

HDFC AMC -PMS Real Estate Portfolio - I

November 2007



Structure of the presentation

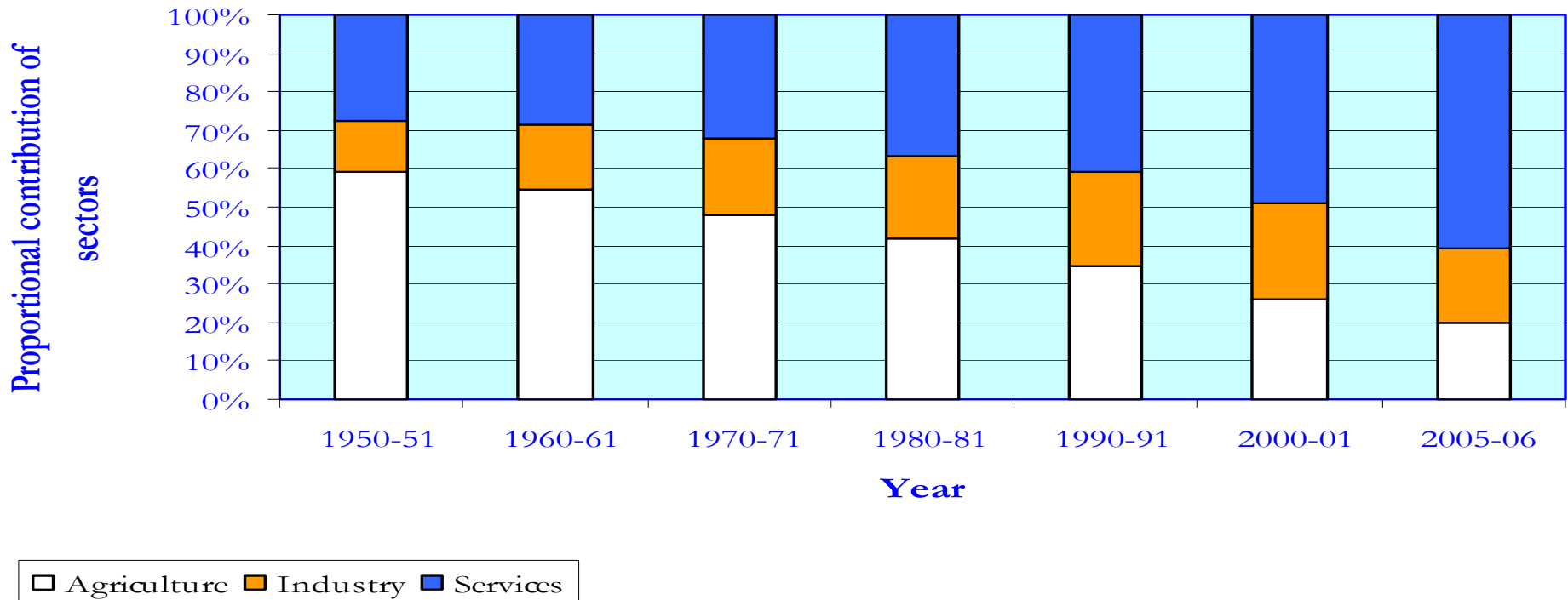
- **The Market**
 - India – Macro growth drivers
 - Indian Real Estate
 - Risks
- **The Opportunity**
 - Market Gaps
 - Investment Strategy
- **The Partner**
 - HDFC Limited – Investment Advisor
 - HDFC Asset Management Company Limited - Portfolio Management Services Division (HDFC AMC PMS)
- **The Product**
 - HDFC AMC PMS Real Estate Portfolio - I (Portfolio)
 - Why should one invest in the Portfolio?
 - Salient features

