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Funding Opportunities in Indian Real Estate

KEY INSIGHTS ON INNOVATIVE FINANCING MECHANISMS, REGULATORY NUANCES, AND INVESTMENT TRENDS

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GRI Club

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INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potential using the real estate market.

GRI Club reports provide the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following the conversations that took place at **GRI Club India's** forum **GRI Funding Opportunities India 2024**, which connected industry players, investors, lenders, and real estate developers through dynamic discussions on key topics such as capital sourcing models, the influx of domestic and foreign capital, equity investments, accessible investment venues, AIFs, REITs, and asset diversification.

ADDRESSING CHALLENGES AND SEIZING OPPORTUNITIES IN TODAY'S FINANCING MARKET

The Indian real estate market continues to demonstrate strong potential, driven by shifts in capital allocation, beneficial government policies, and strategic developments across multiple sectors. The market's optimism is underpinned not only by favourable macroeconomic conditions but also by a deeper understanding of demand-supply dynamics, supporting sustained growth.

Over recent years, India has consistently attracted Foreign Direct Investment (FDI) of around USD 4-5 billion annually. In the first half of this year alone, FDI exceeded USD 3 billion, reflecting significant interest from both global and domestic investors.

Government initiatives have further accelerated growth, particularly in Tier 2 cities and semi-urban regions. Additionally, capital sources have diversified, with domestic investors playing an increasingly prominent role and a growing emphasis on quick turnovers and efficient capital utilisation, especially in the affordable housing segment.

While the market was once dominated by residential projects, it has now expanded into office spaces, logistics, and alternative assets, with rising interest in emerging trends like data centres, student and senior housing, and flexible workspaces.

Developers have also adapted to changing dynamics, moving away from traditional capital-heavy models towards more agile, asset-light approaches. The focus has shifted from speculative land holdings to operational margins and efficiency.

The market's emphasis on quality developments, prudent capital management, and strategic diversification across asset classes ensures that opportunities remain abundant. Whether in residential, office, retail, logistics, or hospitality sectors, developers and investors are capitalising on the evolving landscape with a more informed and strategic approach, setting the stage for sustainable growth across India's real estate market.

A significant shift has also occurred in financing strategies, with a move from debt-heavy investments to increased equity involvement. This transition offers a margin of safety by reducing the risk of defaults during downturns, though it introduces new risks if equity-backed projects are based on unrealistic expectations.

In regions with more flexible development regulations, developers have leveraged available land and favourable building rules, leading to significant growth. Despite recent high bidding prices, these regions remain attractive due to competitive pricing and infrastructure advantages.

However, challenges persist. Over-leverage and speculative pricing remain risks, especially in areas experiencing rapid price appreciation. One of the primary concerns is the over-reliance on continuous price growth, with some developers building strategies on unsustainable price increases. Rising land and construction costs, along with higher taxes and competition, further add to the pressures.

Developers who over-leverage or depend too heavily on speculative pricing may face significant challenges if market conditions shift. The real estate market is not homogenous; different segments - such as high-end, affordable housing, and plotted developments - experience varied cycles, requiring cautious and tailored strategies.

Ultimately, the market's success hinges on striking a balance between strategic investments, realistic pricing, and a nuanced understanding of regional dynamics. While the long-term outlook remains positive, with abundant capital seeking quality projects, the risks of over-leverage and speculative behaviour highlight the need for disciplined investment approaches.

Caution is essential to avoid the pitfalls of a market driven by euphoria and price spikes, which can lead to unsustainable growth. In this environment, focusing on the right locations, micro-markets, and sustainable growth models - while resisting the assumption of continuous price appreciation -is key to navigating the complexities of India's real estate landscape.

PRIVATE EQUITY AND FOREIGN FUNDS VS DOMESTIC FUNDING

Over the last decade, there has been a significant shift in capital sourcing for real estate investments in India. While foreign capital has traditionally played a dominant role, domestic capital has grown rapidly, largely driven by the emergence of high-net-worth individuals (HNIs) and family offices.

A decade ago, family offices were virtually non-existent in the Indian market. Today, however, they represent a burgeoning class of investors with substantial disposable income. The rise of these new investor classes has created a robust domestic investment ecosystem, with many now actively seeking diversified portfolios. They are moving beyond traditional equity and debt markets to explore alternative investments, including real estate funds.

Unlike foreign investors, these domestic investors do not need a compelling “India story” to justify their investments; they are already well-versed in the local landscape and focus primarily on the intrinsic value of the product. This localised familiarity makes capital raising within the domestic market faster and more straightforward, especially for established managers who can deliver consistent performance and cultivate long-term relationships.

In contrast, raising foreign capital involves competing not only on the merits of the asset class but also on the global attractiveness of India as a whole. Despite common assumptions, foreign capital is not necessarily cheaper; it often comes with higher return expectations due to the perceived risks of investing in emerging markets.

The process of securing foreign investments can also be more time-consuming, frequently delayed by extensive due diligence and external factors such as geopolitical events. Nevertheless, foreign interest in Indian real estate remains strong, particularly in sectors like offices, warehousing, and the residential market, where the potential for stable exits through REITs and other mechanisms is clearly visible.

» Attracting Global Investors

As the Indian economy maintains its consistent growth trajectory, global investors can no longer afford to overlook its potential. While the share of domestic capital in real estate investment has grown from 10% to approximately 30% in recent years, it is anticipated that domestic and foreign capital could soon reach parity.

