Listed or Unlisted InvITs – Which way to go?

Key Takeaways

- Tracking evolution of InvITs – resurgence and success
- Debate between private listed and unlisted InvITs – which way to go?
- Unlisted InvITs remain attractive for investors seeking tax optimal returns and de-regulated landscape
- Perception that unlisted InvITs have lost SEBI's favour may not be accurate

The Beginning of Investment Trusts

InvITs have clearly come a long way and have their foundation in the Indian real estate investment trusts (**REIT**) regime. It was in about 2007 that the SEBI first thought of a REIT regime under the mutual funds umbrella. Real estate mutual fund regime (REMF) was introduced in 2008 amending the SEBI Mutual Funds Regulations, but never took off due to the over-prescriptive nature of the regulations. Nevertheless, pathway was laid for a sophisticated investment vehicle that could attract institutional investors to listed real assets. At this time, several Singapore business trusts and AIM listed London vehicles setup as REITs to invest in Indian real estate and infrastructure assets had failed miserably. There was still substantial interest in the high yield Indian real estate and infrastructure assets, but a well-regulated institutional play was required for true value unleashing of such mature assets.

In 2014, when REIT regime was finally introduced, the product had to succeed, and real estate developers had their own reputational issues. Hence, significant obligations on a REIT sponsor were imposed in stark contrast to a sponsor's role generally, which is generally that of an anchor investor. In fact, at one time valuations could for real estate were also required to be done by SEBI registered merchant bankers and not the IPCs as SEBI wanted valuers to be under its leash - to prevent aggressive valuations. SEBI did not even enable a private listing (let alone unlisted) regime for REITs as there was a fear that though private listed, the units may be down-sold to retail investors - SEBI never wanted to let its guard down. The REIT regime took off to a lukewarm response – but SEBI was confident of launching a similar product in the infrastructure space.

InvITs - The Younger Sibling with all the Freedom

Modelled after the REITs regime, SEBI launched the infrastructure investment trust (InvIT) regime. Considering the need for capital, and interest of 'patient capital' from SWFs and PFs, InvITs (unlike REITs) could be privately listed, or even unlisted. Unlisted or private listed InvITs could take developmental risks as well, and weren't to be seen as 'bond proxies' like a REIT. Large institutional investors started considering Indian infrastructure opportunities more seriously – however, the inherent risk-return profile was still lopsided. The federal government then upped the ante to extend the tax benefits to unlisted InvITs – same as listed InvITs. That was a turning point. Unlisted InvITs had all elements to attract global interest – a light-touch regime, comfort of SEBI's supervision, tax benefits and ability to make higher returns by investment at developmental stage.

Was too much given - Change of heart

Unlisted InvITs soon became the favourite. However, some developers soon started contemplating structures that involved rollover of their semi-constructed, yield generating assets to the InvIT, but without any new investor coming in or any debt recast. The

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structures thus potentially involved the developer being the sponsor, manager and investor in the InvIT without any external capital coming in and yet achieving cost step-up and tax optimisation. In many ways, such structures defeated the very purpose of InvITs as a product.

SEBI then, probably at the instructions of MoF, stepped in and brought arduous diversification requirements. Effective August 2021, every unlisted InvIT was mandated to have a minimum of five distinct unitholders (other than the sponsor, its related parties, and its associates), where such five unitholders hold at least 25% of the total InvIT units. Well-intended, these amendments were premised to achieve the following purposes – to discourage sponsors from setting up unlisted InvITs which are driven by tax incentives, but do not result in either (a) fresh capital infusion, (b) monetisation of assets, (c) development of infrastructure, or (d) repayment of existing domestic debt.

However, the market has perceived this as SEBI's reluctance to allow for any further unlisted InvITs, since the fundamental tenet of unitholder selection has been compromised. In fact, SEBI's intended purpose may also not have been achieved fully since minimal participation by non-sponsor unitholders (except one) will still result in compliance with the diversification requirements. Hence, while the norms can be met, a subjective test may have been more appropriate instead of overhauling the nuts and bolts of the InvIT framework – such that if SEBI is of the view that the purposes sought to be achieved by the amendment have not been met, then such unlisted InvIT will be disbanded or disallowed from claiming tax benefits. However, prescribing public (non-sponsor-related) float requirements also tends to rub the wrong way for investors that invested in unlisted InvITs, especially considering the broad manner in which a sponsor's associate is defined.

Which way to go now – unlisted or private listed?

Barring certain minor issues like no preferential issue (only rights issue) regime available for unlisted InvITs, there is nothing as such that would attract a sponsor to a private listed InvIT (please refer to Annexure below). On the other hand, the two big drawbacks of a private listed InvIT are the leverage limits (max 70% of asset value) and disclosure of all material information to the public. The debt level of most infrastructure companies is well above the 70% limit and hence, private listed InvITs get ruled out at the very threshold. Also, by their very design, private listed InvITs are private vehicles with ownership concentrated between a close group of investors, which makes such public disclosure of material information counterintuitive. Inter-se unitholder arrangements also become challenging in the listed context as institutional unitholders may not be able to achieve enhanced contractual/ governance protections, unless such rights are taken through shareholding in the manager entity, which comes with its own challenges. We have set out the crisp differences between the private listed and unlisted regime in the Annexure.

