The Indian R.E./COV/ery Mantra

A BLACK OLIVE VENTURES RESEARCH
An insight into the impact of COVID-19 on Indian Real Estate and the potential ways to emerge out of the crisis.
Abstract

“We wish you a very happy and prosperous New Year 2020”, is the wish that the whole world listened to and repeated on the night of 31st December 2019 as it entered into a new decade. Like at the start of every New Year, the hopes were high of achieving new heights, setting new performance benchmarks, and achieving our goals. But how have our perspective changed just in the first four months of this year, from hopes of glory it is down to struggle for survival.

As COVID-19 started to spread at an unprecedented rate throughout the world, it completely changed our lives in ways we never fathomed, by altering how we live, work & play. Now, we are close to hitting mid of May, 212 countries and territories around the world have reported a total of 3.5 million confirmed cases of the novel coronavirus, COVID-19, and a death toll touching 300,000. With all the major economies of the world announcing a complete or partial lockdown, global economic growth has come to an abrupt halt. As physical & social distancing became the need of the hour, and with restrictions on traveling and free movement of people and goods, it’s hard to imagine a business that has not been impacted by the COVID-19 pandemic, however, Real Estate is among the most affected sectors, especially the real estate sector in India.

This article elaborates on the impact this virus has had on the various segments of the industry, and the long term and short term changes this sector would go through, along with exploring the way forward.

We, though, believe that in the long run once the cure of COVID-19 is found, real estate and other businesses will return to normalcy and “This too will pass”. As human beings are “Social Animals” and have “Short Memories” (No history book that most studied ever mentioned “Spanish Influenza”) and are always driven by passion and hunger, world will see animal spirits come back for sure ….. it is just a matter of how much time and what one does in the interim? Guess prepare for it!
### Key Takeaways

"The impact of COVID-19 on Indian Real Estate Market:

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<th>Trends</th>
<th>Impact on Indian Real Estate</th>
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<td><strong>Social Distancing</strong></td>
<td><strong>Need based travel</strong>  • Hospitality - most affected.  • Budget hotels in star and three star categories will be first to recover.</td>
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<td><strong>Digital Seminars &amp; Events</strong>  • MICE (Meetings, Incentives, Conferences and Exhibition) category of real estate / Hotels - severely affected due to increase in e-conferences, webinars, video conferencing and lesser large events.  • Banquet Halls may also find lower event volumes and see decline in profits.</td>
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<td><strong>Digital Education</strong></td>
<td>• Demand for educational Real Estate to decrease.  • Universities may offer excess space to incubators.</td>
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<td><strong>Work from Home</strong></td>
<td>• Fall in office space demand due to Work from home, however ‘per person’ space requirements to increase.  • Data Centre REITs to do well internationally.</td>
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<td><strong>Home Delivery</strong></td>
<td>• Retail Real Estate to have a loss in demand and most of the malls may resort to revenue share to retain tenants.  • Malls may be re-positioned as destinations of leisure.  • Managed warehouses will be in demand and should do well.</td>
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<td><strong>Hygiene &amp; Lifestyle</strong></td>
<td>• Negative impact on co-living, co-working, B&amp;B, OYO, etc.  • Hygiene friendly hotels (star to three star) to comeback in the long run.  • Demand for healthcare spaces to significantly increase.</td>
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<td><strong>Risk Aversion</strong></td>
<td><strong>City Planning</strong>  • Concepts such as high density (High FSI) and transit oriented development (TOD) to be re-evaluated.  • Infrastructure led demand and parking requirements to decline.</td>
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<td><strong>Investments</strong></td>
<td>• Demand to increase in affordable housing, farm lands, gold and equity of firms having strong accounts.</td>
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<td><strong>Loans</strong></td>
<td>• Demand for Loan against Property to increase.  • Lenders to get more circumspect.</td>
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<td><strong>Frugal Lifestyle</strong></td>
<td>• Reduced spending - negative impact on luxury and second home market.</td>
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<td><strong>Insurance</strong></td>
<td>• Demand for ‘Life’ and ‘Loss of income’ policies to increase.  • Cost of ownership of income producing assets to increase.</td>
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<td><strong>SMEs &amp; Start-ups</strong></td>
<td>• Non-tech based entities to get investor traction as investors look for safer options too.  • Increased demand for prime Grade A Office and prime High Street to increase as they offer more stable returns.</td>
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<td><strong>Shift in World Order</strong></td>
<td><strong>Companies moving out of China</strong>  • Positive impact on Indian industrial real estate market in limited modern industrial areas near large cities.</td>
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<td><strong>De-globalization and local production</strong>  • Because of overall increase in demand for industrial assets, however, many small industries may face financial difficulties and may see negative pricing pressure due to oversupply through auctions by lenders.</td>
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<td><strong>Low interest rates</strong>  • Positive impact on the value of prime leased assets that withstand vacancy pressure.</td>
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The ways in which Indian Real Estate Market can emerge out the current crisis:

