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Realty Bytes

Quarterly Flash – January 2015

Real Estate and Construction sector

Executive summary

In several ways, the Indian real estate sector bid adieu to 2014 on a positive note. The formation of the new government with a strong majority and its first Budget that gave a significant impetus to the sector were the bright spots in 2014. Much progress has been made through several policy reforms as well. SEBI codified REITs norms and the government announced the tax pass through. FDI norms were relaxed for investments in real estate, Real Estate Regulation Bill got its final shape and the Land Acquisition Act received the Presidential assent. "Housing for all" has been adopted as the new mantra and the smart city concept is gaining traction.

The winds of change are now blowing. Inflation, including the house price component, has now been reduced to the lowest level in the last few years. Property buyers are back in force in most cities as enquiries have rebounded, and developers are finally reading the writing on the wall more accurately and are trying to bridge the demand-supply gap.

Historically, developers have always had wonderful Diwali. However, bucking the trend, the festival of lights failed to bring cheer to the Indian real estate sector in 2014. According to analysts, although the season was better than the previous season in terms of sales and volumes, but the performance was still below expectation. The festive season failed to revive the growth momentum of the sector, as was anticipated. Besides, considering the RBI's policy to keep the current interest rates unchanged with a view to safeguard against further inflationary trends, it is probable that several more months will be needed for the market to revive.

Meanwhile, it is interesting to note that several Private Equity players are gearing up for REITs, picking up large chunks of unsold inventories, which is helping developers increase construction activity. E-commerce companies, with some significant investments in recent past are also gearing up to facilitate sales/ rentals of RE units. Further, Private Equity funds and sovereign wealth funds have pumped millions of dollars into the country's real estate, indicating that they are bullish about the future of the market.

Going forward, the real estate industry as a whole will have to focus on faster implementation of projects and deliver on time to the customers. They will have to also improve the quality of construction to cope with the growing expectations of customers and investors.

In the last few months, vital signs of India's economy have improved and policy makers are taking significant steps to improve growth prospects. This will have a positive effect on the real estate sector and 2015 will surely be a better year for the industry.

News updates

Land ordinance gets Presidential assent

An ordinance to introduce significant changes in the Land Acquisition Act such as removing consent clause to acquire land for five different types of projects - industrial corridors, PPP projects, rural infrastructure, affordable housing and defence, has received the Presidential assent. Under the amended law, clauses for mandatory "consent" and Social Impact Assessment will not be applicable to any of the five types of projects for which land is acquired. As per the changes, multi-crop irrigated land can also be acquired for these projects. The earlier Act mandated consent from 70% land owners whose land is acquired for these five types of projects. While the government believes that the amendments are pro-farmer, political parties in the opposition have labelled these changes as "anti-farmer", "unjust" and "deeply disturbing".

The Real Estate (Regulation & Development) Bill set to be legislated soon

The Bill has undergone a few changes and is expected to be soon taken up by the Cabinet for approval. The two important changes proposed by the Ministry of Housing are - bringing down the percentage of receivables (from 70% to 50%) from home buyers that has to be kept in the escrow account for the purpose of construction. The other is to bring the commercial segment of the real estate sector within the ambit of the Bill, which earlier was limited to regulating only the residential segment. While the changes have been largely welcomed by various industry players, the expectation of it becoming a law soon comes as a relief to the home buyers who have been facing delays in delivery of projects by developers and inconsistency in fulfilment of promises made to them at the time of booking.

Foreign Direct Investment (FDI) norms revised

In a bid to boost the cash inflow, the government has relaxed rules for Foreign Direct Investment (FDI) in the construction sector by reducing minimum built-up area as well as the capital requirement, while also easing the exit norms.

Significant changes include reduction in floor area to 20,000 sq mt from the earlier requisite of 50,000 sq mt and minimum capital requirement to USD 5 million from USD 10 million, and for the development of serviced plots, the mandate of having a minimum land of 10 hectares has been removed.

