Managing Indian REITs
The Conventional Wisdom

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Opinions expressed and errors, if any, are personally of the presenter.
Agenda

• The Story of REITs
• I-REITs
• Conventional Wisdom
• Opportunities & Challenges for I-REIT Management
Buying a Piece of Empire Estate

ESRT: Market Cap (Jan 2015): $1.87B

Image Source: libertyunyielding.com
Stock Data: Yahoo! Finance
### ESRT

<table>
<thead>
<tr>
<th>Institution Name</th>
<th>Empire State Realty Trust, Inc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets (Mi US$)</td>
<td>2,476,061</td>
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<tr>
<td>Total Liabilities (Mi US$)</td>
<td>1,472,876</td>
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<td>Total Equity (Mi US$)</td>
<td>1,003,185</td>
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<td>Common Equity (Mi US$)</td>
<td>385,158</td>
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<td>Total Preferred Equity (Mi US$)</td>
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REITs: USA versus India

Investor-centric versus investment-centric
# Evolution of REITs and Their Ownership Structure

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Total (Count)</th>
<th>Insider (avg %)</th>
<th>Float (Avg %)</th>
<th>Inst. Own. (avg %)</th>
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<tbody>
<tr>
<td>USA</td>
<td>1960</td>
<td>186</td>
<td>9</td>
<td>91</td>
<td>76</td>
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<tr>
<td>Netherlands</td>
<td>1969</td>
<td>5</td>
<td>19</td>
<td>81</td>
<td>48</td>
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<tr>
<td>Australia</td>
<td>1971</td>
<td>26</td>
<td>17</td>
<td>83</td>
<td>42</td>
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<tr>
<td>Canada</td>
<td>1993</td>
<td>47</td>
<td>14</td>
<td>86</td>
<td>23</td>
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<tr>
<td>Belgium</td>
<td>1995</td>
<td>11</td>
<td>40</td>
<td>60</td>
<td>11</td>
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<tr>
<td>Turkey</td>
<td>1995</td>
<td>7</td>
<td>67</td>
<td>33</td>
<td>7</td>
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<tr>
<td>Greece</td>
<td>1999</td>
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<td>36</td>
<td>25</td>
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<tr>
<td>Japan</td>
<td>2001</td>
<td>44</td>
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<td>33</td>
<td>32</td>
<td>68</td>
<td>22</td>
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<tr>
<td>France</td>
<td>2003</td>
<td>18</td>
<td>50</td>
<td>50</td>
<td>29</td>
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<tr>
<td>Malaysia</td>
<td>2004</td>
<td>5</td>
<td>46</td>
<td>54</td>
<td>40</td>
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<tr>
<td>Hong Kong</td>
<td>2005</td>
<td>8</td>
<td>43</td>
<td>57</td>
<td>16</td>
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<tr>
<td>Germany</td>
<td>2007</td>
<td>3</td>
<td>20</td>
<td>80</td>
<td>29</td>
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<tr>
<td>Italy</td>
<td>2007</td>
<td>2</td>
<td>54</td>
<td>46</td>
<td>23</td>
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<tr>
<td>UK</td>
<td>2007</td>
<td>32</td>
<td>16</td>
<td>84</td>
<td>60</td>
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<td>Spain</td>
<td>2009</td>
<td>4</td>
<td>6</td>
<td>94</td>
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<tr>
<td>Finland</td>
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<td>1</td>
<td>34</td>
<td>66</td>
<td>8</td>
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<td>Mexico</td>
<td>2011</td>
<td>7</td>
<td>12</td>
<td>88</td>
<td>18</td>
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<td>UAE</td>
<td>2011</td>
<td>1</td>
<td>0</td>
<td>100</td>
<td>14</td>
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<tr>
<td>Ireland</td>
<td>2013</td>
<td>3</td>
<td>10</td>
<td>90</td>
<td>64</td>
</tr>
<tr>
<td>South Africa</td>
<td>2013</td>
<td>14</td>
<td>18</td>
<td>82</td>
<td>43</td>
</tr>
<tr>
<td><strong>TOTAL (%)</strong></td>
<td></td>
<td><strong>461</strong></td>
<td><strong>17</strong></td>
<td><strong>83</strong></td>
<td><strong>51</strong></td>
</tr>
</tbody>
</table>