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<th>Measures</th>
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<td>FISCAL MEASURES</td>
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<td>Income Tax</td>
<td>• Abatement of at least 10% in individual tax.</td>
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| GST | • Advanced GST to be suspended. Should be charged on receipt of payment instead of invoice.  
• Reduction in slabs.  
• Zero GST on essential items. |
| Import Duty | • Exemption on import duty on capital goods imported for setting up new ventures or expansion. |
| Amnesty Scheme | • Offer small window.  
• Liberal Amnesty Scheme with only 30% penalty. |
| INDUSTRY - SPECIFIC MEASURES |
| Stimulus Package | • The current real estate revival package of ₹ 25,000 crores should be doubled at the least.  
• Disbursements to be done through more agencies. |
| Inventory | • Industry must sell off at discounts and look to clear debts.  
• Government must buy inventory at discounted prices and offer them to government employees. |
| Debt | • Allow one time restructuring of debts to developers to complete stranded projects.  
• Such developers should not be allowed to launch new projects. |
| Labour Laws | • Must be suspended for FY 2020 - 21.  
• PF and ES should not be deposited. |
| Infrastructure Projects | • Public spending on infrastructure development to boost market sentiment and may kick start economic cycle. |
| MONETARY MEASURES |
| Deficit Financing | • Government must increase money supply and resort to deficit financing if required |
| Interest rates | • Rates are already low.  
• Must not be reduced further (lower than 6%) to incentivise and mobilise savings. |
| AVOID REGRESSIVE MEASURES |
| Regressive Approach of Governments | • Increasing tax on fuel will only increase inflation instead of reviving the economy.  
• Proposal by Income Tax Department to impose excessive tax on super rich is also regressive and a negative reinforcement to entrepreneurs. This may also not any meaningful revenue |
| Hard Ball from Asset Managers | • Many Leases are getting into a “Litigation” mode. This should be best avoided and the Lessor and Lessee must come to revised terms. This will lower the impact of disruption. |
| Banks and Lenders | • Banks and Lenders, especially on lease rental discounting, should charge interest "AT COST" for at least next 6-8 months. Only deferral without waiver of interest is not a good solution. If the entire industry is shut, lenders can not run the business as usual and at the same profit levels. |
Indian Real Estate and construction industry together is the second biggest employer in the country, and is projected to contribute 13% of the country’s GDP by 2025, and reach a market size of US$ 1 trillion by 2030. Therefore any slowdown and impact on this sector should be a matter of grave concern.

The Indian Real Estate sector, especially the residential real estate (which is around 80% of the sector) had been struggling for the past two-three years now. The situation created by this pandemic has just pushed the sector further down. Liquidity crunch, subdued demand and buyer sentiments, inventory overhang, and high price points creating less affordability were some of the existing problems for the real estate sector, before COVID-19 added salt to injury.