Unsold inventory of apartments touches a record high

The unsold inventory with real estate developers has touched a record high of 800,000 for apartments. While many reasons are being attributed for the prolonged slowdown in the sector, sluggish home sales is turning out to be an opportunity for some private equity (PE) funds in the country. These PE funds are lapping up apartments in bulk from developers who are willing to give significant discounts given the current slowdown in the sector. A number of PE funds, including Piramal Fund Management, Aditya Birla Real Estate Fund and the PE fund founded by the former Indiareit Head - Ramesh Jogani in a joint venture with Centrum Wealth Management, have launched apartment funds in the past few months. An apartment fund makes bulk deals of apartments and enables the developer to block a substantial number of units for an institutional buyer. The developer can then use the proceeds to speed up construction activities and increase visibility for the project.

E-commerce, real estate embrace each other

The developers and various players in the market are exploring unchartered avenues to reach out to potential customers. Taking advantage of the Google Online Shopping Festival (GOSF), Tata Housing has launched two projects, one each in Bengaluru and Mumbai. Through the online medium, Tata Housing has sold over 700 units amounting to about Rs. 400 crore, an average of one house every two days.

It has also entered into an exclusive arrangement for selling homes on Snapdeal.com. The developers participating in the GOSF include Unitech, Raheja, Puravankara, Mahindra Lifespaces, Godrej Properties and Brigade among others. Even housing loan providers such as HDFC Home Loans, Tata Capital and others had various offers going on during the GOSF. Further, some of the e-commerce companies dealing in real estate such as – housing.com, commonfloor.com and indiahomes.com are getting significant funding to create infrastructure to support the sale/ renting of real estate units.

Sharia-compliant REITs in India

With the announcement of REITs guidelines by the Securities and Exchange Board of India (SEBI), many players are now keen to explore the possibility of attracting investments from the Middle East. Some prominent real estate developers are in advanced talks with lawyers and real estate experts for launching Sharia-compliant REITs in India. The developers are interested in a Sharia compliant product which fundamentally provides security and dissuades one from taking excessive risks with complex products with committed returns. Sharia compliance is an Islamic banking way of attracting investments. The way Indian companies are currently complying with anti-corruption laws in the UK or the US, the Indian companies will also have to comply with the Sharia requirements. On the flip side, the biggest challenge in a Sharia-compliant REIT will be the lower yields due to stringent laws around accepting interest and others. However, realtors believe that there are many investors who would accept a marginally less return as long as it is in compliance with their religious beliefs.

Reckoner rates hiked in Maharashtra

Home buyers in Mumbai will have to pay more for their dream homes after a cash-strapped Maharashtra government sharply increased government rates used to calculate taxes paid by consumers when purchasing property.

Ready reckoner rates have been increased by 30-40% in case of some fastest-growing, popular suburbs in the city, triggering protests from builders and consumers and causing unease among members of the ruling BJP-Sena alliance, which came to power in the state after 15-years.

Lodha Group sells Rs 500 crore worth flats in 9 days at Mumbai high rise

Premium realty player, the Lodha Group, has registered bookings to the tune of over Rs.500 crore for an ultra-luxurious residential project in Mumbai between 29 November 2014 to 9 December 2014. This proves that the scenario is not so gloomy for the sector.

A series of reforms that have been recently rolled out in the sector including the announcement of REITs, relaxation in the FDI norms and priority to affordable housing under the Land Acquisition Act, 2015 are expected to give a fresh impetus to the sector this year.

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Challenges in transition to Ind AS for real estate and infrastructure companies

Entities in the infrastructure and real estate sector currently prepare financial statements based on the Accounting Standards (AS) notified by the Ministry of Corporate Affairs (MCA). Additionally, they also rely on certain Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI) for transactions specific to the industry.

