Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Macroprudential Policy for the Property Fund Sector – Consultation Paper 145

Feedback from Dillon Eustace LLP

Do you agree with the proposal in Consultation Paper 145 to limit leverage and introduce additional Guidance around liquidity mismatches as a means to meet the Central Bank's objective of safeguarding resilience of the property fund sector to shocks in the Irish CRE market? If not, which measures, or combination of measures, do you think best meet the objective of safeguarding resilience of the property funds sector, so that it is better able to absorb – rather than amplify – shocks in the Irish CRE market?

Response:
Following consultation with our clients and other stakeholders in industry, we have dealt separately in this response with each of the Central Bank's proposals to:

(a) limit leverage; and

(b) introduce additional Guidance around liquidity mismatches

LIQUIDITY MISMATCHES RESPONSE

In commentary received on this proposal, our clients and colleagues have noted that the majority of Property Funds are established as closed-ended funds with an ability to extend the term of those funds subject to shareholder approval, which flexibility allows for judicious management of the sale of real estate appropriate to prevailing market conditions at the end of such term. Based on feedback we have received, those which have been established as open-ended funds with limited liquidity have a liquidity timeframe greater than that proposed by the Central Bank in the Consultation Paper.

We therefore agree with the Central Bank that in the case of Property Funds, aligning the timeframe of redemption terms with the liquidity of underlying assets is the most effective way of reducing liquidity mismatch for Property Funds.

LEVERAGE LIMIT RESPONSE

We note that the rationale put forward by the Central Bank in the Consultation Paper for imposing a proposed limit of 50% on the ratio of Property Funds total loans to their total assets "Proposed Leverage Limits") on Property Funds is to guard against excessive levels of leverage across the sector of funds holding Irish property assets, and in particular the Irish commercial real estate (CRE) market.

Whilst the benefits to macroeconomic and financial stability arising from prudent supervision of the CRE market are acknowledged, as highlighted by ESMA in its Guidelines on Article 25 of Directive 2011/61/EU 'ESMA Leverage Guidelines", the introduction of any leverage limits should always be in proportion to the systemic risks posed by the use of leverage and must also avoid a situation where a different type of AIF could be used to avoid such limits. In this regard, the feedback received from our clients and other contributors has been that the imposition of such Proposed Leverage Limits will disrupt the CRE market to an extent that is likely to be detrimental to the ultimate goal of prudential management of that market. We have set out below a summary of the responses we have received which we hope will provide clear insight into these views.

Measures, Or Combination Of Measures, That Best Meet The Objective Of Safeguarding The Resilience Of The Property Funds Sector

The objective of safeguarding the resilience of the property sector has underlying it, in our view, two separate objectives:

(a) Safeguarding the interests of investors; and

(b) Safeguarding the Irish commercial real estate market from adverse market movements

Safeguarding the Interests of Investors

Investors in Property Funds should not be distinguished from investors in other types of Irish regulated investment funds. It is the view of respondents that existing measures in place arising from existing legislative requirements, in particular around limiting investors to Qualifying Investors, and maintaining requirements around pre-contractual and ongoing disclosure (including the obligation to set a maximum level of leverage which can be generated by the Property Fund and disclosing same in the pre-contractual document) provide robust and appropriate safeguards to this class of investors.

Safeguarding the Resilience of the Property Funds Sector from Adverse Market Movements in Irish CRE

Feedback received indicates that measures which best meet the objective of safeguarding the resilience of the Property Funds sector

from adverse market movements in Irish CRE are those targeted at the CRE market, and not at the Property Fund sector in isolation (which product is adequately safeguarded with existing legislation).

For reasons elaborated on further in this response, it is the view of respondents that Property Funds as investors, should not be carved out from other investors in Irish CRE as to do so is likely to either cause a migration of investors from Property Funds to one of (a) direct investment, (b) investment through third structures in the non-regulated space, (c) through non-Irish investment vehicles or (d) divest from Irish CRE (in the case of existing Property Funds) or not to invest in Irish CRE. Please see further detail on this in our response to Question 4 below, "(e) Move Away from Property Funds to Access Irish CRE". Such safeguards are likely to disrupt the market therefore, either lowering demand for Irish CRE, or moving the same investors in the market to structures outside of the remit of the Central Bank's oversight.

