

Residential market unlikely to look up soon

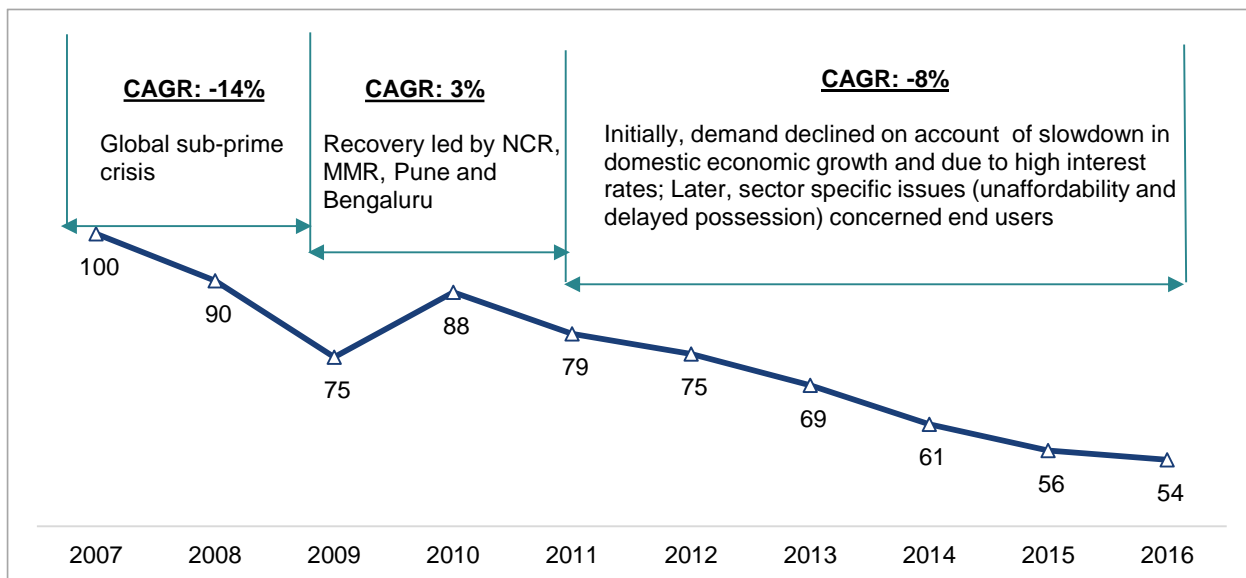
Despite a favourable policy framework, end users continue to be fence sitters as they await effective implementation of RERA and new launches in the affordable housing segment.

CRISIL Opinion | October 10, 2017

Absorption of new homes declines in last six years...

The real estate sector in India has been witnessing prolonged sluggishness over the last 6-7 years. Absorption of new homes in top 10 cities (Ahmedabad, Bengaluru, Chandigarh, Chennai, Hyderabad, Kochi, Kolkata, Mumbai Metropolitan Region (MMR), National Capital Region (NCR) and Pune) has slipped at a compound annual growth rate (CAGR) of 8% in the last six years. The sector has witnessed a decline in area booked and area launched over the last few years. Developers have been majorly focusing on mid-category/luxury/premium housing projects. This has created a wide gap in demand-supply dynamics, resulting in pent-up demand for affordable housing units and a huge unsold inventory of unaffordable units across most micro markets. **Respite is unlikely in near future as investors are out of the market and end users continue to wait for the right opportunity.**

Trend in absorption of new homes across top 10 cities (indexed to 2007)



Note: Absorption numbers are indexed to 2007 figure (2007: Index 100)

Source: CRISIL Research

...Trend unlikely to change for at least 12-18 months

CRISIL Research’s assessment of changing trends across segments

Changing dynamics			
	Affordable Housing/ Low cost housing	Mid-category housing	Premium/ Luxury housing
Pent up demand	High	Moderate	Low
Supply trend	Increasing	Moderate	Reducing
Unsold inventory	Low	Moderate	High
Medium term outlook on prices	Gradual increase in prices on account of rationalised supply and healthy / moderate demand		Prices to remain stable

Note: Images shown for representation purpose only
Source: CRISIL Research

Pressure on residential real estate prices across top 10 cities was clearly visible during H1 2017. While several developers offered upfront per square feet discounts, a few large developers bundled financing schemes and reduced interest schemes to offer ‘all inclusive house prices’. Home buyers, in many cases, were also offered indirect benefits such as reduced floor charges or premium location charges. Taking into account these aspects, the effective price correction was 5-10%.

