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Real Estate

Sector update

- **DLF** (ADD)
- **Oberoi Realty** (BUY)
- **Macrotech Developers** (ADD)
- **Mahindra Lifespace Developers** (BUY)
- **Prestige Estates Projects** (ADD)
- **Brigade Enterprises** (BUY)
- **Godrej Properties** (SELL)
- **Sunteck Realty** (BUY)
- **Sobha Ltd** (ADD)

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INDIA

Real Estate

Residential: Set for an upcycle

Heading into the festive season in India in H2FY22, listed developers have lined up a number of launches across Tier I cities. Low mortgage rates, stable property prices and robust hiring outlook for IT/ITeS and financial services, especially in South India and continued Work-from-Home is expected to support residential housing demand. While we are believers in an upcycle for the residential sector, we are of the view that a sustained single digit sales price CAGR is beneficial for all stakeholders rather than a super cycle similar to FY03-07 where prices went up by 3-4x in a short period. We estimate that the pan-Indian residential market share for our coverage universe will grow from 25% in FY21 to 29% in FY24E. Top picks: DLF, Oberoi Realty, Brigade Enterprises, Sunteck Realty and Mahindra Lifespaces.

- **Low mortgage rates and affordable prices to support demand:** Mortgage rates offered by most large lenders range in the 7-7.5% range for 20-year housing loans and is the lowest ever historically since 2005. Even assuming that mortgage rates may inch up over H2FY22-23E, we believe that mortgage rates of 8-8.5% (assuming 100bps increase) are still affordable and would not significantly dent buying decisions. Robust hiring outlook for IT/ITeS/Fintech/GICs and salary hikes will help to support housing demand, especially in South India. While prices have remained stagnant over the last 5 years, we believe that prices may see a single digit rise over the next 2-3 years annually as inventory levels have stabilised. While we are believers in an upcycle for the residential sector in India, we are of the view that a sustained single digit sales price CAGR is beneficial for all stakeholders rather than a super cycle similar to FY03-07 where residential prices went up by 3-4x in a short period.
- **Listed developers to see continued market share gains:** We believe that owing to healthy balance sheets, access to capital and many unlisted, weaker developers being shunted out of the market, the market share of large organized developers is set to grow further in the next 2-3 years. Most developers in the listed space have aggressive launch plans from H2FY22 onwards and are looking to grow at a double-digit sales value CAGR over the next two-three years which will lead to market share gains assuming that industry size remains stagnant (we assume that overall annual residential market sales value remains similar to FY20 levels in FY23E and FY24E). We estimate that the pan-Indian residential market share for our coverage universe will grow from 25% in FY21 to 29% in FY24E. We believe that the old adage of “A rising tide lifts all boats” may play out in the residential space with an improved demand outlook leading to many large unlisted developers and smaller developers with few projects also looking to jump into the fray and trying to complete with Tier I developers by offering projects at lower prices in the same micro-market.
- **Listed developers’ net debt levels have declined by 37% post Covid:** On an aggregate basis, listed developers in our coverage universe (ex-REITs) have been able to bring down their consolidated net debt levels by 37% to Rs274bn (ex-DCCDL) between Q4FY20-Q1FY22 (Mar’20 to Jun’21). This has been achieved through a combination of reduction in cost of debt by 80-160bps, reduction in corporate overheads by 20-40% from pre-Covid levels, operating cash surpluses, asset sales and equity capital raises either through the QIP route or through dilution at the SPV level. While the overall real estate sector in India, especially the unlisted space, continues to grapple with high cost and quantum of debt, listed developers’ balance sheets have become leaner and puts them in a strong position to invest for growth in the medium term and is likely to accelerate the pace of consolidation in the sector.

