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ECONOMY & REALTY

Knight Frank

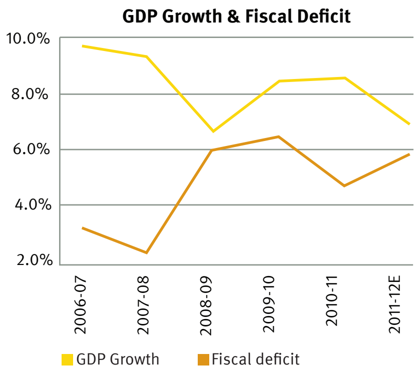
Economic Outlook

Against all expert predictions, the economic growth has faltered in the current financial year. The estimated GDP growth of 6.9% for FY2011-12 is as worse as the 6.7% growth witnessed during the global financial crisis in FY2008-09. This coupled with high fiscal deficit of 5.9% of GDP has put the government in a quandary. Hence, the underlying theme of Union Budget 2012 was balancing fiscal situation in the wake of decelerating economic growth. As a result budgetary announcements revolved around measures that can either lead to increased tax collection or provide relief to stressed sectors. The adequacy and intensity of these measures is something that can be debated.

Real estate industry is facing a difficult situation of high property prices and low demand. This coupled with tight lending environment and high interest rate has strained the industry. The situation has created a need for concerted efforts on the policy front. Demand for real estate is a derived demand and as such several announcements of the Union budget will have a direct and indirect impact on the sector.

Service Tax:

With the contribution of the service sector to GDP at its highest at an estimated 59% in FY2011-12, the government has taken a much anticipated step of including all the services within the ambit of service tax barring a few of those covered in the negative list. The rate of tax has also been increased from 10% to 12%. In case of leased out property, commercial property rentals already attract service tax. This budget has included residential leasing in the negative list for service tax; implying residential rentals will



Source: Government of India

not be exposed to service tax. However, under construction property, which was a point of contention between developers and customers, has been clearly covered within the ambit of this tax.

TDS on property:

Buyer will have to deduct 1% TDS on transfer of immovable properties (other than agricultural land) above Rs.5 million in specified urban centers and above Rs.2 million in other places. The amount considered for calculating the TDS will be higher of consideration paid or ready reckoner value. Further, property will be registered only when a TDS challan is furnished and the seller will get a tax credit on the basis of this challan. This amendment will take effect from 1st October, 2012. While it does not impact the tax liability, the administrative hassles of this additional procedure of tax payment and claiming tax refund will be a challenging task for an individual buyer.

Affordable housing:

Affordable housing has been in the limelight since the global financial crisis hit the Indian economy and resulted in a slump. In this budget, Investment linked deduction of capital expenditure (other than land, goodwill and financial instrument) has been increased to 150% as against 100% earlier.

In order to ease the funding for the sector External Commercial Borrowing (ECB) has been allowed for low cost affordable housing projects. At 350 bps above LIBOR, the cost of borrowings through the ECB route will be around 5%, which is substantially lower than domestic borrowings. Further, withholding tax on interest on ECB for affordable housing is reduced from 20% to 5%.

Others:

With an intention to provide relatively cheaper funding to the affordable housing segment buyers, Interest rate subvention of 1% on house value up to Rs.2.5 million and loan value up to Rs.1.5 million has been extended for an additional year. In order to channelize funding to the residential segment National Housing Bank (NHB) and HUDCO have been permitted to issue tax free bonds worth Rs.50 billion each. This will enhance their ability towards refinancing of housing loans to banks and state housing authorities. The increase in funding for rural housing from Rs.30 billion to Rs.40 billion benefits the cause of addressing the housing shortage in the rural sector.

Capital gains arising out of the sale of residential property will be exempted from tax

AT 350 BPS ABOVE LIBOR, THE COST OF BORROWINGS THROUGH THE ECB ROUTE WILL BE AROUND 5%, WHICH IS SUBSTANTIALLY LOWER THAN DOMESTIC BORROWINGS.

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if sale consideration is used for subscription in equity of a manufacturing SME utilized for purchase of new plant and machinery. The extent of realization of this benefit depends on the avenues for such investment. Allowing investment through the new SME exchanges that have been recently set up will help realize this incentive for property investors.

Income tax slabs

Tax rate	Earlier	Revised
0%	Upto Rs.1,80,000	Upto Rs.2,00,000
10%	1,80,000 – 5,00,000	2,00,000-5,00,000
20%	5,00,000 – 8,00,000	5,00,000-10,00,000
30%	Above 8,00,000	Above 10,00,000

Source: Government of India

The increase in basic income tax exemption limit from Rs.1,80,000 to Rs.2,00,000 for male tax payers will translate in to a insignificant monetary savings. However, the change in income tax slabs for income above Rs.8,00,000 will increase disposable income upto approximately Rs.22,000 pa. But the increase in household consumption expenditure on account of higher excise duty and service tax means that the impact on affordability for supporting a housing mortgage isn't any significant.

While benefits in bits and pieces have been announced for the sector, there is a need for a road map to address challenges of high housing shortage and rising urbanization. The progress of reformist measures like real estate regulatory bill, land acquisition bill and other significant measures is pending clarity.

