iJRASET
International Journal For Research in
Applied Science and Engineering Technology

INTERNATIONAL JOURNAL FOR RESEARCH

IN APPLIED SCIENCE & ENGINEERING TECHNOLOGY

Volume: 5 **Issue:** VII **Month of publication:** July 2017

DOI:

International Journal for Research in Applied Science & Engineering Technology (IJRASET)
ISSN: 2321-9653; IC Value: 45.98; SJ Impact Factor:6.887
Volume 5 Issue VII, July 2017- Available at www.ijraset.com

Assessing the Investment Performance of REIT in India

Digvijay S. Kadam [1], Prof A. R. Vasatkar [2]
First-Third Department, First-Third University
[1]PG Scholar, M.E. Department of Civil Engineering, [2]Department of Civil Engineering,
Bhivarabai Sawant college of Engineering & Research, Savtribai Phule University, Pune, India.

Abstract:** Real Estate Investment Trust is a company which modeled after mutual fund that owns or finances income-producing real estate. It provides investors regular income streams, long-term capital appreciation and diversification. REITs typically distribute all of their taxable income as dividends to shareholders. On those dividends shareholders pay the income taxes. REITs are strong income vehicles because REITs must pay out at least 90 percent of their taxable income in the form of dividends to shareholders .Office buildings, hotels, shopping malls, apartments, resorts, warehouses, self-storage facilities and mortgages or loans are the income producing real estate assets of REITS. India has also tried to establish REIT. Mainly due to global slowdown and resultant impact on the property markets in India the earlier attempts to introduce REITs in India did not succeed. The other aspect is mortgage backed securities which is not permitted to invest, resulted real estate market opportunities shrinkage. However, SEBI announced the draft consultation paper on Real Estate Investment Trust (REIT) Regulations on October 10, 2013. Earlier in 2008, SEBI had issued certain draft regulations for introducing REITs. I-REITs (REITs in India) will invest in completed rent generating properties in India (to comprise minimum 90% of net asset value) and mortgage backed securities, would issue securities, which would be listed on stock exchanges and. In earlier phase I-REITs are planned to be available only to high net worth individuals and institutions to develop the market but now there are some relaxations introduced.

***Keyword:** Real Estate, REIT, SEBI, Asset Value, Appreciation, Shareholder. Returns on Investment.*

I. INTRODUCTION

A. Background

The total amount of retail spending in India's top 7 cities is `3,586 bn (US $59.8 bn), with Mumbai having the highest share of 29% followed by NCR and Bengaluru at 25% and 15% respectively. Retail spending across top cities is more than double in the next five years. The share of modern retail is also expected to rise by a substantial amount of 24% from 19%. In the next five years the top 7 cities will require a retail space of 4.3 mn sq ft/annum .Retail sector in India has an interesting structure. There has always been a struggle regarding finding the right property at the right time. The forecasted growth rate of Indian retail sector is nearly 15% which seems very attractive. Currently Mumbai has the highest share in mall space of 59% which is followed by NCR and Pune. Hyderabad has the lowest share of mall space. NCR has the highest in terms of mall space per capita in India, at 536 sq ft per 1,000 population followed by Bengaluru and Pune at the second and third position respectively. In the high income group, Pune ranks first in mall space per 1,000 populations for households earning more than `300,000 per annum. NCR comes second, followed by Chennai in the third place Mumbai fares poorly in terms of mall space penetration per capita, at just 350 sq ft per 1,000 populations. In the past few years, Indian Retail sector has seen tremendous growth in the organized segment. Major domestic players have stepped into the retail area with long term, ambitious plans to expand their business across verticals, cities and formats. The strong fundamentals of the Indian economy are having a favorable impact on all asset classes of Indian real estate viz. housing, commercial – office space and retail and hospitality. In recent years, the growth has spread out to tier-II and III cities as well. High growth in services as well as manufacturing sector has resulted in high demand for commercial and industrial real estate. Further the economic growth has trickled down to the large Indian middle class increasing affordability and affluence. Improving living standards are driving the demand for better quality housing and urban infrastructure.
(Source: Think India, Think retail, a definitive view on India's Retail market by Knight Frank, 20150

