



INSURANCE COMPANIES – INVESTMENT IN DEBT SECURITIES ISSUED BY INFRASTRUCTURE INVESTMENT TRUSTS (INVITS)

MAY 2019

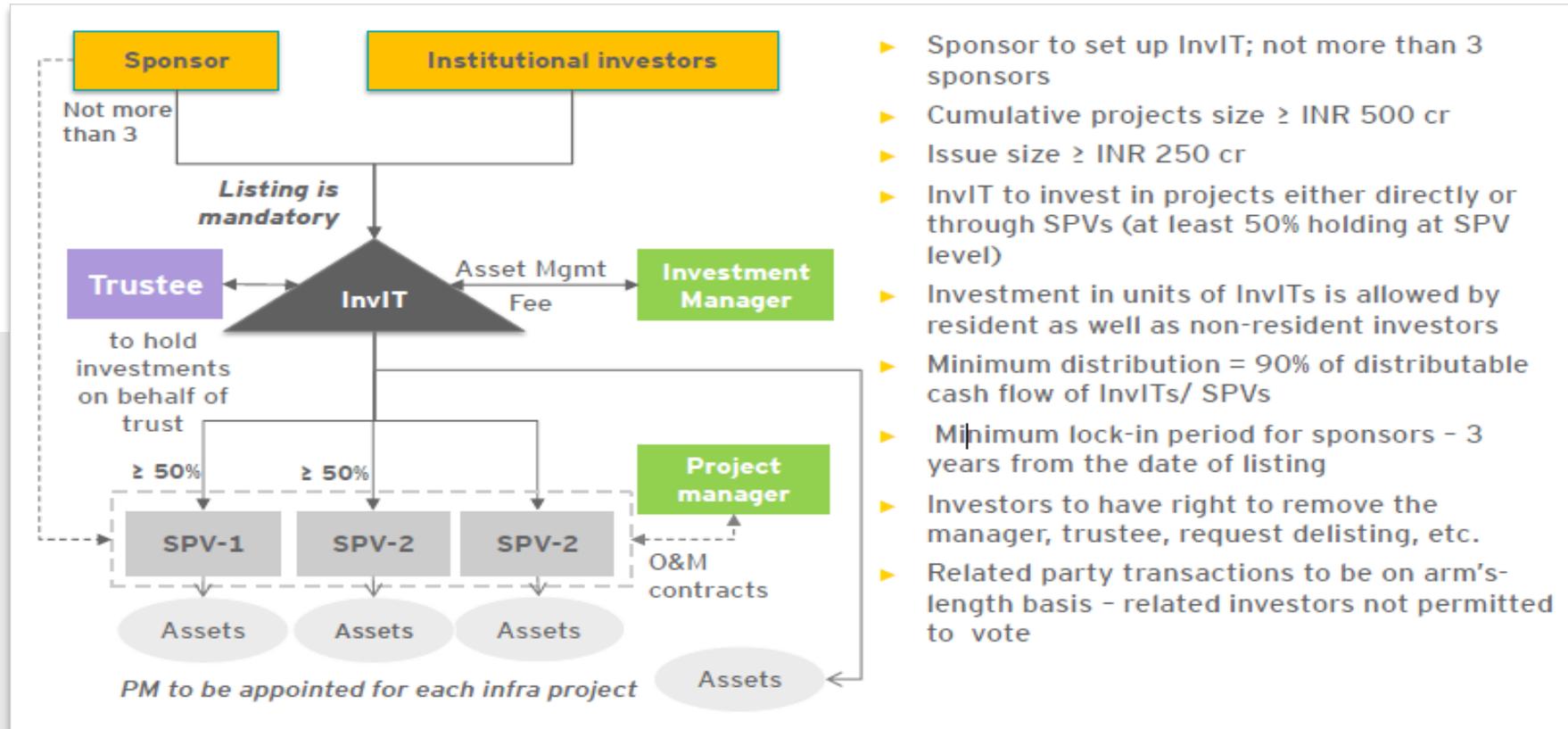


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Typical InvIT Structure



- ▶ Sponsor to set up InvIT; not more than 3 sponsors
- ▶ Cumulative projects size \geq INR 500 cr
- ▶ Issue size \geq INR 250 cr
- ▶ InvIT to invest in projects either directly or through SPVs (at least 50% holding at SPV level)
- ▶ Investment in units of InvITs is allowed by resident as well as non-resident investors
- ▶ Minimum distribution = 90% of distributable cash flow of InvITs/ SPVs
- ▶ Minimum lock-in period for sponsors - 3 years from the date of listing
- ▶ Investors to have right to remove the manager, trustee, request delisting, etc.
- ▶ Related party transactions to be on arm's-length basis - related investors not permitted to vote

Why InvITs?



