

GETTING THE DEAL THROUGH

Real Estate

in 30 jurisdictions worldwide

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ACQUISITION OF REAL ESTATE

Legal system

1 How would you explain your jurisdiction's legal system to an investor?

India has a civil procedure code, 1908 and follows the doctrine of common law system. The substantive law however is the Transfer of Property Act 1882.

Under Indian law, a party who is vested with some manner of right over a property may move a civil court and obtain injunction restraining others from infringing such right.

The Indian courts do rule in equity if three conditions for an injunction order on equity are satisfied: a prima facie case; balance of convenience; and irreparable hardship and loss.

Both oral and documentary evidence are admissible but documentary evidence will prevail over oral evidence in case of inconsistencies between the two. The Evidence Act, 1872 deals with what forms of evidence are admissible before courts of law.

Section 10 of the Contract Act also deals with oral contracts and their enforceability. An oral contract is valid and enforceable but it is a question of construction whether a further written contract is a condition or terms of the bargain or whether is a mere expression of the desire of the parties to the manner in which the transaction already agreed to will in fact go through.

Contracts can be oral or written. However, contracts must be written in the case of: sale of immovable property; bill of exchange or promissory note; trust; and any contract without consideration on account of natural love and affection. Except for the above, oral contracts are accepted and enforceable. But it is always preferable to put a contract in writing.

Recording conveyance documents

2 What are the legal requirements for recording conveyance documents?

An immovable property is normally conveyed through a contract referred to as 'sale deed'. For a conveyance to be recorded, the sale deed must be presented for registration before the office of the sub-registrar of the concerned locality. The parties to the document must be present (in person or through their registered power of attorney) with photographs and proof of identity and address.

For registration to be valid, a percentage of the value of the land conveyed is paid as stamp duty and a further percentage paid towards registration charges. The figure varies slightly from state to state but the total usually works out close to 9 per cent. The stamp duty and registration charges are customarily borne by the purchaser.

Foreign investors

3 What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Foreign investment in India is governed by the Foreign Exchange Management Act 1999. Foreign direct investment in real estate is governed by the Reserve Bank of India (RBI), which issues notifications from time to time. Depending on the nationality of the investor, different notifications apply. For instance, foreign nationals of Indian origin (a person of Indian origin (PIO), who is not a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal or Bhutan) and non-resident Indians (NRIs) are free to invest directly through the automatic route which means prior approval is not necessary from the Foreign Investment Promotion Board and other authorities. However, foreigners not resident in India cannot invest into real estate. This condition is relaxed if foreigners are resident in India and subject to approvals, immovable properties may be purchased in India. There is an absolute bar on acquisition of agricultural land by non-Indians. It is however possible for NRIs or foreigners to incorporate companies in India and since such companies are distinct legal entities, properties can be purchased by such companies.

There is no reporting necessary for purchase of residential or commercial property by an NRI or PIO. An institutional investor is required to furnish returns of the investment with the RBI. In the case of lease of immovable property, no prior permission from RBI or reporting is required, provided the period of lease does not exceed five years.

Exchange control

4 If a non-resident invests in a property in your jurisdiction, are there exchange control issues? What about return of capital?

An NRI or PIO may repatriate the sale proceeds of immovable property in India, if the property was acquired out of foreign exchange sources, ie, remitted through normal banking channels or by debit to an NRE/FCNR account.

The amount to be repatriated should not exceed the amount paid for the property: in foreign exchange received through normal banking channel; or by debit to an NRE account (foreign currency equivalent, as on the date of payment) or debit to an FCNR account. Repatriation of sale proceeds of residential property purchased by an NRI or PIO out of foreign exchange is restricted to not more than two such properties.

Capital gains, if any, may be credited to the NRO account from where the NRI or PIO may repatriate an amount up to US\$1 million per financial year, as discussed below.

If the property was acquired out of rupee sources, the NRI or PIO may remit an amount up to US\$1 million per financial year, out of the balances held in the NRO account (inclusive of sale proceeds of assets acquired by way of inheritance or settlement), for all the bona fide purposes to the satisfaction of the 'authorised dealer' bank and subject to tax compliance.

