Brave new world for India real estate:

Policies and trends that are altering Indian real estate
Indian real estate is going through a phase of transition in the process of its development. From being an unorganized sector traditionally, the Indian real estate sector is gradually moving to become a more organized one. This has largely been possible due to the entry of international real estate players, foreign investors and Indian corporate houses into the real estate sector. The real estate sector in India has witnessed phenomenal growth in the past decade due to rapid urbanization, increasing levels of income and opening up of the sector to Foreign Direct Investment (FDI).

In 2007-08, the global conditions impacted the Indian economy at large and the real estate sector in particular. The industry in India faced the heat of the global crisis in terms of a demand slowdown and a severe liquidity crunch. Despite the consequential impact of the global slowdown, the Indian real estate sector managed to emerge without too much distress due to the sound fundamentals of the economy, some regulatory intervention and an overall better-protected financial regime. The challenge for the sector today is to meet the rising demand for world class infrastructure in cities, housing across different income levels and create sustainable cities for future generation.

The FICCI-EY Indian Real Estate Report 2013 has made an attempt to sensitize all stakeholders about the changing scenario of Indian real estate and trends and progress at the policy front. The report provides valuable insights into the policy environment impacting Indian real estate such as REITs, the Company’s Bill, FDI, Real Estate Regulation Bill and the new trends in realty development.

I wish all success in the release of the findings of the Report at the 10th FICCI International Real Estate Summit 2013.
“Anticipating and gearing up for change,” seems to be the emerging motto of the Indian real estate sector as it is transformed from being one dominated by unorganized family-run businesses to one, which adopts a more corporate approach. The resultant, and welcome, wave of new thinking and energy in the sector is reflected by an appetite to innovate — with emerging real estate formats responding to changing lifestyle needs.

Considering the challenging economic situation currently facing India, if this new thinking and energy is not harnessed through an appropriate policy environment, the real estate market may not fulfill its potential.

In 2013, India recorded the lowest growth since 2009, which, combined with a significant fall in the value of the currency, increasing inflation, political uncertainty with impending elections and a highly volatile stock market, has increased concerns about future economic performance. Caught in red tape, confusing land laws, uncertainty of raw material supply, labor issues and concerns over law enforcement and property rights, it is still difficult for the real estate and construction industry to operate in India. To add to the woes of the sector, the new Land Acquisition Act may affect real estate prices, cause project delays and increase project costs.

On the bright side, it is encouraging to observe that, after almost a decade of contemplating the policy issues kick-started by the liberalization of the foreign direct investment (FDI) policy in 2005, in the past year subsequent reforms seemed to have gained pace. We observe a momentum for change and a will to rethink. The reforms range across all aspects of the real estate business from land acquisition, through regulating the industry and taking care of customer interests, to considering further liberalization of the FDI and the introduction of the concept of real estate investment trusts (REITs). However, the debate on the impact of these policies still rages, which are signs of a healthy pro-active industry.

If India is to successfully compete with other real estate markets, it needs to take this holistic approach but at the same time not lose the sense of urgency. The new impetus behind the development of a REIT regime (albeit five years after its introduction) is a welcome positive step. In order for the Indian real estate market to reap its full benefit it is crucial to address impending issues such as clarifying the permissibility of FDI in REITs, as well as developing an attractive tax regime that successfully competes with other markets such as the Singapore REITs.

For real estate to flourish, it is imperative that infrastructure development becomes an integral part of city planning. The concept of efficient public transport seems to be gaining ground now with a number of cities such as Delhi, Mumbai, Bengaluru, Jaipur, Kolkata and Chennai having mass rapid transport systems in various phases of construction and operation. Cities such as Greater Noida have planned infrastructure and connectivity before real estate development took off — unlike the erstwhile model followed by Gurgaon. The Government of India (GoI) has committed to fast-track approval for US$28 billion of infrastructure projects but a significant push from the GoI is needed for an effective implementation. Records currently show that in India only a quarter of infrastructure projects are completed on time.

As the Western property markets emerge from crisis, emerging markets may lose some of their attractiveness with a risk that foreign investors withdraw capital. However, with appropriate and timely policy measures and an absolute commitment by the GoI to overcome the hurdles, investors will still find a fair risk adjusted return and capital flight can be avoided.

The evolving global scenario and a wave of change in the Indian policy regime have together left a lot to be re-learnt, making it crucial for the Indian real estate market to re-think its business practices. With globalization, investors will invest capital where they see an investor-friendly environment with associated ease of operation. Therefore, in order to be competitive the Indian real estate sector must become more transparent and demonstrate the potential for developing international standard properties and infrastructure, whilst at the same time cater to the unique requirements of an Indian population polarized at the two ends of the economic spectrum. A challenge, we believe, that the talent in the Indian real estate market and policy makers can together rise to meet in this brave new world for Indian real estate.
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Indian real estate: the year gone by and outlook
Economic overview

India’s economy exhibited healthy growth rates in the last decade, with the exception of 2012. The average growth rate registered over the period 2000-2012 was approximately 7.2%. The growth has been achieved on account of increased consumption, increased investment activity as well as productivity gains. 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 of 5% in 2012-13. This presents a sharp contrast from a growth rate of approximately 9.5% achieved two to three years back. Successive reduction in key lending rates to control inflation, a consequent increase in borrowing costs, poor availability of overseas credit, sluggish industrial output and weak private-sector investment were the key reasons behind this deceleration in the growth of the Indian economy.

The country’s current account deficit was recorded at 4.8% of the GDP in 2012-13 as compared to 4.2% in the previous year, on the back of declining government and private savings; excessive spending on imports of commodities and a corresponding decrease in exports. The deficit further widened to a record high of 6.7% of GDP in the third quarter of the fiscal on account of high imports, even though exports remained stable. On the other hand, the country’s exports were recorded at 4.9% of the GDP for 2012-13, down from 5.8% in 2011-12.

Parameter | Statistics
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Land area | 3,287,590 sq.km.
Population | 1,210 million (Urban - 377 million)
Rank of doing business | 132 out of 185
Average household size | 5.0
Key economic activities | Information technology services, manufacturing and agriculture

1. India Census 2011- “District-wise population aggregates”
4. Reserve Bank of India- “Statistics report Q2, 2013”
Inflation has been a major cause for concern for the Indian economy for many years due to its adverse effects on investments and savings, and ultimately growth, showed a favorable downswing in 2012–13. The Wholesale Price Inflation (WPI), India’s benchmark indicator of price rises, averaged 7.4%, down from 8.9% in the previous fiscal. The Indian rupee has been significantly volatile in 2012–13. This has been ascribed to the supply-demand imbalance in the domestic foreign exchange market on account of slowdown in Foreign Institutional Investment (FII) inflows.

The exhibit below depicts the annual GDP growth rates of different countries in the world as compared to India.

As is evident from the graph, China is exhibiting the fastest growth, followed by India as compared to other countries. The US and the UK are among the countries with the slowest growth rates.

Real estate: the year gone by and outlook

The contribution of the real estate sector to India’s gross domestic product (GDP) has been estimated at 6.3% in 2013 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 sub-sectors 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 investment over the past few years. The growing stability of the market is reflected by the continuous growth of the core investors, with over US$1.14 billion (INR7,705 crore) invested in commercial office space during the last three years.

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5 Office of the economic advisor, Government of India, Central Statistics Office “Key Economic Indicators, Q3, 2013”
6 Confederation of Real Estate Developers’ Associations of India; “Report on assessing the economic impact of India’s real estate sector - 2013
7 Confederation of Real Estate Developers’ Associations of India; “Report on assessing the economic impact of India’s real estate sector - 2013
8 Confederation of Real Estate Developers’ Associations of India; “Report on assessing the economic impact of India’s real estate sector - 2013, contributed by Cushman and Wakefield
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.

**Residential: robust supply; however, stabilized capital values and growth on account of impending economic uncertainty**

**Residential market overview:** 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 Bengaluru. Developers continued to face challenges of high borrowing costs, rising input prices and shrinking profit margins, while investors/buyers had to bear the brunt of high interest rates coupled with delayed product delivery. Interest in premium and luxury housing was restricted to certain affluent prime locations, while mid segment and affordable housing continued to be the predominant demand driver especially in urban fringes of metro cities. Slowdown in demand was visible as supply declined in the three leading cities.

**Supply trends upbeat in the country:** 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 in 2013, approximately 70 million sq.ft. of investment grade residential space has been launched in key cities namely the National Capital Region (NCR), Mumbai, Bengaluru, Hyderabad, Chennai, Kolkata etc.

**Stagnation in capital values:** An increase in supply, not commensurate with demand levels, led to an over supply situation in most cities. Subdued demand led to a correction (approximately 5%-10%) in capital values across most markets in the NCR. The capital values stabilized in South and Central Mumbai, while it increased marginally in Navi Mumbai, Western and Eastern suburbs. Micro-markets in Bengaluru witnessed a marginal increase in capital values lead by North Bengaluru. East Bengaluru witnessed stabilization in rates on account of an oversupply situation. Several regions in Hyderabad and Chennai have generally witnessed stable capital value trends.

**Peripheral markets witness increased action with affordable housing:** 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.

**Policy measures:** 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 by the Finance Minister and was notified by the Income Tax Department to be applicable from June 2013. The broad intention behind this budgetary proposal is to increase the reporting of property transaction and bring about transparencies.
Commercial: oversupply and cautious approach by tenants that are dictating rentals

**Commercial market overview:** 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. NCR, Mumbai and Bengaluru continue to be the leading cities accounting for more than 75% of the entire space getting absorbed in the country in the last two to three years time frame. Most leading office destinations are expected to witness a strong supply pipeline, which might widen the demand-supply gap, thereby impacting rental growth negatively. However, prime corporate office space in the central business districts (CBDs) of most of the major centers is not expected to be adversely affected to this extent and values here should remain stable. The information technology special economic zone (IT-SEZ) segment will lose its attractiveness among occupiers due to continuing lack of clarity on tax-related incentives. Occupiers are expected to increasingly focus upon affordable suburban and peripheral micro markets; with consolidation being in focus and built-to-suit developments gaining popularity 10.

**Cautious approach by tenants:** Slowdown in commercial demand was evident from subdued job growth in the IT sector, where average quarterly net headcount addition in 2012-13 was around 28%-32%, lower than that in the previous two years. Office space tenants focused on consolidation and efficient use of the available space 11.

**Supply outpaced demand:** The major markets of India (NCR, Mumbai, Bengaluru, Chennai, Hyderabad and Pune) witnessed addition of approximately 22 million sq.ft. of investment grade office space in the first six months of 2013. Approximately 14 million sq.ft. of absorption was reported in the major markets thereby, indicating a difference in supply demand dynamics. This is exerting considerable stress on the prevailing rentals across various micro-markets in the country 12.

**Transaction activity:** Transaction activity was dominated by cities such as NCR, Mumbai, Bengaluru and Pune accounting for approximately 80%-85% of the total leasing in first 6 months of 2013 13.

**Outlook:** The overall mood in the leasing market is also expected to remain cautious. While few large scale transactions for consolidation or relocation of offices might be reported, majority of the demand is expected to be for small- and medium-sized office space. Supply levels will continue to exert pressure on rental movement and market recovery in most micro-markets. Introduction of REIT is likely to have a positive impact on the retail market segment.

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10 ISI Emerging Markets - “India property market overview 2013 published by FRPT research” ; EY research
11 India ratings and research pvt. Ltd - Article published in The Economic Times, January 16, 2013
12 ISI Emerging Markets - “India property market overview 2013 published by FRPT research” ; EY research
13 ISI Emerging Markets - “India property market overview 2013 published by FRPT research” ; EY research
Retail market overview: 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. Retail Real Estate Planning and Development trends and strategies for India, which, in selected cases, has seen them consolidate and reduce the size of some stores. Among domestic retailers, home furnishers and supermarkets are expanding in metro cities.

