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India's new real estate and infrastructure trusts

The way forward

APREA

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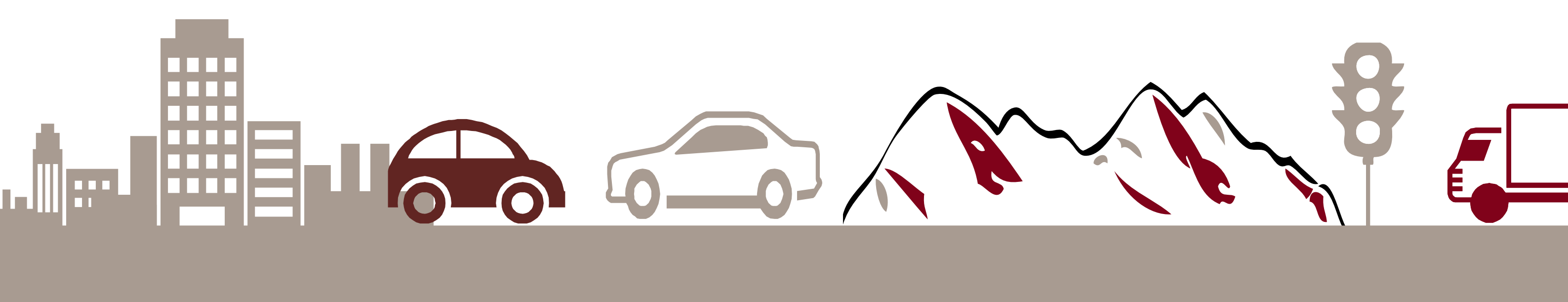


Preface

Infrastructure and real estate are the two most critical sectors in any developing economy.

A well-developed infrastructural set-up propels the overall development of a country. It also facilitates a steady inflow of private and foreign investments, and thereby augments the capital base available for the growth of key sectors in an economy, as well as its own growth, in a sustained manner. A robust real estate sector, comprising sub-segments such as housing, retail, hospitality and commercial projects, is fundamental to the growth of an economy and helps several sectors develop significantly through the multiplier effect.

However, both these sectors need a substantial amount of continuous capital for their development.

Currently, India's real estate sector is the second-largest employer in the country after agriculture and is slated to grow at a steady pace over the next decade. At the same time, the infrastructure sector, which includes segments such as energy, transport, water and sanitation, communication, and social and commercial infrastructure, is the focus area for key policymakers, banks and corporates to formulate and implement regulations. This is expected to ensure the time-bound creation of world-class infrastructure in the country. India's real estate industry has witnessed a paradigm shift from traditional finance to an era of structured finance, private equity and public offering.

Given the importance of these two sectors in the country, and the paucity of public funds available to stimulate their growth, it is imperative that additional channels of financing are put in place.

Real estate investment trusts (REITs) and infrastructure investment trusts (InvITs) are investment vehicles that can be used to attract private investment in the infrastructure and real estate sectors, and also relieve the burden on formal banking institutions. Regulations governing REITs and InvITs were introduced in India as recently as 2014.

This report aims to provide an overview of the market for REITs and InvITs in India, and the benefits that accrue to various stakeholders by investing in these investment vehicles. It also elaborates on regulations governing the structure of these instruments in India and compares REIT markets across major countries in the world.

I hope this report is a useful reference point for you on India's REIT and InvIT regulations and that you enjoy reading it.

Regards,
Abhishek Goenka
Partner & Leader, Real Estate Tax

PwC India

Preface

India's REIT and InvIT platforms are rated amongst the best in the world. No other country has launched such securitisation vehicles that power both real estate and infrastructure investment. APREA commends the Government of India and the Securities and Exchange Board of India (SEBI) for championing this initiative.

REITs and InvITs will help to finance, develop and manage infrastructure that drives growth and productivity. In addition, they can facilitate the process of setting up large-scale housing for ordinary citizens, key workers and the disadvantaged. In short, these securitisation vehicles can help to build enhanced communities that will enrich hundreds of millions of lives across the sub-continent.

India's REITs and InvITs can also help to drive smart urbanisation, underpinned by economic and social infrastructure. They can capitalise roads, vital community utilities, data centres, logistic facilities and transport systems, to name a few. Furthermore, they are efficient platforms for implementation of social infrastructure, including child care, senior living, health facilities and students' accommodation.

The coming era of securitisation in India is also likely to foster rural investment trusts and renewable energy, which can modernise and benefit different regions in the country.

Across the world, REITs are tried and tested channels for building the retirement wealth of ordinary citizens. In India, as real estate and infrastructure trusts evolve, they are expected to empower Indians with increased independence and peace of mind in their retirement years.

REITs are a globally recognised brand that offer assurance of quality to international investors. By launching REITs, the Government of India has reinforced its priority of opening up the economy, especially financial and fund management services. This is expected to lead to deeper, more liquid and disciplined real asset capital markets, which will attract a much larger share of the world's patient capital than at present.

APREA gratefully acknowledges the very substantial assistance provided by Indian Government officials in helping to bring this exciting new REIT and InvIT regime to fruition. We also thank our members for their unstinting efforts and PwC for providing its invaluable contributions.

We recommend this publication to all investors.

Peter Verwer
CEO,

Asia Pacific Real Estate Association

Introduction

Since the turn of the century, infrastructure has been considered the sunshine sector in India, and has played a pivotal role in helping the country emerge as one of the fastest growing economies in the world. Moreover, the public private partnership (PPP) model introduced by the Indian government in the sector has attracted domestic as well as foreign investment and stimulated the economy.

The global financial crisis in 2008, coupled with factors such as the weak macroeconomic and inflationary environment in India, a policy gridlock, delays in land acquisition and environment clearances, and political instability, had led to the sluggish growth of the sector in the recent past. However, since 2014, it has been witnessing a revival on account of several reform measures undertaken by the Indian government. The liberalisation of foreign direct investment (FDI) rules for the real estate sector, opening up of the domestic fund industry to foreign investment and the passage of the Real Estate (Regulation and Development) Bill, 2013, have brought vigour and vitality to this industry. Furthermore, the Indian government's strong resolve to provide housing for all by 2022 and the development of smart cities have led to increasing activity in this sector.

National Institution of Transforming India (NITI) Aayog has projected an investment of 1 trillion USD in the infrastructure sector during the Twelfth Five Year Plan (2012–2017). Since half of this investment was projected to be from the private sector, a need for alternative sources of finance, in addition to traditional bank finance, was felt. In addition, new sources of finance were needed for stalled infrastructure projects.

