The Mindspace REITs IPO that opens on July 27 and closes on July 29, will only be the second REITs IPO after Embassy. If you are wondering whether or not to invest in the Mindspace REITs IPO in the light of the COVID crisis, these FAQs are just for you.

1. Can you give me the basic details of the Mindspace REITs IPO?

The total offer size of the Mindspace REIT IPO is Rs4,500cr. Out of this Rs1,000cr will be by way of fresh issue while the balance Rs3,500cr will be by way of Offer-for-sale (OFS). The REIT is sponsored by K Raheja Corporation (KRC) which will have a 65% holding in the REIT post the IPO. Blackstone will hold another 10% of the post IPO capital.

The IPO process will commence with the anchor issue placement on 24 July. The actual Mindspace REITs IPO will open for subscription on July 27, 2020 and will be open for 3 days till July 29, 2020. The expected date of listing of the REITs IPO is August 12.

The price bank fixed by the company for the REITs IPO is Rs274-Rs275 and the valuation of the REITs post the IPO will be in the range of Rs16,300cr to Rs16,500cr. As is the case with all REITs, the minimum investment will be Rs50,000 by an investor.

2. Is it true that COVID-19 could be a risk to the future of commercial real estate?

There have been some cases of companies cutting down on their real estate plans but that is more of a normal and routine restructure of capital allocation. It is hard to envisage work-from-home (WFH) replacing offices altogether. The last few months, people have been managing only because they did not have a choice. So, there could some very short term volatility in the realty market but the long term demand for commercial realty should be back sooner rather than later.

Let us see why Mindspace is specifically of interest. It has a completed portfolio of nearly 23 million SFT that is largely spread across Mumbai, Pune, Chennai and Hyderabad. These are cities with a strong start-up culture and a very strong tech / IT franchise. That explains why its 23 million SFT portfolio shows an occupancy rate of nearly 88%. While there is nothing like assured returns in REITs, it is projecting a distribution yield of 7.0% for FY21, 7.5% for FY22 and 8.0% for FY23. By FY22, the Mindspace REIT proposes to distribute 93% of its distributable surplus in the form of dividends.

In the light of the sharp growth in commercial realty demand in FY22 and FY23 as well as the high quality portfolio mix, the risk of any COVID-19 disruption on the business model of the Mindspace REIT is very low.

3. The quality of any REIT is contingent on the quality of the property portfolio. Can you give me a quick idea about the property portfolio mix of the Mindspace REIT?

The property portfolio of the Mindspace REITs is spread across the high growth centres of Mumbai, Pune, Hyderabad and Chennai. Here is quick peek at the property portfolio of the Mindspace REIT.

- Mumbai region has a total leasable area of 12.1 million square feet with a market valuation of Rs9,202cr and FY20 revenue of Rs660cr. Mumbai accounts for 38.9% of the all-India property portfolio mix of the Mindspace REIT.

- Hyderabad region has a total leasable area of 11.6 million square feet with a market valuation of Rs9,057cr and FY20 revenue of Rs624cr. Hyderabad accounts for 38.3% of the all-India property portfolio mix of the Mindspace REIT.

- Pune is relatively smaller with total leasable area of 5.0 million s quare feet with a market valuation of Rs4,268cr and FY20 revenue of Rs482cr. Pune accounts for 18.0% of the all-India property portfolio mix of the Mindspace REIT.

- Chennai is the smallest with a total leasable area of just 0.8 million square feet with a market valuation of Rs595cr. Chennai accounts for just 2.5% of the all-India property portfolio mix of the Mindspace REIT.

Out of the total 29.5 million SFT of leasable property, 23.1 million SFT is already completed. The occupancy which is currently 88% is expected to go up to 92%.

4. Can you give me a profile of the major clients that have signed up for property leases with Mindspace REITs? Is it diversified enough?

There are two ways to look at the client mix. The first way is to look at the sectoral distribution of clients and the second way is to look at the actual pedigree of specific clients. Let us look at the sectoral mix of the clients of Mindspace REITs.

