

Amendments to SEBI (Real Estate Investment Trusts) Regulations, 2014 in order to streamline provision related to tenure of auditor, computation of leverage and treatment of unclaimed / unpaid distributions

1. Objective

1.1. This Board Memorandum proposes amendments to the SEBI (Real Estate Investment Trusts) Regulations, 2014 (hereinafter referred to as "REIT Regulations") in order to mandate statutory auditor of REIT to undertake limited review of audit of all entities whose accounts are consolidated with the accounts of Real Estate Investment Trust (hereinafter referred to as "REIT"), streamline the tenure of auditor, inclusion of overnight funds as cash and cash equivalents for computation of leverage and treatment of unclaimed / unpaid distributions of REIT and seeks approval of the Board for the same.

2. Background

2.1. SEBI notified REIT Regulations on September 26, 2014. SEBI constituted its Hybrid Securities Advisory Committee (hereinafter referred to as "HySAC") on June 16, 2022 in order to provide recommendations, inter-alia, on development and regulation of primary and secondary markets of Hybrid Securities (i.e. REIT, InvIT, etc.) in India.

2.2. The details of REITs which are registered and raised funds through issuance of units as on October 31, 2022 are tabulated below:

S.No	Name of REIT	Registration Date	Listing date	Funds raised (INR Cr.)
1.	Embassy Office Parks REIT	03/08/2017	01/04/2019	10,750
2.	Mindspace Business Park REIT	10/12/2019	07/08/2020	4,500
3.	Brookfield India Real Estate Trust	15/09/2020	03/02/2021	4,750
	Total			20,000

2.3. SEBI's HySAC in its first meeting dated July 19, 2022 constituted a working group on regulation revamp to recommend changes in the provisions of REIT Regulations. The working group submitted its recommendations, inter-alia, on below issues/items:

2.3.1. Statutory auditor of REIT to undertake limited review of audit of all entities whose accounts are consolidated with accounts of REIT

2.3.2. Inclusion of liquid funds as cash and cash equivalents for computation of leverage

2.3.3. Tenure of auditor

2.3.4. Treatment of unclaimed / unpaid distributions

2.4. The intent of recommendations submitted by working group is to align the current REIT Regulations (along with circulars issued therein) with SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as 'LODR Regulations') and/or Companies Act 2013.

2.5. The above mentioned issues/items, submitted as recommendations by the working group, were taken up for discussion at the second meeting of HySAC dated November 15, 2022 and the same are elaborated in the following paras:

3. Statutory auditor of REIT to undertake limited review of audit of entities whose accounts are consolidated with accounts of REIT

3.1. Extant Regulatory Requirement:

3.1.1. Regulation 33(8) of LODR Regulations which is applicable for equity listed companies reads as under:

“The statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/ companies whose accounts are to be consolidated with the listed entity as per AS 21 in accordance with guidelines issued by the Board on this matter.”

3.2. Recommendation of the working group:

3.2.1. In case of disclosure of consolidated financial results, the working group, inter-alia, recommended that the statutory auditor of REIT shall undertake a limited review of

the audit of all the entities/ companies whose accounts are to be consolidated as per applicable Ind AS.

3.3. Consultation:

3.3.1. SEBI HySAC in its meeting dated November 15, 2022 deliberated on the recommendation made by working group as referred in Para 3.2 above. The members unanimously agreed with the proposal.

3.4. Proposal:

3.4.1. Although the existing REIT Regulations read with circulars issued thereunder mandates that the auditor appointed for REIT shall carry out audit/limited review, it does not specifically mandate that the statutory auditor shall undertake limited review of audit of all the entities/companies whose accounts are to be consolidated with the REIT. Thus the assurance on the disclosures by the REIT may not be as comprehensive as it would be desirable.

3.4.2. Hence, it is proposed that existing REIT Regulations be amended to provide that the statutory auditor of REIT shall undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the REIT as per the applicable Indian Accounting Standards (Ind AS) and any addendum thereto as defined in Rule 2 (1) (a) of the Companies (Indian Accounting Standards) Rules, 2015, in such manner as may be specified by the Board.

