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Real Estate Investment Trusts (REITs) for Faster Housing Development in India: An Analysis in the Context of the New Regulatory Policies of SEBI

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Abstract: Mutual Funds (MF) industry in India has been growing fast in the ongoing reforms era, particularly since the 2000s when the MF industry has witnessed many innovations. In spite of this, instruments which are very similar to MFs viz. Real Estate Funds (REFs), and its variants like Real Estate Investment Trusts (REITs) are yet to pick up momentum in India. In fact, REFs and its variants like REITs have tremendous growth potential in India; given the very low mortgage penetration in the country. Investments in REFs or REITs can offer significantly higher returns in India as against similar investment in developed nations. Hence, if properly developed REFs or REITs can significantly support the growth of residential real estate sector in India by attracting greater investment into this sector. Securities and Exchange Board of India (SEBI), the regulatory authority in respect of securities market, has been trying to develop these innovative models for financing over the last few years. Its first attempt to bring in REITs in 2007 was not complete. Likewise, the second attempt of SEBI in 2008 to bring in a REIT regime in the REMF format was also not very successful for want of adequate response from the investors. The third attempt of SEBI in 2013 has been successful in releasing the Draft of the REIT Regulations 2013 and gathering the public comments on this Draft. Accordingly, SEBI flagged off the REIT Regulations in 2014, but still the investors were unenthused unlike the property developers and lenders to the real estate sector. Of late, the recent SEBI regulations 2016 seek to relax the norms and make REITs more attractive for the investors. The Union budget 2016 has removed the Dividend Distribution Tax (DDT). Government of India has unleashed the second wave of FDI reforms in June 2016 which in turn may benefit the REITs and the real estate sector. These measures give an impetus for the growth of REITs. SEBI has done a commendable job by considering international models, views of the stakeholders etc. while redefining its regulations. As SEBI goes ahead with the promotion of REITs, this paper closely looks into the features of the REITs, SEBI regulations and its implications, and suggests strategies for faster and sustainable development or real estate and housing sector in India through the REIT route.

Keywords: Real Estate, Housing Development, Dividend Distribution Tax, Tax Incentives, REFs, REMFs, REITs, SEBI.

I. INTRODUCTION

It is well recognized that housing and real estate sector has immense potential for economic development of any nation, apart from its social development role. This is particularly true in respect of developing nations like India. On the one hand, its vast forward and backward linkages with 269 other industries enable it to promote faster and balanced economic development of a nation. On the other hand, from a social perspective, housing being a primary requisite of human life underscores its significance in a welfare state. With the initiation of the economic reforms in India in 1991, the housing sector has been getting added attention and more conducive environment for its growth, notwithstanding the fact that successive Governments used to accord high priority to this sector even before the reforms era, especially since the early 1970s. Reforms era resulted in more business opportunities and added demand for commercial and residential space. Manoj P. K (2003) [1] in his paper 'Retail Credit – Strategies for Success in the Emerging Scenario' has noted that housing has tremendous potential to kick-start a recession-hit economy. Housing and other retail credit products of banks can not only ensure sustained and balanced growth of banks but also accelerate economic growth of the whole nation, particularly in times of recession. Thus, in the early 2000s when there was an economic slump in India, housing loans (and other retail credit products) were aggressively promoted by the commercial banks (CBs); because the regulator viz.RBI (Reserve Bank of India) encouraged housing credit, allowed the onward lending of housing finance by the CBs and even earmarked 2 per cent of the incremental credit of CBs for housing credit. This enabled CBs to grow faster and even to overtake the specialized housing finance providers viz.Housing Finance Companies (HFCs) in 2003. In spite of the support from the successive Governments at the centre and also a generally favourable macroeconomic environment, the housing and real estate sector in India is still in its infancy in the country and there is tremendous scope for further growth. There is huge scope for specialized funds like Real Estate Funds (REFs) and its variants like Real Estate Investment Trusts (REITs) in India. The business of REFs has witnessed a steep rise due to the high returns it yields as is observed in real estate boom in India in the recent past. Many Real Estate Venture Funds have been attracted towards India due to the high returns and significantly superior benefits. As per a recent estimate, a similar investment in developed countries would fetch a return of 3 to 4 per cent whereas it fetches 12 to 15 per cent in India. The realty sector in India has attained newer heights and now it is a potential avenue for investment of huge funds.

II. RELEVANCE AND SIGNIFICANCE OF THE STUDY

Large-scale investments in commercial and residential properties in India through REFs can ensure faster and sustainable economic development of the country, given the very low level of investment in this sector at present. A number of New Fund Offers (NFO) has catapulted the fortunes of the mutual fund industry in India, in the last few years. Mutual fund schemes have huge mobilization capacity and have vast popularity among the general investing public. This industry has witnessed a number of new product innovations since the late 2000s. As the housing industry in India is currently growing from strength to strength, there is a need to sustain the interest of the investing public in this industry, which in turn requires the continuation of constant product innovations. Equally important is the need to promote particular segments in this industry like REITs which have immense growth potential, though yet to catch the attention of the investors significantly in India. In spite of the appreciable growth of institutional finance to housing in India, the problem of housing shortage is still very high. The Technical Group on Housing Shortage of the Twelfth Plan (2012-2017) has estimated the housing shortage in urban India at 18.78 million as of 2012 of which as high as 95 percent corresponds to EWS (Economically Weaker Section) and LIG (Low Income Group) categories. Besides, the Working Group on Rural Housing Shortage has estimated the rural housing shortage at the level of 43.90 million as of 2012; and in respect of rural housing also, more than 90 percent of the housing shortage relates to low income and marginalized groups of the population (NHB, 2013) [33]. Moreover, the mortgage penetration ratio in respect of India as of 2013 is just about 9 percent as against more than 80 percent for many advanced countries like UK and USA. Nasar K K & Manoj P K (2013) [19], in their joint paper "Strategies to Attract FDI in the Real Estate Related Sectors in India: A Study with a Focus on Kerala State" in Asian *Academic Research Journal of Social Sciences & Humanities (AARJSSH)*, have pointed out the need for attracting FDI into the real estate sector and allied sectors like housing, in India. Because, housing and real estate sector can grow faster only if FDI inflows are available. This sector can spur growth in other sectors through its vast forward and backward linkages. The authors have suggested a few strategies for the faster and sustainable flow of FDI into India's housing and real estate sector. The regulator of housing finance in India viz. National Housing Bank (NHB) in its most recent report, NHB (2014) [24], "Trend and Progress of Housing in India" (for the year 2014) has pointed out that policy-based efforts like providing tax sops for the Real Estate Investment Trusts (REITs), as announced in the Union Budget of 2014-15, could result in extracting new growth opportunities through Rental, Affordable and Senior Citizen Housing projects that can increase the depth of the industry. It has also been pointed out that REITS have been successfully used as instruments for pooling of investments in the real estate sector several countries. REITs will definitely attract long-term finance from foreign and domestic sources including the NRIs. In this paper, the recent initiatives for the promotion of REITs by the regulatory authority viz. Securities and Exchange Board of India (SEBI) are sought to be studied, as SEBI has recently relaxed its norms to make REITs more attractive.