- The share of technology / IT companies has fallen from 54% to 44% reducing the concentration risk. Financial services account for 22% of the clients while telecom and media account for 10.3%. Among the other major sectors; engineering accounts for 7.4% while pharma and healthcare account for 6.5%. Let us also look at the individual client mix to understand concentration risk, if any.
- The client profile is certainly at the top end with nearly 85% of its rentals being attributable to MNCs and half of that attributable to Fortune-500 companies. Pedigree is hardly the question. The concentration risk is minimal as the property portfolio of Mindspace REITs is spread across 172 clients with no single client accounting for more than 7.7% of the total rentals. That makes the portfolio largely de-risked. The weighted average lease expiry is around 5.8 years so the revenue assurance is more of a medium to long term nature. The tenant list reads like who's who and includes Accenture, Qualcomm, Barclays, Schlumberger, JP Morgan, Amazon, UBS; to name a few.

For an investor in Mindspace IPO, the risk of sectoral concentration or client concentration is almost minimal, and well managed.

5. What are the likely growth drivers for the Mindspace REITs in the years ahead?

The REIT has projected the operating income of the REIT to growth at CAGR of 17% between 2020 and 2023. Some of the key drivers are as under.

- Contract price escalations are the key growth driver with the average escalation being in the range of 12-15% after every 3-4 years. That can sustain growth in the future.

- Nearly 6.5 million SFT of its total portfolio of 29.5 million SFT is under construction and development. By 2023, all of this property is likely to be available for leasing.

- With an existing utilization of 88% of space, the company expects large lessees to pick up contiguous spaces and that could give a boost to occupancy ratio and profits.

- Market rentals in most properties are 15-25% higher than the in-place rentals. These properties are likely to be re-leased at the market rentals, giving a major trigger.

In addition to these intrinsic factors, it is expected that the pick-up GDP growth and the Make in India program should attract a flurry of global players into India. All these are likely to revenue accretive for the REIT.

6. Would you suggest I invest in the Mindspace IPO?

Mindspace has certain advantages in terms of its work in progress, the quality of its clients, the potential rent escalations and the diversified nature of its portfolio. For investors, this surely provides a safe and paper approach to buying into real estate.

However, before investing in the Mindspace IPO, you need to consider two factors. Firstly, check that it fits into your overall financial plan. Secondly, these are long term assets so you must remain invested for at least 5-6 years to get the full dividends of the REIT. This is not for the short haul.

However, it is still advisable for you to talk to your financial advisor and consult with them before investing in the Mindspace REITS IPO.

Now if you want to know more about REITs, its legal and tax aspects, continue reading the following detailed FAQs on the finer points of REITs investing

1. **What exactly is a REIT (Real Estate Investment Trust) and how is a REITS typically structured?**

REITs were permitted by SEBI in 2014 but the actual launch of REITs in the market was delayed due to legal uncertainties. However, the first REIT (Embassy REIT) was only launched in the middle of 2019 with Mindspace REIT being the second REIT.

A REIT or Real Estate Investment Trust must be seen in the same way as a mutual fund. The only difference is that the mutual fund holds a portfolio of equity, bonds and cash while the REIT holds a portfolio of commercial real estate. Currently, Indian regulations do not permit REITs on residential property.

The 3 key components of a REIT are the Sponsor, Investment manager and Trustee. This is largely similar to the structure that the mutual funds in India also follow. In the case of REIT, the sponsor is responsible for setting up the REIT and also transferring interest and right in real estate assets in the SPV to the REIT. The Investment Manager is like a fund manager and makes asset decisions pertaining to buying and selling. While the onus is on the investment manager to generate decent returns on the REIT, they have an additional responsibility of title verification. Here is why!

Unlike equities and bonds, where titles are straightforward, the titles and link documents can be a lot more complicated in the case of REITs. The investment also has to ensure that assets have legally enforceable titles and even the contracts are enforceable. This becomes more pronounced as each state has its own method of title documentation and digitization of land records is still a pipe dream. Finally, the Trustee acts like the conscience keeper for the REITS. Like in the case of mutual funds,

the trustee ensures that the interests of the unit holders of REITs are protected at all times and that the investment managers are acting in the larger interest of the REIT and its unit holders.

The minimum investment permitted in a REIT is Rs50,000/-.

