India’s new infrastructure investment trusts

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Improving domestic infrastructure and increasing foreign investment are both at the top of India’s to-do list. New Prime Minister Narendra Modi has singled out infrastructure for attention, and his administration's latest innovation is the infrastructure investment trust (InvIT), which received regulatory approval in early August.

The stock exchange-listed InvITs are designed to tackle the two main problems facing infrastructure development in India: a lack of developer access to equity funding and a lack of suitable vehicles for foreign investment in India.

The Modi administration hopes that InvITs can kick-start stalled infrastructure construction activity, but industry observers worry that InvITs may suffer the same fate as previous state-led investment efforts, which have largely failed to inspire investor confidence.

Outside equity

In India, developers that have taken on project development and construction risk have found it difficult to access new sources of equity for assets in their post-construction period. They in turn find it hard to recycle equity into the backlog of new projects to which they committed during the infrastructure boom that began in 2006.

Although global institutional investors are increasingly attracted to India’s long-term growth potential and infrastructure requirements, they have not historically invested in the sector because of considerable legal and bureaucratic obstacles to infrastructure development and operation. The InvIT concept is a response to interest from investors such as Canadian pension funds in accessing lower-risk operational assets.

InvITs will acquire stakes in infrastructure assets from developers and pool their individual project risks into a regulated and listed fund that will offer yield to investors. This access to cheaper, international funding should then free up developers' capital for new projects. It will also reassure developers' corporate lenders that these developers are managing their exposures to particular projects.

“It is all about the government opening up infrastructure assets to be able to access larger pools of private capital and thereby lighten the exposure risks that the bank balance sheets might accumulate over time,” said Suneet Maheshwari, executive vice-president for corporate affairs at L&T Financial Services, part of Indian engineering and construction group Larsen & Toubro.

Interest in InvITs from major domestic sponsors such as L&T and GMR in India is high. GMR told *IJGlobal* that it believes the increase in available capital will encourage more developers to enter the market and benefit the sector overall. Although InvITs are aimed at all infrastructure sectors and can in theory contain assets from a number of developers, the first funds to appear are likely to contain pooled road assets from single named developers.

Bumpy road ahead

InvITs are not the Indian government's first infrastructure-focused investment initiative.

In 2012 India finalised regulations for infrastructure debt funds (IDF) and the soon launched its own $2 billion IDF, Infradebt, in conjunction with ICICI Bank, Bank of Baroda, Citigroup and Life Insurance Corporation of India. State-owned infrastructure lender India Infrastructure Finance Company (IIFCL) and the infrastructure finance arm of private developer L&T then each launched IDFs in 2013.

Observers of Indian infrastructure finance say they can learn two things from the IDF precedent. First, it is likely to be a couple of years before the first InvITs come to market. Second, InvITs may not be Indian infrastructure’s promised panacea. IDF uptake was slow and limited, and managers raised less capital than they expected. Many have dismissed the IDF regulations as not fit for purpose.

A particular worry with InvITs is that their regulations may be too restrictive to help developers deal with the problems posed by their existing portfolios. The InvIT regulations, which the Securities and Exchange Board of India (SEBI) will approve on 10 August this year, stipulate that the funds must invest 80% of their assets in post-construction infrastructure and 20% in infrastructure under construction. They must have a minimum 25% public float and at least 20 investors.

Another worry is that international investors in the funds will not have enough information to assess the quality of the assets in InvITs. While the government believes that listing InvITs will increase their transparency, this level of disclosure still might not provide enough clarity for institutional investors' risk appetites.

The appearance of InvITs also depends on a few final regulatory issues being ironed out, the most important of which is InvITs' tax status. Market observers are watching this issue carefully, because in July this year India’s Central Board of Direct Taxes (CBDT) shocked domestic and international investors by changing the tax rate on Alternative Investment Funds (AIF), which launched in 2012, to the maximum 30%. AIFs pool capital to invest in a range of asset classes and represent a similar state-led push to InvITs as a means of attracting investment to the country.

A private solution

Amid the hope and caution surrounding InvITs and other state-led initiatives, some major developers and institutional investors are choosing to create their own long-term infrastructure investment vehicles by forging bilateral partnerships.

At the end of July this year Dutch pension fund APG and India’s Piramal Enterprises formed a joint venture to invest $1 billion in rupee-denominated mezzanine infrastructure debt over the next three years. In June, the Canada Pension Plan Investment Board (CPPIB) decided to invest $166 million, in two tranches over a year, in L&T subsidiary L&T Infrastructure Development Projects (L&T IDPL).

Listed vehicles for sponsors' infrastructure holdings can emerge naturally. In the UK, developer-backed listed infrastructure equity funds that have been used to acquire sponsors' project equity holdings - such as the London-listed John Laing Infrastructure Fund (JLIF) and Bilfinger Berger Global Infrastructure (BBGI) - were private and not government-led initiatives.

The high domestic and international interest in Indian infrastructure is creating momentum in the search for viable financial products for the sector, but the journey is not over yet.