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CURRENT STATE OF REAL ESTATE SECTOR IN INDIA: AN INVESTOR'S PERSPECTIVE

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ABSTRACT:

India's real estate market is expected to reach US$ 180 billion by 2020 from US$ 93.8 billion in 2014. Emergence of nuclear families, rapid urbanization and rising household income are likely to remain the key drivers for growth in all spheres of real estate, including residential, commercial and retail. Real estate is currently the fourth-largest sector in the country in terms of Foreign Direct Investment (FDI) inflows. Total FDI in the construction development sector during April 2000–May 2015 stood at around US$ 24.07 billion.

The Government of India has been supportive to the real estate sector. In August 2015, the Union Cabinet approved a very lucrative project for developing 100 Smart Cities in India. The Government has also raised FDI limits up to 100% for investment in township and settlement development projects. Real estate projects within the Special Economic Zone (SEZ) are also permitted 100 per cent FDI. In Union Budget 2015-16, the government allocated US$ 3.72 billion for housing and urban development. The government has also released draft guidelines for investments by Real Estate Investment Trusts (REITs) in non-residential segment. The present paper is an attempt to analyse the scenario of real estate market from investor's point of view.

INTRODUCTION:

At present, India is one of the fastest growing economies. Its past years have seen good growth and this was possible due to many reasons. One of the key factors behind this was the boom in the real estate sector caused by IT and related businesses and also the significant changes related to real estate businesses. This sector is now considered as the next economic growth engine. According to the tenth Five-Year Plan, it was projected that by 2007 there would be a shortage of housing units running to the extent of 22.7 million, which would force the government to increase spending in this sector. In order to accelerate growth in this sector the government has taken various measures like reforms in urban land ceilings, lowering of stamp duty rates, availability of finance at low rates etc. Further liberalization of Foreign Direct Investment (FDI) rules is also expected to increase the inflow of money into this sector. As per the report of the Federation of Indian Chambers of Commerce and

Industry (FICCI), after agriculture sector, this is the second largest employment generating sector of Indian economy. This sector is very lucrative as it has given excellent returns in the past.

WHY DO INVESTORS INVEST IN REAL ESTATE?: SOME REASONS:

India is a large country with huge potential for development of real estate sector. The ever increasing movement of population from rural to urban areas keeps creating pressure on urban infrastructure. Development of service industry is also somewhat responsible for this mounting pressure on urban lands. Further huge gap between opportunities and facilities in rural and urban areas has also increased migration from rural to urban areas. Thus there is huge potential for development of real estate sector in our country. Some major reasons for the development of this sector are given below:

EASY FINANCING BY BANKS:

This is the topmost reason of growth of real estate sector in India. Today's the young professionals and entrepreneurs find it easy and more return oriented to buy/build a house instead of taking a property at rent. The major reason behind it is the availability of cheaper finance by banks and their easy repayment schedules. When they see that paying the installment is easier than paying the rent as the former gives the option of owning the property also which is absent in the case of later options.

CHANGING PRIORITIES:

Gone are the days when one would work hard all his life and only at the far end of his career one was able to purchase a house that too after exhausting his all life's savings. Continuously increasing disposable incomes have created a neo-rich class which considers buying a real estate property as an investment. With easy and variety of loan options available, more and more youth are now availing these loans.

ATTITUDE OF BANKERS:

In the old days attitude of bankers was so negative that they would never want to give a loan except to their trusted few. Apart from their attitude, formalities of raising a loan were so cumbersome that after applying for loan, the loan aspirant would think it better to withdraw his application. But the scenario has changed now. Banks, too, prefer extending loans to young professionals/ businessmen as compared to elders as these are long-term loans.

MARKET SIZE:

The Indian real estate market is expected to touch US$ 180 billion by 2020. The housing sector alone contributes 5-6 per cent to the country's Gross Domestic Product (GDP). In the period FY08-20, the market size of this sector is expected to increase at a Compound Annual Growth Rate (CAGR) of 11.2

per cent. Retail, hospitality and commercial real estates are also growing significantly, providing the much-needed impetus for India's growing real estate needs.

