The Wider Implications of COVID-19 on Indian Real Estate

INTEGRATING RESILIENCE, PRUDENCE & ACUMEN

A HANDBOOK BY

360 REALTORS

Commitment | Honesty | Reliability

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Foreword

Indian Real Estate has been suffering from numerous challenges in recent years such as policy changes (GST, RERA), demonetization & Liquidity crunch. The industry was highly hopeful that 2020 will be a turnaround year where trends will revive.

However, after the lockdown following the outbreak of the perennial Coronavirus, industry activities have come to a momentary halt. Construction activities have been suspended & site visits are not taking place. Everyone from individual buyers to larger corporate is in wait and watch mode. Potential buyers and investors are deferring their decisions amidst these turbulent times.However, after the lockdown the industry is demonstrating some limited yet prudent maneuvering by proactively embracing the digital medium. Meeting in person, physical site visits & payment are being replaced by e-meetings, digital tours & online transactions to control the damage & build in some momentum in otherwise silent market conditions.

Nevertheless, the momentary loss of business is unavoidable, especially in a time that is believed to be very opportune for Real Estate (FY closure, festive season, school holidays, etc.). However, to understand the longitude & latitude of the overall damages done to the sector, it might take some more time.

Moreover, different asset classes will respond individually. In the residential sector, subdued sentiments are visible. Yet in an end-user centric market, positivity will likely be restored shortly after the suspension of the lockdown. As home loans will be cheaper following a rate cut by the RBI, demand should further rise. Developers are also coming up with very attractive payment plans.

In the office sector, bigger enterprises are now deferring their leasing decision. In the future, the demand will rely on how fast the economic recovery unfolds. The downside risk of softening of demand due to poor economic outlook can't be negated completely.

Retail again is facing the heat of a slowdown & this might be prolonged if consumer spending takes a beating. On the contrary, demand for warehouses should pick up fuelled by a possible expansion in e-commerce activities.

Interestingly, other new trends are also emerging amidst the current crisis. As the financial & equity markets are currently very volatile, the significance of Real Estate as a hard asset is restored. Investors are once again looking forward to Real Estate to hedge against future fragility. Especially small ticket size commercial assets such as retail & office spaces with the potential of recurring rental income are becoming the new favorites. Developers are also coming up with new schemes to match the emergent sentiments. Buyers just have to pay a token amount (5-10% of the price) online & the rest can be paid after the lockdown following a site visit.

Coming to the crux, the implications of COVID will be widely felt in the industry. It will not just be limited to linear relationships between demand & supply dynamics. Rather, it will reverberate across the value chain influencing the industry in a multivariate fashion- fundraising to the changes in operational & marketing strategy to the relooking of sales planning.

Few implications will adversely impact the business while other few might have a positive effect in the longer run. Besides, there will be others which might create a new landscape for alternate models to emerge. Industry players who would understand the evolving themes and calibrate their offerings accordingly will mitigate the risks & seize the opportunity. Others might lose their competitive edge.

In these turbulent times adopting changes are imperative, whether one likes or not. The industry has to show resilience, practice prudence & develop the acumen to navigate through changing dynamics. The objective of this Handbook is primarily to give industry leaders perspectives on the current situation alongside offering insights on the knock-on effects & how to organize their thinking & responses accordingly.

COVID-19

Impact on Global Economy

The Perennial Coronavirus that started in the Wuhan district of China has spread like a wildfire across the length & breadth of the globe. Has the deadly virus has taken more than 230,000 lives but it also very badly impacted the world economy. The January- March Quarter is believed to be one of the worst nightmares in world history in recent years, further exacerbated by growing tensions between Iran-USA & a slump in petroleum prices. As per initial research by JP Morgan, the global economy is expected to be contracted by around 12% in this period.

The situation has normalized in China & gradually life is coming back on track. However, in other major economies of the world such as the Eurozone, the USA & India, infection rates are rising sharply Apart from a terrible medical crisis, COVID-19 will continue to undermine economic growth. As major cities around the world are imposing compulsory complete lockdown, economic activities have come to a grinding halt. Amidst such a crisis, a decline in GDP is unavoidable. Countries that rely on tourism & commodity export will suffer the most.

International financial institutions have already downgraded growth forecasts for most of the economies. Central banks in individual nations are in damage control mode to bring in policy changes & manage key macroeconomic levers- monetary, fiscal & structural. Financial stimuli are being deployed to minimize the downside risks of an economic slowdown.

Around the globe, the consensus is being built towards more synchronized actions to contain the spread of diseases & simultaneously offer financial support, especially to SMEs to keep them afloat. As per UN's Department of Economic & Social Affairs (UN-DESA), in a worst-case scenario, global GDP can contract by around 0.9% in 2020. This is drawing parallel to 2009 when the world GDP contracted by 1.7%. However, UN-DESA has also assured that in case of effective usage of financial stimulus & other prudent policies, the overall damage can be largely mitigated with an expected GDP growth of 1.2%.

