India Real Estate Overview

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The real estate sector in India assumed greater prominence with the liberalisation of the economy, as the consequent increase in business opportunities and labour migration led to rising demand for commercial and housing space. At present, the real estate and construction sectors are playing a crucial role in the overall development of India’s core infrastructure. The real estate industry’s growth is linked to developments in the retail, hospitality and entertainment (hotels, resorts, cinema theatres) industries, economic services (hospitals, schools) and information technology (IT)-enabled services (like call centres) etc and vice versa.

The Indian real estate sector has traditionally been dominated by a number of small regional players with relatively low levels of expertise and/or financial resources. Historically, the sector has not benefited from institutional capital; instead, it has traditionally tapped high net-worth individuals and other informal sources of financing, which has led to low levels of transparency. This scenario underwent a change with in line with the sector’s growth, and as of today, the real estate industry’s dynamics reflect consumers’ expectations of higher quality with India’s increasing integration with the global economy.
Residential real estate industry has witnessed stupendous growth in the past few years owing to the following reasons:

- Continuous growth in population
- Migration towards urban areas
- Ample job opportunities in service sectors
- Growing income levels
- Rise in nuclear families
- Easy availability of finance

Demand for houses increased considerably whilst supply of houses could not keep pace with demand thereby leading to a steep rise in residential capital values especially in urban areas.

Broadly, residential real estate industry can be divided into four growth phases, as can be seen in the chart below:

**Housing growth trajectory**

<table>
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<tr>
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<tbody>
<tr>
<td>2001</td>
<td>Initial growth phase with offtake and prices picking up</td>
<td>High growth phase with high demand and prices more than double</td>
<td>Substantial slowdown in demand due to dented affordability and economic environment</td>
<td>Consolidation phase, with demand, supply and prices gradually moving up in line with improvement in economic environment</td>
</tr>
</tbody>
</table>

**Note:** All years represent financial year (April-March). For instance- 2011 represents April 2010-March 2011.

**Source:** CRISIL Research

**Phase I (2001-2005)** was an initial growth phase with stabilising residential real estate prices following the global recovery post the “dot com” bust and 9/11 terrorist attacks in New York. At the same time, there was steady growth in Indian economic activity, noteworthy recovery in IT/ITES industry, growing urbanisation and a rising trend towards nuclear families.

**Phase II (2006-2008)** was a high growth phase where high demand for residential real estate led to doubling of housing prices. Demand rapidly increased due to India’s growing population, accentuated urbanisation, rising disposable incomes, rapidly growing middle class and youth population, low interest rates, fiscal incentives on interest and principal payments for housing loans and heightened customer expectations.

**Phase III (2009-2010)** witnessed substantial slowdown and part recovery in demand because of the global economic downturn, which led to a decline in affordability and tight liquidity. The retreat of various real estate investors, accompanied by slowdown in the capital markets, has resulted in oversupply and falling prices.
**Phase IV (2011-2014)** is expected to remain a consolidation phase after slowdown. Demand is expected to remain strong with capital values witnessing modest rise. This period is expected to witness substantial supply of housing especially in urban areas.

In spite of the stupendous growth witnessed in the past 10 years, substantial housing shortage is still prevalent in India. According to CRISIL Research, housing shortage in India is estimated at 78.7 million units at the end of Phase II. The overall housing shortage in India is likely to decline to 75.5 million units by the end of Phase IV.

![Housing shortage in India](image)

**Source:** CRISIL Research

CRISIL Research expects housing shortage to decrease due to the government’s thrust on improving rural housing by providing houses to the homeless under various development schemes and by enabling slum redevelopment programmes in urban areas under Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

However, housing shortage in urban areas will continue to rise owing to migration towards urban areas and increasing trend of nuclear families. Housing shortage in urban areas is estimated at 19.3 million units at the end of 2008, up from 15.1 million units at the start of 2005. Housing shortage in urban areas is likely to touch a whopping 21.7 million units by the end of 2014.

