PROPTIGER

2016 - THE LANDMARK YEAR FOR REAL ESTATE & WHAT LIES AHEAD

JANUARY 2017

FOREWORD

The year 2016 is a landmark in the history of Indian real estate for its series of regulatory reforms, ranging from RERA, GST, strengthening of Benami Act and currency demonetisation. While all of these will affect the sector in the short to medium term, collectively they will provide the much-needed cleansing of the sector; one that would set the momentum for long term sustainable growth based on sound fundamentals.

While the year 2016 was promising to break the falling trend of residential launches and sales with both of them showing consolidation with marginal increase over the last 4-5 quarters; the momentum was broken; although temporarily, on account of the demonetization drive. The old notes would eventually be replenished by the new currency and economy would start moving forward – probably more digitally powered now than ever. The real estate sector though would have to grapple with the negative sentiments towards the price fall a bit longer; this eventually would affect the volume in the next couple of quarters. The softer interest rate regime, expectation of favourable budgetary incentives, increase in offers and discounts along with reduction in supply (projects failing to comply with RERA norms) are the factors which will lead to revival of sentiments and hence demand.

In 2017, with RERA in place, the launches are going to be filtered and largely backed by quality developers. This along with overall economic rebound is expected to lead to incremental demand as few buyers, who postponed their buying decision in 2016 will also enter the market. The supply side however would need to continuously align the product positioning to end user's preference. The developers will need to exhibit greater flexibility and focus more towards bringing back the confidence of the consumer by being more transparent.

We continue to look at the positive and fundamental aspects of the country including urbanization, sound economic fundamentals, political stability, better investment climate, increasing investments in socio-economic infrastructure and proactive steps by the Union government to bring transparency and discipline in the sector. All these will drive positive sentiments for residential real estate in 2017.

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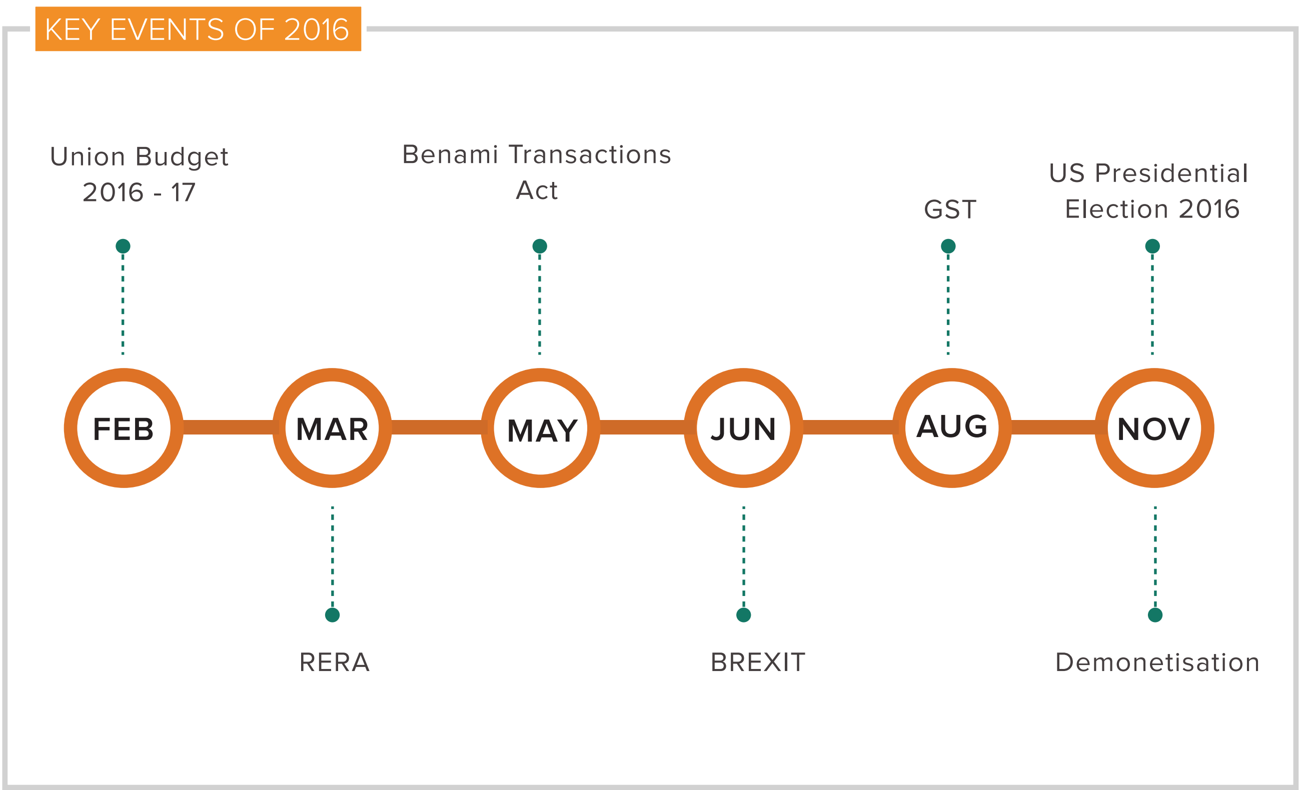
KEY EVENTS OF 2016

