Capital Markets: Last Decade & Next Phase

- The Decadal Cycle hypothesis in our Nugget-1 (refer here) roughly, albeit uncannily seems to apply in capital markets - specifically, private equity deployment patterns in Indian real estate.

- The previous decade started with increasing investor interest in the residential segment and culminated in growing confidence in office, retail, warehousing, industrial and alternatives like coworking, coliving, etc.

- The upsurge in the residential demand in 2010 emerging post the Global Financial Crisis fueled the expansion of HFCs/NBFCs/domestic PEs. Thus, the residential segment saw huge infusion of domestically raised capital. This led to massive overbuilding mainly in the high end residential segment. However, the liquidity crisis in the NBFC sector triggered by the ILFS crisis completely choked the cash flow to many residential projects in the high end segment.

- Investments in the office segment became a firmly established trend in Phase 2 and continues to gain strength. Investments in residential have reduced drastically in the current phase 3 post the NBFC crisis.

- Once Foreign Direct Investment (FDI) was permitted in completed retail malls in Phase 2, a large amount of offshore equity was invested in this segment mainly led by the large intrinsic demand from the growing Indian population.

- De-leveraging pressures will get enhanced post COVID. Coupled with this, implementation of RERA regulations will further fasttrack the consolidation in the residential sector.

- Due to a huge demand supply gap and massive policy tailwinds, the affordable and middle income housing segment is likely to remain resilient segment and gain back investments in the next phase (Phase 4).
Covid-19 against the Run of Play: REIT Imagery and Markets

COVID-19 HIT: against the run of play, but, resilience persists

- Office segment may have been impacted in the middle of a rising cycle of 2018 and 2019, where it recorded unprecedented highs
- With the leasing activity having dropped and scepticism building up for near future, there are short-term resets in the making
- COVID-19 has created possibilities of rent renegotiations, rental structure changes, space uptake revisions & has clouded cashflow visibility to a certain extent
- Additionally, probable reassessments of operational projects in portfolios and delay in listings are likely
- India’s impact measure on the overall spectrum of REIT Performance (refer the chart here) leaves scope for guarded optimism. Coupled with the rebound-hypothesis in our recently published NUGGET-2 (refer here), resilience remains within the markets

![REIT Performance - YTD Change (%)](chart)

- In the previous decade, there had been an emerging trend of investments into building warehouses, especially post GST; openness to explore evolving products like senior and student living as well
- The ongoing pandemic has catalyzed investment and portfolio reassessments
- A gradual reconsideration of investment strategies as well as structures is expected in the post pandemic world
Savills India Research presents the results of an extensive survey covering over 80 respondents in the domain of Capital Markets in this section.

These responses were collected at the height of the lockdown 2.0 (April-14 to May-3, 2020) and provide the most current insights among those available.

The insights and conclusions shown here cover perceived changes in portfolios and strategy as well as possible alternations to valuations.
COVID-19 Induced Adjustments: Reconsideration of Portfolios

- Warehousing and industrial segments are expected to be relatively less impacted from the pandemic and clock the fastest recovery time.
- Retail, hotel and other residential are expected to take significant time to recover from the pandemic related sectoral slowdown.
- Office and affordable housing are expected to recover faster in the medium term.

*Recovery period starts once the nationwide restrictions are significantly eased up.
Affordable residential/housing:
Ticket size of INR 20-40 lakhs in Mumbai MMR and INR 10-20 lakhs in other cities.
Strategy changes in Residential

Immediate Impact

- Portfolio REASSESSMENT with focus areas being:
  - Labour and the raw material adequacy, rate of collections from sold inventory, cancellations, disbursement of home loans for end buyers
- Investor supported and developer driven fast tracked consolidation - Increase in DMs/JVs

Post COVID Impact

PREFERRED INVESTMENT CATEGORIES

- SIGNIFICANTLY SOLD projects
  - With NBFC’s inability to provide liquidity and forced deleveraging of weaker yet financially viable projects, significantly sold projects with high collection visibility might be preferred by investors
- AFFORDABLE and MID SEGMENT – Continued government support envisaged in these categories
- RESTRUCTURED and NON-PERFORMING LOANS at attractive valuations
  - Post the 3-month moratorium facilitated by RBI, existing loans are likely to be restructured
- Focus would continue to be in the top 6 cities- Mumbai MMR, Delhi NCR, Bangalore, Chennai, Hyderabad and Pune

UNDERWRITING FOCUS

- ASSESSMENT of impact on sale velocities and capital values and the resultant change in valuations
- FRESH DEVELOPMENT OPPORTUNITIES in MAINLY Affordable and Mid Segment at discounted rates

