REAL ESTATE – Sources of Capital

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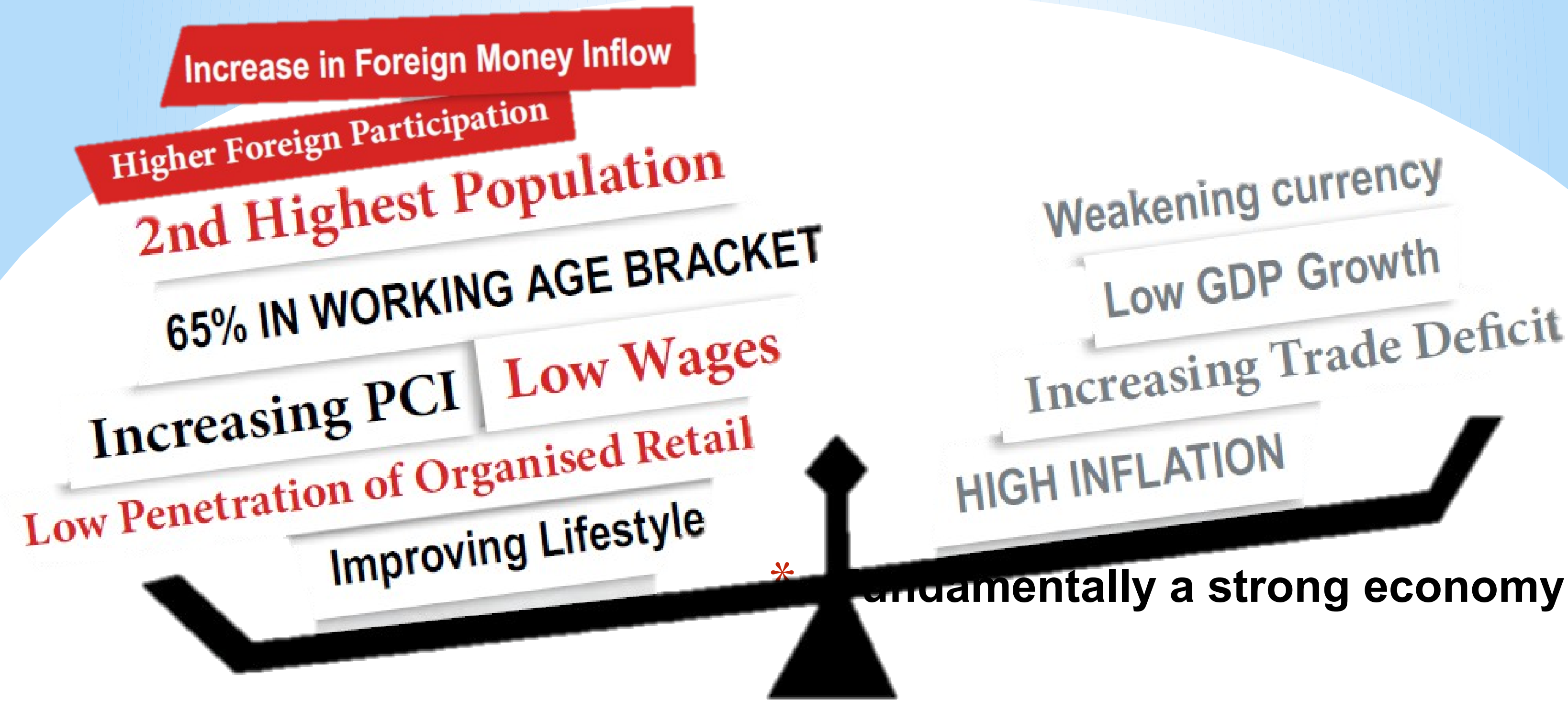
* Evolution of Private Equity in Indian Real Estate

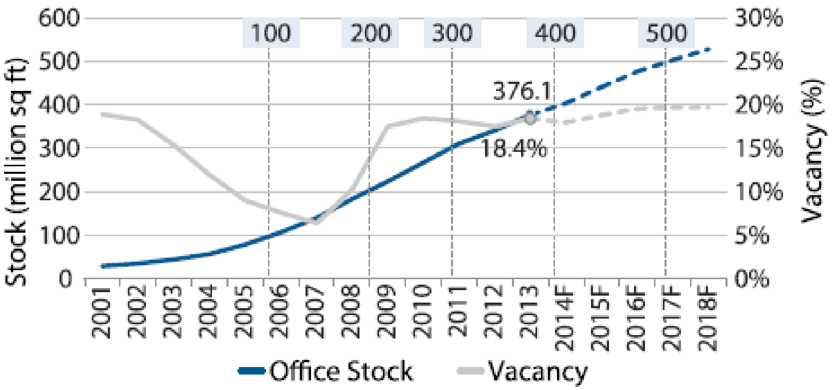
* Journey in the Past 10 years



* undamentally a strong economy

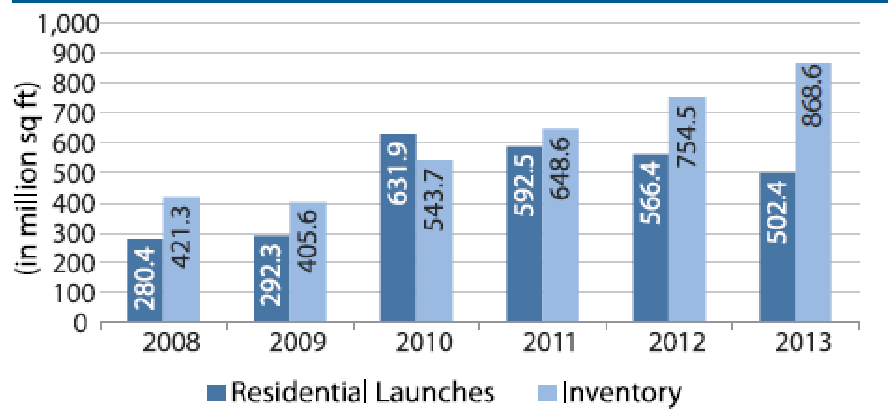
* Demand for Finance

Figure 3: Growth of Office Stock



Source: Jones Lang LaSalle-REIS, Brookfield Financial
Note: Figures are aggregates for the top seven metropolitan cities of India – Mumbai Metropolitan Region, National Capital Region, Bangalore, Chennai, Pune, Hyderabad and Kolkata

Figure 4: Residential Launches and Inventory



Source: PropEquity
Note: Figures are aggregates for the top seven metropolitan cities of India – Mumbai Metropolitan Region, National Capital Region, Bangalore, Chennai, Pune, Hyderabad and Kolkata

