VALLUM CAPITAL

The End game of speculation in Indian Real Estate has begun

"We do not care anything for the heaviest storms in these big ships. It is the fog that we fear. The big icebergs that drift into warmer water melt much more rapidly under water than on the surface, "
-Captain Edward Smith, Commander of Titanic, April 1912
Age 62, Experince 32 years, Ex commander Majestic, Baltic, Olympic, Adriatic

VALUENOMICS

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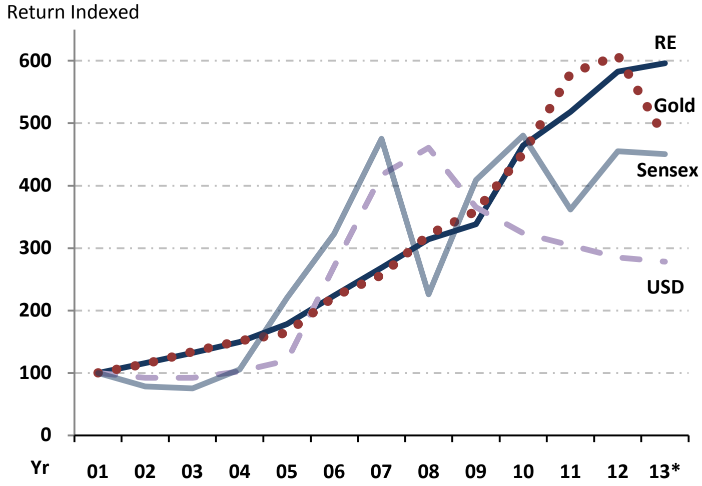
The favorable demographics, acute shortage of housing, easy credit condition and high velocity of illicit money in the economy over the last few years has made Real Estate (RE) as one of the most preferred investment in India. A decade of super turbo charged Bull Run has resulted in Real Estate emerging as one of the biggest consensus investment trades in our society. Real Estate has the highest allocation in the household portfolio. This consensus trade is also supported by multitude of other factors like high inflation, negative return in comparison to inflation by Fixed Deposits, chequered performance of equities, and the ease of investing illicit wealth in the Real Estate sector. The crescendo that Real Estate, as an asset class, will generate positive return under any economic condition has grown louder day by day. The discovery of this elixir by Land Baron's has displaced industrialists and even erstwhile Maharajas, in most of the cities of India. Inadvertently, the "*soaring property prices*" is the key to all the social conversation these days. This unprecedented wealth creation in such a short span of time is baffling and perplexing.

A recent survey by ASSOCHAM has revealed that 82% of Indian youth finds real estate as one of the safest and preferred investments avenue. Today, Indian Real Estate is one of the most expensive pieces of land in comparison to cross country per capita income. The opaqueness in pricing due to fractured approvals, non standardization of products, dispersed buyers and diversion of cash flow as well as loose regulation has devoided these assets, of rationality in pricing. I am bewildered by everyone's growing belief about the infallibility of Real Estate prices in India.

The term "bubble" refers to a situation where excessive future expectations lead to rise in prices. The "*amplification mechanisms*", whereby, a large increase in asset price is followed by a higher demand, as investors think that further increases in prices will follow. This "super-exponential" acceleration in prices due to a positive feedback (or "pro-cyclicality") leads to formation and then maturation of a bubble, which has happened in case of the Real Estate prices in India.

Real Estate : Highest return among all asset classes



Source : Vallum Capital, NHB Residex

Indian Real Estate is highly priced in comparison to Per Capita

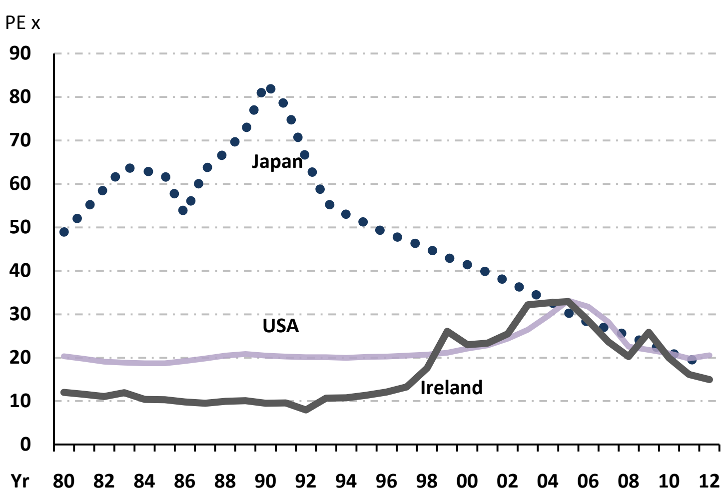
Country	GDP/Capita ($)	Rent Yield (%)	Price/Rent (x)
Singapore	50,714	2.9%	33.9
USA	48,147	4.7%	21.3
Japan	45,774	4.5%	22.4
Russia	13,236	3.6%	27.5
Brazil	12,917	6.3%	15.8
Malaysia	8,617	6.2%	16.1
China	5,184	2.7%	37.6
Indonesia	3,469	9.3%	10.7
Philippines	2,255	8.6%	11.6
India	**1,527**	**2.7%**	**37.3**

Source : Global Property Guide

Multitudes of factors are converging after a decade, setting a stage for a deep correction in Real estate.

The story at our own backyard has all the ingredients of a making of a bubble of a biblical proportion when compared to the Mississippi Scheme, the South Sea Bubble or the Tulip Mania which had hit the world centuries ago. For years, yield on the respective asset class has served as the best indicator of boom and bust of those particular markets. I must remind readers what Keynes said “*Market can remain irrational longer than you can remain solvent”.* We examine multitude of factors, which have converged after a decade and will lead to steep fall in prices of real estate across the country.

