



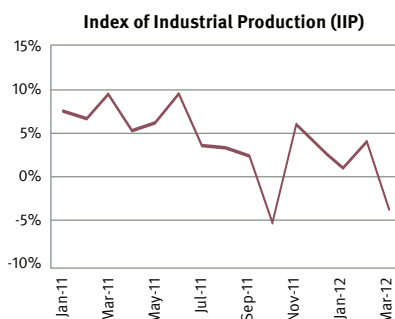
# MAY 2012 E&R @ GLANCE

ECONOMY & REALTY

## Knight Frank

### Outlook

The Index of Industrial Production (IIP) fell 3.5% in March-2012. This broad slowdown across industry groups has taken the market by surprise as the IIP had expanded by 4.1% in February. Among all the sub-sectors which witnessed deceleration; Capital-Goods fell the most by 21%. IIP for the year ended 31st March 2012, now stands at 2.8% as against 8.2% in the previous year. A low IIP number will drag the overall GDP. Hence, despite the recent reduction of 50bps in the policy rate by the central bank it is imperative for the RBI to continue its monetary easing stance in order to revive the business sentiment.



Indian economy is again in the doldrums with the IIP not seeing the light at the end of the tunnel and the upward stickiness of inflation. The Wholesale Price Index (WPI) - representative for inflation - stood at 7.23% in April-2012 as against 6.89% in March-2012. Slowing industrial growth adversely affects the job market thereby leading to reduction in consumption in the economy and consequently impacting the profit for the India Inc. This may pose a dilemma before the RBI whether to tame inflation or boost industrial growth. Further, in order to stimulate economic growth, the central bank needs to reduce the cost of funds for businesses as well as for individuals.

However, this seems to be an uphill task with India's stubbornly high inflation.

Unexpectedly the parliament has withdrawn the TDS (Tax Deduction on Source) on transfer of immovable property. The 'Finance Bill 2012' had proposed that "every transferee of immovable property (other than agricultural land), at the time of making payment for transfer of the property, shall deduct tax at the rate of 1% of such sum". Parliament, citing increased compliance burden on the part of the buyer withdrew the proposal.

The BSE Realty Index has fallen by 14% since the Budget for FY13 was announced while the broader market (BSE- Sensex) fell by 7%. The fall was mainly on account of new regulation regarding GAAR (General Anti-Avoidance Rule) which proposes to tax the FII which is routing money through tax haven countries and avoiding paying tax in India. The notification of the Alternative Investment Fund (Regulation) 2012 has also had a bearing impact on the realty companies.

### Alternative Investment Fund (Regulation) 2012

SEBI in August-2011 proposed to regulate private equity (PE) funds, venture capital (VC) funds, PIPE or private investment in public equity funds, strategy funds and social funds under one regulation – Alternative investment regulation. The same has been approved in April-2012 and it is now framed as SEBI (Alternative Investment Funds) Regulations, 2012. The new regulation will be replacing the SEBI (Venture Capital Funds) Regulations, 1996. However, existing VCFs shall continue to be regulated by the VCF Regulations till the existing fund or scheme managed by the fund is wound up.

Key highlights of the regulation-

- The low end of the corpus has been capped to Rs.200 mn while there is no limit to the maximum corpus as against a cap of Rs.2.5 bn proposed in the draft bill in August-2011.
- The sponsor is required to bring in lower of 2.5% of the initial corpus or Rs.50 mn as a continuing interest in the fund. This number was pegged at 5% of the initial corpus in the proposed draft bill. The said continuing interest will not be through the waiver of management fees.
- As per the new regulation all funds have been categorized into three types depending on the nature of the fund. Real estate funds fall under Category II; as per the regulation, all AIFs under this category shall have a minimum tenure of 3 years and will be a close-ended fund.
- The new guideline restricts the size of investment to a minimum of Rs.10 mn from an investor.
- SEBI allows units of an AIF to be listed on a stock exchange subject to a minimum tradable lot of Rs.10 mn. However, it has directed AIF to not raise funds through the stock exchange mechanism.
- AIFs cannot invest more than 25% of the investible funds in one Investee Company; they also cannot invest in associate companies.

**THE NEW AIF  
GUIDELINES RESTRICT  
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FROM AN INVESTOR**

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**Comparison of Draft and final version of the SEBI-AIF 2012 guidelines (applicable to Real estate funds)**

Features	Draft Bill proposition - August-2011	Final Notification - April-2012
<b>Fund Perspective</b>		
Corpus	Min. Rs.200 mn and Max. Rs.2.5 bn	Min. Rs.200 mn
No. of Investors	Max. 1000	Max. 1000
Continuing interest of the Sponsor	5% of the corpus	Min. of 2.5% of the initial corpus or Rs.50 mn
Tenure	Min. 5 years	Min. 3 years
Fund Type	Closed-end	Closed-end
Listing on stock exchange	After 3 years of investment	Immediate listing allowed subject to a min. lot of Rs.10 mn
<b>Investment Restrictions</b>		
Size of Investment	Max of 0.1% of the corpus or Rs.10 mn	Min Rs.10 mn
Investment in a single company	Not greater than 25%	Not greater than 25%
Investment in Associate company	Not Allowed	Not Allowed

Source: SEBI

- The SEBI will take up with the government to extend the tax pass through status to AIFs.

