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2017 HOLDS THE KEY

REAL Estate Investment Trusts or Reits is fast becoming the most preferred vehicle internationally to own real estate. As per a recent study undertaken by Ernst & Young, the global market capitalisation of Reits stands at approximately $1.7 trillion as of 2016, which is roughly a 130 per cent jump over the 2010 figure of $734 billion.

This is primarily because global property investors today are quite circumspect in backing companies whose underlying value is derived from illiquid real estate and where they may not have control over the decision-making process.

Reits, on the other hand, can play a significant role in improving transparency by putting in place sound financial practices, good corporate governance and systematic communication with the investors. As the Reit concept continues to grow globally, new entrants such as India can draw valuable insights.

For a developing country like India, real estate along with the infrastructure sector has been the backbone of the economy. However, the real estate sector in particular has been constrained due to limitation on the avenues to raise capital at competitive interest rates. Most developers are over-leveraged and in dire need of funds. With banks not very keen to lend to this sector, the projects have either been stuck or the developer is forced to borrow more at exorbitant interest rates. All this results in the eventual customer losing-out.

All stakeholders thereby considered the announcement of the Reit regulations by the Securities and Exchange Board of India (Sebi) in September 2014 a welcome step. It was expected that Reits would provide developers with an avenue to monetise completed assets and to

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raise capital.

This was anticipated to infuse liquidity in the system, which would have not only given a fillip to development of more real estate and infrastructure, but also helped in bringing cost and consequently prices down. However, these expectations have not turned into reality as not a single Reit has been listed so far with investors wanting further measures, including tax breaks, to make these instruments more attractive.

> **Expect Blackstone, DLF and K Raheja with sizeable portfolio of operational commercial assets, to set up the first few Reits**

The central government, though, has been committed to this cause and based on feedback from industry participants, it brought about a raft of changes in the regulations, particularly from a taxation perspective. This included the most sought after request that dividends distributed by the project SPV to the Reit be exempted from dividend distribution tax (DDT). Other key amendments announced recently include:

1. **Development projects:** Allowing Reits to invest up to 20 per cent in construction projects from the earlier provision of 10 per cent.
2. **Sponsors:** The limit on the maximum number of sponsors has been removed. The earlier norm provided for a maximum of 3 sponsors.
3. **Board control:** Reits are now allowed to have the right to appoint majority directors on the Board of the project SPV's.
4. **Public holding:** The public holding requirement in a Reit has been realigned i.e. Reit could be listed with only 10 per cent public holding, eventually rising to a minimum of 25 per cent within three years from the date of listing.
5. **Minimum investors:** The minimum number of unit holders, other than sponsor(s), its related parties and associates, forming part of the public will not be less than 200. In the event, if the number falls below 200, there will be no mandatory requirement to delist the Reit.
6. **Material decisions:** Key decisions such as removal of the Reit manager, material change in investment strategy, which earlier required approval of a minimum of 75 per cent of unit holders has been reduced to 60 per cent.
7. **Easing of administrative matters:**

a) Audit shall now be required only once a year instead of the earlier requirements of twice a year;

b) Time limit to submit audit report to the stock exchange increased from 45 days to 60 days from the end of the financial year.

c) Minimum experience requirement for the valuer reduced from 10 years to 5 years.

In matured markets like the US, Reit market cap as a percentage of the listed real estate market cap is approximately 80 per cent. Even in markets like South Africa and Singapore, this percentage is about 90 and 50 per cent respectively.

As far as India is concerned, whilst based on the aforesaid amendments we expect the first Reit to be listed in 2017, on an overall basis, Reit-compliant assets in India are presently estimated to be in excess of 400 million sq ft. These are primarily located in the top eight cities of the country and valued at approximately $75 billion.

Even if 20 per cent of these are listed over the next three years, the Reit market in India would be around $15 billion by 2019. To begin with, we expect the obvious names of Blackstone, DLF and K Raheja with a sizeable portfolio of operational commercial assets to set up the first few Reits in the country.

Success of these vehicles will offer long-term capital and exit opportunities for developers and their lenders. The amount so released will hopefully find its way back in development projects. It will also provide foreign investors a transparent platform to invest in liquid yield-generating assets with strong capital appreciation prospects and exit flexibility. Perhaps, a new chapter in the Indian real estate sector is now ready to unfold.

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