Challenging the tides: Indian real estate
Analysis of the new development concepts and investment trends changing the course of Indian real estate

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Foreword

The real estate sector in India has witnessed a paradigm shift in the last decade. From being a largely unorganised sector in the past, the sector is steadily transforming over the years to become a more structured one. Apart from other factors, much of this transformation can be attributed to investments by institutional private equity and strategic investors in the sector.

The Private Equity (PE) funding channel within the real estate sector gained significance post the global financial crisis, as cash flows from other sources of finance (such as capital markets, banks and private lending) moderated. However, several issues on the macroeconomic front, including muted growth, rising inflation and falling currency, coupled with a muted real estate sector, led to modest investments by private equity funds between 2009 and 2013.1 In the year 2014-15, India emerged as one of the very few economies with a favourable market outlook. Political stability and focussed efforts by the government to strengthen economic revival and growth sparked renewed interest by the global investor community towards India. Further, policy announcements and reforms to revive the real estate space, particularly, relaxing the FDI norms, tabling of the Real Estate (Regulation and Development) Bill and establishment of Real Estate Investment Trusts (REITs) helped in generating a positive outlook for the real estate investment market.

Such positive sentiment fostered several private equity and strategic investors, including pension and sovereign funds, to commit significant funds to the Indian real estate sector in the past 12 to 18 months. Investors committed or invested around USD4134 million across 78 deals in the past 12 months.2 The average deal size increased significantly and renewed interest was witnessed in entity-level/joint venture equity deals (as opposed to project level structured debt deals) implying increasing risk appetite and a sense of faith by marquee investors in the long-term growth prospects of the real estate sector. However, it may be noted that such equity deals were restricted only to investments in few leading developer entities with sound fundamentals, an established track record of execution, and have implemented the best corporate governance practices, with focus on investor interests and shareholder value.3

Effectuating the government’s vision of ‘Housing for All by 2022’ and a speedy revival of the real estate sector would require a further substantial inflow of private equity capital in the coming years. Additionally, such capital deployment may need to be in the nature of patient equity capital to fund land acquisitions and initial stages of the project(s).

Such significant quantum and renewed nature of funding from global investors necessitates adoption of strong corporate governance practices by developers, and initiation of new policy measures by the government in terms of streamlining project approval mechanisms and increasing transparency and accountability in real estate transactions (including a speedy enactment of the Real Estate (Regulation and Development) Bill).

I am confident that The Real Estate & Infrastructure Investors’ Summit 2015 shall provide a meaningful platform to deliberate on the concerns faced by the global investor fraternity for investments in the real estate sector, evaluate the reforms already initiated by the government and assess the need for further reforms to increase the attractiveness of the sector for these investors. This study, an effort by KPMG in India and NAREDCO, attempts to analyse the current state of the real estate sector, highlights key reforms undertaken by the government to augment the sector and explains key investment themes employed by the investor community in the current market. I would like to thank the stakeholders involved in preparing this study and hope that you would find this report insightful.

Neeraj Bansal,
Partner and India Head of Building,
Construction & Real Estate Sector
KPMG in India

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India has emerged as one of the few world economies with a healthy economic outlook, amidst the mood of cynicism and uncertainties that have occupied a number of advanced and emerging economies over the past couple of years.

The gradual recovery of the economy and growth rate has been supported by improving macro-economic fundamentals such as:

- **Declining fiscal deficit**: The fiscal deficit narrowed from the peak of 5.9 per cent of the GDP in FY2012 to 4.1 per cent in FY2015.

- **Reducing inflation**: The Consumer Price Index (CPI) in India was recorded at 3.66 per cent as of August 2015; a decline of about 4.56 basis points in comparison to the average inflation rate of 8.22 per cent recorded in India between 2012 and 2015. Further, the Wholesale Price Index (WPI) continued to stay in the negative zone and was recorded at -4.95 per cent in August 2015.

- **Narrowing Current Account Deficit (CAD)**: The CAD reduced to 0.2 per cent of GDP (January-March 2015) from 1.6 per cent in the previous quarter.

Overall macro-economic situation and growth prospects are expected to be strong going forward owing to several factors including positive business confidence and reform initiatives by the new government providing a boost to the industrial and investment activity in India. The International Monetary Fund (IMF) projects India to grow at 7.5 per cent in 2015 as against 6.9 per cent in 2014, to become one of the fastest growing major economies in the world.

The above mentioned factors are likely to have a positive compounding effect on the real estate sector in India.
On the investment front, Foreign Direct Investment (FDI) increased by ~24 per cent from USD36 billion in FY2014 to USD45 billion in FY2015. Further, the Foreign Institutional Investors (FIIs) investments in India touched a record high with FIIs having invested USD46 billion in FY2015, which is ~5.3 times the investments made in FY2014 (USD9 billion).
The Indian real estate sector remains in the grip of a downturn owing to slow purchases from homebuyers and low absorption across all asset classes (barring the commercial office and warehousing segments which have witnessed considerable traction in recent times), leaving developers struggling with unsold inventory. However, several reforms by the Government of India (GoI) have been initiated or are underway to encourage the development and growth in the sector. Some of them include easing the FDI rules, REIT establishment, Smart City projects, focus on affordable housing and Housing for all by 2022. All of these reforms and policy announcements along with favourable economic growth prospects are expected to provide an impetus for the speedy revival of the sector. The following illustration outlines the journey which the real estate sector has witnessed since CY2000.

The real estate canvas: optimistic outlook driven by dynamic market potential
Trends in the Indian real estate sector: 2000 onwards

- Low interest rates, easy availability of funds mostly through bank and private lending.
- National Capital Region (NCR), Mumbai, Bengaluru along with selected Tier II cities emerge as key real estate investment hubs in the country.

2000-2004

- FDI under automatic route in real estate attracting offshore PE/RE Funds.
- Realty index was launched. Corporate developers accessed capital markets for funds.
- Real estate market witnesses strong growth across all asset classes.

Global economic downturn

2005-2007

Global economic downturn

2008-2009 (mid)

- Revival in growth of residential market while other asset classes lag.
- As rentals bottom out, occupiers revisit expansion plans.
- Cautious investments by PE funds towards last-mile funding for projects

2009 (mid)-2010

- Stagnating transaction volumes in 2011-12 in the residential sector followed by sluggish demand in 2013-14 leading to high unsold inventories.
- Steady corporate expansion led by domestic and few international occupiers.
- PE investors continue to follow a cautious approach (focus on structured debt deals)

2011-2014 (mid)

- Economic slowdown and tight liquidity adversely affecting the RE sector.
- Subdued demand and investment sentiments.
- Halt in expansion plans by key corporates and financial institutions.
- Stalled PE investments.

2014 (mid) onwards

- Positive government reforms (such as Housing for All scheme, REIT, Smart Cities, Real Estate Regulation and Development bill) introduced to revive the industry.
- Increased investments by PE global investors and selective penetration by sovereign & pension funds implying increased confidence in the long-term growth prospects of the sector.

Source: KPMG in India’s analysis.
Residential demand has lagged behind supply in major cities across India over the past few years, which has led to high unsold inventories and in turn resulting in the fall of newly launched units. H1 2015 witnessed an overall substantial fall of 28 per cent in new launches across the major cities in India (14 cities) in comparison to H2 2014.

Bengaluru, being one the better performing markets, witnessed the highest number of new launches (15,000 units) followed by Ahmedabad (13,000 units) and Pune (12,000 units).

1.1. Residential real estate market
1.1.1. New launches

New launches across major Indian cities


- Residential demand has lagged behind supply in major cities across India over the past few years, which has led to high unsold inventories and in turn resulting in the fall of newly launched units. H1 2015 witnessed an overall substantial fall of 28 per cent in new launches across the major cities in India (14 cities) in comparison to H2 2014.

