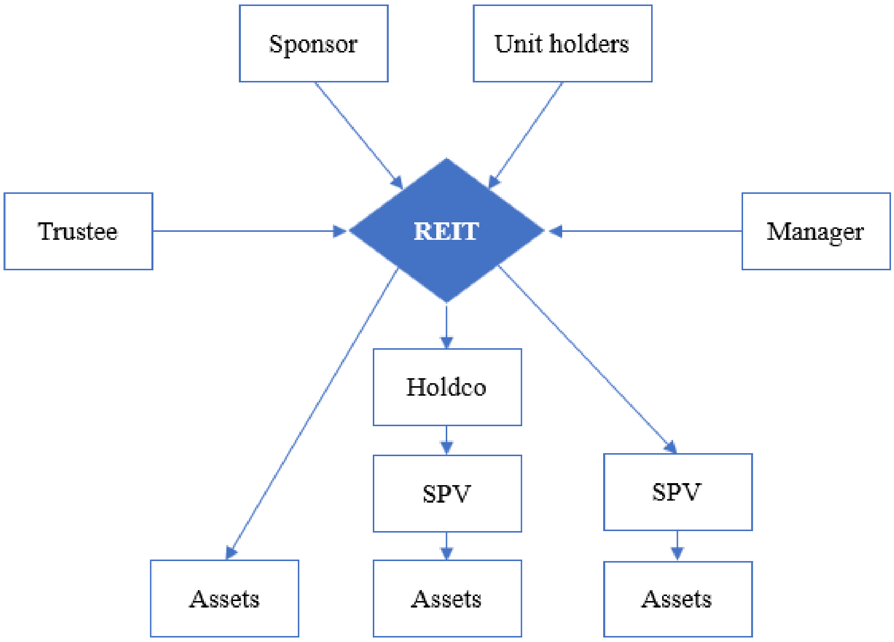
REAL ESTATE INVESTMENT TRUST (REIT)

Introduction

Real Estate Investment Trust (REIT) is a form of collective investment scheme that would enable an investor to invest in a portfolio of income-generating real estate assets. Investment is made in assets such as shopping malls, office spaces, hotels, apartments and renting or leasing of such spaces with the aim of generating income for the unitholders from the pool of funds contributed by them.

REITs are different from traditional avenues of real estate investment in the sense that it would interest even small investors to invest in high-quality assets, as the units of a REIT are publicly traded. Additionally, such portfolio of assets has the benefit of being under purview of professional management. REIT is in the form of a trust; therefore, the assets are held by a trustee on behalf of the unitholders.

Structure



- Sponsors are the persons or entities which initiate and formulate a REIT
- Unit holders acquire and hold units of a REIT
- Trustee is the person who holds the REIT assets on behalf of the unit holders
- Manager is appointed to manage the assets and investments of the REIT and to undertake its operations.
- REIT would own real estate assets and distribute the income earned from such assets to the unit holders.
- The assets may be directly owned by the REIT or through a 'special purpose vehicle' (SPV) or through a holding company (Holdco) which in turn holds those SPVs.

- SPVs are intermediary entities which are owned by the REIT which hold real estate assets and are engaged in the activity of holding and developing properties.

Features

- REIT is an alternative to financial markets.
- The shortcomings of investing in physical real estate assets can be mitigated by investing in real estate assets through REIT structure.
- Unitholders of REIT can maintain their investment liquidity just like equity investment even while investing in real estate assets.
- Listed REITs provide value appreciation in the stock market.
- REITs are managed by independent trustees, managers and are under professional management much like mutual funds.
- There are stringent regulations governing REITs so as to maintain transparency and professionalism in its operations.

Benefits

- Investors are provided with an assured regular source of income through REITs.
- It has tax pass through status and benefit from certain exemptions and concessional rates of tax on capital gains.
- REITs invest in real, tangible and income-generating assets which provide regular and has scope of wealth generation over a period of time.
- It has low correlation to other stocks and shares and provide scope for diversification of portfolio for investors.
- It ensures improved fund availability to real estate developers by sourcing long-term finance from domestic as well as foreign investors.
- It reduces the burden of liquidity trap in completed assets owned by real estate developers.
- The Indian real estate sector has been predominantly seen as an unorganised sector and corporatisation of the sector is the need of the hour to attract better foreign capital investments.

