



**Pimpri Chinchwad Branch of
WIRC of ICAI and CREDAI and
Builders Association of Pimpri
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INDIAN REAL ESTATE SECTOR AND FUNDING OPTIONS FOR DEVELOPERS

Presented **by Housing Guru CA.Ramesh Prabhu,**
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AGENDA

1) Introduction to Indian Real Estate Market

2) Government Initiatives to Boost the Sector

3) Emerging Themes In The Indian Real Estate Market

4) Investment in Real Estate Sector (Specially Hsg)

AGENDA

5) Funding Products Bouquet

6) Funding Options Through Life Cycle of a Typical Project

7) FUNDING OPTIONS & ASSET CLASSES

8) INSIGHT ON FDI FUNDING

AGENDA

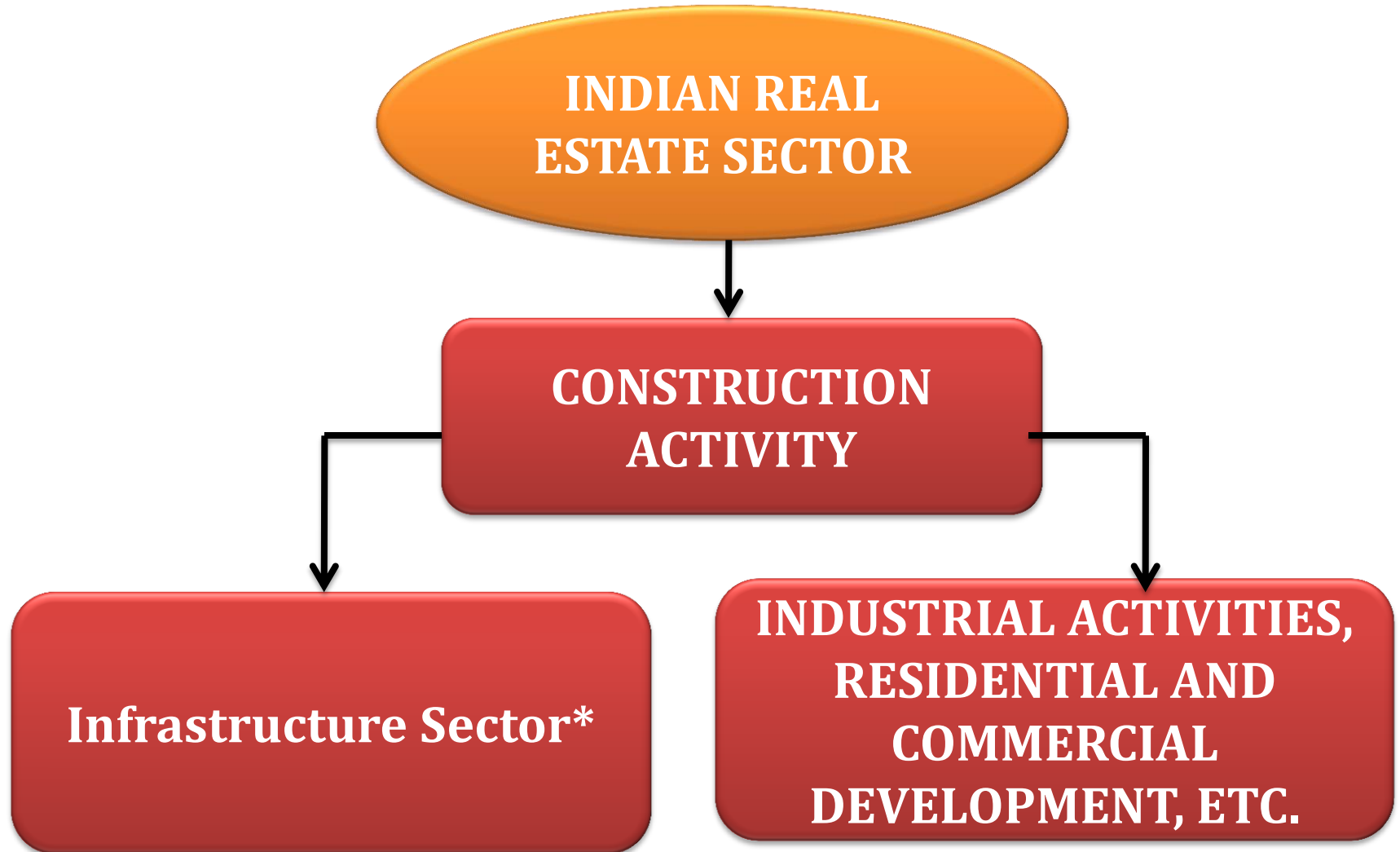
9) SOURCES OF INVESTMENT

10) FINANCING OF REAL ESTATE PROJECTS BY DEVELOPMENT PHASES

11) FINANCING SOURCES FOR INDIAN REAL ESTATE

12) CONSTRUCTION FINANCE: KEY CONSIDERATIONS & Examples of Funding Options

INDIAN REAL ESTATE SECTOR



* comprising of real estate linked infrastructure development

INTRODUCTION TO INDIAN REAL ESTATE MARKET



Asset Classes

Residential, Commercial, Industrial, Retail, Hospitality, SEZs, Land, Schools, Hospitals, Utility, Amenities, etc.



Investor Classes

Banks, Housing Finance Companies, Private Equity Investors, Insurance companies, Pension funds, NBFCs, HNI, Land Owners, Public Market Investors (FIIs, MFs, Retail, etc.)

KEY DRIVERS OF DEMAND

Sustainable economic growth, urbanisation and rapid change in socio-economic profile will continue to drive demand for real estate in India.

Economic growth

- Growth in the service sector is expected to raise demand of real estate sector
- Focus on industrial corridors and nodes to boost manufacturing output – expected to raise related real estate demand

Urbanisation

- About 10 million per annum people moving to urban cities
- Urban cities are expected to contribute 75% of the GDP by 2030

KEY DRIVERS OF DEMAND

Smaller family size

- Household size is expected to decrease from 4.8 currently to 4.4
- Smaller household size is expected to add incremental demand for about 10 million new housing units

Rising income levels

- Per capita income in India is expected to increase from 2,800 USD in 2012 to 8,300 USD by 2028

GOVERNMENT INITIATIVES

The government has taken a number of steps in the past two to three years to boost confidence and investments in the real estate and infrastructure sectors:

FDI Relaxation

- Relaxed FDI norms to attract investments in Defense, building townships, housing and infrastructure

New PPP Initiatives

- Revisited risk-return allocation between public and private sector in PPP projects
- Introduced Hybrid Annuity based PPP model in road sector and others like railways proposing to introduce the same

GOVERNMENT INITIATIVES

The Central Port Authorities Act 2016

- This shall replace the existing Major Port Trust Act, 1963 as a part of reforms in the ports sector
- Removes regulation of Tariff
- Aims to give more autonomy to the major port trust including fixing of tariffs

NIIF*

- National Investment and Infrastructure Fund or NIIF – Set up to attract investment from both domestic and international financial sources for infrastructure development in commercially viable projects

RERA**

- Approved in 2016 by the both houses of the Parliament
- Act aims to regulate and promote real estate sector, Protect interest of consumers, Ensure sale of plot, apartment in efficient & transparent manner and Establish adjudication mechanism

EMERGING THEMES IN THE INDIAN REAL ESTATE MARKET

Real estate has been conventionally looked at as mainly residential, commercial (office and retail) and hospitality. However, lately, newer themes are gaining momentum and offering enormous opportunities to various types of investors. These include:

Affordable housing

- Government's target of 'Housing for All by 2022'

Smart cities

- 100 smart cities – 60 cities already approved
- Estimated investment outlay of over 22 billion USD by 2020

EMERGING THEMES IN THE INDIAN REAL ESTATE MARKET

Infrastructure linked real estate development

- **Aerotropolies or City Side Development**
- **Transit Oriented Development (ToD)**

Industrial corridors related opportunities

- **Six industrial corridors in various stages of planning and development**

INVESTMENT IN THE REAL ESTATE SECTOR NEEDS TO GROW ANNUAL @ 18-20 PER CENT

India housing demand by 2022

Particulars	Urban (Million units)	Rural (Million units)	Total (Million units)
Current shortage	19	40	59
Additional	28	23	51
Vacant houses	9	10	20
Core demand	38	53	90

Source : Census 2011; Report of the technical group on urban housing shortage (2012-17), Ministry of Housing and Urban Poverty Alleviation, Working Group on Rural Housing for XII Five Year Plan, Ministry of Rural Development, KPMG in Indian analysis 2014.

