Our Views

REITs InvITs now occupies significant mindspace of capital markets

The Securities and Exchange Board of India (SEBI) had introduced Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs) as an alternative investment funds in 2014. REITs/ InvITs are innovative pooled investment vehicles which allow monetization of infrastructure and real-estate assets while providing investors the opportunity to invest in these assets without fully owning them. The underlying idea behind launching REITs/ InvITs is to transform illiquid investments in infrastructure and real estate assets into liquid investments with attractive returns.

At March 31, 2023, there were 20 InvITs and 5 REITs registered with SEBI with aggregate net assets under REITs/InvITs of INR 2.5 across various sectors like energy, transport & logistics, communications, social and commercial Infrastructure, real estate, etc. The current market cap of listed REITs/ InvITs is approximately INR 1.0 tn.

Significant investment in infrastructure, favorable government policies, attractive returns and interest of global investors have driven fund mobilization through listed REITs/ InvITs to INR 18,658 cr in H1FY24 as compared to INR 2,596 cr raised in FY23. Further, several new issuers are planning to tap the market.

Global investors such as Blackstone, KKR, Brookfield, CPPIB, Actis, GIC, ADIA have been increasingly investing in infrastructure sector in India through REITs/ InvITs. Now there is an increased interest from domestic mutual funds and corporates as well.

The evolution of REITs/ InvITs has led to innovation in the financial products. For example, NSE launched REITs and InvITs indices to track performance of listed REITs/ InvITs. Further, domestic mutual funds have requested the market regulator to allow mutual fund houses to have schemes dedicated to REITs/ InvITs.

SEBI has been proactive in taking various steps to facilitate ease of doing business while ensuring the highest standards for governance and transparency are upheld to protect the interests of stakeholders. It is also looking to develop the REITs/ InvITs market through various policy measures. To facilitate higher governance and uniformity to sponsors and unitholders of REITs/ InvITs, SEBI has recently issued various circulars and consultative papers on framework for issuance of subordinate units and computation of net distributable cash flows. It has also envisaged board representation for retail and institutional investors, follow-on offers, etc.

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Framework for Issuance of Subordinate Units

At present, REITs/ InvITs can issue subordinate units to sponsors and their associates; however, there is no clarity and framework detailing the mechanism for issuance of such subordinate units.

The issuance of subordinate units is primarily intended to bridge the valuation gap that may arise because of difference in valuation of an asset perceived by the Sponsor (asset transferor) and the REIT/ InvITs (investors/ unitholders).

SEBI had issued a consultative paper in Dec-23. As per the proposed framework, subordinate units can be issued only to sponsors and shall carry only inferior rights as compared to ordinary units. Further, the issuance of subordinate units would require prior approval of 75% of the unitholders in value, and such subordinate units shall not be considered for the purpose of mandatory minimum unitholding requirements applicable to the sponsors. The subordinate units can be converted into ordinary units on achievement of performance benchmark.

Further, another consultative paper in Jan-24 clarified that maximum number of subordinate units that can be issued to sponsor shall not exceed 10% of total number of outstanding ordinary units or 10% of acquisition price at the time of acquisition of an asset. It also clarified that there shall not be multiple classes of subordinate units and all subordinate units shall carry uniform voting and distribution rights.

The concept of subordinate units is a welcome step to resolve valuation differences among the participants. Further, the cap on issuance of subordinate units will protect the interests of unitholders by limiting the impact of potential dilution resulting from conversion of subordinate units. Hence, SEBI's further detailing of the mechanism for issuance of subordinate units is a win-win for sponsors as well as unitholders.

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Framework for Computation of Net Distributable Cash Flows

However, the requirement for distribution of cash available with SPV for identified acquisition at the time of formation of InvITs is an area that requires further clarification.

To bring uniformity and to standardize the framework for calculation of Net Distributable Cash Flows (NDCF) by REITs and InvITs, with effect from April 1, 2024, NDCF is to be calculated at both Holdco/ SPV level and REIT/InvIT level. Also, the Trust, along with its SPV, must distribute at least 90% of NDCF to its unitholders.

As per InvIT Regulations, the distribution of sale proceeds from infrastructure assets is not required to be made to unitholders if such proceeds are proposed to be re-invested in another infrastructure assets within a period of one year. However, clarification is required on whether the cash available with an SPV (for identified acquisition) at the time of formation of REIT/InvIT needs to be distributed. The market regulator can consider providing a mechanism through which such cash can be used to make identified acquisition and need not compulsorily be distributed to the unitholders.

Considering the government's emphasis on infrastructure capital expenditure, SEBI's proactive governance measures for REITs/ InvITs and the growing confidence of global investors in India, REITs/ InvITs will continue to occupy a larger mindspace of investors and our markets.

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