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Rate of Capitalisation- Prevailing Trends in the Indian Real Estate Market

Introduction

The cap rate is a metric used in real estate to evaluate the rate of return on investment properties.

In this article, we will discuss the prevailing Cap Rate in the Indian Real estate Market for different types of assets like residential, commercial, industrial use etc, which may help to determine the Valuation of income-generating assets of Land & Building.

Rate of Capitalisation

Capitalization is the process of converting net income of a property into its equivalent capital value. The rate of Capitalisation is the ratio of net operating income (NOI) to the property's market value and rates are not based on current short-term market activity, they must be derived from long-term market developments. The capitalization process also reflects the time value of money by reducing or discounting future income to present worth by the Year's Purchase concept.

If an asset has less risk on the investment, then the Cap rate will be on the lower side and if the risk attached to the asset is on the higher side, then the Cap rate will be high. This can also be expressed in other words viz. "Higher the security of investments higher will be the Year's Purchase and lower the security, lower will be the Y.P."

Key Factors and Trends Affecting Cap Rates:

The cap rate for real estate properties in India may vary based on various factors like location demand, property type, and the broader economic environment etc.

- **Location:** Micro- and macro-location, local environment.
- **Market situation:** Supply and demand, development perspectives.
- **Interest Rates & Inflation:** The government's monetary policies directly affect cap rates, as higher interest rates push investors to seek better yields.
- **Building attractiveness:** Appearance, design, cost-effectiveness.
- **Demand for Green and Sustainable Buildings:** Investors are increasingly interested in green-certified buildings, which may slightly lower cap rates for sustainable properties due to their rising desirability.
- **Urbanisation & Infrastructure Development:** Cap rates in rapidly urbanizing areas or those benefiting from infrastructure projects (e.g., metro, expressways) tend to be more compressed due to high demand.

Let's take a look at the current trends influencing cap rates in India's real estate market

Commercial Real Estate:

Office Spaces: Cap rates for office spaces in India have remained relatively stable in prime cities like Mumbai, Delhi, Bengaluru, and Pune. These cities tend to have cap rates ranging from 6% to 8%, though specific areas with high demand may witness lower cap rates.

Retail Spaces: Retail real estate has seen a shift post-pandemic, with big malls and shopping centres in top-tier cities offering cap rates of around 7% to 8%. However, smaller cities or less favourable locations may show higher cap rates, indicating higher risk.

Shops of daily necessities and banks: offering cap rates around 6% to 7%.

Shops catering electronic or luxury goods: offering cap rates around 7% to 8%.

Shops providing for occasional requirements e.g. jewellery: offering cap rates above 10 %.

Residential Real Estate:

Cap rates for residential properties are generally lower, especially in metro areas. For high-end residential properties, cap rates often range between 4% to 5%, reflecting lower income yields but potential appreciation in property value.

Warehousing and Industrial Real Estate:

With the growth of industrial, logistics & e-commerce, industrial real estate has gained prominence. Cap rates for warehouses in regions like Mumbai, Delhi & NCR, Chennai, and Pune can vary from 8% to 10%, showing attractive returns due to strong demand.

Hospitality and Co-living:

Hospitality and co-living sectors have experienced volatility post-pandemic. While cap rates for hotels in prime locations are 7% to 9%, other locations may see rates above 10% as the sector recovers and investor sentiment fluctuates.

Reference for Rate of Capitalization

Sr No	Description	Source	Cap Rate
1	CPWD & Income Tax	https://cpwd.gov.in/Publication/GuidelinesProperties2009.pdf	Freehold Land – YP = 12.5 i.e. Cap Rate = 8% (YP=1/r) For Leasehold 50 yrs. and more, YP = 10 i.e. Cap Rate = 10% (YP=1/r) For Leasehold less than 50 yrs, YP = 8 i.e. Cap Rate = 12.5% (YP=1/r), (Lease hold more than 50 yrs)
2	No Broker.com	https://www.nobroker.in/blog/capitalization-rate/	5 % - 10 %
3	Housing.com	https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://housing.com/news/a-guide-to-cap-rate-and-valuation-of-property/&ved=2ahUKEwi-tYmh8l-JAx6xzqGHRcGJTUQFnoECCMQAQ&usq=AQvVaw0R3xJbGBfooh1PwauUegilU	7.5 % - 9 %
4	IBBI Study Material	https://ibbi.gov.in/en/publication/study-materials	6 % - 7 %

Conclusion

The present Cap Rate for the Real estate sector in India varies from 4 % to 10 % (approx.) depending upon the market scenario and the risk involved. In some cases, it is observed that the Cap Rate is even more than 10%, i.e. 12.5% in the case of leasehold property.

