

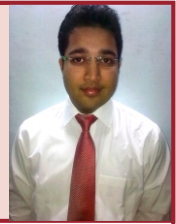


Securitized Real Estate market via Real Estate Investment trusts



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Introduction & Understanding

A **real estate investment trust (REIT)** is an entity that owns, and in most cases, operates income-producing real estate. REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centers, hotels and even timberlands. Some REITs also engage in financing real estate.

REIT is a special investment company that invests money obtained from investors directly in real estate, either through properties or via mortgages. Investors receive the income from rent obtained from underlying properties as well as capital gains when properties are sold.

REITs ensure transparency as investors know what is being bought, including the property's current value. They also have a realistic income expectation from their investment. REITs offer accessibility to invest in real estate for those who find it difficult to purchase real estate as an investment option.

REITs were designed to provide a real estate investment structure similar to the structure mutual funds provide for investment in stock.

Types of REITs :- Equity REITs and Mortgage REITs

(1) **Equity REITs** are real estate companies that acquire commercial properties such as office buildings, shopping centers and apartment buildings and lease the space in the structures to tenants, who pay rent. After paying the expenses associated with operating their properties, Equity REITs pay out annually the bulk of the income they collect to their shareholders as dividends. Equity REITs also include capital appreciation from the sale of properties in the dividends they pay.

In the case of Timber REITs, their dividends include gains from the sale of timber. In all cases, this significant dividend distribution is designed to approximate the investment return investors would receive if they owned properties directly.

(1) **Mortgage REITs** (Financing Real Estate) invest in real estate mortgages or mortgage-backed securities, earning income from the interest on these investments, as well as from the sales of mortgages. Mortgage REITs, like other businesses, earn their profit from the difference between the income they receive and their costs, including their funding costs to purchase mortgage investments. They have the same requirement as Equity REITs to distribute the bulk of their income to their shareholders annually.

Benefits of REITs:-

- The greatest benefit will be that of fast and easy liquidation of investments in the real estate market unlike the traditional way of disposing of real estate.
- REITs typically own multi-property portfolios with diversified tenant pools. This reduces the risk of relying on a single property and tenant which one faces when directly owning a real estate property.
- The REIT investor enjoys the advantage of the power of the pool of capital to acquire interests in much larger opportunities than would be available to their personal capital alone.
- The process of buying or selling a REIT is transparent and flexible, just like trading stocks listed on the exchange. Investors can access information on the REIT prices and trade REITs throughout the trading day.
- REITs will help in curbing black money menace. As real estate is the major sector engulfing black money thus, listed REITs will prune black real estate transactions.
- Provide hedging against properties:
 - If you are holding property, and want to sell it in future, you may short REITs index
 - If you want to buy property, you may long REITs index.
- Offers attractive and regular income distribution to wide range of investors and in return, entities gain access to debt and equity market often at very favourable costs.



Risks involved in REITs:-

- As REITs distribute a large amount of their income to unit holders, they may not have the ability to build up cash reserves to repay loans as they fall due. Thus they will typically seek financing by entering into new borrowing agreements, or other capitalisation measures such as rights or bond issues. One potential risk is higher refinancing cost when loans are due for renewal.
- Another risk is that a REIT which is unable to secure refinancing may be required to sell off some properties if they are mortgaged under the loan. These risks could affect the unit price and income distribution of a REIT.
- REITs are, however, more volatile than property prices (due to public trading).
- REITs have relatively higher correlation with equities than real estate prices.
- Asset price bubbles is always a cause for concern in REIT as seen in 2008 Sub-Prime Crises.

As there are dividend distribution requirements, REITs cannot grow the way corporate grow. Hence, REITs have to continuously look for capital and debt issuance.

Governance Structure :-

Sponsor, Trustee and Manager are the main parties to the REIT.

Sponsor is just like the promoter of the company who conceptualize the idea and set up the REIT and transfers his interest in real estate to REIT or SPV as the case may be and then, offering of shares to public via IPO or so. Sponsors are however mandatorily required to hold collectively at least 25% of the total units of the REIT on post issue basis along with lock in period of 3 years.

For Instance: In most cases, a **sponsor or a major share holder** is also present. For example, if a property developer launches a REIT, he may choose to keep X% (say 30% to 50%) stake in the REITs itself. Like any other investor, the developer in this instance will receive income distributed as dividends, where applicable.

