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

[^] 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)?

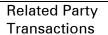
Various income Streams will be charged as follows:

- 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	 At least 80% of total value must be comprised of 	
Risk	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	50% independent directors on the Board	
Corporate	REIT Manager can be removed with 60% approval of	
Governance	unrelated unitholders	
	 Alignment with unitholder interests due to a 	
	performance linked management fees structure	
Free Cash	Minimum 90% of distributable cash flows to be	
Utilization	distributed semi-annually	



- 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