Why residential property prices never fell in cities

Amit Shanbaug & Sakina Babwani, ET Bureau Jan 16, 2012, 10.23AM IST

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The last time Bharat Sharma went looking for a house that fit his budget of Rs 40 lakh was in January 2011. Prices were high then and so were interest rates.

The same month, he came across reports about a possible correction in property prices in the next one year.

The arguments were compelling. Property prices and interest rates were high, making EMIs unaffordable. Income growth had slowed down, job creation was on the wane, inflation was high and there was oversupply in the market.

With everything pointing to property prices coming down, Sharma decided to wait. He is now back in the market looking for a property, with a slightly higher budget (Rs 42 lakh).

But contrary to his expectations, prices have not gone down. In fact, they have risen. "The project that I was considering is now sold out and the others launched recently in the same locality are quoting at higher prices," he says. Why did property prices defy what the market pundits were expecting? What prevented them from falling?

Continuing investor interest

Investors are the lifeline of a cash-strapped developer. They are the ones who are keeping builders afloat even now.

Pankaj Kapoor, managing director of real estate research firm Liases Foras, explains that compared to 1995, when there was shortage of liquidity in the market which led to a crash in the real estate sector, the situation now is quite different. "There are hardly any avenues which offer you safe returns today.

The stock markets are volatile and gold prices are also at an all-time high. So, investors look at the real estate sector to park their excess funds. It is not the developers who would have to take a price cut but the investors," he adds. According to Kapoor, it is the investors who are instrumental in the property prices staying firm.

"Besides this, there are a lot of venture capital firms which have bought huge stakes in realty projects. For the developers, it is a win-win situation. Since they have already cut down on their losses, they won't be losing much even if the rates come down a bit," he adds.

NO SIGNIFICANT CORRECTION IN 2011

Despite the buzz about a correction, prices have not gone down significantly in most locations.

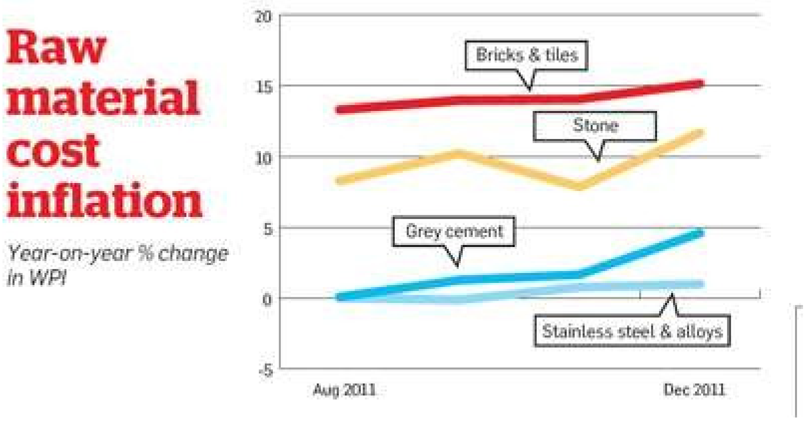
City	District	June 2008	June 2009	June 2010	June 2011
Bangalore	Malleshwaram, Rajajinagar	4,500 - 6,000	3,900 - 5,400	3,800 - 5,400	**4,300-6,200**
Chennai	Velachery	3,800-4,200	3,800-4,000	3,500-5,000	**3,500-5,300**
Hyderabad	Banjara Hills	6,500	5,800	6,500	**6,850**
Mumbai	Bandra (W), Khar (W), Santacruz (W), Juhu	28,000-32,000	20,000 - 24,000	24,000-31,000	**24,000-32,000**
Delhi NCR	Defence Colony, Gulmohar Park, Hauz Khas Enclave, Safdarjung Development Area, Panchsheel Park	24,000-25,000	20,000-23,000	24,000-32,000	**27,000-40,000**
Pune	Koregaon Park, Bundh Garden	7,000-12,000	6,000-9,000	6,750-10,500	**9,000-13,000**
Kolkata	Ballygunge, Queens Park, Rainy Park, Gurusday Road	8,500-10,000	8,300-9,500	9,500-11,500	**10,000-17,000**

