

Infrastructure sector Pre Budget expectations 2010



Infrastructure sector

Overall industry outlook

The Indian economy has posted an average compounded growth rate of more than 8% over the past couple of years which is significantly higher than many developing countries. To sustain its phenomenal growth and investment, India needs additional investment in Infrastructure. In rapidly developing economies such as India, population growth, urbanization and the demands of an increasingly consumer-driven society place pressure on existing infrastructure, especially basic services such as electricity generation, telecommunications, etc. To meet this growing demand, Government needs to increase the gross capital formation in Infrastructure from the current 5% of GDP to a more sustainable level of 9 to 10% if Indian infrastructure has to match the more advanced Asian economies. This means a target of US \$500 billion investment in infrastructure over the next five years. The furtherance of Indian economy is related to the infrastructure it offers like power, telecommunication, transport, etc

Power sector

The biggest and most immediate need in spending is in the Power sector. To protract the overall economic growth rate the power sector has to grow by at least 9% if not more. India's total installed capacity of electricity generation has expanded from 105,045.96 MW at the end of 2001-02 to 155,859.23 MW at the end of November 2009. But a significant portion of this capacity is idling because of the scarcity of fuels such as coal, gas and uranium. The green energy sector is of late generating interest both from Foreign as well as domestic investors. However, the same would need to be sustained on an ongoing basis for it to make any significant contribution to the total power supply of the nation. Besides the margins in this segment are thin and therefore pose a challenge in attracting large investments.

Telecom sector

The Telecom industry witnessed a compounded annual growth rate (CAGR) of approximately 29% from 2002-03 to 2007-08. Total telephone penetration, including landline and mobile phones, in the country of nearly 1.2 billion stands at 43% - up from 2.8% in 2000 and testimony to the telecom sector's blistering growth. India added 14.98 million new phone customers in September 2009, pushing the number of users to over 500 million - 15 months ahead of a government target

for reaching the milestone. India is the second-biggest cellular market, lagging behind only China, which has over 600 million users.

Transport sector

India has the world's second largest road network, aggregating over 3.34 mn km. According to industry sources, road sector in India would require an investment of at least US \$ 80 billion in next 3-4 years of which US\$ 45 billion is anticipated from private sector.

The Indian Government has launched a number of ambitious projects like the National Highway Development Programme (NHDP) involving a total investment in excess of US\$ 50 billion up to 2012 and the Bharat Nirman Programme that aims to cover every village having a population of over 1,000 or over 500 in hilly and tribal areas, with all-weather roads.

The Indian coastline has 12 major ports and 187 minor ports. All areas of port operation have been opened for private sector participation. The Government of India has identified approx. 276 port projects entailing an investment in excess of US\$ 10 billion. According to the Planning Commission, there is an investment opportunity of US\$ 25 billion by 2011-12 in India's shipping and ports sectors. To meet the increased traffic demands, India's ports are likely to increase cargo handling capacity to 1,855 MT by 2012 from the present 758 MT, with an investment in excess of about US\$ 20 billion, as foreign trade expands. The above mentioned developments will take shape in the form of Public-Private Partnership.

Real Estate sector

Almost five per cent of the country's GDP is contributed to by the housing sector. In the next five years, this contribution to the GDP is expected to rise to 6 per cent. Indian real sector has seen an unprecedented boom in the last few years. This was ignited and fueled by two main forces. First, the expanding industrial sector has created a surge in demand for office-buildings and dwellings. Second, the liberalization policies of Government have decreased the need for permissions and licenses before taking up mega construction projects. Opening the doors to foreign investments is a further step in this direction. The Government has allowed FDI in the real estate sector since 2002. FDI was deemed necessary in the view of making the sector more organized and increasing professionalism. Total FDI



inflows in the real estate sector were recorded at US\$ 27.3 billion in 2008–2009 and US\$ 7 billion in the first three months of FY2009. FDI in the real estate sector expected to witness a US\$ 21 billion increase in the next 10 years.

Key Drivers and Challenges

The key driver as well as the biggest challenge is to get adequate investments for developing the Infrastructure of this Nation. Even though the flood gates of Foreign Direct Investments have opened up long back the action in this space is yet to pick up. The Government has taken a number of steps to spur investments in this sector like setting up an infrastructure fund and lending money at competitive rates. Further, being a priority sector, it can avail all the benefits and effective lending rates from domestic banks. In addition, overseas borrowing is also permitted in this sector without any regulatory restrictions.

Times have evolved and the Government can no longer be expected to bear on its own the entire burden of setting up, operating and maintaining the infrastructure of the country. Public Private Partnership is the key and should be encouraged to meet the ever increasing demand in the infrastructure sector.

However, to attract private investments, the sector needs to offer returns which would keep the interest of investors alive. Classically, Infra projects are capital intensive with long gestation period that have direct impact on the investor's return. The inadvertent delays in completion of the projects do not help the investors cause either.

Of late, quite a few private equity funds have shown interest in the infrastructure sector willing to take long position on the Indian economy. However, one of the critical ingredients influencing their decision to invest is the fiscal benefits which the sector has to offer. This is true internationally also, where Governments offer fiscal benefits for investment in infrastructure to supplement

the returns for the investors.

On the contrary, in India if any investor wishes to invest in sectors like telecom, power, natural gas, road, port, airport, highway, water, etc and is exploring to carve out the undertaking by way of amalgamation or demerger from existing operating company, it loses the tax holiday benefits enjoyed by the said undertaking. Hence, attracting investments in these cases proves to be a challenge.

Industry's expectations/demands from the Government (Union Budget 2010)

Some of the key demands of the Industry from the Government on regulatory and tax matters are:

- The tax holiday benefits should not be denied in the case of amalgamation or demerger of Infra undertakings and the benefits should be available to the amalgamated or resulting company
- As infra projects are increasingly becoming capital intensive and pay-back time is significant, the Government needs to consider restoring the benefit of offering tax exempt interest on long term debt investment in Infra sector to attract higher debt funding
- There are many venture capital funds set up for investing in Infrastructure and Real Estate sectors. However, the benefits of pass through status under section 10(23FB) is restricted to couple of sectors in Infrastructure projects. These benefits need to be extended to other projects in Infrastructure sector like telecom, power, etc to attract higher FDI.
- Unfortunately, under the current scheme of fiscal benefits offered to the Infrastructure projects, there is no benefit offered for timely completion or efficiency of the project and no penalty for delay in completion of the project. Hence, the sometimes projects are stretched beyond reasonable expectations. Though difficult these concepts need to be bought under fiscal benefits. The inter-ministerial group needs to address these issues.

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

This material prepared by Deloitte Touche Tohmatsu India Private Limited (DTTIPL) is intended to provide general information on a particular subject or subjects and are not an exhaustive treatment of such subject(s). Further, the views and opinions expressed herein are the subjective views and opinions of DTTIPL based on such parameters and analyses which in its opinion are relevant to the subject.

Accordingly, the information in this material is not intended to constitute accounting, tax, legal, investment, consulting, or other professional advice or services. The information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser. None of Deloitte Touche Tohmatsu, its member firms, or its and their respective affiliates shall be responsible for any loss whatsoever sustained by any person who relies on this material.

© 2010 Deloitte Touche Tohmastu India Private Limited

Designed by Brand & Communications, DTTIPL