Keeping in mind the necessity for additional capital requirements in the sector, the Securities Exchange Board of India (SEBI) took an innovative step and introduced infrastructure investment trust (InvIT) regulations for infrastructure projects. These regulations have been in effect since 26 September 2014, and are expected to alleviate the burden on the banking system by making available fresh and patient capital for the infrastructure sector.

The real estate sector is closely related to infrastructure and is fundamental to its growth. And given the capital-intensive nature of this sector and the limited options available to real estate developers and owners for raising funds, real estate investment trusts (REITs) offer a way forward.

In general terms, a REIT is an investment vehicle that owns and operates real estate-related assets, and allows individual investors to earn income produced through ownership of commercial real estate without actually having to buy any assets. Typically, the income-producing real estate assets owned by a REIT include office buildings, shopping malls, apartments, warehouses and mortgaged property.

REITs were first introduced in the US in the early 1960s and have since then been adopted as a preferred investment mode across the world. Over the years, they have constructively changed the way in which the real estate market operates, benefitting investors as well as real estate developers.

In India, SEBI introduced its draft REIT regulations in 2007. Over the years, the regulator has done a commendable job of structuring these regulations by closely partnering with important stakeholders, government bodies, investors and real estate developers in the country, and bringing them in sync with globally recognised norms. After considerable modifications, REIT regulations were finally enacted in India on 26 September 2014.

SEBI has devised detailed guidelines governing the markets for investments, covering the following:

- Eligibility of the sponsor (the person who sets up the REIT or InvIT), the manager of the trust and the trustee
- Investment conditions such as the ratio of the value of income-generating assets as well as other assets
- Policies and requirements with respect to distribution of dividends, minimum capital required for an initial public offer (IPO), listing requirements, key responsibilities of the parties to the trust, etc.

It is interesting to note that the regulatory regime governing these investment vehicles in India is similar to those in other developed and developing countries, especially with respect to distribution policies, capital requirements, etc.

REITs and InvITs: Key advantages

Over the last decade, REITs and InvITs have developed into a mature market, providing easy access to high-quality assets and enabling a stable return on investments. To illustrate this, as of 2012, there have been over 500 REITs across 22 countries, with total market capitalisation of more than 850 billion USD. Countries such as the US, Australia, France, Japan and the UK were the top five markets for REITs in the world. [1]Asia, with 138 REITs and total market capitalisation of over 118 billion USD, accounts for over 12% of the global REIT market, with Japan and Singapore being significant markets in the region. The recent popularity of these investment channels is driven by the multiple benefits they offer multiple stakeholders.

Stakeholders and parameters		Benefits
Developers	Liquidity	REITS and InvITs facilitate the following: • An increase in entry and exit opportunities for developers, asset owners and financial investors, enabling them to monetise their assets (real estate or projects) • Availability of last-mile funding for stalled projects
	Business	• Transformation of business from an asset-heavy to asset-light model • Focus on core competencies, and segregation of operations and infrastructure • Capital-raising avenues for developers of small companies
Investors	Retail investors	• Facilitation of easy entry and exit in the real estate sector • Small retail investors able to participate in asset classes that are normally unaffordable for them • Additional income generating and stable investment avenues offered for retirement planning • Diversification of investment holdings enabled to help financial and strategic investors manage risk • Risk management strengthened by allowing holding of multiple assets to reduce concentrated asset risk • Fragmentation of real estate asset holdings with multiple owners avoided, leading to focussed high-quality asset maintenance • Forced strata sale of assets at discounted valuation discouraged
	Broad-based institutional investors	• Facilitation of easy entry and exit for existing financial investors • Alternative financing offered • Low-risk investments offered to attract long-term investors such as insurance and pension funds
Macroeconomy	Capital markets	• Development of primary and secondary capital markets by the establishment of a perpetual structure for raising capital at a reduced cost from long-term patient investors • Replacement of bank debt with long-term equity capital • Decrease in the financing burden on banks by reducing exposure to real estate/infrastructure, thereby enabling the creation of additional capital for other sectors
	Corporate governance	• Improvement in transparency, disclosure standards and professionalism within the sector • Informed decision-making enabled for investors
	Government	• Augmentation of the government's revenues • Increased financing for critical sectors, including transportation and energy, and a boost to its vision for 100 smart cities
	Societal benefits	REITs and InvITs augment direct and indirect employment opportunities through the following: • Fund management services • Project management and operation • Property management and operation • Valuation services • Trusteeship services • Assurance and other professional services

Various characteristics of the Indian economy are conducive to the growth of these markets in the country, the significant ones being an average growth rate of over 6% over the last five years.[2]This, coupled with other factors such as availability of land, has led to a significant rise in the interest taken by private equity firms in the real estate sector in particular. To illustrate this further, the total investment made by private equity funds in the real estate sector was around 256.8 billion INR (4 billion USD) in 2015, which is nearly 72% higher than that recorded in the previous year. In fact, this is the highest ever annual investment recorded in the sector in rupee terms since 2008.[3]

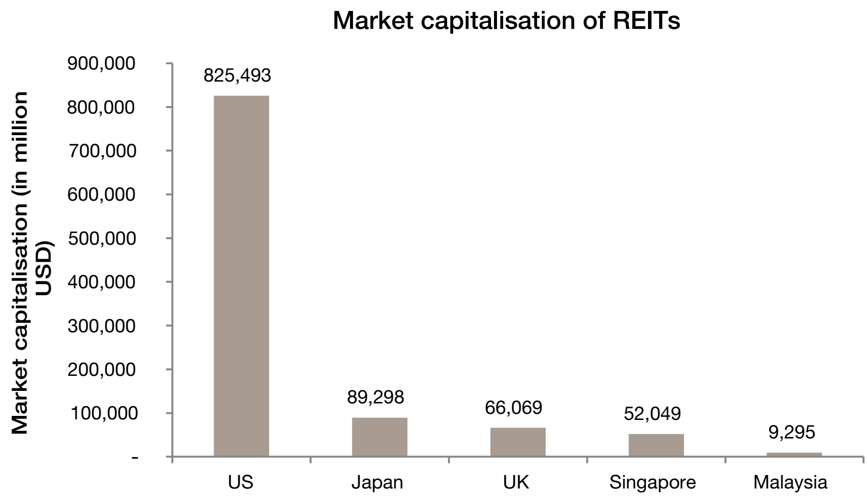
[1]*APREA. (2012, November). The investment characteristics and benefits of Asian REITs for retail investors. Retrieved from http://www.propertyoz.com.au/library/APREA_The-Investment-Characteristics-and-Benefits-of-Asian-REITs-for-Retail-Investors-report.pdf?*

