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Indian Real Estate Sector Handbook 2015

Disclaimer:

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Executive Summary

For the real estate sector, the last few years have been quite agonising. Declining sales and mounting debts played havoc for the sector that is seen as one of the growth drivers for the economy. However, things changed for the better in early 2014 as a stable government came to power at the Centre with a thumping majority. This led to a boost in investor confidence coupled with renewed interest from key stakeholders. The government has unleashed a lot of reforms in the last few months to give a fresh impetus to the sector.

First, the notification by the Securities and Exchange Board of India (SEBI) on the Real Estate Investment Trusts (REITs) regulations paved the way for introduction of an internationally acclaimed investment structure in India. The tax pass through status has been provided to the REITs through necessary amendments to the Indian tax regime. This is one of the key requirements for feasibility of REITs.

Secondly, the government's vision of smart cities and affordable homes to all received a significant boost with the Presidential assent to The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. Though this Act was introduced by the erstwhile UPA-II government, the current government introduced significant changes in this Act by removing the consent clause to acquire land for five different types of projects. This was done through an ordinance, which has now received the Presidential assent.

The government also amended the rules for Foreign Direct Investment (FDI) in the construction sector by reducing minimum built-up area as well as the capital requirement, while also easing the exit norms. The market expects that these relaxations will go a long way in attracting more investments in the sector.

Lastly, the much-awaited Real Estate (Regulation & Development) Bill that was introduced in the Rajya Sabha last year, is still being debated at various levels. To iron out the differences between various stakeholders, the government recently introduced three revisions to the bill to ensure that it sees the light of the day soon. These recommendations have been made by the ministry and now await the clearance from the Prime Minister's Office. While one cannot be certain that the Bill become a law in 2015 but the fact that the Bill is being debated and discussed at all levels shows the positive intent of the government.

There are some interesting trends that are also visible on the horizon. Private equity players are gearing up for REITs, picking up large chunks of unsold inventories, which is helping developers' fast-pace construction activity. E-commerce companies, with some significant investments in 2014, are also gearing up to facilitate sales / rentals of real estate units.

On 28 February 2015, the Finance Minister presented this government's first full year Budget. Clarity on the tax structure of REITs, commitment to "housing for all" and increased budgetary allocation towards the infrastructure sector were the key takeaways for the sector. The Budget is forward looking and pragmatic and holds the vision that goes beyond just this fiscal. The policy initiatives and tax proposals announced in the Budget mirror the intent of the government to set the economy on a high growth trajectory. It also aims to implement the proposals of the interim budget, which was followed by some key reform measures.

With several positive regulatory changes taking place to complement the Companies Act, 2013, the sector is poised for a fast growth in 2015. However, the real estate sector as a whole will have to focus on faster implementation of projects and on-time deliveries. Developers will have to also improve the quality of construction to cope with the growing expectations of customers and investors. Finality on the Real estate (Regulation & Development) Bill, a single window clearance system and the seeds for reforms sown in 2014 will surely bear fruit for the real estate sector in 2015.

Content

Key highlights - 2014

January
- New land acquisition law comes into force
- RBI hikes the repo rate by 0.25 basis points

February
- Private sector allowed to buy in to Delhi's government colony revamp

March
- RBI opposes plan to give Sarfaesi powers to HFCs
- 200 low cost airports planned in the next 20 years

April
- Jaypee sells assets worth Rs 10,000 crore to pare debts

May
- APG Asset Management and PE firm Xander have launched a US$ 300 million (Rs 1,800 crore) India office fund

June
- Government plans US$ 4-5 billion infrastructure fund
- Japanese & Korean investors show interest

July
- Union budget: encourages FDI
  - housing for all, affordable housing
  - smart cities
  - approval for REIT

August
- Piramal Enterprises gets a partner in Holland's APG for US$1 billion infrastructure joint venture

September
- Countries line up to develop Smart Cities
- SEBI announces REITs guidelines
- Google Capital, Tiger Global and Accel Partners invest US$ 80 million in Common Floor

October
- ASK group launches Rs 1,500 crore RE fund
- Housing.com launches product to create rental agreements

November
- Poor sales post the festive season;
- SoftBank invests US$ 90 million in Housing.com
- Government relaxes FDI norms for RE and construction

December
- Presidential assent to ordinance on Land Acquisition Act
- Reckoner rate hike in Maharashtra

Regulatory developments:
The big picture

The year 2014 witnessed a change of guard at the Centre, which not only propelled the positive sentiments of the market but also, as widely expected, led to the introduction of several reforms. These, including the announcement of REITs, relaxation in the FDI norms and affordable housing getting higher priority under the Land Acquisition Act, 2015 are expected to give an impetus to the sector and offer players an opportunity to rewrite the growth story.

The REIT Regime in India[1,2]

On 26 September 2014, the SEBI notified the REITs regulations, thereby paving the way for introduction of an internationally acclaimed investment structure in India. The Finance Minister has also made necessary amendments to the Indian taxation regime to provide the tax pass through status, which is one of the key requirements for feasibility of REITs.

The India REIT regime is aimed at providing:

- an organised market for retail investors to invest and be part of the Indian real estate growth story
- a professionally managed ecosystem that is risk averse and is aimed at protecting the interest of public
- an exit platform for the real estate sector to ease out liquidity burden

REITs provide tax transparency. This means that the REIT does not pay any corporate tax in exchange for paying out strong, consistent dividends. Rather, taxes are paid by the individual shareholder only.

Further, considering that the listed REITs will be registered and regulated by the SEBI and adhere to the highest standards of corporate governance, financial reporting and information disclosure, the REITs will provide operational transparency.

Legal framework of REITs:

- REIT shall be a Trust set up under the Indian Trust Act, 1882 and it must be registered under the SEBI (Real Estate Investment Trusts); Regulations 2014
- REITs will raise funds through an initial offer and subsequently through follow on offers, rights issues, qualified institutional placements, etc.
- minimum asset size, to be proposed by REITs, is prescribed as Rs 500 crore and the minimum offer size for initial offer is prescribed as Rs 250 crore
- minimum 200 subscribers required to form a REIT (excluding related parties)
- REIT units are mandatorily required to be listed on recognised stock exchanges in India. Besides, they need to be in dematerialised form
- minimum public share in initial offer should not be less than 25% of the number of units of the REIT on post issue basis
- mandatory distribution of at least 90% of the net distributable cash flows to be to investors on a half-yearly basis
- mandatory distribution of at least 90% of the sale proceeds from sale of assets to unit holders, unless reinvested in another property
- onerous duties and responsibilities casted on Trustee and Manager to ensure strict adherence to the REIT regulations
- mandatory requirement for a full-fledged valuation of all REIT assets on a yearly basis through a registered valuer. Semi-annual updation made mandatory

- declaration of Net Asset Value (NAV) within 15 days from the date of valuation/ updation of valuation of assets
- any acquisition/ transfer of REIT assets to meet prescribed valuation guidelines

REITs assets/ investments:

