Real Estate Sector in India: Retrospects and Prospects

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Abstract

The Indian real estate sector has a huge multiplier effect on the economy and therefore it is a big driver of economic growth. Estimates show that for every rupee that is invested in housing & construction, 0.78 paise gets added to the GDP. Traditionally, the real estate sector in India was dominated by a number of small regional players with relatively low level of expertise and many times financial resources. The scenario changed for the better after liberalization. The real estate industry in India has been on a roller coaster ride since 2005. The industry achieved new heights during 2007 and early 2008, characterized by a growth in demand, substantial development and increased foreign investments. However, by mid 2008, the effects of the global economic slowdown were evident here too, and the industry took a 'U' turn. 2009- 10 witnessed substantial slowdown along with part recovery. 2011-14 is & will remain a consolidation phase after slowdown & demand is expected to rise continuously. The present paper traces the past of the India Real Estate Sector, describes its present status & focuses on the challenges it is facing. Then it discusses the ways by which these challenges can be overcome & the future prospects of this sector.

Keywords: Real Estate, Economy, GDP, FDI, Infrastructure

Introduction

Indian economy is one of the fastest growing economies of the world. The real estate industry is considered a growth engine of the economy. Thus, this sector is a critical sector of our economy. It is the second-largest employment-generating sector after agriculture. Growing at a rate of about 20% per annum, this sector has been contributing about 5-6% to India's GDP. Not only does it generate a high level of direct employment, but it also stimulates the demand in over 250 ancillary industries such as cement, steel, paint, brick, building materials, consumer durables and so on. Some of the major areas which have been greatly affected by the growth in Indian economy are Delhi NCR, Mumbai, Hyderabad, Chennai, Bangalore, Pune and Kolkata. This growth is observed in all forms of property such as commercial, residential and industrial.

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Growth of the Indian Real Estate Sector

The Indian real estate sector comprises of four sub-sectors- housing, retail, hospitality, and commercial. The sector has traditionally been dominated by a number of small regional players with relatively low levels of expertise and/or financial resources. Historically, the sector has not benefited from institutional capital; instead, it has traditionally tapped high net-worth individuals and other informal sources of financing, which has led to low levels of transparency.

India's real estate sector has witnessed two cycles over the past 15-20 years, during 1994-99 and 2004-09. Both cycles had unique characteristics, yet displayed notable similarities in the manner of their occurrence. A glance through these cycles reflects some of these peculiarities and distinctions, and helps to gauge the changing dynamics of this industry.

The genesis of India's industrial boom, which began in 1994, can be traced back to the 1991 liberalisation reforms that were undertaken by the ruling Government of the day against the backdrop of a looming fiscal deficit crisis in the country. In addition to several other steps, investments in the real estate sector were opened up for the participation of Non-Resident Indians (NRIs) and Persons of Indian Origin (PIOs) for the first time. The massive investments into the sector that followed coincided with a broader economic and stock market boom. Developers started aggressively reaching out to the NRI / PIO community by opening offices in major NRI-resident countries. The policy-driven bullish cycle culminated in an industrial boom, thereby helping property prices to finally peak in 1995.

However, at this peak, some of the dark realities of the Indian economy started to resurface. Poor banking penetration, high domestic interest rates, a lack of transparency in the real estate sector and insufficient availability of market information, etc. became major hindrances for this growth. As a result, the market tapered off post-1995.

The second known cycle began in 2004, again having its roots in certain critical reforms. The new Telecommunication Policy, 1999 and the Information Technology Act, 2000 gave rise to an era of digitisation, creating a favourable investment climate and ample job opportunities across many Indian cities. For the first time, real estate development expanded beyond the Tier I cities, unlocking opportunities in the commercial as well as the residential property sectors.

The Indian real estate industry has been on a roller coaster ride since 2005. In 2005, the Special Economic Zone (SEZ) Act and the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) facilitated huge investments into building infrastructure to connect larger cities with 60+ smaller cities and towns - provided a fillip to investment sentiment. The full opening up of FDI into selective real estate projects provided a thick layer of icing on the cake. Consequent to the government's policy to allow Foreign Direct Investment (FDI) in this sector, there was a boom in investment and developmental activities. The sector not only witnessed the entry of many new domestic realty players but also the arrival of many foreign real estate investment companies including private equity funds, pension funds and development companies entered the sector lured by the high returns on investments. The real estate sector has been riding through many highs and lows since then. The industry achieved new heights during 2007 and early 2008, characterised by a growth in demand, substantial development and increased foreign investments.