New entrants in job market avoid long-term financial burden amid job security concerns

Taking a home loan is the biggest and probably the longest financial burden during one’s life. To add to it, there are concerns regarding job losses for low skilled profiles on account of increasing automation mainly in the IT/ITeS sector. Housing demand in metros such as Bengaluru, Hyderabad, Chennai and Pune is driven by employees working in this sector. While the sector’s combined employee base is estimated to have stood at ~3.8 million in 2016-17, employee additions declined to 1.1 million over 2011-12 to 2016-17 compared with 1.2 million during 2006-07 to 2011-12. We expect net additions to drop further, and more rapidly over 2017-18 to 2020-21. Much of the reduction is expected to be due to lower growth in the sector, with the impact of automation limited to highly repetitive tasks such as data entry. Thus, it definitely requires cautious decision making to handle long-term financial burden during changing employment scenario.

Preference for rental housing, lack of affordable options keep buyers away

Urbanisation in India has been increasing at a rapid pace over the last few decades and is estimated to reach 36% by 2020 (from 31% in 2011). Increasing employment opportunities and educational needs are the key reasons behind migration. According to the Economic Survey 2015-16, the country witnessed inter-state migration of 60 million people between 2001 and 2011 (*and interestingly, number of inter-district migrants was around 80 million during the period*). During 2011-2015, the number of inter-state migrants increased by 45 million. As per Census 2011, over 27% of urban residents of the country are living on rent, mostly in informal settlements.

It is also interesting to understand the math behind renting vis-à-vis purchasing a house. Despite lower interest rates, rental makes more sense considering the down payment requirements and hefty monthly loan payments. In fact, many nuclear families these days prefer staying on rent in suburbs than purchasing a house in peripheral micro markets. However, the math may not surpass the sentimental value attached to an owned house, and hence, when the situation improves, the demand will ramp up – but only in the long run.

Assessment of overall housing supply across select cities indicates that developers in most cities have planned projects targeting mid-income households. Only in the case of MMR, a significant share of supply is targeted towards high-income households.

Ticket-wise split of overall supply across select cities

City	Less than Rs 5.0 mn	Between Rs 5.0 mn and Rs 7.5 mn	Between Rs 7.5 mn and Rs 10.0 mn	Between Rs 10.0 mn and Rs 15.0 mn	Above Rs 15.0 mn
Ahmedabad	70%	16%	3%	4%	7%
Bengaluru	29%	28%	19%	16%	8%
Chandigarh	26%	37%	23%	12%	1%
Chennai	50%	25%	10%	7%	7%
Hyderabad	22%	33%	21%	15%	9%
Kolkata	66%	17%	11%	5%	2%
MMR	20%	14%	12%	18%	36%
NCR	52%	18%	9%	11%	9%
Pune	47%	32%	10%	7%	3%

Note for interpretation: 70% of on-going supply in Ahmedabad is priced below Rs 5.0 mn

Source: CRISIL Research

With investors out of the market, industry will have to wait for end users' action

End users prefer buying ready-to-move-in properties due to risks associated with delivery of under-construction projects. While effective implementation of RERA will address this issue in the medium term, states across the nation are not yet in rhythm with the central RERA and scheduled timelines. Though most states and all union territories have notified their respective acts, many states are yet to form a permanent RERA authority. In addition, only a handful of state RERA websites are operational and have started publishing project information online. However, dilution of on-going project definition as notified by some states is a matter of concern. **This needs an immediate and effective monitoring by the central authority.**

Status of RERA implementation in major cities

City	State	Notified	Website	Permanent authority	In line with model act
Ahmedabad	Gujarat	Notified	Operational	Formed	Project definition
Bengaluru	Karnataka	Notified	Operational	Not formed	Project definition
Chandigarh	Chandigarh	Notified	Operational	Not formed	In line
	Punjab	Notified	Operational	Formed	In line
	Haryana	Notified	Not operational	Not formed	Project definition
Chennai	Tamil Nadu	Notified	Operational	Not formed	In line
Hyderabad	Telangana	Notified	Not operational	Not formed	Project definition
Kochi	Kerala	Repealed	Not operational	Abolished	Multiple points
Kolkata	West Bengal	Not notified	Not operational	Not formed	
MMR/ Pune	Maharashtra	Notified	Operational	Formed	Payment schedule
NCR	Delhi	Notified	Not operational	Not formed	In line
	Haryana	Notified	Not operational	Not formed	Project definition
	Uttar Pradesh	Notified	Operational	Not formed	Project definition

Note: For the last column, comment in the box represents difference from the central RERA.