Supply-demand dynamics: The supply of organized Grade A malls in the leading cities of India (the NCR, Mumbai, Bengaluru, Chennai, Pune, Kolkata, Hyderabad) is approximately 55 million sq.ft. Apart from the investment grade malls, these major cities have also witnessed development of 20-25 million sq.ft. of hypermarket spaces. Considering the stable leasing activity and slowdown in completion of malls the vacancy levels in malls have also declined. NCR, which has completed supply of approximately 25 million sq.ft., is currently witnessing a vacancy of approximately 14%. Chennai and Pune are currently witnessing vacancy levels of 12%-20% on account of influx of fresh supply and relatively slow leasing activity. Prominent cities such as Bengaluru and Mumbai have low vacancy levels of approximately 8%-9% on account of stable leasing activity and non-addition of large retail spaces in the last 1-1.5 years. Hyderabad has minimal space available to lease in investment grade formats.

A retail malls which are located in good locations (proximity to residential and commercial hubs) with good tenant mix across floors were witnessed to be performing well and attracting good footfalls. Further, various locations in the country have witnessed launch of large scale malls (mega- malls) which provides multiple options for shopping, entertainment and food. These malls have witnessed larger footfalls and better conversion of footfalls to sales as compared to small scale malls.

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.

Outlook: The number of retailers expected to set up shop are expected to increase over the course of the year with a number of major fashion groups lodging enquiries and planning market entry and expansion. On the legislative side, while clarity has been provided on sourcing and city spread there is still confusion over the regulations concerning limitations on minimum investment and creation of back-end infrastructure as pre-conditions. In future, Government support is expected in this area.
Hospitality: inventory overhang likely to exert downward pressure on demand

**Hospitality market demand trend:** Domestic travel spends generated approximately 81% of the direct travel and tourism GDP, with domestic tourist visits (1,036 million) registering an increase of close to 20% from 2011. International tourist arrivals, on the other hand, were recorded at 6.6 million in 2012, an increase of 4.3% over the previous year. Foreign Exchange Earnings also increased by 7.1% over the same period. The top-three international source markets for India continued to be the US (16%) followed by the UK (12%) and Bangladesh (7%).

**Supply-demand dynamics:** The country has approximately 95,000 hotel keys currently in the organized segment. This represents a growth of approximately 18% from 2008-09 to 2012-13, which is considered as one of the strongest in the world. Majority of the branded hotels in India were constructed during the last five years, which means that inventory commenced operations around the worst financial crisis of 2008-09. The demand for hotel keys for the purpose of tourism, conventions and business activities has grown at a compound annual growth rate (CAGR) of approximately 18% over the last five years. During the last one year the industry has witnessed growth of approximately 9% demonstrating healthy demand. However, on account of large scale inventory being operational in the last four to five years, supply has outpaced demand. Key cities such as Ahmedabad, Bengaluru, Chennai, Gurgaon, Noida, Jaipur, and Pune have witnessed large scale addition of hotel keys in the last four to five years.

**Average room rates (ARR) and occupancy trends:** Key cities such as Bengaluru and Chennai witnessed ARR of approximately INR5,500–INR6,000 whereas Gurgaon and Noida witnessed ARR of INR6,500–INR7,000. Mumbai witnessed ARR of approximately INR7,500–INR7,800. The occupancy rates in these key cities was approximately in the range of 55%-65%.

**Outlook:** 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 zone (SEZ) and industrial: changing regulations

**Current SEZ scenario in India:** In 2012-13, the SEZ sector contributed 29% of India’s total exports of approximately US$266 billion (INR16.35 lakh crores). In the first quarter of FY14, SEZ contributed close to 28% or US$18 billion (INR1.1 lakh crore) of the total exports of approximately US$65 billion (INR4 lakh crores).17

During the last two to three years, several developers have applied for de-notification of SEZ applications. The primary reasons are discussed below:

**Reasons cited for de-notification of SEZ**

- 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
- Host of other benefits including exit/sale of SEZ units and tax incentives announced in annual supplement (2013-14) to the Foreign Trade Policy 2009-14

**Outlook on SEZ:** Captive requirement based SEZ development is still witnessing good acceptance as compared to SEZ developed for sale/lease to third party units only, as NFE units are difficult to locate. The incentive under the SEZ policy are still lucrative and export-based units may consider availing such benefits.

**Logistics and warehousing:** Pure play warehousing and specialized ones such as temperature controlled warehouses present lucrative avenues for growth in India. The emphasis is slowly increasing to enhance the scope of the warehousing sector to include supply chain management, material management, inventory management and tracking.

The development of Delhi Mumbai Industrial Corridor (DMIC) has set a new precedent to the development of the logistics and warehousing sector. A joint development between the Government of India and Japan, the project aims to build a Dedicated Freight Corridor (DFC) between Delhi and Mumbai and develop infrastructure across 150km to 200km on both sides of the alignment of DFC. The project is expected to create seven new cities including two smart cities. It will involve development of 24 manufacturing cities (investment region and investment area). Overall, the project comprises 24 nodes, 11 investment regions and 13 industrial areas in DMIC, expected to be completed by 202518.

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17 Department of Industrial Promotion and Policy (DIPP) - “Statistics report released for industrial activity 2012-13”
18 “Noida, Dadri are slowing down Delhi-Mumbai Industrial Corridor,” The Economic Times, 15 February 2013.
Trends in real estate funding
Evolution of the real estate transaction landscape

After foreign direct investment (FDI) was allowed in the real estate sector in 2005, there was a major transformation of the investment sentiment for the sector. In addition to traditional sources of funding, the policy change opened up the floodgates for funds from global Real Estate Funds, Private Equity Funds, hedge funds, and strategic investors/foreign developers.

**Primary sources of real estate financing**

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Source: EY research

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 (AIM, Singapore).
However, the global financial crisis of 2008 resulted in a significant shift in the funding scenario in the real estate sector in India. While the availability of capital continues to be there, albeit at a reduced level, the nature and sources of capital have changed over the years.

**FDI inflow in real estate**

![Graph showing FDI inflow in real estate from 2005-06 to 2012-13.](image)

Source: Department of Industrial Policy & Promotion\(^1\), EY Research

After 2008, the sector has seen a substantial decline in FDI inflows due to a more cautious approach from investors in a volatile market.

**Private equity funding in Indian real estate**

Private equity funding peaked in 2007 with several deals at the entity level. Following the financial crisis of 2008, the availability of funding is more at a project level than at an entity level. Within the sector, funds have been actively looking at residential projects due to their self-liquidating nature and commercial leased assets that provide attractive rental yields along with capital appreciation.

**Private equity in real estate sector**

![Graph showing private equity investments in real estate from 2006 to H1 2013.](image)

Source: Grant Thornton\(^2\), EY Research\(^3\)

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1 Department of Industrial Policy & Promotion  
2 Grant Thornton Deal Tracker, www.grantthornton.in  
3 Building new dimensions for real estate growth, September 2013 - EY FICCI Report, Page 18
Current trends in real estate funding and transaction space

Banks' credit exposure to the real estate and housing sector declined from 10% (as a percentage of Gross Bank Credit) in FY10 to 7.9% in FY13. While bank construction finance continues to be the cheapest source of funding, end-use restrictions and close monitoring of proceeds for construction has impeded the ability to use these funds for growth capital such as land acquisition.

With several equity investments in real estate companies/projects going sour, investors have shifted focus to mezzanine and structured equity instruments. With relaxed regulatory norms governing non-convertible debentures, this has become the instrument of choice for foreign investors. The key advantages of this instrument are the flexibility of tenure, alignment of returns to the project cash flows and the ability to get real security over assets. Reflecting this trend, non-convertible debentures (NCDs) worth c. US$4.2 billion were issued in 2012 as compared to c. US$3.8 billion in 2011. On the domestic front, there has been an increasing dependence on non-banking finance companies (NBFCs) for funding in the real estate sector. In particular, NBFCs have been actively looking at last mile funding opportunities, where projects in which substantial investments have been made are not getting completed due to lack of “last mile funding.”

Divestment of non-core assets and leased assets is another very strong theme that has been visible. With several developers dealing with unmanageable debt levels, asset disposal is being adopted to deleverage their balance sheets. Non-core assets in the form of projects/land not under development/outside the core geographical region continued to be on the sell-off list in order to reduce the debt burden on the company. Apart from real estate companies, several industrial groups have been trying to monetize the value of real estate assets lying hidden in their balance sheets.

With respect to leased assets, the action has accelerated significantly in the last couple of years. Apart from lease rental discounting facility by banks, Grade A office space assets that have been leased or are near completion and hence, do not have any residual development risk have found ready buyers in some of the leading private equity (PE) Funds.

Raising funds from the capital markets continues to remain an unviable option for the sector. Nevertheless, one of the largest real estate companies in India was able to successfully place a large US$345 million follow-on public offer (FPO) in line with Securities and Exchange Board of India (SEBI) requirements to bring the promoter holding down to 75%.

Another emerging trend is where global funds are backing large real estate developers to develop a portfolio of projects. In these “platform deals”, the real estate developer will be the exclusive development manager of the projects to be pursued through such equity commitments for which it will receive a development management fee. Several large pension funds and sovereign wealth funds have demonstrated their long-term commitment to the sector in India through this route.

The Government, on its part, is also re-evaluating policy measures to provide a boost to the industry. Recent changes to the SEZ policy, in terms of reduced area requirements, easing of external commercial borrowing (ECB) norms for affordable housing and enhancement of limits for listed NCDs for all are positive steps for the sector. Game changers such as FDI in multi brand retail, can provide the necessary spark to revive investor interest in the sector. Furthermore, SEBI has come out with a revised draft Real Estate Investment Trusts (REITs) Regulations, 2013, which was made public on 10 October 2013 for inviting stakeholder’s views. Once finalized, REITs will have a positive impact on the real estate industry and open another avenue for investment in the real estate sector. All these factors are expected to have a significant impact on the industry.

“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.”

For any queries, please contact Randhir S. Kochhar, Partner, EY, Email: randhir.kochhar@in.ey.com

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4 Reserve Bank of India - Deployment of Gross Bank Credit by Major Sector data
New policy environment and its impact on Indian real estate
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 currently contributes around 5% of India’s GDP and in the next three to five years, its contribution to GDP is likely to increase to 6%.

Exclusion of real estate from financial market

Currently, real estate assets are kept out of the financial market and are not a full-fledged investment option. Real estate as an asset class is significantly different from capital market assets.

What is a 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 as 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.

1 Economic Survey of India, 2010-11
2 Approach Paper for Tenth Five Year Plan, Planning Commission
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.
- A REIT has a time horizon of around five to seven years.
- 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.

REITs follow stringent disclosure norms and reporting requirements.

**Types of REITs**

REITs can be of various kinds, such as:

- **Equity REITs**: Equity REITs invest in and own properties. Their revenues come principally from their properties’ rents.
- **Mortgage REITs**: Mortgage REITs deal in investment and ownership of property mortgages. These REITs loan money for mortgages to owners of real estate, or invest in (purchase) existing mortgages or mortgage-backed securities. Their revenues are generated primarily by the interest that they earn on mortgage loans.
- **Hybrid REITs**: Hybrid REITs combine the investment strategies of Equity REIT’s and Mortgage REITs by investing in both properties and mortgages.
- **Sector-specific types of REITs**: Some REITs invest specially in one area of real estate, e.g., shopping malls, office buildings, apartments, warehouses, and hotels. Such REITs include:
  - **Housing REITs**: Housing REITs acquire, renovate, lease and manage residential properties located in markets to generate rental income. They hold properties over the long term and generate virtually all revenue by leasing the properties. This revenue is used to pay for operating costs and distribute among shareholders as dividends.
    - Most residential REITs are multifamily REITs, also called apartment REITs. An apartment REIT owns a portfolio of rental apartment properties, which may be large residential properties such as mid-rise and high-rise buildings, student housing, senior housing or social housing.
  - **Industrial REITs**: Industrial REITs acquire, own and manage industrial properties, such as warehouses, distribution centers, manufacturing centers, office buildings, undeveloped land, business parks and high-tech space. The tenants of industrial REIT properties are wide ranging and cut across all kinds of businesses.
  - **Hotel REITs**: Hotel REITs own hotel, lodging or resort properties and could include different types of properties such as limited service, full service, resort, conference center, suite and airport properties. Hotel REITs derive value from the underlying value of hotel properties the REIT owns and from the income generated by those properties.

