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“CONSTRAINTS TO CAPITAL RECYCLING: AN ANALYTICAL STUDY ON THE RISE OF INVITS IN INDIA”

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ABSTRACT-

Infrastructure Investment Trusts, or InvITs, are emerging as the new entrants in the Indian market as a new and innovative way of addressing the long-standing issue of the funding gap in infrastructure and the need to release the capital trapped in operating infrastructure assets. An infrastructure investment trust is a transparent and highly structured way of raising long-term domestic and international funds to be invested in infrastructure projects. Like real estate trusts and mutual funds, infrastructure trusts enable investors to purchase units that represent actual stakes in infrastructure assets with the promise of regular returns through mandatory payout mechanisms. This article discusses the evolution of infrastructure trusts in India by focusing on the structure of infrastructure trusts and the way they operate and how they can address the long-standing issues of India by focusing on the debt burden, stressed assets, and the lack of private sector participation in the infrastructure sector. It also discusses the regulatory framework set by SEBI with regards to infrastructure trusts and the way they can attract domestic as well as international investors by focusing on the tax efficiency, diversification of asset-specific risks, and the global norms of investing. The article also concludes that infrastructure trusts are not just fundraising mechanisms but can also promote greater transparency and governance and mobilize long-term capital. However, the success of infrastructure trusts depends on the stable regulations in the infrastructure financing sector of India and the level of awareness among investors regarding infrastructure trusts. Finally, the article concludes that infrastructure trusts are the future of infrastructure development in India as long as the regulations are stable and in line with international best practices.

Literature Review –

1. SEBI Consultation Paper on InvITs-

The consultation paper presented by SEBI states the rationale for the existence of InvITs: they were created as a solution to the squeeze that India has been putting on the financing of its

infrastructure, the pressure on PPP assets, and the heavy dependence on expensive loans. The consultation paper describes an effective structure of governance, which involves independent valuers, project managers, sponsors, and trustees, along with the enforcement of high transparency parameters. It is stated that the necessity of long-term refinancing, capital recycling, and the protection of investors is of utmost importance, as is the enforcement of parameters such as 76% SPV ownership and 90% income distribution. The risk of InvITs is addressed by SEBI by focusing on the formulation of guidelines that are sector-specific, along with the implementation of multiple project portfolios, as well as the benefits that may accrue from these regulations.

2. NISM “Understanding InvITs” –

NISM's investor education material interprets InvITs from the perspectives of both institutional and retail investors. InvITs are entities that enable pooled investment into infrastructure assets that produce income, offer liquidity, and yield predictable returns through stock market listing, according to the article. In order to promote openness and lessen information asymmetry, the paper describes structural components such as sponsors, trustees, valuation standards, and required payouts. NISM presents InvITs as dependable, income-focused investments suitable for long-term investors by highlighting accessibility through low minimum investments and open disclosure standards. It also highlights how important it is for investors to understand and be aware of the risks related to concession conditions and project performance.

3. CDSL Investor Education PPT on InvITs -

The CDSL investor-awareness presentation provides a brief and helpful overview of InvITs, with a focus on how investors may access and benefit from them. It clarifies that InvITs enable investments in operational infrastructure assets that must be paid to unit holders and have steady cash flows. The PowerPoint highlights important advantages such as decreased entry barriers, liquidity through exchange listing, diversity, and transparency through frequent NAV announcements. Additionally, the appropriateness profile is explained, emphasizing how appealing InvITs are to investors seeking steady returns from assets like electricity transmission, highways, and the like. CDSL identifies risks such as project reliance, regulatory vulnerability, and shifting market liquidity with a focus on informed participation.

CHAPTER 1-INTRODUCTION

InvITs: What they're all about?

What is an InvIT, you ask? An InvIT, or investment trust, is an investment tool that allows investors to put their money into infrastructure ventures. The primary purpose of an InvIT is to provide investment opportunities in the domain of infrastructure, which has traditionally been reserved for institutional investors, to the general public.

You can invest in various infrastructure ventures through InvITs, earning returns and growth for your investment, as well as channeling your savings into infrastructure projects.¹

Where do they make their investments?

