

Real Estate Investment Trusts (REITs)

09-July-2021



Real Estate Investment Trusts (REITs)

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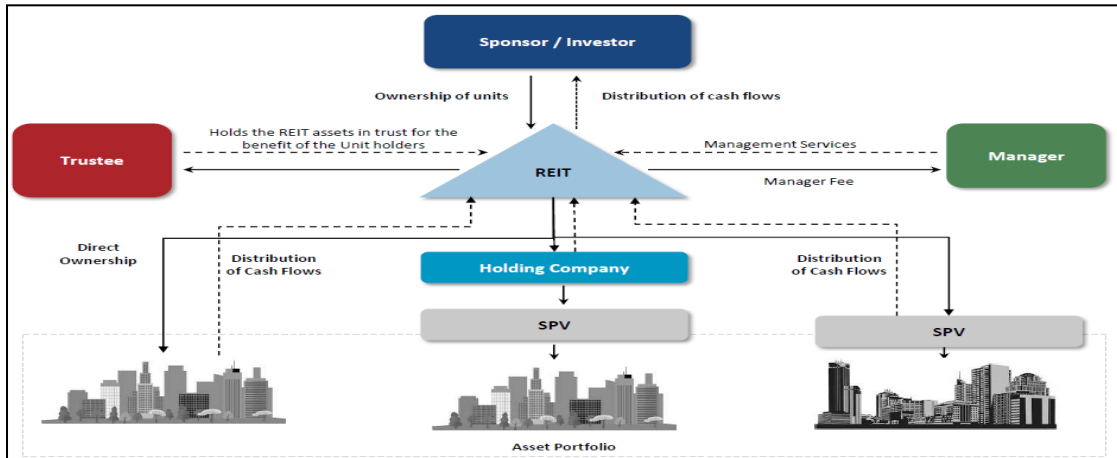
About REITs:

REITs are investment trusts which own and manage income-generating real estate assets such as commercial real estate assets such as offices, hospitality assets and malls. A REIT raises money from unit holders by issuing units. This money is used for purchasing/investing in real estate assets (either directly or through SPVs). REIT generates lease rental/ other income through these real estate assets. The income so generated is distributed to the unit holders. In India, units of 3 public REITs are listed and traded on the stock exchanges (NSE/ BSE) viz., Embassy Office Parks REIT (Embassy REIT), Mindspace Business Parks REIT (Mindspace REIT) and Brookfield India Real Estate Trust (Brookfield REIT).

REITs were first introduced in the US in the 1960s. REITs are now prevalent in more than 40 countries in the world. The total market capitalization of the FTSE EPRA/ Nareit developed REIT index is around USD 1.5 trillion. According to Crisil, India's top 10 commercial real estate owners alone, which include both developers and funds, have a portfolio of around 184 million square feet (msf) translating into an annual lease rental income of over Rs 17,000 crore. This portfolio has the potential to raise as much as Rs 1.5 lakh crore through the real estate investment trust (REIT) route.

REITs – Structure and key Stakeholders

The chart below shows the general structure of a REIT and the role of each of the key stakeholders.



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Role of Key stakeholders:

Unitholder/ Investor

- The unitholder subscribes to REIT units and receives interest, dividend and debt repayment from REIT.
- Unitholders' total returns would also depend on any increase or decrease of the market price of the units which in turn is dependent on interest rate trends and appreciation in the value of the property held by the REIT.

Sponsor

- Sponsor is responsible for setting up the REIT and appointment of trustee.
- Sponsor(s) should collectively hold at least 25% of the units issued by REIT for at least 3 years and 10% after that. Sponsor(s) holdings above 25% have a lock-in period of one year from listing date.

Trustee

- A trustee oversees the activities of REIT and is registered with SEBI as a debenture trustee

Manager

- Manager manages assets of REIT and is responsible for day-to-day activities

REITs: Regulatory framework

REITs in India are governed by the SEBI (REIT) Regulations, 2014. The regulations build in some key features for investor protection:

- Minimum 80% of total value of assets to be invested in completed and income generating properties
- Net Debt to not exceed 49% of total asset value
- REITs must pay out at least 90% of their net distributable cash flows (NDCF).
- Sponsors cannot vote on any transactions involving the Sponsor group entities.

Returns drivers of REITs:

Total returns of unitholders are driven by two factors:

- Distribution received from REITs- interest income, dividend income, rental income, amortization of debt.
- Appreciation/ depreciation in unit value of the REIT which in turn is dependent on interest rate trends and appreciation in the value of the property held by the REIT.

