SECTOR UPDATE

HOT PROPERTY

Stressed realty fund succour for beleaguered sector

India Equity Research | Real Estate

The Union Cabinet has approved last-mile funding support to stalled realty projects through an alternative investment fund (AIF) structure. This will boost sentiments, kick-start liquidity flow and provide relief to home buyers, developers & real estate financiers. What's more enthusing is the widened scope: 1) expanded beyond affordable segment to include units with ticket size up to INR10-20mn (benefitting 1,600 stalled projects with 0.46mn units); 2) providing relief, where it's needed the most, by including projects that are NPAs or under NCLT proceedings; and 3) enhancing corpus size to at least INR250bn. While clearly a succour during testing times, successful implementation will require close coordination between all stakeholders. Based on our interactions with market participants, we believe, the fund can address half of the stalled units. While a positive outcome can bring incremental supply equivalent to six months of all India sales into the system, we believe industry consolidation and market share gains for organised developers will continue. Resolving stalled units' issues will be structurally positive for real estate-heavy NBFCs and banks.

Government gets cracking to resolve realty mess

Following up on its earlier announcement in September 2019, the government has announced setting up of an AIF with ~INR250bn corpus to revive stalled housing projects. While the government will provide ~INR100bn funds, balance will be provided by SBI, LIC and other prospective investors. In a departure from previous stance, now projects which are NPAs or under NCLT proceedings (but not announced as liquidation worthy) will also be eligible for relief from this fund. The project funding will be construction-linked under the scheme.

Projects need to satisfy certain eligibility conditions

In order to get relief under this scheme, a project should be: a) net worth positive i.e., cash flows should exceed project cost; b) an affordable or mid-income project; c) should be an on-going project registered with RERA; d) referenced by an existing lender; and e) ticket size should be up to INR20mn in Mumbai, INR15mn in NCR, Chennai, Kolkata, Pune, Hyderabad & Bengaluru and INR10mn in other cities.

Outlook: Much needed step

As highlighted in our comprehensive sector report, ***Real Estate - The Charge of the Consolidating Brigade***, liquidity crisis has accelerated the realty slowdown in India. By providing last-mile funding, AIF will aid project completion, providing relief to homebuyers, lenders and to the larger economy in general. We believe this decision will boost confidence and help kick-start liquidity flow into the sector. Though this decision has the potential to release incremental supply from currently stalled projects, we believe consolidation in the realty space will continue due to structural developments like RERA. Hence, we continue to prefer Godrej Properties (**BUY**), Sobha (**BUY**) and Brigade Enterprises (**BUY**).

Parvez Akhtar Qazi
+91 22 4063 5405
parvez.qazi@edelweissfin.com

Kunal Shah
+91 22 4040 7579
kunal.shah@edelweissfin.com

Prakhar Agarwal
+91 22 6620 3076
prakhar.agarwal@edelweissfin.com

Archit Ranka
+91 22 4063 5523
archit.ranka@edelweissfin.com

November 7, 2019

AIF announced to resolve stalled projects' issue

The Union Cabinet has approved establishment of a 'Special Window' to provide priority debt financing for the completion of stalled housing projects in affordable and mid-income categories. The government will act as the sponsor and will commit INR100bn funds. SBI, LIC and prospective investors (including sovereign wealth funds, public & private banks, domestic pension & provident funds, global pension funds and other institutional investors) will pool another ~INR150bn.

The funds will be set up as Category-II AIFs registered with SEBI and will be entrusted to professional investment managers.

The AIF will provide last-mile to stalled housing projects, enabling their completion and consequently ensure delivery of homes to a large number of home buyers. It will release funds to developers in stages through an escrow account, which can only be utilised for completion of a project, not for repaying dues of existing lenders to the project.

As per the government, 1,600 projects, with 0.46mn housing units are stalled in the country. As per media reports, ~INR3.5tn has been invested in these stalled projects and ~INR550-800bn investment is needed to complete them.

Significant changes from earlier announcement

The government had announced its intention to set up an INR200bn stressed realty fund for stalled projects in September 2019. It had then stipulated following conditions for projects to be eligible for relief:

- The projects should be in affordable or mid-income category.
- 60% of construction work should have been completed.
- The projects should not be an NPA or in NCLT.