Prices in ₹ per sq ft. Source: Cushman & Wakefield

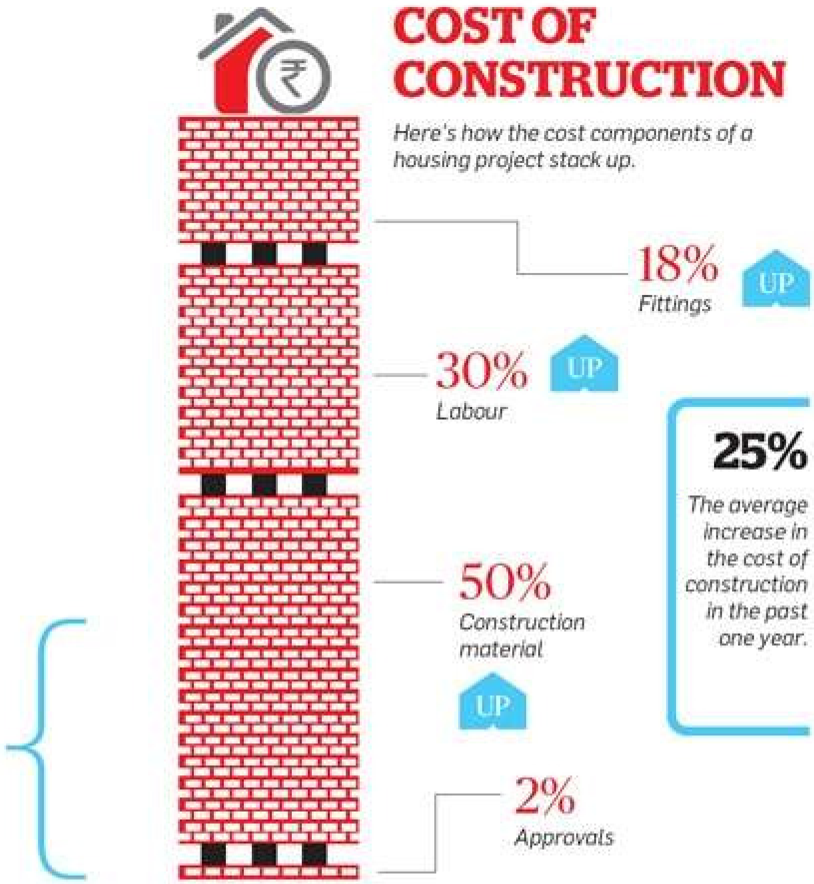
However, in some cases it is also because of these investors that the builders cannot reduce prices substantially. "A big investor who puts in money at the pre-launch stage of the project is also looking to exit at a higher rate later," says a Gurgaon-based real estate broker. "If the developer reduces the ticket price, the investor will not be able to sell his properties in the market and, therefore, will not invest in the builder's projects in future," he says.

Restricted supply

One of the main reasons for residential property prices correcting only marginally in some locations or not at all in most, was the restricted supply of new projects. According to real estate consultancy firm Knight Frank, the pace of new project launches was severely crippled in 2011.



During 2010, roughly 3.61 lakh residential units were launched across the top seven cities of Mumbai, Delhi NCR, Pune, Kolkata, Bangalore, Chennai and Hyderabad.



However, only 1.72 lakh units came up in 2011, a decline of 52% over the previous year. The decline in new launches was sharper in certain locations, such as Mumbai, where prices were high and buyers few.

For instance, just about 19,470 units were launched in Mumbai in 2011 compared with the 54,968 housing units built in the previous year.

While fewer new launches were one reason for the restriction in supply, project delays also played an important role.