- Efficient tax structure
- Low risk compared to directly investing in Infrastructure assets
- Strong Corporate Governance Framework
- Stable Business Model with Annuity Cash Flows
- AAA ratings with consolidated cap on leverage

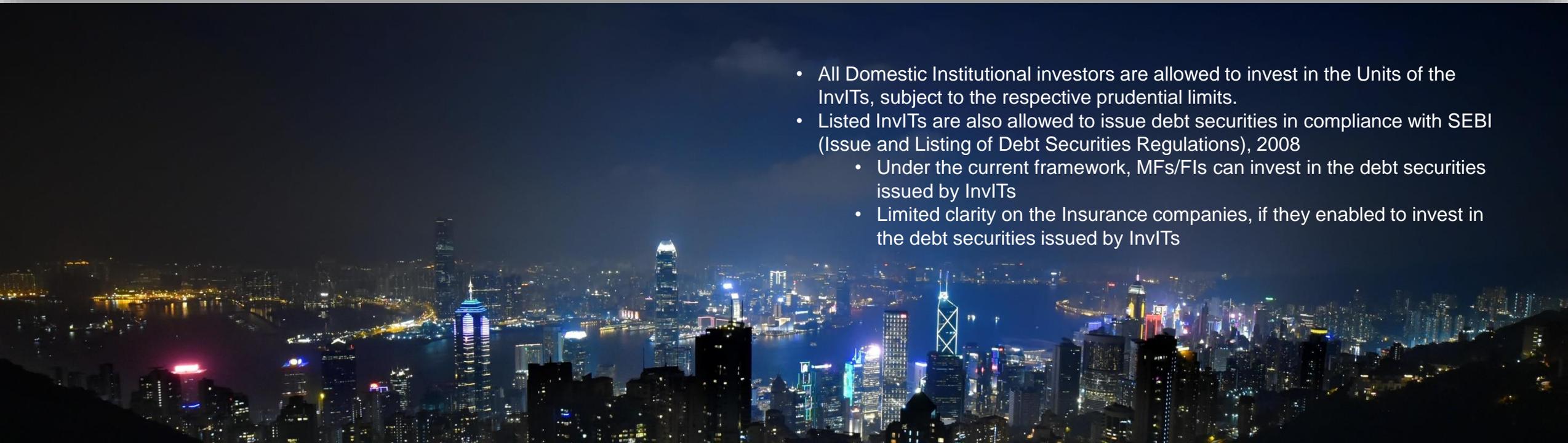
Background of InvITs

- Ministry of Finance through SEBI with the perspective of safeguarding all stakeholders' interest, has been proactive in implementing this new product and working with different stakeholders to balance the requirements of developers, regulations and minority shareholders.
- As indicated in their consultation paper, these were heavily inspired by the Singapore regulations governing business trusts. Moreover, with a very pragmatic approach, SEBI recently approved policy changes by increasing leverage limit from 49% to 70% and reducing trading lot size to 100 units with minimum value of Rs.1 lakh.
- **InvITs and REITs have taken off well:**
 - ❑ InvITs guidelines were issued by SEBI in 2014 with an objective of mobilizing capital for operating infrastructure assets in India and releasing capital for future investment in infrastructure.
 - ❑ Since June 2017, a number of InvIT / REIT issuances have happened with over 25,000 Cr raised by L&T IDPL, Sterlite – IndiGrid, IRB, and Embassy. Global investors like CPPIB, GIC, Brookfield, Blackstone amongst others have participated. Moreover, [Reliance Jio](#) has registered two InvIT entities namely, Digital Fibre Infrastructure Trust and Tower Infrastructure Trust with SEBI.
 - ❑ 8 quarters of track record for 2 public InvITs; all InvITs AAA rated by all 3 rating agencies
 - **Distribution by IndiGrid since listing– ~611 Cr (21.6/unit)**
 - **Distribution by IRB InvIT since listing– ~1,323 Cr (22.1/unit)**

