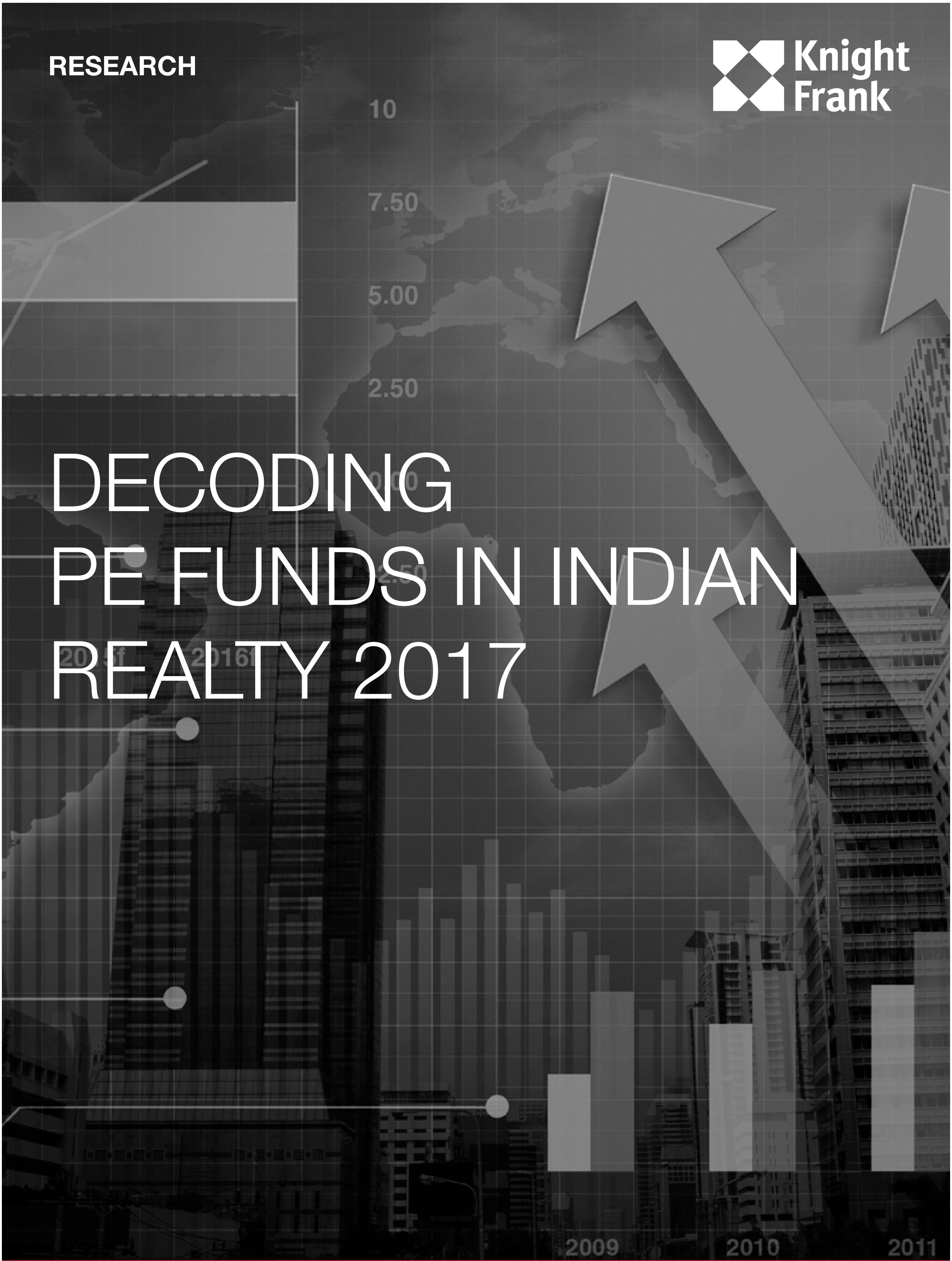
RESEARCH

DECODING PE FUNDS IN INDIAN REALTY 2017



Demystifying the whipped appetite of private equity funds changing the dynamics of the sector

Connecting People & Property, Perfectly.