As per industry reports in 2019, owing to the financial crisis and the slowdown in the sector, residential projects worth around USD 66 billion were facing bankruptcy proceedings, and nearly 4.54 lakh units were running behind their completion dates due to various reasons. COVID-19 has further exacerbated some of the existing problems affecting the sector along with creating new ones.
The Impact of COVID-19 on Residential sector

The residential sector has experienced one of the worst hit in history and it has affected the overall demand, cost of construction, financing, project delivery and sales. We have analysed each of these aspects in the following section.

“A FUNNY THING HAPPENS IN REAL ESTATE. WHEN IT COMES BACK, IT COMES BACK UP LIKE GANGBUSTERS.  
– BARBARA CORCORAN
Lower Demand

As per industry reports there was a stock of more than 6 lakh units as unsold inventory in the top 7 real estate markets of India. The percentage of unsold inventory has been increasing throughout the four quarters of 2019.

The demand for residential housing was already low, but now it would dive further down. Due to the threat of loss of income and jobs, people have started cutting down on their spending. Only essential items are being purchased, and a new residence would not fall into essential items for many families especially now.

Moreover buying of residential real estate involves a physical site visit by buyers, and looking at the current situation, people may themselves restrict their movements even after the lock down is lifted. Also potential buyers would be anticipating a price cut, over the next few months. Due to these factors, prospective buyers would postpone their purchase of a new house.
Increase in Cost of Construction

As the supply chain would be affected, the prices of building materials would go up. Also, many fittings and fixtures which were being exported from China would become expensive and difficult to procure. Shortage of labour can also increase the price a contractor could demand or re-negotiate, along with this the finance cost would increase for the projects due to poor sales and delay in the project completion.

Project funding through pre-sales

As the uncertainty in the sector has increased and the sentiments of buyers have gone down, the preference for ready-to-move in and near completion projects have increased. This preference would further increase in the post-COVID-19 world, for some time to come. This could make it difficult for the developers to raise funds for the projects through pre-sales.

Some developers, especially small scale developers may find it difficult to repay the debts they have taken and can go bankrupt. To avoid this the sector would see even more consolidations among developers.
Delay in Projects

As the nationwide lockdown was announced, the migrant laborers and daily wage earners started moving towards their villages and towns from the cities they had been working in. This would cause a shortage of labor and would delay the work from commencing on site at full potential. As per industry experts, this situation can take up to six months to normalize after lockdown is lifted. Also due to the lockdown the building material supply chain has been affected, as the movement of goods is not permitted which can create a shortage of material in the short term. These factors can push back the completion date of a project by 6 months to 1 year.

Sale Price

Industry experts have pointed out that people should not expect a drop in sale prices, as after factoring in the increase in costs, it would be difficult for developers to further reduce costs. The prices should remain more or less stagnant as looking at the demand scenario, the developer may not be able to transfer the additional costs onto the buyer, post lockdown.
The Impact of COVID-19 on Commercial sector

In the times moving into the lockdown, the commercial real estate was witnessing a considerable growth given increasing demands and strong returns.

In this section, we analyse the impact of COVID-19 on various commercial segments.

“IN THE BUSINESS WORLD, THE REARVIEW MIRROR IS ALWAYS CLEARER THAN THE WINDSHIELD.
- WARREN BUFFETT
Commercial office space has remained a silver-lining in the commercial real estate for India now for the past few years.

Investors have always preferred to park their funds in the more stable and secure office spaces. The returns on investment have also remained highest for this asset class. With the launch of the first REIT in the country, the commercial office space seemed an attractive investment option. Investments in the office sector rose to $2.9 billion during the year from $1.8 billion a year ago. The Mumbai Metropolitan Region’s investments share grew to 43% of national investments in 2019-20 from 23% in 2018-19.
Office Space

Due to COVID-19, the institutional investment in the office space could come down for 6 months, as the world economies are now starting to get back on their feet, the investors would be on a wait and watch mode and would be focusing on risk aversion. But after this time, the commercial office market would be the first to bounce back and the overall impact of the pandemic on this asset class would remain marginal.

