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National Real Estate Development Council (NAREDCO), established as an autonomous self-regulatory body in 1998, under the aegis of the then Ministry of Urban Affairs & Employment (now Ministry of Housing & Urban Affairs), Government of India, is mandated to induce transparency and accountability in the real estate business and transform unorganized real estate sector into one that is mature and globally competitive. NAREDCO strives to be the collective force influencing and shaping the real estate industry. It seeks to be the leading advocate of developing standards for efficient, effective and ethical real estate business practices, valued by all stakeholders of the sector and viewed as crucial to their success. It works to create and sustain an environment conducive to the growth of real estate industry in India, partnering industry and government alike through advisory and consultative processes.

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Secondary Research on Reinvigorating Real Estate Finance in India

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Secondary Research on
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Contents

Addressing Challenges & Progressing Ahead in Real Estate

The Indian economy has seen a major growth in the past two decades, with the country ranking amongst the top six major economies of the world.

The current Government agenda of reforms, putting in place a robust regulatory framework around sectors which until recently were largely unregulated, bringing transparency around their functioning have been rewarded, with India's ranking on the Ease of Doing Business Index, rising from an abysmal 142 in 2014 to one of the most improved performances 2019, ranking 63rd. There is an expectation that on the back of further reforms continuing, India's ranking is only likely to improve further and push economic growth to higher GDP numbers, in comparison to other major economies.

However, the set of reforms introduced have brought about multiple challenges and crisis for the Real Estate sector, which traditionally remained opaque and unregulated. The onset of regulations "brought out the skeletons" in the sector, leading to an environment of mistrust amongst customers, thereby fuelling a consumption crisis, as well as a financial crisis.

While the commercial, retail, hospitality and industrial segments are growing, there is a need for immediate intervention by the Government's monetary policy, fiscal tools and macroprudential measures, in order to handle the crisis.

The solution needs to be categorized in accordance with the severity of the problem. The good news is – a majority of the problem projects can be managed through some key collaborative actions between the Government, Authorities, Financiers, Developers and Customers. However, some will require larger measures for resolution.

While the immediate crisis can be resolved through some of these suggested measures, it is important to impart more focus on developing a robust financial system which is well regulated and transparent. The use of innovative financial tools for the development of the Real Estate sector is integral to the sustainable growth story of India.

The sector is poised to grow significantly in the coming years and become a trillion Dollar sector by 2030. However, this time around, the growth will not be based on speculation but on diligent operations with appropriate protocols and checks and balances around finance, feasibilities, professional project management and regulations.

1. Current Scenario:

Real Estate is one of the most globally recognized key sectors to a country's economy, a major investment asset class, that defines the fundamental build of an economy. The sector has been one of the major contributors to India's GDP as well. The construction and real estate industry are ranked third in the sectoral contributors to India's GDP with direct, indirect and induced effect on the economy and employment generation.

The components of real estate – residential, commercial, retail, hospitality and industrial, all have an interplay and impact and influence each other in growth of the overall sector.

With increased urbanization, the growth of the sector has traditionally been through urban and semi-urban areas. However, with the Government's focus on development of Dedicated Freight Corridors; Industrial Corridors; Special Economic Zones; and some key large infrastructure projects - it has spurred growth in certain rural areas as well. While some cities have developed into mega cities over the past two decades, there has been significant development in many semi-urban areas as well, converting them into self-sustaining growth centres that are fueling real estate and industrial activity.

The Indian economy over time has evolved directly from a Primary to Tertiary Sector, with the country becoming a major IT player globally. Traditionally, most other developed economies went through a longer transition, moving from a Primary to Secondary and finally Tertiary sector. In this process, they maintained a robust economic base and created strong employment generation opportunities.

Over the last two decades, the transition of India from a Primary to a Tertiary economy in comparison to other major economies, to a very large extent can be attributed to real estate. While this has helped transformation and growth, it has been accompanied by its ow fair share of challenges, mainly with respect to infrastructure planning and implementation; skill development; regulations (rather the lack regulation, particularly in the first decade of this growth phase); financial systems; and lack of a controlled environment, which gave rise to certain undesired practices and outcomes.

#	Sector	GVA in 2018-19 (Rupees in Crore) Constant prices	share (%)	Current prices	share (%)
1	Primary Sector	2,228,008	17.39 %	3,149,734	18.57 %
1.1	Agriculture forestry & fishing	1,842,873	14.39 %	2,692,433	15.87 %
1.2	Mining & quarrying	385,135	3.01 %	457,301	2.70 %
2	Secondary Sector	3,644,647	28.45 %	4,585,286	27.03 %
2.1	Manufacturing	2,346,216	18.32 %	2,853,986	16.83 %
2.2	Electricity, gas, water supply & other utility services	287,109	2.24 %	452,683	2.67 %
2.3	Construction	1,011,322	7.90 %	1,278,617	7.54 %
3	Tertiary Sector	6,936,122	54.15 %	9,226,346	54.40 %
3.1	Trade, hotels, transport, communication and services related to broadcasting	2,467,622	19.27 %	3,157,709	18.62 %
3.2	Financial, real estate & prof servs	2,775,970	21.67 %	3,555,780	20.96 %
3.3	Public Administration, defence and other services	1,692,530	13.21 %	2,512,857	14.82 %
	GVA at basic prices	12,808,778	100.00 %	16,961,365	100.00 %

Fig1: Sector wise GVA in 2018-19 (Rupees in Crore)

While Real Estate, grew leaps and bounds in the first decade (2000-2010) on the back of growth in the Tertiary Sector (led by changing consumption patterns and rising income levels of people), it didn't have the requisite checks and balances in place to create systems that could break the Boom and Busts cycles. The world we live in today, is intrinsically linked, where what happens in one part of the world, impacts the other. As a country and the Real Estate Industry, we saw through the first great recession of the new millennium (triggered by the subprime mortgage market crisis). The Great Recession - which officially lasted from December 2007 to June 2009, was a consequence of an 8 trillion-dollar housing bubble that burst.

However, the Real Estate industry couldn't establish the correlation between the mortgage crisis and it's boom-bust cycles. While there were clear learnings from the subprime mortgage crisis of the Great Recession of 2008, it conveniently ignored the fact, that Indian Real Estate was completely unregulated and was a haven for undesirable financial transactions.

The perceived lack of effect of the 2008 subprime crisis on Indian Real Estate, was probably a clear indication of the aforementioned ignorance and provided a false over-confidence in the underlying basic principles of Real Estate growth in a major economy.

The overconfidence of the industry, led to oversupply, overindulgence, overleveraging of financial resources – all in expectation of similar handsome returns, which the industry was enjoying in the first decade of this millennium – when it was under, rather not regulated. The sector in India, ultimately ended up simulating exactly those conditions, which led to the global financial crisis in 2008 – a result of inadequately regulated real estate and financial markets.

The learnings from the Great Recession were conveniently ignored with the real estate housing bubble being allowed to disproportionately inflate; improper or over valuations being done; under or unsupervised mortgage lending taking place;, innovative fiscal tools being developed by financial markets to ride the futures; credit ranking agencies ignoring ominous signs of potential risks; customers/ real estate investors not carrying out due diligence and failing to evaluate risks associated with inflated real estate and getting attracted to (without fully understanding) innovative financial tools offered to them.

The result of all this, had a telling effect on the health of the realty market. The rate of change in prices year-on-year started seeing a sharp decline (Ref Fig….)

Nominal house price changes = the figures published by most official statistical sources.

Real house price changes = house price changes after adjusting for inflation.

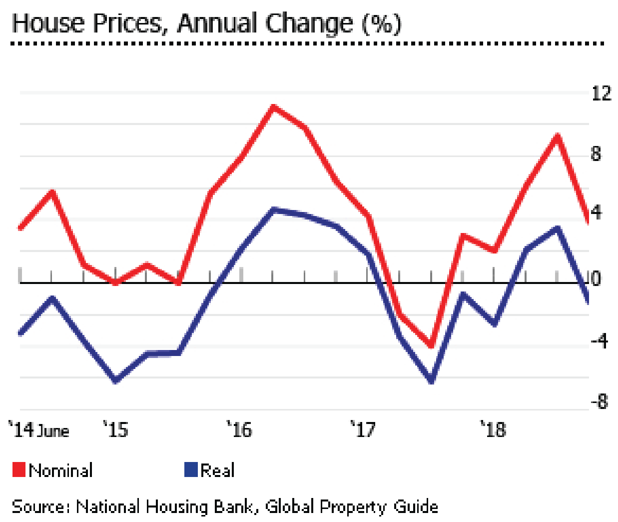


Fig2: Nominal and real change in annual house prices over the years.

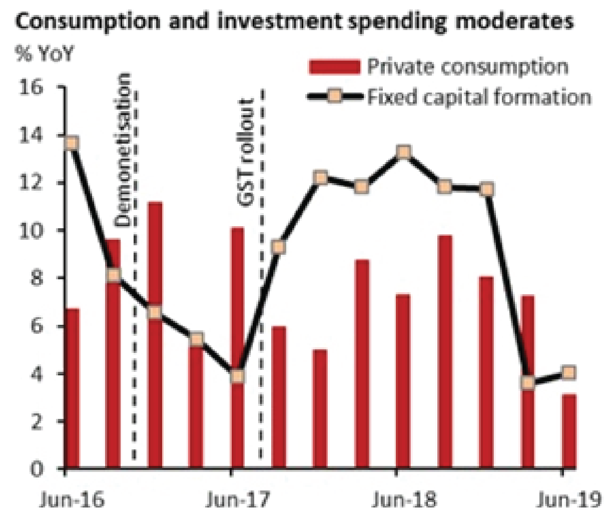


Fig3: Consumption and investment spending moderates.

Source: CEIC, DBS

Once adjusted for inflation, the yields from real estate investments were significantly low. The effect of demonetization was immediately felt, as cash vanished from real estate transactions. In most cases, the market could no longer rely on hard cash based opaque and unethical transactions. With the reform agenda coming into full swing, the introduction of regulation in through RERAs and GST, further put a counter on unethical practices that were taking place in the Real Estate market.