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In the context of Indian regulatory landscape, it is equally important to understand the perspective of the regulator as it is to understand the law itself. The background of REITs to the evolution of InvITs gives us a glimpse of the underlying regulatory thought process – one where innovative products necessary for the evolution of the markets are encouraged while also being overcautious of potential abuse. Unfortunately, rollover of assets to an unlisted InvIT only to achieve tax optimisation fed right into SEBI's sense of suspicion.

Naturally, a perception developed that unlisted InvITs no longer have regulatory favour and private listed InvITs are the safer bet. However, if SEBI's intent was indeed to thwart the unlisted regime, detailed diversification norms would not have been introduced. Yes, SEBI's approach with the diversification prescription could have been better – but it may be imprudent and too early a call to consider this as the death knell for unlisted InvITs. Therefore, where the underlying purposes of bringing in fresh capital and developing infrastructure are indeed being achieved, unlisted InvITs could be considered with an open mind, especially because of the significant operational flexibilities the product offers.

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ANNEXURE

Comparative Analysis – Private Listed vs. Unlisted InvITs

Key Parameters	Privately placed listed InvITs	Privately placed unlisted InvITs
Listing	Mandatory listing	Unlisted
Asset size	INR 5,000 mn	INR 5,000 mn
Minimum offer / issue size	INR 2,500 mn	INR 2,500 mn
Minimum no. of investors	5 (other than sponsor & its related party)	5 (other than the sponsor, its related parties and associates)
Minimum non-sponsor float	Post issue capital calculated at offer price to be held by public: 1. Where the post issue capital is less than INR 16,000 mn – at least 25% of the outstanding InvIT units; 2. Where the post issue capital is between INR 16,000 mn to INR 40,000 mn – of a minimum value INR 4,000 mn. If this does not constitute at least 25%, then, public float to be increased to 25% within a period of 3 years from the date of listing; 3. Where the post issue capital is INR 40,000 mn or more - minimum 10% of the outstanding InvIT units, which needs to be increased to 25% within 3 years of listing.	Persons other than the sponsor, related parties and associates should collectively hold at least 25% of the total units of the InvIT at all times.

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Maximum no. of Investors	1000	20
Minimum subscription	INR 10 mn per investor (INR 250 mn if ≥ 80% InvIT assets in completed and revenue generating assets)	INR 10 mn per investor
Trading lot size	INR 10 mn (INR 20 mn in certain cases)	NA. INR 10 mn per investor by practice.
Timeline for listing	Within 30 days from date of allotment	NA
Further fund-raising	Can be undertaken by way of preferential allotment, qualified institutional placement or rights issue.	Can be undertaken by way of rights issue.
Dividend distribution	At least once in every 12 months	At least once in every 12 months
Leverage	1. Borrowings > 25% to 49% - credit rating & majority unitholders' approval required. 2. Borrowing above 49% up to 70% - credit rating (AAA or equivalent) and 70% unitholders' approval (by value) required. Borrowed funds to be used only for acquisition or development of infrastructure projects. InvIT should also have a track record of at least 6 continuous distributions to its unitholders.	No limit /restriction on undertaking borrowings.
Audit of Accounts	Once every year, and report is submitted to the stock exchanges.	Once every year, and report is submitted to the trustee and unitholders.

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Change in IM	Approval from unitholders and SEBI.	Approval from unitholders only.
Information Rights to Unitholders	Difficult to enable selective information to any single unitholder – because of SEBI's reluctance to permit this in a listed InvIT.	Selective information sharing with any unitholder should be possible.
Stock Exchange Disclosures	1. Valuation reports received by the investment manager shall be submitted to the stock exchanges. 2. Disclosures under Regulation 23 should be made to the stock exchanges. These include (not an exhaustive list): a. acquisition or disposal of any projects, directly or through holdco or SPV, value of which exceeds five per cent. of value of the InvIT assets; b. additional borrowing, at level of holdco or SPV or the InvIT, exceeding fifteen per cent. of the value of the InvIT assets; c. additional issue of units by the InvIT; d. details of any credit rating obtained by the InvIT and any change in such rating; e. any issue which requires approval of the unit holders; f. any legal proceedings which may have significant bearing on the functioning of the InvIT. 3. Practically, all important unitholder communication may have to be disclosed to stock exchanges.	No disclosures to the stock exchanges.

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Author:

Ruchir Sinha

Ruchir has 17 years of experience advising clients primarily on private equity, PIPE, M&A and structured finance transactions. With background in fund formation and tax, he has been involved in developing the first generation of asset-specific tax optimized investment platforms and managed accounts. He advises leading global financial sponsors, SWFs and other institutional investors on private equity and PIPE deals primarily focusing on financial services (BFSI), technology and infrastructure sectors, few of which have been recognized as most innovative by Financial Times, London.. He was involved in structuring the first unlisted InvIT, and advised on several other listed InvITs. He regularly advises strategic acquirers, SWFs and other global sponsors on cross border deals in listed and unlisted space, with a special focus on control deals...*read more*

Heena Ladji

Heena advises on cross-border PE transactions, public equity and M&A providing a legal and strategic lens. She has advised leading financial sponsors around various matters including structuring and executing investments, advisories in and around the regulatory and securities market landscape, cross-border consultancy and employment arrangements in a tax optimized manner...*read more*

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