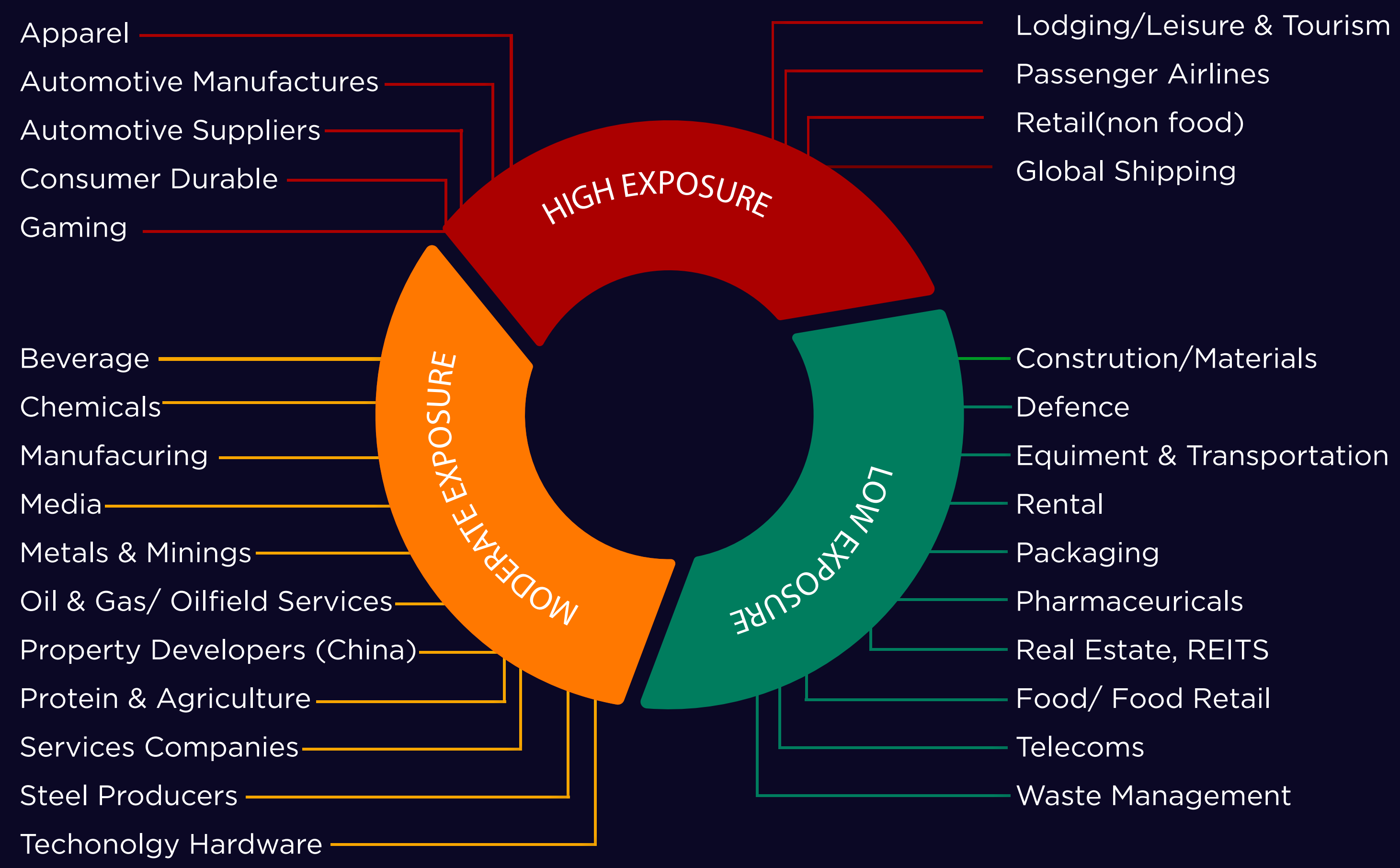
Impact on Major Economies

China	Growth Forecast	1.1%	Industrial output fell by	16%	Unemployment	2.9%
USA	Growth Forecast	- 5.9%	the Unemployment rate is as high	13%		
Brazil	GDP Growth	-5.5%	PMI fell to 48.4 in March			
Russia	GDP Growth Forecast	0.5%	Weakened Investments, Poor Oil Prices further weighing on the economy			
India	Growth Forecast	1.5%	Weakened Private Investments			
UK	Growth Forecast	- 6.5%	Lowest Household Spending since 2011, Contraction in Private Investments			
EU	Growth Forecast	- 7.5%	Disruptions in the supply chain			
KSA	Growth Forecast	-2.2%	Subdued Govt. spending due to poor oil prices			
Australia	Growth Forecast	-6.6%	Fallout from tourism & education sector			

COVID-19

Impact on Individual Sectors of Economy

COVID-19 is a Black Swan, whose negative impacts will reverberate across the global economy, impacting various sectors in some way or another. However, despite early predictions of slowdown, its impact will vary across sectors. Not each sector is exposed to the same degree to the crisis. Sectors such as tourism, international trade, aviation, big retail, etc. are badly hit. On the contrary, sectors such as Real Estate, manufacturing, defense, agriculture, etc. are also facing the heat, but the shockwaves are still limited. There are other sectors such as telecommunication, internet service companies, online retail etc., which are expected to expand in the crisis.



Impact on Global Real Estate

Major International Real Estate markets were recovering in 2019 & the industry was looking forward to an upbeat 2020. Industry Pundits around the world believed that 2020 will be marked by an upturn in demand across the globe- cutting across regions & asset classes. In the USA, at the onset of 2020, it was widely believed that residential & commercial demands will rise due to healthy underlying fundamentals, rate cuts by Federal Reserve, low inflation rates & a resilient economy. Likewise, the industry in the UK also believed in a potential rebound in investment volumes on the back of a low-interest rate environment & the prospect of Real Estate as a viable investment alternative.

In China, the sentiments were muted, as the outbreak began in Wuhan in December 2019. It was believed that the economic growth will dip in Q1 2020. & the downtrend will be visible in Real Estate as well.

After a prolonged crisis, Russian Real Estate finally bounced back in 2019, as investments into commercial & residential Real Estate racked up significantly. Although pain areas such as weak rouble & poor oil prices remained, the industry was gaining momentum backed by low interest rates, steady macro-economic indicators & surge in debt-financing opportunities. The industry was set for further expansion in 2020

In other emerging markets like Brazil & India, a strong domestic demand was driving the economy, thereby dovetailing the Real Estate sector in a positive direction. As these economies were less exposed to downtrends in global economic cycles, the Real Estate sector continued to show moderate growth.

