

- **India – Still a growing economy?**  
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- **Real estate trends** - Foreign Direct Investment flows in and out of India



# Cityscape Intelligence Focus on India

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Welcome to the first of a new series of special reports looking at business to business real estate in the emerging markets called "Focus on". These reports will look at investing, property laws and FDI as well as featuring interviews with key real estate figures within the country featured. Our first report "Focus on India" aims to assess the impact the current global financial crisis has had on Indian real estate markets. We have put together facts and figures from reputed sources along with interviews from Indian real estate industry professionals with the aim to bring you clarity in these times of uncertainty. We trust that you find it informative and enlightening and we look forward to hearing your thoughts and comments.

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# India – Still a growing economy?

Over the last five years, India's real GDP has surged by an annual average of nearly 9% and the Economist Intelligence Unit forecasts it is set to be the fastest growing economy in the world 2008-2030, with an average annual expansion of 6.3%. However, the slowdown in the global economy has been more pronounced than previously anticipated and monetary tightening, combined with strong inflation have dampened consumer demand. High interest rates have discouraged firms from investing and expanding their capacity which in turn has reduced productive potential. The Economist Intelligence Unit has recently lowered their real GDP growth forecasts for India to 7.3% for 2008/09 (April-March), while the actual for the same period 2007/08 was 9%.

In light of the overall economic picture and the rapid escalation in prices in real estate over the last few years, many real estate markets in India are currently undergoing a price correction. However, there still exists a fundamental demand-supply imbalance and real estate remains an attractive longer term investment prospect, with demand likely to be particularly strong for affordable housing and sustainable office buildings. A report by Jones Lang LaSalle Meghraj estimates India will develop approximately 110m sq ft of green space over the next few years and in the next 3-4 years about 200m sq ft of commercial space and 45m of retail space is expected to be constructed across the major cities providing ample opportunity for the development of environmentally, economically and socially sustainable buildings.

Special Economic Zones are also cited as being an area of particular interest. A recent report by Cushman & Wakefield analysed the growth and development of Special Economic Zones and said: "SEZ developments have a significant impact on the real estate scenario in India" and have "augmented the real estate activities in India with a number of real estate projects of significant size kicking off", particularly with the growth of the IT/ITES sector.

# Boom or bust?

## Indian investment opportunities



**Anuj Puri**, Chairman & Country Head, **Jones Lang LaSalle Meghraj**, talks to **Cityscape Intelligence** about the changes that are currently taking place in the Indian economy and discusses the possible outlook for real estate markets, the maturing market and long term investment opportunities.

**Cityscape Intelligence (CI): How do you see the progression of Indian real estate from its boom period until the current slowdown and what are the impacts?**

The structural adjustment programme of the early 1990s initiated the liberalization of the Indian economy. We find the roots of the high appreciation rates on India's property market in the reduction of interest rates that the NDA Government instituted after 2001. In early 2004, home loan rates sank to a record low of 7.5% and this paved the way for the alarming spiking that typified the country's property rates in many Indian cities. The very amenable borrowing rates encouraged individuals to get home loans to buy residences, where previously purchasing property had only been an option for the considerably rich. This resulted in a huge demand for quality real estate all over the country post 2003.

After March 2005, Indian real estate rates displayed a seemingly unstoppable upward curve. This is directly related to the opening up of FDI in real estate. The market then proceeded to expand at an

unbelievable rate of 100%+ right until the current slowdown, which is bringing many locations with overenthusiastic rates to its knees. Overheated pockets have now seen corrections of between 12-25%, and it's still too early to exhale yet. Smaller investors, who are often small in stakes but large in numbers, are pulling out as fast as they can offload their holdings.

Those with broader visions and capital bases are hanging on, hoping to see some glimmer of the erstwhile glory associated to Indian real estate in the future.

In India as of today, the dominant trend is still a huge demand-supply mismatch in the housing sector, this would indicate that property prices will rise again in the foreseeable future. However, the finance ministry will first have to finish stabilizing the market artificially - until then, interest rates and negative cash flows will certainly put downward pressure on property prices.

It seems the rollercoaster ride will never have the same exhilarating twists and turns again, the onus from now on will be on affordable housing in the residential sector, and sustainable buildings in the office sector. The present market vagaries have force-fed transparency into Indian real estate and the sector is gaining maturity. Over the next decade we will see increasing transparency via the introduction of; sector regulators, more professionalism and international best practices being introduced into Indian real estate. Unethical practices will be phased

out, and smaller operators will merge into larger, more sustainable entities, all of which will benefit the consumer.

