

Homebuyers: Secured or Unsecured creditors under IBC, 2016



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The categorization of homebuyers as secured or unsecured financial creditors under the Insolvency and Bankruptcy Code, 2016 (IBC) has been a contested issue. However, under Section 55(6)(b) of the Transfer of Property Act, 1882 and various provisions of the Real Estate (Regulation and Development) Act 2016 (RERA), homebuyers seem to have been categorized as secured financial creditors. This categorization has also been upheld by courts under certain conditions. Moreover, NCLT in a recent judgement in the case of Snehanjali and S.B. Developers recognized homebuyers as secured financial creditors based on possession-linked security. After analyzing various provisions and related judgements pertaining to the Transfer of Property Act, 1882, RERA and IBC, the authors advocate for inclusion of homebuyers under the secured financial creditors.

Read on to know more...

1. Introduction

Ever since the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) was enacted, the issues pertaining to real estate insolvency have taken a substantial consideration and time of the judiciary as well as the legislator. The insolvency framework on real estate corporates/projects as it stands presently has undergone many interpretations, discussions, deliberations, and analysis. The importance of it can be seen from the fact that out of the total

companies getting admitted into Corporate Insolvency Resolution Process (CIRP) under the IBC, real estate companies account for 22%.¹

The Code which has brought paradigm shift from “debtor in control” regime to “creditor in control” regime has also brought a positive change in the quantum of relief to the homebuyers in the real estate cases who previously only had the option to approach the Real Estate Regulatory Authority (RERA) under the Real Estate (Regulation and Development) Act, 2016 (RERA) and Consumer

1. The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India, April – June 2024 | Vol. 31 accessible at (<https://ibbi.gov.in/uploads/publication/9bc46bf1e4b86dab3b0310cb8284cb74.pdf>).

2. Section 2(zk) of The Real Estate (Regulation and Development) Act, 2016.

Redressal Commissions under the Consumer Protection Act, 2019 (previously Consumer Protection Act, 1986). Now, if the promoter² fails to adhere to his commitments to allottees/homebuyers, he might end up losing control over the company/project on admission of a CIRP application by the Adjudicating Authority (AA) of National Company Law Tribunal (NCLT) under Section 7 of the IBC. Thereafter, the control of the company/project goes into the hands of the Interim Resolution Professional (IRP) or the Resolution Professional (RP) who work under the guidance of the Committee of Creditors (CoC). The CoC in majority of the real estate insolvency cases comprises of lenders (banks) who are generally the secured creditors, homebuyers (as unsecured creditors, represented through Authorised Representatives) and operational creditors (if meeting the prescribed threshold).

2. Inclusion of Homebuyers as Financial Creditors under the IBC

Initially, the IBC did not have provision for treating homebuyers as financial creditors who were generally categorized as other creditors. However, the ordinance³ (upheld in Chitra Sharma case⁴) and subsequent amendment⁵ (upheld in Pioneer Urban case⁶), allottees were held to be treated as financial creditors as defined under Section 5(7). Vide the ordinance and amendment, an explanation was added in Section 5(8) (f) of the IBC which provided that the amounts raised by the allottees under real estate projects shall deemed to have commercial effect of borrowing thereby making it a financial debt. This was held by the Supreme Court⁷ to be a clarificatory amendment who further stated it to have been a part of the main provision, i.e., Section 5(8) (f), with effect from the inception of the IBC.

Although the question pertaining to homebuyers being

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secured or unsecured was first raised in Chitra Sharma's case, but the same was left open to be decided later by the Court. However, the Apex Court in Pioneer Urban case has categorically held that homebuyers are unsecured financial creditors having vital interest in the amounts funded by them for completion of the project. Further, at every step of the project, certain amounts are to be paid by the allottees which are then utilised in constructing the flats/apartment. The nature of amount raised under the contract of homebuyers is actually for the purposes of raising finance (which in majority of the projects is to the tune of 50% of the total funding), thus the clarification regarding terming homebuyers as financial creditor was upheld by the Court. The Court compared allottees with the debenture holders and fixed deposit holders (who have advanced certain amount to the company) to categorize them under unsecured creditors having vital interest in the amount advanced for completion of the project.

However, the categorization of homebuyers as secured or unsecured does not have much relevance in the formation of the CoC but it has an impact on distribution of payouts and accordingly on the Resolution Plan or at the time of distribution of proceeds under liquidation. Further, letting real estate project into liquidation will not be of any interest to the homebuyers as disposal of assets will deprive them of their rights to own a home (if not done as liquidation as a going concern). Even if the project is liquidated, the categorization (of being secured or unsecured) becomes imperative as during liquidation the payout to creditors depends upon waterfall mechanism as prescribed under Section 53 of the IBC. Thus, it becomes important to reconsider if homebuyers are to be treated as secured or unsecured creditors under the Code.

