REITs- A new KICK for Real Estate

On August 10, 2014, real estate sector received a KICK to boost up the cash strapped industry a new route to tap capital with the approval of setting up of Real Estate Investment Trusts(REITs) by SEBI, market regulator.

What is REIT?

RE- Real Estate	To construct homes, offices, townships
I- Investment	All investors are welcome
T-Trust	Operated by professional managers (similar to mutual fund managers)

REIT is an investment pool, which finds alternative means of financing real estate through an initial public offering (IPO), which is then used to buy, develop, manage and sell assets in real estate. This pool of real estate generates income through renting, leasing and selling of property and distributes it directly to the REIT holder on a regular basis.

REITs can be viewed as mutual funds that invest in real estate properties and/or mortgages instead of securities such as bonds and shares. REITs are financial intermediaries specializing in real estate investments and channel funds from the financial markets to the real estate sector. REITs raise the funds required through issue of shares, borrowings from institutions such as banks and insurance companies and issue a variety of debt instruments. A major benefit of REITs is that they do not have to pay tax on the income received by them, as 90% of the income is distributed to the shareholders. This distributed income is taxed only in the hands of the shareholders and double taxation is avoided. Smaller real estate investors are offered certain important qualities through the modem REITs, which previously were never accessible and available to them before:

- **Liquidity:** The greatest advantage that REITs have in comparison to other forms of real estate investment is the liquidity of the investment. REITs have helped turn real estate liquid. Shares of publicly traded REITs traded on the major stock exchanges. Illiquidity, the bane of real estate investors, is gone.
- **Security:** The security lies in the requirement that REITs pay out 90% of their income. The hefty dividends provide a cushion when the market falls.
- **Performance:** Since their inception, REITs have provided competitive investment performance. REIT market performance has exceeded returns on fixed debt instruments or direct investment in real estate.

- **Current income:** REITs annually pay out almost all their taxable income; a significant component of total return reliably comes from dividends.
- **Professional management:** REIT managers are skilled, experienced real estate professionals.
- **Portfolio diversification:** REITs let conservative investors add real estate to their portfolios without taking huge risks.

Types of REITs

- **Equity REIT Fund -** It specializes in property ownership. By directly owning, investing in or acquiring, managing, or developing real property. An equity RE fund derives its regular revenue primarily from income generated by rental and lease payments. An equity RE fund can benefit from appreciation in its underlying real properties; its income can grow through increases in rents from such properties; and cash in excess of taxable income can be produced through property depreciation.
- **Mortgage REIT Fund -** It concentrates on financing activities. A mortgage RE fund invests in the mortgages, mortgage-backed securitization and whole or sub prime loans, or portions thereof, on real property assets. In essence, mortgage RE funds loan money to real estate owners and such RE funds generate their revenue from the interest earned on such loans.
- **Hybrid REIT Fund -** As the name suggests, owns a combination of equity and mortgage interests in properties.
- **Finite Life REIT Fund** - It sets forth in the offering documents for its securities a termination date (seven to fifteen years from the RE fund's date of inception) and an investment strategy.
- **Special Purpose or Dedicated REIT Fund -** It invests in a single type of property and may be tied to a particular developer or user of real estate. Certain RE funds invest in a variety of property types (e.g., apartments, hotels, self storage facilities, restaurants, golf courses, office building).

Structure of REIT

REITs in India are required to be set up as private trusts under the purview of the Indian Trusts Act, 1882 and trust deed shall be registered under the provisions of the Registration Act, 1908

