International Journal of Social Science and Economics Invention (IJSSEI)
Volume 03 Issue 01 February 2017, ISSN No. – 2455-6289
Available Online at - www.isij.in

ISIJ PUBLICATION ISSN - 2455-6289 Open Access Journal

REIT and its Future in India

Sangeetha D.

Research Scholar, Bharathiar University, Coimbatore

Under the guidance of Dr. G.Lalitha Kumari – Associate Professor

Abstract:

Investment is a positive connection to the future world and life of many people. The knowledge about investment among investors is highly increasing nowadays because of the increase in financial literacy through self development and government Financial Inclusion Programs. This has yield to the emergence of many investment products in India and across the world, one such product which recently got emerged in India is REIT (Real Estate Investment Trust). Most of the Advantages and disadvantages of Real Estate Investment gets added to this but still because of its nature it varies from the actual real estate investment. It had shown progressive growth in many countries in the past decades but its growth and progress is unpredictable in India because of various reasons like it is a new product, economic and financial conditions in India is entirely varied from other nations. So this paper will provide a broad description about REIT across the world and in India.

Introduction:

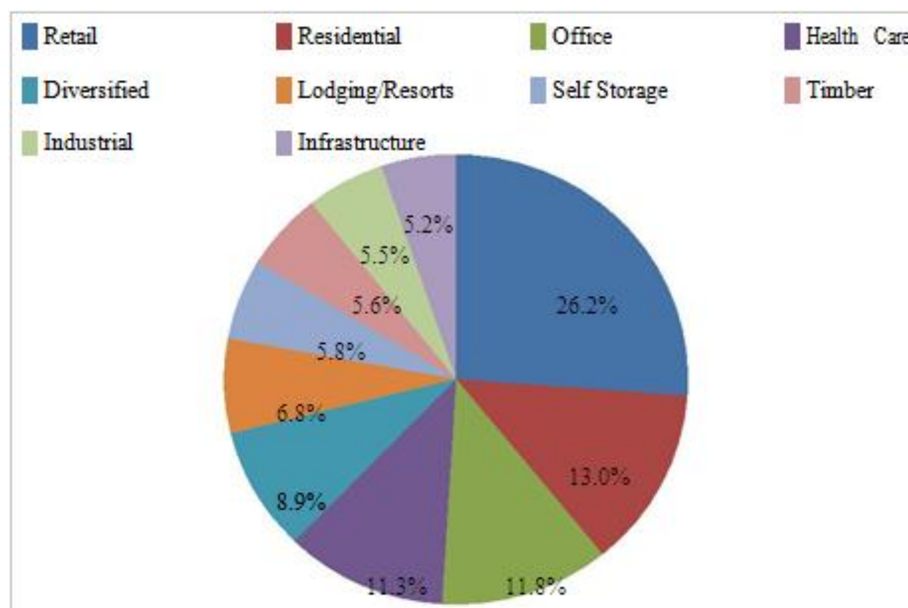
Real Estate Investment Trust (REIT) is a security that sells like a stock and invests in real estate directly or indirectly. Consequently, there are different type of REITs; such as Equity REITS and Mortgage REITs. More than 40 countries around the world have established REIT regimes, with more countries in the works. The spread of the REIT approach to real estate investment around the world has also increased awareness and acceptance of investing in global real estate securities. The Equity REITs invest in and own properties, and their revenue is linked to the rent. On the other hand Mortgage REITs deal in investment and ownership of property mortgages and their revenue is primarily linked to the interest they earn on the mortgage loans.

History of REIT across the world

REITs, an investment vehicle for real estate that is comparable to a mutual fund, allowing both small and large investors to acquire ownership in real estate ventures, own and in some cases operate commercial properties such as apartment complexes, hospitals, office buildings, timber land, warehouses, hotels and shopping malls.

REITs have existed for more than 50 years in the U.S. Congress granted legal authority to form REITs in 1960 as an amendment to the Cigar Excise Tax Extension of 1960. That year The National Association of Real Estate Investment Funds, a professional group for the promotion of REITs is founded. The following year it changed its name to the National Association of Real Estate Investment Trusts (NAREIT).

Today's U.S. Equity REIT Market



In 1965 the first REIT, Continental Mortgage Investors, is listed on the New York Stock Exchange (NYSE). By the late 1960s, major investors, including George Soros, become interested in research on the value of REITs. Mortgage based REITs account for much of the growth of REITs in the early 1970s, and they fuel a housing boom. The boom busts after the oil shocks of 1973 and the recession that follows.

Since their development in Europe, REITs have become available in many countries outside the United States on every continent on Earth.

- The first listed property trusts launch in Australia in 1971.
- Canadian REITs debut in 1993, but they don't become popular investment vehicles until the beginning of the 21st century.
- REITs began to spread across Asia with the launch of Japanese REITs in 2001.
- REITs in Europe were buoyed by legislation in France (2003), Germany (2007) and the U.K. (2007). In total, about 40 countries now have REIT legislation.

