

RESEARCH



DEMONETISATION IMPACT ON INDIA REAL ESTATE



AHMEDABAD | BENGALURU | CHENNAI | HYDERABAD | KOLKATA | MUMBAI | NCR | PUNE

2016 a recap

There is never a dull moment in real estate. 2016 began promisingly in comparison to 2015; however as things stand, the year has not ended on a healthy note. A major factor for this could be attributed to the policy developments by the government which in the short term have led to an unpredictable disruption but in the long run are projected to augur well for the industry as a whole. On the global front, developments like Brexit and the US President elect are expected to have their bearing on the Indian real estate sector. The writing's clearly on the wall - 2016 has gone down as a watershed year in the history of Indian real estate.

The residential property market witnessed improved sales in the first six months of 2016. Barring Delhi-NCR, other markets did well in the first half of this year as compared to previous years. Mumbai and Bengaluru led the way and the manner in which markets responded in the initial phase of 2016 gave us the feeling that the year would end on a high note for the residential property sector. 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.

Just when the industry was gearing up to meet the deadlines set by the government for Real Estate Regulation & Development Act 2016 (RERA) and Goods and Services Tax (GST) and most of us awaited the results of the US presidential elections on 8th November 2016, the Prime Minister of India brought about the most sweeping change in recent history by demonetising the ₹500 and ₹1000 notes which was a rude awakening for the Indian economy with the real estate sector being at the receiving end due to this move. While the broad motive of the Government of India behind this announcement was to curb the menace of fake currency notes and abolishing unaccounted money, the impact of this move could be felt across economy and sectors including real estate. This move created a real dent in the residential real estate sector, pulling back the last quarter trend of residential sales substantially across the cities; consequently sales are at a historical low and 2016 performed worse than 2015, which was one of the worst years itself.

Interestingly, the office market continued to do well in 2016 and the overall transaction volume by the year end is at par with the 2015.

DEMONETISATION DENT ON INDIA RESIDENTIAL MARKET

- The residential market of the top eight cities in India started off on a positive note in 2016 with H1 2016 witnessing a 7% jump in sales volume compared to the same period of the previous year. More than 135,000 units were sold in H1 2016 as compared to 126,620 units in H1 2015.
- The second half of 2016 started with the same pace, with Q3 2016 sales volume showing a positive growth on the back of the start of

the festive season. Sales volume across the top eight cities were holding steady at 67,000 - 68,000 units per quarter since Q1 2016 and we expected Q4 2016 numbers to be marginally better than the first three quarters. As a result, we projected sales volume of 2016 to be marginally higher than 2015 and had estimated an 8% growth during the year.

- However, the Indian Government's

demonetisation move on 8 November brought the market to a complete standstill. Against this backdrop, developers refrained from announcing any new launches and buyers turned extremely cautious before committing on purchases.

- The fourth quarter numbers are a testament to the effect that the demonetisation move has had on the real estate market of the country that was barely recovering

from its earlier sloth. Sales volume dropped by 44% YoY in Q4 2016 and new launches fell by a massive 61% YoY during the same period.

