Department of Commerce (CA)

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Marketing of Financial Services (18MCC25E)

UNIT 5 :

Real Estate Industry - Concept - Classification - Benefits of real estate investment Developments in Indian real estate markets Securitization - Mechanisms of Securitization. Advantages of securitization - Securitization in India

Reference Book

Marketing of Financial Services

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Real Estate Industry

Real estate is a real property that consists of land and improvements, which include buildings.

Ex. Plant and equipments, fixtures, roads

Property rights give a title of ownership to land and natural resources such as minerals, plants and animals.

Jobs (or) Careers in Real Estate Industry

1. Analyst - Performing financial analysis and valuation of properties
2. Appraiser - Valuing properties
3. Agents - Connecting link between buyers and sellers of properties
4. Building Inspector - Some one who determines buildings and work with appraisers
5. Commercial Broker - An agent who sells commercial properties
6. Loan underwriters - A person who analyses the credit worthiness of borrowers

7. Mortgage Specialist } A person who approves mortgage applications

8. Real Estate Attorney } A lawyer who specialises in real estate transactions

Concept of Real Estate Industry

In real estate markets are properties are available for sale. Because of large economic forces, there are times when these properties rise in value or fall in ~~fall~~ value. This what people mean when they say the market is up or down.

The housing market is a segment of real estate market that consists of residential properties only. Trends in housing markets are closely watched because they provide a measure of general welfare

Real estate agents help people to buy and sell properties by providing expertise advise in real estate market. They know the local laws and regulations and negotiate on behalf of their clients.

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Classification of Real Estate Industry

The main types are

1. Land
2. Residential
3. Commercial
4. Industrial

Land

It is the base line for all types of rea property. Land refers to underdeveloped property and vacant land. Developers acquire land and combine with other properties. It is called assembling. They modify the land to increase the value of property

Residential

It consists of housing for individuals, families or groups of people. This is the most common type of real estate industry

Commercial

It refers to land and buildings that are used by business to carry out their operations. ex. Shopping malls, individual stores, office building, parking area and hotels.

3

Industrial

It refers to land and buildings that are used by industrial businesses for activities such as factories, mechanical productions, research and development, construction, transportation, logistics and warehousing.

Examples of real estate Industry

1. Single family dwelling - Any home designed for only one family
2. Multi family dwelling - Any group of homes designed for more than one family.
3. Attached - Any unit that is connected to another
4. Apartment - An individual unit in a multi-unit building. The boundries of the apartment are generally locked with doors.
5. Multi family house - Multi story detached building where each floor is a separate apartment

5. Condominimum (Condo)

A building with individual unit owned by individual person.

6. Detached house

A free standing building not connected to anything (ex) traditional homes

7. Portable house

House that can be moved

8. Mobile home

A vehicle on wheels that has a permanent residence

9. Villa

A building with large space normally a large house that can be used for holidays

10. Hut

A house made of raw materials such as bamboo, mud and clay

Benefits of Real Estate Investment

1. Allows diversification of asset
2. Instantaneous dual income
3. Great inflation hedge
4. Saves income tax

5. Provides leaverage

6. Real Estate business can be easy to understand

7. Real estate properties can be financed easily

Disadvantages

1. It has higher transaction cost
2. It has low liquidity
3. High cost of maintenance
4. It creates heavy liabilities
5. Capital gain tax is applicable
6. Finding suitable tenant is difficult
7. Assessing the value is difficult

Developments in Indian Real Estate Market

Real estate development is a process that involves the purchase of raw lands, rezoning, construction and renovation of buildings and sale or lease of the finished products to end users. Developers earn a profit by adding value to the land and taking the risk of financing the project.

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Challenges faced by Indian Real Industry

1. Procedural and approval difficulties
2. Lack of clear land titles
3. Speculation in land and real estate prices
4. Poor sources of finance - Funding
5. High Input Cost
6. Heavy capital gain tax rate
7. Outdated buildings
8. Unending project delays due to delayed construction
9. Available land is low.

Future of Indian Real Estate Industry

The real estate industry in India is expected to reach a market size of \$ 1 trillion by 2030 and contribute 13% of country's GDP by 2025. It has witnessed high growth in the recent times with rise in demand for office and also residential spaces.