" PE capital flow into Indian realty is expected to set a new milestone in recent history, estimated to exceed USD 4 bn in 2017. "

OVERVIEW

Private equity (PE) capital comes primarily from institutional investors and accredited investors, who can dedicate substantial sums of money for extended time periods. These include Sovereign Funds, Pension Funds, Pure Private Equity funds and Real Estate Funds. PE has emerged as one of the pillars of the real estate sector in India in recent history.

Delving deeper into the investment patterns reflect that PE contribution in Indian realty had been largely stagnant until 2014. But the thumping mandate for the ruling government brought in a new lease of life. And, it appears that PE-driven investments are likely to end on a record-breaking high note by the end of 2017.

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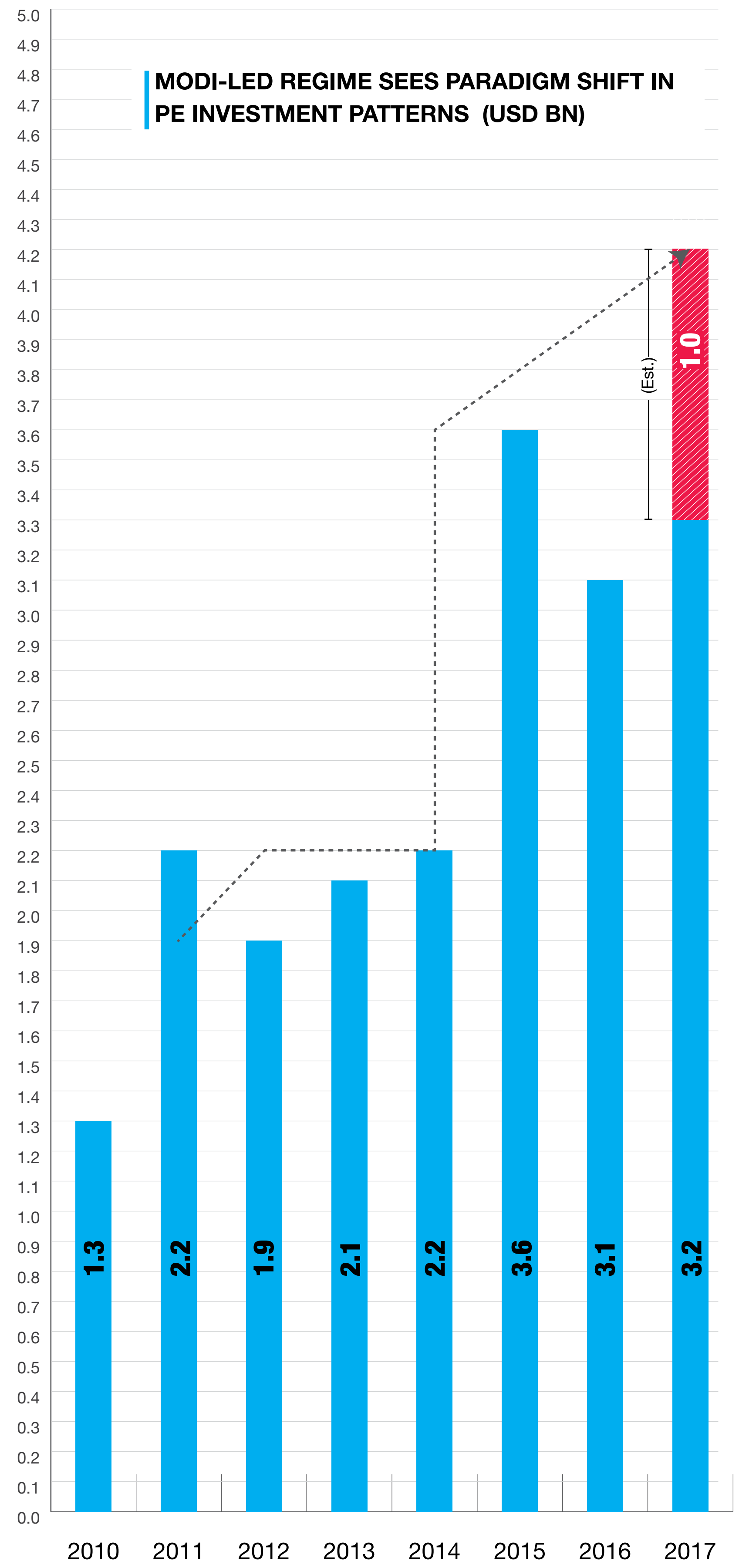
1. BACKDROP