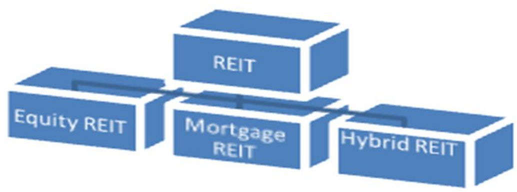
B. Characteristics of REITs

The following are the characteristics of REITs

International Journal for Research in Applied Science & Engineering Technology (IJRASET)
ISSN: 2321-9653; IC Value: 45.98; SJ Impact Factor:6.887
Volume 5 Issue VII, July 2017- Available at www.ijraset.com

1) REITs are closed-ended or open-ended companies or trusts that hold, manage, lease, develop and/or maintain real estate for investment purposes.
2) REITs receive special tax consideration and are characterized by low transaction costs.
3) REITs can only be used to invest in completed properties and not under-construction projects.
4) The income source for REITS mainly comprises regular lease rentals and asset sale proceeds.
5) REITs has a time horizon of five to seven years.
6) REITs are mandatorily required to distribute 90% of their net income to investors every year.
7) Internationally, REITs are allowed to raise debt.

C. Types of REIT



There are three types of REIT
1) Equity REIT.
2) Mortgage REIT.
3) Hybrid REIT.

II. LITERATURE REVIEW

A. The article focuses on the international presence of REITs. It highlights the different regulations which are present in the countries of Singapore, Finland, USA and India. It then elaborates on the rules and regulations regarding listing of the REIT which is laid down by SEBI (securities exchange board of India). USA is the birthplaces of REITs in 1960.The portfolio of us REITs suggest that it has invested maximum in the area of retail. The securities exchange board of India (SEBI) notified the real estate investment trusts regulations, 2014. The regulations give us a complete picture as of what are the requirements to setup a REIT

B. The article by Link laters gives an insight on the comparative analysis between Hong Kong REIT, Singapore REIT, Japan REIT and South Korea REIT. The comparison parameters are as follows-
1) Structure
2) Minimum capital requirement
3) Authorization requirement
4) Fund management
5) Investment restrictions
6) Geographical restrictions
7) Borrowing restriction
8) Shareholding restriction
9) Earnings payout
10) Tax treatment at the level of REIT
11) Tax treatment at the shareholder's level
12) Withholding tax for foreigners
13) Mandatory listing
14) Special listing requirements
15) Number of entities

C. The paper by CS Vinita Nair focuses on SEBI's legal framework on 16-04-2008 by way of SEBI (Mutual Funds) (Amendment egulations, 20081 and inserted Chapter VI A – Real Estate Mutual Funds Schemes (REMFs).

The paper focuses on the draft regulations set up by SEBI. It gives a detailed report on the eligibility criteria for registration as REIT. It gives a detailed requirement for applicant regarding trust, trust deed, sponsor and manager along with their net worth, years of experience in the industry. It also gives a comparative chart between India, USA and Singapore on the following parameters:

1) Year of Introduction
2) Governing cod
3) Legal structure
4) Listing requirement
5) Investment condition
6) Other permissible investments
7) Revenue restriction
8) Shareholder's restriction
9) Distribution of income
10) Mode of investment in propertie
11) Location restriction
12) Non permissible investmen
13) Permitted investment in a single project
14) Initial offer restriction
15) Minimum subscription and unit siz
16) Borrowing and deferred payments
17) Cap on income from other source
18) Investment in units of other REI
19) Transaction with related parties

III. METHODOLOGY

Following methodology was followed

A. Observations and Analysis

The performance and operation of REITs were studied in Asian countries of Singapore, South Korea and Japan. Along with these countries REITs were also studied in the Indian context.

B. Literature Review

A detailed literature analysis was done to review the REITs and their performance in existing countries. Various research papers and reports on REITs were also studied.

C. REITs in the Indian Context

REITs were also assessed in the Indian context. SEBI issued regulations for REITs in India. These regulations were studied to create the REIT model along with the entire framework of REITs

D. Illustrative Case Analysis

An analysis of investments is performed through a case study and carries it into REIT framework.

