Indian real estate

Unfolding the new era of growth

August 2017

KPMG.com/in

Regulatory reforms transforming Indian real estate

Pradhan Mantri Awas Yojana (PMAY)

PMAY – Urban launched in June 2015, PMAY – Gramin launched in November 2016. Aims to build **50 million (mn)** housing units in urban and rural India by 2022, over **0.7 mn** housing units to be built per month to achieve the vision

Real Estate (Regulation and Development), Act, 2016

Came into force on 1 May 2017
Aims to increase transparency, accountability, and overall efficiency.
Over **19,000** projects across 27 cities alone entailing an investment of over INR21 trillion (tn), or **USD320 billion (bn)** expected to come under purview of RERA

Real Estate Investment Trust (REIT)

Guidelines released in September 2014. Government allowed tax pass through status in Union Budget FY17. Aimed at providing avenues for fund raising and alternate investments

Goods and Services Tax (GST)

Implemented from 1 July 2017. Aims to streamline the indirect tax structure by subsuming multiple taxes into a unified GST The net tax rate on real estate post-GST is **12 per cent**

Ease of Doing Business

Construction permits to be issued in just **60 days**

Sector potential and key trends[1,2,3,4,5]

The sector presents multi-trillion dollar opportunity

Green building material and technologies market potential 2025
USD300 bn (INR19 tn)

100 Smart cities
Investment required: **USD1.2 tn (INR78 tn)**

Infrastructure investment need by 2022
USD646 bn (INR42 tn)

REIT-eligible stock in top seven cities worth

Commercial office:
USD53 bn (INR3.4 tn)

Retail assets:
USD24 bn (INR1.6 tn)

Housing for All by 2022
Affordable housing requirement
110 mn

USD2 tn (INR130 tn)
investment potential

Industrial corridors
One of the world's largest infrastructure project
Delhi-Mumbai Industrial Corridor (DMIC)
Expected investment
USD100 bn (INR6.5 tn)

Others:
Amritsar-Kolkata Industrial Corridor (AKIC), Bengaluru- Mumbai Economic Corridor (BMEC), Chennai-Bengaluru Industrial Corridor (CBIC), Visakhapatnam-Chennai Industrial Corridor (VCIC) and Chennai-Kolkata Industrial Corridor (CKIC)

Key trends shaping the Indian real estate sector

Key trends in the sector

- Increased prominence of green buildings
- Industry consolidation
- Emergence of new business models
- Rising foreign investments
- Increased transparency
- Shift in financing medium

1. Smart Cities, Make In India, accessed on 17 August 2017
2. Decoding housing for all 2022, KPMG, September 2014
3. evitalising Indian Real Estate, Cushman & Wakefield, November 2016
4. India needs Rs43 trillion of investment in infrastructure over next 5 years: Jaitley, Live Mint, 01 April 2017
5. Fuelling growth: Delhi Mumbai Industrial Corridor, Make In India, accessed on 17 August 2017

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Foreword – KPMG in India[1,2,3,4]

The Indian real estate sector has transformed significantly over the past decade. The pace of transformation has gained further momentum as the central government has set the stage for the next era of growth. The fulcrum of this transformation is the enabling regulatory environment being created through several policy reforms, such as the Real Estate (Regulation & Development) Act, 2016 (RERA); Goods and Services Tax (GST); Pradhan Mantri Awas Yojana (PMAY); and Real Estate Investment Trusts (REITs), to name a few, undertaken over the past three years.

It is expected that the policy reforms highlighted above, would lead to higher accountability and transparency, and increase efficiency in the sector. With these reforms, the government has opened up plethora of opportunities for growth in the real estate and construction sector. It is estimated that India would require investments of over **USD4 tn (INR260 tn)** over the next five to seven years to meet the several development goals such as 'Housing for All'; 100 Smart Cities, Delhi Mumbai Industrial Corridors (DMIC) and for creating support urban infrastructure. In addition, rise in green building and smart home concepts is driving the sector towards sustainability. It is forecasted that green building materials and technologies market provides investment opportunities worth about **USD300 bn (INR19.5 tn)** spread across asset classes. Further, India has approximately 350 million square feet (msf) of REIT-able office and retail stock valued at over USD75-80 bn (INR5 tn).[5] These opportunities would likely result in attracting higher interest from private as well as public institutions for considering Indian real estate a safe and an attractive investment avenue of growth.

India's rapid urbanisation growth, favorable economic fundamentals, impetus on affordable housing, improvement in 'ease of doing business environment', amongst others have led to increased demand for organised space across real estate asset classes. The Grade A commercial office inventory across top-seven cities in India has increased by about five times from little over 100 msf in 2006, to about **500 msf** in 2016.[6] Similarly, the demand for organised space across other asset classes too has witnessed multifold growth.

Concurrently, the overall industry is witnessing consolidation and emergence of new business models, diversification of portfolio, and higher foreign investments through FDI and alternative investments route. The foreign direct investments (FDI) in the construction development sector, which attracted cumulative FDI of over **USD24.3 bn** (INR1.5 tn) during 2000–16, and accounted for the second highest share in total FDI inflows during this period, is expected to get significant boost going forward. Similarly, private equity (PE) investments that totaled about **USD20 bn** (INR1.3 tn) during 2008-16, are also anticipated to grow manifold in the coming decades, with growing interest from foreign investors and developers in Indian realty.[5]

However, there are several challenges, such as land scarcity, construction delays, mass production inability, high project funding costs, and inadequate private sector participation in affordable housing segment, which need to be overcome to exploit the true potential of the sector. Further, banks are still reluctant to lend to the real estate sector; which accounted for meagre **3 per cent** in the share of outstanding commercial loans from banks.

The report, 'Indian real estate: Unfolding the new era of growth', by KPMG in India, calibrates the steps taken so far to streamline the real estate and construction sector, and identifies the opportunities that need to be harnessed. Further, the report highlights key trends shaping the Indian real estate sector and elaborates how key reforms, could further transform its future landscape. The real estate and construction sector can be a game changer for the Indian economy. The government could streamline approval processes, simplify taxation, build institutional capacity, and introduce urban planning and real estate-related reforms such as organised and social rental housing. The industry stakeholders need to adopt modern construction technologies and techniques, and bring higher discipline and professionalism for a sustainable business.

I would like to thank everyone involved in preparing this background paper, and hope that you find it insightful.

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1. Smart Cities, Make In India, accessed on 17 August 2017
2. Decoding housing for all 2022, KPMG, September 2014
3. India needs INR43 trillion of investment in infrastructure over next 5 years: Jaitley, Live Mint, 01 April 2017
4. Fueling growth: Delhi Mumbai Industrial Corridor, Make In India, accessed on 17 August 2017
5. Revitalising Indian Real Estate, Cushman & Wakefield, November 2016; KPMG in India's analysis, August 2017
6. 2017: The Inflection Point of Indian Real Estate, July 2017; KPMG in India's analysis, August 2017

Foreword – NAREDCO

The central government has been making conscious efforts to create an enabling environment through policy reforms, for the real estate sector to achieve higher growth. Reforms such as the Real Estate (Regulation & Development) Act, 2016 (RERA); Goods and Services Tax (GST); Pradhan Mantri Awas Yojana (PMAY); and Real Estate Investment Trusts (REITs), and demonetisation, to name a few, have been implemented over the past 2-3 years. These reform initiatives are expected to result in higher transparency, efficiency, bring more accountability in the system, and also protect the interests of home buyers as well as investors.

With these reforms, the government has opened up significant investment opportunities in the real estate and construction sector. It is estimated that India would require significant investments over the next five years, to meet the targets under several mega programmes such as 'Housing for All'; 100 Smart Cities, 500 AMRUT cities, and industrial corridors, etc.

It is estimated that India would require about USD2 tn (INR130 tn) till 2022 to fund the development of housing shortage of 110 million units by 2022. Furthermore, the supportive urban infrastructure, including utility services, is inadequate, which fails to meet even the basic standards in certain cities. Hence, another USD1.0 -1.5 tn (INR65 – 97 tn) would be required by 2030 to upgrade and create new supportive urban infrastructure.[7]

The real estate and construction is an engine of economic growth for India, as it contributes the fifth highest share (about 8-9 per cent) to the Indian economy. It is also the second largest employer in India, with an employment base estimated at 52 mn.[8] Further, it accounts for the second highest inflows of FDI into India, with cumulative inflows of USD24.3bn (INR1.6 tn) during 2000-16 period.