Rising salaries coupled with low interest rates and increased banking penetration converted every homebuyer into an investor, as properties were bought not merely for consumption but for investment even by the salaried class. By mid 2008, the effects of the global economic slowdown were evident in India, and the industry took a 'U' turn. Following the peak of the second cycle in 2008 was a large accumulation of debt with almost every stakeholder. Developers had accumulated land at increasing prices, small investors/ homebuyers had taken huge amounts of loans to purchase additional houses, banks were holding stakes with buyers and developers and institutional investors were also holding stakes with developers. Globally, the collapse of Lehman Brothers triggered a panic, leading investors to deeply analyse the rationality in investments across asset classes. The ensuing economic slowdown and risk of job losses made it difficult for investors to exit from their stakes.

FDI inflow into real estate dropped significantly and what had emerged as one of the most promising markets for foreign investments experienced a downturn. In the Financial Years 2007-08, 2008-09 and 2009-10, the housing and real estate sector attracted FDIs of 8.9%, 10.3% and 11% respectively, of the total FDI in India. However, the financial year 2010-11 saw a mere 6% FDI in this sector. Despite a steep slowdown in the Indian economy and financial markets following the outbreak of the crisis, housing prices in India on an average - witnessed a limited fall. On the contrary - prices started to rise after 2-3 quarters of sharp fall, and even crossed the previous peak of mid-2009.

Further, lack of consistency in rules relating to development of SEZs, increased monitoring of the sector by regulatory agencies, tightening of rules for lending to the real estate sector and increase of key rates by the RBI several times during the last one year, have arrested the growth of the sector. There is a need to streamline government policies and introduce reforms to boost the real estate sector.

The Present Scenario

The Indian real estate sector which has traditionally been an unorganised sector is slowly evolving into a more organised one. The sector is embracing professional standards and transparency with open arms. The major established domestic players in the sector are DLF, Unitech, Hiranandani Constructions, Tata Housing, Godrej Properties, Omaxe, Parsvanath, Raheja Developers, Ansal Properties and Infrastructure and Mahindra Lifespace Developers Ltd to name a few. International players who have made a name for themselves in India include Hines, Tishman Speyer, Emaar Properties, Ascendas, Capital and, Portman Holdings and Homex.

India ranked 20th in the list of world's top real estate investment markets with investment volume of US$ 3.4 billion in 2012, according to the latest report titled 'International Investment Atlas' by Cushman & Wakefield. Bengaluru witnessed the highest number and value of private equity investments at Rs 32.5 billion (US$ 585.57 million) in 2012, recording more than double of investment over last year, followed by Mumbai with Rs 13 billion (US$ 234.17 million) and National Capital Region (NCR) with Rs 7 billion (US$ 126.09 million) of investments. The sector is set for robust inflows of US$ 4-5 billion from overseas investors in the next couple of years, with Bangalore, Delhi and Mumbai emerging as the favourites, according to Jones Lang LaSalle, a global real estate consultancy giant. The total revenue generated in fiscal 2011-12 stood at around 314 million USD. Some projects in mass housing segments that sold well were priced in the range of Rs.4,000-5,500 per sq. ft. in areas such as Noida, Navi Mumbai and Bangalore. Projects in the Rs.16,000-19,000 per sq. ft. range in Central Mumbai, too, sold well.

After undergoing corporatisation and professionalisation, today real estate is recognized as one of the key sector contributing to the country's economic development. India's real estate sector is estimated to have a total supply pipeline of close to 3.6 billion sq ft lined up for completion in the year 2013, with about 98% of this being concentrated in the residential, said a report prepared by CBRE titled "Assessing the Economic Impact of India's Real Estate Sector". The size of the Indian real estate market is expected to touch 180 billion USD by 2020.

