

Corpsec Hotline

May 22, 2007

TOWNSHIP PROJECTS CANNOT BORROW FROM OVERSEAS

The Government of India in consultation with the Reserve Bank of India ("RBI"), has limited the use of **External Commercial Borrowings** ("ECB"), by removing "development of integrated townships" as a permitted end-use under the ECB guidelines. Further the all-in-cost ceilings for the amounts payable to the lenders for the ECB (which includes interest) have been reduced by 50-100 basis points ("bps"). The RBI has as of May 21, 2007 issued the relevant notification under the Foreign Exchange Management Act.

Background

As per the extant ECB guidelines, ECB proceeds may be utilised only for permitted end-use, which is primarily directed towards capital expansion or overseas acquisitions. Real estate is expressly prohibited as an end-use for ECB, however the term "real estate" in the ECB guidelines was defined to *exclude* "development of integrated townships" as defined by Press Note 3 (2002 Series) dated January 04, 2002 issued by Ministry of Commerce & Industry. The aforesaid Press Note 3 defined "development of integrated townships" as *inter-alia* including housing, commercial premises, hotels, resorts etc. Further conditions were also imposed such as a minimum area requirement of 100 acres, a minimum capitalisation and a minimum lock-in period for repatriation of original investment.

The notification by the RBI pursuant to the Government's press release has withdrawn the exemption accorded to the "development of integrated township" as a permissible end-use under the ECB guidelines.

The all-in-cost ceilings (the upper limit of the cost) for borrowings with 3-5 year minimum average maturity period has been lowered to the rate of 150 bps above the benchmark 6 month LIBOR, against 200 bps at present. Further for borrowings with a minimum average maturity period greater than 5 years the rate has been lowered to 250 bps over the 6 month LIBOR, as against 350 bps currently.

Analysis and Implications

The decision to prohibit Indian companies from utilising debt raised under the ECB guidelines for developing integrated townships seems to be aimed at curbing the inflow of foreign capital into the real estate sector. It is believed that the RBI and the Government, fear the build up of an asset bubble in the Indian real estate sector, due to the heightened interest of foreign investors and the consequent sky-high property valuations. Further the recent steady appreciation of the rupee compounded with a spurt in the inflation may have motivated the government decision to curb the surge of foreign investment.

It is interesting to note that this move has been quick on the heels of an earlier press release dated April 30, 2007 which characterised foreign investments in Indian companies in the form of preference shares, other than compulsorily convertible preference shares issued on or after May 1, 2007, as ECB and not foreign direct investment ("FDI") and therefore issuance or transfer of the same would be subject to the terms and conditions of the ECB guidelines ([please refer to our hotline on the same](#)). Traditionally FDI in to the real estate sector, like investments in other sectors, was structured as quasi-equity in the form of preference shares (optionally convertible, non-convertible or partially convertible preference shares) as this brought fixed returns and an option to convert into equity. This was considered ideal for the real estate sector as long gestation periods; various regulatory approval risks made equity investments a high risk proposition. Further as the ECB guidelines prohibited real estate purchase or development as an end-use, the use of preference shares were the only instruments which could provide debt like seniority and assured returns during the gestation period of the project.

With the above mentioned restrictions on structuring of FDI as preference share, the latest press release modifying the ECB guidelines is seen as a further blow to foreign investments in to the real estate sector effectively curtailing all forms of debt or quasi-equity investments in the real estate sector.

However, companies may now be able to tap ECBs at lower rates of interest due to the reduction in the all-in ceiling costs for ECBs by 50-100 bps. The downward revisions in

Research Papers

Mergers & Acquisitions

July 11, 2025

New Age of Franchising

June 20, 2025

Life Sciences 2025

June 11, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India

April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Audio

CCI's Deal Value Test

February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

[Click here to view Hotline archives.](#)

Video

Reimagining CSR: From Grant Giving to Blended Finance & Outcome Based Funding

June 16, 2025

Courts vs Bankruptcy code: The

the existing all-in-cost ceilings, has been ostensibly stated as in view of the upgrading of the country's sovereign credit ratings.

As per the notification the changes will apply to ECBs both under the automatic and approval routes.

Sources:

- A. P. (DIR Series) Circular No. 60 "External Commercial Borrowings (ECB) – End-use and All-in-cost ceilings - Revised"
- Press release – ECB policy modified
- Press release - Guidelines for Foreign Investment in Preference Shares

- **Jitender Tanikella** & **Ruetveij Pandya**

You can direct your queries or comments to the authors

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

JSW-Bhushan Saga

June 04, 2025

Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025