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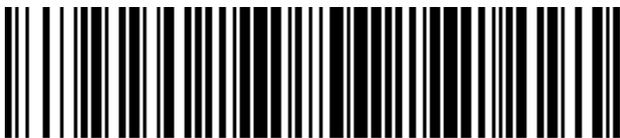
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Analysing the challenges and prospects in Real Estate Investing

Siddhant Narayan and Shivam Gupta

ABSTRACT

One of the most vulnerable sectors for any investor or fund manager to invest is the real estate sector. However, it is still one of the most preferred one. Also, real estate sector is that sector which gives an idea about the development and growth in a country. Investment in every sector involves a lot of challenges as well as prospects which every investor must analyze before investing so that there is minimum risk involved and there is maximum return.

The major purpose of the study is basically about the Pros and Cons of real estate investing, its importance, methods of investing in real estate, mostly about the challenges of real estate investing and lastly it ends with the emerging trends or the prospects of real estate investing.

INTRODUCTION

The real estate sector is one of the largest sectors in India after the agriculture sector. It is one of the major sources of livelihood for the Indian Labour and for the unorganized sector of the country. Real estate sector is one such sector which is recognized all across the globe. Almost 90% of the people in this sector are engaged in construction work, while the other 10% workforce is engaged in completion work, plumbing, demolition work, finishing work, etc. Post liberalization in India, the real estate sector was one of the major gainers as there were lot of foreign direct investments in India. At present, this sector is growing at a rate of 20% per annum. The real estate sector is also a major contributor to the GDP of the country.

Despite being one of the major sectors, there is a huge difference between the demand and the supply in this sector as in the last few years the demand for the real estate investing has increased enormously. Although the Government through its various schemes tries to fulfill the demand in the market, but still it is not able to cope up with the increasing demand and because of this, private players entered this market who worked on their own pace and they had no concerns with the demand.

Earlier, the real estate sector in India was unorganized because of factors like absence of centralized title registry, lack of uniformity in local laws, high interest rates, lack bank financing and lack of transparency. But now due to its demographic location and strong economic growth, it has become a favorable place for the investors to invest. Also, the real estate sector has become more organized and transparent with the help of various reforms like repealing of the Urban Land Ceiling Act, modifications in the Rent Control Act, computerization of the land records, etc. The indicators of value have become more reliable and there has been a great development towards organized investment. For the real estate developers, there has been an increase in the availability of financing which will

help them to take up more projects and meet both the commercial as well as the residential demand in the market.

IMPORTANCE OF REAL ESTATE INVESTMENT

Importance of Real estate investment can be understood by seeing the factors stated below:

1. Location of the Property

The location is one of the most important factors in real estate investment. Close proximity to amenities like green space, scenic views, closeness to markets, warehouses, transport hubs, freeways etc. are some of the factors that are looked into.

2. Value of the Property

Valuation of the property is important because during the purchase many factors are looked into like the listing price, investment analysis, insurance, tax benefits etc.

3. Expected Cash Flows and Profit Opportunity

Expected cash flows means how much cash flow is going to come through rental income and if the property is sold in the near future, whether the property can provide a good income.

4. New Construction v/s Existing Construction

New construction always provides attractive pricing, better and modern amenities, better discounts etc.

Existing property provides convenience, faster access, established improvements and in some cases lower costs etc.

5. Be careful with leverage

Loans are easily to get but making commitment to it for the future at the cost of interest can be a difficult task.¹

¹ Importance of Real estate Investment, Investopedia (Sept. 22, 2020, 10:53 AM), <https://www.investopedia.com/articles/investing/110614/most-important-factors-investing-real-estate.asp>

ADVANTAGES

Every investor before making any investment in any of the assets lists down the advantages which are there with the investment so that there is minimal risk involved.

Similarly, Real Estate investing also comes with numerous advantages with it. At present the major advantage for the real estate investors is the low rate of home loan interest. The home loan interests are at an historic low rate. In India, the government is also working in improving the rental laws to ensure the safety and security of the investors so that they can have not only asset appreciation but also safe rental income as well². Another key benefit of this type of investing is the cash flow which it generates. Over time, the cash flow strengthens as the mortgage is paid. With this type of investment, one can have a lot of tax benefits as in general cost of owning, operating and managing is deducted at the time of tax. For real estate investors, apart from having rental income, profits generated by property dependent business activity, they also earn the appreciation on their property. The value of the real estate increases over time and it can give profit at the time of the sale. Real Estate investing also helps in building equity. As the owner pays the mortgages, an asset is built which is added to the net worth of the owner and when finally the property becomes free from the mortgage, one has the advantage of buying more properties and increase income. Having real estate makes the financing readily available as it is a tangible asset and it serves as a collateral. There is a positive relationship between the economy and the real estate. As the economy grows, the demand for the real estate increases the rents. This in turn increases the capital value by putting some inflationary pressure on the tenants and some in the form of capital appreciation³.

