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Title: "Real Estate Investment Trusts (REITs): Development in India"

* Mr. Rohit Arora

* IIFT, NEW DELHI

ABSTRACT

The study focuses on the proposed policy rules and regulation, investment structure of Real Estate Investment Trusts (REITs) for India. The study also demonstrates the importance and benefits by REITs introduction in India and issues concerning launch of REITs in India. REITs shall be able to achieve standardization and transparency in India Real Estate. The introduction of REITs is also expected to attract more FDI into India. REITs are expected to benefit in overall infrastructure & real estate development and also the investors, hence a win-win situation. The implications and characteristics REITs are discussed and an attempt has been made to offer explanations for the same.

Keywords : REITs, real estate, investment

Introduction

One sector that has assumed growing importance owing to liberalization in economy in India is its real estate sector. The consequent increase in business opportunities has escalated demands for commercial and residential space. Real estate India is currently in a nascent stage with unlimited growth options. Though unorganized unlike its counterparts in developed countries, this sector is luring foreign investors in a big way. Indian government has realized that real estate sector's growth is key component of economic growth and any factors inhibiting its growth will have a negative impact on the economy. Introduction of Real Estate Investment Trust (REITs) will help India overcome this problem in a big way by institutionalizing the real estate sector and will also provide foreign investors with ample of opportunities to invest.

Advantages of REITs

There are various advantages for the investor in investing in REITs:

- REITs help diversify investment in the real estate sector by offering more choices to an investor within the 'real estate asset' class: ie retail, office, residential, industrial etc.
- As the REIT units are easily traded on a stock exchange, the investor's investments become more liquid.
- Since physical property has a negative correlation with stocks, investing in REITs becomes more attractive. Thus, investment in REITs, to a great extent, removes the risk of volatility linked with traditional stocks.
- Investment in physical property through REITs will induce greater transparency and order in the real estate market in India. This is because trusts are obliged to supply a flow of information about rents and capital values to their investors.
- REITs in general are valued higher than their property is actually worth. This is because REIT units are more predictable, less risky and easily traded.

Policy, Rules & Regulations

Securities & Exchange Board of India (SEBI) has come with draft guidelines in year 2008 in respect of REITs to in order to establish regulatory framework for REITs. A summary of the policies applicable to REITs is as under:

- any trustee of the REIT or a director of the real estate investment management company shall not be a direc-

tor in any other associate of the REIT or the real estate investment management company unless such person is an independent director and approval of the board of such associate of which such person is an independent director, has been obtained;

- the REIT and the real estate investment management company shall forthwith inform the Board of any material change in the information or particulars previously furnished, which have a bearing on the certificate of registration granted by it;
- appointment of a trustee of a REIT or director of a real estate management company shall be made with the prior approval of the Board;
- the REIT and the real estate investment management company shall comply with provisions of the Act and these regulations;
- no change in the controlling interest of the REIT or real estate investment management company shall be made without obtaining prior approval of the Board and the unit holders holding at-least one-half of the nominal value of the unit capital of the scheme.
- the REIT and real estate investment management company shall take adequate steps to redress the grievances of the investors within one month from the date of receipt of the complaint from the aggrieved investor.
- REIT and real estate investment Management Company shall comply with the Code of Conduct as specified in the Third Schedule.

Investment Criteria

As per draft guidelines issued by SEBI, A REIT may invest in following:

- I. The scheme shall only invest in real estate.
- II. The real estate shall generally be income-generating.
- III. The scheme may acquire uncompleted units in a building which is unoccupied and non-income producing or in the course of substantial development, redevelopment or refurbishment, but the aggregate contract value of such real estate shall not exceed 20% of the total net asset value of

