



KPMG India Real Estate Conference 2007

Is This A Good Time To Be A Real
Estate Private Equity Investor in India?

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September 02, 2007, Tel Aviv (Israel)

LEHMAN BROTHERS

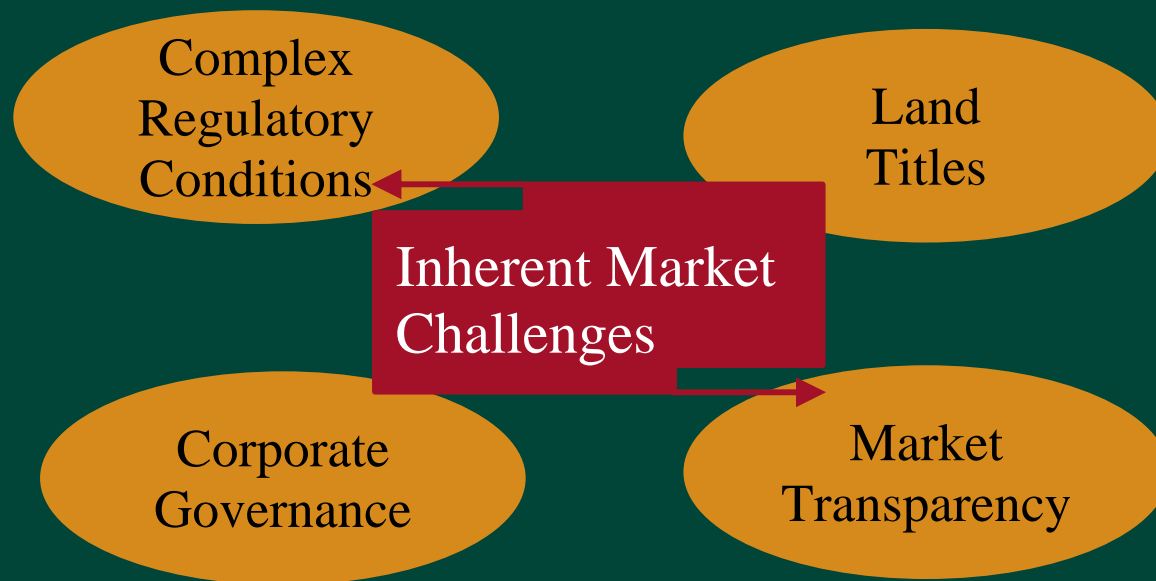
India – Market Opportunities

	Description of Changes	Details
Easing of Regulatory Restrictions	<ul style="list-style-type: none">◆ FDI in property developments allowed◆ Rationalization of legislative framework and stamp duties, revision of municipal bye-laws◆ Simplification of procedures for land use conversions	<ul style="list-style-type: none">◆ Only Greenfield development is allowed. Foreign investors cannot buy and sell unimproved/raw land or already developed buildings◆ Commercial projects under construction over 540,000 sft. Residential developments larger than 10 hectares◆ Minimum investment of \$10mm for wholly owned subsidiaries and \$5mm for JVs◆ Repatriation cannot occur until after 3 years from minimum capitalization threshold (variances can be granted)◆ Special Economic Zones facilitate the entitlement process and provide 10-year corporate tax exemption◆ Stamp duties can be as high as 10-12% in some states encouraging the use of SPVs or SPEs

India – Market Opportunities

	Description of Changes	Details
Increase in transaction transparency 	<ul style="list-style-type: none">◆ Computerization of land data by selective state governments◆ Rating agency (e.g., ICRA & CRISIL) focus on real estate and construction industry◆ Formation of associations to promulgate code of ethics & standard procedures	<ul style="list-style-type: none">◆ REITs are projected to be introduced as soon as 2008, providing potential exit liquidity and increased transparency

India – Market Challenges



India – Market Challenges

Constraints on capital availability

- ◆ Institutional debt finance is expensive, access is limited to large developers, with strict collateral and debt coverage ratio requirements, and requires long lead times
- ◆ Bank debt is made “with recourse” to developer
- ◆ Developers resort to unorganized private financing from multiple small investors, thus increasing management and financing costs
- ◆ Pre-sale financing - limited to residential projects – depresses returns

Constraints on land availability

- ◆ Though improving, limited availability of clear titled land for development
- ◆ Landowners with “prime” properties prefer to enter into joint-development deals with reputed developers (who have limited financing capacity)
- ◆ Gaining access to government-owned land is time-consuming

Other constraints

- ◆ Absence of national players in property development
- ◆ India’s construction industry productivity significantly lower than global average

India – Challenges and Risks

	Major Risks	Mitigating due diligence/deal selection criteria
Market Risks	<ul style="list-style-type: none">◆ Supply vs. Demand (overbuilding)◆ Transparency<ul style="list-style-type: none">– The real estate market is not as transparent as international practices require◆ Terms of Lease<ul style="list-style-type: none">– Typically lease terms are short, sometimes as little as three years, and tenancies turnover frequently◆ Quality of Development<ul style="list-style-type: none">– Quality of building standards are not uniform across the country and not as stringent as in other more developed countries	<ul style="list-style-type: none">◆ Understand market trends; avoid conditions of over-supply◆ Check tenant creditworthiness; negotiate longer lock-in periods; have tenants build their own interiors◆ Involve honorable entities, inquire into developers' track records

India – Challenges and Risks

Investment and Financing Risks

Major Risks

- ◆ Security of Investment
 - Loans for acquiring or developing properties are made for relatively short terms, and the amortization period runs parallel with the loan term.
 - Much of a property's cash flow goes to debt service, and owners look to appreciation in the value of their properties at the end of the investment period to meet their return expectations

Mitigating due diligence/deal selection criteria

- ◆ Investigate developers' balance sheets and quality of prior construction
- ◆ Banks now taking a more favorable view of project-level real estate risks, and are considering bullet structures for loans
- ◆ Structure favorable lease terms; conduct careful market and project analysis

India – Challenges and Risks

	Major Risks	Mitigating due diligence/deal selection criteria
Regulatory Risks	<ul style="list-style-type: none">◆ Conversion & title of land (titles to land are not clear in many cases)◆ Cannot trade land (even if market conditions change)◆ Local bye laws (high transfer taxes; tax regime)◆ Authority approvals<ul style="list-style-type: none">◆ There is bureaucracy and possible delays in obtaining approvals which may be required at the local state level◆ Corruption<ul style="list-style-type: none">◆ In Transparency International's last corruption ranking, India ranked 88th of 150 countries	<ul style="list-style-type: none">◆ Ensure clear titled land and ease of conversion of land use◆ Secure compliance of all construction with local bye laws◆ Obtain all necessary governmental permits and approvals

India – Challenges and Risks

	Major Risks	Mitigating due diligence/deal selection criteria
Execution Risks	<ul style="list-style-type: none">◆ Large availability of foreign/domestic capital◆ Creates auction situations and tougher term sheet negotiations for partnerships/JVs)◆ Structuring<ul style="list-style-type: none">◆ Local developers would rather own property long-term than sell, leading to disconnect about exit strategy◆ Unfamiliar with promote structures◆ Desire to be compensated (premium) for their lengthy effort to amass land and conversion◆ Legal<ul style="list-style-type: none">◆ Court system can be ineffective in enforcing “paper” agreements (e.g. term sheets)◆ Experience<ul style="list-style-type: none">◆ Developers taking on much larger volume projects than ever before	<ul style="list-style-type: none">◆ Must be able to act quickly and opportunistically in evaluating transaction opportunities◆ Leverage existing relationships and strength of Lehman global brand name to become preferred partner

India Reality Check: Is There A Problem?