III. Previous Research and Research Gap

Earlier studies on Real Estate Funds (REFs), including its variants like Real Estate Investment Trusts (REITs), are very scarce in India, probably because the concept as such is in its infancy in India; the market regulator (viz. SEBI) being experimenting with various models that could fit well with the expectations of the investors, since 2008. Drawing inputs from many international experiences and learning from its own bad experiences twice, SEBI in its third attempt seeks to bring in REFs in India in the shape of REITs (Real Estate Investment Trusts). Draft Regulations on REITs were made open by SEBI for public comments until the end of Oct. 2013. The revised regulations were formally implemented by SEBI in early 2014. A few studies have analysed the significance of real estate development, like, the huge development potential of real estate investments, the need for attracting FDI into the real estate sector, strategies for attracting FDI into real estate etc. while some empirical studies have probed into the factors influencing the behaviour of real estate investors. Studies in the relevant areas are briefly discussed hereunder:

Manoj P K (2003) [1] in his paper, 'Retail Credit – Strategies for Success in the Emerging Scenario' published in IBA Bulletin has suggested strategies for the sustained growth of the retail credit portfolio of banks, which primarily comprises of housing finance, as a safe means of increasing business and also kick-starting the then recession-hit industry of India. The vital significance of the linkages that housing has got with other industries, and hence the author points out its immense potential for faster economic growth. In his another research paper, Manoj P K (2004) [2] 'Dynamics of Housing Finance in India' has pointed out the growing appetite of commercial banks (CBs) towards housing credit, the declining share of housing finance companies (HFCs) in the housing finance market, and has suggested macro level strategies for the sustained and balanced growth of housing finance market in India. The need for promotion of a secondary mortgage market for housing finance like residential mortgage-backed securitization (RMBS), need for alternative models for housing finance like Housing Micro Finance (HMF) etc. have been pointed by the author in order to ensure faster and equitable housing development in India. Through its Centre for Microfinance, the research agency Institute for Financial Management and Research (IFMR) (2007) [3] in its Working Paper No. 19, 'Housing Microfinance: Designing a Product for the Rural Poor' has pointed out the vital significance of promoting Housing Microfinance (HMF) in addressing the chronic housing problem in India. The real housing problem in India is that of the poor and marginalized, like those in the LIG (Low Income Group) and EWS (Economically Weaker Sections) groups. Only through alternative financing models like HMF these sections could be served as they are beyond the access of the formal housing finance system in India.

Manoj P. K (2008) [4] in his research paper, 'Learning from Cross-country Experiences in Housing Finance: A Microfinance Approach' seeks to suggest appropriate macro level strategies for promotion of housing micro finance (HMF) in the Indian context by suitably replicating successful and time-tested HMF and such other alternative housing finance models prevalent elsewhere in the world. Manoj P K (Ed.) (2009) [5] in his edited book, 'Emerging Technologies and Financing Models for Affordable Housing in India; has discussed many housing finance models and technologies which could promote affordable and low cost housing in the Indian context. The research agency ICRA (2010) [6] in its research report, 'Housing Finance Companies and the Indian mortgage market' has analysed the changing landscape of India's housing finance market, the greater growth rate and gradual re-emergence of housing finance companies (HFCs) vis-à-vis the housing finance portfolio of commercial banks (CBs), the superior asset quality and profitability of HFCs. The significant role that HFCs has to play in the emerging scenario to meet the huge housing shortage in the country has been highlighted. Manoj P K (2010) [7] in his research paper, 'Benchmarking Housing Finance Companies in India: Strategies for Enhanced Operational Efficiency and Competitiveness' has studied in detail the relative competitive position of the major HFCs in India and has suggested specific strategies for their enhanced operational efficiency and competitiveness. In another paper by Manoj P K, (2010) [8] "Determinants of Successful Financial Performance of Housing Finance Companies in India and Strategies for Competitiveness: a Multivariate Discriminant Analysis" the determinants of superior financial performance of HFCs are identified using MDA (Multivariate Discriminant Analysis). The author has derived a discriminant function involving five parameters (from among the total of 21 parameters) that significantly influence the financial performance of HFCs; these five parameters being (i) Total Income to Housing Loan Assets, (ii) Other Income to Total Assets, (iii) Total Expenses to Housing Loan Assets, (iv) Interest Expenses to Housing Loan Assets, and (v) Interest Expenses to Total Expenses. Karnad, Renu S (2010) [9] the CEO of HDFC (Housing Development Finance Corporation Ltd.) – the largest and pioneer HFC in India, in her presentation at National Housing Bank (NHB) – the industry regulator in India, entitled as 'Base Rate and Impact on HFCs' has pointed out as to HFCs are going to be affected by the then RBI policy towards directing commercial banks (CBs) to arrive at their lending rates on loans based on specific 'base rates' as fixed upon by they themselves as per the said policy. It has been noted that as CBs are not allowed to lend below their base rates, the policy would affect HFCs as they often depend on CBs for raining funds. The lending rates of HFCs would then be still higher, as they have to cover their own borrowing rates from CBs, thus adversely affecting their business. Manoj P K (2010) [10] in another paper, 'Financial Soundness Housing Finance Companies in India and Determinants of Profitability: A 'CAMEL' Approach along with ROE Decomposition Analysis' has used 'CAMEL' methodology and ROE decomposition analysis to identify the determinants of profitability of HFCs. Maps of India (2011) [11] report has pointed out that some of the advantages of FDI in India's real estate viz. FDI makes the Indian real estate sector more organized, it increases professionalism in the sector, it introduces advanced technology in the construction business, and it creates a healthy and competitive environment for both Indian and foreign investors. A paper by Manoj P K (2011)[12], 'Determinants of Profitability of Housing Finance Companies in India and Strategies for Competitiveness: a Multiple Partial Correlation Approach' has suggested competitive strategies for different groups of HFCs based on the basic parameters that significantly influence the respective groups of HFCs. Mittal, Parul & Aggarwal, Sandeep.(2012) [13] have studied the trend and pattern of FDI inflows and outflows in the context of LPG era in India and have suggested strategies for effective growth of the economy through FDI route. In a joint paper by Manoj P K & L. N. Dash (2012) [14], "Role of Real Estate Funds for the Faster Growth of Indian Real Estate Sector" published in *J S International Journal of Economics*, the vital role played by Real Estate Funds (REFs) in enhancing the prospects of housing and real estate sector in India has been pointed out and strategies have been suggested for the faster growth of real estate sector in India through REFs. A study in the Kerala on green homes, Manoj P K (2013) [15], 'Prospects and Challenges of Green Affordable Homes: A Study with Reference to Ernakulam, Kerala' in *Global Research Analysis* has pointed out the vital significance of green housing in Kerala due to the growing environmental degradation and the unaffordable nature of housing for the majority of the population. It is found that over 90 percent of the households are unaware of the concepts like green housing and green finance.

