

Small and Medium Real Estate Investment Trusts

In recent years, numerous Fractional Ownership Platforms (FOPs) have emerged in the market which is offering public to invest in buildings and offices spaces including warehouses, shopping centres, conference centres, etc. The minimum investment on these FOPs ranges from INR 10 lakhs to INR 25 lakhs. FOPs provides investment opportunity primarily in pre-leased real estate, where investors can earn the rental yield as well as upside in value of such real estate which is distributed to the investors after deducting management / maintenance fees and other charges, costs and expenses. Such investments provides investors a steady stream of cash flows and long-term returns thereby reducing financial burden on a single investor.



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INTRODUCTION

In recent years, numerous Fractional Ownership Platforms (FOPs) have emerged in the market which is offering public to invest in buildings and offices spaces including warehouses, shopping centres, conference centres, etc. The minimum investment on these FOPs ranges from INR 10 lakhs to INR 25 lakhs. FOPs provides investment opportunity primarily in pre-leased real estate, where investors can earn the rental yield as well as upside in value of such real estate which is distributed to the investors after deducting management / maintenance fees and other charges, costs and expenses. Such investments provides investors a steady stream of cash flows and long-term returns thereby reducing financial burden on a single investor. For eg:- There is an office space at a prime location in Delhi worth INR 50 crores which is already pre-leased by an entity, ensuring a steady rental yield and potential upside in the long term.

However, a single investor with only INR 10 lakhs may not be able to invest in such property. FOPs provides such single investors to pool the amounts with other investor and jointly own such property. As a result, a single investors can invest in the INR 50 crore valued property with an investment of just as low as INR 10 lakh.

Typical structure of present FOPs are as follows:

- Identified Property is listed on the website of FOP seeking expression of interest from Investors with minimum token amount of as low as INR 10,000.
- Once 100% expression of interest is received, the placement memorandum to subscribe to securities to be issued by a SPV (Private Limited Company) which will purchase the identified property or which owns such property is shared with investors.
- Investors then transfers the amount to the SPVs escrow account and then securities are allowed to the Investors by the SPV.
- Rental income and / or income from sale of property in future earned by SPV is distributed to Investors as Dividend or any other permitted mode.

The underlying real estate assets offered on FOPs are similar to real estate / property defined under existing SEBI (Real Estate Investment Trusts) Regulations 2014 (SEBI REIT Regulations). However, SEBI REIT Regulations mandates Real Estate Investment Trusts (REITs) to have a minimum asset size of INR 500 crores and minimum initial issue size of INR 250 crores. This is one of the main reasons why there are a smaller number of investors in an REIT.

Considering the growth of FOPs and the surge of investors investing through FOPs, a need was felt to mandate registration and regulate these platforms by Securities and Exchange Board of India (SEBI). This would lead to the establishment of regulatory oversight on such structures enabling transparency and protection of interest of such investors. Thus, on May 12, 2023, SEBI issued a consultation paper for public comments on Regulatory Framework for Small & Medium REITs and proposed to bring such FOP structures under existing SEBI REIT Regulations.

Basis feedback received from stakeholders, SEBI amended the existing SEBI REIT Regulations through SEBI (Real Estate Investment Trusts) (Amendment) Regulations 2024 (SM REIT Regulations), establishing a regulatory framework for Small and Medium Real Estate Investment Trusts (SM REIT). The objective of this framework is to govern FOPs (present and future) and ensure adequate regulatory protections for retail investors participating in the real estate market.

This article provides an overview of the SM REIT Regulations notified by SEBI and the key highlights of the same are mentioned below:

KEY DEFINITIONS:

1. Small and Medium REIT (SM REIT)

“Small and Medium REIT” means a REIT that pools money from investors under one or more schemes whereby:

- Asset size proposed to be acquired is at least INR 50 crores and less than INR 500 crores; and
- Minimum number of unitholders of a scheme are not less than 200 (excluding Investment Manager, its related parties and associates of the SM REIT).