Source: SNL & authors

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Potential I-REIT Candidates

• Commercial Real Estate in India:
  – Large number of properties held by foreign REITs and non-REITs (Offices, healthcare, and retail)
  – Several hundreds are operated by listed companies (Hotels, apartments, offices, and retail)

• Natural targets for conversion to IREITs, along with established RE developers and international funds
Structure of I-REITs (REITs in India)

- **Trust**
  - Sponsored by Sponsor
  - Managed by Manager
  - Protected by Shareholder

- **Manager**
  - Invests and manages assets

- **Sponsor**
  - Provides initial capital

- **SEBI**
  -监管

- **Shareholder**
  - Protect benefits

- **Auditor**
  - Appointed

- **Appraiser**
  - Appointed

- **Investment Banker**
  - Appointed

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I-REIT Features
Ownership, Activities & Assets

• Must be publicly traded and listed
• Insider ownership
  – sponsor must hold between 25% and 75%
  – Responsible management versus entrenchment
• SPV assets must mimic the REITS’
  – Taxable REIT subsidiaries?
I-REIT Features

External Management

• Management vs. Advisory
  – Internal advisory is sought after; not management
    – Over 60% of REITs globally are internally advised
    – Nearly 50% of REITs are internally managed

• External advisors
  – Reluctance from sponsors (dilutes control)
  – Costly; but bring-in expertise
  – Impact on performance: ambiguous
  – Prevalent if high corruption and poor property rights
    (Cashman et al., 2014)
Are REITs Real Estate?

Stocks are from Mars, Real Estate from Venus

The Nature of REITs

– Stock, commercial RE, or a mixture?
– Academic Debate
– Difference of perception before and after the economic crisis (Das et al., 2015)
Financing REITs

- Major shift in financing approach
  - Rental assets are LT collateral
    - Debt contracts are simpler
  - Key challenge is availability of equity, not cost of debt (Chinloy, Das & Wiley, 2014)

- 49% cap on leverage
  - Majority of capital must come from equity
  - Liquidity issues for early I-REITs
Indian RE Development Firms are Increasingly More Leveraged:

Debt/Enterprise Value

Secured Debt / Property Value

Source: SNL & authors
Preferred Equity is not allowed in I-REIT

Preferred Equity RE Developers in India

Source: SNL & authors
Creating Shareholder Value

- S&P BSE200 average return ≈20%

\[ R_E = R_A + \frac{D}{E} [R_A - K_D] \]

If, \( R_A = 10\% \), \( \frac{D}{E} = 0.96 \), \( K_D = 8\% \)

\[ R_E = 12\% \]

- Arguably, I-REIT cash flows will be less volatile
  \( \Rightarrow \) Relatively smaller return expectations?
  - 15%?

- Internal growth + External growth
  - Dividend yield + Price Appreciation

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Internal Growth

Dividend Yield of Publicly-Traded RE Developers in India

Source: SNL & authors
Free Cash Flow Coverage

Source: SNL & authors

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External Growth

• Capital Gains
  – Is this sustainable Business model for REITs?
  – Capital constraints in recycling assets
    • Leverage is capped
    • 90% distribution

• Improve NAV?
  – REITs generate value from Income return (Mühlhofer, 2013)
Challenges to REIT Managers in India

Price/NAV for Publicly-Traded Real Estate Developers in India, 2006-14

Price/EPS for Publicly-Traded Real Estate Developers in India, 2005-14

Source: SNL & authors

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Opportunities for REIT Managers in India

• Market inefficiency
  – Real estate in inefficient in general
  – Data wizardry may offer an edge: predictability

• IFRS vs. US-GAAP:
  – BV vs. MV narrower with IFRS?
  – Improved performance legibility

• Growth Potentials
  – Increased appetite for space markets?
  – Degrading affordability in asset markets?
Questions?

Thank you
References


References (cont.)

References (cont.)


References