Do you agree that the definition of property funds – for the purposes of the proposed macroprudential measures – should include all AIFs that are domiciled in Ireland, authorised under domestic legislation, and investing over 50 per cent directly or indirectly in Irish CRE, subject to the narrow class of exclusions noted in the consultation paper? If not, what do you see as a better alternative definition of property funds for the purposes of application of the proposed measures?

Response:
We agree with the definition of property funds including all AIFs that are domiciled in Ireland, authorised under domestic legislation, and investing over 50 per cent directly or indirectly in Irish CRE and welcome the clarity on this point.

Do you agree with the Central Bank’s proposal to have a single leverage limit, irrespective of the type of property holdings? If not, how would you differentiate the limit with respect to property

holding type, and what would be the practical implications of doing so (e.g. additional, more granular data collection)?

Response:
Notwithstanding our views on the proposed new limits being discussed in this paper, we suggest that the status quo around leverage rules being applied in consideration of the protection of investors should prevail, with lower levels (ie 30% for RAIFs) being applied to retail AIFs, and qualifying investor AIFs continuing with a disclosure-based leverage limit as per existing disclosure requirements set down in the AIFM Regulations.

In our view, and in the view of those who provided their feedback to us, taking a property type-based approach to leverage limits will not fully future-proof for market shocks. For example, noting the Central Bank's observation that leverage appears to be lower for Property Funds with residential portfolios, such lower limits will not have anticipated market shocks such as COVID where, for example, the short to medium term value of office space in central business districts has been affected, while, for example, residential property has not. We would see substantial risk in the Central Bank seeking to limit market risk on a property type basis.

As a separate point, we note the socio-economic benefits and increase in prevalence of mixed use real estate developments. We note in this regard that any proposed calibration of Proposed Leverage Limits based on the type of Irish CRE acquired by the Property Fund would be extremely difficult to implement in the case of investment in "mixed-use" developments.

We note market commentary also that if a leverage limit is to be introduced to Property Funds, such limit should be introduced on a sliding scale for leverage based on income and financing (see: https://www.irishtimes.com/business/commercial-property/central-bank-must-tread-carefully-on-leverage-rules-1.4802751) . In our view such an application would be preferable to any limits based on the type of commercial property held by a Property Fund.

Do you agree with the proposed calibration of the 50 per cent total loan to total asset ratio as the appropriate leverage limit for property funds? If not, what level of leverage limit would you see as appropriate for Irish property funds, taking into account the risks the sector is exposed to and the levels of leverage employed by property funds throughout Europe? Please explain why you have suggested this level and the evidence that would support that.

Response:
We do not agree with the proposed calibration of the 50 per cent total loan to total asset ratio as the appropriate leverage limit for property funds. We have set below our rationale for this view.

(a) Impact on Property Fund Internal Rate of Return

Based on current market activity, we have found from consultation with our clients and other contributors, that CRE financing is typically issued on a day one basis at 55% - 65% loan to value .

Actual leverage limits are negotiated on a case by case basis between the parties to a loan. LTV rates are offered by lenders who are subject to prudential regulation on the levels of risk they may hold and leverage that they can offer to clients. As a corollary, LTV rates are priced-in by Property Funds to their anticipated internal rate of return 'IRR") and value for money assessments at the proposal stage of a Property Fund.

Where the LTV is decreased from the LTV'priced in' on a day one basis the anticipated IRR of the Property Fund will reduce.

Please see attached worked example {SEE APPENDIX 1 - PAGE 1 – EXAMPLE PORTFOLIO} which provides the breakdown of IRR on a Day 1 Asset purchase of â‚¬50,000,000 with a 60% LTV loan, compared to a 50% LTV loan. Detailed assumptions are listed in the worked example, but a summary of the impact on IRR is as follows:

In summary, in this case, using a sample Asset purchase price of â‚¬50,000,000, the impact of a reduction of day 1 leverage limit from 60% to 50% is as follows:

{SEE APPENDIX 1 - PAGE 2 – CHART}

(a) Additional day 1 funding from Shareholders required in the amount of â,¬2,192,220;

(b) Implied purchase yield moves from 4.25% to 4.46%;

(c) Reduction in IRR of 1.95%.

