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IVCA
INDIAN PRIVATE EQUITY &
VENTURE CAPITAL ASSOCIATION

Destination India – Are we ready for REITS?

Insights on taxation and regulatory issues

September 2014

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Foreword - KPMG

Neeraj Bansal
Partner and Head
Real Estate and Construction

The investment grade office stock in India has witnessed a significant transformation with respect to its distribution, volume and composition in the last decade. The office stock has almost quadrupled from 90 million square feet in 2005 to about 350 million square feet in 2014[1]. The development activity was supported by several institutional and non-institutional investors such as banks, Non-Banking Financial Companies (NBFCs), private equity players, and high-net worth investors. However, despite strong progress, the sector continues to lack large scale institutional funding.

Some efforts were taken in this direction with Securities and Exchange Board of India (SEBI) by drafting Real Estate Investment Trusts (REITs) regulations in 2007. However, it had to be postponed due to the Global Financial Crisis in 2009. SEBI re-initiated the process in October 2013 and after taking industry input, amendments to REITs regulations were made and the draft allowing setting up and listing of REITs was approved. Post the clarifications provided in the 2014 budget, a final draft was introduced by SEBI in August, 2014. In our view, introduction of REITs is among the important reforms introduced by the government in 2014. To make REITs successful and to improve the liquidity constraints in the sector overall, the government has recently relaxed Foreign Direct Investment (FDI) norms. Among the major changes in FDI policy are reduction of built-up area from 50,000 square meters to 20,000 square meters and minimum capitalisation requirements from USD10 million to USD5 million. Clearly, the government is keen to revive the foreign investment in the country and it views the real estate sector as a major source to achieve this agenda.

Punit Shah
Partner and Co-Head of
Tax Practice

While we await a comprehensive and clear regulatory framework permitting the establishment of REITs, there is no doubt that the imminent realisation of the long-awaited investment instrument could provide a long term liquidity channel to the commercial real estate sector. Over the long term, the REITs are expected to drive the development of capital markets in India and provide existing investors with easy exit options. However, there are several taxation and regulatory challenges which need to be critically evaluated to make Indian REITs successful.

REITs in India, a study jointly prepared by KPMG in India and IVCA, provides a perspective on the current taxation and regulatory issues which may act as a road block in seemless execution of REITs in India. We hope that you find this study insightful.

[1]CBRE India View Point, CBRE, August 2014

Foreword - IVCA

Arvind P. Mathur
President, IVCA

Real estate is a capital intensive sector. But besides capital, it requires expertise in a variety of areas for investments to be successful.

Firstly, the quality and track record of developers and sponsors is of paramount importance. Those who have built a reputation, brand and track record have the best prospects of attracting private equity as well as debt.

Secondly, the highest standards of corporate governance has gained great significance. This is not only due to developments in India but also by the entry of international players such as pension funds. These players will only engage with companies that have an impeccable track record of corporate governance.

Thirdly, the interesting part of the sector is that a variety of business models are being pursued including asset-light models. Each model has its own issues and require varied solutions, some of which are addressed in this publication.

Finally, India has great diversity. Different factors are at play in different parts of the country. At the same time, demographic trends are a major driver of demand for real estate.

This publication, written by experts from KPMG in India, addresses the various intricacies of real estate investing, deal structuring and taxation in India. The publication is all the more important, because many of the regulations are in a state of flux.

The Indian Private Equity & Venture Capital Association (IVCA) is most grateful to KPMG for producing this publication. It will be an insightful reference tool not only for all players in the real estate investment world in India, but also for regulatory authorities.

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1 | REITs – game changer for commercial real estate

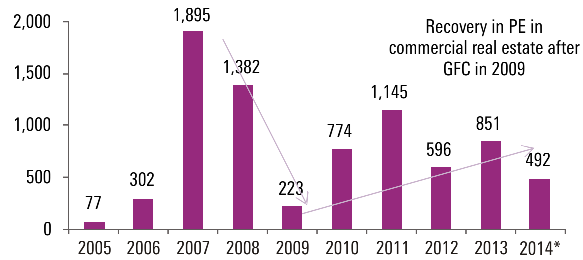
REITs – game changer for commercial real estate

An underdeveloped capital and debt market, coupled with limited options for raising funds has resulted in significant cash blockage for developers owning commercial assets. However, the sector, which witnessed considerable headwinds after the Global Financial Crisis of 2009, has witnessed some sign of recovery in the last couple of years. In the last two years, private equity firms have shown increasing interest to acquire commercial assets on the back of decreasing vacancies, somewhat stabilization of rentals and depreciated Indian currency. These firms have taken advantage of the liquidity crunch and have acquired assets at attractive price. However, a large proportion of ready commercial assets are still owned by developers who continue to evaluate avenues to offload these assets.

Launch of REITs in current times is expected to be a major relief for developers and could be an important reform, brought into the real estate sector, in recent years.

> *"Private Equity will be an important source of capital for well governed professionally run real estate companies as it provides an attractive alternative to listing prematurely or taking on debt at the holding company level."*
>
> Paddy Sinha, Managing Partner, Tata Capital Ltd.

