Realty in changing times

November 2012



ERNST & YOUNG
Quality In Everything We Do

FICCI

Foreword



Real estate is an important sector of Indian economy. The image of Indian real estate is undergoing change from an unorganized sector to a more organized one as companies increasingly adopt global best practices to aid in this transition process. The opportunities in the Indian real estate sector have attracted globally renowned companies, retailers, architects, planners and private equity investors.

The business of real estate is influenced by global factors. The global financial crisis of 2008 led to some correction and slowdown in this sector, but Indian real estate bounced back quickly from the downturn, due to strong economic fundamentals, strategies adopted by the Government of India and the focus of the industry on delivering affordable housing projects.

Indian economy is expected to grow at about 6% in FY 2012-13, down from 6.5% in FY 2011-12 and 8.4% in FY 2010-11. The real estate sector has the potential to be the game changer as it gives impetus to more than 250 ancillary industries and is the second largest employment generator in the economy. However, the sector is saddled with many challenges, such as high domestic inflation, increasing interest rates, slow economic growth and the increasing cost of labour and construction materials.

I feel it is the right time for the Indian real estate industry to come together and brainstorm ways to beat the slowdown in the economy and the sector, and at the same time deliberate upon policies and strategies to deliver what it is supposed to deliver for the common man – an affordable house. The 9th Annual FICCI Real Estate Summit 2012 will debate critical issues of concern for the realty sector and suggest various measures for boosting the growth of the sector.

The FICCI-EY Indian Real Estate Report 2012 to be released at the summit will sensitize all stakeholders about the changing scenario for Indian real estate and the trends and progress that India is making at the policy front. The report provides valuable insights into the urban growth story in India, housing and livability in India, its maturing policy environment and emerging trends in India, and other emerging economies in raising funds for the real estate sector.

I am sure the FICCI Annual Real Estate Summit 2012 will create an ideal platform to discuss the findings of this report and find ways to enhance the competitiveness of Indian real estate.

Mr. Niranjan Hiranandani
Chairman, FICCI Real Estate Committee &
MD, Hiranandani Constructions Pvt. Ltd.



Foreword



Amid continuing global turmoil in the financial markets, it is exciting to witness that emerging markets such as India, Africa and Brazil are among the world's economic growth drivers and gaining more and more interest from investors across the globe. However, investors from the traditional economies are still cautious and somewhat critical of developments around the political and social environment, infrastructure and the real estate legislatory framework.

As such, it is imperative for emerging countries such as India to take note of the events that shaped the world in the US and Europe. The aim should be to replicate the good elements of those economies and communities and to steer clear of the potholes in the road. Despite this, the good does not always come from the West. The US and the EU will still have to take tremendous steps towards very substantial fiscal and monetary reforms. Growth, if any, in the West and especially Europe is therefore expected to be modest.

These less promising aspects of the well-established economies, combined with the superior growth forecasts of emerging countries, demonstrate that emerging markets are gaining attractiveness in the eyes of institutional and other investors – especially those with a long term horizon looking to outperform returns in the developed countries. Slowly, but steadily, institutional investors are starting to close real estate transactions and even take development risk in India and are able to form the right partnerships for this. Equally important, the government of India announced significant reforms, allowing foreign investment in sectors such as aviation, retail and broadcasting. Inevitably, this will have a positive spin off on the real estate sector. Another element that could further boost and open up the real estate market in India would be the introduction of robust and effective REIT legislation. REITs are a success story across the globe, with examples including Australia, Canada, France, the United Kingdom, the United States, and many others. Our message to the real estate community is to continue with developing REIT legislation.

Nevertheless, doing business in India comes with many challenges too. Still, there is also a sense of inevitability about the benefits that will come from a large, increasingly educated population and a country that year over year doubles the growth of the world economy.

We take pleasure in presenting our perspectives on the India real estate market and to assist you in conducting your research and due diligence to help you make your investment decisions. We are there to support you along the way, from all of our disciplines, be it Assurance, Tax, Transaction Support or Advisory. We are in a position to be instrumental in developing your business, whether you are an investor, developer, contractor, financier, asset or fund manager, using your business acumen and our global reach, brought to you by a dedicated, first class local real estate team.

In this seventh iteration of our report, presented at the FICCI International Real Estate Summit, we once again aim to present you with valuable insights to help you grow your business, We are looking forward to meeting you at the Summit or thereafter.

Ad Buisman
EMEIA Real estate Leader







Contents

1. **The Indian urban growth story**
   Housing and liveability in urban India

2. **Indian realty**
   Influences of a maturing policy environment

3. **Raising funds**
   Trends in private equity in India and other emerging economies

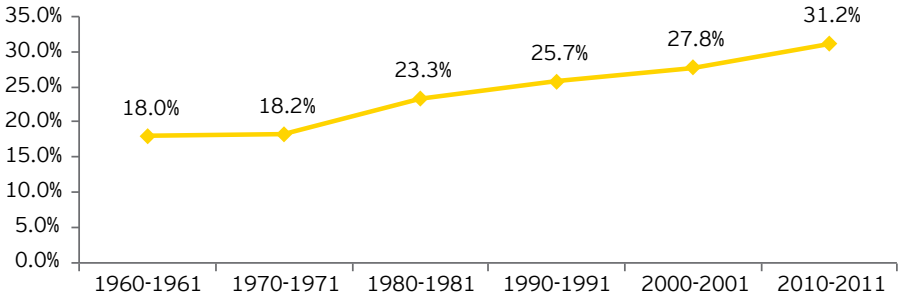
1 The Indian urban growth story

Housing and liveability in urban India

Introduction

India, the world's largest democracy, is home to 1.2 billion people, the world's second-largest population, following none other than the emerging economic powerhouse, China. This growing population has rapidly fueled the process of urbanization. With 31 out of every 100 people in the country living in cities or towns, India has a higher number of people living in urban areas (377 million)[1] than the entire population of the US (approximately 308 million)[2]. As the economy of India grows, its urban centers shall continue to grow and develop. Ironically, despite being in the development phase, the allocation for housing and urban development has never crossed 4.9%. The Fifth Five Year Plan allocated 2.9%, the second highest. It was only 60 years after independence that due importance to urban development was recognized and a structured mission, The Jawaharlal National Urban Renewal Mission (JnNURM), was focused on upgrading India's urban centers. The mission puts in place a reform driven, fast-track, planned development for identified cities, focusing on infrastructure service and delivery, community participation, and of urban local and parastatal bodies.

Urbanization rate of India



Source: Census of India, 2011.

The integration of the Indian economy with that of the world following the liberalization in 1991 has seen ongoing urban expansion, albeit the pace and potential of this growth has constantly been the center of much debate. It is estimated that by 2040, 40% of the country's population will be living in urban areas. A key question constantly challenging the pace of India's growth is that of the proficiency displayed by Indian states and cities to provide the necessary framework to support this economic growth and, at the same time, provide the citizens a good standard of living. "Can this proficiency be measured?" is a question this paper asks.

1 "Provisional Population Totals," *Census of India website*, www.censusindia.gov.in/2011-prov-results/paper2/data_files/india/paper2_at_a_glance.pdf, accessed 27 September 2012.

2 "USA QuickFacts," *United States Census Bureau website*, http://quickfacts.census.gov/qfd/states/00000.html, accessed 27 September 2012.

Assessing India's urban growth

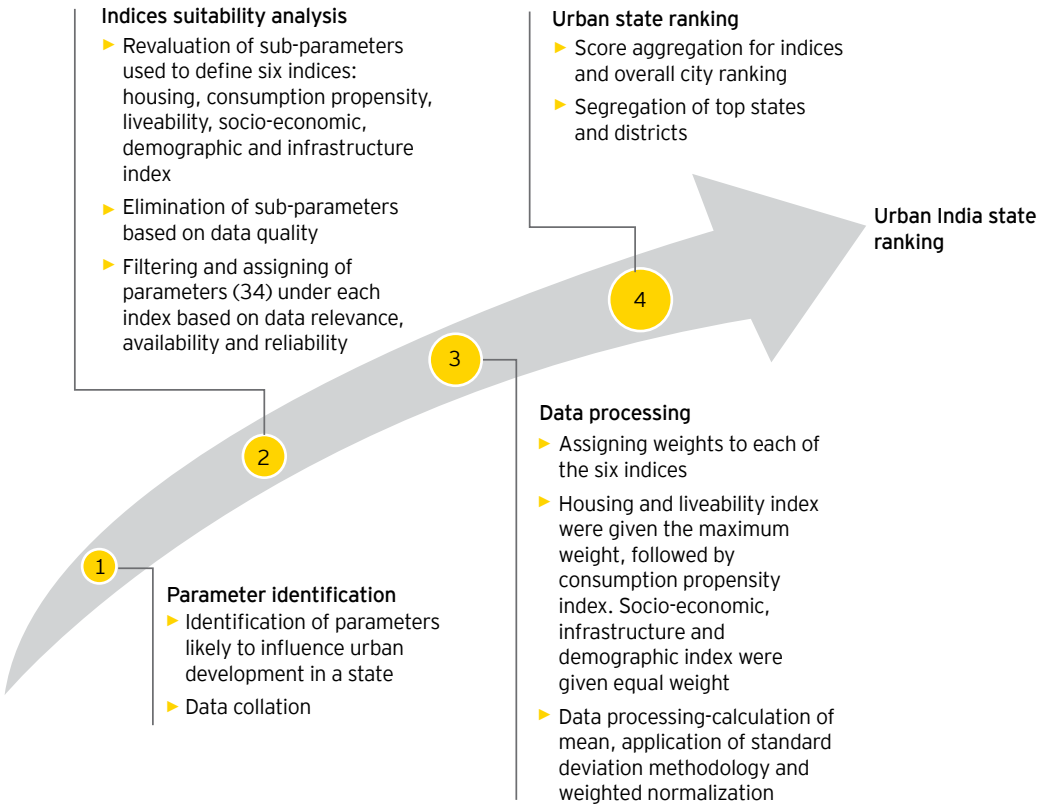
Objective

This paper provides the current state- a comparative performance of the urban areas in each of the Indian states.

Methodology

Availability of urban infrastructure, though a direct indicator of a state's prosperity and ability to drive the economy, is limited in its assessment of condition and comfort of everyday living. Access and condition of housing is likely to be considered to be a more direct outcome of the economic and social prosperity of the population. In order to determine urban prosperity of Indian states, 34 parameters likely to influence urban development and liveability were identified and grouped into 6 broad indices to arrive at a ranking to compare the status of urban development across 35 Indian states and union territories.

Methodology of ranking



Source: EY analysis.

Composition of indices

Housing	Consumption propensity	Liveability	Demography	Socio-economic	Infrastructure
▶ Condition of households ▶ Households without residences ▶ Ownership status ▶ Access to finance	▶ Affordability ▶ Prosperity of the citizen	▶ Access to basic urban amenities ▶ Safety/crime	▶ Market size ▶ Urbanization ▶ Growth rate ▶ Literacy	▶ Economic performance of the state ▶ Foreign investment in the state ▶ Human Development Index (HDI)	▶ Connectivity ▶ National and domestic access to the state

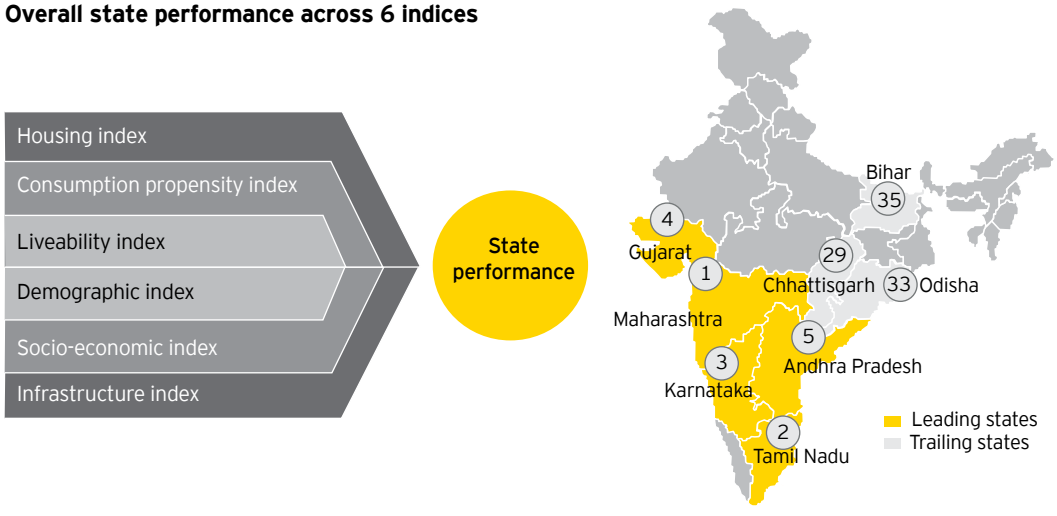
Source: EY analysis.

