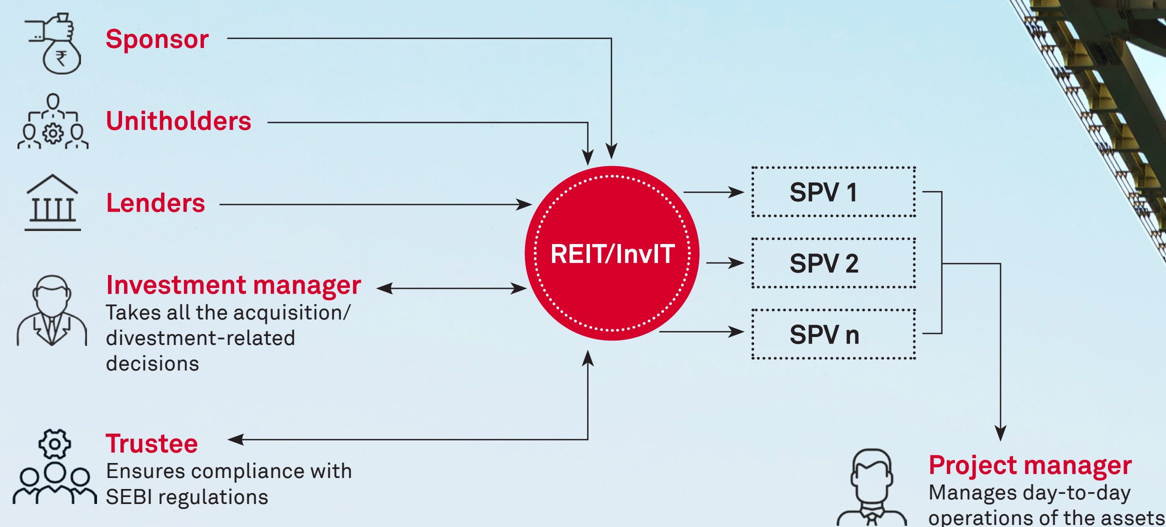
CRISIL
Ratings
REIT & InvIT
The investment vehicles with structural safeguards

A real estate investment trust (REIT) or an infrastructure investment trust (InvIT) is an investment vehicle that owns revenue-generating real estate or infrastructure assets. These entities are 'trusts' by definition and their 'units' (akin to equity shares) are generally listed on exchanges. They have a pass-through structure and are required to mandatorily distribute at least 90% of their net distributable cash flow to unitholders. REITs and InvITs were primarily formed with the idea of making investment in operational real estate/infrastructure assets accessible to a wider pool of investors, including retail investors. Operational assets generally do not require significant intervention in day-to-day operations. If well-maintained, they provide a steady cash flow over the concession period/life of the asset. The steady revenue source aligns with the investment requirement of patient capital investors as well as retail investors.

While REIT/InvITs are a relatively a new concept in India, REITs have been popular among global investors since their inception in 1960. The US was the first country to form REITs and now these vehicles are widely seen globally. There are 865[1] listed REITs outstanding across countries, with the US being the biggest REIT market with gross assets of $4.5 trillion[2] (Source: Nareit) as of Q3 CY2022. In the global context, REITs include various asset classes, such as residential properties, office spaces and hospitals, as well as infrastructure assets, such as fibre cables, telecommunication towers and energy pipelines. REITs are particularly sought after by long-term investors due to their ability to generate a stable stream of cash flow over a long period of time. In the US, the FTSE Nareit All REITs Index, which had a portfolio of 213 REITs as of March 31, 2022, has given an average annual return of 9.46%[3] in the past 25 years.

Indicative structure of investment trusts



REITs/InvITs in India are regulated by the Securities and Exchange Board of India (SEBI). Since their introduction in 2014, the regulations around REIT/InvITs have undergone a series of changes and the structures have gained traction. As of October 2022, there are 19 SEBI-registered InvITs and five REITs. The assets under management (AUM) for Indian REITs/InvITs stand at ~ Rs 4,50,000 crore as on March 31, 2022.