**CI: Is this an appropriate time for individual investors to increase their real estate exposure in Tier I and II cities?**

The primary metros continue to look strong for informed investors. However, in general terms, the Tier II/III story is currently not living up to previous expectations. Investors should judge the opportunity on a number of factors; local demand for property, the type of property being invested in, the number of units already sold/booked in the project, and market drivers scheduled to arrive in that locality. Among the Tier II cities, only Pune, Chennai, Kochi and Hyderabad continue to show some of the previous effervescence.

**CI: In what respect is the tier II and tier III story not living up to expectations?**

The Tier II/III story hinges largely on the establishment and expansion plans of players from the IT/ITeS sector. The space requirements for such projects, as well as the spin-off demand for residential and retail spaces generated by such projects, are the primary drivers for real estate in Tier II/III cities. With the global downward trends in IT/ITeS business activity, the potential is now in abeyance and demand has decreased among investors.

**CI: Is further correction anticipated in the housing and commercial markets and how much longer should investors wait for more lucrative opportunities?**

There will continue to be price corrections in overheated pockets of the country, particularly in locations in the metros and Tier II cities that have seen unrealistic price trends. We estimate that the rates in correcting markets will reach a decisive low point by January 2009. Those who are not in immediate need of a property should consider holding on to purchase until then. One must judge the market carefully in terms of local dynamics - there is a definite danger in waiting too long for the perfect opportunity. Much as in the stock market, it is almost impossible to predict the point of lowest ebb in the real estate market. The danger in delaying a purchase too long is two-fold, firstly, the buyer may lose out on the best properties, secondly, the market may regain equilibrium, meaning that the add-ons and even lowered rates may no longer be available.

**CI: What are the lead indicators of the economy and real estate which investors should consider while timing their purchase in India?**

The state of the stock market decides the quantum of liquidity available, so it should definitely be considered. Inflation is not as good a yardstick, as one tends to invest in growth-oriented instruments such as real estate to hedge AGAINST inflation. Cost of credit is significant in the case of mid-income and low-cost housing and small-ticket office spaces, while those who invest in luxury residential spaces and large floor-plate quality commercial constructions are less affected by this dynamic. Investors should consider the opportunity rather than overall market trends - for instance, investing into a technologically enabled commercial space at a prime business location, or

in an integrated township with a healthy product mix, will always offer a lucrative avenue.

**CI: For investors-traders who had acquired commercial or residential property in 2006/07, when should they look at exiting – should they hold these properties for the long term or sell now?**

For those in urgent need of liquidity, the best time is when the best offer comes along and before a further correction. For those who can hold on, here is a word of wisdom -while real estate is currently facing a setback, it still remains a good long-term risk diversifier that has the potential to generate very satisfactory risk-adjusted returns. The fact is, despite the current market dynamics, real estate has a low volatility quotient, and also low correlations with stock markets and debt. Investors with a long-term view should continue to include property in their investment portfolios. The quantum of buyers for quality properties in good, established locations at the right price is still significant.

**CI: Do you think there will continue to be a strong focus on development and demand for sustainable buildings?**

In India, those coming to the new Green Market Place do so either out of commitment towards the environment, to enhance their building USPs and some simply to be part of an emerging movement. However, it is hard to ignore the bottom line – sustainable



developments are the most lucrative business models of the future, both in India and elsewhere in the world.

For companies that deal in real estate, environmental sustainability is not a concept too distant from business sustainability. In other words, there is no difference between sustaining the environment and maintaining the marketplace for indefinite business activity. Growing awareness of this fact, and also the fact that sustainable real estate will be the primary focus of foreign investments, have helped keep interest in this concept alive.

**CI: How do you think retail, logistics and infrastructure development will be affected?**

They are already affected on the expansion plans level, though the degree to which players are affected depends on the market segments they cater to and the locations in question. Generally, consumption has decreased at all levels as market sectors are going further and further into conservation and preservation mode.



**CI: Have any major developments been put on hold or had difficulty obtaining finance?**

This is a truth visible across the country as we speak, though the degree depends on which players we are talking about. Those with large capital bases are obviously less affected. Developers had traditionally raised money from debt funds via corporate deposits and commercial papers. However, debt funds have not been enthusiastic about having added exposure to real estate to begin with, and developers will face increasing problems with completing ongoing projects and launching new ones.

There are other traditional routes for financing, one is internal accrual, another option is debt and the least preferable – but often the only option in large projects – is equity which dilutes the developer's stake to the extent to which the equity is raised. There are two ways to raise funds through the equity route – via private equity (real estate venture capital or private equity

funds) and public equity, where the two options are a listing on the Indian stock market and a listing on the foreign market (such as AIM in the UK).