Rural areas, on the other hand, will witness a reduction in housing shortage due to migration and conversion of *kutcha* houses into *pucca* houses. The government’s continuous focus on improving the housing situation, especially for population below poverty line, under schemes like Indira Awaas Yojna, Rajeev Gandhi Aawaas Yojna, Two Million Housing Programme, is expected to reduce housing shortage in rural areas. Rural housing shortage is expected to decline to 53.8 million units by 2013-14 from 59.4 million units at the end of 2008.

**Recent industry trends**

Despite strong fundamentals backing the residential real estate, the segment is highly influenced by economic cycles. Owing to global meltdown, the residential real estate market in India too witnessed an astounding fall in demand and capital values, between first half of 2008 and first half of 2009. However, the sector experienced a pickup in demand during the second half of 2009 across major cities mainly attributed to improvement in economy. Residential projects across cities saw several new mid-income housing projects being launched by developers to attract potential buyers. Demand for houses mounted as the global economy improved bringing back financial confidence to the home buyers along with low interest rates. End-users, who had put their purchasing plans on hold due to the fall in affordability levels and job-related uncertainties, started booking houses.
Improvement in demand also brought back the construction activity to back on track. CRISIL Research expects around 668 million square feet of residential supply to be constructed between 2009-11 in top 10 cities (Mumbai, NCR, Bengaluru, Chennai, Kolkata, Ahmedabad, Kochi, Chandigarh, Pune and Hyderabad). These top 10 cities account for around 15-20 per cent of overall supply in urban India.

**Outlook**

Going forward, strong underlying demand would continue to aid an improvement in absorption levels in major cities. Average residential capital values which declined by 18-20 per cent in March 2009 from the highs witnessed during the first half of 2008, remained more or less stable between March and November 2009 in most of the places. Mumbai led the recovery and witnessed an 11 per cent spurt in residential capital values between March-November 2009. According to CRISIL Research, capital values are further expected to witness a modest increase backed by better job security owing to higher growth in the economy in 2010 and 2011. Absorption levels are also expected to remain strong during the economic recovery.
COMMERCIAL REAL ESTATE

The commercial office space in India has evolved significantly in the past 10 years due to change in business environment. The growth of commercial real estate has been driven largely by service sectors, especially IT-ITeS. Previously commercial properties were concentrated towards CBD (Central Business District) areas in large cities. However, with the emergence of IT-ITeS, which had huge office space requirement, commercial development started moving towards city suburbs. It resulted in multifold development of city outskirts and suburbs like Gurgaon near New Delhi, Bandra and Malad in Mumbai, and the Electronic city in Bangalore. In addition, over the last 10 years, locations such as Bengaluru, Gurgaon, Hyderabad, Chennai, Kolkata and Pune have established themselves as emerging destinations for commercial development, which are competing with traditional business destinations such as Mumbai and Delhi. Tax sops on the profits of IT-ITeS companies also led to stupendous development of IT Parks and SEZs.

Demand for office space is directly linked to addition in number of employees, which in turn is dependent on economic growth. When economy slows down, companies hold their expansion plans leading to lower demand for office space. The demand for commercial real estate was on an upswing between 2005 and early 2008, driven by exceptionally high employee additions in the IT/ITeS sector. The strong demand from domestic IT/ITeS companies and captives of large global players was a result of increased business, primarily from the US and European markets. A healthy domestic economy coupled with aggressive corporate expansion plans led to strong demand from sectors such as Banking, Financial Services and Insurance (BFSI) and media and entertainment. Furthermore, limited supply of quality office space led to a sharp increase in lease rentals for commercial office space in most micro-markets, with an average increase of 108 per cent between 2005 and early 2008, according to CRISIL Research.

CRISIL Research has estimated supply of office space at around 172 million square feet in 10 major cities (Mumbai, NCR, Bangalore, Kolkata, Chennai, Hyderabad, Pune, Ahmedabad, Chandigarh and Kochi) during 2009-11. Expected demand during the same period is 70 million square feet Supply in the top 10 cities account for approximately 70-75 per cent of total office space supply in the country.

