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Changes In The Real Estate Sector In India: A Case Study

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Abstract: The objective of financial sector reforms is to increase the efficiency and effectiveness of the financial system. To mobilize saving effectively and channelize such saving efficiently to most deserving sector, suitable strategies had to be developed. The objective of real estate sector reforms was to bring transparency and confidence in the sector. The RERA Act 2016 was passed and came into force on May 1, 2016, has given the Indian real estate industry first regulator. It aimed to bring fair and equitable transaction between buyer and seller, making transaction accountable and transparent. I as a developer and real estate agent in the small city of north India thought that lot of work needs to be done in order to register all projects to authority thus impact the way of doing business in the sector. In the meantime, benami property amendment act 2016 came into force from November 2016, which is a step to reduce corruption in India. Then came one fine night when as an owner of the real estate company I was sitting in my office and closing one deal. Suddenly the Indian Government banned currency notes of Rs. 500 and Rs.1000 on national television. As a developer, I sensed that it will impact the real estate market as it nullified 86% of the country's banknotes. On the first note, I assumed it will bring down the property prices as home buyers generally pay 30 to 40 percent value in cash to avoid tax. As a last piece of change came the Goods and Services Tax Act, 2017 which disturbed real estate transactions further. In the year 2018 real estate sector's unsold units and delayed projects have given the indication that the slowness in real estate will linger in the future also. Beyond the data, there are many stories of distress where investor's money stuck in delayed projects. After all these changes in the sector, as a developer, I thought how external factors changed the way of doing business and the participants had to understand the changing dynamics to survive in the sector.

Keywords: RERA Act, Reform, Demonetization, GST.

I. INTRODUCTION

Traditionally real estate sector is dominated by a large number of unorganized players. For a long time, Indian real estate transactions lack regulator and buyer felt that transactions are largely in favor of developers. The Real Estate (Regulation and Development) Act, 2016 (RERA) intends to bring transparency and protect the interest of stakeholders in the real estate sector. The RERA Act was passed by RajyaSabha and LokSabha, respectively on March 10, 2016, and March 15, 2016. Finally, it came into force from May 1, 2016. In six month the central and state governments were required to notify their own rules under the Act. As a developer, I was thinking of the various compliance which had to be followed like-

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- The act will provide a unified regulatory environment and will standardize practice across the real estate sector.
- Projects should be compulsorily registered subjects to condition with state RERA. Information be provided to the concerned allotted person for minor addition or deletion and transferring majority rights to the third party.
- The compulsion for timely completion and delivery in the favor of the consumer.
- A separate account to be maintained to park funds of project receivable.
- The standard sales agreement is prescribed by the act in order to prevent to insert any punitive clauses against homebuyers by the promoters.
- In case of noncompliance imprisonment and provision up to of 10% penalty on project cost has been prescribed under the Act.

The broker segment needs to register under the act which is around USD 4 billion industry with estimation of 5,00,000 to 9,00,000 brokers[1]. This industry was unregulated and unregistered. Agents have to perform now more accountable role as they can't promise now anything which is not in the document. Agents who are professional and have faith in transparency in business will be benefitted and those who are inexperienced, unprofessional and do not follow guidelines will face a hefty penalty or jail or both[2].

A. Stepping Ahead

In the meantime benami property amendment act 2016 came into force from November 2016, also created a lot of curiosity in people about the possible outcome on real estate. Real estate in India is a major sector where people invest unaccounted money. This act provides to curb black money to ensure all real estate transaction is conducted in actual owner's name where consideration is paid from known sources. It will bring more revenue to the government and will increase transparency, further it will impact corruption and unfair trade practices in the real estate sector. So the act prohibits benami transaction which is punishable by imprisonment for one year which can be increased to seven years. In addition to this fine, up to 25% of the fair market value of property shall be payable. Whether this act will impact rich investor putting unaccounted money in properties and dodge tax authorities to earn a decent return on investment and increase end users is to be seen in the future.

As a developer, I was struggling with the rules and their implementation of the RERA Act, and then came the 8 the November 2016 when I was sitting in my office. Suddenly currency notes of Rs.500 and Rs.1000 were banned by the Indian government on national television. As a developer, I sensed that it will impact the real estate market as it nullified 86% of the country's banknotes. On the first note, I assumed it will bring down the property prices as home buyers generally pay 30 to 40 percent value in cash to avoid tax. As I predicted there was a lot of uncertainty and a significant slowdown in the real estate market due to cash crunch [3]. If we go by figures in the last quarter of 2016, India's eight major cities registered a fall of 44% in the year to year sales which are the lowest level since 2000. Also figure of new launches was down by61% in the year to year by the end of 2016.