Globally, the REIT route has evolved to become a mainstream form of investment that both institutional and individual investors increasingly perceive as a key component of a diversified investment portfolio. The REIT model offers moderate returns with a low risk profile. Currently, apart from the US and the UK, Japan, Australia and Singapore have advanced and highly active REIT regimes.

**International experience**

REITs were introduced in the US during the mid-1960s as a means of providing small investors the opportunity to participate in the benefits of ownership of larger scale commercial real estate or mortgage lending. They gained in popularity due to the fact that income distributed is not taxed at the REIT entity level.
Several other countries, primarily Canada and Australia, followed suit, developing their own REIT frameworks. These markets are smaller as compared to the US; however, their value is slowly rising, and their share in the global sector is increasing.

**The US**

US REITs must comply with a number of requirements related to their operations and distributions, and must meet detailed information report requirements. The most fundamental of these requirements are:

- A US REIT must pay at least 90% of taxable income to shareholders.
- Most of the assets of the REIT must be real estate related.
- REITs must derive most of their income from real estate held for the long term.
- The REIT must be widely held.

For REITs, dividend distributions for tax purposes are treated as ordinary income, capital gains or return of capital, each of which is likely to be taxed at a different rate in the hands of shareholders. Dividends are deductible from income. For example, if a REIT distributes 90% and retains 10%, it is taxed on the retained 10% at the normal corporate income tax rate. These rules generally also apply to capital gains taxation.

**Hong Kong**

The Securities and Future Commission (SFC) in Hong Kong introduced the new Code on REIT (the Code) in July 2003, marking the introduction of this new form of collective investment scheme in Hong Kong.

It is mandatory for the REIT to be listed on the Hong Kong stock exchange. With effect from 17 June 2005, the Code has been amended to allow a SFC authorized REIT to invest in overseas properties.

According to the Code, a REIT seeking authorization from the SFC is required to have the following:

- Dedicated investments in real estate, which generates recurring rental income.
- Active trading of real estate is restricted.
- An increased proportion of income is derived from real estate rentals.
- It must distribute at least 90% of net audited income after tax to investors in the form of regular dividend.
- Maximum borrowing limit is defined.
- Related party transactions are subject to investors’ approval.

If the REIT holds the real estate directly, it will be subject to Hong Kong property tax. If the REIT holds the real estate indirectly via special purpose vehicles (SPVs), any dividends received by the REIT from the SPVs will be exempt from Hong Kong profits tax. The SPVs will be chargeable to Hong Kong profits tax in respect of the rental income derived.

The REIT must distribute at least 90% of its audited annual net income after tax as dividends to unit holders each year. Where the scheme holds real estate via SPVs, each SPV must distribute to the REIT all of its income as permitted by the laws and regulations of the relevant jurisdiction. As regards the revaluation surplus credited to income, or gains on disposal of real estate, the trustee must determine whether any of these amounts are to form part of the net income for distribution to unit holders.

**Singapore**

In May 1999, the Monetary Authority of Singapore (MAS) issued a set of regulatory guidelines for property funds offered for sale to retail investors in Singapore. The first Singapore REIT to be listed on the Singapore Exchange was launched in July 2002.

One of the current requirements for tax transparency is that the REIT must be listed on the Singapore stock exchange. For purposes of applying for a listing, a REIT, if it is denominated in Singapore dollars, must have a minimum asset size of at least S$20 million and at least 25% of its units should be held by a minimum of 500 public shareholders. Once listed, REITs need to comply with the Property Funds Guidelines and the applicable requirements set out in the Singapore Exchange Listing Manual.

Under the Tax Ruling, subject to meeting the terms and conditions specified therein, the Trustee of the REIT is not taxed on its distributed income. Instead, unit holders are taxed on the distributions they receive from the trust at income tax rates, as applicable to them individually. Furthermore, a REIT is required to distribute at least 90% of its income, in the form of distributions to unit holders. Although it is not a requirement, most of the listed REITs now make distributions annually out of their taxable income on a quarterly basis.
France

The Societe D’ Investissement Immobiliers Cotes (SIIC) tax regime is a new rule that came into force in 2003.

Under the French regime, listing is a mandatory requirement to obtain REIT status and the REIT vehicle should give small investors the possibility to pool their investments. Income generated by the REIT from qualifying activities is generally exempt from tax. The income from non-qualifying activities is subject to tax at a normal rate of tax. The capital gains generated from the disposal of assets and those which are duly distributed are also exempt from tax.

Dividends paid out of exempt income and gains are subject to French income tax with application of the progressive rate schedule and for additional social insurance contributions in the hands of the French resident individual. They do not carry over any tax credit.

The French regime has the following profit distribution requirement:

- At least 85% of the tax exempt profits from the qualifying leasing activity must be distributed before the end of the tax year following the year in which they are generated.
- At least 50% of capital gains must be distributed before the end of the second tax year following the year in which they have been realized.

100% of the dividends received from a qualifying subsidiary that has opted for SIIC regime must be distributed in the tax year following the year in which they are received.

Why REITs in India?

Globally, REITs have demonstrated the ability to attract and effectively manage investments in the real estate sector. Besides other advantages, REITs bring increased transparency in the sector by adopting better corporate governance, disclosures and financial transparency practices.

The demographic dynamics in India are changing fast, leading to an ever-growing demand for quality real estate that continues to be higher than supply. REITs can help bring the needed investments for meeting this increasing demand.

Following are some of the significant factors that bring out the need for introducing REITs in India:

a) Rising demand due to changing demographics and growing urbanization: According to UN estimates, India has the highest rate of change of urban population among the BRIC nations. An estimated 843 million people will live in Indian cities by the year 2050, which is about the same as the combined population of the US, Brazil, Russia, Japan and Germany.

More than 300 million persons are expected to be added to India’s working age population by the year 2050. Needless to say, this will add to growing urbanization and the need for providing housing/accommodation facilities for this section, including the increasing number of women in the workforce.
Brave new world for India real estate: Policies and trends that are altering Indian real estate

Urbanization rate of India

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<thead>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Urbanization rate</td>
<td>18.0%</td>
<td>18.2%</td>
<td>23.3%</td>
<td>25.7%</td>
<td>27.8%</td>
<td>31.2%</td>
</tr>
</tbody>
</table>

Source: Census of India, 2011

b) **Investment gap**: The capital intensive real estate sector faces a severe constraint in terms of adequate and structured financing options. According to EY’s estimates, the investments required in the Indian real estate market by the year 2015 is approximately US$42 billion (excluding EWS housing) and approximately US$257 billion (including EWS housing). Residential real estate alone will require an investment of US$29 billion.

<table>
<thead>
<tr>
<th>Asset</th>
<th>Investment excluding EWS housing (USD billion)</th>
<th>Investment including EWS housing (USD billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>29</td>
<td>244</td>
</tr>
<tr>
<td>Retail</td>
<td>4.8</td>
<td>4.8</td>
</tr>
<tr>
<td>Office</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>42</strong></td>
<td><strong>257</strong></td>
</tr>
</tbody>
</table>

Source: EY estimates

The Indian economy is ready to experiment with advanced funding options such as REITs and provide industry players with a globally competitive edge.

c) **REITs bring transparency**: REITs can help improve the much-needed transparency levels in the Indian real estate domain in the following ways:

(i) Availability of real estate financing from more structured, institutional sources helps in reducing the over dependence on a particular means of financing and therefore increases transparency. In this context, REIT’s will assist in streamlining the real estate sector by creating a transparent mechanism for raising finance in the real estate market.

(ii) REITs are registered with the concerned regulatory body of the country, for instance the Securities and Exchange Commission in the case of the US. They are, therefore, subject to stringent regulation and monitoring by the regulator.

(iii) REITs are required to comply with corporate governance, information disclosure and financial reporting standards laid down by the Regulator. In this sense, there is a regular information exchange and availability of information in the public domain.

(iv) REITs bring more professionalism. There is a clear emphasis on issues such as reducing risks attached to title in property and minimizing transaction costs.

d) **Improvement in debt-equity balance**: Specifically in the context of real estate, introduction of REIT’s being pure equity capital, will assist in improving the debt-equity balance in the real estate market through provision of equity financing and thereby assist in the growth of a more stable and mature real estate market.

e) **Vehicle for addressing non-performing assets (NPAs)**: Specifically in the context of the Indian market, introduction of REIT’s can be used as an efficient investment vehicle to wipe out NPAs/sick or defunct companies holding large values of real estate mostly in the form of land. Sale of such NPAs/companies to REIT’s will have a two-fold effect – realization of true value for the real estate and ease in liquidating the sick company after removal of the high value of real estate from its books. This will largely help financial institutions in regaining strong profitability positions, which is currently being hampered through large NPAs being booked by them.
Major channels of financing real estate development in India

<table>
<thead>
<tr>
<th>Offshore listing</th>
<th>Offshore listing</th>
<th>Offshore listing</th>
<th>REIT/REMF/AIF</th>
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</thead>
<tbody>
<tr>
<td>Offshore listing</td>
<td>QIP</td>
<td>QIP</td>
<td>REIT/REMF/AIF</td>
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<td>IPO</td>
<td>IPO</td>
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<td>Offshore listing</td>
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<td>IPO</td>
<td>ECB</td>
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<td>NBFC lending</td>
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<td>Bank lending</td>
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<tr>
<td>Private lending</td>
<td>Private lending</td>
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<tbody>
<tr>
<td>High</td>
<td>Average</td>
<td>Low</td>
<td></td>
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</tr>
</tbody>
</table>

Source: Real Estate Intelligence Service (Jones Lang LaSalle)

* Forecast

f) **Opportunity for common investors to share in the gains of this asset class:** REITs provide a more liquid component to the current range of property investment vehicles and improve investors’ investment profile through diversification of investment base and increasing stability of income source. REITs usually provide a good hedge against inflation as the rentals, i.e., the underlying income, adjust themselves in line with the cost of living.

Usually, more than 90% of the profits are distributed to investors as dividends. In India, the returns from this source are not only expected to be high due to an increase in demand, the REITs will also provide protection against inflation.

In its recent consultative paper on Draft REITs Regulations, 2013 SEBI has recognized the need for investment vehicles such as REITs to meet the investment demands of the rapidly growing real estate sector. SEBI observed that - “By the very nature of REITs, it is beneficial to both the investors and the industry in different ways. On one hand, REITs provide the investors with an investment avenue, which is comparatively less risky than investing in under-construction properties and provides regular income.

On the other hand, REITs provide the sponsor (usually a developer or a private equity fund) avenues of exit thus providing liquidity and enable them to invest in other projects.”

**REITs: The Way Forward**

In view of the crucial role that REITs could play as an investment vehicle, the SEBI brought out draft REITs regulations in December, 2007 to encourage and facilitate a healthy growth of REITs in India. However, these regulations could not be finalized for various reasons including the global economic slowdown, which also impacted real estate markets.

In an welcome move, SEBI once again brought out Draft REITs Regulations, 2013, which were made public on 10 October 2013 for inviting stakeholders’ views.

The Draft Regulations are pragmatic, take into account most of the concerns of stakeholders and contain many positive features. The same are out lined in the ensuing paragraphs.
Key features of Draft SEBI (Real Estate Investment Trusts) Regulations, 2013:

An overview of the structure of a domestic REIT as envisaged under the Draft SEBI Regulations, 2013 is given below:

The key features of the Regulations are as follows:

- **Qualifications/parties to the REIT**
  - **Sponsor** — minimum net worth of INR200 million and experience of 5 years in real estate
  - **Manager** — minimum net worth of INR50 million, 5 years experience in fund management and at least 50% of investment committee should be independent
  - **Trustee** — registered with the SEBI and 50% independent directors

- **Roles and responsibilities of all parties have been outlined in detail**

- **Listing related criteria**
  - Minimum value of REIT assets = INR10 billion
  - Minimum public float = 25% and minimum fund raise = INR2.5 billion
  - Minimum issue size of lots = INR100 thousand and trading lots = INR200 thousands
  - Minimum outside unit holders = 20

- **Delisting guidelines outlined**

- **Sponsor lock-in of 25% for 3 years and 15% for lifetime of REIT**

- **Investment criteria**
  - Can invest in real estate or SPV (minimum 51% and control with REIT), which holds real estate
  - Cannot invest in vacant land, agricultural land or mortgages except mortgage backed securities
  - At least 90% of REIT assets should be invested in completed and rent generating assets
  - Balance 10% can be invested in developmental properties, Government securities, listed/unlisted corporate debt etc
  - Cannot invest in units of another REIT
  - At least 90% of income after tax should be distributed to unit holders.