- All assets to be situated in India
- REIT assets to include:
  - land and any permanently attached improvements to it (whether leasehold or freehold) including buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc.
  - Transferable Development Rights (TDRs)
  - Any other assets incidental to the ownership of real estate
- Assets not forming part of REITs
  - hospitals
  - hotels, with project cost of more than Rs 200 crore each in any place in India and of any star rating. 3-star or higher category classified hotels located outside cities with population of more than 1 million
  - common infrastructure for industrial parks, Special Economic Zones (SEZs), tourism facilities and agriculture markets
  - convention centres, with project cost of more than Rs 300 crore each
  - agricultural land or vacant land
  - units of another REIT
- mortgages not eligible to be REIT assets
- at least 80% of value of the REIT assets to be invested in completed and rent generating properties. Specific conditions prescribed for investing the balance funds in other assets
- REIT shall invest in at least two projects, and investment in one project should not exceed 60% of the value of assets owned by REIT
- REIT assets could be held directly by the REIT or via Special Purpose Vehicles (SPVs)
- REIT to hold not less than 50% equity and controlling interest in SPVs
- SPV to hold 80% equity in REIT assets
- multi-layer SPV structure may not be permitted and multiple scheme under REIT is not permitted

Tax regime:

Specific taxation regime has been introduced to deal with income earned via REITs. This is summarised as follows:

- Interest from the SPV will be exempt in the hand of the REIT but will be taxable as income of the unit holders/ sponsor
- Dividend will be exempt income for everyone
- Capital gains earned by REITs on sale of share of SPV will be taxable in the hands of the REIT at applicable rates but will be exempt in the hands of the unit holders/ sponsor
- Long-term capital gains earned by unit holders on sale of REIT units will be exempt whereas short-term capital gains will be taxable @ 15%
- Long-term capital gains earned by sponsor on sale of REIT units will be taxable @ 20% whereas short-term capital gains will be taxable @ 30%
- The REIT will be taxed for other income at the maximum marginal rate whereas the same will be exempt for the unit holders/ sponsor

For the sponsor, transfer of shares of SPV to a REIT in exchange of units is not considered a transfer. The tax payable is deferred to the date when the sponsor sells the units of REIT

> REITs will help unlock the value of commercial assets and provide developers a new avenue to raise funds. REITs have been successful in Singapore, Hong Kong, the United States and other economies, whereby they have helped developers raise capital. Further, it has helped in creating a new vehicle for investments for institutional and retail investors. Looking at our portfolio of more than 21 million square feet, we are definitely interested in REITs.

Ashok Kumar Tyagi, Chief Financial Officer, DLF Limited

The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013[3]

This legislation was introduced by the erstwhile UPA-II government and came into effect from 1 January 2014, replacing the archaic Land Acquisition Act, 1894. This Act combines both land acquisition, and rehabilitation and resettlement for the loss of land and livelihoods of those even marginally affected by land acquisition. It focuses on increasing transparency and involves prior consultation with local landowners and the local Panchayati Raj institutions.

However, the current government brought in an ordinance to bring about significant changes in the Act such as removing consent clause to acquire land for five different types of projects - industrial corridors, PPP projects, rural infrastructure, affordable housing and defence.

In a nutshell:

- Under the amended Act, 13 legislations including those relating to defence and national security, to provide higher compensation and rehabilitation and resettlement benefits to farmers whose land is being acquired have been brought under the Centre's purview
- Clauses for mandatory "consent" and Social Impact Assessment will not be applicable to any of the five types of projects for which land is acquired.
- Multi-crop irrigated land can also be acquired for these projects
- These amendments are viewed by the government as 'pro-farmer' steps but has been criticised by other political parties including allies of the ruling combine.

Foreign direct investment in real estate[4,5]

In a bid to boost cash inflows, the government has relaxed rules for FDI in the construction sector by reducing minimum built-up area as well as the capital requirement, while also easing the exit norms.

In a nutshell:

To support dwindling cash flows and the decreasing FDI in the real estate sector, the government introduced the following:

- The minimum floor area has been reduced to 20,000 sq. mtrs. from the earlier requisite of 50,000 sq. mtrs.
- The minimum capital requirement has been reduced to US$ 5 million from US$ 10 million which is to be achieved within 6 months from the date of commencement of the project
- Subsequent tranches of FDI can be brought till the period of ten years from the commencement of the project or before the completion of the project, whichever expires earlier.
- The investor will be permitted to exit on completion of the project or after three years from the date of final investment, subject to development of trunk infrastructure.
- The Government may permit repatriation of FDI, before the completion of the project. These proposals will be considered by the Foreign Investment Promotion Board (FIPB) on a case to case basis.
- The Government may, in view of facts and circumstances of a case, permit transfer of stake by one

> FDI investors want good returns. Indian policy makers will have to be aware of this and keep a keen eye on the overseas markets. For instance, the US market has started doing well, so to attract foreign investors to India would be challenging. Another part of the puzzle is the foreign exchange fluctuations, which hurt investors whenever the currency market dwindles.

Vineet Relia, Managing Director of SARE Homes Project Services Private Limited

non-resident investor to another non-resident investor, before the completion of the project. These proposals will be considered by FIPB on a case to case basis
- The revised policy states that 'developed plots' means plots where trunk infrastructure including roads, water supply, street lighting, drainage and sewerage, have been made available
- Low cost affordable housing has been defined, which is in consonance with the intention of the government to provide housing for all by 2022
- For the development of serviced plots, the mandate of having a minimum land of 10 hectares has been removed.

The Real Estate (Regulation & Development) Bill (RER) deferred[6]

The much-awaited RER, which has been debated at every level, has been deferred once again. While everyone agrees that it must be enacted at the earliest, no version of this Bill that has evolved so far has been universally accepted. Three recent revisions to the RER, which could conceivably lead to its unilateral acceptance and consequent ratification in 2015 are:

- Reduction of minimum balance to be maintained in the escrow account of a project has been reduced from 70% to 50%: This was from the monies collected from the buyers. This will effectively allow developers to continue their practice of diverting funds collected for a project towards land acquisition or other projects, and will work in their favour by also allowing them to grow their land and/or project portfolio. The 50% mandate will still place enough restriction on developers to divert funds elsewhere and ensure better completion records. However, for buyers, the concerns regarding funds diversion would be higher, and the Bill would be slightly less protectionist towards buyers.

- Coverage expanded to the commercial real estate sector: While the previous version of the bill envisaged coverage of only residential sector, the new government wants commercial real estate to also fall under the ambit of the regulatory authority and its clauses. Commercial projects under the purview of the bill would provide protection to investors of commercial assets, as well.
- All projects, which have not received their completion certificates, will also be now covered under the bill and hence this allows larger umbrella coverage for buyers and investors. Worryingly, while the RER was initially aimed at providing an alternate redressal mechanism, the new provisions are talking of no recourse to other consumer forums. This can lead to pressure on this regulatory body in terms of increased log of cases, though it will reduce instances of multiplicity of suits.

These recommendations have been made by the ministry and sent to the PMO for approval. After the approval of the PMO, it will be placed before the cabinet for its approval. Thereafter, it will be tabled in Parliament for passing the bill and making it an act. It is unclear whether the Real Estate Regulatory Authority will finally be ratified as a law in 2015, but the fact that hard discussions are happening is definitely positive, and indicative of the new government's determination to make it a reality.

Investment scenario: Buys and Ties

FDI inflow in real estate (termed as "construction development" by Department of Industrial Policy and Promotion [DIPP], which encompasses townships, housing and built-up infrastructure) has declined by 14% in 2014-15 (based on linear extrapolation of available data up to November 2014) as compared to 2013-14. Linear extrapolation of available data suggests FDI inflow will reach US$ 1,055 million for the year as compared to US$ 1,226 million in the previous fiscal.[7]

As per DIPP figures, the real estate sector witnessed FDI inflow worth US$ 703 million in 2014-15 till November.[8]

Change of government at the Centre lifted the mood of the sector and improved the overall sentiments of the economy. The global investor acknowledged this and we witnessed a deal resurgence in India Inc. Several deals were inked, the effects of which will be evident in 2015 when the actual inflows start coming in.

