

INDIAN REALTY FINANCE

Issue 1 - October 2008

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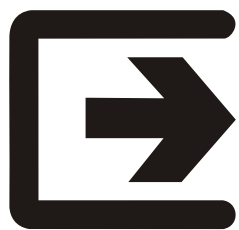
**AN INTERVIEW WITH
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An interview with Mr. A.P. Kurain,
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INFRASTRUCTURE MUTUAL FUNDS: INDIA'S LEAP INTO THE FUTURE



THE MEANDERING PATH: INVESTMENT REGIME FOR INDIAN REAL ESTATE SECTOR

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ABSTRACT

The pull factors embedded in the booming economy of India seem to offer great succour to the global investor scathed by the downturn in the economies of the western world, especially the sub-prime crisis in the US. Just as water seeks its own level, global investment too, is gushing into real estate in India, its meandering path is revealed in detail in the following write-up. The various routes permissible within the Indian legal framework and the sluice gates that have been set up to channelise the barrage of foreign investments, flowing into the real estate sector in India, have been exposed threadbare. An exit after securing good returns over a period of time, through the labyrinths of tax structure, is the dream target of every global investor parking his money in the Indian realty mart.

1. BACKDROP

1.1 Real Estate Sector: The Growth Story

The rapid globalisation of Indian economy has led to an increased demand in real estate sector including residential units, commercial premises, amusement/entertainment parks, and infrastructure. With an annual growth of 9%, the real estate sector in India has been attracting a large number of foreign investors. According to the reports, India is one of the fastest developing economies, with a focus on infrastructure and is poised to report growth between 20% and 30%. This growth story has attracted foreign investors including realty funds for making investments in India.

Indian real estate sector has seen an unprecedented boom in the last few years. This was ignited and fuelled by two main forces. First, the expanding industrial sector has created a surge in demand for office-

buildings and dwellings. The industrial sector grew at the rate of 10.8% in 2006 - 07 out of which a growth of 11.8% was seen by the manufacturing sector. Second, the liberalisation policies of the Government have decreased the need for seeking permission from numerous authorities and licenses before taking up mega construction projects.

Some of the key drivers for such phenomenal growth of the sector are - a change in the FDI Policy, high return on investments, enactment of SEZ Policy, booming service sector, rapid urbanisation, rapidly growing organised retail sector, proactive development measures of the Indian Government, easing mortgage lending regulations, formulating model concession agreements for road projects, fiscal incentives for infrastructure development in road, railways, airports, seaports, power and water, higher budgetary allocations et al.



Investments in Indian Real Estate projects have caught the fancy of some of the biggest names including Goldman Sachs, Morgan Stanley, J P Morgan, GrandVision, Citigroup, Emmar and so on.

Despite the recent real estate rise in India seen over the last 3 years, it is said that it is yet in a nascent stage and its scope is simply unlimited. An unhindered growth in the next two decades appears certain.

1.2 Regulatory Snapshot

Initially, real estate sector was open only for Non Resident Indians and Overseas Corporate Bodies for limited activities¹. In May 2001, the sector was opened up for foreign investors, whereby 100% foreign investment was permitted with prior Government approval for development of integrated townships including housing, commercial premises, hotels, city and urban level infrastructure etc. Further, Foreign Direct Investment in hotel and tourism sector was brought under the “automatic route” (AR)².

The real momentum began since Press Note 2 was issued in March 2005³, when the investment in real estate sector was allowed under the AR. Albeit, the investment is allowed in Indian companies engaged in the development of real estate and not in trading in real estate.

1.3 Landmark Investments

Today, the entire world has focussed its attention on the Indian capital market. Real estate and infrastructure are some of the sectors that have attracted foreign investors to India.

Some of the major investments made in this sector in the past 3 years are tabled below. They manifest the success story of the sector.

2. REGULATORY FRAMEWORK

2.1 Investment Framework

Investment in India is regulated by the Foreign Investment Promotion Board (FIPB) through FDI Policy and the Reserve Bank of India in terms of various regulations issued by the RBI under Foreign Exchange Management Act, 1999.

Foreign Direct Investment in India is covered under two routes:

- ➔ Automatic Route and
- ➔ Prior Approval Route.

In terms of recent significant liberalisation, a majority of investments are covered under the Automatic Route except for some sectors e.g. insurance, retail etc. which fall under the approval route. Under the AR, investment upto 100% is permitted in Indian companies without any prior approval of any regulatory authorities mentioned above. The Indian company has to intimate the RBI once an investment has been made and

Investor
Goldman Sachs
Purpose of Investment
Real estate and infrastructure sector
Investment
Over US\$ 1 billion planned
Investor
Morgan Stanley
Purpose of Investment
To fund development pipeline of 15 million sq.ft. in Mumbai
Investment
➔ Recently closed a deal worth about US\$ 150 million
➔ Invested US\$ 65 million
Investor
JP Morgan
Purpose of Investment
Real estate - residential project in Chennai
Investment
Invested over US\$ 300 million
Investor
Vision Express, part of Europe's largest optical retail group GrandVision
Purpose of Investment
Planning to set up distribution centres in India
Investment
Not Disclosed
Investor
Citigroup property investors
Purpose of Investment
Real estate project in Pune
Investment
US\$ 125 million

¹ Schedule 1 to FEMA Notification No. FEMA 20/2000-RB, dated 3 March 2000 as amended from time to time.