Global investment committees now see India as a bright spot in the global economy, offering unique opportunities compared to other regions. India’s competitive positioning on the world stage is further enhanced by the fact that other major economies, like China, are currently viewed as uninvestable, particularly in real estate.

As one of the few large economies experiencing steady organic growth, India stands out despite the financing constraints that continue to limit domestic channels. This combination of growth and constrained financing is uncommon, attracting significant attention from global investors.

However, when evaluating India, global committees often apply a “relative value” lens, balancing expected returns against perceived risks. Historically, India has carried a premium due to emerging market risks, but there is growing recognition that this premium should be adjusted downward as India’s economic stability and legal frameworks improve. The increasing presence of domestic capital competing with international capital is helping drive this adjustment, though there is still progress to be made.

Offshore investors, particularly from the APAC region, continue to provide follow-on funding, while capital from the US and Europe faces a mismatch in risk-return expectations due to high interest rates in their home markets.

The attractive returns available in their domestic markets, especially in areas like distressed office assets, make it difficult for these investors to justify the additional risks of Indian development projects, which involve factors like currency volatility and counterparty risks specific to India.

Global capital’s hesitancy to fully commit to Indian real estate is particularly evident in the residential sector, where developmental equity remains limited. Despite substantial inflows into equity-oriented products globally, Indian general partners still struggle to attract these funds. Many foreign LPs prefer to deploy capital directly or through global funds, bypassing domestic GPs, except in select separate managed account arrangements.

For fund managers, raising India-dedicated funds from global LPs remains a challenge. Global managers often deploy from broader Asia or global pools, offering greater flexibility and scale. However, the India-specific risk premium continues to be a significant barrier, and until there is a consistent track record of performance, especially in equity investments, this premium is unlikely to decline meaningfully.

Nevertheless, the “relative value” debate is still evolving. While some investors have adjusted to a lower cost of capital for Indian investments due to consistent returns and improvements in legal frameworks, others remain cautious.

From a strategic perspective, organisations must carefully assess whether to seek domestic or foreign capital based on their product offerings and desired returns. Domestic capital offers greater flexibility and faster access, with a higher likelihood of repeat investments from the same investors.

This is demonstrated by the number of investors who initially committed smaller amounts, only to increase their contributions over time as their confidence grows. However, foreign capital, while slower and more complex to secure, remains crucial for large-scale, long-term projects.

Both domestic and foreign capital sources offer unique advantages, and the decision between the two depends on a company's specific objectives, market conditions, and the nature of the investment opportunity. While the domestic market provides greater certainty and scalability, foreign capital brings valuable diversification and long-term stability, making it essential for the sustained growth of the Indian real estate sector.

It is important to distinguish between the risks being underwritten by investors and the instruments they choose to participate in. While most institutional capital is structured as credit, the underlying risk often mirrors that of equity. In sectors like residential development, the market has traditionally relied on layers of leverage, with limited equity contributions from developers.

This reality has led to the predominant use of structured credit instruments, allowing investors to hold a senior position in the capital stack while still effectively underwriting development risk. The fragmented nature of the market, coupled with enforcement challenges, has necessitated this approach.

However, the high return expectations reflect the equity-like risks being absorbed. Developers, particularly those with smaller operations, often prefer financing options that enable them to retain control over their projects.

This dynamic results in a focus on optimising capital cycles rather than pursuing traditional equity raises. For many developers, the cost of capital is secondary to maintaining flexibility and control in a market where timing and land acquisition play crucial roles in profitability.

In residential real estate, project-level equity remains elusive. Most equity investments occur at the company level, leading to exit challenges. IPOs or negotiated exits with developers are often the only viable options, making these investments less attractive to many institutional investors. This structural limitation has further entrenched the dominance of credit over equity in the sector.

For those raising capital, especially from domestic investors, success depends on several factors. Demonstrating a track record of effective capital deployment, strong governance, and the ability to scale operations are critical. Recent funds have raised significant amounts domestically by focusing on distribution-driven strategies and partnering with established channels. As the domestic retail market has grown, so too has the appetite for alternative investments.

Managing a large base of retail investors presents its own challenges, particularly regarding transparency and communication. Investors are increasingly demanding clarity and timely updates, and failure to meet these expectations can lead to significant trust issues.

A key concern for fund managers is managing investor expectations during adverse market conditions. Real estate cycles inevitably face downturns, and during such times, investor anxiety can escalate quickly, especially if clear communication is lacking.

This challenge is amplified as funds scale, requiring careful management of investor relations across multiple investment vehicles. Performance and transparency are crucial in maintaining investor confidence. While a solid track record provides some insulation, any underperformance or perceived lack of openness can lead to heightened scrutiny and dissatisfaction.

Another critical factor is ensuring that investors, especially those in the retail segment, fully understand what they are buying into. Given the involvement of multiple distribution channels, fund managers must implement checks and balances to prevent mis-selling.

Proactively addressing these concerns through a robust onboarding process, transparent communication, and strong governance measures can significantly reduce issues down the line. Although adverse market conditions may still cause heightened investor anxiety, fund managers who have built trust through these practices are better equipped to manage such situations effectively.

BANKING AND NON-BANKING FINANCE VS AIFs AND NCDs

The discussion on capital needs for key real estate asset classes often centres around comparing Banking/Non-Banking Finance Companies (NBFCs) and Alternate Investment Funds (AIFs)/Non-Convertible Debentures (NCDs) to determine which funding option aligns more effectively with various capital requirements, such as construction finance (CF), Lease Rental Discounting (LRD), land banking, and other growth capital needs.