Similar to mutual funds or REITs, InvITs make investments in infrastructure assets such as pipelines, electricity transmission lines, and toll highways.

Organization

Sponsors, usually private equity firms or infrastructure businesses, develop InvITs. The sponsor establishes the InvIT and gives the trust ownership of the underlying infrastructure assets. Investors then get units from the trust, which signify an ownership share in the trust and, consequently, the underlying assets.

Regular payments and possible capital growth are the two ways that investors in InvITs might profit. The majority of InvITs' profits are usually distributed to investors as dividends, which can offer a consistent source of income. Additionally, investors may be able to sell their units for a profit if the underlying assets increase in value over time.

CHAPTER 2 OBJECTIVE AND RATIONALE FOR INVITS-

The following are fundamental issues that InvITs seek to address are listed in the paper:

1. Challenges in Financing and Refinancing-

High-cost financing, implementation delays, and equity lock-up plague stressed infrastructure assets, particularly transmission lines, highways, and PPP projects.

- a. InvITs are suggested to offer an appropriate framework for financing or refinancing infrastructure projects in the nation given the difficult stage of infrastructure development now facing the nation.

¹ <https://www.nism.ac.in/investor-education/understanding-invits>

b. Many ongoing infrastructure projects in India are "stressed" and delayed for a variety of reasons, including growing debt financing costs, private investors' lack of or locked-up equity in projects that prevents them from being interested in taking on new projects, a lack of foreign funding for Indian infrastructure projects, project implementation delays caused by a variety of factors like the global economic slowdown, cost overruns, concessionaires' failure to meet funding requirements on time, etc. InvITs might be useful as an investment vehicle:

- to offer longer-term, more comprehensive financing for ongoing infrastructure projects
- to allow existing developer funds to be reinvested in new infrastructure initiatives.
- To assist banks free up or decrease loan exposure by refinancing or taking out current high-cost debt with long-term low-cost capital, so creating bank headroom for new funding requirements

2. Recycling Capital

There are various infrastructure players whose capital is idle in projects that are either generating returns or are almost completed. This creates a problem in terms of funding infrastructure, and InvITs help release these funds for new projects.

3. Diversification and Portfolio Approach

InvITs are structured as perpetual structures, which can absorb various assets over time, reducing the risk associated with any particular asset. This is in line with global infrastructure funds, and InvITs are attractive for pension funds, insurance companies, and international investors.

4. International Capital Mobilisation

India is facing a problem in terms of long-term financing, and InvITs provide a structure that is familiar and acceptable globally, along with contracts, investment-grade valuations, and cash flows.

5. Improvement of Governance

Compared to infrastructure development at the SPV level, InvITs have stricter

requirements for transparency, valuation, and independent monitoring. This improves trust and reduces governance issues that have historically afflicted the industry.

6. The Requirement of a Specific Framework

Divergent stakeholder ideas, such as the mutual fund approach, distinct rules, or REIT adaption, are acknowledged by SEBI. These choices are contrasted in the next chapters.²

CHAPTER 3- INVITS AS MUTUAL FUNDS

The concept suggests that InvITs in India might benefit from the mutual fund structure that is currently in existence there. A framework for such InvITs may be found in a different chapter of the SEBI (Mutual Funds) Regulations, 1996 or in a set of rules called the SEBI (InvIT Mutual Funds) Regulations.

Important aspects of the plans include the following: InvIT registration and structure

1. Like any other mutual fund, an InvIT must be set up as a trust under the Indian Trusts Act, 1882. There will be participation from independent engineers, project managers, sponsors, trustees, and other stakeholders.
2. The Trust must first register with SEBI as an InvIT and meet the requirements outlined in the Draft Regulations.
3. InvITs would purchase SPV interests in infrastructure projects, primarily PPPs involving the public and private sectors. Additionally, non-PPP projects might be added to the framework.