REIT is more like a company than Mutual Fund

When people buy units of a mutual fund, they are buying a piece of the fund's portfolio. Any money that they invest in the scheme is directly re-deployed into stocks, bonds or other instruments. This portfolio is valued daily and when they sell units, they get an NAV-linked price.

But Indian REITs will function more like listed companies than mutual funds. The REIT, which is floated by a sponsor, makes an IPO of units (akin to shares) to investors. Investors buy these units based on an offer document and the REIT is then listed on the stock exchange.

The money so raised is used by the REIT either to buy into Special Purpose Vehicles (SPVs) which invest in property or directly take majority stakes in real estate projects. The REIT receives income from these properties, which is distributed as dividend to the REIT investor. If the investor wants to exit a REIT, they have to sell their units (like shares) to another investor, at the stock exchange, just like shares, REIT units can be traded at a discount or premium to the company's intrinsic value, at the market. This is unlike a mutual fund where investor can always exit at NAV-linked prices.

Less transparent and liquid than Mutual Fund

Mutual funds deal only in liquid, exchange traded securities. Therefore they value their portfolios on a daily basis, mark them to the market and arrive at a daily NAV based on the last traded price. They also offer the investors' money back at any time (if the fund is open end) at the prevailing NAV. They disclose their portfolios on a monthly basis, financials on a half yearly basis and have their NAV-based returns ranked by independent agencies.

Now, the real estate market in India is scarcely as transparent as the stock market. Property transactions often involve a grey market component. Even within the same city or locality, different property deals can also take place at vastly different prices. Therefore there is no way of measuring the 'daily value' of a REIT's assets. Therefore, REITs, even if listed, are likely to be far more opaque than mutual funds. SEBI has asked for Indian REITs to get their property portfolios valued by an independent valuer twice a year. Therefore, the investor will probably get to know their REIT's NAV at half-yearly intervals.

But they can't expect this NAV to be as water-tight as that for a mutual fund. Given that property values can fluctuate quite a bit based on the most recent transactions.

REIT will focus on dividends than capital gains

Most Indian investors love real estate because they believe that it gives them manifold capital gains over the long-term. Now, REITs are not structured to make them bumper gains from buying and selling property. They are intended to pay the investors a regular dividend out of the rent they receive from property.

SEBI's regulations for Indian REITs require them to invest at least 80 per cent of their funds in completed, revenue-generating properties. Only 20 per cent is allowed to be deployed in under-construction property, bonds from developers, listed shares of realty companies and instruments like gilts and money market securities. The regulations also require REITs to pay out 90 per cent of the income they earn each year as dividend to investors.

This structure will ensure that REITs earn much of their returns by way of rental income from their property and not from capital gains. As an investor, everyone should expect returns which in keeping with commercial rental yields (at the most, 8-10 per cent) and not the fancy multi-bagger returns that are possible from owning land or apartment blocks.

REIT invest in commercial, not residential property

Given that earning a regular rental income is the primary purpose of a REIT, the majority of its investments will be in office space, malls, commercial complexes, multiplexes and so on. The bulk of the investment will not be in plots of land, residential townships or luxury villas, which most property buyers fancy so much. Commercial property in fact yields higher rents than residential property. In India,

residential rental yields in most cities are not above 2-3 per cent, scarcely an attractive return for the REITs to seek.

REIT won't match property, on tax breaks

In India, most people buy property because of the sizeable tax breaks they get on the investment itself. The interest they pay on a home loan upto a Rs 2 lakh limit, can be deducted from their annual income, before they calculate income tax. But their investments in REITs will not earn any such tax exemptions. Yes, the REIT itself has been granted pass-through status in the previous budget. That is, the REIT will pay no tax if it buys or sells property or earns a rent from its holdings. But as an investor, if a REIT distributes the income back to you as dividend, this could be subject to dividend distribution tax.

Benefits of REITs

A typical REIT offers a number of advantages to investors:

1. It allows accessible indirect investment in real estate. Participants can invest in a professionally managed portfolio of real estate that is held in tax transparent structures. This serves to open up real estate investment to the small investor who otherwise could not have had this investment opportunity;
2. It enables participants to broaden their investment portfolio and diversify risk;
3. It is typically tax transparent. There is only one level of taxation. Typically a US REIT will pay back at least 90 per cent of its profits to its shareholders and in many cases even more than that, with some REITs distributing all their profits to their shareholders. REITs can also serve to eliminate some of the tax and other difficult experienced by institutional investors, such as pension funds and foreign inventors, if they invest more directly in real estate.
4. It provides ease of liquidation of assets into cash primarily because of their being traded on a stock exchange;
5. It offers historically low volatility. REITs tend to be stable, and therefore, offer an attractive return for investors.