Following are the stakeholders in the trust:

- A sponsor sets up a REIT/ InvIT by transferring assets to it for a price and holds a stake in the trust
- An investment manager takes strategic decisions of the trust, including acquisition/divestment and appointment of a project manager
- The project manager manages operations and maintenance of the assets
- The trustee ensures compliance with the SEBI regulations
- Unitholders are investors akin to shareholders
- Lenders provide debt financing to the trust or to the underlying assets housed in special-purpose vehicles (SPVs)

[1] *https://www.reit.com/investing/global-real-estate-investment*
[2] *https://www.reit.com/data-research/data/reits-numbers*
[3] *https://www.reit.com/sites/default/files/2022-04/MediaFactSheet_Mar-2022.pdf*

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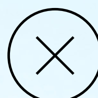
Indian REIT/InvIT structures, relative to their international counterparts, have higher inbuilt safeguards emanating from certain regulatory requirements that are credit-supportive:

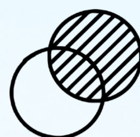
Investments in operational projects

Investments are primarily in cash flow-generating operational assets and restriction on investments in under-construction projects (applicable to public InvITs and REITs).



Leverage restrictions

Leverage should not exceed 49% of the total asset value (applicable to listed InvITs and REITs; up to 70% allowed for InvITs if they meet certain conditions).



Better transparency

Disclosure requirements that improve transparency and mandatory credit rating requirement, if leverage crosses 25% of the overall asset value

The introduction of these trusts was an important development, as they act as vehicles for developers to monetise their investments in operational assets. Capital, thus released, can be deployed in new infrastructure projects, wherein lies the expertise of the developers. This helps in asset recycling and deployment of capital for the next phase of infrastructure growth – a critical requirement to meet the infrastructure needs of the country.

While InvITs are a newer concept to Indian investors, with the first InvIT registered in 2016, their popularity has gained traction over the past couple of years, with different asset classes now forming a part of these trusts. REITs/InvITs are expected to play a major role in the Indian infrastructure buildout story, by acting as a major asset-monetisation vehicle. Overall potential of these vehicles is estimated at Rs18-22 lakh crore over the medium term.

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FAQs

Q What does CRISIL Ratings rate in a REIT/InvIT? What does the rating signify?

- CRISIL Ratings rates the debt either of a REIT/InvIT or that of the underlying SPVs. In case there is no debt in a REIT/InvIT or the underlying SPVs, CRISIL Ratings may carry out a corporate credit rating exercise to indicate the debt repayment capability of the trust as an issuer.
- CRISIL Ratings does not rate the units of the REIT/InvIT, since they are akin to equity shares in a company.

Q Is credit rating mandatory for REIT/InvITs?

- The SEBI mandates rating of debt, if the consolidated net debt of a REIT/InvIT exceeds 25% of the market value of its assets.
- Even when the debt is below 25%, REITs/InvITs tend to seek an external credit opinion in the form of a credit rating as this would complement the investors' own analysis. Many lending institutions also seek ratings, as they have restrictions on investments allowed in unrated entities.

Q From a credit perspective, which one is safer -- debt raised by a REIT/InvIT or their units listed in the market?

Compared with an equity holder, a debt holder has superior right over the cash flows and assets of a company in case of a bankruptcy. The units of REIT/InvIT are akin to equity. Due to the predictable cash flow and steady returns, these units can be visualised as quasi debt instruments. However, structurally they are subordinated to the debt holders.

Therefore, debt holders are safer when compared with the units of REIT/InvIT.

Debt in Indian REIT/InvIT is further supported by additional safety features, such as:

- Restriction in overall debt outstanding at 49%, leading to better debt-service coverage ratios (DSCRs)
- Diversification benefit due to the presence of multiple underlying assets
- Better transparency due to mandatory disclosures required as per the SEBI regulations

Q How is investing in a debt instrument issued by a REIT/InvIT different from taking exposure to multiple individual debt instruments?

