Accelerated growth of Infrastructure, Real Estate, InvITs, and ReITs in India & Role of Debenture & ReIT/ InvIT Trustees

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The Indian bond market is witnessing a remarkable surge in infrastructure bond issuances as large investors lock in their investments in long-tenor instruments. This trend, which has gained momentum since April 2024, is driven by major banks, public sector undertakings (PSUs), infrastructure funds, and municipalities. This growth is essential for financing the country's infrastructure needs and supporting economic development.

1. Major Banks and AAA-rated Issuers

Prominent AAA-rated issuers, including major banks, are keen to tap into the bond market. These institutions can borrow funds competitively in the current market conditions, with yields ranging from 7.35% to 7.55% annualized, offering minimal spreads over corresponding government securities. These bank offerings attract a substantial number of investors looking for stable and lucrative investment opportunities. Several large banks like State Bank of India, ICICI Bank, Canara Bank, Bank of India, HDFC Bank, Bank of Baroda, Axis Bank, and Kotak Mahindra Bank have very large borrowing programs in the form of long-tenor infrastructure bonds this year to meet the increasing demand for infrastructure funding, leveraging their robust balance sheets and strong market presence. Some of these banks have already successfully tapped the bond market with significant amounts.

Last FY, overall, banks raised approximately Rs 51,000 crore through infrastructure bonds. In contrast, in the first 3-4 months of the current financial year, these banks have already raised approximately Rs 38,000 crore through EBP-listed bond issuances. Projections indicate that bank infrastructure bonds could exceed Rs 1,00,000 crore by the end of the current financial year.

2. Other Infrastructure Bond Issuances

Public sector undertakings in the infrastructure lending space, such as Power Finance Corporation (PFC), Rural Electrification Corporation (REC), India Infrastructure Finance Company Limited (IIFCL), and the National Bank for Financing Infrastructure and Development (NABFID), have increased their borrowings year on year through bond issuances and are aggressively issuing bonds. These entities leverage their strong credit ratings and the growing demand for infrastructure investments to secure necessary funding for large-scale projects.

Key Infrastructure Development Funds (IDF)—India Infradebt, NIIF Infradebt, and Kotak Infradebt—have also entered the bond market for the past few years, channeling investments into infrastructure projects to ensure steady capital flows for long-term development.

As per projections Infrastructure bond issuances are expected to see a significant increase, potentially doubling the previous year's figures as demand for infrastructure investment grows.

3. Municipalities

Last year, Pimpri Chinchwad, Ahmedabad, and Vadodara municipalities raised funds through municipal bonds. More municipalities are expected to tap the bond market in the third and fourth quarters of this fiscal year. Several municipalities plan to enter the infrastructure bond market this financial year, including Pimpri Chinchwad which is considering raising up to Rs 200 crore through green municipal infrastructure bonds, pending approval from the state government and other relevant authorities.

As per projections Municipal bond issuances are expected to grow substantially this year with the help of the regulator SEBI. Many investor meetings and conferences are being conducted along with SEBI, municipalities, and industry experts to increase investor awareness. SEBI has, in fact, uploaded all relevant municipal bond regulations in a single window for easy access to issuers and investors.

4. InvITs

As per SEBI data as of July 17, 2024, a total of twenty-five Infrastructure Investment Trusts (InvITs) have registered with SEBI. However, only 7-8 InvITs are regularly tapping the bond market to raise funds. It is expected that these InvITs will step up their borrowing this year aggressively. Even though they are able to borrow long-term tenor bonds, such bonds mostly come with put/call options which may impact their ALM to that extent. However, complexity of the taxation for unit holders may hamper the growth of InvITs.

The total amount raised through EBP-listed bonds last fiscal was around Rs 10,000 crore. In the first 3-4 months, their borrowings have been somewhat muted. This year we expect these InvITs to tap the market more aggressively in the third to fourth quarter of the financial year as we expect bond yields to soften further.

5. Real Estate

Currently, real estate enjoys several tax advantages, such as interest deductions on home loans, capital gains exemptions with indexation benefits, and Section 80C benefits for principal repayment of home loans. Removing these tax advantages fully could increase the effective cost of owning a home, making it harder for low and middle-income groups to afford housing. Without tax incentives, the financial attractiveness of purchasing property diminishes, potentially slowing down homeownership rates among these groups.

