# FY16 Outlook: Real Estate Sector

## Demand Revival Driven by Lower Property Prices Key to Sector Improvement

**Outlook Report**

**Sector Outlook**

**NEGATIVE TO STABLE**

**(2014: NEGATIVE TO STABLE)**

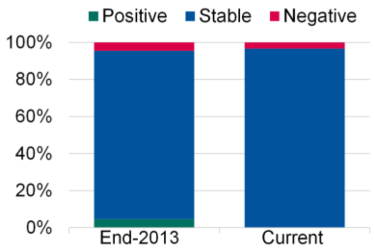
- Weak End-user Demand
- Persistent High Prices
- Deterioration in Credit Metrics

**Rating Outlook**

**STABLE**

**(2014: STABLE)**

**Rating Outlooks**




Source: Ind-Ra

**Negative to Stable Sector Outlook:** India Ratings & Research (Ind-Ra) maintains a negative to stable outlook on the real estate sector for FY16. This is because demand drivers and affordability remain weak, given sluggish economic growth and high property prices. These factors have resulted in falling unit sales and EBITDA margins and thus deteriorating credit metrics for the sector.

Any improvement in property demand will depend on a positive change in consumer expectations of economic growth, job and income prospects and also lower property prices. Property prices have remained high and are unaffordable to end-customers. While economic growth is likely to improve in FY16, property prices might not correct. This could lead to end-customers postponing purchase decisions.

**Stable Outlook for Companies:** Most Ind-Ra rated real estate companies have a Stable Outlook, as the risks impacting the sector have been factored in to their ratings. The entities rated at investment grade are either leased properties with stable revenue or residential companies with comfortable cash flow or strong parentage.

**Deterioration in Credit Metrics:** Ind-Ra believes the credit metrics of real estate companies will continue to deteriorate in FY16, as demand will remain subdued amid high prices, even while inventory is being built-up using bank funding.

**High Prices Hit Sales:** Sales of fresh residential units (in sq.ft.) by listed real estate companies continued to decline during 2014, falling 25.6% yoy for the 12 months ended September 2014. The fall in sales can also be gauged from the sharp decline in the 12-month trailing disbursements of housing loans during 1HFY15.

The fall in sales was due to persistent high property prices, even while affordability continues to be an issue due to high inflation and continued economic weakness. This is also reflected in the relative resilience of sales of the real estate players focussed on Bengaluru, where the prices are more affordable.

**EBITDA Margins Under Pressure**: The EBITDA margins of real estate companies could become stable during FY16, as commodity prices are likely to be under control. However, some margin erosion may be seen due to overheads, if sales do not increase. Margins declined marginally during 2014 due to the companies' inability to pass on increases in input prices to end-customers and falling sales, leading to under-absorption of overheads.

**Strong Incremental Lending:** Bank credit to the sector grew by double digits yoy in 2014. This, when coupled with declining sales, indicates bank funding is being used to build up inventory, which may further deteriorate the credit profile of the sector.

**Demand Pick up in Office and Retail Segment:** Ind-Ra expects demand for both office and retail spaces to pick up during FY16, as better economic growth and customer sentiments boost net hiring by IT/ITeS and banking financial services insurance sectors and also revive expansion plans of both local and foreign retailers.

**Related Research**

**Other Outlooks**

www.indiaratings.co.in/outlooks

Go to appendix for list of rated entities

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**High Investor Interest:** The interest of investors in the sector remains high, especially in rent-yielding commercial properties. Transactions continue in the residential segment though investors are now using structures such as debt or debt-like hybrid instruments and bulk unit purchases, instead of equity investments to better secure their interests. The use of debt/hybrid instruments is a concern, as it only shifts the funding gap to the redemption date with high funding costs.

The relaxation of thresholds for foreign direct investment in real estate projects is likely to improve fund inflow. The announcement of the guidelines for the introduction of real estate investment trusts and the clarification of tax pass-through status for such vehicles are also positive for the sector, as they improve fund availability to companies owning rent-yielding assets.