A number of studies have suggested that, housing wealth has a very strong influence over consumption growth, and thereby affecting overall economic KPIs.

A closer look at India's consumption growth indicates immediate resonance with house price changes above.

The cash starved developer started defaulting on deliveries and servicing their mortgages, thereby hugely impacting customer confidence and trust. This further led to a liquidity crunch in the residential segment, which had been relying on shadow banking to refinance its mortgages, led by the consumption crisis of the current decade. The ripple effect of this shadow banking, with the NBFCs now facing the results of their over-enthusiastic predatory lending, led to a complete draught of funds in the industry. Today, the consumption crisis continues to linger; fiscal tools are unavailable; NBFC loan books are unattractive on account if being overloaded with poor quality real estate mortgages for loan-asset traders; all of which account for not a double but a multiple whammy for the sector.

There is a silver lining, though. Commercial and industrial real estate have shown very promising trends in the past few months. Demand has outstripped supply in many areas in commercial and industrial real estate. The activism by RERAs has resulted in restoring some trust in customers, as finally regulation has started producing desired results. The fear of reprisal, reprimand and resolve by RERAs and judicial bodies has led to expeditious delivery of residential projects which had an inordinately long execution until now.

Tremendous success of the first REIT has also led others to think beyond conventional real estate models. The current situation of real estate post absorbing multiple shocks in the form of demonetization, GST, RERA, NBFC crisis etc., promises a reasonably sustainable growth in the near term and a robust long term future.

1.1. Market Size Projections

The Real Estate sector in India is projected to grow at a rapid pace, from US$120 billion in 2017 to US$1 trillion by 2030. This will lead to the sector contributing an impressive 13 per cent to the country's GDP by 2025. The substantial growth in retail, hospitality and commercial real estate has also led to the development of infrastructure, to aide India's rising requirements.

Currently, sectors such as IT and ITeS, retail, consulting and e-commerce are driving high demand for office space. Commercial office occupancy in India is slated to touch a record 42 million sqft by this year end. It is expected that office space leasing in India will cross 100 million square feet between 2018-20. Gross office absorption has increased 26 per cent year-on-year to 36.4 million square feet between Jan-Sep 2018, in top Indian cities. Due to the growing preference of global occupiers and a positive policy environment, co-working space absorption across top seven cities has increased sharply, reaching 3.75 million square feet in 2018, in comparison to 1.11 million square feet for the same period in 2017. It has gone up to 5.8 million square feet till now in 2019 and is expected to grow continuously in the coming years.

1.2. Investments/Developments

The upswing in demand for office and residential spaces has positively impacted the sector, steering its upward progress. The sector has witnessed high growth in recent times with Private Equity and Venture Capital investments in in the sector accounting for US$ 5.5 billion in 2018 and this year it is estimated to reach a level of US$ 6.5 billion, despite the global conditions not being favorable.

According to data released by the Department of Industrial Policy and Promotion (DIPP), the construction development sector in India has received Foreign Direct

Investment (FDI) equity inflows to the tune of US$ 25.04 billion during the period April 2000-March 2019.

1.2.1. Investment in Indian Real Estate Sector in 2019, some key developments:

- During the first six months of 2019, the real estate sector witnessed private-equity (PE) inflows of USD3.9 billion and is expected to hit USD 6.5 bn by this year end.
- Foreign private equity funds continued to show interest in real estate investments. Top investors included Blackstone, Hines, Ascendas and Brookefield.
- The average deal size of commercial office investments increased by 66% to USD168 million (INR1,165 crore), in H1 2019.
- In March 2019, Embassy Office Parks, India's first real estate investment trust (REIT) went public allowing all kinds of investors to invest in the Indian real estate market. It is expected to create an opportunity worth Rs 1.25 trillion (US$ 19.65 billion) over the years and it seems to be headed in this direction.
- Foreign funds remain active, with increase of 25% in H1 2019.
- Investments in commercial office assets accounted for 42% share of total investments.
- Retail saw investments of around USD1.2 billion (INR8,328 crore), accounting for a 31% share. 100% FDI in single-brand retail has encouraged brands to set up shop in India, despite the rapid growth of e-commerce.
- Commercial Office Space
  - The office market witnessed over 11 million sft. of transactions in H1, 2019.
  - Around 50 million sq.ft of commercial office space is under construction in major locations
  - The consumption is largely driven by IT/ ITeS, e-commerce, start-ups and large consulting firms
  - Co-working has emerged as a new demand sector accounting for 25% of office demand
- Retail
  - H1, 2019 saw transactions of around 9.0 million sq. ft of retail space across major markets
  - Supply of retail space is likely to increase to 5.0 million sq ft in 2019
  - Due to limited supply in major markets, the rental market saw appreciation.
- Industrial and Warehousing sector
  - The total demand of warehousing is pegged at 200 million sq. ft of Grade A facility by 2025 with total potential investment of $10 billion
  - Industrial and warehousing saw brisk activity in H1, 2019 with total cumulative supply reaching 130 million sq. ft
  - The total supply added in H1, 2019 is around 7.5 million sq. ft
- Commercial Real Estate continued to lead the funds inflow, attracting 79% of the total investment or $3 billion, in the first three quarters, up 43% from $2.1billion in the year-ago period.
- The residential segment attracted $295 million against $210 million a year ago. Retail and logistics and warehousing have seen total inflows of around $260 million and $200 million so far in 2019, respectively.
- Among key markets, the Mumbai Metropolitan Region (MMR) saw the maximum inflows at $1.59 billion, up 3%. Neighbouring Pune registered more than a 200% rise in investments to nearly $390 million

from $125 million. Hyderabad saw a 76% decline to $190 million. Bengaluru had a 17% yearly gain at nearly $490 million in 2019. Private equity funding in NCR, however, fell further in 2019 to $115 million from $150 million.

- Blackstone crosses $12 billion investment milestone in India.
  - Blackstone aims to surpass the $13 billion mark by December 2019, which will also mark its 13th year of operations in India
  - Blackstone made real estate investments of $6.6 billion as of end-September, surpassing private equity funding at $6 billion
- The global investment firm - Xander Group's private equity real estate arm Xander Investment Management (XIM) has set up an industrial real estate platform for India. XIM Singapore will act as the investment advisor to the platform that will invest $250 million or over Rs 1,780 crore in high quality assets over the next 12 months.

1.3. Government Policy Initiatives

The Central Government, along with respective State governments have taken several initiatives to encourage development in the sector. The Government has been able to take some bold decisions in this regard, keeping the inflation rate in check, giving confidence to RBI to rationalize the repo rates.

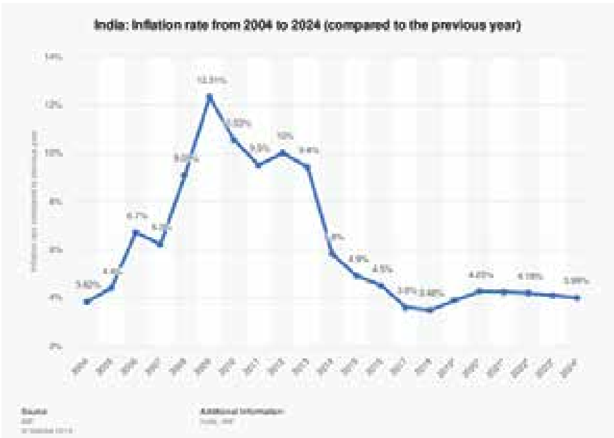


Fig 4: A comparative graph showing the inflation rates from 2004 to 2024.

While the Government has continuously been making attempts to ease the liquidity flow, post sustained strain in the real estate market, its focus on schemes like Smart Cities, Amrut, PMAY, Bharatmala and Sagarmala are generating newer opportunities for the sector. Below are some of the other major Government Initiatives:

- In February 2018, the creation of the National Urban Housing Fund was approved with an outlay of Rs 60,000 crore (US$ 9.27 billion).
- The Central Bank has been slashing repo rates on a continual basis since inflation and fiscal deficit have remained in check.
  - RBI has slashed the repo rates by 135 basis points since Feb 2019.
  - SBI offered a cut of 10 bps in the interest rate for loans up to Rs 30 lakh

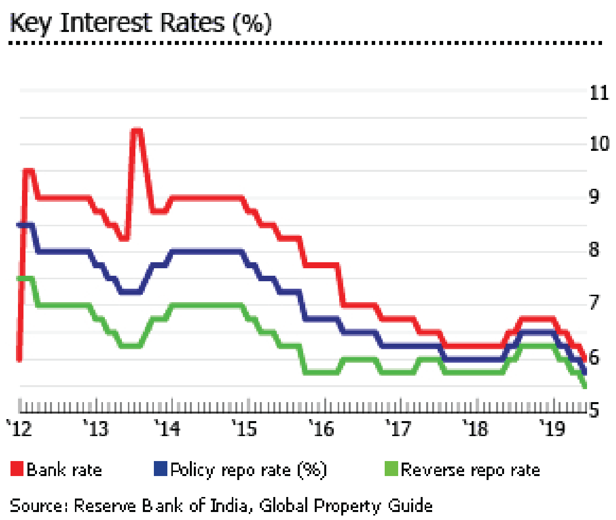


Fig 5: Comparative graph of bank rate versus repo rate versus reverse repo rate from years 2012-2019.

- The first budget by the Government in its second term in office, announced several pro-growth reforms including 60 lakh additional homes under the Pradhan Mantri Awas Yojana (PMAY)-Gramin scheme
- Enhanced tax benefit of Rs 3.5 lakh on homes priced under Rs 45 lakh
- Proposal to introduce the Model Tenancy Law
- Funding for well-performing NBFCs
- Opening of Government land parcels for affordable housing developments
- GoI has released funds amounting to INR 13,850 crore till March'19 under the Smart Cities mission.

