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Financial Stability Notes

Specialist Property Lenders and Private Credit: Financial Stability Considerations

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Vol. 2025, No. 1

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Central Bank of Ireland

2025

Abstract

In this *Note*, we focus on non-bank lenders that lend almost exclusively to the commercial real estate (CRE) sector and are set up as Special Purpose Entities. These Property SPEs (PSPEs) are typically sponsored and financed by international financial intermediaries that engage in the private credit markets. They also rely on third party financing that is highly concentrated in the European banking sector. PSPEs represent the majority of new lending by non-bank lenders to the CRE sector and they typically provide large loans to developers (€8.3mn average loan size). This activity benefits the domestic economy by deepening and widening the availability of credit to a supply-constrained property development sector. Increased sensitivity of domestic credit provision to international financial conditions, concentration risk, and exposure to opaque international private credit markets are key financial stability risks stemming from PSPEs. A reduction in credit supply from PSPEs could directly affect the real economy through the property market channel and indirectly through spillover effects to the broader financial system.

1 Introduction

The aims of this *Note* is to both enhance our understanding of *Specialist Property Lenders* in the Irish non-bank sector and to deepen our assessment of the associated financial stability risks. Funding for *Specialist Property Lenders* is mainly coming from outside of Ireland, generally from a combination of debt financing from sponsors in the international financial sector and loans from international banks (Moloney et al. 2023). Lending from *Specialist Property Lenders* diversifies the sources of credit for the Irish CRE market at a moment where housing supply is constrained (Central Bank of Ireland 2024a). While the presence of *Specialist Property Lenders* brings a number of benefits to the domestic economy, including increasing the number of lenders in the market and diversifying risk away from Irish depositors, it comes with its own financial stability risks. The credit provided by these lenders is in the sphere of private credit, defined by the International Monetary Fund (IMF) as 'the provision of credit by Non-Bank Financial Intermediaries to often small borrowers through direct lending and other structures'. The IMF April 2024 Global Financial Stability Report identifies private credit as a potential financial stability risk as credit provision to the real economy migrates

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from the banking system towards more opaque, less regulated non-banks. Given the nature of how *Specialist Property Lenders* are funded, overall domestic credit provision could become more sensitive to international financial conditions and less resilient to shocks as this sector grows proportionately within the domestic economy. This *Note* will examine in more detail the cohort of *Special Property Lenders* registered in Ireland as *Special Purpose Entities* (SPEs) – Property SPEs or PSPEs – to assess potential financial stability risks to the Irish financial sector.[3]

This *Note* extends previous analysis of Specialist Property Lenders. The analysis here follows the *Note* by Moloney et al. (2023), where we examine the financial statements of non-bank lenders to identify financial stability risks within the non-bank lender to SME sector. We show that Specialist Property Lenders are the primary cohort of importance. This is on the basis that they are lending to a systemically important sector of the Irish economy (commercial real estate); that they are specialist lenders (increasing concentration risk); and that they appear to be more sensitive to tightening financial conditions. In that *Note*, we found a significant portion of their financing is coming from third parties in the form of floating rate loans, making these lenders more sensitive to international shocks than banks. In this *Note*, we use proprietary SPE returns data to examine these *Special Property Lenders* more closely. We extend our previous analysis to include all new CRE lending by non-bank lenders – including to both SMEs and other NFCs – and look at lending products and lender characteristics.[4]

Non-bank lenders have grown as a provider of credit to the real estate sector in the last number of years. Lambert et al. (2024) indicate that the total share of loan balances to the CRE sector from non-bank lenders is approximately 35 per cent. Recent evidence from the *Financial Stability Review* estimates that 50 per cent of new lending to real estate SMEs is from non-banks (Central Bank of Ireland 2024c). The Department of Finance estimates that in 2022, 43 per cent of debt financing for residential development came from Secondary Lenders or Alternative Debt Funds (Department of Finance, 2024). Industry advises that while they may charge higher interest rates, these lenders are willing to lend at higher leverage levels and may have quicker decision-making timelines than banks (Department of Finance, 2024). Thus, while still a relatively new sector, it is growing in importance from a real economy and financial stability perspective. Many data and analytical gaps remain as the market is still quite opaque and insights are limited (Central Bank of Ireland 2024b).

In this *Note*, we examine the funding models of a cohort of Specialist Property Lenders, known here as PSPEs, to assess how they raise funding and from whom. We build on the insights of Moloney et al. (2023) and take advantage of proprietary data collected by the Central Bank of Ireland. The remainder of the *Note* is broken down into five sections: background on SPE lenders; methodology and data used; stylised facts on PSPEs; financial stability analysis; and conclusion.

2 Background on SPE Lenders

A Special Purpose Entity (SPE) is a company created to fulfil a narrow, specific purpose.[5] 71 per cent of *Specialist Property Lenders* are set up as PSPEs, representing 88 per cent of *Specialist Property*

[3] We define PSPEs as non-bank lenders that are registered as Special Purpose Entities and have more than 80 per cent of their lending going to the commercial real estate sector. Special Purpose Entities that are also Section 110 vehicles (under tax law) must report balance sheet data to the Central Bank of Ireland on a quarterly basis.

