An Insight into Real Estate Investment Trusts in India

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Abstract: *Real Estate Investment Trusts, also known as REITs, are entities that invest in different kinds of real estate or real estate related assets. Its different types are Equity, Mortgage and hybrid REITS's . – REIT'S can be incorporated in the form of a contract or company-type investment trust. It receives investment from various parties like Individual Investors, Banks in the form of loans and third party funding to buy exposure to real estate projects.*
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I. INTRODUCTION

Real Estate Investment Trusts, also known as REITs, are entities that invest in different kinds of real estate or real estate related assets, including shopping centers, office buildings, hotels, and mortgages secured by real estate. There are basically three types of REITs:

Equity REITs

Equity REIT's are the most common type of REITs which invest in or own real estate and makes money for investors from the rents thus collected.

Mortgage REITs

Mortgage REIT's lend money to owners and developers or invest in financial instruments secured by mortgages on real estate

Hybrid REITs

Hybrid REIT's are a combination of equity and mortgage REITs. There are some specialized REITs which hold only specific types of property, such as apartments, commercial office space or retail. Most REITs contain numerous properties ranging in size, activity and function. REITs tend to have a broad shareholder base and are often, but not always, traded on a public stock exchange.

II. STRUCTURE OF REIT

Step 1: Incorporation of Investment Corporation

REIT'S can be incorporated in the form of a contract or company-type investment trust. These investment trust or companies are the special purpose vehicle established for the purpose of investing in and managing real estate assets.

Step 2: Investment from Investors

REIT'S receives investment from various parties like Individual Investors, Banks in the form of loans and third party funding to buy exposure to real estate projects. REITS can be public REITs where they are listed on stock exchanges or Private REITs.

Step 3: Issue of Investment Certificates

In return, investing companies issues Investment Certificates to Investors carrying ownership rights, including dividend entitlement. Investment Certificates issued by these company or trust are actively traded in the stock market making it one of the attractive investment options.

Step 4: Sub-Contracting to Investment Management

Investment Corporation gets involved in an arrangement with third party manager know as Asset Management company for managing real estate properties. Although the corporation is technically responsible for owning and managing the real estate properties, in reality this function can be sub-contracted to a third party.

Step 5: Sub-Contracting to Asset Custodian

Investment Corporation also get involved into an agreement with Asset Custodian Company who then provides various services such as custody of assets, custody of certificate of beneficiary and hard assets on behalf of the investment corporation. These services also includes other administrative duties, such as registration of investment certificate holders and issue of new certificates, are handled by investment trusts and securities companies, respectively, on behalf of the investment corporation.

Step 6: Sub-Contracting to Real Estate Management Company

Investment Management company in turn sub-contracts management of real estate assets to Real Estate Management Companies who handle all aspects of the direct management of the real estate assets, including physical management of the real estate properties and handling rental contracts and invoices.

Generally a REIT should fulfill the below mentioned four specifications to retain special tax status

- The REIT must distribute at least 90 percent of its annual taxable income, excluding capital gains, as dividends to its shareholders.
- The REIT must have at least 75 percent of its assets invested in real estate, mortgage loans, and shares in other REITs, cash, or government securities.
- The REIT must derive at least 75 percent of its gross income from rents, mortgage interest, or gains from the sale of real property. And at least 95 percent must come from these sources, together with dividends, interest and gains from securities sales.
- The REIT must have at least 100 shareholders and must have less than 50 percent of the outstanding shares concentrated in the hands of five or fewer shareholders.

REITs boost and help to stabilize capital access, and reduce capital costs. They help real estate business by creating conditions for building integrated property businesses. Most REITs in the leading markets are internally managed, and have diverse skill bases in property development, redevelopment, acquisitions, leasing and management. They provide better access to stable, global and more competitively priced capital, as well as stronger and more professional property businesses. They are a tax vehicle for a corporation investing in real estate that reduces or eliminates corporate income tax. REITs are required to distribute their earnings, which become taxable at investors' end. The trusts can be public or private.

