Residential Real Estate: Resilient with Deleveraging Focus

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Synopsis

- Amidst an inflationary environment and turbulent geopolitical scenarios, marked by the Israel-Palestine and Russia-Ukraine conflicts, India remains a beacon of growth. To balance inflation control with economic growth, the Reserve Bank of India (RBI) maintained the repo rate at 6.5% for the tenth consecutive time on October 09, 2024. Additionally, the RBI shifted its stance to Neutral, opening the possibility of a rate cut in the second half of FY2025 (FY refers to financial year- April 01 to March 31). This move is expected to benefit the real estate sector, a significant contributor to India's GDP.
- The Indian residential real estate (RRE) landscape has transformed significantly in recent years. Prior to the pandemic, it grappled with high unsold inventory levels, pessimistic customer sentiments and lender aversion, all contributing to the sluggishness. However, in the post-pandemic era, the sector witnessed a remarkable revival, driven by increased homeownership demand, rising incomes, surged offshoring activity with growing presence of Global Capability Centers (GCCs), infrastructural development and government incentives. Inventory levels, which regularly exceeded 30 months before the pandemic, are now trailing below 18 months. Driven by the expectation of continued robust sales momentum, CareEdge Ratings expects the inventory levels to sustain below 15 months over the next two years.
- The structural shift can be largely attributed to enhanced transparency and a rigorous regulatory framework following the enactment of Real Estate Regulatory Authority (RERA). This has resulted in the exit of many weaker/smaller players from the market, and consequent consolidation within the sector.
- Notably, there has been a significant transition in consumer preferences towards larger and premium homes, which now capture the largest share of total bookings, which was dominated by the affordable segment in the pre-pandemic era. Additionally, sustainability living has become a key factor, while making house purchasing decisions.
- Established developers, having navigated various economic cycles, have cultivated stronger financial discipline, by relying more on customer advances while adopting asset-light growth models. The approach has resulted in significant deleveraging and robust balance sheets. It also positions them well to capitalise on future growth opportunities, with a focus on Environmental, Social and Governance (ESG) compliances and leveraging innovative technologies to enhance operational efficiency.
- CareEdge Ratings anticipates the housing demand to remain resilient over next two years, accompanied by growth in launches and sales of 10-15%. The combination of strong collections and an asset-light growth model will likely maintain robust balance sheets of leading listed companies[1] with the aggregate debt-to-collection ratio expected to remain below 0.70 times. In FY25, aggregate bookings and collections of these players are expected to increase by 15-20%, surpassing Rs. 130,000 crore and Rs.80,000 crore, respectively.

[1] Hereafter includes Ashiana Housing Limited, Brigade Enterprises Limited, DLF Limited, Godrej Properties Limited, Kolte Patil Limited, Macrotech Developers Limited, Mahindra Lifespaces Developers Limited, Oberoi Realty Limited, Prestige Estates Limited, Puravankara Limited, Sobha Limited, Sunteck Realty Limited.

- Through this opinion piece, CareEdge Ratings delves on noteworthy trends in the residential segment, the performance of key listed players including deleveraging trend, as well as views on the credit ratings landscape and the overall outlook for the segment.

