Development Significance of REITs and InvITs in India: A Better Fixed Income Instrument for Retail Investors

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Abstract:
In India, REITs and InvITs are similar to mutual funds in that a sponsor raises money and invests it in infrastructure or real estate projects. The government, SEBI, and other regulators in India have been proactive in popularising and supporting REITs and InvITs. These platforms primarily focused on infrastructure development and were established to provide diverse sources to propel India's $5 trillion economy forward. The National Infrastructure Pipeline (NIP) and National Monetization Pipeline (NMP) mega policy initiatives anticipate that InvITs will play a significant part in capital allocation and asset monetization. The increasing popularity and emergence of InvITs/REITs in India is a welcome development for capital-hungry industries. Investors gain from producing consistent cash distributions, a stable yield, and the chance for the sponsor(s) to increase the size of their asset base.

INTRODUCTION:
In 2016, both InvITs (investment trusts for infrastructure assets) and REITs (investment trusts for real estate assets) were recognized in India. These platforms, which largely focus on infrastructure development, were created to provide a range of financing sources in addition to traditional ones to assist India's $5 trillion economy grow. Since then, 19 InvITs and 4 REITs have been launched in India, with a total asset under management of around Rs 3.5 trillion, resulting in phenomenal growth in acceptance by investors and markets alike.

INFRASTRUCTURE INVESTMENT TRUST (InvIT)
An innovative trust-based financial product called the Infrastructure Investment Trust (InvIT) allows involvement in infrastructure funding through a reliable and liquid vehicle. Infrastructure investment trusts (InvITs) offer the chance to purchase properties with steady dividends and revenue flows. InvITs were launched in India in 2014, and they are used by proprietors of infrastructure assets to combine funds from a variety of investors against the periodic payout of cash flow produced by the assets. In an InvIT deal, the proprietors of infrastructure assets move numerous SPVs that generate income to a trust, which then sells units to investors to raise money. The advance money so collected is used by the developers to fund the construction of new greenfield assets and debt settlement, allowing lenders to have capital available for financing or investing in new projects. As compensation for their investment, the owners receive a part of the Trust's Net Distributable Cash Flows (NDCF; this is comparable to dividend payments) on a regular
basis in proportion to the number of units they own. Adding revenue-generating initiatives and broadening its inventory can guarantee higher yields for unit holders.

**A NEW OPPORTUNITY SET**

InvITs have made a substantial contribution to India's effort for robust infrastructure across the country, with a total stock created through these instruments of Rs. 550 billion in FY 2021 and Rs. 220 billion in FY 2022. Through InvITs, which also offer quick price discovery and expert management of such long-term assets by AAA-rated organisations, infrastructure assets may be owned by the general public. As a recent major policy effort of the Indian government, the National Infrastructure Pipeline (NIP), InvITs are anticipated to play a big role in this capital distribution. The total assets covered by the InvIT umbrella will rise as a result. Due to the current National Monetization Pipeline (NMP) of over Rs. 6 trillion in brownfield assets, there is also a larger playing field where InvITs will play a vital role in the monetization of these assets.

**THE LARGER PERSPECTIVE**

Due to developments in the regulatory environment and InvITs in general during the preceding five years, the investor profile of unitholders in all InvITs has altered. As evidence of the constantly rising confidence InvITs have earned in the Indian stocks market environment, more than 20% of the units are presently held by retail investors. The rising narrative of India and the acceptance and success of InvIT have continued to excite institutional investors, both local and global. about the years, FIIs and DIIs have played a significant role in helping REITs and InvITs raise about Rs 750 billion in the capital. The majority of the InvITs are heavily supported by companies like KKR, Brookfield, and CPPIB as Sponsors, demonstrating confidence in India's tale of infrastructure expansion. India's financial needs for its medium-term infrastructure ambition would benefit from the development of both the presence of a solid institutional foundation and of InvITs as an asset class.

**What have been the REIT and InvIT returns been like?**

Because neither REITs nor InvITs have a long history in India, it is too soon to make a judgment. So far, it's been a bit of a mixed bag. Since entering the market, India Grid Trust has outperformed its rivals and relevant indices including the S&P BSE India Infrastructure Index and S&P BSE Realty Index, whereas Embassy Office Parks REIT and Mindspace REIT have had a more subdued performance.

