

## RATING METHODOLOGY – REAL ESTATE

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### Table of Contents:

|   |    |
|---|----|
| Overview .....  | 1  |
| Business Risk Assessment.....                                 | 3  |
| Financial Risk Assessment.....                                | 8  |
| Other Elements of Credit Risk Assessment.....                 | 10 |
| Management Quality.....                                       | 11 |
| Assessment of Environmental, Social and Governance Risks..... | 12 |
| Summing Up .....  | 13 |
| ANNEXURE.....   | 14 |

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This rating methodology document describes ICRA's approach to assess the credit quality of entities in the real estate industry and supersedes ICRA's earlier methodology document on this subject, published in August 2019. While ICRA's overall approach to rating entities in the sector remains materially similar, the revised methodology document incorporates a more detailed description of certain financial parameters that ICRA assesses for credit assessments, besides incorporating various presentation-related changes. Also, a section has been added to provide a broad perspective on how environmental, social and governance (ESG) risks are incorporated by ICRA in its credit assessments of real estate entities.

### Overview

The real estate industry can be broadly categorised into the development of residential and commercial properties, with the latter comprising office properties, retail malls and industrial warehouses. The revenue model in the industry is based either on the sale of constructed properties or on the leasing of properties that are held on the balance sheet as long-term assets.

This methodology document discusses ICRA's approach to rating real estate entities (REEs), where the primary business model is to construct and sell built-up area in the residential segment or the commercial segment. While the rating approach is broadly similar for both the segments, ICRA notes that there could be differences in the demand-supply dynamics and sales/collection cycles of the two.

For projects in the commercial real estate sector (including retail malls and industrial warehouses), that are intended to be held for leasing, ICRA analyses the projects' ability to generate adequate lease income to cover the debt repayments. The factors considered therein for analysis are described in detail in the note on "Rating Approach for Lease Rental Discounting (LRD)".

For analytical convenience, the key factors for analysing the REEs are grouped under the following broad heads—Industry Risk Assessment, Business Risk Assessment, Financial Risk Assessment, Management Quality, and various other elements of credit risk assessment. Appropriate emphasis is laid on the relevant rating factors that take into account the features that are specific to the real estate industry, including its execution and cash collection cycle, funding mix, the terms of typical debt sanctions and general industry practices.

### Industry Risk Assessment

- Competitive intensity and cyclicality
- Legal and regulatory risk

### Business Risk Assessment

- Scale and track record
- Market standing
- Funding risk
- Market risk
- Construction risk
- Diversification
- Expansion plans

### Financial Risk-Assessment

- Profitability
- Capital structure and leverage
- Liquidity and debt coverage

### Other Elements of Credit Risk Assessment

- Parentage
- Financial flexibility
- Debt servicing track record
- Accounting quality
- Contingent liabilities and off-balance sheet exposures
- Event risk

### Management Quality

### Assessment of Environmental, Social and Corporate Governance Risks

## Industry Risk Assessment

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### Competitive intensity and cyclicity

The industry is characterised by the presence of many large as well as small unorganised developers. Nonetheless, the regulatory developments over the past decade, particularly the Real Estate Regulation and Development Act of 2016 (RERA Act), have resulted in consolidation of the industry, in turn benefiting larger developers. Other factors like the Covid-19 pandemic have also accelerated the trend of consolidation in the industry.

The real estate industry is cyclical in nature and has positive correlation with the macro-economic environment. Some of the key drivers of the industry are the state of the economy reflected in the growth rate of the manufacturing and the services sectors, employment levels, increase in the proportion of employed workers in the total population and the extent of rise in disposable income. The purchase of a residential real estate unit is considered to be an investment by many customers and the buying decisions are influenced by factors such as expectations of future income stability and capital price appreciation, affordability, apart from various personal preferences. Moreover, the demand-supply trends within the real estate industry may vary in different geographies and product segments. Given that the typical implementation period for a real estate project can range from three years to six years, the cyclicity in the industry trends may significantly impact a project's performance.

### Legal and regulatory risk

Real estate projects are subject to significant regulatory risk on account of the various approvals that are required from Government bodies for the construction and sale of buildings. In addition, the legal status of the title of the underlying land for the project can also be subject to litigation and poses a major risk to developers and buyers in real estate projects.

The regulatory oversight on the real estate sector has increased significantly with the passing of the RERA Act, which emphasises on adherence to contractual obligations and regulatory guidelines. Developers who have a strong track record of adhering to regulatory stipulations and contractual obligations are better placed to operate under the new framework. Thus, the introduction of the RERA Act has gradually resulted in consolidation of the industry, which hitherto had been characterised by a fragmented structure with the presence of large unorganised segment and intense competition.