Reported private equity inflow in commercial real estate



Investments in commercial real estate sector have recovered in the last couple of years

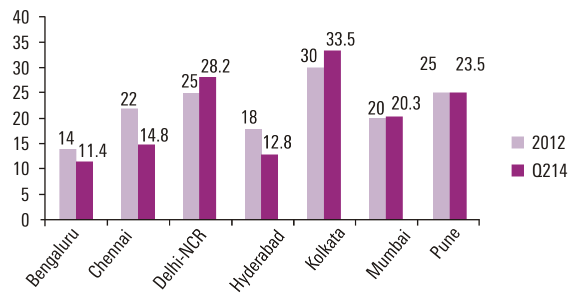
Source: Private Equity in Real Estate Database, Venture Intelligence, accessed September 2014
*Data from January 2014 to September 2014

Prominent deals in Indian commercial real estate sector in 2013 and 2014

Investor	Investee	Investment (USD million)	Description
GIC	Ascendas	600	Acquired office assets
Golden State Capital (GSC)	Burman	500	Acquisition of office assets
Blackstone	Embassy Group	367	Acquisition of a business park in Bengaluru along with Embassy Group
Brookfield	Unitech Corporate Parks	349	Outright purchase of six SEZ and IT parks in Noida, Gurgaon and Kolkata
Canada Pension Plan Investment Board	Shapoorji Pallonji Group	200	Acquired stake in let out commercial office space across metro cities in India
Canada Pension Plan Investment Board	Piramal	200	Invest in office space through REITs
Xander	Infinity Technology Park	108	Investment in a leased out office space in Mumbai
Qatar Investment Authority	RMZ Corporation	97.5	Acquisition of IT parks in India
Blackstone	Panchshil Realty	83	Acquired a stake in an IT SEZ in Pune

Source: Private Equity in Real Estate database, Venture Intelligence, accessed 10 September 2014; Indian real estate – Opening doors, KPMG in India, 2014

Vacany rates across key markets

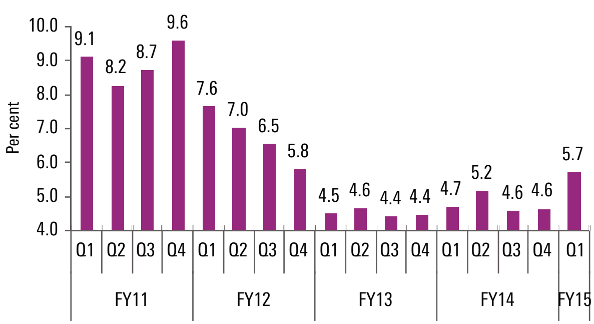


Vacancy rates have declined in most markets over the last two years.

Source: Market Beat 2Q14, Cushman & Wakefield

The recent developments such as formation of the new government, improvement in domestic as well as global economic growth and resumption of infrastructure cycle in India are expected to further support the commercial real estate sector.

India's quarterly GDP growth



Government focusses on infrastructure growth

Within 100 days of the new Government, Ministry of Environment and Forest have cleared 240 of the 325 infrastructure projects delayed for want of environmental clearance.

This is expected to spur investments worth INR2 lakh crore (USD30-35 billion).

Source: Reserve Bank of India; India's GDP to improve to 5.2 per cent in 2014: Moody's, The Economic Times website, http://articles.economictimes.indiatimes.com/2014-09-10/news/53770611_1_downside-risks-cent-gdp-growth-prime-minister-narendra-modi, 10 September 2014; "Prakash Javadekar clears 240 projects in 3 months," Hindustan Times website, http://www.hindustantimes.com/india-news/on-fast-track-environment-minister-prakash-javadekar-clears-240-projects-in-3-months/article1-1262676.aspx, 11 September 2014; KPMG in India analysis

> *While a lot of capital for real estate development has been available in some form of debt, I feel that there is also the need for true equity capital. Capital that is long term and patient and can help in creating world-class real estate companies.*

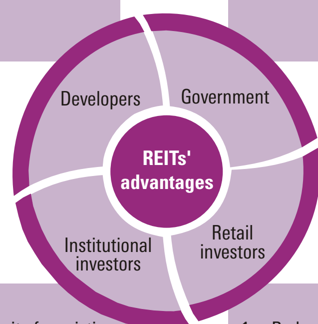
Niten Malhan, Managing Director, Warburg Pincus India Pvt. Ltd.

In our view, REITs in India has arrived at an appropriate time and is expected to nurture the green shoots visible in the Indian commercial real estate sector.

