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Open house in India

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India on Thursday liberalized rules for foreign investment in the real estate sector by deciding to allow 100% foreign direct investment (FDI) in construction. "The cabinet cleared the proposal for 100% FDI on the automatic approval route in the construction development sector," India's Commerce and Industry Minister Kamal Nath announced after a cabinet meeting. Till now, overseas firms were allowed in only after clearance from the highly bureaucratic Foreign Investment Promotion Board (FIPB).

"Foreign investors can enter any construction development area, be it to build resorts, townships or commercial premises, but they will have to construct at least 50,000 square meters within a specific time-frame," said Nath, without specifying the timeframe. "This will ensure they do not hold onto land for speculative purposes."

Nath said higher foreign investment in the real estate and construction sectors would boost employment and generate "positive spin-offs" for India's labor-intensive cement, steel and brick industries.

So far, only non-resident Indians (NRIs) and persons of Indian origin (PIOs) were permitted to invest in the housing and real estate sectors. Foreign investors other than NRIs were allowed only in development of integrated townships and settlements either through a wholly-owned subsidiary or through a joint venture company in India along with a local Indian partner.

Conditions for foreign entities to come into the sector were very restrictive. They were not allowed to make any equity investments in the sector and the area of their involvement was limited to providing engineering, architectural and designing services. The minimum area they were required to develop was 100 acres (40 hectares), a minimum of 2,000 houses or for at least 10,000 people. Foreign companies were allowed to invest upfront US$10 million for wholly-owned subsidiaries and $5 million for joint ventures, but with a lock-in period of three years. The land area criterion meant that foreign developers could only work on plots away from cities as major cities in India don't have that kind of empty space.

These restrictive norms resulted in just a handful of foreign players, including a consortium of High Point Rendel of the UK, US-based Edaw Ltd, Kikken Sekkel of Tokyo, Canada-based Royal Indian Raj International Corporation, Dubai-based Emaar Group, Lee Kim Tah Holdings and CESMA International (a subsidiary of the Singapore government's housing agency). In fact, the FIPB has received just three development proposals in the past four years, thanks to the restrictive rules.

Various international players and trading partners, like Singapore, have long been lobbying with the Indian government to do away with the acreage requirement. Singapore, as part of the negotiations for the Comprehensive Economic Cooperation Agreement, had proposed that it be reduced to 20-30 acres to enable companies to set up multi-storied residential complexes in cities like Hyderabad and Bangalore, but the government didn't relent.

However, it began to rethink its options seriously after the recent World Economic Forum meeting in Davos, where foreign participants made a strong case for freeing up the sector, which, they said, would attract huge FDI into India. While China attracts about 3.2% of its gross domestic product as FDI in its real estate sector, India draws a measly 1.1%.

According to the new norms, the existing 100-acre stipulation has been reduced to 25. Foreign investment will be allowed in office accommodation, too. Earlier, FDI was permitted in commercial construction, but only as part of a township project. In the new dispensation, a foreign investor can even construct stand-alone facilities. The minimum capital requirement for foreign firms wanting to set up wholly-owned subsidiaries in the construction sector has been fixed at $10 million, and $5 million for joint ventures. The funds will have to be brought in within six months of commencement of business and foreign firms will not be allowed to repatriate their original earnings before three years unless an early exit is cleared by the FIPB.

The policy also defines "undeveloped plots" which cannot be sold by a foreign investor. Undeveloped plots will mean areas where roads, water supply, street lighting, drainage, sewage and other facilities have not been made available. The investor will have to provide this infrastructure and obtain a completion certificate from the local body before it can dispose of the plots. This has been done to avoid speculation in real estate. Foreign ventures in development from now on will thus be approved by state governments and municipal bodies, not the central administration. FDI projects will be accorded national treatment on par with local developers, Nath said, adding this sector will not displace or replace the local investor, but help it grow. The government is expected to come out shortly with norms that will make FDI in the sector more construction-centric rather than land-centric.

The 100% FDI under the automatic route, apart from speeding up investment in the vital infrastructure sector, is likely to have a multiplier effect on the economy by boosting construction activities of all types. This will result in employment creation and lead to spin-off benefits for the manufacturing sector. The National Real Estate Development Council has welcomed the relaxation of the FDI norms, saying this will speed up the growth process in the sector. "This is a good decision," executive director R R Singh was quoted by media reports as saying, adding the earlier norm of 100 acres was a constraint in attracting FDI.

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