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Article

An overview of Real Estate Investment Trusts in India

By **Kritika Krishnamurthy**

Real estate is the second largest employer after agriculture and is slated to grow at 30% over the next decade. The Indian real estate market size is expected to touch \$180 billion by 2020.¹ The sector has attracted a host of major Indian businesses in the last few years but continues to remain largely unorganized and poorly regulated with no technical standards for quality of construction and other parameters. Moreover, Indian banks were reluctant to lend to this sector and foreign direct investment was also highly restricted resulting in many unfinished projects due to lack of funds.

The Securities and Exchange Board of India (SEBI) initially introduced draft regulations on Real Estate Investment Trusts (REITs) in 2008, but the same was never implemented. Meanwhile, REITs have become ubiquitous across the globe with their introduction in USA way back in the sixties, Australia in the seventies and a host of other nations in the 2000s including in jurisdictions closer to home such as Japan, South Korea and Singapore. In 2013, SEBI issued a consultation paper and it seemed that this time, there was a serious move to usher REITs in India, though the tax aspects

of REITs were unclear. Budget 2014 has now introduced amendments in the Income-tax Act, 1961 to provide tax benefits to REITs. SEBI has also finally issued SEBI (Real Estate Investment Trusts) Regulations, 2014 with effect from 26th September 2014 ('SEBI REIT Regulations') providing a detailed regulatory framework for establishment and operation of REITs in India. With these recent developments, REITs are finally ready to take-off in India.

Meaning and features

REITs in India are in the nature of private trusts registered with SEBI, to be listed on the stock exchange and with the object of primarily investing in completed, revenue generating real estate assets in India, the earnings of which shall be mostly distributed to their unit-holders. The REITs shall be governed by the 'Trust Deed' (registered under the Registration Act, 1908), the SEBI REIT Regulations and since REITs are in the nature of private trusts, by Indian Trusts Act, 1882.

Parties to the REIT

The key gears in running the REIT machinery shall be as follows:

	Sponsor	Trustee	Manager
<i>Role</i>	The person who shall primarily setup the REIT and designated as such at the time of registration with SEBI	The person who shall hold the REIT assets in trust for the benefit of the unit holders and designated as such by the trust deed	A company, LLP or body corporate incorporated in India which manages assets and investments of the REIT and undertakes operational activities of the REIT as provided in the Investment Management Agreement

¹ The Confederation of Real Estate Developers' Associations of India (CREDAI), 2014 at <http://www.credai.org/indian-economy>

	Sponsor	Trustee	Manager
<i>Number</i>	Not more than three	At least two	At least one
<i>Net Worth</i>	Collectively, not less than INR 100 crore Individually, not less than INR 20 crore	No specified requirement	If LLP, net tangible assets of not less than INR 10 crore Any other body corporate or company, net worth of INR 10 crore
<i> Holding</i>	Individually, not less than 5 % of the number of units of the REIT on post-initial offer basis Collectively, 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 collectively 15% of the units and individually, not less than 5% of the outstanding units of the listed REIT throughout the life of REITs	Cannot invest in units of REIT	Not required. No restriction in relation to investment in units of REIT
<i>Experience</i>	The sponsor or its associate(s) has not less than five years experience in development of real estate or fund management in the real estate industry Where the sponsor is a developer, at least two projects of the sponsor should be completed	The trustee must have the wherewithal with respect to infrastructure, personnel, etc. to the satisfaction of SEBI (no notification issued till date)	The manager or its associate has not less than 5 years experience in fund management or advisory services or property management in the real estate industry or in development of real estate The manager has not less than 2 key personnel who each have not less than 5 years experience in fund management or advisory services or property management in the real estate industry or in development of real estate
<i>SEBI Registration</i>	Not Required	Required under SEBI (Debenture Trustees) Regulations, 1993	Not Required

Further, the sponsor(s), manager and trustee must all be separate and non-connected entities. The trustee cannot be an associate of the sponsor(s) or manager. The REIT shall pool funds by issue of units to unit holders. The SEBI REIT Regulations prohibits grant of preferential

voting rights or issue of multiple classes of units amongst unit holders.

