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How realty funds are creating new sub-asset class underwriting apartments in bulk

BY SWET SARIKA

At least half a dozen realty funds are deploying or have earmarked a part of their existing or upcoming funds for buying apartments in bulk.

Move aside real estate brokers, a new beast is in town to snap up residential apartments in bulk at the time of official launch and possibly even before a formal launch. Real estate dedicated private equity funds, which have typically invested in specific projects through debt or direct equity stake in project level special purpose vehicles, have found a new sub set for investments owning a piece of the property itself.

Indeed, such investments are not new.

Brokers and high net-worth private investors have long bought apartments in bulk. They have also been blamed for pushing up prices through the practice. Entry of realty fund in the bulk-buying spot makes it a more institutionalised way of underwriting an under-construction project.

Experts tracking the space say that it is a new chapter in the evolution of deal making and diversifies product range of structured finance market in real estate. "Bulk buying is another variant among other financial instruments like structured debt, mezzanine, etc," said Vinit Deo, managing director, Posiview Consulting Partners, a real estate advisory firm which recently worked on exit of ASK Property from Liviano, a project by Darode Jog Properties in Pune.

Who is doing it

While Piramal Fund Management has just launched a dedicated fund for the purpose under Indiareit Apartment Fund and aiming at Rs 700 crore corpus, at least half a dozen peers are deploying or have earmarked a part of their existing or upcoming funds for this investment segment, sources told VCCircle.

At the time of launch of the fund, Khushru Jijina, managing director at Piramal Fund Management, had said, "The trend of buying houses in bulk has been there for years but restricted to HNIs. Being an institution, we purchase in bulk and enter an agreement with the developer where he will sell our apartments in a proportion to his after a stipulated time."

According to the arrangement, the fund will buy the apartments at a discount of approximately 25 per cent and hold the asset for a period of two-three years.

Segregated Funds Group, the investment arm of the consultancy firm Jones Lang LaSalle India, is launching its second residential fund with a target corpus of Rs 500 crore, of which a good portion of the money will be used to underwrite inventory.

"The proposition looks attractive as we expect inventory to move fast now. This will constitute an important theme of our upcoming fund," said Mridul Upreti, CEO, Segregated Funds Group.

Milestone Capital is sealing a deal with Assotech wherein the fund will underwrite a portion of under-construction project Breeze. Sources in the know of the development say that the arrangement mandates the developer to offload its units in proportion to the inventory of the fund. The spokesperson of Milestone did not confirm the structure of the deal.

Market sources also indicate that a realty fund associated with a large conglomerate has bought 15-20 apartments from a Mumbai-based developer for Rs 70 crore. In another transaction, a fund associated with a diversified financial services firm has sealed a similar deal, sources said.

Investment thesis & risk mitigation

The investment model is fairly simple. Fund managers seal deals with developers to purchase or underwrite inventory in under construction projects at a deep discount, with a view to clock appreciation-linked returns when prices appreciate.

Developers get an assured off-take for the project and do not have to deal with as many investment covenants as a conventional PE deal.

"The disbursement of capital could be upfront or linked to construction of the project depending on the clauses of the term sheet," said Nipun Khandelwal, head, real estate advisory at Capstar, the investment banking arm of Essel Finance which has worked on a dozen deals in the past two years.

The investors on the other hand get real assets on its books akin to a share of a public listed firm which provides more flexible liquidity option against a restrictive case of either a buyback by the developer or finding another realty investor to sell stake in SPV level investments. The funds can either let the developer sell it after a period of time or can offload it through their own channel partners.

“When funds invest through debt, which is the case in most of the transactions these days, the return is fixed and based on minimum selling price and in case of equity at SPV level, it is dependent on the overall performance of the project,” said Sunil Jain, partner, Sprout Capital Advisors LLP, which recently advised Shriram Properties on its fundraising from Tata Opportunities Fund.

In the case of bulk buying, the responsibility is restricted to a certain portion of the asset and hence if a part of the project does not find buyers, the investor may not be affected at all, depending on the deal structuring.

This means going a step beyond the traditional investment stage. Previously, there has been a shift in preference from putting in capital at land acquisition level to under construction projects with all approvals in place. And now, it has come to bulk buying which is a step further in de-risking the process.

“As against a typical SPV level investment, one has to work only on execution of project. If parameters like reputation of the developer and location of the project are taken care of, it substantially reduces risk factor,” said Nitin Goel, partner – real estate investments, Milestone Capital Advisors.

While the clauses for this structure are still on drawing board, in some cases the developers are offering buyback options to address the concern of non-execution. “We are working on framing the clauses in such a way that it offers fall back options in terms of personal and corporate guarantee, mortgaged backed securities and buyback options,” he added.

The clauses could also include penalties for not executing the project.

Why now?

A host of considerations emanating from both fund managers and developers has given birth to this concept. Chief among them, on the developer side, is the pressing concern of piling up inventory on the back of slow sales. Muted sales from end users, as a result of slowdown in the economy in the past two-three years, are forcing realtors to find an option to offload the inventory.

“Realtors are offering apartments to funds at a deep discount in exchange of equity-like money which they can use for land purchase or other projects,” said Khandelwal. “Also, this kind of capital does not figure as equity or debt on the book of the project, which seems to have struck a chord,” he added.

Fund managers think prices of apartments will appreciate going ahead, which has become a major factor for them to back this structure. It is also expected that inventory will start moving due to improving market condition. Besides, there is a wave of positive sentiment in the market, post the formation of BJP-led government.

On the flip side

One big risk factor embedded in these deals is security. A leading Mumbai-based fund manager, who did not wish to be named, says "It does not make sense to invest in a project which is backed by some other fund and does not offer security in terms of land mortgage."

"On the security front, it looks like a very risky proposition," he added.

Another fund manager says such deals are nothing but a way to bail out developers who are sitting on unsold inventory.

Globally buying foreclosed properties in bulk or REO assets had gained traction after the housing markets crash following the sub-prime crisis in the US. In some cases the PE funds also converted such properties into a rental asset leasing to individuals.

In India, such distressed asset sales are yet to get institutionalised with PE funds as buyers. However, with funds moving in to own real assets at an initial stage it would create a platform for more diverse set of investment channels in the future.