**REAL ESTATE INVESTMENT TRUST (REIT)**

Since real estate assets require a large upfront investment from the developer, they are considered capital-intensive assets. Although there are currently debt products based on land and buildings, they do not provide the developer with an effective means of risk sharing or affordable financing. The structures of InvITs and Real Estate Investment Trusts (REITs) are comparable. The globe has become more popular with REIT structures than InvIT, which is only used in the Indian context. In the 1960s, the REIT first appeared in the US. Developers will have a variety of options for extending their finance sources thanks to the REIT framework. Only real estate projects 45 are permitted under this agreement. The rules require that 51% of the total revenues of the REIT, holding company, and SPV come from renting, leasing, or letting real estate assets, or from any other income incidental to leasing such assets. There are exceptions, though, for (i) shared infrastructure for composite real estate projects, industrial parks, and special
economic zones, as well as (ii) hotels, hospitals, and convention centers that are parts of composite real estate projects that either generate rent or income.

The Real Estate (Regulation and Development) Act has greatly improved the industry's transparency and accountability. The REIT structure has been able to establish an efficient and thorough corporate governance framework in this environment by clearly defining roles and responsibilities for significant stakeholders like the sponsor, investment manager, etc. and transparency on the revenue/rent collections. Out of the USD 50 billion in Indian real estate investments made between 2005 and the present, USD 30 billion was invested by foreign institutional investors. Significant sovereign wealth funds, private equity firms, and pension funds have increased their real estate holdings in India over time. Some of these funds have established joint ventures or platform funds in an effort to participate more actively in investments. These international investors will be crucial to the expansion of the REITs business in India.

LITERATURE REVIEW
Although the REITs and InvITs are still in their infancy in India, but this model has been effectively used in a number of developed economies, such as the US and the UK, to finance substantial commercial real estate investments. According to real estate consultancy JLL, India's position on the Global Real Estate Transparency Index rose five spots, from 39 to 34, during the course of the last six years from 2014 to 2020 as a result of legal changes, enhanced market data, and green efforts.
Rubens et al., 1989, Existing literature claim that real estate may provide considerable profits while acting as an inflation hedge.

According to co-founder and joint CEO of IIFL Wealth Management Ltd. Yatin Shah, REITs and InvITs offer both regular income and capital appreciation, as well as an additional hedge against inflation because contracts can be renegotiated during inflationary periods.

It will take time to understand products like IndiGrid (first InvITs of India) with known cash flows and yields, according to Pratik Agarwal CEO& MD, IndiGrid [now, June 2017]. InvITs are expected to be essential as India's infrastructure demands and investments are predicted to grow. An evolving regulatory environment will result in greater investor knowledge and involvement as the asset base of InvITs grow written by IndiGrid CEO Harsh Shah.

RESEARCH METHODOLOGY
Three peer comparison tables for listed Infrastructure Investment Trusts (InvITs) make up the sample data utilised for the study. This situation does not fit the usual valuation criteria like PE, EPS growth, margin expansion, etc. While assessing InvITs, certain factors need to be taken into account.

<table>
<thead>
<tr>
<th>InvIT</th>
<th>NSE Code</th>
<th>BSE Code</th>
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<tbody>
<tr>
<td>Powergrid Infrastructure Investment Trust</td>
<td>PGINVIT-IV</td>
<td>PGINVIT</td>
</tr>
<tr>
<td>India Grid Trust</td>
<td>INDIGRID-IV</td>
<td>INDIGRID</td>
</tr>
<tr>
<td>IRB InvIT Fund</td>
<td>IRBINVIT-IV</td>
<td>IRBINVIT</td>
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Underlying Assets
Compared to REITs, invITs are more diversified. REITs typically exclusively deal with assets related to commercial real estate. But InvITs are able to own any type of commercial asset, including those related to roads, power, railways, warehouses, airports, data centers, and telecom towers. It makes sense that different assets will have various risks and risk prospects. For instance, power transfers have better cash flow predictability than airports. Similar to how a warehouse lacks predictability, telecom tower assets do. The InvITs with a stronger asset profile will be more expensive than the competition.

Average asset life span / Concession duration
A corporation or organization has the right to manage and operate a particular piece of infrastructure, such as a toll road or an airport, during a concession term. In the context of INVITs, or Infrastructure Investment Trusts, the concession term refers to the time frame during which the trust has the authority to manage the underlying infrastructure assets. The better, the longer the concession time.

