NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

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REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

October 31, 2013

VIA E-MAIL

Securities and Exchange Board of India
Plot No.C4-A, "G" Block,
Bandra Kurla Complex, Bandra (East),
Mumbai 4000 51
India

Attn: Ms. Nila Salil Khonalkar, Assistant General Manager (nila@sebi.gov.in)
Mr. Naveen Gupta, Assistant Manager (naveeng@sebi.gov.in)

Re: Draft SEBI (Real Estate Investment Trusts) Regulations, 2013

Dear Ms. Khonalkar and Mr. Gupta:

The National Association of Real Estate Investment Trusts (NAREIT)® greatly appreciates the opportunity to provide its comments regarding the Draft SEBI (Real Estate Investment Trusts) Regulations, 2013 consultation paper (the Paper) concerning the potential authorization of an Indian real estate investment trust (REIT) that would provide a new vehicle for investing in property intended to benefit both investors and the real estate industry. NAREIT is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

NAREIT applauds India for its willingness to consider the introduction of an Indian REIT structure. NAREIT believes that adopting a single tax structure that resembles the current United States REIT vehicle would capitalize on over 50 years of experience with, and the evolution of, REITs in the United States, and should promote a number of the Indian government's objectives. About 30 countries have adopted the essential characteristics of the U.S. REIT model, and this global consistency has contributed to the development of a global REIT market with an equity market capitalization of over $900 billion as of September 30, 2013.

Given the increasing global recognition of the acronym "REIT," we are pleased that India proposes to adopt this term and hope it will maximize investor awareness of this new structure.

NAREIT believes that the success of REITs in the United States is largely attributable to the appropriate flexibility of their governing rules, which

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generally rely on market forces rather than government-issued regulations to determine various important matters such as debt levels, self-management versus external management and whether to develop or purchase properties. Accordingly, and as further set forth below, we generally believe that it would be preferable for SEBI not to impose certain specific regulatory requirements as suggested in the Paper, and, instead, to let market forces guide the development of the Indian REIT industry.

EXECUTIVE SUMMARY

NAREIT is pleased that India is proposing the creation of a REIT[1] regime. The Paper states that the proposed regime would contain the following features: i) at least 25 percent of the I-REIT's units, with a minimum initial offer size of Rs. 250 crore would need to be listed on a designated stock exchange; ii) in order to effect an initial offering, the I-REIT would have to own assets worth at least Rs. 1000 crore; iii) the I-REIT would be required to invest solely in securities and properties in India, at least 90 percent or more of the value of the I-REIT's assets would be required to be invested in completed and rent generating properties in India, and up to 10 percent of the value of the I-REIT's assets would be required to be invested in the following assets: developmental properties provided that they are held for and rented for at least three years after completion, company debt, mortgage backed securities, certain listed real estate companies, government securities and money market instruments or cash equivalents; iv) at least 75 percent of the I-REIT's revenues would need to be from rental real estate activities; v) the I-REIT would be required to distribute at least 90 percent of net distributable income after tax of the I-REIT as a dividend to the unit holders; vi) the I-REIT's aggregate borrowings could never exceed 50 percent of the value of the REIT's assets; and, vii) the I-REIT would need to be externally managed.

As further set forth below, NAREIT recommends that India consider making the following changes and/or clarifications with respect to its adoption of the REIT structure: 1) clarify that an I-REIT's income would be taxed solely at the shareholder level, either through allowing a deduction for dividends paid (DPD) or through a tax exemption; 2) allow I-REITs to be either externally or self-advised; 3) clarify the I-REIT's income and asset requirements, by: a) clarifying the definition of real estate assets generally; b) allowing greater development for the I-REIT's own account; c) allowing for investment in tiered special purpose entities; d) allowing investment in properties outside of India; e) expanding the extent to which I-REITs can invest in mortgages secured by real property; and, f) clarifying that qualifying income will include income from real estate-related services; 4) allow formation of non-listed I-REITs; 5) clarify that I-REITs must distribute a specific majority of their income, calculated pursuant to tax, not accounting, principles and that I-REITs may distribute and deduct capital gains; 6) allow the market to set the amount of debt that an I- REIT may carry, but if there are statutory debt limits, they should be based on interest coverage rather than debt to equity ratios; 7) clarify that I-REITs may pay a monetary penalty in lieu of loss of I-REIT status for inadvertent failure to comply with the REIT rules; and, 8) clarify that, to the extent that an entry tax or levy is imposed on a company for converting to or becoming an I- REIT, such tax or levy should be modest, and/or the rules could parallel the U.S. REIT rules mandating the distribution of pre-REIT earnings coupled with taxation of any pre-REIT asset appreciation within ten years of a REIT's election.

[1] This letter will refer to an Indian REIT as an "I-REIT."

DISCUSSION

Background: REITs Benefited Investors and the Economy

By way of background, the U.S. Congress created REITs in 1960 to enable investors from all walks of life to own professionally managed, income-producing real estate through companies modeled after mutual funds. REITs combine the capital of many shareholders to invest in a diversified portfolio of income-producing real estate, such as apartments, hotels, shopping centers, offices, timberlands, storage facilities, data centers, communications towers, warehouses and health care assets such as senior housing. Not only are U.S. REITs required to distribute at least 90 percent of their taxable income to their shareholders, they also must satisfy a host of other operational requirements, including ensuring that most of their income and assets are derived from real estate sources. In exchange for doing so, U.S. law grants REITs a DPD, just as it does for mutual funds. To the extent that a U.S. REIT retains taxable income, it is subject to an entity-level tax on such retained income. In 2012, publicly traded U.S. REITs distributed more than $29 billion to their shareholders.

