



REAL ESTATE INVESTMENT TRUST (REIT) – A BOON TO INDIAN INVESTORS

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ABSTRACT

Today people invest their savings, in many avenues to hedge against inflation and by doing so, the time value of their money is managed. Real Estate Investment Trust provide the investors the way to earn a part of income produced through real estate and real assets and also a part of ownership of the same, without buying a commercial real estate as a whole. This article explain the concept of real estate investment trusts, its types, benefits, Indian scenario and code of conduct by Securities and Exchange Board of India.

KEYWORDS: REIT, Equity REIT, Mortgage REIT, Dividend Distribution Tax, DRIP

Review of Literature

Many of the research on real estate investment trust is conducted on the basis of the portfolio theory developed by Markowitz (1952). The performance of real estate investments in capital markets in the form of real estate investment trust and its impact on the interest rate is analyzed and explained in a study by Aekkachai Nittayagasetwat (2012) and Jiroj Buranasiri (2012). The study is focused on Equity REIT in Thailand. The study incorporated Cox-Ingersoll-Ross model to explain how the interest rates affects the performance of Equity REITs

K. C. Chan, Patric Hendershott and Anthony B. Sanders (1990) analyzed the REIT traded in the important stock exchanges from 1973 to 1987 and found out that three factors which influences the returns of real estate investment trust. The factors are term structures of interest rates, unexpected inflation rates and changes in risk. A study by Gyourko and Nelling (1996) explains about the investment diversification by the REIT firms and the study states that the measures made by the firms in the basis of stock markets in not significantly relevant by the type of property and the economic region.

A study by McCue and Kling (1994), Mueller and Pauley (1995) explains the movement of interest rates influences on the real estate investment trusts and the study concludes that there is an inverse relationship between the interest rates and the real estate investment trust. Ewing and Payne (2003) and Bredin (2007) also states that the relationship between the interest rates and real estate investment trust is negative and both move in opposite direction.

The research conducted by Brueggman (1992), Chandrashekar (1999), and Sing and Ling (2003) states that the investment made on real estates or real assets through the real estate investment trusts given significant benefits over the diversification made in the investments. The study also says that the portfolios which includes the real estate investment trust will get better returns. Lizieri and Ward (2000) explained about the process of how real estate investment trust generates returns and how it is distributed, in their research which is conducted on the investment made on physical and financial real estates in the countries like the United States of America and United Kingdom.

Introduction to Real Estate Investment Trust - RIET?

Real Estate Investment Trust is first introduced in the United State of America in the year 1960. Real Estate Investment Trust is similar to the mutual funds. It functions just like the mutual funds but instead of having a portfolio of securities, the real estate investment trust have income generating real estates. The mutual funds are formed by a mutual fund trust, similarly the real estate investment trust is a company which owns and operates the real estates which generate regular income. Real estate investment trust allows the individual investors to invest in large scale real estate by selling its units to them. The real estate investment trust owns income generating real estates like shopping malls, resorts, hotels, apartments, office buildings, etc. The income generated by these real assets are distributed to the unit holding investors as dividends or reinvested in real estate in dividend reinvestment plans (DRIP) which compound the returns over a period of time. The units of real estate investment trust is traded in stock exchange and this will enhance the liquidity. This provide the investors extreme liquid stake in the real asset or real estate.

The real estate investment trust will register and collect money from the investor through an initial public offer and give units of real estate investment trust to the investors. The money collected from the initial public offer will be invested in income generating real estate properties. Thus the units of real estate investment trust is an investment instrument of real estate that is similar to a mutual funds. The real estate investment trust is basically classified into three, they are equity real estate investment trust, mortgage real estate investment trust and hybrid real estate investment trust. The investor can invest directly in real estate investment trust by purchasing its shares listed in the stock markets or indirectly by investing in the mutual funds which has the units of real estate investment trust in its portfolio. The real estate investment trust is negatively correlated to the stocks and bond and thus investing in it provides a chance for diversified investment. Real estate investment trust is not yet launched in India, even the Securities and Exchange Board of India has given the approval to launch, the dividend distribution tax act as a hurdle. In the Union Budget 2016, the government has proposed to remove the dividend distribution tax for real estate investment trust, so companies will launch it soon. Real Estate Investment Trust may be publically registered, listed and traded in stock exchange or publically registered but not listed in stock exchange or its can operate as a private company.

Why Invest in Real Estate Investment Trust?