While bank lending has traditionally been crucial for CF and safer investments, as market dynamics evolve, AIFs and NBFCs have increasingly stepped in to fund early-stage projects and address gaps left by conventional bank financing. This shift underscores the growing importance of alternative capital sources in the real estate sector.

In particular, AIFs have become essential players, providing early-stage capital and supporting developers in land acquisitions and initial project financing. This trend is expected to gain momentum as private developers face challenges in securing traditional bank funding for high-risk ventures.

While platform-level funding remains limited to a few key players, the broader market is witnessing increasing participation from alternative capital providers, reflecting a diversification in funding strategies.

Despite the prominent role of banks and NBFCs, there is also a rising interest in public markets, particularly through Qualified Institutional Placements (QIPs). For companies aiming to finance land acquisitions and pre-approvals, QIPs present a viable pathway for listed entities to quickly raise capital.

Nevertheless, timing plays a critical role in these decisions, with many promoters carefully weighing the trade-offs between diluting equity now or waiting for potentially higher valuations in the future.

» The Intersection of Regions and Assets in Capital Allocation

When examining the current dynamics of capital availability across different geographies and product types, it's evident that various sourcing strategies are in play, shaped by regional needs and specific asset classes.

In regions like Gurgaon, for instance, there is strong demand for residential growth capital. Meanwhile, in Mumbai, Slum Rehabilitation Authority (SRA) projects face unique challenges that restrict bank participation due to the lack of traditional collateral. In such cases, AIFs and NBFCs step in to bridge the gap, particularly where equity funding for land acquisition is needed.

From a banking standpoint, regions like Bangalore, Pune, and Hyderabad demonstrate robust demand for both residential and commercial growth capital. However, the market remains highly segmented, with needs varying significantly by geography and asset class. For example, in the northern region, particularly in the NCR, demand for CF is relatively low due to strong sales momentum, while cities like Ahmedabad exhibit healthy growth but remain concentrated among a few dominant developers.

Although the hospitality sector is flourishing, lenders remain cautious due to long gestation periods and the cyclical nature of the market. Banks generally prefer to finance hotel projects only once they reach more secure stages, whereas AIFs and NBFCs are more inclined to take on earlier-stage risks.

The industrial and warehousing sectors have also drawn growing interest from both banks and non-banking financial institutions, with partnerships involving major financial entities viewed positively due to fewer capital access challenges. However, the primary obstacle remains land acquisition, where clear and unencumbered land titles are crucial. Once this critical requirement is met, lenders are typically more willing to fund projects.

Redevelopment projects present another area of opportunity, though banks tend to be cautious, typically entering at the CF stage once all approvals are in place. Significant capital is required before reaching that stage, and AIFs have played a key role in filling this gap. While banks are gradually becoming more receptive to these opportunities, the bulk of early-stage redevelopment funding continues to come from non-banking sources.

» Shifting Dynamics in RE Funding

The evolving dynamics between NBFCs and banks have significantly impacted how real estate capital is sourced and structured. While banks have traditionally dominated the sector, recent regulatory tightening and shifting market needs have redefined the role of NBFCs, particularly in real estate.

The regulatory environment, once more lenient for NBFCs, underwent significant tightening after the Infrastructure Leasing & Financial Services (IL&FS) crisis, which exposed gaps in risk assessment, especially with loans backed by illiquid assets like land. In response, regulators implemented stricter guidelines to mitigate systemic risks, thereby altering the capital landscape.

A key distinction between NBFCs and banks remains regulatory compliance versus credit flexibility. Banks, operating under stringent compliance frameworks, have limited capacity to take on higher-risk real estate exposures, especially in areas where liquidity and security are concerns.

In contrast, NBFCs can offer more tailored solutions to address developers' immediate and varied needs, such as funding for government approvals and non-traditional requirements that banks typically avoid.

The interplay between NBFCs, banks, and AIFs is further complicated by the evolving expectations of homebuyers and retail investors, who increasingly leverage capital to invest in real estate. With return expectations often around 15%, this segment creates an environment where AIFs must carefully balance risk and return to stay competitive. This dynamic is especially relevant in markets with limited equity participation, where developers prefer to share risk with buyers rather than institutional investors.

The success of AIFs in this space hinges on their ability to cultivate deep expertise and design structures that effectively navigate both regulatory and market complexities. Unlike individual investors who leverage more agile, informal networks for decision-making, institutions face a steeper learning curve. To remain competitive, they must develop innovative, flexible structures that balance adaptability with rigorous compliance and robust risk management standards.

One promising approach involves hybrid structures where large capital players, such as AIFs, step into roles traditionally filled by homebuyers, setting performance milestones linked to project delivery. This strategy aligns investor interests with project timelines and provides a way for larger capital pools to enter the market without taking on excessive risk.

In the context of rising Credit-Deposit (CD) ratios and increasing regulatory pressures, the impact is more on pricing than on equity availability. Even as some banks scale back growth due to slower deposit inflows, equity remains accessible, though pricing adjustments are inevitable as regulations tighten.

An important aspect of this evolving landscape is the regulatory arbitrage between banks and NBFCs, which continues to influence funding strategies. Banks are restricted from directly financing land acquisitions, creating a gap that AIFs have effectively filled.

Historically, large institutions played a key role in land funding, but recent regulatory changes have shifted this responsibility to AIFs, offering much-needed flexibility. This transition has opened new opportunities for AIFs to finance the development phases of projects, where traditional banking channels cannot participate.

Although NBFCs are more flexible than banks, they remain cautious about land funding. Despite technically being allowed to finance certain land transactions, many NBFCs choose to avoid these due to regulatory risks.

