CHAPTER - 3

INDIAN

REAL ESTATE INDUSTRY

AN OVERVIEW
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1.0 CONCEPT AND DEFINITION OF REAL-ESTATE

The term ‘Real estate’ refers to land as well as building. The word ‘Land’ includes-the air above and the ground below and any buildings or structures on it. It covers residential houses, commercial offices, trading spaces such as theatres, hotels and restaurants, retail outlets, industrial buildings, factories and also government buildings. Thus, the term real estate connotes immovable property which can be either land or building or both. Real estate differs from personal properties such as furniture, money, clothing etc., with regard to the basic assumption that any type of personal property is movable with the owner of it. The real transactions include (i) Purchase (ii) Sale and (iii) Development of Land (both residential and non-residential buildings).\(^1\)

\(^1\) CA Rajkumar S. Adukia, Handbook on Real Estate, \(\text{www.rajkumarradukia@caaa.in} \& \text{www.caaa.in} \) p8
"Real Estate is an imperishable asset, ever increasing in value. It is the most solid security that human ingenuity has devised. It is the basis of all security and the only indestructible security." – Russell Sage

Real Estate sector is a large, huge diversified sector, with many verticals such as land, design/construction, development, investment, lending etc. India, emerging as one of the most important business locations in the world with its favourable demographics and strong economic growth, makes it an attractive place for property investors as the demand for property is determined mainly by business development and demographic trends. Of late, the nature of demand is also changing, with heightened consumer expectations that are influenced by higher disposable incomes, increased globalization and the introduction of innovative real estate products and services.²

2.0 GENESIS OF INDIAN REAL ESTATE INDUSTRY

The oldest use of the term “Real Estate” that has been preserved in historical records was in 1666. This use of “real” also reflects the ancient and feudal preference for land, and the ownership (and owners) thereof. Some people have claimed that the word real in this sense descended (like French Royal and Spanish Real) from the Latin word ‘King’. In the feudal system the king was the owner of all land, and everyone who occupied land paid him rent directly or indirectly (through lords who in turn paid the king), in cash or goods or services (including military service). For almost half of human history, our ancestors moved with the four-legged food supplies of their respective areas, leaving only trace signs of their lives—a cave painting here, some stone axes there and the odd carved trinket in the belly of a saber-toothed tiger. Our ancestors abandoned the hunter-gatherer life style gradually over the period from 30,000 B.C. to 15,000 B.C. This change was far from global and hunter gatherer societies still survive in some areas of the world today, but it did mark a transition towards an agrarian society – a transition that also heralded the advent of home ownership.

The shift towards more and more powerful tribal leaders culminated in pooling of labour along with a CEO of sorts to direct efforts. Irrigation channels were dug, strongholds were built, farming methods improved and temples were erected. With the land improvement, population exploded. The increased fertility increased available labourers. The People paid homage to lord or king who claimed ownership of the land – which in essence was the first system of rent. As these farming villages grew into cities, the leading families maintained ownership by right of lineage – their ancestors had clubbed all other challenges senseless – thus becoming the kings, pharaohs, daimyos and heads of other feudal dynasties. This system of labour-for-protection developed into taxes and tenancy. Royal families spread their wealth to friends, signing away titles and deeds to lands that allowed the holders to collect the revenues (rent) produced by the peasants living there.\(^3\)

The residential segments accounts for 75 to 80 per cent total real estate demand in India. The growth of the segment is being fuelled by rapid urbanization, the rise of the middle class with relatively higher disposable income, the increase in the number of households, a larger pool of buyers and the attractive of investment in residential real estate.\(^4\)

In India, the robust growth of the economy, favourable demographics, rising disposable incomes and changing lifestyles are driving the retail sector revolutions. Both realtors and developers are making forays in to metro cities as well as a number of Tier III cities. Leading developers with a pan-India presence are engaged in mall development.

