REIT-ABLE SPACE IN INDIA

A CLOSER REALITY

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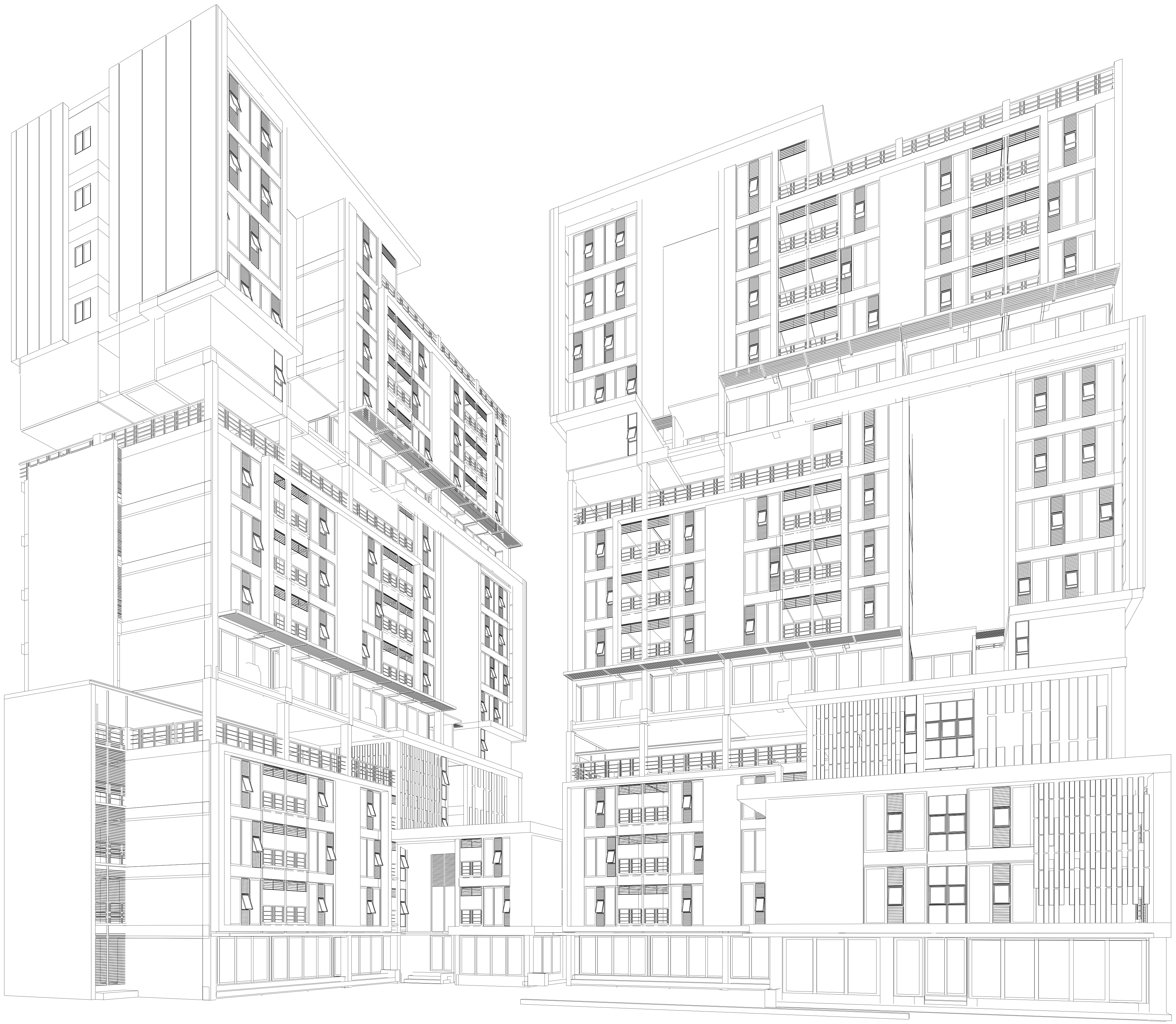

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The Real Estate Investment Trust (REIT) is an investment vehicle that invests in rent-yielding completed real estate properties. REIT holds the potential to transform the Indian real estate sector to a large extent, especially with respect to inculcating an asset light model in realty business, as it helps unbundle the development and investment activities of the property development business.

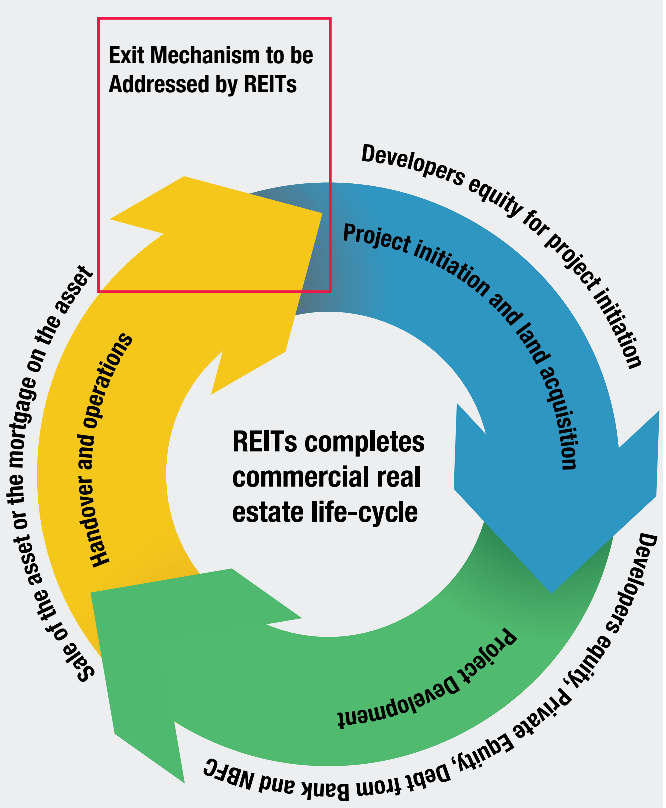
Currently, developers incur huge capital expenditure especially in Commercial Real Estate (CRE), on land, construction, interior fit-outs, etc. which remains locked, even after the asset is complete, until the asset generates returns to break-even. Through REIT, the developers can exit from the completed asset, and focus alone on development activity, which has a different risk-return profile. This is possible as REIT helps attract investment from local and global investors, who prefer a recurring, safe and moderate-yield income.

It is needless to say that REIT will help improve liquidity in the real estate sector as it will help owners of completed assets to raise capital from investors.

For investors, the REIT can provide a new investment option with ongoing returns, elevated transparency and governance standards.

REIT as an investment vehicle has a huge opportunity in India. Presently, India has a rent yielding office inventory to the tune of 537 million sq ft valued in excess of USD 70 billion. Apart from this, there are other properties like warehousing, retail malls, shopping centers, school buildings, etc. which are potential REITable assets.

Importance of REIT in commercial real estate development



Source: KPMG in India

IMPORTANCE OF REIT IN THE INDIAN CONTEXT

REIT is expected to have a large opportunity in the Indian real estate market, which is supported by a strong economic growth, a large portfolio of completed commercial real estate and conducive investment climate.

1. OPPORTUNITY FOR LIQUIDATION OF ASSETS:

With REIT becoming a reality, the developers and Private Equity of commercial real estate now have an opportunity to exit from their investments in completed assets. The liquidity so generated may help developers to focus on their core business of development, which has a different risk-return profile compared to operations and management of the completed asset.

A good feature of REIT is that developers can exit partially and continue retaining a large share in the asset. The REIT units will be listed on an exchange, which will help them keep abreast with the underlying asset value, which may help in raising finance from banks and other financial institution at a better valuation.

2. ALTERNATIVE INVESTMENT OPPORTUNITY:

REIT provides an attractive investment instrument for investors. As mentioned above, REITs are most suitable for investors who are looking at an investment channel providing a recurring, safe and moderate-yield returns, this kind of returns are mostly sought after by pension and funds among institutional investors, and retail investors. It is also suitable for investors who want to invest in real estate sector with a lower ticket size, a feature not available in physical real estate. Mandatory listing of the REITs on recognised stock exchanges is expected to offer an easy entry and exit mechanism for investors. With respect to providing liquidity to the investors, REIT may be at par with equity shares trading on the exchange.

Being a new investment instrument for an Indian investor it is imperative to study the performance of REITs, globally. Over the past decade, returns on equity of traded REITs has comparatively over performed the returns on leading stock markets indexes, across the world. REITs across the globe have provided five year returns in the range of 7 to 16 per cent. With Japanese and Malaysian markets providing returns in the range of 8 to 10 per cent[1], expectations from Asian economies are on the rise.

Following are some key highlights of the performance of REITs in key markets as per S&P Dow Jones at five year and ten year milestones.

Table 1:
REIT performance as per S&P Dow Jones

COUNTRY	REIT PERFORMANCE AS PER S&P DOW JONES	
	5 YEAR	10 YEAR
Americas		
U.S.	11.83%	6.43%
Europe		
France	7.49%	8.00%
United Kingdom	8.49%	N.A.
Pacific		
Australia	9.28%	3.07%
Asia		
Japan	10.04%	6.30%
Singapore	6.61%	8.70%
Hong Kong	16.26%	13.66%
Malaysia	7.85%	N.A.
Taiwan	10.59%	8.99%

Source: Dow Jones Real Estate Indices – S&P Global Property Indices Quantitative Analysis Report for Q1 2016

It is expected that REIT in India would give returns similar to that of other countries represented on the table. Further, a diversified REIT only focusing on rental income can generate returns in the range of 9 to 11 per cent with an additional return of 2 to 3 per cent on capital appreciation, annually.

3. PROFESSIONALISM AND TRANSPARENCY IN REAL ESTATE INVESTMENTS:

REIT may help inculcate the desired professionalism and transparency in the real estate sector in India. As, it will be governed by the SEBI guidelines, investors can expect transparency and accountability in REITs operations. A REIT would have to appoint an independent trustee, managers, auditor and valuer to help ensure that the functioning of a REIT is as per SEBI guidelines. Moreover, experiences in different facets of the real estate business are a prerequisite for the appointment of a manager in a REIT, thereby helping in ensuring professionalism in real estate investments.