Demonetization shook up the working style and it had little impact on good developers with a right product targeted at masses. However, the small players had realized that they have to change their working model if they have to remain in business. As reported by one of the brokers from Mumbai those who were looking property for investment vanished from the market due to the cash crunch. He further added that in the last two decades he has not seen such low demand while working in the industry. Developers in several markets started giving indirect discounts, in the form of duty waivers and freebies.

Yet there are signs of light at the end of the tunnel which was led by Reserve Bank of India[4]. The country's largest lender State Bank of India started slashing lending rates by 90 basis points to 7.75% for overnight maturities and to 8.15% for three-year tenures. The home loan interest rate was at six-year low to 8.6% from 9.10%. So home loan up to 75 lakh is now available at 8.6% and for others, it is 8.65%.

There has been a slight recovery. The demand preference of buyer now shifted towards ready to move in projects. Though there were Inquiries in March 2017 but demand was low as it was last month of the fiscal. Since January 2015 there has been cut of interest rates by 175 basis points In April 2017, credit policy bank kept its repurchase rate at 6.25% and increased the reverse repurchase rate to 6% from 5.75%. As a developer now I am taking interest in affordable housing segment which is also reflected in numbers as it rose in 22% in total launches due to infrastructure status recently.

As per reports, prices have remained range bound in quarter four of 2017 with small increase from1% to 3% in the top nine cities like Hyderabad, Bangalore, Chennai, Ahmadabad, Mumbai, Kolkata, and Pune. The overhang of inventory has decreased. The number of launches increased by 19% to 51, 500 units which are the highest in the last eight quarters.

The last piece of change came was the Goods and Services Tax Act, 2017 which disturbed the real estate transactions further. Once the GST will be in force it will replace at least 17 states and federal taxes and as the consequence, the buyer has to pay one tax at a uniform rate[5]. If the government includes real estate in GST then states should be compensated for the loss of revenue. For under-construction properties, the effective rate of tax was 4.5% of the property's value, while the effective rate of GST is 12% with an inputs tax credit (ITC). For a long time confusion on inputs, tax credit prevailed. The buyer has to pay stamp duty and registration fee in addition which varies from 5% to 8 % that constitutes about 20% of property value which makes the investment with a high cost.

B. Future Steps and Strategies For Survival

However, the economists are now analyzing that the long-term impact of demonetization will be positive as it will increase transparency and confidence of investor. As per consultant property market will have an investment of $$7 billion in 2017 and $10 billion in2020. As per reports, organized growth in real estate sector estimated to increase to 1.35b square feet by 2020[3]. As a developer while sitting in the office I chalked the following points in order to survive in the business in the coming time:

- Focus on becoming a local market leader for sustainable growth. It may include joint venture and profit sharing with the landowner and local knowledge.
- In a more regulated market as now, a developer will be under more scrutiny,he should make the process more efficient at all stages of execution whether at pre-construction, during construction and post-handover.
- Due to shrinking margins focus should be tight cash management of project and return on investment.
- The developer should segment customer and buildbrands to position themselves for various customer types.
- Innovative selling approaches and multiple channels to reach customer which may include direct sales customer referrals, collaboration with channel partners, corporate sales and international initiatives and more.

In the year 2018 real estate sector unsold units and delayed projects are given the indication that the same slowness in the real estate market will linger longer[6]. As per National Housing Bank data, prices of properties annually increased by only by 7.50% and 5.75% between June 2013 and September 2017 respectively. During the same period prices in Delhi fell by -0.70% annually. Beyond the data, there are many stories of distress where investor money stuck in delayed projects.

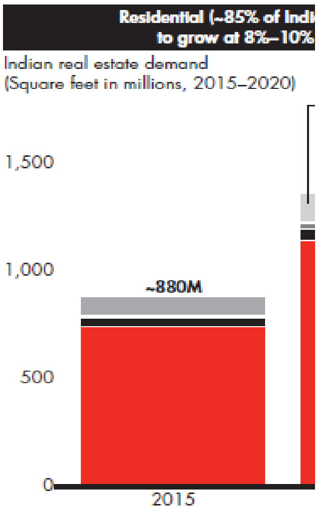
In long run, experts believe that all these measures will bring corporate governance, transparency, and confidence in the real estate sector.