- Bengaluru, being one the better performing markets, witnessed the highest number of new launches (15,000 units) followed by Ahmedabad (13,000 units) and Pune (12,000 units).
1.1.2 Absorption
Absorption across major Indian cities

- Residential sales have continued to fall across major cities in India, except for a few cities such as Kolkata, Pune, Mumbai, Thane and Gurgaon which witnessed increasing absorption in H1 2015 as compared to H2 2014.
- Nevertheless, H1 2015 saw overall absorption exceeding the new supply for the first time in three years across the major cities. Going forward, residential demand could overshoot supply if new launches continue to take place at a diminishing rate, thereby indicating a price rise in the short to medium-term.

1.1.3 Unsold inventory
Unsold inventory in major Indian cities

- The NCR (Faridabad, Noida, Greater Noida, Ghaziabad and Gurgaon) held the highest unsold inventory of 208,000 units followed by the MMR (Mumbai, Thane and Navi Mumbai) with an unsold inventory of 206,000 units as on H1 2015.
- Majority of the cities witnessed a decrease in unsold inventory in H1 2015 barring Ghaziabad, Faridabad and Ahmedabad, which witnessed a marginal increase in inventory.
1.1.4 Inventory overhang

Inventory overhang in major Indian cities

- The inventory overhang in major Indian cities is in the range of 20 to 81 months, with an average of 42 months as of H1 2015, owing to low sales velocity. Pune has the lowest overhang with 20 months, followed by Bengaluru at 25 months, and Thane at 29 months in the same time period.

- NCR has the highest inventory overhang when compared to other cities in India, with Faridabad witnessing an inventory overhang of 81 months followed by Greater Noida at 69 months and Ghaziabad at 62 months, reflecting that it would take ~five to six years for the current inventory to get fully absorbed.

1.2. Commercial office market

- The Indian commercial office segment has witnessed considerable traction over the last two years owing to the growth in IT/Information Technology Enabled Services (ITeS) and Banking and Financial Services and Insurance (BFSI) sectors in the country.

- The Indian IT/ITeS sector is poised to further strengthen in the coming years owing to the improving macro-economic dynamics and corporate expansion.

1.2.1 New launches

New launches across major Indian cities

- New launches for the period H1 2015 were reported at 4.52 million square feet, a 57 per cent decrease as compared to 10.54 million square feet (mn sq.ft.) for the period H1 2014.

- Bengaluru, NCR (barring Faridabad) and Pune have accounted for about 84 per cent of the newly launched space in the country since H1 2014.

1.2.2 Absorption

Absorption across major Indian cities

- Bengaluru, NCR (barring Faridabad) and Pune have accounted for about 84 per cent of the newly launched space in the country since H1 2014.

Source: PropEquity database as of June 2015

• The commercial office market in the major Indian cities have witnessed a surge in absorption levels since last year. The total absorbed space between H1 2014 to H1 2015 amounted to 58.81 mn sq.ft., significantly surpassing the new launches of about 29.34 mn sq.ft. for the same period across 14 major cities.

• Bengaluru market witnessed the maximum absorption of 3.91 mn sq.ft. in H1 2015 (accounting for a 25 per cent share across these 14 Indian cities) followed by Mumbai, Gurgaon and Pune with an absorption of 2.46 mn sq.ft., 2.28 mn sq.ft. and 2.05 mn sq.ft. respectively.

1.2.3 Rental trends

Rental values across major Indian cities


• The office market in the major cities has witnessed limited rental appreciation in the past year which seems to be driving many developers to opt for alternative development solutions such as built-to-suit office buildings.

• Several companies are now migrating to offices in the suburbs, possibly owing to reasons such as cheaper rents and lessening of commute time between office and home leading to a pressure on rentals in prominent business districts of cities.
1.2.4 Vacancy

Vacancy levels across major Indian cities

- Bengaluru has the lowest vacancy levels of 8 per cent as of H1 2015 followed by Pune, Hyderabad and Mumbai with vacancy levels of 9 per cent, 10 per cent and 14 per cent respectively.
- The major cities considered above have exhibited decreasing vacancy levels as of H1 2015 when compared to H2 2014, barring Noida, Greater Noida and Chennai.

1.3. Commercial retail market

1.3.1 New launches

New launches across major Indian cities

- New launches in the 14 major cities were recorded at 2.5 million sq. ft. in 2014. Majority of the launches were witnessed in the cities of Noida and Greater Noida, which accounted for 57 per cent of the total new launches in the country.
- Negligible launches were witnessed in H1 2015 across the major cities in India.
1.3.2 Absorption

Absorption rates across major cities

- 2014 witnessed healthy absorption across markets, with Noida, Hyderabad and Pune leading the way.
- However, absorption levels dropped in H1 2015 across major cities in India as compared to H2 2014 barring Hyderabad, Ahmedabad, Navi Mumbai, Chennai and Faridabad which witnessed increasing absorption levels.
- Pune witnessed the highest absorption of quality commercial retail space in the first half of 2015 owing to various small to medium sized transaction closures in apparel, accessories and food and beverage brands.

1.3.2 Rental trends

- High street markets such as Connaught place (Delhi), Linking Road (Mumbai), Kammanahalli (Bangalore) and Koregaon Park (Pune), and mall clusters in prime retail markets like South Delhi, East Bangalore, Central Mumbai and the eastern suburbs of Mumbai witnessed an increase in rentals, while other suburban markets witnessed stable rental values.
- The advent of e-tailing in the recent years has not affected the rental values in high streets and mall clusters at prime locations in major cities of India.\(^3\)

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\(^3\) Demand for prime retail space in first half of 2015 comes from healthy mix of domestic and global brands, CBRE India publication, 23 July 2015.
1.4. Special Economic Zones (SEZ) and warehousing

1.4.1. Industrial

SEZs contribute almost 25 per cent to the country’s total exports. Total exports from SEZs stood at USD58.10 billion during April-December 2014, declining 7.61 per cent from the corresponding period in 2013. In 2013-14, exports from SEZs stood at USD 82.35 billion.

<table>
<thead>
<tr>
<th>Years</th>
<th>Exports</th>
<th>Growth over previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value in Rs. Crores</td>
<td>USD billion</td>
</tr>
<tr>
<td>2010-2011</td>
<td>3,15,868</td>
<td>70.19</td>
</tr>
<tr>
<td>2011-2012</td>
<td>3,64,748</td>
<td>81</td>
</tr>
<tr>
<td>2012-2013</td>
<td>4,76,159</td>
<td>88.18</td>
</tr>
<tr>
<td>2013-2014</td>
<td>494,077</td>
<td>82.35</td>
</tr>
</tbody>
</table>


In order to promote large scale industrial activities, the government introduced the SEZ Act in 2006. But after the Minimum Alternative Tax (MAT) and Dividend Distribution Tax (DDT) incentives were withdrawn in 2011, SEZs have not been able to garner investments from new units. The table below shows that the number of SEZs has declined sharply, and more than 15,000 hectares of the SEZ land has already been de-notified since 2012. Over 57 per cent of the processing area in notified SEZs is unoccupied.