4. Inclusion of overnight funds as cash and cash equivalents for computation of leverage

4.1. Extant Regulatory Requirement:

4.1.1. Regulation 20(2) of REIT Regulations reads as under:

“The aggregate consolidated borrowings and deferred payments of the REIT, holdco and/or the SPV(s), net of cash and cash equivalents shall never exceed forty nine percent of the value of the REIT assets.....”

4.2. Recommendation of the working group:

4.2.1. The working group recommended that the investments in liquid mutual funds be considered as cash and cash equivalents instead of current investments for the purpose of computation of leverage as per REIT Regulations.

4.3. Rationale for change:

4.3.1. It has been represented by market participants that cash available with REIT or HoldCo or SPV is usually invested in liquid mutual funds as a temporary utilization. Hence, the liquid mutual funds be considered as cash and cash equivalents for computation of leverage.

4.4. Consultation:

4.4.1. SEBI HySAC in its meeting dated November 15, 2022 deliberated the agenda item on inclusion of liquid funds as cash and cash equivalents for computation of leverage and deduction of cash and cash equivalents from the value of REIT assets in order to compute leverage. The members unanimously agreed with the proposal.

4.5. Proposal:

4.5.1. It is proposed that considering the mark to market risk on liquid mutual funds, it is proposed that the overnight funds, characterized by their investments in overnight securities, having maturity of one day, be considered as cash and cash equivalents for computation of leverage.

4.5.2. Additionally, it may also be clarified that the cash and cash equivalents that has been deducted from consolidated borrowings and deferred payments in order to compute total consolidated borrowings needs to be deducted from the value of assets of the REIT also, in order to compute percentage of leverage of REIT correctly.

4.5.3. Hence, the following explanations be inserted under Regulation 20(2) of REIT Regulations for the purpose of computation of leverage:

- a) Investment by REITs in overnight mutual funds, characterized by their investments in overnight securities, having maturity of one day, be considered as cash and cash equivalent.
- b) The amount of cash and cash equivalent be excluded from the value of the assets of the REIT.

5. Tenure of auditor

5.1. Extant Regulatory Requirement:

5.1.1. Regulation 10(6) of REIT Regulations reads as under:

“The manager shall appoint an auditor for a period of not more than five consecutive years:

Provided that the auditor, not being an individual, may be reappointed for a period of another five consecutive years, subject to approval of unit-holders in the annual meeting.”

5.1.2. Section 139 of the Companies Act, 2013 reads as under:

“(1) Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the member of the company at such meeting shall be such as may be prescribed:

.....

(2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—

- (a) an individual as auditor for more than one term of five consecutive years; and
- (b) an audit firm as auditor for more than two terms of five consecutive years:

Provided that—

(i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;

(ii) an audit firm which has completed its term under clause (b), shall not be eligible for reappointment as auditor in the same company for five years from the completion of such term:

.....”

5.2. Recommendation of the working group:

5.2.1. The working group in its report mentioned that the current requirement of appointment of an auditor for five year period does not provide clarity from when the five-year period begins and ends since there could be cases where the REIT is in existence for some time before it undertakes an initial offer.

5.2.2. The working group recommended that the Manager shall appoint an auditor who shall hold office till the conclusion of the fifth annual general meeting in line with the requirement for Companies Act, 2013. Provided that the auditor, not being an individual, may be reappointed for a period of another five consecutive years, subject to approval of unit-holders in the annual meeting in accordance with Regulation 22 of REIT Regulations.

5.3. Consultation:

5.3.1. SEBI HySAC in its meeting dated November 15, 2022 deliberated the agenda item on tenure of auditor. The members unanimously agreed with the proposal.

