



*The Most Reliable Opinion on Risk*

## Methodology For Rating Real Estate Developers

The rating methodology for real estate developers entails assessing a developer's track record in executing projects and his organizational and financial risk profile.

The developer's track record is analysed with reference to the types of projects undertaken, legal compliance, adherence to construction schedules and the like. The key factors that are considered for assessing organizational and financial risks include the extent of formal quality systems, organizational structure, existing financial position, financial flexibility and an evaluation of the management and its strategies for developing and executing projects. These factors are detailed below.

### **Developers' Track Record**

CRISIL assesses a developer's track record on the basis of his past projects in terms of the following:

a) *Legal Track Record:* CRISIL examines and rates the extent of compliance to legal requirements. These include factors like the number of non-compoundable violations, receipt of completion and occupancy certificates from the competent authority, compliance with floor space index (FSI) rules, transfer of clean titles to investors and the like.

*Construction Track Record:* The developers' commitment to safety as demonstrated by the quality of his past projects is the primary factor considered under this parameter. Other factors include the quality of on-site and off-site infrastructure provided to customers, compliance with agreed specifications as detailed in the sale agreement and the level of after-sales services. CRISIL also looks at the scale and size of past projects that have been completed by the developer and the total area developed under different project categories. The time taken to form a cooperative society in residential projects is one of the factors used to assess whether the title has been fully passed on to the investor.

b) *Market Track Record:* Real estate projects face very high market risks due to volatile market conditions. Given this, CRISIL takes note of the market's perception and reputation of the developer and the brand value attached to his properties while assessing his track record. The sales record of past projects is a healthy indicator in this regard. Any complaints outstanding in consumer courts and other disputes are also factored into the rating exercise.

### **Organizational Risk**

Efficient project execution in the real estate sector depends on the infrastructure that a developer has at its disposal, on well-structured and effective systems and a dynamic land acquisition and development strategy.

c) Systems: CRISIL assesses the extent to which a developer adopts a structured approach to business management and controls. Standardization of workflow processes, increasing computerization levels and modernization of various steps in the project conceptualisation, design, planning and execution stages can enhance a project's quality. Adherence of time schedules and cost estimates are critical and a developer should have systems to monitor and control the same.

Internal quality control systems, especially material and labour specifications, as well as project monitoring have a significant impact on a project's construction risk. CRISIL also gives additional weightage to systems that facilitate the easy flow of information to investors and other market groups.

d) Structure: CRISIL assesses the organizational structure, role definition, staffing and management style and availability of a qualified talent pool within the organization. A professional approach on these parameters indicates the developer's progressive vision and ability to sustain the business in the long term.

e) Strategy: One of the most important factors in any real estate project is the developer's land identification and acquisition strategy. Strategies to mitigate legal risks are equally important. For example, some developers prefer to buy

disputed properties at lower rates and hence expose themselves to higher risks. In the long run, a developer's track record is mainly determined by the ability to transfer a clear title. Hence, legal strategies assume importance.

The developer's marketing strategy too is important as it impacts his brand equity, sales and therefore, the project's realizations. It also influences his ability to charge a premium. Construction strategies that ensure quality, timeliness and cost controls will lead to effective and efficient execution of projects.

Geographical diversifications or diversifications into related or other businesses too provide strategic comfort as they reduce the concentration risk, help moderate adverse business cycles and provide an alternate source of funds, when required.

### **Financial Risk**

A developer's financial risks are assessed to ascertain his ability to complete projects on time with adequate cash flows. This entails an understanding of the company's past financial performance and financial flexibility. To this end, the following are analysed:

f) Existing financial profile: A developer's financial health is very important as the construction industry is extremely capital-intensive. A large quantum of funds is needed upfront and during the course of the development. CRISIL analyses the developer's cash flows, funding pattern and the like for past and ongoing projects.

Financial flexibility: A developer's financial flexibility is viewed in relation to the number of projects under development and the funding tie-ups for the same. The ability to tie up a project's end-to-end funding requirements is essential for timely and cost-efficient execution.