## Outlook Sensitivities

**Improvement in Demand:** A rise in demand, leading to strong free cash flow and a reduction in debt levels could change the sector outlook to stable.

**Asset Monetisation:** Sale of land and commercial property assets, leading to a substantial reduction in debt levels could be a driver for issuer ratings.

## Key Issues

### Weak Demand Drivers

While inflation worries seem to be easing over the past couple of months and economic growth is likely to improve in FY16, a change in consumer sentiment would require a perception of sustainability of these trends and an expected improvement in job and income prospects. Demand for real estate was impacted by weak consumer sentiments in 2014, driven by high inflation and weak economic growth.

Easing of inflation and expectation of income growth will improve disposable income. At the same time, lower interest rates in FY16 will lead to lower equated monthly instalments and thus higher loan eligibility. However, continued high prices of real estate remain a concern, as it may deter customers' purchase decisions until an actual improvement is seen in income and interest rates.

### No Signs of Easing of Prices

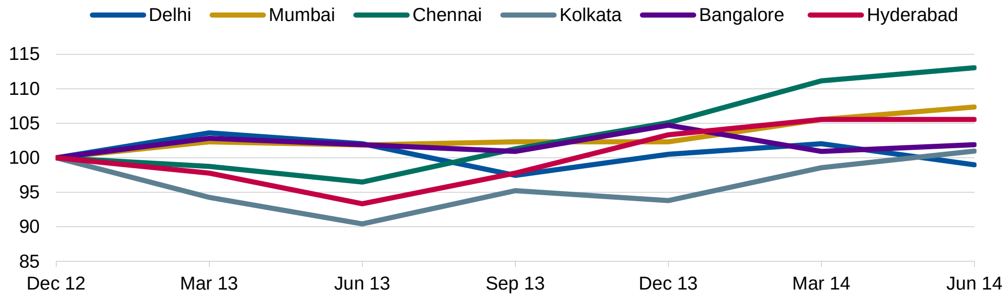
Any fall in property prices will require steps for reduction of land costs, shortening of the approval process and removal of red tape and also pressure from lenders on such companies to liquidate inventory to reduce debt. However, this is not likely to happen during FY16.

Property prices continued to increase during 2013-2014 despite a fall in sales, as indicated by NHB Residex in all metro cities except Delhi, where prices were unchanged. Real estate companies rely on sales to investors/speculators. Such class of buyers invest in real estate as an asset class with target returns and reliance on them does not allow companies to reduce prices even in case of lower demand from actual end-customers.

Furthermore, an increase in the cost and time incurred for land acquisition as well as in the funding costs of acquired land during the approval process (which may take a year or more) and increasing construction costs have added to the upward pressure on property prices.

Figure 1

**NHB Residex (Index with Dec 2012 as Base)**




Source: NHB

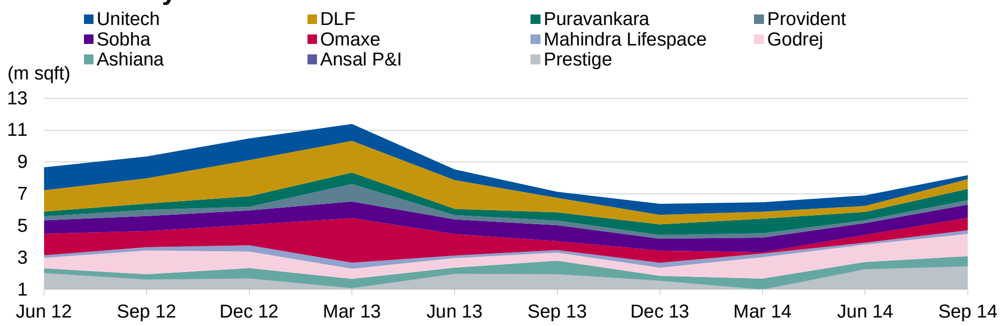
## Weak Residential Demand

Sales of residential units are not likely to recover during FY16, although they will continue to be stronger in locations where affordability is better. This is reflected in the resilience of sales volume of Bengaluru-focussed real estate players, as against players in Delhi.

