ASIAN REAL SnapShot!

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Current developments in the key real estate markets in Asia Pacific

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KPMG

cutting through complexity

October 2013

Introduction

Welcome to the second edition of KPMG's Asian Real Estate snapshot. In this edition, the focus is on the region's differing government policies implemented and the effects it has on real estate investment in Asia Pacific. From Hong Kong's introduction of a series of measures aimed at lowering residential property prices and curbing excessive speculation to India's government reforms, these changes are aimed at creating a stabilised growth of the real estate market in the region.

This document is prepared by a network of seasoned KPMG professionals aligned to different functional groups within Asia. All have a deep understanding regarding the complex nature of the regional real estate markets. KPMG Real Estate has professional experience and an understanding of real estate and the related financial factors as well as an extensive database on regional submarkets. Through a pan-Asian and global network of interdisciplinary professionals, KPMG firms offer real estate and construction related services across the spectrum of the industry. KPMG professionals offer valuable insight in real estate and construction related issues based on their extensive knowledge and experience in the industry.

Andrew Weir
Global Chair, Real Estate and Construction

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Australia

Tightening of debt deductibility rules

For many years, Australia has maintained a thin capitalisation tax regime to impose a cap on the maximum amount of deductible debt which could be borrowed by Australian taxpayers. Both foreign investors looking to make Australian acquisitions and also Australian outbound investors must pay careful attention to these rules in structuring acquisitions. Recent announcements by the Federal Government[1] in this area will impact the structure of future acquisitions and require an analysis of existing investments to confirm whether they will comply with the new law going forward.

What are the changes?

In a announcement made in conjunction with Australia's most recent Federal Budget in May 2013, there will be a number of changes to the thin capitalisation rules. Additional proposed changes to Australia's transfer pricing rules are expected to further impact investment structures.

Australia's existing thin capitalisation regime includes a 'safe harbour' provision, which effectively enables Australia taxpayers to apply a 75:25 debt to equity ratio. The ratio is modified for banks and non-bank financial entities to align with banking capital requirements. There is also provision for additional debt in excess of the safe harbour provision where it can be shown the borrowings are comparable to independent commercial arrangements and hence satisfy the 'arm's-length' test. Finally, outbound investors are also able to access a 'worldwide gearing' test, which permits gearing to the level of the worldwide group of which the entity is a member.

The May 2013 announcements will reduce the safe harbour ration to 60:40. The test applies to all Australian taxpayers that are subject to thin capitalisation and to all debt – both external and related party debt. The announcement is premised on the basis that the current safe harbour rules are overly generous when compared with comparable foreign jurisdictions. In fact, a large number of foreign jurisdictions only apply the rules to related party debt and hence the validity of this statement is questionable. The new rules are intended to apply for the first tax year commencing on or after 1 July 2014 and, most importantly, will apply to existing debt as well as future debt. In other words, taxpayers will need to give careful consideration to their existing financing structures to confirm whether they will continue to comply with the rules as amended. If the rules are breached, then a deduction will be denied for interest paid to non-residents on debt to the extent it is in excess of the relevant cap. It should be noted that such interest would continue to be subject to a 10 percent withholding tax notwithstanding its non-deductibility.

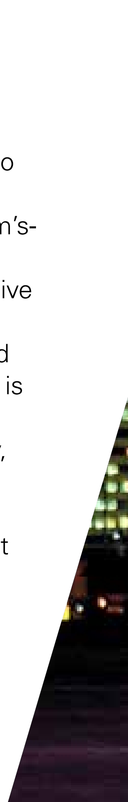
While the safe harbour test is conveniently referred to as a debt to equity ratio, the actual application of the test requires a comparison between the average value of the debt for a relevant year and the average value of the taxpayer's assets for the same year. This is a subtle distinction given that asset values (and hence the maximum cap for debt) will fluctuate over time. Note that the average value can be calculated by reference to the opening and closing balances for the particular year or by way of other stipulated alternatives at the election of the taxpayer.

Without going through the complete intricacies of a complicated formula, the safe harbour debt commences with a measurement of the average value of the taxpayers assets. Total average assets are then reduced by non-debt liabilities and other specific items to isolate the value of the entity's Australian assets upon which thin capitalisation calculations are based. Assets and liabilities are determined by reference to Australian accounting standards and the calculations must comply with those standards.

Clearly it is essential to ensure proper recognition of all assets (including specified intangibles that can be revalued for these purposes), which can be taken into account for the purposes of this calculation. The requirement to comply with accounting standards is modified in certain cases. For example, deferred tax assets/liabilities are not recognised for the purposes of the calculation whereas there can be recognition of certain internally generated intangible items. There are also particular rules around valuation of assets. It can be seen that a comprehensive safe harbour calculation, particularly with regards to the tightening in the ratio, requires not only detailed tax advice, but also the appropriate accounting input. Given the reduction, the safe harbour potential avenues to be explored include revaluing tangible and certain intangible assets, converting debt to equity or injecting further capital.

Arm's-length test

If the safe harbour provisions will be breached, then one should consider whether the arm's-length test may apply to enable a deduction for the interest on the excess debt amount. The May 2013 announcements stated that the arm's-length test will be referred to the Board of Taxation "to consult on ways to make the arm's-length test more effective by reducing compliance costs and making it easier for the Australian Taxation Office to administer while having regard to the policy objective of the thin capitulation rules"[2]. There is a general market concern that the test will be significantly curtailed following the period of consultation. Interestingly, the Board of Taxation is not due to report back on its work until December 2014 – six months after the introduction of the new safe harbour provisions. This will pose a significant



[1] "Protecting the corporate tax base from erosion and loopholes - measures and consultation arrangements", The Treasury – Australian Government, 14 May 2013

[2] "Protecting the corporate tax base from erosion and loopholes - measures and consultation arrangements", The Treasury – Australian Government, 14 May 2013

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challenge for taxpayers who exceed the reduced safe harbour debt amount, but satisfy the current arm's-length test provisions – will they also satisfy those provisions following any subsequent changes following the Board of Taxation report?

Finally, inbound investors will be able to access the world-wide gearing test under the new changes (this test is currently only available to outbound investors). Whether this provides any benefit to inbound investors remains to be seen.

Recent changes in transfer pricing

Related party debt is not only subject to the thin capitalisation rules (in terms of the quantum of maximum deductible debt), but also to Australian's transfer pricing rules when determining the appropriate rate of interest on cross-border debt. The government also recently introduced changes to update Australia's transfer pricing legislation[3]. An important practical consideration related to the changes concerns the impact of preparing contemporaneous transfer pricing documentation (or more importantly, the impact of not preparing it).

Under Australia's current law, the taxpayer is effectively protected against the imposition of culpability penalties in the event of a successful Tax Office challenge to its position provided the taxpayer can establish it has a Reasonable Arguable Position (RAP). This has been an important foundation of the Australian tax law for many years, which is intended to apply where the position adopted by the taxpayer is at least as likely as not to be correct.

The new transfer pricing rules will deem a taxpayer to not have a reasonably arguable position if they do not prepare the appropriate transfer pricing documentation contemporaneously. This is defined as the lodgement date of the tax return for the year in which the related party transaction has entered into. In the light of the trend by Revenue Authorities to challenge related party positions, it is imperative to ensure the appropriate documentation is in place before lodgement of the relevant tax return.

[3] "Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013", Australian Tax Offices – Australian Government, 29 June 2013

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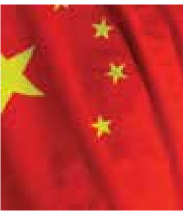

China

Impact of China's VAT reforms on the hospitality sector

The Chinese Government is currently embarking on an ambitious reform program for its indirect tax system; the objective is to replace the current dual system of indirect taxes –Value Added Tax (VAT) and Business Tax (BT) – with a single VAT system, which applies to the whole of the goods and services sector.

The reform process is being implemented progressively over a period of time, with BT being replaced by VAT on a sector-by-sector and province-by-province basis. It commenced in Shanghai on 1 January 2012 with the transition to VAT for the 'modern services' and transportation sectors. That initial phase of the VAT pilot program has recently been completed nationwide, and attention is now turning to the remaining sectors of the economy yet to transition to VAT.

Background

By far the most significant sector yet to transition to VAT is the construction and real estate sector. Not only does this sector account for the majority of all BT revenue raised on a national basis[4], but the potential impact on prices and demand in an industry, which has been experiencing phenomenal levels of growth over the last decade, will be watched with interest.

One asset class within this sector is the hospitality industry. This is undoubtedly an area of significant foreign investment given the proliferation of major international hotel brands entering the Chinese market, and their increased expansion into so-called 2nd and 3rd tier cities.

In this article, we take a brief look at the potential implications of the VAT reforms on the hospitality sector. The observations contained in this article are based, in part, on consultation discussions between KPMG China and China's Ministry of Finance (MoF). However, the proposals discussed here are not the subject of any formal announcement and are therefore highly susceptible to change. For convenience, the analysis is split between the main implications for hotel owners as compared with hotel brands given that in many cases, they are subject to separate ownership structures.

Hotel owners – development phase

Based on the most recent discussions with the MoF, the government is proposing to apply an 11 percent VAT rate to both the construction and real estate sectors sometime during 2014. This means that prospective hotel owners will need to factor VAT into their forward budgeting projections, both in respect of the purchase of any real estate for development purposes, and for construction.

Where a hotel is to be developed initially through the purchase of land use rights, it is not expected that this transaction will be subject to VAT given the acquisition is from the local government authority. However, the subsequent development on the land is expected to incur VAT on the construction services at the rate of 11 percent in place of the existing 3 percent BT rate. Hotel owners will need to ensure they factor this higher rate into cash flow projections, because although the VAT is creditable, there is generally no entitlement to a refund of excess input VAT credits in China. Consequently, during the development phase of a project, hotel owners will be expected to generate significant input VAT credit balances, which can be carried forward indefinitely and offset against output VAT in the future. This may take several years.

For existing hotel owners, the timing of any major renovation projects should be carefully considered. For example, a renovation project undertaken now would be subject to BT at the rate of 3 percent, and any of the VAT incurred on the materials used in the renovation is not creditable. However, once the VAT reforms apply to the hospitality sector, the input VAT on those materials would generally be creditable, thereby potentially reducing the overall cost.

Hotel owners – operating phase

Hotel owners currently operating existing hotels generally account for 5 percent BT on their revenue from accommodation, food and beverage outlets, conferences and events. It is expected that each of these activities will become subject to VAT during the latter half of 2014, or early 2015 (at the latest). The proposed rate of VAT for the hospitality sector is not yet known, but the choice of VAT rate is likely to be made from amongst the existing rates (6 percent, 11 percent and 17 percent), with 11 percent being speculated upon as the most likely option.

A key issue for hotel owners will be to effectively manage the transition to VAT. Due to the prevalence of forward bookings, 12 months in advance in some cases, the VAT impact needs to be factored into decision-making well in advance. If not, hotel owners may be left to bear an irrecoverable VAT liability. The government has not currently provided other industries with broad grandfathering relief for existing contracts entered into prior to the commencement of the VAT reforms, so hotel owners should not assume it will be forthcoming.

