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

Feedback from Irish Funds

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:
Our members have expressed concerns with the proposals to limit leverage in regulated Irish property funds and have also identified some weaknesses with the proposed guidance on liquidity.

Fundamentally, we do not believe that focusing on Irish property funds (one channel for investment into the Irish CRE market) can achieve any true resilience of such sector, or protect it from shocks, when the likely result of imposing restrictive measures on only one investment channel will be to drive investment either to other, unregulated and therefore uncontrolled structures, or to drive capital, the vast majority of which is international institutional (and therefore mobile) capital from the sector altogether.

Further, the proposal to apply new restriction retrospectively to existing structures has the potential to be extremely damaging not only to those structures and their investors, but also to the reputation of the jurisdiction and the consultation paper does not contain any suggestion as to how existing funds, many of which have passed final closings, should raise additional capital, which would suggest that a series of forced asset sales would be expected to achieve the stated objective.

We believe that a significant source of resilience in the Irish commercial real estate market since the financial crisis has been the very diverse participation of international and institutional investors and lenders in this market. We believe that the proposed leverage restrictions in particular will increase the cost of capital as supply of debt will decrease and the margin on debt which lenders seek will increase.

In addition, the uncertainty caused by a leverage limit which could be periodically tested and even altered will lead to a degree of uncertainty that many investors will be unable to tolerate. Long term investors investing in real estate traditionally commit a fixed amount of capital upfront and do not reinvest in the same fund or project over its life as that's not the nature of such investments. However, for a fund to operate under conditions where a limit has been imposed (as well as the potential that it can be altered over the life of the fund) and to remain viable without forced asset sales, such funds would have to have the ability to draw further capital from investors. From the investor's perspective, the uncertainty associated with the potential to have to make additional follow-on investments (of uncertain size, timing and duration) and timing is unattractive.

Our members are concerned that the proposal does not take into account the fact that the Irish real estate market is considerably broader than the property fund sector impacted by the proposals. It is therefore unavoidable that a regulatory leverage limit creates a risk of regulatory arbitrage as investors seek other legitimate means to achieve their market and investment aims. By restricting leverage in the most regulated part of the market we are concerned that the effect will be to encourage higher leverage transactions and strategies into unregulated, and therefore unreported, monitored or controlled sectors of the market.

For these reasons and as set out in further detail in our response to the consultation questions, we believe that considerable further thought and revision would be required in respect of the proposals and that as currently drafted they are more likely to have a detrimental impact of the Irish CRE market than to protect it.

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:
As a general observation, the question assumes that "property fund" owners of Irish CRE will continue to be structured as Irish authorised AIFs and that the macroprudential measures will have the influence the Central Bank desires as set out in the Consultation Paper. As we outline elsewhere in our responses, we believe that the nature of the proposed measures and its application to already existing Irish authorised AIFs are such that they will be viewed very negatively by market participants and investors and that other structures (over which the Central Bank shall have no transparency or regulatory reach) will be utilised for a significant proportion of future and existing "property fund" ownership of Irish CRE.

Notwithstanding that view, we had the following observations on the definition of "property funds" to include "all AIFs that are domiciled in Ireland, authorised under domestic legislation, and investing over 50 per cent directly or indirectly in Irish CRE":

(a) Clarity required on whether only authorised AIFs investing in the Irish commercial real estate sector are captured

The Consultation Paper appears to be primarily concerned with the Irish commercial real estate and "CRE" is defined by reference to the ESRB definition which excludes social housing and residential real estate owned privately but being let to tenants. The definition is stated as including residential property owned by institutions such as funds for income-producing properties.

Our first observation is that within the Consultation Paper, although it is implied, it is not wholly clear whether the macroprudential measures are only to apply to funds investing (directly or indirectly) over 50% in Irish "CRE" – terms are sometimes used interchangeably at various points e.g. reference to funds with exposure to "Irish property assets" with no distinction for Irish CRE (see top of page 14). A little more certainty that this is the case would be welcomed.

Assuming that the measures are only to apply to Irish CRE funds (for which, as noted, we believe greater clarity is necessary), we also believe the "CRE" definition requires much more clarity. For example, do funds with Irish CRE exposure include/exclude funds with an investment strategy to develop or hold social housing? Further, do "in-scope" funds include Irish AIFs whose sole purpose is to develop residential housing and take to sale to the private market (i.e. not income producing). Given the range of strategies implemented by Irish AIFs, it will be necessary to be much more granular with respect to which strategies are captured by the measures and which are not.

