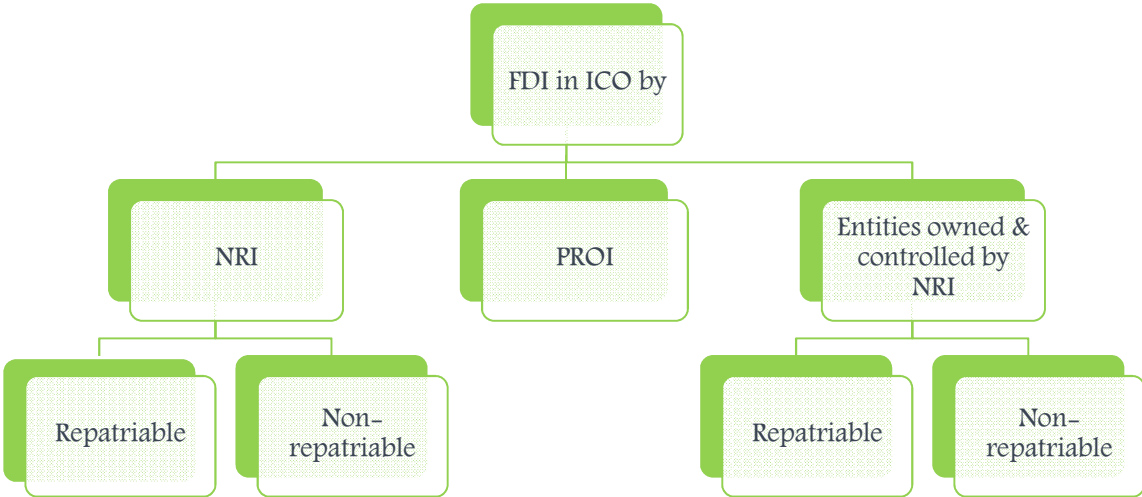
FDI in COMPLETED ASSETS



- Whether FDI in yield generating stabilized assets such as malls, business centres, etc. will be permitted?
 - ✓ PN 12 of 2015 dtd 24.11.2015 clearly sets out that income earned by way of rent / income on lease not amounting to ‘transfer’ does not tantamount to ‘real estate business’ and hence permitted.
 - ✓ The DIPP has further clarified that "business centre" includes where multiplicity of businesses of the same or different nature are being carried out from a particular building. Thus, it appears that any building which has commercial user and houses multiple businesses would fall under this definition.

FDI IN INDIAN COMPANIES

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FDI IN LLP ENGAGED IN CONSTRUCTION & DEVELOPMENT SECTOR



- **As per FDI Policy 2016** - FDI is permitted under the automatic route in Limited Liability Partnership (LLPs) operating in sectors/activities where 100% FDI is allowed, through the automatic route and there are no FDI-linked performance conditions.
- Hence, FDI in LLP engaged in construction and development sector will not allowed.
- However, As per Schedule 4 to FEMA 20: A Non-resident Indian (NRI), including a company, a trust and a partnership firm incorporated outside India and **owned and controlled by non-resident Indians**, may acquire and hold, **on non-repatriation basis**, equity shares, convertible preference shares, convertible debenture, warrants or units, which will **be deemed to be domestic investment at par with the investment made by residents**.
- Based on the above provision can it be said that Investment by NRI or entities owned and controlled by NRI are allowed to invest in LLP engaged in construction and development sector????

Disclaimer:

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Thank You

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