Real Estate Market Forecast- post demonetisation in India

[1]Jigar V Pandya, [2]Dr. Vikram M. Patel
[1]PhD. Research Scholar, [2]Professor
[1]Civil Engineering, [2]Infrastructure Engineering
[1]KSV University, Gandhinagar, India, [2]Adani Institute of Infrastructure Engineering, Ahmedabad, India

Abstract: On November 8, 2016, RBI (Reserve Bank of India) withdrew currency notes of Indian Rupees 500 and 1000 denomination, rendering them invalid legal tender from midnight November 9, 2016. The event resonates as second 9/11 as it brought down economic activities of many sectors in India, especially the cash sectors. Real Estate was the highest impacted sector. Real estate project developers, land traders and investors, all require high amount of working capital to stay, invested in the real estate markets. The move has been seen as a bold fiscal reform by many analysts, and succeeded partially to bring back the unaccounted money back into the banking systems. However; demonetisation did set the equation straight with all bankers who had extended soft loans to real estate developers though 80:20 financing Schemes. Unaccounted NPAs (Non performing assets) of the banks went down considerably while Real estate developers who had delayed their real estate project projects were left further cash stripped. A close inquiry into the Ahmedabad city market shows a clearer picture on how the real estate activity will shape up in coming years as new developments are likely to intensify in the urban city core and put brakes on urban sprawl.

Keywords: Real Estate; investors; developers; demonetisation; impact

I. INTRODUCTION

The formal reforms in Indian Real Estate were only a matter of time. To induce system transparency and to help end users (property buyers), demonetization and the Real estate Regulation Act (2016) set the tone for things to come in future. Year 2016 will be regarded as an historical year in real estate reforms. The reform cycle was further consolidated by implementation of the GST (Goods and Service Tax) Act in mid 2017.

Market observations reveal a critical factor which contributed to post demonetisation was return of all dummy loans which were given by the banks to real estate developers through the dubious 80:20 Scheme. The scheme was banned by RBI in 2013 looking at the slowdown in the real estate sector. Real estate developers took hefty loan amounts on name of buyers who had booked housing units by paying 20% down payment who were then given assurance under the scheme that their EMIs (Equated Monthly Installments) for loan repayments would not begin before getting the possession of their property. The remaining 80% of the sanctioned loan amount was not meant to be disbursed until the completion of the project. However, some banks were observed with a malpractice of extending the 80% disbursement to the real estate developer as per existing housing interest rates to the developers who then had formal working capital to invest in new projects, leaving the existing project unfinished. Ultimately the projects were delayed and so was the possession. Many banks were frustrated with this stalemate situation a sales were not moving and construction was delayed. Demonetisation settled most of the 80:20 exchequers without leaving any noticeable trace. This however, left a bigger blow to many developers who had converted their cash into such loan settlements, leaving their working capital largely impacted.

II. LITERATURE REVIEW

For real estate markets, demonetisation not only brought in the aspects of transparency into light but also impacted the sales of real estate units in all major cities. Data of first two quarters of year 2017 suggests that sales were hugely impacted in four metropolitan cities of India; Mumbai, Chennai, Delhi and Kolkata. The sales dip was as high as 40% while new project announcements fell by 11% immediately after demonetization.[1]

One of the key elements that distinguishes the pricing in Real Estate is the component of black money (Informal finance/ Cash) Depending on the developers purchase history of a particular land parcel, the real estate projects have non uniform breakups of Cash and Cheque payments to realize a purchase. Demonetisation is expected to bring back the standardization in real estate markets; however, this requires multiple factors to work in its favour to achieve this feat. Real Estate Developers (builders) are now in an improved position to avail formal business finance for their projects.

All Real estate markets have taken a huge hit in terms of sales and unit absorption. High end luxury apartments and bungalows/villa properties have seen a huge decline in buyer inquiries all across India. This has to do with the fact that this particular segment has one of the highest cash transaction components in the total sale price. Since cash transactions were unregulated and unrecorded, it was almost impossible for the government to levy taxes on them. Real estate had become a heaven for people to park their unaccounted cash.[2]. Demonetisation ensured that such buyers had to declare their cash and had to reach banks through a formal source, thus stripping their purchase wallets and impacting the overall market. The most important motive for the Reserve Ban k of India to go through demonetisation was to bring money back into the banking sector, which it has achieved.

