

# HOT PROPERTY

## SECTOR UPDATE

### The more things change...

For the property space, CY21 ended pretty much like CY20 (refer to [Hot Property - Rising like a phoenix](#)) with buoyant housing demand (up 71% YoY in CY21) and improvement in office leasing (Q4CY21 demand highest in past eight quarters). Industry consolidation continued—nearly a third of the overall residential area today is sold by large listed and unlisted players, as per Anarock.

Despite the looming third wave and worries around the rate hike cycle, we believe buoyancy in housing sales will sustain in CY22; office space supply though is expected to outstrip demand during the year, like the past two years. We remain positive on property stocks from a medium-term perspective; DLF and Sobha remain our top picks.

#### Housing space in CY21: Building on the gains of CY20

Q4CY20 had witnessed a 72% QoQ upsurge in housing demand; the trend continued in CY21 with absorption at ~0.24mn units rising 71% YoY. CY21 demand was ~90% of pre-covid levels; the MMR recorded the highest sales at 76,400 units, followed by the NCR at ~40,000 units. The year ended on a strong note with Q4CY21 demand at 90,860 units being the highest quarterly sales since 2015. Housing launches catapulted 85% YoY to ~0.24mn units in CY21, touching the pre-covid levels of 2019's. Average residential property prices across the top cities increased by 3-5% YoY in CY21 as unsold inventory declined 2% YoY to ~0.64mn units at end-CY21.

#### Annuity space: Some recovery, but third wave tempers hope

Office space leasing at 11.6msf in Q4CY21 was the highest in past eight quarters; nevertheless, absorption in CY21 was up only 2% YoY at 26.2msf. Supply rose 23% YoY to 45.7msf in CY21. The trend is expected to sustain in CY22 with JLL forecasting absorption at 31–33msf (up 20–25% YoY) and 45–47msf of supply. Vacancies, at 15.3% at end-CY21 (up 130bps YoY), are consequently likely to increase in CY22. Consumption in malls has been picking up, and we believe the trend will gather traction going ahead albeit after a temporary hiccup due to the looming third wave.

#### Outlook: Hope beckons

As highlighted in our comprehensive sectoral research [Real Estate – Leadership matters](#), RERA-driven consolidation is throwing up growth opportunities for organised players, and covid-19 has only accelerated the process. We believe housing demand will remain robust in the near term, despite a likely increase in mortgage rates. Office space absorption will recover fully only in CY23 with the looming third wave delaying the return of employees to offices. Market share gains for organised developers will continue. Hardening interest rates/reduction in liquidity going ahead may put some pressure on the valuation of realty stocks; nevertheless, the recent correction has made stock attractive from a medium term perspective. We continue to prefer land bank owners such as DLF (**BUY**) and Sobha (**BUY**).

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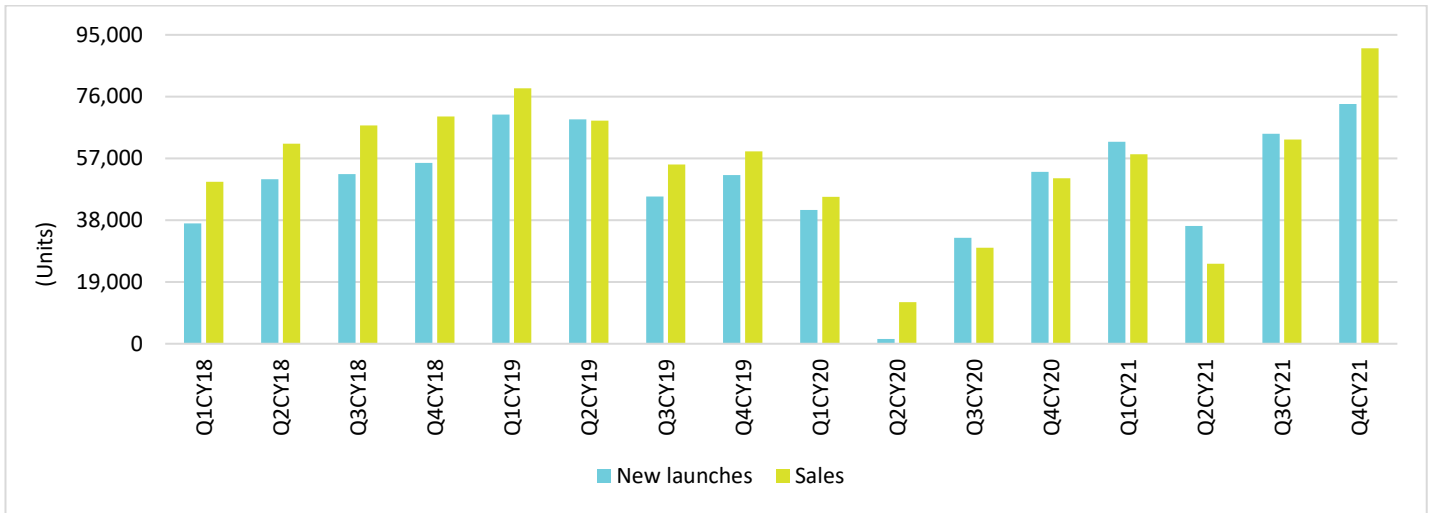
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## Housing space: Blockbuster end to the year...once again

The housing space continued its upward trend in CY21, building upon the momentum witnessed last year. While the second wave did impact demand in Q2CY21, the other three quarters more than made up for it.

**Demand:** As per Anarock, housing sales in Q4CY21 rose 79% YoY to 90,860 units; this was the best quarterly sales performance since 2015. QoQ, demand was up 45%.

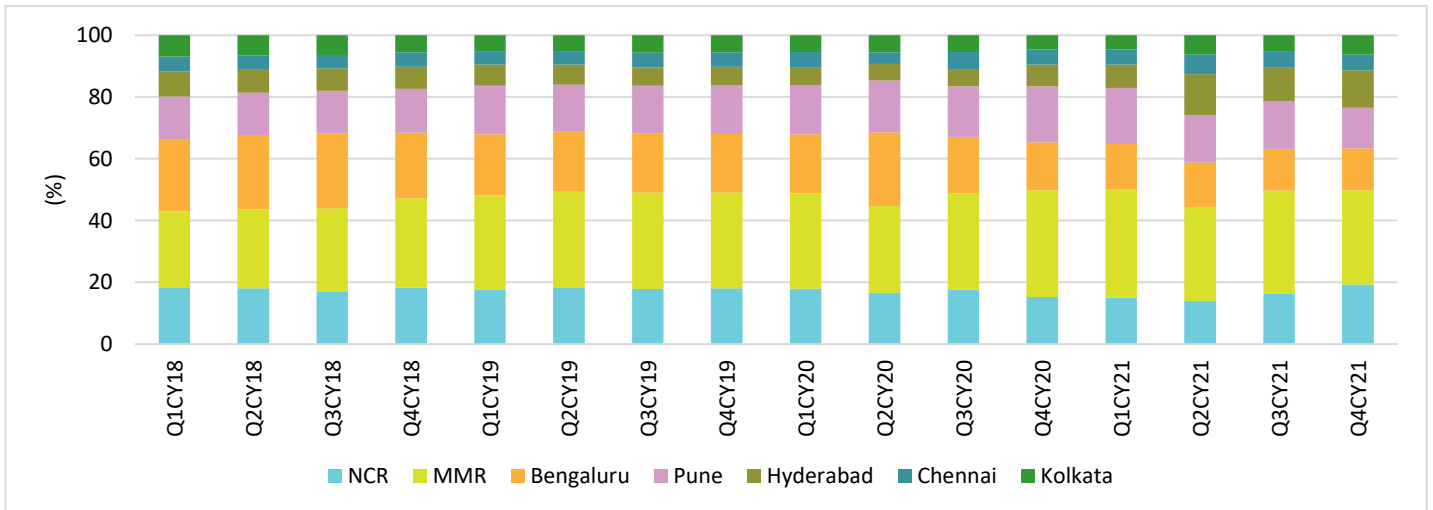
**Exhibit 1: CY21 ends on a strong note**



Source: Anarock, Edelweiss Research

With a share of 30% in sales, MMR spearheaded housing demand during the quarter. NCR, with a 19% share came next.