> “After almost half a decade of near-stagnation, private equity investments in Indian real estate picked up a newfound energy with the change in government in 2014.”

MODI-LED REGIME SEES PARADIGM SHIFT IN PE INVESTMENT PATTERNS (USD BN)

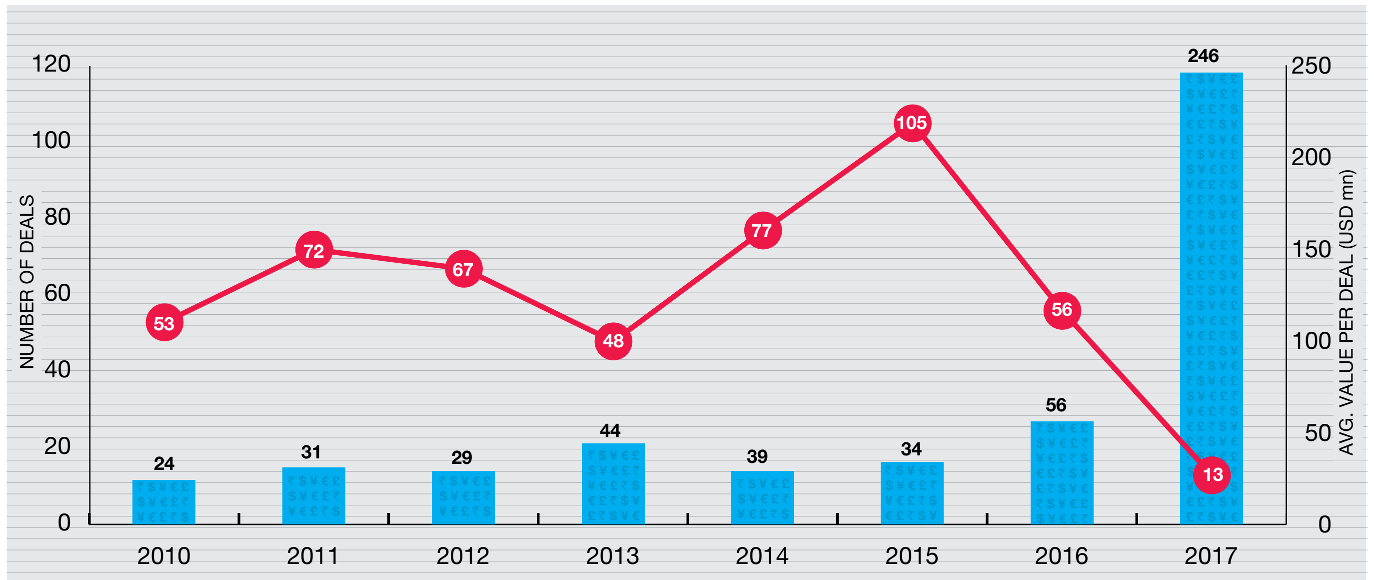


Note: *-Till Sept 15, 2017

Source: VCCEdge, Knight Frank Research

- Private equity investments into Indian real estate had almost stagnated between 2011 and 2014. However, with the new government assuming office in 2014 and the subsequent roll out of a battery of reforms, there has been a paradigm shift in investors’ interest. From an average investment of USD 2.1 bn in 2011-14, capital flows rose by 57% to an average of USD 3.3 bn between January 2015 and mid-September 2017.
- In 2017 the number of deals dwindled to 13, just over one-fourth of the tally in 2010. However, the average investments per deal increased 10-folds to USD 246 mn per deal in same period.
- Bulk of the investments in 2016-17 went into pre-leased properties. Investments into development sites saw a sharp drop courtesy the low risk appetite among investors. Now PE investors are avoiding execution risk, approval risk and marketing risk.
- Some of the biggest path-breaking reforms of independent India became a reality in 2016. The Real Estate (Regulation and Development) Act (RERA) 2016, the Benami Transactions (Prohibition)

AVERAGE INVESTMENTS PER DEAL GOING UP