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REIT Taxation:

REITs are gaining popularity as such structures are tax friendly and avoid taxation at multiple levels of the REIT structure. The taxation for a resident Indian individual unit holder of a REIT is shown below:

Distribution from SPVs to REIT: Interest Payments, Dividend Payments and Debt/Capital Repayment are not taxable

Distribution from REIT to Unit holders:

- Interest Payments are taxed at applicable slab rate of the investor.
- Dividend Payments are tax-free if the SPVs are under the old regime of corporate taxation
- Dividend Payments are taxed at applicable slab rate of the investor, if the SPVs are under the new regime of corporate taxation
- Debt/Capital Repayment are not taxable
- TDS for resident individuals @10% for both interest and dividend (if taxable)

Sale of units by unit holders on exchange: Long Term Capital Gains are taxed at 10% and Short Term Capital Gains are taxed at 15%. Period for gains to be considered long term is 3 years or more.

Investment rationale:

Asset Diversification of portfolio:

REITs should be viewed as a distinct asset class compared to either debt or equity. Returns from REITs would depend, inter alia, on the performance of the commercial real estate. Returns from REITs would generally have low correlation to equity market returns. REITs therefore provide benefits of asset diversification in multi-asset portfolio.

Well diversified, high quality real estate assets:

REITs have a well-diversified asset base with income accruing from multiple properties often spread across multiple cities. Diversification of asset base reduces the volatility of rental income and the investor is less exposed to a single asset risk. Also, the assets of REITs are generally Grade A office buildings which witness higher rentals and occupancy levels within a micro-market.

Increase in Net Operating Income (NOI):

The increase in NOI would be driven by the following factors:

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- Increase in occupancies
- Completion of under-construction portfolio
- Contractual lease escalation for leased properties (annual rental escalation clauses built-in- typically an increase of 10-15% every three years)
- Re-leasing of expired leases at higher lease rentals: As lease periods expire, the re-leasing would typically happen at market lease rentals which in most cases are higher than existing lease rentals.

Valuations of REITS, generally using a discounted cash flow method, are sensitive to assumptions about re-leasing rentals, occupancy levels and interest rate trends (discounting factor). Occupancy levels have been impacted by the Covid-19 pandemic as detailed later in the note.

Strong performance of underlying industries:

Around 40-45% of the office absorption in India is by the IT and ITES industry. These industries have received a demand push from Covid-19 pandemic as companies globally invest in digital capabilities. A further 10-15% is absorbed by the BFSI sector which has been moderately impacted. The balance demand comes from global captive offices, consultancy and legal services firms and large MNC companies. Most of the underlying demand has been resilient and is expected to expand in FY22.

Valuation at a discount to NAV:

Currently, the listed REITs are trading at a discount to their NAVs (as calculated by independent valuers). This reflects pessimism around the occupancy levels, rising lease rentals as also the lack of direct control of investors over the property/ies.

Key Risks:

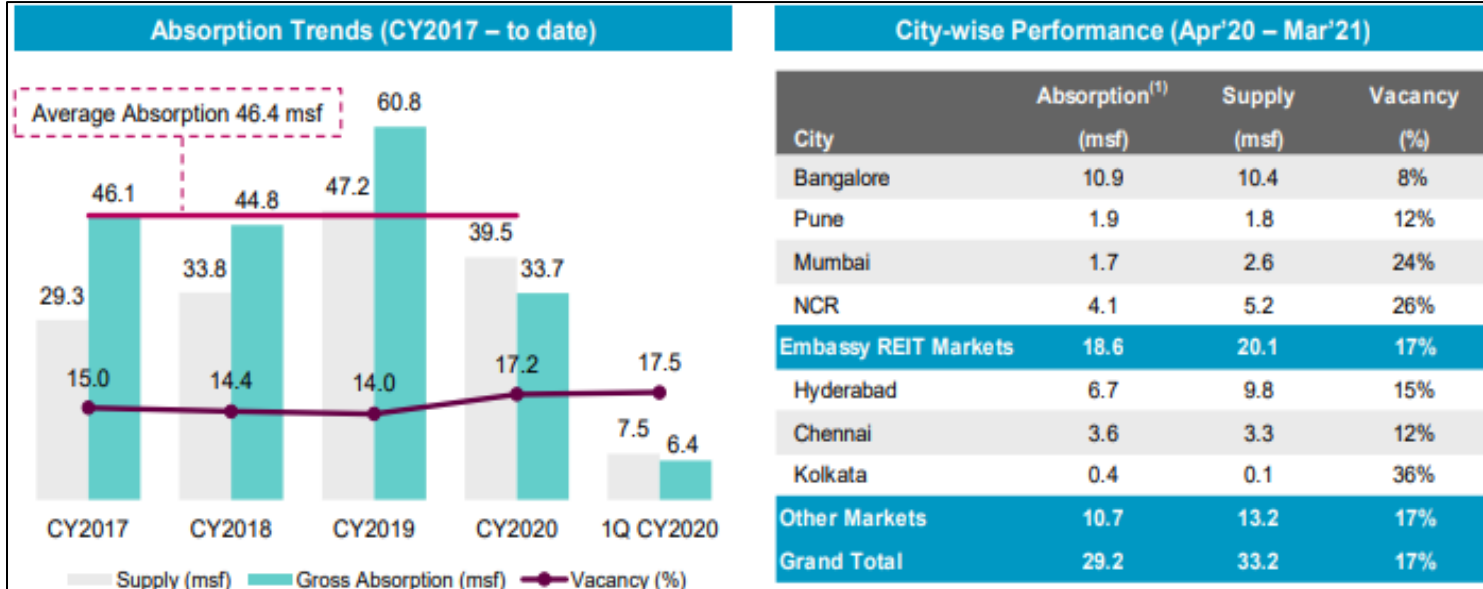
Increase in interest rates: REIT valuations are negatively impacted by increase in interest rates. With rising inflation, long term interest rates are expected to increase and this could impact REIT valuations.

