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Tall Story

Crores of rupees are pouring into real estate and starry-eyed companies have lined up massive IPOs. How long will the boom last?

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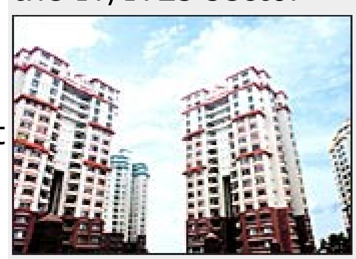
For Whom The Cranes Toil?
India is in the middle of an unprecedented real estate boom. Commercial and residential projects are mushrooming all over the country, and things seem too good to be true.

Work in progress: In Gurgaon, high-end apartments start from Rs 1.5-2 crore and the boom has been fuelled largely by the expansion of the IT/ITEs sector



Prices are going through the roof and genuine buyers are being priced out of the market. Still, any major price correction seems unlikely as of now

Vijay Devarajan, 28, is worried. For the last several weeks, he has been using his weekly off to scout for a suitable place to buy. He visited Adyar, Thiruvanmiyur and Kottivakkam in Chennai. But, no luck. And, not because there is no supply of houses, but because they are well out of his range. A team leader at the Chennai office of Covansys, an it services company, he got a 15 per cent pay hike last year and wanted to use the equated monthly instalment (EMI) instead of the monthly rent to fund his acquisition of a house. Today, however, he is feeling priced out of the market. Prices across locations have gone up by 40-50 per cent (see See How They Surge). A two-bedroom apartment, about 700 sq. ft, with a few basic amenities, miserly parking space and other common spaces, is quoting at Rs 25 lakh in most parts of the city, that too exclusive of registration. The EMI at Rs 1,030 per lakh would work out to nearly Rs 22,000 if Devarajan takes 85 per cent of the cost as a home loan. The instalment on a monthly salary of Rs 30,000 would leave little for him to manage other expenses. Devarajan is not sure if he would like to take on this burden, even though his monthly rent is a bit on the steep side at Rs 8,000 in Thiruvanmiyur.

Devarajan's case typifies the conundrum in the residential sector. And that comprises nearly 90-95 per cent of the real estate sector in India. Commercial realty makes up 4-5 per cent, while retail corners the residual 1 per cent. It is people like Devarajan who fuelled the housing boom in India over the last five years and yet they are now feeling the pinch, the breathtaking rise in prices having outpaced their expectations. Adding to the problem is the supply. There just seems to be not enough new development at the budget end of the spectrum. However, at the same time Rs 1-crore apartments, which were a novelty a few years ago, have lost their shock and awe value.

If genuine buyers are being priced out of the market, then is the price rise sustainable? Is there a correction in real estate prices in the offing? If one were to believe Gaurav Dalmia, Chairman, Landmark Holdings, then a price correction is long overdue. Landmark currently has projects worth Rs 7,500 crore under development. Dalmia is unsure of the real buyers in the market at current prices. "Majority of current buyers are speculators and the prevailing prices are not time tested in the real user marketplace."

The Boom's for Real, They Claim

His is an increasingly lonely voice in a crescendo which says that though there may be minor corrections in smaller markets, there is no overarching correction in the offing. The case for a price correction needs to be seen in an appropriate context, believes Emaar-MGF's Executive Vice Chairman and MD, Shravan Gupta. The joint venture with the Dubai-based Emaar Properties has placed the biggest bet on Indian real estate in the form of the largest foreign direct investment. "If you take high-end properties in cities such as Delhi, then they are unlikely to correct as prices in that segment are inelastic," he says. However, he does not rule out corrections in the low middle to middle market categories, but they may also take some time to materialise because of the current momentum. "The economy is growing, more wealth is being created and income levels of the salaried class are rising," Gupta adds in support of his argument.

