FICCI-NAREDCO-KNIGHT FRANK

REAL ESTATE SENTIMENT INDEX

Q3 2017 (JULY – SEPTEMBER 2017)

The real estate sentiment index is developed jointly by Knight Frank (India), the Federation of Indian Chambers of Commerce and Industry (FICCI) and the National Real Estate Development Council (NARDECO). The objective is to capture the perceptions and expectations of industry leaders in order to judge the sentiments of the real estate market.

OVERVIEW

Business sentiments in the modern history of real estate in India have hit the rock bottom. While sentiments are largely transient in nature, the prevalent mood in the industry reflects the most matured opinion on the battery of reforms that became a reality over the past12-odd months.

It all started on November 8, 2016 when the government decided to derecognise high denomination currency. The first, in the slew of long-term reforms, took the industry by storm; however, it remained hopeful of brighter future. A few months later we saw another structural reform, the Real Estate (Regulation and Development) Act, 2016 come into effect. And, the final salvo in the reforms-driven new order was the roll out of the Goods and Services Act.

Despite widespread heartburns sparked off by each of these policy decisions the realty sector stayed optimistic. Today as we look back at the year since demonetisation it is clear that the industry has a much more objective view of the changing times. The real estate sector, in particular, has come to terms with the fact that buoyancy is unlikely to bounce back in the immediate future. Even the festive season that is known to bring in the occasional cheer has failed to scuttle the gloom.

The results of the latest FICCI-NAREDCO-Knight Frank Sentiments Index for the quarter ending September 2017 stand testimony to the somber scenario across the industry today. This time the survey results assume higher relevance as it captures the industry mood nearly a year since demonetisation. In a nutshell the future sentiments score i.e. the outlook for the next six months has hit an all-time low in the NDA-regime.

There is also an evident slowdown in the overall economy. Industry analyses of India's business performances have seen a steady decline. Capital expenditure has dwindled to worrisome levels and growth is unlikely to revive in the near future.

Going forward I feel that the next 12 to 18 months are likely to be the 'under observation' period for the real estate sector. Industry stakeholders should spend the period in reorienting businesses in line with the new order. India's strong economic fundamentals still puts it among the fastest growing economies in the world. The need of the hour is to put our heads down and allow the consolidation process to take its own due course.

APPROACH

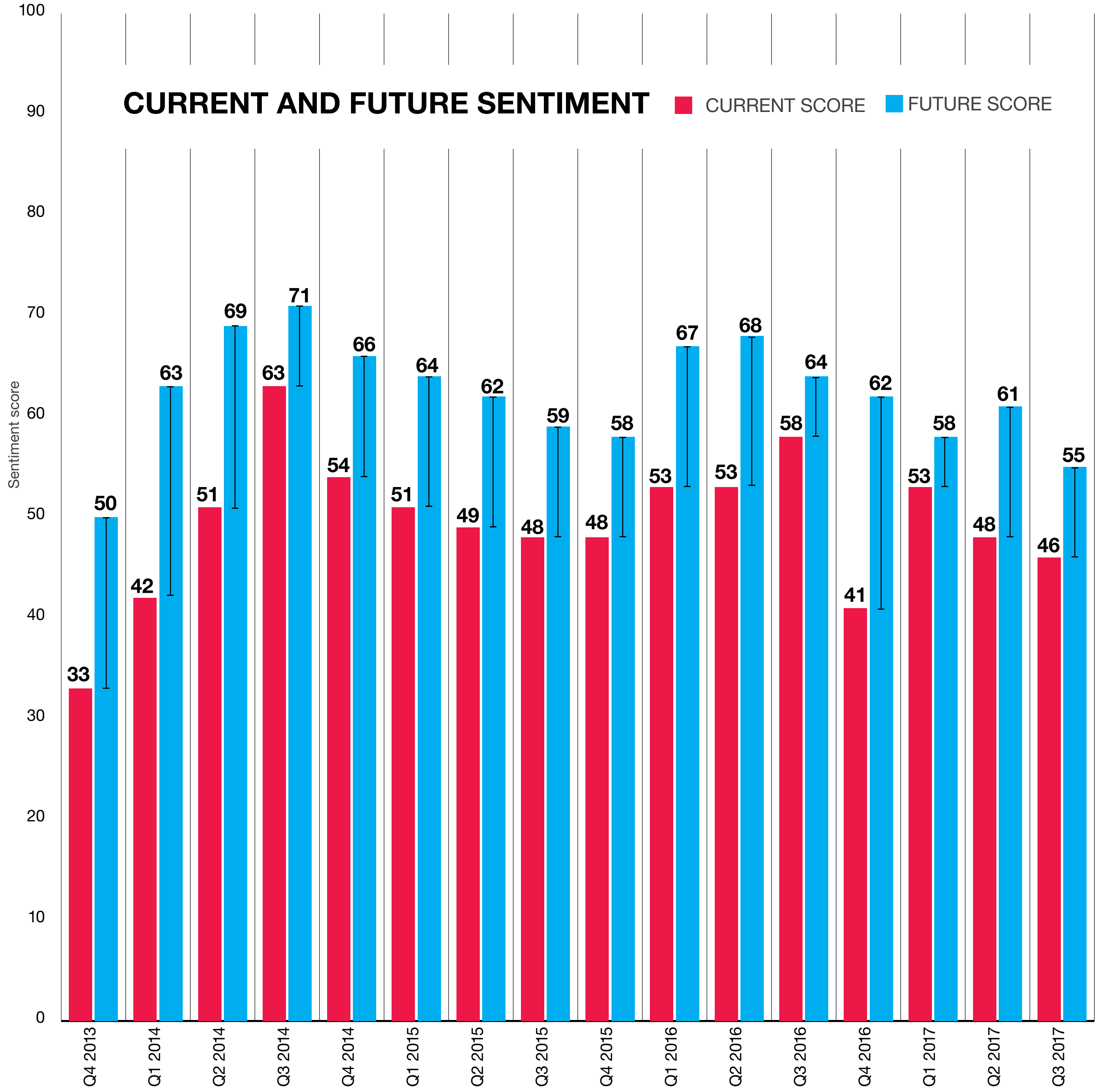
The real estate sentiment index is based on a quarterly survey of key supply-side stakeholders, which include developers, private equity funds, banks and non-bank financial companies (NBFCs). The survey comprises questions pertaining to the economy, project launches, sales volume, leasing volume, price appreciation and funding. Respondents choose from the following options, for which weights have been assigned: a) Better (100 points) b) Somewhat Better (75 points) c) Same (50 points) d) Somewhat Worse (25 points) and e) Worse (0 points). The index is determined by calculating the weighted average score of the percentage of responses in each of these categories.

