PEAK Urban

Unpacking Impact of Real Estate Policies and Regulations on Inclusive Housing Development in India

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India's economy was liberalised in 1991, with regulatory reforms and easing of licence regimes facilitating significant privatisation across sectors. This led to rapid GDP growth, but also increasing inequality (Oxfam, 2021). The real estate sector in particular has been a significant contributor to this dichotomy. While the sector has grown in terms of private-sector participation, global capital flows and GDP metrics (IBEF, 2022), its focus has been both narrow and exclusionary. Geographically, India's metropolitan centres have benefitted more than second- and third-tier cities. Real estate demand from sectors such as information technology, biotechnology and other globally connected sectors of the knowledge economy, across residential and commercial asset classes, have captured a substantial proportion of new investment interest in the real estate sector.

This briefing seeks to inform policy to address the dichotomy emerging in the formal housing sector between investment growth and affordability, within the context of India's post- liberalisation real estate growth. It reviews three key regulatory reforms that have restructured the processes and range of actors operating within the formal housing sector: the deregulation of foreign direct investment, the Real Estate (Regulation and Development) Act (2016) and the Insolvency and Bankruptcy Code (2016). These reforms have a direct impact on the sector's capacity to meet the country's housing need. Drawing on primary research with key stakeholders in real estate financing in India, the briefing shows how these reforms target a narrow range of stakeholders in the housing sector, with deep equity implications for India's urban future.

Key findings and recommendations:

1) Despite deregulation of foreign direct investment into India's real estate sector, many developer-led residential projects are experiencing land and financing constraints, and have delayed or stalled housing delivery.

Norms for foreign direct investment (FDI) into India's post-liberalisation real estate sector have been deregulated through multiple iterations, with progressively lower entry barriers and conditionalities for foreign investors. The rounds of deregulation have been investor-focused (rather than end- user focused) and have attempted to keep pace with investor sentiments. Early rounds of deregulation encouraged foreign investors' to enter India, while later rounds have tried to offset and mitigate low investor interest caused by risky and low investment returns in India, or by the global slowdown in 2008. While overall FDI flows into the real estate sector have increased, interest in the residential sector has slowed, as housing is perceived as being relatively more high- risk and low- return, as compared to commercial, retail and hospitality sector projects. Developer-led formal housing, which has been securing finance from global capital flows, has been active primarily in metropolitan urban centres and in luxury housing segments, which are relatively low- risk. Thus, the deregulation of FDI has not significantly affected the affordable housing market. Moreover, deregulation has created greater benefits for larger private developers and has been instrumental in facilitating the consolidation of land banks by these developers, which has further skewed land availability and land prices in the vicinity of India's metropolitan cities. However, the most important insight is that despite deregulation, a significant proportion of developer-led residential projects in India, tied into foreign investment cycles, are experiencing land and financing constraints, and have delayed or stalled housing delivery.

2) Large developers have fared better than small and medium-sized developers under the new Real Estate (Regulation and Development) Act.

The Real Estate (Regulation and Development) Act, 2016, passed to discipline developers and protect the interests of homebuyers, has played a significant role in improving informational and financial transparency and housing delivery for end- users. However, it, has impacted small and medium-sized developers adversely, while large developers have been better at consolidating their operations under the new regulatory climate.

3) The Insolvency and Bankruptcy Code, 2016 allows homebuyers to be included in project insolvency proceedings, but their influence is constrained by the voting threshold for passing resolutions.

