PVAI
Valuation Professional Organisation

Er. & Vr. Kedar Chikodi

INDEPENDENT DIRECTOR
REGISTERED VALUER
PVAI VPO

Mr. Chikodi is Master's in Real Estate Valuation & Plant & Machinery Valuation & practicing as a "Registered Valuer" under Company's Act, 2013 & Section 34 AB of Wealth Tax Act, 1957.

Have a rich working experience for more than 17 years in construction industry & valuation of fixed assets and empaneled with more than 50 Banks, Government Departments, Courts & Financial Institutions all over India & abroad.

Presently practicing as "Lender Engineer & TEV Consultant" having empanelment with United Bank of India, Uco Bank, Bank of Maharashtra, Bank of India, Bank of Maharashtra, State Bank of India etc.

LEARNINGS FROM IBBI VALUATIONS

In this article, I want to shed light on important Risks and challenges faced by Registered Valuers while evaluating assets under Insolvency and Bankruptcy proceedings with the help of some case studies.

The Insolvency and Bankruptcy Code 2016 came into force on 28th May 2016. It deals with the provisions of bankruptcy i.e. a state when an individual fails to repay its creditors and facilitates a procedure for recovering the debt. It is not only applicable to the organization but also to individuals. In the case where a corporate body fails to repay the loans, the insolvency proceeding is known as corporate insolvency.

It makes the process of liquidation more efficient and handles it rapidly and swiftly. A collective mechanism for the resolution of insolvencies has been laid down in the IBC 2016 to preserve the economic value of the process in a timely manner. The Insolvency and Bankruptcy Code 2016 provides a time-stipulated process by which creditors and borrowers must make decisions within the time frame of 180 days. In case of a default in repayment, the creditor gains control over the borrower's assets and both make decisions to resolve the insolvency.

THE POWER OF INSOLVENCY AND BANKRUPTCY CODE 2016 - A NEW ERA IN CORPORATE RESTRUCTURING

In the ever-evolving landscape of business and finance, it is crucial to have robust legislation that addresses the challenges faced by corporate bodies, partnership firms, and individual entities when it comes to insolvency and restructuring procedures. Prior to the enactment of the Insolvency and Bankruptcy Code 2016 (IBC), these matters were dealt with by a combination of different laws.

- The Companies Act 1956,
- The Sick Industrial Companies (Special Provisions) Act 1985 (SICA),
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act), and
- The Recovery of Debts due to Banks and Financial Institutions Act (RDDBFI Act) were some of the key legislations governing insolvency proceedings.

However, with the introduction of IBC in 2016, a new era emerged in corporate restructuring. The IBC aimed to consolidate all existing laws related to insolvency into a single comprehensive legislation. Its primary objective was to provide an efficient and time-bound mechanism for resolving insolvencies, protecting stakeholders' interests, promoting entrepreneurship, and facilitating ease of doing business.

WHY THE VALUATION IS SO IMPORTANT?

As per the provisions outlined in the IBC, asset valuation holds significant weight during a corporate insolvency resolution process (CIRP). This process involves the assessment of assets i.e. Land & Building (L&B), Plant & Machinery (P&M), and Securities & Financial Assets (SFA) by qualified professionals i.e. Registered Valuers (RV). Their expertise enables them to ascertain the current market value of assets held by a company undergoing insolvency proceedings which guides the Committee of Creditors (COC), Insolvency Professional, and NCLT in decision-making.