The above requirement is not applicable to existing structures migrating to SM REIT.

2. Investment Manager (IM)

“Investment Manager” means a company incorporated in India and which Sets up the SM REIT, manages assets and investments of SM REIT, and undertakes operational activities of SM REIT.

SM REIT Structure

• Investment Manager / Sponsor

The Investment Manager is responsible for setting-up the SM REIT. Application for registration with SEBI shall be filed by the Investment Manager. Under the SM REIT framework, there is no requirement to have separate entities as Investment Manager and Sponsor. The investment manager can act as a sponsor.

• Trustee

Trustee holds the assets of the SM REIT and its scheme in trust and for the benefit of the unit holders. Trustee shall be registered under the under SEBI (Debenture Trustees) Regulations, 1993. It should not be an associate of the IM.

• Small And Medium Real Estate Investment Trust

The SM REIT shall be established as a Trust and the Trust Deed shall be registered under the Registration Act 1908. The primary objective of this Trust shall be to undertake activity as a SM REIT through one or more schemes.

• Special Purpose Vehicle

The real estate assets of the SM REIT shall be held by Special Purpose Vehicles which shall be companies set up as wholly owned subsidiaries of the SM REIT. No other entity shall have ownership capital interest in the SPV.

Eligibility

The Investment Manager (IM) shall meet the following criteria for the purpose of SM REIT:

- It shall have a minimum net worth of INR 20 Crores out of which INR 10 crores shall be positive liquid net worth.
- It shall have minimum experience of 2 years in real estate industry or real estate fund management. If not, it may employ two Key Managerial Personnel, each having at least five years’ experience in real estate industry or real estate fund management.
- At least half of the Directors must be Independent and shall not hold directorships in the any manager or IM of another REIT or SM REIT.

Investment Conditions

The SM REIT shall adhere to the following conditions while making investment:

- The Scheme of SM REIT shall invest 95% of its assets in completed and revenue generating properties and the balance 5% may be invested in unencumbered liquid assets.
- In no case the scheme shall invest in under-construction or non-revenue generating real estate assets.
- The SM REIT scheme shall only lend to its SPVs. In turn, the SPV shall refrain from lending to any entity.

Fund raising by SM REIT

The scheme of the SM REIT can raise funds in the following ways:

• Issue of units

The scheme of an SM REIT may raise funds from investors (Indian or foreign) by issue of units. Issue of units to foreign investor shall be subject to Reserve Bank of India guidelines.

The units shall be issued only in dematerialized form and shall be compulsorily listed. The minimum subscription from an investor shall be INR 10,00,000 and the scheme shall have at least 25% of the total outstanding units held by public at all times.

Further, no person, other than the IM or its related parties and its associates, shall hold more than 25% units of a scheme of the SM REIT either individually or with persons acting in concert with him.

Considering the growth of FOPs and the surge of investors investing through FOPs, a need was felt to mandate registration and regulate these platforms by Securities and Exchange Board of India (SEBI). This would lead to the establishment of regulatory oversight on such structures enabling transparency and protection of interest of such investors.

• Utilizing Leverage

The scheme of an SM REIT may undertake leverage either by borrowings or issue of debt securities under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. The option to undertake leverage should be disclosed in the offer document.

The total borrowings and deferred payments, after accounting for cash and cash equivalents, should not exceed 49% of a scheme's asset value. However, if it exceeds 25%, the scheme must acquire a credit rating from a SEBI registered credit rating agency and obtain approval from its unit holders.

CONDITIONS FOR INITIAL OFFER

- The IM shall designate one or more merchant bankers to handle and execute the responsibilities associated with the issue process. The draft offer scheme shall be filed by the IM through the merchant banker.
- The assets, bank accounts, investment or demat accounts and the books of accounts of each scheme shall be segregated by the IM and trustee.
- The property documents evidencing the title to the real estate assets or properties shall be maintained in safe-deposit boxes, at a scheduled commercial bank and be annually inspected by the trustee.
- The value of real estate assets or properties in each scheme shall be at least INR 50 crores.
- The minimum price of each unit of the scheme of the SM REIT shall be INR 10,00,000.
- Adequate disclosures as required under these regulations shall be made in the offer document of the scheme.
- If the SM REIT does not make an initial offer of a scheme within 3 years from the date of registration, it shall surrender its certificate of registration to SEBI and cease to operate as an SM REIT.