Congress' vision has been realized: as of September 30, 2013, nearly 200 publicly traded REITs had a total equity market capitalization of approximately $660 billion. Throughout the U.S., real estate owned by REITs generates millions of dollars in property taxes on top of the individual income taxes currently generated by REIT dividends paid to state residents. Investors have benefited from owning REITs: the 15-year compound annual return for the period ending September 30, 2013 of the S&P 500 stock index was 5.33 percent, while that of all equity (property-owning) REITs was 10.29 percent. The economy benefits from REITs as well – because REITs are not pass-through entities, they cannot pass through losses to investors (unlike partnerships), and their focus must be on creating value for shareholders. Furthermore, unlike other real estate owners that use high levels of debt, average debt levels for public equity REITs are around 40 percent, leading to less volatility in the real estate market and fewer bankruptcies and workouts. Additionally, academics have noted the positive impact REITs have due to the transparency of information about commercial real estate that becomes available to investors, financial institutions, regulators and private real estate investors.[2] Simply put, REITs are the most practical method for investors to add commercial real estate in their investment portfolios to obtain the asset diversification recommended by most financial advisors.

I. Clarify that an I-REIT's Income Will Be Taxed at Shareholder Level Only

The anticipated tax treatment of I-REITs is not clear from the Paper. In order to obtain the greatest benefit for I-REIT investors and the Indian economy, NAREIT recommends that an I-REIT's income be taxed solely at the shareholder level, either by means of exempting income from taxation or by allowing a DPD.

Nearly every one of the over 30 countries that has implemented a REIT regime has followed the U.S. REIT model in an effort to gain the benefit of adopting some form of REIT structure, and the

[2] Frank Packer, Timothy Riddiough and Jimmy Shek, *Securitization and the Supply Cycle: Evidence from the REIT Market*, 39 J. PORTFOLIO MANAGEMENT 134, 135 (2013).

majority of these countries allow for a single level of tax, whether through a DPD or tax exemption at the entity level.[3] For example, all income of a French SIIC is tax-exempt if it meets a 90 percent rental test.

II. Allow for I-REITs To Be Either Externally-Advised or Self-Advised

The Paper would require I-REITs to be externally advised. NAREIT recommends that India modify the law in order to permit I-REITs the option to be either externally or internally advised (also called "self-advised). Doing so would provide investors with the maximum REIT investment choices. NAREIT does not take a position as to whether either alternative is the preferred structure. Instead, NAREIT suggests that both types of companies be allowed so that investors can make their own decision. As noted below, the listed U.S. REIT industry has moved to more of a self-advised model over the past 30 years.

A self-advised REIT has its own employees who devote all of their time to the REIT just like the employees of any other U.S. publicly traded company. An externally-advised REIT typically hires a separate business entity, which can be an investment manager, bank or insurance company or an affiliate of these entities, to supervise the ongoing entity-level operations of the REIT in exchange for an advisory fee. Such advisory services include, for example, making decisions or recommendations to buy or sell a property, declare dividends, raise capital, or hire on-site mangers or other employees, in all cases subject to the oversight of the company's board of directors or trustees. An externally-advised REIT can have employees as well, but it subcontracts with an outside entity for supervisory services.[4]

Some observers believe that there is a greater potential for conflicts of interest for an externally-advised REIT than for a self-advised REIT, especially when the REIT employees own the external advisor.[5] In the last few decades, some externally-managed REITs have addressed these potential conflicts of interest by various mechanisms, *e.g.*, requiring the REIT employees or

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[3] For a survey of the various REIT regimes worldwide, *see EPRA Global REIT Survey 2013*, available here: http://www.epra.com/regulation-and-reporting/taxation/reit-survey/.

[4] As a side issue to whether the I-REIT is externally-advised or self-advised, an **externally-managed** REIT is not only typically **externally advised,** but also typically uses outside entities (called "independent contractors") to provide on-site services to tenants at its properties. In contrast, a **self-managed** REIT provides these services through its own employees. (This definition applies to "equity REITs," which are REITs that own real estate (rather than "mortgage REITs," REITs that own mortgages.). In the U.S., Congress has permitted REITs to be self-managed since 1986, and today nearly all listed U.S. REITs are self-managed. NAREIT's recommendation is that SEBI permit I-REITs the option to be either **externally-advised** or **self-advised**.