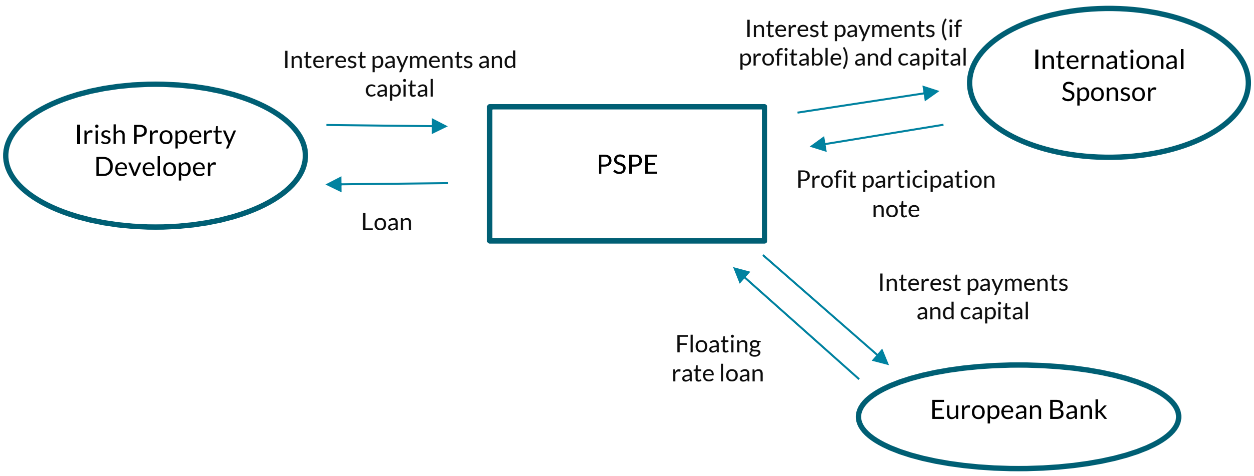
[4] CRE lending includes lending for Real Estate Activities and Construction. The CRE sector can include office, retail, industrial and residential real estate.

[5] Central Bank of Ireland, 'Explainer - What is a Special Purpose Entity?' see here

Lenders real estate lending. Motives for setting up an SPE include tax optimisation, investor protection and risk management (Galstyan et al. 2019, BIS 2009). The sponsor of the SPE sets up the vehicle and will economically benefit from the activities of the SPE (Central Bank of Ireland, 2015). Many, but not all, of the PSPEs are set up as bankruptcy remote vehicles. The advantage of being bankruptcy remote is to protect both the assets of the sponsor from the creditors of the SPE, should the SPE fall into bankruptcy, and the assets of the SPE from creditors of the sponsor, should the sponsor fall into bankruptcy (Golden & Hughes, 2018). We consider funding coming from the entity sponsor to fall under the group/parent funding taxonomy outlined in Moloney et al. (2023).

PSPEs typically have two sources of funding: group/parent (sponsor) funding and third party funding. Figure 1 below illustrates a typical funding structure for an Irish PSPE set up for loan origination. In this example, the PSPE is funded by two counterparties. The first is group/parent funding in the form of a profit participation note or loan from the sponsor. Secondly, there is a third party floating rate loan from a European bank. The PSPE lends to an Irish property developer to construct commercial real estate. This could be for residential, retail, office, industrial and social housing development purposes.[6] There is little equity or capital in the PSPE entity. The sponsor benefits from the activities of the PSPE through a profit participation note. Unlike a typical bank's business model (where the bank is mainly funded by domestic deposits), the financing of the development of domestic commercial real estate is ultimately funded by overseas creditors. In a broad sense, this type of activity would fall under the definition of *private credit* as defined by the IMF, as the PSPE sponsor is an international financial intermediary specialising in private credit and/or private equity markets.

Figure 1: PSPEs access a mix of international funding from their sponsors and the banking sector



Sponsors don't hold equity in PSPEs, but benefit from (quasi-equity) profit-participation liabilities. Sponsors benefit directly from the activities of the PSPEs by lending to them, usually in the form of a profit-participation note (PPN). Golden & Hughes (2018) describe PPNs as an instrument whose holder participates directly in the profit and losses of the SPE. A share of all profit and/or losses transfer to the holder of the PPN. The losses are limited to the size of the capital invested and are typically unsecured. PPNs have been described by industry as 'quasi–equity investments' (CMS 2024) as, like equity, they provide investors with returns linked to profits, but they do not provide other features such as voting rights. Also, as noted previously by Godfrey et al.

[6] The residential sector is included in the definition of CRE when it is being used for commercial purposes (Central Bank of Ireland, 2024b).

(2015), PPNs often include covenants that limit the rights of creditors to petition for liquidation. This again makes the funding more similar to equity. However, they are generally not considered regulatory capital under frameworks such as Basel III (BIS 2017) and are not considered a perfect alternative to equity capital.[7] Instead, they provide the PSPE with some flexibility in terms of debt repayments and losses should the entity experience a shock and/or be unprofitable while also returning profits to the parent company when profitable.

PSPEs do not come under any specific entity-based regulation. They are set up as Irish companies and as such are subject to Irish law. They can be in scope of activity-based obligations that are currently imposed via EU regulatory instruments, such as Regulation (EU) 2017/1129 ("Prospectus Regulation") if they list debt on a public market, or Regulation (EU) No 648/2012 ("EMIR Regulation") if they partake in derivatives. If they are section 110 vehicles, they are subject to quarterly statistical reporting to the Central Bank of Ireland.[8] Unlike banks or insurance companies, they are not subject to prudential or conduct regulation.