The situation is likely to continue for some more time. According to property research firm PropEquity, nearly half of the 9.3 lakh under-construction residential units in the country, scheduled for delivery between 2011 and 2013, are likely to be delayed by up to 18 months.

While reducing the number of new launches is a natural reaction from the builders in a slow market, developers also restrict the number of projects in the market by other means. Some builders have recently started inserting restrictive clauses in the sale contracts that prevent buyers from selling the house before a specified time (usually one year of buying).

While the builders claim that they are doing this to prevent speculators from buying into the projects, the real reason is that the developer does not want the housing units to be out in the market at a lower price (by the seller) in times of a slowdown.

"This is primarily to have control over the time period before their property comes back in the market for sale. It would also deter speculators to offer the property at a lower price than what the developer is offering," says Ravi Goenka, advocate at Mumbai-based Goenka Law Associates.

Rising construction costs

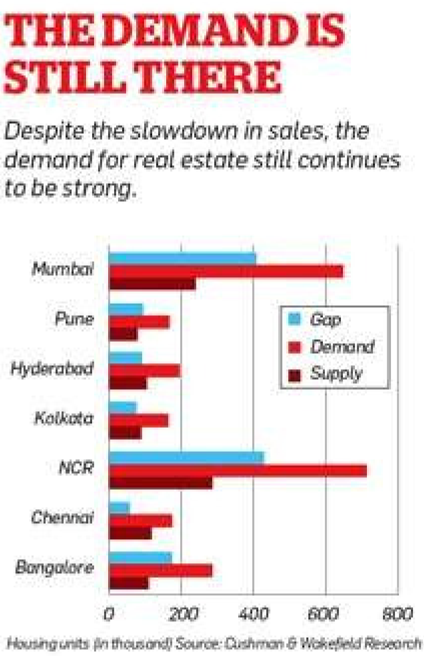
Almost all builders will today quote this as one of the main reasons for increasing property prices. Though the impact is often exaggerated and may sometimes look like an excuse, the fact is that the cost of construction and materials has actually gone up in the past one year.

"With the cost of raw material like cement, steel and other inputs going up by 25%, it is just not possible for developers to reduce the cost, unless the government offers some subsidy," says Niranjan Hiranandani, managing director of Hiranandani Group. The incidence of taxes, among the highest in the world at nearly 30-32%, Hiranandani points out, is also coming in the way of a price reduction.

Multiple intermediaries

In many markets in North India, the developer is no longer the one selling his project to the retail buyers. There are underwriters, big brokers, brokers and sub-brokers in the market who have entered the sales flow (see From the seller to the buyer) and who have their own margins to take care of before an apartment reaches the end-user.

The intermediaries also affect the resale market. "The estate agents are the first point of contact who influence the decision making process of both the buyer and the seller," says Ganesh Vasudevan, vice-president, Indiaproperty.com, a real estate portal.



Builder cartels also at work

While on the one hand builders complain of cement and steel cartels pushing up the construction cost, they have now started operating their own mini cartels in smaller markets. They fix the quoted price as a group in a location. "There is usually a pattern in which the developers increase prices around the same time," says the marketing head of a real estate company.