Limitations of the study

- The study is limited to urban areas and does not look at rural development in the different states.
- Ernst & Young has used well-accepted statistical methods and tools. The application and impact of such methods and tools is likely to vary significantly, depending on the evaluation parameter and context to which it is applied. All limitations pertaining to those statistical methods and tools are applicable to the outcome of this exercise.
- The results are sensitive to the weight allocations of the indices and sub-parameters.
- The analysis is done based on data computation by the Census of India. Limitations of the Census of India data would apply to this study.

Urban legends

Overall state performance across 6 indices



* Trailing states also include smaller northeastern states of Tripura (rank 34), Nagaland (rank 32), Assam (rank 31) and Manipur (rank 30).
Source: EY analysis.

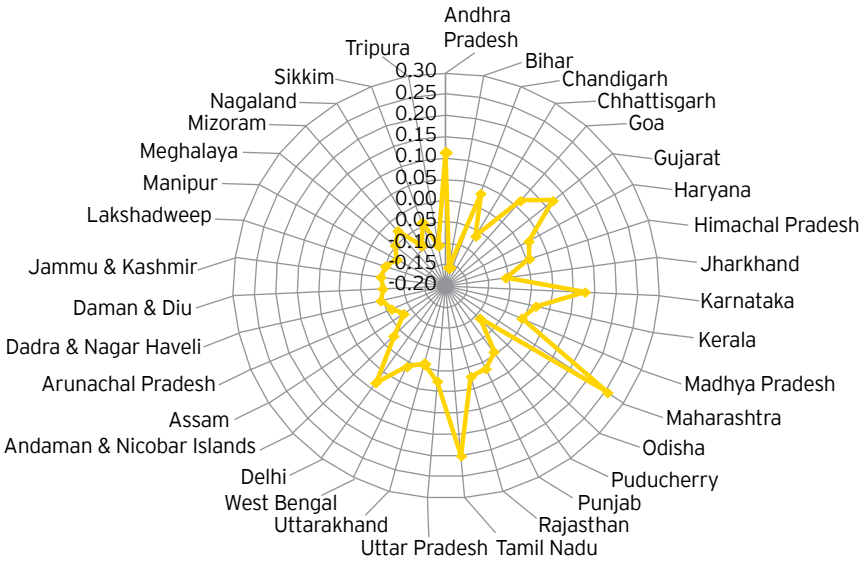
State performance across indices

States	Overall rank	Housing index	Consumption propensity index	Liveability index	Demographic index	Socio-economic index	Infrastructure index
Maharashtra	1	High	Medium	High	High	High	High
Tamil Nadu	2	High	Medium	High	High	High	High
Karnataka	3	High	High	High	High	Medium	High
Gujarat	4	High	Medium	High	High	High	High
Andhra Pradesh	5	High	Low	High	Medium	Medium	High
Delhi	6	Medium	High	High	High	High	Medium
Goa	7	Medium	High	Medium	Medium	High	Medium
Chandigarh	8	Low	High	Low	High	High	High
Uttar Pradesh	9	Low	Low	High	High	Low	High
Rajasthan	10	Medium	Medium	High	Medium	Medium	Medium
Haryana	11	Low	High	Medium	Medium	High	High
Kerala	12	Medium	High	Medium	Medium	High	High
Punjab	13	Low	High	Medium	Low	Medium	Medium
West Bengal	14	Medium	Low	High	Medium	Medium	Medium
Himachal Pradesh	15	High	High	Medium	Low	High	Low
Madhya Pradesh	16	Medium	Low	High	Medium	Low	Medium
Puducherry	17	High	Medium	Low	High	High	High
Uttarakhand	18	Medium	High	Medium	Low	Medium	Medium
Mizoram	19	Medium	Medium	Medium	High	Medium	Low
Andaman & Nicobar Islands	20	Medium	Medium	Medium	Low	Low	Low
Sikkim	21	Medium	Medium	Low	Low	Medium	Low
Dadra & Nagar Haveli	22	High	Low	Low	High	Low	Low
Jammu & Kashmir	23	Low	High	Low	Low	Low	Low
Meghalaya	24	Low	Low	Medium	Medium	Medium	Medium
Lakshadweep	25	High	Medium	Low	Medium	Low	Low
Daman & Diu	26	High	Low	Low	High	Low	Low
Jharkhand	27	Low	Low	Low	Low	Low	Low
Arunachal Pradesh	28	Low	Medium	Low	Low	Low	Low
Chhattisgarh	29	Low	Low	Low	Low	Low	Low
Manipur	30	Low	Low	Medium	Low	Low	Low
Assam	31	Low	Medium	Low	Low	Medium	Medium
Nagaland	32	Medium	Low	Low	Low	Low	Low
Odisha	33	Low	Low	Medium	Low	Low	Low
Tripura	34	Low	Low	Low	Medium	Medium	Medium
Bihar	35	Low	Low	Low	Low	Low	Medium

High Medium Low

Source: EY analysis.

State performance (overall score based on six indices)



Source: EY analysis.

- Maharashtra occupies the number one position, thereby indicating presence of better urban areas in the country, followed by Tamil Nadu and Karnataka. Districts of Mumbai, Thane and Pune are the most prominent centers.
- An evaluation conducted by Ernst & Young in 2011 revealed that the top five states (Maharashtra, Tamil Nadu, Karnataka, Andhra Pradesh and Gujarat) also have the most matured environment for industrial development (parameters considered for evaluation includes labor scenario, quality of manpower, infrastructure availability and state socio-economic conditions).
- The top-three states are also among the highest gross state domestic product (GSDP) generators for the country where there is a high rate of economic growth.
- Bihar (rank 35) ranked the lowest in the pack. Among the larger states, Orissa (rank 33) and Chhattisgarh (rank 29) also trail in the end. The slow pace of development in the northeast is emphasized by four of the seven states appearing in the bottom rung of the spectrum (Arunachal Pradesh 28; Tripura–34; Nagaland–32; Assam–31 and Manipur–30).

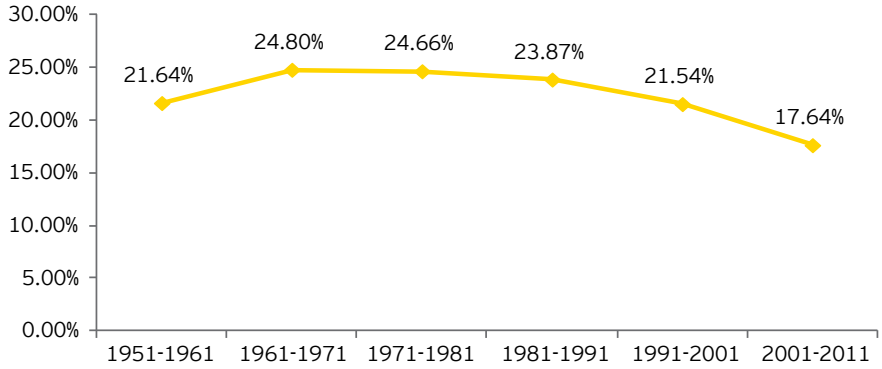


Assessing population welfare through housing

Housing in India

According to the Ministry of Housing and Urban Poverty Alleviation (MHUPA), the housing shortage in urban India has been estimated at 18.78 million households living in unacceptable dwelling units in 2012, a decline of 5.93 million from the 2007 estimation of 24.71 million. The drop in housing demand corresponds to the period, which has seen the sharpest decline in decadal growth rate of population by 3.90% from 21.54% (1991-2001) to 17.64% (2001-2011).

Percentage decadal growth rate of population



Source: Census of India, 2011.

The shortage in the housing segment is heavily skewed towards the bottom of the pyramid, with more than half the shortage (56.18%) arising due to the economically weaker section (EWS), followed by the lower income group (LIG) at 39.44% and a mere 4.38% estimated for the middle income group (MIG) and above[3].

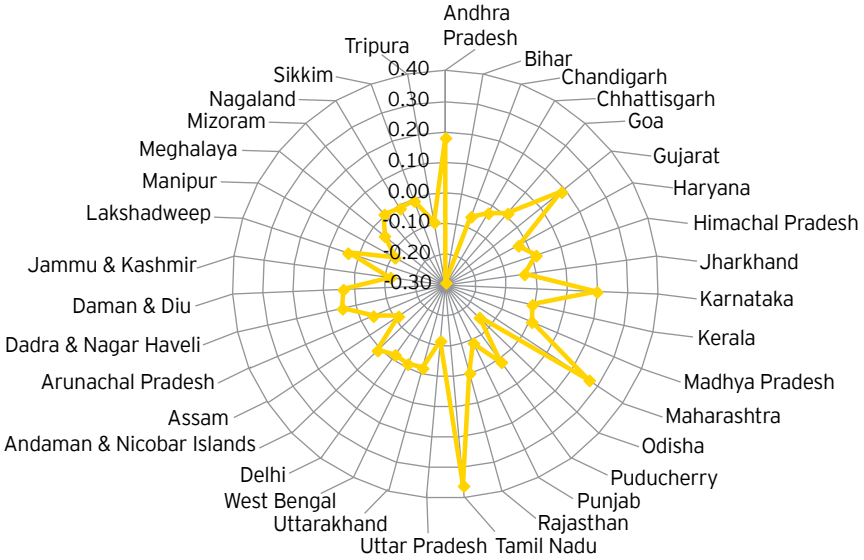
3 Report of the Technical Group on Urban Housing Shortage (TG-12) (2012-17), Government of India, Ministry of Housing and Urban Poverty Alleviation, National Buildings Organization, 2012.



Housing index ranking

The housing index ranking analysis has been established considering parameters to set up living conditions with respect to quality of housing, access to housing, ownership trends and awareness to avail banking and financial services.

State performance: housing index

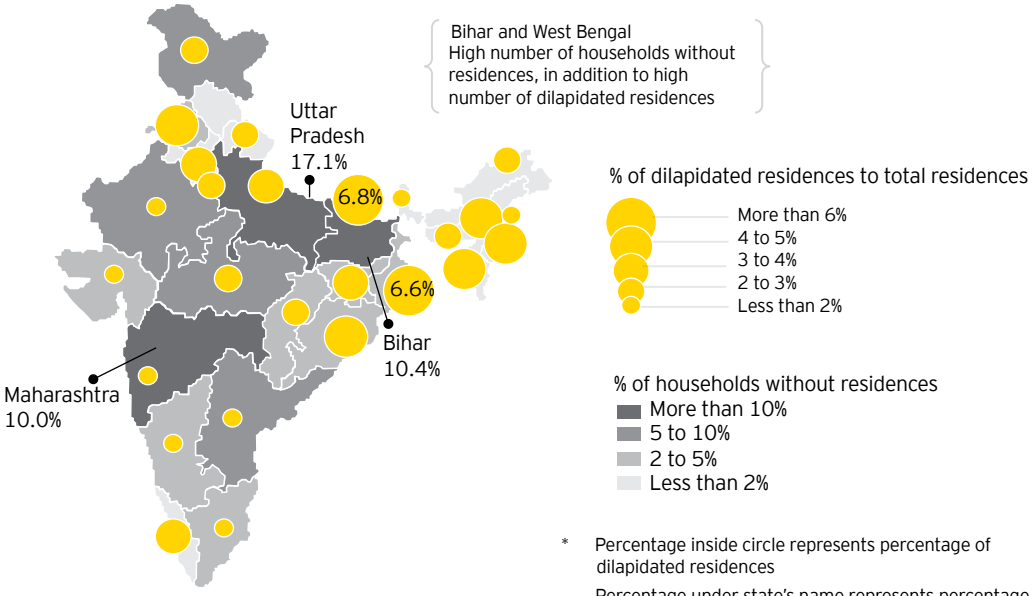


Source: EY analysis.

