



Demonetisation Structurally Positive For Real Estate Sector



The short term impact of demonetisation of high value currency notes was drastic, causing the realty stocks to collapse like a pack of cards initially. However, in the long run, the demonetisation move may have a beneficial effect with decline in interest rates on home loans and decline in the influence of black money on the realty sector. **Abhishek Kumar** and **Arshad Hippargi** bring this report for our reader-investors:

The Indian real estate sector, which comprises of four major sub-sectors, viz., housing, retail, hospitality and commercial, was witnessing a slack in demand over the last couple of months. The real estate market in India was in the grip of rigid prices and plunging demand. As per PropEquity research report, the July–September quarter of key residential markets across India remained fragile and the housing demand across key cities declined 22 per cent, largely on account of muted end-users demand even when developers continue to offer heavy discounts and benefits. Capital values across cities remained under pressure. As per latest available statistics, only Noida and Mumbai were able to register a marginal price increase of two and one per cent, respectively. Many real estate giants believe that the sector is going through a transition phase that will hamper unethical practices and eliminate unorganised developers. The real estate

Anshuman Magazine Chairman – India and South East Asia, CBRE

“It is a bold move. While it may cause some pain in the short-term, the long-term outlook for the industry looks positive. It certainly helps that the real estate industry has already moved towards transparency in its operations. Several steps taken by the government in recent times—from the RERA Act and GST, to REIT—combined with this announcement, will further improve transparency and increase investor confidence in the real estate market in the long run.”

players got goose bumps when PM Narendra Modi announced the government’s decision to demonetise the high denomination currency notes as they realised that they will be adversely affected by the move.

TO HIT PRICES

As per the PropEquity report, housing

prices in 42 major cities across India could drop up to 30 per cent over the next 6-12 months after the demonetisation of high-value notes, wiping out over ₹8 lakh crore worth of market value of sold and unsold residential properties since 2008.

According to this report, residential real

estate valuation in the top 42 cities in India - both sold and unsold - will take a tumble by approximately ₹8,02,874 crore, a fall of about 30 per cent from ₹39,55,044 crore to ₹31,52,170 crore. Today, the unorganised players have taken a hit and the sector itself will take time to absorb the fall. Industry is expecting secondary sales transaction to come down in volume.

Rohit Gera, MD, Gera Developments & VP, CREDAI - Pune Metro, says "There is no doubt that where sales take place with cash being an integral part of the sale proceeds will be affected. This will affect land prices too. If land prices crash on this account, then there is a likelihood that property prices can come down as a result. Most projects in the affordable segment as well as those where people are availing home loans are sold without any cash. Therefore, projects that cater to this segment will see no impact. There will be a temporary setback for those projects that are sold to customer segments where cash payments are a major component of the purchases".

On the other hand, demonetisation will be a positive change for the secondary real estate market. This is because investors who booked properties but did not register them to avoid taxes and instead flipped over the tax liability to the next buyer, may not be able to do so anymore.

RATE CUT TO BOOST DEMAND

The demonetisation move that has left the real estate sector and the economy gasping for breath has a silver lining too. This is because this move will lead to an increase in demand for housing and provide a boost to the sector. Bank deposits post November 9 have swelled and industry experts believe that RBI may cut interest rates by around 25 to 50 basis points. If this happens, home loan interest rates may be reduced by 100-150 basis points over the next six months, which in turn will spur the demand for housing loans. So, as the real estate prices fall, the demand for home loans will increase and with low interest rates the dream of affordable housing will not be a

Surendra Hiranandani Chairman & MD, House of Hiranandani

Demonetisation is undoubtedly a landmark event in the history of our economy. It is bound to cause widespread disruption in the short term, but will reshape the way of commerce and economics in the future. I feel confident that these kind of policy directives will move India into a new era.

The primary reason behind this massive decision is to take down the menace of unaccounted money circulating in the economy. In my view, this move will be effective with initiatives taken by the government in weeding out corruption. Layers upon layers of regulations breed inefficiency and give way to corrupt practices. Demonetisation accompanied by deregulation will produce great results.

As per syndicated reports, black money constitutes 25-30 per cent of India's GDP, indicating that the size of the parallel economy could be about ₹28 lakh crore. Demonetization is expected to bring a substantial amount of funds into the system. It will also bring a larger number of people into the banking system.