<table>
<thead>
<tr>
<th>Date Approval (No.)</th>
<th>Notified (No.)</th>
<th>In-principal approval (No.)</th>
<th>Operation (No.)</th>
<th>Land (Hectare)</th>
<th>Units (No.)</th>
<th>Investment (In Crore)</th>
<th>Employment (No.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>As on July, 2012</td>
<td>589</td>
<td>389</td>
<td>48</td>
<td>153</td>
<td>71,502</td>
<td>3,400</td>
<td>844,916</td>
</tr>
<tr>
<td>As on Jan 2015</td>
<td>491</td>
<td>352</td>
<td>32</td>
<td>196</td>
<td>56,067</td>
<td>3,864</td>
<td>1,350,071</td>
</tr>
</tbody>
</table>


Key reasons for de-notification of these SEZs were:

1. Applicability of MAT and DDT
2. Absence of complimentary infrastructure
3. Problems with land acquisition
4. Economic meltdown
5. Non-availability of skilled labour force

Government steps/initiatives to improve the SEZ scenario in India:

- The government is likely to forego revenue to the tune of USD416 million by way of incentives given under Merchandise Exports from the India Scheme (MEIS) and Services Exports from India scheme (SEIS) to units located inside Special Economic Zones (SEZs) under the new Foreign Trade Policy (FTP) 2015-2020. Under the two new schemes: MEIS and SEIS, – exporters will be allowed rewards for export of goods given as a percentage of realised free-on-board (FOB) value. The rate of these rewards, given in the form of duty scripts, will be 2-5 per cent. Similarly, under the Served From India Scheme (SFIS), the rate of rewards will be 3-5 per cent.

- Reduction in minimum land area requirement for setting up SEZs in various categories and dispensation of the same for setting up IT/ITES SEZs.

- Subject to fulfillment of certain conditions, an SEZ unit can opt out of a SEZ by transferring its assets and liabilities to another person by way of transfer of ownership, including the sale of SEZ units.
1.4.2. Warehousing:  
Sector-wise industrial space absorption

- Demand for warehousing space strengthened in H1 2015. The demand was driven majorly by Third Party Logistics (3PLs) and e-commerce companies, with more than 50 per cent demand arising from these two sectors.
- Approximately six mn sq.ft. was taken up by warehousing space occupiers in H1 2015, translating to a growth of nearly 75 per cent over the previous six months.
- Absorption by e-commerce industry was recorded at 1.32 mn sq.ft. in H1 2015 as compared to 0.6 mn sq.ft. for the corresponding period in the previous year (growth of ~2.2 times).

Government initiatives to attract foreign investors/companies to India
- Measures are being taken to persuade foreign companies to set up their manufacturing Hubs in India.
- The ‘Make in India’ initiative is also expected to boost manufacturing in India, with its focus on 25 sectors such as automobiles, chemicals, IT, pharmaceuticals, textiles, ports, aviation, leather, tourism and hospitality, wellness, railways, design manufacturing, renewable energy, mining, biotechnology, and electronics. The initiative aims to make India the next manufacturing hub and in turn create job opportunities, improve quality of products, enhance skill and minimise impact on the environment.


08. India Industrial and Logistics MarketView, H1 2015, CBRE India website, 28 August 2015.
The real estate sector which is beset with muted sentiments since the past few years, is expected to witness a turnaround going forward on the back of several measures and reforms initiated by the government in order to augment the sector. Some of these measures include:

- USD1,333 million allocated to the rural housing scheme under National Housing Board (NHB).¹
- USD8,000 million allocated for the development of 100 new Smart Cities in the country, over the next five years.²
- USD83.3 million allocated towards development of 12 heritage cities in the country³.
- USD667 million allocated for low-cost housing⁴ and USD3,735 million for urban housing⁴.
- Slum development to be treated as Corporate Social Responsibility (CSR) activity; large companies meeting certain financial criteria should spend 2 per cent of their average net profit of the last three years on CSR activities⁶.
- Introduction of Real Estate Investment Trusts (REITs). SEBI has since issued guidelines in this regard⁶.
- Increase in income tax deduction limit on interest paid and repayment of principal of home loans⁵.
- GoI has also implemented interest subvention schemes like 1 per cent interest subsidy scheme, Interest Subsidy Scheme for Housing the Urban Poor (ISHUP) and Pradhan Mantri Awas Yojana (PMAY), etc⁷.

Each of these measures/reforms introduced by the government have been categorised into four key emerging trends detailed here under.

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². At present the list is confirmed for 98 cities. One city from Jammu & Kashmir and one from Uttar Pradesh are yet to be finalised.
⁵. General Circular No. 21/2014, Ministry of Corporate Affairs, 18 June 2014.
2.1. Affordable housing

With the urban population expected to reach ~81 crore by 2050⁸, India is on the verge of large scale urbanisation over the next few decades. The government has proposed an initiative ‘Housing for all by 2022’ which entails a development of ~11 crore housing units, including closing the current gap of ~6 crore units in urban and rural areas. A projected investment of more than USD2 trillion or ~USD250-260 billion annual investment is required to achieve the proposed mission by 2022⁹. The mission on low cost affordable housing is proposed to be anchored by National Housing Bank (NHB) and a sum of USD667 million has been earmarked with a view to increase the flow of cheaper credit for affordable housing to the urban poor/Economically Weaker Section (EWS)/Low Income Group (LIG) segment¹².

The government has identified 305 cities and towns across the states of Madhya Pradesh, Odisha, Rajasthan, Chhattisgarh, Gujarat, Telangana, Jammu and Kashmir, Kerala and Jharkhand, among others, for constructing homes for the urban poor under this scheme¹³.

The following table illustrates the current housing shortage and the required housing units by 2022:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Urban (Crore units)</th>
<th>Rural (Crore units)</th>
<th>Total (Crore Units)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Housing Shortage</td>
<td>1.9</td>
<td>4.0</td>
<td>5.9</td>
</tr>
<tr>
<td>Required Housing Units by 2022</td>
<td>2.6 – 2.9</td>
<td>2.3 – 2.5</td>
<td>4.9 – 5.4</td>
</tr>
<tr>
<td>Total Housing Need</td>
<td>4.4 - 4.8</td>
<td>6.3 - 6.5</td>
<td>10.7 - 11.3</td>
</tr>
</tbody>
</table>


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⁸ World Urbanization Prospects: The 2014 Revision, United Nations, Department of Economic and Social Affairs, Population Division (2014); KPMG in India’s analysis.
⁹ Decoding Housing for all 2022 report, KPMG in India, 2014.
¹₀ Affordable homes offer USD 11.8 billion opportunity for builders, Business Standard website, 24 August 2015.
¹³ 305 cities and towns identified for building houses for urban poor under Housing for All scheme, Press Information Bureau, 30 August 2015.
Shortage of urban housing is prominent across the Economically Weaker Sections (EWS): 39.44 per cent and Low Income Groups (LIG): 56.18 per cent which together constitute ~96 per cent of the total housing shortage, presenting an opportunity for affordable housing across India.

However, amidst the prospective opportunity which the affordable housing segment presents, some of the challenges it includes are:

- **Scarcity of land:** Non-availability of land within city limits along with rising land and construction costs, making affordable housing projects unviable.
- **Lack of adequate policy framework:** Low focus on housing for EWS and LIG segment from the developer fraternity owing to lack of effective policy framework.
- **Development norms:** Stringent development norms seem to have led to sub-optimal utilisation of land, in-turn raising the per unit value.
- **Approval processes:** The lengthy and complex approval process leads to a high gestation period which eventually results in project cost escalation by 20-30 per cent.
- **Unfavourable taxation policy:** With several taxes such as stamp duty, Value Added Tax (VAT), etc. accounting for about 30-35 per cent of the total housing cost, in turn impacting the final sale price of the unit.
- **Funding:** The lack of funding sources at lower coupon rates for developers has resulted in an increase in housing cost. This coupled with limited access to credit by the EWS/LIG segment led to a reduction in housing affordability.