- Tamil Nadu leads the housing index (with good access to housing for its population, good quality housing and a reasonably high ownership status), followed by Maharashtra and Karnataka.
- Although Maharashtra has good quality housing and a high percentage of owned residences (70%)[4], it has a high number of households without residences, indicating poor access to suitable homes. This number is particularly high in the industrialized districts of the state, such as Amravati, Nagpur, Kolhapur, Mumbai and Mumbai suburbs, Thane and Pune.
- Karnataka has the distinction of having an almost equal percentage of owned and rented households, with most households providing access to good quality residences.
- The states at the lower rung of the ranking, namely Bihar, Uttar Pradesh and Odisha, have all recorded a significantly high number of dilapidated residences. Uttar Pradesh also recorded the highest number of households without residences.
- A time series evaluation shows that Gujarat and Haryana have shown a decline in the status of ownership from 2001 to 2011, possibly an indication of increased migration on account of jobs and/or inappropriate supply not catering to demand. On the other hand, Madhya Pradesh, Chhattisgarh and Odisha have shown an increase in ownership status, indicating a supply stream suitable to the affordability of the population.

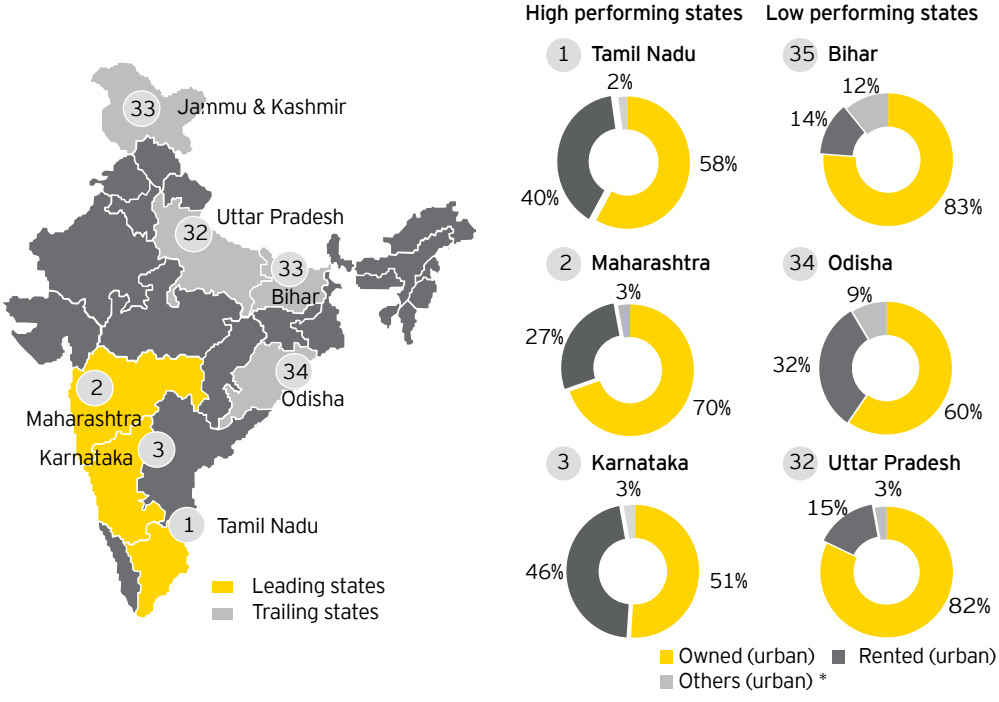
4 "Houselisting and Housing Data," *Census of India website*, www.censusindia.gov.in/2011census/hlo/District_Tables/HLO_District_Tables.html, accessed 27 September 2012.

Distribution of dilapidated residences and households without residence



Source: Census of India, 2011.

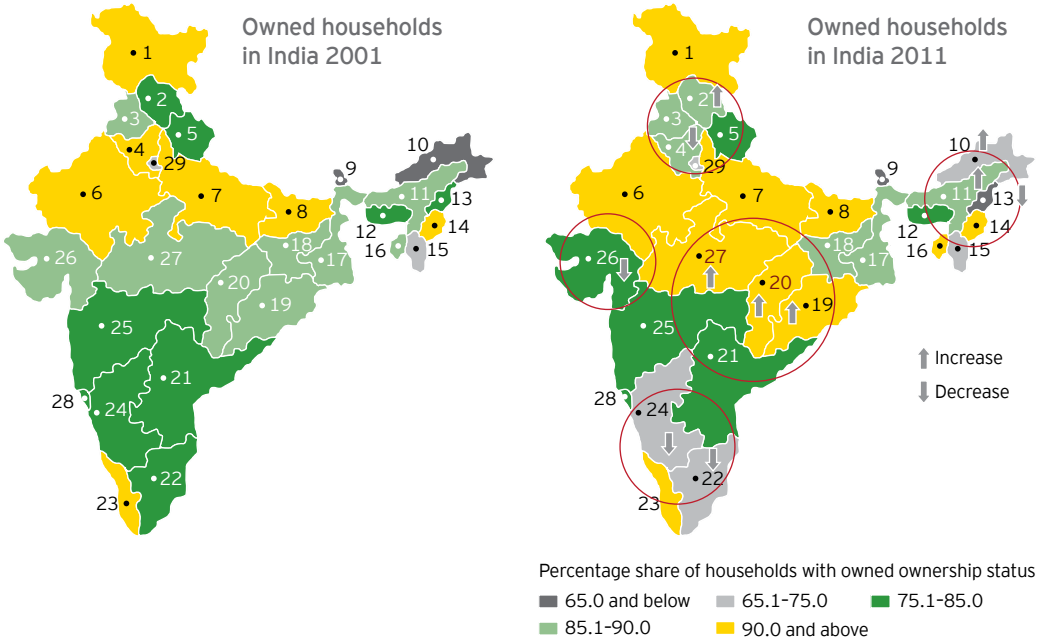
Ownership status and housing index ranking



* **Other households**: This includes households where rent-free accommodation is provided to employees by their employers or where the ownership either of the land or of the structure does not belong to the household, i.e., houses constructed on encroached land in un-regularized slums or anywhere else. This also includes households living in an unauthorized manner in abandoned buildings, buildings under construction and buildings identified for demolition for which they have not paid any rent. Households living in caves and similar natural shelters are also covered under this category.

Source: Census of India, 2011.

Distribution of households by tenure status - owned



1. Jammu & Kashmir, 2. Himachal Pradesh, 3 Punjab, 4. Haryana, 5. Uttaranchal, 6. Rajasthan, 7. Uttar Pradesh, 8. Bihar, 9. Sikkim, 10. Arunachal Pradesh, 11. Assam, 12. Meghalaya, 13. Nagaland, 14. Manipur, 15. Mizoram, 16. Tripura, 17. West Bengal, 18. Jharkhand, 19. Odisha, 20. Chhatisgarh, 21. Andhra Pradesh, 22. Tamil Nadu, 23. Kerala, 24. Karnataka, 25. Maharashtra, 26. Gujarat, 27. Madhya Pradesh, 28. Goa, 29. Delhi.

Source: Census of India, 2011.

Providing housing at more affordable prices to cater to the economically weaker section (EWS), lower income group (LIG) and middle income group (MIG) segment has traditionally been the responsibility of the Government. Entry of the private sector to cater to this segment, coupled with ease of getting housing finance to lower segments of the society, along with state government reforms and policies is likely to be the solution to bridging the housing shortage gap.

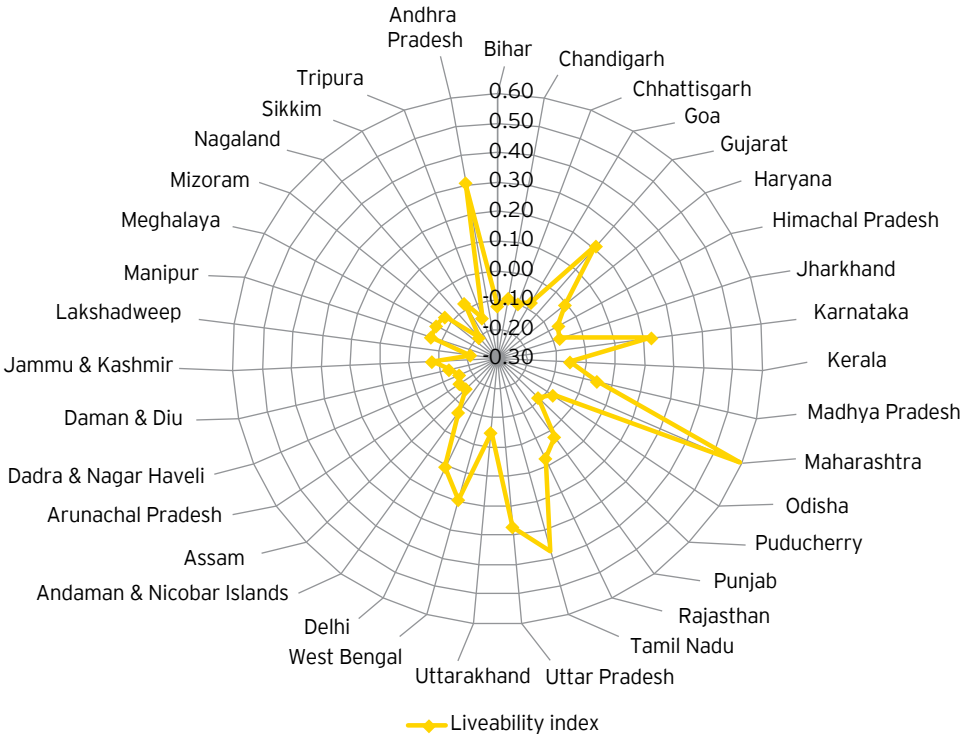
Liveability index

A state's progress and liveability cannot be mapped only by its economic progress. The living conditions of the people and their access to basic services such as lighting, treated drinking water, a bathing and sanitation facility within the household, along with a sense of safety, plays an important role in judging the liveability of the state. For example, the gross state domestic product of Uttar Pradesh is the third highest at US$78 (INR4,190) (at constant price: 2011-2012)[5], and ranks fourth in the liveability index; however, provision of basic services such as drinking water from treated sources to urban households is just 51.1%, according to the Census of India 2011. This is much lower than the national average of 65.3%. Thus, the liveability index ranking has captured data sets, which will analyze the overall living condition profile of the state with respect to physical infrastructure at the household level, such as access to electricity, sanitation facility, safety, and awareness level gauged by access to the Internet.

5 "Reports and Publication," *Ministry of Statistics and Programme Implementation, Government of India website*, www.mospi.nic.in/Mospi_New/upload/State_wise_SDP_2004-05_14mar12.pdf, accessed 27 September 2012.



