Residential real estate: An investible asset

Building, Construction and Real Estate sector

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Prelude

What role does the housing sector play in our lives and the economic development of a nation? Housing is considered as one of the most important basic necessities of living. For some nations, the housing sector can be an engine of economic growth, owing to its linkages to over 250 ancillary industries, providing opportunities of growth, which can have a multiplier effect on the economy. For a nation like India, which has been witnessing rapid urbanisation over the past decade with an addition of over 10 million people to its urban population annually, the need for housing becomes even more important. India is the second-largest urban community in the world, after China, with an urban population of over 420 million, which is growing rapidly.  

Overall, India accounted for about 12 per cent of global urbanisation between 2000 and 2015. However, the penetration of urbanisation is low in India with nearly one-third (32.4 per cent) of its population residing in urban areas, far below in comparison with that of its global peers, such as China (54.4 per cent), Brazil (85.4 per cent) and Russia (74 per cent). On an annual basis, about 10–11 million people move to urban regions in India. As a result, the urban population is anticipated to grow approximately 38 per cent to over 580 million by 2030. This is expected to lead to substantial increase in demand for housing, and hence the Indian housing market holds significant potential.

Purchasing a house entails large amount of investment by an individual, for which a majority of the population utilise their lifetime savings. Investing in property without analysing the market dynamics may sometimes erode a large proportion from the investment for a certain period of time and can also entail other associated risks. Hence, it becomes important to critically understand the property dynamics.

This KPMG in India report — ‘Residential real estate: An investible asset’, prepared jointly with Magicbricks, aims to decode the Indian housing market to educate homebuyers about the major factors, such as demographics, economic development, regulatory environment, and physical and social infrastructure, that could impact their investments. These factors coupled with others, such as demand-supply dynamics, have a major influence on property prices over various property market cycles. The Indian residential property prices have more than doubled over the last decade (2007–15) considering 2007 as the base year, with an index value of 100; it is now amongst the best performing markets globally. Over the last decade, affordability to own properties have reduced 50 per cent, as the income growth has lagged behind the growth in property prices.

The Indian government has undertaken several policy initiatives to address the bottlenecks arising from the demand and supply sides, which homebuyers and the industry, respectively, have been challenged with. Some of these initiatives are, providing the infrastructure status to the affordable housing segment, easing foreign direct investment (FDI) norms for the construction development sector, and the introduction of credit linked subsidy schemes (CLSS) for Economically Weaker Section (EWS)/Lower-income Group (LIG) and Mid-income Group (MIG) segments.

We appreciate that the government is cognisant of the bottlenecks, and also acknowledges the fact that several initiatives have been undertaken to tackle them. However, there are a few areas that still need attention from the policymakers to restrict uneven/unplanned growth in the property markets, which puts pressure on the available resources and infrastructure — thereby impacting the property prices and affordability. Highlighting those factors, we have also offered in this report a few recommendations for the industry players — real estate developers, which can safeguard their interests, and help them identify new avenues of growth for a sustainable future. Overall, India holds a strong potential for residential property market growth as there would be a significant price appreciation over the next decade, with property market fundamental drivers, such as the GDP, urbanisation, income growth, savings rate, mortgage growth and affordability, expected to improve going forward.

1. Decoding Housing For All by 2022, KPMG in India, 2014
India will soon have the largest number of home owners that it has ever had, thanks to the government’s stated objective of bridging the perennial housing shortfall that has been carrying forward for decades. With easy access to home loans too, the number of buyers has grown exponentially over the past two decades. Residential property currently accounts for over 70 per cent of the real estate industry and touches the lives of every one of us.

Ownership of homes comes with a series of benefits and returns on investment that was never really computed. As the largest residential real estate online portal in the country, Magicbricks decided to partner with KPMG in India, to decode what the real estate asset class means to the buyer in the long term. Through the year of disruptive and dramatic policy changes, the two teams have steadily worked to decode the asset class that spells hope, social status and a definite return on the investment, intended or unintended.

Houses are the only asset class that the consumer purchases for self-use but benefits from value appreciation. Among other major asset classes, stocks and mutual funds are not usable till encashed and gold is used sporadically, if purchased as ornaments. A home, on the other hand, is a product that is continuously usable from Day 1, continues to appreciate in value and gets the buyer the status of an asset owner. However, when the user turns seller he or she is often confused as to the final value since benchmark rates have traditionally not been available.

Over the past few years, Magicbricks has been publishing and making available values of properties on a specially created calculator – Propworth. However, all properties within the same project, or all projects within the same locality, do not fetch the same value. Buyers are also confused about where to buy, from whom to buy and how long to hold the property to get best returns. To compute these, KPMG in India referred to various sources of information including Magicbricks data, to study and analyse medium and long-term trends. This study is the result of this comprehensive exercise. There is a lot more research that needs to be done in this eminently investible asset class. Here a significant beginning has been made.

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Foreword

The Indian housing sector is just out of its infancy. Its history as a mass market product, where a consumer has a choice to look around and purchase a unit he or she desires, began only in 1998 when the government evolved the first Housing and Habitat Policy. This was revised in 2007 when the first level of tax incentives to the private sector to construct smaller and more affordable housing units to match the pockets of consumers ended. The current dream of the Prime Minister Narendra Modi to provide every Indian family a liveable house by 2022 is one of the ambitious plans to house all of India.

Housing is primarily a need-based purchase. It is the one where a consumer takes formal finance, pegged at today’s rates, for an asset that takes four years to construct and has a life of at least 25 years. This is not the case in either stock investments or in high-value investment assets such as gold.

The roller coaster ride for property buyers in the past few years was because of the clouded vision of the new generation of buyers. When housing finance to retail buyers at affordable rates began during 1998-2001, end users purchasing for self-use were the beneficiaries. The need was so great and the yearning so high that they would not default on loans, for fear of losing the house. However, this need was replaced by greed — both of the buyer and the seller. As policy was unable to keep pace the effort floundered.

Unlike the early buyers, investors looking for quick returns were driving the property market. While end-users wanted quick construction, good quality structure, social and physical infrastructure and most importantly, liveability, investors sought stretched timelines, slow delivery, with no concern for liveability, and wanted easy exit strategies. While the end user put pennies together, the investor, flush with cash became a developer’s friend.

During 2005-08 investors had a bull run in the housing market, trading on little slips of paper and holding the investment often only till the next tranche of instalment had to be paid. As a result, they invested in more units and spread the existing money across many projects to make more money. The housing market became only an investment-oriented sector. The developers, too, made money out of multiple investors who bought into and exited the project during the construction cycle, after which the end-user would buy into the almost complete project, to live in. Money paid by investors was used to purchase more land and completion of projects were replaced by more launches.

This was anticipated by the early policymakers who were reluctant to open housing to Foreign Direct Investment and wanted to service end users. With delays of 5-12 years, end users warily retreated.

So is housing an investible asset at all, and should it be treated as such? Whether you are an end user or an investor, a secure, fully functional housing market gives good returns. It is second only to systematic investments in equity markets in terms of returns. However, unlike other asset classes, this investment is a usable asset. If one buys a unit at an early stage of a housing project, the asset should be ready in about three-four years. In that time the asset value grows manifold.

Unlike what a house used to be for early buyers, it is currently an asset that matches the young urban lifestyle mind-set. As jobs make the workforce mobile, the attachment to cities and houses also fades away. It makes sense to sell and purchase afresh in the next city. However, there are very few buyers who lose money exiting a good property. The only drawback is that the property market is cyclical and therefore the investment is not as liquid as other asset classes.

