DEBT FINANCING BY FOREIGN PORTFOLIO INVESTORS (FPIs) IN REAL ESTATE INVESTMENT TRUST (REITs) AND INFRASTRUCTURE INVESTMENT TRUST (INVITs)*

Introduction

In a significant move to augment funds for the infrastructure and real estate sectors, the government, in the Union Budget for 2021-22, proposed permitting foreign portfolio investors an entry into debt financing of emerging investment vehicles – REITs (Real Estate Investment Trusts) and InvITs (Infrastructure Investment Trusts). In the Union Budget for 2021-22, Finance Minister Nirmala Sitharaman also proposed that dividend payments on REITs and InvITs would be exempted from Tax, which will make such investment vehicles attractive and lucrative for investors.

REITS AND INVITS - MEANING

REITs

As per Regulation 2(zm) of SEBI (Real Estate Investment Trusts) Regulations, 2014, "REIT" means a trust registered under SEBI (Real Estate Investment Trusts) Regulations, 2014.

In general parlance, REIT refers to an entity created with the sole purpose of channelling investible funds into operating, owning or financing income-producing real estate. REITs are modelled on the lines of mutual funds and provide investors with an extremely liquid way to get a stake in real estate. REITs allow anyone to invest in portfolios of real estate assets the same way they invest in other industries – through the purchase of individual company stock or a mutual fund or exchange traded fund (ETF). It is mandatory for units of all REITs to be listed on a recognised stock exchange having nationwide trading terminals, whether publicly issued or privately placed.

The REIT regulations came into force in September 2014. The objective was to monetise existing unsold inventory of real estate and make it a revenue generating asset under the REIT model. In September 2018, Embassy Office Parks (a joint venture of US private equity firm Blackstone Group and Embassy Group) filed draft offer document with the Securities and Exchange Board of India (SEBI) proposing to raise over INR 5,000 crore through REIT.

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INVITS

As per Regulation 2(za) of SEBI (Infrastructure Investment Trusts) Regulations, 2014, "InvIT" means a trust registered under SEBI (Infrastructure Investment Trusts) Regulations, 2014.

An Infrastructure Investment Trust (InvITs) is like a mutual fund, which enables direct investment of small amounts of money from possible individual/institutional investors in infrastructure to earn a small portion of the income as return. InvITs work like mutual funds or real estate investment trusts (REITs) in features. InvITs can be treated as the modified version of REITs designed to suit the specific circumstances of the infrastructure sector.

REITs (Real Estate Investment Trusts) and InvITs (Infrastructure Investment Trusts) are relatively new investment instruments in the Indian market. While a REIT comprises a portfolio of commercial real assets, a major portion of which are already leased out. InvIT comprises a portfolio of infrastructure assets such as highways and power transmission assets.

REITs versus INVITs

Particulars	*REITs*	*INVITs*
Meaning	REITs serves as an investment tool that helps own and operate income-generating real estate properties. Such properties serve as a stream of annual revenue and mostly include warehouses, healthcare centres, commercial buildings, malls, etc.	**INVITs** is planned to pool money from investors to invest it in assets generating cash flow. Moreover, they invest in projects like roadways, highways and other high-value infrastructural units.
Liquidity	The lower unit price and trading size of REITs make it a viable option for small investors.	Compared to REITS, InvITs are more liquid. InvITs come with a large trading lot size, which is often not feasible for small investors.
Growth prospect	The growth prospects of REITs rely on the redevelopment or acquisition of assets, new construction, etc.	Their growth prospect depends mainly on the success of acquisition and concession of assets.
Income Stability	REITs tend to provide a steady flow of income mostly because their income yielding properties come with extensive rental contracts.	The stability of income for InvITs depends mainly on those factors that tend to affect the capacity of usage and also the scalability of tariffs. Hence, in most cases, income is quite uncertain.

Associated risks	REITs are better insulated from regulatory/ political risks. REITs tend to hold properties that are either leased or owned on a freehold basis.	The infrastructure sector is prone to react to regulatory policies and political interference. Thus, parking funds in **infrastructure investment trusts** often prove risky.

