

DISCUSSION NOTE – BORROWINGS BY TRUSTS AND ENFORCEMENT

This note proposes to address the following concerns raised by the Ministry of Finance, Department of Economic Affairs, in relation to the subject of trusts, and specifically real estate investment trusts (“REITs”) and infrastructure investment trusts (“InvITs”, together with REITs, the “Trusts”)

- (i). availing loans from banks and financial institutions at the Trust level.
- (ii). investment by foreign portfolio investors (“FPIs”) in debt securities issued by Trusts; and
- (iii). the legal framework for enforcement options for such financing.

I. INTRODUCTION AND BACKGROUND

1. The Indian Trusts Act, 1882 (the “**Trusts Act**”) does not contain any provisions that which either permit or prohibit trusts from availing loans. This is entirely governed by the powers conferred on the trustee in terms of the trust deed entered into by the trustee of the Trust. If a trust deed explicitly permits the trustee to avail loans for the benefit of the beneficiaries, the trustee is entitled to raise such debt. In case a borrowing is made pursuant to such provision in the trust deed: (a) the trustee will be the borrower on record; (b) the proceeds of the loan shall be applied towards the lawful purpose of the trust; and (c) in the event of a default in repayment of the loan, the trust properties shall be available to the trustee for applying towards the repayment of the loan and the lenders as set out in the commercial understanding.
2. We further understand based on discussions with market participants, even currently various Trusts including, educational trusts, hospital trusts avail of lending from various lenders including Banks and NBFCs.
3. Under the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (the “**SEBI REIT Regulations**”) and the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 (the “**SEBI InvIT Regulations**”, together with the SEBI REIT Regulations, the “**SEBI Regulations**”), it is the trustee who holds the assets for the benefit of the unit holders. On the other hand, a ‘unit’, by definition, represents the beneficial interest in the Trusts, and not the ownership interest in the Trusts or its assets. The rights of unitholders under the SEBI Regulations are similar to, and only on a slightly higher pedestal than the rights of beneficiaries in a typical trust, by virtue of the requirements of seeking unitholders’ approval in relation to certain matters.
4. Please note, that the Trusts are registered in terms of the Trusts Act and the SEBI Regulations with the Securities and Exchange Board of India (“**SEBI**”). In terms of the SEBI Regulations, Trusts are permitted to borrow subject to a consolidated leverage limit prescribed under the SEBI Regulations.
5. Further, presently, listed Trusts are permitted issue listed debt securities in accordance with the SEBI Regulations and the Debt Issue Guidelines which prescribe certain conditions (which are highlighted below). Recently, the Reserve bank of India (“**RBI**”) has also permitted InvITs to avail loans from banking companies subject to certain conditions.

II. RATIONALE FOR PERMITTING BORROWINGS AND ISSUANCE OF DEBT SECURITIES BY TRUSTS

1. *Structure of Trusts:*

- 1.1. There is a holding company-subsidary relationship between the Trusts and its underlying special purpose vehicles or holding companies and such debt issuances would be in the ordinary course of business. Further, these Trusts provide a comprehensive holding and regulated framework with underlying income generating assets – which have been amongst the most secure asset class for banks and NBFCs in India. Accordingly, allowing FPIs to invest in a Trust, which is an aggregation of income producing assets is a “derisked” and appropriate structure

