

# Grading of Construction & Real Estate Entities

**CIDC & ICRA Ltd.**

# Presentation Structure

- Real Estate and Construction - Engines for growth
- Concerns
- Efficiency Enhancement
- Need for risk assessment tools ...

... (Grading)



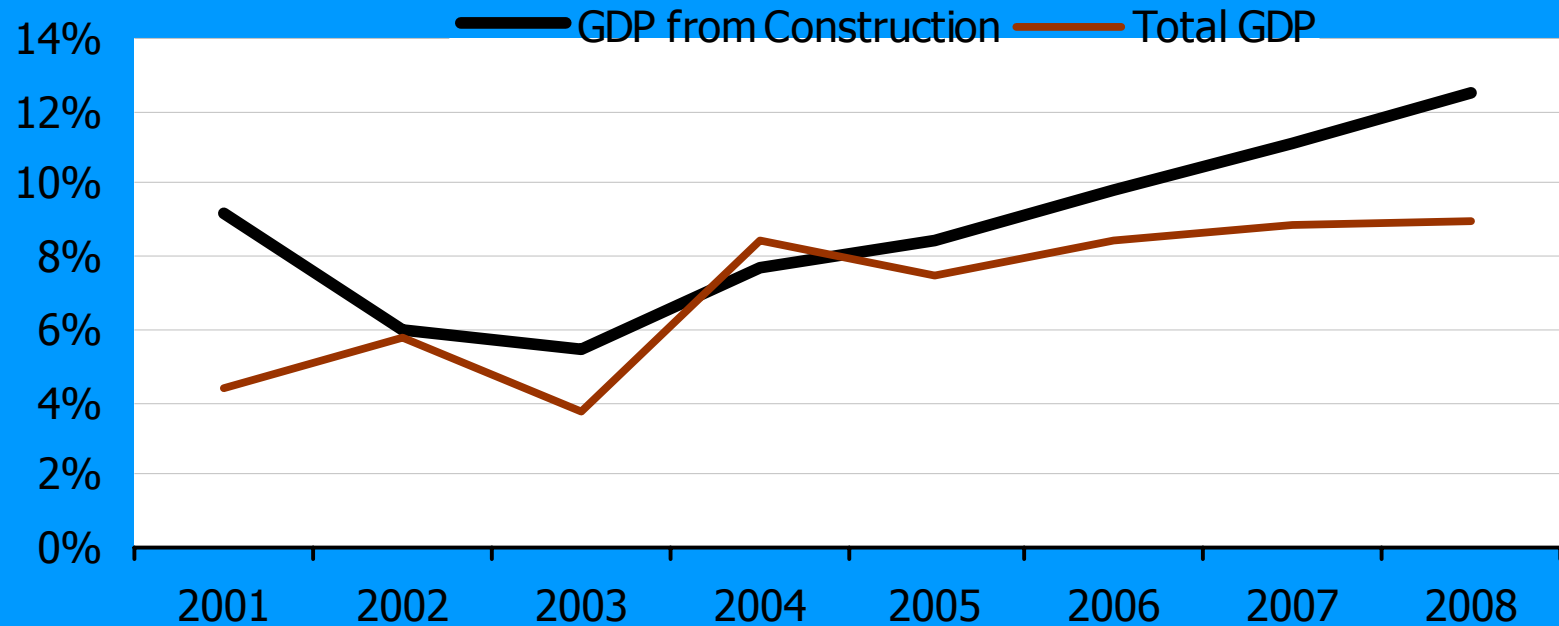
# Real Estate and Construction Sectors in India

- Real estate and construction: contribute 10-11% to the GDP
- Construction - Engine for economic growth - high multiplier effect
- Organised Real Estate and Housing development - Key component of country's infrastructure development
- Adoption of practices often do not support good quality asset creation
- *----- While funding needs to be channelised to the right projects, benchmarking quality and efficiency of development is the need of the hour.*