Manager is basically representing the board of directors of a company for carrying out day to day activities of the trust however, approval need to be taken on timely

basis from trustees and also quarterly monitoring on the basis of reports. The underlying real estate properties are managed by a property managers and the REIT itself is managed by a REIT manager in exchange for a fee.

The underlying assets are held by a trustee on behalf of the investors. **Trustees** are basically working on behalf of the unitholders i.e owners of the trust.

REIT Structures Umbrella Partnership REIT (UPREIT) and Traditional REIT:-

- UPREIT structure created to shield owners contributing real estate assets to the REIT from capital gains taxes on contributed property
 - Transfer is then partnership shares for partnership shares, and this is not a taxable event for the owners.
- UPREIT owns a controlling interest in a limited partnership that owns the real estate, as opposed to a traditional REIT structure in which the REIT owns the real estate.

Indian Scenario

The Securities and Exchange Board of India (SEBI) notified the SEBI (Real Estate Investment Trusts) Regulations, 2014 and SEBI (Infrastructure Investment Trusts) Regulations 2014 on 26th September 2014 and laid down a framework for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) and their registration and regulation in India. As per these regulations, both REITs and InvITs have to be registered as Trusts under the Indian Trusts Act, 1882. SEBI had introduced legal framework for real estate mutual funds on 16th April 2008 by way of SEBI (Mutual Funds) (Amendment) Regulations, 2008 and inserted Chapter VI A Real Estate Mutual Funds Schemes (REMFs) and that for Infrastructure Debt Funds was added by inserting Chapter VI B - Infrastructure Debt Fund Schemes on 30th August 2011 to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

**SEBI (REITs) Regulation 2014:-**

S.No.	Particulars	Regulations
1.	Sponsor	<ul style="list-style-type: none">• Maximum number of sponsor restricted to 3• Minimum holding for each of the sponsor shall be equivalent to 5% of the no. of units of REITs (i.e. Post initial offer size)• Aggregate Net worth of sponsors shall be of atleast Rs 100 crores. Moreover minimum networth requirement for individual sponsor is Rs 20 crores.• Minimum 5 years experience in development of real estate or fund management in real estate industry. Moreover, where the sponsor is a developer, at least two projects have been completed.
2.	Manager	<ul style="list-style-type: none">• Minimum Net worth Rs. 10 Crores.• Minimum 5 years experience in fund management or advisory or property management in the real estate industry.• Atleast 50% of directors or members of governing body as independent and not directors or members of governing body of another REITs.• Entered into an investment management agreement with the trustee which provides for the responsibilities of the manager in accordance with regulation 10
3.	Trustee	<ul style="list-style-type: none">• Registered with SEBI under SEBI (Debenture Trustees) Regulations, 1993 and not an associate of the sponsor or manager.• Having such infrastructure and personnel as specified by SEBI.
4.	Minimum Asset Criteria for listing	<ul style="list-style-type: none">• In order to offer units to public the value of all the assets owned by REIT should be at least Rs 500 crores.• The offer size is not less than Rs. 250 Crores.• Initial offer of REIT units has to be through public issue only.
5.	Investment Conditions	<ul style="list-style-type: none">• Investments only permitted in following channels:<ul style="list-style-type: none">- SPVs (only if SPV holds 80% of the properties directly)-Properties-Securities-TDRs (Transferable Development Rights)• Can't invest in vacant land, agriculture land and mortgages other than mortgage backed securities.• At least 80% of the value of REIT shall be invested in completed and rent generating properties. Lock-in-period of 3 years from date of purchase.• Investment in TDRs and Unutilized Floor Space Index (FSI) now permitted under second tier of Investment mode with a maximum cap of 20% of REIT's Assets.• If investment in under construction properties under the sub second tier of Investment mode with maximum cap of 10% of REIT's Assets then, lock-in-period of 3 years from date of completion.• Not less than 75% of the revenues of REITs and SPVs, other than gain arising from disposal of properties, shall be from rental, leasing and income incidental to leasing of real estate.



