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An Overview of Real Estate Investment Trusts in India

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Real Estate Industry is one of the largest growing sectors in India. This industry has evolved from a traditional to a more organized and structured form. Real Estate over a while has opened venues for many different investment options like Real Estate Mutual Funds, Crowd funding, and Real Estate Investment Trusts (REITs). REIT is one such investment option that is gaining popularity across the nation. It was initially introduced in the USA and later spread across 40 nations with 893 total listed REITs.[1] In India, the REIT Regulation was passed by SEBI in September 2014. In a developing market like India, REITs are taking off at a slow pace, as it is notable that since its inception REIT India has 4 listed REITs.[2] This research attempts to offer an overview of the REITs, and an analysis of the recent amendment by SEBI, in REIT Regulation. The first part of the paper attempts an overview of REITs, the Global presence of REITs, their types, the REIT's working model in India, outlining the eligibility and responsibility of various stakeholders, and the advantages and limitations of REITs. The second part of this research explains the REITs' Regulatory Amendments brought in by SEBI in 2023 and a critical Analysis of such amendments. The paper concludes with suggestions and emphasizes the potential of REITs as a viable investment option for investors looking to diversify their portfolios and gain exposure to the real estate sector.

Keywords: *real estate, sebi, regulations, investment, stock exchange.*

[1] 'Global Real Estate Investment' (*Nareit*) <https://www.reit.com/investing/global-real-estate-investment> accessed 16 August 2023

[2] 'India likely to see listing of four REITs in next 18 months: Property stalwart Anshuman Magazine' (*The Economic Times*, 26 May 2023) <https://economictimes.indiatimes.com/markets/stocks/news/india-likely-to-see-listing-of-four-reits-in-next-18-months-property-stalwart-anshuman-magazine/articleshow/100519524.cms?from=mdr> accessed 16 August 2023

INTRODUCTION

Real estate has historically been regarded as the most valuable component of wealth in the global economy. This also helps to balance the economy and increase people's incomes. The expansion of the real estate industry is seen as one of the key indicators of a country's economy. There is no disputing that when it comes to investment, Indians prioritize Real Estate. In most of the cases, the investments were in the form of residential houses or residential plots and never can an individual investor consider investing in the commercial properties due to its high-ticket size. Apart from the huge investment requirement, the hassles in seeking necessary regulatory approvals are another reason for individual investors not to explore investing in commercial income-generating real estate. On the other hand, investing in mutual funds always has its market risks and volatility.

Thus, it's the need of the hour for a developing country like India to promote other asset classes as investment options. To meet the needs of investors, and to bring in the necessary capital to the infrastructure and Real Estate Industry the Indian Government has introduced Real Estate Investment Funds, Infrastructure Investment Funds and Alternative Investment Funds which are governed by SEBI (Security Exchange Board of India). These instruments give investors various investment possibilities. It is said to be tough to see the country's progress without structured Investment options.

REITS IN THE GLOBAL MARKET

REIT was introduced in the developed country USA in 1960. The lawmakers of the REIT intend to allow their countrymen to enjoy the benefits of investing in commercial real estate. Real Estate Investment has come across vast changes the central objective of the REIT model remains the same. The REIT concept has not stopped with the USA, this model of Real Estate Investment Trusts was adopted across the Countries in the World. According to recent research by the National Association for Real Estate Investment Funds, there are 893 total listed REITs globally accounting for 83% of global GDP with a combined population of over 5 billion people that have implemented REIT laws across 41 nations and regions.

Asia has a strong uptake of REITs, growing from 31 REITs in six countries and regions in 2005 to 223 REITs in 11 countries and regions in 2022. Since 2015, the number of Asian REITs has grown by 58% (or 82 REITs), with more REITs in every country in the region and five REITs in China with the country's adoption of the REIT structure in 2021. Notably, South Korea had the most significant increase with three REITs in 2015 to 21 in 2022.[3]

ABOUT REITS

REITs or Real Estate Investment Trusts are Companies that buy, finance, and manage income-producing real estate and are often listed on stock exchanges like other public corporations.[4] It can be a property of any type like an apartment building, self-storage facility, office building or shopping center, all different types. REIT is a combination of Real Estate as a product and has the concept of a Mutual Fund that offers regular income streams, diversity and long-term capital growth to investors. Real estate has been the most popular type of investment in India and typically, involvement in real estate has meant buying private property primarily for residential use. REITS opened the venue of investing in commercial properties for retail investors, which is otherwise not a feasible option.