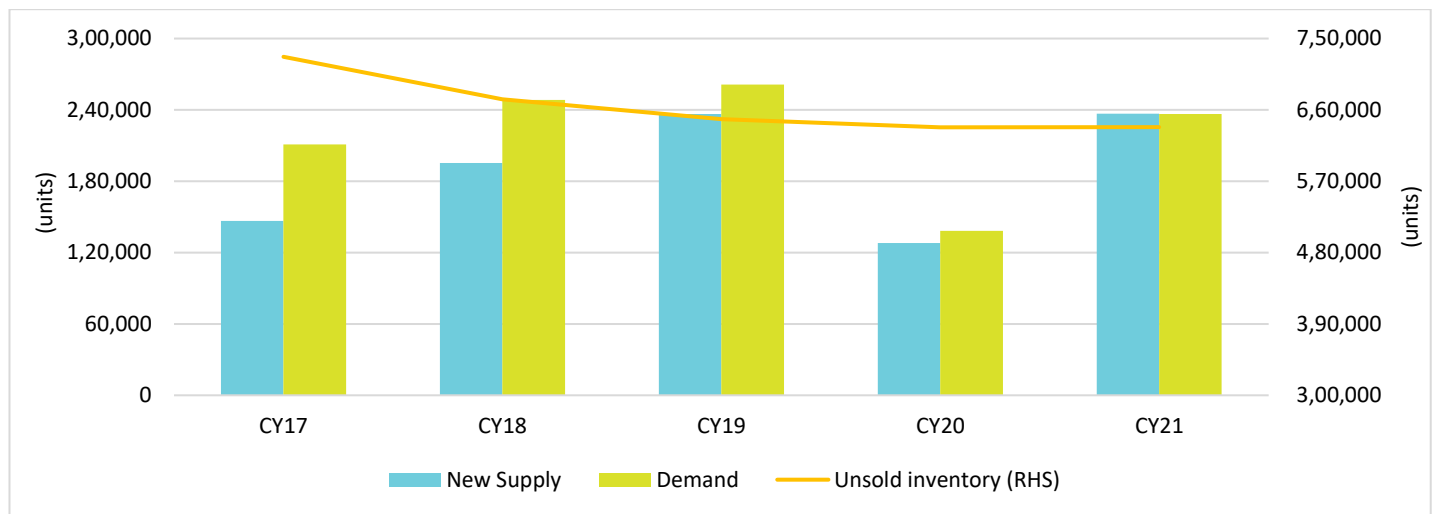
**Exhibit 2: MMR and NCR accounted for almost half of absorption in Q4CY21**



Source: Anarock, Edelweiss Research

For CY21, absorption stood at 2,36,530 units, up 71% YoY. Compared with CY19 sales of 2,61,360 units, it was down 10%.

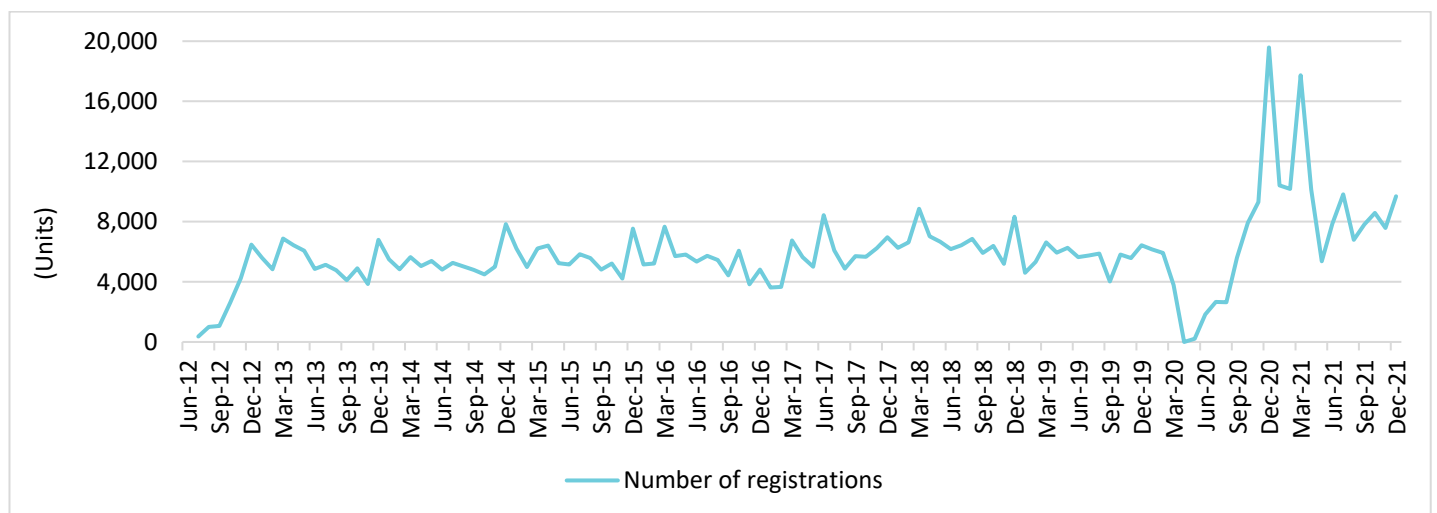
**Exhibit 3: Demand and supply improved YoY in CY21**



Source: Anarock, Edelweiss Research

For the year as a whole, the MMR (32%), the NCR (17%) and Pune (15%) were the major contributors to sales.

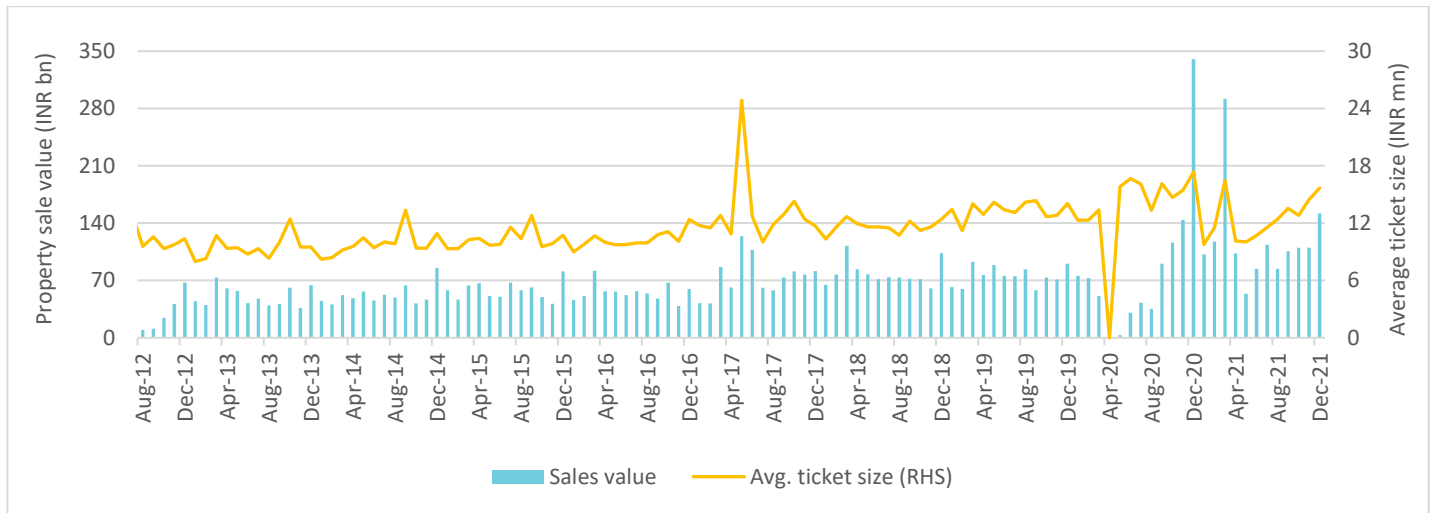
**Exhibit 4: Property registration volumes in Mumbai remained healthy**



Source: Government documents, Edelweiss Research

Total registrations in Mumbai in CY21 stood at ~111,914 units (up 71% YoY). This came in despite the lower stamp duty benefits not getting extended beyond Mar-21.

**Exhibit 5: Mumbai property sale value in CY21 shot up 42% YoY**

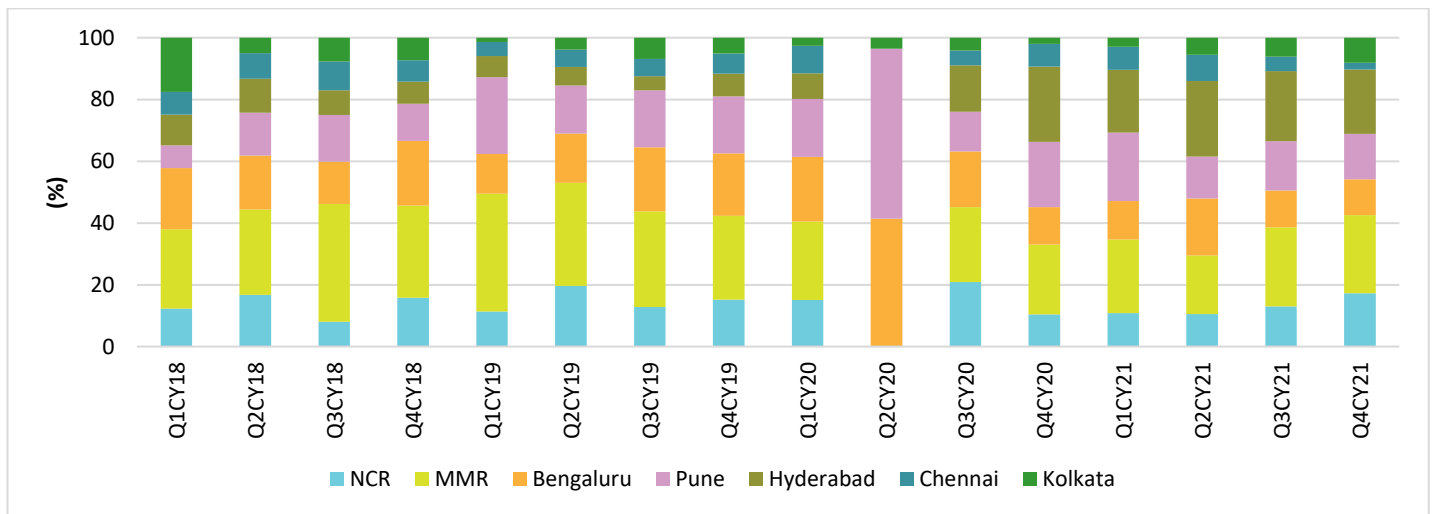


Source: Government documents, Edelweiss Research

The value of properties registered in Mumbai in CY21 shot up 42% YoY to INR1,426bn.

**Launches:** Launches also improved during Q4CY21, rising 40% YoY. Supply came in at 73,770 units during the quarter, up 14% QoQ. The MMR (25%) and Hyderabad (21%) contributed to the launches during the quarter.