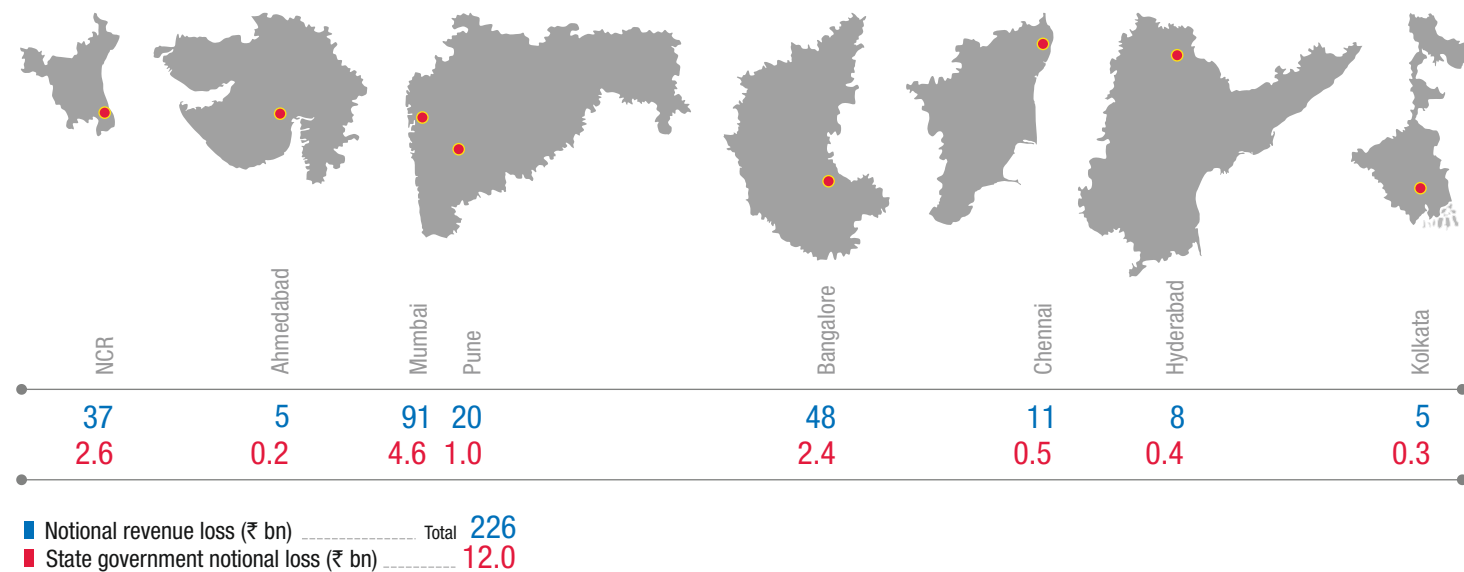
- At 40,940 units, the Q4 2016 sales volume is at its lowest quarterly level since 2010. The average quarterly sales used to be in excess of 90,000 units in 2010. The new launches number is much worse at just 24,300 units in Q4 2016, which is not even one-fifth of its peak

quarterly level observed during 2010.

- The fall in sales volume and new launches were so severe during Q4 2016 that it brought down the entire H2 2016 numbers compared to H2 2015. As a result of this, 2016 has replaced 2015 in terms of the worst performing year in terms of sales volume in the recent history.
- The drop in sales volume during Q4 2016 due to the demonetisation move has

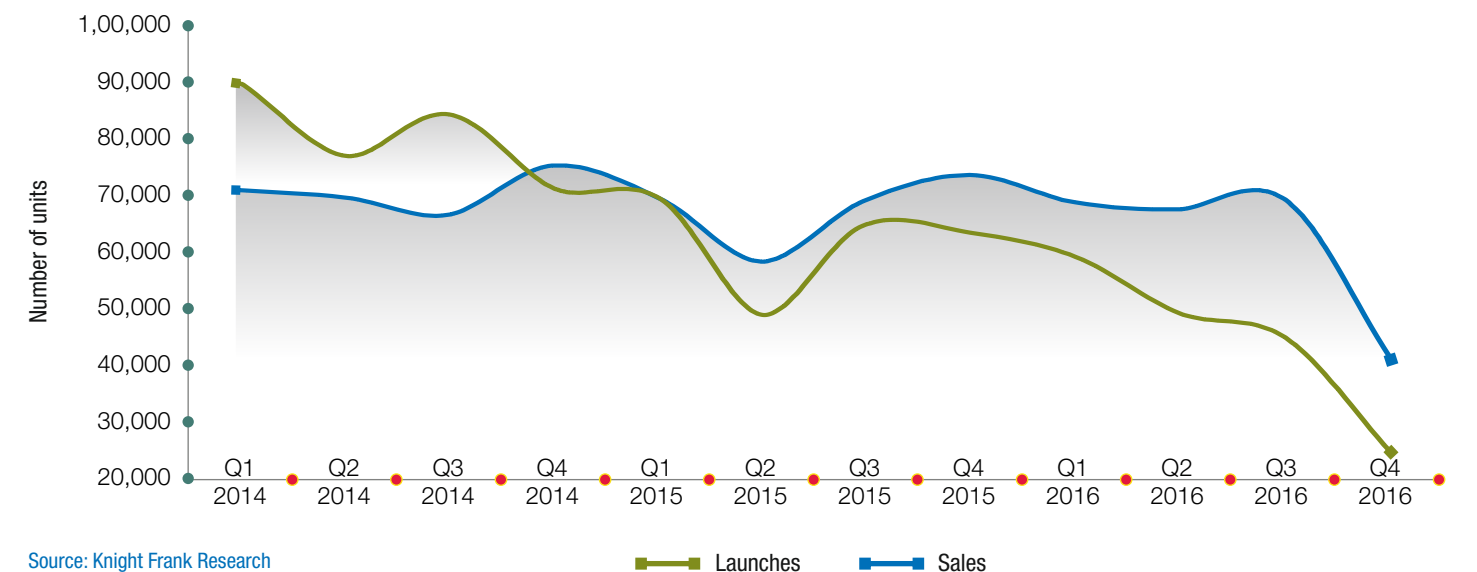
resulted in a massive notional revenue loss of more than ₹226 bn to the real estate industry across the top eight cities. In other words, if the Government of India had not taken the demonetisation move, the residential segment would not have suffered a revenue loss of ₹226 bn. Similarly, the notional loss to the various state governments on stamp duty collection has been in excess of ₹12 bn during the last quarter of 2016.