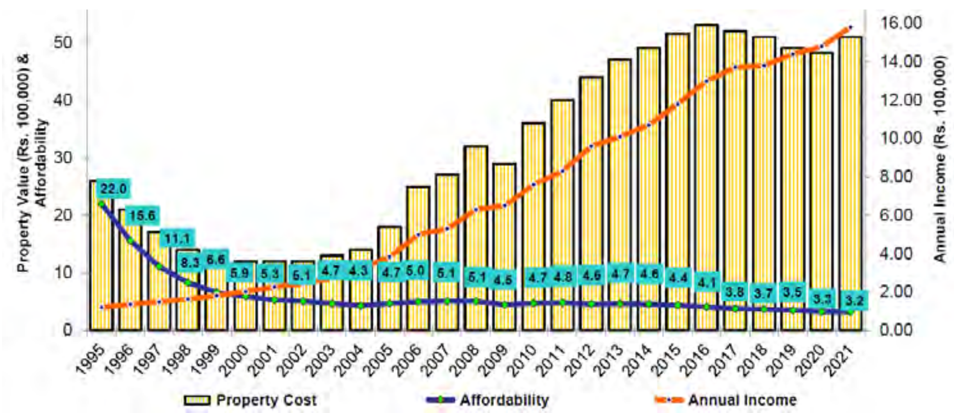
Residential Real Estate: Set for an Upcycle

The Indian real estate sector, especially in the residential space has seen multiple rounds of disruption over FY17-21 owing to demonetization, RERA/GST implementation, NBFC funding crisis and the first and second wave of Covid in India. This period has also been characterized by stagnant property prices and stagnant industry volumes/value owing to issues of stuck projects, high debt on developer balance sheets and overall muted sentiment for residential real estate. However, heading into FY22 and beyond, we believe that the sector is set for an upcycle because of the following factors:

Affordability of residential homes are favourable owing to low mortgage rates and stable prices

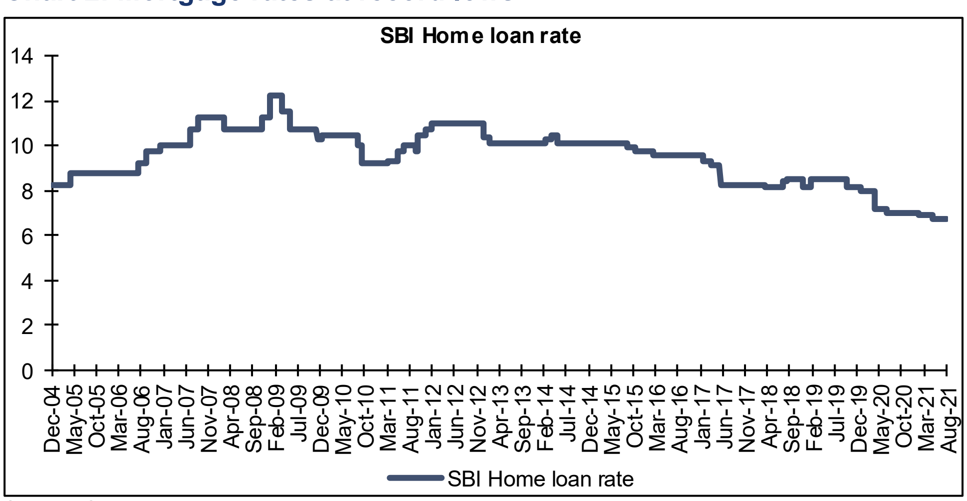
Mortgage rates offered by most large lenders range in the 7-7.5% range for 20-year housing loans and is the lowest ever historically since 2005. Even assuming that mortgage rates may inch up over H2FY22-23E, we believe that mortgage rates of 8-8.5% (assuming 100bps increase) are still affordable and would not significantly dent buying decisions.

Chart 1: Affordability* of homes is at 3.2x, best in last 25 years



Source: HDFC Limited Investor Presentation, Isec Research,
* Affordability equals property prices by annual income

