

40
Years of
Leadership

Real Estate Investment Trust – REITs

October, 2016



India Gears Up to Face
Realty



TABLE OF CONTENT

| Sr. No. | Particulars |
|---------|-----------------------------------|
| 1. | Background |
| 2. | Evolution of REITs in India |
| 3. | Structure of REITs in India |
| 4. | Overview of SEBI REIT Regulations |
| 5. | Taxation Implications |
| 6. | Valuation Methodologies |

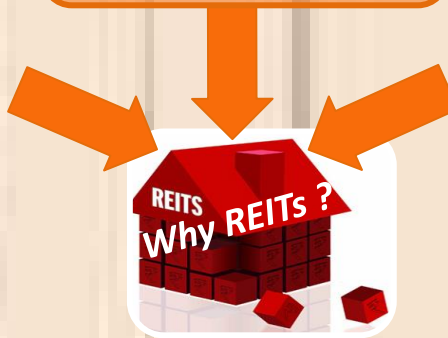
BACKGROUND

- A Real Estate Investment Trust ("REIT") is a trust that uses pooled capital of investors to purchase and manage income property ("Equity REIT") and/or mortgage loans ("Mortgage REIT"). REITs schemes invests in a portfolio of completed and revenue generating real estate assets such as shopping malls, offices, hotels etc., usually established with a view to generate income for unit holders. REITs offer several advantages to people who do not have sufficient money to invest in real estate but desire to own property.
- On 26 September 2014, the Securities and Exchange Board of India (SEBI) notified the Real Estate Investment Trusts (REITs) regulations. The Finance Minister has also made necessary amendments to the Indian taxation regime to provide the tax pass through status, which is one of the key requirements for feasibility of REITs.
- Assets of REITs are professionally managed and revenues generated from assets (primarily rental income) are distributed at regular intervals to the unit holder.

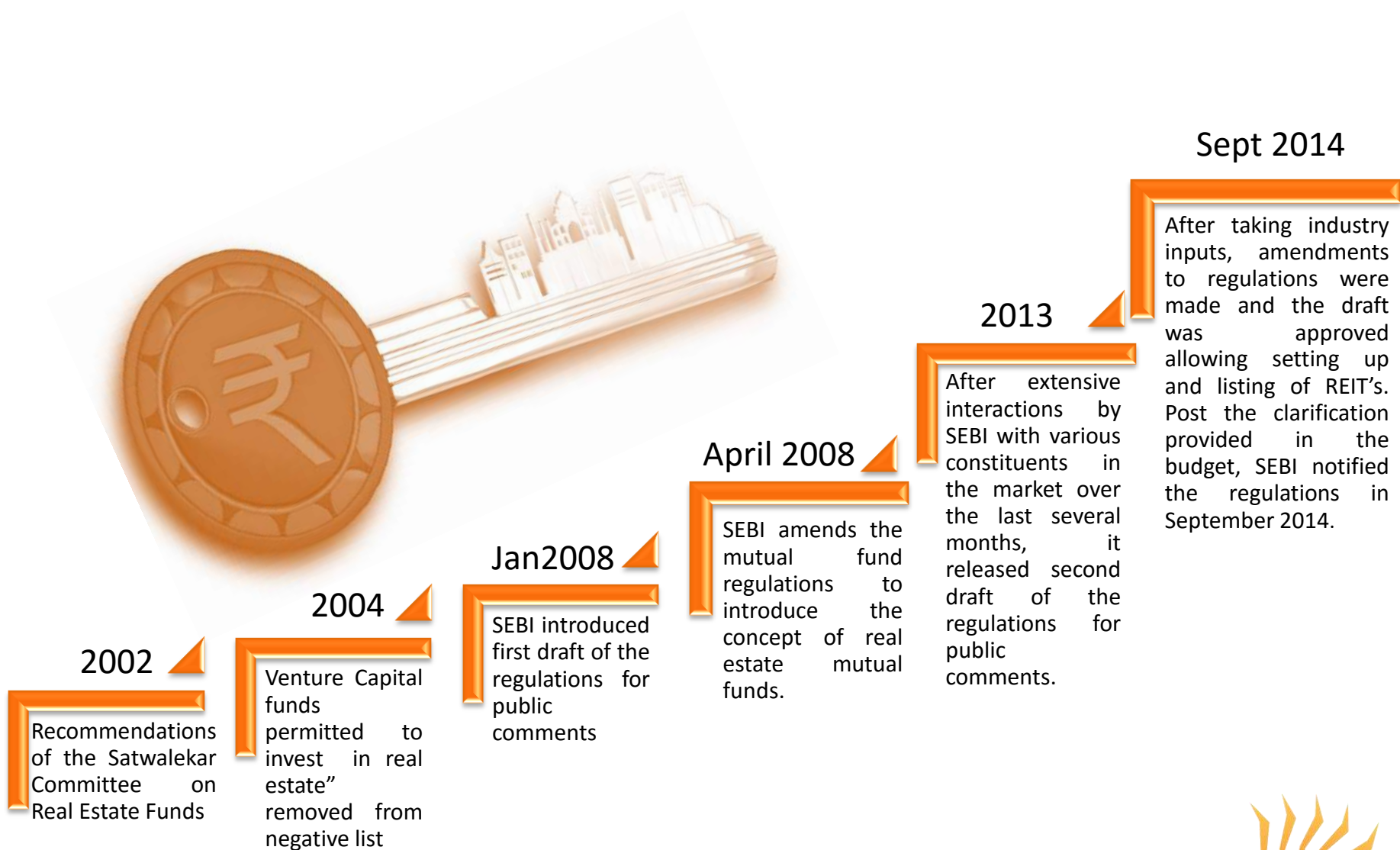
Advantage of Liquidity i.e. ease of converting assets into cash