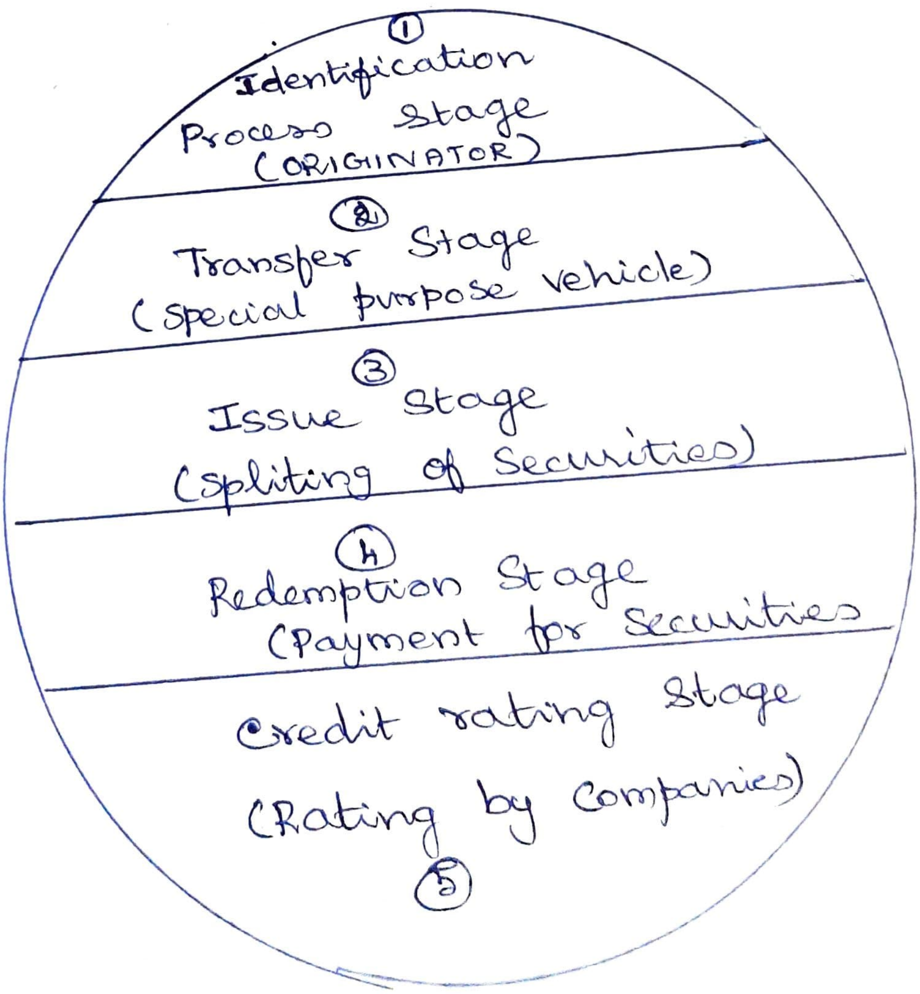
SECURITISATION

It is the process by which a company clubs its different financial assets to form a consolidated financial instrument which is issued to investors. Investors will get return which is interest

Mechanism of Securitisation

(or)