Hence, a score of 50 represents a neutral view; a score above 50 demonstrates a positive outlook; and a score below 50 indicates negative sentiment.

In order to present a holistic view of the real estate industry, the report is divided into two sections. Section A comprises two indices: the overall current sentiment index that indicates the respondents' assessment of the present scenario compared to six months prior, and the overall future sentiment index that represents their expectations for the next six months. Section B focuses only on the future sentiments of the stakeholders. This survey was conducted between July–September 2017.

SECTION A – OVERALL CURRENT AND FUTURE SENTIMENT SCORE

REAL ESTATE INDUSTRY FACES A PROLONGED CRISIS, INDUSTRY SENTIMENTS LOWEST IN THIRTEEN QUARTERS



- The future sentiment score has reached its lowest point (55) in Q3 2017 – the lowest over the thirteen quarters, indicating a significant decline in optimism pertaining to the sector's future performance. The fall in future sentiments has come as a more matured and thoughtful impact of demonetisation and implementation of other structural reforms like RERA and GST. The supply side stakeholders' sentiments have not yet touched the pessimistic zone but they feel that no revival is expected in the sector in the coming six months.

- It is to be noted that the future sentiment score during the demonetisation quarter (Q4 2016) was quite high indicating that the industry was bullish about the future of the sector. Demonetisation was backed by fairly strong argument of long-term benefits for the economy. As a result the industry took at least three to four quarters to realise its adverse short-term impacts.

- The current sentiment score (46) has been hovering in the pessimistic zone for two consecutive quarters - Q2 and Q3 2017 indicating a deterioration in the already pessimistic sentiments of the stakeholders. The industry also feels that the real estate sector is at a much worse position right now than it was six months ago. The current sentiments suggest that the real estate industry has finally started to feel the heat of the structural reforms such as demonetisation, Real Estate (Regulation & Development) Act, 2016 (RERA) and the implementation of the Goods and Services Tax (GST), which has greatly impacted the current sentiments of the stakeholders.

