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REITs As a Real Estate Investment

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Abstract

Rental revenue is one of the most prevalent types of passive income that one might produce for oneself. One of the most common forms of passive income that one might generate for himself is rental revenue. However, establishing it as a source of passive income necessitates a significant financial investment, which is generally out of reach for the majority of investors. One of the reasons REITs were established was to take care of and maintain the property, as well as to deal with tenants and other issues. The article provides a quick overview of REITs, their operations, and the many types of REITs. The authors have attempted to explain the concept of REITs and other real estate-based organizations to the reader, as well as the differences between the two. A detailed analysis of an investor's investment possibilities is offered, including pros and drawbacks, as well as if it is a viable option to invest. REITs, according to the author, are a notion that has yet to fully mature in India. The point of the article is to illustrate how it works and how important it is to general investors.

Keywords: REIT, property, infrastructure, investment, real estate and housing

INTRODUCTION

The term "real estate" refers to any land on which buildings or structures are constructed for economic and infrastructure development. One of the most flourishing industries in the world is real estate. It has been significant to the economy's growth. The liberalization of the economy aided the sector's growth, which in turn raised investment demand. Landlords, tenants, purchasers, and real estate agents are just a few of the important participants in the industry. It is, after agriculture, India's largest major source of employment. The expansion of the corporate environment is equivalent to the expansion of the real estate market.

Housing, hospitality, retail, and commercial real estate are all sub-sectors of the real estate industry.

The real estate sector has maintained a consistent level of performance over the years, allowing it to earn the trust of investors. The real estate industry in India is regulated by a set of laws, such as the Real Estate (Regulation and Development) Act of 2013, the Transfer of Property Act of 1882, the Indian Contract Act of 1872, the Right to Fair Compensation and Transparency in Land Acquisition Act of 2013, and the Rehabilitation and Resettlement Act of 2013.

Real estate being a comparatively safer form of investment than stock market and providing elevated returns attracts the interests of various investors, however investing in real estate requires the investors to pay a huge sum of money as well, unless one does not actually invest in the physical properties. With that in mind let us look at various ways by which one can invest in real estate without actually purchasing any property.

REAL ESTATE INVESTMENT TRUST (REIT)

"What mutual funds are to share market, REITs are to real estate."

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Almost everyone wishes to invest in real estate in order to obtain a consistent monthly rental income. However, for a number of reasons, it is not possible for everyone to purchase property because of the following reasons:

1. Property is quite expensive
2. It requires a significant amount of investment
3. Choosing a property in terms of location is tough.
4. Lack of funds

There is a myriad of reasons why people invest in mutual funds. It is because there's less money, thus there's more diversification and there is no obligation for individual research.

REITs function in a similar manner as mutual funds. Mutual funds do not need investors to do any research because they allow specialists to invest their money in stocks that they believe will produce the best returns. But the issue remains, what exactly are REITs? REITs are enterprises that allow anyone to buy or finance real estate in the same manner that shareholders benefit from owning stocks and other corporations. The investors of a REIT receive a part of the money generated by real estate investment without having to purchase or finance real estate.

Most REITs are listed on the stock market and buying and selling of REITs could be done by investors in the similar manner as stocks. REITs was first formed in the USA in 1960. The motive was to provide everyday investors an opportunity to invest in income generating real estate portfolios just as an investor has a right to invest in other typical tradable assets like securities, etc.

Thus, REITs make it possible for people who cannot afford to purchase the property and fulfil their desire to earn passive income in the form of rent.

WORKING OF REITS

REITS are typically formed by real estate companies that act as the REIT's sponsor at the time of formation. A sponsor is similar to a majority shareholder of a company in that it appoints a trustee who is responsible for holding real estate assets so that the sponsor has no direct control over the assets.

The trustee then hires a manager to oversee the trust's assets and make trust management decisions. Following that, in order to attract retail shareholders, REITs begin to circulate in the market, with retail investors acting as the trust's unit holders.