In 2007, SEBI in India published its proposed REIT regulations. The regulators have worked with real estate developers, significant stakeholders, government agencies and investors to bring them in line with globally accepted norms. The Real Estate Investment Trusts Regulations, 2014 (REIT Regulations) was passed in India on September 26, 2014, which was later followed by multiple Amendments. Real Estate Investment Trusts will hereinafter be mentioned as REITs.

[3] 'Global REIT Approach to Real Estate Investing' (*Nareit*) <https://www.reit.com/sites/default/files/2023-04/2023_Global_REIT_Brochure.pdf> accessed 16 August 2023

[4] *Ibid*

TYPES OF REITS

Classification of REITs based on Nature of Operation:

- **Equity REIT:** Equity REITs are the most common form of REITs, as they own the income-producing properties. Their major source of earnings is from Rents and the earnings will be divided among all investors. The REITs in India are Equity REITs.
- **Mortgage REIT:** Mortgage REITs do not generate money from rent, but rather through EMI or mortgage payments as these REITs lend loans to the real estate industry. These also acquire mortgage-based assets that generate revenue in the form of interest distributed to all investors. They are often known as mREITs.
- **Hybrid REIT:** This is the combination of both the characteristics of Equity and Mortgage REITs. They include both owned and mortgage-based properties and generate consistent income through rent and interest. It enables investors to diversify their earnings and earn from both sources.

Classification of REITs based on Registration & Listing:

- **Publicly Traded REIT:** REITs that are registered with the stock exchange and listed on the Stock Exchange.
- **Public but not listed REIT:** These REITs are registered with the stock exchange but have not gone for the listing of their units.
- **Private REIT:** These are REITs not registered with SEBI and not listed on any stock market.

Classification of REITs based on Sector of operation:

- **Office REITs** invest and operate mostly in office property.
- **Commercial REIT's** major underlying asset is commercial retail space, such as malls and freestanding retail businesses.
- **Residential REIT** invests largely in housing real estate such as apartment buildings, residential complexes and so on.

- **Healthcare REIT** is a trust that primarily owns and operates healthcare facilities such as hospitals, clinics and diagnostic centers.
- **Infrastructure REIT** holds communications towers and fiber optic cable, which house the equipment used to transport voice and data messages and allow data to move between devices all over the world.
- **Data Center REIT** owns the buildings that contain the servers that assist in connecting data communications, storing data and keeping the internet running.
- **Industrial REITs** and logistics facilities, which are critical in e-commerce and cold storage are owned by industrial REITs. Temperature-controlled warehouses ensure the quality of products such as electronics, frozen and fresh perishable grocery items and medical supplies before they are delivered.

REITS IN INDIA

Though the SEBIs Regulation for REIT came into force in India on September 26, 2014, the first REIT listed was in April 2019. It's pertinent to note that in India, only public REITs that have been registered with SEBI are in effect, as opposed to other nations like the US where private REITs and public non-listed REITs are also regulated. The REITs in India are Equity REITs and majorly into office space while the recently listed Nexus Select Trust REIT is the only retail REIT. In India, the first REIT Embassy Office Parks was listed in April 2019. Following this, Brookfield India Real Estate REIT was listed in early 2021 Mind Space Business Parks REIT was listed in August 2020, and Nexus Select Trust REIT was listed in 2023.

