Real Estate (Regulation and Development) Bill

Driving change and accountability

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The time is near

The much awaited Real Estate (Regulation and Development) Bill, which has been envisaged as a landmark reform for the real estate sector, may finally arrive. The Bill was recently passed by both the Rajya Sabha and the Lok Sabha recently, and is awaiting the assent of the President, before it becomes a law.[1]

The Bill is expected to modify traditional practices and bring out a more professional approach amongst developers. With a focus on improving the transparency, governance and accountability in the sector, the law is expected to segregate the quality and time-focussed developers from casual operators.

The government appears to be working towards its promise to deliver its vision of 'Housing for All' by 2022[2] and propel growth in the realty sector. The Bill is the latest addition in the series of reforms introduced in the last couple of years, including the relaxation of Foreign Direct Investment (FDI) norms, introduction of 100 smart cities, direct and indirect tax benefits for affordable housing projects, Real Estate Investment Trusts (REITs), etc. to name a few, in addition to other reforms by several state governments.

The Bill requires every state to draft its respective laws within one year from the date, when Bill becomes the law. The proposed regulator, to be set up in each state, is expected to address one of the key concerns of the property buyer – timely delivery. As per the Ministry of Finance's Economic Survey 2015-16, about 25 per cent of the residential real estate projects are delayed due to poor project management, lack of capital and commitment by developers, and delay in seeking regulatory approvals. In our view, the Bill is expected to support organised and large developers in the long run, as we expect limited competition from part-time developers who do not comprehend real estate development in depth, and are unable to evolve. Developers may now need to upgrade their project development skills, especially in the area of project planning, project management, risk management, engineering and design, etc., to deliver qualitatively on time.

As a next step, the government must complement this landmark development by addressing various supply side issues, especially the approval mechanism. At present, a developer may have to deal with over 40 regulatory bodies, across the real estate development life cycle, to deliver a project. The approval mechanism must be streamlined and priority must be given to graduating towards a single window clearance. We hope that the scope of the proposed regulator gradually expands to govern various approving agencies and helps in achieving sustainable growth in the realty sector.

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1. Real Estate Bill Cleared By Both Houses Of Parliament, NDTV Website, 15 March 2016
2. "Housing for All by 2022" Mission – National Mission for urban housing, Government of India website, 17 June 2015

Prevailing concerns

It is now the state governments that must draft a strong law which has no room for ambiguity or interpretation. The successful enactment of regulations is likely to strengthen the confidence buyers, investors, funding agencies and anyone related to the property sector have in the real estate sector. In the long run, it may help revive weak sales and the gradual decrease in funding costs for developers. For this initiative to be a success, the states must also draft finer regulations, carefully. For instance, a provision in the Bill requires a builder to obtain the consent of two-thirds of the allottees for any modification of building plans, which could become a point of contention. The finer details of the law enacted by the states could make way for genuine changes in project design. Some key concerns which may hold up the successful implementation of the law are as follows:

Top 5 concerns

- With many projects in the advanced stages of construction, or in the process of a handover, further clarity is needed on the applicability of the key conditions of the Bill on existing projects. For instance, guidance on establishing escrow accounts for projects, etc.
- Clear guidelines are required on whether projects recently approved, but not formally launched, would be governed by the Bill or not.
- The financial penalty for any contravention of the provisions of the law is 5 to 10 per cent of the estimated project cost/building cost. Thus, clarity on the definition of the project cost/building cost could help avoid ambiguity at a later stage.
- No inclusion of any guidelines regarding the operation and maintenance phase of the project until handover of same to Residents Welfare Association (RWA). The cost and services component of this phase of the project are included in customer agreements, and the level/extent of the service provided has often been a key area of concern for customers and developers alike.
- There is still a need for a clear definition of the term ‘structural defects’ to avoid any ambiguity or misinterpretation in the future.

Hits and misses of the Real Estate Bill

The Real Estate (Regulations and Development) Bill seeks to balance out the interest of all the stakeholders. In its initial form, the various potential hits and misses for two major stakeholders, consumers and developers, are listed below.