² **Dr. Niranjana Hiranandani**, Why Real Estate Is A Good Investment in Current Times, Financial Express, Oct 29, 2019.

³ Barclay Palmer, Key Reasons To Invest In Real Estate, Investopedia, Sept 3, 2020, 10:10 PM, <https://www.investopedia.com/articles/mortgages-real-estate/11/key-reasons-invest-real-estate.asp>.

DISADVANTAGES

It's not only the advantages which the investors should only consider while investing their money in any investment portfolio, but they should also do an analysis of the risks and the cons which are associated with the investment in the particular asset so that they can invest their money in some better option. There are certain aspects in the real estate as well which can discourage the investors from investing in this portfolio. The first aspect which should come in the light is the heterogeneity of the real estate. Various physical features like the location, use, design, etc. makes a property unique. But it's not only the physical factors which makes a property unique, there are other features like varying lease structures which causes changes in the income of the investors. It's because of this heterogeneity that an investor has to undergo due diligence before investing in the property. The second disadvantage is the lumpiness of the real estate. The major issue with real estate is that it cannot be bought and sold easily and inexpensively in such size and quantity which is agreeable to both the parties as the direct real estate ownership is difficult to trade in size and quantity desired by the market. Although, there are various alternatives for indirect ownership, but the investors at single property level either have to buy the entire property or not. The last major disadvantage of this type of investment is the liquidity of the real estate. It is one of the highly illiquid assets when compared to other traditional securities because it is private, non- exchange traded asset with high unit and high transaction cost⁴.

⁴ Garay, Urbi. (2016). Real Estate as an Investment (Chapter 14).

METHODS OF INVESTMENT IN REAL ESTATE

1. Moving to a rental Property

For investing through rental property, we need to purchase a property first so that a combined monthly mortgage payment, home insurance payment and property tax payment is lower than the rent the property commands.

There are many ways to do this online through Housing.com and some other websites.

There are two major downsides of owning through a rental property:

- a) It requires a lot of cash for down payment
- b) We have to deal with the tenants.⁵

2. Investing in Real Estate ETF's

Exchange trade funds are a collection of stocks or bonds in a single fund. They are similar to index funds and mutual funds because they come with broad diversification.

Investing in real estate through real estate ETF's is a smart move. Vanguard's VNO, for eg. Is a real estate ETF that invests in stocks issued by real estate investment trusts (REIT's) that purchase office buildings, hotels and other types of property.⁶

3. Through a property manager

Hiring a property manager is one of the best things because they take care of all the basics like minor repairs, vetting prospective tenants, collecting rents etc. One of the most important roles that a property manager plays is that they act as a buyer between tenant and owner.⁷

⁵ Methods of Real Estate Investment, College Investor (Aug. 29, 2020, 12:30 PM), <https://thecollegeinvestor.com/10414/ways-to-invest-in-real-estate/>

⁶ Methods of Real Estate Investment, Forbes (Aug. 29, 2020, 12:45 PM), <https://www.forbes.com/sites/jrose/2019/02/22/real-estate-investing-without-buying-property/#6700191371f5>

⁷ Methods of Real Estate Investment, Forbes (Aug. 29, 2020, 1:15 PM), <https://www.forbes.com/sites/jrose/2019/02/22/real-estate-investing-without-buying-property/#6700191371f5>

4. Real Estate Investment Trusts (REIT's)

They are bought and sold on the major exchanges like any other stock. Like, regular dividend paying stock, they are considered to be one of the solid investments who desire regular income.⁸

5. Rent out a room

Renting out a room is a convenient concept of real estate investing. If there is a spare room, then we can rent it.⁹

⁸ Methods of Real Estate Investment, Investopedia, (Aug. 29, 2020, 1:30 PM), <https://www.investopedia.com/investing/simple-ways-invest-real-estate/>

⁹ Methods of Real Estate Investment, Nerd Wallet, (Aug. 29, 2020, 1:45 PM), <https://www.nerdwallet.com/blog/investing/5-ways-to-invest-in-real-estate/>

CHALLENGES IN REAL ESTATE INVESTMENT DURING THE COVID-19 PANDEMIC

Since, the corona virus hit the world in Dec.19, many things have changed. Many countries are taking measures to control the pandemic, businesses came to a halt across the world, forcing monetary agencies to forecast the global economy, including India International Monetary Fund say India will have a contraction of 4.5% in FY21.

The effort of coronavirus has been felt across the world and this has put a major impact on real estate sector.

Some research analysts say that housing sales in India's nine major cities declined by 79% in the period between April-June 2020.

