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INFLATION AFFECTING THE REAL ESTATE MARKET: A COMPARATIVE ANALYSIS BETWEEN USA AND INDIA

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ABSTRACT

Real Estate projects in India are regulated under the Real Estate (Regulation and Development) Act, 2016 and hold an integral part in a country's economy. The rise in the increase of prices of goods and services in an economy has a proportional effect on its real estate activities. Inflation is known to be a boon to the real estate sector as the prices of the properties rise considerably with the rise in price overall. This is known to be disadvantageous to the homebuyers as they have to spend more out of their pockets for the same property had there been no inflation in the economy. Therefore, the authors have tried to find out the key issues related to such high prices leading to lower purchasing power for the homebuyers in India and the US.

KEYWORDS: Economy, Homebuyers, Inflation, Proportional effect, Purchasing power

INTRODUCTION:

Real estate has always been known to be one of the most lucrative fields for investors in any economy. With the rising demand for houses amongst the young generation, married couples, newly employed, the prices of property is mostly high. Real estate also offers ample amount of earning possibilities to developers, promoters, real estate agents etc. It is a highly volatile market with constant fluctuations in prices affecting both homebuyers and home developers to a considerable extent. Here, inflation and deflation in the economy have an impact on the property prices, rental accommodations, cost of living, cost of production/construction of the project. Inflation is known to have a positive effect on the real estate market with respect to home developers as they have the advantage of charging high prices for their property or even charging high rents as the demand for rental accommodation rises during such periods. It can be said that property owners have an upper hand over homebuyers during inflation. Skyrocketing home prices

are taxing on the hardworking families as they are forced to spend more and for the basic amenities like that of shelter. Pricey housing forces people to get married early or have less children than planned or move out to cities with affordable stay. Across the nation, local government agencies frequently and proactively forbid homeowners from making the most use of their property. When it comes to building on their land, let alone making repairs or improvements, landowners frequently encounter unending red tape. Without providing any compensation, these regulations lower the potential value of a property. Local governments provide an informal, hard-to-enforce collective property right, supported by state power, that enables homeowners to dictate to their neighbors what they should and shouldn't do on their land, in place of weakening individual property rights. The determining factor here is the increased demand of the homebuyers for new property. Therefore, investing in real estate sector is essentially a plus point for buyers¹.

CORRELATION BETWEEN INFLATION AND REAL ESTATE:

Talking about how inflation affects the real estate market, it is important to note down the pointers which lead to the appreciation in prices. Real estate being a tangible hard asset appreciates in value as the price rises along with retaining such high price during uncertain times. Another correlation between inflation and real estate is the fact that landlords tend to increase rental rates to keep pace with the rising expenses thereby leading to higher rental income. Central banks also increase their interest charges to control inflation thereby increasing borrowing costs of individuals, borrowers and businessmen making it difficult for them to finance real estate purchases as higher interest rates deter potential buyers from investing in the sector. There are also instances in which construction costs have severely risen because of increased prices of materials and high labor cost again increasing property prices because of less supply and higher demand for the same. Inflation in the financial market also prompts investors to diversify their investment choices leaning more towards the real estate sector thereby driving up the prices yet again. Inflation has been known to slow down the housing market and deter qualified buyers from entering the market as their affordability decreases². All of these factors boil down to an investor's sentiments which essentially means that if investors feel that real estate is a good hedge against

¹ Rohit Malik, Rising inflation – Should you invest in real estate, in Voices, Economy, India, TOI, June 9, 2022, 6:59 PM IST, <https://timesofindia.indiatimes.com/blogs/voices/rising-inflation-should-you-invest-in-real-estate/>

² JOSEPH NGUYEN, Is There a Correlation Between Inflation and Home Prices?, May 31, 2022, <https://www.investopedia.com/ask/answers/correlation-inflation-houses.asp>

inflation, it can drive up prices and demand for property.

Comparative Analysis of the effect of inflation between the countries of USA and India:

INDIA:

India in the field of Real estate is recently developed compared to other countries where the centralized act Real Estate (Regulation and Development) Act, 2016 was brought with the main aim to protect the “home buyers”³ from fraud, misrepresentation and other illegal activities, the act came into force to fasten the process and to seek justice to the homebuyers. This is formulated in every state that it should have its own RERA as it is considered as Fast Track Mechanism. The cost of living is changing every year, according to the latest statistics, India’s retail inflation eased to a three-month low of 5.02% in September 2023⁴. where it has been a positive aspect for real estate owners as they get higher yields on their assets, the value of the land mostly does not depreciate so the potential buyer need not worry as the period for which the infanterry period lasts is not predictable. Inflation is connected with various factors simultaneously in which a number of changes like higher mortgage rates, higher home prices, devaluation of long-term debt, increase in the cost of construction and more price of property. Property prices shoot up and this is due to the complementary effect when the construction material rises then automatically there is higher price quotation which results in increasing the cost of developing properties and this is because of the decrease in the value of currency which is also known as devaluation effect. So, in such a case the lender has no other choice but to raise the price. Secondly, increase in rental prices is primarily due to an increase in rental property demand brought on by the greater cost of borrowing to finance real estate purchases.

