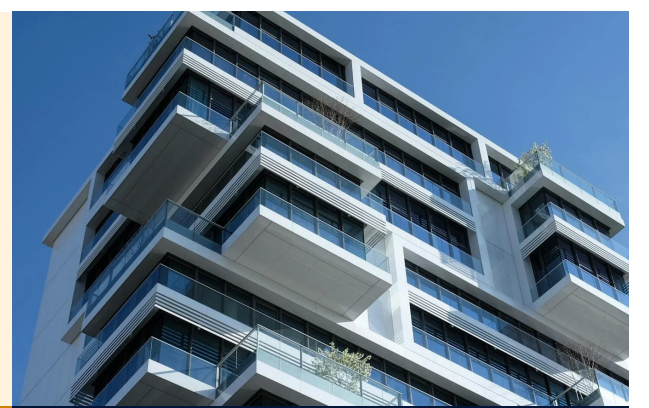


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Unlocking New Horizons: SM REITs Transform the Indian Real Estate Landscape for Independent Owners

Step into a new era of possibilities, where the playing field is levelled for independent owners. Imagine the potential of accessing the kind of capital that was once exclusive to the 'big players'. This is not a dream, but a reality for many owners, thanks to the advent of SM REITs (Small and Medium Real Estate Investment Trusts). These SM REITs empower independent owners to tap into a pool of investor resources, enabling them to monetise their assets and pursue their expansion dreams, be it a new wing, a fresh project, or a greenfield venture. This is your opportunity to take control of your future in the real estate market.

In response to the increasing popularity of Fractional Ownership Platforms (FOPs) and the subsequent rise in investor participation, the Securities and Exchange Board of India (SEBI) took a proactive step to ensure regulatory oversight. On March 8, 2024, SEBI issued comprehensive guidelines, 'Regulatory Framework for Small and Medium REITs (SM REITs)', solidifying the legitimacy and security of this new opportunity, thereby instilling confidence in the system.

Previously, the benefits of Real Estate Investment Trusts (REITs) were primarily limited to larger companies. However, with the advent of SM REITs, the real estate landscape has undergone a significant metamorphosis. SM REITs now offer a compelling opportunity for SMEs in the real estate industry to unlock their growth potential. By listing themselves as SM REITs, these companies can access a broader pool of capital, similar to their larger counterparts. This expanded access to funding empowers them to seize the opportunities in the lucrative real estate market and pursue strategic expansion or property upgrades.

In India, owning a piece of land or a brick-and-mortar property has always been a dream – a way to secure your future and build wealth. For many, it's like gold – a reliable investment that feels safe and familiar. A recent study showed that 66% of Indians in 2024 prefer these tangible assets.

The problem? Real estate wasn't exactly open to everyone. Until recently, it was a game reserved for the wealthy. The down payments were huge, the upkeep a hassle, and figuring out the market required connections and know-how that most folks didn't have.

The landscape is indeed shifting! With the rise in disposable incomes, more Indians now have surplus funds. As they become increasingly comfortable with financial risk-taking, they explore investment avenues beyond conventional gold.

Let's dive into the world of REITs, your gateway to steady income and real estate growth.

Think of a REIT as a pool of money from many investors, like a community pool. This money is used to buy income-producing real estate assets – shopping malls, office spaces, and hotels. Each investor gets a share representing their ownership in this pool of properties. Income generated by the properties is then distributed to unitholders at regular intervals. This distribution can take the form of dividend payments and potential capital appreciation upon the sale of assets. Following their initial public offering (IPO), REITs are listed and traded on stock exchanges like other equity shares, offering the same amount of liquidity. Investors can benefit from this liquidity, unlike those investing directly in real estate.

Big dreams, small budget? SM REITs are here to break down barriers to real estate-yielding investment.

Unlike traditional REITs, SM REITs offer greater flexibility, allowing them to invest in commercial and residential properties. Furthermore, an SM REIT can strategically subdivide its entire portfolio into distinct schemes, each encompassing various property types, effectively representing different asset classes.

Notably, the minimum investment threshold for SM REITs is significantly lower than that of traditional REITs. This reduced barrier to entry, with an investment amount as low as Rs 10 lakh, presents a compelling opportunity for the Indian middle class to participate in the expanding real estate investment trust market.

It is essential to understand the critical differences between SM REITs and REITs

	SM REIT	REIT
Asset Size	INR 50 crores to less than 500 Crores	INR 500 crores or more
Minimum Subscription	INR 10 lakhs or as specified by SEBI	INR 10,000 – INR 15,000
Co-investment	Not Permitted	Permitted
Schemes	Permitted to list through separate schemes	Not Permitted
Distribution by REIT/ SM REIT	100% of net distributable cashflows every quarter	90% of net distributable cash flow to be distributed
Ownership	To be held 100% by the SM REIT scheme	51% controlling stake either directly or indirectly
Investment Condition	95% in completed and revenue-generating assets only	80% assets completed and revenue-generating- under construction permitted up to 20%

SM REITs offer a compelling entry point for investors seeking to participate in the Indian real estate market. This innovative concept allows you to co-own a portion of a diversified real estate portfolio, significantly lowering the entry barrier with a smaller investment. SM REITs break down the walls that previously excluded retail investors, opening doors to a world of opportunity.

But SM REITs go beyond just accessibility. The Securities and Exchange Board of India (SEBI) has established a robust framework to govern these investments. This translates to clear rules, fair practices, and enhanced investor protection. Unregistered and unregulated structures are now incentivised to operate under the SM REIT structure, further strengthening market integrity.

