Better days on cards for Real Estate sector; implementation of reforms hold the key

The real estate sector is a critical sector of our economy. It has a huge multiplier effect on the economy and therefore, is a big driver of economic growth. The sector, which is presently worth $15 billion and growing at a phenomenal rate of 30% per year, contributes to about 5-6% to India's GDP. It is the second-largest employment-generating sector after agriculture and stimulates the demand in over 250 ancillary industries such as cement, steel, paint, brick, building materials, consumer durables and so on.

The industry, which witnessed prolonged period of lull, is now in a much better position to ride the economic recovery, with leading developers sharply focusing on execution (have hired specialised third-party contractors, adopted modern technology), while cutting debt by selling assets and focusing on operating cash flow.

Reports suggest that developers over the past four-six quarters have focused relentlessly on debt reduction, largely through asset monetization. For instance, DLF has sold Rs 7,100 crore worth of assets, while Jaypee Infratech has sold land parcels for Rs 1,600 crore. Purvanakara and Brigade have raised Rs 330 crore and Rs 180 crore, respectively, through this route. Mahindra Life-space has sold a plot of land for Rs 320 crore and Godrej Properties has raised a total of Rs 700 crore. The sector's debt-equity ratio is now a manageable 0.7.

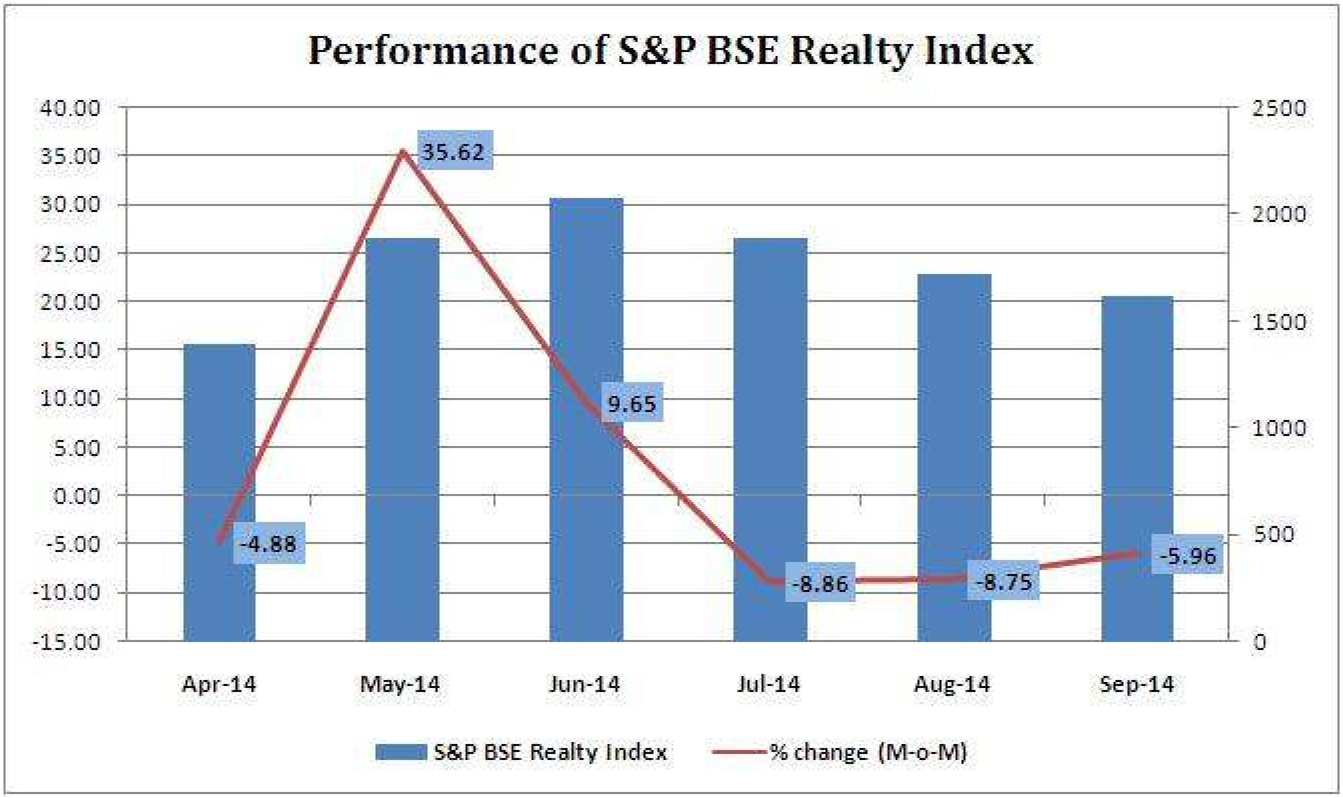
Further transformation has already begun with clearance of several reforms in the last couple of months such as the LARR Act, 2013, opening up of FDI in multi-brand retail, allowing external commercial borrowings and changes in several regulations and taxation rulings. Several other reforms in the pipeline such as the Real Estate (Development and Regulation) Bill, 2013, Real Estate Investment Trust, relaxing foreign direct investment norms, single-window clearance mechanism and introduction of PPP mechanism in real estate are intended to promote further growth in the sector.