[2]*Union Budget of India. (2013). Retrieved from http://indiabudget.nic.in/es2013-14/echap-01.pdf*

[3]*Cushman & Wakefield. (Q4 2015). Investment market beat. Retrieved from http://www.cushmanwakefield.com/~/media/reports/india/India%20-%20Investment%20-%204Q2015.pdf*

Cross-country REIT markets

Since the inception of REITs in the US in the 1960s, several countries around the world, developed as well as emerging markets, have introduced these instruments in their jurisdictions. The table below highlights similarities and differences in five countries—the US, Japan, the UK, Singapore and Malaysia. While there are many similarities in the basic structure of this investment vehicle—for instance, with respect to the distribution policy on returns—its growth varies across these countries. The US and Australia, which were the first two to introduce REITs, have witnessed high growth in their REIT markets, possibly due to the tax reforms they introduced. Market capitalisation in some countries, including Malaysia, where the REIT market (Property Trust Funds in 1989) started late, is relatively untapped, compared to other countries such as Singapore. While the market is nascent and still evolving in India, key guidelines—for instance, with respect to distribution of income—are the same as in other jurisdictions.



Source: EPRA Reporting, Global REIT Survey 2014

Country	Inception	Number of listed REITs	Market capitalisation (in million USD)	Requirements	Breakthroughs
USA	1960	231	8,25,493	• No capital requirements • No listing requirements • Minimum 100 shareholders • No restrictions on ownership by foreign investors • At least 90% of ordinary taxable income to be distributed • Domestic unitholders liable to pay tax at a maximum of 39.6%[4] as ordinary income and an additional 3.8% as Medicare contribution tax • Non-resident unitholders subject to tax on capital gain/dividends to file US tax returns	REIT Modernization Act, 2001, which emphasised creation of REIT subsidiaries
Japan (J-REIT)	2000	53	1,07,099	• Minimum share capital of 100 million JPY (9,09,000 USD) • No listing requirements • Based on the requirement of the Tokyo Stock Exchange, the number of units expected to be held by the lead investor at the time of listing needs to be 75% or less of the total, and the number of investors (other than lead investors) to be at least 1,000 investors • Restrictions on foreign ownership to continue and offers of investment in a J-REIT to be made in the domestic market • A J-REIT to pay out dividends of over 90% of its distributable profits	REIT infrastructure to be listed this mid-year

[4]*The tax rate of 39.6% will apply to taxable individuals in the US. Tax rates are different for domestic corporations and tax-exempt entities.*

Country	Inception	Number of listed REITs	Market capitalisation (in million USD)	Requirements	Breakthroughs
UK	2007	30	67,357	• No capital requirements, but limitation on the type of shares the parent of a UK REIT can issue • Mandatory listing on a stock exchange ecognised by UK tax authorities • A UK REIT cannot be 'close' or under a few investors' control. • No additional restrictions on ownership by non-resident investors (but limitations imposed on companies' shareholdings, if any) • At least 90% rental profits to be paid out	Reforms to relax listing requirements; provisions implemented to enable a UK REIT to invest in another UK REIT, three-year grace period for REITs to become widely held and not be close to investors or under their control, abolition of a uniform 2% tax charged on the value of properties of groups entering the REIT market
Singapore (S-REIT)	1999	29	44,770	• Regulated by the Securities and Futures Act (Cap 289) • Minimum market capitalisation of 300 million SGD (226 million USD) • Listing required for tax concessions • At least 25% of share capital to be held by a minimum of 500 public shareholders in the case of S-REITs denominated in SGDs • No restrictions on ownership of non-resident investors and on foreign assets • At least 90% of taxable income (generally refers to rental income from property in Singapore) to be paid out by investors for them to be eligible for 'tax transparency' treatment • In the case of domestic non-individual taxpayers, distributions made by an S-REIT to be exempt from Singaporean income tax unless distributions are made out of the taxable income (which is granted tax transparency), in which case the prevailing corporate tax rates (currently at 17%) will be applicable	S-REIT tax regime designed to offer concessions for S-REITs in the form of tax transparency treatment (i.e. flow through treatment) for specified income—e.g. qualification of immovable property rental and ancillary income in Singapore, exemption from tax for certain foreign sourced income derived from underlying investments in overseas properties, GST concessions that allow a qualifying S-REIT to treat all supplies made by its multi-tiered structure taxable or exempt from tax on supplies made by the parent S-REIT, etc.
Malaysia	1989	17	9,611	• Regulated by the Securities Commission of Malaysia (SC) • Minimum fund size of 100 million MYR (28 million USD) • Only REITs registered with SC to be listed on Bursa Malaysia • No requirement regarding number of investors • No restrictions on ownership by non-resident investors • Repatriation to be made in foreign currency other than the currency of Israel • Domestic corporate unitholders to be taxed at 24% withholding tax, foreign corporate unitholders at 24%, and individuals and institutional investors at 10% withholding tax	Growing market in REITs, although pace is slow

REIT / InvIT regulations: An overview

A detailed analysis of regulations relating to REITs and InvITs will help those interested in taking advantage of these investment vehicles.

A	Key aspects	
1	Eligibility	**Sponsor (person who sets up a REIT)** • A maximum of three sponsors, each holding at least 5% of REIT units on a post-initial offer basis • Consolidated net worth of at least 100 crore INR (15.58 million USD), with each sponsors' net worth being at least 20 crore INR (3.12 million USD) • Minimum experience of five years in the development of real estate or real estate fund management • Track record of at least two completed projects for a developer sponsor
		Manager (corporate or company) • Minimum net worth of 10 crore INR (1.56 million USD) • Five years' experience in fund management, advisory and property management in the real estate sector or real estate development • A minimum of two key personnel with five years' experience
		Trustee • Registered with SEBI, and not related to the sponsor or manager
2	Key investment conditions	**Asset-related conditions** • At least 80% of the value of a REIT to be in completed and rent-generating real estate, with a lock-in period of three years from the purchase date • A maximum of 20% of the total value of REITs can be from: - Under construction properties with a lock-in period of three years after completion (sub-cap of 10%) - The listed or unlisted debt of real estate companies - Mortgage-backed securities - Equity of listed companies in India, generating at least 75% of their income from real estate activities - Government securities - Unutilised floor space index (FSI) and transferable development rights (TDR) with respect to existing investments - Cash or money market instruments **Additional conditions** • A minimum of two projects to be held by a REIT with an investment cap of 60% for a single project • Direct holding of real estate assets in India or through a special purpose vehicle (SPV) • Investment not permitted in vacant land, mortgages or agricultural land (with certain exceptions) • At least 75% of the revenue to be from rental or leasing of assets, or incidental revenue • Investment in other REIT or lending not permitted • Unitholder's approval required for disposal of a REIT's assets or interest in the SPV if it exceeds 10% of the value of the assets in a financial year • Co-investment permitted subject to conditions
3	Distribution policy	• A minimum of 90% of the net distributable cash flow of a REIT • Distribution to be undertaken at least once every six months • At least 90% of sale proceeds to be distributed unless reinvestment is proposed
4	Public offer	• Minimum value of REIT assets: 500 crore INR (77.88 million USD) • Minimum public float: 25% • Minimum offer size: 250 crore INR (38.94 million USD) • Minimum subscription amount: 2 lakh INR (0.0031 million USD) per applicant • Trading lot: 1 lakh INR (0.0016 million USD) • Minimum number of subscribers: 200
5	Listing requirements	• Mandatory listing within 12 working days of the IPO • Mandatory public float of at least 25% • Number of unitholders to be a minimum of 200
6	Leveraging	• Net consolidated borrowings and deferred payments to be capped at 49% of the value of a REIT's assets • Net consolidated borrowings and deferred payments higher than 25% of the REIT's assets to be subject to the following: - Credit rating (no minimum rating prescribed) - Approval of the unitholders (where the number of votes cast in favour are at least 1.5 times the number of votes cast against)

