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# New sources of Realty Financing

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*Jan 2018 , by Admin (http://realtyplusmag.com/author/realtyuser/), in Trends (http://realtyplusmag.com/category/trends/)*

***"That, which does not kill us, makes us stronger"*** **– these words of German philosopher Friedrich Nietzsche can certainly be implied on the long term effects of the RERA and GST. Ankit Gohel gets industry opinions on the funding options available for real-estate developers in the post RERA climate.**

The provisions and penalties imposed by RERA have left the small and medium sized real estate developers under pressure to secure funding to complete the projects. They are now turning to their lenders for help.

The lenders or the financial institutions on their part are too willing to help and adopt a more hands-on approach. Some of the institutions are hand-holding small and medium developers to complete unfinished projects and even go the extra mile to sell unsold inventory on their behalf.

In order to oversee project completion, many lenders are hiring project managers and recruiting technical staff. They are increasing the working capital on under-construction projects and on behalf of developers they are also underwriting and distributing unsold stock. Therefore, this assistance from the financial institutions with strong balance sheets is helping the developers in completing delayed projects and earning back their lost reputation due to the delay.

Currently, the commercial real-estate space in India has attracted significant attention from global investors. The impending launch of Real Estate Investment Trusts (REITs) in India saw some large global private equity, sovereign, pension funds investing in commercial office space and malls especially in Tier 2 and Tier 3 cities.

The year started off with wild predictions of a price correction of 30 to 40% across the entire sector after demonetisation. The implementation of RERA and GST succeeded it. Due to all the uncertainties, there was an expectation of fall in prices which resulted into homebuyers deferring their decision to purchase homes. Therefore, this created difficulty for developers as their primary source of funding has been pre-sales advances from the homebuyers.

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Mr. Punit Agarwal

Terming RERA a game changer for the industry and talking about the difficulties faced by the developers, **Punit Agarwal, CEO, Nirvana Realty** said, “Now there are additional compliances to complete, the banks are not releasing any funds without a RERA registration to safeguard their interest, this has stopped funding of projects at the initial stage when developers need funds the most to buy the land and get required permission.”


(http://realtyplusmag.com/wp-content/uploads/2018/01/Ajay-Jain-Joint-Managing-Director-Sun-Capital-Advisory-Services-Pvt-Ltd.jpg)
Mr. Ajay Jain

On a brighter note, **Ajay Jain, Joint Managing Director, Sun Capital Advisory Services Pvt Ltd** mentioned, **"**Inflow of foreign fund in last 12 to 24 months had been good due to the RERA, GST and, Benami, that brought transparency and improved corporate governance in real-estate sector. Furthermore, PMAY, various tax sops by government and affordable housing project has reasonably improved the sales and returns on projects."

A recent JLL research shows that the period between 2015 and Q3 2017 saw an astonishing 54% of investments in retail real-estate happen in Tier II- III cities such as Pune, Bangalore, Amritsar, Indore, Ahmedabad and Chandigarh.

**The Finance Avenues**

Fund-raising for the real estate developers has never been an easy business. And, in the post RERA era, it has become tougher. The builders require construction finance, inventory finance, takeover finance and much more during various stages of development of a project. Thus, at an early stage, the builders are in need of equity capital which is said to be patient money.

Debt Financing – The developers are choosing offshore fund raising options and debt or equity financing. Under Debt financing, the developer borrows money in exchange of future payments. The creditor, considered as secured, will get regular interest payments which will be based on pre-defined rates. But, he will possess no ownership rights to the developer's projects.

Private Equity- The developer can also opt for private equity or public equity if he decides to go through Equity-based financing. In public equity, he can opt for a listing on the local stock market, or a listing on a foreign market whereas in private equity through real estate venture capital or private equity fund. Banks have invested in many projects with a buyback guarantee or a clause allowing them to convert debt to equity and take over the project partially. "Developers initially used to raise funds from private investors with secured and unsecured terms, however now there has been a lot of debt funding from private banks and NBFC. Also a lot of PE funds who are nationals and international funds are taking stake in real-estate projects now," said **Agarwal.**

NBFC- Going through public market is often a big-budget job. Loans from banks also come at high rate of interest. Thus, Non-Banking Financial Companies (NBFC) and generating funds from High Net Individuals (HNI) in the form of Non-Convertible Debentures (NCD) are other options which a developer can look for.

According to **Jain,** a developer can borrow from Banks and NBFC for construction finance. For Takeover Finance, Top-up finance and Inventory funding, NBFC and funds from HNI clients in the form of NCD can do the task.

