APPROACH IN RAISING BANK FINANCE FOR CONSTRUCTION INDUSTRY

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Real Estate is one of the major drivers of the economy with their significant contribution to the country's GDP. As such, the construction finance is critical to ensure that real estate development faces no hurdles.

In view of this massive funding requirement of the construction sector, there is a need for a robust financing ecosystem, supported by enabling policy initiatives. The banks provide the largest share of the construction finance followed by HFCs (Housing Finance Companies), NBFCs and by trusteeship (Alternate Investment Funds). Over the past several years, the government has undertaken several reforms and positive policy initiatives to meet the construction finance requirements, but despite this promising support, the road ahead has many challenges to surmount.

Bank credit for construction finance remains a challenge. It is not just restrictive but also costlier for the small and medium real estate companies. However, over the past few years, several policy measures have been taken to improve construction finance, including re-finance schemes for construction finance for affordable housing by the National Housing Bank (NHB).

A spate of reforms including RERA to regulate the real estate sector, making it more organized and transparent, has helped boost sourcing of foreign funding. Today Greater transparency adopted by real estate developers with regard to accounting and management systems to meet due diligence standards of investors, will further boost funding in the coming years.

Reforms have opened up alternate financing routes for the construction sector. Alternate Investment Funds (AIFs) have emerged as another construction financing option.

Construction Industry is a capital-intensive industry, where heavy fund investments are required on daily basis at the initial stage of the construction project and the payment from bookings comes in installments. There will be always cash flow deficit in the project at the initial stages. Banks and other financial institutions funds the deficit of the project and get the loan repaid at the nearing completion of the project.

India is a developing country. Government is encouraging various industries including Real Estate. Government has been giving many concessions to Real Estate i.e. increase in TDR, development of SRA properties, additional FSI, Fungible FSI etc. for last 2 decades. Many banks are positive about sanctioning loan to Real Estate. Therefore, many companies are entering into Real Estate development projects.

Real Estate sector offers an attractive avenue for deployment of funds, especially in the present environment of active marketing of housing finance by commercial banks and other housing finance companies; resulting in an increase in construction activities which results in the requirement of more Project Finance.

Banks and financial institutions consider the following types of funding for Construction Industry:

1) **Construction Finance:**

- Construction finance is the shortage of Cash Flow funding. In construction projects developers needs more funding at the initial stages for acquiring land or Development rights, paying premiums and buying FSI, paying for TDR and for starting the construction

- Banks and financial institutions gives finance for the construction cost of the project and as per the progress of the work banks disburse the loans to the developers

- The prior permission from Government / Local Government / Other Statutory Authorities for the project should be in place before sanction of the loan.

- The construction finance is not extended to developers :

    i) For acquisition of land.

    ii) For meeting the cost of acquisition of development rights, for paying Premiums and FSI cost.

    ii) For meeting the tenancy settlement cost.

- Developer firm or partners should have completed projects in recent past and having project delivery track record

- Project should be RERA Registered (or RERA Registration process must be initiated)

- All the permissions for construction should have received

- Construction of the project must have started at the time of first disbursement of loan.

- Banks mortgage entire project and in some cases banks may ask for additional collateral securities.

- The total securities including collateral securities shall not be below 150% of the loan amount.

- Bank take personal guarantee of all partners/directors

- The funding can be done covering maximum 60% of the total project cost

- Promoters margin should be 40% of the total project cost. Booking advance received from the customers are treated by the banks as part of the promoter's contribution.

- Developers have to submit Architect Certificates and CA certificates at periodical intervals for ascertaining the progress of the work and funds deployment.

- The payments from the loan are issued directly in the name of suppliers and contractors

- Sales inflows would be charged (hypothecated) with the lender

- depending on the project status principal moratorium would be given

- The loan tenor ranges from 3 to 5 years as per the need of the project. The loan gets disbursed in periodical intervals as per funds required for the project.

- Repayment of the loan will be at the end of the loan period as per the cashflow

- Rate of Interest range for majority of lenders is 10% to 13%

2) For Inventory Finance :

Banks and NBFC gives loans against unsold inventories to developers.

This funds developer can use for the same project or for any other project or for their day to day requirements

- Even first time Developer's proposal can get funding against inventory

- Saleability of the project and latest sales trend in the surrounding market is considered

- Project in which units to be mortgage should have completed more than 90%

- Developer can utilise this money for his any business purpose

- Lender gives funding upto 60% to 65% of the value of the property

- Bank take personal guarantee of all partners/directors

- The loan tenure ranges from 3 years to 7 years

- Loan repayment is in equal monthly installments, so its start from next month of disbursement

- Developer firm and the partners should have justified income for repayment of installments

- Rate of Interest range from 10% to 13%

3) For Structured/Early stage Finance

AIF (Alternate Investment Funds) and some of the NBFCs gives early state funding. They give funding at the early stage of the project.

Developer need more money at the initial state for acquisition of land or Development rights, for paying for FSI, premiums and other charges to authorities for buying TDR, In case of redevelopment projects, developer needs to pay for corpus, mobilisation advance and rent also. Banks don't give finance for all such needs, so in case of early funding needs AIF and some NBFC play a key role and fund the initial stage of requirements. The various terms of the sanction and disbursements are as follows

- The disbursement of the funds is directly of the specific purpose mentioned in the term sheet

- They give funding to the corporate entity i.e.project should be either under private limited or public limited companies

- Interest is paid either monthly or quarterly as per sanction arrangement with the lender.
- The lender mortgage the entire project and create charge on entire project
- Lender issues NCDs (Non Convertible Debentures) for the loan amount
- Shares of the borrower company needs to be in demate form and it needs to be pledged in favour of lender.
- Lender takes personal guarantee of all the directors
- Lender take PDCs cheques as per Repayment schedule and one blank undated cheque for the entire loan amount as security.
- They monitor the cashflow and the progress of the project at periodical intervals
- Other Majority of terms are similar to Construction Finance; however, funding can be done at pre-approval stage (and even for Land Acquisition)
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