[5] *See, e.g.*, Susanne Cannon and Stephen Vogt, *REITs and Their Management: An Analysis of Organizational Structure, Performance and Management Compensation*, 10 JOURNAL OF REAL ESTATE RESEARCH 297 (1995). *See also Corporate Governance of Externally Managed REITs Presents Credit Risks* (Moody's, November 2007) available at https://www.moodys.com/sites/products/AboutMoodysRatingsAttachments/2007000000456227.pdf (discussing corporate governance and credit risks and factors to mitigate those risks for externally managed REITs). *Cf. Real Estate Investment Trusts: The US Experience and Lessons for the UK* (Investment Property Forum, May; 2009) at page 21, available at: http://www.cornerstoneadvisers.com/_pdf/REITsTheUSExperienceandLessonsfortheUK.pdf (noting that "[t]oday a US REIT can choose whether to be internally or externally managed, and almost all have chosen the internal option.").

sponsor to invest their own capital in the REIT and by linking the compensation of the outside advisor to performance-based criteria, rather than to assets owned by the REIT.

Although there is no legal requirement that a U.S. REIT be self-advised, the capital markets tend to prefer that listed U.S. REITs be self-advised. Accordingly, about 90 percent of the publicly traded U.S. REITs that are NAREIT members (and an even higher number of listed equity U.S. REITs) are self-advised. This number represents approximately 97 percent of listed U.S. REITs by market capitalization. Most non-traded U.S. REITs appear to be externally advised.

Self-advised REITs do not need outside advisers, thereby obviating potential conflict of interest issues arising from external management structures. Therefore, we do not believe that there need be any distinct regulatory supervision or rules for listed, self-advised REITs that are above and beyond those applicable to listed public companies generally. Furthermore, we believe that the market perception of inherent conflicts of interest between REITs and their related parties, independent of any specific disclosure requirements, could lead more I-REITs to become self-advised over time.

III. I-REIT's Income and Asset Requirements

A. <u>Clarify Asset Tests</u>

1. *Definition of Property and Completed Property*

The Paper indicates that an I-REIT would not be able to invest in vacant land, and only 10 percent of the value of its assets may consist of developmental properties, debt of companies, mortgage backed securities, equity securities of listed real estate companies, government securities and money market instruments or cash equivalents. Further, at least 90 percent of the value of the I-REIT's assets must be in completed and rent generating real estate properties.

The Paper would define "real estate" or "property" as "land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, carparks, etc. and any other assets incidental to the ownership of real estate and does not include mortgage and Transferable Development Rights" (which is not defined).

"Completed property" means property for which an occupancy certificate has been received, and "Developmental property" means a property which is under construction and for which an occupancy certificate has not been received.

NAREIT agrees with SEBI in defining real estate assets relatively broadly. However, NAREIT respectfully requests that SEBI clarify that permanently attached improvements to land, which appear to be defined as "property," are in fact "completed property" notwithstanding the absence of an occupancy certificate. For example, a parking lot or structure adjacent to a shopping mall or office building; tennis courts or a swimming pool in an apartment complex; roads in a suburban office park, air rights over property; a "total energy system;" warehouses and communication towers, all of which have long considered "real estate" in the U.S., may generate "rents from real property" for U.S. REIT purposes even though space is being rented or used for "things", rather than for people. [6]

In addition, NAREIT respectfully requests that the definition of "property" for an I-REIT also include other types of interests in real property. Quarterly, at least 75 percent of a U.S. REIT's assets must consist of "real estate assets," Government securities, cash and cash items. The term "real estate assets" is defined broadly to include interests in real property (fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon and options to acquire leaseholds of land or improvements thereon), as well as interests in mortgage notes secured by real property, shares of other U.S. REITs and any property that is attributable to the temporary investment of new capital. In addition, U.S. REITs may invest in U.S. properties or non-U.S. properties, and the two are treated equally under the U.S. REIT rules. Last, U.S. tax law "looks through" all of the tiers of a REIT's ownership of fiscally transparent entities (like partnerships) to determine the assets (real estate or otherwise) owned by the REIT for purposes of the foregoing 75 percent asset test). On the other hand, U.S. REITs cannot own more than 10 percent of the securities of any corporate entity other than another REIT, a taxable REIT subsidiary, or a "qualified REIT subsidiary" (a wholly owned subsidiary which is completely disregarded for U.S. tax purposes, and the income and assets of which are viewed as owned by the REIT).

The foregoing broad definition of "real estate assets" allows for a great amount of flexibility, not just for the newly formed REIT as it looks for investment opportunities, but also for the existing REIT as it considers other types of real estate related investment opportunities. Flexibility has been important to U.S. REITs because it has allowed them to own new types of properties as market conditions change. For example, as of December 31, 1999, health care REITs comprised only 3 percent of the total U.S. REIT market while as of September 30, 2013, health care REITs comprised about 12 percent of the total U.S. REIT market (based on market capitalization).

The broad definition of "real estate assets" also has allowed U.S. REITs to invest in all types of loans and notes secured by real property. For example, in recent years, some U.S. REITs have enhanced their debt portfolios by providing short-term mezzanine financing to borrowers secured by the borrower's ownership interest in the tax transparent entity that owns the relevant real property. Mezzanine financing provides for a higher than average rate of return as well as fairly

