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RESEARCH ARTICLE

IMPACT OF PREVAILING FACTORS ON INDIAN REAL ESTATE INDUSTRY TO SHOT DOWN.

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Abstract

We are seeing a broad based real estate pullback, with prices increasing in most tier-1 and tier-2 cities in India, alongside sharp drops in transaction and new launch volumes. The drivers for this slow down are a mix of supply-side factors (banks have pulled back lending to developers) and its demand-side factors (Black Money Bill has created fear amongst speculators) making any property practically unviable for purchase. However, despite this the real estate industry has been trudging on that was until last year. In 2015, couple the existing pressure points with a slowdown in the global economy, which slowed India down too, and had effect on customers postponing their buying decisions indefinitely.

The result is not just a drop in demand for building sales and challenges for lenders with big mortgage, but also generalized slowdown in GDP growth as the sector which drives 50% of India's cap expenditure and 30% of its jobs.

The real estate industry now has an inventory pile up of 46 months in the Mumbai Metropolitan Region (MMR).The rising prices and falling demand led to stagnation in the industry in 2015, pushing prices down by 0.95 and 3.23% in MMR region and Mumbai. The quarter to quarter fall is 0.99% in MMR and 1.51% in Mumbai. However union cabinet's approval of real estate bill in early year is expected to pace for real estate industry in this year.

This paper magnifies the vital factors which had major effect on drastic increase in the prices of the houses and implements various measures to slow it down in the coming year.

Introduction:-

The real estate sector in India has come a long way by becoming one of the fastest growing markets in the world. It is not only successfully attracting domestic real estate developers but foreign investors as well. The growth of the industry is attributed mainly to a large population base, rising income level and rapid urbanization.

The sector comprises of four sub-sectors as housing, hospitality, retail, commercial. While housing contributes to five-six percent of the country's gross domestic product (GDP), the remaining three sub sectors are also growing at rapid pace, meeting the increasing infrastructural needs.

Real estate has historically been viewed as a local phenomenon. Builders and investors for decades prided themselves in their ability to find the best "location, location, location" based on their local knowledge. In the last decade, however, globalization has increasingly involved the internationalization of services sectors as much as of manufacturing, and the various sub-sectors of the real estate industry have been enthusiastic participants in this global surge. Builders, brokerage firms, consulting and services firms, real estate finance firms and investors have extended their area of operations beyond local markets to a world-wide base.

Objective:-

This paper is a preliminary look on the existing state of Real estate Sector in India by studying major prevailing impact on Indian Real Estate industry to shot down. To unfold major effect on transaction and mortgage along with sharp drop in sales. Major drivers for this slowdown ,various pressure points have indirect effect on real estate sector and challenges to the developers to increase their sales has been discussed in this paper.

Literature review:-

The real estate sector finally unravels:-

The construction sector in India saw an unprecedented boom over 2002-08, due to a surge in GDP growth and hence per capita income. The construction sector grew at an average rate of 8.75% every year over year 2002-10 vs an average of 3.41% over year 1993-2001. Due to this rapid growth over year 2002-10, the construction sector became the largest employment creator in India.

The slowdown in the construction sector is not only visible through the drop in new launches but also through a sharp decline in cement production on a pan-India basis. Data released by the Office of the Economic Adviser, the Ministry of Finance, suggests that cement production has dropped significantly in recent months.

WHAT HAS TRIGGERED THIS SHARP SLIDE?

The three **supply-side factors** responsible for the fall in real estate prices are:

Lending squeeze by banks to commercial real estate:- Lending by banks to commercial real estate has grown by just 7.5% during the course of one year ending 29 May 2015. This is slower than the overall lending by banks at 8.5%. Usually in India, lending to real estate grows much faster than overall bank credit growth. This suggests that the banking sector seems to have cut off the funding tap for developers. That is not only resulting in new launches dropping off, but it is also creating a funding squeeze for developers, which is making them more predisposed to cutting prices.