Moreover, amendments to the Insolvency and Bankruptcy Code, provide homebuyers the status of financial creditors, thereby granting them the right to initiate insolvency proceedings against developers who have not fulfilled their commitments under the sale agreements. However, such rights are restricted by certain threshold limits on the number of homebuyers who must jointly initiate such proceedings. ICRA assesses the risk of such claims by homebuyers by looking at the project commencement dates and contracted handover dates to identify delayed projects which may be vulnerable. In addition, the past track of complying with regulations and delivery as per scheduled timelines is viewed favourably.

## Business Risk Assessment

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The key rating factors evaluated under Business Risk include the REEs' past track record in the industry, market standing and execution capabilities. These have a direct bearing on the REEs' ability to execute, market and finance their portfolio of ongoing and planned projects. In addition, there are risk factors that are specific to the projects being developed by the REEs and need to be analysed separately. While assessing REEs, ICRA evaluates each project in the portfolio on an individual basis. However, given that there can be fungibility of cash flow surpluses across projects, an evaluation of the project portfolio on an aggregate basis becomes critical even when these are taken up in multiple entities promoted by the REE. A description of the factors assessed under Business Risk is given below.

### Scale and track record

While evaluating an REE, ICRA lays emphasis on the developer group's execution track record in terms of years of presence in the real estate sector, types of projects developed, geographic diversification, as well as the number and area of projects delivered. A developer's long presence in the sector is looked at in conjunction with the scale and type of development over the years. An REE with a successful track record of developing large-sized projects with the required quality and within timelines is looked at favourably as such a track record enhances its market position as well as brand equity. The track record is also examined in relation to the type and scale of projects being currently undertaken vis-à-vis projects executed in the past. A higher scale of cash flow generation is seen to be correlated with enhanced market position, financial flexibility, greater economies of scale and access to lower cost capital.

### Market standing

ICRA believes there is a positive correlation between the market position of a real estate player and its ability to attract customers/brokers, engage with key lenders/investors, and get projects approved for home loans from banks/housing finance companies. Therefore, while assessing the fundamental strength of an REE, ICRA evaluates the market position of the entity on the basis of the qualitative and quantitative determinants of relative market strength, such as market share, brand equity, track record of sales/bookings, and velocity of sales. With a large share of the funding mix in real estate projects being met through customer advances (typically 50-70%), a superior market position can translate into relatively faster sales and hence, reduced funding risks for the project.

### Funding risk

The funding mix for real estate projects usually involves equity, debt and customer advances with the latter generally forming the largest share of the mix. ICRA evaluates the adequacy of the committed cash flows as the sum of the balance collections from the sold area divided by the balance cost to be incurred to complete the project and the debt outstanding. A lower ratio implies that there will be high dependence on either fresh sales (market risk) or promoter contribution (sponsor risk) to bridge the funding gap.

$$\text{Adequacy of Committed Cash Flows} = (\text{Receivables from Sold Area}) / (\text{Pending Cost} + \text{Debt Outstanding})$$

In the case of residential projects, timely collection of dues from customers as per the sale agreement terms is critical for meeting the funding requirements. In this context, the ratio of customer advances received to the total value of sale agreements should be commensurate with the stage of construction and the corresponding billing milestone as per the payment schedule.

For commercial real estate projects, the payment milestones could be more spread out, resulting in lumpiness in collections and potential cash flow mismatches during the construction stage. Hence, the specific payment terms for the sale agreements need to be evaluated to estimate the funding risks.

Since projects in the initial stage can be dependent on debt funding, especially given the increasing preference among homebuyers for completed inventory, the status of financial closure, conditions precedent for debt disbursement and adequacy of equity margin funding for debt disbursement are considered.

### Market risk

The saleability of the REEs' ongoing and upcoming residential projects is assessed by the projects' type, location, price, amenities on offer, competition from nearby projects and target customers. The saleability of commercial projects is evaluated through parameters such as expected demand for office/retail space in the location and price competitiveness (vis-à-vis other sale projects or leased area). Market risk associated with each project is also assessed through the level of bookings (percentage

of total area sold) and velocity of sales over the project tenure. Projects where the sales proportion is significantly high and sales velocity has been strong in the recent years are expected to have lower market risk.

Factors that mitigate market risks for an REE include diversity of project portfolio in terms of geography, product, price points and clientele, and presence of strong marketing channels. In ICRA's experience, the market risks associated with commercial real estate properties tend to be higher on account of the narrower target customer segment and larger ticket size per transaction. Developers that have a strong track record of selling commercial space through strata sales and demonstrated ability to tie up leasing for the space under development are better placed to absorb the market risks associated with such projects.

For each of the launched projects, ICRA assesses the proportion of booked space to the total area offered. A lower proportion of booked space increases the market risk for the project and can lead to a delay in project execution as the projects are largely financed from customer advances. The sales volume and pricing trend since the launch of the project are also analysed to understand the market response and are used to draw inferences on future sales which will determine the projected cash flows. The years of unsold inventory (calculated as area pending to be sold divided by average sales in trailing 12 months) are evaluated in relation to the general industry.

