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### RESEARCH ARTICLE

#### IMPACT OF THE 2016 DEMONETISATION ON THE REAL ESTATE SECTOR IN INDIA

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#### Abstract

The sudden note-ban (demonetization of Rs. 500 and Rs. 1000 notes) on 8th November 2016 in India left the country in a state of shock and uncertainty. This paper highlights the impact this demonetization had on India's real estate sector, in the short run as well as the long run, and whether it was of overall benefit to the sector in the long run. It is a descriptive study which uses data collected from secondary sources and websites to analyze the main reasons the real estate sector was so largely impacted in the short run, key government policies and acts imposed during that time which impacted the real estate industry, the condition of the real estate sector pre and post demonetisation, the benefits and challenges to economic agents (buyers and sellers, primarily), and the long run consequence of this sudden move. The state of the real estate sector 5 years into demonetisation has also been considered, which has helped reach a conclusion as to whether or not this demonetisation was of an overall benefit to the real estate sector.

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#### Introduction:-

Demonetization is a situation where the central government of an economy invalidates or withdraws the currency notes of specific denominations as an acceptable means of payment. On 8th November 2016, the government of India demonetised Rs.500 and Rs.1000 banknotes, thereby announcing that these currency notes would cease to exist as legal tender for trade in the future (Badhwar, 2017). The main aim of this sudden move was to reduce the outreach of the informal economy in India and eliminate the use of black money to fund illegal business activity and terrorism (Shirley, 2017). The impact of the 2016 demonetisation has been felt widely across most sectors, such as healthcare, retail and financial, and one such sector affected largely by it is India's real estate sector.

The real estate sector in India is one of the largest sectors in India, estimated to form about 18% of India's GDP by 2030 (Abrol, 2023). Before this demonetization took place, India's real estate industry was largely informal and had a low transparency when compared to similar industries in the more developed economies. It was a heavily cash dependent sector with a somewhat unorganized structure. Some argued that this made the sector less consumer-friendly and restricted growth, since reliable information wasn't readily available. Despite this, it was large enough that any major changes in the industry would have the potential to impact the economy as a whole (Verma, n.d.).

As a result, due to its cash dependent nature, when the government announced the note-ban, the immediate consequence was a lot of uncertainty and skepticism in the real estate industry. This was because it brought about a scarcity of cash which led to many buyers and investors going off the market, leaving sellers with little to do. Therefore, it was no surprise that this brought about a huge fall in prices in the real estate industry. This made it crucial to find out about how deep and long-lasting the impact was on the real estate sector in India (Bhagwat, 2018). With this backdrop, this study

aims to investigate whether the mega demonetization of 2016 had negative consequences for India's real estate sector or would it be beneficial for the real estate industry in the long run. In essence, the study seeks to answer the following research questions:

*RQ1: What was the effect of the 2016 demonetization on the real estate sector? RQ2: How has the real estate sector recovered in five years post demonetization?*

Some studies in the past have analyzed key topics such as the cash dependency nature of the real estate industry, consumer confidence in the industry post demonetization, challenges faced in the sector post demonetization and the effect of demonetization on corruption while others have looked at a particular city (for example, Mumbai) or one aspect within the industry (for example, residential) but they haven't really looked at the short term and long run growth rate of the sector post demonetization and whether or not this note-ban would be beneficial for the real estate industry in the long run.

**This manuscript is structured as follows :**

**Structure of the paper :**

The rest of the article is structured as follows: Section 2 presents the literature review while Section 3 considers the methodology and some key government policies. Section 4 deals with the scenario of the real estate market pre and post demonetisation while section 5 talks about the impact of the note-ban on the main economic agents and concerned parties. Section 6 gives an insight about the state of the real estate industry 5 years into demonetisation and this is followed by an overall conclusion.

### **Literature Review:-**

A study by Bhagwat (2018) analyzed factors namely, cash payments, tax evasion, correction in prices and government policies which directly impacted the real estate sector post demonetization. It was noticed that, based on these variables, the real estate was already in a poor state before the demonetization and post it the industry only worsened. The study has concluded that this delayed the recovery time of the sector and emphasizes on the poor timing of the demonetization. However this conclusion isn't applicable for the whole country as only one city- Mumbai- has been considered in this study.

Another study by Badhwar (2017) emphasized on how the demonetization increased transparency and professionalism in the real estate industry in the long run. This, the study claimed, especially benefited buyers in the sector due to the shortage of demand immediately after demonetisation, which led to a fall in the price level in the industry. The study also claims that other government initiatives along with demonetization, such as the lowering of interest rates (due to banks having excess funds to give out) and the Benami Property Act increased investor confidence and activity in the real estate sector, thus fostering growth in the long run. This paper has largely focused on the positive effects in the real estate sector post demonetisation.