However, in the long term, property prices may adjust downward to reflect the reduced tax incentives, potentially making homes more affordable. Increased costs of owning a home might push more low and middle-income families towards renting instead of buying, impacting rental market dynamics. With fewer incentives to invest in real estate, these groups might shift their focus to other forms of savings and investments, potentially leading to better diversification of their investment portfolios. Maintaining the tax benefits for first-time buyers and low- and middle-income groups may safeguard them and boost the affordable housing sector. Strategies to enhance transparency and digitalize property registrations and transactions could help homeowners and landowners. Offering tax benefits or subsidies for formal real estate transactions could attract more participants into the formal sector.

6. Promoting REITs

Real Estate Investment Trusts (REITs) provide a way for small investors to invest in real estate without the need to buy property directly, offering liquidity, diversification, and regular income. As per SEBI data as of July 17, 2024, a total of only five REITS have registered with SEBI and only two REITs are active in bond markets. The growth of REITs can help formalize the real estate sector by bringing more transparency and professional management. They can also attract foreign investment, providing a boost to the real estate market. However, regulatory hurdles, tax issues, and lack of investor awareness can hinder the growth of REITs. The main REITs are credit rated AAA.

SME-REITs is the new product introduced by SEBI recently to those investors who is willing to invest in high yield instruments with certain risk. This will help them in diversifying their investments on the basis of risk-reward.

7. Role of Debenture Trustees in Supporting These Sectors

SEBI Registered Debenture Trustees' primary responsibility is to safeguard the interests of the investors or unit holders (in case of REITs & INVITs), ensuring that the issuers comply with the terms of the issue and that investors receive timely payments of interest and principal. Trustees act as intermediaries between the issuer and the investors, providing an additional layer of accountability. Debenture trustees are tasked with monitoring the financial health of the issuers. This involves regular scrutiny of financial statements, project progress reports, and other relevant documents to assess the issuer's ability to meet its obligations. By ensuring that the financial covenants and conditions specified in the debenture agreement are adhered to, trustees help maintain investor confidence and protect their investments. Additionally, trustees facilitate communication between the issuers and investors, addressing any concerns or issues that may arise during the tenure of the debentures. They are responsible for convening meetings of debenture holders, where necessary, to discuss and resolve any matters affecting their interests. This role is crucial in maintaining transparency and trust in the market. Debenture trustees also play a pivotal role in enforcing security interests. In cases where the debentures are secured by assets, trustees ensure that these assets are adequately maintained, providing an additional layer of security for investors. In the event of default, trustees are empowered to take legal action to recover the investors' dues, including the enforcement of security. Additionally, debenture trustees monitor any delays in interest payments or funding of the escrow account. They are required to notify the rating agencies of any anticipated delays in the funding of interest and principal payments. In cases where the issue is fully guaranteed, the debenture trustees are obliged to invoke the guarantee if the issuer fails to make timely payments.

8. SEBI's Role in Supporting Infrastructure, Real Estate, InvITs, and REITs

The Securities and Exchange Board of India (SEBI), the capital market regulator, can support the development of infrastructure, real estate, InvITs, and REITs by streamlining and amend the regulations when necessary to reduce compliance burdens, helps to seek tax incentives for investors with the support of the Government, and implementing measures to improve transparency and simple reporting standards to boost investor confidence. SEBI's role is critical in ensuring that the regulatory framework is conducive to attracting investment while protecting the interests of investors.

Conclusion and Recommendations

The Indian bond market is experiencing a significant surge in infrastructure bond issuances, driven by major banks, PSUs, infrastructure funds, and municipalities. This growth is crucial for financing the country's infrastructure needs and supporting economic development. Formalizing the real estate sector and promoting REITs can enhance transparency and attract more investment in the real estate sector. The development of InvITs and REITs, supported by regulatory amendments and the crucial role of debenture trustees, will be key to channeling investments into India's infrastructure and real estate sectors, driving sustainable growth in the long term.

Recommendations:

1. *Regulatory Reforms:* Focus on regulatory reforms that enhance transparency, provide tax incentives, and reduce compliance burdens.
2. *Strengthening the Role of Trustees:* Further Strengthening the role of DTs and REIT & INVIT trustee to ensure compliance, maintain transparency, and protect investor interests.
3. *Digitalization and Formalization:* Promote digitalization in real estate transactions and formalize the sector to attract more investment.
4. *Support for InvITs and REITs:* Provide regulatory support & tax incentives to promote the growth of InvITs and REITs, enhancing investor confidence & market stability.
5. *Government Policies:* Align with government policies and affordable housing initiatives to drive sustained growth in infrastructure and real estate.

By implementing these recommendations, India can continue to attract substantial investment into its infrastructure and real estate sectors, driving sustainable economic growth and development.