

Small & Medium REITs (SM REITs)

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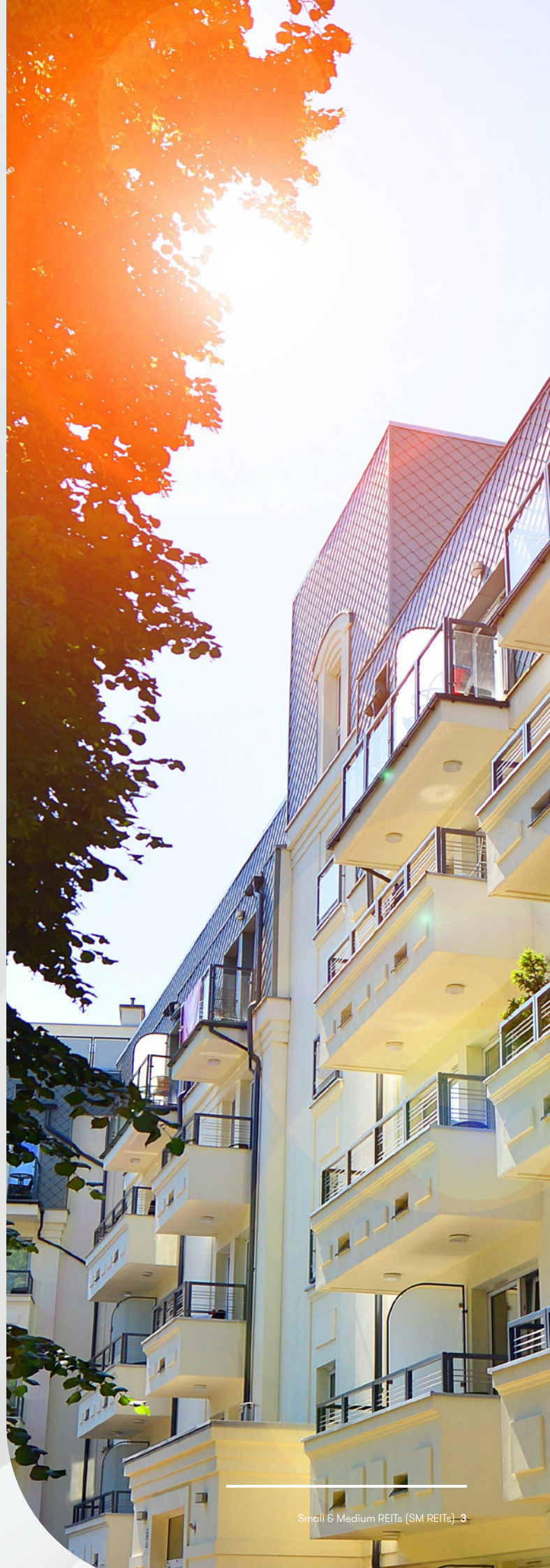
SM REITs

The Securities and Exchange Board of India (SEBI) has revised the regulations governing Real Estate Investment Trusts (REITs) to introduce Small and Medium REITs (SM REITs).

These revisions represent an advancement in the framework regulating the sector, specifically tailored to enhance the landscape of fractional ownership investments while maintaining a market that is both transparent and conducive to investor interests. This brief aims to offer a clear outline of the regulatory modifications and delineate the distinctions between SM REITs and traditional REITs.

