

Guidelines for Financing of Housing units in under Construction Projects

Extension of housing finance exposes banks and DFIs to risk of default from their customers. To mitigate this risk, Prudential Regulations on Housing Finance requires the banks to ensure, among other things, that:

- Borrower of housing finance has sufficient capacity to repay their housing finance. This is ensured through assessment of net worth and regular income of the borrower.
- House being financed has clear title document and legally enforceable mortgage is created on it in favor of the financing bank.

In case of normal housing finance for purchase, construction or improvement of houses, both of the above requirements can be complied with and are built in the normal credit assessment and risk mitigation processes of banks/DFIs. However, for housing units in under construction projects, banks/DFIs face the obstacles of availability of clear title documents especially in cases where allotment letters do not specify share of ownership in land, inseparable ownership in land parcel and housing units not yet constructed. In such cases, banks/DFI avoid extension of housing finance due to difficulties in creation of legally enforceable mortgages. This situation necessitates issuance of regulatory guidance to facilitate the banks/DFIs to develop financing products and other elements of market infrastructure for financing to housing units in under construction projects.

The under-construction projects may either be horizontal constructions i.e. single or two-storey standalone land based houses or vertical constructions i.e. flats/apartments in multistorey buildings. Further, the builders/developers of the housing projects may or may not have availed construction financing.

Thus, on these two parameters under-construction projects may be categorized into following four groups:

- Projects comprising of horizontal houses where builders/developers have availed construction financing
- Projects comprising of horizontal houses where builders/developers have not availed construction financing
- Projects comprising of vertical houses where builders/developers have availed construction financing
- Projects comprising of vertical houses where builders/developers have not availed construction financing

Creation of legally enforceable mortgage in case of projects of horizontal houses is easy as the borrower owns the land parcel and subsequent constructions thereon. The availability of clear title documents allows banks to extend financing and create mortgage. In fact, banks are already extending financing for construction of horizontal houses which is usually termed as construction of house on already owned plot or purchase of plot and construction of house thereon.

On the other hand, the land parcel of the apartments/flats is inseparable and is jointly owned by the purchasers/owners of all flats/apartments in the building. Further, title documents of flats/apartments may not be valid during the construction period such as an allotment letter of an incomplete flat in grey structure of an under-construction building or a flat on 7th floor of a building presently having three floors.

The mortgage on houses/apartments in under-construction buildings may not be perfected due to defects/non-availability of title of ownership.

Enforceability of mortgage in multistorey under construction buildings is further complicated as some purchasers of flats/apartments in an under-construction building may avail bank/DFI financing while others may not have availed bank/DFI financing. Therefore, in case of default of builder/developer or mortgage borrower, seeking consent of all owners to sell incomplete building or selling of a flat/apartment therein to recover housing finance may not be possible for the financing bank/DFI.

However, many of the issues and challenges are resolved in case a bank or consortium of banks/DFIs have provided financing to the builder/developer and the same bank/DFI or consortium of banks/DFIs is providing housing finance to the purchasers of housing units in the building. In this situation, project non-completion risk gets mitigated as the structure contemplates the creation of appropriate mortgage over the project land. This security (if enforced by the bank(s)/DFI(s)) can allow bank(s)/DFI(s) to sell-off the unfinished/incomplete project, recover its outstanding amounts and even refund any excess balance to the end-user unit purchasers who have made advance payment of instalments.

Further, this structure also facilitates enforcement/transfer of allotment of individual units in case of default as the same consortium would have the benefit of mortgaged land as well as the individual unit. From a practical standpoint, the allotment of a unit cannot be effectively enforced without a mortgage on the underlying land.

Considering the above, the financing to the housing units in under construction projects of vertical housing units shall be allowed only in the scenario that same bank/DFI or consortium of banks/DFIs which has provided construction financing to the builder/developer is providing housing finance to the purchasers of housing units in the building with the following conditions:

- 1. Builder/Developer Selection Criteria:** Bank(s)/DFI(s) shall devise Builder Selection Criteria and Project Selection Criteria to select builders and their projects which are eligible to enter into arrangements for financing of under construction projects. The builder selection criteria may inter-alia include builder's/developer's financial soundness, track record of builder/developer regarding compliance with legal and urban planning as well as fulfilment of milestones of completion in previous projects. For the purpose of these guidelines, builders/developers are entities which undertake construction of vertical residential or commercial-cum-residential projects for the purpose of selling of housing units in these projects to general public. These builders/developers can be private entities or government owned entities/departments/agencies.
- 2. The projects must have obtained all applicable approvals from regulatory and developmental authorities.** Bank(s)/DFI(s) shall ensure physical and legal verification of the project's overall documentation such as title documents, NOCs from relevant development authorities/agencies, approved site plan etc. The project selection criteria may additionally include such factors as accessibility to schools, hospitals, availability of external road infrastructure, transport, utilities, etc. and marketability of housing units in the project. For the purpose of these Guidelines, under construction projects are vertical residential or commercial-cum-residential projects on which construction work is yet to start (new projects) or housing projects on which partial construction has already been made.
- 3. Bank(s)/DFI(s) shall sign a Master Financing Agreement (MFA) with the builder/developer.** This agreement, in addition to financing terms shall also include the construction plan, timelines for

