Real Estate Intermediaries: A Missed Opportunity in the Recent ECB Framework?

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Recently, the Reserve Bank of India ("**RBI**"), through the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, consolidated all the erstwhile foreign exchange regulations governing the borrowing and lending in foreign currency or Indian rupees between persons resident in India and outside. In an attempt to enable the ease of doing business for corporate India, these revised regulations have significantly eased norms for accessing overseas funds. Illustratively, the scope of the 'eligible borrowers' has been expanded to include all entities eligible to receive foreign direct investment ("**FDI**"). The previous external commercial borrowing ("**ECB**") framework was burdened with the cumbersome division of sectors into tracks, which had to be analysed to determine if ECB funding was permitted, and to what extent. The revised regulation does away with the sectoral limits on ECB and, therefore all eligible investors may now raise ECB up to 750 million dollars in a financial year.

However, the RBI, in its process of revising the erstwhile regulations, has missed the opportunity to carry out certain obvious changes which would have benefited the real estate sector. A major change that may have been overlooked is that real estate activities fall under the negative list as set out in the ECB Framework, that is, the amounts borrowed cannot be used for real estate activities. The definition of real estate activities under the ECB Framework reads:

'*Any real estate activity involving own or leased property for buying, selling and renting of commercial and residential properties or land **and also includes activities either on a fee or contract basis assigning real estate agents for intermediating in buying, selling, letting or managing real estate**. However, this would not include* *construction/development of industrial parks/integrated township/SEZ, purchase/long term leasing of industrial land as part of new project/modernisation of expansion of existing units or any activity under 'infrastructure sector' definition'.*

(emphasis supplied)

From the above, it is clear that real estate brokers are not still not permitted to raise ECBs. The policy rationale for not liberalising ECBs for real estate broking is not clear, since this sector is already eligible to receive FDI, and therefore qualifies as an eligible borrower under the ECB framework. By way of background, FDI was earlier not permitted in '*real estate business*', including the broking business; however, the FDI norms were amended in March 2018 to permit FDI in real estate broking business.

Another issue being faced by real estate broking companies is that, due to a rise in the number of loan defaults and non-performing assets, banks have progressively become more unwilling when it comes to lending to the real estate sector. According to newspaper reports, bank lending to this sector has come down from 68% in 2013 to 10% in 2017. Non-banking finance companies ("**NBFCs**") had stepped in to provide funding at higher rates of interest (18-21 % interest as opposed to the 11-13 % interest charged by banks). However, after recent defaults by certain major institutional NBFCs, other NBFCs have become even more unwilling to lend in general, and interest rates for the real estate sector have gone up by a further 150 basis points.

With the present scenario of lack of borrowing options from financial institutions in India and the inability of real estate broking companies to raise ECBs, real estate broking companies are seeking to ascertain legally compliant structures to raise funds for expansion of their business, as the omission of the Government to liberalise the ECB regulations has put a serious dent in the growth prospects of such companies.

For instance, a foreign real estate broker, or a company acting as an intermediary for facilitating real estate transactions is permitted to set up a wholly owned subsidiary in India. However, this subsidiary cannot borrow funds from its holding company, and is forced to raise funds from its holding company only by way of equity or quasi-equity instruments, which have their limitations, including taxation issues. This would result in an unintended embargo on the availability of liquidity for such companies, amplifying the current liquidity crunch.

The revised ECB regulations have therefore stunted the expansion plans of real estate broking companies, instead of accelerating it. The question remains whether this was a deliberate omission or an oversight by the regulator.