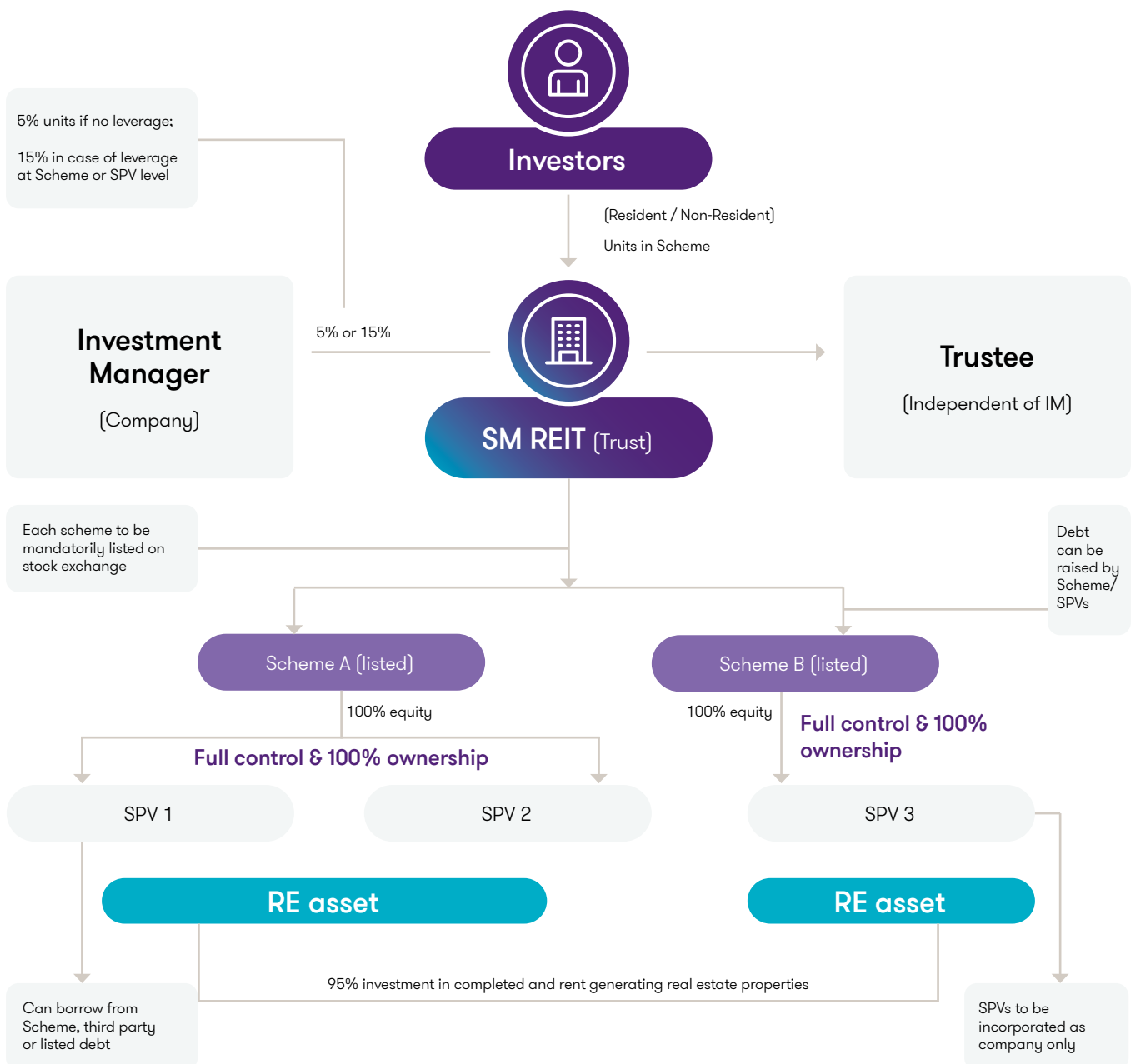
The setting up of a structured framework for SM REITs, lies at the centre of these revisions. It encompasses the transition of pre-existing structures, increased regulatory supervision, detailed disclosure obligations, and a specialised mechanism for addressing investor complaints. This methodical approach is anticipated to refine the regulatory environment, facilitating a more favourable environment for the growth of small and medium-scale enterprises within the real estate domain.

Crucially, these alterations facilitate the transition of current fractional ownership models into the SM REIT framework, an essential step for those active in the fractional ownership arena. The new regulations necessitate the submission of an application to SEBI for registration, detailing a migration strategy for transitioning to the SM REIT model and assimilating into SEBI's comprehensive regulatory framework.



SM REIT: Structure

SM REIT which pools money from investors under one or more schemes to be mandatorily listed – asset size under a scheme is atleast INR 50 crores and has more than 200 unitholders



REIT defined

Earlier REIT was defined to mean a trust registered under REIT Regulations. However, now it is defined as below and also includes SM REIT.

01 Pools funds

Pools INR 50 Crore or more

02 Issues units

Issues units to at least 200 Investors for giving returns from the underlying income from real estate

