

Real Estate: H1FY19 and Update on 2018

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- The industry witnessed favorable revenue growth. The Government kept up with its affordable housing push, providing incentives to economically weaker and Low Income groups. The industry has also been able to tap some latent demand after a long gap mostly from the end-users. Many more developers are now focusing on offering finished inventory with an aim to cut on RERA led penalty on delays to buyers as well as focusing on optimum utilization of capital to complete projects which would also help them to improve realization. Overall, our sample set of 25 companies reported an average revenue growth of 11.3% in H1FY19 over a lower base of H1FY18.
- Most developers seem to be wary of the impact of factors like implementation of RERA and GST, which were long standing needs for sustainable development of the industry. The implementation though seems to be far from over, with significant number of states yet to take proper measures to implement the much important regulations even after 18 months having elapsed. At the same time, states like Maharashtra, Uttar Pradesh, Haryana and Rajasthan need to be lauded for the pro-activeness in implementing RERA.
- As the industry witnesses a regulatory overhaul for developers, the need to push for more transparent process for obtaining permissions is the next logical step, which has to come from the Government's end. A time bound, single-window clearance regime is the need of the hour.
- An important development was the stress level in the NBFC and HFC segment which are major sources of funds for private developers. This is expected to impact the overall funding scenario in the industry but temporarily.
- REIT listing is expected to now remain on the backburner. A more favorable REIT listing regime in other and much deeper markets like Singapore and sizable demand for commercial real estate in the secondary markets further makes a case for not getting assets listed in India.

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Development: Supply and demand

Commercial real estate: Rise of Gig Economy

Total leasable commercial real estate is approximately 550-575 million sq. ft (msf) and the same is expected to touch 600 msf by the end of 2019 as more projects near completion especially in Bengaluru, Hyderabad, Mumbai Region and Kolkata markets. Thane, Bengaluru, Kolkata, Hyderabad and Amaravati would continue to add more commercial office space going forward.

Most companies with leasing business reported double digit growth during H1FY19 over H1FY18. The growth in lease has been a mix of further addition of leasable space and increase in rents. The segment also witnessed healthy buying and selling activity, especially from foreign institutions.

Co-working spaces have caught the imagination of lessor and tenants alike. As more organisations are focusing on flexible work locations, there is steady increase in the co-working space inventory across metro cities and to an extent in non-metro cities where co-working spaces have doubled up as commercial spaces and start-up/incubation centres. Bangalore, Mumbai, Pune, Chennai, Hyderabad and Delhi are among the key markets for co-works' space. Co-working space may become an answer for non- A grade office spaces to improve realisation and occupancy; and is cost effective for small tenants. The total co-working space inventory across the major cities is nearly 7 msf and is expected to grow to 15 msf over the next 2 years.

Residential Real Estate

Governments move to incentivize affordable housing has come as a shot in the arm for urban and semi-urban population, and first-time buyers are taking benefit of the schemes especially under the Credit Linked Subsidy Scheme. The Government has been able to reach over 2,00,000 beneficiaries and an additional 1,25,000 home buyers are expected to benefit by the end of FY19. This in turn would mean an additional buying of over 1,25,000 units in urban and semi-urban centres in the remaining quarters. Most of the sales though may materialize into sales of some units peripheral markets of major cities and tier-3/4 cities.

Table 1: Pradhan Mantri Awas Yojana (Urban) – Credit Linked Subsidy Scheme

Particulars		Year of implementation			
		2016-17	2017-18	2018-19*	Cumulative(2015-19)
No. of beneficiaries	EWS/LIG	22,607	85,424	47,103	160,969
	MIG	--	27,025	15,843	42,868
Total (no.)		22,607	1,12,449	62,946	2,03,837
Subsidy Released (in ₹ cr.)	EWS/LIG	424	1,918	1,090	3,531
	MIG	--	564	335	899
Total (in ₹ cr)		424	2		

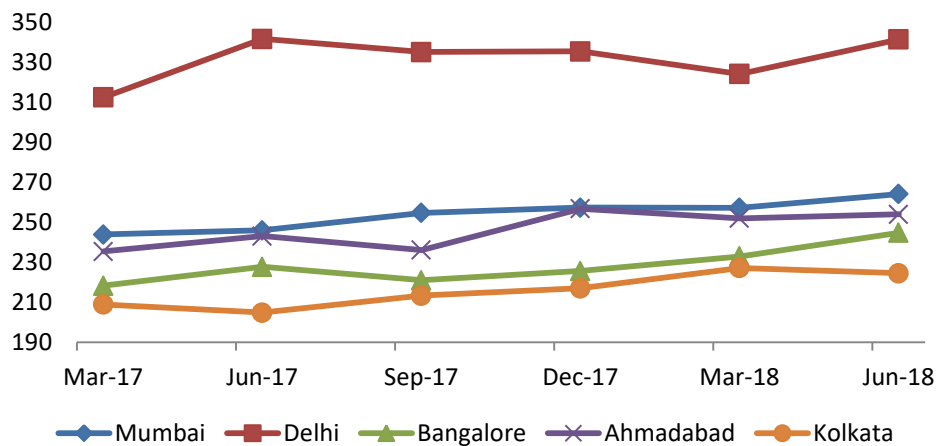
Source: MoHUA as of July 2018, *upto July 2018

Housing inventory in peripheral markets of major cities seemed to have peaked. The demand for the same now remains subdued as fewer buyers would prefer buying properties at escalated prices in far-distant locations. The overall focus for developers would return to development and redevelopment of properties nearer to city centre with good access to public transport and civic amenities.