Debt has now become even costlier and the readiness of banks to sanction more debt is at its lowest ebb for many years. Due to the lack of success in the IPO market, public equity is not a very viable option either, which only leaves private equity.

**CI: To what extent do you think India's domestic demand will shield it from global events?**

It appeared that domestic demand alone would insulate India from the worst of the global economic downturn. However this has not been the case and the impact has been very pronounced.

**CI: To what extent have rising commodity prices had an effect?**

They have impacted the overall interest in

home buying, as potential middle-income buyers are very susceptible to such rises and are deferring purchase decisions until some kind of normalcy is established.

**CI: Do you think the Indian market is ready for REITs and REMFs and are private equity and hedge funds withdrawing from the market?**

India's market has not evolved sufficiently to be a suitable platform for REITs, which require a more mature market model in order to prove feasible. REMFs, on the other hand, are both feasible and likely, they can be launched domestically by local financial institutions. In fact, if the current market dynamics do finally result in lowered property rates, this would be an ideal time for REMFs to make an entry.

Further interviews with leading industry commentators can be found at [www.cityscapeintelligence.com](http://www.cityscapeintelligence.com)



## Mumbai; taking stock

According to a report by Oxford Business Group, the total stock of investment grade property is made up of approximately 102 million sq ft of residential space, 33 million sq ft of commercial office space and approximately 3.23 million sq ft of formal retail supply.

The residential market in Mumbai has witnessed a marked shortage of ready apartments. Under-construction projects are selling out before completion and most of the under-construction projects have an absorption rate of close to 80%

Oxford Business Group have stated that the total stock (completed & under-construction) of high-end residential apartments in Mumbai at the end of 2007 was approximately 31,500 Dwelling Units (DUs) and for the mid-end residential apartments there were approximately 58,500 units. The total stock of high-end residential apartments is expected to increase by 14% between 2008 and 2010 and mid-end residential apartment stock is expected to increase by 12%, showing that there is still a marked under supply of units.

The report estimates that approximately 4.44 million sq ft. of office space was added in 2007, with the majority of this new space (more than 73.37%) located in the Suburban and Emerging Business Districts. The strong demand for investment grade office space coupled with limited supply resulted in lower vacancies and rapidly rising rental prices across Mumbai.

In the hospitality segment, Mumbai has a total existing supply of 6,615 hotel rooms in the five star and five star luxury segments, with occupancy often running at capacity.

The supply of investment grade retail space across Mumbai is expected to appreciate significantly to 2011. Around thirty-five climate controlled retail centres are currently under development in Mumbai alone, of these, perhaps 32 (around 21.1 million sq ft of leasable area) should become operational by 2010. This new supply is expected to increase the current stock from 3.3 million sq ft. to 24.4 million sq ft.

As in the previous two years, strong demand for investment grade space coupled with limited supply has resulted in a decline in vacancy levels together with a marked escalation in rental and capital values.

# Staying within the law

## Real estate FDI and ownership in India

Shuva Mandal, Managing Partner, FoxMandal Little, discusses the legal system in India and the laws governing foreign direct investment in Indian real estate.

### What are the foreign ownership laws on land and property?

The following laws are some of which govern foreign ownership on land and property in India:

- Foreign Exchange Management Act, 1999.
- Regulations under FEMA [Foreign Exchange Management (Acquisition and transfer of Immovable property in India) regulations, 2000].
- Various circulars/notifications/ master circulars issued by Reserve bank of India (RBI).-
- Press notes issued by the Department of Industrial Policy and Promotion (DIPP) under the Government of India.

### What laws have been introduced to encourage FDI?

The reserve bank of India and the Ministry of Commerce and industry issues circulars and press notes from time to time primarily under the Foreign Exchange Management Act [FEMA] facilitating FDI in India. Since the FDI regulations are exhaustive and cover a large number of sectors, it is difficult to dwell upon them in detail in this context due

to their vastness, but we are happy to clarify specific queries directly.

The FDI regulations and policies for various sectors can be accessed from the official website of the Reserve Bank of India and Department of Industrial Policy and Promotion, Government of India. Since the beginning of economic reforms in 1991, major initiatives have been taken in the fields of; investment, trade, financial sectors, exchange control, simplification of procedures, enactment of competition and amendments in the intellectual property rights laws, all of which provides a liberal, attractive and investor friendly investment climate.

FDI in sectors/activities to the extent permitted under the automatic route does not require any prior approval either by the Government or RBI. The investors are only required to notify the Regional office of RBI within 30 days of receipt of inward remittances.