Having said this, the smallest and most affordable property is an asset that yields big dividends long-term. The reason why Magicbricks and KPMG in India have decided to put this study together is because of the changing policy measures by the government that would impact the housing market significantly. Indian housing was benchmarked against global markets. Should one enter it as an end user or an investor? The more information and analysis tools there are for buyers, the more scientific the process and the safer the purchase will be. The government, on its part, has already started fixing policy to facilitate the marginalised end users with a real estate regulator, affordable housing policy to dovetail into the Pradhan Mantri Awas Yojana and the Credit Linked Subsidy Scheme for those who cannot afford to buy.

With this umbrella of policy protection, go ahead, read the analysis and contribute to your asset wealth creation and managing it as well.

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Residential real estate: An investible asset
Housing sector in India – the next big thing

Key takeaways

» Indian residential property prices have more than doubled over the last decade

» It is among the best performing markets, globally

» The property prices have weakened during calendar year (CY) 2013 and 2014 and have witnessed moderate growth during CY 2015 and 2016

» Over the last decade, affordability to own properties have reduced by 50 per cent, as the income growth has lagged property price growth

» However, India’s property market is relatively affordable as compared to that of its global counterparts

» Few cities, including Mumbai, are among the most expensive property markets, globally

» Overall, the Indian real estate sector holds strong potential for residential property market growth and price appreciation, as property market fundamental drivers, such as the GDP, urbanisation, income growth, savings rate, mortgage growth and affordability, are growing strongly in India.
Residential prices in India on a long-term uptrend

India’s residential real estate has outperformed many of its global peers over the last decade. Based on available data from The Economist, residential real estate prices in India have more than doubled between 2007 and 2016. The only other markets to have delivered such returns during this period were Brazil and Hong Kong.

Global property price index (Base 2007 = 100)

The sudden surge in property prices in India increased successively for about three years before witnessing some correction from 2013 onwards. Towards the end of 2014, property prices appeared to have bottomed out and Indian residential real estate witnessed a moderate growth.

The income growth in India has been slower than the housing price appreciation, invariably affecting the housing affordability. In the last few years, housing prices in India have inflated by about 45-50 per cent in real terms. However, the increase has been witnessed across major economies and the change in property price to income ratio in India has been moderate. In fact, housing in India is not excessively expensive compared to its peers, such as Brazil, China, Hong Kong, Japan, Singapore, Russia and Indonesia. However, it is still expensive when compared to developed economies, such as the United Kingdom, the United States of America, Australia and Germany.

1. Property Prices Index for Country 2015, Numbeo.com, accessed on 23 March 2017
In the last few years, the number of property transactions by Indians in the U.S. and the U.K. have increased significantly as they offer a better value proposition compared to housing options in India. This is a compelling reason for several high-net-worth individuals in India to invest large sums of money abroad.

Residential real estate has exhibited strong upsurge in capital value trends on long-term basis (2007-16). However, in the medium-term (from September 2013 to September 2016), the growth in prices has been muted. The Magicbricks PropIndex, which captures price movements of residential properties in India, witnessed only 4 per cent increase in the index value over the past three years (September 2013 to September 2016), translating to CAGR of mere 1.3 per cent. This was primarily due to the following reasons:

- Significant delay in project completions across India, which led to prolonged slump in sales. As a result, unsold inventory continue to increase across all cities over the years, which restricted the price growth.
- Over speculation in certain markets based on healthy demand during the boom period, led to number of projects being launched one after the other. However, residential sales started to decrease in subsequent years and supply entering the market far exceeded the sales, which resulted in lower price appreciation.
- Banks have been reluctant to lend to real estate developers, due to higher risk-weightage assigned to the real estate sector by the RBI. Lack of sufficient funds led to substantial decrease in efficiency, leading to construction delays. This resulted in real estate developers resorting to Private Equity (PE) funds and Non-Banking Finance Companies (NBFCs), which comes at a high cost compared to bank lending.
- Lack of appropriate physical and social infrastructure in the peripheral regions of the cities, adversely impacted the decision of home buyers, who continue postponing their buying decision, which led to decline in sales.
- Last but not the least, home buyers have continued to postpone their decision to buy properties as they kept on waiting for interest rates on home loans to come down. Further, they expected that slowdown in residential sales and construction delays would force developers to reduce prices of their projects, this did not happen and hence, buyers were deterred from making a purchase.

In real terms, property prices in India have appreciated by only 40-50 per cent – much slower than global trend


The Indian investors have disposable income enough to buy a housing unit. However, arbitrary pricing and risk of delay locally has spurred investment abroad. Subdued housing demand for over three years also has hit returns on investments domestically

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Unaffordability exists in few cities

Although the overall level of housing prices in India appears affordable, there are few markets which are amongst the unaffordable cities globally, suggesting that property price appreciation in India has not been broad-based. As per the data in the table below, it appears that only a few cities, such as Mumbai, Thane and Delhi, are part of the unaffordable market in India.

Property price to income ratio

<table>
<thead>
<tr>
<th>Top 10 expensive cities globally</th>
<th>Price to income ratio</th>
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<tbody>
<tr>
<td>Shenzhen, China</td>
<td>38</td>
</tr>
<tr>
<td>Mumbai, India</td>
<td>38</td>
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<tr>
<td>Hanoi, Vietnam</td>
<td>36</td>
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<tr>
<td>Hong Kong, SAR, China</td>
<td>35</td>
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<tr>
<td>Beijing, China</td>
<td>33</td>
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<tr>
<td>Shanghai, China</td>
<td>31</td>
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<tr>
<td>London, United Kingdom</td>
<td>31</td>
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<tr>
<td>Lviv, Ukraine</td>
<td>28</td>
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<tr>
<td>Kiev, Ukraine</td>
<td>26</td>
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<tr>
<td>Guangzhou, China</td>
<td>26</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Indian cities</th>
<th>Price to income ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mumbai</td>
<td>38</td>
</tr>
<tr>
<td>Thane</td>
<td>21</td>
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<tr>
<td>Delhi</td>
<td>16</td>
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<tr>
<td>NaviMumbai</td>
<td>14</td>
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<tr>
<td>Chennai</td>
<td>13</td>
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<tr>
<td>Kolkata</td>
<td>10</td>
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<tr>
<td>Bhubaneswar, Gurugram, Kochi, and Ahmedabad</td>
<td>9</td>
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<tr>
<td>Pune and Bengaluru</td>
<td>8</td>
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<tr>
<td>Noida, Vadodara and Hyderabad</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: Property Prices Index for Country 2015, Numbeo.com, accessed on 23 March 2017

The strong growth in property prices has been supported by a confluence of numerous factors, assembled under three broad categories. India has been amongst the leading performers in the following factors supporting the phenomenal growth in residential property prices.

Due to the focus and numerous reforms introduced by the Government of India in the last few years, the sector share in GDP is expected to double from the current 6-7 per cent by 2030.

Demographics
- Urbanisation
- Households size

Economics
- Gross domestic product (GDP)
- Employment growth
- Income growth
- Households savings

Regulatory
- Mortgage growth
- Tax incentives
India is the urban community in the world, after China, with an urban population of over 420 million, which is growing rapidly. Annually, India is adding about 10 million people to its urban population2.

In the last 15 years, the urban population of India has expanded by about 46 per cent. While, it is lesser than Vietnam and Indonesia in terms of growth, the scale is extensive and second only to China. Overall, India accounted about 12 per cent of global urbanisation between 2000 and 20153.