An investor may invest in a debt instrument issued by a REIT/InvIT or take an exposure to multiple debt issuances on their own. In both instances, the investors enjoy diversification benefit. However, there are some differences between the two:

- **Better transparency and disclosures** – Listed REITs/InvITs are required to adhere to certain disclosure norms. On the other hand, sponsor-owned individual infrastructure assets tend to be housed in private limited companies with minimal disclosure requirements. Therefore, exposure to debt of REITs/InvITs benefits from better disclosures and transparency
- **Low leverage** – Investments in REIT/InvIT debt benefit from lower leverage and better debt-servicing cushion. In the case of infrastructure SPVs, debt tends to be high with leverage (debt-to-equity ratio) touching 70:30 or 80:20
- **Diversification benefit** – REITs/InvITs tend to maintain fungibility of cash flows among their SPVs. Therefore, underperformance by an asset tends to get offset by others in the portfolio. However, in case of exposure to debt issuances

by multiple infrastructure SPVs, a default by one SPV cannot be offset by surplus from another.

- **Recycling of assets –** A portfolio of infrastructure assets is actively managed and, if required, divested by the investment manager of the REIT/InvIT. In case of exposure to a portfolio of debt instruments, the investor has to make the churn on his own

Q Does the credit-rating methodology distinguish between a publicly listed, private listed and an unlisted REIT/InvIT?

CRISIL Ratings' methodology does not vary depending on the underlying type of REIT/InvIT.

However, the key characteristics of these entities influence the credit profile of the REIT/InvIT. The key characteristics are:

	Public InvIT	Private-listed InvIT	Private-unlisted InvIT
Investment flexibility in under-construction projects	Cap of 10% of the value of the InvIT	Flexibility to invest in under-construction projects	Flexibility to invest in under-construction projects
Leveraging	• 49% of asset value • For InvITs, leverage up to 70% of asset value permissible after three years of track record of distribution and AAA rating		At the discretion of the InvIT, subject to the amount as specified in the trust deed

The presence of predominantly operational projects and lower leverage are generally beneficial to the credit-risk profile and benefit publicly listed InvITs. On the other hand, the private unlisted InvITs showcase flexibility in terms of investment in under-construction projects and leverage, which is factored in the credit assessment.

Q How does CRISIL Ratings assess the credit-risk profile of a REIT/InvIT? How are the borrowings at the trust versus SPV level evaluated?

The methodology for assessment of credit profiles of REIT/InvITs and their underlying SPVs is similar. CRISIL Ratings generally consolidates the business- and financial-risk profile of the trust, along with its SPVs. This is because these structures tend to operate as a combined entity, each supporting the other's repayment obligations.

CRISIL Ratings evaluates the following key parameters:

- Quality of the asset portfolio assessed using asset class-specific criteria
- Coverage, leverage, and financial flexibility assessed using asset class-specific criteria; in case of multiple asset portfolios, each portfolio is assessed and then combined to arrive at the overall evaluation
- Impact of cash flow prioritisation, presence of debt covenants and diversification benefit
- Management-risk assessment

The rating of debt instruments at the SPV level and the trust level are usually equated. However, in a few instances where cashflow fungibility may be restricted, CRISIL Ratings may differentiate the SPV rating from the consolidated trust rating.

For further details, please refer CRISIL Ratings criteria on REIT/InvITs at www.crisil.com

Q How does CRISIL Ratings factor in the possibility of addition of new assets/asset classes?

CRISIL Ratings interacts with the management of REIT/InvIT to understand the asset acquisition strategy with respect to:

- Target asset classes, quantum of investments and asset composition over the foreseeable future and expertise in managing the same
- Proportion of investment in under-construction assets
- Leverage-related policies

These aspects are suitably factored into the credit assessment and are disclosed in the rating rationale in public domain. Any change in strategy is periodically incorporated into the assessment.

Q How does CRISIL Ratings assess the management-risk profile in a REIT/InvIT?

The investment manager is responsible for making strategic decisions such as those related to investment/divestment, selection of a particular asset class for investment, determining leverage policy, and the policy on liquidity and refinance. The management team is therefore evaluated on the parameters of integrity, competence and risk appetite. CRISIL Ratings may interact with the sponsor / large investors to understand various aspects, such as their investment philosophy and growth strategy.

Q How does CRISIL Ratings view the absence of a sponsor guarantee or collateral security at the trust level?