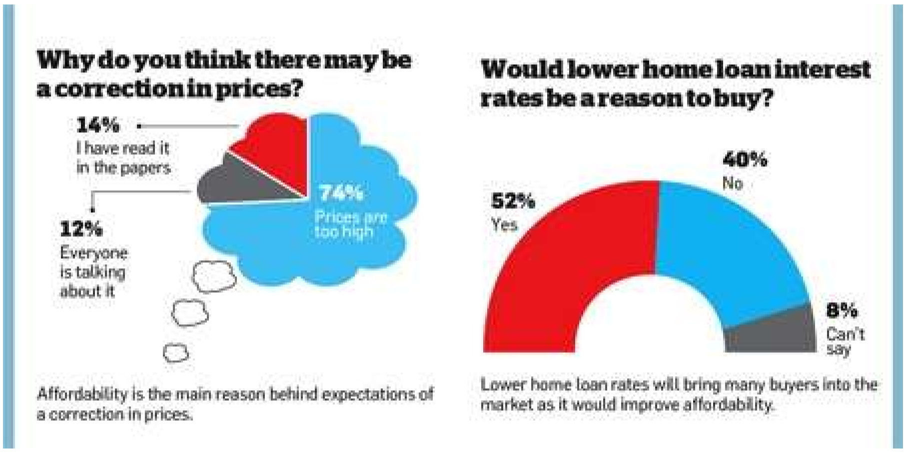
It's another matter that the differentiation in price happens in the form of discounts being offered to serious buyers. When 37-year-old Vasanta Sobha Turaga from Hyderabad started scouting for a property in the prime location of Banjara Hills, she found it tough to get one in her modest budget of Rs 30 lakh.

"Though there is virtually no demand in the market, the developers just won't let the prices come down. Many brokers do agree that they hardly manage any business, but the developers work in tandem and just won't agree to sell the property with a price cut," says the conservation architect.

Unit sizes have shrunk

Another tactic that builders are using to maximise their returns is by reducing the size of the units. The standard apartments being sold today are far smaller than the average unit sold a few years ago.

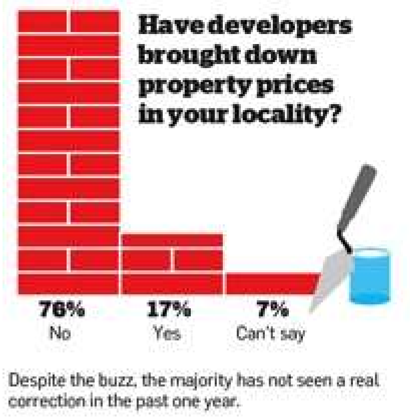
"The per square feet value remaining constant, what has shrunk is the size of units in places where density norms were eased, such as in Noida, and where FSI restrictions have been rejigged," says Jayashree Kurup, head, digital content and research, Magicbricks, a real estate portal.



By building smaller flats the builder not only makes more money since he is selling more units, his expenses on the common facilities also remains the same despite the rise in units. Builders have also begun to increase the margin between the super area (which he quotes while selling) and the carpet area (the usable area that you get).

Why you should not bet on a correction

Real estate is unlike any other investment in many ways-the entry barrier is high, liquidity is low and reliable market information is rare. It is different from other investments also when it comes to a correction. When it comes to the primary market, builders rarely ever decrease the price.



In case of a cash crunch, the first resort is attracting buyers by offering discounts, which varies from buyer to buyer. This means that you cannot point to a new lower base price.

If the builder is really short of cash, then instead of reducing the ticket price of his existing project, he launches a new one with different specifications at a lower price point.

NRIs flocking to invest in property

2011 has been a good year for non-resident Indians (NRIs) remitting money to India. With the Indian rupee depreciating by over 20% against the dollar in the past five months, homes are increasingly cheaper in dollar terms. For example: $1,000 sent from the US was valued at ₹44,800 on 7 June 2011. It is now valued at ₹52,730. This means a 20% discount straightaway for NRIs without any effort. NRIs are already cashing in on it and are actively trying to invest in the Indian property market. Om Ahuja, managing director, residential services, Jones Lang LaSalle India explains that the depreciating rupee has been one of the major reasons for large developers to hold on to the prices. "The depreciating rupee has also caused NRI property purchases to increase in the larger cities, again making it possible for many developers with good projects to hold on to their rates," he says. NRI buyers are responsible for around 5-8% of the total sale in the real estate market in India. The added advantage for NRIs in Europe and the US is that property prices in both these locations are also close to their all-time lows, which means repatriating gains made in India is also a good idea. For those looking at pure investments with a time horizon of at least three years, a property under-construction offers the best deals in the market today. For those with lower budgets, a real estate fund may also be a good option. These funds are similar to mutual funds but are usually closed-ended. This means that investors can enter only when the fund is launched and must stay locked in for the duration of the fund. The funds have a minimum ticket size of at least ₹25 lakh. Apart from lower entry price, these funds also offer the benefit of diversifying into various real estate properties and that too, with the help of a professional manager.