LOCK IN AND MINIMUM INVESTMENT REQUIREMENTS

The lock-in and minimum investment requirements are applicable to the investment manager of the SM REIT schemes. The same is summarized below:

| Time period from initial listing | Minimum investment and lock-in requirements |
|--|---|
| Initial 3 years | <p>For the SM REIT which has not opted to undertake leverage, 5% of total outstanding units of the scheme shall be held by the IM.</p> <p>For the SM REIT which has opted to undertake leverage, 15% of total outstanding units of the scheme shall be held by the IM.</p> <p>Any excess holding of the IM over the minimum investment i.e. 5% or 15% respectively shall be held for at least 1 year from the date of listing of units.</p> |
| 4 th and 5 th year | 5% of total outstanding units of the scheme. |
| 6 th year onwards and upto 10 th year | 3% of total outstanding units of the scheme. |
| 11 th year onwards and upto 20 th year | 2% of total outstanding units of the scheme. |
| Post 20 th year | 1% of total outstanding units of the scheme. |

VALUATION OF ASSETS

- A full comprehensive valuation of the assets of each scheme of the SM REIT must be carried out by a valuer and which shall be submitted to IM as mentioned below:
 - ♦ Valuation Report shall be submitted Annually within 2 months from the end of the financial year.
 - ♦ In case of any material development having impact on the valuation of the assets of the Scheme, valuation report shall be submitted within 2 months from date of such event.
- The valuation is also required to be carried out before any issue of units to public or before purchase of any property.
- The investment manager shall submit the valuation reports to the trustee, designated stock exchanges and unit holders within one working day from the receipt of such valuation reports.
- The Valuer shall not be an associate of the IM or trustee of the SM REIT. Further, the signatory to the valuation reports shall have at least 5 years of experience in valuation of real estate, and possesses relevant qualifications, experience and track-record.



DISTRIBUTIONS

- **Distribution by the SPVs to the Scheme**
 - ◆ 95% of Net Distributable Cash Flows (NDCF) of the SPV shall be distributed to the scheme of SM REIT subject provisions of Companies Act, 2013.
 - ◆ The remaining amount shall be utilized as per the guidelines issued by SEBI.
- **Distribution by the Scheme to the Unit Holders**
 - ◆ 100% of NDCF of the Scheme shall be distributed to the unit holders of the SM REIT.
 - ◆ The distributions shall be declared on a quarterly basis not later than 15 working days from the end of the quarter.

- **Interest in case of delayed distribution**

In case of failure to make timely payment of the distributions to the investors, IM shall pay interest at the rate of 15% per annum to the unitholders and such excess interest amount shall not be recovered by the IM from the SM REIT.

MIGRATION OF EXISTING PERSONS, ENTITIES, OR STRUCTURES

- The framework also provides for registration of existing persons, entities or structures which are in the nature of an SM RIET i.e. FOPs.
- The timeline for applying for registration is 6 months from notification of this amendment.
- Once the registration is granted, the applicant shall complete the migration of existing persons, entities or structures within 6 months.

RELATED PARTY TRANSACTIONS

“Related Party” shall mean related parties under the Companies Act, 2013 or applicable Accounting Standards and the following:

- i. Parties to the REIT;
- ii. Promoters, Directors and partners of the persons in clause (i) above.

SM REITs are prohibited from entering into transactions with related parties including transactions relating to facility management and property management services.

However, this restriction does not extend to the payment of fees to the IM and trustee for carrying out activities of the REIT.