Today people invest their savings, in many avenues to hedge against inflation and by doing so the time value of their money is managed. One of the popular investments which people opt is the bank deposit which gives fixed returns without risk but no type of ownership advantage is there in the bank deposits. If an investor expects high returns from his investment and a type of ownership together, then he will choose equities, but it involves high risk and need professional fund management skills as well. Mutual fund is a solution for this problem. An investor gets the advantage of investment appreciation, professional fund and risk management and ownership by investing in mutual fund. An investor will select the mutual fund schemes on the basis of his risk taking capacity. Similar to mutual fund, Real Estate Investment Trust also gives the ownership of the real assets to the investors and dividend as well and it is based on the number of units held by the investors. Real Estate Investment Trust provide the investors the way to earn a part of income produced through real estate and real assets and also a part of ownership of the same, without buying a commercial real estate as a whole.

The Real Estate Investment Trust is a total return investment. It provides returns to the investors in the forms of dividend and moderate long term capital gain. The units of Real Estate Investment Trusts are traded like stocks in stock exchanges in order to enhance its liquidity. One of the best ways to grow wealth is investing in real estate, but real estate investment requires huge money and the liquidity is less compared to others. But Real Estate Investment solves this problem. An investor can buy the units of real estate investment trust on the basis of his income i.e., no huge money is needed for real estate investment. If the investor wants to sell his units means he can easily sell it through stock exchanges, thus the real estate investment trust solves the liquidity problem of real assets as well. The most justifiable reason for investing in real estate investment trust is the rich dividend paid to the investors or the unit holder. Mostly, all the profit earned will be distributed to the investor or the unit holder via dividend, there is no retention or less retention of dividend by the real estate investment trust. This makes their

distributions are higher while comparing with other asset classes.

All these reasons explain why an investor should invest in real estate investment trust. In simple words it is affordable real assets which give ownership and capital appreciation with high liquidity and less risky compared to others.

Types of Real Estate Investment Trusts

Real Estate Investment Trust is widely classified into two, equities and mortgage. Equity Real Estate Investment Trusts own a wide range of property types including offices, shopping malls, hotels, apartments, etc. which are income generating real estates. They derive the major revenue from these properties in the form of rents and also engaged in income generating activities like leasing, developing and maintaining the real assets and the services offered to the tenants. The equity real estate investment trust should acquire the real estate properties and operate them as a portion of their portfolio and not to sell them once after developing it. This makes equity real estate investment trust different from others.

The mortgage type of real estate investment trust is very much different from equity type. They finance both residential and financial properties. They earn most of their income from interest earned through mortgages or mortgage backed securities. They lend money directly to the owners of the real estate and its operators as well. Most of the mortgage real estate investment trust offers mortgage based finance only on existing properties. The mortgage real estate investment trust uses many techniques to manage their interest rates and credit risk by using securitized investments, active hedging techniques and many other strategies.

So an investor should understand the characteristics of the real estate investment trust in which he is planning to invest, well in advance before making his investment. If he wishes to have high liquidity in his investment means he should opt the units which are listed and traded in major stock exchanges. This type of units involves risk as well and he should be ready to accept the risk and the risk he takes in his investment will be rewarded with premium at times. When an investor tries to understand the real estate investment trust, it seems to be like a partnership to him but real estate investment trust is not any type of partnership. They are the companies which develop, own and manage commercial and residential real estate assets actively. The units of real estate investment trust are traded in major stock exchanges just like stocks. This provides complete liquidity to the units and market pricing also. The units which are publically traded in stock markets have to fulfill the same requirements of other publically traded companies. Thus the units of real estate investment trust are not a type of partnership. It operates just like a joint stock company.

Benefits of Real Estate Investment Trust

The benefits of real estate investment trust are categorized into income, diversification, inflation protection, liquidity, transparency, performance, etc. The strong and reliable payout by the real estate investment trusts proves that it gives regular income to their investors which tend to increase over a period of time. Since the income is generated in the forms of rents and interest, the risk is less compared to other equity investments. Diversification is also a benefit of real estate investment trust because diversification always reduces the risk and increases the returns. Research conducted on portfolio says that the real estate investment trust has moderate to low relationship with the volatility of equity stocks, bonds and other asset classes. The benefit of diversification helps the investors to make long term returns without taking additional risks. Real Estate Investment Trust provides a natural protection against the inflation because the returns are based on the rent and interest from real estates, it increases when inflation rises. So the investor doesn't want to adopt hedging strategies to hedge against inflation. This is one of the exclusive benefits of real estate investment trust.

Real Estate Investment Trust provides opportunity to the investor to invest their money in income generating real estate without owning the actual property. The units of real estate investment trust are traded in secondary market. Thus the real estate investment trust has liquidity benefit. The unit holder or the investor can convert it into money through the stock exchange where the units are traded. The real estate investment trust makes the investments more effective and accessible for the investors. It helps them to own real estate assets without buying and maintaining even seeing it physically. It also reduces the liquidity risk of real estate assets, by secondary trading at major stock exchanges. The performance of real estate investment trust is remarkable as it has a tremendous track record of reliable dividend which grows year by year and it has a good long term capital appreciation. They are performing well because of the professional management by the companies which aim to increase the wealth of the investors who invested in real estate investment trust through them.

