

# Recovery and Real Estate: A Tale of Three Nations

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*Real estate markets in India, China and America exhibit different characteristics. Yet, they have gone through the same, globally spread credit crunch. This commentary compares the scenarios in the three nations.*



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**T**he ubiquitous economic crisis did not come as a surprise to several nations- China and India in particular; two emerging giants whose largest trade partner is the US. The American Real estate shares a two-ways culprit-victim relationship with the ailing economy. The situation is complex and the form of this complexity varies drastically between China, India and the USA. This article takes a short peek on those contrasts. I came across these interesting quotes from recent newspaper articles that give you a snapshot of the contrasts:

***“...the young (cab) driver (in Fort Myers, Florida) volunteered that he had just bought his first house, paying \$65,000 for a foreclosed property...that last sold for over \$250,000”***

-a Wall Street Journal columnist; “Yes, the housing market has rarely looked better”; Wall Street Journal, Sep 02 2009

***“We used to talk about monthly price growth, but recently, it's more about daily change.”***

-a Chinese real estate broker; “Real estate goes through roof in China”; UPI.com; July 03 2009

***“This (India) is a country with very large government debts...You cannot start to expect China-style packages”***

-a sovereign credit analyst at moody's, Singapore; “India's stimulus package: more help needed”; Business Week, Dec 09 2008

### ***At the Bottom of the Market***

Present is dark and the future hazy for US real estate. While the stakeholders of this market continue mourning at the dire lack of market liquidity, the “south” is gearing up for business take-off. Real estate investors in

the middle-east are ready with their blueprint to immediately start new ventures in China and south-east Asia. Australia, already boasting of a stable real estate market, recently eased the foreign ownership laws and introduced attractive exchange rates. Chinese are, therefore, eyeing the Australian luxury real estate markets. What was named as the “Bestest” (superlative degree of ‘best’) syndrome among middle-eastern developers a few years ago is nowhere visible in the approach of Chinese developers. That this modesty is due to credit crunch would be bad argument to describe the phenomenon. Here are some eye openers: In the first seven months of 2009 Chinese property sales grew 60%. In 2010, the Chinese real estate market is to grow by 30%.

The world must face it: Chinese approach towards real estate is more strategically planned; not only at the business entity level; but at the national policy level too. It hardly surprised the world when the China Investment Corporation (CIC), a \$300 billion sovereign-wealth fund, decided to buy American distressed assets. The wisdom of this decision manifests in the fact (among others) that CIC will buy assets in both forms: securities backed by real estate assets as well as direct ownership interest in buildings. Remarkably, CIC's recent stakes in biggies like Morgan Stanley has only led to losses (forcing several to believe that the decision to buy stakes were hasty) so far. China is, however, optimistic about using their knowledge in facilitating smart investments. CIC's one-month investment in 2009 in global financial markets (around \$5 billion) equaled its annual investment in 2008! By 2014 this investment is said to grow up to \$20 billion.

The story of contrast (from the US) is not limited to China; Indian real estate has

started showing signs of improvement as well while the American market is yet to touch the bottom. The burgeoning Indian middle class and increasing number of foreign enterprises are less affected by the credit crunch and have been creating demand continuously. The trend has dampened a bit; yet heavy investments are expected to start pouring into the Indian real estate market by 2010. Developers have already started chasing the target of 2 million affordable homes.

### *Rescue- Rescue Everywhere!*

Victory over opposition's strong hue and cry on President's Obama's stimulus plan seems to have done little to improve the cash-strapped real estate market of the US. On the other hand, a \$585 billion stimulus plan by Chinese Premier Wen Jiabao vastly routed the decline of Chinese real estate market. Some other remarkable key monetary efforts by Chinese central bank kept the economy immune from global recession. What more? Chinese real estate market actually had to get "alarmed" by the aggressive growth in the debt market; and expectations of growth in the equity market. Wall Street Journal reported in August that China Construction Bank, the second largest bank in China announced to cut its lending to curtail the sharp growth.

Traditionally, in both India and China, acquiring housing mortgage loan has not been as easy as in the US. Thanks to the rigorous underwriting process that involves strict scrutiny of eligibility and ability for repayment that the credit crunch is not indigenous to these markets. It is another thing that a vast number of Chindians are deprived of home-ownership due to lack of access to easy mortgage. This, in part, is also good news for the world as Chindia is one of the few hopes for global economic

recovery.

