THE HINDU Business Line

Investment opportunities in housing

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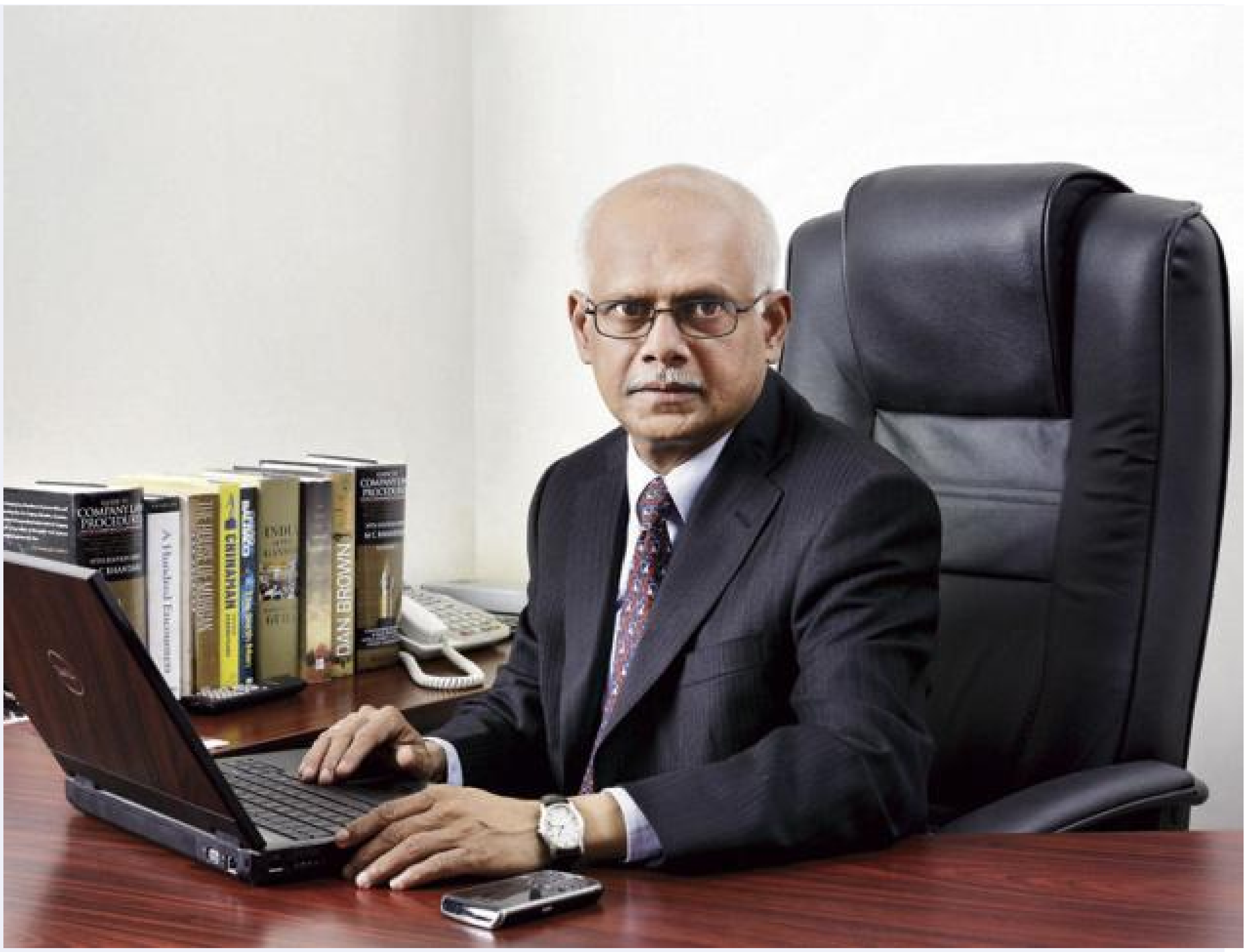

MR BIKRAM SEN, DIRECTOR AND CEO, ARTHVEDA FUND MANAGEMENT

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ArthVeda, the fund management arm of Deewan Housing Finance, has launched its second realty fund — ArthVeda STAR. Targeting middle-income housing in Tier-II and Tier-III cities, this fund hopes to provide improved disclosures to its investors compared with other private equity or venture capital funds.

Excerpts from an interview with Mr Bikram Sen, Director and CEO, ArthVeda Fund Management on what the fund has on offer:

How different is ArthVeda STAR fund compared with a number of other real estate funds that are currently being floated in the market?

