

# Fractional property shares: Come either as Small REIT, or wind up



## Brief overview & Background

- Several fractional property shares selling units or ownership interests in properties proliferated in recent past; lack of clear regulations bred their growth.
- Amendments in REIT Regulations bring such fractional ownership schemes within regulatory discipline; or else, wind up within 6 months of effective date
- No question of any guaranteed returns in any form
- No question of raising money against properties not identified
- No question of raising money against land; 95% of the assets to consist of rented real estate



## Size and Listing of SM REITs

- **Mandatory Listing:** For Small REITs, Listing mandatory; however, public issue does not seem mandatory
- **Minimum asset size:** For coming with an initial offer, the asset size of SM REITs should be atleast Rs. 50 crores and a maximum of Rs. 500 crores.
- **Minimum investment and unit size:** The minimum subscription size to SM REITs shall be Rs.10 lakhs, this means it is not for small investors as of now.



## Strict Conditions for Sponsors of SM REITs

- **Networth:** The sponsor of the SM REITs shall have a networth of atleast Rs. 20 crore. Out of which, the Sponsor will have to maintain a liquid networth of Rs 10 crore. Liquid net worth shall mean net worth deployed in liquid assets which are unencumbered. Liquid Asset shall be an asset that can easily be converted into cash in a short amount of time, including cash, money market instruments, Government Securities, T-bills and Repo on Government Securities.
- **Experience:** The sponsor shall have an experience of at least 5 years in real estate industry as a developer or a fund manager.
- **Lock in:** The sponsor shall be required to hold a minimum of 15% of the units of each scheme for a period of 3 years from the date of such listing of units pursuant to the scheme on a post issue basis, any holding in excess of the above, shall be held for a period of 1 year from the date of listing of such units.



## Tax transparency

- Since SM REITs are coming under REIT regulations, it seems the present tax provisions on tax transparency of business trusts will be extended. Accordingly:
  - Rent, interest and dividends will not to be taxed in the hands of the trust; these will be taxed in the hands of the investor.
  - Capital gains to be taxed in the hands of the fund; not to be taxed in the hands of the investor



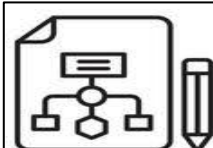
## Organisational framework

- **Trust:** The Small REIT ('SM REITs') shall be registered as a trust under the provisions of the Indian Trusts Act, 1882.
- **Trustee:** It shall have a trustee who will hold assets in trust for the benefit of unit holders. It shall be registered under SEBI (DT) Regulations, 1993 and shall not be an associate of the sponsor or investment manager of SM REITs.
- **Sponsor:** There shall be a sponsor who will set up the SM REITs.
- **Investment manager:** Investment Manager shall manage the assets and investments and undertake operational activities of the SM REITs.
- **Special Purpose Vehicle (SPV):** SM REITs shall hold real estate assets through a wholly-owned company incorporated under the Companies Act, 2013, known as an SPV.
- **Valuer:** The valuer shall be appointed by an investment manager who shall conduct the valuation of the assets of SM REITs.



## Even stricter conditions for Investment Managers of SM REITs

- **Structure:** The investment manager must be a company registered under the Companies Act, 2013. No other legal body can act as an Investment Manager of Small REITs.
- **Networth:** The investment manager shall have a minimum networth of Rs.10 crore, as a positive liquid networth.
- **Experience:** The investment manager through a distinct entity shall only be engaged in the business of managing the assets and investments of the SM REITs and undertake operational activities of the SM REIT. Apart from the above the investment manager shall not undertake any other business.
- **Board of IM:** Half of the board members of the investment manager must be independent directors. Additionally, these independent directors should not hold director positions in other SM REITs or regular REITs.
- **Self Sponsored SM REIT:** The role of Sponsor and Investment Manager could be combined into making the Investment Manager into a self-sponsored entity.



## How will the structure work

- The scheme essentially envisages fractionalising the ownership of an identified real estate, which is already rented. Properties under construction not to be invested into.
- Property may be owned in an SPV. Shares of the SPV to be owned by the trust.
- SM REITs can have multiple schemes, i.e. different properties can be purchased & housed under separate schemes.
- Further, Small REITs are prohibited from issuing debt securities, unlike how it is permissible under the present REIT regulations.
- Structure seems closed-end; however present REIT regulations have a provision for buyback
- Rentals earned from the real estate, minus costs and management fees will be distributed to the extent of at least 90%. Present REIT regulations provide for half yearly distribution.

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