REITs (Real Estate Investment Trusts)

What are REITs?

- REITs are investment vehicles that own, operate and manage a portfolio of income generating properties.
- REITs are real estate equivalents of Mutual Funds. While Mutual Funds hold stocks, bonds and gold on behalf of it investors, REITs hold income generating commercial properties

How are REITS structured?

REITs operate with a Sponsor, Investment Manager and Trustee.

- Sponsor is responsible for setting up of an REIT and transferring or undertaking to transfer assets, interest and rights in the SPV to the REIT prior to allotment of units to the applicants.
- Investment Manager is responsible for making the investment decisions with respect to the underlying assets of the REIT including any further investment or divestment of assets. It is responsible for management of REIT assets and ensuring that the assets have legally enforceable titles and material contracts are enforceable under the law.
- Trustee ensures that the money is managed in the interest of unit-holders. It is responsible for overseeing manager's activities or operations and reviewing related party transactions

How do REITs generate Income?

- REITs distribute 90% of its net distributable cash flows to the investors.
- Price of an REITs units can rise/fall (like stock prices) and result in capital gains for the investor.

Comparison of investing in REIT versus Direct investment in Real estate.

	Investments in India REITs	**Direct Investment^**
Investment Characteristics	Min investment of Rs 50,000 with no cap Freely transferable securities listed on stock exchange Professionally managed with no entry/exit load	Rs 25-200 Crores for strata interest Illiquid and non-transparent secondary market Transaction costs & hassles in managing the properties
Diversified Portfolio with High Quality Tenants	Grade A assets in prime locations across cities Multiple tenants across sectors with high credit Worthiness	Usually strata interests in standalone buildings Usually exposed to single tenant risk
Return Profile	Returns driven equally by regular cash distributions and capital appreciation	Returns driven by a timely and profitable exit
Tax Efficiency	Dividends are tax exempt 10%-15% capital gains tax* on sale of listed units	Dividends are subject to applicable marginal tax rates 20%-30% capital gains tax* at exit
Perpetual Growth Platform	Professionally managed by an experienced team Ability to grow portfolio by acquiring assets without additional investment by the same investor	Limited capability to negotiate lease terms with tenants Limited liquidity to acquire additional assets

^ Assumed held through a SPV; * Excluding applicable surcharges and cess

How will the units be traded on the exchanges?

REITs are typically listed on the stock exchanges through an Initial Public Offer(IPO). The units will be traded on the Equity Cash segment on the stock exchanges just like any other equity instrument is traded. Once listed, they serve as permanent capital vehicles to raise debt and equity in the capital markets to acquire new assets to grow.

What are the rights of the unit holders in the REIT?

Broad rights of the unit holders:

- Right to receive returns through cash distributions made by the REIT
- Rights to vote on matters pertaining to acquisition of new assets
- Right to vote on matters such as appointment or change of Investment Manger

What are risk factors in REIT investing?

- Rising interest rate leading to higher yield expectation and resultant sell off in REIT prices
- High vacancy rate of underlying properties
- Quality of Tenants and their creditworthiness
- Lease rates vis-a-viz., adjacent properties
- Property location turning unfavorable

What are the tax Implications for Investors (Split by income stream)?

Various income Streams will be charged as follows:

- Interest income shall be taxable in the hands of Unit Holders
    - At applicable rates for resident unit holders, the withholding tax on interest income is 10%.
    - At 5% for non-resident / offshore investors; benefits under DTAA, if any, shall be available
- Dividend Income distributed by the REIT is exempt in the hands of the unit holders if the REIT follows the old tax regime
- Sale of listed units of REIT on the exchange to attract levy of STT at par with that of listed equity shares
- Long term Capital Gains (LTCG) where units are held for over 36 months would be taxed at 10% and Short term Capital Gains (STCG) would be taxable at 15%

All income received by the REIT from the SPVs receives a pass through treatment and is not taxable at REIT level, hence providing a clean and transparent tax structure.

Regulatory Framework of REITs in India

Consideration	Regulatory Framework
Execution Risk	• At least 80% of total value must be comprised of completed and income generating properties • Restrictions on speculative land acquisition
Leverage	• Majority unitholder approval required if debt (1) exceeds 25% of asset value • Debt cannot exceed 49% of asset value
Strong Corporate Governance	• 50% independent directors on the Board • REIT Manager can be removed with 60% approval of unrelated unitholders • Alignment with unitholder interests due to a performance linked management fees structure
Free Cash Utilization	• Minimum 90% of distributable cash flows to be distributed semi-annually

Related Party Transactions	• Sponsors are prohibited from voting on certain related party transactions, subject to a threshold • Majority unitholder approval required for acquisition or disposal of asset which exceeds 10% of REIT value • Acquisition or sale price of new asset cannot deviate from average valuation of two independent valuers by +/- 10% • Fairness opinion from independent valuer required if related party leases exceed 20% of the total REIT Area