FUNDING & INVESTMENT STRUCTURE

- Increased INTEREST from OFFSHORE INVESTORS both in Debt and Equity, once the sales and deliveries stabilize in the next phase
- Financing with priority to the incoming investor, majority of the investment going into the project as against refinancing of existing debt, DOWNSIDE GUARANTEED and UPSIDE LINKED STRUCTURES

Survey Results (in %)

Return Expectation - Affordable Residential

- Increase 28%
- Decrease 25%
- Stable 47%

Return Expectation - Other Residential

- Increase 37%
- Decrease 42%
- Stable 21%

75% of the respondents feel that return expectations of the investors from the projects in the affordable housing will increase or be stable
Strategy changes in Commercial

Immediate Impact

- Possible ACQUISITIONS at discount prices
- Continuous REVIEW AND REASSESSMENT of EXISTING portfolio-REVISITING underlying assumptions
- COPING strategies to mitigate potential delays in REIT listing

Post COVID Impact

PREFERRED INVESTMENT CATEGORIES

- Increased interest for VALUE ADD and STRUCTURED DEBT strategies
- Continued interest in BUILT TO CORE platforms
- Focus would continue to be in the top 6 cities- Mumbai MMR, Delhi NCR, Bangalore, Chennai, Hyderabad and Pune

UNDERWRITING FOCUS

- New RENTAL STRUTURES are expected to be assessed with greater scrutiny
- Possible changes in LEASING REQUIREMENTS are also expected to be assessed carefully

FUNDING & INVESTMENT STRUCTURE

- Equity products: Discounted purchases for the stock emerging from DE-LEVERAGING with a value add angle
- Debt products: Structured credit in office space
- Short term: increased REVISITING of underlying assumptions - Direction depends on asset type, micromarket location, developer, partner fund, operation and sustainability of tenants as well etc. Long term impact on valuation is however a “Wait and Watch policy” for most investors

Survey Results (in %)

<table>
<thead>
<tr>
<th>Return Expectation – Office</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase</td>
<td>35%</td>
<td>32%</td>
</tr>
<tr>
<td>Decrease</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stable</td>
<td>33%</td>
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</tbody>
</table>

Survey indicates comparatively higher confidence on India’s office space
Strategy changes in other asset classes

### Ongoing as well as future implications

<table>
<thead>
<tr>
<th>Warehousing &amp; Industrial</th>
<th>WAREHOUSING</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Most resilient</td>
<td></td>
</tr>
<tr>
<td>• Active identification of incremental space on account of increased storage needs</td>
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<tr>
<td>• Essentials and ecommerce may be preferred subsectors</td>
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<tr>
<td>• Stable interest from OFFSHORE INVESTORS</td>
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<table>
<thead>
<tr>
<th>INDUSTRIAL</th>
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<tr>
<td>• Increased activity - anticipated dislocation of manufacturing activity from China</td>
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<tr>
<td>• Increased interest from OFFSHORE INVESTORS</td>
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</table>

<table>
<thead>
<tr>
<th>Retail</th>
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<tbody>
<tr>
<td>• Fully owned high street models may emerge as strata sales volumes may get impacted</td>
</tr>
<tr>
<td>• INCREASED OFFSHORE INVESTOR participation in STRESSED ASSETS</td>
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<table>
<thead>
<tr>
<th>Hospitality</th>
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<tbody>
<tr>
<td>• Cash burn for three to four quarters, drop in revenues and de-leveraging pressures for weaker players</td>
</tr>
<tr>
<td>• Distressed asset sale across select hotel categories. Business hotels are likely to be better placed relatively for a faster recovery</td>
</tr>
</tbody>
</table>

### Survey Results (in %)

<table>
<thead>
<tr>
<th>Return Expectation – Warehousing</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stable</td>
<td>47%</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Return Expectation – Industrial</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stable</td>
<td>52%</td>
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</table>

<table>
<thead>
<tr>
<th>Return Expectation – Retail</th>
<th>Increase</th>
<th>Decrease</th>
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</thead>
<tbody>
<tr>
<td>Stable</td>
<td>12%</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Return Expectation – Hospitality</th>
<th>Increase</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stable</td>
<td>05%</td>
<td></td>
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</table>

The survey indicates industrial & warehousing sectors to remain relatively unscathed in the pandemic.

Retail and Hotel are expected to bear the consequences of a head on collision with public space congregation restrictions, nationwide travel and movement.
COVID-19: Re-Laying the Base & The New Normal

India, though not as immune to capital market shocks as during the GFC, is expected to weather the storm in a relatively successful manner, compared to several large economies around the world.

Nevertheless, the current pandemic presents an opportunity to cash-in on emerging strategies and investment avenues across varied real estate asset classes: As is expected of a sharp-investor in the moment of crisis.

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