RESEARCH

OCTOBER 2011
E&R @ GLANCE

ECONOMY & REALTY

Knight Frank

Economic outlook

Global economic slowdown and uncertainty in the financial markets is finally having its consequences on the Indian economy with all the lead indicators of growth showing a downward trend. Index of Industrial Production (IIP) grew at 4% in August 2011 which is at one of the lowest levels since April 2010. The manufacturing Purchasing Managers Index (PMI) is at its two year low of 50.4 for the month of September 2011 raising serious questions about the growth momentum of the economy. PMI is a survey-based compilation by HSBC of manufacturing sentiment and is considered a good indicator of factory output. An index level above 50 indicates expansion, and higher the index above that threshold greater the growth.

The impact of slowdown is already being felt on the real estate market with residential segment witnessing sluggish demand across all the major cities. Apart from demand slowdown, impact of rising cost of funds, increasing construction cost and delays in government approvals is worsening the already dismal condition of the sector. Like any other sector, the aforementioned factors clearly point towards a price correction in the real estate market. However, residential prices in most of the cities have either remained steady or increased marginally in the past few quarters. This implies that demand-supply conditions are not having any significant impact on the residential market prices in the short term and there are other factors at play which are having a greater influence on price.

Financial condition or holding capacity of real estate players is one such factor which influences the price movement in the market to a great extent. A reasonable estimate of the stalemate between buyers and developers coupled with an understanding on the holding capacity will provide the direction in which prices may move in the market going forward. For the purpose of understanding this relationship, we have conducted a financial analysis on a group comprising leading 19 realty players.

Since FY08, revenues and profits have dropped by 19% and 70% respectively despite property prices witnessing an increasing trend. On the other hand, debt and interest outgo have increased by 1.5 and 2.3 times respectively in the same period. Although networth has also strengthened during this period, it happened mainly during FY08 when equity markets had a flair for real estate Initial Public Offerings (IPOs) and many realty companies raised large amount of equity through this route. However, fund raising through this route has slowed down considerably in the last couple of years due unfavorable market conditions for realty companies.

Since studying absolute debt and equity numbers does not provide much insight, it is better to analyze the liquidity ratios for understanding the financial stress of the sector. Debt equity ratio of the industry has improved over the last five years from 1.9 to 0.8. Although this ratio has improved, the ability of the industry to service this debt has deteriorated over the years. Interest coverage ratio, which is a measure of the number of times a company could make the interest payments on its debt with its earnings before interest and taxes, has consistently fallen since FY08 from 12.5 to 2.7. Even the Debt Service Coverage Ratio (DSCR), which is a better measure of gauging liquidity since it takes into account both interest and principal repayments on debt, has dropped from 1.54 to 0.56 in the last four years. The lower the interest coverage ratio and DSCR, the higher is the company's debt burden and greater the possibility of default.

Table 3 analyzes the cash flow situation and the financial stress level of the industry over the past five years. In FY08, when the global economy was going through a recessionary period, the stress level of the sector was at its highest level and many developers were on the verge of defaulting on their debt payment. However, the Reserve Bank of India (RBI) had allowed banks to restructure the debts of these companies keeping in mind the recessionary condition of the economy and hence giving the much needed breather. But the possibility of this happening in the current scenario is very bleak and looking at the stress level of the industry in FY11, the road ahead for real estate industry looks bumpy.

The liquidity condition of the real estate industry may look grim but it does not necessarily imply that the players will default on their debt or interest payment. Ideally, the

Table 1: Consolidated Financials of Real Estate Companies (INR Bn)

Particulars	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11
Income	148	299	209	192	242
Interest paid	8	14	22	24	31
Profit after tax	48	126	72	39	38
Networth	116	387	459	570	601
Borrowings	223	335	391	436	493

Source: Prowess, Knight Frank Research

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Table 2: Consolidated Liquidity Ratios

Particulars	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11
D/E	1.9	0.9	0.9	0.8	0.8
Interest coverage ratio	9.3	12.5	4.8	3.2	2.7
DSCR	1.42	1.54	0.91	0.51	0.56

Source: Knight Frank Research

Table 3: Financial Stress Level of Real Estate Companies (INR Bn)

Particulars	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11
Operating cash flow (OCF)	-101	-73	3	100	39
Cash outflow for interest & debt repayment	48	120	129	174	171
Stress (Interest + Debt repayment - OCF)	149	193	126	75	132

Source: Knight Frank Research

operating cash flow of a company should take care of the interest and debt repayments. However, when a company is not able to generate enough operating cash flows, it raises additional long term funds to meet the short term requirement. Over the last two years, developers have raised huge amount of debt and equity through private routes and have now practically exhausted this option. Additionally, the rising interest rate scenario and dwindling sales volume have put further pressure on their capability to raise funds through this route. Even promoters who had pledged their shares in lieu of funds have already breached the comfort levels of investors and this may result into losing control over their company to lenders.