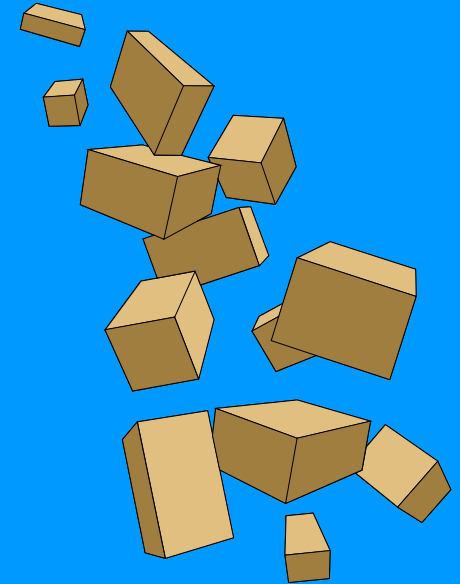
# Growth in Construction Sector and GDP

(GDP at factor cost and constant prices)



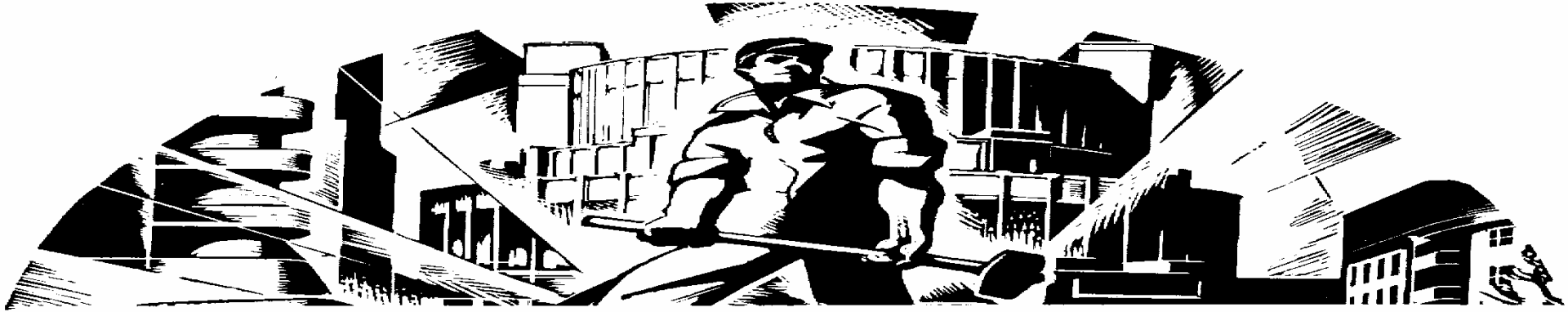
# Concerns

- Unstructured regulatory frame work leading to ineffective entry barriers
- Inefficiencies
- Lack of transparency
- Credit flow to the sector can be widened



*Value to the customer needs to be enhanced by mitigating these concerns*

*----- Grading a facilitator*



# Grading of Real Estate and Construction entities

## *The Rationale*

Tools for Choice



Differentiating **Transparent** Mechanism



**ICRA option**

# About ICRA

- Set Up in 1991 as a Credit Rating agency
- Promoted by leading Financial institutions and Banks. Moody's Investors Service is currently ICRA's largest shareholder
- Diversified into Industry research, Performance Gradings, Advisory Services
- Completed more than 4000 assignments across various sectors

# About CIDC

- Planning Commission, Government of India along with Construction Industry have set up the Construction Industry Development Council (CIDC) to bring about the re-organisation of the Indian Construction Industry. Shri. G. V. Ramakrishna and Dr Uddesh Kohli are Chairman Emeritus of CIDC. Shri Chander Verma, Director, Continental Constructions Ltd. is the present Chairman.
- CIDC is now the Apex Nodal Agency for all types of construction and related activities in India. Construction is an activity which forms a major part of the capital expenditure of many sectors (and their corresponding Ministries). Founded by the Planning Commission, Government of India, it has amongst its 87 members.
- The Council started functioning from August, 1996 and has taken up several important projects related to the vital issues of the Construction Industry