Significant potential for urbanisation led housing demand

The penetration of urbanisation is low in India with nearly one-third (32.4 per cent) of its population residing in urban areas, far below, compared to its global peers, such as China (54.4 per cent), Brazil (85.4 per cent) and Russia (74 per cent). About 11-12 million people are moving to urban regions in India on an annual basis. As a result, the urban population of India is anticipated to grow by nearly 36 per cent to over 580 million by 20302. This is expected to lead to substantial increase in demand for housing in India.
**Shrink in household size**

The shrinking of household size is a major cause of rapid urbanisation being witnessed in India. A massive proportion of youth population, migrating from rural areas to urban areas in search of employment has resulted the household size shrink in India.

The average household size in India fell from 4.6 in 2007 to 4.2 in 2011, exhibiting the highest decline of about 9 per cent, amongst the developed and emerging economies. The shrinking household size is another facet adding to the demand for small and compact housing in India.

**Change in average household size**

It appears that the developers have been aligning their supply in line with market fundamentals. In the last decade, the average size of apartments have decreased suggesting that developers are focussing on smaller sized homes.

Source: The World Factbook, Central Intelligence Agency, accessed on 20 December 2016, KPMG in India’s analysis, 2017
Real estate developers have become more cautious. They have started aligning their business strategies with the changing dynamics of the industry. For example, the new residential supply has been controlled cautiously owing to headwinds in the real estate over the past two–three years. Further, the ticket sizes of housing units have been reduced in order to make housing units more affordable.

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Source: Propequity, accessed on 28 November 2016; KPMG in India’s analysis, 2017
Economic drivers

Gross domestic product (GDP)

In the last 15 years, India’s GDP has almost tripled to reach USD2 trillion (INR113.50 lakh crore). It is amongst the fastest growing economies globally, second only to China. Higher GDP growth, led primarily by services and industrial growth, has supported one of the fastest employment growth trajectory, globally.

It is estimated that India’s non-agricultural employees increased by more than 43 per cent between 2000 and 2010 to reach over 223 million6.

Real GDP growth (2000-15)

Despite the significant growth in the economy, India’s fast growing population restricted the per capita income growth. The increase has been slower than Russia, Vietnam, Indonesia, and China.

However, savings (which includes real estate investments), have increased sharply from 23 per cent in 2000 to 31 per cent in 20157. An increase in savings rate suggests that Indians have diverted their increased income over the years in financial and physical assets, including real estate.

Nominal per capita GDP growth (2000-15)

Employment growth in non-agriculture sectors (2000-10)

Domestic savings (per cent of GDP)


6. The World Factbook, Central Intelligence Agency; Employment in industry, The World Bank, accessed on 12 December 2016; KPMG in India’s analysis, 2017

7. India: Savings rate in need of a boost, DBS Group Research, September 2016
Over the next 15 years, India is expected to lead the global economic growth, surpassing China. By 2030, India is expected to grow five times and become the third-largest economy after China and the U.S.

The youth population is expected to be an integral variable supporting the strong growth in India. The median age of the population is 27.6 years, which is far below the developed economies (such as Germany, Japan, the U.K. and the U.S.) and China. Additionally, with nearly two-thirds or over 281.6 million population falling under the age group 15-64 years, India again has one of the largest base of potential home owners. Higher working age population led to comparatively higher economic output which resulted in increase in disposable income, because of which, the demand for housing increased over the years and raised the price of houses.

**Median age**

![Median age chart]


The average age of borrowers has been declining over the years and was estimated at 33-35 years in 2015-16. It is expected that the average age of a borrower may decline further, encouraged by growth in salaries, population’s growing preference to accumulate assets as a means of investment and to gain tax benefits.

**Average age of home loan borrowers**

![Average age of home loan borrowers chart]

Source: Crisil Research
India became one of the fastest growing large economies in the world in 2015, after it reported 7.57 per cent GDP growth. It even exceeded China where growth tapered to 6.9 per cent in 2015, from an average of 8.6 per cent in the last five years. Indian cities contribute over 62-65 per cent to the Indian GDP. With large scale unprecedented urbanisation growth projected over the next decade and a half, the contribution of urban regions in India’s GDP is forecast to grow to 75 per cent. This is likely to lead to increased demand for housing in India.

Globally, every sixth person getting urbanised is an Indian. The government has released several programmes on mission mode in urban infrastructure, housing and mortgage finance to tap the opportunity offered by the urban blessing. It is envisaged that by 2030, the real estate and construction sector in India is expected to become the third-largest globally, doubling its share to over 15 per cent in the Indian GDP.

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Healthy growth in mortgage in an otherwise under penetrated market

The mortgage in India has grown at a CAGR of nearly 19 per cent over the past five years, which is one of the highest growth rates in the world. With this growth the total mortgage to the housing sector has reached INR11 trillion (USD167 billion) by 2015\(^\text{10}\).

A majority of the demand lies in affordable and mid segment housing and potential buyers falling under this category usually depend on home loans/mortgage to buy their homes. Hence, increase in loan disbursements supported the demand for real estate which led to the house price increase.

Residential mortgage and growth

The housing mortgage in India has grown at one of the fastest pace in the world, supported by government policy reforms. The trend is expected to continue as the housing mortgage penetration in India is one of the lowest (9 per cent) in the world.

Mortgage to GDP ratio

Source: Countries, Housing Finance Network, accessed on 15 December 2016; KPMG in India’s analysis, 2017

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\(^{10}\) "PNB Housing Finance Ltd", HDFC Securities, accessed February 2017
Potential for increased mortgage penetration in the coming decade
The mortgage penetration in India, which is gauged by mortgage to GDP ratio, is one of the lowest in the world at 9 per cent. India’s peers China and South Africa have more than double the penetration of mortgage, supporting the demand in their respective countries. There is still vast scope for mortgage penetration to increase considerably in India, and the growth in India is expected to accelerate in the coming years from nearly 19 per cent to over 20 per cent.

Housing credit to grow rapidly in the long-term
The Government of India has introduced several measures in the recent past to promote mortgage growth by making it cheaper. Some measures include – reducing loan-to-value ratio for housing loans; granting infrastructure status to affordable housing; and allowing External Commercial Borrowings (ECBs) in affordable housing.

Further, the government has taken focussed steps, especially Jan Dhan Yojna, for financial inclusion of poor and ensure access to financial services namely banking/savings and deposit accounts, remittance, credit, insurance, pension in an affordable manner. About 250 million bank accounts were opened through this reform, which is expected to help in bringing in large base of customers in the underserved rural economy.

Also, the recent step to demonetise high value currency notes to promote digitalisation of economy is expected to open up the Indian population to financial products especially with respect to formal credit.

Lastly, the expansion of interest subsidy scheme to the mid-income group (MIG) segment, named as credit linked subsidy scheme (CLSS) urban for MIG, coupled with the extension of loan tenure of CLSS for EWS/LIG to 20 years from 15 years earlier, are expected to go a long way in increasing the mortgage penetration in India. These steps are likely to increase the genuine end-user demand for housing in India.

It is anticipated that the recent policy initiatives are likely to result in affordable housing segment to grow at a much faster pace (30 per cent) than the industry growth over the next three years, and would be a key growth driver for the mortgage finance market in India.

However, in the short-term, it is expected that the growth in disbursement of a housing loan may moderate, as perception of wealth erosion coupled with the anticipation of a fall in property prices may affect demand for houses and housing loans.

Foreign Direct Investment norms
The construction development sector in India has attracted USD24.2 billion cumulatively between 2000 and 2015, and accounts for over 9 per cent share in total FDI inflows into India during the same period. FDI is one of the important sources of funding in real estate projects. Hence, the government has eased the FDI norms for building townships, housing, built-up infrastructure and construction development projects, to attract higher foreign capital.

Need for more reforms
Going by the above trends, India seems to require a significant amount of affordable housing or mass-housing in the next decade. India would need to build 11 crore houses by 2022 to provide accommodation to all its citizens, of which about 70 per cent of the housing requirement needs to be in the affordable segment (less than 60 square metres priced below INR10 lakhs).