2. **What are the legal and statutory rules that the REIT has to conform to?**

There are a number of detailed regulations that REITs need to comply with. However, the highlights of these REIT regulations with respect to protecting the interests of the unit holders can be summarized as under:

- The REIT is only permitted for commercial property, which could be factory land or office building. REITs are not permitted currently on residential properties.
- At least 80% of the corpus of the REIT fund must be mandatorily invested only in completed projects, which are already income generating properties. The balance 20% can be invested in semi-finished projects at the discretion of the investment manager.
- The total debt of the REIT cannot exceed 49% of the value of the assets. There is an additional first level check because a majority of the unit holders of the REIT have to approve if debt crosses 25% of asset value itself.
- At least 90% of the distributable cash flows of the REIT have to be mandatorily distributed to the unit holders on a semi-annual basis. The distributable cash flows include rental payments received, any interest received and capital gains on sale of properties.
- To protect the interest of unit holders, the REITs regulations have strict checks and balances on related party transactions. For example, sponsors are not allowed to vote on some related party transactions. Disposal of more than 10% of the assets of the REIT requires majority unit holder approval.
- There are also conditions pertaining to asset valuation in REIT. Buy/Sell price of any property cannot deviate more than 10% either ways from the average of 2 independent valuations. Independent valuation is required if related party transactions are more than 20% of the REIT value.

- Finally, SEBI also insists that half of the directors on the board of the REIT must be independent directors. The REIT manager can be removed with approval of 60% of unrelated shareholders.

All these are intended to essentially protect the interests of unit holders.

3. Can you explain the tax implications of investing in REITs?

Tax implications for the investor in REITs will differ based on whether the income is in the form of dividend, interest or in the form of capital gains on sale. Here is how the tax computations will be done.

- Interest income from the REITs will be taxed at the peak rate of marginal tax applicable. For example, if the individual is in the highest 42.7% tax bracket, then the interest on REITs will also be taxed at that peak rate. Resident investors will be subject to 10% withholding tax which will be deducted by the REITs and credit can be claimed while filing the tax returns.

- Dividend income is technically tax-free in the hands of the investor as it is a pass-through payment by the REIT. However, dividends have been made fully taxable in the 2019 Union Budget. Now the tax treatment will depend on whether the REIT follows the old tax regime or the new tax regime. In the case of REIT following the old tax regime, the dividend on REITs will be full tax-free. Otherwise, it will be taxable.

- Capital gains arise when REITs units are sold. Firstly, the sale of REITs will attract securities transaction tax (STT) at the same rate as applicable to equity delivery sale. REITs will be treated as short term if held for less than 36 months, in which case the gains will be taxed at 15%. REIT units sold after 36 months will be classified as LTCG and taxed at 10%.

The benefit of indexation will not be available in the case of LTCG on REITs.

4. What are the major advantages of investing in REITs?

There are some distinct advantages of investing in REITs as an asset class.

Investing in REITs does not require as much capital as investing in property. The minimum investment of Rs.50,000 is a lot more reasonable.

- It allows you to get an indirect ownership of commercial real estate, which is out of reach for most retail and medium sized investors.

- Since the REIT is a portfolio of commercial property, the risk for the investor in REIT is lower than investing directly in property.

  REITs come under stringent SEBI regulation and that adds to the transparency and safety of investing in REITs compared to directly buying real estate.

- On the subject of transparency, the REIT discloses its entire property portfolio on a half-yearly basis so investors know perfectly well where their money is invested.
- For investors looking at regular flows, REITs can be useful as it is mandatory for REITs to distribute 90% of all distributable cash flows every six months as dividends.
- As per the SEBI mandate, REITs have to invest in at least two projects with the value of one asset comprising not more than 60% of the investment. This provides a more diversified portfolio and avoids concentration risk.
- Since 80% of the corpus has to be invested only in revenue generating projects, the unit holders do not have to worry about the end use of funds invested.
- For investors looking at diversifying into real estate as an investment, REITs can be a very good option as they combine liquidity, transparency and diversification.

5. Who provides liquidity on REITs and can I look for assured returns on REITs?

Let us address the liquidity issue first. REITs are typically listed on the stock exchange via an IPO. Embassy Group was the first to come out with a REITs IPO in mid-2019 followed by Mindspace REIT which is planning its IPO that is slated to open on 27 July 2020 and close on 29 July 2020. The REITs will typically get listed after a period of 15 days and from that point they are freely tradable based on the value of the underlying assets of the REIT. These REITs units can be held in your regular demat account and can be freely bought and sold in the secondary market.

There are no assured returns on REITs, just as there are no assured returns on asset classes like equity or even mutual funds. REIT is a risk asset and hence returns cannot be guaranteed. However, it is expected to deliver returns more than debt in the long run.

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