Passage out for Promoters
(Subject to minimum lock-in for sponsors)

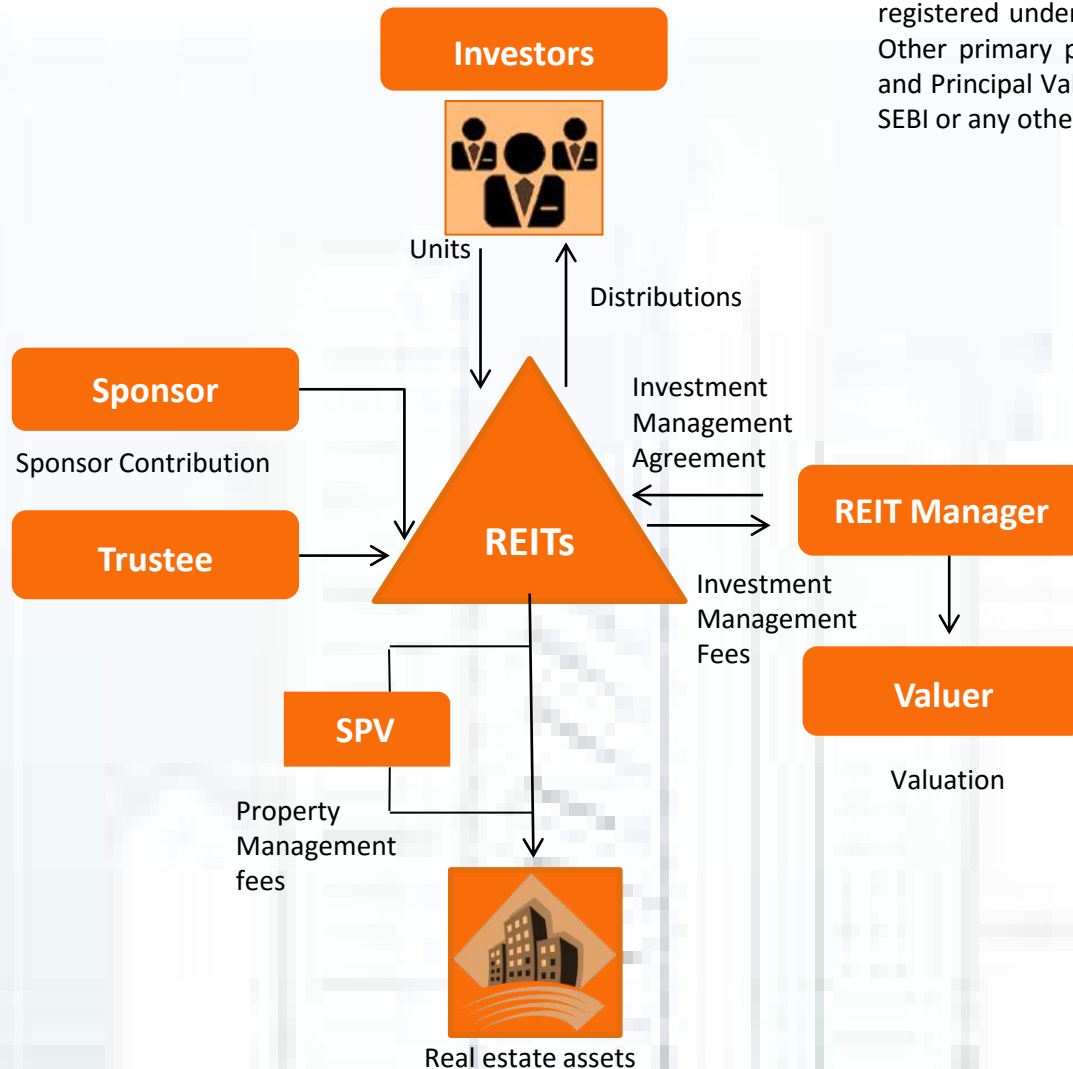
Stabilised equity financing through investment in own properties as against debt financing and promotes real estate market.