3 Methodology and Data

The Central Bank collects data on non-bank lenders from a number of sources. Loan level data is collected in the Central Credit Registry (CCR) along with certain borrower and lender characteristics.[9] We use this data to identify and classify non-banks as described in Moloney et al. (2023). In this *Note*, we consider all non-bank real estate lending between 2019 Q1 and 2024 Q3. We focus on the activities of *Specialist Property Lenders* that are set up as *Special Purpose Entities*, i.e. *PSPEs*.

We use the Central Bank quarterly SPE returns as the basis for our balance sheet assessment. SPEs are required to submit quarterly balance sheet data to the Central Bank including counterparty data. While in our previous *Note*, we used financial statements as our primary data source, SPE returns are reported more frequently and more promptly than financial statements and so can be used to assess financial stability risks in a more timely fashion. However, important details about interest rate sensitivity and counterparty risk are not included. Therefore, we use annual, publicly-available financial statements from the Company Registration Office to collect further qualitative information on the liabilities-side of lenders' balance sheets.

Financial statements can provide more qualitative information on counterparty and interest rate risk. From financial statements relating to SPEs we can assess the sector and region of lending counterparties, identify sponsor lending versus third-party lending, and identify the terms of the borrowing by SPE lenders. However, the structure of financial statements is not uniform across the sample, which makes comparisons more challenging, and therefore data gaps remain. The data relating to counterparty sector and country in the SPE returns can be in conflict with the information found in annual financial statements. Where there is a conflict, we defer to the financial statements. We also consider SPE registration data, which contains sponsor information, to assess counterparty risk.

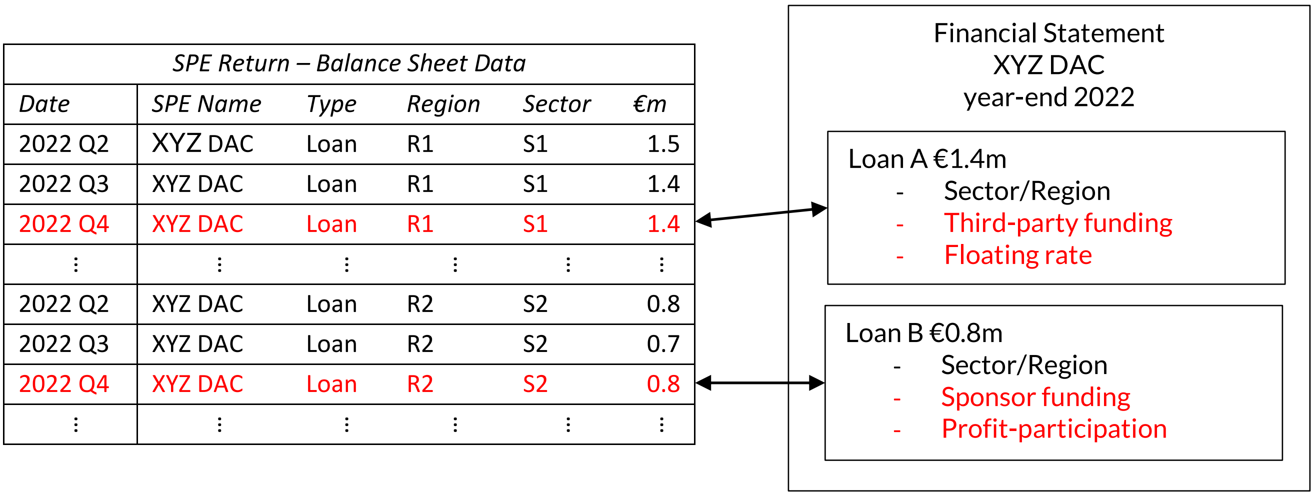
[7] To be classified as equity capital under Basel III, PPNs must demonstrate features such as convertibility or write–off capabilities.

[8] Central Bank of Ireland SPVs see here.

[9] The CCR contains records on loans granted over €500, where the borrower is an Irish resident at the time of applying for the loan and/or the loan is governed by Irish law.

We propose a crude matching technique between the SPE returns and financial statements. SPEs are generally set up for a specific purpose and borrow to fulfil that purpose, which means their balance sheets are relatively stable. We therefore make the simplifying assumption that the characteristics of the SPE's liabilities are consistent over time. For each loan or debt security reported in the SPE returns, we identify the corresponding liability in the entity's published financial statements at a given point in time (Figure 2). For example, in Figure 2, all liabilities reported as being from Region R1 and Sector S1 will have the characteristics of Loan A, while all liabilities from Region R2 and Sector S2 will have the characteristics of Loans B. While this matching isn't perfect, we find it sufficiently consistent over time to provide a reasonably accurate outline of non-bank liabilities for the purposes of a macro-financial stability assessment.

Figure 2: Financial Statements are matched with SPE balance sheet returns



Notes: Financial Statements information is matched with the SPE balance sheet data at a point in time. For entity XYZ DAC, all liabilities reported as being from Region R1 and Sector S1 will have the characteristics of Loan A, while all liabilities from Region R2 and Sector S2 will have the characteristics of Loans B.

4 Stylised Facts on PSPEs

4.1 PSPE Lending to the Irish CRE Sector

A comparison of non-bank lender cohorts indicates that PSPEs offer significantly larger loans to a small number of borrowers. Non-bank lending to the Irish CRE sector comes from a diverse set of lenders. Table 1 summarises the lending of non-banks between 2019 Q1 and 2024 Q3. PSPEs (and non-PSPE Specialist Property Lenders) provide large loans to a small number of counterparties. The average loan size provided by PSPEs is over €8m, far larger than other categories of non-banks. CRE lending from PSPEs is concentrated in larger companies with only one third of lending to SMEs. In contrast, General Lenders and Asset Finance Providers generally provide smaller loans to a wide variety of counterparties, primarily in the SME sector.