With scarcity of cash, a large corpus of buyers went off the market and sellers can do little but wait. This will also result in the reduction of prices, thereby benefitting buyers. However, the pricing reduction might take time - and the magnitude of reduction cannot be predicted [3]. A total of 85% of the total currency that was being circulated was demonetised. The fact is, demonetisation has already resulted in a major reduction of home loan rate interest rates, and they are expected to reduce further. Developers offering incentives and discounts to buyers are maintaining their position in a market which is now ideal for serious end-users[1]. This being observed, the end-users are awaiting a further price correction as their cash savings have also gone back into the banking system and is invested into other sources of investments such as Stocks, bonds, precious metals or Forex markets.

Construction companies operating with cash found themselves unable to meet their operational expenses like wages for labourers and purchase of raw materials[4]. When one wishes to include the informal sector into formal financial circuit, there needs to be incentives, ease of operations and hope for an improved future; all which was lacking in the demonetisation method. The Centre for Monitoring Indian Economy (CMIE), a private forecaster, estimated that 1.5 million jobs would be lost between January and April 2017, as the employment level fell to 405 million people[5]. The numbers cannot be confirmed as of now, but the construction sector is in such a big slump that majority of construction workers are out of jobs.

The number of suspicious transactions reported in the banking system had raised to 473,000 in Fiscal Year (FY) 2017, up from 106,000 in FY 2016, a possible source of future tax revenue[6]. The surplus money in the banking system has led to lowering of interest rates, which will further reduce to drop as tight economy has now more liquidity. Higher liquidity in the system also ensures that inflation is likely to go up in future as money starts flowing in the economic system.

It may be too early to conclude but not too late to begin as serious research needs to be done extremely carefully and reasonably long-term data must be considered before reaching any conclusion about unprecedented policy events such as demonetization[7]. As for the different case scenarios of demonetisation, as much as 4.5 trillion could have been disappeared from the system[8]. RBI has claimed to have received 98.96% of currency back which is 15.28 trillion out of 15.44 trillion, which was out in circulation[8].

Researchers agree that more transactions in Real Estate are held in cash and that people use the black money to purchase the property[9]. This also counters the theory that developers insist on cash rather than buyers insisting to buying the same using cash. Systems do not change until people change it. The awareness of the drawback of black money can only help eliminate it[10]. The National Institute of Public Finance and Policy (NIPFP) defines- "Black Money is the aggregate of incomes which are taxable but not reported to authorities." Another reason for the existence of Black Money is the presence of Corruption in every field of the economy[11]. Income which can never be declared due to its illegal nature of operation does not fall in the category of black money, unfortunately, for which, Real Estate is the biggest hub for investment.

III. OBJECTIVES OF THE STUDY

- To understand how future real estate markets are likely to behave by understanding the nature of finance in real estate as observed in different neighbourhoods of the city.
- To understand the micro-factors responsible for real estate growth by understanding the working capital of a real estate developer and predicting future outcomes
- To evaluate and forecast a city's real estate market and help derive similar models for other urban cities of India.

IV. DATA COLLECTION AND OBSERVATIONS

A survey of 60 real estate projects in the city of Ahmedabad revealed a specific pattern of financing the real estate projects. All the projects taken up in the sample size of 60 were belonging to Real Estate developers registered with the local association of Gujarat Institute of Real Estate Developers (GIHED). The project included experienced as well as new developers. The projects included residential and commercial projects completed in 3 years market cycle (2013 to 2015), pre demonetisation. The new circle rate (revised Jantri) came into effect from April 2011. As the circle rate have a high bearing on this study, and the land values were fairly stable during this period, to avoid skewness and have valid data, this period was considered for data collection. Table 1 shows the average breakup of Real Estate project's input cost. A real estate project has 3 distinct phases of investment.

Phase 1 is land acquisition where, real estate developers purchase the land which forms biggest component in terms of investment. Land is purchased at market rate which is invariably higher than the existing Circle rate (Jantri – Document of Annual Statement of Rate) as documented by the Land revenue department. The Circle rate is the rate on which existing 4.9% Stamp Duty and 1% Registration fee is levied in state of Gujarat. Due to this, all Sale deeds performed quote purchase price at par with the Circle

Rate. Among the 60 projects surveyed real estate developer executed a sale deed above the circle rate price. This is required to be done as the seller of the land has high implications of paying capital gains tax, and not necessarily save on the stamp duty rate only.

