

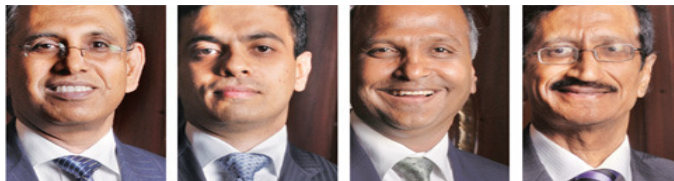
We don't see any fire sale

Experts discuss the problems being faced by the realty sector as sales dip and banks turn cautious in lending

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Madhurima Nandy, Khushboo Narayan & Anup Roy

Mumbai: Home sales are dipping leading to a pile up of inventories while debt levels of real estate developers have been on the rise. On top of that, banks have turned cautious after the suspected involvement of realty firms in the bribe-for-loan scam in November and the second-generation (2G) spectrum scam.



Photos by Abhijit Bhatlekar/Mint

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BA PRABHAKAR
Executive director, Bank of India

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GAGAN BANGA
CEO, IFSL

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LALIT KUMAR JAIN
President, Credai

Open to lending... but a Lavasa or an Adarsh creates a thought whether my money is safe or not.

RK BAKSHI
Executive director, Bank of Baroda

B.A. Prabhakar, executive director, Bank of India; S. Srinivasan, chief executive, **Kotak Realty Fund**; Lalit Kumar Jain, president, Confederation of Real Estate Developers Association of India (Credai); Gagan Banga, chief executive, **Indiabulls Financial Services Ltd** (IFSL); V. Srinivasa Rangan,

executive director, Housing Development Finance Corp. Ltd; Sanjay Dutt, chief executive-business, **Jones Lang LaSalle India** (JLLI), and R.K. Bakshi, executive director, Bank of Baroda debated on "innovative financing options to drive growth in real estate" at *Mint's* Clarity Through Debate in Mumbai last week.

Mint's deputy managing editor Tamal Bandyopadhyay moderated the discussion.

Edited excerpts:

On banks' reluctance to extend money to real estate developers

Prabhakar: In this sector, we have to balance the regulatory and the commercial aspects of lending. When you finance a project, you can't be certain of a title of a property, or other clearances. Another concern is that in any project, equity of developers is very low. With the organized players, the due diligence becomes easier; but with the unorganized players, it is difficult. Banks are financing viable projects but the expectations of the sector from banks are very high.

Srinivasan: The mess that we are in is a systemic issue. The problem that a developer faces is of approvals, and this is an issue straight out of the government. We can't computerize our land records because the political will is not there.

Jain: Out of the 30 loans sanctioned in the bribe-for-loans scam, only three loans were for the real estate segment. Even in the 2G scam, there are other companies involved, besides real estate firms. It has become a fashion to blame real estate.



About 99% of genuine buyers are in tier II and (tier)III cities, where there is no selling to investors. Mumbai and Delhi contribute only 4% to the entire real estate sector.

Banga: Is the money of bankers safe? It's a function of viability of projects and developers. One understands that real estate development has been slightly undisciplined, diverting money meant for construction finance to buy land. But it's also true that real estate bashing has become fashionable. But policy has to come around and the only thing plaguing the sector is the lack of a regulator.

Rangan: The sector needs to be understood in a different perspective because it is a sensitive sector along with capital markets. Regulatory impositions on the sector are very high. We need to differentiate between long-term and short-term requirements of funding. Transparency is also an issue...

Dutt: It is a growing sector. Go back to the 1970s in Delhi, Mumbai and Bangalore and there were a few developers who built the central business districts. New players have come in and not all of them have been following the path they should have. Developers entered into sectors that are not of core competence...

Bakshi: I fully agree on the growth of tier II and III cities in India and we are very open to lending. We treat real estate funding as project funding. But banks, of late, are lending increasingly for home loans. It's not that we are funding projects only at mature stages, but we are also funding at inception stage. But a Lavasa or an Adarsh creates a thought whether my money is safe or not.

On fear of defaults:

Bakshi: We have seen over expansion. It happens as builders go abroad or into any property market and pricing bubbles get formed and it doesn't phase out. There is a lot of commercial real estate which is lying vacant now in many of the cities. We have not seen any default happening, but the fact that a lot of commercial spaces, not getting taken up...definitely proves that there are incidents of default.

Prabhakar: There will not be NPAs (non-performing assets) right now. But we are seeing stresses in the sector. The customers will try to re-finance through some other informal markets. They will borrow at high rates of interest from other finance companies...

Jain: No real estate developer can go bad unless it's a blunder or some kind of conscious mistake. Real estate loans are the safest and the banks earn their maximum profit through real estate funding. If industry can roll over finance in times of stress, can't the real estate developers do the same? Real estate offers two times minimum security by mortgaging property. Even during the worst phase of 2008 and today you have not got any report of real estate default. Why is there a fear psychosis...

Srinivasan: From our point of view, stress in the system is good as it helps us put out capital. There is stress in the system without a doubt. We have funded and part of the reason that they have borrowed from us at a higher cost is that they can keep their accounts clean with the banks. Today if a developer comes to me, my job is to charge a Shylockian rate and I am able to get it because rest of the organized system is not

providing that capital. There is no need for us to take risk when I can get equity returns by lending money which is what I have been doing in the last 12 months.

