# Government revises FDI norms for construction development sector

**October 2014**

# Executive Summary

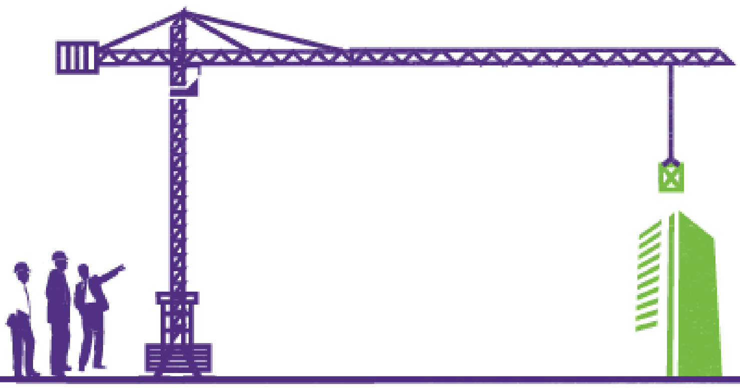
In a major boost to the real estate sector, the Union Cabinet has eased norms for foreign direct investment (FDI) in construction development making the sector attractive for overseas investors. This comes close on the heels of the government announcing a slew of economic reforms in the last few months including formalisation of Real Estate Investment Trusts (REITs) & Infrastructure Investment Trusts (InvITs) and relaxed FDI norms for the railways sector. The construction development sector has been battling a slowdown and liquidity crunch for the last couple of years. The Government believes that this announcement will not only give a fresh impetus to the sector but will also have a ripple effect on the economy by way of infrastructure creation and substantial employment generation. Further, positive activity in this sector will trump up demand in a number of allied industries including those in the manufacturing sector such as cement and steel.

The Government has sweetened the deal for both the Indian players and prospective foreign investors by relaxing the minimum built-up area of the construction development project to 20,000 sq. metres for attracting FDI, from the current 50,000 sq. metres. This was first announced in the Budget speech of the Finance Minister earlier this year. The new norms also entail that the investee company will be required to bring minimum FDI of USD 5 million within six months of commencement of the project, this minimum capitalisation amount is now applicable to both wholly-owned subsidiaries and joint venture entities.

On the issue of lock-in period for foreign investors, the new policy states that the investor will be permitted to exit on completion of the project or after three years from the date of final investment, subject to development of trunk infrastructure. The term trunk infrastructure includes roads, water supply, street lighting, drainage and sewerage. The new norms will override the earlier position according to which the original investment cannot be repatriated before a period of three years from completion of minimum capitalisation.

To promote affordable housing, the Government has announced certain relaxations in the policy. The conditions linked to minimum area, minimum capitalisation and period of investment will not apply to the investee/joint venture companies which commit at least 30% of the total project cost for low cost affordable housing. This is a welcome move by the government as it will prevent the proliferation of slums in cities and encourage the cash-strapped sector to seek foreign investment in the affordable housing space.

Grant Thornton is delighted to present the summary of the changes to the FDI policy on the construction development sector, which have been approved by the Government on 29 October, 2014. We hope you will find this useful.



## Revised FDI Policy on the construction development sector

| Subject | Earlier position (Press Note 2 of 2005 and the FDI Consolidated Policy of DIPP) | Revised Position | Our view |
|---|---|---|---|
| **Minimum area** | Minimum area to be developed under each project would be as under:<br>1. In case of development of serviced housing plots, a minimum land area of 10 hectares<br>2. In case of construction-development projects, a minimum built-up area of 50,000 sq. metres<br>3. In case of a combination project, any one of the above two conditions would suffice | Minimum area to be developed under each project would be:<br>1. In case of development of serviced plots, there is no condition of minimum land,<br>2. In case of construction-development projects, a minimum floor area of 20,000 sq. metres.<br>3. In case of a combination project, any one of the aforestated two conditions will need to be complied with.<br><br>'Floor area' will be defined as per the local laws/regulations of the respective State governments/Union territories. | No minimum area requirement for serviced plots i.e. the minimum land area of 10 hectares requirement removed.<br><br>In case of construction development project, minimum floor area of 20,000 sq. metres prescribed.<br><br>*Floor area very widely defined but presumably refers to net usable floor area excluding common areas etc. (from the definition of "Carpet Area" under the Draft Real Estate (Development and Regulation) Bill 2011).*<br><br>Please also refer to the point no. 7 below for discussion on meaning of 'Serviced Plot'. |
| **Minimum capitalisation** | Minimum capitalisation of USD10 million for wholly owned subsidiaries and USD 5 million for joint ventures with Indian partners was prescribed. The funds were to be brought in within six months of **commencement of business of the Company**. | The investee company will be required to bring minimum FDI of USD 5 million within six months of commencement of the project. **The commencement of the project** will be the date of approval of the building plan/lay out plan by the relevant statutory authority. | Minimum capitalisation amount reduced to USD 5 million which is now applicable to both wholly owned subsidiaries and joint venture entities.<br><br>The minimum capitalisation to be achieved within 6 months of commencement of project now as opposed to commencement of business of the company earlier which was vague. |

"This is the first real change in the FDI conditionalities in the sector ever since it was opened for foreign investment almost a decade ago. The current set of reforms, as announced by the Government, seems to provide norms which are project-specific. From the trigger date for achievement of minimum capitalisation to the barrier to exit from the venture, everything has been tied to project completion or to development of 'trunk infrastructure' to the very least. The regulators have learnt from their experience and have reiterated their desire to encourage strategic investment in the sector as opposed to investment for quick financial gains.