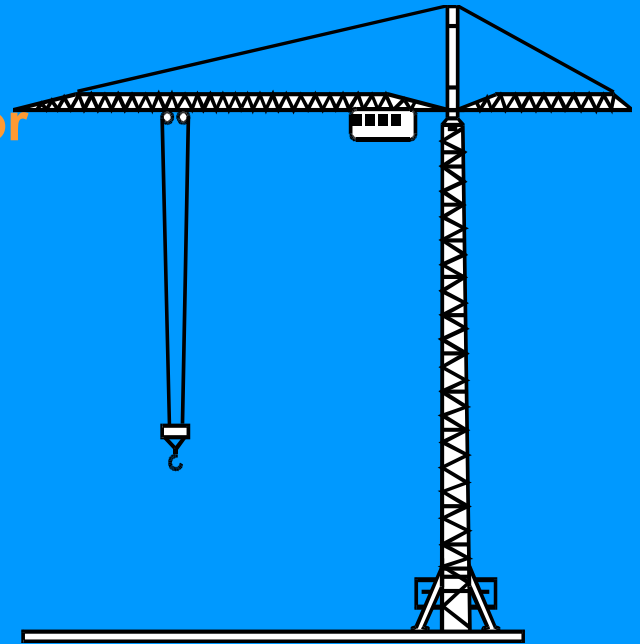


# Who are being Graded ?

- **Real Estate entities**

- The Real Estate Project
- The Real Estate Developer

- **Construction Company or the Contractor**



# How would Grading help?

## **Broadly...**

- Encourage transparency, objectivity and standardization
- Enabling the Developers to benchmark themselves against competition
- Provide effective entry barriers against inefficient operators
- An input for decision making
- Facilitate pricing and credit decisions

***More specifically for the market participants ....***

# ... How would Grading help?

## Benefits of Grading Developer(s)/project:

- **Investors (end user / buyer of property / relevant stakeholder):**
  - Aware of the risks involved in the developer's ability to deliver as per specified terms, quality parameters, and,
  - Transfer of ownership on time
  
- **Facilitate flow of institutional funds:**
  - A scientifically graded project would lend itself to a more accurate and reliable estimation of risks thereby **increasing the confidence of the lenders**

# ... How would Grading help?

- **Facilitate effective alliances:**

- In real estate ventures through independent and **objective opinions on the capability of concerned entities** (such entities may include joint venture partners / participant in any Special Purpose Vehicle)

- **Facilitate positioning:**

- Especially a developer / project in an unorganised market

*Moreover, grading would facilitate the **overall growth of the real estate sector by providing the developers with incentives to conform to fair trade practices and legal requirements***

# ... How would Grading help?

## Benefits of Grading of Construction Companies / Contractors:

- **The project owner / project developer:**

- Select the appropriate entity and evaluate project completion risks

- **The contractor or the construction company:**

- Facilitates acceptance while highlighting his competence and eliminating unhealthy undercutting or unrealistic bidding
- Facilitates funding and lowers its cost of funds

# ... How would Grading help?

- **Lenders:**

- Independent and unbiased input to assess risk associated with the construction entity

- **Joint venture / joint venture partner:**

- Objective understanding of techno-financial capability for participating in joint ventures / Special Purpose Vehicles

*The **ultimate beneficiary is the project itself**, which would gain from the smooth flow of work through the deployment of compatible participants and availability of lower cost of funds arising out of efficient availability of credit.*

# What do we grade them on ?

## The Real Estate Project

### *Project Strength*

#### **Business Risk**

**Price Risk** – relative price of the final product

**Resource Risk** – adequacy and appropriateness of the resources mobilised

**Quality & Non-Conformance Risk**

**Project execution Risk** – relates to capability of relevant agencies involved in project execution

**Transfer of Ownership Risk**

**Permitting Risk** – risks arising out of non-availability / delays in relevant permits

**Political Risk**

**Site Risk** – location and availability of infrastructure

**Interest Rate Risk**

**Penalty Clause** – extent of protection to the customers

**Completion Risk**

# What do we grade them on ?

## The Real Estate Project

### *Project Strength*

#### **Financial Risk**

- Cash Flow vs obligations : **for project development and debt servicing**
- Developer's financial position and flexibility to support uninterrupted project development