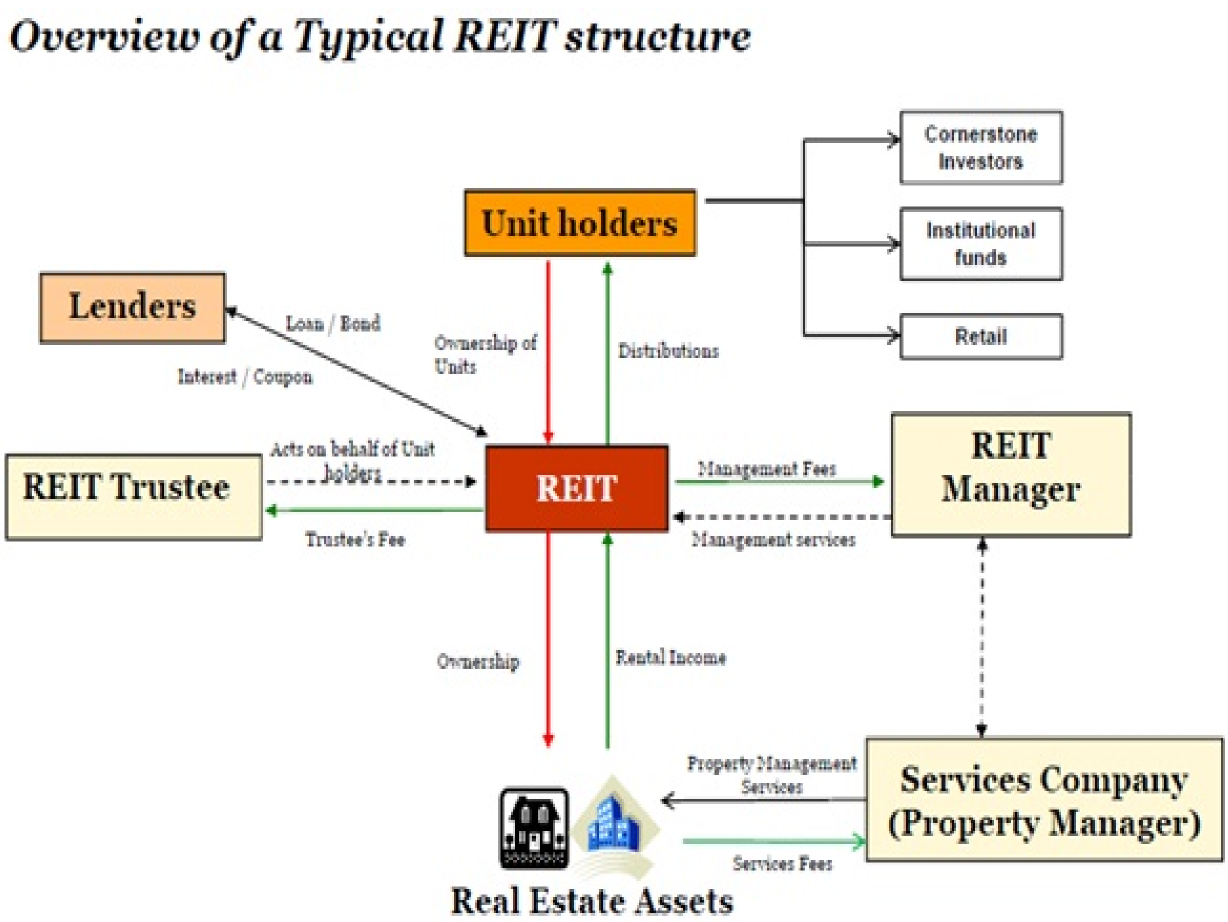
i. ***Parties*:** The parties in the REIT include the sponsor, the manager, the trustee, the principal valuer and the investors / unit holders. Sponsor sets up the REIT, which is managed by the manager. The trustee holds the property in its name on behalf of the investors. The roles, responsibilities, minimum eligibility criteria and qualification requirements for each of the abovementioned parties are detailed in the Regulations. Sponsors are required to hold a minimum of 15% (25% for the first 3 years) of the total outstanding units of the REIT at all times to demonstrate skin-in-the-game.

ii. ***Use of SPV***: REITs may hold assets directly or through an SPV. All entities in which REITs control majority interest qualify as an SPV for the purpose of the Regulations.

iii. ***Investment* and Listing:** Units of a REIT are compulsorily required to be listed on a recognized stock exchange.

iv. ***Potential income streams***: REITs are principally expected to invest in completed assets. Income would consist of rental income, interest income or capital gains arising from sale of real assets / shares of SPV.

v. ***Distribution***: 90% of net distributable income after tax of the REIT is required to be distributed to unit holders within 15 days of declaration.



Raising Funds and Listing of Securities of REIT

The trust shall be registered with SEBI post which it can raise funds through an initial offer and once listed, may subsequently raise funds through follow-on offers. The value of REIT assets shall not be less than INR 500 Crores. This is to ensure that only established players enter the market. The minimum initial offer size and minimum public float of INR 250 crore and of 25% respectively has been specified in order to ensure adequate public participation and float in the units. Further, minimum size of one unit of REIT shall be INR 1 lakh and minimum subscription size shall be INR 2 lakhs. It shall be mandatory for all units of REIT to be listed on the exchanges and shall continue to be listed on the exchange unless delisted under the Draft Regulations. Further, the funds may be raised by REITs from resident or foreign investors.

Investment Conditions and Dividend Policy

It has been mandated that 80% of the value of the REIT assets shall be in completed and rent generating properties and 20% can be invested in other assets as specified under the Draft Regulations. The investment by a REIT shall only be in assets in India. The REITs are not permitted to invest in vacant land/ agricultural land/ mortgages other than mortgage backed securities. REITs have been allowed to invest in properties directly or through a SPV. REIT shall invest in at least 2 projects with not more than 60% of the value of assets invested in one project. Further, to ensure regular income to the investors, it has been mandated to distribute 90% of the net distributable income after tax of the REIT to the investors at least on a half yearly basis.

ECA's Commitment:

- Complete assistance for making the necessary filings, applications etc. to SEBI for approval.
- Informal discussion with contact personnel within SEBI so as to perfect the application before the same is submitted.
- Follow up support at various points in time during and after the pendency of the application so as to ensure that any additional documents/records requested by SEBI are submitted in a systematic and timely manner.
- Updating on a regular basis as to the status of the pending application.

Disclaimer

Our article is based on the laws of India as on date. The laws and Rules mentioned herein are subject to changes from time to time and any such changes may affect the article. We have no responsibility to update our note for events and circumstances occurring after the date of this memorandum, unless specifically requested for.

We do not, in giving this article, accept or assume responsibility for any other purpose or to any other person to whom this memorandum is shown or in whose hands it may come unless expressly agreed by us in writing.

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