Although number of office spaces in India has increased to 27% year-on-year in 2019.¹⁰

Some of the challenges in Real Estate invested are listed below:

1. Delay in Projects

Today in India, real estate construction has been facing a lot of delay, which sometimes create a dispute between developers and homebuyers. These delays happen due to several factors like the wrongful acquisition of a land, lack of finance, lack of raw materials, delay in approvals, non-availability of labourers etc. RERA has helped in identifying and addressing the issue of right usage of funds, clearance to fasten up the construction.

2. Non-Availability of Funds

One of the most important things in Real Estate industry is Finance or availability of money to construct the project. The ongoing liquidity crises during the COVID-19 pandemic have made lending more cautious through Non-Banking Financial Companies.

3. Rising price of property

The rise in the price of property have made some people to stop investing in real estate. Most of them think that the increase in price is due to the inclusion of G.S.T over the years because it was only 30% of tax of the total cost of property.

Moreover, the exclusion of stamp duty and registration charges together account for 5 to 7% of additional tax payment.

¹⁰ Challenges of Real Estate Investment, housing.com, (Jan. 30, 2020, 1:00 PM), <https://housing.com/news/impact-of-coronavirus-on-indian-real-estate/>

4. Piling Unsold Inventory

The level of unsold inventory in India has increased over the number of years. Delhi accounts for nearly 70% of unsold inventory across the top eight metro cities in India. Further, Maharashtra accounts for 48% of unsold inventory. While there is a huge demand in real estate sector, more than 30% of domestic and commercial housing are lying vacant in major cities. Moreover, lack of land titles, speculations and procedural difficulties are also posing a threat to the market.¹¹

¹¹ Challenges of Real Estate Investment, 99acres, (Jan 30. 2020, 1:35 PM), <https://www.99acres.com/articles/challenges-in-the-indian-real-estate-sector-in-2019.html>

REAL ESTATE PROSPECTS

The real estate sector in India has seen a lot of changes in the era of globalization and liberalization. The business opportunity has improved a lot which in turn led to demand in retail, hospitality and entertainment industries, economic and social infrastructure and IT enabled services. The concept of sustainable development is getting importance day by day. Nowadays sustainability, green design and renewable energy are the major aspects and they form an integral part of the real estate system.¹²

Indian realty sector has turned the business environment in the country in the past couple of decades. It has widened the career opportunity in realty sector. Corporate expansion in IT, banking and financial services, insurance, hospitality, media and entertainment have given resurgence to commercial properties.¹³

Real estate prospects during the COVID-19 Pandemic

The nationwide lockdown has paused and things are going back to normal after reducing the sales of real estate to 80% as compared to previous year. The real estate sector in 2020 has seen this opportunity to renew the consumer confidence and provide houses at affordable costs. If we consider COVID-19 as an opportunity, we can think of investing in real estate during this time because of first the availability of more houses, the falling price of house and the lower interest rate offered by banks for home loans.¹⁴

¹² Prospects of Real Estate, Legal Bites, (Aug. 31, 2020, 2:30 PM), <https://www.legalbites.in/future-prospects-of-the-real-estate-sector-in-india/>

¹³ Future Prospects of Real Estate Sector, Legal Bites, (Aug. 31, 2020, 2:45 PM), <https://www.legalbites.in/future-prospects-of-the-real-estate-sector-in-india/>

¹⁴ COVID-19 Pandemic, Legal Bites, (Aug. 31, 2020, 3:00 PM), <https://www.businesstoday.in/opinion/columns/covid19-pandemic-an-opportunity-in-disguise-for-indian-real-estate-realty-sector-coronavirus-lockdown/story/411317.html>

CONCLUSION

Real Estate basically means a piece of land which includes permanent improvements attached to the land whether natural or man-made like trees, fences, bridges, water, etc. People can invest in real estate in many ways like homeownership, rental properties and house flipping. Although there are various other investment options available for the investors, but still most of the investors prefer investing in real estate as it generates cash flow, it can be leveraged for financing, it gives tax benefits and it gives various other advantages. However, with every investment there are certain challenges which the investor has to face like the real estate is the most heterogeneous asset, it is highly illiquid and it is lumpy. Although, there may be many challenges in this type of investment but the demand for real estate will keep rising because now days people have become more aware and they have become systematic. Because of urbanization, cities and mega cities will become a major element of real estate investment in the near future. The best strategy to follow when investing in real estate is to build alliances and collaborations. Every market has its ups and downs, but still real estate sector is the most stable one as compared to the other sectors. Introduction of many new laws in different countries related to the real estate investment has made people more secure as many builders, agents, real estate companies, etc. indulge in unfair and malpractices to increase their profits and to get maximum benefits.

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