

India Notes

India announces its Budget for the financial year 2010-2011

The Union Budget 2010-11 was a challenging event, given the balance that was required between lowering deficit and providing growth catalysts to the economy. The government seems to have done well on both counts. While the fiscal deficit has been curbed at 5.5% for FY11, growth catalysts have been provided with further sops for private consumption. The Budget has been prepared with GDP growth estimate of 8.5% for FY11 v/s 7.2% for FY10 which according to most analysts is realistic.

There was also a partial withdrawal of the stimulus measures on expected lines through a 2% hike in excise duty (what was unexpected was the additional hike in duty on auto fuels and steep hike in excise duty for tobacco).

Economic Survey points at strong growth prospects

The government should start fiscal consolidation beginning in April by reforming spending, eliminating its finance revenue deficit, and putting a cap on government debt. The ministry's economic survey for the financial year 2009-10 urged a calibrated exit from fiscal stimulus, which cushioned India's economy from the worst of the global downturn but pushed the fiscal deficit to a 16-year high of 6.8% of GDP. The report, presented in Parliament ahead of the Union Budget, forecast economic growth at 8.25%-8.75% in 2010-11, accelerating to over 9% the year after, compared with projected growth of 7.2%-7.5% in the current year.

Budget and Indian Real Estate: - Devil in the details....

Real estate stocks rallied initially after the union budget was announced on Friday. They however came off from later in the day as concerns emerged in the fine-print. The primary concerns were related to the levy of service tax on lease rentals and real estate construction. Most of the developers and market watchers are waiting for greater details on the budgetary announcements before expressing any opinions.

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Economy & Markets

India Budget 2010

Coming out of a difficult year in the global economy, the finance minister in his Budget 2010-11 has painted a fairly-poised picture of the expected way forward for the Indian economy, balancing economic growth and reducing fiscal deficit. The reinstatement of central excise duty to 10% may have some inflationary impact.

However, the need for fiscal prudence was overriding. The economic growth seems to have generated momentum with manufacturing sector growing at 18.5% in December 2009. The government also reiterated the divestment agenda with Rs 250 bn (€4 bn) for the current year and plans to increase it in 2010-11 to an estimated Rs 400 bn (€6 bn). The importance of the investment flows has been recognised with the announced simplification of FDI flows which are expected to be slightly higher in the current year. There is also an emphasis on domestic savings with exemption on investments in long-term infrastructure funds, which is somewhat lower than expected.

With the thrust on financial inclusion and education the setting up of an apex-level Financial Stability and Development Council recognises the need for more banks and the role of rural banks in financially inclusive growth. Granting banking licence to private sector players and NBFCs meeting required criteria could prove to be the third wave in banking after the first two waves of 1992 and 2000. The infusion of Rs 165 bn (€ 2.7 bn) as tier-I capital in public sector banks also seems to have kissed goodbye to the PSBs consolidation agenda.

The contribution of the SME sector to the economy and important part it plays in financial inclusion has been reiterated by the credit support to exports and farmers.

In the same vein national social security measures for the unorganised sector have been extended to the NSS fund, NREGA beneficiaries and New Pension Scheme in terms of central and state government contributions rather than the expected tax exemptions. Significant thrust in the budget seems to be on financial inclusion and extending the economic benefits to the weaker sections of society. The Budget also has balanced the various pulls and pressures of sustaining economic growth and better fiscal management keeping in mind the market expectations without making any significant policy announcements.

The Budget also had a challenge on its hand, given the balance that was required between lowering deficit and providing growth catalysts to the economy. The government seems to have done well on both counts. While the fiscal deficit has been curbed at 5.5% for FY11, growth catalysts have been provided with further sops for private consumption. The Budget has been prepared with GDP growth estimate of 8.5% for FY11 v/s 7.2% for FY10.

There was a partial withdrawal of the stimulus measures on expected lines through a 2% hike in excise duty. A high disinvestment target of Rs 400 billion would call for stake sale in several state-owned companies over the next 12 months while the revenues of Rs 350 billion from 3G auction would be crucial for achieving growth estimates.

The most important positive has been concessions on personal income tax, which will release significant amounts for discretionary spending. The average savings of Rs 56,000 (€ 1000) for an income earner of Rs 800,000 (€ 13000) per annum are forecast. This will boost demand for Autos, Real Estate and various savings products. Movement to Direct Tax Code and General Sales Tax from April 2011 will be key reforms to watch for. Over the next couple of months, monetary policy will be in focus, given the expected rise in inflation in March. Analysts believe that RBI will focus on medium-term inflationary outlook rather than just the near-term one.

Retail To be hit by Service Tax

The Budget announcement relates to the inclusion of the “act of renting immovable property” by itself, as a taxable service, under Finance Act, Section 65(105) (zzzz), with a retrospective effective June 1, 2007. Further, the definition of immovable property has been broadened to include vacant land under agreement / contract for construction or commercial purposes.

