



भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CONSULTATION PAPER

DEPARTMENT OF DEBT AND HYBRID SECURITIES – POD II

ADDITIONAL PROPOSALS REGARDING FRAMEWORK FOR ISSUANCE OF SUBORDINATE UNITS – REITs and InvITs

JANUARY 2024



भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

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Timeline to Respond

Comments on the
Consultation paper (CP) may
be sent by January 31, 2024

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1. OBJECTIVE:

1.1. The objective of this consultation paper is to seek comments / views / suggestions from the public on the following additional proposals pertaining to the framework for issuance of subordinate units by REITs and InvITs:

- (a) Specification of a ceiling on the extent of subordinate units that can be issued;
- (b) Bringing uniformity in the nature of rights conferred on subordinate units;
- (c) Dealing with changes in terms and conditions of the subordinate units post issuance

2. BACKGROUND:

2.1. SEBI issued a consultation paper titled [“Consultation paper on Framework for issuance of subordinate units and Unit Based Employee Benefits - REITs and InvITs”](#) on December 09, 2023. The said consultation paper, inter-alia, invited public comments on the framework for issuance of subordinate units by REITs and InvITs to sponsor(s), their associates and sponsor group. The last date for receipt of public comments for the aforementioned consultation paper was December 29, 2023.

2.2. In view of the public comments received and internal deliberations, this consultation paper invites public comments on certain additional proposals which are detailed in the next section.

3. ADDITIONAL PROPOSALS REGARDING FRAMEWORK FOR ISSUANCE OF SUBORDINATE UNITS

The following norms are additionally proposed with respect to issuance of subordinate units:

3.1. Specification of a ceiling on subordinate units that can be issued by a REIT / InvIT

3.1.1. Rationale:

3.1.1.1. The creation of and the issuance of subordinate units is primarily intended to bridge the valuation gaps that may arise as a result of difference in the valuation of an asset perceived by the Sponsor (i.e. asset transferor) and the REIT/InvIT (and/or its investors/unitholders or potential investors/unitholders). The same is explained by the below example:

REIT "XYZ" is proposing to acquire a commercial real estate property from Sponsor "A". The valuation arrived at by the sponsor assuming growth rate in revenue of 10% p.a. comes out to Rs. 1000 crores. However, the REIT perceives 9% p.a. as the achievable revenue growth rate and accordingly values the asset at Rs. 900 crores. In such a case, the sponsor may subscribe to ordinary units of REIT for Rs. 900 crores and the REIT may issue subordinate units to the sponsor for Rs. 100 crores i.e. for the difference in valuation as perceived by the sponsor and REIT. The terms and conditions of issuance of subordinate units may provide that the subordinate units shall be converted to or reclassified to ordinary units at the end of five years if REIT achieves an average revenue growth rate of 10% p.a. during the five-year period (i.e. on achievement of the pre-determined performance benchmark). Till the

time the subordinate units are outstanding, they shall carry inferior rights vis-à-vis ordinary units of the REIT.

Typically, these valuation gaps will not be too wide or broad and hence the proposal to specify an upper ceiling up to which subordinate units can be issued.

3.1.1.2. Subordinate units, are in essence, units issued to the sponsor for the valuation gap if agreed upon by the investors/unitholders. Such gap could potentially disappear if pre-agreed performance benchmarks are met, reflecting also in increased value of the asset. This can in turn result in the conversion or reclassification of the subordinate units to ordinary units. Accordingly, to ensure due accrual of the potential capital appreciation in the value of the asset, if performance benchmarks are achieved, to also the investors/unitholders rather than only accruing to the Sponsor, the specification of a cap on the subordinate units is required.

3.1.1.3. The conversion of or the reclassification of subordinate units to ordinary units results in dilution of proportionate unitholding for the existing unitholders of the REIT / InvIT. REITs and InvITs, being investment vehicles, are open for investment by institutional as well as non-institutional investors. Many investors (especially retail investors) may not perceive the impact of potential dilution of their unitholding at the time of issuance of subordinate units by the REIT/InvIT. Accordingly, the specification of a cap on the subordinate units will also aid in limiting the impact of this potential dilution.