An interesting development will be whether the shift from BT (a tax on business) to VAT (a tax collected by business, but ultimately imposed on the end consumer) will result in a shift to 'plus VAT' pricing. That is, where prices for accommodation and other services are quoted to consumers on a price plus VAT basis. Certainly, that is the experience in countries like Singapore, but is legislatively prohibited in places such as Australia.

[4] China Tax Yearbook 2012

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With many international hotel brands servicing the business consumer market, a further question will be whether businesses will be eligible to claim input VAT credits for the accommodation provided for the benefit of employees travelling for work purposes or attending conferences and events. At this stage, the government has adopted a relatively conservative approach to allowing input VAT credits for expenditure, which potentially can be either of a personal or business nature – for example, no input VAT credits are currently allowed for domestic air travel, irrespective of its nature. If the VAT charged to business customers is creditable, this would go a long way to assisting hotel owners in their ability to 'pass on' the VAT to their customers.
A further issue of considerable interest is the proposed VAT treatment of food and beverage (F&B) outlets. Ideally, all of the services provided in hotels will be subject to a single VAT rate, although the potential for different VAT rates to apply to some services as compared with others would seem high. In relation to F&B, the replacement of BT with VAT may provide the government with an opportunity for considerable simplification. At present, broadly speaking, F&B sold at supermarkets is subject to VAT (usually at 17 percent), while those sold for consumption at the premises is subject to BT (at 5 percent, with the VAT being embedded in the price of the inputs by the supplier).

The imposition of a 17 percent VAT rate for F&B outlets would provide an opportunity to remove the differential treatment between 'eat in' and 'take-away' products – between the provision of goods and the provision of service in a restaurant. However, whether this occurs remains to be seen.

Irrespective of the rate which is chosen, a key point is that the imposition of VAT will have a significant impact on hotel operations. The invoicing system in China, known as the 'Golden Tax System', is manually driven and very labour intensive. The likelihood of an exponential increase in special VAT invoices being requested by customers, coupled with the complexity of potentially having different VAT rates for different services provided within the one hotel, highlights the importance of hotel owners addressing their IT systems needs as a matter of priority.

Hotel brands

Many of the hotel brands which are well known to the public typically enter into licensing arrangements with hotel owners. That is, the 'brand name' is licensed to the hotel owners in return for royalties paid. Similarly, these brands often provide various marketing support services, too. Leaving aside the cross-border aspects of these arrangements, which are relatively commonplace, the licensing of trademarks since 1 August 2013 is now subject to VAT at the rate of 6 percent on a nationwide basis as a 'modern service'. Because hotel owners are not generally subject to VAT in respect of their operations, the VAT liability is effectively embedded in the supply chain. However, once the hospitality sector transitions to VAT, it is expected that they will be eligible for an input VAT credit for the purchase of these services, effectively reducing the overall cost.
Similarly, many marketing support services provided by the hotel brands are not currently subject to VAT, but this is expected to change in the near future. Overall, these changes are expected to be beneficial to the hotel brands because the previous BT system was a real cost in these B2B transactions. By contrast, the VAT will generally be fully creditable.

Notwithstanding this, hotel brands will need to carefully consider their existing contractual arrangements with hotel owners. The ability to pass on VAT is dependent on the terms of their contracts with the hotel owners. Moreover, in many cases the hotel brands are remunerated on the basis of a percentage of the revenue derived from the hotel's operations. Whether that revenue share is based on the VAT-inclusive revenue, or the VAT-exclusive revenue, is a further contractual issue, which the parties will need to clarify.
Many of the hotel brands also operate loyalty schemes. The VAT implications of these loyalty schemes require very careful consideration. Under the existing BT rules, there is no 'deemed sales' rule requiring BT to be assessed on the market value of the benefits provided. However, the VAT rules do contain broadly based 'deemed sales' rules. Thus, the provision of a free night's accommodation, discounted meal, or other benefit to loyal customers, may give rise to significant VAT implications.

Conclusion

The transition to VAT for the hospitality sector represents a holistic business change, not simply a tax change. It impacts several functions and personnel within the operation of a hotel, e.g., sales and marketing, IT systems, and finance and legal. Each of these teams will need to carefully consider the VAT implications, develop a project plan or issues register in conjunction with their advisers, and progressively work through the changes.

Based on recent experience in other industries, the timeframe for VAT reform implementation in China is likely to be very short. With the reforms expected to be implemented during 2014, you need to act now.

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Hong Kong

The Double Stamp Duty

Over the last three years, the Hong Kong Government has introduced a number of demand-side management measures aimed at lowering residential property prices and curbing excessive speculation. The government has stated that the measures are necessary under exceptional circumstances to ensure the stable and healthy development of the market; and as interest rates are still low and supply in the short run is tight, the risk of a property bubble cannot be ignored[5]. The Government has indicated that the measures will be adjusted or withdrawn once the property market has regained some balance.

The first measure introduced was Special Stamp Duty (SSD), introduced with effect from 20 November 2010, on transactions in residential property and is imposed at penal rates, ranging from 5 percent to 15 percent depending on when the property is bought and sold. The SSD applies to residential properties acquired on or after 20 November 2010 and resold within 24 months or less and is in addition to the ad valorem rates of Stamp Duty already imposed (up to 4.25 percent).

Subsequently, the government noted that with the introduction of SSD, resale of residential properties within 12 months has virtually disappeared. However, the number of transactions for resale between 12-24 months had increased, indicating that property prices have weakened the deterrent effect of SSD[6].

A further round of measures was announced on 26 October 2012, which reflects the government's intention to take further action if continued inflows of foreign capital into Hong Kong further exacerbated asset price inflation. These measures involved an increase in the rate of SSD and an extension of the restriction period. In addition, a Buyer's Stamp Duty (BSD) payable by buyers of residential property in Hong Kong was also announced.

Under the adjusted regime for SSD, any residential property acquired on or after 27 October 2012, either by an individual or a company (regardless of where it is incorporated), and resold within 36 months, will be subject to the new rates of SSD upon the enactment of the relevant legislation. Transactions which took place between 20 November 2010 and 26 October 2012 will be subject to the original SSD regime. The SSD payable for resale within six months will increase to 20 percent; 15 percent if the property is held for more than six months, but less than 12 months; and 10 percent if the property is held for more than 12 months, but less than 36 months.

The second measure, BSD payable by buyers of residential properties, is not applicable to Hong Kong permanent residents. However, other buyers, including both local and non-local companies, are required to pay BSD at a rate of 15 percent on top of existing stamp duty. SSD will also be charged on a resale made within three years.

The proposed legislation will also put in place a refund mechanism so that the acquisition of residential properties for the construction of a new building will be exempted from the BSD. This is on the proviso that the properties being constructed are completed within six years, with an extension allowed in specific circumstances.

Finally, on 22 February 2013, in response to signs of renewed exuberance in the property market, the government announced another round of demand-side management measures. This included the doubling of the ad valorem stamp duty rates across the board from 4.25 percent to 8.50 percent for all property transactions. Similar to BSD, an exemption from the new stamp duty rates will be given to Hong Kong permanent residents who are either first-time home buyers, do not own other residential property or who sell their only flat and buy a new one within six months.

These measures also need to be viewed against measures introduced by the Hong Kong Monetary Authority (HKMA), which require local banks to impose stricter requirements for mortgage financing for property purchases.

Despite legislation being introduced to implement the last two measures on 28 December 2012 and 5 April 2013 respectively, the Bills have yet to be passed by the Legislative Council. Indeed, in an unprecedented move at the Bills Committee meeting on 31 May 2013, a non-binding motion was passed asking the government to withdraw the legislation. Despite the widespread opposition to the measures, the Government has indicated that it remains committed to taking the measures forward.

The most reliable guide to the impact of the government's measures can best be seen in transaction volume. The average volume of residential property sale transactions fell by 38 percent during the period from November 2010 to October 2012 and by a further 26 percent within the three months following the announcement of BSD and the extension of SSD in October 2012.

[5] Legislative Council Brief "Stamp Duty (Amendment) Bill 2012", Legislative Council of the Hong Kong Special Administrative Region

[6] Legislative Council Brief "Stamp Duty (Amendment) Bill 2013", Legislative Council of the Hong Kong Special Administrative Region

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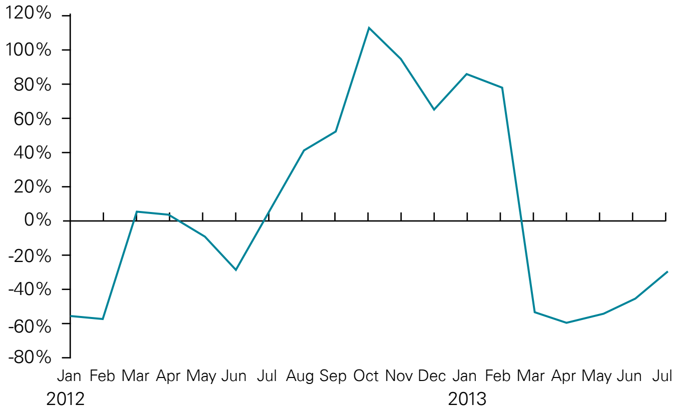
Hong Kong

Year-on-Year rate of change in the number of sale and purchase agreements



Source: The Land Registry, Government of the Hong Kong Special Admistrative Region

Further, stamp duty statistics from the Inland Revenue Department (IRD) indicate that purchases of residential property by non-local individuals and companies (local and non-local) fell to a monthly average of 249 cases, or 4.6 percent of total transactions, in the first five months of 2013, well below the monthly average of 1,089 cases, or 13.6 percent of total transactions, from January to October 2012 (i.e. the period immediately before the October 2012 announcement).

Prospective buyers have apparently taken into account the additional charges into their total acquisition costs on the basis that capital appreciation would remain intact. This is evidenced by the fact that, apart from a mild correction after the announcement of each new measure, prices have started to increase again. Current thinking is that this will continue to be the case, notwithstanding the doubling of stamp duty rates in February 2013.

However, low mortgage rates and high liquidity among lending institutions combined with no substantial additions to existing residential stock is likely to see demand continue to outstrip supply for the foreseeable future. When viewed against inflation, mortgage rates are effectively negative and this translates into home ownership representing a real return even in the absence of any rental income or capital gains. This makes the residential market in Hong Kong attractive for both investors and end users.

That said, the government's cooling measures have had an impact, particularly on sales volumes, as noted above. However, prices have not been affected to the same degree, with average prices only down slightly and likely to remain flat going forward and with the relatively small number of transactions appearing to be linked to self-use.

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New regulatory measures announced

The Indian real estate sector is witnessing a challenging time driven by local and global economic factors. Riding high on the back of rapid urbanisation, positive demographics and rising income levels, it has become an integral part of Indian economy and plays a significant role in the development of the country's infrastructure base. In an attempt to encourage investor's participation, the Indian Government has taken certain positive steps in an attempt to encourage investor participation.