Future sentiments score of

55

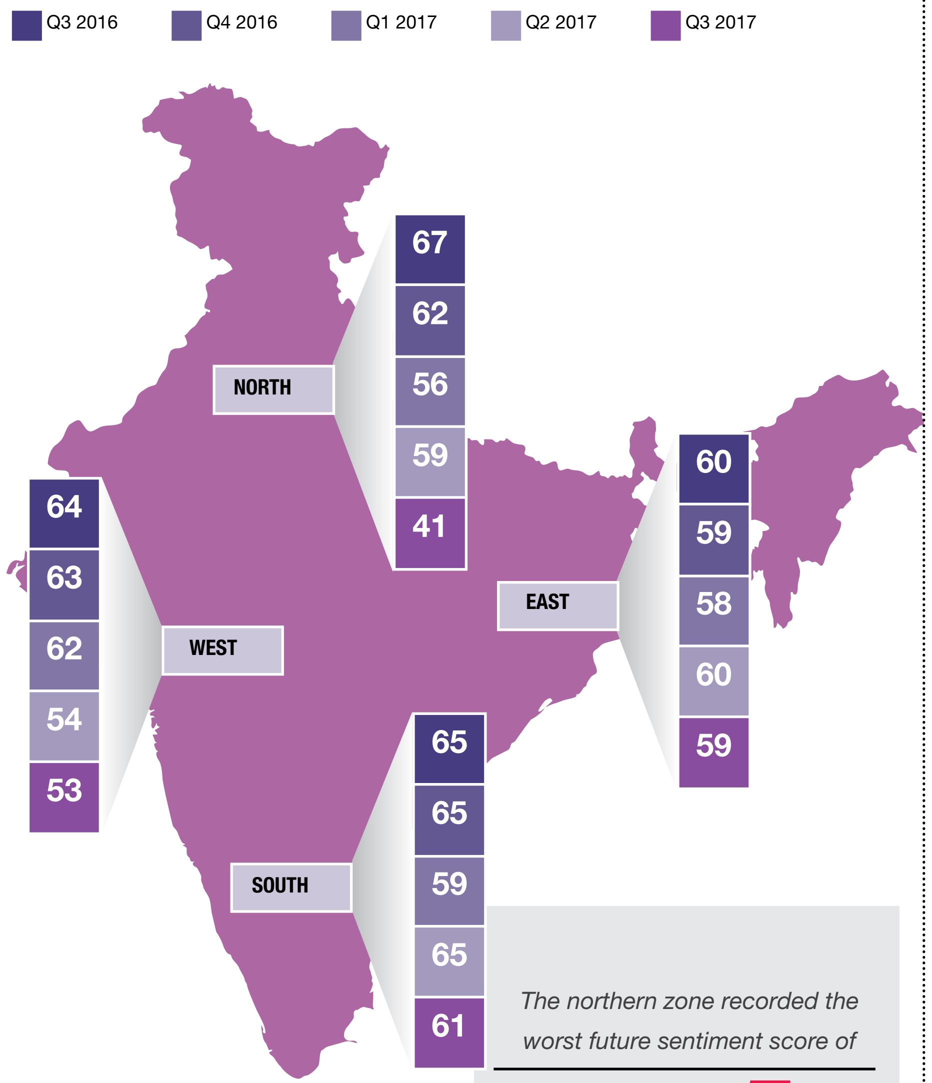
— all-time low in the past thirteen quarters has come as a more matured and thoughtful impact of demonetisation and implementation of other structural reforms like RERA and GST.

SECTION B – FUTURE SENTIMENT SCORE

ZONAL SENTIMENT SCORE

NATIONAL CAPITAL REGION FALLS FLAT, WEST SLIPS FURTHER, OTHERS HOLD ON

SCORE>50: Optimism SCORE=50: Same/Neutral
SCORE<50: Pessimism



The northern zone recorded the worst future sentiment score of

41

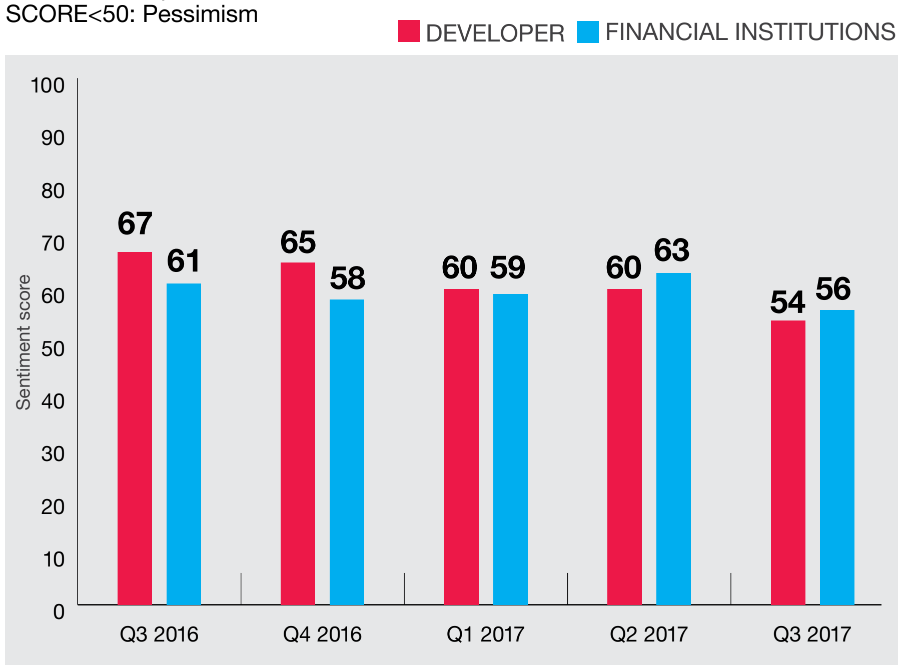
courtesy a prolonged crisis in the National Capital Region

- The future sentiments pertaining to the real estate sector's performance in the north have gone from bad to worse. One of the largest real estate contributors to the northern zone is the National Capital Region (NCR), which is going through a prolonged crisis and the stakeholders' future sentiments reflect the same. With the future sentiment score going down to 41, the industry feels that the coming six months are going to be very tough for the real estate markets in the north.
- This crisis contagion has rubbed off from the north zone to west zone as well. The future sentiment score in the west has been on a constant decline (53) and is the lowest over the past thirteen quarters. Both north and west zone have had a fair share of investors' interest in the past, which has now waned off from the market.
- The two zones namely south and east on the other hand are more or less holding on to their sentiments.