2. ***Regulatory Safeguards in relation to borrowings by Trusts:***

- 2.1. In terms of the SEBI Regulations, the manager is the entity responsible for undertaking day to day activities of the Trusts, which is governed by a board of directors comprising of at least 50% of independent directors. Additionally, the SEBI Regulations require that certain decisions including in relation to borrowing (50% or 75% of the unitholders present and voting, subject to the leverage limits), related party transactions (50% of the unitholders present and voting) are required to be approved by the unitholders of the Trusts (being the beneficiaries).
- 2.2. In terms of the SEBI Regulations, Trusts are permitted to borrow monies. The SEBI Regulations prescribe certain limits up to which the Trusts on consolidated basis may avail borrowings (70% of the InvIT assets for InvITs and 49% of the REIT assets for REITs) subject to certain conditions, including approval of the unitholders and the mandatory credit rating requirement for any borrowing above 25% of the Trusts' assets on consolidated basis. In the event the credit rating falls below AAA or such other equivalent rating in case of InvITs having leverage limits above 49%, the leverage limits are required to be reduced to 49%. Additionally, there are mandatory disclosures required to be made to the stock exchanges and the unitholders on a regular basis including, publication of valuation reports by independent registered valuers (semi-annually, if the leverage limits of a Trust are below 49% of the Trusts assets, and quarterly, in case of InvITs, if its leverage limits are above 49%) and regular disclosure of credit rating, DSCR, ISCR ratios. The above compliances and requirements, provide comfort to lenders.
- 2.3. Please note that the above limits as prescribed under the SEBI Regulations are applicable to the Trusts, the Holdcos held by the Trust and the SPVs held by the Trust on aggregated and consolidated basis. Accordingly, since the borrowing limit is on a consolidated basis (i.e. Trusts, the Holdcos held by the Trust and the SPVs held by the Trust), there would be no instance of additional exposure.
- 2.4. As such, lending to Trusts would enable lenders to diversify their portfolio by adding low risk completed, income generating assets with the added protection of a credit rating. Additionally, the SEBI Regulations also require that certain credit rating is obtained by the Trust prior to availing such borrowings in excess of 25% of the Trusts' assets on a consolidated basis. Such ratings are required to be obtained from SEBI registered credit rating agencies.
- 2.5. We understand that rating agencies have a detailed rating framework in place which emphasizes on the benefits of cashflow pooling at the Trust level. A well-diversified asset base with no single asset dominating the cash flows with low receivable concentration is viewed favourably by credit rating agencies. The rating methodology issued by CRISIL and ICRA is attached for your ease of reference.

3. ***Servicing of Debt and Repayment:***

- 3.1. Specifically, in the context of Trusts, please note that in terms of the SEBI Regulations, it is mandatory that the SPVs are controlled by the Trusts in all circumstances other than as may be required under law or under concession agreements. Accordingly, any repayment shall effectively be made through the monies earned by the SPVs. Lending at the Trusts level would also ensure that the debt of the Trusts may be serviced through the proceeds of all SPVs simultaneously. In the case of Trusts, it would be under the lenders' control to ensure that protection measures are built in for the purposes for of seeking recourse from the SPVs.
- 3.2. Further, please do consider that Trusts are generally rated higher than any one individual asset, and lenders at the Trust level, based on their internal credit requirements, may seek an appropriate security package from the assets of the Trust including cross collateralization and or from any or all of the SPVs controlled by the Trust.

- 3.3. Being regulated entities which are set up with the protection of the interests of the investors in mind, Trusts are even better suited to act as borrowers as compared to registered trusts which have the general flexibility to avail loans for the benefit of their beneficiaries.
4. ***Borrowing at Trust level, widens the avenues available for fund raise and reduces the overall cost of borrowing***
 - 4.1. The above regulatory safeguards available to Trusts and majority of the assets of Trusts comprising completed and rent generating assets, provides lenders with greater comfort. Besides, the holding company structure of the Trust enables the Trust to secure better credit rating at the Trust level due to (i) diversification of the assets held through the SPVs, (ii) mitigation of the risks associated with lending to a single SPV or a single asset and (iii) low gearing levels on a consolidated basis compared to the SPVs. Further, the loans provided to the Trust can be secured by the assets of the SPVs. These could help the Trusts widen the avenues of fund raise and reduce the borrowing costs. This is evident from the fact that the existing listed Trusts have been able to raise large quantum of debt at the Trust level, at costs significantly lower than the cost of borrowing at the SPV level.
5. ***Security creation and cross-collateralisation:***
 - 5.1. In the event debt is availed at the Trust level, security may be created on the assets of the Trusts which includes the loans given by Trusts to one or more of the holding companies or SPVs and the assets of the holding companies or SPVs. The Trust itself does not typically hold any infrastructure or real estate assets over which security may be created. Accordingly, collateral is created over the assets of one or more of the holding companies or SPVs (which hold the infrastructure or real estate assets). In practice, one or more of the holding companies or SPVs may also issue guarantees on behalf of the Trust in order to create further security over the loan.
 - 5.2. CRISIL in its paper dated December 2018, titled “*Bullet bonds, co-obligor structures attracting investments in infrastructure*” expounding on co-obligor structures attracting investments in infrastructure sector by imparting portfolio diversification benefits. Co-obligor structures are those wherein multiple SPVs of a developer act as co-obligors for the collective debt of all SPVs. Such structures are typically governed by a common loan agreement and cashflows from individual co-obligors i.e. SPVs are made available for servicing collective debt obligations. Credit strength of each SPV gets linked to their combined strength of all SPVs, in addition to diversification benefits. We believe, Trust structures provides same benefits of the co-obligor structure with much higher governance standards and regulatory compliances and restrictions.