Opportunities for the Indian Real Estate Sector

- **Growing Urbanization**

  Urbanisation in India has been increasing at an unprecedented rate, with almost 71 million people added to the urban population from 2001 to 2011. At this rate, close to 534 million people (greater than the combined population of the United States, Russia and France) will live in Indian cities by 2026. This offers tremendous opportunities for real estate development, particularly for housing.

- **Growth in Household Income**

  India's household income is expected to increase by an average INR 60,000 per annum over a period of six years from 2009-10 to 2015-16. This is expected to fuel consumption and be a support base for growth in India's organised retail industry. Industry research indicates that out of the top five priorities of household spending, three categories belong to the retail segment. Also, as per the Centre for Monitoring Indian Economy (CMIE), close to 30% of a total household's income is spent on retail categories such as grocery, apparel and food & beverage. The most noticeable increase in income is likely to be observed in urban areas, which will result into further investment in the development of organised retail real estate.

- **Growth in Information Technology / Services Industry**

  High growth in the information technology and outsourcing industry is a major demand driver for the growth of commercial real estate space in the country. This sector is the biggest office occupier in the country, comprising of approximately 70% of the entire office stock (including IT parks and special economic zones). As the IT industry grows in size, the demand for commercial real estate is likely to increase. This provides a significant opportunity for real estate developers to step in to meet the requirements of this sector.

- **Easy Availability of Finance**

  Today, various national and multinational banks are present in India that has made the home/ property loans easily accessible. So, buying a property is not difficult even for those belonging to middle-class. Thus, it has enabled the overall growth of the Indian real estate. Demand for houses increased considerably while supply of houses could not keep pace with demand thereby leading to a steep rise in residential capital values especially in urban areas.

- **Attractive for Investors**

  All types of assets have depreciation value. Investment in property is believed to be the smartest move as chances of loss is negligible. In our country, if a person having a property of his owns it is a matter of pride for him & the attachment to the property is massive. Also, it is the most profitable investment in India.

Challenges Faced by Real Estate Sector in India

While the sector offers ample opportunities for development across verticals, there are certain intrinsic challenges that hinder growth of the sector. Factors such as high borrowing costs for developers, lack of institutional funding, liquidity issues and slow (and uneven) development of urban infrastructure are some of the key challenges facing the sector.

- Foreign investment is also a critical factor primarily on account of the capital intensive nature of the sector. While domestic financial institutions have been willing to lend to developers for real estate development, their borrowing costs are high and regulations are very stringent. Unlike developed nations, India still does not allow concepts such as real estate mutual funds and investment trusts. Such challenges limit the sources of funding for the sector, which in turn restrict private sector involvement in large scale construction activity in the country.

- Infrastructure development also plays a pivotal role in unlocking the potential of cities by decongesting city centres and developing new suburban towns and cities. The pace & level of infrastructure development in India is not very satisfactory. Increasing population and land paucity continue to exert pressure on city limits, thereby highlighting the need for a balanced development of infrastructure. Suburban towns have been mushrooming around key cities due to limited space availability and high land prices in city centres. Hence, a multi-pronged approach is required that aims at strengthening the delivery of urban infrastructure and ensure that infrastructure development precedes real estate development in order to provide for more sustainable and self-sufficient cities. Fast tracking approvals, execution and completion of urban infrastructure projects will enhance confidence in private players and will allow for greater private sector participation in real estate development.

- Obtaining the several permissions to begin construction of a project can take as much as two years. During this time, the cost of acquisition or even just holding the land for a project rises. builders are already beset with the increased costs of license costs and cost of construction.

- Economic weakness continued with the associated apprehension of employee downsizing and salary freezes, which adversely affected consumer sentiments. Persistence of adverse sentiments, high inflation and high interest rates which reduce affordability, coupled with high property prices, continue to hinder any improvement in demand.

- The industry is grappling with labour shortage. Ernst &Young reported 30% labour shortage in its report which is exerting pressure on the real estate sector. The situation is expected to worsen in next decade when the demand is expected to increase three-fold.

Key Recommendations to Encourage the Real Estate Sector

Following are some key recommendations that can help spur growth of the sector in the coming years.

