The Real Returns from Real Estate Have Been Very Low

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The best way to challenge myths is to look at data. The trouble is that India's real estate sector is very opaque and does not give us enough data points to do a proper job of analysing it. In the process, the myth that any real estate investment yields massive amounts of returns at all points of time, continues to persist.

Thankfully, now we have some data which we can use. Sometime back, the National Housing Bank (NHB), the regulator of housing finance companies, launched a revamped RESIDEX, a housing price index. The index claims to offer home prices of 50 cities across the nation though I could find data for only 49. In this column, I look at data referred to as HPI@Assessment Prices based on the information furnished by banks and other lending agencies regarding home prices.

This should help us get some idea about which way the real estate prices have gone over the last few years. And for the first time we should be able to calculate the actual city wise returns. This should give all the real estate *bhakts* out there some idea of how their investments have done over the years.

As I said at the beginning, the NHB RESIDEX has price data for 50 cities. Let's take a look at Table 1. It shows the per year returns of these cities between June 2013 and March 2017. It also shows the one-year return between March 2016 and March 2017. While the NHB RESIDEX claims to have data from 50 cities, I could find data only for 49 cities.

Also, even though it has data from 50 cities, it can't claim to be a pan India index given that many of the cities represented separately are essentially the satellite cities of some of the bigger cities like Mumbai, Delhi and Kolkata. Further, some of the bigger cities in states haven't found representation in the index. These include Jamshedpur in Jharkhand, Madurai in Tamil Nadu, Jalandhar in Punjab, Allahabad and Varanasi in Uttar Pradesh.

Nevertheless, the index is a good start which can give us a good sense which way the real estate market in India is ed. Also, it will give us a good idea of how well or badly has the real estate market in India performed, over the last few years. Typically, this sort of information is rarely available in the public domain and will allow us to settle once and for all, how good an investment real estate has been over the last few years.

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Table 1:

	Name of the city	Return per year between June 2013 and March 2017 (in %)	One-year return between March 2
1	Mumbai	6.7	
2	Delhi	-2.6	
3	Bengaluru	7.3	
4	Kolkata	6.5	
5	Chennai	7.1	
6	Pune	7.2	
7	Nagpur	5.6	
8	Nashik	2.5	
9	Kalyan Dombivali	8.6	
10	Mira Road-Bhayander	5.11	
11	Navi Mumbai	3.4	
12	Panvel	2.9	
13	Thane	7.1	
14	Vasai Virar	3.2	
15	Chakan	6	
16	Pimpri Chinchwad	5.2	
17	Coimbatore	-0.8	
18	Ahmedabad	0.5	
19	Surat	3.5	
20	Vadodra	1.6	
21	Rajkot	2.5	
22	Gandhinagar	-7.8	
23	Kanpur	8.3	
24	Lucknow	4.7	
25	Meerut	13.5	
26	Ghaziabad	2.9	
27	Greater Noida	4.3	
28	Noida	2.7	
29	Howrah	10.5	
30	New Town Kolkata	4.2	
31	Bidhanagar excluding Rajarhat	5.4	
32	Chandigarah(Tricity)	2.1	
33	Ludhiana	4.8	
34	Faridabad	3.7	
35	Gurugram	4.8	
36	Jaipur	5.2	
37	Bhiwadi	1.6	
38	Indore	6.2	
39	Bhopal	3.2	
40	Vizag	10.3	
41	Vijaywada	8.8	
42	Kochi	6.8	
43	Thiruvananthapuram	7.7	
44	Hyderabad	4.1	
45	Patna	2.6	
46	Guwahati	4	

47	Dehradun	0
48	Ranchi	-2.6
49	Bhubaneswar	1.5

Source: Author calculations on data obtained from https://residex.nhbonline.org.in/NHB_Residex.aspx

Table 1 makes for a very interesting reading. If we look at returns per year across different cities from June 2013 onwards, very few cities have given a return of greater than 10 per cent year, which is what is needed, in order to meet the regular expenses for upkeep of real estate, along with beating the rate of inflation. Regular expenses would include the maintenance charge that needs to be paid to the housing society every month and a property tax that needs to be paid every year. Of course, the home could be put on rent, the rental yield would work out to around 2 per cent per year. (rental yield is essentially annual rent divided by the market price of the home). If you had bought the home on a loan, then interest would have to be paid on the loan. But a tax deduction would also be available.There are only three cities which have given a return of greater than 10 per cent per year (Meerut, Howrah and Vizag), since June 2013.

