India: Rera, Lender's Perspective- Obstacles and Mitigation

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The Real Estate Regulation and Development Act, 2016 (Rera) came in at a time when the banking industry was, and continues to be, in turmoil. Non-Performing Assets (NPAs) have touched record highs, having jumped from Rs. 2,63,372 crores in 2013-2014 to Rs. 7,76,087 crores by September 30, 2017. Even safe havens such as the affordable housing sector are falling apart. Delinquencies in the sector are on the rise. Worse, most of the affordable housing loans are below Rs. 2,00,000. For their recovery, the recently enacted Insolvency and Bankruptcy laws will be of no use. The real estate sector is headed for a full blown sub-prime crisis. Unfortunately, the woes do not end here.

Rera was accompanied by Demonetization, and The Goods and Service Act, 2017; none a good bellwether for the last quarter, nor for the New Year. However, the most dreaded of all is the projected 6.5% growth in Gross Domestic Product (GDP). Now here is a look at how Rera impacts lenders, and how it can be mitigated.

Under Rera, a developer is bound to deposit 70% of the receivables from the apartment purchasers into a separate no-lien-no-charge-account. This fetter has retarded cash flows from the project to a trickle. Withdrawals from the aforesaid separate account are based on the stage of completion of the project. For this purpose, certificates from an architect, engineer, and chartered accountant are required. The Maharashtra Real Estate Regulatory Authority (MahaRera) has come up with Rules stipulating formulae, formats etc. for these professionals. Accordingly, the chartered accountant is required to certify the proportion of land and construction costs incurred to the total estimated cost of the project. This is essential to keep a tab on the expenses. Further, notably, the maximum permissible withdrawal at any given stage is the total estimated cost of the project multiplied by the aforesaid proportion. Withdrawals from the separate account have thus been capped. In effect, as the construction advances and expenses surmount, larger withdrawals will be accordingly possible. Although principal and interest payments to the fanciers are permissible deductions from the separate account, any loan amount towards purchase of the project land or development rights cannot form a part of the deductions.

MahaRera has also issued various Circulars dissipating doubts regarding the application of various provisions of Rera. These rules and circulars have thrown up many solutions. Given below is a quick overview of some of the most vital questions and their answers.

Until the enactment of Rera, a lender could demand the developer to deposit its entire revenue, in whatever form, into an Escrow Account opened at the time of availing of the project finance. Instead of abandoning the Escrow Route, a simple detour, within the current framework, can be easily adopted by the banking community. Circular 7/ 2017 issued by MahaRera, in unambiguous terms, records that *although preferably the amount withdrawn may be utilized for the purpose of the completion of the Real Estate Project, there is no end use restriction*. Here's a real opportunity for bankers. Loan documents, therefore, can continue to have a covenant making it obligatory upon the developer to deposit all the withdrawals from the separate no-lien-no-charge-account into the Escrow Account. Needless to add, the Escrow Account arrangement, with respect to the remaining 30% of the receivables, need not be disturbed.

Interestingly, the Circular recommends that the developer may open other accounts for deposit of pass-through charges (amounts collected for society formation charges, etc.) and indirect taxes collected from the allottees. Obviously, these accounts are not bound by the restrictions under Rera. This recommendation is merely in the nature of a silver lining since such moneys are held by the developer in trust.

Once the occupancy certificate is obtained by the developer, all monies become freely available. Optimum phasing of the project and timely completion of each phase, shall ensure quick accessibility to the funds parked in the separate account. In fact, the whole scheme of Rera is meant to incentivize prompt project completion.

The next hurdle is Section 15 of Rera captioned '*Obligations of promoter in case of transfer of a real estate project to a third party'.* Under Section 15 the promoter cannot transfer his majority rights in a real estate project without (a) the prior written consent of at least 2/3rd of the allottees, and (b) the prior approval of Rera. This has a direct bearing on the step-in rights of the lenders. Circular No. 11/ 2017 issued by MahaRera addresses this issue. If such transfers result from the enforcement of any security interest held by a lender registered with MahaRera then no such prior consent or approval is required. However, the Circular does mandate a set of prior intimations to be given to the allottees and MahaRera. Post transfer compliances are also set out in the said Circular. The point that needs to be noted is that if the lender's charge is registered with MahaRera, then its security interest is fully protected from the weathers of Section 15.

Other roadblocks can be easily negotiated by seeking additional securities, contractual comforts, representations, and warranties from the promoter. Risks to the lenders can be circumvented by strengthening the language of the transaction documents in favour of the lenders. This should be taken up on a priority basis as far as equity arrangements are concerned. Equity infusion into a project in return for a fixed dividend may be the norm. However, the wide definition of *promoter* under Rera covers equity participants. MahaRera has, time and again, clarified that in case of complaints of Rera violations, the role of such an equity investor shall be scrutinized on the basis of his agreement with the developer.

Slight innovations though not tested may help save the day. For example, under Section 8 of Rera, the association of allottees have a right of first refusal for completing the remaining development works in case of stalled projects. The Agreement for Sale between the developers and the allottees may contain provisions whereby the allottees agree to voluntarily exercise this right in favour of the lender. Winning over the confidence of the allottees is of as much importance to the lenders as to the developers. Safeguards against any challenge to the agreement on the ground that it amounts to contracting out of the beneficiary provisions of the statute must be incorporated.

The time is ripe for a detailed review of standard templates. Should lenders ignore to update their drafts they may eventually land up paying a huge price. In the simple words of Benjamin Franklin "*An ounce of prevention is worth a pound of cure*."

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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