1.4. Road Ahead

The Securities and Exchange Board of India (SEBI) has given its approval for the Real Estate Investment Trust (REIT) platform, which will now help in allowing retail investors to invest in the realty market. It will create an opportunity worth Rs 1.25 trillion (US$ 19.65 billion) in the Indian market over the years.

Responding to an increasingly well-informed consumer base and, bearing in mind the aspect of globalisation, Indian Real Estate developers have shifted gears and accepted fresh challenges. The most marked change has been the shift from family owned businesses to that of professionally managed ones. Developers in meeting the growing need for managing multiple projects across cities, are also investing in centralised processes to source material and organise manpower and hiring qualified professionals in areas like project management, architecture and engineering. The growing flow of FDI in the sector is encouraging increased transparency. Developers in order to attract funding, have also revamped their accounting and management systems in order to meet due diligence standards.

This report covers various suggestions from industry leaders, keeping in mind assessment of applicable policies which have worked elsewhere in the world, and recommendations on other aspects for reinvigorating Real Estate finance in the wake of a consumption and financial crisis.

2. Key Challenges Faced

2.1. Macro-economic Scenario:

We are living and conducting business in a highly connected world, where what happens in the east affects the west and vice versa. With trade wars and vested interests taking precedence, the overall growth rate in India has been impacted as well. The global economy is staring straight into a recession, mainly on account of commercial conflicts and a protectionist approach that leading economies tend to follow to safeguard their interests. Consequently, political and economic climates of numerous countries including India, are impacted and affected.

Considering India's growth forecast was ~7- 7.5% for this fiscal year, it has already been downgraded to 6%. However, the growth fundamentals of the economy are still intact. Therefore, it wouldn't be wrong to say that what we are witnessing is a slowdown, not a recession.

With employment rates still needing some push, the approach of millennials in investing on experience, rather than capital assets has reflected poorly on domestic consumption patterns. This is evident basis lower consumption trends in automobiles, consumer durables and real estate assets being used purely from an investment perspective. This despite the fact, that the RBI repo rate has been at one of its lowest in recent times.

Government recognition for and focus on reforming the business environment, across governance structures, -through regulation, policy, and other initiatives (eg. RERA, GST etc.) combined with a wider government agenda, that includes Housing for All, Smart Cities etc., make it a conducive environment for buying real estate.

Now is a good time to contemplate investing in real estate, as prices are falling in key established markets. Bank interest rates are at a record low. Those buyers who were reluctant to buy property, due to project delays now have a large ready-to-move-in stock (currently 16500 flats ready in NCR, which has been the most impacted) to choose from, in line with their budget. While customer sentiments are looking up in most parts of India, areas (read cities) with large unsold/ incomplete inventories continue to pose a challenge to consumer trust and hence consumption crisis remains in these areas.

2.2. Distressed real estate asset management in banking organizations

In the stagnant macro-economic scenario of today, the liquidity crunch created due to realization of NPAs / defaults by banks and NBFCs has impacted the sector adversely. Bank & NBFC customers have experienced increasing difficulties in servicing their debts, which has impacted developers to a very large extent as they have largely been relying on these financial institutions as the primary source of funds.

Higher volumes of non-performing debts with banks and NBFCs has impacted those regions more where the realty market conditions are more difficult. These include markets of NCR and parts of Mumbai, that have been facing the aftermath of a real estate bubble, coupled with (on some occasions) unscrupulous developer behavior, which has lead to a breach in trust on the part of the customer, and a general consumption crisis.

During the time of the real estate bubble, the number of developers, as well as their construction sites, sharply increased. The price of properties soared (sometimes increasing every week), fueled not only by an increasing demand for properties, but also by the speculation that realty prices will continue to grow, leading to sustenance of demand. With ever enhancing market prices, the scale of real estate finance operations and mortgage loans granted by banks, rapidly grew many times over, led by predatory lending. This drove up capital reserves that banks needed to set aside to cover potential future loan defaults.

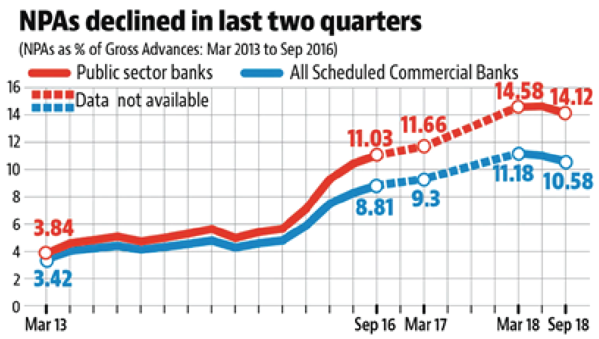


Fig 6: Graph showing the NPA as percentage of gross advances: Mar 2013 to Sep 2016.

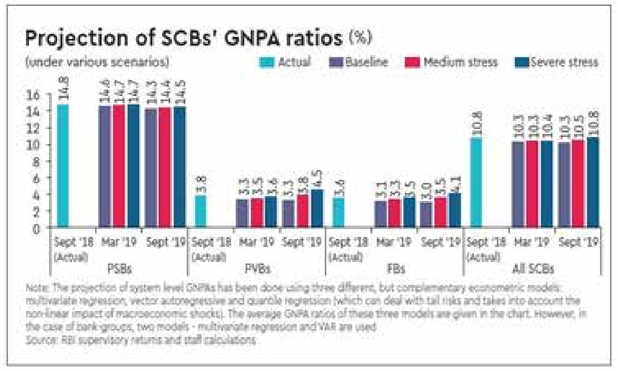
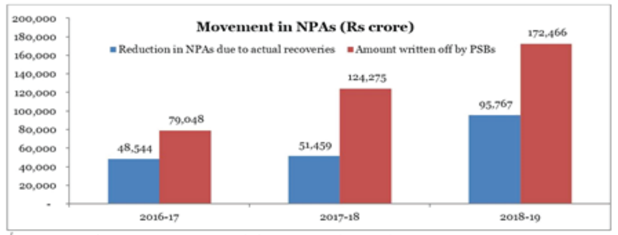


Fig7: Projection of average GNPA ratios using different economic models are given in the image.

Post the recession, in 2011-12 and policy reforms through demonetization, GST and RERA coming in 2016; liquidity in the real estate sector was badly affected, leading to stalling or slowdown in project execution. This triggered negative sentiments with customers leading to a decrease in market demand, reduction in real estate prices and consumers pulling out of the project through various regulatory and judicial interventions.

Developers and other debtors defaulted on their loans, and banks started facing increasing capital requirements through these defaulted loans and had to eventually write-off full or part of the exposure. The effect got pronounced due to reduced real estate prices, as the value of collaterals could no longer support the over-optimistic valuations against which the loans were provided.

While the overall macro-economic conditions were no longer bullish, the regulatory pressure on banking organizations also increased over time. As is evident from the data above, the GNPA ratios remain very high. The situation is compounded by the NBFC crisis, triggered by the collapse of ILFS and resultant NPAs.



Source- Information received from RBI through RTI

Fig 8: Graph showing the movement in NPAs from year 2016-17 to 2018-19, which clearly describes the reduction in NPAs due to actual recoveries.

While the GNPA and net NPA with banks has been rising, the capital adequacy ratio has been dipping alarmingly.

The liquidity crisis has forced the BFSI sector to focus on recoveries. This is evident from the fact that the reduction in NPAs due to actual recoveries has nearly doubled from Rs. 48,544 crore in 2016-17 to Rs. 95,767 crores in 2018-19. However, there is a greater increase in the amounts written off by PSBs, which is reflected in the capital adequacy ratio falling significantly.

This scenario of tougher economic & fiscal conditions, and intervention by regulatory bodies has forced Banks,

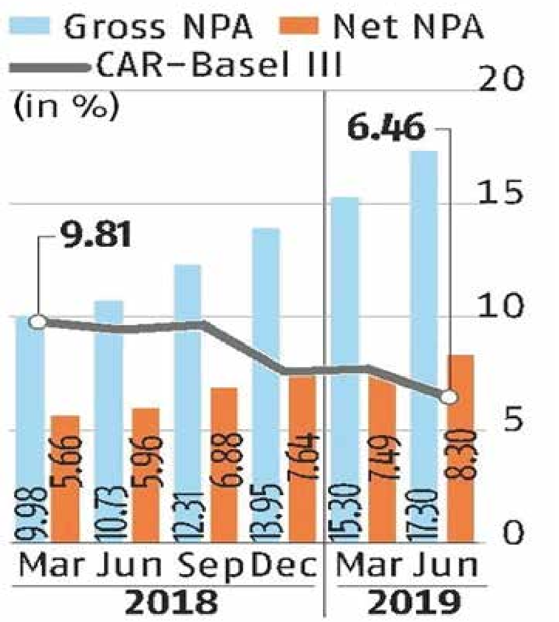


Fig 9: A comparative graph showing the Gross NPA and Net NPA over the quarters 2018-19.

NBFCs and HFCs to reassess their current operating models, which they have been using to manage their distressed real estate asset portfolios (i.e. pool of real estate assets which is collateralized with the bank for its non-performing loans).

As real estate asset management is typically a non-core business for such financial institutions, BFSI sector companies significantly lack the required in-house competencies (e.g. property valuation; feasibility & technical diligence systems; evaluating real estate asset quality & completion strategies; forecasting real estate markets outlook; etc.) and the organizational structures (e.g. dedicated in-house real estate & construction professionals; policies and procedures,;approval processes; systemized checks and balances; project risk management; project audit systems; project management capabilities) required to effectively manage investments in real estate assets.

The goal is to identify the areas (e.g. functions, policies, decision-making bodies, etc.) where a more competent real estate management approach should be applied.