A	Key aspects	
7	Related party transactions	• Permission granted subject to the following: - Arm's-length requirement being met - Specified disclosures made to unitholders and the stock exchange - Valuation reports or fairness opinions obtained from independent valuer(s) in the case of specified transactions (for instance, buying and selling of assets) - Unitholder's approval required for certain specified transactions (for instance, borrowings from related parties exceeding 10% of total consolidated borrowings)
8	Key rights and responsibilities	**Sponsor(s)** • Setting up a REIT and appointing a trustee • Transferring or undertaking to transfer assets and interest in the SPV to the REIT before allotment of units to applicants • Minimum post-IPO holding of at least 25% - Three-year lock-in period of 25% of post-IPO holding - One-year lock-in period for balance post-IPO holding • Sponsors' consolidated holding of at least 15%, and individual sponsors at least 5% at all times • Divestment of 15% continued holding subject to the following: - Completion of a three-year lock-in period from the listing date - Another sponsor acquiring the minimum holding with the prior approval of the unitholders
		Manager • Ensuring that REITs and SPVs' assets have proper legal, binding and marketable titles and agreements • Identifying and recommending investment opportunities • Complying with the conditions and strategy mandated for the investment • Appointing other service providers in consultation with trustee • Undertaking lease and property management (directly or through agents) • Ensuring that a REIT's assets are adequately insured • Addressing unitholders' grievances and distribution-related issues • Ensuring audit of a REIT's accounts by an auditor • Overseeing developmental activities • Providing activity and performance reports on the REIT every three months to its board or governing body • Ensuring adequate disclosure and timely submission of documents to the concerned stock exchange
		Trustee • Appointing an investment manager and executing his or her agreement • Overseeing the manager's activities and operations and obtaining compliance certificates on a quarterly basis • Reviewing related party transactions • Obtaining unitholders' approval on specified matters
B	**Other aspects**	
1	Legal form	• REIT to be mandatorily set up as a trust • No other form of entity (for example, company or limited liability partnership [LLP]) permitted
2	Key definitions	**Completed property** • Property for which occupancy certificate has been granted by the relevant authority **Real estate or property** • Land and any permanently attached improvements made to it, whether leasehold or freehold, including buildings, sheds, fittings and any other assets incidental to the ownership of real estate • Excluding mortgages and any asset considered as 'infrastructure', as defined by the Ministry of Finance **Related party of REIT** • Sponsor(s), redesignated sponsor(s), manager, trustee or any unitholder holding more than 20% of units directly or indirectly • Associates, sponsors, directors and partners of the parties mentioned above **SPV** • A company or an LLP in which a REIT holds or proposes to hold a controlling interest and an equity stake or interest of at least 50% • Eighty per cent of the assets to be directly held by such an SPV • Not allowed to be engaged in any other activity

B	Other aspects	
3	Valuation	• Complete valuation of the REIT (in the prescribed format) to be undertaken at least once every financial year • Valuer not to be related to or associated with the relevant REIT parties • Half-yearly valuation of REIT assets to be conducted for the half year ending 30 September • Complete valuation to be undertaken for purchase or sale of property; unitholders' approval needed if: - The acquisition price is more than 110% of the valuation - The sale price is less than 90% of such valuation • Two-year cooling-off period for the valuer after every four continuous years of valuation being done of the same property • Valuer's remuneration not to be linked to the value of the asset
4	Governance aspects	• Unitholders' meetings to be convened at least once every year within 120 days from the end of the financial year, with the gap between two meetings not exceeding 15 months • Generally, a resolution to be considered as passed if unitholders casting votes in favour are 1.5 times more than those casting votes against it • Certain specified matters (for instance, a change in the manager or sponsor, or delisting) to ensure that votes being cast in favour are at least three times the votes cast against • Annual report to be provided to unitholders within three months from the end of the financial year; half-yearly report to be given within 45 days from 30 September • Price-sensitive information as well as that having a bearing on operations or the performance of a REIT to be disclosed to the stock exchange
5	Others	• Multiple classes of REIT units not permitted • Parity to be maintained between unitholders (no preferential voting or other rights among unitholders)

InvIT regulations: Overview

A	Key aspects	
1	Eligibility	**Sponsor (person who sets up the InvIT)** • A maximum of three sponsors, with a net worth or net tangible asset of at least 100 crore INR each (15.58 million USD) (except where the sponsor is an SPV undertaking a PPP project, with its net worth defined in the project documents) • A minimum of five years' experience in infrastructure development or fund management in the infrastructure sector • Track record of at least two completed projects in the case of a developer sponsor
		Investment manager • Minimum net worth of 10 crore INR (1.56 million USD) • Minimum five years' experience in fund management, advisory or development activities in the infrastructure sector • A minimum of two employees with the five years of experience mentioned above • A minimum of one employee with at least five years' experience in sub-sector(s) relevant to the investment of the InvIT
		Trustee • Registered with SEBI and not related to the sponsor or manager