- **Promotion of Affordable Housing**

  About 85% of India's housing shortage of 18.4 million units in 2012 was concentrated in the

EWS and LIG sections. In order to bridge this gap, affordable housing schemes should be promoted across the country, with active participation from the private sector. This will not only fuel construction activity across the country, but also promote growth in allied industries such as construction materials. Streamlining the approval process for affordable housing projects, augmenting the supply of land at affordable prices and subsidising construction costs through investment in innovative construction technologies are steps that will promote growth in this sector.

- **Easing Supply Bottlenecks**

  India's rapid urbanisation has fuelled demand for housing and support services across the country. However, the urban limits of our cities are often constrained by slow and uneven release of land parcels for development. These supply bottlenecks can be resolved through concerted efforts such as permitting higher density developments by increasing FSI norms, releasing land parcels for development on a sustained basis and encouraging private participation in land aggregation. Recent steps taken by the Delhi Development Authority (DDA) to implement a policy of land pooling in new development zones of the city, allowing owners to accumulate their land parcels and develop the land jointly with private players is an example of efficient management of supply dynamics in our urban centres.

- **Streamlining the Approval Process**

  The sector has been bogged down by multitude of regulatory approvals which need to be cleared by developers to commence construction. Approvals regarding building layouts, ownership, environment clearances, structural planning, utilities, amongst others, are time consuming, cumbersome and are often delayed. Hence, it is important to facilitate policy measures that streamline approval processes (both at state as well as at national level), which help in reducing the number of approvals required for real estate projects. There should be a "single window" clearance system. This can be enabled by establishing regulatory bodies/investment boards to oversee the approval process for real estate projects, especially for large scale integrated townships.

- **Making Funding Easier**

  New instruments of funding should be permitted for the sector, amongst the most prominent of which are the Real Estate Investment Trusts (REITs). REITs could provide an additional exit route for investors and enable retail money to be channelized into the sector through a regulated network. The introduction of REITs would propel the sector by spurring capital inflows and bringing institutional credibility. Other key steps that can be undertaken to promote funding for the sector include expanding the credit limit for realty projects from the present 2.8% to as high as 25-30%, reducing borrowing costs for developers (especially from banks and non-banking financial companies) and reduce the risk weightage attached to the sector. These measures can be further supported if the government provides an infrastructure status to real estate projects (particularly large integrated townships). This will help the sector in securing long term loans at lower cost, and also avail the tax benefits provided to infrastructure sectors such as power and railways.

- **Sustained Infrastructure Upgradation**

  Infrastructure upgradation is imperative for the spatial spread of real estate in the country. The development of peripheral towns in India has largely been led by the private sector with public infrastructure not being able to keep pace with development. Hence, for the country's urban sprawl to flourish, a multi-pronged approach is required that aims at strengthening the delivery of urban infrastructure and ensure that infrastructure development precedes real estate development in order to provide for more sustainable and self-sufficient cities. Fast tracking approvals, execution and completion of urban infrastructure projects will instil confidence in private players and will allow for greater private sector participation in real estate development.

Government policies have been instrumental in providing support after recognising the need for infrastructure development in order to ensure better standard of living for its citizens. In addition to this, adequate infrastructure forms a prerequisite for sustaining the long-term growth momentum of the economy. India needs to invest US$ 1.2 trillion over the next 20 years to modernise urban infrastructure and keep pace with the growing urbanisation, as per a report released by McKinsey Global Institute (MGI

- **Engaging Retail Investors**

  Easier investment norms should be provided for end users and investors for attracting investments in the sector, especially in residential real estate. Reduced interest rates and decreasing the limit of margin money requirement will attract more retail investors towards the sector and help propel real estate demand.

- **Research & Development Activities**

  The Government must provide incentives to the public and private sectors to take up R&D activities for new building materials and technologies so that the industry can deliver low cost, affordable, sustainable and environment friendly housing and building structures.

