Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

The Central Bank's macroprudential policy framework for Irish property funds

Contents

Executive summary

Irish authorised funds investing in Irish property ("property funds") have become a key participant in the Irish commercial real estate (CRE) market, holding approximately €22.1bn of Irish property (as at mid-2022).[1] This growing form of financial intermediation entails potential benefits for macroeconomic and financial stability. Often established and funded by overseas investors, property funds provide an alternative channel of financial intermediation for investment in the CRE market, reducing reliance on domestic sources of capital.

This changing nature of financial intermediation also raises the potential that new vulnerabilities could emerge, so it is important that the macroprudential framework adapts accordingly. Given the growth in the property fund sector, the resilience of this form of financial intermediation matters more today for the functioning of the overall CRE market than it did a decade ago. In turn, dislocations in the CRE market have the potential to cause and/or amplify adverse macro-economic consequences, through a range of channels. These include potential losses on lenders' CRE exposures; funding constraints for borrowers using CRE as collateral; and potential adverse implications for activity in the construction sector.

The main risk that the Central Bank's interventions seek to guard against relates to the potential that financial vulnerabilities in the property fund sector lead to forced selling behaviour in times of stress. Excessive leverage and liquidity mismatch are potential sources of vulnerability in property funds.[2] The presence of high leverage and liquidity mismatch increase the risk that – in response to adverse shocks – some property funds may need to sell property assets over a relatively short period of time, causing and/or amplifying price pressures in the CRE market**.** Central Bank analysis highlights that there is a cohort of Irish property funds that have high levels of leverage and, to a lesser extent, liquidity mismatch. Leverage in Irish property funds is – on average – higher than leverage in EU property funds. Irish property funds have a low dealing frequency, but liquidity mismatch is still evident in a subset of these funds.

In order to make this growing form of financial intermediation more resilient to shocks, the Central Bank is introducing new macroprudential measures for property funds. These are the first policy measures to be introduced under the third pillar of the Central Bank's macroprudential framework, which covers non-banks. In particular, the Central Bank is introducing a sixty per cent leverage limit on the ratio of property funds' total debt to their total assets (hereafter referred to as the "leverage limit") and Central Bank Guidance (hereafter referred to as "Guidance") to limit liquidity mismatch for property funds.

The Central Bank will provide a five year implementation period to allow for the gradual and orderly adjustment of leverage in existing property funds. The Central Bank expects that funds

[1] CRE is defined as 'commercial real estate" (CRE) means any income-producing real estate, either existing or under development, including rental housing; or real estate used by the owners of the property for conducting their business, purpose or activity, either existing or under construction; that is not classified as RRE; and includes social housing' ESRB 2019.

[2] Central Bank analysis for Irish property funds is largely based on a bespoke survey of Irish property funds carried out in 2020 (i.e. the Deep Dive Survey) together with regulatory and statistical data collected regularly by the Central Bank.

will make early and steady progress towards lower leverage levels over the implementation period. The Central Bank will provide an 18 month implementation period for existing funds to take appropriate actions in response to the Guidance. The Central Bank will only authorise new funds if they meet the sixty per cent leverage limit, while it expects that property funds authorised on or after 24 November 2022 will adhere to the Guidance from inception.

The proposed measures aim to safeguard the resilience of this growing form of financial intermediation, so that property funds are better able to absorb – rather than amplify – future adverse shocks. In turn, this would better equip the sector to continue to serve as a sustainable source of investment in economic activity. The new macroprudential measures for property funds will enhance the resilience of property funds, with broader benefits for macroeconomic and financial stability. However, like all policy interventions, they entail both benefits and costs, which the Central Bank is seeking to balance. The final policy proposals for Irish property funds take account of the considerable feedback received from CP145 and further analysis conducted by the Central Bank. The summary of the macroprudential framework for Irish property funds is outlined in Box A.

The Central Bank will closely monitor the adoption of the measures, their impact and conduct a periodic review of the framework. The Central Bank will conduct regular monitoring of the measures to ensure that they are achieving their macroprudential aims and that they are not imposing undue burden on market participants or on the broader economy. The Central Bank does not intend to recalibrate the leverage limit regularly**.** These measures are intended to deliver a structural level of resilience for the property fund sector to adverse shocks. The Central Bank will however be monitoring implementation closely, including to assess whether the technical specifications of the policy are operating in line with the ultimate objectives. Consistent with the Central Bank's macroprudential policy approach for banks and borrowers, the property fund policy measures will be subject to periodic review.