Table 1: Lender characteristics – lending to the Irish CRE sector

Lender Category	No. Lenders	Total Real Estate Loans €m	Average Real Estate Loan €m	Average No. Counterparties	% Lending to SMEs
PSPEs	36	6,444	8.30	15	33%
General Lenders	10	1,623	0.19	356	92%
Specialist Property Lenders (non-SPE)	15	843	2.30	18	69%
Assets Finance Providers	21	466	0.03	268	88%
Other	18	440	0.05	331	57%
Total	**100**	**9,816**	**0.31**	**160**	**50%**

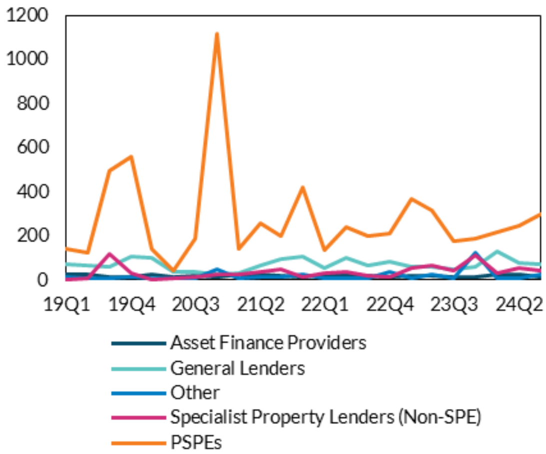
Source: Central Credit Register
Notes: All lending refers to new commercial real estate lending in the period 2019 Q1-2024 Q3. % Lending to SME is the proportion of CRE lending to SMEs.

PSPEs account for the majority of new lending from non-banks to the Irish CRE sector. We identify 36 PSPEs (with 17 groups underlying this), making them the most common type of non-bank operating in this space. PSPEs are major market participants and are by far the most significant category of non-bank lender in the real estate sector. In the period from 2019 Q1 to 2024 Q3, PSPEs account for 66 per cent of new non-bank lending in the real estate sector, or €6.4bn (Figure 3). PSPEs are established to lend for specific projects or to specific borrowers. As a result, they are registered as SPEs and so have narrow, specific objectives and segregated assets and liabilities to limit risk to the entities' sponsor. Generally, each PSPE provides a small number of loans before becoming inactive, with the creation of new SPEs causing large fluctuations in the level of new lending (Figure 3).

PSPEs appear to lend to the real estate sector to fund large scale development. Publically available media reports and PSPE websites link PSPEs with projects such as housing estate developments, apartment buildings, purpose-built student accommodation and commercial office developments. Most PSPE lending is done in the two years after the PSPE has been registered. Many of the PSPEs are being registered as bankruptcy remote. Bankruptcy remote vehicles protect the assets (and investors) of the sponsor but could make lending to these entities less attractive for creditors.

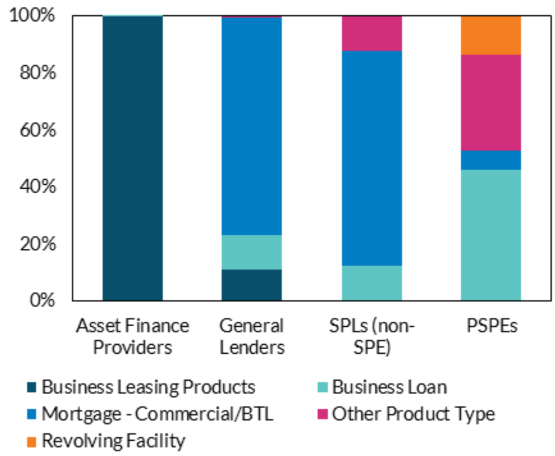
PSPEs appear to offer a differentiated product set in the non-bank sector. General Lenders and non-SPE Specialist Property Lenders mainly lend to the CRE market through mortgages, while Assets Finance Providers lend through business leasing products. PSPEs primarily lend through Business Loans and Revolving Credit Facilities (Figure 4). Data limitations obscure a portion of PSPE lending, which is characterised by the residual category "Other Product Type". This differentiated product offering suggests they may be operating in a particular market niche and not in direct competition with other non-bank lenders in the mortgage or asset leasing space. PSPEs lend at both variable and fixed rates, with an average maturity of three years. McCarthy and Navarro-Ramirez (*forthcoming*) estimate that Specialist Property Lenders lend with a significant premium over similar bank loans. This suggests that PSPEs are providing finance to riskier borrowers or loans than banks. This view is also supported by other sources (Gaffney and McGeever 2022 and Department of Finance 2024).

Figure 3: PSPEs account for 79 per cent of non-bank CRE lending
New real estate lending €m



Source: CCR
Notes: New real estate lending from each lender type in the real estate sector and construction sectors. Last observation 2024 Q3.

Figure 4: PSPEs primarily lend through Business Loans and Revolving Credit Facilities
Real estate product type by lender type and as a percentage of new lending



Source: CCR
Notes: Real estate includes Real Estate Activities and Construction. SPLs are Specialist Property Lenders. "Other Product Type" is a residual category.