There has been an addition of approximately 100 Million sqft of office space every 2 to 3 years since 2006 and approximately 500- 630 million sft of residential space launched annually since 2010

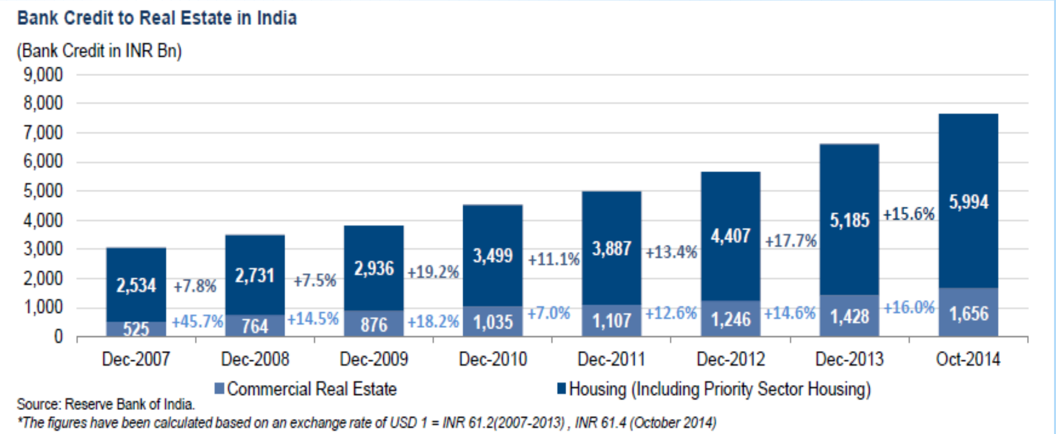
* Conventional sources of Funding

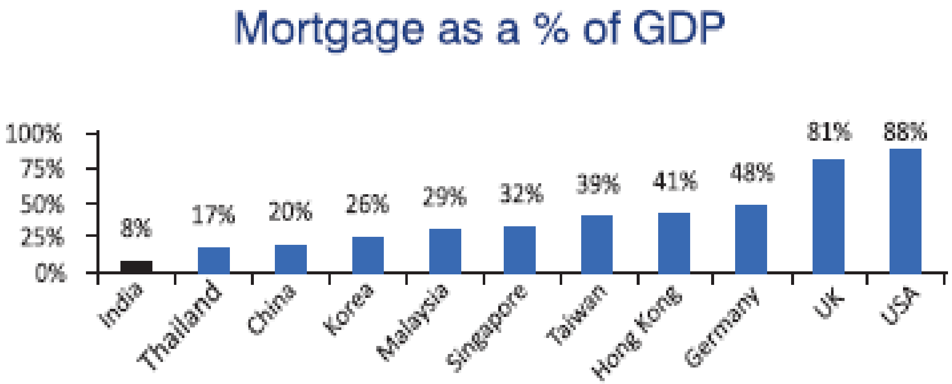
Banking Institutions	Non-Banking Financial Companies (NBFCs)	Listed Equity Capital Markets
USD 23.3 billion	**USD 2.4 billion**	**USD 12.5 billion**
Outstanding bank credit to Commercial Real Estate (includes residential projects developed by private builders), as of December 2013	Real estate allocation of 16 Active NBFCs focused on lending to Indian real estate	Market Capitalization of top 25 real estate developers and vehicles listed offshore holding Indian Assets, as of March 2014

Source: Brookfield Financial

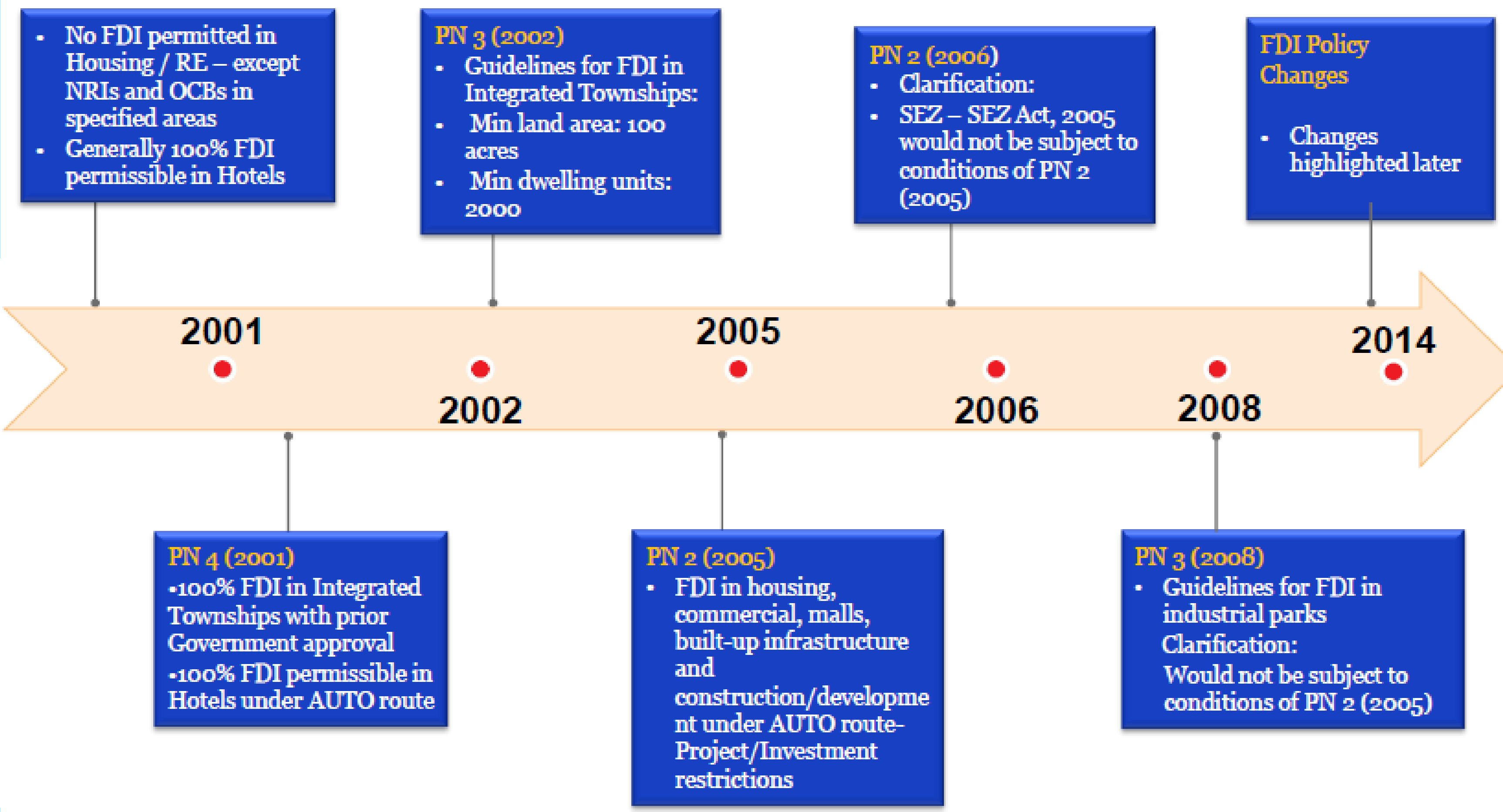
* Bank Credit- still a tip of iceberg as compared to mature markets