In a joint paper by Nasar K K & Manoj P K (2013) [16], "Real Estate Development in India and the Behaviour of Investors to Invest in the Real Estate Market: An Empirical Investigation", *S.S International Journal of Economics and Management (SSIJEM)*, the authors have pointed out that there has been a change in the mindset of people resulting in a shift from their interest from being conservative regarding making investments in real estate projects. Accordingly, in Kerala people are growingly interested in making investments in real estate market, motivated primarily by the profit accruing from such investments; particularly among the areas with larger Muslim population in the state. In another joint paper by the same authors, Nasar K K & Manoj P K (2013) [17], "Customer Satisfaction on Service Quality of Real Estate Agencies: An Empirical Analysis with reference to Kochi Corporation Area of Kerala State in India" published in *International Journal of Management, IT and Engineering (IJMIE)*, the authors have analyzed in detail the factors influencing the real estate agency business and have also developed a customer satisfaction model for real estate agency business. The model is built on six specific factors that influence the success of real estate agency business, viz. (i) Real estate agent's goodwill, (ii) Real Estate property, (iii) Information delivery, (iv) Behaviour of agents, (v) Punctuality, and (vi) Emergency services. In another paper by Nasar K K &

Manoj P K (2013) [18], “Role of Foreign Direct Investment in the Development of Real Estate and Allied Sectors in India: A Study with a Focus on Kerala State” published in *Global Research Analysis (GRA)*, the authors have pointed out the utmost significance of FDI for the economic development of India, particularly Kerala. Strategies are suggested for the effective use of FDI for economic growth.

In a joint paper by Nasar K K & Manoj P K (2013) [19], “Strategies to Attract FDI in the Real Estate Related Sectors in India: A Study with a Focus on Kerala State” in *Asian Academic Research Journal of Social science and Humanities (AARJSH)*, strategies for attracting FDI have been suggested, given the utmost significance of FDI for the faster development of real estate and housing and allied sectors in India. A model for effective use of FDI for the development of real estate sector is suggested. In another joint paper, Nasar K K & Manoj P K (2013) [20], “Factors Influencing the Purchase of Apartments: Some Empirical Evidence” published in *CLEAR International Journal of Research in Management, Science and Technology (CLEAR IJRMST)*, the authors have sought to identify the major factors influencing the purchase of apartments. Besides, these factors are ranked in the order of their significance. Accordingly, the most important factors in the decreasing order of significance are as follows: (i) Price, (ii) Location, (iii) Quality, (iv) Motivation (parents/friends), (v) Bed-rooms (no.) and Living space (area), (vi) Image of the developers, (vii) Basic facilities, (viii) Proximity of educational institutions, hospitals, bus, etc. (ix) Accessibility of loans from banks, and (x) Interest rate and Tenor of the loan. Reserve Bank of India (2014) (a) [21] in its Working Paper 3, ‘Re-emerging Stress in the Asset Quality of Indian Banks: Macro-Financial Linkages’ has expressed concern over the declining asset quality and increasing NPAs of bank loans. Regarding the quality of priority sector advances, the significant share of non-priority sector loans in the total NPAs (at about 55 per cent) in the post-2000 period as against about 45 per cent for priority sector loans is pointed out. It has been pointed out that retail loans occupy the highest share of NPAs followed by SSIs, agriculture, personal loans, housing loans, exports, credit cards and auto loans. The RBI points out a declining trend in the relative share of housing loans in the sectoral share of NPAs since 2007. Reserve Bank of India (2014) (b) [22] in its Financial Stability Report Dec. 2014 (including Trend and Progress of Banking in India 2013-14) has pointed out the generally satisfactory situation of the asset quality and asset prices in respect of housing loans. The correction in the housing prices witnessed in many cities in India, and the gradually falling trend in both the LTV (Loan to Value) ratio as well as LTI (Loan to Income) ratio is pointed out in this vital report of the RBI.

National Housing Bank (NHB) in its annual publication as of FY 2014, NHB (2014) [23], “Trend and Progress of Housing in India”, for the year 2014 (the latest available, as of now) has pointed out that policy-based efforts like providing tax sops for the Real Estate Investment Trusts (REITs), as announced in the Union Budget of 2014-15, could result in extracting new growth opportunities through Rental, Affordable and Senior Citizen Housing projects that can increase the depth of the industry. It has also been pointed out that REITs have been successfully used as instruments for pooling of investment in several countries and such instruments will definitely attract long-term finance from foreign and domestic sources including the NRIs. REITs would reduce the pressure on the banking system while also making available fresh equity. Besides, this report points out the incentives for REITs as per the Union Budget 2014-15, according to which complete pass through for the purpose of taxation and a modified REIT-type structure for infrastructure projects as the Infrastructure Investment Trusts (InvITs) may attract long term finance from foreign and domestic sources including the NRIs. The research report by the agency IFMR (2015) [24] entitled ‘Affordable Housing Finance Sector: Overview’ makes a detailed analysis of the need, relevance and significance of affordable housing in India in the context of the national goal ‘Housing for All by 2022’ adopted by the Government of India. The vital role that HFCs has to play in this context is highlighted in the report. The fact that there has been a gradual re-emergence of HFCs since 2013, with HFCs surpassing the CBs in growth rates and significantly improving their market share is specifically pointed out in the IFMR research report. In a recent paper, Manoj P K (2015) [25], “Real Estate Investment Trusts (REITs) in India: Relevance and Significance in Emerging Scenario”, published in *International Journal of Trade & Global Business Perspectives*, has studied the relevance of REITs in enhancing the liquidity of the developers thus enabling them to offload their unsold housing inventory, and reducing the risk of the lenders of various real estate projects etc. The potential of

