Foreign Investment in Real Estate

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Classification of Foreign Investment in Real Estate

- Foreign Direct investment by any Person Resident Outside India in Real Estate development activity (regulation 5(1) read with Schedule 1 of TIS Regulations)

- Investment by NRIs in Housing and Real estate sector (Schedule 1 of the TIS Regulations)

- Investment by Registered Foreign Venture Capital Investors in Indian Venture Capital undertakings (VCUs) and Venture Capital Funds (VCFs) in real Estate sector (regulation 5(5) read with Schedule 6)

- Investment in Real Estate Mutual Funds

Foreign Direct investment by any Person Resident Outside India in Real Estate Development Activity

- Annexure “A” of Schedule 1 of TIS Regulations prohibits FDI in companies carrying on real estate business
- Real estate business defined under Explanation to Regulation 4(b) of the Capital Account Regulations as under:

  “real estate business shall not include development of townships, construction of residential/ commercial premises, roads and bridges”.

- Schedule 1 of TIS Regulations deals with FDI Scheme (under which inter alia Press Note 2 of 2005 has been issued)

Permitted Real Estate and Construction Related Areas

• Construction Development (as per Press Note 2)	100%
• Roads and highways, ports and harbour	100%
• Hotel and tourism	100%
• Industrial Parks	100%
• Special Economic Zones	100%
• Airports	74%

Press Note 2 – 2005 series

- 100% investment under the automatic route in townships, housing, built-up infrastructure and construction development projects, including:
  - Housing
  - Commercial premises
  - Hotels and resorts
  - Hospitals
  - Educational institutions
  - Recreational facilities
  - City and regional level infrastructure

Press Note 2 – 2005 series – conditions stipulated

Minimum area requirements:

- for development of serviced housing plots – a minimum land area of 10 hectares
- for construction-development projects – a minimum built-up area of 50,000 sq. mts.
- for combination projects – either a minimum land area of 10 hectares or a minimum built-up area of 50,000 sq. mts.

Capitalization norms and restrictions:

- for wholly owned subsidiaries minimum capitalisation of USD 10 mn
- for joint ventures with Indian partners minimum capitalisation of USD 5 mn.
- funds to be brought in within 6 months of commencement of business
- Lock-in period of 3 years for original investment (earlier exit would require FIPB approval)

Press Note 2 – 2005 series – conditions stipulated

Time frame for completion:

- 50% of the project must be developed within 5 years from the date of obtaining all statutory clearances
- Investor would not be permitted to sell undeveloped plots (i.e. where roads, water supply, street lighting, drainage, sewerage and other conveniences have not been made available)

Conformity with state and local laws

- The project shall conform to the norms and standards as laid down by the applicable rules, building control regulations etc.
- All necessary approvals to be obtained and to comply with requirements under applicable state and local laws

Press Note 2 – 2005 series – Update

• As per Press Note 2 (2006) Series the Government clarified that the constraints of Press Note 2 will not apply to company engaged in construction of Hotel and running of hotel, hospitals and special economic zone.

•As per Press note 3 of March 12, 2008 the government of India has clarified that FDI is permitted upto 100% under automatic route in both setting up and established Industrial Parks/ Model Towns and such investment would not be subject to the constraints of Press Note 2 subject that the Industrial Park satisfies the following conditions:-

- It would comprise of a minimum of 10 units and no single unit shall occupy more than 50% of the allocable area;
- The minimum percentage of area to be allocated for industrial activity shall not be less than 66% of the total allocable area. conditions.