Prospects

In the years to, the opportunities in the real estate sector will attract more global players to India and hence will help the industry to mature, become more transparent, improve management and adopt advanced construction techniques. With real estate reaching a point of saturation in developed countries and the demand and prices falling, global real estate players are looking at emerging economies such as India for tapping opportunities in real estate. Indian real estate will stay attractive due to its strong economic fundamentals and demographic factors. Moreover, there is a high level of global uncertainty looming over the developed and developing nations of the world. While developed economies are still struggling to regain their growth momentum, developing countries including India and China are expected to grow at a reasonably high rate. Investments in Indian real estate will fetch higher returns for investors as compared to other global markets. The Union Budget 2013 is looking forward to improve the sector sentiment further and at the same time re-stimulate its growth.

Some of the recent policy initiatives which are expected to serve as a trigger to boost the investment in the real estate sector in India include:

- Foreign citizens of Indian origin have been granted permission by the Reserve Bank of India (RBI) to purchase property in India for residential or commercial purposes.
- The Reserve Bank of India in 2012 allowed established real estate developers and housing finance companies to raise up to $1 billion through external commercial borrowings.
- Foreign direct investment (FDI) in multi-brand retail was permitted. Pranab Dutta, Chairman, Knight Frank India, a real estate consultancy, felt that “This will attract foreign investment which will not only benefit the retail industry but also boost the demand for commercial real estate”.

Fig. 1 shows the projected growth (in Billion Rupees) of Indian Real Estate Sector by 2015.

The year 2013 is likely to reap the benefit of the Real Estate Regulation Bill and the Land Acquisition Bill. The change in sentiment on account of these measures will certainly make 2013 a much better year in comparison to the last year. Anshuman Magazine, Chairman and MD, CBRE South Asia Pvt Ltd, said, “The potential for development and growth in the real estate sector is tremendous. It is expected to generate over 17 million employment opportunities across the country by 2025, thereby making a significant contribution to the GDP. However the industry does require the support and encouragement of policy makers in order to achieve its goals.”

Conclusion

The real estate sector has transformed from being unorganised to a dynamic and organised sector over the past decade. India has huge potential to attract large foreign investments into real estate. To tap this potential the government should address issues such

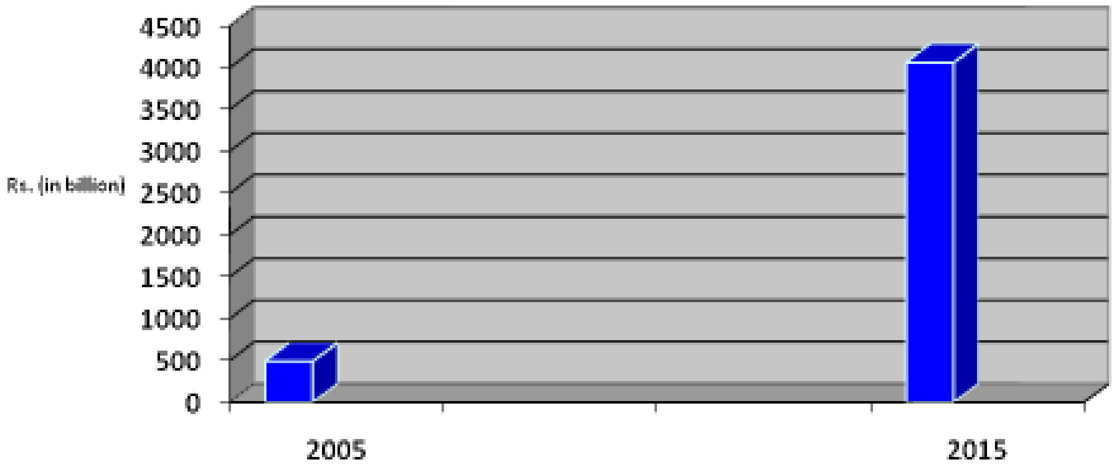

Fig. 1: Projected Growth Rate of the Real Estate Sector in India

(Source: www.empulseglobal.com)

as supply constraints related to inadequate land availability in most of our urban centres, complex acquisition process and restricted development control regulations hindering higher density developments. Other key measures include streamlining the approval process for construction, permitting new sources of real estate funding such as investment trusts, easing interest rates, promoting private sector participation in building mass housing schemes, renewal of our built environment by regular infrastructure upgradation and support to export promotion regimes such as the Special Economic Zones. An effective implementation of these policy recommendations will definitely accelerate growth in the sector and also augment the share of organised real estate in the country's built environment.

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