

FINANCING CONDOMINIUM HOUSING UNITS

THE NEED & RECENT DEVELOPMENTS IN LEGISLATION, THE CONCERNS AND CONSEQUENCES

By Delrene Seneviratne

The need for developing housing finance has received much emphasis in the recent past, particularly due to the vibrancy and the future growth potential of the sector. The rising demand in the property development and housing industry has thus necessitated the development of a conducive macro environment supported by well developed institutional and legal infrastructure to cater to the rising financial demands of a myriad of players in the sector ranging from property developers and contractors to potential buyers of housing units.

The need

The Central Bank in its Annual Report for 2002, estimates the current shortfall in housing units at 400,000. However, according to the statistics furnished by the Ministry of Housing, Population and Infrastructure, the shortfall would increase to 650,000 by 2010, highlighting the need for greater financing in this sector. In addition, the Central Bank Annual Report notes that a substantial number of existing housing units in the country are of substandard quality, requiring re-construction/renovation.

The conclusions that can be derived from the above analysis is that housing investment in the country is a significant one, probably exceeding Rs. 100 billion annually, based on the average cost of Rs. 600,000 per housing unit.

On the contrary, the financing provided by the banking sector exclusively to the housing industry is relatively a lower figure. As per the Central Bank Annual Report 2002, the demand for housing expanded rapidly in 2002, with the recovery of the economy and falling interest rates. In addition to the special housing loan schemes initiated by the government, public sector housing finance institutions as well as private housing finance institutions further expanded their housing finance projects during the year 2002. It has been estimated that housing finance institutions granted 83,698 housing loans in 2002 compared to 58,760 granted in 2001. As per the said report, State Mortgage and Investment Bank (SMIB) Housing Development Finance Corporation (HDFC) and National Savings Bank (NSB) granted 25,124 housing loans in 2002, in comparison to 18,994 loans granted in 2001. Meanwhile commercial banks, namely, Bank of Ceylon, People's Bank, Hatton National Bank, Seylan Bank and Commercial Bank, together granted 43,677 housing loans in 2002 which is a 92% growth over 2001. The loans approved by all financial institutions during the year 2003 grew by about 27% and amounted to Rs.7.8 Billion while the loans approved by the four housing finance institutions during the said period increased by 25% amounting to 4.8 billion. Hence it is evident that there is a significant gap between the actual investment and financing provided in the country, creating a great potential for a housing finance market.

In this regard it is rather interesting to note that most of the state banks are exposed to small loans, ranging between 2 to 3 hundred thousand Rupees, while the average loan size of the commercial banks is around 1 million Rupees.

Geographical distribution of Housing Units

The census conducted by the Census and statistics department in 2001 has estimated the total housing units in the country at 4,687,157 out of which the Western Province alone accounts for 27.51% of the Housing stock in the country. Five provinces, namely Western, Central, North Central, Southern and Sabragamuwa account for approximately 76.61% of the housing stock in the country. A district-wise analysis as to the distribution of housing stock reveals that 7 districts account for over 50% of the housing units in the country; Gampaha, Colombo, Kurunegala and Kandy accounting for 10.92%, 10.83%, 8.78% and 6.75% respectively.

Hence it should be noted that scarcity of lands, particularly in the urban areas supplemented by the increase in population density have prompted high rise apartment buildings to evolve as the highest growth sector in the industry. The development of construction technology too has undoubtedly played a distinct role in the creation of multi storeyed residential buildings in urban areas to cater to the rising housing demands within the fixed supply of land. According to a recent research apartments have been identified as a significant growth sector which had in fact provided a much needed boost for the construction and real estate market in Sri Lanka. Demand is primarily driven by location and convenience. Most apartment towers have been planned at very residential locations which would otherwise have been off limits to many people. Many are priced at the upper market segment, although the term 'luxury' is loosely and ambiguously used. Most existing players have targeted non-resident Sri Lankans who see such a purchase as a retirement option. New developments in the pipelines are marketing to the working class in Colombo.

According to the findings of the said Market Research, general demographic trends have played an important part in this demand for apartments within the city. As is evident with most players, non resident Sri Lankan professionals who have worked or are still working, are buying these properties as retirement options. Aged and aging Sri Lankans, who will migrate from the suburbs to the convenience of apartments, will see an increase in the long term, funded partially by exchanging their existing dwellings and partly by children working abroad.