REITs advantages to different stakeholders

1. Improves liquidity in the sector
2. Capital raising opportunity for mid-tier developers especially for small companies with lower/minimal credit worthiness

1. Help improve government's revenue
2. Funding through REITs could help facilitate other key real estate policy implementation like targeting 100 smart cities



1. Provides an exit opportunity for existing PE players, developers and financial investors
2. Act as an alternative financing opportunity with increase depth of Indian real estate capital markets
3. Help attract long term investors such as pension and insurance funds looking for moderate risk v/s return ratio

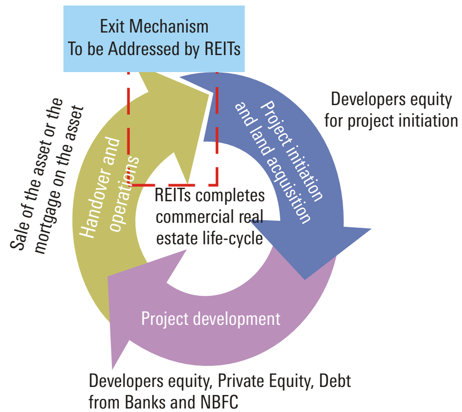
1. Reduces ticket size for investing in real estate sector
2. Transparent investment alternative in real estate sector with experienced professional and independent oversight
3. Easy entry and exit in the real estate sector

> *Participation in Real Estate funding & REITS extends beyond financial returns. It assists socio-economy objectives of filling the gaps on the rising need of affordable dwelling for masses and helping balance urbanization by aiding creation of smart cities with economic and superior quality of life.*
>
> Bharat Banka, CEO, Aditya Birla Private Equity

REITs, which completes the commercial real estate project cycle, is expected to provide an exit route to developers from completed commercial assets as it is expected to help attract investors seeking investment in high-quality investment-grade properties.

Launch of REITs in India is likely to facilitate introduction to new set of large moderate (risk v/s return) investors such as Insurance and Pension Funds. These funds typically invest for a long term and seek a steady return on their investments.

Importance of REIT in commercial real estate development



Source: KPMG in India analysis

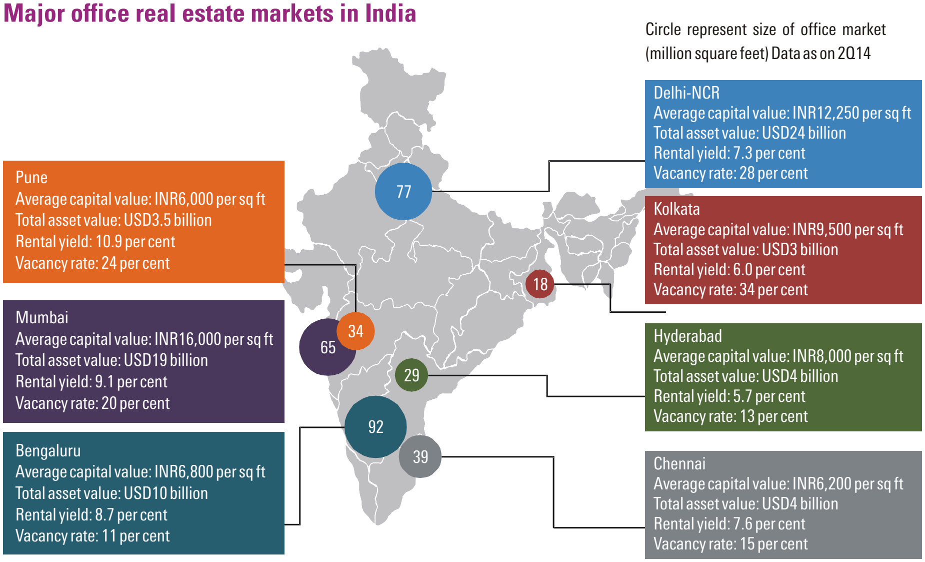
Globally, there are about 500 REITs present in 22 countries with a market capitalisation of over USD800 billion[2]. Of the 22 countries, nine are emerging real estate markets. The leading REITs markets are the United States of America, Australia, France, Japan and the United Kingdom accounting for about 84 per cent of global REITs market share (refer annexure for further details).

[2] The Investment Characteristics and Benefits of Asian REITs for Retail Investors, APREA, November 2012; FTSE NAREIT

It is estimated that India has about 350 million square feet of 'Grade A' office space which is valued at about USD65- 70 billion. Of this, about 80-100 million square feet is estimated to be eligible for REITs in the next 2-3 years valued at about USD15-20 billion. Forecasted pipeline development during 2015 and 2016 are expected at 52.6 million sq ft and 57.1 million sq ft respectively. Most of the 'Grade A' property in India is concentrated in seven major cities namely Delhi NCR (includes Gurgaon and Noida), Mumbai, Bengaluru, Chennai, Pune, Kolkata and Hyderabad[3].

> *"Real Estate investing offers great value creation opportunity and is very fulfilling too as it literally contributes to Building India, part of IDFC's mission"*
>
> Satish Mandhana, Managing Partner and Chief Investment Officer
> IDFC Alternatives Limited

Major office real estate markets in India



Source: Market Beat 2Q14, Cushman and Wakefield; Property times India offices Q4 2013, DTZ, via ISI Emerging Markets; KPMG in India analysis, 2014

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[3] "Commercial property: opening up to retail investors," The Financial Express website, http://www.financialexpress.com/news/commercial-property-opening-up-to-retail-investors/1204517/0, 7 December 2013; The Changing Face of Commercial Offices in India, Jones Land LaSalle, September 2011; Property times India offices Q4 2013, DTZ, via ISI Emerging Markets; KPMG in India analysis, 2014

Apart from these 'Grade A' office space, there are other commercial properties which might come under the purview of REITable properties including shopping centers, retail malls, hotels, hospitality, industrial warehouses and other storage solutions.

