SECTOR UPDATE

HOT PROPERTY

Expert Call: Plumbing residential properties in pandemic

India Equity Research | Real Estate

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We recently organised an investor call with Mr. Sunil Mishra, MD & CEO, TRESPECT India, a residential real estate broking firm promoted by ANAROCK. Mr. Mishra's key perspectives: i) Demand, which plunged ~72% QoQ to ~13k units in Q2CY20, is expected to recover to ~25k/55k units in Q3/Q4CY20. ii) Q2CY20 absorption does not include sales through digital channels, which could be 12–15k units. iii) Launches are likely to recover to 20–25k units in Q3/Q4CY20 from ~1.4k units in Q2CY20. iv) Customer enquiries (as percentage of pre-covid-19 levels) are now 50–60% in Bengaluru, 25–30% in NCR, 20% in Pune and 5–15% in Mumbai. v) The luxury segment is the hardest hit; however, some are looking for bigger homes as they work from home. vi) Many developers are offering discounts of 5–8%. With green shoots emerging in the property space, we continue to prefer market leaders with low leverage such as DLF ('BUY') and Godrej Properties ('BUY').

Absorption to recover faster than launches

The covid-19 pandemic plunged the realty space into turmoil (refer to ***COVID-19: Bolt from the blue***). Absorption nosedived from ~45k units in Q1CY20 to ~13k units in Q2CY20, and is expected to recover to ~25k/55k units in Q3/Q4CY20. Hence, CY20 demand would aggregate 130–140k units, down 45–50%. Supply plummeted 97% QoQ to ~1.4k units in Q2CY20. With launches expected to be 20–25k units in Q3 and Q4 of CY20, supply for the year would be 80–90k units, down 60–65%.

Green shoots emerging and other interesting takeaways

Key takeaways: i) Q2CY20 demand of ~13k units does not include sales through digital channels, which could be 12–15k units. ii) Sales through digital channels, which made up 2–3% of total sales pre-covid-19, could rise to 10–20% in the future. iii) Some units booked in Q1/Q2CY20 may be cancelled with buyers getting into financial troubles. iv) Customer enquiries (as percentage of pre-covid-19 levels) are today 50–70% in Bengaluru, 20–25% in NCR, 20% in Pune and 5–15% in Mumbai. v) The luxury segment is the hardest hit and faces a hiatus of three–six months before any meaningful activity. vi) The work-from-home phenomenon is driving demand for bigger houses in certain pockets. vii) Many developers are offering price discounts of 5–8%; however, a massive correction in prices is unlikely with industry consolidating and margins already under pressure.

Outlook: Stick to quality

As highlighted in our comprehensive sector report ***Real Estate - The Charge of the Consolidating Brigade***, consolidation is the driving feature of India's property space, and we expect covid-19 to accelerate the process. We expect a gradual recovery in the housing market beginning H2CY20. Developers with reputable brands and low leverage such as **Godrej Properties ('BUY'; TP: INR922**) and healthy office portfolios such as **DLF** ('**BUY**'; **TP: INR202**) remain our preferred picks.

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Covid-19 pummels already weak housing market

The Indian property space has been sluggish since CY13 with demand and supply both a long way down from their respective peaks. At its peak (CY10–12), annual housing demand (across India's top ten cities) used to be 450–500k units, out of which about half came from end-users and the remainder from investors. This had fallen to ~325k units per year in the CY13–15 period and further to ~250k units per year over CY16–19.

With prices declining in real terms over the past few years, most investors have exited the residential property market. The 250k units of annual demand seen over the past couple of years can thus be considered as the 'core/base' housing demand (end users) in the country; this has remained more or less constant over the past decade. This demand is generated by the annual migration of about 5mn people to major cities. The 250k annual housing demand translated into a quarterly absorption run rate of 50–60k units.

The downturn in the economy over the past year had the housing demand submerged in a maelstrom; absorption decreased 8–9% YoY each during Q3/Q4CY19. The trend persisted into CY20 with absorption coming in around 45k units in Q1CY20. Considering that the second half of March 2020 was a near washout due to the pandemic (implying 75 days in the quarter for sales), the absorption is more or less in line with the preceding two quarters.