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[6] *See, e.g.,* Treas. Reg. § 1.856-3(d) ("real property" includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term "real property" includes interests in real property); Rev. Rul. 71-286, 1971-2 C.B. 263 (air rights over real property are "real estate assets"); Rev. Rul.73-425, 1973-2 C.B. 222 (mortgage interest covering a "total energy system," which is a self-contained facility for the production of all the electricity, steam or hot water and refrigeration needs of associated property, including electric generators powered by turbines or reciprocating engines, waste heat boilers, heat exchangers, gas-fired boilers, cooling units, fuel storage tanks, control and sensor equipment, electrical substations and air handling equipment for heat, hot water and ventilation, and the building which it serves will qualify as a "real estate asset"); and Rev. Rul. 75-424, 1975-2 C.B. 269 (a building, the heating and air conditioning system, microwave transmitting and receiving towers and the chain link fencing are "real estate assets"). NAREIT respectfully requests that India clarify that these types of assets would be similarly qualifying REIT assets under the proposed I-REIT regime.

expedited default procedures in the event of default. A loan secured by a partnership or limited liability interest is treated as a "real estate asset" if most of the partnership or limited liability company's assets consists of real property with a valuation equal to or in excess of the amount of the loan, and a number of related conditions are satisfied. Mezzanine financing can serve as the basis for a lender to acquire the property secured by the financing in case the borrower gets into financial difficulty.

2. *Allow Greater Development for REIT's Own Account*

The Paper would severely limit the extent to which an I-REIT could develop properties for its own account to no more than 10 percent of the REIT's assets, and then only if the completed property is held for and leased for at least three years after completion. NAREIT recommends that I-REITs be permitted to develop for their own account so long as the property is not held primarily for sale in the ordinary course of the REIT's business, and that a safe harbor be provided for rental property held for at least two years.

U.S. REITs may develop property for their own account that, once developed, they hold for investment. In the U.S. context, the relevant inquiry is whether the property is held as investment (for the long term) or as inventory as a dealer (for the short term). This rule provides the flexibility for those REITs that have property development expertise to benefit their shareholders by undertaking development for their own account, thereby achieving cost efficiency and savings. This rule also helps spur development by REITs with particular development and redevelopment expertise.

Gains attributable to the sale of "dealer property" are taxed to a U.S. REIT at a 100 percent tax rate. On the other hand, gains from the sale of property held for investment are qualifying real estate income. Thus, the REIT faces strong discouragement, but not loss of REIT status, from directly developing property for third parties. The determination of whether property is "dealer property" is based on the facts and circumstances of the situation, but a safe harbor does apply. A U.S. REIT may develop properties for third parties through its fully taxable subsidiary (which may not be greater than 25 percent of the U.S. REIT's gross assets).

Specifically, no tax is imposed on a U.S. REIT's property sales if, among other requirements, the REIT has: 1) held the property for at least 2 years; 2) not spent more than 30 percent of the net selling price of the property over the last 2 years; and, 3) not made more than 7 sales of property within the taxable year (or the aggregate fair market value or adjusted bases of property sold during the taxable year does not exceed 10 percent of the fair market value or aggregate adjusted tax bases of all of the REIT's assets as of the beginning of the taxable year). Further, these objective tests are merely a "safe harbor," and so a REIT will not be assessed the 100 percent tax if it can demonstrate that it did not act as a dealer based on the surrounding facts and circumstances.

3. *Allow for Tiered Special Purpose Vehicles in Which REIT Can Own Less Than Majority Interest*

Although the Paper would allow I-REITs to invest in a single level of certain special purpose entities or vehicles (SPVs), their use would be quite circumscribed. For example, SPVs would not be permitted to invest in other SPVs. Further, an I-REIT would be required to own a controlling interest in each SPV and not less than 51 percent of the equity share capital of each SPV.

NAREIT believes that these limitations could prevent an I-REIT from entering into valuable joint venture agreements pursuant to which one investor might provide capital while the other investor provides management and operational expertise. They also could prevent other flexible types of property ownership arrangements that could help to maximize shareholder value, such as the use by a REIT of a fiscally transparent SPV as a holding entity for lower tier SPVs.

In fact, due to U.S. tax considerations, the majority of listed U.S. REITs own and operate all of their properties through a majority-owned "operating partnership" that typically, although not necessarily, owns majority interests in lower tier SPVs.[7] Although the U.S. law does not require that non-REIT owners of SPVs not be able to contravene the REIT rules, market forces essentially require U.S. REITs to insist upon compliance with the REIT rules by their SPVs through governing documents or other agreements. Almost all commercial real estate in the United States is owned through an SPV to limit the owner's liability. NAREIT strongly urges that India consider allowing its REITs to invest indirectly through levels of SPVs and allow the market to set the terms by which such I-REITs invest in lower-tier entities.

4. *Allow Investment Outside of India*

NAREIT recommends that India not be one of the very few countries to limit investment to primarily domestic real estate and instead allow its REITs to make investments throughout the world based on market demands.

B. Modify and Clarify Definition of Real Estate-Related Income

Additionally, the Paper provides that at least 75 percent of the "revenues of the REIT other than gains arising from disposal of properties would need to be derived from rental, leasing and letting

[7] Specifically, U.S. tax law generally provides that the transfer of appreciated property to a REIT in exchange for stock in the REIT is a taxable transfer. On the other hand, in general, the transfer of appreciated property to a partnership is not a taxable transfer. As a result, investors may transfer their appreciated properties in exchange for partnership units of a partnership (an "operating partnership" or "OP"). in which the REIT is the majority-owned general partner. After approximately one year, investors may exchange their OP units for REIT stock or cash (at the REIT's option) in a taxable transfer. The United States Internal Revenue Service has indicated that it is generally amenable to the UPREIT structure. See Example 4 of Treas. Reg. § 1.701-2 (the partnership anti-abuse regulations).

