

## **Real Estate Sector – The India Story**

*Submitted by*

*Miss Sonia Sahni  
Asst Manager  
Corporate and Investment Banking,  
ABN AMRO Bank  
Nariman Point  
Mumbai  
India 400021*

*Cell: +91 9833097087*

*[soniasahni@gmail.com](mailto:soniasahni@gmail.com)*

*Prachi Phadnis  
Team Lead - IBM global services*

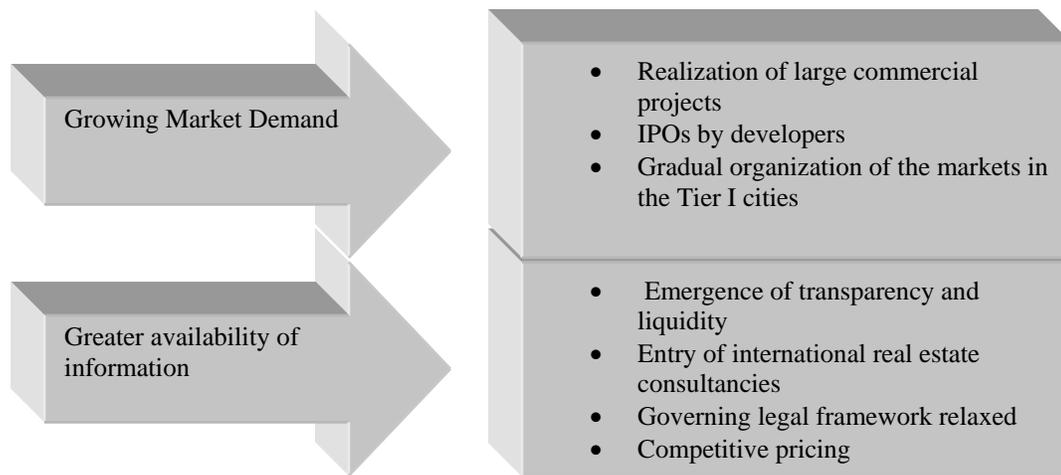
*Email: [prachiphadnis@gmail.com](mailto:prachiphadnis@gmail.com)*

## Real Estate Sector - The India Story

### Current Scenario of the Real Estate Market in India

Commercial real estate sector is in boom in India. In the last fifteen years, post liberalization of the economy, Indian real estate business has taken an upturn and is expected to grow from the current USD 14 billion to a USD 102 billion in the next 10 years. This growth can be attributed to favorable demographics, increasing purchasing power, existence of customer friendly banks & housing finance companies, professionalism in real estate and favorable reforms initiated by the government to attract global investors

### Characteristics of the Real Estate Market in India



### *Cause-Effect scenario leading to emergence of organized real estate market in India*

The property market in India has traditionally been unorganized and fragmented. However, the recent past has seen a consolidation of positions in the market as developers are stretching their capacities to the maximum in order to meet the growing market demand, which in turn has encouraged large projects with sourced financing. The IPOs by large real estate developers like Sobha, Raheja and DLF have led to organization of the market in the Tier I cities, but the Tier II and Tier III cities still demonstrate the traits of an unorganized market. Whilst the Indian real estate market still lacks transparency and liquidity compared to more mature real estate markets, the increasing requirements of multi national occupiers, as well as the influx of international property consultancies has led to the introduction of greater availability of market information, both in published and private form pushing the sector to an organized market form.

### Driving Forces

Stated below are the reasons that have led to the real estate boom in the country

- Booming economy; accelerated GDP to 8% p.a.
- India's emergence as an attractive offshoring destination and availability of pool of highly skilled technicians and engineers ; Development of large

captive units of major players include GE, Prudential, HSBC, Bank of America, Standard Chartered and American Express

- Rise in disposable income and growing middle class, increasing the demand for quality residential real estate and real estate as an investment option.
- Entry of professional players equipped with expertise in real estate development;
- Relaxation of legal rulings and processes by the governing bodies encouraging investments in real estate
- Improvement in infrastructure facilities

### **Categorization**

The demand for new office space in India has grown from an estimated 3.9 million sq. ft in 1998 to over 16 million sq. ft in 2004-05. 70% of the demand for office space in India is driven by over 7,000 Indian IT and ITES firms and 15% by financial service providers and the pharmaceutical sector. In 2005 alone, IT/ITES sector absorbed a total of approx 30 million sq. ft and is estimated to generate a demand of 150 million sq. ft. of space across major cities by 2010. This data clearly demonstrates the growth of the real estate sector in the country.