Since 2010, there has been a lot of pain in the market where developers sold properties at low prices and then were hit by severe inflation, resulting in a large number of projects being uncompleted. Construction and approval costs spiralled out of control. This was coupled with very high interest rates as borrowings are essential for construction projects. Most projects sold during that period resulted in heavy losses on the balance sheets of developers

Demonetisation is expected to reduce inflation and interest rates considerably which would make projects viable. Developers will be able to have a handle on costs through the life of the projects.

The primary residential market and projects undertaken by credible and reputed builders will not be affected. Transactions in these markets are broadly financed through legal channels of banks and housing finance institutions providing home loans to buyers. Projects in cities where there is a cash component will only be affected. Here also, the benefits will be that the market will adjust to more open transactions, making the projects viable for funding.

In the past one year, there have been some positive and potentially long-lasting changes in the Indian real estate. The passing of RERA (Real Estate Regulation and Development Act 2016), the Benami Transactions Act in addition to the demonetisation move will only ensure that a higher degree of transparency enters the industry. Players who conduct their business with transparency will thrive. These policy initiatives will not only ensure more credibility for the industry, but also make it attractive to global investors. Our population growth and the consequent need for more development will only grow. Investors shall be able to trade with more confidence and not be wary of the security of their investments. The Indian real estate sector will only emerge stronger, healthier and will be poised for sustained growth.

A major impediment to real estate development in India remains the approval process. The government has rightfully laid great emphasis on improving India's ranking in the World Bank Global Ease of doing Business Index and continuously monitors the same looking at improvements in ranking as a success. The same World Bank released an Ease of obtaining Construction Permits Index. Here India ranks a shocking 183 out of 187 countries. We are in the same club as war-torn countries, where institutions have collapsed and literally offices which accord approval have been bombed to rubble. It would be welcome if the government can look into this as well and take pride in improving our rank on this index also.

The benefits of low inflation, low interest rates and transparency will give a big boost to real estate development in the country, only if it is coupled with deregulation.



Brotin Banerjee **MD and CEO, Tata Housing Development Company**

There has been an unwarranted fear mongering with regards to the impact of currency demonetization on the real estate industry. One can understand that a certain segment will feel the pinch – but the greater impact of this move will be the wind given to the aspirations of thousands of home buyers who, firstly, have a fierce desire to buy their first home and, secondly, have utmost faith in real estate as an asset class. Even before this announcement, the primary housing market was being driven by easy access to home loans. The housing credit market has been growing at a CAGR of approximately 19 per cent.

Now, this move has come as an elixir for the consumer, and the organised real estate sector will be in a better position. More money will be brought into the banking system, while excess liquidity in the market will be normalised, having a deflationary impact. The RBI, which had to keep interest rates high all these years, will now have the leg room to bring rates down.

Demonetization, coupled with the implementation of RERA, will make the buying process for consumers more transparent. With this move, the government has done right by the consumer and there has never been a better time to buy your dream home. We can look forward to better times in the real estate industry.”

Abhishek Lodha **MD, Lodha Group**

“The path breaking step of demonetisation by our Prime Minister has been undertaken with the clear intent of increasing the economic strength of all law abiding citizens, especially in the middle class and the poor. This drive will push banks to cut lending rates significantly, triggering a revival in economic activity in the country.

There have been various views and opinions around price correction due to demonetisation. However, one must understand that this move will subsequently improve liquidity and lowering of interest rates by 1--1.5 per cent in the next few months. With this, EMIs will also reduce by almost 12 per cent, signalling consumers to buy soon before demand and prices for housing move up. All these factors will have a spiralling effect on the ability of consumers to buy homes, providing impetus to real estate demand and the overall economic growth.

More importantly, in the long run, the professional and well-organised companies in the real estate sector will significantly benefit from this move and the scourge of black money and corruption will eventually vanish from the sector. This in turn will further strengthen the functioning of RERA, once it comes into play. Hence, positive effects of demonetisation and the realty bill will only lead to an increase in the demand for real estate.

This is a win-win situation for both consumers and investors as transparency will increase and risks will reduce substantially over the next 6-12 months.