#### **Management Risk**

- **Track record** of the developer
- Promoter profile



# The Grading Symbols

## The Real Estate Project:

- RT1**      **Very strong project.** The prospects of successful implementation of the real estate project and transfer of ownership as per terms are highest. The project risk factors are lowest.
- RT2+**      **Strong project.** The prospects of successful implementation of the real estate project and transfer of ownership as per terms are high. The project risk factors are low.  
**RT2**  
**RT2-**
- RT3+**      **Moderate project.** The prospects of successful implementation of the real estate project and transfer of ownership as per terms are moderate. The project risk factors are moderate.  
**RT3**  
**RT3-**
- RT4+**      **Inadequate project.** The prospects of successful implementation of the real estate project and transfer of ownership as per terms are inadequate. The project risk factors are high.  
**RT4**  
**RT4-**
- RT5**      **Weak project.** The prospects of successful implementation of the real estate project and transfer of ownership as per terms are poor. The project risk factors are highest.

# What do we grade them on ?

## The Real Estate Developer

### **Business Risk**

- Project development track record & Market position
- Project composition – On going Projects
- Adherence to time schedules and local norms for development
- Project Quality Record – *past projects and on-going projects. quality of entities deployed in execution.*
- Project management capability
- Contractual clarity with customers
- Transfer of ownership / clarity of title in projects
- Customer satisfaction

# What do we grade them on ?

## The Real Estate Developer

### Financial Risk

- Profitability
- Leverage
- Financial Flexibility
- Cash flow vs obligations
- Contingent Liabilities

### Management Risk

- Management Quality – *promoters and management profile*

# The Grading Symbols

## The Real Estate Developer

- DR1:** **Very strong project development capacity.** The prospects of development of real estate projects as per plan are best and the ability to transfer ownership as per terms is highest.
- DR2+:** **Strong project development capacity.** The prospects of development of real estate projects as per plan and the ability to transfer ownership as per terms are high but not as high as DR1.  
**DR2**  
**DR2-**
- DR3+:** **Moderate project development capacity.** The prospects of development of real estate projects as per plan and the ability to transfer ownership as per terms are moderate. Project development capacity can be affected moderately changes in the real estate sector prospects.  
**DR3**  
**DR3-**
- DR4+:** **Inadequate project development capacity.** The prospects of development of real estate projects as per plan and the ability to transfer ownership as per terms are inadequate. Project development capacity can be affected severely by changes in real estate sector prospects.  
**DR4**  
**DR4-**
- DR5:** **Weak project development capacity.** The prospects of development of real estate projects as per plan and the ability to transfer ownership as per terms are poor.

# What do we grade them on ?

## The Construction Company or Contractor

### Business Risk

- Market Position & sectoral concentration
- Ability to be an integrator
- Project Quality Record
- Project management & design systems
- Extent & quality of subcontracting
- Equipment Base
- Human Resources
- Management Quality
- Client Category & diversity
- Labour relations & Disputes

### Financial Risk

- Profitability
- Leverage
- Financial Flexibility
- Liquidity
- Liquidated Damage exposure
- Contingent Liabilities
- Insurance cover
- Cash flow vs Obligations

# The Grading Symbols

## *The Contractor*

- CR1**      **Very strong contract execution capacity.** The prospects of timely completion of projects without cost over-runs is best and the ability to pay liquidated damages for non-conformance with contract are highest.
- CR2+**      **Strong contract execution capacity.** The prospects of timely completion of projects without cost over-runs and the ability to pay liquidated damages for non-conformance are high but  
**CR2**      not as high as CR1  
**CR2-**
- CR3+**      **Moderate contract execution capacity.** The prospects of timely completion of projects without cost over-runs and the ability to pay liquidated damages for non-conformance are  
**CR3**      moderate. Contract execution capacity can be affected moderately by changes in the construction  
**CR3-**      sector prospects.
- CR4+**      **Inadequate contract execution capacity.** The prospects of timely completion of projects without cost over-runs and the ability to pay liquidated damages for non-conformance are  
**CR4**      inadequate. Contract execution capacity can be affected severely by changes in the construction  
**CR4-**      sector prospects.
- CR5**      **Weak contract execution capacity.** The prospects of timely completion of projects without cost over-runs and the ability to pay liquidated damages for non-conformance are poor.