Investment

The REITs can only invest directly in real estate assets or properties, securities, Transferable Development Rights (TDRs) in India or indirectly

in all of the above through Special Purpose Vehicles (SPVs). Real estate has been defined to mean land and any permanently attached improvements to it, whether leasehold or freehold including buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other

assets incidental to the ownership of real estate. However, real estate shall exclude mortgage and assets falling in the definition of ‘infrastructure’ under notification of Ministry of Finance dated 7th October 2013. The following thresholds are applicable to the REIT’s investments:

Threshold (% value of REIT Assets)	Allowed Investments
Not less than 80%	Completed and rent generating properties subject to prescribed conditions
Not more than 20%	(i) listed or unlisted debt of companies or body corporate in real estate sector excluding any investment made in debt of the SPV; (ii) mortgage backed securities; (iii) 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 as per the audited accounts of the previous financial year; (iv) government securities; (v) unutilized FSI of a project where it has already made investment; (vi) TDR acquired for the purpose of utilization with respect to a project where it has already made investment; (vii) money market instruments or cash equivalents.
Not more than 10%	(i) under-construction properties to be held by REIT for not less than 3 years after completion; (ii) under-construction properties which are a part of the existing income generating properties owned by the REIT to be held by the REIT for not less than 3 years after completion; (iii) completed and not rent generating properties to be held by the REIT for not less than three years from date of purchase

Further, an REIT is required to invest in at least two projects and the maximum threshold limit for a single project is 60% of value of REIT’s assets.. REITs are prohibited from investing in other REITs, vacant land, agricultural land and mortgages other than mortgage backed securities. However, this does not include any land which is contiguous and extension of an

existing project being implemented in stages.

Sources of revenue

REIT and SPV collectively - Not less than 75% of the revenues, other than gains arising from disposal of properties, shall be, at all times, from rental, leasing and letting real estate assets or any other income incidental to the leasing of such assets.

REIT individually - Not less than 75% of value of the REIT assets proportionately on a consolidated basis shall be rent generating.

Revenue distribution

SPV is liable to distribute 90% of its net distributable cash flows to the REIT in proportion to its holding in the SPV. Similarly, the REIT is liable to distribute 90% of its net distributable cash flows to the unit holders. All such distributions shall be made not less than once every 6 months in every financial year and shall be made not later than 15 days from the date of such declaration. Further, if any property is sold by the SPV/REIT, 90% of the sale proceeds shall be distributed to the REIT/unit holder, as the case may be. However, if the REIT/SPV proposes to re-invest the sales proceeds in another property, the REIT/SPV shall not be liable to distribute the sales proceeds.

Mandatory listing and related requirements

Every REIT is required to make an initial offer by way of public issue within 3 years from the date of registration with SEBI failing which it shall be required to surrender its registration certificate. However, SEBI has the discretion to extend this period by one year.

REITs can make an initial offer only upon fulfillment of following requirements:

- Value of assets is not less than INR 500 crores (including value of the specific portion of the holding of REIT in the underlying assets or SPVs);
- The units proposed to be offered to the public is not less than 25% of the total

outstanding units of the REIT and the units being offered by way of the offer document. For initial offer of value greater than INR 500 crore rupees, if prior to the initial offer units of the REIT are held by the public, the units proposed to be offered to the public shall be calculated after reducing such existing units for satisfying the 25% requirement;

- The offer size is not less than INR 250 crores;
- Minimum subscription shall be INR 2 lakh per applicant.

Any subsequent issue of units by the REIT may be by way of follow-on offer, preferential allotment, qualified institutional placement, rights issue, bonus issue, offer for sale or any other mechanism as per SEBI norms. For practical purposes, it is advisable for the REIT to provide for the above mechanisms in its trust deed.

Foreign investment

Although the SEBI REIT Regulations allow subscription of units by foreign investors, foreign direct investment (FDI) in trusts other than venture capital funds (VCFs) is prohibited under the present FDI Policy. Corresponding changes shall be required to enable foreign investors to invest in REITs. However, the foreign investors may invest in the SPVs of the REIT subject to fulfillment of conditions prescribed under the extant FDI Policy.