Source: VCCEdge, Knight Frank Research

Note: *-Till Sept 15, 2017

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Amendment Act, 2016, infrastructure status to affordable housing projects, demonetisation, interest subvention schemes, relaxation of norms to encourage REIT listings and the recently rolled out Goods and Services Tax have collectively set a new order.

- Overall investments in 2016 slipped marginally as the reforms-driven new order pushed all stakeholders into wait and watch mode. Despite the sluggishness the total investments in 2016 was USD 3.1 bn - 48% higher than the average investment of USD 2.1 bn between 2011 and 2014.
- Institutional investors have already smelled the coffee and the positive sentiment is reflecting in the investments this year. The cumulative investments into the Indian real estate since the beginning of 2017 till mid-September 2017 has been higher than the annual investment numbers for the past several years.
- It is pertinent to note that one major deal of USD 1.8 bn significantly altered the investment scenario in 2017. Nonetheless; such deals reflect the remarkable upswing in investors' confidence.
- Private equity investment in 2017 is estimated to exceed USD 4 bn this year, well past the 2015 mark – highest since 2010.

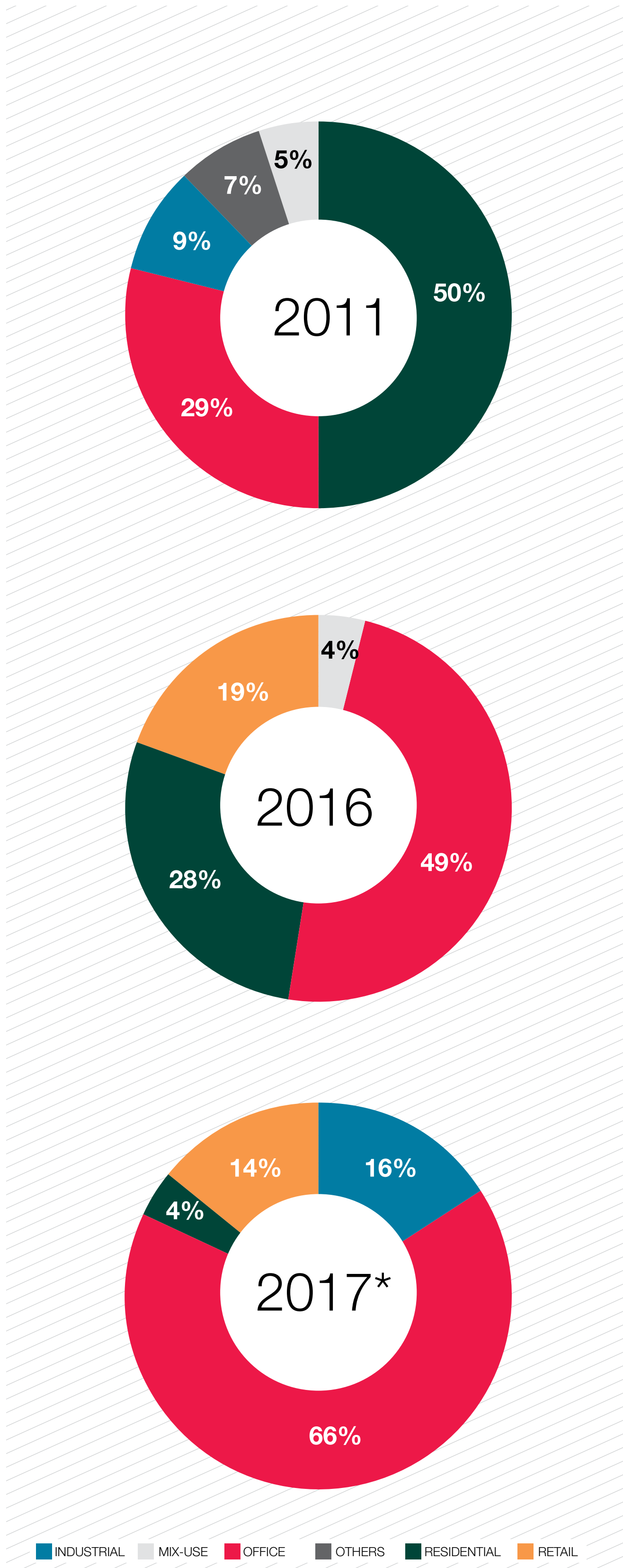
> "From an average investment of USD 2.1 bn in 2011-14 flows rose by 57 % to an average of USD 3.3 bn between 2015 and August 2017."

