Realty Bytes

June 2015

Real Estate and Construction sector

Executive summary

In 2014, the sector witnessed several positive regulatory changes which complemented the Companies Act, 2013 and sowed the seeds for optimism in the growth prospects of the sector.

With the new and unarguably a business-oriented government at the Centre, there is a renewed sense of confidence at the corporate and global investor levels. Campaigns like 'Make in India' are fuelling capital inflows, and thereby pushing up the demand for commercial real estate in the country.

Relaxed Foreign Direct Investments (FDI) norms, facilitation of Real Estate Investment Trust (REITs) and attempts to increase transparency through Real Estate Regulatory Bill are steps in the right direction. There are positive sentiments among the foreign investors with regards to these developments, which is likely to improve the investment inflow into the sector.

Major roadblock for the government has been its inability to push for the legislation of reform initiatives. Also, the lack of numbers in the Upper House of the Parliament is a concern for the ruling party as they are unable to push through critical reforms. After having failed to get the Land Acquisition Bill cleared in the Parliament, the government referred it to a Joint Committee comprising MPs from both the Houses. Any recommendation of the Joint Committee will be binding on both the Houses of the Parliament. The encouraging part of this development is that the Joint Committee has been instructed to submit its report on the first day of the upcoming monsoon session of the Parliament.

While the government had already stated its intentions of introducing a regulator for the sector, the government is still carving out the roles and responsibilities of the proposed regulator. REITs was expected to be the vehicle which would take the sector into a new growth trajectory. However, the uncertainties on matters like Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT) have acted as spoilers and have kept the developers at bay. However, there have been clarifications issued by the government but only time will tell if these will translate into actual investment through the REIT vehicle.

In 2015, some of the key areas on which the real estate sector will have to focus are faster implementation of projects, on-time deliveries, improved quality of construction and a single window clearance system, amongst others.

We are through the first half of the year and we can only expect the coming months to be more encouraging and fruitful for the sector.

News updates

Government to re-promulgate the land ordinance for the third time[1]

The government is set to introduce another ordinance on the Land Acquisition Bill after it failed to get the legislation passed in the Rajya Sabha and had to refer it to a Joint Committee of both Houses during the just-concluded Budget session of Parliament. Parliamentary Affairs Minister, M Venkaiah Naidu was quoted saying that the third ordinance on The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (Amendment) Bill, 2015 would be issued soon.

Department of Industrial Policy and Promotion (DIPP) clarifies rules for Foreign Direct Investment (FDI) in construction2

DIPP, in a clarification note issued recently, specified that the minimum capitalisation norm for FDI in construction was project-specific and not company-specific. This means that the norm, which specifies that the new FDI will be allowed only if the minimum cap of US$ 5 million is achieved within six months, refers to a particular project and not the company making the investment. After the minimum capitalisation norms are met, FDI can be brought in for a period of 10 years or till the project is completed. The note also specified that exit is permitted even before completion of the project or development of trunk infrastructure, with the approval of the Foreign Investment Promotion Board (FIPB) on a case-to-case basis. After the completion of the project, exit is permitted by following an automatic route. The DIPP further specified that if the project is ongoing, the non-residence to non-resident transfers would need the FIPB nod. The government allows up to 100% FDI in construction projects including townships, housing and built-up infrastructure, subject to specific conditions. In its effort to remove the last hurdle to big-ticket foreign investment in the real estate sector, the Finance Ministry has floated a draft Cabinet note to amend the Foreign Exchange Management Act (FEMA) to permit overseas funds in real estate investment trusts. The amendments have already received a green signal.

Relief for foreign investors and REITs[3]

Recent provisions of the Central government as part of the Finance Bill, 2015, including issuing a clarification that minimum alternate tax (MAT) will not be applicable to capital gains on the sale of securities, royalty, technical service fees and interest income, have provided some relief to foreign investors. The relief is available only in those cases where the normal tax rate is below 18.5%, the rate at which MAT is levied, and will be available prospectively from the current fiscal, disappointing investors who were looking to the Finance Bill to roll back demands levied for previous years. The relief is available to all types of investors, including corporates and private equity. The Finance Minister also eased MAT rules for real estate investment trusts (REITs) and Infrastructure Investments Trusts (InvITs). The Finance Minister lowered the export duty on low-grade iron ore to 10% from 30% to boost exports from Goa and revive mining of the commodity in the State.