“India may be too hot to handle as supply surges...Is too much being developed too soon...?”
(*DTZ Research, May 2007*)

“Cyclically, challenging times — India’s real estate market is in pain: transaction volumes are drying up, higher interest rates and prices have damaged affordability, developers are suffering a regulatory/capital markets squeeze, supply is impending, and the consensus view is almost unanimous that property prices are set to fall. In sum, it’s pretty tough for the country’s property developers...” (Citigroup Research, May 2007)

“India’s greatest asset today is everyone’s imagination...”
(*US Billionaire Sam Zell, Mumbai Real Estate Conference, April 2007*)

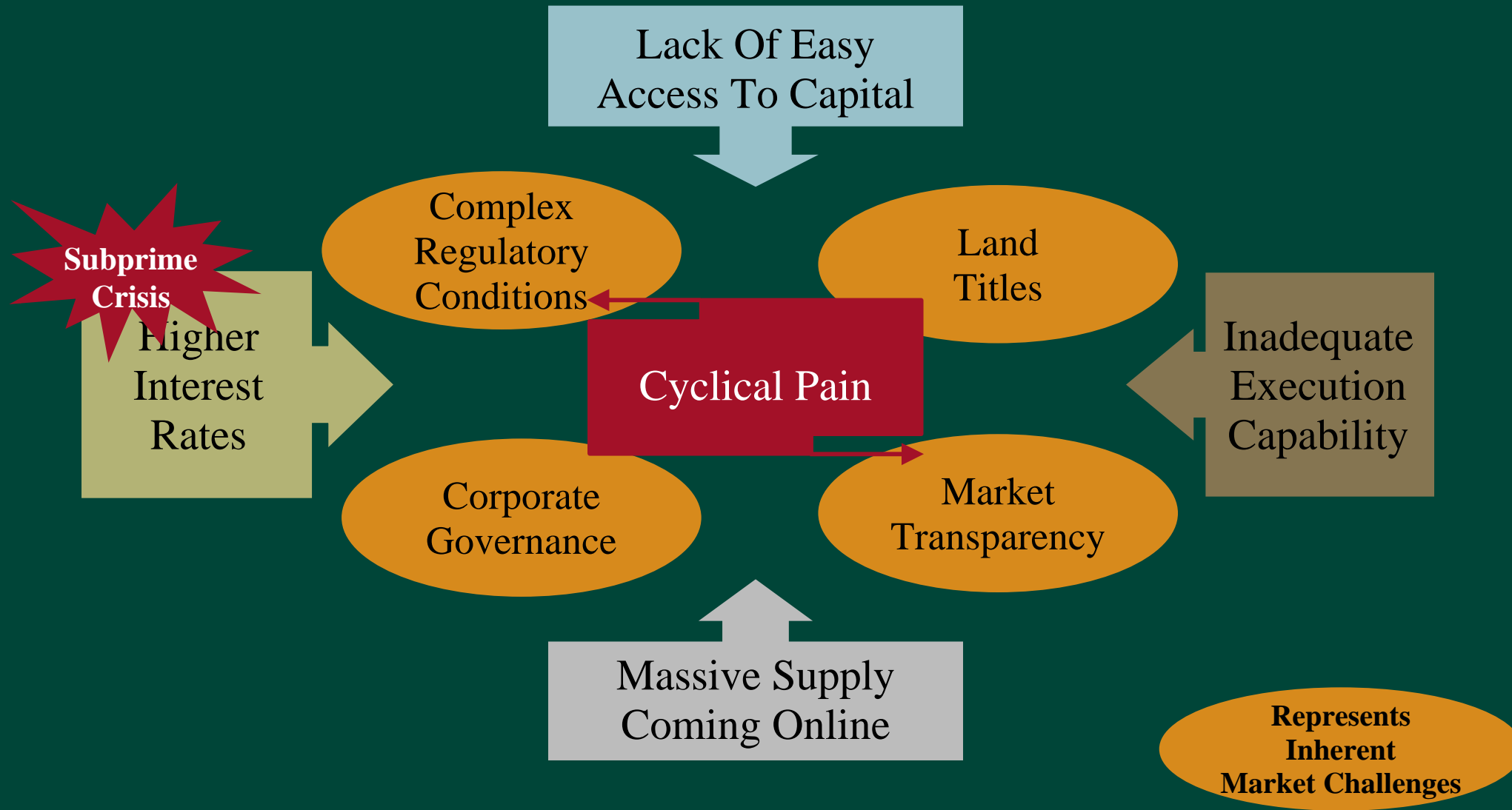
“It's very scary, prices are sky high...I don't know when the correction will happen, but there's significant overheating...Our expectation is that sometime in the course of this year you'll see a 30 to 40 percent drop in prices...”
(*Various Fund Managers, Mumbai Real Estate Conference, April 2007*)

India Reality Check: Is There A Problem?

“Though indirect ripples cannot be ruled out, the subprime crisis should not affect Indian real estate sector as much as it impacts European countries and the US...There may be some blips or dips in the real estate sector as it is closely related to mortgage loans, but infrastructure looks perfectly fine. As far as India is concerned, the construction sector would continue to do well in the long-term...the sector would be bouyant as foreign direct investment into India is unlikely to drop...?” (*Ekmkay Shares and Stock Brokers analyst Navin Jain, ET August 2007*)

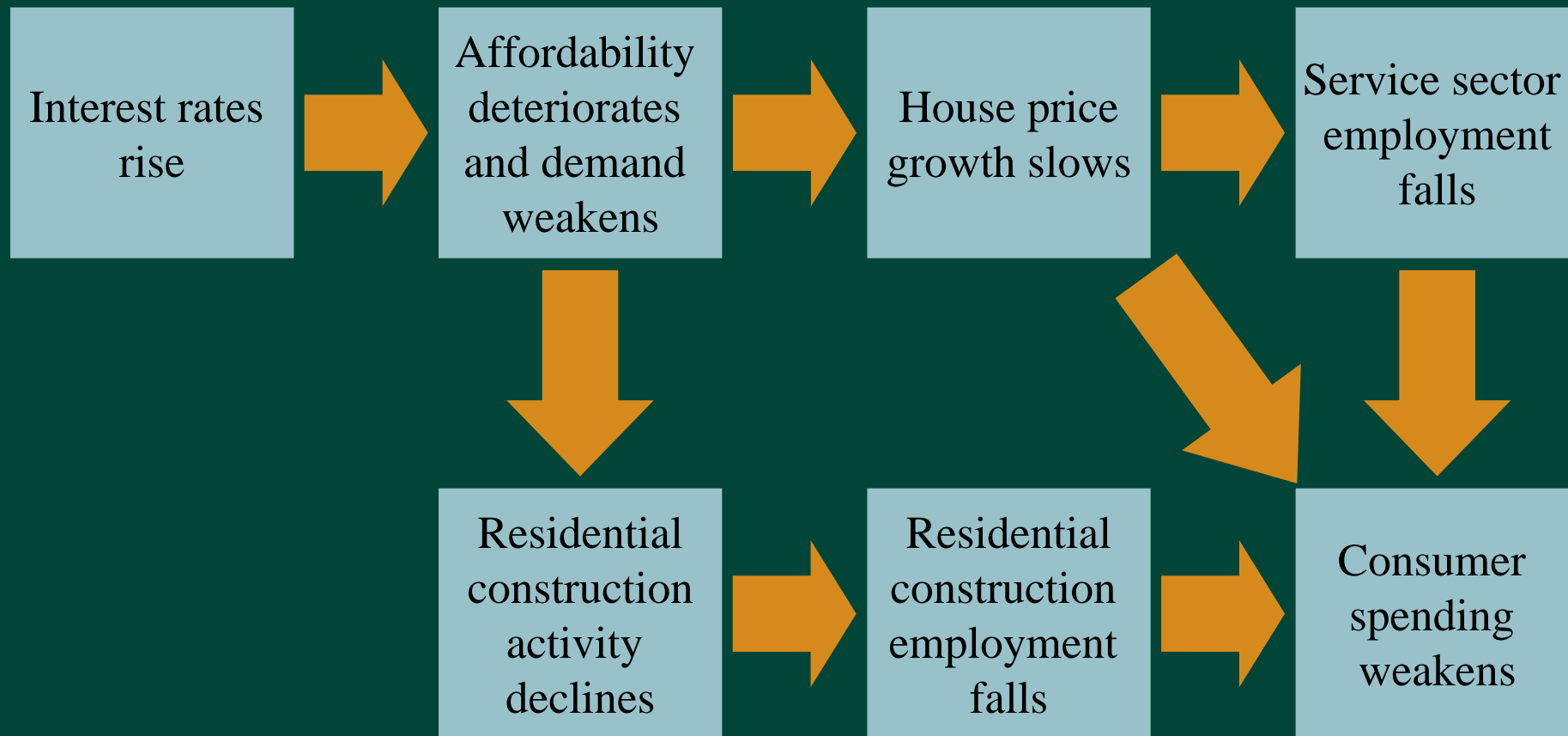
“Indian real estate does not have any direct exposure to the US subprime credit market. Moreover, subprime fears in the US can only trigger negative sentiment in markets that have low or no exposure; there will be only concerns of a probable real estate slowdown shrouding the sector in subprime insulated markets.. However, to be on the safer side, investors can overlook real estate stocks for some time; infrastructure companies look good even in these market conditions (*India Infoline vice-president research Amar Ambani, ET August 2007*)

