The Bubble In Real Estate

As interest rates continue to climb, and prices soar to unsustainable levels in key pockets of the country's landscape, it's time for real estate developers, investors and end users to be worried. The bubble won't burst- not yet-but there's a bubble all right. By Krishna Gopalan

Appreciation in residential property prices in big cities is slowing down

Ceejay house in up-market Worli in central Mumbai is a swank, mint-new, 11-storey commercial structure. Till recently, the going rate for rentals here was around Rs 300 per square foot per month, making it one of the most expensive office spaces in the financial capital. A clutch of Wall Street banks had lined up to purchase offices at Ceejay. In a few months the asking rate duly zoomed to Rs 450 per square foot per month. That meant an area of 30,000 square feet, which is what at least one of the investment banks was looking for, would command a price tag of a cool Rs 1.3 crore per month. Now investment bankers are no doubt making money hand over fist, but they're also quick to spot a bum deal. According to those familiar with the Mumbai property market, two of the Wall Street firms have backed out from their respective transactions after the 33 per cent spurt in Ceejay's rentals.

Cut to Whitefield, the technology nerve centre of Bangalore, where rentals have plateaued over the past three months. At Rs 27 per square foot per month, the appreciation over a year is just 17 per cent. What's more, the buying rate for commercial property is the same as what prevailed a year ago-Rs 2,300 per square foot. Now remember Whitefield is home to the International Technology Park, and to some of the biggest names in the information technology sector, like AOL and IBM to name just two.

It's been party time for the property pashas of Punjab. Prices of commercial plots have doubled over the past 24 months. Plots in Chandigarh measuring 500 square yards, which could be bought for Rs 50-60 lakh each three years ago, had shot up to Rs 3 crore by early 2006. Those prices have now cooled off a bit to Rs 2.4 crore. In Mohali, residential plots with an area of 500 square yards, which were going for Rs 1.7 crore a year ago, are down to Rs 1.5 crore. Similarly, a 250 square yard plot which was quoting at Rs 95 lakh a year ago is down to Rs 80 lakh today.

SCAM IN THE SLUM?

The stakes in Mumbai's ghetto rehabilitation exercise are akin to prices in upscale South Mumbai-high.

If developers in Mumbai continue to expect heady prices for their constructions, it's simply because of the sheer demand for space-residential, commercial and retail-in the chock-a-block commercial capital. Creating more spaces to accommodate more supply is the need of the day, and it's here that slum rehabilitation could prove a major determinant of future price trends. Mumbai's Dharavi area-the largest slum in Asia-occupies an area of 535 acres, almost all of it prime property in the heart of the city. Slums in Mumbai are estimated to occupy around 60 per cent of the city's land. Given the high stakes involved, the entire exercise somewhat predictably has degenerated into a scam, with a section of builders reportedly claiming ownership to some slums in Mumbai. The rules of the Slum Rehabilitation Authority (SRA) specify that a builder who is interested in developing slum land will necessarily have to get the consent of at least 70 per cent of the slum residents. The tricky part is in rehabilitating the residents and what can be done with the surplus land. The normal process entails providing affordable housing to the slum residents and charging higher rates from the surplus land which normally has better housing. Media reports have suggested a nexus between the builders and the government.

According to eminent Mumbai architect, Hafeez Contractor, it is important to provide more slum housing. "If there are 50 people living in the slums, it is important to create housing for at least three times that number," he states. In his opinion, the important thing is to employ the land in a more productive manner. "If you have 10,000 acres of land out of which half is housed in a salt pan, it is necessary to increase the floor space index (FSI) on the balance 5,000 acres," adds Contractor.

The environmentalists have a different point of view. Debi Goenka, who heads the Bombay Environment and Action Group (BEAG) thinks the present policy of slum rehabilitation is not the right approach. "The policy rewards people who are breaking the law and it appears to be a political move. Mumbai's slums are just vote banks and are never a priority," he says. Goenka adds that the policy will have to be corrected to the extent where a free house cannot be given to an encroacher.

With 350 families estimated to be entering the city every day, affordable housing is critical. At the same time, the city boasts a super-rich elite whose appetite for upscale housing is still not sated. "It is hard to imagine what will happen to Mumbai's housing when the city's population hits a figure like 30 million (from the current 16 million)," shudders Contractor.