IV. CASE STUDY

A. Illustrative Case Study Of Phoenix Malls

After understanding the requirements of REIT business and the process of income and other calculations, which are required for floating by the developer before an REIT, we also need to also understand whether it would be profitable or not. For this we perform a case study, as mentioned earlier, we chose PHOENIX MILLS LTD as a live case as they have huge commercial real estate in Tier 1 cities of India.

International Journal for Research in Applied Science & Engineering Technology (IJRASET)
ISSN: 2321-9653; IC Value: 45.98; SJ Impact Factor:6.887
Volume 5 Issue VII, July 2017- Available at www.ijraset.com

B. Phoenix Mills Ltd

Phoenix group is one of the pioneers of the Real Estate industry in Retail sector, through there retail malls. This group has investments in retail units, entertainment complexes. Commercial real estate, hotels, residential complexes. This group has presence in 8 major cities – Mumbai, Bangalore, Pune, Chennai, Raipur, Agra, and Indore. The group also plans to foray into developing real estate measuring of around 214 lakh square feet in these cities. Recent report by HDFC shows that Phoenix Mills Ltd is showing keen interest in REIT and wants to float one such business portfolio.

For our study, we have assumed that Phoenix forms an SPV for REIT and includes

1) Phoenix Market City- Bangalore
2) Phoenix Market City-Pune
3) Phoenix Market City – Mumbai
4) Phoenix Market city – Chennai

For this case study of Phoenix retail real estate business ,we collected several financial reports- Balance Sheet , Consolidated Balance Sheet of these Malls , there P&L sheet etc. some of them are included in annexures of the report.

From Balance Sheet of Individual Malls of Phoenix Mills Ltd,we got to know the following:-

Later, we collected the information of each mall and combined them together as all these malls would form an SPV of the REIT.

From the Financial Statements, the following analysis of debt equity is made)

Table 2 shows Equity – Debt source of Finance for REIT properties (Source: Phoenix investor guide)

Financials in Rs.Mn.	Equity	Debt	Total project cost
Phoenix market city Bangalore	1,950	3,567	6,111
Phoenix market city Mumbai	3,091	6,006	11,150
Phoenix market city Pune	1,568	4,334	8,053
Phoenix Market city Chennai	1,498	3,455	6,650
Total	8,107	17,362	31,964

Collecting Financial Reports and Studying them
Determine Rental Value / sq ft
↓
Determine other incomes
↓
Find ROI or Estimated ROI
↓
Calculate Rental Yield
↓
Through this rental yield calculate income of REIT
↓
Calculate expenses of REIT

C. Data Sources and Assumptions

1) REIT –Amount Rs1750 crores (4 Phoenix Malls together)
2) Ticket size to be around Rs 2 Lakh
3) We have not assumed any limitation on number of subscribers.
4) Not all debt of the Phoenix Mills is converted for REITs; only Debt of the 4 Malls is taken into considerations.
5) All data, is data from Phoenix Mills Ltd annual reports and further from Institutional Research by HDFC Securities.
6) We have made estimates for 2016 and 2017, by assuming the occupancy rate to be the same, have increased the rental rate for each mall by 7%, and have assumed the income from other sources than rental (all recoveries, parking, etc.) as 40% of rental income, which is less than the actual.
7) We have assumed the expenses as shown in the table above
8) Taking a single tax, as dividend distribution tax and no other tax into consideration.

Now, entire money they will get through the REITs trust and all the rental yield shall be distributed to all the investors of REITs. We shall assume the ticket size is of Rs2Lakh each as we cannot determine how many tickets will be sold, nor can we assume number of people buying the shares in REITs. The process involved in the financial analysis of REIT is as shown in the following Steps:-

a) Using various reports check there estimated balance sheet, estimated rental income etc.
b) Use this data for reference only.
c) Find out what is the current rental income achieved by all the malls, and divide by their leasable area. By this we can determine the rental value per sq ft.
d) Then we found out other incomes with a particular mall, like income from Parking, advertisements, events etc.
e) For all that, we found out Return on Investment for the Phoenix Mills.
f) Now, assuming the REITs is started in 2016. We first calculate the Rental yield per sq ft by assuming an increment in the rental yield of 7 % (keeping it conservative)
g) Through this rental yield and estimated other recoveries and income (used from their financial reports, HDFC bank Ltd) , we calculated the Income for the REITs .
h) Then we calculated the expenses for the REITs – Malls. This we did by first finding the previous year's expenditures, and incremented it.

