



January 2009

REAL ESTATE UPDATE

Real Estate Investment in India

As one of the world's fastest growing economies, India possesses great potential for commercial real estate investors and developers. Changes in the rules governing foreign direct investment (FDI) in real estate have made the Indian market more favorable to foreign investors; however, many pitfalls remain. In order to fully realize the benefit of these rules and regulations, it is critical to understand the tax and regulatory framework and how to properly structure a foreign investment in Indian real estate. This briefing identifies and explores some of the key issues concerning real estate investment and development in India today.

INDIA'S REAL PROPERTY FRAMEWORK

The Indian real property system differs from that of many other developed countries in several important respects, including the fact that a guaranteed land title system has yet to be developed and owners of vacant land must either develop the land or risk confiscation of the land by the government.

Current land ownership records in India provide only presumptive title because most transfers of real property have not been recorded with the state. As a result, it has been reported that ownership of nearly 90 percent of land in India could be subject to conflicting ownership claims. Although the federal government is working to improve India's land title system by establishing a certification authority to register land titles and encouraging state governments to implement and maintain their own updated land title databases, no state has taken the lead in implementing necessary reforms.

In addition to the presumptive title system, many states are still operating under the Urban Land Ceiling Regulation Act (ULCRA), which the federal government enacted in 1976 to prevent the hoarding of real property. The ULCRA requires that owners of vacant land beyond a certain size (the standard varies by state but ranges from 500 to 2,000 square meters) register the land with the state government. Once registered, the government can restrict any transfer, change in use and development of the land, as well as take possession of the land if certain criteria are met. Although the federal government repealed the ULCRA in 1999, the law remains in effect in some states, such as Andhra Pradesh, Assam, Bihar, Maharashtra, Orissa and West Bengal.

Because land regulation falls under the control of state government, regulations affecting development can vary greatly by location. In addition to the ULCRA, some states continue to enforce rent control provisions, as well as stamp duties as high as 10 to 12 percent.



FOREIGN DIRECT INVESTMENT IN REAL ESTATE

As the Indian economy continues to grow at a rapid pace—8 to 9 percent each year for the past three years—regulators have struggled to maintain a balance between attracting foreign investment and controlling speculation. Historically, FDI in real estate has been tightly controlled and limited to highly regulated development of integrated townships, technology and industrial parks, and special economic zones (SEZs).

With the issuance of Press Note 2/2005 in March 2005, the federal government substantially relaxed restrictions on FDI in real estate. While foreign investors are still prohibited from acquiring real property directly, their ability to invest through a joint venture or wholly owned subsidiary has expanded significantly.

Press Note 2/2005 authorized FDI to comprise 100 percent of the financing for housing, built-up infrastructure, township (mixed-use development that includes residential plots, townhouses and villas along with retail, office and recreational areas) and construction-development projects, including residential buildings, offices, resorts and city and regional infrastructure under the automatic route. When investing under the automatic route, foreign investors are not required to seek any prior approval from the government or the Royal Bank of India before investing, so long as the development meets certain size, timeframe and capitalization requirements. Although Press Note 2/2005 significantly broadens FDI in real estate, it still prohibits foreign investors from directly investing in fully developed existing properties under a pure rental model.

In order to take advantage of the new, more lenient standards found in Press Note 2/2005, investors must meet several requirements, a number of which are imposed on foreign investors and relate to the size of the project. Housing projects are required to consist of at least 25 acres and construction-development projects are required to result in at least 50,000 square feet of new building space. Other requirements affect planning as to the timing of the project and exit strategies. Once a project obtains all statutory clearances, such as state and local approvals regarding construction, water and environmental issues, developers are required to complete 50 percent of the project within five years of obtaining such statutory clearances, and companies investing in housing projects are prohibited from selling “undeveloped plots,” which are plots that lack access to roads, water, sewers, lighting, drainage and other conveniences. Press Note 2/2005 also established minimum capitalization and duration requirements for the projects of foreign investors. Joint ventures with Indian partners require a minimum capitalization of US\$5 million, while projects undertaken by wholly owned subsidiaries of a foreign investor require a minimum capitalization of US\$10 million. Once a project achieves minimum capitalization, investors may not repatriate their investment for a period of three years, unless repatriation is approved by the Foreign Investment Promotion Board. In addition to the requirements set out in Press Note 2/2005, projects must also comply with any additional state and local regulations.

Press Note 2/2006 clarified that the requirements set out in Press Note 2/2005 are inapplicable to SEZs (governed by the SEZ Act of 2005) and the establishment and operation of hotels (governed



by Press Note 4/2001) and hospitals (governed by Press Note 2/2000), which were all eligible for FDI under the automatic route prior to the issuance of Press Note 2/2005. Press Note 3/2008 established that FDI up to 100 percent under the automatic route would be allowed with respect to industrial parks without being subject to the conditions set forth in Press Note 2/2005, provided that certain conditions established therein are satisfied.