Chart 2: Mortgage rates at record lows

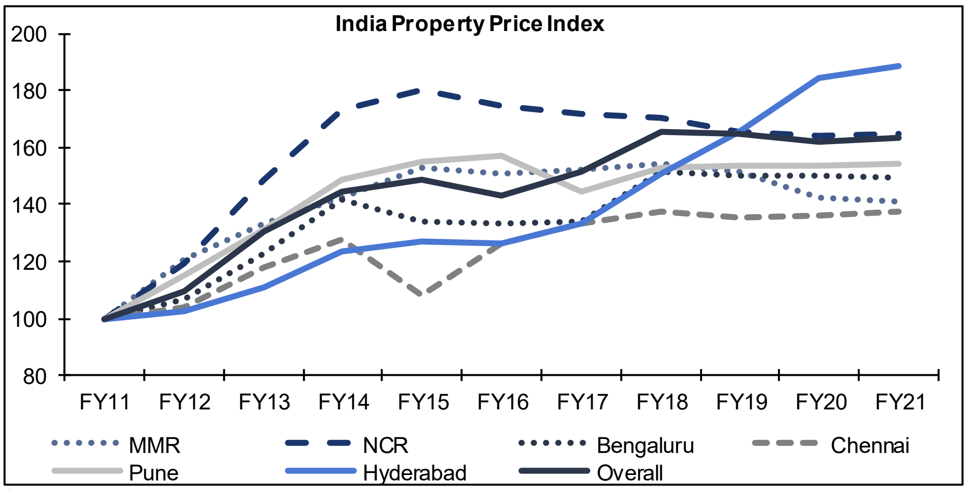


Source: Company, Bloomberg, Isec Research

Residential prices have been stagnant over FY17-21 and may gradually increase going ahead

While prices have remained stagnant over the last 5 years, we believe that prices may see a single digit rise over the next 2-3 years annually as inventory levels have stabilised and the Indian residential real estate market has undergone clear signs of consolidation with the market share of larger, organized developers having grown to over 24% in FY21 of Tier 1 residential sales value vs. ~11% in FY17. With an increase in input costs of 5-10% over the last 12 months, there is a case for a price increase and we have already seen marginal price hikes of 2-5% by developers in Q1FY22. In the medium term, we believe that single-digit price hikes are sustainable and healthy as it protects margins and also encourages developers to launch new projects and gives confidence to buyers to purchase a new home. Hence, while we are believers in an upcycle for the residential sector in India, we are of the view that a sustained single digit sales price CAGR is beneficial for all stakeholders rather than a super cycle similar to FY03-07 where residential prices went up by 3-4x in a short period.

Chart 3: Residential prices have remained stagnant between FY18-21



Source: Liases Foras, Isec Research

Listed developers' net debt levels have declined by 37% post Covid

On an aggregate basis, top 10 listed developers in India (ex-REITs) have been able to bring down their consolidated net debt levels by 37% to Rs274bn (ex-DCCDL) between Q4FY20-Q1FY22 (Mar'20 to Jun'21). This has been achieved through a combination of reduction in cost of debt by 80-160bps, reduction in corporate overheads by 20-40% from pre-Covid levels, operating cash surpluses, asset sales and equity capital raises either through the QIP route or through dilution at the SPV level. While the overall real estate sector in India, especially the unlisted space, continues to grapple with high cost and quantum of debt, listed developers' balance sheets have become leaner and puts them in a strong position to invest for growth in the medium term and is likely to accelerate the pace of consolidation in the sector.

Table 1: Consolidated net debt levels (Q4FY20-Q1FY22)

(Year ending March Rs mn)

Company	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Decline from Q4FY20 (%)
DLF (ex-DCCDL)	52,670	52,250	52,150	51,000	48,850	47,450	*-9.9%*
DLF - DCCDL	1,80,070	1,78,880	1,81,030	1,80,900	1,91,920	1,90,720	*5.9%*
Godrej Properties	11,590	17,520	27,330	30,770	(5,820)	(2,380)	*NM*
Oberoi Realty	8,915	9,725	9,657	14,705	12,595	11,352	*27.3%*
Macrotech (Lodha)	1,82,272	NA	NA	1,66,250	1,60,760	1,24,250	*-31.8%*
Phoenix Mills*	32,564	27,992	26,205	26,756	25,490	16,861	*-48.2%*
Prestige Estates*	81,743	84,058	86,676	84,645	13,141	21,706	*-73.4%*
Sobha Ltd.	30,230	30,210	30,500	29,750	28,520	28,170	*-6.8%*
Brigade Enterprises*	28,311	28,831	29,911	29,479	26,547	21,175	*-25.2%*
Sunteck Realty	6,158	6,875	7,041	6,723	4,637	4,678	*-24.0%*
Mahindra Lifespaces^	1,021	1,120	1,668	663	1,142	926	*-9.3%*
Total ex-DCCDL	**4,35,474**	**2,58,581**	**2,71,138**	**4,40,741**	**3,15,862**	**2,74,188**	***-37.0%***
Total with DCCDL	**6,15,544**	**4,37,461**	**4,52,168**	**6,21,641**	**5,07,782**	**4,64,908**	***-24.5%***