### Are foreigners allowed freehold ownership?

Acquiring immovable property in India by persons resident outside India is regulated under the Foreign Exchange Management Act (FEMA) and the concerned Regulation on acquisition of property by a person resident outside India FEMA and Transfer of Immovable Property in India Regulations 2000, under which a person resident outside India may hold, own, transfer or invest in immovable property situated in India, if such property (a) was acquired, held or owned by

such person when he/she was a resident in India, or (b) if the same was inherited from a person who was a resident in India. A foreign national of non-Indian origin, resident outside India cannot purchase any immovable property in India. But, he/she may take residential accommodation on lease provided the period of lease does not exceed five years. In such cases, there is no requirement of taking any permission of or reporting to Reserve Bank.

### Can a foreign national who is a person resident in India purchase immovable property in India?

Yes, but the person concerned would have to obtain the approvals and fulfil the Requirements, if any, prescribed by other authorities such as the concerned State Government, etc. However, a foreign national resident in India who is a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal and Bhutan would require prior approval of the Reserve Bank. Such requests are considered by the Reserve Bank in consultation with the Government of India.

### How stringent and established is the regulatory framework for property ownership?

Acquisition of property is guided by stringent laws and also regulated by various approvals to be accorded by statutory authorities. Following are some of the laws which govern the regulatory framework for property ownership:

- The Transfer of Property Act, 1882
- The stamp Acts corresponding to

the respective state where property is situated

- The Registration Act, 1908
- The Land Reforms Act
- The Land Revenue Act
- Prevention of transfer of certain lands Act, 1978
- Inam Abolition Act
- Personal laws
- Foreign Exchange Management Act, 1999

Apart from these statutes there are various state and local laws that must be observed.

#### **Is there a system of escrow accounts?**

Yes there is a system of escrow accounts where authorized banks can provide escrow account services for various types of transactions, including equity deals, real estate transfers, loan repayments and bond redemption. We have assisted several of our clients in escrow agreements, wherein International Banks have played the role of escrow holder.

#### **What regulatory bodies oversee property ownership?**

The jurisdictional sub registrar is responsible for registration and transfer of ownership and the civic authorities are responsible for the collection of property tax to be paid by the owners. The Reserve bank of India regulates the flow of foreign money for the purchase of the property

#### **What current mortgage laws are in place?**

The Transfer of Property Act is the primary Act which deals with mortgages, however when it involves foreign exchange and creation of security in favour of a foreign national, there are certain restrictions imposed under the FEMA regulations.

NRI / PIO can mortgage with:

- (i) (a) an authorised dealer / housing finance institution in India – without the approval of Reserve Bank.

(b) a party abroad - with prior approval of Reserve Bank.

ii) a foreign national of non-Indian origin can mortgage only with prior approval of Reserve Bank

iii) a foreign company which has established a Branch Office or other place of business in accordance with FERA/FEMA regulations has general permission to mortgage the property with an authorized dealer in India.

#### **Is there a particular FDI law for the construction of townships, infrastructure, housing etc?**

Item No. 19 of Annexure to press note 7 of 2008 provides for 100% automatic route for construction development projects including housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, townships are subject to the following restrictions

(i) Minimum capitalization of US\$ 10 million for WOS and US\$ 5million for joint venture. The funds will have to be bought within 6 months of commencement of business of the company.

(ii) Minimum area to be developed under each project – 10 hectares in the case of development of serviced housing plots; built up area of 50,000 sq.m in case of construction development project; and any of the above in case of a combination project.

However, FDI is not allowed in real estate businesses that are not infrastructure, housing or township projects.

#### **Are green building regulations in place?**

Yes, the concept of Green Building is taking shape at a fast pace. The Indian Green Building Council and the LEED-India Green Building Rating System and various other such systems together are striving to make all projects environmentally friendly. Most

Municipal Corporations have made rain water harvesting mandatory.

#### **What are the legal pitfalls to investing in property in India?**

Although the Indian market today is witnessing a sudden surge in investments in the Real Estate sector, due to certain hiccups prior to investing, it is necessary to ascertain the actual and current owner/s of the property.