- the scheme at the time of acquisition.
- IV. The offer document shall clearly disclose if the scheme intends to acquire further properties during the first 12 months from listing.
 - V. No REIT under all its schemes shall have exposure to more than 15% of any single real estate project.
 - VI. No REIT under all its schemes shall have exposure to more than 25% of all the real estate projects developed, marketed, owned or financed by a group of companies.
 - VII. The scheme is prohibited from investing in vacant land or engaging or participating in property development activities.
 - VIII. A scheme shall not lend, assume, guarantee, endorse or otherwise become directly or contingently liable for or in connection with any obligation or indebtedness of any person nor shall it use any assets of the scheme to secure the indebtedness of any person nor shall it use any assets of the scheme to secure any obligations, liabilities or indebtedness without the prior written consent of the REIT and unit holders.
 - IX. A scheme shall not acquire any asset which involves the assumption of any liability that is unlimited.

Challenges for REITs

Launch of REITs in India has been delayed because SEBI (Securities and Exchange Board of India) feels that Indian property markets lack depth and liquidity required for proper functioning of REITs. Along with the regulatory issues, there are some legal issues that are caused by our antiquated laws and which will hamper the smooth and profitable functioning of the REITs. Thus these laws need to be reformed since they also increase the risk level of a Real Estate Investment. Some of the problems that need attention before launching of REITs in India are as under-

- I. Institutional grade space-For the purpose of comparison these Real estate properties are grouped into three classes Class A, Class B, and Class C with class A being the best class of real estate. These classes represent a subjective quality rating of buildings which indicates the competitive ability of each building to attract tenants and a combination of factors like rent, building amenities, location and market perception. Except for office space some of which can be classified as grade A, organized real estate space market for other property types like health care, retail storage, apartments and specialties do not exist in the form of income producing properties.
- II. Valuation models-Currently there are no valuation models for audit and sales purposes, no requirements to be an evaluator and lack of specialized personnel in this domain.
- III. Lack of trained employee base - REITs require asset and portfolio management expertise along with development and leasing expertise whereas in India there is no Real

- Estate education at corporate or university level and is not looked as a career option.
- IV. Weak legal structure – Non uniform state taxes, title issues with land and stamp duty on every sale and purchase which can effect IRR that is Internal Rate of Return(the discount rate at which sum of your cash flows equals the initial cash investment) of REITs.
 - Stamp Duty – This is a state subject and unless the Central Government decides to make it uniform, it will be difficult and time consuming to expect any changes in the stamp duty framework. It is recommended that either there should be no stamp duty for a SEBI registered REMF or even if a minor stamp duty is imposed it should take the form of value added stamp duty structure and thus double stamp duty will be avoided in case of frequent transfer of the properties.
 - Property Taxes – this is a State/City subject. It recommended that the relevant authorities provide exemption from annual property taxes to real estate investment schemes. This would help real estate investment schemes to provide better returns to investors.
 - Records – A significant issue in dealing with properties is the custody of title and paper form of transaction. It would be very helpful if all the property records are computerized and the properties be transacted in a dematerialized format, exactly how the securities are traded right now.
 - Rent Control Act – The provisions of this Act have been amended in some of the states. Since, several states continue with the ancient Rent Control provisions and it is believed that the Rent Control Act is one of the main reasons why people are not very enthusiastic in building a house and giving it on rent.
 - Urban Land Ceilings and Regulations Act – This act lays a ceiling on the land which a person can hold in an urban area, the excess land is either to be handed over to a competent authority or is to be developed by the owner for a specified purposes only. Thus if the REIT has to come to any meaningful existence this law has to be scrapped.

Conclusion:

Real estate sector has provided the best return on investments in recent years and, with ever increasing real estate projects all across India, REITs will act as a special vehicle for investment in the sector. REITs will provide investors with an alternative investment class and an access to ownership in a large high value Real Estate project at a low ticket size.

The absence of any one of the above elements stated in the issues concerning to the launch of REITs could lead to an inefficient REITs market and trigger a collapse in the entire system, rather than a failed attempt it would be wise to build up each element over time before initiating REITs in India.

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