With reference to the availability of infrastructure facilities, following cities are currently attracting MNCs/corporate/real estate developers:

Tier I cities, Mumbai (Commercial hub), Delhi (Political hub) and Bangalore (Technological hub):

- Preferred option for many new market entrants
- Command the highest international profiles and significant proportion of FDI
- Offer qualified labor pool and the best infrastructure facilities
- Exhibit development of sub-urban commercial real estate
- Yield of 9.5 – 10%

Tier II cities, notably Hyderabad, Chennai, Chandigarh, Kochi, Mangalore, Mysore, Thiruvananthapuram, Goa, Bhubaneshwar, Ahmedabad and Pune

- Yield of 10.5-11.5%
- Offer competitive business environments, human resources availability, telecommunications connectivity, quality of urban infrastructure,
- Attract high value IT, ITES and biotech corporate houses

Tier III cities, like Cuttack and Jaipur

- Low liquidity and still highly unorganized.

Special Economic Zones:

- 28 operational SEZs in the country, including those converted from Export Processing Zones (EPZ) to SEZ

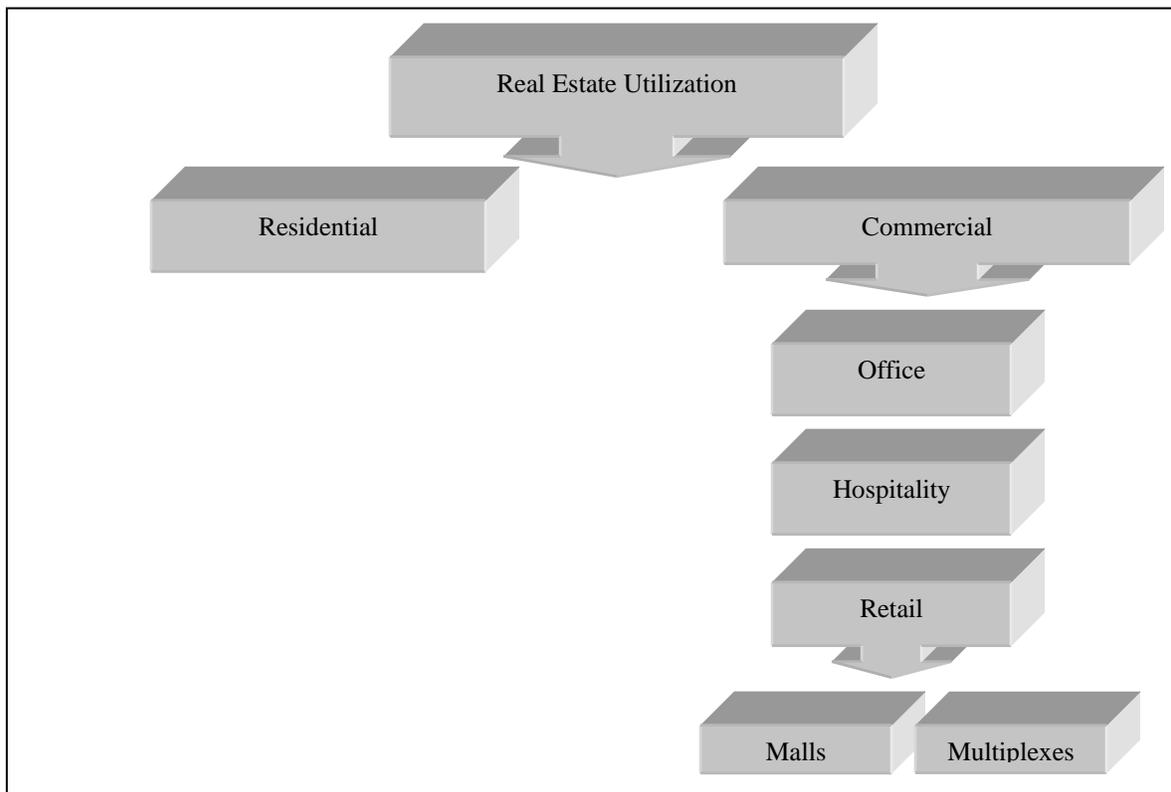
- Development of SEZs in various segments such as multi-product, Information Technology, Bio-technology, Gems and Jewellery, Textiles and technology intensive industries
- Attract both developers and corporate houses (refer table for a list of corporate that have shown interest in development of SEZs)

<b>Corporate</b>	<b>Location</b>
Reliance Industries	Gurgaon, Mumbai/Navi Mumbai
Adani Group	Mundra
TCG Refineries	Haldia
Suzlon	Coimbatore, Udipi, Vadodara
Hindalco	Sambalpur
Genpact	Bhubaneshwar, Jaipur, Bhopal
Vedanta	Orissa

*Corporate interested in development of SEZs in India and the location of interest*

Apart for the corporate clientele, the SEZs also attract a number of real estate developers, including DLF, Ansals, Omaxe, Parsvnath, Shipra Estate to name a few.

