



SECP

SECURITIES AND EXCHANGE
COMMISSION OF PAKISTAN

CONSULTATION PAPER

IMPROVEMENT IN REAL ESTATE INVESTMENT TRUST REGULATIONS, 2022

JUNE 2024



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1. Rationale for circulating Consultation Paper

This consultation paper is published for eliciting feedback/suggestions on potential areas of improvement in the Real Estate Investment Trust Regulations, 2022 (REIT Regulations).

The revamped REIT Regulations were notified by the Securities and Exchange Commission of Pakistan (SECP/Commission) in November 2022. The SECP has now initiated impact analysis to assess efficacy of the REIT Regulations in catering to the rapidly evolving landscape of the Real Estate Investment Trust (REIT) sector within the country.

This entails review of the REIT Regulations from perspective of further streamlining requirements and procedures, benchmarking the REIT Regulations with international best practices, removing any interpretational ambiguities, introducing additional measures for protection of the rights of unitholders and updating the REIT Regulations in light of the Shariah governance framework.

2. Introduction to REITs

A REIT is a fund managed by a REIT Management Company (RMC) in which an RMC pools money from investors for making investments in real estate projects. Investors become unitholders of the fund (referred to as a REIT Scheme) and get proportional share in the ownership of the income-generating real estate project. In doing so, they become entitled to rental incomes and/or capital gains of the real estate project.

Enabling regulatory framework for REITs was launched in Pakistan in 2008. In terms of the regulatory framework, a company is required to obtain license as an RMC from the SECP under the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003. Once license is obtained, an RMC can launch REIT Scheme(s) and raise funds from the investors under the REIT Regulations.

3. Overview of REIT Sector

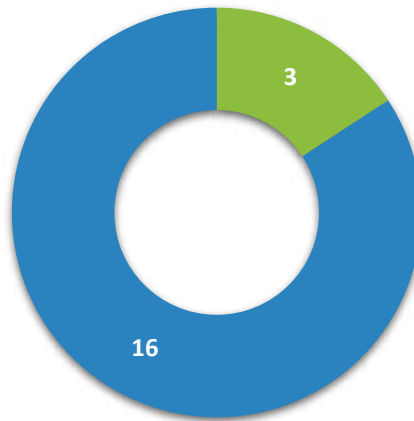
The country's first REIT Scheme was launched in 2015. Since then, the SECP has been actively engaged in development of the REIT Sector by optimizing regulatory framework and aligning it with international best practices.

The SECP introduced the Real Estate Investment Trust Regulations, 2022 which repealed the earlier REIT Regulations, 2015. The revamped REIT Regulations focus on enhancing the universe of REIT projects, creating ease for RMCs in launching different types and categories of REIT schemes and enabling a further shift towards a disclosure-based regime.

Consistent efforts to improve the regulations and address impediments for making REITs a competitive investment avenue has resulted in phenomenal growth in the sector. Synopsis of the the REIT industry is given below: -

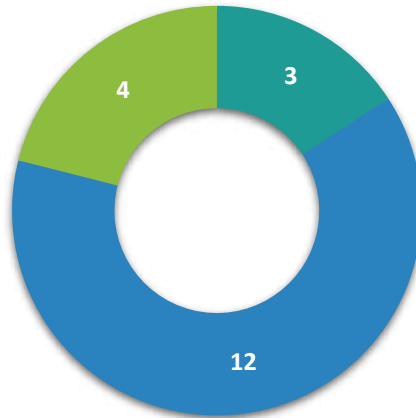
Listed vs Unlisted REIT Schemes

Total Number of REIT Schemes	
REIT Schemes	19



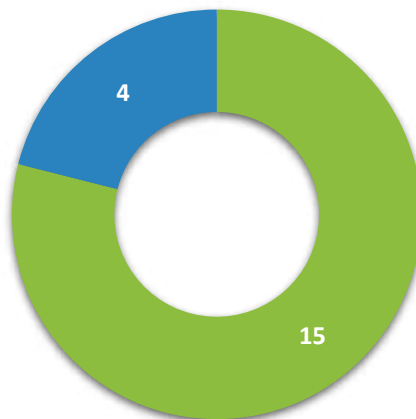
■ Listed REIT Schemes ■ Unlisted REIT Schemes

Type of REIT Schemes



■ Rental REIT Schemes ■ Developmental REIT Schemes ■ Hybrid REIT Schemes

Shariah Compliant vs Conventional REIT Schemes



■ Shariah Compliant REIT Schemes ■ Conventional REIT Schemes

4. Identification of Potential Areas - Regulatory Review

The Commission has initiated impact analysis to assess efficacy of the REIT Regulations in catering to the rapidly evolving REIT landscape within the country. This entails review of the regulations from perspective of addressing ambiguities and fortifying requirements and procedures in a simplistic manner, to encourage a larger number of RMCs and real estate developers to launch real estate projects under the REIT Structure.