The revised policy also covers sale of stake by the foreign investor to another foreign investor as an 'exit' requiring approval if the project has not been completed. This may be seen as a regressive step, considering that financing of the project or India's foreign exchange position is not impacted in a non-resident to non-resident sale.

The move seems to have a two-pronged approach to reforms in the sector. While on the one hand, the revised norms are aimed at encouraging FDI in smaller projects / affordable housing as is evidenced by the relaxation in the minimum area requirements, on the other hand, the aim is to encourage developers and investors to make concerted effort towards delivery and project completion."

**Vishwas Panjiar**
**Director**
**Walker Chandiok & Co LLP**



Source: Department of Industrial Policy and Promotion website

# Revised FDI Policy on the construction development sector (contd.)

| Subject | Earlier position (Press Note 2 of 2005 and the FDI Consolidated Policy of DIPP) | Revised Position | Our view |
|---|---|---|---|
| **Period of investment** | Prescribed no such condition. | Subsequent tranches of FDI can be brought till the period of ten years from the commencement of the project or before the completion of the project, whichever expires earlier. | There was no long stop date prescribed in the policy earlier. |
| **Lock-in** | Original investment cannot be repatriated before a period of three years from completion of minimum capitalisation. Original investment means the entire amount brought in as FDI. The lock-in period of three years will be applied from the **date of receipt of each installment/tranche of FDI or from the date of completion of minimum capitalisation, whichever is later.** | The investor will be permitted to exit on **completion of the project** or after three years from the date of final investment, **subject to development of trunk infrastructure.** | The lock-in now is subject to development of trunk infrastructure.<br><br>The term trunk infrastructure includes roads, water supply, street lighting, drainage and sewerage.<br><br>The lock-in can be effectively longer now as tied to date of final investment. |
| **Early exit** | The investor may be permitted to exit before the completion of the lock in period with prior approval of the Government through the FIPB. | The Government may permit repatriation of FDI, before the completion of the project. These proposals will be considered by FIPB on case to case basis.<br><br>Completion of the project will be determined as per the local bye-laws/ rules and other regulations of State Governments. | The exit has been tied to completion of project in addition to completion of the lock in period under the previous policy.<br>In other words the revised policy seems to suggest that even where the lock in period has elapsed but, the project is not completed, in such cases the foreign investor would need prior FIPB approval for exit.<br><br>This seems to be contrary to the lock-in criteria mentioned above. |
| **Transfer from non -resident to non - resident** | No specific mention. | The Government may, in view of facts and circumstances of a case, permit transfer of stake by one non-resident investor to another non-resident investor, before the completion of the project. These proposals will be considered by FIPB on case to case basis. | The earlier policy was silent on transfer of stake from one non-resident to another.<br><br>The revised policy clarifies that transfer from one non-resident to another before project completion would require prior FIPB approval in all cases. This again seems to be contrary to the lock-in criteria mentioned above. |



Source: Department of Industrial Policy and Promotion website

# Revised FDI Policy on the construction development sector (contd.)

| Subject | Earlier position (Press Note 2 of 2005 and the FDI Consolidated Policy of DIPP) | Revised Position | Our view |
|---|---|---|---|
| **Meaning of undeveloped/ developed/ services plots** | Earlier policy provided that ‘undeveloped plots’ means where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. | The revised policy states that ‘developed plots’ means plots where trunk infrastructure including roads, water supply, street lighting, drainage and sewerage, have been made available. | Serviced plots, in terms of earlier policy presumably meant developed plots which obtain a completion certificate. |
| **Low cost affordable housing** | No mention of low cost affordable housing. | The conditions at point minimum area, minimum capitalisaiton and (period of investment above, will also not apply to the investee/ joint venture companies which commit at least 30% of the total project cost for low cost affordable housing.<br><br>Affordable housing projects shall be those projects which use at least 60% of the FAR/FSI for dwelling units of Carpet Area not more than 60 square metres. In addition, 35%of the total number of dwelling units constructed should be of carpet area 21-27 square metres for economically weaker section (EWS) category. Such projects can have a mix of EWS/LIG/Higher Category DUs and commercial units. Provision of servant’s quarter along with the main dwelling unit will not be counted as dwelling units for EWS/LIG under Affordable Housing (AH) project. | This is in consonance with the intention of the government to encourage foreign direct investment in smaller/ marginal projects and encourage development of low cost affordable housing projects. |

“ The relaxation in the FDI norms for the construction development sector will give further fillip to the Government’s agenda of "creation of smart cities" and "Housing for all by 2022". Apart from garnering funds for the cash -strapped sector, this move will also help in shaping the sentiments of the investor community in the right direction. ”

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Source: Department of Industrial Policy and Promotion website

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