From April 2000 to November 2014, the sector has attracted US$ 24,009 million in FDI (10% of the total FDI inflow), and stands second only to the service sector.[9]

In 2014, total value of deals in the real estate sector aggregated US$ 1,559 million, which was an increase of 64% from US$ 954 million in 2013. If we compare the number of deals, in 2013 there were 30 deals as compared to 41 in 2014, an increase of 33%. While the number of interested investors have increased, the average size of the investments have also increased year on year.
Some of the major planned/ proposed investments in India are:

- Canadian asset management firm Brookfield is looking to set up a US$ 500 million real estate investment trust (REIT) and list it in India[10]
- Boston-based Taurus Investment Holdings LLC plans to invest US$ 200 million over three years into developing offices, shops and a hotel on about 20 acres of land in the southern state of Kerala[11]

Last couple of years of slowdown has resulted in the pent up demand for real-estate. This demand is likely to get unleashed in the near future. In addition to this, initiatives taken by the new government at the Centre and the new State government in Haryana will further boost the economy - resulting in new job creation and increase in investment in the infrastructure sector. During my recent travels to various countries in Asia and Europe, I have personally noticed change in investor confidence towards India. Overall we expect that the financial year 2015-16 will be a year of economic turnaround for our country, especially in sectors like manufacturing, infrastructure and construction.

Pankaj Bansal, Director, M3M

Top M&A Deals in 2014 in Real Estate (Source: Grant Thornton Deal Tracker 2014)

Embassy Office Parks - JV between Embassy Group and Blackstone	Vrindavan TechVillage - 106 Acre development	US$ 330millon	60%
Indiabulls Real Estate	87,444 sq ft property in London Mayfair	US$ 264millon	100%
M3M India Ltd	Land-Sahara group	US$ 202millon	100%
Oberoi Realty Limited	25 Acre Borivali Land Parcel from Tata Steel	US$ 186millon	100%
Lodha Developers	87 acre land parcel in Thane - Clariant Chemicals	US$ 186millon	100%

Top M&A Deals in 2014 in Infrastructure (Source: Grant Thornton Deal Tracker 2014)

New Generation Holdings Inc-	Valecha Engineering Ltd - 3 projects	US$ 52 million	100%
Tata Realty and Infrastructure Limited	Madhucon Group- Agra Jaipur Expressway	US$ 42 million	100%
HAL Offshore Ltd	Seamec Ltd – Technip	US$ 202millon	-75%
Alstom, through Alstom Transport India Ltd	Alstom India Ltd - Transportation system unit	US$ 29 million	N.A
Container Corporation of India-Angul	Angul-Sukinda railway line (ASRL)	US$ 25 million	26%

Top Deals in 2014 in e-commerce

- SoftBank-Housing.com[12] — US$ 70 million -30%
- Google Capital-CommonFloor[13] — US$ 48 million –.N.A.
- Tiger Global and Accel Partners-CommonFloor[14] — US$ 40 million –N.A.
- New Enterprise Associates, Foundation Capital and others-IndiaHomes[15] — US$ 50 million –N.A.
- Tata Capital-Shriram Properties Private Limited-IndiaHomes[16] — US$ 25 million –N.A.

Top PE Deals in 2014 in Real Estate (Source: Grant Thornton Deal Tracker 2014)

- Brookfield Property Partners – Unitech IT parks — US$ 347 million -N.A.
- GIC – Nirlon Ltd — US$ 114 million -34%
- Xander Group – Infinity Tech Park — US$ 108 million -100%
- Blackstone – SEZ Oxygen Boulevard — US$104 million -100%%
- Tata Capital – Shriram Properties Private Limited — US$ 80 million -18%

Top PE Deals in 2014 in Infrastructure (Source: Grant Thornton Deal Tracker 2014)

- Temasek , IDFC– GMR Infrastructure — US$183 million -12%
- KKR-GMR Holdings — US$164 million -N.A.
- Canada Pension Plan Investment Board –L&T Infrastructure Development Projects — US$161 million –N.A.
- Standard Chartered Private Equity –Sterlite Power Grid Ventures Limited — US$100 million –20%.
- Squared Capital –Jaipur Mahua Tollways Pvt. Ltd. — US$80 million -100%

In a nutshell

- FDI in the sector during April–November 2014 stood at US$ 703 million
- The real estate market of South India led by Bengaluru has outdone Mumbai and Delhi in terms of attracting private equity funding. Healthy sales volume has made the region a preferred destination for investors
- The online realty space has been the recent recipient of investor attention as the space is seen to witness heavy advertising spends both offline and online

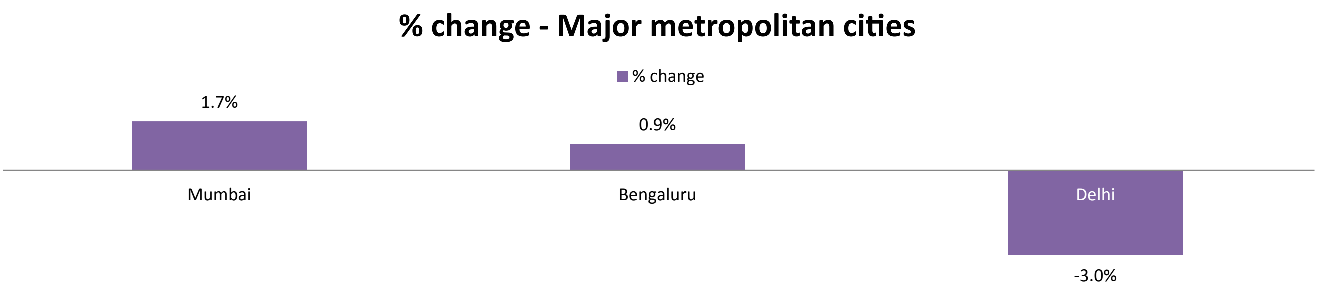
Key trends in the sector

With growing economy and changing buyer expectations, real estate developers are constantly being innovative with their business plans. Buyers in different cities have reacted to the changes differently and the developers have had to adapt accordingly.