Squeeze on subsidies:- Subsidies under the UPA regime grew at a staggering CAGR of 19% per annum from 2004-14. A substantial portion of these subsidies (30-50%) was pilfered by the political class and used by them to fund investment in gold and real estate. The NDA has cut subsidies sharply (down 9% in 2016) and is shifting subsidies to Direct Benefit Transfer (DBT); at least 10% of the overall subsidies have already been moved to the DBT. As a result, the ability of the politician-and-builder to pilfer subsidies to fund real estate construction has been checked.

Rising inventories:- The knowledge that there is many years worth of unsold real estate inventory in most of India's tier-1 and tier-2 cities is causing investors to hold back their purchases. Data from property research houses suggest that regions like Mumbai and Delhi would take as much as 11-14 quarters to clear the inventory.

The three **demand-side drivers** for the correction in real estate prices appear to be:

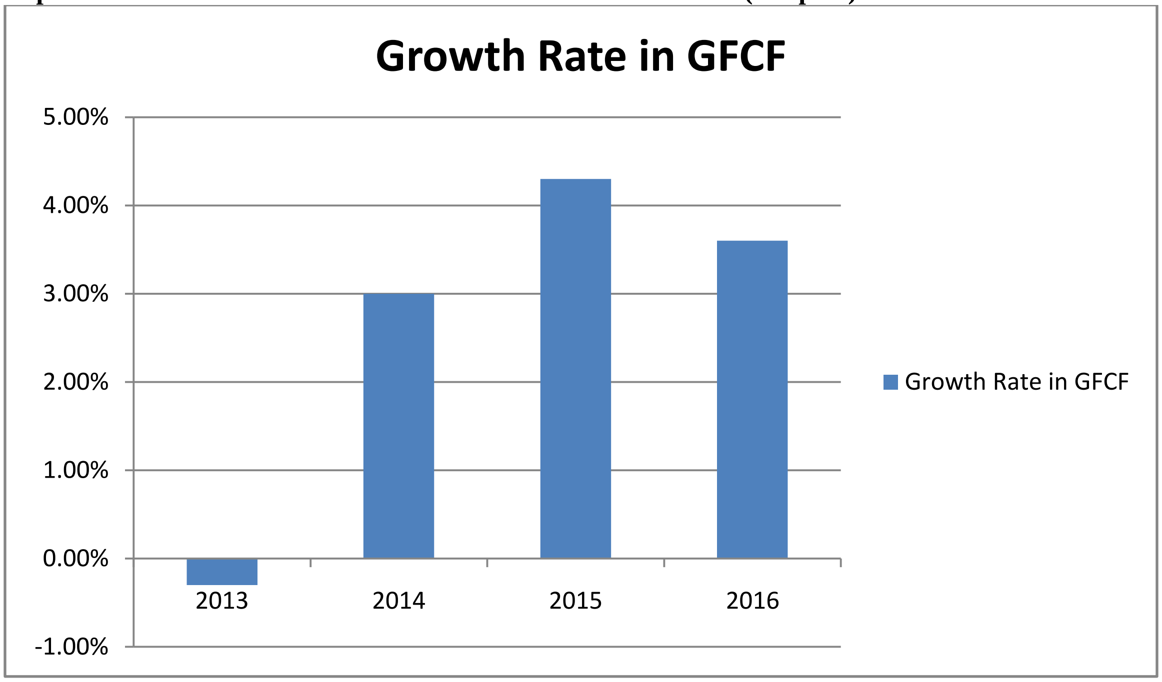
Affordability:-In a fairly-priced real estate market, the rental yield tends to be somewhere close to the cost of borrowing. Instead, Mumbai has a rental yield of close to 2% (this is gross of tax and maintenance charges) whilst the lending rate hovers around 10%. The difference between lending rates and rental yields is one of the highest in India. Even if one assumes that buyers are willing to live with only 5% rental yields (as they might have an view of capital gains arising from real estate in India), this would imply halving of real estate prices in Mumbai.