Recent trends

During the economic slowdown, demand for commercial real estate dropped sharply leading to sharp correction in lease rentals since the second half of 2008. Lease rentals have corrected in the range of 25-50 per cent during the first half of 2008. With demand slowing substantially, most of the urban cities are faced with a humungous oversupply of office space. Subdued demand and rentals has impacted the execution adversely in addition to cancellation of many projects.
Downturn in the commercial real estate market in India, which had commenced during the second half of 2008, continued during the second half of 2009. The sustained decline was largely the result of postponement of expansion plans by corporates, which adversely impacted demand for office space. IT/ITeS, which had been a major demand driver for the sector in the last 2 years, increased utilisation rates of existing commercial space by increasing the number of shifts. The resultant drop in demand for commercial office space led to correction of lease rentals in the range of 25-50 per cent since the peaks touched during the first half of 2008. According to CRISIL Research, in 2010, commercial office lease rentals are expected to decrease by an additional 3 per cent at most of the micro markets, in view of the considerable oversupply across cities and lack of adequate demand.
The retail industry in India has witnessed a slowdown in the past year after increasing at a CAGR of 28 per cent in the 2005-08 period. The industry is expected to increase at a CAGR of 14 per cent in the short term and 19 per cent over the next 5 years. Organised retail penetration has grown to about 5.6 per cent in 2009-10, which is further expected to increase to about 7.3 per cent by 2012-13.

In the past few years, India's organised retail industry has posted high growth rates given improvement in key driving factors namely, lavish lifestyles, high disposable incomes and a propensity to spend. India's retail market was mainly unorganised until early 2000.

### Retail market sizing

<table>
<thead>
<tr>
<th></th>
<th>2007-08 E</th>
<th>2009-10 P</th>
<th>2012-13 P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total retail</td>
<td>Rs 15.5 trillion</td>
<td>Rs 19.7 trillion</td>
<td>Rs 27.9 trillion</td>
</tr>
<tr>
<td>ORP ORP</td>
<td>Rs 0.9 trillion</td>
<td>Rs 1.1 trillion</td>
<td>Rs 2.0 trillion</td>
</tr>
<tr>
<td>ORP ORP</td>
<td>5.5 per cent</td>
<td>5.6 per cent</td>
<td>7.3 per cent</td>
</tr>
</tbody>
</table>

Note: ORP - Organised Retail Penetration
Source: CRISIL Research

### Demand–supply situation

Keeping in step with growth in the organised retail market, the retail real estate market recorded an increase in demand. The supply of organised retail real estate, which was mainly concentrated in Tier I cities until a few years back, spread to Tier II and Tier III cities as well.

Cashing in on the retail real estate market boom, developers in most cities announced new malls, which indicated a large amount of supply coming up in 2008. This, in turn, created an excess supply in the existent weak demand scenario, a resultant of the economic slowdown.

The real estate sector was significantly hit with the downturn in late 2008. A sector that was riding high on the economic boom until recently found itself grounded by the economic slump. In addition, the concentration of such developments rose given the supply of multiple malls in cities. This resulted in shrinking catchment areas and lower footfalls for the existing malls. The sudden downturn not only forced developers to postpone the launch of new projects but also delay those under construction. A number of plans went back to the drawing boards to avoid coming on-stream in this weak market.

Going forward, organised retailing is expected to grow with revival in economy and a strong growth outlook; however, the planned supply in the retail real estate market is much higher than the demand. The total planned supply across 10
major cities (constituting 75 per cent of the pan India market) for 2009-2011 is 115 mn square feet. CRISIL Research estimates the actual supply for 2009-2011 to be 50 mn square feet with the larger share of supply (about 27 per cent) expected to come up in Mumbai.

Absorption to be lower than supply
The organised retail industry is expected to increase at 14 per cent CAGR over the short term whereas the total retail space available is expected to increase at a CAGR of 36 per cent from the current 60 mn square feet to 110 mn square feet by 2011. Hence, absorption is expected to be lower than the supply with the oversupply situation likely to continue in most of the cities.