### Construction risk

The stage of construction of each of the ongoing projects is evaluated from the perspective of an REE's ability to complete the project in a timely manner. Any delays in project execution can negatively impact collections from customers (which are generally linked to construction milestones) and saleability of projects, leading to a vicious cycle of lower funding availability that further constrains execution progress. Projects in the initial stage of execution are more exposed to risks of time and/or cost over-runs. For evaluating construction risks, ICRA considers the financial progress achieved in ongoing projects. The physical and financial progress on the projects is also seen in relation to the completion dates as per RERA registration.

Adherence to the legal and regulatory processes is assessed by ICRA to understand any deviation, which could have a bearing on an REE's ability to execute a project in a timely manner. The availability of RERA registration for the ongoing projects is evaluated as generally this registration is taken after the receipt of all other critical approvals such as building plan sanction, environmental clearance, airport authority approval, fire authority approval, etc.

### Diversification

ICRA assesses the developer's presence across multiple assets, geographical markets and product segments and the consequent cash flow generating capability from each market/segment. A diversified product mix, while allowing a developer to address a wider customer market, also reduces its reliance on a single segment/project. ICRA, while making the assessment, also looks at the developer's geographical presence as that helps the latter to mitigate the risks to its portfolio from exposure to a single region as well and helps it to leverage on growth opportunities in other regions. Diversification reduces an REE's exposure to demand volatility and competition in any particular segment/location. An REE that has revenues coming in from diverse projects in terms of location, type and price points may be expected to have relatively sustainable and smoother cash flows. Operational cash flows in projects that are performing well can be a source of cash flow to support relatively weak ongoing projects.

However, the RERA Act of 2016 imposes a cash flow ring-fencing mechanism, with 70% of the collections to be received in the project escrow account and withdrawals permitted on the basis of the cost incurred on the project. In ICRA's experience, REEs that have been maintaining adequate financial discipline, in terms of utilisation of customer advances, have not been significantly impacted by the RERA separate account requirement, since they generally are eligible to withdraw most of the collections into this account by maintaining commensurate construction progress. To that extent, the working capital blockage

due to the RERA account mechanism has not been a material credit negative and the REEs continue to benefit from having a diversified project mix. Overall, a diversified project portfolio tends to support the financial flexibility of REEs.

Many REEs are present across multiple business segments such as residential, commercial, retail and hospitality. Within commercial real estate, developers can follow the for-sale model or held-for-leasing model. In such cases, ICRA analyses the business model, financial profile and cash flow position of each segment separately to understand the inherent risks and determine the impact of each segment on the overall credit profile of an REE. For instance, an REE which owns a portfolio of completed and leased commercial real estate with moderate leverage levels would be assessed for good financial flexibility. On the other hand, a portfolio of projects in commercial real estate/hospitality segments in the nascent stage could constrain an REE’s free cash flows.

While analysing the various segments, ICRA uses the specific rating methodologies applicable for those segments – viz, Rating Approach for Lease Rental Discounting (LRD), Rating Methodology - Hotels. In the case of commercial real estate developments intended to be sold, the subject rating methodology is applied since the cash flow cycle and other fundamental risk factors closely match that of a residential real estate project.