Performance of Realty Index:

The S&P BSE Realty index has been underperforming since previous three months, though losses have subsided in the month of September, but still the index continues to show contraction.

However, Real Estate stocks were on a roll in the month of May and June on the bourses after President Pranab Mukherjee in his joint address to the Parliament underscored that the government proposed proper housing to all citizens by 2022.

Euphoria ran across these stocks as the BJP manifesto promised a house for every family in India within 75 years of Independence that is by 2022. To cater to the BJP vision for the next eight years, builders and consultants off lately have been rushing to ready their blueprint on affordable housing, a promise that has not been delivered effectively so far by any government.



Challenges for the sector:

Delayed Clearance process: One thing obstructing the growth of the sector is the complicated processes involved in getting clearances for projects. The red-tapism and delays add to the cost of projects, which in turn is passed on to buyers, consequentially impacting demand.

As per a report by the Ministry of Housing and Urban Poverty Alleviation, the approval process is extremely long drawn. For any housing project in a metro, there are a minimum of 34 regulatory processes to be followed by a developer for obtaining construction permits, which takes an average of 227 days, even more. As a result, the project is not only delayed, but the cost of the property also goes up by 10-20%.

Hence, a single window clearance system and clearly defined guidelines will go a long way in reducing delays and associated costs. Speeding up the approval process will also bring transparency.

Housing Shortage: One of the biggest pitfalls of India's unplanned real-estate sector is the under-supply of housing units. According to housing data available as per 2001 census available at NHB, much of the shortfall was witnessed by South Zone, which covers states like Andaman and Nicobar Islands, Andhra Pradesh, Karnataka, Kerala, Lakshadweep Puducherry, Tamil Nadu, while the shortage is least witnessed in South zone, which includes states like Dadra and Nagar Haveli, Daman and Diu, Goa, Gujarat, Maharashtra and Rajasthan.

Housing shortages: Zone wise

This contraction in shortage in West Zone is mainly on account of lack of demand in the state of Maharashtra, Daman Diu and Dadara and Nagar Haveli. Meanwhile, all the other zones continue to stage housing demand and leading them is the East & North East Zone, which includes states like Arunachal Pradesh, Assam, Bihar, Jharkhand, Manipur, Meghalaya, Mizoram, Nagaland, Orissa, Sikkim, Tripura and West Bengal.

Lack of suitable developable land: Suitable developable land with basic infrastructure has become scarce in Indian cities. This has resulted in significant surge in land prices in the urban areas. To address the issue of unavailability of urban land and promote growth of housing stocks, several state governments have initiated land pooling policy. Land pooling, which has been successful globally is increasingly being adopted by policy makers in the states of Gujarat, Maharashtra, Delhi, Chhattisgarh, Tamil Nadu, Punjab and Kerala.

Scarce funding channels: Arranging the initial funding can be a grave challenge affecting the housing supply to a large extent. The Reserve Bank of India (RBI) has set threshold for the total maximum exposure to real estate, including individual housing loans and lending to developers for construction finance, for banks at 15%, which is quite low and is curtailing growth of the sector. Absence of long term funding from banks is prompting developers to look at alternative source of funds, most of which do not offer affordable interest rates and hence, the supply is being subdued. In the case of individual buyers, the persistently high inflation rates have made them suffer in multiple ways affecting their buying capacity. Besides having lesser disposable incomes and savings, they are faced with increasing housing prices, further compounded by the high interest rates on mortgages.