India Reality Check: The Cycle



India Reality Check: The Cycle

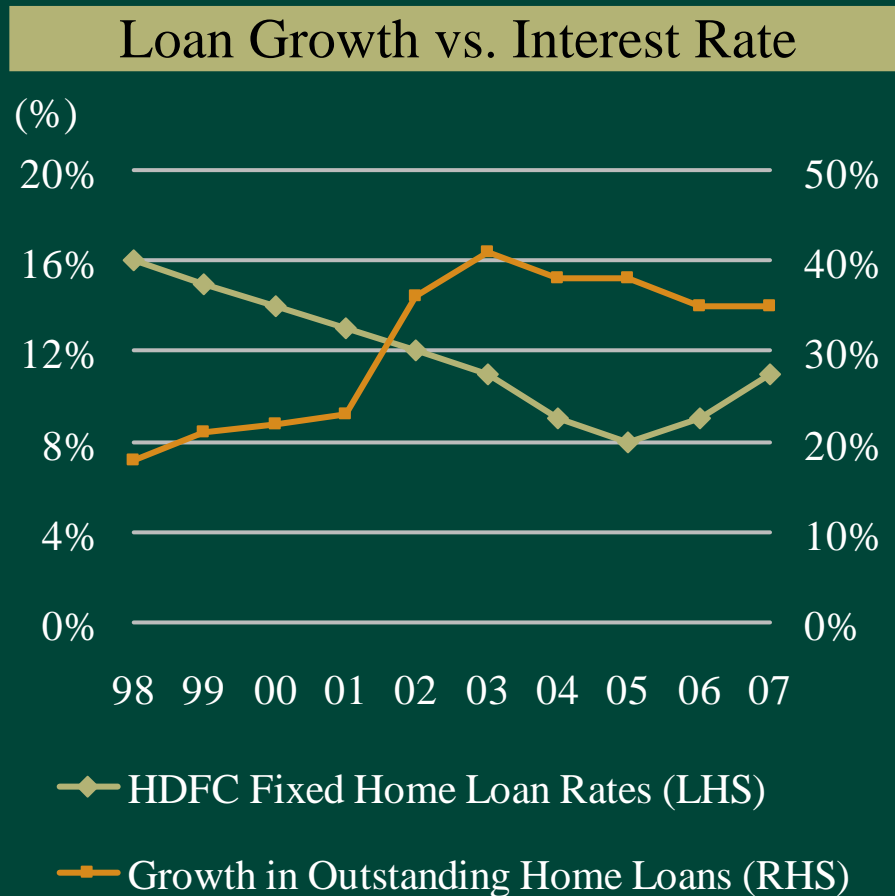
Higher Interest Rates (1 of 3)



Source: Macquarie Research Equities, November 2006.

India Reality Check: The Cycle

Higher Interest Rates (2 of 3)



Interest Rate / EMI

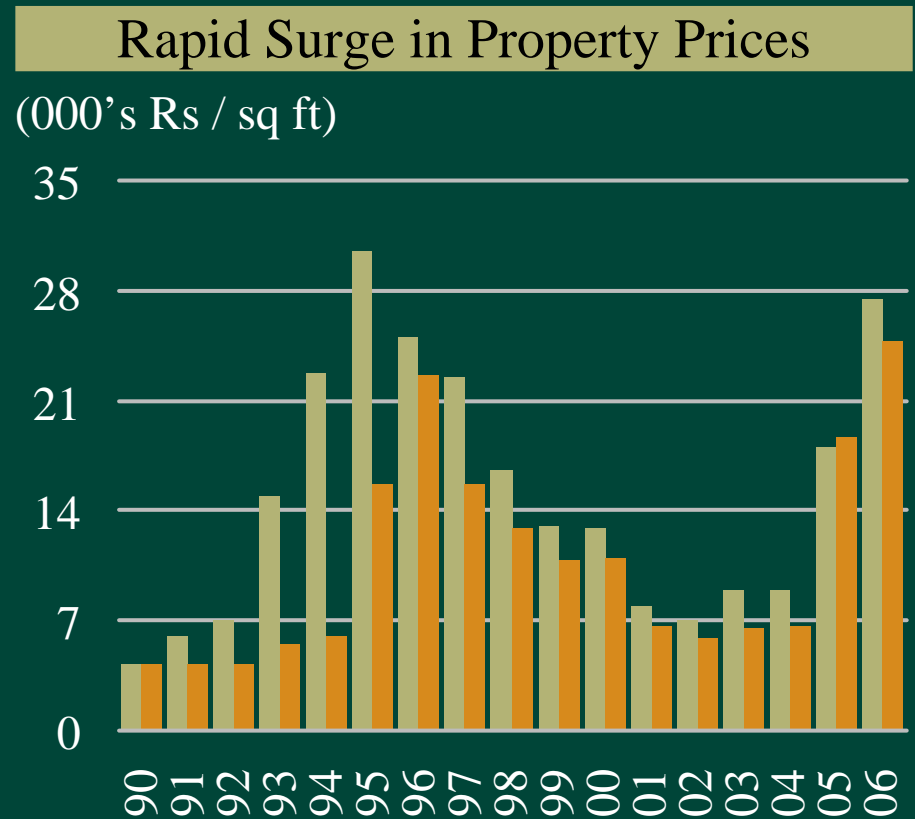
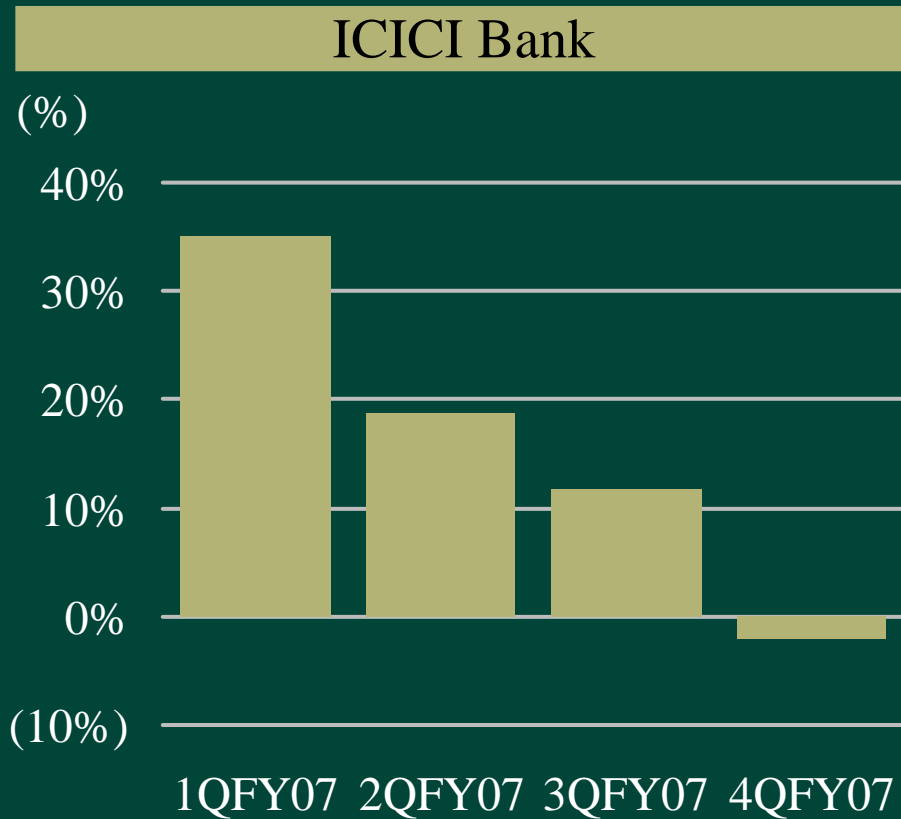
Interest Rate (%)	EMI (Rs)
7.5	806
8.5	868
9.5	933
10.5	999
11.5	1,067

Sensitivity is High

Source: Citigroup Investment Research, ENAM Research.

