

India - April 2020

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SPOTLIGHT
Savills Research

COVID-19: Building again - Brick by Brick

(Volume 3)



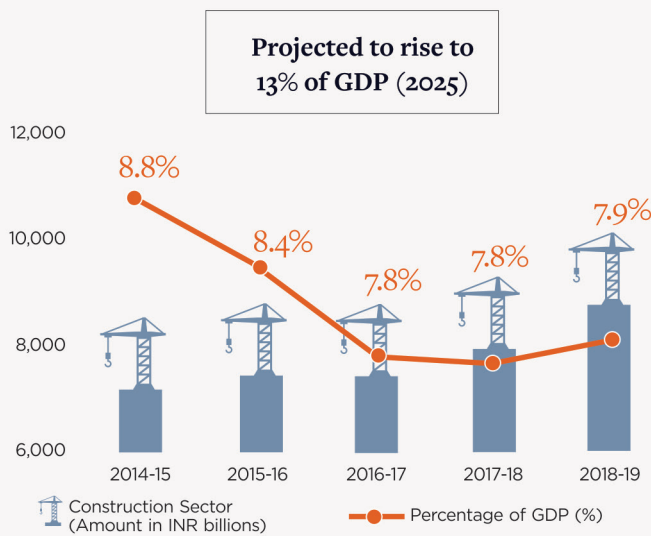
Construction Sector in India: Growth paused temporarily

The Construction industry in India consists of the Real estate as well as the Urban development segment. The Real estate segment covers residential, office, retail, hotels and leisure parks, among others. Urban development segment broadly consists of sub-segments such as Water supply, Sanitation, Urban transport, Schools, and Healthcare.

- By 2020, construction equipment industry's revenue is estimated to reach USD 5 bn
- By 2022, The construction industry in value terms is expected to record a CAGR of 15.7% to reach USD 738.5 bn.
- By 2025, construction market in India is expected to emerge as the third largest globally
- By 2025, Construction output is expected to grow on average by 7.1% each year

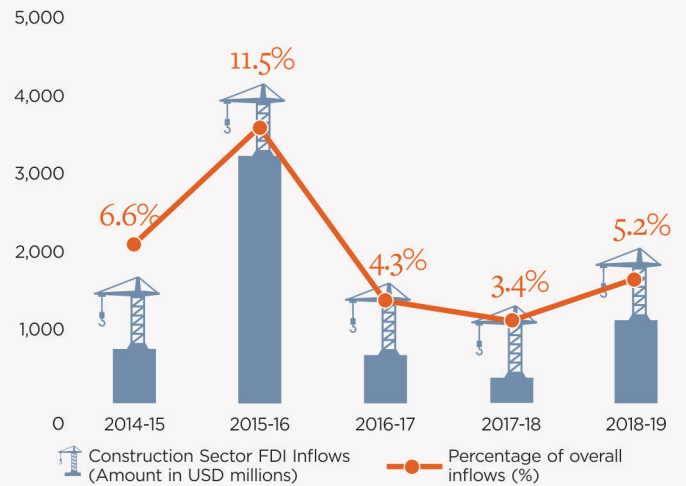
Source: <https://www.investindia.gov.in/sector>

Construction share in India GDP



Source: MOSPI

Construction share in India FDI inflows



Source: RBI

Last leg of FY 20: COVID-19 acts as a speed breaker

- Temporary shortage of labour, due to reverse migration
- Nation wide pause in all types of construction activities
- Impact on pace of order book execution
- Working capital issues for financially weak companies

More than 51 million construction workers - Potential high exposure to economic impacts of COVID-19

Source: investindia.gov.in

Although, the overall lull in construction sector is an honest reality check, the sector is poised to start afresh with greater vigour & intensity, once the country wide shutdown is gradually replaced with heightened activity in all spheres.

THE AMBITIOUS GOAL REMAINS INTACT : USD 5 trillion economy by FY25, albeit, MORE CHALLENGING, POSSIBLE NONETHELESS.

National Infra Pipeline (INR 1 trillion):

(Industrial corridors, Metros, Bharatmala & Sagarmala projects, Irrigation & Health Infra as well)

Allied Sectors: Commercial, Retail & Hospitality

Smart City Project



Decoding the 3 M's of Real Estate Construction

The overall output or the productivity of the sector is dictated by three major parameters- **MAN, MATERIAL, MONEY** & the all encompassing impact on- **TIME & COST** of construction.