Comparison to other Modes of Real Estate Investment

Characteristics of Various Investments in Real Estate

	REITS	Direct Property Ownership	Real Estate Company Equity	Corporate Property Bonds
Type of Investment	Units in a listed trust/share of corporation owning real Estate	Investment in physical real estate	Shares of a listed company owning real estate and other business	Debt issued by the underlying real estate company
Payout	Majority of taxable income paid to unit holders	Majority of income paid to owner	Discretionary dividends to shareholders	Fixed Payout
Investment Strategy	Focused Activity	Focused Activity	Investment Choices Determined by the Company Board	Investment Choices Determined by the Company Board
Liquidity	Liquid investment	IllLiquid investment	Liquid investment	Low Liquid investment
Diversity	Diversified portfolio	Concentration risk	Diversified portfolio	Concentration risk
Risk	Perceived low risk	Perceived high risk	Perceived high risk	Perceived low risk
Gearing	Gearing is limited by regulations	High gearing between 70% to 80%	Moderate gearing level between 60% to 70%	Moderate gearing level

Source: KASB Analysis

India and REIT

India released its first draft guidelines for a REIT market in December 2007 but the initial framework did not receive approval because of a lack of clarity on taxes. And with the onset of the financial crisis in 2008, market conditions were very far from ideal. As such, it wasn't until 2013 that the Securities and Exchange Board of India (SEBI) released a consultation paper on a new set of guidelines for the REIT market. REIT was formulated to provide new avenues for raising funds, capital markets regulator. Sebi has norms for the public issue of Real Estate Investment Trusts (REITs) by including cap of 75 per cent allocation to institutional buyers. The Securities and Exchange Board of India (Sebi) said the proposed norms for the public issuance of REITs relate to appointment of merchant bankers, disclosures in the offer documents and filing of draft papers, keeping them in the public domain for at least 21 days.

For an issue made through the book building process or otherwise, the allocation in the public issue should be maximum 75 per cent to qualified institutional buyers (QIBs) and at least 25 per cent to other investors, Investment

manager can allocate up to 60 per cent of the portion available for allocation to QIBs to anchor investors, subject to certain conditions.

An Anchor Investor should make an application for at least Rs 10 crore in the public issue and allocation to such investors should be on a discretionary basis and subject to the minimum of two investors for allocation up to Rs 250 crore and five such investors for over Rs 250 crore.

Issuing the draft paper, Sebi said that REITs will need to deposit, before the opening of subscription, and keep deposited with the stock exchange, an amount calculated at the rate of 0.5 per cent of the amount of units offered for subscription to the public. The issue would need to be opened after at least three working days from the date of filing the offer document with Sebi. Besides, the issue would need to be kept open for at least three working days but not more than 30 days. The investment manager may issue advertisements for issue opening and closing advertisements.

After further modifications to the tax structure for REITs, the final guidelines were finally released in 2015 September. However, the story is far from over with investors and industry experts still harboring concerns about tax rules in India’s REIT regulation. The Asia Pacific Real Estate Association (APREA) described them as “tax kinks”.

The 2015 February budget, the most highly anticipated event of Modi’s government by global investors, contained helpful fine-tuning, but didn’t remove all hurdles to an Indian REIT marketplace which could be worth $15 billion in three years.

Will REIT Succeed in India?

The US average REIT yield is of 4 per cent vs 10-year treasury yield of 2.4 per cent; Singapore: 6.5 per cent vs 2.3 per cent; Malaysia: 7 per cent vs 4 per cent. In India’s case, the current 10-year G-Sec yields are in the 8.2 per cent range. That means that REIT should provide returns of at least 14-16 per cent annually to make a success story in India. Though taxation on this would depend upon the underlying capital structure adopted by the REIT, but net of tax, returns should probably be in the 12-14 per cent range to provide an appropriate risk premium over conventional debt products.

Conclusion:

REIT though successful in many countries, the success in India entirely depends upon the rules and regulation of SEBI and importantly the situation and acceptance of investors in India. Investors are really interested in real estate investment that is why the acceptance of REIT is very high in foreign nations. In India to make such situation happen, awareness about the product should take place as a first step, but before investing any investor will make a comparative study on the various investment avenues, in such situation the REIT’s yield should prove itself that it is comparatively good than the real estate investment, for which the government has liberalized the tax and return norms accordingly to attract more investors but still more initiatives is expected by the investors for the REITS. In such case the REIT will be a successful investment avenue in India.

References:

[1] Tang, S. (2014). International Comparison and Enlightenment of REITs. Chinese Finance, 13, 74-75.

[2] Aditi R Khandelwal (2016), International Journal of Research in Engineering, IT and Social Sciences, ISSN 2250-0588, Volume 06 Issue 08, 26-28

[3] Michele lerner (2014) http://www.realtor.com/advice/ask-michele/real-estate-investment- trusts -work/accessed on 02/04/2016

[4] Jay C. Hartzell, Libo Sun and Sheridan Titman (2005), The Effect of Corporate Governance on Investment: Evidence from Real Estate Investment Trusts (REITs)

[5] Ambrose, B. W., & Linneman, P. (May 2001). REIT Organizational Structure and Operating Characteristics. Journal of Real Estate Research, 21(3), 141-162.

[6] “Indian real estate and the prospects for REITs” – Moody’s Investor service