But this too is not technically a correction since the project and specifications are different.

The same holds true in the resale market. Unlike in stocks or mutual funds where you can track prices or NAVs, you do not have access to a reliable valuation of your property on a given day or month.

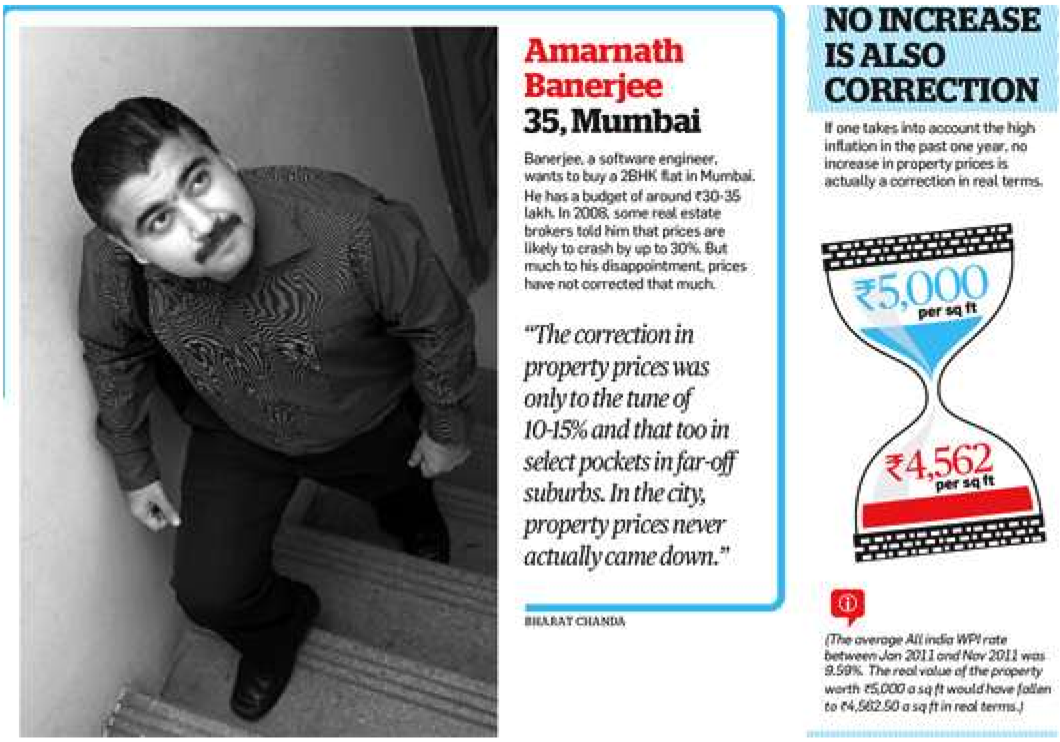
Best locations get sold out first

Getting a good property is also about getting a good location-both for the project as well as for your apartment within a housing project.

And the fact is that the best locations get sold out first, such as park-facing corner apartments.

One of the major reasons for prices holding up in places close to business districts or work places is that consumers do not want to travel long distances for work.