Legal liability

- 5** What types of liability does an owner of real estate face? Is there a standard of strict liability and can there be liability to subsequent owners? What about tort liability?

Any liability that flows with the land will automatically be transferred to a subsequent purchaser of the property. The various liabilities a real estate owner is likely to face include: acquisition of property by government for public purposes; defective title; *pendente lite* sale; tax liabilities; and any fine or penalties payable towards the Land Acquisition Act or Urban Land Ceiling Act.

A defective title illegally conveyed would entitle the purchaser only to recover the sale consideration along with applicable interest and damages. The purchaser cannot perfect his title by stating that he is a bona fide purchaser for consideration without notice of the defect in title. In such a case, the vendee who is deprived of title and possession as a result of the vendor's defective title should establish that he was unaware of the defect in the title of the vendor in the first place and that he with ordinary ease could not discover such defect. A defective title conveys no title to subsequent owners.

In India several environmental laws are in place and certain projects require clearance from the Pollution Control Board and the Ministry of Environment. Care should also be taken to see that the property is in a zone where the planned development can be carried out. In certain coastal zones commercial construction is prohibited. There is also a bar on sale of forest land.

Tortious liability is recognised in India. Though there is no codified law of torts, common law principles are followed in fixing tortious liability. A third party injured by the landlord's failure to take due care can file a suit for damages under tort.

Protection against liability

- 6** How can an owner protect itself from liability and what types of insurance can they obtain?

Legal liability under the law of tort can arise under several circumstances in any premises such as: collapse of building structure; accidental falling of fixtures; bad maintenance or poor housekeeping resulting in accident to visitors on the premises; accidental leakage of toxic substance that pollutes the atmosphere and injures or kills people; and fire, flood or any other natural disaster.

There are government insurance companies as well as private insurance companies operating in India and insurance policies can be taken for a liability arising out of any of the above-mentioned cases. The owner of the property can take insurance for damage caused by natural disasters, arson or accidents. Depending on the location of the property and the use to which it is put, the insurance requirements may vary. The Public Liability Insurance Act 1991 mandates that business owners operating hazardous substances take out insurance policies covering potential liability from an accident and establish environmental relief funds to deal with accidents involving hazardous substances.

Site-specific environmental insurance policies are available that allow the insured to design a programme suitable for the

insurable risks of a facility. The policy covers site-specific environmental coverages and includes on- and off-site coverages for property damage, bodily injury and clean-up costs triggered by pollution conditions.

Choice of law

- 7** How is the governing law of a transaction involving properties in two jurisdictions, one outside of your jurisdiction, chosen? What are the conflict of laws rules in your jurisdiction?

Real estate laws apply uniformly throughout India and as such there are no conflicts. The only scope for conflict is regarding the laws pertaining to registration of a conveyance, which may vary from state to state. In case of properties falling in two jurisdictions, the property has to be split into parts on the basis of territory and the appropriate registration law would apply.

Subject-matter jurisdiction

- 8** Does subject-matter jurisdiction exist? Who are necessary parties? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Yes. In matters pertaining to real estate, subject matter plays an important role in clothing the court with jurisdiction. It is settled law in India that the court within whose jurisdiction the property is situated will exercise jurisdiction for a suit on land.

In case of agreement for sale, a suit of specific performance can be filed against the seller for executing the sale deed.

In case of any liability existing on the property, suit can be filed against the erstwhile owner for damages and recovery of arrears.

In case of interference by third parties, suit can be filed restraining third parties from interfering with the peaceful possession of property.

If the property is situated within the jurisdiction of a court, then that particular court can send summons even to defendants residing outside its jurisdiction.

It is not necessary for a party to reside or carry on business within the local territory to bring an action in a court of law. In a matter involving a property, a suit can be initiated even if the plaintiff or the defendants are residing outside the jurisdiction of the court.

Investment entities

- 9** What entities does your jurisdiction recognise? What are pass-through entities for tax purposes and what entities best shield ultimate owners from liability?

Proprietorship, partnership and joint-stock companies (liability limited by shares) are the entities recognised in India.

Pass-through entities do not exist in India. However, venture capital funds (VCFs) are being used in India for making investments in the real estate sector too. There are several VCFs dedicated to making investments in the real estate sector. In fact, in the absence of real estate investment trust (REIT) legislation, the VCF route was being used for realty investment.