Decline of Real Estate Prices in US, Japan, Ireland



Source : OECD

History of Burst of Real Estate in Various Countries

Select Cross-Country (Nominal) House Price Declines (%)

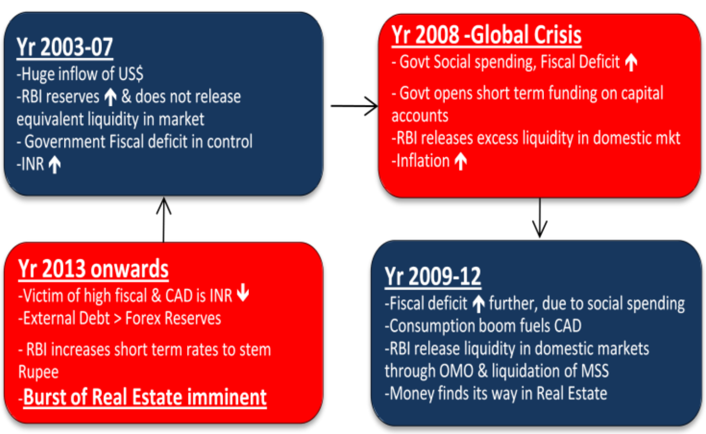
Country	Quarter of Peak	Quarter of Trough	No. of Quarters	Peak-to-Trough (%)
Japan	1991-01	2011-03	82.0	-49.1
Switzerland	1989-04	2000-01	41.0	-25.2
Norway	1988-01	1993-01	20.0	-25.8
USA	2007-02	2011-02	16.0	-16.3
Netherlands	1978-02	1982-02	16.0	-32.8
Ireland ^	2007-03	2011-03	16.0	-44.2
Finland	1989-03	1993-02	15.0	-36.9
Spain ^	2008-01	2011-03	14.0	-18.2
Sweden	1991-01	1993-03	10.0	-20.9

Source : Central Bank of Ireland

A. The End Game of Expansionary Monetary Policy by RBI has begun:

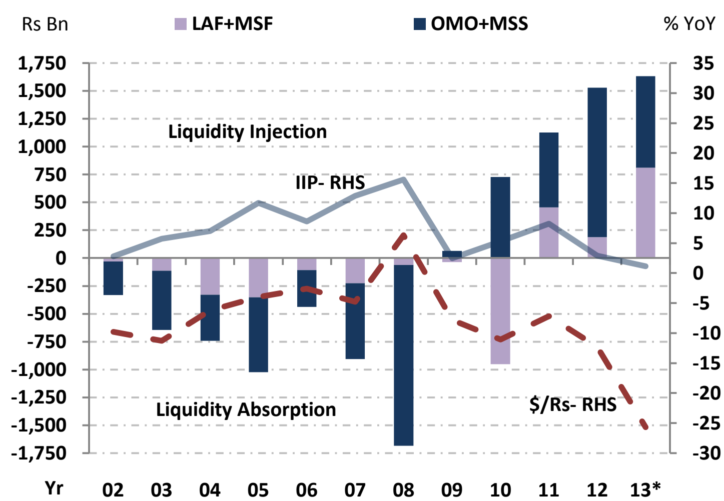
We all are obsessed with Quantitative Easing which has happened in the western world. However, QE in the form of Open Market Operations (OMO) by Reserve Bank of India has gone unnoticed in India. The central bank has periodically used various instruments like Liquidity Adjustment (LAF), Open Market Operations (OMO) and Market stabilization schemes (MSS) for release of liquidity in the banking sector. The period of Year 2004-2007 reflected a lot of inward dollar remittance in the country due to heightened activity. The process of dollar mop up, by RBI, was accompanied by reverse OMO, which resulted in building up of its foreign exchange reserves, thereby keeping a fine balance of checking inflation and currency. Moreover, consequent to global crises in the year 2008 and socialistic spending spree by the central government has resulted in a huge increase in fiscal deficit. *The fiscal dominance of our monetary policy with* overestimation of money supply by RBI by way of OMO, liquidity diverted to domestic markets rather building forex reserves. The money supply (M3) has grown more than 16.8% CAGR over the Year 2004-2013, much ahead than the growth rate of nominal GDP. The excess liquidity, a double edge sword has two victims; runaway inflation and a depreciating currency. We estimate a total of $133 bn worth of additional liquidity came into the banking system during Year 2008-12, which was unwarranted. Considering, the subdued growth in Index of Industrial Production (IIP) and low capital intensity of services sector economy, the excess liquidity has fueled price appreciation in the real estate sector and driven consumption boom in the country thereby expanding CAD.

Crisis : Life Cycle of Monetary Policy come to full circle



Source : Vallum Capital Estimates

Quantitative Easing by RBI which has led to asset inflation

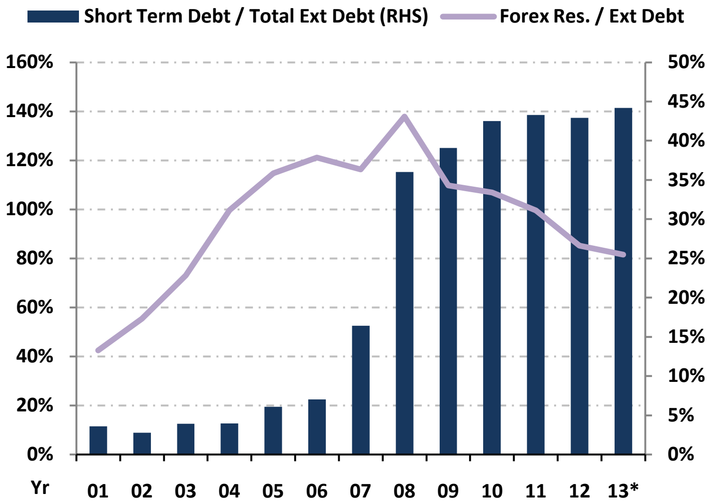


Source : RBI, Vallum Capital Estimates

Now, with rising US bond yields and declining attractiveness of the Indian economy, RBI is forced to make a *reverse* turn on its expansionary policy in order to stem outflow of short term debt and attract further capital. In compulsion to finance the ever increasing CAD, the central bank has accumulated external debt at US$ 390 bn against forex reserve of US$ 280. Now any further depreciation of INR causes more harm due to negative revaluation and interest outflow. The withdrawal of liquidity from domestic markets is an irreversible process for now and signals that interest rate will remain high for considerable period to attract capital till exports recover to support the rupee.