Institutionalisation of real estate sector reforms

Recently, the government has institutionalised several reforms in the real estate sector to meet the large urban housing deficit and support growth. Some of the major reforms are:

Real Estate Bill: a step towards the advancement of real estate sector

The cabinet approved the much-awaited draft Real Estate (Regulations & Development) Bill, 2011, in June 2013; it is expected to be passed in the upcoming months. A key feature of the bill is that it seeks to establish a Real Estate Regulatory Authority (RERA) along the lines of the Telecom Regulatory Authority of India (TRAI), which regulates the telecom sector. The other key features of this bill are:

- Developers will be required to seek registration and approval of a residential project from RERA before launch
- Funds collected from the allottees must be mandatorily deposited in an escrow account; only 30 percent of these funds can be used in activities other than the development of a specific project.
- Detailed disclosures such as information about promoters, projects, layout plans, plan of development works, land status, carpet area, number of plots/ apartments booked, status of statutory approvals, name and addresses of agents, contractors, architect and structural engineer are required.
- Acceptance of advance payment before the signing of an agreement with the allottee has been restricted.
- RERA has also prescribed stringent penalties such as imprisonment of developers for not adhering to the guidelines.

Right to fair compensation and transparency in the Land Acquisition, Rehabilitation and Resettlement Act 2013

The government recently cleared the new Act, which replaces the centuries-old Act on land acquisition. This Act has provisions to provide fair compensation to those whose land has been taken away, increases transparency in the process of land acquisition to establish factories or buildings, infrastructural projects, and facilitates the rehabilitation of those adversely impacted. The key features of the Act are:

- **Consent of project affected families:** An acquirer would have to seek consent of no less than 70 percent (for PPP projects) or 80 percent (for private projects) of project affected families (families dependent on land for livelihood).
- **Compensation:** The Act requires payment of compensation of four times the market value in rural areas and twice the market value in urban areas in addition to the compensation for assets attached to the land (house, trees, plants, standing crops etc.)
- **Resettlement and Rehabilitation:** an acquirer would have to provide 10 types of R&R entitlements to the project affected families. These includes housing, employment to one member of each project affected family, land (in case land is acquired for irrigation purpose), transportation cost, subsistence grant etc. additionally, an acquirer would have to provide 25 infrastructural amenities in case of displacement of population.
- **Return of unused land:** in case land remains unused for 10 years after acquisition, the new Act empowers the State to return the land either to the owner or to the State Land Bank.
- **Share in appreciated land value:** When the acquired land is sold to a third party for a higher price, 20 percent of the appreciated land value (or profit) has to be shared with the original land owner.

The government is considering relaxing the foreign direct investment (FDI) norms in real estate sector

The major changes proposed for the FDI funded firms in the real estate sector are:

- Relaxing the three-year lock-in period for foreign investors.
- Reducing minimum capitalization to USD 5 million from the present USD 10 million.
- Reducing land parcel size for plotted development from 10 hectares to 2 hectares.
- Allowing FDI-funded firms to purchase farmland for development purpose that is not allowed in current policy.
- Reducing the present requirement of the minimum built-up area of 50,000 m^2 to 20,000 m^2 for construction and development projects
- Allowing foreign investors to sell their shares in a real estate company to other non-resident investors
- Permitting foreign investors to sell underdeveloped plots, if the Indian company provides infrastructure and undertakes development before occupancy (as per the plans approved by the state authorities). Relaxing additional approvals for housing plots from a local body or service agency, either by means of FDI or by the recipient Indian company, as a pre-requisite for selling such plots is also in discussion.

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Promoting affordable housing in the country

According to estimates, urban India faces a deficit of about 18.8 million housing units[7]. This has led to the mushrooming of slum and squatter settlements on expensive public land. Currently, about a quarter of India's urban population resides in slums and squatters[8]. Concerned with the growing shortage of urban housing in the country, the government has introduced several measures to counter the housing deficit. Some of these reforms are:

a) **Revision of income criteria for eligibility under various housing schemes for the economically weaker section (EWS) and lower income group (LIG)**
The government has revised the income criteria for various housing schemes for EWS and LIG households. For the former, the income ceiling has been increased from USD 923 per annum to up to USD 1,540 per annum and, for the latter, from between USD 924 and USD 1,846 per annum to between USD 1,541 and USD 3,075 per annum[9]. This will increase the ambit of various schemes.

b) **Extension of the Jawaharlal Nehru National Urban Renewal Mission (JNNURM)**
The mission, launched on 3 December 2005, facilitates the provision of housing and basic services to urban poor/ slum dwellers in 65 specified cities through the two sub-missions — Basic Services to the Urban Poor (BSUP) and Integrated Housing and Slum Development Program (IHSDP). The mission was supposed to end by 31 March 2012, but it has now been extended by two more years to ensure the completion of projects sanctioned up to March 2012.

c) **External commercial borrowings for affordable housing**
The government has permitted developers and housing finance companies to raise up to USD 1 billion debt in foreign currency for affordable projects. The cost of foreign debt, post-adjustments against the currency risk, is about 10–11 percent per annum . This is good news for developers, as the local debt cost is about 15–24 percent[10].

d) **Establishment of the Credit Risk Guarantee Fund**
The government has established a fund for lower income housing with a corpus worth INR 12 billion. This fund would be used to disburse loans to EWS and LIG households to support them in purchasing houses without any collateral.

Valuations in the sector attractive due to liquidity constraints

As the economy and the real estate experience a slowdown, it is becoming increasingly challenging for developers to secure funding for their projects. Banks and financial institutions have tightened their exposure to the real estate sector, citing cautious measures, leaving high-cost finance options such as non-banking financial companies (NBFCs), high-net-worth individuals (HNIs) or private equities (PE).

Recent measure by India's central bank, the Reserve Bank of India (RBI), to discontinue well known 80:20 scheme is one such instance. The 80:20 scheme is an interest subvention scheme wherein a home buyer would have to pay only 20

[7] Twelfth Five Year Plan, Planning Commission, Government of India
[8] Twelfth Five Year Plan, Planning Commission, Government of India
[9] "Income Criteria for EWS & LIG Revised Upwards for Defining Beneficiaries under Government Schemes for Housing", Press Information Bureau, Government of India, 14 November 2012
[10] KPMG in India analysis

Some prominent fund raising currently underway:

Project	Company	PE investor	Deal amount (USD million)	Date
Vrindavan Tech Village	Embassy Group	Blackstone, HDFC Venture	367	February 2013
Eon Free Zone	Panchshil Realty	Blackstone	83	March 2013
Hinjewadi SEZ	Paranjape Schemes Construction	IDFC PE	46	March 2013
Downtown-The City Centre	Suma Shilp	IL&FS, Milestone Group	16.4	May 2013
Hyderabad IT Park	Phoenix Group	Ascendas	110	June 2013

Source: Venture Intelligence

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Some prominent fund raising currently underway:

Manager	Size (USD million)	Date
Element Capital	1,000	Feb-2013
TriVeda Capital	500	Jun-2013
RedFort Capital	500	Aug-2013
Jones Land Lasalle	220	Apr-2013
Essel Group	200	Apr-2013

Source: Venture Intelligence

percent of the housing cost and rest is financed by the bank. The interest on the housing loan is paid by the developer, instead of the home buyer, for an agreed upon period. This results in a significant reduction of funding cost for developers — from 18–24 percent to 10–12 percent. Limited financing avenues have put investors in an advantageous position, pushing the developers to offer attractive valuations to investors.

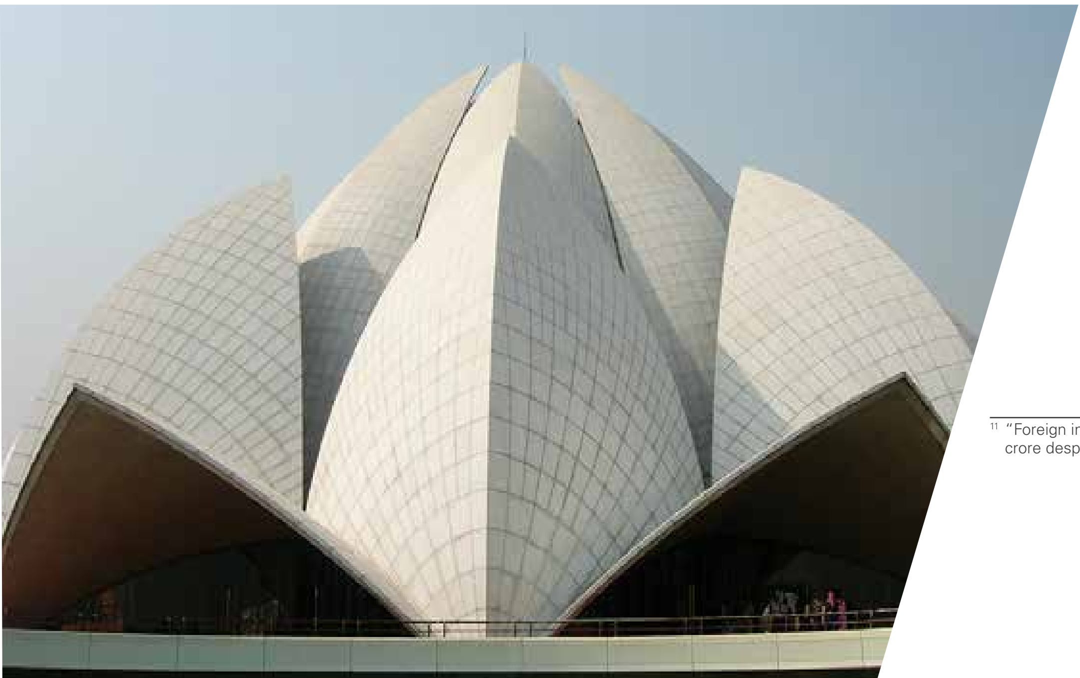
The liquidity constraint has created opportunities for lenders to choose projects that suit their requirements. In the residential segment, investors are looking to invest in projects that are struggling due to insufficient liquidity. Investors are thus able to secure assets at attractive valuation, enabling them to generate returns in the range of 18–20 percent annually.

In the commercial space, high-quality built-up properties or properties nearing completion are the most sought-after by investors. Projects at the conceiving or nascent stage, are still not favoured by the majority of investors, especially PE players. A PE cycle is about four –five years-long, subsequent to which investors demand their funds back from PE. However, commercial projects take about six –seven years to complete, making it difficult for PEs to exit during an ongoing project. Thus, PEs are more interested in projects that can deliver quickly. Such commercial properties offer a safe exit, higher surety of return and fewer disputes for PEs.

Despite weak fundamentals, PE funds were able to raise more than USD 2 billion in last year. However, unlike earlier, foreign investors are entering India through domestic funds due to the latter better performance compared to foreign funds. For instance, Abu Dhabi Investment Authority (ADIA) recently invested USD 200 million in Kotak Realty Fund, Sovereign Fund of Oman and Government of Singapore invested USD 200 million in HDFC Real Estate Fund, Qatar Investment Authority (QIA) is investing USD 300 million for jointly purchasing office assets with RMZ Corp[11].

Rising demand for branded and luxury residences amid slowdown

The real estate sector has evolved significantly over last decade, witnessing an emergence of several large developers, higher consolidation, a better product mix, increase in scale of development and influx of foreign participants. With continuous evolution, some new opportunities have emerged in India's real



[11] "Foreign investors bullish on Indian realty, raises Rs 11,854 crore despite sceptism," The Economic Times, 30 July 2013

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estate sector, which are providing the next growth opportunity for developers in the current challenging situations. One such opportunity is the development of branded and luxury residences (generally above USD 1.5 million) in major Indian cities. Out of over 25,000 developers in India, there are only a few who have the necessary capability of merging branded luxury with housing. Many developers, who are facing the headwinds of slow down are trying their best in this field; nevertheless, lack of sophisticated development capability is proving to be a deterrent for them.

