Business Standard

# Reits could invest in realty stocks

**Final regulations likely at Sebi's board meeting on Sunday; regulator might also change minimum asset criteria**

**Jayshree P Upadhyay | Mumbai August 05, 2014** Last Updated at 22:50 IST

The Securities and Exchange Board of India (Sebi) might permit a real estate investment trust (Reit) to invest up to 20 per cent of its assets in shares and debentures of real estate companies.

The market regulator is likely to issue final regulations on Reits at its board meeting on Sunday in the capital. According to sources, the board is likely to approve key changes to the draft regulations, issued in October last year, to ensure attractiveness of the investment product, aimed at providing liquidity to the cash-short sector.

Among the most important changes will be the move to allow a Reit to invest up to 20 per cent in under-construction projects and in shares and debentures of a real estate firm.

**FRESH LOOK**

**Likely changes**

- Reit can invest up to 20 per cent in under-construction projects and real estate shares and debentures
- Minimum assets of Rs 500 crore
- Manager needs to have net worth of Rs 10 crore

**Earlier proposal**

- Reit was allowed to invest up to 10 per cent in under- construction projects
- Minimum assets of Rs 1,000 crore
- Manager needs to have net worth of Rs 5 crore

*Source: Industry officials, Sebi draft regulations*

Market players said the move will particularly benefit real estate firms having a majority of completed projects. “Under the erstwhile system, a real estate firm had to transfer an asset into a special purpose vehicle (SPV) to enable Reit investment. If Sebi allows investment into securities of realty companies, a Reit will directly be able to invest in shares of compliant real estate firms,” said an expert.

However, some believe a Reit should ideally target investment into a yield-generating asset, instead of shares of realty companies, to ensure better clarity on returns.

“Increasing the investment limit to 20 per cent in real estate equity doesn’t come across as an investor-friendly move, as it could increase the level of risk. A Reit should prefer investing in yield-generating assets,” said Gautam Mehra, executive director at PricewaterhouseCoopers (PwC).

Sebi might also revise downward the minimum asset criteria for a Reit to Rs 500 crore from the earlier proposed Rs 1,000 crore. This is to enable more issuers to tap this product.

The regulator could, however, double the net worth requirement for investment managers of a Reit to Rs 10 crore.

Experts say other critical issues also need ironing out to ensure success of this instrument. “The requirement that a sponsor needs to have real estate experience has to be done away with. There are a lot of entities with real estate holdings but no real estate experience, which will be left out due to this,” said Ruchir Sinha, co-head private equity and head of private debt, Nishith Desai Associates.

Sebi in the draft regulation had prescribed a minimum experience of at least five years in property or fund management in development of real estate. According to sources, the regulator is likely to retain the experience criteria for Reit managers. Sinha also said the delisting framework for a Reit has to be put in place so that a sponsor has clarity on the exits. “Right now, a delisting will have to go by what is there in the Companies Act, which is clearly not feasible for delisting a Reit, as it requires the promoter to purchase all units as against liquidation of a Reit,” said Sinha.

A source said the Sebi board is likely to keep the investment limit for investors unchanged at Rs 2 lakh. As also the other requirement that a sponsor will be required to mandatorily hold up to 25 per cent as initial holding for three years and 15 per cent thereafter.

There had been extensive consultation with market participants and the Union finance ministry, which recently awarded pass-through status to Reits.

Experts, though, say the pass-through status given by the government isn’t on the lines of what the market had expected. “The pass-through status given in the Budget is only on interest income received by a Reit. The question is what the SPV will do with the debt, since the asset is already completed. Again, capital gains tax exemption is given only on transferring the share of the SPV, not the actual transfer of the real estate. Such exemption might not help much,” said Sinha.