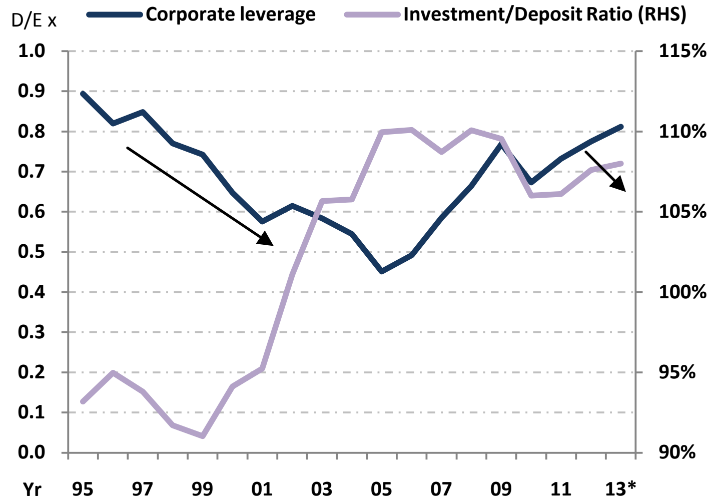
This will hit the real estate sector the most by, scaring away home seekers, pushing away the credit quality sitting on the fence and starts the process of deleveraging in the economy.

Rising Short term debt (on residual maturity) of India



Source : RBI, World Bank

Deleveraging cycle is about to begin by Banks and Corporates



Source : RBI, BSE All Sensex ex IT, Financials, MNC companies (45 in No)

One of the most important proponents of fall in the property prices is likely to start from the **Deleveraging cycle,** by the Indian banking sector**,** which is running a multi decade investment to deposit ratio (108%). The reversal of easy business cycle, scarcity of capital, tight monetary cycle in domestic and international market will force SCB banks to deleverage their balance sheet over the next three to four years. One can observe the same scenario, witnessed in the Year 1997-2003, when deleveraging by the Indian Banking Sector was accompanied by deleveraging corporates that had accumulated huge debts on their books during good times. This augurs a difficult time for the Real Estate Industry, which has witnessed huge inflows during the last decade and set the stage for its correction. The previous deleveraging cycle in year 1997-2003 witnessed price correction by more than 50% in Mumbai Metro Region (MMR) property.

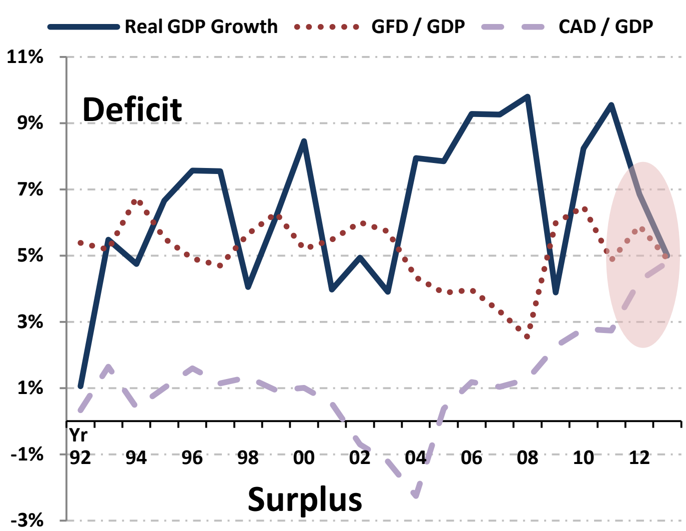
B. Triple FIVE is more powerful than Triple ACE in the game of Macro Economics:

We realized that the Indian growth story was lifted by easy global monetary accommodation, a phenomenon of "*a rising tide lifting all boat"* rather than an exception. The country grew at 8.8% CAGR just a percent more than Emerging Markets (comprising of 150 countries in this category) during Year 2003-2008. As the blip fades, a generation is waking up to a cocktail mix of a five percent GDP growth rate, a five percent current account deficit and a five percent fiscal deficit.

Prolonged mis-governance, severe underinvestment in physical and social infrastructure, disincentives in creating economies of scale in manufacturing and poor policy for substituting import are all reflected in the current depressing economic outlook of the country. We have ushered into an era of low growth, high fiscal deficit, accompanied by lower investments by private sectors and falling affordability of Indians.

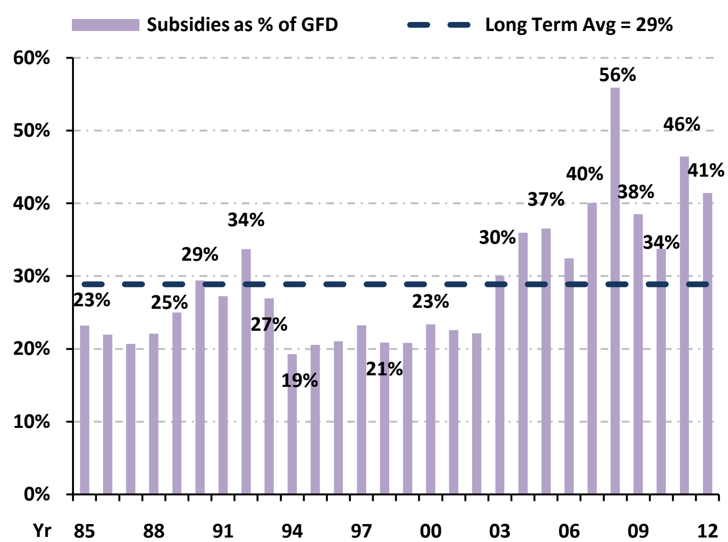
Years of misallocation of the country's resources disguised as uplifting the poor, has created a persistent high fiscal deficit, an irreversible process. The fiscal policies like farm waiver loan, huge pay hikes for government employees, MNERGA to upcoming Food Security Scheme are biased towards consumption purposes rather than productive one. This distorted policy structure ensures that subsidies remain high and all the attempts towards fiscal consolidation look a very distant dream. Today, subsidies accounts for 42% of Gross Fiscal Deficit exactly double of the size of a decade ago.