However, the state of real estate in India is not as hopeful as in China. It seems to have fared better than the US, though when it comes to the hopefulness of the market. Compared to colossal stimulus packages given away by the American and the Chinese counterparts, Indian government limited its package to just around \$8 billion. The small sum was largely blamed at the fiscal deficit of the federal and state governments of India. However small, this stimulus package added to the government debt by 0.8%; as per Moody's estimates. Of the package, only \$1.5 billion was allocated to National Housing Bank; a Fannie Mae-type institution of India. The government has been trying hard to make up for limitations of fiscal policies by adequate monetary policy measures, though. Interestingly, the state governments have started issuing stimulus packages too, Punjab being an example. Indian efforts were somewhat similar to China's: Interest rate cuts and going easier on banks' cash reserve requirements, the typical monetary tools. These led to \$60 billion of liquidity in the Indian banking system.

Primarily due to the stimulus packages by the government, Credit has grown easier in China boosting mortgage activity and, of course, home buying. This is a phenomenon which Americans are not even dreaming of today. Chinese stimulus plan helped real estate developers in two ways: first, they got access to debt and secondly, their customers felt empowered by mortgage finance availability. Results have not been as pleasing in India though. Indian real estate market is still struggling with lack of mortgage financing, diminishing rentals and interrupted development projects. Yet, things are changing fast (by the time this article is being finalized, Indian newspapers

have started reporting about how the housing sector in India is "shining again" with all the major players showing upswing in both sales and net profit during the recent quarter (June 2009). Indian Finance Minister is dogged not to curb the credit in order to maintain the pace of economic growth.

### *Anybody alive over there?*

The American capital-market scenario is not much different: banks continue to keep their lending policies tightened up in spite of the stimulus plans implemented by the government. Disturbingly, the very loan demand has been shrinking. A WSJ columnist noted that the American real estate prices, nationally, are 30% lower from their 2006 peak. Panicked by the nightmare of liquidity crisis, the American policy makers came up with the much-talked "Public-Private Investment Program" (PPIP). PPIP is designed to let the US treasury share the risk with the private investor as a partner in ventures while purchasing distressed assets. This anxiety is equally visible in private American entrepreneurs who are desperately encouraging overseas capital to flow into the market. This demand has been backed by a hope that increased capital will stop further decline in commercial property values. The PPIP is, no doubt, aimed at foreign capital as the local investors are too careful.

Attitude towards foreign capital in the local markets has not been much different in the US and China: exhibiting intrinsic contrasts. Several Americans have historically disliked the aggressive Japanese and Chinese money coming into US real estate. When the government introduced PPIP, it was obvious that China would be one of the biggest to invest heavily in the US Real Estate through PPIP. As a result, a cap of 9.9% was introduced on the investment amount made by a single investor. In spite of such

resistances, foreign money has been an important source of capital for American real estate; a painful truth!

Chinese have been equally wary of increasing foreign investment in the real estate sector. They revoked special tax status to foreign investors as early as 2007. More recently, foreign exchange, regulatory supervision and approval process for foreign direct investors were tightened up. As a result, the FDI figures slid by roughly 20%. However, Chinese too had to face the bitter truth: foreign investments cannot be let go just because they make you feel nervous. Although they do not have any counterpart of PPIP in place; the Chinese government did relax the controls on foreign investments recently.

Indian attitude does not exhibit such an ebb and flow. India has not been extremely friendly to foreign direct investors in real estate either; but it has constantly been growing friendlier. Several restrictions apply including a lower cap on land size, venture structure and a minimum capitalization. However, perhaps in the aftermath of the credit crunch, the relevant government departments are working towards easing the rules. Remarkably, the FDI targets also have been raised by the government.

### *Take Aways*

These contrasts shall remain worth watching for a while. The reason being in spite of all the shortcomings, real estate models of the US are being adopted in India and China. It looks like the three heterogeneous markets are trying to merge with as a global monolithic mass. The markets for mortgage based securities are flourishing in Chindia that had led to the disaster of the financial system in America (long ago, it seems). Real Estate Investment Trusts are being

introduced in Chindia when the American REITs are suffering. Will this lead to the self-destruction of markets in China and India? Perhaps not, as the mortgage markets in these nations are not likely to be effective

soon as it was in America five years ago. However, Chindia must learn from the American experience before implementing any 'American-style' financial system. American failures have a lot to teach.

### About the Author



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