Avoid over-regulation

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Fractional ownership platforms, key to realty sector

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Until recently, the only way to invest in real estate was to invest in an actual property. Given the sky-high prices in most cities, this would mean only rich investors can afford real estate for an investment.

The introduction of REITs in 2019 allowed retail investors to get exposure to commercial real estate for as little as ₹10,000- 15,000.

But only three REITs currently trade, with none allowing investments in residential real estate where most investors have a natural interest. This is where the fractional ownership platforms (FOPs) come in.

FOPs have been one of the most exciting developments to hit the Indian real estate sector in recent years.

Leveraging technology and data, they allow investors to take concentrated bets in real estate, sometime literally in a single building or in a single floor. They also enable capital-starved developers to monetise excess stock or unlock their investments.

Unfortunately, they have been operating under the radar of regulators, raising concern that reckless practices could cast a bad light on what otherwise is a useful product for the Indian investor.

SEBI recently decided to seek public comments on its proposal to regulate FOPs.

SEBI’s concerns

The concern within SEBI is genuine. Following the age-old practice of regulatory arbitrage, these platforms registered themselves as brokers under RERA when they were, in reality, soliciting funds as collective investment vehicles.

They did broker these transactions but that is like saying an angel fund manager should also be considered a broker for connecting their investors to needy start-ups.

To be fair, many only take a fee, but some do get paid as percentage of the assets by using a higher valuation for the underlying assets. In addition, the SEBI has listed out numerous other issues ranging from lack of KYC/AML checks to use of stringent Power of Attorney structures that are open to abuse.

Interestingly, the SEBI had two existing regulatory models to choose from for FOPs.

Given the unlisted nature of the underlying SPVs, SEBI could have opted to bring them under the Alternative Investment Funds (AIF) umbrella, either by creating a new category or squeezing them under the existing Category II that already contained Real Estate Funds.

Alternatively, since the investments are mostly on properties yielding rental income, it could bring FOPs under the existing REIT regulatory structure.

While each path has its pros and cons, the regulator preferred the latter by re-characterising these platforms as Micro, Small and Medium REITs (MSM REITs).

This has allowed them to neatly drive those ventures which seek to provide capital for development into an AIF structure, while retaining

those that invest in completed, rent yielding properties into a REIT like structure.

MSM REITs

The need to assemble stable, rent-yielding properties at scale through REITs has been a challenge so far. This is where MSM REITs can become an attractive proposition.

There is no need to wait till properties worth ₹500 crore are assembled (though SEBI lists ₹500 crore as a cut-off, market participants feel that it should at least be two or three times that size at the time of listing to attract investors).

A few buildings in the neighbourhood are enough to float a MSM REIT.

While the larger REITs present a large, diversified portfolio of real estate, the MSM REITs can take concentrated, localised bets that may be more appealing to smaller investors.

But SEBI's proposed rules seem onerous. It is imperative that the regulator marries its desire to avoid bad outcomes with its goal of developing new markets.

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