In summary, the Indian Real Estate sector has seen several cyclical storms in the past, but the current situation is most complex. It is so, because residential real sector is facing blows from several directions i.e. market pressures and demand slow down, regulatory environment, broken trust between buyer and seller, as well as an unprecedented capital market squeeze. On one hand, the sector is struggling to square off its unsold inventory and on other, it is unable to deliver sold houses. The latter is a more critical issue at present, as it has led to consumer agitation, litigation and criminal proceedings against builders / developers. Such penal and consumer action has only resulted in further negative sentiments around the sector and has not been able to resolve this complex situation.

The key immediate issue which needs immediate and urgent resolution is the Shortage of working capital required to complete construction.

- Residential development works on a system of internal accrual where the customer pays in advance for his/her booked units that a builder uses to construct the project.
- In a construction linked payment system, initially the customer pays a disproportionately high amount (40%) at the time of booking and the balance over a period of time when the construction work is underway.
- This higher proportion of payment was used for promoter takeout rather than construction funding.
- This situation led to working capital shortage, since residential projects never got to financial closure.
- Situation further deteriorated with market slowdown, a new regulatory regime coming into effect, implementation of GST and Demonetization.

3. Solutions Undertaken:

The current set of solutions undertaken to overcome the issues are multi modal. While the efficacy and the results of these solutions is debatable, it is important to acknowledge that most of them are in the right direction. It is also very important to acknowledge, that while the Government is doing its bit, the crisis in the Banking sector and the over-leverage/ cross-leverage/ and/or diversion of funds by few developers, will require deeper short to long term measures on the back of continued robust regulation, where both the Real Estate and Financial Sector are in tandem and work together to create an efficient ecosystem.

The government undertook quite a few steps in tackling the financial crisis through new and amended monetary policies, identification of new fiscal tools and sharpening macro-prudential tools.

Major policy decisions till date to help tackle the current crisis since 2016 are as follows:

1. **Introduction of Insolvency and Bankruptcy Code:** Previously, resolving insolvencies was an inordinately long and wasteful process as the generated results were not economically viable. While it repealed Presidency Towns Insolvency Act 1909 and Sick Industrial Companies (Special Provisions) Repeal Act 2003 among others, the new code aimed at protecting interests of even minor investors and smoothening business processes. In this process, BIFR (Board for Industrial and Financial Reconstruction – an agency of Govt of India set up in 1985) was dissolved and referred all proceedings to the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) as per provisions of the Insolvency and Bankruptcy Code. The Code proposes two separate tribunals to oversee the process of insolvency resolution, for individuals and companies: (i) the National Company Law Tribunal for Companies and Limited Liability Partnership firms; and (ii) the Debt Recovery Tribunal for individuals and partnerships.

   Upon the Supreme Court giving home buyers the status of a financial creditor, customers, who were earlier unsecured creditors under IBC, eventually acquired the status with the neoteric amendment in the Insolvency and Bankruptcy Code (IBC). This was a much-appreciated move, which granted home buyers equal priority as the banks and other institutional creditors, while recovering dues from debilitated entities. While this will provide relief to home buyers, it is anticipated to encourage developers to create an overall conducive environment for better project execution, lest they be penalized.

2. **RERA Act:** The Real Estate (Regulation and Development) Act, 2016 which came into force in March 2016 laid down a regulatory, development and quasi-judicial framework which has made significant strides in course-correcting unprofessional market operations. Of the 36 RERA bodies, 21 have been permanently established, 8 are interim establishments, with more than 450,00 projects registered under various RERAs as on 19th Oct 2019. While it aimed at bringing in much needed transparency, accountability and setting disclosure norms to protect the interest of all stakeholders, the Act itself should be heading for an amendment to help it develop 'more teeth'. While speedy execution of property disputes is being ensured in most cases, there is a challenge with multiple forums being simultaneously available to a homebuyer. With the Apex Court also ruling IBC to prevail over all cases, it is tending to dilute the ability of RERAs to dispose of cases efficiently and effectively.

3. **Amendment to the Benami Transactions Act:** The Benami Transactions (Prohibition) Amendment Act, 2016 brought in strict rules and severe penalties to defaulters engaging in 'benami' transactions. The amendment created a regulatory framework to deal with benami transaction disputes and levying penalties to defaulters, in the overall vision of enhancing transparency and standards of ethics.

4. **100% deduction in profits for affordable housing construction:** To promote affordable housing and the PM's vision of Housing for All, the Finance Minister proposed 100% deduction in profits to an undertaking from a housing project for flats of up to 30 sq metre in four metro cities and 60 sq metre in other cities. An important condition that the project should be completed within three years of grant of approval shall also create opportunities for adoption of strong project management practices and newer construction technologies to avail this benefit.

5. **Interest subsidy for first-time homebuyers:** To stimulate housing demand from first- time home buyers, the Government proposed an enhancement of a total tax benefit of Rs. 3.5 lakh per annum for first-time home buyers for loans of up to Rs 45 lakh sanctioned. This move should positively influence home sales in non-metros in the long term where residential product prices are not as high as those in metros.

6. **Change in arbitration norms for construction companies:** Poor contract enforcement (India is ranked 163 of 192 countries) and arbitration cycle lasting more than 1400 days has continued to mar construction entities. To ease the situation, the Government cleared arbitration reforms including speedier resolution of disputes and the release of 75% of amounts that are stuck in arbitration. The government will now release 75% of amounts against margin-free guarantee in cases where arbitral awards have been given, but have been contested. The same can then be used by contractors to complete projects or clear their liabilities/ debts. This is helping improve the cash flow position of large developers or business houses who also have significant exposure in infrastructure and government contracts. While helping in expedition of

large infrastructure projects, it is a major relief in these days of extreme liquidity crisis.

7. **DDT exemption for SPVs to REITs:** Post approval from the Securities and Exchange Board of India (SEBI) to institutional investors for investment under REIT's, helped augment investments in the market.

   The Union Budget 2016-17 exempted any distribution made out of the income of the Special Purpose Vehicles (SPVs) to Real Estate Investment Trusts (REIT) and Infrastructure Investment Trusts (InvITs) from the levy of Dividend Distribution Tax. This improved the financial viability for retail investors in REITs and hence the first listed REIT in India saw huge success and is fueling more operators to look at this model.

8. **Reduced GST rates for affordable housing projects:** The reduction in GST rates earlier this year, from the erstwhile 12 percent to 8 percent and then reducing it to 1percent without input credit on construction of the affordable houses and 5% on construction of other than affordable houses subject to certain conditions. It is pertinent to note that the rate as mentioned is an effective rate, after giving 33% deemed deduction for the value of the land. With the new GST rate, the affordability of buying a home becomes easier and within the reach of lower MIG and LIG segments.

Particulars	Tax Rate (in %)	Deemed Deduction (in %)	Effective Tax Rate (in %)	Availability of ITC
Affordable residential apartments	1.5	33	1	NIL
Other than affordable residential apartments	7.50	33	5	NIL

9. **Permanent Residency Status for foreign investors:** The Central Government approved the grant of Permanent Residency Status (PRS) to foreign investors, subject to various conditions, with a provision for renewal for another 10 years. PRS further allows the holders' spouse/dependents to take up employment in India, as well as the purchase of one residential property for end-use. This shall increase the end user pool for high-end and luxury segment products which has taken significant beating in the recent couple of years.

10. **Increase in the Carpet Area:** The lower carpet area limits for affordable housing segment was proving to be detrimental to the growth of the sector and was resulting in unsold inventory. To boost affordable housing, the Ministry of Housing & Urban Affairs, approved the revision of the carpet area of houses eligible for interest subsidy under the Credit Linked Subsidy Scheme (CLSS) for the Middle-Income Group (MIG) under Pradhan Mantri Awas Yojana (Urban), in respect of MIG I from "up to 120 square metres" to be increased to "up to 160 square meters" and, in respect of MIG II from "up to 150 square metres" to "up to 200 square metres". The move has helped aspirational homebuyers take a decision along with aiding in the clearance of unsold inventory.

11. **Creation of National Urban Housing Fund:** The Central Government approved the creation of a National Urban Housing Fund (NUHF) of Rs 60,000 crores. The purpose behind the creation of NUHF was to facilitate raising requisite funds for the Pradhan Mantri Awas Yojana (Urban) which aimed to construct 1.2 crore affordable houses in urban areas by 2022.

12. **Reserve Bank's reduction in the repo rate:** There has been a constant review of the Repo Rate by the Central Bank, post an inflationary trend in mid-2018. With the last announcement being made on Oct 4, 2019, the repo rate stands at 5.15 per cent and reverse repo rate at 4.90 per cent. In total, the RBI has cut rates by 135 bps starting February 2019 till date in five successive steps. The Repo Rate stands at one of its lowest levels in two decades, which shall significantly boost numbers of new borrowers. This cut is sweeter for new borrowers, as banks are supposed to link all new floating rate loans to any of the four external benchmarks specified by RBI from Oct 1. External benchmark linked loans are supposed to make transmission of RBI's rate cuts down to the borrower, faster.

13. **NIIF Funding for Affordable Housing:** Recent steps undertaken have led to encouraging developments like – NIIF investing in an affordable housing platform floated by HDFC, along with Soverign Wealth Funds (SWF) like ADIA. PE investors like Blackstone getting into the sector (through its acquisition of Aadhar HFC), ADB and IFC forming a JV with Shapoorji for affordable and mid income housing projects, etc.

14. **Stress Funds for Last mile funding for Affordable Housing:** The Government recently announced a stress fund of a total of Rs. 20,000 crores for affordable housing projects which are not affected by NPA or NCLT. This was recently announced by the FM to alleviate the crisis linked to unfinished housing projects and supporting both homebuyers and developers, alike.

15. **Large Developers in Affordable Housing Projects:** Recently policy changes, reforms and initiatives taken will encourage leading developers to enter the affordable housing segment. Larger developers who had not focused on this segment earlier at all, have finally taken to mass affordable housing projects, based on the Government initiatives and incentives provided under recent policy and budgetary support mechanisms.

