International Journal of Scientific & Engineering Research, Volume 7, Issue 3, March-2016 1265
ISSN 2229-5518

Need Of REIT & It’s Prospective Implication In India

Ajinkya .A. Jagtap

Abstract— A Real Estate Investment Trust is a company which modelled after mutual fund that owns or finances income-producing real estate. It provides investors regular income streams, long-term capital appreciation and diversification. REITs typically distribute all of their taxable income as dividends to shareholders. On those dividends shareholders pay the income taxes. REITs are strong income vehicles because REITs must pay out at least 90 percent of their taxable income in the form of dividends to shareholders .Office buildings, hotels, shopping malls, apartments, resorts, warehouses, self-storage facilities and mortgages or loans are the income producing real estate assets of REITS.India has also tried to establish REIT. Mainly due to global slowdown and resultant impact on the property markets in India the earlier attempts to introduce REITs in India did not succeed. The other aspect is mortgage backed securities which is not permitted to invest, resulted real estate market opportunities shrinkage. However, SEBI announced the draft consultation paper on Real Estate Investment Trust (REIT) Regulations on October 10, 2013. Earlier in 2008, SEBI had issued certain draft regulations for introducing REITs. I-REITs (REITs in India) will invest in completed rent generating properties in India (to comprise minimum 90% of net asset value) and mortgage backed securities, would issue securities, which would be listed on stock exchanges and. In earlier phase I-REITs are planned to be available only to high net worth individuals and institutions to develop the market but now there are some relaxations introduced.

---

1 Introduction

1.1 REAL ESTATE INVESTMENT TRUST

A Real Estate Investment Trust is a company which modelled after mutual fund that owns or finances income-producing real estate. It provides investors regular income streams, long-term capital appreciation and diversification. REITs typically distribute all of their taxable income as dividends to shareholders. On those dividends shareholders pay the income taxes. REITs are strong income vehicles because REITs must pay out at least 90 percent of their taxable income in the form of dividends to shareholders .Office buildings, hotels, shopping malls, apartments, resorts, warehouses, self-storage facilities and mortgages or loans are the income producing real estate assets of REITS.

Most REITs specialize in a single type of real estate. Take an example of apartment communities. There are office REITs, retail REITs, industrial REITs, healthcare REITs, and residential REITs. A REIT must acquire and develop its real estate properties primarily to operate them as part of its own investment portfolio, which are opposed to reselling those properties after they have been developed.

Real estate investment trusts have been around for more than fifty years. In 1960 Congress established REITs to allow individual investors to invest in income-producing real estate in large scale. Without actually having to go out and buy commercial real estate, REITs help individual investors to earn a share of the income produced through commercial real estate ownership.

More than 30 countries around the world have established REIT regimes. The spread of REIT approach to real estate investment around the world has also increased awareness and acceptance of investing in global real estate securities.

India has also tried to establish REIT. Mainly due to global slowdown and resultant impact on the property markets in India the earlier attempts to introduce REITs in India did not succeed. The other aspect is mortgage backed securities which is not permitted to invest, resulted real estate market opportunities shrinkage. However, SEBI announced the draft consultation paper on Real Estate Investment Trust (REIT) Regulations on October 10, 2013. Earlier in 2008, SEBI had issued certain draft regulations for introducing REITs. I-REITs (REITs in India) will invest in completed rent generating properties in India (to comprise minimum 90% of net asset value) and mortgage backed securities, would issue securities, which would be listed on stock exchanges and. In earlier phase I-REITs are planned to be available only to high net worth individuals and institutions to develop the market but now there are some relaxations introduced.

In the budget of 2014, Finance Minister Mr. Arun Jaitley introduced the law for setting up REIT, following which, in September 26, 2014 the securities and exchange board of India released rules for establishing REIT.

2.EARLY DEVELOPMENT OF REIT

The US House of Representatives describes the primary motivation for introducing real estate investment trusts (REITs) as “to provide all investors with the same opportunity to invest in large-scale commercial real estate that previously was open

ISSN 2229-5518

only to large financial institutions and wealthy individuals through direct investment in such real estate".

A REIT is a method of collective investment vehicle that invests in a diversified pool of professionally managed, investment grade real estate. The assets can be office, residential, retail, hospitality and industrial or logistics property. Some REITs concentrate in one asset type, while others offer a mixed portfolio. Investors should generate steady income generated from rent under lease contracts and potentially capital growth by investing in real estate.