Box A: Summary of macroprudential policy measures for Irish property funds

The Central Bank is introducing new macroprudential limits on leverage and Guidance to limit liquidity mismatch in property funds. The measures are as following:

- A sixty per cent total debt-to- total assets leverage limit
  - The Central Bank will impose the leverage limit by way of condition of authorisation under Regulation 26 and, as appropriate, Regulation 9 of the Irish AIFM Regulations.
  - This leverage limit will be subject to a five year implementation period for existing funds, which will last until November 24th 2027. The Central Bank expects that funds will make gradual and orderly progress towards lower leverage levels over the implementation period.
  - The Central Bank will only authorise new property funds with leverage below the sixty per cent limit.
  - Funds investing at least eighty per cent of AuM in social housing will not be in scope of the leverage limit subject to the following criteria:
    - Social housing funds hold long term leases – the properties owned by a fund (or properties that are being developed by a fund) are leased (or pre-leased) to a local authority for a fixed period of time (depending on the type of lease held). These leases are drawn up under the standard or enhanced leasing model as used by local authorities.
    - The income is guaranteed - the local authority pays rent to the fund for the period of the lease (regardless of whether the property is occupied, or market conditions for example).
    - The debt has no LTV covenants or repayment-on-demand features associated with it.
  - Property funds pursuing development activity may use a different methodological framework for the purpose of calculating leverage on those specific assets.

- Central Bank Guidance on the application of Regulation 18 of the Irish AIFM Regulations regarding the minimum liquidity timeframe expected for property funds.
  - The Central Bank generally expects property funds to have a minimum liquidity timeframe of at least 12 months, taking into account the nature of the assets held.
  - The Central Bank will provide an 18 month implementation period for existing funds to take appropriate actions in response to the Guidance.
  - The Central Bank expects that property funds authorised on or after 24 November 2022 will adhere to the Guidance from inception.

1. Introduction

Irish property funds' investment in Irish CRE has grown in recent years with these funds holding a total of €22.1bn in Irish property, or about 35 per cent of the Irish 'investable' CRE market. This growing form of financial intermediation has brought many benefits, including diversification of the financing of CRE away from domestic to international investors and a reduced reliance on debt financing by Irish retail banks.

The changing nature of financial intermediation in the CRE market also raises the potential that new macro-financial vulnerabilities could emerge, so it is important that the macroprudential framework adapts accordingly. Central Bank analysis carried out as part of a *Deep Dive Survey* in 2020 (Deep Dive Survey) highlighted the potential financial vulnerabilities that could lead to forced selling behaviour by the property fund sector as a whole, with knock-on effects for the financial sector and real economy. Leverage, and to a lesser extent liquidity mismatch, have been identified as sources of financial vulnerability in the property fund sector that could trigger such widespread forced sales by property funds in the event of adverse shocks.

The main risk that the Central Bank's interventions seek to guard against relates to the potential that financial vulnerabilities in the property fund sector lead to forced selling behaviour in times of stress. Given the size of the sector, the impact of such sales on the Irish CRE market could be significant. By extension, this behaviour could have implications for broader financial and macroeconomic stability.

In order to guard against potential future financial stability risks, the Central Bank is introducing limits on leverage and additional Guidance to limit liquidity mismatch for Irish property funds. The objective of the proposed measures is to safeguard the resilience of this growing form of financial intermediation, reducing the risk that financial vulnerabilities might amplify adverse shocks in future periods of stress. This in turn would better equip the sector to continue to serve as a sustainable source of funding for economic activity.

These are the first macroprudential policy measures to be introduced under the non-bank pillar of the Central Bank's macroprudential policy framework. The Central Bank is particularly focused on ensuring that the wider macroprudential framework continues to evolve and adapt, to respond to the evolution of the financial system itself. One of the most pronounced changes observed in recent years at a global level has been the growth in the non-bank sector, including the investment fund sector. Given that Ireland has one of the largest investment fund sectors in the world, it is a priority for the Central Bank to develop and operationalise the macroprudential framework for the non-bank sector, safeguarding the resilience of this form of financial intermediation (Central Bank of Ireland, 2021).

This paper covers the rationale for, and objectives of, the measures; the framework design; the calibration of the measures; and the expected impacts associated with the policy measures.

2. Rationale for, and objectives of, the measures

The CRE market is systemically important for the Irish financial system and wider economy. A significant and/or unexpected disruption in the CRE market could have adverse consequences for the broader financial system and the economy as a whole. This could happen through different channels:

- **Lenders' exposures to CRE**: The most direct link between CRE markets and financial stability is through CRE loans. A dislocation in the CRE market could impair the ability of CRE borrowers to service their debts and lead to losses for lenders, impairing their own capital positions and, ultimately, resulting in a reduced supply of credit to the economy. While Irish banks' exposures to CRE have reduced significantly since the GFC, this remains a source of risk.
- **Financing conditions for borrowers using CRE as collateral**: Non-financial companies often use CRE as collateral to borrow from banks. In Ireland, for example, an estimated 45 per cent of Irish-resident SME exposures of Irish retail banks at end-2020 had CRE as collateral. In that context, a dislocation in the CRE market could result in companies finding it more difficult to access finance. This, in turn, could have broader adverse macro-financial implications for investment, employment and growth.
- **Adverse effects through the impact on, and possible spillovers from, the construction sector**: The CRE and construction sectors account for a meaningful proportion of economic activity. For example, construction employment as a share of total employment was 6.6 per cent as at Q2 2022. As a result, if there was a dislocation in the CRE market, construction could be negatively affected, with potential spillover effects into other economic sectors.

