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Economic Outlook

The union budget for 2011-12 presented by the finance ministry seems to have set the momentum of high economic growth for the country with indications of major policy reforms in the financial, agricultural and infrastructure sectors. With an expectation of above 9% GDP growth in 2011-12, the government has tried to address most of the macroeconomic concerns in the current backdrop such as high inflation, high current account deficit and fiscal consolidation. Additionally, with a view to achieve inclusive growth, the budget has provided special emphasis on the rural and social sector schemes.

Keeping a tight leash on government expenditure, the finance minister has set the target for fiscal deficit at 4.6% for 2011-12, lower than 5.1% during the current year. In its move to achieve further fiscal consolidation and plug the leaks in the system, transfer of subsidies henceforth will happen directly to the targeted recipients instead of the current practice of keeping the retail price low.

AN ALLOCATION OF RS 2,140 BN HAS BEEN PROVIDED FOR DEVELOPMENT OF INFRASTRUCTURE, WHICH IS 23% HIGHER THAN PREVIOUS YEAR AND AMOUNTS TO 48.5% OF THE GROSS BUDGETARY SUPPORT TO PLAN EXPENDITURE

Infrastructure development, which is critical for sustaining India's growth trajectory, was once again accorded prime importance in the budget. An allocation of Rs 2,140 bn has been provided for development of infrastructure, which is 23% higher than previous year and amounts to 48.5% of the gross budgetary support to Plan expenditure. Higher allocation to major infrastructure sectors like power, shipping, railways, urban development and road transport has been provided.

On the direct tax front, the exemption limit for the general category of individual taxpayers has been enhanced from Rs 0.16 mn to Rs 0.18 mn in order to provide cushion against the high inflation in the last one year. For domestic corporate taxpayers, the surcharge has been decreased from 7.5% to 5%. However, the Minimum Alternate Tax (MAT) has been increased to 18.5% from earlier 18%. Although it has been increased by 50 basis points (bps), the effective MAT rate will be similar to previous year due a 250 bps reduction in surcharge.

On the indirect tax front, with the aim of preparing the ground for the transition to Goods and Service Tax (GST), the government has maintained the excise duty and service tax rate at 10%. However, in order to expand the tax base while ensuring that the impact is predominantly on sections of society that have the ability to pay, certain new services have been brought under the service tax net. Air travel, investment advice by insurance companies and hotel accommodation where room rent is in excess of Rs 1,000 are some of the services brought under the tax net.

The budget has provided impetus to real estate sector with special emphasis on low cost housing segment. The 1% interest subvention scheme limit has been increased to Rs 1.5 mn from the earlier Rs 1 mn capturing house value of upto Rs 2.5 mn. Another important announcement has been the increase in limit of housing loans that fall under the priority sector lending to Rs 2.5 mn from Rs 2 mn. The unprecedented rise in residential prices across several cities in the last one year has led to such a move by the government so that the intended recipients continue to receive the benefits of this scheme. Additionally, the provision for Rural Housing Fund, which provides housing finance to targeted groups in rural areas at competitive rates, has also been enhanced to Rs 30 bn from the existing Rs 20 bn providing a boost to demand for housing from rural areas.

THE BUDGET HAS PROVIDED IMPETUS TO REAL ESTATE SECTOR WITH SPECIAL EMPHASIS ON LOW COST HOUSING SEGMENT

The budget has made a special provision of creating a Mortgage Guarantee Fund for housing loans to Low Income Group (LIG) and Economically Weaker Section (EWS). Banks and financial institutions are sometimes reluctant to lend to these segments on account of poor repayment capability. This provision will provide the required safety cushion to financial institutions resulting in higher fund flow to this segment.