**Exhibit 6: MMR and Hyderabad contributed ~46% to launches in Q4CY21**

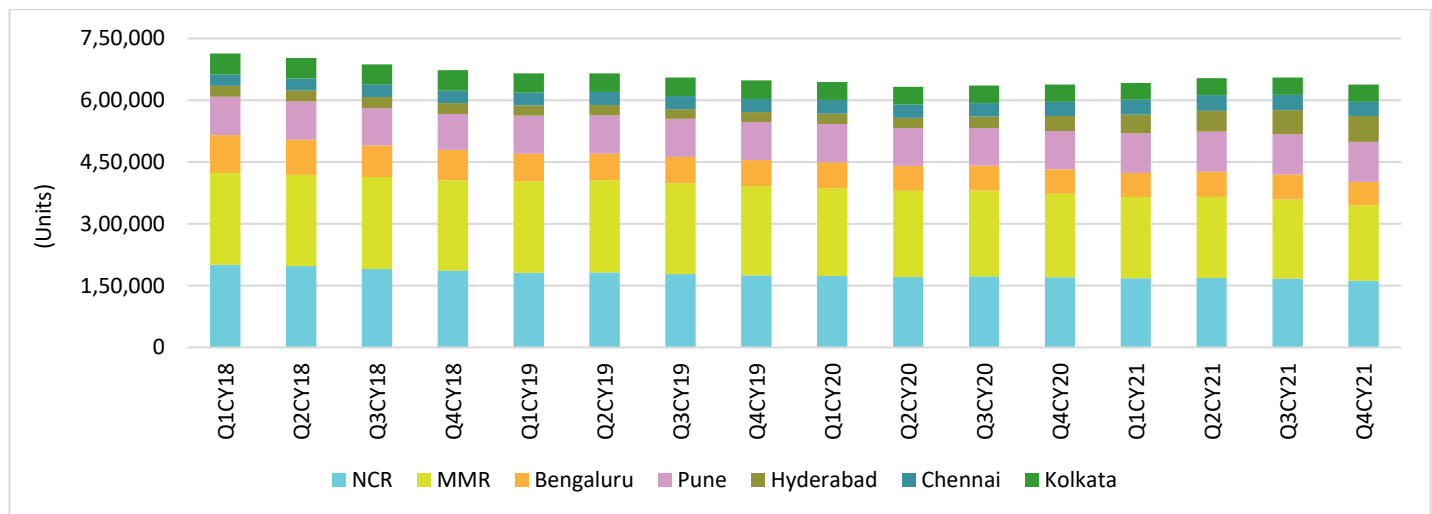


Source: Anarock, Edelweiss Research

For CY21, launches stood at 2,36,700 units, up 85% YoY and in line with CY19 supply. The MMR (24%), Hyderabad (22%) and Pune (17%) were the major contributors to sales during the year.

The mid-segment (INR4–8mn) had the maximum share with 39% in launches during CY21, followed by the affordable segment (priced under INR4mn) with a 26% share. The premium segment (priced between INR8-15mn) had a 25% share.

**Exhibit 7: Unsold inventory broadly flat YoY in CY21**



Source: Anarock, Edelweiss Research

**Unsold inventory** declined 2% QoQ to ~638k units at end-CY21 (flat YoY).

**Prices:** Average residential property prices across the top cities increased by 3-5% in 2021 compared with 2020. Bengaluru and the MMR witnessed the highest price increase of 5% while Chennai and Kolkata witnessed a 3% increase.

### Multiple factors aiding housing demand

Despite worries about job losses due to pandemic, the pace of pickup in housing sales has taken almost everyone by surprise. We attribute the sharp up move in sales to the following:

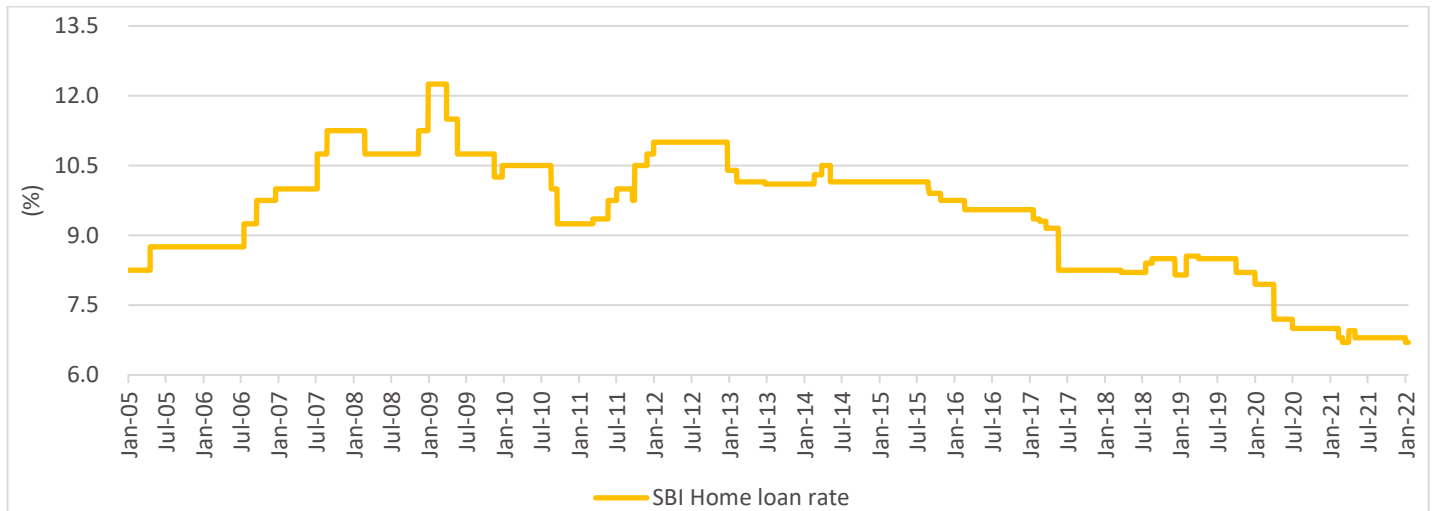
- Government support:** One of the biggest reasons behind the surge in sales is the support provided by various state governments to the realty space. For example:
  - The West Bengal government has slashed stamp duty by 2% and circle rates by 10% till January 2022. Aided by this, housing demand in Kolkata surged 83% YoY in CY21.
  - The Delhi government has provided a 20% rebate on circle rate for land and immovable property. The benefit was originally provided till Sep-21 and later extended to Dec-21 and further to June-22.
  - The Karnataka government has slashed the stamp duty on flats priced between INR3.5mn and INR4.5mn to 3% from 5%. The government had already reduced the stamp duty to 3% for apartments priced from INR2mn to INR3.5mn and to 2% for flats priced below INR2mn.
 

Recently, the government has slashed the property guidance value across the state by 10% for the next three months.
  - The Rajasthan government is giving a concession of 2% in stamp duty on sale documents of flats up to INR5mn. The benefit was originally given till Jun-21 and has now been extended to Mar-22.
  - The Maharashtra government had reduced stamp duty in Mumbai and Pune from 5% to 2% between Sep–Dec 2020 and to 3% between Jan–Mar-21.
  - The Maharashtra government had also slashed construction premiums related to ongoing and new projects by 50% up to December 31, 2021 (refer to, [Hot Property - Cut in premium: Bonanza for developers](#)). Media

articles indicate that the government may extend this benefit till March 2022.

- **Low mortgage rates:** The current mortgage rate at <7% is among the lowest in the past decade. This has boosted housing demand significantly as the gap between EMIs and rents has considerably shrunk. This has led to many fence sitters taking the plunge.

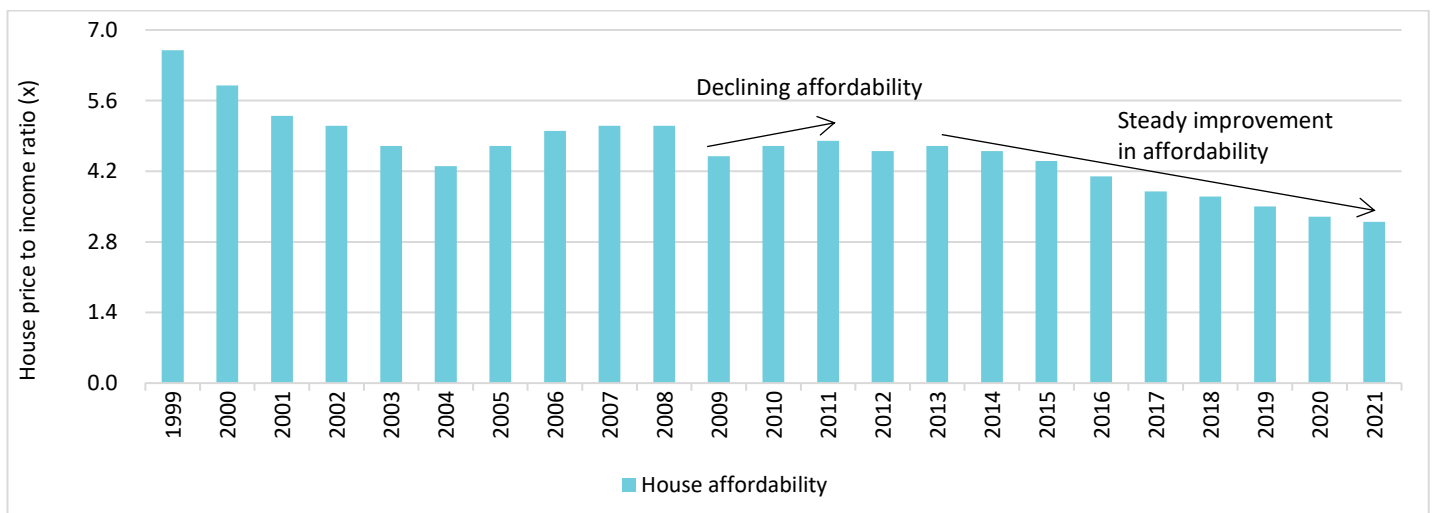
**Exhibit 8: SBI Home loan rate**



Source: SBI, Edelweiss Research

A combination of increasing income levels over the past decade and lower mortgage rates has boosted house affordability significantly.