V. CONCLUSION

	2015	**2016**	**2017**
EXPECTED DEBT	3313.2	3213.2	3063.2
REITS	1750	1750	1750
DEBT AFTER REITS	1563.2	1463.2	1313.2

EXPENSES		
OPERATING, MAINTENANCE & SECURITY		5%
UTILITY EXPENSES & OTHER		3%
	Total	**8%**
DEPRECIATION		6%
INTREST		0
TAX		33%

Estimated balance sheet	(after REITS)		
	2015	2016	2017
share capital	29	29	29
Reserves	1973.4	2342.2	2771.9
Total Shareholders fund	2002.4	2371.2	2800.9
long term Debt	1563.2	1463.2	1313.2
Short Term Debt	42.9	42.9	42.9
Total Debt	6.1	1506.1	1356.1
Deferred Taxes	-85.8	-85.8	-85.8
Total sources of Funds (			
Incl. other sources)	3522.7	3791.5	4071.2
Total current Liabilities			
Net current Assets			

A. It would be one successful source of investment for the common people and also a good option for the Developers, as their financial conditions would not just improve, but they would get good liquidity as fast as possible without much efforts and no need to choose the debt option for going for very big projects.

B. Overall the country's economy condition shall improve as better transparency in the Real Estate Sector would benefit not just this sector but also support other sectors. Better funding shall be seen from Foreign Investors also and there would be a flow in the income and taxes for the Country as a whole.

C. The Return on Investment we achieved in first 2 years of REITs, (2016, 2017) is around 21.9%, 23.4% respectively. Which is less than the Return to Shareholders by their estimates which was 26%. The REIT is thus able to give almost 22.75% yield, which is far more than the secure yield of 8-10% in general securities market and 12-15% in equity mutual fund markets.

D. But, we can understand through this model, that even though the earning per share is slightly less for 1st two years, still REITs is better option.

Using all these assumptions we were able to make a model, to prove REIT for Phoenix can be a successful project.