As per utilization, the real estate space can be classified as follows:



*Real estate utilization*

Listed below are the salient features of each category:

*Commercial Real Estate*

### *Office Space*

- Backed by strong infrastructure
- Promoted by increasing demand from IT industry
- Shift of focus from the traditional CBDs towards secondary centers owing sharply higher land prices in the city centers.

### *Retail Space*

- Growth of 25- 30% expected in the organized retail sector (malls and multiplexes) leading to an increased demand in real estate
- Affected by government policies for foreign retailers
- Pronounced in the Tier I, Tier II and Tier III cities.

### *Hospitality Space*

<i>Criteria</i>	<i>Statistics</i>
Annual growth rate of the industry	8%
Number of foreign tourists in 2005	4000000
Total number of five star rooms (2005)	96000
Total number of five star rooms needed by 2010	150000

#### *Growing demand of real estate in the hospitality industry*

- Increasing demand of lodging in commercial cities such as Bangalore, Mumbai, Delhi etc. from business travelers.
- Established brands in this sector include Asian Hotels, Indian Hotels, ITC, Le Meridien etc are in expansion mode with many new players such as Accor Group, Marriot, Choice, IHG Group

### *Residential Real Estate*

- Development triggered by:
  - Low per capita housing stock
  - Rising disposable income
  - Easy availability of finance
- Currently growing at 30-35% per annum
- Driven by retail investors who view real estate as an attractive investment option as compared to mutual funds and stocks
- Geographically widespread with townships being built in both the metros and the tier II and III cities

### **Real Estate Investment Banking**

Real Estate Investment Banking is an approach to real estate financing – providing the client a host of services including the structuring of real estate projects, legal advice, operative management of real estate projects and support in marketing properties. The banking focus in Real Estate Investment Banking is on structured financing products and

structuring of entire portfolios. Extending on similar lines is the importance of syndication that forms the base line of larger-sized transactions.

Real estate investment banking focuses on the following target market as prospective client base:

#### *Real Estate Consultants*

The increase in transparency and liquidity in the real estate market in India is attracting international real estate consultants to India. These consultants offer end to end solutions for their clients' real estate needs. These services include strategic consulting to developers, investors, advisors and lenders seeking assistance with existing assets, potential acquisitions, new development projects and properties slated for disposition, feasibility studies, concept testing, business planning exercises, investment advice, market research and analysis, demand forecasting, financial modeling and project structuring exercises, portfolio optimization and re-engineering strategies, expansion and occupancy, location and entry, brokerage services, legal documentation review, valuations etc.

Real estate consultants also ensure that the financing needs of the client are well taken care of by liaising with banking/non banking institutions and providing them with investment and structured finance solutions including securitization and sale & leasebacks, structured finance facilitating equity/debt into development projects on behalf of private and government sector clients, structuring development financing, public - private - partnerships, joint ventures, portfolio transactions and privatization exercises. The recent players in the Indian market are Jones Lang Lasalle, Colliers, CBRichard Ellis, Frank Knight and Trammell Crow Meghraj.

#### *Developers and Construction Companies*

With the opening up of the real estate sector in the country, the construction houses are scaling up the commercial and residential constructions. An increasing number of developers are offering IPOs for fund raising. AIM too is a sought after solution to meet the fund requirements for these developers.

Group	Route/Market
Parsvanath	IPO
Sobha	IPO
Pyramid Saimira	IPO
DLF Universal	IPO
K Raheja Corp	AIM
Unitech	AIM
Hiranandani Construction	AIM

#### *Fund raising options by developers*

#### *Domestic Corporate Houses*

As the land prices in the Tier I cities have always moved upward, land was regarded as a safe investment which, regardless of how it was used, would produce capital gains far above the inflation rate. It was thus common for companies in the manufacturing and service industries to acquire real estate even though they themselves were completely unrelated to property rental or real estate investment, seeking collateral value and tax benefits from depreciated assets, and expecting unrealized gains to absorb business risk. Acquisition of real estate as an asset was further encouraged as part of a diversification strategy in the investment portfolio of these corporate houses..

As these real estate possessions are classified as fixed assets held for the company's own business purposes, it becomes feasible recent moves to increase real estate liquidity often involve the conversion of corporate real estate into commercial use. The corporate houses in India are also demonstrating a shift from ownership to leasing. With the advent of MNCs into the country, a growing number of companies no longer see real estate ownership as an absolute necessity.

From the perspective of companies who want to sell off assets, securitization schemes provide a greater diversity of alternatives to liquidate real estate. This has been greatly encouraged by corporate restructuring and a return to focusing on core competencies. Thus, there seems an opportunity to tap the corporate houses who have a large corpus of real estate and are willing to trade this asset for want liquidity.

