भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

Consultation paper for amendments to the SEBI (Real Estate Investment Trusts) Regulations, 2014

I. Objective:

1. To solicit the comments/views from public on suggestions pertaining to making amendments / providing clarifications to the SEBI (Real Estate Investment Trusts) Regulations, 2014 (hereinafter referred as "REIT Regulations").

II. Background:

2. SEBI REIT Regulations were notified on 26th September, 2014, thereby providing a regulatory framework for registration and regulation of REITs in India. The regulations, inter alia, prescribe conditions for making a public offer, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc.

3. Pursuant to the notification of REIT regulations, various representations and suggestions have been received from industry bodies and market participants. The representations received have requested changes/clarification to certain provisions of the REIT regulations. Accordingly, certain amendments/clarifications are proposed for the REIT Regulations which are as under.

III. Proposals for consultation:

4. Removing the restriction on the SPV (only in case of such SPV being a Holding Company) to invest in other SPVs holding the assets.

4.1. Current regulatory requirement:

Regulation 2(1)(zs) of the REIT Regulations, inter alia, defines a SPV as a company or LLP which holds not less than eighty per cent of its assets directly in properties and does not invest in other special purpose vehicles.

4.2. Request for change:

Allowing the REITs to invest in the Holding Companies (Holdcos) which have investments in other SPVs, which subsequently hold the real estate assets.

4.3. Rationale for the change

a) Real Estate assets are usually held through multiple layers of investments as each asset/project may come with its own set of investors, land owners, joint development partners and related requirements. Further, real estate assets/projects are also held through multilevel holding structures for reasons of consolidation, ease of unbundling and itemized scalability and future potential to list the holding companies for fund-raising.

b) Therefore the requirement of having all assets under one vehicle or under multiple vehicles at the same horizontal level for listing through a REIT would involve significant restructuring of existing holdings. Further, such restructuring of assets to single level SPV may involve significant costs in terms of stamp duty on asset transfer.

c) Asset transfers may also result in issues relating to tax on dividend distribution/buyback.

d) Further, section 186 (1) of the Companies Act, 2013 also allows a company to invest through two layers of investment companies.

4.4. Proposal:

To amend the Regulation 2 (zs) of the REIT Regulations so as to permit investment by REIT in a SPV which have investments in other SPVs, which subsequently hold real estate assets, subject to following conditions:

a) The REIT shall hold controlling interest and not less than fifty per cent of the equity share capital or interest in the HoldCo or any other higher level of holding based upon the feedback received. The Holdco shall in turn hold controlling interest and not less than fifty per cent of the equity share capital or interest in underlying SPV(s) or any other higher level of holding based upon the feedback received.

b) Once Holdco's share and control are transferred to REITs, any agreement(s) with the shareholder(s), other than those whose shareholding is folding into the REIT, both at the Holdco and the SPV level shall be amended so that any special rights to such non-participating shareholders at the SPV and/or Holdco level such as veto rights, restriction on transfer of shares, inspection rights etc. are terminated so that it doesn't prevents REIT, Holdco and SPV(s) from complying with the provisions of REIT regulations.

c) The investment manager, in consultation with the Trustee, shall ensure that the REIT or HoldCo appoints the majority of the board/ governing body of the underlying SPV(s);

d) The investment manager shall ensure that in every meeting including annual general meeting of the underlying SPV(s), the HoldCo participates in the voting process.

e) All requirements related to the related party transactions, etc. shall also be applicable at the underlying SPV level in addition to the HoldCo, as may be specified by SEBI.

f) All responsibilities of the investment manager with respect to the SPVs shall apply at both the levels.

g) All investment conditions and leverage requirements shall apply at the consolidated level i.e. including REIT, Holdco and the SPV(s).

h) The requirement of mandatory distribution of at least 90% of the net distributable cash flows shall apply to the underlying SPVs. The Holdco would be required to distribute the entire cash flows it receives from underlying SPVs to the REIT.

i) All financial statements of the REIT shall be consolidated with both the SPVs.

j) The HoldCo shall not be engaged in any activity other than holding of the underlying SPV(s) and any other activity incidental to such holding.

k) Any other conditions as SEBI may deem necessary.