Indirect investment in completed Indian real property projects can be achieved through real estate mutual funds (REMFs), which were authorized by the Securities and Exchange Board of India through an amendment of the rules governing mutual funds in April 2008. REMFs function in a manner similar to real estate investment trusts in other national regimes, but the subtleties of the tax treatment of REMFs is an evolving story. Although the turmoil in global equity markets has affected the near-term prospects for REMFs, they will ultimately provide a necessary source of capital for smaller projects and create a pipeline for the provision of additional liquidity into the Indian real property system.

THE SHAPE OF THINGS TO COME

India is one of the fastest-growing economies in the world, and Goldman Sachs' BRIC Report predicts that India will be the third largest economy in the world by 2032. Although India has experienced unprecedented growth over the past five years, the global financial crisis has softened growth estimates for the 2009-2010 fiscal year by as much as 1.5 percent of the previously projected increase in GDP. In the context of the current liquidity crisis in equity and credit markets, the Indian government continues to remove barriers to FDI, and foreign investors can expect continued growth opportunities in the Indian real estate market. Although investors and developers currently must wade through diverse and archaic local and regional regulations, the federal government is working to create a uniform and straightforward process for FDI in real estate and other markets, which will better position foreign investors and companies to profit from India's economic growth.

Of course, the recent terrorist attacks on the Taj Mahal and Trident-Oberoi Hotels may, in the near term, dampen foreign investor confidence for inbound real estate investment in urban markets such as Mumbai. The ultimate impact of these attacks on foreign real estate investment in the Indian economy will, however, depend upon the Indian government's reaction to the terrorism threat, and the extent to which it will take steps to safeguard foreign investment. Notwithstanding the near-term challenges, India has bounced back from earlier attacks, and it is likely to do so again this time, since the prospects for long-term growth in the Indian economy will continue to lure global investors.

FOR MORE INFORMATION

If you would like to know more about our Real Estate practices, including contact information for our lawyers, please visit www.ThompsonHine.com or www.Burges-Salmon.com.



ABOUT THOMPSON HINE LLP

Established in 1911, Thompson Hine is a business law firm dedicated to providing superior client service. For the last several years, the firm has been named one of the Best Corporate Law Firms in America (in an annual survey of corporate directors conducted by *Corporate Board Member* magazine). With more than 400 lawyers, Thompson Hine serves premier businesses worldwide. The firm has offices in Atlanta, Brussels, Cincinnati, Cleveland, Columbus, Dayton, New York and Washington, D.C. For more information about our international real estate practice, please contact Thomas.Coyne@ThompsonHine.com or Mario.Suarez@ThompsonHine.com.

ABOUT BURGESS SALMON LLP

Burges Salmon LLP is consistently ranked amongst the UK's most successful commercial law firms. The firm's national and international client base ranges from private individuals to government departments and FTSE 100 companies including Wolseley, The Crown Estate, BAE Systems, Bank of Scotland, The Ministry of Defence and FirstGroup. With 72 partners and a total of more than 650 employees based at a single site, the firm offers a cohesive, communicative environment which results in strong working relationships right across the firm and an enhanced service for its clients. The firm is widely recognised for the quality of its expertise in a range of areas, including property, corporate, commercial, litigation and tax and trusts. If you would like more information about the international real estate practice please contact Beatrice.Puoti-Ffiske@Burges-Salmon.com or Richard.Read@Burges-Salmon.com.

THE RELATIONSHIP

The relationship with Burges Salmon is a cornerstone of Thompson Hine's international strategy: a network of close working relationships with independent law firms in key jurisdictions providing real value for clients with international needs through high-quality legal advice and fair pricing. This key US-UK relationship sets the standard by which we judge all of our international law firm relationships.

FUTURE INTERNATIONAL REAL ESTATE TOPICS

- Brazil
- Cuba
- Italy
- Mexico
- Montenegro
- Offshore Tax Havens
- United Arab Emirates
- United Kingdom
- Uruguay



PAST INTERNATIONAL REAL ESTATE TOPICS

- China (<http://www.ThompsonHine.com/publications/pdf/2008/09/realestateupdate1533.pdf>)
- Russia (<http://www.ThompsonHine.com/publications/pdf/2008/11/realestateupdate1606.pdf>)

If you do not wish to receive future communications by e-mail, please send e-mail with the word “unsubscribe” as the subject line to Georgene.Davison@ThompsonHine.com.

This advisory may be reproduced, in whole or in part, with the prior permission of Thompson Hine LLP and Burges Salmon LLP and acknowledgement of its source and copyright. This publication is intended to inform clients about legal matters of current interest. It is not intended as legal advice. Readers should not act upon the information contained in it without professional counsel.

This document may be considered attorney advertising in some jurisdictions. Some of the design images and photographs in this document may be of actors depicting fictional scenes.

© 2009 THOMPSON HINE LLP AND BURGESS SALMON LLP. ALL RIGHTS RESERVED.