

## Industry Flash

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# Indian Real Estate

## Draft Guidelines for REITs in India, a Sentiment Positive

- **More visibility on REITs in India** — SEBI's new draft regulations for the functioning of real estate investment trusts (REITs); these focus on income generating investment vehicles in the domestic market; should open a hitherto closed market, and provide developers/property market, another pool of money (IPO's, off-shore structures, and P/Es, were a rage in 2007). Opening up of this market has been expected over the last 12-months; regulations are indicative as of now, and will be firmed up post market feed-back.
- **Key highlights of the Draft proposal** — 1) Structure; set-up under local laws; managed by a real estate investment management company, 2) Funds; close-ended, listed on stock exchanges with valuations done by independent principal valuers disclosed annually; and 3) Dividend distribution; not-less than 90% of post tax profits d) Issues: No clarity on taxation for REIT's or investors – this is key to the viability of these structures, and needs to be addressed.
- **Investment Scope of REITs** — The investment guidelines for REITs cover 1) Non-income producing/under-development asset: Capped at 20% 2) single Asset exposure: 15% cap 3) Developer exposure/concentration: restricted at 25% for projects developed/marketed/financed by a developer group; 4) Leverage: Capped at 20% of total gross assets 5) Restrictions; Cannot invest in land/participate in development activities.
- **How this compares with Overseas/Domestic structures?** — Regionally, REITs - have a development cap of 10%, no developer concentration limitations, higher leverage of 35% and tax free status. AIM structures, own developmental assets with no fixed dividend policy, hence not comparable. We see the proposed Indian REIT as a combination of the REIT and business trust model. The scope of investment and returns of Real Estate Mutual Funds in India are different, thus this structure should help widen scope of retail investment in real estate.
- **Implications** — We see this as early signs of an evolving commercial asset sale market (office, IT Parks/SEZs, Hotels, Malls, Hospitals) in India; which could result in potential yield compression. Key beneficiaries should be developers with higher leverage towards such assets such as DLF and Unitech. Further, this should provide a new channel for financing projects and enhance levels of disclosures and transparency in the sector. Overall, a sentiment positive for the sector, but believe it will take a while for material benefits to flow through – clarity on taxation will however be crucial.

See Appendix A-1 for Analyst Certification and important disclosures.

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**Ashish Jagnani**<sup>1</sup>  
 +91-22-6631-9861  
 ashish.jagnani@citi.com

**Aditya Narain, CFA**<sup>1</sup>  
 +91-22-6631-9879  
 aditya.narain@citi.com

**Karishma Solanki**<sup>1</sup>  
 karishma.solanki@citi.com

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<sup>1</sup>Citigroup Global Markets India Private Limited

**Figure 1. Comparison of Scope of REIT-like Structures – Domestic & Overseas**

Scope of REITs	Proposed India REIT	Singapore REITs	Business Trusts/AIM Structures/ Domestic REMFs
Developmental Cap	20%	10%	No restriction
Single Asset Exposure	15%	5%	No restriction
Developer Concentration	25%	No restriction	No restriction
Leverage	20% of Gross NAV	35% of deposited property without credit rating and 60% with credit rating	No restriction
Restriction on investments	land/developers	Vacant land/unlisted property development companies/ mortgages (except MBS)	No restriction
Dividend Distribution	not less than 90%	not less than 90%	No restriction

Source: Citi Investment Research

## Appendix A-1

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