Housing sector surfing from headwinds to tailwinds

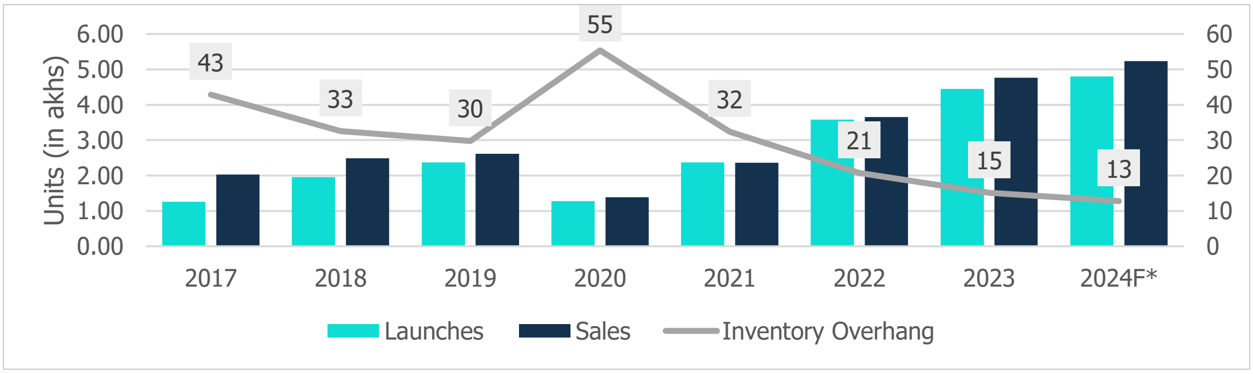
RRE segment, which witnessed nearly a decade of sluggishness, has demonstrated remarkable resilience in the post-COVID era. Prior to the pandemic, the sector was reeling under various challenges of demonetisation, the enactment of RERA, Non-Banking Financial Companies (NBFC) crisis, and pessimistic consumer sentiments. As the industry seemed to navigate these challenges, the pandemic posed a severe setback. However, after a brief hiatus, the pandemic also emerged as a catalyst for resurgence, as sentiments towards home ownership turned more positive than ever. This pandemic-induced demand was also augmented by significant low interest rates, rising income levels, increased household savings and supportive policy initiatives such as stamp duty cuts etc from various State Governments. Consequently, the favourable demand scenario led to consistent multi-year high sales in CY22 (CY refers to calendar year- Jan 01 to Dec 31) and CY23.

The growth momentum in CY24 is likely to mark the third consecutive year of high bookings. Long-term growth drivers include urbanisation, nuclearization and increased offshoring activities in tier-I cities, largely appear intact which continue to strengthen the job market. Additionally, Central and State government-backed infrastructure projects are significantly enhancing connectivity and accessibility, leading to emergence of new real estate development zones. Government Initiatives such as RERA, Pradhan Mantri Awas Yojana (PMAY), and the Special Window for Affordable and Mid Income Housing (SWAMIH) Fund have improved transparency, supply, and affordability, boosting demand. Furthermore, robust institutional investments in CY23 and H1 CY24 indicate adequate capital availability for the RRE sector.

Following favourable trends underpinned the recovery/revival:

- **Consistent decline in inventory overhang:** The industry, once tested through high unsold inventory levels of over four years, have witnessed significant decline in inventory levels to less than 1.5 years in CY23, as reflected from Chart 1. This is mainly due to better demand absorption observed through strong sales momentum witnessed in post-pandemic era, despite robust new inventory additions. This decline in inventory overhang showcases the resilience of the industry and the effective alignment of market demand and supply.

Chart 1: Inventory level declined to less than 1.5 years

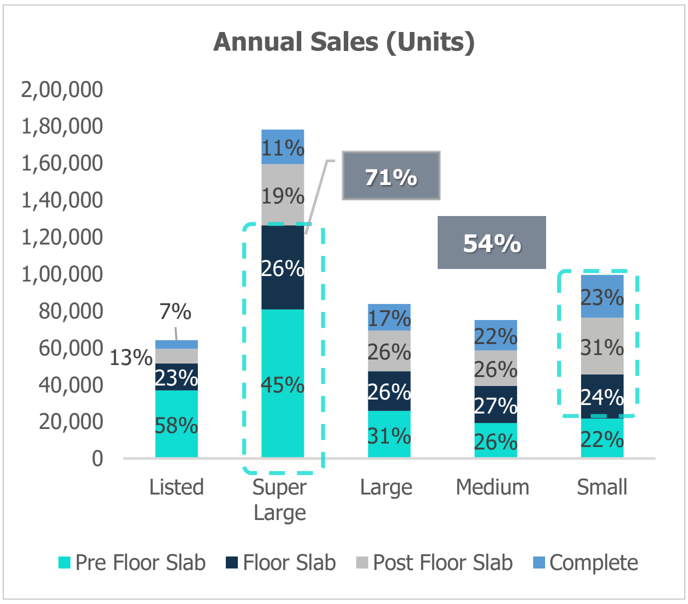


*CareEdge Ratings' Projections
Note: Accumulated for top 7 cities (MMR, NCR, Pune, Bengaluru, Hyderabad, Chennai, and Kolkata). Above period refers to calendar year
Data Source: Anarock (2017-2023)

