DH DECIPHERS

A primer on REITs

The launch of the country's first ever Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) Index, by NSE Indices Ltd, a subsidiary of the National Stock Exchange last week, has given a new status to these asset classes. For the investors this recognition offers a greater scope for diversification of their portfolio. In this edition of DH Deciphers, **Shakshi Jain** *helps understand the concept of REITs and how investing in them works.*

What are REITs?

REITs, or real estate investment trusts, are companies that own or finance income-generating realty assets, offering proportionate ownership to retail investors. They are structured to function much like mutual funds, allowing a manager to pool in investments from multiple parties to professionally manage a portfolio of commercial real estate holdings such as offices, hospitals, malls, hotels, warehouses and even residential spaces.

India saw its first REIT in 2019.

How can one invest in REITs and what is the incidence of tax on income from such investments?

All Sebi-registered REITs in India are mandatorily listed on stock exchanges where investors can purchase units of REITs like stocks in any other listed company. Alternatively, one can indirectly invest in them through mutual funds that have exposure to REITs .

Investors make money in the form of interest, dividend, return on capital by the special purpose vehicle (SPV) or amortisation of SPV debt and capital gains. All interest income is taxable as per the investor's income tax slab and so is dividend if the REIT's SPV opts for tax concessions. Dividends are otherwise non-taxable. Furthermore, if an investor is selling his/her stake in a REIT within 36 months then a 15% short term capital gains tax is applicable and beyond 36 months a 10% long term capital gains tax on an amount exceeding Rs 1 lakh. Lastly, capital gains taxes will be applicable during sale of units by the investor, post reduction of amount received as 'loan repayment' from the cost of acquisition, starting April 1, 2024.

What are some of the benefits and limitations tied to investment in REITs ?

A REIT makes investment in commercial real estate far more affordable, eliminating massive upfront capital requirements. Alongside low barriers to entry, they are professionally managed, offer transparency and allow a steady source of income in the form of interest and dividends. They are also more liquid as opposed to a traditional investment in real estate and offer portfolio diversification away from conventional stock market instruments.

The limitations of investing in REITs include taxes, market volatility and lower growth prospects as only 10% of the net distributable cash flows can be reinvested into the venture.

What REITs are available in India presently ?

At present, there are three listed REITs in India -- Embassy Office Parks REIT, Mindspace Business Parks REIT and Brookfield India Real Estate Trust -- on Indian bourses, with all of them dealing in leased office assets. Global investment firm Blackstone-sponsored Nexus Select Trust is expected to launch India's first retail REIT public offer in early May to raise up to Rs 4,000 crore.

According to a report by fintech company Smallcase, Mindspace REIT delivered the highest absolute returns of 8.11% year to date till October 31, 2022. For the same period, Brookfield India REIT was the second best performing listed REIT with 7.30% absolute returns followed by Embassy REIT with 1.40% during the same period.

What are some key regulatory norms for REITs in India ?

The Securities and Exchange Board of India mandates that at least 80% of investment by a REIT must be into completed and/or rent-generating properties. No more than 20% of investment may be in properties under construction.

No less than 90% of the net distributable cash flows of a REIT shall be distributed to unit holders as dividends or interest.

A REIT must have a minimum asset base of Rs 500 crore.

What are the factors to keep in mind while investing in a REIT ?

It is always a good idea to evaluate occupancy rate of properties owned/operated by a REIT, weighted average lease expiry, distribution yields, portfolio quality or diversification in terms of tenants and geographical spread and lastly taxation benefits offered by the REIT.

Experts however, advice that one must compare the above metrics in context of one REIT versus another, and not in isolation. Furthermore, one must take a holistic view during his/her assessment.

Should you invest in a REIT ?

Investing in REIT is recommended if one is looking to diversify his/her portfolio with the aim of generating a steady and stable income over time.

From a tactical standpoint, industry experts did not exude 100% confidence in such a move given the headwinds that face the office space segment in India currently, especially for IT and tech clients with heavy stakes in exports to the West.