Sales of residential units continued to fall during 2014, with a 25.6% yoy fall in sales of listed real estate players during the 12 months ended September 2014 compared with a 2% yoy fall in the same period last year.

Figure 2

**Area Sold by Builders**

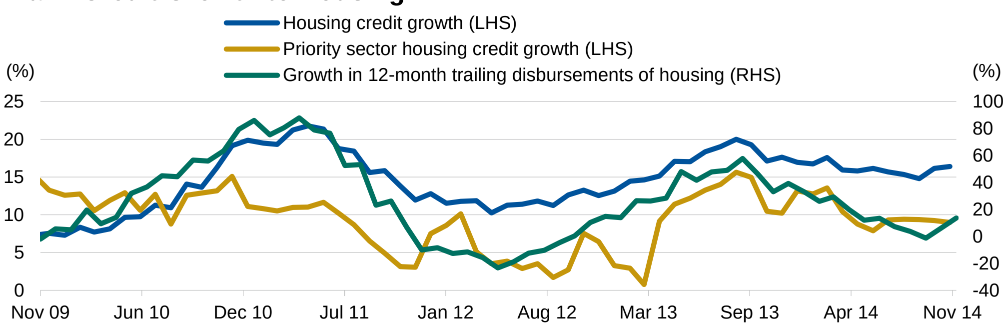



Source: Company presentations, Ind-Ra

A similar trend is visible through a sharp fall in the growth of the 12-month trailing disbursements of housing loans during 1HFY15. This indicates a lag in the impact of sales volumes on loan disbursements.

Figure 3

**Bank Credit Growth to Housing**




Source: RBI, Ind-Ra

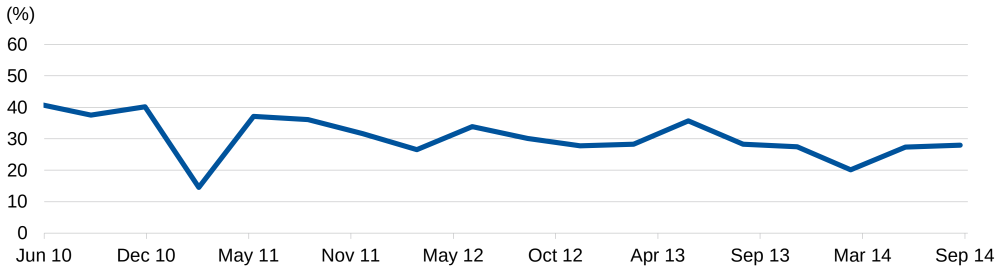
## EBITDA Margins Under Pressure

Ind-Ra expects the EBITDA margins of real estate players to remain stable during FY16 due to stable commodity prices, although margins may fall marginally due to overheads if sales do not increase. However, margins will fall in case companies decide to cut prices to liquidate inventory.

EBITDA margins were marginally down during 2014, after remaining stable in 2013, due to their inability to increase prices despite the increase in construction costs and under-absorption of overheads due to a fall in sales.

