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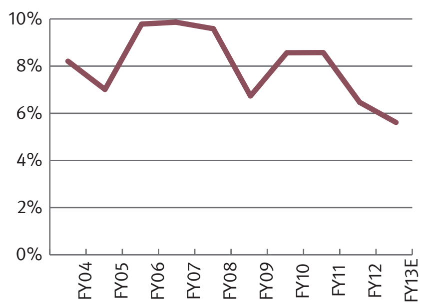
Walking on a tight fiscal rope

At a 5.7% estimated GDP growth for FY2013, the Indian economy will grow at the slowest pace as compared to the last 10 years. There have been several factors that have contributed to bringing the economy to such a standstill. Albeit, the primary reason remains the hiatus on the government's decision making during the last couple of years. Although, the reform measures announced during the second half of the current financial year breaks the hiatus, its translation in to revival of investment and consumer demand will take some time. As a result, amidst this faltering economic growth the industry's voice for state support has increased.

India GDP Growth



Source: GOI

In line with its role, the government has also time and again taken steps to rescue businesses in particularly difficult times. In the past, the government has taken measures to support the ailing industries even if it meant throwing government finances out of gear. However, with a high

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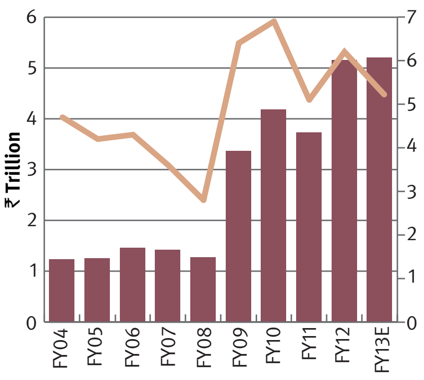
fiscal deficit of 5.2% estimated for FY2013, the state finances are constrained and hands tied up. As a result, there has been a clear shift in the choice of alternatives that the government has been taking recently.

With respect to the real estate industry, the measures announced during the last two quarters highlight the change in the way the government looks at the industry and the manner in which it intends to reach out to the beneficiary. The budgetary allocation for the corporate sector in general and real estate in particular remained muted this time. From the choice of decisions that the government has been taking over the last few occasions including budget, two signals emerge. First, the government will single out housing from the overall real estate industry and second, in terms of providing incentives it would focus directly on the intended beneficiary i.e. the consumer rather than the producer.

A close look at the decisions related to the real estate industry over the last few occasions will substantiate this new mind set.

India Fiscal Deficit



Source: CMIE, GOI

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India Research

Dr. Samantak Das Director - Research & Advisory Services
+91 (022) 6745 0101
samantak.das@in.knightfrank.com

External Commercial Borrowings (ECB) for low cost affordable housing projects

In December 2012, the Reserve Bank of India (RBI) allowed ECB for low cost affordable housing projects. Projects providing at least 60% of the permissible FSI for units having a maximum carpet area up to 60 sq. mtrs. (646 sq.ft.) have been made eligible for this provision. Additionally, slum rehabilitation projects have also been allowed to utilize this financing window.

IF THE BORROWER CAN ADDRESS THE EXCHANGE RATE RISK ASSOCIATED WITH SUCH OVERSEAS BORROWINGS, THE COST ADVANTAGE IN COMPARISON TO THE DOMESTIC BORROWINGS WILL PROVIDE A HUGE CAPITAL ADVANTAGE TO AFFORDABLE HOUSING PROJECTS.

Considering the finance crunch in the real estate sector and the large housing shortage in the country, this move will certainly benefit the cause of creating housing stock in the country. At the same time categorical disallowance for acquisition of land has been made so that the money does not flow in to land speculation. The biggest advantage of this finance window is the low cost, which will be London Interbank Offered Rate (less than 1%) plus a maximum of 500 bps translating in to a total financing cost of around 6%. If the borrower can address the exchange rate risk associated with such overseas borrowings, the cost advantage in comparison to the domestic borrowings will provide a huge capital advantage to affordable housing projects.

Interest deduction for consumers of affordable housing

In the union budget for 2013-14, the government has allowed additional deduction for housing loan interest. The amount of such interest deduction will be ₹ 1,00,000 for the first-home buyer who takes a loan for an amount not exceeding ₹ 25,00,000 and can be claimed in a maximum of two years beginning FY 2013-14. Further, this deduction will be over and above the deduction of ₹ 150,000 allowed for self-occupied properties under Section 24 of the Income-tax Act.