REITs in reviving the real estate sector in India, thus enabling the overall economic development of the nation because of the vast forward and backward linkages of this sector has been pointed in the paper. In a recent study by Manoj P K (2016) [26], "National Goal of 'Housing for All by 2022' and the Significance of Scaling up Priority Sector Credit by Banks in India: Some Empirical Evidence" published in *International Journal of Advance Research in Computer Science and Management Studies (IJARCSMS)*, the author has pointed out the vital significance of scaling up priority sector (PSL) housing credit by Commercial Banks (CBs) in India in order to attain the 'National Goal of 'Housing for All by 2022' in India. PSL housing credit by CBs can ensure that housing development in done in an equitable and balanced manner by including the relatively poor and marginalized among the housing loan customers; CBs being the largest intermediary group in the formal sector housing finance in India with 63 per cent market share, the rest 37 per cent being that of housing finance companies (HFCs). As a continuation of the above paper, another paper by the author, Manoj P K (2016) [27] "National Goal of 'Housing for All by 2022' and the Housing Finance Companies (HFCs) in India: Strategies for the Sustained Growth of HFCs" published in *Asian Academic Research Journal of Multidisciplinary (AARJMD)*, focuses on the specialized intermediary group in housing finance viz. HFCs. HFCs represent the second largest group in the formal sector housing finance with a share of 37 per cent of the total. As specialized agencies in housing finance, HFCs must play a key role to attain the 'National Goal of Housing for all by 2022' as in the case of CBs – the largest group in the formal sector housing finance. In a recent industry report on *Real Estate*, India Brand Equity Foundation (IBEF) (2016) [28] has studied the prospects, problems, growth pattern, competitive structure of the real estate sector in India. It is pointed out in the report that real estate is the fourth largest sector in terms of FDI inflows. It has been reported that the market size of the sector is estimated to grow by 1.92 by 2020. Using Porter's five forces model IBEF has studied the competitive position of the industry and has accordingly suggested the strategies for more effective growth of the industry in the days to come.

In view of the foregoing, it is noted that though there are many studies on the real estate sector in India and the role of FDI in the real estate sector, studies focusing on REITs are scarce. The exceptions are the author's study, Manoj P K (2014) [25], "Real Estate Investment Trusts (REITs) in India: Relevance and Significance in Emerging Scenario", published in *International Journal of Trade & Global Business Perspectives*, and a joint study by the author, Manoj P K & L. N. Dash (2012) [14], "Role of Real Estate Funds for the Faster Growth of Indian Real Estate Sector" published in *J S International Journal of Economics.* This study seeks to bridge the above research gap by making a closer look into the significance of REITs in view of the recent policy initiatives by SEBI to relax the norms for REITs and the favorable governmental policies.

IV. Research Questions

(i) Why the housing and real estate sector is important for the overall growth of Indian economy? In the present scenario when there is an overall slump in the lending activity of banks in India, including that for housing and real estate sector, why a special thrust is required for targeting the housing and real estate sector for the national economic development?

(ii) What have been the major problems and weaknesses of the SEBI Regulations on REITs implemented in 2014? What are the features of the SEBI regulations of 2016 on REITs, especially the relaxations allowed vis-à-vis the 2014 regulations?

(iii) What could be the strategies to ensure faster and sustainable growth of housing and real estate sector in India by way of REITs? What all modifications are required for the REIT regulations? What could a model for real estate development?

V. Objectives of the Study

(i) To study the significance of housing and real estate sector for the economic development of India and the role of REITs;

(ii) To study the REIT regulations prescribed by SEBI in 2014 in light of the proposed changes in June 2016 and to assess the implications of the proposed REIT regulations 2016 of SEBI; particularly from the perspective of investors;

(iii) To suggest strategies for the growth of housing and real estate sector in India through REIT route, and a suitable model.

VI. Research Methodology

The methodology adopted is descriptive-analytical and exploratory. The study is descriptive to the extent that it describes the developments in the field of real estate sector in India with a focus on the role of REITs in the faster development of this vital sector, and the role played by SEBI in promoting REITs. The recent relaxations in the norms of REITs so as to make them more attractive are focused in the study. The paper is analytical too as it seeks to analyze the weaknesses of the SEBI Regulations on REITs 2014, particularly the reasons for poor investor preference towards REITs etc. and accordingly to suggest remedial strategies. The study is based primarily on the secondary data from authentic sources.

VII. Significance of Housing and Real Estate Sector in India: Need for more Liquidity

The problem of housing shortage is very acute in India, indicating the need for higher investments in the housing and residential real estate sector, particularly in the affordable housing segment or housing for the low income populace. As as of 2012 the housing shortage in India was at the level of 18.78 million (urban areas) and 43.90 million (rural areas) (NHB, 2013) [34]. Though India's position in respect of Mortgage to GDP Ratio (MGR) has improved significantly from 3.4 percent (2001) to nearly 9.00 percent (2012), its status is still very poor when compared with other major nations of the world. (Table I).

Table I: Mortgage to GDP Ratio of India (2012) vis-a-vis Selected Other Countries

(In Percentages)

India	China	Thailand	Korea	Malaysia	Singapore	Taiwan	Hong Kong	USA	UK
9.0*	12	17	26	29	32	39	41	80	86

Source: European Mortgage Federation (2007), Asian Development Bank (2007) & NHB (2013) [34]
Note: * NHB, as of 2012 (approx.), Report on Trend and Progress of Housing in India, 2013, p.105 [34]

In India, because of (i) the very low percentage of MGR, (ii) the huge housing shortage, and (iii) the well recognised fact that housing and real estate investment has got immense potential for economic development because of the vast 'linkages' (both forward and backward) effects of housing investments with over 269 other industries. The real strength of the housing sector lies, in its not only direct contribution to the economy but also its 'multiplier' or, 'ripple' effects i.e. ability to stimulate economic activity in other industries. While generation of revenues and employment opportunities form some of the direct contributions to the economy, indirect benefits include the increased activity of firms, which supply materials like cement, steel, wood etc., and other allied services. Many studies have conclusively proved the positive impact of housing on economic development of nations. In short, housing and real estate sector plays a pivotal role in the development of economies across the globe, both developed and developing, and India is no exception. Many studies have pointed out the positive economic as well as social impacts of housing.

A survey undertaken by National Buildings Organization (NBO) (Government of India) revealed that 2 million housing units per year would lead to creation of an additional 10 million man-years of indirect employment. Housing results in raising the real purchasing power of the economy which in turn results in development of many an industry, like, consumer durables, domestic appliances, household utensils etc. It may be noted that in the Indian context, rural housing should be promoted and developed into an additional growth engine for ensuring fast rural prosperity, through the income effect. Because, as already noted, rural housing shortage is quite severe in India and is estimated at the level of 43.90 million as against 18.78 million in respect of urban housing as of 2012. More importantly, irrespective of the geographical segments like rural or urban, housing for the poor needs to be given added thrust because vast majority (more than 90 percent) of the housing shortage corresponds to the poor. Thus, specialized schemes like 'affordable housing', 'low income housing', 'budget housing' etc. need to be encouraged so that development becomes equitable and balanced also. The 'National Goal of Housing for All by 2022' that is applicable in India has given another dimension to the need for faster development of housing and real estate sector in India.