Figure 4

**EBITDA Margins**



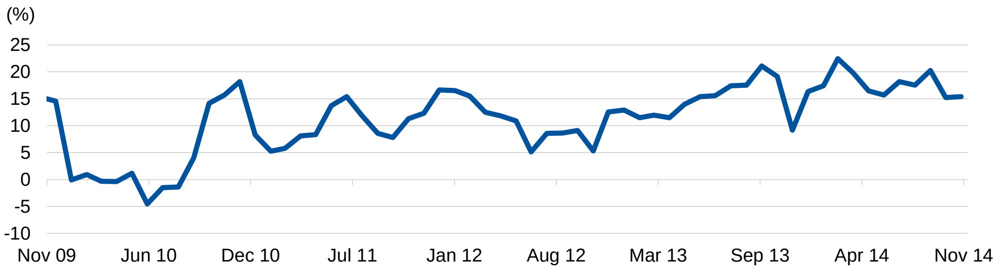

Source: Company reports, Ind-Ra

## Increase in Bank Funding to the Sector

Credit growth to the real estate industry continued to increase by double digits in 2014. This is credit negative for the sector, as falling sales indicate that such funds are being used for building inventory and purchase of land. This could lead to liquidity pressures in case sales do not improve.

Figure 5

**Bank Credit Growth to CRE**




Source: RBI

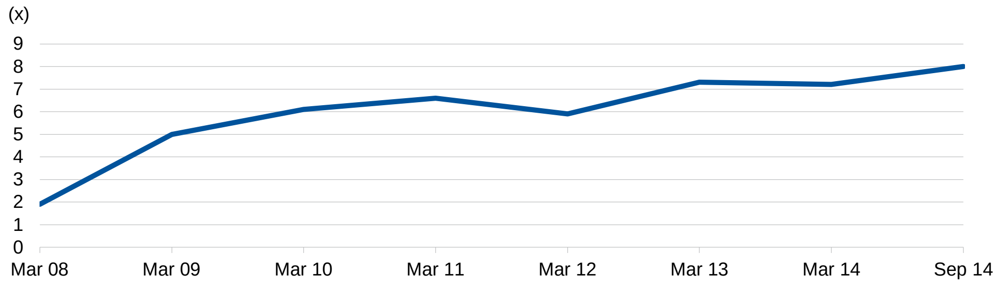
## Deteriorating Credit Metrics

Credit metrics will continue to deteriorate in FY16, as demand is not likely to revive leading to weaker profits and cash flow. Any improvement depends on the ability of companies to reduce prices to boost demand. Asset sales (land or rent-yielding assets) resulting in a significant debt reduction could also be a trigger for movement of issuer ratings.

Leverage deteriorated in 1HFY15, after remaining stable for two years, due to stagnant revenue and a fall in margins, while debt continued to increase to fund inventory creation and land purchases.

Figure 6

**Debt to EBITDA**




Source: Company results, Ind-Ra

## Rebound in Commercial and Retail Demand

Ind-Ra expects demand for the commercial space to pick up during FY16 on improved economic growth, which will increase employment opportunities in most sectors including IT-ITeS and banking financial services insurance.

Demand for the retail space is also likely to improve during FY16 as better consumer spending will revive the expansion plans of various local and foreign retailers.

Many players deferred construction of new properties in these segments over the past couple of years. Therefore, such increase in demand and absorption would result in higher occupancies and thus realisations in FY16.

## Strong Investor Interest

The sector continues to attract strong interest from private equity and foreign investors. This is especially the case in rent-yielding office and retail assets, where there were many major transactions during 2014 such as the acquisition of Unitech Corporate Parks Plc by Brookfield Asset Management Inc and purchase of Express Towers by a JV of Blackstone.

The interest is likely to pick up during FY16, as Securities and Exchange Board of India has released regulations for the introduction of REITs, which will be focussed on investment in rent-yielding properties. However, the benefit of such structures will be limited to those real estate players which own rent-yielding assets. REITs may also provide a monetisation route for investors such as Blackstone, who have made major acquisitions of such properties over the past two to three years.

The residential segment has also attracted interest from investors, though the mode of investment has changed to better protect their interests. From focussing on equity investments earlier, investors are increasingly looking at hybrid or debt instruments with fixed returns or bulk apartment purchases to fund projects. Though such investments provide liquidity to developers, they also add to the stickiness of the prices given the cost of capital involved in such transactions.