One more key point which has been discussed in a paper by Joshi, n.d is how the demonetization brought about an increase in foreign direct investment, due to the increased transparency in the real estate market. The study also mentions that since the new notes of 500 and 2000 do not have any considerably additional security features, the government will have to keep taking strict measures to prevent the informal market from redeveloping. If it is able to do this, the study claims, the overall effect in the long run is likely to be positive in the real estate sector.

A study led by Khurana et al. (2018) focussed on analyzing consumer behavior in the real estate sector post demonetization and the challenges ahead for the industry, and has some interesting insights. Although transparency and digitized payments increased, the severe cash crunch reduced developer specific working capital and consumer sales to a certain extent. The study concluded that investments in projects declined, which hampered the sector in the long run. Declining sales further did not help this cause. It also emphasized on the need for the government to intervene in terms of financial aid, subsidies and the ease of doing business in order to prevent serious future consequences for the real estate industry.

Additionally, a paper by Verma, n.d. primarily talked about the challenges faced by the real estate sector post demonetization, emphasizing how real estate builders and developers were facing the heat of reduced market prices as their margins narrowed down, their stock of luxury houses were piling up, all amidst the working capital pressure situation. However, developers who already kept transparency in their businesses were unaffected according to the study. The increased fair trade improved the condition of the sector in the long run. A limitation of this study was that it

was published just a few months after the demonetisation, so it is not based on sufficient data to draw an accurate conclusion.

Another study by Bhattacharaya (2023) considered three prominent Indian real estate companies and their financial figures, and their quarterly profits were analyzed before and after the demonetisation and it was finally noticed that the effect of demonetisation on these figures were, to an extent, insignificant, especially in the short run. The study went on to assume that perhaps the impact on small and mid-size business organizations were more significant as they were more vulnerable to be affected by the severe cash shortage and the absence of liquidity.

Lastly, a paper by Singh, n.d elaborated on the impact of demonetisation on the real estate sector in terms of governance, the price of real estate, reformation, sectoral growth, foreign direct investment, affordability, policy and interest rates. It also explained how transparency and efficiency will come about in the long run in the real estate industry.

Overall, most of the studies seem to agree that in the long run, demonetisation will bring about an increase in transparency in the real estate sector, while reducing the negative impacts of black money, the informal market and corruption. However, whether the demonetisation has improved or worsened the condition of the sector in the short run, and the overall impact on growth rate in the long run has not been made very clear in the articles and paper discussed, which is what this article aims to present.

### **Methodology:-**

This study is descriptive in nature based on data collected from secondary sources and facts retrieved from the websites (e.g. Moneycontrol, Economic Times), newspapers and journal articles. Based on the published literature, the study aims to present a holistic view of the impact of demonetization on the real-estate sector. The next subsection introduces the readers to the different government acts proposed during demonetization which impacted the real-estate sector.

### **Real Estate Regulatory Authority**

Real Estate Regulatory Authority (RERA), is a significant piece of legislation enacted by the government of India in 2016. RERA seeks to protect the interest of homebuyers and promote fair practices in the real estate sector by increasing transparency, accountability and efficiency. This act aimed to eliminate all buyers' queries and doubts at the time of purchasing property, by providing all the required data needed to make decisions. This act enhanced purchasers' certainty and brought back movement to the real estate sector (Badhwar, 2017). This greatly helped to revive demand while ensuring steady prices, since the segment had become more straightforward.

This act also ensured that purchasers could not be taken for granted anymore. Before when a person booked, for example, a 2000 sq. ft. house, they would get a cover region of only about 1600-1700 sq.ft but now this act restrains the exercise of this practice. While this law is largely consumer friendly, it also incorporates a sense of equal footing for the producer. For example, a home buyer can be jailed too, if he fails to obey the orders of regulatory authorities.