In a case *Legal Heirs and Representative of Deceased Ahmad Mohammad v State of Gujarat* where the Gujarat High court, where the award was passed in the year 1991, it was tested that there is parcel of deferral and for this situation the court has dissected that the land securing needs to be postponed and as such a lot of progress in the field of RERA has taken place. It has been arrived at a cap cost of land have soar past creative mind of the big fan of expansion in the land. The facts confirm that no one would have longed for the costs which the land brought in 2013 when the current land obtaining procedures occurred. This Court had no faltering in putting on record that however at that soar costs of the land, the candidates could not have possibly taken

³ Real Estate (Regulation and Development) Act, 2016, Parliament of India, 2016.

⁴ Dipen Pradhan, Inflation Rate In India, October 2023, October 17 2023, Forbes.com, <https://www.forbes.com/advisor/in/personal-finance/inflation-rate-in-india/>

inconvenience to arrive at this Court and challenge land procurement procedures wherein the land proprietors agreed for giving their properties to the public power in order to empower the public position to design improvement around the city of Surat and the Court won't be off-base assuming it is likewise placed on record that the land proprietors probably had some advantage out of the said modern turn of events and in the recent case *Desh Raj v. Rohtash Singh*, (2023) 3 SCC 714⁵ were the court referred this case of *Saradamani Kandappan v. S. Rajalakshmi*, (2011) 12 SCC 18 the growth of market value of the immovable properties was stable in nature analyzing the price shifts in last quarter of twentieth century has been galloping inflation and price value of immovable properties has raised steeply with a huge distinction from lakhs to crores⁶. Across many countries in the couple of years back during the pandemic period the homebuyers who invested fall in the pit of loan which could not be paid and construction workers demand increased, so automatically the wage of the workers increased and reason being migrant workers moved towards their own countries. According to data, it is said that Average house prices were forecast to rise 6% next year and in 2024 this shows that the real estate sector is a growing platform for overall infrastructure of the country.

In India, the real estate sector faces the core issue for inflation which is due to rapid urbanization ,according to a UN report where it said that there will be 675 million population growth in 2035, and it is more and less irreversible to say that there is “supply and demand concept” linked with the real estate market where the supply is restricted by the government schemes and this is called ‘license raj permit system’ and this results in higher market price compared to fundamental values and leads to bidding wars where two prospective buyers compete for ownership. In 2021, a case dealt with seller’s market and home prices were at peak and in 2022 when the demand dipped , it lead to spike making home buying more expensive, due to fluctuation of continuous supply and demand .However, there was a remarkable revival In the April–June quarter of 2023, compared to the same quarter the year before, sales in India's eight key housing markets increased by 8%, while the supply of new homes increased by 11% year over year, according to Prop Tiger’s Real Insight Residential report⁷and affordability of owning a house has become quite high in price and interest rate therefore the developers are targeting the higher income segments in the

⁵ *Desh Raj v. Rohtash Singh*, (2023) 3 SCC 714

⁶ *Saradamani Kandappan v. S. Rajalakshmi*, (2011) 12 SCC 18

⁷ Faizan Haidar, Residential sale grows by 8% YoY during April-June quarter, ET Bureau, Jun 28, 2023, 09:40 AM IST, https://economictimes.indiatimes.com/industry/services/property/-/construction/residential-sale-grows-by-8-yoy-during-april-june-quarter/articleshow/101326142.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

upcoming launches. Cities like Pune and Hyderabad have seen a speedy commercial growth, the change in the RBI regulations has made a change where Non-Banking financial corporations (NBFCs) are forbidden to take up an initial investment in the real estate sector, which curbs the rural development indirectly by not giving the loans, the core reason is the capital requirement, and RBI is the regulatory financial authority where it initiates to maintain the inflation and the repo rate policy it is steady at 6.5% that leads to increase in EMI's, and this will hike the rate of interest while taking a loan, including auto loan and this serves as a negative impact for the homebuyers as it would lessen the capacity to buy their dream houses. Therefore, it is a two-fold impact where while it makes home loans dearer for retail borrowers, it makes loans costly for real estate developers too, increasing their finance costs and affecting their profitability margins. To protect their margins, they will have to increase home prices⁸.