Table II: Growing Unsold Real Estate with the Builders in Major Cities in Kerala

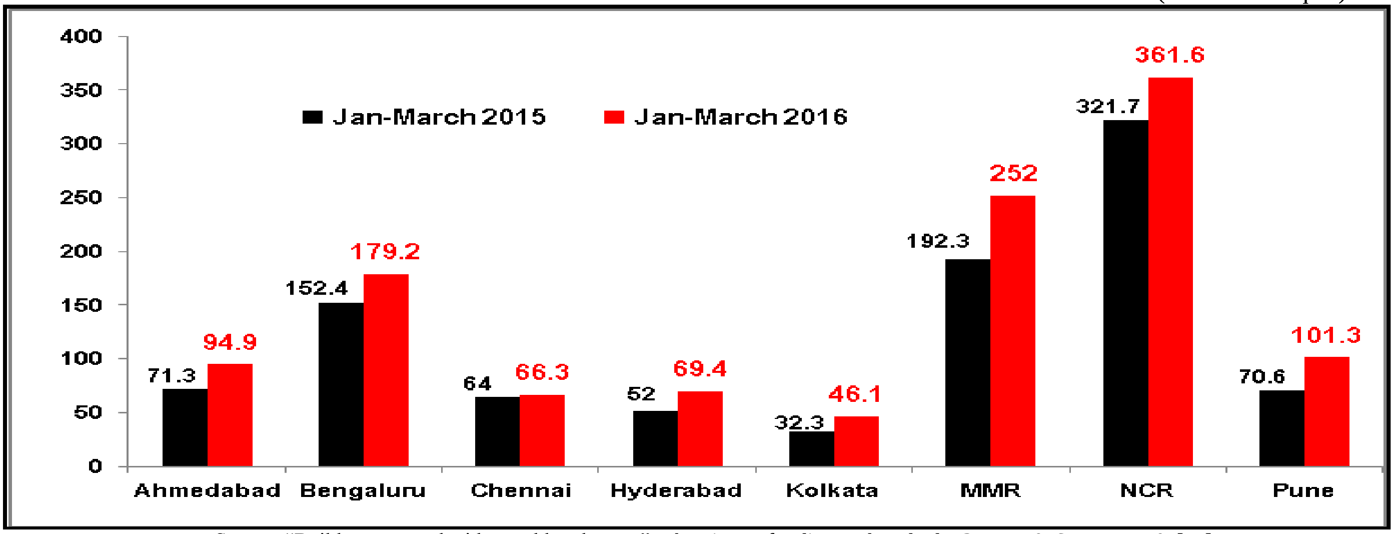
(In Million Sq.Ft)

	Ahmedabad	Bengaluru	Chennai	Hyderabad	Kolkata	MMR	NCR	Pune	Total
Jan-March 2015	71.30	152.40	64.00	52.00	32.30	192.30	321.70	70.60	6.60
Jan-March 2016	94.90	179.20	66.30	69.40	46.10	252.00	361.60	101.30	70.80
Growth (Percent)	33.10	17.59	3.59	33.46	42.72	31.05	12.40	43.48	22.39

Source: "Builders strapped with unsold real estate", *The Times of India*, Kochi Ed., dt.23 June 2016. Print, p.10. [41]

Figure I: Growing Unsold Real Estate with the Builders in Major Cities in Kerala

(In Million Sq.Ft)



Source: "Builders strapped with unsold real estate", *The Times of India*, Kochi Ed., dt.23 June 2016. Print, p.10. [41]

It may be noted that there has been huge accumulation of real estate stock across various cities in India. As is evident from Table II and Figure I, the growth is across all major urban centres, though such accumulation has been maximum at locations like Pune (43.48 per cent) and Kolkata (42.72 per cent). Taking all the eight major cities together there has been a growth of as high as 22.39 per cent as of March 2016 as against March 2015. (Table II). Offloading the accumulated real estate stock as above in various urban centres required better liquidity in the market. REITs offer one effective means of enhancing liquidity in the market; other means include attracting more Foreign Direct Investment (FDI) into this sector.

VIII. Concept of Real Estate Funds (REFs) and its Variants Real Estate Investment Trust (REITs)

Real estate funds (REFs) are quite similar to the mutual funds and are founded by a group of real estate professionals to manage property for investors in such funds. Some other real estate funds do not actually own property and instead they opt to invest in bonds or instruments secured by property. In the former case, the investors or unit holders earn money by getting a share in profits from sale of property or from the rentals on property owned by them. In the second case, a coupon rate received on the investment in bonds or instruments is distributed among the investors or unit holders as dividend. The return from such investments is subject to any administration, management, brokerage and/or marketing fee charged by the REFs concerned. REFs have a longer lock-in period than equity funds. Maximum lock-in period for REFs is 6 years.

Initially it was required to invest a minimum amount of 25 lakhs in the REFs. Naturally, the retail investors could not enter this segment and the potential investors in the REFs used to be commercial banks, financial institutions, high net worth individuals (HNIs) and corporate entities. However, later on the minimum amount to be invested has been reduced to the level of Rs.10 lakhs. Still, REFs are beyond the reach of retail investor's viz. common investing public in India. Real estate in a broad sense includes commercial, residential, IT development, Hospitality, Malls and SEZ projects. Accordingly, REFs may target the development of all or any of the various real estate segments as noted above.

Real estate funds (REFs) or real estate mutual funds (REMFs) are often known, as real estate investment trusts (REITs) internationally. The essential difference between a REIT and a REF (or REMF) is that investments made in REIT are traded in real estate stocks and not invested in stock of companies. It provides a heavier liquidity than MFs. As per an earlier guideline by

SEBI, the NAV of REMFs were required to be disclosed daily but a recent proposal of a quarterly disclosure of NAV is drawing serious speculations from the realty segment. In India, REFs were initially launched in the REMFs format and later on in the form of REITs. At present, the Securities and Exchange Board of India (SEBI), the regulatory authority for REFs and its variants, has been in the forefront for the regulation of REITs in India. Most funds operating in India have a lock-in period of 3 to 7 years. At the end of this period, the fund exits the holding by selling it in the secondary market. If the investment is in a commercial property, the fund may rent it out within the lock-in period and exit later. Most funds invest in residential projects and those commercial projects that are nearing completion. While residential projects move faster in the market, there is a rental yield attached to commercial projects. Because of the improved demand for housing and low capital requirement, often REFs focus on residential and income-generating commercial projects. A few funds invest in projects that are still in the initial stages of construction, based on saleability and track record.