The availability of large number of assets across different cities, inexpensive properties (in comparison to global peers), and high growth potential of commercial real estate sector in India are expected to find takers for REITs in India. However, certain taxation and regulatory aspects of REITs requires amendments, which could further enhance attractiveness of Indian REITs for global investors.

2 | Taxation of REITs

Bird's eye view of taxability at various levels in a REIT structure is tabulated below:

Nature of Income Level	Interest on debt to SPV	Dividend on shares of SPV	Capital gains on sale of shares of SPV / sale of properties held \by REIT directly	Other income (e.g. rental income on properties held by REIT directly)	Capital gains - on market transfer of units of REIT by unit holders*
Unit holder	WHT @ 5 per cent - Non-residents (No further tax in the hands of unit holder) WHT @ 10 per cent - Residents (Taxed at applicable rates in the hands of unit holder)	Exempt	Exempt	Exempt	STCG -15 per cent (held for 36 months or less) LTCG – Exempt (held for more than 36 months)
REIT	Exempt	Exempt	Tax @20 per cent /30 per cent depending on period of holding, etc.	Tax @ 30 per cent	NA
SPV (in the form of a Company)	Tax break available on interest (subject to conditions), no WHT applicable on interest payment	DDT @ 15 per cent	NA	NA	NA

Above rates are excluding surcharge and education cess (All inclusive rate of of the dividend paid by the SPV)

* Sale on the stock exchange and subject to securities transaction tax

Source: Relevant section from Income Tax Act, 1961; KPMG in India analysis

Other taxation provisions relevant to REIT structure:

- Taxation on capital gains arising to Sponsor on exchange of shares in SPVs with units of the REITs, deferred to the point of ultimate transfer of REIT units. Holding period and cost of shares of SPV in the hands of Sponsor available on ultimate transfer of REIT units. However, entire capital gains arising on transfer of REIT units taxable @ 20 per cent/30 per cent depending on period of holding.
- Interest paid to non-resident lenders in case of monies borrowed by REITs in foreign currency, taxable @ 5 per cent subject to specified conditions

Glossary: SPV — Special Purpose Vehicle; DDT — Dividend Distribution Tax; WHT — With Holding Tax; LTCG — Long Term Capital Gain;

3 | Key challenges/recommendations in making REITs successful

Key taxation related challenges/recommendations in making REITs successful

Considering international experience, tax efficiency is critical to the success of REITs. While the basic framework for one-level taxation has been laid down by the Finance Act, 2014, certain challenges persist in structuring a REIT. It is critical that the Government considers further amendments to the Income tax 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:

- Capital gains arising on exchange of shares of SPV initially held by the Sponsor in lieu of units of REIT (at the time of set-up of the REIT) shall not be taxable at the time of such exchange. However, the subsequent transfer of such REIT units shall be taxable at regular rate of tax applicable to capital gains i.e. 20 per cent on LTCG and 30 per cent on STCG. For this purpose cost and period of holding of the shares of the SPV would be considered in computing the capital gains on subsequent transfer of units. This is unlike an IPO of a company where LTCG arising to the promoter on sale of shares through an offer for sale or on the stock exchange post listing is exempt from tax. Given that both are similar in terms of public listing, parity is required to make it lucrative for sponsors to go for a REIT.

- Independent of the above, provisions should be made to tax the subsequent transfer of REIT units received in exchange of shares of the SPV, only to the extent of the value of the property at the time of such exchange and not in respect of the appreciation in the value thereof (or the value of the REIT units) thereafter. The gain accruing on account of appreciation in the market value after transfer to REIT and listing of REIT units should be treated on the same footing as any other investment in REIT units and should not be taxed.

- For instance, if the cost of shares of SPV is INR10 and the fair value thereof on date of transfer to REIT is INR 50 (gain INR 40), and the REIT units are ultimately sold for 80 (gain INR 70), then only INR 40 should be taxed and the balance gain of INR 30 (accrued post transfer to REIT and listing of units) should not be taxed. The provisions as they currently stand would go to tax the entire gain of INR70 in the hands of sponsor.

- Provisions are made to exempt the exchange of REIT units only against the shares of the SPV and not direct transfer of the property to the REIT, though the SEBI Regulations allow the REIT to hold the asset directly as well. Absence of specific enabling tax provisions to exempt such direct transfer of property to the REIT directly acts as a dampener especially where properties are not held by the Sponsor in separate SPVs.

- The exchange of shares of the SPV for units of REIT would happen at the market value and would result in profit in the hands of the Sponsor; which could entail tax liability in the hands of the Sponsor under the provisions of Minimum Alternate Tax ('MAT') even though there is no taxation under normal provisions.