Notional revenue loss due to the demonetisation move in Q4 2016



Quarterly launches and sales trend in the top eight cities

Note: The top eight cities are Mumbai, NCR, Bengaluru, Pune, Chennai, Hyderabad, Kolkata and Ahmedabad



DEMONETISATION LIFTS INDIA REIT MARKET

The demonetisation of high value currency notes of ₹1000 and ₹500 is transferring the liquidity from the informal sector to the formal sector. The extent of such transfer shall depend on several factors. Of the total money in circulation, it is estimated that 84% is in the form of banned currency notes, which is equivalent to ₹14,73,360 crore (10% of GDP).

The demonetisation of high value currency notes has led to deluge of bank deposits thereby significantly pushing up the liquidity in the banking sector. In effect, this has led to a considerable fall in government bond yields. From the perspective of the real estate sector, the decline in government bond yields and the overall interest rate regime

has increased the spread with prime office properties. This has also led to compression of capitalisation rate for prime office assets that are perfect candidates for REITs. This compression in capitalisation rate has led to upward revaluation of office property in prime markets like BKC in Mumbai thereby making REIT listing more attractive.

2017 expectations

Going by the turn of events, it is difficult to crystal gaze into 2017. However, implementations of RERA & GST, lower home loan interest rate regime and fiscal benefits for taxpayers in the Union Budget has infused a “feel good factor” which is extremely important for the revival of the industry. The Prime Minister has already announced a New Year's gift to home buyers in the budget segment (both in rural and urban areas) in the form of interest subvention for home

loans which will go a long way to realise the government's dream of 'Housing for All by 2022'. The Union Budget's gift of infrastructure status to affordable housing is a game changing move that will open up more institutional sources for developers to raise funds at competitive price. The budget has also given leeway to developers to build bigger houses and extended the time of completion of affordable housing projects from 3 years to 5 years. We strongly believe

these moves will encourage leading real estate players to enter this segment going forward thus creating a lot of potential for institutional funds to participate. A lot of churning will happen in 2017 because of the implementation of various policy changes and it is important to see how developers recalibrate their businesses to the changing environment and whether buyers capitalise the opportunity of the various reforms and change their status



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quo position of “wait and watch”.

In the first half of 2017, the residential sector is expected to be largely muted and there would be pressure on prices. With consumers in a wait and watch mode, demand could be subdued due to a mind-set that property prices could undergo reduction along with a substantial lowering of home loan interest rates. Since buying a house is a discretionary need –a need that can be postponed, it is anybody's guess that the real estate sector will be the slowest to recover from the impact of demonetisation vis-à-vis other sectors.

The office market is expected to face challenges to maintain the prevailing pace in the following year. This could be due to shortage of 'A' Grade office

space, the geo-political risk of a probable reduction in outsourcing from the US, structural changes in domestic economy and top technology companies reducing their growth targets. However, with the advent of GST, the warehousing sector will see a consolidation thereby bringing efficiency in the entire system.

The after effects of demonetisation coupled with legislations like the RERA, GST bill and Benami Transactions (Prohibition) Amendment Act, 2016, will further increase transparency and reliability within the sector. Furthermore, this will also see a boost in institutional funds flowing into the sector at competitive rates which will enable the sector to come out of the woods.

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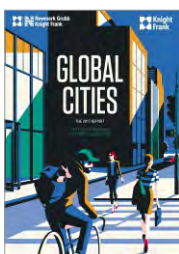
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