Economy

Liquidity crisis is spoiling the realty party: What the industry expects from Modi 2.0

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- The sector contributes 6 percent of the GDP and employs close to 18 percent of the workforce

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The new government comes in at a time when the Indian economy is amidst strong headwinds emanating from both domestic and global avenues. While election cycles are prone to delay investment decisions and weaken consumer sentiment, this time around, a prevailing liquidity crisis has added to the economic woes by muting private capital spending. The crisis is more pronounced within non-banking finance companies (NBFC) and housing finance companies (HFC) who have significantly reduced lending activity since the IL&FS debacle in mid-September. Additionally, lingering US-China trade war also took a toll on business sentiment and adversely affected Indian exports and foreign investments.

NBFCs and HFCs play a major role in today's credit scenario and account for 17 percent of outstanding loans as per an RBI assessment. Further, it is also estimated that almost 40 percent of the incremental credit was disbursed by NBFCs and HFCs in FY18. Hence, it is critical for policy makers to address the credit crunch faced by these institutions with extreme urgency before it manifests into a systemic slowdown of the overall economy.

Incidentally, real estate is one of the prime beneficiaries of NBFC credit. Hence, it is not surprising that the sector was the most impacted as NBFC credit dried up since mid-September 2018. Indian real estate, especially housing market, after witnessing major upheavals due to demonetisation, RERA and GST was pegging on a recovery in 2018, but the liquidity crisis wilted its hopes. The distress has spread across the entire segment as both developers and end users are scorched for funds to build or buy.

India's real estate sector is of strategic importance to the economy accounting for 6 percent of the GDP and employing close to 18 percent of the workforce. Moreover, the real estate sector supports more than 350 industries in the country and therefore, is of paramount importance as an enabler. We would urge the new government to fast-track measures that would enable NBFCs and HFCs to restore lending to this vital sector. The government should consider dedicated credit windows through state lending enterprises for long term lending to NBFCs to help them evolve from the prevailing asset-liability mismatch issues.

Given the rising scale of distress among housing developers and their deep ties to the Indian consumption story, the government should consider a dedicated lending window for some of the major developers as well. NBFCs and HFCs that are well exposed and experienced in real estate funding can be used as vehicles for managing this window. To prevent issues related to moral hazard, the lending terms can emulate those of similar schemes introduced by US Treasury and Fed during the Global Financial Crisis in 2008 to pacify the economy.

Also, active measures need to be taken to resurrect housing demand. We would recommend measures such as -

1. Reintroducing income tax deduction on principal and interest on a second home loan.

2. Income tax deduction limit on interest paid should be hiked to Rs 5 lakh especially in Tier 1 cities. Similarly, IT deduction allowed on principal paid should be increased.

Now that RERA is proving to be an effective tool in reducing some of the inherent risks within this segment, it is fair to expect a decline in borrowing costs paid by developers. Public sector banks should increase their exposures to the better-managed developers offering less expensive credit. Also, measures to deepen India's corporate debt market should be expedited so that developers can access cheaper funds through bond issuances compared to bank or NBFC credit. Additionally, allowing industry status to this segment will also help them lower their borrowing costs and make it more palatable for foreign institutional investors including PE funds and venture capitalists.

Apart from access to capital, the other major challenge faced by developers are delays in administrative processes, which often derails project timelines impacting demand and business. In this regard, we expect RERA to be empowered to exercise its power over government agencies responsible for approvals/certificates etc. Resolution resulting in speedier administrative clearances would be a significant positive for the segment. A major area which leads to significant delays is land acquisitions. We recommend the government should introduce at the earliest a transparent auction process for land acquisition and accelerate digitisation of land records. A recent study by CMIE indicated that as many as 22 percent of construction projects get stalled due to delays in land acquisition. Within such projects, 67 percent of the promoters identified perceived environmental impact as a key reason.

We feel the Indian economy is well poised for a turnaround assuming the new government addresses some of the challenges discussed above at the earliest, coupled with definitive labour reforms, export promotion and technological innovations within agricultural sector.

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