REITs and InviTs in India – The Extant Position

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Abstract--- The real estate and infrastructure sector in India is considered as an engine of economic growth being instrumental for accelerating growth in other allied sectors, while generating employment and providing housing to the growing numbers of the Indian population. Real estate is also considered as a preferred asset class for investment among the small investors in India as it holds the promise of quick appreciation in value with negligible risks. To unleash the potential of this sector, the Government of India has ushered in many regulatory changes to channelize investments into the real estate and infrastructure sectors through policy support. The conception of Real estate investment trusts and Infrastructure investment trusts is a step in this direction. The purpose of this paper is to review the extant legal framework for REITs and In VITs in India in so far as they suit the requirements of small investors to invest. By drawing upon the extant provisions, the paper also discusses the various amendments brought in by the market regulator SEBI to make these instruments favorable vehicles of infrastructure financing.

Keywords--- Legal Framework, Real Estate, Infrastructure, Retail Investors, REITs, In VITs.

I. Introduction

Real estate growth and development has been an essential contributor to the economic growth of the country that has powered the expansion of the country’s infrastructure, further propelling industrial development and trade across sectors including cement, steel, construction material, fittings and fixtures being at the core of the construction industry. This sector is considered as an engine of economic growth being instrumental for employment generation and providing housing to growing numbers of Indian population through policy support. Real estate is also considered as a preferred asset class for investment among the investors in India as it holds the promise of quick appreciation in value with negligible risks. Extant literature asserts that real estate as an asset class has the potential of giving appreciable returns while serving as a hedge against inflation (Rubens et al, 1989). Amidst an increasing realization that the potential of this sector can be employed greatly with policy support, government of India has ushered in many regulatory changes to channelize investments into this sector and ease out the issues in terms of raising financing costs, tedious land acquisition approvals and liquidity crunch and unsold inventory. The real estate sector in India that had witnessed a downslide post the financial crisis in 2008 owing to weak macroeconomic environment, has been revived since 2014 owing to structural reforms brought in by the policy makers (PWC, 2017). The cash trapped real estate sector needed revival to overcome the liquidity crisis. Relief to a certain extent in the form of liberalization of FDI rules sanctioning 100% FDI has infused life into this sector with steady flow of investments. Survey reports (FICCI, 2015) reiterate that FDI inflow in construction development between the period 2000 – 2015 have been impactful, consisting 9% of the total FDI flows. The government’s mandate of providing housing for all by the year 2022 has also been the main driver for the developmental thrust in this sector.

A product of the revival strategy has been the institution of Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InviTs) in India. An REIT is fundamentally a company which develops and acquires ownership of income generating real estate properties. Although still in its nascent stage in India, this model has been successfully implemented in several matured markets including the US, the UK for financing large scale commercial real estate assets. The origins of the concept of REIT can be traced to 1960 in the United States where in REITs were designed to attract investment from a cross section of investors including large and small investors, facilitating investment in the capital intensive real estate structure (Semer, 2009). REITs have since then grown and evolved worldwide globally to reach a market valuation of 1.14 trillion USD as per the FTSE, 2018 (Omokhomiona et al, 2018).

Akin to the real estate sector, the infrastructure sector too is capital intensive demanding steady investment to support the developments needs of the economy. Infrastructure sector in India has its own specific requirements which may vary from that of the real estate sector. These sectors are in a perpetual need of long term funds to fuel their developmental needs.
While traditionally, the financing of real estate and infrastructure companies has largely been thrusted on banks and financial institutions, private sources of financing through the mode of REITs and InViTs has shifted the investing financing burden away from the banks.

**Nature of REITs**

REIT simply put is an investment vehicle construed on similar lines of that of a mutual fund in terms of pooling funds from a cross section of investors and manages a portfolio of investments. In case of REITs, the portfolio comprises of income generating commercial properties that give regular income. SEBI Regulations on REITs have further defined ‘real estate’ or ‘property’ which means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage. The SEBI Regulations on REITs also include the following in the definition of ‘real estate’ or ‘property’, which includes: (i) Hotels, hospitals and convention centers, forming part of composite real estate projects, whether rent generating or income generating; (ii) Common infrastructure for composite real estate projects, industrial parks and SEZ.

REITs and InViTs are new marketable instruments tradable on the securities market and are regulated by SEBI (Securities and Exchange Board of India) through a comprehensive regulatory framework. While the Securities Contract Act, 1956 does not have an explicit mention of REITs, yet the definition of a security under section 2(h) of the Act is inclusive and REITs and InViTs fall within the meaning of the wordings “Any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be”.

