

## WHAT GOES ON IN REAL ESTATE BUSINESS?

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**[Abstract:** Investments in Realty Sector and industries having linkages with this sector have been on the rise and would continue to rise. The sector is also important from the point of view of employment generation so much so that the generation of employment in this sector is next to agriculture. It draws its sustenance from people—out of their life time investment on a single asset for creating shelter and place for business. Such a sector, however, has come to be known as the fountainhead of corruption in the country and nurtures a strong nexus between powers-that-be and the developers. The sector is believed to be a conduit for generation of black money. In the process, the end-users are never confident of accessing services at reasonable costs, in the promised time frame and of the assured quality. The Association of Developers believe that developing a corporate image would help ensure the much needed transparency and also reduce information asymmetry. It is perceived that the establishment of Real Estate Regulatory Authority (RERA), for which draft legislation is now in place, would facilitate the placement of safeguards to provide the much needed transparency. Draft legislation is not 'comprehensive' enough to cover all aspects and situations which one comes across in this sector. Corporates, amongst the Developers who have been operating for years, are high on words but wanting in providing sound corporate governance.

Vandana Singh and Komal<sup>1</sup> have identified the components of real estate business to include professional services such as Appraisal, Brokerage Development, Property Management, Real Estate Marketing, Relocation Services, etc. Types of interests which subsist in real estate have been listed to include freehold, lease hold, etc., among others. An attempt has also been made for collating various players in the Real Estate Market who, among others, would include owners, users, developers and facilitators such as banks, lawyers, etc. Real estate has been divided into three segments, namely Commercial, Residential and Agricultural which can attract investment for capital appreciation, rental income, agriculture produce, lease and commercial use. It has been contended that demand for real estate would be on the rising curve because of continuing impressive GDP growth and also expansion in business activities. According to an estimate quoted in this source, IT industry alone would create real estate assets worth ₹13,200 crore between 2009 and 2012.

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<sup>1</sup> Singh, Vandana and Komal (2009), "Prospects and Problems of Real Estate in India," *International Research Journal of Finance and Economics*, ISSN 1450-2887, Issue 24, 2009.

Gurbachan Singh<sup>2</sup> makes a case that investment in real estates is buoyant in the face of Financial Repression resulting in low returns on financial assets and is given further philip under the influence of black money in an atmosphere of segregated primary and secondary markets. Noise traders also significantly raise the demand thereby getting people to invest.

Taking note of the significant growth projections in the business of Real Estate and its linkages with other sectors of economy, the *Accommodation Times*<sup>3</sup> has argued for 'corporatisation' of real estate business and according it the status of 'Industry'. As of date, 75% of real estate sector comprises smaller and unorganised players. Real estate markets are fraught with problems of information asymmetry, moral hazard, liquidity uncertainties and heterogeneity. Market failures are thus common. This source acknowledges the rise of reputed builders and international property consultants, which is changing the image of the Real Estate business towards 'corporatisation'. It foresees a closer relationship between corporates in this sector and the government to work out a congenial atmosphere for speedy and smoother development.

When a sector claims to develop a corporate image, it takes upon itself the onus of providing good corporate governance which would require its working to be transparent and equitable to its stakeholders. With the presence of corporates, the market should become organised and free from petty local influences. This will result in lower levels of Information asymmetry. Primary and Secondary markets should move towards integration. Real estate companies have been criticised by securities analysts for a lack of transparency in their property dealings and in how they account for projects<sup>4</sup>.

As corporates have come up in the real estate sector, associations in the nature of Confederation of Real Estate Developers Association of India (CREDAI) have been

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<sup>2</sup> Singh, Gurbachan (2008), "Financial Repression, Bank Deposit, Real Assets and Black Money," Discussion Paper 09-05, Centre for International Trade and Development, School of International Studies, JNU.

<sup>3</sup> "Corporatization of Real-Estate Industry," *Accommodation Times*, August 1, 2009.

<sup>4</sup> Range, Jackie and Santanu Choudhury (2009), "Governance Issues Hit India's Property Firms," *The Wall Street Journal*, February 4, 2009.

formed. In April 2011, it presented a time bound programme to the government to tackle the menace of corruption in the real estate sector.<sup>5</sup> It was stated by the industry representative that developer community was being branded as corrupt. The Confederation offered to discuss the entire matter of corruption instead of indulging in a blame game. However, the Confederation is candid enough to lay the blame on government agencies charged with granting plethora of approvals which are accorded only on providing speed money. The Federation refers to a study pointing out such approvals costing as high as 40% of cost of housing.

The above statement of the industry representative is reflective of the malaise that has beset the real estate sector. The situation is further compounded by the fact that in the recent investigations by CBI on G-2 scam, corporates in real estate sector provided parking facilities for funds in the scam giving credence to the belief that real estate sector has become the biggest generator and absorbent of black money. The mere clothing of the sector with the corporate image has not brought about any significant development of transparency measures and assurance of fair dealing. Rather the corporate structure has been used to facilitate the processes of parking and generating black money. Such a mode of working would necessarily be towards creating distance between the developer and the user by creating a layer of brokers who would increase the transaction costs for the user. There would be another set of intermediaries between the developers and government agencies who would be facilitating the approvals albeit on consideration.