- In a case where the SPV is primarily funded by share capital, normal corporate taxes would be applicable at the SPV level and any distribution of profits by the SPV would entail distribution taxes. This would eat up into a significant portion of the yield and make it significantly unattractive for investors to participate. At a minimum, exemption from distribution taxes should be provided to the SPV to the extent it distributes dividends to the REIT.

- Capital structure of SPVs which are primarily funded by share capital may need to be re-structured to a reasonable mix of debt and equity for the REIT to be able to extract cash from the SPV in a tax and regulatory efficient manner. It should be specifically clarified that any interest paid by SPV to the REIT is a deductible expenditure from a tax perspective.

- 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 REIT.

- The REIT should be made a complete pass-through vehicle as against the current provisions which allow such pass-through only with respect to interest income from SPV which is taxed in the hands of the investors directly while other income is taxed at REIT level and exempt in the hands of the investors.

Key exchange control related challenges / recommendations

Allowing foreign investment in REITs is critical to create the necessary liquidity and depth in the market post listing of the REIT. Further, many foreign private equity players are currently invested in commercial stabilized assets and should be allowed to sponsor / manage the REIT.

Amendment to the foreign exchange control regulations on the following lines would be critical in this respect:

- Foreign Portfolio Investors and Non-resident Indians should be permitted to invest in units of REIT without any cap or restriction on the units that can be acquired.
- Foreign Sponsors should be allowed to acquire units of REITs under automatic route. In such a case, swap of existing shares of SPV held by non-resident Sponsor with the units of REIT should be permitted under automatic route.
- It should be clarified that a REIT with majority foreign ownership would not be subject to downstream conditionality related to FDI.

- Managers of 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.
- REITs should be permitted to avail ECBs from non-residents.

Key market related challenges / recommendations

- This measure towards yield maintenance would be important as the commercial rental yields in India range from 6.5 per cent to 10 per cent for 1 year. At these levels of yields, REITs generating income from rentals would be incompetent as bank deposit/ liquid fund yields are around 8 per cent. REITs would then look at capital appreciating in properties and given that commercial real estate is highly volatile in prices as seen over the last few years, investments in REITs would be that much riskier. Thus there would be a challenge in maintaining the yield from REITs higher than other avenues to constantly attract the investors.

> *"The impact of private equity in the development of the Indian real estate sector during the last decade is self evident. During this period, an estimated USD 15 billion of PE capital was invested in the sector which I believe has catalyzed the sector to grow significantly. Globally, REITs have been a key driver for the growth of the sector especially in the developed markets. I believe the REIT framework with some further fine tuning will help in taking the Indian real estate sector to its next level."*

Vishakha Mulye, Managing Director & CEO, ICICI Venture

4 Global comparison of REITs in key economies

Global comparison of REITs in key economies

Regulations governing a REIT framework plays an important role in determining its success in any country. A comparison of REIT regulations across major countries is presented below:

Country	Legal Form	Capital Requirements	Listing Requirements	Restrictions on investors	Restriction on assets	Distribution requirements
Americas						
United States	Corporation. Trust or an association taxable as an association (limited partnership or LLC)	No limitation	No requirements . Both public and private allowed	Must have 100 shareholders, no minimum value for each shareholder. 5 or fewer cannot own more than 50 per cent of value or REIT stock	75 per cent real estate asset. 75 per cent income from real estate related income, 95 per cent from above plus interest & dividends income/securities.	At least 90 per cent of its yearly ordinary taxable income
Europe						
France	Joint stock company. Partnership limited by shares	Minimum EUR 15 million	Mandatory	Shareholders must not hold more than 60 per cent of share capital or voting rights. At the time of election, 15 per cent of the share capital and voting rights must be held by shareholders, who individually own less than 2 per cent.	Main activity restricted to real estate properties for the purposes of renting them out. No restrictions with respect to the value of the property. Development limit is 20 per cent of the gross book value.	85 per cent of tax exempt profits

Country	Legal Form	Capital Requirements	Listing Requirements	Restrictions on investors	Restriction on assets	Distribution requirements
Europe						
United Kingdom	Parent company of UK REIT must listed closed-ended company	No limitation	Mandatory. Can be listed on any S.X. recognized by UK tax authorities	Cannot be "close". At least 35 per cent shares to public. 10 per cent or more shares not allowed for corporate shareholder.	75 per cent of profits and total value of assets must be from property rental business. At least 3 properties, none more than 40 per cent of total assets	3 accounting period grace. 90 per cent of property rental business. 100 per cent of Property Income Distribution from other REITs
Pacific						
Australia	No specific REIT rules. Managed Investment Scheme govern regulatory issues	No limitation. Listed REITs require ASX criteria. Capital requirement s for the manager	No requirements	None	Public unit trust - Primarily in rental deriving income. No flow through treatment for public unit trust that carry on trading business	Undistributed income or gains taxed at 46.6 per cent
Asia						
Japan	Trust or corporation	JPY100 million	No requirements	No requirements	Investment in qualified assets. Asset management role only. Total assets at least JPY5 billion	90 per cent of distributable profits to qualify for dividend payment deduction.