4.2 PSPE Funding Breakdown

PSPEs rely on both group/parent and third-party sources of funding. We describe the funding model of PSPEs by matching financial statements data with proprietary SPE returns and categorising the loans and debt securities as either *Group/Parent Funding* or *Third Party Borrowing*.[10] Group/parent funding is provided by either parents or entities in an overall group structure. For PSPEs, this funding is from the SPE sponsor. Third party borrowing refers to funding provided by third parties in both the bank and non-bank sector. PSPEs have €2.7 billion in liabilities on their balance sheet as of 2024 Q3. Just under half of PSPE liabilities, approximately €1.3 billion, are accounted for as group/parent funding, while approximately 36 per cent can be identified as third party borrowing (Figure 5). 96 per cent of group/parent funding comes from the OFI sector in 2024 Q3, mostly from entities in the UK, Luxembourg, and Ireland (Figure 6).[11] The majority of group/parent funding is in the form of profit-participation notes or loans though there is a fixed interest component. Third-party funding of PSPEs is highly concentrated in the European banking sector and is almost entirely made up of floating rate loans.

Group/parent funding makes up just under half of liabilities. Based on financial statements, group/parent funding generally makes up between 45 per cent and 50 per cent of liabilities in the period between 2019 Q1 and 2024 Q3 (Figure 7). Over time, as PSPEs rely more on third-party funding in 2022 and 2023, floating rate loans have become a larger component of PSPE balance sheets (Figure 8). In 2024Q3, €712 million, or 27 per cent of liabilities, are floating rate loans. PSPEs

[10] Liabilities other than loans or debt securities are categorised as "Remaining Liabilities". If the nature of the funding is unclear from financial statements, then it is categorised as "Unknown".
[11] The OFI sector is a sub-sector defined in the ESA 2010 as consisting of other financial intermediaries (excluding insurance corporations and pension funds), financial auxiliaries and captive financial institutions and money lenders.

hold negligible capital and reserves – on average less than 0.4 per cent of total assets across this period. This is not unusual as Special Purpose Entities typically have nominal equity which is often held in trust. Given the nominal level of equity in PSPE balance sheets, we consider standard measures of leverage to be insufficient to assess the resilience of the aggregate PSPE sector to shocks. Instead, we note the ratio of group/parent funding to total liabilities, which stands at 48 per cent in 2024 Q3, and also the ratio of profit-based funding to total liabilities, which stands at 47 per cent in the same period (Figure 5).[12] Group/parent funding is made up of mainly profit participation notes or loans which have "equity-like" characteristics (CMS 2024). Further engagement with industry would be required to better understand the loss absorbing capacity of this funding.

Figure 5: PSPE financing is approx. 50 per cent group/parent funding and 36 per cent third party borrowing

PSPE Liabilities by Loan Terms

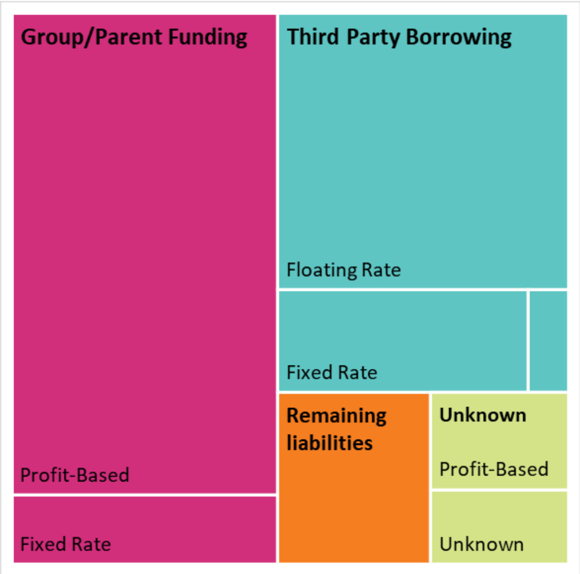
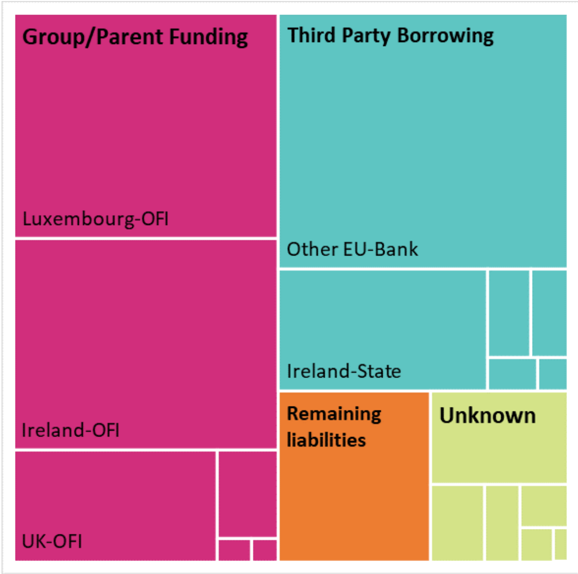


Figure 6: Analysis of first counterparty data shows strong links with OFI and European banking sectors

PSPE Liabilities by Region and Sector



Source: SPE returns and financial statements, authors' calculations
Notes: Group/Parent funding is provided by either parents or entities in an overall group structure. For SPEs, Group/Parent funding comes from the SPE sponsors. Third Party Borrowing refers to funding provided by third parties in both the bank and non-bank sector. This funding can consist of market-based products (i.e. debt securities) and loans. Unknown refers to lack of transparency in the financial statements. Data as of 2024 Q3.

