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Respected Sir,

RE: Proposal for insurance companies to Invest in Debt Securities issuances by Real Estate Investment Trust (REITs)

Many thanks for your time on 20th May wherein we discussed your kind support for APREA's conference on Real Estate Investor Outlook for India which included REITs and was an initiative to provide more information on REITs to the insurance companies. Sir, we are obliged with your kind presence on 3rd July 2019 at APREA's Real Estate and Market Outlook for India held in Mumbai.

Sir, we had also discussed how REITs is a stable investment class and the case for insurance companies to invest in the debt issuances by REITs.

A) Introduction

As per data reports, globally real estate remains a principal component of most pension fund portfolios, with 87% of all public and 73% of all private sector pension funds currently investing in the asset class.

REITs are seen as a stable Investment class. As per APREA's report on "The Impact of REITs on Asian Economies", REITs are generally regarded as providing investment characteristics that lie between stocks and bonds. Similarly to bonds, REITs offer a relatively secure and steady income, in the form of dividends derived from rental income.

From the perspective of long-term patient capital, REITs offer higher income returns than fixed-income investment and are relatively stable through periods of fluctuating economic fundamentals. This will perhaps encourage the Indian insurance companies and pension funds to allocate a greater share to REITs

The success of Embassy REIT's unit listing and subsequent debt raise lends further credence to the viability of the REIT structure in India.

The Annexure provides a case for insurance companies to invest in the debt issuances by REITs, the salient points of which are as follows:

1. REITs are capped at 49% of value in their debt raising activity; any debt issuance above 25% of value requires the approval of unitholders;
2. REITs can only issue debt securities that are listed, which provides further transparency and further scrutiny by investors and regulators, as well as the requirement for additional disclosure per listed debenture requirements;



3. The cash flows of the REIT are secured cash flows and are hypothecated by the hard assets the REIT owns, whether or not the assets are held in the HOLDCO or a Special Purpose Vehicle;
4. The Debenture Trustee Regulations ensure that the “ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
5. The process of enforcement of the security, should the need arise, will be enforced by the SEBI-registered Trustee as well as the REIT manager which is governed
6. Lenders to a REIT are covered by the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI)Act of 2002 and the applicability of enforcement that the Act affords to all

B) Current IRDA Investment Mandate for REITs

Currently, IRDA, as per its Circular dated 14-March-2017, allows insurance companies to investing in REIT units as follows, relevant extract pasted below for ease:

1. Insurers can invest in Units of REITs which conform to the following:

i. The REIT rated not less than “AA” shall form part of Approved Investments. REIT rated less than AA shall form part of Other Investments.

ii. An Insurer can invest not more than 3% of respective fund size of the Insurer (or) not more than 5% of the Units issued by a single REIT, whichever is lower.

iii. No investment shall be made in REIT where the Sponsor is under the Promoter Group of the Insurer

iv. Investment in Units of REIT will form part of “Investment property” as per Note 6 to the Regulation 9 of IRDAI (Investment) Regulations, 2016 read along with Master Circular – Investments

C) Industry Proposal

While the circular enables investment in equity of the REIT it does not contemplate investments in debt securities issued by REITs. We believe that this would enable the Insurance companies to meet their key objectives both by way of equity and debt issuances of REITs and thereby propose the following;

1. **Increase the threshold of holding 5% of a single REIT issuer to 10%** - Mutual Funds in India are allowed to hold upto 10% of the units issued by a single REIT. However, as laid out above, insurance companies in India are allowed to hold a maximum of only 5% of the units issued by a single REIT, provided it is less than 3% of the total investable corpus of the company. We ask you to extend the same benefit as Mutual Funds to all insurance companies so that they shall be able to hold upto 10% of the units issued by a single REIT.

This is pertinent for the REITs to gain popularity within the insurance industry, given that REITs offer stable, long-term yield-oriented investment opportunity – that matches with insurance companies' requirements to meet the long term stable return.