Kotak Realty Fund established in May 2005, is one of India's first private equity funds with a focus on real estate and real estate intensive businesses. It operates as a venture capital fund. Leading banks, domestic corporate, family offices and high net worth individuals have contributed the fund's corpus. The fund is close ended and has a life of 7 years. The Fund has raised around $ 100 million from domestic investors. The strategy of the fund is to make investment at project level with developers and at an enterprise level in realty development companies. The fund has the mandate to invest in retail, hotels, healthcare, education etc. HDFC Property Fund is a 7 years' close ended real estate venture fund called HDFC India Real Estate Fund. The fund has been launched in association with SBI. HDFC holds close to 80 per cent and SBI the remaining stake while HDFC Venture Capital Ltd. manages the fund. The scheme had a minimum contribution of Rs 5 Crores per investor. AnandRathi Real Estate Opportunities Fund (AR REOF) is a close-ended fund, for domestic and overseas investors. The fund focuses on growing markets such as Pune, Bangalore, Chennai, Hyderabad and other cities that are witnessing substantial urban development. The fund's investment strategy is to focus on acquiring secured rental income producing real estate assets with quality blue chip tenants and picking up equity stakes in specified real estate projects being developed by reputed developers. IL&FS Realty Fund is a private equity fund. The fund seeks to achieve a gross investment-level leveraged annual internal rate of return in excess of 25 per cent. In addition, the fund will target a cash-on-cash stabilized yield on equity exceeding 8 per cent per annum for income-generating projects. ICICI Ventures has also launched a property fund, the funds seeks to invest in the commercial, residential, retail and other world-class real estate assets, both in developed and development projects, in the potentially growing cities of India. The fund seeks to deliver a compounded annual rate of return in excess of 20-25 per cent per annum over a 7 years tenor.

IX. Government Initiatives to Attract Funds in to the Real Estate Sector Through REFs

In the recent years, the supportive policies of the successive Union governments in India have further encouraged the liquidity flow into the country's real estate sector. For instance, Government of India has allowed non-resident Indians (NRIs) to invest upto 100 per cent as Foreign Direct Investment (FDI) in housing and real estate sector. This policy of 100 per cent FDI in the real estate sector in India, setting up real estate mutual funds (REMFs) coupled with other fiscal reforms like rationalization of stamp duty, property taxes etc. initiated by the Government are steps directed at making the real estate a promising investment option in India. As an outcome of these policies, the foreign contributions to REFs in India have witnessed a steady rise of 40 to 45 per cent per year. The domestic financial institutions have also built up their investments in REFs like their foreign counterparts. This combined participation from both along with contributions of the corporate houses has accelerated the growth of REFs in India. Securities and Exchange Board of India (SEBI), the regulatory authority of securities market in India, has been trying to develop various innovative models for financing real estate market over the last few years. SEBI's first attempt to bring in REITs in 2007 was not successful. So SEBI went ahead with its second attempt to bring in a REIT regime in the REMF format. But, this was also not very successful for want of adequate interest from the investors. SEBI approved the guidelines for the real estate mutual funds (REMFs) according to which all the schemes having an objective to invest directly or indirectly in real estate property will be governed by the provisions and guidelines under SEBI (Mutual Funds) regulations. SEBI made it clear that the structure of the REMFs, initially, would be close ended. The units of REMFs would be compulsorily listed on the stock exchanges, and NAV of the scheme would be declared daily. The scope of the REMFs was kept wide open, as the guidelines allow these schemes to invest in (i) directly in real estate properties within India, (ii) mortgage (housing lease) backed securities, (iii) equity shares/bonds/ debentures of listed/unlisted companies which deal in properties and undertake property development, and (iv) other securities.

According to SEBI guidelines, REMFs need to appoint a custodian who would grant the certificate of registration to carry on the business of custodian of securities by the Board. The custodian would keep safely the title of real estate properties held by the REMFs. Earlier, in the absence of REMFs, companies setting up REFs had to restrict themselves to financial institutions, corporate sector and high net worth individuals for creating their investor base. The REMFs were supposed to offer the real estate developers another source of funds, as the SEBI guidelines allow the funds to invest in the equity of public listed or privately held real estate developer companies as much as 65 per cent of the fund size. The minimum investment norms stipulated in the SEBI guideline were thoughtfully designed to promote pure investment in the sector rather than speculation. SEBI guideline said that the REMF would invest at least 35 per cent of the assets in real estate properties that were already completed and usable. Under construction projects, vacant land or properties specified for agriculture use would not be considered as "real estate property" for satisfying the above 35 per cent norm. In addition, minimum 75 per cent investment was earmarked for real estate properties, mortgage-backed securities, equity or bonds or debentures of publicly listed or privately held companies dealing in real estate and in other securities. Here, the other securities would mean only debt and money market instruments. Clearly, SEBI wanted the REMFs to abstain from investing in under-construction projects or vacant land, as such investments were supposed to take a longer period to produce a decent yield and the retail investors were not often willing to wait for that long. In addition, such investments were perceived to have higher risks attached and gray areas about valuations. There were mixed views on the efficacy of REMFs in raising funds for the real estate sector and improving the liquidity of the players, and the impact of such developments on real estate prices. Anyway, the response from the investors towards REMFs was not as impressive as expected by SEBI. Hence, the second effort of SEBI to bring in REFs in the form of REMFs was also not successful as in the first case.

X. SEBI Initiatives to promote REITs: REIT Regulations 2014 and Its Revision in 2016 – Implications

Failure of its first two attempts to improve liquidity in the real estate market made SEBI to float REFs in the form of REITs (Real Estate Investment Trusts) again, in its third attempt. As part of its third initiative, SEBI has been successful in releasing the Draft of its Real Estate Investment Trust Regulations (Draft REIT Regulations) in 2013 and gathering the public comments on the above draft. SEBI has so far done a commendable job in taking into account international models and views of stakeholders. Accordingly, it was envisaged that REITs should likely emerge as a preferred form of asset backed investment with established revenue streams, and will go a long way in protecting the interests of investors seeking exposure in real estate as an asset class. More importantly, REITs may infuse additional transparency and liquidity in the Indian real estate market. With Indian players showing an increased keenness to list Indian real asset listings offshore, especially in SGX, SEBI's move is likely to attract such markets onshore and increase depth of Indian real estate capital markets. From a private equity in real estate perspective, REITs will also create exit opportunities for developers and financial investors allowing them to move completed assets to REIT and provide much needed liquidity in the market.

As envisaged, SEBI formally flagged off its final version of REIT Regulations in 2014. While developers and lenders welcomed the move, the investors were still not convinced. For developers REITs offered a convenient way to offload their commercial assets and also to reduce debts, while for lenders REITs reduced their business risk and expand their exposure to real estate business further. The poor turn out from the investors was a setback for the REIT Regulations 2014. Though the launch of REIT Regulations was a positive step forward on the part of SEBI, several issues concerning taxation, stamp duty and foreign participation remained. Thus, in spite of the various benefits as contemplated by SEBI, REITs did not take off as expected because specific tax exemptions are not provided. Besides, foreign investment in REITs also did not materialize as expected, because the amendments to the extant exchange control regulations were not carried out. Here, the investors were primarily put off by the governance risks in the asset class and the low liquidity of REIT investments compared to equities or bonds. Returns on REITs depend on the demand and rents for office space, they also compare poorly to other debt instruments during the economic slump. Table III gives the basic details regarding the REITs in their current form (as per REIT Regulations 2014) and the likely changes that structure of REITs will undergo once the new relaxations as contemplated by SEBI in June 2016 are put in place.

