DHFL Pramerica
MUTUAL FUND

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Forget Real Estate - Should One Really?

"Real Estate" is a subject close to the heart of every Indian. Over last few quarters the outlook for real estate prices has been weak with most investors staying away from the asset class. However some savvy money managers have been adding exposure to real estate stocks. So what is drawing the interest?

Real estate in India like most other sectors is in the initial stages of growth, been an unorganized business and fragmented among large number of players. The buyers so far had very little voice. RERA, a regulation introduced in 2016 has started bringing in accountability, transparency and professionalism to the sector. Some of the legal provisions like for example the builder has to put 70% of the money in an escrow account and also that this can be withdrawn only for the purpose of construction spend. Infact there is a levy of strict penalties in case rules are breached. Also consumers can access project-related documents online. This finally puts consumer first like most other mature sectors. With RERA and GST now in place has resulted in two big structural changes:

A) transparency standards have just seen a big improvement

B) the change in cash flow structure is extremely capital intensive and will drive out fringe players.

We should also not forget that Real Estate remains the second largest employment generator after agriculture and is expected to be a US $180 bn market by 2020. Poor experience of the customer with fringe players and availability of low cost capital from private equity capital funds and Sovereign Wealth funds only to the players who are compliant with RERA and GST is likely to help industry consolidation. So going forward, like any other mature sector three to five players will have the lions share of the market.

Private Equity and debt investment in real estate in the first quarter is estimated to be US $2.6bn, highest for last eleven quarters. We believe it is a start of Mega trend and it will catch momentum as we see more clarity emerge around R.E.I.Ts'. Commercial real estate is recovering as rentals are moving up in most parts of the country. The unsold inventory in residential is slowly getting exhausted.

If we look at some of our neighbouring countries, even with much smaller population and land mass they have large companies in real estate with market cap equal to the sum total of market cap of the real estate sector in India. For e.g. Philippines has Ayala Land with MCap of US $ 11bn and SM Prime with MCap of US $ 20bn, Hong Kong with Swire Properties which has a MCap of US $ 23bn. The market cap of all real estate companies listed in India is approx US$ 20bn.

Smart money is betting on this opportunity of growth over the next decade. We have been early movers to spot this trend and have participated through exposure in our PMS offerings.

Equity markets are witnessing the tug of war between worsening macros and improving micros. Investors should use opportunities provided by the market to add exposure to quality oriented portfolios. Our conviction on fixed income continues to be on the short term and accrual funds. Asset allocation remains the key.

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