Backdrop: Finance Act, 2007 introduced a new tariff in section 65 (105)(zzzz), which introduced a new service category known as the Renting of Immovable Property Service. This was challenged by several retailers across country in various High Courts. In turn, the courts issued interim stay orders restraining Service Tax authorities from collecting service tax from the retailers.

Implication: According to property developers, the tenants for office properties have been compliant to service tax since 2007. The new proposal is unlikely to have an adverse impact on office projects which is not as well understood by the markets. However, mall developers are likely to be adversely affected, since the current proposals appear directed at retail projects. Mall developers like Phoenix confirmed that the majority of the existing pre-leases contractually obligate the tenants (retailers) to bear all statutory levies, implying that retailers may now have to pay the service tax retroactive to June 2007. However, it mentioned that this will affect leasing activity in the future, and could cap lease rentals in the near to midterm.

Interest rate subvention on affordable housing

The government has introduced interest rate subvention of 1% for affordable houses in last year’s budget. The home buyer who takes housing loan of up to Rs1mn for purchase of house not costing more than Rs2m was allowed interest rate subvention of 1 % for the first 12months. The government has extended the scheme for FY11 as well.

Impact on developers – It is a minor positive as most of the large developers do not operate in this space. Few developers do have some products priced under Rs2mn (€ 33000) while others have announced plans to launch new projects in this range. But since the subvention is only for the first 12 months the total savings is a maximum of Rs10,000 (€ 200) for the home buyer.

This will provide only a small push enough for new home buyer to make his decision to buy a home. The government last year has allocated Rs10bn for this scheme, but was able to disburse just Rs3-4bn. This year government has made a provision of Rs7bn for the scheme.

Relaxation in section 80IB (10)

The exemption of 100% was available to the developers under section 80IB (10) for developing small housing units of less than 1000sq ft in Delhi and Mumbai and less than 1500sq ft in other locations for the projects approved by local authorities before March 08. But the developers were required to complete the housing unit within 4 years from the end of financial year in which the approval from local authority is obtained. This period is proposed to be increased to 5 years.

Impact on developers – It is again a minor positive, as very few developers still have ongoing projects that were approved under section 80IB(10). The likely beneficiaries would be Unitech, Puravankara and Sobha, who now have another year to complete the ongoing projects.

Service tax on preferential location charges

Service tax has been introduced on the preferential location charges which are charged by the developer over and above basic sales price. The developers generally charge 5-10% of the basic price as preferential location charges on apartments/ houses/offices have better location like garden facing, or having a superior view of the surrounding.

Impact on developers – The move is unlikely to impact the developers as these charges would be passed on to the home buyer and would comprise just 1- 2% of the total price of the house or office. In some cases developers may do away with the specific charge and may include this in basic price itself. This cost may also get loaded on other amenities where service tax as not been imposed like parking space.

There is a lack of clarity overall on the measures introduced for real estate as the devil is in the details. However it is expected that these measures are aimed at boosting tax revenues whilst not trying to impact the sector negatively. An expected move which will in the short term prove to be a negative but in the long term inconsequential in the larger scheme of things.

Real Estate

Major Banks raise key lending rates

HDFC Bank, ICICI Bank and Kotak Mahindra have raised rates on home and auto loans, reflecting the stiffening market that may lead to the Reserve Bank of India (RBI) hastening with a lift in its policy rates from record lows to fight inflation. These private banks have raised lending rates by as much as 100 basis points, following the hardening of market rates even as the central bank holds on to low rates to avoid derailing the economic growth. A basis point is 0.01 percentage point. RBI has started slowly rolling back some liquidity-boosting measures and has indicated it may not hesitate to raise rates. It raised the cash reserve ratio by 75 basis points in the last review.

Banks are raising lending rates to maintain their profitability after they increased deposit rates in the last few months to attract funds that were beginning to go to higher-yielding stocks and real estate. Investors are seeking higher returns instead of safe bank deposits since prices are running far ahead of the interest rates that banks are offering, leading to negative real returns.

The first signs of interest rates hardening came from the bond markets where yields on the benchmark 10-year bond have risen 10-12 bps since the budget. Since the RBI announced the 75 basis point hike in cash reserve ratio requirement, yields have gone up by 40 bps. The yield on the 10-year government securities are close to 8%, up nearly 3 percentage points from their lows last year. Times of easy money are slowly becoming history.

Axis Bank was the first to cease its teaser loan rates in February after the monetary policy. The bank was offering a fixed rate of 8.25% for two years. Others who pulled out cheap loans are the government-owned Union Bank and Canara Bank.

But bigger ones that are flush with funds such as State Bank of India and Punjab National Bank and even Bank of Maharashtra are continuing with teaser rates, which the RBI has warned against. Teaser rates loans are those where interest rates are low in early years, but progressively climb, making it tough for consumers to repay. This is similar to the US subprime loan regime which caused the global credit crisis.