STRUCTURE OF REIT

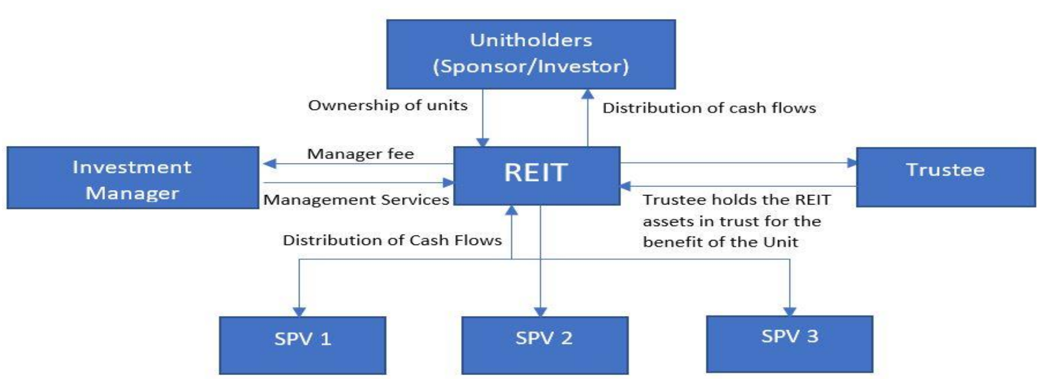

Fig 1: Go-Yubi[5]

As per SEBI guidelines, the sponsor is the person, who establishes Real Estate Investment Trust and appoints a Trustee for the REIT. The Trustee is to identify and appoint an Investment Manager to handle the Management services. REITs that are registered with SEBI and listed on the Stock Exchange shall bring public issue, as its Initial Offer and list its units in the Stock Exchange. Through an initial public offering (IPO), money is obtained from unit holders and utilized by the REIT to buy a pool of real estate holdings. These real estate properties are in turn leased out and the income received from such a lease is distributed to the unit holders in the form of dividends.

REGULATIONS OF REITS

Trustee: A trustee is a person or company who holds and manages property or assets for the benefit of unit holders.[6] It's important to note that the trustee or its associate is not to invest in units of the REIT in which it is designated as the trustee.[7]

Trustee Eligibility: The Trustee should be registered under the SEBI Debenture Trustee Regulations and should not be the associate of the Sponsor or the Manager.[8]

Key Responsibilities of Trustee: The responsibilities of the Trustee are regulated in such a way that they function to protect the interest of the unit holders, safeguard the Assets of the REIT, and supervise the functions of the managers.

Safeguard the Assets: Shall keep the REIT assets in trust for the benefit of the unit holders.[9]

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5 Manav Mahajan, 'The Success of REITs – Participation of Retail Investors in Equity' (*Yubi*, 7 April 2022) <https://www.go-yubi.com/blog/the-success-of-reits-participation-of-retail-investors-in-equity/> accessed 15 August 2023

6 Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 2(zv)

7 Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(15)

8 Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(f)(i)

9 Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(1)

Responsibilities towards the unit holders: The trustee shall assess the status of unit holders' concerns and the manager's resolution of them regularly[10], the trustee must make sure that the Manager calls meetings of unit holders in line with the Regulations, monitors unit holder voting, and announce the results of such voting.[11] The trustee shall obtain prior approval from the unit holders and the Board in case of a change in control of the manager.[12]

Supervising and overseeing the activities of the Manager: The Trustee is in charge of negotiating an investment management Agreement with the manager on behalf of the REIT and making sure the manager complies with the regulations' requirements for reporting and disclosures.[13] The Trustee must also examine the transactions made between the manager and its associates.[14] Appointment and removal of the Manager, subject to compliance with REIT Regulations.[15]

Sponsor: The sponsor is the person who brings in the initial capital for the REIT creation, In the context of SEBI's laws for REIT, he is the person who establishes the REIT and appoints the Trustee for the REIT[16] and is in charge of ensuring that it complies with the rules. Before the allotment of units, the sponsor is required to transfer his entire shareholdings or interest and any rights in the Holdco or SPV or any ownership in the real estate property to the REIT.

Eligibility for a sponsor: Each sponsor is required to have a minimum net worth of 20 crores and collectively required to maintain a minimum net worth of 100 crores.[17] The sponsor or its Associates should have at least 5 years of experience in the Development of Real Estate and fund

[10] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(6)
[11] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(11)
[12] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(14)
[13] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(4)
[14] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(5)
[15] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 9(13)
[16] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 11(1)
[17] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(d)(ii)

management in Real Estate.[18] Each sponsor is to hold at least 5% of the number of units of the REIT on a post-initial offer basis.[19]

Responsibility of the sponsor: Sponsor shall hold at least 15% of the total units of REITs and any holdings greater than the said 15% shall be held for at least one year from the date of listing of such units.[20] The regulation allows the sponsor to declassify themselves as sponsors from the Business Trust, in that case, the sponsor to ensure that REIT units have been listed on the stock exchange for three years. Before the allotment of units in the initial offer Sponsor is required to transfer all the Real Estate Assets, that he has at the time of REIT formation from his name to the REIT.

