Banc Ceannais na hÉireann
Central Bank of Ireland
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Macroprudential Policy for the Property Fund Sector – Consultation Paper 145

Feedback from Henderson Park Advisors Ireland

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:
Henderson Park 'HP" totally disagree with a blanket leverage limit and have a number of significant concerns about the proposal. We have listed our main concerns below and will look to expand on these later on in the submission.

1) The proposal seeks to impose the same restrictions on all property funds without any consideration for the characteristics of those funds or the ownership structure in place.

Investors in retail property funds will have a very different risk appetite to institutional investors and cannot be expected to have the same level of knowledge and expertise, we therefore totally disagree with treating both retail funds and institutional investors on the same footing when it comes to policies such as these. HP have a significant risk management team whose sole focus is to assess the correct levels of risk for our overall funds and for each transaction entered into by one of HP's funds. One of the key parts of the risk management strategy is the leverage that is entered into for each transaction and the level chosen is only done so after a full risk assessment on each deal. HP appreciate that retail investors could not undertake the same level of risk assessment given their resources and given they must rely on third parties to manage the properties and risk for them. Due to this imbalance in knowledge and expertise we completely disagree that the same level of leverage limit should be imposed on institutional investors and retail investors.

A dual approach can be seen in Germany who recently introduced legislation (Fund Jurisdiction Act) where if the AIF management company directly or indirectly holds 100 percent of the capital and voting rights of the fund, they are exempt from leverage limits versus all other funds who have a leverage limit of 60% LTV.

2) Existing funds and loans should be excluded from any proposed leverage limit.

The proposal does not take any heed that a number of existing funds may have fully deployed all or substantial all of their equity (or have the remainder reserved for development projects). The imposition of leverage limits on funds of this type will either force the fund to move into the unregulated space or will force sales of property which the CBI have stated is something they are looking to protect against.

3) New institutional investments in the Irish property market will likely avoid the regulated space should the leverage limit be put in place.

The Irish market has seen many new international institutional investors (HP among them) in the last decade with many of those investors choosing the regulated space to place their investment. A number of these would be sophisticated investors who would use leverage as a tool to enhance returns and should the leverage limit proposal be introduced these investors would be faced with the option of choosing different jurisdictions to hold their property investment such as Luxembourg or to invest via unregulated entities to achieve the leverage levels they require for their investment models. This will lead to a diminished portion of the overall market being regulated and will lead to sub sections of the property market that will have vastly different characteristics and will most likely limit the usefulness of any information that will be available to the CBI as it will only reflect a smaller portion of the overall market.

4) The imposition of a leverage limit that can be tested multiple time at different points would lead to the majority of entities having to impose a leverage limit substantially lower than the threshold proposed by the CBI.

If the LTV test can be imposed at various different point over the ownership period of the asset, entities would have to protect against a fall in value of the property and would have to leave enough of a buffer to the CBI's leverage limit in order to avoid triggering the leverage limit should a fall in property values occur. A strict adherence to the limit could force a number of entities into the sale of assets should prices fall sufficiently to trigger the leverage limit, this is contrary to the CBI's position where they state that they are looking to protect against such incidences.

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:
HP believe the proposed definition only looks at entities in the regulated space which the CBI can govern and as stated above should the leverage limit be imposed on these entities it will force many investors to look at the structure they invest through and will most likely see a number of entities move out of the regulated space.

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:
HP do not believe a single leverage limit across all types of property holding makes any sense. It does not take into account the different characteristics of each type of property holding e.g. a development on an undeveloped site in no way shares any risk characteristics with a fully let city centre office block or indeed a shopping centre. Once again we believe the one size fits all proposal is extremely blunt and does not factor in any proper risk assessment for the underlying property.

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:
As stated in Question 1, HP believe that should a leverage limit be imposed it should be reflective of the type of property fund rather than including a "one size fits all"� policy. HP believe that retail funds have a different risk profile to the overall market than funds backed by institutional investors whose business is to invest in the property sector.

HP also believe that the 50% limit is too low in comparison to the normal levels of debt provided by senior debt finance in Ireland. This is also at odds with the evidence that is most recently coming out of Europe. Germany, who is quoted in the CBI's consultation paper have recently moved their leverage limits from 50% up to 60% and have removed the leverage limit for certain types of funds to reflect the knowledge and sophistication of the investors behind those property funds.

As also stated in Question 1 an imposition of a 50% limit will force certain types of investors to disregard the regulated space and look at the option of investing through a vehicle held in a different jurisdiction or through an unregulated entity. The imposition of a 50% limit could also lead some investors to not enter the Irish market and HP believes that fewer participants in the overall market will have an overall detrimental effect on the market.

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:
HP do not believe that a three year time frame is a sufficient time frame to undertake deleveraging in an orderly manner and does not take into account that some existing funds will have fully deployed their equity or have any remaining equity ring fenced for existing projects. The transition period and in particular the ability of the CBI to impose "individual interim limits"� will force funds into sales and could possibly force funds into rushed sales that will have adverse consequences for those funds as a result.

HP believe that all existing funds should be grandfathered and as such no period of transition is appropriate as forcing existing funds to adhere to the new limits over any time period would fundamentally change the investment that was entered into on creation of the funds.

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:
HP believe that the proposed approach of implementing a leverage limit that can be tested over time to be very blunt and should an unanticipated adverse price shock occur it could lead to numerous breach of the limit and if the limit is then stringently adhered to, this would lead to potential further mass selling of property which is against the stated aim of the CBI in CP 145 where sales of assets into a market that has suffered an unanticipated adverse price shock will further exacerbate the problem of the adverse price shock.

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:
HP do not have an opinion on the liquidity timeframe measures.

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:
HP do not have an opinion on the liquidity timeframe measures.

Do you have any additional evidence on the time it takes to sell property assets in Ireland, both in normal market conditions and in times of stress?

Response:
HP do not have an opinion on the liquidity timeframe measures.

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:
As outlined in the responses to other queries in the submission HP believe that there are a number of unintended consequences from the proposed leverage limit i.e.:

- Force international capital to look at alternative investment vehicles either in other jurisdictions such as Luxembourg or in vehicles that are not regulated and subject to the leverage limit.

- Lead to certain investors excluding Ireland as a destination to invest and thereby reducing the overall pool of capital within the market.
- The potential for a large sell off of property should an adverse price shock occur with numerous funds triggering the leverage limit at the one time thereby exacerbating the adverse price shock.

From HP's point of view, should a leverage limit be imposed even with an extended transition period, HP will have to look at what alternative structures we could move our assets to as our investment model would not stack up without having access to leverage that would likely be above any limit set. This would lead to the assets in our two vehicles being moved out of the regulated sphere.

Any new investment on our part in Ireland would also have to be considered and would most likely not be undertaken in the current structure as it would no longer be a viable model for us.

HP believe that we will not be the only property fund that will take this view and should the proposal be introduced we believe that the level of CRE that will remain in regulated ownership will be severely diminished.

If there are any significant operational difficulties envisaged by AIFMs in complying with leverage limits imposed via Article 25, please provide brief details, including any possible solutions if appropriate.

Response:

If there are any significant operational difficulties envisaged by AIFMs in complying with the draft guidance (Annex 1 of CP 145), please provide brief details, including any possible solutions if appropriate.

Response:

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

Response:

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

Our points are all discussed above.

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