**Exhibit 9: Improving house affordability**

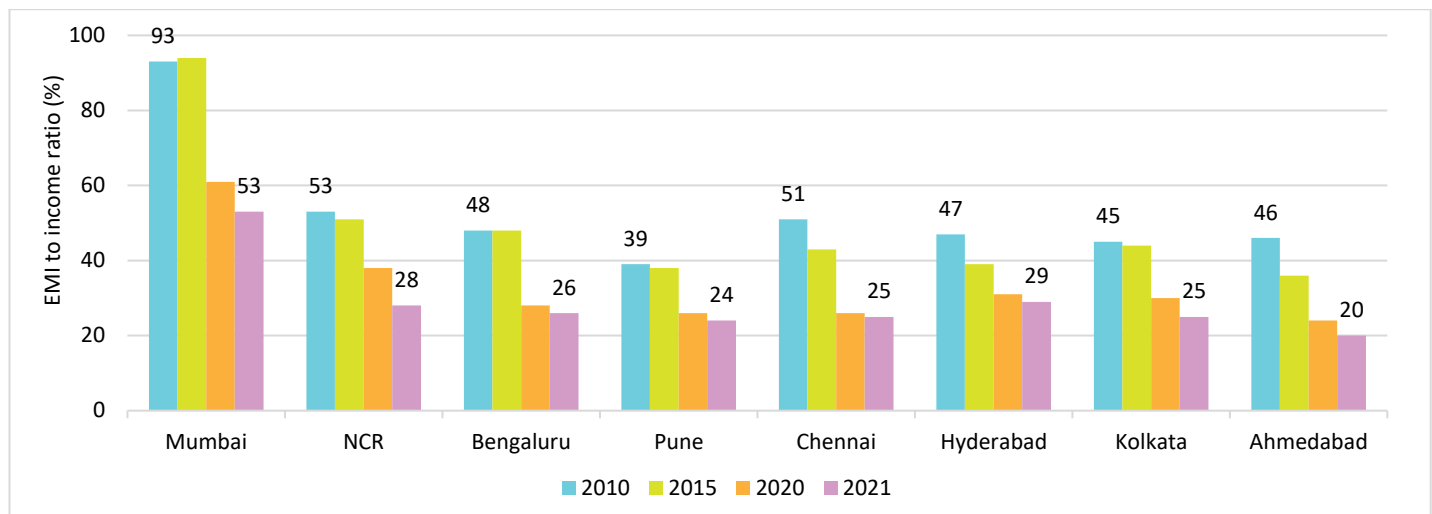


Source: HDFC, Edelweiss Research

Note: Affordability equals property price divided by annual income based on customer data of a large metro city

The pattern has played out across cities uniformly. A recent report by Knight Frank, which tracks affordability (defined as ratio of EMI to income), indicates that all major cities have witnessed significant improvement in affordability over the past decade.

**Exhibit 10: Affordability has improved significantly over the past decade**



Source: Knight Frank, Edelweiss Research

As per Knight Frank, an EMI/income ratio over 50% makes it difficult to secure home loans from banks and housing finance companies, making it unaffordable to purchase a house. Going by this yardstick, Mumbai remains the only major city where houses are still relatively 'unaffordable'.

In fact, except Mumbai, the ratio in all other cities is 20–30% currently (compared to 40–50% in 2010), indicating the rising attractiveness for home buyers.

- **Covid-19-induced factors:** The pandemic accompanied by work-from-home (WFH) has led to consumers realising the importance of owning a house rather than renting one.
- **Strong hiring from tech companies:** As per Knight Frank, India's top 5 IT companies are reported to have hired 260,000 employees over Apr-20-Sep-21 period. This has boosted housing demand in cities such as Bengaluru, Hyderabad, Chennai and Pune.

### Covid-19 forces a change in consumer behaviour...

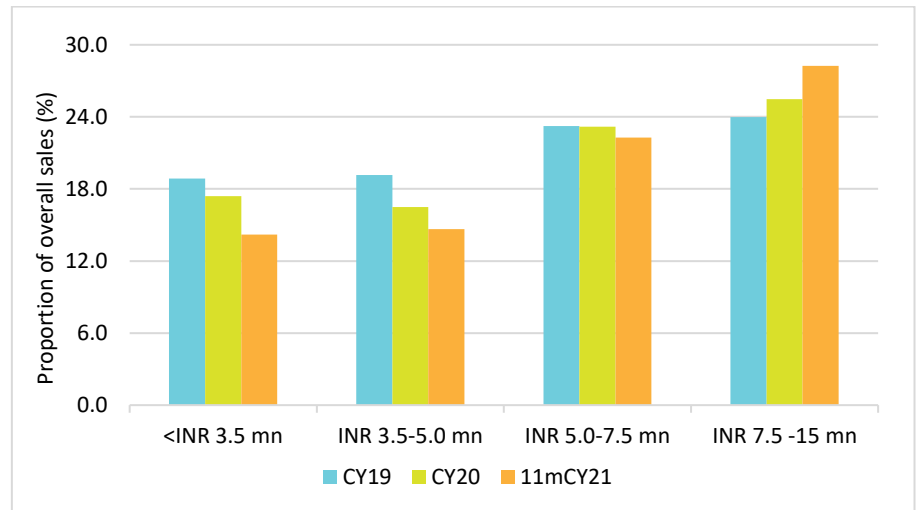
The pandemic and the accompanying WFH has led to the need for a bigger house with a designated 'work area' and a balcony to unwind. This has led to emergence of the following trends over the past few quarters:

- **Preference for higher unit sizes:** With many couples forced to WFH, the need for a bigger house was felt acutely. This led to demand for higher ticket sizes. Multiple reports have confirmed this trend:
  - As per Anarock, with WFH and online schooling the new normal, there was a high demand for larger houses; consequently, mid-income (units priced between INR4–8 mn) and high-end (units priced between INR 8–15mn) did well. Altogether, around 65% of the supply in 9MCY21 came in these segments.
  - According to ANAROCK's latest consumer sentiment survey, there was a clear rise in the preference for properties priced over INR9mn. During the first wave, 27% of respondents preferred properties priced over INR9mn, which increased to 38% during the second wave.
  - On the other hand, the affordable housing segment, slowed down in CY21 because of significant supply addition over the past couple of years. This

segment had witnessed launch of 0.17mn units from 2019 till Q3CY21 (a third of the overall new launches). As a result, developers went slow on affordable housing supply to take stock of the situation and focus on execution rather than adding new projects.

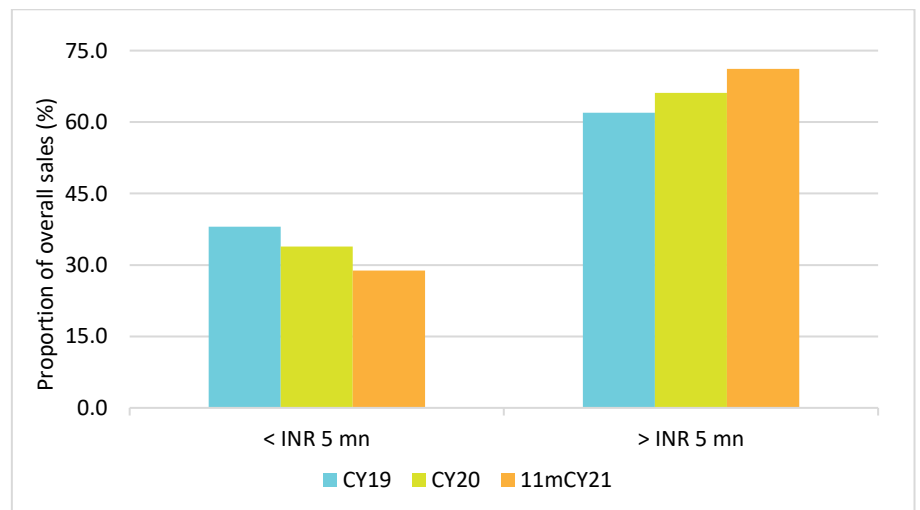
- Data from PropEquity indicates that the share of houses with lower-ticket sizes (as % of overall sales) has fallen steadily since CY19; conversely, a higher proportion of larger ticket size houses are being sold.

