



EFFECT OF COVID-19 IN REAL ESTATE PROJECTS

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INTRODUCTION

Force Majeure is a French term which literally means major force or supreme force. It is also defined as an event or effect that cannot be reasonably anticipated or controlled¹. Typically, a clause on force majeure is inserted in long term contracts to take into account those events or circumstances which may not be in the control of a party and how the affected party would perform its obligations after the occurrence of such an event or circumstance. The events commonly covered in a typical force majeure clause are act of God, natural phenomena, including fire, storms, floods, droughts, earthquakes, lightning, cyclones and epidemics; blockade, revolution, riot or civil commotion; wars and hostilities; strikes and lockouts; any change in law affecting the performance of the contract etc.

The world is facing an unprecedented situation with the outbreak of the novel coronavirus disease called Covid-19. The mode and speed of its spread has resulted that the entire world has been put into lockdown affecting all major commercial activities. The activities of construction, development in the real estate sector are also not immune to the disruption caused by Covid-19 and all the real estate projects have been stalled. Without any doubt, Covid-19 is a completely out of control situation and would qualify any reasonable definition of a force majeure event.

DISRUPTION IN REAL ESTATE DEVELOPMENT

On March 24, 2020, the Government of India declared a 21 days lockdown in India, which has further been extended till May 3, 2020. The real estate sector, which was already reeling under the pressures of slow demand; the lockdown further accentuated the stress in the sector. In our view, some of the key issues which would affect the normal functioning of the real estate sector are:

- i. **Cash Flow:** Prior to Covid-19, the real estate sector was already facing the brunt of economic slowdown, which situation has further been aggravated by Covid-19. The real estate sector is facing a severe cash flow crunch. While earlier there was low demand, now, in the post Covid-19 era, even the existing buyers are trying to conserve their money to take care of higher priority items and to protect themselves from health emergencies, untoward economic situations etc. When Covid-19 started to spread beyond China and major European nations got affected, it was clear that India would not remain unaffected. Many of the buyers had since February, 2020 started defaulted on their payments. In a latest news², it has been reported that the realty sector is seeing 65% default in payments from its customers. Non-payments by allottees is putting further stress on an already fragile sector.

The Reserve Bank of India (RBI), on March 27, 2020, came up with a regulatory package³ to mitigate the burden of debt because of the disruption emanating from the Covid-19 pandemic. But on a fine reading and analysis of the said regulatory package, it appears that the purpose of the package was

¹ Merriam-Webster Online Dictionary, <https://www.merriam-webster.com/dictionary/force%20majeure>

² <https://www.businesstoday.in/sectors/infra/covid-19-lockdown-realty-sector-sees-65-default-in-payment-from-customers/story/400979.html>

³ <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11835&Mode=0>

to protect the balance sheets of banks, non-banking finance companies (NBFCs) etc from worsening off. The moratorium provided in the regulatory package comes at the cost of interest, which needs to be paid after the expiry of the moratorium, if not already served during the moratorium, thus affecting the profit margins of a developer. Though it can be argued that there is some easing in cash flow but at the same time, the receipts of the developers have also severely dwindled because of defaults being made by the allottees. Further to add, the maximum interest which may be charged by a developer from an allottee is capped as per various state rules, which generally hovers around SBI 1 year MCLR plus 2 percent, but the interest contracted by developers for their construction loans are many a times far higher than the interest which a developer can recover from the allottees. In addition to the foregoing, the developers also have the responsibility to bear other operational costs. So, in a nut shell, there is a wide cash flow gap which is emerging and the gap is going to further widen.

- ii. **Loss of execution speed:** Pursuant to the lockdown, the construction activities have been halted. A large number of labourers which were working on various real estate projects, because of lack of livelihood and earning means and also coupled with the burden of high economic costs in the towns, started migrating back towards their villages. Now as and when the economic and commercial activities resume back after the lockdown is lifted, and construction activities commence, there would be an absolute crunch of labour in the market. It would take a long time for the construction activities to pick up speed and to come to the level which existed prior to the Covid-19 scenario. If one were to further add the scarce cash flow, the offtake of construction and other raw materials by developers shall also get impacted thereby affecting the overall speed of development.
- iii. **Supply chain issues:** Covid-19 has stalled manufacturing and production activities in relation to non-essential goods and materials not just in our country but also in many countries around the world. Materials and goods which are related to construction and development generally fall in non-essential category. The supply chain disruption had hit the Indian market even before the lockdown was announced in India. In an article⁴ published in the Harvard Business Review on February 28, 2020, it was noted as to how the global supply chains had got affected and how the situation would further worsen over the period of time. In India, many projects which were dependent upon imported materials and supplies had already got affected prior to the lockdown. The lockdown has brought the entire supply chain to a standstill. Factories have been shut or have been directed to manufacture essential goods. For eg. the automobile manufacturers have been ordered by the government to produce ventilators⁵ or sugar mills and liquor companies were asked to produce hand sanitisers. The purpose of these directions is to produce those essential goods which are critical to help fight Covid-19. One may safely assume that over the period of time when the lockdown would be lifted, there would be larger thrust on production of those things which are more critical for the country. Only when things are closer to normalcy, the real estate sector would see resumption in proper supplies and this may take a considerable amount of time.