RIGHTS AND MEETINGS OF UNIT HOLDERS

- **Rights of the unitholders**

The unitholders of the scheme shall have right to receive distributions as provided in the offer document and to vote in any unitholder’s meeting.

- **Annual Meetings**

Annual meeting of the unitholders shall be held within 120 days from the financial year end (not more than 15 months shall elapse from the previous meeting) in which the following shall be approved by majority:

- i. Annual Accounts and Audit Report of the SM REIT and its schemes, and a report on performance of the scheme;
- ii. Appointment of auditor and the valuer and fixing their fees; and
- iii. Latest valuation reports.

- **Additional matters which require approval of majority unitholders i.e. votes cast in favor shall be more than votes cast against**

- ♦ Transaction where the value is equal to or greater than 10% of the value of the assets of a particular scheme;
- ♦ Borrowings in excess of 25% of the value of the scheme assets (where a scheme of SM REIT opts to utilize leverage);
- ♦ Any issue for which SEBI or the recognized stock exchanges require such approval to be taken;
- ♦ Any issue which is considered material by the Investment Manager or Trustee and which is in ordinary course of business.

- **Matters which require approval of unitholders where votes cast in favor is at least 1.5 times of votes cast against**

- ♦ Change in Investment Manager including its removal or change in control of the Investment Manager;
- ♦ Change in trustee;
- ♦ Material changes in investment strategy or change in fees payable to Investment Manager;
- ♦ Issue of units after initial offer by a scheme, in any form;
- ♦ Proposal to voluntary delist of units of a scheme by the trustee and investment manager;
- ♦ Any issue which is not in the ordinary course of business and which would require approval of the unitholders in the opinion of the investment manager or trustee;
- ♦ Any issue for which SEBI or the recognized stock exchanges require such approval to be taken;
- ♦ Appointment / Removal of auditor or valuer;
- ♦ Delisting of the scheme if the unit holders have sufficient reason to believe that such delisting would act in the interest of the unitholders; and
- ♦ Extension of time period to apply for delisting of units if there are no projects or assets under the scheme for more than 6 months.

- **Matters which require approval of 75% unitholders**

Purchase / Sale of property at a value greater than 105% or less than 95% of the value of property as assessed by the valuer.

- **Miscellaneous**

- ♦ Any additional matter can be taken at the meeting if request is received from 10% of unitholders (by value) of a scheme.

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- ♦ Meetings of unit holders may be conducted through video conferencing or through other audio-visual means.
- ♦ Interested persons or their associates shall not vote on such transaction.

INELIGIBILITY

An SM REIT shall not be eligible to make an initial offer of units of a scheme if:

- SM REIT or parties to the SM REIT including their promoters, promoter group or directors are debarred from accessing the securities market or dealing in securities by SEBI;
- Promoters or directors (except director nominated by a debenture trustee) of parties to the SM REIT is a promoter or director of another company debarred from accessing securities market.
- SM REIT or parties to SM REIT or any promoters or directors of such parties are wilful defaulters;
- Any promoters or whole-time directors of the parties to SM REIT is a promoter or whole-time director of another company which is a wilful defaulter;
- Any promoters or directors of the parties to SM REIT is a fugitive economic offender; or
- Any penalty levied by SEBI or stock exchanges is pending to be paid by the SM REIT.

In case of (i) and (ii), applicant shall be eligible to make initial offer if the period of debarment is over as on the date of filing of the scheme offer document.

CONCLUSION

The introduction of the SM REIT Regulations is anticipated to positively impact India's Real Estate market providing opportunities for prospective retail investors with small ticket size to fractionally invest in rent yielding real estate properties. Additionally, the mandatory listing of units ensures liquidity allowing investors to easily convert their holdings into cash when needed by selling units in the market.

With small asset size, the SM REIT can be a game changer for the real estate market and will open doors for retail investors to diversify their investments and benefit from the real estate market growth.

REFERENCES:

- SEBI Consultation Paper on Regulatory Framework for Micro, Small & Medium REITs dated 12 May 2023*
- SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2024 dated 8 March 2024*

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