Trinity of CAD, GDP Growth, GFD is compounding the problem



Source : RBI, Vallum Capital Estimates

Consumption orientation of Subsidies, a Structural issue



Source : RBI, Vallum Capital Estimates

The country has one of the largest absolute Current Account Deficit (CAD) in the world, on the back of consumption boom. This has put enormous pressure on the currency. The problem is further compounded by misadventure on funding of current account deficit over these years by short term inflow by FIIs investment in financial instruments rather long term sources as FDI. The short term debt (on residual maturity) has accounted for 44% of total outstanding debt; up from 15% a few years back. These conditions are *perfect for making* of the Balance of Payment (BOP) crisis. The solution to correct this situation requires rolling back of consumption related subsidies, moving them for creation of productive assets, renaissance of manufacturing and incentives for large scale infrastructure creation and all of which looks a distant dream. In the backdrop of such a challenging macroeconomic environment, it's quite paradoxical for the property prices to hold such a high ground.

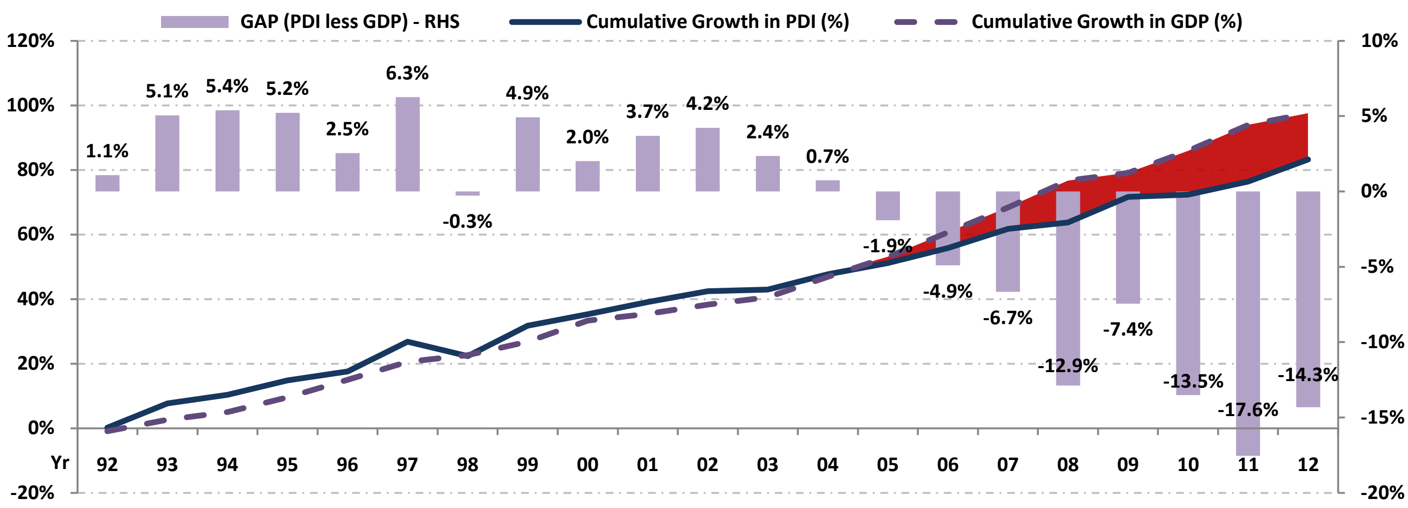
C. Illusion of Affordability of Indians

The decade of Bull Run in the real estate industry has led to one of the largest transfer of wealth from millions of homeowners and investors to a few land barons, developers, speculators and financiers. This reminds me how cartelization by OPEC has led to transfer of wealth from oil consuming nations to oil producing nations over a period of time.

I am quite disillusioned by the argument forwarded by an optimist regarding ever increasing requirement of real estate based on favorable demographics of India. According to an estimate, the country requires 12.0 mn jobs each year to absorb the demographic dividend. The latest NSSO survey regarding job creation paints a grim picture about jobless growth of the economy. Only 4.5 mn regular jobs were created out of the total of 13.9 mn jobs, while balance was created in the casual sector due to Mahatma Gandhi National Rural Employment Scheme (MNERGA) during Year 2010-12, a government sponsored fiscal incentive scheme.

The underlying dynamics of affordability; measured by growth in Personal Disposable Income (PDI) per capita, has slowed on back of high inflation and slow growth. The dismal job addition data also suggest that youth will be either unemployed or underemployed during his prime years of productivity thereby reducing his affordability, significantly.

Growth of Personal Disposal Income Per Capita has declined in last few years



Source : RBI, Vallum Capital Estimates

It is equally surprising to know that tax payers are an extinct species in the growing economy of India. There are only 35 mn tax payers; about 3 percent of population, while only 1.5 mn declare annual earnings of more than a million rupees. There are about 42,800 tax payers with reported income of Rs. 10 mn in a country which has one of the highest real estate prices in the world. This fact clearly indicates that wealth is quite concentrated as well as tax evasion is quite rampant in India. The current real estate price represents affordability of very few, while average users have to sell their twenty years of future earnings to afford a house. With such a grim situation on employment, the on ground reality and the unaffordable real estate price is sure to plummet like a pack of cards, shortly.

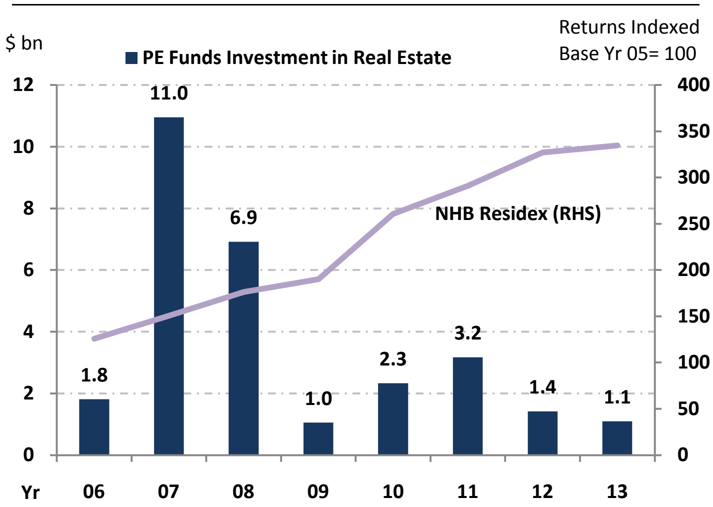
D. Outflow > Inflow in the real estate from 2013 onwards

i) Savior of Developers; Private Equity friends have to leave shore now

Private Equity investments drove in hordes after opening of Foreign Direct Investment (FDI) in real estate sector in the year 2005. The high structural growth story of India attracted a lot of private equity capital the in real estate industry during the Yr 2005-2012, with major inflows coming in the Year 2007-09. Close to $US 20 bn of inflow came to into real estate & construction business, which has put the prices on steroids. Residential Housing projects are funded by advances from customers, except the land and initial approval required to kickstart the project. A back of envelop calculation suggests that a FDI compliant project sale of US$ 150 mn, requires a peak investment (except land and approval) of not more than US $20 mn. The working suggests that developers of residential project do not need private equity money to support the project.