- As of December 2013, banks have an outstanding credit of USD ~24 billion in the commercial real estate sector and USD 97 billion in the housing sector.
- During Jan to Oct 2014, the outstanding bank credit increased by 16% and 15.6% in the Commercial and Housing sector respectively.
- Due to the sensitive nature of the commercial real estate, the central bank has prescribed high standard asset provisioning norm for such loans.
- RBI has discouraged advance disbursal products such as 80:20 and 75:25 schemes that are likely to expose the bank as well as home loan borrowers to additional risks.





FDI in Real Estate- Journey so far



* **Real Estate Private Equity**

* FDI Framework for Real Estate (Press note 2)- 2005

Foreign Direct Investment

Automatic Route

Approval Route

Greenfield/brownfield Projects

Commercial Office

Retail

Residential Housing

Hotels, resorts and tourism

Hospitals

Industrial Parks

SEZs

Educational Institutions

Offers single window clearance for proposals on FDI in India that are not allowed access through the automatic route

* PE Landscape

- Balance sheet/prop book approach of Investing
  - Large global Banks like Wachovia (Wells Fargo), JPM etc. followed this form of investing resulting in a mix of structured finance and Equity in era of pre global meltdown.
- Real Estate Private Equity Funds
  - FDI Compliant/Domestic Funds which invest in Real Estate Asset class. Investment done on the basis of strength of local partner and the financer act as pure financial investors and play little role in the development of the Asset. AIG, Kotak Realty, HDFC Property Fund, Milestone, Indiareit, Red Fort Capital, Xander, Sun Apollo are some of the examples of India focused Real Estate Private Equity Funds.
- Some of the Global or Regional funds with India Allocation
- Investments done by Goldman, Blackstone, Walton etc.
- Real Estate Development
  - Built development capabilities locally Ascendas, Hines, Tishman
- Sector Agnostic Funds
  - Investment of these funds is not restricted to a particular sector. These funds invest in a sector or a company wherever there is an opportunity. These funds may invest in Real Estate Projects whenever there is an opportunity available. Some of the sector agnostic funds are Carlyle, Baring Private Equity, Citi Venture Capital etc.

* PE Landscape

- Sovereign Wealth Funds and Pension Funds

  These are government backed funds are generally sector agnostic in nature. Some of the Sovereign Wealth Funds are GIC, Temasek, ADIA and QIA, Some of these funds tie up with a regional PE Investor whereas the others may invest directly into Projects

- Real Estate Development Funds (Platform Deals)

  These are platform deals signed between a Global Financial Investor and a regional marquee developer. The funds received by the developer may be used to develop and acquire projects or may be used to invest in third party projects. The advantage of these platform deals are that there are only 2 - 3 parties involved with few restrictions and clarity on investment guidelines on the Fund manager.

  Some of the platform deals which have been signed are –

  a) Affiliates of Shapoorji Pallonji Group with CPPIB

  b) Godrej Properties with APG

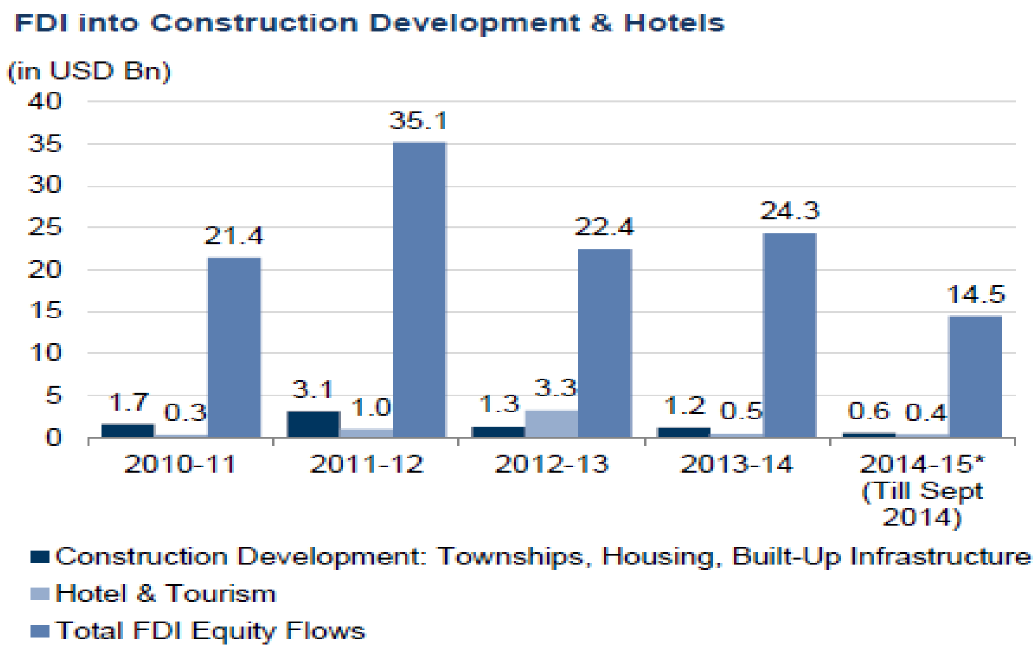
  c) Mahindra Lifespaces with Standard Chartered

  d) Piramal Group with CPPIB

From 2005 onwards, one of the biggest challenge has been that the focused funds providing secondary markets exist never developed.