5. Clarifying the definition of "associates" in the regulations

5.1. Current Regulatory Requirement

Regulation 2(1)(b) of the REIT Regulations defines the associates as

"associate" of any person includes,-

(i) any person controlled, directly or indirectly, by the said person;
(ii) any person who controls, directly or indirectly, the said person;
(iii) where the said person is a company or a body corporate, any person(s) who is designated as promoter(s) of the company or body corporate and any other company or body corporate with the same promoter(s);
(iv) where the said person is an individual, any relative of the individual;

(v) where the said person is a company or a body corporate or an LLP, its group companies;

(vi) companies or LLPs under the same management;

(vii) where the said person is a REIT, related parties to the REIT;

(viii) any company or LLP or body corporate in which the person or its director(s) or partner(s) hold(s), either individually or collectively, more than fifteen percent of its paid-up equity share capital or partnership interest, as the case may be;

5.2. Request for clarification:

To rationalize the ambit of the definition of associates so that entities that have no connection to the investment manager/sponsor doesn't get included in the definition of associates.

5.3. Rationale for change:

a) The REIT Regulations prescribe disclosure requirements on “associates” of the sponsor, manager and trustee. The term “associates” has been very broadly defined which ends up including entities that have no connection to the investment manager/sponsor, as applicable. This puts an onerous obligation on all parties to the REIT.

b) The parties to the REIT may neither have any subsisting business relationships with entities, as covered under the definition of associates, nor have any relation with the REIT or its operations, which may adversely affect the business and operations of the REIT. Therefore they may have no relevance especially in respect of the disclosures to be included in the offer document.

c) Also, obtaining relevant certifications and confirmations from entities where a ‘control’ relationship does not exist, is challenging since such entities may refuse to provide the requisite information.

5.4. Proposal:

a) To introduce the concept of associates which are material, where the test of materiality shall be as determined by the REIT in the offer document.

b) To replace the term *"associate(s)"* with the *"material associate(s)" in* the Regulation 2(zo), 4(2)(d)(iii), 4(2)(e)(ii), 9(5), Schedule I- clause 1(c), 4(f), 5(e), Schedule III Clause 13(b) and Schedule IV Clause 15.

6. Clarifying the definition of "real estate property" in the regulations

6.1. Current Regulatory Requirement

Regulation 2(zi) of the REIT Regulations defines the "real estate" or "property" as under:

"real estate" or "property" means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage:

Provided that any asset falling under the purview of 'infrastructure' as defined vide Notification of Ministry of Finance dated October 07, 2013 including any amendments or additions made thereof shall not be considered as 'real estate' or 'property' for the purpose of these regulations;

6.2. Request for clarification:

Assets such as hotels, hospitals or other sub-sectors which are included under the definition of Infrastructure as per Ministry of Finance Notification should be included within the scope of real estate or property, so long as they qualify as completed rent generating properties.

6.3. Rationale for change:

a) The current definition of "real estate" or "property" under the REIT Regulations excludes all assets falling under the purview of "infrastructure" as defined under the notification of Ministry of Finance dated October 7, 2013 (the "Infrastructure Notification"). Sub-sectors such as hotels, hospitals, convention centers, etc. are excluded from the definition of 'real estate property' by virtue of the Infrastructure Notification.

b) Large townships and commercial projects often offer business parks, hospitals, hotels etc. as part of the project, each of which are rent generating completed assets. Therefore such assets should fall within the definition of "real estate" or "property" under REITs.

c) Further, the intent of the REIT Regulations is to include rent generating properties within the REIT asset profile and therefore so long as an asset is completed and rent generating, the same should be allowed to form part of the REIT, regardless of the asset class it belongs to.

6.4. Proposal:

To amend the proviso to the definition of 'real estate' or 'property' in Regulation 2(zi) of the REIT Regulations so as to allow rent generating properties captured within the definition of Infrastructure by Ministry of Finance, under REITs as well.

7. Increasing the number of sponsors

7.1. Current regulatory requirement:

Regulation 4(2)(d)(i) of REIT Regulations mandate that the REIT can have maximum of 3 sponsors.