CASE STUDY - ONE - Industrial Land & building were taken by a Corporate Debtor (CD) from Karnataka Industrial Areas Development Board (KIADB) for a lease period of 10 years in the year 2010 and accordingly constructed a factory building and Erected machinery thereon. At the time of the Insolvency Commencement date, only 6 months were left before the expiry of the lease period of land.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

1. Here, if the Lessee becomes insolvent then the termination clause was mentioned in the lease cum sale agreement. After the expiration of the lease period, the buildings along with the land will revert back to the lessor i.e., KIADB and if the valuation is supposed to be given in accordance with the remaining lease period, the fair value fetched for the entire land & building would be negligible. In this scenario I visited the KIADB concerned office to gather information regarding KIADB's stand on renewal/extension of lease considering the corporate debtor is under insolvency proceeding. However, the concerned officials verbally informed that, the CD has to clear all the liabilities, follow due procedure by submitting requisite documents. As observed from the Lease Deed, there was no clarity on extension/renewal of lease cum sale deed from such type of government authorities in the event of insolvency.
2. In this scenario, I had considered one of the key objectives in the CIRP process is the "Maximization of Value" of assets of the 'Corporate Debtor'. So, I had presumed that KIADB would grant an extension / renewal of the lease for the further term either to the corporate debtor or successful Resolution Applicant after clearing the liabilities and difference between the prevailing allotment prices. Also, if a prospective Lease takes any land from KIADB then the Lease will get only undeveloped land. However, if a prospective Lease transfers the subject property, then he will get developed land.

SUGGESTIONS/ COMMENTS –

Therefore to avoid such a situation, it was suggested that bankers/ financial institutions should insist on a 99/999-year lease while advancing finance to leasehold properties and the Lease period should be in proportion to the loan amount.

CASE STUDY - TWO

The land on which the metal processing plant was constructed, and the plant & machinery were installed was taken on rent from its Sister Concern Company by Corporate Debtor. Only the Industrial Shed and machinery were owned by the Corporate Debtor.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

1. Fair Value assessed is 'in-situ' and on a 'going

concern' basis which assumes that the company shall continue to operate and run its business and that specified fixed asset shall continue to have economic utility.

2. Under this assessment, I had assumed that the prospective Resolution Applicant for the unit would comprehend the requirement of necessary industrial infrastructure (including other indirect costs which are typically allowed for capitalization) that is required for the operations of the industry.

3. The Fair Value of the assets has been assessed on the basis of the aforementioned premise.

SUGGESTIONS/ COMMENTS –

1. To avoid such kind of situation, while financing these types of projects, banks/ financial institutions should check for single ownership in respective of land parcel and building structures constructed thereon. Land, Industrial Sheds/ Buildings, and machinery are financed together and must be in the name of a single owner/ company.

CASE STUDY - THREE

The net Book Value mentioned in the balance sheet for machinery installed in the Cold Storage Plant was less as compared to the Fair Value and Liquidation Value of the same. I evaluated machinery based on its working condition, age, maintenance, location of plant, etc. According to the IP, the Fair Value of cold storage machinery i.e. Rs.5.41 Cr, and the Liquidation value i.e. Rs. 3.49 Cr are much higher than its Net Book Value i.e Rs.73 Lacs of Corporate Debtor.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

1. At the time of our site visit, the subject cold storage plant was in working condition.

2. Only the Fixed Asset Register and MIDC lease documents were provided by the RP. Relevant invoices of "Processing /Freezing & Cold Storage machinery" were not made available for evaluation of machinery. In the absence of machinery invoices & machinery purchase details, I had considered current market prices as well as new/resale prices of the movable assets of similar specifications as available on web portals for the current evaluation of machinery.

3. Depreciation was charged after giving regard to parameters such as age, physical condition of the components, remaining useful life, technical obsolescence, etc. of individual components.

SUGGESTIONS/ COMMENTS –

1. Here, I would like to mention that Physical depreciation is different than accounting depreciation. Physical depreciation is a measure of the decrease in the market value of an asset over time from influential economic factors. With physical depreciation an asset's decreases in value are not necessarily uniform or scheduled but rather based on influential economic, technical & physical factors. However, in Accounting Depreciation, a tangible asset's value decreases over time based on a set depreciation schedule mentioned in the Companies Act.