- **Cost overrun:** Due to lack of advanced technology and skilled manpower, the overall project economics is not achieved. Many of the on-going affordable housing projects are still adopting conventional construction techniques.

With the growing gap between demand and supply for housing, the affordable housing segment poses a business opportunity worth USD11.8 billion for developers across seven major cities (Delhi-NCR, Mumbai (MMR), Bengaluru, Chennai, Hyderabad, Kolkata and Pune) of India. The success of these developments would lie in the scale of operations, unlike that of the Middle Income Group (MIG) and High Income Group (HIG) which could nurture higher margins but have witnessed lower absorption in the past. In order to bridge the current gap in the segment, the government should adopt a renewed approach towards policy measures to promote affordable housing, along with strengthening of private participation in this segment.

**Our recommendations**

Following are our recommendations to help improve/boost the supply of affordable housing in India:

1. **Creating a conducive and less regulated environment**
   - Streamline approvals required for projects and create a single window clearance
   - Increase FSI and mandate zones for low-income housing
   - Provide government owned land at subsidised rate to developers

2. **Financial assistance:**
   - Provide tax deductions or viability gap funding for affordable housing projects
   - Interest rate subsidies to low-income customers
   - Develop new avenues for project financing for affordable housing including that from insurance and pension funds
   - Provide direct tax incentives to customers (e.g. waiver/lowering of stamp duties, service tax)
   - Increase availability of low cost debt to housing finance companies.

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15. Decoding Housing for all 2022 report, KPMG in India, 2014.


17. Affordable homes offer USD 11.8-bn opportunity for builders, Business Standard website, 24 August 2015.
2.2. Heritage and pilgrimage Cities

The government proposes to develop heritage cities in order to explore the full potential that lies within the diverse historic, cultural and natural resources in India. It has announced the Heritage City Development and Augmentation Yojana (HRIDAY) in order to preserve and rejuvenate the rich cultural character of initially 12 cities in India with a total outlay of USD83.3 million for this project, completely funded by the central government. The scheme would be implemented for cities of Ajmer, Amritsar, Amravati, Badami, Dwarka, Gaya, Warangal, Puri, Kanchipuram, Mathura, Varanasi and Vellankanni. The scheme will broadly focus on four core areas i.e. physical infrastructure, institutional infrastructure, economic infrastructure and social infrastructure for reviving and revitalising the Heritage City. The duration of the scheme will be four years starting from December 2014. The scheme would be merged along with the tourism ministry’s Pilgrimage Rejuvenation and Spiritual Augmentation Drive (PRASAD) scheme which has an outlay of USD16.6 million (for the current year) in order to augment infrastructure at pilgrim sites across the country.

These schemes are inclined towards facilitating inclusive heritage linked urban development by enhancing the infrastructure through various avenues including private participation. Inclusive urban planning targeting infrastructural development, could eventually aid tourism and benefit the overall hospitality sector in the region. This initiative would help to promote tourist in these historic and pilgrimage locations, in turn increasing the spending in these locations, fueling trade and commerce and creating an opportunity for real estate.

Cities under HRIDAY and PRASAD schemes

Source: KPMG in India Analysis, 2015.

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2.3. Smart cities

Smart Cities is a Government of India’s initiative which aims to cater to the growing needs of the population in the country and to ease the pressure on the existing metropolitan cities. The smart city initiative is planned with an investment of USD8,000 million over a period of five years and intends to drive development of 100 cities, drawing the existing focus from major metropolitan cities to a number of untapped cities. These smart cities are expected to cover ~35 per cent of the urban area and benefit ~13 crore population by improving the infrastructure and service delivery through application of better technology and e-governance. Out of these 100 smart cities, 24 are capital cities, another 24 are business and industry centres, 18 are cultural and tourist influenced areas, five are port cities and three are education and health care hubs.

A smart city is typically a self-sustaining urban ecosystem with advanced institutional, physical, social and economic infrastructure. These cities are envisaged to provide core infrastructure and give a decent quality of life to its citizens, and a clean and sustainable environment along with application of smart solutions. The concept is built around collaborating Information and Communication Technology (ICT) services along with urban planning and real estate solutions within the city, in order to create sustainable developments with enhanced living quotient. Key features of smart cities include:

- Mixed use developments and walkable communities
- Preservation and development of open spaces
- Transit oriented development
- Smart governance by making governance citizen-friendly and cost effective
- Utilising ICT services to apply smart solutions to infrastructure and services in area-based development.

The initiative is expected to have induced implications on the real estate sector. Smart city establishment would contribute towards high-quality infrastructure in the selected cities which would further drive several industrial and technological establishments in these identified regions. These industrial and business establishments would lead to higher levels of employment opportunities which could drive the ancillary demand for residential, retail and commercial asset classes in these cities.

The below diagram illustrates the key features of a Smart City with basic infrastructure to give a decent quality of life, a clean and sustainable environment through application of some smart solutions:

Source: KPMG in India analysis, 2015

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23. Smart Cities: Plan to cover 35% of urban India will benefit 13 crore people, Indian Express, 22 July 2015.
24. Centre unveils list of 98 smart cities; UP TN strike it rich, The Hindu, 28 August 2015.
Smart cities are expected to offer larger scope for price appreciation over a long-term horizon since they would provide upgraded technological residential and commercial spaces that are well integrated with the urban fabric of the city. The benefits offered by such development in the medium and long-term is likely to shift the focus of enterprises from the already existing commercial and industrial centres to these new urban centres on account of availability of value added services, ultimately influencing the real estate market in these areas. Developers and investors would benefit as end users could be willing to pay a premium towards the quality infrastructure and services provided for the developments offered. Few of the government smart city projects that have already initiated work are Gujarat International Finance Tec-City (GIFT) in Ahmedabad, Naya Raipur in Chhattisgarh; they are exhibiting significant interests from developers, investors and end users.

To provide a clear perspective on smart cities and their functioning, KPMG conducted a secondary research based study of some of the proposed/upcoming smart cities with the following objectives:

- Understand the concepts used to make the city work in an efficient way.
- Analyse the infrastructure and facilities offered.

The benchmarking of these cities aims to identify the best practices adopted by leading domestic smart cities at present and understand their importance and applicability. For the purpose of the benchmarking study and comparative analysis, smart cities in two locations have been studied: Ghaziabad in Uttar Pradesh and Dombivli in Maharashtra. The following cases have been selected based on factors such as scale of operation and effective concepts applied:

- Wave City, India
- Palava City, India

## Case study: Wave City and Palava City

Private real estate developers are shifting focus by carrying out large scale development such as Wave City and Palava City on the principles of smart cities to counter the turbulent and challenging real estate environment.

### Concepts implemented in Wave City in Ghaziabad, Uttar Pradesh

- Ambient light detectors utilised for street lights, advanced meters to monitor usage and performance, smart grids.

### Concepts implemented in Palava City in Dombivli, Maharashtra

- 10 per cent of the energy demand met by solar power.
- Utilisation of smart pre-paid meters to monitor usage.

### Advanced technology for energy needs

- Gathering real time traffic data through intelligent traffic systems.
- Tracking buses through monitoring devices and advanced guidance for parking systems with space availability updates.
- Real time data integrated with the central command centre and available with citizens.

### Advanced traffic management

- Efficient solid waste management system. Smart manholes to track sewer flow levels.
- Installation of smart meters towards water supply management to detect leakage through remote monitoring.

### Innovative infrastructure

- Proposal to reuse 80 per cent of all household and city waste.
- Reuse of waste water for landscaping, flushing activities.
- Efficient rain water harvesting practices.

### Smart governance

- Efficient emergency services and advanced security systems such as hotlines, analytic-enabled CCTVs, electronic access cards, vehicle identification monitors.
- Utilisation of smart cards which would work as access card taking care of security concerns.