Government has also been working on key policies to provide concessions to developers for availability of land at economical prices for affordable housing. Some part of the peripheral inventories may continue to stick as development of affordable housing closer to city centres pick-up.

- Post demonetization, the shadow economy for real-estate seems to have hit an all-time low, which has also impacted the prices of properties across key markets. The price index by RBI continued to indicate steady or marginal increase across major markets.

Chart 1: Price Index movement across major cities



Source: Reserve Bank of India

- Delay in completion of projects and thousands of home-buyers being stranded due to erring developers has been a trend which has been in news across markets in India. With the advent of Insolvency and Bankruptcy Code, developers both small and large are being cut short to size. Interestingly, apart from facing insolvency cases, past offences and financial transactions too are under scanner. With the latest tweak in IBC for home buyers, who are now being considered at par with financial creditors, cash-strapped projects may finally see turnaround over the next 1-2 years as they are made to go through the resolution process. But this may well lead to further addition in inventory across markets like NCR, thus softening prices of properties.
- Overall development is expected to be led by Southern region followed by Northern and Western region respectively in terms of project completion.
- The improvement in buying has been limited to few markets; mostly smaller cities followed by the major markets. But it is still early to call it revival in buying sentiment. But a meaningful correction would undoubtedly spur sales which is now long awaited and may provide relief to quite a few developers as well.

Opportunity:

Credit Linked Subsidy Scheme: The scheme is targeted at a large beneficiary pool which would avail subsidy on the credit availed to home buyers in the economically weaker (EWS), low-income (LIG) and mid-income groups (MIG). The scheme would make sizable impact on home buying in non-metro cities than in metro cities given the ticket size of affordable homes. Home buyers are provided home loan interest subsidy on purchase/ construction/ extension/ improvement of their house. This interest subsidy provided is channelized through two central nodal agencies

- **Housing & Urban Development Corporation (HUDCO)**

- **National Housing Bank (NHB).**

Housing Subsidy is available to two broad income categories:

- **EWS/LIG:** Applicants who have an annual income of up to Rs. 3 Lakhs and upto Rs. 6 lakh are eligible to avail subsidy under EWS and LIG scheme respectively. Interest subsidy can be availed at a rate of 6.5%* for a tenure of 20 years or tenure of the loan, whichever is lower
- **MIG:** Applicants whose annual household income is between Rs. 6 - 12 lakh fall under the Middle Income Group-I (MIG-I), whereas those with annual income falls between Rs. 12 - 18 lakh fall under the Middle Income Group-II (MIG-II). Interest subsidy can be availed at a rate of 4% on home loans up to Rs. 9 lakh for a tenure of 20 years (MIG I) Interest subsidy can be availed at a rate of 3% on home loans up to Rs.12 lakh for a tenure of 20 years (MIG II)

Real Estate (Regulation & Development) Act

- As of November 2018, 28 states have notified rules under RERA except J&K where RERA is not applicable, 6 NE states (Arunachal Pradesh, Sikkim, Manipur, Meghalaya, Mizoram & Nagaland) and West Bengal has enacted its own act i.e. Housing and Industry Regulation Act. Over 34,600 real estate projects and 26,800 real estate agents have registered under RERA across the country.

Table 2: Implementation status of RERA 2016

	Total	General Rules Notified	Web Portal	Registration Process
States	29*	21	18	19
UT	7	7	5	6

*RERA Not applicable for J&K #as of November 31st 2018

- Maharashtra RERA is among the most pro-active state RERA followed by Uttar Pradesh, Delhi, Rajasthan and Haryana which have also been actively engaging in getting projects registered and acting on errant developers and real estate agents.

Table 3: Implementation status of RERA 2016

	Total	Establishment of regulatory authority		Appellate tribunal			Total
		Interim	Permanent	Total	interim	Permanent	
States	29*	10	12	22	10	5	15
UT	7	3	3	6	2	4	6

*RERA Not applicable for J&K #as of November 31st 2018

- But RERA in its current form still leaves lot of scope for improvement and a “GST council”- like structure would have been a better suited model for its implementation than leaving power with individual states to form their own regulatory authority, rules and appellate tribunals. Even after over 18 months post implementation, 25% of the states are yet to notify the general rules. 30% of the states are yet to come up with web portals and a registration process.