EVOLUTION OF REITs IN INDIA



STRUCTURES OF REITs IN INDIA



REIT shall be a Trust set up under the Indian Trust Act, 1882 and it must be registered under the SEBI (Real Estate Investment Trusts), Regulations 2014. Other primary players in REITs constitute the Trustee, Sponsors, Managers and Principal Valuer. There should not be any disciplinary action taken by the SEBI or any other regulatory authority against the REIT or any related party.

- **Trustee** means a person who holds the REIT assets in trust for the benefit of the unit holders. He is an independent third party appointed to ensure that the right & the interest of unit holders and that the assets have proper legal and marketable title. He should be registered with SEBI
- **Sponsor(s)**, is person responsible for setting up the REIT. REIT can have maximum three sponsors, each holding at least 5% of the units of the REIT, post-listing. Each Sponsor needs to have at least 5 years of experience in the real estate industry. Where Sponsor is a developer, he must have at least two completed projects
- **Manager** means a company or LLP or body corporate incorporated in India which manages day to day operations and management of the REIT. A manager needs to have at least 5 years of fund management/ advisory services/ property management in the real estate industry or in development of real estate
- **Property Management Company** acts as facility management company to ensure that the standard & quality of assets are maintained.

OVERVIEW OF SEBI REIT REGULATIONS

Structure

- To be set up as trust, registered under SEBI
- Relevant parties have been designated as trustee (register with SEBI), sponsor and manager.

Offer & Listing of Units

- May raise funds from both residents as well as foreign investors (subject to guidelines specified by RBI/govt.)
- Minimum subscription size to be INR 2 Lakhs per investor, and the unit size to be INR 1 lakh
- Minimum investors to be 200
- Mandatory listing on recognised stock exchange within 12 days of closure of offer

Valuation of Assets

- Full valuation including a physical inspection of the properties to be carried out at least once a year
- Valuer need to be independent from sponsor, manager and trustee and with minimum 5 years of relevant experience in valuation of real estate.
- Valuation report to be submitted to designated stock exchange and unit holder within 15 days from the receipt of such valuation report.