Many large private property owners typically own U.S. properties through partnerships or other fiscally transparent entities. In general, these owners can convert their property interests into REIT interests (often on a publicly traded basis) on a tax-free basis by transferring their partnership interests to a REIT's OP. Doing so allows these private property owners to benefit from diversifying into a publicly traded REIT's portfolio and to enjoy the increased liquidity that ownership of a publicly traded entity provides. Furthermore, because most new REITs are set up in the UPREIT structure, this facilitates future tax-free transfers of real property by investors to the OP. The majority of publicly traded equity REITs in the U. S. are organized in an UPREIT structure.

real estate assets at all times." The Paper does not define what constitutes revenues from rental, leasing and letting real estate assets.

1. *Expand Definition of Qualifying Income to Income from Mortgages Secured by Real Property*

NAREIT respectfully recommends that India consider modifying the definition of qualifying income to permit an I-REIT to invest in loans and notes secured by mortgages on real property, again as another type of real-estate related investment that can improve shareholder return and that can improve local real estate markets.

2. *Clarify Definition of Qualifying Income to Include Real Estate-Related Services*

Further, NAREIT respectfully recommends that India consider including all real estate-related services in the definition of rental, leasing and letting real estate. To do otherwise would be to limit implicitly the types of key services that an I-REIT landlord/lessor might provide, thereby limiting its ability to satisfy tenants' demands for both basic and "cutting-edge" services both now and in the future. The provision of these services enable REITs to satisfy their tenants' demands for services, which REITs need to be competitive with non-REIT owners of real property, and therefore enable REITs to provide consistent, long-term income distributions to their shareholders, coupled with stable amounts of capital appreciation.

By way of background, prior to 1986 the U.S. tax law's definition of "rents from real property" essentially precluded REIT employees from operating or managing the REIT's real estate. Instead, independent contractors had to provide these services. These prior rules were very constraining, and severely impeded the utility and desirability of REITs in the United States. In 1986, a legislative change allowed REIT employees to provide customary services at the REIT's properties. As discussed previously, after 1986 most listed REITs became self-managed, and the REIT industry grew exponentially.

Following the legislative change in 1986, REITs began to provide the following (non-exclusive) services as part of their rental of real property: furnishing electricity (including sub-metering of electricity), water, heat, light, air conditioning and other basic utilities, elevator services and telephone answering services; performing general property maintenance and related services such as routine engineering and janitorial services and general cleaning services (including cleaning of windows, public entrances, exits and lobbies as well as the cleaning of a tenant's interior space); establishing rental terms, selecting tenants, entering into, negotiating and renewing leases and arranging for payment of taxes with respect to the property; maintaining exercise rooms, leasing space for vending machines (provided by independent third parties); providing parking facilities; and, providing telecommunications services (by negotiating cable lease and easement agreements with internet service providers, broadcasters, long distance operators and other service providers that provide telephone and other communications, cable, e-mail, video communications, electronic research, internet access, networking, safety and security systems and environmental control systems and similar types of systems and services, or in some cases by setting up cable service at a property). *See also* Exhibit A for a more detailed, but non-exclusive, list of services provided by U.S. REITs.

The constraints of the U.S. REIT rules (as well as public market participants, in the case of publicly traded U.S. REITs), rather than different tax rates on qualifying and nonqualifying income, keep U.S. REITs focused on their core business of owning real estate. In this way, the shareholder of a U.S. REIT is taxed comparably (on dividends, for the most part at up to the highest marginal tax rate on ordinary income) to the direct real estate investor (on ordinary income, up to the highest marginal tax rate applicable on ordinary income).

IV. Permit Non-Listed REITs

The Paper contemplates requiring I-REITs to be listed companies. NAREIT suggests that India consider allowing non-listed I-REITs to allow both for the "incubator" REIT, the business plan of which includes a potential public listing, as well as for the REIT that is an investment vehicle owned by a wider variety of sophisticated investors.

As you may know, U.S. REITs do not need to be listed on an exchange, although many are. In the U.S., some REITs have been formed as unlisted "incubator REITs," essentially to develop a track record prior to an eventual public listing. When initially formed, these companies may not own sufficient properties of sufficient size to warrant a public listing. Alternatively, they may begin as private companies to enable their management to develop a track record. However, as these companies increase their portfolios and their expertise, listing may become appropriate, and their prior existence as a REIT may be seen as a benefit by the new public shareholders. Even these non-listed U.S. REITs must satisfy a "five or fewer" individuals rule and be owned by at least 100 shareholders, so they remain consistent with the U.S. Congress' vision of making REITs widely held.

We also point to the success in the U.S. model of the investment in non-listed REITs by pension plans, foundations, public charities and other institutional investors that are attracted to the corporate governance benefits of a corporate structure as contrasted with a partnership under which a general partner has more discretion.