The Market

India – Macro growth drivers

Emergence of Services and Manufacturing sector

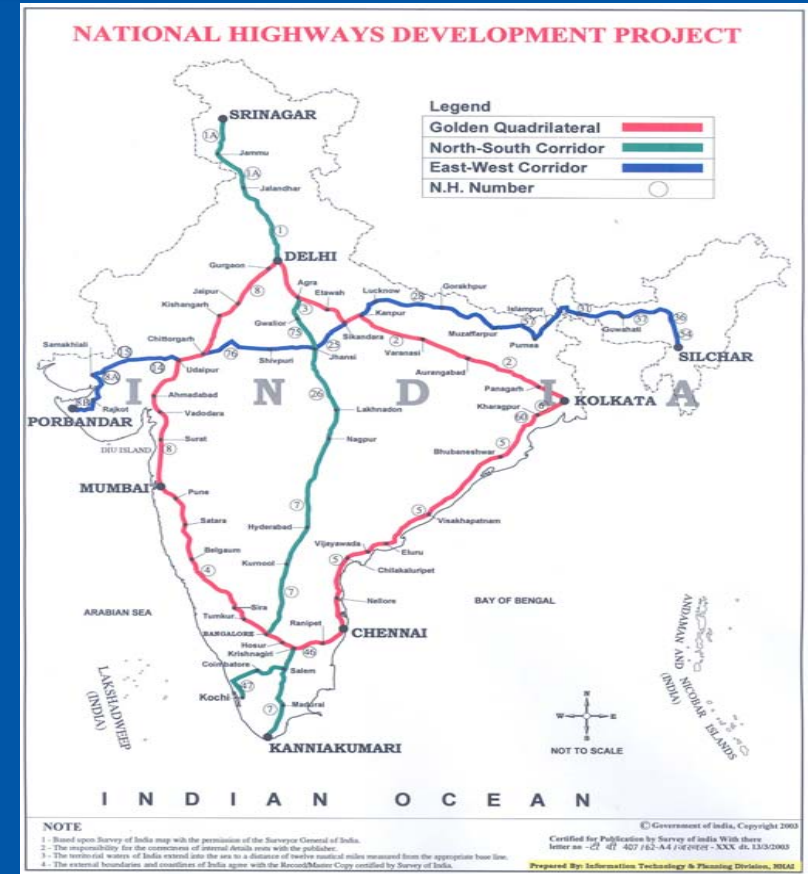
India - Sectoral contribution to GDP



Sources : Finance Ministry's Economic Survey & RBI Handbook of Statistics

Investment in Infrastructure

	Planned Exp in next 5 yrs (Till 2010) Rupees Billion
Airports	400
Irrigation	1300
Ports	500
Power	2000
Railways	750
Roads	1700
Telecom	800
Urban Infra	1400

