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Real Estate Sector in India
-An Update

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New Delhi Law Office: C-1/16, Daryaganj, New Delhi-110002, India

Tel:+91 (11) 65352272, +91 9868119137

Corporate Law Office: B-10, Sector 40, NOIDA-201301, N.C.R, India

Tel: +91 (120) 4352846, +91 9810155766

Fax: +91 (120) 4331304

E-mail: mail@sethassociates.com www.sethassociates.com

INDIA BOOM IN REAL ESTATE SECTOR: AN INTRODUCTION

Over the past decade, India has emerged as a leader in the global economy. It is a magnet for foreign direct investment (FDI), and has displaced Mexico as the third most preferred country for foreign investment. FDI in India is expected to increase to US$15 billion this year, triple the 2004 figure. Many foreign companies are starting or expanding operations in India. One-fifth of all Fortune 500 companies including Eli Lilly, General Electric, and Hewlett Packard have set up research and development facilities in India. The surge in foreign investment, more joint ventures between Indian and foreign companies, and the growth of India's domestic industries have created more employment opportunities for India's young, highly educated, professional workforce and fueled the growth of the country's middle class.

Advantage India: Real estate is one of the fastest growing sectors in India. Market analysis pegs returns from realty in India at an average of 14% annually with a tremendous upsurge in commercial real estate on account of the Indian BPO boom. Lease rentals have been picking up steadily and there is a gaping demand for quality infrastructure. A significant demand is also likely to be generated as the outsourcing boom moves into the manufacturing sector. Further, the housing sector has been growing at an average of 34% annually, while the hospitality industry witnessed a growth of 10-15% last year.

Apart from the huge demand, India also scores on the construction front. A Mckinsey report reveals that the average profit from construction in India is 18%, which is double the profitability for a construction project undertaken in the US. The importance of the Real Estate sector, as an engine of the nation's growth, can be gauged from the fact that it is the second largest employer next only to agriculture and its size is close to US $ 12 billion and grows at about 30% per annum. Five per cent of the country's GDP is contributed by the housing sector. In the next three or four or five years this contribution to the GDP is expected to rise to 6%.

The Real Estate industry has significant linkages with several other sectors of the economy and over 250 associated industries. One Rupee invested in this sector results in 78 paise being added to the GDP of the State. A unit increase in expenditure in this sector has a multiplier effect and the capacity to generate income as high as five times. If the economy grows at the rate of 10% the housing sector has the capacity to grow at 14% and generate 3.2 million new jobs over a decade. The relaxed FDI rules implemented by India last year has invited more foreign investors and real estate sector in India is seemingly the most lucrative ground at present. Private equity players are considering big investments, banks are giving loans to builders, and financial institutions are floating real estate funds. Indian property market is immensely promising and most sought after for a wide variety of reasons. Here's a snapshot!

INFRASTRUCTURE SECTORS WITH PERMITTED FOREIGN DIRECT INVESTMENT UPTO 100% - AUTOMATIC APPROVAL

FDI under the automatic route does not require prior approval either by the Government of India or the Reserve Bank of India (RBI). Investors are only required to notify the concerned Regional office of RBI within 30 days of receipt of inward remittances and file required documents with that office within 30 days of issue of shares to foreign investors.

<u>List of Infrastructure Sectors with FDI Upto 100% under Automatic Route are as follows:</u>

- Electricity Generation (except Atomic energy)
- Electricity Transmission
- Electricity Distribution
- Mass Rapid Transport System, including associated commercial development of real estate
- Roads & Highways
- Toll Roads
- Vehicular Bridges
- Ports & Harbors
- Hotel & Tourism
- Townships, Housing, Built-up Infrastructure and Construction Development Project
- Setting up/ development of industrial park/ model town/SEZ- 100%FDI under Automatic Route

Automatic Route is not available to those foreign investors who already have a financial or technical collaboration in the same or allied field.