(b) Clarity required on the meaning of "indirect"

We see significant risk in applying a "hard" regulatory leverage limitation (to which Irish authorised AIFs would be subject to regulatory sanction for breaching) without very specific definition on what constitutes an "indirect" exposure. We believe achieving a common understanding on what constitutes "indirect"will be very challenging given the number of different fact patterns that may apply to each Irish authorised AIF and its identified investments.

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:
Given the diversity in the investment strategies pursued by Irish Property Funds on behalf of their investors we think that a single leverage limit, irrespective of the type of property holdings is not appropriate as it may have the unintended consequence of disincentivizing certain categories of real estate investors from investing in certain categories of real estate assets or lead to a concentration of investment in a small number of sub-categories of real estate assets reducing the level of diversification in the market and increasing the level of concentration risk.

In the CP145 consultation document the Central Bank recognises that there is significant diversity in portfolio composition and investment strategies across property funds. The real estate industry invests in, develops, maintains, and supports the real estate assets that constitute the built environment infrastructure that is an essential element of Irish economic, business, and social life. It includes activities such as development; construction; maintenance, repair, and refurbishment of real estate assets.

Since the economic shock of 2007/2008, institutional capital has become a much more significant component of the Irish real estate market. These institutional investors include both domestic and international banks, pension funds, insurance companies, specialist private equity firms and Real Estate Investment Trusts (REITS).

The real estate market is not a homogenous market. Each sub-sector has different characteristics which make it more or less attractive to the different categories of institutional investors over time. To illustrate this point the attached chart from CASS Business School Commercial Real Estate Lending Report 2020 which covers the period 2015 to 2020 shows that the Loan to Value (LTV) has fluctuated both across the different categories of commercial real estate and also over time.

Given the diversity in the investment strategies pursued by Irish Property Funds on behalf of their investors we think that a single leverage limit, irrespective of the type of property holdings is not appropriate as it may have the unintended consequence of disincentivizing certain categories of real estate investors from investing in certain categories of real estate assets or lead to a concentration of investment in a small number of sub-categories of real estate assets reducing the level of diversification in the market and increasing the level of concentration risk.

In thinking about how one might differentiate and provide for different leverage limits, one means of doing so would be to allow a higher leverage limit for closed-ended funds as against open-ended property funds that offer limited liquidity.

A further distinction could be to carve out QIAIFs which have binding capital commitments that fully cover the amount borrowed, as the ability to draw down additional capital may address some concerns about funds being forced to sell assets or breach covenants.

Furthermore, the open ended with limited liquidity funds can leave redemptions and the timing of them to the Fund Board who can refuse or scale back as necessary, as this is a further protection, the introduction of notice limits for those funds would seem unnecessary.

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 50 per cent limit proposed. We do not consider that a leverage limit should be imposed for the reasons already outlined in this response. We would have concerns that introducing such a requirement in Ireland could significantly disadvantage Ireland both as a domicile within which to establish a property fund but could also discourage foreign investment in Irish property (as noted by the Central Bank in CP145, Irish property funds are primarily financed by foreign investors).

While we note that certain jurisdictions as referenced in CP145 have introduced leverage limits for property funds, it is also worth noting that Germany has now increased its leverage limit for spezialfonds to 60% as of August 2021. We also note that the UK's LTAF is referenced but our understanding is that while LTAFs may indeed be used for property assets in the future, the UK's Qualified Investor Scheme is more typically used for property assets and that type of fund has a leverage limit of 100%.

Our understanding is that while Luxembourg real estate funds which are subject to the IML/CSSF circular 91/75 (Regulated Part II UCI) have a 50% maximum leverage ratio, the SIF/SICAR and RAIF Laws have not imposed any leverage limits including for Real Estate funds. According to the Luxembourg Real Estate survey, the Part II UCIs subject to the above limit represent approximately 1% of the Lux market in 2021.

The proposed 50% limit does not reflect the market standard (as evidenced in the Central Bank's findings) which is generally between 55% and 65%. Accordingly, we would have a concern that imposing such a limit would limit the number and quality of lenders willing to engage in the Irish property market. Reducing the number of lenders could also have the effect of increasing the costs of any borrowing by an Irish property fund and ultimately its investors.

