Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Macroprudential Policy for the Property Fund Sector – Consultation Paper 145

Feedback from Urbeo Residential

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:
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.

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:
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. 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.

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. The debt market providers to the Irish property market actually offer different loan to value amounts based on the underlying property that they are lending against, highlighting that one single leverage limit is not appropriate across all property holding types as they have different risk profiles.

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. The Irish CRE market is comprised of a wide range of investors (both domestic and international) with different risk and return appetites. Assets are often heterogenous in nature and the various CRE market segments each gives rise to different types of risk. Investment strategies and the return expectations of investors are diverse. A blanket limit of 50% on leverage is not appropriate for the range of investors and assets in this 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:
Urbeo are of the opinion that retrospective application of the proposed leverage limits should not apply and as such no period of transition is appropriate, as this is ignoring the current contractual terms that Funds have in place with their existing lender/s.

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:
Urbeo supports the Irish Funds response in relation to this question which is outlined below.

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:
Urbeo is only involved in closed-ended funds, and due to their nature

they 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.

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:
Urbeo is only involved in closed-ended funds, and due to their nature they 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.

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:
N/A

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:
Potential impact of imposing a leverage limit at 50% might include the following as outlined in the Irish Funds submission:

(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 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.

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:

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

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