2. **Insurance Companies be allowed to invest in REIT debt instruments** – Given that insurance companies are permitted to invest in debentures issued by companies (specifically debentures backed by immovable properties), permitting insurance companies to invest in debt securities issued by REITs would not significantly alter the risk profile of the permitted form of investments. To the contrary, given that REITs typically comprise of multiple assets/ real estate projects, the risk of investments in debt securities backed by REIT assets may be relatively lower as compared to investments in debt securities of a company. Further, given that REITs may only issue listed debt securities, investors are provided with greater liquidity as compared to investments in unlisted debentures (which are currently permitted under the IRDAI (Investment) Regulations.

In light of the safeguards embedded within the existing regulatory framework for REITs, the interests of insurance companies investing in equity and debt securities issued by REITs are adequately protected.

MOST IMPORTANTLY:

1. Given that insurance companies are permitted to invest in debentures issued by companies (specifically debentures backed by immovable properties), permitting insurance companies to invest in debt securities issued by REITs would not significantly alter the risk profile of the permitted form of investments.
2. **Ministry of Finance** : In the Budget 2019-2020 speech of Smt. Nirmala Sitharaman, Minister of Finance on July 5, 2019 she stated that **"FPIs will be permitted to subscribe to listed debt securities issued by REITs and InvITs."** The Government of India is also very supportive of this stance and we request you to kindly consider this as well and support the industry.

APREA members seek a meeting with you to discuss this further.

APREA is a non-profit society that represents the property investment industry across AsiaPac. Our members include prominent pension, insurance and sovereign wealth funds, investment managers, family office platforms, developers, professional firms and thought leaders. At present, APREA hosts chapters in China, Japan, India, Australia, Malaysia, Singapore, Hong Kong and the Philippines.

Our representative Ms. Neetu Singh remains contactable on +91 99875 87550/neetu.singh@aprea.asia
Looking forward to your positive reply,

Best Regards,



Sigrid Zialcita
CEO, APREA

Annexure : Investment by Insurance Companies in Debt Securities Issued by Listed REITs

ANNEXURE

INVESTMENTS BY INSURANCE COMPANIES IN DEBT SECURITIES ISSUED BY LISTED REITS

The Insurance Regulatory and Development Authority of India (IRDAI) has through its circular dated March 14, 2017 expressly permitted insurance companies to invest in units of REITs. While the circular does not contemplate investments in debt securities issued by REITs, the IRDAI (Investment) Regulations permit investments in several forms of debt securities.

For instance, investments in the following debt securities are 'approved investments' under the IRDAI (Investment) Regulations:

- Debentures secured by a first charge on any immoveable property plant or equipment of any company which has paid interest in full
- Debentures secured by a first charge on any immovable property, plant or equipment of any company where either the book value or the market value, whichever is less, of such property, plant or equipment is more than three times the value of such debentures
- First debentures secured by a floating charge on all its assets of any company which has paid dividends on its equity shares

Further, investments in all rated debentures (including bonds) and other rated & secured debt instruments meeting the criteria set out in the note appended to Regulations 4 to 9 of the IRDAI (Investment) Regulations are categorised as 'deemed approved investments'.

Given that insurance companies are permitted to invest in debentures issued by companies (specifically debentures backed by immovable properties), permitting insurance companies to invest in debt securities issued by REITs would not significantly alter the risk profile of the permitted form of investments. To the contrary, given that REITs typically comprise of multiple assets/ real estate projects, the risk of investments in debt securities backed by REIT assets may be relatively lower as compared to investments in debt securities of a company. Further, given that REITs may only issue listed debt securities, investors are provided with greater liquidity as compared to investments in unlisted debentures (which are currently permitted under the IRDAI (Investment) Regulations).

In light of the safeguards embedded within the existing regulatory framework for REITs, the interests of insurance companies investing in debt securities issued by REITs will be adequately protected. It is therefore proposed that amendments be made to the IRDAI (Investment) Regulations to permit insurance companies to invest in debt securities issued by REITs.

