REAL ESTATE – A VIABLE INVESTMENT?

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Over the years, Real Estate has evolved into a full fledged investment class. In this free flowing article, the author discusses the realities and myths about investing in real estate.

For individuals, is investment in real estate still a viable investment option? Or should individuals invest through REITs? How should an individual evaluate whether to invest in real estate? What should be the investment strategy? These are some of the issues addressed in this article. What follows are some important issues, beliefs and myths that are prevalent in real estate.

1. RETURNS ON REAL ESTATE:

Out of the 10 richest persons in the world, 7 have become rich due to Real Estate. Need I say more!! If you had an option, to invest in Real Estate say in 1992, when the industry was liberalised by Dr. Manmohan Singh, the comparison would be somewhat like this:

- Real Estate in south Mumbai up by at least 100 times

- Investment in BSE Sensex stocks up approximately 70 times

- Gold, with all its fluctuations, would have given you 7 fold increase and Silver about the same.

- If you were permitted to invest in USD, it would have been twice.

The conclusion is obvious, that in the long run, Real Estate, if chosen wisely and at a good location, would probably out beat any other asset class.

2. ISSUE OF SIZING AND PRICING:

Lesser the size of Real Estate, bigger is the universe of buyers. Bigger the size of Real Estate and value, the universe of buyers shrinks and, at time, shrinks disproportionately. For a developer to be successful and for a buyer to succeed, the mix of size and price has to be optimum. This is because "the rate per sq.ft.", will have no meaning beyond the affordability level. Having said this, the quality of construction plays a very important role. There is a developer in Bangalore, who provides quality at competitive price, that is unmatched by any other. He goes to the extent of rounding off all edges of walls to ensure that children don't get hurt! The plug points are at the right place and even in high rise buildings the windows withstand the onslaught of rain and extreme breeze.

3. LOCATION:

The mantra for Real Estate is: LOCATION, LOCATION, LOCATION.

It has a double whammy. Exit or disinvestment is easy and quick and appreciation is almost guaranteed. There is no other factor that scores over a good location. Do you know that Altamount Road in Mumbai is the 10th most expensive location in the world?

4. TAX BREAKS AND INCENTIVES:

Over the years, the Government has done a lot to encourage investment in Real Estate, both for the investor and a little bit for the developer. Chartered Accountants will remember section 80-IB (though not many developers have succeeded in taking advantage) and now section 80-IBA. Affordable housing is a new mantra and the good thing is that it has reference only to the size (30 sq. Mtrs. for the four metro cities and 60 sq. Mtrs. for the rest of India). The result is that over 80 percent of the development would qualify to be included as "affordable housing", on which the developer gets full tax break. The end result is that a compact 2 bedroom flat outside the four metro cities would still qualify as "affordable housing". I have seen a number of developments in Chennai recently, which fall into this category and selling despite recessionary market conditions.

5. GOVERNMENT LEVIES AND TAXES:

Stamp Duty is a State subject and continues to be high at 5 per cent and more in the metros.

Property taxes in certain metros have created avoidable litigation and a lot of confusion. The change of basis from annual lettable value to capital values have yet to fully stabilise. There is a need to bunch up similar issues and get a ruling, which can apply to most pending cases, concerning property taxes.

The major problem for Real Estate is the Ready Reckoner values or jantri, as known in some States. Over 30 percent of flats in south Mumbai, are not getting sold because the market value is up to 30 per cent below the Ready Reckoner value. As CAs you know the implication of this mismatch. It not only results in higher stamp duty, which is levied with reference to Ready Reckoner value, but there is a deeming provision both for the seller and the buyer. The difference between the Ready Reckoner value and the sale value has to be offered for taxes, both by the buyer and seller.

For the developer, there are issues on how profit is computed on "under construction" projects and for CAs the new Accounting Standards (Standard 115) offers a major challenge.

GST will take some time to stabilise and there is no guarantee that the benefit accruing to the developer, will be fully passed on to the buyers. For under construction property the GST is a huge additional cost, which in most cases, the developer, under the present recessionary market, is required to absorb fully or partly.

6. INVESTIBLE QUANTUM:

Real Estate as an investible class is for people with deep pockets. The minimum surplus required is at least Rs.2 crores for cities like Mumbai and at least Rs.50 lakhs for other locations.

The investor should remember that exit can be time consuming and expensive. Also Real Estate is incapable of being broken down or split. In most cases, either you keep the property or sell it, but selling "in parts", is not possible.

7. TITLES:

Please do not save on legal fees, at least when you buy a property. Titles can be really complicated and a legal scrutiny is a must. The acid test is "can you sell the property at will, without any possible issues?" One has to be careful about the mortgages, the lock in periods, combined or joined flats (known as Jodi flats), terraces that have been sold to prospective buyers, *etc. etc.*

There is a recent development, which is really going to help small investors – "a title insurance". It's expected that insurance companies will now also offer "title insurance" in line with what is happening in developed countries. This is path breaking and will definitely benefit a buyer/investor.

8. INVESTMENT BASKET:

I would recommend that not more than 30 percent of your investible wealth should be invested in Real Estate, not counting the house in which you live. It would not be wise to put substantial amounts of your liquid assets in Real Estate as not only it would be volatile but exiting would be difficult.

9. REITS:

REITS will not only change the way investment in Real Estate is done, but make it possible for smaller investors to invest in Real Estate. Broadly REITs would operate like a Mutual Fund, where the investments are in commercial Real Estate, earning rental yields. REITs will make investment decisions broad based and spread over wider geographies. With the spread of risk, the returns would also marginally come down. The good thing is it gives an opportunity to a smaller investor to invest into real estate.

There are certain issues like stamp duty, capital gains, *etc*. that are hindering the success. It is expected that over a period of time, this will be resolved and REITs will become successful.

The day when REITs begin to invest in residential Real Estate like in the US, we will begin to see real professionalism and a reach, that we have never seen before.

Investment into commercial properties today gives a yield of up to 7 percent, whereas residential properties barely provide yield of 2 percent. However, if the appreciation for the period of investment is taken into account probably, the residential REITS will fetch more than commercial REITs.

10. INVESTMENT IN REAL ESTATE ABROAD:

Investors who have substantial surpluses and who desire to diversify their investment into Real Estate abroad, will now have an option. Reserve Bank permits remittance of upto USD 250,000 per person, per year, for investments. If we take 2 or 3 family members together then the investment could exceed USD 1 million, which is a decent investible amount. Currently, UK, Dubai, Singapore and certain parts of US are attractive for such investments. Also there are possibilities of investing in a newer class of investments like students housing, old age or retirement homes, *etc*.

For a long period of time, Rupee has depreciated *vis-a-vis* the US Dollar. Any investment made abroad will provide insulation to the investor from such currency depreciation.

11. CONCLUSION:

Over a 10 to 20 year period, investment in Real Estate, if done wisely with good titles and at a good location would give a return that can exceed any other asset class. I have seen this happen in my career and I am confident of the future. The key word is "patience". Don't be desperate if prices stagnate, don't be greedy if prices escalate beyond targeted appreciation. I recommend investing in Real Estate, without borrowing money, excepting for the primary home you stay in.

The real thing about Real Estate is that it is tangible, it is real and more certain than other asset classes.

Good luck to you! Jai Ho! ■