**Exhibit 11: Higher ticket sizes preferred post covid-19**



Source: PropEquity, Edelweiss Research

**Exhibit 12: Higher ticket sizes preferred post covid-19**

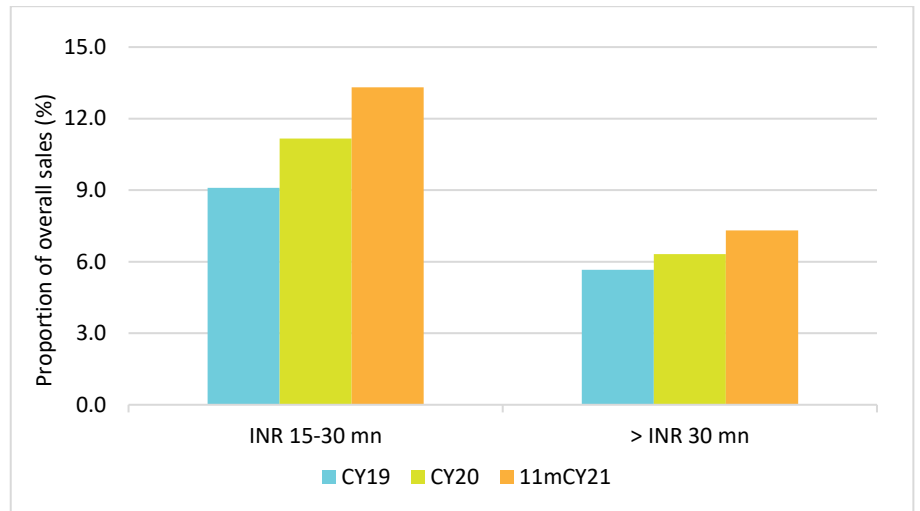


Source: PropEquity, Edelweiss Research

- **Luxury sales:** Not only has the pandemic spurred demand for bigger houses, consumers want more amenities too if they have to spend more time at home. This has led to higher demand for luxury homes.

CY20 had witnessed sales of luxury houses picking up; the trend sustained in CY21 as buyers took advantage of attractive prices/schemes available.

**Exhibit 13: Luxury unit sales have jumped post-pandemic**



Source: PropEquity, Edelweiss Research

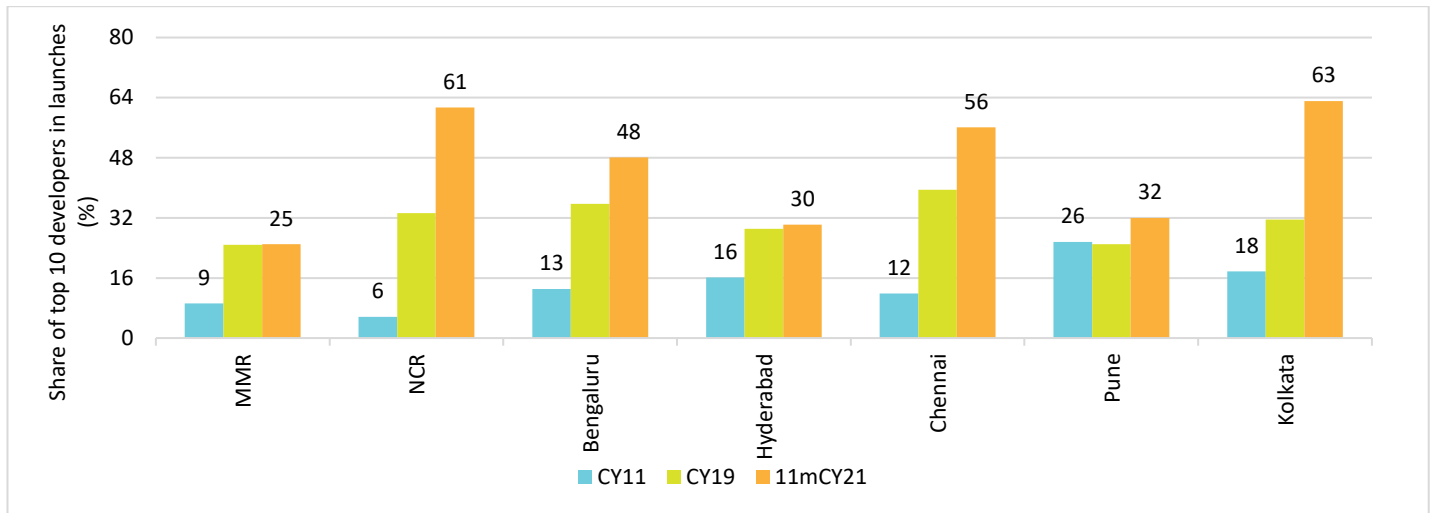
- Anarock indicated that unsold inventory levels in South-Central Mumbai have corrected by ~10% (from 11,900 units to 10,700 units). 1,910 units were sold in South-Central Mumbai over Q4 2020 to Q3 2021– at least 86% more than in the corresponding period a year ago (Q4 2019–Q3 2020).
- DLF has witnessed strong demand for independent floors and has been able to take significant price hikes for the product.
- **Shift towards suburbs:** While most wanted a home closer to office earlier, the growing prevalence of WFH and budgetary concerns (due to need for bigger homes) has led to many consumers being OK at looking houses in suburbs.

In some way, covid-19 has upended the trend towards reduction in apartment size and tepid sales in the luxury real estate segment, which was being witnessed prior to the pandemic. It yet remains to be seen whether these changes are permanent in nature or will be forgotten once normalcy resumes.

### ...and further strengthens trend of industry consolidation

The pandemic disrupted cash flows for the realty space; while the organised developers were able to tide over the crisis, the tier 2/3 developers struggled to manage liquidity. This led to strengthening of the trend of industry consolidation, which has been going on for the past few years.

**Exhibit 14: Share of organised developers in launches skyrocketed post covid-19**

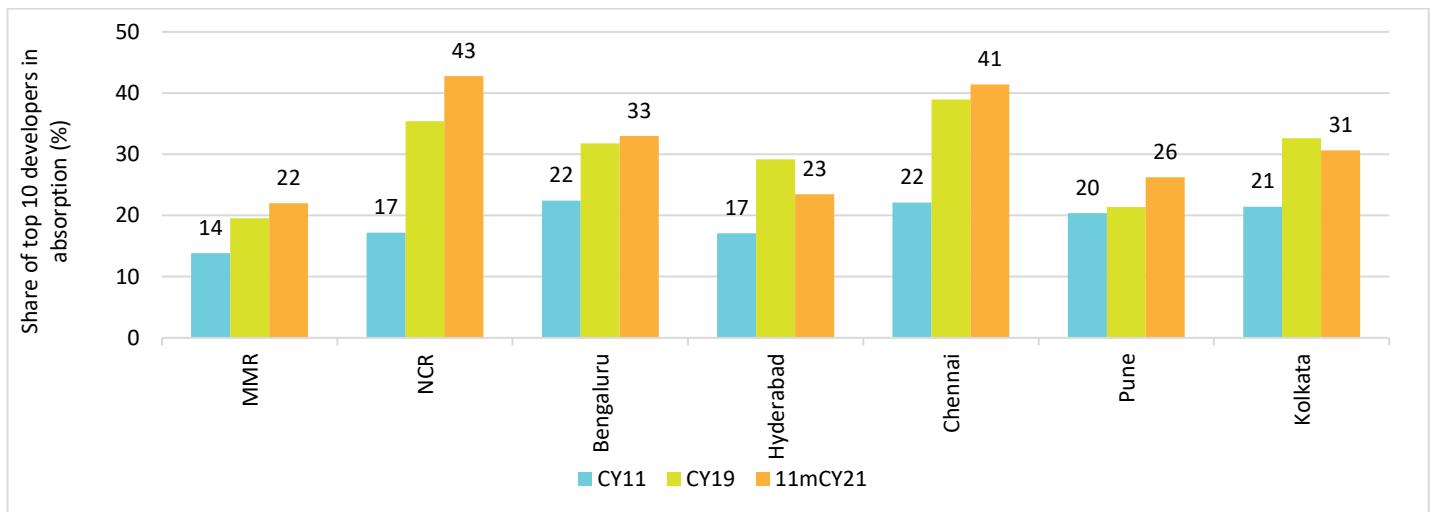


Source: PropEquity, Edelweiss Research

The share of top-10 developers in launches in January–November 2021 was much higher than CY19. In fact, in the NCR, Chennai and Kolkata, more than half of the overall launches were from top-10 developers.

Something similar happened on the demand front as well. Concerns about survival of tier 2/3 players and funding availability meant that consumers flocked to tier 1/organised developers while buying houses.

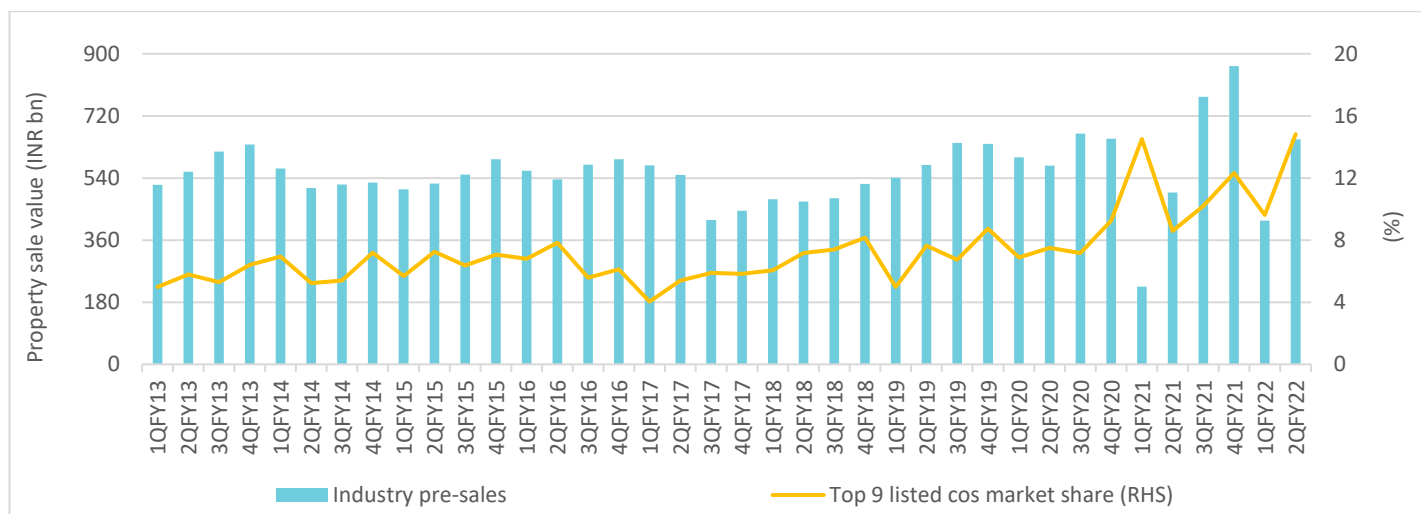
**Exhibit 15: Organised developers increased their share in demand in CY21**



Source: PropEquity, Edelweiss Research

As a result, the share of organised developers in demand, which had already been increasing for the past few years, further rose in the current year.