This results in two separate components of payment for Land purchase; the cheque or formal value which is equivalent to the existing circle rate and the informal or cash value which is the over and above add on to derive the existing market value and subsequent purchase price.

The second phase of investment is the construction cost. A high amount of construction cost by experienced developers is paid using formal finance. However, Labour wages are mostly paid in cash (informally) and no evident data was available on the approximate value that was paid. This however is later offset in the books and cannot be duly traced. Due to this the informal cash component for cash has been neglected in this particular study. The construction cost included in the study also comprises of all the fees paid to the government authorities including stamp duty, betterment taxes, fees paid for No Objection Certificates, all other approvals, fees for Architect and other hired services.

The third and final phase of investment is the marketing, promotion and agent fees which are all mostly paid in cash barring official advertising expenses. These expenses have been included in the informal costs or cash costs.

From the collected data it can be observed that real estate projects which are proposed within the city core neighbourhoods have 15.82 percentage of informal finance as an input cost as compared to projects which are proposed on the outskirts of the city (urban fringe neighbourhoods), where informal finance input cost is as high as 34.59% as shown in Figure 1. This is also directly proportional to the availability of land for future development, which is as high as 74% for urban fringe neighbourhoods.

The Stratified sample of 60 projects was further divided into 4 equal groups for data collected. Each of the 15 projects belonged to City Core neighbourhoods, Prime neighbourhoods, Developing neighbourhoods and Urban Fringe neighbourhoods. In terms of land prices (values) Prime neighbourhoods commanded highest market value for land, followed by city core, developing and urban fringe respectively. These neighbourhoods were further analysed using tool of Google Maps, on percentage of built and percentage of vacant land available for future development. Table 2 shows the breakup of Formal and informal finance for all four neighbourhoods along with percentage of vacant land available for development.

Figure 2 shows the trend for need for cash component Vs availability of vacant land for different neighbourhoods. There is a positive relationship of cash component increasing along with newer neighbourhoods or vice versa, decreasing of cash components as they get slowly developed and become prime neighbourhoods. Understanding the relationship is very important when considering the future forecast of real estate markets post demonetisation, RERA (Real Estate Regulation Authority) and GST

V. ANALYSIS

Post demonetisation, working capital of real estate developers has been severely affected. It is more about the location of the project rather than the choice of project which will be impacted in the future. The study brings to light that 34.59% of finance which comes from cash economy for a project proposed on the outskirts of the city will take a huge hit as the cash money has been removed from the system. Real estate developers are not likely to have this amount and so they will look for locations where the amount of cash component is lesser. This brings us to the prime neighbourhoods which too have lesser component of cash 24.06% which is still higher as real estate developers will struggle to manage such amount. However, the availability of land is about 8% in these neighbourhoods and hence the cost of land acquisition would be very high.

The best neighbourhood for proposing projects where the requirement of cash component is lowest is the city core with 15.82%. This leads us to propose a theory, subjective to city of Ahmedabad as to where and how the developments are likely to happen in next 3 to 5 years, until cash economy returns to the real estate sector. Table 3 and Figure 3 show the skewness of cash component in context to the availability of land in core city areas and prime neighbourhoods. As we move away from the city locations the requirement of cash component increases marginally as compared to exponential increase in the availability of vacant urban land for real estate development.

VI. REAL ESTATE MARKET FORECAST (2018- 2023) AHMEDABAD CITY

6.1 Urban Renewal

There will be higher activity in the City core especially with redevelopment projects. The next 5 years phase will mark urban renewal as old dilapidated housing and commercial settlements will make way for newer real estate developments. This forecast is purely based on the assumption that city core projects will require lesser cash component in the transaction and that there will always be a possibility of Joint venture along with the land owner as real estate developer may not choose to fully buy or purchase the land as it will have its own co-operative housing society. Such projects may also come up by partnering with other real estate developers.

6.2 Core Densification

There will be higher redevelopments in the prime neighbourhoods & city core especially along BRTS (Bus Rapid Transport System) corridors as it offers an overlay FSI (Floor Space Index ,also known as Floor Area Ratio) of 4.0 up to the depth of 200 meters along the BRTS corridor. Here again the underlying assumption is possibility of Joint Venture along with higher FSI incentive.

6.3 Regulation Revision

Common GDR (General Development Regulations) have been proposed for the entire State of Gujarat granting uniform and higher FSI to all cities, including cities of Surat and Vadodara. Core City centres will witness higher real estate development in next five years.