Major Positive Developments:

A lot of positives have emerged for the sector with the new government coming to power. Other than giving incentives to REITs, the government has decided to build 100 smart cities. For this, it has allocated Rs 7,600 crore in the Union Budget. The government has already started the ground work for building these cities. According to reports, it has started holding meetings with various stakeholders in this regard. Besides, the Budget has allocated Rs 12,000 crore to the National Housing Board, which regulates housing finance companies, of which Rs 4,000 crore will be for affordable housing. However, so far, the most important and positive development that has taken place into the sector includes the introduction of Reits, which provides much needed liquidity to the real estate sector which is cash strapped as well as reeling under high cost loans.

'Budget 2014' turned out to be booster for the industry

The annual union budget of 2014-15 turned out to be a big positive for the real estate sector. The finance minister announced a series of measures to bring investment into the sector while giving special emphasis on affordable housing.

1) Hike in the tax-free cap on interest paid on housing loan: As part of tax management and tax structuring, the finance minister has increased the home loan rebate on self-occupied property from Rs 1.50 lakh to Rs 2 lakh.

Income tax deduction limits under 80C on repayment of principal amount on housing loan also is increased from Rs 1 lakh to Rs. 1.5 lakh, which will lead to improved sentiment in the housing market.

The Finance minister also proposed major initiatives in the areas of urbanisation, transportation and other infrastructure development that will give a tremendous boost to the real estate sector in the days to come. Some of these are:-

- Allocation of Rs 100 crore for Metro Projects in Ahmedabad and Lucknow
- Allocation to Urban Renewal (infra development) increased from Rs. 5,000 crore to Rs. 50,000 crore
- Investment of Rs 37,880 crore in NHAI for constructing national and state highways of which 8500 km are to be completed this year
- Expressways to be set up along new industrial corridors-Rs. 500 crore for project preparation
- Setting up new airports, inland navigation system, SEZs etc. through Public Private Participation

2) Building up Smart Cities:

The finance minister has allocated Rs 7,060 crore for developing 100 new smart cities in the country. The move will boost investor sentiment in the real estate segment in the proposed areas of these cities and neighboring towns. With a large number of offices and IT/ITeS segment growth apart from residential growth coming from Tier II and Tier III centres, smart cities can bring opportunities for real estate developers, investors, end users and also the home loan sector.

Further, towards this development, the ministry of urban development has prepared a draft concept note on the smart city scheme. The high-power expert committee on investment estimates that the annual fund requirement for smart cities will be Rs 35,000 crore. This estimate covers water supply, sewerage, sanitation and transport-related infrastructure. A large part of the funds will come from private investments. According to the scheme, this amount shall be covered by complete private investment or through public-private partnership.

3) Affordable Housing: Among the many big announcements in annual budget, Finance Minister, allocated Rs 4,000 crore for low-cost housing alone apart from Rs 50,000 crore for urban housing. Further, he also announced slum development as a part of CSR activities. The allocation of Rs 4,000 crore for NHB will increase the flow of cheaper credit for affordable housing to the urban poor/EWS/LIG segment.

However, the budgetary announcement for a mission-mode programme for affordable housing is hanging fire for lack of clarity on many key concepts as Department of Financial Services (DFS), the nodal body on banks and financial institutions, in the finance ministry coordinating and implementing the financial policies on housing, has sought clarifications from the Prime

Minister's Office on many aspects, including whether this will be in the form of only budgetary allocation or whether it would also include the priority-sector lending shortfall amount that banks provide to the NHB and other institutions as directed by the Reserve Bank of India (RBI).

Also, it highlighted lack of clarity is due to the multiple definitions of the target group - economically weaker segment (EWS) and low income group (LIG) -under different laws and existing schemes in terms of income and area of the houses meant for them as well as the definitions on 'low-cost and affordable housing'.

