

Perspective of Developer, Buyer, Financier and Equity Participants in Real Estate Project Development Process in India: An important constituent of Construction Industry

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Abstract - *The real estate project development is an important constituent of the construction industry. The other important constituent of the construction industry is infrastructure development. The construction industry drives and impacts many other industries and has a substantial multiplier effect on various sectors and hence on economic output as well as on employment scenarios. This article discusses multiplier effect of the construction industry on few of the important economic indicators and further focuses on the real estate project development process. The real estate project development process starts from land acquisition to sales and marketing. The internal stakeholders in the real estate project development process are real estate developers, real estate buyers, and the real estate financiers. The paper discusses alternatives for real estate developers, the opportunistic schemes for real estate buyers, and the role of the portfolio of financing agencies as well as the role of multitudes of equity participants. It also describes the regulatory institutions active in real estate project development and promotion process. The real estate projects are developed by organized real estate project developer as well as by unorganized real estate project developers or local builders. This article contributes regarding the challenges and opportunities among the real estate buyers, real estate developers, the portfolio of financial schemes offered by real estate financiers and the opportunities for real estate equity participants.*

Keywords- *Multiplier effect of construction industry; Real estate developer; Real estate buyer; Portfolio of Real estate finance; Real estate equity participants*

1. INTRODUCTION

The construction sector is the largest contributor to the central exchequer and contributes more than 8% to India's gross domestic product (GDP); it is also the second largest employer of the workforce and is an important driving force of the economy (Human Resource and Skill Requirements in the Building Construction and Real Estate Sector).

The Construction sector in India comprises of Real Estate sector and Infrastructure sector. The Real Estate further comprises of Residential projects, Commercial or Corporate projects, Industrial projects and Special Economic Zone projects. The Infrastructure sector comprises of Utility projects, Urban Infrastructure projects, and Transportation projects. The Utility projects further comprise of Power projects and Irrigation projects. The Urban Infrastructure projects comprise of urban transportation projects, water supply projects, sewage management projects and solid waste management projects. The Transportation projects comprise of Railways projects, Roadways projects, Civil Aviation projects and Port projects. The contribution of real estate sector is 60% and that of infrastructure sector is 40% of the total market value of construction sector. Moreover, the construction sector is highly fragmented. Almost 75%

of the players in real estate market are unorganized because of low entry barrier but the infrastructure sector demands high level of technical expertise and financial capability, so almost 96% is dominated by small and medium level enterprises (Human Resource and Skill Requirements in Building, Construction Industry and Real Estate Services Sector (2022) - A Report).

The important contexts of the real estate sector are: how it impacts other sectors and the overall economy, the financing opportunities for developers and buyers, the opportunities for equity participants and the role of government institutions in promoting and regulating the business.

This paper discusses multiplier effect of construction sector on various aspects of the economy. The multiplier effect is about how the growth of construction sector impacts other factors of the economy. It then discusses the government policy and the role of various government institutions in promoting home ownership and regulating different stakeholders. The paper also discusses the financial schemes for home buyers provided by various funding organizations. This article also describes the channels of participation for equity participants and developers.

2. MULTIPLIER EFFECT OF CONSTRUCTION SECTOR

The construction sector has the significant impact on steel industry; paint industry; glass industry; cement industry; and manufacturers of excavation equipment, automotive equipment, and mining equipment industry. A study by ASSOCHAM-TERI estimated the 'output multiplier' of the construction sector to be 2.384, the 'employment multiplier' of the construction sector to be 2.88 and the 'tax multiplier' of the construction sector to be 1.962 (ASSOCHAM, January 21, 2016)[2]. The multipliers are defined as the factor of proportionality which measures the change in variables with respect to another variable. Here the output multiplier measures the change in the overall output of the economy with respect to increasing of one unit of demand in the construction sector. It means that the increase in demand of construction sector by 1 unit leads to the overall change in the output of economy by 2.384 units. The employment multiplier measures the change in overall employment generated in the economy with respect to change in employment in the construction sector. In the present context, the employment generated in the overall economy is 2.88 times the employment generated in construction sector due to one unit increase in demand in the construction sector. The tax multiplier in the present context measures the increment in the collection of indirect tax with respect to increment in the collection of indirect tax in construction sector due to the increase in demand in the construction sector. In the present context if the indirect tax collection increases by 1 unit in construction sector then the overall increase in indirect tax in the economy is 1.96units.