State performance: liveability index



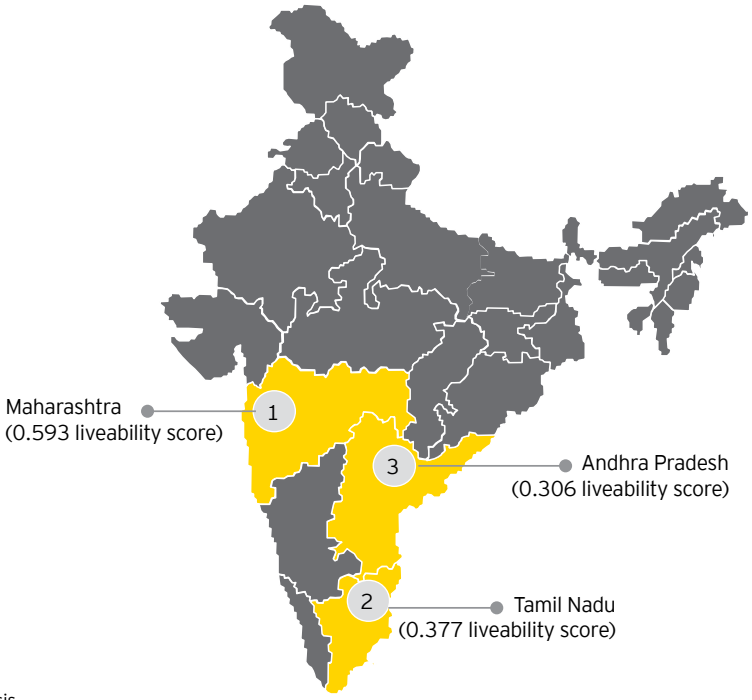
Source: EY analysis.

According to the liveability index ranking:

- Maharashtra, Tamil Nadu and Andhra Pradesh fare the best. All three states have more than 95% of the households with electricity as the main source of lighting. Tamil Nadu and Andhra Pradesh have seen a significant increase in electricity connections in comparison to the 2001 census estimate.
- Larger states, such as Bihar (rank 28), Chhattisgarh (rank 26) discounting union territories and northeastern states, have fared the worst. The unemployment rate is as high as 73% in Bihar, compared to a national average of 34% and a lower HDI of 0.367 (national average -0.467)[6].
- Goa has sound provision of urban amenities, with a maximum number of households having access to treated tap water within the premises (93%).

6 "Human Development,"*Union Budget and Economic Survey, Ministry of Finance website*, www.indiabudget.nic.in/es2011-12/echap-13.pdf,accessed 27 September 2012.

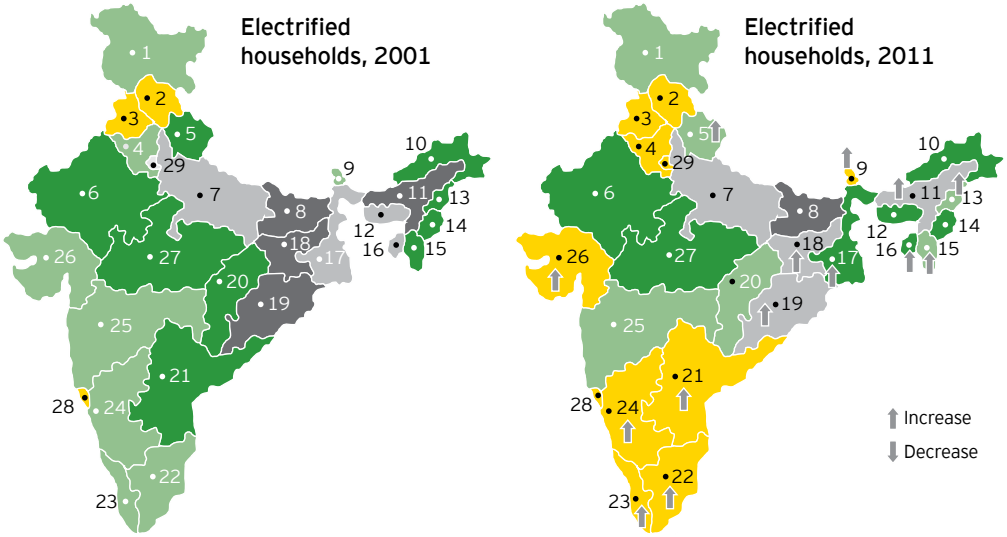
Liveability index ranking



Source: EY analysis.

Leading states

Households using electricity as source of lighting



Source: Census of India, 2011.

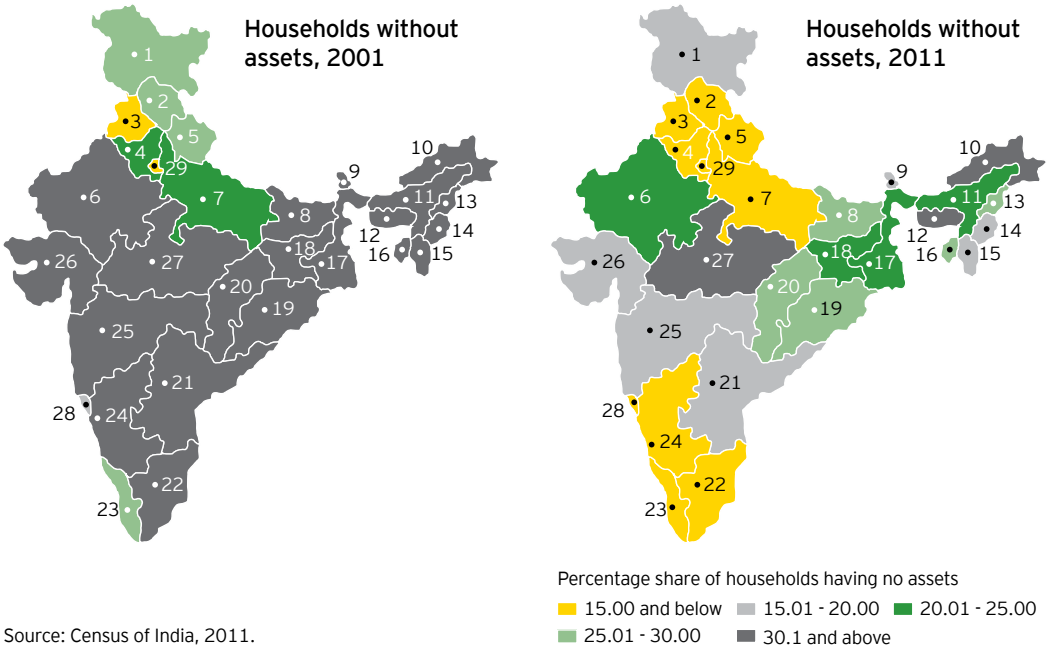
1. Jammu & Kashmir, 2. Himachal Pradesh, 3 Punjab, 4. Haryana, 5. Uttaranchal, 6. Rajasthan, 7. Uttar Pradesh, 8. Bihar, 9. Sikkim, 10. Arunachal Pradesh, 11. Assam, 12. Meghalaya, 13. Nagaland, 14. Manipur, 15. Mizoram, 16. Tripura, 17. West Bengal, 18. Jharkhand, 19. Odisha, 20. Chhatisgarh, 21. Andhra Pradesh, 22. Tamil Nadu, 23. Kerala, 24. Karnataka, 25. Maharashtra, 26. Gujarat, 27. Madhya Pradesh, 28. Goa, 29. Delhi.

Consumption propensity index

The propensity to consume is much higher in developed states with increased awareness and income levels. In the past 10 years, there has been a considerable rise in consumer purchases of items, such as televisions, computers, and two wheel and four wheel vehicles of households across the country. The rise in the middle class is also one of the main drivers for increased consumption.

The consumption propensity index attempts to capture the prosperity of the people in the state and their purchasing power, which will further help in understanding the capacity of its citizens to invest in buying homes.

Change in asset ownership of households

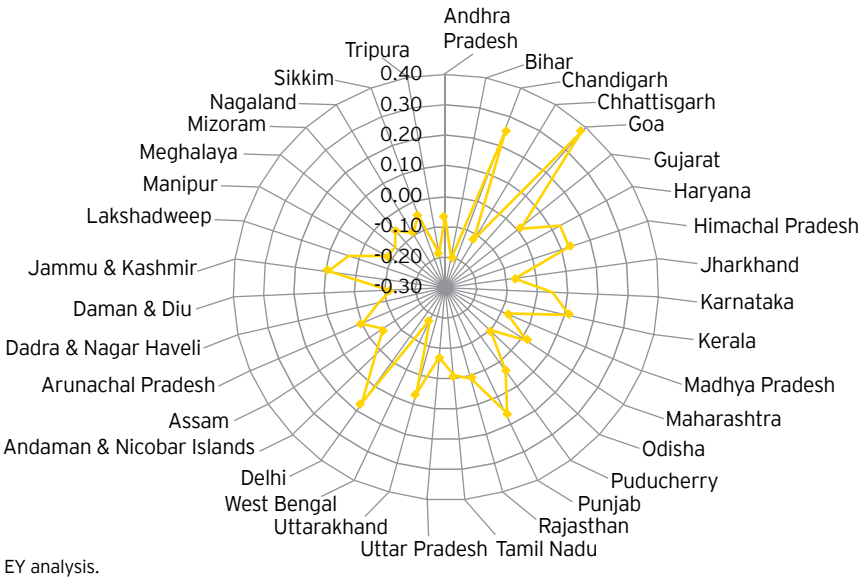


Source: Census of India, 2011.

1. Jammu & Kashmir, 2. Himachal Pradesh, 3 Punjab, 4. Haryana, 5. Uttaranchal, 6. Rajasthan, 7. Uttar Pradesh, 8. Bihar, 9. Sikkim, 10. Arunachal Pradesh, 11. Assam, 12. Meghalaya, 13. Nagaland, 14. Manipur, 15. Mizoram, 16. Tripura, 17. West Bengal, 18. Jharkhand, 19. Odisha, 20. Chhatisgarh, 21. Andhra Pradesh, 22. Tamil Nadu, 23. Kerala, 24. Karnataka, 25. Maharashtra, 26. Gujarat, 27. Madhya Pradesh, 28. Goa, 29. Delhi.

* Assets include television, computer/laptop, telephone/mobile phone, two-wheeler and four-wheeler.

Cosumption propensity index

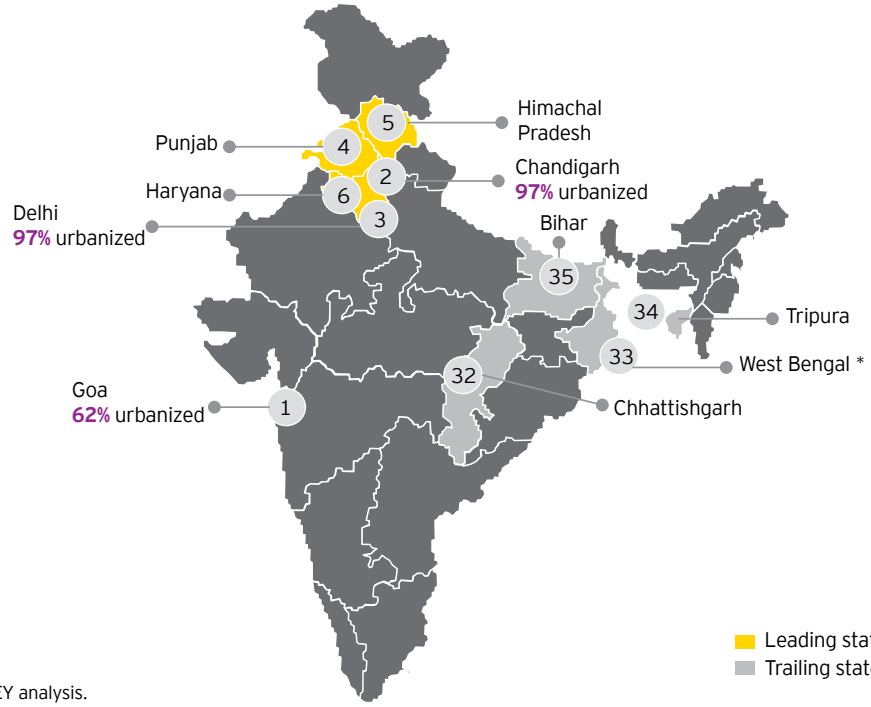


Source: EY analysis.