The Finance Minister in his Budget speech, while proposing to make Ind AS mandatory from FY 2016-17, stressed on the necessity and importance of convergence with IFRS. Despite the few carve-outs, the converged Ind AS would be a big step towards financial accounting and reporting based on international standards. As a consequence of this convergence, few industries are likely to have significant impact in their financial accounting and reporting. Among those industries, certainly companies in the infrastructure and real estate sector are expected to see significant changes in their financial reporting.

Discussed below are a few key items that are potentially expected to have a major impact on their financial statements.

Agreements for the construction of real estate (IFRIC 15)

The guidance under IFRIC 15 has not been adopted under Ind AS. As per IFRIC 15, revenue from certain contracts for construction of real estate, where the ownership is transferred after completion of the construction, is recognised on a completed contract basis i.e. when the construction is completed. Costs are recognised as and when incurred. Post the new standard on revenue recognition, IFRS 15, coming into effect, the disparity between Ind AS (applicable during that period) and IFRS would require to be reassessed for real estate companies.

Complex control structures – impact of 'de facto' control assessment

Large and medium real estate companies usually have complex investment structures with interests in joint ventures, partnership firms, special purpose vehicles (SPVs), etc. Unlike IGAAP, where control assessment is largely based on the proportion of voting rights in the investee, Ind AS 27 and exposure draft for Ind AS 110 require control assessment based on factors like risk and rewards. SPVs are not considered for consolidation under IGAAP; however same may get consolidated under Ind AS based on risk and control criteria.

The concept of 'de facto' control, where control is ascertained based on the actual control exercised by way of contractual arrangements and other facts of the case can have a substantial impact on the nature of relationship with the investee and in turn on the number of entities getting consolidated.

Asset Retirement Obligations (AROs)

ARO is the estimated costs of dismantling and removing an asset and restoring the site on which it is located. Currently, there is no directly applicable guidance under IGAAP but the Accounting Standard on Provisions contains an indication towards capitalisation of such costs. However, various industry practices prevail and in cases where a provision is capitalised, the same is done at its nominal value.

Under Ind AS, the present value of the expected cost for the decommissioning of an asset after its use is included in the cost of the respective asset if the recognition criteria for a provision are met. This would increase the gross value of the asset and consequently, the depreciation charge for the subsequent periods. Further, the unwinding of discount on the provision will also be charged to the income statement. Thus, in substance, company's statement of profit and loss would be charged with depreciation and unwinding of discount.

E.g. Entity A has constructed an asset with a useful life of 10 years. It recognises an ARO of INR 80 for the present value of the cost of dismantling the asset (nominal value INR 100). Consequently, there will be an additional depreciation charge of INR 8 every year and an annual interest charge representing unwinding of discount on the present value of the provision. Estimating the expected cost for dismantling an asset many years down the line involves exercise of substantial amount of judgment on part of the management.

Extended credit terms

A structure that has become popular in recent times in the residential real estate sector is the 20/80 or 30/70 schemes where the buyer is required to pay 20%/30% upfront (at the time of booking) with the balance payable at the time of taking the possession. The construction of these projects usually goes on for more than 12 months and Ind AS would require the recognition of the non-current receivables at their present value. Not only this impacts the revenue recognition on a Year on Year (YoY) basis, it also changes the geography of accounts as the unwinding of the discount is treated as finance income and not revenue from operations or sales.

Determination whether an arrangement contains a lease (IFRIC 4)

Implementation of guidance corresponding to IFRIC 4 contained in Appendix B to Ind AS 17 has been deferred. IFRIC 4 is an interpretation on assessment whether any arrangement meets the lease criteria. The arrangements covered by the said guidance are accounted as either finance lease or operating lease depending on the nature of the arrangement. E.g. a power plant with a long term (say 25 years) power purchase arrangement to supply the entire power generated to the buyer (based on a specific asset) over the period of the arrangement can get classified as a finance lease as a result of application of IFRIC 4.

This would entail the entity derecognising the power plant from Property, Plant and Equipment (PP&E) and recognising a finance lease receivable. The income over the tenure of the contract would be finance income rather than power generation income.

