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India's construction sector gets govt boost

Arbitration procedures have been relaxed to ensure faster completion of projects. BY VINOD RAI

RECOGNISING that India's construction and real estate sectors need a boost, and to ensure that major projects held up for want of funds and heavy over-leveraging to banks get off the ground, the Indian government has taken a few decisions which might well set the economy on an upward path soon. Let us analyse some of these decisions.

The government led by Narendra Modi has relaxed arbitration procedures in the construction industry to ensure faster completion of projects and ease the problem of loan repayments. An array of measures – for quick dispute resolution, pumping in liquidity and dealing with stressed assets – has been put in place to revive stalled construction and real estate projects. The government has allowed the transfer of cases initiated under the old Arbitration Act to the purview of a new and expeditious dispute resolution law. It has approved the release of 75 per cent of the amount in dispute against bank guarantees and provided for a conciliation board comprising experts on new contracts. The arbitration law has also been simplified so that the process of dispute redressal can be made easier.

A commercial court has also been established. Contractors will henceforth have the option to shift their disputes with public bodies to the new arbitration procedures. In cases where arbitral awards have been made and public bodies challenge them, 75 per cent of the arbitration amount will have to be released to the contractor against a margin-free bank guarantee. The amount will have to be spent by the contractor to complete the project and pay back his or her dues to bank(s) and financial institution(s). The surplus can be spent on project expansion.

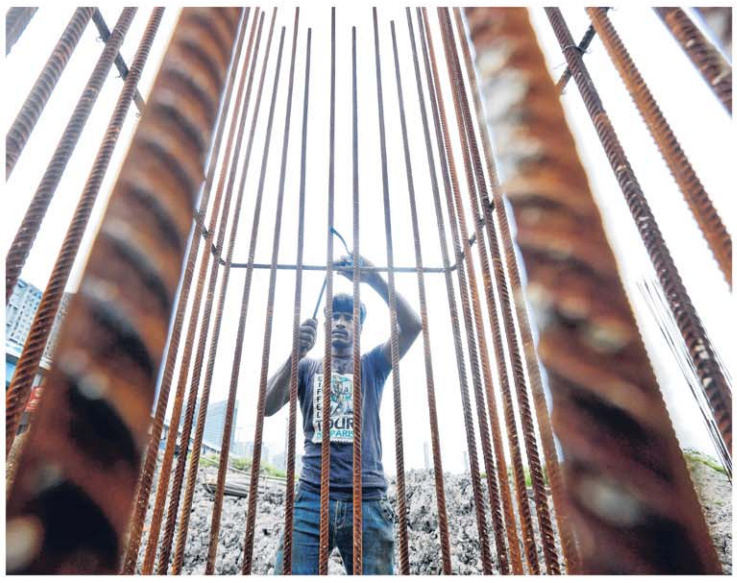
In the case of government contracts where disputes with contractors arise, deciding to err on the side of caution, government departments resort to arbitration on a routine basis. Even if the awards go against the government, they continue to file appeals. In this process, the contractor suffers as his payments are held up pending the appeal. Recently, in recognition of this complication, the Indian government has decided that if an arbitration award goes against the government, 75 per cent of the amount involved in the contract will be paid upfront into an escrow account even if government proposes to challenge the award. This decision can potentially release over 20,000 crore rupees (about S$4.3 billion) to cash-strapped construction companies, and will give a big boost to the construction sector, which is the largest employer in the country.

DOUBLE JEOPARDY

Construction companies which don't get their money despite winning arbitration awards suffer double jeopardy. With their funds stuck in construction, they find it difficult to service their borrowings and have banks breathing down their necks. At the same time, they lack the ability to bid for fresh contracts. The new policy will help to reinvigorate the sector in two ways. It will release funds which can be used to clear bank liabilities and it will speed up the execution of projects.

The National Institute for Transforming India (Niti) Aayog estimates that 597 cases involving 52,488 crore rupees (about S$11.4 billion) spread across central government enterprises such as National Hydro-Electric Power Corporation (NHPC), Oil and Natural Gas Corporation (ONGC), National Highways Authority of India (NHAI) and Indian Oil Corporation, are under arbitration and pending appeal in various courts. The government acknowledges that over 22,000 crore rupees (about S$4.8 billion) of arbitration claims involve the NHAI itself.