3. ROLE OF MULTIPLE INSTITUTIONS IN HOUSING MARKET

The government during different periods of time performed its duty and bought policies to create favorable conditions for home ownership. The hand holding by the government is generally for the disadvantaged sector as well as to promote real estate development. This task is performed by launching schemes and by regulating the development of real estate sector, particularly the housing sector. The other important role of the government is to create transparency in land title and perform land administration. The government has multiple institutions to provide information regarding ownership of land, land usage and administration.

3.1 Housing sector institutions

The important institutional players in the Housing market of India are government, Reserve Bank of India, National Housing Bank, India Mortgage Guarantee Corporation, scheduled commercial banks, and housing finance companies (Singh C, 2013)[14]. The role of government is important in policy matters and regulation issues and among the important government policies are National Housing policy of the year 1988, National Housing and Habitat Policy of the year 1998, National Urban Housing

and Habitat Policy of the year 2007, Pradhan Mantri Awas Yojana (PMAY) of the year 2015[13].

The important government organizations involved in the housing sector is National Building Organizations (NBO) and Housing and Urban Development Corporation Limited (HUDCO). NBO works for technology transfer, experimentation, development, and dissemination of statistics related to housing sector; it also organizes training programs for collection and documentation of data related to housing, slums, poverty as well as infrastructure related (NBO, <http://nbo.nic.in/Webforms/index.html>). HUDCO aims to resolve issues related to the housing shortage, checking increasing slums and other housing issues related to the economically disadvantaged section of the society; it also engages in facilitating loans for housing and infrastructure development projects; it provides loans for social housing, real estate development as well as retail finance (HUDCO, <http://www.hudco.org/>).

The policies of Reserve Bank of India (RBI) impacts the lending rate for home buyers, the scope of mortgage-backed securities, credit flow to the housing sector, and assigning weight to risk for the loan of the housing sector. The National Housing Bank (NHB), which is a wholly owned subsidiary of RBI, also engages the housing finance companies. Many new players are offering competitive products in housing finance business. These housing finance businesses are regulated and supervised by NHB; apart from performing other duties of improving housing stock, crafting cost-effective housing finance for all segments of the population i.e. to create dedicated financing institutions for a particular geographical area or a particular segment of the population (NHB, <http://nhb.org.in/en/>).

The other important organization involved in the housing market is India Mortgage Guarantee Corporation (IMGC). This organization is involved in creating the opportunity to advance home ownership through mortgage guarantee schemes by involving multiple players like banks and financial institutions; it aims to reduce the burden of down payment (www.imgc.com). The tools involved in the process are lower down payment and attractive loan terms for buyers. IMGC also helps lenders by reducing the scope of default by borrowers. It helps to develop expertise in prevention and detection of loss, creates facilities for targeting bigger customer base, increase economies of scale, increase profitability and provides higher capital relief as well as increased earnings without additional risk.

3.2 Land administration institutions

The important arms of the government to perform land administration are the department of Land Revenue, the department of Survey and Land Records, the department of Stamp and Registration, and local bodies (like Municipal Corporation, Zila Parishad). The department of land revenue maintains the database of land records. The task of maintaining spatial data, mapping and demarcating boundaries of the land are performed by the department of

Survey and Land Records. The department of Stamp and Registration performs duties of documentation and collecting tax on land transactions. The land transactions include sales-purchase, lease, mortgage, and transfer. The local bodies are involved in maintaining property tax documents. The regulatory body, Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI) work to shield different banks from offering multiple loans on the same immovable property. CERSAI is empowered to do so under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002(SARFAESI Act)(Singh C, 2013)[14].