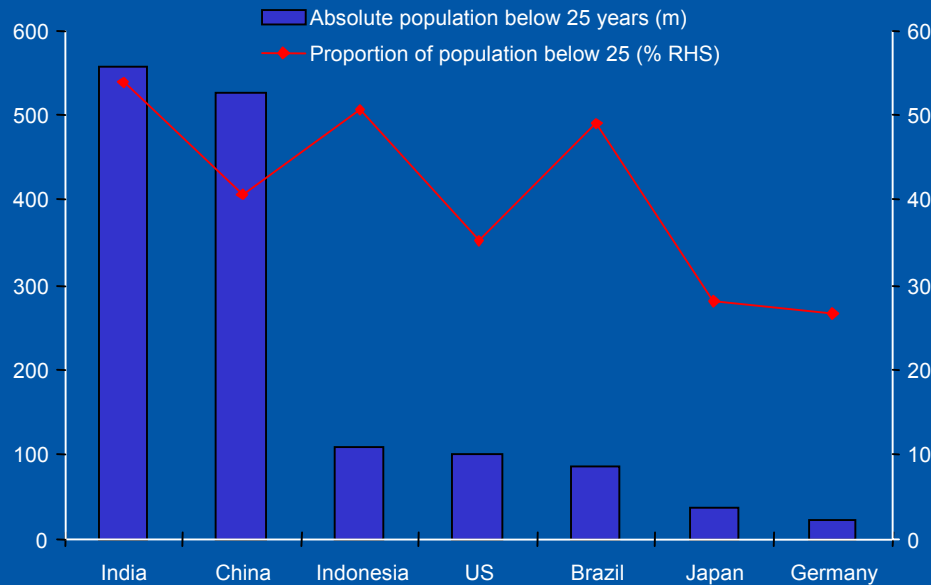


Source: Committee on Infrastructure (CoI), CLSA
 Asia-Pacific Markets / NHA

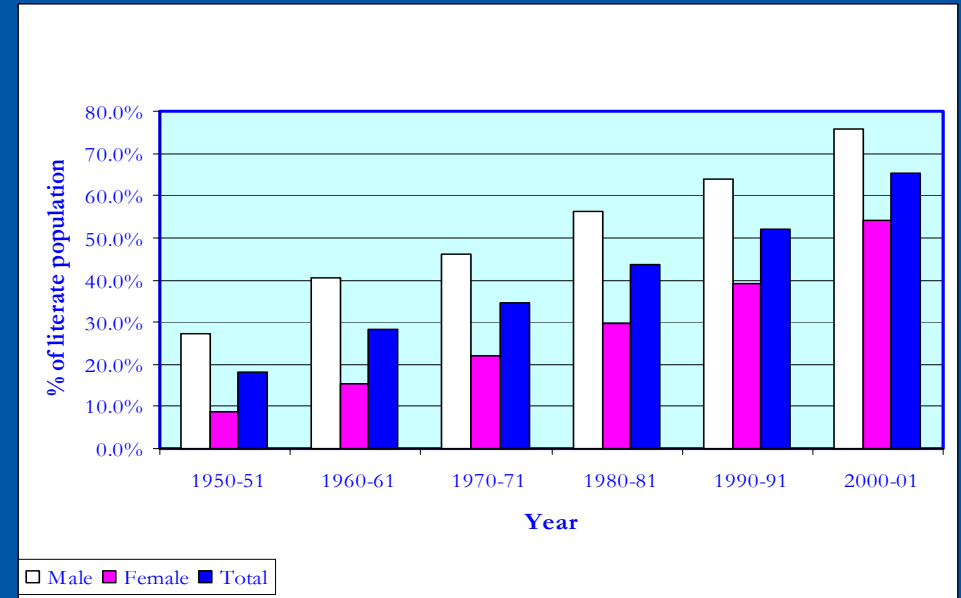


Favorable Demographics

Young Demographic Profile



Improving Literacy Rate

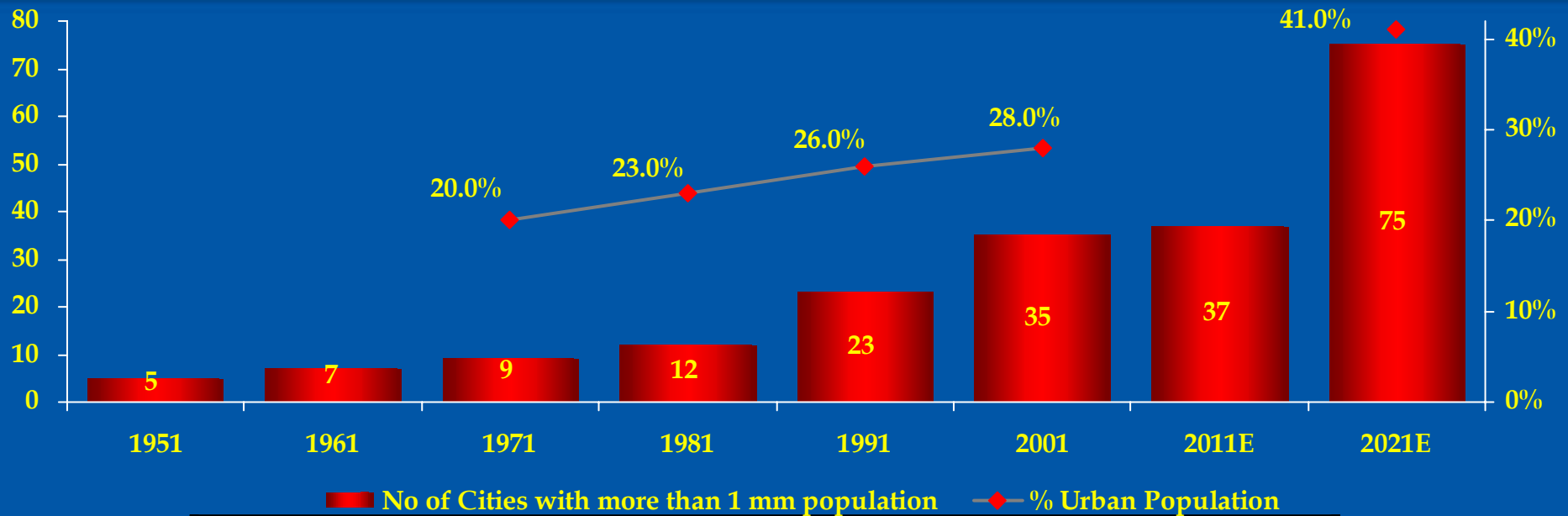


Source: CLSA

Favorable Demographics

- India has a huge young population with high disposable income
- A quarter of the world's youth live in India
- 54% of the Indian population is below 25 years of age
- By 2015, the net addition to the productive population (25-44 years) will be 90m
- Socio economic indicators like literacy, dependency ratios etc are showing a healthy trend