Consequently, developers increasingly turn to AIFs, which provide a clearer and more straightforward compliance structure. This trend has led to more developers establishing their own AIFs to better manage capital, bypass traditional channels, and align funding strategies directly with their operational needs.

» Balancing Opportunity and Risk in Development

From a developer's perspective, striking the right balance between long-term planning and seizing market opportunities is crucial, especially given the unpredictable nature of market cycles, land acquisition strategies, and regulatory changes.

As they navigate these uncertainties, developers have had to adapt to a mix of General Development Agreements (GDAs) and outright land purchases, moving away from the days of committing large amounts of capital upfront. The emphasis has shifted toward capital efficiency, particularly as replenishing land inventories becomes increasingly challenging in an ever-evolving market landscape.

In this context, banks continue to play a vital role, particularly in providing CF and LRD. However, the growing demand for more creative financial solutions has been driven by developers' need for flexibility and the unique complexities of specific projects.

For instance, SRA developments in Mumbai present challenges that traditional banking structures often cannot fully address. This is where NBFCs and AIFs step in, offering bespoke financial products that can be tailored to the nuanced needs of these projects.

An emerging trend is that AIFs are increasingly avoiding approval risks by focusing on projects with key regulatory clearances already in place, leading to intensified competition as they target opportunities offering steady cash flows and lower regulatory hurdles. Developers who secure early-stage AIF funding benefit from favourable terms, but competition for these funds has grown increasingly fierce.

Transitioning to the discussion on distressed assets, particularly in luxury real estate and unfinished projects, developers are assessing the potential of acquiring these assets while managing the complexities of engaging financial institutions, regulators, and promoters.

As the market evolves, attracting the right capital partners is crucial, especially with rising foreign interest in India's real estate sector, which has driven a growing willingness to structure deals that balance fixed returns with upside potential.

Additionally, developers have explored creating sub-brands or adopting distinct structures to manage distressed assets while preserving their primary brand value, but carefully assessing capital pricing remains critical due to the significant regulatory hurdles and execution risks involved.

Developers are also facing a challenge in markets with surging land prices, where they must decide whether to continue with joint development agreements or shift to outright purchases, as rapid appreciation has made operating at the high end difficult without significant upfront capital. With landowners becoming more sophisticated in negotiations, acquiring prime locations has grown increasingly competitive, pushing developers to adopt more aggressive capital strategies.

» Evolving Strategies for Land Transactions

Lenders have adapted to land transactions by offering tailored financing structures based on end-use, whether residential or industrial. Ideally, they prefer acquisitions backed by cash flows from ongoing projects for risk cushioning but are also open to financing standalone land deals if thorough due diligence and approval risks are managed - albeit at a higher cost due to the increased risk.

A key aspect of these transactions is the flexibility lenders now offer with moratoriums on interest payments, acknowledging that regulatory delays or political changes can affect timelines. This accommodation allows developers to focus on approvals and project launches without immediate debt servicing pressure, with financing structures often aligning interest payments with projected cash flows.

Promoter contributions are also crucial, with lenders typically funding up to 70% of land value, requiring higher contributions in overheated markets to mitigate risks. Deals are structured to minimise corporate cash flow impact, helping developers maintain operational efficiency while acquiring land.

Special situation transactions, representing a growing share of land financing, remain complex and require expertise that is still developing in the market. Timely exits are critical to avoid financial strain, with the focus on replacing high-cost financing with more affordable long-term capital as projects progress.

» Exploring Equity Options

Equity financing discussions reveal developers' reluctance to involve equity partners, especially in favourable markets where debt is readily available. Given that equity is the most expensive financing option, most developers prefer leveraging debt, even at higher rates, to retain control and avoid sharing upside potential, with equity usually reserved for large-scale projects where the commitment is justified.

For mid-tier developers lacking established track records, raising equity is particularly difficult due to the absence of sophisticated governance structures. Conversely, larger developers with solid reputations and robust governance find it easier to attract equity investment when necessary.

Interestingly, family offices have emerged as significant players in providing equity-like capital. Having divested from operating businesses, these investors are increasingly willing to invest in real estate projects as long-term partners, and are often more flexible and engaging with developers, providing substantial capital while taking a more hands-on approach to project management.

Despite abundant capital in today's market, both borrowers and lenders must navigate pricing, structure, and terms that align with strategic goals. Whether through debt, equity, or hybrid structures, the evolving landscape offers various options, with success hinging on aligning financing strategies with each project's specific needs and risk profile.

JOINT VENTURES, STRATEGIC PARTNERSHIPS AND CROWDFUNDING

The discussion around joint ventures (JVs), strategic partnerships, and crowdfunding in India's real estate financing landscape highlights key trends and evolving structures, particularly within the warehousing and industrial sectors. As these sectors continue to mature, innovative financing and partnership models are increasingly shaping the future of the industry.

Though still relatively young, these markets have experienced substantial growth over the past decade, particularly during the COVID-19 period. Before the pandemic, they largely operated under traditional models, but now, the landscape has shifted toward more sophisticated partnership structures and diverse funding approaches, reflecting changing market demands.

Built-to-Suit (BTS) Models: Pre-COVID, the BTS model was the dominant approach, with large e-commerce players entering into agreements with developers for customised facilities. However, it has now declined as speculative development becomes less prevalent due to evolving demand patterns and a need for more flexible solutions.

Joint Ventures: JVs are common in the warehousing sector, often involving collaborations between developers and international capital providers, but they differ from other real estate asset classes due to specific tax and GST (Goods and Services Tax) limitations. These partnerships also frequently involve developers and end-users, such as logistics companies, to create customised warehousing solutions that meet the growing demand for specialised facilities.

