SEBI approves norms on Real Estate Investment Trusts Regulations

Pursuant to the proposals outlined in the Union Budget 2014-15, SEBI approved regulations for setting up and listing of Real Estate Investment Trusts **("REITs")** at their board meeting on August 10, 2014.

Earlier SEBI had issued a consultation paper and draft regulations on REITs which was released on October 10, 2013.

REITs, a globally known investment vehicle, are beneficial to both investors and real estate industry. It provides an opportunity for investors to invest in properties which they would be unable to be invest otherwise. The investors stand to earn from both dividends (from rental income of the property) and capital appreciation.

Set out below are some of the salient features of REITs as outlined in the board meeting minutes:

1. Structure and mandatory registration – REITs shall be set up as trusts and registered with SEBI. The Trustee shall be SEBI registered Debenture Trustee who shall not be an associate of the Sponsor/Manager. The REIT shall invest in projects either directly or through an SPV.

2. Ownership of SPV - REITs have been allowed to invest in commercial real estate assets, situated in India, directly or through Special Purpose Vehicles (SPVs) provided such SPVs are controlled by the REIT and hold or proposes to hold controlling interest and not less than 50% of the equity share capital or interest. Further, such SPVs shall hold not less than 80% of its assets directly in properties and shall not invest in other SPVs.

3. Ownership of Sponsor - A REIT may have maximum 3 Sponsors, subject to each holding at least 5% of the units of the REIT. Such Sponsors shall collectively hold 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, the sponsors, collectively, shall hold minimum 15% of the units of REIT, throughout the life of the REIT.

4. Public offer and listing of units

   i. In order to come out with an initial offer, the value of the assets under or proposed to be under the REIT shall not be less than Rs 500 crore with a minimum initial offer size of Rs 250 crore.
   ii. The minimum subscription size for units of REIT shall be Rs 2 lakhs with a trading lot of Rs. 1 lakh each.
   iii. The units offered to the public in initial offer shall not be less than 25% of the number of units of the REIT on post-issue basis.

5. Investment conditions

   a. A REIT shall invest in at least 2 projects with not more than 60% of value of assets invested in one project.
   b. At least 80% of the value of the assets shall be in completed and revenue generating properties. Not more than 20% of the value of REIT assets shall be invested in following :
      i. developmental properties;
      ii. mortgage backed securities;

iii. listed/ unlisted debt of companies/body corporates in real estate sector;
iv. 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;
v. government securities; and
vi. money market instruments or cash equivalents.

6. Borrowings - The borrowings and deferred payments of the REIT at a consolidated level shall not exceed 49% of the value of the REIT assets. In case such borrowings/ deferred payments exceed 25%, approval from unit holders and credit rating shall be required.

ARA LAW's View –

1. Tax – The tax benefits provided in the Finance Act, 2014 may prove to be a significant incentive to shift towards the REITs structure. The Finance Act, 2014 provides tax incentives such as partial tax pass through status for the REIT and certain benefits for the promoter of the SPV.

2. Foreign Investments – The regulations provide that REITs may raise funds from any investors, including foreign investors. However, participation of foreign direct investment and foreign portfolio investors in REITs will depend on necessary clarifications in the FDI policy and also consultations with the RBI.

3. High Transaction Costs – Stamp duties and property taxes are an integral part of any real estate transaction in India. Effect on transaction costs may generally range from 5% to 15% due to stamp duties and registration costs. Such high costs could impact returns under REITs.

While REITs are not the panacea for all the issues facing the real estate sector, the norms approved by SEBI along with the tax benefits provided in the Finance Act, 2014 are expected to give a significant boost to the real estate sector by attracting greater foreign and domestic investments into the sector. Further, the liquidity offered by REITs coupled with the fact that REITs will largely invest is lower risk and income generating completed projects is likely to further attract the attention of the investors. However, since the final regulations are yet to be notified by SEBI, it would be interesting to note if there are any other changes in the fine print which could have an adverse impact on the REIT structure.