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Property boom is over

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With the festive season underway, there has been a spate of advertisements for new property projects. It is important to examine these bids for funds closely, given the current state of real estate. Unless the sector is brought under regulation, it will mop up funds of a dubious kind. Unsuspecting investors can lose money and there could be a rise in loan defaults.

The rise and fall in prices over two years was triggered by excessive liquidity and speculation, caused by a flow of both white and black money. The cycles in the property sector are a result of its peculiarly unregulated nature. As a result, a hype around property becomes easier to create.

After the norms related to secrecy of Swiss banks were tightened a few years ago, black money flowed into this sector due to the lack of regulations. Vested interests would like the property sector to continue in an unregulated fashion.

The last year has seen real estate prices cool off, especially after the Reserve Bank intervened to increase the cash reserve ratio (CRR) of banks and housing finance companies raised interest rates, realising perhaps that they were instrumental in overheating the market. The easing of interest rates on both loan and deposit sides was a correction that was coming.

Housing finance companies and banks gave undue importance to property, vying with each other to extend loans to all and sundry. They created the belief that money invested in real estate will grow at higher rates than in other investment instruments.

The hype around land banks also fuelled the rush into property. When real estate companies talk about developing land banks, they cannot be taken at face value. If one were to calculate the resources required to develop infrastructure and housing in the thousands of acres which some real estate companies have at their disposal, the figure would suggest that they would need 10-15 years to develop these lands into usable habitats. For example, a company which claims to hold about 70,000 hectares in its land bank will need to invest Rs 100,000 crore to develop it into viable housing and habitat. That is a tall order even for the big guns. The business models of such companies still work on speculative forces of hoarding and reselling.

Even as new tracts are developed in outlying areas, there are acres of bypassed land closer to town, more than what the housing industry might need for years to come. So much for land shortage.

Some of these companies are in a bind. With huge amounts having gone into buying land, they are short on funds needed to create projects for which bookings and promises have been made. Hence, they are divesting equity to generate funds. The IPO route of collecting funds has slowed down.

Foreign direct investment will not come unless land management laws are regulated at the central level. Black money is needed to purchase land. Political interests will prevent meaningful reforms to change the land management system of states. It remains to be seen whether market forces will push for change.

The sector suffers from a resource crunch and oversupply. With speculators moving out and end-users stepping in, prices should drop, except perhaps in the high-end market in the metros.

The US sub-prime crash was caused by too much money going into mortgages which turned into defaults. Will India see a similar crisis in the mortgage market? Are the right products being created for the right end-user? Will the sector move towards the right fundamentals, or will it remain a speculator's haven ?

There are indications of change. The stock market is a more attractive investment option than ever, real estate companies are looking for equity partners, CRR is moving up, interest rates are down, and professional players are moving into real estate sector. The rosy years and months are over. The investor better be careful with his money.

The writer is an architect.