Regulation in India

The Securities and Exchange Board of India (SEBI) notified the Real Estate Investment Trusts (REITs) Regulations on 26 September 2014, thereby introducing REIT as an operational business structure in India. The Honourable Finance Minister of India made necessary amendments to the Income-tax Act vide the Finance Act (No. 2), 2014 in order to provide tax pass-through status for REITs and grant other benefits.

❖ SEBI (Real Estate Investment Trust) Regulations, 2014 – Key Considerations

- Registration

A REIT must be registered with SEBI. Application for Registration can be made by the Sponsor on behalf of the REIT. Registration shall be granted if the specified conditions in the regulation are satisfied.

- Eligibility

  - REIT is in the form of a trust with deed registered under the Registration Act, 1908
  - Trust deed has its main objective as undertaking activity of REIT and includes responsibilities of the trustee
  - Separate entities shall be designated as Sponsor(s), Manager and Trustee

- Sponsor

  - Minimum net-worth Rs 500 crores collectively, and Rs 20 crores individually
  - Experience of not less than 5 years in development of real estate or fund management in the real estate industry. In the case of a developer, at least 2 projects should have been completed

- Manager

  - Minimum net-worth of Rs 10 crores
  - Experience of not less than 5 years in fund management or advisory services or property management in the real estate industry or
  - in development of real estate
  - At least 2 key personnel should have 5 years' experience
  - At least half the Directors / Governing Board are Independent and not managers of another REIT.

- Trustee – Registered with SEBI and not an associate of the Manager or Sponsor

- Investment Conditions

  - The Investment by a REIT shall only be in holdco and/or SPVs or properties or securities or Transferable Development Right (TDR) in India and as per the investment strategy of REIT
  - At least 80% of value of the REIT assets should be invested in completed and revenue generating properties
  - Not more than 20% of the value of REIT assets should be invested in following manner:
    - Not more than 10% of value of assets should be invested in the following properties:

        - Under-construction properties to be held by the REIT for not less than 3 years after completion;
        - Under-construction properties that are part of the existing income generating properties owned by the REIT which should be held by the REIT for not less than three 3 years after completion
        - Completed and non-rent-generating properties which should be held by the REIT for not less than 3 years from date of purchase
    - Mortgage backed securities
    - Listed / unlisted debt of companies / body corporate in real estate sector
    - Equity shares of companies listed on a recognised stock exchange in India which derive not less than 75% of their operating income from Real Estate activity
    - Government securities
    - Transferable Development Rights acquired for the purpose of utilisation with respect to a project where it has already made investment; and
    - Money market instruments or Cash equivalents.
    - However, investments in developmental properties should be restricted to 10% of the value of the REIT assets.
- REIT should invest in at least 2 projects with not more than 60% of the value of assets invested in one project
- REIT should not invest in vacant land or agricultural land or mortgages other than mortgage backed securities, provided that this shall not apply to any land which is contiguous and extension of an existing project being implemented in final stages.
- In SPVs, a REIT shall hold or propose to hold controlling interest and not less than 50% of the equity share capital or interest. SPVs should not hold less than 80% of its assets directly in properties and should not invest in other SPVs
- REIT Shall not invest in units of other REITs

- Distribution Conditions

    - **REIT** – At least 90% of the net distributable cash flow shall be distributed to unitholders. A REIT should distribute at least 90% of the sale proceeds arising from the sale of property or equity shares/interest in a Hold Co/SPV, unless reinvestment is proposed within a period of 1 year
    - **SPV** – Shall distribute a minimum of 90% of its net distributable cash flows to a REIT/Holdco
    - **Holdco** – Minimum net distributable cash flows to be distributed by a Holdco to a REIT:
        - 100% of cash flows received from SPVs; and

- 90% of the cash flows generated on its own.
- Distribution to be undertaken at least once every six months

- Issue and Listing

  - Initial offer shall be a public issue
  - Value of REIT assets shall be at least 500 crores
  - Minimum offer size shall be Rs 250 crores
  - Minimum Subscription from any investor shall be Rs 50,000
  - Units shall be listed within 12 days from the Initial Public Offering (IPO)

Income-tax Implications

REIT is treated as 'business trust' under the Income-tax Act, which is defined in Section 2(13A) as,

"*business trust" means a trust registered as, —*

(i) .. .. or

(ii) a Real Estate Investment Trust under the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and

the units of which are required to be listed on recognised stock exchange in accordance with the aforesaid regulations.