How progressive this decision is and how much it will benefit companies is best illustrated by the fact that immediately after the decision was made public by the government, the share price of Hindustan Construction, a prominent construction company undertaking large government contracts, hit the upper circuit limit of 20 per cent. This is because the company has already won large contracts and has significant claims pending in arbitration courts.



The Modi government's measures to revitalise the construction sector will serve as a major boost to the Indian economy. Not only is this sector a major employer, but its growth would also help boost the demand for cement, steel and bricks. PHOTO: REUTERS

It could be argued that in clearing 75 per cent of arbitration awards, the government is playing into the hands of the construction lobby. However, it needs to be appreciated that the majority of awards go against the government and, given that the average settlement time for claims is more than seven years, the government ends up paying a large amount as interest as well. For example, in the case of the NHAI, out of a total of 347 arbitral awards, only 38 went in its favour.

Following a Mumbai High Court verdict against the tax department, the Finance Minister had observed that the government would, by and large, not litigate matters where courts had already ruled. If the government were to follow this business-friendly trend in other sectors as well, it would go a long way towards improving the ease of doing business in India.

Another key decision relates to the Budget proposal of 2014-15 to introduce real estate investment trusts (Reits), which have been successfully used as an instrument for the pooling of investments in several countries, with a view to earning income and distributing the earnings from pooled investments among investors. India's market regulator, the Securities and Exchange Board of India (Sebi), had issued regulations relating to Reits in 2014. However, because of restrictions under Foreign Exchange Management Act (Fema) Regulations (which prevented Reits from accessing foreign investments), there had been no actual investment.

In a decision in May 2015, the government made Reits eligible under Fema such that the entities registered and regulated under the Sebi's Reit Regulations of 2014 would be able to access foreign investments. This approval is expected to catalyse foreign investment inflows into completed rent-yielding real estate projects, which were earlier prohibited.

The logic of introducing Reits is to reduce pressure on the banking system, to which the real estate sector looks for funds, free up the existing funds of banks and encourage construction activities. Reits, while attracting long-term finance from foreign and domestic sources including non-resident Indians, would make available fresh equity to the sector. Sebi has also decided to include hotels, hospitals and convention centres under its definition of real estate as part of the effort to ease the norms related to Reits and make the investment vehicles attractive for investors and developers.

The Indian real estate sector is going through a cash crunch, and Sebi's decision will help increase the flow of capital to this industry. It will make Reits a viable product for investors and a fund-raising instrument for real estate players. The decision will also help attract small investors to participate in the real estate sector's growth.

Due to the difficulties faced by this sector, much distrust has developed between home buyers and companies. Buyers who have not been able to get the apartments for which they have already made payments, have dragged many of these companies to the Supreme Court. However, the plea of the companies before the court is that they do not have funds to either complete the projects or to refund the amounts paid by the buyers. The debt of this sector is assessed at about 80,000 crore rupees (about S$17.4 billion). Since home loans are not easy to come by, sales have also been anaemic. This has adversely affected the capacity of the companies to service their borrowings.

SILVER LINING

There is however, a silver lining in the form of the Real Estate (Regulation and Development) Act 2016 (RERA). This law ensures transparency from builders and stringent provisions for compensation in case of delays. Time limits have been prescribed within which regulatory and appellate authorities have to decide disputes. The more important provision is for the developers to keep 70 per cent of their funds in an escrow account so that they cannot siphon off these funds to other accounts or projects. The Act also provides a level playing field for the buyers and developers as the present-day agreements to buy are heavily loaded in favour of the companies.

This will help inspire confidence among buyers and spur banks to provide mortgage loans. Coupled with the government's decision to hike the salary of state and central government employees by almost 24 per cent, it would have a positive impact on the demand side of residential real estate, as it would boost sentiment for home ownership among a set of buyers who have traditionally been very conservative in matters pertaining to large financial commitments. Pricier cities would not see much of an impact, as this segment of potential home buyers will be looking primarily for budget homes.

The Narendra Modi government's measures to revitalise the construction sector will serve as a major boost to the Indian economy. Not only is this sector a major employer, but its growth would also help boost the demand for cement, steel and bricks, as well as specialised labour like carpenters, plumbers and electricians. The result will be relief for companies, and an easing of stress on the balance sheets of India's banks. The measures will also catalyse much needed liquidity and help roll over some of the funds locked in stalled projects.

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