REIT markets started in US in 1960s, followed by Australia in the early 1970s. From the late 1990s, and particularly the early 2000s, Asian governments have been passing legislation which allows the establishment of REITs, giving tax concessions which replicate the taxation treatment of REITs globally, including in particular the US and Australia.

2.1 DEVELOPMENT AFTER 1956

The spread of the REIT approach to real estate investment around the globe has increased awareness and acceptance of investing in global real estate securities. As of June 2014, the global index included 456 stock exchange listed real estate companies from 37 countries representing an equity market capitalization of about $2 trillion (with approximately 78% of that total from REITs).

The first REITs largely consisted of mortgage companies.There was significant expansion in the industry in the late 1960s and early 1970s. The growth was due to the increased use of mortgage REITs in land development and construction deals. The Tax Reform Act of 1976 authorized REITs to be established as corporations in addition to business trusts.

The Tax Reform Act of 1986 also affected REITs. The legislation included new rules designed to prevent taxpayers from using partnerships to shelter their earnings from other sources. Three years later, REITs witnessed significant losses in the stock market.

With creation of the UPREIT, Retail REIT Taubman Centers Inc. launched the modern era of REITs in 1992. In an UPREIT, the parties of an existing partnership and a REIT become partners in a new "operating partnership." The REIT typically is the general partner and the majority owner of the operating partnership units, and the partners who contributed properties have the right to exchange their operating partnership units for REIT shares or cash. The industry fought beginning in 2007 as the global financial crisis started. In response to the global credit crisis, listed REITs started deleveraging and re-equitizing their balance sheets. Listed REITs and REOCs raised $37.5 billion in 91 secondary equity offerings, nine IPOs and 37 unsecured debt offerings as investors continued to act favorably to companies strengthening their balance sheets following the credit crisis.

From the end of February 2009 through the end of October 2014, stock-exchange listed Equity REITs have posted total returns of 312% (28.4% per year) and all stock-exchange listed REITs have gained 295% (27.5% per year), overtaking the return of 217% (22.6% per year) in the broad stock market and 210% (22.1% per year) in large-cap stocks.