As noted in CP145, there is substantial heterogeneity in the portfolios of Irish property funds and accordingly introducing a leverage limit which applies regardless of the type of property held in the fund does not seem appropriate.

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:
We do not agree that leverage limits could be retrospectively applied to existing structures and as such are concerned that no period of transition is appropriate. Our members are concerned that the retrospective application of such a rule to existing structures, which have been established by managers and funded by Investors and lenders on a particular understanding, will prove to be unworkable without causing a market event which the Central Bank surely seeks to avoid.

In our member's experience, the majority of institutional Property Funds in existence today invest, on a concentrated basis, in large standing assets for a particular time horizon usually reflected in the closed ended term of the Fund. As such it is not anticipated that there will be further closings and investor's commitments are usually fully drawn, leaving these Fund structures with no further access to significant amounts of investor capital. Even Funds authorised as open ended with limited liquidity will often have no access to capital on demand. The original basis for these investments is therefore pre-set. A leverage limit of the type proposed would fundamentally alter the original basis for these investments.

Absent any source of capital to reduce leverage it is unclear how the Funds with leverage levels in excess of the new limit would raise capital to reduce that debt without forced sales. In addition, in more concentrated funds, entire holdings (one large office or apartment block) may have to be sold, effectively closing the fund prematurely.

Impacts from such forced sales will include, inter alia:

a) Triggering early debt repayment penalties at a direct cost to investors

b) Reduction in value achieved by virtue of the forced (rather than normal market) nature of the sale

c) Prejudice to investors by the forced early return of capital invested on the basis of their own investment decisions

d) Negative market pricing impacts caused by forced sales, amplified at the end of the three year period by the large number of sales that will be forced to occur at that time

On the basis of the explanations above, we do not understand how the proposal could be applied retrospectively without imposing significant negative impacts to both the Irish property market and to investors.

Finally, as a general principle, it should be noted that our members have significant concerns about the retrospective application of any new regulation which has such a significant impact on investment managers and investors. Regulatory and legal certainty are core principles upon which funds are established to enable capital to flow effectively. Removing this poses significant challenges for both investors deploying capital and those providing fund solutions.

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:
We do not consider the proposed approach to adjusting the leverage limit in response to price shocks and/or significant overheating to be appropriate. Lenders in this market are sophisticated and experienced when it comes to real estate lending and accordingly the terms of any loan agreement will already contain specific covenants and triggers in respect of the LTV or to measure the performance of the asset more generally. Where there is a market event or risk of overheating or a particular development, it is likely that action will already have been taken in accordance with the terms of the loan agreement and accordingly adjusting the leverage limit or relying on the Central Bank of Ireland to implement a change to permitted levels, could itself cause a market event.

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:
The financial stability and market integrity are key objectives of the AIFM Directive (2011/61/EU) (the'AIFMD'). The AIFMD introduced tools to improve macro-prudential monitoring and supervision of financial stability risks. AIFMs are required to report to supervisors on the main AIF exposures, their liquidity profile and leverage. Supervisory reporting has supported effective macro-prudential supervision and it is helpful for market monitoring.

The AIFMD has also created an effective supervisory cooperation network coordinated by the European Securities and Markets Authority '˜ESMA'), which is contributing to the convergence of supervisory approaches to the AIF activities in the European Union.

The AIFMD has become a significant pillar of the Capital Markets Union '˜CMU') thanks to the ability of investment funds to offer access to market-based sources of financing and to enable investors to better allocate their savings over the chosen time horizon in accordance with their preferences.

The European Commission has stated that regulatory fragmentation, where national frameworks are established to govern certain aspects of the market, can lead to difficulties in identifying and reacting effectively to potential market wide effects that may result from the activities of certain funds. Moreover, diverging national regulatory approaches undermine the establishment of an efficient internal market for AIFs by promoting regulatory arbitrage and varying levels of investor protection.

In November, 2021 the European Commission issued a proposal for an amending Directive to the AIFMD which contains measures regarding availability and use of Liquidity Management Tools '˜LMTs') during times of market stress. The possibility to activate LMTs can protect the value of investors' money, reduce liquidity pressure on the fund and mitigate against broader systemic risk implications in situations of market-wide stress.

