PE firms cash in on last-mile financing in real estate

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Last-mile financing by private equity (PE) firms has caught on in a big way among property developers, who are seeing prolonged slowdown in sales, fewer launches and lower cash flow.

According to fund managers, 70-80 per cent of real estate funding in real estate is happening in this segment and PE funds are charging 16-24 per cent for this, depending on the developer's profile and security. Developers borrow money for a variety of reasons, including funds to complete projects where cash flows have dried up or to give exits to existing investors.

Leading the race is Ajay Piramal-promoted Piramal Fund Management.

Since the beginning of this year, Piramal has sanctioned ₹11,800 crore of debt transactions across its real estate vertical and about 70 per cent of this would be some form of last-mile funding to developers, says Khushru Jijina, managing director of Piramal Fund Management.

"This is due to the fact that many of the projects that were delayed are now coming on-stream. Moreover, such funding also helps bridge the gap between sales receivables and the pace of construction," Jijina adds.

He says they charge between 14 and 18 per cent.

Piramal recently lent ₹2,320 crore to Mumbai-based Lodha Group to replace existing debt and complete projects in south and central Mumbai. Piramal has committed the money across Lodha's multiple projects, to replace existing debt. Lodha, the biggest developer in terms of sales, recently got ₹425 crore investment from Piramal for its project Lodha Venezia, a real estate project in Mumbai.

Jijina says they expect this form of finance to continue, especially in the wake of the consolidation in real estate, wherein smaller developers are tying up with brand names/Tier-I partners to boost execution and sales velocity of under-construction projects.

Recently, US-based Apollo Global Management invested ₹400 crore in Noida-based developer, Logix Group, through the structured debt route. It was a last-mile funding transaction, wherein the money would be used to complete the construction of four ongoing residential developments in the National Capital Region (NCR).

Mumbai-based Altico Capital has also done a large number of such investments, says Amit Pachisia, chief credit officer at Altico Capital.

He says Altico has executed nine transactions aggregating around ₹1,800 crore in the nine months ended September, where a large part of projects secured fall in the late-stage category.

He says Altico has also sanctioned further deals that are under due diligence at present and in this category, totalling around ₹1,000 crore.

"Such trades reduce the risk on all three counts — approvals, sales and construction and still fetch you healthy returns, making these trades compelling for us particularly with credible and resourceful developers. We are currently evaluating deals of over ₹40,000 crore in a year and a healthy proportion of these include refinancing and construction funding," Pachisia adds.

Altico recently lent ₹500 crore to the Mumbai-based Nirmal group where two of the three key projects are late stage. The investment was with regard to three condominium towers in Mulund — Amethyus, Zircon and Turquoise — besides a residential project named One Edition in Nirmal Lifestyle and separately an early-stage project closer to Thane. Pachisia says last-mile financing has caught on also because of lower investor sales due to stagnation of prices and in some cases, the market has become end user-driven with buyers demanding project completion, track record and so on.

Sales to investors in NCR and Mumbai in the initial project stages are a source of funding for developers.

Investors and lenders such as Altico are also ensuring that their lending is adequately covered by collaterals.

Pachisia says they take full charge on the underlying projects, which typically includes first mortgage of project, receivables, cash flows, etc. In many cases, they also take pledge of shares of the special purpose vehicle developing the project. "Our cash cover on loan is generally above 2x. Besides underlying projects, we may also take additional hard assets as collateral," he adds.

When Piramal did the deal with Lodha, it said the deal was structured as a fixed return debt investment with periodic coupon payments and appropriate security mechanism in place, including hard asset cover and an escrow on receivables.

Ajay Jain, executive director at Centrum Investment Banking, agrees that the quantum of last-mile funding has gone up in 2016 as the number of new launches has somewhat dried up due to slowdown in home sales. "Large developers are slowing down the launch of new housing projects, with their primary focus being completion and delivery of existing projects. At present, developers need multiple rounds of refinancing to allow exits to current lenders and to help the projects cross the finishing line."

Piramal's Jijina says this form of funding is required in redevelopment projects to allow exits to current investors due to the lengthy timelines associated with them.

"Last-mile financing is also free of any hurdles related to the initial stages of a project (obtaining permissions, etc) and requires little investment to churn out the balance receivables from the project," he adds.

BRIDGING THE FUNDING GAP

- 70-80% of all realty funding is last-mile financing
- Funds are charging between 16% and 24% for this, depending on developer profile and security
- Developers borrow money for variety of reasons — to complete projects or give exit to existing investors
- Piramal Fund Management, Altico, Apollo key players
- Piramal has sanctioned ₹11,800 cr of debt transactions across its real estate vertical, and about 70% of this would be some form of last-mile funding to developers
- Recently, Piramal lent ₹2,320 cr to Mumbai-based Lodha Group to replace existing debt and complete projects in southern and central Mumbai
- US-based Apollo Global Management has invested ₹400 crore in Noida-based developer Logix Group, wherein the money would be used to complete the construction of four ongoing residential developments in Noida in NCR
- Recently, Altico lent ₹500 cr to Mumbai-based Nirmal Group where two of the three key projects here are at late stage