The regulations for REIT/InvITs were promulgated by the SEBI with the idea of making stable-income-generating, non-public infrastructure and real estate assets available for investment by a wider set of investors. These trusts come under the regulatory ambit, need to adhere to proper governance structures, and bring in transparency through periodic disclosures, thereby making them amenable to public investments. With the participation of financial and retail investors, sponsor discretion comes down. In that sense, these structures are similar to listed companies.

Besides, the trusts have in-built structural safeguards, which support their credit profile:

- Investments primarily in operational assets lead to low business-related risks
- Lower leverage ensures higher cash flow cushion for debt servicing
- Multiple underlying assets provide diversification benefits

In its analysis, CRISIL Ratings factors in the cash flow strength of the underlying assets, the expertise of management and the structural safeguards that these entities provide. For a credit rating assessment, these factors provide far more comfort compared with a standalone SPV.

Given the limited / lower sponsor stake in such entities, sponsor support, such as a sponsor guarantee, may not be present for the debt raised by the trust. However, the absence of such a sponsor support is offset by the presence of the structural safeguards in-built in REITs/InvITs.

In addition to the cash flows from various assets, the debt holders at the trust level can have access to shares of the underlying SPVs as collateral. In case of default, these shares can be used to reduce loss levels. However, the collateral kicks in post default and influences post-default recovery. Since it does not prevent a default, collateral is usually not considered for the credit rating analysis.

Q How does CRISIL Ratings assess refinancing risk in REIT/InvIT?

Any infrastructure / real estate asset typically has long-term concession agreements / rent agreements ranging from 10–25 years. Against this, the typical liability structure in the Indian debt market ranges anywhere between 5 and 15 years. This mismatch in timelines results in refinancing risk.

Similar to the assessment of an infrastructure / real estate asset, CRISIL Ratings evaluates the refinancing plan and the liquidity management undertaken by REIT/InvIT to ensure timely refinance. Cash flow cover available over the balance life of the asset is looked into to assess the possibility and ease of refinance. Given that REITs/InvITs deal with a portfolio of assets, the debt refinance tends to be a portion of the overall debt. CRISIL Ratings factors in the extent of refinance at any given point in time.

CRISIL Ratings' coverage on REITs/InvITs

S. No.	InvITs/REITs	Existing ratings (as on December 25th, 2022)
1	Anzen India Energy Yield Plus Trust (2022)	CRISIL AAA / Stable
2	Bharat Highways InvIT	Provisional CRISIL AAA / Stable
3	Cube Highways Trust	Provisional CRISIL AAA / Stable
4	Highways Infrastructure Trust	CRISIL AAA / Stable
5	India Grid Trust	CRISIL AAA / Stable
6	India Infrastructure Trust	CRISIL AAA / Stable
7	IndInfravit Trust	CRISIL AAA / Stable
8	Jio Digital Fiber Pvt Ltd. (SPV of Digital Fiber Infrastructure Trust)	CRISIL AAA / Stable
9	Oriental Infra Trust	CRISIL AAA / Stable
10	Powergrid Infrastructure Investment Trust	CRISIL AAA / Stable
11	Summit Digitel Infrastructure Pvt Ltd (SPV of Digital Fiber Infrastructure Trust)	CRISIL AAA / Stable
12	Virescent Renewable Energy Trust	CRISIL AAA / Stable
13	Brookfield India Real Estate Trust (REIT)	CRISIL AAA / Stable
14	Embassy Office Parks REIT	CRISIL AAA / Stable
15	Mindspace Business Parks REIT	CRISIL AAA / Stable

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About CRISIL Ratings Limited (A subsidiary of CRISIL Limited, an S&P Global Company)

CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence,

analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 35,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs). CRISIL Ratings Limited ("CRISIL Ratings") is a wholly-owned subsidiary of CRISIL Limited ("CRISIL"). CRISIL

Ratings Limited is registered in India as a credit rating agency with the Securities and Exchange Board ofIndia ("SEBI").

For more information, visit www.crisilratings.com.

About CRISIL Limited

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It is India's foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

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