INVESTMENT BY PEs AND NBFCs:

During the first nine months of 2015, PE funds invested about US$ 2.4 billion in the real estate sector, across 53 transactions as compared to US$ 1.3 billion across 57 transactions during the same period last year. Deal sizes have also increased in 2015 and residential projects both luxury and affordable have attracted a substantial amount of capital. Private Equity (PE) funds and Non-Banking Financial Companies (NBFCs) in India are seen increasingly investing jointly in real estate projects, in order to hedge risk and undertake bigger transactions. In terms of commercial real estate it is seen that Mumbai is the best city in India for commercial real estate investment, with returns of 12-19 per cent likely in the next five years, followed by Bengaluru and Delhi-National Capital Region (NCR).

INCREASING DEMAND FOR OFFICE SPACE:

India's office space absorption stood at 35 million sq ft during 2015, which is the second highest figure in the India's history after 2011 and was driven by corporate houses implementing their growth plans. India had the strongest activity in office leasing space in Asia which accounted for half of Asia's total office leasing in third quarter of 2015. Delhi-NCR is the biggest office market in India with 110 million sq ft area available, out of which 88 million sq ft has already been occupied. Out of all the area covered in Delhi-NCR, Delhi is the most active market in terms of office space requirement. Delhi's Central Business District (CBD) of Connaught Place has been ranked as the sixth most expensive prime office market in the world with occupancy costs at US$ 160 per sq ft per annum. Sectors such as IT and ITeS, retail, consulting and e-commerce have registered high demand for office space in Delhi-NCR in recent times.

IT AND ITeS SECTORS ACT AS CATALYST:

The median age of house loan borrowers in India now stands between 28 and 30 years from the earlier age of late 30s to early 40s, which was the status a few years ago. The trend is primarily being driven by the employees working in the IT (Information Technology) and ITeS (IT enabled services) sectors, for which India holds a lot of potential.

This is the research finding of DTZ (Debenham Tie Leung), a London Stock Exchange listed company. DTZ is one of the leading global real estate advisory and consultancy firm, which began operations in India two years ago. To begin with, the demand for commercial office space is a major factor. The commercial (office) market is dominated by the IT and ITeS sectors that accounts for approximately 80 per cent of the total commercial space absorption in India.

For every 100 sq. ft of commercial (office) space, approximately at least 600 sq. ft of residential space is required. The median age of working in the IT and ITeS companies are relatively younger and consequently, the average age of buyers has also declined.

Add to that, an increase in the number of nuclear families and young working couples, especially IT professionals, both having purchasing power and willingness to make the long-term investments in housing have increased demand for housing from such younger sections of the population. "With the interest rates rising and falling yield in residential property we will have to see how this market will go as there are lots of speculation in this sector," The DTZ Managing Director opines that besides India, China is another country in the Asia Pacific region, which is attracting significant investments across all real estate segments. "China is known for prowess in manufacturing and India for its ability to service offshore clients. Together, these two countries make up a large chunk of the real estate pie in Asia Pac and the world," In the study conducted by DTZ Research, Bangalore ranked third after London and Tokyo for commercial office space absorption in 2005, putting India on the global map with regard to real estate activity.

THINGS TO BE KEPT IN MIND WHILE INVESTING IN REAL ESTATE:

The following things should be kept in mind while investing in real estate sector:

PRICE: The price of property is most valuable factor for determination of real estate. The property must be evaluated with regard to its price in relation to its position and its use. Regarding position, it should be situated in a place where higher rent is available. For example, property situated at Connaught Place in Delhi will be useful for departmental stores and hotels. A property situated in Greater Kailash would be useful for residence, apartments or shops in the shopping area. Property in Delhi situated in Brijwasan would be useful for farms. After the property for farms is being considered it must be found out whether the land is given for growing crops or is the climate suitable for rearing fowls or poultry farms? So the productivity will determine the price. If the land is acquired for a price which gives a less profitable return the price at which the investor purchases it will not be suitable for him. Therefore, when an investor buys and sells property he should evaluate it according to its most productive use.