Stamp duty implications

Although direct tax benefits have been declared by the government for REITs under the

Finance Act, 2014 to come into effect from 1st April 2015, no stamp duty waivers or remissions have been declared by the government till date. The transaction cost for physical assets in India is as high as 5%- 12%. Comparatively, REIT friendly jurisdictions like Singapore offer low transaction costs of 4-6% with better asset quality than India. To make India a more attractive destination for REIT investors, it is advisable for the Indian government to offer stamp duty remissions to REITs.

Conclusion

Although real estate sector is one of the major propellants in the economic growth of India, real estate laws are in a nascent stage in India. So REITs may be considered a step in the right direction. Between 2008 and 2013, private equity funds invested more than INR 452 billion (\$7.6 billion) in Indian real estate, of which more than a third was spent on office

and retail assets². The introduction of REIT structure in India may emerge as an alternate and new source of funding as well as one of many potential exit strategies that can be explored by investors. Various corporates are also considering cashing in on their real estate holdings by setting up REITs. According to recent news reports Blackstone Group and its partner Embassy Group have evinced interest in listing their Indian properties through REIT and they have already hived off their portfolio of assets into a separate vehicle, taking first step towards listing a trust in India. What will perhaps be on the real estate sector wishlist now are stronger system for title determination and verification and ancillary must-haves like title insurance which are already available in many other countries promoting real estate.

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Notifications & Circulars

Company Law Settlement Scheme and disqualification of directors: Ministry of Corporate Affairs has clarified that in case of companies who have filed their balance sheets and annual returns on or after 1-4-2014 but prior to launch of Company Law Settlement Scheme 2014, disqualification under clause (a) of Section 164(2) of Companies Act 2013 (disqualification of directors) shall apply only for prospective defaults. General Circular No. 41/2014, dated 15-10-2014 has been issued in this regard. MCA has further decided to extend the Company Law Settlement Scheme, 2014. General Circular

No. 44/2014, dated 14-11-2014 issued in this regard extends the Settlement Scheme till 31st of December, 2014.

CSR activities – Contribution to Swachh Bharat Kosh and Clean Ganga Fund: Ministry of Corporate Affairs has decided to allow contributions towards Swachh Bharat Kosh set up by the Central Government for promotion of sanitation and towards the Clean Ganga Fund also set up by the Central Government for the purposes of rejuvenation of river Ganga, as eligible activities which may be included by companies in their Corporate

² According to data from Cushman & Wakefield

Social Responsibility (CSR) Policies. Notification G.S.R. 741(E), dated 24-10-2014 issued for this purpose amends Schedule VII of the Companies Act, 2013.

Compounding of contraventions under FEMA: Regional Offices of Reserve Bank of India have been delegated more powers to compound various offences relating to contraventions of Foreign Exchange Management Act, 1999 (FEMA). As per RBI's A.P. (DIR Series) Circular No. 36, dated 16-10-2014, Regional Offices can now compound offences relating to delay in submission of Form FC-TRC, and taking on record transfer of shares by an investee company in the absence of such certified form. Further FED, CO Cell at New Delhi has been delegated power to compound contraventions relating to acquisition and transfer of immovable property outside and in India, establishment of branch

office, liaison office or project office in India and contraventions falling under Foreign Exchange Management (Deposit) Regulations, 2000. There is no monetary limit in respect of such compounding, except in cases of Regional Offices located in Kochi and Panaji.

Consolidated Account Statement (CAS) for all securities assets: Securities and Exchange Board of India (SEBI) has directed all depositories, asset management companies and mutual fund RTAs to facilitate a single consolidated view of all the investments of an investor in Mutual Funds (MF) and securities held in demat form with the depositories. Asset management companies and MF RTAs have been asked to share the requisite information with the depositories on monthly basis. Circular CIR/MRD/DP/31/2014, dated 12-11-2014, analyzing various options, has been issued by SEBI for the said purpose.

