PE Investors Welcome SC Ruling on Int'l Arbitration Orders p4

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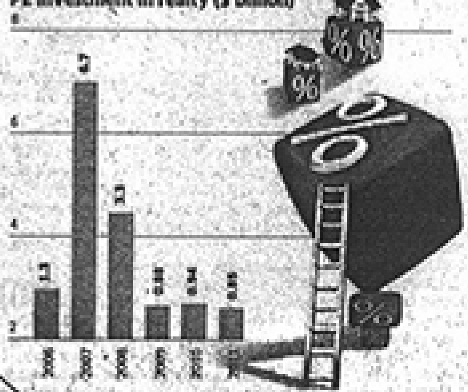
Seven Lessons Realty Players Picked Up from the Slowdown

As reality bites, cos make significant changes to their business models to tackle high debt burden & demand slump

Small is Beautiful

	LAST ONE YEAR'S REVENUE GROWTH (%)	DEBT EQUITY RATIO	INTEREST COVERAGE RATIO	LAST ONE YEAR'S STOCK RETURN
Large Players				
DLF	-5.98	0.65	1.58	-2.84
Unitech	-24.05	0.19	7.59	-30.38
HDIL	-11.64	0.15	2.34	-33.75
Omaxe	16.97	0.36	1.6	8.7
Smaller Regional Players				
Sobha Developers	14.54	0.01	3.73	46.65
Puravankara Projects	36.3	0.35	1.96	-7.56
Kolte Patil Developers	34.06	0.03	7.65	4.02
Thakkers Developers	7.38	0.87	8.4	17.39

PE investment in realty ($ billion)



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The recent economic slowdown has hurt the real estate sector, with the five largest firms seeing a 75% erosion in their combined market capitalisation. Burdened with debt and struggling with poor growth, companies have made significant changes in their business models and strategy. Here are seven lessons they have learnt.

FORGET NATIONAL, STAY LOCAL
Pan-India expansion plans of developers like DLF, Unitech and Indiabull Real Estate have been undermined by highly-leveraged balance sheets, high borrowing costs and slower execution. DLF still earns almost 30% of its revenues from Gurgaon despite its presence in over 20 cities. It recently sold prime land in Mumbai to cut down debt. Godrej Properties, despite the pedigree of a large business group, earns 60-70% of its revenues from Mumbai and Ahmedabad, even though it has projects in 12 cities.

THE SMALLER, THE BETTER
Small regional players like Thakker Developers, Kolte Patil Developers, Puravankara Projects, Sobha Developers and Oberoi Realty have better balance sheets than larger peers. Their stocks have also fared better.

FROM RAISING FUNDS FOR GROWTH TO SURVIVAL
Before the slowdown, realty firms had plenty of easy money. And they used it to grow. Not any more. In the peak of real estate boom in 2008, PE funds invested $6.8 billion in real estate which dried up to $0.85 billion in 2011, as per a report by Jones Lang Lasalle on decoding private equity real estate exits in India. Attempts by Raheja Universal and Lodha Developers to go public were upset by poor stock market response, making PE funds unsure of exit opportunities.

DLF is raising funds by selling non-core assets, Godrej Properties raised funds through a QIP and HDIL is generating funds by selling transfer of development rights (TDR) and floor space index (FSI) — all to lighten the debt burden. Earlier, companies were building land banks and were rewarded for it in the stock market. Now, they are conserving cash to payback creditors.

SOUTHERN MARKETS FARE BETTER
Led by Bangalore and Chennai, realty prices in south Indian cities have remained relatively stable compared to Delhi and Mumbai. The prices in these markets had not soared as much as markets like Delhi and Mumbai. Consequently, south India-based developers like Sobha Developers, Prestige Estates, Puravankara Projects performed better in the last 2-3 quarters compared to other companies such as DLF, HDIL and Godrej Properties. While the BSE Realty Index shed 14.5% in the past six months, the Bangalore-based Sobha Developers and Prestige Estates, the only gainers in the index, logged gains of 22% each.

RE-EMERGENCE OF PARTNERSHIP MODEL
Realty developers are going back to the partnership model — developing property jointly with the landowner. This, according to Anshuman Magazine, chairman and managing director (South Asia), CB Richard Ellis, was always around. However, during the boom period, ambitious developers started buying land and developing projects on their own.

Now, partnerships are back. Godrej Properties, for example, trades at a premium valuation compared to other large multi-city developers due to its asset-light partnership model.

COMMERCIAL PROJECTS TURNED INTO RESIDENTIAL
Commercial property market has been hit more than residential property due to slowdown in industrial growth. Surplus commercial realty space has also put pressure on lease rentals.

In an earnings conference after its June quarter results, the management of Godrej Properties admitted that commercial projects in Tier-II cities have been negatively impacted by escalation in construction cost and weak demand for commercial real estate. The company is now keen to sell these projects at the earliest and has decided to avoid new commercial developments.

Some developers like Sunil Mantri Realty have scrapped plans to develop commercial projects. The company is instead proposing to develop a residential project at its site at Parel. "Excess supply scenario in the commercial segment and possibility of better liquidity in a residential project has prompted us to change our decision," Sunil Mantri, CMD, Sunil Mantri Realty, had told ET in November last year.

FORGET RETAIL, STICK TO REALTY
Wadhavan Group, that owns HDIL, ventured into retailing through food & grocery store chain Spinach. But it has shut down its stores by 2010. Similarly, in 2009 Indiabulls Real Estate wrote off its entire investment in its retail arm, which it took over from the Piramals during the retail boom in December 2007. Some realty firms are building malls, but staying out running retail businesses.

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HIGH RISE Lack of good property in prime locations push up rentals

Rentals, Value of Offices at BKC, Lower Parel may Rise by 20%

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Rentals and capital value of prime office buildings at Bandra-Kurla Complex (BKC) and Lower Parel in Mumbai could rise 8-20% over the next year and a half, according to property consultant Jones Lang LaSalle India. Although the office space vacancy level in the city is high at 19% — a sign of a slowdown in the real estate market — rentals in Bandra-Kurla Complex and Lower Parel areas continue to rise for want of good property in prime locations, a press release issued by the property consultant said.

> Corporate tenants, who need to relocate, expand or downsize, are still scouting for good offices

According to the consultancy, corporate tenants, who need to relocate, expand, consolidate or downsize, are still scouting for good-quality offices in Mumbai's central and secondary business district areas. Property owners in other areas and those with lower quality buildings are using incentives such as rent-free periods, lower deposits and investment in property improvement as tools to retain buyer interest, the consultancy added.

"Landlords are extremely keen to protect their base headline rents, and freebies allow them to sustain tenant demand and to prevent vacuums within their portfolios even if the effective rentals are down," said Ramesh Nair, MD, west, Jones Lang LaSalle India.

"However, with the dwindling supply of quality office space, developers holding prime assets may steadily cut down on value-added incentives over the coming months," Nair added. According to Jones Lang LaSalle India, commercial space vacancy in the central secondary business district, with sub-markets such as Lower Parel, is 24%. And the vacancy level for good-quality and non-IT office space is only 5%. In the Andheri and western suburbs' micro-market, the overall vacancy is about 23% but the same for prime office space is only about 10%. While properties in western suburbs are witnessing interest from sectors such as pharmaceuticals, media, logistics, manufacturing and FMCG, a challenge before occupiers is that most of the office development over the past few years, has been in the form of IT parks.

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