SEBI has provided a number of regulations governing the same in India. The following are the most important:

1. REITS have to distribute 90% of their cash flows in the form of dividends or interest.
2. At least 80% of the REITs assets must be finished or income-generating properties.

WHAT ARE THE DIFFERENT TYPES OF REITS?

Depending on the sort of real estate being invested in, there are different varieties of REITs.

REITs are broadly grouped into the following sorts, namely:

Equity REITs

Most REITs operate as equity REITs. An equity REIT is a real estate corporation that owns or manages income-generating buildings such as offices, apartments, retail complexes, and other commercial properties and leases them to tenants. The following are some of the most frequent forms of equity REITs:

- Residential—acquires residential properties such as apartment buildings, residences, and other similar structures.

- Retail—acquires retail assets such as shops, malls, and so on.
- Office—which buys office buildings, shopping malls, and other commercial properties.
- Industrial—acquires industrial properties, factories, and so on.
- Healthcare, which invests in hospitals, clinics, path labs, and other medical facilities.

Mortgage REITs

Mortgage REITs are fewer in number than equity REITs. Mortgage REITs are companies that invest in mortgages on real estate. These REITs either make loans to property owners or buy existing mortgages or mortgage-backed securities. The interest on mortgage investments generates income for these REITs.

Hybrid REITs

This REIT is a blend of Equity and Mortgage REITs, as the name suggests. It provides investors with the security of owning property as well as the income potential of a mortgage loan interest.

INVESTING IN REITS v. REAL ESTATE BASED COMPANIES

The primary goal of real estate is to develop and profit from it, whereas REITs are required to have 80 percent of their assets completed and generate money from them.

In both circumstances, the level of risk is different.

The amount of risk associated in REITS, for example, is lower because 80 percent of the property is finished. The main objective of REITs is to provide everyday people with simple investment opportunities and to allow them to take advantage of tax benefits not accessible when investing in real estate firms.

In the case of REITs, for example, any interest, dividend, or income received from a Special Purpose Vehicle would be tax-free.

RULES AND REGULATIONS BY SEBI [1] GOVERNING REITs IN INDIA

When SEBI [2] introduced REIT regulations in 2014, it was stated that it should be set up as a trust rather than a company or an LLP. Under the Indian Trust Act, SEBI defined the parameters for incorporating a REIT as a trust.

Second, it stated that it is required to be registered with SEBI and to trade on stock exchanges.

Thirdly, it stated that at least 80% of total asset value should be completed and rent-generating properties, with a three-year lock in period.

REITs are defined in Regulation 2(1) (zm) of the REITs Regulations as Trusts that are registered under the REITs Regulations.

A maximum of 20% of Total Asset value can be derived from:

1. Under construction properties with a three-year lock-in period after completion. Only 10% of the maximum 20% of total asset value can be invested in an underdeveloped company.
2. Debt of real estate companies, whether listed or unlisted
3. Mortgage-backed securities
4. Stocks of real estate companies in India, and real estate companies should generate at least 75% of their income from real estate.
5. Government bonds
6. Money markets or cash markets
7. It is not possible to invest in vacant or agricultural land.

8. Rental properties should generate at least 75% of revenue.
9. Furthermore, investment in other REITs or lending is not permitted.

As a result, no REIT can invest in another REIT.

Regulations for Distribution of Dividends
1. At least 90% of profits earned must be returned to investors as dividends through rent or sales.
2. Unless reinvestment is proposed, at least 90% of the sale proceeds must be returned to investors as dividends.
3. Distribution will take place every six months.

Public Offer
A REIT's total asset value must be greater than 500 crores before it can be listed.
1. The minimum public float should be 25%.
2. The minimum size of the offer should be Rs. 250 crores.
3. The minimum subscription amount is Rs. 2 lakh per applicant;
4. The minimum trading lot is kept at 1 lakh; and • Before listing any REIT, the minimum number of subscribers should be 200.