Service concession arrangements (IFRIC 12)

Implementation of guidance corresponding to IFRIC 12 contained in Appendix A to Ind AS 11 has been deferred. The guidance usually applies to infrastructure entities engaged in public-private-partnerships arrangements that are on Build-own-operate-transfer (BOOT) or Build-own-transfer (BOT) basis. As a consequence of application of IFRIC 12, the entity is required to record an intangible asset or a financial asset or both towards the right to collect revenue over the period of the arrangement. Since the ownership gets transferred at the end of the arrangement, PP&E is not recognised. On the other side, revenue is recognised for (a) construction of the infrastructure and (b) operation of the infrastructure.

With Ind AS implementation, real estate sector will see some big-bang changes in its accounting framework – consolidation of special purpose vehicles (thinly funded promoter entities), fair valuation of financial instruments, revenue recognition under subvention plans, accounting for joint development agreements and evaluation of revenue recognition from customer contracts are few of the several areas which will keep accountants guessing for a while. There is going to be a substantial increase in the degree of judgment to be applied by management.

Ashish Gupta
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Sahara sells Gurgaon land, Vasai plot to raise funds

As Sahara Group tries to raise funds for securing release of its chief Subrata Roy from Tihar jail, it sold a big land parcel in Gurgaon for Rs. 1,211 crore to realty firm M3M India Ltd and a plot in Vasai to Sai Rydan Realtors for Rs. 1,111 crore. M3M India said the 185 acres it bought would be used for 'mixed-use development' and has sales revenue potential of Rs.12,000 crore over the next 6-8 years.

Indiabulls arm laps up 100% stake in India Land and Properties

Indiabulls Distribution Services Limited, a wholly owned subsidiary of Indiabulls Securities Ltd has acquired 100% of the share capital of ILPPL for a consideration of Rs. 600 crore. ILPPL owns a three-tower commercial complex of 3 towers with a total constructed area of 2.4 million sq ft and leasable area of 2 million sq ft. The total land area of the complex is over 10 acres.

Embassy Property Developments buys Goldman, Century realty project

Embassy Property Developments Private Limited ("EPDPL") has acquired a 6.5- acre project in Bangalore from Goldman and real estate firm CREHPL. The deal is valued at Rs. 630 crore. EPDPL hopes to complete the property in two and a half years. Blackstone Group LP, a private equity firm, will invest Rs. 200 crore in the project for a 50% stake, while EPDPL will have the remaining 50% stake. The proposed Four Seasons property will also have a hotel, office space (1.5 lakh square feet) and luxury homes.

Singapore's sovereign fund to buy 39.2% of Mumbai IT park company

Singapore's GIC has struck a deal to acquire a minority stake in public listed IT park owner Nirlon Ltd for Rs. 660-784 crore and has made an open offer to buy more which could cost it as much as an additional Rs. 568 crore. GIC affiliate Reco Berry (a part of Recosia Pvt Ltd which is owned by GIC (Realty) Pvt Ltd) has signed a deal with promoters of Nirlon to buy bulk of their 12% stake besides holdings of two large institutional investors - Geraldton Finance Ltd and Real India Invest Aktiengesellschaft. They together own stake worth just over 29%. The deal with the promoters is conditional on the acceptance level in the open offer.

I Squared Capital buys out Jaipur Mahua Tollway

Private equity firm I Squared Capital, through its ISQ Global Infrastructure Fund, has signed an agreement to acquire a 100% ownership in Jaipur Mahua Tollways Pvt. Ltd., an operating toll road in India, from IJM Corporation, Malaysia which is valued at Rs. 525 crore. The acquisition initially will be for a 74% ownership interest, with the remaining 26% is subject to approval from the National Highways Authority of India. The toll road operates under a 25-year concession to toll, operate and maintain a 109 km stretch of National Highway 11 in Rajasthan, India, and has been operational since 2009.

