June 12, 2018 I Research

Real Estate: Yearly Update and Outlook

Contact:

Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
91-22-67543489

Ashish K Nainan
Research Analyst
ashish.nainan@careratings.com
91-22-67543443

Mradul Mishra (Media Contact)
mradul.mishra@careratings.com
+91-22-6754 3515

Real Estate sector witnessed a slew of policy initiatives and regulatory changes in FY18, especially at a juncture when the sector has been experiencing prolonged period of muted growth in one its largest constituent- residential real estate.

The potential demand in residential real estate i.e. affordable housing offers 6-8 billion sq. ft. development opportunity in India over the next 3-4 years. Majority of this demand remains unmet.

Affordable housing segment of late is being primarily driven by Government policies and incentives. As per Government estimates, over 40 million urban homes need to be constructed by 2022 in order to achieve its housing for all targets. During the last 24 months, the government introduced schemes for affordable housing like interest subsidy for low and economically weaker sections, affordable housing being conferred infrastructure status to ease fund availability for these projects and additional tax-benefit for both developers and home-buyers. The Government is expected to fund 15-20% or roughly Rs. 1.2 trillion over the next 3-4 years in affordable housing. The remaining is expected to come from private investments and PPP projects.

Residential real estate sector started witnessing some revival as more of affordable housing inventory has started hitting the market during the second half of FY18.

Performances of listed companies- NIFTY Realty constituents in particular, indicate possible improvement in demand and more importantly, sales in the sector.

With the economy projected to grow at well-over 7% over the coming years, the need for commercial and warehousing spaces too would grow at a steady pace. Introduction of GST has triggered the need for larger, technologically-driven and centrally located warehouses and industrial spaces.

REITs continued to be a no-show during FY18. Valuations and compliances apart from easier exit options for Commercial real estate investors have led to REITs remaining a non-starter.

Realty market

Indian real estate markets have shown resilience during the past 5 years. Demonetization led to a sharp slump in transactions in the informal property market. It not only affected the secondary market transactions but also led to sudden fall in premium payable for new and old properties. The big ticket or premium residential properties which were earlier perceived to be an investment avenue have stayed with the high income-high net worth individuals and have been hardly traded or down sold to low or middle income group due to price sensitivity which averted a property price bubble.
The RBI continues to direct financial institutions towards controlled but affordable credit. At the same time, regulations like RERA and Insolvency and Bankruptcy Code, have been fixing accountability on developers which has improved consumer and investor sentiment towards the sector.

Residential real estate has rapidly become a more formalised, sustainable and robust business opportunity. Developers have slowly but steadily started catering to the affordable and low ticket segment, which has been long unserved and underserved owing to low margins. On the demand side, support from Government schemes like Pradhan Mantri Awas Yojana and Credit Linked Subsidy Scheme ensures availability of affordable credit for low-cost housing buyers.

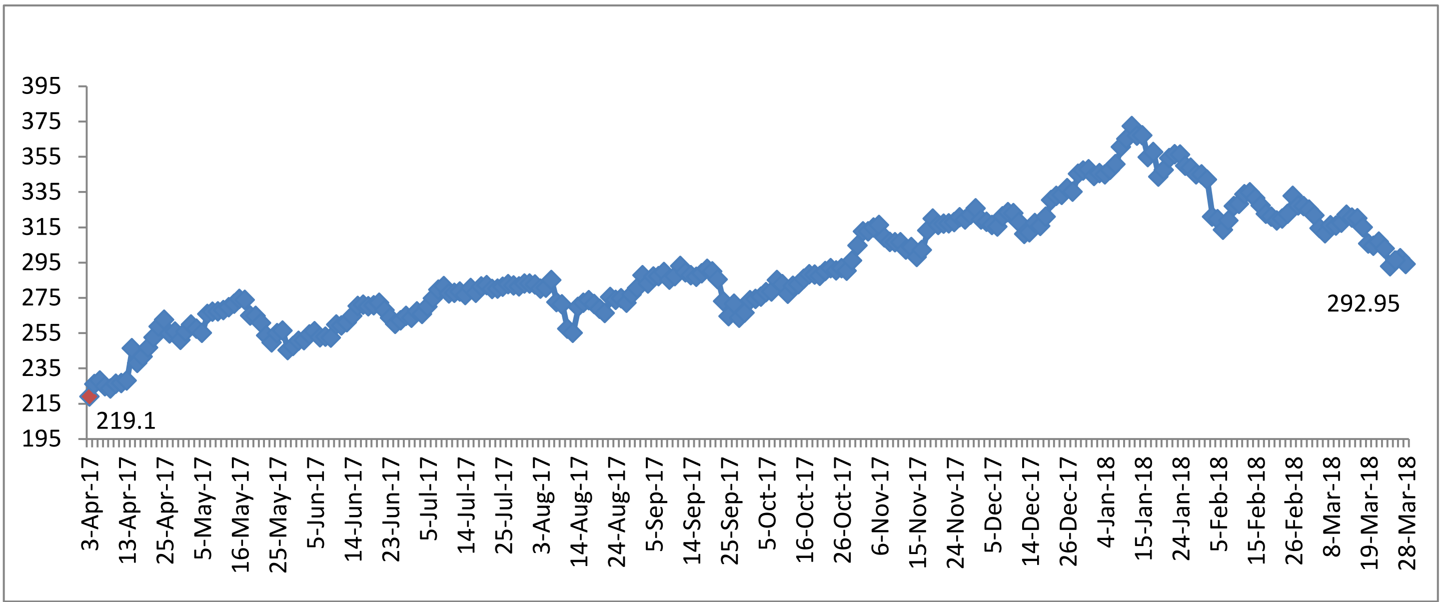
Real estate sector in India:

Affordable housing has been driving bulk of the real estate development in the country. A large part of the affordable housing inventory is being developed by Government and its agencies and pricing of these units too are controlled by these developing agencies.

During FY18, the sector experienced positive disruption due to introduction of RERA in May 2017. Developers across the country chose to put on-hold new-project launches in order to gauge the impact of RERA on their ongoing and tentative projects and the regulatory and compliance measures needed to be taken in order to be compliant. Thus, first half of FY18 remained tepid for the real estate industry.

The second half witnessed large-organised developers launching projects in affordable housing segment which catered to the high-demand affordable home buyers, thereby pushing up their sales during the period.

Graph 1 ***Performance of NIFTY REALTY in FY18***



Source: NSE India

NIFTY realty rallied 58% between Apr-Dec 2017, only to correct during Q4FY19 and settle at 33.6% gain during FY18. The sectoral index had grown at 33% in FY17 as well. NIFTY 50, the broader benchmark index in comparison grew by 9.5% in FY18. The sector is witnessing transformation from a cash-based business to a formally funded industry. Listed real estate companies lowering debt to clean up their balance sheets in order to fund future projects has been another factor which has aided the growth of the sectoral index and its constituents.

Factors like implementation of RERA, investment from PEs and foreign institutions in Commercial Real Estate, Industrial Warehousing and Retail Property segment and policy support on the part of government for affordable housing have led to outperformance of realty companies.

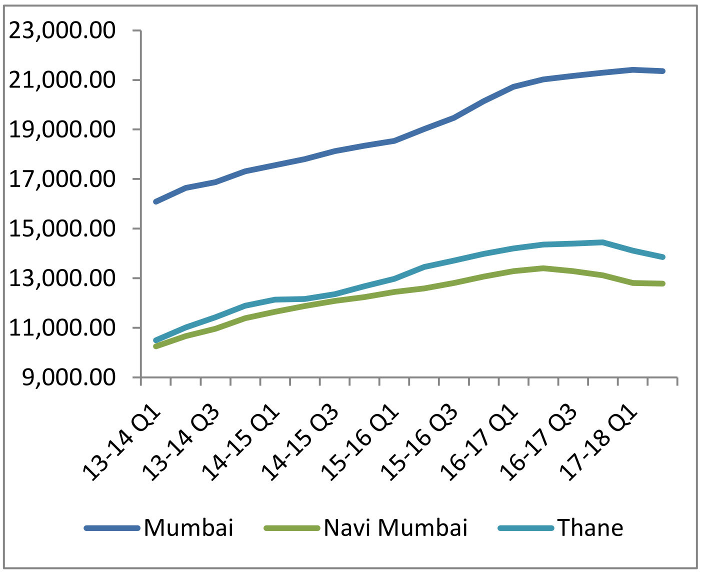
Private Equity investment in the sector crossed $ 4billion mark in 2017. Office and Warehousing space attracted majority of this investment. Among the largest deals during the year, one of the developers in North-India sold 1/3rd stake in their commercial real estate rental arm for Rs. 8,900 crore to Singapore based sovereign wealth fund. Investments in the residential segment have been mostly in the form of foreign funds investing into housing finance companies.