7.2. Request for change:

To introduce the concept of 'sponsor' groups and to allow the maximum number of sponsors from 3 (three) to 5 (five) .

7.3. Rationale for the change

a) In real estate sector the assets are usually held by the developer either by itself or through its group companies/individuals. Similarly, a private equity fund holds the asset(s) through investments by multiple schemes of the same private equity fund or different funds under common control. Also, a sizeable number of assets are owned on a joint venture/ joint development basis by developers and private equity fund(s).

b) Thus, the real estate assets which are to be transferred to the REIT may be held with various companies/funds which may be under common control of a particular developer or a private equity fund, respectively.

c) Therefore, to ensure that various parties in a holding structure (joint venture partners, developers and multiple schemes/funds of private equity fund) may participate in the REIT and are collectively identified as sponsors, it has been represented that the number of sponsors be increased from the current level of maximum 3. Further, it has been represented that the concept of sponsor group be introduced, where such "sponsor group" may comprise of multiple schemes/ funds/affiliates which are under common 'control'.

7.4. Proposal

It is proposed to amend the REIT Regulations to provide the following options, where the REIT may choose between either of the two options:

a) If the holding in REIT is only by the sponsor(s) then the maximum number of sponsors shall be 5 (increase from the current limit of 3 sponsors).

b) The holdings in the REIT may be held by sponsor and other group companies or associates of the sponsor. In such cases the sponsor and its group companies or associates may be collectively identified as sponsor group. In such a case, the maximum number of sponsor group would be 1 (one) and would require to comply with all conditions specified in the REIT Regulation as for the sponsors.

8. Rationalization of compliance with respect to Related Party Transactions (RPTs) requirements

8.1. Current regulatory Requirement:

a) Regulations 22(4) and 22(5) of the REIT Regulations require the approval of 60% of the unit holders, apart from related parties, for passing a related party transaction which is procedural in nature.

b) Further Regulation 22(6) requires approval of 75% of the unit holders, apart from related parties, for passing of special resolutions such as change in investment manager, investment strategy, delisting of units etc.

8.2. Request for change:

The requirement of unit holder approval for the related party transactions should be brought in line with the Companies Act, 2013.

8.3. Rationale for the change

Representations have been received that the requirement of 60% and 75% majority may not be feasible, especially when related parties have to abstain from voting. Further, it has been represented that the requirement of unit holder approval, in case of related party transactions (RPTs), should be in line with the approval requirement under the Companies Act, 2013

8.4. Proposal

Given the nature of the REIT, a complete alignment with the Companies Act cannot be made. It is also felt that it is not possible to achieve the current level of thresholds as prescribed in the REIT Regulations. In the light of the above it is proposed that the requirement of unit holder approval for RPT may be amended as under:

a) For RPTs which requires approval as referred in 7.1(a) above, it is proposed that the number of votes cast by the unit holders in favor of the proposal shall be more than the number of votes cast by the unit holders against it.

b) For RPTs which requires approval as referred in 7.1(b) above, it is proposed that the number of votes cast by the unit holders in favor of the proposal shall be at least one and half times more than the number of votes cast by the unit holders against it.

c) Further in both the above cases, the voting by any person, who is a related party in such transactions, as well as associates of such person(s) shall not be taken in to account.

9. Aligning minimum public holding requirement with Securities Contracts (Regulation) Rules, 1957 (SCRR)

9.1. Current regulatory requirement

a) Regulations14(2)(c) and 16(7) of REIT Regulations, inter-alia, require that the units proposed to be offered to the public shall not be less than twenty five per cent of the total of the outstanding units and the number of unit holders forming part of public is required to be 200 at all times.

b) Further, the minimum public holding for the units of the publicly offered REIT after listing shall be 25% of the total number of outstanding units and the number of unit holders of the REIT forming part of the public shall be two hundred at all times, failing which action may be taken as may be specified by the Board and by the designated stock exchanges including delisting of units.

9.2. Request for change:

Alignment of minimum public holding requirements in line with the SCRR and requiring the test of minimum no. of public unit holders only at the time of initial offer.

