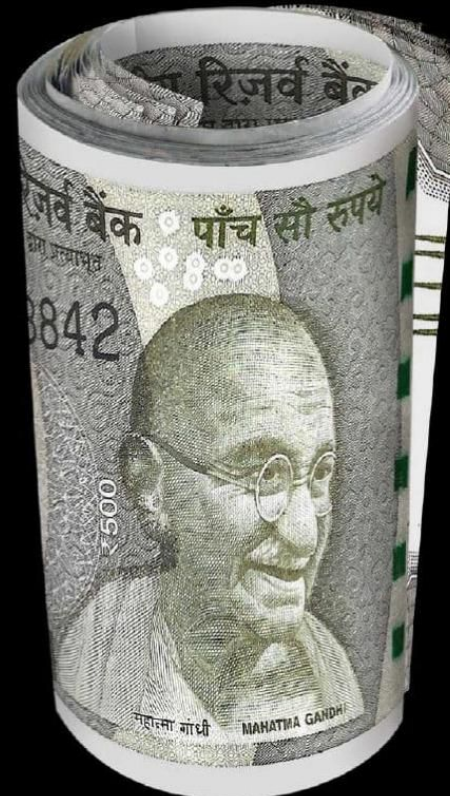
THE REIT CHOICE?



REAL ESTATE INVESTMENT TRUSTS (REITs) ARE GAINING TRACTION AS INTEREST RATES STABILISE. BUT RETURNS COULD BE AFFECTED BY ADVERSE ECONOMIC CONDITIONS AND MARKET VOLATILITY ● BY **NAVNEET DUBEY**

THE SCENE

1 REITs took a while to take off after they were introduced almost a decade ago

2 There were a slew of REIT IPOs beginning in 2019 that carried on till 2023

3 Returns began to surge post Covid-19, attracting investors looking to diversify

4 Sebi, meanwhile, brought in a string of reforms like easing the investment threshold to boost investor participation

5 Experts see the demand for REITs growing; besides, they are expected to expand into newer areas like data centres

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THERE WAS PALPABLE excitement in March 2019 as a new asset class was taking birth. It was finally time for the launch of the initial public offering (IPO) of Embassy Office Parks REIT (real estate investment trust), which marked a partnership between real estate major Embassy Group and private equity giant Blackstone.

By the time the IPO ended on March 20, 2019, the issue had garnered a subscription of 2.5 times, with the non-institutional segment seeing 3.10 times subscriptions. This was the first REIT offering to hit the Indian market, even though the asset class had existed elsewhere for some time.

REITs typically own a diversified portfolio of real estate assets, which may include commercial buildings, shopping malls, apartments, hotels, or even infrastructure projects. REITs allow individuals to invest in large-scale, income-generating real estate without actually having to buy, manage, or finance any properties themselves.

There are four listed REITs in India now—Brookfield India Real Estate Trust, Embassy Office Parks REIT, Mindspace Business Parks REIT, and Nexus Select Trust—having received timely boosts from regulatory changes.

In fact, those changes have attracted some controversy recently after US-based short-seller Hindenburg Research alleged that Madhabi Puri Buch, the Chairperson of capital markets watchdog Securities and Exchange Board of India (Sebi), had a conflict of interest in the matter since her husband Dhaval was employed by Blackstone as a consultant. Buch has refuted this.

But it's not been smooth sailing for REITs. Sebi had allowed REITs in 2014, but there was almost no interest. Around the time of the Embassy REIT IPO, Sebi eased the minimum investment threshold to ₹50,000 from ₹2 lakh earlier. That and a few other tweaks have ensured that there's no longer any shortage of interest in REITs.

In fact, the horizon of the REIT landscape is about to expand with the introduction of small- and medium REITs and their extension beyond office spaces and malls to emerging sectors like data centres.

CRASH AND AFTER

What REITs hadn't bargained for was the Covid-19 pandemic. With offices shutting down and employees working from home, the demand for office space crashed, occupancy rates dropped, and rental income dwindled. In the meantime, Embassy had companies in retail-focussed Nexus Select Trust that had an IPO later in 2019 and Mindspace Business Parks REIT, which went public in 2020. A year later, in February 2021, they were joined by Brookfield India Real Estate Trust.

Unlike Embassy Office Parks REIT, Mindspace Business Parks REIT, and Brookfield India Real Estate Trust, with their heavy reliance on office space, Nexus Select Trust confronted a different set of challenges. With malls and retail space closed for extended periods, footfall dropped, and tenants struggled to pay rent.

