

Legal Due Diligence in Real Estate Transactions

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Introduction

Legal Due Diligence in a real estate transaction is an investigation of real estate property records and anything else deemed relevant to the sale, purchase, lease or mortgage of the property. In other words, it refers to the reasonable measures which every individual shall adapt before executing an agreement in relation to the real estate/ immoveable property. This is for the purpose of making them aware of the risks involved in the transaction and minimizing them in consonance with the parties' requirements.

In the current scenario, legal due diligence is an important component of a transaction involving sale, purchase or mortgaging the immoveable property to any Financing Institutions ("FI's"). However, in India, the procedure of property acquisition and land due diligence is extremely time consuming and complicated, due to the involvement of various regulatory authorities, State specific laws and judicial precedents. It is pertinent to analyze certain issues in relation to the real estate property such as ownership title, legality of development & construction, permitted use, easements and encumbrances which have the potential to influence the essential attributes of the real estate property and its suitability to the transaction.

The process of legal due diligence involves preparing a checklist in accordance with various state jurisdictions and legislations, scrutinizing litigations pending against the immovable property, encumbrances/ charges, easements and registrations/ authorizations with the competent government authorities. This due diligence exercise is to be categorically conducted to procure a crystal clear vision on the preceding title of ownerships of the real estate property with all permitted uses, encumbrances/ charges, compliance of statutory requirements, restrictions vested in the property and modus operandi to overcome obstructions, if any.

The Legal Due Diligence of a real estate property can be performed in two ways i.e. Full Search or Limited Search. Both methods furnish a comprehensive and complete search of all components of a real estate property such as the chain of preceding title ownerships, encumbrances/ charges (mortgage or lien), statutory compliance or authorizations, easement rights, pending judicial proceedings, if any, and the course of action to resolve such disputes. The only variation between the two searches is the tenure of search carried out in Full Search is usually between 30 (thirty) years to 99 (ninety nine) years or as prescribed by the FI's. In contrast, the tenure of search for Limited Search is restricted to 15 (fifteen) years.

Key components of Legal Due Diligence

The due diligence normally involves tracing of the title verification of the present and preceding owners, any encumbrance/ charges and state specific legislations impacting the transfer of the real estate property. For accomplishing this purpose, the following components are required to be examined in conjunction with the real estate property requirements-

1. **Derivation of Ownership:** The title ownership of a real estate property can be derived in the following manner:

- 1.1 If the title of ownership of real estate property is obtained by virtue of sale or purchase, the beneficiary shall verify the registered sale deeds and the title documents of the preceding title ownership holders. Further, all the vested rights over the real estate property shall be alienated to the beneficiary.
 - 1.2 If the title of ownership of a real estate property is obtained by virtue of gift, one shall scrutinize the registered gift deed or any other relevant document to give effect to the transferability of the real estate property.
 - 1.3 If the title of ownership of a real estate property is obtained by virtue of a will or inheritance, the executors shall examine the will document as its conditions doesn't violate the statutory law in any manner and the order of a competent court authorizing legality of the will.
 - 1.4 If the title of ownership of a real estate property is obtained by virtue of lease, the transferee shall examine the lease deed, parties' rights and compliance of all the obligations in regard to transferability of such property.
2. **Authority to transfer the title of real estate property** - It is incumbent upon the vendor to examine the flow of rights or authority in the executed instrument to legally transfer the title of property to the beneficiary or new owner. For this purpose, one has to examine the link documents, mutation and jamabandi records or khatiyas as the case may be. Further, the transferor shall be legally capable (*not minor or unsound mind*) to execute a binding contract in regard to sale or purchase of the property.
 3. **Charges or Encumbrances over the real estate property** - It is necessary to inspect the encumbrances/ charges (mortgage or lien), over the property to any bank or FI's from the office of the Registrar of Charges of that particular jurisdiction by procuring an encumbrance or non-encumbrance certificate as the case may be, providing details of all the registered charges, depending upon the transaction. Further, if any charge over property is created by company, CHG-1 form filed with Registrar of Companies shall be inspected and encumbrance certificate shall be procured accordingly.

In case of equitable mortgage or mortgage by deposit of title deeds, the FI's requires delivery (actual or constructive) of sale deed or conveyance deed. This is to verify the authenticity of the original title deeds and to safeguard FI's interest by assuring non-existence of such unregistered mortgage.

4. **Transfer within a particular category** - In some States by virtue of their local state legislations, if the real estate property belongs to the ST's, SC's or other backward classes, it shall be transferred only to the similar tribes and not to general class. Additionally, while conducting due diligence exercise, the preceding title records of the property shall be examined in this regard and if any preceding title owner is found to be SC, ST or of other backward class, that real estate property shall be transferred to the Government at the very first instance.
5. **Sub-lease for a specific purpose** – In India, the Government provides the property to the lease holders specifically for agricultural purposes which can further be sub leased specifically for agriculture purpose. While performing due diligence exercise of the agriculture land, it is pertinent to verify the sub leases made in the transaction are not for any other commercial or residential purposes.

6. **Development/ Construction over the property** – While conducting the due diligence process, it is necessary to verify the legality of the construction/ development of the property in accordance with the state specific laws in their particular jurisdiction and the development agreement shall be executed. Further, the nature of property shall also be examined i.e. (agricultural or non-agricultural) and if the property is agricultural land, the Change of Land Use is required by that particular State Government.
7. **Government approvals and authorizations** – While performing due diligence process, it is pertinent to inspect and verify that all the approvals and authorization in relation to the transaction have been procured by the competent government authorities for building & industrial approvals, insurance policies, taxes, environment compliance etc.
8. **Acquisition process** – In India, the law of Land Acquisition restricts the alienation rights of the original owner. While conducting due diligence, it is pertinent to ensure that the real estate property is not under any acquisition process because if any transaction is executed on the property which has been acquired by the government, the transaction shall be treated as *void ab initio* and cannot be enforced legally.
9. **Publication** - To be on the safer side and to prevent himself from any unregistered transactions, the beneficiary may publish a notice in atleast two local newspapers, which will endorse the beneficiary's bonafide title ownership, if any dispute is raised later.

Conclusion

In view of the above, Legal Due Diligence plays a significant role for an individual as well as the FI's in any transaction related to real estate property for its sale, purchase, lease or mortgage. It is obligatory to probe and evaluate every such record or information about the real estate property which affects the nature and transactions of such property. Further, it is advisable before entering into any such transaction of a property, to determine and ensure that all chain deeds, title documents, encumbrance certificate, insurance policies and government authorizations are in accordance with the statutory requirements.

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