ArthVeda will specifically invest only in greenfield housing projects in the middle-income segment in Tier-II and Tier-III cities and in small projects which we anticipate will be completed and can be exited in a maximum of 3-3.5 years.

So our investment strategy is quite straight-jacketed, and we have stated as much in the document filed with Securities and Exchange Board of India. The contribution agreement and the presentation are now part of the registered documents with Securities and Exchange Board of India. So this is the first fund where what we are saying to Securities and Exchange Board of India is what we are actually going to do, and we can't deviate from that. Most other funds would have made a general document to Securities and Exchange Board of India that leaves a lot of discretion and flexibility to the fund manager.

We have in fact, even identified the 16 cities where we are going to invest. This is the first unique thing regarding our fund.

The second unique feature is that this investment strategy has been designed to achieve the best risk-adjusted return among real estate funds. We say that because investing in Greenfield middle-income housing projects is safer compared with investing in a hotel, office or a plaza. And because we will be looking at small projects, the risks are also lower. When we put all these features into a fund and invest in 30-34 projects across 16 cities, as a portfolio, it is less exposed to risk. We are confident regarding this and have invited the rating agency CARE to rate each of our investment projects, which again, hasn't been done by any fund so far.

What kind of disclosures would be available to investors during the tenure of the fund?

We will, through our website and physical means of communication, provide updates on what is happening. In fact, we plan to arrange for our larger investors to visit any of our project sites. Our quarterly reports are going to be supported by two external research reports. We will have a research outfit that will mark-to-market the project and the investment. We have also contracted with the research arm of CARE who will give a research report on the cities — on what is happening to property prices in the cities, why it is going up, the income level in the cities and so on. These will go to investors along with the fund's own report. The rating of each investment by CARE will also be enclosed.

What returns do you propose to generate?

We are confident of achieving a gross return, before expenses, of higher than 30 per cent on a compounded annual basis. We will be able to do this because we will be moving in to Tier-II and Tier-III cities, which seldom get any organised equity.

How do you propose to achieve this?

This fund has been launched in conjunction and in collaboration with the owners of ArthVeda Fund Management Pvt. Ltd., which is Deewan Housing Finance (DHFL). DHFL, the third largest housing finance company, primarily focuses on middle-income housing. So they know the middle income segment in Tier-II and Tier-III cities well.

The 16 cities now chosen for investments by the fund are cities where DHFL has a branch network, and is having a sizeable loan portfolio. In other words, it is a regular lender in these markets. DHFL has its panel of advocates there who do title search and so on regularly, and therefore, this fund can take some comfort from that. There are also marketing outfits in each DHFL branch, which will help this fund know the ruling price in various localities. That will give us a second check on what the developer is saying.

So we will basically leverage on the knowledge and the presence of DHFL in these cities. This is something that isn't available to other real estate funds.

We hear from developers that Tier II and III cities aren't too lucrative. How will you manage a 30 per cent IRR in these cities?

I used to be the CEO of DHFL. At that time, we set up a business called project finance, which is basically construction finance. DHFL today has approximately Rs 1,500 crore of construction loans across India. When you do construction finance, you look at the profitability of the project. So, it is based on such experience that we know that such returns are possible.

Also, recollect that in 2007 and 2008, any of the large, listed players would have said that there was a slowdown in the real estate sector. But if you look at DHFL's loan book growth in those years, it was upward of 30 per cent. Why? Because the so-called slowdown, which was dramatic in the metropolitan areas, was almost non-existent in Tier-II and III cities. In fact, DHFL's loan book in Tier II and Tier III cities has seen no slowdown, and instead seen the lowest NPAs in the business. That is the kind of resilient market we are talking of.

We are talking of a 1100 square foot housing project in say Nagpur, at say Rs 2500 a square foot. What is happening in the centre of Mumbai or Bangalore or Gurgaon has no connection whatsoever with what this fund is going to be doing.

Would DHFL be providing funding for these projects both to developers and home buyers?

The day the fund invests in the equity of the project, DHFL and one more bank will provide sanction for both construction finance as well as home finance. So in one sense, when the fund invests, each project would have achieved financial closure.

Sometimes, the builder may not avail of that construction finance as they may have cheaper sources of finance, but then no developer who is our development partner can say that the project is stalled for want of a financing option.

What is the process for returning money to investors?

As we exit projects, we will be returning money to the contributors, and that will be broken down into capital return, dividend and long-term capital gains. There will also be a very small component of interest based on the nature of instrument we use to invest in projects. While the most common form would be equity in each special purpose vehicle (SPV), there could also be a convertible instrument, as that also provides some tax deduction to the SPV. The interest component could come from there. So project by project, we have to look for the best mix of investments.