In addition to housing ownership, there is potential for rental housing as significant number of youths are migrating from rural areas to cities. These youths primarily rely on informal rentals, as income and mobility factors restrict them to opt for house ownership. Lastly, about a quarter of Indian urban citizens are living in slums. Indian cities are increasingly rolling out broad slum redevelopment policies, some of which have been a success.

Development of large scale formal rental housing stock is required to accommodate the migration of rural population to the urban regions in India, which has been growing at an unprecedented rate.

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KPMG in India

11. Affordable housing segment to grow at 30%, faster than industry, ET Realty, 23 March 2017
12. Fact Sheet on Foreign Direct Investment (FDI), April 2000 to December 2015
13. Decoding housing for all by 2022, KPMG in India, September 2014
Key takeaways

» Indian residential market has a bull cycle of about four to five years followed by a two to three year bear cycle.

» The investor-driven markets, such as Gurugram and Mumbai, are much more volatile compared to end-user-driven markets, such as Bengaluru and Pune.

» Property prices start weakening when inventory overhang exceeds the range of 24-30 months.

» In property up-cycle, it is the city-core which appreciates first followed by suburban and periphery markets.

» Property prices are most volatile in a peripheries market compared to suburban and city core. City core is the safest market for a property buyer as it is primarily driven by end-users.

» A suburban market generally trades at a discount of about 30-35 per cent to the average city core market, while a periphery market trades at a discount of about 60-65 per cent.

» A periphery micro-market in a city can witness about 100 per cent appreciation purely due to premium allocation (i.e. in addition to normal price growth) if it transforms into a suburban market and about 70 per cent if it transforms from suburban to city-core.

» Generally, it takes about eight to ten years for a periphery to transform into a suburban market and about 14-15 years for a suburban market to transform into a city core market. For instance, regions such as Golf Course Road in Gurugram took more than a decade to transform from a suburban market to a CBD; Thane in Mumbai took a decade to transform from a periphery into a suburb.

» Physical infrastructure projects have a strong bearing on a micro-market irrespective of its location. The nearby regions where infrastructure projects are being developed, generally witness strong price discovery appreciation for three to four years.
The housing market in India has witnessed significant growth since 2005 aided by strong economic expansion, growth in the IT-ITeS sector, rising infrastructure spending and opening up of the sector for foreign investments. The sector witnessed some weaknesses for a couple of years due to global financial crisis in 2009. However, the market rebounded quickly in 2010 and remained upbeat till 2013.

However, in the past few years, significant construction delays have dampened the investor sentiment which led to rapid build-up of inventory, affecting the new launches and demand. As a result, the growth in capital value declined and some micro-markets even witnessed correction.

Thus, investing in the Indian real estate is not as simple as it used to be a decade ago, primarily due to the opening up of the sector to foreign investment in 2005. With the availability of information related to launches, supply, pricing, etc., it has become comparatively easier to undertake a thorough analysis of the Indian residential real estate. Some interesting trends around the residential real estate cycle, timing of the market, price appreciation, volatility, micro-market classification, etc., have been showcased below.
Residential market cycles in India

Property price movement is an important indicator of property trends. Rising prices attract property buyers’ attention and vice-versa. However, like other asset classes, real estate also witnesses crest and trough periods. As per our analysis of key cities in India, property cycle in recent years has been volatile. In the last decade, property prices have risen strongly for four to five years, and remained either subdued or declined for two to three years.

Price trends

Another factor for softening of the property prices after four to five years of run-up may be due to supply of completed properties, which facilitated the exit of investors and increased the choices for end-users. The initial investors start trickling in from the time a property is purchased at the time of its launch, leading to a sudden glut of supply leading to softening of property prices.

The regions, which are largely driven by end-users (buyers occupying their properties and in close proximity to business districts, have witnessed some stability during the bear phase of the real estate sector. A steep decline was witnessed in peripheral areas, where limited physical and social infrastructure was present.1

The only exception to this is the Gurugram and Mumbai real estate market. While, Mumbai was already an established business centre; Gurugram evolved as a major business district from being just a periphery of Delhi in the late 1990s. The central region of both Mumbai and Gurugram (similarly Noida) witnessed significant appreciation during the first few years of the twenty-first century as investors continued to find value in emerging business hubs.

In contrast, the cities of Bengaluru, Chennai and Pune have developed as major business districts in recent years leading to significant appreciation in central region property prices in the last decade.

The establishment of a central business district with state level and national level importance led to price discovery of the entire property market. Going by this trend, we can expect property price appreciation in smaller cities to take place first in city centres and then in the peripheries of cities with a strong business district.

Price discovery of a housing project is an important phenomenon in real estate, which is influenced primarily by three factors: livability, accessibility, and proximity to employment hubs.

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KPMG in India

1. PE Analytics; KPMG in India’s analysis, 2017
In light of the above table, it is suggested that the industry stakeholders must adopt a cautious approach, during both bull and bear phases, to prevent glut of the market with new projects. Observing discipline in supply of new projects may help reduce the price volatility during the bear and bull phases of the property market.

### City-wise real estate price movement across different regions

<table>
<thead>
<tr>
<th>Region</th>
<th>Bengaluru</th>
<th>Chennai</th>
<th>Gurugram</th>
<th>Mumbai</th>
<th>Pune</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central/Central –Prime</td>
<td>16%</td>
<td>12%</td>
<td>15%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>City-core</td>
<td>12%</td>
<td>13%</td>
<td>14%</td>
<td>9%</td>
<td>14%</td>
</tr>
<tr>
<td>Suburb</td>
<td>13%</td>
<td>10%</td>
<td>19%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Periphery</td>
<td>10%</td>
<td>7%</td>
<td>22%</td>
<td>15%</td>
<td>11%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Region</th>
<th>Bengaluru</th>
<th>Chennai</th>
<th>Gurugram</th>
<th>Mumbai</th>
<th>Pune</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central/Central –Prime</td>
<td>4%</td>
<td>7%</td>
<td>1%</td>
<td>5%</td>
<td>1%</td>
</tr>
<tr>
<td>City-core</td>
<td>8%</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Suburb</td>
<td>5%</td>
<td>4%</td>
<td>2%</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>Periphery</td>
<td>6%</td>
<td>2%</td>
<td>1%</td>
<td>6%</td>
<td>4%</td>
</tr>
</tbody>
</table>

**Source:** Data, PE Analytics, accessed on 10 December 2016; KPMG in India’s analysis, 2017
Timing your property transaction decision

On the basis of the above analysis, investors may choose appropriate markets suiting their budgets, location preferences, etc. However, there are few fundamentals that hold true for all micro-markets, and investors may consider them to time their entry into and exit from the property market.

Tracking inventory overhang

Rapid supply during the bull period without corresponding absorption results in building up of inventory of unsold units with developers. The mismatch between demand and supply therefore creates pressure on property prices at a certain level. Our analysis reveals that unsold inventory with developers to the tune of 24-30 months of demand starts creating pressure on property prices.

Impact of inventory overhang on property prices (city-wise)

Source: Data, PE Analytics, accessed on 12 December 2016; KPMG in India’s analysis, 2017
The timeline is a bit stretched for markets which are largely driven by investors (for instance Gurugram and Mumbai). However, a large inventory overhang impacts only the market which has substantial supply of properties. A micro-market, which has limited number of projects, may continue to witness high inventory overhang without any corresponding impact on property prices.