In this regard, reference is made to the definition of secured creditor under the Code which states that "secured creditor means a creditor in favour of whom security interest is created".⁸ Security Interest as per Section 3(31) means that a "right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person".⁹

³ Insolvency and Bankruptcy (Amendment) Ordinance, 2018.

⁴ Chitra Sharma & Ors. v. Union of India & Ors.

(Writ Petition (Civil) No. 744 of 2017.

⁵ The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.

⁶ Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India & Ors.

(Writ Petition (Civil) No. 43 of 2019.

⁷ Ibid.

⁸ Section 3(30) of the Insolvency and Bankruptcy Code, 2016.

⁹ Section 3(31) of the Insolvency and Bankruptcy Code, 2016.

3. Homebuyers under the Transfer of Property Act, 1882

It is imperative to highlight certain provisions of the law to state that the homebuyers can be categorized as secured creditors on the following basis:

That the charge gets created on the property of the seller (promoter's project in the present case) in favour of the buyer, to the extent of purchase money paid for delivery of the property and interest thereon as per Section 55(6) (b) of the Transfer of Property Act, 1882.

The said provision runs as follows:

(6) The buyer is entitled—

(b) unless he has improperly declined to accept delivery of the property, to a charge on the property, as against the seller and all persons claiming under him, to the extent of the seller's interest in the property, for the amount of any purchase money properly paid by the buyer in anticipation of the delivery and for interest on such amount; and, when he properly declines to accept the delivery, also for the earnest (if any) and for the costs (if any) awarded to him of a suit to compel specific performance of the contract or to obtain a decree for its rescission.”

As per the above provision of the Transfer of Property Act, which primarily deals with immovable property, if the buyer (allottee/homebuyer in the present case) has not improperly declined to accept the performance of the contract, he will be entitled for a charge over property for the purchase money and interest thereon. However, in the event the buyer properly declines to accept the performance of the contract, he will be entitled for a charge even for earnest money and the cost. Reference may be made to the case of *Thomas George v. A.T. Joseph & Ors.*¹⁰ wherein Kerala High Court has categorically held that “if the buyer improperly declines to accept delivery of the property as per the terms of the agreement, a charge will be created in favour of the buyer in respect of the property by operation of provision contained in Section 55(6)(b)”.

Further, in the case of *Ahemmedkutty Bran v. Sukumaran*¹¹, the High Court of Kerala has observed that if the non-performance of the contract is on account of fault by the buyer and the seller or where both the parties are at default or where the seller is on default, the same would not lead to the conclusion that the buyer has improperly declined to accept delivery and thus, would be entitled for a charge over the property of the seller.

“Supreme Court in the case of *State Tax Officer v. Rainbow Papers Ltd.* recognized the charge created over the property of the CD under Section 48 of the Gujarat VAT, 2003 (statutory charge) in the IBC process.”

Hence, relying on Section 55(6)(b) along with the above judgements, it can fairly be said that a “statutory charge”¹² is being created on the immovable property as a consequence of agreement for sale¹³ between the parties. Thus, a homebuyer has a charge over the property of the promoter in case the apartment¹⁴ is not received timely. Further, the Hon'ble Supreme Court in the case of *State Tax Officer v. Rainbow Papers Limited*¹⁵, which was upheld by Supreme Court in the case of *Sanjay Kumar Agarwal v. State Tax Officer & Anr.*¹⁶, recognized the charge created over the property of the Corporate Debtor by virtue of Section 48 of Gujarat Value Added Tax, 2003 (statutory charge) in the IBC process. The Apex Court did not differentiate between the statutory charge and a contractual charge and have observed that the definition of security interest under the IBC includes the statutory charge also thereby making tax department of the State a secured creditor under the IBC who shall be ranked equally with the workmen dues for twenty-four months period preceding the liquidation commencement date as per Section 53(1)(b).

This insinuates that a charge which is created by operation of law is to be considered a valid charge on the property and the charge holder as the secured creditor under the Code. As a closure, the decision on categorization of allottees/homebuyers as unsecured creditors can be reconsidered in light of the above arguments.

4. Homebuyers under RERA

That the wide definition of security interest under the Code can incorporate the protection / security given to homebuyers under the RERA. As per Section¹⁷ 18 of RERA, the allottees are entitled to a return of amount along with compensation and interest, in case if the promoter fails to adhere to the provisions of agreement for sale, i.e., the apartment is not constructed or is not able

10.2016 (1) KLJ 336.