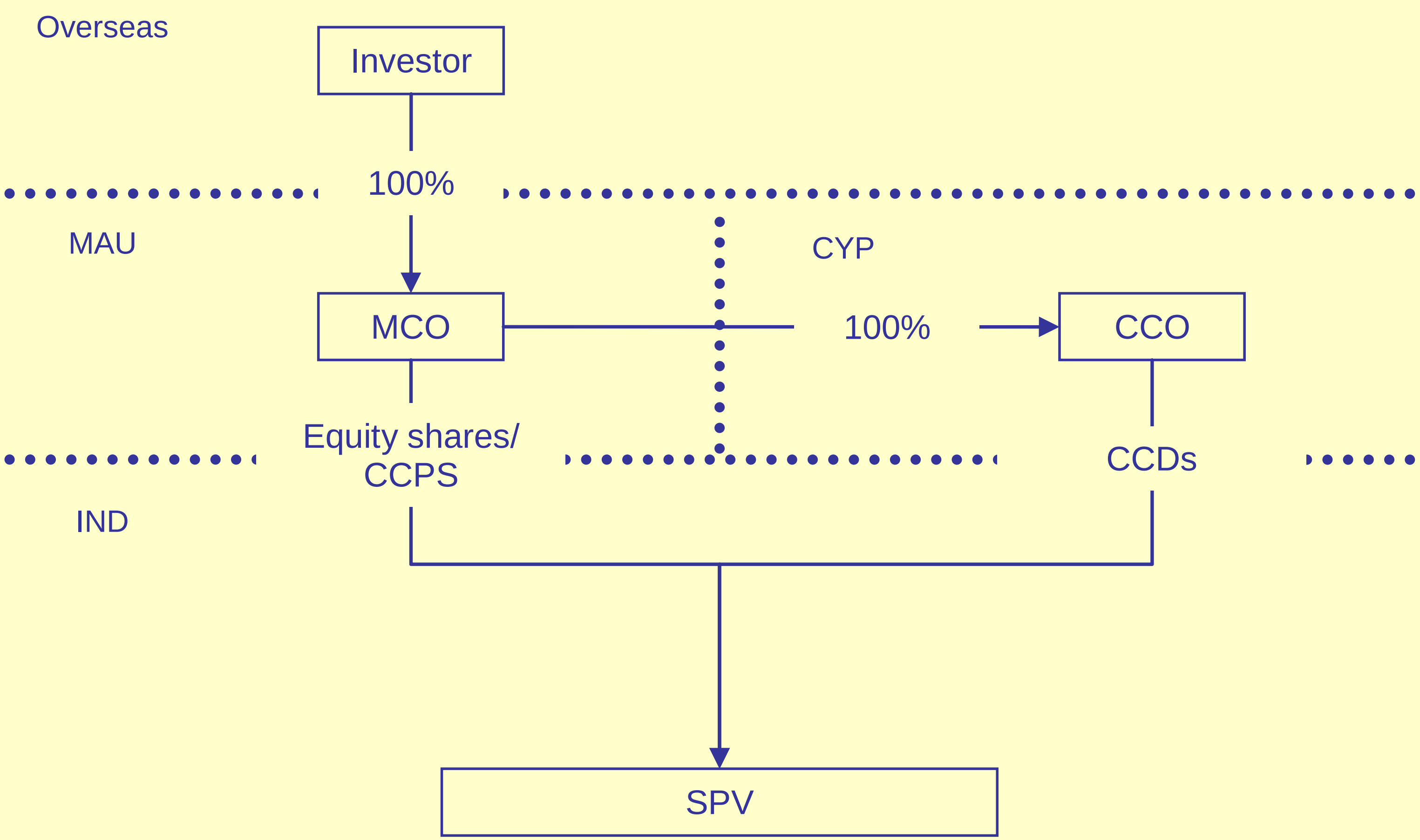
Press Note 2 – Some Issues

- Minimum Capitalisation
- Time limit for bringing in minimum capitalisation
- Lock-in
- Minimum Area

FDI General Conditions

- June 2007 government issued guidelines to clarify that issue of redeemable preference shares and debentures will be treated as ECB. Post 2007, FDI permitted only in equity shares and preference shares and debentures compulsorily convertible into equity
- Issue of shares subject to pricing guidelines
- Transfer of Shares
  - Transfer by a foreign company to another foreign company – No approval
  - Transfer by one NRI to another NRI – No approval
  - Transfer by a resident to any person resident outside India – No approval, subject to compliance of Circular no 16 dated 4th October, 2004 and valuation guidelines.
  - Transfer from a person resident in India to a person resident outside India by way of gift requires RBI approval and is subject to certain conditions.

