# Real Estate Sector

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Sector Update

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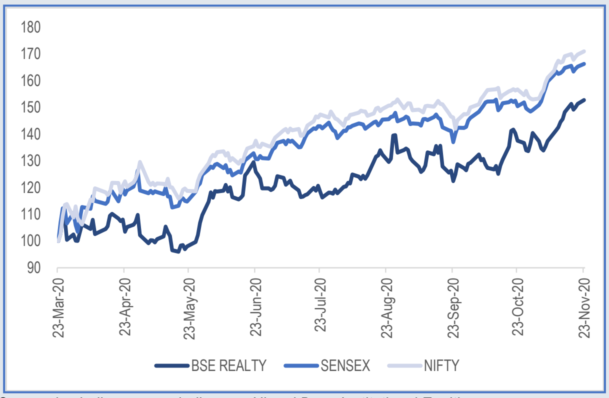
## Rising residential sales volume driving stock prices higher; a case of misplaced optimism

**The BSE Realty index has appreciated by 52.8% from its low struck in mid-March post the impact of the Covid-19 pandemic. In our view, the BSE Realty index's rise is a case of misplaced optimism.**

**BSE Realty vs SENSEX vs NIFTY:**




*Source: bseindia.com, nseindia.com, Nirmal Bang Institutional Equities*

**Our view is based on two key points:-**

**(a) Residential: While we agree that residential sales have increased sharply from Oct'20, many experts have said that this is a case of pent-up demand and that growth will peter out from Feb-Mar 2021. Further, the sale prices continue to decline.**

**b) Office: Strong growth in realty office vertical has slowed sharply, with many companies re-examining their requirements post the impact of the pandemic. Further, the office vertical is near it's cyclical high given that it has been nearly 8 years from the trough of CY12. History indicates that the cycle is due for a trend reversal.**

### Residential segment - sales volume rise but price decline persists

1. **Improving demand, especially in affordable housing:** Experts and our interactions with brokers have indicated that there has been a sharp growth in demand from Sept'20. The sharp jump in demand has been partially attributed to pent-up demand in the wake of the nationwide lockdown in India from late March to June. The other reason for the demand spike has been increasing affordability due to (1) Lower interest rates (2) Reduction of stamp duties (3) Decline in property prices.
2. **Pricing continues to decline in real and absolute terms for the developers:** Our interactions with brokers and experts have indicated that prices continue to decline for the developers. According to some of them, prices have declined by ~10%-30% in absolute terms and ~30%-50% in real terms. It has been stated by many experts that sales have been relatively good in some geographical pockets and/or for some reputed builders. On the other hand, there are many builders who are extremely cash strapped due to extremely low sales.
3. **Discounts and incentives aiding demand growth:** Reduction in stamp duty rates by 3%, coupled with completed projects saving 5% on GST front gives the buyers ~8% discount. This combined with additional discounts given by the builder works out to a total discount of ~10%-15% for the end buyers. The benefits of lower stamp duty and reduction in registrations expenses by the government have been given only up to March 2021, post which they will revert to original stamp duty rates.
4. **Brewing crisis: lack of funding for developers has sharply increased cash flow stress:** Our interactions with experts and the brokers have indicated that both, banks and NBFCs are reluctant to lend to the real estate sector. With slow sales, the stress on cash-strapped developers has increased manifold. While there has been a huge resurgence of demand in the last the 45 days, the situation is not same for all projects.
5. **Developers with a good track record will survive the consolidation wave:** As per experts, in every recessionary cycle, consolidation within the market has played its role and the trend will continue. The key to survival is managing cash flows effectively and maintaining a good delivery track record of delivering quality housing. Developers, who are facing tough times currently because of the slowdown in demand amid the ongoing pandemic but were well positioned in the pre-COVID era, will be able to sail through the tough times and avoid consolidation as they will be able to get last mile funding from special funds set up by the government vis-à-vis their peers. Those developers who were not doing well and were cash trapped in the pre-COVID era will find it difficult to source fundings.

**Commercial segment: cautious optimism:** In the recent past, the impact of the pandemic is clearly visible in the sharp slowdown in the absorption in office space since Mar'20. Some players are being cautious and holding back construction of new commercial properties as they evaluate the emerging WFH situation while some other players are trying to capitalize on the opportunity of contraction in supply in the near term, caused by the holding back of construction by other players.

According to experts in the recent webinars, the commercial segment will be in short supply in the next few months as many developers are neither taking new projects nor completing their existing projects because they are experiencing lack of demand. Developers are unsure as to how the WFH scenario will pan out in future and what the demand outlook will be like. These doubts are restraining developers and causing short supply. On the contrary, some players are increasing supply aggressively in anticipation of good demand and short supply in the near future.

**Valuation:** We maintain Buy rating on NESCO Limited (NESCO), Prestige Estate Projects Ltd (PEPL) and Brigade Enterprises Ltd (BEL) with target price of Rs759, Rs300 and Rs229, respectively. We maintain Accumulate rating on Sobha Limited (Sobha), Phoenix Mills Limited (PML), Embassy Office Parks REIT (EOPR) and Mindspace Business Parks REIT (MBPR) with target price of Rs304, Rs623 and Rs362 and Rs335, respectively.

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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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