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EXECUTIVE BRIEFINGS
POLITICS & ECONOMY: REAL ESTATE

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The Real Estate Act: a good beginning

On the 25th March 2016, the President of India signed into law, The Real Estate (Regulation and Development) Act, 2016. The Bill was introduced in 2013, subsequently scrutinised by two parliamentary committees and finally enacted in 2016. Real estate is a politically awkward subject, not merely since it 'concerns the public' but because of the pernicious nexus that endures between politicians and the builder community. It is also a complex one, as market dynamics vary across the country. Land (and its development) is a state subject and therefore not amenable to unilateral federal policy diktat. Despite these challenges, the Real Estate Bill progressed from conception to reality in less than 3 years, a reasonable achievement given the exasperatingly stumpy benchmarks of legislation set by Parliament over the last 10-15 years.

The debate that took place during this period was inclusive and focussed on material aspects of the Bill. As is frequently the custom, it was not hijacked by one or two extraneous issues nor held hostage to political bickering of the sort that detracts attention from core ones. Consequently, it has turned out to be a largely fine piece of legislation. It has its drawbacks but, nevertheless, provides a decent start to the process of regulating and cleaning up India's realty sector.

It's a fine law…

The Act provides for the creation of a three-member Real Estate Regulatory Authority (RERA) in every state and Union Territory. All realty projects above 500 square metres or involving more than 8 apartments must be registered with the local RERA before they are put up for sale or advertised in any way. The registration process obliges the promoter to specify comprehensive data on the project including construction deadlines, layouts, design, etc. Adherence to commitments would be ensured through financial penalties (as high as 5-10% of the project cost depending on the nature of the lapse), imprisonment (in certain cases) or cancellation of registration, which would make the entire project un-saleable. To assure the quality of construction, the promoter will remain liable for five years after handing over possession, for structural defects. Any material changes to a project, whether entailing a change in promoter or a change in building plans/layout will require the approval of two thirds of the buyers. These provisions basically impose accountability upon project developers to actually fulfil promises they make to buyers.

The law also requires the promoter to ensure clear and unencumbered title to the land and possession of valid construction permits from local authorities. Many real estate projects in India run into trouble because of problems with land titles or lack of building permits. The victim is inevitably the buyer who has already sunk in all or part of the cost and has no option but to wait it out. Notably, the Act requires real estate agents (brokers) to register themselves too, if they wish to facilitate transactions for projects above the size threshold mentioned above.

On the financial front too, the law introduces important reforms. Firstly, builders cannot collect more than 10% of the total cost from buyers without entering into a written agreement. Secondly, 70% of all monies collected from buyers have to be deposited in an escrow account and withdrawals from there may only be made to defray land and construction costs for the project in question – that too, in proportion to the extent of construction completed. This addresses a common malpractice in the trade

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wherein builders divert collections from one project towards the construction of the next one – rather like operating on negative working capital. While convenient from a liquidity standpoint, such practices create an obvious divergence between the reasonable interest of the buyer and that of the developer. The law will restrict this as the developer's incentive to complete a project on time would now be aligned with his ability to access funds. On the flip side, this provision may lead to an increase in costs, as the developer would be compelled to arrange alternate sources of funding to 'build first' and 'be paid later'. Since funding to real estate is available at a fairly high cost, this may lead to an impact on overall project economics. It remains to be seen how large the impact would be in terms of the end price to the buyer; but it would seem fair to accept some escalation as the price for ushering in better practices. The same principle, in fact, should help bring down funding costs for the industry in the long term.

The law provides for the creation of model contracts by the RERA, which will substitute for the heavily one-sided agreements that currently prevail. It also requires builders to compensate buyers for delays, by paying interest at the same rate as that charged to buyers for late payments (currently the latter is much higher than the former); allow buyers to exit from a project under certain circumstances with a full refund plus interest; provide regular status updates on the project through the RERA website; and submit their books of account for audit. In this manner, the law provides wide ranging protection for the consumer and is a much needed step towards reforming an industry that is a significant contributor to growth, employment and consumption.

But has some inadequacies…

However, the Act has its share of shortcomings. Perhaps the most obvious one is the fact that it does not impose any accountability upon state Governments and approval-granting local authorities for the delays and costs they impose. As an example, the average housing project requires 51 different approvals and many of these have to be obtained sequentially, not in parallel. According to an estimate by FICCI, an industry chamber, it can take anywhere between 2.5 and 4 years to get all construction and land permits. Yet, the law simply allows the RERA to *suggest* reform measures to the state Government. Effectively, it places the burden of timely project completion entirely on the developer's shoulders despite the fact that many aspects of the process are beyond his control. The ostensible reason for excluding binding norms on local authorities is firstly, that it would intrude upon the domain of the states (approvals relating to land or its development is a state subject) and secondly, that states have such widely varying norms and processes for land development that it would be logistically challenging to come up with a single model that suits everyone. Possibly the Government feels that the law as it currently stands can incentivise states to clean up their act on their own – since the status of every project would now be publicly available, any delays on account of the approving authorities will be clearly attributed to them as no developer will want to take the rap on their behalf. The combined scrutiny of the RERA and the public will now shift to the authorities as opposed to the developer who currently bears the brunt of public and judicial ill-will for delayed projects.

Secondly, the Act covers all forms of real estate development (an earlier version of the Bill limited itself to residential projects only). This creates the concern of unequal access to regulatory resources between residential and commercial buyers. The former comprises individual households while the latter comprises corporates and institutions with deep pockets and legal resources. Analysts feel that the latter category of buyers will have the organisational muscle to leverage all the protection offered to them under the Act. They may end up consuming a disproportionate share of the regulator's time and resources, leaving little for the retail segment of individual households. Theoretically, such a scenario is possible; however, having foreseen it one can reasonably hope that law makers will take steps to avert it. This would entail adequate resourcing for the RERAs but also the drafting of sensible operating procedures that ensure the fair availability of regulatory attention to all candidates. In any event, the alternative – to exclude commercial property from the ambit of the Bill or to draft a separate law for

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them – would probably be worse. This is why the two Parliamentary committees that examined the Bill categorically recommended its inclusion.

Another objection is the fact that the law allows the setting up more than one RERA in a state. While this may have been done with a view to apportioning resources across districts and to allow customised regulation for each, it is a potential risk as it creates the possibility of varying norms within a state. Whatever the natural variations within a state's real estate market, both producers and consumers should have uniform treatment from a regulatory perspective. This may not happen if multiple RERAs come up with multiple rules (there is no requirement for them to standardise practices and processes) and could end up influencing builders and consumers to favour or avoid certain areas of a state.

Finally, some critics have opined that the law should have covered wider aspects of the industry as well, such as pricing, quality standards, access to funds for the industry at reasonable rates, etc. However, this would amount to micro-regulation (in some cases, duplicate regulation) and would be a sure recipe for disaster. The purpose of regulation should not be to control end outcomes, as that is the market's job. What the regulator must do is to create a deep and well-functioning market, which is what the Indian real estate industry currently lacks. In this regard as in many others, the creators of the Real Estate (Regulation and Development) Act seem to have their heads and hearts in the right place. Now it is up to the states to implement it with the same spirit.

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