- **All related party transactions shall be on an arms-length basis, in the best interest of investors, consistent with the
strategy and investment objectives of the REIT.

- Leverage of 25% is ordinarily allowed and up to 50% leverage is allowed with a credit rating and positive consent of unit holders.
- 60% unit holders consent is required for ordinary matters and 75% (positive consent) for specified matters.
- Full valuation needs to be conducted once a year and half-yearly valuations every six months by a principal valuer.

In addition to the above, detailed guidelines have been included as regards prospectus, disclosure, accounts etc. Overall, the REIT Guidelines are practical and once notified should catalyze investments into completed real estate assets through a new listed vehicle. This will in turn provide public investors an opportunity to make safe investments in real estate on the one hand and provide the much needed liquidity to developers on the other hand. The SEBI has requested for public comments on the draft REIT regulations and some of the requests of the industry are as follows:

- Inclusion of completed infrastructure assets such as roads, ports, airports, power plants in REITs
- Allow investment in LLPs (as a SPV) in addition to companies
- Relaxation of Sponsor eligibility with regard to 5-year experience in real estate to ensure that other players such as hospitals, hotels, corporates with large real estate holdings could also be sponsors
- Increase in leverage limit
- Allowance to invest in debt securities of SPVs where the requisite equity is held by the REIT
- Increase in minimum number of outside unit holders from 20 to 100
- Reduction of minimum 90% completed assets to 75%
- Inclusion of SEBI review process of prospectus
- Specific accounting guidance

Furthermore supporting legislation such as Foreign Exchange Management Act (FEMA) and tax laws need to be amended to ensure that REITs actually take off, because unless these are provided, forming a REIT could be a frightfully expensive exercise and may not be commercially viable. Some of these are:

- Corporate tax at one level (i.e., either RIET level or SPV level) and no other taxes such as distribution etc.
- Furthermore, the distribution received by unit holders should be exempt in their hands
- No capital gains tax on trading of REIT units on the stock exchange where security transaction tax is paid and its long term (i.e., 12 months)
- One-time tax exemption when the REIT is created by Sponsor
- Stamp duty exemption on purchase and sale of properties by REIT or its underlying SPVs
- FDI and FI should be allowed under the automatic route

Conclusion

The Indian real estate industry’s growing need for additional sources of funds and the success story of global REITs is compelling enough to encourage the implementation of a similar regime in India with requisite adjustments, keeping in perspective the unique dynamics of its economy.

With the opening of the sector to REITs, it is expected that there will be increased capital inflows from overseas markets. It is expected that most investors will enter into joint ventures with local developers for projects in India in order to leverage their local expertise to aggregate land for development. There would still be a section of investors who would prefer to invest in tax-efficient vehicles, which provide them stability in returns and at the same time offer diversity in projects in which investments are channeled. Furthermore, comfort of investors through registered and regulated investment vehicles will encourage capital flows toward this sector.

The issue of draft guidelines by SEBI is a welcome step and should provide a fillip to the sentiment in the real estate sector. Draft regulations are largely in line with global REIT regimes and have sought to take into view the interests of various stakeholders. Going forward, it is recommended that the RBI clarify the permissibility of foreign investments in the proposed REITs and the Revenue authorities clarify the tax and stamp duty treatment for the REIT regime to bring certainty in the minds of various stakeholders.

For any queries, please contact

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Companies Act 2013: how does this affect your real estate business?

Companies Act 2013: how does this affect your real estate business?

Journey of Companies Act, 2013

Bringing changes to a five-decade old law was not an easy task. It was a milestone event. Although it began several years back, it was only in the last 5 years when it gathered pace. Listed here, are a few recent activities, which were implemented to amend the existing law. It was presented in Parliament in 2009 and was then sent to the Standing Committee, which presented its report in August 2010. Changes (new law, referred as Bill) were referred to the Standing Committee twice. Revised Bill 2011 was again referred to the committee as certain new provisions were included. Bill passed by the Lok Sabha on 18 December 2012 and by the Rajya Sabha on 8 August 2013. On 13 August 2013, the Lok Sabha discussed and approved these amendments. Presidential consent was received on 29 August 2013. The first phase of draft Companies Rules, 2013 was made public on 9 September 2013. Ministry of Corporate Affairs (MCA) vide notification dated 12 September 2013, has enacted 98 sections, with the remaining sections to be enacted shortly. The second phase of draft Companies Rules, 2013 was made public on 20 September 2013. The third phase of draft Companies Rules, 2013 was made public on 22 October 2013. Fourth phase of draft Companies Rules, 2013 was made public on 26 October 2013.

Key features of Companies Act 2013 impacting real estate companies:

Depreciation

Companies Act, 1956 requires depreciation to be provided on each depreciable asset so as to write-off 95% of its original cost over the specified period. Schedule XIV to the Companies Act, 1956 prescribes straight line method (SLM) and written down value (WDV) rates at which depreciation of various assets need to be provided. While the Companies Act, 2013 requires that depreciation is systematic allocation of the depreciable amount of an asset over its useful life. Where cost of a part of the asset is significant to the total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part will be determined separately. This implies that real estate companies now need to assess useful life, which requires technical evaluation and estimate of usage based on its geographic location and condition. The Act does not prescribe useful life for intangible assets; instead Applicable Accounting Standards will govern the same. This is a difficult task for all real estate companies, given that heavy cranes and critical machines needs to be evaluated based on its different significant component and their useful life. This is likely to impact profit and loss account differently as compared to previous accounting position.

For revalued assets, full depreciation charge on the revalued asset will impact profit and loss. Currently, depreciation on revalued amount can be recouped from the revaluation reserve.

Consolidated Financial Statement (CFS)

Preparation of CFS is mandatory for all companies, which have subsidiaries, joint ventures or associates. Companies, which do not have subsidiaries but only joint ventures (JVs) or associates may also have to prepare CFS. Currently, unlisted companies are not required to prepare CFS. This change will create more cost burden on real estate companies. “Control” and “subsidiary” are defined differently as compared to notified Accounting Standard (AS) 21. At the current stage, it is not very clear whether companies will apply consolidation of subsidiaries, JVs or associates based on definition of control in the Companies Act, 2013 or provided under notification AS 21.
Consolidation of land-owning companies

Real estate companies in India are regulated under the Land Ceiling Act, which fixes a maximum limit on the area of land that may be owned by one company. It is very common in the real estate industry to float various special purpose entities (SPEs) that purchase land from the market. Structure of SPVs can be in various ways such as:

a) Real estate companies directly or indirectly hold 100% or majority share capital of such SPEs and/or have majority on their board of directors.
b) Share capital of SPEs, which is generally a small amount, is held by a third party, which also controls the governing body of the SPEs. In such cases, the real estate companies are involved with the SPEs in various other ways, such as provision of finance to carry out the activities, exclusive rights to develop land, providing guarantee against finance taken by SPEs, guarantee minimum return to the shareholders and/or enter contract, which may restrict the decision-making powers of SPE.

The above structure may very well get within the boundary of the definition of “control” under the Companies Act, 2013, though it might not meet the definition of “control” under AS 21. However, one may need to carefully assess such transactions to evaluate whether the same may get covered under related party? This evaluation will impact the disclosure requirement of related party under notified AS 18 and Companies Act, 2013. This is an additional evaluation real estate companies require to carry out after the application of the Companies Act, 2013.

Dividend

The Act directs that no dividend shall be declared or paid by the company from its reserves other than free reserves. Instead of transferring a fixed percentage of profit to reserves before declaring dividend, company can now transfer no or any amount. However, no dividend can be declared if the company fails to comply with the provision relating to acceptance and repayment of deposits. Therefore, if real estate company has accepted deposit and not been able to fulfill provision related to acceptance or repayment, then it is difficult for the company to repay back to its shareholder via dividend. There is one more criteria added by the Act that any un-paid dividend details should be placed on the company website.

Where, due to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves provided – (a) rate of dividend does not exceed three preceding year’s average, (b) amount drawn from profits should not exceed 10% of the paid up share capital and free reserves (c) amount so drawn should be first used to set off current year's losses, before payment of any dividend and (d) balance of reserves should not be less than 15% of the paid up share capital.
Utilization of securities premium

There is a restriction inserted by the Act on utilization of security premium. Changes are described below:

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Companies Act, 1956</th>
<th>Companies Act 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Prescribed class</td>
<td>Others</td>
</tr>
<tr>
<td>Issue of fully paid equity shares as bonus shares</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Issue of fully paid preference shares as bonus</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Writing off preliminary expenses of the company</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Writing off equity share issue expenses</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Writing off preference share issue expenses</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Writing off debenture issue expenses</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Providing for premium payable on redemption of preference shares/</td>
<td>Yes (77A)</td>
<td>Yes</td>
</tr>
<tr>
<td>debentures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buy-back of its own shares or other securities</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Prescribed class of companies is not yet defined, but once MCA clarifies and if any real estate company falls within the boundary of prescribed class, then any premium payable on redemption of debentures or on any foreign currency convertible bonds, the company may not be able to adjust it against its securities premium. This will affect profit and loss account and in turn may impact the future earnings of the company.

Financial statements authentication and board's report

Under the Act, one of the major responsibilities entrusted to CFOs is that a CFO should mandatorily attest the company’s financial statement. Directors Responsibility Statement should additionally include (a) for all listed companies – statement that internal financial controls are adequate and operating effectively (b) for all companies – statement that the company has devised proper system to ensure compliance with all laws and regulations and such system is adequate and operating effectively. This is a serious responsibility on directors, given that the company now has to allocate more cost not only toward understanding all legal issues but also its implementation and control mechanism. If real estate company is in to more than one operating line of business, on its own or through its group companies, in that circumstances such declaration may have more impact from cost, time and compliance perspective.

Here is a quick summary of additional information required in Board’s report as compared to previous Act.

Boards report and directors responsibility statement
Corporate Social Responsibility (CSR)

Under the Act, constitution of CSR committee is mandatory for a company having (a) net worth of INR500 crore or more or (b) turnover of INR1,000 crore or more or (c) net profit of INR5 crore or more. If real estate company falls under any of the above parameters then it has to constitute CSR committee, which should comprise at least 3 directors with one independent director. Primary role of CSR committee is to formulate and recommend CSR policy, including activities to be undertaken, to recommend amount to be spent and to monitor CSR policy and activities. The Act suggests (not mandatory as of now) to spend minimum 2% of its average net profit during a block of three years on CSR activities. However, if the company fails to spend such amount, the board should, in its report, specify the reasons for not spending the amount.

Rules clarify that “net profit” for spending on CSR activity should mean net profit before tax and should not include profits of branches outside India. The first block of three years shall be the year ending 31 March 2014. Tax treatment of CSR spend will be in accordance with the IT Act as may be notified by Central Board of Direct Taxes (CBDT). This economic compulsion insertion by the Act will enhance the cost burden on real estate companies.

Independent director

The Act has defined for the first time the word “Independent Director.” Nominee director is now not part of the Independent Director’s definition under the Act.

The following companies should have at-least one-third of total number of directors as independent directors

(a) listed company (b) public companies with share capital of INR100 crores or more; or (c) public companies with turnover of INR300 crores or more; or (d) public companies which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding INR200 crores

The Act suggests that one-third of the board should be independent where applicable. Important point to see is that criteria’s of applicability of independent director is different from CSR. However, if the company is under the parameter of CSR and not under Independent Director, then the company needs to appoint one independent director as required under CSR norms under the Act.