Special provision for determining the taxability of income of unit holder and business trust was introduced by the insertion of Section 115UA under Chapter XII-FA of the Income-tax Act. The Section provides a hybrid pass-through status to REIT. Any income distributed by a REIT to its unit-holders shall be deemed to be of the same nature as received by the REIT.

- **REIT**
  - Income by way of interest or dividend from SPV and rental or income from assets directly owned by the REIT shall be exempt from tax in the hands of REIT
  - Capital gains is chargeable at the applicable rates and any other income is taxable at the maximum marginal rate
  - Withholding Requirements
    - Income distributed to resident which is in the nature of interest from SPV and rental income – shall deduct at the rate of 10%

    - Income distributed to non-residents which is in the nature of interest from SPV – shall deduct at the rate of 5%
    - Income distributed to non-residents which is in the nature of rental income – shall deduct tax at the rates in force
  - Reporting Requirements
    - Statement of income distributed to unit holders in Form 64A – to be furnished to the Principal Commissioner or the Commissioner of Income-tax by 30th November of the Assessment Year.
    - Statement of income distributed in Form 64B – to be furnished to the unit-holder by 30th June of the Assessment Year
- **Unitholders**
  - Income received from REIT, the proportion which pertains to interest income from SPVs and rental income shall be taxable in the hands of unitholders
  - Income received from REIT other than the above shall be exempt in the hands of unitholders
  - Capital gains on sale of units of REIT
    - Long-term gains – taxable at the rate of 10% if gains exceed Rs 1 lakh
    - Short-term gains – taxable at the rate of 15%
- **SPV**
  - Exemption from Dividend Distribution Tax (DDT) on amounts distributed to REIT provided the SPV is wholly owned by the REIT.
  - Exemption from withholding requirement on interest paid to REIT
- **Sponsor**
  - Swap of shares of SPV for the units of REIT – exempt from capital gains
  - Exchange of assets (other than shares of SPV) for units of REIT – Capital gains chargeable to tax based on period of holding
  - Capital gains on subsequent sale of units of REIT – chargeable to capital gains at applicable rates. However,
    - While determining the period of holding, the period for which shares of SPV were held shall be included.
    - Cost of acquisition shall be the cost of acquisition of shares of SPV

Embassy Office Parks REIT – India's First Listed REIT

Embassy Office Parks REIT was formed on 30th March 2017 at Bangalore, Karnataka as an irrevocable trust under the Indian Trust Act, 1882. The trust was registered as a REIT with SEBI on 3rd August 2017.

Embassy Property Developers Pvt. Ltd. was the sponsor for the trust. In August 2018, multinational asset management and private equity firm Blackstone joined the trust as a Sponsor.

- Trustee: Axis Trustee Services Limited
- Manager: Embassy Office Parks Management Services Private Limited
- Sponsor(s): Embassy Property Developments Private Limited and BRE Mauritius Investments (Blackstone group)

The REIT went for its IPO during 18th March – 20th March 2019 with the plans of raising Rs 4,750 crores. The issue was priced at Rs 299-300 a unit. The minimum bid size was 800 units and could be increased in multiples of 400. At the end of the 3-day IPO, the issue was oversubscribed by 2.57 times. Embassy REIT was met with positive response and garnered the attention of global entities to the real estate market of India.

Conclusion

REIT is internationally acclaimed business structure which has been successfully operating in various countries such as the United States, the United Kingdom, Japan, the Netherlands, New Zealand, Singapore, Germany, Hong Kong, Australia, Belgium, Canada and France. The main highlights of REITs are the liquidity it provides to the real estate investment arena and the tax pass-through status. As it is apparent from the Office Parks IPO the Indian Investor Market has embraced the REIT form of investment, and the future of the regime relies on the performance of such listed REITs. The Regulations in India are still at a nascent stage and it would be interesting to observe how it evolves. Given the growing need for housing and infrastructure combined with the strong regulatory framework mandating proper governance and transparency, the future of REITs in India looks promising.