According to the state consumption propensity index ranking:

- Goa, Chandigarh and Delhi fare the best in the ranking. These three states function more as city states, exhibiting a high urbanization rate with 62% in Goa, 97% in Chandigarh and 97% in Delhi[7].
- If the larger states are considered (excluding Delhi, Chandigarh and Goa), Punjab (rank 4), Himachal Pradesh (5) and Haryana (6) fare better than the other states.
- Delhi (INR119,032) and Goa (INR112,372) has one of the highest per capita income with a growth rate of more than 10% from the previous year, which can be linked to an increase in consumer purchases of assets[8].

Cosumption propensity index ranking



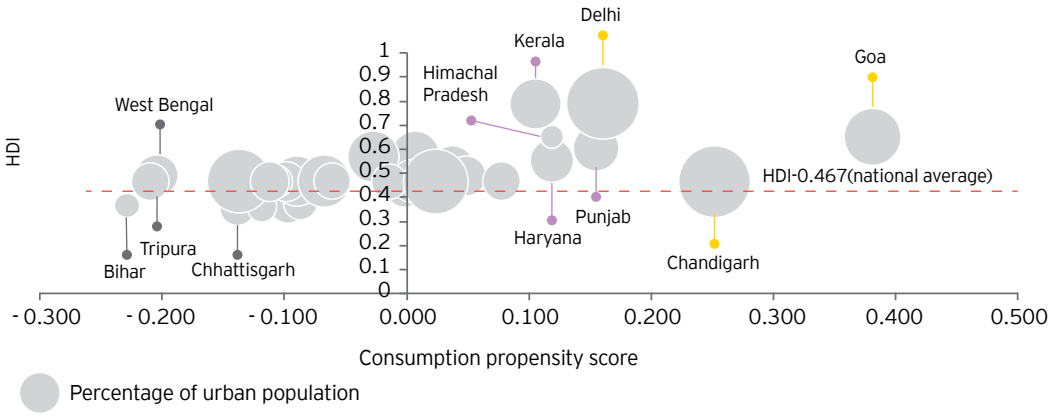
Source: EY analysis.

7 "Provisional Population Totals," *Census of India website*, www.censusindia.gov.in/2011-prov-results/paper2/data_files/india/paper2_1.pdf, accesses September 27, 2012.

8 "Statistical reports," *Department of Planning, Government of Punjab website*, www.pbplanning.gov.in/pdf/Statewise%20GSDP%20PCI%20and%20G.R.pdf, accessed 27 September 2012.

- Bihar (rank 35) fared the worst, despite the state recording one of the highest per capita income growth rates of 13.13%[8]. The state also has a very low urbanization rate of 11.3% (national average of 31.2%), along with a very high unemployment rate of 73% in the urban area (national average of 34%). The urban literacy rate of the state is 78.75%, much lower than the national average of 84.98%[9].
- The top six states also exhibit a high Human Development Index (HDI), higher than the national average of 0.467, which establishes that states with high income levels, more educated and proficient citizens, along with increased exposure to information media, increases the consumption propensity of the state.

States which have an HDI closer to the national average are demonstrating lower consumption propensity.



Source: Census of India, 2011.

Conclusion

Development of new housing stock at an affordable range will be crucial to meet the housing shortage of 18.78 million households living in unacceptable dwelling units. The decline in the housing shortage can be good news, but there is still a considerable housing shortage in urban India. With around 2 million dilapidated households in urban India, planned redevelopment with rationalized floor space index could ease the housing woes in the worst-affected districts. These include Mumbai (59,094 dilapidated houses including suburbs and Thane), Kolkata (25,777) and Patna (21,077), which presents a sizable market[10]. The city of Shanghai is an outstanding example of how a city re-oriented its focus and prospered through redevelopment.

Cities in India need to re-think their strategies and find solutions and innovations to upgrade and match world standards. Singapore, a city state, has been successful in transforming itself into a world class city with excellent urban amenities. This was achieved by making the jobs in the civil authorities the best in the industry, by matching their salaries with private sector salaries. In India, there is a dire need for capacity building in India's urban local bodies. Gurgaon is a clear example of the downfall of comprehensive city planning. Though the city today has a very developed real estate market attracting some of the biggest corporate entities in the world, housed in "A" grade real estate, the civic infrastructure in the city is unable to cope with the demand. On the contrary, the neighboring region of New Okhla Industrial Development Authority (NOIDA), developed its infrastructure before allowing real estate development. Greater NOIDA learned from NOIDA and has exceeded the development profile of NOIDA further.

Considering that in India, development is currently focused around cities, the urban fringes of India's cities take on the character and (often) the waste of India's cities. Acknowledging this growth pattern and increasing focus on regional planning, as opposed to restricted city planning, will immediately ensure planned city expansion.

9 "Provisional Population Totals," *Census of India website*, www.censusindia.gov.in/2011-prov-results/paper2/data_files/india/paper2_3.pdf, accessed September 27, 2012.

10 "Houselisting and Housing Data," *Census of India website*, www.censusindia.gov.in/2011census/hlo/District_Tables/HLO_District_Tables.html, accessed 27 September 2012.

2

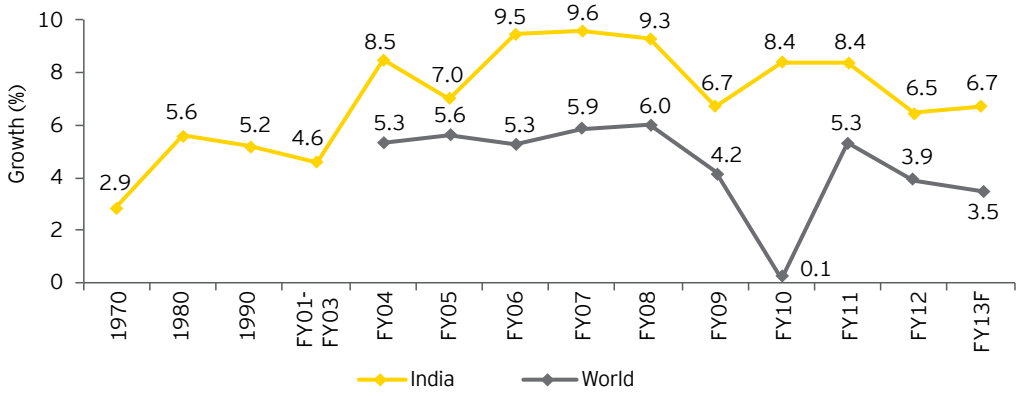
Indian realty

Influences of a maturing policy environment

Economic overview

India has continued on its growth trajectory with an average annual gross domestic product (GDP) growth of 8.5% in the last five years, relative to an average annual growth of 4.3% in real world GDP. Lower demand and reduced business confidence, due to global turbulence, resulted in poor performance by several sectors, affecting India's GDP growth, which was 5.3% in 4Q12. However, the Indian economy is expected to witness a revival in growth in FY2013 with the GDP projected to increase at 6.7%. The primary sector contributing to the growth is the services sector, which has contributed 56% in FY2012.

Real GDP growth rate: India vs. world



Source: Centre for Monitoring Indian Economy and IMF (CMIE); IMF.

Indian real estate market

The Indian real estate industry has witnessed various cycles during 2007–11. While it is in the recovery mode, several problems still challenge market stability. The fundamentals are still strong; however, price increases, tightening liquidity, increasing cost of raw material and surplus supply, along with economic uncertainty, have compelled users to adopt a policy of wait and see while developers struggle to complete their projects on time.

Trends and outlook for Indian real estate

Trends	Outlook
Residential: demand for the right product at a suitable price point	
Regional influence across markets ▶ Markets in southern India being more end-user driven have shown greater resilience than other parts of the country. The Chennai property market has been the most stable. ▶ As of July 2012, months of unsold inventory in prime cities are Gurgaon – 12 months, Bengaluru –19 months, Mumbai – 26 months and Chennai – 13 months[11] Prices remain firm ▶ Rising cost of construction in the past quarter has kept prices firm – despite the slowdown, NCR, Chennai and Bengaluru show 15% year over year and Mumbai shows a 5% year over year increase in prices[12].	▶ There is likely to be an improvement in absorption levels. ▶ A significant number of new launches is expected. ▶ Cautious customers are expected to be wary due to high inventory levels and firm prices.
Office: driven by economy	
Office leasing remains weak ▶ Absorption of office space by information technology/ information technology enabled services (IT/ITES) contributed only 35% in 2011 as compared to 47% in 2010[13]. ▶ For 1Q12, absorption declined by12% year over year to 7.4 msf. New supply in this period has slowed down to 6.0 msf[14]. ▶ Bengaluru has shown positive absorption trends. Lease inquiries have come down in the last couple of quarters, while vacancy levels and rentals are stable because of weak supply. ▶ Incidences of repositioning of commercial office space to attract clientele have been seen in bigger metros. There is limited supply of new office space, albeit at a much slower pace. Polarization in office space markets ▶ Demand exists for well located grade "A" office space. ▶ Favored locations, such as BKC/Lower Parel in Mumbai, Gurgaon, outer ring road (ORR) in Bengaluru, are witnessing strong demand and negligible vacancy. Distant location on the other hand, are experiencing low rentals and high vacancy[15].	▶ Total absorption of the country office space is expected to be approximately 32 msf for 2012, a decline of 13% year over year[16].

11 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

12 EY analysis and "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

13 Office absorption break up by sectors, "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

14 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

15 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

16 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

Trends	Outlook
Retail: brightest star on account of revising policy environment	
Promising absorption indicates return of demand ▶ In 2011, the sector witnessed record completions of 13.8 msf of retail space with absorption of 10.7 msf[17]. ▶ In 1Q12, rentals remained stable across key cities. ▶ High street and good quality malls continue to attract demand. ▶ Changing approach to construct malls – luxury and theme-based malls are increasingly gaining momentum. ▶ Contract model for leasing is witnessing change. ▶ Minimum guarantee, coupled with revenue share, has ecome the most acceptable framework for tenants in new malls.	▶ Demand for retail space is expected to be robust due to the high lease inquiries. ▶ Rentals are likely to remain stable. ▶ Expected supply in 2012 of the retail space is between 10 and 13 msf, while the demand is pegged above 7.5 msf[18]. ▶ Opening up of Foreign Direct Investment (FDI) in multi-brand retail is likely to be a big game changer in the retail segment.
Hospitality: on a potential growth trajectory	
Moderate performance in 2011 ▶ Occupancy levels were sustained in several markets and dropped marginally by 5% in National Capital Region (NCR)[19] despite incremental room inventory in key markets. On an average, occupancy rates had fallen to 62.1% from 66.8% in 2011[20]. ▶ Muted Average Room Rental (ARR) and a marginal decline of 3%–5% in revenue-per-available-room (RevPARs) in 2011–12 on a year over year basis[21]. **International and domestic travel is on rise** ▶ In 2011, 6.29 million foreign tourists visited India – an increase of 8.9% from 2010[22]. ▶ During 1H12, 3.24 million tourist visited India, a 7.4% increase over 1H11[23]. ▶ The domestic tourist visits increased to 851 million, an increase of 13.8%[24], due to the weakening rupee and extension of visa on arrival scheme to 13 countries. As per the Twelfth Five Year Plan, domestic tourists are likely to grow to 1,451 million, whereas foreign tourist arrivals are likely to touch 11.24 million by 2017. With domestic travelers likely to account for 99% of tourists in the country, it is imperative to have hospitality products catering to domestic demand. ▶ A number of ultra luxury brands are looking to enter the Indian market, to capitalize on the country's growing tourism potential. ▶ Demand in budget and mid-market segment ▶ Growing spending power of the middle class has raised the demand for value for money accommodation. ▶ Increased business and leisure travel outside the Indian metros has brought to the forefront the lack of safe, hygienic and affordable rooms in the non-metro cities.	▶ Cost-cutting measures by the corporate sector helped in increasing the demand for budget and mid-segment hotels. ▶ The profitability of premium hotels is expected to dip marginally in FY13 and FY14, as a result of considerable number of room additions if the global economic condition does not improve. This is likely to impact occupancy rates (below 60%) and operating margins (18%)[25].

17 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

18 "Realty Check," J.P. Morgan India Private Limited, 03 July 2012, via ThomsonOne.