Domestic Institutional Investor in InvITs

Source of funding	Current Status	Regulator	Can invest in Units	Can invest in debt securities
Insurance Cos	Not enabled	IRDAI	Allowed to invest in units	Circular does not cover debt securities issued by InvITs
Financial Institutions/ NBFCs	Enabled	RBI	Allowed to invest in units	Allowed to subscribe
Mutual Funds	Enabled but short-term capital	SEBI	Allowed to subscribe	Allowed to subscribe

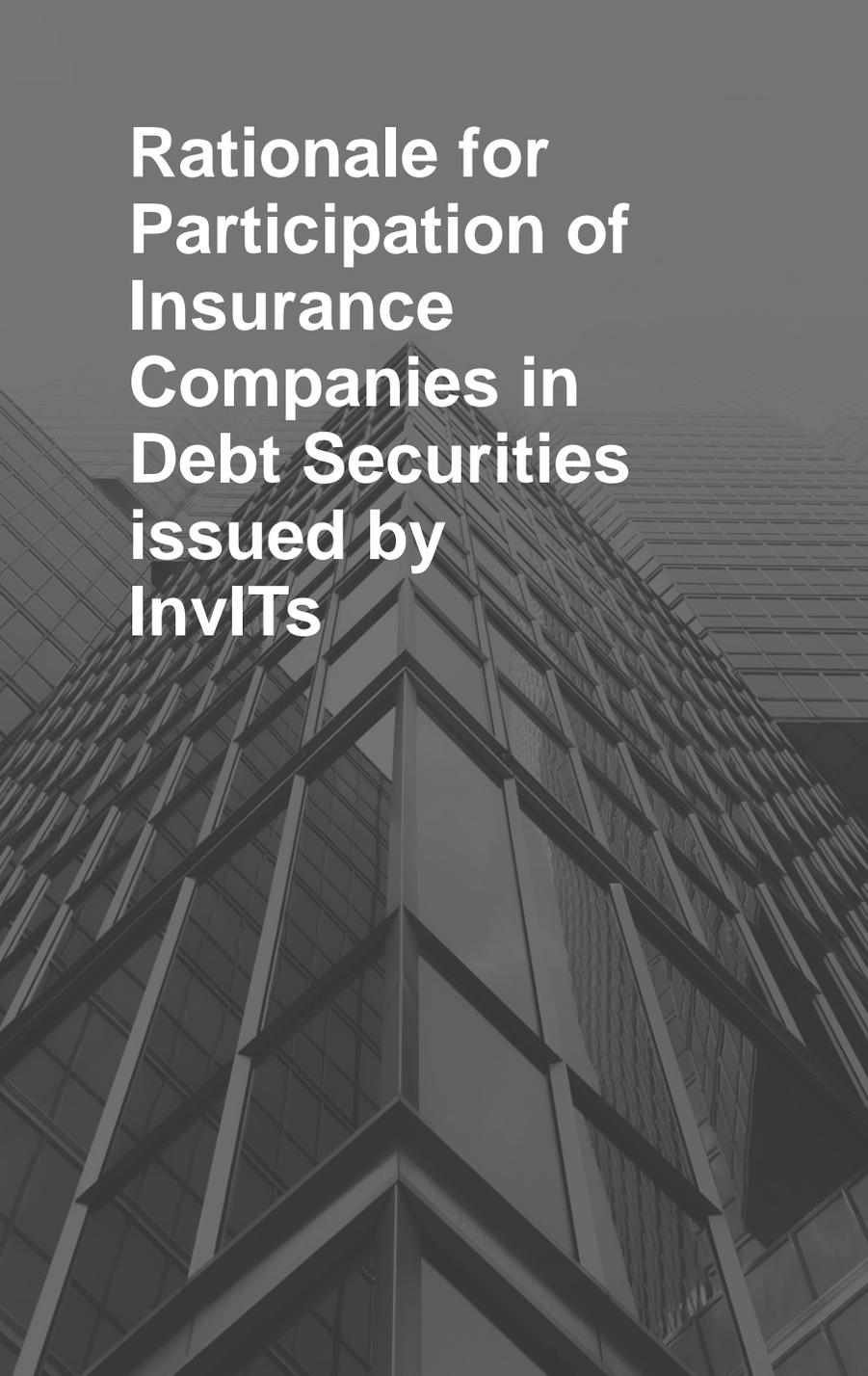
- All Domestic Institutional investors are allowed to invest in the Units of the InvITs, subject to the respective prudential limits.
- Listed InvITs are also allowed to issue debt securities in compliance with SEBI (Issue and Listing of Debt Securities Regulations), 2008
 - Under the current framework, MFs/FIs can invest in the debt securities issued by InvITs
 - Limited clarity on the Insurance companies, if they enabled to invest in the debt securities issued by InvITs