**Exhibit 16: Market share of nine listed companies rising steadily**



Source: PropEquity, Company, Edelweiss Research

The share of nine listed companies in industry pre-sales was ~15% in Q2FY22, the second highest since FY14.

### Housing segment: Outlook for CY22

We believe CY22 is likely to witness the sustenance of demand recovery. In our view, absorption will outstrip supply, leading to a correction in unsold inventory levels.

Anarock expects the following for CY22:

- Supply and demand may reach CY19 levels
- Interest rates may start inching up from H2CY22.
- Prices may appreciate in the range of 5–10% driven by input cost pressure and supply chain issues
- Share of large players will increase
- Mid-end and high-end housing segments will continue to drive bulk of demand
- Private equity (PE) investments in the residential segment to rise further. The residential segment’s share of PE investments has already increased to 22% during H1FY22 from 14% during H1FY21.

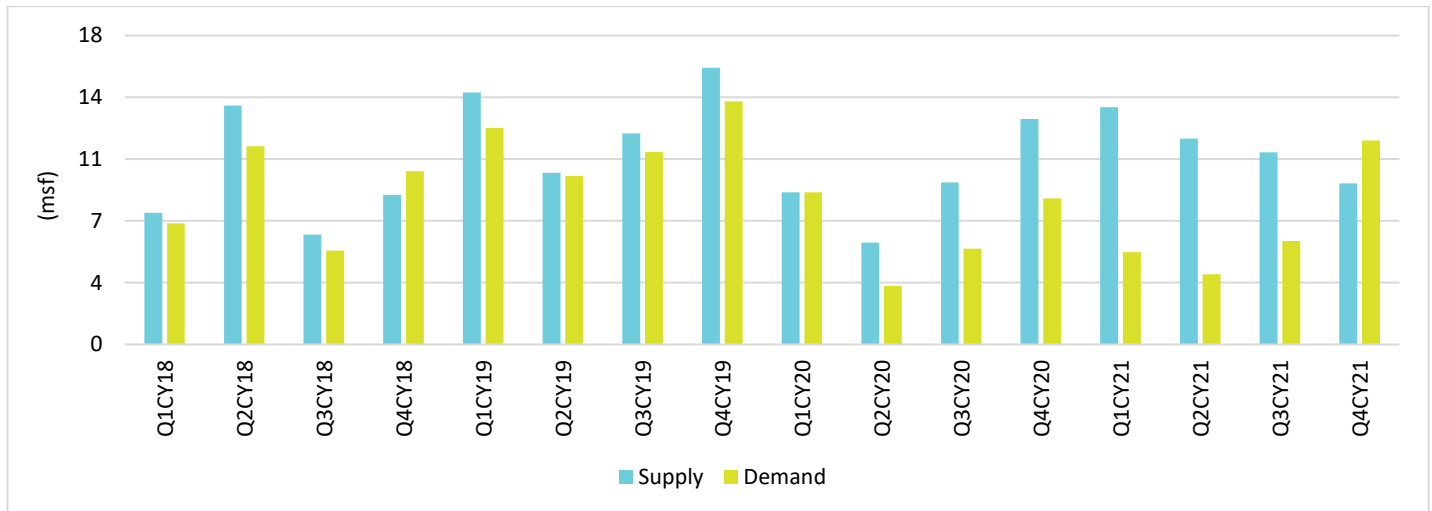
### Office space: Leasing improves in Q4CY21...

Office leasing has been sluggish ever since the pandemic broke out. While demand recovers for a couple of quarters after every wave, it is unfortunately followed by a new wave which defers the return of employees and impacts absorption. This has kept overall absorption much below pre-covid levels. Supply, on the other hand, has been robust, leading to rising vacancy levels.

**Demand:** According to JLL, office demand in Q4CY20 had improved 52% QoQ. Along similar lines, leasing in Q4CY21 was up 40% YoY and 97% QoQ; at 11.6msf, absorption was the highest in the past eight quarters.

Hyderabad topped the absorption charts during the quarter; the city, along with Bengaluru, accounted for ~48% of net absorption during the quarter.

**Exhibit 17: Office space demand ramped up in Q4CY21; supply has remained healthy over last year**

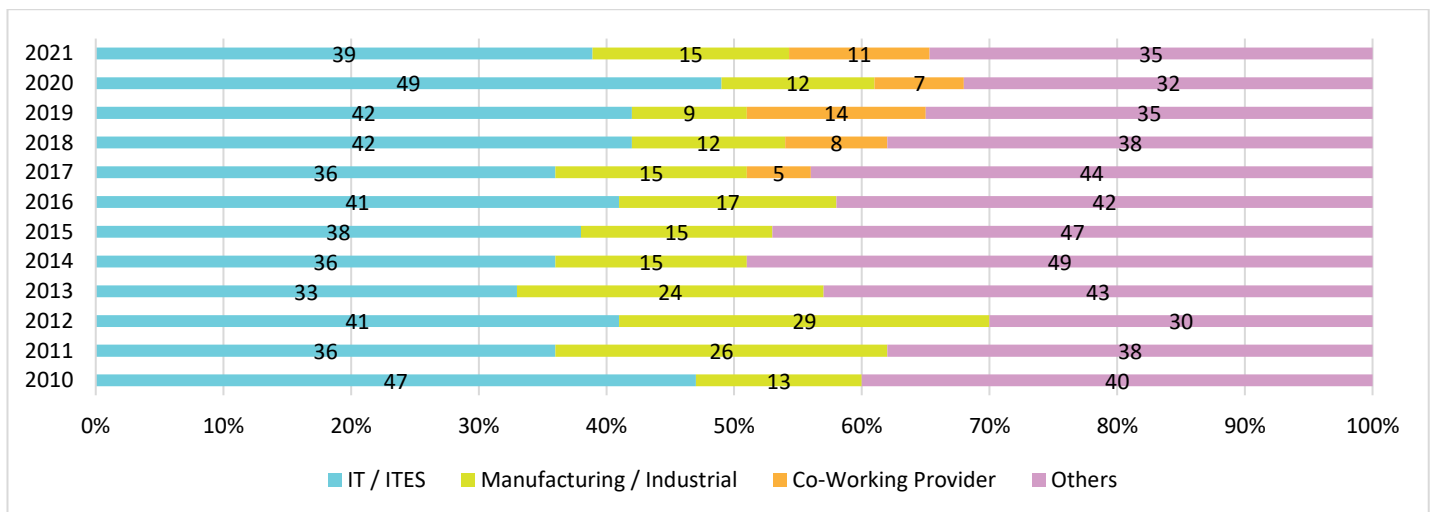


Source: JLL, Edelweiss Research

CY21 absorption came in at 26.2msf, up just 2% YoY. Bengaluru led with a 30% share of demand during the year, followed by the NCR (18%) and Hyderabad (16%).

As per JLL, IT/ITeS (42%), Manufacturing (15%) and flex space providers (10%) contributed to 67% of the total leasing activity in Q4.

**Exhibit 18: IT/ITeS remains dominant occupier of office space in CY21**



Source: JLL, Edelweiss Research

For the year as a whole, IT/ITeS remained the leading occupier category with a 39% share of leasing activity, followed by manufacturing/industrial (15%) and flex space with an 11% share.

**Supply:** As far as supply is concerned, new completions during Q4CY21 came in at 9.1msf, down 29% YoY/16% QoQ. Tech-dominated cities of Bengaluru and Hyderabad contributed ~55% to completions during the quarter.

For CY21, supply came in at 45.7msf, up 23% YoY.