Impact of inventory overhang on property prices (region-wise)

- In city core markets – the impact of high inventory overhang on property prices was limited due to limited supply
- Most impact was on periphery and suburban markets

Residential properties in core areas of a city tend to be more insulated from several factors, such as the slowdown in the real estate sector and domestic or global economy, owing to it being primarily an end-user-driven market with physical and social infrastructure in place.

Source: Data, PE Analytics, accessed on 14 December 2016; KPMG in India's analysis, 2017
Supply concentration

The housing price across different regions in a city does not move uniformly or there can be some lag in property prices appreciating in a city region. A major factor in this variation is the quantum of new launches affecting the supply concentration across regions within a city.

As per our analysis of the primary data available of several property markets in India, the supply must be adequately distributed between central, suburbs and periphery regions in a city. Typical supply concentration across regions in a city, at any given point in time for sustainable growth in prices, is explained below:

- City-core – 5-10 per cent of total supply
- Suburbs
  - Metro and large cities – 25-35 per cent of supply
  - Smaller cities – 70-80 per cent of supply
- Periphery
  - Metro and large cities – 55-70 per cent of supply
  - Smaller cities – 20-25 per cent of supply

Premium/discount to city average

Any variation in the supply concentration may have a direct impact on the property prices in a region. As per our analysis of the primary available data, the typical premium or discount of property prices across different regions over a city’s weighted average prices are:

- City-core – about 2.5 times the premium over the city’s weighted average price
- Suburbs – around the city’s weighted average price
- Periphery – 20-40 per cent discount to the city’s weighted average price.

Source: Data, PE Analytics, accessed on 14 December 2016; KPMG in India’s analysis, 2017
A good way for a property buyer to gauge the health of the market is to look at the relative pricing and supply concentration in a micro-market. Any significant diversion in supply concentration without any corresponding change in property price offers an opportunity to either buy or exit.

It is to be noted that a market with frequent change in supply concentration is expected to witness significant volatility in property prices. It also suggests that the supply side is not efficient in balancing out the supply. In our analysis, we have witnessed significant changes in the supply concentration in the markets of Gurugram and Chennai – which resulted into significant volatility in property prices in both the markets.

As can be seen from the above bar charts, over 62 per cent of the supply and consumer preference in the residential asset class in India, lies in the INR3,000-7,000 per sf bracket. Also, the share of locations falling under this price bracket is the highest (over 60 per cent). These are primarily in the peripheral and suburban micro-markets of a city. This price bracket usually caters to the affordable to mid-income segment of the society. Another 26 per cent lies in the INR7,000-16,000 per sf price bracket and located in the suburban and city core micro-markets. This usually caters to the upper middle income and high income groups. The remaining 10 per cent of the supply and demand lies in the INR16,000 per sf and above, and usually located in the city core and prime central regions of the city. This caters to the high income group and high net worth individuals who have the capacity to pay a premium for the advantages or the luxury which these regions offer. As the price bracket INR3,000-7,000 per sf, is a major influencer in governing the momentum of the residential asset class, the capital values of the projects in this segment are likely to persist at the current levels for the two to three quarters.
Supply concentration scenario across different cities

Supply concentration: Gurugram

Supply concentration: Pune

Supply concentration: Bengaluru

Supply concentration: Chennai

Supply concentration: Mumbai

Source: Data, PE Analytics, accessed on 14 December 2016; KPMG in India’s analysis, 2017
Infrastructure push
It has been witnessed that irrespective of market conditions, the announcement of a major infrastructure project in a city often drives real estate activities, leading to property prices appreciation. Some case studies have been presented to analyse the infrastructure-led growth in real estate.

Case study
Peripheral Gurugram submarket (Dwarka Expressway/Northern Peripheral Road and New Gurugram)

Dwarka Expressway: The high growth corridor of real estate in the Delhi-NCR region
Announcement of the Dwarka Expressway and its development in subsequent years led to the peripheral submarket outperforming other submarkets in the city.

Project highlights
• Conceived in 2007, it is an eight-lane, 150m-wide, and 18km-stretch that connects Dwarka in Delhi to Gurugram
• The construction started in 2010
• Scheduled completion was 2012, however it got delayed, owing to hurdles in land acquisition.
• Total investment outlay of INR3,000 crore

Timeline and price appreciation – maximum appreciation was witnessed post the commencement of construction

2007-10
Project approved
• Dwarka Expressway was proposed in the Master Plan-2021, connecting Dwarka in Delhi to Palam Vihar in Gurugram
• Price appreciation = 14 per cent

2010-13
Project extended
• The extension of the expressway from Palam Vihar to NH8 was enlisted in the Master Plan-2025.
• This extension boosted real estate development along the Dwarka Expressway route
• Price appreciation = 96 per cent

2013-June 2016
Project delayed
• In November 2012, the Master Plan-2031 was released and seven new sectors were added along the New Gurugram and Dwarka Expressway micro-markets.
• Project got delayed due to litigation issues
• Price appreciation = 03 per cent

Source: Regional Plan 2021, National Capital Region, NCR Planning Board, 2005; Haryana Government Town and Country Planning Department Notification, 15 November 2012; KPMG in India’s analysis, 2017
Real estate dynamics along the peripheral submarket (Dwarka Expressway and New Gurugram)

Supply and absorption
The peripheral micro-market of Gurugram accounted for approximately 55-60 per cent of the total supply as well as absorption of organised housing units in the area over the past decade.

Product pricing
Dwarka Expressway offers relatively less expensive residential options, which are available at 25 per cent discount to that of a city weighted average price. Majority of the projects are priced between INR3,500–12,000 per sq.ft

Price growth
The expressway has witnessed approximately 130 per cent growth in residential prices between 2007 and June 2016, owing to a healthy demand. The micro-market has outperformed all other submarkets in Gurugram and witnessed the highest appreciation over the past decade.

Investment
Total investment from home buyers has been estimated to have crossed INR60,000 crore (USD09 billion), spread over more than 70,000 units.

Source: Data, PE Analytics, accessed on 15 December 2016; KPMG in India’s analysis, 2017

E. Jayashree Kurup
Magicbricks Realty Services Ltd.
Conclusion

- The announcement and subsequent development of Dwarka Expressway over the years led to the emergence of a new real estate growth corridor.
- The micro-market witnessed considerable real estate activity and remained on buyer’s radar till 2013.
- However, the expressway project missed the deadline several times owing to delay in acquisition of land.
- The delay significantly affected the property market in the regions surrounding Dwarka Expressway. The situation was aggravated with delays in project completion, driving down the property market of the entire region.
- Similar to Dwarka Expressway, there are case studies on other cities in India wherein an expressway resulted in significant growth of surrounding real estate in the initial three to four years, followed by a slowdown. For instance, the Noida-Greater Noida Expressway and Yamuna Expressway have witnessed significant growth in property prices post the commissioning of the project commissioning.
- However, the price growth sustained for only three to four years and did not witness any growth even after the completion of the expressways.

Case study # 02: Bengaluru Metro

The approval of a metro route in 2005 led to significant rise in property values over the past decade.

Project highlights:
- The Bangalore Metro Rail Corporation Limited is a special-purpose vehicle (SPV) created by a joint venture between the central government and the Karnataka government.
- Phase 1, Reach 1 is part of Namma Metro, East-West corridor, which is named Purple line, is an elevated metro corridor.
- Total length is 6.7km, connecting MG Road and Baiyappanahalli, spread over six stations.
- Once the Phase -1 is fully operational, the Purple line is estimated to carry about 6.5 lakh passengers per day by 2021.

Timeline and price appreciation – highest appreciation was witnessed during project formulation/development stage.

2005-07
Project development stage
- Project was approved in 2005.
- Price appreciation (CAGR) = 20 per cent.