- **Upward pricing trend:** Characterised by robust sales momentum, reduced inventory overhang, an increasing preference for premium units, rising land prices and higher input costs, an increase in property prices seemed inevitable. In CY23, prices rose approximately 8% nationwide, with Hyderabad, Bengaluru, and Gurgaon experiencing the highest growth rates. Notably, despite this price increase, buyer sentiment has remained largely stable. Based on the expectation of continued sales momentum, CareEdge anticipates that property rates across the country will rise between 7-10% in CY24, primarily driven by the end-user market.

- **Preference towards premiumisation and sustainability:** Following the COVID-19 pandemic, the preference for owning spacious homes with integrated workspaces, home automation and advanced safety features has surged. Ecologically sustainable properties have also gained traction, as individuals are increasingly conscious of reducing their carbon footprint and energy consumption. Rising disposable incomes have further fuelled the demand for luxury homes. Consequently, launches in the luxury segment have increased from nearly 10% in CY17 to over 20% in CY23 and first nine months of CY24. Conversely, the affordable housing segment, which once had a strong foothold, experienced setbacks due to rising demand for aspirational living and weakened buyer financial profiles during the pandemic, leading to a decline in segmental launches from over 40% in CY17 to under 20% in CY23 and first nine months of CY24.

Chart 2: Construction Stage wise break up of sales



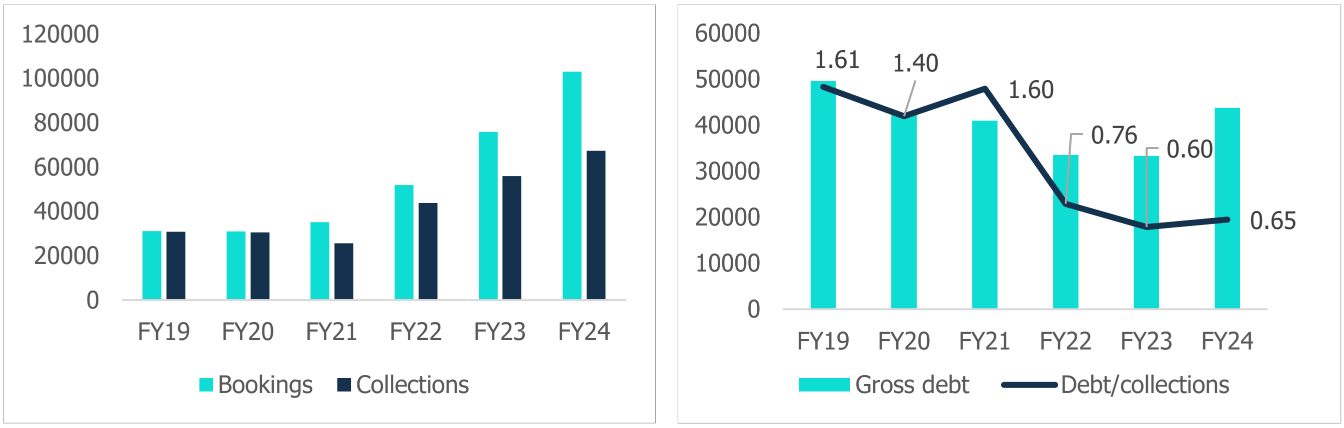
Source: Liases Foras

- **Consolidation theme continues:** Following the implementation of RERA and the NBFC crisis, many weaker/small players faced significant challenges in securing funding and completing projects on time, which ultimately led to their marginalisation. This trend has strengthened over the years, as customers increasingly prefer reputed developers with a proven track record of timely project completion and quality construction. Such established developers have a strong track record of securing significant bookings during the construction phases, while smaller developers tend to achieve more bookings at the completion stage. This shift implies greater challenges in securing initial funding for smaller developers, thus reducing their market presence. As illustrated in Chart number 2, over 70% of bookings for listed and large developers typically occur in the early construction phases, whereas more than 50% of bookings for small developers occur at near completion.