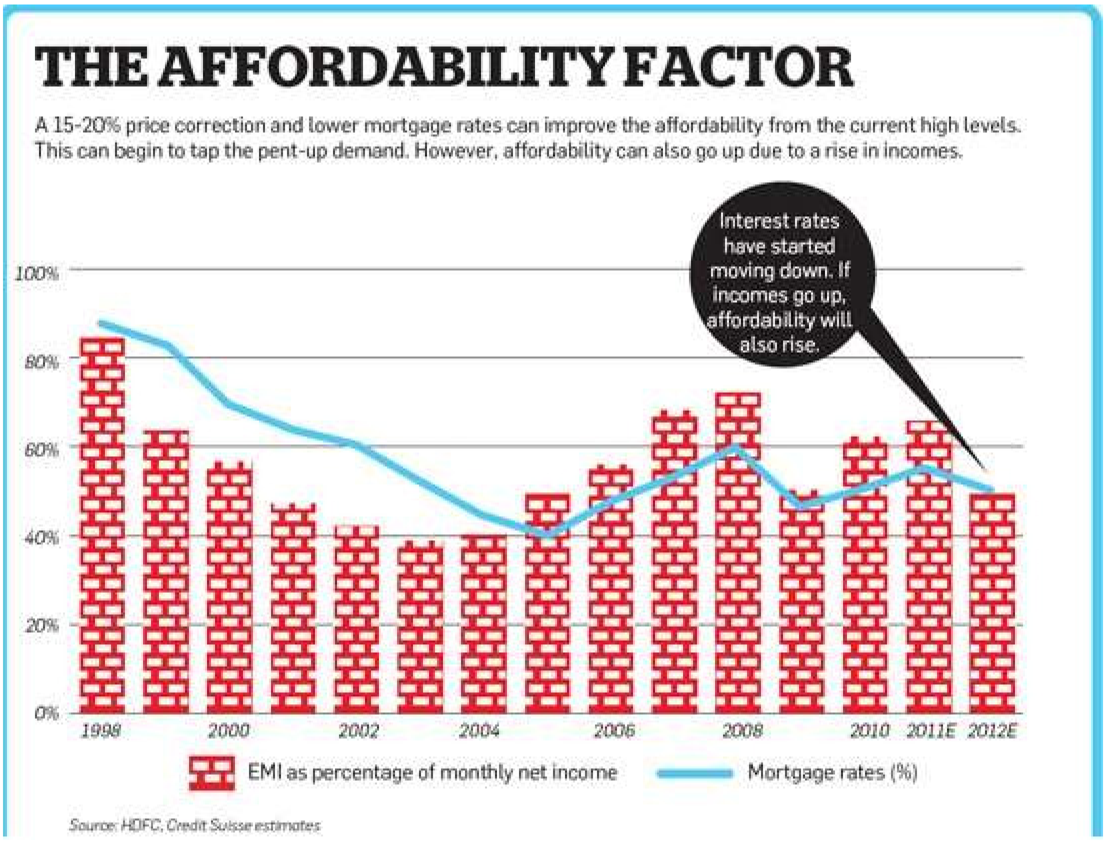
People are willing to pay a high price to stay nearer their workplace. Though there are projects available farther away in the city periphery, the clamour is for the projects closest to the city's business districts. This means that even in a lukewarm market when there are very few buyers, the best locations and projects will be the first ones to be picked up.



Affordability will catch up

As our survey shows, a majority of the buyers would be back in the market if they can afford the EMIs. With interest rates set to go down (a few banks have already brought down their base rates), some of the latent demand will start coming back to the market.