Mortgage To Value
How much debt was borrowed in comparison to the value of the underlying asset is determined by the loan-to-value (LTV) ratio. For instance, the LTV ratio would be 70% if a company borrowed 700 crores to purchase an asset worth 1000 crores. Like in any other firm, the less leverage, the better.

Yield to Dividend
The yearly income that an InvIT is anticipated to provide, given as a percentage of the InvIT's current market value, is referred to as dividend yield. For instance, if an InvIT's current market price is 100 and it is anticipated that it will earn 5 per year, its current yield would be 5%. Better if it's higher.

Right of first offer (ROFO)/Asset Pipeline
The possible investments that an InvIT is looking into or purchasing are referred to as its assets pipeline. A healthy pipeline of assets suggests more growth potential. On the other side, a poorer assets pipeline can mean that there are fewer growth and investment options for the InvIT.

Value of Net Assets
One of the greatest methods for evaluating InvITs is NAV. Consider it similar to a book value per share. It is determined by subtracting all obligations from the projected market value of the properties. Based on the overall number of shares outstanding, this is split. The NAV is a more precise technique to estimate InvIT's share price. InvITs frequently trade below or above NAV. The supply and demand of the exchanged units are to blame for this. Monitoring the share price's distance from NAV is important in such circumstances.

Sponsor
Numerous benefits, such as brand recognition, trustworthiness, on-time delivery, etc., will be enjoyed by a strong sponsor. The right of first offer (ROFO) will also apply to InvITs for properties held by the sponsors.
Taxation

Three factors—interest revenue, dividend income, and debt repayment—combine to form the cash allocated to unit holders. With the exception of dividend income, taxation is the same for all InvITs. It depends on the tax structure that the SPVs choose. Owners of units are subject to the same taxation as InvITs. Investor interest is projected to increase for InvITs with the biggest non-taxable component of NDCF.

The table compares three listed InvITs based on various parameters. PGINVIT owns power transmission assets, INDIGRID owns power transmission and solar assets, while IRBINVIT owns highways and roads. The average concession period for all three InvITs is quite long, indicating that the underlying assets have a stable revenue stream. INDIGRID has the highest revenue growth among the three InvITs, while PGINVIT has negative growth. Availability, which shows that there are many resources available for use, for both PGINVIT and INDIGRID. PGINVIT has the lowest Net Debt/AUM, which shows that it has less leverage. INDIGRID has the largest net asset value, followed by PGINVIT and IRBINVIT. INDIGRID now has the highest market price, followed by PGINVIT and IRBINVIT. PGINVIT is the stock with the biggest distance from net asset value (NAV) and is trading at a premium to NAV. All three InvITs have different DPUs; INDIGRID has the greatest, PGINVIT is second, and IRBINVIT has a negative DPU. The company with the greatest dividend yield is IRBINVIT, followed by INDIGRID and PGINVIT. For PGINVIT and IRBINVIT, sponsor ownership is about equal, although it is larger for