Source: Companies, I-Sec Research, *Proportionate company share, ^excluding World Cities

Table 2: Listed Developers' Cost of Debt (Q4FY20-Q1FY22)

(%)

Company	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Decline from Q4FY20 (bps)
DLF (ex-DCCDL)	9.8%	9.7%	9.1%	8.9%	8.4%	8.2%	***(160)***
DLF - DCCDL	8.9%	8.6%	8.5%	7.8%	7.5%	7.4%	***(148)***
Godrej Properties	7.9%	7.8%	7.6%	7.3%	6.8%	6.7%	***(120)***
Oberoi Realty	NA	NA	NA	NA	NA	NA	***NA***
Macrotech (Lodha)	NA	NA	NA	NA	12.3%	11.6%	***NA***
Phoenix Mills	9.2%	9.1%	8.9%	8.5%	8.2%	7.9%	***(129)***
Prestige Estates	9.8%	9.7%	9.7%	9.3%	9.8%	9.8%	***(2)***
Sobha Ltd.	9.7%	9.6%	9.3%	9.2%	9.0%	9.0%	***(71)***
Brigade Enterprises	9.6%	9.6%	9.2%	9.0%	8.4%	8.1%	***(143)***
Sunteck Realty*	9.4%	9.4%	9.2%	9.1%	8.8%	8.6%	***(80)***
Mahindra Lifespaces	8.7%	8.2%	7.4%	7.5%	7.1%	7.1%	***(161)***

Source: Companies, I-Sec Research, *Isec estimates

Consolidation set to accelerate and is reflected in bullishness of developers' business plans

We believe that owing to healthy balance sheets, access to capital and many unlisted, weaker developers being shunted out of the market, the market share of large organized developers is set to grow further in the next 2-3 years. Most developers in the listed space have aggressive launch plans from H2FY22 onwards and are looking to grow at a double-digit sales value CAGR over the next two-three years which will lead to market share gains assuming that industry size remains stagnant (we assume that overall annual residential market sales value remains similar to FY20 levels in FY23E and FY24E).

While we acknowledge that consolidation will definitely accelerate going forward, we estimate that the pan-Indian residential market share for our coverage universe will grow from 25% in FY21 to 29% in FY24E.

We believe that the old adage of "A rising tide lifts all boats" may play out in the residential space with an improved demand outlook leading to many large unlisted developers and smaller developers with few projects also looking to jump into the fray and trying to complete with Tier I developers by offering projects at lower prices in the same micro-market, especially in suburban and peripheral locations of Tier I cities.

Table 3: Leading India developers' market share

Gross Sale Value (Rs bn)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E	4 Year CAGR (FY20-24E)
Macrotech (Lodha)	69.7	81.3	71.7	65.7	59.7	87.7	102.1	110.0	13.7
Godrej Properties	20.2	50.8	53.2	59.2	67.3	72.2	125.7	138.9	23.8
Prestige Estates	24.6	33.1	45.6	45.6	54.6	61.2	59.7	69.7	11.2
Sobha Ltd.	23.2	28.6	31.2	28.8	31.4	36.8	39.8	41.5	9.6
DLF	8.8	10.5	24.4	24.9	30.8	44.3	54.8	57.3	23.2
Brigade Enterprises	9.6	9.0	16.4	23.8	27.7	31.6	33.1	35.4	10.4
Oberoi Realty	15.2	13.1	17.5	12.6	34.3	28.7	44.5	43.4	36.3
Sunteck Realty	6.0	5.9	12.0	12.2	10.2	12.5	13.7	15.6	6.3
Mahindra Lifespaces	5.4	6.1	10.2	6.7	7.0	12.3	17.6	20.4	32.1
Top 9 Total	**182.7**	**238.4**	**282.2**	**279.5**	**323.0**	**387.3**	**491.2**	**532.2**	**17.5**
Balance Developers	1,429.1	1,587.0	1,603.4	1,529.4	975.9	1,059.8	1,317.7	1,276.7	(4.4)
Overall Market Size	**1,611.8**	**1,825.4**	**1,885.6**	**1,808.9**	**1,298.9**	**1,447.1**	**1,808.9**	**1,808.9**	**-**