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AFFORDABLE HOUSING RECEIVED A BOOST WITH THE GOVERNMENT ALLOWING INVESTMENT LINKED DEDUCTION OF 100% IN RESPECT OF ANY CAPITAL EXPENDITURE (EXCLUDING LAND, GOODWILL AND FINANCIAL INSTRUMENT)

Affordable housing received a boost with the government allowing investment linked deduction of 100% in respect of any capital expenditure (excluding land, goodwill and financial instrument) for developing and building housing project under a scheme of affordable housing as framed by Central or State Government. This will provide an incentive to develop such projects in urban areas where affordability is a major cause of concern for majority of home buyers.

The applicability of MAT on Special Economic Zone (SEZ) developers has been a major dampener to the real estate industry since these developers will now have to pay a tax on book profits at a rate of 18.5%. While it was to be implemented under Direct Tax Code from 1st April 2012, the advancement of this tax by one year will increase the skepticism in the minds of SEZ developers about the future tax benefits of developing an SEZ.

THE APPLICABILITY OF MAT ON SPECIAL ECONOMIC ZONE (SEZ) DEVELOPERS HAS BEEN A MAJOR DAMPENER TO THE REAL ESTATE INDUSTRY SINCE THESE DEVELOPERS WILL NOW HAVE TO PAY A TAX ON BOOK PROFITS AT A RATE OF 18.5%.

The overall impact of the budget has been positive on the industry as well as individual tax payers. However, from a real estate perspective, the urban middle income housing consumers who have been reeling under the pressure of spiraling prices seems to have been left out of any meaningful benefit.

Retail Market in Bangalore

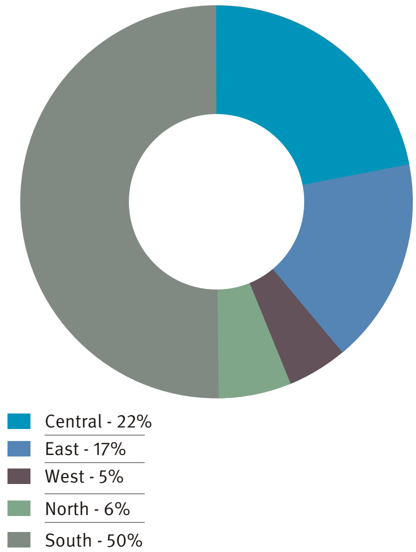
Bangalore has been one of the rising stars on the retail scenario in the southern part of the country. Although the retail sector in the city picked up on a gradual note after the retail revolution took over Mumbai in the west and NCR in the north, it has continuously maintained its ascent in the region. This can be primarily attributed to the city's key driving sector of IT/ITeS and the burgeoning population associated with it.

The growing number of IT/ITeS employees, who are ready to spend, gave the required boost to the retailers and the real estate developers. Also the huge success witnessed by the first few malls developed in Bangalore, was reason enough for other mall developers to follow suit. Today the city is witnessing a range of organized retail formats, whether it is a value mall offering goods at factory prices, or a mall with national players catering to the mid-income segment, or even a mall catering to the upper class with luxury goods. At present, there are about 18 malls operational in the city, comprising almost 4 mn.sq.ft. of organized retail space. Most of them are located in the southern parts of the city, to the tune of approximately 1.73 mn.sq.ft. Chart 1 presents the distribution of the number of existing malls in Bangalore.

The key established retail markets of the city include Brigade Road, Commercial Street, Jayanagar 4th Block and Sampige Road. Post 2006, newer markets emerged in locations like Koramangala, Indira Nagar and Vittal Mallya Road. While these markets saw considerable interest of retailers, of late, new developments have been witnessed in

Chart 1

Distribution of Existing Malls (in number)



Source: Knight Frank Research

locations like New BEL Road, CMH Road and HSR Layout. These developments has been welcomed by the suburban residents, who found the distance to the central markets to be cumbersome, and as a result most of the retail outlets have been witnessing fairly good business. As most upcoming malls are still under construction, many retailers have taken up spaces in buildings at residential areas in the suburban and peripheral locations. The high streets in these locations are moving at a faster momentum due to the presence of the IT population who are residing there and have a higher propensity to spend.