As per the new announcement, a couple of significant changes have been made. The eligibility criteria now include:

- The project should be in affordable or mid-income category.
- It should be an on-going project registered with RERA.
- It should have been referenced by existing lenders.
- Ticket size should be up to INR20mn in Mumbai, INR15mn in Delhi-NCR, Chennai, Kolkata, Pune, Hyderabad & Bengaluru and up to INR10mn in other cities.
- It will also include projects classified as NPA or where NCLT proceedings have already started (but only if the project has not been announced as liquidation worthy).
- The project should have a positive net worth i.e., its cash flows should exceed project cost. As a matter of clarity, a net worth positive project/tower is different from a net worth positive company. For instance, if a project has three towers with the first tower being 70% complete, second tower being 50% complete and construction of third tower yet to start, money will be given to first tower, maybe for second tower, but not for the third tower. The company's financial status will not be considered in such cases.

We believe, the inclusion of projects which are NPA or under NCLT proceedings will widen the scope of the fund.

Rigorous selection process for projects

The AIFs will be set up as priority debt funds. A detailed investment policy will be laid down for selection of projects to be financed through a rigorous due-diligence process that will include legal due diligence, title due diligence, micro-market analysis, financial analysis, etc.

The final decision will be taken by the investment committee of each fund comprising experienced professionals and industry experts. The investment committee will approve individual deals independently as per the investment policy, ensuring alignment with investment objectives of the fund.

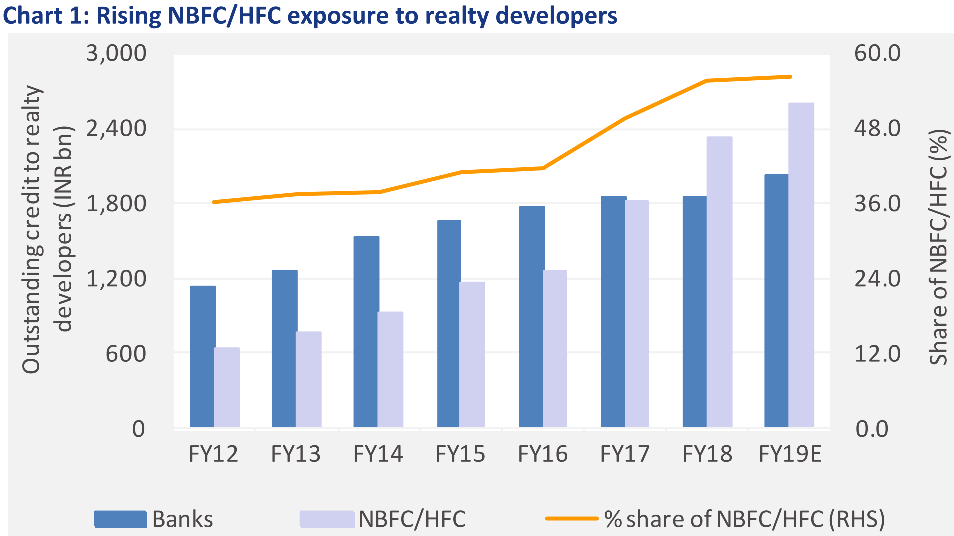
Oversight of the investment process will be done by an advisory board (on conflict of interest issues). A governing council may also be formed for overall strategic guidance.

The investment manager will be responsible of ensuring that the funds are used only for construction through appropriate safeguards mandated by RERA and also through deployment of external project monitoring agencies.

Funding relief for sector struggling with liquidity

Singed by rising stressed assets, incremental bank funding to commercial real estate (CRE) developers has reduced to a trickle over the past few years. In such a scenario, NBFCs had emerged saviours for developers by taking up the mantle to meet the latter's funding requirement.

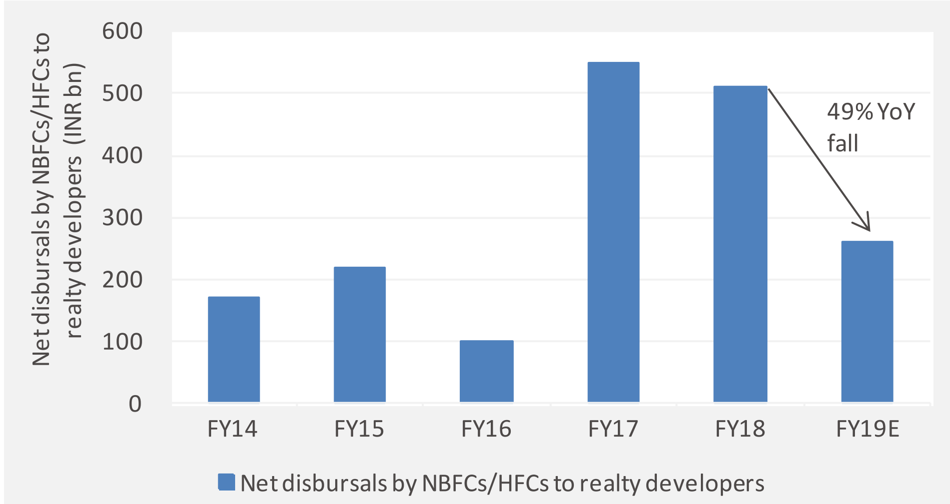
Chart 1: Rising NBFC/HFC exposure to realty developers