Ratio Decidendi

Electricity tariff – Subsidization of other business by electricity distribution business: The Electricity Appellate Tribunal has held that even 'Local authority' cannot subsidize its other business from their electricity distribution business. The second proviso to Section 51 of the Electricity Act requires the distribution company engaged also in 'other business' to maintain separate accounts of its distribution business and the other business to ensure that the distribution business neither subsidises such other business nor encumbers its distribution assets in any way to support such business. However, as per third proviso, Section 51 is not applicable to a local authority engaged

in the business of distribution of electricity before commencement of the Electricity Act. The Apex Court in 2011 had held that third proviso of the Section 51 exempts BEST (Brihanmumbai Electric Supply and Transport Undertaking, respondent here) as a local authority from the requirements of the provisos also.

The Tribunal however held that Supreme Court in the earlier case did not give any finding that local authority can or should subsidize the other business from the their electricity distribution business, thereby allowing BEST to load its entire deficits or losses from its transport business on to the electricity consumers. It was held that the distributing company can

utilise the assets of distribution business for other business (business of transportation here) and in that case there is no need for them to maintain a separate account to ensure that distribution business does not subsidise the other business, but allowing substantial subsidy to other businesses would amount to complete exclusion of applicability of Electricity Act, which is not permissible. Provisions of Section 61(d), 62, 64 and 65 of the Electricity Act were also noted in this regard. [*Indian Hotels Co. Ltd. v. Maharashtra Electricity Regulatory Commission - Appeal No.155 of 2013, decided on 31-10-2014, Appellate Tribunal for Electricity*]

Competition law - No provisions for collective dominance: Competition Commission of India has held that the conduct of members of an association jointly, is not hit by the provisions of Section 4(2)(a) of the Competition Act, 2002 as there is no provision for collective dominance. The Commission in this regard noted that the Director General during its investigation had observed that no single enterprise (member of the two associations) was in a position to dominate the market within the meaning of explanation to Section 4 of the Act, and that the dominance has to be seen and analyzed on the basis of ability and strength of an enterprise qua its competitors only. Further in respect of abuse of dominance by the Ministry of Textiles, the Commission was of the view that the conduct/functioning/ administration of the Ministry in discharge of its statutory duties under the Jute Packaging Materials (Compulsory Use in

Packaging Commodities) Act, 1987 does not render the Ministry an 'enterprise' as provided in Section 2(h) of the said Act.

The CCI, however, held that the provisions of Section 3(1) read with Section 3(3)(a)/3(3)(b) were contravened after it noted the conduct of control in determination of price by the members of an association, inasmuch as the prices were published in Daily Price Bulletin by the association and followed by its members. It was also held that limiting and controlling production and supply in the market in a concerted manner through understanding by the members of associations was in contravention of the provisions of Section 3(3)(b) of the Competition Act. [*Indian Sugar Mills Association v. Indian Jute Mills Association - Case No. 38 of 2011, decided on 31-10-2014, Competition Commission of India*]

Disclosure of securities acquired on invocation of pledge: Securities Appellate Tribunal has held that when a public financial institution acquires shares of a listed company on invocation of pledge, it is also required to make disclosure under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to the stock exchange. The Tribunal in this regard rejected the plea of exemption under proviso to Regulation 29(4) of the said Regulations. Regulation 29(4) provides for disclosure by the pledgee when shares are taken by way of encumbrance under a pledge. Exemption however is provided under the proviso to scheduled commercial banks or public financial institutions from such disclosure in such cases.

The Tribunal in the present case, deliberating on the meaning of expression “such requirement” in the proviso, held that exemption under the proviso is relatable only to deemed acquisitions (when shares are pledged) specified under Regulation 29 and not to actual acquisitions, as normally a proviso does not travel beyond the provision to which it is a proviso. Contention that since exemption under Regulation 10(1)

(b)(viii) is available from making open offer in such cases, exemption is also available from disclosure, was also rejected by the Tribunal. It was also held that it cannot be said that in each and every case the expression “in connection with” has to be construed widely. [*SICOM Ltd. v. Securities and Exchange Board of India – Order dated 28-10-2014 in Appeal No. 190 of 2014, SAT*]

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