<table>
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<tr>
<th>PARAMETERS</th>
<th>PGINVIT</th>
<th>INDIGRID</th>
<th>IRBINVIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underlying assets</td>
<td>Power Transmission</td>
<td>Power Transmission &amp; Solar</td>
<td>Highways &amp; Roads</td>
</tr>
<tr>
<td>Avg Concession period</td>
<td>30 years</td>
<td>29 years</td>
<td>17 years</td>
</tr>
<tr>
<td>Revenue Growth (5Y CAGR)</td>
<td>-9%</td>
<td>49%</td>
<td>9%</td>
</tr>
<tr>
<td>Availability</td>
<td>98%</td>
<td>99.3%</td>
<td>NA</td>
</tr>
<tr>
<td>Net Debt/ AUM</td>
<td>1%</td>
<td>57%</td>
<td></td>
</tr>
<tr>
<td>Cost of debt</td>
<td>7%</td>
<td>7.51%</td>
<td>7.25%</td>
</tr>
<tr>
<td>Assets pipeline (as of AUM)</td>
<td>74%</td>
<td>21.2%</td>
<td>NA</td>
</tr>
<tr>
<td>Net Asset Value</td>
<td>87.7%</td>
<td>135.3%</td>
<td>100.4%</td>
</tr>
<tr>
<td>CMP</td>
<td>127.9</td>
<td>137.1</td>
<td>65.2</td>
</tr>
<tr>
<td>Distance from NAV</td>
<td>45.9%</td>
<td>3.4%</td>
<td>-35.1%</td>
</tr>
<tr>
<td>DPU (FY23E)</td>
<td>12</td>
<td>13.2</td>
<td>-9</td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>9.4%</td>
<td>9.7%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Sponsor shareholding</td>
<td>15%</td>
<td>24%</td>
<td>15%</td>
</tr>
<tr>
<td>Taxation</td>
<td>10.2% of DPU is tax-free</td>
<td>5.7% of DPU is tax-free</td>
<td>35.5% of DPU is tax-free</td>
</tr>
</tbody>
</table>
Table 1 shows that both the power transmission InvITs (PGINVIT & INDIGRID) have better growth visibility & consistency in cash flows when compared to IRB InvIT. Power Grid initially transferred 74% of ownership to PowerGrid InvIT at the time of its IPO. PGINVIT will also acquire the remaining 26% stake in the SPVs in the next 1-3 years. But for growth investors looking for capital appreciation. Considering the growth guidance of 30,000 Cr AUM, increasing DPU, better yield, and high sponsor shareholding, the IndiGrid InvIT is on a growth track for the next 3-5 years.

Units of INDIGRID InvIT have outperformed the benchmark NIFTY50 since its listing in June 2017. INDIGRID InvIT has distributed INR 13.2 per unit since its listing. Over 6 June 2017 to 20 May 2022 INDIGRID InvITs Interest Coverage ratio is 2.11 indicating no current liquidity problems.

Similar to InvITs certain parameters are considered while evaluating REITs.

**Weighted Average Lease Expiry**
Vacancy is the largest threat to managing a business property. The amount of time left before the property becomes unoccupied is determined using WALE. Years are used to quantify it. The better, the higher.

**Distribution Yield**
90% of distributable cash flows must be distributed to investors by REITs under the legislation. A statistic to assess these payments is distribution yield. This is not, however, a pay-out that is guaranteed. Depending on how well the trust performs. The higher, the better once again.

**Loan To Value**
The loan-to-value (LTV) ratio calculates how much debt was borrowed in relation to the value of the underlying asset. The lower the leverage, the better, just as in any other firm.
The NDCF is a key measure of how much money is still available to distribute to unit holders. Most REITs have a two-layered structure.

- The Holding Company is the legal owner of SPVs.
- The Trust is the only owner of the holding company.

According to SEBI regulations, the REIT must receive a mandatory distribution of 90% of the SPV’s NDCF.

- The Unitholders should get 90% of the NDCF of the InvIT.
- The NDCF’s consistency is a crucial measure to monitor.

**High occupancy**
The percentage of available square footage in a REIT’s portfolio is known as the occupancy rate. This is a crucial performance indicator. This guarantee’s reliability in payouts and raises rental and dividend revenue. The cash flows are more consistent with the higher occupancy. It is unlikely to always be fully occupied, though.

**Diversified portfolio**
The highest occupancy rate will be found in a well-run facility in a desirable area. On the other hand, a surplus of properties may result in lower rental rates & earnings. Oversupply and concentration risk are less likely to affect REITs with diverse portfolios across tenants and locations.

**Net Asset Value**
One of the greatest methods for evaluating REITs is NAV. Think of it as being comparable to book value per share. It is calculated by deducting the estimated market value of the properties from all liabilities. This is divided by the number of outstanding shares. NAV may be used to determine a REIT’s share price more precisely.

REITs regularly trade at or below NAV. This is caused by the supply and demand for the swapped units. In such cases, it’s critical to keep an eye on how far the share price is from NAV.

**Sponsor**
Numerous benefits, such as brand recognition, trustworthiness, on-time delivery, etc., will be enjoyed by a strong sponsor. The right of first offer (ROFO) will also apply to REITs for properties held by sponsors.

**Taxation**
Three factors—interest revenue, dividend income, and debt repayment—combine to form the cash allocated to unit holders. Except for dividend income, all REITs are taxed equally. It depends on the tax structure that the SPVs chose. The same rate of taxation that applies to REITs also applies to unitholders. Investor interest is anticipated to increase for REITs with the biggest non-taxable component of NDCF.