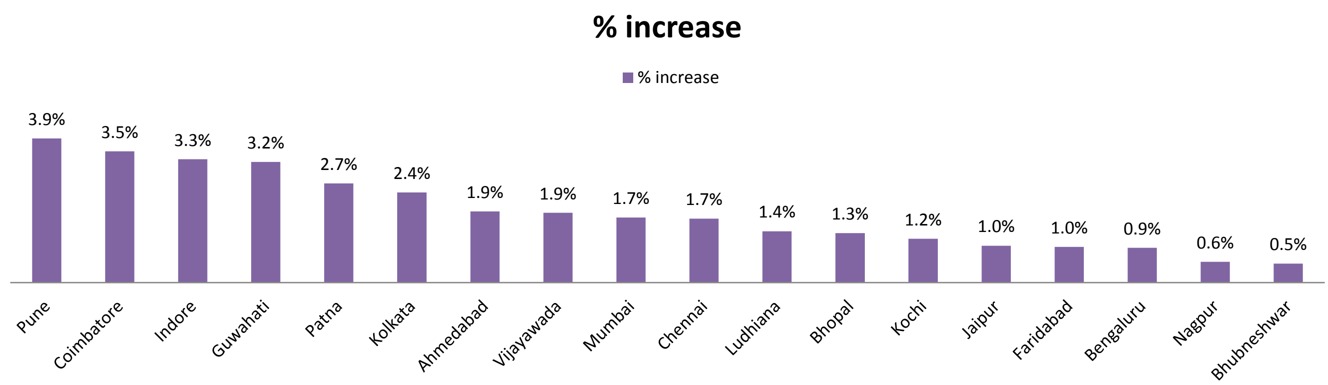
Pricing trends[17]

According to the National Housing Bank (NHB), in the quarter ending June 2014, property prices of residential units in Pune and Coimbatore registered growth of 3.9% and 3.5%, respectively, over the previous quarter, representing the highest increase among all the 26 cities covered under the NHB Residex. At 0.5%, Bhubaneshwar registered the lowest growth in property prices.

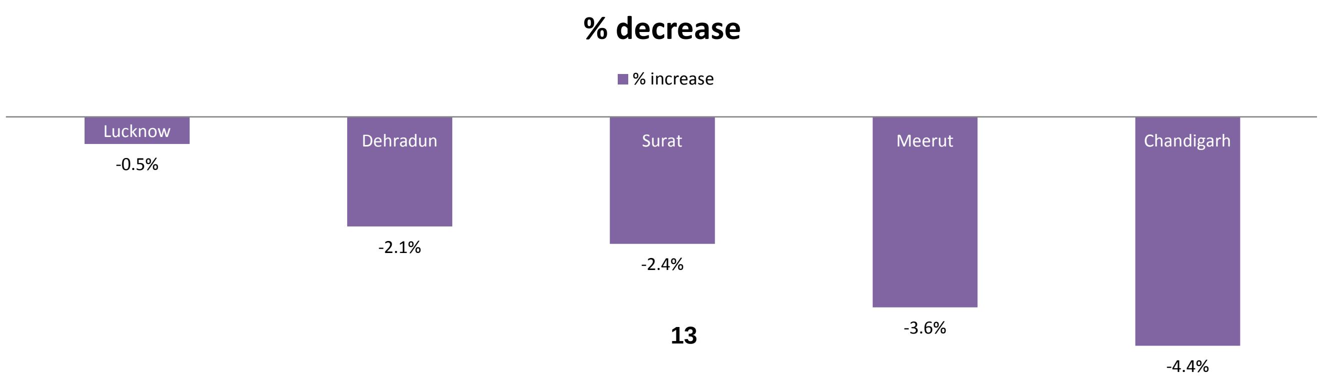
A comparative of the three main markets is as under:



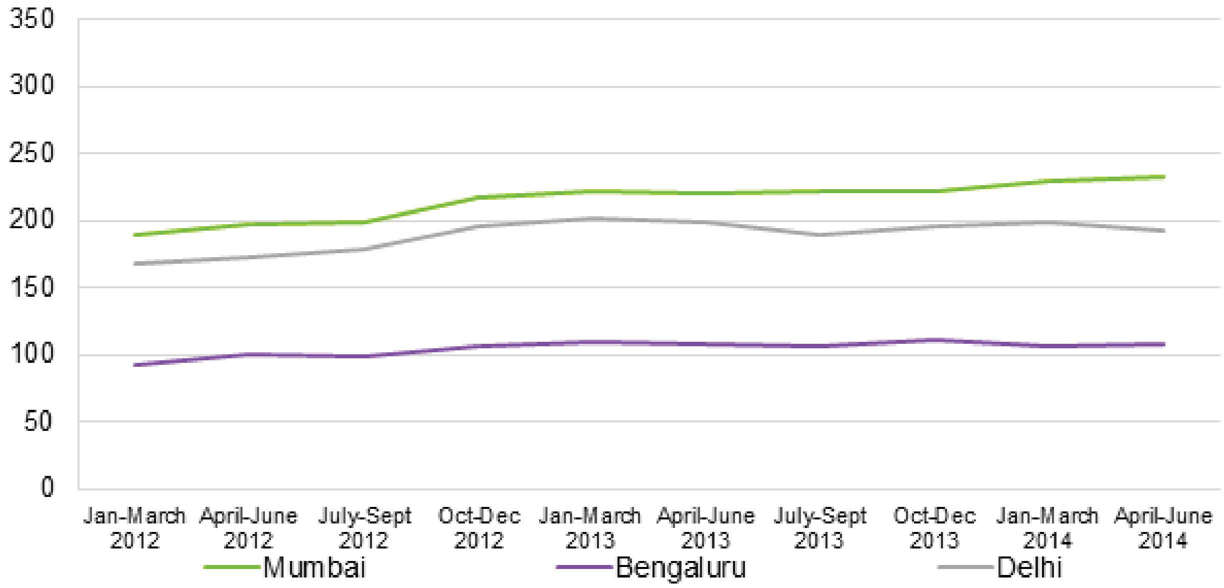
18 cities which showed positive growth quarter on quarter are as follows:



Among all the cities covered under the NHB Residex, five cities (other than Delhi) displayed a declining trend in property prices over the previous quarter with Chandigarh recording the steepest fall at -4.37%.
A comparative of the 5 cities which showed negative growth quarter on quarter is as follows:

