

## Real Estate Update

January 04, 2013

### ECB FOR LOW COST AFFORDABLE HOUSING PROJECTS ALLOWED

The Reserve Bank of India ("RBI") has vide A.P. (DIR Series) Circular No. 61 ("Circular") issued on December 17, 2012 reviewed its policy relating to external commercial borrowings ("ECB") so as to provide guidelines for developers/builders and Housing Finance Companies ("HFC")/National Housing Bank ("NHB") to avail ECBs upto an aggregate limit of USD 1 (one) billion in the financial year 2012-2013, for the purpose of investing in low cost affordable housing projects and financing prospective owners of low cost affordable housing units, respectively. However, the Circular has kept it abundantly clear that such ECBs shall not be utilized for acquisition of land.

The said guidelines have been issued and made effective in furtherance of the RBI Notification No. FEMA. 246/2012-RB dated November 27, 2012 ("Notification") which amended the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2012 to allow developers/builders and HFC/NHB to avail ECBs for low cost affordable housing projects.

### ELIGIBLE PURPOSE FOR AVAILING ECB

1. Low cost affordable housing project wherein at least 60 per cent of the permissible Floor Space Index ("FSI") would be for units having maximum carpet area up-to 60 square meters.
2. Slum rehabilitation projects under the low cost affordable housing scheme, provided that they meet the criteria as may be set subsequently by the Central Sanctioning and Monitoring Committee of the Affordable Housing in Partnership Scheme constituted under the Chairmanship of Secretary, Housing and Urban Poverty Alleviation which administers the slum rehabilitation projects. The said criteria are yet to be notified by the abovementioned government authority.

(The low cost affordable units as mentioned to be constructed in point number 1 and 2 above are hereinafter referred to as "LCHU")

### ELIGIBILITY CRITERIA FOR BORROWERS

While the parameter as specified under the extant ECB Policy<sup>1</sup> with respect to minimum average maturity period, all-in-cost ceilings etc. are same, the developers/builders and HFC/NHB have to meet certain eligibility criteria's before they can avail ECBs for the purposes mentioned above.

The developers/builders should satisfy the following eligibility criteria:

1. should have a proven financial track record,
2. should be registered as a company under the Companies Act, 1956,
3. should have minimum 5 years' experience in undertaking residential projects,
4. should not have defaulted in any of their financial commitments to banks/ financial institutions etc.,
5. the project undertaken by the developer/builder should not be a matter of litigation and should be in conformity with the provisions of master plan/ development plan of the area and all necessary clearances from various bodies including Revenue Department with respect to land

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necessary clearances from various bodies including Revenue Department with respect to land usage/environment clearance etc., are available on record.

Further, the HFCs should satisfy the following eligibility criteria:

1. should be registered with the NHB and operating in accordance with their guidelines,
2. its minimum paid-up capital, as per the latest audited balance sheet, should not be less than INR 50 crore and the minimum Net Owned Funds ("NOF") for the past three financial years should not be less than INR 300 crore,
3. the borrowing through the ECB should be within the HFC's overall borrowing limit of sixteen times their NOF,
4. its net non-performing assets shall not exceed 2.5 % of the net advances. Additionally, the maximum loan amount sanctioned to the individual buyer should be capped at INR 25 lakh subject to the condition that the cost of an individual LCHU will not exceed INR 30 lakh.

The Circular permits NHB to avail of ECB for on-lending to such developers who satisfy the eligibility criteria's mentioned above so as to further aid small developers/builders who are unable to raise ECB directly.

#### PROCEDURE FOR AVAILING ECB

NHB shall act as a nodal agency between the borrower and the RBI with the responsibility to first decide if a project is eligible as a low cost affordable housing project and then forward the application to RBI for consideration under the approval route. Simultaneous with the forwarding of application to RBI, NHB will advise the borrower to approach RBI for availing ECB through their Authorised Dealer in a manner as prescribed.

Developers/builders/HFCs/ NHB are not permitted to raise Foreign Currency Convertible Bonds (FCCBs) under this scheme.