Although presently the retail market has begun to show optimism in the region, the scenario was bleak one and half years ago due to global economic slowdown. The recession in the country led the markets to halt their northward trajectory and take stock of the adverse market conditions. Majority of the mall developments were stalled while developers awaited the market to pick up. This slowdown helped in maintaining a good demand supply equation, especially for markets which were looking at an oversupply situation.

Due to the recession, the rental values suffered significant setbacks in the prime retail locations of the city.

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Retail space rentals in MG Road declined by 30% as compared to their peak values in 2008. The rentals in other key micro-markets like Brigade Road lowered by 33% to reach Rs.270/sq.ft. per month, which were at Rs.400/sq.ft. per month in 2008. Commercial Street, too, was hit by the economic turmoil and rentals decreased to Rs.175/sq.ft.per month from Rs.325/sq.ft. per month charged in 2008. In most high streets, retailers relocated from one project to the other due to the lower rentals offered in the market. Table 1 depicts the decline (in percentage) since the 2008 peak rental values across different retail micro-markets in Bangalore.

Table 1

Micro-markets	Average change in prices 2008 to 2009 (peak to trough)
MG Road	-30%
Brigade Road	-33%
Commercial Street	-46%
Jayanagar	-39%
Indiranagar	-36%
Koramangala	-42%

Source: Knight Frank Research

However, with the strengthening of the Indian economy in the past one year, the city's retail market has been able to somewhat regain its confidence. While the retailers were still cautious of venturing in to new developments, the year 2010 saw a number of high profile transactions taking place in the market. These transactions can be primarily attributed to the commencement of the much awaited retail project, the Mantri Square Mall, at the western suburb of Malleshwaram. Notable lease transactions that took place in the mall include Shoppers Stop, which absorbed around 45,000 sq.ft of retail space, and Taco Bell, which took up around 4,000 sq.ft. Significantly, Mantri Square Mall, with an area of approximately 700,000 sq.ft, along with the 180,000 sq.ft. Gopalan Innovation Mall at Bannerghatta Road, have been the only mall entrants in the past one year. Despite the fact that only two major mall developments became operational in 2010, leasing activity across the city's malls remained buoyant. This can be due to the stable rentals quoted by the developers. Mall rentals remained relatively constant in the first two quarters of 2010, thereby leading the retailers to secure better bargains for their expansion plans. Table 2 denotes some of the key leasing transactions that took place in 2010.

Table 2 Key leasing transactions in 2010

Project Name	Location	Tenant	Area (sq.ft.)
Mantri Square	Malleshwaram	Shoppers Stop	45,000
Mantri Square	Malleshwaram	Taco Bell	4,000
Gopalan Innovation Mall	Bannerghatta Road	Westside	35,000
Gopalan Innovation Mall	Bannerghatta Road	Pantaloons	25,000
Standalone	Koramangala	Croma	14,000
Standalone	Rajajinagar	Star Bazaar	55,000

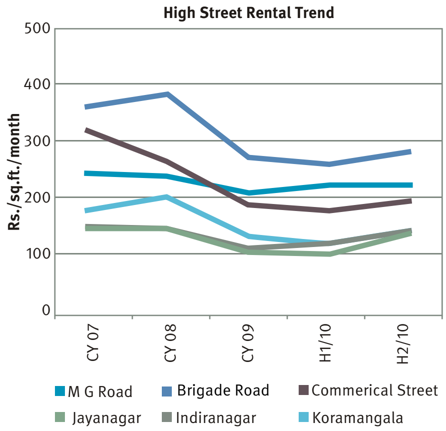
Source: Knight Frank Research

The city's retail market had hit its trough during various quarters of 2009. While the first half of 2010 continued with the trough values in most micro-markets, the second half of the year saw some upward movements in select micro-markets. High streets like Commercial Street and Indira Nagar witnessed an incline of around 8-10% over the first half's values in 2010. Presently, Brigade Road, the prime retail high street of the city, has average rental values of Rs.295/sq.ft. per month, while MG Road which comes second to Brigade Road in terms of premium rentals, charges lease values in the range of Rs.185-220/sq.ft.per month. Brigade Road had witnessed a dip of 33% in 2009 over its 2008 peak values. Today it has regained by 9% over its trough values in 2009. On the other hand, despite the lack of supply, rental values have failed to increase substantially on MG Road, which can be majorly attributed to the ongoing Metro rail works.

