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Demonetisation Policy: Its impact on the Real Estate Sector

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***Abstract*:- The sudden demonetisation policy, which sucked out over 80 percent of the currency in circulation, has hurt the Indian economy with the RBI itself downgrading the growth forecast for this fiscal to 7.1 percent from 7.6 percent earlier. The abolition of Rs 500 and Rs 1000 notes had come as a shock to several Indian industries, especially the real estate market. The real estate market in India has already been witnessing a slow growth and with this move, this sector has become stagnant and will remain this way till there is clarity over money circulation and transactions. Unaccounted money or black money has been affecting the Indian economy for a while and the real estate sector is believed to be a popular channel for such funds. While many have welcomed this move, some have expressed their concern for the real estate market.**

This present paper is an attempt to understand the impact of this historical move on the real estate sector which is the second largest employer after agriculture and has been estimated to grow at 30 per cent over the next decade

***Key Words*: India Brand Equity Foundation (IBEF), Gross Domestic Product (GDP), Compound Annual Growth Rate (CAGR), EV/EBITDA.**

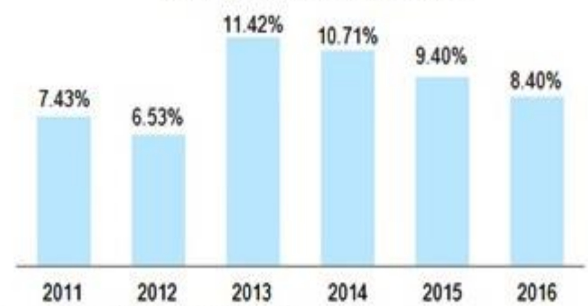
I. INTRODUCTION

Real Estate sector has always been one of the most watched and most sensitive sectors of Economy reflecting the changes that have been inscribed by the economic policy changes. Be it the tax reforms or demonetization or interest rate cuts or Shrinking stock markets real estate sector always reflects without a doubt. Indeed it is concerned with both common man of this country or rich upper class who see real estate as a parking centre for excess funds (including Cash).

The real estate sector comprises four sub sectors - housing, retail, hospitality, and commercial. The growth of this sector is well complemented by the growth of the corporate environment and the demand for office space as well as urban and semi-urban accommodations. According to India Brand Equity Foundation (IBEF), 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 FY2008-2020, 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 estate have also been growing significantly, providing the much-needed infrastructure for India's growing needs. India's real GDP has been estimated to be 6.8 per cent in 2019.

The Indian real estate sector has witnessed high growth in recent times with the rise in demand for office as well as residential spaces. According to data released by Department of Industrial Policy and Promotion (DIPP), FDI in Real Estate has been on a upward trend. The construction development sector in India has received Foreign Direct Investment (FDI) equity inflows to the tune of US$ 24.19 billion in the period April 2000-March 2016. During this period the total cumulative inflows in the construction development sector accounted for 8.4 per cent of total inflows into the country.

FDI in construction development sector as a per cent of India's total FDI



Source: Dept of Industrial Policy & Promotion
Notes: Construction development sector includes townships, housing, built-up infrastructure and construction development projects

The growing flow of FDI into Indian real estate has been encouraging increased transparency. While the demonetisation initiative by the Central government means further delays in ongoing real estate projects due to the massive cash crunch, it also paves the way for a cleaner and more transparent real estate industry in the times to come. Developers would be looking for alternative funding arrangements while end-users or investors would be waiting for more certainty before making any move.

II. OBJECTIVE OF THE STUDY

The present paper has the following objectives

1. To understand the immediate impact of demonetisation on the sales volume of the real estate as well as on the stock prices of the realty firm.
2. To understand whether there is any long term impact of the policy on the real estate sector.

III. REAL ESTATE: PRE-DEMONETISATION

The Indian real estate sector has been facing significant challenges in the past few years when it comes to sales and overall growth. With a lot of measures, the sector was clearly pointing towards a slow and gradual, but sure recovery.

Sales and Prices

After stagnating or even declining sales for past couple of years, the first half of the year saw some upward movement on the back of many positive factors. Prominent among these were the overall growth in the Indian economy, attractive deals and discounts being offered by developers, and the high potential of schemes such as Smart Cities, AMRUT and Housing for All by 2020 initiated by the Government.

The positivity these factors induced, coupled with increasing incomes and lowering of prices, encouraged buyers to begin finalising deals that were previously put on hold. Importantly, it was not only investors but also end-users who had started coming back in the market.

Unsold Inventory

Except for a few pockets in Delhi-NCR, most of the prominent real estate markets - including some NCR micro-markets - saw a gradual decline in the unsold inventories that had been choking up liquidity for builders. One of the reasons was the residential market being flooded with projects that were expensive, against the demand for more affordable ones - in simple terms, a classic supply-demand mismatch. To liquidate their holdings and ensure financial stability, developers became amenable to negotiating more and offering attractive deals. They also tied up with financial institutions to offer affordable loans, and announced other schemes to help buyers take decisions. This had started paying off.

