INDIA | UNION BUDGET 2018-19

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Balanced Budget targeting long-term growth

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While general expectations were tilted towards a more populist Budget, the objectives of the Union Budget 2018-19 were 1) to provide an impetus to economic growth through extensive capital outlays in the agriculture, infrastructure, manufacturing, education and healthcare sectors; and 2) to ensure credit availability for businesses. In our opinion, the Budget was rightly focused on improving basic infrastructure and strengthening capacity building. The government has extended the benefit of corporate tax reduction from 30% to 25% for companies who have reported turnover up to INR 250 crores (USD 0.04 billion) in FY2016-17. This was earlier applicable only for companies with turnover less than INR 50 crores (USD 0.01 billion). We expect these measures should boost job creation in the country and indirectly help the real estate sector grow in the long-term. However, it provides little direct support for the real estate sector other than a boost to future supply in the affordable housing segment. Moreover, the income tax benefits to individuals are insufficient to provide a demand-side to push the sector.

The Honourable Finance Minister of India, Mr Arun Jaitley presented the fourth and the last full-term Union Budget of the current government before the upcoming general election in 2019. The Finance Minister started the Budget speech by emphasizing on the fact that the government has successfully implemented a series of fundamental structural reforms in past 4 years. We believe that the results of the key policy reforms undertaken by the government are rewarding despite consequential short-term adverse implication on growth numbers. The Gross Domestic Product (GDP) growth at 6.3% in the second quarter of FY2017-18 indicates a turnaround of the economy. The Budget forecasts the country's economic growth in the range of 7.2% to 7.5% in the next three years looks achievable. We believe that the Indian economy should perform well, despite many anticipated risks such as the expected US Fed rate hike, increasing global trade protectionist policies, and the threat of job reduction due to Artificial Intelligence (AI) in India. The Budget puts a lot of required thrust on grass root investments in rural areas and infrastructure but it remained largely silent on any direct benefit to the real estate sector.

In our opinion, the Budget is a positive step with a long-term focus on job creation, entrepreneurship, and skill development. For the short-term, the real estate sector has not been completely ignored and several allocations under the 'Housing for All' scheme has been made that should further increase the supply of affordable homes. The government has also reduced tax rates for Micro Small and Medium Enterprises (MSME) who have reported turn over up to INR 250 crores (USD 0.04 billion) in FY2016-17 to 25% with an intension to boost economic growth and job creation. We believe these measures will indirectly help the real estate sector to grow in the long-term.

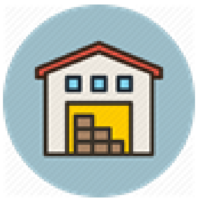
Table 1 - Stock market reaction of listed real estate companies

Company	Change (in %)
BSE SENSEX	-0.16%
S&P BSE REALTY	-0.89%
DLF	-2.18%
Godrej properties	+0.79%
Indiabulls Real Estate Ltd.	-3.26%
HDIL	-2.16%
Prestige Estate	+1.64%
Omaxe Ltd	+0.37%
Unitech	-2.01%
Oberoi Realty Ltd.	-1.10%
Sobha Ltd.	-1.10%
The Phoenix Mills Ltd	+3.51%

Source: BSE India as on 01.02.2018, 4.00 pm IST

Key highlights of the Budget that are likely to influence the real estate sector

Agriculture and food processing are major beneficiaries; direct push to cold storage, warehousing and logistics sector



Impact:

The Finance Minister announced that India's exports are expected to grow at 15% in FY17-18. The Budget proposed liberalisation of export of agri-commodities to realise the actual potential of INR 6.37 lakh crores (USD 100 billion) as against current exports of INR 1.91 lakh crores (USD 30 billion) as on FY2017-18. The allocation for food processing industries has been doubled from FY2017-18 to INR 1,400 crores (USD 0.2 billion) for FY2018-19.

In our opinion, growth in agri-based exports should also help uplift the rural economy and affordable housing. We believe the focus on agriculture and food processing industries should increase the investments in warehousing and cold storage facilities across agricultural and industrial belts.

Dedicated fund to affordable housing sector; creates optimism on the supply side

Impact:

In the Union Budget 2017-18, the government granted the "Infrastructure" status to affordable housing to achieve the aim of "Housing for All by 2022". Under PMAY, the government is constructing about one crore (10 million) houses exclusively in rural areas by 2019. In urban areas, the government provided the assistance to construct 37 lakh (3.7 million) houses. The establishment of dedicated Affordable Housing Fund (AHF) will further support the objective of achieving this ambitious mission.

In our opinion, the profit-linked exemption along with the infrastructure status for affordable housing has started pushing developers to undertake more affordable housing projects, thus increasing private player's participation in the sector. We expect the increased infrastructure investments should address the concerns on inadequate infrastructure in the peripheral and rural areas and the high cost of land in prime areas being major challenges for the affordable housing sector.

World's largest National Health Protection Scheme (NHPS) to push healthcare related real estate development

Impact:

The Budget proposes to introduce a flagship national health insurance scheme which will cover 10 crores (100 million) of poor and vulnerable families (approximately 50 crore beneficiaries, considering an average family size of 5 members). The National Health Policy has envisaged to establish 1.5 lakh healthcare and wellness centres for the easy access of quality healthcare.

In our opinion, it is a steady step towards the universal health coverage in line with the schemes present in other developed nations. These schemes will not only boost the healthcare industry, but should be a vital catalyst in increasing the much-needed public and private investment towards the healthcare-related real estate developments across the nation, especially in Tier-II and Tier-III cities.