But REITs recovered after employers and employees trickled back to occupy office spaces and then came flooding back in. On the retail side, too, there was a return to the outdoors after two years of lockdowns. Listed REITs now collectively manage assets under management (AUM) of more than ₹1.4 lakh crore, and the number of unitholders in these REITs has also seen a significant increase.

One concern that has lingered about REITs is their patchy performance.

Investors in REITs can earn returns on their investment in two primary ways: dividend and capital appreciation. "By law, REITs must distribute at least 90% of their taxable income to shareholders as dividends. As a result, REIT investors typically receive a regular income stream," says Harish Fabiani, Chairman of real estate firm IndiaLand Group. Investors can also earn through appreciation of the share price in a REIT. They can sell these shares at the higher price to realise capital gains.

The performance of Brookefield, Mindspace, Embassy, and Nexus REITs on market price and dividend distribution between FY22 and FY24 has varied. Brookefield's dividend payout has fluctuated, and it paid no dividend in FY24. Its market price dropped from ₹316 a share in FY23 to ₹255 in FY24, reflecting a 19% capital depreciation year-on-year. Mindspace, on the other

HOW REITS WORK

- **DIVIDEND INCOME:** REITs are required to distribute at least 90% of their taxable income to shareholders as dividend
- **CAPITAL APPRECIATION:** They can also generate returns through the appreciation of the underlying properties' value

Payout cycle	Varies between funds, can be monthly or every six months
Returns	Minimum 90% of income
Non-revenue generating assets	Up to 10% of the investment can be in under-construction (non-revenue generating) assets
Debt	Up to 49% of asset value
Yield stability	The yield varies based on the entry price into the REIT
Asset value stability	As a listed product, it is subject to stock market volatility, which can be out of sync with actual property value
Asset sale	REITs cannot sell assets younger than three years

SOURCE *BT* RESEARCH

SEBI TWEAKS

THE CAPITAL MARKETS REGULATOR HAS MADE MANY AMENDMENTS SINCE 2019

- **MINIMUM APPLICATION VALUE:** Reduced from ₹50,000 to a range of ₹10,000-15,000
- **SPONSOR HOLDING:** Reduced minimum requirement for holding from 25% to 15% in initial three years after listing
- **BORROWING LIMIT:** Increased from 49% to 70% of the value of REIT assets
- **UNDER-CONSTRUCTION ASSETS:** The investment limit has been raised from 10% to 20% of the REIT value
- **DISCLOSURE REQUIREMENTS:** Streamlined to reduce compliance burden
- **STRATEGIC INVESTOR FRAMEWORK:** Institutional participation encouraged in REIT public offerings
- **TRADING LOT SIZE:** Reduced from 100 units to a single unit

hand, consistently paid a higher dividend, peaking at ₹17.2 in FY24, but experienced a significant decline in market price by 8%, from ₹383 in FY23 to ₹321 in FY24. Embassy offered a dividend of ₹10 in FY24, up from ₹7 in FY23, while its market price dipped slightly by 4%, from ₹350 in FY23 to ₹335 in FY24. Similar data is not available for Nexus, since it was listed in May 2023.

SIGNS OF A COMEBACK?

Despite these challenges, REITs have shown remarkable resilience. As the economy gradually recovered and businesses adapted to the new normal, occupancy rates began to stabilise. Embassy Office Parks REIT, for instance, reported an improvement in occupancy rates from 81% during the peak of the pandemic to 87% by the end of the last financial year.

According to a report by investment firm Nuvama Wealth, Embassy REIT had a strong first quarter of FY25. Its gross leasing activity surged 70% compared to the previous year, and net operating income (NOI) increased slightly. Distribution per unit (DPU) rose by 4%, while in-place rents grew by 6%. Although occupancy remained flat, it expects that to improve marginally to 88% by the end of FY25. Additionally, the company has increased its leasing guidance for the year. Brookfield and Mindspace REITs too saw similar recoveries, buoyed by a renewed demand for office spaces, especially in tech hubs like Bengaluru and Hyderabad.

About Brookfield, Nuvama said it had a mixed performance in Q1FY25. While it rented out less space than in the previous year, its net operating income increased slightly. Occupancy stands at around 84%, which the management expects to rise to 87–89% by FY25-end, driven by improving office demand. The DPU to investors was lower than in the previous quarter. Additionally, Brookfield acquired a 50% stake in a large commercial property during the quarter. On the other hand, Mindspace had a good Q1. Its NOI increased by 9%, DPU rose by 5%, in-place rents grew by 6%, and committed occupancy improved slightly. Additionally, it saw a significant uptick in leasing, with 1.1 million sq. ft of space leased out.