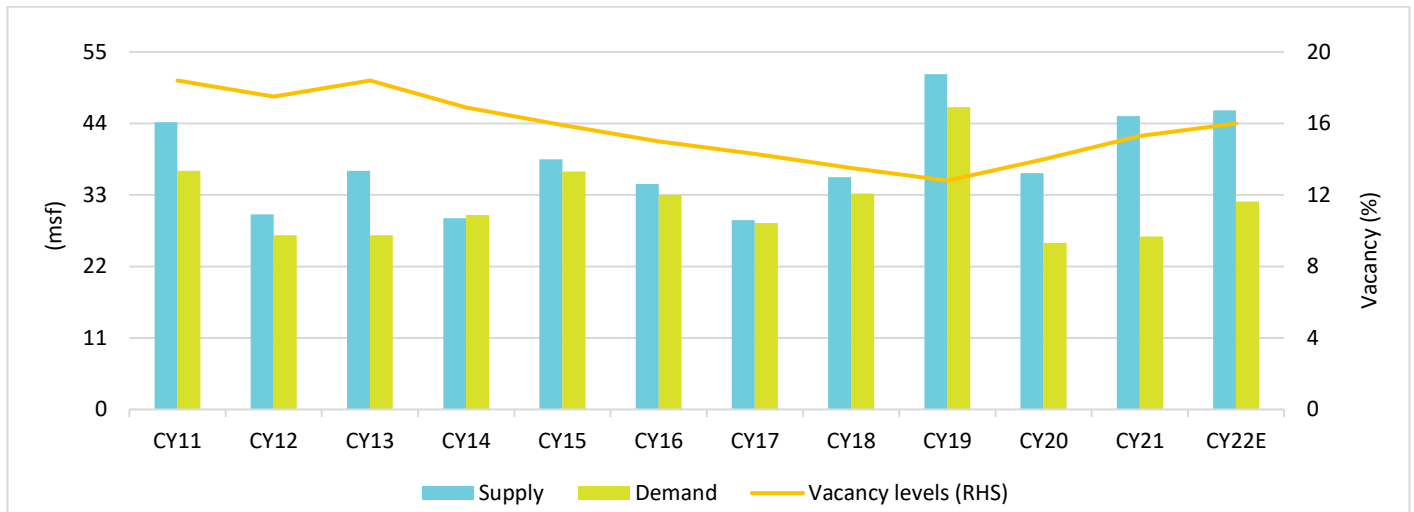
**Vacancy levels:** Vacancy declined 60bps QoQ to 15.3% in Q4CY21. In Pune, vacancy continues to be in single digits while it now stands at 10% in Bengaluru.

Vacancies at the year-end were up 190bps YoY and were higher by 280bps compared with end-CY19. This indicates deleterious impact that covid has had on the erstwhile booming office space.

### ...however, broader concerns remain...

For the second year running, India's office space witnessed leasing of ~26msf. This was down 44% compared to the peak of 46msf in CY19 and ~19% compared to the average demand during CY16–18. Taken in isolation, this might not seem too bad.

**Exhibit 19: Supply likely to be higher than demand in CY22, like was the case in CY20 and CY21**



Source: JLL, Edelweiss Research

The bigger issue is that supply has continued to remain healthy. While completions did decline by ~30% YoY in CY20, they rose 23% in CY21.

Supply during CY21 was down just ~13% from the CY19 peak; also, it was about 5% higher than the average supply during CY16–18, highlighting the disproportionate impact of covid-19 on demand compared to supply.

Consequently, the demand–supply gap continues to widen. Supply eclipsed demand by ~19.5msf during CY21, with the gap widening from 11.5msf in CY20.

With a potential third wave, we expect demand to take a hit again. JLL has forecasted a net absorption of 31–33msf in CY22 (up 20–25% YoY) and 45–47msf of supply (which is already pre-committed to the extent of 25–26%). With supply likely to again outstrip absorption, we expect vacancy levels to inch up further in CY22.

### ...with strong tech hiring providing a silver lining

Amid this challenging scenario, the robust hiring by tech companies provides a ray of hope to the office space. According to NASSCOM, revenues of the IT-BPM industry in FY21 are estimated to be ~USD194bn. The domestic revenues of IT industry are estimated at ~USD45bn in FY21. The IT industry is expected to grow to USD350bn by 2025. This strong growth is likely to create healthy office demand going ahead.

Exhibit 20: Office space requirement from top 5 IT companies

S.No.	Line Items	Value	Unit
1	Total new hires	260,546	People
2	Attrition at 20%	52,109	People
3	<b>Total effective new staff</b>	<b>208,437</b>	People
4	Staff in Work From Home mode @ 30%	62,531	People
5	Total staff utilising office space	145,906	People
6	Average office space per staff @ 80 sq ft/person	11,672,461	Sq ft.
<b>Total space requirement in the future</b>		<b>11,672,461</b>	<b>Sq ft.</b>

Source: Knight Frank, Edelweiss Research

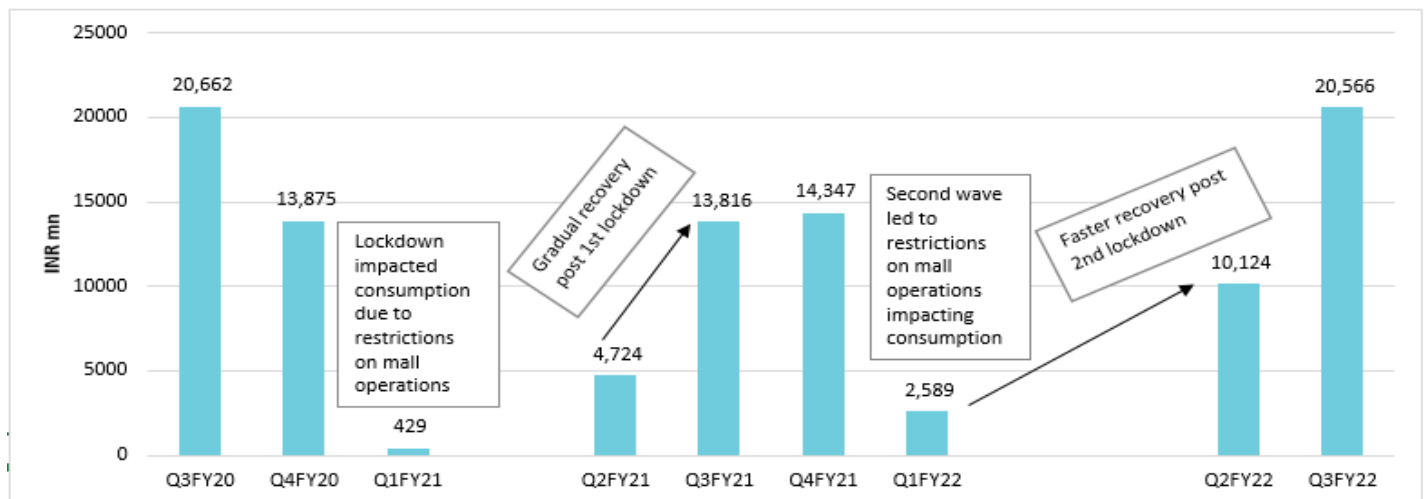
According to Knight Frank, India's top 5 IT companies are reported to have hired 260,000 new employees over the Apr'20–Sep'21 period. This is likely to create requirements of ~11.7msf of office space. Thus strong tech hiring could provide succour to the office space over the medium term.

### Retail space: Consumption bounces back

Despite the second wave during the year and a potential third wave, retail space outlook at end-CY21 is promising. As was the case in CY20, the past couple of months and especially the festive season during CY21 witnessed handsome recovery in consumption. Footfalls have increased significantly and conversion ratios have surged.

For example, for Phoenix Mills (PML), total consumption in Q3FY22 was INR20.6bn, ~100% of Q3FY20 levels (excluding Phoenix Palassio's contribution, which opened in July 2020, Q3FY22 consumption was ~89% of Q3FY20 consumption).

Exhibit 21: PML – Rising consumption trend a positive



Source: Company, Edelweiss Research

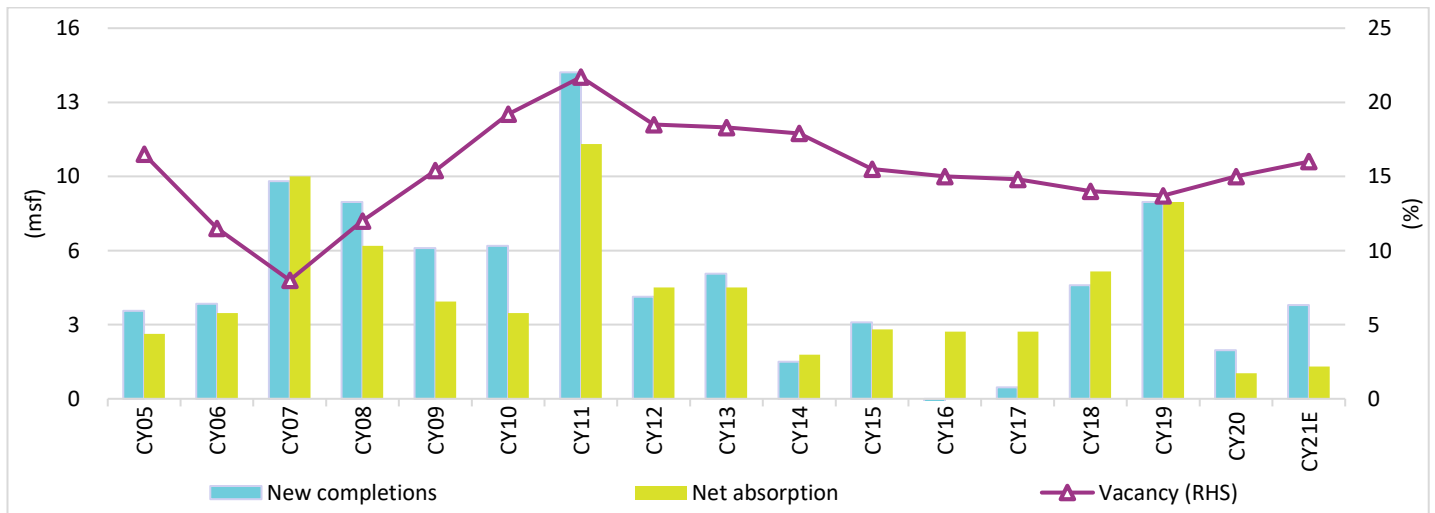
While the third wave will impact consumption adversely, we expect its impact to be transient. We believe rising consumption is definitely a significant positive for retailers and will bring buoyancy back into the retail space soon.