STAKEHOLDER SENTIMENT SCORE

FINANCIAL INSTITUTIONS AND DEVELOPERS FEEL THE HEAT

SCORE>50: Optimism SCORE=50: Same/Neutral
SCORE<50: Pessimism

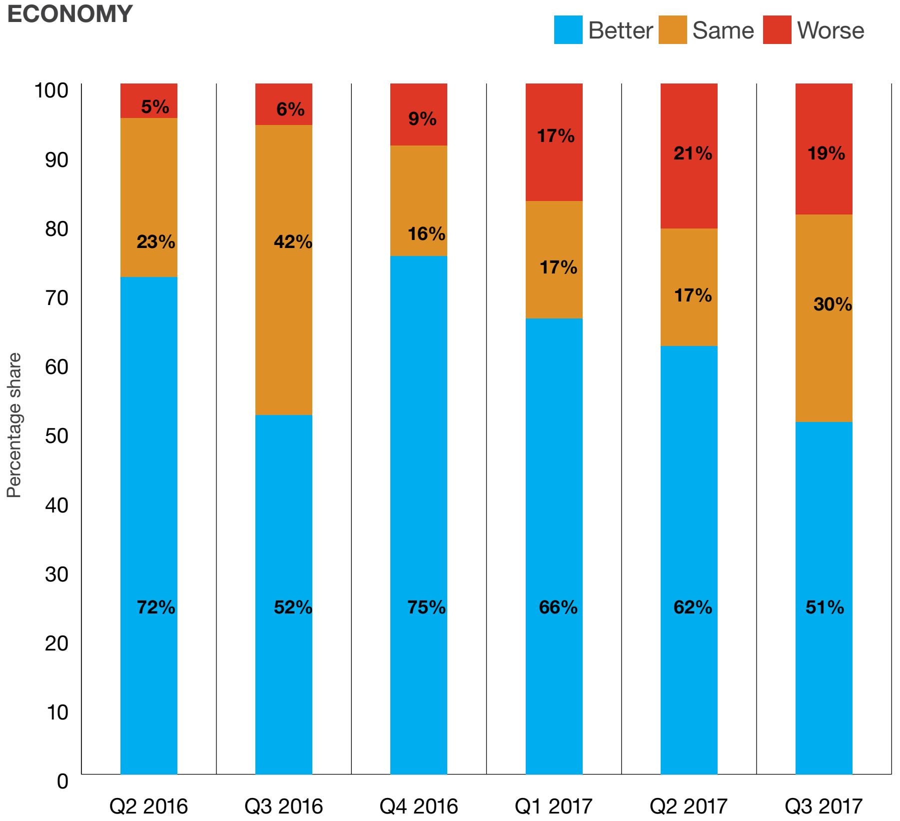


- Future sentiments of both the developers and financial institutions have taken a hit in Q3 2017. The future sentiment score is at its lowest over the past thirteen quarters as the stakeholders are wary about the overall sector. However, the future sentiment score, of both the stakeholders, is still not in the pessimistic zone and is pegged just above 50.
- The dent in the future sentiments of the developers, which has gradually dwindled to 54, comes from the fact that today they are cautious about doing business in the new paradigm of policy reforms such as demonetisation, RERA and GST. The teething problems faced by them in aligning their businesses to the new policy reforms and the wait-and-watch mode of the buyer have dented their sentiments in Q3 2017.
- On the other hand, the future sentiment score of 56 recorded by financial institutions is also the lowest in the past thirteen quarters. The financial institutions have finally gauged the impact of the policy reforms and do not see the situation improving in the coming six months.