For consumers

Hits

- Increased assertion on the timely completion of projects and delivery to the consumer.
- A step towards safeguarding their investment, as 70 per cent of the sales receipt will now be locked in an escrow account.
- An increase in the quality of construction due to a defect liability period of five years.
- Balanced builder-buyer agreements.
- Faster dispute resolution mechanism through dispute settlement forums and appellate tribunal.
- Sale on the carpet area to help improve transparency.
- An increasingly-regulated broker environment.
- Greater visibility into the developer’s delivery track record.

Misses

- The timelines of approvals by regulatory authorities have not been defined. Any delay in approvals from regulatory authorities could impact buyers as well.
- The Bill may lead to slightly higher prices of properties due to the reduced competition.
- New project launches might be limited as developers may not be able to launch without obtaining approvals, which could take two to three years.

For developers

Hits

- Increased scope for eliminating casual operators, leading to the better organisation of the sector.
- Minimum standards of governance and accountability have now been set to an extent, and there’s potential for driving standardisation and professionalism in the sector.
- Greater visibility into the developers’ delivery performances, segregating the established and casual operators.
- Higher investment in the sector and a possible reduction in the cost of funds, leading to a lowered cost for the end users.

Misses

- An additional layer of approvals may be introduced against the extended list of approvals already required for projects.
- No provision to rationalise the number of approvals required for a project or expedite approvals through a single window mechanism.
- Increased reliance on external capital to achieve high growth.
- Possible impact on joint venture arrangements.
- Potential delay in cash-flow realisations from projects.

Top priorities for developers

One of the burning issues real estate developers now face is the need to mitigate new risks that have strong implications for them. In our view, the priorities for developers should include the following:

1

Land acquisition and approvals

Developers must secure equity partners to help secure land and approvals. The existing practice of soft-launch may end due to the restriction on the launch of projects before a builder obtains an approval.

2

Design development

Developers must also prioritise design development and the finalisation of residential and other facilities for ongoing and proposed projects, since it may be difficult to undertake any design-related changes at a later date, as per the Bill.

3

Marketing

Reorganising the sales and marketing function and focusing on employee trainings is also imperative. Developers must strengthen review mechanisms to ensure project collaterals are designed carefully and that they do not contain untenable promises, and are in compliance with the terms of the proposed law.

4

Cash flow planning

Accurate cash flow planning and monitoring needs to be undertaken, considering that 70 per cent of the collections from customers may be locked in an escrow account and governed for the construction of the projects.

5

Project delivery capabilities

Strengthen delivery and management capabilities around design, budgeting, execution, monitoring, and handover and operations, to stay within budget limitations and encourage timely deliveries, apart from avoiding heavy penalties. Use of scientific methods of estimation, planning, monitoring through mechanisms of project audits, cost risk management, project risk reviews, budget and cost audits, and other mature concepts of Project Management Offices (PMO) could lead to successful project delivery. .

6

Customer relationship management

Implement practices, strategies and techniques to better manage customer interactions through the project lifecycle, with a goal to improve business relationship with customers and driving higher sales.

With almost 7 lakh units of unsold inventory across the major cities in India[3], new launches are limited and most developers are concentrating on completing existing projects. Thus, the Bill may not significantly impact the supply-demand equation in the short-term. It may, however, be appropriate for developers to utilise this period for organisational transformation.

3. Over 7 Lakh homes unsold in top 8 cities: Knight Frank, Economic Times website, 28 July 2015

Glossary

- **Project risk reviews –** periodic reviews targeted towards the proactive identification of uncertain events or conditions around key areas of time, cost, quality compliance, etc., assessment of their impact on the success of the project, and identification of possible mitigation measures for under construction projects.
- **Cost risk management –** identification of uncertain events or conditions, impacting the cost of a project and possible mitigation measures.
- **Budget and cost audits –** periodic audits undertaken at strategic intervals during the project life cycle (design, execution, close out, etc.) to measure the performance of the project (budget over or underruns) against the established budget.
- **Project Management Office (PMO) –** a function within an organisation responsible for defining and maintaining the standards of project management, including the implementation of consistent project management practices, monitoring and reporting performance indicators of projects around time, cost, quality, etc.
- **Customer Relationship Management (CRM) –** practices, strategies and technologies used by organisations to manage and analyse customer interactions and data throughout the customer lifecycle, with the goal of improving business relationships with customers, assisting in customer retention and driving sales growth.

Thank You

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