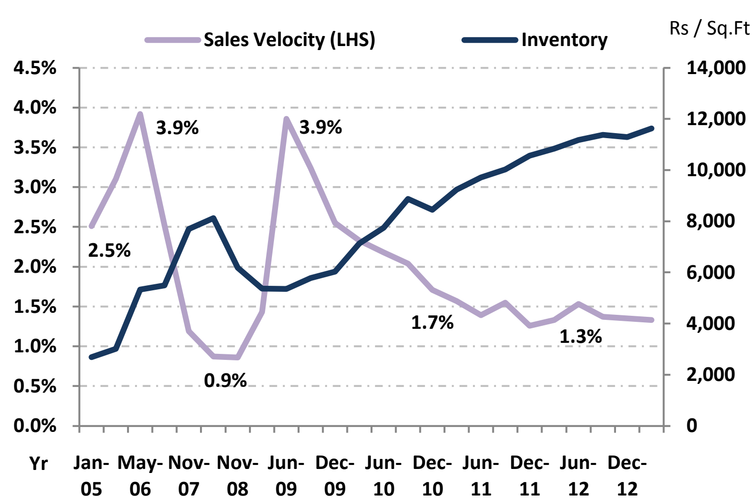
In contrast, the private equity investment is used to fuel the RE prices by creating stock of inventory, diverting money to other projects and investing to build land bank for future projects. This has defeated the very purpose of allowing FDI in real estate sector for making housing affordable to Indians.

PE Funds Investment in Real Estate & Construction



Source : RBI, NHB, Vallum Capital Estimates

Sales Velocity is low and Inventory is highest in recent months



Source : Liases Foras estimates, MMR Market

However, with the average life of private equity fund being around 7-8 years, the Year 2013 marks the beginning of private equity returning back to shores. The imperative is to see down inventory and return the capital back to investors. The incremental fund flow in this sector is an arduous task with headwinds from precarious Indian macroeconomic situation. The sales velocity (measured as monthly sale of housing out of total available housing stock under construction/near completion) is at its lowest in Mumbai Metropolitan Region (MMR), used as proxy of state of Real Estate sector in India.

During our discussion with RE industry veterans it emerged that most of Real Estate funds have been deployed at an average $/Re parity of 45 while the exit after seven years is likely to happen at more than $/Re 60, a loss of around 30% in current itself.

The current situation indicates losses for the fund shareholder at various ends like depreciation of rupee with conversion of forex, slow down of sales in residential projects, steep losses in commercial development ventures and impediment in exits of projects to others. The exit of private equity, a fair weather friend of developer, is going to create distress sale situation in real estate industry, shortly. This would lead to depressing price situation for the next 18 months, scaring further fund raising in this sector.

ii) Impending Centre + State Elections = Outflow of Money from Real Estate Sector

The topic of Investment in Real Estate is incomplete without a discussion on its ancillary role as a vault of illicit wealth. The transactions are partly settled in cash for avoidance of tax and identity of the real buyer is disguised. This unique attribute of Real Estate makes it a preferred medium of investing for all constitutes having stashed money and especially to fund election in India. According to various estimates, an election for central government can cost upwards of US$ 5-6 bn, while average state government elections costs around one billion dollar. With impending central and state election in ten states, costing around US $15 bn, Real Estate will witness outflow of money to fund these elections over the next 18 months.

Another interesting dimension on velocity is of graft money and is its linkage to fiscal deficit. My judgment is that it has an inverse correlation (money paid to facilitate favorable decision making in government) to worsening fiscal situation of the country, although I don't have statistical evidence to prove this. The deteriorating fiscal situation results in lower velocity of graft money in the system as government expenditure, has less room to expand while authorities makes serious attempts to fix leakages. The introduction of Goods and Services Tax (GST) and Direct Benefit Transfer (DBT) has become economic imperative under the current stressful fiscal situation. The various expert studies suggest economic benefit of US$ 15 bn and US$8 bn will accrue with implementation of GST and DBT, respectively. The benefit expressed is referred to reduction of leakages under the current delivery model thereby reducing illicit money in circulation. All the attempts for fiscal consolidation (although socialistic approach of government will not allow Fiscal deficit to contract) will result in the reduction of inflow of money to Real Estate, thereby reducing the support prices to this sector.

The chain is as strong as the weakest Link; Initial Strong sales are a misleading indicator

There is no doubt that a perfect picture has been depicted to justify the rise in prices, factors such as the favorable demographics of India leading to ever-increasing demand, scarcity of land in metro and city limits, sustained underinvestment in housing, archaic land laws and the rising input cost for construction are all quite imperfect. The unaffordable prices and poor execution by developers is masked by marketing and advertising blitz unleashed to attract gullible buyers. In fact, it has paid off in few instances, but there is a flip side to this. A lot of hype and buzz is created through an army of brokers, front page advertisements on national media, opening around festive season, entry by invitation, pre launch discounts attracting gullible investors but limited genuine buyers. The parallel to this can be witnessed in the way, pre-release marketing, advertisement, hype and public relation is handled by Entertainment & Movie industry.