Source: Stay Smart, Money Today, October 2014 and KPMG in India’s analysis.
The domestic case studies showcase are in the early stages of their implementation, but present leading practices that can be utilised for the development of smart cities.

As witnessed in the case study:
• Extensive provision and use of technology comes with initial challenges such as outlay of heavy capital investment and long gestation period; however, in the long-term it presented benefits in terms of an integrated environment for citizens with improved life quality.
• Smart cities are expected to offer larger scope for real estate price appreciation over a long-term.

2.4. Real Estate Investment Trusts (REITs)

REITs is an investment vehicle which invests in income-producing completed real estate assets.
The developers in the commercial office space incur huge capital expenditure on project construction which remains locked for several years until the property stabilises and attains sufficient returns to break-even.
REITs would allow the availability of funds to real estate developers against their completed assets by means of sale and help them offload their current assets. It is not only expected to attract long-term financing from domestic sources and enable investments from small scale investors, but could also attract investments from foreign sources.
REITs pose a large opportunity in the Indian real estate market which is backed by a growing economy and more importantly by a large existing Grade-A REITable commercial real estate portfolio. India potentially has about 375 million sq. ft. of Grade-A office space which is valued at USD65-70 billion.

Advantages of REITs to potential stakeholders

• Increasing the revenue for the government
• Funding through REITs could help facilitate other key real estate policy implementation
• Exit opportunity for existing PE players, developers and financial institutions
• Alternate financing mechanism
• REITs would play a great role in attracting large institutional long-term investors such as pension and insurance funds
• Improves liquidity in the real estate sector
• Easy funding mechanism available for mid-tier developers with low credibility in the market
• As real estate is capital intensive, REITs allow investment at lower ticket size thereby available for the masses.
• Transparent investment climate with oversight from professionally trained management
• Easy of entry and exit in the real estate sector

Source: KPMG in India Analysis, 2015
Out of this, 80-100 million sq.ft. is estimated to be eligible for REITs in the coming two to three years and would be valued at USD15-20 billion. The year 2015 and 2016 has a pipeline of 52.6 million sq.ft. and 57.1 million sq.ft. respectively with most of the Grade-A property in India being concentrated in the seven major cities of India (Delhi NCR (includes Gurgaon and Noida), Mumbai, Bengaluru, Chennai, Pune, Kolkata and Hyderabad). Apart from these Grade-A office spaces, there are other commercial assets such as shopping centers, hospitality and industrial warehouses which might come under the purview of REITable space, thereby presenting a potential for increasing the overall stock.

Globally, there are about 500 REITs in 22 countries which have a market capitalisation of USD800 billion. Of the 22 countries, nine are emerging real estate markets. The leading REIT markets are USA, France, United Kingdom, Australia and Japan which account for 84 per cent of the global REIT market share. The last decade has witnessed returns on equity of traded REITs over-performing the returns on leading stock market indexes across the globe. REITs across the world have provided five year returns in the range of 10 per cent to 22 per cent. With the Japanese, Singapore and Hong Kong REITs providing returns of 13.45 per cent, 12.94 per cent and 22.52 per cent respectively, REITs in the emerging Asian markets are expected to perform on similar lines.

**Performance of REITs in key global markets as per S&P Dow Jones at five year and ten year period**

<table>
<thead>
<tr>
<th>Region</th>
<th>5 years</th>
<th>10 years</th>
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<tbody>
<tr>
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<td>9.69%</td>
</tr>
<tr>
<td>Europe</td>
<td></td>
<td></td>
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<tr>
<td>France</td>
<td>11.84%</td>
<td>11.95%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>14.89%</td>
<td>NA</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>13.45%</td>
<td>5.87%</td>
</tr>
<tr>
<td>Singapore</td>
<td>12.94%</td>
<td>11.29%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>22.52%</td>
<td>14.36%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>16.98%</td>
<td>NA</td>
</tr>
<tr>
<td>Australia</td>
<td>10.60%</td>
<td>2.84%</td>
</tr>
</tbody>
</table>

Source: Dow Jones Real Estate Indices, S&P Global Property Indices – Quantitative Analysis Report, Q1 2015

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29. The Investment Characteristics and Benefits of Asian REITs for Retail Investors, APREA, November 2012, FTSE NAREIT.
Apart from easing the developers from their present liquidity crunch, REITs are also expected to help streamline the real estate sector by creating a transparent mechanism for raising finance in the market. It would be governed by SEBI guidelines which would help in maintaining transparency and accountability of REITs.

The availability of large number of assets across the various cities in India and high growth potential within the commercial space amongst global peers would attract takers for REITs in India. However, certain amendments in the taxation and regulatory aspects of REITs in India are required which would further enhance the attractiveness of Indian REITs for global investors.

**Importance of REIT in Commercial Real Estate Development**

![Diagram showing the importance of REIT in commercial real estate development.](source: KPMG in India analysis, 2015)
3.1. FDI in real estate

To make investments attractive in the Indian construction and development sector, the government has eased rules for building townships, housing, built-up infrastructure and construction development projects as these sectors provide employment potential and boost demand for ancillary industries such as steel and cement. The Union Cabinet has approved the proposal of the Department of Industrial Policy and Promotion to relax the norms relating to FDI. These incentives include the following:

- Minimum built-up area has been reduced from the existing 50,000 sq.m. to 20,000 sq.m; a move which would facilitate FDI in smaller projects and ease the expansion of cities with dense development (for instance, Mumbai and central Delhi).
- Minimum capitalisation has been reduced from USD10 million to USD5 million.
- The three-year post-completion lock-in period which was applicable before has been discontinued under normal circumstances, where an investor can now exit on completion of the project or even after the development of trunk infrastructure, such as construction of roads, water supply and drainage.
- Projects with a commitment of at least 30 per cent of the total cost toward low-cost affordable housing are exempted from the requirements relating to minimum built-up area and capitalisation.

3.2. Real Estate Regulation and Development Bills

The Real Estate Regulation and Development Bill was introduced in Rajya Sabha on 14 August 2013 and was subsequently forwarded to the Standing Committee, which submitted its report on 17 February 2014. The Bill has not been discussed in Parliament as yet, and is currently pending in Rajya Sabha. To protect the interest of consumers, to bring transparency in the real estate transactions and to ensure timely execution of projects, the Bill acts as a revolutionary initiative, aiming to ensure systematic growth of the real estate sector.

The Bill contains provisions for:

1. Establishment of a Real Estate Regulatory Authority
2. Registration of real estate projects and registration of real estate agents with the Real Estate Regulatory Authority
3. Functions and duties of promoters and allottees
4. Establishment of a fast track dispute resolution mechanism through adjudication
5. Establishment of a Real Estate Appellate Tribunal; to look into offences, and penalties, etc.
Key benefits of the Real Estate Bill, 2013:

- The Bill is expected to significantly reduce frauds and delays.
- The Bill is also expected to bring about regularity and consistent growth through efficiency, professionalism and standardisation.
- Without adding another stage in the procedure for sanctions, it simplifies and seeks to ensure consumer protection.
- The Bill will help ensure timely completion of projects, and prevent fund diversion.
- The Bill is expected to bring domestic and foreign investment into the sector, thereby contributing to enhanced activity, and increase in GDP growth.
Traditionally, the real estate sector was financed primarily through private lending by HNIs, bank financing and cash-flows through project sales. Post 2005, diverse channels of real estate financing emerged with the opening of foreign direct investments in the real estate sector. Driven by high returns on investments, the sector witnessed capital deployment from private equity funds as well as strategic investors and foreign developers.