Each of the 3 M's can be further broadly subcategorised into few parameters of varying importance

COVID-19 has affected these parameters by varying degrees. Thus, the recovery time and impact on cost also varies.

We, at Savills have assigned weights to each of the factor that contributes to the end output of real estate construction sector, and have analysed the probable fallout and expected recovery from the ongoing crisis.



A QUICK FACTSHEET ON THE 3 M'S

Man
A significant chunk of construction workers comes from the rural hinterland of the country.

Material
Domestic construction, especially fit-outs, depends highly on imported material - HVAC equipments, elevators, fire protection units- From China, USA, Italy, Germany, Spain, South Korea, etc.

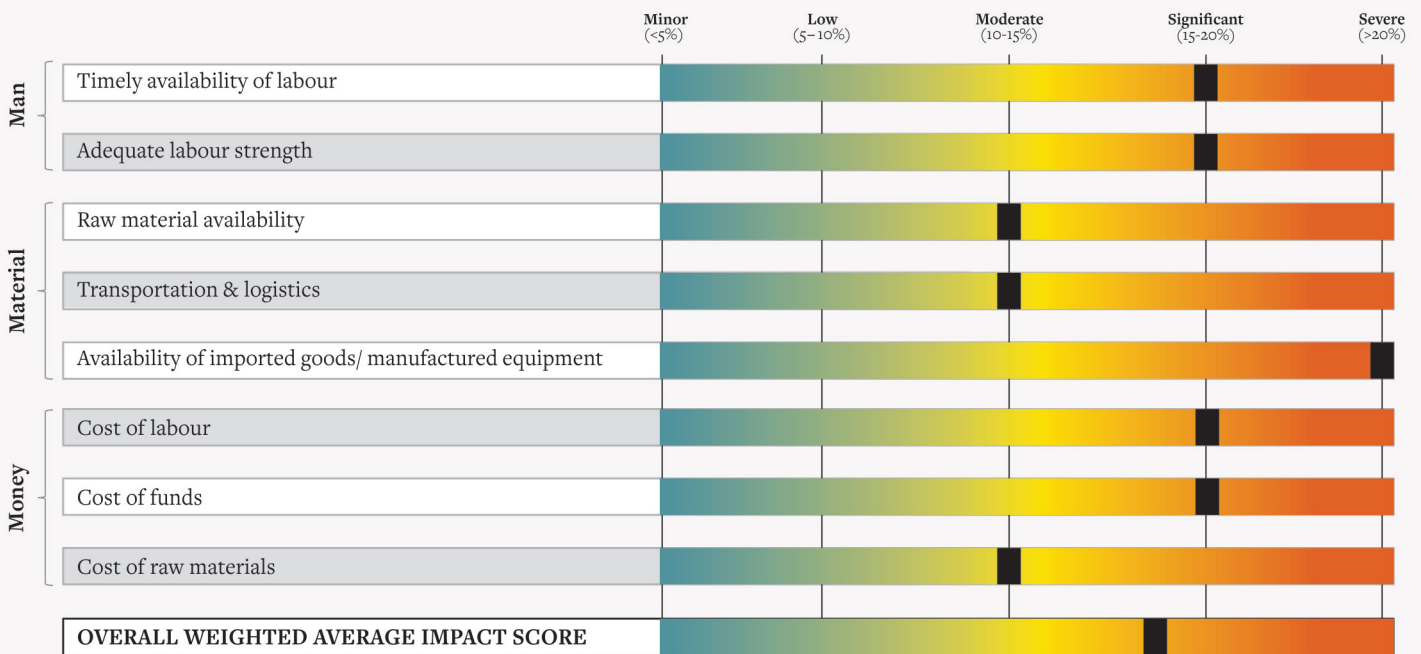
Money
Timely availability of Money, i.e. Cash Flow is of utmost importance for successful completion of projects. Cost of funds, variability of labour and raw materials cost impact project to a significant extent.

COVID-19 : The probable “Fallout”..

IMPACT SCALE: In terms of Time/Cost Overrun

Assumption:

A staggered release from the ongoing lockdown;
Recovery cycle of the construction activity begins as and when the restrictions are removed significantly.