Questions:

1. Whether changes implemented are desirable for real estate sector?
2. Do you think these changes will improve transparency and confidence in the real estate sector?

Exhibits:

Exhibit No. 1: Growth in an organized real estate sector estimated to increase to reach about 1.35b square feet by 2020.



Source: http://www.bain.com/about/press/press-releases/Residential-Real-Estate-in-India-2016-press-release.aspx

Exhibit No. 2:Applicable penalties under RERA

Applicable sections	**Offences committed**	**Applicable penalties**
Section 9 (7)	• Registration secured through misrepresentation or fraud • Breach of terms for which registration obtained	Revocation of Agent Registration Number
Section 62	• Contravention of Section-9 & Section 10	Penalty of INR 10,000/-day during which the default continues extending up to 5% of cost of unit sold
Section 65	• Contravention of orders of RERA authorities	Penalty up to 5% of cost of unit sold
Section 66	• Contravention of orders of Appellate Tribunal	Imprisonment for up to 1 year or with fine extend up to 10% of cost of unit sold

Source:https://housing.com/news/rera-will-impact-real-estate-industry/

II.MAIN RESULTS

A. *Synopsis*

From the last few years, there has been a major change in way of doing business in the real estate sector. The major changes witnessed are RERA Act, benami property act, demonetization in the last years. Further changes were Goods and service tax which has changed the quantum and way of doing business in the sector. Experts are now analyzing that the long-term impact of these changes will be positive as it will improve transparency and confidence of investor.

B. *Learning Objectives*

- To make understand students current scenario of the real estate market.
- To build up the ability to asses impact of changes on real estate business.
- To discuss the challenges faced by the real estate during changes and steps taken for survival due to change in business environment.

C. *Position In The Course*

The objective of the case is to make the participants aware of the impact of changes on business and challenges firms faces to survive in business. The case is ideal for discussion in the session on the impact of environment on business, strategy management and entrepreneurship for MBA and BBA students.

D. *Relevant Readings*

Research papers:

➢ O'Neill, H. &J. Duker,"Study on Impact of Demonetisation on Economy business and people "24 (1), 30-37(1986).

➢ Moulton, W. & H. Thomas,"Firm growth, Industry Growth and Business Failure. Academy of Management Best Papers Proceedings", 27-31,(1988).

➢ Ikhide, S. I. and A. A. Alawode: 'Financial sector reforms and monetary policy in Nigeria", IDS Working paper68, 2-46, (1996).

Books:

Economic environment of business 3rd Edition, PaliwalVeenaKeshav, Prentice Hall, 512 pages(2008).

II. ASSIGNMENT QUESTIONS

Q1: What are the reasons which forced changes in the real estate business?

A: The reasons which forced changes in real estate business are:

- Lack of confidence and transparency in the real estate sector.
- Projects are not timely completed and delivered to the customer.
- Verbal promises were given and every promise is not documented.
- Real estate agents were not registered and regulated.
- The fund collected for one project is diverted to another project which was responsible for the delay in the project.
- The payment is generally made in cash and unaccountable money results increase in price and reduce revenue for the government.
- The number of taxes paid on real estate is not transparent and known to the customer.

Q2: Discuss the pros and cons of changes in the sector.

A: Advantages are as follows:

- The regulated environment for real estate sector.
- Transparency in the utilization of funds.
- Increased confidence and investments in real estate sector.
- Delivery of project on time.
- Buyer protection and quality of delivery.
- Standardized agreements and treatment.

Disadvantages are as follows:

- Increase in project launch cost.
- Initially, a lot of work needs to be done in terms of registration.
- Halt of deals and tight liquidity due to various reforms.

IV. TEACHING PLAN

Discussion Point	Time (Minutes)
Introduction	15
Assignment Question1	15
Assignment Question 2	15
Conclusion	15

V. CONCLUSION

After analyzing the case, it can be concluded that many changes have taken place in the real estate sector like RERA Act, benami property Act, demonetization and GST. These reforms have changed the quantum and way of doing business in the sector. Experts are now analyzing that the long-term impact of these reforms will be positive as it will improve transparency and confidence of investor. Though the changes have created difficulties for various participants in the sector and they have to prepare themselves for whatever lies ahead as it may be the beginning of new innings in thesector.

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