Business Standard

Don't find residential rental yields attractive enough? Opt for REITs

By Sanjay Kumar Singh

The Securities and Exchange Board of India (Sebi) board has approved the amendment to the Sebi (Real Estate Investment Trusts) Regulations, 2014. The revised application value in an initial public offer will now be Rs 10,000-15,000, while the revised trading lot on the secondary market will be one unit, down from 200 earlier.

These measures will make REIT more accessible. “Earlier, when the lot size was higher, institutional investors used to pre-dominate. Now, with the minimum investment required coming down, more retail investors will be able to participate,” says Subhankar Mitra, managing director, advisory services, Colliers India.

Access quality commercial real estate

REITs are investment vehicles that own, operate and manage a portfolio of properties, primarily office spaces at present. These are meant to be income-generating assets. “To ensure regular income to investors, it has been mandated that REITs must distribute at least 90 per cent of their net distributable cash flows to investors at least twice a year,” says Anuj Puri, chairman, ANAROCK Property Consultants.

Also, 80 per cent of the assets must be invested in completed projects. This lowers the chances that they will engage in speculative activities.

According to Puri, “REITs provide investors with a safe and diversified portfolio of high-quality commercial real estate that is under professional management,” says Puri. Investing directly in grade A commercial real estate can require an investment running into crores.

Investors can expect a dividend yield of 4-7 per cent and capital appreciation of 4-5 per cent (over the long term). The rental yield from residential real estate is barely 2-4 per cent and capital appreciation has been low for several years.

REITs also provide easy liquidity. “Investors can sell them on the exchanges and exit easily. Selling physical real estate takes a lot of time,” says Aditya Shah, chief investment officer, JST Investments. He adds that REITs enjoy tax benefits and investors don’t have to incur the high transaction costs, like stamp duty, which they do in physical real estate.

Be prepared for price volatility

The performance of a REIT is tied to that of the underlying real estate asset.

Currently, occupancy levels in commercial buildings have fallen due to the work-from-home (WFH) model. Such developments can affect the rental income of REITs, and hence their dividend payouts and prices on the exchanges. “Investors need to be aware of the potential price volatility these assets come with,” says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. He adds that there are no guarantees on the periodicity of payouts or their quantum.

Look at quality of assets

Location of assets should be a key criterion while choosing a REIT. “If it has real estate in prime areas of metro cities, where businesses would like to set up offices, that would be a positive,” says Shah. According to Mitra, the quality of underlying assets, their geographical diversification, and the occupier profile will have a bearing on the sustainability of returns. Investors should check the amount of debt on the balance sheet and the track record of payouts.

Who should invest?

Three categories of investors will find this product apt: one, those who are seeking regular income, belong to a high tax bracket, and want to allocate a portion of their money away from traditional fixed-income instruments; two, those who wish add real estate to their portfolio without the hassles of physical management; and those who want access to high-quality commercial real estate, which they would otherwise not be able to buy due to the high ticket sizes involved.

Conservative investors may invest up to 10 per cent of their overall portfolio, moderate investors between 10 and 25 per cent, and aggressive investors, between 26 and 40 per cent, according to Dhawan.

Investors should diversify across REITs, and not put all their money in one entity. They should also keep some powder dry because more REITs are expected to be launched in the near future. “Given the

volatility in this asset class, enter with a horizon of at least five-seven years," says Dhawan.

Investors looking for absolutely fixed returns or those who do not want the value of their principal to fluctuate, like retirees with limited corpus, should stay away. Those who already have considerable exposure to high-quality commercial real estate may also avoid REITs. Younger investors looking for growth and compounding should stick to equities. If they invest in REITs for diversification, they should reinvest the payouts they receive.

How different forms of income from REITS are taxed

Interest income

Taxable at marginal slab rates

Dividend income

If SPV has opted to pay taxes according to normal provisions, dividend will be exempt from tax in hands of investor;

If SPV has opted for payment of taxes @ 22 per cent, dividend will be taxable in the hands of the unitholders at rates applicable to him

Rental income

Taxable at normal tax rates or slab rates

Capital gains

If units held for up to 36 months, gains will be short-term capital gains and will be taxed at 15 per cent;

If held for more than 36 months, they will be long term capital gains and will be taxed @ 10 per cent in excess of Rs 1,00,000, without indexation benefit

Source: RSM India