India Reality Check: The Cycle

Higher Interest Rates (3 of 3)



YoY Growth in Quarterly Home Loan Disbursements Declining

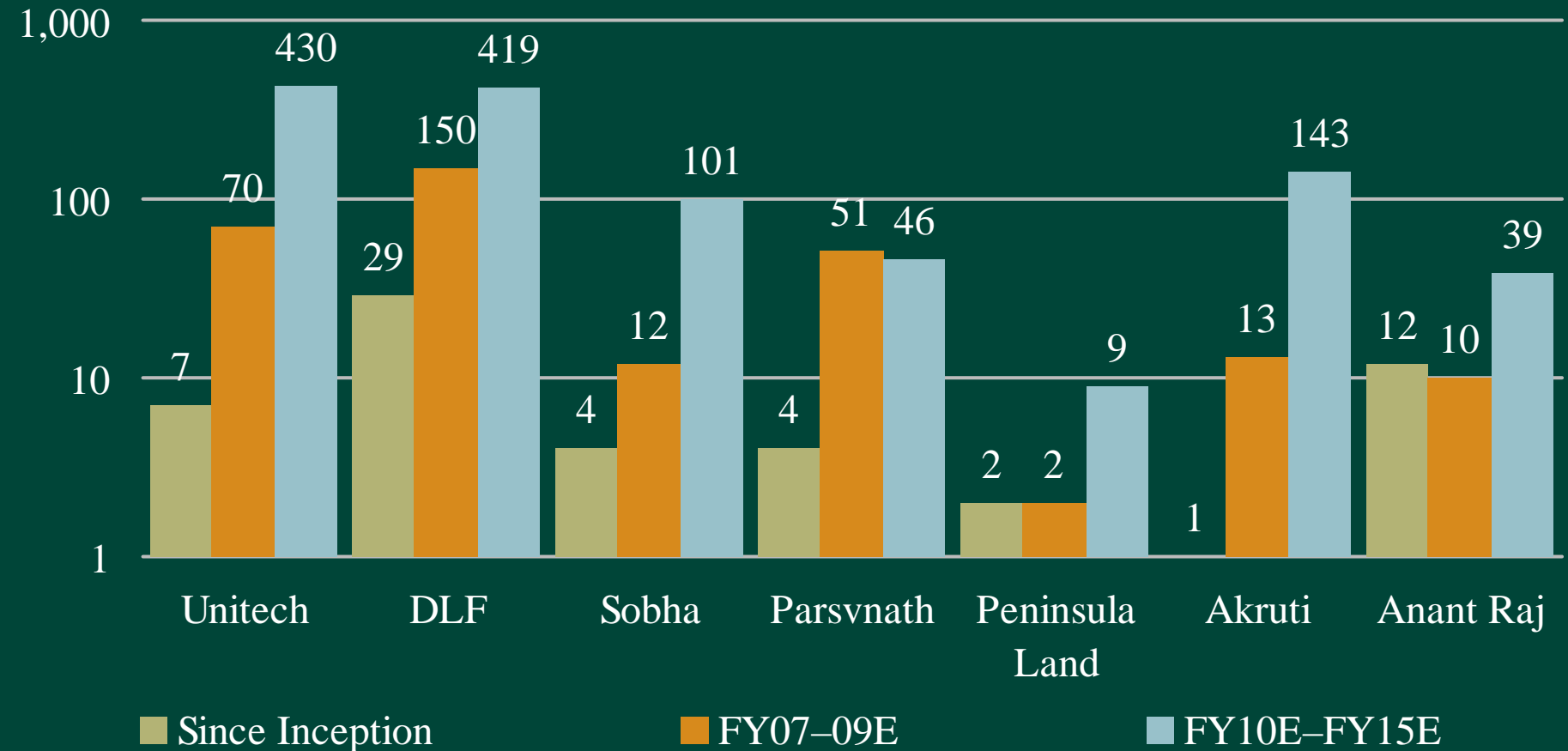
Source: Citigroup Investment Research, ENAM Research.

India Reality Check: The Cycle

Inadequate Execution Capability

Huge Scale-Up in Execution – Can it be Achieved?

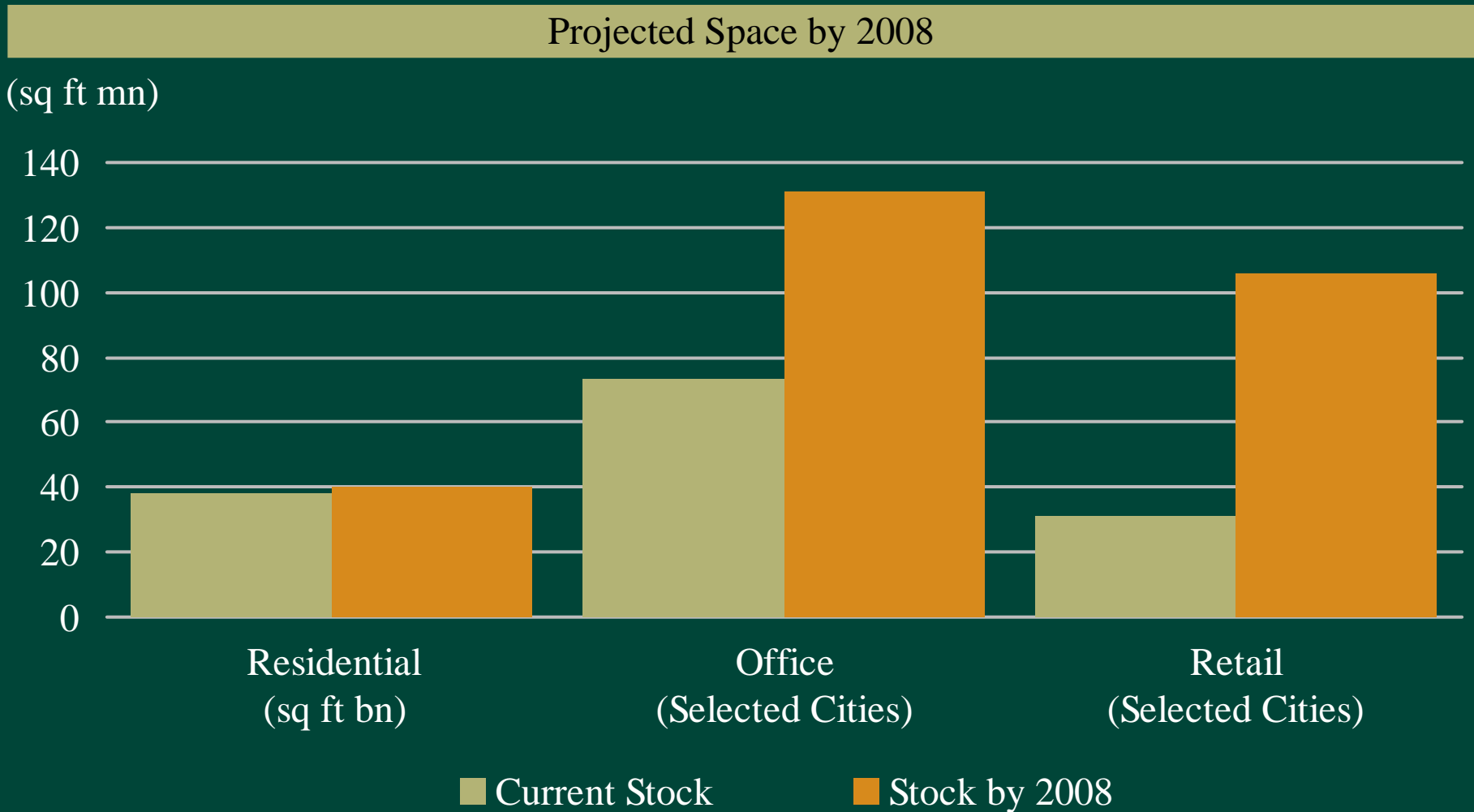
(sq ft mn)



Source: Company Reports, ENAM Research.