Finally, there are dozens of U.S. REITs that, while not listed on a stock exchange, have sufficient numbers of shareholders that they are required to satisfy the same securities filing requirements as listed companies. Several of these companies have become listed over the years, several more have been acquired by listed REITs, others have been acquired by private equity firms, and still others have sold their assets and liquidated after a long-term investment period. These "non-traded, SEC-registered REITs" have raised billions of dollars in investments over the years from "accredited" U.S. investors, and their counterparts in India would be denied this type of access to commercial real estate under the Paper. *See* Exhibit B for a list of formerly non-listed U.S. REITs that are now listed on the NYSE or NASDAQ.

NAREIT suggests that SEBI consider allowing non-listed I-REITs to allow both for the "incubator" REIT, the business plan of which includes a potential public listing, as well as for the

REIT that is an investment vehicle owned by a wide variety of sophisticated investors. We note in particular that Japan, among other countries with a REIT or REIT-like regime, permits non-listed entities to qualify as REITs.

We recognize SEBI's objective of promoting maximum protection to investors, safeguarding the industry's reputation, and allowing enough flexibility for the I-REIT industry to provide maximum return for investors. We believe that the U.S. model, which allows for non-listed companies to qualify as REITs while ensuring that they are widely held, also achieves these objectives. In the U.S., sales of interests in REITs are governed by both state and federal securities rules. As the REIT is generally larger both in size and in number of shareholders, greater oversight is required. For example, REITs with more than $10 million in assets whose securities are held by more than 2,000 (or 500 non-accredited) owners, whether listed or unlisted, must file annual and other periodic reports with the U.S. Securities and Exchange Commission. These reports provide important financial information to investors so that they make informed choices about their investments.

Furthermore, U.S. tax law requires a REIT's shares (whether listed or unlisted) to be transferable, thereby affording investors with liquidity should they desire to exit their investments. Moreover, U.S. tax law requires that REITs be overseen by trustees or by a board of directors with a fiduciary duty to shareholders; this provides additional protection for investors. Finally, by allowing REITs to be private non-listed entities, U.S. law balances these investor protections with the flexibility to provide maximum return for investors – even if that return is with respect to a company that is not publicly listed.

V. Distribution Rules

A. Confirm That I-REITs Should Calculate their Distribution Requirement Using Tax, Rather Than Accounting, Principles

The Paper states that "[n]ot less than 90 percent of net distributable income after tax of the REIT shall be distributed as dividend to the unit holders." We assume that the calculation of this figure would be based on taxable income, rather than financial statement income. However, for the sake of clarity, NAREIT recommends that the rules make clear that the distribution requirement be calculated based on taxable income based on realized transaction rather than income based on accounting profits, so as to avoid a distribution requirement in respect of "phantom gains."

B. Confirm That I-REITs May Distribute Capital Gains

The Paper would not appear to allow for distribution of capital gains by an I-REIT. Clarification that capital gains may be distributed would be helpful. NAREIT strongly believes a rule that would limit the distribution of capital gains could handcuff I-REITs by discouraging them from selling properties and recycling capital at the most opportune time based on market conditions. NAREIT recommends that, like U.S. REITs, I-REITs be permitted to distribute gains from sales of property. To the extent there is concern about excessive sales, these could be limited as they are in the U.S. by imposing a 100 percent tax on gains from sales of property held primarily for sale in the ordinary course of the REIT's trade or business.

In addition to NAREIT's suggestion above that I-REITs be permitted to distribute their capital gains, NAREIT suggests that India follow the U.S. model and tax distributed capital gains solely at the shareholder level. The U.K. REIT regime is similar in ultimate result. Furthermore, in order to avoid double taxation, the U.S. regime permits a U.S. REIT to retain and pay tax on capital gains (without having to reinvest the sales proceeds) while providing its shareholders with a credit for tax paid (similar to a "franked" system of corporate taxation).

VI. Allow Market Forces to Determine Appropriate Debt Levels

The Paper proposes that an I-REIT be entitled to borrow up to 50 percent of the value of its real estate property.

Again, the U.S. experience may be instructive in this context. U.S. law does not provide a limit on the amount of debt that a REIT may incur. NAREIT believes that market forces are the best determinants of the appropriate level of gearing.

The public market (*e.g*., analysts and investors) in the U.S. has encouraged listed REITs to incur a lower level of debt compared with commercial real estate held privately. These market forces, rather than specific legislative requirements, have created this situation. As a result, as of September 30, 2013, the average debt to market capitalization for listed U.S. equity REITs (property-owning REITs, as opposed to REITs that own mortgages or a combination of mortgages and property) was 33.8 percent, their coverage ratio of EBITDA divided by interest expense was 3.3 and their fixed charge rate of EBITDA divided by interest expense plus preferred dividends was 3.0.

Additionally, the market may consider different debt amounts appropriate for different property sectors. Rating agencies also provide an outside force to limit gearing. For example, as of September 30, 2013, 46 U.S. equity REITs, or 62 percent of the industry by market capitalization, had investment grade ratings. For these companies to increase borrowing, they must be prepared to address credit agency concerns and expectations. Furthermore, as the capital markets have become more comfortable with publicly traded REITs and their use of debt, the level of leverage borne by REITs has fluctuated, sometimes increasing as market conditions warranted.

