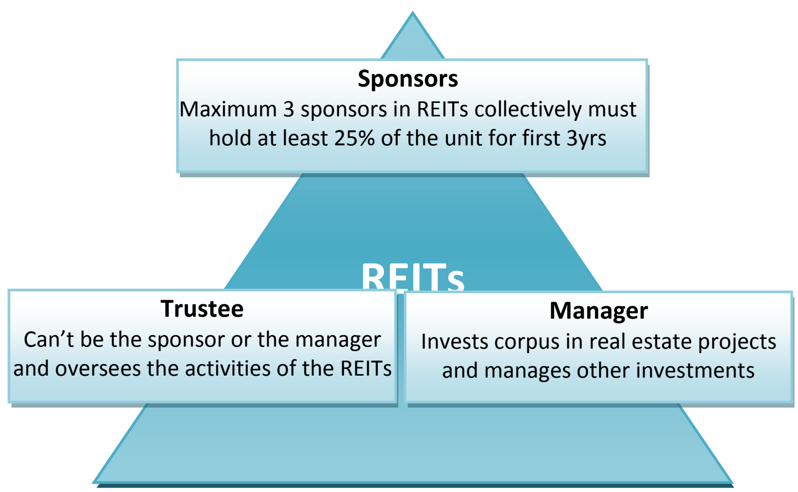
REITs

REITs – Real Estate Investment Trusts- have finally emerged as an investment avenue for investors after SEBI (Securities & Exchange Board of India) approved the setting up of REITs in India through an order on August 10. The regulator's new guidelines allow REITs to raise funds through an initial offering and list on the stock exchanges.

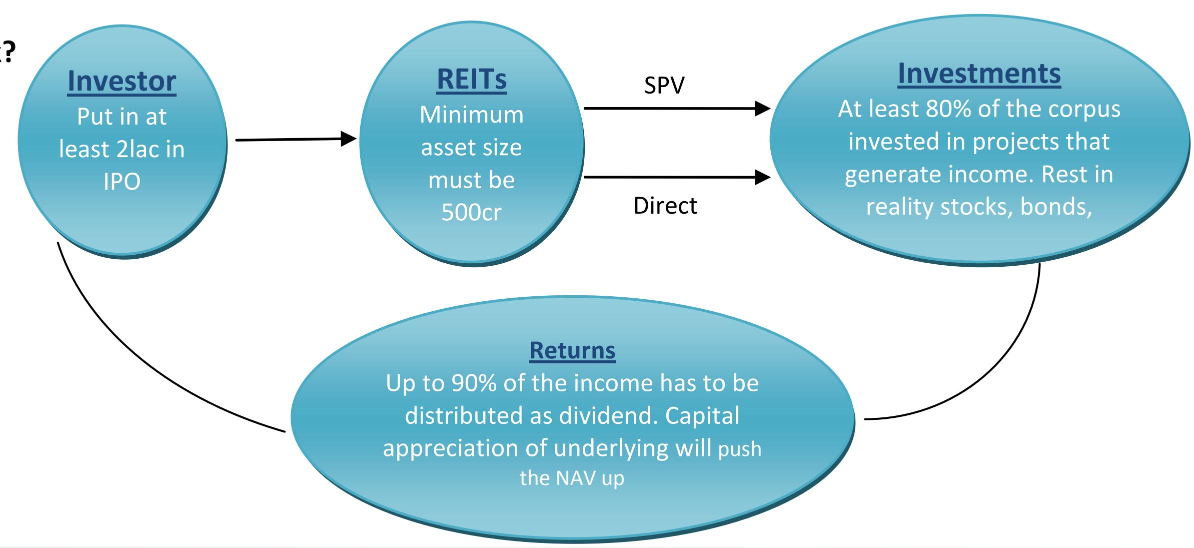
What is REITs?

- REITs is an investment trust that owns and manages a pool of commercial properties and mortgages and other real estate assets.
- In the simplest form, REITs are like mutual funds and invest in real estate properties directly for returns.
- REITs will be allowed to raise funds only through an initial offering similar to initial IPO for equity shares and the minimum issue size has to be ₹250 cr.
- The units of REITs will have to be mandatorily listed on a stock exchange; thus investor can buy and sell units like Stocks.
- For investors, the minimum subscription size for units of a REIT on offer will be ₹2 lakh and at least 25% of the units have to be offered to the public. However, trading lot for such units shall be ₹ 1 Lakh.
- REITs distribute most of their income to shareholders as dividends while investors can also gain from the appreciation of underlying assets.
- As per SEBI ruling, REITs will be required to distribute not less than 90% of their net distributable cash flows to investors at least every six months.