Real Estate Prices:

The trend across 11 markets across India as per data from *NHB Residex* suggests steady assessment prices.

- Inventory overhang: As per data from Economic Survey 2018 released by Government of India, the housing inventory stood at 8.08 lakh units by October 2017, witnessing a 10% decline over the previous reported inventory number. Fewer launches post demonetization and implementation of RERA led to lower inventory addition while sales overtook the number of units added during the year. The same has been a steady trend in the past 2-3 years where the sales numbers have been higher than the number of units added.

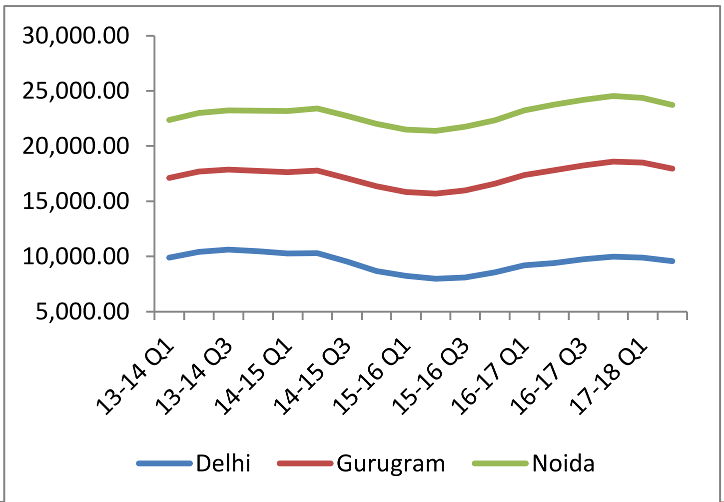
Graph 2 ***NHB Residex (Assessment Prices in Rs. psf)***



Source: NHB Residex

- Mumbai Metropolitan Region realty markets showed resilience but property prices remained subdued throughout the year. Data from NHB recorded prices of residential property between Jan-13 and Sept-17. Peripheral markets like Navi-Mumbai, Thane etc also recorded correction in residential property prices. Among locations with strong demand for Commercial Real Estate, Bandra-Kurla Complex (BKC) has gained prominence due to better infrastructure like roads, public transport, proximity to airport and comparatively newer commercial real estate inventory. Among developing markets, Navi Mumbai