These metrics have the commercial effect of reducing the attractiveness of the asset acquisition, which is contrary to the interests of investors and likely to have the immediate effect of moving such investors away from new Property Fund investment (please see "(d) Move Away from Property Funds to Access Irish CRE" below, reducing diversification of investors in Property Funds, and reducing the ability of investors to access diversified asset portfolios, which as the Central Bank acknowledges plays "a key role in channelling savings into long-term investments".

Separately, Paragraph 22 (a) of the ESMA Leverage Guidelines requires competent authorities to consider the proportionality of the leverage limits to the systemic risk posed by the use of leverage by the AIFM. In considering such proportionality, we note that the reduction of IRR is likely to result in (i) an immediate reduction of new investment in Property Funds and (ii) a medium term divestment from Property Funds and consequently from Irish CRE (see "(c) Potential fire-sale of property held by Property Funds" below). This will mean that the "valuable and sustainable source of funding for economic activity" referenced by the Central Bank, and which has a direct impact on building activity and the provision of new real estate in Ireland, will be significantly diminished.

(b) Breach of Loan Covenants

It is a fundamental covenant in any lending arrangement that the relevant Property Fund will remain in compliance at all times with regulatory requirements, including, of course, compliance with any investment or leverage restrictions imposed by regulators. It is also most common for such lending arrangements to include a provision that the entry into, and performance of, the transactions anticipated by the lending arrangement (that is, the purchase of real estate) "do not and will not conflict with any law or regulation applicable to it"�.

An imposition of a 50% leverage limit, even with a period of three years in which to implement the new limit, risks an immediate breach

of covenant for those Property Funds who have entered into a standard covenant not to enter into a transaction which "will" in the future conflict with a law or regulation applicable to it.

Property Funds with existing loans in place, and whose IRRs and value for money assessments have been predicated on existing agreed leverage limits, will, in such circumstances be forced to deleverage in order to avoid a breach of covenant of the loan agreement. Such deleveraging will necessitate either (a) a call of capital from Shareholders, or (b) a sale of Property Fund assets.

With regard to the ability to call capital from Shareholders, most Property Funds will, at the initial fund raising for the Property Fund, seek a commitment of capital from Shareholders at a level in or about the anticipated purchase price of the assets, together with initial costs. Once such commitment has been drawn down, or contributed from the Shareholder, the Property Fund has no further contractual right to request additional injection of capital from the Shareholder.

Separately, it is likely that for Property Funds which have very recently purchased an asset, they will not have capacity to call additional capital from Shareholders (where those Shareholders' commitments have been fully drawn down). In addition, the value of the real estate will not have increased in this period, nor will have repayments been made on the loan meaning that the LTV will not have reduced. This may result in the forced sale of real estate assets to avoid a breach of regulatory obligation and breach of loan covenant. We have discussed this further in the next paragraph "(c) Potential fire-sale of property held by Property Funds".

(c) Potential fire-sale of property held by Property Funds

In a paper titled "Current considerations for Irish Property Funds" published by the Central Bank in February 2021 in its Financial Stability Notes 'February 2021 Paper"), the Central Bank explains that higher levels of leverage increase the risk of a Property Fund breaching its loan covenants which it notes may result in the Property Fund being "forced to sell property assets, causing further price falls".

Whilst this point is acknowledged, this risk of forced sale will apply equally to all borrowers in the CRE and other real estate markets. For this reason, applying a leverage limit to one category of borrowers,

namely Property Funds, but not to all borrowers at the same time is unlikely to affect in any meaningful way the level of leverage actually acquired by real estate investors and thus the risk of breach of loan covenants and forced sale of CRE. This is because where one avenue of financing an investment is deemed not appropriate for an investor due to regulatory requirements, it remains open to that investor to re-structure the acquisition vehicle to an entity falling outside of the regulatory remit of the leverage limit, and acquire such real estate, and borrow on same, through a non-Property Fund vehicle. We have discussed this in "(d) Move Away From Property Funds to Access Irish CRE" below.