Large capital flows in the form of equity was made available within the market at both entity and project levels. In addition, key corporate developers accessed capital markets for funds through stock market listings, in both Indian and overseas stock exchanges. This led to reduced over-dependence on bank debt as a means of financing real estate projects in favour of equity and mezzanine capital structures.

However, by mid 2008, the global economic slowdown had its ripple effect on financing within the real estate sector as well. The financial crisis significantly altered the quantum and source of availability of finance in the sector. Slowdown in sales on account of muted demand diminished financing from internal accruals and substantially increased the dependence of developers on external capital for funding new projects and repaying existing liabilities. Several banks grew vigilant with respect to extending loans for early stage real estate projects which led developers to resort to high cost mezzanine debt and equity from NBFCs and private equity funds for funding project acquisitions.

The NBFC and private equity funding channels have continued to gain importance ever since with bank credit to commercial real estate and housing sectors declining from 10 per cent in FY 2010 to 8.1 per cent in FY 2015.

### Major sources of funding in Indian real estate

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Bank lending</td>
<td>IPO</td>
<td>QIP</td>
<td>Private equity funds</td>
</tr>
<tr>
<td>Private lending</td>
<td>Listing overseas</td>
<td>Private equity funds</td>
<td>NBFC lending</td>
</tr>
<tr>
<td>Internal accruals</td>
<td>Private equity funds</td>
<td>Bank lending</td>
<td>Private lending</td>
</tr>
</tbody>
</table>

Source: KPMG in India analysis, September 2015

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5.1. Private Equity in Real estate (PERE) investment trend: 2008-2011
Post the financial crisis era, the market witnessed an investment freeze and private equity funding declined sharply to USD1,310 million across 55 deals in 2009.\(^1\) Fund raising activity by third party fund managers dropped as well and remained at sluggish levels till 2011.\(^2\) However, the period between 2010 and 2011 was also viewed as an opportunity by domestic funds to infuse capital in prime and selected projects at attractive valuations.

5.2. PERE investment trend: 2012-2014
As the economy showed signs of improvement and yields stabalised, large scale fund raising activity was witnessed between 2012-14. Driven largely by domestic fund managers, 26 India-focused real estate funds achieved closing in 2012-14 and raised USD3,087 million cumulatively\(^1\). Further, a large flock of sovereign and pension funds looking for long-term value enhancement committed funds to the Indian real estate sector late 2013 onwards, either through fund managers or direct agreements with local developers to invest in projects. A total of USD5,273 million was committed or invested by funds across 151 deals between 2012 and 2014\(^1\).

5.3. PERE investment trend: 2015 (as of August 2015)
Supported by large fund raises in the previous year and an influx of pension and sovereign funds, investments in the Indian real estate sector rose sharply in the first eight months of 2015, backing residential assets, leased office assets and mixed use projects. During the aforesaid period, domestic and overseas funds committed or invested around USD3,222 million across 54 deals\(^1\), as compared to USD1,274 million across 35 deals\(^1\) in the same period last year.

Real estate private equity trends

Source: Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015.

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\(^1\) Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015.
\(^2\) KPMG in India’s analysis based on information procured from Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015.
The residential sector attracted the highest transaction volumes during the period with a 77 per cent share in total investment activity (48 per cent in value terms), followed by office assets, which had a 17 per cent share (32 per cent in value terms).³

Residential and leased office spaces have continued to be the preferred asset classes by private equity investors in 2015. Relaxed performance-linked conditions for FDI in the construction development sector, increased focus on affordable housing and attractive returns have sustained high investments in residential assets during the period. While global funds have committed long-term capital to developers, domestic funds continue to follow a cautious approach and actively look for distressed value deals. Liquidity crunches due to sluggish sales has led residential developers to increasingly partner with private equity investors for refinancing and growth.

In the commercial office space, high occupancy levels along with stable rentals and significant scope for capital value appreciation has encouraged global investors towards acquisition of Grade A IT Parks and IT SEZs. Further, introduction of REITs as a viable exit option within the commercial real estate segment has substantially validated the increased investments by global funds.

Real estate private equity deals (January - August 2015)

Source: KPMG in India's analysis based on information procured from Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015

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³ KPMG in India’s analysis based on information procured from Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015
Post the global financial crisis of 2008, the real estate private equity market increasingly witnessed project-level funding and saw many investors refraining from entity-level funding in order to elude risks associated with defaults or failures by the developer group. Equity was the preferred investment instrument to benefit from higher returns while being exposed to market risks. However, subdued market conditions and grim exit prospects seem to have led to substantial capital erosion for investors.

This fall saw the emergence of debt structured deals in the real estate sector that permit investors to fully securitise their investments and provide an assured return with a possible upside on achievement of certain laid-out conditions. The structure gained attention from a plethora of domestic and offshore private equity funds among others and has dominated the private equity real estate market since then.

However, the gradual recovery of the Indian economy fuelled by a decisive political mandate, improved sentiments and optimistic growth outlook has paved way for renewed interest in entity-level/joint-venture equity deals in the real estate sector in the past two years. Despite a subdued market, many global financial institutions and fund managers are confident about the long-term growth prospects of the Indian real estate sector and are actively tying-up with developers with strong fundamentals for development of greenfield projects across the country along with sound corporate governance practice.

Such new-born faith in the sector seems to have shaped the funding scenario with renewed alternative modes or themes of investment prevalent in the current market. We briefly discuss the structures associated with debt deals and each of these alternate modes of investments, hereunder.

**Prevalent investment themes**

- Structured debt in residential projects
- Bulk apartment Units
- Minority equity stake at entity level
- Commercial pre-leased yield assets

Source: KPMG in India analysis, September 2015.
6.1. Structured debt in residential projects

Structured debt transactions have dominated the real estate private equity transaction market since 20101. Strapped for money to either complete projects or refinance existing debt, developers have been availing structured debt from financial institutions and private equity funds. The share of debt structured deals has increased significantly over the years and peaked in 20144. However, in the first eight months of 2015, the share of debt structured deals fell to 57 per cent (32 per cent in terms of value) owing to investments vide alternate funding options. The structure allows private equity funds to restrict lending to projects with good location and saleability, effectively ring fencing project cashflows. Such transactions are typically structured in the form of non-covertible debentures (NCDs) issued by project companies. The NCDs have a fixed tenure of three to five years and carry a coupon payable at regular intervals with a back-ended redemption premium, if any, to provide the investor with an overall commercially agreed IRR in the range of 18-24 per cent. Further, the issuances are secured through a charge on the asset being funded with a security cover of around twice the size of the investment.

The NCDs may also be structured to provide for preferred cash flows to the investor or may include a put option permitting the investor to exit prior to completion of tenure of the NCDs on achievement of certain conditions (in cases where all apartments are sold or completion certificate is received prior to completion of the tenure of the NCDs).

6.2. Bulk apartment units

Steered by domestic funds, 2014-15 witnessed an institutionalised way of underwriting under construction projects. While, certain fund managers initiated a dedicated fund approach towards investing in bulk apartment units with a three to four year investment horizon, many others are earmarking a part of their existing or proposed funds for such bulk apartment investment modules.3

Under this structure, funds negotiate an agreement with developers to pre purchase stock in under-construction projects at a discount, usually in the range of 20-30 per cent, and seek to benefit from appreciation in the value of the apartments in the medium term. The capital is infused either upfront or in tranches based on the construction schedule of the project. Developers use the funds to complete construction of the project and are required to sell the fund’s stock of apartments in proportion to the rest of the apartments in the project after a stipulated time.