INVESTMENT IN THE REAL ESTATE SECTOR NEEDS TO GROW AT A CAGR OF 18-20 PER CENT

Indian urban housing investment by 2022

Type of house	Target income group	% of housing need	Typical area (Sq Ft)	Number houses (million)	Cost of house (INR million)	Total investment (INR million)	Total investment (USD billion)
Social housing	EWS (1 BK)	40	Up to 300	18.4	0.5	31,280	521
LIG housing	LIG (1 BHK)	30	550-750	13.08	1.5-2.0	23,460	391
MIG	MIG (2-3 BHK)	20	800-1200	9.2	4.0-4.5	38,640	644

INVESTMENT IN THE REAL ESTATE SECTOR NEEDS TO GROW AT A CAGR OF 18-20 PER CENT

Indian urban housing investment by 2022

Type of house	Target income group	% of housing need	Typical area (Sq Ft)	Number of houses (million)	Cost of house (INR million)	Total investment (INR million)	Total investment (USD billion)
High end and luxury	HIG on rich class (above 2-3 BHK)	10	Above 1200	4.6	Above 5.0	46,000	767
Total				46.0		139,380	2,323

FUNDING PRODUCTS BOUQUET

❑ Private Equity

Private equity investment by an FDI or non FDI fund in a real estate project or at an entity level with a real estate developer

❑ Strategic Partnerships (JD/JV)

Land owner participating in joint development or joint venture model with a real estate developer

❑ Construction Finance

Finance for completing the construction works of a real estate project

FUNDING PRODUCTS BOUQUET

❑ Structured/ Mezzanine Finance

Finance structured with quasi debt & quasi equity features

❑ Lease Rental Discounting

Financing for tenanted properties against lease receivables

❑ Commercial Mortgage Backed Securities

Specialized financing for commercial properties

❑ Loan Against Property

Financing against real estate property

FUNDING PRODUCTS BOUQUET

☐ Bulk Inventory Sale

Financing by means of purchasing inventory usually at discount to market value for future capital appreciation

