



Home / RealtyCheck / Rubi Arya



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Pre-leased commercial properties: Compelling investment choice

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Pre-leased Commercial Real Estate (CRE) has been increasingly becoming one of the attractive investment opportunities in India over the last 12-18 months. Large private equity funds both foreign and domestic, sovereign wealth funds, family offices, UHNIs have been very actively investing in this asset class. Especially in an era post the demonetization drive, where the returns on fixed income products like G-secs, bonds, bank deposits are witnessing a declining trend, CRE is an attractive investment opportunity that can provide stabilized returns with appreciation on exit.

Investment into pre-leased CRE are low to medium risk investments with debt-like returns during the investment holding period with an equity upside on exit from these investments. As CRE investments are income generating from day one, the owner enjoys debt-like returns during the asset holding period. These returns range between 8.5%-9.5% p.a. to begin with and gradually improve on account of rent escalations, which is typically 5% on year or 15% after 3 years. These are stabilized returns due to lease tenures typically in the range of 3-15 years.

On exit the owner of CRE would earn equity upside with capital appreciation being earned on the escalated rent as well as on yield compression in an interest falling scenario over the asset holding period. Hence the investors can make around 16-18% p.a. returns from such investment opportunity. These can be bettered further in case some of

the asset acquisitions can be structured through a combination of leverage through lease rental discounting available from banks and financial institutions and equity investment by the asset owner.

Attractive opportunities within the CRE space are available for investment. In bigger cities like Mumbai, Bangalore where capital values are higher in CBD locations as compared to other micro markets, opportunities like part asset purchase are also available in addition to buying entire asset. In terms of tenant profile, a diversified tenant mix from sectors IT/ITES, BFSI, Pharma, Manufacturing, E Commerce etc which provide the owner portfolio balance and diversity. Also with positive macro economic factors along with regulatory initiatives by the Government of India, the demand from various sectors for additional space is bound to increase thereby having a positive impact in CRE valuations.

Given that CRE investments need huge capital, investors prefer investing through a pooling vehicle like a private equity fund. With this, investors get benefits like diversification in terms of asset, developer and geography apart from better due diligence, low overhead costs, collective negotiation, lower entry cost, active control and asset management, which cannot be availed through direct investments.

Our experience with three such funds so far has been rewarding for investors and us because of these benefits of collective investment. The current market is even more conducive for such investments and that's the reason our efforts to raise 4th private REIT-like fund focused on investing into pre-leased Commercial Real Estate in India's top 6 cities is receiving good traction.

The key factors driving such investments into CRE are obvious as office space demand is growing at a robust pace, vacancy levels going down and rising rentals. 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 and capital appreciation with yields compression.

With investment in completed Commercial Assets, there are no risks associated with Land, Project Approvals and Constructions delays. Regulatory initiatives including GST, RERA, REITs as well as demonetization will result into higher transparency that would further boost the commercial space demand and therefore makes a compelling investment choice.

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About Rubi Arya

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