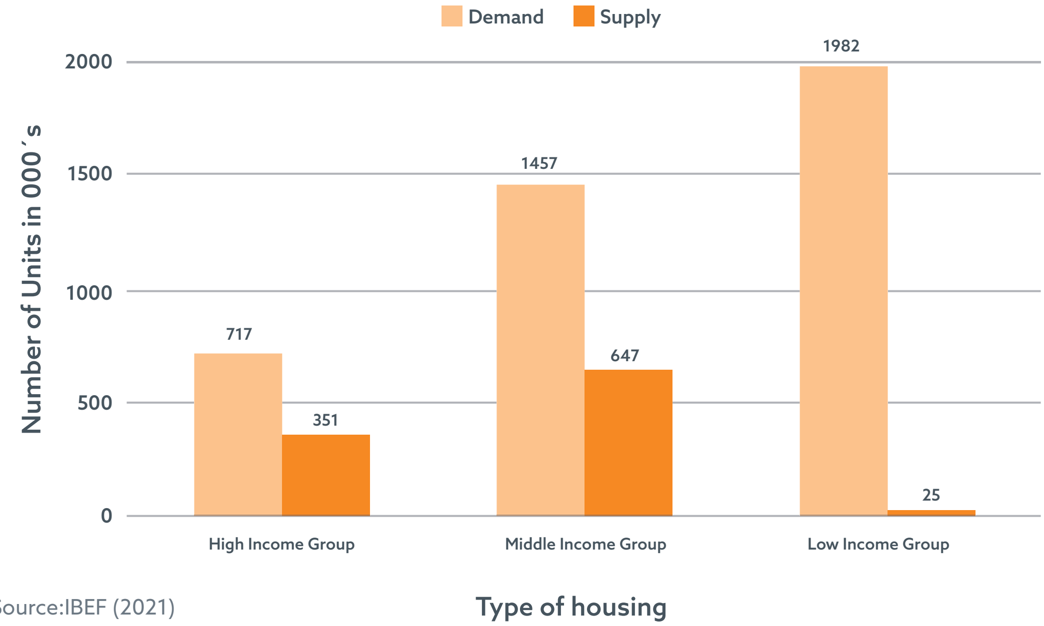
The Insolvency and Bankruptcy Code, 2016 allowed homebuyers' interests to be considered at par with those of project financial investors. The Code has allowed homebuyers to be included in project insolvency proceedings. However, the relative influence of homebuyers in these proceedings is constrained by the stipulation that for a resolution to be accepted or declined, voters representing a 66 per cent share of project value must vote for or against it. As the individual project value share of each homebuyer is small, this means homebuyers must be present en masse and consolidate their voting patterns to effect any changes in resolutions. As such coordination is often difficult to arrange, this stipulation in effect places larger institutional investors in a better position than homebuyers.

Deregulation: foreign investors prioritise luxury housing

From the early 1990s, a series of incremental reforms were put in place to deregulate the flow of foreign investment into the real estate sector. These reforms preceded the Indian government's policy decision to allow 100 per cent FDI, through the automatic route, in 2005. The 2005 FDI policy set high entry barriers in terms of project size and repatriation rules, which restricted entry to the largest investors, both domestic and foreign.[1] Despite this, deregulation led to an increase of 73 per cent in private equity investments between 2005 and 2010 (see Figure 2), with a significant proportion directed at the residential sector.[2] However, on-the-ground project implementation remained a delayed and difficult process, exacerbated by poor communication between domestic developers and foreign investors. Based on interviews conducted by the IIHS team in 2020 with a cross- section of developers and private equity fund managers (investing in the real estate sector) based in India, foreign investors underestimated the time, cost and risk implications of the land question and often invested in large, elite housing projects where land amalgamations were incomplete, delayed or stalled, which also delayed their (investor) project exits. Meanwhile, local developers demanded higher shares of project returns, as they had better operational knowledge about city-level land markets, urban governance, and procedures to secure government permissions and access to infrastructure. They also had the networks and expertise to navigate the socio-political complexities of amalgamating land for large projects. However, foreign investors often did not agree with local developers regarding a higher share of returns, preferring to link investments to quality of construction rather than time and costs of land amalgamation (Searle, 2016; Halbert and Rouanet, 2013). Many local developers used this equity-rich period for extensive land purchases and creating land banks, often diverting funds between projects, which affected the housing sector in particular, and delayed housing delivery and investor exits. Overall, this period played a critical role in restructuring the formal housing sector's focus on the elite end of the market, while developer land banks were consolidated and foreign investors experienced substantive losses.