Work from home trends: Many companies have been allowed their employees to work from home since the beginning of the Covid-19 pandemic. If this trend were to sustain over the long term then it would have a substantial impact on the demand and occupancy for commercial real estate particularly office real estate. This would also depress lease rentals for office real estate. This is a key risk to valuations of REITs.

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Increase in office supply: Over the period CY17 to CY19, office absorption has generally outstripped supply while the absorption has matched supply in CY20 and CY21. Covid-19 has impacted both the demand and supply of office real estate. Any significant increase in the office real estate supply over the next few years could impact occupancy levels and lease rentals.

Table: Covid-19 has impacted both the supply and absorption of office real estate



(Source: Embassy REIT)

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Embassy Office Parks REIT (Embassy REIT)

Key financial metrics:

Key Metrics	
INR Unit Price (As of June 30, 2021)	350
Market Cap as on June 30, 2021 (INR Crores)	33,180
NAV (March 31, 2021, INR per unit)	387.54
Distribution (INR Per Unit, FY21)	21.48
Distribution (INR Per Unit, Q4 FY2021)	5.6
Dividend (INR Per Unit, Q4 FY2021)	2.21
Interest (INR Per Unit, Q4 FY2021)	1.24
Amortization of SPV level Debt (INR Per Unit, Q4 FY2021) (INR per unit, Q4 FY2021)	2.15
Distribution Frequency	Quarterly
Date of Listing	1-Apr-19
Issue Price (INR per unit)	300
Listing Price (INR per unit)	308

(Source: BSE/ Embassy REIT)

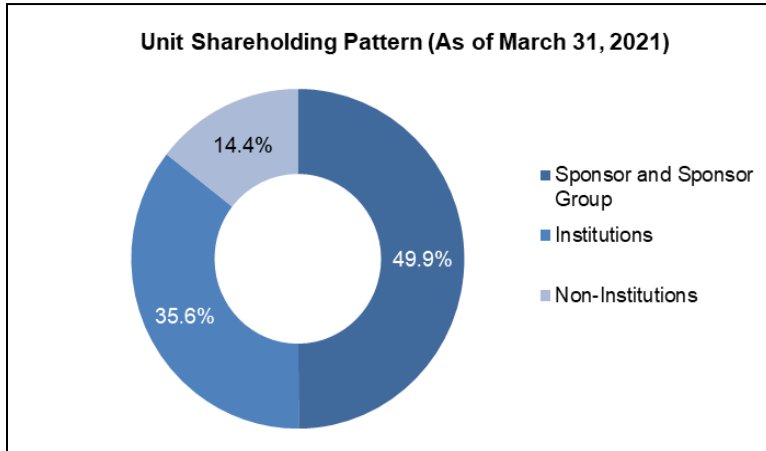
Key Stakeholders:

Sponsor	Blackstone Group/ Embassy Group
Trustee	Axis Trustee Services Limited
Manager	Embassy Office Parks Management Services Private Limited (EOPMSPL)

Unit holding pattern:

Blackstone, one of the sponsors of Embassy REIT, currently has a 37.7% unitholding in Embassy REIT. In June 2020, Blackstone had sold an 8.7% stake in Embassy REIT through block deals at Rs. 341 per share for an aggregate amount of Rs. 2,270 cr. The unit holding pattern of Embassy REIT is shown in the table below.

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(Source: BSE)

Details of Underlying real estate assets: Embassy REIT has a portfolio of 42.4 million sq. ft (msf) as of March 31, 2021. Out of the above, 32.3 msf is completed with a further development potential of 10.1 msf. The completed assets have a weighted average lease expiry (WALE) period of 7 years and have a mark to market (MTM) potential of around 29%. The office assets include 8 infrastructure-like office parks and 4 prime city-centre office buildings.