Squeeze on black money:- Whilst official figures are not available that quantify the size of the black money percolating through the real estate sector, research suggests that more than 30% of India's real estate sector is funded by black money. Our checks suggest that individuals who are involved in real estate transactions for their personal needs in Mumbai are routinely asked for black money payments ranging from 10% to 30% of the transaction value.

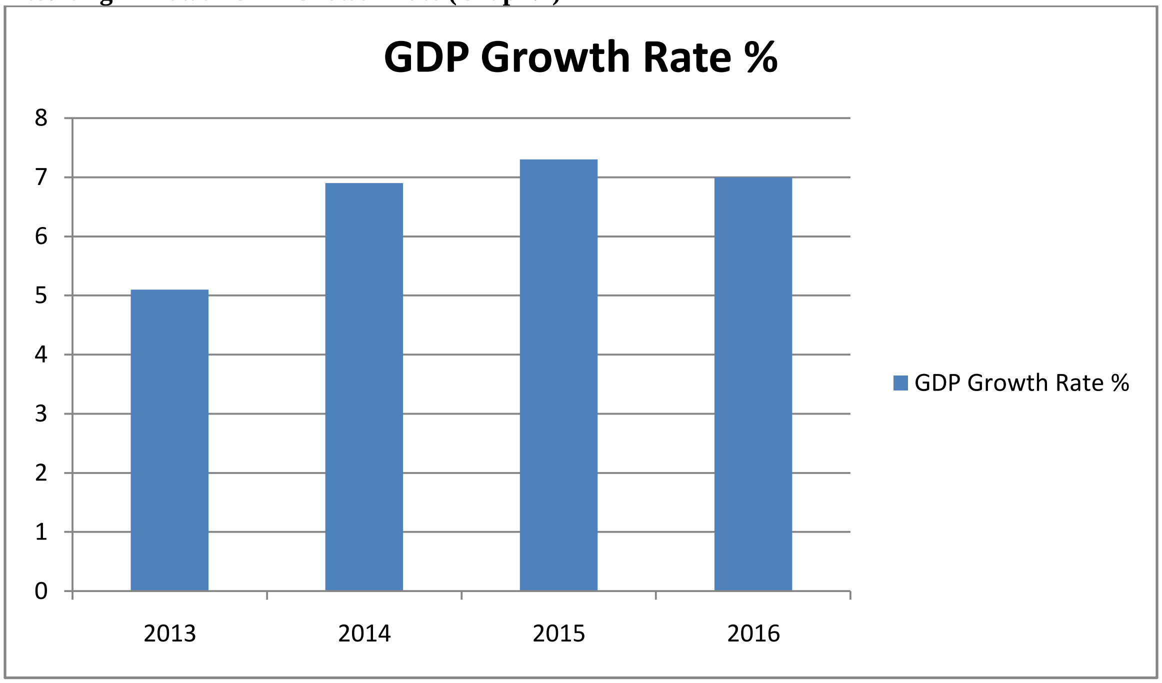
The rise in "ready reckoner" rates:- Starting January 2015, the Maharashtra State Government increased the ready reckoner rates (the price which is set by the State Governments and which becomes the floor price for property prices) by 15-20% in Mumbai, by 40% in the suburbs and on average by 15% across Maharashtra.