Despite the teething problems, due to game-changing reforms in the last two years, the realty market in India has displayed handsome growth in commercial & industrial real estate segments in 2018 and 2019. However, the residential market continues to languish in areas of large unsold inventories. The sector has consolidated and shown pockets of encouragement in certain asset classes and regions where the market has streamlined itself towards doing business under the new regulatory regime. Notwithstanding the disruptive policies, the market is picking up steadily, and it is expected that the short-term pain felt by various policy reforms shall yield some significant long-term sustainable gains in future years.

However, it is expected that the reforms should continue to usher in the introduction and development of existing and new proven Financial Instruments for the sector. The efficacy of these in positively impacting growth will be determined by well-intended regulatory actions.

4. Way Forward:

4.1. Sustainable financing system attributes for emerging markets like India

It is well documented, through multiple case studies across various countries and timelines ranging from early 1900s, that the real estate sector becomes a major driving force for development, producing socio-economic-environmental benefits to an economy, if it is adequately regulated and is based on transparency in real estate and financial markets.

Robust regulation and implementing infrastructure are needed to build a sustainable housing finance system. The main tenets for such a system would be:

1. Enforceable property rights and effective registration system.
2. Enforceable foreclosure for mortgage lenders (cost and availability of collateralized lending v/s uncollateralized lending).
3. Access for all lenders to diversified funding (including mortgage securities).
4. Comprehensive credit information systems.
5. Macro prudential regulatory tools to encourage responsible lending.
6. Equitable conditions amongst lenders to encourage competition.
7. Fiscal tools adjusted to economic and financial status, consumer needs, and robust risk-management practices.
8. Accessible and reliable information on house transactions, prices and forecasts.
9. Professionally qualified real estate process stakeholders, including developers, appraisers, valuers, insurers, and transaction agents.
10. Policies and regulations tailor-made to suit uptake of affordable housing to deserving class i.e. Low MIG to Lower Income Groups.
11. Comprehensive national housing policy, including socially and economically efficient subsidies, slum rehabilitation, land pooling, land acquisition, holistic infrastructure development approach, and title regularization programs.
12. Access to titled land for developers.

In most emerging economies, housing finance has been available or made use of by the middle and upper echelons of the salaried income-distribution structure of households. This is a bigger problem in countries like India, where general people thrived on an informal cash-based economy till demonetization happened in 2016 and the low-income groups never even had a bank account. With a few important exceptions (like Malaysia or Mexico - SOFOLs), low- and informal-income households in various other countries are yet to see any mass-scale implementation of housing finance systems. Given the rapid urbanization and demography of India, the lack of a housing finance system for this stratum of society and lack of holistic infrastructure connectivity to semi-urban or nearby rural areas, fosters proliferation of urban slums. And that starts another set of debates.

4.2. Way ahead for financial systems in emerging markets like India

As stated above the performance of the macro economy, the legal system, and housing sector regulations are inextricably linked to the development of a housing finance system. A stable, growing economy will encourage the growth of the housing finance system through lower inflation, lower interest rates, and lower systemic risk – and these factors all seemed to be very well stacked for India, currently.

Given that Jan Dhan Yojana made millions become part of formal economy, Ayushman Yojana taking the risks away on spending one's entire savings on health scares, India now needs to work on raising the per capita income of households which shall create a demand for housing finance. In such cases, a virtuous circle can emerge, as growth of the financial system pushes overall economic growth. Higher economic growth in turn, will encourage both further financial-sector and housing-finance development.

However, there are various gaps which India needs to cover to ensure a well-regulated finance and real estate sector which work in tandem within the realms of the macro economic and legal framework. The more closely we look at it, the more we understand that these are largely systemic gaps and professional gaps. Let's understand the current gaps, which should actually be taken as recommendations for immediate corrective action, needed to support an efficient primary mortgage market in the short to mid-term:

- Credible property appraisal based on international standards, approved methodology and certified appraisers
- Mortgage-related insurance products, including catastrophic insurance against earthquake and flood combined with increased access to international reinsurance
- Assistance with credit risk assessment via credit bureau information
- Development of more complete databases and IT platforms leading to use of quantitative methods and modeling in both appraisal and credit scoring
- Accuracy of the valuation, through its impact on loan-to-value (LTV);
- Level of property insurance
- Validity of higher- or lower risk weight assignments ltimately impacts credit risk,
- Collateral risk assessment and recourse
- Capital charges for banks to be optimized
- Improved affordability for the borrower through various monetary policy benefits
- Develop sectoral expertise within the lending institutions - Lenders need in-depth knowledge of local real estate markets (prices, demand drivers, and so forth), the realities of the sequenced development process, and the capabilities and capacities of developers, and also must be experts in project management.
- Establish processes to conduct Due diligence on development and construction firms to verify their track records, integrity, capabilities and capacities in managing the construction and sales processes
- Ongoing supervision must be conducted on each project to ensure financial integrity, proper delivery and quality, progress in completing distinct stages of the project linked to loan disbursements, and so forth.
- It is advisable that if Banking Institutions do not have an in-house capability in the above, they should look at hiring qualified Third-Party Project Administrators comprising of Technical and Commercial Project Management resources.
- Banking institutions to adopt proper risk management techniques. For example, ring fence project assets financed by the construction loan from the rest of the assets of the developer (Brazil). Isolation helps to ensure that, should the developer have difficulty completing the project, the bank as first lien holder will be able to transfer its management to another developer to finish the project. Isolating the project also helps to distinguish buyers' cash deposits from other cash the developer manages (most of the times they generally mix the two deliberately to create lack of transparency), and so may increase the likelihood of returning the deposits should the project not move forward. Ring fencing can be done by segregating the land and structures in a special-purpose, limited liability company that is legally off the developer's balance sheet. Thus, in the event of developer bankruptcy, the project can be transferred to another developer to complete.
- Liquidity Risk Management - In India, with hugely under developed bond markets and little long-term finance to real estate sector, the inability to provide long-term mortgage loans out of core deposits effectively precludes lending. Government can improve the liquidity of mortgage assets by accepting mortgage securities as collateral at the discount window—a solution massively used by the central banks of countries affected by the subprime crisis to maintain some liquidity in the mortgage backed securities market. Government can take a limited and targeted role in reducing liquidity risk for primary lenders by backing a liquidity facility
- Incentivize customers for a low-cost prepayment option as a desirable feature of the mortgage instrument for the consumer, though it increases the cash-flow risk to the lender.
- Managing Market Risks for future by enforcing tough disclosure norms and auditable Risk management programs
- Increased collaboration between Public Sector regulators and Private sector advisory professionals. Since government has announced "stress fund" for the sector thus taking a more deep-rooted position in the distressed real estate market, it is important to have an effective public-private partnership to manage market and liquidity risks in future.

4.3. Current Fix - possible solutions to immediate liquidity crisis

The immediate requirement is to handle the liquidity and consumption crisis in the real estate sector, which continues to create strain in the financial system for the BFSI sector and drags down the economic growth of the country. It is imperative that while some of the solutions are identified as quick fixes, the solution design needs to follow the problem project categorization. The strategies to be applied to the portfolio of distressed real estate assets depends on the quality attributes of each individual real estate property (e.g. real estate segment, status and condition of construction, use of building and vacancy rate, etc.) and on the real estate market development potential or, in other words, the expected development of market prices for the particular real estate segment (e.g. commercial building, hotel, agricultural land, etc.).

While the upside potential of the project which can be leveraged to create a more robust market will be dealt with in midterm solutions, the current fix requires to address the projects which are stalled at various stages of completion due to lack of funds.

4.3.1. Pre-requisites prior to problem-project resolution:

In line with the principled suggestions above, the foremost requirement for handling resolutions of problem projects is of an accurate understanding of the size of the problem and the manifestation of complexities in various aspects of the particular real estate development.

It is recommended that a professional certified appraiser be appointed along with a third-party project administrator (comprising of chartered technical and commercial professionals) to ascertain the status of the project with regards to the following:

1. Costs spent till date – land, authority, construction, marketing and sales, and other ancillaries
2. Project completion status – phase wise/ tower wise/ dwelling unit wise and overall project completion
3. Costs required to complete - phase wise/ tower wise/ dwelling unit wise and overall project completion
4. Cash flow status – including identification of defaulter allottees, scale of defaults, detailed inventorization of all assets, current and old liabilities, current and future authority payments & fees
5. Time required to complete analysis - phase wise/ tower wise/ dwelling unit wise and overall project completion
6. Quality assessment of the project completed till date and ascertaining final quality benchmarks
7. Details of contractors (capacity and capability assessment) including risk assessment of existing contracts and supply chain commitments
8. Details of material inventory at the project
9. Final assessment of gaps in project viability and funding.
10. Current asset value and project feasibility findings.

