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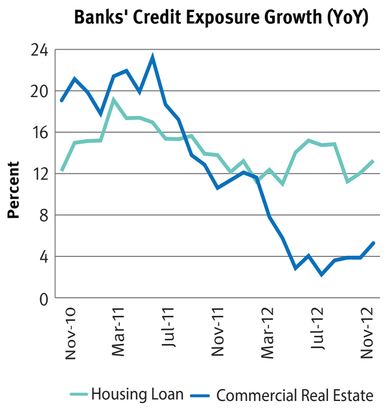
About 377 million Indians comprising 31% of the country's population, live in urban areas according to Census 2011. By 2031, about 600 million Indians will reside in urban areas, an increase of over 200 million in just 20 years. This change in the socio-economic landscape will have a bearing on several things, housing being the foremost. At the same time, The Technical Group on the Estimation of Housing Shortage projects the total shortage of dwelling units in urban areas in 2012 to be 18.78 million. The estimated slum population in India is 94.98 million in 2012. As against this, the number of dwelling units sanctioned under JNNURM in 7 year Mission period was 1.6 million. The supply of decent affordable housing by private sector has remained woefully inadequate. These findings have become the underpinning of the country's Twelfth five year plan (2012-2017).

ABOUT 377 MILLION INDIANS COMPRISING 31% OF THE COUNTRY'S POPULATION, LIVE IN URBAN AREAS ACCORDING TO CENSUS 2011. BY 2031, ABOUT 600 MILLION INDIANS WILL RESIDE IN URBAN AREAS, AN INCREASE OF OVER 200 MILLION IN JUST 20 YEARS

In contrast to this opportunity presented by the housing shortage, the real estate sector has witnessed bottlenecks to service this unmet demand. While there are varied reasons for this situation, lack of sustained financing options remains the most critical one. Institutional finance to the sector has witnessed a slowdown. Bank credit to the sector has slowed down on account of increased risk perception translating to higher provisioning and increased cost of funds. In the last two years, the growth in banks' credit exposure to the real estate industry has come down from 19.08% in Nov'10 to 5.29% in Nov'12. In contrast, credit growth for housing loans has marginally increased to 13.25% in Nov'12 from 12.21% in Nov'10.



Source: RBI

Similarly, foreign investment in the sector has also witnessed a downtrend. First, the overall Foreign Direct Investment (FDI) in the country has declined in the current financial year until October. Second, the share of real estate has declined by an even larger magnitude. From 9% in FY12 the share of the sector has fallen to 5% in FY13 (until Oct) in the total inflows in the country. Raising money through sale of equity shares to public has worked for several industries. However, in case of the real estate industry this route of fund raising has not yielded much result. While there are reasons ranging from poor performance of past issues to information asymmetry on account of the nature of this industry, the fact remains that IPO route is not a dependable option to raise finance and fund real estate development. Just two companies managed to raise funds through this route in the last two years totaling to a paltry Rs.1.87 bn. The last two years have contributed less than 1% to the total IPO money raised by the industry in the last seven years highlighting the uncertainty of this source of funds.

Table 1 : Funds raised by the Real estate industry through IPO/FPO

Year	Funds Raised (Rs. Bn.)	No. of Issues
2006	17.70	3
2007	145.74	10
2008	-	0
2009	4.62	1
2010	43.12	5
2011	0.60	1
2012	1.27	1
Total	213.06	21

Source: NSE

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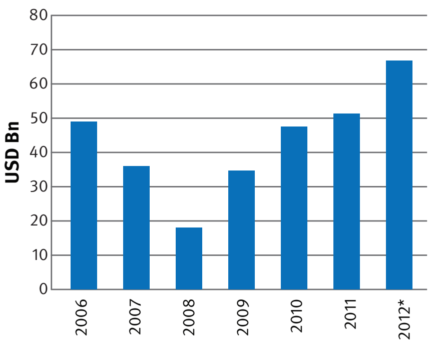
IN CONTRAST TO THE OPPORTUNITY PRESENTED BY THE HOUSING SHORTAGE, THE REAL ESTATE SECTOR HAS WITNESSED BOTTLENECKS TO SERVICE THIS UNMET DEMAND. WHILE THERE ARE VARIED REASONS FOR THIS SITUATION, LACK OF SUSTAINED FINANCING OPTIONS REMAINS THE MOST CRITICAL ONE

All of these factors have contributed to the shortage of fresh supply of houses and are also responsible for high property prices. At the same time, real estate is amongst the largest mainstream asset classes for investment. However, high value of the property prohibits an individual investor from participating in this asset class. The participation of most number of individuals is barely in terms of one house property for self- consumption. It is a quandary for a commoner who has to put off his house purchase decision and at the same time is left out from participation in one of the largest main stream asset class.

