Real Estate Investment Trusts - Ready to roll?

March 2015
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Section 1

REITs – Key considerations
Model structure

Sponsor(s) => 25%
Investors => 25% Public float

Manager

Asset Co. => 50%*
Transfer of property / shares of Asset Co.

REIT

Management Agreement
Trusteeship Agreement

Manager

Co / LLP

=> 50%*

Asset

Trustee

Bank

Leverage <= 49%, subject to prescribed conditions

* + Controlling interest
**REITs - Key points for consideration**

- **Minimum asset size** (For IPO) of REIT - **INR 500 crore**
- **Investment** in real estate and securities of SPVs (including LLP) or TDR (Refer Annexure 1)
- **Distribution to investors** => **90% of net distributable cash flows**
- **Leverage** > **25% of REIT assets** - credit rating & unit holders approval
  - Max. leverage **49%**
- **Min. subscription** - **INR 2 lakh**
  - Trading lot- **INR 1 lakh**
- **Initial public offer** - **Within 3 years** after registration (else registration to be cancelled)
- **Mandatory listing**
  - Min. public float - **25%**
  - Min. offer size - **INR 250 crore**
- **Related party transactions** - Subject to certain approvals, conditions & disclosures
- **No multiple classes of units and no unit holder to have preferential rights**
**Key constituents : Sponsor**

**Multiple sponsors upto 3**, each to hold **at least 5%** in REIT on **post IPO basis**

Mandatory transfer of entire holding in SPV to REIT by the sponsor (subject to any legal and regulatory restrictions)

Atleast **5 years** experience in RE space

**Developer – Sponsor to have at least 2 completed projects**

Minimum net worth*:
(a) Collective: at least **INR 100 Crore**; and  
(b) Stand alone: at least **INR 20 crores**

Minimum holding >= **25%** (on a post issue basis) subject to **3 year lock-in**

Minimum continued holding:
(a) Collective basis: **at least 15%**; and  
(b) Individually: at least **5%**

Sponsor holding exceeding 25% subject to **1 year lock-in** post listing

Exit below 15% after 3 years: Sponsor to arrange for re-designated sponsor (prior approval of unit holders)

Re-designated sponsor to satisfy the eligibility norms to act as sponsor

*In accordance with section 2(57) of the Companies Act, 2013*
**Key constituents : Manager**

- Manage the REIT assets including leasing, procedural requirements and divestments
- At least **5 years** relevant experience* in real estate sector / real estate development
- Minimum **net worth - INR 10 crore** (no restriction on ownership of Manager)

- Make the investment decisions, ensuring appropriate legal title and compliance with Investment conditions
- **50%** of the members of Manager to be independent and not related parties to REIT
- Manager to ensure that REIT activities are in compliance with the REIT regulations

- Quarterly reports to the Trustee on prescribed matters
- Oversee the development of under-construction properties and ensure leasing the assets after completion
- Ensure timely distribution to unit holders and redressal of their grievances

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*Applicable for the Manager entity and at least its 2 key personnel*
**Key constituents: Trustee**

- **Registration with SEBI** under SEBI (Debenture Trustees) Regulations, 1993
- **Review of related party transactions**
- **Trustee and its associates should not be an investor** in REIT
- **Ensure remuneration of valuer not linked to value of REIT assets**
- **Oversee and supervise activities of Manager**
  - **Obtain compliance certificate from Manager**
- **Obtain prior approval of unit holders for change in control of Manager**
- **Enter into Investment Management Agreement with Manager**
Other constituents

Valuer* to act with independence, objectivity and impartiality

Sufficient resources to undertake valuation

Valuer to reject assignment that requires to report based on predetermined opinions by REIT

Valuer and its associates not to invest in REITs

Remuneration of valuer not linked with value of the assets and to be received only from the REIT

Auditor to be appointed to conduct audit of REIT

Valuer not to sell units of REIT or its asset prior to being appointed

Value of the REIT to be certified by Auditor based on the value of the REIT assets determined by Valuer

*A person registered under section 247 of Companies Act, 2013
Section 2

Budget Backdrop
India in a Sweet Spot

“The world is predicting that it is India’s chance to fly”
- Finance Minister, Budget speech

“If India takes the winning leap, it could be a US$10 trillion economy with a CAGR growth of 9% in the next 20 years”
- PwC report: Future of India – the Winning Leap

“India has reached a sweet spot—rare in the history of nations—in which it could finally be launched on a double-digit medium-term growth trajectory”
- Economic Survey 2014-15

“India is a 2 trillion dollar economy today. Can we not dream of an India with a 20 trillion dollar economy?”
- PM address at ET Global Business Summit, Jan 2015

Potential and Expectations are indeed high!