Between 2008 and 2012, about 182 luxury projects comprising 25,570 units across top seven cities of Delhi (including Gurgaon and Noida), Mumbai, Bengaluru, Chennai, Hyderabad, Pune and Kolkata were launched with a value of about USD 30 billion[12]. This was fuelled by the 150,000 HNIs who are increasing in numbers at a fast rate[13]. In 2012 itself, about 5,000 luxury housing units were launched and almost all of them were absorbed[14].

The luxury housing market has grown at a CAGR of about 25 percent over the last few years[15]. Luxury housing constitutes about 5 percent of the total real-estate market[16]. It is expected that luxury housing market may grow at a CAGR of approximately 35 percent in next couple of years[17].

Demand for branded residences is mainly prevalent across sub-urban centres instead of major metro cities such as Delhi and Mumbai. In these cities, HNIs residing in posh localities are looking for better housing facilities at a cheaper price. Branded residential projects in Gurgaon are drawing significant interest of HNIs residing in posh localities of Delhi. Gurgaon also offers better infrastructure and luxury at a high discount. Mumbai has a similar story, where HNIs are looking for better options in suburbs such as Powai or Thane.

Leading developers in India are collaborating with renowned global luxury brands and hotel chains to develop branded-luxury villas, flats and service apartments. The developers are scouting for new ideas to attract the HNIs' attention and re-define luxury living.

12 "Demand for luxury homes still intact despite plunging sales," Firstpost, 19 November 2012
13 "India's rich and their wealth grew last year: report," live mint, 25 September 2013
14 "Luxury homes catch real estate market's fancy," The Economic Times, 3 June 2013
15 "Luxury homes catch real estate market's fancy," The Economic Times, 3 June 2013
16 "Luxury housing market picking pace," Money Today, July 2012
17 "Housing Market in India Witnessing Huge Momentum," SBWire, 23 September 2013

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Indonesia

Land regulation reform and loan restriction

Globally, Indonesia has become a prime residential market due to a strong economic baseline outlook (above 6 percent GDP growth for the past five years) and the rapid expansion of the middle-class[18]. However, the rise in the Indonesian property market has not been without challenges and restrictions. Below details some of the challenges and restrictions faced by the Indonesian real estate industry.

Legal ownership challenge

Legal issues remain the major challenge in the Indonesian real estate industry. There are many land ownership disputes that are due to land certificate conflict. A party with an old customary land ownership certificate may challenge a land owner with a land certificate issued by the National Land Office (Badan Pertanahan Nasional-BPN). This condition is legally possible according to Agrarian Act No. 5 Year 1960, which states that Indonesia recognised customary law for land ownership. Also, according to Government Regulation No. 24 Year 1997 article 32, other rightful parties with appropriate supporting documentation may claim land ownership within five years of the date the land certificates has been issued by the National Land Office (Badan Pertanahan Nasional-BPM).

For addressing land dispute issues, the government is planning to do a land regulation reform. Currently, the draft of the new land act is being discussed on the parliamentary level. The draft mentions that the government will collect data on land ownership in the entire territory of the Republic of Indonesia within a period of five years to provide legal certainty regarding land ownership and establish a special court for land disputes.

Foreign ownership restrictions

Land ownership in Indonesia is regulated by Agrarian Act No. 5 Year 1960. Below is the most common legal land title type available under the act:

1. **Right of Ownership/Freehold (Hak Milik or HM)**
   Absolute land ownership right - this right is hereditary and without time limits.

2. **Right to Build (Hak Guna Bangunan or HGB)**
   The right to construct and possess buildings on land for a limited period and can be extended for a certain period.

3. **Right to Use (Hak Pakai or HP)**
   The right to use or obtain resources from the land for a limited period as defined by the land owner or government official.

4. **Right of Exploitation (Hak Guna Usaha or HGU)**
   The right to cultivate or exploit state-owned land for agricultural, fishery, or husbandry purposes; this right is only for a limited period.

5. **Right to Lease (Hak Sewa or HS)**
   The right to lease or to use property of others for a limited period.

Except for Right of Ownership/ Freehold, all other land title type are some kind leasehold ownership. According to the current regulation, foreigners are not allowed to own freehold land (Hak Milik or HM). Nevertheless, foreigners may set up an Indonesian legal entity as Foreign Investment Company (Penanaman Modal Asing or PMA) to own the land under certain certified land titles.

Legal structure of land titles[19]

Criteria	Right of Ownership (Hak Milik)	Right to Build (HGB)	Right of Use (Hak Pakai)	Right of Exploitation	Right of Lease (Hak Sewa)
Owners					
Indonesian individual	•	•	•	•	•
Foreign individual			•		•
Indonesia company*		•	•	•	•
Foreign company**			•		•
Period					
Initial Period (Mazimum)	No Limit	30 years	25 years	35 years	30 years
Extendable Period	No Limit	20 years	20 years***	25 years	20 years

Notes
* including PMA
** must have a representative office in Indonesia
*** applicable only for state-owned land

[18] 2013 Global Wealth Report, Knight Frank

[19] Law No.5 of 1960 "Principles Provisions of Agrarian", Government of the Republic of Indonesia

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Loan restrictions for real estate companies

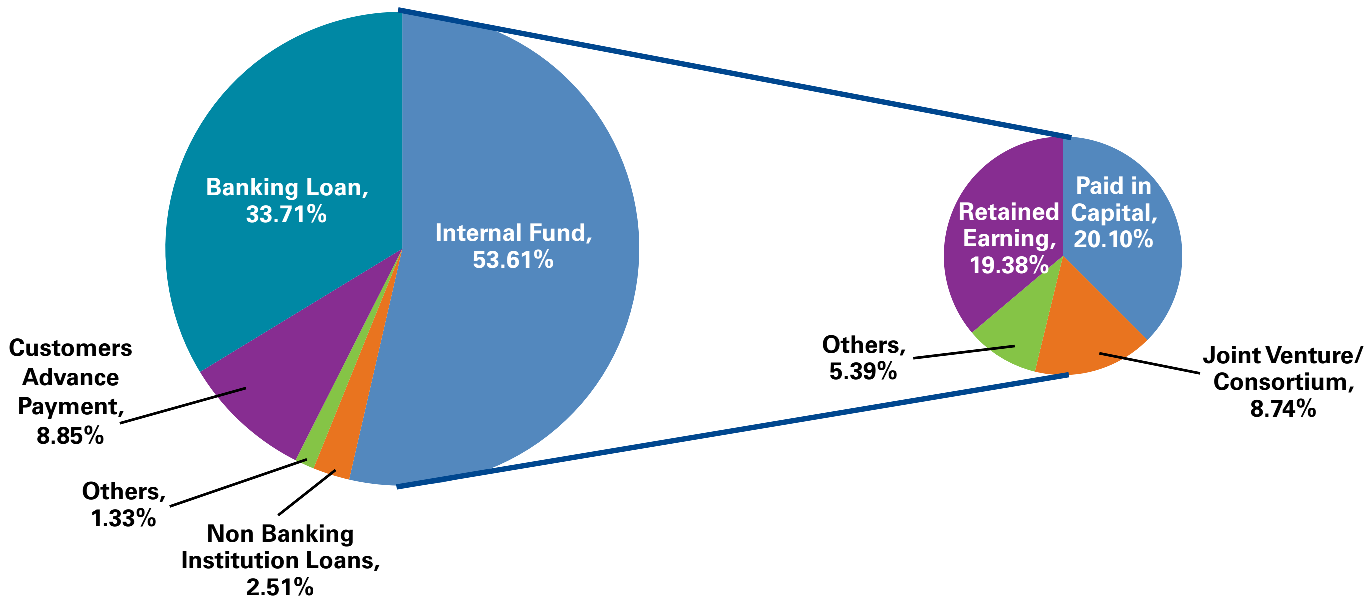
In 1997, Bank Indonesia published the Bank Indonesia Circulation Letter No. 30/2/UK year 1997 regarding Bank Loan Limitations for Land Acquisition and Preparation. Under this stipulation, banks are prohibited to provide loans to property developers for land acquisition and preparation purposes, which limit the source of funds for property developers. Consequently, property developers are expected to have a strong internal fund for accumulating land and performing pre-development activities. Bank Indonesia's survey on several residential property developers shows that more than 50 percent of the financing composition is from internal funds, which result mainly from paid-in capital and retained earnings.

Mortgage down payment restrictions

In March 2012, Bank Indonesia mandated a Loan-to-Value (LTV) ratio for residential property borrowings at a maximum of 70 percent[20] to raise the minimum down payment on housing loans to 30 percent. Financial authorities hope to diminish the purchasing powers of speculators and to curb potential property bubbles that may hurt the economy.

Regardless of the measure, major developers continued to post impressive sales figures and property prices is increasing. A survey conducted by Bank Indonesia reported that residential property sales escalated by 18.08 percent quarter to quarter in the second quarter of 2013, and residential property prices have increased, on both quarterly (2.19 percent) and annually (12.11 percent), for all house

Residential property developer financing composition



Source: Bank Indonesia

[20] Circulation Letter No.14/10/DPNP, Bank Indonesia, 15 March 2012

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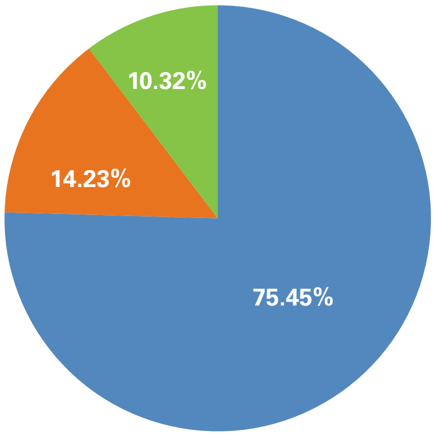
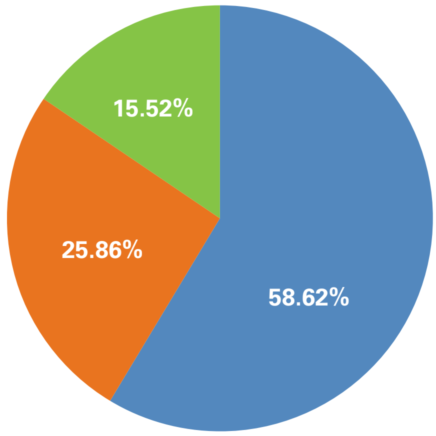
types in second quarter of 2013[21]. The most significant growth found in the price of medium sized house (2.56 percent quarter to quarter)[22]. This condition is followed by a growth in mortgage, which are still the largest share of property loans, counted as 59.97 percent of the total outstanding property loans this year[23]. Housing and apartment ownership loans have reached IDR 259.86 trillion in the second quarter of 2013, an increase of 12.30 percent year on year[24] - this indicates that the majority of buyers are using housing loan facilities(KPR/KPA) as their main source of funding.