In a move intended to make REITs in India more investor-friendly, the Cabinet approved a proposal to allow foreign investment in completed rent-yielding assets. REITs are proposed as listed entities that invest primarily in leased office and retail assets, allowing developers to raise funds by selling completed buildings to investors and listing them as a trust. REITs are expected to open up an estimated US$ 20 billion opportunity for the real estate sector. Till now, foreign investment was allowed only in under-construction projects, and not in completed rent-yielding assets.

Fresh cabinet note on the realty sector soon[4]

The government is in the process of preparing a fresh Cabinet note outlining the roles and responsibilities of a real estate regulator, a top government law officer informed the Supreme Court in his response to a Public Interest Litigation (PIL) on the same matter. The government was asked in 2007 to respond to a court notice on a PIL, which demanded creation of such a regulator in the interest of the consumers. The previous UPA government did introduce a bill that was later referred to a parliamentary standing committee, but there has been no progress on this front since then. Developers were opposed to the bill as it carried punitive provisions including de-registration of projects and penalties.

Government plans Provident Fund investment boost for infrastructure, low-cost housing[5]

The Finance Ministry is proposing changes in the investment norms for non-government provident funds as well as superannuation and gratuity funds to boost flow of funds in infrastructure and affordable housing. The Ministry is suggesting changes in the investment rules from 2015-16 with the draft rules having been finalised at the behest of the highways ministry, which is looking at long-term funding to finance highways, where private developers are finding it tough to raise funds, given the high leverage levels and reluctance of banks to lend.

Getting smarter with smart cities[6]

After celebrity nominations akin to the famous ALS ice-bucket challenge for its Swachh Bharat campaign, and a nationwide contest for an e-governance mobile app for the Prime Minister's Office (PMO), the government is going to choose 100 urban centres for its 'smart city' project through a competition. State governments will participate in a 'city challenge'. This means that states will compete among themselves to find a place for their cities among the 100 cities to be developed as smart cities. After the States have nominated their cities, a Central expert panel will make the final selection on the basis of certain criteria, such as the cities' size, population, infrastructure level and upgradation potential. The first round of selection, perhaps of 20 cities, will be completed by the end of this year. The remaining 80 will be subsequently selected in phases. The government, which proposed to set up 100 smart cities, is planning to start the project in a mission mode from October this year. The government also said that it has planned to form a Special Purpose Vehicle (SPV) for each of the cities to execute the ambitious project. As part of the project, the government is working on an ambitious plan to build one smart city each at the country's 12 major ports, at an estimated total investment of Rs 50,000 crore. These will be green smart cities and work is expected to start in four to six months, which would be completed over the next five years.

Cabinet’s formal sign-off on the creation of smart cities, clarifies the next steps on this big initiative announced by the Government in the budget. Given the facets of a smart city, this creates a significant opportunity for the companies in real estate & infrastructure sector, apart from companies in IT & other related sectors.

The selection process to identify these future urban centres will also be interesting, where different states will compete with each other with regards to various parameters like power supply, water management, revenue generation, municipal planning etc. This process will also ensure the right kind of cities (getting selected), which have a potential of being converted into smart cities with appropriate level of planning and investments.

Neeraj Sharma, Partner
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Regulatory update

The Real Estate (Regulation and Development) Bill (RERB)[7]

The RERB (or the Regulatory Bill) is a pioneering initiative to protect the interest of consumers, to promote fair play in real estate transactions and to ensure timely execution of projects.

The Bill provides for a uniform regulatory environment, to protect consumer interests, help speedy adjudication of disputes and ensure orderly growth of the real estate sector.

The new regulations, covering both residential and commercial properties, require mandatory public disclosure for all registered projects. This includes details of promoters, the project, layout plan, plan of development works, land status and status of statutory approvals. It will also require the disclosure of pro-forma agreements, names and addresses of all those involved such as real estate agents, contractors, architects and structural engineers.

Furthermore, the Bill seeks to reduce the diversion of funds by requiring 50% of the amount (or less as notified by the appropriate government) paid by homebuyers to be put into a separate escrow bank account to cover the cost of construction. The rules also bar promoters from altering plans, structural designs and specifications of the plot, apartment or building, without the consent of two-third of the buyers after disclosure.

Another significant change is regarding establishment of Real Estate Regulatory Authority (RERA) and mandatory registration of intermediaries such as real estate agents with RERA.