Real Estate Industry in India witnessed a historic boom during 2002 to 2007. Record number of projects were launched and sold during this period. Real Estate Developers in India grew multifold very fast. Land and property prices skyrocketed. Many developers went for public issue of shares at very high valuations. Attracted by liberalization of foreign investment regulations, International investors invested billions of dollars in Indian real estate sector. The global economic boom, easy availability of money, crazy jumps in asset valuation and mad rush to go for the IPOs

\(^3\) CA Raj Kumar op. cit Pp 24-25
and desire to claim very high company valuation typically characterized real estate industry at that time. A number of real estate companies went for IPOs between 2006 and 2008. Some companies approached International Markets, like Alternative Investment Market of London Stock Exchange or Singapore Stock Exchange, using innovative structures for raising funds. Innovative multi-tiered structures, using offshore tax shelters like Mauritius and BVI/Panama, were created to ensure tax efficiency and help getting subsidiaries listed in overseas market without having to go through regulatory rigor with SEBI in India.\textsuperscript{5}

All these IPOs and fund raising exercises had one thing in common, they all valued real estate companies on the basis of NAV (Net Asset Value) models. Expected future free cash flows from different projects were discounted, and liabilities netted off against such discounted NPVs (Net Present Value), to arrive at company NAVs, which formed the basis of issue pricing. Interest in Real Estate, availability of cheap money and dearth of quality stocks made it possible for companies to get away with such highly probabilistic valuation models for IPOs. In their zeal to achieve highest possible price for their shares; companies also included NPVs of projects for which the land acquisition had not even started. Such questionable practices were overlooked by investors, riding the global asset price boom, assuming that the growth and profitability of these companies would continue to skyrocket due to insatiable demand for housing and commercial properties.\textsuperscript{6}

3.0 WORLDWIDE DEMAND FOR HOUSING

Many residential property markets around the world remain under considerable stress home prices, adjusted inflation, declined on a year-over-year (y/y) basis in the first quarter of 2012 in the majority of International Markets. The ongoing strains are most pronounced in Europe, particularly in the recession-plagued peripheral economies. Fiscal austerity measures, rising joblessness and tight credit conditions have sidelined potential buyers even as Central Banks maintain highly accommodative monetary policy settings. Housing conditions have also cooled in


\textsuperscript{6} LANCASTER UNIVERSITY Growth Strategy, IPO Performance Of INDIAN REAL ESTATE COMPANIES RESEARCH PAPER For MA in Practicing Management By Sharad Jhingan
Australia and to a lesser extent Canada. The US housing market has shown signs of stabilization in early 2012, though it will take more time to build renewed momentum. The next five year period will see demand for commercial real estate rebound, following a dip caused by the credit crises. During the crises, demand in developing markets, such as India and China helped to make up for lower demand in developed countries. Improving economic conditions in emerging markets due to increased construction activity and lower unemployment will contribute to the global commercial real estate markets. The industry buys, rents, sells, and manages both leased and privately owned real estate, including non-residential building and apartment buildings. Other related services include property appraisal, brokerage and property development.

Worldwide demand for new housing is expected to expand by 3 per cent yearly through 2014, with almost 55 million new housing units to be constructed, according to Freedonia. The 2009 recession caused housing construction to fall off of in Western Europe, Japan and North America. As the construction industry rebounds, these regions will lead market growth through 2014. Africa-Mid East will show the fastest rate of emerging nation growth at close to 4 per cent with construction of 11 million units. Asia-Pacific will lead in terms of volume, with almost 32 million new units representing 2 per cent year growth through 2014. Global housing stock will increase at a yearly rate of almost 2 per cent from a base of almost 2 billion units in 2009. Asia Pacific held the largest share of housing stock at almost one billion units or over half of the global total, with China accounting for almost a quarter of the overall total. China was followed by Africa Mid East, which held over 290 million units of the world’s housing stock in 2009, 15 per cent of the overall total, and Western Europe and North America representing under 20 per cent of world’s housing stock. The global growth rate is expected to settle at just under 2 per cent yearly through 2014 to over 2 billion units. The global real estate management and development industry is predicted to grow at a yearly rate of 0.3 per cent between 2010 and 2015, according to Market Line. The industry is expected to reach in excess of $ 465 billion by 2015. The Chinese residential property market is expected to grow 13 per cent yearly between 2012 to 2015 according to RNCOS. The market will driven by high degree of urbanization following continued recovery after the economic crises, aided Government spending in the sector and rising demand. The
market will equally benefit from state measures to limit climbing domestic real estate prices as the government seeks to expand affordable housing.

