FDI in Real Estate Business

WAYS IN WHICH FOREIGN INVESTMENT CAN BE MADE IN REAL ESTATE

- FDI by NRI in Indian company engaged in Real Estate Development
- FDI by persons resident outside India (e.g. LLP, LLC, Foreign Company, Private Equity Fund) in Indian company engaged in Real Estate Development
- FDI in SEZ, Hotels, IT Parks etc.
- Portfolio Investment by FIIs and NRI's in an Indian Listed Companies engaged in Real Estate development.
- ECB in Real Estate Sector

Applicable and Governing Laws and Regulations

- Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations 2000
- FDI Policy announced by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce, Government of India. **[Consolidated FDI Policy Circular 1/2010, 1st April]**
- If investment is through ECB route: Foreign Exchange Management (Borrowing or lending in Foreign Exchange Regulations) 2000
- Transfer of Property Act 1882
- Indian Registration Act 1908
- Indian Urban Land (Ceiling and Regulation) Act 1976
- Stamp Acts (Stamp Duty which differs from state to state)
- Municipality Laws to get Occupancy certificates

Allowed sectors under automatic route for FDI by a Company outside India in Real Estate

- Companies from Mauritius (or any other foreign company in any form) are allowed to Invest up to 100% under Automatic Root.

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- FDI allowed sectors:
  - ✓ Townships
  - ✓ Housing
  - ✓ Built-up Infrastructure and Construction-development projects (e.g. Housing, commercial premises, educational institutions, recreational facilities, city and regional level infrastructure etc.)
  - ✓ Hotels (Eligibility conditions are different)
  - ✓ Tourism (Eligibility conditions are different)
  - ✓ Hospitals (Eligibility conditions are different)
  - ✓ Mass Rapid Transportation system (Eligibility conditions are different except lock-in period)
  - ✓ Resorts
  - ✓ Special Economic Zones (Eligibility conditions are different)
- FDI not allowed in Real Estate Business or for Trading in Transferable development Rights other than as mentioned above.

Eligibility Conditions and Compliance Norms for FDI in Real Estate Business under Automatic Route

1. **Minimum Area:** The minimum area to be developed under each project is:
   - In case of development of serviced housing plots, a minimum land area of 10 hectares (i.e. 10.76 Lakh Sq. ft. or 25 acres or 1.2 Lakh Sq. yards)
   - In case of construction development projects, a minimum built up area of 50000 sq. mt. (i.e. 5.38 Lakh sq. ft.) (The term built up area has not been defined in the circular but section 80 IB (10) of Income tax act defines it to mean the inner measurements of the residential units at the floor level including projections and balconies as increase by thickness of the walls but does not include the common areas shares with other units.)
   - In case of a combination project anyone of the above two conditions would sufficient.
2. **Minimum Capitalization:**

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- USD 10 million in case of wholly owned subsidiary
- USD 5 million in case of Joint venture with Indian Partners
- The funds have been brought up within six months of commencement of business of the company.

3. **Lock-in Requirements:**
   - The original Investment cannot be repatriated before a period of three years from completion of minimum capitalization.
4. **Completion time:**
   - At least 50% of the project must be developed within a period of five years from the date of getting all statutory clearances.
5. **Agricultural Lands:**
   - Indian company can not raise FDI for acquiring agricultural lands with an intention of subsequently making them non agricultural lands.
6. **Underdeveloped Plots**
   - Sale of Underdeveloped Plots is not permitted

Note: These Conditions are not applicable in case of Hotels, SEZ, It parks, NRI's, Tourism, Hospitals, Mass Rapid Transportation system.

Instruments to be used for Investment

- Equity Shares
- Compulsorily Convertible Preference Shares, Redeemable
- Compulsorily Convertible Debentures
- Warrants (require prior approval of FIPB)
- Partly Paid- up shares (require prior approval of FIPB)
- Non - voting shares (need to comply with sec. 86 if issued by a public company)
- Redeemable/ Optionally Convertible Preference Shares are treated as external commercial borrowing and hence is not allowed

- Non Convertible/ Optionally Convertible Debentures are External Commercial Borrowing and hence not allowed.

Maximum Dividend in case of CCPS

The maximum dividend permissible on CCPS is the prime lending rate of the state bank of India + 3%

Taxation Part (Mauritius)

- Capital Gain Tax payable in the country of residence of the investor (i.e. Mauritius)
- In the case of CCPS, the Indian Company paying dividend would pay dividend distribution tax.
- But in case of CCD's the double tax avoidance agreement says that the tax on interest paid on such debentures shall be 20%, and it shall be deducted by the paying company.

Exit Options

The exit options are available in the following modes:

- IPO of shares of the company. Subsequently, the foreign investor may sell its shares on the floor of the exchange after the lock-in period.
- Buyback of the shares of the investor by the company. However the price can not exceed the lower of the two independent valuation reports. No valuation methology has been given for the same. Certain documents (form FC TRS) required to filed.
- Buyout of the foreign investor by the Indian partners. The buyout is on automatic route and formalities are same as in case of buyback.
- Voluntary liquidation of SPV may also be an exit option. In this case the funds of the SPV may be distributed amongst the shareholders.

Downstream Investment

- If the Investor Indian Company is a company owned and controlled by resident Indian Citizens, then the downstream investment is treated as domestic investment.

- The criteria for considering whether a company is owned and controlled by the resident Indian citizens or not is that the resident Indians must own more than 50% of the equity capital of the company and must have the power to appoint majority of directors.
- By this way investment by such company in another company is treated as if it is the domestic investment and not the indirect foreign investment.

FDI in Hotel, SEZ, IT Parks and Hospitals

- FDI up to 100% is allowed under automatic route for these sectors.
- But the eligibility conditions as mentioned above as per press note 2/2005 shall not be applicable.
- The following conditions must be fulfilled:

Sr.	Type of Project	Condition
1	Hotels	The term hotels include restaurants, beach resorts and other tourist complexes providing accommodation and/ or catering and food facilities to tourists.
2	Hospital	No condition
3	SEZ/Free Trade Zones/	➢ Condition under SEZ Act, 2005 and SEZ rules 2006 must be complied with. ➢ To avail tax benefit us 80IAB of the income tax act the SEZ must specify the condition mentioned therein.
4.	Software/ IT Park	➢ Park should comprise of a minimum of 10 units and no single unit shall occupy more than 50% of the allocable area. ➢ Minimum percentage of the area to be allocated for industrial activity shall not be less than 66% of the total allocable area

Portfolio Investment in Listed Real Estate Companies

- Under schedule 2 to the Foreign Exchange Management (Transfer or issue of Security by a person Resident outside India) Regulations 2000, a FII can purchase the shares of an Indian Listed company under portfolio Investment scheme.
- PIS (portfolio Investment scheme) is not permitted in the shares of a company engaged in the real estate business or construction of farm houses or trading in TDR's
- Real Estate business does not include construction of housing, commercial premises, educational institutions, recreational facilities, city and regional level infrastructure, townships.
- A company which is in the Land Development business would be eligible for PIS
- Under this scheme a FII can also make an investment in the IPO of a real estate company.
- In case of shares acquisition through IPO press note 2/2005 not applicable

ECB in Real Estate Sector

- ECB are foreign loans and prohibited for use in real estate business. They are allowed for a very limited use.
- Companies engaged in the development of Integrated Townships as defined in press note 3 are permitted to avail the ECB but under approval route.
- However the ECB is not permissible for development of integrated townships and commercial real estate within an SEZ.