03 Acquires real estate

Acquires and manages real estate assets/properties for earning income

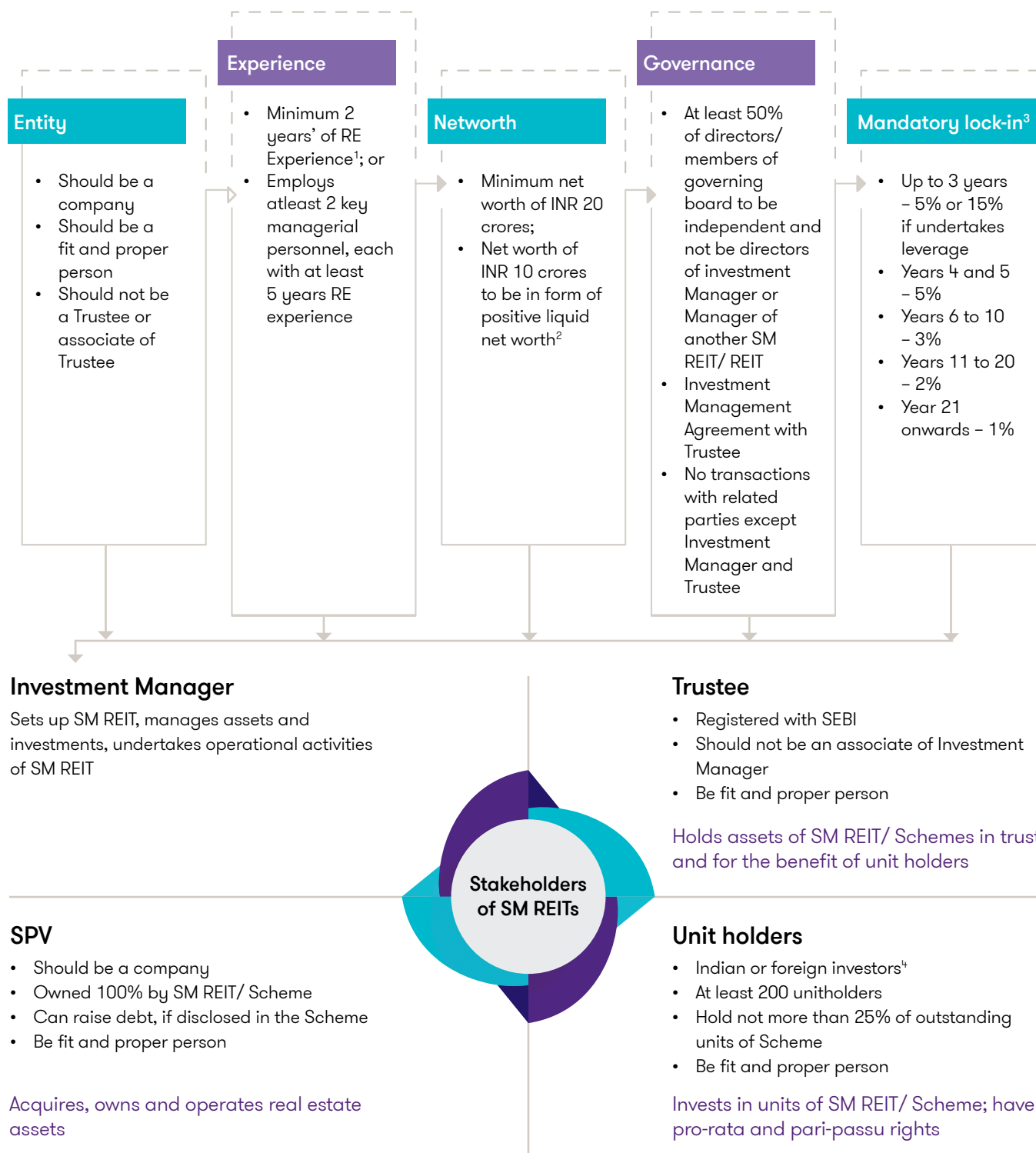
04 No day-to-day control

Does not give day-to-day control over management and operation of such real estate assets/properties to investors



Any company which acquires and manages real estate assets or properties and offers or issues securities to investors, will not be construed as REIT

Parties to SM REITS



1. RE Experience – Experience in real estate fund management / real estate industry
 2. Liquid net worth means unencumbered liquid assets - asset that can easily be converted into cash in a short amount of time, including cash, money market instruments, G-Secs, T-bills and Repo on G-Secs
 3. Lock-in of 1 year for units held more than 5% or 15% as the case may be
 4. Investment by foreign investors subject to RBI guidelines

Key Provisions

Listing of Scheme of SM REIT

Particulars	Key requirements
Appointment	Merchant Banker to be appointed to carry out the obligations related to the initial offering
Initial Offering	Initial offering of Scheme within 3 years of registration
Initial offer size	Value of real estate assets or properties in each Scheme to be atleast INR 50 crores
Investors	<ul style="list-style-type: none"> SM REIT can raise funds from any investor, Indian or foreign by issuing units At least 200 Investors Investors to be unrelated to the investment manager, its related parties and associates
Minimum subscription	INR 10 lakhs
Maximum subscription	25% of the total unit capital of SM REIT Scheme
Minimum Real Asset Value	INR 50 crores
Disclosure in the offer	<ul style="list-style-type: none"> Whether leverage is or will be obtained. If without leverage, file undertaking to not utilize debts in future SPV may undertake leverage if the option to undertake leverage is specified in the initial offer document
Issue Period	Not more than 30 days
Minimum Public Unitholding	25% of the total outstanding units of such schemes
Penalty	Failure to list or allot units within the specified timelines will attract an interest of 15% p.a.