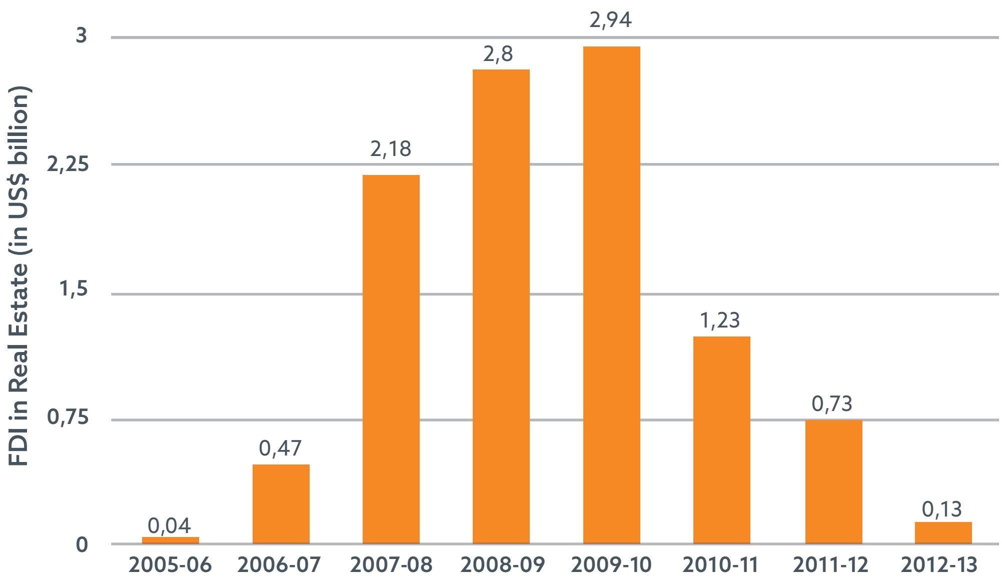
By 2010, low yields on expected returns, combined with the global financial meltdown, led to a sharp decline in investments, from a peak of US$2.94 billion in 2009-2010 to just US$1.23 billion in 2010-2011 (see Figure 2). This trend continued until 2015 (FICCI and EY, 2013). In 2014 and 2015, the government issued Press Note (PN) 12, 2014 series and PN 12, 2015 series, further deregulating FDI inflows into the real estate sector and reducing entry barriers such as minimum area to be developed and minimum capital requirements (DIPP, 2014; DIPP, 2015). Our interviews with fund managers highlighted that the industry responded with internal restructuring, with more professionalised due-diligence services for investors, and a shift from equity investments to collateral-linked, structured debt- based investment instruments, which reduced investor risks. There has also been a trend of investors moving to commercial asset classes – land-efficient and high-yielding – as opposed to residential asset classes – land-intensive and low-yielding (see Table 1) (also see Goldman and Naryanan, 2021). Overall, deregulation of foreign investment flows into real estate from 2014 to 2021 reveals a focus on mitigating investor risks. While this has revitalised overall FDI flows, interest in the residential sector remains low. Inflows have also focused on housing projects in metropolitan centres and those catering mainly to the luxury segment. As such, there remains a significant gap between the effects of FDI deregulation and the goals of equitable and inclusive urban housing, which are the aim of the Indian government's "Housing for All" policy.

Figure 1: Cumulative housing demand and supply in India's eight largest cities, 2016-2020 (in '000 units)



Source:IBEF (2021)

Figure 2: FDI in India's real estate sector (in US$ billion)



Source: FICCI and EY (2013)

Table 1 Investments by Asset Class by Percentage Share

Year	Commercial	Residential	Retail	Others
2015	33	53	7	7
2016	57	22	15	6
2017	49	15	20	16
2018	69	7	7	17
2019 (Jan-Sep)	79	8	7	6

Source: Anarock (2019)

The Real Estate (Regulation and Development) Act: support for homebuyers, but a blow for smaller developers