The Indian Real Estate market due to inflation has led to demand for renting of houses as they don't get credit easily during the inflationary period With housing rentals and related expenses nearing three-year highs and accounting for 10.07% of India's consumer price inflation basket⁹, the central bank, which faced rising food prices for the most of last year, is facing new concerns. In the top seven cities, the rentals rose from 20 - 25% to 30% during the pre-pandemic period, and this is due to the people were working in a hybrid mode and a new era of "Work from Home" where the home buyers wanted affordable facilities, which led to the situation of increasing rent prices. According to a number of forecasts, the Indian real estate market is expected to increase at a compound annual growth rate of 9.2% between 2023 and 2028¹⁰. Veteran members of the industry predict that 2023 will be a historic year for this sector. The Indian real estate market was valued at USD 200 billion in 2021. The sector is expected to increase by USD 1 trillion by 2030. Furthermore, the real estate industry is anticipated to account for 13% of the nation's GDP by 2025. The reason for the inflation growth is due to the increase in the expensive supplies and raw materials, which indirectly makes the landlord increase the rental prices. There is a reliable price hedge, so they have high-cost mortgage rates, which leads to lower purchasing power, on the other hand, there is a negative impact on home buyers as it has a dampening effect dividing homebuyers into three categories. Some categories are provided below:

⁸ JANAKI KRISHNAN <https://www.thehindubusinessline.com/profile/author/Janaki-Krishnan-18390/20 Oct 2023>

⁹ Reuters, 17 Jan 2023, 01:10 PM IST <https://www.livemint.com/economy/indias-new-inflation-threat-rising-home-rent-11673940911056.html>

¹⁰ Deccan Chronicle, Why the Indian real estate market is anticipated to grow with a CAGR of 9% by 2028, June 27, 2023, <https://www.deccanchronicle.com/business/in-other-news/270623/why-the-indian-real-estate-market-is-anticipated-to-grow-with-a-cagr-o.html>

1. Affordable Home Segments- It mainly has low-income class homebuyers and directly has EMI payments whose impact is quite high, and thus, homebuyers alter their home purchase decision and get smaller homes.
2. Middle Home Segments- It is with regard to middle-income families who are capable of handling the interest rates, and their aim is to get their “dream homes” or “forever homes” with preferences for locations, adjust restraints where they move towards adjustment at the cost of borrowings.
3. Luxury Home Segments- It refers to high-income individuals who have stronger financial stability and have priority in what type of home to buy over the cost of borrowings.¹¹

The government has initiated the “Pradhan Mantri Awas Yojana”, which is brought into the housing sector whose main aim is to provide affordable housing to lower and middle-income groups and it is under the “Public Private Partnership” where it is for the economically weaker sections along with improvement mechanism for slum areas whilst providing monetary benefits for construction or enhancement of the house, and it is also a credit linked subsidiary scheme with respect to sanctioned necessary carpet area and this scheme was mainly focused against the inflated real estate sector¹². This scheme, however, has benefitted Delhi in the past as over three crore houses have been constructed so far and handed over keys to 75,000 homebuyers in 75 districts in Uttar Pradesh along with 19,000 houses been built under the programme to beneficiaries in Gujarat¹³ and in recent budget where the allocation of Rs 79,000 crore for the Pradhan Mantri Awas Yojana (PMAY), which increased it by 66%¹⁴, The concept of “Sustainability” focusing on green growth in upcoming housing sector.

Real estate is a booming industry where the investment can beat inflation in the upcoming years as the land value usually bends towards appreciation. Therefore, the area which has a younger generation as residents will see a gradual increment in rental income. Land, just like gold is a tangible asset which acts as a security for investors and this investment provides tax benefits as the return value is twice when the property is put for resale.

USA:

¹¹ Akash Pharande, Managing Director, 11 Aug, 2023 <https://www.constructionweekonline.in/people/impact-of-high-interest-rates-on-home-buyers-across-segments>

¹² <https://www.bajajfinserv.in/home-loan-pradhan-mantri-awas-yojana>

¹³ May 12, 2023, <https://realty.economicstimes.indiatimes.com/news/residential/over-three-crore-houses-built-under-pradhan-mantri-awas-yojana/100173828>

¹⁴ [Ashwinder R Singh](#), Budget 2023-24: What’s in store for Real Estate sector, February 16, 2023, 4:02 PM IST,