2007-11
Project construction stage
- Project was delayed by over an year.
- Metro opened to public in October 2011.
- Price appreciation (CAGR) = 08 per cent.

2011-2013
Post project completion stage
- Higher FAR was announced for plots within 500m radius from the metro corridor.
- Price appreciation (CAGR) = 14 per cent.

Source: Report on Metro Rail Transit System Impacts On Land-use And Land Values in Bangalore, India.
Conclusion

• The announcement of Bengaluru’s first metro rail in 2005 and its development in the subsequent years led to significant rise in both commercial and residential real estate activities

• Despite commanding considerable premium to that of the city’s weighted average, the central submarket has outperformed other submarkets in Bengaluru in terms of price growth

• The projects within a radius of one kilometre from the metro route witnessed higher appreciation. As the distance from metro stations/route increased, the price growth was lesser in comparison

• Higher floor area ratio (FAR) for plots within 500 meters radius from the metro route further spurred the real estate activities

• Due to increased traffic congestion and longer commuting time by road, companies have set up their offices near metro routes. This has increased the opportunities, leading to sustained and higher demand for residential properties in the region

• The provision for feeder buses from metro stations, coupled with the existing BMTC buses, provided a good network of transport, thus making the prospect of commuting by the metro a viable option.
Case study # 03: Navi-Mumbai International Airport
Impact of Navi-Mumbai International Airport on real estate in the peripheral submarket of Mumbai

Project highlights
• One of the largest green-field airports to be developed in India on a Public-Private Partnership (PPP) model; CIDCO is the nodal agency.
• Total project cost is estimated at INR16,000 crore
• Project expected to be commissioned by December 2019
• Projected to handle over 50 million passengers per annum by 2030
• The airport is likely to attract an investment of about INR60,000 crore in MMR and its surrounding regions
• Anticipated to generate over 3.5 lakh direct and indirect jobs

Timeline and property price appreciation over the past decade

2007-10
Project conceptualisation stage
• The Union Cabinet gave the project the in-principle approval in 2007
• The defence ministry and the MoEF (for environment and CRZ) granted clearances for the NMIA project in 2010
• Price appreciation = 20 per cent

2010-13
Project approval stage
• Project was delayed
• The MoCA granted approval for Revised Master Plan for NMIA in 2011
• PMIC was set up by the MoCA in 2012 to expedite implementation
• Project proposed is to be completed by 2017
• Price appreciation = 34 per cent

2013-16
Project development stage
• Project received all approvals in 2016
• Pre-development works started in October 2016
• Price appreciation = 16 per cent

Source: Conception to Clearance, NMIA, CIDCO, Maharashtra, accessed on October 30 2016
Real estate dynamics along the peripheral submarket

Supply and absorption
The peripheral submarket of Mumbai accounted for nearly 24 per cent of the total supply as well as absorption of organised housing units in Mumbai-MMR over the past decade.

Product pricing
The Navi-Mumbai and Kharghar micro-markets offer residential properties in the mid and premium segments (INR7,000 - 12,000 per sf), Kamothe and Ulwe (INR5,700 - 7,000 per sf) and the micro-markets of Panvel and Raigad offers affordable and mid segment options (INR2,500 - 6,000 per sq.ft.)
The peripheral micro-market trades at over 35 per cent discount to that of the city’s weighted average price.

Price growth
The property prices in the peripheral submarket have witnessed nearly 90 per cent growth over the past decade. However, it has underperformed in other submarkets in the Mumbai-MMR region, which have witnessed price growth of 100 per cent and above.

Source: Data, PE Analytics, accessed on 19 December 2016; KPMG in India’s analysis, 2017
Conclusion

• Although the Navi-Mumbai airport project received an in-principle approval in 2007, the realty prices witnessed a growth of only 20 per cent till year 2010.

• The actual impact of the Navi-Mumbai airport on realty prices was witnessed during the 2010-13 period. During this period, the peripheral submarket reported nearly 34 per cent growth in residential property prices. This was owing to the government’s efforts to fast track the implementation process by setting up a PMIC.

• Continued delays due to pending approvals and delay in land acquisitions for the airport project considerably impacted the demand for real estate. This led to the rise in inventory overhang, which exceeded 30 months in 2013 and remained at elevated levels post that period. As a result, residential realty witnessed softening of price growth and reported 16 per cent appreciation between 2013 and June 2016.

• Under the peripheral submarket, Navi-Mumbai and Kharghar micro-markets; which have established physical and social infrastructure along with easy access to the business districts of Mumbai, Thane and Navi-Mumbai, have outperformed micro-markets such as Panvel, Ulwe and Raigad over the past decade.

• However, since the development works have started at the airport project site in 2016, which is likely to be commissioned by 2019, the real estate development activity is expected to pick up in the surrounding micro-markets of the airport. As a result, Panvel, Ulwe and Raigad micro-markets are expected to witness comparatively higher growth in the coming decade.
Major trends in the Indian residential real estate

Since the twenty-first century, the sector has witnessed significant transformation in its scale, size and funding aspects. The projects are much larger, complex and organised in nature. Some major trends are:

Consolidation
The sector is gradually consolidating with limited number of regional players gaining strength in their respective local/regional markets and increased national presence. Real estate sector is highly capital and labour-intensive in nature, and projects especially large ones, which normally have long gestation periods of three to five years and above. Hence, in order to meet significant funding requirements, mitigate risks and share resources, such as land and technical expertise, several regional, national and international players have partnered with others. The sector has witnessed several JVs and JDs over the past decade, which has only gained prominence with each passing year.

Portfolio diversification by conglomerates
The sector has witnessed the advent of large domestic and foreign corporates successfully venturing into the Indian real estate sector. Over the past decade, a number of Indian conglomerates and business groups have diversified and included real estate into their business portfolio.

Divergence of asset classes
The asset classes have expanded and newer concepts, such as mixed-use developments, integrated townships, luxury housing, branded homes, serviced apartments, SEZs, retail zones and specialised malls, hospitality, industrial parks and clusters, have emerged.

Expanded expertise across the real estate value chain
Several players have increased their presence across the value chain of the real estate sector. A number of leading construction and infrastructure giants have emerged as integrated real estate developers with the help of backward and forward integration.

Funding channels
Institutional funding, especially from private equity and NBFCs, are amongst the largest financiers of the real estate sector.

FDI and PE investments
Private Equity (PE) investments in the real estate sector have increased from the post-2008 global financial crisis lows of over USD0.6 billion in 2010, to over record USD5.7 billion in 2016, a staggering increase of over ten times during this period.

On the contrary, Foreign Direct Investments (FDI) into construction development sector have declined year after year since 2008. The FDI inflows have declined to USD107 million in 2016, which was merely 3 per cent of the total FDI of USD3.7 billion recorded in 2008. This is despite the relaxation of FDI norms for the construction development sector undertaken over the past two to three years.

The reason for the substantial and continuous decline in FDI investments over the past decade was that the offshore investors have been deploying a huge portion of their funds through debt or structured debt route, which does not get captured in FDI inflows. Structured debt model of funding protects their investments, as they get certain percentage of fixed returns on the debt provided to developers and at the same time reduces the risk of investments.

The overall positive sentiment was attributed to a host of factors including political stability, regulatory environment, enhanced infrastructure, strong investments, approval to the GST bill, and amendments to REITs.

From an end user home buyer, residential real estate has become an asset class to be counted in portfolios. No matter how small the unit or how far from the core city, this is in an appreciating asset. Computing returns on such property for end use has begun only recently.