☐ Corporate Level Financing

Financing at corporate balance sheet level

☐ Core Asset Sale

Financing by means of sale of yielding core assets

☐ Public Markets

Financing via public market listing or subsequent issues

FUNDING PRODUCTS BOUQUET

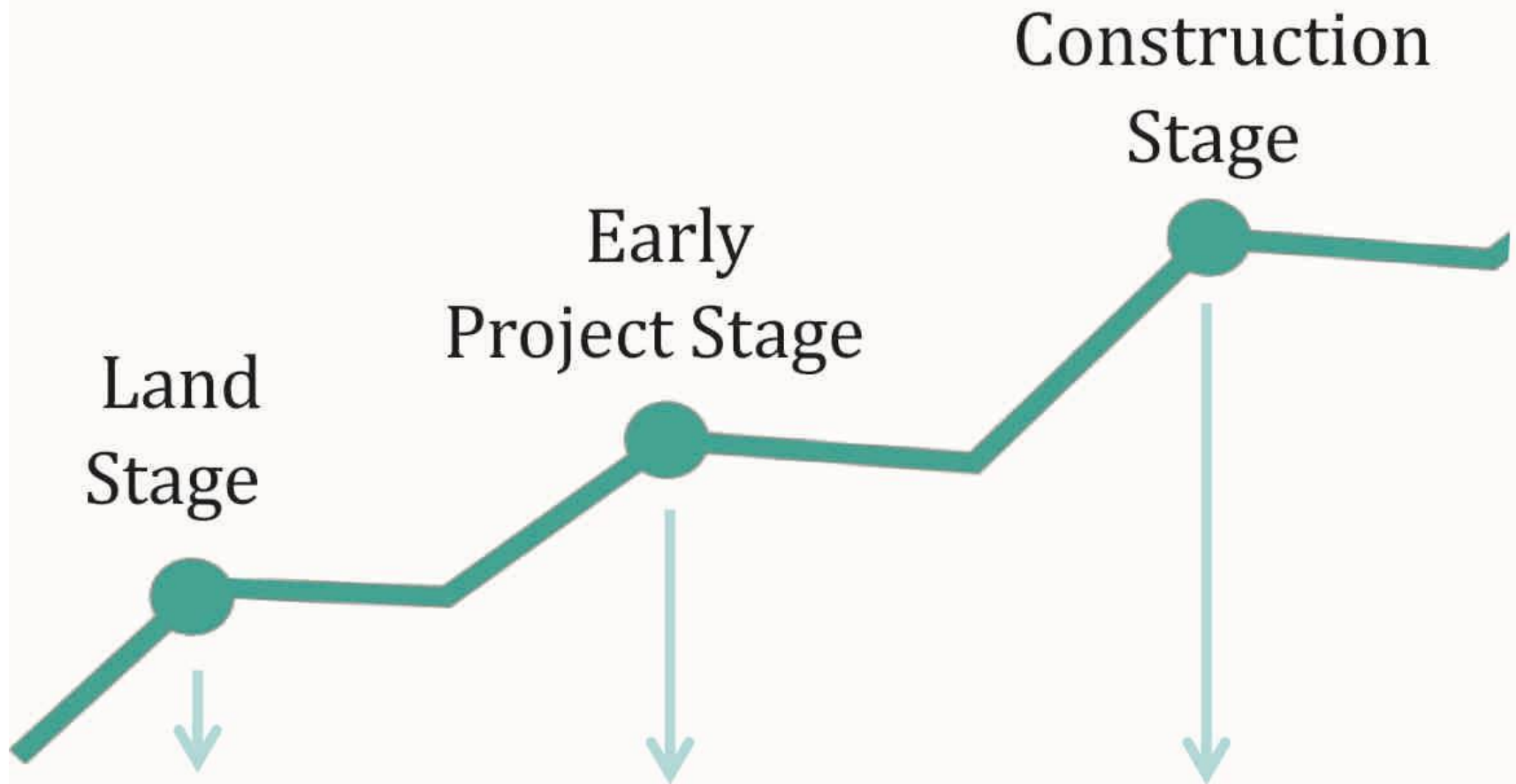
☐ External Commercial Borrowing

Financing via low cost foreign debt issue

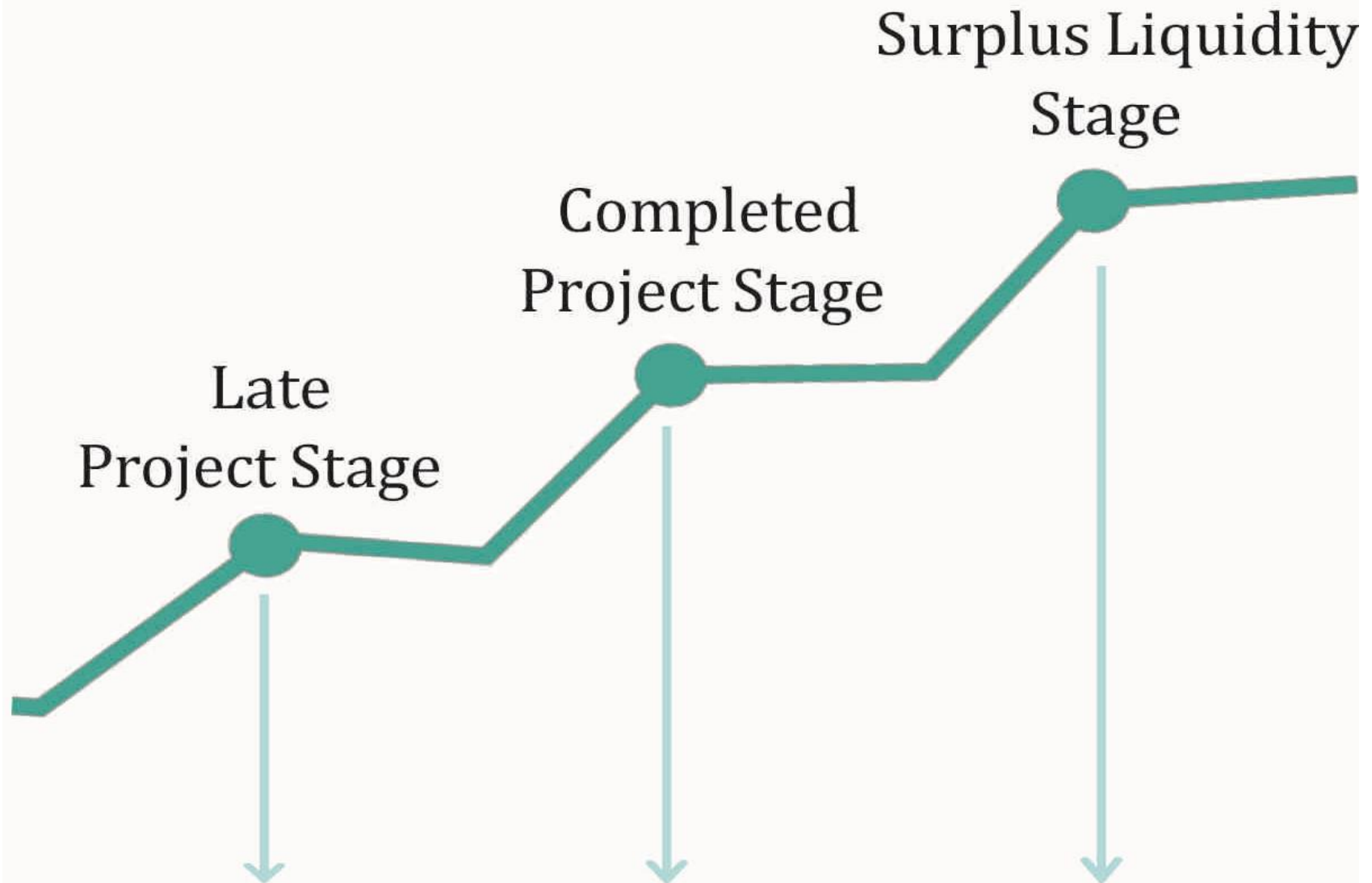
☐ Receivable discounting

Financing against future receivables

FUNDING OPTIONS THROUGH PROJECT LIFE CYCLE



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FUNDING OPTIONS THROUGH PROJECT LIFE CYCLE

Funding Requirement	Land Sourcing & Acquisition Financing	Permission & Planning Costs	Construction Financing
Investors and Products	<ul style="list-style-type: none">• Land owners (strategic partnership)• HNI (bulk inventory)• Private Equity (early)		<ul style="list-style-type: none">• Banks (CF)• HFC (CF)• PE (late stage)

FUNDING OPTIONS THROUGH PROJECT LIFE CYCLE

Take-Out / Fund exits	Take-Out / Fund exits	Take-Out / Fund exits	Fund Utilization
<ul style="list-style-type: none">• NBFC (structured)• PE (structured)• PE (bulk inventory)	<ul style="list-style-type: none">• Banks (LAP)• HFC (LAP)	<ul style="list-style-type: none">• PE (asset purchase)• HNI (asset purchase)• Banks (LRD)• HFC (LRD)	Investors and Products

FUNDING OPTIONS & ASSET CLASSES



Land

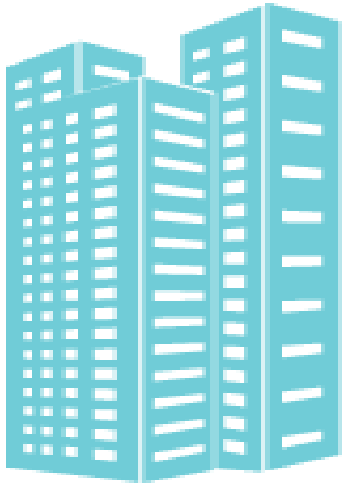
- High risk
- Regulatory risk, market risk and project risk
- Debt on asset based on borrower profile/ cash flows