However, the COVID-triggered economic crisis has put the hopes off the pedestal- at least for the time being. Although it will take some time to gauge the long-term impact on the International Realty Markets, in the short run the distress is visible.

As major economies in the world have implemented the lockdown to contain the further spread of the diseases, economic activities have come to a halt. This has also badly affected the Real Estate demands in the shorter run. In order to adjust amidst these turbulent times, the industry is aggressively embracing the digital way- however, its wider adoption will take time.

Few common
Trends are emerging

CUT IN LENDING RATES

Deal Volumes should increase from Q2, due to upside from Fiscal packages, cut in lending rates

ECONOMIC CYCLES

Poor Deal Volumes will prevail in Q1 2020 due to disruptions in economic cycles

RE-STRUCTURING

Cross Border Investments in stressed assets, distress funding & deal re-structuring will increase

INVESTORS

Investors will leverage more protection options such as Force Majeure & Insurances etc.

ONLINE REAL ESTATE

Online Real Estate will pick up- virtual tours, e-meetings & online deal-closure

Impact on
Indian Economy

India reported its first COVID case on January 30th. Going forward, more cases emerged & the rate of infection started widening. In addition to being a pressing medical challenge, the pandemic also started undermining economic sentiments & immobilizing various aspects of the economy. Tourism was one of the first sectors to be directly affected. As tourism was hit hard, the shockwaves started reverberating across the entire value chain such as aviation, travel, food retail, hotel, entertainment, etc.

As the number of cases has risen, by the end of March, the Government. of India also implemented compulsory lockdown. Although a prudent step to contain the further growth of the virus, this has also impacted the economy, which has come to standstill mode with almost no visible business activities.

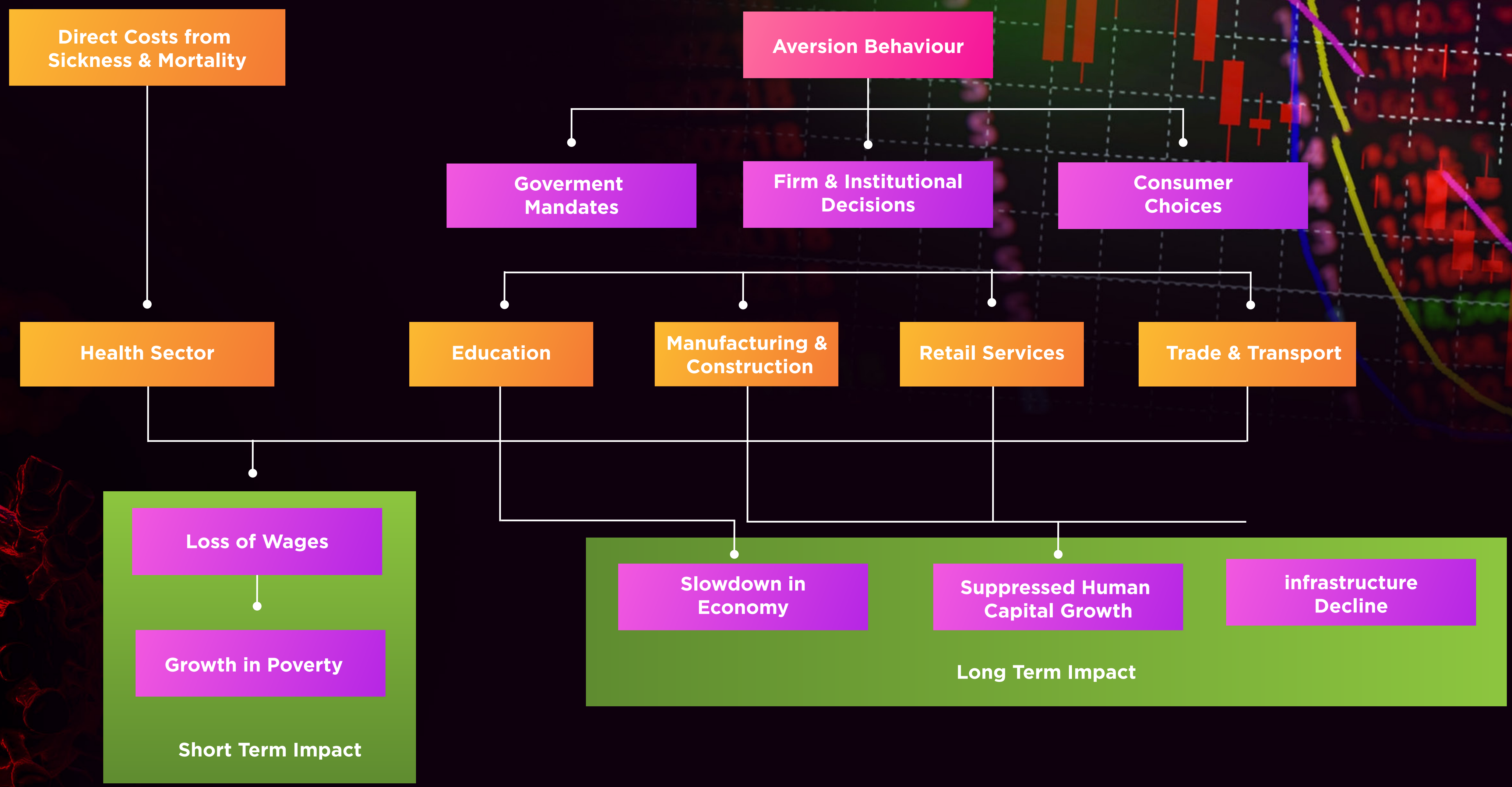
It is not very easy to evaluate to what extent COVID-19 is going to damage the Indian economy at this point, however, growth rates are going to be muted in FY 21. Major financial institutions have downgraded growth forecasts for Indian economy in FY 21.