The lower debt levels associated with REITs compared to privately-owned real estate investment in the U.S. overall have had a positive effect throughout the economy. Average debt levels for U.S. REITs are 30-40 percent of market capitalization, compared to leverage of 60 percent and often higher that is used when real estate is privately owned. The higher equity capital cushions REITs from the negative effects of fluctuations in the real estate market that have traditionally occurred. The ability of REITs better to withstand market downturns have had a stabilizing effect on the real estate industry and its lenders, resulting in fewer future bankruptcies and work-outs. Consequently, the general U.S. economy has benefited from reduced real estate losses by federally insured financial institutions, and thus benefited from reduced system risk in the U.S. financial sector.

NAREIT recommends that legislation provide the flexibility to meet different market challenges and not limit the level of gearing for an I-REIT. If SEBI believes that there must be some limitation on gearing, then NAREIT suggests that gearing be limited based on reference to a REIT's interest coverage ratio (earnings before interest and taxes for a one year, divided by interest expenses for the same year). This is the type of limitation provided for in the U.K. REIT regime. Specifically, the U.K. provides that the interest coverage ratio not be permitted to fall below 1.25, but, to the extent the ratio does fall below 1.25, a tax liability will attach to the amount that causes the ratio to fall below the 1.25 limit. Further, NAREIT recommends that an I-REIT should have the ability to petition the Indian government for an exception to any leverage limits to account for unforeseen market conditions.

VII. Implications of Non-Compliance with Regulatory Requirements

The Paper proposes that "[an I-] REIT or parties to the [I-]REIT or any other person involved in the activity of the REIT who contravenes any of the provisions of the Act or these regulations or notifications, guidelines, circulars, instructions, etc. issued thereunder by the [SEBI] shall be liable for one or more actions specified therein including any action provided under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008." It appears that this provision would apply even in the case of inadvertent violations of the proposed rules. NAREIT is concerned that such draconian liability would be severely detrimental to the formation of I-REITs and growth of the I-REIT market.

In fact, prior to 2004, U.S. tax rules could disqualify a REIT that inadvertently failed to satisfy one or more of the applicable rules. However, in 2004, the U.S. Congress enacted provisions that no longer take an "all-or-nothing" approach to REIT qualification, but, instead, impose lesser, intermediate monetary penalties on REITs for inadvertent failures to satisfy the REIT requirements. [8] NAREIT urges India to adopt similar provisions whereby the monetary penalty is spelled out clearly and is in proportion to the nature and scale of the unintended infraction.

VIII. Tax Transition Rules

The Paper does not address whether an entry tax/levy may be considered in connection with conversion to an I-REIT. It is not clear from the Paper what is intended in this respect. NAREIT suggests that any conversion fee be relatively modest in order to encourage the development of the I-REIT market. Alternatively, a low fee could be coupled with a minimum holding period, as in the case of the French REIT regime, to reduce the potential for abuse of a REIT regime.

A few factors in the U.S. tax laws operate to encourage the formation of REITs by deferring (and possibly eliminating) any entry "toll charge" that could apply to the conversion of an ordinary corporation (a "C corporation") to a REIT. Ordinarily, a C corporation that converts to a REIT is

[8] *See* Sections 856(c)(6) (penalties for failing REIT income tests); 856(c)(7) (penalties for failing REIT asset tests) and 856(g)(5) (penalties for failing remaining REIT tests) of the Internal Revenue Code of 1986, as amended.

required to pay an entity-level tax on the appreciation inherent in its assets (a "built-in gains tax"). But a special provision (I.R.C. § 1374) allows such a C corporation to choose to defer that tax on conversion and instead pay tax on any built in appreciation solely to the extent that its former "C corporation assets" are sold in the 10 years following its REIT conversion. Following the close of this 10-year period, the REIT may sell the assets without paying a REIT-level tax.

Finally, it should be noted that the U.S. does have a form of a REIT entry tax that cannot be avoided. An ordinary corporation that converts to U.S. REIT status must distribute its pre-REIT current and accumulated "earnings and profits" to shareholders by the end of its first year as a REIT. Essentially, this distribution forces the converting corporation to distribute a taxable dividend to its shareholders, thus ensuring that income earned by the corporation (and presumably previously taxed at the corporate level) is currently taxed at the shareholder level as part of the conversion process.

NAREIT suggests that any conversion fee be relatively modest in order to encourage the development of the Indian REIT market. Alternatively, a low fee could be coupled with a minimum holding period, as in the case of the French REIT regime, to reduce the potential for abuse of the REIT structure, or the I-REIT regime could adopt the combination of distribution of pre-REIT earnings and built-in gain rules to mirror the U.S. REIT regime.

Thank you for the opportunity to submit these comments. Please contact me at tedwards@nareit.com or Dara Bernstein, NAREIT's Senior Tax Counsel, at dbernstein@nareit.com if you would like to discuss the comments in greater detail.

Respectfully submitted,

Tony M Edwards

Tony M. Edwards
Executive Vice President & General Counsel

Exhibit A: Partial List of Permissible U.S. REIT Services

PHYSICAL PROPERTY OPERATIONS

- Furnish electricity (including sub-metering of electricity), water, heat, light and air conditioning, elevator services, telephone answering services, incidental storage space, laundry equipment, parking facilities and swimming pool facilities, all if such services are customarily provided to tenants in that geographic market.