It is envisaged that as Sri Lanka's population ages and a majority of those aged 18-30 begin to migrate, a significant growth in demand from the aged sector would be evidenced, as they see apartments being convenient and safe. The demand for condominium housing units, as a more preferred housing option, also stems from the fact that it enables a person to share in the ownership and operation of a housing development, while having negotiable title to his own unit, since the unit owner can sell, lease, or mortgage his unit to raise money as in the case of properties with absolute ownership.

In the context of the current market, Colombo city apartments continue to target the higher end of the market. The findings of the said research further reveals that Wellawatte heads the apartments list as the town with the most number and highest occupancy. Wellawatte occupies a unique position, driven primarily by Jaffna Tamils who sought refuge from the war and

migrant Tamils who want to own property in Sri Lanka. This mix has led to an unusual boom in demand, which also leads to an artificial price premium.

Crescat, Ceylinco-Celestial Towers and Premiere Pacific Topaz remain the blue-chip apartments of choice in the heart of the city. They have various options based on traditional apartment pricing models, including space and elevation. Most have also been planned as communities with retail space been leased out to businesses which cater to the tenants of the building. It is difficult to forecast how successful this strategy would be, as only Crescat is in operation and they have a mall that targets a wider market than those who live in the apartments. Empire towers on the other hand is envisaged to market itself uniquely as an exclusive residential apartment tower with amenities that include a private cinema.

The latest addition to the high value apartments within the city of Colombo would be the Havelock City to be developed as a joint venture between Bank of Ceylon and Shing Kwan Group of Singapore at the former Wellawatte Spinning and Weaving Mills premises. The proposed venture with an estimated development cost of US\$150 Million would consist of 8 blocks of condominium housing providing 1080 individual units ,a 300 room hotel with another 200 units of serviced apartments, a shopping centre, Cineplex, supermarkets and an international food court.

Despite the existing scenario, demand continues to exist for cheaper apartments within greater Colombo. This segment shows a large demand trend for the 2-4million rupee apartments within Colombo city. Unfortunately most developers seem to want to by pass this segment for the present as the returns are not as attractive as at the higher end. The demand for this sector is from middle income earners and is for locations in the suburbs.

Funding of Condominium Property -

With the evolution of mutli-storeyed high rise apartment complexes as the major growth sector in the housing industry, financial Institutions are generally approached by the Developers and owners/potential owners of condominium housing projects/individual units for following purposes ;

- Purchase of land for the establishment/construction of a multi storied condominium building
- Funding the prospective buyers for the purchase of condominium units which have been partly/fully completed.

Financing of above has led to many difficulties on the part of the financial institutions primarily due to the procedural aspects covered under the Apartment Ownership Law Act No. 11 of 1973 (ACT), although a new legal principle was created with the enactment of the said ACT for the registration of title relating to condominium parcels in condominium buildings, subdivisions and amalgamation with common elements appurtenant and to enable the separate ownership and disposition of individual title to such condominium parcels .

Issues relating to registration & financing under the earlier law

As per the provisions of the said ACT, the following issues had been raised by financial institutions in funding property developers/prospective purchasers of the condominium units -

- Any financial institution granting the loan facility to a property developer of a condominium building would mandatorily require that a mortgage be executed in respect of the land as well as for individual condominium units as collateral for the loan facility granted.
- Accordingly, when a condominium building consisting of several independent units have been constructed, the title to all such units will “go with the land” and shall become subject to the mortgage already created in respect of the subject land. However, as per the provisions contained in the ACT , such mortgage is extinguished at the time of registration of the condominium plan at the relevant Land Registry.
- As a result, the financial institutions that originally granted the financial facility for the purchase of the land / construction of the condominium building faces a dilemma unless a fresh mortgage is registered (incurring fresh stamp duty) in its favour, in respect of all condominium units, subsequent to the registration of the condominium plan.
- On the other hand, prospective purchasers of condominium units would require each unit (together with the common elements attached thereto) to be released from any liens and encumbrances in order to obtain further financing for the purchase of such independent units.
- In order to facilitate the creation of such independent title to each condominium unit, it is necessary to register the condominium plan at the relevant Land Registry and open separate volume / folios in the books of the Land Registry for each independent condominium unit.
- However, as per the provisions of the ACT, registration of the Condominium plan at the relevant Land Registry is subsequent to the full completion of the entire condominium building and the obtaining of the certificate of Conformity from the relevant local authority.
- Accordingly, a Condominium unit cannot be treated as having independent title unit such registration has taken place. Hence, the transfer of units or mortgage of such units is not feasible as per the provision of the Act since each condominium unit is not deemed to possess independent title.