First week collection does not reflect the success of a movie

Yr	Film (Rs Crs)	Budget	Collection 1st Week	Collection Life Time	1st Week as % of Life time	IMDB Rating
'08	**Rock On!!**	10	9	27	34%	7.7
'08	**Jodhaa Akbar**	40	22	59	38%	7.4
'09	**Three Idiots**	35	79	203	39%	8.3
'11	**ZNMD**	55	42	87	49%	7.9
'13	**YJHD#**	50	100	190	53%	6.5
'12	**Barfi!**	35	57	106	54%	8.4
'12	**Housefull 2**	75	61	109	56%	5.0
'08	**Ghajini**	65	64	115	56%	7.0
'13	**Kai Po Che!**	30	27	49	57%	7.7
'10	**Raajneeti**	60	54	93	58%	7.0
'13	**Special 26**	42	39	67	59%	7.7
'09	**Kaminey**	35	25	42	59%	7.3
'10	**OUTIM****	28	34	58	59%	7.1
'10	**MNIK***	38	46	73	64%	7.5
'11	**Rockstar**	60	49	73	68%	7.4

Source : ValllumCap Estimates, *My Name is Khan **Once upon a Time in Mumbai
#Yeh Jawaani hai Deewani

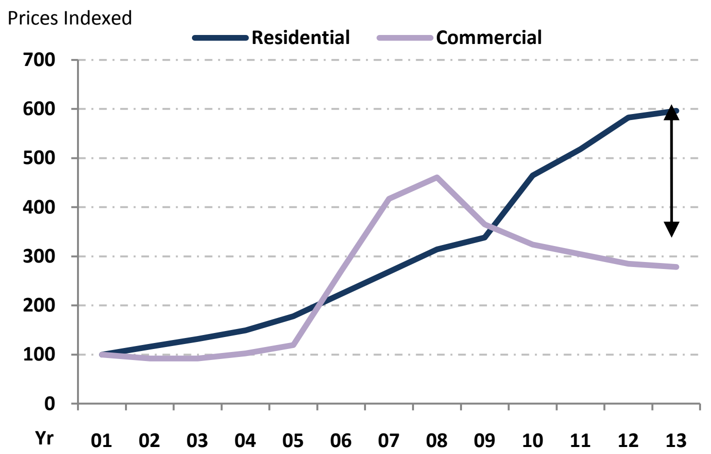
Yr	Film (Rs Crs)	Budget	Collection 1st Week	Collection Life Time	1st Week as % of Life time	IMDB Rating
'09	**MAMK**	40	7	8	93%	3.5
'12	**Tezz**	35	14	15	92%	3.7
'12	**Joker**	40	19	21	92%	2.6
'11	**Mausam**	35	27	30	90%	4.6
'09	**CC to C**	89	26	30	86%	4.1
'11	**Rascals**	45	28	33	85%	2.8
'11	**Ra. One**	177	91	107	85%	4.7
'08	**Love Story 2050**	60	11	13	85%	2.6
'12	**Agent Vinod**	60	37	43	84%	5.1
'10	**Veer**	46	30	38	81%	4.7
'10	**Tees Maar Khan**	28	49	61	80%	2.5
'10	**Action Replayy**	60	23	28	80%	3.7
'11	**Double Dhamaal**	35	36	46	79%	3.9
'08	**Yuvvraaj**	45	13	17	77%	4.0
'13	**Race 2**	60	76	100	76%	5.0

Source : VallumCap Estimates, *Main Aur Mrs Khanna **Chandni Chowk to China

Even a bad movie is able to attract curious onlookers and fence sitter generating sales during the opening week. While there is truth that a bad movie does not see much light beyond the first week, in terms of box office collections; successful movies enjoy a much longer shelf life and a lengthy monetization period. As the word about the poor show spreads, the sales of movie tickets plummet. Quite similarly, the sales of the real estate projects under current economic environment are limited to first few weeks supported by hype instead of longer sales cycle although the project takes 3-5 years to complete. The moral is that however hard developer may sell, highly mispriced product does not resonate economic sense for genuine buyers. According to various estimate, investors account for more than 40% of the sales in Mumbai today.

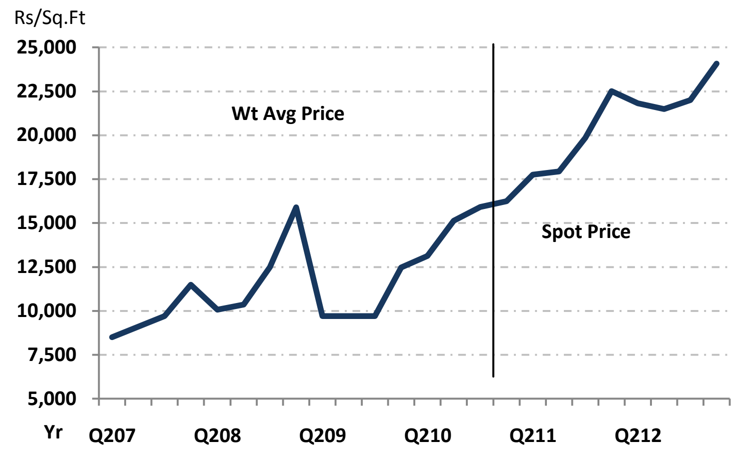
I wonder whether the Real Estate developers realize the imminent end of this Ponzy game leading to a bust of the real estate prices. An artificial sustained price rise, for years, has been created to accommodate investors at each stage of construction and create a greater fool theory. The newly coined terms like 20/80 schemes sounds like developers pleading "*please bail me" now so that you can pay dearly for your foolishness,* later. By designing this scheme, the developers have created a low cost funding model for themselves while passing the execution and financial risk to gullible homebuyers/investors and banks. Let me remind readers that before the Real Estate property bust in Japan & USA, Japanese banks were doling out 99 year long mortgage to home owners, the US mortgage companies extended loans under 2/28 scheme (zero payment for first two years and pay thereafter) a sign of confidence in eternal price stability or rise of the underlying assets

Residential Property Prices scaling new high



Source : NHB Residex, Cushman & Wakefield

A sustained price rise to accommodate investors



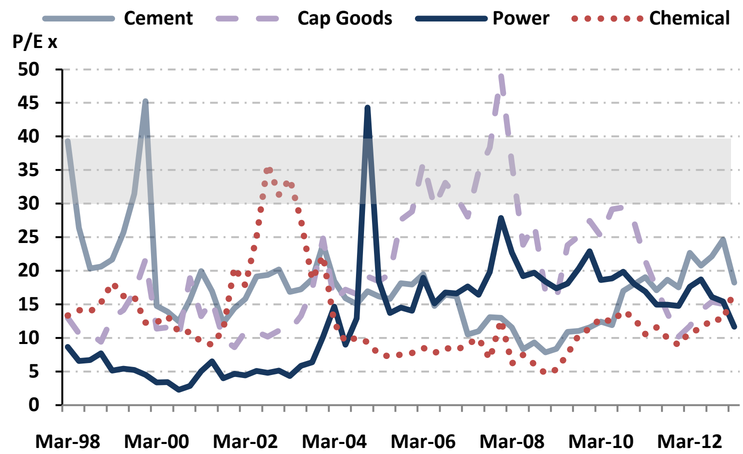
Source : Oberoi Realty, Splendor JVLR Project Investor Presentation

