



Growing Trend towards Financialization of Real Estate

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Background

Real Estate (RE) is a critical asset class, both from an economic and individual point of view. At the economy level, RE sector contributes ~7%⁽¹⁾ to India's GDP and is a major source of mass employment. At an individual level, physical assets (primarily real estate and gold) account for 50%+ of house-hold savings in India. For global institutional investors also, India has been a major focus. These investors invested ~US\$40Bn over the last 6 years. And the interest remains strong despite COVID. In 1H2021, the sector received ~US\$2.9Bn⁽²⁾ of investment, more than 2x of 1H2020.

Most high net-worth families' exposure to real estate is in the physical form i.e. directly owning the assets. Many a times assets are legacy owned and not really being managed by a professional team. Also, asset management of physical real estate could become cumbersome. Therefore, despite the strong fundamentals of the underlying sector (as evidenced by significant institutional interest), the investment experience of individuals/families had been mixed.

Equity markets are at an all-time high and returns on mainstream debt products are anemic (negative real returns). This (1) risk of drawdown on equity portfolios and (2) very low debt yields, is demanding allocation towards opportunities that provide inflation-hedge with a decent real return without taking equity risk. Real estate as an asset class, is best suited to fulfill such a gap but it needs to become easy to invest in to and manage post investment.

Recent trends

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For example, India's first REIT (Real Estate Investment Trust) debuted in 2019 and since then two more REITS have listed, all three backed by some of the largest global investors. Between the 3 of them, they own 85MM sf+ of Grade A office portfolio. In several ways, it is much better to participate in commercial real estate by owning a REIT unit vs. making a lumpy investment in a handful of self-owned assets.

This trend towards financialization of real estate is starting to breakout. Robust digital and payments infrastructure coupled with acceptance of online investing is supercharging this transformation. For example, in the United States, platforms like Cadre, Fundrise, Crowdstreet, etc. are making private equity (PE) type opportunities accessible for individual investment.

Indian real estate sector's capital need is estimated at ~US\$100Bn⁺⁽³⁾ over a seven-year cycle, but capital availability is limited (especially since the credit squeeze initiated by ILFS default in 2018). Fundamentally though, residential is seeing a robust off-take (FY21 sale of listed developers at 2.2x⁽⁴⁾ of FY17 sales) and this demand is likely to remain strong over several years (strong macro fundamentals, affordability and COVID induced premium on home ownership).

Take-away

Robust fundamental demand and low capital availability is creating a very attractive investing vintage. In our opinion, India needs similar modern-day platforms that combine (1) investment expertise with (2) digital convenience and transparency, to allow participation in real estate assets without the hassle of managing physical assets. Such platforms can play a pivotal role both for the sector and investors seeking superior risk-adjusted returns.

References

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