

SEBI - Small & Medium REITs Regulations notified

– Will this be a boost to investment in real estate sector?

1. Background

- The Securities and Exchange Board of India ('SEBI') has notified on 8th March 2024, the SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2024 ('the Regulations') to govern small and medium real estate investment trusts (SM-REITs) for income-generating and completed real estate properties, which includes commercial assets, rental housing, warehousing etc.
- Referring to our previous alert¹ on the subject matter, wherein we had dealt with the draft regulations prescribed by SEBI asking for public comments in the month of May 2023. While most of the points in the prescribed regulations are in line with the draft regulations, SEBI has prescribed for a few additional clarifications/ conditions such as the minimum number of investors, the revised capital requirement for an investment manager etc.
- The SM REIT Framework is applicable with effect from the date of publication (i.e. 8th March 2024). In this alert, we have provided an overview of the amendments made to the framework compared to the consultation paper issued earlier and practical implications of the same.

2. Key amendments and our remarks

- The key amendments prescribed in the notified regulations and its impact has been analyzed as follows:

S No	Particulars	Prescribed regulations	Our remarks
1	Definition of REIT	<ul style="list-style-type: none"> • <i>The word "REIT" has been defined as follows:</i> <i>"A person that pools INR 50 crores or more for purpose of issuing units to atleast 200 investor to acquire and manage real estate or properties that would entitle such investors to receive income generated therefrom without giving them the day to day control over the management and operation of such real estate asset(s) or property(ies)"</i> • Further, it is clarified that the word "REIT" shall also include "SM REIT" under its ambit. 	<ul style="list-style-type: none"> • There is no separate definition prescribed for SM-REIT. The same is linked to the underlying definition of REIT. • The minimum number of investors in order to form a REIT is 200. Hence, any project with less than 200 investors would not get governed under this regulation.
2	Non-qualifying entity	<ul style="list-style-type: none"> • Explanation 2 to the aforesaid definition of REIT clarifies that any company which <u>acquires and</u> 	<ul style="list-style-type: none"> • Basis this explanation, it can be said that companies who own a property and wish to raise funds from the

¹ <https://www.m2kadvisors.com/adminpanel/upload/Pub7453298210631325370M2KAlert-MSM-REIT-Regulations.pdf>



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		<p><u>manages real estate asset(s) or property(ies) and offers or issues securities to the investors, shall not be construed as REIT.</u></p>	<p>public by directly issuing securities such as CCD etc, (and not through the SM-REIT model) would not get covered under these regulations.</p> <ul style="list-style-type: none"> • However, the restriction under the Companies Act, 2013 ('Cos Act, 2013') on giving an offer to issue shares/ securities to maximum 200 persons under a private placement route would continue to apply in those scenarios.
3	Registration and application fees	<ul style="list-style-type: none"> • An application shall be made by the investment manager on behalf of the SM-REIT in Form A with a non-refundable fees as follows: <ul style="list-style-type: none"> A) Upon filing application – INR 1 lakh B) 15 days upon receipt of intimation from the SEBI – INR 10 lakhs C) Upon filing of draft scheme – Higher of INR 5 lakhs or 0.1% of the total scheme issue size including retention of oversubscription. • SEBI shall upon being satisfied with the application and receipt of aforesaid payment, shall grant the registration. If the application is rejected (after a reasonable opportunity to hear is given) then the same needs to be communicated by SEBI within 30 days of taking such a decision. • The registration would be revoked if the initial offer for the scheme is not made within 3 years of registration. However, SEBI, if it deems fit, may extend the period for making initial offer of a scheme by up to one year. 	<ul style="list-style-type: none"> • It is pertinent to note that all the fees need to be discharged to the SEBI before raising of any funds from investors. • Hence, the investment manager shall ensure that the Trust has sufficient funds to file an application and pay the requisite fees.
4	Migration of existing persons, entities or structures	<ul style="list-style-type: none"> • Details of existing persons, entities or structures to be migrated and a migration plan along with the application for registration shall be filed by the entity with SEBI. • The application for registration needs to be made within 6 months 	<ul style="list-style-type: none"> • While existing entities may want to migrate to SM-REIT structure for regulatory reasons, the process of transferring the securities of the unit holders from the special purpose vehicle ('SPV') to the Trust could be time consuming and costly affair. • Further, the existing investors may have to open a demat account as