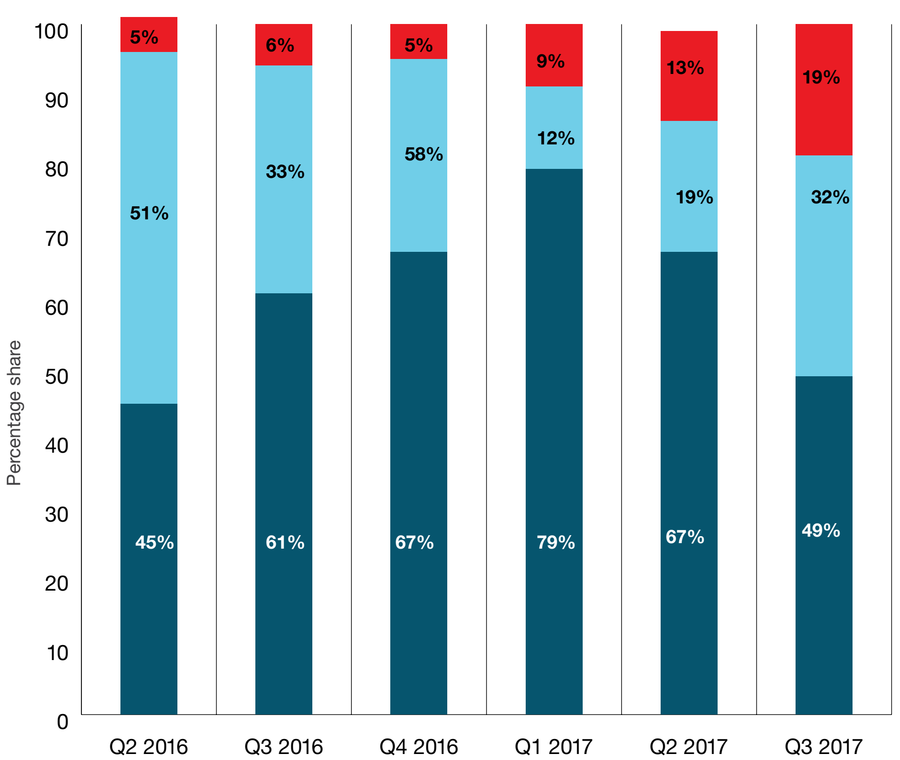
> *Future sentiments of both the developers and financial institutions have taken hit in Q3 2017 – lowest over the past thirteen quarters*

REAL ESTATE INDUSTRY STARTS TO LOSE HOPE ON THE ECONOMIC FRONT

ECONOMY



FUNDING SCENARIO



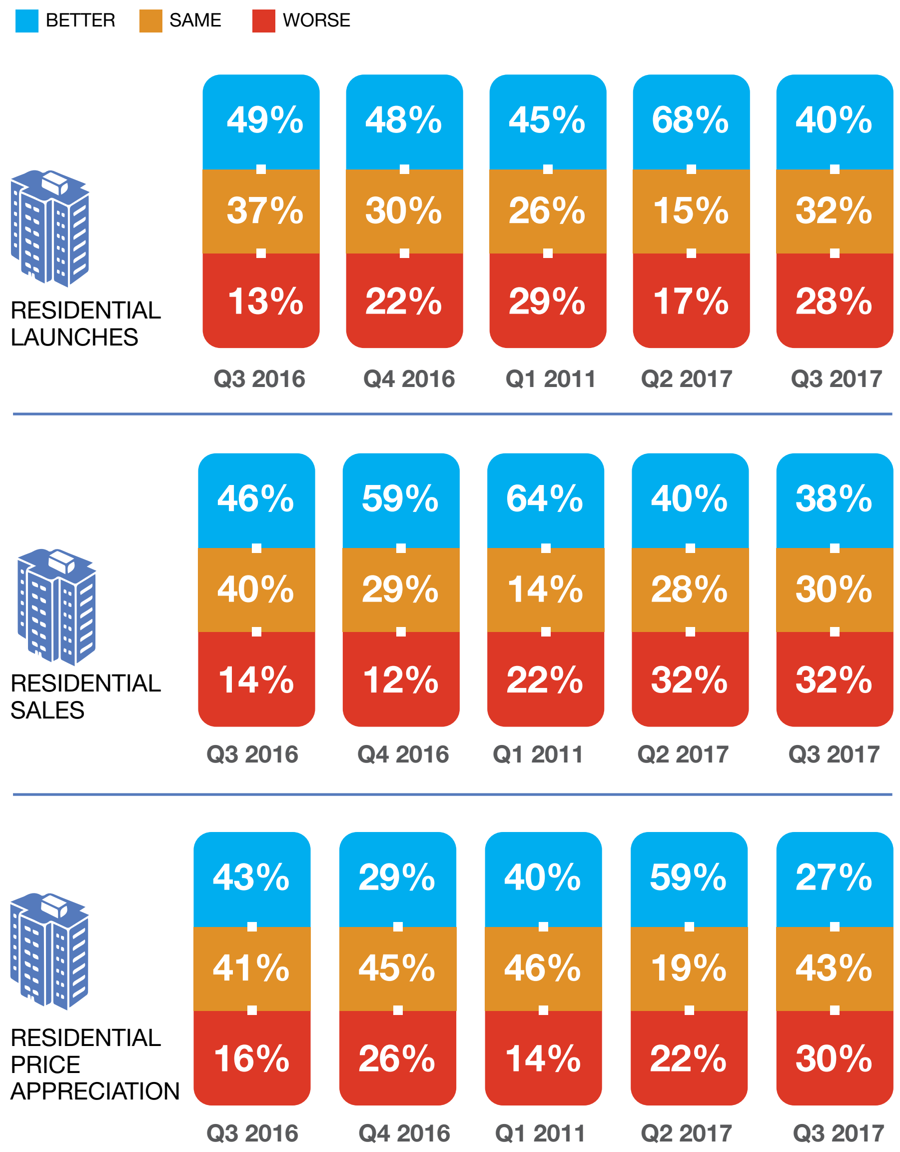
- The real estate industry's optimism regards the economy for the coming six months has come down significantly from the past quarters. Only 51% of the stakeholders have opined that the economy will be better in the coming six months as against 62% in Q2 2017. Around a third of them feel that it will remain the same. This sentiment is corroborated by international agencies like The World Bank and The Organisation for Economic Cooperation and Development (OECD) revising the GDP growth forecast of India, for 2017–18, downwards to below 7%. The agencies have attributed this slowdown in the economy to transitory effects of reforms like demonetisation and GST.