2. SHIFTING INVESTORS' FOCUS TO PRE-LEASED OFFICE SPACE

66%

of investments went into pre-leased office spaces in 2017*

RENEWED INVESTORS' INTEREST IN WAREHOUSING AND RETAIL



Source: VCCEdge, Knight Frank Research
Note: *-Till Sept 15, 2017

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NOTEWORTHY DEALS IN 2017*

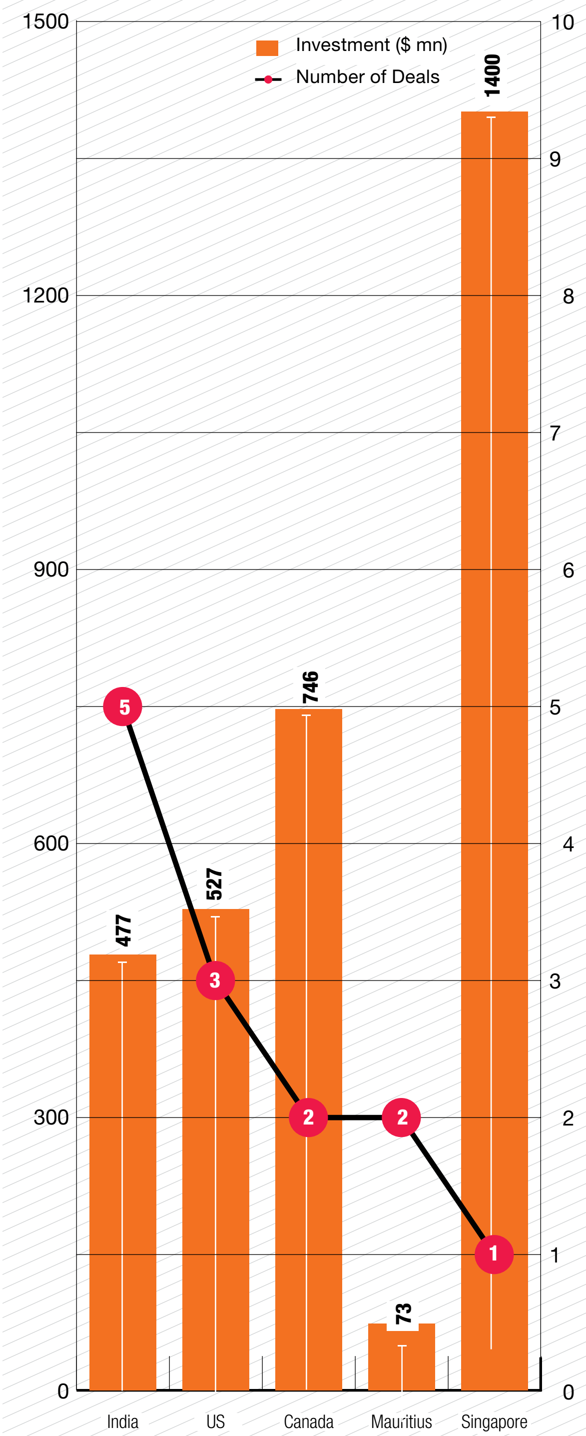
DATE	TARGET	INVESTOR(S)	DEAL VALUE (USD MN)
8-Mar-17	DLF Cyber City Developers Ltd.	GIC Pte. Ltd, others	1,800
15-May-17	Indospace Core	CPP Investment Board	500
8-Feb-17	K Raheja, Commercial Assets	Blackstone Advisors India Pvt. Ltd	300
5-Apr-17	Island Star Mall Developers Pvt. Ltd.	CPP Investment Board	246
9-Feb-17	L and T Seawoods Ltd.	Blackstone Advisors India Pvt. Ltd.	212