The government of India during the year 2008 started the task to digitize all the land records under the Digital India Land Records Modernization Programme (DILRMP)[6]. It aims to modernize land management, increase transparency in the land record, facilitate proper title record and diminish land-related dispute. It is computerizing land record, digitizing maps and integrating textual and spatial data (DILRMP, <http://nlrmp.nic.in/>)

4. HOME BUYERS PERSPECTIVE

Multiple agencies are involved in taking care of financial aspects of home buyers. The government implements policies like tax incentives and stamp duty. The Reserve Bank of India drives the monetary policy rates and hence the home loan lending rate. This part of the article discusses the housing policies and the schemes offered by various institutions and role of various financial channels.

4.1 Institutions offering house buying schemes

The noticeable funding schemes for home buyers are Rural Housing Fund (RHF) scheme which came up in the year 2008, the Reverse Mortgage Loan (RML) scheme which came up in the year 2007, the Reverse Mortgage Loan enabled Annuity (RMLeA) scheme which came up in the year 2009, the Mortgage Risk Guarantee (MRG) scheme which came up in the year 2011 under Rajiv Awas Yojana (RAY), the Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) which came up in the year 2012. The RHF aims to create housing finance in rural areas at the competitive rate. The scheme has encouraged primary lending institutions to spread their housing loan over a wider geographical area and to the wider group of disadvantaged and home desiring population. In the process, the lending institutions first developed insight to understand the rural economy and then developed housing finance products accordingly to satisfy the potential rural customer. The RML scheme is based on the idea of equity and is applicable to senior citizens above sixty years of age and for a maximum period of twenty years on the mortgaged asset. The RML ensures that the owner is not required to pay the monthly loan and assures regular income to senior citizens to meet the increasing expense and at the same time ownership of the mortgaged house. The RMLeA differs from RML in

terms of tenure of the annuity payment. In RMLeA the tenure is lifetime while in RML it is for a maximum period of twenty years. The MRG scheme under RAY is to guarantee against default in payments up to a maximum loan amount of half a million rupees. The CRGFTLIH is a credit guarantee scheme for housing loan up to half million rupees. The MRG and CRGFTLIH are schemes for affordable housing segment (Singh C, 2013)[14].

The Pradhan Mantri Awas Yojana (PMAY) came up in the year 2015. The PMAY is an ambitious project which aims to eradicate the housing problem of the urban poor (PMAY, <http://pmaymis.gov.in/>).

4.2 Home loan financing Channels

The home loan facilities can be availed from scheduled commercial banks (SCBs), regional rural banks (RRBs), cooperative banks, agriculture and rural development banks, Housing finance companies (HFCs), non-banking finance companies (NBFCs), microfinance institutions (MFIs), self-help groups (SHGs) and other financial institutions (Singh C, 2013)[14].

Scheduled commercial banks and housing finance companies are the two largest contributors to home sector credit lending business. The scheduled commercial banks offer portfolios of housing credit products for different segments of customers. It varies on the basis of the slab of the loan, the tenure of the loan, and whether it is for an individual customer or for a cooperative. The housing finance companies contribute to housing sector by engaging credit loan services to individual home buyers, private builders as well as to corporate bodies. The Life Insurance Corporation of India, General Insurance Corporation of India and Provident Funds also participate in the financing of home sector.

5. DEVELOPERS PERSPECTIVE

The striking difference between real estate and infrastructure development project is that the real estate development involves end users money from the beginning of the project, i.e. in real estate, there is focus on sales and construction from the beginning and end users money is involved right at the beginning of the construction of the project.