5.4. Proposal:

5.4.1. It is proposed that existing REIT Regulations be amended to provide the following:

- a) The manager of the REIT shall appoint an individual or a firm as the auditor who shall hold office from the date of conclusion of the annual meeting in which the auditor has been appointed (first meeting) till the date of conclusion of the sixth annual meeting of the unitholders and thereafter till the conclusion of every sixth

annual meeting of the unitholders in accordance with the procedure for selection of auditors, as may be specified by the Board.

- b) The individual auditor shall not be appointed for more than one term of five consecutive years and the audit firm shall not be appointed as auditor for more than two terms of five consecutive years.
- c) The individual auditor or the audit firm which has completed his/its term as mentioned above, shall not be eligible for re-appointment as auditor in the same REIT for a period of five years from the date of completion of such term.

6. Treatment of unclaimed / unpaid distributions

6.1. REIT Regulations mandate distribution of ninety percent of Net Distributable Cash Flows (NDCF) periodically to unitholders. During the course of inspection, it was observed in certain cases, distribution amounts remain unclaimed / unpaid because of various reasons, including failure to update account details by the unitholders ("Unpaid Distributions"), etc.

6.2. Extant Regulatory Requirement:

6.2.1. REIT Regulations provides that the manager shall declare distributions to the unit holders in accordance with the sub-regulation (16) of regulation 18. REIT Regulations also provides that the trustee shall make distributions in accordance with sub-regulation (16) of regulation 18 and ensure that the manager makes timely declaration of distributions to the unit holders.

6.2.2. Further, sub-regulation (16) of regulation 18 of REIT Regulations requires that such distributions shall be declared and made not less than once every six months in every financial year and shall be made not later than fifteen days from the date of such declaration. If the distributions are not made within fifteen days of declaration, then the manager shall be liable to pay interest to the unit holders at the rate of fifteen per cent per annum till the distribution is made and such interest shall not be recovered in the form of fees or any other form payable to the manager by the REIT.

6.3. Need for introduction of a mechanism for treatment of unclaimed / unpaid distributions

6.3.1. As on date 3 REITs have issued units and the details of unclaimed distributions as on October 31, 2022 are as under:

(This has been excised for reasons of confidentiality)

6.3.2. Under the Companies Act, 2013, (“Companies Act”), any dividend that has been remained unclaimed / unpaid for a period of seven years shall be transferred to the Investor Education and Protection Fund. Further, all shares in respect of which dividend has not been paid or claimed for seven consecutive years or more are also required to be transferred in the name of such fund.

6.3.3. However, REITs are not registered under the Companies Act, and therefore cannot rely on Section 125 of the Companies Act for treatment of unclaimed / unpaid distributions. REITs are constituted as Trust under the Indian Trust Act, 1882 and defined as ‘business trust’ under the Income-tax Act, 1961. There are no provisions laid down in the Indian Trust Act, 1882, detailing the procedure to deal with such unclaimed / unpaid amount of unitholders declared by REITs.

6.3.4. SEBI in its Board meeting held on September 30, 2022 inter alia decided that for listed entities that have issued non-convertible securities and do not fall within the definition of ‘company’ under the Companies Act, 2013 and the Rules made thereunder, any amount that remains unclaimed for seven years shall be transferred to the Investor Protection and Education Fund created by the Board in terms of section 11 of the SEBI Act, 1992. LODR Regulations have been amended to include the said provision.

6.3.5. With respect to the non-convertible securities issued by REITs, Regulation 61A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) in relation to dealing with unclaimed redemption and interest

proceeds would be applicable. However, there is no mechanism to deal with unclaimed or unpaid distribution on units of REITs in REIT Regulations.

6.4. Recommendation of the working group:

6.4.1. With respect to unclaimed distributions of REITs, the working group has inter alia recommended the following:

- a) A framework similar to the Companies Act could be adopted for the treatment of unpaid or unclaimed distributions on units and unclaimed units of REITs, with transfer of such amounts and units to the SEBI Investor Protection and Education Fund under SEBI (Investor Protection and Education Fund) Regulations, 2009.
- b) The Manager would be responsible for obligations in relation to unpaid or unclaimed distributions on units and unclaimed units of REITs.
- c) With respect to the non-convertible securities issued by REITs, Regulation 61A of the SEBI LODR Regulations in relation to dealing with unclaimed redemption and interest proceeds would be applicable, and accordingly, changes to the REIT Regulations may not be required in this regard.