Asset light model and robust bookings drive deleveraging for listed players

Due to an increasing preference for reputed and established players, major residential real estate companies have shown strong performance. In FY24, these companies achieved aggregate pre-sales exceeding ₹1 trillion, marking a significant year on year (YoY) growth of 36% over 47% growth in FY23. Their robust operational performance resulted in increased collections, which doubled from ₹30,000 crore at the end of FY19 to over ₹67,000 crore by FY24. Developers effectively utilised these collections to manage their debt, reducing gross indebtedness from nearly ₹50,000 crore in FY19 to approximately ₹44,000 crore in FY24. As a result, the gross debt-to-collection ratio improved from 1.61 times in FY19 to 0.65 times in FY24, as shown in the chart 3 below.

Chart 3: Pre-sales of leading listed players surpassed INR 1 trillion; Debt/collection remains robust



Source: Annual reports and Investor Presentations of companies considered; CareEdge Ratings

This deleveraging can be attributed to prudent business and capital allocation strategies that prioritise sales over inventory retention, balancing land acquisitions with Joint Development Agreements (JDAs) and raising equity.

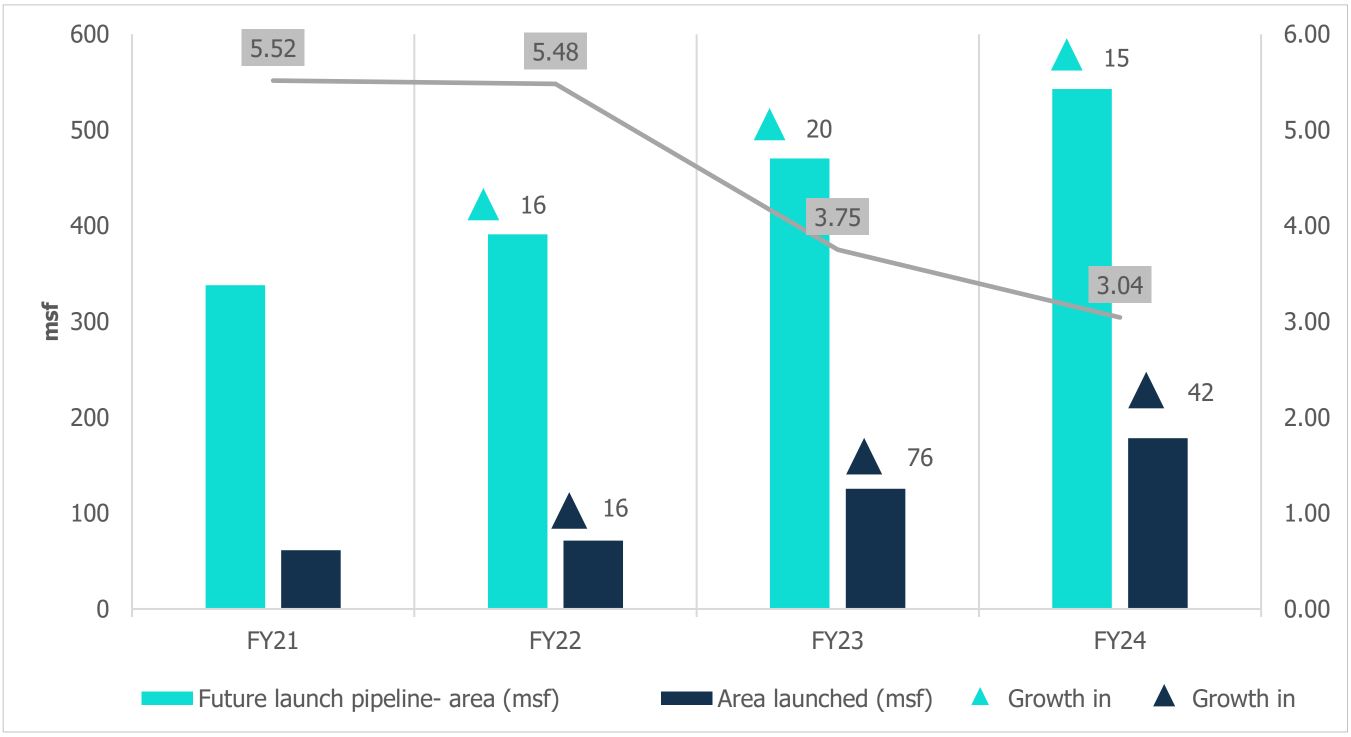
Since CY21, RRE segment has raised over ₹25,000 crore through IPOs, QIPs, and preferential issues, including over Rs.12000 crore raised in 9M CY24, primarily to support growth plans. Going forward, the reliance on external debt for expansion is expected to remain low, supported by a healthy pipeline of customer collections and fundraising efforts.