At present, Commercial Street and Indira Nagar have ground floor average rental values of Rs.160/sq.ft per month. Other major micro-markets like Koramangala and Jayanagar has average rental values of Rs.130/sq.ft. per month and Rs.180/sq.ft. per month respectively, for ground floor retail space. Meanwhile, malls rentals in locations like Whitefield towards the eastern suburbs and Cunningham Road in the central part of the city have average values of Rs.75/sq.ft. per month and Rs.90/sq.ft. per month respectively for vanilla tenants.

The high street rental trend since CY 2007 to end 2010 has been presented in Chart 2 while Table 3 depicts the mall rentals for vanilla tenants as on January 2011.

Chart 2



Source: Knight Frank Research

Table 3

Micro-markets	Mall Rentals for Vanilla Tenants (Rs./sq.ft./month) Minimum	Maximum
Koramangala	90	130
Whitefield	60	90
Cunningham Road	70	110
Madivala	60	90
Sarjapur Road	70	95

Source: Knight Frank Research

A number of prominent mall developments are presently underway in the city, which are scheduled to be completed in the next two years. Around 5.22 mn.sq.ft of fresh retail space is estimated to be infused in to the city's retail market by 2013. On an interesting note, approximately 52% of the total upcoming supply is expected to be operational this year in 2011, which shall constitute of 8 malls.

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The second quarter of the year is projected to witness the commencement of the 500,000 sq.ft. Royal Meenakshi Mall at Bannerghatta Road while the fourth quarter will see the operations of the 750,000 sq.ft. Brigade Orion at Rajajinagar. Brigade Orion is a part of the commercial cum hotel project Brigade Gateway and rentals for vanilla tenants in this project are at around Rs.100-150/sq.ft. per month. The mall shall have tenants such as Landmark, Star India Bazaar, Westside and PVR Cinemas. Meanwhile, the Royal Meenakshi Mall will have Reliance Trends, Hypercity, The Body Shop and McDonalds, amongst others.

Amongst the other major malls under construction, note can be made of the 1.5 mn sq.ft. Phoenix Market City located off the Outer Ring Road, towards Whitefield, which is scheduled to become operational in 2012. This retail-led mixed-use development is spread across 17 acres of land and has a judicious mix of retail, office space, entertainment and hospitality. Table 4 presents some of the key upcoming retail projects in Bangalore.

With the quantum of retail space in the pipeline, the retail rentals are expected to firm up in the forthcoming months. Given the recent economic slowdown, the retailers will be 'cautiously optimistic'. They are expected to expand their operations but after much deliberation on the market conditions. The retailers are also expected to insist on minimum guarantee and revenue sharing while striking a deal with the developers. This would imply the involvement of the developers in the business of the mall as well. While the success of retail developments coming up in Bangalore is subjective, it would be prudent to assume that given the city's purchasing power and retailer preference, Bangalore shall remain a strong retail market to reckon with in the southern part of the country.

Table 4 Key malls under construction

Project Name	Developer	Location	Micro-market	Expected end date	Area (sq.ft.)
Soul Space Arena	Soul Space Projects	Marathahalli ORR	East	2011	300,000
Soul Space Spirit	Soul Space Projects	Bellandur ORR	South	2011	235,000
ITPL Mall	Ascendas	Whitefield	East	2011	400,000
Royal Meenakshi Mall	JV between Vishala India Commercial Developers & Shankarnarayanan Commercial Developers	Bannerghatta Road	South	2011	500,000
Orion Mall	Brigade Gateway	Rajajinagar	West	2011	750,000
Phoenix Market City	Kshitj	Whitefield	East	2012	1,500,000

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