Manager: The Manager is in charge of making investment choices for the REIT, managing REIT assets, and carrying out general business activities. A REIT's corporate functions include conducting unit-holder meetings, assuring compliance, and addressing investor complaints.

Eligibility for Manager: A Company or Body Corporate or LLP can be the REIT Manager. In the case of a Body corporate or a Company being the REIT Manager, its net worth should be at least 10 crores and in the case of an LLP being the REIT Manager, then the net tangible asset value should be at least 10 crores.[21] The manager or his associate should have five years of experience in fund management advisory services or property management in the real estate industry or development of real estate.[22] The Manager should have at least two Key Managerial Personnel, each with at least five years of expertise in real estate development, fund management, consulting services, or property management.[23] The board of directors (or governing board of the LLP, as the case may be) of the Manager should consist of at least 50% independent Directors, and such independent directors should not be directors (or members of governing board of LLPs) of any other REIT.[24]

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[18] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(d)(iii)
[19] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(d)(i)
[20] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations2014,11(3)
[21] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(e)(i)
[22] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(e)(ii)
[23] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(e)(iii)
[24] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 4(2)(e)(vi)

Key Responsibilities of the Manager:[25] Deciding on investments relating to REIT assets, including any future investments or REIT asset sales. Making timely appointments of different middlemen concerning the activities of the REIT after consulting with the Trustee, this includes auditor, registrar and transfer agent, merchant banker, custodian and any other intermediary or service provider or agent for managing the assets of the REIT. Making sure that all unit holders' complaints about REIT operations are adequately and promptly addressed and being in charge of all activities related to the REIT unit issuance and listing. Performing any additional tasks that have been entrusted to it.

Holdco or Holding Company:[26] It is an LLP or business in which REIT has ownership and intends to hold a stake of at least a 51% equity investment. It is only permitted to conduct operations related to owning underlying SPVs and infrastructure projects.

SPV or Special Purpose Vehicle:[27] Any company or LLP that is formed for a special purpose and holds at least 80% of its assets directly in real estate does not invest in other special purpose vehicles and holds at least 51% of its equity share capital or interest in either the REIT or the Holdco and is not engaged in any activity other than holding and developing real estate and any other activity.

Investment Conditions: SEBI has enabled REIT, to either directly invest in Real Estate or to create a special Investment vehicle (SPV) and SPV to invest in Real Estate or REIT to create Holdco and Holdco has an option to directly invest in Real Estate or Holdco to invest in one or more SPVs, which in turn would invest in Real Estate. When a REIT is investing through SPV or Holdco, the REIT should have 51% of its interest with the respective SPV or Holdco. SPVs are not allowed to invest in another SPV and not to engage in any other activity. SPVs are not allowed to invest in other SPVs, and REITs are not allowed to invest in another REIT to avoid cross-holdings.

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[25] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 10

[26] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg (qa)

[27] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg (zs

Out of the total investment, 80% of the investment is to be made in properties that are capable of generating revenues[28] and strictly prohibited from investing in vacant land, agricultural land and mortgages.

Regulations for Issue and Listing of Units:[29] When a REIT offers Public Issue, as its Initial Offer and lists its units in the Stock Exchange below are the Regulations that the REIT has to comply with.

a) REIT to be registered with SEBI.

b) The value of all the Assets by REITS should be greater than 500 crore rupees

c) The minimum number of Unit holders is to be 200.

d) Maximum subscription from any Investor shall not exceed 25% of the total units.

Distribution Policy: REITs pay dividends and interest on their net rental income. This is the revenue received by a REIT from renting and leasing commercial real estate after deducting certain critical expenditures connected to facility management and maintenance. Management fees, depreciation, maintenance charges, and other expenses are subtracted from Gross Rental Income to calculate a REIT's Net Income. According to the current SEBI requirement, REITs must pay out at least 90% of net rental revenue as dividends and interest to investors.

According to the current SEBI requirement, REITs must pay out at least 90% of net rental revenue as dividends and interest to investors.[30] In addition, the SPVs must distribute at least 90% of their net distributable cash flows to the REIT or, if applicable, the Holdco. If a REIT has a two-tiered structure, the Holdco must distribute to the REIT, 100% of the cash flows it receives from the SPVs and 90% of the net distributable cash flows it generates. These distributions are to be made once every 6 months in the financial year as per the guidelines.