Advantages of Investing in Real Estate via the REIT route

1. REITs provide a similar structure for investors buying into real estate as mutual funds provide for investment in stocks.
2. The transactions are transparent and the returns are passed on to the investor with regularity, as opposed to direct investment, where a builder may or may not pass the returns to the investor or delay it for maintaining liquidity or diverting the funds to other ongoing projects.
3. It takes the cumbersome effort out of investing in a large and diversified real estate portfolio, with the right product mix to ensure greater returns.
4. The investor need not worry about his lack of knowledge about local property and can invest in real estate across cities.
5. With this corporate avatar of real estate investment, the foreign investors' fear of investing in an alien unorganized market will be allayed.
6. REIT also helps reduce the volatility of the market in general.
7. Investments are relatively high yielding when compared to other forms of real estate investment.
8. An interesting thing about REITs is that they are probably the best inflation hedge around. Most of them yield 7-10% dividend yield. However, they almost always lack the potential for tremendous price appreciation (and depreciation) that you get with most common stocks. There are exceptions, of course, but they are few and far between.

III. REITs IN INDIA

SEBI has taken positive steps towards initiating REMFs in India. There is considerable interest among established asset managers to launch REMFs in India. A few of them have also filed draft prospectus with SEBI. Taking into consideration the Indian Real Estate scenario, a structure similar to that of PMVs in UK which are in the form of Trusts and is also identical to Mutual Fund / Collective Investment Schemes currently regulated by SEBI is ideal for REMFs in India.

Real Estate Investment Trusts (REIT's) as SEBI has proposed still need the Finance Ministry's approval. The proposed tax benefits have long-term implications in an economy that has a sustainable growth pattern. In particular, the buoyancy in real estate, which has so far benefitted select few individuals, will now begin to also envelope small investors in the upward surge due to this initiative by the Government, as REIT's will provide small investors with a platform for investment in real estate. In addition to this, the introduction of REITs will facilitate and support growth in the real estate market. In the long run, it will help to provide shelter for all and facilitate overall improvement in the infrastructure and housing sector, while generating funding in an organized manner. The real estate investment trusts would be regulated by the Government of India as well as the Securities and Exchange Board of India (SEBI).

According to the Draft regulations, the criterion of the trust is

- Minimum net worth, for the time being stated as Rs 5 crore. To begin with a net worth of Rs. 3 crore is permitted provided it is increased to Rs 5 crore within three years
- At least 50% of the trustees, directors shall be independent and not directly or indirectly associated with the persons in control of the Trust or the Management company
- The trustees, directors shall have adequate professional experience in related field and be fit and proper and their appointment shall be made with the prior approval of the Board.
- The draft Regulation prohibits providing any guaranteed or assured returns as part of the scheme. Further, every scheme shall appoint an independent property valuer who shall have a minimum net worth of Rs. 5 crore.

The Board has proposed certain investment and dividend limitations which are worth noting

- No real estate investment trust shall under all its schemes have exposure to more than 15% of a single real estate project
- No real estate investment trust shall under all its schemes have exposure to more than 25% of all the real estate projects developed, marketed, owned or financed by a Group of companies.
- Real estate shall generally be income generating and the scheme is prohibited from investing in vacant land or participating in property development activity.

Limitations

- Real estate funds have the same risks that are associated with equity/debt mutual funds. For instance i.e. one could make the wrong choice while selecting a real estate fund in which case one could be saddled with a non-performer. Although this is not a limitation with real estate funds per se, it serves to highlight that there can be poorly managed real estate funds just like there can be poorly managed equity/debt funds.
- If with equities three years is the minimum investment time frame, then with real estate investments one needs to be even more patient. Buying property, developing it and then renting it out or selling it, is a high gestation activity. It could take some time before the real estate mutual fund actually starts making money.
- One has no control over when the company will sell its holdings or how it will manage them, as in the case of one's own apartment.

However, there are certain issues that require more clarity in the draft

- Clarity required on taxation matters
- Clarity required on percentage of REIT fund that can be used for real estate income producing properties
- Absence of de-risking from investor's point of view
- Lack of clarity on Foreign Ownership and Foreign Asset Purchase
- This project aims to study this investment vehicle thoroughly, analyze the challenges in implementing them in India and provide solutions for the same.

IV. REFERENCES

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