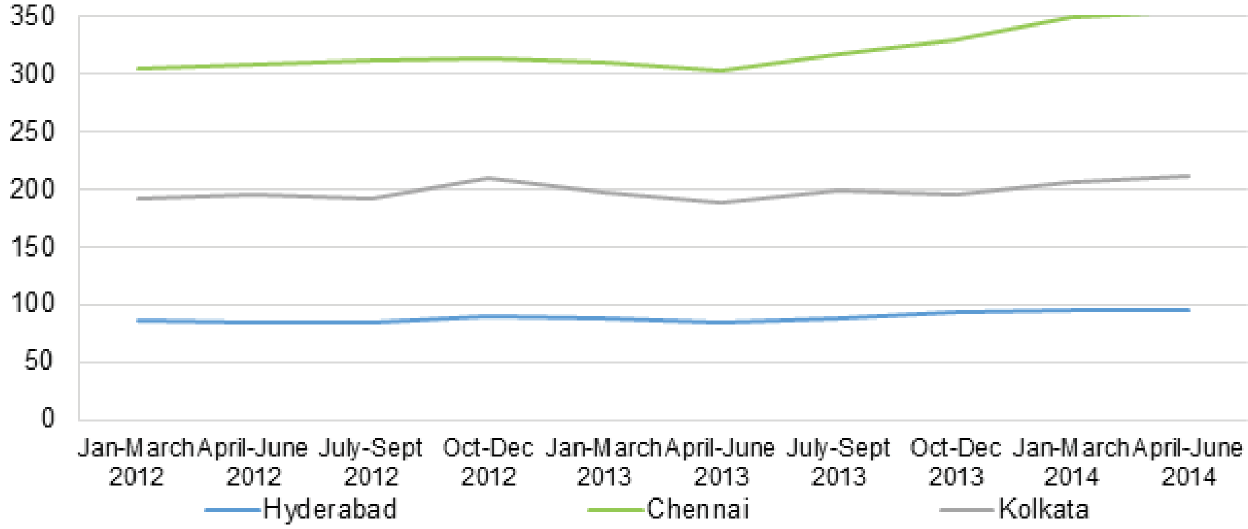


City-wise housing price index – major metropolitan regions



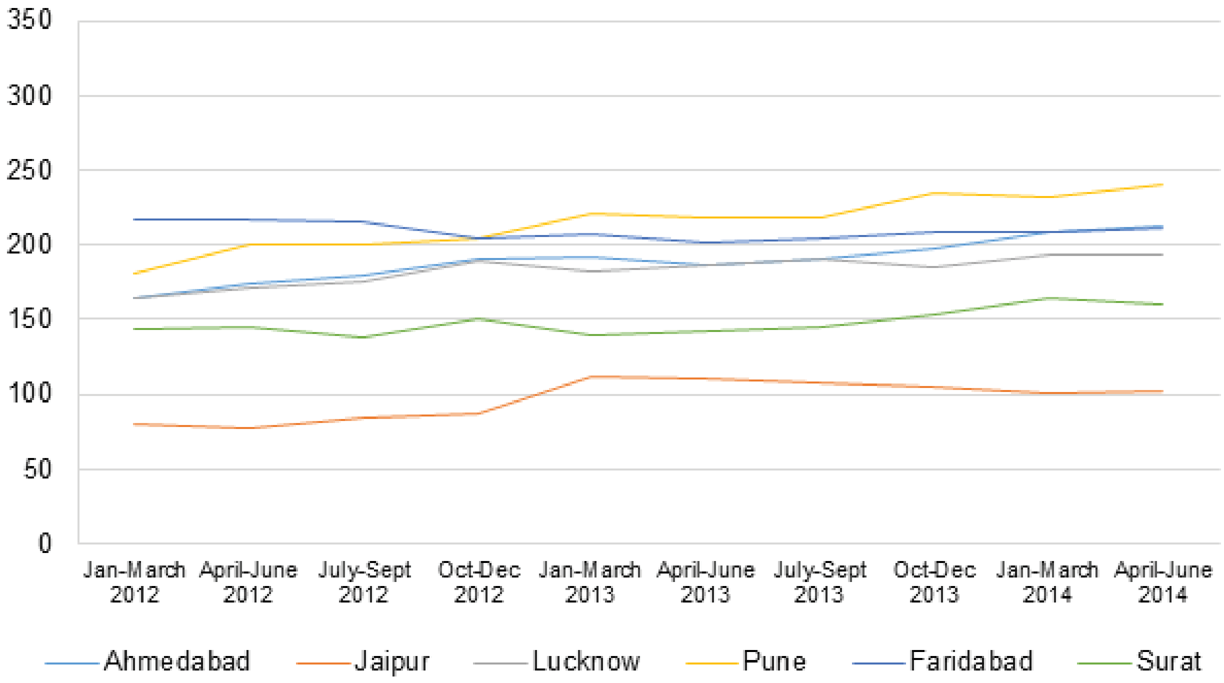
Source: http://www.nhb.org.in/Residex/Data&Graphs.php

City-wise housing price index – Tier I cities



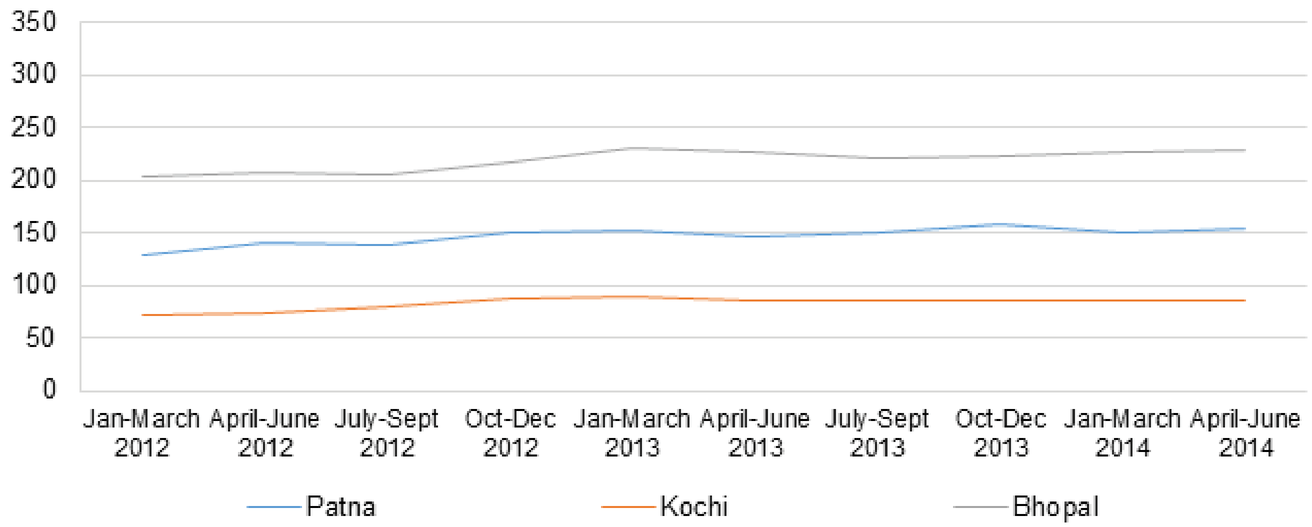
Source: http://www.nhb.org.in/Residex/Data&Graphs.php

City-wise housing price index – Tier II cities



Source: http://www.nhb.org.in/Residex/Data&Graphs.php

City-wise housing price index – Tier III cities



Source: http://www.nhb.org.in/Residex/Data&Graphs.php

Residential real estate market:[18, 19]

2014 saw a sharp decline in demand of about 30% in the seven major cities in India. This is mainly attributable to the high prices, higher interest rates and cautious buyer sentiments. The developers responded to the decrease in demand by reducing the supply whereby there was a 25% decline on a year on year basis. The decline, which was reported in the premium and high end/ mid end business segments, was observed across all the major cities, steepest in the NCR. Considering the muted response during the festive season, sector experts believe that the prevailing prices need to be rationalised in line with the average per capita income.

However, as the year drew to a close, the affordable housing segment began to gain favour. The ruling government at the Centre and the Central Bank have clearly spelled out their intention to push for affordable housing. Buyers were seen finding comfort in investing in such projects given the smaller ticket sizes and improving connectivity in the suburbs of the major cities. The developers who are currently holding an inventory of approximately 30 months realised the potential of this segment and were seen shifting their focus to the affordable market segment. This new focus also helped them with their cash flows.
For the developers, the most challenging part of delivering affordable homes will be to align this format with their existing brand image without impacting it. Some developers cater exclusively to the high end consumers and their venturing into the affordable segment has to be marketed as an extension of their current natural brand. While the thought and effort to bridge the demand-supply gap and cater to the affordable segment is a noble thought, let us not forget that it was forced on to the builders by the stagnant economy. If the past is anything to go by, it will not be surprising to see the developers lose interest in this segment after the economy picks up.

Commercial real estate market:[20]

Over the past few years, the real estate developers have always been too optimistic about the revival in economic activity which led to an increased supply of office space in the market as against the actual demand from the consumers. A study suggests that until 2014, the supply of office real estate was higher than demand by 4 to 10 million sq ft. Given the current state of the economy and the pricing in the commercial real estate space, buyer opted to keep expansions/ new space acquisitions on hold. While the developers did not put a hold on the supply, the demand-supply gap kept on increasing.