The housing loan limit of ₹ 25,00,000 has been devised keeping in mind the lower and middle income segment of the population, which also accounts for the largest chunk of housing shortage in the country. The step provides a clear message that although government finances are constrained, as reflected in the high fiscal deficit numbers, it wants to provide the benefit to the section of population which requires it the most. Indirectly, a boost to the housing sector would provide a fillip to a number of industries like steel, cement, brick, wood and glass besides jobs to thousands of construction workers on account of linkages of the housing sector with these industries.

Increased financial assistance for Rural Housing

The government has entrusted National Housing Bank (NHB) with the responsibility of managing the Rural Housing Fund to serve the cause of increasing the housing stock in rural India. Through this fund, the NHB refinances lending institutions that extend loans for rural housing. In the latest budget, the government increased the allocation to this fund by 50%. As a result, the corpus of refinancing for rural housing has increased from ₹ 40 billion in the last year to ₹ 60 billion in 2013-14.

The impact of this fund can be assessed from the fact that until now 4,00,000 rural families have taken loans and purchased a house with this assistance. With the allocation to the fund increasing by a handsome 50% in the latest budget despite the fears of fiscal imbalance, there is clearly a message from the government to support the tenet of housing.

Setting up a fund for creation of housing stock in urban centres

Akin to the Rural Housing Fund and taking cues from its success in rural India, the government has announced the setting up of a fund with an objective to enhance financing for housing projects in the urban centres in the country. The fund will fall under the ambit of the National Housing Bank (NHB) and will have a corpus of ₹ 20 billion in 2013-14.

National Housing Bank (NHB), a wholly owned subsidiary of RBI, has a mandate to promote a sound, healthy, viable and cost effective housing finance system to cater to all segments of the population and to integrate the housing finance system with the overall financial system. With the setting up of this fund, financing for urban housing will get a renewed focus. At ₹ 20 billion, although this fund for urban housing is just a third in size of the rural fund, it should be construed as the first step in the direction of focus for urban housing.

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Going forward, what should the real estate industry expect from government?

To a great extent, the choice of alternatives by the government is now being guided by past experience. In the past, incentives intended for the consumer but routed through developers did not reach the intended beneficiary. For example, the deduction under Section 80 IB (10) provided for affordable housing projects was intended to benefit buyers of houses that do not exceed 1000 sq.ft. Supporting such affordable housing projects through income tax deduction to the developer was intended to translate into lower cost of housing for the middle and lower income sections of the population. The scheme was applicable for a long period and successive budgets focused on tightening the boundary conditions of this provision to curb misuse and diversions. However, the benefit did not reach the intended beneficiary and the scheme has been discontinued now.

Further, the strengthening of this belief is also guided by the visibility on potential benefits in other areas of government intervention. For instance, in the case of pricing of fuels like petrol and diesel, the government has demonstrated a resolute determination to cut down on subsidy and allow market forces to determine prices. Similarly for domestic fuel like LPG, the government has acted in a similar manner. Now, the frequent price changes of these items do not create a hullabaloo in either the political circle or public at large. The move is expected to have a far reaching positive impact on the country's finances. Firstly, allowing market forces in determining the price would limit the government's subsidy burden and improve fiscal position. Secondly, a lot of illicit activity arising out of this pricing gap is also expected to reduce.

Another step in this direction, the ambitious Direct Cash Transfer (DCT) Scheme of the Government of India is also gaining ground with every passing day. With the scheme already being rolled out in more than 20 districts of the country, the government has a target of covering the entire country by the end of 2013. The scheme aims to provide the subsidy amount through direct bank transfer to the eligible beneficiary thereby cutting down delays and diversions.

The choice of alternatives by the government, in the backdrop of high fiscal deficit and slowing growth that fuelled concerns of sovereign downgrade, clearly highlight the new mindset. From the above instances of government intervention it is clear that besides a few paltry measures here and there, meaningful intervention will be guided by the new mindset This approach isolates housing from the overall real estate sector and aims to provide the benefit of government intervention directly to the intended beneficiary i.e. the consumer rather than the developer. Going forward, we expect the focus on housing to be large and directly reaching out to the intended beneficiary even larger.

Dr. Samantak Das Director - Research & Advisory Services
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samantak.das@in.knightfrank.com