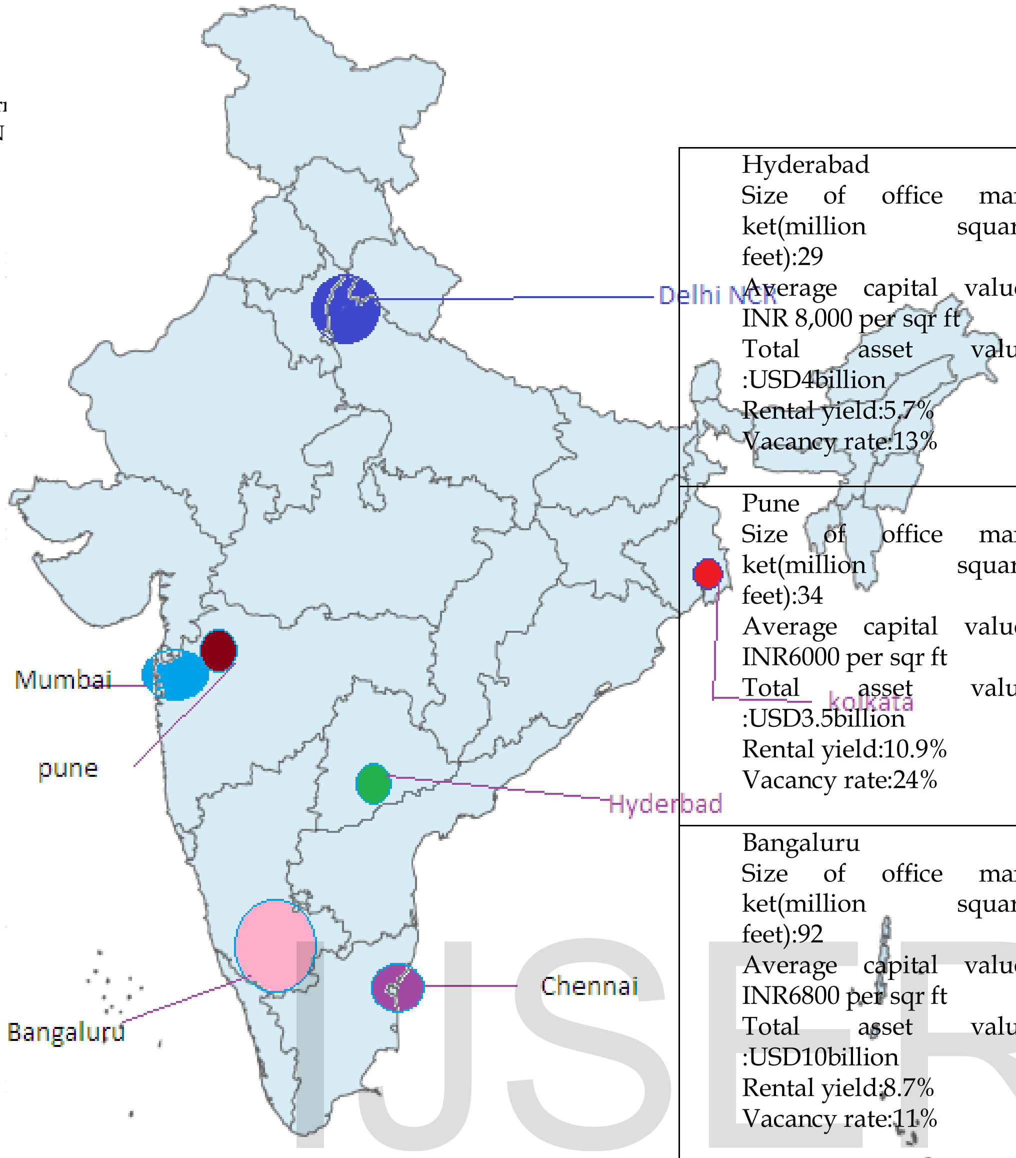
2. DEVELOPMENT OF REIT IN INDIA

1 Over the past two decades, the global commercial real estate sector has seen a dramatic shift from private sector to public markets. The Indian real estate industry's growing demand for additional sources of funds and the success story of global real estate investment trusts (REITs) is compelling enough to encourage the implementation of a similar regime in India with requisite adjustments. Normally, REITs invest in completed, revenue generating commercial properties and distribute a major portion of the earnings among investors. For retail investors they have recognized to be an attractive investment option.

2 Generally, global REITs have been able to generate significant market traction. Apart from other advantages, REITs bring in increased transparency in the sector by adopting better corporate governance, disclosures and financial transparency practices. Being required to comply with the corporate governance, information disclosure and financial reporting standards lay down by the regulator; REITs will bring in a regular information exchange and availability in the public domain. As a result of which higher professionalism with a clear emphasis on issues such as risks attached to titles and transaction costs. Equity financing would certainly improve the debt-equity balance in the market. REITs will also provide a vehicle for addressing non-performing assets (NPAs). Sale of such NPAs to REITs will have a double effect—realization of the real estate's true value and ease in liquidating the NPA once the high value of the real estate is removed from its books. This will help financial institutions regain strong profitability. It is evident that Indian real estate is seeing rising demand due to changing demographies and growing urbanization.

3 As per estimates by the United Nations, India has the highest rate of change for urban population among the BRICS nations. With advanced funding option such as REIT, it's time that the economy experiments and provides the industry a globally competitive edge. Apart from making the real estate sector financially and economically mature, REITs will give common investors a huge opportunity to share in the gains of this asset class. Along with the provision of investing with less risk than investing in under-construction properties, it will also provide an income source in form of rentals, which, in turn, could be a good hedge against inflation as the underlying income will adjust itself to the cost of living. Moreover, being a more liquid instrument among the current range of property investment vehicles, REITs hold the potential of improving investors' investment profile through diversification of investment base and increasing stability of income source.

4



Hyderabad Size of office market(million square feet):29 Average capital value: INR 8,000 per sqr ft Total asset value :USD4billion Rental yield:5.7% Vacancy rate:13%	Chennai Size of office market(million square feet):39 Average capital value: INR6,200 per sqr ft Total asset value :USD4billion Rental yield:7.6% Vacancy rate:15%
Pune Size of office market(million square feet):34 Average capital value: INR6000 per sqr ft Total asset value :USD3.5billion Rental yield:10.9% Vacancy rate:24%	Mumbai Size of office market(million square feet):65 Average capital value: INR16000 per sqr ft Total asset value :USD19billion Rental yield:9.1% Vacancy rate:20%
Bangaluru Size of office market(million square feet):92 Average capital value: INR6800 per sqr ft Total asset value :USD10billion Rental yield:8.7% Vacancy rate:11%	

