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REAL ESTATE SECTOR IN INDIA- CHALLENGES AND OPPORTUNITIES

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Abstract

The real estate sector is the third largest employer (after agriculture and manufacturing) in India and presently employs over 40 million workforce. India's construction industry will continue to expand over the forecast period (2016–2020), with investments in residential, infrastructure and energy projects continuing to drive growth. Various government flagship programs – including 100 Smart Cities Mission, Housing for All, Atal Mission for Urban Rejuvenation and Transformation (AMRUT), Make in India and Power for All – will be the growth drivers. There are certain challenges associated with India's real estate industry outlook. Limited funding, slow policy reforms and a weak currency are factors that will continue to limit the growth potential. Due to industrialization, urbanization, a rise in disposable income and population growth the demand for real estate is set to rise. This paper studies the key policy initiatives of the government for this sector and what the future holds. It is a secondary data based study.
Key words: Real estate, GDP, FDI, Interest, Housing

Introduction

The real estate sector is the third largest employer (after agriculture and manufacturing) in India and presently employs over 40 million workforce. With forward and backward linkages to over 250 sectors and ancillary industries, the real estate sector is the third-highest contributor to the Indian economy.

The total market size of Indian real estate is estimated to have doubled since 2008 . The market size of real estate in India is expected to increase at a CAGR of 15.2 per cent during FY2008 – 2028E and is estimated to be worth USD853 billion by 2028. The potential for growth is significant as India would need to develop over 170 million houses until 2030 to meet the needs of the rapidly urbanising population.

Contribution to Gross Domestic Product (GDP): The housing sector alone contributes 5-6 per cent to the country's Gross Domestic Product (GDP). Real estate contribution to India's GDP is estimated to increase to about 13 per cent by 2028. India has the largest housing market in the world, with over 75–80 per cent share in the total real estate market size in India.

Robust private equity investments in real estate: The Indian realty attracted the second-highest Private Equity (PE) investments during 2016, which increased by over 62 per cent y-o-y to INR38,000 crore. However, the Foreign Direct Investment (FDI) in construction development sector remained subdued with only INR470 crore worth of investment reported during January–September 2016. This was primarily owing to foreign investors preferring quasi-debt route, which is not captured in the FDI. .

Strong commercial office space leasing: Grade A leasing activity in the commercial office space remained upbeat during 2016, with over 9 per cent increase compared with that of the previous year. This resulted in 2016 recording the highest leasing of over 43 million square feet (msf), primarily driven by IT–ITeS and Banking, Financial Services and Insurance (BFSI) sectors. Due to lack of quality spaces in completed projects, the year saw strong pre-leasing in under-construction projects, contributing to nearly one-fourth share in the total leasing during the year.

Housing credit: The institutional credit to the housing sector is estimated to have grown by about 19 per cent during FY16. As a result, the total outstanding credit to the housing sector has reached INR12.5 lakh crore.There is still significant potential for credit growth as mortgage to the GDP ratio in India is only 9, far below than in the developed countries, such as the U.S. (68 per cent) and Germany (42 per cent).

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Significant supply gap: The urban housing shortage is 19 million units, of which, 95.6 per cent is in the Lower Income Group (LIG) and Economically Weaker Section (EWS). The union government had launched Pradhan Mantri Awas Yojana – Housing for All (Urban) in June 2015, to address the urban housing shortage. The government aims to achieve this through credit-linked subsidies and Public–Private Partnerships (PPP) model.

Weak housing sales and new launches: Residential sales across top-eight cities in 2016 fell to a seven-year low of about 245,000 units, owing to subdued demand over the past three to four years. Similarly, new residential unit launches, too, fell to pre-2008 crisis levels with only 176,000 unit launches during 2016.

Key Issues/Challenges

The real estate sector has been facing a number of issues, of which some of the major ones are enlisted below:

• While there is a significant shortage of housing in urban regions, it is estimated that the top-eight cities in India have approximately 6.5 lakh units of unsold housing stock. At the current rate of absorption, it may take over five years to clear the housing stock in regions, such as Delhi–NCR, which has the highest unsold inventory

• There is a scarcity of developable land in urban areas, and peripheral regions of cities lack appropriate urban infrastructure, which escalates the final project cost

• One of the major issues that the real estate sector is facing is lack of clear land titles and land title insurance, which lead to litigations and causes project delays

• Despite the real estate sector contributing the third highest share to the Indian economy, the share in outstanding loans from banks to the sector is extremely low at 3 per cent. This results in limited access to long-term and low-cost funding channels, especially through banks and external commercial borrowings (ECB) route

• The real estate sector has been grappling with liquidity issues and piling debt. The total outstanding debt of listed real estate developers in India has risen from INR25,000 crore in FY07 to over INR83,000 crore in FY16

• Lack of a strong micro finance sector makes it difficult for the Economically Weaker Section (EWS) and Lower Income Group (LIG) to secure housing finance credit

• With over 30–35 regulatory approvals required to be obtained by a developer to develop a real estate project in India, the whole process becomes cumbersome and also leads to delays, which inflates the project cost by 20–30 per cent

• Higher rates of statutory fees and taxes, including multiple taxation inflate the cost of construction, making affordable housing projects financially unviable for the private sector developers

• Unfavourable taxation structure for Real Estate Investment Trusts (REITs) impact the launch of REITs in India.