FOREIGN DIRECT INVESTMENT IN INDIA IN REAL ESTATE SECTOR -RECENT REGULATORY CHANGES

<u>Press Note No. 2 (2005 Series) Indian FDI Policy 2006</u>

With a view to catalysing investment in townships, housing, built-up infrastructure and construction development projects as an instrument to generate economic activity, create new employment opportunities and add to the available housing stock and built-up infrastructure, the Government of India has decided to allow FDI up to 100% under the automatic route in townships, housing, built-up infrastructure and construction development projects (which would include, but not be restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure), subject to the following guidelines:

100% FDI is allowed under automatic route in townships, housing, built-up infrastructure and construction development projects (which would include, but not be restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure) subject to certain guidelines as follows:

a. Minimum area to be developed under each project would be as under:
i. In case of development of serviced housing plots, a minimum land area of 10 hectares
ii. In case of construction-development projects, a minimum built-up area of 50,000 sq. mts
iii. In case of a combination project, anyone of the above two conditions would suffice
b. The investment would further be subject to the following conditions:
i. Minimum capitalization of US$10 million for wholly owned subsidiaries and US$ 5 million for joint ventures with Indian partners. The funds would have to be brought in within six months of commencement of business of the Company.
ii. Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

c. At least 50% of the project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor would not be permitted to sell undeveloped plots.
For the purpose of these guidelines, "undeveloped plots" will mean where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. It will be necessary that the investor provides this infrastructure and obtains the completion certificate from the concerned local body/service agency before he would be allowed to dispose of serviced housing plots.
d. The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/ Local Body concerned.

e. The investor shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye Yaws /regulations of the State Government! Municipal/Local Body concerned.

f. The State Government / Municipal / Local Body concerned, which approves the building / development plans, would monitor compliance of the above conditions by the developer."

INDIA-REALESTATE MARKET ON AN UPSURGE!

- It's ever growing economy which is on a continuous rise with 8.1 percent increase witnessed in the last financial year. The boom in economy increases purchasing power of its people and creates demand for real estate sector.
- India is going to produce an estimated 2 million new graduates from various Indian universities during this year, creating demand for 100 million square feet of office and industrial space.
- Presence of a large number of Fortune 500 and other reputed companies will attract

more companies to this country thus creating **more demand for corporate space.**

- Investment in India yields huge dividends. 70 percent of foreign investors in India are making profits and another 12 percent are breaking even.
- Apart from **Services & Business Process Outsourcing**, India has shown its expertise in sectors like auto-components, chemicals, apparels, pharmaceuticals and jewellery where it can match the best in the world. These positive attributes of India is definitely going to attract more foreign investors in the near future.

SEBI ISSUES GUIDELINES FOR REAL ESTATE MUTUAL FUNDS

The Securities and Exchange Board of India on 26 th June, 2006 approved guidelines for real estate mutual funds, allowing them to invest directly in real estate properties in India. These funds would initially be close-ended schemes. Their units would be compulsorily listed on the stock exchanges and NAVs of the schemes would be declared daily.

Investment norms: Apart from real estate properties in India, the schemes can invest in mortgage (housing lease) backed securities and equity shares/bonds/debentures of listed and unlisted companies dealing in properties and undertake property development. The board has also decided to exempt venture capital funds and foreign venture capital investors from the lock-in period during an IPO only if they hold shares in that company for a period of at least one year at the time of filing draft prospectus with the SEBI. This would help to ensure that only those who invest in the company with a long-term perspective would be allowed to get the benefit of exemption from requirement of lock-in period. The funds would be required to appoint a custodian who has been granted a certificate of registration to carry on the business of custodian of securities by the board. This is a welcome development for the mutual fund industry which enables common investors to participate in the growth of the real estate sector.

GENERAL TAX INCENTIVES FOR INDUSTRIES IN INFRASTRUCTURE SECTORS

Tax incentives available for those engaged in development of infrastructure are listed below:
Deduction of 100% of the profits from business for a period of 10 years for special category states for

i) Development or operation and maintenance of ports, airports, roads, highways, bridges, rail systems, inland waterways, inland ports, water supply projects, water treatment systems, irrigation projects, sanitation and sewage projects, solid waste management systems.

ii) Generation, distribution and transmission of power which commence before 31.3.2006.

iii) Development, operation and maintenance of an Industrial Park or Special Economic Zone before 31.3.2006.

