Legal Update

New Rules for Irish Property Funds

Property funds have grown to assume an increasingly important section of the overall property market in Ireland. The Central Bank of Ireland ("CBI") has been monitoring the area and has identified excessive leverage and liquidity mismatch as potential sources of financial vulnerability which could lead to amplification of future shocks and real estate market dislocation. In their consultation paper CP145, the CBI proposed the introduction of measures to limit the ratio of property funds' total debt to their total assets (the "leverage limit") as well as guidance pertaining to their liquidity timeframes. These proposed measures were informed by feedback to CP145 from key stakeholders in the sector.

New Macroprudential Measures

The CBI has now issued additional rules for Irish property funds.

- The leverage limit will be set at 60% rather than 50% as was originally proposed. This reflects that funds may operate with a buffer below the leverage limit to avoid breaches resulting from normal market movements. The limit will apply to Irish funds with direct or indirect investment in Irish property assets, subject to a materiality threshold of 50%. Funds structured as QIAIFs were not previously subject to leverage limits although most applied these in practice and the CBI had shown reluctance to approve highly leveraged funds.
- Irish property funds investing at least 80% of their assets in social housing will not be subject to these leverage limits. The CBI has assessed that these funds pose a lower systemic risk as the likelihood of forced asset sales is considerably less than other property funds.
- Irish property funds involved in development activities are permitted to use a different methodological framework for the calculation of leverage. This reflects that lending for development purposes is often done on a loan-to-cost basis.
- The CBI Guidance sets out that generally property funds should provide for a liquidity timeframe of at least 12 months. The liquidity timeframe will assist in ensuring that the redemption terms of property funds align with the liquidity of the assets held in both normal and exceptional circumstances, and in a manner consistent with the fair treatment of investors.
- The liquidity timeframe may not be required where (i) the designation of a redemption dealing day is at the discretion of Directors rather than at the option of investors and (ii) the property fund has sufficient liquid assets not generated by disposal of Irish property assets for the purpose of funding the redemption.

Implementation

The implementation period for the leverage limit has been extended from a proposal for three years to five years to allow for the gradual and orderly adjustment of leverage in existing property funds. This implementation period will run from 24 November 2022 to 24 November 2027. There is an expectation that existing property funds with leverage levels above the limit would not increase the quantum of their debt during this period. The CBI will only authorise new funds if they meet the sixty per cent leverage limit. The CBI will also provide an 18-month implementation period for existing property funds to take appropriate steps in response to the Guidance.

ESMA Response

ESMA have since issued their advice on CBI's proposed leverage limits. They conclude that the conditions for taking actions under the Alternative Fund Managers Directive are met and that the proposed measure is justified and should contribute to improving the resilience of property funds and limiting the build-up of risk in the commercial real estate sector.

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