

CASE STUDY

MUMBAI'S REAL ESTATE HOUSING PRICES STUBBORNLY HIGH DESPITE SLUMPING DEMAND

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A country's economic performance has direct repercussions on the dynamics of various markets, especially real estate. Over the last few years, various economic issues have declined the overall demand, specifically in the residential sector. Absorption rates have stagnated, causing high levels of overhang across all major cities, with Mumbai being the worst hit. Customers are waiting for a more profitable scenario, whereas developers largely remain in "wait and watch" mode without lowering prices. Interestingly, this decrease in demand has not lead to decrease in prices, which is otherwise suggested by the micro economic theory of price demand and supply.

Keywords: *Indian Real Estate, Demand-Supply Curve, Indian Metro City; Mumbai, Microeconomics, Prices.*

INTRODUCTION

It's a warm Sunday afternoon, and Mr. Goel is enjoying a nice cup of tea, in his plush South Bombay Villa. A real estate regulator by profession, it is not very often that he has such free time in hand. Skimming through today's Economic times, an article on current real estate scenario catches his attention which reminds him of one of his most challenging and unique ongoing case that rejected a well-established theory. This peculiar case was presented to him by Mr. Mahesh, head of M&M Developers, Mumbai. He remembers Mr. Mahesh being a strong hold person who came seeking advice for a business problem.

Mahesh is a 50 year old business head of a successful construction company. In his long spanning career the pace of development of real estate in India has jumped leaps and bounds, successfully luring the foreign investors on top of the domestic investors, reasons being the large population base, rising income level and rapid urbanization. He has witnessed the metamorphosis of real estate from being unorganized to a charismatic, industrious and systematic sector. The regulatory policies have been contributory in envisioning the need for infrastructure development to establish better standards of living for the people [1].

He is optimistic that the sector would grow further in near future due to huge number of Non-Resident Indian (NRI) investments. In his recent reads of an industrial survey conducted, a 35% increase in enquiries related to NRI investments with property dealers was noted. Also, attractive valuations have led to the advancement in Private Equity funding. The survey concluded that the real estate sector in India has reaped sufficient growth over the years, thanks to the induction of new Government policies that support investment in this sector. This positive scenario encouraged him to expand his business.

THE REAL ESTATE SECTOR IN INDIA

It was primitive for him to study the real estate sector in India for business expansion. After reading numerous articles and journals he understood that real estate is one the most acknowledged sectors of all the global sectors. After agriculture, it is the second largest employer in India. He read that the real estate sector is subdivided into housing, commercial, retail and hospitality. The key drivers for demand in housing real estate include emergence of nuclear families, rapid urbanization, rising household incomes, government schemes, policy initiatives and regulatory reforms.

He found that the Indian economy slowed down during 2012-2014 and the GDP growth rate stagnated, and gross fixed capital formation (GFCF) and industrial production slowed down. This downturn contributed to inventory "overhang," in which supply exceeds demand but prices remain high. Post 2014 it recovered to become

the fastest growing economy in the world, and was estimated to maintain the momentum with 7% plus GDP growth rates over the next five years. The real estate market was about 126 billion USD annually in the year 2014-2015, and was estimated to be about 180 billion USD by 2019-2020. Share of housing real estate sector in India's GDP being 5-6%.

He also came across the reforms introduced by the government of India in this sector that brought about transparency, stimulating foreign direct investments (FDI) and hence reducing the gap between supply and demand. Reasons for high demand for housing real estate is attributed to robust demand, increasing investments, policy supports and attractive opportunities. Some of the major issues prevailing the sector for a slump in demand are unsold inventory, higher interest rates and credit growth, weakening of Indian rupee, lack of credit, lack of transparency in the sector, land acquisition, lack of focus on enhanced transit systems and green construction practices etc.

The development in the sector has been encouraged by the Government of India by introduction of schemes, policies and regulatory reforms. Some of the schemes were affordable housing (Pradhan Mantri Awas Yojana), Smart city mission, AMRUT (Atal Mission for Rejuvenation and Urban Transformation), HRIDAY (Heritage City Development and Augmentation Yojana). The various policies included REIT (Real Estate Investment Trust), its implementation drew more investments in the sector, relaxation

of FDI policy etc. Implementation of such schemes and policies lead to an improvement of customer perception about the sector and thus lead to an increase in demand.