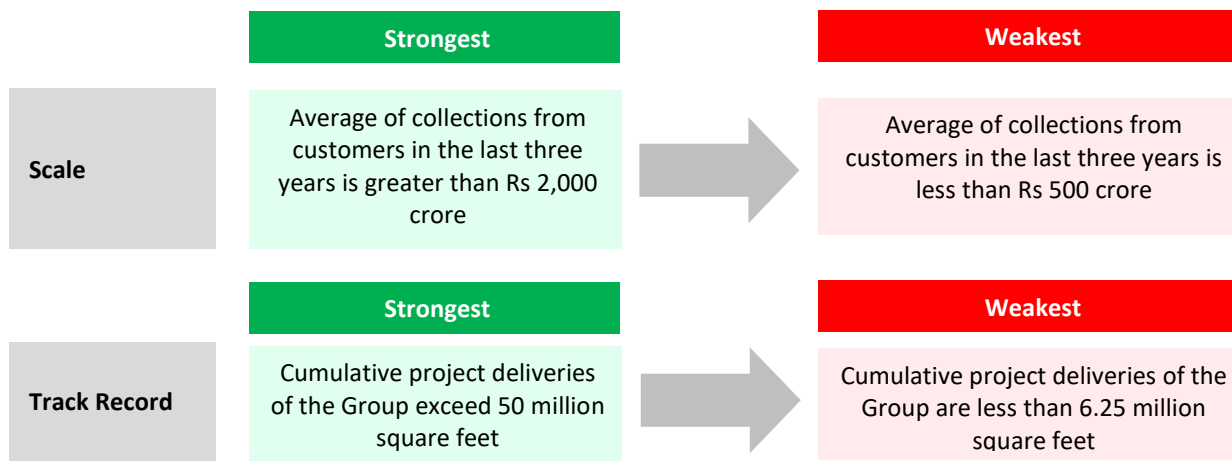
**Expansion plans**

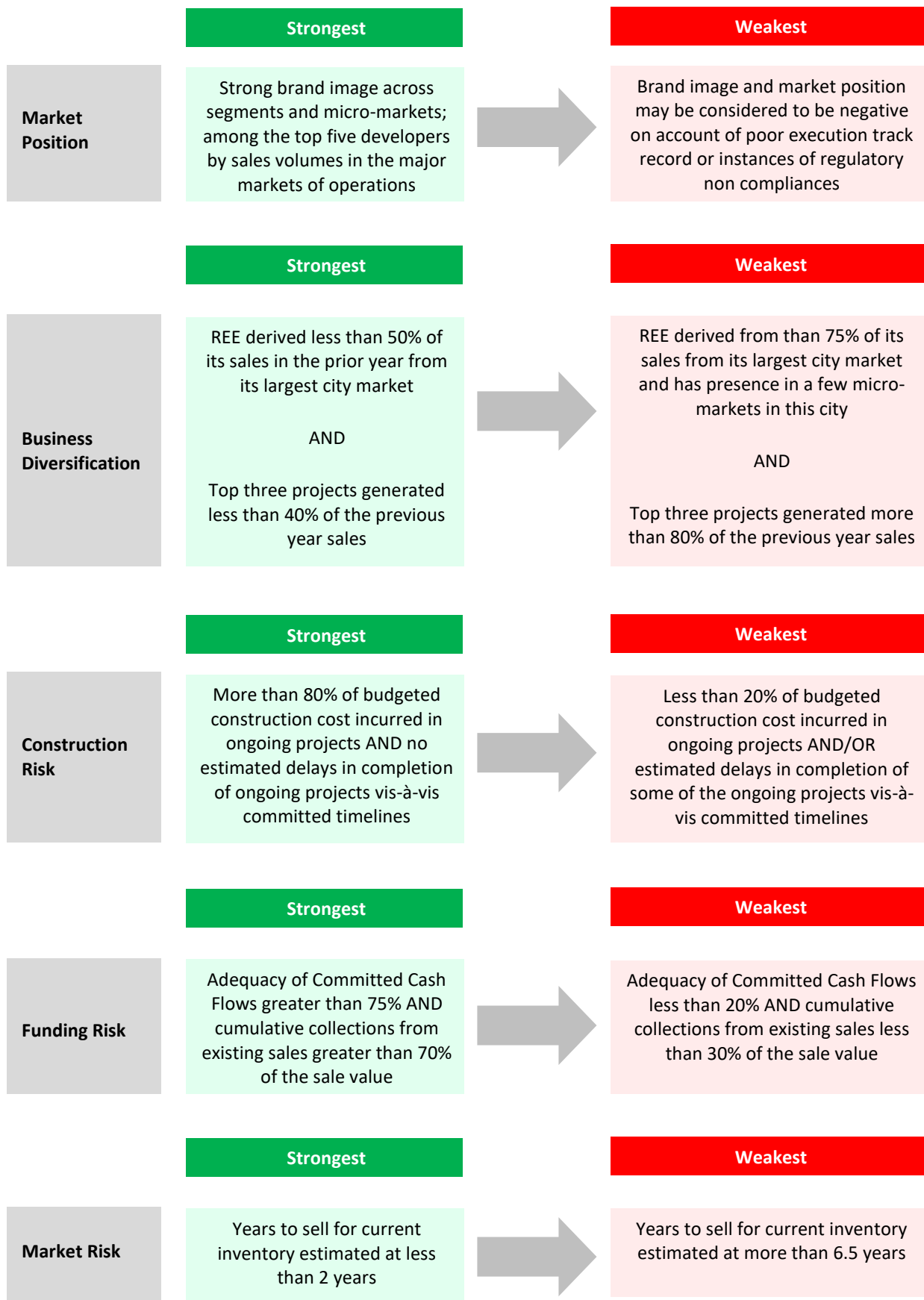
ICRA’s rating approach also evaluates the project launch plans of the REEs and the ability to tie up land, funding and regulatory approvals for the same. ICRA assesses the quality of the land bank that is available with an REE for future development. The key parameters considered include the location of the land bank, i.e. its proximity to the city centre, any other location-specific advantages, availability of the infrastructure in the surrounding areas, zoning of the land bank and status of the approvals for development. Other factors which are important while assessing the land banks are their historical cost as the developers that would have acquired land at relatively lower costs would have had a higher flexibility in pricing the final products.

ICRA also evaluates the land aggregation strategy with regard to the current and planned investment in land bank for future growth, as this could be a key determinant of the overall cash flows and leverage levels of an REE. A business model that focuses on joint development agreements (JDA) for land tie-ups can lower the upfront capital requirements and minimise large outflows on land purchase. Discussions are done with the management to gauge the planned utilisation of projected cash surpluses. Amounts payable as internal/external development charges for land (as applicable in certain states) are treated as committed outflows and can pose a risk to the financial profile of an REE in case of inadequate collections from the associated project.