Graph 3 *NHB Residex (Assessment Prices in Rs. psf)*

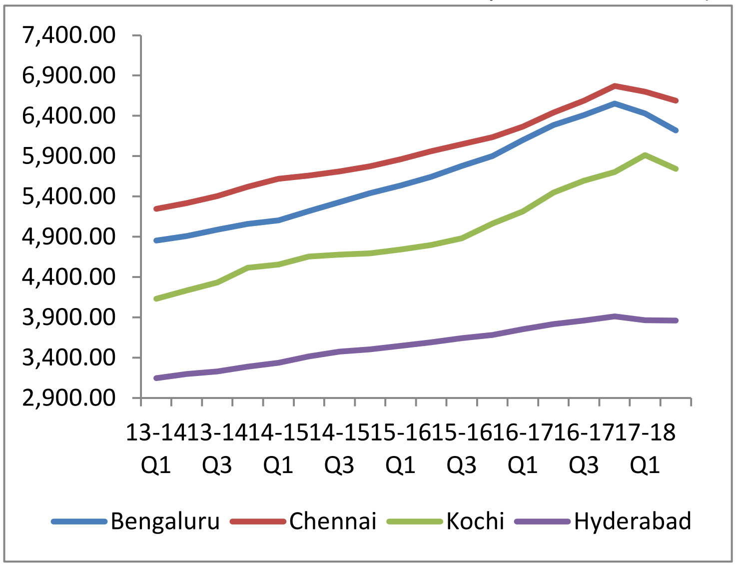


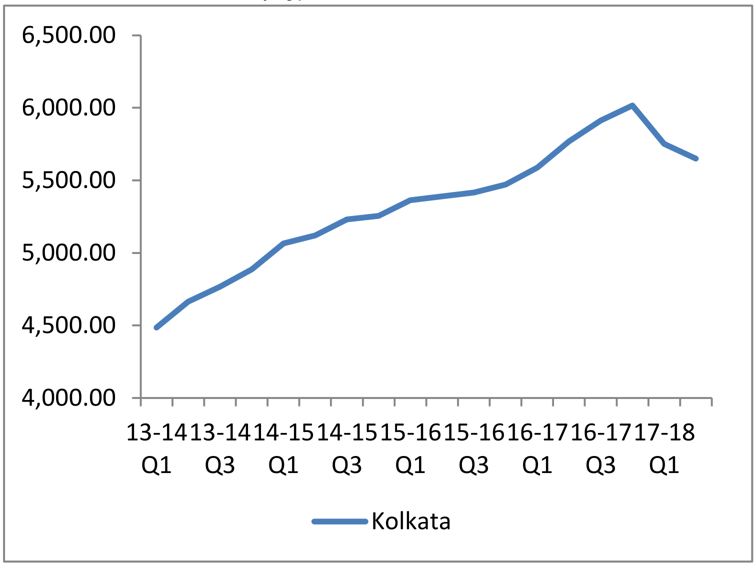
is expected to develop as a favourable commercial real estate location once the Airport Infrastructure nears completion. Navi Mumbai also offers huge potential of becoming one of the largest logistics-hub in the Western region due to JNPT.

Delhi-NCR markets continued to witness pricing and sales pressure especially in the Delhi and Noida property market. Large inventory overhang in Noida-Ghaziabad markets and long delayed incomplete projects has affected the consumer sentiment.

- Mumbai and Delhi-NCR account for over 2/3rd the total unsold inventory among the top-8 cities as per various sources. Unsold inventory consists of completed residential units which have received occupancy certificates and all other requisite approvals.

Graph 4 *NHB Residex (Assessment Prices in Rs. psf)*





Source: NHB Residex

- Southern residential markets, which are predominantly end-user driven, continued to remain subdued. Prices for residential properties witnessed minor correction. With IT industry steadying, sales in residential segment are expected to pick-up during FY19. Commercial real estate demand remained high especially in Bengaluru, which in particular witnessed some of its developers gaining prominence in terms of total commercial real estate owned and managed. E-commerce and outsourcing businesses also contributed to new demand for commercial real estate.
- All the 11 real estate markets as shown in Graph 2-4 witnessed downward correction in property prices during first half of FY18.

Financial performance of NIFTY Realty Constituents:

Table 1 Performance of Nifty Realty Constituents (FY18 vs FY17)

Quarterly Numbers	Net Sales	Operating Profit	Interest Cost	Profit after tax	EBITDAM%	PATM%
			April – March '17 (A)			
Jun- 16	3145.0	1431.6	747.84	477.6	45.5	15.2
Sep- 16	2790.0	1402.4	740.2	413.3	50.3	14.8
Dec- 16	3380.3	1594.6	733.3	530.1	47.2	15.7
Mar- 17	3685.4	1342.3	741.3	631.3	36.4	17.1
FY '17	13000.7	5770.9	2962.6	2052.3	44.4	15.8
			April- March '18 (B)			
Jun- 17	3325.8	1414.7	698.0	441.7	42.5	13.3
Sep- 17	2722.2	1226.9	720.3	373.6	45.1	13.7
Dec- 17	3281.4	1170.0	753.0	137.0	35.6	4.2
Mar-18	4350.2	1637.7	623.4	616.8	37.6	14.2
FY '18	13679.6	5449.3	2794.7	1569.1	39.8	11.4
Change (A vs B)	+5.22%	-5.6%	-5.6%	-23.5%	-460 bps	-440 bps

Source: Aceequity

There are 10 constituents in the NIFTY Realty index and geographically, the operations of these constituents put together cover all major real estate markets in the country. Revenues of these companies constitute income from sale of residential units as well as rental income from their commercial real estate properties.

During FY18, these companies reported total revenue of Rs. 13,679.6 cr, recording a growth of 5.2% over FY17. Operating profit margins for these companies contracted by 460 bps to 39.8% during FY18 vs 44.4% in FY17. PAT margins contracted sharply by 440 bps to 11.4% during FY18 vs 15.8% in FY17. Interest cost of these companies reduced by 5.6% in FY18 over FY17 to Rs. 2,794 crore which is a positive sign.