Proposal:

Allow Insurance
Companies to invest
in the Debt Securities
issued by InvITs

- Whilst IRDAI has through its circular dated March 14, 2017, permitted insurance companies to invest in the units of InvITs, it does not cover debt securities issued by InvITs.
- Further, the circular provides that an investment in the units of InvITs will form a part of “Infrastructure Investments” for the purpose of determining the pattern of investments under the Insurance Regulatory Development Authority (Investment) Regulations, 2016 (the “IRDA Investment Regulations”). The definition of “Infrastructure Investments” includes bonds issued by a company but does not cover debt securities issued by an InvIT.



Rationale for Participation of Insurance Companies in Debt Securities issued by InvITs

Asset- Liability Match

- The Infrastructure projects under InvITs are operational and offer stable returns over a long period owing to concession periods up to 35 years
- InvITs owning operating infrastructure projects are inherently more stable, less risky and less speculative as compared to equity securities and provide a higher return compared to debt securities.
- Case in point is IndiGrid InvIT, where rating agencies (CRISIL report attached for reference) have viewed the business and financial risk profiles of IndiGrid along with its underlying SPVs. This is because IndiGrid has direct control over these SPVs and will support them in case of any exigency. Further, SPVs under the InvIT have to mandatorily distribute 90% of their net distributable cash (post servicing of their debt) to the InvIT, leading to highly fungible cash flow.
- Also, as per extant regulations, the cap on borrowing of the InvIT has been defined at a consolidated level

Rationale for Participation of Insurance Companies in Debt Securities issued by InvITs

Robust Corporate Governance

- InvITs have a consolidated leverage cap as per InvIT Guidelines
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- Majority of projects under InvITs (as of now all) are operating projects with a very good credit rating
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- Strong credit profile consisting of operating and revenue generating assets
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- All the three InvITs in the market are AAA rated by all 3 rating agencies
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- **STRONG CORPORATE GOVERNANCE PRACTICES –**
 - Min 90% earnings to be distributed
 - Unit holders to vote on incremental leverage (above 25%)
 - Unit holders (excluding sponsor) to vote on new asset acquisitions/bids or any material related party transaction
 - 50% independent directors of IM board
 - Independent trustee and valuers

Reduced Infrastructure exposure

- Insurance firms have an option to fund only operational infrastructure assets under an InvIT; risk profile of assets under an InvIT is significantly reduced due to no construction/execution risk; as per InvIT guidelines, size of under-construction assets cannot exceed 10% of total AUM.
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- InvITs being listed and regulated by SEBI are far better governed than many unlisted infrastructure companies where disclosure and information available with banks may be limited. However, with InvIT regulations, the regulations also require to provide disclosures at every incremental level of debt raise.

Rationale for Participation of Insurance Companies in Debt Securities issued by InvITs

Stringent Disclosures Norms

- SEBI regulations have made sure that lending to InvITs will not lead to any risks to the financial system as there are sufficient checks at every level of incremental debt raise for InvITs as illustrated below:

Borrowing limit	SEBI Regulations
Upto 25%	No rating requirement
Above 25% and Upto 49%	<ol style="list-style-type: none"> Obtain Credit Rating from a credit rating agency registered with the Board Unitholders approval
Beyond 49%	<ol style="list-style-type: none"> Obtain Credit Rating of AAA or equivalent from a credit rating agency registered with the Board Unitholders approval Utilize the funds only for acquisitions Have a track record of atleast 6 distributions Quarterly valuations for the assets to be prepared within one month from quarter end Apart from financial disclosure, disclosures related to <ul style="list-style-type: none"> Asset cover available Debt-equity ratio, Net worth Debt service coverage ratio Interest service coverage ratio