Capital Raised by REITs in the US Market



*Until November

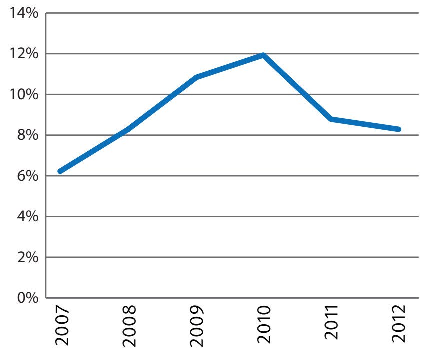
Source: SNL Financial, NAREIT

Hence, a sustained effort is required to address the twin challenges in context of the Indian real estate market. One that can address the housing shortage and another that can enable an individual to participate in real estate investment. A Real Estate Investment Trust (REIT) has the potential to emerge as an answer to these twin challenges facing the Indian real estate market. A REIT is a company that directly owns income producing real estate assets and provides a trading mechanism to the investors. In most of the cases it is commercial projects like office buildings, retail malls and hotels and in some cases housing complexes. On one hand an institutional market of REITs can ensure steady supply of capital to real estate development which shall aid in increasing the supply of houses and on the other it shall serve as an investment vehicle for individuals. The depth of the REIT investment vehicle in developed markets can be assessed from the amount of capital raised over the years. For instance, in the US market, REITs have raised USD 66.8 billion in 2012 (until November) alone and the momentum of fund raising through this investment vehicle has steadily increased since the global financial crisis of 2008.

While the benefit of sustained financing to housing does not need an elaboration, the investment argument in a REIT needs to be highlighted. Investment in REITs has several advantages to the investor.

Hedge against inflation: The country has witnessed a high inflation environment. The CPI inflation consistently increased between 2007 and 2012 reaching a peak of 12%. While it has come down in the last two years, at over 8% in 2012 it still remains above the comfort level of the central bank and continues to threaten household savings. In comparison the long term government of India bond yields approx. 8.09% clearly highlighting a near zero real rate of return. In contrast, over the long term hard assets like property appreciate in value in accordance to maintaining the purchasing power of the money. For instance, data for FTSE NAREIT (Represents all REIT's listed in NYSE, AMEX, and NASDAQ) indicates that the dividend growth rate has surpassed the consumer price index in 18 annual periods out of the 20 since 1992.

CPI Inflation



Source: GOI

Income stability: Real estate is a productive asset and investors in REIT earn on account of both dividend and wealth accumulation. Dividend accrues from the rentals of the property and wealth accumulation on account of capital appreciation of the underlying property. Consequently, REITs tend to generate a stable and consistent income stream for investors. In India, in case of commercial properties like office buildings and retail spaces the rental yield, hovers between 9-12% pa. and residential property averages around 2-3% pa. The data for FTSE NAREIT indicates that REITs have yielded an annual income component of 8.3% during 1972-2010, representing approximately 60 percent of the industry's average annual total return of approximately 13.75%. Such annuity income lends stability to the investment and provides an income stream which has a significant value for a class of investors like retirees.

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Enhanced Liquidity: The real estate sector lacks an efficient trading mechanism for purchase and sale of property. Hence, the asset is considered to be highly immovable and illiquid. However, REITs in the U.S. and many other parts of the world now make real estate investing easy and efficient, thanks to market liquidity. The units of companies that own portfolio of properties are bought and sold on major stock exchanges across the globe. This trading mechanism provides liquidity to this investment vehicle.

Corporate governance: The real estate sector is considered to be opaque and this information asymmetry pushes the investor on the fringes of the transaction. However, listed REITs are registered and regulated by the regulatory body and adhere to high standards of corporate governance, financial reporting and information disclosure. These factors result into increased transparency in this investment instrument.

Diversification: Diversification of investment portfolio helps to minimize risk. In case of a REIT the diversification benefits accrue on account of its low correlation with other asset classes. This has been the case with the US REIT market, which has witnessed a low correlation with other asset classes over a long term horizon. Hence, creating a portfolio with a combination of REIT along with other mainstream asset classes will lead to portfolio optimization.