At the onset of the year, the Indian economy was already facing headwinds. The rate of unemployment was rising, the fiscal deficit was widening & private investments were slowing down. As COVID-19 blew in, the crisis further aggravated.

However, it is also believed in certain quarters that COVID might have a limited impact on the Indian economy. As India has higher rates of domestic demand & is not reliant on the global supply chain, the shockwaves from COVID will be mostly absorbed.

There are also hidden benefits which can be seized. In an aftermath of COVID-19, the global supply chains have disrupted & China might lose its central position in the global flow of goods. Indian manufacturing holds a chance to stepup its game and fill the gap. This can boost the economy in the longer run.

Threat Analysis of COVID-19 on Indian Economy



Source: Adapted from World Bank

COVID-19

Impact on Indian Real Estate

The downtrends emanating from the COVID-19 triggered crisis are visible in Indian Real Estate, marked by a slowdown in site visits, transaction volumes & new launches.

However, the industry continues to fight against the odds. Most of the Realty companies have given Work from Home (WFH). Likewise, a lot of sales & operational processes have been brought online.

Since the past few years, the sector has been fighting against uncertainties & challenges. Earlier as well, the sector has shown resilience & successfully absorbed many shockwaves such as RERA, Demonetization, GST implementation, NBFC crisis, etc. This time as well industry insiders are hopeful that with combined efforts, the sector will be able to contain the risk from escalating to a larger extent & emerge stronger.

It might take some time to evaluate the long-term loss in the industry, triggered from the outbreak of COVID-19; initial research has shown dip in the site visits & transactions alongside drying of new launches. This is even though the given time is one of the most opportune for home buying as we have many festivals such as Navratri, Gudi Padwa & Baisakhi, etc.

As of now, most of the new launches have either been suspended or have been delayed. Developers are taking a backseat & are back to the drawing board to relook into their sales strategy. However, there have been instances of online launches. Numerous leading brands such as Godrej & Prestige embraced the digital way. There has also been considerable increase in enquires, as people are getting extra time to research & learn about properties.

The implication of COVID-19 on Indian Retail Real Estate

The Indian Retail industry has been growing steadily, underpinned by high demand, expansion in the middle class, spurred urbanization & change in consumer preference. In 2020, as per IBEF (India Brand Equity Forum), the total amount of private consumption is expected to reach USD 3600 billion, growing at a pace of a CAGR of 22% between 2016-2020. Likewise, the value of retail consumption is expected to reach USD 1100 billion from USD 630 billion in 2015

USD 630 Billion
2015

USD 1100 Billion
2020

Source: BCG

Although a majority of Indian retail is run by the unorganized sector, the organized retail, which currently holds a share of 9%, is also deepening its foothold. At the onset of the 2000s, there were very few malls in India. However, at present there are almost 350 malls, which chronicles the growing propensity for modern retail in Indian households.

The growth in Indian organized retail has also been dovetailed by policy reforms. During the previous decade, FDI in Single Brand Retail Trade (SBRT) was capped at 51%. By 2018, there have been iterations of reforms, which have enabled 100% FDI in SBRT without any prior government permission. In Multi-Brand Retail Trade (MBRT) FDI is capped at 51%, but in food MBRT, 100% FDI is again allowed subject to goverment permission.

International retailers in big volumes are eying India to tap into the growing consumer market. Thye are also drawn by the fact that the cost of running operations is cheaper in India when compared to their home countries. Retailers are coming either on their own or through JVs with Indian companies. In 2020, around 50-80 international retailers were scheduled to enter the Indian market However, after the COVID crisis, these numbers can drastically alter.

