

## The renaissance of real estate investment trusts

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**T**he reintroduction of a consultative draft paper for industry feedback on real estate investment trusts (REITs) by the Securities and Exchange Board of India (SEBI) after a gap of five years has once again boosted the sentiments of the finance deprived real estate sector. The draft SEBI (Real Estate Investment Trusts) Regulations propose that REITs be established as a trust duly registered by SEBI with a framework similar to that of an initial public offering, thereby requiring the listing of units issued by REITs.

By its very nature, a REIT is beneficial both to the sponsor and the investors. It provides sponsors with an exit option from their investments and enables investors to invest in real estate along with the benefit of a diversified portfolio. Apart from easy liquidity, the risk exposure in REITs is greatly reduced. In view of such advantages REITs have been globally accepted but they have received limited hype in India.

### Regulatory framework

REITs may raise funds from any investors, resident or foreign. However, initially the units may be offered only to institutions and high net worth individuals.

A REIT would be established as a trust under the Indian Trusts Act, 1882, and duly registered with SEBI along with parties such as trustee, sponsor, manager and principal valuer. Post registration, it would raise funds initially through an initial offer and, once listed, may subsequently raise funds through follow-on offers.

Listing of the units will be mandatory for all REITs. The minimum value of assets stipulated is ₹10 billion (US\$160 million). The minimum value of units proposed to be offered to public will be 25% of the REIT's value, the minimum offer size being ₹2.5 billion and the size

of an individual unit being ₹100,000.

The general procedure for an initial/follow-on offer, the filing of documents in respect of an offer, and allotment and listing of units is also specified. Governance, disclosures and transparency are emphasized, and customary responsibilities are laid down for each of the trustee, sponsor, manager and principal valuer.

Basically, the trustee will hold the REIT assets in the name of the REIT for the beneficiaries (unit holders), the manager will assume all operational responsibilities while sponsor will set up the trust, appoint the trustee, and maintain a specified percentage of holding in the REIT or arrange for a redesignated sponsor where it sell its units. Minimum net worth and experience are specified for both the manager and sponsor.

Notably, REITs are to invest only in securities or properties in India and a minimum 90% of the value of a REIT's assets must be in completed rent generating properties. Not more than 10% of the value of the REIT's assets can be invested in specified categories such as developmental properties, a company's listed or unlisted debts, government/mortgage backed securities, etc.

A REIT must distribute a minimum 90% of its net distributable income, giving investors assured returns. REITs can invest directly or through a special purpose vehicle (SPV) provided such SPV holds at least 90% of their assets directly in such properties. The investors' interests are assured since the REIT must have control over the SPV at all times. Investment in vacant or agricultural land or mortgages is prohibited.

Detailed provisions are specified for related party transactions, disclosures (both continuous and event based) and valuation of assets. Taking into consideration price fluctuations of the sector, it is proposed that properties be physically

inspected at least once a year and their values updated after every six months.

### Our take

Introduction of the REIT signals the maturity of the Indian real estate market and would reduce individual speculation, generate assured returns despite small ticket size in real estate, allow professional investment and reduce banks' exposure to risky assets. Although the draft appears to be fairly balanced, appropriate steps must be initiated to provide clarity on legal issues relating to clear title, rentals based on market rate and incomplete or even non-existent agreements. Further, for a smooth implementation, REIT parties and investors need a detailed understanding of taxation and stamp duty implications.

Amendments will also need to be made in related laws such as the Securities Contracts (Regulation) Act and in various regulations. Clarifications and suitable modifications would be required in the foreign direct investment (FDI) policy as at present FDI in trusts other than funds registered under the SEBI (Venture Capital Funds) Regulations is not permitted.

### Conclusion

SEBI having circulated the initial draft will need to finalize the proposed REIT Regulations in light of industry feedback. The central government would then have to carry forward the momentum in tweaking the loopholes as mentioned above. We hope this draft will initiate a positive trend in bolstering the dampened spirits of the real estate sector.

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