A	Key aspects	
2	Key investment conditions	**Asset-related conditions** • At least 80% of the value of the InvIT to be in completed and revenue-generating infrastructure projects • A maximum of 20% of the total value of the InvITs can be from: - Under construction infrastructure projects—directly or through an SPV (with an investment cap of 10% of the value of the InvIT)* - Listed or unlisted debt of the companies in the infrastructure sector - Equity of listed companies in India generating at least 80% of their income from the infrastructure sector - Government securities, money market instruments, liquid mutual funds or cash equivalents *Additional investment flexibility for privately placed InvITs to invest more than 10% of the value of under construction projects, subject to the following: • Funds raised through private placement from qualified institutional buyers and body corporates • The InvIT to only invest in eligible infrastructure projects, the securities of companies or partnership interest in LLPs in the infrastructure sector, and such investee entities to derive at least 80% of their operating income from the sector, based on the previous financial year's audited accounts **Additional common conditions** • Direct holding of infrastructure projects in India or through an SPV, but investment in PPP projects to be mandatorily made through an SPV • Investment through an SPV to be subject to the following: - There being no restriction in the agreement with other shareholders or partners on compliance with InvIT regulation - At least one authorised representative to be on the board - Voting rights to be exercised by the investment manager on behalf of the InvIT in every meeting of the SPV • Investment in other InvITs or lending not permitted • The InvIT to hold the infrastructure asset (directly or through an SPV) for at least three years • Co-investment permitted, subject to conditions
3	Distribution policy	• At least 90% of the net distributable cash flow of the InvIT • Distributions to be disbursed at least once every six months in the case of publicly offered InvITs and at least once every year in privately placed InvITs • At least 90% sale proceeds to be distributed unless reinvestment is proposed
4	Fundraising through public offer of units	• Minimum value of InvIT assets: 500 crore INR (77.88 million USD) • Minimum float: 25% • Minimum offer size: 250 crore INR (38.94 million USD) • Minimum subscription amount: 10 lakh INR (0.0156 million USD) per applicant • Trading lot: 5 lakh INR (0.0078 million USD) • Minimum number of unitholders (other than sponsors): 20
5	Fundraising through private placement of units	• Minimum value of InvIT assets: 500 crore INR (77.88 million USD) • Minimum offer size: 250 crore INR (38.94 million USD) • Minimum subscription amount: 1 crore INR (0.156 million USD) per applicant • Trading lot: 1 crore INR (0.156 million USD) • Minimum unitholders (other than sponsors): 5 • Maximum unitholders (other than sponsors): 1,000
6	Listing requirements	• Mandatory listing within 12 working days of IPO and within 30 working days for privately placed units • For publicly offered units: mandatory to have a public float of at least 25% and number of unitholders (other than sponsors) to be at least 20; none of the public investors to hold more than 25% of InvIT units • For private placed units: mandatory to have at least five investors (other than sponsors), with none holding more than 25% of InvIT units
7	Leveraging	• Net consolidated borrowing and deferred payments to be capped at 49% of the value of InvIT assets • Net consolidated borrowings and deferred payments of more than 25% of the value of InvIT assets, subject to the following: - Credit rating (no minimum rating prescribed) - Approval of unitholders (where the number of votes cast in favour is at least 1.5 times the number of votes cast against)
8	Related party transactions	• Permitted subject to the following: - Transaction meeting arm's-length requirement - Specified disclosures made to unitholders and the stock exchange - In the case of publicly offered InvITs, unitholder's approval required for the following: ◦ Acquisition and sale of investment (exceeding 5% of the value of InvIT assets) in securities or assets from or to related parties ◦ Borrowings from related parties exceeding 5% of total consolidated borrowings

A	Key aspects	
9	Key rights and responsibilities	**Sponsor** • Setting up of InvIT and appointment of a trustee • Transferring or undertaking to transfer assets and interest in the SPV to the InvIT prior to allotment of units to the applicants • Minimum post-IPO holding to be at least 25% with: - Three-year lock-in period for 25% of the post-IPO holding - One-year lock-in period for the balance post-IPO holding
		Investment manager • Ensuring infrastructure assets have legally enforceable titles and material contracts are enforceable under the law • Identifying and recommending investment opportunities • Complying with investment conditions and strategy • Overseeing project manager's activities • Appointing other service providers in consultation with trustee(s) • Ensuring InvIT assets are adequately insured • Addressing unitholders' grievances and distribution made to them • Ensuring audit of InvIT accounts by the auditor • Providing activity and performance report of InvIT every three months to the board or governing body, and undertaking other specified compliance measures • Adequately disclosing and submitting documents to the stock exchange
		Project manager • Undertaking operation, management, maintenance and supervision of assets • Undertaking project implementation in compliance with the terms of project management agreement
		Trustee • Executing investment management agreement • Overseeing manager's activities or operations, and obtaining a compliance certificate on a quarterly basis • Reviewing related party transactions • Appointing investment manager and project manner in identified circumstances • Obtaining unitholders' approval in specified matters
B	**Other aspects**	
1	Legal form	• InvIT to be mandatorily set up as trust • No other form of entity (for example, a company or LLP) permitted
2	Key definitions	**Completed and revenue-generating project** • An infrastructure project that has received a commercial operations date (COD) and all requisite approvals to commence operations and generate revenue from operations for at least one year **Eligible infrastructure project** • For PPP projects, the project to have been completed and generating revenue or a pre-COD project • In the case of other projects, the project to have received all the requisite approvals and certification to commence construction **Infrastructure** • Includes all infrastructure sub-sectors, as defined vide notification of the Ministry of Finance (dated 7 October 2013) and to include any amendments thereof (please refer to the Annexure, List of infrastructure sub-sectors, for a list of infrastructure sub-sectors included in the notification) **PPP project** • An infrastructure project undertaken on a PPP basis by a public concession authority and a private SPV concessionaire (selected on the basis of open competitive bidding or a memorandum of understanding with relevant authorities)

B	Other aspects	

		Pre-COD project
		• A project which has not achieved a commercial operation date under relevant agreements, and has the following:
		  - Completed 50% of the infrastructure project (as certified by an independent engineer)
		  - Expended at least 50% of the total capital cost
		Project manager
		• A person who is responsible for the execution and achievement of project milestones, in accordance with relevant project documents
		Related parties of InvIT
		• Sponsor, investment manager, project manager, trustee, any unitholder holding more than 20% of units (directly or indirectly)
		• Associates, promoters, directors and partners of the parties mentioned above
		SPV
		• A company or LLP in which the InvIT holds or proposes to hold the controlling interest and an equity stake or interest of at least 50%. (However, there is an exception for PPP projects.)
		• Ninety per cent of the assets directly held by an SPV that is not engaged in any other activity
		Under construction project
		• Infrastructure project (PPP or otherwise) that has not achieved COD under the relevant project agreement

