Central Bank of Ireland Consultation on Property Funds

November 2021

On 25 November 2021, the Central Bank of Ireland (“**Central Bank**”) published a consultation paper (“**CP145**”) on macroprudential measures for the property fund sector. The publication of CP145 follows recent regulatory focus on the Irish property fund sector, looking at leverage and liquidity mismatch as potential sources of financial vulnerability that could affect the resilience of this form of financing in future periods of stress. The Central Bank’s view is that, in the absence of policy interventions, the property funds sector could respond to future adverse shocks through sales of property assets over a short period of time, potentially amplifying adverse shocks to the commercial real estate market and the wider economy.

The Central Bank is proposing the introduction of leverage limits on Irish domiciled funds which invest over 50% directly or indirectly in Irish property assets (“**Impacted Funds**”) and additional guidance to limit liquidity mismatch.

Leverage

The Central Bank has proposed the introduction of a 50% leverage limit for Impacted Funds, to be imposed through existing regulation under the Irish transposition of the Alternative Investment Funds Managers Directive (“**AIFMD**”), in line with European Securities and Markets Authority (“**ESMA**”) guidelines.[3] The leverage limit will be determined by the ratio of total assets to total liabilities (but the CP 145 specifies that the limit may be issued as any combination of the four separate definitions of leverage under the relevant ESMA guidelines). In practice, this would affect Qualified Investor AIFs (“**QIAIFs**”) that meet the property exposure criteria and currently have leverage in excess of this level. Retail Investor AIFs (“**RIAIFs**”) would not be impacted as they are currently covered by an existing leverage limit of 30% under the Central Bank’s AIF Rulebook.

The Central Bank will review the use of leverage by Impacted Funds as part of its annual review of funds and based on the reporting received from such funds. Where in the course of that review, the Central Bank identifies Impacted Funds with levels of leverage close to, or above the 50% limit, such funds will be issued with notices confirming the application of a specific leverage limit.

2 The AIFMD provides for the imposition of leverage limits that AIFMs are entitled to employ with respect to the AIFs they manage, where the use of leverage by those AIFs contributes to systemic risk or disorderly markets. The 50% leverage limit would reflect international practice (Germany applies a 50% limit to spezialfonds) and is also the same as the limit applied to Real Estate Investment Trusts (“**REITS**”) in Ireland.

The Central Bank may temporarily remove the leverage limit in the event of adverse commercial real estate market shocks. The Central Bank would also have the option to tighten the limit if market developments indicated that this was appropriate.

Transitional Arrangements

The Central Bank acknowledges that existing Impacted Funds with leverage levels in excess of the leverage limit will need time to comply in order to ensure the reduction of leverage is effected in an orderly manner. A three year transitional period is proposed. Impacted Funds will be allowed to devise their own plan for reducing leverage in a gradual and orderly manner. The Central Bank may impose individual interim limits (on a path towards 50% total loans to total asset values) during the transitional period.

All new Impacted Funds will be subject to the leverage limit at the time of authorisation.

Liquidity Mismatch Guidance

Under the AIFMD, an AIFM must ensure that the investment strategy, the liquidity profile and the redemption policy of the AIF it manages are consistent. The Central Bank proposes to introduce additional guidance for Impacted Funds on aligning their redemption terms with the liquidity of their assets. The Central Bank expects to see a lengthening of the timeframe between the cut-off point by which investors are required to submit a redemption request and the point at which funds would need to pay those investors.

AIFMs of Impacted Funds will be required to consider the liquidity profile of the assets in both normal and stressed market conditions when determining redemption terms.

Where an Impacted Funds is an open-ended fund with limited liquidity, the Central Bank has suggested a liquidity timeframe of at least 12 months, which it believes should assist in ensuring that the redemption terms, including notice periods and settlement periods, of the Impacted Funds align with the liquidity of the assets held in both normal and exceptional circumstances. The Central Bank notes that such a proposal would potentially impact 48 property funds (which represents less than a third of the number of authorised property funds) which would be required to elongate their liquidity timeframes.

The Central Bank proposes that existing Impacted Funds should make any necessary changes to their structure and fund documentation “at the earliest possible opportunity”. New Impacted Funds would be expected to comply with the draft guidelines from the date of authorisation.

Next Steps

The consultation period will close on 18 February 2022 and the Central Bank will then consider all of the feedback submitted. No further indication is given in the consultation paper as to when the changes will be introduced.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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