MAN

- Lockdown has mainly impacted labour availability
- For safety reasons, all labour – migrant as well as local -barred from construction sites

MATERIAL

- Raw material manufacturing units- Production issues persist; only continuous production units operating at lower capacities
- Interstate borders sealed; Goods trains operating for transportation of essential commodities
- Restrictions on import of intermediate goods & fitouts from China, USA & Europe

MONEY

- Govt. directive- continue paying on-roll staff & labour, prolonged shutdown to test financial capability of organisations
- Mid-sized firms may avail deferments of liabilities towards financial institutions. Penal interest, however, will be applicable
- Volatility in commodity prices- steel, cement and sand- sluggish demand and supply side constraints as well

With an overall impact score of 3.71, the real estate construction sector is expected to be significantly impacted at least in 2nd and 3rd quarters of 2020.

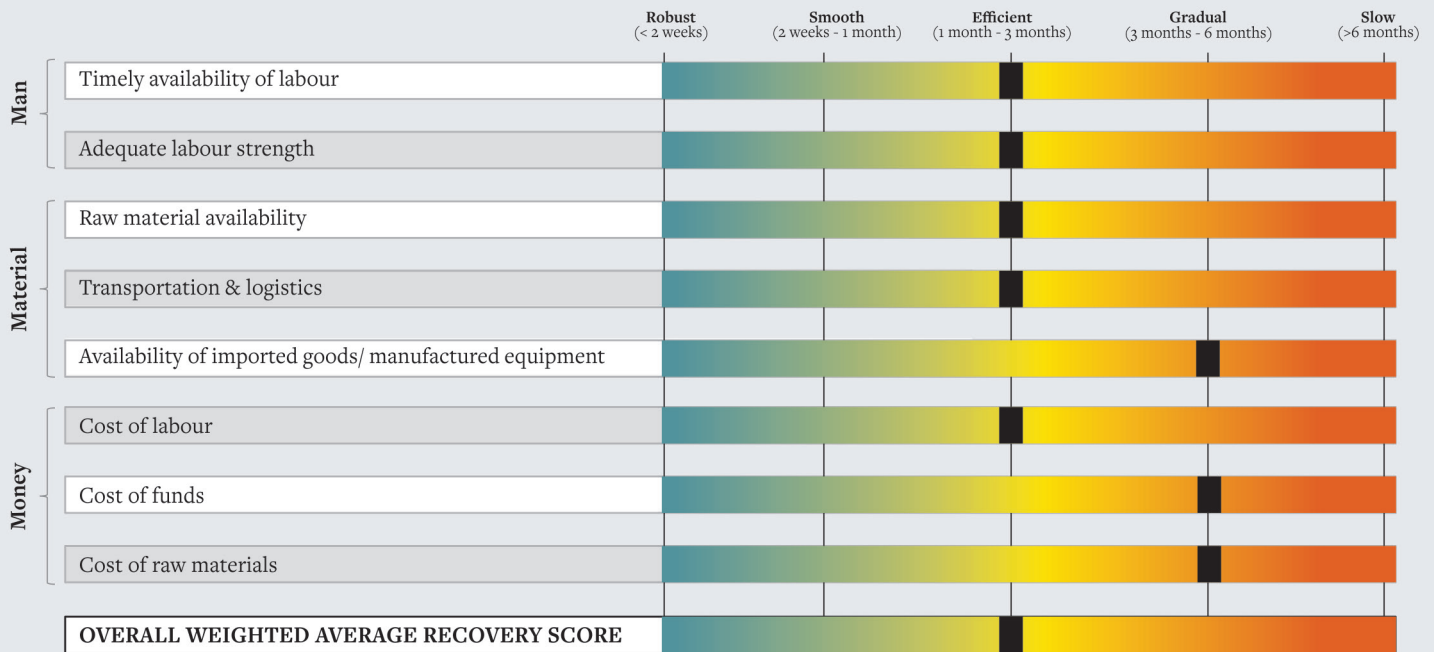
Individual parameters of 3 M's represent the average rounded score of a panel of industry experts

.. And the expected “Recovery Cycle”

RECOVERY CYCLE SCALE

Assumption:

A staggered release from the ongoing lockdown;
Recovery cycle of the construction activity begins as and when the restrictions are removed significantly.



MAN

- Local labour expected to resume work immediately
- Migrant labour still stationed near sites can also resume work immediately

MATERIAL

- Raw material availability to improve substantially once restrictions aimed at pandemic containment ease up
- Imported and intermediate goods availability will depend to a large extent on scale of COVID-19 infection in trade partners of India

MONEY

- Post crisis: With lesser labour available immediately, cost of labour may witness temporary upward spike
- Time overrun to ultimately result in cost overrun- Relatively less prudent suppliers, contractors & organisations to feel the pinch
- Raw material cost recovery, again is bound to be linked with demand recovery

With an overall recovery score of 3.05, the real estate construction sector is expected to recover in an efficient manner, as and when the nation-wide restrictions are eased significantly.