The new Bill will allow real estate agents to-sell only those properties that are registered with RERA. A code of conduct will be established which will ensure that intermediaries maintain books of accounts, records and documents, and that they are not involved in any unfair trade practices.

This Bill also contains provisions in respect of functions and duties of promoters and allottees; establishment of fast track dispute resolution mechanism through adjudication; establishment of a Real Estate Appellate Tribunal; offences and penalties, etc.

The Bill will, no doubt, bring transparency and accountability to real estate transactions, and also provide a way to cut down on undeclared monies.

However, there is some skepticism on the effectiveness of implementing these new regulations, and whether it is at all possible to monitor rogue intermediaries and developers. And as land is governed by the states, there may be one or more RERA in each State or Union Territory, which will lead to potential confusion and conflict.

The Bill, if implemented, is expected to ensure greater accountability towards consumers, and to significantly reduce frauds and delays. The Bill is also expected to promote regulated and orderly growth through efficiency, professionalism and standardisation. It seeks to ensure consumer protection, without adding another stage in the procedure for sanctions.

Dissecting the Regulatory Bill

Mandates property brokers to register themselves with the real estate regulator

Mandates promoters to deposit 50% of the amount collected from buyers in a project to a separate bank account within 15 days

Mandates developers to register their projects with the regulatory authorities.
Developers are now required to mandatorily disclose all information regarding layout plans, status of statutory approvals, schedule of development works, etc.

Provides for appointment of one or more adjudicating officers to fast-track dispute settlement

Authorises buyers to claim refund with interest and compensation

Makes developers liable to rectify structural flaws and refund money, in cases of defaults

Seeks to set up of a real estate regulator in each State

Has brought within its purview all projects that have not received completion certificates

Empowers the regulator to impose penalties on the developer and de-register the project

Prohibits the promoters to change plans, structural designs and specifications of a project without the consent of 2/3rd of consumers

Buys and Ties

Some of the significant PE deals			
Investor	**Investee**	**% stake**	**US$ million**
Equis Fund Group	Assetz Property	Not available	116
Piramal Fund Management	Ozone Group (Urbana Project)	N.A.	93
Brick Eagle Group	Tanaji Malusare City	100	48
Blacksoil Realty Investment Advisors – Black Soil Realty Fund - I	Gala and Ghosheh Group	Not available	40
Piramal Fund Management and Aditya Birla Real Estate Fund	Adarsh Developers	Not available	33
Creador	Ashiana Housing Limited	5	32
Aditya Birla Real Estate Fund	Ozone Group	Not available	11
Motilal Oswal Real Estate	Shriram Properties	Not available	14
Angel Investors	Janaadhar India Private Limited	Not available	10
Essel Financial Advisors and Managers	Unicon Shelters	Not available	9

QIPs	
Investee	**US$ million**
IRB Infrastructure Development	71
Ashiana Housing	33
Poddar Developers	21
Supreme Infrastructure	17

IPO	
AGI Infrastructure	
Issue Price	Rs.54
Equity offered (nos.)	2,776,000
Capital raised (Rs. million)	150
Exchange listed on	BSE

Source: Grant Thornton DealTracker

Buys and Ties

Some of the significant mergers and acquisitions					
Acquirer	**Target**	**US$ million**	**Deal type**	**% Stake**	**Nature**
Brick Eagle	DBC Affordable Home Strategy Limited	Not available	Strategic	49	Domestic
Brigade Properties	Brooke Bond Real Estate	Not available	Acquisition	100	Domestic
Nitesh Estates Limited	Plaza Centre Mall	39	Acquisition	100	Domestic

Source: Grant Thornton DealTracker

Whilst sales velocity continues to be a challenge across RE segments, institutional funding from non-banking sources is gaining momentum with foreign investors reviving investment plans for India, resulting in a substantial increase in investments in comparison with 2013. As seen in previous years, debt-oriented or mezzanine structures continue to be the preferred investment routes with investors, due to their potential to limit risk exposure and yet achieve 18-20% annualised returns. The investment sentiment does not appear to be inclined towards equity-oriented structures in the near term until there occurs either pickup in bank credit or consumer offtake in the sector.

Sumeet Abrol, Partner
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Market Trends[8]

City Index (CI) is the weighted average of the average rate per square foot in that city and the supply of properties in that city. As part of a recent study, 13 cities were considered while evaluating the movement in the CI of the respective cities as compared to the previous quarter. Apart from the four metropolitan cities, the 13 cities consist of Ahmedabad, Bengaluru, Coimbatore, Ghaziabad, Gurgaon, Hyderabad, Noida, Pune, Vadodara.

