Indian Real Estate

The 2018 story so far

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Housing sales jumped by nearly 8% in the first 3 quarters of 2018

NBFC crisis hijacks Indian real estate's growth story, fallout into 2019

General elections will play a role in the sector's fate in 2019

As we embark on the final lap of this calendar year, it is appropriate to take a quick glimpse of what has happened in the Indian real estate sector during a highly tumultuous 2018.

Given the RBI's alternating cautious and proactive stance towards managing the overall economy, it remains to be seen if 2018 will bring any further surprises for the real estate sector. If not, we can expect fairly steady sailing until the end of the year.

2018 So Far

Residential Real Estate

The year 2018 brought with it a new ray of hope for the residential sector, with both sales and new supply gradually picking up across the top 7 Indian cities – Bengaluru, National Capital Region (NCR), Mumbai Metropolitan Region (MMR), Chennai, Kolkata, Pune and Hyderabad.

As per ANAROCK data, the new launch supply across the top 7 cities in first three quarters of 2018 stood at nearly 1,39,700 units approx., increasing by nearly 18% against the corresponding period in 2017. Housing sales have also witnessed a jump of nearly 8% in the first three quarters of 2018 as against the same period in 2017. While we are still far away from historic peak levels, the positive impact of reformatory changes like RERA and GST has been making itself felt.Indian real estate is grudgingly adjusting itself to an unaccustomed market environment – one of transparency and efficiency. In fact, as per ANAROCK's recent Consumer Survey, 81% of respondents feel that Indian real estate has become more efficient and transparent.

Office Real Estate

From a point of view of market traction, commercial real estate definitely retained its status as the most buoyant sector, both in 2017 and 2018.

With the IMF pegging India's economic growth at 7.3% in 2018, this segment gained – and continues to gain – traction across major cities. Demand for Grade A office spaces is growing and vacancy levels are declining in prime locales.

Simultaneously, India's first REIT listings are a sure-fire draw for liquidity infusions into the office sector. In fact, REITs will cause commercial property players to focus even more on this segment to cater to the sustained demand from occupiers across the IT/ITeS, BFSI, manufacturing and co-working sectors.

In terms of retail real estate, about 85 malls are in the pan-India deployment pipeline over the next 5 years. Of these, over 30 new shopping malls accounting for almost 14 million sq. ft. are expected to open shop in the top eight cities in the next two years.

Low vacancy levels and high rentals in Tier I cities have also kick-started faster expansion of organized retail in tier II cities, including Coimbatore, Lucknow, Ahmedabad, Mangalore and Chandigarh.

The NBFC Crisis

The ongoing NBFC crisis has, for all intents and purposes, hijacked Indian real estate's growth story over the short to mid-term. It will not only freeze funds to the real estate sector but also impact private equity (PE) funds flowing into the sector. That is because PE players will become extra cautious in lending to developers, become more selective, and engage in extremely deep due diligence before making any plays in the currently tense market environment.

Private equity players will prefer last-mile funding, meaning for projects nearing completion. In the short term, funding for greenfield projects will cease to exist. This will inevitably impact new launches across cities. PEs have been seen to be more focused on commercial real estate and commercial real estate developers have also historically shown a marked preference for private equity. However, PEs will definitely increase their risk premium now. Moreover, the residential sector's vulnerability to the NBFC crisis is not limited to curtailed funding for developers alone. As a result of this crisis, it can be expected that home loan interest rates will see a slight rise in the near future, primarily brought on by the dearth of funds. Non-banking housing finance companies will also be a lot more cautious about disbursing loans and will be conserving liquidity till the market returns to normalcy. This can reasonably be expected to put an upward pressure on home loan rates. Along with the formal banking system, NBFCs that provide home loans to individual homebuyers will tighten their norms around home loan disbursements. The absence or scarcity of home loans to homebuyer could exacerbate the already protracted slowdown in residential demand in the short to mid-term. All in all, the NBFC crisis has rattled the real estate industry to the core – much more than the disruptions that recent policy implementations brought on – and now consolidations will galore. Only the fittest will survive this perfect storm.