Forward Purchase Agreements: Another growing trend is the use of forward purchase agreements, which allow developers to secure funding based on future land development plans. While this model provides flexibility, it is not without challenges - extended timelines between initial agreements and project delivery often lead to renegotiations due to shifting market conditions.

Long Leases: Given the high land costs in warehousing, long leases spanning between 30-50 years have emerged as a viable structure that has gained traction in urban centres and has even facilitated exits to international REITs, highlighting its growing appeal. These agreements enable developers to secure land without significant upfront capital while offering landowners long-term security.

Urban warehousing and distribution centres have become essential for last-mile logistics, particularly in the fast-growing quick-commerce and e-commerce segments. These facilities are strategically located within cities, with land costs often comparable to residential properties, underscoring the need for creative financing solutions.

Special Economic Zones (SEZs) have also gained renewed attention, offering tax incentives and proximity to major transport hubs, making them attractive for warehousing needs. Additionally, hybrid developments blending warehousing with office, retail, and F&B spaces are emerging, catering to the rising demand for mixed-use facilities.

On the strategic partnership front, major players have successfully scaled their operations by pooling resources across capital, land, and expertise. This collaborative approach has enabled large-scale developments that are resilient across multiple market cycles, highlighting the value of well-structured alliances in an unpredictable market.

For first-time developers entering the warehousing sector, delivering a high-quality initial project is crucial, as a successful launch with credible tenants not only builds trust but also facilitates capital attraction for future ventures. Despite this, JVs and strategic partnerships remain essential, especially in fragmented regional warehousing markets lacking national developers, which presents challenges in standardising quality.

While the initial e-commerce boom led to a surge in warehousing demand, the market's stabilisation has shifted focus toward quick commerce and urban logistics. With traditional large-scale warehousing becoming more competitive and dominated by fewer players, developers are increasingly exploring niche opportunities such as in-city warehousing, SEZs, and specialised storage solutions to meet evolving market needs.

» The Complexities of Structuring Resilient JVs

Despite notable success stories, not all joint ventures achieve their intended potential. Many face early exits or fail to fully deploy committed capital, primarily due to challenges related to scalability, governance, seed assets, and team stability. Understanding these challenges is crucial for developers and investors looking to establish resilient JVs.

Scalability is a key factor in determining a JV's success, closely linked to how efficiently capital is deployed. For example, when raising a USD 500 million platform, the ability to deploy capital effectively and achieve performance milestones is essential for building investor confidence and securing additional funding. Governance plays an equally critical role, particularly for international investors who prioritise strict standards.

These standards typically involve independent boards, well-structured incentives, and transparent management practices. Promoters, therefore, must be willing to share wealth with employees to ensure aligned incentives across the organisation, which is vital for long-term success.

Additionally, having seed assets ready for immediate deployment is essential for maintaining momentum. Deploying a significant portion of capital on day one can greatly enhance investor confidence and accelerate growth. Equally important is the stability and consistency of the team. High turnover or leadership instability can undermine the JV's prospects, making it imperative to maintain a cohesive and experienced management team to navigate challenges over the long term.

A critical aspect of JVs is the exit strategy, which remains one of the most challenging phases, even when meticulously drafted agreements include provisions like drag-along, tag-along, and buyout rights; exits can still become drawn-out and contentious. Misalignment in exit timing between founders and developers often leads to prolonged negotiations, particularly during capital market events like IPOs or REIT listings.

Legal experts highlight that unincorporated JVs, which lack ring-fencing and expose partners to unlimited liability, often face significant challenges during funding and exit stages, leading many established players to favour incorporated platforms that offer better safeguards and structured exit options, underscoring the importance of carefully choosing the right JV framework.

» Maximizing Potential in CRE Joint Ventures

JVs have been a key driver of growth in the commercial real estate space, enabling partners to pool specialised expertise and resources for mutual benefit. This strategic division of knowledge is particularly prevalent in commercial real estate, where collaboration allows for more efficient project execution and risk management.

A particularly effective yet often overlooked structure is the forward purchase model, which has played a crucial role in several major transactions. By allowing buyers to make phased payments over time, this model is especially attractive for landowners seeking to monetise prime assets gradually, rather than through lump sums. Breaking large transactions into distinct phases - such as land acquisition, construction, and regulatory compliance - also helps developers manage risks and cash flows more effectively, ensuring smoother project progression.

Large-scale JVs in the commercial sector typically involve foreign capital, driven by the substantial investment size and long-term commitment required. However, domestic capital, whether sourced from HNIs or local institutions, is increasingly making strides and, particularly in smaller or niche markets where international players may be less active, domestic investors step in to fill any gaps left by foreign capital.

The enduring appeal of JVs in commercial real estate lies in the significant value they bring, whether in terms of capital infusion, specialised knowledge, or enhanced governance structures. The success of these ventures depends on several critical factors, including scalability, governance standards, seed assets, and team stability.

THE IMPACT OF NEW AMENDMENTS ON AIFs

Recent amendments in the regulations governing AIFs have introduced significant changes, particularly in the areas of liquidation and dissolution schemes. Among the most notable developments is the conversion of the liquidation scheme into a dissolution scheme, addressing long-standing issues that previously left certain funds lingering indefinitely, complicating tax and compliance matters.