**Residential
Project**

- Cash generating model of sales
- High reliability given low sales risk in tier one cities
- Construction finance/ Take-out financing / Bulk sale

FUNDING OPTIONS & ASSET CLASSES



Commercial

- Sale/ lease model
- Moderate reliability due to higher sales risk/ leasing risk
- Leasing with lock-in periods
- Construction finance/ CMBS/ LRD/ LAP/ Core asset purchase/ Bulk sale



Retail

- Sale/ lease model
- Moderate reliability due to higher sales risk/ leasing risk
- Leasing typically without lock-in periods
- Construction finance/ LRD/ LAP/ Core asset purchase

FUNDING OPTIONS & ASSET CLASSES



Warehouse

- Similar to commercial & retail
- Business risk in case of captive warehouses



Financing on business profits

Hospitality



Others: Schools, Hospitals, etc.

Retail

INSIGHT ON FDI & ECB FUNDING

❑ **Recent guidelines & implications**

- Minimum project built-up area reduced to 20,000 sq. m. (from 50,000 sq. m.)
- Eliminated requirement for minimum area for housing plots (from 10 hectares)
- Minimum capitalization requirement reduced to USD 5 Mn. (from USD 10 Mn.)
- No minimum area & capitalization requirements for affordable housing projects
- 100% FDI in operations & management projects of completed townships, malls, shopping complexes, business centers (from 100% FDI only in industrial parks)
- Pass through status for REITS

External Commercial Borrowings for affordable housing and slum rehabilitation projects

What is ECB (External Commercial Borrowings)?

