

# **Economic Recession and Indian Real Estate – Hopes and Implications**

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## **Abstract**

Indian real estate has been witnessing a golden era with a property boom spreading in all directions and it is touching new heights. The Industry experts feel that Indian real estate has huge demand and potential in almost every sector, especially commercial, residential, and retail. However, Indian real estate could not remain unaffected from the impacts and implications of global recession. This is evident from the fall in demand of all types of property and a marked decline in construction activities. It was believed that Asian economies like China and India would not only remain insulated but also play a major role in moderating the global slowdown. However, the ‘decoupling theory’ has proved wrong. The worldwide economic slowdown has definitely impacted the real estate sector – both across the world and India as well.

Key Words: Real estate, property, investment cycle, scenario planning

### **Introduction**

Economic slowdowns are regular occurrences around the world. The last two centuries witnessed many slowdowns manifested in banking panics, stock market crashes, currency crisis, and bursting of the real estate bubble. In such situations, the supply of money out spaces the demand evaporating the liquidity. The main cause of this financial disaster is unregulated capitalism leading to suboptimal outcome. Unregulated markets adversely affect the macro economic variables resulting in instability of local currency as well as equity and increased uncertainty. This is detrimental to the business confidence and overall economic activities.

Indian Real Estate was a sunrise sector in 2006 passing through a golden era. It was fascinating to know that the value of commercial property in Delhi and Mumbai is at par with New York, Paris and London. Multinationals have been desperate to invest here. It was moral boosting to hear about the number of mergers, acquisitions and joint ventures taking place with important role of Indian companies in them. In most of them, Indian partners were the initiators. The globalization and liberalization had trickled down an otherwise closed Indian economy. The impact was revolutionary on the social, economic, and cultural fabric of India, a country known in the world as tradition bound and always resistant to change. Indian real estate is expected to increase from \$12 billion to \$90 billion by 2015. The demand for housing is expected to increase to 80 million with an expectation to add new jobs to the value of 4 million by 2015. Investments in the real estate segment are expected to yield 13-16 per cent return (IBEF, 2007). It was expected that it would increase to become one of the top real estate markets in the world.

### **Review of Literature**

Indian economy has been mostly insulated from global downturns, showing a degree of stability. After survival through the recession of 2008, it is striking back more forcefully and

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confidently with corrected prices and improved product variety. India's consumption-driven model is also more people-friendly than other development strategies (Bandhopadhyaya, Arindam, Basu, Sanjay, Baid, 2008). There was no direct exposure of India to the US subprime credit market but it triggered negative sentiments in India. The Bombay Stock Exchange Sensex fell 3.35% or 469 points on September 15. The most affected was the realty index which dropped 7.6% on the same day (Sehgal, 2008).

India has not witnessed a boom and bust cycle of the kind experienced in developed countries. However, no liberalized economy can remain unaffected by external factors. (Subramaniam, 2006; Garg, 2008). It is only after liberalization that the Indian economy has been witnessing several cyclical movements. Economic cycles do impact real estate and there is a relationship between real estate and financial markets (Born and Pyhrr, 1994; Mueller, 1995). In real estate, the most common cycles are considered to be of 8-10 years (Laposa, 1995) and there are evidences of such 15 different real estate cycles (Pyhrr and Roulac, 1996).

It was realized that the boom/bust of 1920–34 exhibited many similarities to the boom/bust of 1980–93. Both periods were initiated by an unusually high period of inflation and rapidly rising rents (Kaiser, 1997). The ripple effect of US financial crisis acted as a double edged sword for India. Firstly, banks, financial institutions, MNC pruned staff. Secondly, the affluent NRI community began to have second thought about purchasing property in India. More so, demand for luxury flats declined because of job scenarios. Developers finding it difficult to sell high-end apartments began to move towards lower income segments (Sarthak, 2008; City Group Research, 2007). Studies revealed the importance of the government in moderating boom-bust cycle (Hoyt, 1993). It was realized that internal policy can be planned in such a way that it minimizes affect from external factors (Garg, 2008).

It was analyzed that uncertainties can arise for real estate managers in economic growth, political and social development within and outside the country (Dewulf and Van der Schaaf, 2004). To overcome the pitfalls scenario building could be used as an important technique to study future property development, investment and management decision (Ratcliff, 1999). In 2006, FHWA office of Real Estate services, Virginia developed four most important predetermined elements – possible, probable, preferred, present, strategy. To overcome the fall in supply, real estate companies explored new investment opportunities. Builders of residential property took to developing commercial space. For example, Raheja moved into constructing special economic zones, Omaxe went into modernizing and maintaining airstrips. DLF, Unitech and Omaxe initiated bidding for road projects being offered by the National Highways Authority of India. Unitech made a foray into telecom.

The second trend was to move abroad to market real estate companies' products, raise funds, source raw materials and launch projects like the one by Sobha Developers, which opened an office in China and Dubai. Parsvnath Builders has a subsidiary in Singapore. Puravankara Projects too has started operations in Sri Lanka, UAE to build super luxury villas on the outskirts of the capital Colombo.