Paragraph 21 of the ESMA Leverage Guidelines requires competent authorities to take into account their effectiveness in "addressing the risk of market impact, fire sales, spill-overs to financial counterparties, and disruptions of credit intermediation to ensure that the sector remains able to provide valuable services to the economy".

In fact, in the view of those who provided their feedback to us, the introduction of the proposed 50 per cent total loan to total asset ratio has the risk of resulting in the forced sale of property in response to the rule change for the following reasons:

(i) Existing Property Funds with leverage in excess of 50 per cent will be required to inject capital into the fund in order to reduce leverage within the implementation timeframe. Most such Property Funds obtain Shareholder investment by way of contractual capital commitment by an investor to invest a maximum amount in such Property Fund. Such maximum amount is generally agreed with investors before the launch of the Property Fund, reflecting the anticipated purchase payment for the real estate in question, with an additional buffer for expenses. For those Property Funds already in place, such contractual capital commitment will largely have been drawn down from investors, and those Property Funds are unlikely to have any contractual right to request additional investment from Shareholders.

Our respondents have universally stated that their investors would be very reluctant to contribute additional capital, given that the investors' investment in the Property Fund will have initially been approved by those investors based on the initial IRR target of such

Property Fund, and any such additional investment will create a reduction in such IRR (see above "(b) Impact on Property Fund Internal Rate of Return"). In the absence of agreement from Shareholders to provide additional funding to the Property Fund, the only method of reducing leverage in such Property Fund will be the sale of assets of that Property Fund.

(ii) Many lending agreements governing leverage limits for Property Funds will be put into automatic breach by the possibility of future breach of regulatory limit and existing Property Funds will be forced to sell assets in order to address this breach (see (b) "Breach of Loan Covenants" above).

(iii) Prudent management will anticipate a proportion of Property Funds leaving the CRE market at the end of the proposed 3 year transition period, and therefore lead Property Funds to seek to enter the sales market early to avoid a congested market.

(d) Move Away from Property Funds to Access Irish CRE

In responses received by us from our clients and other contributors to this paper, we have had consistent feedback that the imposition of the Proposed Leverage Limits put forward by the Central Bank in the Consultation Paper will reduce significantly the attractiveness of the Irish QIAIF as a vehicle to be used to acquire Irish real estate.

As described in further detail above in "(a) Impact on Property Fund Internal Rate of Return", above, the negative impact of any lowering of leverage limits for Property Funds is likely to counterbalance any existing positive impact on the IRR of a CRE investment using a Property Fund.

Fund promoters that in such circumstances their alternatives to acquiring Irish CRE will include:

(a) Use of an unregulated Irish entity not being an AIF;

(b) Using a non-Irish AIF, including a Luxembourg or Cayman Islands AIF; or

(c) Chose alternative (non-Irish) real estate investment.

Where (a) or (b) are chosen, the relevant investment vehicle investing in Irish CRE will not be regulated by the Central Bank. As a result of this, the Central Bank will not have any oversight on acquisition by such investors of Irish CRE. Further, it will not receive any information on leverage within those vehicles which would otherwise be available to it if such investments were housed in an Irish QIAIF and managed by an Irish AIFM as a result of quarterly/bi-annual/annual reporting on leverage levels required to be reported to it under Regulation 25 of the AIFM Regulations and Article 110 of Commission Delegated Regulation (EU) No 231/2013. Furthermore, the Central Bank would no longer receive the information disclosed via the annual financial statements of the relevant vehicle which must be filed by any Irish AIFM in respect of each EU AIF it manages with the Central Bank under Regulation 23 of the AIFM Regulations.