#### IMPLICATIONS OF THE CIRCULAR

- 1. Availability of cheaper construction funding**  
Considering that ECBs are available at significantly lower rates as compared to other sources of funds available in India vide banks, private equity funding the Circular will assist in ensuring availability of construction funding for the developers/builders venturing into the low cost housing projects.
- 2. Opportunity for developers/builders in maximizing their gains**  
Stipulation regarding construction of LCHU upto a minimum of 60% is a positive move and will be a significant impetus for developers/builders, to engage into such low cost affordable housing projects as they have the flexibility to develop 40% of the total FSI in any manner to maximize their returns while continuing to utilize the low cost funding and accordingly help in overall development of this segment of real estate projects in India.
- 3. Low cost loans for buyers of units in low cost housing project**  
Availability of cheaper loans for individual buyers buying individual LCHU upto INR 25 Lakhs for the LCHU costing within INR 30 lakh assuming that the benefit of borrowing at lower rates of interest by HFCs via ECB is likely to be passed on to the buyers. However, the regulator may want to specify the limit upto which interest arbitrage can be availed by HFCs engaging in on-lending activities with funds availed through ECBs. Doing so may ensure that HFCs do not hold back the benefit of low cost borrowing to itself.
- 4. Entry barrier for new builders/developers**  
Low cost affordable housing projects are a niche segment and many new developer/builders may want to venture into this segment of constructing LCHU. However, the eligibility requirement for the builders/developers to have past experience of minimum five years and a proven financial track record may create an entry barrier for new players.
- 5. Possibility that promoters financial track record and experience is not taken into account**  
Although it is likely that the track record of the promoters of the newly established developers/builders companies will also be considered in ascertaining the financial track record and/or experience for the companies, the Circular leaves some room for uncertainty and needs clarification.
- 6. Onerous requirement for the project to be free of litigation**  
In the Indian real estate context, there may be very few projects which will be entirely free from litigations and may significantly narrow down the extent of utilization of ECB.
- 7. Onerous requirement for the borrower not having defaulted in financial commitments**  
The requirement that the borrower shall never have defaulted on any of their financial commitments may substantially reduce the extent of eligible borrowers as the Circular does not provide any leeway to entities that may have defaulted but cured such defaults, and does not specify any thresholds of default. It may be helpful if the regulator further specifies the extent or thresholds for such defaults in financial commitments so as to ensure that the purpose of the

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Circular is not defeated.

**8. Uncertainty on the extent of clearances required**

The requirement of having all necessary clearances from various bodies including Revenue Department with respect to land usage/ environment clearance etc. does not give clarity with respect to the identified benchmarks upto which approvals should be obtained. It is worth noting that for real estate projects it is a common practice that approvals from authorities are provided in different stages as the project progresses, hence, an unqualified requirement of obtaining all necessary clearances for a low cost housing project may lead to uncertainty.

**9. Non availability of ECB for acquisition of land required for the low cost housing project**

Restriction on the developers/builders from utilizing the ECB proceeds for acquisition of land is likely to act as a dampener on the developers/builders since major capital requirement for execution of a low cost real estate projects is for the acquisition of land.

## ANALYSIS

Keeping in view the objective of providing housing for low-income groups and corresponding with the 2012-13 Budget announcement wherein the Finance Minister had proposed to allow ECB for low-cost affordable housing projects the Circular appears to fall short in meeting certain expectations with overpitched safeguards introduced by RBI. Further, Whilst regulatory intent behind some of the safeguards seems understandable, care must be taken to ensure that such safeguards do not defeat the purpose and intent of allowing ECB for low cost affordable housing projects. The onus on the regulator to safeguard government's intent can be considered to be higher considering the fact that in addition to the above announcement, in the 2012-13 Budget, government had taken certain other welcome measures for ECB in low cost housing projects. The said benefits to low cost affordable housing projects were in the form of reduced interest withholding on ECB from 20% to 5% for three years, investment linked deduction of capital expenditure at the enhanced rate of 150% as against the then existing rate of 100%. Also on indirect taxes front, service tax exemption for construction services relating to low-cost mass housing up to an area of 60 square meters was provided.

- Mukul Aggarwal & Ruchir Sinha

You can direct your queries or comments to the authors

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<sup>1</sup> extant ECB Policy as provided under the Master Circular on External Commercial Borrowings and Trade Credits, Master Circular No. 12 /2012-13, July 2, 2012

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