Listing of SM REIT

Valuation report	<ul style="list-style-type: none"> Include a summary report of the full valuation in the scheme offer document Report should be not more than 6 months old from the date of offer
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Investment and distribution conditions

Investment conditions	<ul style="list-style-type: none"> At least 95% of Scheme AUM to be invested in completed and rent generating real estate properties, at all times Balance 5% can be deployed in unencumbered liquid assets SM REITs not allowed to invest in under-construction or non-rent generating real estate properties Scheme of the SM REITs will be permitted to lend only to the SPV The SPV is not permitted to lend to any other entity
Distribution conditions	<ul style="list-style-type: none"> At least 95% of net distributable cash flows at SPV level to be distributed to SM REIT, subject to provisions of Companies Act, 2013 100% of net distributable cash flows at SM REIT level to be distributed to unit holders of the respective scheme Distributions are declared at least once in every quarter and not later than 15 working days from the end of the quarter Distributions are to be paid to the unitholders within 7 working days of such declaration, failing which will attract an interest @ 15% p.a to be paid to investors

Funding and valuation

Particulars	Key requirements
Modes of fund raising	<ul style="list-style-type: none"> • Indian and foreign investors both can invest in the units of the scheme • Undertake the option of leverage only if it has been specified in the initial offer document. • Modes of fund raising by a scheme of SM REITs and SPVs: <ul style="list-style-type: none"> – Raise Capital only by way of issuance of units – Undertake Leverage through borrowings or issuance of debt securities under SEBI Regulations • Scheme opting to utilise leverage: <ul style="list-style-type: none"> – Total borrowings + deferred payments – Cash and Cash considerations \leq 49% value of scheme of assets • Approval from the unit holders and credit rating from a credit rating agency registered with the Board shall be obtained if: <ul style="list-style-type: none"> – Total borrowings + deferred payments – Cash and Cash considerations $>$ 25% value of scheme of assets
Valuation of assets	<ul style="list-style-type: none"> • Valuation of assets held by SM REIT schemes to be undertaken by registered valuer who has an experience of not less than 5 years in valuation of real estate • Valuation to be undertaken on annual basis as on 31st March. The NAV of each scheme shall be declared and disclosed to the recognised stock exchange within 1 working day from the receipt of such valuation reports • Sale of property at less than 95% of fair value of asstes and purchase of property at more than 105% of the fair value of the assets will require unitholder approval – votes in favor to be at least 3 times the number of votes cast, if any, against the resolution • The same valuer should not value the properties of the scheme for more than 4 consecutive years

Governance

Investor Protection and Minimum Safeguards	<p>Investor Rights</p> <ul style="list-style-type: none"> • Removal of Investment Manager, auditor, principal valuer, seek winding up of the scheme, etc. • Mandatory annual meeting of investors to be conducted – to cover matters such as annual accounts, valuation reports, performance of SM REIT, approval of auditors & their fees, appointment of valuer/relevant intermediary • Investor approval mandatory for change in Investment Manager, change in investment strategy • Interested party (including where transaction is with associate) to not participate in voting on specific issues <p>Other safeguards</p> <ul style="list-style-type: none"> • SEBI to specify cap on total expense ratio for SM REITs • SEBI to prescribe minimum disclosure requirements for (a) offer Document, annual/quarterly reports to investors, (b) Periodical disclosures under listing agreements, and (c) Property-wise disclosure of lease rentals along with comparable lease rentals of similar properties by independent registered valuer/ intermediary
Website for SM REIT	<ul style="list-style-type: none"> • Investment Manager to maintain website, disclose details of scheme, proposed real estate assets to be acquired • Trademark, brand name, website or other medium of communication to be exclusively of SM REIT • No information of other entity, structure or person shall be provided on the website
Related Party transactions	<ul style="list-style-type: none"> • No transactions with related parties including for facility management and property management[^] • Investment Manager to manage assets and investments of SM REIT, undertake operational activities of SM REIT

[^] Fees paid to Investment Manager and Trustee not to be treated as related party transactions