- Source of funds for corporates from abroad
 - Include commercial loans
 - Bank loans, buyers' credit, suppliers' credit, securitised instruments
 - Minimum average maturity of 3 years
- Advantages
 - Lower rates of interest.
 - Longer maturity period

Purpose of ECB :

- For development of approved low cost affordable housing projects (*A project in which atleast 60 percent of the permissible Floor Space Index (FSI) would be for units having maximum carpet area upto 60 square meter*)
- For approved slum rehabilitation projects;
- By housing finance companies for financing prospective owners of low cost affordable housing units; and
- By the National Housing Bank (“NHB”) for financing low cost affordable housing units by individual borrowers and for on-lending to developers.

Regulations in connection with ECB

● Conditions associated with Eligible Borrowers - Developers/Builders :-

- Be a company registered under the Companies Act, 2013
- Have a proven financial track record and be credentialed in terms of quality and delivery.
- Have a minimum 5 years experience in undertaking residential projects; and
- Not have defaulted in any of their financial commitments to banks/ financial institutions or any other agencies

Regulations in connection with ECB (Contd...)

- **Permissible End Use by Developers/Builders**

- **For low cost affordable housing projects:**

- The ECB proceeds shall be utilized only for development of low cost affordable projects and not to be used for acquisition of land.
- As mentioned earlier, a low cost affordable housing project is a project in which at least 60 percent of the permissible Floor Space Index (FSI) would be for units having maximum carpet area upto 60 square meters.

Regulations in connection with ECB (Contd...)

● Permissible End Use by Developers/Builders (Contd...)

➤ For Slum Rehabilitation Projects (“SRPs”):

- SRPs will also be eligible as permissible end use under this Scheme.
- The parameters for SRPs to qualify as eligible projects would be set by the Committee constituted by the Housing & Urban Poverty Alleviation (HUPA) which administers SRPs.