[1] Refer Table 1

4. CONDUCIVE INVESTMENT ENVIRONMENT

01

GROWING ECONOMY:

The thriving economy could be a key driver for growth of the REIT regime in the Indian market. The business confidence index has strengthened and the economy is looking forward to another phase of decent growth, with political stability and a Government focusing on growth.

02

INCREASING WORKING AGE POPULATION:

UN World Population prospects, projects Indian median population from 26.4 in 2013 to 36.7 in 2050[2], this signifies a large pool of young population in India. This employable young workforce demands employment and could attract global corporates especially in IT-ITES and promote the development of commercial real estate.

03

HOUSING AND URBAN INFRASTRUCTURE REQUIREMENT:

To support the increasing population, huge investments are required to meet India's housing needs, and additional investments would be required for commercial and urban infrastructure to support the housing growth. India needs to develop about 110 million housing units by 2022 to meet its housing deficit.[3]

04

DISPOSABLE INCOME AND RETIREMENT SAVINGS:

Increase in income of working age population, would result an increase in disposable income. This disposable income gives individuals flexibility to invest in long-term investment options for future savings.

05

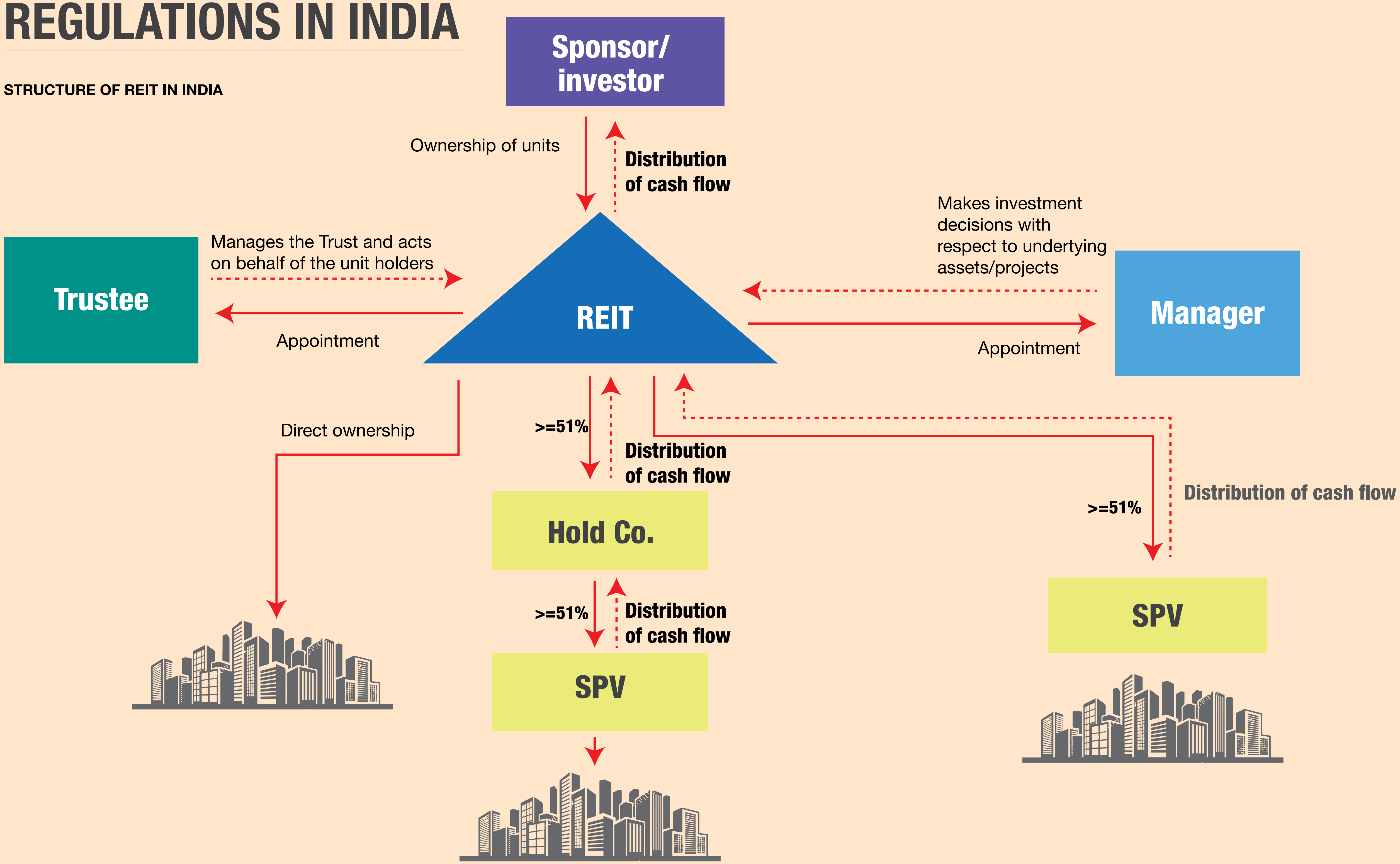
WORLDWIDE, AN AFFORDABLE OFFICE SPACE:

India is one of the countries globally offering affordable prime spaces, with high growth potential. The availability of such assets is expected to find takers for REITs in India.

[2] http://esa.un.org/wpp/documentation/pdf/WPP2012_%20KEY%20FINDINGS.pdf
[3] KPMG in India Analysis; Decoding Housing for all by 2022, KPMG in India, 2014

REIT STRUCTURE AND REGULATIONS IN INDIA

STRUCTURE OF REIT IN INDIA



SEBI REGULATIONS APPLICABLE TO REIT

The REIT regulations have sought to create an ecosystem by detailing the role and responsibilities of each stakeholder and laying down the conditions for operating and managing a REIT in India.

After the draft regulations issued in January 2008 and October 2013, for the first time, the Securities and Exchange Board of India (SEBI) had notified the SEBI (Real Estate Investment Trusts) Regulations, 2014 on 26 September 2014 ('Original Regulations'). Thereafter, SEBI issued consultation paper on 18 July 2016 for public comments followed by Press Release dated 23 September 2016. After considering certain proposals forming part of consultation paper, SEBI has amended Original Regulations by issuing Amendment Regulations vide notification dated 30 November 2016 ('Amendment Regulations') liberalising REIT regulations and making it more attractive investment vehicle. Original Regulations read with Amendment Regulations are hereby referred to as ('Revised Regulations'). Further, in December 2016, SEBI has issued various circulars providing guidance on public issue of REIT units and disclosures/ compliances to be made by REIT viz. circular dated 19 December 2016 on Guidelines for public issue of units of REIT, circular dated 26 December 2016 on Disclosure of Financial Information in the offer document for REITs and circular dated 29 December 2016 on Continuous disclosures and compliances by REIT.

Table 2: Key SEBI regulations applicable to REIT have been summarised as under:

ASPECT	REGULATIONS
SPONSOR	• Any person could be Sponsor, interalia, company, LLP, individual etc. whether resident or non-resident; • Original Regulations capped the maximum number of Sponsors at 3. However, such ceiling limit has now been removed in the Amendment Regulations and concept of Sponsor Group is introduced; • Sponsor Group includes, ❖ Sponsors, ❖ In case the Sponsor is body corporate, (a) entities or persons which are controlled by such body corporate, (b) entities or persons who control such body corporate; (c) entities or persons which are controlled by person(s) as referred at clause b. ❖ In case Sponsor is an individual, (a) immediate relative of such individual, (b) entities or persons controlled by such individual; ❖ For each sponsor group atleast one person shall be identified as Sponsor. • Sponsor or its associate to have minimum 5 years of relevant experience in real estate development or fund management • Net worth/net tangible asset – minimum INR 200 million for each Sponsor and collectively INR 1 billion • In case Sponsor is a developer - Track record of atleast 2 completed projects required • Lock-in period: ❖ minimum holding of 25% – atleast 3 years from listing date; ❖ Holding above 25% - atleast 1 year from listing date ❖ Beyond 3 years – 25% holding could be reduced down to collectively 15% and with re-designated Sponsor-below 15% ❖ Each Sponsor to hold atleast 5% at all times and Sponsor and Sponsor Group collectively to hold atleast 15% of outstanding units at all times;
MANAGER	• Manager can be a company or LLP or a body corporate incorporated in India which manages assets and investments of, and undertakes operational activities, of REIT • Minimum net worth/ net tangible asset value of INR 100 million • Manager or its associate to have minimum 5 year of relevant experience in fund management or advisory services or property management or in development of real estate • Manger to have minimum 2 of its employees with 5 years of experience in fund management or advisory services or property management or in development of real estate • At least half of its directors or member of governing body to be independent and not a directors or member of governing body of another REIT
TRUSTEE	• Need to be registered with SEBI under SEBI (Debenture Trustees) Regulations, 1993 • To be independent from Sponsor / Manager of REIT • Trustee cannot invest in units of REIT; As per the Amendment Regulations, associates of the trustee are now permitted to invest into units of REIT • Trustee need to enter into an investment management agreement with the Manager and regularly overview activities of Manager and report to SEBI, whenever required
INVESTORS IN REIT	• Can be any person whether resident, or non-resident (Mutual funds, insurance companies recently permitted to invest, subject to certain conditions) • Minimum investment per investor – INR 0.2 million (initial as well as follow-on) offer Trading lot size per unit - INR 0.1 million
LISTING REQUIREMENTS	• Mandatory • Minimum assets worth INR 5 billion to be owned by REIT at the time of public offering • Minimum offer size INR 2.5 billion; • Minimum public holding – ❖ At the time of initial offer - 25% or such % of holding equivalent to INR 4 billion or 10% depending upon value of post issue capital of REIT ❖ Post 3 years from date of listing under initial offer – 25% • Minimum number of unit holders other than Sponsors, its associates and related parties to be 200 at all times;
INVESTMENT BY REIT	• REIT to invest atleast 80% in completed and rent-yielding assets • Rent-yielding assets (could be offices, retail, warehouses, etc.) Amendment Regulations have expanded REITable asset definition to include hotels, hospitals and convention centres, forming part of composite real estate project and common infrastructure for composite real estate projects, Industrial Parks and SEZ • Maximum of 20% of investments could be in following assets: ❖ Under-construction properties, completed but not rent-generating properties (earlier restriction of 10% liberalised to 20% by Amendment Regulations) ❖ debt of companies/body corporates in the real estate sector, ❖ Mortgage Backed Securities (MBS), government securities, ❖ money market instruments/cash equivalents ❖ listed equity of companies having 75% or more operating revenue from real estate activity ❖ unutilised FSI and TDR for utilisation in investee projects