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Rising non-performing assets (NPA), higher risk provisioning assigned to the real estate sector by the Reserve Bank of India (RBI) and dwindling profits in the real estate sector, have made banks reluctant to lend to the sector. As a result, bank lending to the real estate sector has significantly dropped from over 57 per cent in 2010, to less than 24 per cent in 2016.

Interestingly, PE funds and financial institutions such as pension funds and sovereign wealth funds have replaced banks as the largest source of funding to the real estate sector. The share of PE funds and other financial institutions in real estate funding has gone up significantly from 25 per cent in 2010 to over 75 per cent in 2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>PE Investments</th>
<th>Bank Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>20%</td>
<td>55%</td>
</tr>
<tr>
<td>2016</td>
<td>55%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Source: Analysis of Institutional Funding in Real Estate, Knight Frank, March 2017; KPMG in India’s analysis, 2017
Way forward
The Indian residential real estate sector has been going through several ups and downs, and there is considerable amount of property data that can be analysed in detail to understand consumer trends. The analysis on the available data facilitates informed decision-making, which helps in lowering risk. Some key considerations for various Indian real estate stakeholders are listed below.

**Property buyers**

In addition to serving the basic need of access to a decent accommodation, many property buyers also evaluate the economic benefits (such as saving on rent and capital gains) a property would deliver. Thus, while property purchase decision may or may not be out of necessity, the financial aspect is largely the driving factor behind a property purchase decision.

The decision of a buyer to purchase a property competes with numerous other investment opportunities, such as gold, stock market and bank deposits. Real estate is amongst the most preferred asset classes for Indian investors and it is estimated that real estate accounts for about 30 per cent of total household savings.

With the availability of multiple units in the real estate industry, property buyers can now make an informed decision to help them take full advantage of their returns from residential properties. A list of factors to be considered while selecting an inappropriate property is provided below. The factors have been clubbed in three sections viz.

- City selection
- Micro-market or region selection
- Project selection

### City-wise real estate price movement across different regions

<table>
<thead>
<tr>
<th>Factors</th>
<th>Parameters</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic growth</td>
<td>GDP, Income growth</td>
<td>A property buyer could consider the local economic development of a city. Cities which are state capitals, economic hubs of states or regions are very attractive propositions</td>
</tr>
<tr>
<td>Demographics</td>
<td>Urbanisation, Nuclearisation, Average age</td>
<td>Urban areas experiencing abundant/excessive migration especially of young population is expected to witness significant growth in housing demand</td>
</tr>
<tr>
<td>Affordability</td>
<td>House price to income ratio</td>
<td>The housing prices, especially in suburban or peripheral areas, could be in the range of 8-10 times of the income of a middle-income household in the city</td>
</tr>
<tr>
<td>Property market movement</td>
<td>Property prices, Inventory overhang</td>
<td>A property buyer need to be cautious in a market which has witnessed a continuous appreciation for several years in a row. Likewise, a market may be evaluated if it has not witnessed any significant appreciation for the last couple of years. Further, property buyers can check over the inventory overhang in a property market. A market with an inventory overhang of more than 24 months could be avoided</td>
</tr>
<tr>
<td>Holding period</td>
<td>Short-term (&lt;1 year), Mid-term (1-3 years), Long-term (3-5 years)</td>
<td>For short-term, a buyer may consider a newly launched project which can deliver strong returns. For medium-term, an investor may consider properties which are launched near urban infrastructure projects. In the long-term, investors need to be very careful in selecting a micro-market. One of the safest options for long-term play are premium properties in the city-centre region.</td>
</tr>
</tbody>
</table>
Selecting the right region or a micro-market in a city

<table>
<thead>
<tr>
<th>Factors</th>
<th>Parameters</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply concentration</td>
<td>Units launched in a particular region</td>
<td>Property buyers need to be cautious of investing and keeping a close watch on a region in a city, which is witnessing significant launches, without corresponding launches in other parts of the city.</td>
</tr>
<tr>
<td>Pricediscovery</td>
<td>Premium-discount to that of a city’s average prices</td>
<td>Property buyers need to be cautious of investing in a region if the price in a particular region is commanding a significant premium over other regions in the city.</td>
</tr>
<tr>
<td>Affordability</td>
<td>Housing price to income</td>
<td>The housing prices, especially in suburban or peripheral areas, could be in the range of 8-10 times of the income of a middle-income household in the city.</td>
</tr>
<tr>
<td>Infrastructure play</td>
<td>Physical and social infrastructure development, such as metro, airport and expressway</td>
<td>An announcement of a major physical and social infrastructure project in a region or a micro-market generally stimulates the property market around that region. Investors may consider investing in such market; however, they need to keep a close watch on the infrastructure development as any delay may impact the region/micro-market property market.</td>
</tr>
<tr>
<td>Holdingperiod</td>
<td>Short-term (&lt;1 year)</td>
<td>For short-term, a buyer may consider a newly launched project which can deliver strong returns.</td>
</tr>
<tr>
<td></td>
<td>Mid-term (1-3 years)</td>
<td>For medium-term, investor may consider properties which are launched near urban infrastructure projects.</td>
</tr>
<tr>
<td></td>
<td>Long-term (3-5 years)</td>
<td>In the long-term, investors can carefully select a micro-market. One of the safest options for long-term play are premium properties in the city-centre region.</td>
</tr>
</tbody>
</table>

Selecting the right project

<table>
<thead>
<tr>
<th>Factors</th>
<th>Parameters</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developer and project track-record</td>
<td>Background on developer Project background</td>
<td>Property buyers can closely monitor the background of a developer and the project, especially with respect to delays, financial position, etc. Further, before investing in a property, buyers need to take a legal opinion and verify that the developer has obtained all the necessary approvals from the local development authority. In our view, with the Real Estate (Regulation and Development) Act, 2016 (RERA), gradually becoming a reality, property buyers can view the credentials of a developer on the website of the proposed regulatory authority to be set up in each state.</td>
</tr>
<tr>
<td>Accessibility</td>
<td>Social infrastructure, such as school, hospital, convenience stores and road connectivity</td>
<td>A project with good accessibility to social infrastructure is preferred much more and may command better value in comparison with other projects in the vicinity.</td>
</tr>
<tr>
<td>Product type</td>
<td>Size of unit Amenity (basic, premium or luxury)</td>
<td>Property buyers need to consider the mix of units in a project. Typically, projects in the city-core have large configuration, while in peripheries, smaller units is the norm Further, buyers can also consider the grade of the project — a luxury project in a peripheral location may not yield much return in the short-term.</td>
</tr>
</tbody>
</table>

Factors listed in the property investment decision tree are just for guidance purpose to educate an investor on factors that could be considered or evaluated before purchasing a property. In addition to the above, there are many more personal and other regulatory factors that drive the investment decisions of a property buyer.

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A steady progression in the real estate sector is important to support the high economic growth of a country. India is witnessing a mass-migration of population from rural to urban areas, and lack of proper housing facility could act as a roadblock to help the country achieve optimal economic growth.

Few important takeaways with reference to regulatory interventions required from the government are listed below:

1. Promote affordability
   As analysed earlier, the Indian residential real estate demand primarily consist of affordable housing units. However, large Indian cities have witnessed significant price appreciation, surpassing the general income growth that led to properties becoming unaffordable to a large extent. Some important steps to promote affordability are listed below:

   **Review various taxes and statutory charges**
   Real estate development in India is subjected to several central, state and local taxes and charges, which are ultimately passed on to consumers. It is estimated that taxes and charges, collectively, account for about 25-30 per cent of housing cost. Several important taxes and charges levied are presented below:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Tax</th>
<th>Percentage of property cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Developer agreement stamp duty</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Stamp duty on purchase of property</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>Registration</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Value added tax</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>Service tax</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>VAT to contractors</td>
<td>4</td>
</tr>
<tr>
<td>7</td>
<td>Excise and custom duty</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>~35</td>
</tr>
</tbody>
</table>

   Rationalising these taxes and charges could significantly help reduce the cost of housing development in India to promote affordability.