The review also focusses on reinforcing early listing of REIT Schemes so that REITs can function as a viable capital market asset class, especially for the small investors. To promote protection of rights of unitholders, the REIT Regulations are being evaluated for strengthening the roles and responsibilities of the RMC and trustee in ensuring effective supervision and control over a REIT Scheme and to mitigate any regulatory arbitrage between different REIT structures. Such regulatory infrastructure coupled with accurate and timely disclosures is deemed vital for complementing the consistent shift towards a disclosure-based regime for REITs in Pakistan.

Given increased preference for Shariah compliant REIT schemes, the regulations are also being reviewed for ensuring better linkage and enabling enhanced adherence to Shariah principles and the Shariah governance regulatory framework recently notified by the SECP.

5. Initial Consultation with Stakeholders

Initial consultations have been held with existing RMCs and registered trustees on potential areas of improvement through in-person sessions held in Karachi and Lahore. Various RMCs and trustees have also made written submissions which have aided in further refining potential areas and helped identify further areas of improvement. In meantime, the Commission has also carried out review to benchmark existing REIT Regulations with the continuously evolving REIT regulatory regime in other jurisdictions.

As a result of the regulatory review journey, the Commission has identified various potential areas that can help improve the REIT Regulations, these are discussed in detailed in the next section.

6. Potential Areas for Improvement

Potential areas for improvement in the REIT Regulations along with the thought process and rationale based on which these areas have been identified are detailed below:

(i) Regulation 2: Definitions

- (a) Accredited Investor: The definition of Accredited Investors is proposed to be expanded to include Limited Liability Partnerships (LLP) and other registered partnership.

The concept of accredited investors is provided in the regulations to enable sophisticated/high net worth investors to become early stage investors in REIT Schemes based on their risk appetite and capacity to analyze the risks of a particular investment. LLPs and partnerships can independently evaluate risks and benefits of investing in a particular REIT Scheme and can therefore qualify as accredited investors.

- (b) Borrowing: Scope of borrowing can be expanded to enable a REIT Scheme to borrow from its associated companies/associated undertakings.

The Commission has received proposals to allow a REIT Scheme to borrow from its associated companies/associated undertakings. As per existing regulations, an RMC can arrange borrowing for a REIT Scheme only from financial institutions through loan arrangement or funds received through issuance of debt securities.

The scope of borrowing can be expanded while taking into consideration that the REIT Regulations require for an RMC to carry out related party transactions in relation to a REIT Scheme with prior approval of the Trustee. It is being deliberated that additional checks can be introduced to ensure rights of unitholders are protected and transaction is at arms-length basis, such as requirements for RMC to seek prior approval from unitholders in case of borrowing from associated company/undertaking of REIT Scheme.

- (c) **Customer Advances:** It is being contemplated that clarity may be provided through the definition of customer advance in the REIT Regulations, to clearly pronounce that an SPV can receive customer advances against sale of real estate in case a REIT Scheme is executed in SPV structure. At present, customer advances are only allowed in the name of the REIT Scheme, which is causing operational difficulties for REIT Schemes being executed in SPV structure.
- (d) **Financial Close:** It is being deliberated that the concept of financial close may be omitted from the REIT Regulations.

Under the existing regulations, the concept of financial close is only used in the context of triggering the timelines for transfer of real estate in the name of the REIT Scheme and for listing of the REIT Scheme. Since financial close depends solely on the financial decisions of the RMC, possibilities of delays in financial close can unnecessarily prolong the transfer of real estate in the name of the REIT Scheme and thereby adversely impact listing timelines.

To encourage timely listings and make REITs a viable capital market asset class, the timeline for transfer of real estate and listing of REIT Scheme may be linked to the date of registration of REIT Scheme. Concept of financial close would resultantly become redundant and can accordingly be omitted from the REIT Regulations.