INVESTMENT BY REIT	• Investment by REIT could be directly or through SPV or through Hold Co structure (Hold Co structure permitted under Amendment Regulations) – SPV/ Hold Co could be a Company or LLP • REIT to hold atleast two projects, directly or through the Hold Co and/ or SPV, with not more than 60% of the value of assets in one project • Assets should be situated in India • Investments in vacant land and agricultural land or mortgage (other than mortgaged back securities) are not allowed • Investments in vacant land or agricultural or mortgaged is allowed where it forms a contiguous extension of an existing project being implemented in stages; • Investment in other REITs is not allowed
INCOME RESTRICTIONS	• Minimum of 51% (liberalised from 75% in Original Regulations) of the revenue of the REIT, Hold Co and SPV - to be rent income (except gains arising from the disposal of properties)
DISTRIBUTION POLICY	• 90% of the net distributable cashflow generated by REIT, Hold Co and SPV needs to be distributed, not less than once every six months and not later than 15 days from date of declaration • Additionally in case of Hold Co, 100% of the cashflow received from SPV needs to be distributed, not less than once every six months. • If sale proceeds of asset are reinvested within 1 year, then the same need not be distributed
VALUER	• Should not be an associate of the Sponsor or the manager • Separate valuers for undertaking financial and technical valuation (as per Amendment Regulations) • Minimum relevant experience of 5 continuous years, in relevant area of valuation practice/ asset value and categories and be citizen of India • Valuation criteria – Twice a year and to be in line with international valuation standards and valuation standards as specified by ICAI for valuation of real estate assets
RELATED PARTY TRANSACTIONS	• Permitted subject to the following conditions: ❖ Should be at arm's length price; ❖ Specified disclosures to be made periodically to unit holders and stock exchange; • Purchase or sale of property from related party should be in accordance with two independent valuations and must be at a price not greater than 110% (in case of purchase)/not lesser than 90% (in case of sale), of the average of the two independent valuations
BORROWINGS & DEFERRED PAYMENTS	• Consolidated borrowings and deferred payments of REIT, Hold Co and SPV – not to exceed 49% of the value of REIT assets provided that such borrowings and deferred payments shall not include any refundable security deposits to tenants. • For borrowings and deferred payments in excess of 25% - mandatory credit rating and investor approval

CERTAIN KEY RELAXATIONS BROUGHT OUT IN THE AMENDMENT REGULATIONS HAVE BEEN SUMMARISED AS UNDER:

Allowing two layer investment structure

Real estate assets are usually held through multiple layers of investment companies as each asset/project has its own set of investors, land owners, joint development partners, lenders etc. The requirement to have all the assets under one or multiple SPVs at the same horizontal level for listing through REIT involves significant restructuring of existing holdings and costs associated with such transfer.

Considering these complexities, the Amendment Regulations have brought in changes in respective regulations to enable REIT to own the real estate projects through two layer structure i.e. Hold Cos and SPV, wherein Sponsors can easily exchange shares of Hold Co with units of REIT.

Expanding the definition of Real estate property

As per the definition of Real estate property in the Original Regulations, all assets falling under the purview of 'infrastructure' as defined under the notification of Ministry of Finance dated 07 October, 2013 (for example hotels, hospitals, convention centres, etc.) were excluded. Large townships and commercial projects often offer business parks, hospitals, hotels etc. as part of the project, each of which are rent/ income generating completed assets. Therefore, it was suggested to include such assets in the category of REITable assets.

Accordingly, the Amendment Regulations have widened the scope of REITable assets to include hotels, hospitals and convention centres, forming part of composite real estate projects, whether rent generating or income generating and common infrastructure for composite real estate projects, Industrial parks and SEZ, which is a welcome move and will enable many sponsors to offload their composite real estate projects into REIT.

Removal of ceiling limit on number of Sponsors and introduction of concept of Sponsor Group

In real estate sector the assets are usually held by the developer either itself or through its group companies/relatives. Similarly, a private equity fund holds the asset through multiple schemes of the same private equity fund or different funds under common control. Also, a sizeable number of assets are owned on a joint development basis by developers and private equity funds.

In addition to above, considering the minimum experience and net worth eligibility criteria to be fulfilled by the Sponsor, Amendment Regulations removed ceiling on maximum number of Sponsors as prescribed in the Original Regulations and have introduced the concept of 'Sponsor Group'.

Increasing the limit of investment in under construction asset from 10% to 20%

In order to provide fungibility and to revitalize the cash-strapped under-construction projects, Amendment Regulations have increased the limit of investment in under construction asset and completed and not rent generating properties from 10% to 20%

Embarking on an initial public offering (IPO) journey and completing it successfully calls for strategic planning, sound advice and understanding and addressing the potential risks. For a successful REIT listing, the sponsor and manager must critically evaluate various issues including legal and tax structure, cohesive strategy and equity story, business intelligence and financial reporting challenges, corporate governance, risk management and availability of robust internal control systems.

Vide circular dated 19 December 2016, SEBI has issued detailed guidelines for public issue of units of REIT which have been summarized hereunder.

Table 3: **Key SEBI regulations for Public Issue of REIT units have been summarised as under:**

ASPECT	REGULATIONS
APPOINTMENT AND OBLIGATIONS OF MERCHANT BANKER AND OTHERS	• Manager shall in consultation with Trustee, appoint one or more merchant bankers and other intermediaries with at least one lead merchant banker • If there are more than one merchant bankers, the rights and responsibilities of each merchant banker shall be predetermined and disclosed in the offer document
FILING OF OFFER DOCUMENT	• Meaning of the draft offer document, offer document and final offer document has been given • Draft offer document to be filed with the Board and Designated Stock Exchanges • Lead Merchant Banker shall submit to the Board alongwith draft offer document: ❖ Certificate confirming agreement between Manager (REIT) and merchant banker ❖ Due diligence certificate in prescribed form • Draft offer document to be hosted on specified websites for at least 21 days and any comments and/ or changes made to the offer documents based on the comments received shall be filed with the Board by the lead merchant banker • Board may specify changes or issue observations within later of following: ❖ 30 days from of, (i) date of receipt the offer document, or (ii) date of receipt of clarification/ information from any regulator or agency (if any), or (iii) date of receipt of copy of in-principle approval letter by recognized stock exchanges ❖ 21 days from the date of receipt of reply from lead merchant banker • Merchant banker(s) shall ensure that all comments received from Board is suitably addressed prior to filing of offer document with Board and Stock Exchanges • Lead Merchant Banker shall submit: ❖ Statement certifying that all changes, suggestions and observations of the Board are incorporated ❖ Due diligence certificate in prescribed form • If changes are made to the draft offer document with respect to the prescribed information, lead merchant banker shall make a fresh draft offer document. However for any other information the lead merchant banker shall file the updated information. • Manager shall make a pre issue advertisement
ALLOCATION IN PUBLIC ISSUE	• Issue through book building process or otherwise shall be as follows: ❖ not more than 75% to the Institutional Investors ❖ not less than 25% to Other Investors • Allocate up to 60% to the Institutional Investors and Anchor Investors based on the conditions specified in circular interalia lock-in of 30 days on the units allotted to Anchor Investors from the date of allotment in public issue • Parameters for selection of Anchor Investor to be clearly identified by merchant banker
APPLICATION AND ABRIDGED VERSION OF THE OFFER DOCUMENT	• Application form and abridged version of the offer document (with all disclosures prescribed) and arrangements for the distribution shall be made by the Merchant Banker • Disclosures in the abridged version as specified • No person shall make an application in public issue for that no. of units which exceeds the no. of units offered to public
SECURITY DEPOSIT	Manager shall deposit before the opening of subscription and keep deposited 0.5% of the issue size or INR 50 million, whichever is lower with the stock exchange.
OPENING OF AN ISSUE AND SUBSCRIPTION PERIOD	• Issue shall be opened after at least five working days from the date of filing the document • Lead Merchant Banker shall submit a due diligence certificate in prescribed form immediately before the opening of the issue • A public issue shall be kept open for at least three working days but not more than thirty days • Manager may issue advertisement for issue opening and issue closing
UNDERWRITING	The merchant banker(s) and syndicate members shall not subscribe to the issue except for fulfilling their underwriting obligations and incase of underwritten issue, the merchant banker(s) shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992
PRICE AND PRICE BAND	• The Manager may determine price of units in consultation with merchant banker or through book building process • Differential price shall not be offered to any investor • The Manager shall announce the floor price or price band at least five working days before the opening of the bid along with the basis of Issue price • The Manager shall determine the issue price and the units shall be accordingly allotted • Merchant banker may reject a bid placed by Qualified Institutional Buyer at the time of acceptance of the bid and reasons shall be disclosed
BIDDING PROCESS	• Entire application money shall be collected or blocked from the applicants before order is placed • The payment accompanied with any revision of Bid, shall be adjusted against the payment made at the time of the original bid or the previously revised bid.