completion of project, different construction milestones, loan disbursement plan and procedure for repayment of financing to bank(s)/DFI(s).

4. Bank(s)/DFI(s) may decide about debt equity ratio for the project keeping in view the risk profile of the builder/developer. However, bank/DFI financing shall not exceed 70% of the project value. In case of cost overruns, bank(s)/DFI(s) shall require builder/developer to arrange additional funds from own sources. Bank(s)/DFI(s) shall ensure that project feasibility accounts for cost overruns and builder/developer withstand unexpected additional project costs.
5. Bank(s)/DFI(s) shall create mortgage charge on the project land and constructions thereon. During interim period till completion of construction and formalities for legal transfer of titles of housing units to purchasers, consortium bank(s)/DFI(s) shall keep mortgage on project land along with constructions and appurtenances thereon as an arrangement of third party mortgage from builder/developer on behalf of housing finance borrowers.
6. The builder/developer shall be required to obtain NOC from the lead consortium bank/DFI, on behalf of all financing banks/DFIs, before selling any housing unit in the project to a purchaser.
7. All purchasers of housing units in the project availing mortgage finance shall sign a tripartite agreement with the builder/developer and bank(s)/DFI(s) specifying superior rights of bank(s)/DFI(s) over the project land and constructions thereon. Further, banks shall also obtain informed consent from the purchasers who do not avail mortgage finance under these guidelines.
8. The 'allotment letters' for the housing units in the projects shall be appropriately drafted jointly by legal counsels of bank(s)/DFI(s) and builders/developers so as to cover the undivided rights/interests of purchasers of housing units in project land and also clearly spell out superior rights of bank(s)/DFI(s) over the land/unit. The allotment letter shall also clearly spell out that purchasers may obtain mortgage financing against their housing units, if so desired, only from one of the banks/DFIs in the consortium for project financing.
9. The builder/developer shall provide guarantee to buyback the housing unit or arrange an alternative purchaser in case of delinquencies, whether delinquencies in payment of markup installments by the borrowing purchasers or delinquency in regular construction payments in case of non-borrowing purchasers of housing units in the projects. Further, in case of delinquencies by the borrowing purchasers of housing units during construction period, financing banks/DFIs shall require builder/developer to prioritize re-allotment/transfer of such housing unit to interested/potential purchasers.
10. Bank(s)/DFI(s) shall require builder/developer to neither give possession nor transfer the ownership of housing unit without clearance of all over dues at the time of possession or transfer.
11. All payments to the builder/developer for completion of construction/project shall be routed through an escrow account maintained by the lead bank/DFI of consortium. The builder's/developer's equity and purchasers' equity contribution and subsequent payments of the purchasers through mortgage financing shall be routed through the same account.
12. Disbursements to the builder/developer shall be made in tranches upon completion of construction milestones as per agreed terms and conditions of financing arrangement between the builder/developer and the bank/DFI.

- 13.** The sale/booking proceeds of housing unit and subsequent instalments (if any) would be adjusted against the outstanding financing of the project as per purchaser's payment schedule.
- 14.** In case of purchasers availing mortgage financing from the bank/DFI, the bank/DFI shall pay the instalment of housing unit due against the purchaser(s) by booking a loan of similar amount in the name of purchaser(s). In this way, only mortgage financing shall be outstanding at the time of completion of project.
- 15.** In case of purchasers not availing bank/DFI financing, the builder/developer shall be responsible for the collection and deposit of due amount, as per their payment schedule, in the Escrow Account.
- 16.** The builder/developer shall be required to complete the project with arrangement of completion certificate, connection of utilities (water, electricity, gas etc) and other approvals/NOCs from the relevant authorities/agencies.
- 17.** Upon completion of the project, builder/developer shall be required to transfer ownership of housing units to purchasers through registered title deeds along with completion of all formalities as prescribed by relevant law and creation of mortgage in favor of mortgage financing bank(s)/DFI(s) without any legal impediment.

Further, the banks/DFIs shall adhere to applicable prudential regulations and their own risk assessment policies while extending housing finance in under construction projects.