Policy and regulatory updates:

- *IBC ordinance for home buyers*: The President of India gave his assent to promulgate the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, recognising home buyers as financial creditors. The move is aimed at offering respite to homebuyers in projects which are far from completion and delayed by years where they could directly approach the NCLT seeking resolution under IBC. There are concerns as well to this approach of classifying homebuyers as financial creditors, which may require them to take haircuts in order to resolve cases of defaulting developers. This in turn is a negative for homebuyers who would end up losing part of payments made towards buying a house.
- *Infrastructure and connectivity development:* Development of tier-2 cities and smart cities are a major factor which would further lead to development of commercial real estate in the country. More importantly, providing air connectivity to smaller cities is a major milestone which would lead to large businesses setting up offices in smaller cities thereby generating jobs. UDAN (regional air-connectivity scheme) has been able to unlock the potential of smaller urban centres like Chandigarh, Surat, Ludhiana and many other cities in the North, North-East etc. All of these developments would also lead to development of residential real estate in tier 2 and tier 3 cities.
- *Single-window approval*: The approval process for real estate projects has been one of the major pain-point for the sector. Apart from internal issues like unclear titles and property disputes, getting approval under 21-22 separate heads is a major challenge which includes approvals from municipal corporation, fire department, traffic department and environment and civil aviation authorities. RERA has been able to expedite some of these

approvals where RERA registration is mandatory. Few other approvals have been clubbed together for ease of application and clearance. Certain approvals where host of State as well as Central agencies together grant the final nod, has somewhat been hindering the formation of a single window approval process. The current status-quo on single window approval is expected to continue unless a uniform code for approvals for the sector is introduced in line with RERA which is highly unlikely in the near future.

- *Industrial and Warehousing space*: GST has triggered large scale consolidation in warehousing industry with ease in movement of goods across states making manufacturers opt for larger hubs as warehouses. This would require warehouses with over 1 lakh square feet of storage space depending upon the type of goods. Further, the e-commerce industry which is expected to double its volume of goods shipped and delivered to end-users over the next 2-3 years would lead to demand for large and modern, goods handling and warehousing hubs.
- *Increase in limit for affordable housing under Priority sector lending:* RBI in its June-18 monetary policy increased housing loan limits for Priority Sector Lending (PSL) eligibility from existing Rs 28 lakh to Rs 35 lakh in metropolitan centres (with population of ten lakh and above), and from existing Rs 20 lakh to Rs 25 lakh in other centres, provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed Rs 45 lakh and Rs 30 lakh, respectively. This move is expected to bring more residential units situated in peripheral areas of metropolitan regions to be re-categorized as affordable housing units.

CARE Ratings View:

- *Capital Availability*: Introduction of RERA in mid-2017 is expected to be a major driver for availability of capital for developers. Specialized non-banking finance companies have picked up the business of lending to residential and commercial real estate developers in the last 2-3 years and RERA is a major boost for these financing companies. The capital requirement for the overall sector would be in excess of Rs. 4 trillion over the next 2-3 years especially with more affordable housing projects expected to be launched.

- *Pricing*: The overall price of residential real estate is expected to remain steady. Peripheral markets in larger metropolitan regions will experience correction. The prices are unlikely to witness any major uptick over the next 12 months especially in Mumbai, Bengaluru and Delhi-NCR regions.

- *Office*: Fundamentals for the Commercial real estate has improved with visible improvement in business sentiments. Consolidation across few sectors like telecom may lead to lower incremental growth in occupancy for commercial space from these businesses. ITES and BPO businesses have shrugged off some of the slowdown worries which would lead to steady demand and occupancy from these sectors. BFSI especially Outsourced & back-end services, Private lenders and fin-tech companies are expected to drive demand especially in tier 2 cities as they move part of their operations from tier 1 cities like Mumbai and Bengaluru to cities like Pune, Mangalore etc.

- *Retail*: Limited inventory addition in retail property segment and significant number of single brands retailers entering India offers some opportunity for the segment with demand expected to pick up in untapped tier-2 and tier 3 cities.

- Apart from affordable housing; co-working and warehousing spaces are expected to be major investment opportunities in the real estate market in India. Warehousing business is expected to attract over $ 5-6 billion, predominantly from foreign investors over the next 2-3 years in the country. Co-working space business which provide flexible office space solution at nominal prices have picked especially across major markets like Mumbai, Pune, Bengaluru, Delhi-NCR and Hyderabad and has also been attracting funds from global investors.

CARE Ratings Limited (Formerly known as Credit Analysis & Research Ltd)
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022. CIN: L67190MH1993PLC071691
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457
E-mail: care@careratings.com I Website: www.careratings.com

Follow us on /company/CARE Ratings
/company/CARE Ratings