**Summary of the Salient Business Risk Factors**

[Indicative Metrics]





## Financial Risk Assessment

ICRA uses direct cash flow statements to evaluate the past performances as well as to estimate the debt servicing capability under various projected scenarios. The various parameters assessed under the business and financial risk assessment form the inputs for the projected cash flow statements. A description of the factors assessed as a part of the financial risk assessment is given below.

### Profitability

Profitability is impacted by various factors such as the real estate company's cost of operations, land cost, brand equity, and the expected realisations. While the land cost may vary based on location and book value of land is linked to the vintage of purchase and hence cannot be easily compared across locations, the construction costs for projects with similar specifications are typically comparable. Lower-than-comparable costs could also imply a risk of cost overrun at the later stages and lower eventual profitability. On the other hand, reasons for higher project costs are analysed in relation to additional features in project specifications, if any. An REE with higher profitability margins and returns on capital has a greater ability to generate internal accruals, attract external capital, and withstand business adversity. The profitability is evaluated primarily through the profit before tax (PBT) margin. The PBT margin is considered appropriate for evaluation of profitability as it is not impacted by the accounting treatment for finance cost in under development projects.

### Capital structure and leverage

An REE usually requires capital in large tranches, especially during the land acquisition and approval stage. While evaluating an REE's capital structure, ICRA assesses whether the entity's leverage profile is in line with the underlying business risks and whether it is in line with that of other companies with similar business models and project portfolios. Conservative leverage ratios are viewed favourably as the same reduces the committed outflows via interest and principal repayment.

ICRA assesses the leverage in an REE's projects by calculating the ratio of debt financing to the net working capital (excluding land assets), ie, the cost incurred on the projects to the extent not financed by customer advances. This ratio should ideally be in line with the proportion of debt and equity funding as per the projects' initial budgets. However, in ICRA's experience it tends to be higher than the initial budgets in projects with good sales velocity and collections, as some of the surplus collections received could be deployed towards other projects/investments for future projects. A ratio that is significantly higher (more than 100%) could indicate that the debt against the current project portfolio is supporting high investments in future growth requirements or other business segments.

|  |
|--|
| Leverage Ratio = Debt Outstanding / Net Working Capital (excluding land) |
|--|

The leverage is also evaluated through the ratio of debt to cash from operations. Cash from operations refers to the cash flow generated through operational activities, before investments in new land / upcoming projects and finance cost, but net of any land payments made for ongoing projects. Due to the possibility of the volatility in cash from operations across reporting periods, a longer-term average of the metric is considered.

### Debt coverage

The ability of an REE to match the committed future cash outflows, including towards construction, land investment and debt servicing, with the schedule of inflows, including from customer advances and debt drawdown, is analysed through cash flow projections, which are based on the expected operating and financial performance of the entity, ICRA's outlook on the real estate industry, and the entity's medium/long-term development plans.

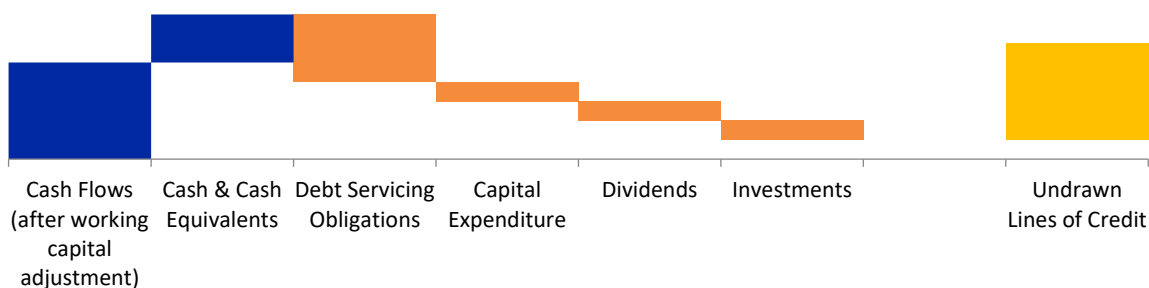
The total funds available in the form of cash flow from operations and debt available for drawdown in each of the projected periods is compared with the scheduled repayments (including collection linked prepayments, if any) and finance cost due. The higher the gap between the available sources of funds and the repayments due, the better will be the ability of an REE to withstand adverse variations in sales or collections performance and lower its dependence on refinancing / promoter contribution.

**Liquidity**

The sources of liquidity for a real estate entity include the cash flows from operation, cash and equivalents available and undrawn credit lines, if any. Also, the projected capital expenditure, land acquisition outlay (either committed or proposed), and investment in Group companies are of importance. While preparing the projected cash flows, the impact of any institutional investor funding availed for the projects (which could have terms relating to distribution of surpluses in a specified ratio) or cash sweep mechanisms imposed by the lenders are also considered. In the projected cash flows, the need for incremental debt drawdown is compared with the debt sanctions already in place to estimate the dependence on fresh debt sanctions.