Budget proposals deny tax exemption to VCFs other than those investing in certain high-tech industries. Without tax transparency, there is no motivation to use the VCF route for real estate investments. India has not adopted REIT as yet – hence, other than mutual funds, the scope for using a pass through vehicle for real estate investments is ruled out.

US investors
10 What form of entities do US investors customarily use in your jurisdiction?

Foreign investors can make investments or operate their business in a number of ways such as: liaison/representative office; project office; branch office; wholly owned subsidiary; and joint venture company.

Any company set up with foreign direct investment has to be incorporated under the Companies Act 1956 with the registrar of companies, and all Indian operations would be conducted through this company. Typically foreign investors put their money in real estate through companies as it overcomes the legal hurdles involved when a non-Indian invests in real estate. A foreign company incorporated under the Companies Act is treated on a par with any domestic Indian company within the scope of approval and is subject to all Indian laws.

Organisational formalities
11 What are the organisational formalities of creating the above entities? What requirements does your jurisdiction impose on a foreign entity? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The law mandates registration with the registrar of firms in the case of partnership firms and with the registrar of companies in the case of incorporated entities limited by shares.

Apart from restriction on foreign direct investment in real estate as detailed above in response to question 3, there are no other restrictions.

The rate of taxation is the same for both partnership firms as well as incorporated companies. However, the taxable profit would be higher in the case of a partnership firm as there are limitations on the amount of profit that can be shown as expense in terms of salary to a partner etc, whereas no such limitations exist in the case of an incorporated company. Therefore, an incorporated company limited by shares is most advantageous for a foreign investor in terms of tax consequences.

Documentation
12 Does your jurisdiction or customs recognise a non-binding form of agreement? Is there a form of non-binding agreement before a contract? Is it customary to take the property off the market while negotiation of a contract is ongoing?

Non-binding agreements such as a letter of intent or a memorandum of understanding is not unknown to Indian jurisprudence.

However, such documents are subject to interpretation by courts of law as to whether it was the intention of parties to create a binding agreement or not and whether they can be specifically enforced.

The practice in India is that a property will be taken off the market only when the vendor receives a token advance out of the sale consideration or enters into an agreement for sale.

Contract of sale
13 What are typical provisions in a contract of sale?

The following are the fundamental ingredients of a sale deed or document: names; date; parties to the document; tracing of title; testatum; consideration paid or to be paid; receipt thereof; operative clauses; parcels; reservations (if required); habendum; testimonium; signatures; attestation.

The purchaser can buy an immoveable property by:

- making full payment and getting the sale deed registered on the same day before the registrar; or
- entering into an agreement of sale and making a part payment (usually about 20 per cent) and agreeing for a date to be fixed for registering the sale deed by paying the balance consideration.

If the title of the property is not clear and the purchaser is not willing to risk his money, he can request to deposit the amount in an escrow account to be given to the seller on clearing the title.

A purchaser can receive the following in terms of evidence of good title to the property: all original title deeds pertaining to the property; and revenue records of the government standing in the name of the seller.

Environmental clean-up
14 Who takes responsibility for a future environmental clean-up? By representation with survival provisions? What are typical general covenants? What remedies do the seller and buyer have for breach?

The real estate sector is bound by the Environmental Protection Act 1986. However, the concept of environmental clean-up is not yet mandatory in India. Domestic legislation affecting infrastructure environmental services like refuse disposal is fairly new (eg, the Municipal Solid Waste Management & Handling Rules 2000), such that the municipalities across the country and the domestic environment industry have only just begun to respond to the legal requirements. However, there have been instances of judicial activism where the courts have ordered environmental clean-up in areas where hazardous waste or pollutants have been discovered. The Supreme Court has even established a monitoring committee to oversee the same. Since, the concept of environmental clean-up is fairly new there are no standard or typical general covenants.

Under the Income Tax Act 1961, income earned during a tax year is subject to income tax and the same applies to real estate.

The risk of loss until closing, if undertaken voluntarily by the realtor will also be met by him.