Source: RBI, NHB, JLL, Edelweiss research

However, NBFCs have faced significant liquidity issues over the past year, post the IL&FS crisis. Consequently, the flow of incremental credit to CRE has declined to a trickle. Not only have new sanctions become hard to come by, some NBFCs have even delayed release of funds for existing sanctions. Consequently, developers have been facing significant funding crunch.

Chart 2: Net disbursals by NBFC/HFC to realty developers plummeted in FY19



Source: RBI, NHB, JLL, Edelweiss research

As per JLL, in FY19, net disbursals by NBFCs/HFCs to real estate developers plunged by almost half to ~INR260bn from ~INR510bn in FY18.

Thus, the formation of AIF will provide much needed liquidity to the sector, which is struggling with a credit squeeze. It can help plug the funding gap in projects where existing lenders are not willing to increase their exposure. It will enable completion of stalled projects and provide relief to homebuyers and developers.

Will supply become an issue?

One of the major reasons behind industry consolidation and market share gains by organised developers over the past few years has been the fact that many tier 2/3 players have been facing liquidity issues and are struggling with stalled projects. If these developers are now able to avail liquidity and complete their projects, new supply from these units can enter the market. This has the potential to enhance inventory levels in the system since demand continues to be low.

As at H1CY19 end, stalled projects in the top-7 cities comprised 0.38mn units worth INR2.85tn. Of these stalled projects, 0.23mn units worth INR1.4tn have been sold, **while 0.15mn units (comprising ~51% of value) remain unsold**.

The unsold units in these stalled projects form ~20% of the overall unsold inventory (which is ~0.75mn units) at an all India level. **Adjusting for these units, unsold inventory levels at an all India level, which were at ~31 months at H1CY19 end, fall to ~25 months.**

Post the AIF, there is a possibility of these stalled projects seeing the light of the day and an incremental ~0.15mn units entering the market. Since demand continues to remain weak, this can lead to higher unsold inventory levels; in addition, it can also impact demand from organised developers, which were hitherto gaining market share with their smaller peers struggling.

However, we believe, industry consolidation and market share gains by organised developers are here to stay. Liquidity crisis is only one of the factors driving consolidation; there are stronger factors at play like RERA, burgeoning formalisation in the sector, regulatory actions, rising brand consciousness/aspirations amongst home buyers, etc. We believe, these factors will continue to drive consolidation, even if some stalled projects get funding.

For e.g., even if one adjusts for stalled projects, unsold inventory in NCR was high at ~38 months at H1CY19 end. **Despite the high inventory levels, Godrej Properties' projects in NCR continue to do well. It has sold more than 1msf in NCR in FY18 and FY19 and its market share has surged by ~3.5-4.0x in the region.**

Also, once existing stalled projects are completed, it would have been 8-10 years since the launch of these projects. During this time, customer preferences, unit sizes, configurations etc., have changed significantly. So customers are likely to prefer units from established developers rather than from these stalled projects.

Thus, we believe, the industry consolidation theme is here to stay even if stalled projects get completed and incremental supply enters the market.

Relief for NCR and MMR markets

Of the overall stalled units, while ~0.2mn units are in NCR (bulk of them in Noida), ~0.1mn units are in MMR. Thus, the AIF will significantly improve liquidity conditions in these markets.

One potential issue in the NCR market is of land payments to the Noida Authority. Many developers have paid part of the land dues to the authority and a significant portion is yet to be paid. We believe, the government will have to step-in and provide relief to developers in the form of waiver in payment of these dues to Noida Authority, otherwise it will be difficult for projects to have positive net worth.

