Finance

REITs: The New Real(i)ty

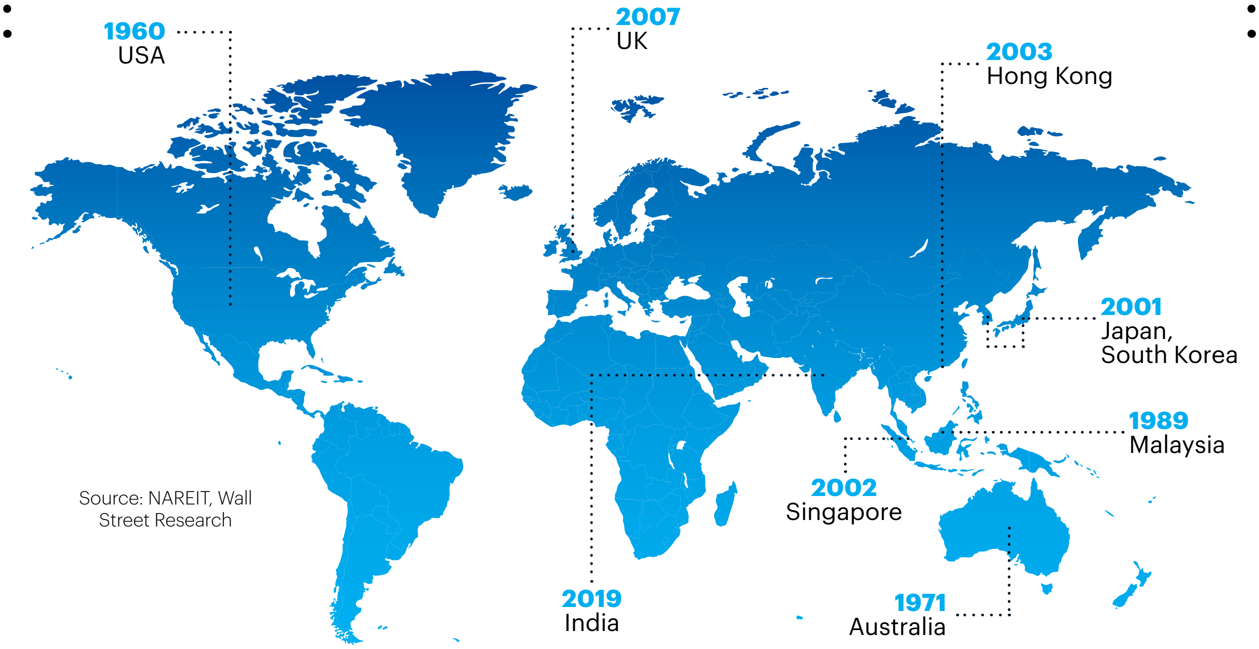
Though India caught on to the Real Estate Investment Trust model late, successful listings have not only demonstrated investor appetite, but also paved way for many others to consider a new approach to commercial real estate

BY RUKMINI RAO

Leading the way in 1960, the US Congress signed a legislation introducing Real Estate Investment Trusts (REITs) to bring the benefits of commercial estate to the common American, which were largely available to financial institutions and wealthy individuals. REITs are securities linked to real estate that can be traded on stock exchanges once they get listed. They invest in income-generating real estate. This income gets distributed among unit holders, including sponsors, trustees, fund managers and unit holders. Bradley Real Estate Investors, Continental Mortgage Investors, First Mortgage Investors and First Union Real Estate were among the first ones to create REITs in the US. In 1965, Continental Mortgage Investors listed on the New York Stock Exchange.

Back home, though the Securities and Exchange Board of India (Sebi) introduced the draft REIT regulations as early as 2007, it was only seven years later in 2014 that Real Estate Investment Trusts Regulations, 2014 (REIT Regulations) were enacted. Other reforms, including liberalisation of foreign direct investment (FDI) norms in real estate, opening up of the domestic fund industry to foreign investments and clarity on

REIT's GLOBAL FORAY



tax implications of REITs, helped the market get ready for its first REIT listing in 2019. On April 1, Embassy Office Parks (a joint venture between US private equity firm Blackstone and Embassy group) REIT got listed on the BSE. Investors lapped it up.

According to estimates of the European Public Estate Association, the total value of listed real estate globally is around \$3,864.3 billion and property under REITs forms nearly 53 per cent, around \$2042.8 billion. However, this is largely concentrated in developed markets.

The two listed REITs of Embassy and Mindspace Business Parks hold a tad over 60 million square feet under listing out of the 500-plus million square feet of Grade A office space in India, according to industry estimates.