Between 2005 and 2008, when the first set of FDI investments flowed into the real estate sector in India, there was a lack of robust regulations to safeguard homebuyer interests, and poor industry-level due-diligence practices to safeguard investor interests. These factors allowed developers to move funding between projects, and use it to consolidate land banks, and leverage additional investments, rather than focusing on project completion. This impacted housing delivery and end-users who had paid for the housing. It also delayed investor project exits. Trust in developers' willingness to complete and deliver housing projects was eroded among both end-users and investors. Projects were delayed and FDI in the sector declined. As a corrective measure, the government enacted the Real Estate (Regulation and Development) Act in 2016, the first statutory regulation for the real estate sector. The Act mandates developers to register every construction project with an area of more than 500 square metres or for eight or more apartments with the regulatory authority established in each state (MOHUA, 2016). It addresses major problems in developer practices around ensuring unencumbered and legal land titles, adherence to planning norms, financial management of homebuyers' funds, accountability, and penalties payable to homebuyers in case of project delays. For example, it requires that developers deposit 70 per cent of the accruals from allottees (homebuyers) in a separate account and use these funds solely for that project.

However, these legal provisions to discipline developers in the interest of homebuyers have had some unfavourable consequences for small and medium-sized developers. Data highlights that the overall number of developers operating within the formal space and being tracked through the Act has fallen (CREDAI and JLL, 2018) (see Table 2). Small and medium-scale developers account for the bulk of this attrition (Victor, 2020). This highlights not only that larger developers have been able to adjust their practices to the Act's stipulations more easily, but that such adjustments have put them in a better position to leverage foreign debt and equity investors looking for lower risks and greater transparency. However, the focus of these larger developers is predominantly on luxury housing segments. Thus, an unintended outcome of the Real Estate Act's implementation has been increasing financial pressure on small and medium-sized developers operating in the low-to-mid-range of the housing market.

Table 2: Percentage change in number of developers across major Indian cities

City	2011-12	2017-18	Change (%)
Bengaluru	646	251	-61.1
Mumbai	364	248	-31.9
Kolkata	235	83	-64.7
Guragon	82	19	-76.8
Pan-India	3,538	1,745	-50.7

Source: PropEquity (2018), documented by Sanjiv Aundhe as cited in Goldman and Narayan (2021)

The Insolvency and Bankruptcy Code: inadvertent prioritisation of investors over homebuyers

The Insolvency and Bankruptcy Code (IBC) was enacted in 2016 to address the crisis of distressed assets – those their owner is forced to sell to remain solvent – in a timebound manner.[3] The real estate sector is the second-most significant category among all insolvency petitions filed in India (Tripathi, 2021).

Prior to the IBC, only institutional creditors were part of the insolvency process. Under the IBC, for the real estate sector, homebuyers are now acknowledged as financial creditors (Mishra, 2018). This is significant, as it includes homebuyers in the insolvency resolution process (Mishra, 2018), giving them and their interest in the physical delivery of housing some relevance during insolvency proceedings, in which investor objectives may be skewed towards recouping financial losses – for example, through liquidation of assets.

However, for any resolution to be passed, the Act requires 66 per cent of financial creditors (by value) to vote for it. As each homebuyer individually holds a very small share of a project's overall financial value, homebuyers can play a significant role during voting only if they combine their votes. This means homebuyers have to show up en masse, with a unified voting strategy, to have any significant agency – which is often difficult to orchestrate in practice.

In addition, new actors such as Asset Reconstruction Companies[4] (ARCs) have gained prominence, and existing modes of investment instruments, such as structured debt, are shielding investors from risks. Such instruments limit investors' financial exposure to projects via debt instruments, rather than equity, structured into financing cycles of 1-3 years, rather than the full project lifecycle. They also focus investments on projects with clear land titles and in the construction phase. These factors mean the IBC, in its current form, is not sufficient to tilt the balance of power between institutional investors and individual homebuyers. A recent committee report appointed by the Reserve Bank of India for the revival of ARCs highlights this: "... if 66 per cent of the lenders (by value) agree to sell an asset to ARCs, 'the same may be binding on the remaining lenders and it must be implemented within 60 days of approval by majority lenders'" (Roy, 2021).

