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A Descriptive Study of Real Estate Investment Trust in India

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Abstract: The Indian Mutual Funds (MFs) has witnessed tremendous growth in the current reforms. Since 2000 the MFs segment has introduced various diversified products and has undergone several innovations. Real Estate mutual funds and Real Estate Investment Trust (REIT) functions in a similar way to mutual funds and offers investors an easy way to invest in real estate. It provides the advantage of diversification and long-term capital appreciation. REITs are a great as well as regulated way of investing in the real estate sector as they are listed on the stock exchanges. Long-term investors have the potential to reap the rewards of dividend income and capital appreciation if held for a long duration. Since their inception in year 2019 REITs have emerged as one of the most viable investment alternatives, outperforming other financial products. The REIT market opens the door to small and medium investors, and takes away almost all the concerns of the commercial market risks. It enables investors to generate stable returns through rent-yielding cash flows. Now, as the country's commercial real estate sector emerges from the negative effects of the pandemic, REITs have tremendous growth potential in India. As the commercial office market bounces back, there is huge potential for more stock getting added to the existing REITs segment. REITs were introduced in India by the Securities and Exchange Board of India (SEBI) in 2007, almost 50 years after they were first incorporated as a viable investment avenue. Subsequently, there were regulations framed to facilitate the operational functions of these investment funds, which were revised and reformed over years. REIT companies listed on the Indian stock exchanges are monitored and regulated by the Securities and Exchange Board of India to ensure adherence to industry practices and safeguard the interest of the investors. As SEBI goes ahead with the promotion of REITs, this paper closely looks into the structure of the REITs, its regulations and implications, and further suggests strategies for sustainable development of real estate sector in India through the REITs in the new regime.

Keywords: Real Estate, REFs, REMFs, REITs, SEBI.

INTRODUCTION

A Real Estate Investment Trust (REIT) is an entity or investment fund that is created with the main purpose of channelising the funds that could be invested in operational functioning or ownership of the real estate to further generate stable income for its investors.

The structured formation and implementation of REIT funds, ensure that the investors of all financial capacity get an opportunity to investment and thus contribute to the growth and development of the real estate sector. In India, the government is taking necessary steps to ensure the funds reach the real estate sector by continuous promoting awareness for citizens' participation.

There have been developments in this regard by way of the SEBI by introduction of Real Estate Regulation Bill. It ensures the rights of the investors and protecting the interest in real estate development funds.

For a company to qualify as a REIT, the SEBI has laid certain mandatory requirement. The companies are required to distribute around 90% of its income in the form of dividend to its investors. There is also strict restrictions for undertaking investment in properties that are capable of generating revenues in the form of rent. Whereas only a small portion of capital can be invested in under construction properties.

The REIT industry boasts a diverse profile that offers investors a chance to make investments in real estate-related funds. REIT's could be classified as Equity REITs and Mortgage REITs. Equity REITs hold commercial properties like offices, hotels, shopping centres, malls condominiums and draw most of their revenues through rent from such properties. On the other hand, mortgage REITs look over the financing of both residential as well as commercial properties thus generating income from interest earned on the investment in mortgages or mortgage-backed securities (MBS). It provides a somewhat low risky and well-diversified investment opportunity to get into real estate investments. The holdings of REITs are transparent as there is compulsory valuation of its properties every year along with a half-yearly audit. As per the guidelines, REITs have to invest in at least two projects with the value of one asset comprising 60% of the investment. There is low risk exposure in REITs as a minimum of 80% of the assets are invested in revenue generating projects that are completed. The remaining 20% is allocated to investments in under-construction properties, mortgage-based securities, equity shares deriving at least 75% of income from real estate activities, government securities, money market instruments, cash equivalents etc.

REVIEW OF LITERATURE

Earlier studies on Real Estate Funds (REFs), including its variants like Real Estate Investment Trusts (REITs), are very scarce in India, probably because this concept has been recently introduced in Indian Market. A few studies have analysed the significance of real estate development, like, the huge development potential of real estate investments, the need for attracting FDI into the real estate sector, strategies for attracting FDI into real estate etc. Studies in the relevant areas are briefly discussed hereunder:

Manoj P K (2003) in his paper, 'Retail Credit- Strategies for Success in the Emerging Scenario' published in IBA Bulletin has suggested strategies for the sustained growth of the retail credit portfolio of banks, which primarily comprises of housing finance, as a safe means of increasing business and also kick-starting the then recession-hit industry of India. Through its Centre for Microfinance, the research agency Institute for Financial Management and Research (IFMR) (2007) in its Working Paper No. 19, 'Housing Microfinance: Designing a Product for the Rural Poor' has pointed out the vital significance of promoting Housing Microfinance (HMF) in addressing the chronic housing problem in India. The real housing problem in India is that of the poor and marginalized, like those in the LIG (Low Income Group) and EWS (Economically Weaker Sections) groups. Only through alternative financing models like HMF these sections could be served as they are beyond the access of the formal housing finance system in India.