[28] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 18(4)
[29] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 14
[30] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 18(16)(b)

In addition to the above-mentioned periodic distributions, if the REIT sells any real estate asset, at least 90% of the proceeds of such sale must be distributed to Unitholders unless such proceeds are proposed to be reinvested in other real estate assets within a year.

Taxation: For the investors, the interest income obtained and Rental income from property held from REITs is taxed at the applicable rate. The tax on dividend income is determined by whether the REIT received a special tax concession from the government. If so, the dividend is taxable in the investor's hands. Otherwise, no tax is levied. Income from SPV debt amortization is similarly tax-free in the hands of the investor. Capital gains on the sale units of REITs are liable to Short-term capital gain tax at a rate of 15% if held for less than one year. Long-term capital gains beyond INR1 lakh are taxable at 10% if held for more than a year.

BENEFITS OF THE REITs

Benefits to the Sponsor: REITs invest in income-producing real estate. It provides a cheaper cost of capital by attracting the right type of long-term investor (pension funds).

Benefits to the Unit Holder:

- **Small Investment:** One of the most significant issues with Real Estate investments is the enormous ticket size and REITs; on the other hand, demand a far lower initial investment of roughly Rs. 15.
- **Diversifying Portfolio**: REITs are great investments for portfolio diversification. They provide exposure to real estate without owning and managing commercial property.
- **Regular source of Income:** REITs provide a consistent source of income for their investors, 90% of its rental revenue is distributed to its investors in the form of interest and dividends.
- **Capital gains**: REITs offer the investor Capital Gains, as the REITs are listed and traded on stock exchanges, and their value is determined by their performance. A well-performing REIT may thus rise in value over time and be sold at a profit.
- **Professional Management:** Professional Management is the inbuilt nature of REIT.

LIMITATIONS IN THE REITs

Performance of REIT basis the sector: REIT returns vary greatly depending on the respective trust in which the investment was placed, Each REIT has a significantly distinct risk and return portfolio. The fact that the underlying industry in which REIT invests is not performing well, the REIT's performance also would be in the same line. Thus, the performance of the REIT greatly depends on the underlying sector's performance.

Limited Growth: Approximately 90% of the rental revenue earned by REITs from these assets is distributed to investors as a dividend. Only 10% is kept, and that is only for emergencies and administrative costs. As a result, REITs are often unable to expand the number of properties under management. Any expansion is solely the outcome of price increases.

Economy: Commercial properties are not immune to economic difficulties such as a recession. If the economy deteriorates, REITs may suffer and the rise in loan interest rates reduces returns.

Taxable: The interest earned by REITs is taxable. In addition, capital gains from the sale of REIT units are taxed as Short-Term Capital Gains and Long-Term Capital Gains, as they are for equity investments.

REITs AMENDMENTS 2023

Definition of 'change in control': Because the REIT Regulations' definition of 'change in control' had a narrow scope, SEBI worked to harmonize the term's definition to cover

(a) listed companies and listed body corporate and link it to the definition of 'control' under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(b) unlisted companies or unlisted body corporate, and link it to the definition of 'control' under the Companies Act, 2013;

(c) for entities other than body corporate, the scope of the term has been expanded to include changes to its legal formation or ownership or changes to the controlling interest of not less than 50% voting rights or interest.[31]

Independent Directors: There was no codified definition for 'Independent directors' in the current framework required that at least half of the investment manager's board of directors (or governing board in the case of an LLP) be made up of independent members. The REIT Regulations' definition of an 'Independent director' is formalized by the Amendment, which also aligns it with the Listing Regulations.

Senior Management: A new concept of 'senior management' has been introduced and this is in line with the Listing Regulations. Senior management is defined as the officers and employees of the investment manager who make up its core management (apart from the board of directors), as well as the company secretary and chief financial officer, who are at the same level as the chief executive officer, managing director, or whole-time director.