With strong economic fundamentals, stable and growth oriented political and regulatory environment, and favourable demographics, Indian real estate sector has been able to attract increased interest from both MNCs and foreign investors. As a result, the organised commercial rent-generating real estate asset classes have been performing well over the past few years.

However, the organised residential real estate has been affected by numerous challenges, such as demand-supply mismatch across segments, schedule and cost overruns, inadequate liquidity, and trust deficit between home buyers and developers. Additionally, the real estate sector has limited access to long-term funding, and taxation and fees structures are either complicated or irrational, leading to higher project cost, impacting the end-users/buyers.

This background paper: 'Indian real estate–Unfolding new era of growth', jointly prepared by NAREDCO, and KPMG in India, broadly covers the key policy reforms undertaken in past few years which can transform the sector significantly and put the sector on a higher growth trajectory. In addition, it also highlights the key opportunities that the sector presents and key trends that have been shaping the Indian real estate sector. Furthermore, through this paper, it is an endeavor to attract the attention of the policymakers towards the major challenges that the real estate sector is facing, and which are acting as impediments to growth. Last but not the least, it is crucial that all the stakeholders involved develop strategies, which are covered in this paper as recommendations, to provide a fillip to the real estate sector for sustainable growth.

Rajeev Talwar
Chairman
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President
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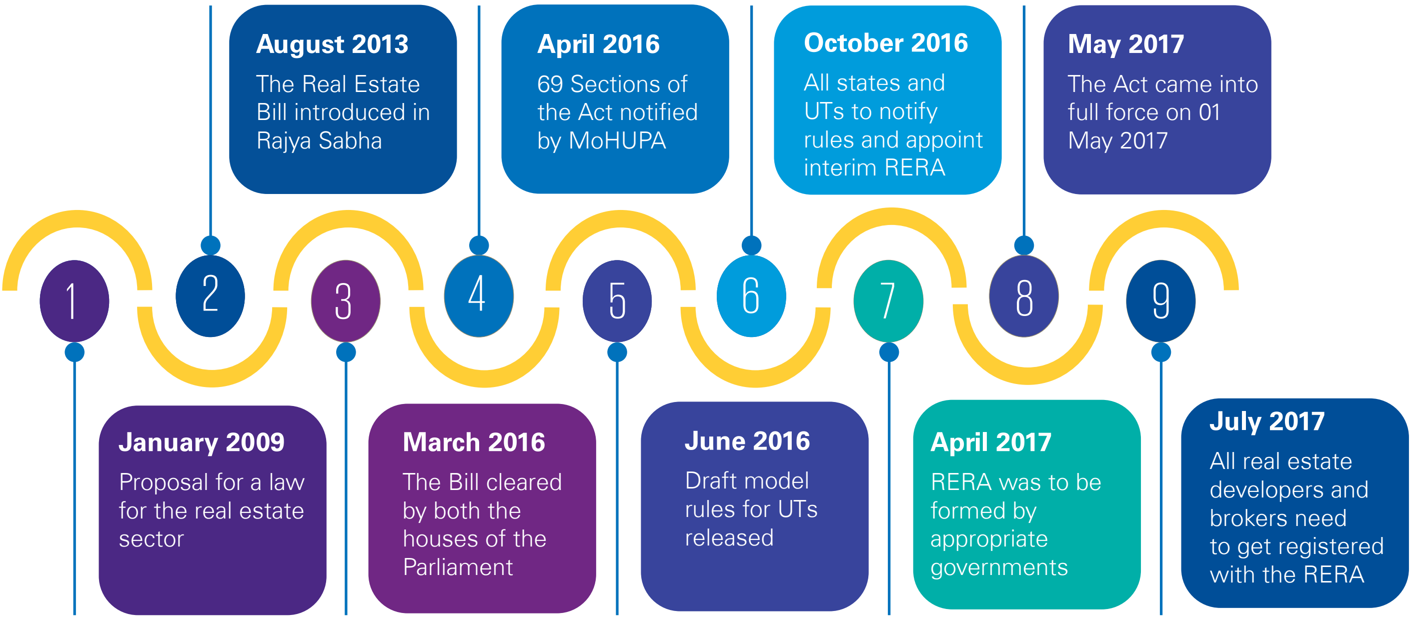
7. Funding the Vision: Housing for All by 2022, KPMG in India, August 2014
8. Human Resource and Skill Requirement in the Building Construction and Real Estate Sector, February 2015

3. Regulatory reforms transforming Indian real estate

3.1 Real Estate (Regulation and Development) Act, 2016 (RERA)

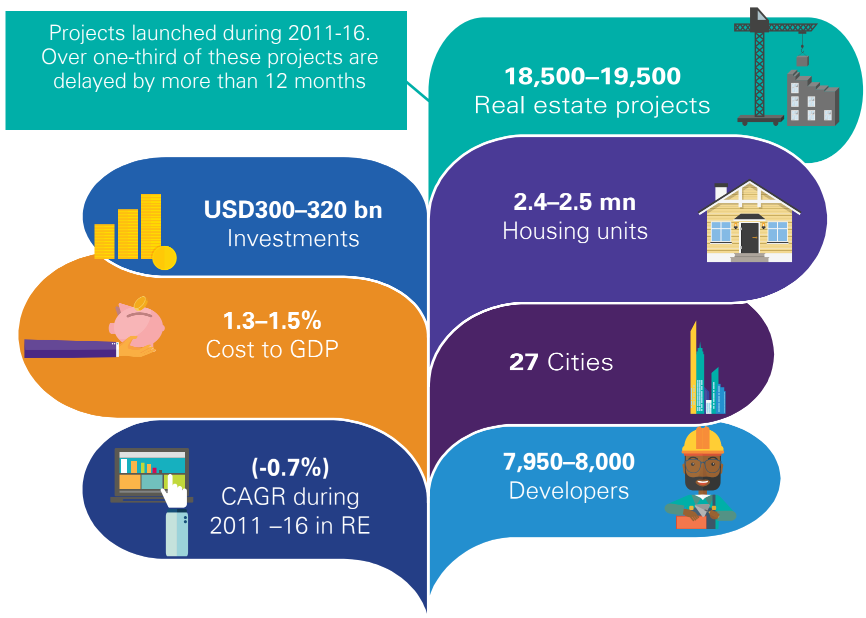
Government of India has been making conscious efforts at the policy front for creating an enabling environment to overcome the challenges in the real estate sector. The Real Estate (Regulation and Development) Act, 2016, which is expected to increase transparency and accountability in the sector, has finally become a reality. It is anticipated that accountability would lead to higher growth across the real estate value chain, while compulsory disclosures and registrations would determine transparency. These two aspects are likely to lead to higher efficiency.

Chronology of events



Need for RERA[1]

Project delay is one of the major risk factors for the Indian real estate, and is one of the key reasons for consistently high residential prices. Over 19,000 projects across 27 major cities, entailing an investment of over USD300–320 bn (INR19.5–21tn), would come under the purview of the RERA. The RERA is the need of the hour to reduce delays, help ensure speedier completion and bring higher investments into the sector

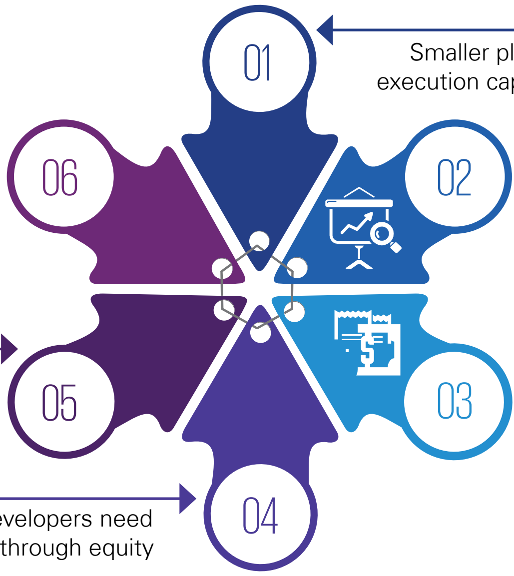


1. The Real Estate Regulatory Bill - Royal nod from the Rajya Sabha, Liasas Foras, 2016

As of now, out of 35 states and union territories (UTs) in the country, excluding Jammu & Kashmir, 23 states and UTs have already notified their respective RERA rules.[2]

Impact of RERA

Impact on the sector



Industry consolidation

Smaller players with lack of strong financial and execution capability may find it challenging to survive, leading to consolidation.