The Act also lays down the Code of Professional Conduct, performance evaluation mechanism and duties /liabilities of independent directors.

Woman director

Woman director is mandatory in case of (a) a listed company and (b) public company with paid up capital of INR100 crores or more (c) public company with turnover of INR300 crores or more. This may impact the existing board of real estate company.

Related party

For the first time the term “related party” was defined under the Act. Notified AS 18 defines the term “related party” by stating that “parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.” It is clear that the definition of the term related party under notified AS 18 and the Act is different. One has to seek clarification that in terms of relevant disclosure in the financial statement, which guidance will prevail?

Under Companies Act, 2013 there will not be any requirement to obtain an approval from the Central Government for entering into related-party transactions (RPT). Rather, companies will need to pass special resolution at the general meeting, if relevant criteria are met. Interested members will not be entitled to vote on such resolution. Whilst this provision is likely to ensure closer scrutiny by shareholders of related-party transactions, the minority group of shareholders could still be a silent spectator.
Even if a company has entered related-party transaction at arm’s length, it appears that the same will need to be referred to in the board’s report, along with justification for entering the transaction. The disclosure requirement is also likely to cover non-cash transactions involving directors, if they are entered with a related party.

**Who are the parties?**
- All companies are covered
- All related parties are covered
- Difference between AS 18 and Companies Act

**What are the transactions?**
- Sale, purchase of goods, materials and services
- Property – sale and lease
- Appointments to office of place of profit
- Agency /underwriting

**Approval ladder**
- Board Resolution required for all transactions
- For specific companies previous special resolution is required

**Key issues**
- Member who is a related party cannot vote at GM
- Transaction at arms length not covered
- All transactions to be reported to shareholders in Board Report

It is common to see that many real estate companies in India follow the practice of entering joint development agreements (“JDA”) with the land owner. These agreements entail the land owner grant the real estate developer permission to construct a building in return for ownership of a part of the building or any other form of agreed way of return.

**Boards Report and Directors Responsibility Statement**

JDA may be structured in different ways and may involve significantly different terms and conditions. Real estate companies engaged in such arrangements will need to examine closely the terms and conditions of the arrangement to determine their true substance. Real estate companies need to evaluate all such structure carefully since it might need to be disclosed under director’s responsibility report along with justification for entering such contract or arrangement.

**Restrictions on non-cash transactions involving directors**

Companies Act contains a new requirement to the effect that without prior approval of the company in a general meeting, a company will not enter into an arrangement by which a director of the company or its holding, subsidiary or associate company or a person connected with him acquires or is to acquire assets for consideration other than cash from the company. Value of such transaction needs to be duly calculated by a registered valuer.

**Loans and investments by company**

Companies now prohibited from making investments through more than two layers of investment companies, except for (a) acquisition of foreign companies with multiple layers of
investment subsidiaries and (b) meeting the requirements of any other law. No clarification is provided whether or not this restriction will apply retrospectively, hence, question remains open as what needs to be done for all existing structure? This clarity is likely to impact the group structure of real estate companies.

**Loans to Director and investments**

Unlike the previous Companies Act, Companies Act 2013 does not contain any specific exemption/exclusion with regard to loan given by a private company or by a holding company to its subsidiary or for guarantee given or security provided by a holding company in respect of any loan given to its subsidiary company. This might affect real estate companies’ operational efficiency.

Companies Act 2013 expressly states that no company shall, directly or indirectly, advance any loan to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by director or such other person. “Explanation” provided in the Companies Act, 2013 clarifies that “to any other person in whom director is interested” means any body corporate, the board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the board, or of any director or directors, of the lending company. Such “explanation” raises a question, what if parent’s director or Board, controls the subsidiary’s board or managing director then in such cases parent company cannot lend to its subsidiary? This will affect existing structure of the group and may create an issue of going concern for subsidiaries who cannot borrow on its own.

**Audit and auditor**

The Act mandates rotation of auditor for all companies except small companies and one person company. A real estate company (if it is not within the definition of small companies and one person company) will now have to appoint the auditor or audit firm for a term of 5 years or 10 years, respectively as required by the new Companies Act, with ratification of such appointment by shareholders every year. This will impact real estate companies where they had long-term relationship with auditors, will now be forced to face the rotation. However, companies will have three years to ensure compliance with auditor rotation requirements once notified. The Central Government’s approval and special resolution will be required to remove an auditor before his term. If no auditor is appointed/re-appointed at the annual general meeting (AGM), the existing auditor may not continue if it has already completed its maximum tenure. Such provision under the Act will increase the cost of audit for real estate companies given that the learning curve experience is not available to new auditors.

Real estate companies will now have to obtain specific, non-audit specified services from other than statutory auditor, which includes investment advisory services, management services, rendering of outsourced financial services and few other services.

**Mergers and acquisitions**

Auditor’s certificate on accounting standards compliance is mandatory. Tribunal cannot sanction without filing of Auditor’s certificate on compliance with notified Accounting Standards. This requirement applies to both listed and unlisted companies. This will enhance the compliance part and may increase the cost for realty companies.

**Internal audit**

Internal Audit is now required for (a) every listed company, (b) public company with a paid up share capital of INR10 crores or more and (c) every other public company with any outstanding loans or borrowings or debentures or deposits exceeding INR25 crores or which has accepted deposits of INR25 crores or more at any point of time during the last financial year. However, positive aspect is that internal auditor may be a CA, ICWA or other professional as decided by the board. Audit Committee, in consultation with the internal auditor, shall formulate the scope, periodicity functioning and methodology.

**Audit Committee, Nomination and Remuneration Committee**

Companies shall constitute an Audit Committee and Nomination and Remuneration Committee are (a) every listed company; (b) every other public company with paid up capital of one hundred crore rupees or more; or (c) every other public company which have, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding two hundred crore rupees.
Class action suit

Such number of member or members, depositor or depositors or any class of them, as the case may be, may file an application before the Tribunal on behalf of the members or depositors, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors.

Establishment of Serious Fraud Investigation Office (SFIO)

The Central Government will establish a serious fraud investigation office (SFIO) to investigate frauds relating to a company. Stringent penal provisions have been defined for fraud-related offences. The SFIO will be headed by a Director, who will be an officer not below the rank of a Joint Secretary to the Government of India.

Drag along and tag along rights, put or call option shall be enforceable

The Companies Act, 2013 expressly states that any contract or arrangement between two or more persons in respect of transfer of securities will be enforced as a contract. This has a significant impact on the existing contract or arrangement, which has such clause. Many real estate companies structure a transaction for infusion of capital where such put and call option has been provided to assure minimum return to the holder. Assessment of such clause may impact the assessment of control. Such embedded clause may impact future operation of the realty business.

Real estate companies need to conduct a careful internal assessment with respect to changes discussed in the Companies Act, 2013. Legal interpretation of law and its impact is likely to change the face of internal control, existing system and compliance protocol. For example, understanding the revised definition of control and subsidiary, given that definition of control and subsidiary may enhance the legal and compliance work of companies.

Definition of a listed company, which includes any company whose securities are listed on any recognized stock exchange. If a real estate company have existing investment in a non-listed company but whose debt is listed, then such company may also fall within the ambit of listed company and therefore needs to comply with all the required criteria of listed company under the Companies Act 2013, such as compliance with internal financial control, independent directors, internal audit, secretarial audit, woman director etc. Therefore, understanding of law in substance and making changes internally is imperative, since all these changes will have an external impact, for example on article of association of company, annual report including director responsibility statement, financial disclosures etc.

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Foreign Direct Investment (FDI): changes in FDI in construction development sector - is real estate back in business?

Over the years, the real estate construction development sector in India has grown to become one of the fastest growing real estate markets in the world. The sector is critical to the Indian economy given the significant multiplier effect it has on the economy. This is evidenced by the fact that the contribution of the sector to India’s GDP is estimated to be 6.3% in 2013. According to industry estimates, the size of the Indian real estate market was estimated to be approximately US$78.5 billion in FY13 and is expected to grow to approximately US$140 billion in FY17.

The sector, riding high on the back of rapid urbanization, positive demographics and increasing income levels, has attracted significant investment over the past few years. Between 2009–11, it grew at around 8% but witnessed a deceleration during 2012–13 to around 6.5% primarily due to the sluggish growth of the Indian economy, rising input costs and overall global economic sentiments. In the current scenario, developers are evaluating alternate sources of real estate funding, as traditional fund-raising channels are increasingly facing challenges.
The policy for allowing FDI in the construction development sector was announced in March 2005 vide Press Note 2 of 2005. The salient features of the existing policy as it has evolved from March 2005 till date are as follows:

<table>
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<th>S No</th>
<th>Nature of projects</th>
<th>% of FDI allowed and whether approval route or automatic route</th>
<th>Key conditions</th>
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| A    | Housing, townships, commercial premises, shopping malls                              | 100% – automatic route                                       | ▶ Minimum area to be developed - in case of serviced housing plots – 10 hectares; in case of construction-development projects – built-up area of 50,000 sq.mts; in case of combination project – any one of the above two conditions would suffice.  
▶ Minimum capitalization of US$10 million for wholly owned subsidiaries and US$5 million for joint ventures with Indian partners.  
▶ Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to exit earlier with prior approval of the Government through the Foreign Investment Promotion Board (FIPB).  
▶ At least 50% of each such project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor/investee company would not be permitted to sell undeveloped plots. |
| B    | Hotels and tourism projects, hospitals, Special Economic Zones (SEZs), education infrastructure, old age homes, warehousing, etc | 100% – automatic route                                       | No conditions prescribed |
| C    | Industrial parks                                                                    | 100% – automatic route                                       | ▶ Infrastructure, common facilities, industrial activity etc., specifically defined in the policy  
▶ It should comprise a minimum of 10 units and no single unit should occupy more than 50% of the allocable area  
▶ The minimum percentage of the area to be allocated for industrial activity shall not be less than 66% of the total allocable area |
| D    | FDI is not allowed in real estate business.                                          |                                                              |                |

Given the global sentiments, currency volatility, rising input costs and slowdown in sales, the sector is facing a severe crunch of quality sources of funding. One of the important sources of funding after 2005 has been foreign direct investment (FDI). This is evident from the fact that from April 2011 to July 2013 the sector attracted FDI of approximately INR100,000 crores. However, the volume of FDI into the sector has been on a declining trend. In order to boost FDI inflows into this sector, the Government should consider overhauling the FDI policy for this sector. This is also necessary given that the policy is almost a decade old, it has outlived its useful life, and significant changes are required to help this sector evolve to the next level.

Some of the key demands of the industry and investors are discussed below:

**Size criteria**

The current size requirement is 50,000 square meters in case of built-up properties and 10 hectares in case of serviced housing plots where infrastructure has been made available. A relaxation in this regard will be welcome:

▶ The policy should reduce the size to 20,000 square meters in case of built-up properties and 4 hectares in case of serviced plots. This is primarily because in tier-I cities, large land parcels are no longer available in prime areas and in tier-II and tier-III cities, such large developments do not sell.
The policy should allow sale of plots where infrastructure has been made available irrespective of whether these are housing plots or any other kind of plots.

**Lock-in on investment**

The current lock-in requirement prohibits a foreign investor from exiting the investment for a period of 3 years from the date of investment. Furthermore, the 3-year period applies on every tranche of investment from its respective date. The following changes will be relevant:

- Allow exit prior to 3 years where project is complete
- Allow one non-resident to sell to another non-resident/resident (irrespective of the status of the project) as long as the project confirms to FDI requirements in terms of size and area

**Greenfield vs. brownfield**

A holistic reading of the current policy indicates that investment in this sector is only allowed for green-field ventures. Given the economic slowdown a considerable number of projects are languishing mid-way and customers are stuck, since they have to pay interest on the one hand and on the other face delays in delivery.

A change in the policy to allow FDI in under construction projects will ensure requisite funding to such projects and closure of such projects.