High cost of property: Investing in real estate involves huge amount of capital. The high cost of residential and commercial property in the top urban centers like Delhi-NCR, Mumbai and Bangalore acts as a barrier for investors with small sums of investible surplus. While these cities present an extremely attractive real estate market, the high cost of real estate assets prohibit an individual investor from participating in this opportunity. Whereas, a REIT investment vehicle holds a portfolio of properties and allocates divisible units in smaller denominations making small investor participation possible.

Table 2 : REITs promoted by Indian real estate developers

Sr. no.	REIT	Promoter	Incorporation	Listing
1	Unitech Corporate Park PLC	Unitech Ltd	2006	London Stock Exchange
2	Indiabulls Properties Investment Trust	Indiabulls Real Estate	2008	Singapore Stock Exchange
3	Hirco Plc	Hiranandani Group	2006	London Stock Exchange
4	Ishaan Real Estate Plc	K Raheja Corp	2006	London Stock Exchange

Source: Company, Knight Frank Research

Monitoring cost: Property investment involves a monitoring cost in terms of time and money during different stages of investment. This cost arises at the time of purchase, regular maintenance and sale of property. Such commitment makes it difficult for the individual investor to participate in an investment opportunity, however promising, beyond his primary location of residence. A REIT structure efficiently addresses this concern by owning and managing the properties in its portfolio, thereby enabling an investor to participate in real estate investment opportunities irrespective of the geographical boundaries.

A REAL ESTATE INVESTMENT TRUST (REIT) STRUCTURE HAS THE POTENTIAL TO EMERGE AS AN ANSWER TO THE TWIN CHALLENGES FACING THE INDIAN REAL ESTATE MARKET

While the REIT structure of investing in real estate has immense benefits for the investors, it still lags in terms of implementation in India. Securities market regulator Securities & Exchange Board of India (SEBI) had issued draft REIT Regulations in 2008. However, things have not moved since that time. There are several reasons for the same. The foremost being that the confusion with another set of guidelines for Real Estate Mutual Funds (REMF) in 2008, which has also not translated in to product offerings yet. This confusion arises from the fact that both would regulate a similar product. Besides, lack of transparency and uncertainty involved in the conduct of real estate business has delayed the establishment of the REIT investment structure. The irony is indicated by the World Bank report which ranks India at 182 out of 185 countries in the ‘dealing with construction permits’ category. In May 2012 SEBI introduced SEBI (Alternative Investment Funds) Regulations which shall regulate Real Estate Funds. However, these will essentially be non-REIT investment vehicles eg. private equity funds in real estate where the minimum investor contribution is much higher at Rs.10 million. As a result even as of 2012, REIT guidelines are on the back burner.

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Table 3 : City and segment presence of the REITs promoted by Indian real estate developers

Sr. no.	REIT	Property Type	Cities
1	Unitech Corporate Park PLC	Commercial	Delhi-NCR, Kolkata
2	Indiabulls Properties Investment Trust	Commercial & Residential	Mumbai
3	Hirco Plc	Commercial & Residential	Mumbai, Chennai
4	Ishaan Real Estate Plc	Commercial & Residential	Mumbai, Pune, Bangalore, Hyderabad

Source: Company, Knight Frank Research

In the absence of REIT guidelines in the country, some real estate developers have already listed their REIT's overseas. These investment vehicles invest in FDI compliant properties in India and hold both commercial and residential properties mainly at the development stage. The properties within these schemes are located in top urban centers like Delhi-NCR, Mumbai, Bangalore, Chennai, Kolkata, Hyderabad and Pune. However, these vehicles were floated before the global financial crisis and the investors are yet to see meaningful returns from these.

Going forward we expect stakeholders to take cognizance of the opportunities offered by the REIT structure of direct investment in real estate. As a result, the REIT mode of investing in real estate should emerge as the most preferred way of participating in the promising real estate asset class. As the preconditions of transparency and certainty in the conduct of real estate business will be addressed by the real estate regulation bill, the ground will be ready to set the ball rolling.

GOING FORWARD WE EXPECT STAKEHOLDERS TO TAKE COGNIZANCE OF THE OPPORTUNITIES OFFERED BY THE REIT STRUCTURE OF DIRECT INVESTMENT IN REAL ESTATE

ON ONE HAND AN INSTITUTIONAL MARKET OF REITS CAN ENSURE STEADY SUPPLY OF CAPITAL TO REAL ESTATE DEVELOPMENT WHICH SHALL AID IN INCREASING THE SUPPLY OF HOUSES AND ON THE OTHER IT SHALL SERVE AS AN INVESTMENT VEHICLE FOR INDIVIDUALS

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