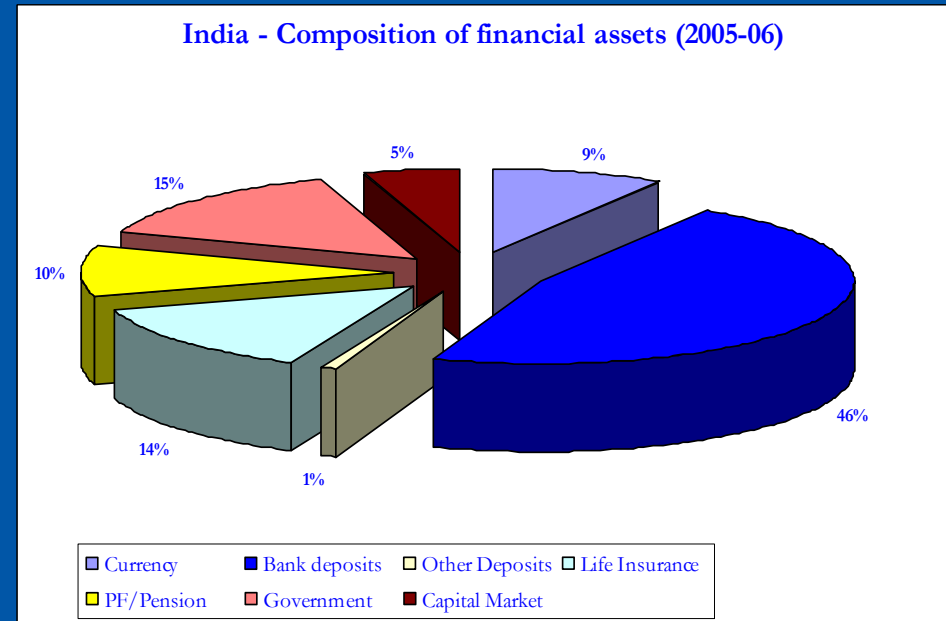
Trend towards Urbanization



- Number of Urban Agglomerations / Towns have increased to 4,378 (2001) from 3,768 (1991)
- Urban population has increased from 217 million in 1991 to 300 million in 2006 and is expected to increase to ~500 million by 2010

Source : Statistical Outline of India

Favorable Savings & Spending Patterns



- Reflective of the conservative attitude and risk aversion
- The absence of alternative asset classes in an organized manner is one of the key factors

Sources : Finance Ministry's Economic Survey & RBI Handbook of Statistics

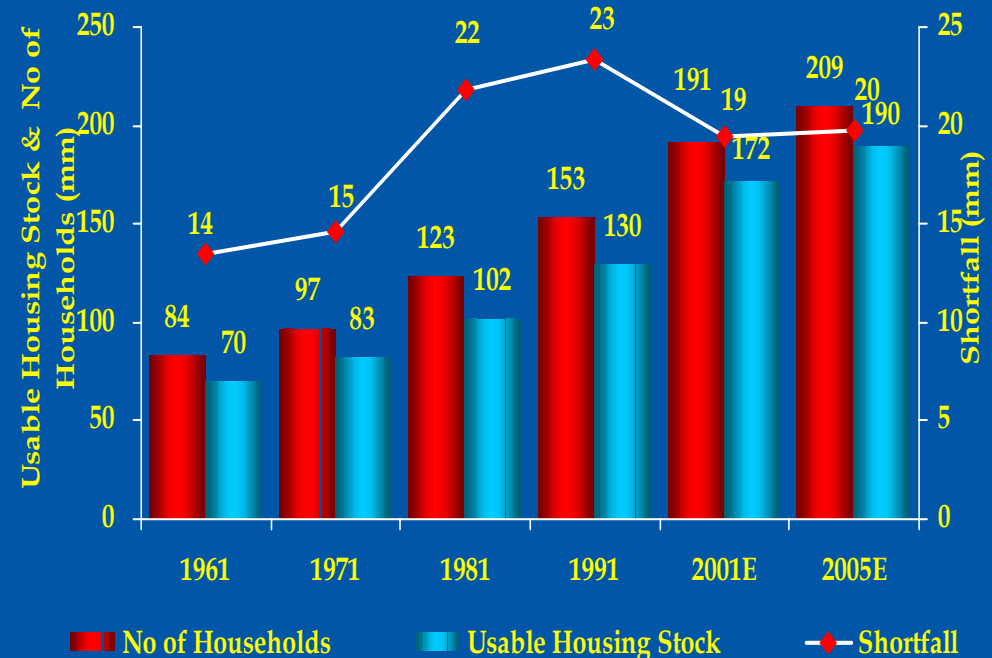
The Market

Indian Real Estate

Residential Real Estate

Housing Market In India

- Demand drivers:
 - Emergence of real estate as a strong investment class
 - Preference towards owning a house as against renting
 - Higher aspiration levels
 - Increased disposable incomes
 - Better transparency and availability of finance
- At present, there is an estimated shortfall of 24.7 million dwelling units (census report)
- Household Income to cost of home is 5-6x as compared to 18x in 1995
- Development margins in residential real estate are lower than other options, however, ROE is much higher



Source : HDFC estimates

Commercial Real Estate

There is a huge demand supply mismatch for quality Grade A commercial space

- **IT services industry is the primary growth driver in Top 10 cities**
- **Estimated incremental requirement of 2.25 million IT/ITES professionals by FY2010 (Source: NASSCOM-McKinsey Report 2005)**
- **Manufacturing sector and other services industries also fueling growth**
- **Huge replacement demand in Tier I cities of existing low quality office space**
- **Rental yields are around 11% - 14% per annum on the capital value**
- **High land prices is the key deterrent for movement to the periphery of main cities or Tier II/III cities**