Appointment of Auditor: The Amendment has now clarified that the investment manager of the Trust shall appoint an auditor for the Trust for five years, which shall end upon the conclusion of the sixth annual general meeting of the unit holders. This provision is introduced to avoid situations where the REIT has been established before the initial offering. If the auditor is an individual, they are not eligible for reappointment after serving one five-year term; if they are a firm of auditors; they are not eligible for reappointment after serving two five-year terms. Also, a five-year cooling-off period has been announced, during which such auditors will once more be qualified for new appointments. These modifications comply with the standards that apply to listed companies.[32]

Limited review of consolidated entities by the Trust's auditor: Under the applicable Indian Accounting Standard, the Trust's auditor is now required to conduct a limited review of the audit of all entities whose accounts are being consolidated with the Trust's accounts.[33] Before

[31] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 2(g)
[32] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 10(6)
[33] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 13(5)

the amendment, the auditor of the Trust was required to undertake the audit or limited review of the financials of the Trust, and the auditor was not obliged to perform procedures on the financial statements of the businesses that are being consolidated or combined with the Trust's financial statements. This amendment is introduced to provide a higher level of assurance on the disclosures made by the Trust.

Calculation of leverage threshold: Under the Borrowings and deferred payments as per regulation 20, the total combined borrowings and deferred payments of the Trust, the holding company, and/or the special purpose vehicles, net of cash and cash equivalents are not allowed to exceed 49% of the Trust's assets. By the 2023 amendment, investments in overnight mutual funds, which are distinguished by their investments in overnight securities and have a maturity of one day, have been categorized as being under the category of cash and cash equivalents to calculate leverage. Additionally, the valuation of the Trust's assets must not include the cash and cash equivalents and it shall be excluded from the consolidated borrowings and delayed payments to determine the total consolidated borrowings. The computation of the leverage ratio for Trusts may need to be reevaluated, in a way that the overall leverage does not get decreased. This is because the Amendment now mandates that cash and cash equivalents be cut not just from debt but also from the total assets of the Trusts.

Obligations of the Investment Manager: This Amendment has introduced Obligations of the Investment Manager in Chapter VIA which brought in the application of certain corporate governance requirements under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, with the requisite customizations for such Trusts.

Introduction of Investor Protection and Education Fund: Any funds that are unclaimed or unpaid to the distributions that a REIT has declared per those rules must be transferred to the 'Investor Protection and Education Fund' which was established by the Board.[34]

[34] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 18(16)(f)

Vigil Mechanism: Investment managers must now create monitoring systems, such as a whistleblower program, allowing directors and staff to disclose legitimate concerns. The Amendments further provide that the audit committee must examine how the vigil mechanism is working and that it may be provided or operated by an independent service provider who would report to the audit committee. Including a safeguard mechanism is a strong framework for business trust governance.[35]

SEBI's BOARD MEETING on 28 JUNE 2023 - REIT Amendments

SEBI's Board meeting on 28 June 2023[36] adopted many substantial changes to the regulatory system governing InvITs and REITs. The proposal for this modification was initially made available for public comment in a consultation document titled 'Consultation Paper on Special Rights to Unit Holders and the Role of Sponsor in REITs & InvITs' dated 16 May 2023 ('First Consultation Paper'). The consultation Paper is based on feedback from stakeholders during the consultation stage. These revisions significantly alter the dynamics of the parties involved in REITs, notably the Sponsors, Unit holders, and Investment Manager. The modifications are not just confined to the functions, but also to their core duties.

Board Nomination Rights: The REIT Regulations prohibit any unit holder of REIT from having superior voting rights or other privileges over another unit holder. As a result, the prevailing legal framework did not allow major institutional investors to have board nomination rights. SEBI has approved the amendment for Director Nomination by the unit holders in its Board Meeting. It amended the REIT Regulations to require each unit holder owning at least 10% of a REIT to designate a director to the board of the Investment Manager of the REIT, respectively. In case the unit holdings are less than 10% for any unit holder, they can combine with other unit holders to get an aggregate of 10%, and they are called 'Combined Unit holders' and they can nominate the Director on the Board of Manager of the REIT.