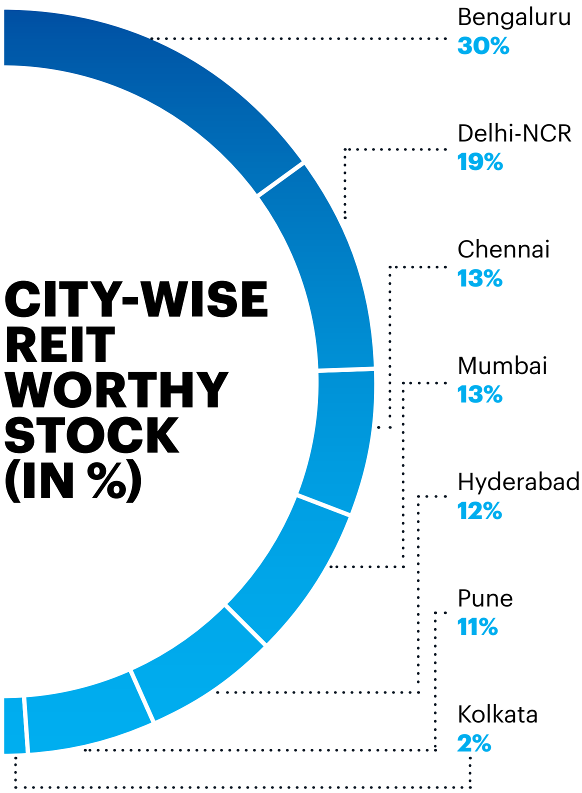
A healthy demand and supply dynamics for office space, factors such as low interest rates, falling yields of government bonds globally, and interests from global firms have opened up opportunities for developers to tap into. The next two-three years could see another four-five listings, according to experts.

The India Story

Despite Covid-19, Mindspace Business Parks REIT, jointly owned by K. Raheja group and Blackstone, launched its ₹4,500-crore initial public offering (IPO) in August 2020. While the institutional portion was subscribed 10.61 times, the non-institutional segment, including HNIs and retail investors, was subscribed 15.77 times. Vinod Rohira, MD and CEO, Commercial Real Estate & REIT at K. Raheja Corp, calls the pandemic a blessing in disguise. "Since we were doing our roadshows over Zoom calls, we could reach out to far more people within the time range than we could have done physically," he says. The company managed to reach out to nearly 800 people over Zoom, including HNIs, which helped them expand their reach. The listing consisted of a fresh issue of ₹1,000 crore and offer for sale (OFS) of ₹3,500 crore, and 29.5 million square feet of leasable area.

Brookfield India Real Estate Trust's ₹3,800-crore REIT issue closed recently with an overall eight times subscription. Barclays, Bank of America Continuum, RBS, TCS, Cognizant, and Accenture are some of the clients of Brookfield India Real Estate Trust. The company has campus-format office parks in Mumbai, Noida, Gurugram, and Kolkata.

It was, however, Bengaluru-based realtor Embassy group's maiden listing in 2019 that showed the way for others. Vikaash Khdloya, Deputy CEO and COO, says