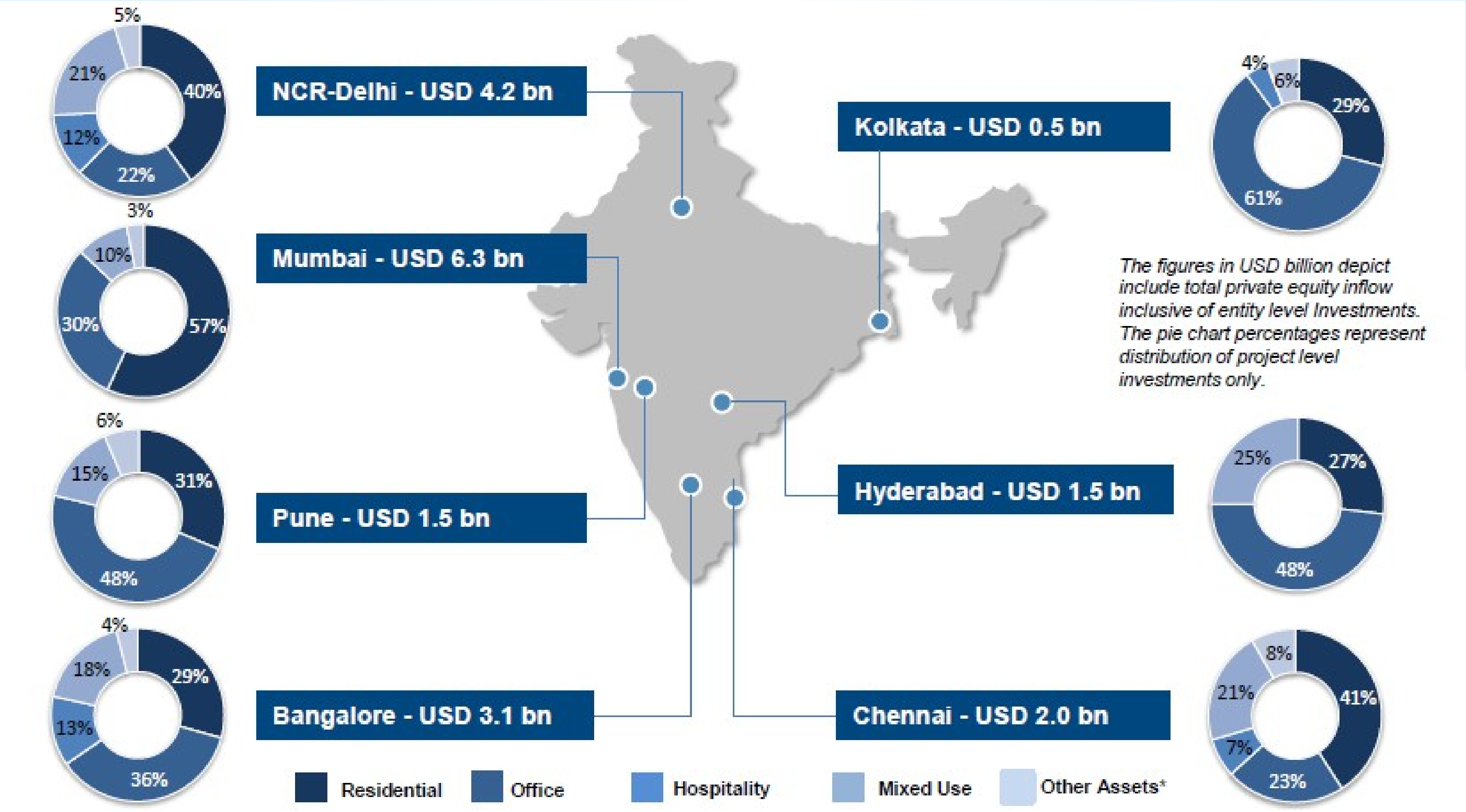
* Private Equity in Indian real estate

- Total Private Equity Investments into construction development sector in India through FDI is USD 23.9 billion.
- The sector ended the year attracting PE investment worth around $1.84 billion spread across 68 deals, against $1.29 billion spread across 45 deals in 2013,
- PE investment in the Indian Real Estate is the highest since 2008. , in the good old days of 2007-08, close to 100 deals were struck two years in succession worth $4-5 billion each.



Source: VC Circle and Brookfield Financial

* PE Investment Spread



Source: Brookfield Financial

* PE Exit in Indian Real Estate

- Of the total institutional PE capital deployed until March 2014, nearly a fifth amounting to USD 6.9 billion has been exited by PE funds.
- As per JLL, returns from Indian Real Estate for Private Equity Investments with vintage of 2006 stand at 1.1 times compared with the global average of 0.86 times.
- Performance in the last six years is even better at 1.34x.
- The residential sector accounted for over 58% of the exits and the office sector 24%.
- 85% of the exits were through Promoter buybacks.
- Some of the Challenges that were witnessed in Private Equity exit are –
- Partner Issues
- PN2 ambiguities
- Unenforceability of put/call options
- Litigation

* Controls, evaluation and management

- Changing mindset of all stake holders
- Project Management
- Addressing delivery bottlenecks
- Preparation of annual business plan highlighting cash flows from various projects
- Accessing different sources of finance to ensure sufficient liquidity and capital in the Project
- Improved transparency, reporting and Corporate Governance

* Future landscape

- Platform level deals with global Institutions- skin in the game
- Enhanced involvement and controls in the decision making by Investors
- Risk mitigation and controls
- Commercial RE investments (core/core plus) - yield generating- Emerging asset class
- Mezzanine finance- continue to be preferred
- ‘Forward purchase’ transactions- largely by domestic funds- wholesaler approach
- Hybrid structures- Debt with Equity kicker
- Focused Funds- Rehab fund/ NCR Fund
- Enhanced focus on asset management
- Shorter cycles- investments in smaller projects
- Research driven approach to investing
- Investments with partners which have demonstrated exits
- Leadership and teams with demonstrated track record
- Emergence of Secondary markets -exits

