EMBASSY REIT

Investor FAQs

REIT Basics

What is a REIT?

- REIT stands for Real Estate Investment Trust
- REITs originated in the US in the 1960s as a way to allow retail investors to efficiently invest in commercial real estate that is listed on the stock exchanges
- In India, REITs allow investors to access the benefits of investing in real estate through a publicly traded unit
- REITs own, operate and/or manage income or rent generating real estate assets
- REITs are tax efficient vehicles that are required to distribute at least 90% of their cash flows to the unitholders, atleast semi-annually
- REITs provide distribution yields with in-built capital appreciation potential
- REITs are heavily regulated by SEBI and exhibit high levels of disclosure, transparency, and corporate governance

What assets can an Indian REIT own?

- Indian REITs are permitted to own real estate, such as offices, retail, among others. They are not permitted to own speculative landbanks
- Indian REITs can only own assets situated in India
- Indian REITs must have at least 80% (by value) of their assets completed and income or rent generating; the remaining 20% can be invested in under-construction assets and certain other investment instruments

Why were Indian REITs created?

- Globally, REITs have been in existence for over 60 years, with the first-ever REIT listed in USA in the 1960s
- Currently, there are over 1,000 listed REITs globally valued at over $2 trillion, which contribute to over 60% of the global real estate market
- Historically, Indian real estate has been illiquid and primarily residential-focused. REITs were launched in India to enable investors to invest in commercial or other real estate without actually having to buy, own and manage a physical real estate asset
- The first REIT was listed in India in April 2019, and since then 3 other REITs have been listed on the Indian bourses

How can one buy or sell Indian REIT units?

- REIT units are listed on the Indian stock exchanges NSE and BSE through an Initial Public Offering (IPO)
- Any eligible investor (domestic / foreign / retail / institutional) can buy REIT units in India
- The REIT units can be bought or sold through a demat account, and the process is similar to the buying or selling of an equity share of a listed company
- An investor can buy or sell a single unit at a time

What are the advantages of investing in Indian REITs?

- REITs are universally considered to be a safe and transparent way to invest in income producing real estate
- Real estate has always played an important role in a global asset allocation strategy. REITs are a 'total return' product that typically offer stable distributions along with long-term capital appreciation
- REITs are liquid, allow investors to invest and trade in small amounts, and represent ownership in a real estate vehicle while leaving the management to professionals
- In summary, there are 6 key advantages of investing in Indian REITs:
    - Accessibility – REITs allow ownership in professionally-managed real estate assets, even with a small capital outlay
    - Liquidity – REIT units are freely traded in the stock markets like equity shares
    - Transparency – REITs are highly regulated with a strong governance framework and disclosure requirements prescribed by SEBI
    - Tax-efficient Yields – REITs typically provide consistent tax-efficient income, due to the regulatory requirement to distribute at least 90% of REIT cash flows at least semi-annually
    - Growth Upside – REITs allow investors to participate in the potential capital appreciation of REIT units from organic or inorganic growth
    - Diversification – REITs offer access to the real estate market which typically has low correlation with other asset classes and can also help in diversification of portfolio across sectors and cities

How does a REIT fund its operations and growth?

- Given that REITs are required to pay out at least 90% of their NDCFs to their unitholders at least semi-annually, they are reliant on the capital markets to fund their operations
- A REIT primarily funds its operations and organic or inorganic growth through several sources, such as:
    - Debt, which can be raised through listed non-convertible debentures, commercial papers, term loans, among others.
    - Equity, which can be raised through institutional placements, preferential allotments, or rights issues

REIT Distributions

How does a REIT generate cashflows and how is REIT NDCF calculated?

- A REIT generates rental income from its underlying properties by leasing space and collecting rent from its tenants
- Post deducting cash expenses (such as property tax, insurance, interest, income tax etc.) and other relevant adjustments, the remaining cash flows, referred to as 'Net Distributable Cash Flows' (NDCF), are available for distribution to the unitholders
- For Indian REITs, the NDCF is calculated as per the standardized NDCF framework defined under the SEBI REIT regulations
- Also, Indian REITs are mandated to pay out at least 90% of their NDCF to their unitholders at least semi-annually

Valuing REITs

How are REITs valued?