There has been a 10-15 per cent increase in average salaries across the board last year alone. This has enhanced affordability to take loans. For instance, the average individual loan size in HDFC's portfolio had almost doubled from Rs 4.50 lakh in 2003-04 to Rs 8.40 lakh in 2005-06. Niranjan Hiranandani of Mumbai-based Hiranandani Constructions points to another trend, stating that the home buyer's average age (at least in the case of his company) has decreased from

45 years to 30 years over the last five years. "There is unlimited demand for housing in the Rs 2,500-3,000 per sq. ft. segment in the metros and Rs 1,500-2,500 per sq. ft segment in the next group of cities," he says, asking the next moment, "Where (in which market or segment) is the supply commensurate with demand?"


The escalating prices are beyond the middle class buyer. And there just seems to be not enough new development at the budget end of the spectrum

Robust and unflagging demand is certainly an indisputable argument in favour of rising prices. While the Tenth Five Year Plan (2002-07) estimated a shortage of over 22.4 million dwelling units in India, Housing Development Finance Corporation (HDFC) estimates the housing shortage at 19.8 million units at the end of 2005-seven million in urban areas and 12.8 million in rural areas.

So, are there no imperfections in the current market scenario? Of course, not. HDFC's Executive Director, Renu Karnad, believes there could be a case for some correction in cities such as Bangalore, parts of Delhi-NCR, Mumbai and Pune. In these locations, the IT/ITEs sector expansion has been more pronounced and ownership of multiple homes is prevalent. "In Gurgaon, virtually nothing is available at less than Rs 1.5-2.0 crore," she adds. In places like Parel in downtown Mumbai, there are apartments ranging from Rs 4-5 crore. HDFC has been funding the residential mortgages for over 29 years and is the largest housing finance company in the country. Karnad, however, adds that strong demand for these high-end apartments has been a surprise.

ICICI Ventures' Kishore Gotety offers an explanation even as he makes a case for more emphasis on affordable housing. "The luxury segment is a hugely underserved market. However, in absolute terms, there are only a handful of people who can afford these apartments, and they don't sell as fast. So, going forward, developers might reduce the luxury developments in the overall mix," he says. In markets, where there could be an oversupply of these high-end apartments, there could be a 5-10 per cent correction, he believes.

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Demand from businesses for real estate seems robust. Some 38 million sq. ft of commercial office space is expected to come up in top seven cities by 2007

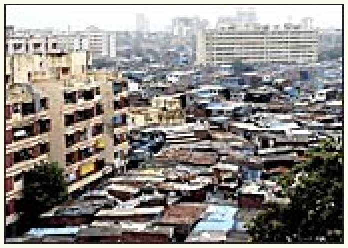
A good amount of demand has also been coming from the smaller towns and cities-traditionally called Tier-III cities, though that classification seems to be getting outdated. Pranav Ansal, Director at Ansal API, which claims to be one of the largest developers in this segment, believes there is reason to be bullish on these cities. "Banks, insurance companies, telecom companies, FMCG, electronics companies are all expecting growth in smaller cities. And backing this is the pent-up demand in these cities, which have only now received good quality real estate products." Ansal continues to bank on the middle market in housing, although he says the definition differs across markets, ranging from Rs 20-25 lakh.

Sahara group's senior advisor, Sundar Lal agrees. "The local economies in these second-rung cities are very strong." Sahara reportedly has one of the largest land banks in these cities. Lal says Sahara has the necessary approvals for integrated townships in around 12 cities such as Lucknow and Indore, and around 45 more are in the pipeline with each project costing Rs 600 crore apiece. But for the investors punting on these cities, there are the added disadvantages of illiquidity of the investment as also over-supply in the short term. Jaipur, Mohali and Kundli are cases in point. Sustainability of demand in these cities will also depend on how much it companies flirt with Tier-III cities and other employment opportunities.

At present, demand from businesses for real estate seems robust. Some 38 million sq. ft of commercial office space is expected to come up in top seven cities by 2007. In fact, the industry has a thumb rule that says for every 500-700 sq. ft of residential space added, another 100 sq. ft of commercial space must be added. While there are concerns of oversupply in cities like Kolkata and Pune, builders aren't too worried.

THE LOW-COST HOUSING OPPORTUNITY

A house for Rs 5 lakh? Possible, say some investors.