India Reality Check: The Cycle

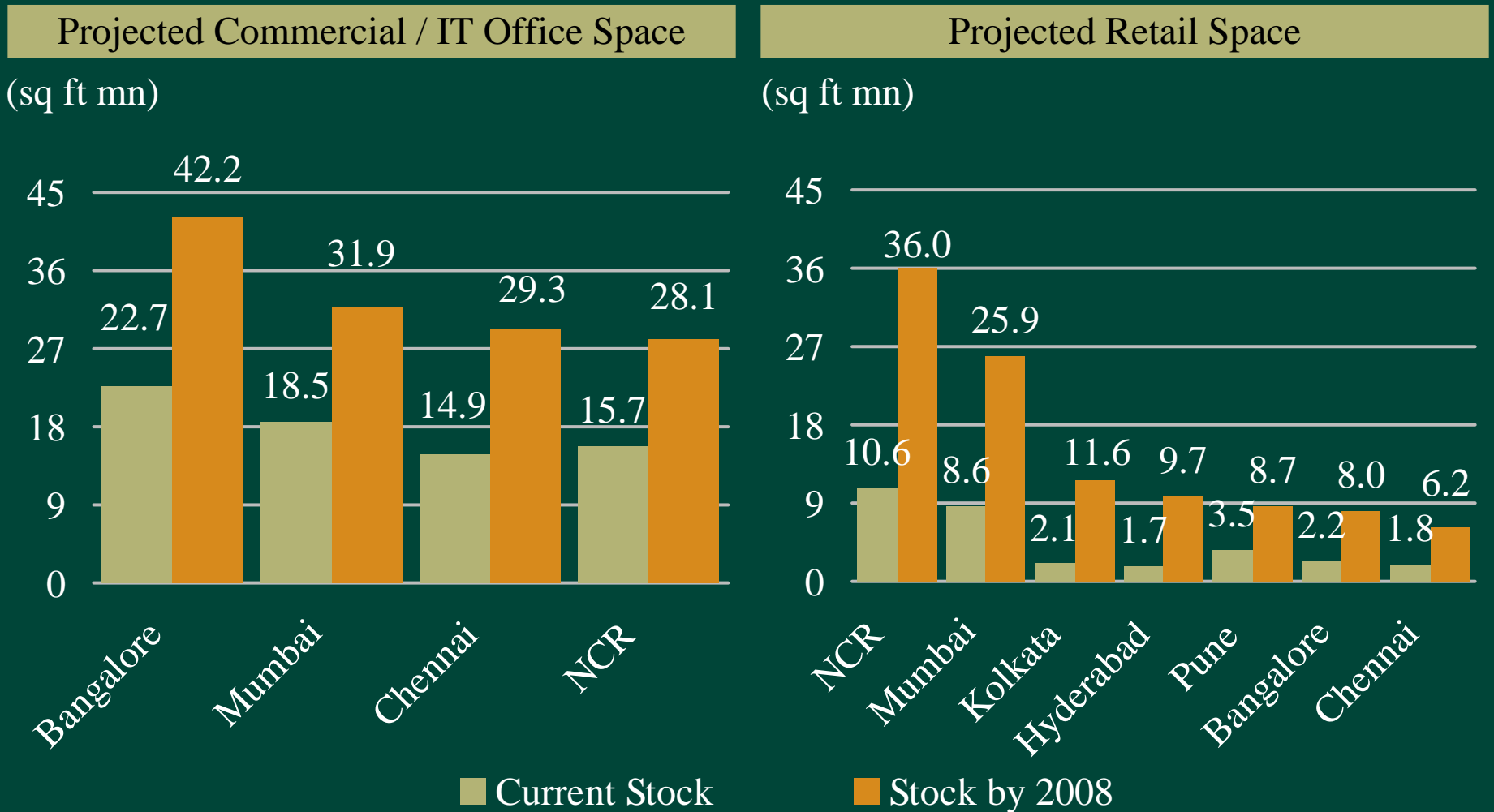
Massive Supply Coming Online (1 of 4)



Source: Jones Lang Lasalle, Knight Frank, Citigroup Investment Research.

India Reality Check: The Cycle

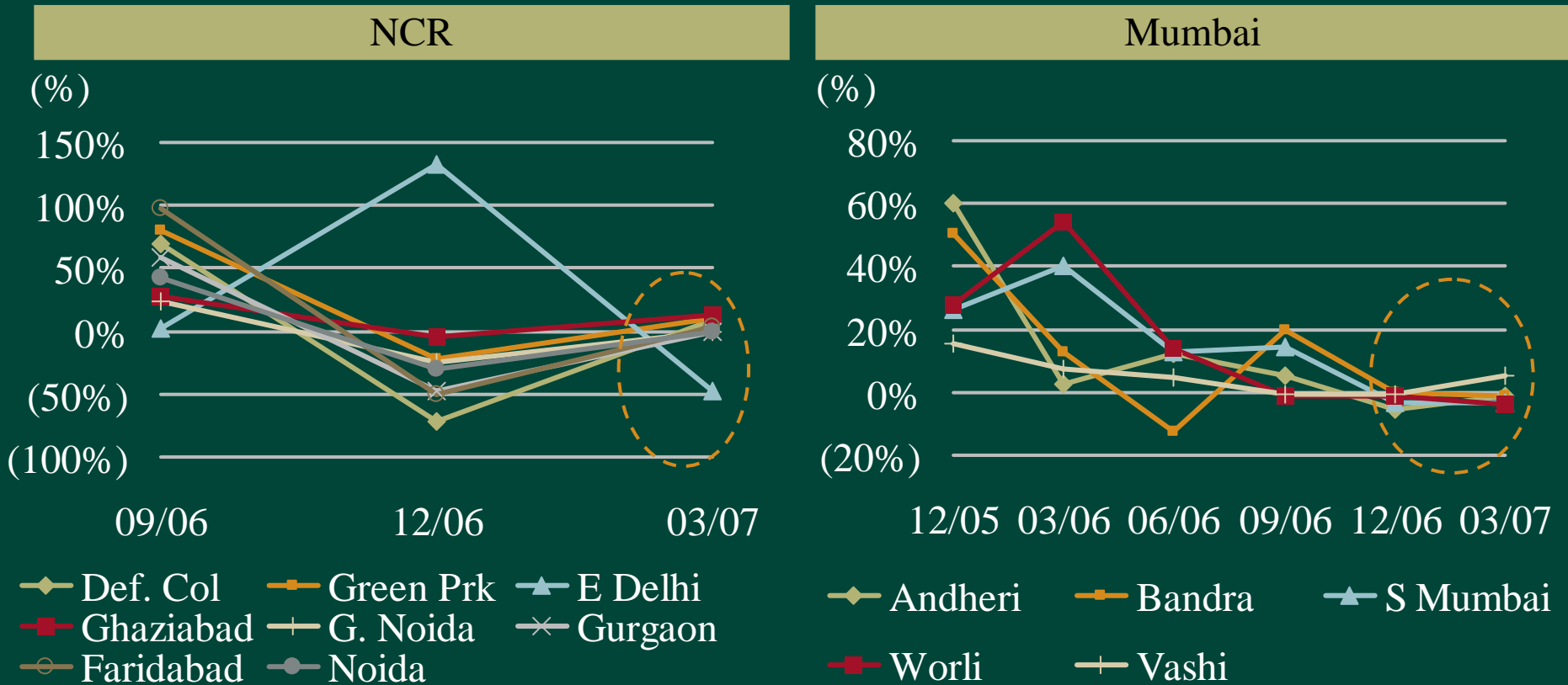
Massive Supply Coming Online (2 of 4)



Source: Jones Lang Lasalle, Knight Frank, Citigroup Investment Research.

India Reality Check: The Cycle

Massive Supply Coming Online (3 of 4)

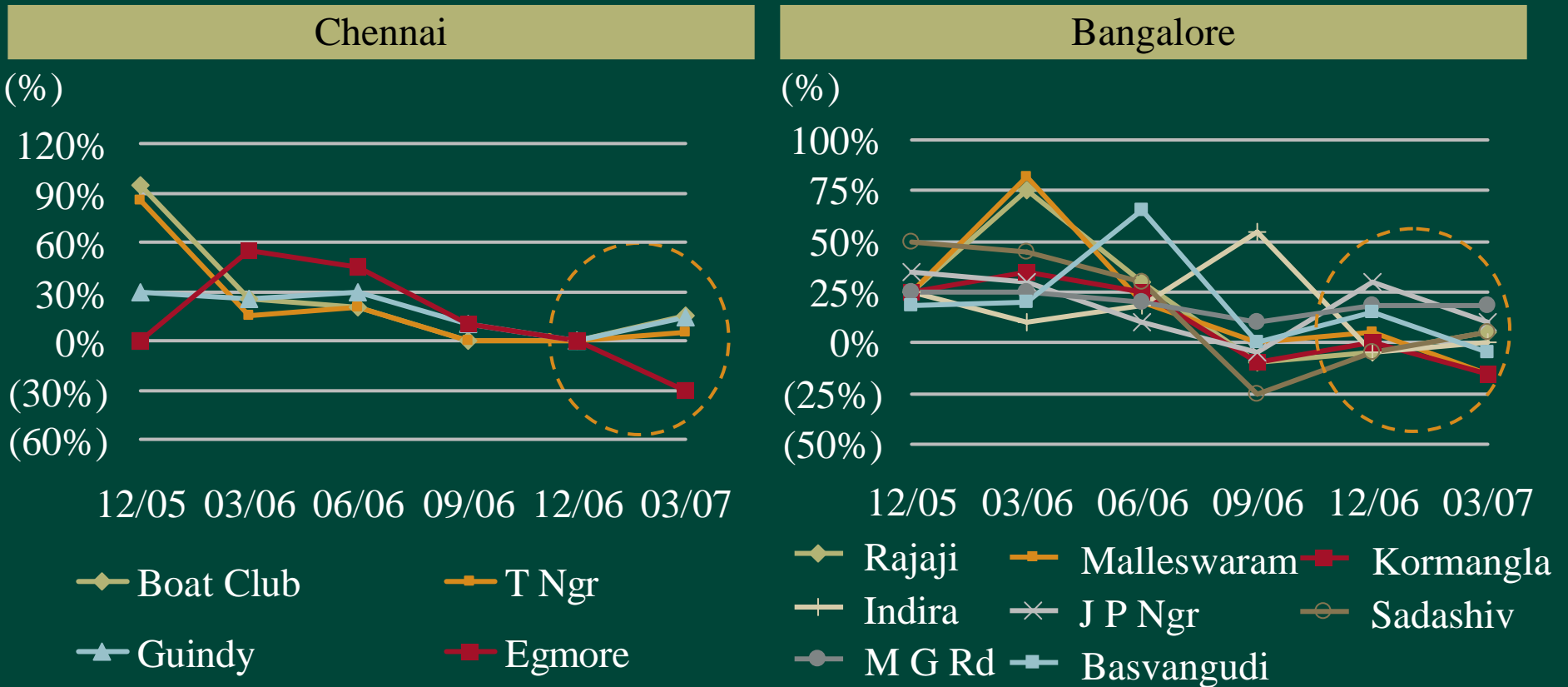


Prices Already Weakening
 (Price Trend q/q over the Last Year Given Current Supply)

Source: Cushman & Wakefield, Knight Frank India, ENAM Research.