Increased project cost

Registration with the RERA and insurance cost for construction and land title, may result in higher project costs.

Tight liquidity

Pre-launch concept would be a thing of the past; land and approval costs would have to be meted out of internal accruals..

Rise in cost of capital

The cost of capital may go up as developers need to fund the land and approval cost through equity

Initial backlog

A lot of work needs to be done initially to get the existing and new projects registered.

Increased project launch time

The project launch time may increase since a lot of time would be invested in finalising the finer details before a project launch

Source: KPMG in India's analysis, August 2017

Potential benefits of RERA

Although there are some initial steps that may pose as challenges to the sector, in the long-term the benefits of RERA are far more, with the ability to transform the real estate sector in India. Key benefits of RERA are depicted below:

For industry

- Higher governance and transparency
- Project efficiency and robust project delivery
- Enhanced confidence of investors
- Regulated environment

For developers

- Adoption of best practices
- Higher efficiency
- Sector consolidation
- Corporate branding
- Higher institutional funding

For home buyers

- Buyer interest protection
- Quality product and timely delivery
- Balanced buyer-seller agreements
- Higher transparency — home sales on carpet area
- Security of money and efficient utlisation
- Standardisation

2. RERA deadline ends. Only 15 states have notified rules, 6 states are online, The Economic Times, 01 August 2017

3.2 Goods and Services Tax (GST)

The Goods and Services Tax (GST) a crucial and much-needed indirect tax reforms for the Indian economy — has finally been implemented on 1 July 2017.

The new tax structure would subsume various indirect taxes, such as excise duty, service tax and Value Added Tax (VAT), which are currently levied by the central and state governments. The government, through the GST, aims to create a uniform market and eliminate multiple levels of taxations. This step is expected to pave the way for higher transparency on the back of streamlined tax structure.

The GST Council has recommended a four-tier tax rates i.e., 5 per cent, 12 per cent, 18 per cent and 28 per cent. The new tax rate slabs applicable on some of the key real estate products and services as per the GST law are as follows:

• Building bricks • Small restaurants (turnover < INR5million)	• Works contract • Sanitary ware • Budget hotels (Tariff INR1,000-2,000) • Restaurants (non-ac)	• Commercial lease agreements • F&B • Budget hotels (Tariff INR2,500-5,000) • Restaurants (AC)	• Cement • Paints and varnishes • Wall paper • Wall fittings • Plaster • Luxury hotels (Tariff > INR5,000) • Restaurants in luxury hotels
5 **per cent**	12 **per cent**	18 **per cent**	28 **per cent**

Source: Central Board of Excise and Customs, Department of Revenue, Ministry of Finance, Govt. of India

Impact of GST on the real estate sector

Warehousing

GST has led to an increase in warehouse services tax from 15 per cent to 18 per cent. However, removal of state level barriers is expected to create a positive impact resulting in increased operational efficiency following consolidation of warehousing locations and reduction in transit time`

Transaction cost

The cost of transactions in the real estate sector is expected to rise by about 6 per cent. However, if the developers pass the input tax credit advantage to the customers, the property price hike could be restricted within 1 to 2 per cent

Rental market

Residential property owners would not be taxed under GST for renting their properties. However, the tax rates for commercial renting has increased from 15 per cent to 18 per cent, which is likely to make commercial leasing more expensive

Home loans

Tax rate on financial services increased from 15 per cent to 18 per cent, upon GST implementation. Thus, home loans are expected to become more expensive due to increased bank charges

Property resale

Since buyers are not liable to pay any indirect tax for the purchase of ready to-move-in properties, the impact of GST on buyers of resale properties is likely to be minimal

Affordable Housing

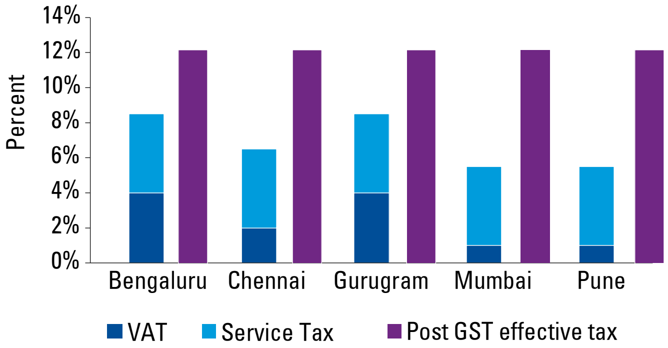
Housing projects under the affordable housing scheme are exempt from GST, hence there will be no impact on these projects

According to the GST regime, the construction of a building, civil structure, or part thereof, intended for sale to a buyer, wholly or partly, is subject to 18 per cent GST rate on two-thirds of the value of the property. Hence, the effective tax on such properties would be 12 per cent, with facility for the developers to avail input tax credits (ITC); this would be subjected to no refund in case of overflow of ITC.

It is anticipated that real estate transaction costs would increase by up to 6 per cent, in case no ITC is passed on by developers. If developers pass on the ITC to buyers, the property price increase could be limited to 1–2 per cent. The stamp duty has been kept outside the ambit of the GST law. In addition, the GST would not be applicable on completed properties.

The GST is expected to bring the unorganised sector under the ambit of taxation, which could help the Indian economy to increase its tax base. It would not only create a level playing field for all organised as well as unorganised players, but also across geographies. Furthermore, GST would provide an audit trail to better control and monitoring of the sector. Hence, GST is expected to result in higher transparency in the sector, which is currently facing a perception issue.

Pre-GST and post-GST tax on real estate transactions



Contentious issues pertaining to GST in Indian real estate

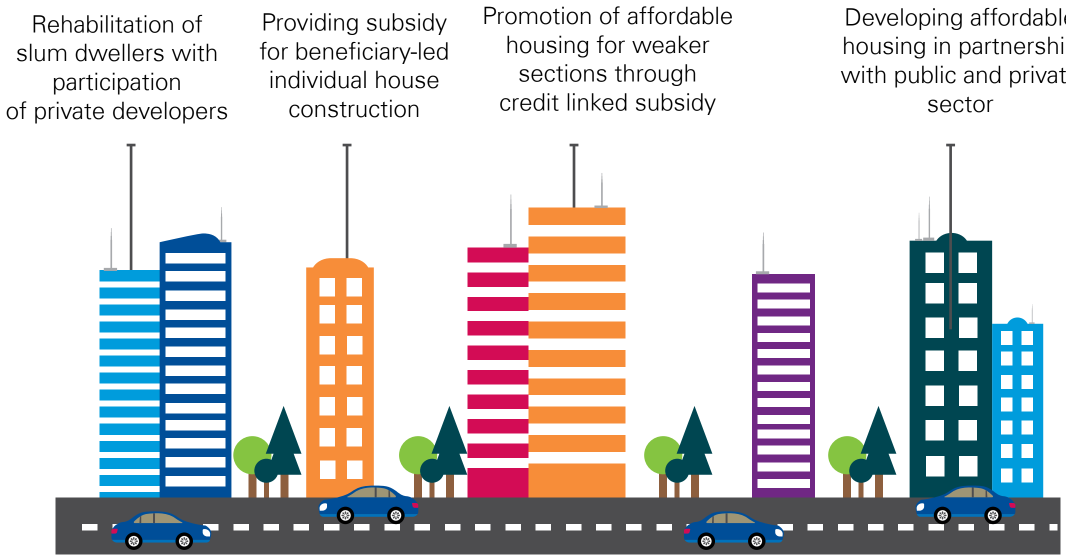
Although the GST regime is likely to bring higher efficiency through streamlined indirect tax structure into the real estate sector, there still exists a few grey areas that need policymakers' attention. Some of the challenges are enlisted below:

- **JDAs, TDRs and area sharing agreements:** Joint development agreements (JDAs), transferable development rights (TDRs) and area sharing agreements are not covered under the purview of the GST. Hence, ambiguity pertaining to such development models still persists, for which clarity is required
- **Cancellation of bookings:** The GST does not cover the completed/ready-to-move-in residential projects under its purview. If a buyer cancels a booking in case the sale is made after the completion certificate is received, then the developers are not entitled to get the refunds.
- **Under-construction projects:** Suppliers of raw materials not issuing excise invoices for materials bought from them by developers. However, developers could have already paid service taxes and VAT for procurement of goods and services for projects that are under different phases of construction. In such a scenario, developers would not be able to take full credit of taxes paid by suppliers, which remains unaddressed under the GST law.
- **Stamp duty charges remains:** In addition to the GST, the home buyers would also have to bear expenses such as stamp duty which ranges between 5 per cent and 7 per cent of the value of housing units. Hence, the basic principal of subsuming all multiple taxes under GST becomes invalid. We recommend that the stamp duty to be also brought under the ambit of GST.