9.3. Rationale for Change

a) Representations have been received that the in case of REITs, where large commercial rent generating real estate assets would be parked, the underlying value in the REIT would be very high. Further, given the nature of such REITs and the asset base involved, marketing and selling an issue size of 25% (twenty five per cent) at one instance, may not be plausible, given the product being at a conception stage, novelty of the product, the appetite of the market for large issues of this kind and the specific pool of investors the product caters to.

b) Therefore the proposal has been received to align the requirement of minimum offer to public in case of a REIT with the requirements of minimum public offer as under Securities Contracts (Regulation) Rules, 1957 (SCRR).

c) Further, it has been requested that the requirement of maintaining the minimum public holding of 200 at all times may not be feasible, since the REIT would be unable to control the inter-se transfer of units among the public and therefore may not be able ensure the minimum number of public unit holders to 200 at all times.

9.4. Proposal

a) The requirement of minimum offer to public and minimum public holding, of the outstanding units, shall be linked with the requirement of public offer of 25%/10%, as specified under Securities Contracts (Regulation) Rules, 1957.

b) Further the requirement of the minimum number of public unit holders may be amended to allow minimum of 200 public investors at the time of initial offer only.

c) It is proposed that Regulations 14(4)(c), 16(7) and 22(8)(c) of REIT Regulations be amended for the same.

10. Allowing REITs to invest up to 20%, in under construction assets

10.1. Current regulatory requirement

a) Regulation 18(4) of REIT Regulations, inter-alia, requires that not less than eighty per cent of value of the REIT assets shall be invested, proportionate to the holding of the REITs, in completed and rent generating properties.

b) Further, as per Regulation 18(5)(a) of the REIT Regulations, of the remaining 20% of value of the REIT assets, not more than ten per cent of value of the REIT assets,

shall be invested in under construction properties and completed and non- rent generating properties.

10.2. Request for change:

Remove the sub-limit of maximum of 10% investment in under-construction or completed but not rent generating assets, and make it fungible with the limit for investment in other securities/liquid instruments under the limit of 20%

10.3. Rationale for proposal

a) The proposed move will provide greater flexibility to the REIT manager in determining the composition of REIT and also help widen the portfolio and thereby the size of the REIT by adding projects which are at various stages of construction.

b) REITs are also intended to be a means of revitalizing the cash-strapped market for real estate assets, especially under-construction properties. However, such a move would have to be offset against the intent of the REIT Regulations of exposing retail investors to minimal risk. Therefore, it may be worth considering modifying the existing thresholds by making the 20% (twenty per cent) bracket more fungible, while keeping the 80% (eighty per cent) criteria sacrosanct.

c) Most of the international REIT Regulations either do not cap the level of investment in under-construction assets or permit a higher level of investment in under-construction real estate assets.

10.4. Proposal

a) REIT may be permitted to invest up to 20%, of value of the REIT assets in under construction assets, securities of companies or body corporate in real estate sector, government securities, money market instruments etc. Further, the current requirement of at-least 80% investment in completed and rent generating properties shall continue as it is.

b) It is proposed that Regulation 18(5)(a) of REIT Regulations be amended for the same.

11. Responsibilities of trustee and its associates

11.1. Current regulatory requirement

Regulation 2(zo) of the REIT regulations provides that “related parties" of REIT shall include:

(i) parties to the REIT;
(ii) any unit holder holding directly or indirectly, more than 20% of the units of the REIT;
(iii) associates, sponsors, directors, and partners of the persons mentioned in (i) and (ii).

Regulation 9(15) of the REIT regulations provides that “The Trustee or its associates shall not invest in units of the REIT in which it is designated as Trustee. Also, point 13 (b) of Schedule III and point 15 of Schedule IV of the REIT Regulations requires brief description of the material litigations and regulatory actions, whether completed or pending, against the REIT, sponsor(s), Investment Manager, Trustee, or any of their associates, if any in the last 5 years.

11.2. Rationale for proposal

It has been represented that the trustee is an independent entity, which is a Debenture Trustee registered with SEBI. Further, the trustee does not have any financial interest in the REIT, except the fee for its services as a Trustee. Also the assets of the REIT are independent of the assets and liabilities of the trustee company and are even protected against insolvency of trustee. Hence, disclosure of associates of Trustee is not material for any investors in the REIT. Therefore, certain disclosures need not extend to Trustee.