6.	Approval of Unitholders	<ul style="list-style-type: none">• In case of sale of properties of REIT or SPV exceeding 10% of the value of assets.• Purchase of property for a value greater than 110% of the value as assessed by valuer or sale of property which is less than 90% of the value as assessed by the valuer is allowed if approved by Unit Holders (Valuation by two independent valuers is mandatory).• In case of transactions with related parties on crossing of stipulated norms.• If the aggregate consolidated borrowings and deferred payments of the REIT net of cash and cash equivalents exceed twenty five per cent. of the value of the REIT assets, credit rating from credit rating agency is also required along with approval of unitholders.• With respect to the annual meeting of unit holders, approval of<ul style="list-style-type: none">- latest annual accounts and performance of the REIT- auditor and fees of such auditor, as may be required- latest valuation reports- appointment of valuer, as may be required- any other issue including special issues as specified under subregulation (6)• Any issue, in the ordinary course of business, which in the opinion of the sponsor(s) or trustee or manager, is material and requires approval of the unit holders. For instance- Any change in manager including removal of the manager or change in control of the manager, any material change in investment strategy or any change in the management fees of the REIT
7.	Cash Flows	<ul style="list-style-type: none">• Not less than ninety per cent of Net distributable cash flows of the REIT shall be distributed to the unit holders once in 6 months.• However if sale proceeds from any property are reinvested in another property then there is no requirement of distributing 90% of the proceeds to the Unit Holders.
8.	Related Party Transactions	<ul style="list-style-type: none">• Transactions such as acquisition or sale of properties or investments into securities in a financial year; or• Value of funds borrowed from related parties in a financial year requires previous approval of Unit holders if the value of transaction exceeds 10% of the value of REITs or consolidated borrowings respectively
9.	Borrowings	<ul style="list-style-type: none">• Aggregated consolidated borrowing and deferred payment of REIT net of cash and cash equivalents shall never exceed 49% of the value of REIT assets.
10.	Valuations	<ul style="list-style-type: none">• The valuer shall not be an associate of the sponsor(s) or manager or trustee and shall have not less than five years of experience in valuation of real estate.• Full valuation report shall include the mandatory minimum disclosures as specified in Schedule V to these regulations.• A full valuation shall be conducted at the end of financial year i.e at 31st March by the valuer within 3 months along with half yearly valuations.• Prior to any issue of units to the public and any other issue of units as may be specified by the Board, the valuer shall undertake full valuation of all the REIT assets and include a summary of the report in the offer document.



Other Conditions:

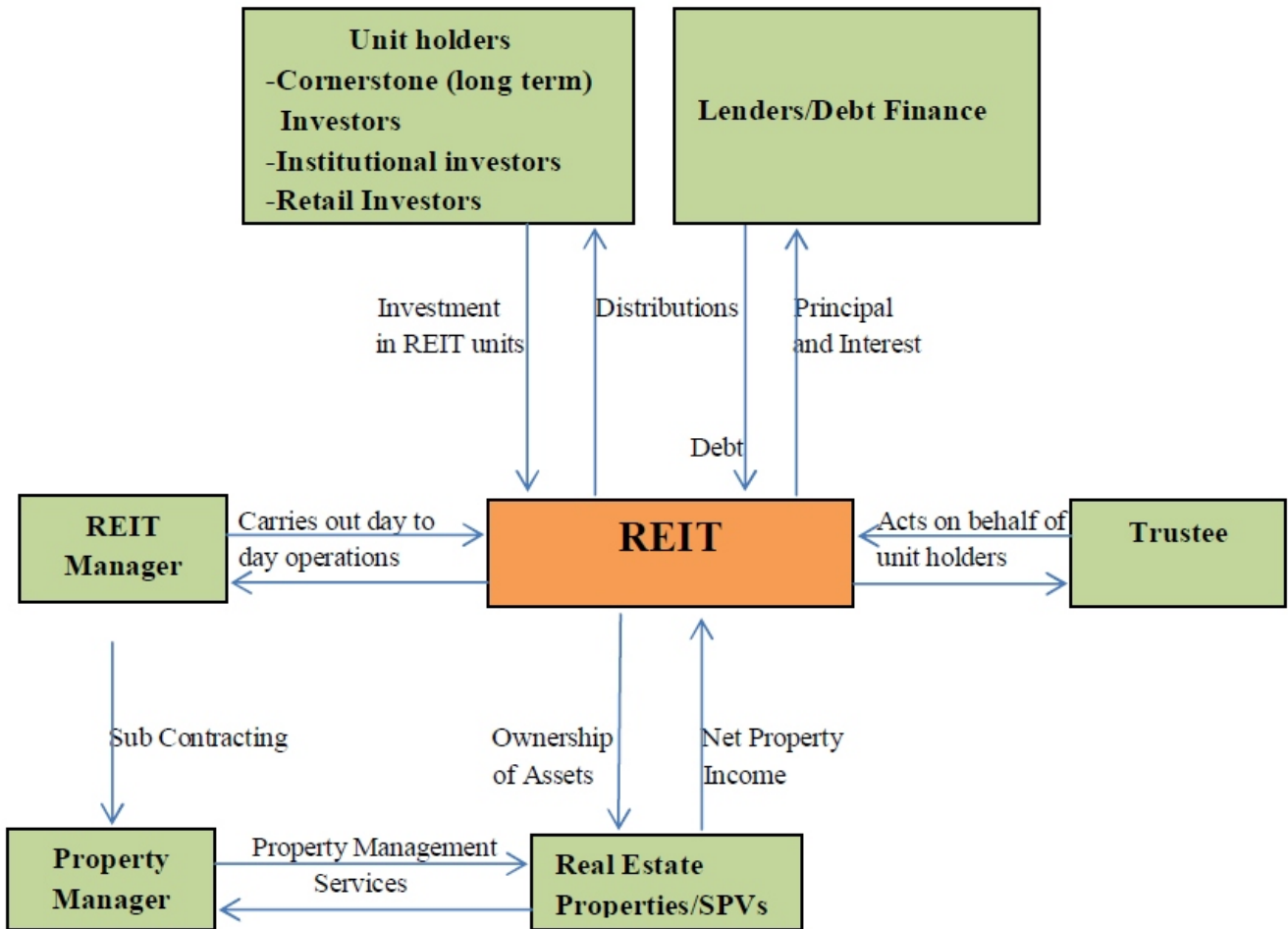
- No unit holder of the REIT enjoys preferential voting or any other rights over another unit holder.
 - Any person other than the sponsor(s) holding units of the REIT prior to initial offer shall hold the units for a period of not less than one year from the date of listing of the units subject to circulars or guidelines as may be specified by the Board.
 - General period of disclosure of information, reports is half yearly.
 - Parties to the REIT are Trustee, Sponsor and Manager.
- Under both the initial offer and follow-on offer, rights issue, QIP, minimum subscription size for units of REIT shall be Rs 2 lakhs.

First REIT listing in India (Embassy Office Parks)

- India's first real estate investment trust (REIT) listing is poised to kick off with the world's largest private equity investor Blackstone and commercial developer Embassy Group ready to move markets regulator SEBI to raise as much as \$1 billion. The assets held under the REIT have a net operating income of just under Rs 2,200 crore annually.
- Currently, Blackstone owns around 43 percent, while billionaire Jitu Virwani-led Embassy, which manages the trust, holds 25 per cent interest. The land owners of some of the country's biggest technology parks are said to own the remaining 32 per cent. A listing this year would follow a regulatory change to the ownership structure governing trusts.
- The listing potentially marks the coming of age for India's rent-yielding grade-A office market, which expanded rapidly in the last decade, riding on the services sector in the fastest growing major economy globally.



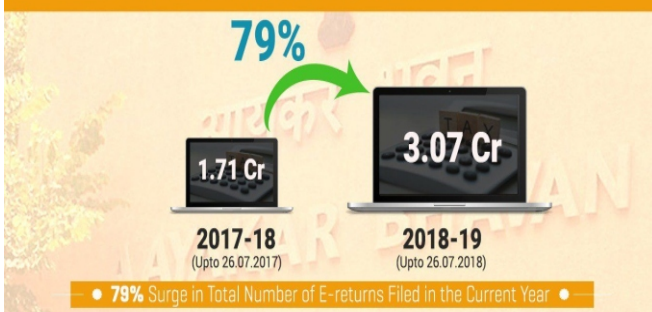
TYPICAL REIT STRUCTURE



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Massive Increase in Returns Filed

— Increase in Tax Compliance and Formalisation —



Government Trusts Taxpayers

— Efficient and Speedy Processing of Total Refunds —