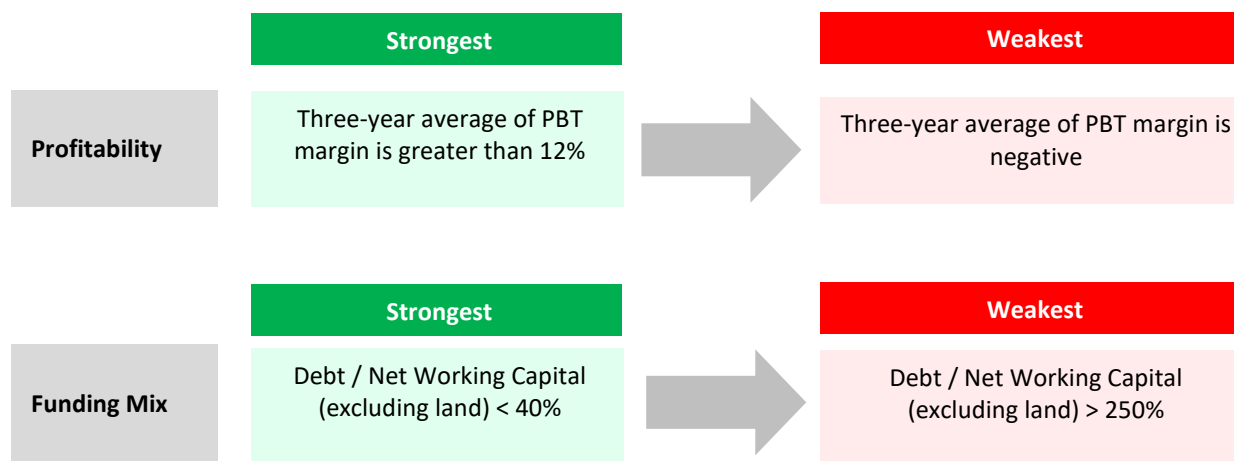
Operational or financial covenants that are stipulated in the debt sanction terms may have a bearing on the availability of undrawn debt limits. Loan structures which require mandatory prepayment of debt as a proportion of the customer collections (that is appropriate for the construction stage) are viewed favourably, as are debt service reserve accounts (DSRA) as they provide the required liquidity buffer.

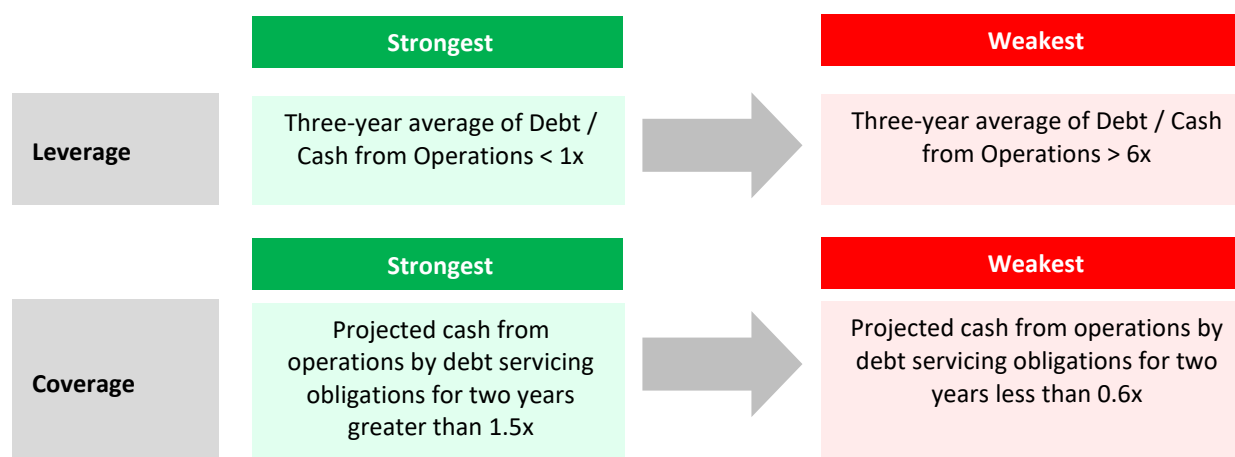
**Liquidity snapshot over any defined period**



**Summary of the Salient Financial Risk Factors**

[Indicative Metrics]





## Other Elements of Credit Risk Assessment

### Parentage

Apart from standalone credit considerations, the likelihood of extraordinary support coming in from the parent/ Group to an entity, or the support that an entity is likely to extend to the other Group companies, is factored in while assessing the entity’s credit profile. This process involves an assessment of the ability and willingness of the parent/ Group to extend support to the entity (and vice-versa), the strategic importance of the entity to the Group to which it belongs, along with the financial strength of the Group entities, among others<sup>1</sup>.