Source: VCCEdge, Knight Frank Research
Note: *-Till Sept 15, 2017

- There has been a pragmatic shift in investors' focus towards pre-leased office spaces, industrial/warehousing and retail real estate projects at the cost of residential investments courtesy poor execution, lack of clarity on approvals and appalling returns from residential projects.
- The share of private equity investments into residential projects declined from 50% in 2011 to 28% in 2016 and further dropped to a meager 4% in 2017.
- The office market that accounted for 29% of PE funds in 2011 today stands at almost two-third (66%) of the investments into in the Indian real estate. The noteworthy acquisitions in the office market over the past two years involved some of the major global sovereign and pension funds. The biggest deal was the Government of Singapore's Sovereign Fund's (GIC) investment into the office arm of DLF this year.
- Post 2010, due to failure of some of the major malls across the country, investors had shunned retail assets and the share of retail investments was negligible in 2011. However, stung by poor returns from residential investments and the gradual uptick in consumer activity, investments in retail assets resurfaced. From a negligible number in 2011, PE investments in retail climbed to 19% in 2016 and sustained at 14% in 2017. The most recent investment was by Canada's pension fund - Canada Pension Plan Investment Board (CPPIB) into a subsidiary of Phoenix Mills.
- We are also witnessing an increase in investors' interest in the warehousing space. The share of warehousing in total investments increased from 9% in 2011 to 16% in 2017. The USD 500 mn deal by the pension fund CPPIB in Indospace was one of the noteworthy deals in this asset class.
- Sovereign and pension funds usually enter a market with an investment life span of 10 to 25 years. The spike in interest from this genre of investors reflects a long-term positive sentiment about India's realty growth potential.