Though office real estate prices failed to recover from the after-effects of the financial crisis up to late 2014, we did see the beginning of a gradual turnaround. This can be attributed to the fact that commercial real estate developers began to strategically reduce the incoming supply to a new-normal level of occupier demand in the range of 27 to 30 million sq. ft. each year. This helped bring down the vacancy rate to 17% from more than 18.5% just a year ago.

Except for the well-managed and leasehold organised retail malls, the retail real estate sector was one of the biggest casualties of the market conditions. The retailers chose to avoid the poorly-managed and badly-located retail properties. 2014 was witness to some of these malls losing sheen and converting into Grade B office spaces. Vacancy in poorly-built and operated malls was as high as 20%, while good quality malls were relatively better off with about 10% of vacant space.

Investors Clinic expects to see significant uptick in real estate demand towards January to March quarter of 2017, as a result of significant steps taken by the government towards employment generation. NCR currently presents best investment opportunities, with most of the currently available projects closer to the replacement cost, something which we haven't seen over last two decades. Bangalore, Chennai and Pune continue to be top end user driven markets propelled by significant job creation and infrastructure development. Hyderabad is a market to watch out for over the next 3 years with possibility of annual returns of over 30% to 40% across all locations.

Nishant Singhal, Promoter, Investor Clinic

Emerging trends

Smart cities

The challenges and opportunities that come with rising urbanisation across the world have given birth to the concept of smart cities. Globally, urbanisation is on the rise and India is not far behind. Growth in urban population is creating excessive pressure on demands for water, transportation, waste management and power. For a city to cope with these challenges and deliver a high-quality of urban living, it has to be energy-efficient and have an efficient and sustainable transport infrastructure. Such cities are known as "smart cities", and are managed and monitored by cutting-edge information and communications technology.

What is special about a smart city?

A smart city functions with increased efficiency. Be it in terms of deploying high-quality street lights, smart grids, energy-efficient buildings, a smart traffic management system, or an efficient water management system. It solves issues of traffic jams, wasted energy, dark corners or crimes, and has a quick emergency response system in place.

Smart cities in India

In India, although the smart city concept is still new, there have been initiatives by the government and private developers to build smart cities. The government plans to develop 100 smart cities over the next 20 years for which an initial allocation of Rs 7,060 crore was provided for in the 2014-15 Union Budget. These cities will include the construction of satellite towns near existing mega cities, upgrading existing mid-sized cities and construction of settlements along industrial corridors in addition to the construction of a few new cities altogether.

Though the idea of a smart city seems appealing, it is full of challenges considering the issues faced by our cities due to rapid urbanisation. Key challenges that the concept of smart cities in India face are:

Poor governance structure

Smart projects invite huge investments, which cannot be driven by a single entity, and therefore, there has to be an integrated model for funding when local and central governments, banks and financial institutions as well as private investors along with entities/ institutes with technical knowhow join hands. Given the current structure of Indian urban local governments wherein they lack financial autonomy and ability to raise resources, the reliance on fiscal transfers and dependence on the central government is high. Research show that overlapping judicial set ups and fragmented institutional responsibilities are major hindrances in smooth delivery of projects. Along with giving the local bodies more autonomy and making them self-reliant, there is a strong need to ensure that those in government are trained to deliver real-time responses to issues and constantly evolve to meet the demands of the citizens.

Social structure

Urban India is a complex maze of population groups classified on the basis of religion, caste, community, social status, occupations, origins, beliefs, etc. Each group has its own way of living and beliefs, which at best, should not be attempted to be altered with. If that was not all, most large cities have half or more of their population dwelling in slums. Smart cities need to be able to cater to these diverse client groups whilst ensuring that their privacy, security and life style are not compromised. Further, all services and infrastructure have to be affordable for all sections of the society. An all-inclusive growth is most desired but is also the most challenging part of smart cities.

International and corporate interest

Several countries and corporates around the world have shown keen interest in helping India achieve her smart cities dream. To name a few:

- Singapore has signed a Memorandum of Understanding (MoU) with the state of Andhra Pradesh to provide knowledge on smart city management. International Enterprise Singapore and the Infrastructure Corporation of Andhra Pradesh signed a deal to train Andhra Pradesh officials in urban planning and governance, supported by the Centre for Livable Cities and the Singapore Cooperation Enterprise.[21]
- Spain has come forward to assist in developing New Delhi into a smart city. The MoU is expected to be signed shortly between the two countries.[22]
- Global networking giant, Cisco, will assist in developing Visakhapatnam as a smart city. Cisco would focus on setting up a skill development centre and provide training through Global Talent Tracker. The company is also keen on working with Andhra Pradesh in digitising education and healthcare.[23]
- Germany has agreed to partner with India in developing three smart cities and a six-member joint committee has been set up in this regard to evolve the way forward including identification of those cities in three months.[24]
- Japan intends to assist and develop Varanasi into a 'smart city' by using the experience of Kyoto, the 'smart city' of Japan. A partner city MoU was signed between the two countries in August last year.[25]
- France is keen on developing Smart Cities in Himachal Pradesh having adequate infrastructure and facilities like proper water treatment, waste management, urban transport and street lighting in the state.[26]

Initiatives by the government

The Urban Development Ministry is in the process of rolling out a City Challenge in which urban centers hoping to be selected for smart city projects will be evaluated on a range of parameters including urban reforms, revenue collection, sanitation levels, capacity of urban local bodies, and creditworthiness. Cities and towns will have to meet qualifying norms on urban reforms and quality of governance before they are identified for the smart cities projects.

Apart from the allocation of Rs 7,060 crore in the Union Budget of 2014-15 towards development of 100 smart cities, the requirement of the built-up area and capital conditions for FDI has being reduced from 50,000 square metres to 20,000 square metres and from US$ 10 million to US$ 5 million, respectively, with a three year post completion lock-in period. This will have dual advantage. This will not only help small developers with good track record to access foreign funds but also enable equity funds to look at a large range of developers to collaborate with.

Reality check

For this project to be successful, the government needs to ensure that the urban policies are wide-ranging, inclusive, innovative and sustainable. With most of our existing cities unplanned, unlike in western countries, a detailed study should be undertaken of the existing cities to check the feasibility of converting them into smart cities. While it remains to be seen how far India can go towards creating world-class smart cities, a start has been made at Detroj (a 1,200- hectare area near Ahmedabad) and Dholera (a region that is twice the size of Mumbai). With inclusive policies, growth centric approach and a determined administration, this grandiosely ambitious project is surely within our reach.

Emerging trends

E-commerce and real estate

The e-commerce frenzy that has been taking India by storm over the last two years was at its peak during 2014 and is expected to grow unabated.

The developers and various players in the market are exploring unchartered avenues to reach out to potential customers. Taking advantage of the Google Online Shopping Festival (GOSF), Tata Housing has launched two projects, one each in Bengaluru and Mumbai. Through the online medium, Tata Housing has sold over 700 units amounting to about Rs 400 crore, an average of one house every two days. It has also entered into an exclusive arrangement for selling homes on Snapdeal.com. The developers participating in the GOSF include Unitech, Raheja, Puravankara, Mahindra Lifespaces, Godrej Properties and Brigade among others. Even housing loan providers such as HDFC Home Loans, Tata Capital and others had various offers going on during the GOSF. We also saw some e-commerce companies dealing in real estate such as – housing.com, commonfloor.com and indiahomes.com getting significant funding to create infrastructure to support the sale/ renting of real estate units.[27]

Currently, in India, the e-commerce business is not regulated and this poses a serious threat to physical retailers and mall developers.