Chennai

Market Overview

Chennai has witnessed steady growth in its residential market in the past few years, barring the period of economic slowdown in the country. The city has typically been a base for the automobile/auto ancillary industry and is one of the premier port cities of the country. In present times, the city's realty market has been driven by a host of other sectors, primarily led by the IT/ITeS sector, which has brought in considerable changes in the city's landscape. Based on its geographical pattern, the Chennai residential market can be divided into four segments – Chennai Central, North, West and South. It may be noted that being a coastal city, Chennai does not have an eastern market. Table 1 depicts the market classification in Chennai.

Table 1. Residential Micro-markets in Chennai

Central	Nungambakkam, Boat Club, Poes Garden, Egmore, Kilpauk, T Nagar
West	Vadapalani, Ashok Nagar, Sriperumbudur, Koyambedu, Mogappair, Porur, Ambattur
North	Purusawalkam, Ayanavaram, Tondiarpet
South	Old Mahabalipuram Road (OMR), GST Road, Velachery, East Coast Road (ECR

Source: Knight Frank Research

While the economic downturn brought the real estate market to a standstill, Chennai's residential market has seen a rebound sooner than anticipated. With the economy springing back to action, the residential real estate market, too, has recovered strongly. Demand has returned, prices have increased substantially and a number of new projects have been launched in the market.

The growth in Chennai's residential market may be attributed to the fact that it is primarily end-user driven. Investor participation is long term in nature, thereby mitigating a speculative market scenario. Stability in the market since 2010 has instilled confidence in the end-users to proceed with their purchase decisions. Demand was more evident in the mid-end category, primarily towards the peripheral locations of the city where majority of the affordable projects are located. However, unfavourable global economic state of affairs and a higher rate of interest in the second and the third quarter of the year somewhat dampened the optimism in the market and slackened the sales figures. Despite the subdued economic conditions, developers went ahead with their plans and several large scale projects were announced during 2011.

CHENNAI IS SLATED TO WITNESS THE INFUSION OF AROUND 67500 RESIDENTIAL UNITS IN THE FORTHCOMING THREE YEARS.

CHENNAI SOUTH LEADS THE MARKET IN TERMS OF NUMBER OF UNITS UNDER CONSTRUCTION ACCOUNTING FOR 68% OF THE TOTAL NUMBER OF UNITS COMING UP IN THE CITY, FOLLOWED BY THE WESTERN REGION WITH 27%.

This may be due to the fact that the Chennai market is primarily self-sustained and is not much affected by the upheavals in the global markets.

Supply and Development

Chennai is slated to witness the infusion of around 67500 residential units in the forthcoming three years. As is evident from Chart 1, Chennai south leads the market in terms of number of units under construction accounting for 68% of the total number of units coming up in the city, followed by the western region with 27%. The southern part of the city is mostly preferred by people employed with the IT/ITeS sector due to the presence of the IT corridor in the region. Majority of the new projects are situated along the OMR in locations such as Perungudi, Sholinganallur, Thoraipakkam, Tambaram and Perungalathur. Another emerging market on the OMR with several new residential launches is Kelambakkam, which is more investor driven due to its lower prices. Of late, the IT/ITeS corridor of OMR is fast turning into a self sustaining region with a number of good schools, colleges, hospitals and organized retail, thereby further augmenting residential market growth in the region.

The western region, meanwhile, has its share of residential growth as well, the demand primarily emanating from people employed with the manufacturing sector. Amongst the western micro-markets, mention can be made of Sriperumbudur where a number of residential projects by leading developers have been launched. Sriperumbudur is strategically located on the Chennai Bangalore highway and improved

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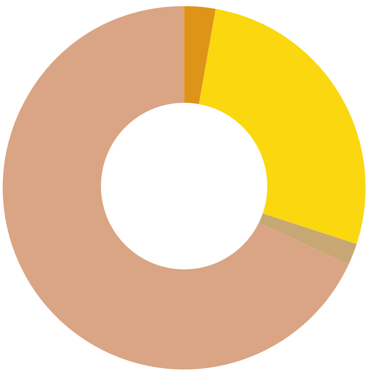
infrastructure coupled with the presence of major industries will continue to drive residential prospects in the region. Other prominent micro-markets in west Chennai witnessing residential development include Mogappair, Oragadam, Vanagaram and Porur.

PURUSAWALKAM, TONDIARPET AND AYANAVARAM ARE SOME OF THE KEY MICRO-MARKETS IN THE NORTHERN REGION WHICH HAVE WITNESSED THE LAUNCH OF RESIDENTIAL PROJECTS BY REPUTED DEVELOPERS

The northern and central parts of the city have minimal supply lined up for the next few years. However, the dearth of developable land notwithstanding, several prestigious projects are scheduled to become operational in central locations like Kilpauk and Egmore. These locations house smaller projects in the premium category catering to HNIs and have demand for individual bungalows as well as re-sale properties. On the other hand, Purusawalkam, Tondiarpet and Ayanavaram are some of the key micro-markets in the northern region which have witnessed the launch of residential projects by reputed developers.

