

Is India Ready for REITs?

October 30 , 2009

The talk of launching REITs in India in a structure similar to what exists in the United States has been going on for many years. What should be realized, however, is that many aspects of real estate in India must be addressed before one could even think of introducing such a product to the investment community.



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As straightforward as the question may seem, the answer is not a direct “yes” or “no.” Rather, it requires a careful consideration of the characteristics of the Indian real estate industry, what it lacks and what needs to be done to develop a mature real estate market capable of sustaining a structure such as REITs.

Because real estate as an asset class is a capital-intensive investment, many retail investors had not been able to include it in their investment portfolios before the creation of REITs. To encourage retail investors to invest in this asset class, REITs were created in the United States as part of special legislation that allowed them to be incorporated as companies without being taxed at the corporate level, provided they followed a set of rules and regulations. One of the main regulations is the distribution of 90% of their income to their investors as dividends. This created a pass-through entity that investors benefited from as they received a consistent income flow, unlike stocks, which may or may not pay dividends.

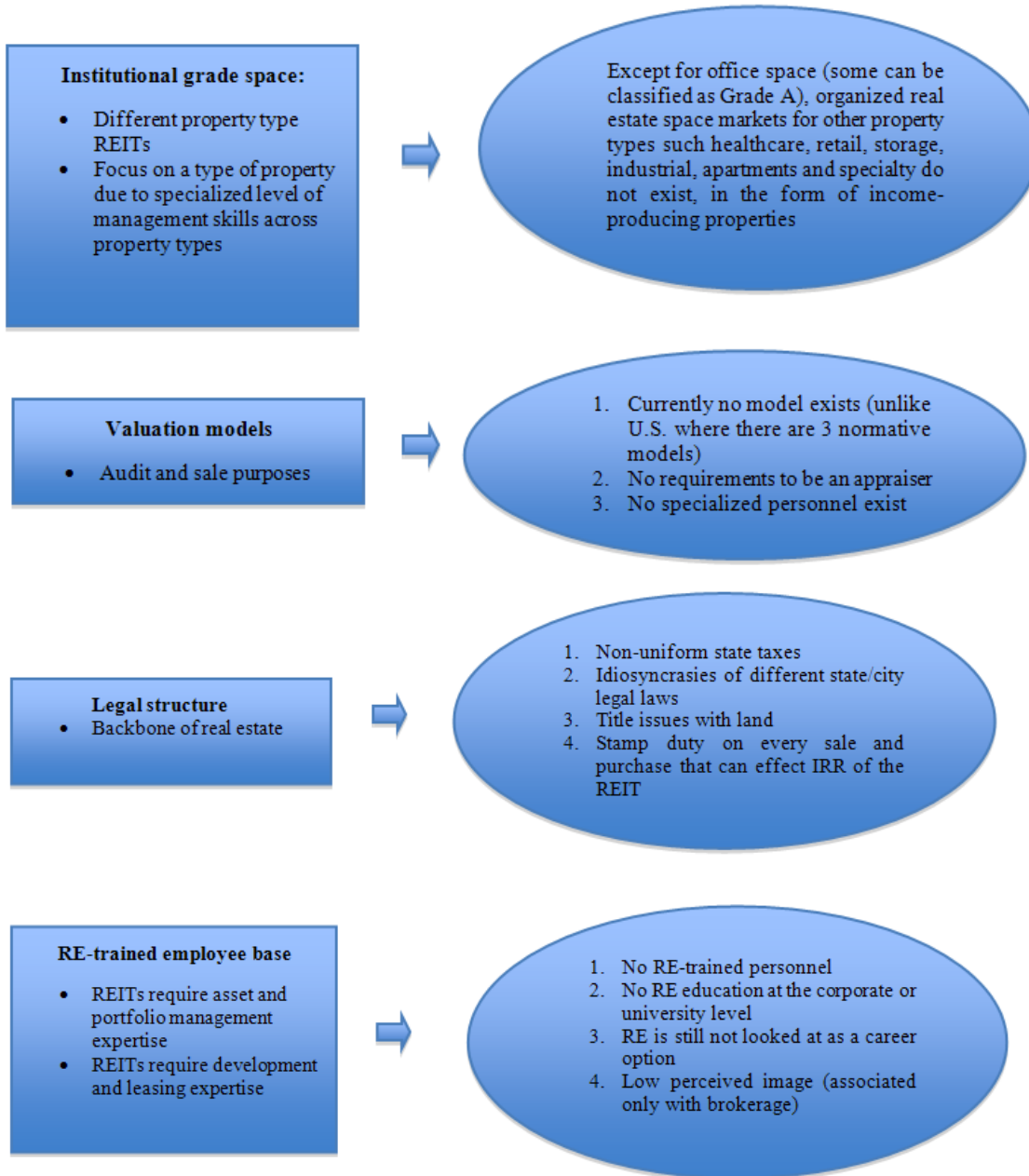
Like stocks, however, REITs are part of the overall capital markets/Wall Street. REITs thus invest the pool of money sourced from their investors—the Wall Street part—into real estate markets, linking them with Main Street as well. It is important to emphasize the dual nature of REITs since the existence of a mature capital market is as important as the existence of a mature real estate market. The absence of one of these elements makes it impossible for a REIT market to function.

REITs are a unique blend of Main Street and Wall Street. They are securitized real estate vehicles, in which a group of investors pool money to buy assets, mainly income-producing real estate. REITs were created to help the retail—vs. institutional—investors participate in the broader real estate market indirectly.

The talk of launching REITs in India in a structure similar to what exists in the United States has been going on for many years. What should be realized, however, is that many aspects of real estate in India must be addressed before one could even think of introducing such a product to the investment community. The dual nature of REITs emphasizes their dependence on the real estate asset/physical space market. Without an organized real estate market, REITs can't deploy the funds they raise. The model below (next page) shows the various components of an efficient REIT market and what India is lacking.

The model shows the absence of various aspects of real estate in India that would be required for the efficient functioning of REITs in India. The absence of even one of these elements could lead to an inefficient REIT market and trigger a collapse in the entire system. Rather than a failed attempt, it would be wise to build up each of the elements over time before initiating any discussion of REITs in India. A failed attempt would be a detriment to the globalization of REITs and discourage any foreign REIT, such as a U.S. REIT, from launching in India in the future.

Mapping the generic REIT structure to the Indian Real Estate Market



Source: the Author

About the Author



Dr. Vivek Sah is an Assistant Professor at Burnham-Moores Center for Real Estate, University of San Diego. Sah's primary research interests are in the areas of REITs, Real Estate Mutual Funds, and Behavioral Real Estate. He actively participates in conferences held by American Real Estate Society and

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