The asset-light model further reduces dependence on debt, ensuring that the debt-to-collection ratio remains comfortably below unity thus reflecting strong credit profile for the listed developers.

Robust Pipeline for future launches:

Due to favourable industry scenarios, leading players are increasingly focussing on fortifying their market position through consistent acquisitions, either by securing land parcels or via JDAs. In recent years, the identified future pipeline of launches for these entities has grown from ~ 340 million square feet (msf) at the end of FY21 to over 540 msf by FY24 end, reflecting substantial expansion in the pipeline. Yet, the multiple of future pipeline to annual launches remains comfortable at around 3 times in FY24 as shown in the following chart, compared to over 5 times during FY21. This is mainly attributed to the substantial launches in recent years.

Chart 4: Strong future launches pipeline



Source: Companies' Annual reports and Investor Presentations; CareEdge Ratings

RRE Way Forward:

In the aftermath of pandemic, contrary to majority expectations, RRE segment exhibited strong performance in CY21 raising apprehension on its sustainability. Remarkably, the sector not only maintained momentum but consistently achieved multi-year high sales figures.

As we approach the close of CY24, the industry continues to showcase resilient performance. While the trajectory of future growth is evolving, the following trends will remain key in influencing the RRE market.

- **Calibrated launches and Insights from China's RE slowdown:** In the past two years, robust demand has been matched by increased launches, reflecting industry confidence. The pre-COVID replacement ratio (launches to sales) was substantially below one due to sector sluggishness in the sector. However, it has since improved and is now closer to one, indicating calibrated launches. This positions the Indian housing market favourably as compared to China, which experienced a significant downturn after reaching its peak. The crisis in China's real estate sector was largely caused by developers launching significant inventory with limited end-user demand, driven by speculative investment and excessive borrowing. In contrast, Indian developers have adopted a disciplined yet cautious growth approach. However, micro-markets like Hyderabad have recently faced oversupply, leading to a buildup of inventory. Balancing supply with market demand will be crucial to maintain stability and avoid sharp slowdown.

- **Urbanization and infrastructural boost to support the demand momentum:**

  In the recent times, infrastructure development has taken center stage in India's economic growth progression. This is evident in the notable increase in India's capital expenditure, from 1.7% of GDP in FY14 to 3.4% in FY24. The allocation of over Rs 11 lakh crore in the budget for FY24, represents a threefold increase since

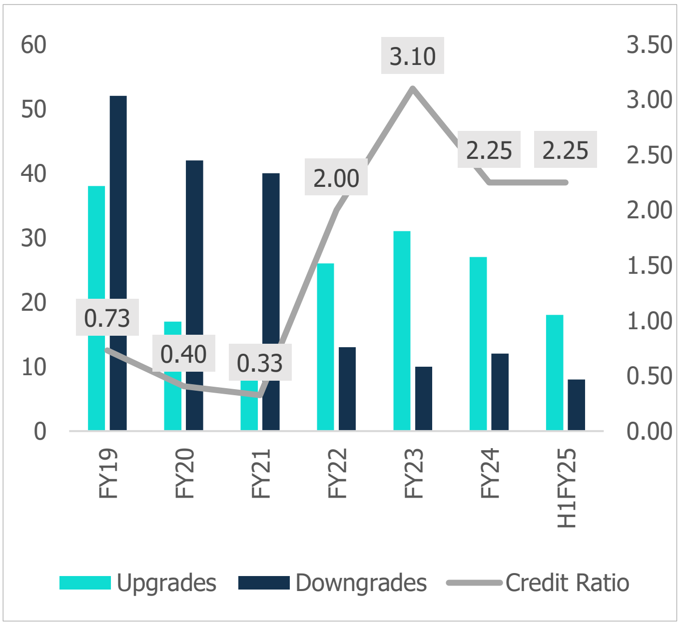
2019. These significant investments not only stimulate economic growth but also augur well for sustained expansion in the RRE segment. Significant infrastructural developments in Tier-I cities, including expressways, airports, and metro systems, are driving demand, enhancing property values, and overall real estate progress. Markets like Gurgaon (NCR) have witnessed significant demand growth and increase in prices owing to robust infrastructural development, strengthening economy of the city and migration of population from nearby cities. In southern micro-markets like Bengaluru and Chennai, growing presence of GCCs is driving the significant housing demand.

