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MILESTONE PRIVATE EQUITY

Connect

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Foreword

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Executive Vice Chairman

Dear Friends and Associates

First of all, let me begin by wishing you a very Happy New Year.

The year 2016 has been a highly eventful year for real estate as various policies with far reaching implications such as RERA, GST and the much debated demonetization were introduced. Over the mid to long term, these measures will bring a fundamental change in how business is conducted in this sector.

In the midst of these changes, we continue to perform quite satisfactorily, with over Rs. 650 crores returned to investors in 2016. We have consolidated our position amongst the best performing PERE managers in India having **returned more than Rs. 3,800 crores** to our investors across funds.

After a fairly long period of consolidation, the commercial real estate is seeing an upward trajectory. I strongly believe that investment in commercial real estate will generate good returns in light of bottomed out capital values and increasing rentals. Further, with low supply of Grade - A commercial spaces, in the last few years, the demand – supply mismatch is likely to rise. Hence, rentals are likely to increase steadily, leading to attractive capital gains in the next 4 - 5 years. With BFSI, e-commerce, manufacturing leading the economic growth, Mumbai, is one of the exciting markets to watch out for. **I expect strong demand and capital appreciation in Mumbai especially for Grade-A commercial assets.**

Milestone being pioneers in the private REIT space, has not only successfully managed about 13 Grade-A properties, but also exited all investments at IRRs between 15-18% p.a. Leveraging our expertise, we have launched our 4th Private REIT like fund and we expect achieve our first close soon for the same. Given the low returns on traditional yield products, I strongly believe that commercial real estate investments is a compelling investment choice especially in light of increased absorption and favourable outlook for Grade A properties. This can further become attractive if the budget provides incentives for developers in the form of exemption from capital gain tax on listing on REITs. In case of GST, allowing developers to avail input tax credit against final demand shall also aid the developers in this tough market scenario.

On the residential side, the last year has seen reduction in new launches across geographies as developers have focused on completion and delivery of projects on hand. In the immediate aftermath of demonetization, a drop in residential sales across cities has also been witnessed and this has accentuated the subdued demand scenario. However, **on the expectations of rate cuts and likely SOPs in the budget, we may see renewed interest amongst the home buyers.** Enhanced tax deduction limit for home loans, and increasing the income threshold for various tax slabs shall increase the disposable income and boost consumer sentiment for house purchases.

Deal structuring in the recent past has mainly centered on mezzanine & structured debt to developers. Going forward, given the falling interest rate regime, high yield debt products will cease to excite developers. We have had a good experience in debt products for residential assets as we introduced such structures six years back and over the period have returned over 20% IRR p.a. across these investments. In my opinion, PE players will have to revisit the drawing board to change the nature of their participation in real estate and will need to take quasi equity positions or pure equity positions to achieve targeted returns. Such transactions, however, shall primarily, be with developers with a strong track record of execution and timely repayment to investors. To ensure risk mitigation, funds will need to be more hands-on in respect of their knowledge of micro markets, project development, leasing and tenant management, property management as well as statutory approvals and processes.

In addition, we are seeing higher interest from global institutional players for alternate real estate asset classes such as industrial estates, industrial parks and warehousing. With impetus being provided through initiatives such as Make in India, Ease of Doing Responsible Business, GST, etc these asset classes could provide steady yields. Entry pricing in industrial real estate is competitive presently and hence should provide good medium to long term returns. Milestone was one of the early movers in organized warehousing and we will continue to take exposure in warehousing while bringing in the corporate culture to establish large format multi-discipline integrated logistics parks. Apart from pure investing, we shall also participate in the warehousing development process, working alongside developers as knowledge partners. With our full cycle exposure and in house team strength, we expect to clock increased returns in this asset class.

From a macro perspective, India saw over USD 5.6 billion being invested through PERE in 2016 of which approx. USD 3.4 billion was invested into residential and the rest into commercial assets. With an increasing economic momentum, attractive real estate pricing available, increased transparency in real estate transactions and positive expectations from the upcoming Union Budget for the sector, real estate will continue to remain a preferred asset class over years to come.