This lack of information will restrict the ability of the Central Bank to monitor the vulnerabilities of the Irish CRE market held by investors in unregulated vehicles or non-Irish domiciled property funds and provides it with no ability to intervene in order to manage the impact of any such market shock on the broader economy. The Central Bank itself has noted that any such move to unregulated vehicles or non-Irish domiciled property funds could "have implications for regulatory effectiveness". We note in this regard that paragraph 22 of the ESMA Leverage Guidelines require competent authorities, in evaluating efficiency of leverage limits in mitigating excessive leverage, to take care to avoid "the situation where an AIFM would declare a different type of AIF to avoid leverage limits".

As noted above, universal feedback received from clients and contributors is that the imposition of Proposed Leverage Limits on Property Funds will have the effect either of a move of investors from a Property Fund to an unregulated vehicle, or the removal of a proportion of investment capital from the Irish CRE market.

Finally on this point, we note that one of the policy considerations taken into account by the Central Bank when finalising the Consultation Paper is to "avoid the possibility for regulatory arbitrage" and that "including loans from affiliated parties and shareholders reduces the options for increasing leverage via unregulated affiliated entities". We would point out, in respect of this concern, that Property Funds are often established on a "per deal"

basis, such that, in order to ring fence a real estate asset from liabilities incurred in respect of a separate real estate asset, a Property Fund will invariably hold only one property investment. Where a Property Fund promoter has identified a new real estate asset for investment it will usually set up a new Property Fund to house this, rather than using a single Property Fund for multiple real estate investments (which would, if used, drive down establishment costs and generate economies of sale). Given that a new vehicle (being a sub-fund) is often used for each new real estate acquisition, where there is a perceived regulatory disadvantage to using a Property Fund to acquire an asset, it will be open to the Fund promoter to use a structure other than a Property Fund to purchase that asset at a similar establishment cost to the creation of a new sub-fund within an existing umbrella. The use of such alternative vehicles will, as noted elsewhere in this submission, reduce the oversight of the Central Bank of such investors in the Irish CRE market.

(f) Interconnectedness with Irish banks' exposure to CRE

The Central Bank cites its concerns around an unexpected disruption in the CRE market causing adverse consequences for the broader financial system and the economy as a whole. In particular, the Consultation Paper notes that "a dislocation in the CRE market that drives prices below fundamentals could impair the ability of CRE borrowers to service their debts and lead to losses for lenders, impairing their own capital positions, and ultimately, resulting in a reduced supply of credit to the economy. While Irish banks' exposures to CRE have reduced significantly since the global financial crises, this remains a source of risk."

The Central Bank also notes that "a dislocation in the CRE market that drives collateral values below fundamentals could result in companies finding it more difficult to access finance" and that "a dislocation such as this could have broader adverse macro-financial implications for investment, employment and growth".

According to the February 2021 Paper , the debt generated by Irish Property Funds was spread across Irish retail banks (27%), other banks (being Irish non-retail and foreign) (26%), shareholder & affiliated parties (38%) , life assurance & insurance corporations (7%) and other third parties (3%).

Given the relatively low percentage of debt provided by Irish retail banks to fund the acquisition of property by Property Funds, the imposition of the Proposed Leverage Limits in our view represents a disproportionate measure. Separately, as discussed in additional detail in "(d) Move Away from Property Funds to Access Irish CRE" above, a limit imposed on Property Funds will not necessarily have a material, if any, impact on lending to the CRE market. Instead, as has been suggested to us by those who provided their feedback to us, the imposition of the Proposed Leverage Limit to Property Funds only would have the effect of either movement away from the use of Property Funds by real estate investors, or movement away from investment in Irish CRE.

(g) Impact of Re-setting of Leverage Limits on Lenders

As discussed in further detail above in "(a) Impact on Property Fund Internal Rate of Return", actual leverage limits are negotiated on a case by case basis between the parties to a loan.

Irish lenders, who are subject to prudential regulation on the levels of risk they may hold and leverage that they can offer to clients, are in a position to offer loans on the basis of their existing balance sheets, which in turn are based in part on expected repayment schedules of existing loans.

Any change in leverage limits on a loan will impact the pricing of that loan, the interest rates charged and the expected income of the lender. A reduction of leverage limits over a three-year period on large borrowers of any lender will have a significant impact on the pricing of those loans.

