

Real Estate in India – Is it out of the woods?

Of late, the Indian real estate sector has been mired in a lot of problems. While price decline (an average of 25 percent) is manifestation of these problems, most of the concerns of the sector relate to two key issues: demand contraction and liquidity constraints. While liquidity woes emanated from the risk aversion of banks and other financiers, demand concerns were more macroeconomic in nature and are likely to be addressed along with other global economic issues. Almost all other reasons for the realty downturn, viz oversupply, unaffordable pricing, etc. – could be attributed to the twin causes of liquidity and demand concerns.

Before we look at the specific issues of liquidity and demand, it is pertinent to underline some positive developments in the political economy of India. After the clear mandate of recent general elections, many observers are convinced that a stable government could bring decisive change in the growth trajectory of Indian economy. At a macroeconomic level, we expect a much improved governance framework that is effective and efficient in its execution. More specifically for real estate, faster implementation of infrastructure projects and more being lending regime would give the much needed fillip to this sector. Already, post election stock market rally has resulted in lot of developers queuing up for recapitalization through QIP route.

The purpose of this article is to assess whether anything has changed materially in the real estate sector vis-à-vis liquidity and demand in the last few months. This assessment would help bring better understanding of the state of realty downturn, and highlight some early signs that could herald some kind of recovery (or otherwise) going forward. In other words, is the worst over for this sector, or whether we need to be prepared for another round of cyclical downturn before things stabilize.

Liquidity woes – Is the end close?

For property developers in India, liquidity or rather its inadequacy continues to be the most critical problem today. Till about three months back, solvency of even the biggest developers was being questioned. With banks not willing to lend due to their own risk concerns and general credit crunch, a lot of properties and projects under construction were suddenly faced an uncertain future. Moreover, given the high degree of leverage in the industry, the interest burden of the existing debt and its servicing became a daunting challenge for many companies. And with cash flows vanishing due to withdrawal of demand, some serious concerns on the viability of the businesses of these developers started looking more real.

However, the turn of events in the last few weeks makes this doomsday scenario somewhat implausible. One, some big developers have successfully managed to raise capital. DLF, India's largest real estate company, managed to sell a 9.9 percent stake to raise INR 3890 cr (~ USD 800 Mn) in May, and Unitech closed a qualified institutional placement (QIP) to investors raising INR 1600 cr (~ USD 325 Mn) in April. More recently, India Bulls real estate raised as much as USD 550 million via QIP route. While it may be argued that these inflows were mainly due to compulsive (if not distress) sale of equity, what is equally compelling to note is that the investors in these companies see very little risk of bankruptcy going forward. Moreover, such developments are likely to improve the overall sentiment in the industry.

Another important development relates to the decision by the Reserve Bank of India (RBI) to allow restructuring of commercial real estate debt. Developers who are battling tight liquidity in the past few quarters are now breathing easy with debt beginning to flow in. Though it is difficult to put a figure for the whole industry, industry observers estimate that DLF, Unitech and Orbit rolled over

nearly Rs 9,000 cr (~ USD 1800 Mn) of debt in the recent past. More interestingly, few banks have started looking positively at fresh loan disbursements, something that was considered quite impossible a few months ago.

Recapitalisation by many Indian developers in the recent past is expected to reduce the debt burden and help ease the solvency risk of developers

Though there have been positive developments in equity raising and debt restructuring, long term liquidity concerns still remain serious. Private equity money, which was a critical funding mechanism for many projects, is still some time away for these developers. Cost of debt still remains high at a time when the interest rates are declining, and this would continue to put pressure on the P&L bottom line of these companies. More importantly, the revenue growth of these developers show little visibility going forward, and unless that improves the tweaking of liquidity problems could turn out to be short lived. And revenue growth and sustainability is nothing but a resolution of demand and supply mismatch, another key issue that has been the cause of the downturn for many stakeholders in this sector.

Real Estate Demand – Is there a ray of hope?

Revenue growth and its sustainability is nothing but a resolution of demand - supply mismatch, the most important issue that has been the cause of the downturn for many stakeholders in this sector. Till global economic crisis put a halt to the seemingly unending boom of real estate, supply saw an unprecedented increase in last few years. But in last year or so, demand simply dried up as buyers lost faith in developers finishing the project and the economic crisis crippled their consumption power.