[35] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 26C
[36] 'SEBI Board Meeting' (*Securities and Exchange Board of India,* 28 June 2023) <https://www.sebi.gov.in/media/press-releases/jun-2023/sebi-board-meeting_73278.html> accessed 21 October 2023

Minimum Withholding Requirement for a Sponsor: For a minimum of three years after the date of listing of units issued or initial offer, a Sponsor is required to hold at least 25% of the total units of the REITs This was amended in 2022 in a way that the sponsor shall hold at least 15% of the total units of REITs and any holdings greater than the said 15% shall be held for at least one year from the date of listing of such units.[37]

Lock-in Requirements: During the life of the REIT, the Sponsor must maintain a specific minimum unit holding on a declining scale for the duration of the REIT. The Sponsor's mandatory unit holding should always be locked in and unencumbered. Though below is the structure proposed by SEBI in its consultation paper, there is no definite quantity for sponsor holding mentioned in the amendment.

S. No.	Time period	In percentage
1.	Upto 3 years	15% of total unit capital
2.	3-5 years	5% of total unit capital or INR 1,000 crores, whichever is lower
3.	5-10 years	3% of total unit capital or INR 1,000 crores, whichever is lower
4.	10-20 years	2% of total unit capital or INR 1,000 crores, whichever is lower
5.	Post 20 years	1 % of total unit capital or INR 1,000 crores, whichever is lower

Further, the Board has brought in the principles of the Stewardship Code to be applicable for all unit holders holding 10% or more of the REIT.

Introduction of Self-Sponsored Investment Manager: The Board felt the need to offer an opportunity for mature and independent, professionally managed Investment Managers to emerge and give an extra exit option for Sponsors. In general, it was noticed that most Sponsors would hold some shareholdings or control over the Investment Managers of REITs. This means that for a Sponsor to quit a REIT, it must withdraw both as a Sponsor and from the Investment Managers. Now that SEBI has ensured that Sponsors have a stake for the duration of the REIT's

[37] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 11(3)

life. SEBI has also established an option for Sponsors to leave the REIT by passing on its liabilities to Self-Sponsored Investment Managers and a Self-Sponsored Investment Manager must meet certain requirements for the same.

CRITICAL ANALYSIS

It is necessary to strike a balance between the rights of both the sponsors and the investor since the REIT is a novel financial instrument and neither investors nor sponsors are yet to trust the instrument. And this trust can be gained only by the regulatory aspects of SEBI for the REIT. The question to be answered is whether SEBI by its amendments to REIT, has gained the confidence and trust of the sponsors and investors, and here is the analysis of recent amendments to understand the same.

Minimum Subscription amount: Since 2014 the minimum subscription amount has been reduced from 2 lakhs to 1 lakh to Fifty thousand and in the 2021 amendment this minimum subscription is further reduced to be in the range of ten thousand rupees to fifteen thousand rupees. These changes seek to speed retail investors' acceptance of these products.[38]

Number of Sponsors: Earlier, the regulation mandated up to three sponsors for REIT formation, and the same has been amended later and removed the maximum number of sponsors, which means no limit for the number of sponsors, this is favoring REITs.

Strategic Investor: The concept of 'strategic investor' was introduced.[39] The fact that the units will now be made available to them before the general public is done to increase investors' trust.

Dispute Resolution: One of the most significant changes for 2018 is the requirement in the event of a dispute between the REIT and the shareholders or partners of the SPV, (where any investment is made by the REIT through the SPV) a dispute resolution clause was included in

[38] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 14(14)
[39] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 2(ztb)

the shareholder agreement or partnership agreement.[40] Dispute resolution provisions and this may aid in the preservation of relationships.

Senior Management: With the introduction of the concept of senior management in the 2023 amendment, SEBI hopes to increase transparency and insight by requiring senior management to have a succession plan, establish a code of conduct for themselves, and disclose all significant financial and business dealings to the investment manager's board of directors. However, it is pertinent to note that the existing REIT Regulations do not prescribe any rights, obligations, or disclosures for the entities falling within the scope of 'senior management'.[41]

Vigil Mechanism: Including a Vigil mechanism is a strong framework for business trust governance.

Self-sponsored Managers: SEBI has ensured that Sponsors have a stake for the duration of the REIT's life.

Board Nomination Rights: To increase corporate governance standards and provide REIT unit holders more control over their investments and participation in decision-making Board Nomination Rights for unit holders is being amended.