REITs in the above case are a better option for following reasons:-

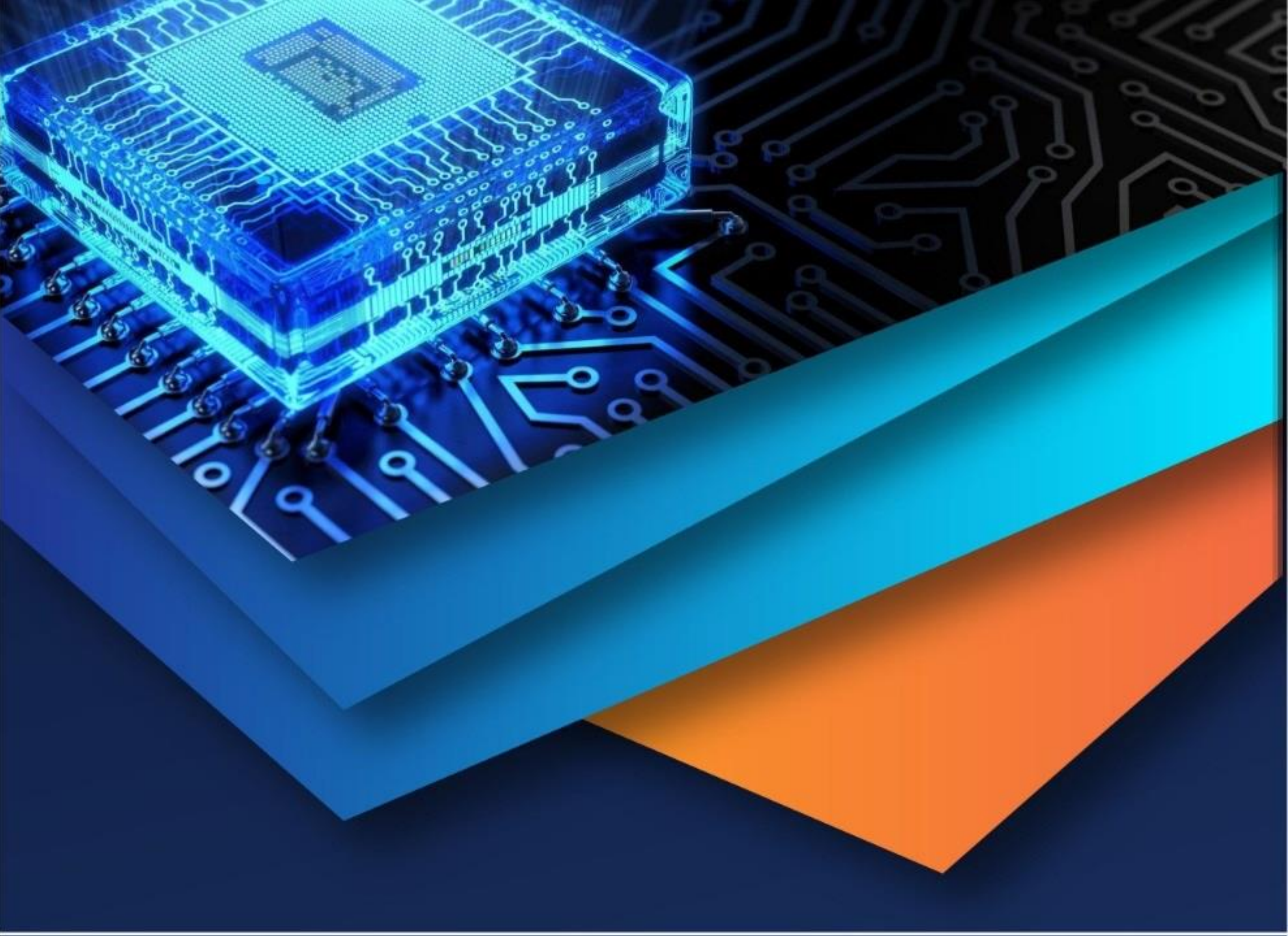
1) Fast liquidity to the Phoenix Mills Ltd.
2) No Debt, i.e. no loans from Banks, Financial Institutes etc.
3) Professionalism and transparency in the investments.
4) More no. of small investors, (smaller ticket size, more the investors).

As REITs would be less risky for investors, as compared to Stock Market , and also better returns can be achieve

REFERENCES

[1] SEBI introduces REIT in India- issues draft SEBI (Real Estate Investment Trusts) Regulations, CS Vinita Nair ,October 16, 2013
[2] Singapore Real Estate Investment Trusts (S-REITs) , Nidhi Bothra, 28th November, 2013
[3] Real Estate Sector – The India Story Submitted by Miss Sonia Sahni , Asst Manager Corporate and Investment Banking, ABN AMRO Bank , Team Lead - IBM global services
[4] The impact of REITs on Asian economies , Ken Atchinson and victor Yeung, April 2014
[5] The Growth of J-REITs in the Japanese Real Estate Market and Real Estate Investment Structures: An Overview, PriceWaterhouseCoopers
[6] A beginning for REITs in India – SEBI finalizes REITs regulations, Nidhi Bothra and Vinita Nair, 12th August,2014
[7] Analysis of REIT regulation KPMG, Knight Frank, NAREDCO, March 2015

[8] REIT Foreign and Indian scenario, anonymous writer
[9] The REIT Structure article by Linklaters
[10] An Overview of Asian REITs Development: Performance and Existing Problems Analysis, Guannan YU, 2009
[11] Nuz azwani mohamad azmin , the relationship of variable with REIT'S performance,may 11 2016
[12] Ford farid , L.T. boyer ,required return on investment in construction 1989
[13] Shameen A. dewan P.E.ASCE , Roger P.E.F.ASCE ,assets and use of values as decision support 2005
[14] Department of finance,(European commission)European construction sector 27march 2013.



10.22214/IJRASET

INDEX COPERNICUS 45.98

IMPACT FACTOR: 7.129

TOGETHER WE REACH THE GOAL

IMPACT FACTOR: 7.429

INTERNATIONAL JOURNAL FOR RESEARCH

IN APPLIED SCIENCE & ENGINEERING TECHNOLOGY