Migration of existing structures

Existing persons, entities or structures has an option to migrate to SM REIT

Qualifying criteria of 200 investors and asset size (minimum INR 50 crore to less than INR 500 crore) not applicable

Application to be made for seeking registration alongwith a plan for migration of existing structure

Application to be made before 07 September 2024 or as specified by SEBI

Migration to be completed within six months of grant of registration or as specified by SEBI

Scheme to comply with the provisions applicable to SM REIT **unless stated otherwise**

Units of SM REIT issued pursuant to swap of securities on migration not to be considered for determining lock-in requirement for IM



Comparative | REIT vs SM REIT

Pools funds | Holds real estate | Needs to list | Can borrow |
Mandatorily distribute Net Distributable Cash Flow

Investment Manager

	REIT	SM REIT
Legal entity form	Company or LLP	Company
Sponsor	Mandatory to have separate sponsor	No sponsor required
Net worth	INR 50 crores	INR 20 crores (INR 10 crores as liquid net worth)
Experience for IM	5 years of RE experience	2 years of RE experience
Key Managerial Personnel experience	2 KMPs with at-least 5 years of RE experience	2 KMPs with at-least 5 years of RE Experience (if IM does not have RE experience)
Lock-in for IM	No lock-in unless self-sponsored IM	Applicable

Listing related

	REIT	SM REIT
Parties to REIT	Sponsor, Investment Manager, Trustee, REIT	Investment Manager, Trustee, SM REIT
Asset size	INR 500 crores or more	INR 50 crores to less than INR 500 Crores
Minimum Offer size	INR 500 crores	INR 50 crores
Minimum public holding	25% of outstanding units	25% of outstanding units
Minimum subscription	INR 10,000 - INR 15,000	INR 10 Lakhs or as specified by SEBI
Borrowing	Through listed debt - need not disclose in initial offer document	Borrowing or listed debt if disclosed in Offer document
Failure to list	Surrender of registration	Interest @15% to Investors

Investment related

	REIT	SM REIT
Holding structure	Can hold assets directly; SPV - company or LLP; Holding company permitted;	SPV to be company – holding company not permitted; cannot hold assets directly
Ownership	51% controlling stake either directly or indirectly	To be held 100% by SM REIT Scheme
Investment condition	80% assets in completed and revenue generating; under construction permitted upto 20%	95% in completed and revenue generating assets only
Co-investment	Permitted	Not permitted
Lock in for property	Lock-in for property - 3 years from date of purchase	Not prescribed
Schemes	Not permitted	Permitted to list through separate schemes
Lending	Can lend to SPV/Hold Co	Can lend to SPV

Income, Distribution and related party

	REIT	SM REIT
Minimum Income	Minimum 51% of consolidated revenue from rents/ lease or ancillary activities	No threshold prescribed
Distribution by SPV	90% of net distributable cashflow to be distributed	95% of net distributable cashflow to be distributed
Distribution by REIT/SM REIT	90% of net distributable cashflow to be distributed	100% of net distributable cashflows on quarterly basis
Related party transactions	Permitted subject to arm's length compliance and other conditions	Not permitted, except with Investment Manager
Unitholder approvals	Sale of property if less than 90% of the assessed value Purchase of property if more than 110% of the assessed value	Sale of property if less than 95% of the assessed value Purchase of property if more than 105% of the assessed value
Website	Nothing prescribed	Mandatory to maintain website with prescribed disclosures

Key Takeaways

01

For existing fractional ownership structures, the regulations do not specifically require to mandatorily migrate to SM REIT

The regulations provide leeway to existing fractional ownership structures to define the migration plan and do not dictate the process/ steps to be followed?

02

The amended definition of REIT excludes companies engaged in acquisition and management of real estate assets/ properties.

Existing structures operated under a company structure would be permitted to continue unless an option to migrate under a SM REIT is exercised?

03

Existing fractional ownership structures can opt to migrate even if the qualifying criteria of property value of INR 25 crore and more than 200 investors is not met

Existing fractional ownership structures can voluntarily opt to migrate under SM REIT structure?

04

The regulations do not permit any transaction with related parties.

The entire fractional ownership structure needs to be brought within the SM REIT construct, including the website which is required to be managed by the Investment Manager entity?

What next?

Thorough assessment of the strategy to be implemented is necessary for:

- Assessing the need to migrate to a SM REIT
- Identifying an efficient migration plan taking into consideration the nuances associated with implementation and the associated costs
- Setting up an efficient, robust and compliant structure



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