# A Case Study

## ***Real Estate Project (P)***

### **Synopsis**

Developer India Ltd (DIL), a developer with over Rs 50 crore turnover, incorporated in 1995, undertaking a residential complex project P worth Rs 50 crore.

# A Case Study

## ***Real Estate Project (P)***

**Step 1:** DIL submits mandate to ICRA for project P

**Step 2:** ICRA requests information through questionnaires



# A Case Study

## **Key information requested includes**

- ✧ I) Audited financial results (incl group companies)
- ✧ ii) Details of past and on-going projects
- ✧ iii) Details of project P in terms of location, cost, scope, duration, land agreements, progress status, current bookings etc
- ✧ iv) Terms of commitment to the customers
- ✧ v) Details of contractors and consultants associated with the project/planned to be deployed
- ✧ vi) Funding profile of the project - means of finance and planned expenditure
- ✧ vii) Organisation details

# A Case Study

## *Real Estate Project (P)*

### Step 3: Project Site Visit-

- To assess the land / site status, local infrastructure,
- To determine the effectiveness of project management
- To assess quality practices actually adopted

### Work practices looked at include

- Nature of executing entities deployed
- Quality assurance systems
- Project management and supervision



# A Case Study

## ***Real Estate Project (P)***

### **Step 4: Assessment of uncertainty associated with project completion**

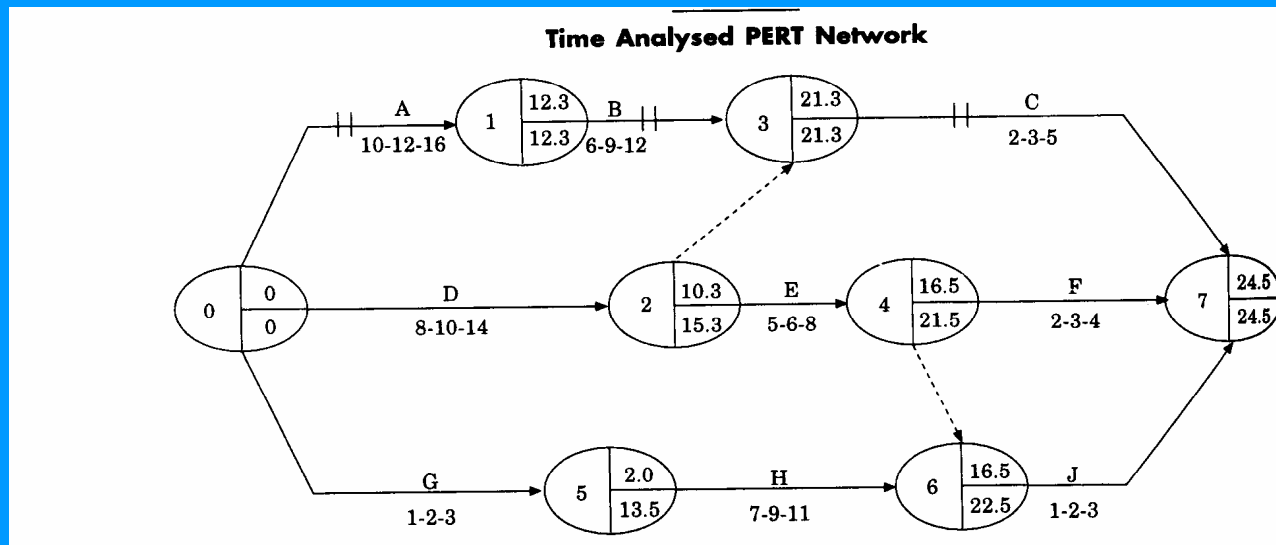
- **Identification of critical activities and extent of mitigation of uncertainties pertaining to these activities**
  - Land Acquisition
  - Building plan approval
  - Foundation
  - Superstructure
  - Services
  - Finishing
  - Completion Certificate
  - Facility management