Macro Effects on Real Estate Sector:-

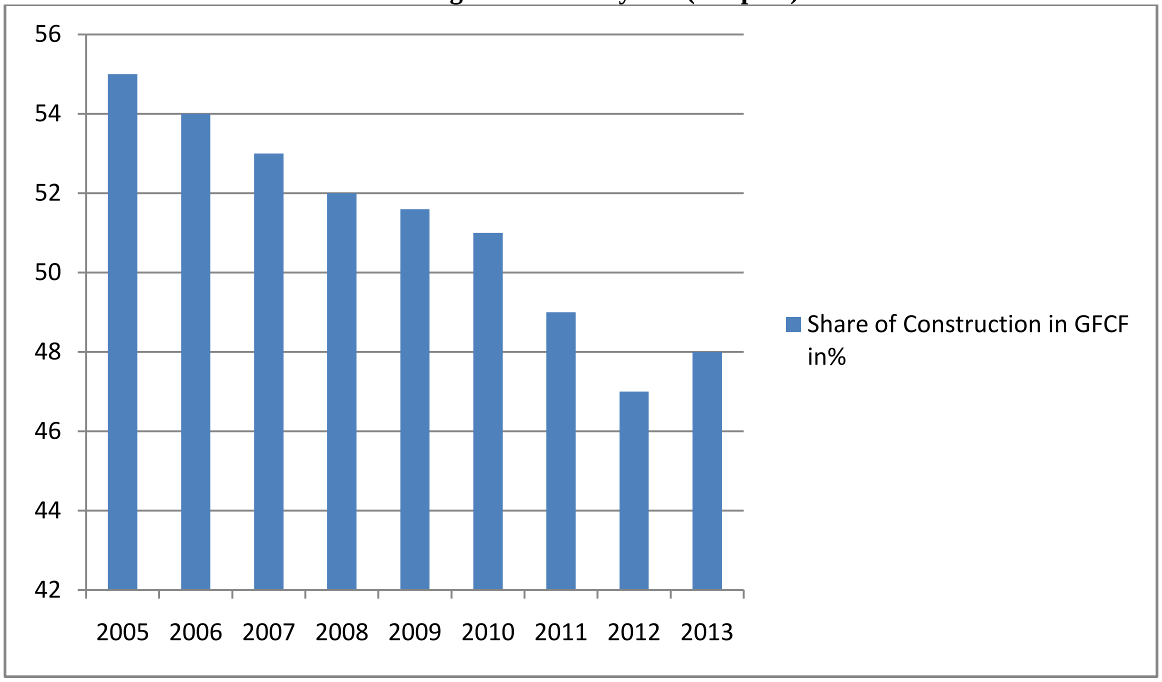
Expected Investment Growth to be lower in Financial Year 2016 (Graph.1):-



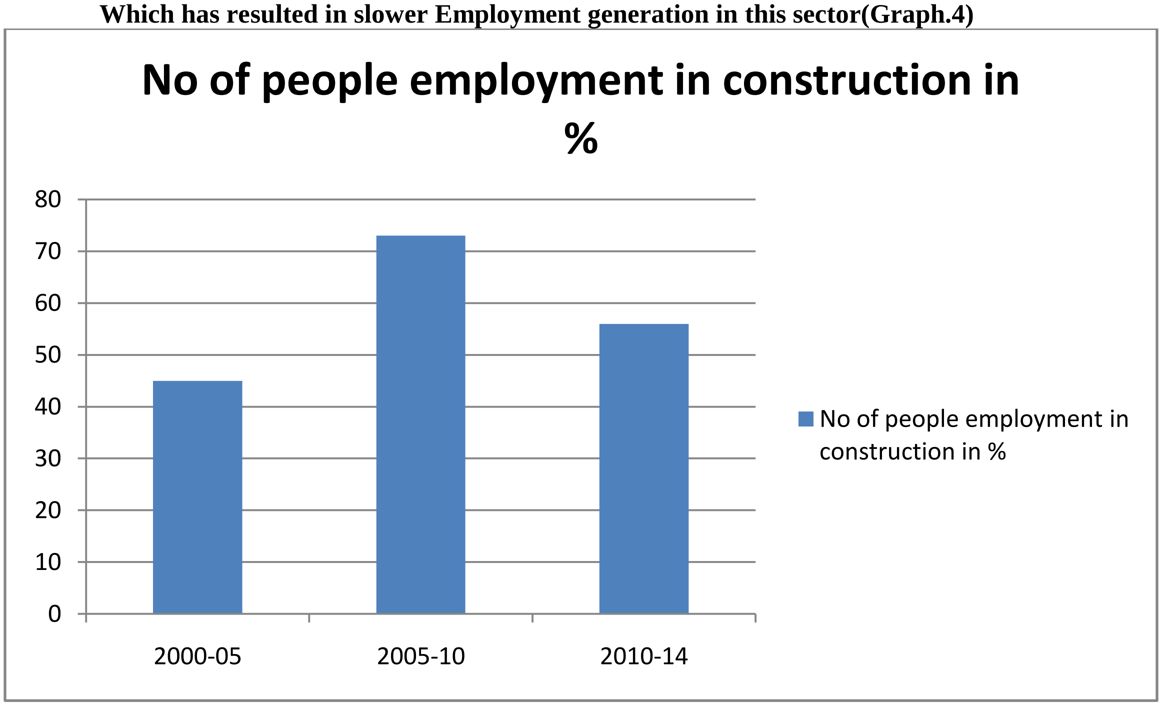
Resulting in Lower GDP Growth Rate (Graph.2)



