



The Most Reliable Opinion on Risk

Methodology For Rating Real Estate Projects

CRISIL's rating on a real estate project pertains to a particular project and is not a rating of the developer as a whole. Only projects with an approved plan and planning permits from the appropriate local authority are considered. The rating is assigned after assessing the factors that could affect the developer's ability to meet the agreed quality specifications, time schedule and transfer a clear title to customers in the specified project.

The rating methodology for real estate projects entails assessing both developer-specific and project-specific factors. The project-specific factors are analysed with respect to the quality of the legal title of the property under consideration, the construction quality and timeliness of delivery of the proposed units, taking into account the specific agreements between the developer and buyers. Additionally, developer-specific factors like its track record, organizational and financial risks are assessed.

In order to evaluate project-specific factors, the process is divided into assessing the Legal Risk on the land and the Construction Risk of the proposed construction project. These are detailed below.

Legal Risk

The most important factor in rating a developer's real-estate project is assessing the quality of the legal title of the property that is being conveyed and the presence of all the legal approvals needed for the project's smooth execution.

A good legal title can be established by assessing whether the title is clear and marketable and by ascertaining that the property is free from encumbrances. Further, the terms of the transfer of the property are determined by the sale and construction agreements between the developer and buyer.

a) Clarity of Title

In order to establish whether the title is transferable, CRISIL independently evaluates the title report provided by the developer. The origins of all title documents are examined and if they are believed to be sketchy or incomplete, CRISIL asks the developer for a second legal opinion.

b) Restrictive Covenants

To evaluate how marketable the title is, CRISIL studies the restrictive covenants that can be applied. In this regard, CRISIL examines whether requisite permissions have been obtained from the competent authorities and the fire department.

c) Encumbrances

CRISIL assesses whether the property is free from encumbrances like mortgages, rates and taxes by examining the following:

☞ Search report issued by the lawyer or *nil encumbrances certificate* issued by the local development authority. This is an important document for establishing that the property has not been mortgaged in favour of a third party.

☞ Land records maintained in the sub-registrars' office and corporation and revenue departments. These documents help to establish the current ownership of the property.

☞ Rates and taxes paid as per the local development control rules. A copy of the latest tax and rates receipt is required from the developer or landlord to ensure that there is no lien on the property as a result of non-payment of taxes.

d) Sale Agreement

CRISIL evaluates the sale agreement between the developer and buyer, which is expected to substantiate the commitments relating to land cost, land area, construction cost, schedule of payment, list of features, time of delivery, post delivery warranty and whether the agreement confirms to the Apartment Ownership Flats (Regulation of the promotion of construction, sale, management and transfer) Act of that state.

e) Development Agreement

In addition, CRISIL also studies the development agreement between the land vendor and the developer to understand the irrevocable power of attorney granted by the former to the latter.

Construction Risk

Under this, CRISIL evaluates the quality of the civil structure, infrastructure and finishes,

the extent to which the developer's services are integrated, the level of after-sales services, timeliness of construction and the adherence to stipulated costs.

f) Structural quality

CRISIL evaluates the developer's ability to translate the plan into a sound civil structure. This ability is primarily a function of the organizational structure, labour and material specifications and cost and project control mechanisms. The building needs to be certified by the project's structural engineers. In addition, CRISIL evaluates the architects, structural engineers and contractors' track record.

g) Infrastructure

CRISIL assesses the infrastructure provided on and off the site. Off-site infrastructure includes approach roads, sewerage, water and electricity systems while on-site infrastructure includes parking facilities, security services and the like to meet planned standards.

h) Finishes

CRISIL evaluates the developer's willingness and ability to specify in advance (to investors) the quality levels of the materials used in internal and external finishes. External finishes include electrical and sanitary fittings.

i) Integrated facilities

The extent to which a developer has integrated facilities is a key consideration in evaluating the construction risk. A developer who has facilities for block manufacturing, carpeting, fabrication and transport and construction equipment is likely to be in a better position to build consistent quality levels than a developer who procures these materials from vendors.

j) After-Sales Services

CRISIL evaluates the extent and type of after-sales services planned by the developer for the

project. This is stipulated in the post-delivery warranty.

k) Likelihood of Time and Cost Overruns

The developer's ability to complete and deliver the project on time is another key factor in evaluating the construction risk. CRISIL takes the project to be completed once the appropriate authorities issue a completion certificate. In addition, the authorities must issue an occupancy certificate. This certificate is linked to the development and completion of an area as per the comprehensive development plan of the region.

The key factors affecting the timely completion of a project are adequate cash flows and monitoring systems to ensure adherence to schedules. Delayed inflows

from institutions and investors, low project sales and limited financial flexibility adversely impact the timely completion of a project. Hence, any escrow arrangement is viewed favourably. Under this, a part of the advances from customers are put into a separate escrow account, withdrawals from which will be linked to project milestones.

The existence of punitive clauses in favour of the buyer in the sales agreement is also viewed positively, whereby the developer commits to pay a compensation for any delays after the promised date of delivery.

Given the project's current status, CRISIL evaluates the likelihood of any cost overruns. The manner in which these overruns are passed on to customers is also studied.