100% FDI

SBRT-Single Brand Retail Trade

51% FDI

Multi Brand Retail Trading

100% FDI

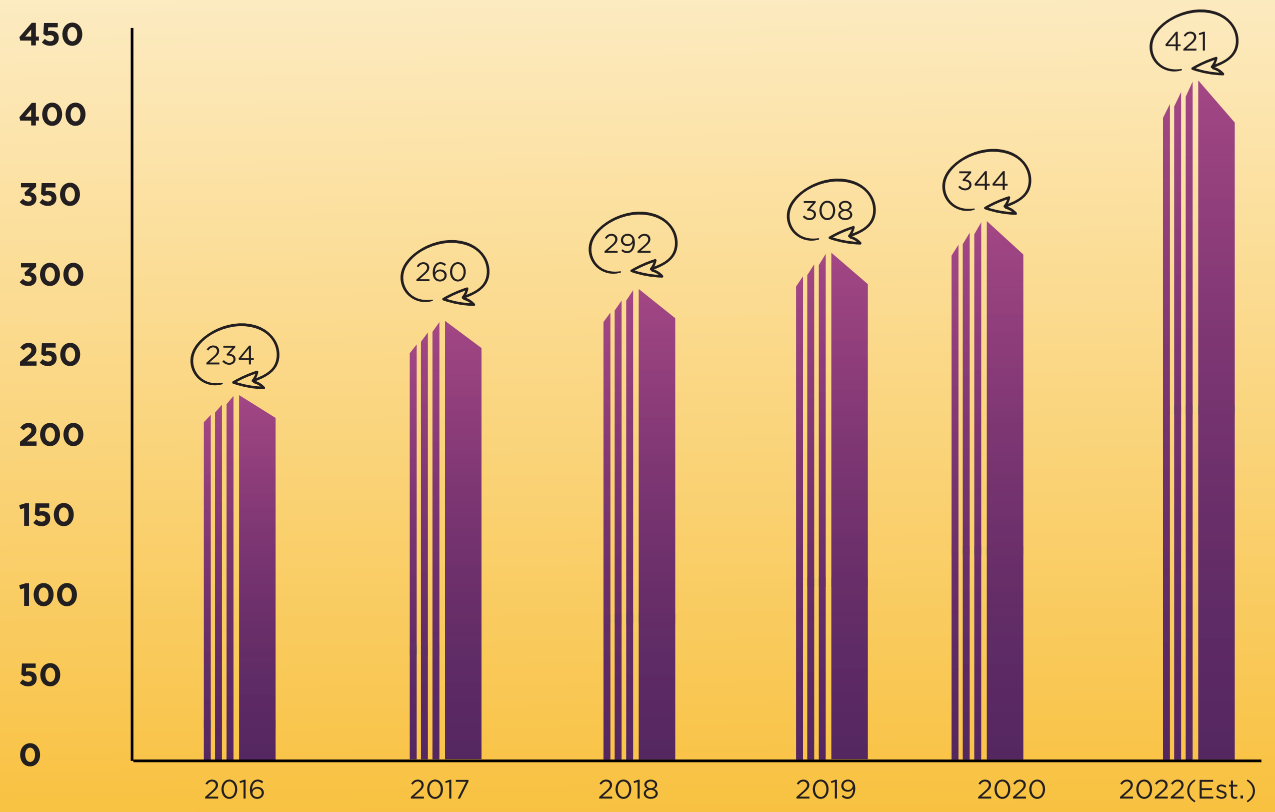
MBRT Food Retail

100% FDI

Cash & Carry Wholesale

As organized retail is growing, so is the demand for retail Real Estate in the country. In 2020, the total malls in India are expected to reach roughly 350 with a total estimated mall retail space of slightly higher than 97 million Sq. Ft. Around 70% of the malls in India are concentrated in the seven major metros- Delhi NCR, Mumbai Metropolitan Region (MMR), Bangalore, Hyderabad, Kolkata, Chennai, & Pune. However, recent years have also seen a notable rise in organized retail in Tier 2 & 3 cities as well such as Lucknow, Cochin, Mysore, Kanpur, Indore, Cuttak, etc.

Mall Supplies in India

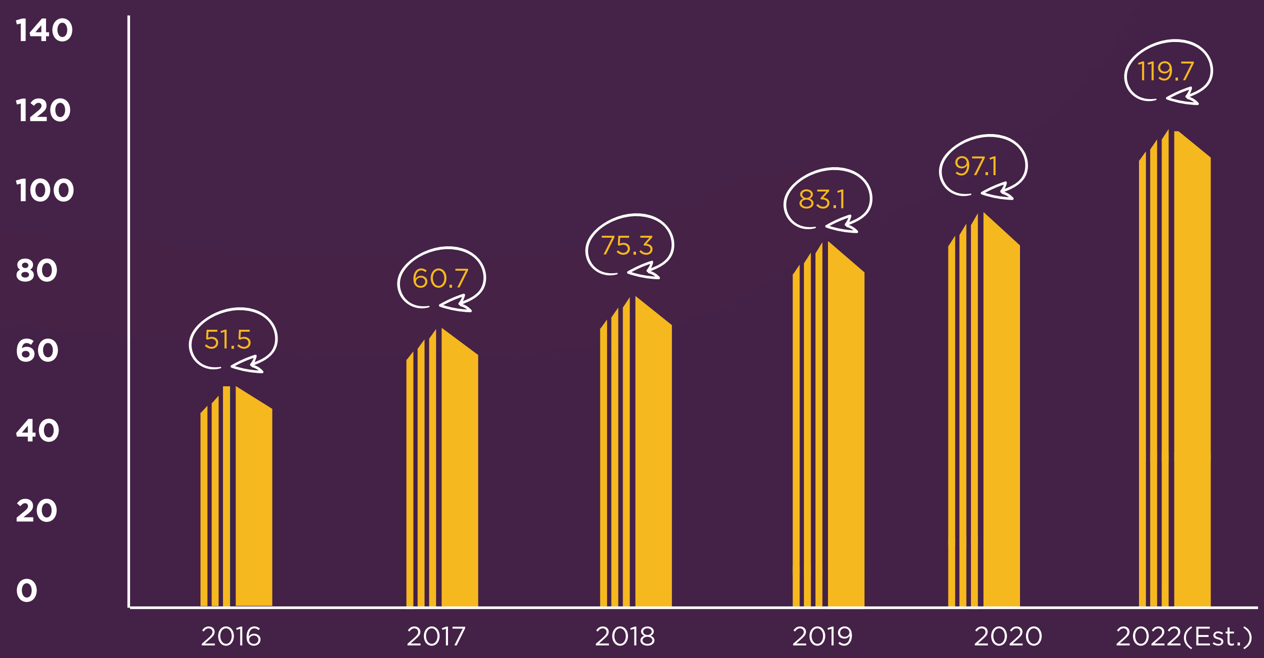


Source: 360 Realtors research

The Private Equity funds were also drawn towards the booming organized Retail Real Estate in the country. In the insert of after period 2015-2019, Retail Real Estate drew institutional money worth USD 2.8 billion, out of which around 59% came from international sources. This further underscores the inherent attractiveness & robust fundamentals of the growing Indian Retail.

In the next 2 years, by 2022, around 75+ new malls are scheduled to enter the market, driven by growing demand for organized retail. The new malls will roughly contribute around 23 million Sq. Ft of retail space. Recent times have also seen closing down of some of the poorly managed malls, as there is growing emphasis on quality standards. Empirical evidence has suggested that malls that encourage better socialization & are laced with bigger brands have better chances to perform. There have also been changed in the mall-mix patterns. Earlier, fashion & apparel used to be the mainstay. Over the years, it was replaced by experiential retail such as F&B, entertainment, wellness, etc.