The above channels mean that a dislocation in the CRE market has the potential to have adverse macroeconomic effects. Indeed, a number of previous financial crises have been associated with sharp adjustments in the CRE market. This was the case in several countries during the GFC, including Ireland. It was also evident during the crises in Scandinavia and Japan in the early 1990s; the US savings and loan crisis; and in the emerging markets that were most affected by the 1997–1998 Asian financial crisis (see ESRB Report on vulnerabilities in EU CRE sector 2018). These negative effects can be long lasting and it can take many years for the market and the economy to recover afterwards.

2.1 Irish property funds and the resilience of CRE financing

Reflecting the systemic importance of the CRE market, the resilience of financing of CRE activity is important. In recent years, the composition of financing of the CRE market has changed, with property funds growing in importance. Over the past five years, property funds' Irish property asset portfolios are estimated to have increased by around €12.6 billion.

As of mid-2022, the 160 identified property funds held €22.1bn in Irish property assets, across a range of market segments. Overall, property funds account for about 35 per cent of the estimated stock of 'investable' CRE in Ireland. Their holdings are mostly across office, retail, and residential real estate and are concentrated in Dublin. As of 2020, the split of property assets by sector was: office 37 per cent, retail 26 per cent, residential 15 per cent and 'other' 23 per cent (Chart 1). There is greater concentration in terms of geography, with 87 per cent of property assets held by property funds located in Dublin. There is also considerable concentration amongst fund managers, with the top five fund managers managing over 75 per cent of property funds.

A key characteristic of the property fund sector in Ireland is the prevalence of single investor property funds. Analysis from the Deep Dive Survey on property funds showed that these funds accounted for €15.3bn (or 65 per cent) of property fund assets at end-2019.[3] Further, the majority of the single investors are real estate firms, private equity firms or other financial intermediaries. Some of these single investors – especially financial institutions – may in turn serve multiple investors.

Irish property funds are, on average, more highly leveraged relative to their European peers. Average leverage in Irish property funds is 45 per cent, while the European value is 17 per cent. The difference is particularly evident in the tails of the distribution. The most highly leveraged ten per cent of property funds in Europe have leverage above 58 per cent, while in Ireland, the most highly leveraged ten per cent of property funds have leverage above 93 per cent. This means that the proposed limit of sixty percent would lie above the 90th percentile of leverage across all EU real estate funds. This suggests that the limit would be "cutting off" the tail or the outliers relative to the European distribution.

Part of the reason for the higher observed leverage in Irish property funds is due to borrowing from shareholders, however this type of debt has been decreasing recently. Shareholder loans are debt-type financing provided by shareholders to the fund, and are typically the most junior debt in a funds' debt portfolio. Shareholder loans accounted for approximately 15 per cent of the total debt held by Irish property funds as at end-2021.[4] Their use had mainly been for tax efficiencies or commercial flexibility, with incentives for the former reduced in the Finance Act

[3] The Deep Dive Survey collected end-2019 data. The total amount of property assets held by these funds in the Deep Dive Survey in that period was €23.6bn.

[4] Figures based on a review of financial statements issued by investment funds identified as being in-scope of the measures. Only funds which reported to the Deep Dive Survey and continue to report financial statements as of end-2021 are taken into account. This was done for the sake of sample comparability.

2019. The Central Bank communicated its regulatory stance around the use of shareholder loans in a Central Bank's Alternative Investment Fund Managers' Directive (AIFMD) Q&A , QA 1141 and 1142.ID Q&A. In particular, the Q&A noted that that shareholder loans are not consistent with the objective of collective investment vehicles unless they were entered into at arm's length and transacted on normal commercial terms. Central Bank analysis shows that the amount of outstanding shareholder loans decreased by 39 per cent, from €2.52bn in 2019 to €1.53bn at end 2021.[5]

Although Irish property funds have a low redemption frequency, liquidity mismatch is also evident for a significant subset of these funds. Liquidity mismatch occurs when the liquidity timeframe of a fund (i.e. the period between the dealing deadline to the period of settlement of redemption proceeds) is shorter than the expected time required to sell property assets. Analysis from the Deep Dive Survey of property funds showed that in normal times, around forty per cent of property assets held by property funds could not be sold within the liquidity timeframe offered to investors (see Chart 2). This figure would likely increase in stressed periods.