Participants in the InvIT -

1. Sponsor- An InvIT's sponsor will be either an infrastructure developer or a special purpose vehicle (SPV) with a concession agreement. The Sponsor will transfer the bulk of the SPV's shares to an InvIT Trust. The InvIT. The Sponsor will be obliged to maintain its commitment in an InvIT structure, sometimes known as a 'skin-in-the-game', either by maintaining a minimum proportion of units in the trust or by having a minimum ownership in the SPV plus units in the Trust.
2. Project Manager–

² <https://www.icsi.edu/media/webmodules/linksofweeks/Consultation>

An InvIT's initial concessionaire for an infrastructure project will be appointed as a Project Manager, with the responsibility of meeting project deadlines as originally stipulated in the concession papers. The new laws will allow project managers to be replaced in the case of unsatisfactory performance.

3. Independent Engineer: As requested, an independent engineer will be employed in the present concession arrangement. It is advised that the parties maintain the concession arrangement for as long as possible. If anything changes, the method provided in the concession agreement or, if applicable, the authority's guidelines must be followed.
4. Advisory Board: An Independent Advisory Board comprised of industry experts and other professionals will assist the InvIT Trustee on technical issues, project manager oversight, and other decision-making.
5. The Authority-Parties to the new concession agreement between Sponsor Concessionaire, Trust, Project Manager, and Authority, as relevant for the particular infrastructure sector (e.g., NHAI for highways).

Offer and Listing-

1. An InvIT may raise additional funds through follow-on offerings after registering with SEBI and issuing units to investors in an initial offer. Both local and international investors may contribute money to InvITs. However, there would be a three-year lock-in period for any non-resident investments in the InvIT units. Nonetheless, throughout this three-year lock-in period, all non-resident investors are free to deal with one another.
4. A portion of the money acquired through an InvIT will be used to purchase at least 76% of the SPV's equity shares; the remaining funds will be used to refinance SPV debt. An InvIT's net distributable income, which will be distributed to investors, will include interest income earned by the SPV on the loan the InvIT supplied. The proposed regulations would include deadlines for share transfers following the conclusion of the fund-raising exercise.
5. SEBI's proposed regulations will specify the basic procedure for initial and follow-on offers, the filing of offer and follow-on offer documents, and the allocation and listing of units (where needed). The regulations will also outline the specific disclosures that must be made in the offer document or follow-up offer document.
6. An InvIT's units might be listed on a stock exchange. Listing MF units will provide

some tax benefits, although it is not required. Units of the InvIT will remain listed on the exchange once they are listed unless they are delisted in compliance with the delisting guidelines outlined in the proposed SEBI rules.³

Investment Conditions and Pay-out Policy-

1. Each InvIT must bundle a portfolio of infrastructure projects, which includes both pre-Commercial Operations Date (COD) projects (at least 50% developed) and post-COD projects (those are currently providing cash flows). Starting an InvIT with at least two or three of these projects is recommended.
2. One developer can create an InvIT that invests in projects from other project developers as well as from its own group firms. An InvIT can also be jointly sponsored by two or more developers.
3. Initially, an InvIT must be sector/sub-sector specialized (for example, it may exclusively invest in road projects). As a result, only infrastructure projects from a single industry can be integrated.
4. The InvIT must possess at least 76% of the SPV's equity shares. For private sector non-PPP projects with investible-grade ratings from RBI-notified Rating Agencies and additional discussions with the relevant authorities, a second method of establishing an InvIT—transferring all assets from an SPV to the InvIT Trust vehicle and dissolving the SPV—may also be considered.
5. According to equity-oriented mutual fund schemes, InvITs must invest at least 65% of their net assets in equity shares of firms.
6. InvIT is obligated to release at least 90% of its net distributable revenue after taxes to its investors. The InvIT will take an active role in the development of the underlying projects.

VALUATION-

1. The Discounted Cash Flow (DCF) technique would be utilized for valuation when purchasing SPV shares. Following conversations and a shadow book-building exercise with potential investors, an InvIT would acquire a post-COD project from a developer at a discount and a pre-COD project from a developer at a deeper discount rate.
2. Post-acquisition of Infrastructure Assets: A full valuation, including a physical

³ <https://www.icsi.edu/media/webmodules/linksofweeks/Consultation>

examination, should be performed at least once a year to ensure an accurate estimate of the underlying InvIT assets. Furthermore, a six-monthly value update documenting substantial changes over the previous six months would be required. As a result, the net asset value (NAV) must be disclosed at least annually. If there are any substantial developments, provisions for value must be mentioned.

