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Get country, thematic exposure with global realty funds

Returns could be slightly lower, but also less volatile, as against international equity funds

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Three fund-of-funds (FoFs) are now available in India that invest in a parent fund, which in turn invests in real estate investment trusts (REITs): Kotak International REIT FoF, Mahindra Manulife Asia Pacific REITs FoF, and PGIM India Global Select Real Estate Securities FoF. Some of them also invest in real estate stocks.

Diversified exposure

These funds offer retail investors international diversification (protection in case of a downturn in India). While the Kotak and Mahindra Manulife funds are focused more on the Asia-Pacific region, the one from PGIM India is focused on developed markets, like the US, Japan, and Europe.

These funds invest in a variety of sub-themes. Says Ajit Menon, chief executive officer (CEO), PGIM India Mutual Fund: "Our fund offers exposure to various sub-themes like grade A commercial, self-storage, logistics, last-mile retail, senior living, cold storage, etc, that are either not available in India, or are not available at scale as investible securities, compared to global markets."

The ability to invest in many sub-themes allows these funds to manage risk better. "When the pandemic occurred, our fund manager moved out of REITs focused on hospitality, malls, etc, and entered those focused on medical real estate, data centres, warehousing, where activity was expected to be higher," says Ashutosh Bishnoi, managing director and CEO, Mahindra Manulife Mutual Fund.

Exposure to global real estate can help in an inflationary environment. "REITs' returns come from rental yields and most rental contracts are inflation hedged," adds Bishnoi.

Investors will also enjoy the benefit of currency depreciation. Over the long run, the rupee tends to depreciate 3-4 per cent annually against currencies like the US dollar.

These funds have lowered the entry barrier for investors who can now invest with just ₹5,000.

Expect some volatility

Real estate assets can be volatile because the returns come from utilisation of capacity, which can fluctuate. "As economies open up, some types of real estate may gain while others may not. Office REITs may benefit from the reopening but those focused on logistics and warehousing may be impacted as people order less online and resume consumption outdoors," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Investing in a globalised fund can also have a flip side. "Returns could get affected due to problems in the parts where these funds are invested," says Arnav Pandya, founder, Moneyeduschool. Diversification across themes and countries will reduce both these risks.

A sharp rise in the US 10-year bond yield could also affect these funds. Buying real estate would become costlier for REITs while their rents would reset upward with a lag.

Global realty fund or Indian REIT?

Retail investors should focus on building a diversified portfolio. Global funds offer a better opportunity to do so. Most Indian REITs are focused on office properties and retail malls.

Another question investors must address is whether to invest in a fund that focuses on the developed world or one that invests in the Asia-Pacific. "Over the long term, real estate in developing markets is likely to offer better returns," says Pandya. According to Dhawan, this decision should depend on the investor's existing exposure. "If you don't have much developed market exposure, go for a fund focused on those markets, and vice-versa," he says.

Build exposure gradually

Enter these funds with a 7-10-year horizon and build exposure gradually. They may constitute 10 per cent of your portfolio initially.

Finally, remember that you are taking exposure to real estate. "If you compare their returns with those offered by other international equity-oriented funds, you could be disappointed," says Pandya.

TAXATION OF INDIAN REITs VS GLOBAL REAL ESTATE MUTUAL FUNDS

Classification of long- and short-term capital gains

- REITs units will be classified as long-term capital assets if held for more than 36 months
- Global fund of funds are treated on par with debt funds; gains will qualify as long-term if units held for more than 36 months

Taxation of capital gains from REITs (listed, STT levied)

LONG TERM: (Sec 112A): Up to ₹1 lakh exempt in hands of unitholders; above ₹ 1 lakh taxed @10% + Surcharge, if applicable and 4% Higher Education Cess (HEC)

SHORT TERM: (Sec 111A): Taxed at 15% + surcharge, if applicable and 4% HEC.

Taxation of capital gains from global real estate mutual funds (FoFs)

LONG TERM: (Sec 112A): Taxed @ 20% + surcharge, if applicable and 4% HEC (with indexation)

SHORT TERM: (Sec 111A): Taxed at nvestor's slab rate

Source: RSM India