- Perform general property maintenance and related services such as routine engineering and janitorial services, general cleaning services (including cleaning of windows, public entrances, exits and lobbies as well as the cleaning of a tenant's interior space), trash collection, snow removal, pest control, landscaping services and fire protection, life/safety system and sprinkler system maintenance.

- Perform regular property inspections.

- Provide routine security guard services if necessary to maintain safety.

ADMINISTRATIVE & OPERATIONAL ACTIVITIES

- Establish rental terms, select tenants, enter into, negotiate and renew leases, arrange for payment of taxes with respect to the property.

- Routinely communicate with the occupants of the property concerning the delivery of services and other management matters.

- Design, implement, or approve and administer a tenant retention program.

- Enforce tenant compliance with lease terms.

- Pursue legal action against any tenants that are delinquent in payment, or in violation of the lease terms.

- Prepare, approve, or execute marketing plans for attracting potential tenants to the property.

- Provide personnel to staff a shopping mall's information center and furnish courtesy wheelchairs and strollers.

- Recruit, train and supervise on-site personnel, off-site management staff, or sub-contracted management firms.

- Select vendors and decide which items or services for the property are to be purchased, determine the quantity and quality of purchases and negotiate or approve contracts for services.

- Supervise employees or direct contractors who perform routine maintenance and repair work, and confirm the vendors' compliance with purchasing and insurance criteria.

- Design and implement and schedule preventive maintenance programs for the property.

- Obtain and maintain property licenses and permits.

- Design, implement, or approve a life-safety and emergency preparedness program for the property.

- Establish or monitor and enforce the property's operating policies and procedures.

- Establish, approve, or monitor adherence to the record-keeping system.

- Establish management and internal controls and monitor property performance.

- Identify the property's insurable risks and choose and monitor coverages.

- Undertake or oversee a physical and financial risk management program.

- Analyze market conditions and approve rental rates, and other lease terms for the property.

- Identify and analyze alternate uses of the property, and implement a plan to change the property's use or approve such a plan.

- Monitor property value and assess the implications that estimates of value have; determine the reasonableness of assessed value and insurable value.

- Prepare annual budgets, including capital expenditure and reserve/impound budgets, or review and authorize such budgets prepared by others.

- Identify, analyze and implement, or approve, major capital expenditure programs, including, but not limited to, maintenance or remodeling projects and major tenant improvements.

- Participate in legal proceedings regarding the property, including undertaking or overseeing valuation appeals with respect to assessed property valuation.

- Monitor and administer the property's compliance with government and environmental regulations and consult legal or other counsel when appropriate.

- Develop, review and or approve business plans for each property.

- Identify properties for acquisition or disposition.

- Provide other types of ancillary amenities and services such as: nine-hole walk on golf courses, boat docks, exercise rooms, whirlpool spas, libraries, car wash areas, automatic cash machines, playgrounds, picnic areas, boat docks; organize tenant social events; lease conference rooms, maintain exercise rooms, lease space for vending machines (provided by independent third parties); and, provide telecommunications services (by negotiating cable lease and easement agreements with internet service providers, broadcasters, long distance operators and other service providers that provide telephone and other communications, cable, e-mail, video communications, electronic research, internet access, networking, safety and security systems and environmental control systems and similar types of systems and services or in some cases setting up cable service at a property).

- Provide “courtesy” services like facsimile and copy machine services, vacuum cleaners, the holding of mail, etc.

CONSTRUCTION AND DEVELOPMENT ACTIVITIES

- Plan, design, supervise and administer the development of properties and the construction and rehabilitation work and remodeling of interior tenant space, perform pricing estimates and cost analysis, negotiate and contract for engineering and feasibility studies, arrange for zoning and building permits, employ and supervise architects and contractors, assist in the layout and design of tenant space, approve and process invoices and disburse funds, order building materials and supplies and inspect and approve plans and work performed for aesthetic factors, effect on property value and compliance with laws and regulation.

- Work with engineers, consultants, contractors and governmental agencies to prevent, detect and remedy environmental contamination.

Exhibit B: List of U.S. Formerly Non-Listed REITs Now Listed on NYSE or NASDAQ

Name	Trading Symbol	As of October 30, 2013 (in $USD millions)
American Realty Capital Properties, Inc.	ARCP	2,457.2
American Residential Properties, Inc.	ARPI	566.4
AmREIT, Inc.	AMRE	348.0
Brixmor Property Group Inc.	BRX	4,559.2
Chambers Street Properties	CSG	2,216.0
Cole Real Estate Investments, Inc.	COLE	6,697.4
Columbia Property Trust, Inc.	CXP	3,022.2
Digital Realty Trust, Inc.	DLR	6,315.3
Franklin Street Properties Corporation	FSP	1,333.5
Healthcare Trust of America, Inc.	HTA	2,743.4
Inland Real Estate Corporation	IRC	1,069.1
Piedmont Office Realty Trust, Inc.	PDM	3,073.1
Prologis, Inc.	PLD	19,964.1
Retail Properties of America, Inc.	RPAI	3,354.9
RLJ Lodging Trust	RLJ	3,097.8
Spirit Realty Capital, Inc.	SRC	3,842.7
Strategic Hotels & Resorts, Inc.	BEE	1,800.4
W. P. Carey Inc.	WPC	4,571.7
Total		71,032.5