III. ENFORCEMENT OPTIONS AVAILABLE AGAINST TRUSTS

1. At the outset it is important to note that the lenders to Trusts have robust and enforceable legal remedies available to them to recover the debt, and any security, created and perfected properly, is fully enforceable.
2. However, cases of default in case of borrowings have not arisen in the context of Trusts until date. This maybe attributed to the following reasons, including, (i) leverage limits applicable under the SEBI Regulations on Trusts at a consolidated level; (ii) regular publication of valuation reports and other compliances by Trusts; and (iii) the asset portfolio of Trusts comprising of mostly completed and revenue generating assets (i.e. capital expenditure is limited).
3. The manager of Trusts, an agent of the Trusts, is empowered to create security over the assets of the Trusts and effect compromises, on behalf of the Trust, in the event of default with the security trustee.
4. Practically, for the enforcement of any security by lenders, a security trustee is appointed on behalf of the lenders or debenture holders, to ensure that, in case of any default, such security

trustee is empowered to act on behalf of the lenders (including to dispose assets of the borrower) in consultation with the lenders. In addition, the lenders shall always have the right to take any action in case of default by a borrower.

5. As highlighted above, assets of the Trusts are housed in the SPVs owned by the Trusts. The cash flows generated by such SPVs and assets of the SPVs, present the true value of collateral of the Trusts. Accordingly, any effective enforcement mechanism should be aimed at evaluating to the ability of a security trustee (acting as a lenders agent) to be able to ensure that the value of the assets under the SPVs can be utilized towards meeting such security trustees' obligation towards lenders in the event of any default by the borrowers.
6. In India, the various enforcement or recovery mechanisms available to lenders are under (i) the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“**SARFAESI Act**”); and (ii) the Recovery of Debts and Bankruptcy Act, 1993 (the “**RDB Act**”); (iii) the Code of Civil Procedure (“**Civil Code**”); (iv) Commercial Courts Act, 2015 (the “**Commercial Courts Act**”) and (v) the Indian Arbitration and Conciliation Act, 1996 (the “**Arbitration Act**”).
7. These remedies are also available to lenders to Trusts, including bondholders and security trustees or debenture trustees.
8. *The SARFAESI Act:*
 - 8.1. A statutory mechanism is available for to lenders for the purpose enforcement of security interest by a secured creditor without the intervention of a court or tribunal pursuant to a security agreement between the secured creditor and the borrower.
 - 8.2. This mechanism can be only invoked by a "secured creditor", specifically: (i) any bank or financial institution or any consortium of banks or financial institution; (ii) debenture trustee appointed by a bank or financial institution; (iii) asset reconstruction companies; (iv) debenture trustee appointed by any company for secured debt securities; and (v) any other trustee holding securities on behalf of a bank or financial institution in whose favour security interest is created.
 - 8.3. Further, “financial institution” is defined under the SARFAESI Act and includes, (i) a public financial institution within the meaning of section 4A of the Companies Act, 1956 (1 of 1956); (ii) any institution specified by the Central Government under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993); (iii) the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958 (42 of 1958); (iiia) a debenture trustee registered with the Board and appointed for secured debt securities; (iiib) asset reconstruction company, whether acting as such or managing a trust created for the purpose of securitisation or asset reconstruction, as the case may be; (iv) any other institution or non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934), which the Central Government may, by notification, specify as financial institution for the purposes of this Act.
 - 8.4. Therefore, any financial institution which is a secured creditor is lending to a borrower (as defined in the SARFAESI Act) has the benefit of the Act. The underlined portion above appears to be wider than the language included in limb (iv) of the definition of secured creditor which includes a debenture trustee appointed by a company (emphasis supplied) for debt securities, and is not restricted to a company but can cover any debt securities for which a debenture trustee is appointed. Since debt securities issuances by Trusts require the appointment of a debenture trustee, based on the above definition of financial institution, both banks and debenture trustees for the debt securities issued by Trusts would be classified as secured creditors in terms of the SARFAESI Act.