19 "INDIAN HOTELS INDUSTRY," ICRA Limited, March 2012, via Thomson One.

20 Nivedita Ganguly, "Increase rooms to meet surging demand, says hotel body," *Business Line (The Hindu)*, 14 September 2012, via Factiva, ©2012 The Hindu Business Line.

21 "INDIAN HOTELS INDUSTRY," ICRA Limited, March 2012, via Thomson One.

22 "Statistics," *Ministry of tourism website*, http://www.tourism.gov.in/, accessed 17 September 2012.

23 "Statistics," *Ministry of tourism website*, http://www.tourism.gov.in/, accessed 17 September 2012.

Trends	Outlook
Industrial: Government taking steps to revive SEZ attractiveness	
Special Economic Zones (SEZ) ▶ 386 SEZs have been notified, and the Board of Approvals has granted formal approval to 586 SEZs[26]. ▶ After the imposition of Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT), growth in exports from SEZs slowed to 15.4% in 2011–12, from 43.1% in 2010–11 and 121% in 2009–10[27]. ▶ The Government is considering incentives to promote IT-related export hubs in small towns as part of its effort to attract back investors to SEZs. ▶ Some of the expected incentives are a decrease in the mandatory minimum area requirement for different categories of SEZs and broad banding of sectors, which will allow ancillary units to come up in sector-specific SEZs.	▶ Once these incentives are imposed and the rules simplified, SEZ may become more popular.

Regulatory changes

FDI in retail to increase demand for retail space: The recent Government move to allow 51% FDI in multi-brand retail will attract investments and has the potential to change the retail landscape. This is likely to go a long way in strengthening organized retail. In the coming months, international retailers will accelerate their entry strategy and are likely to create a huge demand for retail space in key cities[28].

This development will compel the retailing giants to go back to their drawing boards and explore joint ventures. The real estate retail segment will benefit from the increase in demand and investors' confidence in the front end in the form of retail store space. Additionally, warehouses are likely to flourish in the backend. This is likely to bring about a change in design of malls, and the average size of the malls is likely to increase, along with the speed of implementation of these projects to cater to near-term demand.

> The 51% FDI has been permitted with certain caveats, and also subject to final approval from respective states to allow implementation within Indian states. Some of the conditions are : cities with a population of more than 1 million are eligible for 51% FDI in retail, 50% of total investment will have to be invested in "backend infrastructure" within three years of the induction of FDI, and firms will have to source 30% of their products from micro, small and medium enterprises.

24 "Hotel & Tourism Newsletter - July 02 to July 06, 2012," Indiainfoline News Service, 6 July 2012, via Factiva, © 2012 Indiainfoline Ltd.

25 Nivedita Ganguly, "Increase rooms to meet surging demand, says hotel body," *Business Line (The Hindu)*, 14 September 2012, via Factiva, ©2012 The Hindu Business Line.

26 *SEZ India website*, http://www.sezindia.nic.in/index.asp, accessed 17 September 2012.

27 "Govt to promote IT SEZ in tier-II, tier-III cities," *The Times of India*, 21 June 2012, via Factiva, ©2012 The Times of India Group.

28 "FDI will change retail landscape, attract investments", *Business Line (The Hindu)*, 17 September 2012, via Factiva, ©2012 The Hindu Business Line.

Proposed Land Acquisition and Rehabilitation & Resettlement Bill (LARR): The bill likely to make real estate developments costlier. The prime focus of the Bill is integration of Relief & Rehabilitation (R&R) with land acquisition. The LARR is a mixed bag for private developers.

Although private developers are still free to buy land at prices agreed on through private negotiations, they have to provide rehabilitation and resettlement (R&R) benefits if more than 50 acres of land are bought in an urban area and 100 acres in a rural area. Moreover, certain conditions in the R&R package, such as reservation of 20% of developed land for landowners as part of their rehabilitation entitlement, can make real estate projects not viable. Additionally, a subsistence allowance for 12 months and an annuity for 20 years are difficult to implement and can affect project internal rate of returns (IRR), making the project unprofitable in the long run.

Most of the cost of land acquisition and R&R are likely to be passed on to the end users, impacting them significantly. For private developers, the land acquisition process can become more difficult due to the R&R conditions and the fact that the Government will not be able to influence people to sell land, although the cost of land acquisition remains the same[29].

New accounting norms for real estate projects: In a bid to standardize revenue recognition across real estate developers, the Institute of Chartered Accountant (ICAI) has released a final guidance note for accounting of real estate projects.

According to the guidelines, for a project to start contributing, the following four conditions should be met:

a. All major approvals should be in place.
b. Cost incurred should be at least 25% of the total construction cost (excluding land cost).
c. At least 25% of the sales should be secured.
d. Collections – 10% of the amount should have been realized from the sales executed.

29 "India Real Estate," J.P.Morgan, 23 August, 2011, via Thomson One, "India Property," Morgan Stanley, September 2011, via Thomson One.

However, once the 25% threshold is reached, developers can front load the revenue recognition, as land cost is included in percentage completion. For high-end projects, a higher amount can be booked.

A new launch can take about a year before it starts contributing to revenues/earnings as opposed to about one or two quarters now. Some developers are already practicing conservative accounting practice; however, many developers will have to delay the revenue recognition, which would impact the total revenue[30].

Maharashtra assembly clears housing bill: In July 2012, the Housing (regulation and development) Bill was passed by the Maharashtra assembly, which will establish the Housing Regulatory Authority and Housing Appellate Tribunal[31].

> Developers will have to register their housing project with the regulatory authority and display it on the website, along with project details such as title, the floor space index (FSI) used, financing and mortgage details, amenities to be provided, etc. Currently, the regulator's approval is mandatory to launch the project. Complete breakdown of the charges of common areas will have to be mentioned clearly on the website. All delays by the developer will invite penalty charges of up to INR10,000 per day. The developer will be liable to rectify defects up to five years from handing over the project.

Although the bill is an attempt to increase transparency, it will increase the burden of additional approvals in addition to the numerous approvals already on the table.

30 "India Property," J.P. Morgan, 05 March 2012, via Thomson One.

31 "India Property," Nomura, 17 July 2012, via Thomson One.





Outlook

Urbanization will be the single-largest factor driving demand for real estate and housing in particular.

Residential – By 2015, more than 410 million people will be staying in cities, which is more than the population of the US. There is expected to be increased demand in the middle-income residential space segment.

Commercial – Strong growth in the services sector and revival in manufacturing are expected to help the economy maintain high-growth levels in the coming years and enable the office space to gather its lost momentum.

Retail – The retail space is currently witnessing excessive supply; however, the gap between demand and supply is narrowing. Moreover, the Government's decision to allow FDI in multi-brand retail could be a boon for this segment.

Hospitality – According to the report by the Working Group on Tourism (Twelfth Five-Year Plan), India will need an additional 181,752 approved hotel rooms by 2016 to meet demand from foreign tourist arrivals (FTAs) and domestic tourists. Additionally, India will also require another 2,078,288 unclassified hotel rooms by 2016 to meet the demand. Investment in budget hotels and mid-segment hotels is likely to increase.

3

Raising funds

Trends in private equity in India and other emerging economies[32]

The real estate private equity funds sector is witnessing a period of significant structural and cultural change, with cautious investors, large-scale regulatory overhauls and the ongoing illiquidity of the capital markets all driving change. Considering the impact of these factors, the emerging environment for funds is not for the faint hearted. Deal flow remains slow, if not stagnant, in most markets. Fund-raising continues to be challenging, especially for new funds. Furthermore, there is potential for market consolidation, where some of the more enhanced platforms are likely to look to acquire niche, small platforms or mid-tier managers will look to merge. Otherwise, India is likely to see some of the small real estate managers exit the market altogether.

However, amid the many uncertainties, this is a period in which creative investors can thrive. Indeed, devising and offering creative solutions for the market will be a key differentiator for successful funds in this new environment.

In terms of investor relationships, this means forging new partnership arrangements and, increasingly, opening separate accounts with individual investors. The amount of institutional and foreign capital chasing real estate opportunities is at near-record levels in gateway cities across North America and Western Europe. However, while many institutional investors continue to seek local competencies and services provided by fund managers, they are insisting on more transparency and oversight on their investments. They are also demanding considerably low fees, which mean funds must subsist on less to retain and attract new business.

In addition to heightened investor requirements, tighter regulatory standards are forcing funds to reexamine their business and operational strategies. Two major pieces of legislation are creating a direct impact on alternative investment funds, with the objective of improving transparency and oversight of the sector — the Dodd-Frank Act in the US and the second phase of the Alternative Investment Fund Managers Directive (AIFM) in Europe. Both measures have significant near-term compliance requirements that will be costly and will necessitate large-scale structural change for many firms.

The upside to the pressures of intensifying investor demands and regulatory scrutiny is that new solutions are emerging within the real estate funds sector to improve operational efficiency and reduce costs. Software vendors and fund administration service providers, who have not seen a great deal of activity historically from this sector, are rapidly working to devise pure-play real estate platforms and boost staff to meet the current rush of demand. Further, offshore centers are increasingly attracting business from large funds looking to outsource their back-office functions to lower-cost areas. Overall, the challenges posed by the current environment will ultimately make it easier for fund managers to build more efficient, transparent and scalable platforms, which will, in turn, attract a wide range of investors from around the world to the real estate funds sector.

Perhaps, the biggest challenge for global real estate funds remains beyond their control — continued illiquidity in the capital markets. The lack of available bank debt has stifled deal flow and limited the pace of recovery outside of primary markets in North America and Europe. Even the once booming emerging markets are feeling the impact of bank lending constraints, although their economic growth trends remain positive.

32 *Global market outlook: Trends in real estate private equity*, Ernst & Young, October 2012.

Nevertheless, banks' restrictions and withdrawal of capital from the real estate markets has created plenty of new opportunities for real estate private equity funds. Given the large number of assets facing imminent loan maturities and broken capital structures, many funds are finding opportunities in the refinancing space. Senior debt funds are also gaining momentum, particularly where banks are limited by regulation than liquidity, as in China. Most surprisingly, however, is growth in the secondary trading market for close-ended funds. By allowing limited partners to trade out their positions, this solution has opened new doors for opportunistic investors, while also helping to restore investors' confidence in the real estate funds sector.

Spotlight on Asia

The situation in the Asian real estate sector varies significantly from that of North America and Europe. Although the situation in Europe has made a number of limited partnerships (LP) hesitant to pull the trigger on new transactions, there is a considerable amount of capital available in the market.

China is one of the few Asian markets which seems to have a significant opportunity for debt funds to achieve mezzanine debt and distressed-level returns. Due to tightened government regulations on banks, it has become extremely difficult to secure bank lending for the development sector, driving many small- and medium-sized developers to offshore debt providers. However, a number of funds actively sourcing the pipeline in China are still waiting for market clarity before giving the green light, since there is some expectation that prices can drop further.

Such high returns are otherwise not prevalent in the Asian markets because of low interest rates, low cap rates and firm asset pricing. Since the markets crashed in the late 1990s, banks have limited exposure to real estate, but were readily lending because of the continued GDP growth in most Asian countries. The availability of cheap bank financing effectively eliminated the market for mezzanine-debt providers, leaving development risk as one of the only options for funds targeting returns above 20%. This is true even for Indonesia, which has historically had high interest rates. The rates, which stood at around 14% several years ago, have currently declined to 6%.

Beyond China, Vietnam is likely to be another destination that offers distressed-level returns; however, executing and closing these transactions are quite challenging due to regulatory challenges on titles and price gaps.

Deal flow

With regard to overall deal flow, the Asian markets, particularly Singapore and Malaysia, are active. Singapore, looking to position itself as a gateway market such as Hong Kong, has been successful at attracting core investors looking for office, hospitality and other commercial properties. However, Malaysia primarily attracts value and opportunity funds, as do Thailand and Indonesia.

Among the most active players in the Asian real estate markets are the global US-based real estate funds. In spite of high investor interest, the number of transactions being completed by real estate funds in Asia has slowed, due to impact from the crisis in Europe. Growth in asset pricing has also slowed to between 2% and 5% on average, compared with 7% to 10% several years ago.