* **Alternate structures to PE and what do global investors want**

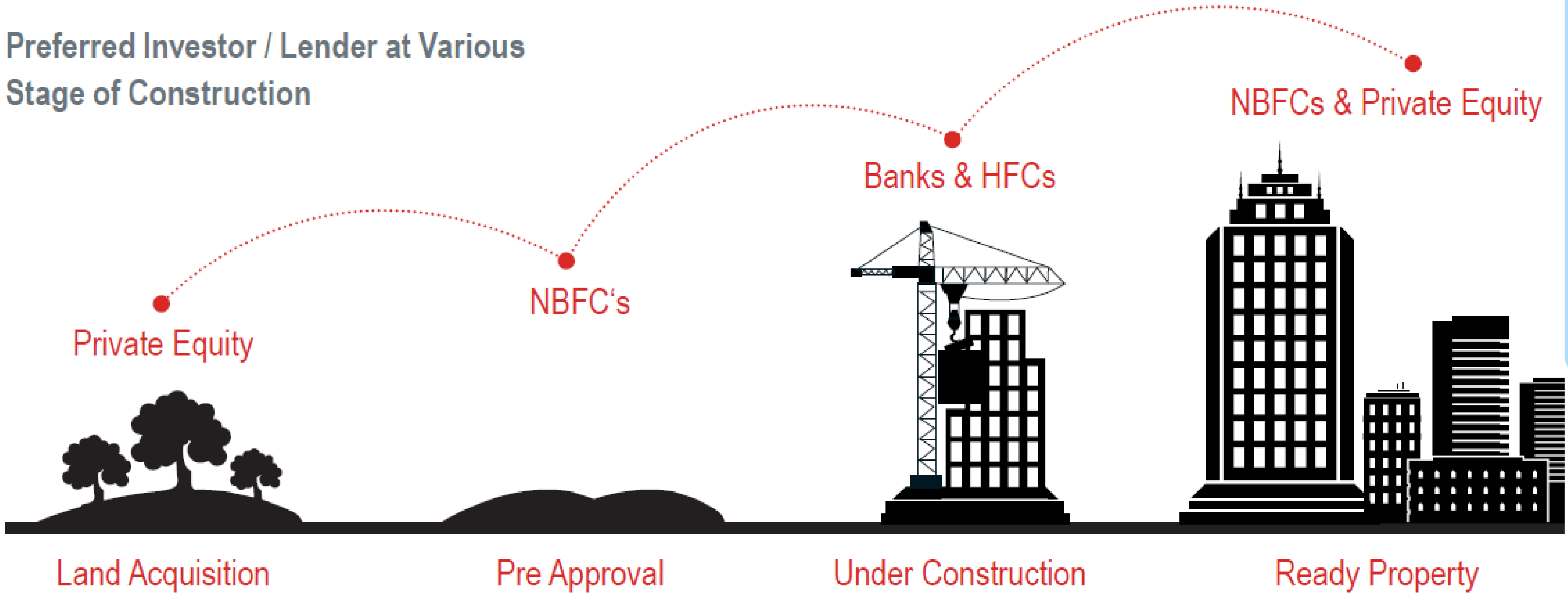
* Type of Structures

* ***Private Equity:*** seeks to invest in high-quality assets in markets or asset classes where it has a competitive or informational advantage.
  * to invest in companies with favorable characteristics, such as businesses who are low cost producers,
  * businesses benefitting from high barriers to entry
  * and businesses with tangible underlying assets
  * to source transactions in favorable sectors
  * In distressed assets and which require restructuring
  * to leverage knowledge in a particular asset class and related operating platforms up and down the value chain
* ***Debt Strategies:*** lending activities include event driven bridge loans and other specialty debt finance solutions
  * bridge loan capital and provide funding for acquisition and growth transactions, buy-outs, leveraging of assets, recapitalizations and refinancing and interim capital solutions.

* Type of Structures

* **Mezzanine Debt**
  * Investing in mezzanine debt that yields attractive risk-adjusted returns.
* **Recapitalizations**
  * Recapitalization opportunities involving highly valued assets financed with excessive leverage that require restructuring or recapitalization.
* **Preferred Equity**
  * Investments in preferred equity investments associated with the acquisition, development and recapitalization of real estate opportunities.

* Sources of Capital- various stages



Source: JLL, REIS & Capital Market Research

* Changing sources of Institutional real estate finance

Major Financing Channels –

Pre-2005	2005-2007	2008-2009	2010-2011	2012-2013
Offshore Listing	**Offshore Listing**	Offshore Listing	Offshore Listing	Offshore Listing
		QIP	QIP	QIP
IPO	**IPO**	IPO	IPO	IPO
	PE Funds	**PE Funds**	PE Funds	**PE Funds**
	ECB	ECB	ECB	ECB
NBFC Lending	NBFC Lending	**NBFC Lending**	**NBFC Lending**	**NBFC Lending**
Bank Lending	Bank Lending	**Bank Lending**	Bank Lending	Bank Lending
Private Lending	Private Lending	**Private Lending**	**Private Lending**	**Private Lending**

Level of Activity | **High** | Average | Low/None

Source: JLL Capital Markets Report

- Financing channels for the real estate sector in India have become limited and expensive
- Bank lending for end-use has been restricted and risk weightage increased by RBI
- Advance Disbursal Facility and 80:20 schemes etc. have been discouraged by RBI
- Developers/land owners are financially stressed due to stretched debt levels, delays in project approvals, diversification in non-core areas etc.

* What happened in PERE- Challenges

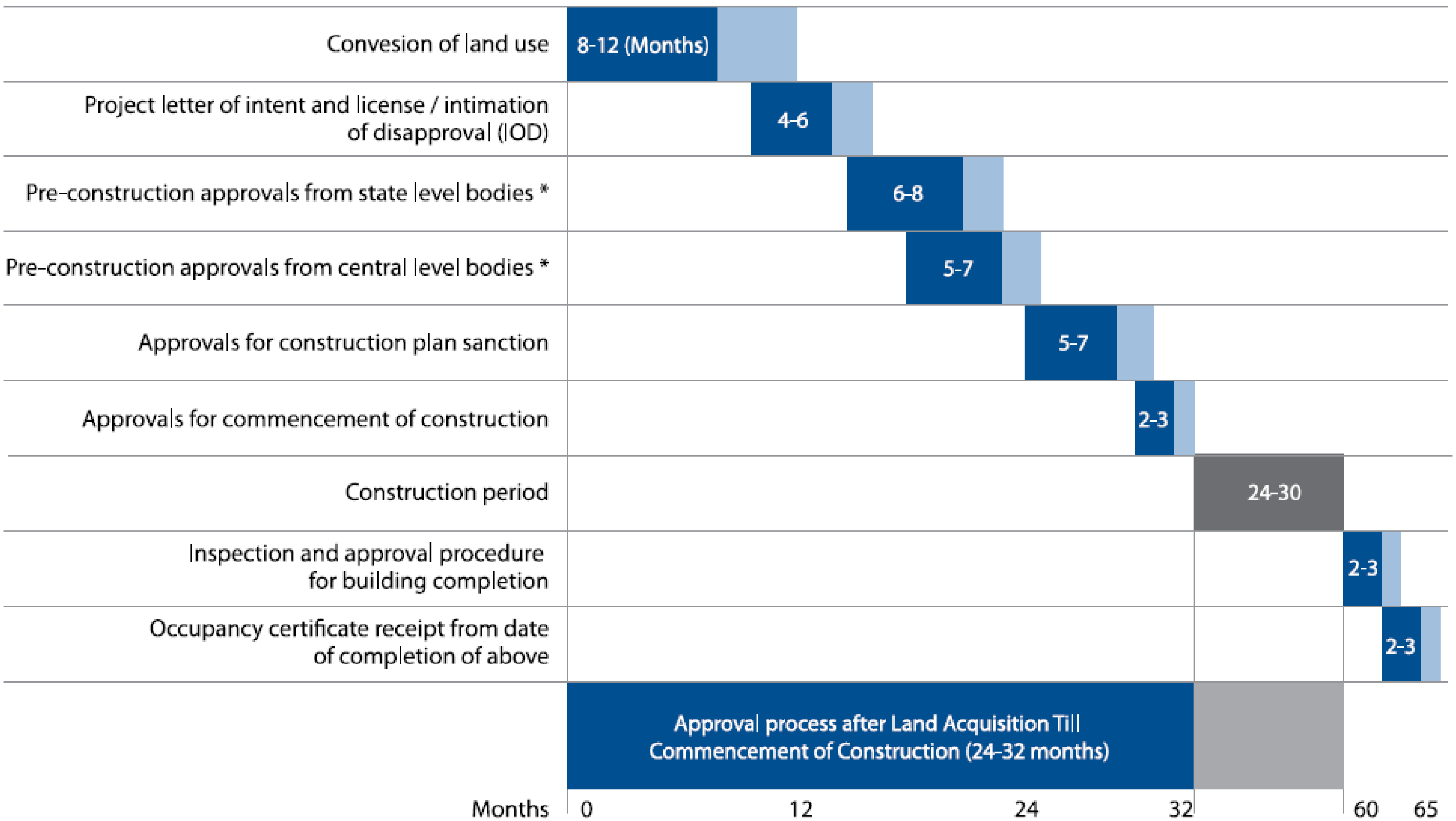
- Approvals have taken a long time resulting in delay of Projects
- Large projects have taken a long time to come to market
- Money has been impatient- the time value of money
- Delay has hurt the bottom line
- Local Partners have valued their existing land bank in excess to the market
- Cash-out to the landholder leaving no skin in the game
- Restricted management bandwidth
- Large Projects have not been very successful
- Funds have been diverted from the project
- Slow sales combined with large capital outlay and fund diversion have made some project financial un-sustainable
- Title insurance