In order to overcome these challenges, developers have resorted to the last option available to them which is sell-off of assets in terms of land, Transfer of Development Rights (TDR), leased properties, SEZ land and others. Over the last couple of quarters many developers have either diluted their stake or completely sold off some of their assets in order to raise funds. We believe that till the time real estate players are able to raise additional long term funds in order to meet their short term obligations, residential prices will remain steady. However, there is always the possibility of some players who are not able to raise fresh funds through any of the above mentioned sources and this will force them to reduce prices in their projects in order to meet the short term cash flow requirement.

Going forward, although real estate market will not witness a significant fall in prices, there will be isolated pockets wherein developers may offer huge discount to existing prices in their projects for the purpose of improving their cash flow position.

Kolkata Residential Market-Q2 FY12

Market Overview

The Kolkata residential market has traditionally been an end user market with a very small proportion of investors. The growth of the IT/ITeS sector and increasing floating population are the major factors that have led to the increasing demand in the residential sector. The government has also been offering land at subsidized rates to developers to start group housing projects in the PPP mode, which has given a boost to supply and a number of national players like DLF, Godrej and Unitech have set up operations in Kolkata.

Kolkata's prime residential locations are concentrated in the central and south central part of the city. Most established residential markets with limited new developments include CBD locations like Park Street, Camac Street and South Central locations like Gurusaday Road, Jodhpur Park, Gol Park and Lake Garden. Besides these other important residential developments are Alipore and Ballygunge, New Alipore, Rashbehari, Tollygunge and Gariahat. The city has expanded to the eastern side with the development of Sector V and Salt Lake City as the IT/ITeS hub, thus fuelling the demand to a great extent. The suburban locations which have seen extensive development in the last five years are Rajarhat in the east, Jessore road in the North and Behala in the South.

Table 1 shows the residential micro-markets in Kolkata.

Table 1: Residential Micro-markets in Kolkata

Central Kolkata	**Dalhousie, Elgin Road, Park Street,Camac Road, APC Road, Park Circus**
East Kolkata	EM ByPass,Sonarpur,Tapsia, Anandpur
North Kolkata	Shyam Bazaar, BT Road,Jessore Road,Lake Town,VIP Road,Baguiati
South Kolkata	Ballygunge, Behala, Alipore, Tollygunge, Maheshthala, Budge Budge, Kamalgachi,Garia
West Kolkata	Kona Expressway
Rajarhat	Rajarhat

THE CITY HAS EXPANDED TO THE EASTERN SIDE WITH THE DEVELOPMENT OF SECTOR V AND SALT LAKE CITY AS THE IT/ITES HUB, THUS FUELLING THE DEMAND TO A GREAT EXTENT.

Kolkata residential market has a seen a dip in the number of project launches in Q2 FY12 compared to the same quarter last year. Even though there was an increase in sales volume in Q2 FY12 compared to the last quarter, limited sales were seen in the high end and premium projects. Average appreciation of 3-5% was observed in Q2 FY12 compared to Q1 FY12.

Supply and Development

Kolkata's residential sector was least affected by the economic slowdown compared to Tier I cities and the demand for housing has been consistently growing. While end users contribute significantly to the housing demand, there has been growing interest from investors. Developers have been able to capitalize the demand and have launched a number of projects in the affordable and mid segment housing in the last couple of years. Most of the developers have decided to have a joint venture project with the government that has not only helped the government to unlock huge urban land parcels but also helped in developing ample housing stock. This arrangement has also ensured timely

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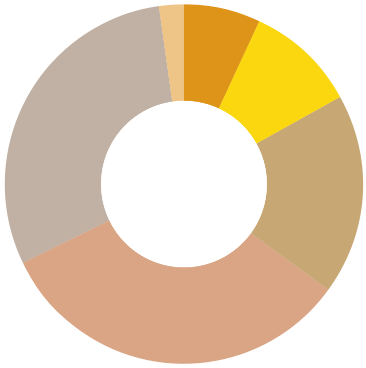
completion of the projects and put a check on the pricing which in turn is beneficial for consumers.

Kolkata witnessed few project launches during the first two quarters of 2011. Most of the projects launched are located in the suburban residential pockets of the city. Developers have been focusing on affordable and mid segment housing which is evident from the new launches as there has been no launch in the premium category housing. All the project launches were in the affordable and mid segment housing in Q2 FY12, mostly in Rajarhat. Projects like Rameswara Water View by Rameswara Group, Club Town Gardens by Space Group and Sapphire Garden by Realtech Nirman, Club Residenza and Green Visata by JPK Enclave were lanched in the price range of INR 1900- 3000/ sq.ft.

KOLKATA WITNESSED FEW PROJECT LAUNCHES DURING THE FIRST TWO QUARTERS OF 2011. MOST OF THE PROJECTS LAUNCHED ARE LOCATED IN THE SUBURBAN RESIDENTIAL POCKETS OF THE CITY.

Chart 1: Distribution of Supply (2012-2014)



- Central Kolkata - 7%
- East Kolkata - 10%
- North Kolkata - 18%
- Rajarhat - 33%
- South Kolkata - 30%
- West Kolkata - 2%

Source: Knight Frank Research

Nearly 28,000 residential units are under construction in Kolkata out of which nearly 7500 units will be ready for possession by the end of 2011. Construction activity is in full swing as quite a number of projects have completion dates of 2012 and 2013. A bulk of supply is coming up in Rajarhat, BT Road, Jessore Road and South Kolkata locations like Behala, Tollygunge and Maheshtala, which will cater to the demand for mid segment housing in the region. Chart 1 shows the distribution of supply amongst the micro-markets in Kolkata.