Tata Realty to buy majority stake in Madhucon's Agra-Jaipur road project

Hyderabad-based Madhucon Group has signed a term sheet with Tata Realty and Infrastructure Limited to divest 74% equity in the Madhucon Agra-Jaipur Expressways Limited (MAJEL) for about Rs. 250 crore. The 57-km Agra-Jaipur express way stretch between Bharatpur and Mahua in Rajasthan was awarded to MAJEL on a build operate and transfer basis with a concession period of 25 years starting October, 2005. The SPV has been collecting the toll since May, 2009.

Buys & Ties

IVRCL to sell equity stake in Chennai desalination plant for Rs 150 crore

As a part of its strategic business plan to monetise its BOT and BOOT assets, Hyderabad-based IVRCL Limited has entered into a binding agreement on December 17 with Dubai based Utico FZC (Utico) to sell its equity stake in Chennai Water Desalination Limited (CWDL), which is a subsidiary of IVRCL. The deal is pegged at Rs. 150 crore.

Tama Homes to take JV route to develop real estate projects in India

Following the announcements with regards to the FDI in real estate sector, Japanese real estate company Tama Homes Co. Ltd. has confirmed its plans to form a joint venture with Developer Group India Pvt. Ltd. to develop Rs.6,000 crore worth of real estate projects in India over the next five years. These will include about 10,000 homes across the mid-income and affordable housing segments. The move has been cheered by the real estate sector, as it will bring in much needed capital. However, for home buyers more inflow of foreign money in realty means higher property prices.

Hinduja Group buys London's iconic Old War Office building

Hinduja Group, along with Spanish company Obrascon Huarte Lain Desarrollos (OHLD), has acquired London's historical Old War Office building which was used by Sir Winston Churchill during World War II to take key decisions. Constructed in 1906, the building is located at 57, Whitehall in central London will now be restored and re-developed into a five star hotel and residential apartments, and will also feature a series of private function rooms as well as a spa and fitness facility.

HCC Concessions sells its Annuity Road Project in Andhra Pradesh for Rs 64 crore

HCC Concessions Limited, a subsidiary of Hindustan Construction Company Limited has sold Nirmal BOT Ltd, its annuity project in Andhra Pradesh to Highway Concession One Pvt. Ltd. an entity majorly held by IDFC Alternatives managed India Infrastructure Fund. HCC Concessions shall receive Rs. 64 crore for this transaction. Further, as per the terms of agreement, arbitration award in favour of Nirmal BOT for Rs. 16.67 crore shall be payable to HCC Concessions upon receipt as a part of sales consideration.

HCL chairman Shiv Nadar buys Rs 115 crore bungalow in Delhi

In one of the latest bulge-bracket property deals in the national capital, HCL chairman Shiv Nadar has bought a bungalow in the Friends Colony East area of Delhi for Rs 115 crore for his daughter. This is one of the largest transactions in recent times in an area of Delhi outside of the coveted Lutyens Bungalow Zone, which is home to high-profile politicians and top businessmen and where deals of over Rs 100 crore are a norm.

Market speaks

We interviewed Vineet Relia, Managing Director of SARE Homes Project Services Private Limited, to seek his views on infrastructure sector. Below are the excerpts from the interview.

What's your outlook for the real estate sector?

Business sentiment has improved in the last few months but we still do not see any change on the ground. Issues relating to the ease of doing business and access to finance are still there. These are the two key areas where businesses want to see more action. In micro-markets, the state governments and developers are not monitoring the demand-supply situation in a diligent manner. This is putting pressure on the entire market in terms of absorption levels and inventory overhang. Also this leads to non-fulfilment of delivery commitments as the developers don't have the requisite bandwidth to execute. As a result, the market gets choked with excessive supply and customer dissatisfaction. The real estate sector in India has only seen prices go up. I believe that for the first time, the industry will have to be ready to take haircuts. We have to realise that prices can head southwards as well. The second big challenge that I foresee is that whenever the markets make a comeback, the sector will have a lot of inventory that will be ready for possession. The customers will be very selective and have higher expectations. As a result, sales cycles have and will go up further– what used to take 3 days or a week earlier has gone up by 3 months today. So the developers will have to gear up to handle this situation.