#### *FDIs/FIIs*

Post liberalization, the investment opportunities in real estate for the FDIs and FIIs have greatly opened up. Foreign investors can now purchase commercial development projects (under construction) over 50,000 sq m (540,000 sq ft), or plotted residential developments with a minimum size of 10 hectares. Foreign investors may purchase an equity stake in an unlisted real estate company and thereby partner in its growth plans across asset classes and cities. Listed real estate companies also offer good liquid investment opportunities routed into designated special purpose vehicles that hold the asset(s) being developed, thereby reducing risk. These investors look for innovative financial products to suit their investing needs.

#### *Financial Institutions – Real Estate Mutual Funds*

Major financial institutions such as ICICI, HDFC, IL&FS and Kotak Mahindra have all launched real estate funds, either as joint ventures or sole investors. Most institutional funds operate on a pan-Indian basis, and are increasingly looking at opportunities in Tier III cities, in order to gain "first mover advantage".

#### *Private Equity/Venture Capital Funds*

As per the Securities and Exchange Board of India (SEBI), Foreign Venture Capital Investors (FVCIs) may invest in real estate assets, within the framework of SEBI. This has paved the way for capital infusion into the market and a significant weight of foreign capital is now chasing Indian real estate. Indirect real estate investments are made into a pooled investment fund; such funds are usually created in partnership with domestic developers or financial institutions. Such VC firms, partnered with developers form a potential client base, keen to invest in the real estate sector.

## **Real Estate and Financing Trends in India**

### *Securitization and CMBS*

From the perspective of companies who want to sell off assets, securitization schemes provide a greater diversity of alternatives to liquidate real estate. Securitization is primarily used by the corporate houses to convert the corporate real estate to commercial real estate.

### *Realty Funds/ Realty Mutual Funds in India*

Initiated by SEBI, the REMFs true potential would be tapped only after the setting up of REITs, as they infuse confidence among investors by serving as custodians of title deeds. (REITs pool various real estate assets, including warehouses, buildings, industrial estates and parks, malls, commercial and residential premises and get listed on the stock exchange to enable investors to buy and sell. They afford an opportunity to diversify the portfolio within that limited sense as well. However, SEBI has not allowed the creation of REITs in India as yet, though REITs are well established in the more mature real estate markets. ) Currently the REMFs in the Indian market are targeted at the HNIS and corporate investors.

## **Risks involved in the Real Estate Investment Market**

### *Liquidity risk*

The real estate investment market is still in its infant stage. The time required for liquidity of real estate property can vary depending on the quality and location of the property.

### *Regulatory risks*

In terms of property ownership, permission from the Reserve Bank of India is required for foreign investors. For capital repatriation, investors need to apply for approval from the RBI, and foreign direct investment is limited to a limited set of opportunities (e.g. townships). The REMFs work within the SEBI framework. Being a developing and growing sector, the rules, regulations and legalities demonstrate frequent changes, making it seem as a cumbersome investment option to the investors.

### *Property market transparency risk*

The Indian property market has low transparency when compared to the more mature and developed real estate markets. Although market transparency has improved, reliable and consistent information on the Indian property market is still not easily available. There are also more professional due diligence and valuation institutions needed. This holds true even for the Tier I cities.

### *Macroeconomic risks*

Interest rates, inflation and exchange rate risks are amongst the important macroeconomic indicators and have shown decreased volatility. The provision of facilities, is in many regions, still inadequate (education, transport infrastructure). These risk factors are not likely to disappear in the near future, impeding the development of the real estate sector.

### *Ownership and Land Title Issues*

Lack of information and low transparency in the real estate segment in India, coupled with the age old property related issues discourages the investment of the large players in the semi urban and rural areas thus slacking an overall growth of the real estate sector.

### **Conclusion**

The Indian real estate sector promises to be a lucrative destination for foreign investors into the country. The Indian realty sector, if channelized properly, could catapult the growth of several other sectors in India through its backward and forward linkages. However, there are potential constraints for domestic as well as foreign investments in India. Absence of a single regulator to monitor business practices prevailing in Indian real estate market is perceived to be a risk factor by investors. The SEZ guidelines which are issued by the Commerce Ministry are constantly modified, creating uncertainty. Since the liberalization of FDI norms, significant foreign investments have flown into real estate; but availability of suitable exit options for such investments is still constrained.

Maturity of the real estate markets will lead to infusion of foreign investment and adoption of international best practices by real estate players. Developers will get more organized, and become more transparent to avail opportunities emerging in the market. With the Indian securities market regulator SEBI allowing real estate mutual funds (REMFs) in India, equity investors will have an exit option available to them. All these factors will contribute in making the Indian real estate market more organized and structured, thus providing better investment opportunities.