In his opinion, real estate is a complex and an opaque market, which depends on several price factors like interest rates, rental yield and transaction volumes etc. Demand in general is one of the key factors in increase or decrease of the prices of any commodity. The property demand depends on positive economic growth, job and income prospects and lower property prices. The demand is high due to strong population growth, rise in nuclear families, continuing urbanization trends and improved regulatory framework. Over the years, economic growth has improved but the property prices have remained high and unaffordable to end customers, hence postponing purchase decisions, reason being increase in cost and time incurred in land acquisition and increased construction cost. Hence a decrease in demand was noted in this sector. A decreased demand for Real Estate, will cause rents and prices to decline, move people into more spacious accommodations, cause market segments that cannot compete to abandon or demolish improvements, and will remain in this state until demand once again increases.

In housing real estate, demand for a particular area is inversely proportional to its supply. Limited supply in housing real estate causes the prices to increase. Conversely an oversupply leads to a decrease in the prices. A balanced market, i.e. at equilibrium

would work well for both the buyers and the sellers. Factors that determine the supply in real estate are supply of real estate property, price of property, availability of land, efficient builders, easy accessibility of credit and skilled labourers. Changes in the supply are caused by cost of production, new technology, new construction and demolition.

According to the studies, in the year 2014, a sharp decline of about 30% was observed in demand in the seven major cities in India. This is mainly attributed to high prices, higher interest rates and cautious buyer sentiments. The developers responded to the decrease in demand by reducing the supply whereby there was a 25% decline on a year on year basis. The decline was reported in the premium and high end/mid end business segments, was observed across all the major cities, steepest in the NCR.

A hustle on the street brought Mr. Goel's attention back from his thoughts. Disturbed by the noise around, he moves to his study room upstairs. Dressed in a crisp white kurta-pyjama, he comforts himself on his favourite leather recliner and remembers the day when Mr. Mahesh called him regarding his business problem. He sounded worried for his business expansion venture. In their meeting scheduled next week, Mr. Mahesh presented him with his study of demand-supply and prices of real estate sector and observed unusual behaviour wherein despite slumping demand, there was still a rise in the price of real estate housing sector in regions of Mumbai. This study came as a surprise to Mr. Goel and promised

to revert back after his analysis.

CASE STUDY: MUMBAI

The report stated: The study is carried out by formulating data for year 2012 to 2015 for the Central Suburb and South Mumbai region of Mumbai. The demand supply quantities are obtained from Knight Frank report [8], which specifies year wise launches and absorption in the market. The prices of these demands are obtained from trends observed by 99 acres.com [9]. This when plotted with the respective demand and supply leads to the depicted plots.

The financial capital of India has a population of 12 million that is growing exponentially by +1.13% since 2011 [10]. It is one of the top ranked cities in the world for residential investments. Starting in 2012, India entered a period of more anemic economic growth, with growth slowing down to 5.6%, and this eventually affected the demand supply relations of the residential property market.

Between the years 2012 and 2015 the demand in the city decreased by 27%. This decrease in demand, subsequently affected the supply of the market, wherein supply exceeded the demand leading to a rise in inventory. The unsold inventory increased to 31% for 2015-16 wherein around 85,000 flats remain unsold. The prices increased by 27% between 2012 and 2015, with a decrease in demand from 85,978 units to 62,581 units [8; 9; 13]. This downward shift of demand from the equilibrium, has incidentally observed an increase in prices.

There is a huge reduction in the new project launches to overcome the slowdown in demand. In second half of 2015, 23% less or 20,776 houses were launched, compared to the same period last year, demand shrunk by 6% to 34,135 houses in this half. Developers in the peripheral markets are the most concerned. Many new project plans were stalled in second half of 2015. The Peripheral Central Suburbs and Navi Mumbai are the worst hit, seeing launches lower by 44% and 59% respectively, as shown in Figure 1 and Figure 2 [8; 13].