3.3 Pradhan Mantri Awas Yojana (PMAY)

With a growth rate of 11–12 mn per annum, the Indian urban population is set to take over its rural population by 2050. On an average, India's housing requirement is increasing at a rate of 2.5–3 mn homes per annum. Increase in urban population has had an adverse impact on the required area per household. This has led to the increase in the number of nuclear families and, therefore, the number of households seeking housing and housing finance.[1,2]

To cater to the housing needs of this growing urban population, the central government in June 2015 had launched the **Pradhan Mantri Awas Yojana (Urban)** under the **Urban Housing Mission**, which aims at addressing the shortage of over 20 mn houses in the urban India by 2022. Under this mission, the government is expected to provide central assistance to the urban local bodies (ULBs) and other implementing agencies through UTs/States for the following:



- In November 2016, the government expanded the scheme to include rural areas with the launch of PMAY (Gramin). The mission aims to develop 'pucca houses' for all rural households by 2022.[3]
- Under the mission, an estimate of 50 million houses are to be built in urban and rural areas combined by 2022.[4]

Key implications and opportunities of PMAY

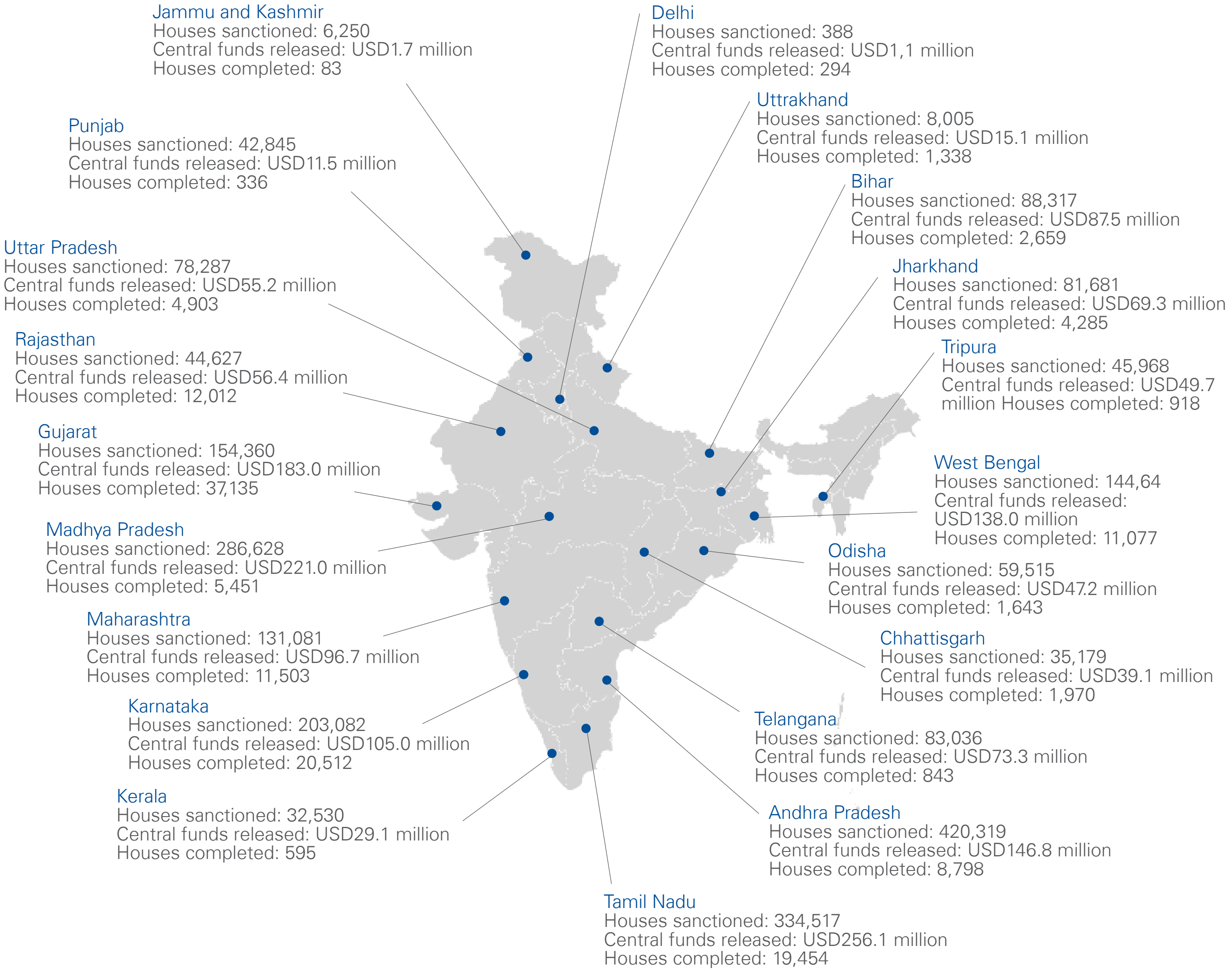
- As per our estimates, there is a need for construction of 110 mn houses to meet the affordable housing demand by 2022. PMAY would help bridge the demand–supply gap in affordable housing segment, thus offering opportunities for foreign and domestic developers to enter the affordable housing segment
- Our estimate suggests that construction of affordable housing to meet the total demand for affordable housing would require an investment of USD2 tn (INR130 tn). Hence, PMAY would provide opportunities for foreign and domestic investors to expand their presence in India's real estate sector
- The affordable housing segment is likely to grow over 30 per cent over the medium-term, and it would be a key growth driver for the mortgage finance market
- In addition, it would provide the government with an opportunity to monetise land that is either unused or occupied by sick/closing public sector enterprises (PSEs)
- Granting of infrastructure status to 'affordable housing' would provide impetus to the government's mission of 'Housing for All by 2022'. With the infrastructure status, the developers would have access to cheaper funding by way of debt, which would reduce the overall cost of homes
- The lowering of cost of homes is expected to result in an increase in participation from domestic and foreign players in the affordable housing sector.

1. Urban population (% of total), The World Bank, February 2017
2. PNB Housing Finance Ltd, HDFC Securities, February 2017
3. PM Launches "Housing for All" in Rural Areas, PIB, 20 November 2016
4. Modi's Fifty Million Homes Moonshot Looks Set to Miss Its Mark, Bloomberg, 25 July 2017

Current status and progress report

- Under PMAY, the government has approved over 2.4 mn housing units for the affordable housing segment in urban regions until 15 August 2017. Of these, over 20 per cent houses have been approved for the benefit of slum dwellers[5]
- As on 31 July 2017, about 157,100 units have been built under the PMAY (Urban) mission, of which over 50 per cent are located in Gujarat, Karnataka and Tamil Nadu[6]
- In the Union Budget 2017–18, the government announced its plans to build one crore houses for the urban poor by 2019; it has allocated USD3.5 bn (INR0.23 tn) for PMAY to fulfil its agenda of 'Housing for All by 2022'
- The government has identified at least seven land parcels totaling over 2,500 acre, belonging to sick and closing PSEs for new housing projects. About half of the built-up areas on these land are expected to be allocated to affordable houses[7]
- About 197,100 houses were constructed in rural areas under PMAY (Gramin) until March 2017. The government has revised the target to complete 44 lakh houses in rural areas by the end of 2017.[8]

State-wise progress of PMAY (Urban)



Source: PMAY (Urban) - Housing for All (HFA) State-wise progress, MHUPA, accessed on 16 August 2017

5. Housing for all by 2022 faces 'slum challenge, ET Realty, 15 August 2017
6. Pradhan Mantri Awas Yojana (Urban) - Housing for All (HFA) Statewise progress, MHUPA, accessed on 16 August 2017
7. Land with sick PSEs to be freed up for affordable housing, ETRealty, 08 August 2017
8. Pradhan Mantri Awas Yojana: Progress of Modi government's ambitious project to build pucca houses by 2022 is tepid, Financial Express, 31 May 2017

PMAY status analysis

The pace of construction of affordable housing has been sluggish to date and it lags far behind the target, i.e., to achieve its target of 50 million houses till 2022.