Lock-in requirements: While SEBI wants to make sure that the sponsor has skin in the game and that their interests are aligned with that of the unit holders, not having a lock-in for life and just for 3 years may lead to sponsors completely withdrawing, leaving the remaining investors and the Investment Manager to bear the consequences of their decisions. However, on the flip side, it's also felt that any M&A deal will probably be complicated by the lock-in rules, especially if a new sponsor wants to join. The lock-in units cannot be used as leverage by the sponsors because the rider states they are unencumbered.

It is evident from the above that, the Regulators are making significant effort to make this instrument investor and sponsor friendly, within the regulatory framework.

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[40] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 18(3)(a)
[41] Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations 2014, reg 2(zra)

MEASURES BY THE INDIAN GOVERNMENT TO STRENGTHEN REITs

The finance ministry proposed changes to assist REITs in borrowing debt capital from overseas portfolio investors in the early months of 2021.[42] This is an attempt to make it simpler for REITs to get financing and increase investment in the real estate market.

The Insurance Regulatory and Development Authority of India authorized insurance firms to engage in debt instruments issued by REITs in March 2021. This step of IRDAI is to provide greater long-term finance for the real estate sector.[43]

SUGGESTIONS

REIT is a success model across the nation. India, considering its market size and potential cannot be an exception. However, at the same time, we cannot ignore the fact that since the inception of REIT regulations in India we have only 4 REITs listed, three in the commercial industry and one of them is a retail-led REIT, integrating its portfolio in the mall properties across the cities. Due to several issues, including low commercial real estate rentals and variations in the performance of commercial real estate based on geographic location, the REIT as an instrument is taking off at a slow pace. The instrument's sluggish takeoff is also a result of the lengthy nature of the site acquisition, legal compliance, and other construction activities. Here are a few suggestions to be considered to boost the REIT market.

1. Fundamental issues with the real estate industry are that the registration procedure and lack of transparency appeared to have affected investor confidence. To gain the confidence of the investors Government boosts through the Real Estate (Regulation and Development) Act, or RERA. The situation should improve as a result of the government's increasing openness.

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[42] Anulekha Ray, 'Govt pays way to allow FPIs to debt finance REITs,InvITs'(*Livemint,* 11February 2021) <https://www.livemint.com/money/personal-finance/govt-paves-way-to-allow-fpis-to-debt-finance-reits-invits-11613059812201.html> accessed 17 August 2023

[43] Abinav Kaul, 'Insurers allowed to invest in debt Instruments of InvITs, Reits' *(Livemint,* 23April 2021) <https://www.livemint.com/insurance/news/insurers-allowed-to-invest-in-debt-instruments-of-invits-reits-11619175038894.html> accessed 17 August 2023

2. It's important to market the product, as most of the investors are unaware of this investment instrument. REITs should have evolved as a viable investment option or diversification strategy for those seeking to avoid market volatility. However, neither the listed firms nor the industry did a good job of marketing the product.

3. To improve supply and flexibility for investors, REITs' sizes should be reduced, allowing them to retain a single asset or a diversified portfolio.

CONCLUSION

To conclude, Real Estate Investment Trusts create a fantastic opportunity for investors to diversify, their investments, and generate a regular income. Additionally, the inherent flaw in the real estate sector, liquidity challenges, can be mitigated by the fractional ownership option that REIT offers, the popularity of this instrument is because of its feature of fractional ownership. Like any other investment product, REITs also have their limitations and market risks, and their merits cannot be overlooked because of limitations. While the Regulators are taking necessary steps to make REITs investor-friendly, it is important to create awareness about this investment product among the investors. One of the sluggish growths of REIT is because of its unawareness. Although interest in REIT investments among investors has grown recently, India's development in this area is still in its infancy stage and REIT is yet to attain its full potential. REITs are a proven success model across the country. India cannot be an exception, given its market size and potential.

According to the experiences of other nations, the capacity to modify the laws governing these instruments following local market conditions is a crucial necessity for its growth. The regulators must strike a balance to keep the unit holders' interest on one hand and to ease the regulatory provisions, to invite more sponsors to form, without compromising the Regulatory framework. From the amendments, it is evident that the government is working significantly on these lines to make REIT a successful investment tool. Though REITs in India are still in their budding stage, the growing population, and their increasing need for real estate, as well as the growing economy and people's positive attitude towards investment, are viewed as favorable conditions for the Indian REIT market, and this gives reason to believe that the market for these investment vehicles will continue to grow at a steady pace.