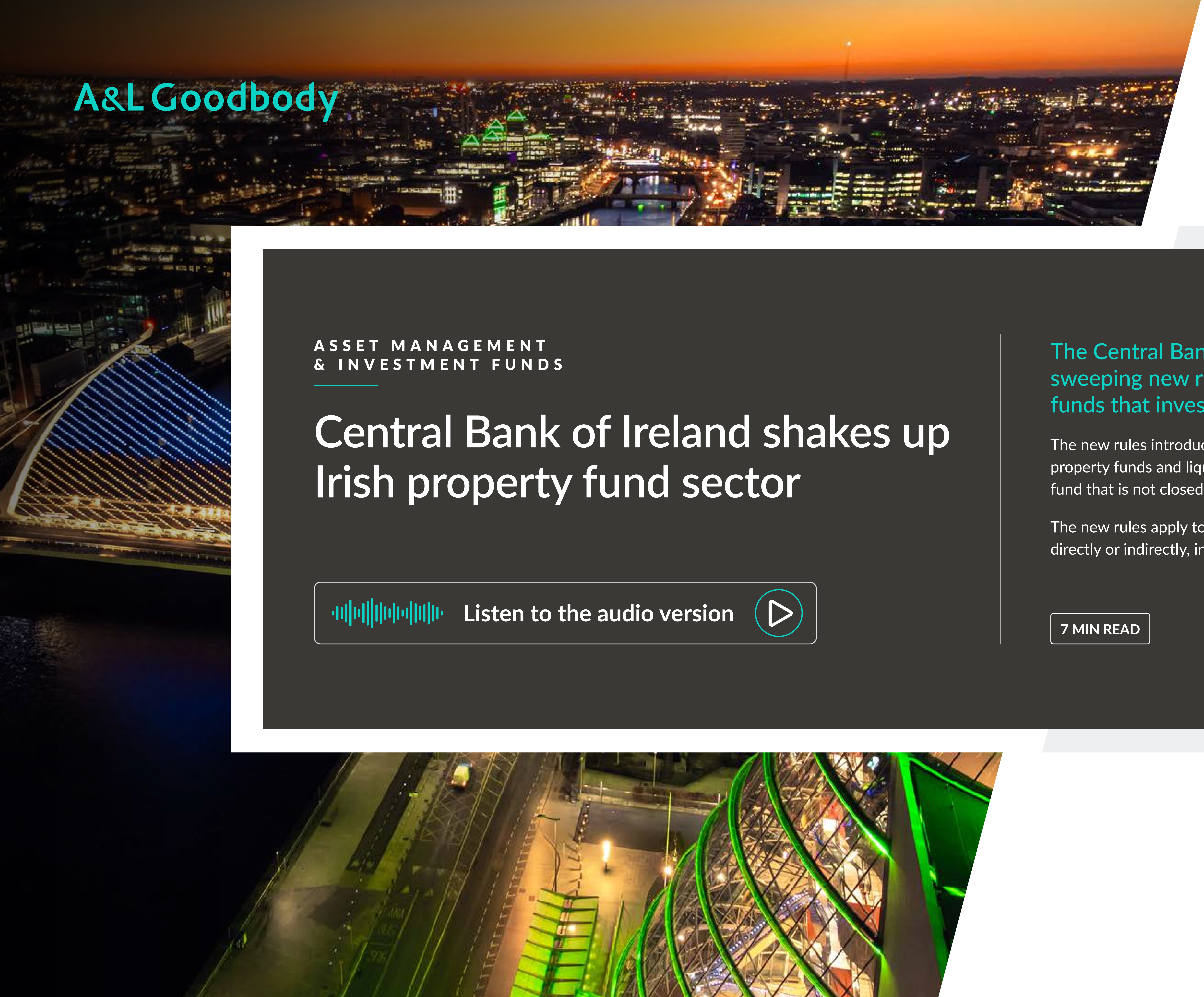

A&L Goodbody

ASSET MANAGEMENT
& INVESTMENT FUNDS

Central Bank of Ireland shakes up Irish property fund sector

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The Central Bank of Ireland (CBI) has introduced sweeping new rules that will impact on Irish regulated funds that invest primarily in Irish real estate.

The new rules introduce mandatory leverage limits for all Irish regulated property funds and liquidity requirements for any Irish regulated property fund that is not closed-ended.

The new rules apply to Irish regulated funds that invest 50% or more, directly or indirectly, in Irish property assets.

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Leverage limit

The leverage limit is a 60% debt to total asset limit. Shareholder loans are included as part of a fund's debt for these purposes.

There is a carve-out from this leverage limit for certain funds that invest primarily in social housing.