In such a scenario, there would be fly-by-night operators who would vanish without a trace, leaving investors stranded. Whenever such a scam surfaces, CREDAI is not wanting in renewing its concern for the stranded investors and urging the general public to invest with a builder who is its member and further places its reliance on the intended Real Estate Regulatory Authority (RERA) which would bring about safeguards in favour of investors<sup>6</sup>. Further CREDAI has proposed to the industry

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<sup>5</sup> Nawaz (2011), "CREDAI calls for time-bound action to fight corruption," *Accommodation Times*, April 30.

<sup>6</sup> "Kochi CREDAI proposes to rebuild public trust," *Track2Realty*, June 7, 2011, [www.track2realty.com](http://www.track2realty.com)

ombudsman to put in place an effective grievance redressal mechanism for investors. It is instructive to observe the practice adopted by one of the most reputed corporate developer who has been in the business for several years. On Saturday, May 28, 2011 a scheme for developing retail space was advertised in National dailies for shops covering an area of over 300 sq. ft. An enquiry was made on SMS on 28<sup>th</sup> May itself for a space of 300 sq. ft. On Monday, May 30<sup>th</sup> an SMS reply was sent on behalf of the developer that 300 sq. ft. was not available. This response was followed immediately by a further enquiry showing interest in allotment for a larger area—more than 300 sq. ft—along with a request for a brochure. A representative of the developer obtained the email address of the enquirer for sending an e-brochure. The brochure sent, *interalia*, included a prescribed application form in which the intending allottee was to make the request for allotment accompanied by a hefty earnest money deposit. Later the applicant was required to agree to execute/sign definitive documents on a standard format which would be deemed to have been seen by the applicant while making the initial application. However, the brochure did not contain the so-called standard documents. A further request was made to the developer to send the said standard documents for perusal before a decision could be taken for making an application, which was to be accompanied by a hefty fee. Thereafter there has been no response from the corporate developer. However, their brokers are aggressively soliciting for applications and selling the scheme.

The draft legislation governing RERA, on which CREDAI has expressed its hope for executing an atmosphere of transparency, requires the developers apprising the allottees about all the documents that they would be required to sign. An organised association like CREDIA should show exemplary governance by ensuring that the elements of the intended legislation around which there is no reservation, are adopted without waiting for the enactment. The concerns expressed by CREDAI towards hapless investors of KOCHI are high on words and hollow in action.

The draft legislation on RERA addresses the concern of residential segment of the real estate sector. Malpractices in the commercial segment are equally pronounced,

as narrated above. There is no justification in excluding the commercial segment. Similarly, there are instances when developers indulge into developing farmlands and lure investments on such lands which are part of reserve forests, etc. Such a situation is created in the absence of proper disclosures. Thus, it would stand to reason that such segments of agriculture land which have been traded as farm houses, etc., should also come under the purview of RERA.

There seems to be a merit in the arguments of the Developers about the over regulation of the sector requiring them to obtain as many as 45 approvals from the local government bodies and local authorities. Such a state of affairs would only cause delays and result in corruption adding to the woes of the ultimate users.

There is thus a justification in building up provisions in the draft legislation creating and empowering RERA to be a watchdog for the process of approvals by the agencies and ensuring the availability of these approvals in a specified time frame on the pain of imposing penalties on the authorities/developers causing delays. Such provisions will be towards loosening the nexus among developers, politicians and bureaucracy.

The draft legislation creating RERA does not include provision for regulating the role of professional services like brokers, etc. Such professionals are vital links between the developers and users and their conduct has not always been above board. Their professional competence in providing services to their clients is not certified. Anyone with local influence can aspire to be a broker or a sub broker. When the Developers are being perceived to adhere to corporate image, it becomes necessary that professional ancillary services are 'professionalised' and regulated to inspire confidence among the users and government agencies. It would be necessary to include enabling provisions in the draft legislations so that RERA is made responsible for the professional conduct of various types of professionals in the Real Estate Business.

There are provisions in the draft legislation towards ensuring development as per the approved plans and in conformity with the regulations. There are also provisions

to address the concerns of users on the quality of construction material used, and, provisions for timely delivery and segregating funds exclusive to the project. The possibility of developers confronting/creating a log jam cannot be ruled out. RERA should have enabling provisions of taking over assets in such a situation and entrusting the task of further implementation to another developer/agency to address the interests of the users without loss of time.

It needs to be understood that it is not feasible to legislate on all aspects and address all situations which may arise in future. Further, enactment of legislations is a time consuming process. Development of a sector cannot afford the luxury of an endless waiting for the enactment of inclusive legislation. Entrepreneurs are there and demand is increasing, yet there is a widening trust deficit between developers and users on the one hand, and rising costs (due to external factors such as nexuses) on the other. CREDIA and other professional associations have to exhibit exemplary governance practices in their respective spheres to ensure that such provisions of draft legislations, which are unexceptional, are implemented by the developers and professionals without waiting for the actual enactment. The governance has to transcend the draft provisions to include initiatives through exemplary behaviour for a better image of the sector. After all, how long can a sector—which generates highest employment after agriculture sector, transcends 250 industries and contributes substantially to GDP—live with the reputation of being a fountainhead of corruption when the association of developers commits itself to transparency and corruption free development.

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