Mumbai's Failed Land Sale May Lead Some Property Prices Lower

Mumbai's failure to lure any bidders in the first government land sale in at least 1 1/2 years may cause rates in that area to fall as India's financial hub seeks to develop the reclaimed marshland into a key business district. The five likely bidders who attended a preliminary meeting last month for the sale of the site in the city's Bandra-Kurla Complex didn't submit offers yesterday, said Dilip Kawathkar, joint project director and spokesman for the Mumbai Metropolitan Region Development Authority. The land was valued at a minimum 4.35 billion rupees (\$95 million) by the agency.

The failed auction may force Mumbai, whose commercial space makes it among the world's five most expensive cities, to cancel or defer sales of land. The government offered the property at 2008 rates even after rents fell by more than a third in Bandra-Kurla, where London-based Standard Chartered Plc and Reliance Industries Ltd., India's most valuable company, plan to shift their offices.

"The land price seemed to be on the higher side," Pujit Aggarwal, chief executive officer and managing director of developer Orbit Corp. Orbit was one of the companies that had attended the pre-bid meeting last month. "It would have been tough to make money."

Rents in the Bandra-Kurla area had dropped 36 percent by December from a June 2008 high, according to data from CB Richard Ellis. The 3,162.5 square meters (34,040 square feet) of land that was to be sold yesterday in the north-central region of the city can be used to build as much as 14,500 square meters of office space, according to the government agency. The reserve price of 300,000 rupees a square meter set by the agency was unchanged from similar sales two years ago. The failed sale has a positive though as it reflects a mature decision of the developers not to bid at high prices which tend to translate into higher rentals and higher vacancies as companies look to cut costs.

Office space demand picking up: CBRE

Global realty consultancy firm CB Richard Ellis (CBRE) today said that office segment has shown an uptrend in the recent past and the level of activity is likely to continue in 2010. Since the third quarter of 2009, the office segment has seen some improvement with corporates slowly returning to the market and office space take-up improving, Chairman and Managing Director (South Asia) CBRE Anshuman Magazine said in the fourth quarter review of the segment.

The review, based on feedback from seven cities, revealed that the segment posted a better show as FMCG, telecom and financial sectors started picking up space during the quarter. Improving economic sentiment, rising confidence of the corporate sector and lower prices propelled improvement in demand, he said.

2009 started with a discouraging note for the entire real estate sector on the back of global economic slowdown, but started picking up following the announcement of a series of stimulus packages by the government. "The demand is expected to improve in 2010 although the rentals are expected to remain flat in the medium term due to forecasted large supply of office space," Magazine said. CBRE said that rentals in the central business district of Delhi, Bangalore, Hyderabad and Kolkata remained constant while in Mumbai and Chennai it dropped by 3 per cent owing to limited leasing activity

Retail real estate yet to recover fully: CBRE

Indian realtors might have seen good October-December sales, but a recovery in the retail real estate segment still hinges on availability of spaces at competitive rates and improvement in consumption, global consultant C B Richard Ellis has said. The retail sector will take some time to fully recover, depending on improvement in domestic consumption, consumer sentiment and availability of retail space at competitive costs," CB Richard Ellis (South Asia) Chairman and Managing Director Anshuman Magazine said in a statement here today. Improving consumer sentiment and competitive retail rentals had, however, resulted in the sector "ambling towards better activity levels, especially in Tier I cities," he added.

The year 2010 may, however, see "some sustainability in the residential market as activity levels have improved", he said. Prices for residential, retail and commercial real estate across the country plummeted in 2009 due as the global economic meltdown froze demand. Residential sales declined significantly and demand for office spaces also saw a substantial drop, triggering a dip in rentals and postponement or cancellation of projects. Retail real estate was also significantly impacted. However, each of these segments have witnessed improvement compared to the previous year as reduction in prices, softening of interest rates and an improvement in the economic sentiment led buyers back to the market, the consultancy firm said.

Residential pricing seen moving up

Home prices may remain firm or inch up slightly in metros such as Delhi and Mumbai and their suburbs despite an expected rise in interest rates as investment rates as demand picks up once again on the back of renewed activity on the employment front, bankers and realty players. However, they felt that prices at extended suburbs — such as Greater Noida and Manesar near Delhi and Navi Mumbai, along with tier-II and tier-III townships — will remain under pressure due to oversupply of housing, lack of connectivity and paucity of jobs in such locations.

The residential demand is not just the function of the interest rate, said Keki Mistry, vice-chairman and managing director of HDFC, the largest home-loan player in the country. "The demand is primarily driven by job creation and job confidence. When any individual buys a home, he or she enters into a long-term payment obligation. Therefore, buyers need to have confidence of retaining their jobs," he said.

Outlook

Strong growth numbers from the economy and increasing investor confidence have ensured that Indian corporate confidence is improving. As India moves towards an 8% projected growth rate most companies are looking at implementing strategies for expansion. This bodes well for recovery in the commercial and retail real estate.