Issues to be addressed

While the announcement is a significant positive, there are many issues which need to be addressed for the overall success of the scheme:

- Whether the funds coming from AIF Will get repaid before those from existing lenders?
- Whether project promoter/developer will be involved? What will be their role and will they generate any profit?
- Whether existing lenders need to take a haircut, especially if prices have to be cut to monetise unsold inventory?
- What will be the rate of interest on funds from AIF?

Outlook: Positive for the realty space

We believe, the development is positive for the realty sector. This will boost sentiments in the housing sector and release liquidity (currently stuck in these projects) in the economy. There will be significant rub-off effect on employment generation, financial institutions, among others.

Our interactions with sector experts indicate that around half of the stalled units can get addressed with this scheme. It will take two-three years to get these units completed. This scheme will help projects where 60-70% work has been completed and post completion a 10-15% price cut can't be ruled out to ensure monetisation of unsold units.

As far as listed developers are concerned, we see limited impact on Sobha, Brigade and Prestige Estates as Bengaluru market has very less stalled projects; hence, completion of such projects and incremental supply are unlikely to be major issues.

DLF and Oberoi cater to the premium residential segment and hence the current scheme which addresses mid-income/affordable housing units is unlikely to impact them.

Some impact on Godrej Properties is likely as the company has significant presence in the aspirational segment. However, its diversified geographical presence, status as the only true pan-India real estate developer, robust brand name and healthy financial muscle mean that it should be able to overcome any challenges arising from this development.

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.
Board: (91-22) 4009 4400, Email: *research@edelweissfin.com*

Aditya Narain
Head of Research
aditya.narain@edelweissfin.com

ADITYA NARAIN

Digitally signed by ADITYA NARAIN
DN: c=IN, o=EDELWEISS SECURITIES LIMITED, ou=SERVICE, 2.5.4.20=3dc92af943d52d778c99d69c48a8e0c89e548e5001b4f8141cf423fd58c07b02, postalCode=400011, st=MAHARASHTRA, serialNumber=e0576796072ad1a3266c27990f20bf0213f69235fc3f1bcd0fa1c30092792c20, cn=ADITYA NARAIN
Date: 2019.11.07 21:53:57 +05'30'

Coverage group(s) of stocks by primary analyst(s): Real Estate

Brigade Enterprises, DLF, Godrej Properties, Oberoi Realty, Sobha Developers, Sunteck Realty Limited

Recent Research

Date	Company	Title	Price (INR)	Recos
07-Nov-19	**Brigade Enterprises**	The smart march continues; *Result Update*	207	Buy
05-Nov-19	**Godrej Properties**	Robust performance reinforces credentials; *Result Update*	955	Buy
31-Oct-19	**Real Estate-Hot Property**	Commercial realty: Boom time's here to stay; *Sector Update*		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

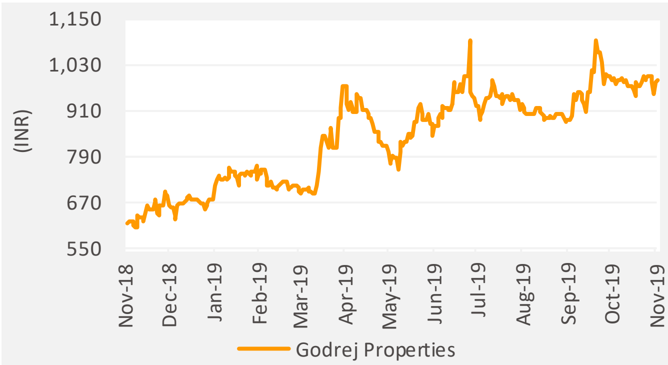
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

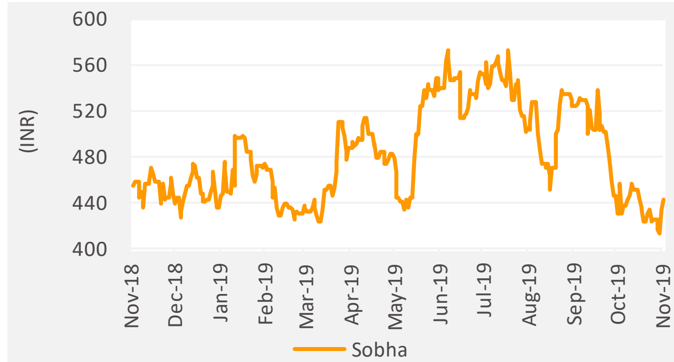
	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