**Mixed use projects**

The number of mixed use projects has increased in the last two to three years and it is very common to see a composite project where a single tower has a shopping mall on the ground floor, a hotel on the next six floors and residential apartments thereafter. In such projects there is no clarity on whether the conditions mentioned against projects listed in A category in the table will apply or not.

The policy should bring clarity to exempt all mixed use projects from any conditionalities.

It is suggested that an Indian company (recipient of FDI) undertaking mixed use projects, which have more than 50,000 sq. m. of built up area, should be permitted to sell identified land parcels to other Indian companies so long as the Indian company (recipient of FDI) is undertaking at least 50,000 sq meters of development and is responsible for overall development of the entire project.

**Land disposal under special circumstances**

Current FDI regulations do not permit investor or investee company to sell undevolved plots.

The Indian company (recipient of FDI) should be permitted under the automatic route to dispose away necessary land (including land without requisite approvals) held by it on a non-profit basis under exceptional circumstances, which may render a construction development project to be un-viable. Examples could include (i) existence of substantial land disputes, which do not permit construction/development of the project; (ii) where necessary approvals/licenses cannot be procured or, necessary state bye-laws cannot be adhered to; (iii) where the project has landed into legal disputes to raise concerns over the completion of the project in the foreseeable future; (iv) where project can no longer be developed or constructed due to unresolvable issues due to various economic, social or political issues.

**Large townships**

In the current FDI regulations, in the case of a large township projects (greater than 100 acres) it is un-clear as to whether the conditions will apply to the township as a whole or to each sub-project (such as group housing complexes, villas, plots, hotels, shopping malls, hospitals, schools etc) within the township.

The policy should bring clarity by applying the conditions of size and investment to the township as a whole and not to each sub-project within a township. The developer should be allowed to house sub-projects in different legal entities as that allows for quick and efficient development. The developer in such large projects should also be allowed to enter joint ventures, joint development agreements etc., as long as the developer himself is doing the minimum size/area and minimum investment has come into the township as a whole.

The above “asks” of the developer/investor community need serious consideration by the Government to put Indian real estate construction development sector back on track. An increase in FDI flows to this sector will, in addition to providing the much needed funding, ensure more organized play and transparency in an industry, which has been traditionally unorganized. An increased FDI flow will also replace the current high cost funding to the sector thereby reducing the overall cost of housing for end users.

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Decoding Real Estate Regulation and Development Bill 2013

The real estate sector forms an important segment of India's economy, with a contribution of approximately 6.3% to GDP. The scale of the industry, as well as its importance in the growth of the economy and its social responsibilities, has led the government to consider the introduction of a Real Estate Authority for planned real estate development through a real estate bill. The bill aims at providing a platform for the sale of immovable property in a transparent and efficient manner. It promotes fair play in real estate transactions and emphasizes on timely delivery of projects to protect consumer interest. The bill was introduced in Rajya Sabha in August 2013 and had been referred to the Parliamentary Standing Committee on Urban Development for review and suggestions.

Analysis of the Bill

Registration of real estate projects

Disclosure of standardized details of each project will enable customers to compare properties and make an informed decision. However, it is yet to be seen if the Bill will define each standard to avoid ambiguity. Relevant standardized information will boost the confidence of customers and will even help avoid the participation of intermediaries. One challenge in this clause will be to monitor that all the projects across the country have been registered; this is likely to turn into a herculean task and will require specialized people and funding. The Bill mandates complete clearance of the project before commencement of advertising or sale of the property. This will ensure that the project is not delayed due to lack of clearances.

However, it does not clarify whether these clearances will be expedited or whether there will be a provision of single-window clearance in a time-bound manner. This is an area of great concern for developers, considering the time taken currently to get clearances. Appropriate provisions need to be accounted for in the Bill to ensure that delays caused on account of lapses of external agencies responsible for granting approval/providing utilities should not result in the penalization of developers. These could include Force Majeure events.

Furthermore, the Bill does not discuss whether developers can approach the regulator if they do not get clearance even after a substantial period of time. Developers will have to arrange funds for approvals and registration of their projects from sources other than customer advances, as the new Bill restricts the collection of money or project launch before the registration and approval of a project. This may lead to an increase in prices of properties and slowdown in project launches.

Moreover, it can lead to fewer projects coming into the market, as the developer will not be able to advertise before receiving approval. So, a reduced supply will lead to an increase in demand and, ultimately, a price rise.

The Bill has made it mandatory for real estate agents to get registered, but it does not have any clarity on the repercussion of falsification of information by agents. In the financial sector, even after enforcing of strict regulations by the SEBI and Insurance Regulatory and Development Authority (IRDA), there have been several cases of fraud and mis-selling. The Bill has not laid down any qualification criteria for an agent to be registered. Furthermore, it will be challenging for regulators to keep a check on agents who may still run their shop without registration and may pose a problem for the regulator while taking strict actions against them.

Project funding

A separate bank account is signed mostly for individual projects in road and other infrastructure Build-Operate-Transfer (BOT) projects, better known as Escrow accounts. According to the proposed Bill, the same principle needs to be followed in the case of real estate projects. Developers will have to set aside 70% or less (percentage to be decided by the state government) of the money collected from buyers, and this sum will have to

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3 "Real estate regulatory Bill," Emkay, 05 June 2013, via Thomson eOne
be used in the same project. This will go a long way in ensuring transparency in each project and will even lower the risk of lenders, allowing developers to access low-interest debt in the long run. However, developers will find it difficult to fund their new land acquisitions, since banks do not fund land purchases in India. This is likely to increase the trend of joint development against the current practice of acquiring the land bank by over-leveraging their positions. Moreover, a 70% cut may be excessive in the case of cities where the developer has already invested a considerable amount in buying land; if developers have to wait for one to two years to begin the project before getting all of the approvals, it would impact their cash flow position.

The exact percentage of customer advances to be reserved for the project in the escrow account will be decided by the state regulator. The absence of clear guidelines on fixing a percentage may cause conflict.

**Safeguarding customer’s interest**

On enactment, the Bill is expected to encourage timely completion of a project, adherence to specifications, sale of property by carpet area and quick dispute resolution. The Bill will discourage diversion of funds from one project to another, publication of misleading advertisements with ambiguous details of project, and rectification of defects after handover.

It will restrict brokers from misleading customers. Moreover, customers are entitled to refund, along with interest, in case of delay of the project or in case the developer does not adhere to specifications promised in the agreement. However, there may be several cases where a developer may not be directly responsible for the delay. The Bill has not provided conditions under which customers can avail the refund, and this may end up in dispute.

The Bill has decided on a penalty of 5% to 10% of project cost in case the developer is found to misrepresent facts in sale of the property and severe punishment of up to 3 years of imprisonment on repeated offences. This is likely to make developers more accountable.

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**Major clauses in the bill**

a) Developers will have to register their projects with a real estate regulatory authority, without which sale, booking or even offer to sell is not permissible. Promoters will have to disclose standard details of the project, along with names of brokers who would represent the project. Developers will sell the project only after all necessary approvals are in place and the project has been registered with the authority. The Regulatory Authority will have to clear or reject projects within 15 days.

b) Developers have to open a separate bank account (escrow account) for each project and will have to set aside 70% (or less as per local authority) of the buyer’s money. This amount can be used only for the construction of that particular project.

c) To check delays in delivery, the bill empowers buyers to cancel booking and claim the full amount, along with interest for delays in the project.

d) To increase transparency, the bill has proposed penalties of 5% to 10% of project cost and jail term of up to three years for misrepresentation of facts to customers or non-compliance.

e) The Bill has proposed setting up of an appellate tribunal, which will hear real estate cases and will have the powers of a civil court. It also proposes setting up of a central and state level real estate regulatory authority to exercise the powers conferred on it and perform functions assigned under the Act.
The setting up of Appellate Tribunal and Real Estate Regulatory Authority

The Tribunal set up for hearing real estate cases must be empowered; otherwise, implementation of the Bill will be difficult. The Tribunal should act as a fast-track court, since delays in decisions will not be able to restore customer confidence. The Government of India (GoI) should clarify and provide details on how the real estate regulator will be established at state levels and who will bear the cost of its functioning.

Conflict between central and state laws

The Bill uses carpet area as a reference area for sale, whereas the Maharashtra Bill uses built-up area in its ready reckoner. There is likely to be conflict because of differing laws in various states. The Bill proposes that states should set up a real estate regulator and tribunals, since real estate is a state subject. However, the response of states to this proposition is yet to be seen. Moreover, the Bill does not clarify whether the Bill overwrites state bills, which may lead to a difficult situation where both the bills are in contradiction.

Conclusion

Although the much-awaited Bill has been introduced in the Rajya Sabha, it has a long way to go before it becomes an Act. There are several long-term benefits of the Bill. For example, the appointment of a regulator will mean a more disciplined industry, timely delivery of projects and better governance with improved transparency. However, there are some shortcomings. In the current form, the Bill lacks implementation clarity and measures to curb parallel economy. It does not resolve developers’ worry about clearing dozens of time-consuming approvals by varying government bodies. The Bill seems to be biased toward customers. Corporate bodies have registered their objections and suggestions, and the Government has to be flexible in implementing certain changes to make it more pragmatic before it becomes an Act.

The Bill, which has laid down several checks and has restricted developers from collecting money before approvals and registrations are completed, may slowdown the industry in the short term and even challenge the very existence of many non-serious players and fly-by-night operators. However, this may eventually make the sector more organized and credible with the presence of only serious players. By regaining the confidence of customers, the industry will ultimately be benefitted by increased demand and easy availability of finance.

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Service tax and value added tax- changes in the legislations and its impact on your business?

Indirect taxes are taxing for the real estate industry

- Rising levels of income, quick urbanization and positive demographics have attracted significant investment in the Indian real estate sector over the past few years. The contribution of the real estate sector to India's gross domestic product (GDP) has been estimated at 6.3% in 2013. The real estate sector in India has come a long way by becoming one of the fastest growing markets in the world and turning into a semi-organized market due to entry of various corporate houses.

- Recently, the Indian real estate sector has witnessed several changes in the scheme of indirect taxation, which have led to multiple issues for the real estate industry, which are discussed in the ensuing paragraphs.

Service Tax

- With the intent of expanding the ambit of service tax in India, a negative list-based taxation has been introduced w.e.f. 1 July 2012, to replace the positive list-based taxation. Central Board of Excise and Customs (CBEC) while introducing the negative list-based taxation specifically included construction of complex, building, civil structure or part thereof under the list of declared services (deemed services) in order to curb the past ambiguities. Furthermore, the old abatement scheme for payment of service tax was carried forward in the new service tax regime with some modifications.

- However, some of the issues, which remain unsettled under the new service tax regime are discussed below:

- It is relevant to note that in addition to the basic cost of the property, the developers typically charge car parking charges, preferential location charges, club house charges, etc., from the flat buyer. In this regard, there have been debates on the classification of such additional charges recovered by the developer and consequently the base of tax to be adopted for each of these charges, i.e., whether these services are naturally bundled, hence fall within the ambit of “construction of complex” services and eligible for abatement benefits or such services are to be treated as independent services, warranting independent classification, which attracts full rate of tax.

- Another issue that merits consideration is the impact of unsold inventory of apartments, which is sold by the developer following the receipt of completion certificate. Typically, most of the flats are booked during the construction phase; however, some flats may remain unsold at the time of receipt of completion certificate.

- Given that the unsold inventory after receipt of completion certificate will not be liable to service tax (as it would constitute transaction involving transfer of title in immovable property), it gives rise to practical issues with respect to:
  - Manner of reversal of Central Value Added Tax (CENVAT) Credit
  - Levy of interest on account of irregular availing and utilization of CENVAT Credit

- Thirdly, doubts are prevalent as to whether Service tax is to be levied on “long-term” lease of vacant land (say, 99-year lease). Toward this issue, Customs, Excise and Service Tax Appellate Tribunal (CESTAT) in the recent case of Greater Noida Industrial Development Authority has granted interim relief treating long-term lease akin to sale of immovable property. However, under the negative list regime, since long-term lease of land (akin to sale) is not specifically included in the negative list or the exemption list, the issue remains as to whether such leases will be subject to levy of service tax or not?

