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A beginning for REITs in India – SEBI finalises REITs regulations

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Real estate investment trusts (REITs) has been one of the most important vehicles for making collective investment in commercial real estate. Emanating in the USA in 1960s as a tax transparent collective investment vehicle, REITs have subsequently been used by several other countries, and have done remarkably well. REITs provide a way of making a diversified investment in realty, which is otherwise beyond the reach of individual investors thus making it popular with investors, and because REITs have demonstrably low correlation with stocks and bonds. Commercial property owners like REITs because they may often securitise the equity in commercial property, leverage it further by instruments such as commercial mortgage backed securities, and thus hold expensive real estate.

Data suggests that REITs legislation in some form exists in 37 countries of the world, and REITs have nearly a market capitalization of USD 93.6 billion.

In India, REITs have been talked about for several years now. SEBI had introduced real estate mutual funds pursuant to recommendations of an AMFI Committee, and thereafter, it came with draft regulations on REITs in 2008¹, which never took off. In 2013, a regulatory framework² was once again put on public domain, and it seemed that this time, there was a serious move to usher REITs in India. The Budget 2014 has introduced amendments in the Income-tax Act 1961 to grant tax transparency to REITs, with a part of the income taxable in the hands investors, and not in the hands of the fund, and another part taxable in the hands of the fund, but not the investors.

Indian tax provisions as well as the structure of REITs differ substantially from the US concept. US REITs typically hold properties; in India, it is presumed that REITs will be holding securities of SPVs, which eventually may hold properties. Unlike the international model, Indian law does not link tax benefits to the REIT to distribution of income by the REIT.

Yet, REITs are now ready to take off in India. With its massive commercial real estate, and fast growing cities needing more investments in commercial properties, India has a potential for REITs that has constantly been attracting attention both domestic and international investors. Whether REITs in India will go the US way, or India will evolve its own model of commercial real estate financing or financing of construction, remains to be seen.

Analysis of Highlights of the final regulations:

SEBI approved the REITs regulation in the Board Meeting held on 10th August, 2014 and issued highlights of the regulations vide Press release No 89/ 2014³. While the final regulations do not

¹ <http://www.sebi.gov.in/commreport/RealEstateReg.pdf>

² http://www.sebi.gov.in/cms/sebi_data/attachdocs/1381398382013.pdf

³ <http://www.sebi.gov.in/sebiweb/home/list/4/23/0/0/Press-Releases>



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have too many deviations from the draft version, a comparative of the final regulations vis-à-vis the draft regulations are mentioned hereunder:

Regulation Requirement	Proposed regulation on REITs	Final Regulations on REITs	Our Observation
Governing Code	SEBI (Real Estate Investment Trusts) Regulations, 2013	SEBI (Real Estate Investment Trusts) Regulations, 2014	
Legal Structure	Trust set up under Indian Trusts Act, 1882	Trust set up under Indian Trusts Act, 1882	Same as proposed in draft regulations
Parties to the REITs	Trustee, Sponsor, Manager and Principal Valuer	Trustee , Sponsor and Manager	Principal Valuer no longer considered as party to REITs
Maximum number of sponsors that REITs can have & Unit holding obligation	<ul style="list-style-type: none"> Such a concept was not included in draft regulations. Sponsor was defined as under: sponsor” means any person and its associates, if any, who set(s) up the REIT and assigned as such at the time of application made to SEBI and who hold(s) not less than 25% of the units of the REIT at the time of making application to SEBI for registration; Sponsors were to hold minimum 25% of total units prior to initial offer; 25% to be held for a period of 3 years from date of listing of such units; Units exceeding 25% were to be held atleast for a period of 1 year from date of listing; Hold at all times 15% of the outstanding units of REITs. 	<ul style="list-style-type: none"> Maximum three sponsors each holding minimum 5% of units of REITs Collectively to hold not less than 25% of the units of the REIT for a period of not less than 3 years from the date of listing After 3 years, required to hold 15% collectively throughout the life of REITs 	Multiple sponsors permitted subject to a maximum of three. Each to hold minimum 5% of the units of REITs. Rest conditions on the limits remain same for collective holding by sponsors as draft regulations to hold 25% of the units of REITs for 3 years from listing and 15% thereafter.
Eligibility for Trustee	Shall be a SEBI registered Debenture Trustee and shall not be an associate of Sponsor, Manager and Principal Valuer and not less than 50% of its directors are independent and are not related parties to the REIT	Shall be a SEBI registered Debenture Trustee and shall not be an associate of Sponsor/ Manager.	Requirement of independent directors has been done away with.