Table III: Proposed Relaxations by SEBI on REIT Regulations 2014 and its Implications on the Market

Structure of REITs as per SEBI's REIT Regulations 2014	Proposed Relaxations by SEBI on REIT Regulations in 2016
This is a step that makes more attractive for the investors. Only single-level Special Purpose Vehicle (SPV) is allowed in 2014 Regulations. Rules relating to related party transactions as per these regulations are elaborate and hence cumbersome to comply with.	The 2016 regulations propose to allow REITs to invest in property via multi-layered Special Purpose Vehicles (SPVs) rather than single-level SPVs as in REIT Regulations 2014. Besides, the 2016 regulations seek to rationalize the onerous rules regarding the related party transactions.
Only three sponsors are allowed as per the 2014 Regulations	The 2016 Regulations propose to allow upto 5 sponsors.
In under-construction projects investment upto 10 per cent alone is allowed	In under-construction projects investment upto 20 per cent alone is allowed

Sources: Compiled by the Author, from sources like SEBI publications, press releases etc.

It may be noted that various relaxations as proposed in the 2016 Regulations (Table III) would make life easier for the sponsors and managers of REITs. However, these may not out to be undesirable for investors. For instance, a multi-layered structure of SPVs may make it harder for the investors to discern the ultimate assets to held in their REIT portfolio. Allowing more sponsors into REIT may reduce the skin in the game for sponsors. Already, the fact that REITs can kick off operations based on property assets transferred by their sponsors. This creates conflict of interest between REIT sponsors and the ultimate investors in REITs. At present, as per the existing regulations, the above risk of investors is addressed by two means (i) elaborate related party rules, and (ii) skin in the game requirements in these regulations. Accordingly, the sponsors are required to invest at least 25 per cent of the outstanding corpus of a REIT for the first three years with a collective networth of at least Rs.100 Crore. Now, as per the new Regulations proposed in 2016, as the number of sponsors go up to 5 (as against 3 in the existing regulations) there will be dilution in the controls and risk of investors would go up accordingly. Though there is an attempt to safeguard the interest of the investors against the related party transactions, by stipulating unit-holder approvals and independent valuation reports for such related party transactions. However, the experience with such related party deals in listed companies in India so far shows that often disinterested investors simply favour such proposals resulting in the interests of affected investors getting not protected. Thus, the investors' interests are not properly safeguarded by the proposed provisions of related party transactions.

XI. Prospects of REITs in India in the Ongoing Regime: Some Strategies for the Faster Growth of REITs

In spite of the limitations of the REIT Regulation 2016 from the perspective of investors, there are some favourable developments too that enhance their growth prospects. Firstly, REITs have obtained exemption from Dividend Distribution Tax (DDT) in the Union Budget 2015-16 and this is a step in the right direction for their growth. Accordingly, a retail investor who invests a minimum of Rs.2 lakhs in REITs would get stable income as per the extant dividend rules. Recently in June 2016, the Government of India (GOI) has unleashed the second wave of reforms in the foreign direct investment (FDI) front would also benefit the growth of FDI in India. Besides, the GOI has allowed 100 per cent FDI in civil aviation, while FDI norms in defence and pharmaceutical sectors have been relaxed and those in single brand retail have been eased. All these reforms in the FDI sector would benefit the REITs and real estate sector also because FDI in various sectors would result in demand more office space, warehouses, logistics, housing etc. which in turn results in enhanced demand for real estate and housing properties.

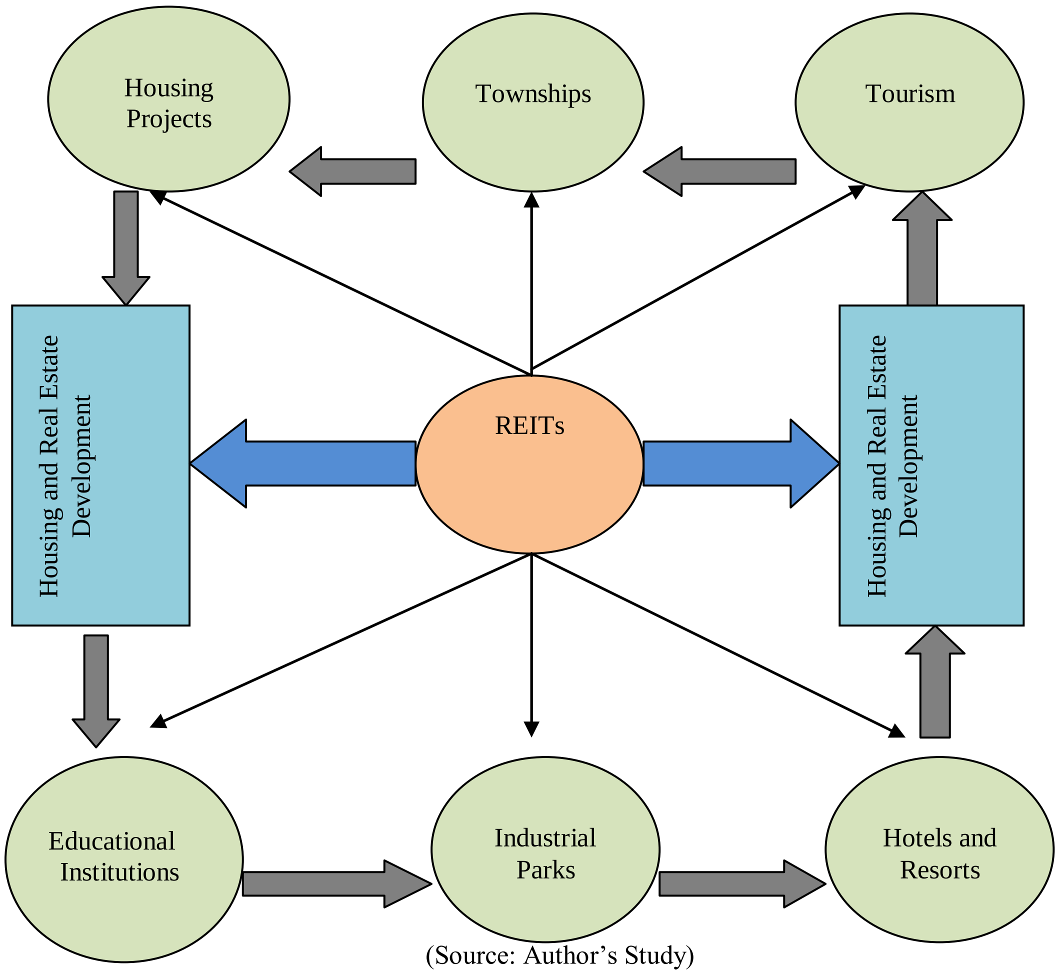
REITs is a good avenue for investment for investors who are averse to invest in physical purchase of property due to risks involved in investments in physical assets. Here, investors can invest in REIT units which in turn can be traded in the stock exchange (like, other securities like shares, bonds etc.) as against transactions involving purchase of physical properties. Thus, REITs are ideally supposed to be very liquid unlike the investments in physical assets. Here are some suggestions to make REIT market in India more effective and also to ensure their faster and sustainable growth in the days to come:

- The relaxations proposed in REIT Regulations 2016 of SEBI are primarily intended to attract the sponsors of REITs and not the investors. For the long term growth of REITs SEBI should instead focus on investors. SEBI should devise a more transparent mechanism with better exit routes for luring the investors.
- SEBI should ensure a more frequent mark-to-market valuation for the vehicle concerned would result in better acceptance of REITs. At present, SEBI insists on compulsory listing to facilitate anytime liquidity. But, to what extent the investors can liquidate their REIT units is doubtful, because the valuation of real estate portfolios will be done only once in six months. Only through more frequent valuations can we ensure better liquidity in the REIT market.
- Focus on commercial real estate is preferred in India at this stage, because investment in residential assets (e.g. rental housing schemes) requires a more mature market; rental housing schemes are still not prevalent in India. The current SEBI guidelines on REITs permit investments only in rent-yielding assets.
- The current policy of the Government of India (GOI) of attracting FDI into housing and real estate sector needs to be continued to attract maximum investment of foreign capital into this sector. The launching of the Real Estate Regulation Bill by the GOI is laudable move. More recently, in June 2016, the GOI has released the Draft rules Real Estate (Development and Regulation) Act, 2016 applicable to the five Union Territories (UTs) in India, for public comments. Once such national policies are in place, the investor confidence will go up and they will invest in real estate, both in the physical properties and in REITs or equivalents (like REMFs).
- Two other critical issues: (i) Exemption from capital gains tax, and (ii) State governments' stamp duty while transferring assets to REIT's holding company, would be key to REITs' success,". Exemption from stamp duties has helped support the expansion of REITs in other financial markets, including Singapore. The removal of DDT, as already noted, has attracted the institutional investors who view India as an untapped market for this asset class. "
- Special schemes for faster development of residential real estate in the country (on the lines of Special Economic Zones) namely Special Residential Zones (SRZs) be promoted by giving tax and other concessions and incentives to real estate developers who are ready to develop residential (housing) units as per Governmental guidelines. Free or subsidized land may also be provided to such developers.
- Last, but not the least, is the special significance of inclusionary housing development. Given the fact that over 90 percent of housing shortage corresponds to people in the low income group and economically weaker section (EWS) sections, insisting on earmarking a specific per cent (say 20 per cent) of the total housing property developed by every developer to the LIG and EWS or budget category customers would ensure that housing development is balanced and sustainable in the long run. It is advisable to encourage specialized REIT schemes by the GOI and offer them privileges.

XII. A Model for Effective Use of REITs for the Faster Growth of Housing and Real Estate Sector

It is meaningful to suggest a model for faster development of housing and real estate sector in India through REITs. (Figure II). As shown, it may be pointed out that REITs would help to stimulate growth not only in the housing and real estate sector, but in a number of related sectors like industrial parks, tourism, educational institutions etc. Conversely, FDI into any one or more of these sectors would trigger the growth of housing and real estate sector too and hence that of REITs, as already pointed out. The model suggested by Nasar & Manoj P K (2013) [19] in the context of FDI in real estate and allied sectors is modified here to suit the case of REITs. In short, the because of the vast multiplier ('ripple') effects and inter-relationships between various sectors to the housing and real estate sector, reforms to attract REITs or FDI inflows into the housing and real estate sector not only promotes the respective sector, but all the allied sectors as well; and vice versa. (Figure II).

Figure II: Effective Use of REITs for the Development of Housing and Real Estate Sector in India – A Model



(Source: Author's Study)

XIII. Concluding Remarks

There are a number of limitations and handicaps for the housing and real estate sector in India. Primarily these are the low level of penetration of the market, significantly low investments by public and private sectors, poor liquidity and resources of the players in the market, and inadequate regulatory and legal system in the country. In this context, the entry of the innovative schemes like REITs can provide the much desired liquidity and dynamism to this vital sector of the economy. Side by side, other innovative instruments and schemes such as Residential Mortgage Backed Securitization (RMBS), Reverse Mortgage Loans (RML), Housing Micro Finance (HMF), FDI in real estate, Special Residential Zones (SRZs) etc. need to be promoted further by the Government for the faster development of the housing and real estate sector and hence the overall development of the economy as a whole. REITs are particularly suitable to the current Indian scenario, because of the rising real estate prices in the past few years making investments an expensive proposition for smaller investors. When the investor sentiments are adversely affected by the capital market developments and poor macro economic conditions, launching of REITs could ensure better liquidity in this sector, which could address the demand-supply gap also. In addition, REITs are useful as they provide an exit option to real estate developers. As REITs develop, healthcare, infrastructure and other stabilized yield generating assets may also be rolled into REITs. Such a framework was initially considered by SEBI. This should ideally be the next progressive step of SEBI in this regard.

The immediate need of the hour is to address the issues relating to tax and foreign investments without which the REITs regime may not take off as contemplated. For instance, issues like dual taxation under the stamp duties and capital gains tax may hamper the successful operation of REITs in India. It is advisable to have capital gains exemption at the time of transfer of real estate asset into REITs, i.e. when real estate is swapped for units of REITs as there is no monetization at this stage. Changes are required in enactments like FEMA and SCRA. he current policy of the Government seems to be in the right direction as the Government has recently introduced the Real Estate Regulation Bill with the intention of bringing in more transparency into the sector. The capital market regulator, SEBI reintroducing its draft regulation on REITs in 2013, followed this. Of late, the central bank of the country, Reserve Bank of India (RBI) is in the process of amending the provisions of FEMA concomitant with the requirements of the proposed REITs Regulations by SEBI.

Because of its vast potential for socio-economic development, housing occupies a prominent place in the policy decisions of the Governments worldwide, particularly in the developing nations like India. In India, the vital significance accorded to housing is reflected in the policies and budget outlays of the Government, particularly since the late 1970s. Governmental concessions by way of tax benefits to the beneficiaries and lenders of housing finance, refinance at low rates to the lenders etc. are examples. The favourable policies of the RBI and the Governments continue even now and the present housing policy of the GOI seeks to attain 'Housing for All by 2022'. RBI, 2014 [21] (b) in its policy report has observed as follows: "Development of housing and mortgage markets has an important role in growth and employment. As the government is committed to a policy of 'Housing for All by 2022', the housing sector has immense potential to grow; so do the mortgage markets". A vibrant REIT market would act as an enabler for the faster growth of the housing and real estate sector and hence the economy as a whole

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