Manager

- Manager to have minimum net worth of INR 100 million
- Manager and its associates to have at least 5 years of specified relevant experience
- Minimum 2 key personnel to have at least 5 years of relevant experience

OVERVIEW OF SEBI REIT REGULATIONS

Sponsor

- REIT can have upto 3 Sponsors (each sponsor to hold at least 5% units). Sponsor to have minimum net worth of INR 200 million on a consolidated basis.
- Should hold at least 25% of the total units of the REIT on post issue basis, which shall be locked in for a period of 3 years from the date of listing
- Sponsor / its associates to have a minimum 5 years experience in real estate industry on individual basis

Borrowings

- Aggregate consolidated borrowings and deferred payments net of cash & cash equivalents capped at 49% of the value of the REIT asset

Investment Condition

- Shall invest only in properties / securities in India
- At least 80 % of the value of the REIT assets to be in completed and rent generating properties and prohibited to invest in vacant land / agricultural and / mortgages (other than mortgage backed securities) and other REIT's
- Permitted to invest in properties through a SPV , subject to certain specified conditions.

Income & Dividend policy

- At least 75% of the revenue of the REIT (other than gains from the disposal of properties) to be from rental, leasing and letting real estate assets all the times.
- At least 90% of the net distributable cash flows of the REIT to be distributed to the unit holders

TAX IMPLICATIONS

Bird's eye view of taxability at various levels in a REIT structure is tabulated below:

| Entity | Income Streams | | | |
|-------------|-----------------------------------|---|--|----------------------------------|
| | Dividend/ Profit | Interest | Capital Gain | Rental/ Other income |
| SPV | No tax on receipt or distribution | Not tax to be deducted | On sale of asset: Tax on capital gains on applicable rates, as per holding period. | Taxable at maximum marginal rate |
| REIT | No tax on receipt or distribution | In case received from SPV - exempt u/s 10(23FC). In case of distribution; tax to be withheld by REIT @ : <input type="checkbox"/> 5% – NR <input type="checkbox"/> 10% – R | On sale of SPV's shares/Capital Assets: Tax on capital gains on applicable rates, as per holding period. | Taxable at maximum marginal rate |
| Unit-holder | Exempt | Taxable at applicable rates <input type="checkbox"/> 5% – NR (tax withheld would be available as credit) <input type="checkbox"/> At applicable rate– R | <input type="checkbox"/> On sale of units: • LTCG – Exempt so long STT is paid • STCG – 15% <input type="checkbox"/> Holding period for LTCG: 36 months | Exempt |

Note: DDT=Dividend Distribution Tax, R=Resident, NR=Non Resident, LTCG= Long Term Capital Gains, STCG = Short Term Capital Gains

VALUATION METHODOLOGIES

Net Asset Value Method: Under this Method, Variables required are:-

- Net Operating Income (NOI):

$$\text{NOI} = \text{Rental Income of fully occupied property} + \text{Other income} - \text{Loss from Vacancies \& Collections}$$

- Growth Rate (g) in Rental Income which depends on:
 - Future prospects for rental rates and no of tenants
 - Level of occupancy rates and any losses incurred from collection of rental payments.
 - Degree to which a REIT can upscale through an inorganic route eg. Acquire low end property and upgrade it.
 - The % of profits that REITS are required to distribute.

- Capitalisation Rate:

$$\text{Cap Rate}(\%) = \frac{\text{NOI}(1 + g)}{\text{Property Value}}$$

- To compute the value of the REIT, find value of underlying property, add assets and deduct liabilities:

$$\text{Value of REIT} = \frac{\text{NOI}(1 + g)}{\text{Cap Rate}} + \text{Assets} - \text{Liabilites}$$

Market Approach Method: Commonly used **market multiples for REIT shares are Price/Funds from Operation (FFO) & Price/ Adjusted Funds from Operation (AFFO).**

$$\begin{aligned} \text{FFO} = & \text{NPAT} + \text{Depreciation} \\ & + \text{Deferred Tax Liability} \\ & - \text{Deferred Tax Assets} \\ & - \text{Gains/+Loss from sale of property} \\ & + \text{Loss from Debt Restructuring} \end{aligned}$$

$$\begin{aligned} \text{AFFO} = & \text{FFO} - \text{Non Cash Rent} \\ & - \text{Maintainable Capital Expenditure} \end{aligned}$$

Non Cash Rent is the difference between Average contractual rent over the lease period and Actual Rent. This differential reflects contractually increasing rental rates.