- (e) **REIT Project:** Clarity is proposed to be added in the definition of REIT project to emphasise that income of a REIT Scheme from the REIT project shall only be in the form of rental incomes or capital gains or a combination thereof.

Through the REIT Regulations, the Commission had clearly pronounced the different types of real estate projects that can be executed under the REIT Scheme, such as residential, commercial, healthcare, transport, power, mining etc. This has however created certain ambiguities in the market that the business income from such projects can also become part of the income of the REIT Scheme and be exempted from tax. This ambiguity may be addressed by clearly highlighting the sources of income of a REIT Scheme.

- (f) **Definition of Trustee:** It is envisaged that the definition of Trustee and eligibility criteria for trustee can be modified so that a trustee already registered under the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (NBFC Regulations) is eligible to act as trustee of a REIT Scheme.

The process of registration of Trustee can be further simplified through single point of registration by way of the already specified mechanisms/procedures for registration of trustee under the NBFC Regulations.

(ii) Regulation 6: Conditions for Launching REIT Scheme

- (a) Approval of Material Deviation in Trust Deed: Approval of the Commission in case of material deviation from standard format of the trust deed can be discontinued.

The trust deed is a constitutive document executed between the trustee and the RMC for establishment of the trust and managing affairs of the REIT Scheme. The trust deed was previously required to be approved by the Commission. Under the revamped REIT Regulations, the number of required approvals were reduced by the Commission for streamlining the procedures for launch of REIT Scheme. The regulations now only require approval of the Commission in case of material deviation from the standard format of trust deed annexed as Schedule I to the REIT Regulations.

Since the standard format requires all provisions of the trust deed to adhere to the REIT Regulations, the concept of material deviation along with requirement of seeking approval for the same from the Commission can be deleted.

- (b) No Objection Certificate from Commission on name of the Trust/REIT Scheme: To facilitate RMCs by addressing issues in the naming convention of REIT Schemes, RMCs should be required to obtain NOC from the Commission regarding name of the REIT scheme, prior to proceeding with registration of the trust with the relevant trust authorities.

The Commission has observed instances in which it becomes essential to advise an RMC to change the name of a REIT Scheme due to various reasons, such as similarity/overlap with the name of an already registered REIT Scheme. Changing the name of a REIT Scheme poses challenges for an RMC once the trust deed has been registered with the trust authorities and the trust stands established. The requirement of NOC for name of REIT Scheme would address these issues.

- (c) Consent of Trustee on Information Memorandum: Clarity can be added in the process flow for registration of REIT Scheme by reinforcing that RMC shall prepare the Information Memorandum (IM) and obtain consent of Trustee on the same prior to submission of IM to the Commission.

The IM is the key offering document for raising funds from accredited investors during the early stages of the REIT Scheme. It includes the vision of the RMC for execution of the REIT project along with other vital information about the RMC and the REIT Scheme. Trustee is responsible for supervising execution of the REIT project in accordance with the IM and other constitutive documents. Therefore, the RMC should be obtaining consent of the Trustee on the IM before submission of the same to the Commission.

- (d) Approval for Registration of REIT Scheme: To streamline the registration process for REIT Scheme, approval of the Commission for registration of REIT Scheme may be reinstated.

The concept of deemed registration of REIT Scheme was introduced in 2022 under which REIT Scheme is deemed registered upon submission of certain documents to the Commission. RMCs have highlighted issues being faced in the absence of any approval/confirmation of registration by the Commission including the following:

- Commission still follows similar protocols/SOPs as required in case of approval of a REIT Scheme since detailed evaluation is required for assessing if any condition is to be imposed on the REIT Scheme.
- Industry does not have any proof of registration of the REIT Scheme, which causes procedural and operational issues such as in opening of bank account, solicitation of funds from investors, transfer of real estate etc.

(iii) Regulation 7 and 8: Procedure for Listing of REIT Scheme & Transfer of Real Estate

- (a) Transfer of Real Estate/shares of SPV and Listing of REIT Scheme: The timeline for transfer of real estate/shares of SPV in the name of the REIT Scheme can be linked to the date of registration of REIT Scheme, whereas the timelines for mandatory listing of a REIT Scheme can be linked to the transfer of real estate/shares of SPV in the name of REIT Scheme.