Structure of REITs



How does it work?



REITs advantage

Particulars	REITs	Direct Investment
Entry	Lower Entry barrier with minimum investment amount of ₹ 2 lakh	Required outlay is at least ₹25-30 Lakh
Risk-Return	Diversified portfolio of properties; thus less risk and regular returns can be expected	Investment in single property is risky and returns might be volatile
Trustworthiness	Due diligence conducted by Fund manager and trustee before investing	Investor has to check the background of builder and property details on his own
Management	Professional management	Self; as maintenance of property and rent recovery has to be done by the investor
Liquidity	High liquidity (subject to market depth), as it will be listed	Illiquid as searching for buyer takes time and can be tedious and time consuming
Reach	No geographical barriers (domestic)	Tedious to buy property in other geographies

Proposed Taxation

	Special Purpose Vehicle	REITs	Investor
Rent Received from SPV	Corporate Tax Rate	N/A	N/A
Capital Gain from SPV	Standard Rates applicable to capital gains	N/A	N/A
Dividend from SPV to REITs	DDT	No Tax	Tax free
Direct Rent by REITs	N/A	Corporate Tax Rate	Tax free
Capital Gain by REITs	N/A	Corporate Tax Rate	Tax free
Interest From SPV to REITs	N/A	No Tax	Taxable at individuals slab rate. There will be 5% withholding tax for NRI and 10% for residents
Capital gains by investors by trading in REITs units	N/A	No Tax	Tax free if held for more than 3yrs, else 15%

Opportunities

- **ETF (Exchange traded Fund)**
  - This ETF Invests in stocks issued by real estate investment trusts (REITs), companies that purchase office buildings, hotels, and other real property
  - ***Vanguard REIT ETF in US*** – The goal is to closely track the return of the MSCI US REIT Index, a gauge of real estate stocks. This model can be replicated in India and another investing instrument can be created for investors. It will also give another way of investing in REITs

- **Mutual fund**
  - ***James Alpha Global Real Estate Investments Portfolio in US*** -This Fund seeks total return through a combination of current income and capital appreciation. The Portfolio's strategy is to invest exclusively (other than cash and cash equivalents) in publicly-traded real estate investment trusts, including REIT preferred stock, and other publicly-traded real estate securities that are included in the FTSE EPRA/NAREIT Developed Real Estate Index (the "index").
  - REITs mutual fund can open up another interesting way of investing in real estate, with option of investing via SIP which will not be available through direct investment in REITs

Concern

- **Taxation**
  - Tax pass through has been introduced, but Sponsor taxation has not been aligned with REITs taxation. Thus; when the sponsor is transferring the shares of the SPV which is holding the REIT, there is postponement of the tax for the sponsor but at the same time the sponsor is going to get taxed when he sells the units of the REIT at a later point in time.
  - However, where REIT has to hold assets through a SPV there could have been instances of double taxation in the form of income tax and DDT at SPV level.
  - The second major issue as far as REIT taxation is concerned; there is no exemption for dividend distribution tax when the SPV plays dividend to the REIT.

- **Foreign investment**
  - Any type of foreign investment in completed assets in India is not allowed unless that property is in the form of an industrial park, special economic zone, hospitals or hotels.
  - Since REIT will own a completed property, currently foreign investment in units of REIT is not permitted and hence there is a need to change the exchange control regulations to allow the foreign investor or FIIs or QFIs to invest in the units of a REIT

- **Returns**
  - REIT is a success in developed countries wherein the return to investors on bank fixed deposits or in Government securities/bonds is much lower, around 3% to 5%.
  - Globally REIT offers a return in the range of 6% to 9% to the investors.
  - However, in the Indian context generally bank fixed deposits and Government securities/bonds offer a return in range of 7% to 9%. Investing in REIT may not be as lucrative unless the investor looks at an upside in value of commercial property over a period of time.

Certainly, REIT as a concept could be a game changer for all stake holders like retail investors, developers/real estate owners and the economy as a whole. REIT could provide the much awaited relief for the funding starved real estate sector by providing capital inflow from overseas markets in India. REIT provides avenues for retail investors to not only invest in big ticket real estate investment but also permits investment in low risk, completed, revenue generating projects as against high risk, non-revenue generating, developing projects whereas for developers/real estate owners it may provide the required avenue to exit a project and fund new project/repay the high cost debt taken.