### **Benami Property Act**

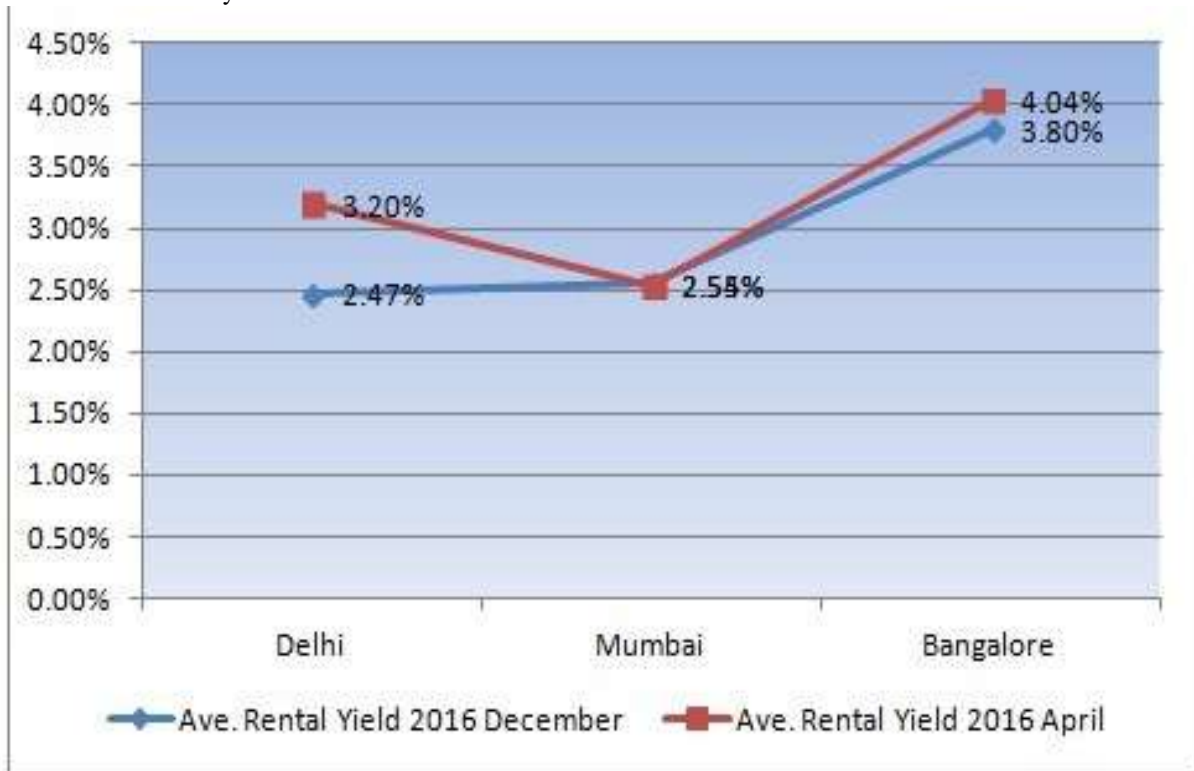
The Benami Property Act is an Indian legislation enacted in 1988, and amended in 2016, which aims to prohibit "Benami" transactions in India. A Benami transaction is when a property is held in the name of a person but the real owner who has paid for the property is someone else. In such transactions, the Benamindar's name is used for purchasing the property to hide the real owner's identity. The main objectives of this Act were to prevent the practice of holding properties over false names to evade taxes and other liabilities, to confiscate these types of properties which were acquired illegally and hence help curb corruption.

In this Act, various authorities were established to investigate and take legal action against benami properties. Moreover, rigorous imprisonments of up to seven years and fines were introduced to punish those who were found guilty of Benami transactions. These measures were necessary in order to contribute to a more transparent and accountable real estate sector. This, in conjunction with demonetisation, acted together to reduce black money and corruption in the real estate sector (Verma, n.d.).

### **The impact of demonetization in different Indian cities**

The average rental yield in three major cities in the country before demonetisation (2016 April) and post demonetisation (2016 December) is represented in Figure 1. It can be observed that the rental income yield has fallen in almost all of these cities (Delhi, Mumbai and Bangalore). This makes sense since prices fell drastically post the note-ban and due to

the severe cash shortage. Thus, landlords had to reduce their rental fees in order to cope up with the reduced demand in the short run and ensure they remain in business.



**Figure 1:-** Impact of demonetization in major Indian cities.

(Source: Project Guru, 2017) <https://www.projectguru.in/impact-demonetisation-real-estate-sector/>

The change in prices of properties across different cities post demonetisation is represented in Figure 2. As expected, except for Delhi, the other cities all witnessed a fall in property prices due to the reduced demand which emerged due to cash shortage and short run uncertainty



**Figure 2:-** Impact of demonetization in major Indian cities.

(Source: TOI, 2017)

<https://timesofindia.indiatimes.com/blogs/vantage-point/demonetisation-and-its-impact-on-real-estate/>

Note: AHM- Ahmedabad, BLR- Bangalore, CHN- Chennai, NOI- Noida, GGN-Gurgaon, MUM- Mumbai, HYD- Hyderabad, KOL-Kolkata, DEL- Delhi, PUN- Punjab

### **The Real-estate sector pre and post Demonetization**

The subsequent section discusses the scenario and the circumstances in the real estate sector pre and post demonetisation.