In addition to being able to suspend redemptions, AIFMs will have to choose at least one other LMT from Annex V (which will be a harmonised list across the EU). AIFMs will need to notify competent authorities (NCAs) about their use of LMTs. The proposals also include the power for the competent authorities to require the activation or deactivation of an LMT. ESMA is to develop draft RTSs to provide definitions, and specify the characteristics, of the LMTs and guidance on selecting and using suitable LMTs.

We therefore believe that the liquidity measures being proposed in the amendments to the AIFMD should be sufficient to equip both Irish AIFMs and NCAs such as the Central Bank with the necessary tools to appropriately manage liquidity risk in Irish property funds in times of market stress.

Furthermore, the open ended with limited liquidity funds can leave redemptions and the timing of them to the Fund Board who can refuse or scale back as necessary, as this is a further protection, the introduction of notice limits for those funds would seem unnecessary.

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:
Around circa 60% of Real Estate funds launched in Ireland have been structured as closed-ended funds under the Qualified Investor Alternative Investment Fund (QIAIF) regime, whereby the investors are required to be sophisticated and/or professional investors in order to invest. The closed-ended funds, due to their nature, do not give rise to liquidity mis-match as redemption mechanisms are not a feature available to investors and therefore the closed-ended funds should be deemed out of scope for these purposes.

Of the remaining QIAIF's, whilst open-ended in nature with redemption capabilities, the funds' constitutional documents prescribe detailed limitations in the redemption notice and settlement timeframes specified to the qualified investors, due to the illiquid nature of the real estate assets and goes further by stating that redemptions are still ultimately at the discretion of the AIFM depending on the market conditions at that time.

As mentioned in our response to question 7, the Commission have recently published its legislative proposal for AIFMD2 (the "proposal"). One of the key takeaways from the proposal was liquidity risk management.

As anticipated, additional liquidity risk management provisions are proposed, including a list of liquidity risk management tools which national competent authorities must make available to AIFMs and from which AIFMs that manage open-ended AIFs must select at least one.

- The proposal introduces a new requirement for AIFs to be structured as closed-ended funds if the notional value of the loans that they originate exceeds 60% of their net asset value;

- The proposal also introduces new requirements for AIFMs that manage open-ended AIFs to select at least one appropriate liquidity management tool from the list set out in a new annex to AIFMD2 and to implement policies and procedures regarding the use of that tool; and

- The proposal confirms that AIFMs managing open-ended AIFs may, in the interests of investors, temporarily suspend the purchase or redemption of AIF units in exceptional circumstances.

Should Ireland take an action to overlay liquidity management requirements in addition to the AIFMD2 proposal detailed above and in particular, redemption periods, we run the real risk that fund managers may opt to structure their real estate funds in other European jurisdictions. This possible outcome would inhibit the Central Bank's ability to monitor the risks / activities being undertaken in respect of Irish real estate holdings by those funds.

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:

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:
Redemption Terms/liquidity timeframe

Whilst the analysis of the Central Bank with respect to redemption periods in the Consultation Paper is noted, feedback from our members is that most Irish authorised AIFs already impose realistic liquidity timeframes that are designed to reflect the nature of Irish CRE assets held and time required to realise assets to meet redemptions. It was observed that whilst the fund documentation for many Irish authorised AIFs reference the minimum settlement duration applicable to structures that are "open-ended with limited liquidity" in order to satisfy Central Bank authorisation requirements per its application forms, the documentation typically qualifies and extends that settlement period substantially. Accordingly, the view is that, in large part, the majority of Irish authorised AIFs investing in real estate already provide for redemption settlement periods in excess of six months.

Notwithstanding this, there is some concern about the imposition of a blanket 12 month liquidity timeframe on all Irish authorised AIFs qualifying as "property funds" in accordance with the guidance. Such concerns include the fact that the application of a 12 month liquidity timeframe obligation to all such Irish authorised AIFs (without exception) does not take into account the individual portfolios or other relevant circumstances that might apply to a particular property fund Irish authorised AIF. For example, more diverse portfolios with broader shareholder base can meet liquidity timeframes of much shorter period without, it is believed, having any impact on the overall market. It should be noted also that such Irish authorised AIFs may hold assets that are neither real estate nor real estate in Ireland and liquidity can be sourced by means unconnected to the Irish CRE market (including realising valid temporary liquid assets within the portfolio and/or utilising regular subscriptions received). It would appear that the proposed measures do not provide for any flexibility in this respect, requiring a 12 month liquidity timeframe even in circumstances where liquidity can be achieved without requiring sale of Irish CRE assets. It would, on the face of it, seem contrary to investor interests for a regulatory rule to lengthen the time investors can expect to receive return on their investment on a redemption request even in circumstances where the ability to settle is more readily available. It seems odd that Irish authorised AIFs would not be permitted to put in place arrangements unconnected to sale of Irish CRE assets that would provide for better liquidity for investors.

