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New realty law set to raise developers' funding needs, may encourage equity capital

Once Real Estate (Regulation and Development) Act is notified, developers will have to rely on external financing as pre-launches of projects will stop

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MadhurimaNandy

Only projects with all approvals and sanctions in place can be sold to customers once the RERA Act is notified. Photo: IndranilBhoumik/Mint

Bengaluru: The new real estate law, which is currently being notified by various states, may pave the way for institutional equity investments in real estate projects.

Developers will have to rely on external financing as pre-launches of projects, through which builders collect funds from property buyers before they obtain the required approvals, will stop.

Only projects with all approvals and sanctions in place can be sold to customers once the Real Estate (Regulation and Development) Act of 2016 (RERA) is notified.

Developers currently pre-launch a project after obtaining the first set of approvals at a slight discount because of the risks involved. The cash flows from the pre-launch help the builder start construction. A formal launch is done with full approvals at a higher price.

“If pre-launches, which are critical for a project because they bring in the first flush of cash flows, stop, then developers have to arrange for financing for 18 months from the time of buying land. Approvals easily take a year or more and realty firms have to raise the funds to develop the project till then,” said AnujPuri, chairman and country head at property advisory JLL India.

The new law is aimed at bringing transparency and discipline to the Indian real estate sector, notorious for its opacity. It will also instil more confidence in institutional investors such as private equity (PE) funds and non-banking financial companies to invest equity capital in a sector where debt has been the primary mode of financing.

RERA requires mandatory registration of ongoing and new real estate projects, disclosures related to the delivery timeline of a project and cash flow management. It provides safeguards against delays and fraudulent practices and has punitive provisions. The law also requires builders to disclose project details on the website of the regulator, along with a quarterly update on its progress.

“Investors like us will be happy to invest and also commit equity because regulatory risk will be reduced and approvals are expected to come in fast. However, there will be risks in the financial closure of the project in the RERA regime, and investors will ask the developer to put money upfront in case there is delay in a project or shortage of funds,” said AnuranjanMohnot, managing director at investment firm Amplus Capital Advisors Pvt. Ltd.

Mohnot added that pre-launches typically contribute 20-30% to a project’s revenue, depending on how the leverage level of a project is determined. Even if leverage levels are predetermined, a project can always run into approval or sales risks.

Over the past four years or so, PE funds have nearly transformed the manner in which they invest in real estate projects given the uncertainties in the sector. They have been reluctant to offer equity capital, and while developers had more access to funds, it was mostly in the form of debt and structured debt.

Amit Goenka, managing director and chief executive of Nisus Finance Services Co. Pvt. Ltd, said that investors would like to build more long-term equity partnerships with developers.

“What will also happen is a lot of consolidation, where the stronger, larger developers will survive and attract capital while the smaller firms may find it tough to sustain in the new environment,” he said.

RERA will monitor every aspect of project development, leaving little scope for developers to go astray.

Ben Salmon, co-founder and chief executive at Bengaluru-based Assetz Property Group, said that the new law is good for long-term, serious developers.

“We have been functioning in that manner, but it will take time for everyone to catch up,” said Salmon.