PMAY status analysis	
Houses to be built under PMAY (Urban) until 2022	**20,000,000**
Houses built until 31 July 2017	157,106
Remaining houses to be built by 2022	19,842,894
Months remaining	65
Houses to be built per month for PMAY(Urban)	**305,275**
Houses to be built under PMAY (Gramin) until 2022[1,2]	**30,000,000**
Houses built until March 2017	197,067
Estimated number of houses pending for PMAY(Gramin)	29,802,993
Houses to be built per month for PMAY (Gramin)	458,507
Total houses to be built under PMAY per month to complete the target of 50 mn units by 2022	**763,782**

Contentious issues[3,4,5,6]

The success of PMAY is clouded by following key issues:

- Scarcity of land to build new houses
- Inadequate private sector participation and only few developers have mass production ability
- Construction delays due to numerous clearances
- Unavailability of property records to avail subsidies
- High project costs owing to high land prices

PMAY's target could only be achieved by fast-tracking the clearance process and removing the bureaucratic delays. Streamlining the centre and state governments' efforts would help increase the overall efficiency of the process. In addition, offering attractive incentives would help increase the participation of private developers and investors, which are imperative for the success of the mission.

1. Ministry of Rural Development, Government of India, accessed on 23 August 2017
2. Centre to build 1 crore houses under PMAY-G by 2019, Press Information Bureau, Government of India, 30 March 2017
3. Draft Model Public Private Partnership Policy for Affordable Housing in India, Naredco, June 2017
4. Housing for all: There's a lot to be built, The Hindu Business Line, 09 July 2017
5. Modi's Fifty Million Homes Moonshot Looks Set to Miss Its Mark, Bloomberg, 25 July 2017
6. Housing for all by 2022 faces 'slum challenge', ET Realty, 15 August 2017

3.4 Real Estate Investment Trusts (REITs)

REIT is a type of investment instrument that invests in rent-yielding completed real estate properties. REIT holds a major significance for the Indian real estate sector, as it has the potential to transform the sector.

Key implications

- Opportunity for liquidation of rent-generating real estate assets
- Avenue of alternative investment for domestic and foreign investors
- Bring higher professionalism and transparency in the real estate sector
- Drive a conducive investment environment

REIT potential in India

The central government allowed the tax pass-through status to REITs and InvITs in the Union Budget FY2016–17. In addition, in January 2017, SEBI has allowed mutual funds (MFs) to invest in REITs and InvITs. However, despite several relaxations provided by the central government and other regulatory authorities, no REIT listing has taken place so far.

REIT as an alternative investment vehicle has significant opportunity in India. It is estimated that India currently has a rent-yielding office and retail inventory to the tune of 350 mn sq ft valued in excess of USD70 bn (INR4.5 tn). Furthermore, other rent-generating real estate assets such as warehouses and hospitality assets, too, have significant REIT-able stock. This would enable developers and asset managers to raise funds, which are expected to reduce the liquidity deficit in the sector.

Our recommendations to accelerate REIT's success in India

Learnings from international REIT structure suggest that mere legalising REITs does not guarantee that it will be accepted readily and be successful. Policy makers have to ensure that the REIT regime is continuously reviewed in accordance with the changing requirement of the real estate market, not just in India, but also in other parts of the world.

Key suggestions to make REITs successful in India are:

- Waive-off one time stamp duty on transfer of asset to REITs or SPVs owned by REITs
- Waive-off stamp duty where a REIT holds property over a specified period of years.

- Exemption of transfer of shares of an SPV by the sponsor in exchange of the REIT units
- Exempt tax on capital gains on REIT by allowing complete pass-through status.

- Amend IRDA investment regulations to allow insurance companies to invest in REITs, to enable a wider investor base.

- Allow the swap of existing shares of the SPV held by a non-resident sponsor with the units of a REIT under the automatic route
- Managers of REIT having FDI should be treated as a non-fund based activity and cannot be subjected to the capitalisation norms applicable to fund based activities.

1. REIT-able space in India, A closer realty- who is this by? When was it released?

4. Indian real estate growth and transformation

4.1.1 Indian real estate inching towards greater transparency

Several reforms undertaken by the central government, coupled with rising participation from foreign developers, asset managers and also institutional investors, have led to increased level of corporate governance standards, adoption of global best practices, and higher professionalism amongst the Indian real estate developers. As a result, Indian real estate has moved higher in the transparency index rankings over the past decade. The ranking is likely to get a further boost with the implementation of the RERA and GST, coupled with other reforms.[1] Furthermore, the increased penetration of large MNCs and corporate occupiers in both tier-I as well as tier-II cities, and across the real estate asset classes, who demand better information on market dynamics, has also resulted in improvement in transparency.

JLL Global Transparency Index Rankings

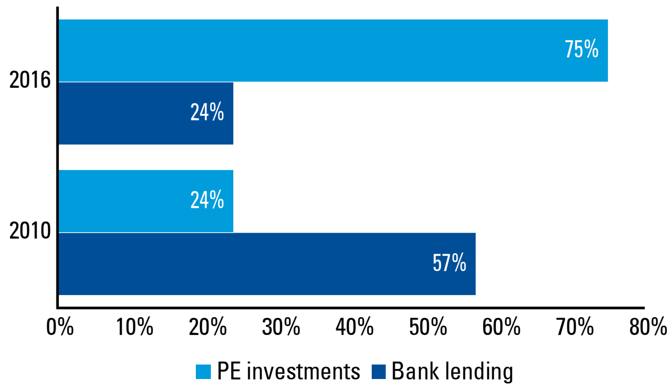
	2008	2016
Tier – I Indian cities	50	36
Tier – II Indian cities	52	39

4.1.2 Paradigm shift from conventional financing medium to institutional financing

Shift from over-dependence on banks and customers' advances to Private Equity (PE) funds, pension funds and Non-Banking Finance Companies (NBFCs)

- Rising non-performing assets (NPA), higher risk provisioning assigned to the real estate sector by the Reserve Bank of India (RBI) and dwindling profits in the real estate sector, have made banks reluctant to lend to the sector. As a result, bank lending to the real estate sector has significantly dropped from over 57 per cent in 2010, to less than 24 per cent in 2016.
- As a matter of fact, PE funds and financial institutions such as pension funds and sovereign wealth funds have replaced banks as the largest source of funding to the real estate sector. The share of PE funds and these institutions in real estate funding has gone up significantly from 25 per cent in 2010 to over 75 per cent in 2016.[2]

Major funding sources to real estate sector



Source: Analysis of Institutional Funding in Real Estate, Knight Frank, March 2017

1. JLL Global Real Estate Transparency Index, 2017
2. Analysis of Institutional Funding in Real Estate, Knight Frank, March 2017

4.1.3 Industry consolidation, portfolio diversification and emergence of new business models

The slowdown in sales and lack of financial prowess among several developers are resulting in increased consolidation in the Indian real estate sector. The significantly competitive real estate sector is expected to become much leaner, owing to the ongoing consolidation via mergers and acquisitions, joint developments, joint ventures (JVs) etc., between developers and landowners with established organised players.

01 Real estate sector is witnessing consolidation via mergers and acquisitions, joint developments, joint ventures (JVs) etc., between developers and landowners with established organised players

02 Many players are involved in forward and backward integration across the real estate value chain — land aggregation, construction contracting, development, asset management, facilities management etc.

03 Large developers have also started providing supportive social infrastructure and services such as private fire tenders, captive power plants, security personnel, healthcare facilities, and private metro to enhance the value of their assets

04 The scale of development has changed significantly from mere standalone buildings to integrated townships, theme based townships, developments linked to economic activities, and even self-sustained mini cities

The trend of large players buying out small developers, and struggling developers selling lands to firms having strong balance sheets to cash in their land banks are expected to continue in the coming years. However, the pace of consolidation would be dependent on several factors such as improvement in banks' debt burden, implementation of new regulatory policies and introduction of new government reforms.