Where the discharge of any environmental pollutant in excess of the prescribed standards occurs or is apprehended to occur due to any accident or other unforeseen act or event, the person responsible for such discharge and the person in charge of the place at which the discharge occurs shall be bound to prevent or mitigate the environmental pollution and shall also: intimate the fact of such occurrence or apprehension of such occurrence; and be bound, if called upon, to render all assistance.

On receipt of such information, the authorities or agencies appointed under the Environmental Pollution Act and other acts shall cause such remedial measures to be taken as are necessary to prevent or mitigate the environmental pollution.

The expenses incurred by any authority or agency may be recovered from the person concerned as arrears of land revenue or of public demand.

Leases
15 What are typical representations and covenants regarding leases? Do they cover brokerage agreements and do they survive closing? Are estoppel certificates customarily required and can estoppel certificates substitute for representations?

A document or deed of lease contains more or less the same as existing in the sale deed such as the date and place of the deed, the parties, recitals, testatum and description of property.

The habendum or reddendum clause follows. Habendum includes the commencement and duration of the lease and reddendum refers to the amount of rent. In case of contradiction between habendum and reddendum, the former prevails.

After the habendum and reddendum clause, the lease deed contains: covenants by lessee; covenants by lessor; special terms and conditions agreed upon between the parties; and the usual four covenants (for title, against encumbrances, for quiet possession and for further assurances).

Lease agreements do not cover brokerage agreements and are prior to letting out the property on lease. Both are two different limbs. Both have their distinct parameters and do not survive closing. Brokerage if any is generally payable by the mortgagor.

There is no firm requirement under law for a mandatory estoppel certificate. Estoppel certificates cannot be a substitute for representations and only supplement the terms covering the transaction and may be useful during court proceedings to hit a defence set up. The requirement of an estoppel certificate varies from one financial institution to another.

Leases and mortgages

- 16** Is a lease generally subordinate to a mortgage pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a mortgage upon foreclosure? Do lenders typically require subordination and non-disturbance agreements?

Yes, lease is subordinate to a mortgage in terms of section 65A of the Transfer of Property Act (TP Act). This permits the mortgagor to lease the property and the same is binding on the mortgagee.

The mortgagor cannot have the lease for a period of more than three years. There cannot be a covenant for renewal.

A lease cannot be superior in priority to a mortgage: the lease deed would be void as it would be contrary to the provisions of the TP Act. Hence any lease contrary to the provision of section 65-A is not binding on the mortgagee.

Lenders do not require subordination and non-disturbance agreements. Once the mortgagor defaults in making the payment, the lender has the right to appropriate the property to recover the monies lent.

Under section 105 of the TP Act, a lease is a transfer only of a right to enjoy the demised premises but there is no transfer of ownership or interest in the demised premises to the lessee such as existing in a sale (section 54) or a mortgage (section 58).

Delivery of security deposits

- 17** What steps are taken to ensure delivery of security deposits to a buyer? How common is it to get a security deposit under a lease? Do leases customarily have periodic rent resets?

Generally there are no security deposits or deliverance of security deposits to the buyer. However, recent trends indicate that the Urban Development Ministry has placed the proposal in the Real Estate Regulatory Management Bill to regulate builders who delay in completing residential projects or develop low-quality houses. The society of property developers has criticised the proposal saying it will put real estate development at risk.

It is, however, a very common practice to get a security deposit under a lease.

To obviate the risk of leasing out premises and subsequently losing possession to a tenant, substantial rental deposits have become common throughout India. The deposit is provided to the landlord on an interest-free basis throughout the term

(and repaid on termination). Though the deposit amount varies depending on city, property type, location and the period of the lease, it may range between six and 18 months rent.

Most Indian landlords have no objection to an option term for a period equivalent to the initial term. However, it is normal for the rent and the security deposit either to be reviewed on mutually acceptable terms in line with market norms on exercising of the option or to a fixed increment.

Due diligence

- 18** What is the typical method of a title search and is it customary to order searches? Is there something akin to title insurance and opinion letters? Does your jurisdiction provide statutory priority for recorded instruments?

Title of the vendor should be traced and scrutinised based on the nature of the property he is offering since his title depends upon the mode by which he acquired the property or the manner in which the property devolved upon him. It is imperative to scrutinize the title of the property before making payments.