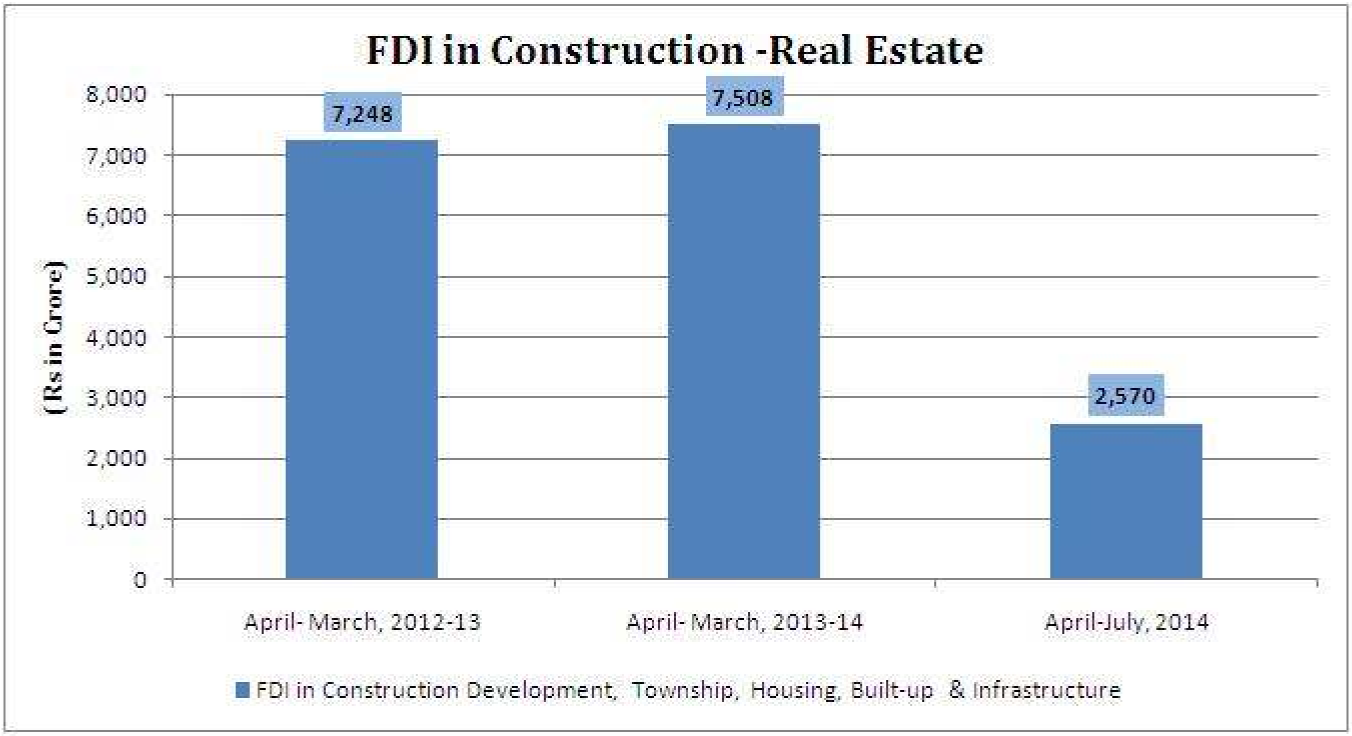
4) Easing of FDI: As a measure to enhance affordable housing and drum up interest in the prime minister's plans for 100 smart cities, the finance minister announced relaxation of FDI norms in the real estate sector. The finance minister announced a reduction in the size of projects eligible for FDI from 50,000 square meters to 20,000 square meters and minimum investment limit for FDI to $5 million from the existing $10 million, which is expected to draw more foreign capital and provide liquidity to the real estate sector.

Further towards this development, government is now trying to fast-track a decision on easing rules for foreign investments in the construction development sector, with Department of Industrial Policy & Promotion (DIPP) floating a Cabinet note in September 2014 proposing to bring down the minimum built-up area requirement for FDI in construction projects from 50,000 sq metres to 20,000 sq metres, also reducing minimum capital requirement for such projects from $10 million to $5 million.

The existing policy allows 100% FDI in the construction sector subject to minimum built-up area and minimum capitalisation requirements.

Further, the draft Cabinet note also suggested that projects which commit at least 30% of the total project cost for low cost affordable housing will be exempted from minimum built-up area and capitalization requirements. The new foreign direct investment (FDI) regime may allow developers to exit after the completion of the project or through the approval of the Foreign Investment Promotion Board (FIPB) against the three-year lock-in period currently imposed, a condition that has been a big deterrent to foreign investment in the sector.

The sector attracted Rs 7508 crore in FDI in 2013-14, up by 3.58% from 2012-13 when the Foreign direct investments stood at Rs 7248 crore. Meanwhile, with the beginning of the new financial year 2014-15, the sector so far has attracted investments worth Rs 2570 crore as against Rs 2092 crore in the corresponding period of the previous year, which is higher by 22.84%.