**Flow of funds in the Realty Sector**

In the October 2011 issue of 'E&R @ Glance', we had analyzed stress case scenarios for the leading 19 realty players. Our study highlighted that in the past few years the holding capacity (financial condition) of real estate players was the pivotal factor in influencing the price movement in the market. Factors like demand-supply, cost of funds, raw material cost and regulatory delays had a relatively low impact on the property prices. Taking forward the above study, it is now imperative to consider the quantum of money, which the real estate sector has been able to attract over the last 5-6 years. For this purpose we studied fund flow through Initial Public Offering (IPO), Follow-on Public Offer (FPO), Qualified

**Real Estate - IPO/FPO**

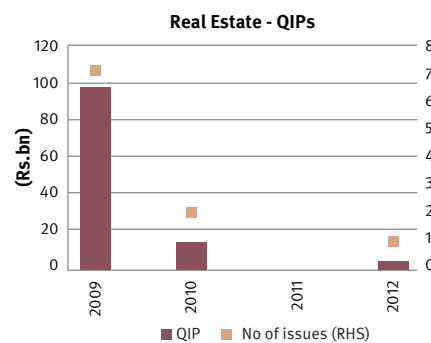
Year	Amount raised (Rs. bn)	No. of Issues
2006	17.70	3
2007	145.74	10
2008	0	0
2009	4.62	1
2010	43.12	5
2011	0.60	1
2012 until April	1.27	1
<b>Total</b>	<b>213.06</b>	<b>21</b>

Source: NSE

Institutional Placement (QIP) and Foreign Direct Investment (FDI) in the real estate sector.

Since 2005, 21 realty companies have raised Rs.213.06 bn through IPO and FPO. Of which Rs.145.74 bn or 68% was raised alone in 2007, post the opening up of FDI in real estate sector. This route of raising money witnessed a slump in the immediate next year due to global financial crisis of 2008. The bursting of the U.S. housing bubble, which peaked in 2007, caused the values of securities tied to U.S. real estate pricing to plummet, damaging financial institutions globally. This had ripple effects on the Indian economy impacting the Indian real estate sector the most. The year 2008 had no new issues in the form of IPO/FPO while there was just one issue in 2009. In 2010, post the global crisis, the economy saw some support in terms of stronger UPA government at the center which helped as many as five promoters to raise Rs.43.12 bn from the public through IPO/FPO route.

In 2009, post the global financial crisis, holding capacity strengthened mainly on account of stable government at the center and RBI's permission for one time debt restructuring. While QIP window opened up for the realty players, improved sentiments coupled with low interest rates resulted in pent-up demand translating into property sales. Of the total fund raised through QIPs since 2009, 84% came in the year 2009 itself.



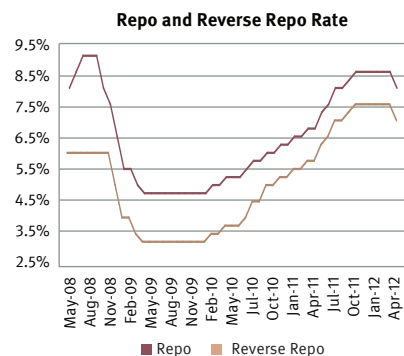
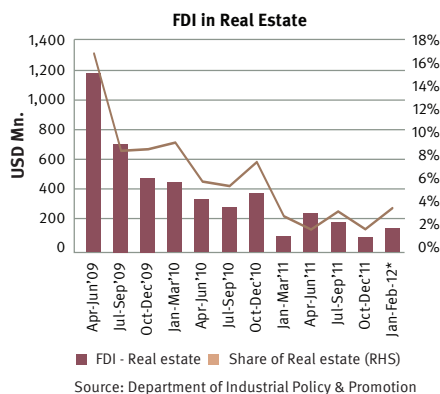
Source: Company Data, CapitalLine.

2011 witnessed a phenomenon of high property prices, high interest rate and low sales. Dismal corporate earnings growth

**2011 WITNESSED A PHENOMENON OF HIGH PROPERTY PRICES, HIGH INTEREST RATE AND LOW SALES. DISMAL CORPORATE EARNINGS GROWTH COUPLED WITH A WEAK EMPLOYMENT SCENARIO IMPACTED THE REALTY INDUSTRY. FUNDING AVENUES LIKE IPOs, QIP AND FDI, WHICH WERE HARNESSSED IN THE EARLIER YEARS, DRIED UP**



coupled with a weak employment scenario impacted the realty industry. Funding avenues like IPOs, QIP and FDI, which were harnessed in the earlier years, dried up. As a leveraged balance sheet was strained amidst slowing sales, developers resorted to selling land, TDR and non-core assets and some even resorted to pledging promoter equity. Private Equity (PE) and HNI money also salvaged the position of the industry.



ALL HOPE IS STEMMED ON REVIVAL IN SALES, WHICH IS IMMINENT ON EITHER A ROBUST ECONOMY OR LOWER PROPERTY PRICE.

As the situation stands today, transaction activity remains slack and the prospective buyers are sitting on the fence in anticipation of price correction. The funding avenues exploited earlier seem to have dried-up. For instance, between Q1 FY10 and Q3 FY12, FDI in real estate declined by a drastic 92% and its share in total FDI shrunk from 16.83% to 1.94%. Fate of fund flow through IPOs, QIP and PE is also similar. As a result, all hope is stemmed on revival in sales, which is imminent on either a robust economy or lower property price.

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