The new structure brings much-needed clarity, ensuring a more definitive resolution process. However, concerns remain regarding the practicalities of in-specie distribution - where assets are directly transferred to investors - especially when assets are embroiled in litigation. In such situations, the responsibility shifts to fund managers, who must continue managing these assets until a resolution is achieved, emphasising SEBI's critical role in holding managers accountable.

The introduction of a more flexible dissolution scheme, which provides a one-year extension with the possibility of further extensions contingent on 75% investor consent, has been a welcome relief for the industry. Despite this added flexibility, managing exits without compromising investor returns or tarnishing the manager's track record remains a primary concern.

This flexibility is especially advantageous for real estate assets, where timelines are often prolonged, though in-specie distributions continue to present significant challenges. In the real estate sector, particularly with NCDs, such distributions can result in foreign exchange complications and negatively impact the manager's performance history, potentially hindering future fundraising efforts.

A key challenge in this process is aligning the interests of fund managers with those of investors, particularly when there are concerns that managers may prolong a fund's life solely to continue earning fees. Here, SEBI's oversight is crucial to ensuring that managers fulfil their duties, even after the fund's original tenure has ended. Instead of resorting to in-specie distributions, which can leave investors fragmented and vulnerable, managers should be held accountable for resolving cases, especially those complicated by litigation.

The governance implications of multiple small investors taking ownership through in-specie distributions add another layer of complexity. Ensuring consistent management and preventing a decline in asset performance due to fragmented ownership becomes increasingly difficult in such scenarios.

When in-specie distribution is unavoidable, it should be treated as a last resort, only considered after exhausting all other options, such as auctions. If an asset holds value, a buyer will likely emerge during the auction phase, offering a more cohesive exit strategy.

SEBI's recent amendments mark a step forward in managing dissolution periods more effectively. Extending a fund's tenure to provide better exit opportunities is generally preferable to forced in-specie distribution, though this approach requires substantial investor buy-in and careful management of dissenting investors seeking early exits.

Convincing investors to extend their commitments for an additional 5 to 7 years is no easy task, especially with the 75% approval threshold. Fund managers also face the challenge of navigating the financial complexities of offering exits to those unwilling to continue. Nevertheless, if the underlying assets are strong, particularly in a recovering real estate market, this approach offers a more stable and profitable exit path for investors.

Ultimately, the onus is on fund managers to demonstrate the value of extending the timeline, as the final investments often have the greatest impact on overall performance metrics. These regulatory changes introduce new operational challenges for the industry but also offer the potential for more investor-friendly outcomes, provided they are implemented with careful oversight and robust governance.

In parallel, the introduction of new regulations in the AIF space has created both opportunities and challenges, particularly in how banks and fund managers engage with these vehicles.

Historically, banks were restricted from investing in AIFs with downstream equity investments due to concerns over conflicts of interest and compliance issues, but recent regulatory changes now permit such investments if the equity meets specific guidelines. While this shift has generated interest from banks and AIF managers alike, it also raises questions about how hybrid instruments will adapt within this evolving framework.

Banks are a vital source of liquidity for AIFs in India, with several funds already benefiting from this access. However, the Reserve Bank of India (RBI) issued a circular last year imposing a blanket ban on banks investing in AIFs connected to companies with existing loans from those banks. This regulation was intended to prevent the evergreening of loans, but it has also created challenges for fund managers who heavily rely on banks for capital.

These ongoing regulatory adjustments highlight the delicate balance between compliance and opportunity. On one hand, fund managers and banks are exploring ways to navigate these rules without disrupting their operations. On the other hand, SEBI has introduced stricter guidelines requiring fund managers to conduct due diligence on investors to ensure that their investments do not circumvent FDI rules.

This additional compliance burden places more pressure on managers to scrutinise the origins of investor funds closely. The industry response has been mixed; while some view these measures as overly restrictive, others see them as necessary safeguards to protect the market.

The conversation also addressed the potential for listing AIFs, particularly as a means of offering liquidity to large institutional investors such as pension funds. Although the regulatory framework allows for listing, significant challenges remain due to the underdeveloped market for trading AIF units.

Issues like large ticket sizes, liquidity constraints, and valuation complexities make listing a distant prospect, though it remains a long-term goal for the industry. Innovations such as fractional ownership and tokenization could help address these challenges, but the market needs time to mature before these solutions can be fully realised.

Governance concerns are also particularly significant in developer-led AIFs, where conflicts of interest can arise regarding investment allocation and investor protection. To manage these conflicts, transparency, full disclosure, and proper alignment of interests are essential, giving investors clear visibility into fee structures, development costs, and potential returns.

Although the AIF landscape in India is growing rapidly, key areas still require regulatory refinement and operational improvement. Focusing on transparency, governance, and compliance will be crucial for maintaining investor confidence and sustaining growth as the industry navigates challenges and capitalises on opportunities like GIFT City, which will be pivotal in shaping its future trajectory.

» Unlocking Fund Potential in GIFT City

One of the most significant areas where these regulatory shifts are evident is in the growing focus on leveraging the Gujarat International Finance Tec-City (GIFT) City as a jurisdiction for fund pooling. GIFT City offers several advantages, including allowing Non-Resident Indians (NRIs) to invest as Foreign Portfolio Investors (FPIs), a process previously hindered by FDI restrictions. Additionally, the zero capital gains tax within GIFT City makes it an attractive option for equity investors.

Beyond these advantages, the broader implications of these changes are evident in discussions around leveraging within the GIFT City framework, where the introduction of leveraging capabilities could draw more interest, particularly for structured debt and real estate investments. The success of these initiatives will largely depend on how effectively fund managers navigate operational hurdles and adapt to the evolving regulatory landscape.