The year 2016 has seen many remarkable domestic and global events which have had a direct or indirect bearing on the potential of the Indian real estate sector. The underlying message though has been empowerment of the buyers – be it through information, tax incentives, legal and regulatory compliance for the projects. Starting from the Union Budget of 2016-17 which laid emphasis on affordable housing, digitization of land records, infrastructure creation and exemption of Dividend Distribution Tax (DDT) for successful listing of REITs in India to the Prime Minister's speech on New Year's Eve reinforced priority on Housing for All and interest rate concession for affordable housing.



KEY EVENTS OF 2016 - HIGHLIGHTS

Union Budget 2016-17

Started the year on a positive note

- The exemption of Dividend Distribution Tax (DDT) for the successful listing of REITs
- Digitization of land records
- Infrastructure creation
- Direct and indirect stimulants to boost affordable housing

RERA

To address homebuyers' grievances

- The Act requires compulsory registration of the property and the developer
- The registration must be done before the developer can advertise, market or sell
- The Act devices a mechanism wherein the RERA can initiate investigations into the affairs of any builder not only upon receipt of a complaint from buyer but also by a suo moto action

Benami Transactions Act

Aimed at increasing transparency and professionalism in Real Estate

- The Act is likely to curb creation of assets in false and bogus names by making the Act more stringent
- It mandates Central government to designate Special Courts for trial of offence punishable under it

GST

It will unify India's 29 States into one

- The GST will eliminate the cascading effects of taxes on production and distribution cost of goods and services
- GST can bring uniformity in tax practices in real estate sector across the states

Demonetisation

Beginning of a new era of cashless Real Estate Economy

- The withdrawal of Rs. 500 & Rs. 1,000 notes with an objective to curb black money circulating in the economy
- The current demonetisation is expected to lead to an increase in demand for organised players, who had been putting their act together over the last 4-5 years

UNION BUDGET 2016-17

The year started on a very positive note for real estate sector. The Union Budget 2016-17 brought a diverse set of announcements for the real estate sector. The exemption of Dividend Distribution Tax (DDT) cleared a final hurdle on the way of the successful listing of REITs in India. The other budgetary announcements with implications for the real estate sector in India were digitization of land records, infrastructure creation and direct and indirect stimulants to boost affordable housing.

The key announcement with implications for the residential real estate sector was the additional tax exemption of Rs. 50,000 per annum for first time home buyers. This announcement mostly benefits the first-time home buyers in tier-II and tier-III cities of India. The other initiatives such as focus on road infrastructure, upgradation of highways, action plan for revival of unserved and underserved airports etc. aimed to improve the connectivity and basic quality of life in various key localities that are pertinent for affordable housing projects.

