

Why Basic Economics is Not Working in Indian Real Estate

Retrieved Monday 28th of August 2017 07:05:19 PM

Why Basic Economics is Not Working in Indian Real Estate

Aug 28, 2017



Over the weekend I appeared on the CNBC Awaaz's Pehredar show, discussing what else but the ['sad' state of India's real estate](#).

At some point of time we started discussing the unsold inventories of builders. I have always been of the view that the builders won't be able to sell these homes unless they cut prices. The representative of the builders on the show took offense at what I said and was of the opinion that they had already cut prices by as much as they could, and a further cut in prices wasn't possible.

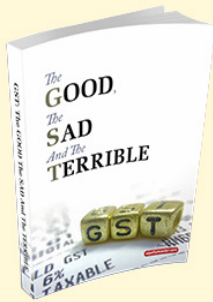
I said what I did on the logic that if prospective buyers are not interested in buying at the current prices, they might see value once builders lower prices. The question is whether the builder wants to unload his inventory or not. If he wants to unload his inventory then he has to cut prices irrespective of the fact whether he is making money on the deal or not. The market doesn't care about that simply because the buyers are not interested in buying at current prices. Also, it is worth remembering that builders are not the only ones carrying a huge unsold inventory of homes.

There are huge number of investors (both professionals as well as amateurs) who have bought homes over the years, in the hope that prices will continue to rise at the same pace as in the past. Hence, the real [unsold inventory of homes](#) is many times the unsold inventory of builders. And if this inventory has to be cleared, then prices need to fall.

When the supply of any product is higher than its demand, then prices need to fall, that is how the demand will go up, and the supply will match demand. But for that to happen in the context of Indian real estate, the builders need to be willing to cut prices, which they aren't. Why? The first reason on offer is that they are already selling homes at almost the cost price (in some parts of the country). Any further cut in price, would mean selling at a loss, which they aren't willing to do. I am neither a civil engineer nor an architect to be able to verify this claim. So, I really don't know how valid this claim is.

Advertisement

FREE Report
[Download Now](#)



Vivek Kaul's inquiry into the GST shatters the myths that the mainstream media is floating. It's a must read.

Download your FREE copy today and learn the hidden truth about the GST and how it could impact the system, and you.

[Download This Special Report Now. It's Free.](#)

But there is another reason why the builders (and their bankers) may not want to cut prices. And this is something the builders are not saying. At least, not in public. Hence, this seems to be the more likely reason. Builders have raised loans from banks and other sources. Against these loans the unsold inventory of homes has been offered as a collateral. If the prices of these homes are cut, then builders may have to offer more collateral to their lenders, which is something they are either not in a position to do or don't want to do.

In fact, if you look at the total lending by banks to commercial real estate, it stood at Rs 1,77,064 crore. It was down by 3.8 per cent from April 2016 and it forms around 2.6 per cent of total non-food lending of banks.

Given this, builders are likely to stick to their current prices, even if they are not making any sales. As I said earlier, there is much more unsold inventory in the market than just with builders.

So, what about the investors, why are they not ready to cut prices? Some of them are anchored on to the prices at which their friends, relatives and acquaintances, had sold homes in the past. They want similar prices for their homes as well and haven't adjusted to what is the new normal. There are still others who can't get themselves to sell at a price which is lower than the price at which they had bought. So, they are waiting for the price to recover.

This is something that varies from buyer to buyer and how desperate he or she is to sell out. Then there is another lot, which is simply waiting for enough indexed long-term capital losses to accumulate, before they think of selling. This will turn out to be the case given that real estate prices haven't really gone anywhere over the last few years, especially once inflation is factored in.

Another major factor hampering sales is the lack of 'enough' cash in the market, given that sellers still want a part of the payment to be made in black. While the process of black money generation and accumulation has re-started post-demonetisation, it will take some time before it reaches pre-demonetisation levels.

Investors who bought real estate over the years, carried out a certain portion of the transaction in black i.e. they paid in cash. Hence, now even if they want to sell what they own, they can't carry out an all-white transaction. A certain portion of the transaction needs to be carried out in black. And as I said earlier, there isn't enough cash going around in the financial system. Further, even those who are in a position to sell out, don't know what they could possibly do with the money that they get. There is a huge reinvestment risk. Real estate is down in the dumps. The stock market is at an all-time high level. Gold hasn't gone anywhere in years. And bank interest rates are at extremely low levels. Hence, the tendency is to hold on to the homes, not sell them at lower prices.

The larger point is that home prices have to fall till they interest the prospective buyers. Whether that price is viable for a builder or the investor, is not the question here. We are beyond that stage now. The market will only clear once the prospective buyers become interested. Currently, they aren't.

Builders who need to make massive debt repayments and do not have enough money going around are the ones who are more likely to cut prices than others. [A Pune based developer DS Kulkarni](#) has been defaulting on fixed deposit interest for a while now. He is likely to pulldown prices in the Pune market.

Many people bought homes assuming that the future will be similar to the past. Given the huge inventory of homes in the market, there is no way the prices are going to rise at the same pace as they had in the past. I will be surprised if anyone makes any return out of real state after adjusting for all the expenses, over the next few years. This is without getting into factoring inflation and the [risk of owning real estate](#).

If builders don't cut prices, we will see the deadlock continuing for a few years more till prices become viable in inflation adjusted terms. This is assuming that salaries and bonuses start to recover soon.

So, if this continues, I guess anyone looking at real estate as a viable investment option, will have to wait for a few years more, perhaps till 2022 (Don't ask me why 2022. It's just that it is not too near like 2019 and not too far like 2027).