# A Case Study

## Real Estate Project (P)

### Assessment of uncertainty associated with project completion

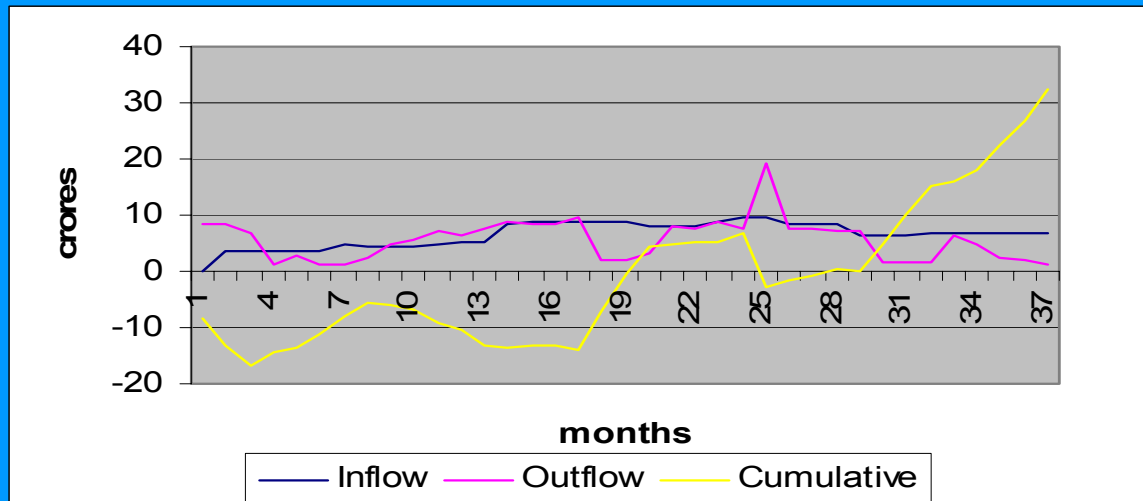
- Expected activity time  $T_e = (T_o + 4T_m + T_p) / 6$   
*Where  $T_o$  &  $T_p$  are optimistic and pessimistic times,  $T_m$  : most likely time*
- Standard deviation =  $(T_o - T_p) / 6$
- Critical path evaluation
- Expected project duration corresponding to 50% probability : sum of  $T_e$  on critical path
- Variance of project probability distribution : sum of Variance of  $T_e$
- Probability of completing the project in x months is equal to the area under the normal curve from  $-\infty$  to x



# A Case Study

## Real Estate Project (P)

**Step 5:** Financial Analysis (eg. Cash flow of the project, developer's key financial indicators)



*Developer's financial flexibility to support the deficit for uninterrupted project development is assessed. Adequacy of cash flow for servicing future obligations is essential*