VIEW OF FUND MANAGER: COMMERCIAL REAL ESTATE

"Pre-leased commercial properties – a compelling investment choice"

Office markets across top 6 cities (Mumbai, Pune, Bengaluru, Chennai, Hyderabad and NCR region) of India have performed exceedingly well in 2016 despite major uncertainties due to Brexit, US elections and slowdown in IT/ITES spending by Europe and USA. This year saw 40.6 Mn sq ft of transactions, which was marginally lower last year. Though demand for office spaces was much higher in 2016 but due to shortage of good quality spaces in prime locations, many occupiers had to either delay or curtail their leasable area. Additionally, there was a dip in the new supply that entered these top six cities during 2016. Vacancy levels, which had peaked in 2012 has been seen huge improvement and is the lowest in recent history at 13%. For cities like Bengaluru and Pune the vacancy is at 6% and 8% respectively. Demonetization drive announced last year, has certainly been one of the major reforms impacting the real estate space and have a positive impact in the coming years such as fall in interest rates, increased transparency in the sector which will make easier for MNCs and Global tenants to absorb more commercial offices. Some expected delays in completion of under construction projects will further boost rentals across completed assets.

Milestone, buoyant on the growth opportunities in Commercial Real Estate in India in the coming years, is raising its 4th Private-REIT like fund, Milestone Commercial Advantage Fund (MCAF), focused on investing into pre-leased commercial office/ITES assets in top 6 cities of India. In a falling interest rate environment, where other financial products show signs of volatility, investment in pre-leased Commercial Asset will provide stable returns in the form of regular quarterly returns (from the rental income received from tenants and balance amount (capital + gains) on exit from the Property. Our experience with three such funds so far has been rewarding for our investors where we could exit from all the past 13 investments made.

VIEW OF FUND MANAGER: RESIDENTIAL REAL ESTATE

"Residential Real Estate to witness consolidation in near future"

The recent demonetization move by the government, albeit a great one to shake up & stabilize the flow of money in the Indian ecosystem, has also led to a high level on uncertainty in the real estate markets. To meet these challenges and requirements of the new regulations by RERA, etc., developers will need to necessarily up their game and maintain high degree of corporate governance and customer satisfaction For the medium term, this shall lead to industry level consolidation with developers having a solid execution record becoming market leaders. These developers shall be the ones having institutional backing enabling them to recover faster from the current slump in business.

Government focus to ensure housing for all has made affordable housing an area of significant interest to developers and institutions alike. Success of affordable housing hinges on meeting strict development timelines and controlling costs. Developers with the requisite execution expertise and ability to quickly churn projects will be partners of choice for funds to enter into affordable housing. We are looking to partner with such developers to participate in and realize the vision of Housing for All.

In the last quarter, we have exited from our investment with the ATS Group, Greater Noida and provided 23% returns to our investors. This exit continues to showcases our strategy of partnering with developers with strong execution capability for mid segment residential projects.

OFFICE RENTAL VALUE INDEX INDICATING COMPELLING OPPORTUNITY

Mumbai commercial rental value way below its previous peak providing a great investment opportunity.

REIS3Q16	RENTS DECLINING		DECLINE SLOWING	RENTS RECOVERING					Renta Value Index
	2008	2009	2010	2011	2012	2013	2014	2015	3Q16
Bangalore	-0.9%	-17.7%	3.3%	10.8%	5.3%	-0.6%	0.8%	6.8%	115.8
Mumbai City	-3.6%	-34.3%	0.8%	1.1%	0.8%	0.5%	0.2%	-1.6%	61.8
Delhi City	-3.8%	-41.6%	2.2%	3.2%	1.3%	0.0%	0.0%	0.5%	58.8
Mumbai Suburbs	-7.0%	-34.3%	0.0%	7.4%	1.1%	2.1%	0.6%	3.0%	76.9
Gurgaon (Prime)	1.6%	-31.1%	2.8%	11.8%	5.7%	5.0%	1.0%	2.8%	86.1
Gurgaon (Office Prime)	-15.0%	-38.2%	-2.4%	9.8%	4.4%	2.1%	0.7%	0.0%	71.8
Noida	-3.2%	-16.6%	-9.0%	3.3%	2.7%	3.6%	0.2%	4.3%	84.4
Chennai	-0.6%	-22.4%	0.0%	6.4%	4.9%	4.4%	0.6%	3.5%	98.3
Pune	-5.1%	-20.7%	0.0%	3.4%	7.3%	6.8%	1.8%	10.6%	98.2
Hyderabad	3.1%	-14.0%	0.0%	4.1%	5.1%	1.1%	1.1%	4.6%	94.5
Kolkata	9.3%	-27.3%	0.0%	5.7%	8.2%	-0.3%	-0.5%	3.4%	77.2

Source: Real Estate Intelligence Service (JLL), 3Q 2016. Base for indexing – Rental levels of 3Q 2008 Note– Mumbai City includes CBD, SBD Central, SBD BKC and SBD North. Mumbai Suburbs includes Eastern and Western Suburbs. Delhi City includes CBD and SBD of Delhi

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