4.3.2. Problem-project's categorization

To ensure we handle the crisis effectively and efficiently, it is imperative that the affected projects are categorized in accordance with severity of the crisis. It is advised that a single solution may not work for all affected projects, hence it is prudent to provide sets of solutions bespoke to "similar problem-projects". It is also recommended that a detailed list of projects be made (we understand that a list is already available with Niti Aayog) which shall categorize the projects into following:

1. **Green Category** – Projects which do not have challenges in its funding plan and can be completed as per their committed plans.
2. **Yellow Category** – Projects which are at a very late stage of completion and require only last mile funding for them to be finally handed over to consumers
3. **Orange Category** – Projects which are at various stages of completion and have a gap in their funding plans. However, it is expected that the amount of funds required shall not pose any challenge to servicing the debt at a later stage due to cumulative amount of receivables / sales from the project.
4. **Red Category** – Projects which are stalled completely due to over leverage of the project finances; adequate project finances not available to cater to project execution (including monetizable inventory); or developer has gone bankrupt

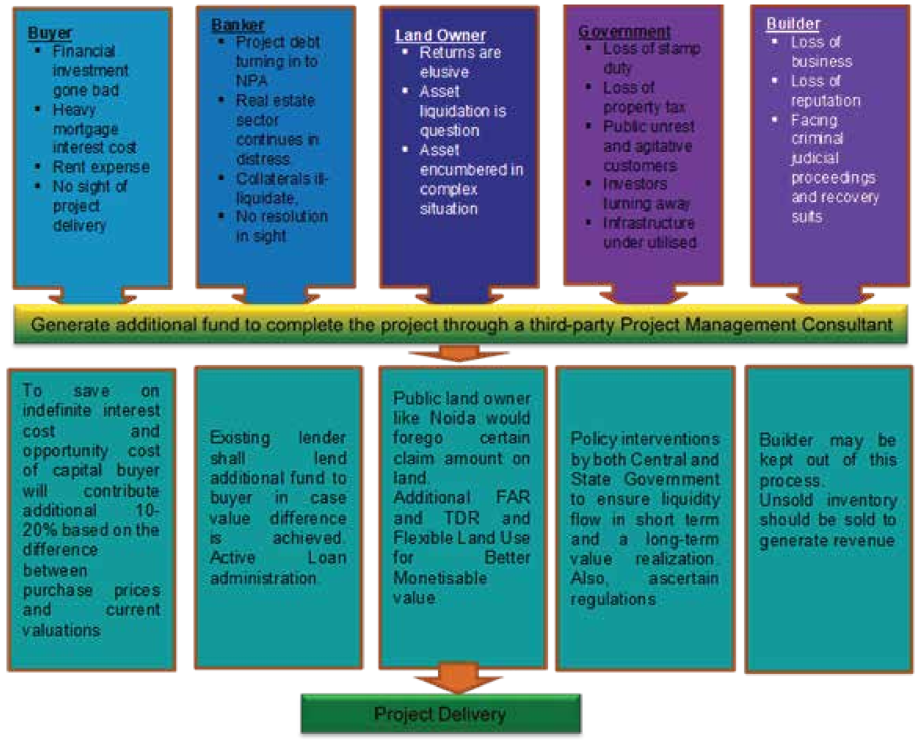
It is natural that solution to finances of each of these will have to be bespoke and effective.

The suggested solutions shall work if the Central Government, State Governments, Regulators and Financers work together in bringing up the necessary monetary policies, urban developmental policies, fiscal tools and macro prudential tools to manage a recovery.

While it may be easier to get stakeholders to agree to resolution strategies of Yellow and Orange Categories, it would require special approaches to handle Red Category projects. For the simple reason that the project has no upside potential and could be a disaster on the balance sheet of any interested entities. It will keep driving stakeholders away to try and manage the resolution or fail to even indicate interests in doing so.

4.4. Suggestion for resolution of orange and yellow category projects:

Since these projects are found to be financially viable, the solution for these has to be focused around cash flows for the project, and effective project management. While these projects will not drive haircuts by most stakeholders, it will require all stakeholders to collaborate to a unidirectional strategy and a temporary hold on realizing government/ business/ personal interests in the overall interests of the project.



To ensure that the fund flow to the project is restored and the newly collected fund is put to better use, the following measures (policy, fiscal, operational and functional) are suggested to be put in place for Yellow and Orange Category projects to boost accrual of funds required for completion of projects:

4.4.1. Maximize realization of construction linked payments by allottees

Due to mistrust in the developer, project delays and the overall dynamics of the real estate industry, the allottees have held back on meeting their obligations towards the purchase agreement. Many of them have not paid their construction linked plan's instalment and are not willing to pay, in the fear of their money not being put to right use or being swindled.

Post a third-party project administrator (henceforth termed TPA) being appointed and a defined strategy put in place, the Authorities, Regulatory Body representatives, Developer and other important stakeholders should meet with the Allottees to regenerate their confidence in the project. They should clearly explain the plan and the details of the resolution plan including transparently sharing the details of finances, costs to complete and schedule of works.

4.4.2. Equitable status on promoter/ allottees financials & obligations till OC

RERA should mediate an equitable solution between the Promoter and the Allottees on Delay Penalties payable by the promoter, interest chargeable on delayed payment obligations by Allottees till the Occupation Certificate (OC) is obtained and possession is given.

Unless it is extraordinarily skewed against one stakeholder, it is advisable that both agree to an amiable solution of diverting their respective obligations towards completion of construction of the project in agreed phases as administered by the TPA. Hence, RERAs should also observe restraint in passing orders on refunds to Allottees generally in all such cases or let the Promoter charge any interests on delayed payments by Allottees.

4.4.4. Conversion of Leasehold to Freehold Developments

The Authorities shall create an option of converting lease-hold properties into free-hold developments by considering a one time or phased payout of premium which can boost liquidity into the project directly or indirectly (through enhanced valuation, leading to more capital). The conversion may also generate additional funds through stamp duty collected on a higher value.

4.4.5. Allotment of additional FAR for the project

Such distressed projects may be allowed to have additional FAR in the project which can be monetized at rates as per suggested valuation (by TPA and Certified Appraisers). Any funds and premium generated from this to be used for funding construction or payouts to Authorities for present or future relaxation considered by them

To manage additional FAR, the Authorities may want to consider relaxation of development norms, including open area considerations. However, only upon recommendations of the TPA and a qualified Architect.

4.4.6. Flexible CLU to enhance monetizable value of the Project

The Authorities may want to consider grant of flexible Change of Land Use License in accordance within existing approved FAR (for later phases of the project) or additional FAR norms as in Measure No. 4.4.5 above to enhance monetizable value of the project leading to additional liquidity in the system and in the project.

4.4.7. Re-organisation of Stamp Duty

The authorities may suspend payment of stamp duty payable against registration of the property by Allottees till the OC s obtained or a fixed time post registration; with identified and defined recourse through various Government channels of claiming it at a later date.

Many allottees delay registration of their property post handing over, due to lack of funds or various other reasons which pose some amount of risks and lack of liquidity in the system. The Government may want to allow financing of Stamp Duty Charges by BFSI companies, to encourage timely registration of properties and flow of liquidity into the system.

4.4.8. Suspension of Property Tax

The authorities may suspend payment of Property Tax payable post handing over, for a fixed time with clearly identified and defined recourse through various Government channels, for claiming the arrears at a later date, however without any interest chargeable on it.

4.4.9. Cheaper Loans by Banking Institutions till OC

A banking organization may be allowed to offer a favorable and a cheaper rate of interest (Fixed Rate) till the OC is received on the outstanding principles or the new value of loans as sought for by Allottees.

4.4.10. Additional Collateral by Promoter

In case where TPAs observe that the Promoter has diverted the project funds to some other assets, additional collateralized assets should be sought from Promoters which can be used to clear the deficit of funds due. This may also be used to clear liabilities of lenders or any Government Authority as may be recommended by TPAs and mediated by RERAs.

4.4.11. Seller Stamp Duty

It has been observed that many Allottees have seen depreciation in their capital due to property prices correction in the past two years. This has led many to go to RERA or other forum to demand a refund. Once the refund is given, they use the same to buy a unit, within the same property at a lesser price or elsewhere as per their value judgement. To ensure that Allottees do not exercise 'exit only' for short term or 'petty benefits', a "seller stamp duty" may be introduced on such projects to maintain liquidity levels in the project.

4.4.12. Multiple Forum Shopping by Allottees to be discouraged

Since various rulings by the honorable Supreme Court, the Allottees are resorting to multiple forum shopping, i.e., RERA, Consumer Courts and NCLT (under IBC) for resolution of disputes. While it is ruled by the SC that IBC prevails over all, it is important that the judicial power vested in the sector Regulator (RERA) is not diluted. The following recommendations are made:

a) The RERAs shall act as the primary Judicial body to resolve disputes amongst concerned stakeholders. It is to be noted that RERAs have a robust knowledge of the market dynamics, project related information and all requisite project details including evidence of progress of project completion.

b) Since RERAs have an appointed AO (Adjudicating Officer) as per Act, the AO along with the help of TPAs would be able to examine the case adequately, much faster.

c) Many RERAs have initiated conciliatory forums (similar to Alternate Dispute Resolution). It would be prudent to have a formal Dispute Resolution System (DRS), in line with International Standards, adopted for first line of resolution.

d) Only in case of an appeal (to be filed against the adjudication by RERAs or DRS) or in cases where the collective grievance of minimum 10% of the Allottees is on the same plank, the cases may be admitted by Consumer Courts or NCLT. However, it is advisable that RERAs do provide their detailed inputs in such cases so that the resolution could be efficient and effective. In cases under NCLT, the Resolution Professionals (IRPs) should work with identified TPAs for an adequate techno-commercial resolution.

4.4.13. Last Mile Funding by BFSI sector

While the Government has approved a "stress fund" of a total of Rs. 20,000 crores for last mile funding of affordable housing, and for non NPA and non NCLT developments, the scope should be increased to include projects of certain value and estimated to be completed within 1-2 years of restarting works on those projects. The stressed asset fund would be used initially to kick-start a stalled project. Subsequently, all money misappropriated, payments received from homebuyers and realisation on account of unsold units should be brought into the stressed project. Only the shortfall amount should be utilised from the stressed asset fund.

4.4.14. Valuation & LTV Ratio Management

Only Chartered Valuers or IBBI certified valuers shall be qualified to carry out valuation for such problem-projects based on International Valuation Standards. This shall ensure accurate valuation of assets. It is also advised to raise the minimum cash margin levels for real estate asset purchase. This shall lead to a lowered LTV (Loan-to-Value) ratio and thereby easing liquidity crisis.

4.5. Suggestion for Resolution of Red Category Projects:

Most banking institutions lack sectoral asset management skills and do not have a structured or guided approach to identify properties with upside potential. Hence, once they are stressed, many pursue a fast-run-down strategy for their real estate collaterals using SARFAESI Act (The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002) which allows banks and other financial institutions to auction residential or commercial properties of defaulters to recover loans.

