

## ERGO

*Analysing developments impacting business*

### KARNATAKA REAL ESTATE REGULATORY AUTHORITY NOTIFICATION

03 August 2023

The Karnataka Real Estate Regulatory Authority (Authority) on 19 July 2023 issued a notification (Notification) which has *inter alia* added to the scrutiny of funds (borrowed from lenders) raised in connection with real estate projects.

As per section 4 of the Real Estate (Regulation and Development) Act, 2016 (Act), a promoter (which includes developers of real estate projects as per the meaning ascribed to it under the Act) is under an obligation to deposit 70% (seventy per cent) of the amounts realised for the real estate project from the allottees, in a separate RERA project designated account (as defined under section 4(2)(I)(D) of the Act) (Designated Account), which is to be maintained in a scheduled bank to cover the cost of construction and the land cost and shall be used only for that purpose (Designated Purpose).

It was observed by the Authority that the promoters of the project were raising additional funds *via* borrowing from banks, financial institutions, and other lenders against the mortgage of project land, apartments, and units in the project. Further, the Authority observed that the money raised from such borrowing was not being fully realised towards the Designated Purpose.

To ensure that the funds borrowed for the purpose of the project are utilised for the Designated Purpose, the Authority via the Notification has brought about the following changes:

i. **Deposit of borrowed money into the Designated Account:**

The Authority has mandated that the promoter of the project shall deposit the entire amount borrowed for the purpose of the project into the Designated Account of the project and the money so deposited shall be utilised and withdrawn only for the Designated Purpose.

ii. **Bifurcation and apportionment of the borrowed amount:**

If the promoter borrows money for the project and registers the project phase wise as per the Act, the promoter shall bifurcate and apportion the amount towards various phases and report the same during the quarterly updates along with the bank statement or chartered accountants' certificate by way of an annexure.

iii. **Disbursal of borrowed sum in the Designated Account and confirmation from chartered accountant for the same:**

The banks, financial institutions, or other lenders lending to the promoter shall ensure the disbursal of borrowed funds only into the Designated Account. Separately, the chartered accountant issuing a certificate as required under the Act shall report whether the amount borrowed for the purpose of the project has been deposited into the Designated Account or not.

iv. **Effect on existing projects & power of the Authority to enforce the Notification:**

In cases where the promoters have already borrowed money for the purpose of the project, and they have not utilised any portion of such money to the respective project shall deposit the unutilised portion of the money into the Designated Account within 3 months from the date of the Notification. Therefore, to this extent, the Notification is effective retrospectively.

Separately, the Notification gives the Authority the power to call for any information or documents from the promoters by issuing a notice in order to enforce the Notification.

**Comment**

With the introduction of the Notification the borrowing of funds in the name of the project will be tracked, thus leading to better fund management and presumably no diversion of funds. The flip side is that the promoters while borrowing funds have to be specifically cautious when defining the 'purpose' for which they are borrowing the funds from any financial institution, bank, other lenders, as improper classification of the 'purpose' could lead to the borrowing being hit by the Notification. This will greatly impact the industry practice of raising debt funds by creating a charge on the project, towards the development of project and other working capital or general corporate purposes. The lender and borrowers would have to upfront split the amounts into borrowing for projects development costs and any other purposes, since the former will be disbursed directly into the Designated Account and utilised only for the Designated Purpose.

- *Smita Jha (Partner), Diksha Singh (Senior Associate) and Parth Tyagi (Associate)*

For any queries please contact: [editors@khaitanco.com](mailto:editors@khaitanco.com)