India Reality Check: The Cycle

Massive Supply Coming Online (4 of 4)



Prices Already Weakening
(Price Trend q/q over the Last Year Given Current Supply)

Source: Cushman & Wakefield, Knight Frank India, ENAM Research.

India Reality Check: The Cycle

Lack of Easy Access to Capital (1 of 2)

Liquidity Problems for Developers

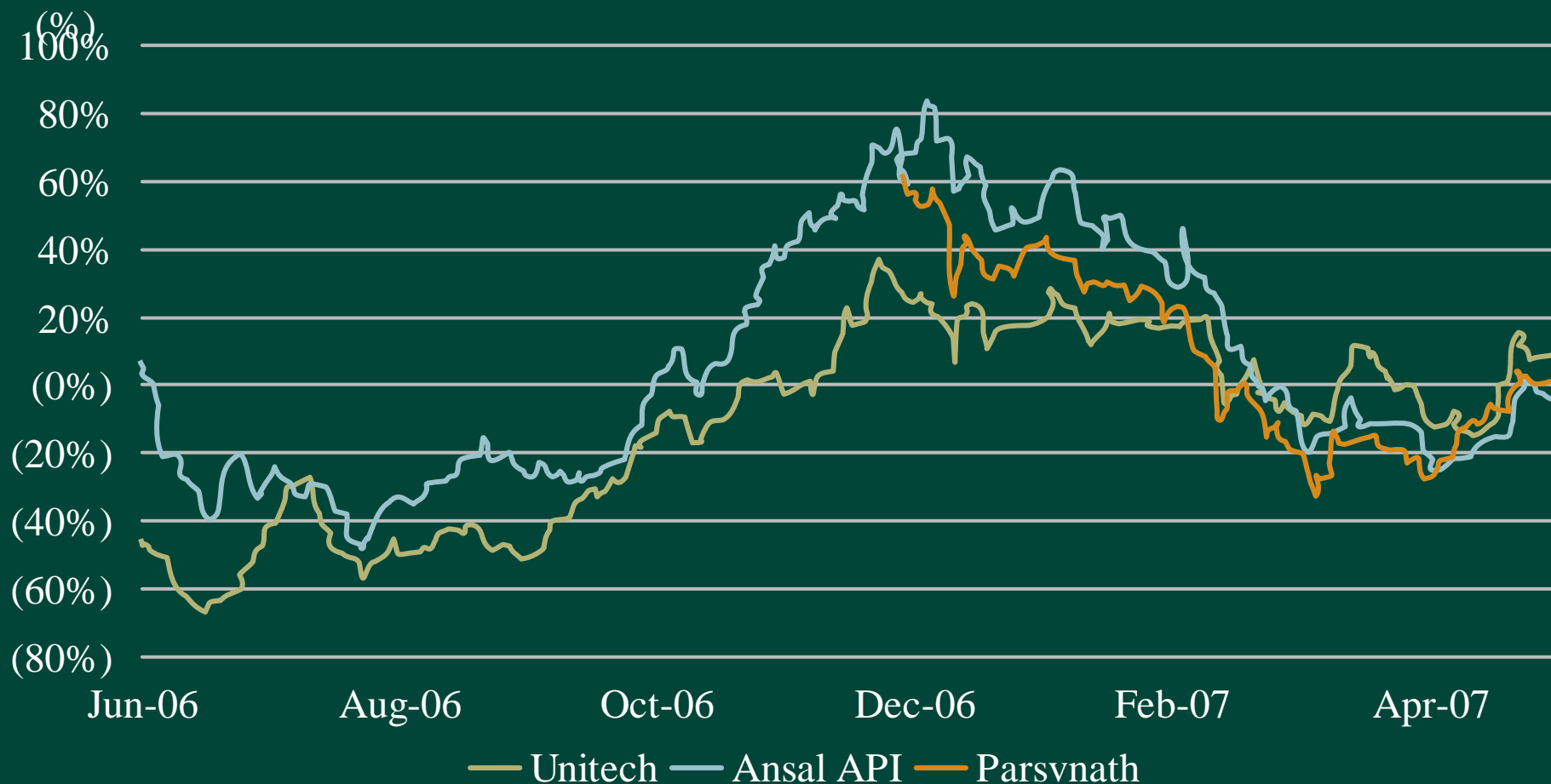
- ◆ Government initiatives to tighten liquidity and increase provision on advances to the real estate sector have led to funding constraints and rising interest cost for most developers
- ◆ Most developers (esp. small ones) have large development plan in pipeline and aggressive land purchases at high prices at auctions, and thus are highly leveraged and feeling heat on cashflows for project execution
- ◆ New regulatory norms for real estate IPOs (land bank disclosure, valuation method) and FDI for ECB dampening near term capital flows to sector
- ◆ The disappointing performance of Indian property vehicles on London's Alternative Investment Market (AIM) over the last year – most of them are trading below their offering price (June 27, 2007 discount to list price: Trinity 15%, Hirco 20%, Unitech Corp Parks 9%, Dev Prop 12%, Ishaan 0%)
- ◆ IPO market oversubscription declining: Sobha (114x in November 2006), Parsvnath (54x in November 2006), DLF (3.5x in June 2007)

Source: Citigroup Investment Research, ENAM Research.

India Reality Check: The Cycle

Lack of Easy Access to Capital (2 of 2)

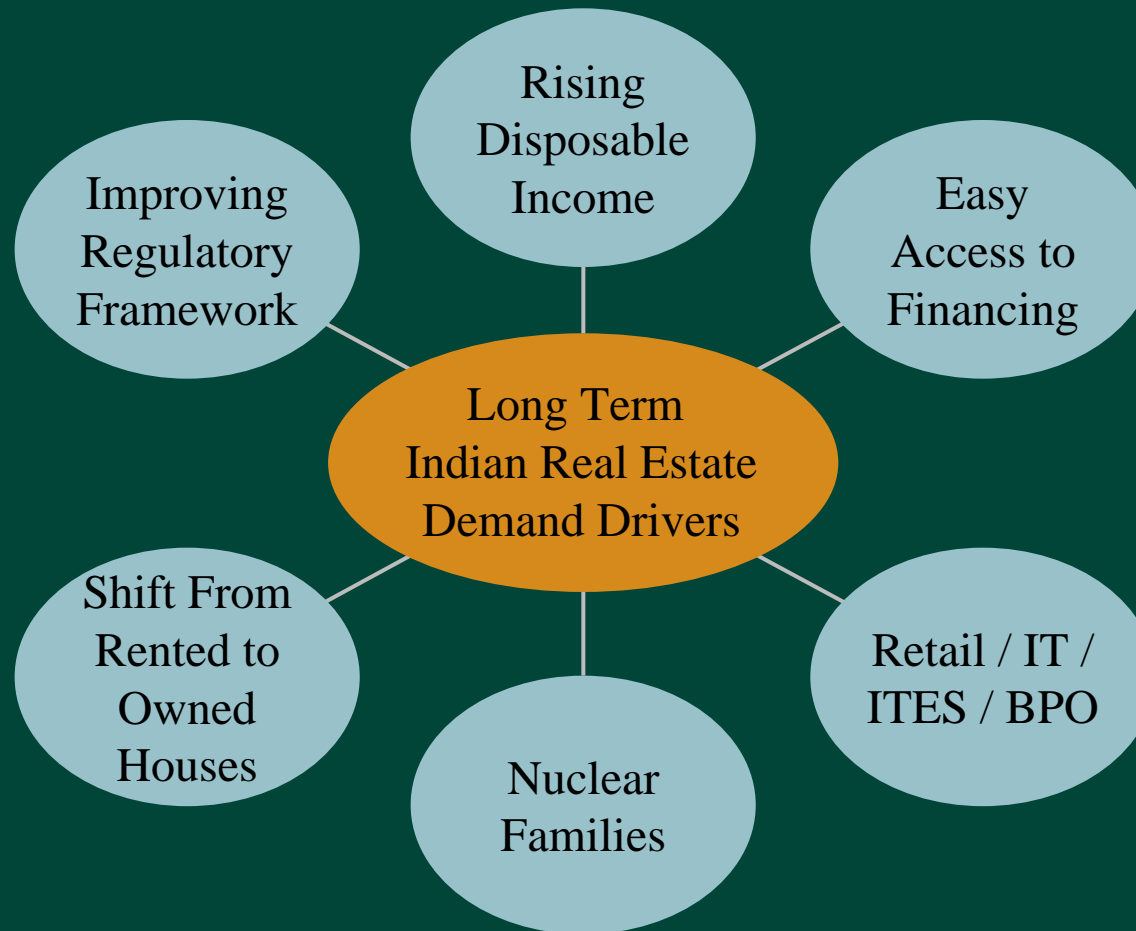
Weak Public Capital Markets – Premium / Discount to NAV



Source: Citigroup Investment Research, ENAM Research.