   **Review development norms in large cities**
   Large Indian cities, especially metro cities, have witnessed considerable improvement in urban infrastructure over the last three to five years. In our view, the government could relook into various development norms, such as FAR/FSI and density norms, to allow efficient utilisation of limited urban land in large Indian cities.

   The government has taken some concrete steps to make housing affordable for the urban poor. Going forward, we expect the government to take more steps to streamline approval processes, rationalise fee and tax structures, and undertake reforms pertaining to land, to achieve the desired objectives of ‘Housing for All by 2022.’

   Neeraj Bansal
   KPMG in India

   **Reduce approval delays**
   The current approval mechanism in many states is a complex process, as on an average a developer requires 30 to 40 different approvals from central and state government departments, and ULBs. Further, multiple factors add to the existing complex process leading to uncertainties and delay in building approvals. It is estimated that it takes about two to three years to obtain necessary approvals, which increases the housing development cost by 20 to 30 per cent. The delay is primarily due to factors such as duplicity due to overlapping regulatory jurisdiction of various authorities, lack of institutional clarity that is open to individual interpretation, involvement of multiple departments and weak allocation of responsibilities and accountability.

   Development of a ‘single window clearance’ system connecting regulatory authorities at the central, state, and ULB levels, supported by a robust technology platform, could help reduce the complexities and delays in receiving approvals.

   This single-window platform could be operated either by the state or ULBs (either municipality or local development authority). Development of technology enabled single-window clearance has also been recommended by a committee on Streamlining Approval Procedure for Real Estate Projects (SAPREP) in January 2013. It is recommended that the central and state governments implement the recommendations to expedite development of housing.

   **2. Expand urban boundaries by unlocking development potential**
   India is witnessing rapid urbanisation with significant contribution from rural to urban migration. To accommodate rising rural migrants, urban geographies cannot be expanded to develop adequate infrastructure.

   The government can must expedite its initiative of expanding urban boundaries of existing large cities by promoting transport infrastructure development and facilitating a conducive land assembly policy.
3. Promote mortgage growth
As residential real estate is a high ticket investment, a significant proportion of Indian property buyers rely on mortgage to finance their homes. However, the mortgage penetration in India is quite low compared with that of developing peers, such as China, Brazil and Vietnam. India needs to promote mortgage growth by providing credit access to informal labour class, which does not have sufficient documented income proof. It can be achieved by promoting micro-finance in the housing sector.

4. Develop new economic regions
The development of new economic centres in urban peripheries can help decongest main cities and promote the real estate sector. The Special Economic Zone (SEZ) policy launched in 2005 was one such policy that promoted the development of urban peripheries. The development of SEZs serves as a strong growth engine for any economy and, globally, those countries that have adopted SEZs and other similar approaches seem to have experienced progress faster. The levy of MAT on SEZ units and developers has adversely affected India’s manufacturing sector’s global competitive edge, as local manufacturers were not able to match the imported goods prices, which have had undesirable effects on exports, and increased India’s reliance on imports. The levy of MAT has stalled the development of SEZs for the past few years, resulting in a significant impact on export potentials, employment generation, and overall economic development. The government must consider providing an exemption from MAT being levied on SEZ units and developers. This may help the government in propelling its leading initiatives, such as ‘Make in India’ and ‘Start-up India, Stand-up India’, in improving exports and, thereby, attaining fiscal stability. It can also create employment opportunities across the sector, further boosting the economic growth of India.

Industry
With increased availability of information surrounding residential real estate development in Indian cities, some suggestions for the industry stakeholders are as follows:

Focus on project delivery capability
Over one-third of the total under-construction residential projects in India are witnessing schedule overrun of about 30 months or even higher. While the inordinate delay in securing approvals is a major concern, some challenges stemming from the industry include inefficient project planning, delay in tendering and finalisation of contractors, insufficient funds, and lack of labour supply.

Project delays can adversely affect a developer’s reputation and standing in the market, resulting in poor realisation of future projects. In fact, the delivery capability may determine the continuity or survival of a developer during a down-cycle.

Real estate developers need to focus on enhancing their project delivery capability in order to deliver projects on time. In fact, they can build sound project management practices to adhere to project timelines.

Informed decision-making
Detailed study and analysis of a micro-market is needed to gauge the available inventory and demand-supply dynamics, before launching a project. As per our analysis, micro-markets which have witnessed a supply glut over a given period have been adversely impacted due to demand not being able to grow at a consistent pace.

Fast-track the completion of ongoing projects
It is witnessed that non-completion or delay of projects has led to higher inventory levels. As a result, inventory overhang in certain submarkets and cities have gone beyond 24 months or even higher. This has further impacted the demand adversely, primarily the under-construction properties. Furthermore, the whole situation has adversely affected the overall cash flows of the developers, which has led to delay in other projects as well. Hence, to overcome such a situation, developers need to consider bringing in equity to first complete the projects which are under construction and fulfil the promises made to the home buyers. This is one of the best possible ways to regain the confidence of buyers, who have lost faith in developers.

Adopt industrial construction techniques
Real estate developers can consider new mass housing construction technologies, such as pre-fabricated, pre-engineered buildings (PEBs), modular homes and tunnel framework technology. Investments in R&D in modern technology space could be made to find out faster and cheaper ways of construction.

The available data suggests that down-cycle in residential real estate is broadly at its faq end and the growth period may be just a few quarters away, supported by improved affordability and lowered level of unsold inventory. Residential real estate in key Indian cities/regions did witness a pick-up in the second half of 2016, but with erosion in consumer sentiments, driven by demonetisation of INR500 and INR1,000 notes, the recovery may get delayed.

City index change Jan-Mar 2017

<table>
<thead>
<tr>
<th>City</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chennai</td>
<td>-1.50%</td>
</tr>
<tr>
<td>Gurugram</td>
<td>-1.00%</td>
</tr>
<tr>
<td>Pune</td>
<td>-0.50%</td>
</tr>
<tr>
<td>Bengaluru</td>
<td>0.00%</td>
</tr>
<tr>
<td>Thane</td>
<td>0.00%</td>
</tr>
<tr>
<td>Navi Mumbai</td>
<td>0.50%</td>
</tr>
<tr>
<td>Mumbai</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

Source: Propindex, Volume 6, Issue 4, Jan-Mar 2017, Magicbricks, May 2017; KPMG in India’s analysis, 2017
Further, the overall residential realty market scenario remains subdued, as a direct impact of demonetisation. However, the above bar chart depicts that there is little evidence of any significant price correction in the residential prices as was expected by many people. This was due to lack of or low transactions volumes in the market and developers’ strong decision to keep status quo and not decrease the prices. In fact, contrary to the expected view of the home buyers and market analysts, the PropIndex from Magicbricks has recorded up to 1 per cent appreciation in Bengaluru, Chennai, Pune and Navi Mumbai during the Jan-Mar 2017 quarter; while only Gurugram and Thane were the two markets which recorded 0.4-2 per cent decline in the index values.

The cleansing of the Indian financial system due to demonetisation, aptly supported by landmark reforms, such as the GST and RERA are expected to drive professionalism, governance and transparency in the Indian real estate sector.

Residential real estate has generated strong capital appreciation for investors and is expected to continue performing so, driven by strong fundamental factors, such as demographics, urbanisation and economic growth. High growth of residential real estate is also important for the Indian economy, as it is amongst the major contributors to the economy, employment and revenue for the government.
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