<table>
<thead>
<tr>
<th>TABLE 2 PEER COMPARISON OF LISTED REITs</th>
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<tbody>
<tr>
<td>PARAMETERS</td>
</tr>
<tr>
<td>Weighted Average Lease Expiry</td>
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[Source: International Journal for Multidisciplinary Research (IJFMR)](www.ijfmr.com)
<table>
<thead>
<tr>
<th></th>
<th>Brookfield REIT</th>
<th>Mindspace REIT</th>
<th>Embassy REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend Yield*</td>
<td>6.00%</td>
<td>5.2</td>
<td>7.00%</td>
</tr>
<tr>
<td>Occupancy</td>
<td>87.00%</td>
<td>86.90%</td>
<td>89.00%</td>
</tr>
<tr>
<td>LTV</td>
<td>26.00%</td>
<td>16.80%</td>
<td>31.00%</td>
</tr>
<tr>
<td>DPU(TTM)</td>
<td>21.2</td>
<td>17.4</td>
<td>20.3</td>
</tr>
<tr>
<td>NAV</td>
<td>400.7</td>
<td>370.3</td>
<td>337</td>
</tr>
<tr>
<td>Distance from NAV*</td>
<td>-11.80%</td>
<td>-9.60%</td>
<td>-14.10%</td>
</tr>
<tr>
<td>Properties Location</td>
<td>Heavily focused in Bangalore</td>
<td>Focused on Mumbai (40.4%) and Hyderabad (40.0%)</td>
<td>Diversified across Noida, Gurgaon, Mumbai and Kolkata</td>
</tr>
<tr>
<td>Sponsor shareholding</td>
<td>51.00%</td>
<td>63.00%</td>
<td>54.00%</td>
</tr>
<tr>
<td>Proposed development as % of total are</td>
<td>6.20%</td>
<td>14.40%</td>
<td>20.80%</td>
</tr>
<tr>
<td>Taxation</td>
<td>82% of DPU is tax free</td>
<td>92% of DPU is tax free</td>
<td>52% of DPU is tax free</td>
</tr>
<tr>
<td>Mark to Market Headroom (FY24E)</td>
<td>18.00%</td>
<td>14.10%</td>
<td>18.00%</td>
</tr>
<tr>
<td>Cost of debt</td>
<td>7.10%</td>
<td>7.30%</td>
<td>7.40%</td>
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</table>

According to Table 2, Brookfield REIT has the greatest occupancy rate and dividend yield. When compared to other REITs, Mindspace REIT offers the highest tax-free distribution (92%). Their LTV (16.8%) is the lowest of the others. While Mindspace is more diversified across 4 major cities, Brookfield & Embassy are more concentrated on NCR (67% of GAV) & Bangalore (74% of GAV).
Units of Brookfield India REIT have outperformed the benchmark NIFTY 50 since it was listed. When all relevant measures, including mark-to-market, projected development area, dividend yield, WALE, occupancy, etc. are taken into account for growth investors seeking capital appreciation, Brookfield either leads the pack or is on par with the competition. Following the purchase of Candour N2 tech park, BIRET has a higher growth outlook for the following two to three years.

Conclusion:
Due to the ability to renegotiate contracts during periods of inflation, REITs and InvITs offer an additional hedge against inflation in addition to providing regular income and capital growth. They are a blend of debt and equity. It has the appearance of a debt instrument due to the frequency of dividend payments. In addition, the unitholder shares, much like an equity investor, in the company's trajectory of growth. InvITs and REITs are being viewed by investors as new investment products that they may utilize to diversify their portfolios. Since InvITs may offer stable returns and sustained growth, this trend will undoubtedly take centre stage in the upcoming years.
As of December 2022, the RBI progressively raised the repo rate from 4% to 6.25%. Investors did not find the returns offered by REITs and InvITs (6-7%) to be alluring because banks were providing yields above 7%. Investors avoided REITs and InvITs as a result, causing a 15-20% decline for all three named players. However, this could only last a short while. We may observe an increase in REITs and InvITs as the interest rate begins to decline. This can be an excellent opportunity for patient accumulation for individual investors who are wanting to create a REIT basket and have a long-term time horizon.

REFERENCES
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