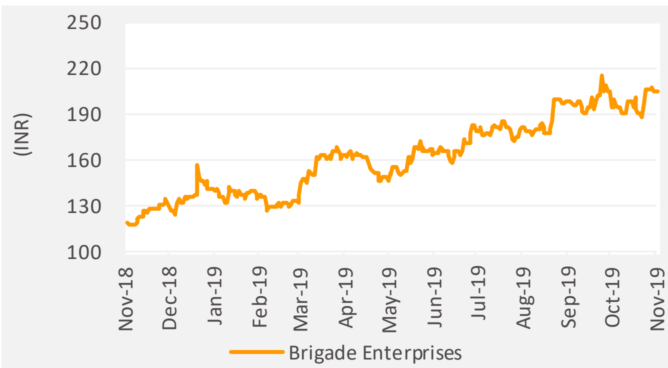
Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart







DISCLAIMER

Edelweiss Securities Limited ("ESL" or "Research Entity") is regulated by the Securities and Exchange Board of India ("SEBI") and is licensed to carry on the business of broking, depository services and related activities. The business of ESL and its Associates (list available on www.edelweissfin.com) are organized around five broad business groups – Credit including Housing and SME Finance, Commodities, Financial Markets, Asset Management and Life Insurance.

This Report has been prepared by Edelweiss Securities Limited in the capacity of a Research Analyst having SEBI Registration No.INH200000121 and distributed as per SEBI (Research Analysts) Regulations 2014. This report does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 includes Financial Instruments and Currency Derivatives. The information contained herein is from publicly available data or other sources believed to be reliable. This report is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this report should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in Securities referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors.

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ESL and associates / group companies to any registration or licensing requirements within such jurisdiction. The distribution of this report in certain jurisdictions may be restricted by law, and persons in whose possession this report comes, should observe, any such restrictions. The information given in this report is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. ESL reserves the right to make modifications and alterations to this statement as may be required from time to time. ESL or any of its associates / group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. ESL is committed to providing independent and transparent recommendation to its clients. Neither ESL nor any of its associates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including loss of revenue or lost profits that may arise from or in connection with the use of the information. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein. Past performance is not necessarily a guide to future performance .The disclosures of interest statements incorporated in this report are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The information provided in these reports remains, unless otherwise stated, the copyright of ESL. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of ESL and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders.

ESL shall not be liable for any delay or any other interruption which may occur in presenting the data due to any reason including network (Internet) reasons or snags in the system, break down of the system or any other equipment, server breakdown, maintenance shutdown, breakdown of communication services or inability of the ESL to present the data. In no event shall ESL be liable for any damages, including without limitation direct or indirect, special, incidental, or consequential damages, losses or expenses arising in connection with the data presented by the ESL through this report.

We offer our research services to clients as well as our prospects. Though this report is disseminated to all the customers simultaneously, not all customers may receive this report at the same time. We will not treat recipients as customers by virtue of their receiving this report.

ESL and its associates, officer, directors, and employees, research analyst (including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the Securities, mentioned herein or (b) be engaged in any other transaction involving such Securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company(ies) discussed herein or act as advisor or lender/borrower to such company(ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of research report or at the time of public appearance. ESL may have proprietary long/short position in the above mentioned scrip(s) and therefore should be considered as interested. The views provided herein are general in nature and do not consider risk appetite or investment objective of any particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with ESL.

ESL or its associates may have received compensation from the subject company in the past 12 months. ESL or its associates may have managed or co-managed public offering of securities for the subject company in the past 12 months. ESL or its associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company in the past 12 months. ESL or its associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months. ESL or its associates have not received any compensation or other benefits from the Subject Company or third party in connection with the research report. Research analyst or his/her relative or ESL's associates may have financial interest in the subject company. ESL and/or its Group Companies, their Directors, affiliates and/or employees may have interests/ positions, financial or otherwise in the Securities/Currencies and other investment products mentioned in this report. ESL, its associates, research analyst and his/her relative may have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of research report or at the time of public appearance.

Participants in foreign exchange transactions may incur risks arising from several factors, including the following: (i) exchange rates can be volatile and are subject to large fluctuations; (ii) the value of currencies may be affected by numerous market factors, including world and national economic, political and regulatory events, events in equity and debt markets and changes in interest rates; and (iii) currencies may be subject to devaluation or government imposed exchange controls which could affect the value of the currency. Investors in securities such as ADRs and Currency Derivatives, whose values are affected by the currency of an underlying security, effectively assume currency risk.