Around 25% of the leases are expiring by FY25 and Embassy REIT expects these to be renewed/ re-leased at the market rates. About 95% of the gross asset value (GAV) accrues from office properties, 2% from hotel assets and a further 2% from utilities. The company has a strong balance sheet with net debt to GAV of 22% against the regulatory maximum of 49%.

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Portfolio Summary

32.3 msf completed Grade A office assets (88.9% occupied, 7 years WALE, 29% MTM opportunity)

Property	Completed	Development	Total	(yrs)	(%)	In-place	Market	MTM (%)	₹ mn	% of total
Embassy Manyata	11.8	3.1	14.8	6.9	93.5%	61	92	50%	173,579	37%
Embassy TechVillage	6.1	3.1	9.2	9.3	97.8%	70	92	31%	106,491	23%
Embassy GolfLinks ⁽¹⁾	2.7	-	2.7	8.0	97.2%	119	148	25%	28,053	6%
Embassy One	0.3	-	0.3	7.9	5.5%	159	147	(8%)	4,324	1%
Bangalore Sub-total	20.9	6.2	27.0	7.9	94.2%	72	103	42%	312,447	67%
Express Towers	0.5	-	0.5	3.7	91.0%	262	270	3%	18,403	4%
Embassy 247	1.2	-	1.2	3.7	82.1%	102	110	7%	16,914	4%
FIFC	0.4	-	0.4	3.0	77.5%	297	270	(9%)	13,889	3%
Mumbai Sub-total	2.0	-	2.0	3.5	83.3%	176	177	1%	49,206	11%
Embassy TechZone	2.2	3.3	5.5	4.8	88.6%	49	48	(1%)	22,827	5%
Embassy Quadron	1.9	-	1.9	4.7	49.7%	47	48	2%	12,938	3%
Embassy Qubix	1.5	-	1.5	5.0	91.1%	40	48	19%	10,414	2%
Pune Sub-total	5.5	3.3	8.8	4.8	75.9%	46	48	5%	46,179	10%
Embassy Oxygen	2.5	0.7	3.3	10.9	73.3%	47	54	14%	23,694	5%
Embassy Galaxy	1.4	-	1.4	1.9	98.5%	35	45	28%	9,028	2%
Noida Sub-total	3.9	0.7	4.6	7.8	82.1%	42	50	19%	32,722	7%
Subtotal (Office)	32.3	10.1	42.4	7.0	88.9%	71	91	29%	440,553	95%
Four Seasons at Embassy One	230 Keys	-	230 Keys	-	6.5%	-	-	-	7,278	2%
Hilton at Embassy GolfLinks	247 Keys	-	247 Keys	-	13.7%	-	-	-	3,995	1%
Hilton Hotels at Embassy Manyata	-	619 Keys	619 Keys	-	-	-	-	-	4,341	1%
Hilton Hotels at Embassy TechVillage	-	518 Keys	518 Keys	-	-	-	-	-	582	0%
Embassy Energy	100MW	-	100MW	-	-	-	-	-	9,302	2%
Subtotal (Infrastructure Assets)	477 Keys / 100MW	1,137 Keys	1,614 Keys / 100MW						25,499	5%
Total	32.3 msf / 477 Keys / 100MW	10.1 msf / 1,137 Keys	10.1 msf / 1,137 Keys						466,051	100%

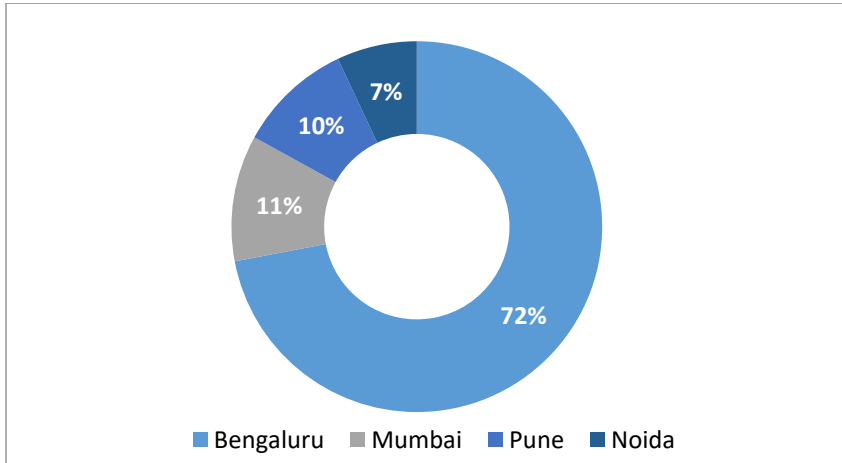
Notes:

- (1) Details included in the above table are for 100% stake in Embassy GolfLinks, except GAV which reflects Embassy REIT's 50% economic interest in GLSP
- (2) Weighted against Gross Rentals assuming occupier exercise their renewal options after the end of the initial commitment period
- (3) Gross Asset Value (GAV) considered per Mar'21 valuation undertaken by IVAS Partners represented by Mr. Manish Gupta, partner, with value assessment services undertaken by CBRE. Valuation exercise undertaken semi-annually. For further details refer notes on slide 52

(Source: Embassy REIT)

Geographical distribution of assets: The asset base of Embassy REIT is diversified geographically. Bengaluru contributes the highest with a 72% share while the balance is split between Mumbai, Pune and Noida.

