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Anticipating and Gearing up Real Estate Sector in India

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ABSTRACT: *The Indian economy has transformed authentically over the last two decades. Indian real estate sector is one of the fastest growing and globally recognized sectors. This sector is the second largest employer in India after agriculture and is captivating huge investments especially by attracting Foreign Direct Investments (FDI). The real estate sector is a critical sector of our economy. It has a huge multiplier effect on the economy and therefore, is a big driver of economic growth contributing about 8-9% to India's GDP. It is not only pioneering the SEZ's but the broader aspects of Special Investments Region (SIR's) also. Indian also ranks 3rd for most L.E.E.D (Leadership in Energy & Environmental Design) –certified space globally with nearly 12 million sqm. The total market is expected to touch US$ 118 billion by 2020.*

This particular research paper enlightens the operation of Indian real estate sector with foremost emphasis upon the challenges and opportunities incurring within sector, the future trends, the causes of global capital to flow into Indian real estate and the key factors driving it. The methodology used for this study is secondary research. Secondary data from various sources like research reports, websites of government, industry associations, news articles have been referred. In conclusion, the need for a booming real estate sector is outlined for future needs of aspiring India.

Key Words*: Operations, Opportunities and Challenges, future trends in Real Estate Sector.*

I. INTRODUCTION

In 1981, the noble prize winner James Tobin was asked to explain the benefits of diversifications in simple language. In response he stated, 'Don't put all your eggs in one basket', Intuitional investors cite diversification as one of the main reason for globalizing their real estate portfolios. India's economy exhibited healthy growth rates in the last decade. The average growth rate registered over the period so far till 2013 is 7.2%. Surviving on domestic demand and enhancing consumption levels, the manufacturing and services industries have also posted healthy growth levels in the past few years. However, on account of the prevailing global economic uncertainty and macro-economic factors the Indian economy recorded a growth record. This presents a sharp contrast from a growth rate of approximately 9.5% achieved two to three years back. The real estate and construction sectors are playing a crucial role in the overall development of India's core infrastructure. Real Estate in India is one of the most important revenue generating sectors. The recorded growth has been almost 30percent per annum. A study carried out by Ernst and Young has analyzed various factors driving the real estate sector in India. The study concludes that India's microeconomics fundamentals are strong and the changing economic portfolio and demographics augur well for all segments of the industry .The growth and appreciation in this sector is directly influences the economy of the country also, it is the most profitable investment in India. The growth graph of the Real Estate sector is observed to be rising day by day.

II. REVIEW LITERATURE

In the field of real estate various research articles have been made. Amongst those, this section reviewed some of those articles.Ernst and Young, (2013); "Indian real estate: the year gone by and outlook",that defined the transaction process of development in India in the real estate sector that has witnessed phenomenal growth in the last few decades. It explains about the various key aspects of the sector such as the SEZ's the governmental reforms and role for the sector to florish. Kunal Wadhwani, (2009); **"**Opportunities and Challenges of investing in Indian Real Estate"This particular thesis identifies the opportunities in India that have caused global capital to flow intoIndian real estate and the key factors driving Indian real estate. It explains the challenges of investing in Indian real estate and seeks to provide strategies for navigating the real estate landscape in India. They also present the suggestions and future prospects of real estate in the country

III. OBJECTIVE

The paper outlines a brief overview of the rising Real estate trends in the booming infrastructural era of our nation. It enlightens up with the new policies and its impact in respect to the investments in the sector and also the policy environment. It also defines the role of the government with the sector and the scope of the same in future aspects.

IV. METHODOLOGY

The facts and figures that are entertained in the following research have been taken from various educational means such as newspapers, white papers, the infrastructure sector magazines and research publications by various groups such as Ernst and Young , KPMG, Cushman and Wakefield etc. These have been a source of full knowledge and played a key role in molding up of the research.

Overview of Analysis of Discussion

The contribution of the real estate sector to India's gross domestic product (GDP) has been estimated at 6.3% and the segment is expected to generate 7.6 million jobs during the same period. It is also expected to generate more than 17 million employment opportunities across the country by 2025.

While housing contributes approximately 5%–6% of the country's GDP, the retail, hospitality and commercial subsectors have also grown simultaneously, meeting the increasing infrastructural needs. Due to rapid urbanization, positive demographics and rising income levels, the Indian real estate sector has attracted significant investments over past few years. The growing stability of the Indian market is reflected by the continuous growth of the core investors with over US dollar $1.14 billion (INR 7,705crores) invested in real estate sector during the last three years. As the economy shows signs of decreasing GDP growth, the real estate industry faces its own share of concerns. Several real estate developers are reeling under high debt due to increasing construction and labor costs. Hardening of interest rates by the central bank is expected to further dampen the sale of real estate properties. Amid these macro-economic conditions, Indian real estate across the major cities is expected to see a mixed performance.