- Some of the commonly used approached for valuing a REIT are as follows:
  - Discounted Cash Flow (DCF) – This method calculates the value of a REIT by estimating future cash flows of the REIT and discounting them to a present value using the WACC ('Weighted Average Cost of Capital') rate relevant for the REIT
  - Dividend Discount Model (DDM) – This method calculates the value of a REIT by discounting all future expected dividends of the REIT to a present value using the cost of equity rate relevant for the REIT
  - Net Asset Value (NAV) – This method calculates the value of a REIT by assessing the fair market value of all assets owned by the REIT and deducting the value of all liabilities. When divided by the number of units outstanding for the REIT, the NAV per unit is viewed by investors as a useful guideline for determining whether the REIT is trading a premium or a discount with respect to its intrinsic value
  - Cap Rates – A cap rate or 'capitalization rate' is calculated by dividing the Net Operating Income (NOI) of a property with its current total value. A higher cap rate implies a higher risk is attributable to the investment and vice versa. The cap rate method is used to determine the appropriate valuation of a REIT, wherein the minimum required rate of return is achieved. Using this method, the value of a REIT is calculated by dividing the REIT's NOI by the market cap rate.
- Indian REITs are required to obtain and publish a half yearly valuation report, based on a valuation exercise conducted by an independent external property valuer, appointed under Regulation 21 of the SEBI REIT regulations

What are the key metrics that an investor should consider while evaluating a REIT for investment?

- Price to Net Asset Value (NAV) – A REIT's NAV indicates an independent valuation of its underlying real estate assets. Price to NAV ratio gives an indication of whether the REIT is trading a premium or a discount with respect to its intrinsic value
- Quality and track record of management, portfolio and financials – A strong management team displays a good track record of creating value for the unitholders. This may be demonstrated by a growing DPU, a growing NAV or a combination of the two
- Occupancy rate – Higher occupancy rates in the portfolio indicate greater assurance of rental income flows from the portfolio assets
- Tenant mix – A good mix of tenants from a diverse range of industries and sectors, along with the creditworthiness of the tenants, reduces concentration risk
- Weighted Average Lease Expiry (WALE) – REITs with longer WALEs face a lower risk of vacancy. However, it is possible that such REITs may not be able to negotiate for higher rents when market rents increase
- Lease expiry profile – A well-staggered lease expiry profile will minimize the number of leases that are due to expire in any given year, thereby reducing vacancy risks
- Leverage (Gearing) ratio – This ratio indicates REIT's net debt to total enterprise value and is capped at 49% by SEBI regulations
- Debt expiry profile – A well-staggered debt expiry profile will reduce debt refinancing risks for the REIT which may otherwise impact the REIT's cash flows
- Interest cost – A lower weighted average interest cost will improve the flowthrough from revenue to distributions

Indian REIT Landscape

Which are the REITs listed in India currently?

- There are 4 REITs listed in India currently – Embassy REIT, Mindspace REIT, Brookfield India Trust and Nexus Select Trust (in the order of listing)
- The 4 REITs have a substantial ₹1.3 lakh crores in gross Assets Under Management (AUM), combined market cap of over ₹80,000 crores and a portfolio of over 112 million square feet of Grade A commercial and retail spaces nationwide (Data as of September 30, 2023)
- Cumulatively, the Indian REITs have distributed over ₹14,300 crores till date since 2019, surpassing the combined dividends distributed by real estate companies constituting the entire Nifty Realty Index (Data as of September 30, 2023)

Who owns Indian REITs?

- The 4 listed Indian REITs have a combined investor base of over 2 lakh unitholders (Data as of September 30, 2023)
- The register across the Indian REIT universe is a stable and growing mix of global and domestic institutional investors, along with an ever-growing base of retail investors

Useful Links

Link to Indian Regulators / Exchanges

- SEBI - Securities and Exchange Board of India
- RBI - Reserve Bank of India
- NSE - National Stock Exchange of India Ltd.
- BSE - Bombay Stock Exchange of India Ltd.

Link to Online Dispute Resolution Portals

- SMART ODR - Securities Market Approach for Resolution Through ODR Portal
- SCORES - SEBI Complaints Redress System

Link To International Real Estate / REIT Associations

- IRA – Indian REITs Association
- Nareit
- EPRA – European Public Real Estate Association
- REITAS – REIT Association of Singapore
- APREA – Asia Pacific Real Assets Association

Link To International Property Consultants

- Colliers
- CBRE
- Cushman and Wakefield
- JLL

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