Income Approach Method: Under this method, Value of REIT is sum of **Present value of Dividend per share** and present value of **Terminal value at a discount rate** which is equal to rate attributable to Investors.

$$\text{Terminal Value} = \frac{\text{Dividend}_0(1 + g)}{\text{Discount rate} - g}$$

DISCLAIMER

The purpose of this Document is to provide interested parties with information that may be useful to them in understanding the content related to this document. This Document includes statements which may reflect various assumptions and assessments arrived at by the RBSA Analysts. Such assumptions, assessments and statements do not purport to contain all the information that each interested party may require. This Document may not be appropriate for all Persons, and it is not possible for the RBSA, its employees or advisors to consider the investment objectives, financial situation and particular needs of each party who reads or uses this Document.

The assumptions, assessments, statements and information contained in the Document may not be complete, accurate, adequate or correct. Each interested party should, therefore, conduct its own investigations and analysis and should check the accuracy, adequacy, correctness, reliability and completeness of the assumptions, assessments, statements and information contained in this Document and obtain independent advice from appropriate sources.

Information provided in this Document has been collated from several sources some of which may depend upon interpretation of Applicable Law. The information given is not intended to be an exhaustive account of statutory requirements and should not be regarded as complete. RBSA accepts no responsibility for the accuracy or otherwise for any statement contained in this document.

RBSA, its employees and advisors make no representation or warranty and shall have no liability to any Person under any law, statute, rules or regulations or tort, principles of restitution or unjust enrichment or otherwise for any loss, damages, cost or expense which may arise from or be incurred or suffered on account of anything contained in this Document or otherwise, including the accuracy, adequacy, correctness, completeness or reliability of the Document and any assessment, assumption, statement or information contained therein or deemed to form part of this Document.

RBSA also accepts no liability of any nature whether resulting from negligence or otherwise howsoever caused arising from reliance of any person upon the statements contained in this Document.

Contact Us

Management:

Rajeev R. Shah | Managing Director & CEO

+91 79 4050 6070

rajeev@rbsa.in

Manish Kaneria | Director

+91 79 4050 6090

manish@rbsa.in

Gautam Mirchandani | Director

+91 22 6130 6000

gautam.mirchandani@rbsa.in

Research Analysts:

Mithil Madia

+91 22 6130 6074

mithil.madia@rbsa.in

Vatsal Shah

+91 22 61306069

Vatsal.shah@rbsa.in

India Offices:

Mumbai Office:

21-23, T.V. Industrial Estate, 248-A,
S.K. Ahire Marg, Off. Dr. A. B. Road, Worli,
Mumbai - 400 030

Tel : +91 22 6130 6000

Delhi Office :

9 C, Hansalaya Building,
15, Barakhambha Road, Connaught place,
New Delhi -110 001

Tel : +91 11 2335 0635/37
+91 99585 62211

Bangalore Office:

Unit No. 104, 1st Floor, Sufiya Elite, #18,
Cunningham Road, Near Sigma Mall,
Bangalore - 560052

Tel : +91 80 4112 8593
+91 97435 50600

Ahmedabad Office:

912, Venus Atlantis Corporate Park,
Anand Nagar Rd, Prahaladnagar,
Ahmedabad - 380 015

Tel : +91 79 4050 6000

Surat Office:

37, 3rd Floor, Meher Park,
'A', Athwa Gate, Ring Road,
Surat - 395 001

Tel : +91 97243 20636

Jaipur Office:

Karmayog, A-8, Metal Colony,
Sikar Road,
Jaipur - 302 023

Tel : +91 141 233 5892

Global Offices:

New York Office:

24 Mission Dr.
Monroe Township,
NJ 08831, USA

Tel: +1 813 751 6474

Email: newyork@rbsa.in

Dubai Office :

ABCN, P. O. Box 183125
4th Floor, Block-B, Business Village, Deira
Dubai U.A.E.

Tel : +971 4 230 6084 / 85

Mob : +971 55 478 6464

+971 52 617 3699

Email: dubai@rbsa.in

Singapore Office:

17, Phillip Street ,
#05-01, Grand Building,
Singapore-048 695

Email: singapore@rbsa.in