Nexus Select Trust, meanwhile, is benefiting from the revival of the retail sector, with its occupancy rates climbing back to 92%. The easing of lockdowns and the return of shoppers to malls have helped restore confidence in retail real estate. Moreover, the diversification of tenant profiles has provided a cushion against potential future disruptions.

Nexus's NOI increased by 7% year-on-year in Q1, reaching ₹410 crore. Additionally, it paid out a dividend of ₹2.1 per unit to its investors, which was 3% higher than the previous quarter. It is on track to achieve a 9% YoY increase in NOI and DPU in FY25. Consumer spending in Q1 rose by 3% YoY to around ₹3,000 crore, and the occupancy rate of its retail properties is now at a high of 97.4%.

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HARISH FABIANI
CHAIRMAN,
INDIALAND GROUP

"Capital gains arising from the sale of units by the unitholder are taxable at 12.5% if the units are held for more than 24 months. Otherwise, the tax rate is 20%"

DEEPA DALAL
PARTNER,
DELOITTE INDIA

Anurag Goel, Director of real estate developer Goel Ganga Developments, says Indian REITs have done well since launch. Embassy Office Parks REIT has recorded stable growth with consistent dividend distribution, Mindspace has shown strong occupancy rates with stable returns, and Brookfield has shown promise due to diversified portfolios. "These REITs have been through pretty rough times on their pandemic challenges but have survived and remained resilient, showing robust rental collections coupled with steady growth of net operating income."

THE PROMISE OF THE FUTURE

For unitholders, the journey with REITs has been one of patience and long-term vision. The initial hiccups caused by the pandemic tested the resolve of investors, but those who held on have started to see the benefits of a recovering real estate market. The number of unitholders across the four REITs stands at over 230,000, a testament to the growing popularity of the instrument.

That interest is not without reason. REITs offer many advantages, even in terms of taxation. For instance, the income is not taxed at the REIT level, unlike direct rental income. Dividend income is exempt in the hands of investors; interest income is liable to tax at applicable slab rates; and capital gains depend on the holding period.

Deepa Dalal, Partner at Deloitte India, says, "For resident unitholders, the tax implications are as follows: Interest... [is] taxable at the applicable tax rates. Dividend income is exempt under Section 10 (23FD) [of the Income Tax Act]." She says capital gains distributed by the REITs are exempt from tax. However, capital gains arising from the sale of units by the unitholder are taxable at 12.5% if the units are held for more than 24 months. Otherwise, the tax rate is 20%, Dalal adds.

But tax considerations apart, the outlook is promising, especially since Sebi has been easing regulatory norms. The gradual return of employees to offices is set to sustain demand for high-quality space.

Fabiani of IndiaLand Group says the uptick in the commercial real estate market is expected to increase the office REIT market size by 6-6.5%. "In fact, India currently boasts a REIT-ready commercial supply of ₹5.8-6.2 lakh crore across 7 key cities, with Bengaluru alone accounting for nearly 31% of the supply."

Besides, the REIT market is still in a nascent stage. Abhishek Raj, Founder and CEO of real estate firm Jenika Ventures, says the diversification of the market is one of the most interesting aspects. "At the moment, commercial real estate, especially office space, is the main focus of REITs in India. Still, a wider range of REIT products will probably be introduced as the industry develops. REITs that concentrate on retail real estate, residential construction, and niche markets like data centres, logistics hubs, and medical facilities may fall under this category," he says. This will spread the risk across categories and make REITs more stable and durable.

On the regulatory side, Sebi and the Indian REITs Association (IRA) are launching a data benchmarking institution (DBI) to provide investors reliable data for informed decision-making. The DBI will serve as a central repository of data across asset classes and will help investors compare REITs across a range of metrics.

All in all, the REIT market may just now be reaching a tipping point. **BT**

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TRACKING PERFORMANCE

Listed REITs	IPO listing date	No. of unit holders	Market cap (in ₹ crore)	XIRR (%)*	Primary asset
Brookfield India Real Estate Trust	Feb '21	100,000	12,831	5.29	Office
Embassy Office Parks REIT	Apr '19	64,000	35,948	11.16	Office
Mindspace Business Parks REIT	Aug '20	45,000	20,280	10.6	Office
Nexus Select Trust	May '23	39,000	20,904	32.44	Malls

*XIRR SINCE LISTING; IT CALCULATES ANNUALISED RETURNS; DATA AS OF SEPTEMBER 4, 2024 **SOURCE** ICICI DIRECT

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