VALUATION OF LESSEE'S INTEREST IN LEASEHOLD INDUSTRIAL PROPERTIES FOR BANK COLLATERAL SECURITY

A Practical Guide with a Case Study on SIPCOT Industrial Estate, Nilakottai, Dindigul District, Tamil Nadu

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Abstract

Across India, many industrial plots are allotted by Government Industrial Development Corporations on long-term leasehold basis. These include **SIPCOT (Tamil Nadu), KIADB (Karnataka), MIDC (Maharashtra), GIDC (Gujarat), RIICO (Rajasthan), APIIC (Andhra Pradesh), TSIIC (Telangana), UPSIDA (Uttar Pradesh)** and many others.

Banks frequently accept such leasehold properties as collateral security. However, valuers often face practical questions:

- What exactly should be valued?
- Is the landowner or the lessee the owner of the property?
- Can the Registered Valuer certify the **Present Market Value**?
- Should the valuation represent the value of the land or only the **Lessee's Interest**?
- How should transfer restrictions and transfer fees be considered?
- Can the Distress Value or Realisable Value be certified?

This article explains these concepts in simple English with a practical case study.

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1. Introduction

Unlike freehold properties, industrial plots allotted by Government Industrial Development Corporations are generally leased for a long period, usually **99 years**.

The lessee enjoys possession and use of the land but does not become the absolute owner. Consequently, the asset available to a bank as security is **the Lessee's Interest**, not the ownership of the land.

Understanding this distinction is fundamental to professional valuation.

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2. Who is the Lessor?

The **Lessor** is the legal owner of the land.

The lessor grants leasehold rights to the lessee while retaining legal ownership.

In the case of SIPCOT industrial estates, **SIPCOT is the lessor**.

The lessor generally retains the right to:

- Own the land.
- Collect lease rent.
- Approve transfers.
- Approve change in management.
- Enforce lease conditions.
- Resume possession in case of violation of lease conditions.

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3. Who is the Lessee?

The **Lessee** is the allottee who receives leasehold rights under the lease deed.

The lessee generally enjoys:

- Possession of the land.
- Right to construct buildings.
- Right to use the property.
- Right to mortgage the leasehold interest, subject to the terms of the lease.
- Limited right to transfer, subject to approval.
- Right to enjoy the property during the lease period.

The lessee does **not** become the absolute owner of the land.

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4. What is Lessor's Interest?

The **Lessor's Interest** represents the ownership rights retained by the lessor.

It includes:

- Legal ownership of land.
- Reversionary interest after expiry of lease.
- Right to enforce lease conditions.
- Right to collect lease rent.
- Right to regulate transfers.
- Right to cancel the lease or resume possession in accordance with the lease conditions.

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5. What is Lessee's Interest?

The **Lessee's Interest** is the economic value of the rights enjoyed by the lessee during the lease period.

It generally includes:

- Right of possession.
- Right to use the property.

- Right to construct buildings.
- Right to mortgage.
- Right to transfer (subject to approval).
- Unexpired lease period.

Banks generally obtain mortgage only over **the Lessee's Interest**.

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6. Freehold Ownership versus Leasehold Interest

Particular	Freehold Property	Leasehold Property
Ownership	Purchaser	Lessor
Possession	Purchaser	Lessee
Mortgage	Freely permitted	Subject to lease conditions
Transfer	Normally unrestricted	Subject to approval
Ownership upon expiry of the lease	Continues	Reverts to lessor

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7. Typical Features of a SIPCOT Lease

Typical lease conditions include:

- Lease period of **99 years**.
- Nominal annual lease rent.
- Prior approval required for transfer.
- Prior approval required for change in management.
- Mortgage of the leasehold interest is generally permitted subject to SIPCOT approval.
- Transfer fee payable as per prevailing policy.
- Violation of lease conditions may result in cancellation or resumption.

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8. Transfer Fee

The latest SIPCOT Lease Deed defines **Transfer Fee** as:

"The amount payable by the lessee towards Change in Management or Transfer of Leasehold Rights."

The lease deed itself **does not specify any fixed amount or percentage**.

The applicable fee is determined under SIPCOT's prevailing policy.

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9. SIPCOT Transfer Fee Schedule

Situation	Transfer Fee
Unit has not commenced commercial production	100% of differential plot cost
Commercial production less than 5 years	20% of differential plot cost
Commercial production more than 5 years	10% of differential plot cost
Listed Public Limited Companies	Nil
Revival of sick units approved by competent authorities	Nil
Sale through NCLT / Official Liquidator	Nil
Sale by Banks / Financial Institutions with SIPCOT NOC	Nil
Certain Government Joint Venture Companies	Nil

Therefore, transfer fee depends upon the facts of each case and not every transfer attracts the same fee.

