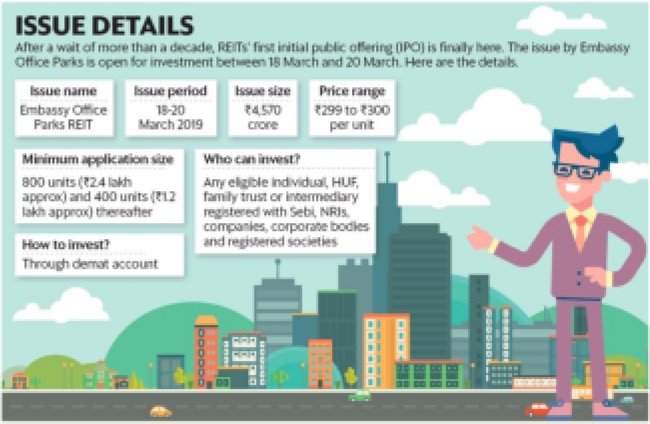
India's first REIT is finally here. Should you invest?

Though REITs are less volatile, there is no historical data for comparison in India

Ashwini Kumar Sharma
ashwini.s@livemint.com



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India's first real estate investment trust (REIT) is soon going to be a reality. The first REIT initial public offering (IPO) by Embassy Office Parks, a Bangalore-based real estate developer backed by Blackstone Group LP, a global private equity firm, is open for investment between March 18 and 20, 2019. The Embassy Office Parks REIT plans to raise ₹4,570 crore through the IPO. The per unit price of the REIT has been kept in the range of ₹299-300, with the minimum application bid of 800 units. This means that an investor will have to invest at least ₹2.4 lakh in this product. Thereafter, one can increase the lot size in multiples of 400 units.

While REITs have been a popular product worldwide for many decades, guidelines in India were formalized only recently. Read on to understand what it is and whether you should invest in it.

WHAT ARE REITs?

REITs are securities linked to real estate that can be traded on stock exchanges once they get listed. The structure of REITs is similar to that of a mutual fund. Just like mutual funds, there are sponsors, trustees, fund managers and unit holders in REITs. However, unlike mutual funds, where the underlying asset is bonds, stocks and gold, REITs invest in physical real estate. The money collected is deployed in income-generating real estate. This income gets distributed among the unit holders. Besides regular income from rents and leases, gains from capital appreciation of real estate also form an income for the unit holders.

BACKDROP

REITs have been in the making for more than a decade in India, but it was only in October 2013 that a draft guideline was issued by the Securities and Exchange Board of India (Sebi). However, lack of clarity on the tax implications on the income earned and some other related aspects were holding back the instrument from becoming a

SHOULD YOU INVEST?

Real estate as an asset class has always attracted investors, but the high ticket size made it out of reach for many. Investing in grade A office space or prime real estate location is out of the question even for many wealthy individuals. But REITs can provide an option to the retail investors to invest in high-end commercial real estate, as the minimum investment has been kept very low. "Investment in commercial real estate is a highly capital-intensive affair. REITs are a very viable addition to investment portfolios as they allow investors to participate in an asset class previously reserved only for the affluent few," said Shobhit Agarwal, managing director and chief executive officer, Anarock Property Consultants Pvt. Ltd.

After recent amendments in the REIT regulations, rating agency ICRA Ltd stated in its press release, "Current investment avenues for retail investors in income generating infrastructure and real estate projects are limited due to high minimum investment requirements for Alternate Investment Funds (AIFs) and other pooled funds. Listed infrastructure investment Trusts

> REITs shall be tax exempt except the interest income received from the SPV and rental income from property owned directly by REITs
>
> **Rakesh Nangia**

before investing in it," said Lovaii Navlakhi, managing director and chief executive officer, International Money Matters Pvt. Ltd.

Once Embassy Office Parks REIT gets listed on stock exchange, it is expected that more REITs will follow. "The listing and its subsequent performance would be closely monitored by various stakeholders—developers, institutional funds, corporate houses, etc. A successful REIT listing might result in multiple offerings by various other sponsors, including office, retail, warehousing, hospitality etc," said Anshuman Magazine, chairman and CEO, India, South-east Asia, Middle East and Africa, CBRE.

EXPECTED RETURN

Typically, commercial real estate provides returns between 8% and 10% per annum. However, grade A office space and commercial space in prime locations can provide even better returns. "The projected return on investments are anywhere between 8% and 14% in the short to medium term (post adjustment of the fund management fee), with minimum risks," said Agarwal.

But one may need to stay invested for a longer period. "As

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FDs, mutual funds and gold as regulations maintain that 80% of the REITs listings must be of rent-generating assets," said Agarwal.

TAX ON RETURNS

Before considering investments in REITs, make sure that you are aware of the taxability on returns. According to Sebi rules, REITs are to distribute 90% or more of its earnings—be it divided, interest or rent—to investors or unit holders at least twice a year. "Such income received by the investor under the Income Tax Act, 1961, shall be treated in the same nature and the same proportion as it had been received or accrued," said Rakesh Nangia, managing partner, Nangia Advisors LLP. Thus, income received by the REITs in the nature of dividend, rent, interest and distributed to its unit holder shall be deemed as dividend, rental and interest income, respectively, in the hands of the unit holder, explained Nangia. Also, "According to section 10(23FD) read with section 115UA of the Act, all the incomes received from REITs shall be exempt from taxation except the interest income received from the special purpose vehicle by the REIT and from becoming a reality. Though there was some movement in the 2016 Budget to overcome the issues, lack of clarity on a few things still remained. In the last few years, several amendments were made to make REITs more attractive. In the latest amendment on 1 March 2019, Sebi reduced the minimum investment limit in REIT to ₹50,000 from ₹2 lakh. However, since Embassy Office Parks REIT IPO was filed much before the amendment, the minimum amount is above ₹2 lakh.

Managing partner, Nangia Advisors LLP

investment trusts (InvITs) and REITs can be a transparent and stable investment option for retail investors due to the various regulatory stipulations."

Since Embassy Office Parks REIT is the first REIT in India, there is no history of REITs performance or risks. Hence, it is making advisers reluctant in suggesting this as an investment to its retail clients. "There are likely to be some teething trouble initially; so we would suggest that investors wait

longer period. "As in any asset class, one needs to keep a long term horizon, and be patient in riding out the real estate cycles that do last long. Expectations in the current market would be of low- to mid-level double-digit returns," said Navlakhi.

Typically, commercial leases are of long periods like six or nine years or even more, with rent escalation clause. Experts believe that this make REITs less volatile than other investment avenues. "REITs are far less volatile than the stock market,

MD and CEO, Anarock Property Consultants Pvt. Ltd

by the REIT and rental income from the property that is owned directly by the REITs," said Nangia. Largely, REITs will distribute most of their income in the form of dividend, which is tax free in the hand of the investor.

You need to have a demat account to invest in these products. Retail investors may need to wait till mutual funds begin to provide these products as a part of their offering. But that is at least a few years away.