The cause of worry can be the decline in the demand for office space compared to what it was. As the biggest users of Grade A office space in India are the MNC’s. As they witness a loss of business due to lockdown, they may postpone or defer their decisions to lease out more office space. As most of these MNC’s are based in the United States and it being the most affected country by COVID-19, the time required by these companies to recover is difficult to estimate.

Also, most of the Indian and foreign corporates were forced to work from home during the lockdown period, they invested heavily in developing this infrastructure for business continuity. Now post-lockdown, they may find some benefit of continuing the same for 25% to 50% of their work force, thus requiring less space. This can hamper the demand for commercial office space in the long run.

Moreover, people would start realising the advantage of flexible work spaces even more, and would want an arrangement where most activities can be clubbed into the same space.

Co-working Spaces: The revenue stream of co-working spaces could be impacted the most in the office space leasing segment, if they have to follow physical distancing norms for a significant time. As they may be forced to reduce the number of seats to achieve this, their revenues would go down.
The organized retail segment, mainly comprising of shopping malls is the worst affected asset class. Due to the closure of malls even before when the countrywide lockdown started, it has severely dented their revenue streams and are now finding themselves in a situation where they are uncertain when they can start their operations again amidst the growing popularity of e-commerce industry.

Mall operators generate almost entire income from lease rentals received by the tenants, now as the tenants have not been able to generate any revenue they are unwilling to pay rents. Depending on the type and conditions stipulated in the lease agreements the tenants are trying to enforce clauses like force majeure to get out from paying rents during the lockdown period. Rental expenses form a sizeable share of 12-16% of revenues for retailers; therefore, all tenants are likely to negotiate for waiver/rebate of the rentals.

It is believed that the rental income of the mall operators will be impacted in the near future. Even after the resumption of operations, the footfalls are expected to be muted; therefore, the financial position of the tenants will continue to be stressed. This would hamper the debt servicing ability of the mall owners. Those mall operators which have a clause of revenue share in the lease agreements with most tenants, it is more likely to witness a faster revival of income compared to those on fixed leases.
Hospitality Industry

This sector would eventually make a comeback as the coronavirus cases reduce and we move closer towards a cure for this disease.

Along with retail, the other most affected real estate asset class is hospitality. Due to lockdown, all international and domestic travel has been banned. Even when the lockdown is lifted the people would be wary of going out to different places for holidays and can even try to avoid business travel. Advancement in video conferencing technology would further discourage the people from non-essential travel. People would be looking for saving money, rather than spending them on vacations to far off destinations. All these factors make the revival of the hospitality industry post lockdown challenging.

Post lockdown, once the COVID-19 threat reduces a bit, this could be a fruitful opportunity for investors and buyers looking for stressed hospitality assets. If they have the funds to carry on the operation and maintenance and of these properties for some time to come, they will be in a position to earn a handsome return on these investments.
Due to lockdown, the industries throughout the country were shut down for a significant time. This has resulted in significant loss of revenue. Some businesses can decide to liquidate their non-core real estate asset. This can include industrial plants which have been performing below par. Also some of the industries may find it difficult to get funding in the current market and may have to sell off their assets. This can result in supply of industrial land in the estates where there was no supply previously. Also some companies can decide to lease out their plot for extra income.

Logistics and Warehousing is another such asset class, which has been performing well and would continue to perform well in the future. Ever since the growth of e-commerce, the demand for logistics and warehousing has grown exponentially. It was evident during this lockdown that people would embrace online shopping even more, thus the demand for warehousing should go further up. It can be a possibility that the industrial plots near urban centers may get converted to warehouse and cold storages.
Government Initiatives

The government announced to create a fund of INR 25,000 Cr. for completion of stuck Real estate projects in the country, in November 2019. Then in Budget 2020, the government announced certain initiatives to further promote affordable housing in the country. But as these initiatives started taking shape India got locked down due to the current pandemic.