Process of Securitisation



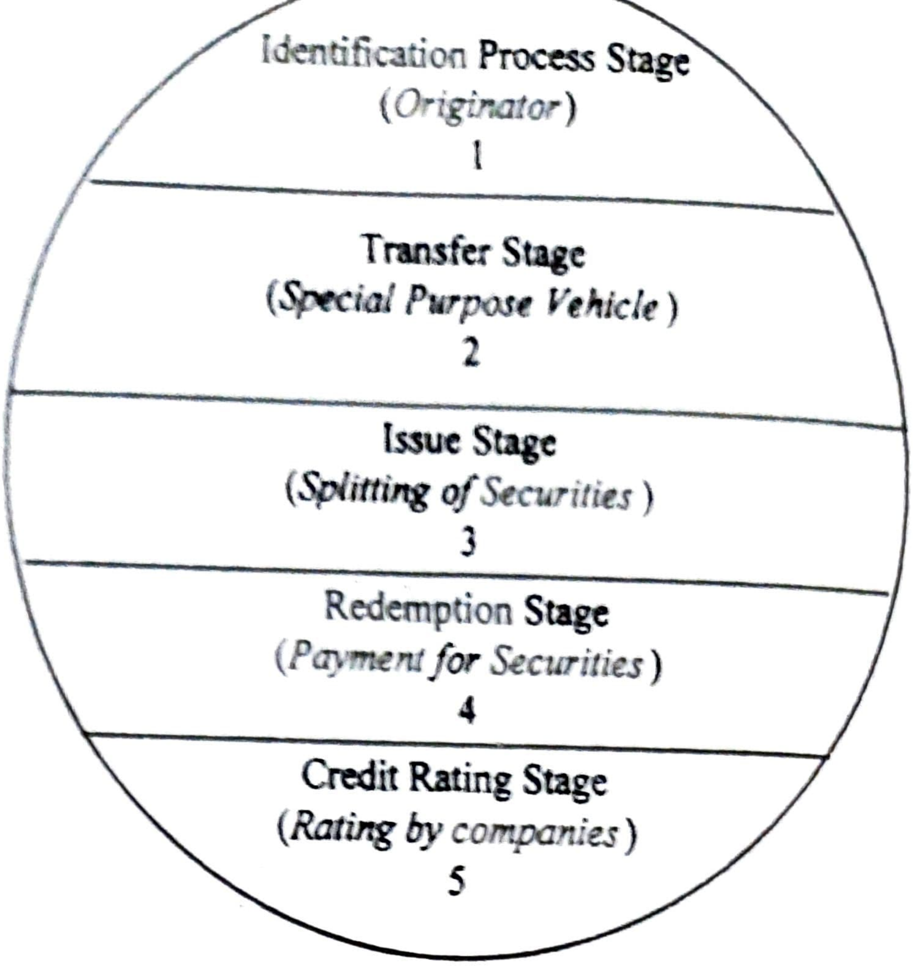


Figure 38.1 - Diagrammatic Representation of Securitisation Process

First stage: In the first stage, the financial institution or the banker, is called the ORIGINATOR. The ORIGINATOR will pool his lendings like mortgages, or account receivables into a homogeneous type based on interest rate, maturity period, etc.

Thus, the first stage is called *Identification process stage.*

Second stage: The origniator will transfer all his assets, to another institution which helps in the process of securitisation. The assets are converted into securities by SPECIAL PURPOSE VEHICLE (S.P.V) or Trust. The Trustees may be retired high court judges who may have knowledge of valuation of assets and finance. There are also merchant bankers who act as SPV and as agents for issue. The reputation of merchant bankers will help in the issue of debt instruments by which the debt instruments will be oversubscribed.

Issue stage: The SPV splits various assets into different types of securities according to their maturity date and interest rate.

The SPV issues securities to investors which are as follows:

1. Pass through certificates
2. Pay through certificates
3. Interest only certificates
4. Principal only certificates

1. In the case of *Pass through certificates*, payments are received from assets such as housing loan from out of which payment for certificate of deposits are met as and when they are due.

2. *Pay Through certificates:* In this case, multiple maturity structure certificates depending upon maturing pattern of various assets will be issued, so that as and when the assets mature the respective certificates will be paid.

3. *Interest only certificates:* The interest for these certificates will be paid as per the earnings from the assets securitised.

4. *Principal only certificates:* Only the principal amount will be paid on the certificates from the realisation of assets.

Redemption process : Payments received from various assets are used for redeeming various credit instruments issued. This is done by the originator himself. In some cases, a separate servicing agent may be appointed who will undertake collection work for which adequate commission will be paid. The job of the servicing agent will be to discharge the assets through the collection of principal and interest and settle the debt instruments.

For example, the housing loan may be collected with principal and interest and from its collection, debt instruments such as certificate of deposits will be met.

A pass through certificate which we have mentioned already may be a with recourse or without recourse certificate. In the case of with recourse certificate, if payment is defaulted, the originator will be held liable by the SPV. Hence, SPV plays a major role in settling the claims of the investors.

Credit rating stage : The pass through certificate issued by SPV has to be credit rated as they are debt instruments which are issued to the public. The financial institutions issuing these debt instruments will have to undergo credit rating which is statutorily mandated in certain countries. The debt instruments are also traded in the secondary market especially for interest swap.

The following are the various assets which can be used for securitisation by financial institutions.

Assets which can be used for securitisation

1. Housing loan
2. Hypothecation of vehicle loans
3. Leasing finance
4. Supply bills of Government departments
5. Outstanding on credit cards.
6. Long-term loans granted to reputed parties

Advantages of Securitisation

1. Enables lending institutions to improve their liquidity by converting long-term assets
2. The earnings of the originator goes up
3. Financial institutions can gain by interest swap - converting variable rate loan to fixed rate loan.
4. Capital adequacy ratio is increased and it reduces risk on assets.
5. Diversification of risk is possible
6. Increasing demand in money market can be met out of long-term assets and so capital market will be dynamic
7. Banks obtain better source of funds
8. Banks can create more credit

Securitisation in India

Though securitisation is very popular among developed countries like UK and USA it is yet to pick up in India. The reasons are

1. Lack of debt instrument market
2. Lack of support from financial institutions
3. Absence of agencies (SPV) Special Purpose Vehicle
4. Difficulty in transfer of asset
5. Higher Stamp and transfer charges
6. Lack of Common arrangement by financial institutions

Future of Securitisation in India

Improvement in the functioning of commercial banks and the increasing number of foreign commercial banks provide more scope for the creation of Securitisation in future.

If RBI creates a permanent organisation then there is more scope for securitisation in our country.