Commercial property rates also haven't gone up sharply in the past one year

Wake up, step outside and take a good look around. Such signs of cooling off in property prices might just be wafting around in that skyscraper being raised in your backyard. Or in that office space for which you're poised to sign on the dotted line. Worli, Whitefield and Chandigarh aren't just aberrations or stray pockets of inactivity in what was till recently an all-embracing manic property market. After three-four years of stunning gravity-defying appreciation, prices of residential and commercial real estate are pausing for breath. Consider some more random examples from across the country: Residential property rates on Delhi's Prithviraj Road and Aurangzeb road are 46 per cent higher than they were a year ago. However, for the past six months those rates haven't budged an inch. Similarly, the average value of homes in Friends Colony and Maharani Bagh is up 104 per cent in a year. The appreciation over the past six months? Just 5 per cent. Move on to Bangalore, where the rates per square foot in the areas of Malleshwaram, Rajajinagar, Jayanagar and Koramangala are up by just 2-6 per cent over the past three months. Even in the financial capital Mumbai, the appreciation in tony South Mumbai is subdued, from 30 per cent-plus levels a year ago to a modest 13 per cent over the past six months. The slowdown is more visible in the commercial sector, with sale prices in suburban areas like Bandra-Kurla, Andheri and Powai stagnating over the past three months. In Bangalore and Kolkata too demand for office space has slowed to a virtual crawl in the past three months.


Property prices have cooled off a bit in smaller cities too

Don't panic: There's no crash waiting to happen. Not yet. But across the country there are investors, financiers and developers who've been caught off guard, as liquidity and appreciation are no longer everyday companions to cosy up with. To use the 'greater fool's theory', there would be many investors out there looking to pass off their overvalued asset to an even more ravenous speculator-the greater fool-at a higher price. The greatest fool will of course be the guy who can't find a sucker onto whom he can palm off the asset at an even higher price. And that's when the bubble will burst. "Prices in the real estate sector are at their peak. We have already seen a slight dip in the demand and some softening of prices in select pockets such as Whitefield, Noida and Ghaziabad. A combination of prevailing prices in the real estate sector and rising interest rates will see some investors exit the market," says Renu Sud Karnad, Executive Director, HDFC.


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Renu Sud Karnad/Executive Director/HDFC

Many such investors would be looking for bail-out options in the North Indian cities of Ludhiana, Chandigarh and Jaipur where, real estate consultants point out, prices are in the over-valued zone. In Ludhiana, for instance, where at least 10 malls are in various stages of construction, commercial property rates have soared from around Rs 1,700 per square foot two years ago to Rs 4,000 per square foot-to put that in perspective, that's the going rate in Bangalore's bustling Koramangala and Indiranagar districts, and in Navi Mumbai's it hub! "In cities like

Ludhiana and Chandigarh I expect a correction over the next three-six months, which will be to the extent of 10-15 per cent," says Anuj Puri, Managing Director, Trammell Crow Meghraj Property Consultants. Puri adds that speculation accounts for at least half the property-related transactions in that part of north India, which has resulted in prices rocketing to bizarre levels.

S. Sriniwasan, CEO, Kotak Realty Fund, points out that the appreciation in some parts of India was too quick for comfort. "Certain micro-markets have got over-heated. Among these are the satellite towns in North India and Bangalore's it parks," he says. One reason for that is that supply in such regions has inevitably raced ahead of demand. That's clearly the situation in Whitefield. "Whitefield was one of the most sought after locations a couple of years ago but an oversupply of realtors has led to a price slump," says Sushil Mantri, Managing Director, Mantri Developers. Purvankara Projects is a developer with a large exposure to Whitefield. Director Ravi Ramu anticipates a shakeout among developers in this district.

"While a price increase of 5-10 per cent yearly can be absorbed, it may not be desirable to have something higher than that"
Rajiv Sabharwal/Head (Retail Assets)/ICICI Bank

It isn't as if the era of over-exuberance is over. In the most expensive market, Mumbai-also the fifth most expensive city in the world for office space-profits booked on the stock market duly find their way into property. And the graph keeps heading northward in upscale south Mumbai. On Altamount Road, prices have hit the Rs 50,000 per square foot mark, and in Tardeo in central Mumbai duplex apartments measuring 10,000 square feet are in the market for Rs 45 crore, which is the annual net profit of a mid-cap company like Geodesic Information Systems and basf India! "The cost of residential housing is typically 3-4 years of the gross earnings of a person. Today, it is at least 6-7 times," says Pranay Vakil, Chairman, Knight Frank India, a Mumbai-based real estate consultancy. At the top end (properties in the Rs 15 crore and above bracket), the cost would work out to 15-20 times an individual's gross earnings.

