

## Real Estate

### Sector update

- Embassy Office Parks REIT (BUY)
- Mindspace Business Parks REIT (ADD)
- Brookfield India REIT (BUY)

### Research Analyst:

**Adhidev Chattopadhyay**  
adhidev.chattopadhyay@icicisecurities.com  
+91 22 6637 7451

## INDIA



## Real Estate

### REITs: Near-term weakness, attractive yields

Indian REITs saw strong rental collections of over 99% in FY21 and were able to achieve double digit re-leasing spreads along with contractual escalations. However, overall portfolio occupancy levels declined by 4-6% owing to continued Work-from-Home and second Covid wave leading to deferment of leasing decisions by occupiers. Heading into FY22E, vacancy levels may rise further in H1FY22 but we expect this trend to reverse from H2FY22E assuming that vaccinations pick up accompanied by a gradual return to offices. Factoring in incremental vacancy levels rising by 2-3% in FY22E, we expect the three REITs (Embassy/Mindspace/Brookfield) to offer distribution yields of 7-9% over FY22-23E along with 13-18% capital appreciation as per current lsec target prices. While a rise in global interest rates is the key risk, cumulative potential returns of 20-25% provides adequate valuation cushion, in our view.

- ▶ **Robust rental collections, FY22 expiries a near-term worry:** Indian REITs saw strong rental collections of over 99% in FY21 and were able to achieve double digit re-leasing spreads along with contractual escalations. A dampener was reduction in overall portfolio occupancy levels by 4-6% on like-to-like basis for Embassy and Mindspace REIT while Brookfield REIT retained flattish occupancy levels in H2FY21. This was owing to exits by tenants for scheduled expiries and early exits as well. Heading into FY22E, the second Covid wave may lead to further rise in vacancy levels in H1FY22. However, we expect this trend to reverse from H2FY22E assuming that vaccinations pick up accompanied by a gradual return to offices and possible pick up in international travel.
- ▶ **Distribution mix of REITs to improve from FY22 onwards:** While the Mindspace REIT is already distributing over 90% of returns in the form of tax-free dividends, the Embassy and Brookfield REITs have also announced measures to improve the tax-free share of dividend plus capital return for investors. For Embassy REIT, the collapsing of the 3-tier structure in the Manyata SPV to a 2-tier structure from FY22E along with injection of Tech Village asset in Dec'20, may lead to a higher share of over 70% in the form of tax-free dividend plus capital return for FY22-23E. For Brookfield REIT, the REIT manager has now converted CCDs having face value of Rs10.1bn to equity in the Candor Kolkata SPV and we expect over 30% of the distribution to be in the form of tax-free dividend and capital return vs. 15% earlier from FY22E onwards.
- ▶ **REITs offer attractive yields of 7-9% over FY22-23E:** We have factored in a fall in occupancy levels of 2-3% for the REITs in FY22E but expect the same to reverse from H2FY22E onwards heading into FY23E. We expect the three REITs to offer distribution yields of 7-9% over FY22-23E along with 13-18% capital appreciation as per current target prices. While a rise in global interest rates is the key risk, cumulative potential returns of 20-25% provides adequate valuation cushion, in our view.
- ▶ **India's long term advantages remain as a high-quality office hub:** While near-term news flow may be negative, our view is that the Indian office market retains many positives such as: 1) Limited number of 8-10 pan-India developers capable of building quality rental assets; 2) India remains one of the more affordable office markets in the world, with average rentals for Grade A office markets in peripheral/suburban micro-markets hovering around 1 USD/psf/month or Rs70-75/psf/month; 3) India leads in STEM (Science, Technology, Engineering, Mathematics) talent for technology assignments with over 2 million students graduating each year.