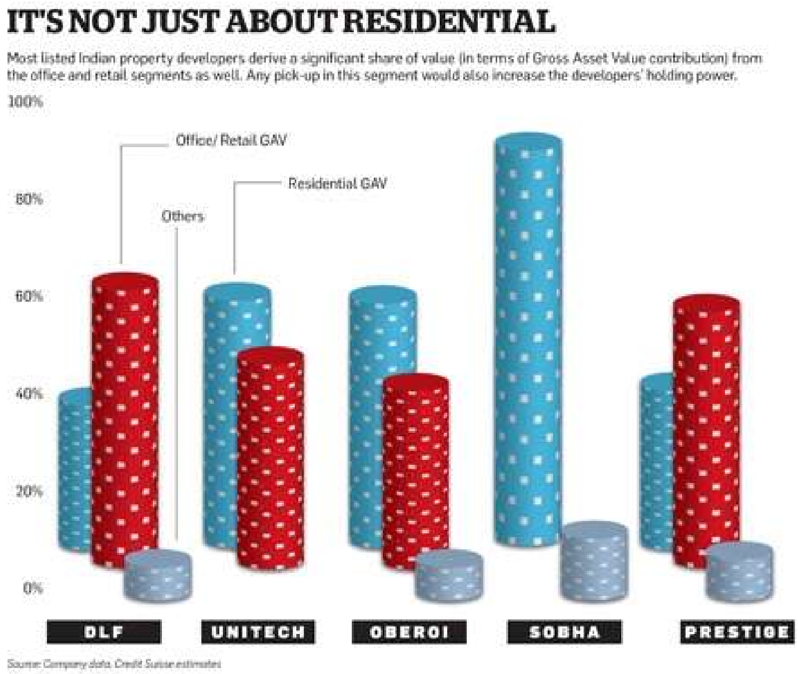
Two years of salary hikes and property price stagnation in the past one year has already cushioned some of the impact of high prices. This will also result in hardening of prices, especially for projects that are ready or are nearing completion.



Mumbai is a different market

Most of the news about a possible correction in property prices is coming out of Mumbai. But keep in mind that Mumbai is a very different market from the others and what you read about the price trend in the city, whether it is the record high deals or a correction in the market, may not be true for your city. The impact of even something like a global crisis on the real estate market varies from city to city.

"Take the example of a city like NCR, where you have a mix of salaried individuals and businessmen. Most of these businessmen have not been affected by the global recession, so I don't think it will affect demand in the real estate market," says Shveta Jain, director at Cushman & Wakefield. However, the same may not hold true for an IT city like Bangalore, which largely comprises the salaried class. "Even Chennai has a mixed set of salaried and businessmen, so I don't see global factors affecting demand there," adds Jain.



Rentals have been going up

This is especially true for the bigger cities where there is a significant chunk of floating population. As buyers continue to be on a wait-and-watch mode, the rental segment of the market has been reaping the benefits. Residential rentals, especially in locations closer to work places, have consistently risen in the past two years.

Some locations in the metros have seen residential rentals go up by more than the usual 10% annual hike. So if you are one of those who has been staying on rent waiting for an opportunity to buy, higher rental payouts would mean losing out from one hand what you gain from the discounts on your property.

It's not all about residential

Builders derive a lot of value from commercial and retail real estate . Any pick up there also increases their holding power for the residential segment. According to recent reports, as the economy starts recovering in the second half of the year and companies start investing the cash they are sitting on, the commercial real estate sector will be among the first to benefit.

Vasanta Sobha Turaga
37, Hyderabad

Vasanta, a conservation architect, has been eyeing a 1,200 sq ft property in the Banjara hills area of Hyderabad. Though she sees no demand in the area, the property is still priced at ₹1 crore and she thinks that prices should come down.

"Developers continue to quote absurd prices. It's like they have nothing to lose. Even if one or two sales materialise in a month, they recover the cost. So they are holding on to the rates."

With the notification of 100% FDI in single-brand retail being announced recently, the retail segment is also likely to see some deals being struck. Since most developers have a mix of both residential and office space/ commercial developments, any pick-up in one segment benefits the other. Despite the fund crunch some developers have managed to raise funds from alternate sources like private equity.

Private equity firms pumped $2.68 billion (about Rs 14,000 crore) into real estate firms during 2011, a 69% jump over the previous year. Even if the high cost alternate fund sources are available to builders, they may be willing to stick to offering discounts rather than bringing down ticket prices of their projects.

Source: http://articles.economictimes.indiatimes.com/2012-01-16/news/30631823_1_property-prices-knight-frank-ticket-price