The response from market participants has been predictable. There have been two rounds of price cuts by the developers in the residential segment. First, in Oct - Nov last year through heavy discounts and then in Feb this year, through substantial reduction in capital values. Commercial prices have seen a more gradual (though equally substantial) price decline in the last two quarters, with the supply far exceeding the demand in most markets of India. Most of the developers have scaled down their supply projections, and are trying to wriggle out of their construction related commitments made during the peak of the boom. This, along with the price decline, is expected to cushion the glaring supply - demand mismatch prevalent in this sector today.

An interesting point to note is that developers are now redesigned the product to cater to the more affordable segment, as against the high - end buyer, especially in the residential space. DLF, Unitech, Tata Housing and Mumbai based Neptune Group have recently launched and/or received favorable response from buyers of their new affordable housing projects. Though it is difficult to establish a trend from the initial success of these projects, it does signify a strong underlying

demand for affordable housing in India. The commercial segment, though, is facing a great difficult set of market constraints and poses a far bigger revenue challenge for developers. This is not only because these commercial projects do not self-finance themselves the way residential projects do, but also because the underlying demand for office space is still weak and intricately tied up with the revival of global economy.

Another early indicator of housing sector revival is mortgage loan growth. Growth in housing loans establishes a trend from the end users, not just investors, and is a positive indicator of pick up in real estate transactions. The reduction in interest rates, coupled with rationalization of home prices, has brought the price-shy home buyer back to the doorsteps of banks. Several banks have claimed that their home loan disbursements have increased in the last three months. Housing Development Finance Corporation (HDFC) saw its loan disbursements during Jan - March 2009 go up by 17.5% to Rs 12,439 cr. Other home financiers such as LIC Housing Finance, Axis Bank, Union Bank of India have also seen increasing home loan portfolios in the last two months of FY09 and the growth continues in April 2009 as well.

Demand for commercial real estate still remains weak as it is intricately tied up with the revival of global economy. Residential segment has seen flurry of new launches in low cost housing segment, most of which have seen favourable response.

The demand sluggishness, though moving away from the negative sentiment territory, is still mired in lot of problems. It is too early to claim that price declines would be arrested. Market participants, including genuine home buyers, may still anticipate further price cuts and this would keep them away for some more time. Moreover, the faith of these buyers in the execution capability of the developers is still low and would need time to be restored. Clearly, we are still some time away before our demand related problems are conclusively resolved.

Table 01: Low cost projects

Developer (Project)	Location(s)	Unit price (Range)	Remarks
Tata Housing (Subha Griha)	Boisar, Near Mumbai	INR 4 - 7 lacs	The project to have 1200 units, and then an expansion to other cities with 15000 units in next 3-4 years.
Neptune (Neptune Swaraj)	Kalyan, Near Mumbai	INR 5 - 9 lacs	Project to have 4000 units over next two years
Purvankara	Cities in South India	INR 10 - 20 lacs	65000 units to be launched in the first phase of the project
DLF	Pan India	INR 15 - 40 lacs	Investment of INR 15,000 cr
Tanaji Malusare City	Karjat	INR 2 - 7 lacs	Investment of INR 8000 cr. 5000 units to be launched

Conclusion

No doubt, the overwhelming response to election results has been an important factor for pushing markets from distressed case valuations to a fair value zone, the journey from here on, will depend on the policy announcements and how the economy responds to them. The property market has shown the first signs of improvement recently, both on liquidity and demand front. Compared to the dismal months of Jan-Feb 2009, the current environment seems more favorable. This combined with falling interest rates and better lending conditions could be a harbinger of better days ahead for the real estate market. However the improvements are still small and other key indicators are still not looking upbeat. Even if the turnaround proves to be lasting, the fact that leading indicators such as sales to inventory ratio have not bottomed out yet signal a possible further contraction in investment at least in the first half of this year. However, even as everyone from market pundits to retail investors try and gauge whether this rally is for real, it is the policy formulation and implementation of next few months that will chart the course of real estate growth in India.