Value added Tax (VAT)

- Recently, the Larger Bench of the Supreme Court, in the case of Larsen & Toubro & Anr. v. State of Karnataka & Anr. [TS-156-SC-2013-NT], has upheld the levy of VAT by state governments on sale of under construction flats, based
Brave new world for India real estate: Policies and trends that are altering Indian real estate

on the finding that such transactions are in the nature of works contract.

The three-judge bench of the Supreme Court in this judgment has approved the much-debated judgment of the division bench in the case of K. Raheja Development Corporation v. State of Karnataka [(2005) 5 SCC 162] and upheld the Bombay High Court’s verdict in the case of MCHI v. State of Maharashtra [2012-(ST1)-GJX-0075-BOM], wherein it was held that the state has the power to levy VAT on sale of under-construction flats.

In view of the above judgment, sale of under construction properties, which were already subject to levy of stamp duty and service tax, will also attract VAT.

It is pertinent to note that since the judgment is pronounced by the Larger Bench of the Supreme Court it is the law of the land till the time it is distinguished/over ruled by a Constitution Bench of the Supreme Court. Accordingly, in the subsequent paragraphs, an attempt has been made to capture the impact of the judgment on the real estate industry without getting into the technical merits of the judgment.

Although, the judgment is delivered specifically in relation to the facts of the real estate structures followed in the states of Karnataka and Maharashtra, the principle that all building contracts will qualify as “works contract,” will undoubtedly impact the real estate transactions throughout the country resulting in increase in prices of these flats.

It is pertinent to highlight that, since the Supreme Court merely interprets the law as it stood, it is possible that VAT authorities may invoke the extended period of limitation ranging as long as 6 to 8 years under the State VAT laws and issue demand notices to all the real estate players for the past period.

Another interesting aspect will be the manner in which the developers recover the burden of VAT and interest thereon from ultimate flat buyers. While contractually it may be possible to recover any additional burden of VAT from flat buyers, however, in cases where the possession of flats has already been handed over by the developer to the flat buyer, it definitely will not be an easy task for the developer to recover VAT from the flat buyer. Furthermore, who will bear the interest cost will always be a question of dispute between the developer and the flat buyer.

Furthermore, this judgment may also trigger certain valuation issues as the Supreme Court has categorically held that only the value addition made pursuant to the agreement to sell under construction flat will be subject to levy of VAT.

Another aspect, which merits consideration of the real estate industry will be the manner in which they can off-set the input tax credit of the VAT paid on procurement of raw material against their output VAT liability for the past and future.

In a nutshell it can be said that the judgment of the Supreme Court unsettles the past settled position of taxation laws, which will require the real estate industry to put their thinking caps on and appropriately decide the way forward. At the same time the real estate industry in each state may need to liaise with the respective state governments in order to arrive at a workable formula to settle the past period tax dues and a simple scheme for payment of VAT on a going forward basis (like 1% composition rate in Maharashtra).

While it may not be possible to quantify the exact impact of the above issues on the real estate industry currently, it is certain that the demand for tax and interest on these accounts in near future will run in several thousand crores. At the same time, if not adequately addressed, the issues lead to series of litigations between the revenue authorities, developers and ultimate flat buyers in future.

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Indian real estate catering to changing needs
Senior living housing: transforming conventional lifestyle with global best practices across Indian markets

Changing composition of Indian demographics with an increase in ageing index, provides an impetus for development of an organized senior living sector. Though India is still younger than its developed counterparts such as the US and Japan, the process of ageing has begun in the country. According to estimates, by 2050, the worldwide population of 60 years and more will reach 2 billion people, and around three-fourths of this group is expected to hail from emerging economies. India alone is expected to house approximately 20% of the total population aged 60+ years by 2050.

Along with increasing numbers, there has also been a paradigm shift in the perception of senior-care in India in recent years. While the concept of old-age or retirement homes still hold a social stigma of abandonment attached to it, such mindset is slowly changing. Today, there are increasing numbers of seniors, who are adopting the idea of “senior living,” spending the sunset years of their lives with companions who are also aged, sharing facilities, where at least security is promised. This change is driven not only by the growing cohort size but also the changing structure of this demographic group and society in general, including increasing dual-income nuclear families and augmented financial independence of senior citizens.

Senior citizens are no longer perceived as a withdrawn, back-dated, risk-averse, and financially dependent population group. This new perception calls for provision of facilities to suit the needs and preferences of the age-group. While a structured senior-living market exists in many developed markets, the sector is at a relatively nascent stage in India. The considerable potential of this segment, with its unique needs and promises, opens an array of opportunities for the real estate market. Real estate developers across the country have started responding to the needs of this sector.

Recent market activity in this segment has led to 10-14 project launches across the country, with another 20-25 projects in the pipeline. Key Indian private players who already ventured into this segment include Ashiana Group of Builders, Covai Properties and Rakindo Developers among others. Renowned health care service providers such as Max Hospitals have also forayed in the market with projects of their own.

Most of the projects launched in recent years primarily follow the development model of a typical residential project with 50-250 units ranging from 1 BHK to 3 BHK apartments, cottages and studio apartments. The capital value for these units ranges from INR2,000-3,400 per sq. ft. depending on the quality of finish, furnishing, location, brand, etc. The recurring fee including food, housekeeping, and services range from INR5,000–15,000 per month depending on the level of services provided. The sale models are now witnessing some variation to suit the market needs including outright sale, deposit and even rental models.

### Outright sale model
- Sale of residential units at prevailing rates and transfer of title

### Lease model
- Upfront nominal security deposit and monthly rentals over the period of stay

### Lease deposit model
- A percentage of the capital value is taken upfront and the rest is paid in the form of monthly rentals over the period of stay

### Others
- Modulations in the lease deposit and residual rental and appropriate mix of sale model

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<table>
<thead>
<tr>
<th>Pros</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Higher returns of project</td>
</tr>
<tr>
<td>▶ Project exit</td>
</tr>
<tr>
<td>▶ Financial assistance during construction</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Share of capital appreciation</td>
</tr>
<tr>
<td>▶ Relatively low occupancy</td>
</tr>
</tbody>
</table>

---

**INDIA**

**Pros**
- Higher returns of project
- Project exit
- Financial assistance during construction

**Cons**
- Share of capital appreciation
- Relatively low occupancy

---

**Lease model**
- Occupancy assurance
- Property ownership
- Capital appreciation
- Project USP for larger development
- Assured annuity flow

**Pros**
- Occupancy assurance
- Property ownership
- Capital appreciation
- Project USP for larger development
- Assured annuity flow

**Cons**
- Lower returns
- High CAPEX risk
- Long gestation period

---

**Lease deposit model**
- A percentage of the capital value is taken upfront and the rest is paid in the form of monthly rentals over the period of stay

**Pros**
- Occupancy assurance
- Property ownership
- Capital appreciation
- Project USP for larger development
- Assured annuity flow

**Cons**
- Low returns
- High CAPEX risk

---

** Others**
- Modulations in the lease deposit and residual rental and appropriate mix of sale model

**Pros**
- Flexibility to development partners and owners
- Assured project absorption

**Cons**
- Low returns on overall project level

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Source: EY primary and secondary research

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1 EY primary and secondary research (“Boom time for retirement homes,” The Economic Times, 29 April 2013)
2 EY primary and secondary research
Over the last five years, the senior living market has also witnessed increased interest level from corporate players, hospitality players, and health care operators with a range of innovative products. Recent initiatives include TATA Housing’s Riva residences and Max India Group’s Antara Senior Living. Max India Group is developing ultra-luxury housing in Dehradun for seniors targeting high net worth individual (HNI) population with integrated facilities and design innovation.

The market has also witnessed an increase in strategic and project-level partnerships between investors/developers and niche service providers. In January 2013, the Assisted Living Federation of America (ALFA) announced a partnership with the Association Senior Living India (ASLI), the first senior living association of India. Furthermore, at the entity level, US-based Signature Senior Living has formed a joint venture with Coimbatore-based Covai Properties to build multiple senior living communities across the country. Similarly, Seattle-based elderly care management firm — One Eighty — has entered a joint venture agreement with Aamoksh Leisure Living and their first project, villas in Kodaikanal, was launched in 2009 and have upcoming properties in Pune and Kasauli.

While the segment is still at a relatively nascent stage in India, recent activity and the changing demographic structure supports the untapped market potential. Senior living developments in India need to be perceived as holistic communities that cater to care, security, health care, and convenience needs of the target population. As the need for diversification for tier-I city developers expands and these players explore innovative business models to differentiate themselves in a crowded real estate market, we will witness an increase in activity in this segment. Developers should focus on partnering with niche players globally, in order to deliver a product that caters to market needs. The Government is also likely to be expected to provide additional benefits for development of this critical housing segment.

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Branded apartments: distinguishing identities

India’s rising economic prosperity has led to contemporary consumerism, which is clearly exemplified in the transformation of the Indian luxury market. The Indian luxury market is projected to reach US$14.72 billion (INR90,000 crores) in 2015 with unprecedented growth rates in categories ranging from fashion to automobiles to fine dining. Often cited as the next China, India is currently witnessing a host of international luxury brands entering the market to benefit from the monetary gains of a “desire” economy.

Exclusivity has always been synonymous to luxury. From the consumer’s perspective, at a very basic level, the ability or affinity to own a luxury brand desirable and recognizable by everyone is exclusivity. It provides a means to consumers to assert themselves or simply to make a statement. As the consumer’s tastes evolve, so does the need to differentiate themselves in order to further confirm their social status and to stand-out among the equals. This need could be satiated through avenues such as the acquisition of limited editions or something with extraordinary product capabilities or a brand with a distinctive personality or simply the knowledge of the brand legacy.

Currently, the Indian real estate sector is also witnessing this metamorphosis. The last decade witnessed an increase in luxury residential development by developers who have positioned themselves in this segment. Consumers have started seeking exclusive attributes in real estate products, it could come in the form of designer homes, exclusive facilities such as terrace gardens, plunge pools or other such attributes. This, in turn, has motivated developers to capitalize on their experience in the hotel sector – associating themselves with luxury hospitality brands.

Over the past decade “branded residences” have become important components of many leading residential real estate markets, often establishing new benchmarks in terms of achieved pricing, quality and service. Typically, the branded residential model combines an upscale residential product with a suite of luxury hotel services that many affluent consumers now demand as integral components of their residential experience. Rather than developing independent market positioning, developers using this model license an international luxury brand in order to differentiate their residential project. The number of units in such developments are generally limited (according to our market experience, it would be in the range of 30-100), primarily to preserve the exclusivity quotient of the development, which would be in the interests of their wealthy clientele.

Given the importance of the service component, luxury hospitality brands are uniquely positioned to deliver a turnkey branded residence solution – licensing their brands to third party developers who build to a defined brand specification, and then serve as residence manager and service provider after the construction. The commercial terms typically include a variable brand-licensing fee calculated as a percentage of sales revenue and a technical services fee. The services are funded through maintenance fees and in some instances, a resort or hotel access fee. In addition to an attractive mix of services and luxurious amenities, consumer confidence is reinforced by the knowledge that the product has been built to and will be managed to demanding international brand standards. This confidence is sustained by the typically long-term nature of associated management agreements.

Select branded residences developments in India (proposed and upcoming)²

<table>
<thead>
<tr>
<th>Location</th>
<th>Four Seasons City View</th>
<th>Four Seasons</th>
<th>Armani Casa Residences</th>
<th>Leela Residences</th>
<th>Leela managed Armani Casa Residences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Bengaluru</td>
<td>Noida</td>
<td>Mumbai</td>
<td>Bengaluru</td>
<td>Noida</td>
</tr>
<tr>
<td>Built - up format</td>
<td>4-5BHK</td>
<td>7,000 sq.ft. units</td>
<td>3-5BHK</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Current status</td>
<td>Launched</td>
<td>Launched</td>
<td>Launched</td>
<td>Launching soon</td>
<td>Signed up</td>
</tr>
<tr>
<td>Estimated no. of units planned</td>
<td>110</td>
<td>40 (100% absorbed)</td>
<td>100-120</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>(Expected) price range (US$ millions)</td>
<td>0.65 onwards (INR4 crore)</td>
<td>3.57-4.06 (INR22-25 crore)</td>
<td>1.14 onwards (INR7 crore)</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

Of late, major luxury fashion houses have also entered the global branded residences market, lending their brand name in addition to providing interior design services and furnishing. These branded residences, on an average, are known to command the highest premiums in the market (50%-150%) and they also, in many instances, are managed by luxury hospitality brands. Moreover, premium serviced apartment players also offer the branded residence product.