## Pandemic hastens consolidation in retail space

The pandemic has led to significant amount of pain for the retail realty sector as it has forced many retailers to shut shop. This has accelerated consolidation in the industry with weaker players likely to exit the market and stronger ones expanding their portfolio through acquisitions.

We have already witnessed significant reduction in supply in the retail space. Prior to the covid-19-induced lockdown in March 2020, Anarock had estimated addition of ~14.6msf retail space in the top-7 cities in CY20. However, due to the pandemic, most new completions were deferred (to 2021 and beyond); major Indian cities added just 2.1msf retail space in CY20.

**Exhibit 22: Mall completion timelines have been deferred post covid-19**

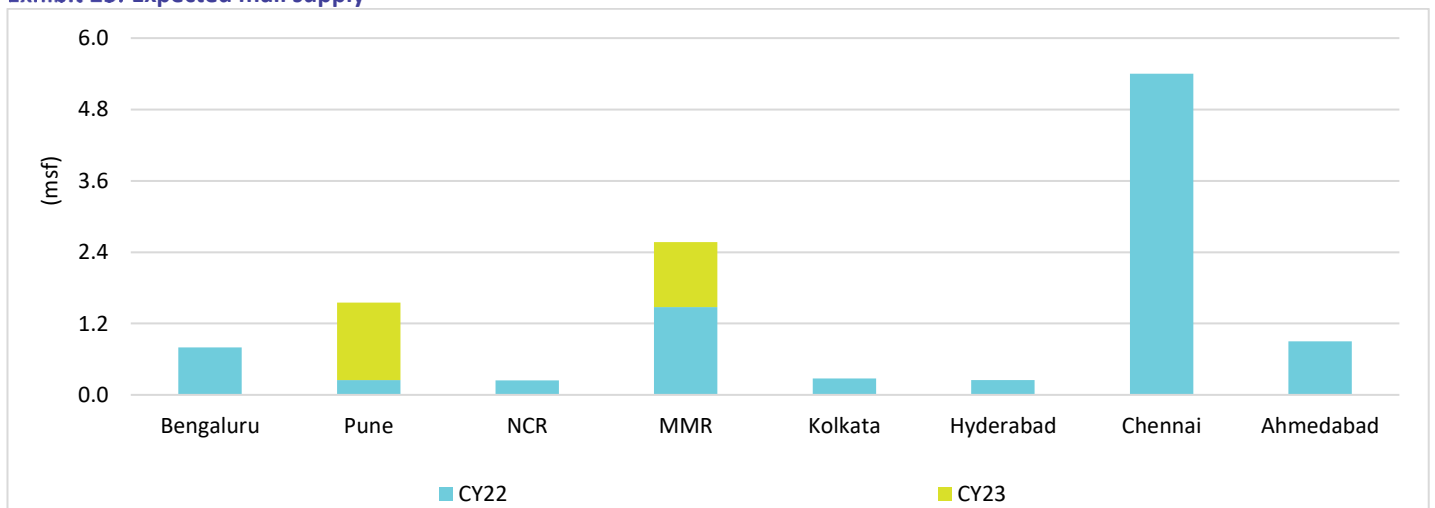


Source: Anarock, Edelweiss Research

Note: Data for top seven cities

As per Anarock, ~4.5msf of new supply was planned for 2021 with tier I cities accounting for about 90% of space.

**Exhibit 23: Expected mall supply**



Source: Cushman and Wakefield, Edelweiss Research

Going ahead, Chennai followed by the MMR are likely to witness large mall supply; on the other hand, Kolkata, the NCR and Hyderabad have low levels of incremental supply.

We believe funding constraints will mean that concerns about future supply will continue to linger. Also, loss of business due to the pandemic and the change in contractual agreements (with higher contribution from revenue share and less from minimum guaranteed revenues) mean that some of the existing mall owners will continue to face difficulties.

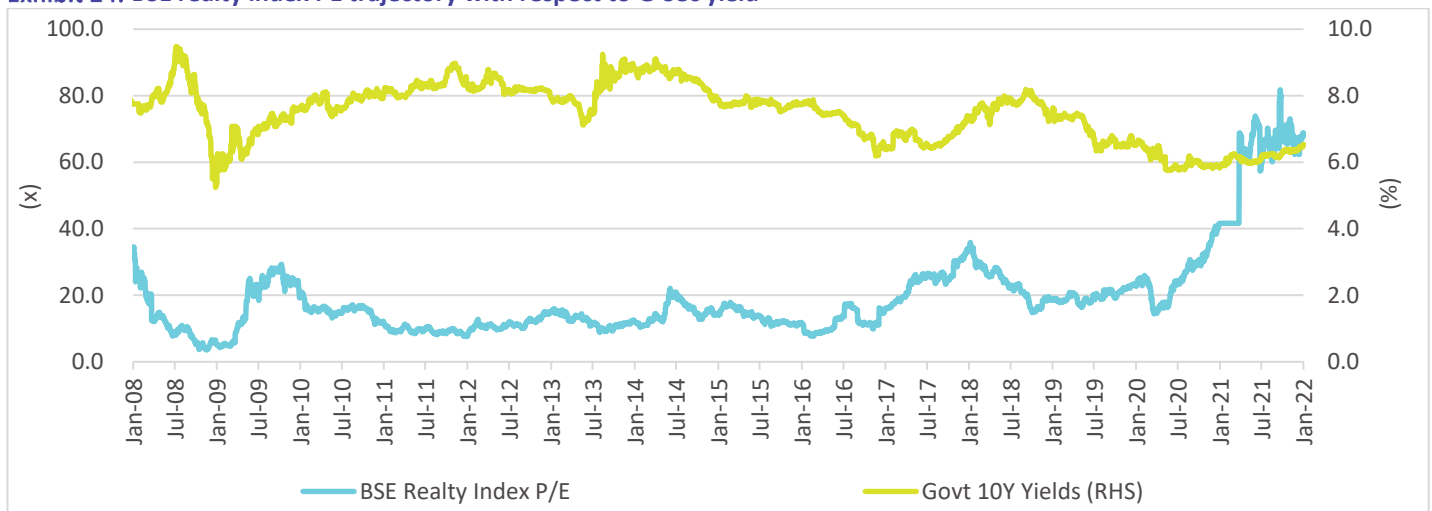
In such a scenario, consolidation in the retail space will accelerate going ahead. Experienced players such as PML are likely to use their strong financial position to take advantage of the acquisition opportunities available in a stressed environment.

### Benign interest rates helping valuations

A soft interest rate regime aids realty developers in multiple ways. Not only does it result in low mortgage rates (thereby boosting demand), but it also aids profitability for developers by bringing down interest costs. It also enhances valuations of realty companies due to lower discounting rates.

Historically, P/E multiples of realty companies have had a negative correlation with interest rates. This is because declining interest rates are not only accompanied by an improvement in profitability, but also have the potential to fuel higher demand from end users. In addition, lower cost of capital boosts rental asset valuation. As a result, a lower interest rate regime, historically, drove outperformance of realty stocks.

**Exhibit 24: BSE realty index PE trajectory with respect to G-Sec yield**



Source: Bloomberg, Edelweiss Research

With interest rates now likely to rise, we expect the valuation of realty companies to come under a slight pressure in the interim. However, considering the tailwinds of industry consolidation and rising housing demand, we believe the structural story for the sector is intact.

## CY22 outlook: A lot to look forward to

We believe CY22 will be a year of growth and gradual improvement for companies in our coverage. While the housing segment will continue to clock good volumes, we expect the retail segment to continue to recover and likely reach normalcy by the year-end. The office space, however, may see vacancies increasing with supply eclipsing demand.

We anticipate consolidation in the realty space in favour of organised developers to gather more steam; focus on execution is likely to aid developers with strong balance sheets and established brands. Developers with robust balance sheets will also benefit from attractive business development opportunities. Overall, we expect stronger players to gain market share going ahead.

## Likely rate hikes leads to revision in target prices

We believe the potential uptick in interest rates will shave off some of the valuation premium for realty stocks. Keeping this in mind, we are reducing the NAV premium for Godrej Properties from 35% to 20%, resulting in a revised TP of INR2,405 (INR2,837 earlier).

Similarly, for Brigade, we are reducing the NAV premium from 30% to 20%, resulting in a revised TP of INR572 (INR620 earlier).

For PML, we believe the third wave will again impact consumption adversely and derail the momentum witnessed in consumption. Consequently, we reduce the NAV premium from 25% to 10%, resulting in a revised TP of INR1,311 (INR1,459 earlier).

### Exhibit 25: Target prices revised for coverage stocks

Company	RECO	CMP (INR)	Premium to NAV	TP (INR)	Upside (%)
DLF	BUY	401	0%	471	17.6
Sobha	BUY	852	0%	1,132	32.8
Godrej Properties	BUY	1,892	20%	2,405	27.1
Macrotech Developers (Lodha)	BUY	1,206	0%	1,428	18.4
Brigade	BUY	441	20%	572	29.6
The Phoenix Mills	BUY	955	10%	1,311	37.3
Oberoi Realty	BUY	911	30%	1,205	32.3
Sunteck Realty	BUY	511	0%	592	15.9

Source: Edelweiss Research

The recent correction in the realty stocks has made them attractive from a medium-term perspective considering rising consolidation. While the spectre of Fed tapering/interest rate hike and a third wave might cause some volatility in the near term, we are sanguine about long-term growth prospects for the sector.

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