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The American satirist and author Mark Twain once famously said **"Buy land, they're not making it anymore"**. While he might have intended the statement as a joke, in India, land, and by extension Real Estate has historically been a preferred investment. Traditionally, for Indians, investment in Real Estate has meant buying residential property primarily for self residence.

A less commonly availed option of investing in Real Estate is commercial property such as shops, office space, etc. However, this type of Real Estate investment often features large ticket sizes of Rs. 1 crore or more especially in Metro and Tier 1 cities. Add to this the hassles of getting appropriate clearances, getting long-term leases from viable tenants, ensuring timely receipt of rents and you stop wondering why few individuals choose this investment option.

There is of course another way to gain exposure to real estate – investment in equity stock of listed Real Estate companies. But these investments are prone to market risk and though real estate is the underlying asset, these investments can be more appropriately termed as mid or small-cap equity investments with a high degree of volatility. As a result, very few individuals are able to include Real Estate in their portfolio. However, over the past couple of years, a new way to invest in commercial Real Estate has emerged in India – Real Estate Investment Trust or REIT.

REITs are stock market listed investments that allow investors exposure to Real Estate without having to purchase or manage properties by themselves. In this blog, we will discuss key aspects of REITs including what they are, how they work, their performance, taxation, and also whether you should invest in them.

What are REITs?

The concept of REITs originated in the United States when President Eisenhower signed the REIT Act title into law as part of the Cigar Excise Tax Extension of 1960. The US Congress had originally created the REIT to provide US investors with the opportunity to invest in and profit from

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diversified, large-scale professionally managed portfolios of US Real Estate.

REITs are similar to Mutual Funds as they allow multiple investors to pool their investments and in both cases, the assets are professionally managed by a designated Manager. But, while the underlying asset of Mutual Funds is usually Equity, Debt, Gold, or a combination of these, the underlying asset in the case of REITs is primarily Real Estate Holdings or loans secured by Real Estate.

When a Real Estate Company decides to form a Real Estate Investment Trust, it becomes the Sponsor for the REIT and appoints a Trustee. The Trustee holds the Real Estate Assets of the Trust in its Trusteeship and these assets are no longer directly controlled by the Sponsor. A REIT may control its Real Estate Holdings either directly or through the formation of a Special Purpose Vehicle (SPV). In the case of REITs, the SPV is a domestic company that holds the Real Estate Assets on behalf of the REIT, and as per regulations, the Trust holds a 50% or higher stake in the SPV.

Next, the Trustee appoints a Manager to manage the Real Estate Assets on behalf of the Trust and also make investment decisions. After the Manager is appointed, the REIT can be registered. Once registered, a REIT can raise money through the sale of units either publicly on stock markets or through private investors.

At the most basic level, a REIT unit represents part ownership of the Real Estate Assets held by the Trust and this entitles the unit holder to a share of the income generated by the REIT. Typically, a REIT is required to pay out at least 90% of its Net Taxable Income to its unitholders in the form of dividends and interest. In the next section, you will get to know the different types of REITs available globally.

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Different Types of REITs

Based on the type of Real Estate holdings, the following are the different types of REITs available globally:

Retail REITs: These REITs are required to invest at least 24% of their assets into commercial retail such as shopping malls and freestanding retail stores.

Residential REITs: These are Real Estate Investment Trusts that own and operate manufactured housing as well as rental apartment buildings.

Healthcare REITs: As suggested by the name, these trusts primarily invest in and operate healthcare-focused Real Estates such as hospitals, nursing facilities, retirement homes, and medical centers.

Office REITs: These primarily invest in and operate office space. Their main source of income for this type of REIT is thus rental received from tenants with long-term leases.

Mortgage REITs: In the case of these REITs, an estimated 10% of investments are made into mortgages instead of physical Real Estate.

Now that we have covered some basic details of REITs, let's how REITs in India operate.

REITs in India

In India, the concept of Real Estate Investment Trust is relatively new and the first guidelines were introduced by SEBI (Securities Exchange Board of India) in 2007. The current SEBI guidelines related to REITs in India were approved in September 2014.

There are currently only 3 REITs available for investment in India – Embassy Office Parks REIT, Mindspace Business Parks REIT, and Brookfield India Real Estate Trust. Going forward, other leading names in the Real Estate Sector like DLF and Godrej are also expected to introduce REITs.

In India, a REIT has a 3 tiered structure comprising a Sponsor, a Manager, and a Trustee each of whom performs key functions for the Trust. Their key roles and responsibilities, as specified by SEBI, are as follows:

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As stated before, a REIT is an investment trust that owns real estate assets, comprising of a Sponsor, a Manager and a Trustee, each of whom is vested with certain key responsibilities to be undertaken with respect to the trust.

1. Sponsor

A sponsor is a person who forms the REIT. They set up the REIT and transfer the property owned by them i.e., the real estate assets to the trust. Therefore, a builder or developer desirous of raising funds through REIT generally plays the role of a sponsor.

2. Trustee

The trustee is a person appointed by the sponsor, who holds the assets on behalf of the unitholders.

3. Manager

The trustee appoints a manager who manages the REIT assets and is responsible for making investment decisions. The manager is typically a private company closely-held by the sponsor.