**Table 1: Brookfield, Mindspace and Embassy REIT Qualitative Comparison**

Details	Brookfield India REIT	Embassy REIT	Mindspace REIT
Completed Area (msf)	10.3	32.3	23.9
Total Area (msf)	14.0	42.4	30.2
Committed Occupancy (%)	91.0%	88.9%	84.2%
Top 10 Tenants as % of Rentals	75.0%	39.0%	40.3%
<b>Geographic Presence (as % of overall area)</b>			
Mumbai Metropolitan Region	11.0%	4.7%	40.9%
Bengaluru	0.0%	63.7%	0.0%
Hyderabad	0.0%	0.0%	39.3%
Pune	0.0%	20.8%	16.9%
NCR	49.0%	0.0%	0.0%
Kolkata	40.0%	0.0%	0.0%
Others	0.0%	10.8%	2.7%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
In-place Portfolio Rentals (Rs/psf/month)	65.0	71.0	55.9
Weighted Average Lease Expiry (WALE) in years	6.5	7.0	6.0
Call option/ROFO Assets from Sponsor (msf)	15.0	34.0	8.6

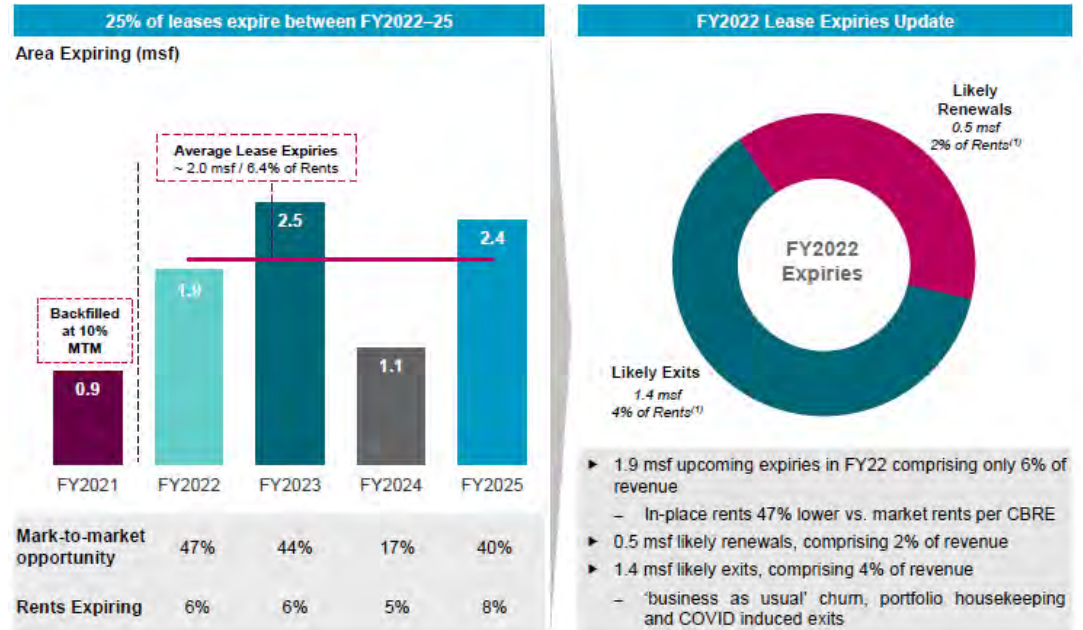
Source: Company, Isec research

**Table 2: Brookfield, Mindspace and Embassy REIT Financial Metrics**

All figures in Rs mn Details	Brookfield REIT			Embassy REIT			Mindspace REIT		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
<b>Area Details:</b>									
Completed Area (msf)	10.3	10.4	10.4	32.3	33.4	36.0	23.9	25.7	25.7
Under Construction/Upcoming (msf)	3.7	3.6	3.6	10.1	9.1	6.4	6.3	4.5	4.5
<b>Total Area (msf)</b>	<b>14.0</b>	<b>14.0</b>	<b>14.0</b>	<b>42.4</b>	<b>42.4</b>	<b>42.4</b>	<b>30.2</b>	<b>30.2</b>	<b>30.2</b>
<b>Financial Metrics:</b>									
Revenue	8,628	9,795	10,754	23,603	29,868	34,175	16,293	18,132	21,371