However, with changing times, some of the developers have changed their style of business to enable them to sail through these difficult times. A revamped tenant mix, adoption of the mixed-use format and delivering theme-based shopping experiences are some of the methods adopted by the proactive developers. These practices are now common in overseas markets, and Indian retail malls will be seen adapting to them more rapidly in 2015.

News round-up: Key highlights for 2014

1 Economy

Though we are yet to see the turnaround in the economy, the new government brought with itself a lot of belief and intent to reboot the economy and put it on a path of fast track growth. Sentiments are positive and the year has ended on a much better note as compared to how it had started.

2 Policies

The Union Budget 2014, to start with and the subsequent policy reforms introduced by the government have brought in positivity in the real estate sector. REITs, FDI and RER are some of the policies introduced, which can go a long way in giving the desired impetus to the sector.

3 Residential real estate

The slump continues, however, developers have become wiser and have embraced change to meet the needs of consumers and the economy. High-end luxurious projects are on the back burner and affordable projects are given the priority. Customer acceptance and ability to invest/ purchase affordable projects are high, given the current state of the economy.

4 Commercial real estate

Realising that the increase in demand from commercial buyers was unlikely and toning down their level of optimism, the developers reduced the supply of commercial spaces. This helped bridge the gap in the demand and supply to some extent.

5 E-commerce

Not one to be left behind in the e-commerce race, the sector embraced the flavour of the season. Buyers were seen to be more comfortable booking flats/ units online and several online portals were up to the challenge to cash in. Developers across India have acknowledged the potential of e-commerce and have seen manifold increase in bookings through this medium.

News round-up

Jaypee group's growing debts[28,29]

In an attempt to cut down its borrowings, Jayprakash Associates Limited intends to sell Rs 10,000 crore worth of assets in 2014-15. Concerned over their massive exposure to the debt-laden infrastructure conglomerate Jaypee Group, its lenders met in October to take stock of the situation. The consortium of as many as 30 lenders led by State Bank and including IDBI Bank and Oriental Bank of Commerce among others, has an overall exposure of Rs 72,000 crore out of which Rs 8,000 crore is due by March.

Adani in realty push, lines up projects[30]

The Adani group had announced a Rs 4,400-crore acquisition of the Dhamra port. Soon after, Adani Realty, announced the launch of a luxury residential project in Mumbai's posh Four Bungalows area, a western suburb. The project promises "the privilege of being up and away" and is coming up on two acres of land the group bought in early 2012 from Mumbai developer HDIL for Rs 900 crore. There will be three towers of 29 storeys each.

Private equity firms exit real estate companies with good returns[31]

At a time when the Indian property market is showing sluggishness, some PE firms have exited their investments in real estate companies and locked in good returns too. Of the total institutional PE capital deployed until March 2014, nearly a fifth, amounting to US$ 6.9 billion, has been exited by PE funds, according to a recent report by Brookfield Financial.

Brookfield Asset Management to buy Unitech Corporate Park assets for Rs 3,500 crore[32]

The Canadian firm - Brookfield Asset Management is likely to acquire 100% shareholding in four SEZs owned by Unitech Corporate Parks and a 60% shareholding in another two of its assets in India for Rs 3,500 crore.

Investors ready US$ 1 billion war chest for office assets in India[33]

Foreign private equity funds and pension funds are among investors that over the last 12 months have committed to invest more than US$1 billion to buy or build commercial property in India as the government works to finalise rules governing REITs.

Mumbai-based realty portal Makaan.com may sell or form JV with MagicBricks or Quikr[34]

The e-commerce business sector, which has witnessed a boom in India in recent times, and caught the interest of the common man, has started to influence the real estate sector as well. Real estate portal Housing.com has launched a rent agreement product that helps people create and customise a property agreement online. The product allows customers to draft their lease document by giving inputs like rent, property area, security deposit and the facilities available. Housing.com then pays stamp duty on behalf of the tenant and the landlord, and delivers the e-stamped rental agreement at their doorstep within 48 hours. On the other hand, People Group, which owns and operates the real estate portal Makaan.com, has entered into talks with potential buyers, to sell the venture, at a time when the country's online property space is being seen as the next playground for strategic investors across the local and global markets.

Japanese realty major Tama Home to invest Rs 6,000 crore in India[35]

Japanese real estate company Tama Home Co. Ltd. confirmed its plans to form a joint venture with Developer Group India Pvt. Ltd. to develop Rs 6,000 crore worth of real estate projects in India over the next five years. These will include about 10,000 homes across the mid-income and affordable housing segments.

High inventory, slow sales make PE funds rush for bulk deals[36]

As per a recent survey, the unsold inventory with real estate developers has touched a record high of 800,000 for apartments. The sluggish home sales are turning out to be an opportunity for some private equity (PE) funds in the country. These PE funds are lapping up apartments in bulk from developers who are willing to give significant discounts given the current slowdown in the sector. A number of PE funds, including Piramal Fund Management, Aditya Birla Real Estate Fund and the PE fund founded by the former Indiareit Head - Ramesh Jogani in a joint venture with Centrum Wealth Management, have launched apartment funds in the past few months. The developer can then use the proceeds on speeding-up the construction activities and on increasing visibility for the project.

A Sharia compliant REIT[37]

The notification of the REITs guidelines by the Stock Exchange Bureau of India has provided real estate players with a new avenue to attract investments from the Middle East. Some prominent real estate developers are in advanced talks with lawyers and real estate experts for launching Sharia-enabled REITs in India. The developers are interested in a Sharia-compliant product which can ensure additional security and provide committed returns, and in the process, dissuade players from taking excessive risks with complex products. Sharia compliance deploys the Islamic banking model to attract investments. Similar to the mode of compliance currently being followed by Indian companies to abide by the corruption laws of the UK and the US, Indian real estate companies will have to adhere with the Sharia requirements of REITs as well. On the flip side, the biggest challenge faced with a Sharia compliant REIT will be lower yields due to stringent laws around accepting interest. However, realtors believe that there are many investors who would accept a marginally less return as long as it is in compliance with their religious beliefs.

Re-launch, co-brand and share of profit[38]

Developers faced with sluggish sale of their real estate projects are forming deals to re-launch, co-brand, share profits or take over such ventures, as buyers in cities continue to sit on the fence. This is a new trend in the market to overcome the funding shortage issue and a capability gap where developers come together to share the burden or risk. The prolonged slowdown in the real estate sector has not led to a fall in prices, but the so-called distressed opportunities are rising in cities except Bengaluru where sales are still holding up.

Conservation of built heritage included in Delhi Master Plan[39]

The Delhi Development Authority (DDA) has dedicated a chapter on conservation of built heritage in the city's master plan, a step that is likely to prove a boon for "unprotected" monuments and buildings in the national capital.

As part of its efforts to preserve the city's architectural fabric, DDA has identified six heritage zones and designated three archaeological parks in the Master Plan for Delhi, 2021.

Supertech verdict may lead to activism in real estate[40,41]

The Allahabad High Court's order to demolish Supertech's two 40-storey towers in Noida for violation of building norms has opened a window of opportunity for disgruntled home buyers. They are now considering legal action against builders who have ignored pleas for timely deliveries.