	• The bidding terminals shall contain an online graphical display of demand and bid prices updated at periodic intervals, not exceeding thirty minutes • The manager may decide to close the bidding by institutional investors 1 day prior to closure of the issue subject to the condition that bidding shall be kept open for a minimum of 3 days for all categories of applicants and suitable disclosures made in the draft offer document and offer document • No investor shall either withdraw or lower the size of bids at any stage • The identity of Institutional Investors except anchor investors making the bidding shall not be made public
ALLOTMENT PROCEDURE AND BASIS OF ALLOTMENT	On receipt of sum on application, the allotment of units to applicants other than anchor investors shall be on proportionate basis and unsubscribed portion may be allotted to the other category applicants. In case of under subscription, the unsubscribed portion may be allotted to applicants in other category.
MAINTENANCE OF BOOKS AND RECORDS	• Merchant Banker shall maintain a final book of demand showing the allocation process • Book Building Prices records to be maintained by Merchant bankers and Other Intermediaries • Board has right to inspect records, books and documents
POST- ISSUE REPORTS	• The lead Merchant Banker shall submit the following as specified: ❖ Initial Post issue report within 3 days of closure of issue ❖ Final Post Issue Report within 15 days of date of finalization of basis of allotment or date of refund • Lead Merchant Banker shall submit a due diligence certificate in prescribed form
PUBLIC COMMUNICATIONS, PUBLICITY MATERIALS, ADVERTISEMENTS AND RESEARCH REPORTS	• Manager shall make prompt true and fair disclosure of all developments taking place between date of filing offer document and allotment of units and make a public communication • Public communication should comply with criteria's prescribed in circular. For example, communications should be truthful, fair and not manipulative, etc. • Merchant Bankers shall submit a compliance certificate for news reports appearing between the date of filing the draft offer document with the Board and date of closure of the issue • No public communication shall- ❖ contain any matter extraneous to the contents of offer documents ❖ be issued giving impression that issue has been fully subscribed/ over-subscribed ❖ contain any offer with direct or indirect incentives

OTHER OBLIGATIONS OF POST-ISSUE MERCHANT BANKER	Post issue merchant bankers shall monitor redressal of investor grievances and continue to be responsible for post issue activities till the subscribers have received credit to their demat account or refund of application moneys and listing agreement is entered into by REIT with the stock exchange and listing/trading permission is obtained
GENERAL CONDITIONS	Circular also gives guidance with respect to restrictions on issue, alteration of rights of holders, prohibition on payment of incentives, appointment of compliance officer and general obligations of merchant bankers.

Further, in addition to Schedule III to the Revised Regulation which provides for mandatory disclosures to be made in the Offer Document/ Follow-on Offer Document, SEBI has vide circular dated 26 December 2016, SEBI has prescribed disclosure norms to be followed by REIT for disclosure of financial Information in the offer document to be filed with SEBI, which has been summarised hereunder.

Table 4: **Key SEBI regulations for Disclosure of financial information in offer document for REITs have been summarised as under:**

ASPECT	REGULATIONS
PART A - FINANCIAL INFORMATION OF REIT	
PERIOD OF FINANCIAL INFORMATION TO BE DISCLOSED	• Financial Information for the past three completed financial years immediately preceding date of offer document • If last completed financial year falls more than 6 months before the date of offer document, then interim financial information to be disclosed in addition to 3 years financial information
NATURE OF FINANCIAL INFORMATION	• If REIT has been in existence for last three completed financial years, then standalone and consolidated financial statements of REIT to be disclosed for the last 3 financial years and the interim period, if any. • If the REIT has not been in existence for last three completed financial years or for a part of last three years, then combined financial statements to be disclosed for such periods

CONTENT AND BASIS OF PREPARATION OF FINANCIAL INFORMATION	• Financial Information shall be prepared as per Ind AS or any addendum thereto • The financial information of the REIT can be in the form of condensed financial statements and shall comply with the minimum disclosure requirements as described in Ind AS on Interim Financial Reporting • Financial information to include: ❖ Balance Sheet; ❖ Statement of Profit and Loss/Income and Expenditure; ❖ Statement of Changes in Unit holders' Equity; ❖ Statement of Cash Flows / Receipts and Payments; ❖ Statement of Net Assets at Fair Value; ❖ Statement of Total Returns at Fair Value; ❖ Explanatory notes annexed to, or forming part of, any statements referred above • Financial Information shall be disclosed after making following adjustments: ❖ Adjustments/ Rectifications for all erroneous accounting practices or failures to make provisions or other matters which resulted in modified audit opinion; ❖ Material amounts relating to adjustments for prior period errors to be adjusted in year to which they relate as per Ind AS on Accounting Policies, Changes in Accounting estimates and Errors. ❖ If there has been changes in accounting policies, then uniform policies to be applied ❖ If any accounting policy followed in past was not in accordance with applicable laws and/ or accounting standards, the financial statements shall be adjusted and recomputed in accordance with correct accounting policies ❖ Balance Sheet shall be prepared after deducting balance outstanding on revaluation reserve account from fixed assets and reserves and the net worth should be arrived at after such deductions • Financial statements shall disclose all material items. Additionally any item of income or expenditure exceeding 1% of Revenue from Operations or INR 1 Million, whichever is higher shall be disclosed separately either on face of financial statement or under schedules/ notes
ADDITIONAL FINANCIAL DISCLOSURES	Following additional disclosures are prescribed: • Property wise Rental/ Operating Income for past 3 years and interim period, if any • Earnings per unit – as per Ind AS on Earnings per Share. • Contingent Liabilities • Commitments • Related Party Transactions – as per Ind AS on Related Party Disclosures. • Capitalisation Statement in the prescribed format along with any change in the unit capital • Debt payment history of all REIT assets (on a consolidated basis) - for past 3 years and interim period, if any.

AUDIT OF FINANCIAL INFORMATION	• Audit carried out by the appointed auditor as per the REIT regulations and holding valid certificate issued by Peer Review Board (ICAI). • In providing the audit report, the auditor shall be guided by the requirements of the 'Guidance Note on Reports in Company Prospectuses' issued by ICAI • Auditor of REIT can take into consideration and rely upon the reports of the auditors of various REIT assets for giving final audit report • Auditor in the audit report shall state whether: ❖ He has obtained all information and explanations which, to the best of his knowledge and belief, are necessary; ❖ Balance Sheet and Statement of Profit and loss/Income and Expenditure are in agreement with the books of account of the REIT; ❖ financial statements comply with the applicable accounting standards • Auditor shall give his opinion on whether financial statements (including statement of net assets, statement of changes in unit holders equity and statement of total return) give a true and fair view
PART B - PROJECTIONS OF REIT'S INCOME AND OPERATING CASH FLOWS	
PROJECTIONS OF REIT'S INCOME AND OPERATING CASH FLOWS	• The projections shall be disclosed for REIT assets (owned/ proposed to be owned) prior to allotment of units in public offer • Following are the minimum items to be disclosed as part of the projections for the next 3 years: ❖ Property-wise income (rental income and/or other operating income) ❖ Property-wise operating cash flows ❖ Assumptions for projections ❖ Any other item deemed important for better readability and understanding • The above projections shall be certified by the auditor and the Manager
Part C - Management Discussion and Analysis of REIT's operations	
MANAGEMENT DISCUSSION AND ANALYSIS OF REIT'S OPERATIONS	• REIT shall prepare and disclose Management Discussion and Analysis (MDA) and a comparison shall be provided for the most recent financial information with financial information of previous two years • MDA shall interalia include the prescribed items, for example, overview of Business, summary of significant items of income, significant developments subsequent to last financial year, etc.

Part D – Other Disclosures for REIT	
OTHER DISCLOSURES FOR REIT	• Working Capital – Statement from the Manager regarding sufficiency of working capital to fulfil present requirements of REIT for at least twelve months from date of listing • Past Market performance – in case of capital offering subsequent to the initial offer, the market value of the units shall be disclosed: ❖ on the last date of reporting period ❖ highest value during reporting period based on intra-day and on closing price with specified date ❖ lowest value during reporting period intra-day and on closing price with specified date
PART E – HISTORICAL FINANCIAL INFORMATION OF THE MANAGER AND SPONSOR	
HISTORICAL FINANCIAL INFORMATION OF MANAGER AND SPONSOR(S)	• Offer document of the REIT shall include summary of the audited consolidated financial statements of Manager and Sponsor for the past three completed years prepared in accordance with applicable accounting standards • In case Manager and/ or Sponsor have done a transition from Indian GAAP to Ind AS at any time during the period of last three years, then disclose based on the following basis: ❖ if the concerned entity is following or required to follow Ind AS for latest two years then, all the three years shall be prepared as per Ind AS ❖ if the concerned entity is following or required to follow Ind AS only for latest year then the recent two years shall be as per Ind AS and the earliest year shall be as per Indian GAAP • In case the Manager and/ or Sponsor is a foreign entity and is not legally required to comply with Companies Act 2013, the financial statements shall be prepared as per IFRS (International Financial Reporting Standards).
Part F – Framework for calculation of Net Distributable Cash Flows (NDCFs)	
FRAMEWORK FOR CALCULATION OF NET DISTRIBUTABLE CASH FLOWS (NDCFS)	• Every REIT/ manager shall define net distributable cash flows (NDCFs) for itself and such a definition shall be subject to compliance with Companies Act, 2013 or Limited Liability Partnership Act, 2008 or any other Central Government act, as applicable and the definition of NDCF shall be disclosed in offer document and followed consistently • Framework determined for NDCF shall be followed by the Hold co/ SPV/ REIT • The circular provides an indicative definition and calculation of NDCF at SPV level and at consolidated REIT level.