Long Term Opportunity

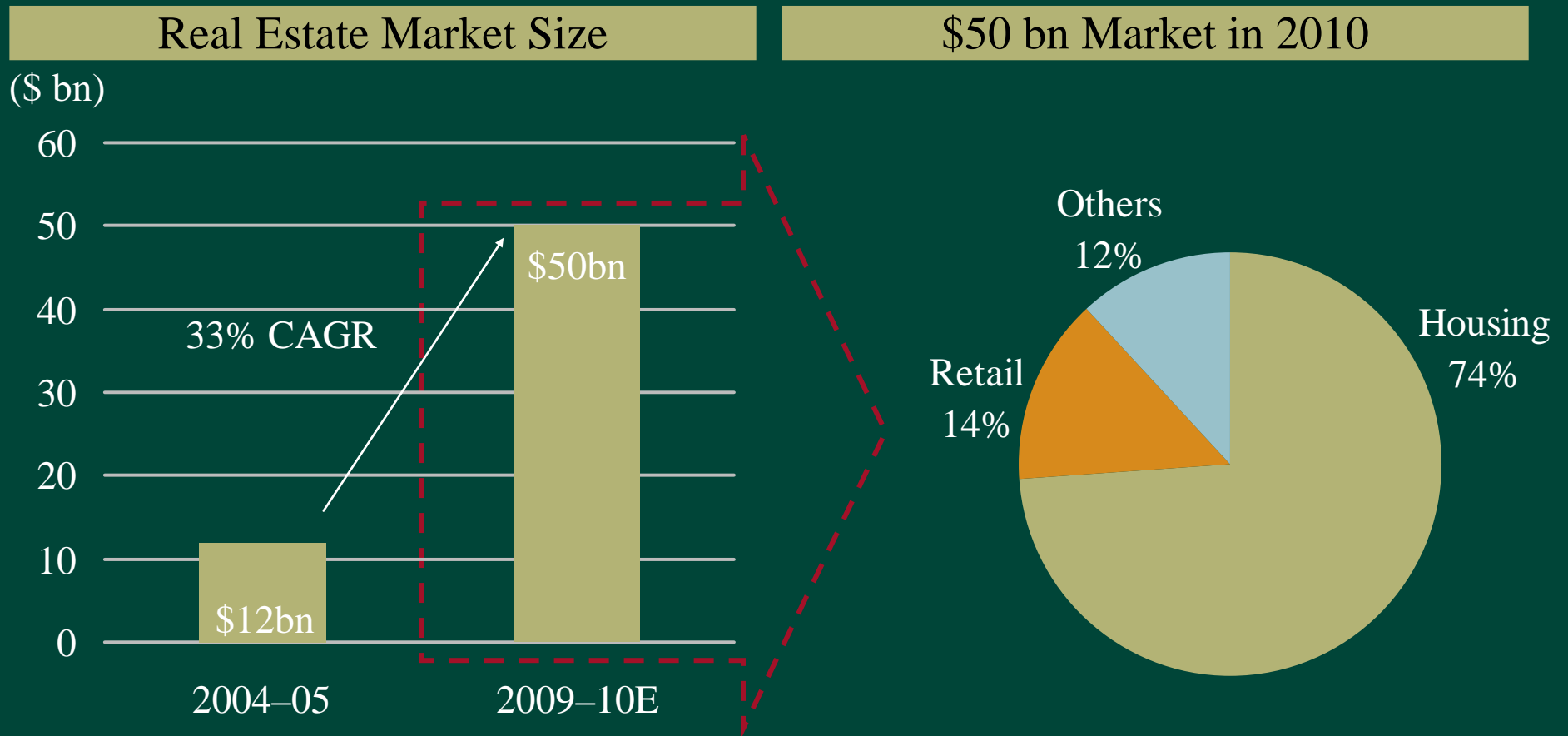
Long Term Opportunity for Indian Real Estate is Intact (1 of 4)



Source: Citigroup Investment Research, ENAM Research, Industry Experts.

Long Term Opportunity

Long Term Opportunity for Indian Real Estate is Intact (2 of 4)



Opportunity for All Real Estate Still Large and Real

Source: Citigroup Investment Research, ENAM Research, Industry Experts.

Long Term Opportunity

Long Term Opportunity for Indian Real Estate is Intact (3 of 4)

- ◆ Market expected to grow at 33% through 2005–2010 to \$50 billion
- ◆ Residential
 - Current shortage seen at approximately 19.8 million housing units
- ◆ Office
 - 5x increase in office space over the next 3–5 years
- ◆ Retail
 - ~ 200 million square foot for organized retail by 2010
- ◆ Hospitality
 - ~ 50,000 new hotel rooms in the next five years

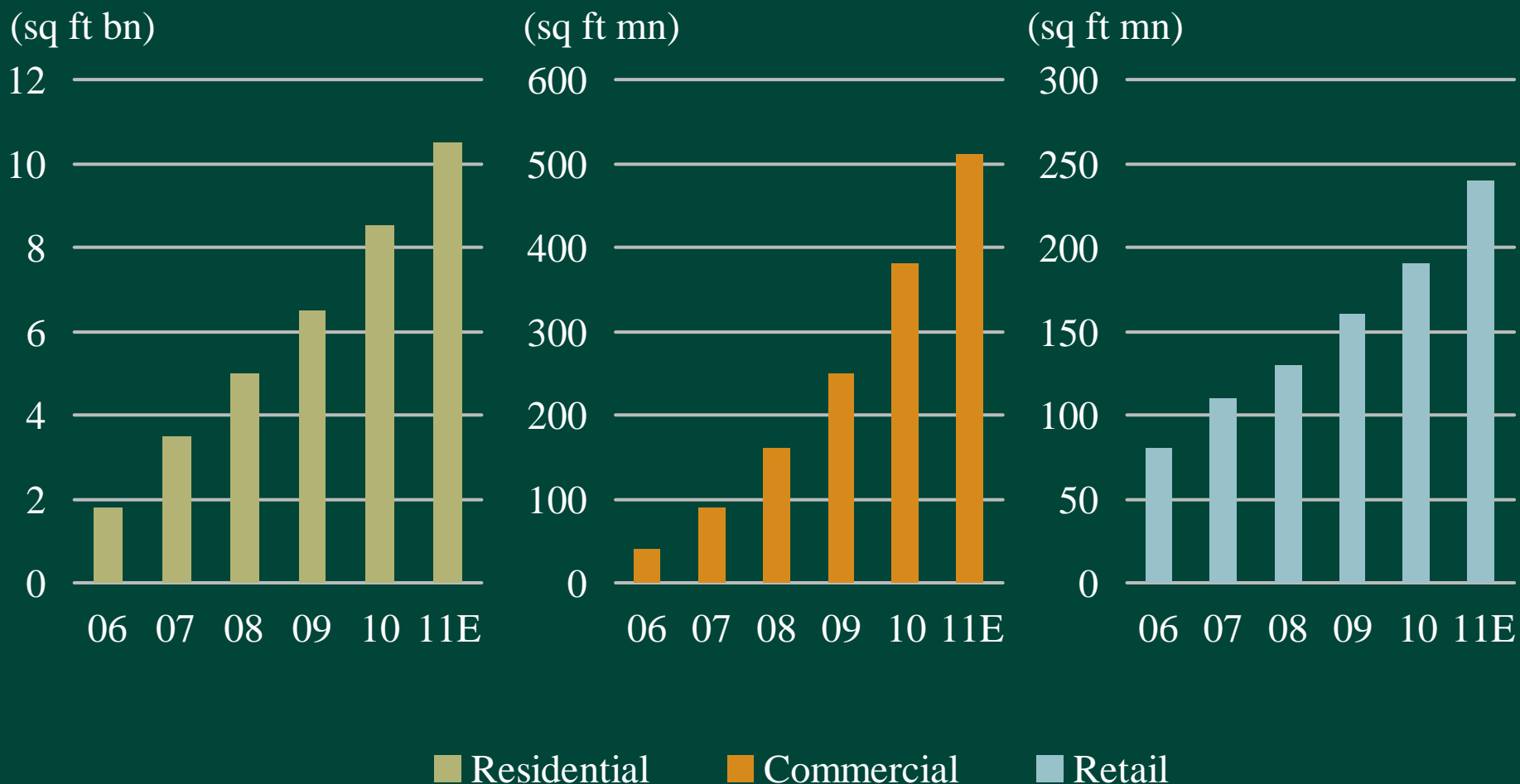
Opportunity for All Real Estate Still Large and Real

Source: Citigroup Investment Research, ENAM Research, Industry Experts.