For the purpose of scrutiny of title, the property can be divided as registered and unregistered.

Unregistered property

In order to satisfy the purchaser, the vendor is required to show a good title and deliver abstract of titles (such as wills, deeds of conveyance and also the events causing the devolution of ownership) at his expense. Proof of possession is a must as it establishes title as well.

Registered property

Unlike the unregistered property where the responsibility of the vendor is heavy, the vendee has to exercise caution while dealing with a registered property. The maxim 'caveat emptor' applies and the vendee alone is liable to trace the title of the vendor and satisfy before purchasing the property.

All the registered properties are entered into appropriate books at the office of the sub-registrar and assigned document numbers. In a typical title search, the proposed purchaser applies for an encumbrance certificate with respect to the property, which reveals all the transactions pertaining to the property. This is then matched with the representations made by the vendor and documents provided by him. It is also possible to obtain certified copies of all title deeds from the concerned sub-registrar. Based on such search and other documents, a legal opinion is normally obtained from an attorney on the title and marketability of the same by the vendor. In India there is no practice of having a title insured and the only remedy in case of improper title being conveyed is to sue the vendor for sale consideration paid and damages. There is statutory priority for recorded instruments as the government requires all immoveable transactions to be registered. This also ensures that the title conveyed is clear and can be verified.

Reviews

- 19** Is it customary to arrange an engineering or an environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Until January 1994, obtaining environmental clearance from the Central Ministry was only an administrative requirement intended for a mega project undertaken by the government or public sector undertakings. However, the EIA Notification issued by the Ministry in January 1994 (as amended in May 1994 and

in 2000) makes environmental impact assessment (EIA) statutory for 30 different identified activities. The government has made environmental clearance mandatory for real estate projects, even small-scale projects. Recently, new procedures have been devised for obtaining clearance. The Ministry in its new guidelines states that clearance is required 'before any construction work begins or before the land is prepared by the project management'.

The typical requirements of EIA consist of pre-appraisal and appraisal. Pre-appraisal can be used to determine whether a submitted project proposal meets the preliminary appraisal requirements such as project siting restrictions, permitting requirements and supporting documentation. A project appraisal is appraised under categories such as description of project, project and process alternatives, description of environment and impacts, mitigation measures, risk assessment, etc.

It is customary to get representations when obtaining an environmental clearance for any of the projects notified by the government.

Review of leases

20 Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers usually review lease deeds keeping in mind the latest trends in law and incorporating the same into the deed. In the event that any party to the document is looking for a change in the covenants, the lawyer can advise them on the appropriate terms. Only the commercial aspect of a lease deed is not touched upon by the lawyer.

The essential elements of a lease such as the parties, the subject matter, the demised premises, the term or period, the consideration or rent and conflict resolution clause are pointed out to the client.

Management agreements contain the policies of the company and are aimed to serve as a guide to the management in the day to day running and future planning of the business. If a management agreement does not provide for taking on lease of a property, the lender may require that the agreement be amended so that there are no legal barriers for letting out the property on lease to the management.

Other agreements

21 What other agreements does a lawyer customarily review?

Documents to review can be divided into six parts:

- deeds for immovable property (sale, mortgage, lease, gift, exchange, trust, partition leave and license, ownership flats and development agreements, easements and ancillary documents);
- deeds for moveable property (sale of goods, sale of business, hypothecation and pledge, hire purchase agreements, copy-rights, trademarks, patents, industrial designs, know-how and actionable claim);
- documents relating to contracts (bailment, indemnity and guarantee, agency agreements, apprenticeship, service contracts, bonds, partnership agreements, building agreements, foreign collaboration agreements, franchisee agreement, advertisement contracts, transport contracts, information technology and computer contracts and labour laws);
- documents pertaining to companies, corporations and societies;
- documents pertaining to shipping and airways; and
- non-contractual documents (power of attorney, banking and

negotiable instruments, acknowledgements and receipts, adoption, arbitration agreement, testamentary documents).