Share of Construction in GFCF is falling in the recent years (Graph.3)



Which has resulted in slower Employment generation in this sector(Graph.4)



Capital Markets Effect on Real Estate:-

A study done by the IMF suggests that out of 78 housing price booms in the past 40 years, 51 were "bad" (i.e. they ended up causing a recession) among only 27 were "good" (i.e. they did not end with a recession). Moreover, out of the 78 housing booms, as many as 47 were caused by private credit booms. In this IMF study, a housing price boom is an event when the growth rate of house prices is greater than 5% or two standard deviations of the country-specific distribution of housing prices growth in a given quarter. Similarly, a credit boom is defined as an event when the growth rate of credits is greater than 10% or two standard deviations of the country-specific distribution of credit growth in a given quarter.

Relaxation of FDI Norms in Real Estate:-

Looking outward for more investment in cash starved sector, the Government of India eased Foreign Direct Investment (FDI) norms in the construction industry by removing two major conditions related to minimum built-up area as well as capital requirement.

According to eth eased norms:-

Conditions of the area restriction floor area of 20,000 square meters in construction development projects and minimum capitalization of Rs33.12 Cr to be brought in within the period of six months of the commencement of business, have been removed.

According to Government, each phase of the project will be considered as a separate project for the purpose of FDI policy. A foreign investor will be permitted to exit and repatriate foreign investment before the completion of project under automatic route, provide that a lock in period of three years, calculated with reference to each tranche of foreign investment has been completed.

The transfer of stake from one non-resident to another non-resident without repatriation of investment will neither be subject to any lock-in-period nor to any government approval.

The exit is permitted at any time if project or infrastructure is completed before the lock in period.

The Real Estate Bill:-

The Union Cabinet had approved the Real Estate (Regulation and Development) Bill,2015,in last December. The proposed Bill calls for setting up a regulatory authority for the real estate sectors with appointees in each state and union territory; putting 70% of amount raised for construction into an escrow account which has equal interest pay-out for buyers and builders, which currently in favor of builders.

RBI plays it tough:-

The Reserve Bank Of India governor Raghuram Rajan played tough with real estate players this year, telling them not to rely on central bank entirely for easy policy stance. Instead, RBI pushed real estate players to cut rates if they want the demand to pick up in the sector.

Conclusion:-

India's Real Estate Market in 2015 witnessed a fall in property prices, slowdown in demand, an increase in inventory pileup and disappointment among real developers and buyers due to various prevailing pressure points contributing its part as important. The initial rise in prices and reluctant decreasing it later to increase the transaction and to reduce inventory pile up will take two more year up to 2018 for real estate sector to be stable.

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