Avenues for real estate investments

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WITH SIGNIFICANT interest in the India growth story amongst both foreigners and Indians alike, both stock markets and real estate prices have been moving with an upward trajectory over the last 12 months.

Equity exposure has been possible through investing in small chunks due to availability of small lot sizes and mutual funds.

However real estate, especially in the metros, has tended to require large commitments. We felt it may be prudent to look at avenues for investors to participate in the real estate growth story with smaller initial outlays.

■ **Real Estate Funds:** Whilst real estate funds have existed in the past, they were available only with very large commitments. Over time, these products have got more broad based and allow investments in smaller chunks. Essentially, these funds raise money from investors and enter into arrangements with developers to fund their projects.

Since the funds typically have management teams with a superior understanding of demand/supply trends, pricing and developer quality, they are in a position to identify multiple opportunities and make a more objective investment decision. They offer the benefit of diversification with smaller sums of monies, as they could invest in different geographies as well as different types of real estate including commercial, residential and retail.

Most of these products also offer a gradual payment program. However, they do not have too much liquidity and requircommitments for 6-8 years in line with the ideal investment horizon for real estate investments.

■ **Primary market purchases/Buying under construction real estate:** Since many developers offer construction linked payment schedules, it is possible to use a combination of future cash flows and existing investments to build on this investment strategy.

This is akin to doing a systematic investment plan in real estate albeit at a fixed locked in rate, except for the fact that a default could result in heavy penalties/forfeiture so it is critical to bite only what one can chew.

A couple of precautions are critical here — firstly, quality and reputation of the builder are critical as there are a large number of cases where financing constraints for the developer end up delaying the project for abnormally long periods.

Secondly, a clear understanding on the cash flows as the initial stages require much larger commitments and you could end up having to put away as much as 85-90 per cent of the project cost one year before possession.

■ **Primary/Secondary market purchases using leverage:** Availability of leverage at attractive rates and the associated tax benefits make real estate an interesting option to consider.

However, please remember that the leverage has a cost attached to it and this needs to be built into the overall cost of investment.

A large number of real estate investors do not account for the interest costs as a part of the overall cost of the investment, thereby believing that the return on investment is higher than what it actually is.

Besides, leverage is a double edged sword when real estate goes through its periods of downturn.

With interest rates likely to start moving upwards over the next few quarters, this tool will need to be used cautiously especially as a large number of loans today are what we call honeymoon loans — lowfixed rates in the beginning and set to climb sharply over the next few years. Please keep in mind that these are recommendations for real estate investors andnot end users.

Also remember that real estate investments are not risk free and are exposed to volatility contrary to what many investors have come to believe over the last few years.

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