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SEBI consultation paper on special rights to unitholders and role of sponsor in REITs and InvITs

The Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (“**REIT Regulations**”) and the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 (“**InvIT Regulations**”), currently restrict any unitholder from exercising any special rights, which are not available to other unitholders. This restriction also covers any nominee rights sought by investors on the board of directors (“**Board**”) of the manager / investment manager (“**IM**”) of REITs/InvITs. Based on representations received from various market participants, the Securities and Exchange Board of India (“**SEBI**”) in its latest consultation paper titled “*Special rights to unitholders and role of sponsor in REITs and InvITs*” (“**Consultation Paper**”) has proposed a framework by which special/nominee rights can be conferred on unitholders.

Special / Differential Rights to Unitholders

SEBI has recognised the need for investors to be involved in the functioning and governance of REITs and InvITs and has proposed the following methods for allowing investors to be involved in the governance of IM and the REIT/InvIT:

- nomination rights on the Board of the IM and/or;
- the constitution of a ‘unitholders’ council’ composed of representatives / nominees of unitholders.

Board nomination rights

The Consultation Paper proposes to provide a framework under which unitholders can be granted nominee rights on the Board of the IM. The nominee rights are subject to following conditions:

Condition	Requirement
Minimum unitholding to exercise the nominee right	10% of the units of the REIT / InvIT. The right includes, the right to nominate one director on the Board of the IM, for every 10% of the units held by such unitholder. (<i>example: a unitholder holding 20%, will have the right to nominate 2 directors on the Board of the IM.</i>)
Aggregation of unitholding to exercise the nominee right	Unitholders who hold less than 10% of the units of the REIT / InvIT individually but are willing to join together such that their collective holding exceeds 10%. (<i>example: 2 unitholders holding 5% each can collective appoint 1 director on the Board of the IM.</i>)
Interested party	Nominee directors will have to recuse themselves from voting on related party transactions where either the nominee director or the unitholder who nominated him/her is a related party.

The Consultation Paper does not specify how this option can be implemented, i.e., whether by including such right in the trust deed or the investment management agreement or in the articles of association of the IM. Similarly, there is no recommendation with respect to fall-away or monitoring of such rights in the event that the unitholding decreases after the nomination right is exercised.



Unitholders' council

The Consultation Paper also proposes an alternate framework of a 'unitholders' council' ("**Council**"), which is similar to the framework provided for alternative investment funds under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012. The purpose of the Council is to serve to improve the activities and oversight of the IM. Investors will have the right to nominate representatives/nominees on the Council, subject to the following conditions:

Condition	Requirement
Minimum members of the Council	The Council is proposed to consist of a minimum of 3 members. In the event 3 nominations are not received, vacancies on the Council may be filled by independent directors. Alternatively, in such instances, such nominees may be directly appointed to the Board of the IM.
Minimum unitholding to exercise the nominee right	10% of the units of the REIT / InvIT.
Aggregation of unitholding to exercise the nominee right	Unitholders who hold less than 10% of the units of the REIT / InvIT individually but are willing to join together such that their collective holding exceeds 10%. <i>(example: 2 unitholders holding 5% each can collective appoint 1 director on the Board of the IM).</i>
Powers of the Council	The Council will be required to approve every decision made by the Board of the IM, except for matters relating solely to the operations of the IM. In the event that the decision of the Council is different from that of the Board of the IM, such matters will be required to be referred to the unitholders for their approval. Any matter requiring the approval of unitholders must mandatorily include the recommendation of the Council thereon.
Voting	Each unitholder nominee is proposed to receive one vote for 10% of the units held by the nominating unitholder. All decisions of the Council are to be taken by a simple majority of members present and voting – note that the aggregate number of votes to which each nominee is entitled will be considered for the purposes of determining majority

The provision for the Council is likely to result in inefficiencies in the governance structure and may lead to delays in decision-making. Investor participation concerns can be sufficiently addressed through the Board nomination rights and there is no requirement for the Council. On the basis of market practice, it is unlikely that Board size would expand to a very large and unmanageable size as stated in the Consultation Paper which is the major reason for proposing the Council framework.

Mandatory Unitholding of Sponsors in REITs / InvITs

In its consultation paper dated February 23, 2023 ("**February 23 Consultation Paper**"), SEBI had proposed a perpetual mandatory lock-in of units held by sponsors in REITs / InvITs. This lock-in was linked to the percentage of units held by the sponsor, with the percentage of units locked-in decreasing progressively. Pursuant to feedback received from market participants, SEBI has proposed linking the thresholds for lock-in to a monetary limit in addition to the percentage of unitholding. The revised proposal as set out in the Consultation Paper is set forth below:

Holding Period	Units to be locked-in
Up to 3 years	15% of the total unit capital
3-5 years	5% of the total unit capital or INR 1,000 crore, whichever is lower
5-10 years	3% of the total unit capital or INR 1,000 crore, whichever is lower
10-20 years	2% of the total unit capital or INR 1,000 crore, whichever is lower
Post 20 years	5% of the total unit capital or INR 1,000 crore, whichever is lower



As indicated in the February 23 Consultation Paper, the units locked-in as outlined above cannot be encumbered by the sponsor.

While market participants have already made various submissions to SEBI that such perpetual lock-in may not be warranted, the current proposal is more preferable than the earlier one as it allows sponsors to avoid chasing a moving target which is inevitable with the growth in the size of the platform. However, SEBI's reluctance to allow for encumbrance on such units is against SEBI's existing framework on this matter and would come in the way of sponsor's ability to raise future financing.

Self-Sponsored REITs and InvITs

The Consultation Paper has proposed the introduction of self-sponsored or sponsor-less REITs and InvITs with a view to provide exit options for sponsors and enable established REITs and InvITs to stand on their own and create a space for mature and independent professionally managed REITs and InvITs. However, the disassociation of the sponsor from a listed REIT / InvIT will be subject to certain conditions, including the following:

- The REIT/InvIT having been listed for at least 5 years;
- The REIT / InvIT having made at least twelve distributions on a continuous basis;
- The REIT / InvIT having been rated 'AAA' by a SEBI registered credit rating agency for a continuous period of five years;
- The REIT / InvIT not having breached the maximum leverage thresholds during the 5 preceding financial years;
- The IM being able to meet the net worth and mandatory unitholding requirements of the sponsor. *Notably, if the IM is unable to comply with the mandatory unitholding requirements, the shareholders of the IM may contribute their own units in the REIT or InvIT to facilitate such compliance;*
- The sponsor proposing to disassociate from the REIT / InvIT having been the sponsor of such REIT / InvIT for at least 5 years; and
- The REIT / InvIT not having any under-construction assets acquired from the sponsor as part of its asset portfolio.

Similar to de-classification of the sponsor, the condition for being categorised as a self-sponsored REIT/InvIT will require approval from 75% of the unitholders by value. Additionally, an exit option will also need to be provided to dissenting unitholders in the event that required approvals are not received.

While the self-sponsored REIT/InvIT is a welcome move, certain conditions, notably the requirement of 'AAA' credit rating and the REIT/InvIT not having any under-construction assets acquired from the sponsor are onerous conditions, which will not be easy to comply with by REITs/InvITs. Separately, the requirement for lock-in of units (by the IM or the shareholders of the IM) could act as a significant barrier to achieving a sponsor-less status. A point to be noted is that there is no such similar requirement for companies which have no identifiable promoter.

Please feel free to address any further questions or request for advice to:

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