6.4 Land Value Correction

The land values along the urban fringe areas will have a correction in prices by 15% to 20%. This correction will likely happen only to limit or decrease the existing skewness in the circle rate and market value. The correction will predominantly be in the cash component. This however will not encourage land trading but it will allow some real estate developers to provide attractive housing options to the market as they will always be affordable compared to city core locations. Such projects are likely to come about in the affordable housing overlay zone on the outer periphery of the Sardar Patel Ring Road.

6.5 Revision of GST on Construction Materials

By end of year 2018 the GST revision on Construction material will most likely ease the input taxation burden to help resume regular construction activity.

6.6 Revision of Stamp Duty and Circle Rates

Stamp duty rates are likely to come down to 2 -3% from existing 4.9% to reduce the cash component as more real estate developers are encouraged to quote the realized market value on their Sale deeds. If the reforms head in the right direction, the Capital Gains Tax structure may also be revised by the Central Ministry and Circle Rates may be further revised by the State Government to make real estate cash free economy. This however is a distant hope rather than a forecast.

6.7 Confident Lending

With setup and implementation of RERA in Gujarat, Banking institutions are likely to be more aggressive in lending to the Rea l estate developers and housing interest rates are likely to go as low as 6.5 % in next five years. This will encourage home buyers and improve supply-demand equilibrium.

VII. CONCLUSIONS

The case study of Ahmedabad Real Estate projects, neighbourhoods and real estate developers suggests a trend for things to come in other major cities of the State and the country, since many of these cities have a similar framework of urban planning, governance, land revenue department and customers. Parallels of the study can be drawn in context to other cities where urban development initiatives have been included in the city's Master Plan and their state government is in sync with the Central Government's reform centric attitude towards the real estate sector.

Table 1: Real estate project input cost breakup (100%)

Ahmedabad city	Land acquisition		Construction cost	Marketing & others	Total
	Jantri/ circle rate (A)	market value add on (B)	Materials, labour, legal sanctions & design fees (C)	Promotion, marketing fees & others (D)	
	%				100%
City core neighborhoods	58.55	11.15	25.73	4.57	
	69.70		30.30		100
Prime neighborhoods	59.15	13.82	21.52	5.51	
	72.97		27.03		100
Developing neighborhoods	40.32	20.68	33.26	5.74	
	61.00		39.00		100
Urban fringe neighborhoods	28.63	27.52	36.78	7.07	
	56.15		43.85		100

Table 2: Data of Neighbourhoods, Vacant Land and finance break up

Ahmedabad city neighbourhoods	Formal Transaction Breakup (accounted) % (A + C) (table 1)	Informal Transaction breakup (unaccounted) % (B + D) (table 1)	Total 100%	% of Vacant Land
City core neighbourhoods	84.18	15.82	100	1 to 2%
Prime neighbourhoods	80.67	19.33	100	5 to 8%
Developing neighbourhoods	73.58	26.42	100	35 to 42%
Urban fringe neighbourhoods	65.41	34.59	100	65 to 74%

Table 3: Cash component (Informal finance) Vs Vacant Land available

Ahmedabad city	(Informal Finance) Cash Component	Adjusted %	Vacant Land (Range 2)	Adjusted %
City core neighborhoods	15.82	19.69	2	1.61
Prime neighborhoods	19.33	24.06	8	6.35
Developing neighborhoods	26.42	32.89	42	33.41
Urban fringe neighborhoods	34.59	43.05	74	58.63
	80.34	100.00	124	100.00