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Embassy Tech Village (ETV) Acquisition:

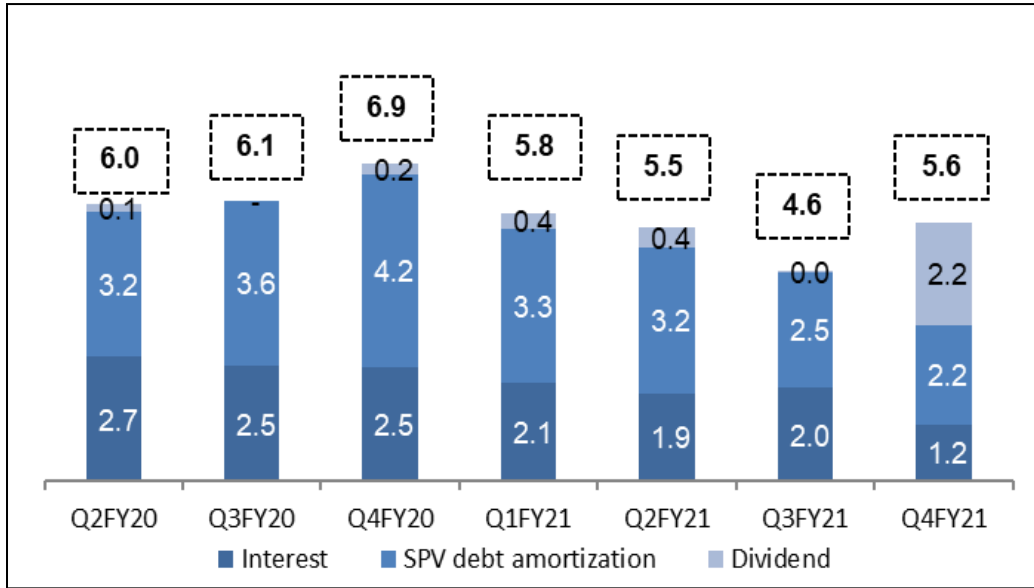
Embassy REIT acquired the 9.2 msf ETV from the Sponsor group and certain third party sellers for Rs. 9,782 cr in Dec 2020. Of the above, about 6.1msf is completed while 3.1 msf is under construction including two proposed 518-keys Hilton hotels within the overall campus. The acquisition was partly funded through a Qualified Institutional Placement (QIP) of Rs. 3,680 cr issued at a price of Rs. 331 per unit. Embassy REIT also preferentially issued units worth Rs. 2314.7cr to certain third party sellers at Rs. 356.7 per unit as part consideration for the acquisition.

ETV is a large-scale, integrated office park situated on the Outer Ring Road (ORR) in Bengaluru. ETV spans over 84 acres and derives 88% of its revenues from multinational companies. It has occupancy of 97.3%, has a weighted average lease expiry (WALE) of 9.7 years and with a 33.7% mark to market (MTM) potential.

As per Embassy REIT, ETV acquisition results in accretion of 4.2% to Distribution per unit (DPU) and 3.0% to Net Asset Value (NAV) per unit.

Historical Distribution per unit: Embassy REIT has a quarterly dividend payment policy. Distributions in Q3FY21 were impacted by issuance of new units for ETV acquisition and were a one-off event for the quarter. Distributions per unit recovered in Q4FY21. Embassy REIT says that its dividend distribution is tax free in the hand of the unitholder.

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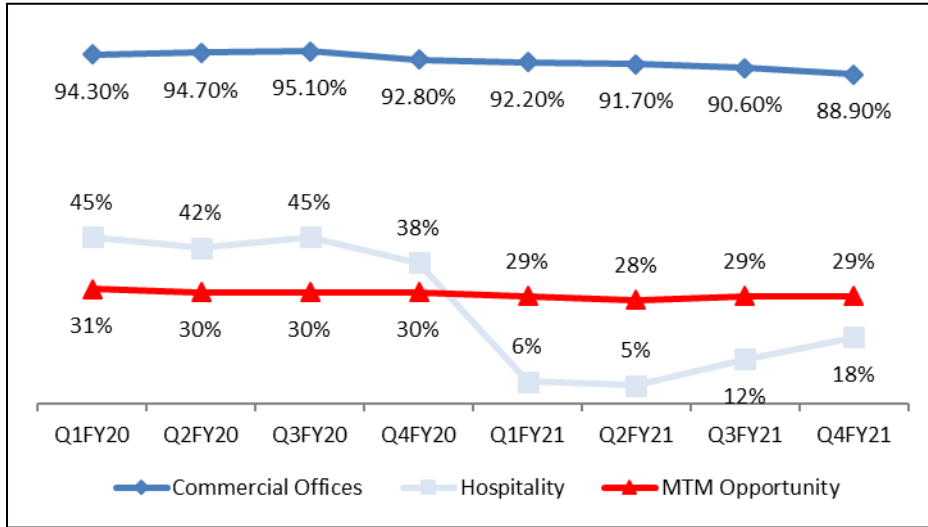
Impact of COVID:

The collections for Embassy REIT have remained strong during the COVID period with collection ratio in the March 2021 quarter exceeding 99%. Around 48% of the company's rentals are from Fortune 500 companies. The company has not given any rebates/discounts for office rents. Embassy REIT has given some discounts for retail/ Food & Beverages (F&B) businesses but these are less than 1% of net operating income.

However, two key metrics, occupancy ratios and mark to market opportunity have reduced as a result of COVID 19 (see table below). Occupancy has declined from 95.1% during Q3FY20 to 89% in Q4FY21.

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Table: Dipping occupancy rate and mark to market opportunity



(Source: Embassy REIT)

NAV calculation and Details

All REITs are required to publish the Net Asset Values (NAVs) per unit every six months. The NAV is based on a valuation to be done by an independent asset valuer. In case of Embassy REIT, iVAS Partners (iVAS) is the registered valuer and CBRE Advisory Services India (CBRE) is the value assessment service provider. The valuer has used a discounted cash flow methodology to arrive at the valuation. The NAV calculation as of March 31, 2021 is summarized in the table below:

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Embassy REIT – NAV Breakup (As of March 31, 2021)	
Particulars	INR million
Gross Asset Value (GAV)	466,051
Add: Other Assets	81,820
Less: Other Liabilities	(74,298)
Less: Gross Debt	(106,223)
Net Asset Value (NAV)	367,350
Number of units (millions)	947.89
NAV as of March 31, 2021 (INR per unit)	387.54

(Source: Embassy REIT)

The NAV of Embassy REIT was Rs. 362 as of March 31, 2019 and Rs. 374.6 as of March 31, 2020. The increase in NAV in March 31, 2021 to Rs. 387.5 has been driven in part by increase in valuation of Embassy Manyata (its Bengaluru integrated office) and in part by acquisition of ETV.

Mindspace Office Parks REIT (Mindspace REIT)

Key financial metrics:

Key Metrics	
INR Unit Price (As of June 30, 2021)	283.0
Market Cap (INR Crores)	16,782
NAV (March 31, 2021, INR per unit)	345.20
Distribution (INR Per Unit, Q4 FY2021)	4.81
Dividend (INR Per Unit, Q4 FY2021)	4.44
Interest (INR Per Unit, Q4 FY2021)	0.37
Distribution Frequency	Quarterly
Date of Listing	Aug 07, 2020

(Source: BSE/ Mindspace REIT)

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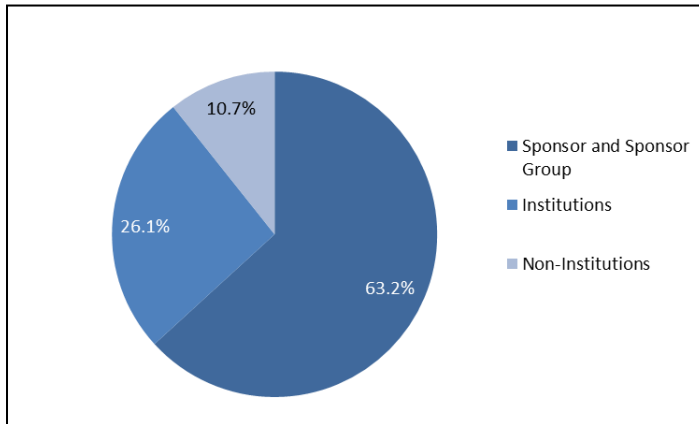


Key Stakeholders:

Sponsor	K Raheja Corp (KRC) Group
Trustee	Axis Trustee Services Limited
Manager	K Raheja Corp Investment Managers LLP

Unit holding pattern:

Mindspace REIT is sponsored by the K. Raheja Corp (KRC) group, a prominent real estate developer in India. Its other group companies include Shoppers' Stop, Chalet Hotels and Inorbit Malls. KRC owns 63.2% of the units of Mindspace REIT. Other prominent shareholders include Blackstone group, Govt. of Singapore, Capital Income Builder fund etc.