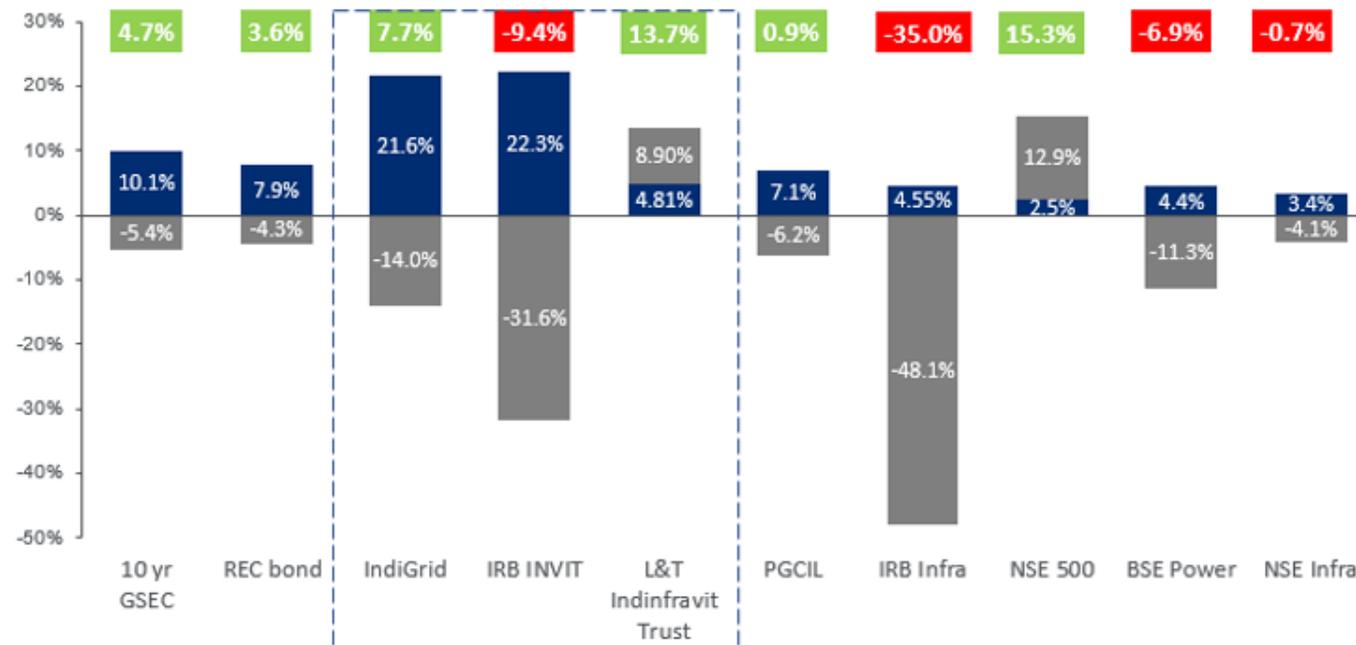
Based on the above restrictions put in place by SEBI on availing leverage by InvITs, insurance companies can rely on these regulatory requirements which ensure that there are no risks to the financial system through lending to InvITs.

Risk-Adjusted Total Returns:

InvITs as an asset class provide returns to their unitholders in two components – one by providing distribution to its unitholders in cash and other by gain / loss in unit price change. For eg: Mentioned below is the total return for IndiGrid vs bonds and comparable sector indices.

Total return = Distribution / Dividend paid by security + change in price during the period.

The following chart outlines the total returns for India Grid Trust, IRB InvIT and IndInfravIT Trust (private InvIT) vs other Infra stocks/ indices since its listing. As can be seen, IndiGrid InvIT and IndInfravIT Trust have generated better returns than comparable indices and infrastructure stocks as well as 10 yr Gsec and REC bond. It is pertinent to note that the other listed InvIT, IRB InvIT, is performing better than the parent entity IRB Developers, a pure Infrastructure stock by a large margin.



Note: The chart is for the time period from 6th June 2017 (IndiGrid listing date) to 10th May 2019.