2. According to Investopedia, "The book value of an asset and the market value of an asset is usually very different. The economic value or market value of an asset may not be reported on financial statements, but it is the value a company could potentially get if they chose to sell it". Therefore, while evaluating secondhand machinery items, one should consider physical depreciation based on visual inspection of the machinery rather than

accounting depreciation calculated based on the figures mentioned in the financial statements of the CD.

CASE STUDY - FOUR

The Corporate Debtor who is a builder/developer started multiple construction sites on CRZ Influential Lands in the Mumbai Suburban Area. I had been appointed to ascertain the feasibility of the proposed redevelopment projects being developed on land that was falling under the Coastal Regulatory Zone (CRZ) influential area in Versova, Andheri.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

After going through the proposed redevelopment projects in CRZ areas, CRZ norms, etc; I concluded that this redevelopment project may not be feasible at the time of valuation. However, in the future, if the requisite NOCs from MOEF & MCZMA are provided, then this project can be reviewed further as per the reconstruction norms stated in DCPR 2034.

SUGGESTIONS/ COMMENTS –

Construction under CRZ norms is very stringent and complicated which includes a lot of government compliance work such as NOCs from the Ministry of Environment and Forests (MOEF) & Maharashtra Coastal Zone Management Authority (MCZMA) and permissions from local regulatory authorities. Hence, banks should consider these factors while mortgaging such types of lands.

FACTS OF THE CASE - PROPOSED UNDER-CONSTRUCTION RESIDENTIAL PROJECT

Here the existing society entered into a development agreement with a Corporate Debtor, for the redevelopment of a plot by demolishing the existing building structures and a ground-floor chawl.

- The plot under reference derives access from 9.00 meters. Wide sanctioned Road Line on the south side. However, it was observed that the Road Line has not been fully implemented on the site and the road width of 9.00 meters is not fully available on site.
- At the time of the site visit 35% of the total construction work was completed however, there was a stay order on further construction initiated by the officials of the Local Authority on account of the area of the subject plot going under road widening as per DP remarks.

CASE STUDY - FIVE

Where one of the Directors of the company was given one part of the land undervaluation to its company for 20 years lease period vide unregistered "Lease Agreement Letter" without paying any stamp duty & registration charges to the Government Authorities. Subsequently, the Owner/ Director of the subject land has given another part of the land on rent to the Corporate Debtor by virtue of the unregistered "Leave & License Agreement" for the period of 36 months. These land parcels has to be evaluated along with factory land. Here, factory was constructed on the land which has no demarcation and combined with land under plant by construction of stone compound wall.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

1. As observed there are multiple discrepancies in the land documents which are unregistered. Both documents are contradictory to each other and are currently expired and not renewed by the landowner. Also, the lease agreement has to be registered by depositing actual stamp duty & registration charges to the Government Authorities for 99 / 999 years.

2. All these contradictions related to land under the proposed project must be verified by concerned bank officials before lending money because the subject land under the proposed project is in the personal name of the Owner/Director. Therefore, without a clear title of the land subject advancing of loan is not feasible.

SUGGESTIONS/ COMMENTS –

1. It is advisable to transfer the land in the name of the Corporate Debtor/ Company so that the land becomes freehold and the company should have a clear & marketable title of land. Bank can also explore the way to mortgage both lands with a Tripartite Agreement i.e, 1)Owner/ Director 2) Company, and 3) The Bank

CASE STUDY - SIX

The land was given by the Lessor to a Corporate Debtor (Developer/Builder) on B.O.T (Build, Operate & Transfer) basis for the construction of Hotel premises. Further, separate lease agreements for transfer of tenancy have been executed for the Hotel between Lessor and corporate Debtor (Lessee). These commercial properties are income-generating properties and the balance lease period of above-mentioned Shops and offices is around 17 to 20 years as of date of Valuation.