Legal Safeguards

➤ *Position under the Trusts Act*

While the Trusts Act, 1882 does not contain any provisions that which either permit or prohibit trusts from availing loans, if a trust deed explicitly permits the trustee to avail loans for the benefit of the beneficiaries, there is no prohibition under the Trusts Act on the trustee from doing so. 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. Hence, if the provisions of the trust deed provide for all of (a), (b) and (c) above, it is the obligation and duty of the trustee to avail a borrowing in case it is in the best interest of the beneficiaries

➤ *Built-in Safeguards under the SEBI REIT Regulations*

The Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (SEBI REIT Regulations) expressly permits the REIT to borrow and specifically permits the issue of listed debt securities. Several checks and balances are built into the SEBI REIT Regulations to ensure that the rights of stakeholders are protected at all times.

- ✓ At the very outset, the aggregate consolidated borrowings and deferred payments of the REIT, its holding companies and its SPVs, net of cash and cash equivalents, is capped at 49% of the value of the REIT assets to ensure that a REIT is not overleveraged.
- ✓ Further, any consolidated borrowings and deferred payments (net of cash and cash equivalents) exceeding 25% of the value of the REIT assets, require credit rating from registered credit agencies and approval of unitholders.
- ✓ REITs are only permitted to issue listed debt securities which are issued and listed in accordance with the SEBI (Issue and Listing of Debt Securities) Regulations, 2012 (SEBI ILDS Regulations). Investments in listed debt securities provides investors with (a) liquidity and (b) additional pertinent disclosures given the specific corporate governance measures required in respect of listed debt securities.

- ✓ While the REIT Regulations require the REIT mandatorily declare distributions every six months, the net distributable cash flows to be distributed to unitholders is arrived at net of amounts owed to lenders, thereby ensuring that the rights of lenders are protected.
- ✓ The REIT framework also prescribes a stringent corporate governance framework for REITs. REITs are required to be managed by Investment Managers having a majority of independent directors. Further REITs are required to mandatorily nominate nominee directors on the board of its SPVs/ holdcos. Further, as an additional layer of protection, the REIT Trustee is entrusted with the responsibility of overseeing the functions of the REIT Manager.

➤ *Safeguards under the SEBI ILDS Regulations*

- ✓ The Debt Circular makes it mandatory for the REIT to comply with all disclosure requirements applicable to companies issuing debt securities.
- ✓ Proceeds of the debt issue are monitored periodically with the REIT being required to mandatorily disclose a statement setting out the material deviations in the use of proceeds of the debt issue every six months.
- ✓ Financial statements issued by REITs that have issued debt securities are required to include certain additional line items in its financial statements, i.e.
 - Asset cover available
 - Debt – equity ratio
 - Debt service coverage ratio
 - Interest service coverage ratio
 - Net worth

➤ *Role of Debenture Trustee*

- ✓ The SEBI Debenture Trustee Regulations impose a specific obligation on debenture trustees in relation to the security interest created for the issuance of debt securities in the following manner:

ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders

The SEBI Debenture Trustee Regulations also require a debenture trustee to do such acts as are necessary in the event the security becomes enforceable. Additionally, the ILDS Regulations require the debenture trustee to submit a due diligence certificate with SEBI confirming that the issuer has adequate security cover for the debt securities to be issued. In cases where the issuer has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities, any distribution of dividend shall require approval of the debenture trustees. The ILDS Regulations also enable the debenture trustee to publicly disclose the fact of default by an issuer in the repayment of interest or redemption of premium. Further, the debenture trustee is empowered to appoint a nominee director on the board of the issuer (in this case, the board of the investment manager of the REIT/ InvIT) for the protection of the interests of the debenture holders.