CAPITAL GAINS ON INFRASTRUCTURE FUNDS

Income by way of dividend, interest, or long-term capital gain of an infrastructure capital company or an infrastructure capital fund is 100% tax-exempt. Income of Venture Capital Company or venture capital fund set up to raise funds for investment in a venture capital undertaking is also tax-exempt.

TAX EXEMPTIONS

Following tax exemptions are available in different sectors:
Deduction of 100% of the profit from business of

a. Development or operation and maintenance of ports, air ports, roads, highways, bridges etc.
b. Generation, distribution and transmission of power

c. Development, operation and maintenance of an Industrial Park or SEZ
d. By undertakings set up in certain notified areas or in certain thrust sector industries in the North-eastern states and Sikkim.
e. By undertakings set up in certain notified areas or in certain thrust sector industries in Uttaranchal & Himachal Pradesh
f. Derived from export of articles or software by undertakings in FTZ / EHTP / STP
g. Derived from export of articles or software by undertakings in SEZ
h. Derived from export of articles or software by 100% EOU
i. An offshore banking unit situated in a SEZ from business activities with units located in the SEZ.
j. Derived by undertakings engaged in the business of developing and building housing projects. Deduction of 50%of profits derived from the business of building, owning and operation of multiplex theatres of convention centre is also available.
k. Derived by an undertaking engaged in the integrated business of handling, storage and transportation of food grains.
l. Derived by an undertaking engaged in the commercial production or refining of mineral oil
m. Derived by an undertaking from export of wood based handicraft

SPECIAL PACKAGES FOR SPECIAL CATEGORY STATES

1. Backward Areas/Regions North Eastern States & Sikkim

Deduction of 100% of profits derived by undertakings set up in certain notified areas or in certain thrust sector industries in the North-Eastern States and the State of Sikkim, for a period of ten years.

2. Uttaranchal & Himachal Pradesh

Deduction of 100% of profits derived by undertakings set up in certain notified areas or in certain thrust sector industries in the States of Uttaranchal and Himachal Pradesh for the first five years and 25% (30% in the case of companies) for the next five years.

SERVICE TAX:

Construction services are liable to VAT/ Sales tax (WCT). Tax rates on such contracts/ materials used in such contracts differ from State to State, generally ranging from 4% to 12.5%. In VAT states, input tax credit is available to contractor on local purchases of construction material.

Confessional rate of CST is available (in case of inter-state purchases)/ input tax credit (in case of local purchases) on goods indirectly used in construction (e.g. cranes, earth moving/ leveling equipment, etc.). Input tax credit (under VAT) is also available on purchases made for construction of own residential/ commercial property (which may subsequently beleased/sold).

LOOKING AHEAD....

The new FDI guidelines are expected to trigger a surge of foreign investment, approximated at US$1 billion to US$1.5 billion annually, into India's construction development sector, including housing, office buildings, retail stores, research and development facilities, hotels, resorts, technology parks, and other commercial real estate projects. Since April 2004, when the Securities and Exchange Board of India allowed venture funds to invest in local real estate, some 30 foreign funds have applied to start operations in India. The first domestic fund, Fire Capital, got the green light in July 2005 to raise as much as $50 million. Interest in India's real-estate

sector has increased since the government allowed direct foreign investment in Greenfield real-estate projects in February 2005.Reurns in India range from 12% to 15%, compared with 3% to 4% in mature markets such as the U.S. and Western Europe. According to Jones Lang LaSalle's latest Global Real Estate Transparency Index (2006), India has achieved one of the region's most significant improvements in real estate transparency over the past three years. Moreover, the increasing participation of foreign investors and the emergence of new investment vehicles including the introduction of real estate investment trusts (REIT) will continue to force the pace of structural change over the remainder of the decade.

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