Key Holds of the Sector

Residential:

After the strong growth momentum in the residential market in 2011 and 2012, sales of residential property declined in 2013 in all metro cities, particularly in the National Capital Region (NCR), Mumbai and the other metropolitan cities. Major cities witnessed approximately 130 million sq.ft. of investment grade residential space, which was launched by developers in the country in 2012. Keeping the momentum charged still ignited. Most of the new launches were located in the urban fringes and targeted at the mid segment in order to cater to rising demand for affordable housing in view of the current economic situation. The Government of India developed the draft Real Estate Regulation and Development Bill, 2013, which is a policy measure to bring in increased transparency in the sector and protect customer interest. Furthermore, the introduction of tax deducted at source (TDS) of approximately 1% on property transactions above US$81,468 (INR50 lakhs) was announced in the union budget 2013-14. The broad intention behind this proposal is to increase the reporting of property transactions and bring out transparencies.

Commercial

In the commercial segment, while the inventory has declined in the last couple of years due to low development activity, absorption has remained slow, since corporates have deferred their expansion plans. The major markets in India witnessed addition of approximately 22 million sq. ft. in 2013 which is constantly rising at a tremendous rate. The overall mood in the leasing market is also expected to remain cautious. Majority of the demand is expected to be from small and medium sized spaces. . Introduction of REIT is likely to have a positive impact on the retail market segment.

Retail

The retail real estate market appeared to be promising despite global concerns and economic uncertainty. Major cities continued to witness steady expansion by international apparel and food and beverage (F&B) retailers. Several well established international mass market brands have also entered the non-metro cities, partly due to lack of space options in metro markets. Domestic retailers are expanding steadily in tier-I locations but intense competition with international brands for prime space in core locations is pushing some to non-metro cities.

(Kunal Wadhwani, (2009); **"Opportunities and Challenges of investing in Indian Real Estate")**

Legislative Introductions:

- Norms for FDI in multi-brand retail has been eased to attract global retailers; rules governing sourcing of products, infrastructure investment and selection of cities have been relaxed.
- Global retailers have to invest 50% of the initial investment of US$100 million to develop back-end infrastructure.
- Government plans to allow foreign retailers to set up shop within cities with a population of less than 1 million, which was not allowed earlier.
- Proposal worth US$132 million (INR810 crores) was cleared by the Foreign Investment Promotion Board (FIPB) with regards to single brand retail in the last 6–7 months.
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Hospitality:

According to World Travel & Tourism Council's (WTTC) estimates, domestic travel spending will grow by 6.1%, while international visitor spending will increase by 8.7% per annum in 2013–15. However the major concern for the industry is that approximately 85,000 hotel room keys are in various stages of construction in major Indian cities highlighted above, which is expected to exert downward pressure on ARR and affect occupancies.

Special Economic Zones (SEZ's)

The Special Economic zones contributed to a 29% of India's exports by 2013 and early 2014.During a last few years, several developers have applied for de- notification of SEZ applications and the points which arose mainly were as:

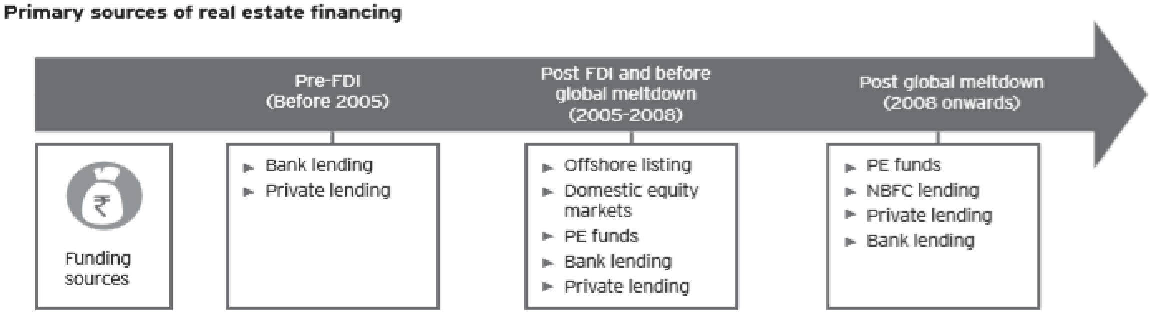
- Imposition of minimum alternate tax (MAT) and dividend distribution tax (DDT)
- Economic slowdown
- Restriction of units being net foreign exchange earner (NFE)