A combination of incentives both for the sector as well as for the consumers to boost development and buyer interest that is essential for the revival of real estate market in India was the main motto of union budget presented almost a year back.

REAL ESTATE (REGULATION AND DEVELOPMENT) ACT, 2016

OBJECTIVES

The bill passed in the Rajya Sabha on 10th Mar'16, aimed to bring transparency and revive consumer confidence in both the residential as well as commercial real estate segments.

IMPLEMENTATION TIMELINES AND STATUS

The Act came into force on May 1, 2016. Many states such as Tamil Nadu, Karnataka, Delhi and Maharashtra have finalized the draft rules under RERA Act, other states will also join the league in 2017. The Central government has also notified the final rules for five union territories - Andaman & Nicobar Islands, Dadra & Nagar Haveli, Daman & Diu, Lakshadweep and Chandigarh.

SUMMARY

The Act requires compulsory registration of the property and the developer. The registration must be done before the developer can advertise, market, or offer the concerned property for sale. The Act devices a mechanism wherein the RERA can initiate investigations into the affairs of any builder not only upon receipt of a complaint from buyer but also by a suo moto action.

Once implemented, the developer-specific risk can be reduced by transparent and even-handed playing field created by the law and the enforcement mechanism, as it will shift the cost of regulatory risk to the developer's account making the developer liable to pay compensation for delay in project delivery.

PROS & CONS

PROS

- Increases credibility of project delivery
- Increases transparency
- Regulates broker environment
- Visibility of the developer track record
- Emphasis on financial discipline
- All project details in disclosure

CONS

- Not all states have notified the draft rules; possible delay in implementation
- Not applicable on projects of less than 4,000 sq mt
- Absence of responsibility for timely plan approval for projects

BENAMI TRANSACTIONS (PROHIBITION) AMENDMENT ACT, 2016

OBJECTIVES

The objectives of this amendment are amending the definition of benami transactions, establishing adjudicating authorities and setting up an appellate tribunal to deal with benami transactions, and specifying the penalties for entering into benami transactions. It also aims at increasing transparency and professionalism in the industry.

IMPLEMENTATION TIMELINES AND STATUS

The Benami Transactions (Prohibition) Amendment Act, 2016 was first introduced in the Lok Sabha on 13th May 2016 to amend the older Benami Transactions (Prohibition) Act 1988. The Act came into force on November 1, 2016.

SUMMARY

The Act is likely to curb creation of assets in false and bogus names by making the act more stringent. It mandates Central government to designate Special Courts for trial of offence punishable under it. While on one side all old Benami cases would be subject to legal recourse, the practice of undertaking property transactions in a more transparent manner is likely to reduce the title risk and will bring transparency in the sector.

The Act seeks imprisonment of up to seven years & be charged a fine up to 25 per cent of the fair market value of the benami property. If any false information is provided, it would lead to imprisonment for six months to five years and a fine of up to 10 per cent of the fair market value of the benami property.

PROS & CONS

PROS

- Increases transparency and professionalism
- Title risk of the property will be minimized
- Increases buyer's confidence
- Attracts offshore investors & private equity

CONS

- The success of the amended bill will lie in its quick and strict implementation by the empowered authority

GOODS AND SERVICES TAX (GST)

OBJECTIVES

The Goods and Services Tax (GST) is a tax reform, which will subsume all indirect taxes levied by the Centre and States. The key objective of GST is to eliminate the cascading effects of taxes on production and distribution cost of goods and services.

IMPLEMENTATION TIMELINES AND STATUS

The Rajya Sabha and Lok Sabha cleared the Constitution Amendment Bill for the rollout of GST in Aug 2016, which paves the way for making GST a reality, as it passes the systematic process towards implementation. The GST council will define the final contours of implementation of the bill. This council will be responsible for deciding the overall GST rate, which includes IGST (Central) and SGST (State), which may vary for different goods and services.

SUMMARY

At present, the real estate sector has two primary levies, service tax and VAT. However, varied tax rates across geographies within the country leads to diverse practices being followed by developers. It is imperative for the industry to have the same tax base and this is likely to be enabled by the proposed GST. GST can bring uniformity in tax practices in real estate sector across the states.