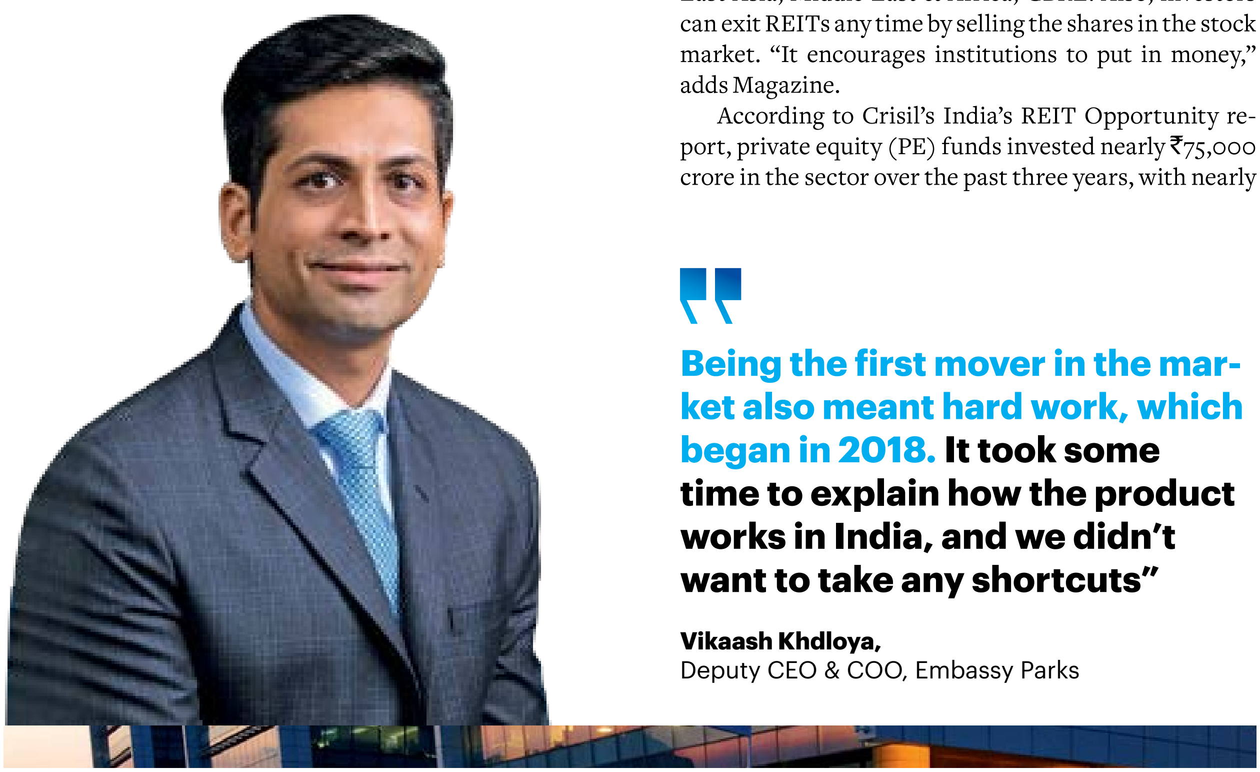
being the first mover in the market also meant hard work, which began in 2018. To set the right context for institutional investors "it took some time to explain how the product works in India, and we didn't want to take any shortcuts," he adds. The listing garnered a good response with investors placing 181 million bids and the issue getting oversubscribed 2.6 times. Embassy Office Parks REIT comprises 26.2 million square feet of completed and operational commercial properties across India. With approximately 7.1 million square feet of on-campus development in the pipeline, the total portfolio spans 33.3 million square feet across seven Grade A office parks and four city centre office buildings in India.

Winner All The Way

The reason for such enthused investor response to REITS is due to a variety of factors. These include the trustee and manager-managed model, the mix that REITs offer (only 20 per cent of a property can be under construction, 80 per cent should be rent-yielding), listing and disclosure norms that ensure transparency, and the 90 per cent income distribution rule (to qualify as a REIT, the trust must distribute at least 90 per cent of its taxable income to shareholders).

"A large part of Indian investors put money in government bonds and fixed deposits. Interest rates have dropped significantly and that makes REITs very attractive since there are chances of higher return," says Anshuman Magazine, Chairman and CEO, India, South East Asia, Middle East & Africa, CBRE. Also, investors can exit REITs any time by selling the shares in the stock market. "It encourages institutions to put in money," adds Magazine.

According to Crisil's India's REIT Opportunity report, private equity (PE) funds invested nearly ₹75,000 crore in the sector over the past three years, with nearly



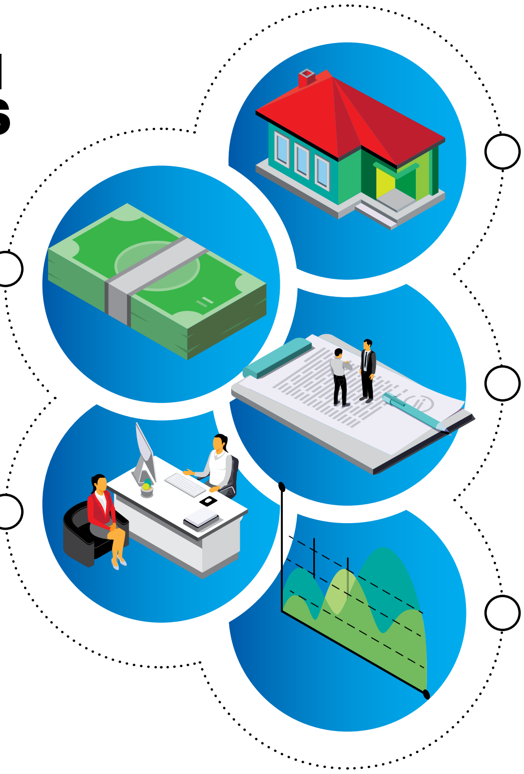
"Being the first mover in the market also meant hard work, which began in 2018. It took some time to explain how the product works in India, and we didn't want to take any shortcuts"

Vikaash Khdloya,
Deputy CEO & COO, Embassy Parks

A HIT WITH INVESTORS

LIQUIDITY: REIT units can be traded like equity

TRANSPARENCY: Strong governance framework & disclosure to regulators



ASSET QUALITY: Professionally managed, high-quality commercial spaces

DISTRIBUTION: Unlike equity-related uncertain dividend, stability in distribution due to regulation

PERFORMANCE: Upside participation in capital appreciation from organic / inorganic growth

LISTED REITs

Embassy Office Parks REIT

Mindspace Business Parks REIT

Brookfield India Real Estate Trust

70 per cent in the commercial and office space.