Source : HDFC estimates



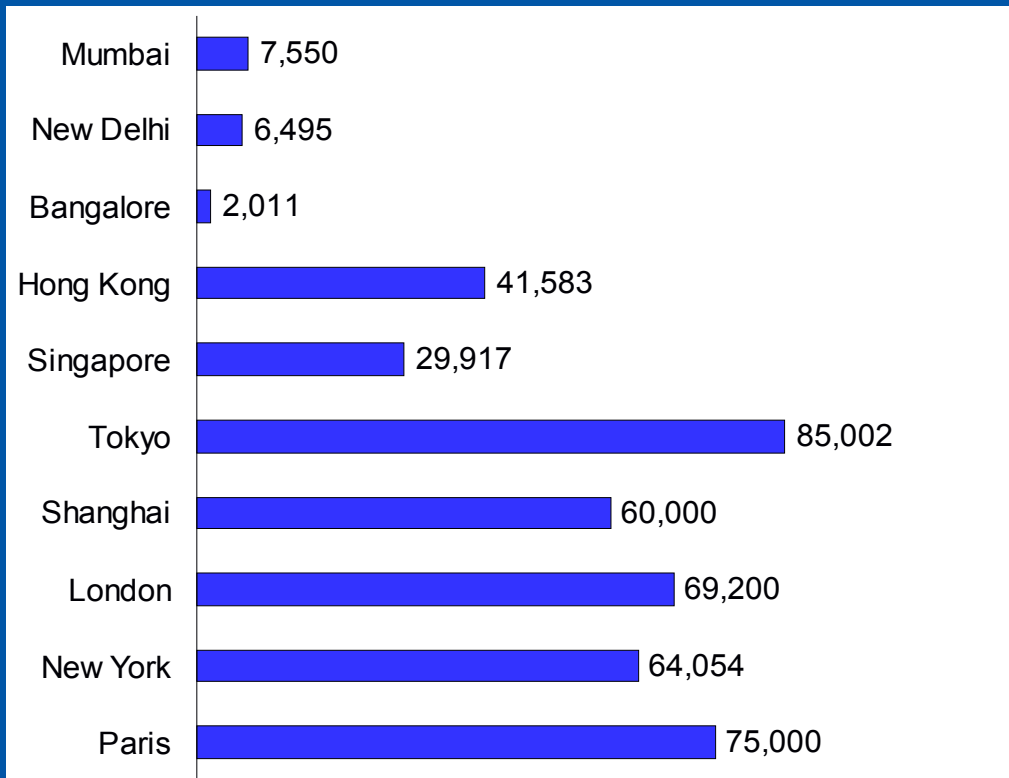
Hospitality Real Estate

Increased disposable incomes, enhanced role of the services sector and high aspiration levels are driving demand in this sector

- **Rapid increase in domestic leisure and business segments as well as the international tourists in the country**
- **2006 was the best year so far for tourism with number of foreign tourists being 4.5 million**
- **Large demand supply gap – across the spectrum in 5 star deluxe, 4 star, 3 star budget hotels**
- **Large number of global giants looking to invest in India : Dawnay Day, Hilton , Jumeirah, Golden Tulip, Istithmar and Shangri la**
- **Increase in business travel, cheaper air fares, medical tourism to augment demand**

Hospitality Real Estate

Total Star Category Hotel Room Supply



■ The entire country has only approx 104,000 rated hotel rooms across 354 cities/towns

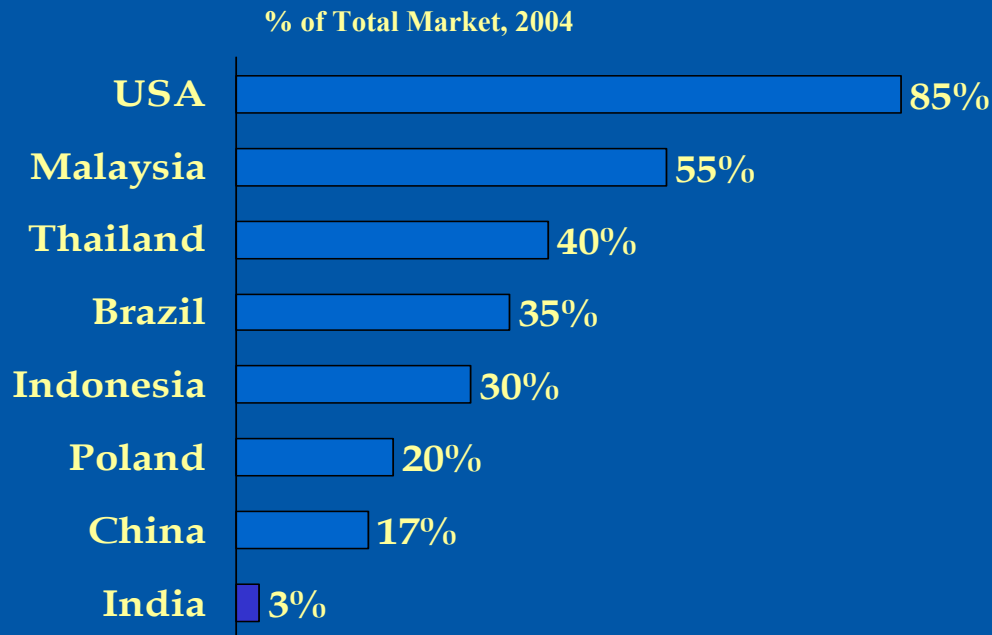
■ City of Bangkok (Thailand) has greater number of 3, 4 & 5 star rooms than the entire country of India!