4. Unitholders

They are the beneficiaries of the trust, who become indirect holders of REIT assets by subscribing to the units of the REIT. Unitholders can be Indian residents or foreign investors.

5. Independent valuer

Apart from the sponsor, manager and trustee, a REIT appoints a credible independent valuer who values the REIT's assets at periodic intervals.

Additionally, auditors, registrar and transfer agents, merchant bankers and custodians may be appointed by the manager, to carry out activities incidental to the operation of REITs and additionally, meet the

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requirements of law. The assets belonging to a REIT may be directly owned by the REIT or through a "special purpose vehicle" (SPV) or through a holding company (Holdco) that, in turn, holds such SPVs.

6. SPV

A SPV is a company in which either a REIT or Holdco, holds or proposes to hold, an equity stake or interest of at least 50%. The SPV holds at least 80% of its assets, directly in properties, and is not allowed to invest in any other SPVs nor engage in any activity, other than holding and developing a property and any incidental activity relating to such holding or development.

7. Holdco

A Holdco is a company or a limited liability partnership in which the REIT holds or proposes to hold an equity stake or interest of at least 50% and which, in turn, has made investments in other SPV(s), which ultimately hold the real estate property or properties.

The Holdco does not engage in any other activity other than holding of the underlying SPV(s), holding of real estate or properties and any other activities pertaining to and incidental to such holdings. The aforementioned structure allows the retail investors with an opportunity to invest in commercial real estate and generate stable passive income.

Eligibility of REITs

As the name itself denotes, a REIT is a trust and thus must be setup in accordance with the provisions of the Indian Trust Act, 1882, duly registered under the SEBI REITs Regulations. It is imperative that the trust deed of a REIT desired to be established is duly registered, which specifies the main objective and the responsibilities of the Trustee(s). It must be further ensured that no disciplinary actions are taken by the SEBI or any other regulatory authority against the REIT or any related party. For a company to qualify as a REIT, it is vital that the following criteria are satisfied:

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1. 90% of the income must be distributed to the investors in the form of dividends;
2. 80% of the investment must be made in properties that are capable of generating revenues;
3. Only 10% of the total investment must be made in real estate under-construction properties;
4. The company must have an asset base of at least INR 500 crores;
5. Net Asset Value must be updated twice in every financial year

How to Invest in REITs

REITs entered the Indian market only in April, 2019 when Embassy Business Park REIT became the first REIT to be listed in India. Unlike in other countries such as the U.S. wherein, private REITs and public non-listed REITs are also regulated; in India, only public REITs registered with SEBI are in place as of now.

REITs are listed and traded on stock markets just like exchange traded funds (ETFs), as a result, purchasing units on the stock market is the best way to invest. Thus, a Demat account is mandatory for investing in REITs in India. Just like ETFs, the price of REITs units on stock markets changes depending on both the demand for units as well as the performance of the REIT. To encourage investors, SEBI has made two significant amendments to rules of investing in REITs in India –

(i) the previous minimum requirement of INR 50,000/- for an investor to invest in units of REITS, has been done away with. Presently, the minimum investment amount required is INR 10,000/- INR 15,000/- only, for investment through initial public offerings and follow-on offers; and

(ii) the minimum lot size of REITs traded has been reduced from 100 units to 1 unit.

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Benefits of Investing in REITs

The following are some key benefits of investing in REITs:

1. **Diversification**

REITs allow you to diversify your investment portfolio through exposure to Real Estate without the hassles related to owning and managing commercial property. This diversification allows you to go beyond the usual asset classes of Equity, Debt, and Gold as part of your overall Asset Allocation Strategy.

2. **Small Initial Investment**

As mentioned earlier, one of the key problems associated with making Real Estate investments is the large ticket size especially in the case of commercial properties. REITs require a much smaller initial investment of around Rs. 50,000 to provide similar portfolio diversification benefits.

3. **Professional Management**

Properties owned by a REIT are managed professionally. This ensures smooth operations and with no effort on your part towards managing Commercial Real Estate.

4. **Regular Income Generation**

REITs generate income from rental collections and are required to mandatorily distribute 90% of this income to investors as dividends and interest payments. In this way, REITs provide regular income to investors.

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Limitations of Investing in REITs

However, there are also a few limitations that an investor must be aware of:

1. **Limited Options**

Currently there are only 3 REITs and 1 International REIT Fund of Fund in India. This significantly limits the choices for investors.

2. **Low Liquidity**

While REITs are listed and traded on Stock Markets, the number of market participants is currently low especially with respect to retail investors. As a result, selling REIT investments profitably might be a challenge especially in an emergency. This results in low liquidity of the investment.

3. **Taxable Dividend**

Any dividend or interest earned from REITs is completely taxable in the hands of the investor according to the applicable slab rate. Thus those in the 30% tax slab will lose a substantial portion of their dividend income as taxes. Another important aspect to consider before investing in REITs are the taxation rules and that is discussed next.

Further, REITs are required to invest in at least two projects and investment in any one project should not be more than 60% of the value of assets owned by the REIT itself. Further, REITs are restricted to investing only in the assets situated in India.