Overall, the GST regime is expected to bring more transparency and reduce compliance cost to the developers. Since the new tax will subsume multiple taxes, there will be smooth cash flows in the real estate value chain.

PROS & CONS

PROS

- Unified tax system
- Brings more transparency
- Smooth flow of funds in the value chain
- Reduces compliance cost to developers

CONS

- No clarity on taxability of TDR
- Final rate would define whether it would be beneficial for the sector
- It would call for significant technology and compliance time frame

DEMONETISATION

OBJECTIVES

Prime Minister Narendra Modi on 8th November announced the withdrawal of Rs. 500 and Rs. 1,000 notes with an objective to curb black money circulating in the economy. It is not only bold but also a turning point in the history of economic reforms in India.

IMPLEMENTATION TIMELINES AND STATUS

The unfolding of event in the next 50 days after 8th November affected the buyer's sentiments. The residential real estate across top Indian cities witnessed a slowdown in November and December as buyers postponed their buying decisions due to uncertainty in the market.

SUMMARY

The current demonetisation is expected to lead to an increase in demand for organised players, who had been putting their act together over the last 4-5 years. While there might be a temporary slowdown in transaction activity, residential projects of organised developers are likely to see an increase in demand because of a shift in demand from unorganised projects.

Overall, the much-needed cleansing of the sector will set the ground for growth based on sound fundamentals. It is expected to lead the beginning of a new era of cashless real estate economy which will boost the sentiment and hence demand in the medium to long term.

PROS & CONS

PROS

- Helps to fight Black money, corruption, terrorism and counterfeit currency
- Start of new era of cashless real estate economy
- Increase in liquidity to trigger reduction in interest rates

CONS

- Luxury and Resale segment to be hit the most
- Real estate in Tier II & III cities of India is expected to slow down as cash component is still involved in property transactions in such cities
- Approval process until made system-oriented will not be able to curb generation of black money

OTHER INTERNATIONAL EVENTS

BREXIT

Britain's decision to exit from the European Union has weakened the pound against the rupee (touched ~84 against INR on Dec 30th, 2016 compared with ~ INR 100 as on Jun 30th, 2015). Several major Indian IT firms assumed to earn a third of their revenues from the European Union (EU). UK's exit from the EU indicates a possibility of EU slowing down in the future. This will have an adverse impact on the revenues of Indian IT companies. The IT dependent residential cities like Bengaluru, Hyderabad, Chennai and Pune are, in turn, likely to face the heat. NRI investors from the UK are likely to stay away from investing in Indian residential real estate due to the fall in value of the Pound against the Rupee. This is likely to affect luxury residential sales.

US PRESIDENTIAL ELECTION 2016

When India was counting notes on 8th Nov'16 due to demonetization drive announced by Indian Prime Minister, United States was counting votes. Donald John Trump was elected as the 45th president of the United States in a spectacular culmination. Based on the sentiment implied by statements made by Trump during the election campaign and so far after winning the elections with regards to India indicates the possibility of positive political implications. However, Trump repeatedly mentioned saying that his government will stop jobs leaving from US to other countries and his intention to restrict the entry of skilled labour from overseas to the US. If so, the IT/ITeS sector could come under pressure and residential sector may face the heat as the employment in IT/ITeS sector has had a direct correlation with the residential demand in the country.

PRIME MINISTER MODI RINGS IN THE NEW YEAR WITH A FOCUS ON ACHIEVING HOUSING FOR ALL

Prime Minister Narendra Modi addressed the nation on the last day of 2016, after the end of the 50-day period of demonetization and gave common people a reason to hope for a better tomorrow. The various schemes announced are meant to usher in a better climate for the urban and rural home buyers, farmers, small and medium scale enterprises, senior citizens and pregnant women. The efforts seem to be undertaken to effect normalcy at the earliest.