A Glimpse into 2019

Residential Real Estate

The NBFC crisis will surely have a fallout effect on the early part of the coming year. However, current trends in the Indian housing market and ANAROCK data indicate that there can be a 15-18% increase in the number of new residential launches in H1 2019.
The resultant supply would be anywhere between 96,000 to 98,600 units. This calculation is basis the fact that new residential units across the top 7 cities increased from about 75,970 units in H1 2017 to almost 83,520 units in H1 2018.
Despite the teething pains of game-changing policies like RERA and GST in 2017 and early in 2018, project launches increased by 18% in the first three quarters of 2018 as against the same period in 2017.
Considering this growth pattern and the fact that the real estate sector is looking more upbeat in terms of overall consumer sentiments, builders will focus on launching more new projects across the cities in 2019.
However, the ongoing consolidation process brought on by the NBFC crisis as well as RERA and GST will cause a lot of this supply to change hands. Crises and disruptive policies notwithstanding, residential real estate is picking up slowly and steadily in India and the trend may continue in 2019 as well, even though it may not be quite fast. Unsold inventory has declined from 7.44 lakh units in Q3 2017 to around 6.87 lakh units in Q3 2018 in the top 7 cities.
Meanwhile, ANAROCK's recent consumer survey also indicates that after a prolonged period of fence-sitting, as much as 61% buyers with genuine purchase intentions hope to buy homes in the next 12 months. The conducive Indian real estate environment over the last few quarters has already prompted as many as 24% of the polled buyers to take the plunge.

Office Real Estate

The commercial real estate market will be a strong beneficiary of the country's overall economic growth. Both global and domestic companies will continue investing in India.
The country's pull factors are its massive skilled workforce, rapidly improving and business-friendly investment climate and the fact that a lot of InfoTech work previously done by Indians in the US now needs to be within the country. Many more global and domestic players will commit to large office spaces across the country.
For real estate investors, the commercial segment will certainly remain most attractive in 2019, not least of all because of the huge rental yield difference between commercial and residential real estate.
The current rental yield of commercial properties, including Grade A office spaces in prime locales, is anywhere between 7-8%. For residential properties, the yield – even in the best of locations – is between 2-3%. This is much lower than residential rental yields in thriving global markets like Indonesia, Philippines and Thailand, to name a few.
Also, the increase in institutional investors in Indian commercial real estate is boosting global-level governance in this space. The resulting transparency makes the office space sector even more attractive for new global investors.
Likewise, with increasing demand for Grade A office space, rents will see a steady rise and contractual terms will be far more structured.

The Impact of General Elections 2019

The overall picture that Indian real estate presents for 2019 is favourable. Nevertheless, the industry will only gain traction in 2019 if the macroeconomic environment remains healthy and wholesome, and much depends on if and how the current NBFC crisis gets resolved. The current growth momentum must sustain and not slow down.
The general elections coming up in the first half of 2019 will definitely play a pivotal role in deciding the fate of Indian real estate in the coming year.
It is a known fact that prior to elections, many prospective homebuyers adopt a wait-and-watch approach because a new Government may announce new schemes and policies which may impact the attractiveness of real estate investments.
For this reason, the current time before the general elections is decidedly favourable for homebuyers as they can do some hard bargaining. Developers generally refrain from launching new projects until the general elections results are in.
If we consider ANAROCK data, 2014 (the year preceding the last elections) saw maximum launches and absorption across the top 7 cities with nearly 5.45 lakh units launched during the year and nearly 3.43 lakh units being sold.
However, with the spate of industry-shaking policies that followed the 2015 elections, new launch and sale numbers declined y-o-y. Each new policy announced by the incumbent Government brought its own kind of disruption to real estate, and the sector has not yet recovered completely from the ensuing confusion.
With the next general elections impending, it bears watching if the current Government remains in power to finish the work it has started in reforming the real estate sector, or whether a newly-elected government will be strong enough to hold on to the baton of change and take it to the next lap.