As per our analysis, the investments are usually structured to provide for a minimum assured return (ranging upwards of 20 per cent) to the investor at a pre-determined exit date, giving it a flavour of mezzanine finance. In case of failure to do so for any reason including delays in construction or stocks going unsold, the developer will be required to buyback the stock from the investor. On the flip side, in case the sale price of apartments to end users is higher than the minimum assured return, the upside may be shared by the developer and the investor in an agreed ratio as per the terms of the agreement. To address the risk of non-execution of the project, the agreements may also include clauses such as personal and corporate guarantees among others.

From a developers perspective, offloading inventory in bulk at discounts provides them with the necessary funds to advance the construction of projects and increase visibility of site progress. Further, the capital neither appears as equity or debt in the books of the project company encouraging developers to increasingly opt for bulk deals.

6.3 Commercial pre-leased yield assets

Commercial pre-leased assets have garnered significant institutional investor interest over the past three to four years backed up by stable yields and expectation of capital value appreciation. As real estate focused private equity funds look for guaranteed returns, a sizeable amount of capital is being invested in pre-leased projects, including IT parks and special economic zones. Although such projects do not typically generate returns as high as residential developments, they are generally perceived to be a safer bet as investors are assured of a fixed annual return on investment in the form of rental yield.

Further, with the introduction of REITs in India, private equity investments in these assets is expected to grow significantly. 2014-15 witnessed many fund managers aggressively acquiring good quality yield generating realty assets for REIT listing in the coming years. In the past six months, deals worth USD423 million4 were sealed in this space.

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1. KPMG.in India’s analysis based on information procured from Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015.
2. However, in the first eight months of 2015, the share of debt structured deals fell to 57 per cent (32 per cent in terms of value) owing to investments vide alternate funding options.
3. Under this structure, funds negotiate an agreement with developers to pre purchase stock in under-construction projects at a discount, usually in the range of 20-30 per cent, and seek to benefit from appreciation in the value of the apartments in the medium term. The capital is infused either upfront or in tranches based on the construction schedule of the project.
4. Further, with the introduction of REITs in India, private equity investments in these assets is expected to grow significantly. 2014-15 witnessed many fund managers aggressively acquiring good quality yield generating realty assets for REIT listing in the coming years.
As per our analysis, the transaction typically involves the investor buying-out the entire or a majority equity stake of the developer in the project company. Further, any debt at the project level is assumed by the private equity investor in 100 per cent acquisitions. Investors typically look for a capitalisation rate ranging from 9-11 per cent and an overall return of 14-16 per cent over a three to five year investment horizon.

6.4 Minority equity stake at entity level

Optimistic growth outlook with respect to the Indian economy coupled with improved investor sentiments and proposed reforms by the government to simplify regulations and eliminate supply side bottlenecks in the real estate sector has drawn several global investors to place strategic bets on Indian real estate. The year 2015 has seen a resurgence in holding company level deals by marquee private equity players signifying renewed faith in the sector. In the past six months, deals worth USD551 million were sealed in this space.\(^3\) Investments were witnessed within the corporate developer fraternity which have demonstrated strong values and governance and are credited with an established track record. Further, developers engaged in delivering affordable and mid-income housing have seen entity level investments as well.

As per our analysis, such structures typically involve investment vide plain vanilla equity or quasi equity instruments (compulsorily convertible into equity at a prospective valuation date) on a private placement basis for a minority stake in the holding company which may range from as low as 3 per cent to as high as 49 per cent. Exits may be structured either through an initial public offering, promoter buyback, sale to third party or sale of GP interest among other options. Investable projects may or may not be identified at the time of investment.

6.5 Platform deals

Driven primarily by sovereign and pension funds, platform deals have been gaining ground in the Indian real estate space over the last few years. Hitherto, participation by sovereign and pension funds in the Indian investment scenario was restricted through investments vide private equity funds. However, with several funds seeking increased exposure to real estate as an asset class, the past two to three years witnessed such funds to increasingly partner directly with Indian developers with strong fundamentals for development or acquisition of residential, mixed-use and commercial segments across the country. In the past six months, three deals aggregating to a capital commitment of USD802 million\(^3\) were sealed in this space.

As per our analysis, a typical platform-level deal involves the creation of a joint pool of capital between a global investor and a developer with an established track record. The investor’s capital contribution to the platform ranges from 50-75 per cent of the total capital committed by both the parties. The developer assumes responsibility as the exclusive development manager of the projects and receives a development fee for the same. The portfolio may comprise of a mix of existing and proposed projects as may be identified by the parties. Profit-sharing is in proportion to the capital contributed by the investor and the developer till the returns touch the hurdle rate post which sharing may be aligned in the favour of the developer.

\(^3\) KPMG in India’s analysis based on information procured from Private Equity in Real Estate Transaction Database, Venture Intelligence, accessed 11 September, 2015.
7.1. Background
Till mid-2008, many of the developers were looking at augmenting their land banks, and this coupled with high liquidity encouraged them to look at outright acquisition of land parcels and also entering into joint ventures with landowners. With the tapering of the real estate boom, the market place has been witnessing very selective outright acquisitions and joint ventures with developers preferring the joint development route which is less capital intensive. Another emerging business model for developers with strong brand equity is the development management model.
Developers have been tweaking their business models over a period of time and this has impacted land owners holding the asset. The risk return matrix across the options from a land owner perspective is provided below.

Risk/Return matrix – Land owner perspective

- **Outright sale** – Though the upfront payment is the highest of all the options, the land owner returns would be also be low since premium on valuation would be low.
- **Joint Venture** – Returns to the land owner would be medium though the risk would be higher since land owner is an equity partner in the Company.
- **Joint Development** – Returns to the land owner would be lower than the Joint Venture option and so would be the risk since the land owner gets either a revenue share or area share.

Development Management (DM) is a business model which is attractive from a corporate land owner perspective since the land owner steps into the developer ‘shoes’ and undertakes the development for the project which would give higher returns compared to the other options. In this case, the developer undertakes the marketing of the project for which they would receive a certain percentage of the revenues as marketing fees.

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7.2. Evaluating the options

7.2.1. Outright sale
This monetisation option still holds its charm for the land owner since the cash flows are realised upfront and can be deployed in any other business venture. Some of the key negatives are that the valuation would be heavily negotiated and one has to factor in the impact of upfront capital gains tax. From a developer perspective, this option is very capital intensive and can be explored only on a very selective basis.

7.2.2. Joint Venture
As per our analysis, in case of a Joint Venture (JV), the land owner registers the land parcel in a Special Purpose Vehicle (SPV) or converts the partnership holding the land parcel into a Limited Liability Partnership (LLP). The land owner then divests partial stake in the SPV (upward of 50 per cent) in favour of the developer. In a JV, the construction and financing risk would be undertaken by the developer and the profits are normally shared in the ratio of the JV partners’ shareholding. In a JV, the land owner would get upfront cash flows by divesting 50 to 70 per cent stake in the JV. The returns to the land owner would typically be higher in a JV when compared to an outright sale option since the land owner is an equity partner in the JV company. Both the parties can divest/dilute stake in favour of a private equity player in case additional funding is required or if they are looking at a cash out.

Key aspects to be considered are:

- Since the JV would be for a longer period in time, it would be crucial for both the parties to strike a good business relationship.
- Upfront payment to the land owner is typically upward of 50 per cent of land value, hence negotiating the valuation would be a challenge in a JV.
- Any cost overrun would require additional capital contribution which can be a financial stress for the land owner.
- Tax implications - Capital gains tax would be applicable to the land owner at the time of divestment of stake; also, the profits from the JV would be taxed at the applicable corporate tax rates. In case of repatriation of profits from the JV, a tax efficient structure combining Dividend Distribution Tax (DDT) and buy back of shares would have to be worked out.