CHAPTER 4 FEATURES-

Focus Asset Class: Predominantly completed infrastructure assets with more than 80% of the value of the InvIT coming from revenue-generating infrastructure projects.

Mandatory Distribution: Unitholders must get 90% of the net distributable cash flow.

Tax efficiency: Trusts have pass-through arrangements, which means they are not taxed.

Leverage Management: Net borrowing is limited to 70% of AUM (if rated AAA).

Strong corporate governance: independent trustees and valuers, at least 50% independent directors, enhanced transparency and rating requirements.

Key Unit Holders' Rights: To vote on material acquisition/borrowing, IM appointment/change, and Sponsor induction/exit.

Who can Invest in InvITs?

1. Any investor (domestic, international, retail, or institutional) can purchase InvIT units in India.
2. Public InvITs have a minimum subscription amount of ₹10,000 to ₹15,000/- and a trading lot of one unit. (updated effective July 30, 2021) Previously, it was ₹1 lakh and 100 units.
3. Investors can acquire InvIT units using a Demat account, just as they would purchase equity shares.
4. InvITs are appropriate for those seeking pricing benefits or returns from infrastructure projects and highways.
5. InvITs are also excellent for people who want to include infrastructure in their investment portfolio.

Where may an InvIT invest its funds?

1. At least 80% of a public InvIT's worth must be invested in 'finished and revenue-generating' infrastructure projects.
2. Up to 20% of the total value of InvITs might come from: • Infrastructure projects are

now under construction.

- Listed or unlisted infrastructure enterprises' debt (excluding Holding Company/SPV debt).
 - List of Indian listed firms with at least 80% revenue from infrastructure.
 - Government securities, money market instruments, liquid mutual funds, and cash equivalents.
3. Privately placed InvITs might include a mix of under construction and finished infrastructure projects.⁴

CONCLUSION-

Infrastructure Investment Trusts signal the beginning of a new chapter in the way India finances its infrastructure development needs. Never before has there been a sustainable business model that meets the requirements of investors, regulators, and operational efficiency at the same time. By converting operational infrastructure into realizable value, InvITs free up locked capital for infrastructure developers to channel back into new projects, thus improving the overall liquidity of the infrastructure sector as a whole.

InvITs are significant not just as a capital mobilization tool but also as a concept that offers greater project accountability, financial discipline, and the implementation of best-in-class global investment norms in India's infrastructure sector. The inclusion of trustees, project managers, independent engineers, and the establishment of the monitoring committee are aspects of the InvIT structure that are not necessarily part of the conventional infrastructure development projects using the SPV model. All these factors combined make the concept of InvITs more attractive to investors and suitable for pension funds, insurance companies, sovereign wealth funds, and retail investors as well.

However, there are still some challenges that need to be addressed with regards to long-term sustainability, regulatory complexities, investor awareness, liquidity risks, and changing dynamics in terms of India's infrastructure policies. There are also some uncertainties with regards to valuations, reliance on concession arrangements, and sector-specific risks that some InvITs are facing. Nevertheless, deeper secondary markets and more diversified asset portfolios are required to realize the true potential of InvITs. More monetization of public

⁴ <https://investor.sebi.gov.in/pdf/reference-material/ppt>

sector assets through InvITs, as seen in roads and power transmission, would be great for building sectoral confidence.

InvITs are seen as having tremendous transformative potential in terms of improving India's infrastructure. The potential is huge, given that InvITs provide a robust solution with regards to capital raising, better governance, and unlocking sustainable investment opportunities. As seen with regards to reforms, regulatory changes, and more investor participation, InvITs are set to become a key part of India's infrastructure growth strategy that would help realize long-term development goals in a sustainable manner.

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