Market Share (%)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E	Market Share Gains (FY20-24E) bps
Macrotech (Lodha)	4.3%	4.5%	3.8%	3.6%	4.6%	6.1%	5.6%	6.1%	*245*
Godrej Properties	1.3%	2.8%	2.8%	3.3%	5.2%	5.0%	7.0%	7.7%	*441*
Prestige Estates	1.5%	1.8%	2.4%	2.5%	4.2%	4.2%	3.3%	3.9%	*133*
Sobha Ltd.	1.4%	1.6%	1.7%	1.6%	2.4%	2.5%	2.2%	2.3%	*70*
DLF	0.5%	0.6%	1.3%	1.4%	2.4%	3.1%	3.0%	3.2%	*179*
Brigade Enterprises	0.6%	0.5%	0.9%	1.3%	2.1%	2.2%	1.8%	2.0%	*64*
Oberoi Realty	0.9%	0.7%	0.9%	0.7%	2.6%	2.0%	2.5%	2.4%	*170*
Sunteck Realty	0.4%	0.3%	0.6%	0.7%	0.8%	0.9%	0.8%	0.9%	*19*
Mahindra Lifespaces	0.3%	0.3%	0.5%	0.4%	0.5%	0.8%	1.0%	1.1%	*76*
Top 9 Total	**11.3%**	**13.1%**	**15.0%**	**15.5%**	**24.9%**	**26.8%**	**27.2%**	**29.4%**	***1,397***
Balance Developers	88.7%	86.9%	85.0%	84.5%	75.1%	73.2%	72.8%	70.6%	*(1,397)*
Overall Market Size	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**-**