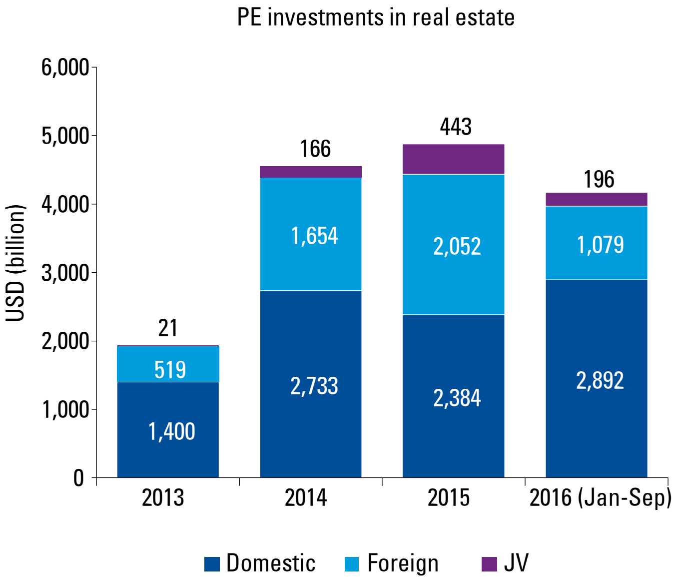
4.1.4 Rising interest of foreign developers and PE investors in Indian realty

The Indian real estate sector has become one of the key focus areas of foreign developers and PE investors. Several foreign developers have entered the country in a bid to capture a share of the high potential Indian market.

Over the past four years, PE investments in the Indian real estate sector has witnessed rapid growth.

Factors such as stable government, strong GDP growth, positive economic outlook and several government reforms have helped build the confidence of foreign investors, enabling them to increase their exposure to the real estate sector. With the closure of several high-value foreign investment deals in Q416, the total amount of foreign investment in the Indian real estate sector was anticipated to surpass the 2015 value.[1]

In addition, several large investors entered into JVs with established real estate developers in a bid to make investments in new projects or purchase assets across the country. Furthermore, government reforms such as the grant of infrastructure status to affordable housing, establishment of the Real Estate Regulations Act (RERA) and the Real Estate Investment Trust (REIT) are expected to increase the attractiveness of the real estate sector amongst institutional investors, providing an upsurge to the investment scenario.



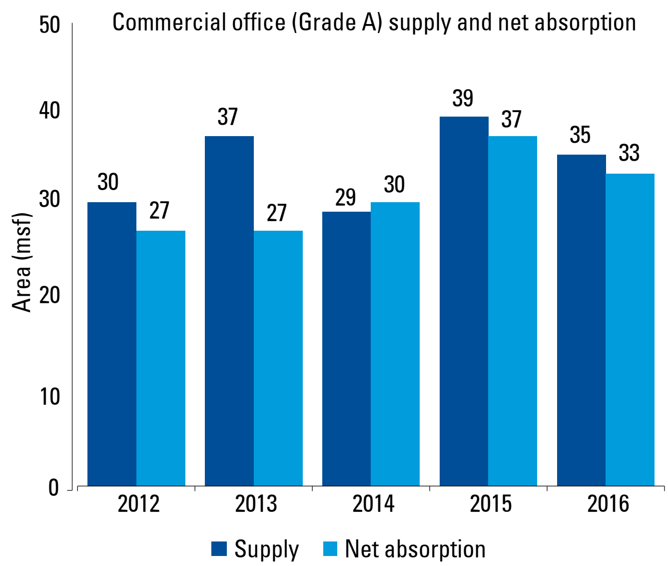
Source: Revitalising Indian Real Estate. Cushman & Wakefield, November 2016

4.1.5 Commercial office (Grade A) stock to cross 500 million square feet (msf) in 2017

The top-seven cities (Bengaluru, Chennai, Delhi-NCR, Hyderabad, Kolkata, Mumbai and Pune) in India recorded over 35 msf of Grade A office space in 2016, which has taken the total Grade A office inventory in these cities to over 475 msf. It has been forecasted that by the end of 2017, the Grade A office inventory across these cities would cross 500 msf landmark, from little over 100 msf in 2006. This means that Grade A office inventory has grown nearly five times during the past decade. An attractive policy pertaining to IT parks and IT–Special Economic Zones (SEZ), which account for over 70 per cent of the Grade A office inventory in India, coupled with favourable economic and demographics fundamentals have been some of the key reasons for this growth.

The total Grade A net absorption across these cities declined nearly 9 per cent to 33 msf in 2016 over the previous year, In fact, the reduced supply and healthy demand resulted in narrowing the gap between the demand and supply.

It is estimated that commercial real estate in India generates about USD5 bn (INR0.3 tn) of rental revenues annually.



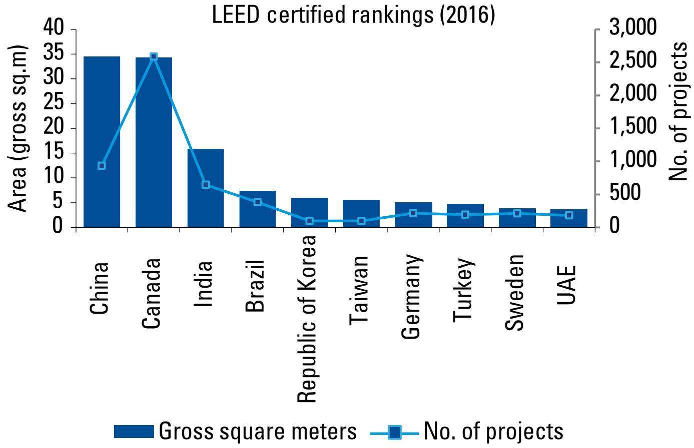
Source: Revitalising Indian Real Estate, Cushman & Wakefield, November 2016

1. Revitalising Indian Real Estate. Cushman & Wakefield, November 2016

4.1.6 Smart homes and green building concepts are gaining popularity

In 2001, the green building footprint in the country was about 20,000 square feet (sf). India has now progressed to over 4,500 IGBC registered green buildings today with a footprint of over 4.5 bn sf of space getting constructed across its land. The conversion and retrofit of existing structures is driving its scope significantly.[2]

Currently, India accounts for 10–12 per cent (15.9 mn gross square metre) of global space under green buildings, which puts India in the third position (outside the U.S.) in the world, next to Canada and China.[2] India has over 640 projects that have received LEED certifications. The projected market potential for green building materials and technologies is estimated to be about USD300 bn (INR19.5 tn) by 2025.[2]

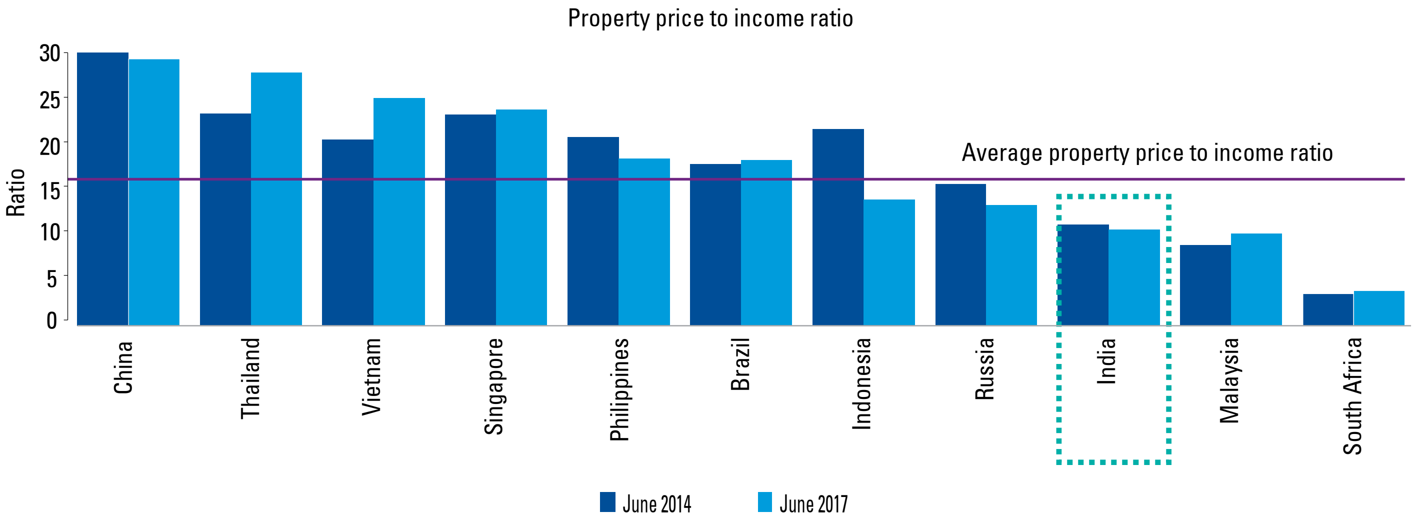


Source: USGBC Announces International Ranking of Top 10 Countries for LEED; USGBC, 14 December 2016

Note*: Gross square meters are reported in millions

4.1.7 Increasing housing affordability

India falls in the spectrum of most affordable nations among the key ASEAN (Association of Southeast Asian Nations) and BRICS (Brazil, Russia, India, China and South Africa) countries. Its property price-to-income ratio is far below several countries, for example China, Thailand, Vietnam and Singapore. While majority of these nations witnessed an increase in their property price-to -income ratio from June 2014 to June 2017, India's real estate witnessed a decline of over 5 per cent, thus indicating the increasing affordability of the sector.