3.1.2. **Proposal:** In view of the above, the following is proposed:

- 3.1.2.1. The amount of subordinate units that can be issued at the time of acquisition of an asset (real estate asset / infrastructure project by a REIT / InvIT respectively) shall not exceed ten percent of the acquisition price of the asset.
- 3.1.2.2. Further, at any point of time, the total number of outstanding subordinate units shall not exceed ten percent of the total number of outstanding ordinary units.

Consultation: Kindly provide your comments separately for each of the below proposals along with supporting rationale:

Proposal No. 1: Whether there should be a cap on subordinate units which can be issued by a REIT / InvIT?

Proposal No. 2: If the answer to Proposal No. 1 is affirmative, are the proposed caps of ten percent adequate at the asset acquisition level and at the cumulative level in the unit capital of the REIT/InvIT?

3.2. To bring uniformity in the nature of rights conferred by subordinate units

3.2.1. **Proposals and their rationale**

3.2.1.1. REIT Regulations and InvIT Regulations provide that subordinate units shall carry only inferior voting or any other rights compared to other units. In response to the consultation paper issued on 9th December, 2023, few respondents have requested to clarify on the nature of the inferior rights such subordinate units can carry.

It is proposed to provide clarity on the nature of inferior rights which the subordinate units may carry. Accordingly, it is proposed that subordinate

units shall only carry inferior voting rights or inferior distribution rights or both.

Consultation:

Proposal No. 3: Whether it should be provided that subordinate units shall only carry inferior voting rights or inferior distribution rights or both?

3.2.1.2. The extant regulatory provisions and proposals made in the consultation paper dated December 09, 2023 may result in various different types / classes of subordinate units being issued by a REIT / InvIT i.e. a REIT / InvIT “XYZ” can issue one class of subordinate units with 40% distribution rights (in comparison to ordinary units), another class of subordinate units carrying 70% distribution rights etc.

To bring uniformity in the nature of rights conferred by the subordinate units, it is proposed to provide that inferior rights on all subordinate units issued by a REIT / InvIT shall be similar i.e. there shall not be multiple classes of subordinate units.

Consultation:

Proposal No. 4: Whether it should be provided that inferior rights on all subordinate units issued by a REIT / InvIT shall be similar i.e. there shall not be multiple classes of subordinate units?

3.2.1.3. The consultation paper dated December 09, 2023 did not contain any proposal as to the extent of inferior rights which can be offered on the subordinate units i.e. whether inferior rights shall mean zero distribution rights, or 10% distribution rights, or 90% distribution rights, etc. The absence of clarity in this regard will result in various different types of

rights being offered on the subordinate units by different REITs and InvITs.

If there is a uniformity across the industry with regard to the extent of inferior rights offered on the subordinate units, it will aid in easier understanding of subordinate units for investors, and easier comparison of unitholding across REITs and InvITs.

3.2.1.4. Further, to bring in uniformity across the industry with regard to the extent of inferior rights offered on the subordinate units, the following options are being put forth for public comments and feedback:

- (a) subordinate units shall carry no distribution and no voting rights, or
- (b) subordinate units shall carry inferior distribution rights and inferior voting rights to the extent of ten percent of the corresponding rights conferred on ordinary units, or
- (c) a combination of floor and cap may be specified (i.e. a range) as to the extent of inferior distribution rights and inferior voting rights which can offered on the subordinate units vis-à-vis ordinary units.

Consultation:

Proposal No. 5: Whether it should be provided that inferior rights on subordinate units should be uniform across the industry i.e. uniform inferior rights for all REITs and InvITs? If yes please comment which option out of (a), (b) and (c) of proposal 3.2.1.4. should be specified to ensure uniformity in the extent of inferior rights offered by REITs and InvITs.

3.3. Dealing with changes in terms and conditions of the subordinate units post issuance:

3.3.1. **Proposals and their rationale**

3.3.1.1. Para 5.13 of the consultation paper dated December 09, 2023 stated as under:

“A one-time extension in the entitlement date as specified in the offer document, placement memorandum or placement document, may be permitted for a maximum period of one year subject to the following:

5.13.1. Such extension shall require approval from seventy five percent of the unitholders by value. Sponsor(s), sponsor groups, associates of sponsor(s) and any other parties related to the transaction shall not vote on such matter;

5.13.2. Such extension can be done only for cases where a possibility of such extension is clearly contemplated and duly approved and duly disclosed prior to the issuance of subordinate units;

5.13.3. Adequate disclosures regarding the process and specific details of such extension are included in the trust deed, offer document, placement memorandum or placement document at the time of initial offer and/or at the time of issuance of such subordinate units.”