Demonetisation will negatively impact those parts of land and/or real estate market that transact with large amounts of cash. This will affect prices in rural areas and cities where cash is large part of transactions. In Mumbai and Bangalore, less than 70 per cent of transactions (by volume) are with established players and cash is largely absent in this part of the market.”

distant dream. R C Lodha, Executive Director, Central Bank of India, says “In the short run, the impact is negative for the financial institutions having a portfolio of loan against property, as property prices are expected to correct in the short term and loan to value ratio is expected to rise, which is a risk. Further, there may a sluggish growth in the short run as 10 to 70 per cent of the value of property in real estate is bought or sold in cash. Due to excess liquidity in the Indian financial system, the interest rates are expected to fall in the economy.” However, in the long run, there may be a surge in demand for organised real estate. The three factors that could lead to such a surge are:

- Homes will be more affordable due to decline in prices.
- Increase in buyer's purchasing power due to fall in inflation
- Lower interest rates may increase demand for home loans.

IMPACT ON STOCKS

The worst-hit sector post demonetisation of high value currency notes has clearly been the Indian real estate sector. This was clearly evident from the stock market reaction to the recent developments.

One of the most important and reliable criteria to gauge the immediate economic impact of a sudden policy decision is to observe stock market trends. It is often viewed as a barometer of the economic activity in the country and persistent plunges in the stock market indicates deteriorating economic movement.

An analysis of BSE data vindicates this. We studied the price movements of top 5 realty companies in terms of market capitalisation on the BSE. The closing values of the Sensex, BSE Realty Index and individual companies are taken into consideration from November 8 to December 5 i.e. 19 trading days post the demonetisation drive.

Rajeev Talwar, CEO, DLF

What are your thoughts on the demonetisation move? How will it impact the real estate sector?

It is a move to clean the economy and we welcome it. Larger real estate companies will tide over this short term disruption of sales and liquidity, and we expect smaller companies from the unorganised sector to be effected in the short and medium term.

Do you see any meaningful price correction in the short to medium terms?

The present market prices in the primary market are at their lowest and there is no further scope of a correction there. The secondary market may witness a correction in the short and medium run.

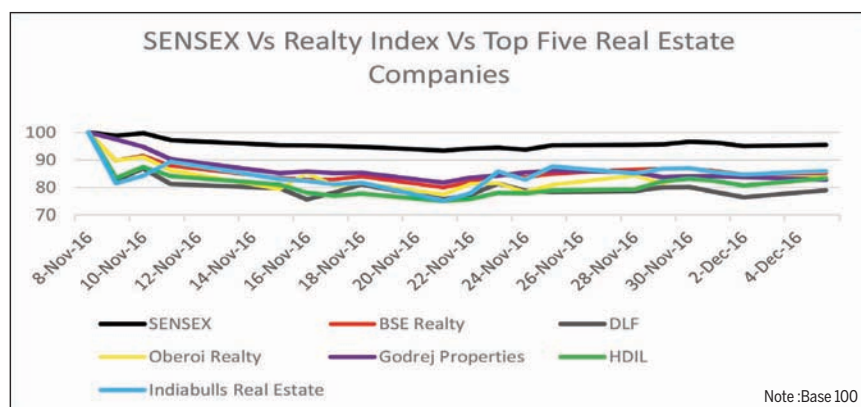
Which is the segment to be impacted the most due to the demonetisation move by the government?

It is difficult to pin point any sector in particular that has been impacted the most by demonetisation. However, we see that the unorganised sector would be the hardest hit amongst all, as majority of the transactions are cash based. In fact it would be a blessing in disguise for organised players like us who mostly deal through organised banking channels.

We expect a change in consumer mindset, as regards the way they look at companies which are compliant, and these companies will surely reap the dividend of increased enquiries and sales conversions in the medium and long run

What will be the road ahead for the real estate sector from hereon post demonetisation and implementation of Real Estate Regulation and Development Act?

Companies that have a strict corporate governance and compliance system in place will eventually be rewarded in the long run. We expect a change in consumer mindset, as regards the way they look at companies which are compliant, and these companies will surely reap the dividend of increased enquiries and sales conversions in the medium and long run. In fact we are of the opinion that the Real Estate sector will be one of the key economic drivers of GDP in the coming fiscals, as there are over 20 million houses to be made under the "Housing for All 2022" scheme and we have another 6 years to complete it.



From the graph, it is quite evident that the worst hit by demonetisation are the real estate stocks.

The BSE realty index was the top sectoral loser since the demonetisation drive, with DLF and HDIL contributing most to the losses. The index tanked as much as 17 per cent on a single trading day as

panic gripped investors post the decision on November 8.