4.0 GROWTH AND DEVELOPMENT OF IREI

Many aristocracies were eventually displaced – usually by displacing an aristocrat’s head from the body – with supposed meritocracies – a system where the best and brightest lead a nation for the good of all. Title lands were broken into smaller parcels and sold on free market of sorts. But the people with the money to buy the deeds were either merchants or former aristocrats who managed to escape been shortened by revolutionary fervor. The industrial revolution was one of the great equalizers in human history, perhaps only matched by the invention of firearms. The use of machines for manual labour freed many peasants for different tasks and allowed a privileged few time for education and specialization into new fields of labour opened by the mechanization of industry. After the industrial revolution, however, the wealth of the world increased to the point where, banks opened themselves to “higher-risk” mortgage loans to common people. This allowed individuals to own their own homes and, if so desired, to become landlords themselves. It took 30,000 years, but home ownership is now opened to many people. Ownership, specifically ownership of land, was the basis of all the investment opportunities that is seen today.

Right from independence (15th August 1947), land has been an intensely emotional issue in India. In order to correct the imbalances in society, symbolized by large hereditary land holdings being concentrated in the hands of few feudal families, successive Indian Governments followed a socialist path. “Right to Property” was classified as “Legal Right” as opposed to “Fundamental Right”. Poor landless peasants and sharecroppers constituted majority of people across the country. It was considered critical for the development of the country to mitigate the problems of landless and poor peasantry. Land reforms were implemented to redistribute land for

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7 www.icsc.org — International Council of Shopping Centres.
8 CA Rajkumar S. Adukia, Handbook on Real Estate Pp 25-26
mitigating poverty following adoption of socialism as the guiding principle for development of the country.⁹

Zamindari and Land Ceiling Acts were enacted by various State Governments, prescribing the limits of land holdings of individuals. Separate limits were prescribed for agricultural and urban land holdings. All extra land holdings were compulsorily vested in the Government. Various Urban Development Authorities and State Housing Boards were formed and entrusted with the work of acquiring the extra land and developing the cities and towns across the country. Government, through its urban development arms and housing boards and municipal corporations, thus became the largest and most organized player in Real Estate Sector. It still is the largest player in terms of land holding, size and spread of projects and impact. Private sector was always a much smaller, fragmented and extremely local presence for decades. It was only in 1980s that we saw emergence of larger companies focused on providing housing and development of commercial space.¹⁰

Indian real estate industry witnessed a historical boom during the period 2002–2007. Revenues, volume, profitability and prices of properties skyrocketed. Developers announced a chain of projects and expanded operations exponentially across the country. Foreign investment was virtually locked out of this sector, Government of India liberalized direct foreign investment policy for real estate sector, and billions of dollars were invested in projects across the country. Valuations were extremely stretched, and it was evident that a major correction was in the offing. Yet driven by collective greed and supported by massive injection of cheap global liquidity, people throw caution to wind and invested in real estate for short term capital gains, so much so that residential and commercial units were booked and position liquidated, within a couple of months, for profit. Prices were rising almost on a weekly, if not on a daily basis. Some developers went and listed themselves on London Stock Exchange. The timing of boom coincided with the global liquidity surge. Cheap money sloshed around the system driving asset prices to unprecedented

⁹ Sharad Jhingan, Growth Strategy, IPO & Performance of Indian real estate companies research paper for MA in Practicing Management, Lancaster University.
¹⁰ FDI Consolidated Policy – March 31st 2011 - Department of Industry Policy and Promotion – Ministry of Commerce
levels. With this backdrop, after financial crisis, real estate stocks are barely a pale shadow of themselves.  

Consistent 8-9 per cent growth rate was returned by the economy during the period 2003-04 to 2007-08. Personal Disposable Incomes grew at correspondingly higher rate over this period. As a result growth in Financing, Insurance and Real Estate Sector was also very high. The rate of growth in Finance, Insurance and real Estate Sector declined quite sharply from a high of 13.78% in 2006-07 to 11.74% in 2007-08, and further to 7.81% in 2008-09, pointing to a cooling down of the sector. Next to Agriculture, Real Estate is the second largest employer in the economy. It comprises of four sub-sectors – housing, retail, hospitality, and commercial. While housing contributes to 5-6 percent of the country’s GDP, the remaining three sub-sectors are also growing at a rapid pace, meeting the increase in infrastructural needs.

The key demand drivers of the real estate industry are the (i) residential properties (ii) office spaces (iii) retail space (iv) hotels etc.