Retail Mall Space in Million Sq. Ft



Source: 360 Realtors research

The Impact of COVID-19

The outbreak of COVID & the stringent social distancing & lockdown measures taken by the govt. has badly undermined an otherwise healthy retail sector in the country. Apart from convenience stores & a few departmental stores, most of the malls, high street retail, F&B enterprises are closed, which has badly affected the business in the last quarter. In return, this has started to impact the realty business as well. As rentals comprise of around 15-20% of the total costs, most of the retailers are asking for a rental waiver or rebate from their landlord.

The adverse impact on retail Real Estate will continue even after the suspension of lockdown, as individuals will still adhere to certain self-imposed social distancing & avoid crowded places. It might take some time for normalcy to be restored & sentiments to revive. Even post that, weakening private consumption will continue to hit the retail markets.

New insights & themes will emerge as an aftermath of the current crisis. The governing bodies might be forced to prescribe newer standards of footfall density, safety measures & layout management. Retailers & landlords need to be prepared for such possible changes. Likewise, property management is going to play a pivotal role as the focus will be on improving the overall hygiene levels & offer better safety standards for customers, staff & other visitors.

Even in this time of crisis, retailers that adopted an omnichannel model with a strong emphasis on online sales continue to show resilience. The ones, who solely relied on the brick & mortar model, were the worst hit. In the foreseeable future, retailers will redesign their marketing strategy as the e-commerce model will rise. In an offline-online design, malls will play a proactive role by developing digital capabilities. New apps will be developed, wherein if an SKU is not available in the store, it could be booked & dispatched to the customer. In these retailers & malls will augment their overall sales by synergizing offline & digital channels.

After an inevitable slowdown in sales during the H1, retailers are expected to put more targeted efforts to recover sales in the 2nd half of the year. Apart from building digital capabilities, large-scale flash sales will be common to turn-around the out-of-stock inventories. Similarly, as sales numbers have plunged badly, the retail industry will look forward to more government-backed incentives such as waiver in tariffs, a moratorium in loans, etc. Retailers are also demanding to forego minimum guarantee & switch to revenue sharing based rentals with malls. Likewise, malls need to go the extra mile & offer numerous incentives in the form of revenue sharing, marketing support, digital channels to help fashion, apparel, footwear brands to turnover the inventory as soon as possible. These are the worst-hit in the crisis.

The 5 steps Mckinsey Model for the Retail Industry

1 Resolve

Current loss is inevitable, offer rebates & concessions to retailers to share the risk, take care of employees, partners & customers

2 Resilience

Address near term cash management issues, take a close look at the current liquidity profile, build & utilize digital capabilities

3 Return

Make a detailed plan to return, Continue developing digital capabilities, think of touchless & self-checkout options to win back the trust of customers, Incentivize fashion & apparel brands

4 Reimagine

Reimagine alternate models, revenue sharing rental models, higher safety standards, Omni-channel distribution

5 Reform

Get clarity on regulatory changes in property management, safety standards, layout management, etc.

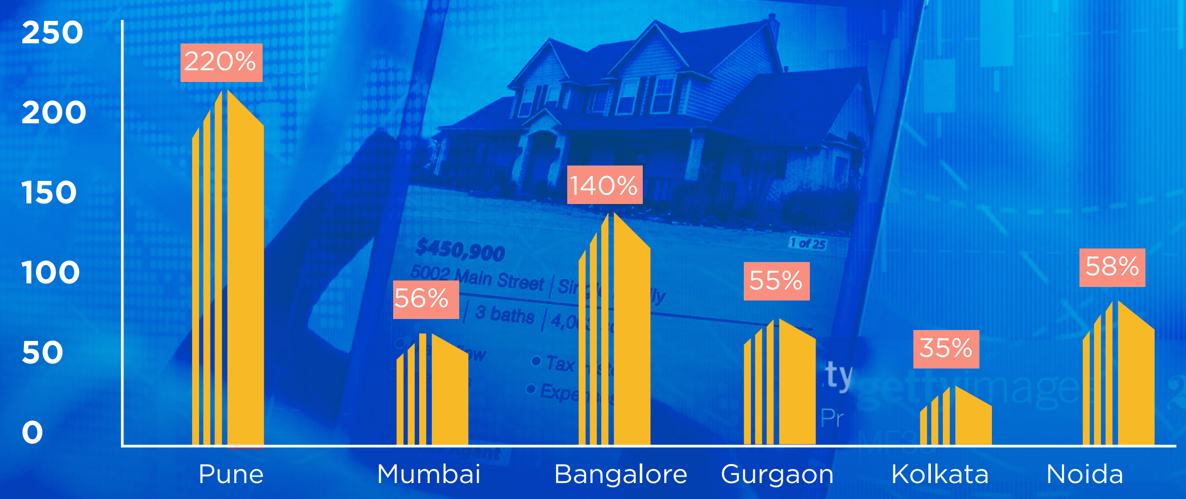
Source: Adapted from McKinsey 5 R Model

Implications of COVID-19 on Residential Real Estate

Despite healthy fundamentals, 2019 saw the softening of Indian residential markets, due to liquidity crisis & slowdown in GDP growth. However, as the Govt. declared an Alternate Investment Fund (AIF) to offer last-mile financing to stalled projects, the Industry was hoping for a quicker revival. At the onset of 2020, the Indian Housing industry was further pinning its hope on the fact that markets will turn around on the back of healthy end-user demand, wider participation by NRIs & price cuts by developers.

The month of March & April were further opportune for the industry due to a host of festivals such as Gudi Padwa, Baisakhi & Navratri, which generally result in a spike in home sales in India. Nevertheless, as a complete economic shutdown was declared, the market took a beating. The industry showed some resilience by leveraging the digital medium, but a knock-off in site visits & sales was inevitable. The numbers plunged, thereby tanking overall sentiments. Interestingly, there was a steep rise in enquiries as people are having plenty of extra time due to lockdown.