There's potential here, too: Mumbai's, and Asia's, largest slum Dharavi

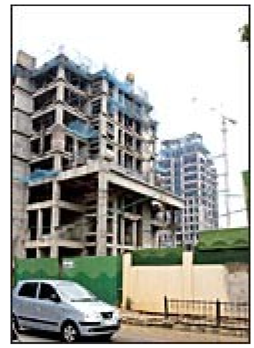
It is an extremely underserved market," says Gopal Patwardhan, Managing Partner, Duke Equity Partners, a UK-based private equity fund, which has allocated some $300 million towards investments in India, mostly in low-cost housing. Patwardhan believes that there is solid profit to be made in the segment. It is possible to sell a house at a price of Rs 5 lakh by keeping a tight rein on land cost and generating economies of scale (minimum 1,500-2,000 tenements), he adds. Notwithstanding his optimism, land cost alone makes such stand-alone projects unviable in Tier- I cities. A stronger business case is possible in sub-urban areas. New York-based Trikona Capital's founding member Rak Chugh tends to agree, as his fund is planning to invest a billion dollars in Mumbai real estate, including low-cost tenements. Chugh, however, believes that the government will have to pitch in to meet demand at this end. "It could be a public-private partnership model," he says. Small measures also could help. For instance, "the government could allow higher floor space index in such projects", says Duke's Patwardhan.

One option that has been explored in Mumbai, and now in Maharashtra and other states, is a free sale of additional land in lieu of the developed tenements. Mumbai-based developer Akruti Nirman has built 12,000 low-cost houses in the last 12 years in various parts of Mumbai under such a scheme. Akruti's Vimal Shah finds it is a sustainable model. If India's housing deficit is to be bridged, then low-cost housing has to be the

Apart from it and ITEs, there are three other drivers of the boom, they say. Retail, hospitality and special economic zones (sezs). Organised retail has just about taken off and the global giants (Wal-Mart, Tesco, Carrefour) aren't even here. "(Their entry) will swing the pendulum in a huge way," says Cushman's Verma. "However, that uncertainty makes retail full of potential, yet quite unpredictable," he adds. Hospitality is another segment that has taken off. Hotels are now being offered as part of a mixed land use property, prompting developers to move from one-off hotel projects to long-term alliances with hoteliers. DLF has a joint venture with Hilton, and Unitech has signed management contracts with the likes of Marriot and Carlson Hospitality. As the magazine went to press, Emaar-MGF was expected to tie up with Accor for a multi-location deal. "It's a natural progression for us to move from real estate to hospitality," says Vineet Verma, who was recently appointed as CEO of Brigade Hospitality.

The final piece in the picture is the real estate development in the form of SEZs, since these are nothing but a real estate play with tax breaks. However, there is a lot of uncertainty and controversy over the SEZs policies that could take a few years to play out.

Keep a Wary Eye Out



Hotel boom: Developers are going for long-term alliances with hoteliers

If demand is so robust across the nation, then what is so worrying? A couple of things: the rate at which prices have escalated and the practices prevailing in the property market. Developers till recently were doing pre-launches of projects, raising money from end-consumers to fund more land acquisition as land prices kept going up. No heed was being paid towards timely delivery. A lot of this land acquisition by developers was also being funded by the banking system. "Often developers were raising funds on the basis of allotments only," says Karnad. That seems to have changed with RBI clamping down on loans to commercial real estate projects. Now loans can only be raised on the back of proper plans and approvals. Not unexpectedly, there seems to be a cooling off in speculative activity. More of this will happen as the market winnows the good from the bad. "Pricing pressures would be acutely felt by developers who do not deliver on time or deliver poor quality products," says Sanjay Chandra of Unitech. (For more impact on developers see The Bulls in Real Estate on page 160 and Is There a Shakeout...on page 170).

Though the cost for the end consumer has also increased, there seems to be no slackening of demand visible just yet. Loans continue to be available at 9.00-9.25 per cent, and the mortgage to GDP ratio is around 3 per cent, far lower than 51 per cent in the US and 12-20 per cent in more economically comparable countries. How will the situation play itself out over the next few months and probably years? There may be localised price corrections, but as long as the economy keeps humming, both man and machine in the real estate industry will continue to be in overdrive.