⁴ <https://hbr.org/2020/02/how-coronavirus-could-impact-the-global-supply-chain-by-mid-march>

⁵ <https://www.businesstoday.in/sectors/auto/coronavirus-update-govt-asks-automobile-manufacturers-to-make-ventilators/story/399618.html>

REAL ESTATE ACT AND FORCE MAJEURE

The Real Estate (Regulation and Development) Act, 2016 (“Act”) was enacted with a primary purpose of regulating the sale of real estate projects by real estate developers and to protect the interest of buyers/allottees in real estate projects. In order to safeguard the interests of such allottees, the Act requires that the real estate projects are completed by a definite date, failing which the developer is heavily penalized.

Covid-19 has put a spanner in the wheel and disrupted all the construction and development activities. As stated above, this would lead to delays in project execution and completion. Under Section 6 of Act, a developer may seek extension of its registration under the Act for delays caused by force majeure. Section 6 of the Act is reproduced below:

“6. Extension of registration. - *The registration granted under section 5 may be extended by the Authority on an application made by the promoter **due to force majeure**, in such form and on payment of such fee as may be specified by regulations made by the Authority:*

Provided that the Authority may in reasonable circumstances, without default on the part of the promoter, based on the facts of each case, and for reasons to be recorded in writing, extend the registration granted to a project for such time as it considers necessary, which shall, in aggregate, not exceed a period of one year:

Provided further that no application for extension of registration shall be rejected unless the applicant has been given an opportunity of being heard in the matter.

Explanation. - *For the purpose of this section, the expression "force majeure" shall mean a case of war, flood, drought, fire, cyclone, earthquake or any other calamity caused by nature affecting the regular development of the real estate project.”*

(emphasis supplied)

Section 6, in its explanation, defines force majeure. Though ‘epidemic’ as a term is not there in the said definition, however the phrase ‘calamity caused by nature’ is wide enough to take into account the effects of Covid-19. Further, the rules framed by various states under the Act, provide that the RERA authority has the power to waive off the fees payable for seeking extension of projects pursuant force majeure.

On the other side, the relationship of the allottees and real estate developers is governed by agreement for sale, the format for which have been prescribed by the states in their rules. The format does provide that the developer shall be entitled to extension of time if delay in handover of possession or conveyance of the property is caused because of force majeure events.

As on the date of this alert, few of the RERA authorities like the state of Maharashtra, Karnataka, Tamil Nadu and Uttar Pradesh, have gone a step further and have suo motto, extended the registration period of real estate projects falling under their purview.

- The RERA authority of Maharashtra has, vide its order dated April 2, 2020, extended the validity of registration of all the projects whose completion date, revised completion date of extended completion date falls on or after March 15, 2020, by three months⁶;
- The RERA authority of Karnataka has, vide its circular dated April 4, 2020, extended the validity of registration of all the projects whose completion date, revised completion date of extended completion date falls on or after March 15, 2020, by three months⁷;
- The RERA authority of Tamil Nadu has, vide its circular dated April 6, 2020, extended the validity of registration which were valid till February 1, 2020 upto June 30, 2020. Also, the completion of all the registered projects shall be extended by 5 months⁸;
- The RERA authority of Uttar Pradesh has extended the registration of those projects which have completion dates falling within March 15, 2020 and December 31, 2020 by three months, as announced by its press release dated April 14, 2020⁹.

CONCLUSION

It is apparent that most of the projects would face delay in execution and delivery because of disruption caused by Covid-19. Some of the RERA authorities have extended the completion period of the projects. It would be ideal that all the RERA authorities follow suit and extend the completion date of the projects which are registered with them.

Further, we observe that Uttar Pradesh RERA authority has only extended the registration date of the projects which are due for completion between March 15, 2020 and December 31, 2020, while we believe that extension should be granted to all the projects because Covid-19 would have long term impact on all the projects. In our view, the extension of registrations should be for all the projects which are already registered.

Also, the construction and development of projects is also governed by the building permissions, licenses, approvals etc which are granted by various other regulatory authorities. For eg., the Department of Town and Country Planning in the state of Haryana, the various development authorities in the state of Uttar Pradesh, the various urban improvement trusts in the state of Rajasthan, etc.

These other authorities should also suo motto extend the period of approval, building permit, licensee etc, without the requirement of the developer applying for such extension and also without the requirement of payment of any fees. These are unprecedented times and these times require unprecedented measures.

⁶ <https://maharera.mahaonline.gov.in/Site/Upload/PDF/Final%20Order%20for%20Revision%20of%20Duration%20v4.pdf>

⁷ <https://rera.karnataka.gov.in/reraDocument?DOC=nbHboHdOzsUUksQRs9UF%2Fw%3D%3D>

⁸ <http://www.tnrera.in/Downloads/CircularsAndOrders/TNRERA-Circular-06042020.pdf>

⁹ <https://www.up-rera.in/frm Ifram for Pdf.aspx?Param=Press Release 32603ExtensionofValidityperiod.pdf>

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