# A Case Study

## ***Real Estate Project (P)***

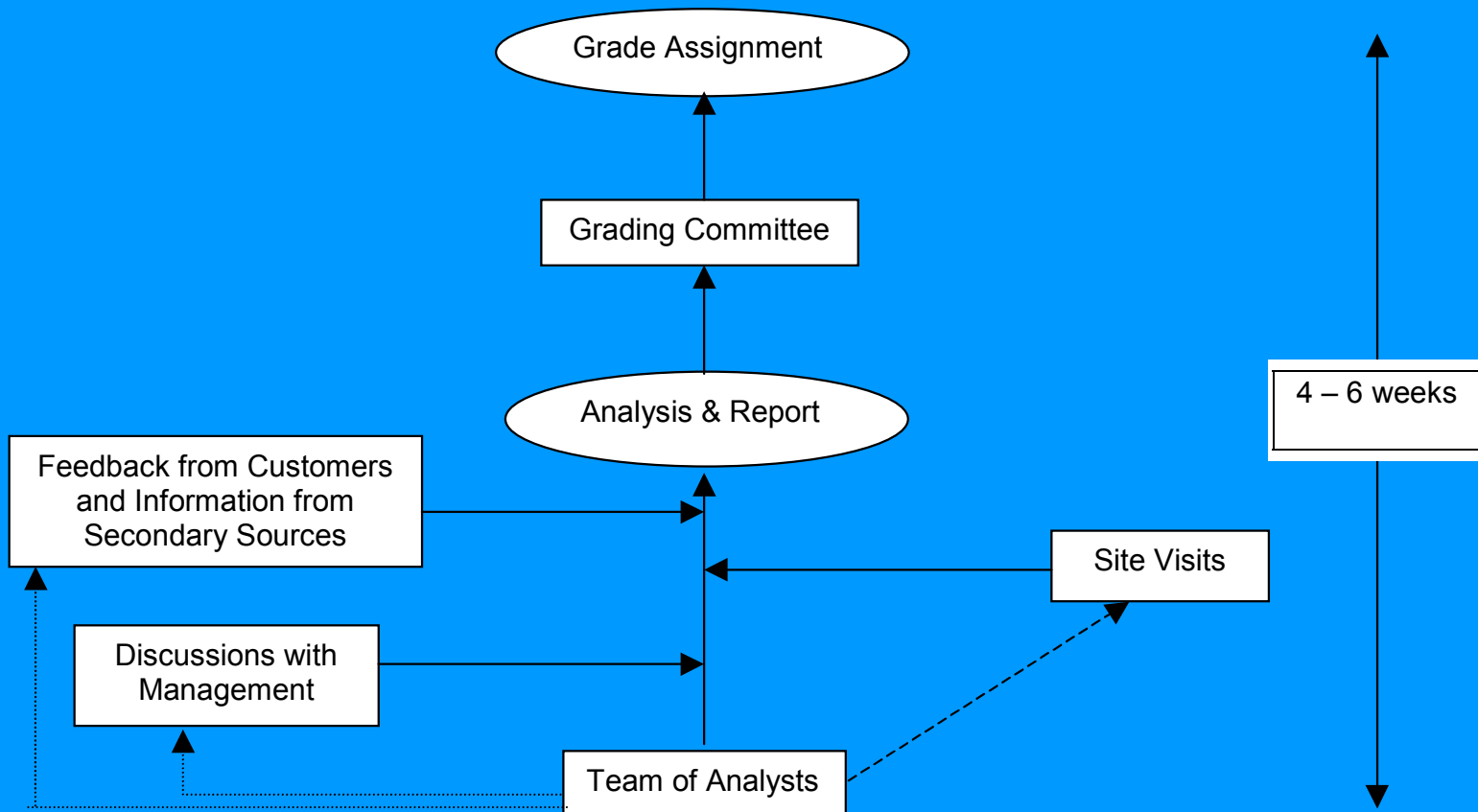
**Step 6:** Customer feed back & other secondary information

**Step 7:** Deliberations

**Step 8:** Grade assignment

# The Grading Process

## The Steps :



# The Grading Process

- Traditionally Grading is asked for by lender / investor / customer / JV partner / developer itself / any other stakeholder
- Grading request / mandate to ICRA by Real Estate Project Developer for
  - Grading of a specific Project / Projects
  - or
  - Grading of the concerned entity as a Developer
  - or
  - Grading of a specific project/projects as well as grading of the Developer as a whole
- Interactive process



# Grading of Real Estate entities published include...

## Real Estate Developers

Name of the Entity	Location	Grade
Bengal Ambuja Housing Development Limited	Kolkata	DR1
Bengal Ambuja Metro Development Limited	Kolkata	DR1
Parsvnath Developers Limited	Delhi	DR3+
Eldeco Infrastructure & Properties Ltd	Delhi	DR2

## Real Estate Projects

Name of the Project	Developed By	Location	Grade
Hiland Park Phase II	Calcutta Metropolitan Group Ltd	Kolkata	RT2+
Millenium Phase I	Brigade Enterprises Pvt Ltd	Bangalore	RT2+
Hiland Park Phase I	Calcutta Metropolitan Group	Kolkata	RT2
Westwind	Right Address Projects Ltd	Kolkata	RT2
ATS Greens - Phase II	ATS Infrastructure Limited	Noida	RT2-
Akshay Colony	Suresh Enterprises Limited	Hubli	RT2-
ATS Greens Village	ATS Infrastructure Limited	Noida	RT2
International Convention Centre-Ph I	ICC Realty (I) Pvt Ltd	Pune	RT2-
Golden Nest Ph XI-XIV	Sonam Builders	Thane	RT3+
Infinity Project	Infinity Infotech Parks Ltd	Kolkata	RT2

.....more are in progress

# Example

Cut off grade as specified in the Bidding Document - CR<sub>2</sub><sup>-</sup>  
Bid submitted by the Contractors.