The commercial real estate sector, reflecting the current state of our depressing economy, has shown signs of distress, while residential sector has scaled a new high every day, a major contradiction. Residential developers have increased the prices in orderly manner to accommodate investors at every stage of development thereby creating a false sense of price appreciation for public and investors at large. With a steep slowdown in genuine sales, real estate developers are caught in a tangle of their own ill designed inverted pyramid scheme, where investors sit on top of each other. As first signs of weakness start setting in, investors sitting at the top of this inverted pyramid scheme will panic the most and set downward spiral in prices. The precarious situation will also result in significant drop in prices and clearing of unsold inventory.

History of Investing has never escaped the "Mean Reversion" process

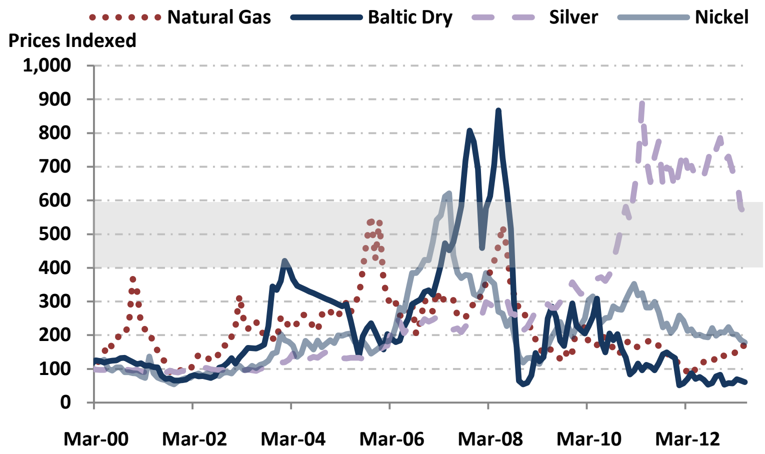
One of the most important tenets of investing is the reversion of prices to its mean. The current residential rental yields are at 2.5% pretax p.a. implying a high level of price to earnings ratio of more than 38x. Indian equity investors have experienced various manias at stock market, like paying for eyeballs during the technology boom, footfall for retail ventures, endless possibilities in alternative energy to rush for investing in lending against gold companies over the last few years. Ultimately investors pay a heavy price for their own irrational exuberance. We have looked at data across various industries, represented in large indices and having trading history of more than two decades. Rise in prices of stocks in Information Technology sector in 2000, Retail & E-Commerce business stocks in 2007, Property developers stocks in 2008, Gold Loan companies in 2012 and a steep fall thereafter, is prime example of the mania which has gripped investors. As the dust settles, the stock declines leaving investors high and dry.

Mean Reversion of PE Multiples



Source : Vallum Capital Estimates

Boom and Bust Cycle of Commodities



Source : Global Prices, Vallum Capital Estimates

The real estate sector is reflecting a similar irrational exuberance with the expectation of a sustained price rise. As per RBI data, currently two third of Indian household savings is invested in physical assets like Gold and Real estate. The data by RBI is inconclusive as it does not explain what all is included in real estate and how investment in barren land is treated and accounted. I am sure that the size of investment in real estate is manifold than reported due to velocity of illicit wealth in the system. Hence, Household runs a significant risk of erosion in wealth with significant drop in prices of the real estate.

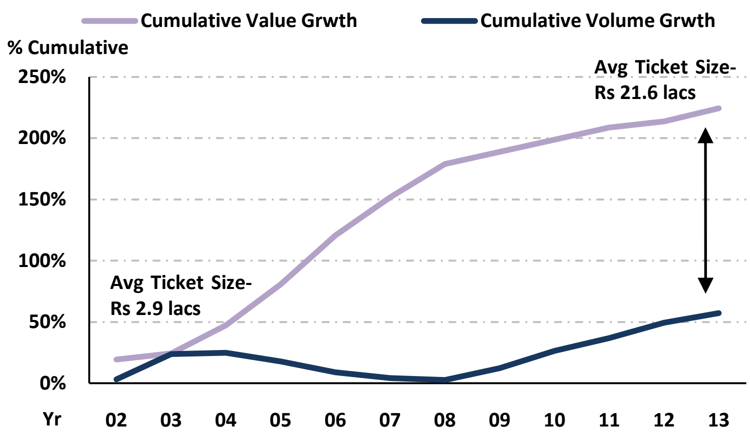
I am equally aghast by the attitude, that people are willing to pay heavily for expert advice, especially when an expert appears on Media, gullible crowd treats his advice as a free lunch. The seer sucker theory by *J Scott Armstrong published in Technology Review, June/July 1980* indicates that expertise beyond a minimal level is of little value in forecasting change. This theory advocates that expertise breeds an inability to accept any new idea, search for disconfirming evidence to look for contradiction. As I see, today there is no dearth of experts from Housing Finance Companies, Developers, Real Estate Consultants of repute, dishing out advice of ever increasing real estate prices in the country. My professional experience in investing has taught that one can gain more by disbelieving experts rather than listening to them. I would suggest that real estate participants should develop distaste for expert advice.