Long Term Opportunity

Long Term Opportunity for Indian Real Estate is Intact (4 of 4)

Total Cumulative Demand (2006–2011E)



Source: Citigroup Investment Research, ENAM Research, Industry Experts.


India – Market Opportunities by Asset Class

	Demand Drivers	Outlook and Future Trends
Residential	<ul style="list-style-type: none">◆ Higher disposable incomes and aspiration levels◆ Changes in cultural norm of multi-family households◆ Easier access to finance◆ Fiscal incentives on house loans◆ Housing is a priority of the Government's policy agenda◆ Rapid urbanization – 2.5% of population per year; cities over 1mm to double from 35 in 2001 to 70 in 2025◆ Favorable Demographics – population projected to increase until 2030 stabilizing at 1.5 billion (currently 200mm households)◆ Shortage of housing units expected to be around 20mm units. Large market for low-medium housing; 10 mm new units required per year	<ul style="list-style-type: none">◆ Residential development to follow commercial development – more development in suburban areas◆ Value-added facilities like gym, swimming pool becoming standard offerings

India – Market Opportunities by Asset Class

	Demand Drivers	Outlook and Future Trends
Office Space	<ul style="list-style-type: none">◆ India is accepted across the world as one of the most attractive destination for IT and BPO services◆ India's IT and BPO industry is expected to grow at a CAGR (2003 – 12) of 35% from US\$12 billion to US\$148 billion by 2012◆ Requirement from IT & BPO industry for next 5 years is expected to be about 200 million sft	<ul style="list-style-type: none">◆ High quality and efficient Grade A infrastructure to be norm◆ Increase in Build to Suit type developments◆ Shift towards a tenant driven business – grow with tenants

India – Market Opportunities by Asset Class

	Demand Drivers	Outlook and Future Trends
 Retail	<ul style="list-style-type: none">◆ Entry of global brands◆ Organized retailing is only 3% of total retail industry and to increase to 11% by 2010◆ India is ranked by AT Kearney as the second most attractive retail destination◆ Growing around 10% per year◆ Most current construction is of poor quality◆ Total mall space in the major cities expected to increase from 5 million sft in end 2004 to 40.9 million sft by 2006	<ul style="list-style-type: none">◆ Second phase of mall development expected in Grade B towns◆ Localization of malls◆ Focus on mall management◆ Differentiation, specialty malls

India – Market Opportunities by Asset Class

Demand Drivers

Outlook and Future Trends

Hotels

- ◆ Increased business travel domestic as well as foreign due to buoyant growth in domestic economy and growing foreign investment
 - ◆ Large domestic market of 230 million tourists
 - ◆ Requirement of about 100,000 to 125,000 rooms over next 5 years. Only 35,000 to 40,000 rooms under construction – huge supply gap expected
- ◆ Budget hotels and service apartments expected to be high growth areas
 - ◆ Mixed-use developments

Liquidity Crisis For Developers Leads To Difficulty In Financial Closures – Private Equity To The Rescue? (1 of 2)

Developers clearly believe in these long term real estate fundamentals and continue to generate a new pipeline of projects...however, it has become tougher for them to find the money to bridge their project funding requirements



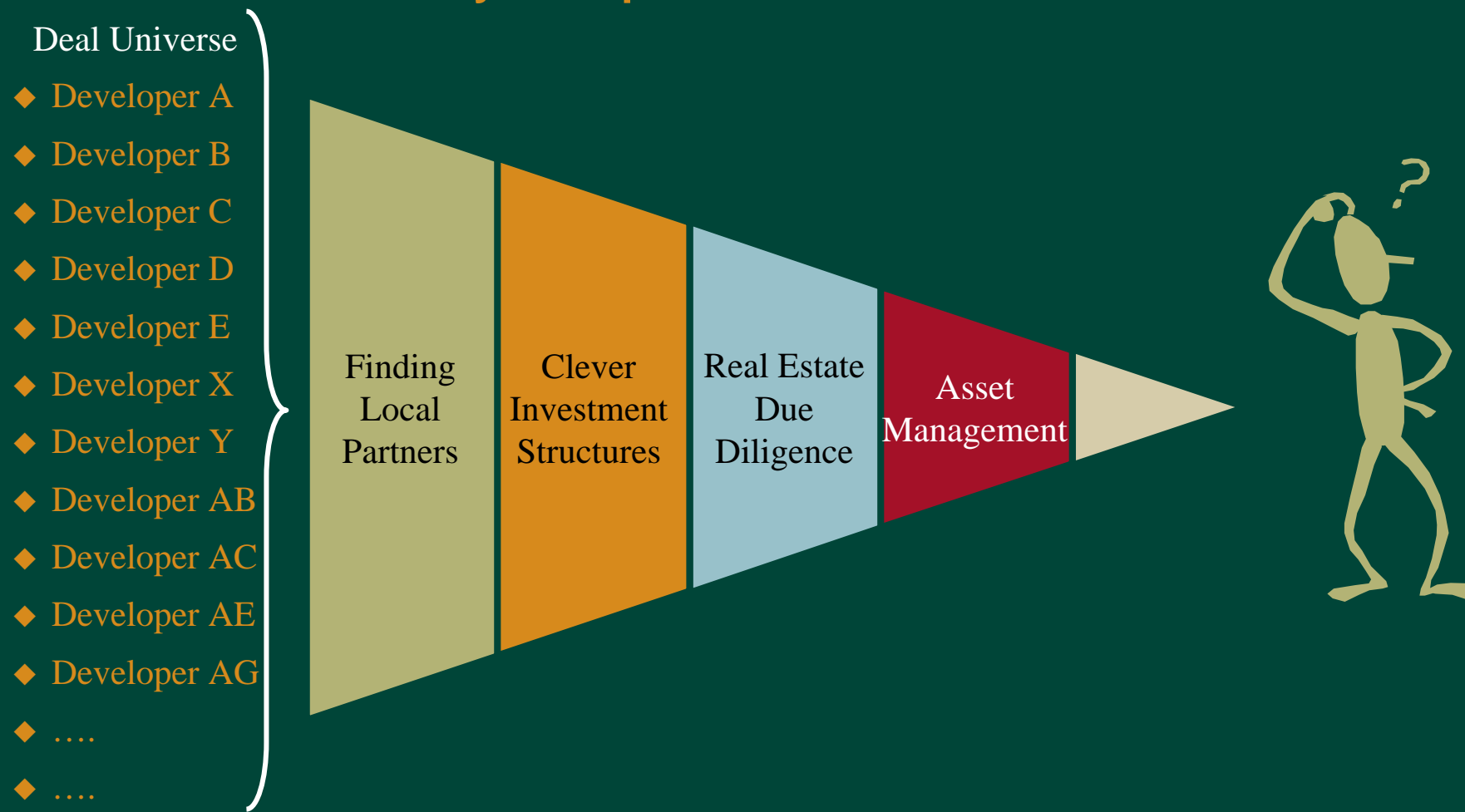
Liquidity Crisis For Developers Leads To Difficulty In Financial Closures – Private Equity To The Rescue? (2 of 2)

“Liquidity crunch in the real estate market is driving many small-time developers to look around for a cover. Many want to liquidate their land or incomplete projects by selling them to larger developers or private equity players even on reduced valuations...there is pressure on real estate developers due to the tightening of fund-raising norms...the developers are seeking private equity funds even for small-sized projects. The valuations are also more realistic now...” (*Economic Times, June 27, 2007*)

“Several real estate funds admitted that they are working on a clutch of projects now, much more than what they used to around two-three months ago...The quantum of deals has seen a manifold increase over last three months. We feel it is mainly due to the tight fund raising norms introduced in the sector...” (*Fund Manager and Economic Times, June 27, 2007*)

Current Keys to Successful Indian Real Estate Private Equity Investing

Even with the developer's liquidity crisis, how does a P/E investor gain comfort in Indian real estate investing given both the inherent market risks and short-term cyclical pains?



Closing Remarks and Q&A