POINTS CONSIDERED WHILE ASSESSING THE FV & LV –

1. Hotel premises were never functional since completion of civil work. So, data regarding profit / loss of Hotel were not available.
2. Further, cost approach cannot be adopted as the land has been given to Corporate Debtor on B.O.T. Basis.
3. Also, there is no clarity about terms & conditions regarding renewal of lease. So, the balance lease period is relatively short & sale transactions of similar Hotel having comparable balance lease period was not available.
4. Hence, we have adopted Income approach for Valuation of Hotel assuming that hotel will generate income assuming the hotel will be operational in nearby future. While evaluating Hotel Building by Income approach, I had assumed that total outgoings to remain constant throughout the balance lease period as the relevant information was not available.

SUGGESTIONS/ COMMENTS –

- Therefore to avoid such type of situation, it was suggested that bankers/ financial institutions should insists for 99/ 999 years lease while advancing finance to such type of properties and Lease period should be in proportion to the loan amount.
- It is a conventional Public-Private Partnership model in which a private partner is responsible to design, build, operate (during the contracted period) and transfer back the facility to the public sector where private sector partner has to bring the finance for the project and take the responsibility to construct and maintain it. In this case, the financing institution lending money to such type of project should assess the revenue potential of a project in the cycle of certain years in early stages.

CASE STUDY - SEVEN

The corporate Debtor has a business in Digital Marketing but when going under insolvency proceedings, only the stock of shoes, a few old machinery and furniture & office equipment where asked for assessment under CIRP proceedings. Here, the directors of the subject company have multiple assets all over India in his personal name which we cannot evaluate under insolvency proceedings because under IBC, 2016, only those assets are accountable which are in the name of the Corporate Debtor. Although other properties which are kept as collateral security owned by the directors, they don't come under IBC valuations. Even the personal property of the other Guarantors of the loan could not be assessed under the Corporate Insolvency Resolution Process of the Corporate Debtor, even though, their properties were mortgaged with the Financial Creditors as they come under SARFAESI Act, 2002.

SUGGESTIONS/ COMMENTS –

To avoid such kind of situation, while financing these types of projects, banks/ financial institutions should thoroughly check title of the immovable assets being mortgaged. Assets such as land, building, plant & machineries owned by the company only should be mortgaged while lending the money to the company. Land, Industrial Sheds/ Buildings and machineries financed together and must be in the name of single owner/ company.

SUMMING UP –

Asset valuation plays a crucial role in the insolvency proceedings against corporate debtors. However, Registered Valuers are facing numerous complexities and limitations when determining accurate property values. In this article, I explored the challenges and limitations faced by me while evaluating L&B and P&M such as the lack of availability of requisite documentation & reliable data, the influence of market trends & fluctuations, uniqueness & characteristics of each property, Legal and Regulatory Considerations, conflict of interests, etc. and subsequently discussed some of the strategies to overcome them with help of several case studies.

Some of the valuable insights/ suggestions are as follows -

1. Banks/ Financial Institutions should have thoroughly checked the track record and financial viability of the borrower while financing such types of projects.
2. Banks/ NBFC's should take immovable assets as collateral as a way to recover their loan in the event the borrower fails to pay as planned.
3. Banks/ Financial Institutions/ Insolvency Professionals should provide all the requisite documents to Property Valuers at the time of valuation.
4. Having a good credit history, cash flow, collateral properties, repayment capacity of the company and clear documents should be a priority for banks when granting a business loan application.
5. Banks should insist borrowers invest more of their own capital in the business because if, the owner is not investing in his own business, why should the bank? Also, when owners have more personal capital in the business, they will fight harder and sacrifice more to save the business and repay their debts.

Real estate property valuation is a challenging task due to numerous reasons and Valuers must continuously adapt to changing market dynamics and seek reliable data sources to ensure accurate valuations. Therefore, by recognising and addressing these challenges, Professional Valuers can provide Banks/ NBFC's & Insolvency Professionals with valuable insights and support decision-making under insolvency proceedings.