(i) Residential properties: Residential property in India is an emerging market. The growth in the residential real estate market in India has been largely driven by rising disposable incomes, rapidly growing middle class, low interest rates, fiscal incentives on both interest and principal payments for housing loans, heightened customer expectations as well as increased urbanization and growing number of nuclear families.

(ii) Office Spaces: The growth of commercial real estate development in India has been fuelled by increased revenue growth of companies in the services business especially, in the IT and ITES sectors. As these sectors continue to grow and generate additional employment, it will result in increased demand for commercial space. Commercial real

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11 LANCASTER UNIVERSITY Growth Strategy, IPO & Performance of Indian Real Estate Companies Research Paper For MA in Practicing Management By Sharad Jhingan
12 Indian Real Estate: Opportunities and Returns: Knowledge Paper by Ernst & Young for FICCI (Federation of Indian Chambers of Commerce and Industry) September 2006. The Indian Economy Source – Handbook of statistics – Reserve Bank of India
estate development is rapidly taking place at all up growing cities in India and in the developing tier-2 cities.

(iii) Retail Space: Although the retail real estate segment has the smallest pie in the real estate industry, it is growing rapidly and the demand for good quality mall space is fuelled by the growth in organized retail and the entry of international retailers into India. Over the past few years, retail has become one of the growing industries in the country.

(iv) Hotels: Of late, the growth prospect in Indian Hotel Industry is transcending the boom to the Indian real estate market. The land prices have been touching new heights as hospitality giants, hunt for land to establish their new hotels. Given the rapid economic development going on in the country, India is likely to become one of the top five destinations for business travelers in the year ahead as per the statement given by London based World Travel and Tourism Council.

5.0 PRESENT STATUS OF IREI

The Real Estate sector in India is being recognized as an “infrastructure service that is driving the economic growth engine of the country” according to industry experts. In fact, foreign direct investment (FDI) in the sector is expected to increase to US $ 25 billion in the next 10 years, from present US $ 4 billion according to report released by McKinsey Global Institute (MGI) – India’s urban awakening: Building inclusive cities, sustaining economic growth – on April, 2010. The country’s urban population will soar to 590 million by 2030, from 340 million in 2008. India’s cities could generate 70 per cent of net new jobs created by 2030, produce more than 70 per cent of the country’s gross domestic product (GDP), and stimulate a near four-fold increase in per capita income. It also says that India needs to invest US $ 1.2 trillion over next 20 years to modernize urban infrastructure and keep pace with the growing urbanization. Further, growth prospects and price stability of small cities are attracting large real estate developers in such cities in the recent past, according to a report titled ‘Real(i)ty Next Beyond the Top 10 Cities of India’, released by Crisil Research in June, 2011. The report estimates that the sale of new residential apartments in 10 such smaller cities at around US $ 4 billion in 2012. Industry experts feel that with attractive pricing and innovation in construction technology and variety
of designs, NRIs are taking a fresh look at India as a unique market in which they can invest.\(^{13}\)

FDI flows into housing and real estate in April- March, 2011 stood at US $ 731 million, according to the Department of Industrial Policy and Promotion (DIPP). Housing and real estate sector including Cineplex, multiplex, integrated township and commercial complexes etc., attracted a cumulative foreign direct investment (FDI) worth US $ 11,168 million from April, 2000 to 2012. Real estate also emerged as the popular sector for private equity (PE) funds, which witnessed investments worth US $ 1,700 million in the sector during 2011. According to the ULI-Price Waterhouse Coopers (PWC) report titled ‘Emerging Trends in Real Estate R Asia Pacific 2011’, which surveys comments from 150 industry leaders across the Asia Pacific Region, India will continue to maintain a GDP growth momentum of 9-10 per cent by 2015 as the country will witness new private equity in capital markets which will inject capital in infrastructure projects. Some of the key trends in the India real estate sector include geographic de-concentration of real estate activity from large metros (such as Bangalore, Mumbai and Delhi- NCR) to medium and small cities (such as Chandigarh, Pune, Jaipur, Kochi, Visakhapatnam etc..) and development of mixed use projects encompassing residential, commercial and retail complexes, increase in demand for affordable housing etc.\(^{14}\)

Realizing the acute shortage of housing and commercial space in Indian cities, and potential of real estate sector in creation of jobs and alleviation of poverty, Government of India decided to open real estate sector to foreign investment. To encourage transparency and competition following major reforms were carried out:

1. Government of India supported repealing of Urban Land Ceiling Act (ULCA); by 2007 nine States had already repealed ULCA.