REITs PROS [3]
- REITs in real estate without having massive capital requirement obligations provide real estate investment benefits.
- Provides diversification benefits to small shareholders who are unable to invest in various types of properties.
- REITs address real estate issues such as illiquidity and the length of time it takes to complete transactions.
- All REIT assets are properly maintained, resulting in the smallest amount of hassle for asset owners and unit holders.
- The requirement for REITs to distribute 90% of their cash flows ensures that shareholders have a consistent and reliable stream of cash flow.
- REITs also provide capital appreciation, which is a key component of the real estate business.

REITs CONS
- While there is a tax advantage for businesses in REITs, there is no explicit tax advantage for investors. As a result, the income obtained by REIT shareholders is taxable in accordance with the income tax slabs.
- Market risk in the real estate market applies to REITs as well. REITs can give minimal diversification benefits to shareholders in order to minimize industry counter risk for investment.
- Although REITs provide better liquidity over traditional real estate, they are still on a smaller level in India and are less liquid in terms of stocks and fixed income investments.

TOP REITs IN INDIA
Embassy Office Parks REIT [4]
Office parks for embassies REIT is India's first publicly traded REIT. The trust owns approximately 42.4 million square feet of property.t is 88.5 percent occupied, with over 193 blue-chip tenants such as Google, Flipkart, JP Morgan, Cognizant, and others. The weighted average lease expiry for the company is 6.9 years. Its Net Asset Value per share is Rs. 388.

The REIT mostly owns office buildings, as well as a few hotels and a solar park that provides power to the offices.

In the following states, the trust possesses properties:
- Bengaluru (74 percent of assets)
- Mumbai (10 percent of assets)
- Pune (9 percent of assets)
- NCR of Delhi (7 percent of assets)

Mindspace Business Parks REIT [5]

The K Raheja Group is a sponsor of Mindspace REIT. It covers a total of 31.2 million square feet of leasable space, with 23.8 million square feet under development. With 165 tenants, it has an occupancy rate of 84.4 percent, including Accenture, Qualcomm, L&T, Barclays, and Amazon, to mention a few. Mindspace primarily owns office buildings.

In the following states, the trust possesses properties:
- Mumbai (41 percent of assets)
- Hyderabad (40.4 percent of assets)
- Pune (16 percent of assets)
- Chennai (2.6 percent of assets)

Brookfield India Real Estate Trust [6]

Brookfield AMC is the sponsor of Brookfield REIT. As of March 2021, Brookfield maintained more than $600 billion in assets, ranking it one of the world's largest alternative asset managers. It owns 14 million square feet of property and has the option to buy another 8.2 million square feet. It has an 87 percent occupancy rate with 118 tenants, including Accenture, TCS, and cognizant.

The average trust-weighted lease expiration period is seven years, and the Net Asset Value per share is Rs. 317. The majority of the company's assets are office buildings.

The trust owns real estate in:
- Gurugram (38 percent of assets)
- Mumbai (22 percent of assets)
- Kolkata (22 percent of assets)
- Noida (18 percent of assets)

CONCLUSION

REITs were developed to make real estate an appealing investment choice and to address the issue that it is expensive to invest in properties. REITs are investments that are comparable to stocks in that they can be exchanged in the same way that equities can. The investor who owns the REIT can reap the benefits of rental revenue and other perks that a property owner could get without having to deal with maintenance and other issues that the owner would have to deal with. REITs are thus gaining popularity in India for the aforementioned reasons. They are predicted to grow in popularity as a form of investment in the coming years. As a result, it is critical to understand the mechanics and distinctions between investing in real estate and REITs. The study dives deeply into the issue.

Furthermore, because there are multiple sorts of REITs available and one can invest in either of them, it is critical to know which REIT to invest in and for what purpose, which is also the article's goal to make a reader understand.

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