In fact, the median rate of return on real estate investment across the 49 cities is 4.3 per cent per year. As John Allen Paulos writes in *Beyond Numeracy: "The median of a set of numbers is the middle number in the set."*

Hence, it is easy to see that unless a massive amount of black money has been invested in real estate, the returns have been meagre across the country since June 2013. This is the point from which the NHB RESIDEX data is available, in case you are wondering, dear reader, as to why have we taken this as a cut off.

The situation has gotten worse in the one-year period between March 2016 and March 2017. The median rate of return has fallen to 2.8 per cent. In fact, if we remove Vizag where one year return has been close to 25 per cent return during this period, the median rate of return falls to 2.55 per cent. Money in a savings bank account would have yielded more.

This basically means that real estate returns across the country have been subdued lately. In fact, between March 2016 and March 2017 prices have fallen in 13 out of the 49 cities under consideration. This is if we just look at prices. If we take other expenses into account (maintenance charges, property tax, interest paid on a home loan after adjusting for the tax benefit and inflation etc.) into account, the real returns would be negative in many other cases.

Of course, this logic works on weighted average prices for cities and individual experiences may have been different. Also, the logic could have been completely different if black money was being invested to buy real estate.

Hence, real estate as an investment hasn't gone anywhere in the last four years and the situation has only worsened in the last one year. Having said that prices are not falling. This, despite the sales crashing in the aftermath of demonetisation.

Recently, the real estate consulting firm PropEquity released some interesting data. As per the data, for the period between January and May 2017, the housing sales fell by 41 per cent to 1.1 lakhs, across 42 major cities. During the same period in 2016, the housing sales had stood at 1.87 lakh.

But as we have seen the median price hasn't really fallen between March 2016 and March 2017. While, real estate hasn't made for a great investment for a while now, it hasn't reached a stage where those actually wanting a home to live in, can buy one, in most cities. What are the reasons for the same?

a) Those who have already invested in real estate have a substantial amount of black money invested in it. The trouble is that if they sell right now, there isn't much they can do with the black money that they will get in the form of cash after the sale. This is because black money generated by real estate finds its way into real estate all over again. But given the very low returns that real estate has given over the last few years, there is no point in doing that.

b) In some cases, the investors are sitting on losses and they are waiting for prices to rise before they will sell. As Richard Thaler writes in *Misbehaving-The Making of Behavioural Economics: "Roughly speaking, losses hurt about twice as much as gains make you feel good."* This basically leads to a tendency among investors who are facing losses on their investment to continue to hold on to the losses, until they reach the positive territory again. This leads to a slow correction in prices.

c) In some other cases, investors are anchored on to the high returns that their friends, relatives and acquaintances, had made during the *go go* years of real estate between 2002 and 2011. They are waiting for that era to return. We wish them luck.

d) Up until last year, home loans taken to finance self-occupied homes, were allowed a deduction of up to Rs 2 lakh for the interest paid on the home loan against taxable income.

For home loans taken to finance non-self-occupied homes, any amount of interest on the home loan could be deducted to arrive at taxable income. This was allowed as long as the real rent (if the home was rented out) or the notional rent (if the home wasn't rented out, but the rent the home owner was likely to earn if he would rent it out), was adjusted against it.

Typically, given the high home prices, the interest paid on a home loan these days, is many times the rent a home is likely to earn, if rented out. This essentially ensures that by buying a second home (or a third or a fourth or fifth home...), individuals could create a massive tax deduction and bring down their taxable income dramatically. The corporate crowd used this anomaly with great success by buying second and third homes, as they went up the hierarchy.

This basically ensured that even if the investment was not yielding any returns in terms of price increase, the tax arbitrage available was good enough to stay invested.

In his budget speech, the finance minister Arun Jaitley limited all such deductions (for self-occupied as well as other homes financed through home loans) to Rs 2 lakh. This has basically ensured that the market for homes to be create a tax deduction has now effectively come to an end. Whether this has an impact on prices remains to be seen.

To conclude, without a genuine price correction the mess in the real estate sector is likely to continue. Investors have sustained the sector for *many many* years now. It's time the real estate companies realised this. If they want to continue to make money in the years to come, it's time they addressed the genuine home buyers as well.

Until that happens, we don't see any *acche din* for this sector.

Note: This originally appeared as a part of the Vivek Kaul Letter on July 14, 2017.