2. Modification in Rent Control Acts to give more protection to home owners to encourage rental housing investments.

3. Property tax rationalization.

\(^{13}\) www.nalop.org – National Association of Industrial and Office Properties

4. Large scale computerization of land records.

5. Liberalization of foreign direct investment (FDI) guidelines, enabling large scale fund flow to the realty sector.

6.0 PROBLEMS OF IREI

The problems that the Indian real estate industry is facing are:

- lack of clear land titles,
- absence of title insurance,
- absence of industry status,
- lack of adequate sources of finance,
- shortage of labour,
- rising manpower and material costs,
- approvals and procedural difficulties.

The Indian real estate sector has traditionally been an un-organized sector but it is slowly evolving into a more organized one. The sector is embracing professional standards and transparency with open arms. Lack of consistency in rules relating to development of SEZs, increased monitoring of the sector by regulatory agencies, tightening of rules for lending to the real estate sector and increase of key rates by the RBI several times during the last one year, have arrested the growth of the sector.¹⁵

There is a need to streamline government policies and introduce reforms to boost the real estate sector. One of the most common complaints of buyers against builders is regarding the specifications of the built up area and the carpet area. Buyers are often misled by some builders regarding the money that they need to pay for the area that they are investing in.

- Customers are frustrated and tired of some builders who inevitably have hidden costs to offer with any transactions you make with them. People invest and book a flat or a house, with a certain monetary budget and plan, which is totally wrecked by such hidden costs. There are many builders, who

incorporate hidden costs in areas that would not be easily detected by the common man’s eyes.

- Quality is yet another area, where the builders prove themselves as unscrupulous. Many a times, builders do not provide with what they initially promise. There are horror stories of buyers finding cheap local made fittings in bathrooms instead of branded quality promised initially. Often builders promise a plethora of amenities like swimming pool, gym and so on to attract buyers but these never really materialize.

- On an overall basis, companies from the real estate and construction sector faced issues related to higher interest costs on the back of leveraged balance sheets. The Reserve Bank of India kept the interest rates on the higher side due to concerns over the high inflation levels.16

7.0 PROSPECTS OF IREI

According to estimates of the Technical Group constituted by the Ministry of Housing and Urban Poverty Alleviation (MHUPA), the urban housing shortage in the country at the end of the 10th Five Year Plan was estimated to be 24.71 million for 66.30 million households. The group further estimated that 88 per cent of this shortage pertains to houses for Economically Weaker Sections and another 11 per cent Lower Income Groups. For Middle and High Income Groups the estimated shortage is only 0.04 million. During the 11th Five Year Plan the group estimated that the total housing requirement in Indian cities (including backlog) by end of 2012 will be to the tune of 26.53 million dwelling units for 75.01 million households. If, the current increase in backlog of housing is maintained, a minimum of 30 million additional houses will be required by 2020. The main reasons for rise in shortage in affordable housing on the supply side is lack of availability of urban land, rising construction costs and regulatory issues while lack of access to home finance for Low Income Groups are constrains on the demand side. Construction costs form nearly 50 per cent to 60 per cent of the total selling price in affordable housing projects while

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for luxury projects this figure is 18 to 20 per cent. Moreover, majority of the loans disbursed by banks and housing finance companies are above Rs.10 lakhs. In fact, the inadequacy of housing stocks and lack of spaces for house, these units in Indian cities manifest in the form of growth in slum and squatter settlements. It is the 6 per cent growth of slums that is fast outstripping the growth in urbanization in India and its cities at 3 per cent respectively. According U N Habitat India is adding 4.4 million people to slums every year and 202 million Indians will be residing in slums by 2020.\(^\text{17}\)

Currently the offerings in the market are at various stages of readiness vis-à-vis the development cycle and pose varying levels of risk to the investors. These offerings range from projects where, land is not acquired, to projects where, all the structures are in place.\(^\text{18}\)

