

FINANCIAL LITERACY



TOPIC

Real Estate as an Investment

◆ COMMENTARY

- ▶ Real estate or property investment is very common in India. It is not just a dream of most Indians to have their own home, but also to own multiple properties. But is it worth it?
- ▶ Real estate has more negatives than positives if thought of solely from the point of view of capital investment.
- ▶ Indians have this blind belief that any property bought at any price will always turn out to be a good investment. Even a bad piece of real estate is not sold just because of this belief.



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◆ NEGATIVES

- ▶ Illiquid asset: Real estate is an illiquid asset. You cannot sell a property you own at your convenience. Unless a buyer becomes available at the exact time you want to sell, the asset cannot be called liquid.
- ▶ Transaction and maintenance costs: Buying and selling property involves significant costs such as stamp duty. Often you will also pay a commission to a broker. However, the costs don't just end while executing a transaction. You will incur costs in maintaining the property and keeping it up to the mark.



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◆ NEGATIVES

- ▶ Legal issues: Even if a piece of property is absolutely clean, there can still be legal issues. If someone has bad intentions they can create fake legal issues simply to put a property into dispute.
- ▶ Requires high capital: No piece of decent property can be bought in a few lakh rupees. Any property that has the potential to yield better returns will cost significantly. Whether someone pays the cost from their pocket or takes a loan, the investment is undoubtedly very substantial.



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◆ NEGATIVES

- ▶ Low returns: Very often people buy a flat or an office with the desire to rent it out for an income. But they only focus on the absolute rent, not the percentage return on their investment. Usually the annual rent is around 4-8% of the property value. Don't forget the maintenance costs you incur.
- ▶ Blocks capital: As the ticket size in real estate is very high it leads to blockage of huge amounts of capital. This becomes of greater issue when you need money urgently or the markets are in a slump.



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♦ WHY THE REAL ESTATE OBSESSION?

- ▶ From a young age the talk in Indian families is about property. Ancestral property is an aspect that is very common, and we take pride not just in owning but carrying properties forward through generations. This creates a natural affinity toward real estate.
- ▶ We hear stories about how someone sold a plot for ₹1 crore that was bought for just ₹10 lakhs 25 years back. Everyone ends up fixating on the one crore figure not understanding that the actual return made on the investment is less than 10%.



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♦ WHY THE REAL ESTATE OBSESSION?

- ▶ Real estate has become the most prominent status symbol in our society. Owning a second house or another flat is considered a major boost to a person's status (and to one's ego). Even if the property is bought by taking huge debt, who cares? Also, real estate can be 'showed off'. It quickly becomes the talk of the town as it is an asset that is *visible*. On the other hand, assets such as equity aren't visible. You can't go around showing people your portfolio. Hence, the fact that real estate can be seen really adds to the obsession toward it.



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✦ COMMON MISTAKES

- ▶ The first mistake made is rushing to buy a house in one's late 20s or early 30s. This is the time when a person can take most risk in investing as they have the least obligations and the longest time horizon. But it is at this very stage that people often burden themselves with heavy debt. Income that could go towards building wealth is directed toward paying off a loan. If your social situation permits, delay buying a house till your late 30s or early 40s. Also, your total EMI (paid toward all loans) should not be more than 40% of your income.



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✦ COMMON MISTAKES

- ▶ The other major mistake is buying real estate to fund a future financial goal. This is the *riskiest* investment. Firstly, you cannot predict how much return you will make. Secondly, what's the guarantee you will find a buyer when you want to sell? And if you do, what are the chances they will offer the price you want? Lastly, what if there's a real estate slump when you have to sell to fulfil a goal?
- ▶ Remember: plots are not easy to sell; individual houses have lost demand; and everyone prefers a brand new flat.



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◆ WHEN IS BUYING PROPERTY APPROPRIATE?

- ▶ If buying and selling real estate is your business or if that's something you want to do, then of course you must be investing in real estate.
- ▶ When you are yet to buy your first home. But like we've mentioned before, do not take a house beyond your financial capability. Just because you can pay the EMI through your income doesn't mean you can afford the house. I have seen instances where people bought a house for which they were paying 70% income as EMI. They did not have money left even to expand their health insurance!



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◆ WHEN IS BUYING PROPERTY APPROPRIATE?

- ▶ When you need an office for yourself. If renting one is not a viable option, you can buy an office.
- ▶ If you have a business model that requires a property of your own, then you can think about buying real estate. This needs a unique business idea. Most people simply buy real estate to rent it out. This, in majority cases, is a bad investment. You will get more in a fixed deposit. Hence, purchase property only if the return through your business can exceed 10% of the investment net of all expenses.



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◆ WHEN IS BUYING PROPERTY APPROPRIATE?

- ▶ When you have the opportunity to buy a piece of real estate that has something unique which gives it a significant premium. For example, in certain hill-stations, new constructions are banned. Even the plans that get approved take a lot of time, money and bureaucratic management, and hence, are not everyone's cup of tea. In such cases, the demand for real estate is much higher than the supply. Due to this mismatch, the properties trade at a high premium irrespective of the market sentiment or the logical price.