The use of hybrid instruments is also a concern, as it only postpones the funding gap to the instrument’s redemption date with high funding costs.

## Other Developments

The introduction and promulgation in to law of the Real Estate (Regulation and Development) Bill would be a positive development for the sector. Various provisions in the bill such as prior registration of projects and agents with the regulator, information transparency about booking and construction, launch of projects only post receipt of all approvals and escrowing of a portion of receivables from the buyer for construction purposes are positive for buyers.

A proper implementation of such provisions may lead to an improvement of customer perception about the sector and lead to an increase in demand. The provision regarding escrowing will also ensure that the sale proceeds from any project are used for its construction and will improve implementation of projects.

## 2014 Review

Ind-Ra affirmed most real estate companies in 2014 while upgrading two and downgrading three. Indian Express Newspapers (Mumbai) Limited was upgraded by one notch to 'IND A' to reflect the improvement in its debt service coverage ratio resulting from its ability to renegotiate expiring leases at high average rental rates. Ansal Housing & Construction Limited was upgraded by two notches to 'IND BBB-' to reflect better-than-expected cash flow.

Of the three companies downgraded, two were downgraded to 'IND D' - Omcon (Reign Forest) Projects and Oragadam City Developers Pvt Ltd - due to delays in debt servicing. IVR Hotels and Resorts Limited was downgraded to 'IND B+' following a similar rating action on its parent, IVRCL Limited.

## Appendix

Figure 7
### Issuer Ratings

| Issuer | Long-term Issuer Rating | Outlook/Watch |
|---|---|---|
| The Phoenix Mills Ltd | IND A | Stable |
| Indian Express Newspaper (Mumbai) Limited | IND A | Stable |
| My Home Construction Private Limited | IND A- | Stable |
| Vikhroli Corporate Park Pvt Ltd | IND BBB+ | Stable |
| Bhoruka Park Pvt Ltd | IND BBB+ | Stable |
| Rolta Limited | IND BBB | Stable |
| Pacific Development Corporation Limited | IND BBB | Stable |
| Sky Realty Projects Pvt Ltd | IND BBB- | Stable |
| Supreme Housing and Hospitality Pvt. Ltd | IND BBB- | Stable |
| Altius Management Advisors Pvt Ltd | IND BBB- | Stable |
| Shree Venkatesh Buildcon Pvt Ltd | IND BBB- | Stable |
| Nila Infrastructures Limited | IND BBB- | Stable |
| Ansal Housing & Construction Limited | IND BBB- | Stable |
| Sweta Estates Private Limited | IND BBB- | Stable |
| Terminus Infrastructures India Pvt Ltd | IND BBB- | Stable |
| Sun Infrastructures Private Limited | IND BB+ | Stable |
| Vicky Realtors | IND BB+ | Stable |
| Shah Group Builders Limited | IND BB | Stable |
| Harihar Infrastructure Development Corporation Limited | IND BB | Stable |
| Trinity Infrapark LLP | IND BB | Stable |
| Prime Newline AOP | IND BB | Stable |
| Lap Developers Private Limited | IND BB- | Stable |
| Nambiar Builders Pvt Ltd | IND BB- | Stable |
| W.S. Electric Limited | IND B+ | Stable |
| OMR Mall Developers Pvt Ltd | IND B+ | Stable |
| IVR Hotels and Resorts Limited | IND B+ | Stable |
| Amba Highrise Private Limited | IND B | Stable |
| Ninex Developers Limited | IND B | Stable |
| Lilasons Infrastructure Pvt Ltd | IND B- | Negative |
| BNK Investments | IND B- | Stable |
| Silver City Housing & Infrastructure Ltd | IND B- | Stable |
| Deeksha Housing Private Limited | IND D | |
| M/s. Omcon (Reign Forest) Projects | IND D | |
| Oragadam City Developers Pvt Ltd | IND D | |

Source: Ind-Ra

The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings and Research has been compensated for the provision of the ratings.