Real estate development in India has spread from the large metros to smaller cities and towns. Several factors such as sustained GDP growth, higher disposable incomes, proactive Government policies etc. have induced this transformation. The IT/ITS sectors accounts for 80 per cent of absorption of office space: this sector is seen as the driver foremost importance of current scenario. The companies in IT/ITS sectors are exploring opportunities to move to smaller cities and towns to reduce cost of operations. The favourable growth of the economy has put more purchasing power in the hands of the people. There is growing consumerism and organized retail is gathering momentum. There is a marked preference on the part of the retailers of today, to move to smaller cities and towns, to cash in on the "first-mover" advantage. Demographic factors, the emergence of double income, nuclear families and the availability of house loans at reasonable interest rates have spurred the demand for housing. The rapid pace of urbanization in India is another factor that is contributing to the growth of real estate. According the Census of India 2001, by the 2011, 41 per cent of the total population of India will be residing in urban centres. Further, the number of cities with the population of one million or more is expected to go up to 70 percent by 2005 by 35 per cent in 2011. With the growth of the real estate sector,

\(^{17}\) http://mhupa.gov.in/index.htm - Ministry of Housing and Urban Poverty Alleviation, India.

\(^{18}\) BVS Prasad and K. Gowri Shankar, "Indian Real Estate Trends, Challenges and Prospects", ICFAI University Press, 2008, P 114
several state capitals and smaller cities are emerging as favoured destinations, due to better infrastructure support and relatively better economic growth trends. Most importantly these locations have more land parcels available and lower cost of real estates. The man power pool in these locations, being largely untapped is another advantage for commercial establishments. Moreover, these smaller cities and towns have an industrial/tourism base which augurs well for future growth. In the light of the foregoing several real estate developers and retailers have embarked on plans to tap the potential available in these cities/towns.  

The real estate development cycle starting from land acquisition, approvals to developments and finally, sales/leasing is unique and complex in the Indian scenario. In order to successfully invest in the Indian real estate sector, an investor has to be able to discern the issues and considerations at every step of the above process. Complexity is added to the fact that various states have differing regulations and process pertaining to development.

The Government has aided the growth of real estate by allowing access to overseas equity while at the same time it has put in place checks and balances to control the sector and avoid any speculative bubble formation. Equity participation in the real estate sector has been encouraged to promote a long term development vision. The Government has also taken steps to regulate the liquidity in the real estate sector through debt. The growth in the sector continues to rise at a steady CAGR of 30 per cent and is estimated to reach US $ 60 billion by 2010. The growth of real estate in India is in direct proportion to the upward GDP growth increased urbanization, improving demographics as well as the development of various sectors like IT/ITES, retails, consumer durables, automobiles, telecom, banking, insurance, tourism and hospitality etc. A key indicator of the growth in real estate markets is the office supply absorption statistics which is double of what it was a few years ago. Over the last few years, the Indian real estate sector has been seen an increase in the range and scale of investment options. This has also been a result of increase in the scale of development, consolidation of developer balance sheet, greater stream lining of the

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19 K. Gowri Shankar, "emerging Growth Centres in India, 2007, Knight Frank India Research, Quarter –1, 2007 Pp 69-70
industry, greater emphasis on incorporating best practices, development standardized processes etc. The recent developments in the Indian real estate markets are examined from the perspective of capital, supply and transactions.

DLF Ansals and Unitech in North India; Hiranandani, Raheja and Tata Housing in West and Purvankara, Sobha etc in South India emerged as larger development companies with project development and execution capabilities. This also coincided with growth of housing finance providers like HDFC, ICICI, and LIC Housing Finance etc. To attract real estate investment by FDI's and other investors the government and companies through its Real estate association have to undergo change in doing business. More transparency and capacity building is needed to make investors confident about the Real estate sector. Many foreign companies find it difficult to business in India without having an Indian partner lack of structured practices and understanding of Indian market. The real estate projects are very capital intensive and only transparency and good governance of projects can bring in better investments to this sector.21

With growth in economy, gradual opening up of society and spread of media networks, consumer sophistication, demand and expectations also changed. Favorable demographic composition, phenomenal growth of IT industry and general economic growth placed huge purchasing power in the hands of youth. This provided the boost to real estate sector and laid the groundwork for the real estate boom of 2001 to 2007. It is estimated that around USD 1.2 trillion dollars will be needed to develop infrastructure and create new cities in India.22

8.0 FINANCING STRATEGIES

Real Estate Developers adopted various strategies to finance this extremely high growth phase. In fact not only the projects under execution, at the time of going to IPO, were many times larger than what they had historically completed; the number and size of the projects which they had planned, was exponentially larger still, and the land banks which they proposed to acquire for their future projects could probably out