This is generally done by selling real estate collateral through in-court or out-of-court enforcement proceedings, with an aim to partially recover the losses on defaulted loans. This leads to accepting a significant lower selling price compared to actual valuation and then triggering a price collapse for the project. However, this approach should be taken only in case of properties with no upside potential; properties still in early construction phase or properties with negative real estate market outlook with a view to limit the losses on the capital investments. In certain cases, if the exposure is significantly lower than the collateral market value, the banking institutions cover it through the above Act.

In addition to some of the solutions as identified above (for Yellow and Orange Category Projects), which may be used on the merit of each case, there is a need to look at various radical alternatives as well to take such projects to completion. The principle of resolution of such projects lies within all stakeholders taking some haircuts in their asset values.

1. Suspension of Land Lease Payouts for Leasehold Properties till OC

2. Enhanced Stamp Duty & Property Taxes for a predefined period post handing over, in lieu of funding by the State Govt Bodies

3. Deploying Professionals to lead the recovery and Project Execution: Upon identification of such Red Category projects, it is suggested to mandate appointment of TPAs and IRPs for project resolution.

4. The stressed developers may be allowed to mobilise funds through ECBs (External Commercial Borrowings)

5. Involve other developers with healthy balance sheet and investment portfolio in the project (post repossessing from existing developers) with additional incentives like additional FAR, Flexible CLU as in Measure no. 5 and 6 of Yellow and Orange Category. In case, that is not available, a SPV can be made which shall be allowed to lucrative deals in other areas of the state. The valuation of the same to be made by a Chartered Valuer

6. The funds collected from Labour Cess, may also be repurposed for a short-term duration to resolve such projects. However, this would involve collaboration between Ministry of Labour Welfare and the State Government

7. Temporary relief against GST liabilities can be provided. However, the liabilities to be accounted and later on recovered in a phased manner from stakeholders (Promoter + Allottees)

8. Provide special income tax benefits to Allottees on the project to encourage them to meet their liabilities

9. One-time allowance to use monies from PF with Income Tax benefits to be extended to Allottees to encourage them to pay

10. Identification of corpus available in unused PF monies collected from Labours working in a particular state. The available funds may be converted into designated Housing Provident Fund which can be made available to such projects on an attractive interest rates

11. Allowing complete/ partial buy-outs by FII (Foreign Institutional Investors) and easy exit routes being provided to them. These FIIs (backed by Pension Funds or Sovereign Funds) may provide cost effective mortgages for such projects.

12. As another option, in case the bank's assessment indicates an insufficient selling price (through SARFAESI), the bank may repossess the asset (with no upside potential) with a goal to sell it within a short time (e.g. 1 to 2 years) at a price higher than the current enforcement value. However, the bank should desist from large-scale investments for development of the property during the holding period due to forecast weaker market outlook for specific segment/market. This allows the Banks sufficient time to initiate and conduct a proper sale process to sell the property at the current market value.

13. Introduction of Revolving funds through a program similar to TARP (Troubled Asset Relief Program) in the US will help create a virtuous cycle of purchase and sale of such financial assets which currently are not generating gains, but are expected to do so in near future (please refer to detailed note in next section).

14. ECBs – Healthy developers partnering or taking over this category of project may be allowed to access ECBs which currently is in negative lists as per the Government.

For a new project development, following should be considered as a minimum action items to ensure that we do not see repeats of such cases.

a. Credible project feasibility studies must be undertaken before project launch.

b. RERA must ensure that every project must show financial closure where financing through internal accruals should not be more than 30% of project cost.

c. Banks must undertake active project debt finance administration to ensure financial prudence.

d. RERA must also ensure conclusive penal action against those buyers who stop payment mid-way.

e. A new financing mechanism must emerge specifically for real estate sector since risks are higher for both equity as well as debt.

f. Private Equity must behave like an equity finance not like structured debt, which is a current practice.

g. RERA must ensure certain entry barrier for real estate sector so that credible entrepreneurs could flourish and lead the sector.

h. Accessing overseas funds (external commercial borrowings) should be eased out so that large developer can access debt, leaving domestic fund availability for smaller developers.

i. Digitisation of land records, clear titles etc will create ease of accessibility to land data and records.

4.6. Alternate Instruments of Finance for Reinvigorating Real Estate Finance:

While the above measures given for Problem-Project Categories cater to immediate sets of issues with projects stalled due to financial crisis, it is important to consider alternate instruments of finance which streamline Real Estate Finance and create a very well-regulated approach to ensure transparency and robust risk management.

The suggested innovative financing tools covering aspects of monetary policies, fiscal and macro prudential tools presented here, have been tested in various developed and emerging economies. These need to be developed by the Union Government in consultation with the BFSI Sector, Regulators and Real Estate Developers. They are explained herewith, in no particular order of preference or efficacy.

4.6.1. CSH – Contractual Savings Scheme for Housing including Hire Purchase prior to Mortgaging

CSHs has been a major choice with policymakers in emerging markets as an approach to raise capital for housing finance, centrally. The concept relies upon a potential borrower to save money over a period which builds up equity at one end and improves his reliability and capacity to repay a debt, on the other end. Post the saving period, a loan will be advanced to the saver, which will typically be equal or represent some low multiple of the amount already saved. Both loan and accumulated equity are jointly disbursed. Interest rates for both savings and the loan are fixed below the market rate, generally. It is preferred in many countries mainly due to the following:

- The lack of long-term funding instruments which hinders development of fixed-rate mortgage products;
- Greater financial stability through CSH by providing mortgage finance access to LIGs and younger households which stay away from mortgage finance due to higher cash margin and low credit-risk information availability;
- It helps provide loan supply in unconventional areas which have low loan volumes and high servicing costs.
- Since CSHs directly result in mobilization of savings for housing, it impacts general economic development positively.

However, CSH didn't work in India in the first Instance: The BHW Home Finance in India is a subsidiary of German BHW Bausparkasse, now part of Deutsche Postbank. The Easy Home Loan Deposit scheme was created in 2002 as a closed fixed-rate system, regulated as other fixed-rate deposit schemes applicable under the Indian mortgage company charter. The scheme was initially well received by consumers. In the Indian context characterized by high levels of informality then, the target groups were lower-income and lower-middle-income households; however, many of those households had no bank accounts then and there were fewer options to buy low-cost housing or land; BHW over time ran into difficulties to organize distribution and collection. After a series of problems with collection agents, the scheme was discontinued by BHW in 2006 and accumulated savings were reimbursed.

However, post demonetization, and JAN DHAN YOJANA – there is a significant surge not only in the formal economy but there is a greater availability of affordable housing in semi-urban and rural areas in closer vicinities to mid to large cities. Hence, the correct set of factors are now there in India for this to be successful.

4.6.2. Housing Provident Funds

HPFs are suggested as Government regulated (through existing PF department) specialized financial institutions that run on mandatory savings from employees as a defined percentage of their salary (similar to our current PF system). In few cases, the employers are also required to make additional proportional contributions (for example, this is 1:1 in China). The HPF manages these accrued long-term savings, which are often remunerated at a below-market yield. This permits the contributing members of the HPF to

- withdraw their savings as a down payment for housing (else, retain their savings till retirement);
- receive long-term housing loans, at a preferential rate (directly by the HPF or another lender);
- retirement savings; and
- in some cases as severance payment.

HPFs are created and determined by law. HPFs have been running successfully in many emerging economies, including Mexico, Nigeria, Brazil, Jamaica, Philippines, and China. In addition to this, Singapore's development thrived upon the Housing Development Board enabling HPF as a major funding source.

It is important to note that HPF is a long-term housing funding tool. Since it works on accrued savings, it not only provides a push to the general economy, it works in creating a long term sustainable financing model.

4.6.3. Mortgage Securities in Emerging Markets

In most emerging economies, residential lending is typically small, poorly accessible, and depository / collateral based. Lenders carry significant credit, liquidity, and interest rate risks. As a result, housing finance is relatively expensive and often capped by ceiling. The capital markets in India need to provide an attractive and potentially large source of long-term funding for housing. Pension, PF, ESI and other insurance products have helped create funds which can be accessed by institutional investors to create mortgage related securities such as bonds, and structured finance.

The use of mortgage-related securities to fund housing has a long and rich history in industrial countries in Europe and US with more complex finance instruments catering to 50% of the debt requirements. These help lenders more efficiently mobilize domestic savings for housing. Mortgage securities complement government bonds to develop and diversify fixed income markets. Their success is dependent on a proper legal and regulatory framework and liberal financial sector, and a developed primary mortgage market.

Mortgage securities improve housing affordability, fund flows to the housing sector, better risk allocation, help tap new funds for housing, resulting into reduced risk and risk premiums. Better risk allocation through efficient fund management results in development of specialist competitive landscape in primary markets resulting into cheaper loans and increased efficiency. Mortgage securities are a natural evolution stage of CSH and such capital market finance helps smooth housing cycles by accessing alternative sources of funds. This leads to financial deepening, fostering economic growth, stimulate investment, reduce cost of capital, spread risks and improve stability of the financial system.

Post cleaning of NPAs, increased regulatory compliance, macroeconomic environment, India seems to have all the right factors to develop aMortgage Securities Market with more complex instruments, to increase its share in housing finance.

4.6.4. Bond Market Development & Covered Bonds

A natural evolution of Mortgage Securities with complex instruments playing in the Capital Markets is development of the Bond Market or Debt Market or Credit Market.

Bonds positively impact mortgage interest rates because they compete for the same type of investors, who want a fixed and stable return in exchange for low risk. Bonds are lower risk, as they're loans to larger entities, such as cities, companies, and countries - hence have a larger assurance of pay back. Bond rating agencies study each company and bond on safety of the products and the fact that bonds can be resold on a public market – makes them easy to trade.

The developed and emerging economies are fast moving towards covered bonds which are fixed-income securities (as debt instruments) backed by a covered pool of mortgage loans (with real estate asset as collateral) or public-sector debt to which investors have a preferential claim in the event of default. Security by a collateral pool, in addition to the creditworthiness of the lender, makes Covered Bonds a very conservative debt finance instrument, to which generally AAA credit ratings are assigned. The German Pfandbrief (European specialist Real Estate & Public Investment Finance Bank) has become the most followed model of many covered bond models in Europe and beyond. The Pfandbrief bond market is the biggest segment of the private bond market in the world, equaling about Euro 900 billion in volume outstanding.