Since lockdown has been announced, two more favorable initiatives have been announced by the government:

RBI has announced measures to boost liquidity into the system by reducing the reverse repo rate, to encourage the financial institutions to lend money to corporates. It also announced an additional Rs 50,000 crore through targeted long-term repo operation (TLTRO) and another refinancing window of Rs 50,000 crore for institutions like Nabard, National Housing Bank, and Sidbi.

RBI has allowed NBFCs to extend the Date for Commencement for Commercial Operations (DCCO) in respect of loans to commercial real estate projects by an additional one year if the projects get delayed for reasons beyond the control of promoters.

Apart from this the Government Notified Exclusion Of The Lockdown Period From Insolvency And Liquidation Processes. As per this notification any activity under the Corporate Insolvency Resolution Procedure cannot be undertaken during the lockdown period. It states that activity under the liquidation process that cannot be completed during lockdown is excluded from calculation in the time-line of this process. The government had suspended the provisions of the Insolvency and Bankruptcy Code (IBC) for six months & suspension can be extended for one year, given the present financial situation due to coronavirus. This has given a big relief to the corporates as well as the real estate sector.
The Indian real estate industry was already facing strong headwinds for the last few years before being decimated in the light of the current pandemic. The impending danger, that one might perceive, posed currently could be the onset of an inevitable structural reform that has been long coming that could catapult India’s position in the global real estate arena. Our analysis has indicated that the real estate sector in India would witness a change in trends backed by innovations and new strategies.

Such changes would occur owing to the recent behavioral transitions, which have been classified into Social Distancing, Risk Aversion, and Shift in World Order. We would be discussing each of these and elaborate on the impact they will have as we start to inculcate the new standards of normalcy.
Social Distancing is here to stay and it will have the largest impact on the hospitality industry as travel will predominantly be need-based. However, it must be noted that the budget hotels in the star to three-star categories will be the first ones to recuperate, given they strictly follow the hygiene measures. Another segment that is going to bear the brunt is Meetings, Incentives, Conferences, and Exhibitions (MICE) as the seminars and events have already started to operate online. For the same reasons, the real estate demand in the education industry will also plunge but the universities might provide their excessive spaces for incubation activities. Banquet Halls may also find lower event volumes and see decline in profits.

Work from home might indicate a fall in office demand but it will only be marginal as ‘per person’ space requirements in workplaces are going to increase significantly owing to safety measures. Furthermore, the data centre REITs will be doing relatively better on the international level. As people will increasingly rely on home delivery, the negative impact on retail assets might force the re-positioning of malls as leisure destinations but will drive the demand for managed warehousing.

Also, the revenue-sharing model for retail leasing will be the unanimous choice of both lessor and lessee. The stakeholders of co-working and co-living segments, which once seemed to be the future of the millennial lifestyle, might have to contemplate moving back to the drawing boards. Needless to state, the demand for healthcare spaces will see robust growth, which was never able to catch the attention of our industry.
Risk Aversion measures will be observed on a variety of scales, starting with city planning. City managers will have second thoughts on modern-day concepts such as compact development, transit-oriented development, etc. as each aspect of city planning (especially transportation, housing, and commercial) will require solutions. It is to be noted that infrastructure-led demand and parking requirements will steeply decline.

Also, there will be an increase in investments in affordable housing, farmlands, gold, and equity of large corporations having strong balance sheets. One can also see an increased demand for loans against properties (LAP) but the lenders will be circumspect during disbursements of funds. Now, people will adopt a frugal lifestyle by reducing their spending non-essential items and services. This will have a direct impact on leisure and the second home market.

There will also be a rapid increase in the demand for ‘Life’ and ‘Loss of Income’ insurance policies, thus increasing the cost of ownership of income-producing assets. There will be increased investor interest in non-IT start-ups and ventures, including prime Grade A office REIT and High Street commercial.
The shift in world order will be characterized by a large number of companies relocating out of China, which can be quite attractive for the industrial real estate markets in suburban India. It might also be seen as a silver-lining that a range of global companies are assessing the possibilities of shifting operations from China to India. These are early times to assume the realisation of this influx.