3. ORIGIN AND DESTINATION OF FUNDS

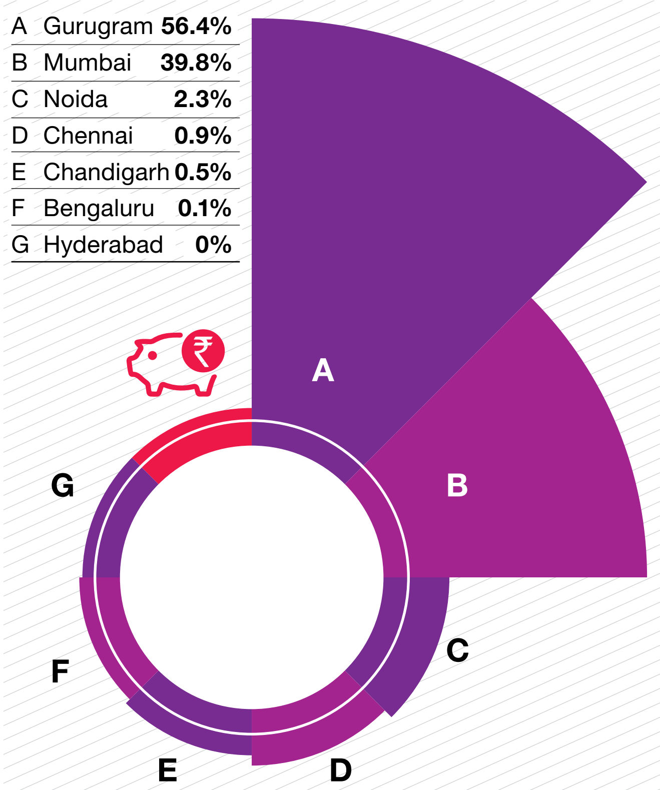
GIC-DLF DEAL MAKES SINGAPORE THE BIGGEST SOURCE OF INSTITUTIONAL FUNDING IN 2017*



Source: VCCEdge, Knight Frank Research
Note- * - Till Sept 15, 2017

- Majority of private equity investors in 2017 are domestic investors followed by investors from USA and Canada.
- Canada followed Singapore in investment made per deal.
- Gurugram attracted 56.4% of total investments in real estate.

GURUGRAM ATTRACTS MAXIMUM INVESTMENT FOLLOWED BY MUMBAI IN 2017*



Source: VCCEdge, Knight Frank Research

96%

Gurugram and Mumbai collectively command 96% of the PE investment pie in the Indian real estate in 2017*

"Big boost for India's strong economic fundamentals as more than 70% of the PE capital contributors in 2017 were long-term sovereign and pension funds."

"Investors tread cautiously; investments into development sites dry up, bulk of capital flows veer towards pre-leased properties."

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INVESTMENTS CLASSIFIED BY INVESTOR TYPE 2017*

INVESTOR TYPE	ASSET CLASS	INVESTMENT (USD MN)
Pension fund	Retail	246
	Industrial/warehousing	500
	Sub-total	746
Private equity	Office	700
	Residential	59
	Retail	212
	Mixed use	15
	Sub-total	972
Real estate fund	Office	25
	Residential	81
	Sub-total	106
Sovereign fund	Office	1,400

Source: VCCEdge, Knight Frank Research
Note- * - Till Sept 15,2017

- Sovereign and pension funds emerged as the biggest investors accounting around 70% of the total investments in 2017. Sovereign funds invested in the office market while pension funds were split between retail and industrial/warehousing assets.
- Pure private equity funds have invested across office and retail assets with some investments in residential and mixed use projects. Blackstone has emerged as one of the biggest office space landlords in India. It had recently acquired L&T Seawood's retail assets and commercial assets of K Raheja Corp in deals over USD 200 mn each.
- Real estate funds have majorly invested into residential projects and select office projects. The most recent office investment by a real estate fund was - Milestone Commercial Advantage Fund's USD 25 mn investment in the Kharadi Information Technology Business Park.

4. OUTLOOK

RESIDENTIAL

The residential sector has been facing immense challenges in attracting institutional investment over the past few years owing to the lack of transparency, delay in approvals and poor accountability of developers, which has led to indefinite delay in delivery of projects. The indefinite delay had caused humungous losses to consumers and investors.

- The scenario is likely to change with RERA being implemented across several states and Goods and Services Tax (GST) now implemented. RERA would bring in accountability and transparency thereby minimizing the scope for delay in delivery of projects. With GST, everyone involved in the supply chain of real estate development, from material suppliers to contractors to developers, would have to shift to an organized model.
- These reforms would streamline the construction sector ensuring only reputed developers with a good track record of delivery combined with sound financials remain in the market.

> “RERA-shielded residential markets to whip up appetite for private equity financing as funding from customer advances come under scanner.”