Trends in lease rentals
In the 4-year period, 2005 to 2008, demand for retail space was higher than the supply, leading to an increase in lease rentals on account of increase in footfalls and penetration of organised retail. During the period, lease rentals increased by 95 per cent (average across 10 major cities). However, after 4 consecutive years of rising lease rentals, 2009 witnessed a sharp decline in lease rentals (average 45 per cent decline) given the economic slowdown. Post the crash of late 2008, the Indian retail real estate market retailers revaluated expansion plans and renegotiated with developers in an attempt to bring down lease rentals in malls. This impacted the development of new retail malls and most of the developers delayed their construction plans.

Lease rentals declined at an average of 14 per cent in 2009 with the National Capital Region (NCR), specifically Noida and Greater Noida, witnessed the sharpest fall in retail lease rentals at 31 per cent. Concentration of malls in several areas of NCR gave rise to a skewed demand-supply scenario, leading to relatively high vacancy levels.

![Average lease rentals across 10 cities](image)

Source: CRISIL Research

Lease rentals to skid further by 6 per cent in 2010
The retail industry has seen a marginal recovery in the recent past due to the economic revival, better job prospects and higher disposable income given the sharp rise in equity markets. Going forward, CRISIL Research expects retailers to remain cautious about their expansion plans despite the industry showing signs of revival. In spite of rentals reducing to realistic levels in malls, retailers are tweaking the size of stores to ensure viability. Retailers are now eyeing prime high streets and mall spaces for expansion plans, considering rentals in these areas have corrected notably following reduced demand. Considering the large number of upcoming malls, we expect retail lease rentals to fall further in 2010 on an average by 6 per cent in view.
## Expected change in retail lease rentals during Dec '09 to 2010

<table>
<thead>
<tr>
<th>City</th>
<th>Change</th>
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</thead>
<tbody>
<tr>
<td>Ahmedabad</td>
<td>0%</td>
</tr>
<tr>
<td>Mumbai Metropolitan Region (MMR)</td>
<td>0%</td>
</tr>
<tr>
<td>NCR</td>
<td>0%</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>-3%</td>
</tr>
<tr>
<td>Bengaluru</td>
<td>-4%</td>
</tr>
<tr>
<td>Kolkata</td>
<td>-6%</td>
</tr>
<tr>
<td>Chennai</td>
<td>-6%</td>
</tr>
<tr>
<td>Pune</td>
<td>-14%</td>
</tr>
<tr>
<td>Chandigarh</td>
<td>-25%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>-6%</strong></td>
</tr>
</tbody>
</table>

*Source: CRISIL Research*
India’s hospitality industry has enjoyed robust growth over the past few years buoyed by a benign economic and political environment. Increase in domestic, business and leisure travel has benefited hotels in India. Rising incomes, higher weekend trips and increased access to travel-related information over the Internet have propelled growth in hospitality. Premium segment hotels are more prominent in major business destinations in India and are dominant in popular tourist destinations like Goa, which attracts a lot of foreign clientele.

**Demand-supply gap assessment**

**Higher growth in demand than supply led to higher ARRs and ORs**

Due to the robust demand growth, the market size of the hotel sector has more than doubled from Rs 77.13 billion in 2003-04 to Rs 179.2 billion in 2008-09, registering an impressive CAGR of 15 per cent. During the same period, supply grew at a much lower rate of 6 per cent CAGR leading to increase in average room rates (ARRs) and occupancy rate (OR).

However, in 2008-09, the market size decreased by around 4 per cent due to decline in revenues. The hotel industry faced a fall in room demand in the wake of the global financial crisis and the 26/11 terror attacks in Mumbai. This was accompanied by large additions in supply across all major destinations. As a result ARRs and ORs fell considerably, having a significant negative impact on hotel revenues.