Maturity has emerged in the developer/fund relationship- Views may vary

* Inefficiencies in the process of Project life cycle

What stage does PERE enter?

Figure 6: Approval Process for Real Estate Development in India



Source: CREDAI-Jones Lang LaSalle Real Estate Transparency Survey 2011

What prompted alternative structures in Private Equity

1. Governance

Under pressure from regulators and investors the board of asset management companies and funds have/ask for greater oversight responsibilities than ever. Firms are increasing by responding by rethinking their governance models, increasing executives' and directors' responsibilities.

2. Risk

The financial crisis and its aftermath revealed the true extent of asset managers' are beginning to place more emphasis on emerging investment risk, additionally they are also taking enterprise-wide approach to risk. There is enhanced requirement of Group level data beyond the spv level.

3. Regulatory Complexity

Evaluate the issue of list of approvals required in a real estate project. This issue is further compounded with the element of lack of clarity in certain aspects of FDI regulations.

New regulations are creating complex web of regulations around the globe, just as national regulators step up their scrutiny and enforcement procedures. Firms will want to review the operation, resources and effectiveness of compliance programmes, especially in key risk areas

* What prompted alternative structures in Private Equity

4. Operations and Technology

   Evolving regulatory regimes, combined with greater and more complex transaction structures and volumes, and stretching front, middle and back office systems. Asset managers are implementing a range of initiatives including outsourcing, workflow management and improved data management. The knowledge and learning on the concept of waterfall

5. Global information reporting

   New tax and regulatory requirements, investor expectations, the globalization of AM and mounting product complexity are all increasing information reporting needs. The challenges around on-ground quality data remain, which make the task of AM difficult.

6. Trust and Transparency

Asset managers are finding that greater transparency enhances trust. The change in mindset is required by certain developer/project teams.

7. Strategic M&A

While M&A volumes have failed to meet expectations, asset managers have good strategic reasons for making acquisitions. The M & A and secondary market is virtually non existent.

* What prompted alternative structures in Private Equity

8. Organic Growth

   Growth is struggling against the headwinds of economic uncertainty and market volatility. Future growth will depend largely on execution.

9. Human Capital

   As signs of tentative market recovery continue, asset managers are investing in recruiting and retaining talent

10. Regulations

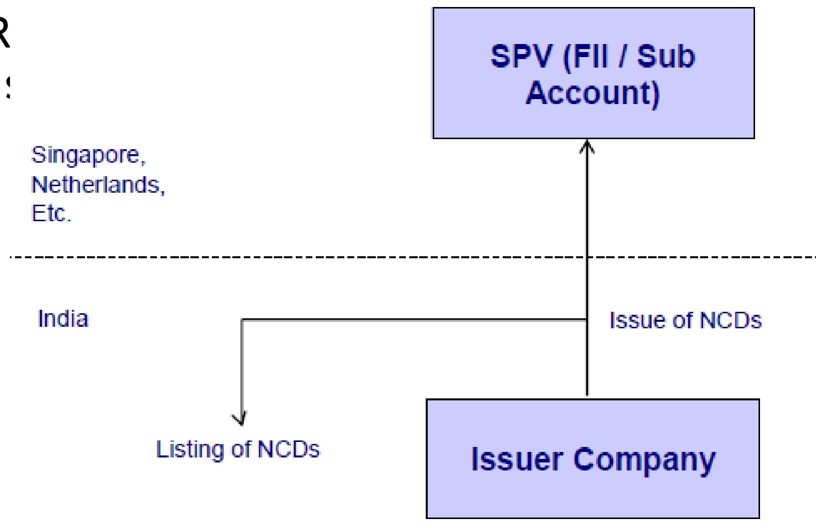
    With the markets becoming more, matured there was certain relaxation of FDI policies. Also listed NCD as a finance option.

* Mezzanine /Structured Debt Financing- An emerging trend

- Mezzanine finance typically is a structured debt-like instrument, earning mid/high yields, through a combination of cash coupon and terminal yield and/or equity linked components, such as warrants and convertibles.
- It bridges the financing gap in a company's capital structure and occupies a place between senior debt and equity, both in security and total returns
- Presently 8 out of 10 deals in real estate finance - through structured finance, as compared to 5 – 6 deals in 2011-2012 and may be 1 out of 10 in 2006- 2007
- The Mezzanine Finance done through CCDs in pre Lehman-era has been replaced with NCDs which provide better security/charge creation. The CCD deals were done with a call/put options where the coupon was serviced regularly and the exit was structured through call option premium (conversion at minimum DCF value).
- Some of the PE players have set up an NBFC arm to undertake mezzanine finance and debt deals.
- Mezzanine funding generally provides for a coupon/preferred return of 19% to 22%. Most transactions provide for a waterfall structure on the Equity component now.
- The collateral backing where finance is done through NCD route is through collateral of land and project receivables along with standard covenants of debt.