Closing

22 What does a lawyer customarily prepare for a closing?

Deliverables for closing a real estate transaction include:

- absolute sale deed or conditional sale deed or auction sale deed executed by statutory authorities;
- encumbrance certificates from the sub-registrar's office from the date of purchase;
- possession certificate issued by statutory body or society.
- allotment letter issued by statutory body or society;
- *khattha* certificate issued by statutory authority;
- certified copy of the lease-cum-sale agreement/auction sale agreement;
- latest tax receipt from the corporation/*panchayat*;
- auction sale confirmation issued by statutory authorities; and
- genealogical tree.

A banker also requires the following for scrutiny of title:

- one set of photocopies of all the documents pertaining to the property – these must be attested by the branch manager of the bank or a gazetted officer of the state/central government;
- permission to mortgage the property in favour of the bank in case of lease property;
- affidavit;
- approved building plan with license for construction;
- valuation certificate in case of purchase of property;
- detailed estimate for construction;
- declaration for margin money (ie, difference amount of estimated cost and loan applied);
- income proof for salaried persons and self-employed; and
- sureties.

A proper scrutiny of the above along with searches in revenue records, sub-registrar's office, land acquisition office, registrar of companies and court ensures that your document will be reviewed favourably. Prorations are not practised generally.

FINANCING

Form of lien

23 What is the method of creating and perfecting liens?

Apart from a banker's lien, which is commonly recognised, financial institutions typically create lien by having the property mortgaged in their favour. Such mortgage may be equitable (by deposit of title deeds to the property) or by way of a registered mortgage (terms of mortgage put in writing and registered with the office of the sub-registrar). Apart from the mortgage deeds, other documents such as confirmation of deposit of title deeds and a power of attorney in favour of the financial institution to execute sale deed in place of the vendor are also obtained.

As for personal liens, financial institutions typically obtain personal guarantees from the directors of a company or other willing persons, who have valuable security in their names. Thus there is an option for the financial institutions to attach the personal properties of such guarantors if need arises and there is a possibility that the secured asset may not fetch the amount financed. A lien may be perfected by having the mortgage registered.

Such an encumbrance is reflected in the office of the sub-registrar and acts as a deterrent for third parties to deal with the

property. In case the property belongs to a company, the creation of charge in favour of a party may be intimidated by filing an appropriate form before the registrar of companies.

Lien on accounts and intangibles are far less definite and difficult to enforce. It has to be evaluated on a case-by-case basis.

Legal requirements

24 What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A foreign lender would typically be placed in the same footing as an Indian entity. It is therefore essential to ensure that the foreign lender is a legal entity and has not transgressed the law in lending the money. It is not required that the foreign lender must be qualified to do business in India and it can sue in India even without a physical presence in the country. However, recoveries made will be amenable to local taxes. It may also be noted that it is possible to have jurisdiction and governing law agreed to between parties and in the event that a foreign court does have cause of action, a suit may be instituted even in a foreign court. If such country is one with whom India has reciprocity, such foreign decrees may be straightaway executed. Otherwise a separate suit based on a decree of the foreign court may be filed.

The common forms of lien documents include: mortgage agreement; bank guarantee; negotiable instruments; and power of attorney.

Mortgage recording requires payment of stamp duty and registration charges. Assignment of mortgage can be done by payment of additional stamp duty. But if the entire company/entity is transferred to another company then the assets and liability will be transferred automatically, in which case no additional stamp duty is required to be paid.

Interest

25 Is interest charged on a spread over LIBOR, EuribOR or relevant equivalent? What rate of interest is usurious in your jurisdiction and what are the consequences if a loan exceeds the usury rate?

Lending in India is regulated by the RBI guidelines and notifications (issued from time to time based on various public policies).

The interest rates charged in India are subject to the guidelines of the RBI and banks are not permitted to charge interest higher than prescribed by the RBI.

In India, banking companies and financial institutions levy fees in addition to the interest levied for the sum lent. The banking companies and financial institutions are bound to disclose to the borrower the fee chargeable for various services offered by the bank or financial institution.

Enforcement

26 How are remedies enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding?

Enforcement of remedies is a completely judicial process. Remedies are of two types, legal (eg, monetary damages) and equitable (eg, an injunction). A court of general jurisdiction will usually have the power to grant both legal and equitable relief.