The real estate players are also closely looking at the bi-monthly policy reviews of the Reserve Bank of India. The rate cuts will lead to the softening of interest rates by the commercial banks on the loans. This can have a sizable amount of inflow of funds in the market, also raising the demand. The higher rate of interest can affect the developers negatively on both- supply as well as demand- side of the market.

According to data by News Corp, investors put in around $1,096 million in equity and $501 million in debt financing in real estate projects, totalling $1,597 million in the January-June period. The residential projects constitute of more than 70% of the real estate sector in India. It has mostly attracted debt financing in recent years. While, the major chunk of equity investments in India have mainly been for buyouts of commercial office assets.

**The Investors View**

The investors will bet only for the developers with good track record, delivery capability and possessing a favourable market sentiment. The investors will invest the money after understanding the business plans and knowing the management team. The lender also takes into consideration the strength of the builder in repayment of loans and his timely interest payment record. Therefore, the credibility of the developer plays an important role in generating funds.

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Mr. Sunil Rohokale

**Sunil Rohokale, MD & CEO, ASK Group** commented, “In the last 5-7 years, most developers who utilised their land banks by obtaining approvals and launching projects are facing a cash crunch as sales velocity is not as high as expected. Most of these projects are leveraged at high cost and due to slow sales there is a mismatch in cash flows. Their problems are further aggravated as they have to be RERA compliant and focus on project completion. Since the sales velocity is slow, to fast track construction, there is a huge need for flexible and patient capital.”

While, making an investment, **Jain** puts forward certain parameters for financing a developer. The eligibility criteria demands that a developer must have delivered at least 5 lakhs sq. ft. in last ten years and his account is regular with all lenders and not an NPA. Another significant consideration is the location of the project. He also states that the developer should not have any criminal or unsatisfactory legal record.

On the other hand**, Rohokale** believes in partnering with developers. His considerations include an good track record of timely project delivery, developer's product offering and customer centricity. "A strong regional brand with a focus on affordable and mid income segment who has availed funding from banks and private equity players and serviced loans/provided exits are preferred. The project needs to be in job corridors of top 5 cities and the ticket size of up to Rs. 50 lakhs for a 2BHK unit is a good proposition to attract demand. The project on an independent basis needs to have the capability to generate sufficient cash flows to attract private equity funding."

**The REIT Hype**

When questioned about the REITs in India, **Jain** pointed out certain pre-requisites for any real-estate assets to be listed on REITs, "Good sizable commercial property which are rent yielding, superior quality of construction, quality of lessee (in term of brand and financial to pay continuously rent for long tenure say 10 to 15 years), track record of developer doing similar many projects is past and capacity to pay interest and loan repayment even if space is not fully leased out or rental is not sufficient to address both are some of them."

Talking about the returns earned by investing in REITs, **Rohokale** said, "Two types of income can be earned from REITs. One is the regular dividend income and the other is through capital gains on transfer of REIT units on exchanges. REITs are structured to generate regular income as 90% of rentals are to be distributed to investors. The average yield generated by REITs can range 8-9% and are meant for risk-averse investors who want income without taking too much risk. Thus, the returns are low and are akin to that generated by fixed income/debt instruments but they provide a new avenue to small investors to participate in commercial real estate and earn stable income."

**Agarwal** feels that there will be a lot of consolidation and REITs may change the way commercial real estate functions at the moment. "The Rental ROI in residential market is very low which doesn't make REIT's interested in them, so it should not affect housing segment at the moment."

In the last 5 years, with residential real-estate witnessing a slump, commercial real-estate space in India has attracted significant attention from global investors. The rekindled interest of foreign funds in residential real estate after a gap of 10 years is quite evident as we saw many foreign funds visiting India this year.

An important thing to be noted here is that the lenders are now taking more proactive role in a real-estate development project. It is because all the information regarding the project and its stakeholders is now publicly available due to RERA. Additionally, banks & funds have an additional security of RERA to make sure the developer delivers the project on time with the right quality. In coming years, such confidence among the lenders will gradually ease the funding to real-estate projects.

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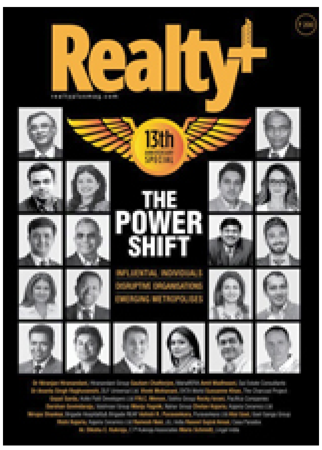

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