Fractional ownership is for deep-pocketed investors

Most retail investors will be better off opting for a REIT

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Investors who have bet their money on residential real estate are a disappointed lot today. The rental yield of 2-3 per cent fails to combat inflation and capital appreciation has been poor over the past six-seven years. Meanwhile, large private-equity players have been acquiring the commercial real estate portfolios of Indian developers, a pointer to their bullishness on this asset class. If you, too, have wanted exposure to a grade A commercial property, you can do so now by investing through a fractional ownership platform.

How does it work?

The platform offering fractional ownership does the due diligence and selects a property. A special purpose vehicle (SPV) is created that owns it. Investors become shareholders in the SPV. Each investor is part owner of a specific property. Rental income is distributed annually. At the end of four-six years, the property is sold and the capital gain is distributed.

The platform charges an annual management fee of around 1 per cent. When the property is sold, it charges a performance fee. This could be around 10 per cent on the portion of the internal rate of return (IRR) that is in excess of a hurdle rate of, say, 8 per cent.

Access to grade A property

Through this vehicle, an investor can get access to a grade A office building, which has traditionally been the preserve of high-net-worth individuals. It also comes with the promise of high return. "You can expect a rental yield of 8-9 per cent. Along with capital appreciation, the IRR can be 15-18 per cent over the investment period," says Shiv Parekh, chief executive officer and founder, hBits, a real estate fractional ownership platform.

The property is built, so investors circumvent the risk of delay in approval or construction. "We vet the property and ensure that all the statutory clearances and the occupancy certificate are in place," says Riaz Maniyar, co-founder, Yieldasset Real Estate Tech. The building is leased, so investors don't bear vacancy risk at entry.

These platforms get the property title verified by lawyers. They also maintain an escrow account, and appoint a trustee who ensures that investors' funds are not misused.

FRACTIONAL OWNERSHIP VERSUS REIT

Criterion	Fractional ownership	REIT
Ownership	Investor gets part ownership of a single asset	Gets to buy units of a fund that holds multiple properties
Degree of choice	Investor gets to select the property he wishes to own	No choice; fund manager picks the properties
Likelihood of alpha generation	Higher	Lower
Concentration risk	Higher	Lower
Liquidity	Likely to be lower as investor holds unlisted shares in an SPV	Likely to be higher as units of REITs are listed

Beware of concentration risk

Here, investors take exposure to a single property, and not a diversified basket of properties, as happens in a real estate investment trust (REIT). "If the investor makes the wrong choice, his investment could underperform a REIT," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

The timing of exit can be an issue. "Not all the owners may want to sell at the same time," says Anuj Puri, chairman, Anarock Property Consultants.

If an existing tenant vacates and a new one is not found on time, the rental income could take a hit. The anticipated capital appreciation of 7-8 per cent annually may also not materialise. "If supply exceeds demand in that micro-market, capital appreciation could be lower than expected," says Dhawan. The platforms do try to ameliorate this risk by purchasing buildings in established commercial hubs with high demand and few vacant land parcels.

Who should go for it?

Investors who can shell out the minimum ₹25 lakh may take the fractional ownership route. It is suited for experienced investors who want a say in the choice of the property their money gets invested in.

Retail investors, who have less money to invest, say, ₹50-70,000, should opt for REITs. They will get exposure to a diversified basket of commercial assets, chosen by the fund manager, and usually spread across cities.

REIT, being a listed entity, is more tightly regulated. "It is a tested investment option across developed nations. In India, too, it has received a favourable response from investors since its launch," says Puri.

Since the units of REITs are listed, liquidity is likely to be better. In fractional ownership, investors hold unlisted shares that may not be easy to dispose of if they wish to exit prematurely. "Check whether you may have to sell at a high discount if you wish to exit prematurely," says Dhawan.

Finally, understand the taxation of the two vehicles. "If the investor has made the investment through a company, then the company will be liable to tax on rental income. When the investor receives dividend income, it will be taxable in his hands," says Suresh Surana, founder, RSM India. REITs enjoy more favourable tax treatment. "REITs are accorded pass-through status. The income distributed by the REIT is considered as rental income in the unit holder's hands and subject to tax as income from house property," says Surana.