Chart 1. No. of Units Under Construction (Region-wise)



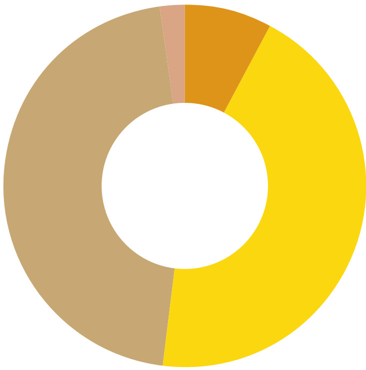
Central - 3%
West - 27%
North - 2%
South - 68%

Source: eyestate (Q3 FY 2011)

Another important observation regarding the Chennai residential market is the demand for 3 bedroom apartments exceeding other unit configurations. Around 46% of the total number of units under construction belongs to the 3 BHK category, followed closely by 2 BHK at 44%. While 1 BHK and 4 BHK apartments are lower in numbers, 5 BHK apartments understandably have a marginal presence in the number of units underway in the city.

Significantly, the projects under construction have seen encouraging absorption with all the regions witnessing more than 50% of residential units sold. Barring the central locations, which saw around 51% absorption, 60-64% of the total number of units in the residential projects under construction in the other regions has been booked or sold.

Chart 2. Type of Units Under Construction



1 BHK - 8%
2 BHK - 44%
3 BHK - 46%
4 BHK - 2%

Source: eyestate (Q3 FY 2011)

Price Trend

Chennai residential market has seen a steady appreciation in prices across all major micro-markets in the city. According to National Housing Board Residex, residential prices in Chennai have increased by 2.18 times in the last four years. Except for a slight dip in prices between July and December 2008, primarily on account of the global meltdown, Residex has been steadily heading northwards in Chennai.

Table 2: Micro-market wise Absorption

Micro-market	Percentage
Central	51%
West	64%
North	63%
South	60%

Source: eyestate (Q3 FY 2011)

Over the past four quarters preceding March 2011, Chennai has topped the NHB survey, which has 15 other cities. Between January 2010 and March 2011 when the latest residex was released, apartment prices in the city have increased by close to one-third. However, prices in other parts of Chennai - Tondiarpet, Perambur and Tiruvottiyur – have seen a decline due to slow infrastructure development.

During 2011, the highest price rise was observed in the central areas of the city, to the tune of around 10-18%. This may be attributed to limited supply as compared to the demand for property in the central region. Better infrastructure and presence of premium schools are factors which have attracted buyers to these markets.

DURING 2011, THE HIGHEST PRICE RISE WAS OBSERVED IN THE CENTRAL AREAS OF THE CITY, TO THE TUNE OF AROUND 10-18%.

Table 3: Residential Capital values (in INR/sq.ft) in March 2012

Micro-markets	Minimum	Maximum
Egmore/Kilpauk	6000	15000
Boat Club	18000	25000
Poes Garden	15000	24000
T Nagar	8000	12000
R A Puram	10000	17000
Anna Nagar	9000	12000
Moggapair	4000	7000

Source: Knight Frank Research

Outlook

According to a United Nations study, Chennai has a deficit of around 60000 housing units. About 6000 of them are in the high income group segment, 12000 in the middle income group and 18000 in the low income group. The economically weaker sections in Chennai need 24000 housing units. While around 67500 residential units are in the pipeline, they will be catering to the housing needs of the high income and the mid income

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Table 4. Select Upcoming Projects in Chennai

Project Name	Developer	Location	Number of Units
Akshaya 36 Carat	Akshaya Homes	Egmore	36
KG Signature City	KG Builders	Mogappair	992
Courtyard	Prince Foundation	Egmore	150
Cerus	Appaswamy Real Estates Ltd	Virugambakkam	167
Sobha Meritta	Sobha Developers	Pudupakkam	556
Boulevard	Vijay Shanthi Builders	Kandigai	321
Woodside	Rajarathinam Constructions	Thirumullaivoyal	136
Orchid	DABC	Polachery	248
Savithanjali	MARG Properties	Kalavakkam	678
S & P Living Spaces	S & P Foundation	Ayanambakkam	592
Bella Vista	Prestige Group	Iyyappanthangal	2613

Source: eyestate

segments only. This has led to the demand for a change in the city's development control rules to facilitate more residential growth. With the quantum of supply lined up in the aforementioned categories, developers may be faced with pressure on pricing in the forthcoming quarters. However, prices are unlikely to decline drastically due to the rising cost of construction.

In the recent years, OMR has transformed to a preferred high-end residential destination and will continue to attract investors and end-users alike. Also, micro-markets like Perambur and Tondiarpet towards the north and Sriperumbudur in the west are emerging as newer growth corridors with the launch of several residential projects. Another micro-market that is gaining prominence is the ECR stretch in the south which has a number of premium villa developments coming up in the next few years.

However, a major issue that needs to be addressed is the lack of social infrastructure in the peripheral locations of the city which have seen majority of the projects being launched with affordable prices. Without social infrastructure, these projects shall not witness positive price movement and will have an adverse effect on their sales.

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