

Dynamics of Real Estate Economics: The Untold Conundrum

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Abstract. The amount of land on Earth is fixed and as a result of that our national / State boundaries are well defined. Even our own localities are well measured and the available land for housing is well marked. With Globalization in its full swing we witness societal changes as also changes in the family structure. Small families are now preferred to big families while bigger space is preferred to moderate spaces. As the role of the Government gets marginalized, employment opportunities in the formal sectors diminish but self employment and business ventures are on the rise. A large number of people are spontaneously getting engaged in real estate business which is apparently very lucrative and rewarding. This phenomenon is so prominent that we even find big business houses engaging in realty business and come across coinage of phrases like Promoter-Raj. Individuals are starting real estate business and subsequently diverting the profit earned into other form of business by horizontal expansion. The reward from real estate business is so prompt and appealing that it is becoming increasingly important for areas where financial capital is of utmost importance. Quick profit is thus channelized into promised stream of income for various sectors of the economy. It essentially happens because the capital involved in real estate deals is of an exclusive genre. It is a fluid that assumes the shape where it is poured in. Be it culture like production of films or be it media like running a daily or a Television channel this capital has an omnipresence character. That being so it commands a high bargaining power whereby it controls the framing of public policies even manipulating at times. The fundamental law of economics tells us that where there is profit savings it keeps pouring in and hence the attraction of lump sum profit draws excess supply of real estate dealers and to keep profit from falling they are undertaking various nefarious measures thereby disturbing and distorting the basic fabric of the society.

1. Introduction

Real Estate is a physical and a financial asset. As a physical asset it is fixed in a given place, thereby grounding the economic/political/social relations that create real estate. As a financial asset it is mobile and tradable. A real estate project might be sold on completion with additional transactions likely. Real state has a spatial dimension that is best exemplified by the mantra use to describe the source of real estate value: location, location, location. The real estate economy as we have known has three main pillars namely the i) *Vacant land*, ii) *Residential Properties which includes apartments, condominiums, separate homes, duplexes, vacation homes etc.*, iii) *Commercial properties which looks into the income potential of the property, historical revenue etc.*

2. Supply and Demand factors

The primary determinants consumers' buying attitude for houses include current and expected interests rates, wealth, expected real disposable income, expected change in financial status, and housing prices. The secondary determinants include tax concessions, family size, expected government policies etc. Of all the primary and secondary determinants the interest rates explain a large proportion of consumers' perception towards real estate market.

On the supply side we find new real estate housing project continually surfacing. The capital needed is obtained from diversifying the profit from other business units or more from a combination of personal savings and / or loans and / or advances. As the land on earth is fixed the only option therefore is to replace the old buildings with multistoried blocks or complexes. As transactions in the real estate market are fast and time-bound, the expected cost and expected income are also somewhat certain. It is this certainty of income or risk-neutral income which invites new players thereby enlarging the circle. As land prices never depreciate, but only appreciate at various paces depending on locality people often by the high return buy houses to sell them dearer. Thus there is always a sustained demand and supply interaction in this real estate world.

3. Size of the Real Estate player

Let us briefly examine the expression:

$$\text{Seed Capital (S.Cap)} \equiv \text{PS} + \text{L} + \text{ADV} \quad (1)$$

The right hand side explicitly can be used to define the size of the developer or as is commonly called a promoter. Real Estate financing is obtaining funds for the purchase or construction of real estate. Borrowers include individual and families who wish to buy homes, as well as promoter of commercial and industrial venture who hope to obtain a higher yield than the interest they will have to pay for borrowed funds. Lenders are chiefly commercial banks, mutual savings banks, savings and loan association, life insurance companies etc.

If personal savings (PS) is high among the three it means the developer is a small entrepreneur or is an individual venturing in this business initially. For those already in the game the ADV will be providing for the maximum of S Capital while firms with good reputes can borrow afresh from the market thus making L high. These variables however do not behave independently in the market but are strongly correlated to other factors. Advance for example is the amount that potential buyer would make for the project and in the event of a rise in interest rate (borrowing) the demand for housing will go down thus ADV will fall. For an established well reputed unit however that may not be a problem as it can then take recourse to market borrowings. However in general if ADV falls signaling a fall in demand for housing, the completion of the project is delayed thus witnessing a cost escalation. For units already operating in other industries diverting of surplus funds will then be 'the option' I call this 'the option' because over the last two decades the Indian society as witnessed a large number of such units operating in the real estate sphere with their business roots in other sectors of the economy. The real estate sector likewise has also provided many firms a platform to 'rise' and many are operating in different sectors whose started as REP (Real Estate Players).

Of particular interest is the case where PS forms the major chunk of S Cap. As we noted earlier this is a situation where the REP is a new entrant with / without business experience elsewhere that is REP (BX) and REP (NBX) respectively.

