

Making home owners creditors under IBC may not solve the problem: View

The IBC process has been amended and included home owners as creditors with a seat on the creditors committee. This has come about due to the numerous cases in the NCR region with companies like Jaypee, Amrapali, Unitech, etc. not delivering and in financial difficulty.

However, there is a fundamental flaw in trying to resolve real estate projects through the IBC route. The IBC regulations have been designed for resolution and revival — the primary assumption being that the business is a going concern, and if run properly, will be a continuous cash flow generating entity.

The fundamental issue is that real estate project companies are NOT “going concerns” and will likely not attract investor interest, unless there are other assets in the same projects to exploit.

The project Special Purpose Vehicles (SPVs) in IBC are real estate projects with finite cash flows with finite costs. Consequently, in several of these cases, the cash inflows (i.e. sales) have been taken out of the company or misused. Someone else has to now step in to put in that cash.

In the absence of any further scope for profit and the costs yet to be incurred in that project (assumes no additional land to be exploited), no investor will be interested in performing this social service of completing the project.

A resolution plan may therefore require some sacrifice by creditors — which in this case means home owners too. Funnily in such cases a sacrifice by home owners would mean putting in more money to complete the project and giving up delay penalty, etc.

Home ownership is an emotional issue, and it would be extremely challenging to herd a large group of owners to a consensus in such a complex matter. In a country where two people are a party and three people are two parties, it is very likely that the cacophony of home owners will drown out any sensible solution in the creditors committee.

The fallout of the admission of home owners as creditors on par with other lenders would deter lenders in providing debt to developers. Simply because their senior charge or collateral is immediately diluted the day the sales are started. The real estate industry is a big employer and has a multiplier effect on the economy. The industry has already been hit by several negatives and this deterrent for lenders is ill advised.

Therefore, the only option is for the Government (state and centre) to step in. Anecdotally, NBCC was brought in the case of Amrapali and they have concluded that additional funds to complete the project have to come from some source a.k.a Government or home owners. It would perhaps be prudent to have a rethink on the admission of such residential cases or on the role of home owners in the credit committee and resolving it through the IBC process. One suggestion would be that any case involving more than say 50 home owners or lenders claim of over Rs 100 crore must be dealt at the state RERA level and larger ones to be dealt under a special track in IBC.

It is feasible to mandate under law that the deficit in the project after accounting for say additional 8% of balance cost as contract management fee must be shared in the ratio of creditor's value by home owners and lenders. That would settle the disharmony and get the homes delivered.

(Economic Times)