6.5. Consultation:

6.5.1. SEBI Hybrid Securities Advisory committee (HySAC) in its meeting dated November 15, 2022, deliberated the recommendation of working group on treatment of unclaimed / unpaid distributions of REITs, where the members of HySAC agreed with the proposal.

6.6. Proposal:

6.6.1. In view of the above, it is proposed that any amount remaining unclaimed or unpaid out of the distributions declared by REITs be transferred to the 'Investor Protection and Education Fund' constituted by the Board in terms of section 11 of the SEBI Act, 1992 in the manner as specified by the Board.

7. Proposal to the Board:

7.1. The Board is requested to

7.1.1. consider and approve the proposals as detailed under paragraphs no. 3.4, 4.5, 5.4 and 6.6 above, changes proposed as detailed under and the draft amendment notification placed as **Annexure** to this memorandum:

7.1.1.1. **With regard to proposal mandating statutory auditor of REIT to undertake limited review of audit of entities whose accounts are consolidated with accounts of REIT (refer Para 3.4):**

The following provision be inserted as Regulation 13(5) under Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014:

“The auditor shall undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the REIT as per the applicable Indian Accounting Standards (Ind AS) and any addendum thereto as defined in Rule 2 (1) (a) of the Companies (Indian Accounting Standards) Rules, 2015, in such manner as may be specified by the Board.”

7.1.1.2. **With regard to proposal mandating inclusion of overnight funds as cash and cash equivalents for computation of leverage (refer Para 4.5):**

Regulation 20 of Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 be amended to include the following explanations under Regulation 20(2) of REIT Regulations:

“Explanation 1. – Investment by REITs in overnight mutual funds, characterized by their investments in overnight securities, having maturity of one day, shall be considered as cash and cash equivalent.

Explanation 2. – The amount of cash and cash equivalent shall be excluded from the value of the assets of the REIT.”

7.1.1.3. **With regard to proposal specifying tenure of auditor (refer Para 5.4):**

Regulation 10(6) of Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 be substituted with the following:

“Subject to the provisions of this chapter, the manager of the REIT shall appoint an individual or a firm as the auditor, who shall hold office from the date of conclusion of the annual meeting in which the auditor has been appointed till the date of conclusion of the sixth annual meeting of the unitholders and thereafter till the conclusion of every sixth annual meeting of unitholders in accordance with the procedure for selection of auditors, as may be specified by the Board.”

Further, the following provision be inserted as Regulation 10(6A) under Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014:

“The manager of the REIT shall not appoint or re-appoint—

- (a) an individual as the auditor for more than one term of five consecutive years; and
- (b) an audit firm as the auditor for more than two terms of five consecutive years:

Provided that—

- (i) the individual auditor who has completed the term under clause (a) shall not be eligible for re-appointment as the auditor in the same REIT for a period of five years from the date of completion of the term;
- (ii) the audit firm that has completed its term under clause (b), shall not be eligible for reappointment as the auditor in the same REIT for a period of five years from the date of completion of its term.”

7.1.1.4. With regard to proposal for treatment of unclaimed / unpaid distributions (refer Para 6.6):

The following provision be inserted as Regulation 18(16)(f) in Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014:

“any amount remaining unclaimed or unpaid out of the distributions declared by a REIT in terms of sub-clause (c), shall be transferred to the ‘Investor

Protection and Education Fund' constituted by the Board in terms of section 11 of the Act, in such manner as may be specified by the Board.”

- 7.1.2. authorize the Chairperson to make consequential and incidental changes and take necessary steps to give effect to the decisions of the Board.

Draft Notification

Amendment shall be notified after following the due process