To enforce remedies, one can file a civil suit for both, legal and equitable relief. For breach of agreement of sale one can get

and injunction as well as damages from the same court and in the same proceedings. The process is judicial. If the matter pertains to the same parties and out of same cause of action, then one proceeding is sufficient to recover all collaterals.

In India the mortgage holder can usually initiate foreclosure any time after a default on the mortgage or when the asset becomes a non-performing asset (NPA). In most cases agreements provide for sale of property through a public or private auction in accordance with the TP Act. A notice to the borrower would be necessary before such an action. Some companies notified under the Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 or under the State Financial Corporations Act can resort to remedies provided in the said Acts, which are faster.

Under law, a party approaching court must sue for all reliefs arising out of the same cause of action, failing which further actions will be barred. However, there is a provision to obtain leave from the court to sue for some reliefs and reserve the right to sue for other reliefs later.

Protection of collateral

27 What actions can a lender take to protect its collateral until it has possession of the property?

Once an action has been initiated for enforcement of remedy, an interim application can be filed under the Civil Procedure Code for attachment of the property before judgment or an injunction.

Such orders will protect the interest of the lender till final decree is passed. All the benefits accruing out of that asset can also be attached. It is also possible for a receiver to be appointed to collect rents or other income of the properties and maintain the same till the issue is finally adjudicated.

Recourse

28 Do the security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy filing?

Recourse in most cases is limited to the assets on which lien is created, unless personal guarantees have been executed, in which case properties of such persons can also be attached and brought to sale. In cases, where the lender is unable to recover the entire sum due by the borrower, the lender is entitled to take recourse to other properties on which he may not have any lien. Such an action is subject to the rights of other lenders who may have a lien on those assets. In such cases, the preference would be given for the debts of a secured creditor and only after their satisfaction, the unsecured creditor would step in. In case of bankruptcy, the assets of the estate are distributed in a manner set out in the statute and priority is given to workers dues and crown debts.

The secured creditors stand on a better footing as compared to unsecured lenders.

Cash management systems

29 Is it typical to require a cash management system and do lenders typically take reserves?

The RBI mandates a cash management system, whether a bank is nationalised, private-sector, foreign, cooperative or a specialized banking institution. All banks governed by the RBI also mandate a cash management system.

All lenders require security arrangements and contracts that

Update and trends

The proposed legislation on Real Estate Management (Regulation & Control), commonly known as Licensing & Registration of Developers and Brokers, ensures greater accountability of real estate developers – and even unscrupulous builders. It is proposed that a regulator should clear a project only after ensuring that all title deeds are in place and that the last 30 years of transaction records have been examined. There is a requirement that without execution of sale agreement the builder cannot collect any advances or deposits from buyers. Further, there is a prohibition on diversion of funds meant for one project to another and mortgage of lands and fraud committed by builders for which there will be an imposition of penalty or imprisonment for breach of terms.

ensure minimal default risk. While lenders as such do not take reserves, they try and minimise the default risk by financing only a percentage of the value of the collateral. Depending on the profile of the borrower the percentage of lending varies. This offsets the need to take reserves.

Credit enhancements

30 What other types of credit enhancements are common? What about forms of guarantee?

The following forms of credit enhancements have been used:

- cash collateral – where a specified amount of cash collateral is kept reserved with the sole purpose of meeting shortfalls in making contractual payouts to investors, if the need arises;
- guarantee by a highly rated corporate or a bank – the rating assigned to the securitised instrument cannot be higher than that of the guarantor; and
- over-collateralisation or the issue of subordinate securities – subordinate securities are typically unrated and invested in by the originators themselves. The payouts on these securities are subordinate to the meeting of all obligations on the senior class of securities which are rated.

Normally performance or completion guarantees are given in the form of irrevocable bank guarantee. In case the guarantor is unable to perform his obligation, the bank guarantee is encashed by the depositor. In most cases, bank guarantees are unconditional and it is not possible to injunct enforcement of a bank guarantee.

There is nothing comparable to recourse carve-back guarantee in India.

Covenants

31 What are commonly used covenants in loan documents? What is the difference depending on asset classes?

Covenants for the purpose of real estate are of two types, namely: covenant running with the land; and personal covenant. Personal covenants are binding on the covenantor alone whereas covenants running with land bind even the successors or heirs of the covenantor.