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10. Illustrative Case Study

Property

Industrial Plot - SIPCOT Industrial Estate- Nilakottai- Dindigul District-Tamil Nadu

Area : **5.00 Acres**

Purpose	:	**Bank Collateral Valuation**
Lease	:	99 Years from 2023
Remaining Lease Period	:	Assumed to be **96 Years as on 2026**

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11. Market Evidence

Assume that the prevailing market rate for comparable freehold industrial plots in the locality is

₹1,20,00,000 per acre.

Therefore, 5 Acres = **₹6,00,00,000/-**

This represents the **Freehold Market Value**.

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12. Valuation of Lessee's Interest

Step 1

Freehold Market Value

₹6,00,00,000

Step 2

Consider lease restrictions such as:

- Ownership retained by SIPCOT.
- Prior approval for transfer.
- Change in management approval.
- Transfer fee.
- Resumption clause.
- Marketability restrictions.

Illustrative Adjustment for Leasehold Restrictions

Assume **15%**

15% of ₹6,00,00,000 = ₹90,00,000

The above deduction of 15% is adopted based on professional judgment after considering transfer restrictions, SIPCOT approval requirements, marketability, transfer fee implications, and other lease conditions. The appropriate deduction may vary depending on the facts and circumstances of each case.

Step 3

Freehold Market Value	**:**	**₹6,00,00,000**
Less: Leasehold Restrictions	:	₹90,00,000
Value of Lessee's Interest	**:**	**₹5,10,00,000**

This represents the estimated value of the **Lessee's Interest**.

It is **not** the value of ownership of land.

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13. Distress Value

Assume a discount of **20%**

Lessee's Interest = ₹5,10,00,000 × 80% = **₹4,08,00,000**

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14. Realisable Value

Assume a discount of **10%**

Lessee's Interest = ₹5,10,00,000 × 90% = **₹4,59,00,000**

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15. Summary of Values

Description	Value
Freehold Market Value	₹6.00 Crores
Less: Adjustment for Leasehold Restrictions	₹0.90 Crores
Present Market Value of the Lessee's Interest	₹5.10 Crores
Realisable Value	₹4.59 Crores
Distress Value	₹4.08 Crores

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16. Can the Registered Valuer Certify Present Market Value?

Yes.

However, the valuation report should clearly state:

The value certified represents the Present Market Value of the Lessee's Interest in the Leasehold Property and not the absolute ownership value of the land.

This distinction is extremely important because ownership continues to vest with the lessor.

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17. Can Distress Value be Certified?

Yes.

The distress value should also represent only the **Distress Value of the Lessee's Interest**.

It should not be described as the distress value of the freehold land.

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18. Can Realisable Value be Certified?

Yes.

The valuation report may certify the **Realisable Value of the Lessee's Interest** for banking purposes, provided the basis and assumptions are clearly stated.

Again, the value relates only to the leasehold interest and not to the freehold ownership of the land.

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19. Limitations

The valuation should clearly state:

- SIPCOT remains the owner of the land.
- Only leasehold rights are being valued.
- Transfer requires prior approval of SIPCOT.
- Mortgage is subject to lease conditions.
- Transfer fee and transfer restrictions may affect marketability.
- Future policy changes may influence value.
- Lease violations may result in cancellation or resumption.

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20. Essential Disclosures

The valuation report should disclose:

- Nature of tenure.
- Remaining lease period.
- Annual lease rent.
- Transfer restrictions.
- Mortgage conditions.
- Transfer fee policy.
- Renewal provisions.
- Existing approvals.
- Pending dues, if any.

- Litigation, if any.

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21. Suggested Caveats

The valuation is subject to the following:

1. SIPCOT continues to remain the legal owner of the land.
2. The valuation represents only the value of the **Lessee's Interest**.
3. Transfer of leasehold rights requires prior approval of SIPCOT.
4. Applicable transfer fee, Government policy, and amendments to the lease conditions may affect the marketability and value of the leasehold interest.
5. Any breach of lease conditions may result in cancellation or resumption of the lease.
6. The lending institution should independently verify compliance with the lease deed and obtain all necessary approvals before accepting the property as collateral security.

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22. Professional Opinion

In leasehold industrial properties, the Registered Valuer should **not certify the market value of the land as though it were a freehold property**. The correct subject of valuation is the **Lessee's Interest**, after considering the remaining lease period, transfer restrictions, approval requirements, transfer fee, and other lease conditions.

When this distinction is clearly explained, the valuation becomes transparent, technically sound, and more useful to banks, financial institutions, and other stakeholders.

Important Note

The discussion and case study in this article are based on SIPCOT (State Industries Promotion Corporation of Tamil Nadu Limited), **a Government of Tamil Nadu undertaking responsible for industrial infrastructure development in the State.**

Lease conditions, transfer policies, transfer fees, mortgage provisions, renewal clauses, and approval procedures may vary from State to State and from one Industrial Development Corporation to another, such as KIADB, MIDC, GIDC, RIICO, APIIC, TSIIC, UPSIDA and others.

Therefore, the Registered Valuer should **always examine the specific lease deed, allotment order, applicable policy, office orders, and statutory provisions governing the particular industrial development authority before arriving at the valuation of the Lessee's Interest.**

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