Also, as de-globalization happens in physical terms, exports of the majority of items will reduce and support local production. Eventually, this will bolster the growth of industrial real estate. However, because of overall increase in demand for industrial assets many small industries may face financial difficulties and may see negative pricing pressure due to oversupply through auctions by lenders. It will be interesting to observe a considerable decrease in interest rates, which will have a positive impact on prime leased assets that withstand vacancy pressure.
Expectations in the Indian Real Estate Sector

The central government has been fairly proactive in taking steps to battle the crisis and has tried to provide relief to citizens through various initiatives but the real estate sector in India requires and demands some specific measures. To simplify, these measures have been classified into four categories, namely, Fiscal Industry-specific, Monetary and Avoiding Regressive measures. These have been elaborated as follows.

Fiscal Measures

With the economy at a standstill and shrinking of income sources, it is imperative that an abatement of at least 10% on individual income tax is provided to the citizens. This also surfaces the need to suspend the advance GST, i.e., it should be payable only on receipt of payments and not on invoice.

Also, there is a need for absolute reduction in the GST slabs and removal of the same on essential items. There must also be an exemption on import duties on all the capital goods which are imported for setting up and/or expansion of commercial units. Also, a liberal Amnesty Scheme (with only a 30% penalty) will be welcomed by the industry.
Industry-specific Measures

In the recent budget, a stimulus package of ₹ 25,000 crores was attributed to real estate, but now there is a need to increase this package to at least double the amount. Furthermore, disbursements of such packages must be carried out through more agencies to ensure its swift delivery to the industry.

It will be important that the industry stakeholders sell-off their inventory at discounts and look towards clearing their debts. Another alternative can be the buying of inventory by the government at discounted prices and offering those to government employees.

The developers must be allowed to have a one-time debt structuring on the condition that they don’t launch new projects. Additionally, the banks should only charge interest on only cost (for LAP) and must not be allowed to charge spread for at least six-eight months.

Labour laws could be suspended for FY 2020-21, wherein there is a provision to not deposit Provident Fund (PF) and Employee State Insurance (ESI). It is noteworthy that the government spending on infrastructure development will greatly boost market sentiments and may also kick-start the economic cycle.
Monetary Measures

These are the times when the government pushes money supply into the market and resort to deficit financing if needed. As the interest rates are already low, they must not be reduced further (lower than 6%) to incentivise and mobilise savings.

Avoiding Regressive Measures

The moves to raise liquor prices and taxes on fuel should be avoided as such measures will lead to an increase in inflation instead of reviving the economy. The proposal by the Income Tax Department to impose an increased tax on wealthy individuals is a regressive approach that gives rise to unethical practices of deferring taxes.

Many Leases are getting into a "Litigation" mode. This should be best avoided and the Lessor and Lessee must come to revised terms. This will lower the impact of disruption. Banks and Lenders, especially on lease rental discounting should charge interest "AT COST" for at least next 6-8 months. Only deferment without waiver of interest is not a good solution. If the entire industry is shut, lenders can not run the business as usual and at the same profit levels. Some support is required from them too.
Valuation of Assets in the Post-COVID era

It would become challenging to assess the impact on lease rents moving forward once the lockdown is lifted. The rents and capital values would remain the same for a short while once the lockdown is lifted. The valuations done during this time will solely depend on these short-term values and will not factor in the future impact of the lockdown and pandemic. Thus, the values derived during these valuations may not hold in the mid and long term. Also, the Valuation of less liquid and private investments becomes even more arduous with increased market volatility, uncertainty, and illiquidity.

Therefore, valuers must begin assessing for triggering events and potential changes to valuation models and assumptions. Also, site visits will become cumbersome as the property owners will discourage the entry of a site surveyor into their premises. Hence, the day is not far when the valuations are done using data-driven software and the site inspections are done using drones.

Black Olive Ventures (BOV) is a new age "Valuation & Advisory Services" company and is approximately 75 people strong team which is dedicated towards ensuring safety and hygiene standards moving ahead in the post-pandemic era.

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