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		<p>from the date of publication of the regulations in the official gazette².</p> <ul style="list-style-type: none"> • Further, the migration needs to be completed within 6 months of obtaining the registration from SEBI. 	<p>the units of SM-REIT shall be listed and mandatorily be in demat form.</p>
5	Appointment of investment manager	<ul style="list-style-type: none"> • The following are some of the key criteria prescribed by SEBI for persons to qualify as an investment manager: <ul style="list-style-type: none"> ○ A company incorporated in India. ○ Has a minimum net worth of INR 20 crores. ○ Has net worth more than INR 10 crores in the form of <u>positive liquid net worth</u>³; ○ Has <u>at least 2 years of experience</u> in real estate industry or real estate fund management. ○ In case the above condition of experience is not met, it shall employ at least 2 Key Managerial Personnel – each having more than 5 years of experience in the real estate industry or real estate fund management. ○ Not less than half of the directors are independent and not directors of the investment manager of other REIT or SM REIT. ○ The trustees of the Trust should not be an associate of the investment manager. 	<ul style="list-style-type: none"> • While SEBI had in the draft regulations prescribed for the requirement to appoint sponsor, manager and investment manager, the notified regulations have only prescribed for appointing an investment manager. • An investment manager necessarily needs to be a Company and not an individual ensuring that even an investment manager is regulated by a governing body. • Additional responsibilities have been placed on the investment manager such as lock-in requirements (tabulated in Annexure 1), maintaining the websites etc.
6	Investment conditions	<ul style="list-style-type: none"> • The SPV shall solely own all the assets that are acquired or proposed to be acquired for the scheme of the SM REIT of which the SPV is a wholly owned subsidiary. • At least 95% of the scheme’s AUM shall be invested in completed and rent generating real estate properties at all times. • The balance can be invested in unencumbered liquid assets such as 	<ul style="list-style-type: none"> • It has been specifically clarified that the funds of the entity cannot be invested into under-construction or non-revenue generating real estate.

² The regulations have been published in the official gazette of India on 8th March 2024

³ Liquid net worth includes cash, units of overnight or liquid mutual funds scheme, fixed deposits, government securities, treasury bill etc.



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		<p>money market instruments, government securities, T-Bills etc.</p> <ul style="list-style-type: none"> The scheme of SM REIT shall not be permitted to lend to any other entity other than to its own SPV. The SPV shall not be permitted to lend to any other entity. 	
7	Fund raising requirement (key amendments only)	<ul style="list-style-type: none"> The minimum subscription size to the units and the unit size of a SM REIT Scheme shall be INR 10 lakhs. For every offer of a scheme, the size of the asset proposed to be acquired should be at least INR 50 crores and should not exceed INR 500 crores per scheme. The capital shall be raised only by way of issuance of units pertaining to the particular scheme. The SM REIT is also allowed to leverage a maximum of 49% of the value of scheme asset through borrowings or issuance of debt instrument⁴. 	<ul style="list-style-type: none"> The minimum asset size (per scheme) has been increased to INR 50 crores, as against INR 25 crores prescribed in the draft regulations.
8	Offer related requirements	<ul style="list-style-type: none"> The minimum offer and allotment to the public in each scheme shall be at least 25%⁵ of the total outstanding units of such scheme. The minimum unitholding requirement applicable to the investment manager for the first three years of listing of units (shall be unencumbered and locked-in) is as follows: <ul style="list-style-type: none"> i) In case the entity has not opted for leverage, then 5% of outstanding units at all times. ii) In case the entity has opted for leverage, then 15% of outstanding units at all times. The offer document <u>shall not provide for any guaranteed returns</u> to the investors. 	<ul style="list-style-type: none"> While the draft regulations had prescribed for a maximum fund raising from a single investor (25% of the total unit capital), the said requirement has been done away with in the notified regulations.

⁴ In accordance with the SEBI (Issue and Listing of Non-convertible Securities) Regulations, 2021.

⁵ The REIT shall be asked to delist if this condition is breached by the entity.



