Corpsec Hotline

June 27, 2006

MUTUAL FUNDS GET READY FOR THE 'REAL' ACTION

The Securities and Exchange Board of India ("**SEBI**") has , in a Board Meeting held in Mumbai on Monday, June 26, 2006, approved the guidelines for Real Estate Mutual Funds ("**REMFs**").

A press release to this effect has been issued by the SEBI (Press Release No. 166/2006), as per which the REMFs would be allowed to invest directly in real estate properties within India, in mortgage (housing lease) backed securities, equity shares/ bonds/ debentures of listed and unlisted companies which deal in properties and also undertake property development, as well as in other securities.

*This essentially means that unlike the real estate Venture Capital Funds ("**VCFs**"), the REMFs would be allowed to own properties directly, thereby making the structure more tax efficient. Further, the REMFs may have more flexibility in structuring of investments as compared to real estate VCFs.*

The REMFs shall be governed by the provisions and guidelines under SEBI (Mutual Funds) Regulations, 1996 ("**Regulations**") which are to be amended soon. Accordingly, REMFs would be required to appoint a custodian, who has been granted a certificate of registration to carry on the business of custodian of securities by the SEBI, for the safe keeping of the title of real estate properties held by the REMFs. The units of the REMFs shall be compulsorily listed on the stock exchanges to provide liquidity to the investors and the net asset value will have to be declared daily. The structure of the REMFs, initially, shall be close ended. The final set of guidelines governing the REMFs are awaited and are expected to be notified soon.

The Association of Mutual Funds in India Sub-Committee on Real Estate Funds ("**Committee**") had earlier recommended that the REMFs should be close ended for a minimum of 3 years, offering redemption/ repurchase at the end of this period in a staggered manner. Further, the Committee recommended that the schemes may be open at the end of every quarter for sale of fresh units and remain open for a minimum period of 15 days, and should be eligible for all tax benefits as other mutual funds.

Internationally, the Real Estate Investment Trusts ("**REITs**"), are structured as open ended vehicles. However, in India, the SEBI has moved in line with the recommendations of the Committee to initially allow only close ended schemes, so that it can not only test the waters but also provide for building up of liquidity for the asset class. Once adequate liquidity is achieved, open ended schemes may be allowed. It would also be important to see the valuation guidelines that may be laid down by SEBI in this regard and compare the same to the international practice followed by REITs.

Concerns over foreign investments

Time and again, the Reserve Bank of India ("**RBI**") has made it clear in its position that it would like to be cautious about the inflating 'asset-price bubble'. Accordingly, over the last several months the RBI has been raising concerns against opening the realty sector to investments from overseas investors, albeit, the same has not been reflected in SEBIs decision on Monday. However, it is still unclear as to whether (i) the imbroglio surrounding Foreign Venture Capital Investment in real estate, owing to concerns that allowing the same would be akin to Foreign Direct Investment ("**FDI**") without the necessary norms being followed (FDI up to 100% is allowed in real estate subject to compliance with specified criteria), would be resolved any time soon, and (ii) whether any foreign participation would be permitted in the REMFs, and if so, in what form.

- Anirudh Rastogi & Siddharth Shah
You can direct your queries or comments to the authors

Source:

- *SEBI Press Release 166/2006*
- *The Economic Times dated June 27, 2006*

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