Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Macroprudential Policy for the Property Fund Sector – Consultation Paper 145

Feedback from Property Industry Ireland (Ibec)

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:
Property Industry Ireland (PII) is the trade association within Ibec which represents the property and construction sector, including contractors, developers and builders; property professional service providers including, architects, surveyors, engineers and planners; as well as banks, financial institutions, asset and property managers.

Ireland is still grappling with a serious undersupply of homes. Most recent figures show that while the Central Bank's latest estimate is that on average 34,000 new homes need to be built each year to satisfy demand to 2030, the latest housing completion data from the CSO show only 20,433 homes were built in 2021. The financing of new home development has changed in the almost decade and a half since the financial crisis. At that time, many new homes were developed directly through bank debt financing. However, this has changed over the years, with an increase in finance coming from property funds. This money plays an important role in the development of new homes.

Therefore, while PII welcomes the initiative by the Central Bank to introduce macroprudential measures for property funds, we would urge caution as the new limit to leverage, at the levels proposed, would have a significant impact on the provision of new homes.

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:

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:
Total loan to total asset value limits are too blunt an instrument and do not adequately reflect the underlying default risk and refinance risk profile of a real estate fund. The 50% single leverage limit is a particular concern for property funds that finance new property development. Assets under development tend to have debt ratios much higher than those post construction. Debt for development purposes is raised on a Loan to Cost basis, then on practical completion the debt is refinanced into investment debt facilities based on debt yield and LTV. Any Loan to Costs ratio would need to take account of the potential occupier risk i.e. is the development speculative, forward sold or pre let. In an environment where we have high cost inflation, it is critical that leverage caps do not have the effect of making developments unviable.

Shareholder loans, when put in place along with third party debt, are typically fully subordinated to the third-party debt and have no acceleration rights. Therefore, they seldom present a higher level of default risk to the fund than equity.

Finally, a leverage limit that could be altered and changed is a concern due to the uncertainty it could cause in the development process, putting the viability of some developments at risk mid-construction. Investors require certainty. These proposed measures could, if not decided on quickly, have the effect of creating further uncertainty for potential institutional investors and lead them to invest in other markets. Furthermore, the introduction of leverage limits that can be adjusted during the life of the fund creates additional uncertainty.

These changes are also a concern because they will impact on how international capital perceive the Irish market, undermining our position as a place to invest, and jeopardising a source of new finance that can be used to build more homes. If the proposed measures are considered to be overly restrictive by investors it is likely to have the effect of encouraging investment in CRE through unregulated structures rather than regulated structures. This could be counter-productive.

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:
In effect, the 50% limit will mean a limit lower than this will be necessary to provide for any fluctuations in the valuation of assets. A total LTV cap at 50% is likely to lead to <40% Effective Leverage (as can be seen in REITs) which will materially impact on equity returns, thereby impacting real estate values. This will have the effect of making Irish CRE less attractive to international capital. Furthermore, the measure is overly restrictive as it looks solely at Loan-to-Value.

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:

While three years will be sufficient for some funds to re-finance, as mentioned above there are certain circumstances in which this will be very challenging, in particular for funds investing in new property development and because of the retrospective effect of the measures. The proposed measures should not be retrospective. However, if they are to be, then the proposed adjustment period of 3 years is too short. A period of 5 years should be considered.

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:

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:

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:

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:

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.

T: +353 (0)1 224 5800
E: publications@centralbank.ie
www.centralbank.ie

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