Real estate sector – on the road to gradual recovery

Low consumer confidence during CY2013 and H1CY14: reduced housing absorption levels, increase in the inventory levels and correction in prices

The year 2013 (Calendar Year; CY) was not good for the Indian real estate sector on account of weak macro economic conditions and lower confidence levels in the country. Rising inflation combined with high borrowing rates as well as slow growth in income and job levels impacted the consumer spending. Continuance of these issues in H1CY14 and the uncertainties related to general elections resulted in continuance of low consumer confidence. Banks' reluctance to lend to the sluggish real estate sector and drying up of other sources of finance such as FDI and PE investments resulted in increase in cost of debt for the developers. On one hand, there was a steep hike in EMIs that the buyers had to bear and on the other hand there was an increase in costs of construction and debt for the developers.

On account of the subdued sentiment in CY2013 and the cautious sentiment in H1CY14, housing absorption showed negative growth and this resulted in high inventory levels. Inventory levels have remained high in most of the key cities, with Mumbai market having one of the highest inventory levels. Burdened with the high inventory, developers offered various discounts and incentive schemes to increase the sales and there was a correction in prices in most of the cities. Commercial real estate was also affected during this period. The vacancy rates have increased and the rental prices have remained stable /reduced in most of the cities.

Outlook

Residential volumes to pick up from Q4CY14 with a nominal increase in prices

With a stable Government at the centre, there is now more optimism in the country. As the new Government wants to focus on reviving growth, the interest rates are expected to decline in the near future. In the recent budget, the exemption limit on account of interest on loan in respect of self-occupied property has been increased to Rs.2 lakh from Rs.1.5 lakh. Based on these factors, sales of residential units are expected to pick up from the last quarter of CY2014. As per RBI data, the annual exposure of banks to home loans as a percentage of total non-food credit portfolio has remained almost stagnant in the range of 9.50% to 9.75% during FY12- FY14 period. Deeper penetration of existing banks as well as upcoming banks will increase the exposure to home loans. With rapid land and infrastructure development as well as improved standard of living in Tier II and Tier III cities, housing demand is likely to increase more in these cities. The Government's announcement to develop 100 smart cities will also provide new opportunities for the real estate sector.

On the supply side, the inventory is likely to remain high, despite the expected pick-up in sales, as developers in various cities have lined up a good number of projects in pipeline. There is a huge housing shortage in mid-income and low-income group categories. Even the new Government has a mandate of housing for all and in order to achieve this, it has allocated funds for cheaper credit to low cost housing. Such incentives for affordable housing projects will encourage more and more developers to undertake affordable housing projects. As far as prices are concerned, downside risk has reduced considerably in metro-cities and in case of Tier II and Tier III cities, prices are likely to increase in the range of 8% to 10%, with the expected recovery in volumes. The commercial sector volumes and prices are also expected to pick-up, but with a lag of one or two quarters.

High cost of borrowing has been a cause of concern for the developers. Granting of "industry status" to the real estate sector will help in quicker and cheaper financing for the developers. The Real Estate (Regulation and Development) Bill, 2013, which will help both the developers and the buyers by instituting transparency and accountability, has been initiated. In this backdrop, the various measures undertaken by the new Government to give a boost to the real estate sector are likely to be seen. The Securities and Exchange Board of India issued draft regulations for Real Estate Investment Trusts (REITs) in October 2013. REITs will provide a new funding option for the developers, investors will get access to income-generating real estate assets and there will be transparency in terms of pricing. In the recent budget, REITs have been given a tax pass-through status to avoid double taxation.

To conclude, with the improvement in macro-economic conditions in the country, the real estate sector is expected to attain a gradual recovery. The various proposals announced in the recent budget for this sector as well as the finalization of various policy initiatives taken for this sector will aid in faster recovery of the sector.

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