Potential Structure for Investment



Offshore REIT Structures

- A route for tapping into global funds
- Subject to Press Note 2 of 2005
- Attractive returns by holding property post development
- Fund structure with the advantages of a REIT – stable income and upside on property gains

Investment by NRIs in Housing and Real estate sector

- In addition to Press Note 2 (2005) investment permissible only in 7 specified categories
  - Development of serviced plots and construction of built up residential premises
  - Investment in real estate covering construction of residential and commercial premises including business centres and offices
  - Development of townships
  - City and regional level urban infrastructure facilities, including both roads and bridges
  - Investment in manufacture of building materials, which is also open to FDI
  - Investment in participatory ventures in categories listed above
  - Investment in housing finance institutions, which is also open to FDI as an NBFC

Investment by NRIs in Housing and Real estate sector

- Such investment not subject to the rigours of Press Note 2 inter alia relating to:
  - Lock-in
  - Minimum Capitalization
  - Minimum Area requirement

- Investments may be made on a repatriable basis

Investment by Foreign Venture Capital Investors

- FVCI registered with SEBI permitted to invest in VCFs and VCUs under automatic route
- VCF and VCU defined under TIS Regulations
- FVCI permitted to purchase equity/ equity linked instruments, debt/ debt instruments, units of scheme set up by VCF, subject to stipulated limitations
- Investment in VCU and VCF by FVCI not subject to pricing restrictions, lock-in or valuation guidelines. FVCI can purchase and sell shares of VCFs and VCUs at mutually agreed price
- April 2004 - amendment to the SEBI (Venture Capital Funds) Regulations, 1996 (“the VCF Regulations”) - “real estate” removed from the Negative List - paved way for Real Estate Venture Funds
- As per clause 11(1) of the VCF Regulations, VCF may raise monies from any investor whether Indian, foreign or non-resident Indian by way of issue of units

Investment by Foreign Venture Capital Investors

- FVCI – controversy regarding applicability of FDI Policy
- Several FVCI applications are held up on this account.

Investment in Real Estate Mutual Funds ("REMFs")

- Introduced by way of amendment to the SEBI (Mutual Fund) Regulations, 1996 on April 16, 2008
- Some key conditions:
  - REMFs to be set-up as schemes of a Mutual Fund
  - Investment only in specified real estate assets – cannot invest in projects under construction
  - At least 35% of net assets to be invested directly in real estate assets (therefore cannot be "equity-oriented")
  - Valuation
  - Closed-ended
- Certain anomalies

Investment in Real Estate Mutual Funds (“REMFs”)

- Applicability of Press Note 2 of 2005 to REMFs – RBI has expressed concerns that FII/ NRI investment in units of REMFs would amount to indirect flow of FDI into real estate sector; circumventing the conditions of Press Note 2 and as such is in violation of the spirit of the conditions of Press Note 2

Summary

FDI – Other than NRIs/ PIOs

- Press Note 2 compliant projects
- Investment in units issued by a VCF requires prior approval from FIPB

FDI – NRIs/ PIOs

- Press Note 2 compliant projects
- Investment in units issued by a VCF requires prior approval from FIPB
- Shares of an Indian company carrying on the any of the seven specified activities
- REMF???

FII

- Shares of Listed Companies and pre-IPO offerings of Real-Estate Companies
- Press Note 2 – not applicable
- REMF???

FVCI

- Approval of RBI required through SEBI
- Shares/ units of VCF
- Shares of VCU

Tax Benefits

- ***Industrial Parks Scheme of January 8, 2008***
  - Deduction under section 80IA(4(iii) provided certain conditions are satisfied for developer of Industrial Park
  - Exemption from tax upto 100% of profits and gains from such business for a period of 10 consecutive years out of 15 years

- ***SEZ Act, 2005***
  - Deduction available to developer of SEZ under section 80IAB
  - Exemption for a period of 10 consecutive years out of 15 years from the date the SEZ has been notified
  - Developer of SEZ not liable to dividend distribution tax
  - Developer of SEZ exempt from levy of Minimum Alternate Tax (MAT)

THANK YOU