3	Valuation	• Complete valuation (in the prescribed format) to be undertaken at least once in a financial year
		• Valuer to have a minimum five years' experience in valuation of infrastructure assets and not related or associated to parties to the InvIT
		• Valuer to not be related to or associated with parties to the InvIT
		• Half-yearly valuation of InvIT assets of publicly offered InvIT to be conducted for half year ending September 30
		• Complete valuation to be undertaken for the purchase or sale of property by the publicly offered InvIT; unitholders' approval required where:
		  - The acquisition price is more than 110% of the valuation
		  - The sale price is less than 90% of the valuation
		• Two-year cooling-off period for valuer after four continuous years of valuation of the same project
		• Valuer's remuneration not to be linked to the asset value of the InvIT

4	Governance aspects	• In the case of publicly offered InvITs, unitholders' meetings to be convened at least once a year within 120 days of the end of the financial year, with the gap between two meetings not exceeding 15 months • Generally, resolution considered to be passed if unitholders casting votes in favour are 1.5 times the number casting votes against • Certain specified matters (e.g. change in manager, delisting.) requiring the number of votes being cast in favour of to be at least three times the votes cast against • Annual report to be provided to unitholders within three months from the end of the financial year; half-yearly report to be provided within 45 days from the end of 30 September • Price-sensitive information as well as that having a bearing on the operation or performance of an InvIT to be disclosed to the stock exchange
5	Others	• Multiple classes of InvIT units not permitted • Parity to be maintained between unitholders, i.e. no preferential voting or other rights to be given to them

Tax implications

The Finance Act, 2015, and the amendments proposed in the Finance Bill, 2016, read together, lay out the tax regime for REITs/InvITs as they stand at the time this report is being drafted. Taxation-related aspects at various levels are discussed below:

Level	Transaction	Taxation
Sponsor	Swapping of the shares of an SPV (a company) with REITs/InvITs units	• No tax implications at the time of the swap • Deferral from minimum alternate tax (MAT)^ at the time of the swap
	Swapping of assets (other than shares in an SPV) with the units of REITS/InvITs	• Taxable at the time of the swap • Long-term capital gains at the rate of 20% • Short-term capital gains at the rate of 30%
	On sale of units of REITS/InvITs on the stock exchange*	• Long-term capital gains exempt** • Short-term capital gains at concessional tax rate of 15%** • MAT^ to be levied at the time of actual sale
REIT	Interest income	Not taxable However, REIT to undertake tax withholding: • Foreign investors: 5% • Domestic investors: 10%
	Dividend	Not taxable
	Rental income from property held directly by a REIT	Not taxable Withholding requirement: • Foreign investors taxed at rates in force • Domestic investors taxed at 10%
	Capital gains on sale of assets/shares of SPV	Taxable at the REIT/InvIT-level at applicable rates, depending on the period of holding
SPV	Dividend distributed	Exempt from payment of dividend distribution tax, subject to certain conditions
	Rental income from SPV	Taxable at applicable rates
	Interest paid to REITS/InvITs	• Deduction on interest available • No withholding requirement
	Capital gains on sale of assets	Taxable at applicable rates, depending on period of holding
Unit holders	Interest income	• Foreign investors: 5% (withheld at REIT level) • Domestic investors: at applicable rates (credit for tax withheld @10%)
	Dividend	Not taxable
	Capital gains on sale of assets/shares of SPV	Not taxable
	Rental income from property held directly by REIT	Taxable at applicable rates#
	On sale of units of REITS/InvITs on the stock exchange*	• Exempt from long-term capital gains tax** • Short-term capital gains at concessional tax rate of 15%** • MAT^ to be levied

**The date of purchase and the cost of the shares of an SPV will be considered to compute capital gains in the hands of a sponsor at the time of transfer of units.*

*** The rates above are subject to payment of securities transaction tax (STT).*

 # Based on the current tax regime, investors are taxable on distribution of rental income by a REIT letting out property directly. The quantum and manner of taxation of such income in the hands of investors are unclear and need to be clarified.

^ MAT will be chargeable at the rate of 18.5% (plus applicable surcharge and cess).

Notes

1. The tax rates mentioned are only base rates. Applicable surcharge and cess would need to be added separately.

2. The holding period of units is to be more than 36 months in order for them to be considered as long-term capital gains.

Transfer Pricing implications

The SEBI regulations on REITs and InvITs mandate that all related party transactions should be at arm's length. As per the regulations, the related party definition is very wide. Further, significant compliance and disclosure requirements have been prescribed for transactions entered into with related parties under REIT and InvIT regulations.

Under SEBI regulations for REITs, specific guidance for valuation has been provided for related party transactions of purchase/sale of properties. However, no guidance is available for other transactions, such as leasing, remuneration to the manager and pricing of debt/securities. In case of InvITs, no guidance is provided for any category of transactions. In this regard, reliance can be placed on the guidance for arm's length pricing emanating from other regulations, such as the Indian Income-tax Act, 1961.

Specific certification from a chartered accountant will be required for related party transactions in cases of conflict of interest. The onerous disclosure and compliance requirements will require the manager to ensure that all related party transactions are at arm's length and that the disclosures have been complied with.

Ind AS for REITs/InvITs

Adoption of Ind AS by Phase I companies at the beginning of 1 April, 2016 is likely to have a significant impact on their financial statements, since Ind AS are relatively more prescriptive and elaborate in many areas, compared to the current generally accepted accounting principles in India (Indian GAAP). The extent of the impact may vary across industries. One industry that is expected to be significantly affected is the real estate and construction sector in the country.

At a fundamental level, Ind AS focusses on substance rather than the legal aspect, and the risks and rewards of the underlying transactions. It breaks away from legal structure-based accounting and moves to a more substance-driven process. Adoption of Ind AS is also expected to result in accounting that more closely reflects the underlying business rationale and the true economics of transactions.

The impact of adopting Ind AS is expected to cascade down beyond accounting. For example, its implementation is likely to affect key performance metrics, and will necessitate extensive communication with and between board of directors, shareholders and other stakeholders. It may also have a wide-ranging effect on a company's budgeting and reporting processes, IT systems, internal control systems, income tax liabilities and contractual arrangements. Other focus areas include credit rating, compliance with debt covenants, distribution of dividends, employees' key performance indicators (KPI) and incentive programmes, and managerial remuneration.

It should be noted that SEBI's regulations have not yet clearly indicated the accounting standards to be followed by REITs or InvITs. We have summarised the key likely impacts on financial reporting in the operations of real estate and construction entities, which could require them to make significant changes if they adopt Ind AS.