Source: Respective state websites, RERA website, secondary sources, CRISIL Research

Meanwhile, participation of the investor community has reduced significantly on account of falling returns on the asset class, owing to stagnant real estate prices, limited income tax benefits on let-out properties (announced in Union Budget 2017-18), and change in the regulatory framework to curtail pre-launch transactions.

Changed perception of buyers

Demand from this set of buyers will cease to exist now

- * Ban on high value cash transactions post demonetisation
- * Ban on pre-launch activities post RERA

*Example of speculator:
A person or family buying certain area (and not necessarily units) during the initial phase of project (sometimes even before the project is formally launched). Makes profit from price appreciation during construction period. Exit made by selling area back to developer or investors/ end users.*



Reduced participation on account of

- * Reduced returns delivered by real estate (as an asset class) in the past few years; limited scope of significant price increase at least in next two years
- * Comparatively equity market has given better returns in the last few years
- * Limited income tax benefits on let out properties (as announced in the latest budget)

*Example of investors:
A person or family buying unit(s) in a project during early stage of construction with an aim of renting it out once ready and occupying the same after few years.*

End users continue to remain fence sitters

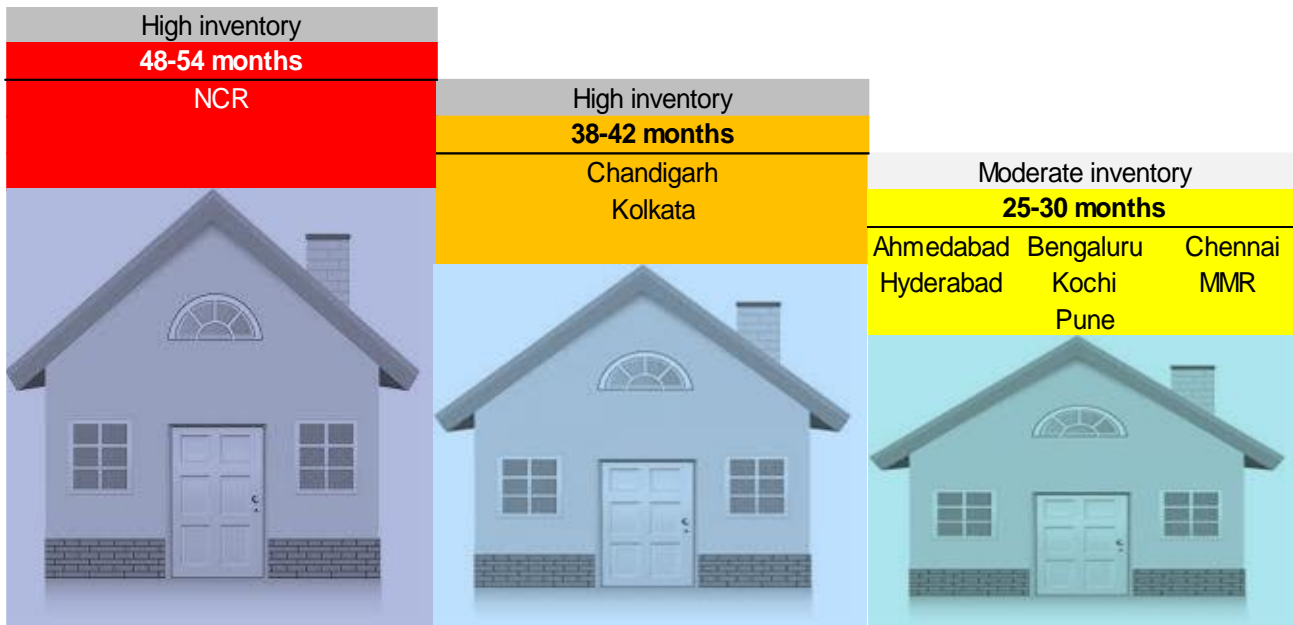
- * They prefer buying ready to move in properties due to risks associated with delivery of under construction projects; Resurgence in buyers' confidence will happen only when they see RERA framework working in their favour
- * While government has announced credit linked subsidy scheme benefits to boost affordable housing segment, supply of smaller units is limited at present

Source: CRISIL Research

RERA has forced developers to focus on completing their existing projects. This coupled with sluggish demand has resulted in reduced new launches.

Lately, developers have started aligning their supply to suit buyers' affordability. This is being done either through the supply of smaller studio apartments and 1 BHK units or by reducing the size of 1 and 2 BHK apartments. This strategy has worked in favour of developers, especially post announcement of infrastructure status to affordable housing. However, such projects-at present- form a miniscule share of overall supply across these cities.