Apart from the usual parts to a document, a loan document would contain the following covenants: covenant by the borrower to repay the loan by the date fixed for redemption; covenant to pay interest and compound interest in case of default; covenant by the lender for redemption or retransfer of the property on repayment; and powers to be exercised by the lender.

Real estate is an asset class that can deliver handsome returns on a long-term basis. Depending on the nature of real estate document, the following covenants will find a place: against encumbrance; against assignment; for peaceful possession; for redemption; for clear and marketable title; and for repossession in case of default or breach of agreement.

Financial covenants

32 What are typical financial covenants?

Financial covenants in India are not normally based on any rigid ratios and differ from borrower to borrower on the basis of the credit rating of the borrower and the nature and value of the property. In case of corporate borrowers, debt service coverage ratio gives an indication of the credit worthiness and repayment capacity and financing is made on that basis. However there is normally no covenant requiring the borrower to maintain this ratio at a particular level. The covenants merely amortise the payments over the period of loan and give the repayment schedule.

However, for large corporate borrowings and project financing regular reporting requirements and periodical appraisals are a must and do not wait for a default.

Bankruptcy

33 Describe the bankruptcy system in your jurisdiction.

Insolvency laws in India can be divided under two headings: (i) personal insolvency, which deals with individuals and partnership firms governed by Provisional Insolvency Act 1920 and Presidency Towns Insolvency Act 1908; and (ii) corporate insolvency, whose consequence is the winding-up of the company under the Companies Act.

The concept of involuntary bankruptcy, where insolvency proceeding is being initiated by the lender against the borrower is prevalent in India. The Provincial Insolvency Act, section 7 entitles both the debtor and the creditor to file a petition for insolvency.

In the sphere of insolvency laws in India, where all the suits are stayed on making of the winding-up order, parties may pursue individual claims in certain circumstances.

In context of corporate laws, the word 'insolvency' has neither been used nor defined. However, section 433(e) covers a company that is 'unable to pay its debts', and thus constitutes a ground for winding-up of the company. Inability to pay its debts would be a case where a company's entire capital is lost in heavy losses and no accounts are prepared and filed and no business is done for one year. In such circumstances, the registrar of companies or the creditors of the company can make out a case of inability to pay debts. However, these would only include debts incurred after the legal incorporation of the company.

The winding-up procedure implies all personal rights be converted into right to prove debt in winding-up. Under section 446 of the Companies Act, there is a stay on all suits and the winding-up court decides all suits by or against the company. A secured creditor may enforce security interest without a suit and therefore, real rights of secured creditors are protected. However, criminal proceedings or proceedings against directors or officers

are not stayed. Further, income tax proceedings will continue against the liquidator.

Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognise the jurisdiction of foreign courts in respect of branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is filed before an insolvency court for winding up of its branches in India.

Lockboxes

- 34** What are the requirements of creation and perfection? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Not applicable.

Single purpose entity (SPE)

- 35** Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy filing, has the concept been upheld?

Although a single-purpose entity (SPE) is unlikely to become insolvent as a result of its own activities, lenders in India do not specifically require each borrower to be a SPE. Lenders in India only require security arrangements and contracts that ensure minimal default risk. The statutory regime of the Indian jurisdiction, however, provides for the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 to protect the interests of the lenders.

There does exist a concept of independent directors. The fundamental objective behind appointing independent directors is to ensure appropriate checks without stifling entrepreneurial flair.

The primary contribution of an independent director should be a neutral independent judgment regarding strategic, business and other decisions taken by the company.

The rules laid down by the RBI interlocking directorates between the directors of the SPE and that of its parent present a potential conflict of interest. If the parent becomes insolvent in a situation where the SPE is performing adequately, there may be an incentive for the parent entity to voluntarily file the SPE into bankruptcy and consolidate its assets with those of the parent.

If the SPE has at least one director who is independent from the parent and this director's vote is required in any board action seeking bankruptcy protection for the SPE, the SPE is unlikely to voluntarily file an insolvency petition. Therefore the independent director is in place to prevent a bankruptcy filing.



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