* Non Convertible Debentures Issuance Procedures and Regulations

- NCDs are Rupee denominated instruments, hence ECB regulations won't apply as ECB regulations deal with foreign currency
- Issuance of NCDs to any foreign person including an FII would not attract the provisions of Deposit Rules
- No prior approval of RBI is required to remit principal, coupon and redemption premium payments to the FII or sub account which holds the NCDs
- Prior approval of R ments pursuant to the enforcement of the



Investment structure

* Non Convertible Debentures Issuance Procedures and Regulations

- FEMA Issue Regulations allows Permitted Investors* to subscribe to NCDs issued directly by an Indian Company, provided such NCDs are committed to be listed in 15 days of investment
- Permitted Investor is required to immediately dispose of the NCDs by sale to a third party or to the Issuer if the NCDs are not listed within 15 days of issuance
- Issuer required to make certain disclosures in the Information Memorandum to be filed with the stock – exchange along with listing application
- The disclosures to be provided are MOA, AOA, necessary resolutions, audited financials, resolutions related to security creation
- Credit rating from at least one agency registered with SEBI to be obtained - ICRA, CARE, Brickwork
- In-principle and final approval for listing to be obtained from the Stock Exchange
- Trust deed and security documents to be executed and the issuer to maintain 100% asset cover sufficient to discharge the principal amount at all times for NCDs
- Can include all types of securities including immovable properties, movable properties, receivables, cash flows, pledge of shares and other securities
- All such security to be created in favour of Debenture trustee
- No SARFESI protection

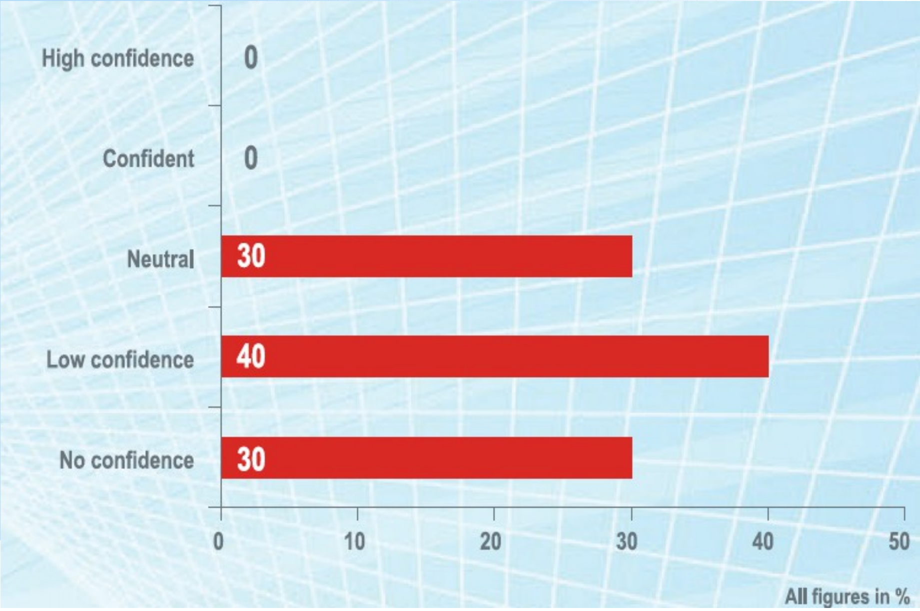
* Non Convertible Debentures and Compulsory Convertible Debentures

Particulars	CCD – FDI	NCD - FPI
Equity Ownership	Initially debt, but equity on conversion	Mere lending rights; however, veto rights can ensure certain degree of control.
ECB Qualification	Assured returns on FDI compliant instruments, or put option granted to an investor, may be construed as ECB.	Purchase of NCDs by the FPI from the Indian company on the floor of the stock exchange is expressly permitted and shall not qualify as ECB.
Coupon Payment	Interest pay out may be limited to SBI PLR + 300 basis points. Interest can be required to accrue and paid only out of free cash flows.	Arm's length interest pay out should be permissible resulting in better tax efficiency. Higher interest on NCDs may be disallowed. Interest can be required to accrue only out of free cash flows. Redemption premium may also be treated as business expense.
Pricing	Internationally accepted pricing methodologies	DCF Valuation not applicable
Security Interest	Creation of security interest is not permissible either on immoveable or movable property	Listed NCDs can be secured (by way of pledge, mortgage of property, hypothecation of receivables etc.) in favor of the debenture trustee who acts for and in the interest of the NCD holders
Sectoral conditionalities	Only permissible for FDI compliant activities	Sectoral restrictions not applicable.
Equity Upside	Investor entitled to equity upside upon conversion.	NCDs are favorable for the borrower to reduce book profits or tax burden. Additionally, redemption premium can be structured to provide equity upside which can be favourable for lender since such premium may be regarded as capital gains which may not be taxed if the investment comes from Singapore.
Administrative expenses	No intermediaries required	NCD listing may cost around INR 10-15 lakh including intermediaries cost. In case of FPI, additional cost will be incurred for registration with the DDP and bidding for debt allocation limits, if required.

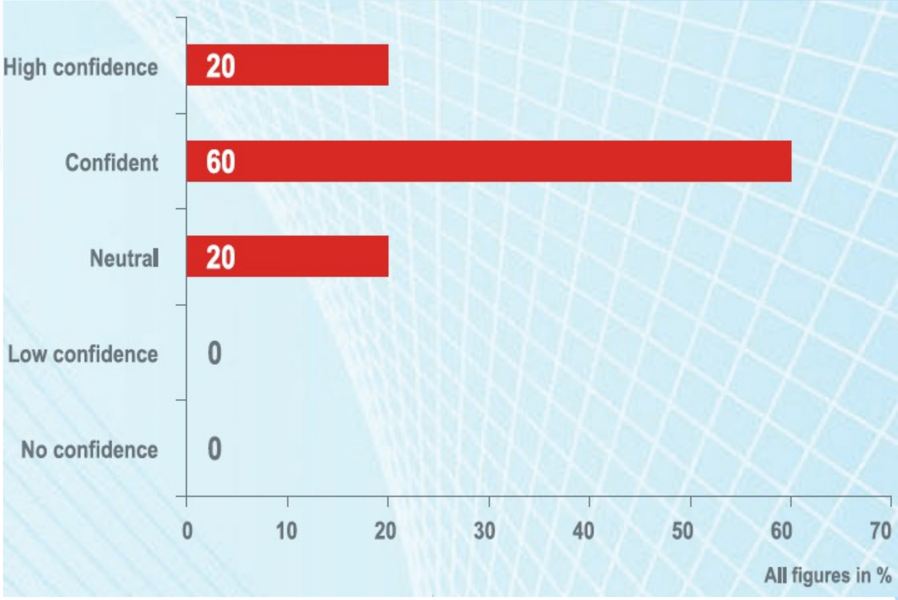
* REIT- An idea whose time has come?

