Is REITs right for your investment portfolio?

Ashish Parwani, partner, Rajani Associates and Yogesh Nayak,senior associate, Rajani Associates, says the industry should be optimistic about REITs.

A Real Estate Investment Trust ("REIT") is an investment vehicle wherein the money from investors is pooled and invested in pre-defined sectors with a predetermined objective much akin to mutual funds. In case of REITs, there involves pooling of money/ funds from investors (where investors get units in the REIT in lieu of their investment in the REIT) where the monies would be used solely for investing in revenue/ rent generating real estate properties and other permissible areas in the proportions as set out in the SEBI (REIT) Regulations, 2014 ("REIT Regulations"). The returns earned by the REIT would be then distributed to the investors in proportion to the units held by such investors. REITs typically make investments in office complexes, information technology parks, large malls, certain hotels & resorts, and residential complexes that have apartments on rent or lease.

Why REITs:

REIT Regulations provides the real estate sector with alternative means to raise funds for the various projects. It appears to be a much needed respite for the cash starved real estate developers. The developers also stand to gain as there would be access to foreign funds for the real estate sector, an area which is closely monitored by the Reserve Bank of India ("RBI"). However, it will be interesting to see the categories of non-resident investors that may be eligible for such investment and terms and conditions that may be issued by the RBI for investing in units of REITs (which is set up in the form of trust) especially, in current scenario, where foreign direct investment in trusts other than FVCI investment in registered VCF is not permitted.

Although the REIT Regulations provide for mandatory listing of units of the REITs, the level of trading activity in the units of REITs will have to be seen. The REIT Regulations would provide much needed transparency and is expected to make real estate a bit 'organised' to say the least.

Another factor is that REITs also serve as a good avenue to look at monetising opportunities especially for developers and real estate companies which are struggling with enormous debts in their books of accounts. This is because in the commercial space, we are observing a gradual shift from ownership of properties to leasing of properties. Larger corporations and companies are, today opting to lease space and not buy property.

Understanding the Government's approach towards REITS:

REITs, in spite of having garnered a favourable response at large, certain issues pertaining to tax and stamp duty had initially kept the investors at bay. Fortunately with certain key announcements made by the Government of India coupled with certain amendments proposed by Securities and Exchange Board of India ("SEBI"), there is certain clarity providing much required comfort and optimism to the investor community.

Certain amendments were proposed to the REIT Regulations by SEBI in its board meeting dated September 23, 2016 wherein, interalia clarity to the definition of real estate property is provided, REIT is allowed to invest in two levels of SPVs through a holding company subject to certain conditions, removal of the limit on the number of sponsors and introduction of the concept of sponsor group. SEBI is also expected to issue detailed guidelines for public issue of units of REITs. These proposed amendments are likely to provide further impetus and generate further interest in formation of REIT.

However, there are certain teething troubles in a few areas where the investor community is looking forward to speedy action from the Government's which includes aspects pertaining to one time exemption/reduction on stamp duty.

Investment Conditions:

Investors keen on investing in REITs should be aware of the following conditions:

• Invest in the properties, either directly or through a special purpose vehicle (SPV), controlled by the REIT;

• Not less than 80% of the value of the REITs assets shall be invested in completed and revenue generating properties;

• Not more than 20% of the value of REIT assets shall be invested in under-construction properties, completed and not rent generating properties, mortgage back securities, listed/ unlisted debt of companies/ body corporates in real estate sector and such other avenues as set out under the REIT Regulations. However, investments in under-construction properties and completed and not rent generating properties shall be restricted to 10% of the value of the REIT assets;

• Investment in at least 2 projects with not more than 60% of value of assets invested in one project.

• Distribute at least 90% of the net distributable income (after tax) to the investors;

• Invest only in assets based in India;

• Investment not allowed in vacant land or agricultural land or mortgages, other than mortgage backed securities; and

• Cannot invest in units of other REITs.

The Investors outlook towards REITs:

Investors as well as fund managers have started showing interest and a few the promoters have already tied up with investors. A lot of traction has taken place and we expect a lot more in the due course. Significant real estate players including DLF, K Raheja, Embassy and RMZ have either partnered with global investors or are meticulously working towards forging alliances. Many more such alliance and partnerships are expected to be formed whereby resulting in succour to the real estate industry.

Most certainly, REITs will gather the long-term and HNI investors. Unlike other investment options, easy liquidity in the form of secondary sale of units of REIT will be bit challenging since the investor, who is seeking to exit from the REIT, will require to find another suitable buyer, who is ready to invest in such infrequently traded units of REIT. The investor, who is acquiring units of REIT, can expect two-fold earnings- firstly by receiving regular rent from REIT and secondly, the long term appreciation on such REIT properties. However, aforesaid two-fold earnings will lot depend upon market scenarios and real estate market in general.

The favourable factor about investing in REITs is that it offers a far more foreseeable valuation process that is well-defined and where one can identify the assets.

In India, the ecosystem for REIT has now been made almost as conducive as established REIT systems elsewhere. In light of the exemptions provided under the Finance Act, 2016 and the recent proposed amendments from the Government, industry players should be optimistic about the setting up of REITs which shall place India as a hub for REITs market and the real estate industry will be encouraged to have REITs set up in India as opposed to approaching other jurisdictions.