Source: Morgan Stanley Research, Knight Frank Research

Retail Real Estate

Organised Retail Poised to Grow Rapidly

Penetration of Organized Retail



- Indian retail industry size is expected to be US\$ 320 billion in 2007

- Penetration of organized retail is expected to move up from 3% to 8% of total market by 2010.

- This will lead to incremental demand of approx. 100 million sq. ft. of quality retail space

Source : HDFC estimates

Growth Potential Overview

Key Demand Drivers

Residential

- High disposable incomes and aspiration levels
- Easier access to finance
- Fiscal incentives on housing loans
- Housing is a priority of the Government's policy agenda

Commercial

- India is accepted across the world as 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 USD 12 billion to USD 148 billion by 2012

Hospitality

- There is across the board demand in 3-4-5 star category
- The sweet spot of the market is in the budget / business category
- Land pricing and positioning is the key factor

Retail

- Entry of global brands
- Retail industry estimated to have grown by 40% in the last few years
- Organized retailing is only 3% of total retail industry

Market Risks

- **Government Intervention – changes in policies/regulations, tax incentives**
- **Land acquisition related problems**
- **High transaction costs**
- **Lack of transparent and large national developers with management skills**
- **Demand dependence on mortgages and volatile Interest rate scenario**
- **Legal issues : Tenancy laws, ULCRA etc**
- **Unclear land titles**
- **Relationship driven market**

Experience, Pan India presence and relationships are key for success in Indian real estate

The Opportunity

Real Estate Market Gap Analysis

Foreign Equity Funds

- Account for almost 75-80 % of project level equity investments in real estate
- Size restrictions (As per FDI norms, minimum size of the project has to be 50000 sq m or 25 acres)
- Minimum investment size restrictions : Typically look at large value deals
- Lock in periods of 3 years discourage short term investments
- Regulations do not permit risk hedging through debt / mezzanine instruments
- Funding can be only for licensed land post approvals
- Cannot purchase substantially ready / ready properties

Domestic Venture Funds

- Domestic real estate funds are not currently feasible due to absence of a tax efficient structure

Debt

- Debt availability for projects is restricted due to recent strictures on the real estate sector
- Can be given primarily for construction finance
- Only Top tier of the developer community is covered by debt market;

Real Estate Market Gap Analysis

Implication

- Funding is available only for large projects and long tenure projects
- Funding at green field level, equity or debt is not available
- As a result, developers borrow money against other projects/raise equity from capital markets etc for funding at significantly high rates
- Mezzanine funding not available for projects as domestic equity appetite is very limited

Market Gaps

- Mezzanine funding i.e. convertible debt options
- Funding for smaller size projects
- Funding for substantially complete/ ready projects
- Gap funding for developers for projects– This shall result in getting better deal on the equity component
- There are very restricted options for developers for a complete debt and equity solution

Investment Strategy

The geographical footprint shall cover India but with a special focus on Top 20 cities

- **Act as a one stop shop for the developers for their financing requirements**
- **Have a diversified portfolio across multiple segments and regions**
- **Invest in mezzanine equity instruments which have higher risk adjusted returns than pure equity/debt**
- **Invest in equity of holding companies of emerging developers, provide support and inputs to facilitate growth**
- **Participate in smaller projects with well defined business plan and sales strategy**
- **Partner with developers who have a clean track record and reputation**

**The Partner –
Housing Development
Finance Corporation Limited
(HDFC)**



HDFC Limited

- Incorporated in 1977 as the first specialized housing finance company in India
- Evolved into a financial conglomerate with interests in Insurance, Asset Management & Banking apart from housing finance
- HDFC has financed over 3 million housing units with loan of over Rs 1.3 trillion ; Services 1 million depositors through 50,000 agents
- Provides financial assistance to individuals, companies and developers for the purchase or construction of residential housing, commercial properties etc.
- Widely held enterprise with over 1,00,000 shareholders; Approx. 90% of initial shareholding in the hands of domestic institutions and retail investors; 80% of current shareholding is with foreign investors
- Total Assets as at September 30, 2007 : Approx USD 17.50 bn



HDFC Limited

■ Property Services Group

- In house domain knowledge of real estate across the country
- Provides advice to developers – locations, product mix, acquisition of land, pricing strategies etc
- Active relationship with approx 350 developers
- Provides advice to corporates, institutions for commercial properties, structuring of real estate portfolio, etc.
- Provides brokerage services to large institutions and corporates

■ Construction Finance Group

- Largest player in the market with over 30% market share
- Lending to developers across the country for over two decades
- Loan tenure : 3-4 years
- Number of active accounts : 375

■ Real Estate related corporate loans

- Lending to corporates, mid sized companies(SME segment) for offices
- Rental discounting

HDFC Limited

HDFC

HDFC Bank

- HDFC stake: ~22%
- Listed on NYSE
- Key business areas include Wholesale banking, Retail banking & Treasury operations
- Network of 684 branches in 316 locations
- Customer base of over 9.6 million
- Mcap: Approx USD 14 bn as on October 07
- Reported a 31% increase in PAT for 2006-07

HDFC Standard Life Insurance

- HDFC stake: 79%
- Tie up with Standard Life Assurance Company, U.K.
- Offers 21 retail products and 6 group plans along with 5 optional riders
- Network of 438 branches covering 693 cities and towns with a network of 79,000 financial consultants, 833 corporate agents

HDFC Asset Management

- Joint Venture with Standard Life Investments Ltd (SLI)
- Offers 32 equity & debt schemes
- FY07 PAT of approx. USD 16.52 mn
- The total assets under management of HDFC AMC stood at over USD 12.08 bn as on Oct 07.