- 8.5. Further, under the SARFAESI Act, the term borrower means “*any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of an asset reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance or who has raised funds through issue of debt securities*”.
- 8.6. In the case of a REIT or an InvIT, the borrowing by the Trust (on whose behalf the Trustee acts), may be classified as the borrower for the purposes of the SARFAESI Act. If this is the case, then the relevant Ministries may consider whether the Debenture Trustees acting for debt securities issuances by Trusts should already have the benefit of the SARFAESI Act.
9. *The RDB Act*
 - 9.1. The RDB Act was enacted to ensure for expeditious adjudication and recovery of debts due to lenders. The options for recovery under the RDB Act are available only to banks and financial institutions and no other class of lenders including public trusts and foreign lenders. Please note, however, in terms of the RDB Act, financial institutions include a debenture trustee registered with the Board and appointed for secured debt securities (being the debenture trustee for debt securities issued by Trusts) being a financial institution will be able to utilize the recovery process under the RDB Act.
 - 9.2. Therefore, for adjudication and recovery of debts due to banks and financial institutions the benefit of the RDB Act is available. The underlined portion includes a debenture trustee appointed by a company (emphasis supplied) for debt securities. Since debt securities issuances by Trusts require the appointment of a debenture trustee, based on the above definition of financial institution, both banks and debenture trustees for the debt securities issued by Trusts would be able to avail benefits of the RDB Act.
 - 9.3. Further, under the RDB Act, the term debt means “*debt*” means “*any liability (inclusive of interest) which is claimed as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned, or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgage and subsisting on, and legally recoverable on, the date of the application and includes any liability towards debt securities which remains unpaid in full or part after notice of ninety days served upon the borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of debt securities*”.
 - 9.4. Further, the definition of debt securities is as prescribed by SEBI, which in terms of the SEBI ILDS Regulations includes debt securities issued by Trusts.
 - 9.5. In the case of a REIT or an InvIT, the borrowing by the Trust (on whose behalf the Trustee acts), may be classified as the borrower for the purposes of the RDB Act. If this is the case, then the relevant Ministries may consider whether the Debenture Trustees acting for debt securities issuances by Trusts should already have the benefit of the RDB Act.
10. *Other measures:*
 - 10.1. In addition to the above, the civil courts in India may be approached for the resolution of any civil dispute by any party, including lenders. Further, as one of the initiatives by the Government to ensure Ease of Doing Business in India, as a measure to streamline the procedures relating to commercial litigation including summary judgment of claims in case of commercial disputes introduced the Commercial Courts Act, 2015.

- 10.2. Further, in the event the agreement provides for arbitration, parties (i.e. lenders and borrowers) may also use arbitration for the purpose of recovery or enforcement or both.
- 10.3. In light of the above, we understand that for the purposes of recovery by all lenders, enforcement proceedings before civil courts and commercial courts and resolution through arbitration are commonly used and available.

11. Insolvency and Bankruptcy Code

- 11.1. The Insolvency and Bankruptcy Code, 2016 (the “**Insolvency Code**”) is a mechanism by which lenders may obtain resolution by way of reconstruction of companies, limited liability partnerships, partnership. It is strictly not a method of enforcement, but a method to restructure all the liabilities of the notified debtors. The Insolvency Code does not apply to trusts, co-operative societies and body corporates. However, please note that the Insolvency Code does apply to the holding companies and SPVs in which the assets of InvITs and REITs are housed. Additionally, the Insolvency Code does not explicitly provide a mechanism for recovery or enforcement by lenders but may be a consequence of restructuring process.
- 11.2. In the event borrowings of Trusts are guaranteed by one or more of the holding companies or SPVs of the Trusts, security trustees or lenders shall have the ability to initiate proceedings for restructuring against such holding companies or SPVs under the current framework of the Insolvency Code.
12. These remedies are also available to lenders to Trusts, including bondholders and security trustees or debenture trustees.

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