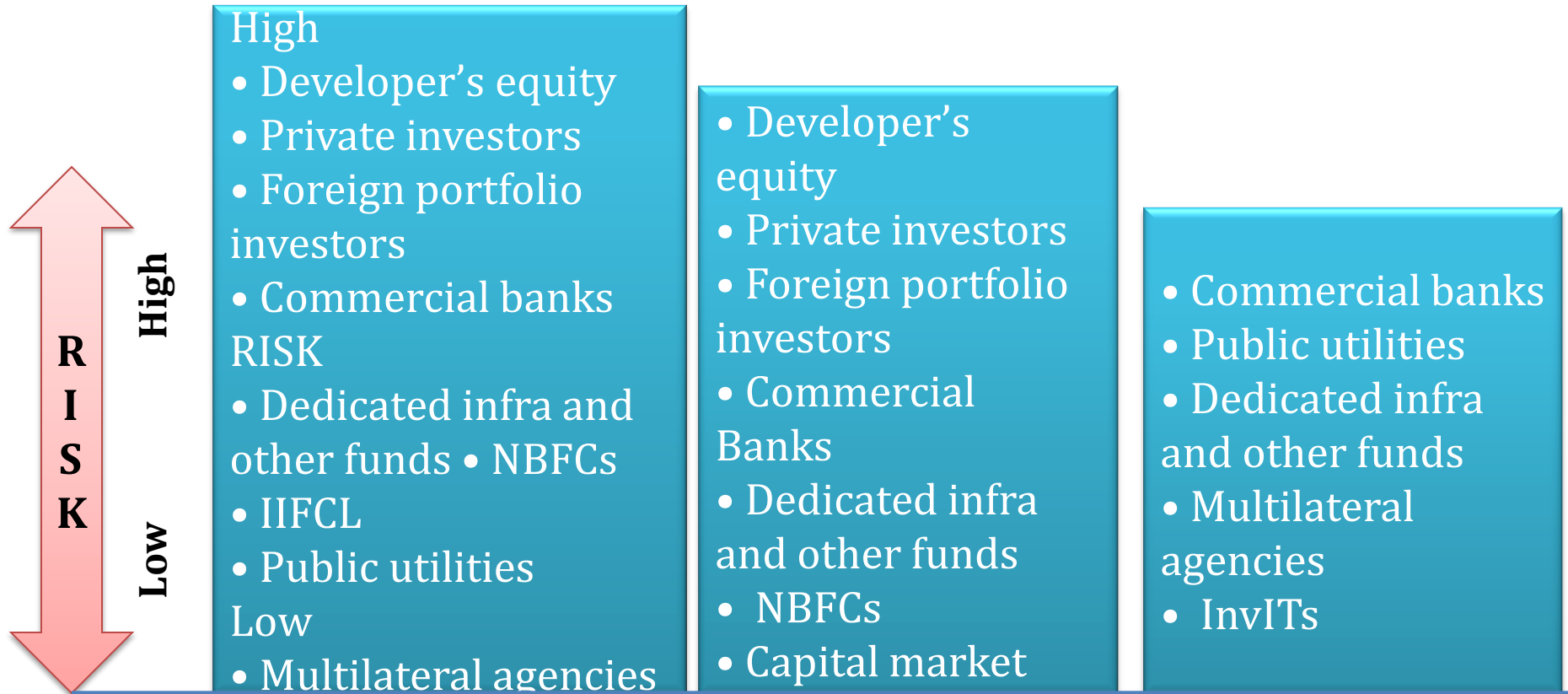
Definition of Eligible Projects for ECB

- **Low cost affordable housing project** - A project in which at least 60 per cent of the permissible FSI would be for units having maximum carpet area up to 60 square meters.
- **Slum rehabilitation projects** - The eligibility of slum rehabilitation project for ECB will be based on the parameters to be set by the Central Sanctioning and Monitoring Committee of the
 - Affordable Housing in Partnership Scheme (AHP) constituted under the Chairmanship of Secretary, Housing & Urban Poverty Alleviation (HUPA) which administers the slum rehabilitation projects.

Procedure for obtaining approval for availing ECB

- Step I: Obtain clearance from NHB which acts as a nodal agency
 - The builder/developer shall apply to NHB, which shall act as the nodal agency in the prescribed format (guidelines with respect to format of application, project monitoring, etc are to be issued by NHB)
 - NHB, on being satisfied with the projects' eligibility as a low cost affordable housing project, shall forward the application to RBI for its consideration under the approval route.
- Step II: Apply to RBI
 - The builder/developer shall apply to the RBI through its authorized dealer in the manner prescribed by the regulations on being advised by the NHB to approach the RBI.

SOURCES OF INVESTMENT



Initiation & Planning

Implementation

Closing

Time
frame

1 to 3 years

2 to 6 years

0 to 2 years

% of
project
cost

5-15%

75-85%

5-10%

FINANCING OF REAL ESTATE PROJECTS BY DEVELOPMENT PHASES

Stage	Pre-construction	Construction	Operational
Time frame	1–3 years	2–4 years	0–3 years
% of total cost	Tier 1 cities: 50–60% Tier 2 cities: 40–50% Tier 3 cities: 40–50%	Tier 1 cities: 30–40% Tier 2 cities: 35–45% Tier 3 cities: 35–45%	Tier 1 cities: 5–10% Tier 2 cities: 2–7% Tier 3 cities: 2–7%

FINANCING OF REAL ESTATE PROJECTS BY DEVELOPMENT PHASES

Stage	Pre-construction	Construction	Operational
Sources of funds	<ul style="list-style-type: none">• Developer's equity• Private equity• Cash flow from customers	<ul style="list-style-type: none">• Cash flows from customers• Commercial banks• Private equity and real estate funds• NBFCs• Bond markets	<ul style="list-style-type: none">• Commercial banks• Long-term investment funds: sovereign, pensions, insurance, etc.• REITs

FINANCING SOURCES FOR INDIAN REAL ESTATE

- Bank/FI/HFC/NBFC Lending.
- Private Lending.
- Private Equity Funds.
- Mezzanine/Structured Equity instruments by Foreign Investment.
- REITs.

FINANCING PRODUCTS

- Construction Finance (Residential / Commercial).
- Corporate Term Loan
- Lease Rental Discounting

CONSTRUCTION FINANCE: KEY CONSIDERATIONS

- ❖ Business Background & Market Position.
- ❖ Financial Parameters.
- ❖ Security Parameters.
- ❖ Technical Parameters.
- ❖ Project Cash Flows.

BUSINESS BACKGROUND & MARKET POSITION

- ❖ Execution Track Record.
- ❖ Management Capability & Quality.
- ❖ Market Position.
- ❖ Development Model (JDA/ Land Banking).
- ❖ Level of Diversification.
- ❖ Analysis of Projects Delivered & Under Execution.
- ❖ Credit History.

FINANCIAL PARAMETERS

- ☐ Ownership Pattern.
- ☐ Revenue & profitability.
- ☐ Capital Structure & Debt to Equity Ratio.
- ☐ Current Ratio.
- ☐ Exposure to group companies.
- ☐ Compliances
- ☐ Auditor's Qualifications.