Additionally, SM REITs provide the security of a tangible asset class: real estate. Investors gain peace of mind knowing that physical properties back their investment. Due diligence reports are readily available, allowing investors to understand the specific assets the SM REIT holds thoroughly. This transparency fosters trust and empowers investors to make informed decisions.

Furthermore, SM REITs prioritise risk mitigation. Focusing on pre-leased commercial and residential properties minimises the potential for vacancies and rental defaults. These properties are typically occupied by established companies, further bolstering the security of the investment. The potential rewards extend beyond just regular income. SM REITs offer the exciting prospect of dual income streams: steady rental yield and potential for capital appreciation. The Indian real estate sector is projected for significant growth, with a Compound Annual Growth Rate (CAGR) of 18.7% expected between 2020 and 2030. This translates to the potential for the investment to increase in value over time.

SM REITs also recognise the importance of investor flexibility. The concept of the time value of money comes into play here. Regular monthly cash flow distributions can compound over time, leading to potentially higher yields. Additionally, investors enjoy the liquidity advantage of selling their holdings on the stock exchange whenever desired. Taxation for SM REITs follows a straightforward structure similar to other investment options. Short-term capital gains tax applies to investments sold within a year, while a lower long-term capital gains tax applies to those held for more than a year.

Listing a Firm as an SM REIT

Eligibility Criteria for an Investment Manager:

“Investment Manager” means a company incorporated in India that establishes an SM REIT manages its assets and investments and undertakes its operational activities.

- The applicant, the investment manager, on behalf of the trust, must form a deed duly registered in India under the Registration Act, 1908 provisions.
- The trust deed has the main objective of undertaking any activity of SM REIT through one or more schemes under these regulations and includes the trustees' responsibilities.
- The investment manager has to have a net worth of not less than INR 20 crore
- Not less than INR 10 crore is the positive liquid net worth.
- The investment manager has at least two years of experience in the real estate industry or real industry fund management.
- Not less than half of the directors of the investment manager should be independent and are not directors or investment managers of another REIT or SM REIT.
- In the case they are, the investment manager agrees with the investment management and is provided with a list of responsibilities by the regulations.

The Next Wave of Indian Tourism

India's tourism sector is a powerhouse projected to grow annually by 7% to 9% between 2019 and 2030. By 2028, it's expected to contribute a massive US\$512 billion to the GDP and create an additional 53 million jobs by 2029. However, with such rapid growth comes vulnerability. The hospitality industry, still recovering from the shocks of COVID-19, needs protection from market fluctuations. This is where SM REITs can play a vital role.

Let's take the example of Host Hotels and Resorts, the largest hospitality REIT in the USA, primarily affiliated with Marriott and other significant properties, boasting around \$3 billion in revenue. They specialise in high-end hotels, managing a geographically diverse collection of 79 luxury and upscale properties. Unlike traditional hotel chains, they don't handle day-to-day operations. Instead, they sign management contracts with established hotels like Marriott, Hilton, or Hyatt. This model allows them to focus on acquiring and managing a portfolio of high-quality hotels across various locations while established brands handle guest services.

This model can serve as an example for the Indian REIT market. First, REITs are freed from the complexities of hotel management, allowing them to specialise in real estate investment. Second, their focus on luxury hotels generates significant revenue. Finally, strong financial structures, like Host Hotels and Resorts' flexible capital strategy, enable them to adapt and thrive during different economic cycles. The success of established Hospitality REITs paves the way for exciting new investment opportunities like SM REITs in the Indian market.

Unlocking Growth: How SM REITs Can Revolutionize the Indian Hospitality Landscape

SM REITs attract a wider pool of investors to the hospitality sector, unlocking new capital sources for development, renovations, and expansion. Hotel owners listed under SM REITs can monetise their assets while retaining partial ownership, freeing up capital for further ventures or expansion. This liquidity encourages investors to invest in SM REITs, knowing they can quickly redeem or invest more whenever they want.

By uniting a portfolio of hotels under a single REIT brand, SM REITs create a more recognisable force in the market. Hotels can leverage this collective strength to attract more guests, strengthening the hospitality landscape.

Investing in hospitality REITs requires a higher risk tolerance due to the industry's inherent ups and downs. Unlike other REITs, hospitality REITs are more susceptible to seasonal fluctuations. Investors must be aware of these risks before entering the market.

The Bottom Line

REITs have been established overseas over time. Options range from office buildings to hospitals, and they have the advantage of a deep pool of investors.

In contrast, India's REIT market, launched in 2019, is a young athlete, still building its track record. Previously, US REITs had a history of offering attractive returns through dividend yields and capital appreciation. India's market is young, and its long-term performance is yet to unfold. However, the Indian real estate sector itself is projected for significant growth, offering the potential for high returns.

The real estate industry faces a new and complex landscape with evolving tax regulations, potential yield fluctuations, and other unforeseen challenges. This uncharted territory necessitates careful risk assessment for established players like REITs and future entrants. Factors like the impact of potential tax changes, fluctuations in interest rates, and emerging trends and technology can significantly influence investor and business decisions.

In addition, SM REITs can emerge as game-changers for the hospitality sector. They can offer diversification and the chance to capitalise on India's under-penetrated hospitality market. They can become a powerful engine for India's booming tourism industry by providing stability and growth opportunities. They will attract new investment and entice more people to participate in India's flourishing tourism industry.

Sources: IBEF 2024, Indian Ministry of Tourism, Jefferies 2024, Economic Times, SEBI 2024

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