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Valuation of REITs in India: Framework, Challenges & Opportunities

A **Real Estate Investment Trust (REIT)** is a company that owns or oversees income-producing properties such as office buildings, shopping malls and residential complexes. Think of it as the real estate equivalent of a mutual fund. Instead of buying a property yourself you can invest in a REIT and in return you will receive a share of the income earned from these properties usually in the form of dividends.

In India many investors are emotionally inclined towards owning physical real estate. Nevertheless, REITs offer more flexible option. They allow you to invest in real estate without the hassle of buying, maintaining or renting out a property. It's a smarter way to invest in the real estate market without dealing with the usual complications. For many, it has become an attractive choice offering regular income with far less effort.



REITs typically invest in a diverse portfolio of income-generating assets such as residential buildings, cell towers, data centers, hotels, hospitals, offices, retail spaces and warehouses. These buildings are located in desirable, prime areas and are frequently leased to reputable tenants which guarantee a steady and predictable flow of revenue. The consistency of this cash flow plays a crucial role in assessing the value and appeal of a REIT.

CLASSIFICATION OF REITS

REITs are generally categorized into three types, based on how they operate:

1. Equity REITs

Equity REITs hold ownership of real estate assets such as offices, malls and residential complexes. They are actively involved in their management as well. Their main source of income is the rent collected from tenants which is then distributed to investors as a form of dividends. Equity REITs usually focus on long-term ownership rather than buying and selling properties for profit.

2. Mortgage REITs

Mortgage REITs don't own physical properties. Instead, they finance real estate by lending money to developers or investing in mortgage-backed securities. Their income is generated from interest on these loans, which is then passed on to investors.

3. Hybrid REITs

Hybrid REITs blend the features of both equity and mortgage REITs. They invest in physical assets and provide financing, allowing them to earn both rental income and interest.

VALUING REITS

Valuing REITs involves assessing both their operational performance and the value of the underlying properties. Common methods include **Net Asset Value (NAV)**, **Discounted Cash Flow (DCF)** analysis and the **Dividend Discount Model (DDM)**.

The two major valuation approaches used are **Relative Valuation** and **Absolute Valuation**.

1. Relative Valuation

Relative Valuation involves comparing a REIT's value with that of similar companies using metrics like Enterprise Value/Revenue, EV/EBITDA and Price-to-Earnings (P/E) ratios. This approach helps highlight differences across peer groups.

- **Yield Comparison Method:** This compares a REIT's yield to that of other REITs or income-generating assets offering a view on whether the current share price aligns with the income it provides.

- **Net Asset Valuation (NAV):** NAV reflects the market value of a REIT's assets minus its liabilities serving as a proxy for its book value. It values the real estate portion of the balance sheet based on the cash flows generated and the expected market returns. By doing so NAV allows for a more accurate, property-level comparison across REITs, something corporate-level metrics often miss.

2. Absolute Valuation

Absolute Valuation focuses on estimating the intrinsic value of a REIT, though it can be highly subjective since it depends on projected cash flows. It focuses on maintaining a margin of safety and is commonly applied to determine price targets.

Its key metrics include **Price per Square Foot/Unit, Replacement Cost, Implied Cap Rate** and **Discounted Cash Flow**.

Among these, Implied Cap Rate is a significant metric. It represents the cap rate that would make a REIT's NAV equal to its stock price. It's calculated by dividing the expected 12-month Net Operating Income (NOI) by the REIT's adjusted enterprise value, providing a clear picture of whether a REIT is over- or under- valued compared to the actual worth of its portfolio.

REITs IN INDIA

REITs entered the Indian market in 2019 with Embassy REIT's IPO, setting the stage for the launch of Mindspace REIT and Brookfield REIT in 2020. Since then, Indian REITs have continued to handle debt in a prudent manner. **The Net Debt to Gross Asset Value (GAV) ratio was 28% as of December 31, 2024** indicating sound financial management.

Since their inception, Indian REITs have seen their Gross Asset Value (GAV) triple, growing at an impressive **CAGR of 36%**. Their market influence has been substantial with total distributions crossing ₹14,300 crore since 2019; an amount that even exceeds the combined dividends paid by all real estate firms in the Nifty Realty Index as of September 2023.

Indian office REITs have outperformed the property sector and the broader market substantially in 2025 due to improved fundamentals and a return to 8-10% distribution per unit growth.

FACTORS DRIVING THE GROWTH OF REITS IN INDIA

There are numerous factors that are driving the growth of REITs in India:

1. Urban Expansion and Rising Demand for Commercial Real Estate

India's ongoing urbanization along with the growth of startups and multinational operations has led to increased demand for commercial office and retail spaces.

This structural demand has directly contributed to the expansion and stability of REITs portfolios.

2. Supportive Regulatory Environment

The **Securities and Exchange Board of India (SEBI)** has taken notable steps to make REITs more accessible and transparent. A key development was the reduction of the minimum investment amount from **INR 50,000 to INR 15,000** which enabled greater participation from retail investors.

3. Consistent Rental Income

A key appeal of REITs is their capacity to deliver consistent rental income. These returns are often derived from long-term leases with corporate tenants offering investors predictable income with comparatively lower volatility.

4. Increased Foreign Participation

Relaxation of Foreign Direct Investment (FDI) norms in the real estate sector has encouraged global institutions to invest in Indian real estate through REITs. This has enhanced both liquidity and credibility in the market.

5. Effective Hedge Against Inflation

Real estate is often viewed as a reliable shield against inflation. As costs rise rental income and asset values typically move in tandem helping REIT investors maintain real returns over time.

CHALLENGES FACING

1. Limited Investor Awareness

Despite growing traction, many retail investors are still unfamiliar with the structure, benefits and performance of REITs. This knowledge gap continues to restrict broader participation.

2. Sectoral Concentration

The Indian REIT market is presently concentrated in the office segment. Other potential sectors such as retail, warehousing and healthcare remain largely untapped, limiting diversification.

3. Sensitivity to Interest Rates

REITs, like other yield-oriented instruments, tend to be sensitive to changes in interest rates. In a rising interest rate market, the relative attractiveness of REITs may decline when compared to other fixed-income options.

4. Liquidity Constraints in Secondary Markets

While REITs listed in major cities enjoy better trading volumes, units listed in smaller or less active markets may face liquidity issues affecting exit options for investors.

5. Taxation on Distributions

Dividends paid by REITs are subject to taxation in the hands of investors. This tax liability depending on the investor's income bracket can reduce the net returns particularly for those in higher tax slabs.

CONCLUSION

REITs have emerged as a compelling investment avenue, blending the advantages of real estate ownership with the ease and accessibility of stock market participation. With stable income generation, professional management and regulatory support REITs in India are becoming an increasingly attractive option for both retail and institutional investors. As the sector matures and diversifies beyond office spaces, REITs offer a smart, efficient and hassle-free way to benefit from the real estate market. For investors seeking consistent returns, portfolio diversification and a potential hedge against inflation, REITs present a good investment opportunity worth considering.