Source: Companies, Liases Foras, Isec Research estimates

Table 4: Medium term residential sales outlook for listed developers

Company	Medium-term sales outlook
DLF	The company intends to launch new projects of 8.3msf in FY22E and is targeting an annual booking run-rate of at least Rs40bn vs. pre-Covid levels of Rs20-25bn on the back of new launches along with completed inventory worth Rs51.8bn as of Jun'21. DLF has outlined a long-term plan to launch and develop ~35msf of projects having potential sale value of Rs360-400bn. In spite of the impact of the second Covid wave in North India during the quarter, the company clocked net sales bookings of Rs10.1bn in Q1FY22 vs. Q4FY21 bookings of Rs10.6bn and Q1FY21 bookings of just Rs1.5bn.
Godrej Properties	In Q1FY22, GPL achieved gross sales bookings worth Rs5.0bn (decline of 68% YoY and 88% QoQ). This was along expected lines as residential sales were impacted severely in April and May 2021 with bookings of just Rs1.9bn before improving to Rs3.3bn in Jun'21. As per management, sales bookings have improved to Rs5.0bn in Jul'21 and with 4-5 launches in Q2FY22 (two in NCR and one each in Bengaluru and Pune), sales trajectory should meaningfully improve to levels seen in H2FY21. With around 21 launches lined up in FY22E spread over 13.3msf (excluding Bandra/Worli projects in Mumbai), we expect GPL to clock Rs72.2bn of sales bookings in FY22E (7% YoY growth), even after accounting for a muted H1FY22 on account of Covid impact. Over FY23-24E, we expect GPL to clock over Rs100bn of annual sales bookings in both years subject to launch of high value projects in MMR (Bandra/Worli) and NCR (Ashok Vihar).
Oberoi Realty	While Q2FY22 is expected to be a muted quarter owing to second Covid wave impact, OBER is targeting launches in H2FY22 across Thane and Borivali/Goregaon and other ongoing projects once lockdowns are eased. While exact timing and quantum of launches is awaited, we expect OBER to clock at least Rs25bn of sales bookings in FY22E and over Rs40bn each in FY23-24E owing to new launches and completed/near completion inventory in Worli/Mulund/Borivali projects.
Prestige Estates	As per company management, there is a large pipeline of residential launches of 12-15msf lined up between September 2021-March 2022 across South India (The Prestige City), Noida (NCR) and Mumbai (Jasdan Classic, Byculla and Cosmos, Mulund projects). As per the company, three Mumbai launches spread over 6msf are lined up for launch in Q3FY21 and final leg of approvals are in process. With the launch of the new Mumbai and Noida projects, the company is targeting gross sales bookings of Rs60-65bn in FY22E and has a medium-term target of reaching Rs100bn of gross sales bookings by FY24-25E of which 50% share may be from markets outside Bengaluru.
Sobha Limited	Sobha's Q1FY22 gross sales bookings of 0.90msf worth Rs6.8bn were up 38% YoY in volume terms and 40% YoY in value terms. We believe that the company's Q1FY22 sales performance is commendable considering the second Covid wave impact across India, and expect sales momentum to sustain heading into FY22E as well on the back of new launches. We believe that the relatively muted impact of COVID-19 on the IT/ITeS sector in South India in FY21 has helped to a large extent along with increased sales through digital channels. While quarterly sales volumes may remain volatile depending on Covid induced lockdowns and pace of new launches, we model for 4.7/5.0msf of gross sales volumes in FY22E/FY23E, respectively.
Brigade Enterprises	Q1FY22 saw BRGD achieving residential sales bookings of 0.8msf worth Rs4.8bn (82% YoY in volume terms and up 92% in value terms). This was driven by Hyderabad (Citadel) and Chennai (Xanadu/WTC) markets which contributed to 40% of the quarter's sales similar to H2FY21. While Q1FY22 was relatively muted owing to second Covid wave impact, with 1.9msf of planned launches in the remainder of FY22E and 7.6msf of unsold inventory, we have built in sales bookings of 5.0msf each in FY22-24E worth over Rs30bn annually which will enable the company to tide over any prolonged weakness in rental asset leasing and hotel operations.
Sunteck Realty	Sunteck Realty's (SRIN) Q1FY22 sales bookings of Rs1.8bn were up 74% YoY driven by continued momentum in ODC, Goregaon project (Rs0.8bn), Naigaon (Rs0.7bn) and Rs0.3bn from other projects. As per SRIN's management, in light of the sales momentum sustaining for completed/launched inventory, the company is targeting to launch the Naigaon Phase III and Vasai/Vasind projects in FY22E which is expected to boost sales in FY22-23E. In addition to these upcoming launches, the company also has an estimated unsold inventory of Rs13bn in ODC, Goregaon project (Rs9-10bn in Avenue 4 and balance in completed/nearing completion Avenue 1 and 2 phases) and Rs5bn in the Naigaon Phase 1 and 2 affordable housing project. Apart from its existing portfolio of projects, the company continues to pursue business development opportunities through an asset light JDA model. Over the long term, SRIN's affordable housing projects are expected to contribute 50% of sales bookings.
Mahindra Lifespace Developers	A lack of aggression has resulted in MLIFE's residential business remaining stagnant with annual sales volumes of just 1-1.7msf and sales value of Rs7-10bn over FY17-21. However, with the current MD and CEO, Mr. Arvind Subramaniam at the helm for a year and a new set of business heads, the company is well poised to grow its business in the medium term. As per the company management's stated intent, it is targeting addition of three to four new land parcels each year which will entail annual land spend of Rs5bn and can generate annual sales value of Rs20-25bn. We expect MLIFE to clock Rs12.3bn of sales bookings in FY22E and expect annual sales to touch Rs25bn by FY25E implying a sales value CAGR of 39% over FY21-25E.

Source: Companies, I-Sec research

Appendix: Real Estate Regulator, a game changer

H2FY17 saw major disruption in the form of demonetisation, which led to a virtual washout in terms of new sales with buyers shying away from home purchases on expectations of prices dropping and developers holding back launches owing to weak market conditions and imminent introduction of the Real Estate (Regulation and Development) Act, 2016 (RERA) and the implementation of the Goods & Services Tax (GST) in H1FY18.