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21 FDI Consolidated Policy – March 31st 2011 - Department of Industry Policy and Promotion - Ministry of Commerce
22 Saurabh Verma, Real Estate Stock Performance in comparison to Real Estate Market Dynamics Year 2007 onwards, Amity University August 2011
last an entire generation. In this process all these companies leveraged to the maximum extent possible and their balance sheets were almost entirely funded by debt. Additionally, they entered into a number of structured deals with foreign investors to finance projects. Return expectations were extremely high due to galloping property prices. Large capital gains on land holdings made the transactions look very simple and extremely lucrative at that time.  

Banks unwittingly supported large scale speculation in land banking by providing liberal finance to developers for construction of projects and easy home loans at zero margins to home buyers. Another strategy adopted by developers and supported by banks was to disburse upfront to homebuyer, by making payment directly to the developer, 100% of home loan sanctioned to purchase a property. In such a case the EMI's would start only from the date possession and the home buyer would not have to pay any interest during construction period, interest being paid out by the Developer to the lender by way of subvention payments. The entire revenue was thus received upfront by the developer who could then utilize this cash to acquire more land and announce more projects. The flip side of this was huge interest cost being loaded on to the development process and balance sheets of companies. The liability of the developer, to pay interest on such loans, was unlimited in case of construction delays. Another cause of concern was very low stake of buyer in this whole process. An investor could practically speculate by paying small margin money (0% to 15%) of the cost of house property to the developer, balance 85 % disbursed by the bank upfront, the developer servicing the interest for the period of construction. Therefore, in case of declining prices, the investor would opt for backing out of his commitment to take delivery by forfeiting the margin money. This practice, instead of helping the genuine buyers, increased the risk inherent in such deals.

The catch being that although it was the developer who was liable for payment of interest during construction period, the loan never appeared in his books, because the investor was the borrower. In such cases, investors acted as the agent of developer to enable very high over all leverage in individual projects. International real estate investors and funds, hedge funds and private equity funds raised lot of money from

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21 Guidance Note on Recognition of Revenue by Real Estate Developers- By Institute of Chartered Accountants of India – June 2006 Issue of the Institutes Journal
investors for investing in Indian Real Estate Market. Due to rapid price rise in land and property prices, there was a rush to participate in the market. Investors were pressurizing fund managers to quickly close deals in Indian real estate. As a result a number of unwise, inadequately evaluated, and improperly valued investments were made by these global investors. Global private equity funds and investment banks invested billions of dollars in Indian Real Estate Projects. This created a situation of excess liquidity chasing few good deals in the market.

Many Indian companies went and listed themselves on Alternative Investment Market (AIM) of London Stock Exchange and raised billions of dollars. Prominent names which went to AIM market are: Hiranandani Constructions (HIRCO), Raheja Developers (ISHAAN), Unitech, and Indiabulls. The valuations were again driven by NAVs and hence suffered erosion of values to a great extent. This virtually shut the AIM market for Indian paper. AIM market was established by London Stock Exchange for alternative investments i.e., for such companies which would need relatively smaller amounts of capital and which would find it costly and cumbersome to approach the main market. AIM market was primarily meant for institutional investors and provided some liquidity to the investors. Indian real estate developers raised billions of dollars from that market when the interest in India was at its peak. As soon as markets corrected after the crisis the valuations evaporated. As a result investors virtually turned away from Indian paper being offered on AIM market.24

9.0 SUMMING UP

The Real Estate sector in India is being recognized as an “infrastructure service driving the economic growth engine of the country” according to industry experts. Real estate development in India has spread from the large metros to smaller cities and towns. Several factors such as sustained GDP growth, higher disposable incomes, proactive Government policies etc. have induced this transformation. The Government has aided the growth of real estate by allowing access to overseas equity while at the same time it has put in place checks and balances to control the sector and avoid any speculative bubble formation. Equity participation in the real estate sector has been encouraged to promote a long term development vision. With growth in

24 ibid
economy, gradual opening up of society and spread of media networks, consumer sophistication, demand and expectations also changed. Favorable demographic composition, phenomenal growth of IT industry and general economic growth placed huge purchasing power in the hands of youth. This provided the boost to real estate sector. Real Estate Developers adopted various strategies to finance this extremely high growth phase.