Government Initiatives for Real Estate Sector in Union Budget 2016

The year 2016 has been transformative and disruptive for the real estate sector. The Union Government has undertaken several policy initiatives to improve transparency and accountability, and improve liquidity in the sector.

• The Real Estate (Regulation & Development) Act, 2016 was passed by the Parliament in March 2016, which was a landmark legislative reform for Indian realty. The act would come into implementation from May 2017. This is expected to weed out corruption from the system

• Model GST Law has been implemented from 1 July 2017. This is viewed as a historic tax reform, and is likely to benefit the real estate sector, owing to expected reduction of the impact of prevailing multiple taxation.

• The Union Government in November 2016 demonetised Indian currency notes of INR500 and INR1,000, with an aim to bring back unaccounted money into the formal economy. This is expected to improve the liquidity of the banking system, thereby allowing banks to increase lending. Also, this move is likely to expand the tax base that may lead to higher tax revenues

• After the Central Government allowed tax pass through status to REITs and InvITs in the previous year's Budget, the Securities and Exchange Board of India (SEBI) has recently (January 2017) allowed mutual funds (MFs) to invest in REITs and InvITs

• The Benami Transactions (Prohibition) Amendment Act, 2016, has been cleared by the Parliament and has come into force from 1 November 2016. The act has provisions that would allow the adjudicating authorities to confiscate benami properties

The Union Budget aims to provide thrust to increase government spending in rural areas, infrastructure, alleviate poverty and maintain fiscal prudence. The government's agenda for the next year would be: 'transform, energise and clean India'.

Major policy announcements

• Infrastructure status has been accorded to the affordable housing projects
• Rural housing expenditure increased from INR15,000 crore to INR23,000 crore, under Pradhan Mantri Awas Yojana (Gramin)
• Over one crore houses to be built for the homeless in rural areas by 2019
• The National Housing Bank (NHB) would refinance individual housing loans of about INR20,000 crore in FY2017–18
• Allocation to infrastructure sector is at a record high of INR3.96 lakh crore for FY2017–18, an increase of over 38 per cent over the previous fiscal year
• The pace of construction of roads under the Pradhan Mantri Gram Sadak Yojana (PMGSY) has accelerated to reach 133km per day in 2016–17, as against the average of 73km during the period 2011–14
• The Airport Authority of India Act would be amended to enable effective monetisation of land assets
• The government is dedicated towards improving the ease of doing business in India. A number of tribunals are expected to be rationalised and appropriate tribunals would be merged to reduce overlapping functions
• Foreign Investment Promotion Board (FIPB) to be abolished in FY2017-18 and a road map is to be announced. Liberalisation of FDI policy under consideration and necessary announcements to be made in due course.
• The government plans to amend, simplify and rationalise the existing labour laws through legislative reforms. The existing law would be amalgamated into four codes: wages, industrial relations, social security and welfare, and safety and working conditions.
• A specific programme for the development of multi-modal logistics parks, together with multi-modal transport facilities, would be drawn up and implemented.

Key direct tax proposals

Corporate tax:

• Corporate tax rate reduced to 25 per cent (for FY2017-18) for companies whose total turnover or gross receipts of FY2015-16 does not exceed INR50 crore. In all other cases, the tax rates continue to remain the same.

• Certain conditions for claiming 100 per cent profit linked deduction by a developer of affordable housing projects as introduced by Finance Act 2016 has been relaxed as under:

— With respect to eligibility limits of 30 sq. meters and 60 sq. meters – built-up area has been substituted by carpet area as defined under Section 2(k) of Section 2 of the Real Estate (Regulation and Development) Act, 2016;

— Time limit for completion of a project extended from three years to five years from the date of approval by the competent authority;

— Limitation on size of residential unit of 30 square meters shall be applicable only to four metro cities (Chennai, Delhi, Kolkata and Mumbai) and shall not apply to a place located within 25km from the municipal limits of such four metro cities .