Part G – Principles for preparation of combined financial statements	
Principles for preparation of combined financial statements	• As mentioned above, if the REIT has not been in existence for last three completed financial years or for a part of last three years, then combined financial statements to be disclosed for such periods • All the assets/entities proposed to be owned by the REIT shall collectively form part of Combined Financial Statements • Combined Financial Statements shall be prepared based on an assumption that all the assets and/or entities, proposed to be owned by REIT, were part of a single group for such period when REIT was not in existence • Preparation of Combined Financial Statement shall be as follows: ❖ Prepared and presented as if REIT assets were a part of the single group since the first day of reporting period ❖ Principles for consolidation apply except that Combined Financial Statements shall not have a parent – as per Ind AS on Consolidated Financial Statements. ❖ Transactions with entities proposed to be owned by REIT shall be eliminated while preparing Combined Financial Statements ❖ Where any of the underlying REIT assets have been held by the sponsor or its associates or its group entities for a period lesser than the last three completed financial years, then such assets may be reflected in the Combined Financial Statements only from the date of holding by such entity or date of acquisition by the Sponsor or its associates or its group entities (if discrete financial information for REIT assets for the pre holding period is available then such assets shall be reflected in Combined Financial Statements for such pre holding period as well) ❖ Assets for which the financial information of a period of less than 3 year and additional interim period has been considered, then such fact shall be disclosed with all pertinent details ❖ Assumptions made shall be disclosed in 'Basis of Preparation' ❖ Guidance Note on Combined and Carve-out Financial Statements issued by ICAI should be referred for further guidance
Part H – Minimum Disclosures for key financial statements	
MINIMUM DISCLOSURES FOR KEY FINANCIAL STATEMENTS	Minimum disclosure line items have been prescribed for the following key financial statements: ❖ Balance Sheet ❖ Statement of Profit and loss/Income and Expenditure including additional line items ❖ Statement of changes in Unit holders' equity including a reconciliation between carrying amount at the beginning and the end of the period with necessary disclosures ❖ Statement of Cash flows / Receipts and Payments ❖ Statement of Net Assets at Fair Value ❖ Statement of Total Return at Fair Value ❖ Headings, line items, sub line items shall be added or substituted if such presentation is relevant in understanding of financial information or of required for compliance

In order to provide transparency, in addition to the disclosures required to be made in the Annual and Half yearly report to the unit holders as per Schedules IV of the Revised Regulation, SEBI has vide circular dated 29 December 2016, prescribed norms for Continuous disclosures and compliances by REIT to the Stock Exchanges as summarised hereunder.

Table 5: **Key SEBI regulations for Continuous disclosure and compliance by REIT have been summarised as under:**

ASPECT	REGULATIONS
PART A - FINANCIAL INFORMATION OF REIT	
FREQUENCY AND TIME PERIOD FOR DISCLOSURES	• Submit half yearly and annual financial information • Timelines for Submission ❖ Within 45 days from the end of the first half year ❖ Within 60 days from the end of the financial year (annual and second half year financial information) • Note to be given stating that the figures for second half year shall be the balancing figures as provided therein,
NATURE OF FINANCIAL INFORMATION	Standalone and consolidated financial information
COMPARATIVE INFORMATION	• To be disclosed for both annual and half year. Half year comparative information to include immediately preceding half year and corresponding half year • To consist of corresponding amounts for all the items shown in the key financial including notes and for the additional disclosures to the extent applicable • If Comparatives are not available due to non-existence of the REIT, such fact shall be disclosed
BASIS OF PREPARATION OF FINANCIAL INFORMATION	• Financial information of REIT be prepared as per Ind AS • Hold Cos/ SPVs owned by REIT may prepare the financial statements as per the applicable laws and accounting standards but the consolidated financials of REIT to be as per Ind AS • In addition to Ind AS financials, REIT may submit the financial information as per IFRS with the material differences between Ind AS and IFRS highlighted and explained
KEY FINANCIAL STATEMENTS	• The financial information of the REIT can be in the form of condensed financial statements and shall comply with the minimum requirements as described in Ind AS on Interim Financial Reporting • Annual financial information to include: ❖ Balance Sheet; ❖ Statement of Profit and Loss/Income and Expenditure; ❖ Statement of Changes in Unit holders' Equity; ❖ Statement of Cash Flows / Receipts and Payments; ❖ Statement of Net Assets at Fair Value; ❖ Statement of Total Returns at Fair Value; ❖ Explanatory notes annexed to, or forming part of, any statements referred above • Half yearly financial information shall include: ❖ Statement of Profit and Loss/Income and Expenditure ❖ Explanatory notes annexed to, or forming part of, any statements referred above • Minimum information to be disclosed for the key financial statements as per SEBI circular on Disclosure of financial information in offer document for REITs • In case of sale/ divestment of any holding/ investment in the underlying SPVs or sale of real estate, the profit/ loss should be shown on gross basis
ADDITIONAL DISCLOSURES WHILE SUBMISSION OF FINANCIAL INFORMATION	• Following disclosures shall be included as part of the financial information: ❖ Statement of Net Distributable Cash Flows (NDCFs) for the REIT and all the underlying Hold Cos/ SPVs ❖ Details of the Manager fees paid including any material changes to fees paid compared to previous period. Further explanations/ justifications for the fees paid to the Managers should be provided ❖ Disclosure for Change in accounting policy as per Ind AS ❖ In case the auditor has expressed a modified opinion, the REIT shall file a 'Statement on Impact of Audit Qualifications' with prescribed details. Such statement shall be signed by Chairperson/ CEO/ MD, CFO/ Head of finance, Statutory Auditor • If the modified opinion pertains to the corresponding period, then the REIT shall disclose the following: ❖ Brief details of the modified opinion/ reservations ❖ if such opinion has been resolved, details for the same. However, if the opinion/ reservations are not resolved, the reasons and steps intended to be taken • REIT shall disclose the following statements in the prescribed format: ❖ Statement of Earnings per unit ❖ Statement of Contingent Liabilities ❖ Statement of Commitments ❖ Statement of Related Party Transactions

APPROVAL AND AUTHENTICATION OF FINANCIAL INFORMATION	Financial information shall be authenticated and signed in the following manner: • Two designated personnel of the manager certifying that financial information do not contain any false or misleading statement or figures or does not omit any material fact • Subsequent to the above, shall be signed by the Chairperson/ MD/ Managing Partner/ Whole time director/ partner
AUDIT OF FINANCIAL INFORMATION	• Annual financial information shall be audited • Half yearly financial information may be either audited or subject to limited review by auditors appointed as per regulations • Audited financial information shall comply with the specified requirements. Additionally, the auditor shall give his opinion on whether the statement of NDCFs gives a true and fair view of NDCFs. • Financial information submitted to the Stock Exchange shall be filed along with the Audit Report/ Limited Review Report
PART B – FINANCIAL INFORMATION OF THE MANAGER	
FINANCIAL INFORMATION OF THE MANAGER	• REIT shall disclose summary of the audited consolidated financial statements of the Manager for the latest financial year along with comparative figures prepared in accordance with accounting standards as applicable for Manager • Above information may not be disclosed if the manager's net worth is not materially eroded, but such fact shall be disclosed (material erosion to be judged by Trustees)
PART C – OBLIGATION TO MAINTAIN PROPER RECORDS	
OBLIGATION TO MAINTAIN PROPER BOOKS OF ACCOUNTS AND RECORDS, DOCUMENTS, ETC.	Maintain proper books of account, records and documents for a period of minimum eight years immediately preceding a financial year
OTHER CONTINUOUS DISCLOSURES TO STOCK EXCHANGES AND OTHER COMPLIANCES	
LISTING AGREEMENT	REIT shall enter into simplified listing agreements with all stock exchanges as per REIT regulations

DISCLOSURE OF UNIT HOLDING PATTERN	• REIT shall disclose its unit holding pattern for each class of unit holders based on the specified format • Time lines for disclosing is as follows: ❖ 1 day prior to listing of units on Stock exchange ❖ Within 21 days of end of each quarter ❖ Within 10 days of any capital restructuring resulting in a change exceeding 2% of the total outstanding units of REIT
REVIEW OF CREDIT RATING	• Every credit rating shall be reviewed once in a year by a registered credit rating agency within 30 days from the end of the financial year with intimation to the stock exchange
WEBSITE OF REIT	Functional website shall be kept updated up to last 2 days and shall contain all relevant data
GRIEVANCE REDRESSAL MECHANISM	• Steps shall be taken for redressal of complaints. • REIT shall file a statement with the Recognized Stock exchange specifying details as prescribed within 21 days from the end of each quarter
STATEMENT OF DEVIATION OR VARIATION	• REIT shall submit following statements on a quarterly basis for any public issue, rights issue, preferential issue, etc: ❖ Statement indicating deviations, if any ❖ Statement indicating category wise variation, if any • Such statements shall be submitted till such time the issue proceeds have been fully utilized for the purpose for which such funds are raised.

FOREIGN EXCHANGE REGULATIONS APPLICABLE TO REIT

GOVERNING REGULATIONS AND ELIGIBLE FOREIGN INVESTORS

As per Regulation 14(12) of the Revised Regulations, any person whether resident or foreign are permitted to subscribe to the units of the REIT which shall be subject to guidelines as may be specified by Reserve Bank of India and the Government from time to time.

Schedule 11 of FEMA 20/2000 – RB dated 03-05-2000 [GSR 406 (E), dated 03-05-2000] -'Foreign Exchange Management (Transfer or issue of security by a Person Resident outside India) Regulations, 2000 ('FDI Regulations') permits any person resident outside India including Registered Foreign Portfolio Investor (RFPI) and Non-Resident Indian (NRI) to invest in units of REIT.

DOWNSTREAM INVESTMENT BY REIT

Downstream investment by REIT in Hold Co/ SPV shall be regarded as foreign investment if either the Sponsor or the Manager is not Indian 'owned and controlled'. Investment by persons resident outside India into units of REIT shall not be the determining factor as to whether downstream investment is foreign investment or not.

In this regard, Sponsor or Manager shall be considered as owned by resident Indian Citizen if more than 50% of the share capital (in case of company) or more than 50% of investment (in case of LLP), is beneficially owned and controlled by resident Indian citizens and/ or Indian Company/ entities which are ultimately 'owned and controlled' by resident Indian citizens.

In case of Company, 'Control' has been defined to include the right to appoint a majority of the directors or to control the management of policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement. In case of LLP, 'control' has been defined to mean right to appoint majority of the designated partners, where such designated partners have control over all the policies of the LLP.