When it comes to leveraging GIFT City and AIFs, the scenario presents both opportunities and challenges. The ability to apply leverage at both the fund and asset levels within GIFT City's flexible framework has become a crucial strategy for maximising returns, particularly in commercial real estate and other income-generating asset classes.

These opportunities come with inherent challenges, as leveraging at the fund level has historically been difficult due to enforcement issues and regulatory constraints. While jurisdictions such as Mauritius have made this process relatively straightforward, the Indian context presents complexities, especially when enforcing foreign-denominated loans on domestic assets, creating significant barriers.

The regulatory framework and foreign exchange regulations create additional limitations, making it difficult to pledge assets and secure loans effectively. For example, foreign banks often struggle to enforce their rights on Indian assets due to cumbersome legal procedures and restrictions, adding layers of risk for investors. Operational challenges - such as setting up offices and staffing in Ahmedabad - also remain significant deterrents for some.

Even with these challenges, GIFT City offers potential solutions, although enforcement remains a crucial concern. While GIFT City operates as a foreign currency jurisdiction, making it attractive to offshore investors, constraints on rupee financing and complexities in pledging assets within India still present obstacles.

As the regulatory environment continues to evolve, its role will be critical in determining how effectively these leveraging opportunities can be realised, particularly as new regulations aim to simplify processes and enhance fund-level financing.

TRANSFORMING REAL ESTATE WITH INDIA'S FIRST SM-REIT

While globally established for over 65 years, particularly in the US, REITs in India operate under a robust regulatory framework, offering investors exposure to real estate assets like commercial properties, office spaces, and retail centres. SM-REITs take this model further by introducing greater flexibility and customisation, enabling smaller players and niche markets to participate more effectively.

Unlike traditional REITs, which pool all investors into a single portfolio, SM-REITs allow for multiple schemes under a single framework. Each scheme can focus on different properties or portfolios, providing investors the flexibility to choose their exposure based on specific investment goals. This modular approach caters to diverse investor needs, offering options that align with various risk profiles and preferences.

Once registered with SEBI, SM-REITs can scale by launching tailored schemes for different property types and market conditions. Structurally, they share similarities with traditional REITs - such as having a sponsor, manager, trustee, and pool of investors - but add the flexibility to manage distinct portfolios within a single entity. This enhances transparency and operational efficiency while allowing managers to expand across diverse asset classes and geographies.

Regulations limit each SM-REIT scheme to INR 5 billion in assets, promoting controlled growth while enabling managers to launch multiple schemes to build a balanced portfolio. As industry players prepare to explore these opportunities, the first wave of SM-REITs is expected soon, potentially reshaping real estate investment in India.

By offering a dynamic and scalable model, SM-REITs provide targeted exposure for investors and operational efficiency for managers. Their structure - tailored to the specific needs of smaller and medium-scale investments - introduces distinct features that streamline governance and align stakeholder interests.

SM-REITs involve multiple stakeholders, including a SEBI-registered trustee, an independent investment manager, and unit holders. The investment manager must meet specific criteria to align interests, while unit holding rules prevent any single investor from dominating the scheme.

Flexibility in leverage is another advantage of SM-REITs, allowing managers to opt for either leveraged or unleveraged models depending on market conditions. For leveraged schemes, the manager is required to hold a minimum stake for the first three years, ensuring alignment of interests before relaxing requirements over time.

» Migration System

Existing platforms can migrate to the new SM-REIT framework, allowing established asset managers to benefit from the enhanced regulatory environment and provisions that retain certain existing features. This flexibility enables seasoned players to leverage their expertise while accessing new growth opportunities within the SM-REIT model, positioning themselves advantageously in a rapidly evolving market.

Specific exemptions have been introduced to facilitate the transition for real estate structures, such as waiving the usual requirements for a minimum number of investors and the INR 50 crore asset threshold. However, the INR 10 lakh minimum investment requirement remains to ensure participation is limited to sophisticated investors, offering a balanced approach that encourages involvement without compromising investment quality.

Importantly, the migration process is time-sensitive, requiring applications to be submitted within six months, followed by a processing period and an additional six months to complete the transition. Only structures that existed before the March 8, 2024, regulations are eligible, ensuring a smooth yet structured transition that allows participants to align with the updated regulatory framework.

After migration, each SM-REIT scheme will go through a formal IPO process on stock exchanges. Although the process is more streamlined than traditional REITs, it still requires significant due diligence because each scheme is focused on a single property, making it a more concentrated investment vehicle.

Unlike mutual funds that raise capital with broad investment mandates, SM-REITs are designed to raise funds specifically for pre-identified real estate assets, offering targeted exposure for investors interested in specific asset classes.

» Key Observations and Industry Sentiment

Industry leaders are actively navigating both the opportunities and challenges surrounding SM-REITs, which are poised to reshape India's real estate investment landscape. Key discussions have focused on diverse topics, such as rent-generating assets, compliance costs, and market expectations, reflecting both the potential and complexities of this new framework.

The introduction of SM-REITs has been well-received, with SEBI's regulatory framework providing a solid foundation, but real estate investments require a tailored approach that considers factors like ticket sizes, liquidity, and investor accessibility. T

One primary concern is the INR 10 lakh minimum ticket size, which restricts participation mainly to HNIs and restricts broader investor access, while liquidity challenges persist, especially for those seeking early exits before the lock-in period ends.

While current regulations primarily cater to top-tier investors, there is growing interest in making SM-REITs more inclusive. Concepts like fractional ownership and tokenization are being explored to democratise access, allowing smaller investors to participate. Given the tech-savvy nature of Indian investors, leveraging technology for innovative solutions could expand market reach and engagement.