Consolidation

REITs or InvITs can invest either directly or indirectly through
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SPVs, i.e. a company or LLPs, in real estate assets. Ind AS are likely to change how sponsors and asset managers assess REITs or InvITs for consolidation as well as the consolidation of such SPVs by REITs or InvITs.

Principles relating to consolidated financial statements under Ind AS are set out in Ind AS 110, 'Consolidated financial statements'. Ind AS 110 has a single definition of control and sets out requirements for an entity on its preparation of consolidated financial statements, defines its principles of control, explains how it should apply the principles of control and comply with the accounting requirements for preparing consolidated financial statements.

Under Ind AS, control exists and consolidation is only required if an investor exerts power over an investee, is exposed to variable returns from its involvement with the investee, and uses its power over the investee to affect its returns.

Ind AS 110 provides a limited scope of exception for parents that are 'investment entities'. If an entity is an investment entity under Ind AS 110, it is prohibited from consolidating its subsidiaries, with one exception, i.e. to consolidate a subsidiary that provides services for the entity's investment-related activities. An entity qualifies as an investment entity only when the following conditions are met:

- It obtains funds from one or more investors and provides these to an investor (or investors) in the form of investment management services.
- It makes a commitment to its investor(s) that its business purpose is to only invest funds for returns from capital appreciation, investment income or both.
- It measures and evaluates the performance of all its investments, based on their fair value.

Investment-related activities include investment management services, investment advisory services and administrative support. Such services may form a substantial part of a business and may be provided to third parties as well. This will not disqualify an entity from being an investment entity.

Under Ind AS 110, if an entity qualifies as an investment entity, it is required to account for its subsidiaries at their fair value through profit or loss (except as mentioned above), in accordance with Ind AS 109, 'Financial Instruments', and to prepare separate financial statements.

On adoption of Ind AS, this new guidance may result in consolidation of entities that may not have been previously consolidated under Indian GAAP, and may also result in deconsolidation of certain entities in the future. Depending on the facts relating to and circumstances of specific entities, certain special purpose structures or vehicles may no longer remain outside a consolidated group, which could significantly affect the reported net worth and performance of certain groups.

In other words, sponsors along with their asset management entities (not qualifying as investment entities) will have to evaluate whether they control REITs or InvITs, and if so, whether this could trigger consolidation, either at the sponsor or at asset management entity level. Furthermore, it would also need to be evaluated whether REITs or InvITs qualify as 'investment entities' under Ind AS, in order to avail of the benefit of their not having to consolidate their investments in underlying SPVs through which they hold their real estate or infrastructure assets.

Joint arrangements

A joint arrangement necessitates a contract where at least two parties agree to share control of the activities undertaken under the arrangement. Unanimous consent on decisions taken on relevant activities between the parties sharing control is a requirement to comply with the definition of joint control.

Joint arrangements can be shared operations or joint ventures (JVs). The classification is based on principle and depends on the parties' exposure in relation to the arrangement. When this only extends to the net assets of the arrangement, it is a JV.

In contrast, joint operators have rights to assets and obligations for liabilities. Joint operations are often not structured through separate vehicles. When a joint arrangement is separated from the parties and included in a separate vehicle, it can either be a joint operation or a JV. In such cases, further analysis is required on the legal form of the separate vehicle, the terms and conditions included in the contractual agreement, and sometimes, other facts and circumstances as well. This is because in practice, the latter two can override the principles derived from the legal form of the separate vehicle.

Joint operators account for their rights to assets and obligations for liabilities and JVs, for their interest by using the equity method of accounting.

Indian GAAP require JVs to be consolidated proportionately, whereas under Ind AS 111, 'Joint Arrangements', with certain exceptions, consolidation is achieved by using the equity method of accounting.

Many companies may be affected by this change, since they will have to move from proportionate consolidation to the equity method of accounting. This could effectively change the gross total of their reported assets and liabilities, and other performance-related measures, although this may not change reported net assets and net results.

The process of structuring joint arrangements, e.g. to develop and construct property, can be complicated. As a result, it is important for sponsors, REITs and InvITs to not only understand the legal structure, but also the contractual terms, of their arrangements, in order to assess the likely impact on these.

Leases

REITs or InvITs own income-producing real estate assets such as office buildings, shopping malls, apartments, warehouses and mortgages, and mainly earn revenue by leasing space or selling property holdings. Under Ind AS 17, leases cover a wider range of transactions than they did under Indian GAAP. It also provides more explicit guidance on leasing of land and buildings. Ind AS 17 requires that the land and building elements of leases be considered separately for their classification, unless the land element is immaterial. Minimum lease payments are allocated between the land and buildings elements in proportion to the relative fair values of leasehold interests in the land element and the building elements of the lease at its inception. This can be a particularly time-consuming process, since companies are likely to require well-informed advice to help them value land and buildings. If lease payments cannot be allocated reliably between these two elements, the entire lease will be classified as a finance lease, unless it is clear that both the elements include leases, in which case it is classified as an operating lease.

Furthermore, any sale and leaseback transaction between a sponsor and the REITs or InvITs of underlying assets will need to be evaluated. Primarily, it will have to be seen whether any upfront recognition of potential gain on transfer of such assets from the sponsor to REITs or InvITs can continue or will have to be deferred over the term of the lease. In addition, elimination of unrealised profits (to whatever extent applicable) will have to be factored in if the REITs or INvITs are either fully consolidated or 'equity accounted' as joint ventures or associates in sponsors' consolidated financial statements.

The implications of the new leasing standard (introduced worldwide) and its likely impact in the future, as and when Ind AS adopts it, will need to be scrutinised closely. The basic underlying premise embedded therein implies that all leased assets reflected as a finance lease on the balance sheets of lessors (sponsors in our case) may require a detailed evaluation of the overall structure of REITs or InvITs.

Revenue: Sale of real estate

Accounting for the construction contracts of real estate developers is dealt with under Ind AS 11, 'Construction contracts', since it has been kept out of the scope of Ind AS 18, 'Revenue'.

In Ind AS 18, the definition of a construction contract under Ind AS 11 has been modified to include agreements for development of real estate. The revised definition refers to agreements for development of real estate, which involve the provision of services and construction materials. This definition seems sufficiently broad to cover all circumstances where real estate is constructed or modified for a buyer, no matter how significant the construction activity or how tailored the service is for the buyer.

It should be noted that international financial reporting standards (IFRS) may require gains from construction-type sales of residential units to be deferred until completion of the construction, depending on the ability of buyers to provide input on the construction design and continuous transfer of risks and rewards in the real estate sector during construction. In contrast, sale of residential units and other construction will be accounted for under the 'percentage of completion method' under Ind AS, thereby maintaining a stable accounting platform for REITs and InvITs involved in real estate construction and development (in contrast with Indian GAAP).