Downstream investment by REIT that is reckoned as foreign investment shall have to conform to sectoral caps and conditions/ restrictions, if any, as prescribed in the principal FDI regulations. Thus, conditions prescribed in Schedule 1 and Schedule 9 of FDI Regulations need to be complied with in case of downstream investment in a Company and/or LLP respectively.

PRICING GUIDELINES AND REPORTING REQUIREMENTS

Pricing guidelines for issuance of REIT units to foreign investors are yet to be prescribed. REIT having foreign investment is required to make reporting to RBI or SEBI in a format which has not yet been prescribed.

EXTERNAL COMMERCIAL BORROWING ('ECB') IN REIT

The RBI has permitted REITs to obtain ECBs under Track II vide its AP DIR Circular No. 32 dated 30 November 2015 ('ECB Guidelines') under following parameters,

- Minimum average maturity period - 10 years,
- End use restrictions – ECB proceeds could be used for any purposes excluding the following, a) Real estate activities, b) Investing in capital market, c) Using the proceeds for equity investment domestically, d) On-lending to other entities with any of the above objectives, e) Purchase of land

Permissibility of foreign investment and ECB in REIT shall channelize overseas investment into India and shall provide low cost funds to cash trapped real estate sector in India.

INCOME-TAX IMPLICATIONS

The Finance Act, 2015 introduced the 'pass through' regime for taxation of REIT and its stakeholders which was further liberalised by Finance Act, 2016. While Budget 2017 pronounced certain direct tax proposals for the real estate sector, it missed out providing certain clarifications like according 'pass through' regime to Hold Co Structure under REIT, including LLP in the definition of 'SPV' etc. Appropriate representations should to be made before the Finance Ministry to consider the same for removing road blocks and making REIT structure successful in India.

Some of the key tax implications in hands of REIT as well as its stakeholders on different streams of incomes viz. capital gains, rental income, dividend income and interest income have been summarised below:

1) CAPITAL GAINS

A. Sponsors' tax liability on the transfer of shares in SPV in exchange of units of REIT / on transfer of asset to REIT

Capital gains tax as well as Minimum Alternate Tax ('MAT') on swap of shares of the SPV (being Company) to REIT in exchange of units of the REIT by the Sponsor is deferred till date of sale of REIT units.

However, such favourable tax treatment is not provided in case of swap of interest in LLP in exchange of units of the REIT. This seems to have been missed out in all 3 years past Budgets and should be brought at par.

Subsequent sale of units of REIT under an IPO listing or sale on stock exchange are subject to Capital Gains tax. Depending on holding period of units, i.e. 'held for more than 36 months' or not, gains on sale of units are taxed as long term capital gains ('LTCG') or short term capital gains ('STCG') respectively. If such transaction is subject to Securities Transaction Tax ('STT'), LTCG is exempt from taxation and STCG is taxable at 15%[4] subject to tax treaty benefits.

Cost of acquisition of the shares of the SPV as well as the date on which the shares were originally purchased should be considered while computing the capital gains tax on sale of REIT units held by a Sponsor.

Direct transfer of immovable property / asset by Sponsor to REIT is taxable in the hands of Sponsor at 20%[4] as LTCG or at 30%[4] as STCG depending on the holding period of such property/asset. Holding period of immovable property to qualify as long term capital asset, has been reduced down from 36 months to 24 months as per recently announced Budget 2017 proposals. Also, the base year for indexation has been shifted from 1981 to 2001 vide said Budget proposals, which shall significantly reduce the capital gains tax liability in the hands of the transferor. However, the beneficial treatment of deferment of tax liability as in case of exchange of shares of SPV for units of REIT, is not available in case of direct transfer of asset by Sponsor into the REIT, thus making such direct transfer of asset more costlier and unviable option.

B. Tax liability in the hands of REIT on the disposal of assets/ shares of Hold Co/ SPV

Any income/ gains arising in the hands of REIT from disposal of assets (being immovable property or shares of Hold Co / SPV) are taxable as LTCG/STCG, depending on its holding period being held for more than 24 months or not, respectively.

C. Unit holders' tax liability on the sale of REIT units on the stock exchange

Sale of REIT units by unit holders on stock exchange are subject to Capital Gains tax. If the units are sold after holding for a period more than 36 months and on which STT is paid, then gains on such sale are LTCG and exempt from tax. However, if units are sold before 36 months and on which STT is paid, the gains thereon are treated as STCG chargeable to tax at 15%[4] subject to tax treaty benefits.

2) RENTAL INCOME

A. Rental income earned by REIT and distributed to unit holders

Rental income earned by REIT on leasing of assets held directly is exempt in its hands and is taxable in hands of unit holders in same manner as it would have been taxed in hands of REIT.
Further, the tenant or lessee is not required to withhold tax on payment of rent to the REIT. However, REIT is required to withhold tax at 10 per cent on distribution of such income to the resident unit holders and at the applicable rates on distribution to the non-resident unit holders.

[4] Plus applicable surcharge and education cess

B. Rental Income earned by SPV / Hold Co

Aforementioned pass through tax treatment as in case of rental income earned by REIT, is not available in case of rental income earned by SPV / Hold Co. Rental Income earned by SPV / Hold Co is taxable in their hands at 30%[4] like any other business income.

3) DIVIDEND INCOME

A. Distribution of dividend by SPV to REIT and further distribution by REIT to unit holders

Dividend Distribution Tax ('DDT') is not applicable on dividend distributed by SPV to REIT, if REIT holds 100% of the equity share capital of such SPV (excluding certain % to be mandatorily held by other person as per applicable laws). Such Dividend income is exempt in the hands of REIT as well as the unit holders.

B. Distribution of dividend by SPV to Hold Co, by Hold Co to REIT and by REIT to unit holders

Dividend income received by Hold Co, REIT and the unit holders is exempt in their hands.
SPV distributing dividends to Hold Co is required to pay DDT at 15% grossed up to 17.65%[4]. Further such DDT is also required to be paid by the Hold Co on distribution of dividends by it to the REIT. However Hold Co is eligible to claim credit of the DDT paid by SPV on the dividends distributed to Hold Co.

However, such exemption from payment of DDT by SPV and Hold Co is not prescribed under two layer structure. Complete pass through taxation of dividend income should also be provided in case of such two layer structures similar to single layer structure.

4) INTEREST

Debt funding in Hold Co/ SPV through REIT shall provide tax break to Hold Co/ SPV in form of interest deduction.

Tax treatment as per current tax laws on such interest payment is as under:

A. Interest payment by SPV to REIT and distribution from REIT to unit holder

Withholding tax is not applicable on interest paid by SPV to REIT. The interest income earned by the REIT from the SPV is not taxable in hands of REIT and is taxable in hands of the unit holders. However, REIT is required to withhold tax on interest payable to unit holders at 5% for a non-resident and 10% for resident unit holders. It is worthwhile to note that for the non-residents, 5% is the final tax incidence on such interest income.
The definition of SPV as provided under the IT Act does not include LLP and hence, aforesaid 'pass through' tax treatment available in case of SPV being company is not available if the SPV is a LLP. This seems to have been missed out in all 3 years past Budgets and should be brought at par.

B. Interest payment by SPV to Hold Co, Hold Co to REIT and distribution from REIT to unit holders

Withholding tax at 10% is applicable on interest payments by SPV to Hold Co and by Hold Co to REIT. The interest (to the extent of spread) is taxable in the hands of the Hold Co. Interest paid by Hold Co to REIT is taxable in hands of REIT and any distribution of such interest income by REIT to unit holder is exempt in the hands of the unit holders.

'Pass through' treatment in case of interest under two layer structure needs to be brought at par with the treatment provided for single layer structure.

5) OTHER INCOME DISTRIBUTED BY REIT TO UNIT-HOLDERS

Distributed income received by the unit holder from REIT, except the proportionate interest and rental income (as discussed above in 2(a) and 4(a)) is exempt in their hands under the provisions of the IT Act.

6) LOWER WITHHOLDING TAX RATE OF 5% ON INTEREST PAYMENT IN CASE OF ECBS AVAILED BY A REIT.

The beneficial provisions of lower rate of withholding tax at 5% is available on interest payment by REIT to non-resident unit holders.

Kindly find bird's eye view of taxability at various levels under REIT structure as tabulated hereunder:

TABLE 6: **TAX IMPLICATIONS IN SINGLE LAYER STRUCTURE (SPV- REIT- UNIT HOLDER)**

TRANSACTION	SPV LEVEL	REIT	UNIT HOLDER (INCLUDING SPONSOR)
Interest payment by SPV being a company to REIT and distribution by REIT to unit holder	• Interest expenditure is deductible • No WHT	• Exempt • WHT on distribution at 10% to residents and at 5%[4] to non-residents	• Taxable for resident at normal rate • Taxable for non-resident at 5%[4]
Interest payment by SPV being a LLP to REIT and distribution by REIT to unit holder	• Interest expenditure is deductible • WHT at 10%	• Taxable at 30%[4] • WHT credit available • No WHT on distribution to unit holders	• Exempt
Rental income earned by REIT on property directly owned by it	• Not applicable	• Exempt • WHT at 10% on distribution to residents & at rates in force on distribution to non-residents	• Taxable at normal rates • WHT credit available
Business income and other income earned	• Taxable at 30%[4]	• Taxable at 30%[4] • No WHT on distribution to unit holders	• Exempt
Dividend from SPV to REIT and distribution by REIT to unit Holders	• No DDT at SPV level (provided the SPV is 100% owned by the REIT)	• Exempt	• Exempt
Capital gains on sale of immovable property/ shares (if period of holding is more than 24 months – LTCG, else STCG)	• Immovable property sold by SPV –Taxable at 20%[4] if LTCG or 30%[4] if STCG	• Immovable property or shares sold by REIT - Taxable at 20%[4] if LTCG or 30%[4] if STCG • No WHT on distribution to unit holders	• Exempt
Capital gains on sale of units of REIT on stock exchange	• Not applicable	• Not applicable	• LTCG – Exempt (if period of holding more than 36 months and STT paid) • STCG – Taxable at 15%[4] (if STT paid and subject to tax treaty benefit) • MAT applicable, if unit holder is a Company