The chart below depicts that Volatility in prices for IndiGrid is much lower as compared to others as implied below.

Beta as compared to NSE 500	IndiGrid	BSE 500	BSE Power	BSE Capital Goods	NSE Infra	G-Sec Bond
	0.21	0.99	0.91	1.11	1.02	0.04

Beta has been calculated since IG listing date June 6, 2017 to March 29, 2019 on weekly basis.

Source: Bloomberg

About APREA

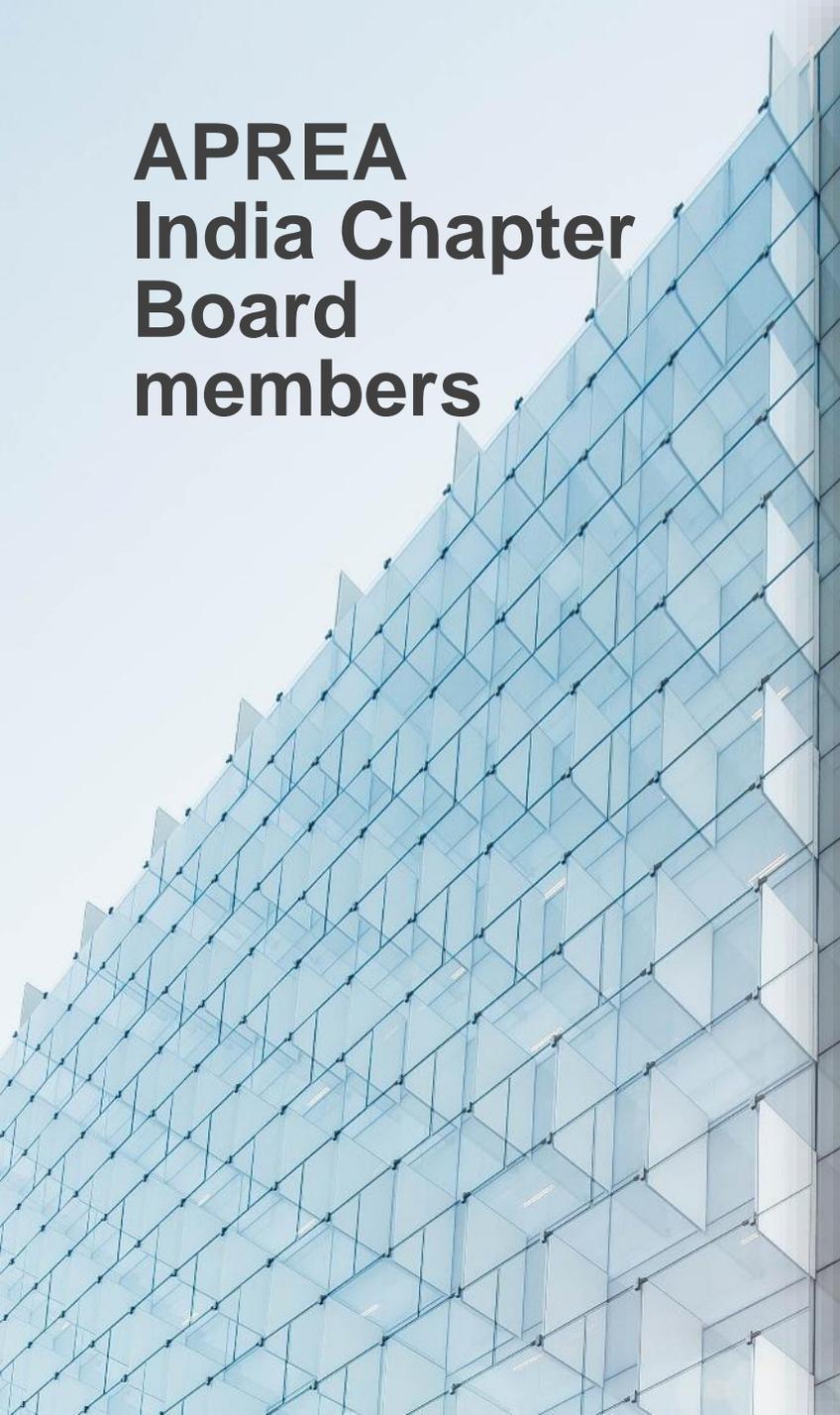
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