SECURITY PARAMETERS:

- Clear, marketable and mortgage-able title of the project land/security.
- Satisfactory technical due diligence of the project.
- Asset coverage - 1.5 to 2 times
- Hypothecation of the receivables.(Receivables cover net of project expenses of 2 times)
- Corporate Guarantee/Personal guarantee / Debt Service Reserve Account as per requirement.
- Assignment of Project Insurance policy.

TECHNICAL PARAMETERS

- **Approvals to be checked**
 - ✓ Title, License, Building Plans , No of units and details.
- **Other statutory approvals**
- **Construction Schedule**
 - ✓ Proposed schedule vs. current status, Time over run, if any
- **Project Cost**
 - ✓ Details of Project Cost, Cost incurred etc.
- **Sales**
 - ✓ Selling Price, Sales Velocity & Target Segment.

PROJECT CASH FLOWS

- ❖ Break-Even Analysis
- ❖ Sensitivity Analysis.
- ❖ Net Cash Flow.
- ❖ Repayment Schedule and moratorium period etc.
- ❖ Acceptable Gearing Levels
- ❖ Adequate Debt Service Coverage Ratio

BANK CREDIT – CC/OD/ PROJECT LOAN

- **Purpose:** To meet working capital requirements.
- **Amount of facility:** Based upon the Bank's assessment of the working capital requirement (WIP & book debts)
- **Security:**
 - Charge on current assets
 - Collateral(s) on case to case basis.
- **Interest Rates:** 12% -16%

BANK CREDIT -LOAN AGAINST PROPERTY

Loan against property is similar to other loans like home loan, Equipment Loan etc.

- **Quantum of Loan:** Depends on type of property & income of the borrower
- **Tenure:** Flexible for 1 – 15 years
- **Interest Rates:** 11%-14%
- **Security:** Charge on Property and LTVs are generally at 65- 70% of PMV

PRIVATE EQUITY- DOMESTIC FUNDS

- Private Equity players have been very active in the real estate sector especially in housing from the past few years (2005 onwards).
- Besides Equity, structured debt-like instruments are used in light of volatility this industry faces.
- Major Domestic Players in India:
 - ICICI Ventures
 - IDFC
 - HDFC
 - IL &FS
 - Kotak Private Equity
 - Urban Infra RE Fund (Jay Corp)
 - Indiareit (Piramal Group)

Real Estate Mutual Funds (REMF)- Introduction

In simple terms, Real Estate mutual funds are close ended mutual funds with a lock-in period of 3 years. These mutual funds will invest in real estate properties and being the owners of these properties, they will let out these properties on rent. The rent so earned will be distributed to investors as dividend. When the mutual fund attains maturity, the company can sell its holdings and return your investments.

SEBI has kept the scope of the REMF wide open, as the guidelines allow REMF to invest in the following sectors:

- Directly in real estate properties within India
- Mortgage (housing lease) backed securities
- Equity shares of companies which deal in properties
- Other securities like debt instruments

KEY PARAMETERS : CONSTRUCTION FINANCE

Loan to Project Cost	Maximum 50% depending on the merits of the case.
Promoter's Contribution	Minimum 20% of cost of the project.
Dependency on booking money	Maximum 50%.
Project Debt Equity	2 times
Project DSCR	1.5 times
Loan to Value Ratio	50% to 75% of security value depending on the merits of the case.
Financials (Company/Group)	Consistently profit making D/E: maximum 2 times. Current Ratio: 1 time.

KEY PARAMETERS : CONSTRUCTION FINANCE

Loan to Project Cost	Maximum 50% depending on the merits of the case.
Audited Financials	Balance Sheet: Net worth, Debt, Advances from customers (current liability), WIP (current asset). Profit & Loss: Turn over and PAT (trending and margins) Contingent Liabilities and auditor's qualifications.

LEASE RENTAL DISCOUNTING:

Lease Rental Type	Rent from Commercial Office Space, Retail Mall or Shops, Educational Institute, Hotel, Service Apartments and Multiplex etc.
	The loan funds may be used for meeting business/personal needs of the applicant, such as:
Purpose of loan	<ul style="list-style-type: none">• Acquisition of new property.• Part financing of project implementation expenses of on-going projects or upcoming projects.• Repayment/consolidation/substitution of high cost debts.• Funding Business Expansion.
Income Considered	Net rent as per registered lease deed post deduction of TDS and maintenance expenses.