Such impacts will necessitate lenders either:

(a) agreeing to agree to a lower rate of income to the Lender from interest payable on a number of loans to large borrowers at the same time (namely within the three year implementation period mooted by the Central Bank), which will have a negative affect on that Lender's balance sheet; or

(b) revisiting the pricing of those loans for the Property Funds in order to address shortfall in predicted income, further impacting the IRRs of those Property Funds discussed in further detail above in "(a) Impact on Property Fund Internal Rate of Return".

Do you consider three years to be a sufficient amount of time to undertake any deleveraging in a gradual and orderly manner to meet the leverage limit as proposed, without the need to sell property assets over a short period of time? If not, what would an alternative transition timeframe be? Please explain why you have suggested this alternative length of time.

Response:
To allow for the prudent management of any deleveraging of Property Funds, the Central Bank has proposed a transitional timeframe of 3 years for existing Property Funds to comply with the Proposed Leverage Limits.

In the view of those who provided their feedback to us, although any new leverage limit should be avoided, a transitional timeframe will ameliorate slightly, but will not prevent, the sale of property in response to the rule change for the following reasons:

(i) Many lending agreements governing leverage limits for Property Funds will be put into automatic breach by the possibility of future breach of regulatory limit (see (b) "Breach of Loan Covenants" above).

As a result, prudential management of disposal of assets would dictate that where equity contributions from existing shareholders in the relevant Property Fund and renegotiation with lenders is not possible, the assets may need to be put to market in the near term to avoid a breach of the Proposed Leverage Limits.

(ii) Prudent management will anticipate a proportion of Property Funds leaving the CRE market at the end of the 3 year period, and therefore lead Property Funds to seek to enter the sales market early to avoid a congested market in three years.

Given that property funds accounted for over 40 per cent of the estimated stock of "investable" real estate at the end of 2020 , it is likely that a large number of assets in the CRE market coming to market at the same time to allow completed sales in advance of the expiry of the 3 year transition period will drive the prices of CRE property below fundamental values.

Similarly, any forced sale of CRE assets in order to comply with the Proposed Leverage Limits is also likely to have an adverse effect on the Irish construction sector, being one of the areas of concern identified by the Central Bank in the Consultation Paper.

Do you consider the proposed approach to adjusting the leverage limit in response either to large, unanticipated adverse price shocks and/or significant overheating to be appropriate? If not, what do you see as a better alternative approach to adjusting the leverage limit to reflect cyclical risk developments in the Irish CRE market?

Response:
For the reasons that are set out most particularly in response to Question 4 above, we do not agree with the imposition of a regulatory limit of 50% leverage on Property Funds.

However, we note the fundamental importance of central banks and financial regulators and their ability to respond robustly in unanticipated market circumstances and support the continuing role of the Central Bank in this regard. We submit however, that in any market shock, to prevent large scale default, we would anticipate that what may be required would be an extension, rather than shortening, of any leverage limits applicable to market participants in the short term.

Separately, please see below our response to Question 13 "(a) Fund Manager Concern on Regulatory Policy Changes and Predictability and Stability of Irish Financial Products" in respect of any perceived changes to regulatory policy that may arise from this position.

Do you agree with the use of Guidance on liquidity timeframes (with a focus on longer notification periods) to reduce liquidity mismatch in property funds? If not, how would you propose to reduce liquidity mismatch in property funds?

Response:
We agree with the use of Guidance on liquidity timeframes (with a

focus on longer notification periods) to reduce liquidity mismatch in property funds and note that those who provided their feedback to us are in agreement that liquidity timeframes in Funds must align with exit strategies from real estate assets.

Do you agree that 12 months is an appropriate liquidity timeframe (notification period plus settlement period) for property funds, to ensure that a sufficient timeframe is available to meet unexpected redemptions without requiring forced sales, even under conditions of collective market stress? If not, how long of a liquidity timeframe period do you think would be sufficient to reduce liquidity mismatch, even under conditions of collective market stress?

Response:
We agree with the proposed liquidity timeframe, though stress that an early repayment of proceeds to investors should be at the Property Fund Board discretion to allow for best practice in any early completion of asset sales.