Net Operating Income (NOI)	6,600	7,455	7,884	20,323	25,357	29,478	13,741	14,660	17,297
EBITDA	6,077	6,899	7,297	18,508	23,717	27,225	NA	13,342	15,693
PAT	3,912	4,638	4,859	6,984	9,169	10,369	NA	5,910	6,834
Net debt/equity (x)	0.2	0.3	0.3	0.3	0.4	0.5	0.2	0.3	0.4
<b>NDCF at REIT level</b>	<b>4,914</b>	<b>6,570</b>	<b>6,873</b>	<b>18,364<sup>^</sup></b>	<b>22,010<sup>^</sup></b>	<b>23,801<sup>^</sup></b>	<b>5,687<sup>*</sup></b>	<b>10,813</b>	<b>11,847</b>
NDCF - Interest %	94.3%	67.1%	60.8%	34.0%	32.7%	33.2%	9.4%	8.1%	7.2%
NDCF - Dividend %	1.5%	5.1%	7.2%	14.0%	31.6%	36.2%	90.6%	91.9%	92.8%
NDCF - Principal repayment %	4.2%	27.7%	31.9%	52.0%	35.7%	30.6%	0.0%	0.0%	0.0%
<b>Distribution/Unit (Rs)</b>	<b>16.2</b>	<b>21.7</b>	<b>22.7</b>	<b>21.5</b>	<b>23.2</b>	<b>25.1</b>	<b>9.6</b>	<b>18.2</b>	<b>20.0</b>
CMP (Rs/Unit)	250	250	250	322	322	322	280	280	280
<b>NDCF Yield (pre-tax)</b>	<b>6.5%</b>	<b>8.7%</b>	<b>9.1%</b>	<b>6.7%</b>	<b>7.2%</b>	<b>7.8%</b>	<b>6.9%</b>	<b>6.5%</b>	<b>7.1%</b>
<b>Target Price/NAV (Rs/Unit)</b>	<b>296</b>			<b>391</b>			<b>318</b>		

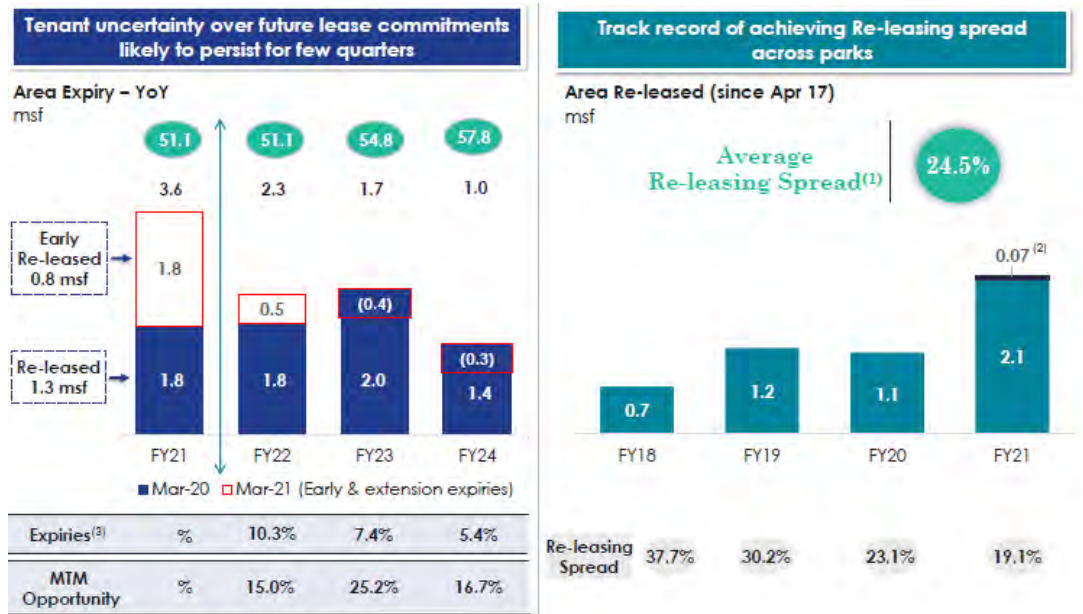
Source: Isec research estimates, \*For 6 months in FY21 from October 2020 to March 2021, <sup>^</sup>For Embassy REIT we have assumed refinancing of Zero-Coupon Bond (ZCB) in FY23E, #assuming number of shares prior to ETV acquisition which was done in Dec'20