### Financial Flexibility

An entity’s financial flexibility (or the lack thereof) is reflected in its ability to access capital or money markets at short notice and enjoy the confidence of banks, financial institutions, and intermediaries. A strong financial flexibility allows an entity to raise fresh borrowings or refinance existing ones in quick time, whenever required. Financial flexibility could arise from factors such as an entity’s large scale of operations with strong financials, large, unencumbered cash flows, unencumbered assets and the flexibility to borrow against such assets, or strong parentage or linkages with a strong group.

The future cash flow potential from ongoing projects can also be a key input in assessing the financial flexibility of the issuer as unencumbered cash flow potential can support its fund-raising ability, should the need arise. This is evaluated through the cash flow security cover ratio, as defined below. Though the unencumbered land base is an inherently less liquid asset, it can provide financial flexibility through debt raised against it.

$$\text{Cash Flow Security Cover} = (\text{Receivables} + \text{Value of Stock} - \text{Pending Cost}) / \text{Debt Outstanding}$$

In contrast, among the various measures of an entity’s depleting financial flexibility, one relates to a high share of pledged promoter shareholding. A sign such as this may imply that the entity might be persuaded to distribute high dividends or support the promoter group through other means to the detriment of its own credit profile. If the promoters fail to repay their loans (availed by pledging of shares) or top up collateral when required, the lenders could sell the pledged shares. In some cases, this could trigger a change-of-control clause in the rated entity’s bond indentures or loan documents and require it to redeem its debt ahead of schedule, creating a liquidity squeeze, besides affecting fresh capital-raising ability.

<sup>1</sup> For more details on this, readers may refer to the document titled, “Impact of Parent or Group Support on an entity’s Credit rating”, available on ICRA’s website

### Debt-Servicing Track Record

Any history of past delays or defaults in meeting interest and principal repayment obligations reduces the comfort level with respect to the company's future debt servicing capability and willingness. Nevertheless, the reason behind past defaults is also analysed, which could also be due to adverse demand situations in the underlying industry. The company's ability to honour its debt obligations during the period of cyclical stress is also factored in.

### Accounting Quality

ICRA reviews the accounting policies, notes to accounts, auditors' comments and other disclosures that are parts of the Annual Report of a rated entity. Deviations, if any, from the accounting standards/ practices are assessed and the financial statements of the entity are adjusted to reflect the impact of such deviations. As the revenue recognition policies may vary across entities, impacting the comparability of financial statements, ICRA's assessment is based more on the adjusted cash flows and related ratios.

### Contingent Liabilities and Off-balance Sheet Exposures

ICRA reviews the contingent liabilities and off-balance sheet exposures as disclosed by the entity in its Annual Report and evaluates the likelihood of their devolvement and the financial implications of the same.

### Event Risk

ICRA recognises the possibility of events, such as unrelated diversification, mergers and acquisitions, business restructuring, asset sales and spin-offs, capital restructuring and litigations, which could have a material impact on the credit profile of a company. Incorporating the impact of such discrete events in the credit rating, from the beginning, is often difficult. Depending on whether and when such events occur, the rating opinion could be substantially different. To take rating decisions in such cases, ICRA applies its analytical judgment based on the rated entity's track record, the credibility of the management and the experience of having seen similar situations play out in other entities. However, given the nature of such events, it is possible that the rating may undergo a material change later, upon the occurrence of the event.

### Management Quality

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In addition to the business and financial risk analysis, all debt ratings incorporate an assessment of the quality of the entity's management and its financial policies.

In addition, the likely cash flow impact on the rated entity, from the possible need to support other group entities are of importance, in case the rated entity is among the stronger ones within the group. Usually, a detailed discussion is held with the management of the rated entity to understand its business objectives, plans and strategies, and views on past performance, besides the outlook on the rated entity's industry.

Some of the points assessed are:

- Experience of the promoter/ management in the industry
- Commitment of the promoter/ management to the concerned line of business
- Risk appetite of the promoter/ management and risk mitigation plans
- The rated entity's plans regarding new projects, acquisitions, and investment in non-core business segments
- The rated entity's policies on leveraging, interest risk and currency risks

Periodic interactions with the management also help to estimate the possibility of the management's tendency to deviate from its core philosophy in times of stress.

## Assessment of Environmental, Social and Governance Risks

The assessment of the Environmental, Social and Governance (ESG) risks by ICRA involves a broad range of considerations that pertain to the sustainability of an entity, with focus on aspects that can have a material impact on its credit quality. While the Environmental (E) & Social (S) risks tend to be both sector-related as well as entity-specific and could be driven by external factors such as regulations or demographic changes, the G risks are largely entity-driven. The impact of the E&S risks on an entity's credit profile tends to be asymmetric. If the ESG risks are material but unmitigated, these generally translate into pulling down the rating, but generally the ratings are not pushed up even when the ESG context is favourable.

### Environmental and Social Risks

While undertaking credit assessment of entities, ICRA seeks to incorporate all relevant credit considerations into its rating decisions while taking a forward-looking view on the risks and the mitigation. The relevant credit considerations include (sometimes overtly, sometimes covertly) the E&S factors that could affect the rated entity/ transaction.