The Recent Amendments

In the above circumstances, it is evident that the owner or developer can sell their product only after completion of the whole condominium building and registering at the land registry. This has invariably resulted in increase in the unit cost due to high cost of capital. The position is further weakened by the fact that even the prospective purchasers of the independent condominium units are not in a position to raise funds from the lending institutions due to non availability of collateral until the condominium buildings are completed and registered at land registry.

In order to address the above issues and to create conducive legal environment for the financing of high rise condominium housing units, amendments were enacted by the Parliament

of Sri Lanka recently to amend the Common Amenities Board Act No. 10 of 1973 and the Apartment Ownership Law Act No. 11 of 1973.

It is envisaged that the above amendments will ensure the protection of the interest of both lending institutions and prospective purchasers and also facilitates property developers and prospective purchasers to enable them to raise required finances at the initial stage of constructions of the condominium building and to ease out the risk of lending institutions in providing financial facilities to property developers as well as individual purchasers.

In addition to the foregoing the said amendment also empowered the newly established condominium Management Authority to manage the condominium properties and common elements, supervise and administer the affairs and activities of the Condominium Management Corporates, demolish the unauthorized constructions and carry out urban renewal programmes by demolishing dilapidated condominium properties.

The salient features of the new legislation could be set out as follows :

- Extend the applicability of the law to buildings already erected / to be erected / partly erected.
- Registration of the Condominium plan at the early stage of construction on provisional basis at the land registry.
- Registration of partly completed condominium building having two or more completed condominium parcels at the land registry on incremental basis.
- Recognition of titles for provisional condominium parcels of the provisional condominium property upon registration at the land registry.
- Impositions of restrictions on the titles of the land parcels which cover provisional condominium property for the protection of the interests of lending institutions and prospective purchasers.
- Recognition of “agreements for sale” as effective legal instruments to be used as collateral for securing the loans by the individual prospective purchasers and to ease out risk factors of the mortgagee in granting loans.
- Intervention of the Superintendent of Surveys in the registration process.
- Specific Provision for the Issue of Certificates of title even during the interim period of construction / completion of the condominium property.
- Strengthen the capacity of the owners of the condominium parcels corporation known as “management corporation” by empowering the said corporation with powers to administer land, manage all common elements, common amenities of the condominium property and to deal with unauthorised constructions.

- Provision for the supply of common amenities such as water and electricity to individual unit owners and occupiers through the management corporations, properly observed by the respective stakeholders and the ancillary powers to administer such services such as disconnection and recoveries.

In addition to the foregoing, in order to ensure that the above provisions in the Apartment Ownership Law are properly administered, amendments have also been introduced to the Common Amenities Board Act by converting the Common Amenities Board as a Condominium Management Authority with powers to oversee the overall management of the condominium buildings in the country.

Concerns and Consequences

Despite the encouraging developments to the legislation referred to above, the financial sector still continues to be conservative on lending to apartments. As per the findings of a recent study on the subject many banks are reacting cautiously to the new “apartment boom” and are not aggressively marketing housing loan packages to this segment. While some banks are hindered by certain internal / legal policy guidelines as to the ascertainment of independent title to each independent unit , most others tread conservatively.