Financial instruments

India has decided to be the first to adopt the equivalent of IFRS 9—the new standard for financial instruments. This standard will be globally effective in 2018, and is expected to have a wide-ranging impact on companies. It is a myth that the standard will only affect financial institutions. Based on our observations, its impact on other corporate entities and industries could also be substantial. On a high level, use of the fair value and the present value in recording financial instruments is expected to increase.

Ind AS 109 provides extensive guidance on the identification, classification, recognition and measurement of financial instruments. It also provides guidance on the derecognition of financial instruments and hedge accounting, and includes extensive disclosure requirements. Presently, there is no comprehensive mandatory guidance on financial instruments under Indian GAAP.

Classification, recognition and measurement principles, as well as certain disclosure requirements for financial instruments, are addressed in the following three standards:

- Ind AS 107, 'Financial instruments: Disclosure', which includes disclosure requirements
- Ind AS 32, 'Financial instruments: Presentation', which distinguishes debt from equity and provides guidance on netting of financial instruments
- Ind AS 109, 'Financial instruments', which includes classification, recognition, measurement, hedge accounting and impairment-related requirements

The objective of these three standards is to establish the requirements for all aspects of accounting for financial instruments.

Investment in debt instruments

Ind AS 109 includes three categories for classifying debt instruments—amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVPL). This classification is driven by an entity's business model for managing financial assets and the characteristics of its contractual cash flow.

Investment in equity instruments

On adoption of Ind AS, investments in equity instruments will be measured at their fair value. This will be a big change from the current practice. Equity instruments are defined as those that comply with the definition of 'equity' from the perspective of the issuer, as defined in Ind AS 32. Equity instruments held for trading will be classified at FVPL. For all other equities, the management will be able to irrevocably decide on initial recognition on an instrument-by-instrument basis, to present the changes in fair value in other comprehensive income (OCI) rather than on profits or losses. If this is done, all changes in fair value, excluding dividends that are a return on investment, will be included in OCI. There will neither be any recycling of amounts from OCI to profit and loss (e.g. on sale of an equity investment) nor will there be any impairment-related requirements. However, an entity may transfer its cumulative gain or loss within its equity.

Debt/equity/compound financial instruments

Under Ind AS, classification of financial instruments as either debt or equity is based on the substance of the contractual arrangement underlying the instrument rather than its legal form. For example, a redeemable preference share, which is economically similar to a bond/debenture, will be accounted for as a liability rather than an equity, even though it is legally the issuer's share.

Other instruments may not be as straightforward. An analysis of the terms of each instrument (in light of detailed classification-related requirements) is necessary, particularly since some financial instruments have both liability and equity features. Such compound financial instruments, for example, bonds/debentures that are convertible into a fixed number of equity shares, are accounted for as separate liability and equity (and given the option to convert if all equity-related criteria are met) components.

Treatment of interest, dividends, losses and gains in an income statement follows the classification of the related instrument. If a preference share is classified as a liability, its coupon (preference dividend) is shown as the interest cost. However, the discretionary coupon on an instrument, which is treated as equity, is shown as distribution within equity.

The impact can be significant for REITs or InvITs or their underlying SPVs that use such compound instruments in financing their operations, affecting their capitalisation profile, reported earnings, net worth and debt covenants, as well as increased disclosure requirements emanating from new financial instrument standards.

Therefore, it is clear that introduction of Ind AS to REITs or InvITs, or their underlying SPVs, sponsors or asset management companies, could significantly affect financial statements, depending on the complexities involved in each case.

Conclusion

The REIT market has evolved substantially in several countries and these investment vehicles have gained immensely in terms of their market capitalisation. A primary condition for the growth of these markets, as demonstrated by the experience of different countries, is their ability to customise regulations governing these investment vehicles in conformity with domestic market conditions.

In the near future, we expect REITs to increase the depth of the Indian property market through a sound regulatory framework which ensures transparency and high governance standards, and promotes regular monitoring of their performance.

The market for REITs and InvITs is relatively nascent in India. However, with various enabling factors such as the growth of the economy and the middle class, and a concomitant need for housing and infrastructure, we are positive that the market for these investment vehicles will witness considerable growth in the near future.

Annexure: List of infrastructure sub-sectors

Sr. no.	Category	Infrastructure sub-sectors
1	Transport	• Roads and bridges • Ports[5] • Inland waterways • Airports • Railway tracks, tunnels, viaducts and bridges[6] • Urban public transport (except rolling stock in the case of urban road transport)
2	Energy	• Electricity generation • Electricity transmission • Electricity distribution • Oil pipelines • Oil, gas and liquefied natural gas (LNG) storage facility • Gas pipelines[8]
3	Water and sanitation	• Solid waste management • Water supply pipelines • Water treatment plants • Sewage collection, treatment and disposal system • Irrigation (dams, channels, embankments, etc.) • Storm water drainage system • Slurry pipelines
4	Communication	• Telecommunications (fixed network)[9] • Telecommunications towers • Telecommunications and telecom services
5	Social and commercial infrastructure	• Education institutions (capital stock) • Hospitals (capital stock)[10] • Three-star or higher category classified hotels located outside cities with a population of more than 1 million • Common infrastructure for industrial parks, special economic zones, tourism facilities and agriculture markets • Fertiliser (capital investment) • Post-harvest storage infrastructure for agricultural and horticultural produce, including cold storage • Terminal markets • Soil-testing laboratories • Cold chain[11] • Hotels with project cost[12] of more than 200 crore INR (for each) in any place in India and with any star rating • Convention centres with project cost of more than 300 crore INR on each

[5]Includes capital dredging
[6]Includes supporting terminal infrastructure such as loading or unloading terminals, stations and buildings
[7]Includes strategic storage of crude oil
[8]Includes city gas distribution network
[9]Includes optic fibre, wire and cable networks, which provide broadband and Internet services
[10]Includes medical colleges, paramedical training institutes and diagnostic centres
[11]Includes cold room facility for farm-level pre-cooling, and preservation or storage of agricultural and allied produce and marine products and meat
[12]Applicable with prospective effect from the date of notification and available for eligible prospects for three years from the date of notification; eligible costs excluding cost of land and lease charges, but including interest during construction period

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Contact us

Abhishek Goenka
Partner & Leader, Real Estate Tax,
abhishek.goenka@in.pwc.com

Bhairav Dalal
Partner - Tax & Regulatory,
bhairav.dalal@in.pwc.com

pwc.in

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