Source: Property Prices Index for Country. Numbeo website, accessed on 13 August 2017

In addition, the Indian government's initiatives such as Pradhan Mantri Awas Yojana (PMAY) and Credit Linked Subsidy Scheme (CLSS) for the mid-income group are likely to facilitate the affordability of real estate properties for the middle and lower income groups. [3]

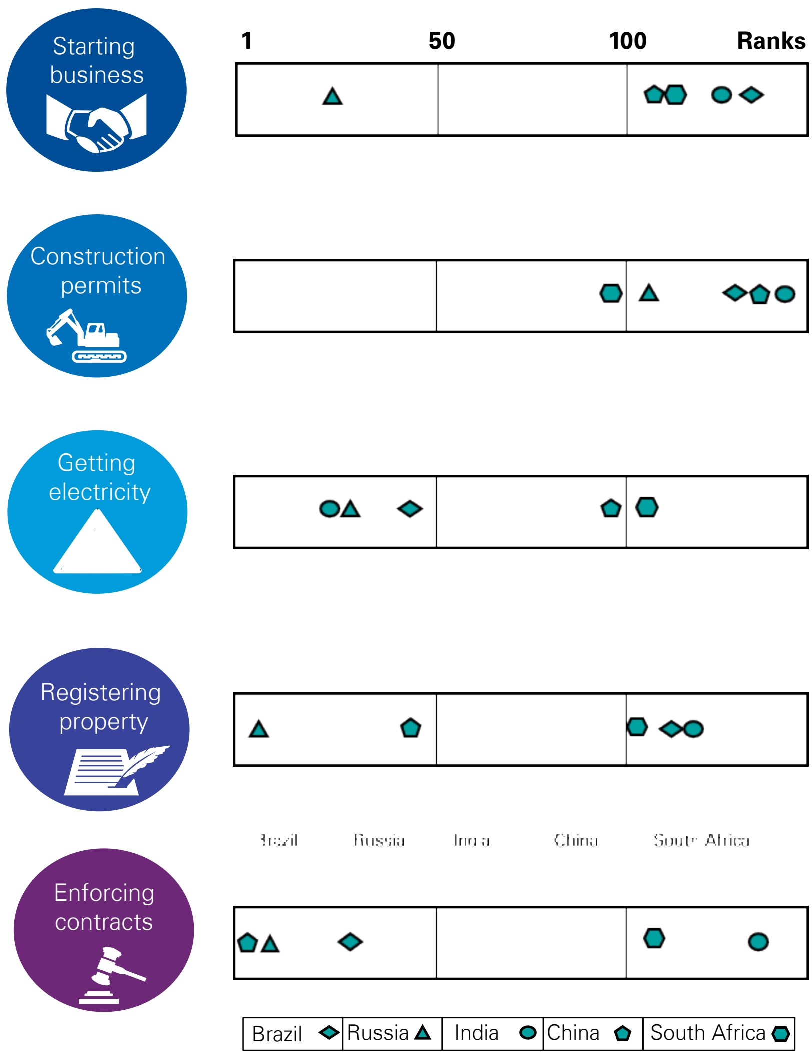
2. Green buildings footprint to triple in India by 2020, ETRealty, 13 July 2017
3. 6 major trends in Indian real estate in 2017, The Economic Times, 01 March 2017

4.1.8 'Doing Business Rankings 2017' – the World Bank

- India, ranked 130 out of 190 nations in the World Bank's EoDB ranking for 2017, lags behind its peers in BRICS and ASEAN. However, the Indian government is making persistent efforts to improve the country's EoDB with an aim to reach among the top 50 economies of the world, in a bid to stimulate investments and improve country's perception globally.[1]
- The government has taken several measures to improve the EoDB in the country, including the setting up of investor facilitation cell, creating single-window clearance systems, launching of the Insolvency and Bankruptcy Code 2016, reducing the corporate tax rates, introducing 24x7 online application for industrial licence through e-Biz website, limiting the documentations required for imports and exports, and liberalising the FDI limits in various sectors.[2,3]
- In addition, the government has improved the processes for granting construction permit, which now takes 60 days following eight online procedures, whereas it takes 93 days and 10 procedures to attain a construction permit in New Zealand, which has been ranked first in the World Bank's EoDB ranking.[4]

Country	EODB rankings
Singapore	2
Malaysia	23
Russia	40
Thailand	46
South Africa	74
China	78
Vietnam	82
Indonesia	91
Brazil	123
India	130

Comparison of selected EODB parameters across BRICS economies



1. India aims to join top 50 in World Bank's ease of business ranking, The Economic Times, 12 December 2016
2. Economic Survey 2016-17, India's Union Budget website, accessed on 13 August 2017
3. Ease of Doing Business, Make In India website, accessed on 13 August 2017
4. India set to climb up in ease of doing business ranking, The Economic Times, 03 July 2017

5. Way forward

5.1 For the government

The central government has undertaken a host of policy reforms over the past couple of years to create an enabling environment for the real estate sector. However, more initiatives are needed to help the real estate sector overcome the challenges that it has been still facing and warrants government's attention.

Our recommendations to further enhance the government's efforts

Rental housing reforms

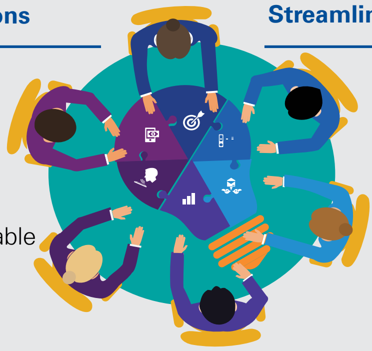
- Finalisation and adoption of Draft Model tenancy Act by state governments must be expedited
- The Draft National Urban Rental Housing Policy must be cleared soon

Land reforms

- There is a need to expedite digitisation of land records
- The government must fast-track the land title insurance process

Create infrastructure and expand urban regions

- The development of new economic centres in urban peripheries can help decongest main cities and promote the real estate sector
- Expedite development of physical and social infrastructure in the peripheral regions to enable appropriate habitation



Streamline approval mechanism and statutory levies

- Development of a 'single window clearance' system connecting regulatory authorities at the central, state, and ULB levels, supported by a robust technology platform, could help reduce the complexities and delays in providing approvals
- It is essential to streamline the statutory levies and taxes which accounts for 30-35 per cent of the total cost of a housing unit

Institutional capacity building

- The government administrations have their own limitations in terms of capacity to deal with various matters. Hence, there is an urgent need to create institutional capacity to assist the government on institutional advice

Development norms

- The government could relook into various development norms, such as FAR/FSI and density norms, to allow efficient utilisation of land parcels

5.2 For the industry[1,2]

Real estate and construction is expected to require over 66 mn workforce by 2022 across several skill sets, which is the largest amongst all sectors. It is anticipated that India is expected to have a shortfall of 2.5–3.0 mn workforce by 2022. Furthermore, getting the right kinds of training partners, managing stakeholder effectively, and obtaining buy-in from the corporate sector are also major challenges.[3]

The scarcity of skilled workforce and lack of infrastructure to train them, leads to project delays. It has been noticed that an inadequate project planning and the absence of robust project management capabilities have led to project complexities not being accounted for, which led to schedule and cost overruns.