March 2015
PwC
## Macro Picture

<table>
<thead>
<tr>
<th>Metric</th>
<th>FY14 (actuals)</th>
<th>FY 15 (est.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth</td>
<td>6.90%</td>
<td>7.40%</td>
</tr>
<tr>
<td>Inflation</td>
<td>9.7%</td>
<td>6.20%</td>
</tr>
<tr>
<td>Fiscal Deficit</td>
<td>4.50%</td>
<td>4.10%</td>
</tr>
<tr>
<td>Current Account Deficit</td>
<td>1.70%</td>
<td>&lt; 1.30%</td>
</tr>
<tr>
<td>Tax-GDP</td>
<td>10.20%</td>
<td>10.60%</td>
</tr>
<tr>
<td>Industrial Growth</td>
<td>-0.10%</td>
<td>2.10%</td>
</tr>
</tbody>
</table>

- **Aiming for double digit growth**
- **Trending down, FY16(E) 5 – 5.5%**
- **Aimed at 3% by FY 17**
- **Drop in oil prices and Foreign inflows helped**
- **Need to broad base**
- **Inching up**

Source: Economic Survey 2014-15 / DIPP website
Section 3

REITs

Budget impact
**REITs Timeline**

- **Oct ‘13**: SEBI introduces draft REIT regulations
- **Dec ‘13**: SEBI comes out with a consultation paper on InvIT regulations
- **July ‘14**: SEBI introduces draft InvIT regulations
- **Aug ‘14**: Tax amendments related to REITs announced in the Budget
- **Sept ‘14**: SEBI approves REIT and InvIT regulations
- **Feb ‘15**: Final regulations released by SEBI
- **Amendments in Union Budget 2015**
Investment Trusts (REITs)…
Investment Trusts (REITs)…

Past          Present          Future
Investment Trusts (REITs)...Past

REIT / InvIT lifecycle

Setup

- Capital Gains deferral
- MAT

Income recognition & distribution

- Dividend – exempt
- Interest – taxable (Domestic @ 33%, Foreign @ 5%)

Exit

- Exit of Swap units - taxable
- LTCG exempt
- STCG taxable

Sponsor

Investor

REIT / InvIT

Asset SPV

*Not applicable to LLPs

Tax efficient foreign investment in levered assets ...
Investment Trusts (REITs)...

**Ask from Budget 2015!**

<table>
<thead>
<tr>
<th>LEVEL</th>
<th>ASK</th>
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<tbody>
<tr>
<td><strong>Sponsor</strong></td>
<td>CG deferral/ exemption</td>
</tr>
<tr>
<td></td>
<td>MAT deferral</td>
</tr>
<tr>
<td></td>
<td>CG deferral / exemption on asset transfer</td>
</tr>
<tr>
<td><strong>Asset level</strong></td>
<td>DDT exemption</td>
</tr>
<tr>
<td></td>
<td>Tax loss retention</td>
</tr>
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Investment Trusts (REITs)...

Past

Present

Future
Investment Trusts (REITs)...

Ask from Budget 2015!

<table>
<thead>
<tr>
<th>LEVEL</th>
<th>ASK</th>
<th>STATUS</th>
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<tbody>
<tr>
<td><strong>Sponsor</strong></td>
<td>CG deferral/ exemption</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>MAT deferral</td>
<td>×</td>
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<tr>
<td></td>
<td>CG deferral / exemption on asset transfer</td>
<td>×</td>
</tr>
<tr>
<td><strong>Asset Level</strong></td>
<td>DDT exemption</td>
<td>×</td>
</tr>
<tr>
<td></td>
<td>Tax loss retention</td>
<td>×</td>
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</tbody>
</table>
Investment Trusts (REITs)...

Migration to REITs /

- Sale of units (received under swap) either during IPO or subsequently post listing
  - Long term (> 36 months) – exempt
  - Short term (<36 months) – taxable at beneficial rate
- Not applicable on off-market transactions

<table>
<thead>
<tr>
<th></th>
<th>Pre Budget</th>
<th>Post Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost Base</strong></td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td><strong>Swap Value</strong></td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td><strong>IPO / Sale on exchange</strong></td>
<td>350</td>
<td>350</td>
</tr>
<tr>
<td><strong>Long term gains</strong></td>
<td>250</td>
<td>250</td>
</tr>
<tr>
<td><strong>Tax on gains</strong></td>
<td>50</td>
<td>-</td>
</tr>
</tbody>
</table>

*Assuming that the asset was held for a period exceeding 36 months*
...Investment Trusts (REITs)...

Rental income of REIT on properties directly owned...