Country	Legal Form	Capital Requirements	Listing Requirements	Restrictions on investors	Restriction on assets	Distribution requirements
Asia						
Singapore	Unit Trust	Minimum market cap of SGD300 million	No requirements. Listing required for tax concessions	25 per cent of REIT's capital held by 500 public shareholders. Foreign denominated REITs require spread of holders.	75 per cent investment in income producing. No property development allowed unless REIT intends to hold property after development. Property development and investments in uncompleted property development not to exceed 10 per cent	90 per cent taxable income
Hong Kong	Have to be in the legal form of a trust and governed by the Code on REITs. They also need to be authorized by the SFC of Hong Kong.	No limitation	Mandatory Listing on SEHK	No restriction on investors - minimum number or foreign investors	Real estate investment a must. 90 per cent property income generating. No investment in property development or vacant land.	90 per cent of audited annual income after tax
Malaysia	Registered trust	RM100 million	Not mandatory. Only REITs registered with the SC are allowed to be listed	No requirements	50 per cent asset in real asset and/or single purpose companies.	90 per cent of total income

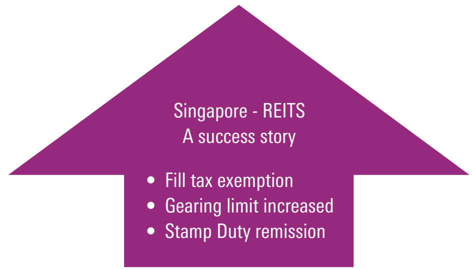
Country	Legal Form	Capital Requirements	Listing Requirements	Restrictions on investors	Restriction on assets	Distribution requirements
Asia						
India	Trust	Minimum INR 500 crore	Mandatory. Initial offer size of at least INR 250 crore and public float of at least 25 per cent. Minimum subscription size INR 2 lakh Trading lot INR 1 lakh.	Maximum 3 sponsors, each holding at least 5 per cent of the units, together should hold not less than 25 per cent of units for a period of not less than 3 years from date of listing. Minimum 200 unit holders from the public.	Minimum 80 per cent value of assets in completed and revenue generating properties. Not more than 20 per cent in developmental, mortgage properties, listed/unlisted debt of companies in real estate sector. Investment in at least 2 properties, with not more than 60 per cent asset value in one project	90 per cent of the net distributable cash flow, at least on half yearly basis

Source: www.epra.com/regulation-and-reporting/taxation/reit-survey/

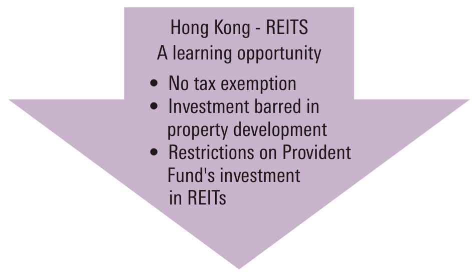
India regulation – SEBI (Real Estate Investment Trust) Guidelines, 2013 and Board Meeting 2014)

Case Studies[4]

Singapore REITs or S-REITs market is one of the best performing REITs markets in Asia. The 26 listed S-REITs on Singapore stock exchange (SGX) have yielded about 7.7 per cent return YTD (as on 14 May 2014). However, S-REITs had to face challenges when they were initially launched. The first REIT Initial Public Offering (IPO) in Singapore was only 80 per cent subscribed and consequently had to be scrapped. Several regulatory changes were made which resulted in better performance of S-REITs.



Hong Kong REITs or H-REITS were introduced in 2003. Currently, there are only 11 H-REITs while Japan has 46 listings, Singapore 29 and Malaysia 16. In 2013, while there were 23 and 26 stock offerings from Singapore and Japan respectively, there were none in Hong Kong. The Securities and Futures commission, in July 2014, released consultation conclusions on REITs giving H-REITs flexibility to invest in property developments and financial instruments.



"Report: Hong Kong Must Change REIT Rules, Current System 'Failing'," World Property Channel website, http://www.worldpropertychannel.com/asia-pacific-commercial-news/hong-kong-must-change-reit-rules-kong-kong-reits-china-reit-hong-kong-property-market-7725.php#sthash.xxxMSZOW.dpuf, 4 December 2013 ; "REITs average 7.7% total return in 2014 YTD," The Motley Fool website, http://www.fool.sg/2014/05/14/reits-average-7-7-total-return-in-2014-ytd/, 14 March 2014; "Singapore REITs — History and Regulation," The Finance website, http://thefinance.sg/2012/12/18/singapore-reits-history-and-regulations/, 18 December 2012; "Getting Hong Kong REITs right," IFR Asia website, http://www.ifrasia.com/getting-hong-kong-reits-right/21121139.article, 23 November 2013; "SFC publishes Consultation Conclusions on Amendments to the Code on Real Estate Investment Trusts," Securities and Futures Commission website, http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR91, 22 July 2014; KPMG in India analysis

5 | Conclusion

Conclusion

The real estate sector has been at the forefront of the Government of India's agenda on account of its potential to propel as well as support high economic growth. The Indian real estate sector's growing need for additional sources of funds and the success story of global REITs has been compelling enough to encourage the implementation of a similar regime in India with requisite adjustments, keeping in perspective the unique dynamics of Indian economy.