² Press Note No. 4 (2001 Series), dated 21 May 2001 issued by the Government of India, Ministry of Commerce & Industry

³ Press Note 2 of 2005 Series, dated 10 March 2005 issued by the Government of India, Ministry of Commerce & Industry



IN FOCUS: **INFRASTRUCTURE MUTUAL FUNDS**

IREF Research

ABSTRACT

With the opening up of Indian economy and the development of the financial markets, the popularity of Mutual Funds increased manifold. India has felt the need of infrastructure development acutely, so that it can expand economically at a sound pace of 8% - 9% GDP. Mutual Fund managers have found a new investment avenue in the infrastructure development sector, cutting across segments such as power, oil and gas, roads, transport, telecom etc. Various asset management companies are launching infrastructure funds and all are holding out the promise of making the investor ride the crest of the infra development wave and reaping rich dividends.

INDIA'S LEAP INTO THE FUTURE WITH INFRASTRUCTURE MUTUAL FUNDS

“

Infrastructure is our biggest opportunity. In the next 10 years, we must invest at least US\$ 150 billion to modernise and to expand India's infrastructure... we need a new experimentation with public-private participation because the public sector may have a role, but by itself it cannot meet all the requirements. I see an expanding and very profitable role for foreign direct investment in meeting the challenge of modernising infrastructure.”

- Honourable PM, Dr. Manmohan Singh



The above statement made by our Honourable Prime Minister, Dr. Manmohan Singh, at NYSE, September 2004, seems to be a prophecy come true today. Yes, infrastructure is indeed the biggest opportunity in India in 2008, requiring humongous investment. Equally essential is private participation and the inflow of FDI in infrastructure development, its all happening in circa 2008.

Gone are the dismal days of 3% - 4% GDP growth rate, the watershed being 1991, both the liberalisation of economy within the policy framework that has been overhauled to bring the GDP growth rate at 8% - 9%; apart from the pre-requisite of the governmental will to propel the engine of economic development, it is a sound world-class infrastructure which forms the skeletal structure for economic progress of the nation. For a faster consistent economic growth, for India to emerge as the leading economic power, infrastructure is an imperative. Those in power who provide infrastructure are likely to attain lasting political support.

Infrastructure needs to be created in terms of "human capital" with better education and health care, one may label it as "social infrastructure" and the other in conventional terms, "brick and mortar" industries like

roads, ports, airports, water and sewage systems, transportation facilities, telecommunications, power and so on. Collectively, this forms the pedestal for economic growth. The next priority has been to sort out these elements of infrastructure which can be developed immediately and primarily by private capital. Telecommunications, power and airports are obvious examples. Private capital to finance long-term development has bailed out the public sector.

THE STRIVINGS

The Committee of Infrastructure (COI), under the Chairmanship of the Prime Minister was constituted on 31st August, 2004, with the objectives of initiating policies that would ensure time-bound creation of world-class infrastructure delivering services, matching international standards, developing structures that maximise the role of public-private partnership (PPPs) and monitoring progress of key infrastructure projects to ensure that established targets are realised.

The infrastructure deficit perceived by COI is as follows:-

INDIA'S INFRASTRUCTURE DEFICIT

Highways:

65,569 Km of NH (2% of network, 40% of traffic): only 12% Four - lane; 50% Two - lane; and 38% Single - lane

Ports:

Inadequate berths, rail/road connectivity and draft are constraints

Airports:

Inadequate capacity: Runways, aircraft handling capacity, parking space and terminal buildings

Railways:

Old technology; saturated routes: slow average speeds (freight: 22 kmph; passengers: 50kmph); low payload to Tare ratio (2.5)

Power:

11% peaking deficit and 7% energy shortage; high T&D losses; absence of competition and inadequate private investment

FDI in infrastructure investments into India is permitted upto 100% in various sectors viz., Roads & Highways , Ports & Harbours , Electricity, Generator, Transmission & Distribution, Mass Rapid Transport System, Industrial Parks/SEZs, Integrated Townships over 100 acres. Hotels & Tourism, CNG Projects, Greenfield Airport, Ventures etc.

The Government of India has also taken various policy initiatives to strengthen the Indian Infrastructure sector. This include provision of Viability Gap Funding (VGF), setting up of an Infrastructure SPV.

IIFCL

IIFCL is a Government-owned company and was established in January 2006 with the objective of providing long-term finance to viable infrastructure projects. Besides providing long-term debt to various infrastructure projects, IIFCL also provides refinancing to banks and other financial institutions for their loan to infrastructure projects. Recently, in a bid to give a further boost to infrastructure financing, the Finance Ministry has now allowed India Infrastructure Finance Company Ltd (IIFCL) to receive certain interest payments, without them being subjected to tax deduction at source (TDS). IIFCL need not also go through the procedure of claiming refunds, if any, from the tax department from the TDS deducted in the