5

6

7

8 From overall statistics the opportunity of real estate growth can be assumed in tier I cities. Large real estate developers like Sobha, Raheja and DLF have led to organization of the market in the Tier I cities, but the Tier II and Tier III cities still demonstrate the traits of an unorganized market Whilst the Indian real estate market still lacks transparency and liquidity compared to more mature real estate markets. As REITs in most cases, that owns or finances income-producing real estate it can provide investors stable income stream, diversification & long term capital appreciation. At a time when India's realty sector has been struggling for alternate avenues of funding other than traditional banks & financial institution, REITs can act as a key enabler for capital markets in the country. This provides investors with low entry levels into the sector as well as with exit options. Its successful implementation and development will depend on regulatory environment, market condition & issuers investors. India has plenty of completed real estate assets ready to be packaged into REITs. The total value of office real estate pan-India stood at USD 34 billions on of end 2013.This statistics do indicate a strong potential investment opportunity. In addition REITs will provide a new source of funds to Indian developers, struggling to reduce debt, while giving investors the access to benefit from regular income & appreciation from the country's property market. The draft guidelines issued by the SEBI for REITs is a move in right direction to bring about the desired transparency in the system with making an organised market with highly involvement of managers with certain specific rules & regulation. It will attract the much needed institutional money into the sector. It is linked with economic growth of India based on some clarity on potential & economical front. The uncertainties are still looming large & there is need some concrete policy measures to bring the economy back on track.

9 So REITs can be a game changer for the realty sector but lack of clarity on taxation and regulatory aspects might create some doubts for attracting foreign investors. A few amendments with respect to market need will definitely give REITs the required push and eventually move the real estate industry in an upward direction.

10 TAXATION

11 REITs are beneficial not only for the sponsors but also the investors. It provides the sponsors an exit opportunity thus giving liquidity and enables them to invest in other

ISSN 2229-5518

projects. Also, it provides the investors with an avenue to invest in rental income generating properties in which they would have otherwise not been able to invest, and which is less risky compared to under-construction properties. REITS are a great instrument to tap cash flow into the Indian economy, and help smaller investors' access income-generating real estate assets. This will give the Indian real estate market more depth. Providing tax incentives to REITs for investment in housing, especially the affordable housing sector, will increase chances of its success.

12 Tax efficiency is a critical factor to the success of REITs that the Government considers further amendments to the income tax act to provide a tax efficient and stable regime for REITs in India.

13 Some of the key challenges in the current taxation regime at various level of REIT structure are elaborated below.

14 For sponsors, capital gains tax benefit will be given only when shares of SPV holding the real estate are transferred to a REIT against units of a REIT, and not when real estate is directly transferred to a REIT. This will add to unnecessary corporate layer imposed between the REIT and the real estate asset, which could result in a tax leakage of about 45% (corporate taxes of 30% at the SPV level and distribution tax of 15% on dividends, exclusive of surcharge and cess)

15 The exchange of shares of the SPV for units of REIT would happen at the market value and would result in profit in the hands of the sponsor, which could entail tax liability in the hands of the sponsor under the provisions of minimum alternate tax (MAT) even though there is no taxation under normal provisions.

16 When a unit holder sets off units of a REIT, long term capital gains ("LTCG") (units held for more than 36 months) would be exempt from tax and short term capital gains ("STCG") would be taxed at 15% since units would be treated as listed securities under the ITA. Also, securities transaction tax is to be payable on transfer of units of a REIT.

17 The transfer of shares of the SPV into a REIT in exchange for issue of units of the REIT to the transferor (or the sponsor) will be exempted from capital gains tax under the ITA. Even though, the units of a REIT would be listed on a recognized stock exchange, specific amendments to exclude units of REITs from the exemption of tax on LTCG / STCG if sold by the sponsor; and the cost of acquisition of the shares of the SPV by the sponsor will be deemed to be the cost of acquisition of the units of the REIT in his hands.