Research analyst has served as an officer, director or employee of subject Company: No

ESL has financial interest in the subject companies: No

ESL's Associates may have actual / beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report.

Research analyst or his/her relative has actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report: No

ESL has actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of research report: No

Subject company may have been client during twelve months preceding the date of distribution of the research report.

There were no instances of non-compliance by ESL on any matter related to the capital markets, resulting in significant and material disciplinary action during the last three years except that ESL had submitted an offer of settlement with Securities and Exchange commission, USA (SEC) and the same has been accepted by SEC without admitting or denying the findings in relation to their charges of non registration as a broker dealer.

A graph of daily closing prices of the securities is also available at www.nseindia.com

Analyst Certification:

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

Additional Disclaimers

Disclaimer for U.S. Persons

This research report is a product of Edelweiss Securities Limited, which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Edelweiss Securities Limited only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Edelweiss Securities Limited has entered into an agreement with a U.S. registered broker-dealer, Edelweiss Financial Services Inc. ("EFSI"). Transactions in securities discussed in this research report should be effected through Edelweiss Financial Services Inc.

Disclaimer for U.K. Persons

The contents of this research report have not been approved by an authorised person within the meaning of the Financial Services and Markets Act 2000 ("FSMA").

In the United Kingdom, this research report is being distributed only to and is directed only at (a) persons who have professional experience in matters relating to investments falling within Article 19(5) of the FSMA (Financial Promotion) Order 2005 (the “Order”); (b) persons falling within Article 49(2)(a) to (d) of the Order (including high net worth companies and unincorporated associations); and (c) any other persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as “relevant persons”).

This research report must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this research report relates is available only to relevant persons and will be engaged in only with relevant persons. Any person who is not a relevant person should not act or rely on this research report or any of its contents. This research report must not be distributed, published, reproduced or disclosed (in whole or in part) by recipients to any other person.

Disclaimer for Canadian Persons

This research report is a product of Edelweiss Securities Limited ("ESL"), which is the employer of the research analysts who have prepared the research report. The research analysts preparing the research report are resident outside the Canada and are not associated persons of any Canadian registered adviser and/or dealer and, therefore, the analysts are not subject to supervision by a Canadian registered adviser and/or dealer, and are not required to satisfy the regulatory licensing requirements of the Ontario Securities Commission, other Canadian provincial securities regulators, the Investment Industry Regulatory Organization of Canada and are not required to otherwise comply with Canadian rules or regulations regarding, among other things, the research analysts' business or relationship with a subject company or trading of securities by a research analyst.

This report is intended for distribution by ESL only to "Permitted Clients" (as defined in National Instrument 31-103 ("NI 31-103")) who are resident in the Province of Ontario, Canada (an "Ontario Permitted Client"). If the recipient of this report is not an Ontario Permitted Client, as specified above, then the recipient should not act upon this report and should return the report to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any Canadian person.

ESL is relying on an exemption from the adviser and/or dealer registration requirements under NI 31-103 available to certain international advisers and/or dealers. Please be advised that (i) ESL is not registered in the Province of Ontario to trade in securities nor is it registered in the Province of Ontario to provide advice with respect to securities; (ii) ESL's head office or principal place of business is located in India; (iii) all or substantially all of ESL's assets may be situated outside of Canada; (iv) there may be difficulty enforcing legal rights against ESL because of the above; and (v) the name and address of the ESL's agent for service of process in the Province of Ontario is: Bamac Services Inc., 181 Bay Street, Suite 2100, Toronto, Ontario M5J 2T3 Canada.

Disclaimer for Singapore Persons

In Singapore, this report is being distributed by Edelweiss Investment Advisors Private Limited ("EIAPL") (Co. Reg. No. 201016306H) which is a holder of a capital markets services license and an exempt financial adviser in Singapore and (ii) solely to persons who qualify as "institutional investors" or "accredited investors" as defined in section 4A(1) of the Securities and Futures Act, Chapter 289 of Singapore ("the SFA"). Pursuant to regulations 33, 34, 35 and 36 of the Financial Advisers Regulations ("FAR"), sections 25, 27 and 36 of the Financial Advisers Act, Chapter 110 of Singapore shall not apply to EIAPL when providing any financial advisory services to an accredited investor (as defined in regulation 36 of the FAR. Persons in Singapore should contact EIAPL in respect of any matter arising from, or in connection with this publication/communication. This report is not suitable for private investors.