Some of the primary concerns raised in financing condominium units (which is vital in establishing independent title to the units to be financed as security for the financial facilities to be obtained) could be broadly summarised as follows;

- Although the recent amendments recognize the registration of all condominium plans (provisional Condominium plans or semi condominium plans) at the relevant land registry, obtaining of a Certificate of Conformity (which is a condition precedent for registration) from the local authority within whose limits the land is situated and empowered to approve the building plan may not be feasible, in the event of registering a semi condominium plan.
- the specific requirements to be fulfilled by the developer / owner of the condominium property as to the obtaining of the Certificate of Conformity from the relevant local authority (which is a condition precedent for registration of the Plan) is not specified in the amendment Act since such ambiguities and uncertainties lead to many delays in the title registration process.
- the eligibility and the exact time frame for making an application for the registration of the provisional / semi condominium plan also appears to be rather ambiguous as per the provisions of the new amendments.
- more emphasis should be placed on defining the rights and responsibilities of the developers and penal provisions must be incorporated into the act to punish defaulting developers.
- in the event of inordinate delays, provision should be made in the Act for potential purchaser/s of the condominium units (who already have entered into an agreement with the owners) to remove the developer / or take possession of the incomplete apartment and undertake completion works at his / their own cost.

- in the event of the owner / developer of the condominium property failing to transfer the completed units after receiving the stipulated consideration, provision should be made for the competent authority to exercise its powers and facilitate same.

Above all as per the provisions contained in the amendment , “upon registration of a condominium plan or a semi condominium plan, each condominium parcel depicted therein, together with the common elements appurtenant thereto, shall be deemed to be absolutely owned by the person or persons described in the relevant plan as the owners of the condominium property or the semi condominium property, as may be applicable without prejudice to the rights of the mortgagee to exercise the right of execution of parate or to obtain monetary compensation, in terms of the law relevant to such mortgage or to the right of any other person to obtain monetary compensation for any loss suffered as a result of any mortgage agreement for sale or interest he had in the condominium property or in the semi condominium property before such registration being adversely affected.” It should be noted that the above provisions are not uniformly applicable in the case of provisional condominium plans, although the existence of mortgages prior to the registration of the provisional condominium parcel shall extend to each such condominium parcel and no instrument in respect of any of the condominium parcels could be executed in favour of any other party without the consent of the mortgagee/s.

The future -

The liberalized economic environment and urbanization process that has prevailed in the recent decades has added much emphasis in enhancing housing and the development of related infrastructure within the city of Colombo and its immediate suburbs. Associated with the scarcity of land the present situation has demanded the development of vertical condominiums in order to address the issue of housing the population which migrated to the city for employment and other economic activities.

In the foregoing scenario where more and more high rise condominiums coming in to existence, it is necessary to install a financial mechanism to cater to the potential developers / owners of such buildings as also to the end-users of such condominium units. The success of any such system would primarily be dependent inter-alia on the administration and monitoring of the progress of the construction of the registered provisional condominium property in order to ensure that the interest of the relevant parties (the purchasers / lending institutions) are protected and to intervene wherever it is necessary to protect such interests.

In addition to the foregoing, it is vital that other contributory authorities, such as the relevant local authorities, Urban Development Authority, the Survey General's Department should liaise with the relevant land Registry to enable the smooth functioning of the registration process particularly to facilitate the lending institutions to consider end-user financing while the subject condominium property is still under construction since the Registrar of Lands has been traditionally assigned with the task to act single handedly as the watchdog to facilitate the registration / implementation of the process.

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Her career in banking commenced in 1990 when she joined the National Development Bank of Sri Lanka as a Law Officer attached to the Legal Department specializing in merchant banking and business consultancy work. In addition she also served as the Company Secretary / Lawyer for several subsidiary/ associate companies of NDB.

In 1997 she was assigned the non-performing portfolio of NDB and was responsible for instituting foreclosure action/entering into terms of settlement, acquisition and sale of assets acquired by the Bank until early 2004 in the capacity of Manager (Special Projects). A former American Field Service scholar, Delrene was also awarded a scholarship under the Foreign and Commonwealth Officer (United Kingdom) under which she pursued Post Graduate Studies at Queen Mary College University of London on Law and Practice relating to International Commercial Law and Arbitration. She has also completed her Masters in Labour Studies from the University of Colombo and is in the process of submitting a thesis on "Legal Implications Applicable to Female Workers Under The 200 Garment Factories Program".

Currently she functions as the Head of Business Development at NDB Housing Bank on secondment from NDB. In addition she has also been nominated to serve on several Wages Boards functioning under the Wages Boards Ordinance.