11.3. Proposal

In view of the above it is proposed that the following amendment may be made to the REIT Regulations:

a) Associates of the trustees would not form a part of the parties to the REIT.

b) Associates of Trustees would be allowed to invest in units of the REIT in which it is designated as Trustee, subject to such transactions being conducted at an arm’s length basis.

c) The disclosure of litigations related to associates of trustee would not be required to be given as per Schedule III and Schedule IV of the REIT Regulations.

12. Operational aspects:

12.1. Liability of the unit holders

A. Current regulatory requirement

As per the REIT Regulations, the liability of the unit holders is limited to the extent of the units held by them. However, representations have been received that the REIT Regulations explicitly doesn't provide for the clause on the liability of unit holders.

B. Proposal

It is proposed to clarify that the unit-holder is an investor and its rights and obligations are limited to the amount of its investment in the units of REITs.

12.2. Rationalizing the experience of the associate of the sponsor

A. Current regulatory requirement

Regulation 4(2)(d)(iii) of the REIT Regulations provide that the sponsor or its associate(s)shall have not less than five year experience in development of real estate or fund management in the real estate industry, provided that where the sponsor is a developer, at least two projects of the sponsor should have been completed.

B. Proposal

In order to provide operational freedom to the sponsor, it is proposed that where the sponsor is a developer, at least two projects of the sponsor or its associates should have been completed.

12.3. Obtaining confirmation or a fairness opinion from a chartered Accountant / Valuer

A. Current regulatory requirement

Regulation 9(5) of the REIT Regulations provides that the Trustee shall review the transactions carried out between the manager and its associates and where the manager has advised that there may be a conflict of interest, trustee shall obtain confirmation from a practicing chartered accountant that such transaction is on arm's length basis;

B. Proposal

It is proposed that in case of the RPTs, as referred in regulation 9(5) of the REIT Regulations, the trustee shall obtain confirmation or a fairness opinion from a practicing chartered accountant or a valuer, as the case may be.

12.4. Pricing of Related Party Transactions for purchase/sale of real estate assets

A. Current regulatory requirement

Regulation19(3)(c)of the REIT Regulations, provides that in respect of related party transactions, the transactions for purchase/sale of such assets shall be at a price not greater / less than average of the two independent valuations respectively.

B. Proposal

Representations have been received that the regulatory requirement of for purchase/sale of assets from a related party at a price not greater / less than average of the two independent valuations respectively, is restrictive and doesn't provides the REIT any flexibility while entering in such a transaction. Therefore, to provide REITs flexibility and a window to price the transactions, following is proposed:

a) In case of a purchase transaction, the property shall not be purchased at a value greater than 110% of the average of the two independent valuations.

b) In case of a sale transaction, the property shall not be sold at a value less than 90% of the average of the two independent valuations.

12.5. Change in sponsor or re-designated sponsor or change in control of sponsor or re-designated sponsor within a year.

A. Current regulatory requirement

Regulation 22(8)(c) of the REIT regulations provides that in case of any change in sponsor or re-designated sponsor or change in control of sponsor or re-designated sponsor, if on account of such sale, the holding of unit holders which are not related parties to the REIT falls below 200 or the minimum public float falls below 25%, the trustee shall apply for delisting of the units of the REIT in accordance with regulation 17 of these Regulations.

B. Proposal

It is proposed that in case of public float decreasing below 25% and number of unit holders forming part of the public falls below two hundred, the new sponsor should have a one year window to comply with the above said requirements by secondary sale or dilution through a fresh issuance. Further, the current requirement of minimum float of 25% and the minimum number of unit holders forming part of the public at two hundred, shall be finalized in terms of the decision taken in regards to the proposal as mentioned at point 9 above.

IV. Public Comments:

In light of the above, public comments are invited on the proposals contained in the consultation paper. Comments/ suggestions may be provided in the format given below:

Name of entity / person / intermediary/ Organization			
Sr. No.	Pertains to Point No.	Suggestions	Rationale

The comments may either be forwarded by email to reit@sebi.gov.in or may be sent by post to the following address latest by August 07, 2016.

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