HDFC General Insurance

- It was a joint venture with Chubb Corporation, USA
- HDFC has now acquired 26% shareholding held by Chubb thus making it a 100% subsidiary of the corporation
- New joint venture partner is ERGO, Germany
- Non life insurance venture offering Auto, Home and other insurances
- Country wide presence in 27 locations

HDFC Property Fund

- Launched in 2005 as real estate private equity arm
- "HDFC India Real Estate Fund" (HI-REF) is the first scheme of the fund
- HI-REF is a domestic 7 year closed ended fund of US\$ 250 mm
- Advisor to HIREF International LLC – USD 800 million Fund

HDFC

PORTFOLIO MANAGEMENT

HDFC AMC - Portfolio Management Services (PMS)



Management Structure

- **HDFC AMC - PMS division has a dedicated team of real estate professionals which shall be managing the Portfolio of Investment**
- **Advisor to the Portfolio shall be HDFC Ltd through an Advisory Board**
- **Advisory Board headed by Mr. Deepak Parekh, Chairman, HDFC**
- **The Board shall also comprise regional level representatives from HDFC to aid the sourcing, due diligence and monitoring of the various projects**

HDFC AMC - PMS
Real Estate Portfolio -I
(Portfolio)

Portfolio Target Investments

The Portfolio shall invest in securities of special purpose vehicles / holding companies of developers etc

Various Investment Options Would Be :

- **Shares/Debentures of Special Purpose vehicles(SPV)**
 - Invest in a project level SPV with developer
 - Invest in a SPV with land owner and developer
 - Enter into a JV through SPV with developer and do Joint development agreement with land owner

- **Shares / Debentures of holding companies**
 - Invest in listed/unlisted holding company of a developer
 - Invest in asset holding companies holding real estate land banks

Exit Strategy

- Sale to the end user at company level and get returns through dividends/interest on debentures



Primarily applicable for residential projects

- Sale to third party/other funds at the SPV level and get returns as capital gains



Primarily to be used in case of commercial projects

- Sale to funds/institutions who have appetite for fixed income securities



Primarily applicable in case of investment with holding company of developers /commercial properties

- Public listing of the investee company

Tax Implications – Investment in Shares

■ Dividend income

- Dividend received by shareholders is exempt from tax – section 10(34) of IT Act
- However, Company distributing dividends is liable to pay dividend distribution tax @ 16.995%

■ Profits from sale / transfer of Shares

- If considered as capital gains (capital gains = sale consideration – cost of acquisition – expenses incurred in connection with such transfer)

Capital Gains	Long-term Capital Gains		Short-term Capital Gains	
	Period of holding	Rate	Period of holding	Rate
Listed Shares (where STT paid)	More than 1 year	Exempt u/s 10(38)	1 year or less	11.33%
Unlisted Shares	More than 1 year	22.66% (with indexation benefit)	1 year or less	33.99%

- If considered as business income – net income taxable @ 33.99%

Notes

1. Tax rates include surcharge @10% , Education Cess @2% & secondary and higher education cess @1% of the tax amount
2. It is assumed that income would be taxable in the hands of investors at the maximum rate.



Tax Implications – Investment in Debentures

Interest income

- Interest received by debenture holder is taxable @ 33.99%

Profits from sale / transfer of Debentures

- If considered as capital gains (capital gains = sale consideration – cost of acquisition – expenses incurred in connection with such transfer)

Capital Gains	Long-term Capital Gains		Short-term Capital Gains	
	Period of holding	Rate	Period of holding	Rate
Listed debentures	More than 1 year	11.33% (see note 4)	1 year or less	33.99%
Unlisted debentures	More than 3 years	22.66%	3 years or less	33.99%