After facing uncertainty for the last two months, the real estate sector has received some positive measures in the form of schemes for affordable housing, small borrowers and rate cuts from banks. The government has taken some major decisions to ensure homes for the economically weaker sections of the society with 33 per cent increase in the number of houses to be built under Pradhan Mantri Awas Yojana. Moreover, the steps were taken to push affordable housing by making home loans attractive. Going forward to build new homes as well as to renovate or expand existing homes, home loans up to Rs. 9 lakh will get 4 per cent interest exemption, and loans up to Rs. 12 lakh shall get 3 per cent exemption in interest rates. In rural areas, home loans up to Rs. 2 lakh will get 3 per cent interest exemption.

In a surprise move, after PM Modi urged banks to reduce the lending rates, many PSU banks including State Bank of India, PNB, Union Bank and IDBI reduced their marginal cost of funds based lending rate (MCLR) by up to 90 basis points. This may compel other leading private sector banks as well as NBFCs to follow the trend to remain competitive in the home loan market. All in all, the move will bring benefits to the end users and in turn will lift the demand for the affordable segment. However, decrease in lending rate will automatically reduce the interest rate payable on deposits, especially in the current scenario when banks have received more than anticipated cash. Therefore, in a move to benefit senior citizens, the government has ensured a fixed 8 per cent interest rate payable on deposits of up to Rs. 7.5 lakh for 10 years.

Other strategic initiatives were announced for the benefit of small and medium term enterprises, keeping in the mind that Micro Small and Medium Enterprises (MSME) contribute significantly towards the GDP as well as create employment opportunities for the youth of the country. The credit guarantee of MSMEs set to be doubled to Rs. 2 crores will also cover loans from NBFCs along with banks and the latter has been asked to raise the credit limit for small industry from 20 per cent to 25 per cent of the turnover.

OUTLOOK FOR 2017

The Indian residential real-estate sector has undergone massive transformation in 2016, especially on the policy front. While it is widely understood that there will be temporary slowdown of residential realty in the first few months of 2017, the measures taken in 2016 including RERA and GST would bring in some uncertainty around the implementation process. The second half of the year is expected to be much better, backed by strong fundamentals and positive sentiments.

There are several factors that are likely to impact the sentiments-driven residential real estate in 2017. The year may shed the dark clouds despite the temporary slowdown. The possible reasons behind it would be huge government spending on schemes such as Pradhan Mantri Awas Yojana (PMAY), Smart Cities Mission and other infrastructure initiatives.

The year brings in its wake implementation of RERA across states. While it may restrain supply of fresh launches for a few months, this is surely going to consolidate the sector. Stronger developers will become stronger, unorganized brokers would need to look out for other means of livelihood.

The impact of demonetisation is expected to fade as we move in the Q-2 (April-June) of 2017. The excess cash flows and likely reduction in liability of RBI and tax inflow on account of income declaration scheme is expected to provide ammunition to the government to announce measures to boost Investment and hence demand for housing.

In 2017, buyers will have more protection. There is reason to believe that the consumers will reinstate their faith in the market as developers will focus towards being more transparent. This will also encourage fence-sitters to enter the market and consider a purchase. So, investors who want to take a long-term bet on the Indian real estate would consider it the right time to invest in residential real estate.

The implementation of GST will simplify indirect taxation in the sector and bring more transparency, increase buyer's confidence, reduce compliance cost to the developers and enhance smooth cash flows in the real estate value chain.

After facing uncertainty for the last two months, prime minister Narendra Modi's speech on the last day of 2016, after the end of 50 days' period of demonetisation is likely to bring in some hope for residential buyers. The sops in the form of schemes for affordable housing, exemption on interest for home loans for economically weaker sections and government's major decision to ensure homes for the economically weaker sections of the society with 33 per cent increase in the number of houses to be built under PMAY hint at a much lower interest regime which will power the housing demand.

The commercial space absorption is expected to be robust in 2017 and we might see REIT listing – creating an instrument for providing much needed liquidity in the sector. This will lead to more institutional and FDI inflows into India.

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