NEARLY 28,000 RESIDENTIAL UNITS ARE UNDER CONSTRUCTION IN KOLKATA OUT OF WHICH NEARLY 7500 UNITS WILL BE READY FOR POSSESSION BY THE END OF 2011.

Tr ansaction volumes have also gone up by 7% in Q2 FY2012 compared to Q1 FY2012. Nearly 75% of the absorption has been in the affordable and mid segment housing with a ticket size of INR ‹25 Lakhs and INR 25-50 Lakhs. Since most of these projects with rates of INR 1900-4500 are located in suburban locations of Rajarhat, Behala, BT Road, Tollygunge and Jessore Road, these are the areas that have seen maximum absorption. Based on the absorption trends, unsold inventory in Rajarhat and South Kolkata will be absorbed in five quarters where as West Kolkata will take approximately nine quarters.

TRANSACTION VOLUMES HAVE ALSO GONE UP BY 7% IN Q2 FY2012 COMPARED TO Q1 FY2012.

Table 2: Select Upcoming Residential Projects in Kolkata

Project Name	Developer	Location	Number of Units	Price./sq.ft(INR)	Possession
Eden City Maheshtala	Eden City Group	Maheshtala	1604	1725	Jul-12
Unitech Vista	Unitech Group	Rajarhat	840	3650	Dec-12
Green Field City	Greenfield City Projects	Shibrampur Road	816	1775	Jul-13
Godrej Prakriti	Godrej	B T Road	587	2425	Jul-12
New Town Heights	Dlf Building India	Rajarhat	836	3900	Jul-14
Unitech Harmony	Unitech Group	Rajarhat	570	3950	Dec-14
Unitech Cascades	Unitech Group	Rajarhat	525	3900	Jan-13
Fortune Township	Fortune Park Housing Projects	Barasat	560	1750	Oct-12
Godrej Prakriti	Godrej	B T Road	456	2525	Dec-13
Eden City Maheshtala	Eden City Group	Maheshtala	420	1500	Jan-13
Kolkata West Height	Universal Group	Kona Expressway	504	1950	Oct-12
Urbana	Bengal NRI Complex Ltd	Anandapur	466	6850	Jun-13
Green Field City	Greenfield City Projects	Shibrampur Road	448	2250	Jul-12
Avani Oxford	Avani Group	Jessore Road	504	4330	Mar-14
Forum Projects	Forum Pravesh	Girish Ghosh Road	500	2750	Dec-13
Bengal Shelter	Neel Diganta	Barasat	480	1795	Oct-14

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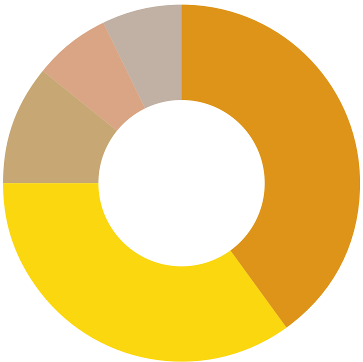
Chart 2: Ticket size wise share of absorption (Q2 FY12)



- ‹ 25 Lakhs - 40%
- 25-50 Lakhs - 35%
- 50-75 Lakhs- 11%
- 75-100 Lakhs- 7%
- 100-125 Lakhs - 7%

Source: Knight Frank Research

Prices

Residential demand has seen an upward trend in the last two quarters, due to which capital values have seen an average appreciation of 11-12% compared to Q2 FY2011. South Central locations like Ballygunge and Alipore have seen an appreciation to the tune of 10-11% due to consistent demand and limited supply in these areas as compared to Q2 FY2011. Capital values in these locations are in the range of INR 10,000-15,000/sq.ft. On the eastern side of the city, EM Bypass has also observed an appreciation of 11-12%. Capital values in these locations range between INR 5000-8000/sq.ft. The western part of the city has not seen much movement in prices due to limited demand. Prices in suburban residential locations like Rajarhat, Behala, Garia and Maheshtala range between INR 2000-4000/sq.ft. As the demand for affordable housing is high, these locations have seen a 20% appreciation compared to Q2 FY2011.

Table 3: Price increase in Q2 FY2012 over Q2 FY2011

Location	% Change in price since Q2 FY 2011
Central Kolkata	12%
East Kolkata	12%
North Kolkata	10%
South Kolkata	15%
Rajarhat	20%

Source: Knight Frank Research

Outlook

The Kolkata residential market has shown positive trends with increasing demand, new project launches and considerable price appreciation in the first two quarters of FY12. This trend is expected to continue in the future as well and. capital values are expected to rise steadily especially in the suburban locations. This is a result of the strengthening interest of developers owing to affordable land prices and increasing demand from the consumers for affordable and mid segment housing. However, rising home loan interest rates and increasing prices are expected to have an impact on the premium and high end segment housing.

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