REGULATORY LANDSCAPE FOR SM REITS IN INDIA

The Securities and Exchange Board of India **("SEBI")** amended the SEBI **(Real Estate Investment Trusts)** Regulations, 2014, ("REIT Regulations") in March 2024 to allow for the creation of SM REITs. The primary purpose of this amendment was to regulate fractional ownership platforms ("**FOPs**") offering ownership in real estate assets.

FOPs enable investors to access real estate assets that might otherwise be inaccessible due to high entry costs. However, while the number and value of such platforms are increasing, several concerns have surfaced regarding their regulatory oversight and investor protection. The main issues stem from the untested nature of the instruments, promises of high returns, ambiguity in legal recourse for investors, inconsistent disclosures related to property valuations, title diligence and investment risks. Additionally, FOPs are heavily dependent on their platform's ability to provide liquidity, valuation clarity, and proper exit strategies, which are often not guaranteed. This has resulted in increased regulatory scrutiny.

SEBI amended the REIT Regulations to extend the REIT framework to FOPs for better governance, investor protection and liquidity options. The SM REIT framework under the REIT Regulations introduces specific parties, structures, eligibility criteria, and requirements for registration and management, distinct from traditional REITs.

Parties to SM REITs

An SM REIT is set up as a trust and registered with SEBI. The key parties to an SM REIT are the Investment Manager ("IM") and the Trustee. An IM, which must be a company incorporated in India, is responsible for setting up the SM REIT, managing its assets and investments and overseeing operational activities. The IM must satisfy minimum eligibility criteria regarding net worth, experience, and the composition of its Board of Directors before applying to SEBI for a certificate of registration as an SM REIT.

The Trustee of an SM REIT must be registered under the SEBI (Debenture Trustees) Regulations, 1993, and should not be an associate of the IM. The trustee holds the assets of the SM REIT and its schemes in trust for the benefit of the unit holders, ensuring compliance with applicable laws and safeguarding investor interests.

Key Aspects of SM REITs

An SM REIT can invest in real estate assets by launching a scheme, which must have a minimum corpus of at least Rupees fifty crore (Rs. 500 million) and less than Rupees five hundred crore (Rs. 5 billion), with at least 200 investors other than the IM, its related parties and associates of the SM REIT. The real estate assets acquired under the scheme must be directly owned by the SM REIT through a special purpose vehicle ("SPV"), which must be a wholly owned subsidiary of the SM REIT scheme, with no external capital or ownership interest.

An SM REIT is required to invest at least 95% of the scheme's value in completed and revenue-generating properties. The remaining 5% may be invested in unencumbered liquid assets. Additionally, SM REITs are prohibited from entering into any related-party transactions, including those related to facility and property management services.

Registration Process and Requirements

According to Regulation 26I(1), the application for registration must be submitted by the IM on behalf of the trust in the prescribed Form-A, as specified in Schedule IA of the REIT Regulations, along with a non-refundable application fee. The application must include details of the SM REIT, IM, and Trustee, along with disclosures regarding the business plan, investment strategy, and any past regulatory actions against the SM REIT, its parties, their directors and promoters.

Once SEBI is satisfied that the SM REIT meets all the necessary requirements, it will grant the certificate of registration. This is sent to the SM REIT upon payment of the registration fees, as detailed in Schedule IIA. Registration is formalised with the issuance of a certificate in Form-B, accompanied by specific conditions to ensure compliance with governance and investor protection norms.

Regulation 26M specifies the operational conditions post-registration. These include adherence to the relevant laws, submission of migration plans at the time of application, and timely updates to SEBI regarding any false or misleading information previously submitted. Additionally, the SM REIT and its parties must comply with ongoing regulations, including the Code of Conduct specified in Schedule VI wherever applicable.

Launching a Scheme under the SM REIT

An SM REIT must launch a scheme within three years of registration, failing which it must surrender its certificate of registration and cease operations. However, SEBI may extend the initial offer period by up to one year, if deemed appropriate.

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To launch a scheme, the IM must appoint one or more registered merchant bankers. The minimum price of each unit in the SM REIT scheme must be Rupees ten lakh (Rs.1 million), and at least 25% of the total outstanding units must be held publicly. All scheme units must be issued in dematerialised form.

To ensure the IM has a continuing interest in the scheme, SEBI mandates certain minimum lock-in requirements for the IM's unitholding, depending on whether the scheme undertakes leverage.

The primary steps in listing a scheme are as follows:

1. The draft scheme offer document, filed by the IM through the merchant banker with SEBI, must be hosted on the websites of SEBI, the stock exchanges, and the merchant banker for 21 days.
2. SEBI may issue observations, which the merchant banker must incorporate into the scheme offer document.
3. The issue period cannot exceed 30 days.
4. During this time, the IM must issue public notices on the SM REIT's website disclosing all material developments affecting the scheme.
5. Investors subscribe via the Application Supported by Blocked Amount (ASBA) mechanism.
6. Units are allotted upon receipt of payment within a specified timeline.
7. The merchant banker files a post-issue report and a due diligence certificate within seven working days of finalising the allotment or refunding money if the issue fails.

The regulatory framework for SM REITs aims to ensure a robust, transparent and well-governed structure. By setting clear eligibility and operational guidelines, SEBI seeks to promote investor confidence, enhance market liquidity, and foster growth in real estate investments in India. This framework not only protects investors but also standardises practices across FOPs and SM REITs, contributing to a more inclusive and dynamic real estate market.

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