The real estate investment has the above mentioned benefits but how it can be trusted. No real estate investment trust can create their unit holder because they are under the hawk eye of regulatory authorities. In India, it will be controlled by the Securities and Exchange Board of India. So they maintain high transparency in their dealing and that becomes one of the benefits.

Real Estate Investment Trust In India

Real Estate Investment Trust is not yet launched in India. In the year 2014, Securities and Exchange Board of India (SEBI) has given approval for setting up real

estate investment trust, but due to some problems like taxation, institutional grade space, valuation models, shortage of trained manpower, weaker legal structure, etc., it is not yet launched in India. One of the major reasons for the delay in the launch of real estate investment trust is the Dividend Distribution Tax and Minimum Alternative Tax levied on them, because as per the guidelines of Securities and Exchange Board of India, the real estate investment trust must distribute 90% of the distributable cash flow to its unit holder twice in a year and because of the Dividend Distribution Tax, no company is ready to launch real estate investment trust in India. In the Union budget of 2016, the government has taken steps to remove the Dividend Distribution Tax levied on real estate investment trust and if it happens means many companies will launch and it provides good opportunities to the Indian investors to invest in growing real estate and infrastructural developments in India.

If real estate investment trust is introduced in India, then it will provide liquidity position to the commercial real estate developers and opportunity to the individual retail investors to participate in real estate market growth. If the Dividend Distribution Tax is removed as proposed by the government, then we can witness some real estate investment trusts, listing in this year itself. In India, the minimum subscription amount for real estate investment trust is fixed as two lakhs rupees by Securities and Exchange Board of India, which will not encourage the retail investors to invest. So government should take steps to reduce the subscription limit which should be affordable to all the investors. The real estate investment trust will become one of the widely acceptable investment options in India because its risk return will be worthwhile to the investor and offer high rate of returns, the returns are based on the yield of the real estate assets which generates a risk free income regularly. Securities and Exchange Board of India specified that, real estate investment trusts are permitted to raise funds through Initial Public Offer (IPO), Follow-On Public Offer (FPO), Offer For Sale (OFS), Qualified Institutional Placements (QIP), right issue. Thus real estate investment trusts units become a dividend paying liquid investment instruments which has a strong asset backup.

Code of Conduct for Real Estate Investment Trusts (REIT) and its Parties, by SEBI

1. The real estate investment trusts and its parties should do all the activities which protect and enhance the interest of the investors who hold the units of real estate investment trust
2. The real estate investment trusts and its parties should disclose the necessary material information to its unit holders and the stock exchange where the units are listed, on time.
3. The real estate investment trusts and its parties should charge a reasonable fee for their services to the unit holders
4. The Manager who decides the investments is free to take investment decisions on his/her own. The investment decisions should be solely in the interest of the investors or the unit holders.
5. The real estate investment trusts and its parties or the third party appointed by the managers should not involve in any type of unethical practices at any cost. If the third party appointed by the manager, involved in any unethical practices means the manager will be liable for the same.
6. High standard of conduct of business, integrity and fair dealings are expected from the real estate investment trusts and its parties
7. Due diligence, proper care and all time good services should be provided by real estate investment trusts and its parties to their unit holders
8. No oral or written statement which exaggerates the services, capabilities, quality, etc. of the real estate investment trusts and its parties should be made.
9. It is the sole responsibility of the real estate investment trusts and its parties in the case of commission charged, not abiding the contents of the contract, etc. with the unit holders
10. The real estate investment trusts and its parties are regulated by Securities and Exchange Board of India under Securities And Exchange Board Of India (Real Estate Investment Trusts) Regulations, 2014

Conclusion

Real Estate Investment Trust provides an opportunity to the unit holders or the investor to take part in the infrastructural development of the country. The money invested in its units are less risker compared to other investments, because the income generated by the real estates is not from the profit from the business operations, it is generated from rent and payment to the services rendered. So the risk of loss of sales or profit loss is not there in real estate investment trust and even though if an investor feels that the income generated via rent and services has some risk means he can opt the mortgage real estate investment trust unit in which the income is generated by the interest on money lent to the real estates. Many countries in the world enjoy a remarkable development in their infra-

structure through real estate investment trust and the people of such countries holds ownership in the country's infrastructure via the same. The units of real estate investment trust is traded in major stock markets like stocks and this will enhance its liquidity. The real estate investment trust sells their units to all type of investors through Initial Public Offer (IPO), Follow-On Public Offer (FPO), Offer For Sale (OFS), Qualified Institutional Placements (QIP), right issue. The current Union Budget of Indian has given a very positive move to real estate investment trust and if it is launched means all the Indian investor will have their ownership in the infrastructure developments in the country, which is highlighted in the current budget. Thus the real estate investment trust will be a boon in long term to the investors always even though it has some risks.

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