- REITs invest in completed, revenue generating commercial properties and distribute a major portion of the earnings among investors.
- The latest release of draft regulations for setting up REITs in India is one major step by market regulator SEBI to bring high level of maturity into Indian Real Estate
- It is expected that with the opening up of the sector to REITs, there will be increased capital inflows from overseas market
- Of the 375 msf of Grade A office market across top six cities, 80-100 msf could be up for REIT listing once it is introduced. It is also expected that the cap rates will compress by 100 bps to 150 bps.
- REIT has a potential market size of USD 10 -15 Bn in medium term
- REITs bring in increased transparency in the sector by adopting better corporate governance, disclosures and financial transparency practices.
- Current expectations on tax-breaks from the government granting a pass-through tax status for REIT, grey areas continue to exist in terms of stamp duty and capital gains on transfer of asset to REIT, apart from whether DDT will also be waived off.
- Currently most leased assets have LRDs on them, which leaves little for distribution as dividend, and CMBS which is more appropriately suited for leverage in a REIT is still in its infancy in India.

REITs Confidence Index



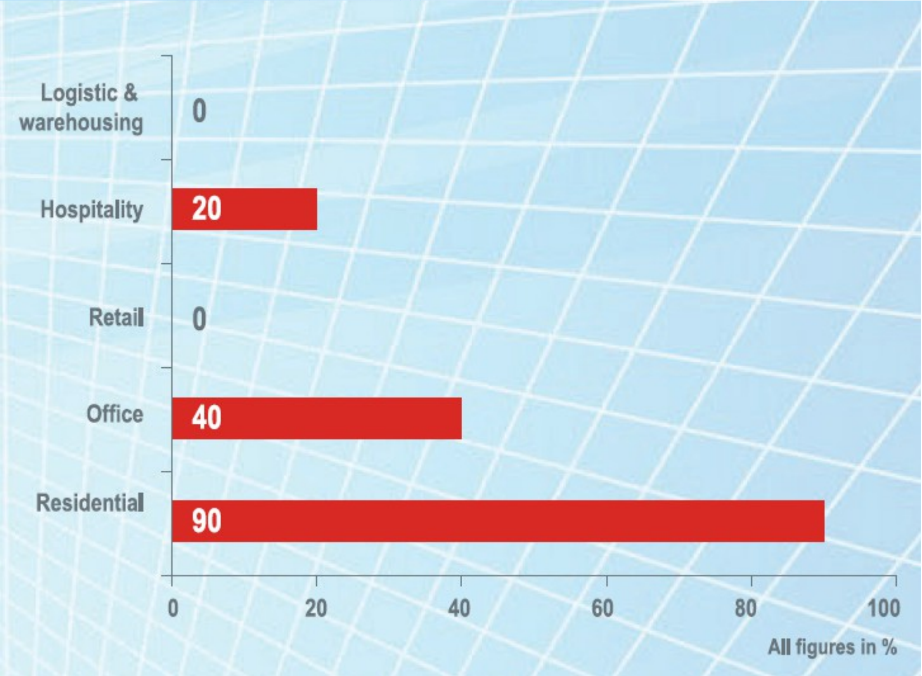
REIT will be a success in short term (next 3 years)

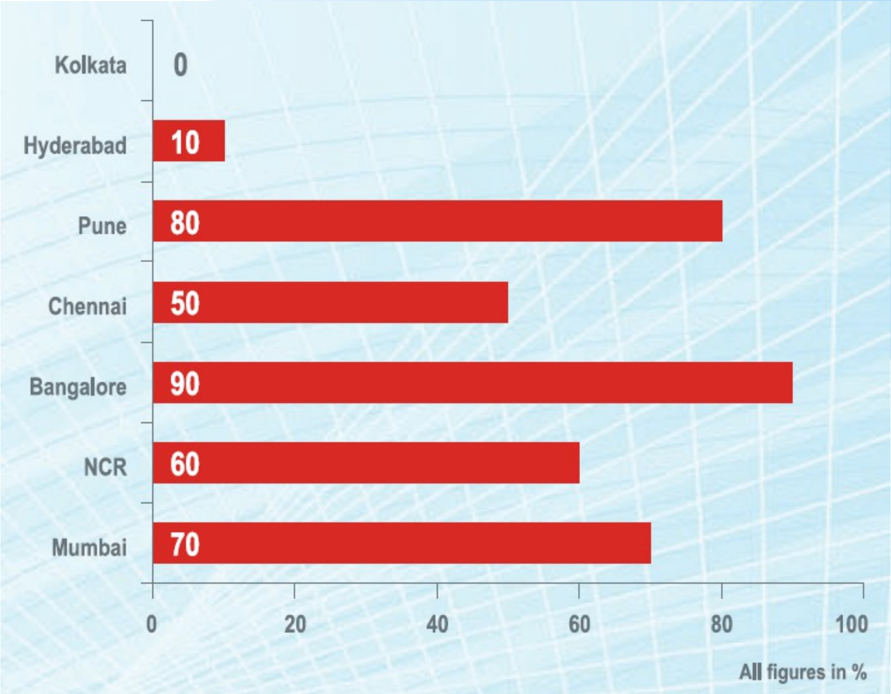


REIT will be a success in long term (next 10 years)

Source: JLL, REIS & Capital Market Research

* Future outlook- asset class and preferred cities





* Future landscape

- Platform level deals with global Institutions- skin in the game
- Enhanced say in the decision making by Investors at platform level
- Risk mitigation and controls
- Commercial real estate investments (core/core plus)
- Mezzanine finance- won't loose flavour
- 'Forward purchase' transactions- largely by domestic funds- wholesaler approach
- Hybrid structures- Debt with Equity kicker
- Focused Funds- Rehab fund/ NCR Fund
- Enhanced focus on asset management
- Shorter cycles- investments in smaller projects
- Research driven approach to investing
- Repeat deals-Investments with partners which have demonstrated exits
- Leadership and teams with demonstrated track record– importance on years of working together as a team
- Emergence of Secondary markets –exits. Will it remain wishlist?

*Thank You