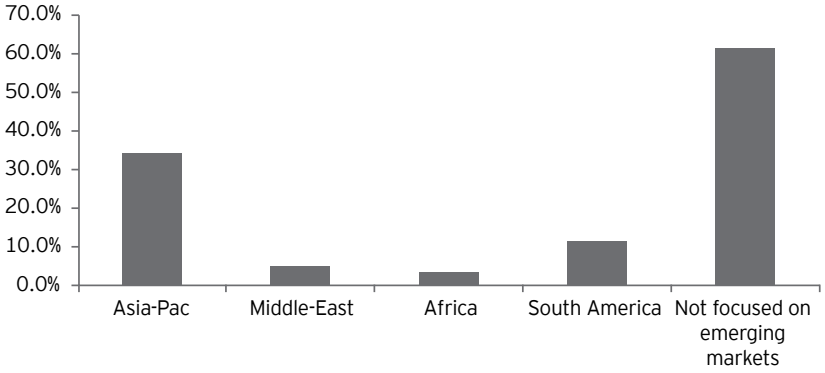
Emerging markets in focus

Real estate activity in the emerging markets of Brazil, Russia, India and China (BRIC) has not been immune to challenges in the global economy. The retreat of European funds has been felt throughout the BRIC nations. The recent slowdown of foreign capital chasing deals in these markets can primarily be attributed to the perceived level of risk.

Real estate experts in each market agree that risk perception among investors is highly dependent on the level of the investor's market familiarity. Local investors often end up with a competitive edge on new deals because they appear to have higher risk appetites, while the reality may be that they are more comfortable with otherwise "risky" assumptions, since they understand their home markets better. Foreign investors, who have continued to have success in finding opportunities with returns between 20% and 30%, either have a long-standing presence in those markets or have been diligent in their choice of local partners.

In spite of this common theme, the BRIC nations have very individualized market dynamics and drivers. Key real estate trends and issues in each of these nations are discussed in the following sections.

What region(s) are you most focussed on for exposure to emerging markets?*



Source: EY analysis.

* Extracted from private equity fund survey conducted by Ernst & Young. Detailed survey available in Global market outlook: Trends in real estate private equity, Ernst & Young, October 2012

Ernst & Young embarked on a survey of real estate private equity funds to enhance the industry's knowledge, as well as our own, of what we have seen as a large and growing sector. The survey, which included 12 questions covering many subjects, including capital markets, financial and performance reporting, taxes, was sent to more than 300 real estate private equity managers. We received 66 responses. Not all respondents answered every question, and certain responses were supplemented with information gathered in personal interviews with the General Partners.

Ernst & Young has maintained the confidentiality of all responses and respondents. Under no circumstances will the identity of the respondents be revealed to the public or the other respondents. In preparing this report, Ernst & Young relied on the data and information supplied by the respondents. We did not attempt to verify the responses provided by the respondents, and we do not take responsibility for the accuracy or reliability of the data.

India funding trends

India's real estate markets are currently in a state of transition. Following the heavy influx of private equity funds to focus on new real estate development projects from 2005–07, the last couple of years have seen a slow, steady exit of that first wave of capital with the closing of the five- to six-year investment cycle. Currently, a new set of investors is taking an interest in Indian real estate with a focus on buying completed projects, last-mile funding and funding annuity assets. In the case of new development, funds seem to be showing a preference for smaller projects, with their interest confined to five major cities — Delhi, Mumbai, Bengaluru, Chennai and Kolkata. Institutional capital has focused on hotels and urban residential projects, suggesting that new capital is taking a more focused approach to specific asset classes.

Most foreign investors (still a small part of the investor community in India) continue to partner with local developers and real estate experts on deals. Most real estate activity in India continues to be conducted by individual investors, as domestic institutions are largely limited in their ability to invest in real estate due to regulatory interventions.

One of the fastest-growing segments is the residential mortgage market (currently in a nascent state), due to a growing middle class population and rising average household income. The size of this growing market has also had a positive impact on demand for retail. In addition, the bond market is fast maturing and is becoming an increasingly popular means for institutional investors (both foreign and domestic) to engage in the Indian real estate market. The growth can be attributed to the preference of most local investors and developers to seek lending partners over equity partners on deals.

Despite this growth, the real estate sector in India continues to face significant challenges. The foremost challenge facing the sector today is the continued rise in prices (which started in 2005 as a result of the Government's market liberalization programs) even though investor interest has slowed due to the global economic crisis. Additionally, securing land for new projects remains difficult since a vast majority of land is designated for agricultural use. Lastly, raising new funds has become more difficult. Many investors have taken a wait-and-see stance, as they wait for proof from the first major wave of real estate investment, which is currently exiting the market.

- Massive urbanization, strong local demand and a thriving economy have all been driving a strong commercial real estate sector in India over the past several years.
- Banks are lowering their exposure to real estate so developers must obtain financing from non-banking sources.
- India has favorable demographics for real estate investment that are attracting foreign investors: a large labor force, a young population and a growing middle class with greater amounts of spending power.

Source: Real Capital Analytics, DTZ.

Funding trends in other BRIC nations

Brazil

Brazil continues to attract substantial interest from real estate private equity funds based both within and outside the country. An estimated US$3 billion has been raised by these funds for investment in Brazilian real estate. In spite of the market's strong growth potential, deployment of this capital has slowed down because of the crisis in Europe and its impact on the global economy as a whole. Since most of these funds have a fairly long investment timeline — typically 7 to 10 years — investors feel they can afford to be selective with investment opportunities.

With Brazil's emerging market status, many funds focused on Brazilian real estate continue to target returns between 20% and 30%, although there are fewer projects which are able to match these rates than there were two to three years ago. Most of these that fall within this range are ground-up development projects. Foreign funds, in particular, are likely to face difficulty in establishing whether a project's assumptions are reasonable without partnering with local real estate experts or hiring independent advisors and engineers to supervise construction.

Corporate office properties remain the primary focus because of considerable demand for office space and extremely low vacancy rates. For example, in prime office areas of São Paulo, empty office space is roughly 0.5%–1% of total inventory. Demand for business hotels is also high among investors, particularly in São Paulo, Rio de Janeiro and Recife. Demand for residential developments is also high in these cities, due to Brazil's growing middle class and rising number of first-time home buyers.

Many funds are increasingly focused on the Brazilian real estate derivatives market, either on the receivables end, which is proving a stable source of income for many, or by listing assets on the stock market. As this market has grown more sophisticated, it has become a popular entry point for smaller investors.

- The weak global economy has started to affect Brazil. Its economy grew only 0.75% in 1Q12. However, inflation and unemployment are both declining.
- Sales of trophy assets drove average prices for retail and office properties to multi-year highs.
- Transaction activity has picked up in Brazil's secondary markets, where development is meeting the needs of a growing consumer class in previously underserved markets.

Source: Real Capital Analytics, Prudential Real Estate Investors.

Russia

The trends in the Russian real estate market has shifted from last year, which was the country's most active year for investment and deal flow. Highly liquid, at-home investors have remained engaged in the market, but deployment of foreign capital has slowed, outside of a few trophy office and retail sales, where competition from less risk-averse local investors is significant.

The retreat of European investors has been felt more acutely in Russia than in other emerging markets because of its close economic ties with Europe. Furthermore, North American, Middle Eastern and Asian investors are less familiar with Russian real estate and have historically provided a very small share of total transaction volume.

The debt markets in Russia remain liquid relative to other global markets, even though many international banks have withdrawn to address problems in their own domestic markets. Russian banks are continuing to lend on transactions and development projects in spite of their considerable exposure to real estate. However, interest rates remain relatively high. Foreign banks that have remained engaged in the Russian real estate market often offer less costly capital than domestic lenders. Mezzanine debt funds have not managed to take off in Russia, as sophisticated capital structures are uncommon in real estate transactions.

Over the long term, real estate players in Russia should expect to see considerable market growth beyond Moscow. The Government of Russia is kicking off a number of significant development initiatives in the region particularly around the northern Caucasus and the Black Sea, ahead of the 2014 Winter Olympics. While these plans are in their early stages, the goal of attracting investors to these areas means that both system and market transparency will likely improve.

- Russia has survived the challenging global economic conditions. The International Monetary Fund has forecast GDP growth of 4% for both 2012 and 2013.
- The country's relative economic stability and lack of investment-grade properties should support asset prices.
- Observers note that investors are likely to favor Russia in the near term because pricing has been stable there and the market appears to have the ability to recover quickly once systemic risks abate.

Source: Real Capital Analytics, FTI Consulting via Europe-re.com.

China

Overall real estate fundamentals in China have remained strong, though the gap between investor interest in residential and commercial properties has widened as a result of recent Government of China's initiatives to stabilize property pricing. New restrictive measures on bank financing have been especially affected residential developers and have increased investor uncertainty.

The Government of China has also created new value opportunities for debt funds. Since China is one of the few Asian markets where investors can still achieve mezzanine debt and distressed-level returns, a number of offshore funds are moving to fill the lending gap in China.

Policy measures for the commercial sector have been less restrictive, which has fueled investor demand and driven cap rates down. Demand for office properties remains concentrated within China's top-tier cities, but retail properties are attracting interest in secondary and tertiary markets as urbanization trends continue.

In terms of total deal volume, more than 80% of real estate transactions in China are still dominated by the local players. This is partially a result of considerable restrictions on foreign investment in real estate, but also high real estate taxes and foreign investors' difficulty in finding sophisticated local investors to work with. While local partnerships are not a requirement for foreign investors, they facilitate the process of navigating complex regulations and local government processes.

Also, while Government of China's initiatives have had an impact on capital available from domestic lenders, there is no shortage of funds investing in the real estate markets. This means that foreign investors face considerable competition when trying to compete independently on deals.

- Economic growth decelerated in China over the past several months. Even then, some analysts forecast an almost 8% growth rate for 2012, much higher than any of the developed economies.
- Investment activity in the Asia Pacific region has recently fallen, as the global economy tries to right itself and economic uncertainty subsides.
- The retail and office sectors are the best-performing property sectors.
- Increased urbanization and improved household incomes have led to a rapidly growing consumer class. This trend should continue and will boost values of investment-grade shopping centers.

Source: Real Capital Analytics, DTZ.

Outlook

As the newspaper reports so aptly and consistently remind us, persisting volatility in the financial markets means that the real estate funds sector will continue to face some level of uncertainty in the foreseeable future. This means it is not immune to individual symptoms that draw so much attention and indeed, it will need to become even more adept in adjusting to them. However, the solution is not in treating these one-off shocks; the solution lies in growth.

Naturally, not all businesses will emerge unscathed from this transitional period. Difficulty in fundraising, increased business costs and widespread market consolidation will continue to claim casualties in the funds sector. But this corrective phase is necessary for the sector's overall quality and credibility, purging excessively risky and poorly run players from the market, as well as rewarding those able to bring creative solutions to the recovery process and helping to rebuild investor confidence in the funds space over the long term.

Definitions

(Census of India, 2011):

Dilapidated: The houses, which are showing signs of decay or are breaking down and require major repairs or are decayed or ruined and are far from being in conditions that can be restored or repaired may be considered as "Dilapidated."

Household: A "household" is usually a group of persons who normally live together and take their meals from a common kitchen unless the exigencies of work prevent any of them from doing so. The persons in a household can be related or unrelated or a mix of both. However, if a group of unrelated persons live in a Census house but do not take their meals from a common kitchen, then they will not collectively constitute a household. Each such person should be treated as a separate household. The key to determining whether it is a separate household is whether there is a common kitchen. There may be one member households, two member households or multi-member households. There are three types of households – (a) normal households, (b) institutional households and (c) houseless households.

Housing shortage (estimated by Ministry of Housing and Urban Poverty Alleviation): Number estimated by putting together (a) excess of households (that do not include homeless), (b) the number of households residing in unacceptable dwelling units – computed by considering the obsolescence factor, (c) those residing in unacceptable physical and social conditions – calculated using overcrowding/congestion factor, and (d) the houseless households.

