Budget Housing - *Is SMALL the new big?*

Last one year of market slowdown has led residential developers to realign their product offering to the change in market demand. A unanimous consensus has emerged towards building houses for the lower and middle income class. This trend is in stark contrast to approach adopted during the last 3-4 years by developers in the private sector, when development concentration was towards building middle to high-income housing units that recorded high sales during that period. While the demand for budget housing has always existed, the segment has been under serviced by private developers for reasons including construction cost, land cost, availability of civil infrastructure. The onset of the slowdown has on one hand limited the off-take of high priced residential units by increasing its liquidity, marketability and finance risks. On the other, it has brought to fore a new breed of home buyers willing to take position in the low price segment, backed by finance support from banks. Though the development in the segment has garnered sufficient press coverage, its dynamics remain unravelled. To understand the dynamics of the budget housing segment and establish its characteristics, DTZ researched the emergence of this trend across three major cities in India.

A clear shift towards development of budget houses has been observed across Delhi NCR, Mumbai and Bengaluru. 39,366 out of 48,600 (or 81%) residential units launched during the last six months were priced in the range of INR 1500 – 3000 per square foot. This makes an average housing unit cost less than INR 30 lakh, fitting the budget of the middle income buyer.

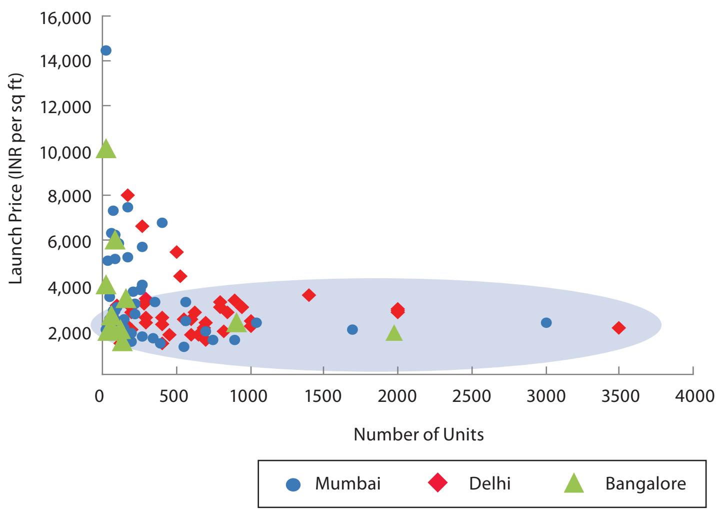
Fire behind Smoke

Survey findings prove the existence of a definite trend towards budget housing. DTZ conducted an exhaustive survey of 100 new projects that were launched in the first half of 2009 across three cities - Delhi, Mumbai and Bengaluru.

Almost All New Supply is Budget Housing

Of the 48,600 housing units launched across the cities, approximately 81% fall under the budget housing segment (see figure above). Most of this new supply was concentrated in Delhi NCR and Mumbai (with

Figure1: Launch Price of Projects launched between Jan – June '09



60% and 32% respectively). Bengaluru reported low residential project launches during the last six months, yet, a majority it was in the budget segment.

Have Registered High Sales

Budget segment has been well received by investors and end-users alike. Approximately 60% of the new supply has been absorbed in the first few months of its launch. Absorption has been the healthiest in Delhi NCR with 66% of budget housing units already sold out, followed by Bengaluru (51%) and then by Mumbai with only 48% of the same sold out.

Budget Dynamics

Location

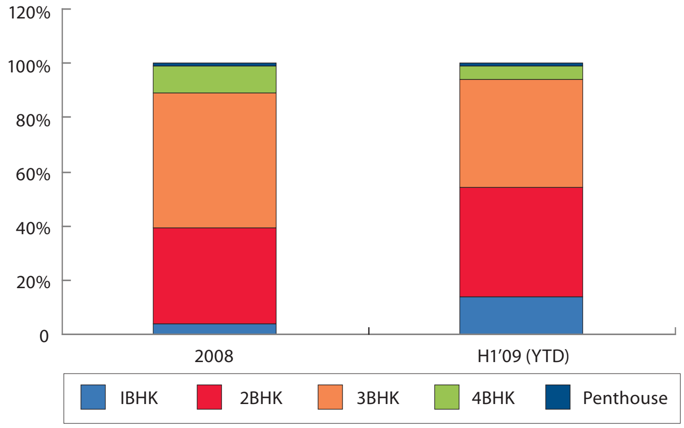
The difference in absorption levels across the three cities can be attributed to the location of such projects within the city. Many a times such projects are distantly located from the city centre, which leads the buyer to question — are these projects affordable in the true sense? While the price of the house offered at such projects may be low, the added cost of accessing the basic infrastructure facilities and transport to the city centre increases the overall cost to the buyer. Thus, projects that are located closer to city centres with a low price tag are perceived as truly budget by the buyer.