Out of the 13 tracked cities, five noted a rise in the CI value between 1-9%. Noida recorded the maximum rise in the CI value by 9%, followed by 5% in Coimbatore. Mumbai recorded the maximum drop of 6% in the CI value and Chennai was the second highest at 4%. Bengaluru, Gurgaon, Hyderabad and Pune's CI value saw no change in the current quarter.

On the supply side, no major new launches were noted across cities. Supply across budget, BHK and property type was almost stable in comparison to the last quarter. Rental market continued to remain upbeat in the last six months. However, the capital market is yet to see any significant surge.

The real estate activity remained slow in the Jan-Mar 2015 quarter. The top preferred cities in the sale and rental space has remained more or less the same. Following are the top five cities in the sale and rental markets:

Sale – Preferred cities (Rankings)			Rent – Preferred cities (Rankings)		
Locality	**Q4**	**Q3**	**Locality**	**Q4**	**Q3**
Mumbai	1	1	Mumbai	1	1
Bengaluru	2	2	Bengaluru	2	2
Pune	3	3	Pune	3	3
Delhi	4	5	Delhi	4	4
Hyderabad	5	4	Chennai	5	5

Q4: Jan – Mar 15
Q3: Oct – Dec 14

Market Speaks

We interviewed Mr. Ramakrishna Prabhu, Chief Financial Officer, Hindustan Construction Company – Engineering & Construction Division, to seek his views on the recent developments in the infrastructure sector. Below are the excerpts from the interview.

Your views on the current scenario within the infrastructure & construction sector

The government has shown an intent to boost the infrastructure development in the country. However, there are issues which the industry is facing. Firstly, the industry is facing a crunch in working capital. This has resulted in a substantial delay in project execution up to four to five years. Unless this current working capital shortage is addressed, the industry will be challenged to take up new commitments, especially the huge volume of the projects which the government is talking about. Secondly, the government has announced several new projects but orders have been released only for a few.

What do you think about the current business environment?

There has to be an environment of confidence. Irrespective of the problems faced by the industry while executing the project, there has to be an assurance that the issues will be addressed taking into consideration the views of all the interested parties. Considering the volume of projects which the government intends to start off, the problems of the sector will increase manifold if the environment in which we operate is not made feasible to do business.

What are your views on the recent regulatory announcements for the infrastructure & construction sector by the government?

Regulatory is more on the land acquisition front, apart from which no other regulatory mechanism has been put in place. They spoke about having a committee to implement a regulatory mechanism in the last budget, however there is no clarity on the modality of the same and on how it will work. The mechanism for settlement of disputes has to be simplified as it has a direct impact of project delivery and working capital position of the industry.

What steps should the government take to give a fresh impetus to the infrastructure and construction sector? Do you feel they should come up with a special set up for the infrastructure sector?

According to me, one thing which the government must do for the infrastructure and construction sector is speedy redressal of the issues – both capital and contractual ones, for example, you should be very clear that when you award the work, the work space is available to the contractor. If it's not available, all the other issues associated with the delay and cost escalation, etc. starts from the day you give the work order.

The Modi government has completed a year, please share your thoughts on how was the term in general and for the infrastructure & construction sector?