11.RFA No. 349 of 2022.

12.K. Shanmugam and another v. C. Samiappan and Others, [2013 (6) CTC 28].

13.Section 2(c) of The Real Estate (Regulation and Development) Act, 2016.

14.Section 2(e) of The Real Estate (Regulation and Development) Act, 2016.

15.Civil Appeal No. 1661 of 2020.

16.Review Petition (Civil) No. 1620 of 2023 in Civil Appeal No. 1661 of 2020.

to provide possession of the apartment on the specified date or can withdraw from the project. Further, Section¹⁸ 11 which provides for functions and duties of promoter, in its Clause (4) subclause (h) provides that the promoter shall not be eligible to create a mortgage or charge post the execution of an agreement to sale any apartment / plot / building. It also provides that if such a mortgage or charge is created, the same shall not affect the rights and interest of the allottee of such apartment / plot / building. Moreover, the provision to Section¹⁹ 8 provides that in case the real estate authorities revoke the registration of the promoter under Section 7 of the Act, the association of allottees have the first right of refusal to carry out the remaining development works.

Considering the above provisions read with the definition of security interest as provided in the Code, it can be interpreted that the protection provided to the allottees under the RERA Act in the form of return of money with interest, right on the property over which developmental works were undertaken by not allowing promoter to sell or create a charge and the right of first refusal) in lieu of the consideration paid by them considerably brings them under the umbrella of secured creditors under the IBC.

5. Conclusion

Further, the definition of security interest as provided in the Code provides that it is a “right, title, interest or claim to a property”. Also, the definition further provides that the security interest is for “performance of any obligation of any person”. The homebuyers surely have the right/ interest/claim in the property considering the amount advanced by them in return for the flat/apartment which the developer/promoter is under obligation to provide.

To buttress further, reference is made to the NCLT order in the interim application (IA (I.B.C.) No. 3383/MB/2024 and IA (I.B.C.) No. 2284/MB/2024 in CP (IB) No. 1046/MB/2023), in which the NCLT classified the homebuyers from “unsecured financial creditors” to “secured financial creditors”. The NCLT upheld the reasoning of the RP in classifying homebuyers as secured financial creditors on the basis that the security interest (having possession of specific units) to the homebuyers has been created upon payment of consideration value. Though its earlier order in the same matter, the NCLT directed the RP to reconsider its previous classification of homebuyers as unsecured financial creditors and further directed to provide equal rights and status to both homebuyers and re-settlers. The

“The protection provided to the allottees under the RERA Act also brings them at par to the secured creditors under the IBC.”

AA observed that the re-settlers have entered into developmental agreements with the Corporate Debtor vide which the re-settlers have secured performance of certain obligations by the Corporate Debtor (which include construction and handing over of flats to the re-settlers). Thus, the NCLT held that re-settlers are to be considered as “secured other creditors” and homebuyers as “secured financial creditors”.

Furthermore, on conjoint reading of Section 55(6)(b) of the Transfer of Property Act, 1882, above mentioned provisions of the RERA, definition of secured creditors (under Section 3(30) and security interest (under Section 3(31)) in the IBC, it is suggested that the allottees under a real estate project can be considered as secured creditors. Thus, bringing homebuyers under the secured creditors category will prioritize and protect homebuyers under both, during CIRP and liquidation. However, the same differs from the existing ruling of the Supreme Court in the case of Pioneer Urban. Hence, any specific observations/ directions from the judiciary or the legislature or the regulator on the above discussed aspects can clear the clouds on the subject matter considering the fact that the homebuyers actually fund the project similar to the banks (who having security are considered as secured creditors). Lastly, via the recent amendment²⁰ brought in by the Insolvency and Bankruptcy Board of India (BBI), Regulation 4E has been inserted in the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) which obligates the RP to handover the possession of the plot, apartment, or building etc., agreed to be transferred to the allottee under the real estate project provided the allottee has requested for the same, has performed its part under the agreement and the same has been approved by the sixty-six percent of the CoC. This seems to be a welcoming step towards the categorization of homebuyers as secured creditors as they will be having control over their apartment, building etc. upon adhering to the requirements under the agreement, provided the same has been approved by the CoC.

¹⁷Section 18 of Real Estate (Regulation and Development) Act, 2016.

¹⁸Section 11 of Real Estate (Regulation and Development) Act, 2016.

¹⁹Section 8 of Real Estate (Regulation and Development) Act, 2016.

²⁰Regulation 4E, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2025.