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Too much money & few deals force NBFCs to reduce interest rates for real estate developers

In the 18 to 24 months, interest rates for debt deals, which are mostly structured transactions, have dropped by 1-2%.

Sanu Sandilya & Ravi Teja Sharma | ET Bureau | 19 April 2016, 7:20 AM IST

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NEW DELHI: Too much money, too few deals. That's what is pushing non-banking finance companies (NBFCs) and private equity funds to further reduce interest rates on debt deals with real estate developers.

In the 18 to 24 months, interest rates for debt deals, which are mostly structured transactions, have dropped by 1-2%. For instance, transactions before 2014 were being inked by investors at anywhere between 19% and 20%. Since the mid of 2014, however, they have gradually come down to between 16.5% and 18%, say NBFCs and funds.

"There is a migration to back better quality developers and to finance better quality projects, which is leading to competitive pressures and, therefore, the rates are coming down," said Sanjay Grewal, chief executive officer of NBFC Altico Capital, which is looking to invest around Rs 2,500 crore in tier-I cities this year.

Grewal points out that there is a lot of liquidity coming into the sector and everyone is looking to finance good quality developers and projects in the same tier-1 cities, with very similar strategies. "This has pushed down interest rates between 1% and 2% in the last year and a half," he said.

Gurgaon-based builder Orris Infrastructure, for instance, had taken Rs 80 crore from Kotak Realty Fund in 2011-12 at 21%. In 2013, it took Rs 200 crore from Xander at 20%, using some part of the money to repay Kotak.

A few months back, Orris took Rs 325 crore from NBFC Indostar at sub 18% using it to prepay Xander. Recently, the builder again raised Rs 100 crore from NBFC Xander Finance at an interest rate of sub 18%.

The supply of debt has increased exponentially over the last two to three years as several new players, including the likes of Piramal, KKR, Altico, Indiabulls Real Estate, IndoStar and others, ventured aggressively into funding real estate projects.

Diwakar Rana, managing directorcapital markets at property consultancy Cushman & Wakefield, said the nature of deals has changed since 2010-11, when builders were borrowing to enhance their profits by buying more land and starting new projects.

"Post 2014, developers have realized home sales are not happening and cash flows are going to be tough. Now they are borrowing for sustaining existing projects," says Rana.

As home sales have slowed down, investors are betting more on secure projects where they can see actual data in terms of project performance, sales etc. This means most money is gunning for late stage deals, especially in projects where good sales have happened in the initial stages.

"That is why many deals are refinance deals, where cheaper money is replacing older, more expensive money," he says.

Some funds and NBFCs are also doing special situation funding where some part of the return is back-ended.

"Cash flow is a big factor in real estate projects and you can't have a deal now where margins are around 25% and the coupon rate is around 22%. That's not sustainable.