India revamped

The private real estate investment market in India is today almost unrecognizable compared with a decade ago, reflects Subhash Bedi, founder of Rising Straits Capital

Since the opening up of Indian real estate to foreign capital in 2005, the private real estate sector has seen three pronounced waves of investments exhibited through their corresponding strategies: equity, preferred equity and debt investments.

In retrospect, the country's regulatory environment for foreign capital had inherent limitations that weakened investment potential. High return expectations saddled with a restrictive regulatory environment led to investments in greenfield projects with land, title, approval and planning risks. Fueling the situation was the limited experience and capabilities of developers, project completion delays, the opaque nature of the market and the non-availability of authentic data resulting. These factors resulted in sub-optimal returns, disappointed investors and a trust deficit.

But, since then, there have been a number of positive changes. Firstly, improved market dynamics have materialized, driven by more experienced real estate developers with proven track records, as well as veteran managers who have matured through the last few cycles.

Secondly, the regulatory environment in India has evolved to become more investor friendly. Key changes include, firstly, a liberalized Foreign Direct Investment policy providing easier entry and exit conditions, including investments and repatriation during brownfield stages. Secondly, is clarity on investment structures through debt instruments. Thirdly, a strengthened governance framework through the Real Estate Regulatory Act. And fourthly, global standards for REIT regulations. In addition, recent renegotiations of tax treaties with Singapore, Cyprus and Mauritius removed ambiguities on tax matters.

This backdrop presents unique challenges alongside opportunities for Indian investment managers.

Strategy selection. Managers need to carefully match expectations of foreign capital providers with the right strategy. This creates a need for clearly defined and differentiated investment strategies with realistic return expectations. It is important these strategies are derived from market analytics and complement broader sector dynamics and capital requirements. For example, investment managers may look at shorter tenured strategies in brownfield projects that steer clear of land, FSI and approval related risks.

Investment structure. To bridge the trust deficit with foreign investors, Indian investment managers need to look at structures that enable active investor participation, transparency and control in decision making. This could include influence over investment entry and exit decisions as well as the ability to opt-out of investments. This customization of the investment structure will help align stakeholders and enable a partnership culture versus a client-manager interface.

Another element that can bring in more predictability and comfort to investors is clarity in selecting tax jurisdictions for pooling vehicles, and simplicity in financial instruments and investment structures. Indian investment managers should take active steps to avoid any grey areas in matters that could cause capital repatriation issues.

Next, investment managers should strengthen internal capabilities for more efficient asset management related to the different stages of an investment to mitigate inherent risks in strategies being marketed to foreign investors. Unless some of these skills are internally cultivated, sole reliance on development partners could impact the project timelines and returns. In addition, managers must continue to improve reporting and risk management processes to meet global standards.

India is a diverse country and the key challenge is understanding the heterogeneous nature of the market while discerning the perceived versus actual risks. This responsibility falls on the manager to be transparent, and on the investor to make the necessary diligence efforts.

The sector today has access to a strong pool of investment professionals, who have the experience of investing and managing real estate in India through multiple development cycles, while providing the transparency and fiduciary oversight that global investors expect. Indian investment managers adhering to the standards above are well positioned to tackle the challenges of trust deficit and alignment with global financial investors.

Indian real estate has matured at a fast pace, for the better, over the last decade. The regulatory environment and the market have evolved, developers and investment managers have institutionalized and data availability and accuracy has improved. For investors, India today is by no measure the same as it was in previous cycles. □