They target the long stay travel market and typically offer the buyer, sale and lease back options, and rental pool programs. Entertainment conglomerates, which offer themed branding (e.g., Hollywood or sports themed), are yet another kind of player prevalent in the high-end residential market. Themed branding will also include celebrity branded residences such as Michael Schumacher, Vijay Amritraj, Angelina Jolie, etc.

**Broad management terms for different hospitality players**

<table>
<thead>
<tr>
<th>Branded residence players</th>
<th>Premium over non-brands</th>
<th>Brand value-add</th>
<th>Brand restrictions</th>
<th>Associated cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Hospitality groups</strong></td>
<td>15%-150%</td>
<td>Access to global sales and marketing network, Hospitality services and residence management, Products of high quality and functionality, Brand association to status and prestige, Rental pooling option, Targets industry bigwigs and corporate heads</td>
<td>May require an attached hotel property, May have very strict design specifications</td>
<td>Brand Commitment Fee: 1% of projected sales revenue, Marketing fee: 5%-6% of sales, Technical services fee: US$0.15 million - US$0.30 million, Operating/management fee for basic hotel services</td>
</tr>
<tr>
<td><strong>Leading fashion houses</strong></td>
<td>50%-150%</td>
<td>Superior quality residences, complete with furnishings and fittings from the design or fashion house, High sales velocity, Brand association to glamorous lifestyle, exclusivity and prestige, High brand loyalty, Products are synonymous with creativity, innovation and precision, Targets trend-savvy UHNWIs*</td>
<td>Number of units generally limited</td>
<td>High maintenance and furniture, fixture and equipment (FF&amp;E) costs, Large capital required due to superior specifications and finishes</td>
</tr>
<tr>
<td><strong>Themed</strong></td>
<td>20%-50%</td>
<td>Hollywood/Bollywood/sports themed properties have high brand recall value among the younger generation, In the case of entertainment houses: High value-add in terms of entertainment and technology - mini theaters for private screening, film libraries, High snob value</td>
<td>Residences from entertainment houses generally associated with a resort, theme park or casino</td>
<td>Brand commitment fee: 1%-3% of projected sales revenue, generally non refundable, regardless of whether projects come up or closing of sales takes place</td>
</tr>
<tr>
<td><strong>Serviced apartment</strong></td>
<td>15%-30%</td>
<td>Targets long stay travel market, Serviced residences have a higher brand appeal than vanilla residences, as the owners can avail of hotel-like services, Rental yield of 8%-12%</td>
<td>Major cities only, Offers highest segment brands</td>
<td>Incentive fee: 5%-8% of GOP, Management fee: 1%-3% of gross revenues, Sales and marketing fee: 1%-2% of gross revenues</td>
</tr>
</tbody>
</table>

*Ultra High Net Worth Individuals (UHNWIs)

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3 EY market experience
The key features of branded residences include a prime location, whether a central business district (CBD) location or a pristine holiday destination. The brand association also influences other aspects of the properties such as iconic design concepts and distinctive interior decorations and premium specification. The wide range of value-added services can also include round-the-clock concierge services, personal butler services, housekeeping, etc. With this complete package, branded residences have been found to command high premiums, particularly across some of the leading holiday destinations globally. The table below provides an average premium commanded by branded residences in different parts of the world.

**Premium commanded by branded residential developments in India vis-a-vis other locations**

<table>
<thead>
<tr>
<th>Country</th>
<th>Bali</th>
<th>Phuket</th>
<th>Seychelles</th>
<th>Malaysia</th>
<th>Singapore</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>~120%</td>
<td>~50%</td>
<td>~75%</td>
<td>&gt;200%</td>
<td>&gt;200%</td>
<td>~30%-100%</td>
</tr>
</tbody>
</table>

Currently, the branded residences in India are limited to a few developments in tier-1 cities. Since the concept is at a relatively nascent stage in India, the premium commanded by these developments is significantly lower as compared to other locations (typically in the range of 30%-40%, which can go up to 100%)\(^4\). However, this is expected to change with the fast rise in the number of India’s wealthy – the cash-rich and time-poor HNWIs with their constantly evolving tastes and increasing need for ownership of luxury lifestyle assets. This, combined with the growing list of players in the field and the high margin potential that branded realty offers developers, has resulted in the launch of multiple branded residence projects and will continue to attract new players into the market.

In future, a significant increase in the number of new project launches is expected in the medium term. New and unconventional players are also expected to enter the Indian branded residences market and will continue to prefer locating within prime real estate areas of tier-1 cities.

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\(^4\) EY market analysis through primary research
Rental housing: can rental housing be a solution to meeting our affordable housing needs?

The need for rental housing in the context of India

With 31 out of every 100 people in the country living in cities or towns, India has a higher number of people living in urban areas (377 million) than the entire population of the US (approximately 314 million). It is estimated that by 2030, this number is likely to increase to 590 million people that would live in approximately 60 cities from the current 42. Consider the amplification of our housing problem, when these numbers are evaluated against our current housing shortage. According to the Ministry of Housing and Urban Poverty Alleviation (MHUPA), for the 81.35 million households estimated to be living in the cities in 2012, the housing shortage in urban India has been estimated at 18.78 million. The ten states of Uttar Pradesh, Maharashtra, West Bengal, Andhra Pradesh, Tamil Nadu, Bihar, Rajasthan, Madhya Pradesh, Karnataka and Gujarat constitute around 76% of the urban housing shortage. According to MHUPA around 56% of the shortage is among the economically weaker section (EWS) households with average household annual incomes of up to US$1,624 (INR1 lakh), and approximately 40% of this shortage is among the lower income group (LIG) households, with average household annual income of US$1,624 to US$3,248 (INR1 lakh to INR2 lakhs). Providing housing to this segment of people that have a limited ability to save to be able to buy a home is a clear challenge before India.

The lack of housing catering to the low income segment is rather grim with 2,543 towns (63%) out of 4,041 statutory towns recording slums. These account for 17.4% of the total households in urban India.

Mumbai, which has the highest slum population in the country (41.3% of total urban households), has seen the development of an alternate informal real estate market, which operates in the slums. The Slum Rehabilitation Scheme requires developers to provide transit camps or alternatively provide monthly rentals to the displaced residents to make their own arrangements during the duration of construction. Most slum dwellers prefer to opt for the rental option and reside in other similar informal settlements. In such cases, the monthly rental provided by the developer can range from US$130 to 162 (INR8,000 to 10,000) depending on the location of the redevelopment. This inflow of rental income has to some extent fueled this alternate informal real estate market. The knowledge of the range of rentals being paid by the developers, leads to slum landlords increasing their rentals, in accordance with this rental income. Rents could range from INR3,000 to 10,000 (for approximately a 150–225 sq.ft. tenement) depending on the area of Mumbai the slum is located.

The slum census of India in 2011, gives a clear indication of the demand for rental housing with a significant 26.3% being rental census houses in slums.

4 EY market assessment
Case study: Maharashtra

Maharashtra State Housing Policy of 2007, Government of Maharashtra (GoM) initiated the Rental Housing Scheme (RHS) with the participation of the private sector. Rental housing projects are in progress in the urban local bodies of Thane, Mira Bhayander, Kalyan and in Panvel Taluka of Raigad district.

Mumbai Metropolitan Regional Development Authority (MMRDA) aimed at building 0.5 million (5 lakh) homes, admeasuring 160 sq.ft. in five years, without any land or financial support from the Government. The scheme considered allotment of extra buildable area as incentive buildable area in two forms

a) Floor space index (FSI): The developer got an FSI of 4, within which an FSI of 1 is reserved for construction of rental housing and the balance FSI of 3, could be used as a sale component to be sold in the open market.

b) Transfer of development rights (TDR): Developers build rental housing on self-owned land, and receive an incentive FSI of 4 as TDR to be used to the north of the rental housing plot.

The developer will also need to incur an infrastructure charge US$4-16/sq.m. (INR250-1,000/sq.m.). 90% of this goes to the local municipality for external infrastructure and 10% goes to MMRDA for maintenance of rental housing.

It is estimated that around 75% of the urban households in cities live in the bottom income segment earning less than US$1.80 (INR80) a day. This data throws forth a crucial question – can these households save to buy homes?

This is where the concept of rental social housing becomes crucial for a country like India.

Policy environment for rental housing

For the past six decades since independence, the housing policy in India has focused on home ownership rather than home rental. This line of thought was elaborated in Budget 2013, which incentivized home ownership by proposing a tax deduction on interest paid increasing it from US$2,453 (INR1.5 lakh) to US$4,088 (INR2.5 lakhs) for home loans less than US$40,878 (INR25 lakhs). Rental housing found a mention only as recently as 2009, when the “Affordable Housing in Partnership” initiative was undertaken as part of the “Basic Services for the Urban Poor (BSUP)” segment of Jawaharlal Nehru National Urban Renewal Mission (JnNURM) (JnNURM), which was dove-tailed into Rajiv Awas Yojana (RAY) in 2011. Archaic laws such as the Rent Control Act, which were intended to protect tenants from eviction and substantial increase in market rent, have been extended out of context in recent times and only ended up making landlords wary of losing their property, resulting in withdrawal of stock from the rental market and reduced investment in rental housing. Over the years the GoI has moved from the role of a provider to that of a facilitator. Among the Indian states, Maharashtra was the first to implement a rental housing model.

Facilitators for rental housing

Rent to own option: This option provides the tenant the option to pay for the house in comfortable installments. Part of the monthly payment goes toward the purchase of the house. This arrangement allows families to stay on rent in the initial stages and finally become homeowners. This model works well for families that have regular incomes but are unable to save to make a substantial deposit to purchase. Hybrid versions of this scheme have been adopted in Chile, Colombia and South Africa.

In many countries, housing associations or housing funds facilitate the rent to own processes and act as intermediaries between the owners/local bodies and the rent to own tenants.

Rental housing may be a viable option for low income groups, given the high migration rates in search of employment to our cities and a large population drawing daily wages with a limited ability to save. The staggered payment allows households, without a saving, to finally own a home.

Rental housing allows for the creation of a flexible housing solution both for those looking for short-term and long-term housing solutions.

Continued maintenance of rental houses is a big concern faced by a number of already operational facilities. However, including project management companies can help resolve some of these concerns.

The concept of dormitories for industrial workers/single migrants into urban areas is another rental housing option that could reduce the dependence of our urban cities on slums.

With the REITs regime opening up, it could be a viable financial instrument for rental housing, since REITs invest in and own properties with revenues from rentals and asset sale.

REITs can increase investors’ participation in housing. It may be considered to have a type of REIT focused only on rental housing. These could be incentivized by offering tax benefits.

Case study: Chile

The program was designed to help households that required housing but were unable to pay the deposit to buy one. The tenant signs a contract with a financing company for a period of 15-20 years, which continues to own the house until the complete payment is made.

The monthly payment rendered by the tenant includes the rent and a savings contribution. The accumulated savings and the interest earned on those savings provide the funds to purchase the house. The scheme accounted for mobility by allowing the tenant to transfer the house to another family and enter into another contract for a different home.

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New policy environment and its impact on Indian real estate
- REIT- Is the Indian real estate market REIT- ready and what it could mean for the industry?
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Indian real estate catering to changing needs
- Senior living housing: transforming conventional lifestyle with global best practices across Indian markets
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Our Mission

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Brave new world for India real estate: Policies and trends that are altering Indian real estate
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