#### **Pre-Demonetization**

Before the 2016 note ban, the real estate sector in India was growing at a rapid rate, with investors showing increasing signs of optimism and trust in the sector. A profound reason for growth had been the increasing shift from family oriented businesses to more professionally managed ones. The market also had growing expectations from the government and central bank in the upcoming fiscal year, mainly in terms of income tax relief and greater clarity on indirect taxes, particularly the Goods and Services Tax (GST). GST is mainly an overall indirect tax imposed instead of more complicated and multiple other taxes. It has simplified transactions, while also reducing the price of certain residential and corporate properties.

#### **Post-Demonetization**

The sudden note-ban came as a huge shock for the real estate industry, especially since roughly one third of the transactions were based on black money, which meant the cost of the property shown on paper was much lower than what the property was actually worth and the worth of the transactions made. Thus, prices fell by as much as 30% and in a matter of days, this wiped out

0.8 million crore rupees of worth out of the real estate market. Another immediate effect of the note ban was some buyers shifting towards looking at properties on rents and leases due to the severe cash shortage that arose shortly after the note ban. However in the long run, the mega fall in prices, combined with decreasing home loan rates and government land schemes made it a perfect period of time for buyers, especially of residential properties, to make their purchases.

### **Findings and Discussion:-**

#### **Positives of demonetization for the real estate business in India**

##### **Developer's perspective**

As the prices in the real estate industry tumbled post demonetisation, more buyers were willing to take advantage of this and purchase property after the initial cash shortage was over. Thus, real estate developers cashed in on this opportunity they had to clear off their overpiling inventories and further resume their investments on future projects. (Badhwar, 2017)

##### **Buyer's perspective**

The dramatic price fall which followed post demonetisation came as a gift for buyers looking to purchase or invest in properties. With many residential properties sold during this time, it was a buyers' paradise. The recovery of the sector slowly started in this phase, with investor confidence gradually increasing and developers taking on more future projects. Moreover, government schemes such as the Benami Property Act and lowering of interest rates on home loans further assisted buyers and investors. (Badhwar, 2017)

#### **Challenges of Real Estate Business in India and Demonetization**

##### **Developer's Perspective**

Most importantly, the issue of black money and transparency were the biggest for developers immediately after the note-ban. There were abundant informal businesses and developers who all had to become completely transparent post demonetisation (Verma, n.d.). This process was time consuming, especially since such a huge number of businesses suffered huge losses and to make matters worse, the mega price fall due to a contraction in demand did not help this cause. Moreover, in the short run, due to the cash shortage from the buyers' part, the inventories of developers went on piling up which increased their storage and maintenance costs and reduced their inventory turnover rate, leading to negative financial consequences. Investors also suffered massively since prices fell by as high as 30%. And the looming economic uncertainty posed a threat to the sector since investors were reluctant to put in their money at that time, quite understandably. Lastly, the timing completion of ongoing projects amid huge working capital pressure further added to the challenges faced by real estate developers and brokers. (Verma, n.d.)

### Buyer's Perspective

The immediate cash shortage after the note-ban was a challenge for buyers, especially those who had ongoing work going in residential properties. Some potential buyers even had to shift from buying to renting a house due to the cash crunch and the sudden economic uncertainty which became widespread. However in the longer run, it was a golden period for buyers in the real sector due to huge price falls which made it an incredible opportunity to buy property (Verma, n.d.).

### Five years from Demonetization

The impact of demonetisation on the real estate sector 5 years after the note-ban was announced hasn't gone unnoticed. Although there was a lot of confusion and uncertainty in the first year after the demonetisation, the sector has settled and is now stable, 5 years after the radical move. Piyush Gupta, Managing Director, Capital Markets and Investment Services, India at Colliers has said, "The real estate sector as a whole has moved up the curve on organization and administration since reforms started and this has helped navigate the crisis such as NBFC and then Covid-19."

The housing market is strong today in the more transparent real estate industry, while the demand for luxury housing and properties have surged too. Black money laundering has reduced in the sector and the negative effects of demonetisation have gradually faded away. The increase in digitalisation has also helped this cause, making the sector more transparent than ever. (money control)

So, overall, it is safe to conclude that the demonetisation has brought about a positive change in the real estate sector in the long run, mainly in terms of the increased transparency which has increased the scope for further expansion and investment in the industry in the upcoming years.

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