Asset Management & Investment Funds Update

December 2022

Leverage Limits and Liquidity Guidance for Irish Property Funds

On 24 November 2022, the Central Bank published final leverage and liquidity-related macroprudential measures for Irish property funds following its consultation on such measures this time last year (**CP145**). The final measures, as set out in the Central Bank paper 'Macroprudential measures for Irish property funds' and supported by a CP 145 feedback statement, are:

1. **Leverage Limit:** 60% debt to assets leverage limit (increased from 50% under CP145) applied as a condition on authorisation under the Irish AIFM Regulations (or relevant domestic rules in the case of non-Irish AIFMs); and

2. **Liquidity Guidance:** for

    - a 12-month minimum liquidity timeframe (i.e., from redemption notice to redemption settlement) which should be appropriately balanced between the notification and settlement periods;

    - a longer liquidity timeframe where the property fund cannot sell its assets within the minimum timeframe;

    - property funds to only be structured as closed-ended or open-ended with limited liquidity; and

    - liquidity management tools, including liquidity buffers, to only be considered as complementary to, but not a replacement for, effective redemption policies (the **Liquidity Guidance**).

The Leverage Limit and the Liquidity Guidance are applicable to Irish and non-Irish AIFMs of Irish-authorised AIFs with >50% AUM in Irish property assets (**Property Funds**).

Timing of application of the macroprudential measures

- **Leverage Limit:** the Leverage Limit is immediately applicable as a condition for authorisation of new Property Funds from 24 November 2022. For existing Property Funds, application of the Leverage Limit is subject to a five-year transition period (up from three years under CP145) with a regulatory expectation for deleveraging to be significantly progressed by end of year three and for those existing Property Funds with leverage above the limit not to increase the quantum of their debt during the transition period. Those existing Property Funds with leverage close to or above the Leverage Limit will be required to submit action plans to the Central Bank outlining how they will deleverage or maintain leverage below the Leverage Limit throughout the fiver-year transition period in a gradual and orderly manner.

- **Liquidity Guidance:** new Property Funds are expected to adhere to the Liquidity Guidance from authorisation and existing Property Funds will have an 18-month transitional period in which to take 'appropriate actions in response' to the Liquidity Guidance.

Scope of the macroprudential measures

- The Leverage Limit and the Liquidity Guidance are applicable to Property Funds and do not target Irish funds 'invested mainly' in non-Irish property assets.
- Calculation of the 50% threshold for classification as a Property Fund should take account of direct (on-balance sheet) holdings and indirect holdings including through SPEs (or similar vehicles), partnership arrangements, investments in other funds but excluding holdings via equities, debt instruments and derivatives where those instruments are (1) traded on a regulated trading venue; and (2) the underlying Irish property asset is controlled by a party that is independent of the AIF, the AIFM and/or its delegates, and its investors.
- The Leverage Limit is applicable as a single limit across the property fund sector and therefore applies irrespective of Property Funds' individual investment strategies or sub-sector exposure.
- All on-balance sheet leverage, irrespective of borrowing source, should be included in the calculation of the Leverage Limit. Specifically, shareholder loans must be included in the debt calculation. Although the Central Bank acknowledged CP145 feedback highlighting the reduced risk associated with shareholder debt when compared to third-party debt, the Central Bank consider such loans will be 'more akin to commercial lending arrangements' in light of its recently published AIFMD Q&As setting out criteria for shareholder loans to be on an arm's length basis and transacted on normal commercial terms.
- Off-balance sheet leverage as a result of derivative investments is not to be included in the calculation of the Leverage Limit.
- The Liquidity Guidance, including the 12-month minimum liquidity timeframe, is applicable to the whole portfolio of Property Funds and not just the property-related assets.
- The Liquidity Guidance may not be applicable where (i) the designation of the redemption dealing day is at the discretion of the Directors (and not the option of the investors) and (ii) the Property Fund has sufficient liquid assets not generated by disposal of Irish property assets to meet redemptions.

Exemptions/derogations from the macroprudential measures

- *For social housing funds:* Property Funds investing at least 80% AUM in social housing are not in scope of the Leverage Limit subject to satisfaction of specified conditions; and
- *For development activity:* Property Funds pursuing development activity have the option to apply a 20% margin to the value of development assets for the purposes of calculating the Leverage Limit. The definition of 'development activity' is as defined by Revenue and the permission to apply a margin is to reflect that borrowing for development is done on an LTC basis. Property funds which avail of the 20% margin option will be required to include details in an ONR regulatory return, the form of which will issue in H1 2023. Once a development asset becomes an investment asset, the margin option falls away and the standard calculation method for the Leverage Limit must be used.

Regulatory monitoring and treatment of breaches

- Regular implementation monitoring of the Leverage Limit will be undertaken by the Central Bank via an annual risk assessment process supplemented by a tailored ONR return requiring information on e.g., ongoing satisfaction of exclusion criteria (for social housing funds); use of a different leverage calculation method (for development activity); indirect holdings of funds and the maturity of shareholder loans.
- Breaches of the Leverage Limit will be dealt with 'in accordance with the Central Bank's general approach to failure to adhere to regulatory requirements'.

- Regular monitoring of the implementation and effects of the Liquidity Guidance will be undertaken as part of the overall monitoring of the macroprudential measures (see below)

Regulatory review of the macroprudential measures

The Central Bank will keep the Leverage Limit and Liquidity Guidance under periodic review and while it does not intend to recalibrate the Leverage Limit regularly, it confirms that the limit may be tightened if deemed necessary to achieve its macroprudential objective e.g., if there was evidence of significant market overheating. Should the risk environment justify, the Central Bank may consider expanding the policy measures to apply additional measures for unregulated property funds.

Next steps

The Leverage Limit and Liquidity Guidance are immediately applicable (i.e., from 24 November 2022) for new Property Funds. Existing Property Funds (i.e., as of 24 November 2022) have a transition period in which to arrange for compliance with macroprudential measures. The transition period for the Leverage Limit expires on 24 November 2027 and that for the Liquidity Guidance on 24 May 2024.