- Pass through status at REIT level
- No TDS by tenants
- REIT to deduct tax at source on distribution:
  - Resident unit holders: 10%
  - Non-resident unit holders: At rates in force (the rates provided in respective tax treaties to be available)
- House property based characterisation on such income?
  - Deductibility of interest?

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<thead>
<tr>
<th></th>
<th>Pre Budget</th>
<th>Post Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rental income</strong>*</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td><strong>Standard Deduction</strong></td>
<td>30</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>70</td>
<td>100</td>
</tr>
<tr>
<td><strong>Tax / TDS</strong></td>
<td>~21</td>
<td>10#</td>
</tr>
<tr>
<td><strong>Available for distribution</strong></td>
<td>~79</td>
<td>90</td>
</tr>
<tr>
<td><strong>Additional tax for unit holders</strong></td>
<td>-</td>
<td>20</td>
</tr>
<tr>
<td><strong>Net income for unit holders</strong></td>
<td>~79</td>
<td>70</td>
</tr>
</tbody>
</table>

*Ignoring CAM revenues / expenses
# Applicable to resident unit holders
@ Assuming no loss set-off
...Investment Trusts (REITs)

The Yield play ...

NOI - 100

100% Foreign Debt

100% Equity

~35%

5%

Tax costs
...Investment Trusts (REITs)...

Unfinished agenda ...

<table>
<thead>
<tr>
<th>Regulatory – FEMA</th>
<th>Other issues</th>
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<tbody>
<tr>
<td>FIPB approval for exchange</td>
<td>Transaction costs</td>
</tr>
<tr>
<td>FDI/ FPI investment in REITs</td>
<td>Stamp duty costs</td>
</tr>
<tr>
<td>ECB (at REIT level)</td>
<td>Multi-tier structure</td>
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Transaction costs
Stamp duty costs
Multi-tier structure
Investment Trusts (REITs)...
...Investment Trusts (REITs)

### Asian REIT Market

<table>
<thead>
<tr>
<th>Market</th>
<th>Listed REITs</th>
<th>Dividend yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>46</td>
<td>3.40%</td>
</tr>
<tr>
<td>Singapore</td>
<td>33</td>
<td>6.07%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>7</td>
<td>4.69%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>15</td>
<td>4.84%</td>
</tr>
<tr>
<td>China</td>
<td>2</td>
<td>6.97%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>6</td>
<td>2.87%</td>
</tr>
<tr>
<td>South Korea</td>
<td>8</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Source: Lazard Asset Management, Asia REIT Report

India set to join the bandwagon?
## Way forward

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<tr>
<th>Identifying assets for REIT structure</th>
<th>Separation of operations and assets holding</th>
<th>Set up REIT structure</th>
<th>Transfer the ownership of companies to REIT</th>
<th>Offer documents &amp; Definitive agreements</th>
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<tr>
<td>Short list assets</td>
<td>Selection of methods - slump sale; transfer of shares; demerger, etc.</td>
<td>Identifying constituents</td>
<td>Compliance with FDI regulations - Pricing guidelines (for offshore investors)</td>
<td>Finalising the structure</td>
</tr>
<tr>
<td>Identify commercial, legal, regulatory and tax aspects</td>
<td>Determination of consideration</td>
<td>SEBI approval</td>
<td>FIPB approval (for offshore investors)</td>
<td>Documentatio n &amp; IPO process</td>
</tr>
<tr>
<td>Transaction costs - stamp duty</td>
<td></td>
<td></td>
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Annexure I - Investment conditions for REITs

Real Estate (‘RE’) assets or properties

- Not included:
  - Infrastructure (defined by MoF)
  - Vacant land (except land under development)
  - Agricultural land

- At least 2 projects – Max 60% in one project
- Minimum 75% of revenue of the REIT: Lease rental income
- Monitoring of above conditions on half yearly basis and at time of acquisition
- RE Assets to be held at least for 3 years post its purchase
- Investments in other REITs not permitted
- Co-investors not to have more favourable terms than the REITs

Securities of SPVs holding RE Assets

- Investment into SPV subject to:
  - SPVs holding =>80% of RE assets directly
  - SPVs to not invest in other SPVs
  - REIT to hold controlling interest and =>50% of equity share capital of the SPVs

TDR (Apart from 20% Project related TDRs*)

Annexure I - Investment conditions for REITs

Value of the REIT Assets

- At least 80%:
  - Completed and rent generating (75% on a continued basis)

- Not more than 20%:
  - Debt of companies;
  - Listed shares of companies earning $75\%$ revenues from real estate activity;
  - Unutilized FSI and TDRs of REIT related projects; and
  - Other securities

Not exceeding 10%:
- Under construction property; and
- Completed but not rent generating properties with 3-year lock-in post-completion

* Government securities, money market instruments, mortgage-backed securities, etc.
Questions?...
Thank You

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