Too early to start investing in Reits and InVITs

Sebi has reduced the minimum subscription limit for Reits from ₹2 lakh to ₹50,000, and for investment trusts (InVITs) from ₹10 lakh to ₹1 lakh

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In a move that will open up real estate investment trusts (Reits) and investment trusts (InVITs) to retail investors, capital market regulator Securities and Exchange Board of India (Sebi) has reduced the investment limits in these instruments. Through a circular issued on 23 April, Sebi reduced the minimum subscription limit for Reits from ₹2 lakh to ₹50,000, and that for investment trusts (InVITs) from ₹10 lakh to ₹1 lakh. Those with investments worth less than ₹2 lakh are considered retail investors in India's capital markets.

WHAT ARE REITS AND INVITS?

Reits invest in commercial real estate. They earn rental income from their holdings which is passed on to investors. It has to distribute 90% of its cash flows to investors at least once in six months. Investors also benefit from capital appreciation in the underlying assets.

An infrastructure InVIT invests in infrastructure projects and has a similar structure. "REITs and InVITs are good substitutes for physical real estate," said Vinit Iyer of Wealth Creators Financial Advisors, a Pune-based Investment Advisory Firm. "Physical real estate also typically involves a lot of debt that the buyer takes on. This does not have to happen here, due to the small ticket size," he added.

The income earned by a Reit or InVIT is taxed in the form in which it is received. For example, if a Reit receives rental income, it is taxed as income from house property. Similarly, interest income of a Reit is taxed as interest income (under income from other sources). Dividend distribution tax (DDT) is not payable on Reit dividends.

WHAT WORKS

Earlier, retail investors were only able to take exposure to these products indirectly through vehicles like mutual funds and National Pension System (NPS). Mutual funds, typically, permit exposure up to 10% to Reits and InVITs (*see graph*). In the case of NPS, exposure to Reits and InVITs is available up to 5% of the pension corpus under Asset Class A, which invests in alternative assets such as Reits, InVITs and mortgage-backed securities.

REPORT CARD

The performance of investment trusts (InVITs) has been erratic. Real estate investment trusts (Reits) are too new to the market.

Change from issue price (in %)

IndiaGrid Trust InVIT Fund	IRB InVIT Fund	Embassy Office Parks REIT
Issue date 17 May 2017	Issue date 6 Jun 2017	Issue date 1 April 2019
-18	-34.2	9.6

Data as on 26 April 2019

Source: Mint research

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"The minimum ticket size was a constraint for retail investors earlier. The reduction opens up an opportunity for them to take exposure to the real estate market through an efficient financial vehicle," said Prakash Praharaj, a Mumbai-based registered investment adviser.

Reits and InVITs are long-term assets which can serve retail investors well, said Sanjeev Chandiramani, national director, Knight Frank (India) Pvt. Ltd, a real estate consultancy. "REITs and InVITs are successful abroad also. With the Real Estate Regulation and Development Act, 2016 (RERA) in place, the sector as a whole is regulated properly," he added.

WHAT DOESN'T

Sebi has also increased the leverage or borrowing limits in InVITs from 49% to 70%, subject to additional disclosure requirements. A statement from rating agency ICRA Ltd noted that at such a high leverage, it will be difficult for InVITs to maintain AAA rating benchmarks. "At 70% leverage, the total debt to net worth ratio will increase to 2.33 times compared to 0.96 times at 49% leverage levels. With higher leverage, the debt-service coverage ratio, a key ratio for measuring creditworthiness, will also be significantly lower, assuming other things remain the same," it said.

Earlier, retail investors could take exposure to Reits, InVITs only through vehicles like mutual funds and NPS

The higher borrowing limits make InVITs riskier for retail investors.

The other issue is that these products are complicated. "Even today, retail investors get confused about basic things such as the difference between mutual funds and systematic investment plans (SIPs). Expecting them to invest in a complex instrument like a Reit or InVIT may not be in their best interest," said Amol Joshi, founder, Plan Rupee Investment Services, a financial planning firm.

Shyam Sekhar, chief ideator and founder, iThought, an investment consultancy, highlighted the lack of liquidity in Reits and InVITs. "These products are not meant for retail investors due to the poor liquidity levels in them," he said.

Moreover, the performance of InVITs has been erratic so far, and Reits are too new in the market. (*see graph*). While IndiaGrid Trust InVIT and IRB InVIT have given negative returns since launch, Embassy Office Parks REIT, India's first-ever Reit launched in March 2019, gave 9% as on 26 April. These products are still evolving, and it doesn't make sense to rush into them just yet.