Leverage limit

We note that the Central Bank acknowledges "regulatory arbitrage"as an unintended consequence of introducing the macroprudential measures but that "this would not be a sufficient reason for not seeking to safeguard the resilience of this form of financing". However, we believe that the potential scale of this risk is not fully appreciated or given sufficient weight, particularly if the leverage limit measures remain as proposed.

Irish Funds is aware of a prevailing view (amongst various interested stakeholders including lenders, investors, AIF promoters and property developers) that the selected leverage limitation is unworkable within the Irish property market. Based on knowledge of financing arrangements over the past 5 years, most stakeholders believe that the significant majority of deals involving Irish authorised AIFs (and other structures) investing in Irish CRE involve leverage at a range of between 60% and 70%.

The proposed leverage limitation at 50% is viewed, therefore, as conservative and inconsistent with the practice and convention in the financing market (in Ireland and in other jurisdictions). Accordingly, a negative market reaction to the imposition of a proposed 50% leverage limit is likely and future and existing deal structuring will be influenced by such limit to a material degree (i.e. structures that will be outside the scope of the proposed measures will be preferred).

Feedback from members is that the comparison with the German property market (relied on heavily throughout the Consultation Paper) is not comparing "like-with-like" with each market having its own distinct features and history. It is worth noting also that members have queried the accuracy of the example provided within the Consultation Paper of German "spezialfonds" being subject to a 50% leverage limit – there is feedback that such leverage limit is at 60% and there are other nuances that are relevant when undertaking a comparison (e.g. additional temporary leverage of 30% is permitted) that mean the proposals within the Consultation Paper are viewed as being more conservative than the German example provided and there does not appear to be any other examples of other EU jurisdictions applying principles similar to those now proposed by the Central Bank. There is general concern, therefore, that rules imposed on Irish authorised AIFs are significantly more onerous than those imposed in any equivalent structure in other jurisdictions.

Potential impact of imposing a leverage limit at 50% (viewed as "off-market" as outlined above) might include the following:

(a) There is a significant risk that the leverage limit proposed will lead to market participants increasingly using "property fund"⍰ structures that are not Irish authorised AIFs (whether that is AIFs authorised/established in other EU states or unregulated structures). It is believed that such a result (the risk of which is considerable) would be contrary to any Central Bank policy objective to be in a position to take measures it sees as necessary to protect the broader economy against the impact of market forces in the Irish CRE market. In introducing the measures in their current form, there is a view that the result for the Central Bank will be that it significantly diminishes any current capacity (as a result of the current level of Irish CRE held within Irish authorised AIFs) to protect the market, investors and consequently the broader economy from any potential impact of variations in the Irish CRE market.

In short, there is significant risk that by introducing the macroprudential measures as currently proposed for Irish authorised AIFs investing in Irish CRE, the likely outcome is that they will no longer be utilised for such Irish CRE investment strategies (and existing Irish authorised AIFs will be restructured to structures not within scope of the measures). In that scenario, the Central Bank will have lost transparency with respect to "property fund" investors in the Irish CRE market and will have no ability to intervene in periods of turbulence (given that they will have no regulatory authority to do so with respect to structures they do not regulate). As a result, the measures may not in any way mitigate the risks within the Irish CRE market that the Central Bank has identified as being of concern to it, rather they may well exacerbate any perceived risks as owners of Irish CRE will potentially have the same profile but simply be in structures over which the Central Bank has no ability to influence or obtain relevant information from.

(b) If the expected move away from Irish authorised AIFs were to occur (as members expect it will if the current measures proposed are subsequently adopted), this will also have negative consequences for investors. Currently, any investors with exposure to Irish authorised AIFs benefit from significant protections of both AIFMD and the Central Bank's QIAIF regime. In circumstances where the market elects, potentially solely because of the nature of the proposed macroprudential measures which are viewed as "off-market", to restructure existing or establish future "property funds"outside of the regulatory regime, investors will no longer benefit from such protections. We do not believe that would be a positive development.