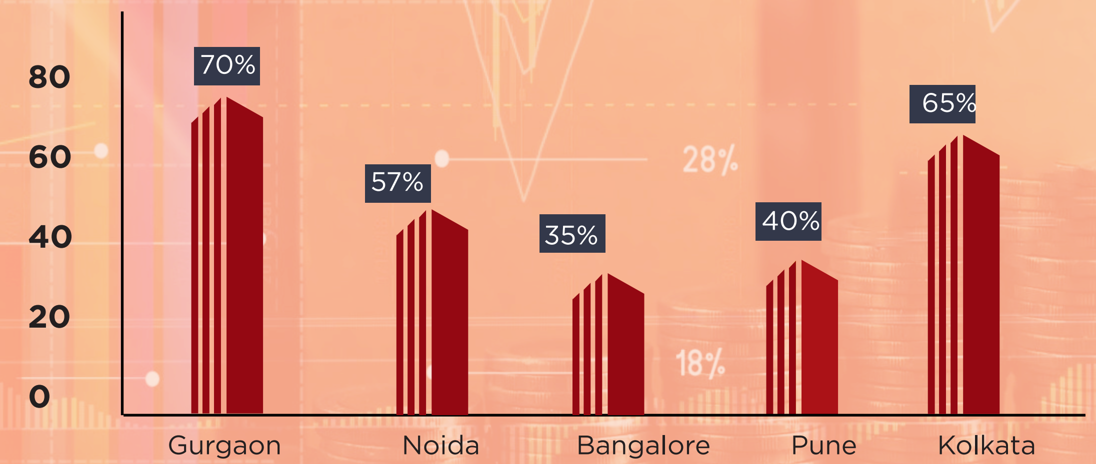
Monthly growth in Enquiries
(till 22nd of April)



Source: 360 Realtors research

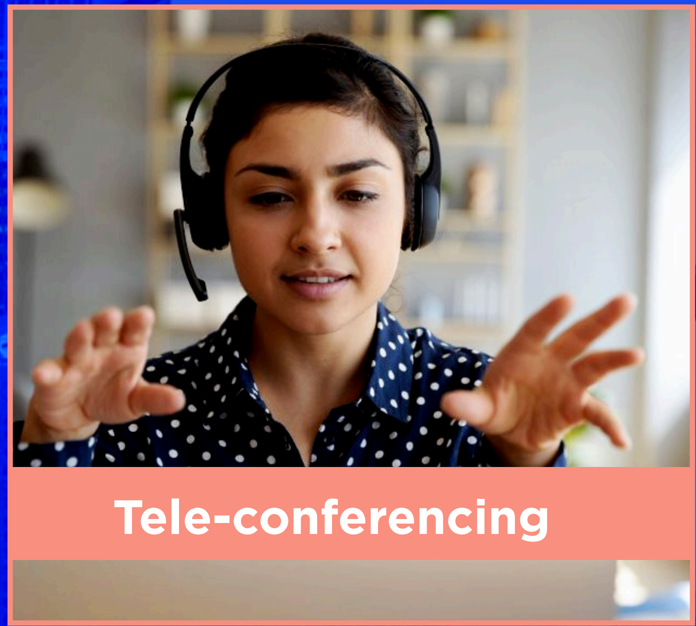
The strains are also visible on the supply side as construction is suspended. Even after the lockdown is lifted, due to labor shortage & disruptions in the supply chain, it will take some time for normalcy to resume.

Monthly reduction in closures
(till 22nd of April)



Source: 360 Realtors research

Hidden Opportunities and Roadmap to Recovery


Tele-conferencing


Online Webinar


Virtual Meetings


Digital Launch

Despite sentiments being hit hard currently, there are numerous hidden opportunities in this crisis. Developers, realtors & buyers now understand the significance of online Real Estate. Although online Real Estate has existed for some years, its application was minimal. The COVID-19 crisis might be an inflection point that can stimulate wider usage of technology across the entire value chain- marketing, product launch, site visits, transactions, & CRM.

The demand will also get thrust from the government's redressal measures. Reduction in repo rates will make home loans more affordable. Likewise, iterations of reverse-repo rate cuts will ensure that the money is not kept in banks but will float in the system, thereby injecting liquidity. The Government. has also pledged to recapitalize NBFCs alongside earmarking INR 10,000 Crores for the National Housing Bank (NHB). This will ensure a smoother flow of capital to HFCs thereby expanding credit support to developers- one of the much-required steps.

In the near future, substantial movements will be visible in the affordable & mid-income housing segments primarily in the INR 30-70 lacs segment. These segments, driven by end-users are expected to largely remain resistant to any price corrections. However, in the higher end (INR 2 Crores & above), a correction to the tune of 15-20% can be observed. Developers will also continue to deploy flexible payments plans to keep the momentum rolling.

1 Resolve

Current slowdown is inevitable, use the digital medium to sell, tailor-make attractive payment plans, take care of employees, partners & customers.

2 Resilience

Address near term cash management issues, take a close look at the current liquidity profile, develop digital capabilities, Focus on mid & affordable segments (INR 30-70 Lacs)

3 Return

Make a detailed plan to return, Continue developing digital capabilities, Introduce new payment plans

4 Reimagine

Reimagine alternate models, New product propositions for investors (rental homes, smaller units)

5 Reform

Get clarity on regulatory changes in property management, stronger safety standards,

Source: Adapted from McKinsey 5 R Model

Implications of COVID-19 on Office Real Estate

The Indian Office Real Estate looked promising in 2019, with a fresh supply of over 50 million Sq. Ft. Net absorption was estimated to be over 45 million Sq. Ft. –primarily driven by IT/ITeS, BFSI, Consulting & Co-working space.
In upcoming markets such as Bangalore, Chennai & Pune, total vacancy was in single digits.