- Similarly, stakeholder sentiments regards the funding scenario has also come down from the preceding quarter. Only 49% of the stakeholders have opined that the funding scenario will be better in the next six months as opposed to 67% in Q2 2017.

49%

Respondents feel that the economy would either worsen or remain similar

RESIDENTIAL SECTOR IN THE ROUGH

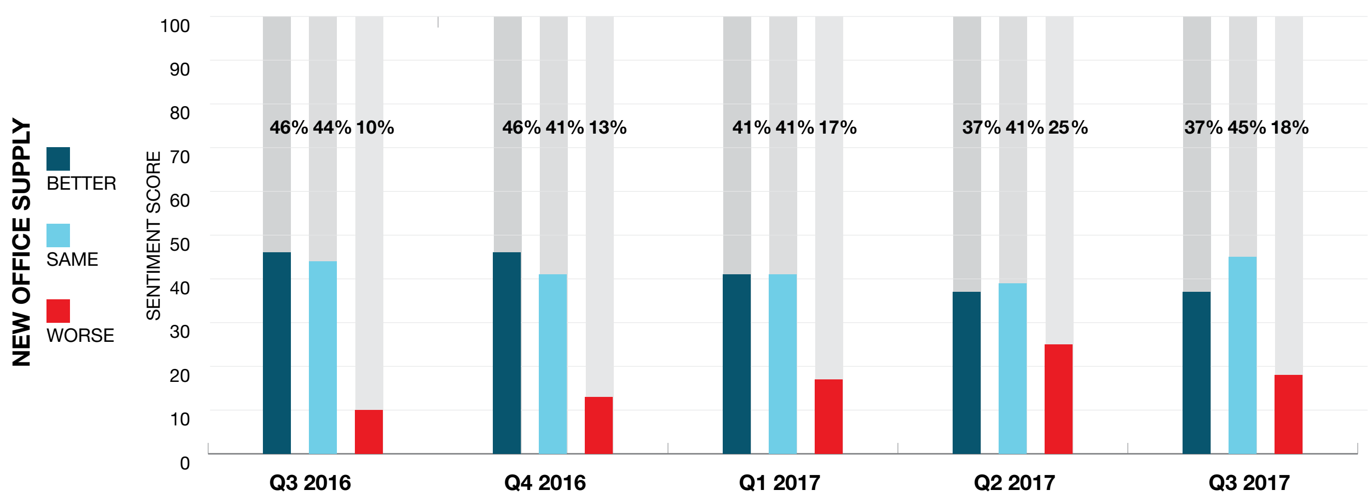


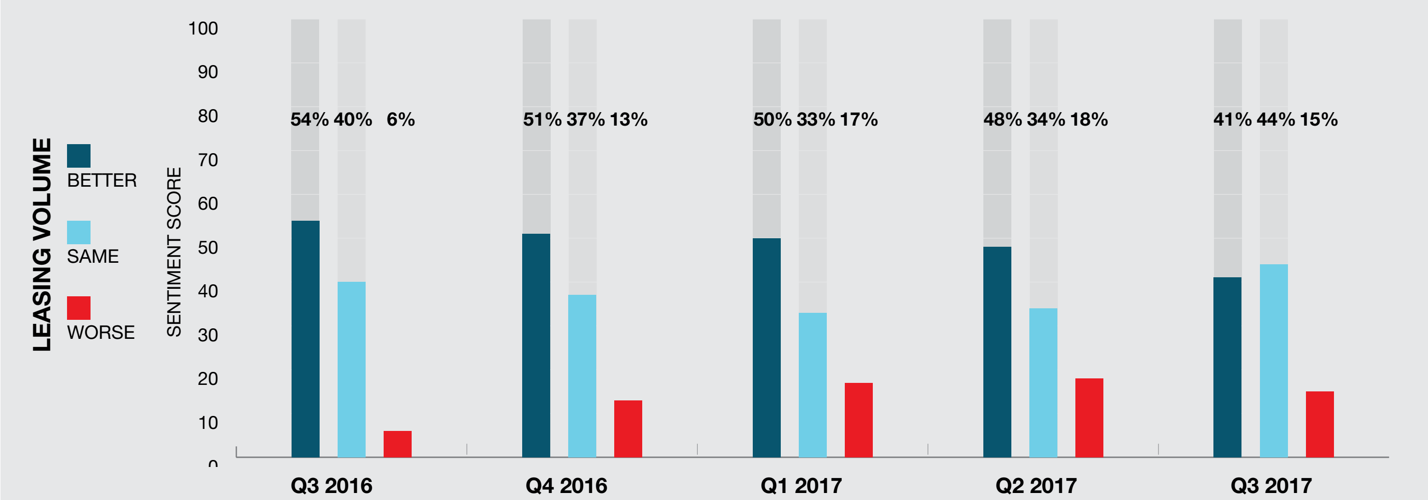
- Majority of the stakeholders are of the opinion that the residential new launches and sales are either going to be worse in the coming six months or will hold steady to their current level, which itself is abysmally low.

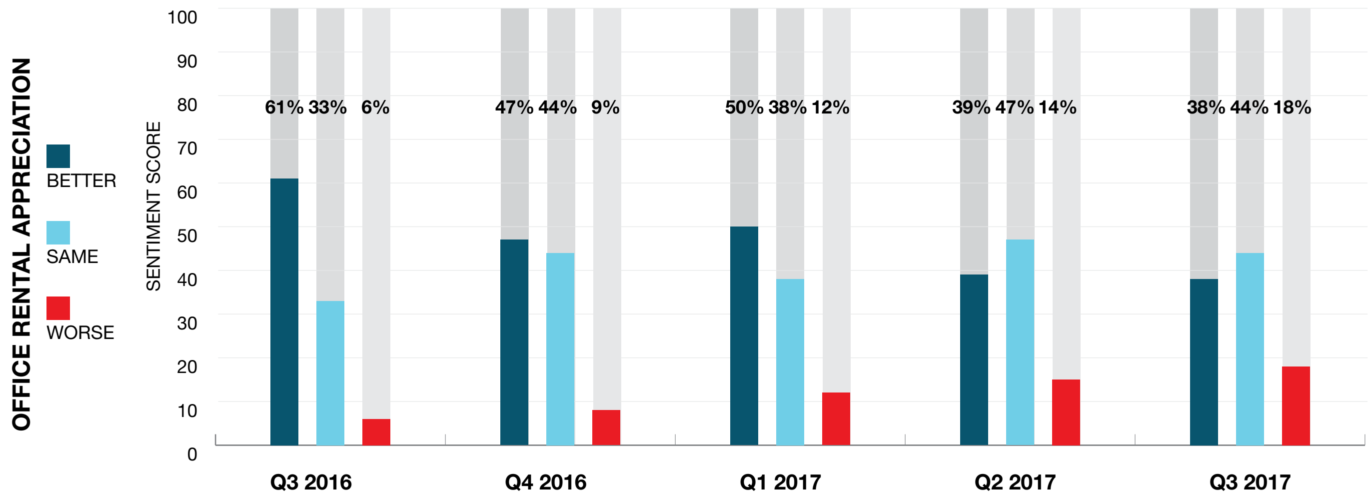
- In line with the lacklustre sentiments on residential sales and launches, 73% of the respondents have opined that the residential price appreciation will either worsen or remain the same in the coming six months. Respondents feel that with a handful of launches and demand failing to pick up, there is little room for any price appreciation at least in the short term.

> *"Residential launches and sales are either likely to worsen or hold steady to current levels which are abysmally low, feel majority of the stakeholders"*

OFFICE MARKET HOLDS STEADY







- The office market is showing a much better future trend than the residential sector in Q3 2017. Majority of the stakeholders have opined that the office market will either improve in the coming six months or maintain the present levels. With the real estate sector going through a rough patch the new office supply has also taken a hit across cities. However, though the respondents believe that new supply will remain a challenge in the coming six months, the ongoing construction of numerous key projects in various cities such as the NCR and Bangalore, gives the stakeholders some confidence.
- This lack of supply will lead to an upward pressure on rentals. Nearly 82% of the respondents opine that office rental will either remain the same or would move up in the coming six months.

CONCLUDING REMARKS

The analysis of the stakeholder expectations from the residential and office sectors for Q3 2017 versus the actual market statistics reveals interesting insights.