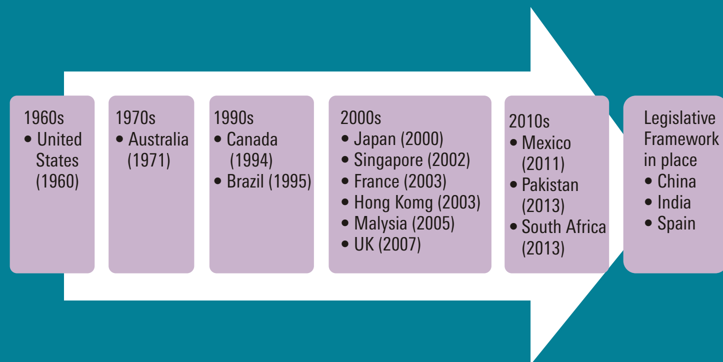
Establishment of REITs could be a game changer for commercial real estate sector in India, which is beginning to see a renewed interest from global investors. However, there are several taxation and regulatory aspects (listed in the study) which makes investment through REITs hostile with respect to pricing and asset quality compared to direct real estate investment and other investment asset classes. It is essential that government holds detailed discussions with all stakeholders and helps make Indian REITs a preferred investment channel for real estate investors.

6 | Annexure

Annexure

Section 1: Evolution of REITs

Global evolution of REITs



Source: European Public Real Estate Association (EPRA) – Global REIT Survey 2013

REITs started in the US in 1960. Over the past 50 years, the US REITs has attracted a market capitalisation of over USD600 billion and has been adopted in several parts of the world. As of 30 June 2014, there were 456 stock exchange-listed in the FTSE EPRA/NAREIT Global Real Estate Index in 47 countries around the globe. Of the USD1.2 trillion in equity market capitalisation represented in the Developed Markets index, 78 percent came from REITs[4].

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[4]Global Real Estate Investment, NAREIT website, http://www.reit.com/investing/reit-basics/reit-faqs/global-real-estate-investment, accessed 15 September 2014

S. No.	Country	No of REITs	Market size (USD billion)	Per cent of global REITs market	REITs performance as per S&P Dow Jones (Annual return in Per cent)	
					5 Year	10 Year
1	United States of America	163	621	57.68	23.80	9.58
2	Australia	52	86	8.33	18.11	5.10
3	France	37	68	6.33	20.74	16.46
4	Japan	41	64	5.98	14.84	7.78
5	United Kingdom	23	49	4.55	18.52	N.A.
6	Singapore	32	45	4.23	22.04	15.09

Source: European Public Real Estate Association – Global REIT Survey 2013

Evolution of REITs in India

In 2007 SEBI formally introduced the draft REITs regulations for public comments. Because of downturn in the market during that period, no further development took place in the REITs regulation, until October 2013 when a second draft of the regulations was issued for public comments by SEBI. After taking industry inputs, amendments to regulations were made and the draft was approved allowing setting up and listing of REITs. Post the clarifications provided in the 2014 budget, a final draft was introduced by SEBI in August 2014.

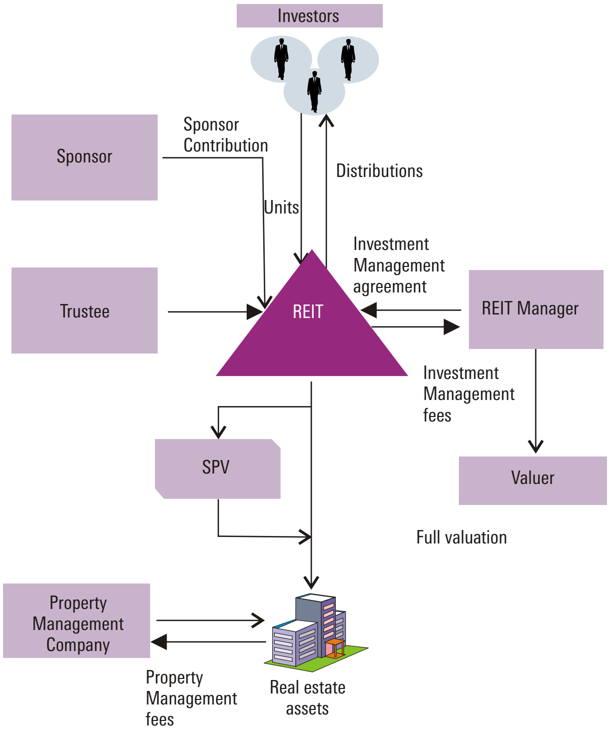
2002	2004	Jan 2008	April 2008	Oct 2013
Recommendations of the Satwalekar Committee on Real Estate Funds	Venture capital funds permitted to invest in real estate" removed from negative list	SEBI introduced first draft of the regulations for public comments	SEBI amends the mutual fund regulations to introduce the concept of real estate mutual funds	After extensive interactions by SEBI with various constituents in the market over the last several months, it released second draft of the regulations for public comments