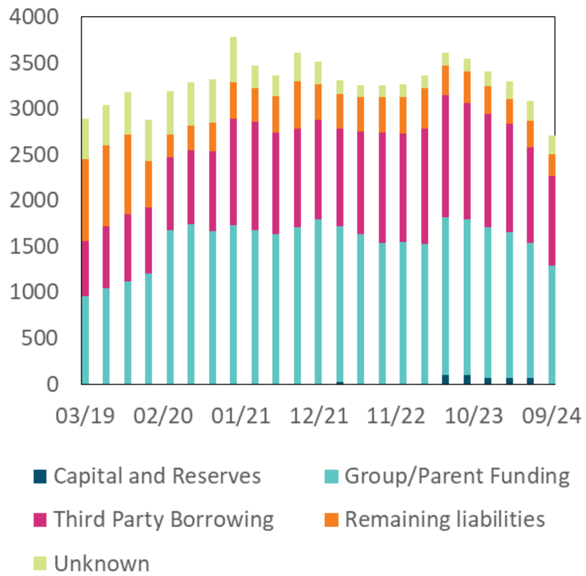
Almost all group/parent funding is from the international OFI sector, with opaque interconnections to international private credit markets. The OFI sector is complex, and we have limited understanding of the ultimate risk and interconnections. Based on financial statements, the direct contribution from the US OFI sector appears to be limited (Figure 9a). However, SPE registrations submitted as part of the SPE return suggest that a substantial portion of PSPE have sponsors based in the US (Figure 9b). Using the qualitative evidence collected from financial statements, we note that group/parent funding from Luxembourg is coming largely from international OFIs that are subsidiaries of or closely linked to large American firms involved in the

[12] We note that some proportion of group/parent funding is fixed rate funding. Fixed rate funding is generally provided alongside a PPN, meaning the "equity-like" component of the balance sheet is more difficult to identify for some PSPEs. Given data limitations, some profit-based funding is not characterised as either group/parent funding or third party borrowing.

provision of private credit.[13] It is quite common for chains of Special Purpose Entities to be set up in different jurisdictions to optimise tax strategies and for regulatory compliance.[14] While half of sponsors (by PSPE total assets) at the end of 2019 were based in the US, this had fallen to 30 per cent by 2024 Q3. Much of this fall can be attributed to growth in the proportion of PSPEs being sponsored by entities based in Luxembourg. Therefore, we posit that most sponsor funding identified in financial statements can ultimately be linked back to private credit markets in the US and the UK. The ultimate source of this sponsorship requires further analysis and is difficult to assess due to the complexity of the international firm structures. We can see in this *Note* that PSPEs are highly interconnected with the international financial system as part of a wide network of (potentially leveraged) players ranging from borrowers to investment funds to end investors.

Figure 7: Third party funding has become a larger component of PSPE balance sheets

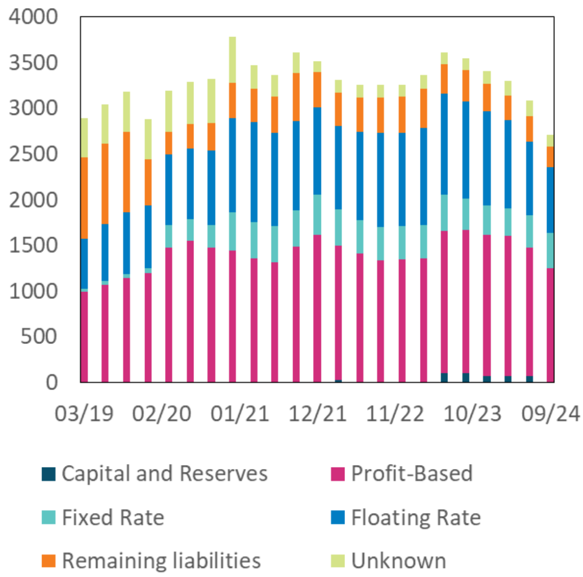
PSPE Liability Type
€ million



Source: SPE returns and financial statements, authors' calculations
Notes: Liabilities categorised by source. Group/Parent funding is provided by either parents or entities in an overall group structure. For SPEs, Group/Parent funding comes from the SPE sponsors. Third Party Borrowing refers to funding provided by third parties in both the bank and non-bank sector. This funding can consist of market-based products (i.e. debt securities) and loans. Unknown refers to lack of transparency in the financial statements.

Figure 8: Floating rate loans have also become a larger component

PSPE Liabilities and Loan Terms
€ million



Source: SPE returns and financial statements, authors' calculations
Notes: Liabilities categories by interest terms. Based on qualitative data from financial statements.

A large proportion of third-party funding is linked to the Euribor and is sensitive to financial conditions. €978 million, or 36 per cent of total liabilities, can be attributed to third-party funding in 2024 Q3. This funding "leverages" the group/parent funding and €695 million of this is made up of floating rate loans from banks, with most of the remaining liabilities coming from the Irish State. These bank loans are generally linked to the Euribor, meaning the cost of servicing them will have increased through 2022 and 2023 as interest rates rose. The proportion of third-party funding for

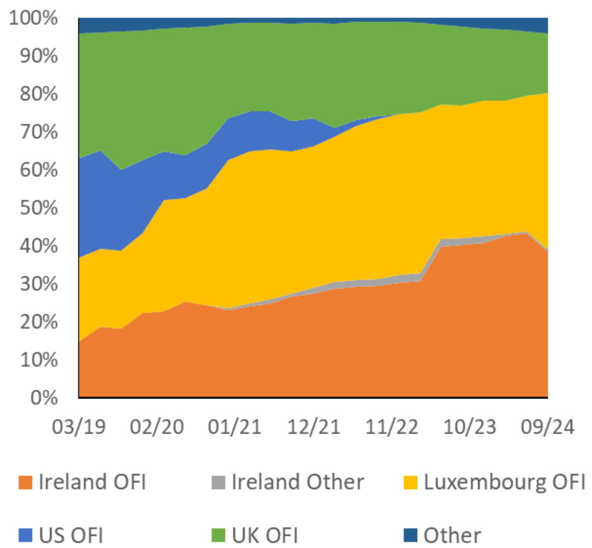
[13] Providers of private credit include, for example, investment firms and asset managers that are active in private credit markets.
[14] CSO, 2023 'Special Purpose Entities and Pass-Through', see here.

