

**Government of India
NITI Aayog**

Press Note

Initiatives to revive the Construction Sector

New Delhi – 31 August 2016: The Cabinet Committee on Economic Affairs chaired by the Prime Minister Shri Narendra Modi approved short-term and long-term initiatives to address the issues ailing the construction sector.

These initiatives, inter alia, include:

- (i) PSUs/ Departments may seek the consent of the contractors/ concessionaires to transfer the arbitration cases initiated under the pre-amended Arbitration Act to the amended Arbitration Act, wherever possible;
- (ii) In case of claims where the PSU/ Department has challenged the Arbitral Award, 75% of the award amount may be paid by the PSU to the contractor/ concessionaire against margin free Bank Guarantee;
- (iii) All PSUs/ Departments issuing public contracts may consider setting up Conciliation Committees/ Councils comprising of independent subject experts in order to ensure speedy disposal of pending or new cases;
- (iv) Item-rate contracts, may be substituted by EPC (turnkey) contracts, and PSUs/ Departments may adopt the Model EPC contracts for construction works; and
- (v) Department of Financial Services, in consultation with Reserve Bank of India, may evolve a suitable one-time scheme for addressing stressed bank loans in the construction sector.

Background

Construction sector has an important place in the Indian economy. It is the second largest contributor to economic activity accounting for about 8% of GDP; accounts for the second highest inflow of FDI after the services sector; generates the highest level of direct and indirect jobs employing about 40 million people and creating 2.7 new jobs indirectly for every Rs. 1.00 lakh invested. The sector has major forward (infrastructure, real estate,

manufacturing) and backward (steel, cement, etc.) linkages, implying a high multiplier effect on economic growth, almost two times. Major construction activity originates in the infrastructure, industrial and real estate sectors, where infrastructure sector accounts for almost half of the demand.

The demand for construction services is expected to rise due to several factors, like massive expansion of the infrastructure sector, industrialisation, urbanisation, rise in disposable incomes, various Government initiatives to improve India's residential and transport infrastructure (Smart Cities project, 'Housing for All by 2022', Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and easing of FDI norms in 15 sectors including real estate and construction). Timetric's Construction Intelligence Centre (CIC) projects major growth for the construction industry in India, with average annual growth in real terms expected to improve from of 2.95% in 2011–2015 to 5.65% during 2016-2020.

However, of late, the construction sector has been showing signs of stress. Revenue growth and profit before tax (PBT) margins have declined significantly. Most companies are barely able to cover interest costs from earnings. Increasing debt levels remain a critical issue affecting financial stability and borrowings. Several factors have contributed to this stress e.g. in stalled assets in infrastructure sector and high levels of receivables especially from the government entities, slowdown in real estate sector leading to stretched liquidity and limited resources.

A report commissioned by the CII indicates that: (i) Pending claims from government bodies are key factor behind burgeoning debt of construction companies, accounting for ~150% of the debt; (ii) Over 85% claims raised are still pending of which 11% are at the level of employers, 64% at arbitrators and 8.5% in Courts; (iii) Average settlement time is 7.5 years; (iv) "Awarded claims" do not get settled after the Arbitrator's decision; (v) Almost all court orders uphold the arbitrators' decisions and referring claims to courts leads to delayed pay-out by about 2.5 years; and (v) Only about 8% of total claimed amount (among settled claims) was agreed for and paid out by NHAI in FY15.

The issues ailing the sector have been discussed with the representatives of construction companies, banks, NHAI, concerned Departments/ Ministries and PSUs. Based on inputs received from all stakeholders, the following position emerges: (a) Substantial claims raised by contractors/ concessionaires against PSUs are pending

either in the arbitration proceedings or in courts; (b) Most of the pending claims are legacy issues relating to old item-rate contracts. With phase out of item-rate contracts and adoption of EPC (turnkey) contracts in NHAI, the number and quantum of claims is likely to come down; (c) Settlement of claims through conciliation proceedings by committees of experts has proved to be much more effective than arbitration and the settlement is reached at a much lower value than the claimed amount in conciliation proceedings; (d) Delays in final settlement of disputed claims implies significant interest payments by the PSUs by way of delayed payment charges; (e) The amended Arbitration Act addresses some of the lacuna of the original Act; and (f) Mounting claims in public contracts indicate deficiencies in the contracting regime thus warranting reform.

Based on detailed discussions, it was decided that NITI Aayog would move a proposal to the CCEA suggesting various initiatives required for addressing the issues ailing the construction industry in view of the larger economic importance and multi-sectoral nature of the issues. Accordingly, after detailed stakeholder consultations, the abovementioned initiatives have been suggested to address the issues impacting the construction sector.

Major Impact

These initiatives are expected to help in improving the liquidity in the short run and reform the contracting regime in the long run. Given the significant multiplier effect the construction sector has on the economy, these measures are expected to give a major boost to economic growth. As the sector provides the largest segment of direct and indirect employment, the revival of the sector would also help in significant employment generation.