Details of Underlying real estate assets: The portfolio comprises of 10 office assets: five integrated business parks and five independent offices, totalling to 30.2 million square foot (msf) in leasable area. The completed area is 23.9 msf and represents 92.3% of the portfolio value. Mindspace REIT has a WALE period of 6.0 years and an MTM potential of 13.8%.

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Portfolio Overview			
Property	Region	Completed Area (msf)	Committed Occupancy
Integrated Business Parks			
Madhapur	Hyderabad	10	88.00%
Airoli East	Mumbai	4.7	91.20%
Airoli West	Mumbai	3.5	68.50%
Gera Commerzone Kharadi	Pune	1.3	93.10%
Commerzone Yerwada	Pune	1.7	99.90%
Independent Office Assets			
Commerzone Porur	Chennai	0.8	8.30%
Paradigm, Malad	Mumbai	0.7	94.00%
The Square, BKC	Mumbai	0.1	27.40%
Pocharam	Hyderabad	0.4	71.10%
The Square, Nagar Road	Pune	0.7	100.00%

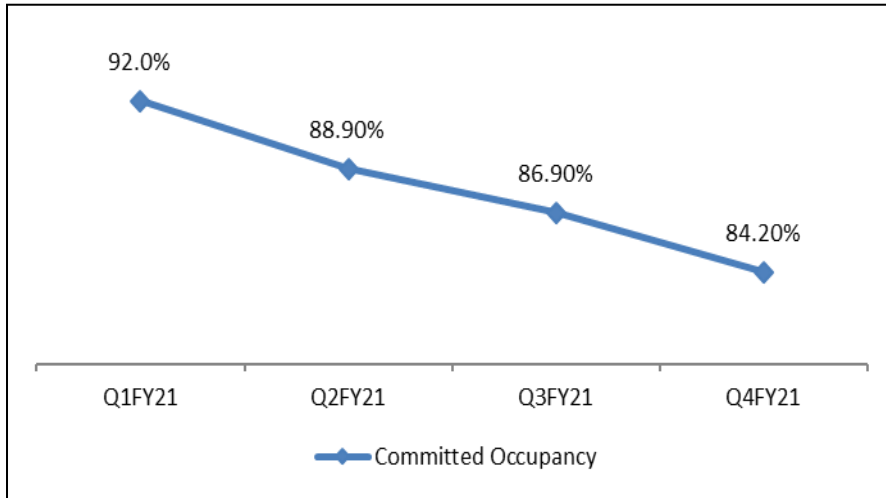
The geographical distribution of portfolio assets is shown below:

Geography wise portfolio summary				
Region	Leasable Area (msf)	Wale (years)	In place Rent (INR psf)	Market Value (INR mn)
Mumbai	12.8	5.1	56.1	92,647
Pune	5.0	7.3	63.7	46,973
Hyderabad	11.6	6.3	52.8	93,574
Chennai	0.8	8.3	64.0	6,993

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Historical Occupancy ratio

Mindspace REIT's occupancy ratio has declined sharply from 92% in Q1FY21 to 84.2% in Q4FY21 as a few customers deferred leasing and some exited their leases prematurely. Mindspace expects tenant uncertainty about re-leasing to persist for a few more quarters because of Covid-19.



Historical Distribution per unit:

Mindspace REIT declared first distribution of INR 4.78 per unit in Q3FY21 and subsequently of Rs. 4.81 per unit in Q4FY21. The distribution per unit in Q4FY21 comprised of Rs. 4.44 per unit of dividend and Rs. 0.37 per unit of interest. As per Mindspace REIT, dividend is tax-free in the hands of the investor.

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NAV calculation and Details

Mindspace REIT – NAV (As of March 31, 2021)	
A Fair Value of Real Estate Assets (INR million)	246,167
B Other Assets at Book Value (INR million)	7,445
C Other Liabilities at Book Value	48,906
D Net Assets Value (A + B - C)	204,706
E No. of Units (Millions)	593
NAV as of March 31, 2021 (INR per unit)	345.20
NAV as of March 31, 2020 (INR per unit)	326.09

Brookfield India Real Estate Trust (Brookfield REIT)

Key financial metrics:

Key Metrics	
INR Unit Price (As of June 30, 2021)	268.33
Market Cap (INR Crores)	8,125
NAV (March 31, 2021, INR per unit)	317
Distribution	June 2021 onwards
Distribution Frequency	Quarterly
Date of Listing	16-Feb-21
Issue Price (INR per unit)	275

(Source: BSE/ Brookfield REIT)