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- In addition to this, the government's thrust on affordable housing by providing infrastructure status to affordable housing projects, interest subsidy scheme under Pradhan Mantri Awas Yojna (PMAY) coupled with now functional RERA and GST would make the residential sector appealing to investors and buyers alike.
- With the change in regulatory environment minimizing the risk associated with development projects, it would only be a matter of time before investors start flocking this sector again. We also envision tremendous potential in the residential sector to attract funds in the affordable housing projects.
- There has been 2 major fund raising planned in the affordable housing segment by domestic companies –
    - Kotak Realty Fund looking to raise USD 100 mn and Brick Eagle planning to raise USD 110 mn to invest in projects in the affordable housing segment.
- In the RERA-era now, the need for private equity financing would accentuate considering that developers can no longer rely on customer advances for funding pre-launch stage of projects (land acquisition and regulatory approvals). Further, utilization of customer payments linked to construction progress would translate into stretched working capital requirement for projects with low sales velocity. This shall also supplement the need for such funding.

OFFICE AND RETAIL

Office and retail assets are not just being absorbed by global investors, even domestic investors are joining the bandwagon.

- According to recent reports and fund raising plan announcements, domestic institutional investors are raising money to invest into pre-leased commercial assets in India.
- Some of the recent announcements include –
    - ICICI Prudential AMC, Indiabulls Asset Management, Milestone Capital advisors in talks to raise INR 1000 crore each to invest into pre-leased commercial assets.
    - Large land parcel of Dhirubhai Ambani Knowledge Centre (DAKC) in Navi Mumbai (133 acres) has attracted very strong interest from institutional investors and developers alike for mixed development projects. Some of the renowned names include Brookfield, Blackstone, LnT, Hiranandani, RMZ and Ascendas.
    - Blackstone is in talks to acquire the First International Financial Centre (FIFC) Tower in Mumbai's business district Bandra-Kurla Complex for USD 135 mn.
    - Phoneix mills is buying back stake worth USD 215 mn from its early equity investors. Going forward, pick up in management buying back stakes from early investors would lead to increase in churning of investors' and provide confidence about exit opportunities. This would lead to greater confidence while investing in this sector.

WAREHOUSING/INDUSTRIAL

The global sovereign and pension funds are not just settling for office and retail assets in India but are scouting for warehousing opportunities in India. The government has planned dedicated freight corridors, industrial corridors, manufacturing corridors, multi-modal logistics hubs and intends to invest over USD 30 bn in developing them. In addition, with the biggest tax reform Goods and Services Tax (GST) now implemented, the logistics industry of India would undergo unprecedented transformation and we would see more institutional investments coming into the warehousing space.

- Some of the recent major announcement by institutional investors in warehousing space include-
    - Ascendas-Singbridge JV plans to invest USD 500 mn for developing warehouses in India.
    - Warburg Pincus-backed ESR is planning to invest USD 100 mn annually to develop organic warehousing assets.

> “Big ticket investments on the cards for affordable housing projects with already about USD 130 mn in the pipeline to milk the government-backed initiative.”

5. GOING FORWARD

We foresee a revival of private equity investments into the residential sector. Capital flows are projected to bolster into two key genres - affordable housing space and financing of projects at the pre-construction stage (land acquisition to approvals).

Despite office markets and a few retail markets performing well in recent years, the investors would eschew risks and prefer acquiring pre-leased office and retail spaces over investing into development of new office and retail spaces.

The warehousing space would start attracting significant amount of investors' interest in both – new developments as well as acquisition of pre-leased or ready to move in assets.

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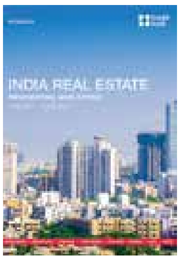

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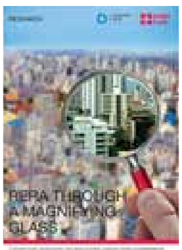

RERA through a magnifying glass

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