RBI eases reserve norms for banks issuing infra bonds: In order to encourage infrastructure development and affordable housing, the Reserve Bank of India (RBI) in July exempted long-term bonds from the mandatory regulatory norms such as the Cash Reserve Ratio (CRR), the Statutory Liquidity Ratio (SLR) and Priority Sector Lending (PSL), provided the funds raised from these bonds, which have minimum maturity of seven years, were utilized for lending to long-term projects in infrastructure sub-sectors and affordable housing.

According to RBI circular, the central bank intends to ease raising long-term funds by banks for infrastructure and allot infrastructure status for affordable housing projects. This is much in pursuance of Finance Minister Arun Jaitley's budget speech in which he underscored the need to encourage banks to extend long term loans to infrastructure sector with flexible structuring to absorb potential adverse contingencies, sometimes known as the 5/25 structure.

Under the 5/25 structure, bank may fix longer amortization period for loans to projects in infrastructure and core industries sectors, say 25 years, with periodic refinancing, say every five years. However, RBI in its circular did not prescribe ceiling or floor on repayment term. Also, no cap on the quantum of long-term bonds to be issued by banks was fixed.

However, RBI underscored that it would allot infra status for home loans up to Rs 50 lakh though with some riders. Further, central bank also has allowed banks to issue infra bonds via private, public placement and eased priority sector norms for banks' long-term bonds.

However, it barred the cross-holding of infra bonds among banks and maintained long-term bonds of banks being plain vanilla in form, not having call or put option. It further mandated banks to share data on long-term bonds soon after issuance and ordered them of not fixing infra loan amortization schedule at appraisal stage, exceeding 80 percent of project life. Additionally, RBI allowed banks to issue only rupee-denominated infra bonds, which may offer initial term of 5-7 years for infra, core loan.

SEBI clears the way for REITs: In a move that may offer new source of financing to India's cash-strapped property developers, the Securities and Exchange Board of India (SEBI) approved the setting up of real estate investment trusts (REITs). These are nothing but listed entities that primarily invest in completed properties such as shopping malls, office buildings, apartments, warehouses and hotels, which provide regular income to investors from rentals received from such properties.

Just as mutual funds do with equity and debt, REITs would pool money from investors and invest them in income-generating (rental assets) offering them a way to diversify their portfolios by investing in property. While, for developers, it would improve property market transparency, smoothen volatile property cycles, and potentially lower the cost of capital, for investors, REITs would offer yet another regulatory backed organized investment instrument after debt, equity, commodity and currency.

Introduction of REITs provides much needed liquidity to the real estate sector which is cash strapped as well as reeling under high cost loans. It is expected to bring copious amount of money in the coming days.

However, the SEBI guidelines mandate that at least 90% of the value of the REIT assets shall be in completed revenue generating realty projects. The balance can be invested in under-construction property, mortgage-backed securities, listed or unlisted debt securities, govt. securities and money market instruments.

Further, REITs will be allowed to invest in commercial real estate assets, either directly or through special purpose vehicles (SPVs). In such SPVs, a REIT must have a controlling interest of at least 50% of the equity share capital. Further, such SPVs have to hold at least 80% of their assets directly in properties.

Besides, REITs will be allowed to raise funds only through an initial offering and units of REITs have to be mandatorily listed on a stock exchange, similar to initial public offering (IPO) and listing for equity shares. Moreover, it would require to-have assets worth at least Rs 500 crore at the time of an initial offer and the minimum issue size has to be Rs 250 crore.

SEBI in October last year, had announced plans to introduce REITs, but the plan was delayed amid uncertainty about the taxation structure for the new instrument. However, in the budget announcement 2014-15, Finance Minister Arun Jaitley cleared the way for REITs and infrastructure trusts by announcing tax benefits for both.

Outlook:

The fortunes of the real estate industry seem to be turning for the better, mainly on account of improving political stability and business confidence on back of the new government coming to power, which so far has announced its intent to boost the growth in the sector, be in terms of announcement of introduction of Reit, increased tax benefits on housing loans or allocation of Rs 7600 crore in Union Budget to build 100 smart cities.

Further, plans for relaxing foreign direct investment norms, single-window clearance mechanism also are in pipeline, which will promote further growth in the sector. This combined with improving macro-economic conditions works out to be favorable metrics for the sector.

However, the success of the sector depends upon the implementation of these reforms by the new government, with large hopes being pinned from the introduction of REIT, which is expected to be a game changer for the industry.