In Delhi NCR, majority of the budget projects were launched at locations hitherto considered high end (Gurgaon), thereby posing a more attractive proposition to the end user buyer. In Mumbai, and Bengaluru, such projects are located as far as 2 hours from the city centre, where their pricing is perceived to be only in line with the surroundings, and thus not as attractive.

Changes in the Product Offering

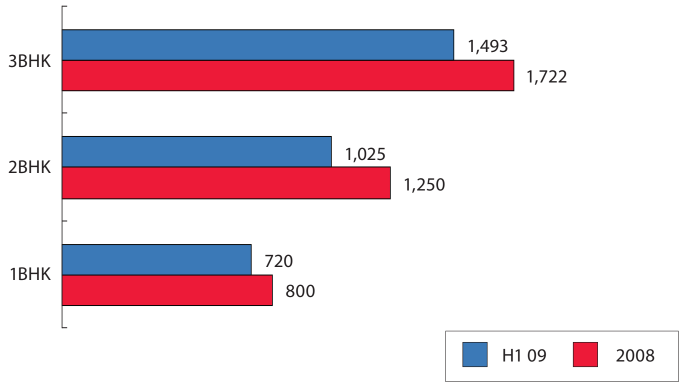
- *Shift in focus* from 2 and 3 BHK units to 1 and 2 BHK units has enabled the developer to reduce the absolute cost of residential units and increase housing density to retain profitability. Other changes in product configuration include reduction in average size of housing units and curtailment of amenities. The developers are now building more 1 and 2 bedroom houses than what they were in 2008 and 2007, across the three cities surveyed. While in Delhi NCR and Bengaluru, the focus has shifted from 3+BHK's to 2 BHK units (8% and 22% more 2BHK units in 2009 respectively than in 2008), in Mumbai 1BHK apartments have registered a 5% increase over last year. (see figure 2)

Figure 2: Shift in housing format



- *The average size of housing units* in the newly launched projects has also reduced. On an overall basis over the three cities, the average size of a 2BHK apartment has come down from 1200 sqft to 1025 sqft in 2009 (see Figure 3). All the units launched in 2009 have witnessed a decrease in unit size as compared to the 2008 launches, to the tune of approximately 8-15%. Of the three cities, Mumbai has suffered the most in terms apartment size in a bid to provide cheaper houses.

Figure 3: Fall in size of housing units (sqft)



- *Features and amenities* have also been done away with to reduce the cost of a residential unit. Almost all housing projects during the last few years offered amenities like free car parking space, clubhouse, gymnasium, swimming pool and power back-up (depending upon the city and its need). Many such facilities are not provided or are optional at extra cost in the newly launched projects. However, basic facilities like car parking and power back up are still being provided in most projects but even this has seen a downfall in cities like Mumbai.

While by reducing the format of residential unit (from 3BHK to 2BHK) and its size, the capital cost of the apartment goes down, further, by limiting amenities to just the basic ones, the recurring cost of maintenance also comes down per residential unit.

Segment Risks

The active development activity in the segment may seem a win-win situation both for the developers and buyers, the segment has its own dynamic set of risks that need to be addressed.

Development Risk

Since most of the projects in the budget housing segment have been recently launched (one year or less), these are either in early construction phase or still on the drawing board. The buyer is thus exposed to delay in completion timelines or, in an extreme case, withdrawal of the project. Many developers, who have ventured into the segment as a means to manage liquidity in the downturn may not find such projects profitable enough during the impending up-cycle.

Infrastructure Risk

Budget housing projects which are located far from the city centre lack the basic physical and social infrastructure facilities commonly associated with city life. Per our survey, most of the larger developments in the segment (of more than 900 housing units) do plan to provide such facilities within the township, these facilities generally figure only in the later phases of development. Thus, the buyer is exposed to a high risk being stranded in a location with little or no support infrastructure.

Across the three cities, budget housing is in its early days of development. Initial success manifested in high absorption levels has already been recorded, pushing more and more developers to enter the segment. The rising supply in the segment is expected to widen the base of organized housing across a larger section of population and ensure composite development of real estate. But, whether this segment would become an integral part of repertoire of the private developer would depend upon the overall profitability of such projects, adherence to product quality and timelines and development of infrastructure around budget locations.