No adjustment on transactions where circle rate values do not exceed 5% of the consideration; limited impact on real estate

Impact:

Currently, while taxing income from capital gains, business profits and other sources with respect to transactions in immovable property, the consideration or circle rate value, whichever is higher, is adopted. The difference is counted as income both in the hands of the purchaser and seller. However, in recent years, due to consistent hikes in circle rates despite of a slow property market, the scenario has reversed in many micromarkets where circle rates have become higher than the market rates.

Further, sometimes, this variation can occur with respect to different properties in the same area because of a variety of factors including shape of the plot and location. To minimize hardship in real estate transactions, the Budget proposes that no adjustment shall be made in a case where the circle rate value does not exceed 5% of the consideration. In our opinion, it will only provide a small benefit and will not really impact property markets/prices. The ideal way of removing this anomaly is to have a market mechanism to recalibrate the circle rate system in such a way that the difference between the circle rate and the average market rate over 6 months is negligible.

Focus on smart cities; futuristic path towards planned developments in Indian cities

Impact:

An outlay of INR 2.04 lakh crore (USD 32.6 billion) has been allocated for 99 smart cities to aid in the implementation of various projects like smart command and control centre, smart roads, solar rooftops, Intelligent Transport Systems (ITS), and smart parks etc. Also, it has been announced that additional 18 SPAs would be established in the Indian Institutes of Technology (IITs) and National Institutes of Technology (NITs) across the country.

In our opinion, these initiatives are likely to uplift Indian cities to witness more planned developments with adequate infrastructure in upcoming years. With an overlay of the smart systems on infrastructure and planning, the smart cities will greatly benefit from a new ecosystem on the thrust of using technology as the backbone.

Promised reform measures with respect to stamp duty

Impact:

There is a long-standing demand from the real estate sector to rationalise the stamp duty on immovable property transactions across all the states. Currently, the stamp duty ranges between 3% to 8% in various states. Real Estate Investment Trust (REITs) are also looking for exemption from stamp duty as it impacts the financial feasibility of return while transferring assets to a REIT investment vehicle. We expect the revision of stamp duty in consultation with states to be a positive step and should encourage transparency and standardization of property registration costs.

Revitalization of heritage cities; Iconic tourist destinations to boost retail and hospitality

Impact:

The Budget revealed that the government will be investing money in the holistic developments of the top 10 prominent heritage cities in India to make them as the country's iconic tourist destinations. The government plans to achieve this with the help of private sector participation instilling major thrust in infrastructure, technology, tourism marketing and branding. The development of the tourist-friendly cities in India would surely impact both social and physical infrastructure in prime areas, which coupled with the boost in economic activities will pave the path for the new real estate assets in retail, hospitality and Food and Beverage (F&B) sectors.

Infrastructure uplift; Holistic development of railways, airports and roadways on the cards

Impact:

Development of infrastructure has been one of the focus areas of the reigning government. The Finance Minister expressed that India requires INR 50 lakh crores (USD 780 billion) of investment in the field of rail, road and inland waterways. The highest ever allocation for railways pegged at INR 1.48 lakh crores (USD 23.1 billion) which are to be utilized in the capacity creation, safety enhancements and modernization of the 600 railway station via equipping it with better facilities.

The Budget shows special attention on cities like Bangalore and Mumbai to improve the railway connectivity in the metropolitan area. In our opinion, this investment will unburden the excessive strain on the existing railways and unveil new growth corridors in these cities. There is also a push for the regional domestic airway connectivity scheme which will expand to 56 unserved airports from the present 16 airports.

All the initiatives are healthy sight for the real estate industry with a long-term positive impact on the real estate cycle. In our view, the increased investments in the redevelopment of railway stations and airports will act as a major hotspot for commercial activities, eventually mushrooming office, retail and hospitality related real estate projects. Improvement of national highway roads and inter-state connectivity are moves that will further in strengthen the real estate activities related to logistics industry.

Tax benefit of 25% extended to MSMEs; likely to benefit real estate indirectly by promoting job growth

Impact:

As a major boost to MSMEs profits, the government has extended the benefit of corporate tax reduction from 30% to 25% for companies who have reported turn over up to INR 250 crores (USD 0.04 billion) in FY2016-17. This is likely to benefit the entire MSMEs which amounts for 99% of these companies filing their tax returns. The package for MSME along with an allocation of INR 3,794 crore (USD 0.61 billion) for credit support, capital and interest subsidy, and innovations in the sector will provide huge relief to MSMEs in this post demonetization and GST scenario. This should boost economic growth and job creation which would enhance the focus on real estate sector. However, the announcement should create dissatisfaction among big corporates that were hoping the corporate tax cut will be across the board.

10% tax on Long-Term Capital Gains (LTCG) on equity; investment focus to tilt towards real estate

Impact:

Under the proposed new tax regimes, realized capital gains of more than INR 1 lakh (USD 1560) from stock and equity mutual fund investments held over one year will be taxed at 10%. At present, profits from stock and equity mutual fund investments held for more than 12 months are tax exempt. The long-term capital gains made on investments up to January 31, 2018 will not be taxed.

In our opinion, this proposal to levy 10% of long-term capital gains tax on equities is a negative move to India's stock market as LTCG exemption was an attraction for new investors into equity/equity mutual funds and brought funds from other low paying avenues. The change in capital gain tax for equity could accelerate the shift of preference allocation from equity to other investment assets like real estate. This would be a reversal of the trend we have seen in the last 5 years.

Conclusion

The Budget has minimal direct impact on real estate sector. However, it is a balanced budget targeting on long-term economic growth. It provides the long-term guidance in bringing the economy back on track. On the face of it the budget seems to have overlooked the real estate sectors. However, the thrust on infrastructure, skill development and job creation can be a tremendous boost to the real estate sector with a much bigger impact than a few incentives that the sector looks for.

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