In addition to the analysis provided in Consultation Paper 145, what potential unintended consequences do you see from the proposed measures, and how could these be mitigated?

Response:
Please note our responses, in particular to Question 4, above.

Additional data in support of any of your responses to the previous questions.

Response:

Summary - change in LTV from 60% to 50%	
Reduction in IRR	-1.95%
Purchase price adjustment needed	(€2,192,220)
% purchase price adjustment	-4.38%
Implied purchase yield	4.46%

Example Portfolio 60% LTV	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Day 1 Asset Purchase (4.25% yield)	€50,000,000					
Shareholder Investment	€20,000,000					
Bank Loan (60%)	€30,000,000					
Asset Purchase Contribution	(€20,000,000)					
Acquisition Costs (incl stamp duty)	(€2,230,000)					
Asset Sales Price (4.0% yield)						€53,921,875
Sales Costs						(€2,404,916)
Rental Income (assume 1.5% growth)		€2,724,359	€2,765,224	€2,806,703	€2,848,803	€2,891,535
Opex (22%)		(€599,359)	(€608,349)	(€617,475)	(€626,737)	(€636,138)
NOI		€2,125,000	€2,156,875	€2,189,228	€2,222,067	€2,255,398
Add:						
ICAV Running Costs		(€250,000)	(€250,000)	(€250,000)	(€250,000)	(€250,000)
Financing Costs	(€375,000)					
Bank Interest (2.25% Margin)		(€675,000)	(€675,000)	(€675,000)	(€675,000)	(€675,000)
Repayment of Bank Loan						(€30,000,000)
	(€22,605,000)	€3,325,000	€3,388,750	€3,453,456	€3,519,133	€25,102,754
IRR	14.48%					

Example Portfolio 50% LTV	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Day 1 Asset Purchase (4.25% yield)	€50,000,000					
Shareholder Investment	€25,000,000					
Bank Loan (50%)	€25,000,000					
Asset Purchase Contribution	(€25,000,000)					
Acquisition Costs (incl stamp duty)	(€2,230,000)					
Asset Sales Price (4.0% yield)						€53,921,875
Sales Costs						(€2,404,916)
Rental Income (assume 1.5% growth)		€2,724,359	€2,765,224	€2,806,703	€2,848,803	€2,891,535
Opex (22%)		(€599,359)	(€608,349)	(€617,475)	(€626,737)	(€636,138)
NOI		€2,125,000	€2,156,875	€2,189,228	€2,222,067	€2,255,398
Add:						
ICAV Running Costs		(€250,000)	(€250,000)	(€250,000)	(€250,000)	(€250,000)
Financing Costs	(€325,000)					
Bank Interest (2.0% Margin)		(€500,000)	(€500,000)	(€500,000)	(€500,000)	(€500,000)
Repayment of Bank Loan						(€25,000,000)
	(€27,555,000)	€3,500,000	€3,563,750	€3,628,456	€3,694,133	€30,277,754
IRR	12.53%					

If you have any further thoughts or considerations on the proposals outlined in Consultation Paper 145, please share them below.

(a) Fund Manager Concern on Regulatory Policy Changes and Predictability and Stability of Irish Financial Products

In the Consultation Paper, the Central Bank proposes that it will have the ability to tighten or loosen Proposed Leverage Limits in certain circumstances. It also provides that it may impose individual interim limits on certain Property Funds in one or more years of the transition period in order to ensure that "all property funds are deleveraging gradually and appropriately".

As we note above in our response to Question 6, the ability of regulators and central banks to respond to unforeseen financial crises is fundamental to shoring up financial stability in any market and we agree that this is a key function of regulators and policy makers. However, feedback received on this proposal has indicated a wariness from fund promoters around a perceived level of regulatory uncertainty for Irish Funds.

Respondents have pointed to change to Property Fund policy that have been introduced in the recent past without stakeholder engagement, such as Revenue changes to taxation of shareholder loans in Property Funds and Central Bank near-prohibition on shareholder loans introduced simultaneously to this change. Respondents have stated that these types of changes are perceived as markers of regulatory uncertainty and have cited perceived regulatory uncertainty as a reason not to structure future products in Ireland.