**Number of hotel rooms by category**

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</tr>
</thead>
<tbody>
<tr>
<td>Premium segment</td>
<td>24,334</td>
<td>24,719</td>
<td>26,457</td>
<td>27,951</td>
<td>29,097</td>
<td>31,018</td>
<td>31,408</td>
<td>32,351</td>
</tr>
<tr>
<td>Mid-market segment</td>
<td>29,001</td>
<td>28,506</td>
<td>28,788</td>
<td>33,094</td>
<td>32,209</td>
<td>34,971</td>
<td>35,885</td>
<td>37,321</td>
</tr>
<tr>
<td>Budget hotels</td>
<td>10,974</td>
<td>10,423</td>
<td>10,119</td>
<td>9,746</td>
<td>8,107</td>
<td>7,783</td>
<td>7,783</td>
<td>7,861</td>
</tr>
<tr>
<td>Heritage hotels</td>
<td>2,492</td>
<td>2,258</td>
<td>2,297</td>
<td>2,567</td>
<td>2,611</td>
<td>2,689</td>
<td>2,703</td>
<td>2,730</td>
</tr>
<tr>
<td>Others (unregistered etc)</td>
<td>30,440</td>
<td>29,816</td>
<td>30,854</td>
<td>31,712</td>
<td>37,368</td>
<td>40,357</td>
<td>45,200</td>
<td>49,720</td>
</tr>
<tr>
<td>Total rooms</td>
<td>97,241</td>
<td>95,722</td>
<td>98,515</td>
<td>105,070</td>
<td>109,392</td>
<td>116,818</td>
<td>122,979</td>
<td>129,982</td>
</tr>
</tbody>
</table>

**Growth (y-o-y)**

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium segment</td>
<td>-2%</td>
<td>3%</td>
<td>7%</td>
<td>4%</td>
<td>7%</td>
<td>5%</td>
<td>6%</td>
<td></td>
</tr>
</tbody>
</table>
Please note that the sections below refer to the premium segment hotels that constitute about 60 per cent of the hotel industry revenue.

**Supply additions hamper hotel revenues despite a revival in room demand**

Buoyed by improving macroeconomic conditions and international tourist arrivals, the premium segment hotels have witnessed a revival growing at 8 per cent y-o-y during the period October-December 2009. Overall room demand across destinations has recovered to pre-crisis levels. However, there was a 10 per cent y-o-y increase in room supply, thereby increasing competition amongst players, as a result ARRs declined by 22 per cent y-o-y. ORs stood at 57 per cent for the current year compared to 64 per cent in 2008-09. Due to lower occupancy levels and considerable cuts in room rates across destinations, revenue per available room (RevPARs) fell by 30 per cent y-o-y in 2009-10.

**Outlook**

**Supply growth to be higher than demand growth**

Going forward, between 2009-10 and 2013-14, demand is anticipated to outstrip supply growth. Demand is expected to increase at a CAGR of 15 per cent while room availability is expected to record a CAGR of 9 per cent across premium segment. Business destinations are poised to see higher growth in room inventory compared to leisure destinations.

**Gurgaon, Ahmedabad and Pune to witness the highest growth in room inventory**

The premium segment room inventory is expected to increase at a CAGR of 9 per cent from 2008-09 to 2013-14 across Mumbai (North and South), NCR, Kolkata, Chennai, Bengaluru, Hyderabad, Pune, Ahmedabad, Goa, Jaipur, Agra and Kerala. Gurgaon, followed by Ahmedabad, tops the growth in room inventory with a CAGR of 31 per cent and 27 per cent, respectively. In absolute terms, North Mumbai, closely followed by Bengaluru, will see the maximum room additions.
With demand growth exceeding addition of supply, hotels are expected to see higher ORs between 59 per cent and 65 per cent over the next 5 years compared to 57 per cent in 2009-10. Average ARRs are expected to shoot up to Rs 8,300 in 2013-14 from the current levels of Rs 7,900 as a result pushing up RevPARs to Rs 5,400 in 2013-14 from Rs 4,500 in 2009-10.