In the case of REP (NBX) the maintenance of the time schedule is all the more important because of anticipated cost escalation. We have even come across cases where REP (NBX) gets merged with REP (BX) as the latter finds the project profitable notwithstanding technicalities of the company law which do not allowed this merger. In case the REP (NBX) goes alone and in the event of its venture turning out to be a success, the process is repeated not only once but several simultaneously to reap the economies of scale. Profit as we know has an universal acceptance, and therefore targeting profits takes the form of a passion and pervades all sections of the society. The real

estate project is so lucrative causes minor and major injuries to even the cultural heritage of the society. We have multiple examples of localities in our city of Kolkata which used to have single storied building with beautiful gardens and grounds, that have over the last few decades turned jungles of into concrete high rise blocks. Even Shantiniketan a place where Tagore started his dream University ‘Viswabharati’ which was all green them is now a big concrete mass.

We quickly turn to define a few terns that we may need to know.

a) The stairway of Real Estate Economics. This is defined by the following stairs

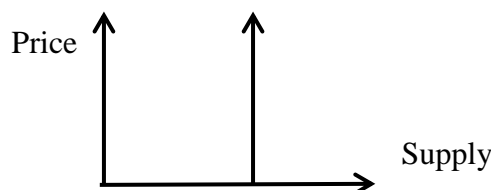


Gross absorption is another concept defined as the total amount of space involved all leases signed during a particular period. As such it thus does not really indicate anything about changes in aggregate demand for real estate. There is how ever a gap in this conceptualization as with changes in municipalities laws the available space can be increased and hence the developer can execute the project at a reduced cost by which his profit increases. Gross absorption thus plays a role in supply side and REP (BX) are always interested in calculating the same. Thus,

$$GA_t = \sum_{i=1}^n S_i \tag{2}$$

where S is thus square footage, for n leases at time t.

Over a short run time period since the aggregate supply is given or fixed we have as supply curve as



As can be well understood changes in demand will automatically raise the price, and developer therefore will undertake an extensive campaign, artificial booking etc.

4. The Changing Trend

Let us turn our attention to the puzzle now or the untold conundrum. We state two hypothesis and try to established them.

- I) Real Estate guarantees quick profit and thus makes its presence felt in almost all spheres of the society.
- II) Attracted by profit, investible funds from a cross section of sources are made available and this compromises with the heritage of the source-society.

As both the buyer of RE and seller of RE prefer to work on a time schedule so as not to allow a cost rise, the profit is guaranteed because for buyers the opportunity cost of buying a real estate is higher than the price. (People do not have prior knowledge of civil works, the legalities, the supervisory work and the nitty-gritties of construction, along with the time need for this). From the sellers point of view the price is quoted keeping in mind the growing demand and hence the schedule drawn necessarily yields profits. As these projects are time bound (unlike building public goods) other people not in the trade find it lucrative and agrees to lend a handsome amount out of their savings. A comparison the make is the market rate of interest or the bank’s interest rates with the percentage of profit. With the first venture turning out to be a success, successive projects do not face any capital dearth and Politicians, Policemen, Doctors, Lawyers, Sportsmen, all make such investment gladly.

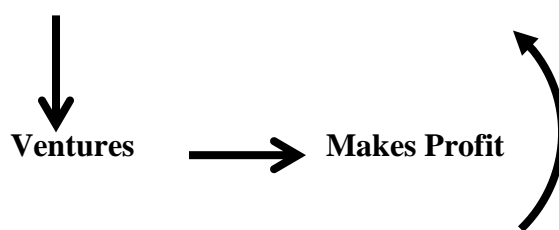
My second hypothesis of compromise stems from this very fact that when a physician turns his attention to earn more profit he has to necessarily compromise with his sincerity in terms of number of patients examined or surgeries performed. When an ordinary businessman earns that that whole some profit he intends to make a permanent asset and ventures to open an educational institution or a clinical laboratory. Such unchecked growth of academic units or health units are welcome as they provide opportunity for employment as well as the service they provide, but the vital question that remains unanswered is the quality they are producing rendering. This is so much disturbing and alarming that we even have films coming out with these stories narrating how space is being looked for and allied consequences. The alarming part however is that the battle for a space may turn out to be frightening, when one group is ousted to take control of a land by yet another group with the help of muscle man, and also through unfair means.

We have in recent past come across situations when old building settlements have been put into flames allegedly by developers to grab the land. The interesting part of the dynamics however is real estate promoters do not stay long in the industry. If the developer is a sole entrepreneur he would attain a certain level in terms of capital accumulation and then move out for a diversification into some other ventures creating permanent real asset like schools / clinics / Malls etc.

We finally mention two stages of the dynamics as follows:-

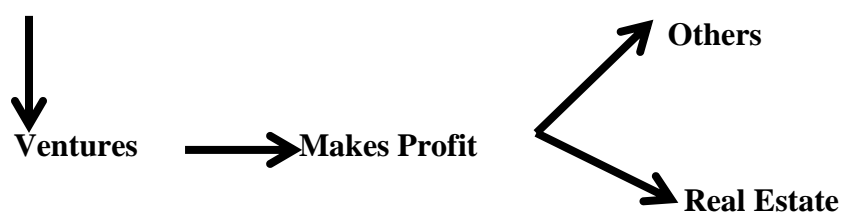
Stage I

Individual Real Estate Developer (IRED) Ploughs back and repeat



Stage II

Individual Real Estate Developer (IRED)



The time gap between stages I & II is determined by whether IRED can manage to fetch funds easily or whether there is adequate supply of capital for the venture. The adequate supply of capital is the less will be the time gap between the stages.

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