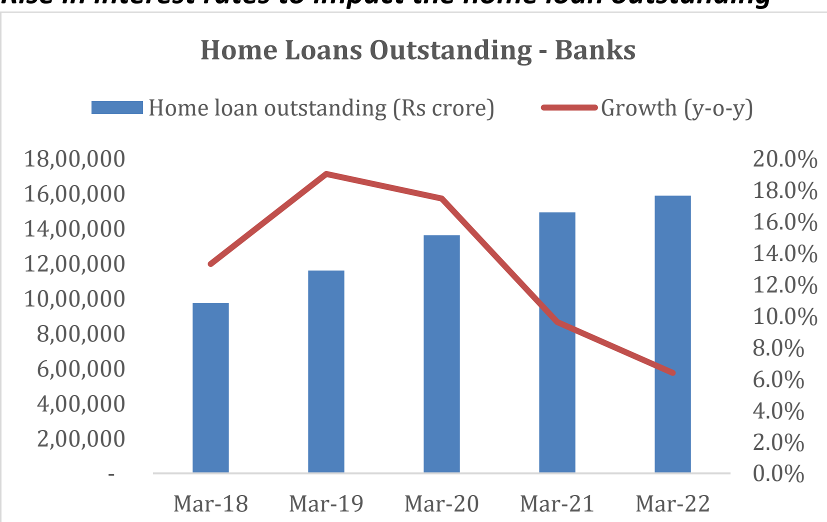
Rising interest rates and heightened input costs may disrupt growth in real estate market in FY23

Brickwork Ratings, Bengaluru, 1 July 2022: The real estate market, after witnessing robust growth in FY22, is expected to continue the growth momentum, albeit with some risks in FY23, with healthy demand from commercial real estate and slowing momentum from residential real estate. After witnessing a slowdown in the last few years and the pandemic in FY21, the real estate industry recuperated in FY22, especially residential real estate. With the economy reviving, demand for commercial properties also started to increase in H2FY22. For residential real estate, demand surged, especially in India's top-tier city, backed by historically low interest rates, pent-up demand, stagnant real estate prices, attractive offers from developers, the need for owning a space and very importantly, a cut in stamp duty. The reduction in stamp duty in states such as Karnataka, Maharashtra and West Bengal led to a robust increase in sales in these states. Buyers' preference for ready-to-move-in properties also led to a decrease in inventory levels.

Rise in interest rates to impact the home loan outstanding

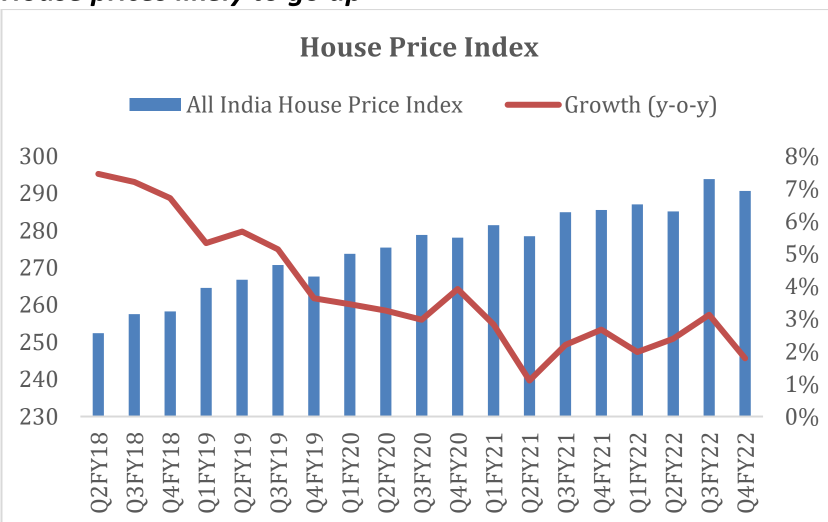


Source: RBI, BWR Research

Real estate developers faced constraints such as labor shortage and soaring raw material costs in FY22. The prices of key raw materials for the real estate industry, including steel and cement, witnessed a y-o-y surge of 45% and 7%, respectively, in FY22. However, with demand still reviving, developers preferred liquidating their inventory through attractive offers, and in the process, the margins took a hit.

In FY23, BWR expects demand in residential real estate to remain healthy, although the momentum is expected to be disrupted by various factors. Rising interest rates can be a major dampener as the finance cost of owning a house is expected to go up (RBI Repo rates have increased by around 90 bps to 4.9% since the start of FY23). Moreover, higher inflation (averaging around 7.79% in the last 12 months and expected to remain higher) could eat up the discretionary income, resulting in buyers deferring their decisions. Current market sentiments also, if prolonged, could have a negative impact on the sector. Moreover, prices may be expected to go up as developers will pass on the rise in input costs. These factors cumulatively may put a brake on the growth momentum in the residential real estate market.

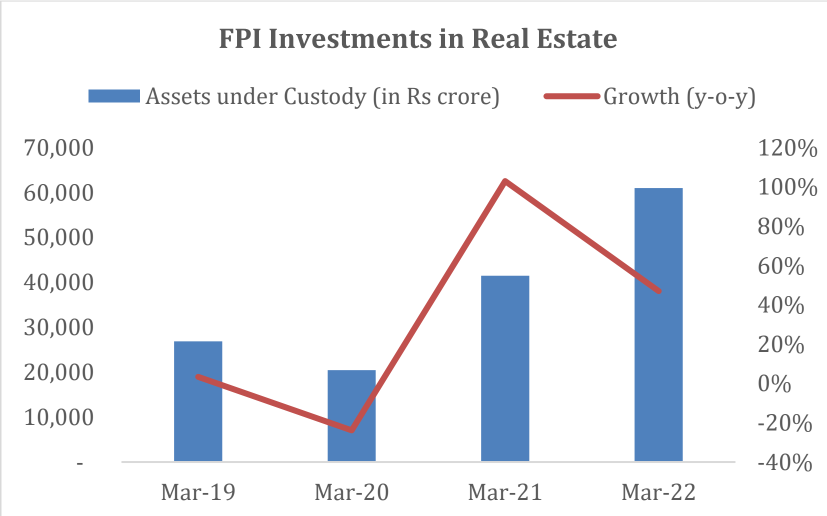
House prices likely to go up



Source: RBI, BWR Research

On the other hand, BWR expects a rise in demand for commercial properties in FY23. After almost negligible demand for commercial properties in FY21 and some improvement in FY22 due to the reopening of offices, demand for the commercial real estate segment is expected to witness a rise, backed by demand from data centers, warehouses, IT&ITeS, co-working spaces and other service segments. With the economy reviving, manufacturing activities have increased, leading to a rise in demand for warehouses. In addition, technology blending with various service segments has not only expanded these individual segments, but has also increased the requirement for data centers.

Investment soared on account of demand for commercial properties



Source: NSDL, BWR Research

With rising demand in the real estate sector in FY21, there was an increase in terms of investment from Foreign Portfolio Investments (FPIs). The positive trend continued in FY22 with a y-o-y increase in investment from FPIs by 49%, after witnessing robust growth of 103% in FY21. With three REITs already registered with SEBI, the Government of India has made amendments in the lot size and subscription amount to attract more retail investors in the market. In July 2021, the government reduced the lot size of REITs from 100 units to 1 unit and made subscription amounts for initial and follow-up offers to between Rs 10,000-15,000. This will help attract more retail participation in the days to come.

Contacts:

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director - Ratings

Praveen Pardeshi
Sr Research Analyst

Diya Roy
Jr Research Analyst

Investors & Media Contact
+91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

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