Overall unsold inventory across top 10 cities



Source: CRISIL Research

Demand revival is unlikely in the near term. CRISIL Research believes that, in the next 12-18 months, prices are likely to remain stable at current levels on account of weak demand and moderation in new supply additions. **Resurgence in buyers’ confidence will happen only when they see RERA framework working in their favour. Next few quarters will witness launches in the affordable housing category, i.e., projects with smaller configuration, leading to a reduction in the overall ticket size.** This, along with falling interest rates and supportive credit-linked subsidy framework, will benefit end users as affordability improves.

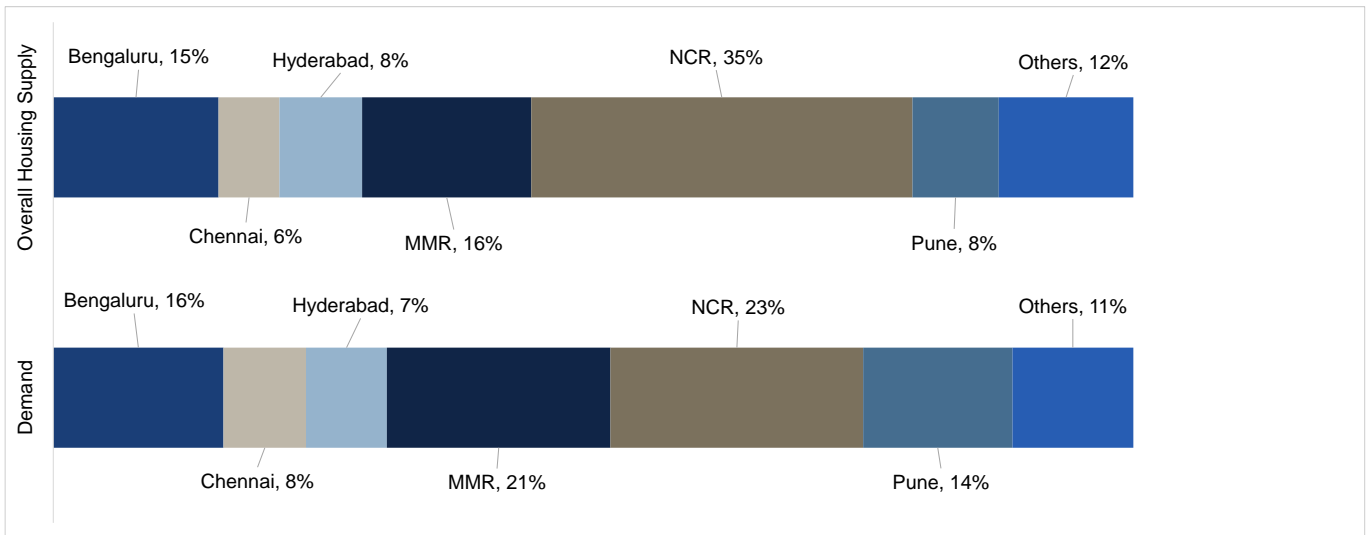
Revival in NCR to be the toughest...

While major cities continue to be plagued by moderate unsold inventory, those in the northern region such as NCR and Chandigarh continue to witness huge unsold inventory. NCR and MMR are two mighty cities in terms of both demand as well as supply of real estate projects, amongst the top 10 cities. However, demand has been dwindling in NCR over the last 4-5 years, and the trend is unlikely to recover in the medium term. The large number of disputes between buyers and developers in the city is a clear indicator of lost confidence of not just end users but also of investor community in the market.

...MMR will be the first to recover

Unlike other states where details of very few projects are available online, Maharashtra has seen tremendous response in both registration of projects as well as disclosure on the MahaRERA website, thanks to close monitoring and active management by the authority. MMR has already started witnessing supply of projects with smaller units – mostly in peripheral micro markets. **CRISIL Research, based on two key leading indicators - effective execution of RERA and developers’ action on housing projects with smaller configurations - estimates that MMR has fared better in terms of both the aspects.** Therefore, once the sector revives, based on end users’ confidence, MMR is likely to recover first.

Relative share of cities in residential supply and demand



Note: Overall housing supply represents on-going (under construction and planned) supply across these cities as of H1 2017. Others in the graph represents cumulative figures for Ahmedabad, Chandigarh, Kochi and Kolkata.

Source: CRISIL Research

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