• Annual value of unsold stock-in-trade in the hands of real estate developers held for a period beyond one year from the end of the financial year in which the certificate of completion of construction is obtained, proposed to be notionally taxed as deemed let out property under the head 'income from house property'

• In order to qualify as long-term capital asset, period of holding for immovable property being land or building or both proposed has been reduced from 36 months to 24 months

• It is proposed to shift the base year for indexation from 1981 to 2001. Thus, if the actual cost of capital asset acquired before 1 April 2001 is less than the Fair Market Value (FMV) as on 1 April 2001, then such FMV to be deemed to be the cost of acquisition

• The concessional rate of TDS under Section 194LC on interest payment on borrowings made in foreign currency (ECB) extended from 30 June 2017 to 30 June 2020. Similarly, concessional rate of TDS under Section 194LD has been extended on interest payable up to 30 June 2020 on rupee denominated bonds (Masala Bonds) .

• Loss under the head 'income from house property' over INR2 lakh shall not be eligible to set-off against income under any other head of income. The excess is to be carried forward for a period of eight years for set-off in future years

• Eligibility to carry forward and set off MAT/Alternate Minimum Tax (AMT) credit increased from ten years to fifteen years from the end of the assessment year. Also, MAT provisions for computation of book profits proposed to be aligned with the provisions of Companies Act 2013 and IndAS

• No changes made in the taxation framework of REITs

Personal tax:

• In case of Joint Development Agreements (JDA) under area sharing arrangement, the capital gains in hands of individuals and HUFs is to be taxable in the year of receipt of certificate of completion for the whole or part of the project based on the stamp duty valuation.

• Withholding tax at 10 per cent to be deducted at the time of payment/credit of monetary consideration

• Specified capital gains exemption to land owners, being individual or HUF in the state of Andhra Pradesh in relation to land pooling scheme

• No change in slab rates of tax except as under:

— Tax rate on income above INR2.5 lakh/ INR3 lakh (as the case may be) upto INR5 lakh reduced to 5 per cent from that of 10 per cent

— Surcharge to be levied at 10 per cent in case total income exceeds INR50 lakhs but does not exceed INR1 crore.

• Individuals/HUFs who are not subjected to tax audit, are now required to withhold tax at source at 5 per cent from rental payments in excess of INR50,000 per month.

The Way Ahead

Going by the turn of events, it is difficult to crystal gaze into 2017. The biggest question in the mind of the stakeholders of the industry is – what next? Sales need to be revived and the following points discuss various measures that we believe will help to revive the demand for homes in the coming quarters.

The first and foremost step that the industry needs to take is to make houses more affordable. Currently, the biggest factor affecting sales is the unaffordability of the homebuyers. House prices till 2012 have increased significantly faster than the income level of homebuyers. During the last four years, the growth in residential prices in most of the top eight cities of India has been below retail inflation growth – a clear reflection of time correction. But still this is not enough to make housing affordable to majority of the homebuyers in the top cities of India. Developers need to give a relook at the pricing, size and configuration of residential units in their planned developments and the government should take a proactive initiative to develop peripheral locations with required connectivity and infrastructure.

Another factor that will help to stimulate the demand for house purchase is the reduction in home loan interest rates by banks. RBI has already reduced its policy rate by 175 bps in the last two years and is likely to lower the policy rates by another 25-50 bps in the next three to six months. Given the liquidity situation and reduced policy rates, banks will have sufficient elbow room to lower the home loan interest rate in the coming months.

The Union Budget's gift of infrastructure status to affordable housing is a game changing move that will open up more institutional sources for developers to raise funds at competitive price. The budget has also given leeway to developers to build bigger houses and extended the time of completion of affordable housing projects from 3 years to 5 years.

Fiscal incentives on home purchase could go a long way in reviving the demand and any move towards addressing this in the upcoming budget will give a huge boost to the industry. Any move by the Government of India to increase the limit on tax exemption on home loan interest and principal amount payment in the upcoming budget could provide the much needed fillip to the ailing sector.

Finally, strict implementation of the Real Estate (Regulation and Development) Act, 2016 ,GST bill and Benami Transactions (Prohibition) Amendment Act, 2016, within the stipulated timeframe could be a major factor in bringing back the confidence of homebuyers in the real estate sector

Conclusion

To conclude, the year 2016 has been one of the worst years for the sector in the recent past but the policy initiatives announced by the government will see the economy undergo structural changes for the first three quarters of 2017. RERA & GST have been implemented but their impact needs to be seen as also the medium term impact of demonetisation and listing of REIT. During this phase, enterprises are expected to streamline their business processes and implement international best practices to adhere to the upcoming changed business environment. There will be a greater influence of FDI (Foreign Direct Investment) that will help create jobs and revitalise growth within the sector. Overall, institutional participation—both domestic and global markets—will help the sector in getting high quantum of funds at competitive rates. In view of the various procedural changes adopted by the government, it is also expected to be an important facilitator in bringing back stability within the real estate sector.

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