

REAL ESTATE INVESTMENTS IN INDIA: AN OVERVIEW

The Indian government issued press note no. 2 (2005 series) on March 3, 2005 (“Press Note”) and permitted 100% foreign direct investment (“FDI”) under the automatic route to develop townships, housing, built-up infrastructure and construction-development projects, including, without restriction, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, and city and regional level infrastructure. Under the Press Note, a foreign investor must develop a minimum of 10 hectares for serviced housing plots and 50,000 sq. meters for construction-development projects.

Previously, under press note 3 (2002 series), foreign investors could, after obtaining prior government approval, develop integrated townships of a minimum 100 acres in size or containing a minimum of 2000 dwelling units. Press note 3 (2002 series) significantly restricted the inflow of foreign investment in the sector, and only nine FDI proposals were approved between 2002 and 2005. This led the government to open up the sector to 100% FDI and issue the Press Note.

With the further liberalization of the real estate sector, there has been a flurry of activity. MGF Group and Emaar Properties, UAE, have undertaken a joint venture project of US\$833 million (the largest investment so far). Keppel Land has partnered with Puravankara Projects Ltd. to develop a large residential project (2000 apartments) in Bangalore. Apart from these, various other joint ventures have also been formed (e.g., ICICI Ventures and Tishman Speyer, and Ascendas with the Tata group and the Government of Karnataka).

However, there are some bottlenecks in the Press Note, which may hamper investment in this sector:

1. The Press Note prohibits repatriation of the original investment for a period of three years after capitalization. However, the foreign investor may apply to the Foreign Investment Promotion Board (“FIPB”) for a waiver of this condition. Press note 3 (2002 series) also contained a similar provision. Therefore, the position pertaining to exit remains unchanged, and as no parameters have been defined, the FIPB has significant discretion.
2. Real property laws in India vary widely from state to state. Various proposals have been put forth to convert all the state laws into a central law, so as to ensure easier comprehension and uniformity. However, nothing concrete has been done so far. As a result, foreign investors will have to

- comply with different state laws and obtain state- and city-specific approvals, depending on where the project is undertaken. In addition, stamp duty levies (which can be very high) need to be calculated state-wise.
3. The Press Note mandates that 50% of the project must be developed within five years from the date all statutory clearances are obtained. Such a requirement seems unreasonable, especially if the project has a long gestation period.
 4. The Press Note also retains the condition of minimum capitalization of US\$10,000,000 for wholly owned subsidiaries and US\$5,000,000 for joint ventures with Indian partners. However, these funds may be brought in within six months of commencement of business. The minimum capitalization requirements seem to be too high and may be an issue if the cash requirement for a project is less.

Private equity investors and REITS

The Securities & Exchange Board of India (“SEBI”) regulates private equity investments in India. In 2004, SEBI amended its regulations (for e.g., the SEBI (Foreign Venture Capital Investor) Regulations, 2000) and permitted foreign private equity investors to invest in the real estate sector, subject, however, to press note 3 (2002 series) and other government regulations (which now include the Press Note). Therefore, the net effect is that a foreign private equity investor may register with the SEBI and may invest in the real estate sector as per the guidelines prescribed in the Press Note.

Real Estate Investment Trusts (“REITs”) invest in real estate much in the same way as mutual funds invest in securities. To date, foreign REITs are not allowed to operate in India. This has significantly affected the inflow of foreign capital into the Indian real estate market. Further, although, domestic real estate funds are allowed to operate through the SEBI (Venture Capital Investor) Regulations, 2000), most of them (like the HDFC Property Fund set up by HDFC in association with SBI) remain beyond the reach of the retail and small investors, as the minimum investment limit is too high. For example, the minimum investment requirement for the HDFC Property Fund is Rs. 50,000,000.

One of the major impediments to organized growth in the real estate sector is the absence of investors with deep pockets. Save for exceptions such as DLF in the Delhi-Gurgaon belt and Hiranandani in Mumbai, the sector is largely made up of small-to-medium sized players who have, neither the resources nor the capacity, to

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assume the risks that come with large projects. It is important, therefore, that easy funding is made available to the sector and not too many restrictions be placed on the inflow and outflow of foreign capital. Thus, although 100% FDI is a step in the right direction, a lot more needs to be done for the real estate sector in India to attain maturity.

Majmudar & Co. is active in the real estate and private equity sectors. It has advised high net worth individuals and funds, on tax and regulatory structures, for investing in the real estate sector in India. For additional information, please feel free to contact Mr. Akil Hirani at akil@majmudarindia.com