Investors have always been pessimistic about the real estate market in the USA as it has been a profitable investment for them so far. Currently the U.S residential real estate market stands at USD 2.53 trillion and is expected to reach USD 2.80 trillion by the year 2028 making it an all-time high. Covid-19 seemed to have hit the real estate market drastically, and the market seems to be in the recovery phase as the sales in property bounced back after the pandemic¹⁵. Owing to the low interest rates in the pandemic, the number of home sales increased sharply in the second half of 2020 and has stayed higher since. In addition, more than 142,406 housing units—of which more than 89% were occupied by owners and renters—were available to satisfy consumer demand in the fourth quarter of 2021. Furthermore, middle-aged and older residents of the nation generate the majority of sales in the sector. For example, in the first four quarters of 2021, over 70% of the nation's homeownership rates were held by individuals between the ages of 45 and 65. One of the worst financial crises the world has ever experienced began in 2007. The American real estate market was the source of this crisis. Government initiatives led to a constructed boom that quickly turned into a manufactured crisis. This is due to the fact that President Alan Greenspan was forced to increase interest rates in the economy once more out of concern for inflation. The subprime mortgage crisis was an unprecedented event brought on by this spike in interest rates. Mortgage payments increased each month as a result of higher interest rates. Many homeowners were unable to pay their rising mortgage. The homes had to be foreclosed upon as a result. Because of the situation of excess supply brought about by the houses' diminishing value, prices were falling even more. Almost all markets in the world were hit but the worst hit was the American Real Estate Sector. Following the 2008 recession, the US real estate market has started recovering. But the recovery has been sluggish. The real estate market is currently experiencing a gradual rise in place of the sharp declines that it once saw. Prior to September 2021, the US real estate market experienced a period of rising home prices. The years preceding September 2021 saw historically low mortgage rates, which boosted demand for real estate. Although rental prices varied by location, they increased in many cities. Therefore, the rent prices drove up drastically around 2021-22¹⁶. Real estate investment trust is a term attributed to a trust dealing with investors planning on diversifying their investment portfolios by investing in this sector. REITs are known as a way to hedge against the high rates of Inflation, The unfavorable interest rates did quite the

¹⁵ Y Chart

[https://ycharts.com/indicators/us_inflation_rate#:~:text=US%20Inflation%20Rate%20\(I%3AUSIR\)&text=US%20Inflation%20Rate%20is%20at,in%20price%20over%20a%20year](https://ycharts.com/indicators/us_inflation_rate#:~:text=US%20Inflation%20Rate%20(I%3AUSIR)&text=US%20Inflation%20Rate%20is%20at,in%20price%20over%20a%20year)

¹⁶ Ari Rastegar, How Rising Interest Rates And Inflation Impact Real Estate Investments, forbes.com, Feb 24, 2022, <https://www.forbes.com/sites/forbesbusinesscouncil/2022/02/24/how-rising-interest-rates-and-inflation-impact-real-estate-investments/?sh=187249c9601f>

opposite. This basically resulted in the fall in demand for properties and losses to the property owners altogether. However, the effects on prices depend the type of REITs which essentially means that the prices of industrial units having low demands have high prices whereas the apartment rents and other housing properties are placed at a low value. According to recent reports, it is held that housing prices have seen a surge in the current US economy. Therefore, it is essential to implement certain schemes or policies to tackle the problem of high priced properties such as restoring property rights to buyers, encouraging down payments to pay off for the property, streamlining the local authorities or government, simplifying building and design rules for property owners, allowing sandbox system for housing innovations, permit better promotional techniques for promotion of the real estate projects thereby elevating the demand for newer projects and rental accommodation by homebuyers¹⁷. Thus, allowing for such schemes provides better opportunities to both the property owners as well as homebuyers resulting in the expansion and growth of the entire real estate sector of the country.

CONCLUSION:

Real estate sector is showing accelerated development which is crucial for the growth of the country's economy. India's real estate sector is expected to grow to \$5.8 trillion by 2047, accounting for 15.5 percent of GDP from the current 7.3 per cent, according to a joint report by Knight Frank and the National Real Estate Development Council (NAREDCO)¹⁸. The real estate sector currently accounts for about 16.7% of the US GDP. Real Estate (Regulation and Development) Act, 2016 which was enacted a few years ago whose main aim is to protect the homebuyers who put their hard-earned money into having a dream house of their own, but unfortunately the reality is biased where the particular community of property owners based on their own varied dimensions get more privileges. Therefore, it is a need to include a "Non-Discrimination Clause" under the RERA ACT, 2016. It is also required to beat another con which is black money involvement in the sector, especially in the housing sector. Inflation which is somewhat unprecedented occurs when the market rates fall as it creates a bottom line growth and Peter Bernstein has rightly quoted that "when inflation is low, you feel that you know more about the future, and are much more willing to take risk" so precautions must be taken to reduce the risk in the industry like proper planning, information of budget allotment and understanding the

¹⁷Brad Cartier, The effect of inflation on real estate investors, stessa .com <https://www.stessa.com/blog/inflation-and-real-estate/>

¹⁸Saurav <https://www.livemint.com/industry/indias-real-estate-sector-likely-to-expand-to-5-8-trillion-by-2047-report-11693042659703.html>

investment process whilst allocating proper monetary value to the land along with the capabilities to return back the home loans fixed by the bank in the right time as the Real estate sector is a circulating form of business with the involvement of government, intermediaries, investors and homebuyers whose cooperation with each other is what sets the market booming or moving ahead.