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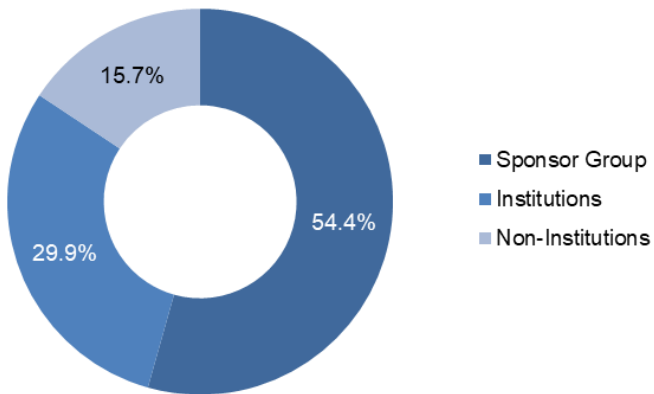
Key Stakeholders:

Sponsor	Brookfield Asset Management
Trustee	Axis Trustee Services Limited
Manager	Brookprop Management Services Private Limited

Unit holding pattern:

Brookfield REIT sponsored by an affiliate of Brookfield Asset Management (BAM). BAM is one of the world's largest alternative asset managers with approximately USD 575 bn in assets under management including about USD 200 bn in real estate assets. BAM has operations in over 30 countries and employs more than 150,000 people.

Unit Shareholding Pattern (As of March 31, 2021)



Details of Underlying real estate assets: Brookfield REIT comprises of Grade-A commercial assets located in 4 major cities - Mumbai, Gurugram, Noida and Kolkata. Three of the office parks (Kensington, Candor Techspace G2 and Candor Techspace K1) are SEZs, Candor Techspace N1 is an IT park. Portfolio has 14.0 msf (leasable land) (comprising 10.3 msf of

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Completed Area, 0.1 msf of Under Construction Area and 3.7 msf of Future Development Potential). Brookfield REIT has a high-quality tenant base with 87% Committed Occupancy along with long-term contracted rentals - WALE (Weighted average lease expiry) of 6.5 years. Brookfield REIT has a MTM potential of 31%.

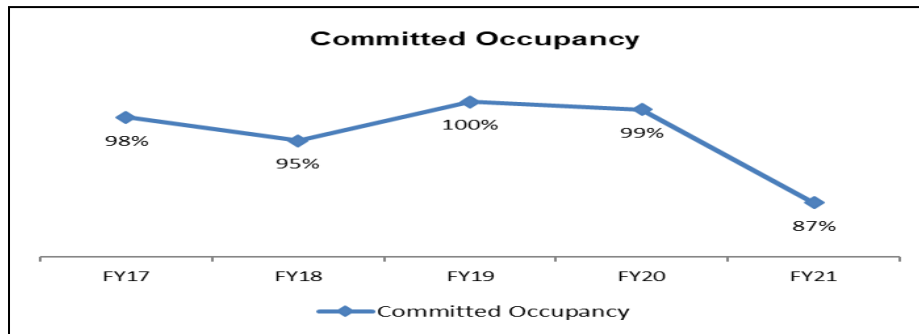
Portfolio assets are well differentiated in their respective markets due to their campus style offering, strategic location, extensive connectivity, high quality specifications, modern amenities and its focus on sustainability initiatives.

Four Large Campus Office Parks – Total 14.0 msf Leasable Area (As of March 31, 2021)

Property	Region	Total Area (Acres)	Leasable Area (msf)	Area Leased (msf)	WALE (years)	In-Place Rent (INR psf)
Kensington, Powai	Mumbai	9.00	1.50	1.30	2.5	92.0
Candor TechSpace, Sector 21 (G2)	Gurugram	28.53	4.00	3.50	7.5	80.0
Candor TechSpace, Sector 62 (N1)	Noida	19.25	2.80	1.30	7.3	46.0
Candor TechSpace (K1)	Kolkata	48.38	5.70	2.80	7.2	43.0
Overall Portfolio		105.12	14.00	8.90	6.6	65.0

Historical occupancy ratio

The company's occupancy ratio has reduced. However, the company has been able to maintain rent collection ratio of 99% till March 2021.



(Source: Brookfield REIT)

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Historical Distribution per unit:

Brookfield REIT got listed in Feb 2021. As such, its first distribution will be in the quarter ending June 2021. Brookfield REIT has guided that the Net Distributable Cash Flow (NDCF) from the IPO till Sept 30, 2021 is likely to be Rs. 12.75 per unit. As per REIT regulations, Brookfield REIT is required to distribute at least 90% of NDCF to the unit holders. The management has also guided that about 30% of distribution from April 1, 2021 is likely to be tax free.

NAV calculation and Details

Brookfield – NAV Breakdown (As of March 31, 2021)

Particulars	INR millions	INR per unit
Gross Asset Value (GAV)	114,808	379.0
Gross Debt	(21,015)	(69.0)
Other Assets	2,071	7.0
Gross LTV	18.3%	-
Net Asset Value (NAV)	95,864	317.0
Value at Issue Price	83,270	275.0

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