

Nangia Andersen LLP

Newsflash

SEBI Consultation paper
on Regulatory Framework
for Micro, Small and
Medium REITs

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SEBI Consultation paper on Regulatory Framework for Micro, Small, and Medium REITs (MSM REITs)



On 12 May 2023, the Securities and Exchange Board of India (SEBI) issued a consultation paper to seek public comments for regulating platforms offering fractional ownership of real estate assets. The proposal is to bring in fractional ownership of real estate assets as Micro, Small, and Medium REITs (MSM REITs) under SEBI (Real Estate Investment Trusts) Regulations, 2014.

Background

In the past 2-3 years, the Fractional Ownership Platforms (FOPs) have been providing investors an option to invest in buildings and office spaces including warehouses, shopping centres, conference centres, etc with ticket size in the range of INR 10-25 lakhs. The underlying real estate assets offered on FOPs are similar to the real estate or property defined under the REIT Regulations.

Given the increasing value of investments with such FOPs, it became necessary to regulate FOPs in order to bring about, inter-alia, regulatory oversight, common uniform standard disclosure practices, ensuring liquidity by way of listing or similar such measure, investor redressal mechanism, etc. to safeguard the interest of investors.

How FOP works?

Fractional investment of real estate through FOPs is an investing strategy in which the cost of acquisition of real estate is split among several investors, who invest in securities issued by a special purpose vehicle (SPV) established by an FOP. Such SPVs purchase real estate assets. FOPs allow investors to own a certain percentage or fractional share in the real estate asset through the securities issued by the SPVs.

FOPs facilitate investment in primarily pre-leased real estate, which earn the investors a rental yield as well as permits participating in potential rise in value of such real estate. They reduce the financial burden on a single investor and provides opportunities to diversify real estate portfolios by investing in multiple real estate assets across different locations and cities.

Proposed Scope of Regulation

Key points of the proposed regulatory framework are given below:

- **Structure of MSM REIT**
 - MSM REIT to be set up as a Trust with separate and distinct schemes for owning of real estate assets through wholly owned (100% by Trust) SPVs constituted as a company
 - MSM REIT to have parties such as trustee, sponsor and Investment Manager with each such person being a separate and distinct entity
- **Provision for registration and regulation of FOPs under REIT Regulations**
 - MSM REIT to be registered with SEBI as MSM REIT under the REIT Regulations
 - Sponsor to have at least 5 years' experience in real estate industry as developer/fund manager
 - Sponsor to hold 15% of the total units of the MSM REIT for each scheme for a period of at least 3 years from the date of listing of such units
 - Sponsor and Investment Manager to have a net worth of at least INR 20 crore and Rs 10 crore, respectively
 - Investment Manager of MSM REIT to not pursue any other business other than management of MSM REIT and its Schemes or SPVs held by such Schemes
 - Investment Manager of MSM REIT to satisfy the prescribed conditions for industry experience and qualified personnels
 - On satisfying with the eligibility conditions, SEBI to grant MSM REIT certificate of registration. After registration, the MSM REIT to raise funds initially through an initial offer of units of a scheme
 - Listing of units of the MSM REIT Schemes to be mandatory
 - Size of the asset proposed to be acquired to be minimum INR 25 crores and maximum INR 499 crores
 - At least 95% of the schemes AUM to be invested in completed and rent generating real estate properties at all times
 - At least 20 investors (resident or foreign) unrelated to the Sponsor, its related parties required. Minimum subscription size is INR 10 lakhs and maximum not exceeding 25% of the total unit capital
 - MSM REIT Schemes not to be allowed to raise debt
- **Existing entities (including FOPs) to ensure that each SPV formed by it is effectively transferred to an MSM REIT Scheme that exclusively will own such SPV, and the investors who were issued securities by such SPV shall receive units of such MSM REIT Scheme in lieu thereof**
- **Conditions pertaining to valuation of assets, disclosure and reporting requirements and investor protection provided**
 - SEBI to specify the cap on total expense ratio for MSM REIT

Nangia Andersen LLP's Take

The consultation papers is a welcome move by SEBI to initiate the regulation of real estate fractional ownership platforms which effectively operate as micro REITs. The SEBI initiative is likely to augur well for investor protection as well as give impetus to these platforms as alternate source of funding to the developers. Public comments on the regulatory framework proposal for MSM REITS contained in the discussion paper and specific comments on the questions mentioned below are requested latest by 27 May 2023

Specific questions are listed below:

- a. Whether to bring persons /entities (including FOPs) organizing or undertaking or facilitating fractional real estate investments under regulatory perimeter?
- b. If so, whether MSM REIT and schemes thereunder as outlined above are appropriate
- c. Whether the time period for existing Persons/Entities (including) FOPs with SPVs to migrate to MSM REIT within six months is sufficient?
- d. Whether net worth of Sponsor of INR 20 crores is adequate?
- e. Whether relevant experience of Sponsor outlined above is sufficient?
- f. Whether the minimum Unitholding requirement of sponsor outlined above shall be mandated?
- g. Whether net worth of Manager of INR 10 crores is adequate?
- h. Whether the cap on Consolidated value of MSM REIT to INR 500 crores or scheme should be capped at INR 250 crores or INR 500 crores?
- i. Whether minimum subscription should be mandated to INR ten lakhs?
- j. Whether trading lot should be kept as minimum value of INR ten lakhs?
- k. Whether the requirement on sponsor holding at least 15% of the total number of units of the MSM REIT on post initial offer basis for a period of atleast three years post listing of units adequate?
- l. Whether the Sponsor and Investment Manager should be two distinct entities, or Whether only one entity (i.e. the Investment Manager) can take up the roles and responsibilities of both the Sponsor as well as Investment Manager? Kindly provide your comments with supporting rationale.



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