South and Central Mumbai markets are critical for the industry because of their value. Even though they represent just 3% of the Mumbai's unsold inventory volume, they contribute a massive 29% to its value. Mumbai has an unsold inventory worth Rs. 2020 billion, of which Rs. 595 billion is in the Central and South Mumbai markets and is shown in Table 1, Table 2 and Figure 1, Figure 2 [8; 13].

New infrastructure projects such as roads and metro networks that were announced in 2015, couldn't quite boost the residential market, due to weight of rising construction costs, demand-supply mismatch and slowly paced infrastructure growth. The festive season in India that includes September, October and November sees better sales as compared to the rest of the year as they are considered auspicious for property transactions. 2015 was the third year in a row that the number of homes on sale fell [14]. A sluggish economy and fear of job losses resulted in uncertainty and weak sentiment. New launches depend on what kind of customer

response developers expect. Since the sentiment remained weak for more than two years, the numbers of launches were fewer [14]. The city has been witnessing an overall slowdown. Mixed market sentiments, anticipation of change in government and general national economic slowdown altogether affected the demand and supply in market.

Table 1: Central Suburb Region: Demand Supply Price 2012-2015 [8; 9; 13]

Years	Demand	Supply	Price
2012	7738	12160	11135
2013	6668	7646	12450
2014	6136	6858	13430
2015	5784	4363	14520

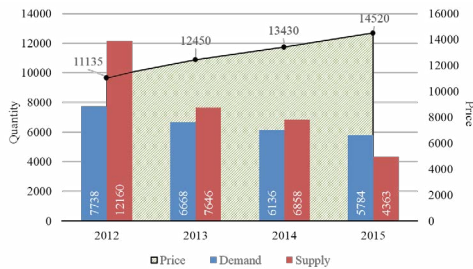


Figure 1: Central Suburb Region Demand Supply Diagram 2012-2015 [8; 9; 13]

Table 2: South Mumbai Region Demand Supply Price 2012-2015 [8; 9; 13]

Years	Demand	Supply	Price
2012	688	973	38590
2013	593	874	41990
2014	542	498	44500
2015	445	317	48110

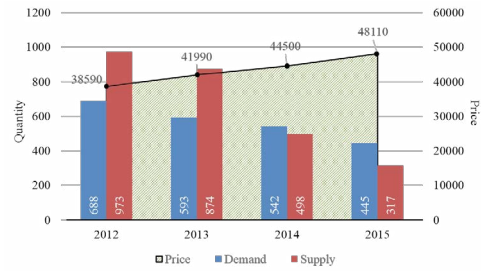


Figure 2: South Mumbai Region Demand Supply Diagram 2012-2015 [8; 9; 13]

SUMMATION

Mr. Goel identifies that Mumbai’s real estate housing sector does not follow the Demand-supply curve. He educated Mr. Mahesh that according to the demand-supply curve, the price of a commodity whose demand is decreasing should also decrease, but the case studies depict the opposite trend. The prices for residential sector have escalated over the years despite a decrease in the demand. The price of the housing unit cannot be determined using this micro-economic theory. The price of a housing unit depends on multiple attributes such as geographic location of the city, local land prices, resources and differing local government policies. Every city based on its geographical location, has its own reasons to not follow the price corresponding to a shift in demand. Proposing a unified theory that would be applicable for all cities encompassing the varying attributes is challenging.

Deviation from the Demand-price curve is questionable for affordable housings, tier two cities, various income groups or even all the metros. With the memories of the case refreshed, Mr. Goel sat on his chair wondering if he would ever find answers to his questions.

QUESTIONS

- What factors influence demand and supply of Real Estate housing?
- Whether all cities in India indicate the same deflection from the Demand-Supply curve?
- If yes, can the same factors be attributed for the deviation in each city?
- Is there any theory that can be applied to such trends or is there a need for a new theory?
- Which of these commodities and consumer goods will follow the Microeconomic theory and which will not? Mangoes, salt, cars, soap, phones, cosmetics, sugar, electronics, furnishing items, cooking oil.
- What are the factors that lead to the deviation from the traditional Microeconomic theory in Mumbai's real estate housing?

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