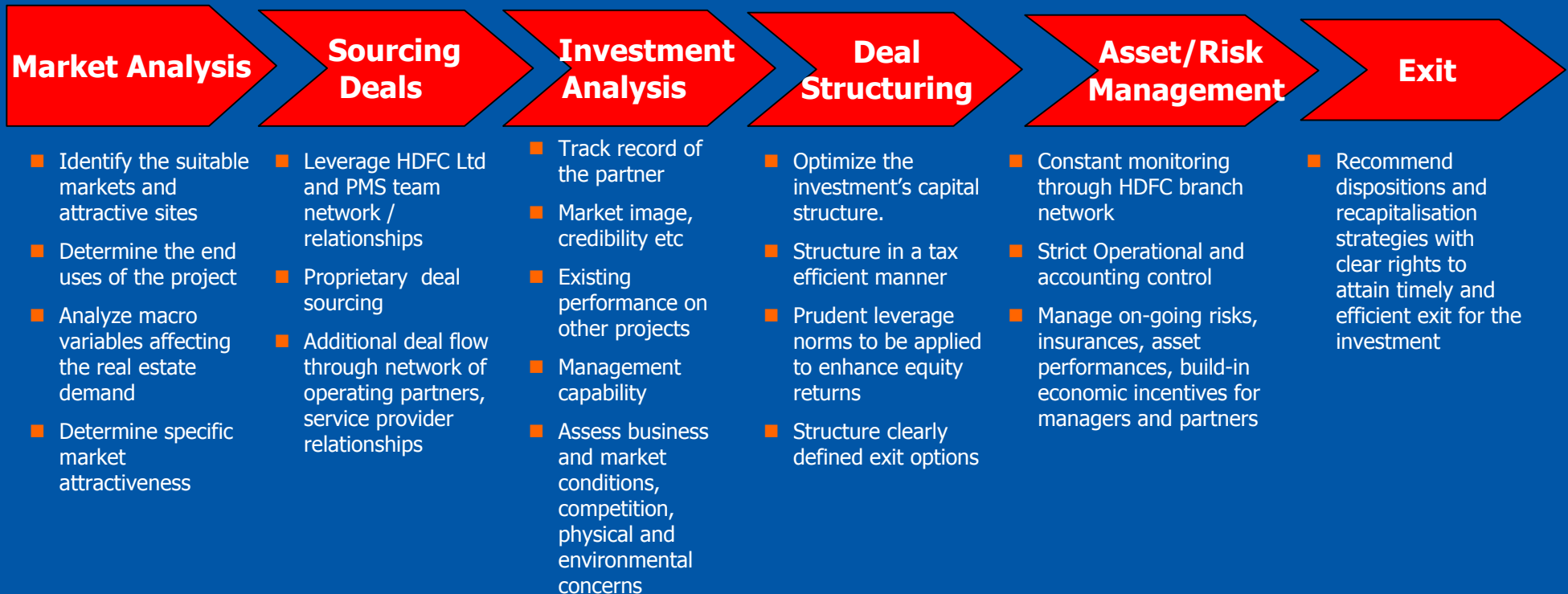
- If considered as business income – net income taxable @ 33.99%

Notes

- Tax rates include surcharge @10% , Education Cess @2% & secondary and higher education cess @1%
- It is assumed that income would be taxable in the hands of investors at the maximum rate.
- According to third proviso to section 48 of the Income Tax Act, indexation benefit is not available to debentures.
- In case of listed debentures, it is possible to take a view that concessional tax rate of 11.33% (without indexation) per proviso to section 112 should be available [reliance could be placed on the recent decision of Authority for Advance Rulings in case of Timken France (Unreported) and on the decision of Mumbai Tribunal in Alcan Inc. vs DDIT (16 SOT 8)]. However, tax authorities may seek to apply normal tax rate @ 22.66% relying on Mumbai Tribunal's decision in BASF Aktiengesellschaft vs DDIT (293 ITR 1)



Portfolio Investment Process



Why HDFC AMC - PMS Real Estate Portfolio - I?

■ **Strong Investment Advisor – HDFC**

- Has in depth and unparalleled understanding of the market
- One of the most trusted and reputed financial institutions in India
- Over 30 years of real estate experience.

■ **Flexible investment strategy**

- No restrictions on the type, size and nature of projects for investment
- Investment can be through structured instruments which protect downsides

■ **Unique proposition**

- This shall help provide a complete financial solution to developers / land owners
- The flexibility on size and nature of investments shall also result in proprietary deal sourcing thereby getting better returns

■ **Sourcing strategy**

- Over two decade old established relationships
- Strong contacts with 300-350 developers across the country
- Key contacts with local consultants, brokers, land owners etc

Salient Features

- **Portfolio Manager** : **HDFC Asset Management Company Limited**
- **Advisor** : **HDFC Ltd**
- **Tenure of scheme** : **6 (+1 +1) years**
- **Commitment period** : **2 year (+1 year extension option)**
- **Carry** : **20% with catch up**
- **Hurdle Rate** : **10%**
- **Management Fees** : **2% p. a.* (of committed amount during commitment period and net invested principal for remaining tenure payable quarterly in advance)**
- **Entry Load** : **Upto Rs. 10 crores: 2.25%, More than Rs. 10 crores - Nil**
- **Management** : **Real Estate investment team at HDFC AMC PMS Division**
- **Investment Strategy** : **Invest in Real Estate projects across India in the Top 20 cities**

* Plus applicable Service Tax



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