The real estate market in India has been on a high for the last decade and as per simple law of gravity or law of economics what goes up must come down. Though the market is slowing down but the situation is not one of a crashing market because this relatively slower rate of correction is a sign of a maturing market (Mangalam, 2008) In the long run, given that the Indian growth story is likely to continue, real estate prices will certainly increase. However, they will not see a meteoric rise as they did earlier. The market will eventually consolidate. It will be a more stable market (Sinha, 2008). Henceforth, the slowdown is unlikely to last beyond the next

2-3 years. In the long term, strong demand for real estate in India will remain intact and will see us through another real estate cycle once the market finds its own level by responding to these short –to mid –term global and domestic factors (Cushman & Wakefield Report, 2009).

### Objectives and Research Methodology

Following are the major objectives of this paper:

- To study the most likely impact of economic recession on the Real Estate sector of India.
- To study the future of the real estate sector of India.
- To study the effectiveness of steps taken by government to boost the Real Estate sector of India by handling the harmful impact of recession.

Questionnaire development involves the stages shown in Chart 1:

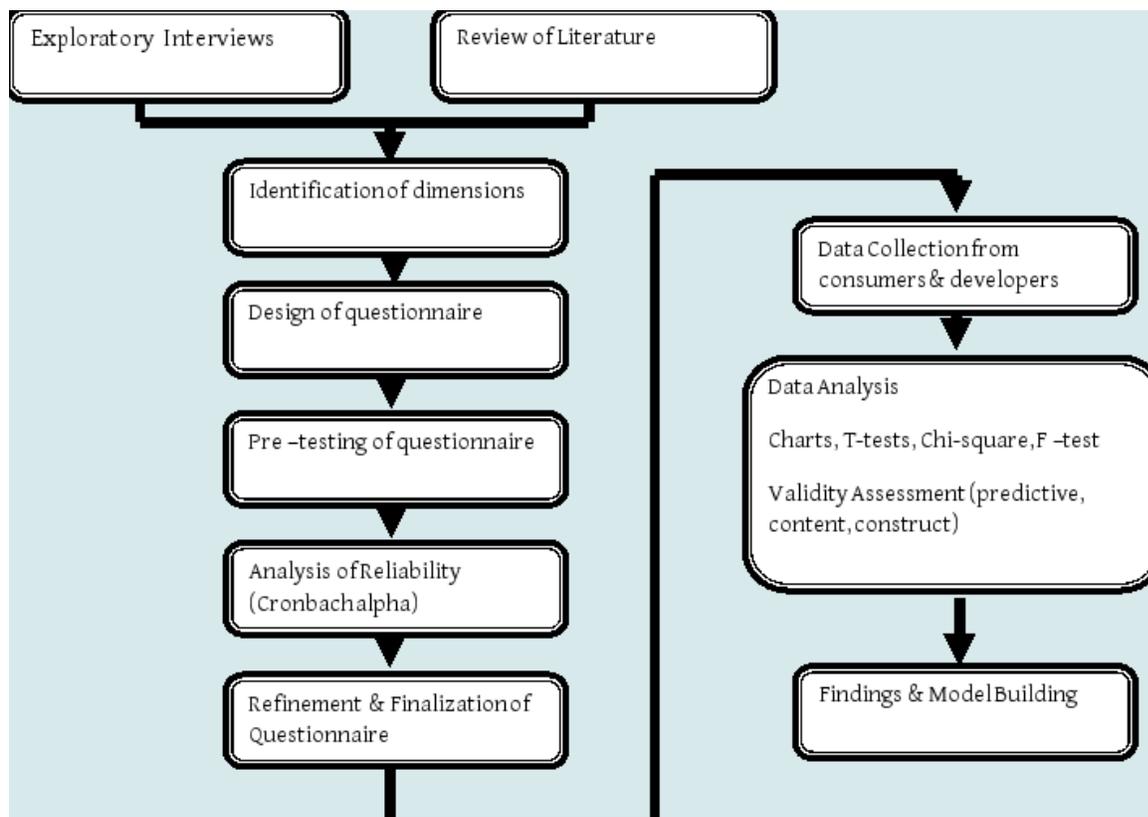


Chart 1: Questionnaire Development

### **Hypotheses**

The following 8 hypotheses have been tested in this paper and the results have been summarized in Table 1.

**Null Hypothesis 1:** There is no significant variance between impacts of economic recession on the real estate of India reflected in terms of various factors.

**Null Hypothesis 2:** There is no significant variance between the future of the real estate of India in three times period (1-2 years, 2-3 years, and 3-4 years) reflected in terms of decline, growth and stability.

**Null Hypothesis 3:** There is no difference of opinion between consumers and developers regarding methods adopted to handle the harmful impact of economic recession on the real estate of India according to developers.

**Null Hypothesis 4:** There is no difference of opinion between consumers and developers regarding methods adopted to handle the harmful impact of economic recession on the real estate of India according to consumers.