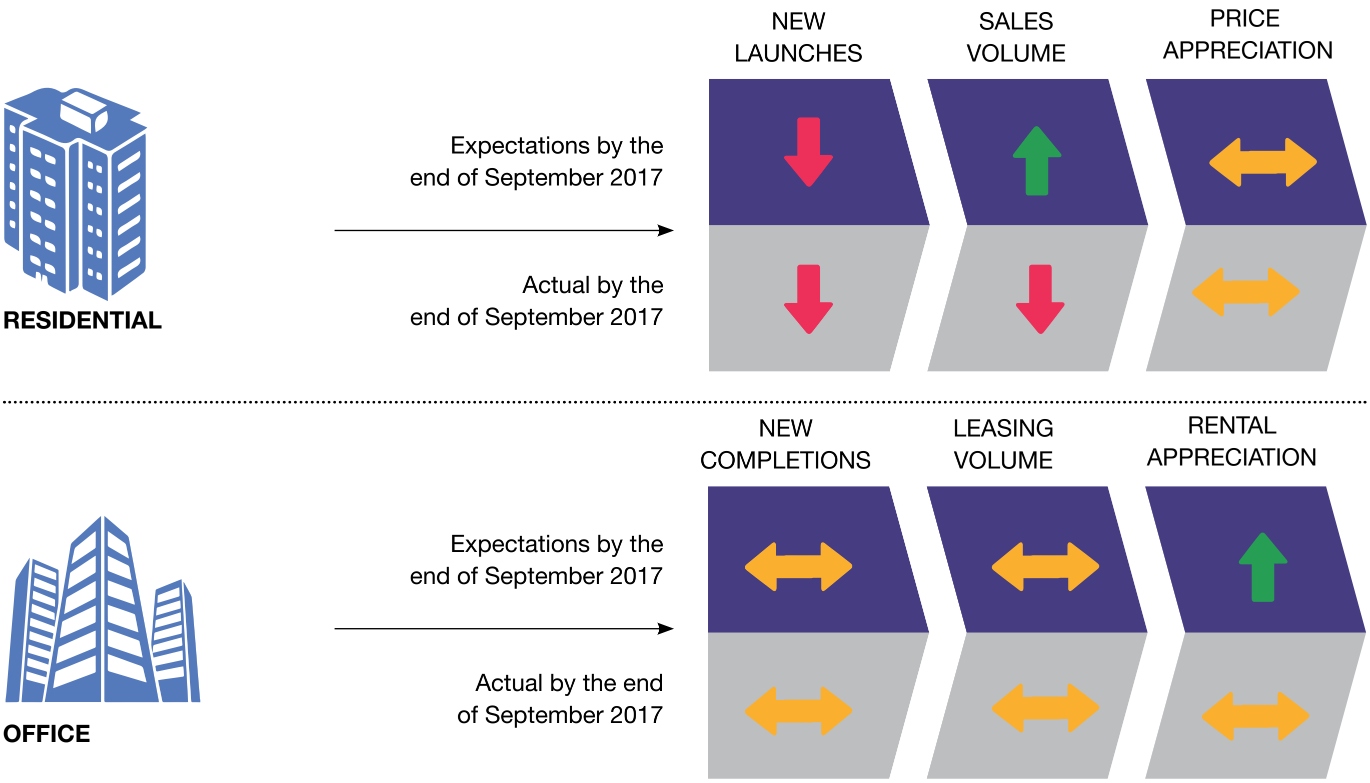
The survey that was conducted in Q1 2017 (January–March 2017) soon after demonetisation had a mixed industry outlook. The current sentiments had picked up in Q1 2017 as opposed to the preceding quarter, with respondents extending their support to one of the most important structural reforms in the country. However, the industry sentiments largely remained tepid for the coming six months. The expectations in our survey in Q1 2017 reflected optimism regarding the residential sales in the following six months (April–September 2017); however, the buyers across major cities have stayed away from the market and have continued their wait-and-watch mode. Buyer evasiveness and developer defaults have all contributed in marring the sentiments for the future of residential sales. As regards residential launches, the survey sentiments in Q1 2017 are in sync with the current market reality. Developers are concentrating on completing their projects and are aligning themselves to reforms like RERA and the GST.

The stakeholder expectations towards price appreciation in our survey conducted in Q1 2017 was not too positive for the next six months. The ground reality substantiates these sentiments since property prices at the end of September 2017 have largely remained stable as opined by the stakeholders six months back.

On the office front, leasing volumes and new supply have been holding steady in Q3 2017 as was opined by stakeholders six months back. In terms of rentals, contrary to stakeholder expectations rentals across cities have remained muted at the end of September 2017.

Therefore, in a nutshell, our survey findings suggest that the real estate sector is going to be under tremendous pressure in the coming six months. The residential sector will see a further downward trend in sales and launches and the prices will remain muted. Office supply will be under stress and leasing volumes will hold steady in the coming six months.

> *"The industry has marginally better expectations from the office market as compared to the residential sector.*
>
> *More than 8 out of 10 respondents opine that office rentals will either remain the same or would move up in the coming six months."*



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