As industry players consider these possibilities, the immediate challenge lies in migrating existing platforms to the SM-REIT framework and adapting to new regulations. This transition requires time for platforms to align with the updated requirements, making the next six months crucial for raising awareness, educating stakeholders, and addressing uncertainties. Continuous dialogue with SEBI is vital for refining the regulations, with initial feedback indicating SEBI's willingness to remain flexible and responsive as the market matures.

For fund managers, the focus during this transition will be on laying a strong foundation, building credibility, and standardising processes, much like the early stages of alternative investment platforms in 2020. Some regulatory constraints, such as extended property acquisition timelines, remain challenges, but there is optimism that ongoing discussions with SEBI will lead to streamlined solutions, including shorter approval timelines.

High compliance costs also present a significant hurdle, making it challenging for market players to launch multiple schemes and potentially diminishing investor interest despite favourable conditions. To address this, industry stakeholders are exploring collaborative solutions with RTAs, stock exchanges, and regulators to reduce costs and unlock the potential of SM-REITs, which could lead to significant market valuations if successful.

Economic return expectations remain a critical focus. Unlike fractional ownership models that clearly define returns based on projected property appreciation, SM-REITs face challenges in meeting investor expectations due to higher compliance and distribution costs. To deliver a 9% return, asset managers must aim for returns closer to 10.5% to cover expenses, which is not always feasible under current market conditions.

SM-REITs provide developers with a strategic exit strategy for non-core properties, offering liquidity while ensuring these assets are professionally managed and monetized. Although SM-REITs are well-suited for smaller or non-essential holdings, concerns about asset quality, investor education, and perceived risks - especially for first-time investors - remain significant challenges that need to be addressed.

Tax regulations also present missed opportunities. If tax deferral options were available for asset swaps, enabling property owners to exchange real estate holdings for SM-REIT units without immediate tax liability, significant value could be unlocked through large-scale redevelopment, particularly in areas like Noida. Such flexibility could drive upgrades of older assets and enhance overall market quality.

SM-REITs have strong potential to capture underserved mid-market assets, but their success will depend on regulatory refinement, cost efficiency, and clear communication of benefits to both retail and institutional investors.

As industry attention shifts toward refining regulations and educating participants, there is optimism that SM-REITs could become a major player in India's real estate market by offering diversified investment opportunities and enhancing liquidity for mid-sized assets. Although initial challenges remain, industry leaders believe that with proper regulatory adjustments, cost management, and investor education, SM-REITs can thrive alongside traditional REITs and AIFs, providing a more nuanced and flexible approach to real estate investment that caters to diverse preferences and asset classes.

» SM-REITs vs AIFs and FOPs

One key observation from market participants is the evolving interplay between different investment vehicles like AIFs, Fractional Ownership Platforms (FOPs), and the newly introduced SM-REITs. As these platforms develop, understanding their unique advantages and limitations becomes increasingly important for investors navigating India's real estate market.

AIFs currently hold an advantage due to their flexibility in raising and deploying capital, especially when timing is critical. With ready capital, AIFs can close deals faster, giving them a competitive edge over SM-REITs, which often face longer timelines due to regulatory and compliance processes.

Yet, as SM-REITs mature and the regulatory framework stabilises, there is growing optimism that these timelines will shorten, potentially levelling the playing field and allowing SM-REITs to compete more effectively in time-sensitive deals.

What sets AIFs and SM-REITs apart is their structural design and investment approach. While AIFs typically require acquiring 100% ownership of an asset, SM-REITs offer more flexibility by enabling fractional ownership without full control. This difference, coupled with the ability to leverage assets, positions SM-REITs as an appealing option for smaller or specialised assets, thereby carving out a distinct niche within the real estate investment landscape.

As regulatory discussions continue, attention has turned to the potential impact of SM-REITs on FOPs, particularly those operating in unregulated or semi-regulated spaces. There is debate over whether SM-REITs could phase out FOPs, but as long as FOPs adhere to private placement norms and avoid public solicitation, they remain within legal bounds.

The key distinction lies in how these platforms raise capital - through private, one-on-one outreach versus public offerings - and the varying regulatory obligations tied to each method. For investors seeking rapid capital deployment into high-quality assets, FOPs might still hold an edge due to their flexibility and speed.

Operational challenges also factor into this evolving landscape, particularly from a tenant's perspective. Tenants generally prefer dealing with professional entities that ensure consistent quality and seamless management, rather than fragmented ownership structures where multiple small investors could complicate decision-making.

As a result, the reliability and reputation of the management team, whether within an SM-REIT or FOP, are critical in mitigating tenant-related risks. This shift toward centralised, professional management is viewed positively, as it enhances both asset quality and tenant satisfaction, ultimately making these platforms more attractive to investors.

SM-REITs, AIFs, and FOPs are expected to coexist in India's real estate investment market, each catering to different investor profiles and asset types. By leveraging their unique strengths - such as FOPs' flexibility, AIFs' established structure, and SM-REITs' regulatory transparency - the market is poised for diversification and growth. As these platforms leverage their distinct advantages, the market is positioned for greater diversification and growth.

Tighter regulations and sophisticated investors are likely to spark healthy competition, driving innovation and raising industry standards. This dynamic environment will enhance the real estate market's resilience and diversity, with SM-REITs, AIFs, and FOPs collaborating and competing to offer more tailored investment opportunities and foster sustained growth in India's real estate sector.

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