PSPEs has grown steadily in recent years, suggesting that PSPEs are becoming more vulnerable to adverse shocks.

Third-party funding of PSPEs by banks is highly concentrated in the European banking sector. The funding model of PSPEs identifies strong interlinkages between bank and non-bank lenders. This third-party funding is significantly concentrated at the firm level. A shock to the relevant cohort of the European banking sector could lead to a sharp reduction in funding for PSPEs ultimately reducing credit to the Irish CRE market via the non-bank channel. As at 2024 Q3, only €32 million, or 4 per cent of third-party funding, is coming from the Irish banking system. However, reports in the Irish media suggest that Irish banks may become more engaged with non-bank lenders in the coming years.[15]

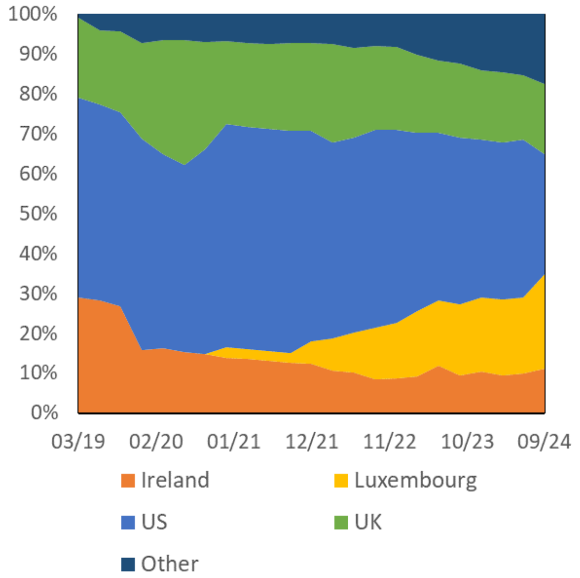
Figure 9: Whereas US OFI sector contribution to funding is limited according to financial statements (LHS), a substantial portion of PSPE sponsors are US based according to CBI registration data (RHS).

Financial Statements per cent of Group/Parent Funding



Source: SPE returns and financial statements, authors' calculations
Notes: Source of Group/Parent Funding region and sector as identified in financial statements. For SPEs, this funding comes from the SPE sponsors.

SPE registration per cent of Total Assets



Source: SPE returns and registrations, authors' calculations
Notes: Assets of SPEs with multiple sponsors from multiple geographies/sectors have been evenly distributed among each sponsors. OFIs include financial auxiliaries, which facilitate financial transactions between third parties without becoming the legal counterparty (for example, stock exchanges, managers of pension funds and mutual funds, or insurance brokers) as well as money market funds and other financial intermediaries

Other sources of Irish funding are relatively limited, with links noted to the Irish State and the OFI sector. In 2024 Q3, €227mn of liabilities, i.e., 8 per cent of total liabilities, came from the Irish State via the Irish Strategic Investment Fund (ISIF). ISIF is a sovereign development fund managed and controlled by the National Treasury Management Agency (NTMA) with a mandate to invest on a commercial basis to support economic activity and employment in Ireland. ISIF works in partnership with private credit providers to lend to strategic industries including real estate development. Funding from Irish entities make up approximately 39 per cent of group/parent

[15] Irish Independent 2024 *AIB launches €500m fund designed to deliver up to 1,000 new apartments every year*. March see here.

funding according to financial statements (Figure 9a). However, by looking through these entities, we see that much of the funding from Irish-domiciled OFIs is ultimately sourced from the international financial system, underscoring the international exposure of the PSPE funding model, as discussed above. We note that only 9 per cent of PSPEs have Irish Sponsors (Figure 9b).

5 Financial Stability Analysis

PSPEs increase access to finance for developers and diversify the sources of credit, reducing the exposure of domestic bank depositors. PSPE lending diversifies the sources of credit for the Irish CRE market as PSPEs compete against a highly concentrated banking sector. It also reduces the exposure of the Irish banking system to potential defaults from Irish CRE lenders, which has been a source of risk for Irish banks and depositors in the past. PSPEs fund many residential CRE development projects including apartments, housing estates, and purpose built student accommodation. Thus, PSPEs have become an additional source of credit in a supply-constrained residential development market. Analysis has found that the supply of 20,000 additional homes per year could require growth of €4.5bn-€5bn in additional private financing, over and above a continuation of 2023 levels (Central Bank of Ireland 2024a). Financing from private credit is important to supporting this growth.