It's such rampant mania that's making lenders cautious. The home finance majors, for their part, have slipped into conservative mode (80 per cent of real estate demand is from the residential sector). "A sharp increase in real estate prices is the biggest worry for a lender. We evaluate a borrower on his current income and we have been conservative on loan to value over the last 1-2 years," points out ICICI Bank's Head- Retail Assets, Rajiv Sabharwal. "While a price increase of 5-10 per cent yearly can be absorbed, it may not be desirable to have something

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higher than that. The more important thing is to increase the supply of land," he adds.

Making it easier for supply to race ahead of demand is sobered-down demand itself, a direct outcome of rising interest rates and tighter liquidity conditions. "Rising interest rates is a cause of concern for the real estate market. Sales have definitely reduced in many locations across many cities in the country. Though the developers in most of the locations have held on to the rates, the rate of appreciation has reduced and may further go down if the mortgage rates continue to increase," says HDFC's Karnad. She adds that the land appreciation in many cities is unhealthy for the market. "The Reserve Bank of India (RBI) has discouraged land funding which is expected to reduce liquidity in land transactions. We expect the land prices to stabilise and in some locations to fall in the near future which will be good for the market in the long-run," she adds.

The RBI's cautious approach on the sector is now well-known. It is precisely because of the speculative flavour of the real estate industry that the RBI specified recently that finance companies accepting public deposits will not be allowed to invest more than 10 per cent of their net worth in land or property except for their own use. "The real estate sector is heated today. Banks would have to take a holistic perspective towards the sector and should be cautious," says Jitender Balakrishnan, Deputy Managing Director, IDBI Bank.

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Architect Hafeez Contractor: It is important to provide more slum housing

An early-on indicator of the correction that's begun to take place is the bear hug on real estate stocks which, on an average, are down by around 50 per cent from their all-time highs (see The Higher They Rise...). Finance Minister P. Chidambaram's budgetary proposals didn't provide much joy, with property stocks tanking by around 10 per cent two days after the announcement. Differential rates of excise duty on cement coupled with the sub-contractor not being entitled to section 80 1A/1B benefits is seen as a dampener for the construction/infrastructure industry, according to Seemanta Roy, Head Amby Valley City & Entertainment Business of Sahara Pariwar. What's more, he adds that in cities like Mumbai where rentals for commercial property are as high as Rs 350 per square foot per month, a service tax of 12.36 percent could well prove to be the proverbial straw that breaks the camel's back.

The picture may not that be that bleak. Demand is not exactly non-existent, and CRIS-INAFAC report on real estate construction points out that the sector will average 5 per cent growth cumulatively between fiscal 2006 and 2008. Developers, for their part, are still full of beans. "There is a continuous growth in demand in the principal cities and people will continue to pick up property," argues Niranjan Hiranandani, Managing Director, Hiranandani Constructions, who adds that prices in Mumbai are still on the rise. In some non-metros too, there would appear to be some headroom left. The Bangalore-based Brigade Group is offering deluxe apartments in Mysore at over Rs 1 crore. "With a new airport on the anvil and overall connectivity being enhanced, Mysore could be the next big real destination," thinks Brigade Group's Managing Director, M.R. Jaishankar. Yet, analysts point out that Mumbai and Mysore aren't the best examples of markets dominated by speculators. It isn't as if the entire Indian real estate market is overheated, but certainly there are some crucial pockets that need to be cooled off. As IDBI Bank's Balakrishnan puts it: "It's not a bubble yet, but we cannot allow it to become one." In many parts of India the greatest fool may be just a couple of transactions away.

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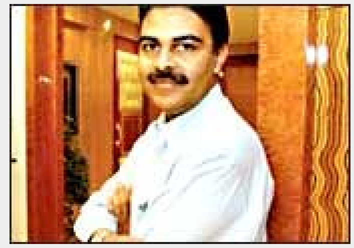

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