Capacity building

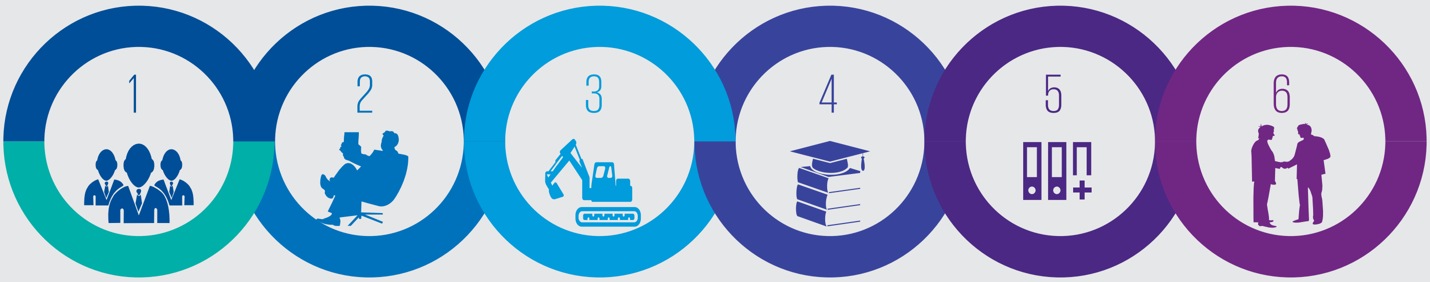
- Invest in human capital by creating the required infrastruc ture such as training institutes and colleges
- Outsource training or develop partnerships to create a skilled workforce.

Adopt modern construction technologies and techniques

- Adopt modern construction technologies for prefabrication, materials and formwork, to reduce the inefficiencies and mitigate risks
- Adopt techniques such as lean project management, building information modelling (BIM) and automated MIS systems.

Manage construction risk

- Set up project monitoring office (PMO) to understand, embrace and control risks
- Plan to optimise costs Ensure effective monitoring and successful execution
- Effective project integration must be targeted.



Bring higher professionalism and discipline

- Become more efficient and organised, and adopt global best practices
- Developers must focus on enhancing their project delivery capability to deliver projects as per agreed timelines.

Comply with regulatory norms

- Ensure all the required processes and procedures are in place through out the organisational ecosystem to avoid any non-compliance to RERA norms, as non-compliance can be detrimental to the company and promoters.

Drive customer centricity

- It is essential to keep customers at the centre of all the decision-making, throughout the real estate value chain, and develop a healthy relationship with them to regain their lost trust.

The adoption of modern construction technologies can play a key role in achieving the desired goals. It would help developers resolve some of the traditional challenges such as shortage of manpower, and low efficiency, and enable them to deliver a quality product in time.

However, mere adoption of new construction technology may not bridge the demand–supply gap. With the growing complexity and scale of projects, coupled with shortage of skilled workforce, it has become essential to seek innovative ways to overcome the challenges of schedule and cost overruns. Hence, in addition to the usage of new construction technologies, it is also important that the real estate developers focus on effective project management and project integration capabilities.

1. Managing Construction Risk, KPMG in India, March 2009
2. Project Management: Need of the hour, KPMG in India, August 2013
3. Skilling India, KPMG in India and FICCI, September 2014

About KPMG in India

KPMG in India, a professional services firm, is the Indian member firm affiliated with KPMG International and was established in September 1993. Our professionals leverage the global network of firms, providing detailed knowledge of local laws, regulations, markets and competition. KPMG has offices across India in Chandigarh, Gurgaon, Noida, Ahmedabad, Vadodara, Mumbai, Pune, Bengaluru, Kochi, Chennai, Hyderabad and Kolkata. KPMG in India offers services to national and international clients in India across sectors. We strive to provide rapid, performance-based, industry-focussed and technology-enabled services, which reflect a shared knowledge of global and local industries and our experience of the Indian business environment.

KPMG International

KPMG International is a global network of professional firms providing Audit, Tax and Advisory services. KPMG member firms operate in 155 countries and have more than 174,000 outstanding professionals working in member firms around the world. The KPMG Audit practice endeavours to provide robust and risk-based audit services that address member firms' clients' strategic priorities and business processes.

KPMG's Tax services are designed to reflect the unique needs and objectives of each client, whether firms are dealing with the tax aspects of a cross-border acquisition or developing and helping to implement a global transfer pricing strategy. In practical terms that means, KPMG firms work with their clients to assist them in achieving effective tax compliance and managing tax risks, while helping to control costs.

KPMG Advisory professionals provide advice and assistance to help enable companies, intermediaries and public sector bodies to mitigate risk, improve performance, and create value. KPMG firms provide a wide range of Risk Consulting, Management Consulting and Deal Advisory services that can help their clients respond to immediate needs as well as put in place the strategies for the longer term.

About NAREDCO

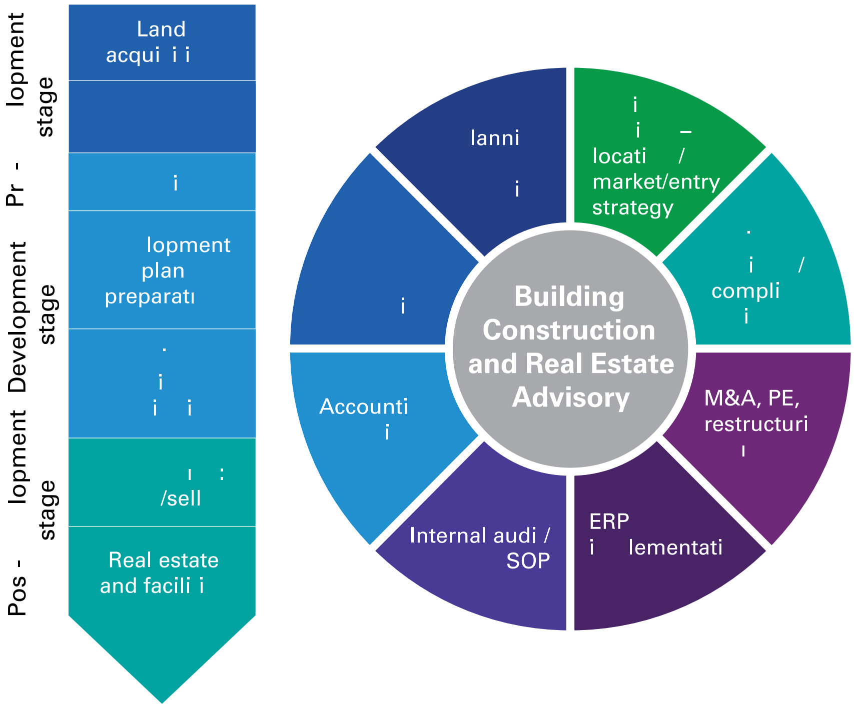
National Real Estate Development Council (NAREDCO) is the apex body of real estate sector, under the aegis of Ministry of Housing and Urban Poverty Alleviation (HUPA), Government of India.

Shri M Venkaiah Naidu, the Hon'ble Minister of UD, and HUPA, is the Chief Patron and seven Joint Secretary level officers from Central Government and Central Public Sector Undertakings (PSUs) are on the Governing Council.

The founders of NAREDCO are prestigious public and private sector organisations including Housing and Urban Development Corporation (HUDCO), National Housing Bank (NHB), National Building Construction Corporation (NBCC), Delhi Development Authority (DDA), LIC Housing Finance, PNB Housing Finance, HDFC, Cement Manufacturers Association, DLF, K Raheja, Hiranandani, Sobha, Prestige, Shriram Properties, Tata Housing, Dewan Housing Finance etc.

Objectives of NAREDCO inter alia includes promotion of housing and real estate sector in India, and inculcate transparency and accountability for the benefit of the customers. NAREDCO and its State Chapters work in close cooperation with Central and various State Governments to achieve these objectives.

KPMG in India Building, construction and real estate sector practice



KPMG in India's BCRE practice serves over 600 clients across audit, tax and advisory. The team works across the BCRE spectrum including developers, contractors, government agencies and private equity investors. Our practice also has extensive experience of working with commercial property users such as IT/ITeS, pharmaceutical, banks, e-commerce etc. Our practice comprises over 300 professionals with a balanced technical, commercial and research skill sets.

Our strength is demonstrated through key features such as:

- Rich experience in process deployment and technology advisory process design, development, training, IT-enablement, implementation support and post implementation review
- Highly collaborative approach incorporating good industry practices as well as management's deep understanding of the business and key concern areas
- Efficient project delivery, improved governance and oversight of capital projects. Leading project management practice support.
- Quality assurance process to challenge the deliverables on compliance, practicality and efficiency
- Multi-disciplinary team, industry and subject matter experts. Professionals include engineers, PMI certified project management professionals, Chartered and cost and work Accountants, risk management experts etc.

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