Contractor	Holding Grade	Moderating Factor	Quoted Price Lakhs	Status	Lowest Effective Price Lakhs	Status
(i) A	CR <sub>2</sub> <sup>-</sup>	1	110	L <sub>1</sub>	110.00	L <sub>5</sub>
(ii) B	CR <sub>2</sub> <sup>+</sup>	0.98	112	L <sub>3</sub>	109.76	L <sub>3</sub>
(iii) C	CR <sub>2</sub>	0.99	111	L <sub>2</sub>	109.89	L <sub>4</sub>
(iv) D	CR <sub>1</sub> <sup>-</sup>	0.97	113	L <sub>4</sub>	109.61	L <sub>2</sub>
(v) E	CR <sub>1</sub>	0.96	114	L <sub>5</sub>	109.44	L <sub>1</sub>

# Major Projects Looked at in course of CIDC-ICRA Real Estate and Construction Grading schemes

## **REAL ESTATE & URBAN INFRASTRUCTURE**

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- Joint sector and Pvt sector housing projects in Kolkata
- Mass Housing cum commercial complex in Kolkata (19 lakh sqft)
- Joint sector commercial-entertainment-residential complex in Kolkata (5.5 lakh sqft)
- Convention Centre including shopping and office complex in Pune (4.8 lakh sqft)
- Residential Township with commercial facilities in Hubli (10.4 lakh sqft)
- Commercial complexes in Gurgaon (2 - 4 lakh sqft)
- Mass housing cum commercial project in Ghaziabad (33 lakh sqft)
- Housing Projects in Bangalore, Mumbai, Noida, Delhi, Kolkata, Chennai, Hyderabad
- Mass Housing project in Mumbai
- Software Park in Maharashtra.
- Software Park in Chennai
- Software Complex in Pune
- Petrochemical Research Facility in Gujarat
- Water Supply schemes in Maharashtra and Karnataka

# .... Major Projects Looked at in course of CIDC-ICRA Real Estate and Construction Grading schemes

## Roads & bridges

- Strengthening and widening of 31.7 km existing two lane road and construction of two additional lanes for a State Highway In Gujarat
- Strengthening and four-laning of 22.9 km two lane road in Gujarat
- Construction of 1.026 km\*11.1 m wide bridge and viaduct
- Bridge on river Yamuna
- Widening to 4/6 lanes and strengthening of existing 2 lanes carriageway in the state of Andhra Pradesh
- Construction of a new 4 lane highway in Andhra Pradesh and strengthening and widening of the existing 2 lane stretch including a major bridge
- Concrete pavement involving widening to 4/6 lanes and upgrading of the existing 2 lane road in West Bengal
- Rehabilitation and upgrading incl. 4/6 laning of 63 km carriageway in Rajasthan (Rs. 151 crore)
- Widening of 4/6 lanes and upgrading of the existing 2 lane road, flyover and road over bridges in Andhra Pradesh

# ... Major Projects Looked at in course of CIDC-ICRA Real Estate and Construction Grading schemes

## ■ Power

- Govt and private sector hydroelectric projects in Himachal Pradesh
- Hydro Power project in Jammu and Kashmir
- Atomic power project in Maharashtra
- Thermal power station in Andhra Pradesh
- Power plant in Chennai

## ■ Ports

- Dry Dock at Mumbai
- Jetty and associated pipeline in Andhra Pradesh

## ■ Oil & gas

- Refineries in Gujarat, Maharashtra and Assam
- LNG terminal in Maharashtra

# Would the verdict be fair?

## **CIDC ICRA Factor**

- Independence
- Research
- Consistency
- Transparency
- Ground Level Realities

## **Grading Committee**

- Guidance
- Experience
- Knowledge

Thank You