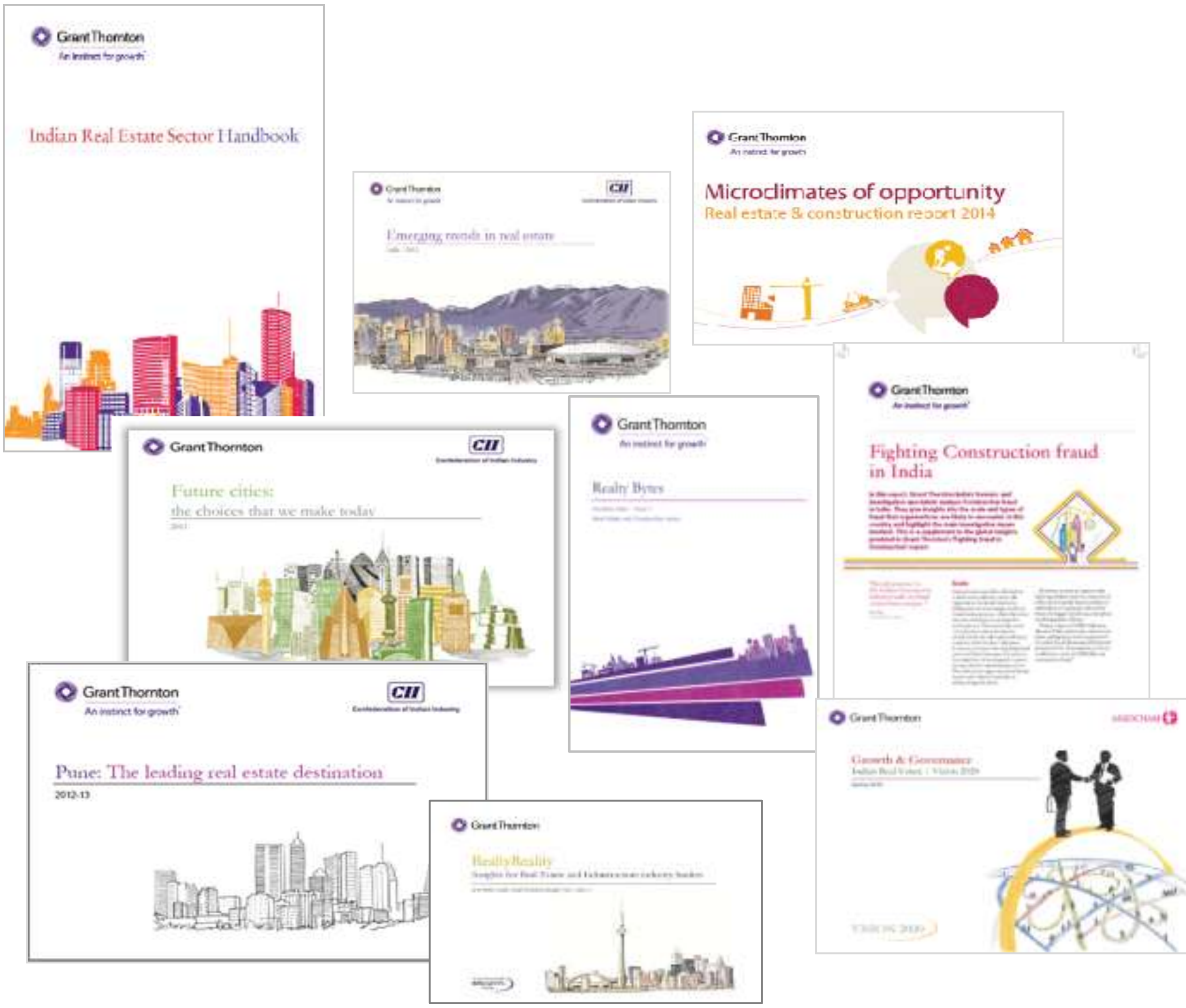
In general, enough talks have happened, however, the government has not been able to demonstrate what they promised. I don't want to add more to that. As far as sector-specific view is concerned, some positive movement has happened. Settlement of claims and other bottlenecks are slowly getting resolved but whether it is to the satisfaction of the people, the answer is definitely no. But in the past, it was zero from where it has come to some level where the willingness is there. And it is definitely a positive movement. And also they made a public statement during the Budget for the creation of a separate set up for the infrastructure sector. So at least the intention is shown but they need to now demonstrate it with actions and the industry is hoping that it will happen.

Your outlook for real estate, infrastructure and construction sector for the next five years

If you look at the real estate sector, where demand is not an issue, it's the pricing in terms of both the end-product pricing and the post-acquisition cost of the acquirer. These are the two elements that need to be clearly focussed upon. The customer today feels that the price at which he is acquiring the property, is not worth it , and it needs to be moderated.

Second thing, the post-acquisition cost definitely has a lot of influence in terms of decision making. Today we have an interest cost, just now some bank has reduced this cost to below 10%. But if you look at the mortgage loan internationally, it is available at a much more competitive rate and if you look at the market when interest rate was 7% and 7.5% a few years back, it was the biggest boom for the real estate sector. I think the time has come to recognise that and see that the interest rate is reduced drastically so that the sector again picks up. At the same time, certain measures should be taken to see that the benefit of the boom that is arising out of this should not be left for the developer to take; it has to go to the end users in terms of the property price moderation.

Insights for real estate leaders in India



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