Banga: This is a cyclical business and cyclicity is countered by ensuring that there is enough equity. Real estate is also a very thinly capitalized business. Private equity (PE) money which was supposed to be coming in to provide capital is now being tempted for equity returns on lending money. So there is no equity being provided for the business and if there is no equity in a cyclical business there is bound to be stress. It is obvious to have stress if the home sales are dipping, cash flows are bound to be affected but there are credible builders who have not leveraged three or four times.

Rangan: Stress in the system is there but we have not seen any specific kind of stress and the reason is that we have been very selective in terms of funding. I think the stress factor is more in the areas of SEZ (special economic zone) and commercial projects built for IT and malls. There are quite a lot of space that was constructed for malls which has remained unoccupied and, therefore, the stress. However, we are seeing enough growth in residential space.

Dutt: There is a lot of stress and many developers have wound up. Many entered the real estate sector from infrastructure and power background thinking that they would make millions through SEZ. There is pain but developers have been able to keep their nose clean by selling all the land parcels that they acquired. They are fortunate that the Indian economy is growing and they were able to find buyers for the land parcels and were able to reduce their exposure. If we look back, almost \$25 billion was raised whether through IPO or AIMS (London's Alternative Investment Market) listing or PE. However, there are just handful of four exits that these investors have made. There is definitely a concern.

On innovative options before developers for funding

Srinivasan: All sources of capital have dried up but we forget that India is a very high savings economy—about 37% of GDP (gross domestic product) and bulk of it is going to bank deposits and a small majority is going to insurance and pension funds. But with new pension plans and the insurance agency focusing on endowment policies as opposed to ULIP (unit-linked insurance plan) policies, greater amounts of money will go into these two categories of investments.



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Photos by Abhijit Bhatlekar/Mint

The total savings pool in the economy over the next 15 years could be \$600 billion. Customer behaviour may change and they may not put money in banks and may directly buy real estate but the managers of these pools of capital would potentially have no choice but to invest in real estate.

Jain: After the 2008 meltdown,

good times came back and liquidity was created through sales and now few markets are very good and very robust. The developers are selling their properties and inviting partners. We are seeing consolidation.

Dutt: Some of the big developers are shaving off their portfolio. If you look at the conventional real estate development business, the focus is now on residential properties. Unless the product is aligned with the market, and I hope they do, the money is going to come from the retail buyer.

Banga: Capital will chase balance sheets which have been managed well. Both equity and debt are available. One trend that I see is that while there will be an odd land deal between developers, joint development is the way forward. NBFCs (non-banking financial company) will happily do a lease rent discounting at 12-12.5%.

Prabhakar: The developers and builders will have to bring in higher equity than what is being done now. The efficiency of the capital has to increase. The stock is relatively high and I think the turnover has to go up—when the builders do not have so much equity what is the reason for them to sit on stock? They should respond to the market...We have done deals at 11% also. It is wrong to say that banks are charging excessively for the sector.

Bakshi: Banks have to set their internal limit. We are continuously funding projects, particularly in tier II and tier III towns as well as in bigger cities. Money will come to any balance sheet that has a sensible leverage and that has not shown any runaway greed and big land banks in any remote areas with the hope that they can be priced up. Money will clearly come from equity—whether of the promoters or the private equity, home owners and bankers are always there to fill in the gaps.

Rangan: At the project or SPV (special purpose vehicle) level, there is enough amount of money that keeps coming either in the form of private equity or structured financing or in the form of senior debt from the bankers and others. But if one is looking at the holding company level, raising equity or debt becomes more difficult. People have to get more comfortable at the SPV level.

Banga: The only innovation required as far as financing is concerned is focus on cash flow. Cash flow is the only long-term financing solution available...

On outlook on property prices

Srinivasan: You are not going to see price correction. You might see people coming and negotiating one-on-one basis but a price correction in a city like Mumbai happens through sheer passage of time. If a developer is quoting price today at Rs 25,000 per sq. ft, he will continue to quote the same price next year too...

Dutt: By August-September, there will be a steady rise in property prices largely backed by two things, a strong demand and also liquidity. There is enough wealth in the system...

Banga: Micro markets will react differently. For instance, Mumbai will react very differently from the rest of the country. We are a country with 8% inflation and 10% interest rate. Which means, if the prices do not rise a year, actually they are down.

Rangan: I don't see a fire sale happening. In some of the micro markets like NCR (National Capital Region) a lot of developers are offering a subvention scheme where they share the

interest cost for the first two years or 18 months, till the property is handed over to the customers. In the commercial side, the prices are slightly going up in terms of the rental value. This is because there has been no fresh supply...

Jain: I don't support any action of developers who unnecessarily speculate or jack up prices. Having said this, today in Mumbai flats are being sold in most areas wherever there are prices below Rs10,000 per sq. ft. Buyers are not buying because interest rates have gone up from 8.5% to 10.5% and they are fearing that it will further go up.

Besides, when a buyer does not buy, he does not buy at any price.

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