Government intervention to rejuvenate SEZ

- Permitting service tax exemption
- Reduction in minimum area requirement

<u>Funding Trends in the Real Estate Sector</u>:

After foreign direct investment (FDI) was allowed in the real estate sector in 2005, there was a major transformation of the investments sentiments for the sector. In addition to traditional sources of funding the policies change opened the gates for funds from Global Real Estate funds, Private Equity funds, Hedge funds and Strategic investors/foreign developers.



Several investments by both domestic and foreign funds took place at entity and project levels. Along with this, there were successful listings of many real estate developers in India as well as listing of several Indian real estate vehicles overseas.

As the above graph indicates, the sector has seen a substantial decline in FDI inflows due to more cautious approach from the investors.
Real estate is a capital intensive sector. While the ever changing dynamics remain a challenge, given the demand for capital in this sector and the returns that it can potentially generate, the supply of capital keeps re-inventing itself.
(Deutsche Bank, (2008); **"India Property - Recipe for the perfect storm)**
(EY**, (2013); "Indian real estate: the year gone by and outlook".)**

New policy Environment and its impact on Indian Real Estate Sector
Real Estate Investment Trust (REIT): The new investment vehicle for Indian real estate market
Indian real estate environment:

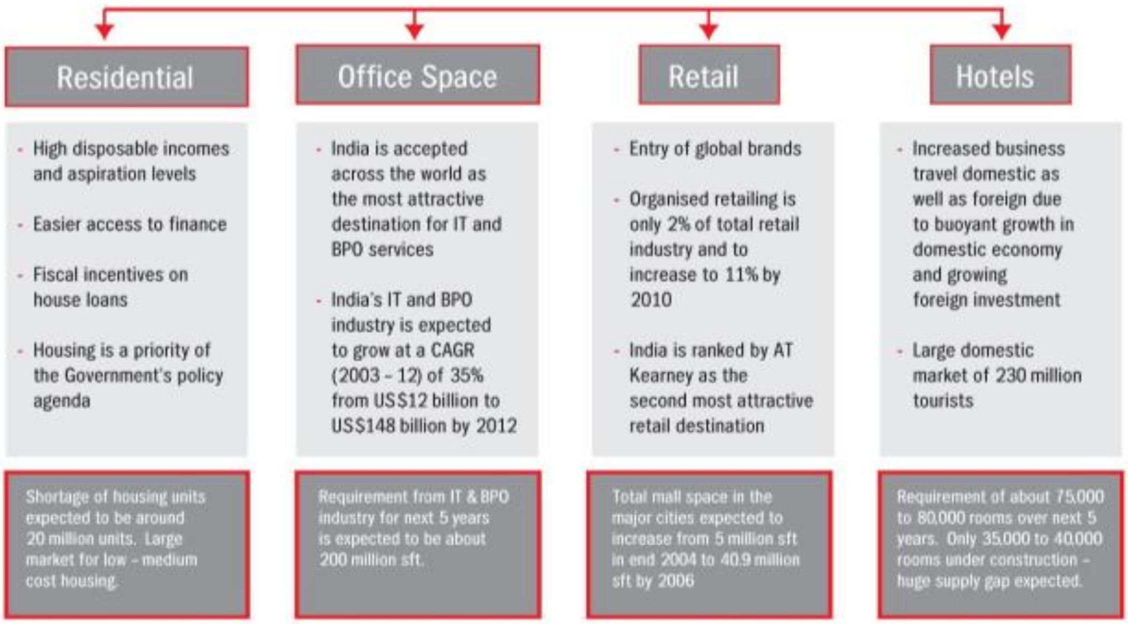
The real estate sector has been at the forefront of the Government of India's (GoI's) agenda on account of its potential to propel economic growth significantly. Within real estate, the housing sector contributes almost around 5% of the nation's GDP which is going to rise2-3% more within next few years.