Despite the slowdown in the economy, office Real Estate continued to be one of the fastest-growing segments of Indian Real Estate. Local & international investors played out loud in the booming office space segment lured by recurrent & attractive rental yields. Institutional money flowed in large volumes & showed ample interest in Greenfield & Brownfield projects alongside ready-to-move-in assets.

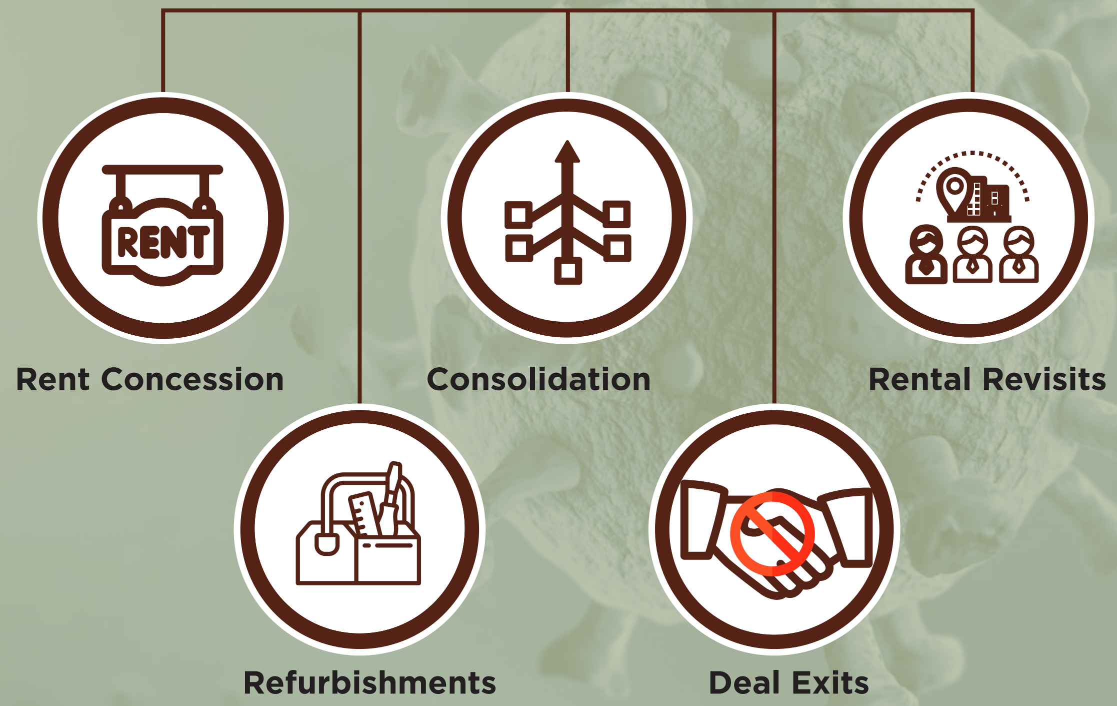
However, the bullish run of the office Real Estate in India has been derailed following the economic shutdown. As economic activities have paused, the fallouts are visible in an otherwise buoyant office Real Estate. It is a little difficult to predict when exactly this faltering of growth will be arrested. However, the downside risk will continue even after the lockdown is suspended to ends.

Due to economic contingencies, larger organizations will defer key leasing decisions. Likewise, developers will also stay away from new launches. Only those projects will start shortly, which are in the last lines of completion (6months -1 Year).

As business activities are affected, they are asking for deferment of rentals or tariff concessions, which are going to impact rental yields.

The crisis will also trigger major makeovers in transaction procedures alongside day to day operations. In the foreseeable future, we will see more consolidation in business, revisit of clauses, rental concessions & refurbishments. Occupiers will go back to their books to evaluate projected topline & revenue. Accordingly, they will ask for rental revisits. Many organizations will consolidate their business & might to shift to relatively cost-effective locations. Deal exits will also rise, as in case landlords not compromising on new terms, tenants have to scout for new places.

Likewise, more refurbishment activities will also take place, as newer directives are expected in terms of layout management, space utilization & space per employee.

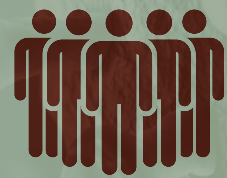


In a nutshell, we can say that some major changes are underway. As economic slowdown will continue, deal volumes & overall rental in FY 21 is going to take a sizable blow. It is estimated that if the renewal of contracts is not taken into consideration, the net transaction won't be more than 20- 25 million Sq. Ft. (This will not include the renewal of contracts) Likewise; an average rental cut of 10-25% is also unavoidable. (This based on the assumption that the economy will revive after Q2 FY 21 If the slowdown persists, the situation might further deteriorate)

20- 25 million Sq. Ft Expected New Deals

10- 25% Average Rental Compression

On a positive side, interest will continue to gain momentum for ready to move in projects and strata leasing. The volatility in the equity & financial markets will reinforce investor interest towards small ticket size commercial assets with INR 20-40 lacs being the sweet spot. Investors will be drawn towards such assets due to recurring rental income & potential gains from capital appreciation in the medium term.



1 Resolve

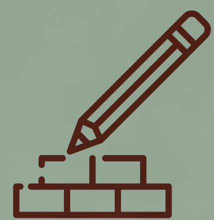
Current loss is inevitable, offer concessions in rentals to the client, take care of employees, partners, & customers.

2 Resilience

Address near term cash management issues, take a close look at the current liquidity profile, build & utilize digital capabilities.

3 Return

Make a detailed plan to return, Continue developing digital capabilities, focus more on ready to move in assets, small set-ups, & strata leasing, deal restructuring to match client's need, flexible payment plans.



4 Reimagine

Reimagine alternate models, willing to take some haircuts in rental, higher safety standards, refurbish office spaces, shift working models

5 Reform

Get clarity on regulatory changes in property management, safety standards, layout management, etc.

Source: Adapted from McKinsey 5 R Model

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