However, the pandemic almost crippled the market in Q2CY20. According to Anarock, residential sales during the quarter plummeted 81% YoY – from 68,600 units in Q2CY19 to just 12,720 units in Q2CY20. Sales were down 72% on a sequential basis.

Launches too hit a low: only 1,390 units were launched in Q2CY20 compared with nearly 69,000 units in Q2CY19, a YoY crash of 98%. On a quarterly basis, launches fell by nearly 97%.

TRESPECT expects CY20 absorption to be 130–140k units. With about 60k units sold in H1CY20, approximately 80k units should be absorbed in H2CY20: **TRESPECT expects demand to be in a ballpark of 25k units in Q3CY20 and 55k units in Q4CY20.**

On supply, TRESPECT believes it would be difficult to return to earlier levels anytime soon. Launches during H1CY20 stood at ~45k units and are **expected to be 20–25k units each in both Q3 and Q4CY20. Hence, supply during CY20 should aggregate 80–90k units.**

Green shoots emerging

Every crisis has a silver lining. Covid-19 has one too. While demand did fall precipitously in Q2CY20, certain green shoots are emerging. For example, the 12,700 units sold during the quarter do not include the sales through digital channels. With site visits off the table, many developers have explored digital sales tools for sales. The response to such strategies has been encouraging with developers notching up significant sales.

Since registrations did not take during the lockdown and also because it is unlikely that any customer will purchase a house without actual site visit, developers collected a token amount of INR35–100k from each customer that booked units through digital channels.

TRESPECT believes there may still be some cancellations of the units booked through digital channels, but 70–80% of such customers should turn out to be serious; hence, including the digital sales, the absorption during Q2CY20 can go up to 25–28k from the reported levels of

12,700 units. The units sold through digital mediums are likely to translate into actual sales over the next one–two quarters as the lockdown ends.

The other positive bit is that footfall/enquiries have improved with the country gradually comes out of the lockdown. The level of recovery in footfall depends on the severity of the pandemic. Bengaluru, which has been the least impacted among major cities, has witnessed site visits returning to 50–60% of pre-covid-19 levels. On the other hand, site visits in Mumbai—the worst-hit city in the country—are just 5–15% of the pre-COVID levels. Comparable figures for Gurugram and Noida are 25–30% and about 20% for Pune.

A note of caution: Due to the economic uncertainties (loss of jobs, pay cuts, etc) as a result of covid-19, some customers have cancelled the units that they have booked. This is because many costumers are wary about their economic circumstances.

In addition, many housing finance companies (HFCs) have strengthened their due diligence/lending criteria due to which some applicants may no longer eligible for home loans. The HFCs have re-evaluated the creditworthiness of their borrowers and have revisited the maximum amount of loan that they would extend. Consequently, some customers have had to cancel the units booked earlier.

Such cancellations pertain to the units sold in either Q1 or Q2 of CY20. The level of cancellations at 5–7%, though low, is definitely higher than historical levels.

A plausible but hard to prove reason for cancellations is also the fact that Indians at large do not like to default on housing loans due to cultural considerations.

Luxury segment hardest hit; some want bigger homes too

The dislocation in sales, as a result of covid-19 has been the highest in the luxury segment. The bulk of sales that happened in Q2CY20 are in the affordable segment. This is because many customers are rethinking bigger-ticket size purchases. Consequently, luxury-segment sales are likely to face a three–six-month hiatus.

This is a continuation of a trend that has been visible over the past few years. For example, around 71% of sales in MMR in the last six–nine months happened in the extended suburbs i.e. in the regions beyond Vashi, Thane or Borivali, and were in the range of INR3.5–5mn. Sales in the Thane city have slid over the past year or so. A significant portion of sales is now happening beyond Thane, in regions such as Kalyan and Dombivali.

At the same time, with people confined to homes for the past couple of months, many have realised the importance of house ownership in general (compared with renting one) and of bigger unit sizes in particular. In fact, a survey conducted by TRESPECT indicates that 15–20% consumers now want a bigger home. This runs in the face of the other trend of a preference for more affordable units. That said, most consumers that want bigger homes are largely employed in the technology sector and are likely to work from home for an extended duration (maybe till end-CY20).

Pricing comes under pressure

Over the past few years, prices have increased marginally. Price appreciation has been 2–3% per year, which has been lower than inflation. In real terms, prices have corrected.