Source of Financing for purchasing houses in Primary and Secondary Market



Primary Market



Secondary Market

Mortgage   Cash Installment   Cash

Source: Bank Indonesia

Growth for period 2011-2013

Type of Financing	LTV Growth 2011 (Q1)	2012 (Q1)	2013 (Q1)
KPR Type 22m² - 70m²	24.6%	18.6%	13.0%
KPR Type > 70m²	35.0%	47.2%	39.8%
KPRS Type < 21m²	7.1%	295.3%	128.9%
KPRS Type 22m² - 70m²	317.3%	80.4%	79.6%
KPRS Type > 70m²	161.2%	68.1%	70.4%
KPHO / KPHS	125.2%	31.4%	34.6%

* KPR = Mortgage for landed house
* KPRS = Mortgage for condominium / apartment
* KPHO / KPHS = Mortgage for Home Office & Home Store

Source: Bank Indonesia

Financial authorities have become cautious of perky lending activities, due to fears that it will lead to an increased number of non-performing loans at banks, which may cause a domestic banking crisis. As a result, Bank Indonesia recently amended its regulation to tighten the Loan-to-Asset ratio (LTV) for property credits and property-backed consumer loans. The regulatory amendment is constrained within Bank Indonesia Circulation Letter No. 15/40/DKMP, dated 24th September 2013. Based on the amendment, reasons to implement the new LTV regulations are to maintain financial system stability, enlarge purchasing power for low to middle class families, and enhance aspects of consumer protection in property sector.

[21] Residential Property Price Survey Quarter II-2013, Bank Indonesia, 28 August 2013
[22] Residential Property Price Survey Quarter II-2013, Bank Indonesia, 28 August 2013
[23] Commercial Property Survey Quarter II-2013, Bank Indonesia, 27 August 2013
[24] Commercial Property Survey Quarter II-2013, Bank Indonesia, 27 August 2013

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The new LTV regulation controls[25]:

1. The maximum LTV for mortgage financing, as illustrated below:

LTV mortgage regulation -2013

Type of Financing	Maximum LTV		
	First Property	Second Property	Third Property
KPR Type > 70m²	70%	60%	50%
KPRS Type > 70m²	70%	60%	50%
KPR Type 22m² - 70m²	-	70%	60%
KPRS Type 22m² - 70m²	80%	70%	60%
KPRS Type > 21m²	-	70%	60%
KPHO / KPHS	-	70%	60%

* KPR = Mortgage for landed house
* KPRS = Mortgage for condominium / apartment
* KPHO / KPHS = Mortgage for Home Office & Home Store

Source: Bank Indonesia

2. The restrictions on banks providing loans for property used as collateral. The bank may provide loan only if the property used as collateral has been completely built and ready to be handed over. The exception to this restriction is subject to the following conditions[26]:
   - First-time mortgage customers;
   - The property developer provide assurance to complete the property development as agreed with the customer;
   - Corporate guarantee from the property developer for to settle the customer's mortgage obligations in case of the property is not completed as agreed;
   - Loan disbursement is to be conducted in several phases according to the development progress of the property.

[25] Circulation Letter No.15/40/DKMP, Bank Indonesia, 24 September 2013
[26] Circulation Letter No.15/40/DKMP, Bank Indonesia, 24 September 2013

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Japan

New economic policies introduced

The "Abenomics" introduced by the Japanese Government after Prime Minister Abe took office is a new economic policy consisting of three strategies to promote private investments: relaxation of monetary policy, flexible fiscal policy and growth strategy. It is expected that the economy will grow if the policy can be successfully implemented. The graph below shows the indexes of the J-REIT and real estate stock on the Tokyo Stock Exchange (TSE). Although both indexes have not yet recovered to pre-Lehman Shock levels, both have increased, by approximately 25 percent and 60 percent respectively[27], after Mr Abe became Prime Minister.

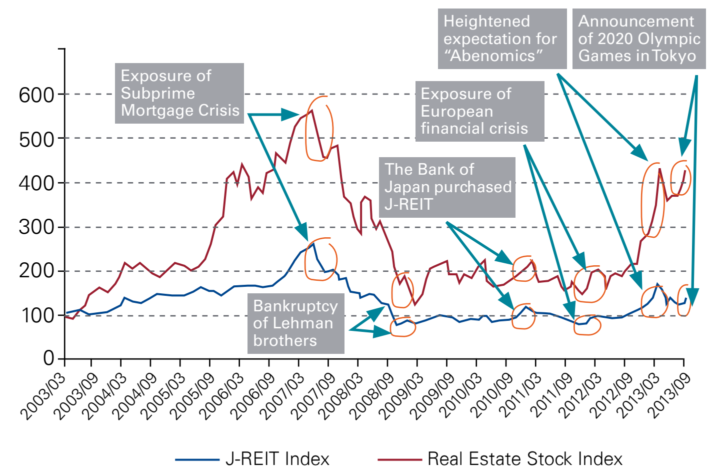
Of Abenomics' three cornerstone policies, relaxing monetary policy has had the most immediate impact on the Japan's real estate market. Under this monetary policy, the Bank of Japan will double the money supply in two years through quantitative easing[28]. However, as Japan's economy remains sluggish, Japanese companies are generally reluctant to increase their capital expenditure through borrowing money, and the current equity ratio remains historically high at approximately 42 percent[29]. Therefore, Japanese banks are not expected to increase lending to Japanese companies in the short term regardless of the quantitative easing measures. Instead, they have turned to increase real estate financing and financing in overseas.

Summary Chart of Abenomics

	Abenomics	Policy Outline	Impact on Real Estate Market	
1	Lax monetary policy	Doubling money supply in two years through the Bank of Japan's purchase of Japanese government bond, J-REIT stock and other risk assets from private sectors	Short-Term	Decrease long-term interest rate
			Mid-Term	Increase long-term interest rate
2	Flexible fiscal policy	Increase public spending for the maintenance of infrastructure, etc.	Short- to Mid-Term	Rent increase due to the growth of economy and increased demand in the private sector
			Mid- to Long-Term	Lower risk premium on investment due to the improved safety of infrastructure
3	Growth strategy to promote private	Deregulation, participation in the Trans-Pacific Partnership, tax incentives for capital expenditure, etc.	Mid-Term	Growth of real estate income due to more robust economic outlook

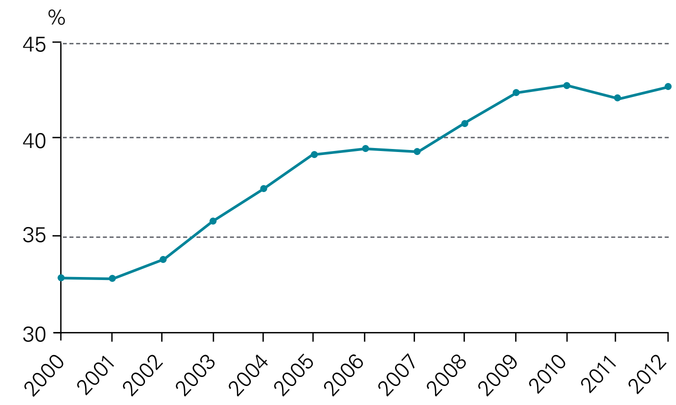
Source: Sumitomo Mitsui Trust Research Institute Co., Ltd.

TSE Indexes of J-REIT and Real Estate Stock



Source: Bloomberg

Historical Equity Ratio of Japanese Company



Source: Japan Ministry of Finance

27 Bloomberg
28 Introduction of the "Quantitative and Qualitative Monetary Easing", Bank of Japan, 4 April 2013
29 法人企業統計, Policy Research Institute, Ministry of Finance Japan

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Japan

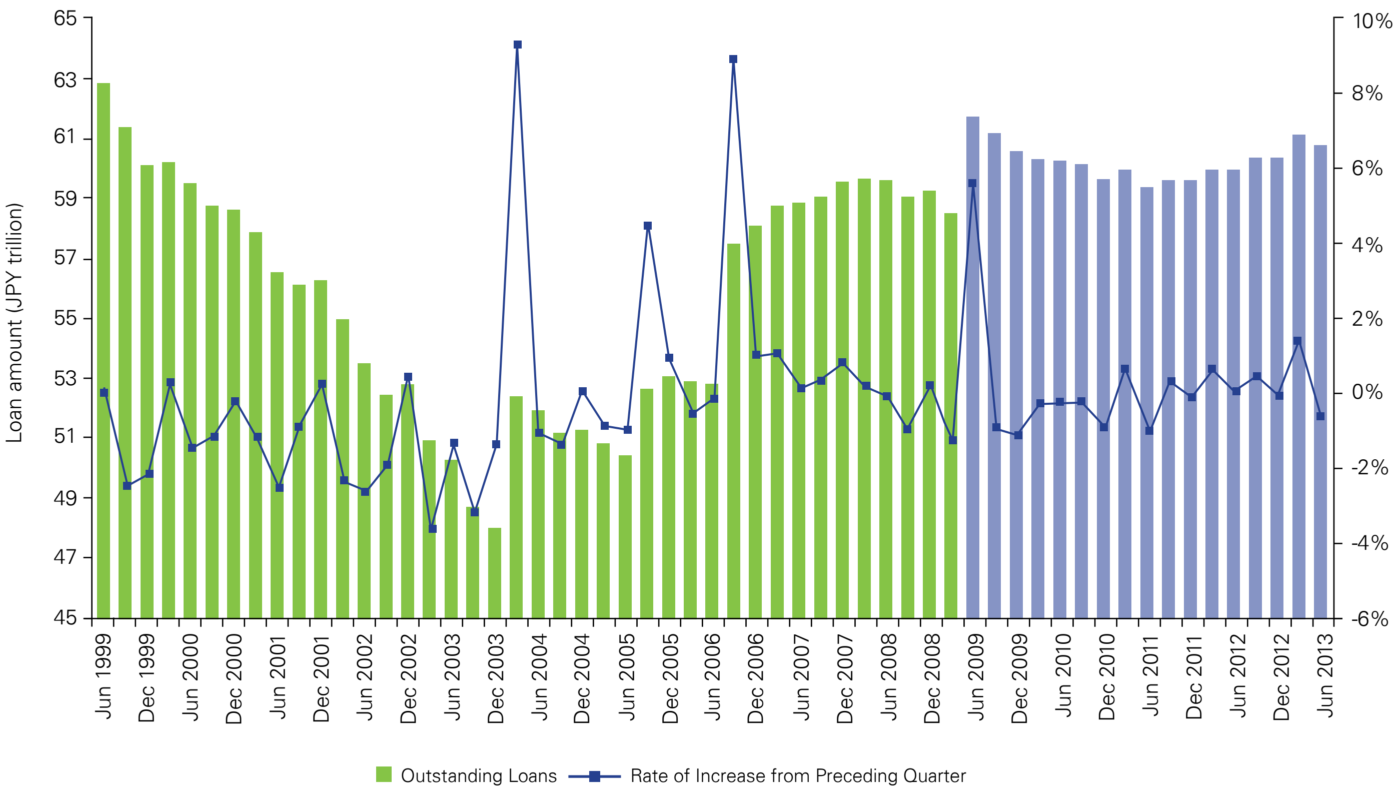
As clearer signs of real estate market bottoming out emerge, both domestic and international investors are eager to resume real estate investment in Japan. This appetite for investment coincides with the increase in real estate financing resulting from the quantitative easing measures. Japanese banks are especially interested in financing office buildings and residential properties in Tokyo because they are generally competitive and generate stable cash flows. However, Japanese banks are still cautious about office buildings in below B locations, and residential properties of more than ten years old, despite their Tokyo location.