Real Estate Investment Trusts

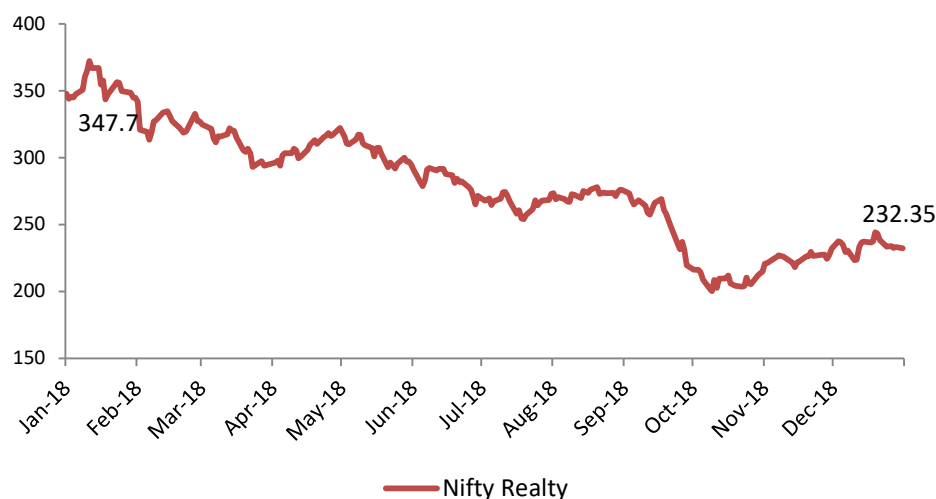
REIT continued to be a no-show during 2018. At the moment, it seems, the market is not yet ready for the instrument and hence, developers looking forward to list may continue to maintain status quo till post 2019 general elections.

Two key factors have kept REIT listing probable’s away:

- NBFC crisis followed by volatility in the emerging markets. The impact was more evident on construction related sectors.
- Realty sector continued to be among the sectors with low investor interest during the year.

Realty sector witnessed FPI/FII outflows during 2018 as per data from NSDL. Nifty realty corrected by 33% during 2018 vs. 98% rise in 2017. Despite regulatory and policy reforms, the demand-supply and overall activity in the sector has remained subdued for a prolonged period which seemed to have kept the investors in the capital markets away from the sector.

Chart 2: Nifty Realty Index in 2018



Source: NSEIndia

Financials of real estate companies during H1FY19

Table 4: Financial performance

	H1FY17	H1FY18	H1FY19
Net Revenue	10,219.2	10,589.7	11,786.4
Expenditure	7,905.8	8,067.2	9,214.2
Other Income	1,203.0	1,082.1	1,136.1
Operating Profit	3,856.4	3,634	3,766.8
Interest	1,863.7	1,853.3	1,694.3
PBDT	1,950.4	1,780.7	2,072.6
PBT	1,717.7	1,560	1,849.4
Tax	389	364.7	432.4
PAT	1,328.8	1,195.3	1,416.9

Source: Aceequity, Financial data of companies covered by CARE Industry

Key strengths: Realty companies exhibited strong performance on the revenue front which was also supported by a low base during the corresponding period in the previous year.

- Revenue growth during the first half of FY19 for our sample-set of companies indicated 11.3% growth over H1FY19. Operating margins contracted by 230 bps for the same. Mid-segment and affordable housing which has been the favoured buying segment is characteristically a low margin offering. Thus the lower margins on a higher revenue

growth trend would continue as a new-trend in the sector. The operating margin of 25 companies analysed seem to indicate the margins hovering around 30-32% levels, well below historical levels of 35-38%.

The sales in Real Estate Industry have bounced back in FY19 after facing headwinds in FY18 due to implementation of RERA and GST. Another factor which has been supporting sales in the industry has been steady addition of high-demand affordable housing units across tier-1 and tier-2 /3 cities. Even though the revenues witnessed uptick, per unit or unitary sales metrics remained steady or indicated a slight decline for many companies.

A positive development has been improvement in the balance sheets of realty companies as they look to pare debt and focus on the development business. Many companies monetised assets and ring-fenced their core-business by segregating other businesses. The Interest coverage for the companies analysed improved from 1.96 in H1FY18 to 2.22 for H1FY18.

Financial Indicators

	Indicators (YOY)	
	FY18	FY19
Revenue Growth	3.6%	11.3%
Expenditure Increase	2.0%	14.2%
Operating Margin	34.3%	32.0%
Interest Coverage	1.96	2.22
PAT Margin	11.3%	12.0%

Source: Aceequity, Financial data of companies covered by CARE Industry

Outlook

- Revenue growth trajectory may continue during the year with over 8-10% growth during FY19.
- We expect further decline in operating margins to 27-30% levels as more mid-segment and affordable housing inventory hits the market for sales during the remaining FY19 & FY20. Nonetheless, affordable and mid-segment housing demand from end-user would drive the industry going forward.
- We expect prices to remain in a lowering trajectory over the next 3-4 quarters as major markets witness inventory clearance. Correction in prices by upto 5% over the next 2-3 quarters cannot be ruled out. Peripheral markets of major cities are expected witness further softening of prices.
- RERA implementation and its impact have been mixed till now. IBC seems to have taken over a larger role of addressing homebuyers problems especially delays and non-performance of developers.
- REIT and other realty-related listings may continue with the status-quo for the remaining part of FY19.