



# REITS

(REAL ESTATE INVESTMENT TRUST)

## AN INTERESTING INVESTMENT AVENUE FOR RETAIL INVESTORS

BY DEEP KANTAWALA

Earlier this year, the Government of India announced REIT regulations, a move much awaited by the retail sector for many years. This regulation is looked upon as a welcome step for the real estate and infrastructure industry, which has been constrained due to limitation on the avenues to raise capital. REITS will provide developers with an avenue to monetise completed assets and this in turn will infuse liquidity in the system, which will not only give a fillip to development but also bring costs, and consequently prices, down.

**REITs, on the other hand, are a more attractive investment option from the investor's point of view. Let us see how REITs can prove beneficial to an investor:**

- Since these assets are complete and trading, there is no development risk. The investor has a clear line-of-sight as to where their monies are being deployed.
- The investor is reasonably assured of the annuity income as these assets would have long signed leases with the tenants.
- REITs provide investors access to a diversified and quality portfolio as compared to single-asset exposure.
- Since the units will be listed, the investor will be able to liquidate the investment in REITs within a reasonable time-frame.
- REITs will save the smaller investors from the hassles of due diligence, paperwork and multiple taxes.
- Lastly, but most importantly, real estate and REITs provide reasonable hedge on inflation and there is potential for capital appreciation over the years.

**W**hile introduction of REITs bode well for the industry, it is also believed to bring good news for retail investors, who will now have options to invest and own portions of large annuity yield bearing assets, such as shopping malls, hotels, and office buildings, something which was otherwise out of reach for most investors. As we know, the current avenues available to a normal retail investor are quite limited; they can either invest in low-risk low-return products such as a bank deposits or tax-free bonds, or high-risk potentially high return products like listed equity. The in-between option is to invest in mutual fund schemes.

In addition, real estate is anyway a fancied asset class for Indian investors. They are open to invest in residential apartments, which provide around 3 per cent per annum rental yields on an average, as compared with bank deposits, which assure a return of 7–8 per cent per annum.

In contrast, we would tend to believe that REITs will be priced such that the effective yield will be around 10 per cent, that is, just a few basis points over the bank interest rate. As mentioned earlier, apart from steady income, REITs still offer a potential avenue for capital growth over the years – either due to upward revision of rental income or owing to yield compression.

REITs have the potential to attract significant monies currently parked in traditional financial instruments. To give some perspective, the US is the most developed REITs market in the world with a market cap of US\$ 620 billion. About one-third of this is held by the US pension funds (Source: Towers Watson and Bloomberg). In India, our retirement fund corpus is about US\$ 200 billion (Source: CII – EY Report). If the government permits and encourages our pension funds and insurance companies to invest even 10 per cent in REITs, the allocation

from this segment alone would account to as much as US\$ 20 billion, not counting the foreign inflows and the investments from retail investors given India's 33 per cent savings rate.

To best achieve the benefits from REITs, there are some more critical steps that need to be taken by the Government of India, particularly:

- Allow and encourage Indian pension funds and insurance companies to invest in such securities.
- Secure active participation from foreign investors and clarify guidelines for Foreign Direct Investment (FDI) in REITs.
- Allow parity between resident and non-resident investors in terms of tax treatment: Five per cent tax for non-resident investors on income in the form of interest should also be applicable to resident investors.
- Dividend distributed by a special purpose venture (SPV) to the REITs should be exempted from dividend distribution tax (DDT) at the SPV level.
- Lastly, since this is a new product, it is important to educate the investors how to evaluate a REIT performance and the assets owned by a REIT, and how to evaluate the performance of a REIT manager, etc. Further, from a transparency perspective, have appropriate disclosure requirements in the prospectus of the REITs. ●●●

### About the author:

Deep Kantawala, Head – Investment, ICS Corporate Advisors