As per existing regulations, for direct investment structure, the timeline for transfer of real estate is linked to financial close whereas listing of REIT Scheme is linked to financial close or transfer of real estate, whichever is later. On the other hand, for SPV structure, the transfer of shares of SPV in the name of REIT Scheme is linked to date of investment in SPV by REIT Scheme.

There is an element of subjectivity in the date of financial close and the date of investment in SPV by the RMC due to dependency on the financial and operational decisions of the RMC. Possibility arises that these activities can be extended in manner that unnecessarily delays transfer of real estate/shares of SPV, and ultimately impacts the mandatory listing timelines.

To enable timely listing and address ambiguities in the ongoing activities of the REIT Scheme, Developmental and Hybrid REIT Schemes get listed within three (3) years from date of transfer of real estate/shares of SPV, while other types of REIT Schemes get listed within one (1) year from the date of transfer of real estate/shares of SPV.

- (b) Return of Subscription Money: In order to protect the retail investors in case of failure of RMC to transfer real estate/shares of SPV in the name of the REIT Scheme within the stipulated timelines, the costs relating to launch of REIT Scheme shall be borne by the strategic investors of the REIT Scheme.

(iv) Regulation 7 and 26: Requirements for Execution of REIT Scheme in SPV Structure

Following additional requirements may be introduced for SPV structure to ensure protection of unitholders, optimize the SPV structure by bringing it at par with direct investment structure and safeguard investment of REIT Scheme against any prior litigations:

- (a) Creation of charge on REIT assets in favor of Trustee for all SPV structures as opposed to creation of charge only in case of SPV structures involving movable assets.
- (b) SPV to keep its money deposited with bank having minimum AA rating.
- (c) Shareholders of SPV other than REIT Scheme to give an undertaking that they shall be liable for any legal obligations arising from commitments/obligations of company prior to appointment of company as SPV by RMC.

(v) Regulation 13: Minimum Holding by RMC and Strategic Investor

Strategic investment can be linked to total fund size instead of initial fund size. Strategic investors, along with the RMC, are the major stakeholders having the decision-making powers and financial capability/resources to ensure successful execution of the REIT Scheme.

As per existing regulations, strategic investors/RMC are required to hold at least 25% units of initial size of the REIT Fund. The subject holding would decrease with any increase in the size of the REIT Fund over time. To maintain the interest of the strategic investors in the REIT Scheme in same proportion, minimum holding by strategic investors be linked to the total size of the REIT fund instead of initial size of REIT fund.

(vi) Regulation 15 and 16: Obligations of RMC and Trustee

It is envisaged that the roles and responsibilities of RMC and Trustee may be enhanced for increased transparency, better coordination, improved supervision and monitoring of the REIT scheme, and to mitigate any regulatory arbitrage between direct investment structure and SPV structure:

- (a) RMC to provide Trustee, original title documents of real estate and all other approvals related to Real Estate including but not limited to NOC and approved layout plan from the relevant building and land authorities.
- (b) Trustee to have half yearly progress review meetings with RMC and relevant stakeholders.
- (c) Trustee to publish progress report on the REIT Scheme and such report to be circulated along with annual financial statements of the REIT Scheme.
- (d) Trustee to provide consent to the RMC on appointment of board of directors of SPV.
- (e) RMC to ensure compliance with the requirements specified in the Shariah Governance Regulations, 2023 in case of Shariah compliant REIT Scheme.

(vii) Regulation 29: Independence

Explanation can be added to the term “independent” to address ambiguity and enable better assessment of independence between RMC, Trustee and the Valuer. Therefore, independence be determined on basis that there is no cross-shareholding or cross-directorship, similar to the criteria for independence as provided under the NBFC Regulations.

(viii) Regulation 35: Retirement or removal of trustee/valuer

- (a) Removal of Trustee: It has been identified that in case of removal of trustee by the Commission, an opportunity of hearing should be provided to the trustee by the Commission.

Under the existing regulations, the Commission can remove the trustee without providing an opportunity of hearing. It is suggested that since this is a major decision, procedure for removal of trustee may be improved by creating provision that the Commission should provide an opportunity of hearing to the trustee before proceeding with removal.

- (b) Removal of Valuer: Power of the Commission to direct RMC to remove valuer is being considered to be deleted. Alternatively, RMC may remove valuer on occurrence of certain events as already provided for in the REIT Regulations, with the consent of trustee.