3.3.1.2. Para 5.20 of the consultation paper dated December 09, 2023 stated as under:

“Post issuance of subordinate units, any change in the terms and conditions of the subordinate units shall require prior approval from:

5.20.1. Seventy five percent of the unitholders of ordinary units by value. Sponsor(s), sponsor groups, associates of sponsor(s) and any other parties related to the transaction shall not vote on such matter

5.20.2. Hundred percent of the unitholders of subordinate units.”

3.3.1.3. The terms and conditions, related to issuance of subordinate units, are mutually agreed between the asset seller (i.e. the sponsor or its

associates/group entities) and the asset buyer (i.e. the REIT/InvIT) at the time of acquisition of the asset. Since the terms and conditions are mutually agreed upon by two parties at the time of asset acquisition, it will be both imprudent to allow changes in such terms and conditions in future and also result in disturbing certainty of a sale transaction by changes being made that have retrospective effect.

- 3.3.1.4. Further, such terms and conditions would, inter-alia, include the performance benchmarks for reclassification. The performance benchmark, defined and specified in the offer document, placement memorandum or placement document (as the case may be) for the conversion of or the reclassification of subordinate units to ordinary units is one of the most important terms and conditions for subordinate units and should not be subject to any change post the issuance of subordinate units.
- 3.3.1.5. As regards the timelines for meeting the performance benchmarks, the consultation paper dated 9th December 2023 envisaged the possibility of extension of the entitlement date with the approval of unitholders.
- 3.3.1.6. Hence, since the extension of entitlement date for achievement of performance benchmark is already envisaged, it is proposed to provide that any other change in terms and conditions of the subordinate units post issuance of subordinate units shall not be permitted.

Consultation:

Proposal No. 6: Whether to provide that no change (except extension in entitlement date) in terms and conditions of the subordinate units post issuance is permitted?

4. Public Comments

4.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted by any of the following modes latest by January 31, 2024 :-

4.1.1. Preferably through Online web-based form

4.1.1.1. The comments may be submitted through the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

It may be noted that the online web-based form will accept comments till January 31, 2024.

4.1.1.2. The instructions to submit comments on the consultation paper are as under:

1. *Before initiating the process, please read the instructions given on top left of the web form as "Instructions";*
2. *Select the consultation paper you want to comment upon from the drop-down under the tab – "Consultation Paper" after entering the requisite information in the form;*
3. *Email Id and mobile number cannot be used more than once for providing comments on the same consultation paper;*
4. *If you represent any organization other than the types mentioned under dropdown in "Organization Type", please select "Others" and mention the type, which suits you best. Similarly, if you do not represent any organization, you may select "Others" and mention "Not Applicable" in the text box;*
5. *There will be a dropdown of proposals in the form. Please select the proposals one-by-one and for each of the proposal, please record your level of agreement with the selected proposal. Please note that submission of agreement level is mandatory;*

6. If you do not want to react on any proposal, you may skip the same by selecting "Skip this proposal";
7. If you want to provide your comments for the selected proposal, please select "Yes" from the dropdown under "Do you want to comment on the proposal" and use the text boxes provided for the same;
8. After recording your response to the proposal, click on "Submit" button. System will save your response to the selected proposal and prompt you to record your response for the next proposal. Please follow this procedure for all the proposals given in the dropdown;
9. Please download the pdf file, link of which is given at the bottom of the form, just before finally submitting the comments to last and final proposal. This pdf will help in case technical issue is faced while final submission of comments;
10. The final comments shall be submitted only after recording your response on all of the proposals in the consultation paper.

4.1.1.3. In case of any technical issue in submitting your comment through web based public comments form, you may contact the following through email with a subject: "*Issue in submitting comments on Consultation Paper on Additional Proposals Regarding Framework for issuance of subordinate units – REITs and InvITs*".

- a) Ritesh Nandwani, DGM (riteshn@sebi.gov.in)
- b) Pawan Kumar Chowdhary, AGM (pawanc@sebi.gov.in)
- c) Barun Gurani, AM (barung@sebi.gov.in)

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