The current spread on non-recourse loans for class A office buildings in prime locations is between 20 bps and 60 bps, while loan to value is around 70 percent. Japanese banks are also sponsor-sensitive, and are willing to offer better financing, albeit non-recourse, at below 20 bps spread for class A office buildings if their sponsor company has a good investment track record, high financial strength and asset management capabilities.

Japanese banks are also cautious and prefer recourse loans over non-recourse loans when it comes to financing construction and development projects. Yet, they are relatively disposed to backing logistics property constructions as these properties are deemed to have relatively lower risk due to the shortage of high-spec logistics properties to accommodate the growth of e-commerce, and their shorter construction period of approximately one year.

Although the current year has seen more real estate transactions than the previous year, transactions are still not in full swing even when the market has bottomed out with the relaxation of the real estate financing environment. This is partly due to the fact that Japanese banks are inclined to refinance existing real estate loans at maturity, or alternatively, to replace financing offered by other banks at maturity. Given the abovementioned difficulty in expanding lending to Japanese companies, this practice is reasonable as the banks need to maintain or increase their outstanding real estate loan balance in this changing environment.

Outstanding Loan Balance of Real Estate Industry



Note: 1) Real estate industry includes real estate companies, real estate investment vehicles and individual investors.
Source: The Bank of Japan

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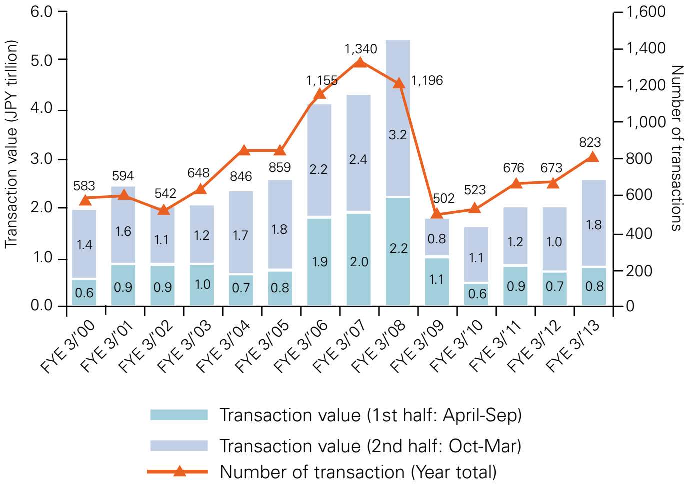
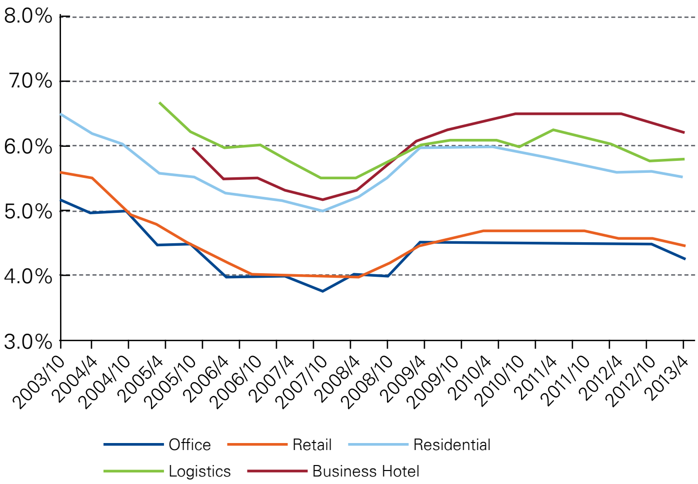
Transaction volume



Note: Data covers transactions made by the listed companies of all industries including J-REITs.
Source: Urban Research Institute, Corp.

CAP Rates by Property Types in Tokyo



Source: Japan Real Estate Institute

Definitions:

- Office: A-class buildings located in Marunouchi and Otemachi
- Residential: Multifamily apartments (50–80 m^2) located in the southern part of Tokyo (Setagaya and Meguro) that are within 10-minute walking distance from stations, and less than 5 years old
- Retail: located in Ginza (along Ginza Chuo Avenue) and brand new or buildings renovated extensively in the past 5 years
- Logistics: buildings of 2 to 3 stories with total floor area of approximately 10,000 m^2 and located in Tokyo Bay area
- Business Hotel: within 5-minute walking distance from stations, building less than 5 years old, ADR 6,000–8,000 yen/room and approximately 100 rooms

Real estate acquisition in Tokyo is very competitive because of the relatively low supply of prime properties. And as Japanese banks do not force borrowers to sell properties to repay debt at loan maturity, the capitalisation rate (CAP rate) has compressed compared to the previous year. The CAP rate of the most competitive office buildings located in the Marunouchi area, around Tokyo Station, is somewhere between 3.3 percent and 4.3 percent, while that of the most competitive high-end retail buildings located in Ginza or Omotesando is somewhere between 3.5 percent and 4.5 percent[30].

The most competitive investors in the market are J-REITs and major real estate companies such as Mitsui, Mitsubishi, Sumitomo, Nomura and Tokyu.

J-REITs are eager to invest through public offerings and take advantage of the recovery in their share prices. At the same time, Japanese banks are increasing their lending to J-REITs because the loan-to-value ratio of J-REIT investments is typically between 40 percent and 50 percent[31], and lending to J-REITs is considered to be a relatively safe investment.

Major Japanese real estate companies also want to expand their business and are looking for development opportunities. In turn, however, they are Japanese banks' targets of lending because they tend to have healthy balance sheets. Under their business model, a property is developed then sold to a private real estate fund that they manage until the property is fully developed and its occupancy reaches a sufficiently high level. After that, the property is sold to a J-REIT also managed by the same company when cash flow stabilizes, typically in 3 to 5 years. This business model ensures that these real estate companies are able to secure a pipeline of properties for their private real estate funds and J-REITs. Real estate companies in Japan also operate private REITs, which are attractive to Japanese institutional investors and pension funds, and are actively investing in logistics property using their balance sheets. It is expected that there will be more logistics property REITs coming on line in a few years.

One of the notable regulatory issues facing the real estate business is to bring old buildings up to date to the earthquake - resistant building standards introduced in 1981. According to the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), approximately USD 1.2 trillion worth of properties constructed before 1981 and owned by the private sector may not satisfy the latest regulatory requirements. In order to accelerate the large scale renovation and reconstruction of these old buildings, beginning from 25 November 2013, buildings along designated major streets will be required to undergo a structural study to assess their need for upgrading. If they fail to undergo this mandatory procedure, the municipal government can publicly announce the names of the non-compliant owners and order renovation work to be done on the buildings. Furthermore, those buildings of more than 5,000 square metres of floor area and are potentially used by an unlimited number of people for purposes such as retail, hospital and hotel are also required to undergo structural examination.

[30] The Japanese Real Estate Investor Survey, Japan Real Estate Institute, April 2013

[31] "財務ハイライト/第19期～第24期", Nippon Building Fund, June 2013 ; "第23期末のLTV（総資産有利子負債比率）情報", Japan Real Estate Invesment Corporation, March 2013 ;"負債の概要", Frontier Real Estate Investment Corporation, 30 June 2013

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Japan will also amend its voting requirement for large-scale renovation of condominium buildings to make compliance with earthquake-resistant building standards easier[32].

According to MLIT, of the 5.9 million condominium buildings currently existing in Japan, approximately 1 million (equal to 17 percent of the total) are not earthquake-resistant. Under current regulations, the owners' association of a condominium needs to secure a 3/4 majority vote to undertake a large scale renovation; under the new rules, also effective from 25 November 2013, it will only require more than 1/2 of the votes for a go-ahead.

Furthermore, the Japanese government is considering amendment to voting requirement for reconstruction of noncompliant condominium buildings from a 4/5 majority vote to a 3/4 majority vote[33].

To facilitate large-scale renovation work and reconstruction, the Japanese government subsidises renovation or reconstruction costs. It also grants additional building-to-land ratio and floor area ratio to make reconstruction projects economically feasible[34]. On top of these incentives, it is expected that the Japanese government will introduce tax breaks for large-scale renovation work aimed at building enhancement. These tax breaks may include halving property tax for certain years and granting accelerated depreciation.

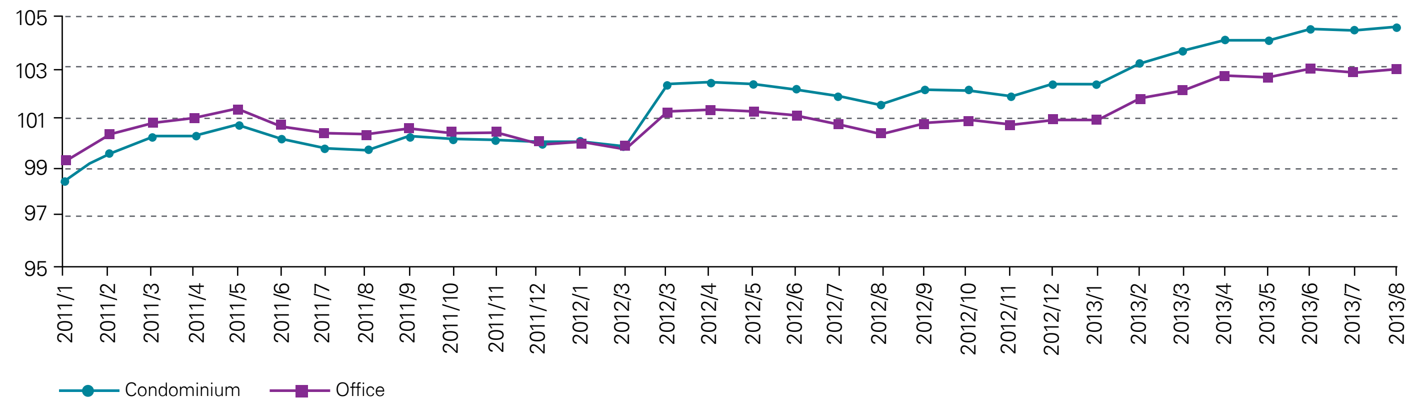
In order to capture opportunistic investment in Tokyo, international investors may consider building rehabilitation or reconstruction projects in the central Tokyo area. Evicting tenants is usually a time -consuming and costly process. But in practice, the eviction of non-fixed term lease tenants could become relatively easier if the building is non-earthquake proofed, and approximately 40 percent of the tenants in the building are under fixed-term lease contracts. In this case, non-fixed term tenants will likely be capable of eviction upon maturity of their lease term if their eviction is necessary to renovate the building to make it earthquake proof.

Typically, for international investors to be able to invest in rehabilitation or reconstruction projects in Japan, one will need to work with a Japanese developer or asset management company that has a good track record in this area. But major Japanese developers are unlikely to be optimal targets for international investors as such companies normally do not require third-party capitals to undertake projects.