[4] Plus applicable surcharge and education cess

Table 7: **Tax implications in two layer structure (SPV – Hold Co – REIT – Unit holders)**

TRANSACTION	SPV LEVEL	HOLD CO LEVEL	REIT	UNIT HOLDER (INCLUDING SPONSOR)
Interest payment by SPV to Hold Co, Hold Co to REIT and distribution by REIT to unit holder	• Interest expenditure is deductible • WHT at 10%	• Taxable (to the extent of spread) at 30%[4] • WHT at 10%	• Taxable at 30%[4] • No WHT	• Exempt
Rental income earned by REIT on property directly owned by it	• Not applicable	• Not applicable	• Exempt • WHT at 10% on distribution to residents & at rates in force on distribution to non-residents	• Taxable at normal rates • WHT credit available
Business income and other income earned	• Taxable at 30%[4]	• Taxable at 30%[4]	• Taxable at 30%[4] • No WHT on distribution to unit holders	• Exempt
Dividend from SPV to Hold Co, Hold Co to REIT and distribution REIT to unit holder	• DDT at15% - to be grossed up to 17.65%[4]	• Exempt • DDT at 15% - to be grossed up to 17.65%[4] • Credit of DDT paid by SPV could be claimed by Hold Co	• Exempt	• Exempt
Capital gains on sale of immovable property/ shares (if period of holding is more than 24 months – LTCG, else STCG)	• Immovable property sold by SPV –Taxable at 20%[4] if LTCG or 30%[4] if STCG	• Immovable property/ shares of SPV sold by Hold Co – Taxable at 20%[4] if LTCG or 30%[4] if STCG	• Immovable property or shares sold by REIT - Taxable at 20%[4] if LTCG or 30%[4] if STCG • No WHT on distribution to unit holders	• Exempt
Capital gains on sale of units of REIT on stock exchange	• Not applicable	• Not applicable	• Not applicable	• LTCG – Exempt (if period of holding more than 36 months and STT paid) • STCG – Taxable at 15%[4] (if STT paid and subject to tax treaty benefit) • MAT applicable, if unit holder is a Company

[4] Plus applicable surcharge and education cess

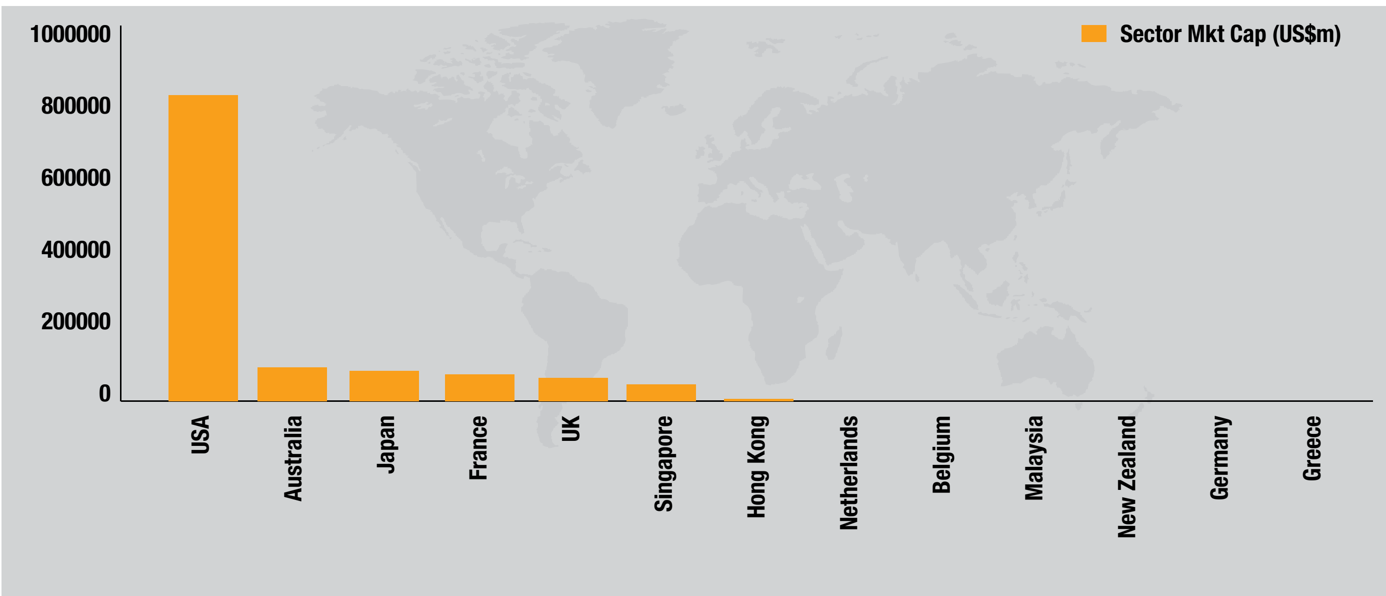
HISTORY AND REGULATORY REFORMS OF REIT MARKETS

REIT or a similar structure is a globally accepted investment vehicle for investing in real estate properties. More than 20 countries now have REIT or a similar structure. Since, its inception in the 1960s in the USA the REIT market is continuously developing across the world. In Asia, Japan was the first country to introduce REIT, later on followed by various Asian counties like Singapore, Indonesia, South Korea, etc. Presently, Japan and Singapore are the market leaders in Asia for REIT. The diagram below showcases the emergence of REIT across the world.

Though the REIT structure across the globe has many similarities or “standard structures”, its success and growth have not been the same across countries. There are instances in some countries where the journey to establish a REIT has not been devoid of hurdles. A study of the history of REIT structures in overseas countries could be relevant to analyse the future of REIT in India.[5]

[5]Hong Kong Financial Services Development Council – FSDC Research Paper No. 04, November 2013 and EPRA Global REIT Survey, July 2014

The chart below showcases market cap of REIT across leading countries.



Source: EPRA Global REIT Survey 2014

EVOLUTION OF THE U.S. REIT MARKET

The U.S. REIT market journey began in the 1960s. In the 1970s and 1980s it was at a developing phase. It was in the 1990s, where the sector had achieved a substantial growth due to increase in acceptance of REIT among the investors as an alternative mode of investment in real estate properties. The reason behind such growth was majorly because of positive changes in the U.S. tax and regulatory laws.

The U.S. REITs are classified on the basis of their investment form such as equity REITs, investing directly in properties and mortgage REITs, investing in housing loans and other real estate finance, which can be managed either internally or externally.

The two important tax and regulatory breakthroughs for the U.S. REITs have been the Tax Reform Act, 1986 (‘TRA’) and the REIT Modernisation Act (‘RMA’) effective from 2001. The TRA pushed for real estate investments to become more tax-transparent and for integration of REITs with ancillary real estate business, like property management, leasing or development, thereby facilitating more effective management of REITs. While the RMA made way for creation of taxable REIT subsidiaries (‘TRS’), which can independently engage in such ancillary business activities.

During the55 years of REIT history, the U.S. REIT market has gone through a roller coaster ride of success, failure, development and change which has transformed today’s REIT as an important vehicle for investment into real estate properties across the world.

EVOLUTION OF THE AUSTRALIAN REIT (‘A-REIT’) MARKET

Australia is one of the leaders in establishing a REIT regime and the first Australian REIT was established in 1971. Australian REITs (erstwhile famous as the Listed Property Trust or ‘LPT’) are relatively simpler tax effective corporate structures enabling pooled property investment. Following the first Australian REIT, the market for listed Australian REITs developed progressively until the 1980s. However, the Australian REIT market received a boost from the lessons learned from the failure of the commercial property market in the early 1990s an essential lesson being the importance of holding some liquid assets along with holding direct properties.

REITs offered a convenient mechanism effectively blending investment in property along with a good liquidity position. This led to a huge roar in the Australian REIT market during the late 1990s, reinforced by both private players as well as institutions, around 60 REITs were listed on the ASX during this time. Further, increase in the popularity of stapled securities and internationalisation of Australian REITs further pushed the growth of the Australian REIT market.

EVOLUTION OF THE JAPANESE REIT (‘J-REIT’) MARKET

Japan is a leading REIT market in Asia. The first two J-REITs were listed in 2001 and thereafter the J-REIT market grew rapidly with around 41 J-REITs listed by early 2007.

The swiftness of this growth mechanism can be credited to efficient tax and regulatory reforms. Reforms such as lowered tax rate on capital gains and dividends, allowing funds-of-funds to invest in REITs further enhanced the growth and appeal of REITs. Other factors such as large gap (“spread”) between dividend yields of J-REITs and interest yields of 10year government bonds, track record of stable dividends among listed names greatly contributed in promoting J-REITs as a lucrative investment alternative.

The J-REIT market demonstrated a reverse trend since mid2007. Several steps such as raising funds from Japanese banks through various mechanisms as well as tax reforms such as allowing retention of negative goodwill brought about at the right time which have facilitated the effective functioning of J-REITs market.

EVOLUTION OF THE SINGAPORE REIT (‘S-REIT’) MARKET

Singapore, along with Japan, is one of the market leaders in the Asian region. The first Singapore REIT (‘S-REIT’) was established and listed in July 2002. The growth of S-REITs market after the launch of the first REIT was slow until 2005. However, post the declaration of the policy of remission of stamp duty in 2005, the S-REITs market experienced a major boost and the number of REITs more than doubled by 2006.

The year 2009 was the first year, when the value of S-REITs assets were significantly written down owing to the impact of the great global financial crisis in 2008. However, S-REITs market gradually improved back to the normal conditions.

Most initial S-REITs are focused on domestic property portfolio, while the more recent S-REITs have expanded their property portfolio base to include overseas, primarily regional properties from China, Japan, Australia and India. Since 2010, Singapore REIT market has achieved huge success with increased focus on securitisation, overseas exposure in the S-REITs.