Ongoing Pain Points

As of now in 2018, Indian real estate is still in several stages of turmoil, but some pain points are more prominent than others:

Stalled Projects

The problem of stalled projects in the residential segment – an issue at the core of buyers' discontent in preceding years – must be given more focused attention in 2019. The current Government is proactively seeking solutions to this problem, but we are still nowhere near a satisfactory catch-all solution.

While the NBCC was being roped in to complete the stalled projects, which could have been a significant move with a long-lasting impact on the sector, its current crisis has put this in a jiffy.

If NBCC takes over even 50% of the currently stalled projects, the resultant construction activities can generate massive employment opportunities, especially for the EWS and LIG segments – key target segment for affordable housing.

Also, the apprehension of banks towards construction finance would ease out as NBCC is a Government entity.

Liquidity Crunch

The ongoing NBFC crisis post IL&FS default has made things even more difficult for developers. Post the banking system's freeze on real estate funding, NBFCs and HFC were the sole sources of funds for the cash-strapped developers.

As the NBFCs themselves are struggling, their disbursals of loans to developers have slowed down significantly. If the current NBFC crisis is not resolved soon, the much-anticipated recovery of the real estate sector might get prolonged by a couple of quarters.

High Cost of Capital

In the absence of a bank finance, developers had been resorting to PE funding and other non-formal modes of funding to finance land purchases. This financing route increases the cost of capital drastically.

The RBI recently increased the credit flow to NFBCs and HFCs has offered a glimmer of hope, but it is still not enough. Reducing GST rates and allowing banks and HFCs to fund land purchase will help developers bring down their costs significantly, thereby benefiting buyers in a highly cost-sensitive market.

Slow Pace of Project Development

While there have been plenty of policy announcements, statistics reveal a rather dismal state of affairs for the much-touted PMAY scheme. In 2015, the Government set a target of building 1 crore homes in urban areas in less than a decade.

However, as per available data, only 15% new LIG/EWS homes have been added under the scheme in a span of three years, underscoring the challenge in achieving this ambitious target.

At a more macro level, statistics show that more than 70% of the buildings that were scheduled to be completed in India by 2030 are yet to be built. This is in sharp contrast to a country like the UK, where more than 80% of the buildings meant to be built by 2050 are already completed.

Uninspiring Progress on Smart Cities

The ambitious '100 Smart Cities' mission has also failed to make remarkable progress. A mere 5% of the proposed projects have been completed as of now. Many of the larger metros enlisted under the Smart Cities scheme.

However, the only really visible progress has been in the smaller tier 2 smart cities. In fact, Nagpur, Vadodara and Ahmedabad easily outstripped tier 1 cities like as Chennai, Pune and many other bigger cities.

Insufficient Focus on Sustainable Real Estate

While the growth numbers for real estate development in India paint a big picture, there are still loud alarm bells ringing in terms of on-ground deployment of sustainable real estate – alarm bells which India's urban developers and policymakers must heed.

There is no repudiating the fact that sustainable building is still in its nascent stage in India. As per the Indian Green Building Council (IGBC), more than 5 billion sq. ft. of green building footprint has been achieved in India till date.

Well, while these numbers represent only 5% of the total buildings in India, IGBC has now re-dedicated itself to its goal to make India a global leader in sustainable built environment and to achieve 10 billion sq. ft. by 2022.

To Summarize

Indian real estate showed signs of recovery across sectors in 2018, though it must be understood that 'recovery' and 'revival' are not necessarily the same thing. While end-users are the lifeblood of the industry, investors are the real 'growth hormone'. For better or worse, it is only the return of investors who buy up several properties or fund entire projects in significant numbers that will signal a genuine recovery and the industry.

In short, for Indian real estate to get into firm recovery mode, both foreign and domestic individual and institutional investors need to become active again.

Certainly, it is not only end-users but also investors who are pinning their hopes and aspirations on the upcoming general elections, and on sustainable macroeconomic growth in the country.

At the end of the day, real estate has always been a preferred asset class for investors in the country. Investor activity on the market has been next to non-existent over the past couple of years.

However, like end-user demand, investor sentiment has not evaporated but is waiting in the wings for the market to become more conducive again.