It should be noted that construction costs are expected to rise along with increased development projects in Tokyo. Following the 2011 earthquake in northern Japan, there is a persistent shortage of skilled construction workers, resulting in rising labour costs. Furthermore, the weak yen, thanks to Abenomics, has mounted up the cost to import raw materials for construction projects.

We may see a further increase in construction costs, especially labour cost, with the additional construction leading up to the 2020 Olympic Games in Tokyo. When considering investment in a development project in Japan, investors are advised to factor in the potential impact of the country's rising construction costs.

Historical Construction Costs



Note: Base period = 2005

Source: Construction Research Institute

32 "建築物の耐震改修の促進に関する法律の一部を改正する法律案", Ministry of Land, Infrastructure, Transport and Tourism, 8 March 2013

33 "建築物の耐震改修の促進に関する法律の一部を改正する法律案", Ministry of Land, Infrastructure, Transport and Tourism, 8 March 2013

34 "建築物の耐震改修の促進に関する法律の一部を改正する法律案", Ministry of Land, Infrastructure, Transport and Tourism, 8 March 2013

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Introduction of the Total Debt Servicing Ratio framework

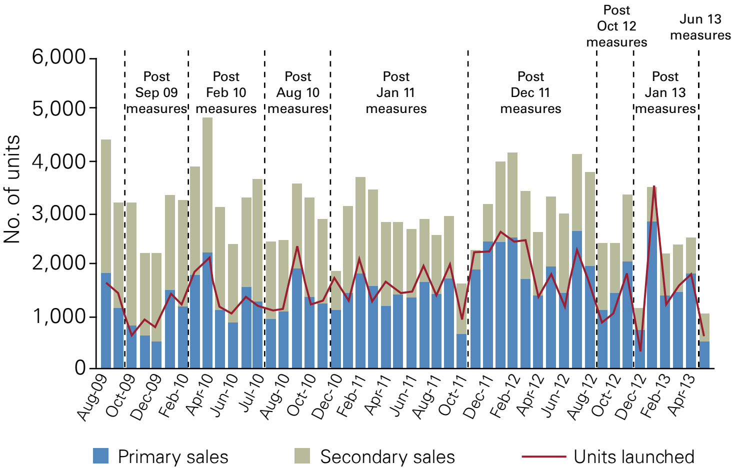
Contributed by Lee Lay Keng, Head of Singapore Research, and Hanna Safdar Husain, Research Analyst, DTZ

By the end of 2009, as the Singapore economy recovered after the Global Financial Crisis (GFC), the property market began its upswing. The residential sector was the first to register positive growth in Q3 2009, with the other sectors following soon as the economy strengthened.

Residential sector

Strong buying sentiment in the residential sector post-GFC contributed to unprecedented price growth of 55 percent (as at Q2 2013) since the last trough in Q2 2009. To ensure a stable and sustainable property market, the government has responded with seven rounds of cooling measures focused on the residential market, with the latest round in January 2013. Even though transaction volume fell in the first few months after the introduction of each round of cooling measures, purchase demand remained robust, supported by positive economic growth and low interest rates. Developer sales hit a new record of about 22,000 units in 2012, and while prices have continued to increase, the pace of growth has slowed from 4.6 percent in 2011 to 2.6 percent in 2012 and to 2.2 percent in the first half of 2013.

Take-up and launches of private home by month



Source: URA REALIS, 15 August, DTZ Research

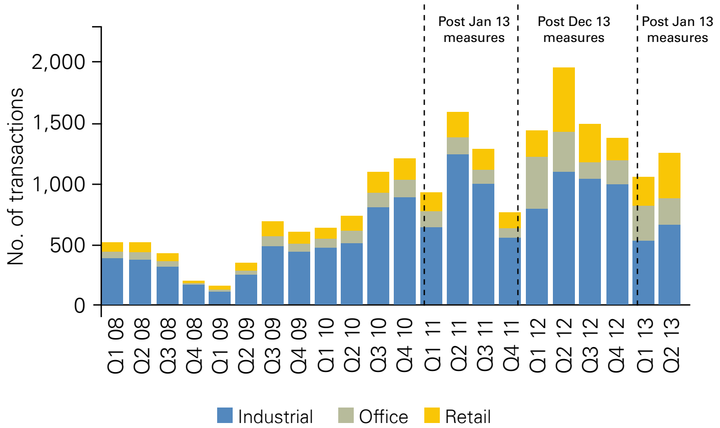
The most recent policy change affecting the property market was the implementation of the Total Debt Servicing Ratio (TDSR) framework for all property loans with effect from 29 June 2013. To ensure that borrowers are not over-leveraged and potentially impacted by rising interest rates, the new framework ensures that any property loan extended by a financial institution should not exceed a TDSR threshold of 60 percent[35]. In addition, the Monetary Authority of Singapore (MAS) refined the rules related to the application of the existing LTV limits on housing loans, thereby reducing the probability of homebuyers purchasing private properties in the name of proxies to circumvent the heavier Additional Buyer's Stamp Duty (ABSD) payable with effect from the January 2013 measures.

Our study on the impact of the TDSR framework on the residential sector[36] shows that the TDSR framework, on its own, is expected to have limited impact on purchase demand for the first and second private residential property for most households. This is despite a reduction of about 30 percent in the maximum quantum of the property they can now purchase. Anecdotally, transactions now take longer to close as the loan approval process is lengthier. Developer sales fell by more than 70 percent in July 2013, after the TDSR framework was implemented. However, the fall in developer sales was also partly due to fewer launches during the month.

Industrial and commercial sectors

As more cooling measures targeting the residential sector were introduced, investors turned to the industrial and commercial sectors as alternatives. There was an increase in the number of transactions for strata-titled industrial and commercial properties after the ABSD in the residential sector was first implemented in December 2011. Industrial properties were popular amongst investors as the required quantum was usually lower. Correspondingly, industrial prices have doubled since the previous low in 2009 during the GFC, registering the fastest pace of growth across all sectors.

Strata-titled transactions in the industrial and commercial sectors



Source: URA REALIS, 15 August, DTZ Research

[35] Calculated using an interest rate of 3.5 percent for housing loans and 4.5 percent for non-residential loans, or the prevailing market interest rate, whichever is higher.
[36] DTZ Insight report: Limited impact on first and second property demand, 10 July 2013

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Mindful that short-term speculative activity could distort the underlying prices of industrial properties and raise the business costs for true industrialists, the government imposed a Seller's Stamp Duty (SSD) of 5-15 percent on the sale of industrial properties and land bought and sold within three years with effect from 12 January 2013. This marked the first property cooling measure specific to the industrial sector.

Consequently, 718 strata factory units were transacted in H1 2013, down 15 percent from 846 units transacted in H2 2012. Meanwhile, the price growth across industrial properties slowed post-SSD, increasing by only 4 percent in H1 2013, compared to a full-year growth of approximately 24 percent in 2012. Price growth in the industrial sector is expected to slow further in H2 2013, before picking up in 2014 on the back of an improving economy.

In the commercial sector (comprising the office and retail sectors), although speculative activity exists, it has been less prominent because the number of transactions is substantially lower compared to the industrial sector. Strata-titled commercial units are limited in supply and moreover, most commercial developments are usually either owned by developers, or Real Estate Investment Trusts (REITs). However, similar to the industrial sector, there was an increase in transactions in the commercial sector as investor interest was diverted away from the residential sector after the ABSD was introduced.

Price increases were seen across both retail and office sectors in 2012 and H1 2013, with stronger price growth in the retail segment. According to the Urban Redevelopment Authority (URA), average prices for retail properties grew by only 2 percent in 2012 but surged by 4 percent in H1 2013.

Outlook

It is too early to assess the full impact of the TDSR framework on the residential sector, but we expect that the dampening effect of the new TDSR framework is greater when the cumulative effects of the earlier rounds of cooling measures, such as the higher ABSD and stricter LTV rules are also taken into account. The combination of the January 2013 measures and the TDSR framework will lead to a fall in transaction volume for private homes this year, while prices are expected to hold, barring any major external shocks.

The new TDSR framework also applies to non-residential property loans, hence reducing the diversion of investor interest to the industrial and commercial sectors as a result of the cooling measures in the residential sector. Investors should also note that purchases of non-residential properties are subject to the Goods and Services Tax (GST) and LTV limits are usually lower. In addition, the property tax concession on vacant properties will be removed with effect from 1 January next year. This will apply across all properties and could impact on property rentals as investors may be more negotiable on rents so as to avoid keeping their properties vacant and paying the property taxes.

Notwithstanding the overhang of policy measures in the property sector, capital and rental values for properties with good connectivity and accessibility, and unique attributes (such as residential developments integrated with commercial components) are expected to hold up. In the longer term, new growth areas that the government is developing, as part of their decentralisation plans to bring jobs closer to homes and to reduce congestion in the city during peak hours, could also see an uplift to the capital and rental values in these areas.

This concept of decentralisation was first introduced in the government's 1991 Concept Plan, and since then the Tampines Regional Centre has been successfully developed. New regional centres in the works now include the Jurong Lake District area (which will be the largest commercial centre outside the Central Business District) as well as the Woodlands Regional Centre, which will anchor the development of the North Coast Innovation Corridor that aims to bring more jobs to people living in the north of Singapore. The development of Woodlands Regional Centre has been kick-started with the release of a commercial site on the H2 2013 Government Land Sales programme, which will provide an estimated 66,000 m^2 (gross floor area) of office space and 3,500 m^2 (gross floor area) of ancillary retail space.

Mr Ho Tian Lam, DTZ SEA's Chief Executive Officer, commented: "With the government plans for the town and improved accessibility as supporting infrastructure such as the new Thomson Line and North-South Expressway are developed, the Woodlands Regional Centre could potentially grow to serve the needs of business users with links and tie-ups across the Causeway."

The development of the Jurong Lake District area and the Woodlands Regional Centre are part of the plans outlined in the Land Use Plan 2030. Amongst the plans is the aim to build 700,000 homes by 2030 to support a population that could grow from 5.3 million (as at June 2012) to 6.5-6.9 million in 2030[37]. In the longer-term, the projected increase in population will support property prices in land-scarce Singapore.

The views and opinions expressed herein are those of the authors and do not necessarily represent the views and opinions of KPMG International or any KPMG member firm.

[37] "Population White Paper: A Sustainable Population for a Dynamic Singapore", National Population and Talent Division, January 2013

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Taiwan

Recent developments in Specifically Selected Goods and Services Tax levied on real estate

In 2011, soaring housing prices in some areas and rising commodity prices driven by consumption of luxury products led to widespread public discontent in Taiwan[38]. In some cases, the tax on the sale of short-term owned building and land were little to none. This has prompted the Taiwan government to learn from United States, Singapore, South Korea and Hong Kong, and implement the Specifically Selected Goods and Services tax ("special sales tax") on short-term owned building and land transactions. The aim of such policy is to address public discontent, promote tax fairness and a healthy housing market, and create a high-quality tax system. Any unit of a building and the share of land associated with the unit, or any urban land for which a construction permit may lawfully be issued, owned for less than one year, would incur 15 percent special sales tax, or 10 percent if the property has been owed for more than one year but less than (and including) two years.