- **Impact on affordability- a key ponderable:** Property prices, which remained largely stable from 2018 to 2021, have surged significantly in CY23 and the first half of CY24 across most tier-I markets. Additionally, home loan rates continue to stay relatively higher and are driving up mortgage payments, further straining prospective buyers' budgets. The continued upsurge in prices, amid high interest rates, may substantially impact affordability, potentially influencing homebuying decisions and the choice to upgrade to larger properties. Moreover, impact of slowdown in hiring, particularly within the IT/ITeS sectors, may dampen demand in tech driven cities in medium term and will remain monitorable.

Rating movement:

Following an upswing in housing market since FY22, the sector has continued to maintain higher credit ratio (implies number of upgrades to downgrades). Although there was a slight decline in credit ratio in past two fiscals, it still stands high at over two times, as reflected in Chart 5. The credit ratio continues to remain robust despite recessionary fears and tighter monetary policies, indicating resilient financial performance. Notably, prior to pandemic, the industry consistently witnessed credit ratio of lower than one, primarily due to regulatory reforms, slow sales momentum, and liquidity crunch. The improved credit ratio can be attributed to enhancements in the operational profiles of companies as a result of improved sales, cash flow generation and significant deleveraging. The liquidity for most players is expected to remain adequate for FY25, on account of expectation of robust cash flow generation backed by strong sales in the previous fiscal year and ongoing sales momentum. Consequently, the credit ratio is likely to remain healthy. Although, CareEdge Ratings will continue to monitor the impact of inflationary pressure, interest rate hikes, employment trends and other macroeconomic developments on demand and affordability and the implications for the rated portfolio.

Chart 5: CareEdge's Credit Ratio



Source: CareEdge Ratings

CareEdge Ratings' View

CareEdge Ratings anticipates that favourable market scenario will persist over next two years, with launches and sales growth rates moderating to 10-15%. Strong demand is expected in the mid-income and premium segments. "With healthy sales momentum expected to continue and new launches calibrated to align with anticipated demand, inventory levels are expected to remain robust under 15 months", says Divyesh Shah, Director CareEdge Ratings.

“Developers are focusing on larger homes and premiumization while expanding their presence in India's major cities. Additionally, Environmental, Social, and Governance (ESG) factors along with technological integrations like digital property walkthroughs, property management systems, etc. are becoming increasingly relevant for enhancing sustainability and operational efficiency in the sector” he adds.

Customer preference for established players is driving bookings during the initial construction phases, thus these players are often seen selling entire projects within a year of launch.

“In FY24, the leading listed players collectively witnessed bookings of over Rs. 1 trillion in FY24, marking a robust YoY growth of 36%. A strong pipeline of collections along with increased adoption of asset-light growth strategy is expected to sustain a healthy leverage profile for these players, with, debt-to-collection ratio likely to remain below 0.70 times”, says Amita Yadav, Assistant Director, CareEdge Ratings.

CareEdge Ratings expects pre-bookings and collections for these players to exceed ₹1,30,000 crore and ₹80,000 crore in FY25, respectively, with robust growth of 15-20% over FY24 levels. The credit profiles of established players are expected to remain stable supported by comfortable cash flow position.

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