Income classification: Economically Weaker Section (EWS) households are those with income up to US$93 (INR5,000) per month and Lower Income Group (LIG) households are those with income between US$93 (INR5,001) to US$187 (INR10,000) per month.

Other households: This includes households where rent-free accommodation is provided to employees by their employers or where the ownership either of the land or of the structure does not belong to the household, i.e., houses constructed on encroached land in un-regularized slums or anywhere else. Also, the households living in an unauthorized manner in abandoned buildings, buildings under construction and buildings identified for demolition for which they have not paid any rent. Households living in caves and similar natural shelters are also covered under this category.



Ernst & Young – Real Estate team

Global real estate contacts

Howard Roth
Global Real Estate Industry Leader
New York
Tel: + 1 212 773 4910
Email: howard.roth@ey.com

Rick Sinkuler
Global Real Estate Markets Leader
Chicago
Tel: + 1 312 879 6516
Email: richard.sinkuler@ey.com

Michael Straneva
Americas Real Estate Leader
Phoenix
Tel: +1 602 322 3610
Email: michael.straneva@ey.com

Ad Buisman
Europe, Middle East, India and Africa
Real Estate Leader
Zwolle, The Netherlands
Tel: + 31 88 407 9433
Email: ad.buisman@nl.ey.com

Christopher Lawton
Asia Pacific Real Estate Leader
Sydney
Tel: + 61 292 48 5165
Email: chris.lawton@au.ey.com

Shohei Harada
Japan Real Estate Leader
Tokyo
Tel: + 81 3 3503 1283
Email: harada-shh@shinnihon.or.jp

Mark Grinis
Investment Funds Leader
New York
Tel: +1 212 773 5248
Email: mark.grinis@ey.com



India real estate contacts

Pankaj Dhandharia
Partner and
National Director
Ernst & Young Pvt. Ltd.
Tel: + 91 22 6192 0390
Mobile: + 91 98198 49915
Email: pankaj.dhandharia@in.ey.com

Ajit Krishnan
Partner and Infrastructure
and Real Estate Sector Leader
Ernst & Young Pvt. Ltd.
Tel: + 91 124 671 4490
Mobile: + 91 98110 32628
Email: ajit.krishnan@in.ey.com

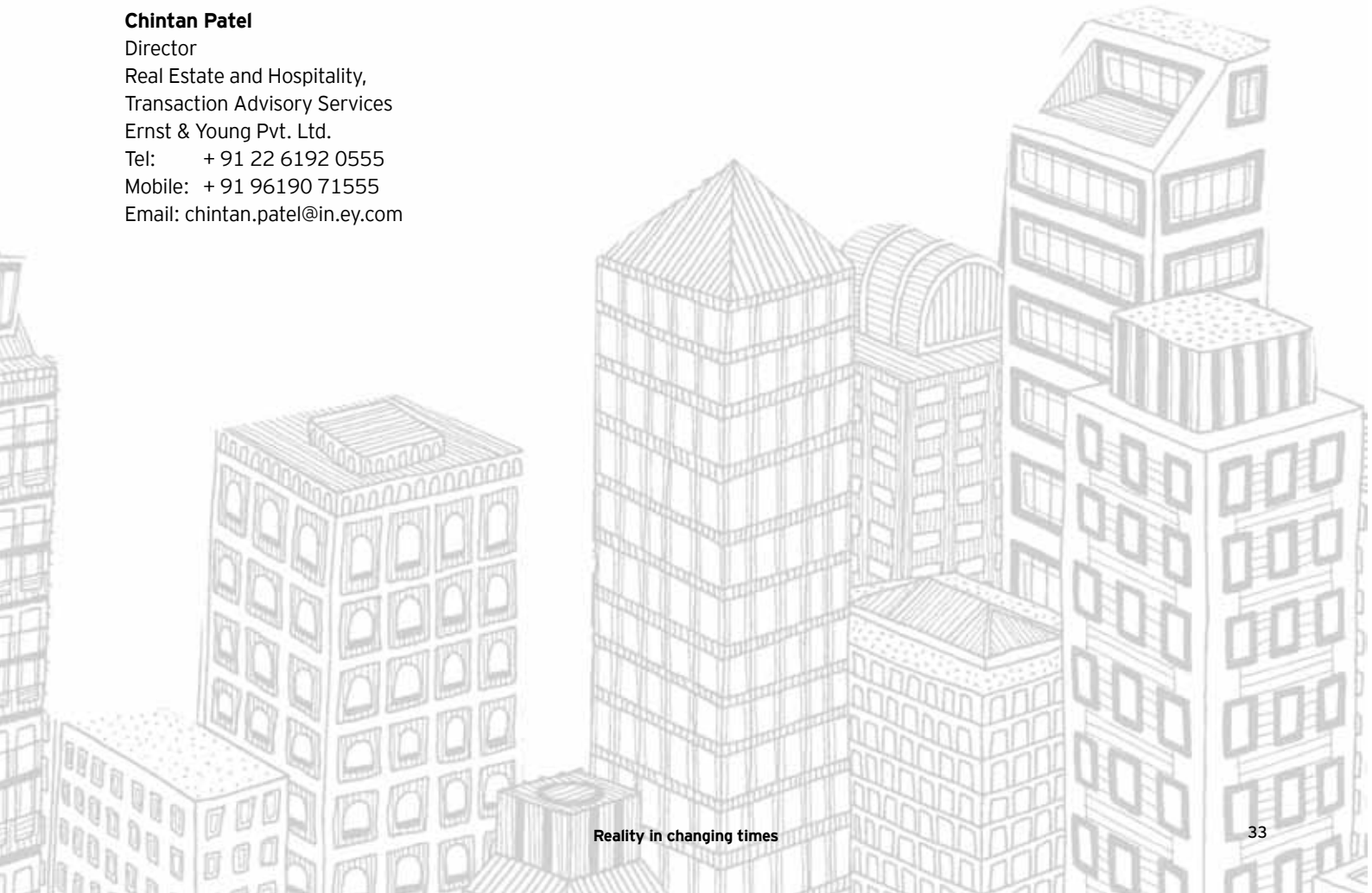
Nitin Bhandari
Partner
Transaction Advisory Services
Ernst & Young Pvt. Ltd.
Tel: +91 124 464 4000
Mobile: +91 98999 93360
Email: nitin.bhandari@in.ey.com

Biren Parekh
Partner
Risk Advisory Services
Ernst & Young Pvt. Ltd.
Tel: + 91 22 6192 0240
Mobile: + 91 98202 29744
Email: biren.parekh@in.ey.com

Avinash Narvekar
Partner
Tax & Regulatory Services
Ernst & Young Pvt. Ltd.
Tel: + 91 22 6192 0220
Mobile: + 91 98201 55244
Email: avinash.narvekar@in.ey.com

Kuldeep Tikkha
Partner
Transaction Advisory Services
Ernst & Young Pvt. Ltd.
Tel: +91 22 6192 0720
Mobile: +91 98201 44564
Email: kuldeep.tikkha@in.ey.com

Chintan Patel
Director
Real Estate and Hospitality,
Transaction Advisory Services
Ernst & Young Pvt. Ltd.
Tel: + 91 22 6192 0555
Mobile: + 91 96190 71555
Email: chintan.patel@in.ey.com



Connect with us

Our services

Assurance, Tax, Transactions, Advisory

A comprehensive range of high-quality services to help you navigate your next phase of growth

Read more at www.ey.com/IN/en/Services

Sector focus

Centers of Excellence for key sectors

Our sector practices ensure our work with you is tuned in to the realities of your industry

Read about our sector knowledge at www.ey.com/IN/en/Industries

Stay connected

Easy access to our knowledge publications at any time.

www.ey.com/subscription-form

Webcasts and podcasts

http://webcast.ey.com/thoughtcenter/

Follow us @EY_India

Join the Business network from Ernst & Young

For more information, visit www.ey.com/India

Ernst & Young offices

Ahmedabad
2nd floor, Shivalik Ishaan
Near C.N Vidhyalaya
Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru
12th & 13th floor
"U B City" Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
Fax: + 91 80 2210 6000 (12th floor)
Fax: + 91 80 2224 0695 (13th floor)

Chandigarh
1st Floor
SCO: 166-167
Sector 9-C, Madhya Marg
Chandigarh - 160 009
Tel: + 91 172 671 7800
Fax: + 91 172 671 7888

Chennai
Tidel Park,
6th & 7th Floor
A Block (Module 601,701-702)
No. 4, Rajiv Gandhi Salai
Taramani
Chennai - 600 113
Tel: + 91 44 6654 8100
Fax: + 91 44 2254 0120

Hyderabad
Oval Office
18, iLabs Centre,
Hitech City, Madhapur
Hyderabad - 500 081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Kochi
9th Floor "ABAD Nucleus"
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 304 4000
Fax: + 91 484 270 5393

Kolkata
22, Camac Street
3rd Floor, Block C
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai
6th Floor Express Towers
Nariman Point
Mumbai - 400 021
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 2000

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (west)
Mumbai - 400 028
Tel + 91 22 6192 0000
Fax + 91 22 6192 1000

5th Floor Block B-2,
Nirlon Knowledge Park
Off Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 3000

NCR
Golf View Corporate
Tower - B
Near DLF Golf Course
Sector 42
Gurgaon - 122 002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 4363 3000
Fax: + 91 11 4363 3200

4th & 5th Floor, Plot No 2B,
Tower 2, Sector 126
Noida - 201 304
Gautam Budh Nagar, U.P. India
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Pune
C–401, 4th floor
Panchshil Tech Park
Yerwada (Near Don
Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900

For details on the publication, contact:
Chintan Patel, Director, Real Estate and Hospitality,
Transaction Advisory Services
Email: chintan.patel@in.ey.com

Tarika Kumar, Associate Vice President,
Transaction Advisory Services
Email: tarika.kumar@in.ey.com

Ernst & Young Pvt. Ltd.
Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

Ernst & Young Pvt. Ltd. is one of the Indian client-serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/in

Ernst & Young Pvt. Ltd. is a company registered under the Companies Act, 1956 having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata 700016

© 2012 Ernst & Young Pvt. Ltd. Published in India.
All Rights Reserved.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

About FICCI
Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialisation, and its emergence as one of the most rapidly growing global economies. FICCI has contributed to this historical process by encouraging debate, articulating the private sector's views and influencing policy.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry.

FICCI draws its membership from the corporate sector, both private and public, including SMEs and MNCs; FICCI enjoys an indirect membership of over 2,50,000 companies from various regional chambers of commerce.

FICCI provides a platform for sector-specific consensus building and networking and as the first port of call for Indian industry and the international business community.

Our Vision
To be the thought leader for industry, its voice for policy change and its guardian for effective implementation.

Our Mission
To carry forward our initiatives in support of rapid, inclusive and sustainable growth that encompasses health, education, livelihood, governance and skill development.

To enhance efficiency and global competitiveness of Indian industry and to expand business opportunities both in domestic and foreign markets through a range of specialised services and global linkages.

For more about FICCI, please contact:

Ms. Mousumi Roy
Senior Director and Head
Real Estate and Urban Development
FICCI
Federation House
Tansen Marg
New Delhi 110001

Authors (alphabatical)

Dwijomala Hanjabam, Executive,
TransactionAdvisory Services
Ernst & Young Pvt. Ltd.
Email: dwijomala.hanjabam@in.ey.com

Rajiv Ranjan Sharma, Strategic Market Intelligence - Real Estate
EY Knowledge
Ernst & Young Pvt. Ltd.
Email: rajiv.sharma@in.ey.com

Tarika Kumar, Associate Vice President,
Transaction Advisory Services
Ernst & Young Pvt. Ltd.
Email: tarika.kumar@in.ey.com

Photos contributed by:
Anchana Chandrasekharan,
Ernst & Young Private Limited

Anurag Meena,
Ernst & Young Private Limited

Dwijomala Hanjabam,
Ernst & Young Private Limited