SUPPLY OF LAND: Land is a fixed asset and its availability is also limited. But its demand is ever increasing. In areas in Mumbai, land is being recaptured by reclamation methods but these are rare incidences and, therefore, the land should be evaluated only in terms of what it actually is in terms of supply. The increasing population and affluence will increase the rate and value of land. Land from the point of view of long term investment can be expected to be a good proposal because it is

expected to cover purchasing power risk with the prices of land which keep on increasing. On short term basis, property cannot be termed as good investment.

LAND AS COLLATERAL: Land is accepted as collateral by banks and other financial institutions. In India it is found that almost all banks consider land as good collateral but lending on property is restricted by the banks to the extent of the market price of the property kept as collateral. If an investor can purchase land and borrow money on such investment at a lower rate of interest it is also a good form of investment.

TAX: The purchase of land must always be determined after carefully examining the payment of tax on property. Tax must be paid on house property as well as other properties at the time it is sold. Capital Gains arising out of such transfer are also taxable under Income Tax Act. Capital gains arise from the transfer of building or land whether self-occupied or let out.

REAL ESTATE MUTUAL FUNDS: AS AN AVENUE OF INVESTMENT:

Market regulator SEBI has defined REMF as a scheme of mutual funds, which has investment objective to invest directly or indirectly in the real estate property. This type of fund will be governed by the guidelines under SEBI (Mutual Funds) regulations. These have evolved greatly in USA where they are referred to as Real Estate Investment Trust (REIT). The basic difference between REIT and REMF is that in case of the former, tax liability is minimal as it is a trust; while in the case of the latter tax rules as per other mutual funds are applicable.

The REMFs can invest in real estate properties within India, mortgage backed by securities, equity shares/bonds/debentures of listed/unlisted companies, which deal in real estate and also undertake property development in other securities. As per SEBI, the REMFs should invest at least 35% of their funds in property and 40% can be invested in shares and securities of realty companies. These funds own properties, commercial spaces and earn income in the way of rent and also in the form of capital appreciation. They acquire, develop and sell the property and the benefits are shared with investors, just like in any other mutual fund scheme. But the process of land acquisition by realty developers across the country had slowed down a bit after the RBI norms have discouraged banks from providing funds to developers for purchasing land. Banks are allowed to lend funds only after the property developers have taken all the necessary approvals from the state and local authorities.

With the emergence of REMFs, not only the investors will earn profits, but overall industry will also stand to gain. The development of the real estate sector will be boosted by the entry of capital that these funds are likely to bring. However, it should be kept in mind that this fund is very different from that of other mutual fund offerings whether on the structural front or on the functional front. It can be used as an excellent diversification tool for minimizing risk and maximizing returns. REMFs

are still in the stages of infancy in India. There are vast challenges to be addressed and it is hoped that as time passes, this fund will prove its creditability and will get established as sound investment option. Now is the time to use the growth potential that this industry offers for generating more resources. For this purpose, mutual fund trustees need to play a greater role as far as few offerings are concerned; besides this, SEBI and AMFI also need to play a crucial role with respect to the guidelines and monitoring of the funds. REMFs should make the potential investors aware about the stock market volatility as the level of knowledge of the investors can affect their returns. It is high time that the untapped potential of REMF industry is tapped.

IMPACT OF DEMONETIZATION ON REAL ESTATE SECTOR:

On 8th of November 2016 demonetization of Indian notes of Rs. 1000 and Rs. 500 was announced. It came as a shock to the entire nation. Indian economy has always been cash rich economy. It is a widely acknowledged practice that the major part of real estate transaction is carried out in cash. Only a small amount of registration tax is paid to the government. As a result the real estate sector is experiencing a slump. But the industry experts say that after some time demonetization of currency will provide opportunity for small and medium real property buyers due to correction in prices of real estate. Benami transaction and land grabs will also witness a fall. It is expected that demonetization can prove a call for 'acche din' for middle class home buyers.

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