➤ *Security enforcement where the underlying hard collateral is in the SPV*

- ✓ REITs are permitted to hold their underlying assets either directly or indirectly through SPVs and Holdcos. Regardless of the holding structure employed by a REIT, i.e. single-tier, comprising of one level of SPVs, or multi-tier, comprising of holding companies and SPVs, the REIT is the ultimate owner of all assets. This structural framework involving SPVs and holdcos was conceptualized under the REIT Regulations given the prevalent holding structures in the sector. It is not uncommon in the real estate sector to have holding structures with multiple layers of investments as each asset/ project may come with its own set of investors, land owners, joint development partners and related requirements. Further, real estate assets/ projects are also held through multi-level holding structures for reasons of consolidation/ corporatization, ease of unbundling and itemized scalability and future potential to list the holding companies for fund raising. The REIT Regulations therefore prescribe that a REIT cannot hold less than controlling interest/ 50% in its underlying holdcos, and that a REIT's ultimate beneficial interest in an underlying SPV cannot be less than 26%.

- ✓ Coupled with the mandatory shareholding requirements set out above, the REIT Regulations also provide for a stringent management framework for assets held through SPVs and holdcos. Each SPV/ holdco is required to have nominees of the REIT manager on its board, proportionate to the shareholding of the REIT/holdco in such entity. Further, the Manager is required to ensure that the voting rights of the REIT are exercised in each meeting of the holdco/ SPV, and that no other shareholder at a holdco/ SPV enjoys any rights which may prevent compliance with the REIT Regulations, thereby ensuring that the REIT is able to exercise complete control over the holdcos, SPVs and the underlying assets held by each entity.
- ✓ SEBI has expressly permitted REITs and InvITs to create security over the assets held by the REIT through its holdcos and SPVs. Specifically, in its circular dated April 13, 2018 (Debt Circular), SEBI has provided that:

“Any secured debt securities issued by REITs/InvITs shall be secured by the creation of a charge on the assets of the REIT/InvIT or holdco or SPV, having a value which is sufficient for the repayment of the amount of such debt securities and interest thereon”

- ✓ The enforcement of security in the context of a REIT will therefore be no different from the enforcement of security created by any other corporate entity – albeit structurally. For instance, it is not uncommon for companies to issue listed debt securities on the basis of security created over assets held by their subsidiaries. Under the REIT Regulations, the trust is required to be under the continuous supervision of an independent trustee, which is required to be a fit and proper, SEBI registered entity. Similarly, a REIT and all assets held by it are required to be under the professional management of an investment manager appointed by the trustee. The trustee and the manager, in addition to being governed by the REIT Regulations, are also governed by the trust deed and the investment management agreement, respectively – regulatorily mandated charter-document equivalents, which specifically empower them to utilize the assets of the trust towards enforcement of security interests (on behalf of the trust).
- ✓ Hence, in case of enforcement of security, a REIT acting through its trustee and investment manager, is empowered to take such steps as may be required by a lender under the terms of borrowing. Even from a Companies Act perspective, any disposal of assets by the holdcos or SPVs, on account of an enforcement event will only require the approval of the board and the shareholders of the holdcos/ SPVs, which in any event will be the REIT and its nominees. Hence, a REIT (acting through its trustee and manager) will be in complete control of the process of enforcement, should the need arise.

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➤ *SARFAESI cover for Lenders at Trust / REIT level*

- ✓ REITs are not precluded from the applicability of the SARFAESI Act. The term 'borrower' as defined under the SARFAESI Act includes any person who has raised funds through issue of debt securities, thereby including within its ambit REITs and InvITs who have issued listed debt securities.
- ✓ As in the case of listed debt issued by body corporates, in case of default, the debenture trustee may enforce the security created in respect of the listed debt securities after serving 90 days' notice of default on the borrower (i.e. the REIT).
- ✓ Given that the Debt Circular contemplates the appointment of a debenture trustee which is SEBI registered entity, and which is independent of the trustee of the REIT, the enforcement of security in the manner provided under the SARFAESI Act can be undertaken by the debenture trustee of the listed securities for the benefit of the lenders.

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