To distinguish between REIT and Alternative Investment Fund (AIF), Units in REIT are mandatory listed until delisted while units in AIF may be listed only after final close of the fund or scheme. There are more liberal investment norms in case of REIT in view of the investment in one asset/company, however in case of AIF, Maximum limit of investment is prescribed for all categories of AIFs

Budget Proposal

The Finance Bill has proposed amendments to permit foreign portfolio investors (FPIs) an entry into debt financing of emerging investment vehicles – REITs and InvITs. The move is aimed at increasing funds for the infrastructure and real estate sectors. Finance Minister Nirmala Sitharaman announced this move during Budget 2021.

The Budget promised to regulate the Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) to attract more investments and the government announced that the regulations will be amended to allow them to raise debt fund from foreign portfolio investors (FPIs).

Global Institutional Investors and sponsors of REITs and InvlTs have been seeking the government's push to enable REIT and InvITs' debt raising from insurance companies and FPIs. This year's budget has also exempted dividends paid to REITs or InvlTs from tax deducted at source (TDS). InvITs and REITs have the potential to emerge as important tools for addressing India's gigantic infra financing needs.

The relaxation on tax compliance for REIT investors will further improve the marketability of such products considering we are likely to witness new REITs this year. In order to provide ease of compliance, the finance minister has proposed to make dividend payments to REIT and InvIT exempt from Tax Deducted at Source (TDS).

Further, as the amount of dividend income cannot be estimated correctly by the shareholders for paying advance tax, the minister proposed to provide that advance tax liability on dividend income would arise only after the declaration or payment of dividend. Also, for FPIs, it has been proposed to enable deduction of tax on dividend income at lower treaty rate.

The Government of India as part of the Finance Bill, 2021 has proposed amendments to following acts to confer the power to Pooled Investment Vehicles (defined to include AIFs, REITs, InvITs etc.) to borrow and issue debt securities.

- Securities Contracts (Regulation) Act, 1956
- Securities and Exchange Board of India Act, 1992
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- The Recovery of Debts Due to Banks and Financial Institutions Act, 1993

The necessary notifications would be issued by the concerned regulators after the Finance Bill is passed by the Parliament.

Brief Impact

- Debt financing of infrastructure investment trusts (InvITs) and real estate investment trusts (REITs) by foreign portfolio investors (FPIs) will help boost much needed liquidity.
- The proposal to make dividend payments to REIT and InvITs exempt from TDS shall also encourage retail individual investors to explore investment opportunities in REITs.
- The budget announcement on allowing debt financing of REITs and InvITs by FPIs and is well poised to providing listing and trading of these products on the exchange with considerable ease of business and quicker time to market for issuers and tax efficient trading for foreign investors across time zones with 22 hours non-stop trading.
- Foreign capital is a vital factor in the overall development of the Indian economy. Private equity with huge dry powder is one of the biggest contributors of foreign capital to India. The policy announcement of permitting offshore debt borrowings for InvITs and REITs and no tax withholding on dividend payments will provide access to foreign debt raising and boost investment in REIT and InvITs.
- Leveraging window will increase further and provide an opportunity for REITs/InVITs to acquire more assets in their portfolio. This will lead to the listing of more REITs/InVITs in 2021.

Brief Analysis

The unlocking of value of real estate assets, especially in the office segment, will provide growth capital for the sector. Investments in infrastructure projects will have access to low cost offshore funds. InvITs and REITs are gaining currency in India, following the footsteps of the developed world.

A recent Crisil Ratings analysis shows these instruments can potentially raise up to ₹8 lakh crore for India's infrastructure buildout over the next five fiscals. A deeper debt market where investors can discern risks and returns across infrastructure asset classes, and stable regulations will be critical to achieving this goal. A government task force has estimated that ₹111 lakh crore of investments are required in infrastructure through fiscal 2025 or twice what was spent in the past five fiscals.

That's a humongous investment need and cannot be met by the government and traditional infrastructure-financing channels alone. Thus, alternative channels need to be pressed into service.

Conclusion

The proposal of providing FPIs an entry into debt financing of REITs and InvITs will open up a large source of fresh funding for the infrastructure and real estate sectors. This will also open up a new avenue for FPIs to invest in a growing market like India.

In the context of the real estate sector, budget announcements relating to monetisation of infrastructure and real estate assets will help increase private sector participation and also assist the government in enhancing fund flow for development of critical infrastructure assets.

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