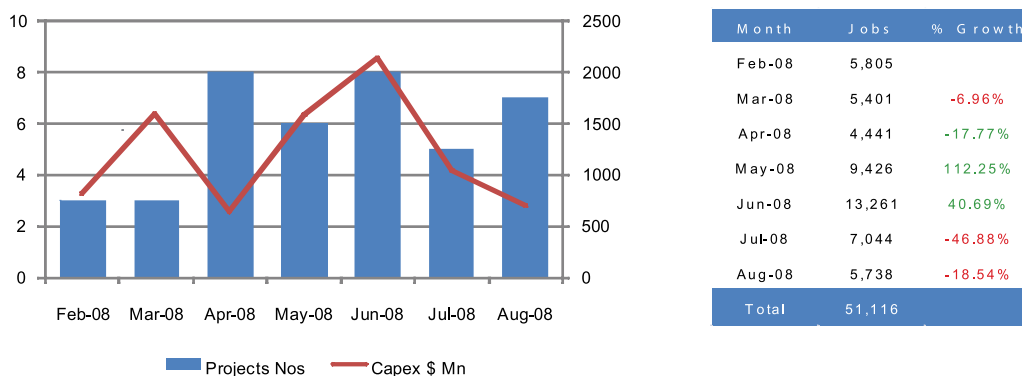
Foreign Investors like Real Estate Funds should therefore be careful in investing in real estate in India. Investors must obtain proper legal advice before investing in immovable property, it is only recently that records are being computerized and are now being systematically maintained; previously the majority of records were made manually. It is imperative to carry out a detailed search on the ownership of the land as previously land was predominantly transferred within the family domain and sale transactions were not recorded, thereby often creating a breach in the flow of title of land. Because of these factors a thorough Due Diligence should be carried out before investing in any property in India.

The concept of Title Insurance has not yet taken its true shape in India, unlike for example in the USA. Normally, law firms or individual lawyers carry out such title searches. Due Diligence Reports involve personal searches of the records at the offices of the jurisdictional Sub-Registrar. Encumbrance certificates reflect the names of the owners to the property and all the sale transactions which took place with respect to that property for the period of the search made. Normally, in practice, searches are carried out for the past 32 years, which may need to be extended to 60 years. The usual bureaucratic hurdles and delays are to be expected although there is sufficient transparency. Once all the requisite permissions and sanctions are in place, implementation is not a problem.

# Real estate trends - Foreign Direct Investment flows in and out of India

India has seen a varied performance in 2008, with no FDI construction projects investing in India in January 08 but a positive performance into the second quarter of the year.

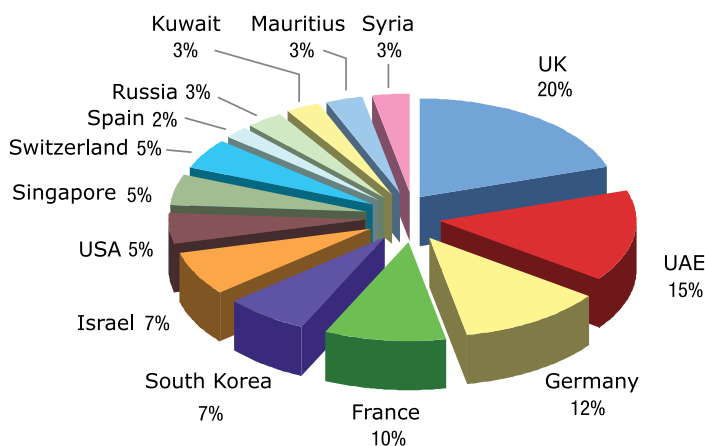
**Figure 2: Global Construction FDI into South Asia by Project No's, Investment & Jobs created (Jan 03- Aug 08)**



Source : fDi Markets, from the Financial Times Ltd

Although April generated 8 construction FDI projects into India, these projects were relatively small with the average project consisting of US\$80.6Mn and the creation of 555 jobs. Compare this to June 08 where the 8 FDI projects had an average investment of US\$265.7Mn and created over 1,650 jobs, over three times April's value. This is primarily due to a US\$625 Million project recorded in June involving the joint venture between Vicat Group (France) and Sagar Cement (India). The new company announced it will build a cement plant in Karnataka, India, which will have an annual output capacity of 5.5 million tonnes.

**Figure 3: No of Global Construction FDI Project No's into South Asia by Source Country (Jan 03- Aug 08)**



The majority of construction FDI projects into India in 2008 are sourced from the UK (20%), although most of these are small offices opened by Gleeds, the International Management and Construction Consultancy. They confirmed that they will open new offices in Bangalore, Mumbai, Chennai and Hyderabad before the end of 2008.

Source : fDi Markets, from the Financial Times Ltd

Companies from the UAE have set up 6 construction FDI projects in India in 2008, the largest by Dubai World's subsidiary Limitless. The developer has entered into a joint venture with Indian developer DLF to develop a US \$12 billion mixed-use project near Bangalore. Work on the Bidadi Township, which will house a population of 750,000 will be made up of residential, commercial and retail components. This project is the largest capital investment into India in 2008 to date.

Source : fDi Markets, from the Financial Times Ltd, Cityscape Intelligence

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