**Entities involved in REITs and InViTs**

Real estate investment trusts in India are regulated by a legal framework consisting of various entities namely sponsors, trustees, and other intermediaries. Analogous to a Promoter of a Company and a promoter group as defined under the SEBI (Issue of Capital Disclosure requirements), 2018, a person who sets up the REIT is designated as a Sponsor under the regulation 2(1)(zt) of SEBI (Real Estate Investment Trusts) Regulation, 2014.

Investments in real estate by the REITs are routed through special purpose vehicles (SPV), an entity devised to channelize funds for projects in real estate and infrastructure. SPV under extant regulations means any company or a LLP in which either the REIT or the holding company holds or proposes to hold not less than 50% of the equity share capital. Special purpose vehicles is not engaged in any activity other than holding and developing property or any activity incidental to such holding or development.

SEBI regulations invite participation from strategic investors in the REITs and InViTs. Institutional investors in the nature of infrastructure finance companies, Non-banking finance company, scheduled commercial banks, multilateral and bilateral development financial institutions, foreign portfolio investors are designated as strategic investors. Strategic investors can subscribe to a REIT to the extent of not less than 5% and not more than 25% of the of the total offer size. They are envisaged to act as anchor investors to the REIT providing stability to the REIT issue. Structurally set up as Trusts under the Indian Trusts Act, 1982, REIT framework also has trustees who hold the properties of the REIT for the benefit of the unit holders. The operational activities of the REITs are overseen by Managers set up as either as a company or an LLP and who manage assets and investments of the REIT

**Are REITs suited for retail investors?**

REIT offers an alternate investment route to investors in real estate with a small investible surplus as against direct investment which entails large investments. Minimum investment limit and trading lots are important factors for small investors to consider before investing. Under regulation 14(1) of the SEBI regulations as originally enacted, the minimum subscription for an investor to invest in an IPO or a follow on public offer has been fixed at two lakh rupees. With an objective to encourage enhance participation from retail investors, it was proposed by the stakeholders that the minimum investment required for subscription and subsequent trading in units of REITs and InViTs be reduced (SEBI, 2019). Accordingly, the minimum application has been revised to suit the requirements of small investors. The minimum application size and allotment lot under the revised guidelines has been fixed at 100 units and the lot sizes have been revised to be within the range of Rs 15,000 to Rs 20,000. With this amendment, the application sizes for retail investment has been aligned with the SEBI regulations for public issues under SEBI ICDR, 2018.

Under the SEBI Regulation for InViIT’s for an investor to invest in an initial public offering or a follow on offer, the minimum subscription has been fixed at Rs 10 lakhs.
SEBI Regulations further prescribe that trading lot for the purposes of trading of publicly listed units, on the designated stock exchange, shall be Rs. 5 lakhs. Further, according to the extant SEBI Regulation REITs, the minimum subscription from any investor in an initial offer, as also in a follow-on public offer shall not be less than Rs. 2 lakhs and the prescribed trading lot for the purpose of trading of units of REIT on the designated stock exchange, is Rs. 1 lakh. Greater reach to retail investors is envisaged with further amendment to the regulations relating to REITs and InvITs (SEBI, 2019).

An increase in the leverage limit for InvITs is also on the anvil. According to extant provisions of SEBI’s InvIT Regulations, the aggregate consolidated borrowings and deferred payments of the InvIT net of cash and cash equivalents shall never exceed 49% of the value of the InvIT assets. The provisions further state that any borrowing exceeding 25% of the value of the InvIT assets requires unit holders’ approval and mandatory credit rating. However, consultations with stakeholders revealed that this limitation to raise debt beyond 49% would impact the profitability of the InvITs on various accounts, inability to offer incremental returns as compared to other alternative investment avenues being one of them(SEBI, 2019b).

The extant SEBI Regulations on InvITs provide for mandatory listing of units of InvITs (issued either through public issue or on private placement basis). As listing provides a public character to even privately placed InvITs, the investor protection and governance measures provided in the regulations are similar to those for publicly issued InvITs.

SEBI regulation require InvITs to invest their assets in completed revenue generating projects to the tune of at least 80%. This ensures that the investment is safeguarded against project failures. The regulations also stipulate regular disbursements of cash earnings to investors making them an avenue for steady earnings.

II. Conclusion

The objective of the paper was to offer a concise overview of the extant position of REITS in India. The regulatory structure for REITs has been constantly evolving since its conceptualization in 2014. The recent amendments in the REIT and InvITs guidelines have positioned these securities as viable investment options for retail investors to invest. Still to be fully optimized in India through successfully public offerings, the regulations have taken care to ensure that the investor interests are protected through a stringent regulatory framework. Along with providing liquidity to the real estate and infrastructure sectors, these instruments also designed to increase retail participation in the market. By making way for tax benefits, these instruments would go a long way in deepening the market with greater retail participation.

References