**Null Hypothesis 5:** There is no association of income with the steps followed by government to handle the harmful impact of economic recession on real estate.

**Null Hypothesis 6:** There is no association of occupation with the steps followed by government to handle the harmful impact of economic recession on real estate.

**Null Hypothesis 7:** There is no association of education with the steps followed by government to handle the harmful impact of economic recession on real estate.

**Null Hypothesis 8:** There is no association of gender with the steps followed by government to handle the harmful impact of economic recession on real estate.

**Table 1: Summary of Hypotheses Testing**

<b>Hypothesis</b>	<b>Significant/Not Significant</b>	<b>Statistical Test</b>
NH 1	Significant	F-test
NH 2	Significant	F-test
NH 3	Significant	One Sample T-test
NH 4	Significant	One Sample T-test
NH 5	Significant association between income and reduction in price of steel and cement and changes in price for purchase of property.	Chi-Square
NH 6	Not significant	Chi-Square
NH 7	Not Significant	Chi-Square
NH 8	Not Significant	Chi-Square

### **Model Building**

The role of government is very important in strategic decision making in real estate. During the period of growth, stability and boom, the government of a country assumes different roles. On the basis of findings the model has taken two major dimensions namely *strategies and scenarios* (Dewulf and Pity Van der Schaaf, 2004). The strategies dimension has three variants: *growth, stable, decline* and scenario have been developed for 1-2 years, 2-3 years, and 3-4 years starting with the economic recession in 2008. The future has been developed for the various factors mentioned in the model (Fig. 1). It was realized that the *role of government* was proactive and very strongly needed to support and improve the condition of real estate in the initial 1-2 years after the recession in 2008, when government was playing the role of an *initiator (I)*. By next year, around the end of 2009 and the beginning of 2010, the situation began to stabilize and the strong role of government was not needed. Here, the government played the role of

*controller (C)*. After March 2010 the situation improved a lot and the real estate market showed signs of strong survival and growth changing the role of government to be of a *moderator (M)*. This phenomenon is indicated with the help of changing shades of blue color. The model is being named as *ICM Real Estate Model (Initiator Controller Moderator Model)*.

Strategies adopted reveal that for the initial 1-2 years there will be growth in sales promotions (g) to attract consumers to buy property. Competition (e) is expected to stabilize in the initial 1-2 years. The remaining demand for real estate (a), price of property (b), profit of builders and developers (c), launch of new products will decline (d), rate of home loans (f) will decline. In 2-3 years, competition (e) will grow as situation improves, demand for property (a), launch of new products will decline (d), rate of home loans (f) will stabilize and the price of property b) and profit of builders will decline (c). In the coming 3-4 years, sales promotion (g) methods will decline because of the increase in demand, the price of property (b) and profit of builders (c) will stabilize, and demand for property (a), launch of new products (d), rate of home loans (f) and competition (e) will increase.

- a) Demand for real estate
- b) Price of property
- c) Profit of builders and developers
- d) Launch of new projects
- e) Competition
- f) Rate of home loans
- g) Sales promotion

		Scenario		
		1-2 Years	2-3 Years	3-4 Years
Strategies	Grow	<b>g</b>	<b>e</b>	<b>a</b> <b>e d f</b>
	Stable	<b>e</b>	<b>a f</b> <b>d</b>	<b>b c</b>
	Decline	<b>a b c</b> <b>d f</b>	<b>c b</b>	<b>g</b>

**Fig.1: ICM Model of Real Estate**

	Government as INITIATOR
	Government as CONTROLLER
	Government as MODERATOR

***Strategic Implications***

This work emphasizes the studies done in the past and checks its validity against Indian real estate. There have been boom and bust cycles in the past in Indian real estate also but not to the extent as experienced in the west. Indeed government has a very important role in controlling the recession in real estate, which is the second largest contributor to GDP. Only commitment can win the support of consumers and developers alike which is very important in the tough time of recession. Studies reveal that in spite of economic recession, the demand for lower income groups is still robust. There is a lot of potential to study the scope of new age construction like Green Construction, fire safety, earthquake resistance housing, etc. and use them effectively

during recession. The present research reveals that though the picture of Indian real estate is not so rosy but it is temporary and the prospects for the future are good. A long overdue adjustment in real estate market is needed. In the long term, strong demand for real estate in India will remain intact. With the economy showing signs of revival, the real estate sector will once again take a giant leap forward.

### **Conclusions and Suggestions**

The economic slowdown has been the offshoot of poor under writing standards and weak regulatory mechanisms, particularly in mortgage lending. Consequent outburst of the housing bubble and resultant financial mayhem gripped the major economies around the globe. The resultant sub optimal outcome had far reaching effects on production and unemployment, particularly in construction and real estate. The following lessons and suggestions are worth noting:

- Sound credit policies should not be violated while sanctioning housing loans.
- There is a need to set up a centralized Real Estate Regulatory Authority in line with existing authorities such as SEBI, IRDA, TRAI and RBI.
- Fiscal stimulus package should be implemented for key areas such as housing to overcome the crisis.

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