While ICRA's analytical approach does not explicitly disaggregate these risks to assess their impact on the rating, these risks are often assessed broadly. Further, it is not always feasible to fully or precisely disaggregate the sub-components of E&S risks in credit analysis since these considerations often tend to overlap. That said, the materiality of the E&S risks and the time horizon over which they are expected to crystallise differ widely across sectors and entities. In some cases, while the E&S risks could be material, their effect on the credit profile may be muted because of other fundamental strengths of the entity. In other cases, the adverse impact of the E&S risks is expected to play out in the future and hence these considerations do not necessarily weigh on the rating today with the expectation that by then they would possibly adapt themselves by realigning their business model.

While evaluating the E&S risks, ICRA's objective is only to assess the direct and indirect risks that an entity faces and how it already is or is intending to mitigate the impact of such risks on its credit profile. As an example, ICRA only assesses whether an entity is exposed to physical climate risks, or carbon transition risks such as those arising from changes in regulations or other environmental and social risks; and seeks to understand the various mitigation and adaptation approaches that the entity is implementing to mollify these risks.

The real estate segment is exposed to risks of increasing environmental norms impacting operating costs, including higher costs of raw materials such as building materials and cost of compliance with pollution control regulations. Environmental clearances are required for commencement of projects and lack of timely approvals can impact business operations. Impact of changing environmental regulations on licences taken for property development could also create credit risks.

Demand for real estate, both residential and commercial, are linked to demographic trends including urbanisation, income growth and preference for home ownership. The business profile would also be adversely impacted by any developments that weaken the developer's brand equity, including non-adherence to committed timelines and quality or perception of non-transparent dealing with customers. The sector is also exposed to social risks such as inadequate labour availability leading to construction delays. Real estate entities are exposed to accident and safety issues at construction sites.

### Governance Risks

A sound corporate governance structure attempts to make clear the distinction of power and responsibilities between the Board of Directors and the management. The constitution of an entity's Board and the Board of Directors' participation in strategy formulation, besides the entity's adherence to legal and statutory compliance requirements are factored in during credit assessments. ICRA seeks to gain a qualitative understanding of an entity's commitment to following transparent and credible practices depending on the way its financial statements are reported, the level of disclosures, consistency in

communication and the openness about sharing information during the credit rating exercise. Besides, the corporate group structure (whether simple or complex), the rated entity's related party transactions and instances of supporting group entities at the expense debt holders are also assessed.

### Summing Up

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ICRA's credit ratings are a symbolic representation of its opinion on the relative credit risk associated with the instrument being rated. This opinion is arrived at following a detailed evaluation of the issuer's business and financial risks, its competitive strengths, its likely cash flows over the life of the instrument being rated and the adequacy of such cash flows vis-à-vis its debt-servicing obligations. As this note highlights, for real estate companies, the analytical emphasis also includes factors like an REE's ability to execute projects, its market risk arising from the operating environment and its market position, its cash flow position, its land aggregation policy, and its debt-servicing obligation and financial flexibility.

ANNEXURE

Summary of rating factors and an example to illustrate the key building blocks of a credit rating

|  |   | Strong    |         |    | Comfortable |      |                  | Adequate |      |          | Moderate |        |    | Weak |               |
|--|---|-----------|---------|----|-------------|------|------------------|----------|------|----------|----------|--------|----|------|---------------|
| Industry Risk  | Industry Position   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Scale of Operations   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
| Business Risk  | Track Record  |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Market Position   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Market Risk   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Business Diversification                                    |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Funding Risk  |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Construction Risk   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Profitability   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
| Financial Risk   | Funding Mix   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Leverage  |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Coverage  |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  |   |           | Enhance |    |             |      | Support/ Neutral |          |      |          |          | Hinder |    |      |               |
| Do these factors enhance or hinder the credit profile? | Diversification   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Refinancing Dependence, Liquidity and Financial Flexibility |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Currency Risk   |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Financial Policy  |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Management, Governance & Reporting                          |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  |   | Very High |         |    |             | High |                  |          |      | Moderate |          |        |    | Low  |               |
| Parent Support   | Likelihood of Parent Support                                |           |         |    |             |      |                  |          |      |          |          |        |    |      |               |
|  | Rating of Parent  | AAA       | AA+     | AA | AA-         | A+   | A                | A-       | BBB+ | BBB      | BBB-     | BB+    | BB | BB-  | B/ C category |
|  | Final Rating  | AAA       | AA+     | AA | AA-         | A+   | A                | A-       | BBB+ | BBB      | BBB-     | BB+    | BB | BB-  | B/ C category |

The above graphic is only for illustration purpose and does not represent a rating output from a formulaic model. The ratings assigned by ICRA are determined by Rating Committees based on both quantitative and qualitative considerations.

Contact us for any feedback or comments at: [methodologies@icraindia.com](mailto:methodologies@icraindia.com)

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