To put it in perspective, if one were to evaluate the upside for investors, JLL's 'The India REIT Opportunity' research report of November 2020 notes that Embassy REIT now enjoys an average cost of capital of 6.7 per cent, allowing it to acquire assets priced at 7.2 per cent, and still provide dividend accretion. So if Blackstone was to exit/divest any stabilised asset to the REIT, it potentially stands to gain. "Blackstone could use the existing arbitrage opportunity by acquiring assets at a cap rate more than 8.5 per cent and divest them to a REIT at a cap rate of 7-8 per cent and reap an immediate divestment gain. REIT management fees are tied to the portfolio size and will likely increase after the REIT acquires more assets. Otherwise the REIT's distribution per unit (DPU) will increase as it would raise debt and equity at 6.7 per cent to acquire assets yielding 7.5-8.5 per cent, thereby improving the return for unit holders." Cap rate is the rate of return on a property based on the income that the property is expected to generate.

Also, fund managers prefer to back REITs compared to other Infrastructure Investment Trusts (InviTs). "Mutual funds invested ₹735 crore in REITs in the first six months of 2020, indicating a nearly three-fold jump from the year-ago period. On the other hand, according to Sebi, mutual funds' investments in InvITs dropped by 8 per cent to slightly lower than ₹5,000 crore during the period under review," says Vishal Ahuja, Head, Private Wealth Group, JLL India.

The Road Ahead

Embassy and Mindspace REITs have seen both foreign and domestic institutional players participate in their public offerings along with retail investors. According to the latest annual report of Embassy, Blackstone and the Embassy group hold over 70 per cent of the units (55.30 per cent and 14.97 per cent, respectively) and foreign portfolio investors hold another 16.37 per cent. Shobhit Agarwal, MD & CEO, ANAROCK Property Consultants, says Mindspace REITs included institutional investors such as Singapore state investor GIC, Fidelity, Capital Group and Fullerton, while Embassy REITs have seen participation from investors, including Fidelity Interna-

EMBASSY VS MINDSPACE

	Market cap (₹cr)	52-wk high	52-wk low
Embassy	33,668.24	518 ▲	301 ▼
Mindspace	20,162.62	342.79 ▲	298.5 ▼

Market cap as of January 17, 2021; Source: BSE

Since we were doing our road-shows over Zoom calls, we could reach out to far more people within the time range than we could have done physically"

Vinod Rohira,
MD and CEO, Commercial Real Estate & REIT,
K. Raheja Corp

tional, Capital Group, TT International and Schroders. Pointing out at a strong domestic interest in Indian REITs, Agarwal adds, "Kotak Mahindra Life Insurance and the family office of Radhakishan Damani (the promoter of Avenue Supermarts that runs the D-Mart chain of supermarkets) participated in the Embassy REIT IPO."

While work from home (WFH) could look like an inflection point in the office space segment, India still commands a 56.5 per cent share of APAC inventory of office space, according to Cushman & Wakefield. In Q2 of FY21, Embassy's rental collections from office occupiers remained at 99.5 per cent, while new leases and renewals stood at 2,10,000 square feet. It even saw rental increase of 11 per cent on 1.9 million square feet in Q2 across 18 office leases, with year-to-date rental increase of 12 per cent on 3.7 million square feet across 40 office leases. Khdloya says the demand for office space is not going anywhere and the company is steadily seeing an increase in footfalls across tech parks, and with vaccine roll-out, employees will be back in office. MNCs such as Goldman Sachs, Facebook and McAfee "want to give the best experience to employees and we have seen some of them spend more on interiors and doing up their office than the lease amount," adds Khdloya.

According to rating agency Crisil, the top 10 commercial real estate owners, including developers and funds, have around 184 million square feet, which could fetch annual lease rental income of ₹17,000 crore and has the potential to raise ₹1.5 lakh crore in REITs. It could mean that India's REIT listing could expand beyond office space. Around 45 million square feet of Grade A mall spaces sized more than 2 lakh square feet, excluding standalone anchors (key tenants), were added across the top seven cities in the last decade. "These malls, with an overall occupancy of more than 80 per cent, can potentially provide a major retail REIT opportunity," says Agarwal of ANAROCK. Even around 110 million square feet Grade A warehousing stock across India has the potential to come under REIT. BT

@rukminirao