Individual parameters of 3 M's represent the average rounded score of a panel of industry experts

The New Normal!!



- Greater emphasis will be on automation, mechanisation & off-site fabrication- Alternate strategies to reduce over-dependence on labour
- Technology to play a critical role in tiding over manpower and demand mismatch
- Providing better on-site facilities (including health & hygiene) to migrant labour; attempt to stop reverse migration in future
- Splitting work teams (smaller crews & longer, staggered shifts)

- Material sourcing selection to gain more prominence- Identifying alternative suppliers
- Greater awareness of geography related supply chain pitfalls
- Building in sufficient flexibility to counter potential disruptions in supply chain
- Risk mitigation- Data analytics driven mobilisation, sensing, configuration and re-configuration of the entire operating cycle

- Continuous assessment of profitability in low revenue environment
- Greater importance on cash flow reserves, revolving credit lines supporting day to day working capital requirements
- Refinancing of debt, although avenues will remain constrained in times of industry wide crisis
- Contractors & developers expected to assess contract provisions, insurances & compliance commitments with much more maturity and foresight

NEAR TERM OUTLOOK ON PROJECT DELIVERABLES

- Developer focus to find the right balance between competing market forces - RERA compliance, financing, customer demands & material as well as labour bottlenecks
- Robust demand-supply modelling; Advanced construction technologies to support forecasting.
- Given the potential uncertainty in relation to contractual performance specially in the current juncture, parties may consider alternative procurement methods based on collaboration and risk sharing.



Afterword

If ever the phrase “VUCA” (acronym for Volatile, Uncertain, Complex and Ambiguous nature) felt appropriate to use, it’s now. With no playbook, for how best to respond to the rapidly evolving concerns about the novel virus, many decision makers are grappling to strike the right balance between prudent cautiousness and panicked over-reaction. With so many unknowns, playing it “extra-safe” is probably a sensible response.

Although the immediate and paramount concern is saving lives, we have initiated a chain of latent responses that may have a greater ripple effect down the road on all spheres of economic activity around the world ; construction in real estate included.

We touched upon the impact on Commercial Real Estate in India in the nugget titled COVID-19: Transforming Workplaces, just a week before.

Do revisit the piece.

COVID-19:
Transforming Workplaces



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Research

Arvind Nandan
Managing Director
Research & Consulting
arvind.nandan@savills.in

Dipali Gandhi
Director
Research & Consulting
dipali.gandhi@savills.in

Suryaneel Das
Senior Manager
Research & Consulting
suryaneel.das@savills.in

Abhinav Pal
Assistant Manager
Research & Consulting
abhinav.pal@savills.in

Central Management

Anurag Mathur
Chief Executive Officer
Savills India
anurag.mathur@savills.in

Kaustuv Roy
Managing Director
Business Solutions
kaustuv.roy@savills.in

Sumit Rakshit
Managing Director &
Head - Project Management
sumit.rakshit@savills.in

Regional Management

Bhavin Thakker
Managing Director - Mumbai
Head - Cross Border Tenant Advisory
bthakker@savills.in

Sarita Hunt
Managing Director
Bangalore
sarita.hunt@savills.in

Shweta Sawhney
Managing Director
Delhi NCR
shweta.sawhney@savills.in

Praveen Apte
Managing Director
Pune
praveen.apte@savills.in

Anup Vasanth
Managing Director
Chennai
Anup.vasanth@savills.in

Gurgaon

3-A, Second Floor, Building 9B
DLF Cyber City, Phase 3
Sector 24, Gurgaon 122002
Haryana, India

Chennai

941 Spaces, 9th Floor, CITIUS A Block
Phase 1, Olympia Tech Park, Plot No. 01
SIDCO Industrial Estate, Guindy
Chennai 600032
Tamil Nadu, India

Mumbai

403, Tower B, Level 4, The Capital
Street 3, G Block, Bandra Kurla Complex
Bandra East, Mumbai 400 051
Maharashtra, India

Pune

WeWork Futura
Magarpatta Road
Pune 411 028
Maharashtra, India

Bangalore

15th Floor, SKAV SEETHALAKSHMI
Corporation No.21, Kasturba Road
Bangalore 560001
Karnataka, India

Hyderabad

Office No. 02A114, WeWork
Krishe Emerald, Hitech City
Hyderabad 500081
Telangana, India

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