Will relaxation in the new FDI norms revive demand in the sector?

This announcement has come a bit late. Nevertheless, the government's plan to develop smart cities cannot be realised without foreign capital, which needs to be incentivised. FDI investors want good returns. The Indian policy makers will have to be aware of this and keep a keen eye on the overseas markets. For instance, the US market has started doing well, so to attract foreign investors to India would be challenging. Another part of the puzzle is foreign exchange fluctuations, which hurt investors whenever the currency market dwindles. Therefore, the government will have to think through these points carefully and then come up with a policy, which works well for investors. Just the marketing rhetoric alone will not work.

What steps should the government take to give a fresh impetus to the real estate sector?

First of all, steps will have to be taken to make it easier to do business in India. Thus, single window clearance is a must. If companies still have to run pillar to post to get 35-40 approvals for every project, the whole purpose gets defeated. These delays result in cost overruns for the companies operating in this sector. The government should also look at tax exemptions on various items. Tax is embedded in various layers, starting from stamp duty when one buys land, then on every item that is purchased, one has to pay excise, sales tax, etc. These are all collections of the government, which should look at reducing these. Instead it should focus on higher volumes.

Vineet Relia
MD, SARE Homes Project Services Private Limited

Vineet Relia is the Managing Director of SARE Homes Project Services Private Limited, a developer of integrated residential township company based out of Gurgaon.

Mr. Relia has over 20 years of experience in managing the start-up and growth of ventures and handling investor relations for private and public listed companies. He started his career as a software engineer and later moved on to head independent business units.

These steps will also arrest the rise in prices, as construction costs can be reduced by bringing down taxes. The third step that the government should take, is to ensure that there is easy access to finance for companies in this sector. There is a huge taboo about funding for the real estate sector. While lending, banks ask for real estate as collateral but when it comes to funding the real estate sector, they act a bit too cautiously. This needs to change.

Take us through the growth journey of SARE Homes. What were some of the challenges that you faced?

Transitioning from a PE fund into an integrated developer firm was quite a big transition because the skill-sets required are completely different. I think we did well by getting the right team on board, which was capable of handling the complexity of the business and scalability of the business model. We have scaled from one project to now seven, pan India. We are doing around 35 million square feet pan India today. Our endeavour is to go to 70-75 million in terms of pure residential space. As for challenges in the growth phase, I believe that once you reach a certain critical mass, there are a lot of regulatory issues that hamper the ease of doing business. Fortunately, we don't do any approvals ourselves. As a policy, we enter post approval stage or when we know there is no policy approval needed. We purely focus on the home-building aspect.

What are the expansion plans, going forward?

We are focusing at the top seven cities because we only focus on residential projects. Currently, we have seven projects, spread across six cities. We want to have two projects in each of the top seven cities, which are strong employment drivers. There has been a shift in our strategy as well. Earlier, we used to do 100-acre projects because the policy stipulated so. Going forward, we want to do smaller projects, typically 500 units, and have a faster turnaround time across every project.

To what do you attribute the success of SARE Homes?

I think the biggest distinction for us has been the execution engine. For us, the biggest achievement is to live up to our commitments and deliver our projects on time. The credit goes to our highly professional team and it is because of our professionalism that we have managed to build trust among customers. We receive a lot of complimentary mails for our work and on-time deliveries. We have been able to bridge the gap between the customer and developer.

The government should take steps to improve ease of doing business for companies in the sector. Thus, single window clearance facility is a must. It should also offer tax exemptions on various items to reduce construction costs and arrest the rise in prices. Finally, the government should also ensure that there is easy access to finance for companies in this sector.