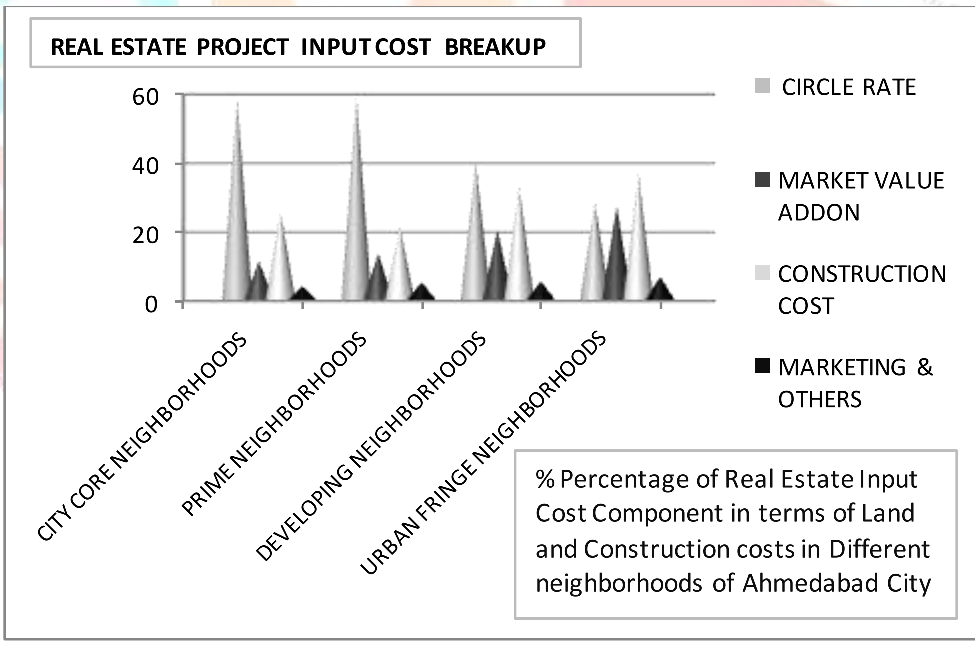

Figure 1: Real estate project input cost breakup

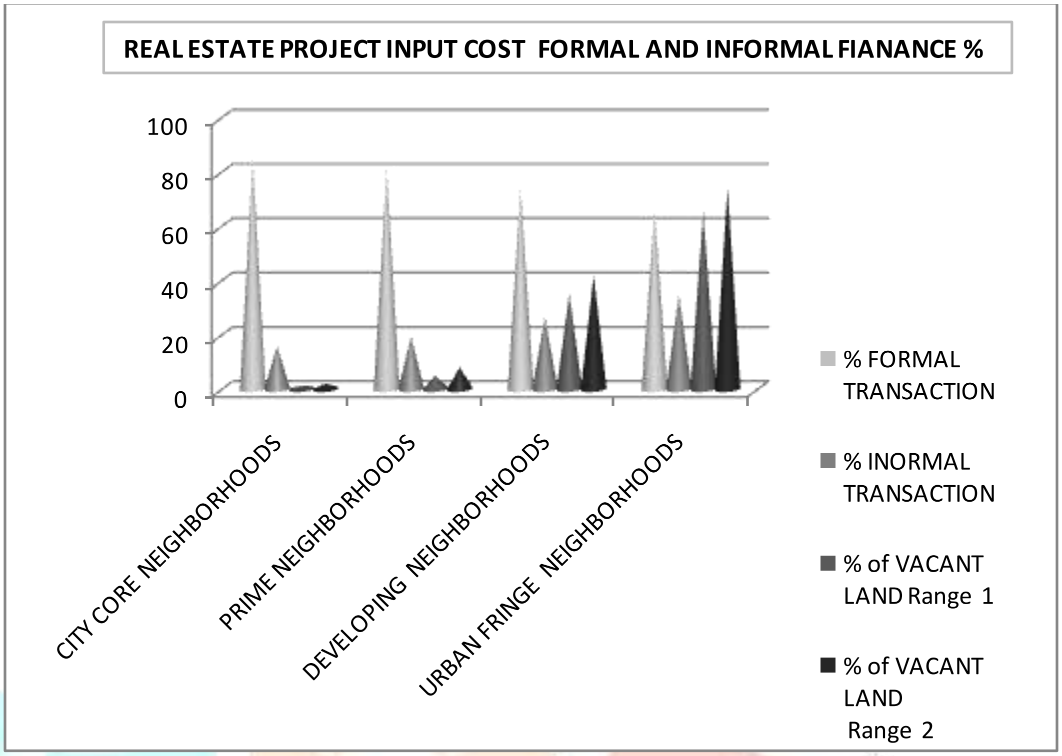

Figure 2: Real Estate input cost for different neighbourhoods

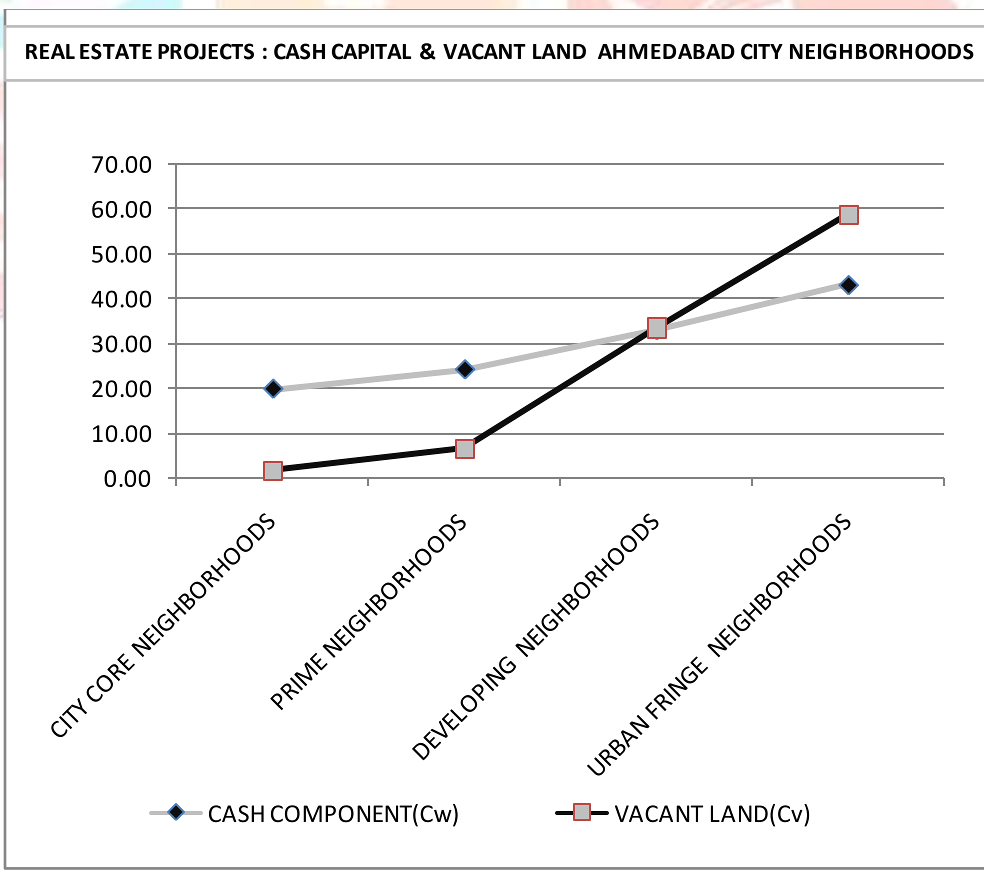

Figure 3: Cash component (Informal finance) Vs Vacant Land available

REFERENCES

1. Impact o Demonetization on Residential Real Estate http://jllapsites.com/real-estate-compass/2016/11/impact-demonetization-residential-real-estate/ (Nov. 14, 2016)
2. Impact of demonetization on India's real estate sector https://www.projectguru.in/publications/impact-demonetization-indias-real-estate-sector/(Aug, 2017)
3. Demonetisation and its impact on real estate. https://blogs.timesofindia.indiatimes.com/vantage-point/demonetisation-and-its-impact-on-real-estate/ (Nov, 2016)
4. Radhakrishnan, S., Selvan, K. G., & Senthil Kumar. Impact of Demonetisation on Construction Industry. International Journal of Economics and Management Studies (SSRG-IJEMS), (2017), Volume 4, Issue 1, Page 24–27.
5. Industry Outlook Report, Center for Monitoring Indian Economy (CMIE) https://www.cmie.com/kommon/bin/sr.php (July, 2017)
6. Bloomberg Quint https://www.bloombergquint.com/(August 30, 2017)
7. Advantages and Disadvantages of Demonetization. https://blog.hrblock.in/demonetization/advantages-disadvantages-demonetisation/ (Nov, 2016)
8. Kaur S., Impact of Demonetization on India, International Journal of Research, (Nov, 2016) Volume 3, Issue 17, Page 220-234
9. RBI on demonetisation news http://www.livemint.com/Industry/e73ZjH3vLuj6tlIn2b6wSJ/RBI-89-million-out-of-67-billion-Rs-1000-notes-not-return.html (Aug, 2017)
10. Yadav R. & Singh V., A Study on Impact of Demonetisation in India. International Journal of Business and Management Invention, (July, 2017) Volume 6, Issue 7, Page 79-81
11. Arora R, Present Status of Black Money in India and the Future Challenges International Journal of Academic Research (Nov. 2012)Vol.3, Issue-12(4), Page 145-153