Valuer plays an integral role as valuation of the real estate directly impacts the Net Asset Value (NAV) of the REIT scheme. The REIT Regulations already provide criteria for appointment of valuer. Critical decisions such as removal of the valuer would require urgent action in a smooth and timely manner to ensure that interests of unitholders are not adversely affected. The process for removal of valuer can accordingly be simplified and to impose additional check, such removal can be decided by RMC after obtaining consent of the Trustee.

(ix) Regulation 36 & 37: Extinguishment/Revocation of REIT Scheme

- (a) Grounds for revocation of REIT scheme: To enable greater flexibility and codify the events that can lead to revocation of a REIT Scheme, following additional events can be considered to be included for revocation of REIT Scheme:

- title of real estate is transferred from the REIT Scheme in any manner other than as stated in the Regulations, Information Memorandum or the Offering Document;
- if in the opinion of the Trustee, any action of RMC results in material violation of the constitutive document, the Companies Act, the Companies Ordinance and/or the rules/regulations relating to REIT Scheme.

(b) **Opportunity of hearing:** In order to streamline the process of revocation of REIT Scheme and make it fairer and more equitable, RMC should be given an opportunity of hearing by the trustee/Commission, in case where revocation of REIT Scheme is initiated by the Trustee or the Commission.

The opportunity of hearing can be restricted to only those events in which the trustee or Commission are initiating the revocation on their own accord. Instances in which revocation is being initiated through resolution of unitholders, or upon completion of life of REIT Scheme, or where RMC goes into liquidation etc., may not require such hearing of the RMC.

(c) **Cancellation of REIT Scheme:** The process for cancellation of REIT Scheme should culminate upon cancellation of the REIT Scheme by the Commission, after all requirements for revocation of the REIT Scheme have been completed by the trustee. Existing regulations specify automatic cancellation of the REIT Scheme upon completion of the revocation process by the Trustee. Since registration of REIT Scheme is being contemplated to be approved by the Commission, cancellation of the REIT Scheme should also be concluded with approval of the Commission.

(x) Regulation 2, 6, 15, Schedule I, IV and IVA: Align REIT Regulations with newly promulgated Shariah Governance Framework

To ensure better compliance with the shariah principles and align REIT Regulations with newly promulgated Shariah Governance Regulations, 2023, multiple changes are being evaluated.

Owing to local market dynamics and increasing demand for shariah compliant financial products, RMCs are preferring to launch shariah compliant REIT Schemes. Out of 19 Registered REIT Schemes, 15 are shariah compliant. Recent changes through the Shariah Governance Framework render the definition of Shariah Advisor redundant and also warrant changes in terms of the requirements for seeking certificate from Shariah Advisor. References to the most recent regulations also needs to be added along with increased responsibility of RMC to ensure compliance with the Shariah principles and Shariah governance framework.

(xi) Schedule III: Annual Monitoring Fee

An explanation may be added to elaborate the calculation of average fund size for determination of the annual monitoring fees to be paid by a REIT Scheme.

Annual monitoring fee of a REIT scheme is required to be paid on an annual basis by the RMC based on the average fund size of the REIT Scheme. The Commission observed that there is no standard practice for calculation of average fund size by RMCs due to lack of clarity regarding the calculation methodology. Following explanation along with formula is being evaluated to be introduced for calculation of the average fund size for determination of monitoring fee:

“Average fund size of the REIT Scheme for each financial year shall be calculated by dividing sum of REIT fund at the end of each quarter by 4.

Formula:

Size of REIT Fund $(Q1+Q2+Q3+Q4)/ 4$ ”

6. Format for sharing feedback/comments

Feedback on these proposed areas for improvement along with any other suggestion on the REIT Regulations may be sent via email to Primary Market Approvals and Development Department (PMADD) at REIT.Feedback@secp.gov.pk as per below format:

Name			
Name of the related Entity			
Sr. No.	Regulation/ Section No.	Views/Proposed Changes	Rationale
Confidentiality			
<i>If you wish to keep all or any part of your submissions and your identity confidential, please indicate the same. In all other cases, your provided comments can be made public, except your contact information.</i>			

7. Indicative Timeline

Stage	Date/Timeline	Details
1	June 24, 2024	Publication of Consultation Paper
2	Within 15 days of publication of Consultation Paper and placement of notification on SECP website	Public comments period
3	Within 30 days of receipt of comments on the Consultation Paper	Consultation on suggestions
4	Within 30 days of conclusion of consultations	Notification of draft amendments to the REIT Regulations



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