We would request therefore, that any correspondence with industry around Central Bank intervention on prevailing rules should clarify that such intervention would only take place in the context of genuine market shocks and not provide to the Central Bank an unfettered right of market intervention for the purposes of implementing policy changes.

(b) Central Bank Proposal to Move the Leverage Limit to Lenders

We note that an alternative approach mooted by the Central Bank in the Consultation Paper to increase the resilience of Property Funds is to seek to limit investment fund leverage through limits imposed on lenders. We agree that the effect of this will have limited effect as the Central Bank's reach on this point will extend to Irish regulated lenders only which, based on information contained in the February 2021 Paper, accounts only for 27% of lending arrangements entered into by Property Funds .

(c) Frequency on Valuation Requirements for Property Funds

We note certain industry discussion and concern with reference to the statement that "the leverage limit would be subject to regular monitoring and review by the Central Bank" and that the Central Bank would have the option to tighten the leverage limit if there "was significant emerging evidence of price alignments". See, for example: https://www.irishtimes.com/business/commercial-property/central-bank-must-tread-carefully-on-leverage-rules-1.4802751 , which raises the question "This begs the question as to how the valuation process will be enforced and how often it will be required".

CP 145 notes that "as part of the regular annual assessment of funds, the use of leverage by property funds would be determined based on their regularly reported asset and liability values. Consistent with ESMA guidelines, those property funds with levels of leverage close to, or above the limit would be issued with a leverage limit pursuant to Article 25 of the AIFMD (Regulation 26 of the Irish AIFM Regulations)."

For the avoidance of any doubt on this point therefore, we would welcome clarification from the Central Bank that the provisions of Article 24(1) of the AIFMD, with regard to "regular reporting"� of certain information, including (pursuant to Article 110 of Commission Delegated Regulation (EU) No 231/2013)) the provision of information on the leverage of each AIF, are not affected with respect to the proposals outlined in CP145.

That is, we anticipate that the frequency of such reporting will depend on the criteria laid down by the legislation and that, as is currently the case, and consistent with this framework, Irish CRE held by Irish Property Funds is valued on an annual basis unless otherwise required under AIFMD. For the purposes of reporting leverage figures as required under Article 110 of the Commission Delegated Regulation, Irish CRE such leverage is calculated using the most recent annual valuation.

(d) Central Bank Finding on Average of 46% LTV

We note the Central Bank's finding of an average of 46% LTV in loans across Property Funds, and we respectfully query whether this figure has been calculated using the LTV of each of the loans surveyed at date of first draw-down date, or whether loans being managed and

paid down over time have been included in this review, thereby including functioning loans which will have started at a high LTV but which LTV has reduced through repayment and increase in CRE values.

(e) Differentiation Between Internal and External Debt

Dillon Eustace LLP has also received feedback on the Central Bank's inclusion of internal debt (including Shareholder loans) in the calculation of leverage exposure for a Property Fund with a request that the Central Bank should exclude such internal debt from the Proposed Leverage Limits outlined in CP145.

We note the Central Bank's position on Shareholder loans as set out in the Central Bank's Alternative Investment Fund Managers' Directive (AIFMD) Q&A (ID 1141 and 1142. However, one proposal put forward to us is that in circumstances where a leverage limit is close to being breached, which breach could result in breach of covenant with third party lenders, or necessitate the fire sale of real estate assets, Shareholder loans should be both permissible and deemed to be outside of the Proposed Leverage Limits outlined in CP145. Based on feedback received, such flexibility would afford Property Funds the opportunity to raise funds where other avenues (such as additional bank finance) are not available to them.

(f) Definition Of Commercial Real Estate

We note that Commercial Real Estate, or CRE, is defined by reference to the ESRB definition which excludes social housing. Please confirm that Property Funds which develop social housing to sell or hold and rent, and Property Funds which buy and let social housing, in both cases to local authorities/approved housing bodies, are out of scope of the proposals outlined in CP145.

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