18 Any Interest income that is received by the REIT from an SPV, it is exempted from tax, while investor will be subject to tax on same. There would be a levy of withholding tax that would be imposed on distribution by the REIT to its unit holder. This withholding tax would be at the rate of 10% if paid to resident unit holders and 5% if paid to non-resident unit holders

19 Taxation of income earned by a REIT that is not in the nature of capital gains, interest income or dividend will be in the hands of the REIT at the maximum marginal rate i.e. 30%. Such income, while distributed by the REIT to the unit holders would be exempt in the hands of the unit holders.

20 SURVEY RESULT:

21 According to investors REIT is beneficial as it gives opportunity to the investors to increase their real estate portfolio with minimum capital, calculated risk and assured dividends. The real estate industry will benefit with capital inflows through REITs. It gives transparency and fairness to investors. It opens up new avenue for investors on lines of MF. It will bring liquidity in industry & dependency on bank will be reduced. REITs have diverse range of assets to invest in different geographical locations. It is relatively more liquid than real estate. It can improve property market.

22 About its success in India they are positive keeping eye on SEBI's rule regulation and also expecting good well established player's entry into Indian REIT market.

23 They are interested in investing with returns varies from 9-15%. Some are not interested due to age factor. Some will invest if they get returns 5 % more than F.D interest rates.

24 The expecting risks in Indian market depend on new business, fluctuation in market conditions (speculative markets), management quality, dividend distribution policy and its frequency of distribution.

25 Maximum investors are giving positive response that REITs will survive in India but in long term basis. It will help boost GDP and will also address the issues such as job creation, fiscal deficit, taxation.

26 Demand – supply scenario can affect the REITs stocks. Other factors that affect REIT stocks are infra development plans, cement & steel prices, urbanisations, political will gold and Foreign exchange rate.

27 By 20 years they are expecting 10% global investable real estate share and growth minimum 5% in urban India.

28 Definitely it will attract foreign investor with some relaxation in SEBI's rules and regulations and wide spread communication is required for its success in India

3. Acknowledgment

I take this opportunity to express my deep sense of gratitude to my guide, **Prof. A. R. Chavan** for his continuous guidance and encouragement during this study. Without his valuable suggestion and encouragement this would not have been possible. It is because of his experience and wonderful knowledge I can fulfill the partial requirement of completing the Seminar- I report within the stipulated time.

I would also like to thank **Prof. S. S. Deshmukh** HOD, Civil. Engineering

I acknowledge with thanks, the assistance provided by departmental staff, central library and computer faculty staff. I find myself spellbound to acknowledge thanks to my father and mother for their silent support, patience, encouragement and affection without which this work would never have been possible and I thank all my colleagues for their valuable co-operation and coordinate which was available time to time.

4. REFERENCES

[1] C. J. Kaufman, Rocky Mountain Research Laboratories, Boulder, Colo., personal communication, 1992. (Personal communication)

[2] D.S. Coming and O.G. Staadt, "Velocity-Aligned Discrete Oriented Polytopes for Dynamic Collision Detection," *IEEE Trans. Visualization and Computer Graphics*, vol. 14, no. 1, pp. 1-12, Jan/Feb 2008, doi:10.1109/TVCG.2007.70405. (IEEE Transactions)

[3] S.P. Bingulac, "On the Compatibility of Adaptive Controllers," *Proc. Fourth Ann. Allerton Conf. Circuits and Systems Theory*, pp. 8-16, 1994. (Conference proceedings)

[4] Journal of surveying, construction and property vol.2 special issue 2011

[5] www.aprea.asia

[6] KPMG flash news

[7] PWC report

[8] India-financing.com

[9] www.spphirecapitalpartners.co.uk

[10] Google.com

[11] Economics times of India

[12] Property line India offices reports

[13] CREDAI data

[14] IPF investment property forum

5. Conclusion

From the above analysis and survey we must say that the success of REITs in any country depends on that country's capability to customise the rules and regulations in such a way that they fit into their own markets. The introduction of REITs will help India's market become more institutionalized and will provide a new source of cash to Indian developers that have struggled to reduce debt with interest rates among the highest in Asia. The legislation has come at the right time so REIT could be the game changer for India's property sector. Globally REITs have been beneficial in improving transparency and standards and improving the professionalism of markets and we are expecting the same in India. India has the entire gradient to witness a successful REIT regime in the long term. A well framed efficient regulatory system is required which can ensure the best interest of investor, the market and the economy with introducing some instruments in terms of higher yield and less risk to both domestic and foreign investors. Definitely India has the right underlying dynamics to fuel the growth of the industry .Only time will tell if the potential is fully realized.