To minimize undue special sales tax burden on the general public, The Specifically Selected Goods and Services Tax Act ("Act") includes several exemptions, mainly:

- The owner (and owner's spouse and lineal relatives of minor age), neither provides the building and land for business use nor leases it out during the holding period;
- Involuntary sale of building and land (i.e., job transfer, involuntary separation from employment or any other involuntary cause);
- Sale of commodity obtained through inheritance or legacy;
- A unit of a building is transferred for the first time after completion of construction by the business entity; or
- An owner, using his or her own residence and land, demolishes and rebuilds or enters into a joint construction and allocation project with a business entity and sells his or her share.

The Ministry of Finance ("MOF") also released a number of rulings thereafter on the applicability and nature of exempt transactions, as well as the calculation method for the two-year holding period. However, there are still outstanding issues that need to be clarified, such as:

A. Merger exemptions

1. After the merger, is the change in registration (reason listed as corporate merger) of rights and obligations pertaining to any properties acquired from the dissolved company by the surviving company or the newly incorporated company considered within the scope of special sales tax?
2. After the merger, is the holding period prior to sale of a property calculated as the period starting from the date the property was acquired by the dissolved company?
3. If the dissolved company was a construction company, after the merger, is the transfer or sale of a building unit for the first time after completion still exempt from special sales tax?

B. Trust exemptions

1. Where trust property is disposed of by the trustee, does the special sales tax exemption apply if the owner (and owner's spouse and lineal relatives of minor age) neither provides the building and land for business use nor leases it out during the holding period?
2. After the settlor transfers a piece of real estate to the trust, and disposes of another piece of real estate, does the special sales tax exemption apply if the owner (and owner's spouse and lineal relatives of minor age) neither provides the building and land for business use nor leases it out during the holding period?
3. Where trust property is returned and the settlor executes sale of real estate by himself, is the holding period calculated as starting from the date of acquisition prior to its delivery to the trust?

[38] "行政院第3237次院會審查通過特種貨物及勞務稅條例草案," CNA News, 10 March 2011

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Taiwan

The MOF has stated in July 2013 that the next stage of special sales tax reform will focus on:

- including non-urban land and industrial land in the scope of assessment for special sales tax;
- extending holding period;
- extending exemptions related to first-time buyers and involuntary sales; and
- relaxing penalty regulations as special sales tax evasions are often nominally small and unintentional. The penalty-free threshold is proposed to be raised to NTD 50,000 with expected completion and implementation of such amendment within the first half of 2014.

Additionally, academics suggest that in order to curb property speculation, buyers should also be subject to special sales taxation, particularly for non-residents who purchase property in Taiwan or entities that hold up a large amount of real estate. Considering the current investment market environment, the government should extend the two-year holding period and thereby raise the investment costs to discourage those investors with massive capital on hand, and therefore can easily withstand such holding period, from property speculation. Furthermore, imposing additional taxes on non-residents and extending their short-term holding period, as Singapore and Hong Kong governments have done, should also be an option. Finally, non-urban land and agricultural land should also be included in the scope of and subject to special sales taxation.

Although the Act has been in effect for more than two years, implementation results of the original legislation have been falling short of government expectations. Actual special sales tax revenue did not meet original estimations, and the tax has only curbed housing trading volume rather than stopping the upward price movement[39]. Besides increasing the tax base, preventative measures should also be developed to tackle those common tax evasion schemes such as household registration, selling one before buying two homes, trading under the guise of real estate trusts and fake divorces[40]. It is important that these outstanding issues be addressed, and confusions clarified, to allow normal market activities to be restored as soon as possible.

[39] "檢討「奢侈稅」漏洞，落實居住正義", National Policy Foundation, 6 May 2013
[40] "檢討「奢侈稅」漏洞，落實居住正義", National Policy Foundation, 6 May 2013

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Vietnam

Obtaining Land Use Rights and associated financial obligations

Foreign investors can enter Vietnam's real estate market through investments in residential or commercial projects, infrastructure projects and real estate related services. However, some activities viewed as pure trading of properties (i.e. to purchase buildings for sale or lease, to lease buildings for sublease, to lease the land for sublease without developing the infrastructure) common in other jurisdictions are not allowed for foreign investors in Vietnam.

The Law on Land of 2003 generally provides that land belongs to the entire people, with the State as the representative owner. All land in Vietnam is collectively the property of the "entire people" and is subject to unified administration by the State. There is technically no private ownership of land in Vietnam, all "persons" (individuals or entities) that have legal rights to use land in Vietnam are regarded as "land users" through holding a Land Use Right (LUR) certificate.

LURs in Vietnam are classified into different types of "rights" based on their intended use, such as agricultural land, forestry land, industrial use land and residential land. Some types of land are only allowed to have their purpose of use converted after obtaining approval from the competent authorities. Hence, investors need to ensure that the classification of the LUR is also qualified for the purpose of the development project.

LURs for real estate projects

Generally, a LUR may be conferred to the land user by one of the following methods: (i) allocation; (ii) lease; or (iii) recognition that the LUR belongs to the land users that are currently using the land on a stable basis. Among local Vietnamese investors, the sale or transfer of a LUR is allowed but this option is not available for foreign investors.

Local investors (individuals or entities) can use all of the above methods to acquire a LUR. But foreign investors are restricted to acquiring land use rights.   As such a lease can only be granted to a Vietnamese incorporated entity (which may be 100 percent owned by foreign investors). No direct lease to foreign investors (a legal entity incorporated overseas) is allowed.

Until recently, nearly all of the real estate projects were set up in the form of joint venture with participation of local partners, who would typically contribute a LUR as their equity stake while the foreign shareholders contribute cash or other assets.

An alternative option to obtain land for real estate projects is to lease the land directly from the government, usually for a period of 50 years. In some cases approved by the Prime Minister, 100 percent foreign-invested companies are allowed to lease land for up to 70 years. The rental payments can be made as a one-off payment for the entire lease term or annually. When the rental amount is paid annually, the land user's rights over the land are very limited. For example, the land user is not allowed to transfer or mortgage the LUR.

In practice, there are a number of wholly foreign-invested real estate projects developing residential apartments. However, due to the scarcity of prime land, especially in major cities like Ho Chi Minh and Hanoi, most real estate projects are still established as joint venture with local partners contributing the LUR. Converting these joint ventures (with local ownership) to 100 percent foreign-owned companies through the transfer of shareholding can be possible.

Another theoretical way to access land in Vietnam, which is less common, is that to exchange the infrastructure for a LUR under a Build – Transfer (BT) contract with the government. But this approach is rarely seen in practice and would be subject to negotiation with the competent authority on the terms and conditions of the BT contract of the investors. So far only a few of these projects have actually been approved.

Associated financial obligations

Property Tax

Property tax is a somewhat confusing topic in to the context of Vietnam as the country does not follow international norms in taxation of property. That said, Vietnam does have a non-agricultural land use tax (NALUT), which may be viewed as a form of "property tax".

NALUT generally applies to certain types of land. Specifically, it applies to residential land and land used for non-agricultural production and business purposes. Taxpayers of this tax may include organizations, and individuals that have LURs or the entity that is using the land.

NALUT is calculated by multiplying the taxable land area with the price of a square metre of taxable land and the applicable tax rates. The price of a square metre of taxable land is set by the provincial authorities, and the applicable tax rate is the progressive tax rate ranging from 0.03 percent to 0.2 percent.

It is worth noting that NALUT exemption or reduction is possible if certain conditions are met.

Land use fees / land rental fees

Land use fees or land rental fees are additional fees applied when the government allocates or leases land to land users.

Generally, land use fees are determined by the provincial authorities and kept constant during a specific period. However, land rental rates can vary depending on how investors obtain the land (e.g. public auction or negotiation with relevant authorities).

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Registration fee (or Stamp duty)
Registration fee is imposed on individuals/organisations upon registration for ownership of the LUR. There are some specific cases when the registration fee is not applicable, including:

- land leased from / allocated by the government; or
- capital contributions in the form of LURs.

Registration fees are incurred when receiving land transferred from other parties. The amount of the registration fee payable would generally be 0.5 percent of the value of LUR, which is the land price set by the provincial authorities at the time of registration; and it is capped at VND 500 million (approximately USD 23,800) for each registration.

Value Added Tax (VAT)
VAT exemption is applicable to the transfer of a LUR, hence, land rental or land use fees payable to the government will not be subject to VAT.

This is the general rule and it is well tested. However, there are situations where the tax authorities will interpret a transfer to be a "real estate business", a term which remains vaguely defined for VAT purposes. For such a transfer the authorities may attempt to apply a 10 percent VAT to the taxable price of the "real estate business" in question, calculating the applicable VAT based on the sales price of the property involved in the real estate business. Thus, care must be taken to ensure that the transaction is purely of a LUR transfer nature and nothing more to prevent the potential incurrence of VAT.

On subsequent sales of property units by the developer that include the corresponding transfer of a LUR to the buyers, there is a non-VAT land price component and this is generally determined based on how the land is acquired. For example, if the land is leased from the government for the development of houses for sale, the deductible land value not subject to VAT would be the land rental amount plus the expenses of land clearance and compensation. Alternatively, if the land is acquired from another organisation or individual, the deductible land price would be the land price at the time of acquisition plus the value of infrastructure, if the land price at the time of acquisition could not be determined, the land price set by the principal authorities at the time of acquisition will be used.

Corporate Income Tax ("CIT")
The transfer of LURs including buildings or engineering works and lease rights would be treated as real estate transfers and subject to CIT at currently 25 percent. Please note that this rate will be reduced to 22 percent from 1 January 2014 and subsequently to 20 percent from 1 January 2016 on any gain. The gain is determined at the transfer price less the historical cost (or remaining book value) of properties and deductible expenses related to the transfer.

For the transfer of a LUR, the applicable price will be the greater of the actual transfer price or the land price set by the relevant authorities at the time of the signing of the contract.

Personal Income Tax (PIT)
The transfer of LURs from individual owners will be subject to PIT at the rate of either 25 percent on the gain (i.e. transfer price less historical cost) or 2 percent of the gross proceeds. In case supporting documents are not sufficient to prove the historical cost of the LUR or related expenses, a 2 percent rate will be applied on the gross proceeds of the transaction.

Other financial obligations
The real estate business in Vietnam is generally open to foreign investors. However, conditions apply. For example, the minimum charter capital required for a real estate company is VND 6 billion[41] (approximately USD 285,000). There are also basic requirements of minimum investment based on the size of the real estate project: for a residential project that uses less than 20 hectares of land, investors must contribute equity equal to at least 15 percent of the total investment capital; and for a project that uses 20 hectare or more land, the basic minimum equity investment amount is 20 percent[42].

For housing development projects with a land area of 10 hectares and above, investors may be required to allocate 20 percent of the project's land area to building low income housing, with the expenses for clearance and construction of infrastructure on such land deducted from the land rental or land use fee payable to the government[43].

Although real estate transactions and investments in Vietnam are not as transparent as those found in some of its neighbouring countries, with proper planning and due diligence, real estate investment in Vietnam can be an attractive option for foreign investors.

[41] Article 3, Decree No. 153/2007/ND-CP, Socialist Republic of Vietnam, 15 October 2007
[42] Article 3, Decree No. 153/2007/ND-CP, Socialist Republic of Vietnam, 15 October 2007
[43] Article 32, Decree No. 71/2010/ND-CP, Socialist Republic of Vietnam, 23 June 2010

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