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Listing requirement	Mandatory	Mandatory	Same as proposed in draft regulations
Investment conditions	At least 90% of the value of the REIT assets ⁴ shall be in completed rent generating properties ⁵ .	At least 80% of the value of the REIT assets needs to be in completed and revenue generating properties;	Investment condition liberalized to some extent.
Other Permissible Investments	Remaining 10% can be invested in : <ul style="list-style-type: none"> • Developmental properties⁶; • Listed or unlisted debt of companies; • mortgage backed securities; • Equity shares of companies listed on a recognized stock exchange in India which derive not less than 75% of their revenues from Real Estate activity; • Government securities; • Money market instruments or Cash equivalents; 	Remaining 20% can be invested in <ul style="list-style-type: none"> • Developmental properties (restricted to 10% of the value of the REIT assets); • Listed or unlisted debt of companies/body corporate in real estate sector; • mortgage backed securities; • Equity shares of companies listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity; • Government securities; • Money market instruments or Cash equivalents; 	Investment in listed and unlisted debt of body corporate engaged in real estate sector permitted.
Restriction on investment in Project	Investment upto 100% of the corpus of the REIT was permitted in one project subject to the condition that minimum size of such asset is not less than Rs. 1000 crore	<ul style="list-style-type: none"> • REITs shall invest in at least 2 projects • Maximum 60% of value of assets can be invested in single project 	<ul style="list-style-type: none"> • Restriction of investing in minimum 2 projects introduced and a cap of 60% has been introduced for each project.
Valuation of assets	<ul style="list-style-type: none"> • Full valuation including a physical inspection of the properties at least once a year and a six monthly updation in 	<ul style="list-style-type: none"> • Full valuation on a yearly basis and updation of the same on a half yearly basis and declare NAV within 	Same as proposed in draft regulations

⁴ “REIT assets” means real estate and other assets held by the REIT whether directly or through a Special Purpose Vehicle

⁵ ‘rent generating property’ shall mean property of which not less than 75% of the area has been rented/leased out

⁶ Provided that such investment shall only be in properties which shall be held by the REIT for not less than three years after completion and shall be leased out;



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	<p>the valuation</p> <ul style="list-style-type: none"> NAV to be declared within 15 days from date of valuation 	<p>15 days from the date of such valuation/updation.</p>	
Distribution of Income	<p>Atleast 90% of the net distributable income after tax of the REIT shall be distributed as dividend to the unit holders.</p>	<p>Atleast 90% of the net distributable income after tax of the REIT shall be distributed as dividend to the unit holders atleast on half yearly basis</p>	<p>Condition of periodicity of distribution of income has been specified in the final regulations.</p>
Mode of Investment in properties	<ul style="list-style-type: none"> Directly or through SPVs holding atleast 90% of their assets directly in such properties and shall not invest in other SPVs. The REIT shall hold controlling interest and not less than 51% of the equity share capital of the Special Purpose Vehicle 	<ul style="list-style-type: none"> Directly or through SPVs holding atleast 80% of their assets directly in such properties and shall not invest in other SPVs. The REIT shall hold controlling interest and not less than 50% of the equity share capital of the Special Purpose Vehicle 	<ul style="list-style-type: none"> Holding not less than 50% may not have controlling interest the rationale for the amendment is not understood as for any entity to get a controlling interest in another it should be not less than 51%
Initial offer restrictions	<ul style="list-style-type: none"> REIT should be registered with SEBI Value of REIT assets⁷ should be atleast ₹ 1000 crores. Minimum offer size should be atleast ₹ 250 crore. Minimum public⁸ float should be of 25% 	<ul style="list-style-type: none"> Value of REIT assets should be atleast ₹ 500 crores. Minimum offer size should be atleast ₹ 250 crore 	<p>Limit on value of assets have been reduced which means it may be possible for more sponsors to consider setting up REITs</p>
Minimum Subscription and unit size	<p>Under both the initial offer and follow-on public offer, minimum subscription amount shall be atleast ₹ 2 lakhs. The unit size shall be of ₹ 1 lakh.</p>	<ul style="list-style-type: none"> Under both the initial offer and follow-on offer, rights issue, QIP, minimum subscription size for units of REIT shall be Rs 2 lakhs. The units offered to the public in initial offer shall not be less than 25% of the number of units of the REIT on post-issue basis Trading lot shall be Rs. 1 	<p>Same as proposed in draft regulations</p>

⁷ "Value of the REIT assets" means aggregate value of all the assets under the REIT as assessed by the valuer

⁸ 'public' shall not include any related party to the REIT or any person as may be specified by the Board



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		lakh	
Borrowings and Deferred payments	<ul style="list-style-type: none"> The aggregate consolidated borrowings and deferred payments of the REIT shall never exceed 50% of the value of the REIT assets. If the aggregate consolidated borrowings and deferred payments of the REIT exceed 25% of the value of the REIT assets, for any further borrowing: <ol style="list-style-type: none"> credit rating shall be obtained from a credit rating agency registered with SEBI; and approval of unit holders shall be obtained in the manner specified. 	<ul style="list-style-type: none"> The aggregate consolidated borrowings and deferred payments of the REIT shall never exceed 49% of the value of the REIT assets. In case such borrowings/deferred payments exceed 25%, approval from unit holders and credit rating shall be required 	Do not understand the rationale of changing the leverage threshold from 50% to 49%.

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