Conclusion

Over the past two decades, regulatory reforms in India's real estate sector have addressed many malpractices, regulatory gaps and investor risk perceptions that have become apparent, since the sector was opened up to global capital flows. Despite the progress that has been made, the scope and jurisdictional ambit of real estate regulatory reform is yet to catch up to the range of activities and the range of actors in India, which is comprised of a range of large to small developers, across the formal and informal housing supply spectrum. Meanwhile, larger developers and institutional investors have been able to navigate the changes in the regulatory terrain better than small and mid-sized developers and homebuyers. The limited ambit of new regulations, continuing malpractices in the sector, as well as limited investments and limited regulatory support for small and medium sized developers, who produce more affordable housing, means that regulatory reforms have not been able to develop capacities in the formal housing sector to deliver affordable housing and fulfil long- term objectives of inclusive urban futures in India.

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1. The conditionalities include a three-year lock-in period with the minimum size of development as 10 acres for housing and 50,000 square metres for other built development in other sectors (Halbert and Rouanet, 2013).

2. Between 2005 and 2010, 50 per cent of the total private equity funds in the urban real estate sector were directed towards the residential segment, with mixed use (housing plus retail and office use) receiving 26 per cent (Goldman and Narayana, 2021).

3. Resolution should be completed within 180 days and is extendable up to 270 days. Under the previous regulations, it took an average of 4.3 years – significantly longer than other countries (Gayam, 2016).

4. ARCs are specially licensed entities that buy non-performing assets from banks and financial institutions (Langhorne & McMyn , 2018).

About us

The PEAK Urban programme aims to aid decision-making on urban futures by:

1. Generating new research grounded in the logic of urban complexity;

2. Fostering the next generation of leaders that draw on different perspectives and backgrounds to address the greatest urban challenges of the 21st century;

3. Growing the capacity of cities to understand and plan their own futures.

In PEAK Urban, cities are recognised as complex, evolving systems that are characterised by their propensity for innovation and change. Big data and mathematical models will be combined with insights from the social sciences and humanities to analyse three key arenas of metropolitan intervention: city morphologies (built forms and infrastructures) and resilience; city flux (mobility and dynamics) and technological change; as well as health and wellbeing.

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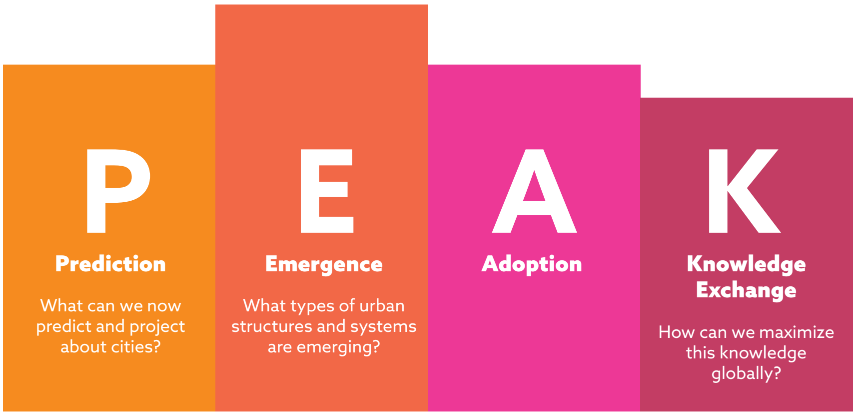
Our framework



The PEAK Urban programme uses a framework with four inter-related components to guide its work.

First, the sciences of **Prediction** are employed to understand how cities evolve using data from often unconventional sources.

Second, **Emergence** captures the essence of the outcome from the confluence of dynamics, peoples, interests and tools that characterise cities, which lead to change.

Third, **Adoption** signals to the choices made by states, citizens and companies, given the specificities of their places, their resources and the interplay of urban dynamics, resulting in changing local power and influencing dynamics.

Finally, the **Knowledge** component accounts for the way in which knowledge is exchanged or shared and how it shapes the future of the city.

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