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		<ul style="list-style-type: none"> The offer document shall disclose lease rental income from each property acquired/ proposed to be acquired by the scheme along with comparable lease rental income from similar properties. While advertisement is permissible for issuing offer, there are various conditions prescribed as to what content can be shown, what offers can be given, who shall advertise (specifically excludes models/ celebrities/ fictional characters or likes from advertising these scheme), the minimum size in which the disclaimers shall be provided and so on. 	
9	Distribution of cashflow (Dividend/ interest payment)	<ul style="list-style-type: none"> No less than <u>95% of net distributable cash flows</u> of the SPV shall be distributed to the scheme of SM REIT on a quarterly basis. <u>100%</u> of the net distributable cash flows of the SM REIT <u>shall be distributed to the scheme wise unit holders.</u> The amount retained at the SPV level may be utilized only in the manner specified by the Board. Distribution shall be declared at least once in every quarter of the financial year and not later than 15 working days from the end of the quarter. The distributions shall be paid to the unit holders within 7 working days of such declaration. 	<ul style="list-style-type: none"> The distribution of cash flows to the investors in every quarter shall ensure that the cash flow liquidity is maintained in the hands of unit holders and the funds are not being utilized for any other purposes.
10	Rights and meeting of unit holders	<ul style="list-style-type: none"> A meeting between the unit holders of each scheme shall be held at least once every year within 120 days from end of financial year and time between 2 meetings shall not exceed 15 months. A special resolution needs to be obtained from the unitholders if the property proposed to be purchased or sold as part of the scheme is greater than 105% or less than 95% of the value as assessed by the valuer. 	<ul style="list-style-type: none"> These measures would ensure that the unitholders have access to financial information of the SPV/ property and be aware of the manner of utilizing the funds by the investment manager/ Board etc. Further, the unit holders will have decision making power if the property is bought/ sold beyond the prescribed range.



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		<ul style="list-style-type: none"> • An ordinary resolution needs to be obtained from the unitholders of that scheme for the following: <ul style="list-style-type: none"> a) any transaction which is more than 10% of the asset size of the scheme. b) any borrowing in excess 25% of the value of scheme assets or any issue which the Board/ investment manager/ trustees finds to be material. 	
11	Related party transactions	<ul style="list-style-type: none"> • SM-REITs are prohibited from entering into any transaction with the related party including transaction for facility management and property management. 	<ul style="list-style-type: none"> • This is a significant change as generally the entity raising funds from investors tend to enter into a common area maintenance ('CAM') agreement with their own group entity, for which a separate fee is charged from the tenant.

3. Overall remarks

- The regulations do not place any restriction on the type of property to be listed in the scheme and hence even developers of residential properties, holiday homes, club houses etc can explore this route to get an exit by listing these properties under the SM-REIT platform. These regulations will help open up an entirely new asset class of "holiday homes" to a wider audience and change the way Indians earn from property investments.
- The income tax implications on income earned under the SM-REIT structure by the unitholders and the Trust shall be same applicable to business trust (which is defined to mean a trust registered as a REIT under the SEBI (REIT) Regulations) as the amended REIT regulations define "REIT" to include a "SM-REIT".
- Since these units shall be listed on a recognized stock exchange, the trading of these units would become fairly easier which otherwise was a difficult task to identify potential buyers off-market.
- Bringing these regulations under the regulatory framework of SEBI would boost the confidence of general public to invest their funds and generate income from rent yielding projects, at the same time would create a fund-raising platform for the developers who otherwise were facing regulatory risk for raising funds from general public under the Collective investment scheme and the Deposit regulations.

Annexure 1 – Lock-in requirement for investment manager

S No	Period of holding in each scheme	Minimum unitholding
1	For first three years from date of listing of initial offer	
	- If opted for leverage in the initial offer scheme	15% ⁶
	- If not opted for leverage in the initial offer scheme	5% ⁶
2	Beginning of Year 4 till end of Year 5	5%
3	Beginning of Year 6 till end of Year 10	3%
4	Beginning of Year 11 till end of Year 20	2%
5	After completion of Year 20	1%

Note: The units issued to investors against swap of securities allotted prior to the date of this regulation by an SM REIT that has received a certificate of registration pursuant to an application for "Migration", shall not be considered for calculating the total outstanding units of the schemes of the SM REIT under this regulation.

⁶ Any holding in excess of 15% or 5% as the case maybe shall be held for a period of at least 1 year from the date of listing of initial offer.

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