Manoj P K (Ed.) (2009) in his edited book, 'Emerging Technologies and Financing Models for Affordable Housing in India; has discussed many housing finance models and technologies which could promote affordable and low cost housing in the Indian context.

National Housing Bank (NHB) in its annual publication as of FY 2014, NHB (2014), "Trend and Progress of Housing in India", for the year 2014 (the latest available, as of now) has pointed out that policy-based efforts like providing tax sops for the Real Estate Investment Trusts (REITs), as announced in the Union Budget of 2014-15, could result in extracting new growth opportunities through Rental, Affordable and Senior Citizen Housing projects that can increase the depth of the industry. It has also been pointed out that REITs have been successfully used as instruments for pooling of investment in several countries and such instruments will definitely attract long-term finance from foreign and domestic sources including the NRIs. REITs would reduce the pressure on the banking system while also making available fresh equity. Besides, this report points out the incentives for REITs as per the Union Budget 2014-15, according to which complete pass through for the purpose of taxation and a modified REIT-type structure for infrastructure projects as the Infrastructure Investment Trusts (Inv ITs) may attract long term finance from foreign and

domestic sources including the NRIs. The research report by the agency IFMR (2015) entitled ‘Affordable Housing Finance Sector: Overview’ makes a detailed analysis of the need, relevance and significance of affordable housing in India in the context of the national goal ‘Housing for All by 2022’ adopted by the Government of India. The vital role that HFCs has to play in this context is highlighted in the report. The fact that there has been a gradual re-emergence of HFCs since 2013, with HFCs surpassing the CBs in growth rates and significantly improving their market share is specifically pointed out in the IFMR research report. In a recent paper, Manoj P K (2015), “Real Estate Investment Trusts (REITs) in India: Relevance and Significance in Emerging Scenario”, published in *International Journal of Trade & Global Business Perspectives*, has studied the relevance of REITs in enhancing the liquidity of the developers thus enabling them to offload their unsold housing inventory, and reducing the risk of the lenders of various real estate projects etc. The potential of REITs in reviving the real estate sector in India, thus enabling the overall economic development of the nation because of the vast forward and backward linkages of this sector has been pointed in the paper. In a recent industry report on *Real Estate*, India Brand Equity Foundation (IBEF) (2016) has studied the prospects, problems, growth pattern, competitive structure of the real estate sector in India. It is pointed out in the report that real estate is the fourth largest sector in terms of FDI inflows. It has been reported that the market size of the sector is estimated to grow by 1.92 by 2020. Using Porter’s five forces model IBEF has studied the competitive position of the industry and has accordingly suggested the strategies for more effective growth of the industry in the days to come.

In view of the foregoing, it is noted that though there are many studies on the real estate sector in India and the role of FDI in the real estate sector, studies focusing on REITs are scarce. Manoj P K (2014), “Real Estate Investment Trusts (REITs) in India: Relevance and Significance in Emerging Scenario”, published in *International Journal of Trade & Global Business Perspectives*. Manoj P K & L. N. Dash (2012), “Role of Real Estate Funds for the Faster Growth of Indian Real Estate Sector” published in *J S International Journal of Economics*. This study seeks to bridge the above research gap by making a closer look into the significance of REITs in view of the recent policy initiatives by SEBI to relax the norms for REITs and the favourable governmental policies.

OBJECTIVES OF THE STUDY

- (i) To study the significance of housing and real estate sector for the economic development of India and the role of REITs;
- (ii) To suggest strategies for the growth of housing and real estate sector in India through REIT.

RESEARCH METHODOLOGY

The methodology adopted is descriptive and exploratory in nature. The study is descriptive to the extent that it describes the developments in the field of real estate sector in India with a focus on the role of REITs in the faster development of this upcoming and crucial sector, and the role played by SEBI in promoting REITs. The study is majorly based on the secondary data which has been collected from previous studies and from authentic sources.

Indian REIT Performance in 2021

India currently has three REITs listed with SEBI, as also two InvITs (Infrastructure Investment Trusts). Infrastructure investment trusts are conceptually similar to REITs, but usually own and operate infrastructure properties like roads, bridges, dams, and power grids whereas REITs generally have business and office spaces. Though the introduction of REITs and InvITs in India is quite new but then too REIT is able to set a recent trend having caught up in the Indian real estate market.

The three Indian REITs are Embassy REIT (started in 2017), Brookfield REIT (commenced in 2019), and Mindspace REIT (began in 2020). All three of them are regulated by SEBI and traded on both the BSE and

the NSE. The two publicly-listed InvITs are India Grid Trust set in year 2016, and IRB InvIT is one of India's largest roads and highway developers.