7.2.3. Joint development
Post 2008, many of the developers have been preferring the Joint Development (JD) route. From a land owner perspective, only the economic interest/development rights is transferred to the developer and the land owner retains possession of the land parcel. As per our analysis, typically 10-15 per cent of the land value would be payable as an upfront deposit, and the land owner also gets either a revenue share or an area share from the project.

Key points to consider in a JV from a land owner’s perspective include:

- Responsibilities of both parties should be clearly defined – The land owner is typically responsible for providing the land in a marketable state to the developer. The developer would be responsible for all construction related approvals, overseeing the day to day operations of the project, appointment of contractors, consultants as well as marketing of the project.
- Development mix, product mix, amenities, FSI utilisation, methodology for sharing additional FSI cost, marketing plan for the project, project cost, sales price, timelines for development is required to be finalised by both parties.
- A mechanism to monitor the costs should be pre agreed and incorporated into the JVA. Third party consultants maybe appointed to monitor the same.
- In case, additional capital is required by the project and land owner does not bring in further capital, then hybrid instruments could be issued where in the shareholding and control would not be diluted but only the sharing of return would be disproportionate (i.e. not in proportion to the ratio of the shareholding in the JV).
- The land owner has affirmative rights in matters like changes in capital structure, additional capital outlay, increase in project cost, change in project consultant, architects, etc.
- A penalty clause could be incorporated if the project is delayed beyond agreed timelines (after factoring in grace period and delay on account of points mentioned under force majeure in the JVA).
Selection of the right developer for the location and proposed product mix is key to a successful project and its timely completion.

In a JD, some of the key highlights are that the land owner does not need to bring in any additional capital for development, and also they can partake in any future upsides in the project. The land owner can raise structured funding against their share of receivables from the project. Though the number of JD’s are very high in the market place, from a land owner perspective they typically have limited control over the project development, and in a period of sluggish sales their Net Present Value (NPV) of receivables from the project would be impacted.

Another aspect that the land owner needs to prepared for in a JD is the timing of capital gains. Since only the economic interest in the land is transferred to the developer at the time of execution of Joint Development Agreement (JDA), the normal treatment is to consider the land as a stock in trade such that the capital gains is taxable in the year in which such stock is sold. Efficient drafting of the JDA is the key to computing the capital gains implication to the land owner.

Key points to ponder in a JD from a land owner’s perspective are as follows:

- Land owner responsibilities – All land related approvals are to the land owner’s account and timelines for the same need to be agreed upfront.
- Product Mix and units allocated to the land owner should be clearly defined in the supplementary sharing agreement.
- The land owner has the right to monitor the cost and project quality on a quarterly basis. Third party consultants may be appointed for monitoring the cost and quality of project.
- A refundable security deposit at 10-15 per cent of the land value could be paid as an upfront security deposit on the date of signing the JDA. In case there are land related approvals to be completed before the signing of the JDA, the developer could try to negotiate a partial payout of the security deposit at the time of signing the JDA and the balance payable upon receiving the land related approvals.
- A penalty clause could be incorporated if the project is delayed beyond the agreed timelines (after factoring in grace period and delay on account of points mentioned under force majeure in the JVA).

7.2.4. Development Management (DM) - Emerging Business Model

Development management is an emerging business model in the real estate space. Overall construction risk of the project tends to vest with the land owner, and the developer gets paid a marketing fee for marketing and branding the project. From a developer perspective, DM provides them the opportunity to market multiple projects across various cities and locations, thus building a scalable business model.

In this case, the land owner and developer enter into Development Management Agreement (DMA) wherein:

- The developer would be responsible for the management of the entire project.
- The land owner gets access to the developer’s brand and development expertise.
- Construction risk rests with the land owner who provides for the development cost.
- Fixed percentage of revenues of the project are shared with the developer, which may include an upfront fee payment also.

DM is emerging as a preferred business model with corporates that have surplus land parcels since they would typically like to have greater project control and not be a passive partner in the project. In all the other options, the land owner typically sells the land, transfers the land into a JV or transfers the economic interest in the land to the developer, whereas in this case the land owner would retain full possession and control of the land. The land owner steps into the developer’s ‘shoes’ from an execution perspective, and on account of that also gets maximum share in the project cash flows and future upsides from the project.
About KPMG in India

KPMG in India, a professional services firm, is the Indian member firm of KPMG International and was established in September 1993. Our professionals leverage the global network of firms, providing detailed knowledge of local laws, regulations, markets and competition. KPMG in India provides services to over 4,500 international and national clients, in India. KPMG has offices across India in Delhi, Chandigarh, Ahmedabad, Mumbai, Pune, Chennai, Bangalore, Kochi, Hyderabad and Kolkata. The Indian firm has access to more than 8,000 Indian and expatriate professionals, many of whom are internationally trained. We strive to provide rapid, performance-based, industry-focused and technology-enabled services, which reflect a shared knowledge of global and local industries and our experience of the Indian business environment.

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KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have more than 162,000 people working in member firms around the world.

The KPMG Audit practice endeavours to provide robust and risk-based audit services that address member firms’ clients’ strategic priorities and business processes.

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KPMG Advisory professionals provide advice and assistance to help enable companies, intermediaries and public sector bodies to mitigate risk, improve performance, and create value. KPMG firms provide a wide range of Risk Consulting, Management Consulting and Transactions & Restructuring services that can help their clients respond to immediate needs as well as put in place the strategies for the longer term.

About NAREDCO

National Real Estate Development Council (NAREDCO), one of the oldest and premium think tank and association of Realty Sector formed around 15 years ago, under the Patronage of Housing and Urban Poverty Alleviation, Govt. of India. Shri. M. Venkaiah Naidu, the Hon’ble Minister of Housing & Urban Poverty Alleviation and Urban Development, is its Chief Patron and six Joint Secretary level officers from Central government and Central PSUs are on its Governing Board.

NAREDCO strives to be the leading advocate for developing standards for efficient and ethical real estate business practices, valued by the stakeholders and viewed crucial for success in India. NAREDCO members inter alia include Housing and Urban Development Corporation (HUDCO), National Housing Bank (NHB), National Building Construction Corporation (NBCC), DDA, LIC HFL, PNB HFL, HDFC besides prominent Bankers & Financial Institutions such as State Bank of Bikaner and Jaipur, Yes Bank, Dewan Housing Finance Limited, Shriram Housing Finance Ltd., Reliance Home Finance Ltd., etc., Leading developers from across India are the Founder/ Patron / Regular members of NAREDCO.

NAREDCO has a Governing Council and an Advisory Council led by luminaries in industry and administration who are responsible for policy formulation, policy advocacy and general administration. NAREDCO’s advisory council includes Shri Rana Kapoor, MD and CEO, Yes Bank, Ms. Sunita Sharma, MD & CEO, LIC HFL, Mr. B. Sriram, MD, State Bank of Bikaner and Jaipur, Ms Renu Sud Karnad, MD, HDFC, Shri Niranjan Hiranandani, MD, Hiranandani Constructions Pvt. Ltd., Dr. M Ravi Kanth, CMD, HUDCO, Shri R. R Goel, CMD, Omaxe, Shri Brotnin Banerjee, MD & CEO, Tata Housing Development Co. Ltd., Dr. P S Rana, Former CMD, HUDCO.

NAREDCO has played a key role in formulating government policies and budgets at the level of central and state governments. Besides addressing issues related to developers, policies on affordable housing, fast tracking project approvals, regulation and development bill and Model Rental Control Act are some of the achievements of the association in the near past.
Challenging the tides: Indian real estate
Analysis of the new development concepts and investment trends changing the course of Indian real estate

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