REIT

A Real Estate Investment Trust (REIT) is a real estate company that offers common shares to the public. In this way, a REIT stock is similar to any other stock that represents ownership in an operating business. A REIT has two unique features — its primary function is managing income-producing properties and it must distribute most of its profits and dividends.
Generally, REITs are closed-ended or open-ended companies or trusts that hold, manage, lease, develop and/or maintain real estate for investment purposes. They tend to have a broad shareholder base and are often, but not always, traded on a public stock exchange. REITs receive special tax consideration and are characterized by low transaction costs. They typically offer investors high yields and a highly liquid method of investing in real estate.
REITs generally have the following characteristics:

- They are corporatized vehicles that pool money from investors for investment in real estate assets.
- REITs can only be used to invest in completed properties and not under-construction projects.
- They are listed and freely traded on stock exchanges.
- The income source for REITS mainly comprises regular lease rentals and asset sale proceeds.
- REITs are typically closed-ended funds. The UK, however, has open-ended REIT schemes
- REITs are mandatorily required to distribute 90% of their net income to investors every year.
- Internationally, REITs are allowed to raise debt.
- REITs are required to publish the fair value of assets and net present values (NPVs) of schemes in accordance with prescribed norms and at prescribed intervals.
- A REIT has a "pass-through" status for tax purposes. There is a single point tax on the investor

(EY, (2013); "Indian real estate: the year gone by and outlook".)



Indian Real Estate Drivers

Transparency

The results of Jones Lang LaSalle's 2008 global real estate transparency survey highlight India's gradual improvement over the last six years. India has shown steady improvement from being classified a "low transparent" market in 2004 to being a "semitransparent" in 2008. The improvements are closely linked to the forces of globalization, with foreign investors requiring much greater transparency. India scores highest with regard to the presence of listed vehicles. Its greatest challenges lie in the limited provision of high quality market information and investment performance indicators. However, this lack of reliable market information is not a feature of all sectors and cities. Reliable market data is available for the office and hotel sectors in India's primary and secondary cities, compared to limited data availability for other sectors and across tertiary cities. India is currently ranked in 50th position out of 82 markets globally with a ranking similar to China's ranking

V. REGULATIONS

Government regulations have had a tremendous influence on the real estate investment opportunity in India. The current regulatory regime restricts investments in certain sectors and in certain financial instruments. It is critical to understand the intention and spirit of the present regulations so that investments can be structured appropriately.
(Kunal Wadhwani, (2009); "Opportunities and Challenges of investing in Indian Real Estate")

FDI Regulations

100% Foreign Direct Investment ("FDI") is allowed under the automatic route to develop townships, built-up infrastructure and construction-development projects, including, without restriction, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, and city and regional level infrastructure. A foreign investor must develop a minimum of 10 hectares for serviced housing plots and 50,000 sq. meters for construction-development projects.

Financial Instruments

FDI can be routed into Indian investee companies by using fully and compulsorily convertible preference shares or fully and compulsorily convertible debentures. Non-convertible, partially convertible or optionally convertible preference shares and/or debentures shall be considered to be ECB and therefore, be subject to the aforesaid ECB Guidelines. These pseudo-equity instruments must be converted to equity prior to repatriation.

Structuring

Some of the jurisdictions commonly used for investment into India are Mauritius, Cyprus and the Netherlands. Singapore and the United Arab Emirates also have favorable treaties with India, but are less popular. This structure complies with the law and at the same time enjoys the tax deduction benefits available to debt instruments. By using the various tax-friendly jurisdictions, tax and exchange-control efficient structures for routing investments into India India's growth rate is expected to slow to 7% from 9% levels in previous years. There is a decline in foreign direct investment flows and bank credit in line with global trends. As a result of the slowdown, there currently exists an oversupply situation in almost all sectors. This has caused the markets to downward correct to the tune of 20-30%. Supply overhangs have been accumulating in some cities, although this appears to be most pronounced outside the key metros. This oversupply is most pronounced in the commercial and retail sectors. In the residential sector, there is a temporary loss of demand in the premium-housing segment but demand for affordable housing is stable. The hospitality sector is presently undersupplied. However, at present the market is in recovery.
(EY, (2013); "Indian real estate: the year gone by and outlook".)

VI. CONCLUSION

The Indian real estate market is growing and there is significant untapped potential. The long-term demand drivers for real estate in all sectors are positive. One must always however remember that India is a very price sensitive and competitive market. Investments in affordable products have a stronger chance of success. An investor must have a long-term investment horizon whilst investing in this country. Improving market transparency and liberalized investment regulations have meant that institutional investors have already invested over $25 bln in the India's real estate sector with a view to secure annual returns upwards of 20-25%. But investors should also clearly understand the risks inherent in investing in Indian real estate. The opacity of the market, rampant speculation, procedural and infrastructural deficiencies mean that investors need to be especially discerning. New entrants need to have a clear understanding of the existing opportunities, the market players and the regulatory environment.

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