**Chart 1: Embassy REIT Lease Expiry Profile**



Source: Company, I-Sec research

**Chart 2: Mindspace REIT Lease Expiry Profile**



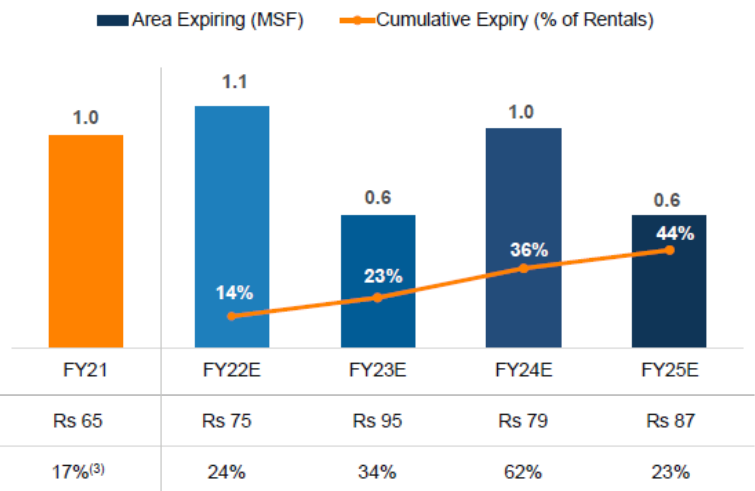
Source: Company, I-Sec research

### Chart 3: Brookfield REIT Lease Expiry Profile

**KEY HIGHLIGHTS**

- **Extended expiries:** 401,000 SF of FY21 expiries extended to FY22
- **Same-store increase:** 415,000 SF estimated increase in FY22 expiries<sup>(1)</sup> (excluding extensions)
- **Renewal Success:** Achieved 54% renewals on term expiries in FY21; Expecting 40%-50%<sup>(2)</sup> for FY22

**LEASE EXPIRY SCHEDULE**

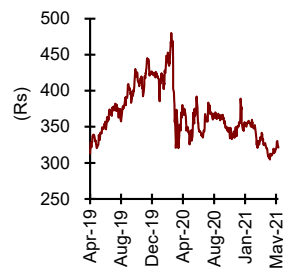


Rent at expiry (Rs PSF) <sup>(2)</sup>	Rs 65	Rs 75	Rs 95	Rs 79	Rs 87
MTM Spread % <sup>(2)</sup>	17% <sup>(3)</sup>	24%	34%	62%	23%

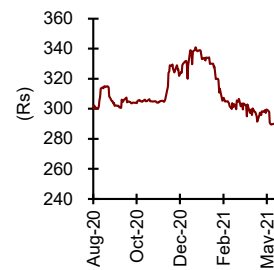
Source: Company, I-Sec Research, (1) Based on on-going discussions with occupiers. BREIT will provide updated renewal guidance as and when it concludes its ongoing discussions, (2) Excludes amenity areas, (3) Re-leasing spread on renewed area

### Price chart

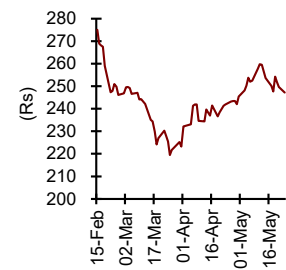
**Embassy REIT**



**Mindspace REIT**



**Brookfield REIT**



Source: Bloomberg

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