(c) As mentioned, in circumstances where decisions are made to simply use structures not subject to the Central Bank proposed measures such as AIFs in other jurisdictions, this will potentially have an impact on the competitiveness of Ireland as a domicile for AIFs investing in real estate and/or other AIFs generally. If promoters/investors are more readily able to structure AIFs in other jurisdictions (whilst still maintaining the same exposure to Irish CRE market) then it is a significant dis-incentive to continue to locate AIFs and their supporting business in Ireland or to attract new AIF promoters to the jurisdiction.

(d) There is a risk that if the broader market (including structurers/investors) see the proposed limits as unworkable (which we think is entirely possible particularly with respect to the proposed leverage limit), they simply decide not to invest in Irish authorised AIF investing in Irish CRE and there is significant underinvestment in the entire sector over time.

(e) This could also impact investment in and delivery of housing units within Ireland at a critical time (on the assumption that residential housing development/holding strategies are "in scope" Irish authorised AIFs). If the proposed leverage limit is confirmed as being applicable to funds developing out/holding residential housing, it is expected that such funds will find it difficult to comply and remain viable as an option for investors. When such funds are in the development phase, because the leverage calculation does not take into account the value post-development but only the "undeveloped" market value, they have relatively high LTV ratios but as the site is developed, such leverage ratio decreases significantly as the value of the developed site increases toward sale of units. There is a substantial risk that if such funds are unable to comply with the proposed measures on Day-1, they will struggle to raise equity and investment in development of housing units within Ireland will be negatively affected.

(f) There is concern that because the proposed leverage level is materially lower than market norms, the limit itself may be responsible for causing a shock to the Irish CRE market. There are real concerns that because a significant proportion of existing Irish authorised AIFs investing in Irish CRE are leveraged in the region of 60-70%, the only means available to comply with the new leverage limit would be to sell assets (raising new equity is not seen as realistic) which could result in Irish CRE assets being flooded onto the market and thus adversely affecting asset values which in turn would likely have the effect of reducing valuations of other Irish CRE assets and result in further leverage breaches. In other words, the measure itself could be the cause of unanticipated adverse price shocks to the Irish CRE market.

(g) There is also concern that existing property financings will simply be unwound by lenders which may either lead to sales all at the one time and/or simply taking structures out of the remit of the macroprudential measures with Central Bank no longer having any transparency on the contribution of such Irish authorised AIFs to the overall Irish CRE market (and its subsequent impact on the broader economy) (as mentioned at (a) above). It is not believed that selecting a period over which existing Irish authorised AIFs need to comply (no matter how lengthy) will significantly cure or mitigate any of these potential risks as the market will all either try to be "first movers" or will, together, leave it to the end of the compliance period to resolve.

(h) One technical point that has also been identified in circumstances where existing affected Irish authorised AIFs attempt to comply with any new leverage limit (and not restructure) is that such Irish authorised AIFs will likely suffer a penalty for making arrangements with lenders to meet any new regulatory requirement on leverage limit. This is because many facility agreements will impose a prepayment fee on Irish authorised AIFs making unscheduled payments to reduce leverage levels. Such cost would ultimately be borne by the investors as, indeed, will any necessary steps taken to ensure compliance with any new leverage limits.

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.

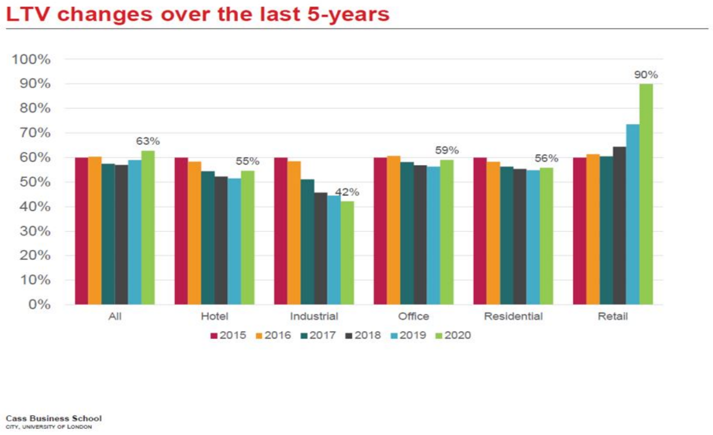
Response:

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:



LTV changes over the last 5-years

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

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