



## Real Estate Sector: Aftermath of Demonetization



The government of India announced the demonetization of 1000 and 500 rupee currency on 8 November 2016. This bold step will reduce tax evasion and wipe out unaccounted money from circulation, which is estimated by various sources to be 30% of the country's GDP. In the real estate development cycle, black money is utilized mostly at the land acquisition stage and also during the secondary sale of residential units and strata sale of commercial units. This quantum varies and is higher in business community dominated cities as compared to cities dominated by the salaried class. Unaccounted money is also involved in construction, liaising approvals, marketing of the projects, etc.; but that is much less in comparison.

We have analyzed the impact of the demonetization of the 500 and 1,000 rupee currency on the real estate market in short to long term.

### Stage 1: Immediate Aftermath (next 1 to 3 months)

As per the Reserve Bank of India (RBI) estimates, more than 86.4% of the total value of bank notes in India were in the denomination of INR 500 and 1000 rupee notes as on March 2016. The government policy of withdrawal of these currency notes will make it difficult for those evading taxes to declare their unaccounted money, which will mostly be in these two denominations. This will result in significantly

reduced liquidity in the market in the near term. We expect an immediate period of deflation, as money becomes dearer, as those who have incurred financial losses are likely to curb spending.

### Impact - Pause in the market

1. We expect little or no transactions in land, commercial strata sale and secondary sale of residential units at least for the next 3 months. The primary reason for this lull in the market is that, majority of the players will get busy in

figuring out how to account the black money and reduce their losses. At the same time, investors with white money will also adopt a wait and watch approach in expectation of decrease in prices.

2. Developers will be negatively impacted and can expect worsening in their cash flows

However, most Grade A developers had stopped the practice of taking cash in primary sales, thus they are less likely to get impacted on an

immediate

basis.



## Stage 2: Short to Mid-term (3 to 12 months)

Due to deflation in the market, we expect fall in inflation rates in the next 3 to 12 months. This should trigger RBI to reduce interest rates in the next cycle by about 50 basis points. The reduction in bank rate will put pressure on the banks to reduce home loan and construction financing rates. The effective price of real estate to the buyers should thus reduce, but not enough to trigger massive sales due to uncertainty in the markets. We expect, some properties to be available for sale in the secondary market at a further discount due to the financial stress.

Primary market sales will continue to be subdued as buyers will prefer secondary distressed property over primary markets. Some developers may be able to provide discounts though we expect them to increase the incentives. We also expect the usual resistance to lower prices.

As RERA starts kicking in, it shall make the business environment more stricter, making developers hold back.

### Impact - Good time to buy property from the secondary market

1. We expect home prices to reduce in the luxury segment first due to paucity of money in the market and the infusion of secondary market units on sale at lower rates. The delta between primary and secondary markets should thus increase.

2. In the affordable segment, we expect both transaction volumes and prices to remain largely unimpacted.

3. In our opinion, commercial rents may see a marginal upward pressure in low vacancy markets

such as Bangalore, Pune and Hyderabad. As new projects may take more time to get delivered.

4. It will also be a great time to invest in the real estate from the perspective of an institutional investor as valuations will be attractive. We believe, the long term fundamentals of the Indian real estate market will remain strong.

5. There will be negative impact on investment sales market as retail investor money will largely disappear.

6. Due to expected lower margins for developers, we are likely to see evolution of more efficient and cheaper construction techniques; and cheaper land prices.

## Stage 3: Long term (1 year onwards)

Along with other regulatory changes such as “The amendment of Benami Transactions (Prohibition) Act, Goods and Services Act (GST), and Real Estate (Regulation & Development) Act (RERA) this amendment is a step in the right direction towards improving transparency in real estate transactions.

We also believe that this pro-active government will make the real estate approval process easier and shorter, as a part of its ease of business initiative. This will ensure entry of more foreign entities (developers and funds) in the Indian market and more liquidity for the Indian developers who have an established track record. This should lead us to a new era of lower interest rate regime, fair competition and a more predictable business environment. At the same time it will lead to a higher threshold to entry in the real estate business.



## Impact – Institutionalisation of Real Estate

In the long run this will lead to an economy that is more aligned to global compliance standards and an industry with high levels of corporate governance making it easier for foreign entities to invest in India. We expect cap rates to compress due to decrease in risk. It should also boost **REIT (Real Estate Investment Trust)** listing in Indian market. We should see a more robust institutional investment market as retail investment participation in these segments will shrink.