Companies Financial Data In Industry

COMPANY NAME	CMP	MCAP (Rs.Crore)	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Mahindra Lifespace Developers Ltd.	514.25	2108.23	315.85	1.17	54.10	9.51
Sobha Ltd.	404.95	3971.10	234.47	1.73	21.42	18.90
National Buildings Construction Corporation Ltd.	688.05	8256.60	96.65	0.73	21.28	32.34
Sunteck Realty Ltd.	305.00	1920.47	80.74	0.33	20.96	14.55
Ganesh Housing Corporation Ltd.	156.20	510.28	200.12	1.66	12.79	12.21
Phoenix Mills Ltd.	338.75	4908.67	131.82	0.65	10.07	33.64
Prestige Estate Projects Ltd.	219.20	8220.00	98.34	0.68	9.53	23.00
JMC Projects (India) Ltd.	138.40	361.48	170.42	0.72	9.17	15.10
Oberoi Realty Ltd.	217.10	7125.94	84.77	0.92	8.07	26.90
Brigade Enterprises Ltd.	143.60	1611.94	113.65	1.39	7.81	18.40
Housing Development & Infrastructure Ltd.	83.45	3496.59	250.24	0.00	6.70	12.45
Ansal Housing & Construction Ltd.	30.85	183.21	68.61	2.59	6.67	4.63
Godrej Properties Ltd.	236.00	4704.59	93.92	0.85	6.32	37.35
Ahluwalia Contracts (India) Ltd.	165.00	1035.58	38.62	0.00	6.02	27.41
DS Kulkarni Developers Ltd.	86.10	222.15	196.03	1.16	5.32	16.19
Kolte Patil Developers Ltd.	178.50	1352.58	100.74	1.74	5.10	35.03
Puravankara Projects Ltd.	102.45	2429.60	77.99	1.87	4.85	21.12
Hubtown Ltd.	113.65	826.64	232.94	0.88	4.36	26.09

Omaxe Ltd.	128.80	2355.76	89.93	0.39	3.17	40.61
DLF Ltd.	150.85	26878.16	93.21	1.33	2.54	59.45
Pressman Advertising Ltd.	19.00	44.62	10.07	5.26	2.45	7.76
Indiabulls Real Estate Ltd.	67.55	2870.02	134.94	4.44	2.25	29.96
Jaypee Infratech Ltd.	22.45	3118.16	43.92	0.00	1.90	11.81
Peninsula Land Ltd.	33.45	933.93	54.94	1.20	1.72	19.45
Ajmera Realty & Infra India Ltd.	131.60	466.98	99.65	1.14	1.69	77.70
Arihant Foundations & Housing Ltd.	42.50	36.55	194.12	0.00	1.56	27.26
Vijay Shanthi Builders Ltd.	13.88	36.35	45.89	5.76	1.52	9.15
Ashiana Housing Ltd.	163.40	1520.43	30.03	0.31	1.31	124.32
Ansal Properties & Infrastructure Ltd.	32.25	507.63	104.18	0.00	1.16	27.85
Nitesh Estates Ltd.	13.82	201.54	30.03	0.00	0.64	21.69
Prozonc Intu Properties Ltd.	17.90	273.16	26.66	0.00	0.38	46.87
Parsvnath Developers Ltd.	21.75	946.52	61.75	0.00	0.29	75.25
Vipul Ltd.	34.95	419.35	34.73	0.14	0.28	125.10
SRS Real Infrastructure Ltd.	36.65	736.72	11.01	0.00	0.25	146.15
Unitech Ltd.	18.95	4957.89	37.79	0.00	0.23	80.80
Landmark Property Development Company Ltd.	5.24	70.29	4.34	1.34	0.22	24.36
MVL Ltd.	1.41	84.78	2.83	0.00	0.14	10.32
Emami Infrastructure Ltd.	35.20	85.53	16.94	0.00	-0.09	0.00
Prajay Engineers Syndicate Ltd.	11.47	80.22	94.86	0.00	-0.48	0.00
DB Realty Ltd.	67.45	1640.78	138.45	0.00	-1.30	0.00
Welspun Projects Ltd.	22.00	88.00	104.86	0.00	-10.62	0.00
Orbit Corporation Ltd.	14.40	164.11	66.59	0.00	-14.33	0.00
Marg Ltd.	12.86	49.02	99.20	0.00	-76.31	0.00

Source – Ace Equity