Lawyers involved in cases against real estate developers say they have received several enquiries from homebuyers, with issues ranging from delayed delivery of apartments, one-sided clauses to maintenance issues after getting possession.

The Supreme Court later directed that status quo be maintained on real estate developer Supertech's two under-construction 40-floor towers, which face demolition.

Budget 2015

Budget 2015

On 28 February 2015, the Finance Minister presented the first full year budget of the current government. The budget was forward looking and pragmatic with a vision that goes beyond just this fiscal. The policy initiatives and tax proposals mirrored the intention of the government to set the economy in the growth trajectory. The budget had its share of goodies for the real estate and infrastructure sector. Some of the key announcements were:

Policy initiatives

- A mission to provide a roof for each family under the "housing for all" scheme by 2022 has been announced. It is targeted to complete 2 crore houses in urban areas and 4 crore houses in rural areas
- The budget proposals have brought much needed relief to the infrastructure sector, by substantially increasing the budget allocations
- As per the budget proposals, the investment in the infrastructure sector will increase by Rs 70,000 crore
- National Investment and Infrastructure Fund (NIIF) to be established with an annual flow of Rs 20,000 crore
- Self-Employment and Talent Utilisation (SETU) to be established as technofinancial, incubation and facilitation programme to support all aspects of start-up business. Rs 1,000 crore to be set aside as an initial amount
- An expert committee to examine possibility and prepare a draft legislation where multiple prior permissions can be replaced by a pre-existing regulatory mechanism to help India become a favoured investment destination
- Tax-free bonds to be issued to raise funds for rail, road and irrigation sectors
- The PPP model for infrastructure development will be revitalised and the government would bear the major risks therein
- Further, there are proposals to allocate Rs 150 crore towards infrastructure research & development, with a view to encourage the involvement of academicians, entrepreneurs and researchers to draw national and international experience to foster scientific innovations, and undertake research and development in the infrastructure sector
- The government also proposes to set up five ultra-mega power projects in the country. Further, the government also plans electrification of the remaining 20,000 villages by 2020
- There will be a specific focus on ports in public sector to attract investments and to promote self-employment and talent utilisation

Proposals on Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (InvITs)

Rental income earned by REITs shall have a pass-through status, being taxable in the hands of the unit holders

No withholding tax on rental income earned by REITs from directly owned real estate assets (w.e.f. 1 June 2015)

Withholding tax on distribution of rental income (w.e.f. 1 June 2015)

- Where unit holder is a resident, REIT to withhold tax @ 10%
- Where unit holder is a non-resident, REIT to withhold tax as per rates in force

Units received by Sponsors of REITs and InvITs on swap of shares in SPV shall be entitled to beneficial tax treatment whereby sale or transfer of such units shall be exempted from tax for long-term capital assets and taxed at 15% for short-term capital assets. This treatment will be available, provided the sale of such units has been subjected to Securities Transaction Tax (STT).

Nature of income	REIT and InvIT	Unit holders including the sponsor
Interest from SPV	Exempt	Taxable as interest income
		Withholding tax to be deducted by REIT on distribution (Non-resident – 5%, Others 10%)
Dividend	Exempt	Exempt
Capital gains on exit by REIT/ InvIT	At the rates applicable to capital gains	Exempt
Capital gains earned by unit holders on sale of REIT/ InvIT units including units held by Sponsors	Not applicable	For unit holders – long-term – exempt – short-term – 15%
Rental income	Exempt	Taxable at the applicable rates

Way forward

With the series of announcements and the change of guard at the helm, the sector has seen some positivity in the last 8-10 months. The Indian real estate sector seems poised for growth. Rapid urbanisation, fast-growing middle class, economic growth and lowering of interest rates is sure to boost demand in 2015-16. The announcement on REITs and revision of rules for attracting FDI in construction development sector were positive moves and has pushed the investor community to take a serious look at the sector. This should support in providing access to capital for the cash-strapped developers.

Having said that, "realty" on the ground is not moving with the same pace as the talks.. The sector has been demanding a single window clearance to improve ease of doing business, which is still a long way ahead. The Union Budget 2015 was also seen as a dampener by many. It was a wonderful opportunity for the government to provide more clarity on smart cities, announce tax holidays for affordable housing and increase the limit on interest deduction on housing loans. However, the government's housing-for-all policy, which aims to provide 6 crore housing units (2 crore in rural and 4 crore in urban areas) by 2020 was among the bright spots in Budget 2015-16.

Land acquisition is still a contentious issue with both the government and the opposition battling it out inside and outside Parliament. The sooner this gets resolved the better, as the ambiguity is only hurting investor sentiment. The sector has been demanding 'industry status' to bring in more transparency and make it easier for players to raise funds.

The Government's pro-reform measures in the last few months have bolstered economic sentiment. Projections for India's GDP for the current fiscal have improved dramatically. Rating agency Fitch has forecasted India's GDP to grow at 8% in 2015-16 and 8.3% the next year. The time is ripe for the Government, dynamic Indian businesses and the investor community to collaborate to identify and remove bottlenecks in the real estate sector and exploit its full potential.

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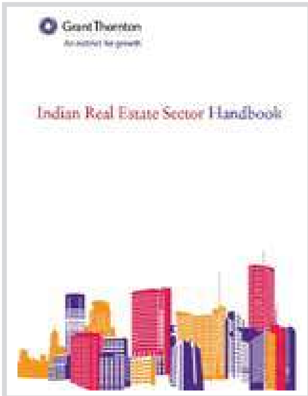

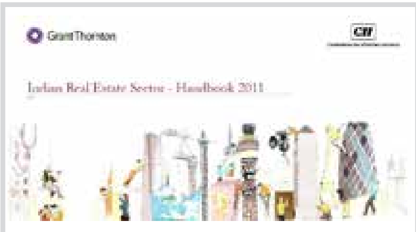

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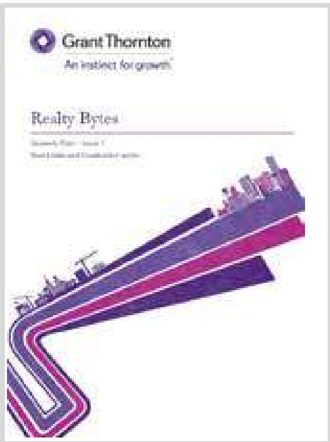

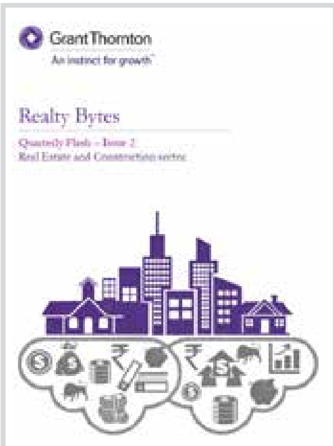

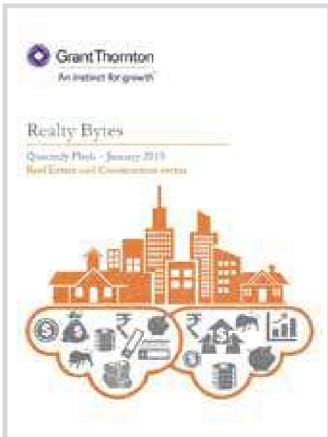

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