A man stands inside a holiday villa. (Photographer: Adeel Halim/Bloomberg)

The Risks Of Buying A Fiftieth Of An Office Or A Tenth Of A Vacation Home

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A tiny segment of India’s real estate market has been growing quietly during the pandemic. Lure of higher returns is drawing mostly rich investors to fractional ownership—buying a small part of an office property or a vacation home. But that comes with a higher risk.

Such projects operate in a regulatory vacuum since India has not framed rules yet. And there are no standardised processes to rely on even five years after they were introduced.

“Both at the entry and exit levels, multiple investors can create disputes regarding the division of usage of the property, expenses incurred on the property, etc.,” Prashant Thakur, director and head–research at Anarock Group. “For a vacation home, there may be an overlap of usage, while the division of the upkeep and maintenance expenses needs to be carefully arrived at. Individual defaults also tend to be higher in a challenged economy, and this affects all co-owners.”

Buying a small share in commercial and residential projects is an established concept in developed markets.But fractional ownership is at a nascent stage in India and, according to property consultant JLL India, transactions worth Rs 750 crore were recorded in the last five years. Nearly half of that came in the last year when the pandemic disrupted the market.

While companies engaged in fractional-ownership projects may be governed by the Companies Act, since there’s no regulatory framework, most such offerings may vary structurally in India, according to Avikshit Moral, partner, corporate commercial and real estate at Juris Corp. “The investment decisions should be based on the documents signed, and not advertisements. It’s important to ascertain the structure of the investment whether it is co-ownership, pure debt or something on the lines of equity.”

Thakur said the model follows the fundamental principle of finance—high risk, high returns. “It is still a risky bet and limited to high net-worth individuals,” he said. It will remain confined to niche investors and requires a lot of understanding of the product and the risk appetite has to be really high, he said.

The model appears similar to real estate investment trusts, but both are very different. In REITs, investors contribute to a pool that’s invested in several assets and the buyer doesn’t have the option to cherry-pick. In fractional ownership, multiple investors co-own a single, selected asset.

Fractional ownership projects are offered by companies called "proptech firms" in industry parlance. These firms usually invest in Grade-A leased commercial properties and offer a rental yield of 7-8%. The returns, however, are not guaranteed.

According to Moral, here's how it works:

- A proptech company will provide a platform for investors to plough money into immovable properties such as land and commercial complexes.
- An investor agrees to put in a certain amount and signs a preliminary agreement with the proptech company.
- The amount is generally deposited in an escrow account, and a custodian or a trustee is appointed.
- An escrow mechanism is designed to release funds to a special purpose vehicle that will own the asset.
- The SPV may be a private limited company, a limited liability partnership, a private trust or a partnership firm.
- All parties sign a contract that lays out the investment period, a process for the sale of the property, and the profit-sharing mechanism.
- Funds are released based on the pre-decided mechanism from the escrow account to the SPV's bank account; investors get equity shares in return.

Fractional ownership companies have created a new set of opportunities for retail investors, said Vishal Ahuja, India head, private wealth group, JLL India, in a statement. "Despite the Covid-19 impact, out of the total fractional ownership market, about Rs 350 crore worth of deals have been transacted or are in the final stage of conclusion in the last one year alone. These are a mix of office and warehousing deals."

According to JLL India, in recent months the acceptance of fractional ownership has jumped multifold. Investor confidence is on the rise, especially during the pandemic, it said.

Ahuja said investors interested in Grade 'A' premium properties, portfolio diversification, capital appreciation, higher liquidity and a superior return on investments are considering this structure.

"High net-worth individuals and family offices see merit in investing their money with a professional setup wherein they get access to some of the best properties with good tenant profile," he said. "This concept is gaining acceptance with investors willing to embrace the shared economy."

Some Differences In The Structure Of These Companies

Company	Lock In Period	Commission Charged	RERA Registration	Exit Route
hBits	No lock-in	Management fee of 1% per year on the amount invested; and 10% performance fee above 8% IRR	Yes	1. Resale market on hBits platform 2. Private sale 3. Property sale
Strata	Three to six-month lock-in	1. One time asset acquisition charge ranges 1-3% 2. Annual maintenance fee at 1% of total investment	Yes	1. Asset Sale 2. Private sale 3. Resale market 4. Dedicated resale window

Source: Companies

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Shiv Parekh, founder of hBits, a fractional ownership company operating since 2019, said the firm follows a stringent due-diligence process to ensure properties that have tenants with the strong financial background are listed. “All the properties with us have Grade-A tenants with long lock-ins and strong credit ratings. In case of contract default (which is extremely rare), hBits will recommend appropriate legal steps.”

Strata, another such firm, has raised assets worth Rs 240 crore across commercial properties. The company provides all necessary details regarding title, investment returns, market research, and scope for appreciation to investors, said Sudarshan Lodha, co-founder, Strata. “We facilitate investments by plugging the gap between real estate owners and retail investors.”

While fractional ownership firms don’t have to fulfil any SEBI requirements, Strata’s investments are compliant with Real Estate Regulation Act, the Companies Act and the transfer of property laws. Ownership, governance and compliance records are made accessible on the investor dashboard of the company that also provides details of compliances received from the government, he said.

One key concern is that no regulatory framework is applicable in case of a default. Varun Mohan, founder and chief executive officer at proptech firm Definite, said the platform will offer the best legal recourse available to owners to ensure they won't have to "run from pillar to post for their grievance".

Residential

A few startups offer fractional ownership in residential real estate, too. But the model may not be as lucrative as commercial property. Ahuja cited two reasons: leases for homes are for 11 months against an average of five years for commercial property. And the rental yield on the housing segment is 2%.

But like in any other real estate asset, caution is advised when selecting a property or even a platform for fractional ownership since the concept is new for India.

There’s no possibility of this model being regulated at least in near future, Thakur said. Citing the long time taken to bring real estate under RERA, he said fractional ownership is a very small segment right now to warrant such changes.