In this backdrop, covid-19 has come as another dampener for the realty industry. At a time when demand was already weakening, the disruption meant that many developers were left with no choice but to enhance the value offerings to customers. This was done through: i) price cuts; or ii) freebies; or iii) deferred payment plans, or a combination of all three. While negotiating with customers, many developers have reduced prices by 5–8% through a combination of the measures listed above.

Nevertheless, TRESPECT does not expect a major decline in prices. While the extent of price correction may be higher at 15–20% for certain micro-markets in a particular city (likely plagued with oversupply) or certain developers (which may be facing cash flow issues), it is unlikely that prices in the broader market would correct so much.

Part of the reason is that raw material price appreciation over the past few years has already eroded margins for developers, reducing the scope for meaningful price cuts. Another reason is that due to market consolidation, a significant amount of sales is happening from larger and organised players, which have strong balance sheets and are not facing cash flow issues. Hence, they are unlikely to reduce prices.

Other takeaways

- **Digital channels**: Digital mediums have come in handy for developers during the pandemic; hence, they are likely to become an integral part of the sales strategy going ahead. Their share in sales was 2–3% prior to covid-19, which is now likely to rise to 10–20% over the medium term.

Our take: How our coverage universe would pan out

We believe activity in the housing segment will remain muted in H1FY21 and a bounce-back would happen in H2FY21.

Over the medium to long term, we expect: i) consolidation in the realty space in favour of organised developers to gather pace; and ii) rising capital intensity of the business, credit crunch and focus on execution are likely to aid developers with strong balance sheets and established brands. Developers with robust balance sheets will also benefit from attractive business development opportunities. Overall, we expect stronger players to gain market share going ahead.

Our preferred picks are Godrej Properties and DLF.

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Coverage group(s) of stocks by primary analyst(s): ***Real Estate***

Brigade Enterprises, DLF, Godrej Properties, Oberoi Realty, Sobha Developers, Sunteck Realty Limited

Recent Research

Date	Company	Title	Price (INR)	Recos
29-Jun-20	**Sobha**	Ground reality: Focus on cash flow; *Result Update*	218	Buy
29-Jun-20	**J Kumar Infraprojects**	COVID-19 fallout: A near-term blow; *Result Update*	93	Buy
26-Jun-20	**Real Estate - Hot Property**	Housing segment: Marooned by pandemic; *Sector Update*		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240

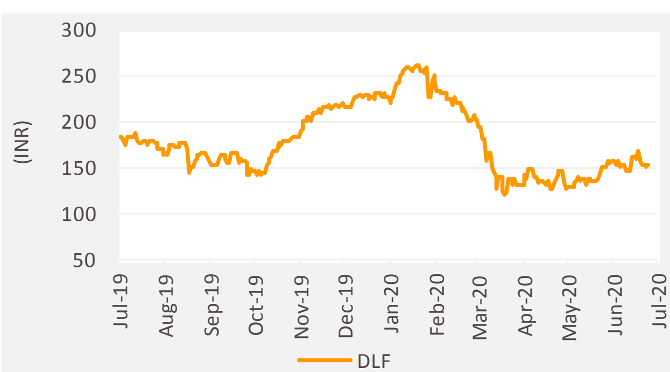
* 1stocks under review

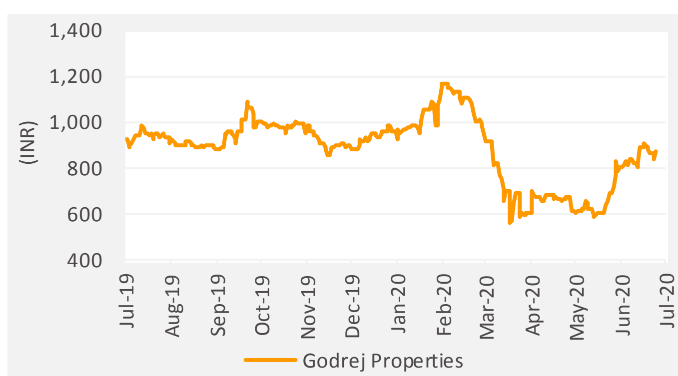
	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price cbart





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