There is a five year implementation period for existing regulated funds. They will have until November 2027 to comply with the leverage limit, however, the CBI expect impacted funds to put plans in place and to have made significant progress within three years.

Different leverage calculation rules apply to property funds that carry out development activities.

The CBI have also provided that they would expect any existing Irish regulated property funds that are currently over the 60% leverage limit not to incur additional debt during the five year implementation period, while they are over such limit.

Redemption requirements

The CBI are also introducing a requirement for Irish regulated property funds that offer redemption facilities. They must have a minimum redemption period of at least 12 months from the dealing deadline to the date of payment of the redemption proceeds. This will be subject to certain exceptions. For this requirement there is an 18 month implementation period for existing funds that offer redemption facilities and do not comply with the requirement already.

The new leverage limit and the requirement regarding minimum redemption periods apply immediately for all Irish regulated property funds authorised after 24 November 2022.

> *"The new measures will apply to funds domiciled in Ireland which are authorised under Irish domestic legislation and invest 50% or more, directly or indirectly, in Irish property assets.*

Background

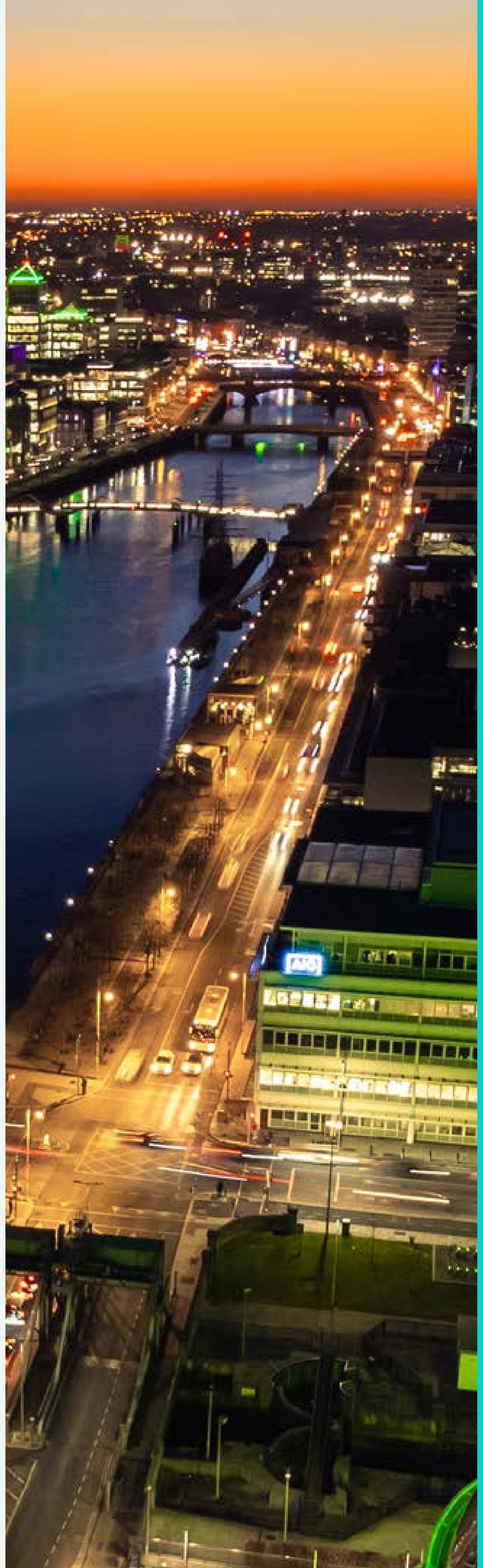
In 2020, the CBI undertook a deep-dive survey into the Irish property market. The CBI believe that this survey highlighted the potential financial vulnerabilities that could lead to forced selling behaviour within a material part of the Irish property fund sector.

The CBI also looked at the impact of any such forced sale activity on the wider economy including on lenders, other borrowers that use commercial real estate as collateral and on the general construction sector. As a result, the CBI believed that a market dislocation caused by forced selling by Irish property funds could have a material adverse macro-economic impact in Ireland. This has led them to introduce the new rules set out in this note.

What fund structures are impacted by the new rules?

The new measures will apply to funds domiciled in Ireland which are authorised under Irish domestic legislation and invest 50% or more, directly or indirectly, in Irish property assets.

The CBI has provided a non-exhaustive list of types of indirect exposure they have in mind including investment through special purpose entities, partnership arrangements or investment in other funds that hold Irish property assets. The CBI has carved out indirect holdings through holdings of equities, debt instruments or derivatives where such instruments are traded on a regulated trading venue and where the underlying Irish property is controlled by a party that is independent of the property fund, its AIFM and/or its delegates and the property fund's investors. Such indirect exposure is not counted towards the 50% threshold, however, the carve-out will be kept under review if the CBI believes that it is leading to the rules being circumvented by technical means.