New Launches

New launches reduced markedly in the current FY 2016-17, owing to higher unsold inventory; this means the developers were focusing their resources on disposing off the developed projects. Also, catering to the demand of affordable housing, new launches started focusing on that segment instead of catering to the high-end residential sector.

IV. POST-DEMONETISATION EFFECT

Owing to its uniqueness as an economic event, demonetisation brought a lot of confusion, uncertainty – and, most of all, rumour-mongering - especially when it came to the realty sector. No doubt, everyone was affected by this radical measure, and initially all possible economic activities slowed down to a large extent. However, the dust soon settled and economic activity resumed. Unfortunately, this quick return to relative stability is not something that has been adequately captured by the more disaster-focused media channels.

Every critic and observer took the easy way out to describe this event as the death of the real estate sector as we know it. This is not to say that the real estate sector has not been affected by the demonetisation move; however, it is important to understand where the pinch really lies, and where the silver lining is.

V. DECLINE IN SALES VOLUME

The year 2016 had projected negative growth of -9%. In the fourth quarter, after demonetisation, sales volumes have dropped by 44% and new launches have fallen by a massive 61% year-on-year during the same period. Had it not been for demonetisation, property markets would have actually fared much better.

NOTEBANDI PLAYS SPOILSPORT

Sales volume across Mumbai, NCR, Bengaluru, Pune, Chennai, Hyderabad, Kolkata and Ahmedabad

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
All India	2,79,784	2,03,344	2,39,723	3,61,483	3,68,568	3,59,308	3,29,238	2,79,822	2,67,957	2,44,686
Growth	–	-27%	18%	51%	2%	-3%	-8%	-15%	-4%	-9%

SOURCE: KNIGHT FRANK INDIA

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“The fall in sales volumes and new launches has been so severe during the last quarter of 2016, that it has brought down the entire second half of 2016 numbers down by 23%

and 46% respectively compared the second half of 2015," says a report by Knight Frank India titled India Real Estate.

"The residential markets of the top eight cities in India had started off on a positive note in 2016 with the first half of the year witnessing a 7% jump in sales volumes. The third quarter sales volumes also showed positive growth on the back of the start of the festive season.

VI. IMPACT FELT BOTH IN PRIMARY AND SECONDARY SECTORS OF REAL ESTATE

The construction industry alone accounts for about 8 – 10% of the GDP and offers employment both direct and indirect to about 40 million people.

- The demonetization has caused abrupt stoppage of work in many projects. The payments, especially to workers, were only by liquid cash. The sudden restriction on withdrawals led the contractor unable to cope with the labour pressure.
- Work at SARE Homes' residential projects, spanning six cities, has slowed dramatically as migrant workers, who are out of cash and have no bank accounts to draw from, have little choice than to return to their home villages.
- According to Property Portal 99 acres, property enquiries also slumped by nearly 80%.

VII. IMPACT ON THE LABOURS AND THE CONSTRUCTION COMPANIES

The first and foremost issue after the currency demonetisation was the fleeing of labour force from the sites. They were not paid money for the days they worked. They could not prolong in a new place without liquid cash. The local people were also reluctant to extend credit facility to migrant workers, as they themselves were badly hit by poor cash sales. Consequently, the labourers were returning to their villages. Many of the ongoing projects came to a standstill.

- Majority of workers do not have bank account at all. As they are the floating population seeking job, it is literally impossible for them to open bank accounts from place to place.
- The Contractors, though they had sufficient balance, could not draw from bank in view of the restrictions on the amount and number of transactions per week. They were only silent spectators to the fleeing of workers from the site.
- The new bookings were virtually nil. The Builders who made a massive investment are in troubled waters. India's decade long construction boom created one in three new jobs as tens of millions of people made journey from rural areas to towns seeking livelihood, came to a grinding halt.
- This sparked a blow also on the Cement and Steel makers who faced a sudden slump in demand.

The cement demand dropped 45-50 per cent in November with the sharp decline in trade segment purchase. According to RP Gupta, Chairman & Managing Director, Shiva Cement, the slowdown in real estate activity has hit the cement industry hard as 65 per cent of the cement produced in the country is consumed by the realty sector.