Final regulations approved by SEBI in its meeting on 10 August 2014
(Draft regulations presented to SEBI board released)

Source: Consultation paper on draft SEBI (Real Estate Investment Trusts) Regulations, 2013; Press release no 89/2014, Securities and Exchange Board of India, August 2014; Report of the Sub-Committee appointed by AMFI, SEBI website, http://web.sebi.gov.in/commreport/amfi1.html, accessed 16 September 2014; SEBI (Venture Capital Funds) (Amendment) Regulations, 2004

Section 2: Structure of a REIT

Typical REIT structure



Parties involved	Description
Sponsor	Sponsors of the REIT and is required to hold specified percentage of security as "skin in the game".
Trustee	Independent third parties appointed to ensure that the right and interest of unit holders are protected.
REIT Manager	• Key role involves identification of investment opportunity, managing the investments and looking after day to day operations of the REIT. • Generally paid management fees and part of upside (IRR based)
Property management company	Acts as facility management company to ensure that the standard and quality of assets are maintained. Generally not required under the regulations, but are appointed to ensure adequate management of the property.
Investors	Subscribers to the units issued by the REIT.
Valuer	Valuation of assets held by REIT

Source: KPMG in India analysis 2014

Overview of SEBI REITs regulation

Structure	- To be setup as Trust, registered with SEBI - Relevant parties to be trustee (register with SEBI), sponsor and manager
Offer and Listing of units	- May raise fund from both residents as well as foreign investors (subject to guideline specified by RBI/Govt.) - Minimum subscription size to be INR 2 lakhs per investor, and the unit size to be INR 1 lakh - Minimum investors to be 200
Eligible Investor	- May raise fund from both residents as well as foreign investors (subject to guidelines specified by RBI/Govt.) - Minimum subscription size to be INR 2 lakhs per investor, and the unit size to be INR 1 lakh - Minimum investors to be 200
Borrowings	- Aggregate consolidated borrowings and deferred payments capped at 49% of the value of the REAT assets
Valuations of assets	- Full valuation including a physical inspection of the properties to be carried at least once a year - Value need to be independent from sponsor, manager and trustee and with minimum 5 years of relevant experience in valuation of real estate
Sponsor	- REIT can have upto 3 Sponsors (each Sponsors to hold at least 5 percent units). Sponsor to have minimum net worth of INR 200 million on a consolidated basis - Should hold at least 25 percent of the total units of the REIT on post issue basis, which shall be locked in for a period of 3 years from the date of listing - Sponsors / its Associate to have minimum 5 years experience in real estate industry on individual basis
Manager	- Manager to have minimum net worth of INR 100 million - Manager / its Associate to have at least 5 years of specified relevant experience - Minimum 2 key personnel to have atleast 5 years of relevant experience
Investment Condition	- Shall invest only in properties/securities in India - At least 80% of the value of the REIT assets to be in completed and rent generating properties and prohibited to invest in vacant land/agriculturall and/mortgages (other then morgage backed securities) & other TEITs - Permitted to invest in properties through a SPV, subject to certain specified conditions.
Income and dividend policy	- At least 75 percent of the revenues of the REIT (other than gains arising from disposal of properties) to be from rental, leasing and letting real estate assets at all times. - At least 90 percent of the net distributable cash flows of the REIT to be distributed to the unit holders.

SEBI (Real Estate Investment Trusts) Regulations, 2014; KPMG in India analysis

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The Indian Private Equity and Venture Capital Association (IVCA) is the oldest, most influential and largest member-based national organization of its kind. It represents venture capital and private equity firms to promote the industry within India and overseas. It seeks to create a more favorable environment for private equity, venture capital investment and entrepreneurship. It is an influential forum representing the industry to governmental bodies and public authorities.

IVCA members include leading venture capital and private equity firms, institutional investors, banks, corporate advisers, accountants, lawyers and other service providers of the venture capital and private equity industry. These firms provide capital for seed ventures, early stage companies, later-stage expansion and growth equity for management buyouts/ buy-ins.

IVCA aims to support entrepreneurial activity and innovation as well as the development and maintenance of a private equity and venture capital industry that provides long term equity capital. It helps establish high standards of ethics, business conduct and professional competence. IVCA also serves as a powerful platform for investment funds to interact with each other.

The Association stimulates the promotion, research and analysis of private equity and venture capital in India, and facilitates contact with policy makers, research institutions, universities, trade associations and other relevant organizations. IVCA collects, circulates and disseminates commercial statistics and information related to the private equity & venture capital industry.

If you would like to become a member, or recommend a firm for membership, please contact Aakriti Bamniyal at aakriti@indiavca.org

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