The yield on investment is the prime determinant of the fair value of any property. The current yield is far lower than the cost of capital or alternative safe investment avenues available in the markets. Investors are accepting the low current RE yield, a third in comparison to financial instruments, in anticipation of a price rise in the future. Here expectation risk stares at us wide open. As discussed, the multitude of factors converges, over the next 18 months, resulting in the collapse of the Real Estate prices. **It is going to witness price correction of more than 40% and thereafter time correction (loss of opportunity cost) for further 4-5 years, leading to huge capital destruction of participants. During this period, banks will deleverage their balance sheet, stomped by losses investors will shy away from further investments while genuine buyers (actual users) would emerge to clear excess inventory.**

“Only when the tide goes out you discover who's been swimming naked” - Warren E Buffet

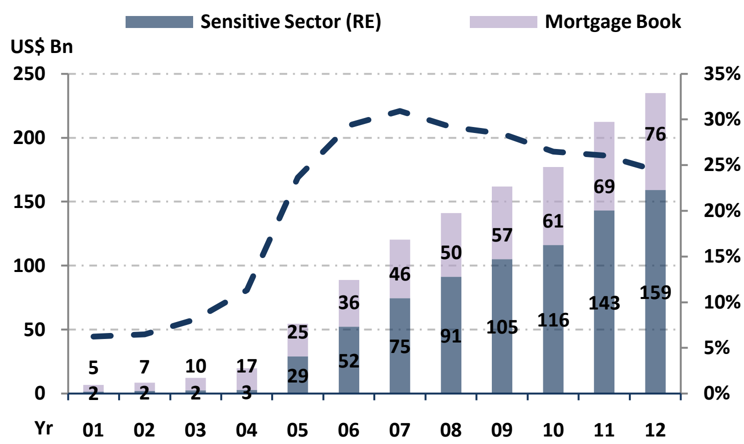
The sustained rise in prices of real estate, misgoverned policy of government has led to huge exposure of financial markets in real estate sector via mortgages, loan to developers and loans to manufacturing & other sectors with real estate being primary collateral. A decade of sustained rising prices in this sector has created an illusion that loan able assets are backed by hard assets, can be liquidated as and when needed and has ready buyer. Retail mortgage Industry has grown at CAGR 22% over the last decade to US$ 76 bn and developers’ loan accounts for 18% (US$ 159 bn) of the total banking advances. Any significant drop in housing prices erodes equity contribution of the individuals but with much higher impact on banks, as leverage plays on real estate prices.

HDFC Sales growth in terms of Value and Volume



Source : HDFC Annual Report

Banking Industry & its exposure to RE



Source : RBI

Investors must understand the basic fact that most of the growth of lenders, over the last decade, is contributed by the increase in the underlying property prices rather than increase in volume. For HDFC, the largest Housing Finance Company in the country, the cumulative value growth has contributed more than 70% of the total growth while balance is volume. With declining affordability, volume growth has not picked up for the Housing Finance Companies and banks. The eventual burst of the property puts significant risk to their business model which has gained over the last decade due to rising property prices. It’s commonly said that developers’ liabilities are not fully reflected on their accounts statements. Lending by NBFCs and private sources (HNI, Structured financing, NCD structure etc) is also quite large and has deployed significant capital in the real estate markets. The notional wealth created by property appreciation has triggered a widespread consumption boom in TIER II/III towns of India. The total sale of super luxury Vehicle (AUDI, BMW, and Mercedes) has increased more than seven folds during the year 2013, a sign of rising conspicuous consumption in India. The rising retail loan portfolio of the banks is also reflection of wealth effect of the country. Companies and Institutional portfolios invested towards the consumption theme are at a significant risk because of the impending burst due to decline in property prices.

Time to correct the Priority of the Nation

The misplaced priority of the nation to promote housing by tax sops and hoarding is turning out to be one of the worst policy decisions. Productive resources are sucked into unproductive and speculative assets. The Nation has to ask itself; how big and how many houses an individual would need for living? Frankly speaking, I am yet to find an answer to this. The same so called pro people housing policies have also bereft millions by making home ownership unaffordable relative to purchasing parity. A recent report by Cushman & Wakefield suggests that more than 30% of houses under construction in Mumbai are priced at more than Rs 10 mn/apartment; unaffordable for all standards, for the country which has GDP per capita of US $1500.

As we discussed in the last edition of our newsletter that making dividends compulsory is the only way to bring corporate governance and attract long term investments in equity markets. Similarly, India needs serious introspection for its approach towards affordability of Housing. The measures taken by China and Singapore government to restrict price expansion in the housing sector should serve as a guiding indicator for all the other nations. Policy makers' should adopt some of these measures at the earliest, in order to bring orderliness in this chaotic property market. The time has come to deflate the bubble in order to save financial institutions and individuals and channelize public resources for better productive purposes.

China : Property Deflation Measures

2010	2011	2012	2013
Mortgage loans for 3rd or more homes are banned nationwide. LTV reduced for buyers	Local governments to set housing price targets in line with local income levels for 2011;		
Restrictions on home purchases by nonresidents.	Second home buyers - LTV = 60% & Mortgage Rates = 1.1x BPLR		
A foreigner can at most buy one house for personal residence under the condition of working in China for > 1 year.	Curb speculative investment and expand home purchases restrictions to second and third tier cities.	Seller Stamp Duty Rates were raised to 20% for resale within 6 months, 15% for 6-12 m and 10% for 12-36 m.	Implementation of a 20 % tax on profits from the sale of second hand homes.

Singapore: Property Deflation Measures

2010	2011	2012	2013
Introducing a Seller's Stamp Duty (SSD) on all residential properties and residential lands that are bought on or after 20/02/10 and sold within 1 year from the date of purchase	Foreigners and non-individuals buying any residential property will pay an ABSD (Additional Buyer's Stamp Duty) of 10%	The maximum tenure of all new residential property loans will be capped at 35 years	MAS will cap the Mortgage Servicing Ratio (MSR) for housing loans granted by financial institutions at 30% of a borrower's gross monthly income
		For residential property loans, the LTV limit will be: a) 40% for a borrower with one or more outstanding residential property loans3; and b) 60% for a borrower with no outstanding residential property loan	Minimum cash down payment for individuals applying for a second or subsequent housing loan will also be raised from 10% to 25%. ABSD imposed on PR, Singaporean Residents and others.
			ABSD imposed on Permanent Residents purchasing their 1st residential property &on Singaporeans purchasing their 2nd residential property

I am a firm believer that contradiction exists in the investing world and investors are not pricing in the collapse of real estate prices. Unless government deflates the housing bubble in orderly manner; the aftermath and reverberating effect of collapse by market mechanism will surprise a generations on how a nation was making its way to prosperity by speculating on a piece of land and eventually lost a fortune.

I am available for further discussion and would be glad to receive your comments on manish.bhandari@vallum.in

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