Carve-out for Irish property funds investing in social housing

The CBI has included a carve-out from the leverage limit provision for funds investing primarily in social housing. This is subject to the following:

- the fund in question clearly sets out in its prospectus that it has an investment objective of investing in social housing
- the fund holds long-term leases in favour of local authorities
- the fund has no loan-to-value covenants or repayment-on-demand features associated with its debt
- the fund must invest at least 80% of its assets under management in social housing assets (and any other assets have to be limited to other property assets and/or cash-like assets)

The reason for carving out such funds is that the CBI believes they pose less systemic risk than other property funds. This is driven mainly by the fact that their core assets are the long-term leases they have in favour of local authorities.

Different calculation mechanics for property funds undertaking development activities

Property funds pursuing development activities are entitled to use a different calculation methodology when calculating leverage on development assets.

Such funds would be entitled to apply a margin of 20% to the value of development assets (which are usually accounted for at cost) for the purposes of calculating the 60% leverage limit.

The CBI has used the same definition for “development activity” as used by the Revenue Commissioners, to include the construction of new buildings and the extension, alteration or demolition of existing buildings. The definition also covers certain engineering operations, construction of roads and other activity which adapts land for materially altered use. Activity which does not adapt land for materially altered use does not qualify as “development activity”.

CBI guidance regarding minimum liquidity time frames

Irish regulated property funds will be required to have a minimum liquidity time frame of at least 12 months. This is measured from the dealing deadline to the expected payment/ settlement date.

An 18 month implementation period is provided for existing funds to take appropriate actions to comply with the guidance insofar as they do not comply with it to date.

There is a carve-out to this requirement where the designation of the redemption dealing days is at the discretion of the directors of the fund in question and the fund has sufficient liquid assets, not generated by the disposal of Irish property assets, for the purpose of funding the redemption.

Revisions and reporting

The CBI note that they do not intend to re-calibrate the leverage limit regularly. They have noted that they may tighten the limit if there was evidence of significant market overheating. However, any such tightening would be flagged well in advance.

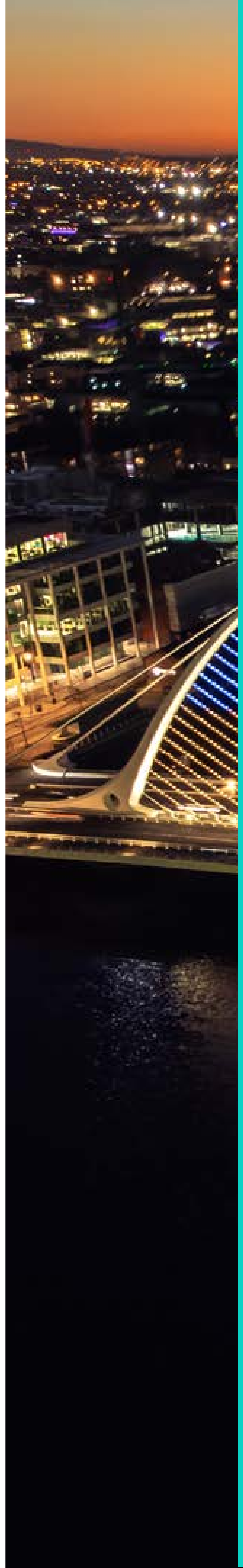
In addition, the CBI noted that they may temporarily remove the leverage limit in the event of a sudden adverse market shock to the real estate market in Ireland.

New reporting to the CBI

The AIFMs of impacted funds will be obliged to submit an annual tailored return with information relating to debt in Irish regulated property funds, including the use of different calculation methodologies in the case of funds undertaking development activities, the indirect holdings of property in funds and the maturity of shareholder loans.

In addition, funds undertaking development activity will be obliged to submit a tailored return if they choose the alternative calculation methodology for valuing assets for the purpose of the leverage limit calculations.

Finally, existing funds that are close to, or above the 60% leverage limit, will be required to submit plans to the CBI on how they will deleverage, or maintain leverage below the 60% limit, through the five year implementation period.



A final word for managers of other types of funds

The CBI note that this is the first macro prudential policy measure to be introduced by them under the non-bank pillar of their macro prudential policy framework. However, it is clear from their note that they do not see it as being their last. They will continue to develop and operationalise the macro prudential framework for the non-banks sector, specifically the funds sector, both here in Ireland and, together with other regulators, within the EU. This is only the start of the macro prudential policy journey.

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