The Embassy company, in association with Blackstone Group, owns and operates 42.6 million sq ft. portfolio of infrastructure, office parks, and buildings. Embassy Office Parks REIT assets comprise of eight office parks, city centre office space, four hotels, and a 100 MW solar power set-up supplying renewable energy. Embassy is Asia's first as well as the largest REIT in terms of area owned. The net operating income (NOI) witnessed an increase of 30% with Rs 6213 Mn along with 100% payout ratio.

The Brookfield India Real Estate Trust is India's only institutionally managed public commercial real estate vehicle with a portfolio of 35 million sq ft. area. The NOI reported at Rs 6600 Mn for 2021-22. It also extended dividend pay-out worth Rs 181.7 crore to unitholders. Mindspace business, with a consolidated leasable area of 30.2 msf, has a strong portfolio of office spaces across cities such as Mumbai, Pune, Hyderabad, and Chennai. The REIT reported an NOI of over Rs 358 crore during 2021-22.

The India Grid InvIT currently has 20 portfolios which fetched returns worth 56% for its unitholders during FY 2020-21, while the IRB InvIT fared even better with 83% returns for the same period.

India REIT: In 2022 and beyond

REITs offer higher returns in comparison to other investment avenues like fixed deposits, recurring deposits, government bonds and other classes and that too with relative less risk exposure. The liberalisation of regulations over the last decade has also permitted the entry of foreign investors and had helped to boost the Indian real estate market. This has made investing in Indian REITs more convincing.

A crucial factor that helps maintain a positive outlook for REITs is the inherent strength of commercial real estate in the country. India has approximately 650 million sq.ft. of Grade A office space, of which 310-320 million sq.ft. is REIT-able stock. The current 3 REITs cover 87 million sq.ft. – Mindspace 31 million sq.ft., Embassy 42 million sq.ft. and Brookfield 14 million sq.ft. In such a scenario, when SEBI has reduced the minimum application value will make REITs a more viable option for retail investors. Similarly, SEBI has also announced a reduction in the number of trading units required in order to encourage more potential investors in this sector. REIT companies were earlier restricted to raise money from the bond market which has now been amended. This step will enable more developers to take the issue REIT for raising money for their projects rather than being solely dependent on debt instruments. This in turn will enhance investor trust as developers have to fully comply with SEBI regulations.

With these announcements, SEBI has helped to encourage more investors who were earlier reluctant to enter the market due to high risk. The increase in number of retail participation, will help in reduction of institutional allotment. Thereby, reducing the fluctuations in the commercial real estate market segment.

The current GDP forecasts indicating a growth of 8-9%, the commercial real estate sector will perform strongly and generate good returns. The owners will get better quality and expert managed infrastructure and investors will get a choice of REITs across asset classes spread throughout the country. There will also insure greater transparency in the market.

In financial year 2022 there may not be any new issue of REITs but existing REITs will continue to perform well in the long run. Finally, there is no denying that REIT could have its own challenges, a professionally managed and publicly traded REIT presents tremendous potential and growth to varied classes of investors.

CONCLUSION

From the above discussion we can conclude that the REIT space in India has been witnessing a gradual upward movement despite the aftermath of the pandemic. In spite of the COVID blues, the REITs companies have ensured that they deliver value to the entire set of stakeholders, including investors, sponsors, trustees, and more.

REIT though successful in many countries, but its success and future in India entirely depends upon the regulation of SEBI and importantly the acceptance of retail investors in India. SEBI is continuously

conducting awareness workshops for promoting the investment in real estate assets among the general public.

This may encourage commercial REIT trend in India and could well open space for its expansion into residential, retail, and hospitality segments in the years to come. As this segment is directly linked to the office and commercial real estate in India, REITs, with their key objective of monetizing rent-yielding office assets, they have a promising future in the years to come.

REITs provide the advantage of quick and easy liquidation of investments in the real estate markets which otherwise is time consuming. The growth and development of any country is highly dependent on the rate of infrastructure development which in turn contributes highly to its economic growth. The basic idea of REIT investments is to boost the existing structure of the real-estate finance industry so that the investments made in this sector are channelised for optimum growth. It is with this purpose that the REITs function in India to make industry-backed financing more structured.

REITs are innovative and lucrative investment but may not be suitable for every investor. The REIT as an instrument has not been very successful due to several factors like limited and variable rental income for the commercial real estate and the performance of commercial real estate varies with the geographical locations. The regulatory body SEBI has liberalized policy related to REITs, but further amendments in taxation benefits are required to lure the investors to make REITs a real success in India and attract the desired investors.

In light of the above, it is imperative for the Government to adopt fast-track taxation and other regulatory amendments and reforms to promote REITs in India.

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