Vineet Relia
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Insights for real estate sector in India

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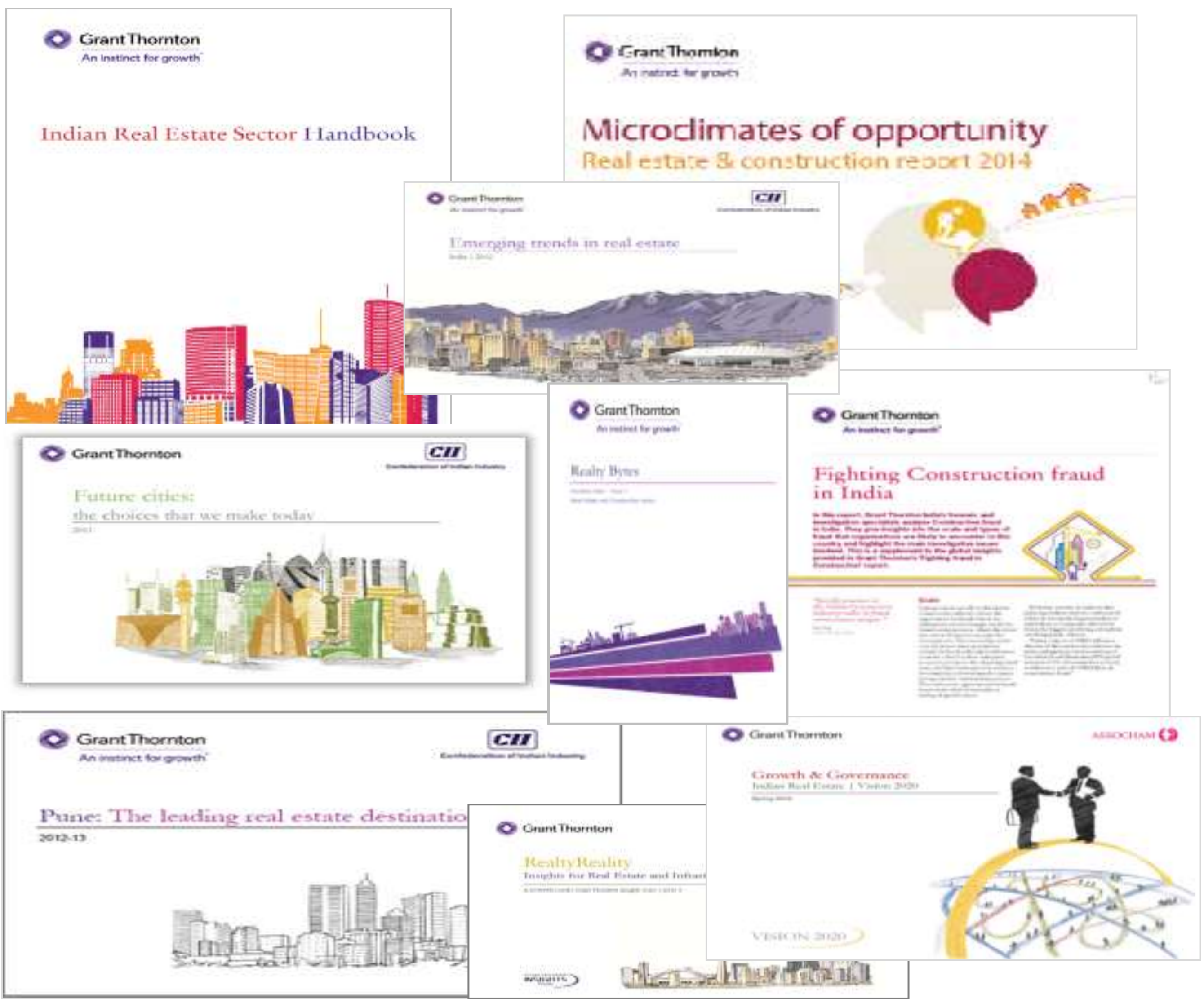

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