If a person had invested ₹100 in a Sensex, realty index, or any individual stock as on the closing prices of November 8, he would have lost money in all the given scenarios. However, if he had invested in the benchmark index i.e. Sensex, it would have eroded his wealth,

but the likelihood of recouping the losses would have been fairly even. On the other hand, Realty index and individual realty stock prices have been badly dented, given their business and exposure in the industry. Investing in a DLF or Godrej Properties would have made the investor poorer by 21 and 17 per cent, respectively.

Realty index corrected more than 20 per cent from its pre-demonetisation day, and closed to hit a multi-month low on November 21. From those lower levels, the index has recovered 6 per cent but it still down by a massive 14 per cent. The widespread negative returns across real estate stocks after demonetisation reflect the immediate negative sentiments attached with the overall economic activity.

Renowned economist and activist Jean Dréze observed that demonetisation was a big gamble for India, and as with any



Irfan Razack, Chairman - CREDAI & CMD - Prestige Group

What are your views on the demonetisation move by the government and how will it help in improving transparency in the industry?

The real estate industry is currently at crossroads, attempting to cope with several new legislations that have been proposed, but are yet to be implemented in their entirety:

- ✓ GST
- ✓ RERA Bill
- ✓ Demonetisation

I believe that demonetisation in the true sense will not affect the dynamics of the residential real estate market, because demonetisation basically means bringing back into the bank system all cash, hitherto being used for expenses and other things. Hence, realistically speaking, with the implementation of this initiative, nobody stands to lose, except those who can't show the source for the cash they hold. Even for such people, the government has now provided the option of depositing the money and paying the tax on it at a higher slab rate. This influx of money into the banking system will reduce the interest rate for home borrowers in the long term and hence increase the demand for home buying. In the short term, people are currently confused with this sudden and drastic step and will take the time to wholly

Despite all odds, in Indian context, housing is a significant need. With rapid urbanisation, demand for housing will always persist in the affordable and mid-income group segments

understand the situation before committing to any large outflow. So for a short period there will be a slowdown in the sale of homes, but which in medium and long term will more than compensate for the short term sluggishness.

What kind of price correction do you envisage in the real estate sector?

Having said that, the pockets or micro-markets where the price is highly inflated, which is not in consonance with the cost of land and construction, may witness some correction downwards.

How do you think the demand scenario will be impacted in the time to come?

Despite all odds, in the Indian context, housing is a significant need. With rapid urbanisation, the demand for housing will always persist in the affordable and mid-income group segments. As long as developers are able to produce homes between fifteen lakhs to a hundred lakhs, there will always be a constant demand.

Where does the real estate sector move from here?

While all these legislations are being implemented, sadly the government machinery, both official and political, has not been made accountable as a part of these legislations. Hence, getting approvals for building developments quickly and in time, in addition to including services and occupation certificates, still remains a challenge. The sooner the government realise this and implements measures to set right this deficiency as a part of their endeavour for 'Ease of doing business', the faster the economy will grow. This will also help the business of real estate and property development to be conducted in a seamless and transparent manner.

gamble, the possibility of a favourable outcome cannot be ruled out. Therefore, the possibility of these effects being temporary may seem to be a ray of hope. We believe the market has already factored in the impact of demonetisation on the stock prices of the companies operating in the realty space. However, in the short to medium-term, investors should let clarity emerge and avoid taking any investment decisions.

CONCLUSION

The demonetisation move augurs well for home buyers. It is no secret that there

is widespread use of black money in property deals. As much as 20-50 per cent of the property prices are paid in cash. It is a given that volumes in real estate will start declining as black money exits the system and prices fall in the short-term. This will lead to prices coming down to more reasonable levels for home buyers. The unsold inventory over the last few years would become relatively affordable, which would pave the way for sales of the unsold stock. More importantly, demonetisation move could well signal the start of a decline in housing prices and a more transparent and cleaner mode of financing for the

real estate companies in the sector. The move will also pave the way for more serious players with deep pockets and expertise to operate in the industry.

On the face of it, the demonetisation move appears to be chaotic, but in the medium to long term, the move is likely to prove structurally positive for the real estate sector, aided by the enactment of Real Estate Regulatory Bill which would usher in a new era in the sector that is currently plagued by corruption, dubious dealings and not so clean image of the players in the eyes of homebuyers and investors.

