Realty Funding Options

Ajay Jain, Executive Director - Investment banking and Head Real Estate, Centrum Capital Ltd., is a sectoral specialist with close to 25 years of experience in fund-raising activities from banks, PEs, NBFCs, mutual funds, HNIs, overseas investors and structured financiers. He shares his inputs with *Sapna Srivastava on* the current real-estate investment scenario.

Q How is RERA influencing developer's financial situation?

RERA provision for developers to obtain all approvals before launching any project prohibits pre-launches to raise funds from the customers. Also, developers now have to keep 70 per cent of the proceeds from a project in an escrow account, which will restrict their ability to dip into project sale revenues. Earlier, developers used 25 per cent of their own funds, another 25 per cent from banks or NBFCs and rest 50 per cent from sale proceeds. Now funds generated from sale proceeds will come down to 20-30 per cent, for rest they would need project-wise funding. Therefore, we do expect to see a lot of turmoil in the next 18 to 24 months.

Implementation of RERA will bring financial discipline, transparency, accountability and compliance in the sector. It will ease the job of lenders as the promoter's track record will be available online with information of any financial misdemeanour or criminal record. With corporate governance coming in Indian real-state, there will definitely be increase in funding in the sector, both domestic and international. The banks have started lending in a big way to NBFC and housing finance companies and directly to credible developers.

The developers have to pay almost 42 per cent in the form of various taxes to the government; about 24 per cent goes towards NBFC loan interest and after including the land cost, developers today make very slim margins. Post RERA developers who have the capabilities, resources and money will only survive.

Q How will RERA impact the home buyers?

Most of the developers will have to borrow project-by-project under RERA,leading to serious under supply and higher rates of real-estate.The luxury-housing segment and mid-market segment are witnessing slowdown but, mortgage rate reductions by banks will encourage sales. Also, administrative reforms to facilitate quicker approval process will help developers complete and handover projects on time, thereby keeping costs in check and benefiting the buyers.

Q What are the various routes available for the developers for the capital?

Many private equity funds are coming up with special situation funds, themed funds and even construction finance at competitive rates. Lender institutions are offering syndication of funds in the form of LAP (Loan against Property), LRD (Lease Rental Discounting and NCD (Non-convertible Debentures).

Moreover, PE funds and NBFC provide options for acquiring land parcels and funding for residential and commercial projects that are at a nascent stage. Structured funds provide choice of flexible repayment schedule matched with cash flows anticipated from a project. Developers have huge land parcels that can also be used as security, enabling a higher loan amount at a concessional interest rate.

Q What are some of the criteria used by investors to identify suitable borrower?

First and foremost is the track record of the developer including, criminal, financial, project delivery and loan repayment, among others. As any project takes about five years to complete, the developer should have seen minimum two cycles of project development i.e. the company should be at least 10 years old also, it must have delivered one million square feet. In case of a particular project, the permissions & approval stage, the location and pricing of the project, developer's execution capability and financial competency are the major criteria.

Investors prefer category A developers and Category B developers in top cities like Mumbai, Pune, NCR, Bengaluru, Chennai and Hyderabad. Usually, finance is offered by banks at 12-15 per cent, by NBFCs at 14-18 per cent, and by PEF at 19-24 per cent.

Category A developers are those which have a legacy of several years and have constructed more than 10 million square feet. The Category B developers have constructed one million square feet and more. The Category C developers are the professionally managed start-ups that have five years of experience. From lenders perspective, only 25 per cent developers across India belong to Category A.

AJAY JAIN

In India, REITs have become more practical after the government exempted dividend distribution tax (DDT).It will help developers to monetize their commercial assets, attract domestic and foreign investors as well as provide liquidity to the commercial and retail segment.

Q Is the Indian real-estate ready for REIT?

REIT must acquire and develop its real-estate properties primarily to operate them as part of its own investment portfolio, as opposed to reselling those properties after they have been developed.

It will take a while for REITs to penetrate Indian realty sector. As of now,investment options for REITs is restricted to office and retail spaces only and that too in Tier-I cities of Mumbai, Delhi-NCR, Hyderabad, Kolkata, Chennai Ahmedabad. Bangalore and Pune.

The challenge is that for REIT, approximately Rs 500 crore assets should be there at one place. To form such a Trust, it is not easy to bring assets which belong to different owners or different companies having one owner, since it attracts stamp duty, income tax and capital gains tax as the case may be. Each company, which holds such assets, should be having different directorship and shareholding pattern.

The other issue is the source of income for the underlying assets would be rental income, which would be distributed in the form of dividend to unit holder. Once it gets listed, due to no depth and takers for such instrument, it might trade lower than the face value.Also, simplification of rules, taxes and stamp duty, would be required to make the schemes workable. In such a scenario, GST Bill is a step in the right direction.