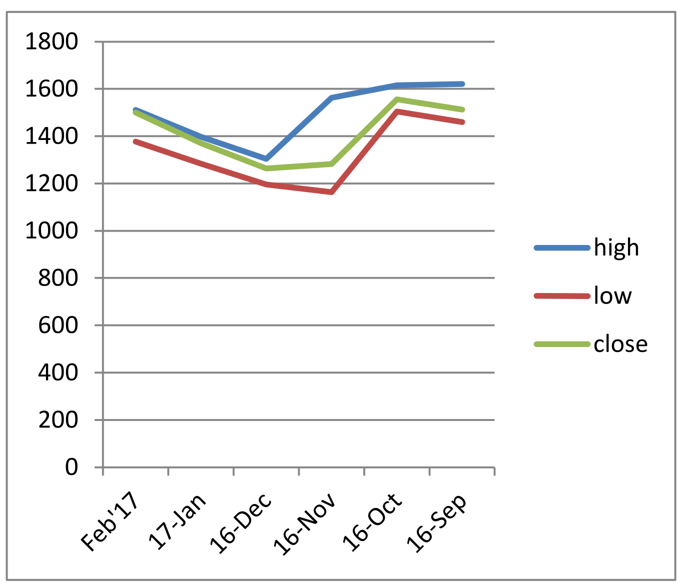
The stocks of bigger cement firms such as AMBUJA, ULTRATECH (BSE 0.57%), ACC (BSE 0.20%) and Shree Cement (BSE -0.34%) are currently trading at 16-18 times their 2016-17 forward EV/EBITDA. As per the recent JM Financial survey, cement volumes are down across markets.

Regions	Fall in sales
Northern and Western regions	25-50% in November
Some southern regions	Declined in the first week of December
Eastern region	70% decline in November

Survey indicated that companies have announced Rs10-25 per bag price cuts in the northern and western regions.

VIII. IMPACT ON REALTY STOCKS

If we look at the figures of the S&P BSE realty index, it has shown a steep down turn in the prices of its stock after demonetization. Companies like Ashiana housing, DLF, Godrej prop., HDIL, India Bulls Real etc. had a sudden down fall. However it seems to be in a recovery trend after the announcement of the union budget 2017-2018, wherein much focus has been given for providing affordable housing and developing infrastructure.



GDP growth is expected to be negative for next six months, but next two years would see exponential revival in growth as inflation is expected to fall sharply with fall in real estate prices.

Government deficit may turn surplus in next two years. Currency is expected to strengthen as inflation drops and growth picks up. Banking sector will get a boost as around 7 - 8 lakh crores legal money enters system. Bond prices are expected to rise as interest rates come down, Real estate is expected to lower borrowing costs, Short term stock markets can be very volatile, in medium to long term, and they are expected to do well. Hence though the realty sector is expected to fall by up to 20%, but will stabilize once interest rates come down. Equity will benefit due to shift from real estate sector, growth of organized sectors, and lower inflation and recommend investors to reallocate assets keeping their risk profiles in mind. Conservative investors can shift from gilt to liquid, moderate investors can invest in debt and aggressive investors should consider balanced funds. Fresh investments in equities should be reviewed once markets have stabilized.

IX. THE LONG-TERM IMPACT

In the midterm improvement in the money floating in the economy, fall in the inflation rates, cut in repo rates by the Reserve Bank of India can lead to a better affordable housing sector. But the secondary market which is heavily dependent on cash has to bear the massive brunt of the demonetization move. This may lead to cheaper prices of resale properties which in turn would have significant impact on the primary market. The upcoming new projects may be offered at a discounted/provide incentives to the buyers. But the rentals of both commercial and residential properties are going upto a maximum of 20%. The affordable housing is expected remain largely unaffected as they are less dependent on cash and more on bank financing.

But on the whole in the Long-term, transparency, revived trust and capital inflows in the realty sector are anticipated. The real estate sector is expected to get cleansed of its ailments in the due course of time owing to the elimination of black money clubbed with multiple regulatory changes such as the Goods and Services Tax Act, Real Estate (Regulation and Development) Act, amendment of the Benami Transactions (Prohibition) Act and the schemes to boost up the housing sector put forward in the union budget 2017-18. Subsequently, project approvals will be quicker, resulting in a substantial reduction in the total cost of construction, thereby, the ‘per unit’ cost. Fair pricing would mean a revived demand for new projects in the market.

X. CONCLUSION

Demonetisation could also mean fresh sources of funding for developers to complete their projects. Some of the alternate sources may include the following:

- Developers will be forced to clean up their balance sheets so that they can avail funding from legitimate sources, however, this may come at extremely high costs from the Non-banking financial companies (NBFC) segment.

- Developers can avail short-term loans from their existing buyers at market price with a promise to deliver the project on time and at an interest rate as per the agreement in the sales deed.
- Investments from private equity firms would usher positive sentiment across the market, helping developers to source funding and strengthen end-user demand.

The real estate sector could witness a major revolution with cash transactions getting eliminated and a major share of trades going online with the penetration of alternative forms of payment such as E-wallets, apps and plastic money. To sum it up, the demonetisation of old currency has ushered a new era for the real estate industry in India that would be transparent, corruption free, organised and veracious.

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