Banking, Insurance and Real Estate

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Banking, insurance and real estate are considered the three siblings intervened with one another with more than one strings. Not to offend or undermine the importance of other sectors but these three can be termed as the corner stones essential to any great economy (the forth spot left open for competition). All developing and developed nations have long realized their importance and hence these are closely monitored and regulated by respective Governments and independent regulatory authorities, with of course one exception, the real estate markets of India.

Lately banking and real estate are stealing the limelight. All business news channels and tabloids are concentrating their efforts on how the Reserve Bank of India (RBI) and the Finance Ministry are tightening the reins on the Indian real estate. Most articles cover the subject with a sense of criticism; however fall short of blatantly opposing the moves. None until now have dealt with the rationale behind RBI's actions. Its not that the Government has suddenly become the sworn enemy of the once blue eyed sector, in addition to controlling inflation RBI is most concerned about speculators having penetrated the sector in a huge way. The typical modus operandi being to undertake bulk bookings by paying a small token amount during pre-launch / launch of a project, holding stock for few months and then selling at a smart profit.

So how do the figures work out, let us assume an apartment of size 2000 square foot priced a Rs. 5000 a square foot. Cost of the apartment works out a modest one Crore, typical price levels existing in all metropolitan cities with the exception of Mumbai where it can be multiplied by a factor of three. The apartment is booked by paying a token amount of 5 or 10 percent when opting for installment payment option, 5 lakhs in this case. In the coming months hype is created and the prices escalate by anything close to 10-20%, speculator then sells at the inflated prices. In this case the sale price works out to Rs.6000 a square foot, a profit of Rs. 20 lakhs on an investment of Rs. 5 lakhs in approximately 3-4 months, 1200% return annualized.

Today the real estate sector once considered safe is being talked of as high risk. In addition to the fear of speculation giving a bad name to the entire industry there is one another uncertainty i.e. risk of a natural calamity like earthquake. 21st Century Finance (formerly 20th Century Finance) went bankrupt after the Northridge earthquake of 1994, suffering a loss of 1.1 Billion US $. The memory is still fresh amongst many bankers and insurance companies. Not to forget that many other companies also with investments in real estate sector suffered similar losses in Billions. Banks also face the dilemma as to what happens to the property loans disbursed by them in case the very property mortgaged gets destroyed in an earthquake (all buildings being designed in India are aimed with protecting lives of occupants and not the building per se implying that they would have to be demolished and re-built as there would be considerable structural damage). Similarly the insurance companies are worried as to how would they pay up the hundreds of thousands of claims especially in densely populated areas like Mumbai.

From lessons learnt from Northridge earthquake in US (1994) and Kobe earthquake in Japan (1995) there does exist an innovative solution. Considerable research has been put into seismic response of structures and means to protect them without structural damage. To start with Earthquake Resistant is now classified into three separate categories depending on the anticipated structural response and the capacity of the building to absorb/ accept structural damage. Earthquake Resistant Life Safety - minimum level of earthquake protection, aims at preventing total building collapse, however there will be structural damage and the building may warrant demolition and reconstruction. The building codes are based on this minimum protection, however leave the window open incase the user wants to opt for higher level of protection.Earthquake Resistant Immediate Occupancy - next higher level of earthquake protection, in addition to collapse prevention, aims at keeping the structural damage to a minimum thereby ensuring safe occupancy even immediately after a major earthquake. Ideally suited for highrise buildings.Earthquake Resistant Fully Operational - highest level of earthquake protection ensures safety and operation ability of non-structural components in addition to the Immediate Occupancy standard of the building structure. Criteria used in important buildings like hospitals and command & control centers.

A key advantage of adopting higher levels of earthquake protection is that a much lower interest rate can be negotiated with the banks for the particular project. Banks would gladly oblige as higher safety also reduces their risk levels. Insurance companies will also follow suit in reducing the premiums. The direct implication for the buyer would be that this twin advantage will offset the cost of higher protection. Typically Earthquake Resistant - Immediate Occupancy would cost Rs. 150 to 200 per square foot implying a 1500 square foot will cost Rs. 2 to 3 lakh more.

The Honourable Supreme Court is presently hearing a PIL on safeguarding the interests of general public who are being exploited by some unscrupulous builders and developers. The PIL has been filed by a NGO called Sanrakshak (The Protector). Hopefully the court ruling would serve as a guideline and expedite the formulation of concrete laws by the Government. On the issue of earthquake protection, the builders/ developers should clearly mention on the buyer/seller agreement that the building is protected against what magnitude earthquake on the Richter scale and what will be the building performance if that scale of earthquake strikes. Will the building sustain structural damage and to what extent. Taking advantage of lack of awareness of the masses most builders are selling 'seismically deficient' buildings. Delhi which falls in Zone 4 can be expected to witness a magnitude 7 earthquake on the Richter scale whereas Mumbai in Zone 3 can experience a magnitude 6.5 quake. However recent studies conducted at IIT Mumbai by Prof. Ravi Sinha have concluded that the risk that Mumbai faces is far greater than what was envisaged earlier. The threat perception of Mumbai should be upgraded to Zone 4/5.

Are Indian citizens not entitled to know what the different levels of earthquake protection are and their building has been designed to withstand what magnitude earthquake? Is it not the responsibility of the Government to increase public awareness and promote earthquake risk mitigation? Is this problem not serious enough to warrant a concerted media campaign?

The present situation is not as bleak as it sounds, National Disaster Management Authority has commenced an advertisement campaign and hopefully the same will spread actionable awareness such as what are different kinds of earthquake resistance and how the respective buildings will perform so that people can then go in for seismic upgrade and retrofitting. With our Prime Minister, Dr. Manmohan Singh heading the organization on whose charter the subject falls we sure can expect swift actions.

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