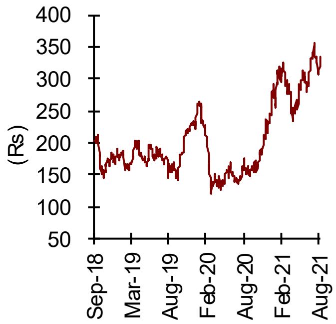
While RERA implementation saw initial teething problems with various states amending the laws as per their preference and few states delaying the implementation, issues have gradually smoothened out from a procedural standpoint with most developers reporting a smooth transition under the RERA regime. However, while organised and large developers will continue to function smoothly under RERA, we believe smaller and unorganised developers will gradually weed out of the market owing to the following reasons:

- Developers can no longer launch projects without approvals and have to wait for a minimum 6-12 months on an average to launch a project post purchasing a land parcel.
- Developers need to maintain an escrow account for each project (can be defined as an entire piece of land or a cluster of buildings) and cannot divert funds to other projects until the construction funding for the existing project has been met through customer collections.
- There are penalties levied for delay in execution and handover of units and developers cannot abandon/leave a project.

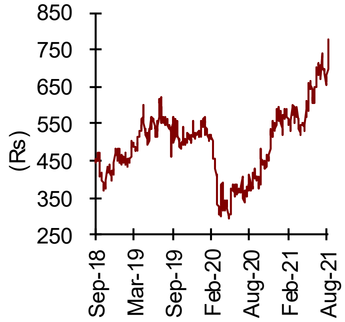
While there may still be many smaller developers who will eventually graduate to an organised way of working under RERA, large and organised developers will have a clear advantage owing to stronger balance sheets, higher customer confidence in delivery capabilities and transparency in pricing and absence of cash component in transactions post demonetisation.

Price chart

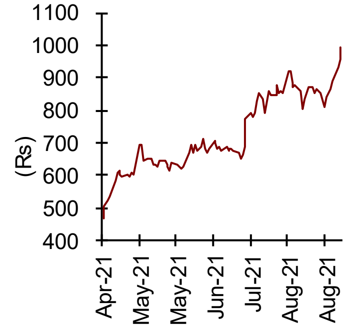
DLF



Oberoi Realty

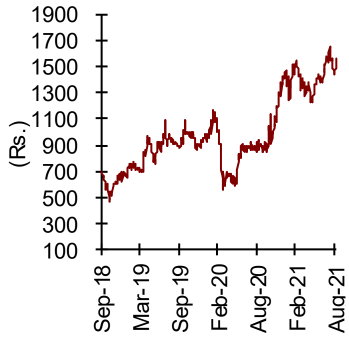


Macrotech Developers

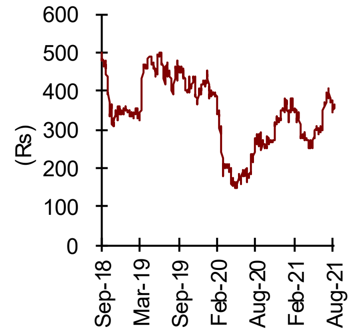


Mahindra Lifespace Developers

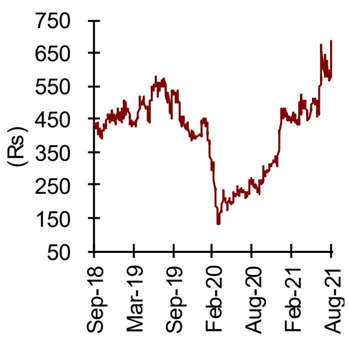
Godrej Properties



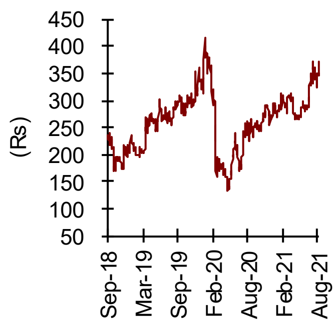
Sunteck Realty



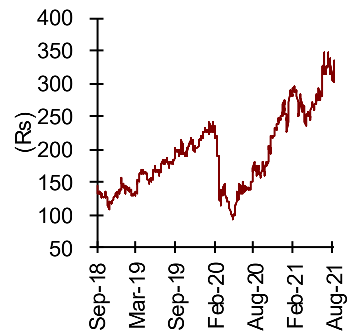
Sobha Ltd



Prestige Estates Projects



Brigade Enterprises



Source: Bloomberg

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