However, international financing of PSPEs increases the risk of *capital flight* that could impact the financing of and resilience of the CRE sector. PSPEs can be seen as intermediaries between international financial institutions and Irish borrowers and are highly dependent on funding from international investors and creditors. Unlike domestic banks, the investors/creditors lending to PSPEs have a weak footprint in Ireland. This international funding of PSPEs is subject to *capital flight* risk, i.e., the risk of sharp and significant repatriation of foreign capital by foreign investors following a shock. Should there be a change in the international perception of risk associated with lending for development of Irish CRE or a significant change in international financial conditions, there is potential for a sharp reduction in the financing of the sector. The South-East Asian crisis 1997-8 is an example of significant capital outflows amplifying a financial crisis.[16]

Interconnections with private credit markets have been identified as a particular financial stability risk. Many of the PSPEs identified here are linked to international groups/parents that are engaged in private credit. As noted by the IMF (2024), there are particular financial stability risks associated with private credit provision, as they are more opaque and less regulated than banks. The link to international private credit markets may increase the risk of contagion to the domestic economy from these markets, as shocks may propagate through the lending channel to the Irish CRE sector. Private credit markets have vulnerabilities including: relatively fragile borrowers, semi-liquid investment vehicles, multiple layers of leverage, stale valuations, and opaque interconnections between participants (IMF 2024). Risks are somewhat lessened by the use of bankruptcy remote structures in over half of the PSPEs analysed.

PSPE balance sheets identify growing interconnections between banks and non-banks, increasing complexity and sensitivity to international financial conditions. Third party PSPE

[16] The South-East Asian crisis of 1997-8 saw large capital outflows from countries such as Indonesia, South Korea and Thailand, amplifying the financial crisis and impacting local property markets. While this crisis was born out of overheating economies and currency devaluation, the IMF (1998) note the risks associated with large capital inflows from external investors and the potential for this to lead to large outflows should a shock or overheating occur.

funding is highly concentrated at a firm level in the European banking sector. Idiosyncratic shocks to individual banks may lead to a significant reduction in credit to the PSPE sector, with implications for credit supply to Irish developers. PSPEs generally take out third-party bank loans at variable rates linked to Euribor. Compared to Irish banks funded by domestic deposits, this funding is more sensitive to global financial conditions. Giuliana and Reddan (*forthcoming*) show that *Specialist Property Lenders* strongly contracted lending (absolutely and relative to banks) during periods of tight financial conditions in the euro area. While Irish banks currently have weak direct links with PSPEs, these sectors may become more interconnected, and warrant monitoring. The funding link between the banking sector and PSPEs can also give banks indirect exposure to the Irish CRE market. The links between banks and SPEs can be complex. Nouy (2017) notes the challenges around defining the regulatory perimeter when banks are interlinked with SPEs. This can create a lack of transparency and increase for the complexity of risk assessments.

PSPEs appear quite resilient to the current CRE market downturn but ongoing monitoring is key. PSPEs are a relatively new type of entity and as such uncertainties remain regarding their resilience to shocks. Since the COVID-19 pandemic, the Irish CRE sector has experienced a significant downturn, with capital values declining by almost 30 per cent from their pre-pandemic peak (Central Bank of Ireland 2024c). As noted above, Specialist Property Lenders are sensitive to international financial conditions. Relative to banks, there was a contraction in lending in 2022 and recovery in 2023 but there has been little evidence of loan restructuring or distress as at 2023 (Central Bank of Ireland 2024c). However, a small number of borrower receiverships have taken place in 2024.[17] This is an area that requires further monitoring.

6 Conclusion

PSPEs typically provide large business loans to Irish developers and their funding is heavily dependent on a mix of entities including international financial intermediaries active in private credit markets and on the European banking system. Previously, in Moloney et al. (2023), we examined the financial statements of non-bank lenders to identify financial stability risks. In this *Note*, we use SPE balance sheet returns to examine all real estate lending by a sub-cohort of Specialist Property Lenders - PSPEs. PSPEs are the largest providers of non-bank funding to the Irish CRE market. They typically provide large business loans to Irish developers operating in both the residential and non-residential CRE sectors. PSPEs are funded by a mix of parent and third-party funding. The majority of group/parent funding is coming from the international OFI sector with links to private credit markets, while third party funding is highly concentrated in the European banking sector and is sensitive to the Euribor.

While PSPEs diversify and deepen the sources of credit for development funding, they come with particular financial stability risks. The growth of PSPEs reduces the risk of loss to the Irish banking system and to Irish depositors as these entities are generally financed by overseas entities. However, PSPEs are linked to private credit markets that are less regulated and more opaque than the traditional banking sector. The funding model increases the sensitivity of the Irish CRE market to international financing conditions and to concentration risk in the European banking sector. CRE borrowers are vulnerable to the current downturn in CRE capital values and high office vacancy

[17] Business Post 2024 *Prime Dublin real estate assets managed by Mel Sutcliffe's Quanta Capital placed under receivership*.

rates in Dublin (Central Bank of Ireland 2024c). This requires ongoing monitoring and uncertainties around resilience to shocks remain.

Further analysis and monitoring of the sector is warranted. In future, a protracted reduction in credit supply from this sector could become systemically significant to the real economy, with a direct impact through the property lending channel and indirect spillovers into the banking system through collateral valuation effects. Given the importance of CRE lending to the domestic real economy, continued analysis of the benefits and risks of non-bank lending is required. Ongoing monitoring of activity in this sector in needed to better understand the business models and in particular how PSPEs respond to shocks. This *Note* outlines a methodology for analysis of the sector using a mix of proprietary and public data sources. Significant data gaps remain, such as the relative share of lending to residential and non-residential CRE development. Further work could also include a deeper assessment of the complex international firm structures underpinning PSPE group/parent funding to better understand the ultimate counterparty risk and likely propagation of international shocks. This would inform future assessments of financial stability risks in this sector.

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