The real estate project development is tedious, challenging, time-consuming process and involves its own share of risk. The real estate broadly comprises of residential project, retail project, hospitality project, commercial project and industrial project. The real estate developers face the financial challenge at multiple phases. It starts from financial support for land acquisition, financial support for project development, financial support for construction and finally needs financial support for sales and marketing (Annamalai, Bansal & Gemson, 2014)[1]. The constraints of funding institutions like commercial banks and external borrowings motivate real estate developers to look for alternative source of financing. This scenario provides an opportunity for private equity players to participate in the real estate

development process. The equity participants are different from debtors and hence are among the last to claim the profit from the project in which they are involved. The equity participants have the alternative to developing a new project on their own means or can look for another portfolio of alternatives. Different equity participants can come together and participate in a joint venture; equity participants can go the route of leveraged buyouts which can be a composition of debt and equity both; equity participants have also the alternative to trying for developing distressed assets by acquiring it or investing in it.

The residential real estate development process passes through five phases in India (Das, Sah, Sharma, Singh, & Galuppo. 2013)[5]. The first phase of the five-phase model is Land Acquisition & Analysis which involves customer analysis and competitor analysis apart from preliminary design and financial issues. The second phase of the model is Project Planning; which consists of site planning and design; the site planning includes landscaping and infrastructure requirement while the design part involves architecture and engineering. The cost budgeting is a component which overlaps within the second, third and fourth phase. The third phase of the model is Approval & Financing; it involves government approval as well as the decision regarding the composition of debt financing and equity financing. The fourth phase of the model is Strategy & Positioning; it involves the simultaneous study of branding, pricing, and analysis of discounted cash flow as well as marketing. The last phase of the model is Disposition; it involves sales and construction.

The real estate investment trusts (REITs) play an important role in ownership and operations of commercial real estate and it was introduced in India in the year 2014. There is debate regarding nature of ownership through REITs channel i.e. whether it's like a stock or a commercial real estate or a mixture of both (Das & Thomas, 2016)[4]. It's an emerging channel for commercial real estate developers to leverage upon.

6. LIMITATIONS AND FUTURE RESEARCH SCOPE

This work can be further extended by incorporating the legal dimensions and tax dimensions of the real estate stakeholders. The information regarding tax saving schemes encourages home buyers and investors to plan their real estate prospects in a better way. The awareness regarding rights and duties will be helpful to explore opportunities for participation in the real estate project development process and in the course also increase the overall efficiency of the process. The theme of the article can be further elaborated to incorporate the infrastructure development process. The infrastructure project development process involves higher authorities in decision making in comparison to real estate project development. The ownership of real estate is mostly at the

individual level while the ownership of infrastructure development project is of the mass population. The real estate development project mostly targets savings and investment opportunities of an individual while infrastructure project development process mostly involves directly or indirectly the tax payer's money. The stakes in infrastructure project development are much higher than the stakes in real estate project development. The infrastructure project development process is relatively more complicated, more time-consuming, more expensive and directly impacts a number of people as well as the overall economy. Infrastructure project development is more strategic and hence demands more preparations and participation of highest level authorities.

7. CONCLUSION

The construction sector is an important driving force of the economy. The construction sector has a huge multiplier effect on the overall economy and is the second largest source of employment, next only to the agriculture sector. The construction industry mainly comprises of real estate industry and infrastructure industry. The real estate industry can be further classified into the organized real estate development project and unorganized real estate development project. This article aims to help different stakeholders of the real estate project development process understand each other and deal accordingly. It discusses challenges and opportunities available to different players of the real estate development process. It helps to gain awareness regarding the structure of land ownership, the challenges faced by real estate developers and the real estate buyers, financial aspects of real estate developers and real estate buyers. The affordable housing project has been specified as infrastructure status during union budget 2017 of India (CARE, 2017)[3]. This step will provide an opportunity for developers of affordable housing to get access to cheaper institutional funds and other benefits which are available to infrastructure developers and in the process increase supply to affordable housing segment. India is passing through a judicious phase in real estate development. The introduction of REITs, GST and Real Estate Regulation and Development Bill will boost the confidence of stakeholders in the real estate sector. Economics of the construction sector is an emerging area for academicians to contribute.

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