In the recent Singapore Budget, to continue to promote the listing of REITs in Singapore and strengthen Singapore’s position as a REITs hub in Asia, the package of tax concessions for REITs has been reviewed. The package of income tax concessions for REITs has been extended to March 31, 2020.

EVOLUTION OF THE UNITED KINGDOM REIT (‘U.K.-REIT’) MARKET

The U.K. REIT vehicle was launched with effect from 1 January 2007 by the Finance Act 2006. Within the first year of the regime itself, the number of registered REITs grew significantly, but since then the growth has been sluggish.

The U.K. REIT regime operates through a combination of legislation (primary and secondary) plus guidance. The primary legislation has been reworked as part of a project to simplify the U.K.’s tax legislation which forms part of the Corporation Tax Act 2010. The legislation now separates the property rental business from the other business activities termed as the residual business for taxation purposes.

Over the seven years from its launch, the U.K. REIT regime has evolved with a number of changes that have resulted in a more attractive REIT regime which are worthwhile to note. Key changes brought about in the regime were, relaxation of listing requirement to allow listing on secondary markets, abolition of flat 2 per cent tax charged on value of properties of groups entering the REIT market, allowing cash to be a good asset for the business test of 75:25 as also modification of stamp duty on bulk purchases of residential property, which were especially aimed at encouraging smaller real estate players seeking to start-up REITs and boosting the residential property markets.

EVOLUTION OF THE HONG KONG REIT ('H-REIT') MARKET

H-REIT was introduced through the Hong Kong REIT Code in 2003. However, since its emergence, the H-REIT market growth has been sluggish. Its development story significantly lags behind the other REIT markets in the Asia-Pacific region mainly due to relative restrictiveness and want of some tangible incentives.

Recognising the need of the current REIT market, the Securities and Futures Commission (SFC) has revised Hong Kong's Code on Real Estate Investment Trusts (REITs) on August 29, 2014, taking immediate effect. Under the new regime, Hong Kong's REIT portfolios have been expanded to allow investment in retail properties, commercial and hotel properties, as well as properties in Mainland China. Further permission has now been granted for REITs to invest in developing properties, also engage in development activities and to purchase financial instruments (including local and foreign property funds), subject to the criteria of minimum investment in rent-generating property. In addition, appropriate provisions have been introduced to ensure transparency in a REIT's activities.

Going by the fact that regulatory changes play an important role in evolution of the REITs, it could be interesting to see how markets react to the recent changes to the Hong Kong REIT regime.

CONCLUSION:

REIT MARKETS EVOLVE WITH MARKET CONDITIONS AND REGULATORY CHANGES

The REIT market over the years has showcased a similar growth phase in various countries like the U.S., Australia and Singapore. Initially, there was slow growth, which gradually moved to substantial growth with changes in the REIT tax and regulatory regime to make it commercially acceptable among the investors, this was followed by sector consolidation. Internationalisation of REIT has deepened the global real estate sector and boosted market liquidity.

Key takeaways from international REITs which currently do not form part of the REIT regime in India are the concepts of stamp duty remission, overseas property portfolio.. Additionally, it is worth noting that, mere legalising REITs does not guarantee that it will take off. REIT regulators have to ensure that the REIT regime is continuously reviewed in accordance with the changing requirement of the real estate market.

MAKING REITS SUCCESSFUL IN INDIA

1. TAX RELATED

Tax efficiency can be critical to the success of REITs. Although, the Government has brought amendments in the IT Act to provide a tax efficient and stable regime for REITs in India, some of the key challenges in the current taxation regime at various levels of the REIT structure are elaborated below:

- While swap of shares of the SPV Company in exchange of REIT units are exempt, no such exemption is provided in respect of direct transfer of assets to REIT, which makes direct transfer of property from Sponsor to REIT unviable.
- Amendments required to provide 'pass through' mechanism for two layer structure, i.e.: SPV – Hold Co – REIT - unit holders:
- Exemption from DDT on dividends paid by SPV to Hold Co and Hold Co to REIT;
- Exemption from WHT on interest paid by SPV to Hold Co and Hold Co to REIT, Further such interest paid by Hold Co to REIT to be exempt in the hands of REIT;
- Capital gain tax and MAT deferral on swap of shares of Hold Co by Sponsor in exchange of units of REIT

- Definition of SPV to include LLP
- Requirement of holding the REIT units for more than 36 months to qualify as long-term capital asset may act as a disincentive for investors to invest in the REIT vis-à-vis listed equity shares where the period of holding to qualify as long-term capital asset is more than 12 months. Parity is required to make it lucrative for investors to invest in units of a REIT.
- The REIT should be made a complete pass-through vehicle as against the current provisions which allows pass-through only with respect to distribution of interest income from SPV and rental income from REIT which is taxed in the hands of the investors directly, while capital gains and other income is still taxed at a REIT level, though exempt in the hands of the investors.

2. EXCHANGE CONTROL RELATED

- Swap of existing shares of SPV held by a non-resident Sponsor with the units of a REIT should be permitted under automatic route.
- Managers of a REIT having FDI should be treated as a non-fund based activity and should not be subject to the capitalisation norms applicable to fund based activities.

3. STAMP DUTY RELATED

If Sponsor seeks to consider an alternative route (other than SPV model) to hold the REIT assets, this may not be feasible for REITs in India due to high state stamp duties and registration costs applicable in various states on acquisition of properties.

In this regard, the Government ought to consider waiving the stamp duty where a REIT holds property over a specified period of years, in line with Singapore REITs or alternatively, the state Governments could consider a one-time waiver of stamp duty on transfer of assets to REITs.

Table 8:

Rates for stamp duty and registration costs in some key cities are provided below:

CITIES	STAMP DUTIES	REGISTRATION CHARGES
Mumbai, Pune (Maharashtra)	5%	1%
Delhi	4-6%	1%
Gurgaon	6-8%	INR 100- 15000
Chennai	7%	1%
Hyderabad	5%	0.50%
Bengaluru	5%	1%
Kolkata	6-7%	1.10%

Source: Government websites

4. OTHER REGULATIONS

Further, changes in some other regulations can help to enhance the REIT regime in India. Some of the potential changes are stated below:

- Inclusion of units of REITs in the definition of ‘Security’ as per the Securities Contract (Regulation) Act, 1956
- Changes should be brought out in the provident fund regime, by notifying REITs as an eligible investment in the prescribed pattern of investment.

CONCLUSION

The regulatory environment for real estate sector in India has evolved significantly and is being refined further for development of this sector. The Government of India is extremely keen and focused on its dream of providing ‘Housing for All by 2022’. However, the relaxations in FDI, providing tax incentives to affordable housing segment in Budget 2016, opening up of ECB window for affordable housing, etc. have not significantly helped the sector. The demand for residential housing remained gloomy and the funding crunch for developer still continued. On the other hand, the commercial property segment saw some momentum across cities with the consumption of spaces by IT/ ITES companies. However, the recent move of demonetisation put a break on this momentum and the sector further witnessed slowdown in economic activities for the past few months.

In order to give fillip to the sector and also bring transparency therein, the Government introduced legislations like the RERA, GST bill and Benami Transactions (Prohibition) Amendment Act, 2016. SEBI amended the REIT Regulations providing certain relaxations in November 2016.The Budget 2017’s gift of providing ‘infrastructure status’ to affordable housing is a game changing move that will open up more institutional sources for developers to raise funds at competitive price. Further, Budget 2017 has pronounced several direct tax proposals to boost growth of the real estate sector viz. reduction in holding period of immovable property from 36 months to 24 months to qualify as long term capital asset, extension of time limit for completion of affordable housing projects from 3 years to 5 years and relaxation in size of units to qualify for tax holiday under affordable housing scheme, etc. Such incentives will give a ‘feel good factor’ which is much required for the revival of the real estate sector.

A lot of churning is expected to happen this year because of the implementation of various policy changes and it is important to see how developers recalibrate their businesses to the changing environment and whether buyers capitalise the opportunity of the various reforms and change their status quo position of “wait and watch”.

The REITable assets may cover completed and rent-generating real estate assets. It is estimated that approximately USD 121 billion or 1.73 billion sq. ft. occupied CRE across office, retail and warehouse segments could potentially benefit from the REIT opportunity. In the case of office and retail, approximately 537 mn. sq. ft. and 75 mn. sq. ft. respectively is REITable area located in the top seven cities, namely Mumbai, NCR, Bengaluru, Chennai, Hyderabad, Kolkata and Pune. With respect to warehousing space, the all-India estimate is approximately 1127 sq. ft. The ambit of the REITable universe extends to almost all rent-generating real estate. As a result, rented residential property can also be considered for the purpose of REITs. However, on account of the absence of an institutional rental market in the residential segment, it has not been considered in our REITable space estimates.

Although, the regulations were notified in the year 2014, developers shied away from listing of the REITs due to several tax and regulatory issues. However, a majority of such issues restricting launch of REITS have been addressed through changes in the tax and regulatory regime.

Amidst the conducive environment of liberalised REIT regulations, clear guidelines on disclosures and governance of REIT, the demonetisation decision of the Government of India has only accentuated the cause of REIT. The move on demonetisation of high value currency notes has led to a deluge of bank deposits, thereby significantly pushing up the liquidity in the banking sector. In effect, this has led to a considerable fall in government bond yields. From the REIT perspective, the decline in government bond yields and the overall interest rate regime has increased the spread with prime office properties. This has also led to the compression of capitalisation rate for prime office assets that are perfect candidates for REITs. This compression in the capitalisation rate has led to the upward revaluation of office property in prime markets like BKC in Mumbai, thereby making REIT listing more attractive. This shall immensely benefit the fabric of India office market which records transaction of over 40 mn. sq. ft. annually.

We expect the REIT vehicle to increase the depth of the Indian property market through enhanced transparency and governance standards along with monitoring of the REIT’s performance on a regular basis. With unfolding of various events, the REIT dream would become a reality in upcoming years. The country’s largest office owners and fund houses have begun the process for an India REIT listing.

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