The debt market in India has seen significant growth over the years, but the growth is more in the G-sec market than corporate bonds. While the G sec market has doubled in the past decade, corporate bond growth has remained flat.

To understand the scale of the Bond Market's potential, it is important to state that India's contribution to the same is less than USD 0.5 trillion as against a global market size of USD 82 trillion, with nearly half of it being in the US alone. Given the positive macro-economic factors, cleansing of the public and private banks, better regulatory controls and faster resolution of insolvency cases, the outlook for growth in the corporate bond market remains bullish, with CRISIL estimating it to double in the next five years. The growth will ride on infrastructure capex funding, regulatory push for incremental funding for non-corporates, stabilisation of the process under the Insolvency and Bankruptcy Code, and improved demand from NBFCs and HFCs.

4.6.5. Residential Rental Housing Finance

While there is focus on affordable housing development in the country, the fact remains that housing remains a mirage for a large portion of the income distribution. This leads to large informal rental housing with generally individuals being the landlords and not firms. This is generally financed by equity only, in contrast to developed countries where a number of financing options are available and are still developing over the years.

While Rental Housing being a focs area in the last Union budget, expeditious steps are required to be taken for the development of a formal rental-housing market, which is expected to grow multiple times and foster growth in the real estate sector for the following reasons:

1. People who are unable to buy a home for reasons related to affordability, mobility,work related migration, not having enough savings, and more recently due to general approach of the young to not to get tied down to a financial commitment at the early stages of their career (and spend money on life experiences instead) - are increasingly reliant on rental housing, tending more towards a formal approach driven by firms than by individuals.
2. Vibrant rental housing is key to active secondary markets and flexible migrant worker markets. Because of high transaction costs, restricted mobility (which then ties up capital wastefully) people will tend to prefer rental housing as a matter of choice.
3. A robust and organised rental housing sector shall lead to further investment in residential housing and associated investment in commercial and retail assets.
4. Affordable rental housing markets facilitates assimilation of cash margin funds and promote mortgage markets, increase value of housing assets, and facilitate the fluidity of secondary housing.

For facilitating growth in the sector, while the rental act has been amended to govern the landlord-tenant contractual relationship, there is a need to look at the taxation system applying to rental housing.

Market Financing Models for Rental Housing

All-Equity Based: Prevalent in many emerging countries with limited financial market access, rental housing is perceived to be too risky by institutional investors. An individual investor drives this market through his own equity (savings accrued through various sources including rentals from older properties). India has largely been following this financing model which locks down the capital and growth of the sector, unless institutional players move into the sector.

Real Estate Investment Trusts (REIT): Investment funds raise equity from investors, and then buy, develop, or manage the rental properties directly. An equity REIT (through pooled funds), acts as a media where dividend is paid from a real estate portfolio to shareholders. REIT fundamentals should benefit from tax reform as well since the corporate tax rate was reduced from 35% to 21%. While that reduction does not directly benefit REITs since they do not pay taxes as pass-through entities, it will benefit many of their tenants.

Bank-Supplied Credit for Residential Rental Investment: Lending for rental housing investment is essentially long term hence potential issues like liquidity and interest rate risks, instruments for matching asset and liability durations, existence of a demand for long-term collateral are relevant.

Capital Market Financing: issuance of bonds or securities backed by the mortgages by banks or local government (with tax benefits) or other lenders for rental investment (residential commercial mortgage-backed securities); direct financing of the rental project on capital markets by bonds, with or without backing from a non-bank intermediary (used in the United Kingdom for the financing of social housing);

Credit Enhancements and Insurance Products: credit enhancement products applying to individual mortgages (primary lenders), and credit enhancement products applying to the bonds

4.6.6. Housing Microfinance

In India a large pool of population living in rural areas, are poor and cannot afford market-rate mortgage for a completed house. However, most of them do borrow small amounts from informal money lenders (at much higher interest rates) for successive short periods of time, to upgrade to an incremental self-built structure, such as an improved wall/ roof, flooring, smaller area additions, connections to municipal services etc.

Microfinancing can help these smaller loan takers who lack proper titles or access to formal lending institutions. The short maturity of each loan shall cater well to the volatility of informal incomes with such individuals. The lack of a mortgage lien in HMF is a big attraction to the poor who will seldom put their most important asset(s) at risk to secure a larger and longer-term loan. These people also do not wish to pay for mortgage processing.

The development of HMF in various emerging economies, shows that productive poor people can finance some of their real estate needs incrementally.

4.6.7. Housing Finance Subsidies

While the current government through its first and second term has promoted multiple real estate finance subsidies, much more can be done to reduce equity participations, improve availability and lower cost of finance for construction, sale and resale of housing in primary and secondary markets. Of all the forms of housing subsidies and policy relaxations, housing finance subsidies are amongst the most prevalent policy tools. Various types of housing finance subsidies which may require greater implementation through policy framework are :

Subsidies Linked to Debt Finance for Rental Housing: Interest rate subsidies and credit risk guarantees.

Subsidies Linked to Equity Investments for Rental Housing: through direct grants or through tax credits for private equity investors in either private-rental or nonprofit-rental housing projects. The U.S. Low-Income Housing Tax Credit (LIHTC) is the most prominent of these programs.

Production Subsidies (i) the provision of land for free or at a below-market price by the state or local authorities (the cost of which is often not appraised at market value), and (ii) up-front grants for a proportion of the total land and construction cost, tax subsidies such as GST exemption, or reduced tax rate on construction.

Operating and Maintenance Subsidies: Income or property tax rebates or exemptions, GST on renovation or improvement, GST on interest payments, taxation of rental income, or depreciation concessions,

Tax Subsidies: Income tax, property tax, capital gains tax further optimisation

4.6.8. Risk Weightage & LTV Ratio Optimization

During the recent monetary policy announcement, the RBI reduced risk weightage for home loans based on lowest delinquency in home-loan category. According to the recent RBI notification, the risk weightage on home loans above Rs75 lakh has been reduced from 75% to 50%. Since banks would have to keep aside lower amounts to provide these loans, they will have more amount to lend and hence reduced the interest rate.

However, the LTV ratio remains at a higher level than global recommended average of 70%, on account of over leverage of mortgage financing due to improper valuation. It may be prudent to put in place a regulatory framework (through IBBI or equivalent regulator) to create a transparent ecosystem of proper valuations by qualified valuers based on International Valuation Standards. Not only will that bring prudence to the real estate asset valuation, it shall also provide necessary comfort to FIIs for them to invest without hesitations

4.6.9. TARP – Troubled Asset Relief Programme in the form of Revolving Funds

On the lines of TARP which was launched by the US, post the recession in 2008, the Government of India may allow Ministry of Finance to purchase or insure problem assets in the real estate sector. This could be a onetime measure for financial instruments dealing specifically with problem projects defined in the “Red Category”.

These troubled assets may be difficult to value and illiquid assets (in current scenario) in the form of collateralised debt obligations by Banking and other financial institutions. The same can be bought against issuance of equity, equity warrants or debt securities. The measure should not allow Banking institutions to book losses on these troubled assets. It is anticipated that prices will stabilise and improve over next few years resulting in gains in near future. This is based on the fact that consumption crisis will be eradicated soon due to impending economic growth of the country and that not all troubled assets are toxic and defaulted.

The TARP should act as Revolving Funds – the purchase limits to be set, the assets to be purchased for reselling or holding for a brief period till prices increase resulting into gains or recovery. The money received from reselling shall be brought back into the program to allow purchase of more such assets. The ceiling of the purchase of such assets may be kept lower initially and increased, based upon performance of the program. The TARP could follow an administrative structure similar to the one in the US, but modified as per spectrum of financial instruments which could be purchased under such a program.

4.6.10. ECBs – External Commercial Borrowings for Troubled Assets

When healthier developers/ agencies or other companies take over troubled projects or assets, those firms may be allowed to take ECBs. There may be a need to look at the policy framework for assess to ECBs. Some of them may be:

1. Currency of Borrowing could be any convertible currency
2. Real estate sectoral finance entities may be notified as eligible for such borrowings and real estate to be taken out of negative list of End uses
3. Once deleted from the negative list, the minimum average maturity period may be kept lower to ensure faster recovery
4. Creating a framework (with limiting conditions) to allow trade credits

4.7. Other Real Estate Boosting Measures

In addition to all the above, the sector could benefit largely from measures to boost consumption in real estate through select measures. Some of them could be:

Affordable Housing

- Increase in ceiling prices of INR 45 lakh to higher values for affordable housing in Tier 1 cities (Mumbai, MMR, Delhi, NCR, Bangalore). Section 80 IBA of Income Tax act be extended for minimum 3 years to include affordable housing
- Preferable lending rates for affordable housing construction finance
- Create Tradeable Land Quotas through which developers will be permitted to construct housing within the sub-urban limits but support cultivable land beyond city boundaries
- Repurposing vacant property, sparsely used/ poorly utilised urban areas into “permanent supporting housing” for the homeless or migrant population.
- Identify mechanisms of Rental Housing to boost Affordable Housing Segment with long term investment scenarios

Commercial Real Estate

- Extension of the sunset date for income tax benefits for units in SEZs from 31/03/20 by 5 years which will also lead to employment generation.
- Allowance of offset of GST input tax credit against GST collected on the first 5-year rents in commercial projects. This will bring parity between commercial projects on sale or on lease.
- Removal of concentration limits for investment into real estate through listed / unlisted non-convertible debentures under the FPI route. This will help bridge the severe liquidity deficit facing real estate projects and help fund completion of scores of incomplete projects
- Repurpose prime real estate, lying locked with key PSUs or Ministries (e.g. Railways) for development of prime commercial real estate

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