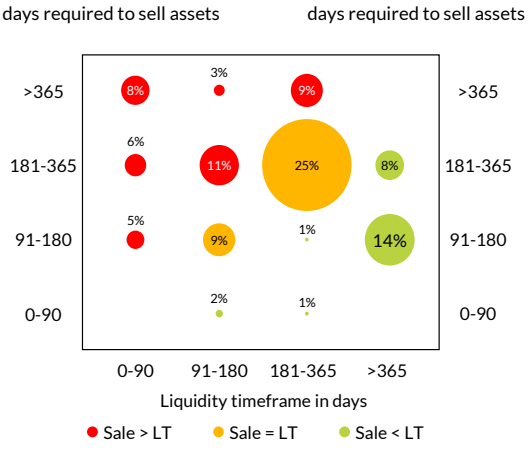
Chart 1 Distribution of property asset holdings by sector

Property funds are mostly invested in offices and retail space, while also holding residential property.

Source: Deep Dive Survey (2020), Prospectus Information and authors' calculations
Notes: Data as of end-2019. Box size is based on data on property asset holdings. Data includes 171 property funds included in the Deep Dive Survey (2020) with total property assets of €23.6bn. Data includes approximately €0.3bn (1%) of property assets not located in Ireland. Funds hold additional

Chart 2 Assets by time needed to sell in normal market conditions and liquidity timeframe[6]

Around forty per cent of real estate assets held by property funds cannot be sold within the liquidity timeframe offered, even in normal market conditions



Source: Deep Dive Survey (2020), Prospectus Information and authors' calculations.
Notes: Data as of end-2019. The size of the bubbles indicates the percentage of the total amount of assets held by the property funds identified. "Sale" refers to the days required to sell assets and "LT" refers to the liquidity timeframe in days.

[5] Figures based on a review of financial statements issued by investment funds identified as being in-scope of the measures. Only funds which reported to the Deep Dive Survey and continue to have more than fifty per cent of their AuM invested in Irish real estate according to MMIF-returns as of end-2021 are taken into account. This was done for the sake of sample comparability.
[6] Based on table 1 in the Financial Stability Note "Property funds and the Irish commercial real estate market" by Daly, Moloney and Myers (2021).

non-property assets, including liquid assets, not included in this chart.

2.2 The role and objective of the macroprudential measures for Irish property funds

The goal of the macroprudential policy measures for Irish property funds is to safeguard the resilience of this growing form of financial intermediation, thereby reducing the risk that financial vulnerabilities might amplify adverse shocks in future periods of stress. The Central Bank is introducing limits on leverage and Guidance on liquidity timeframes for Irish property funds, with a view to increasing the resilience of this significant and growing form of CRE financing. In doing so, the potential for leverage or liquidity mismatch in property funds to contribute to a disruption in the CRE market when shocks hit, will be reduced. This would, in turn, limit the knock-on effects onto the financial sector and real economy, and better equip the sector to provide a sustainable source of funding for economic activity.

This policy is consistent with the Central Bank's broader priority to develop and operationalise the macroprudential framework for non-banks, especially investment funds, working with international counterparts. The Central Bank has previously highlighted the need to develop and operationalise the macroprudential framework for the non-bank sector, both within Ireland and across Europe (most recently see Makhlouf, 2022).[7] As the financial system evolves, it is critical that the macroprudential framework remains fit for purpose to safeguard financial stability. The macroprudential measures for property funds focus on the segment of the investment fund sector in Ireland that has the closest links with the domestic economy.

The policies are not intended to replace or substitute for property funds' or investors' own risk management practices. The measures are designed to mitigate financial stability risk: that is, risks arising from collective action problems that can affect the real economy and/or other parts of the financial system. They are not designed to eliminate risk from investment activities undertaken by property funds on behalf of investors (i.e. the risk of capital loss), and should not be seen as target or optimum levels of leverage or liquidity for any given fund.

3. Framework Design

A key principle of the Central Bank's approach to macroprudential policy is to strengthen resilience before adverse shocks occur. This principle also underpins the Central Bank's proposed approach to limiting potential risks stemming from the property fund sector. The effectiveness of ex-post measures – such as seeking to reduce leverage *during* periods of stress or activating certain liquidity management tools to deal with widespread redemptions – may not be reliable or effective in all situations, especially for property funds. Therefore the Central

[7] See also Makhlouf (2021), and Donnery (2021)

Bank aims to use ex-ante polices to increase the resilience of the financial system before a shock occurs.

The framework design for the macroprudential measures for Irish property funds considered the scope of the policy measures and the choice and nature of the instruments deployed.

3.1 Scope of the policy measures

Reflecting the macroprudential objective of the measures, the measures will apply to Alternative Investment Fund Managers ("AIFMs") of Alternative Investment Funds ("AIFs") that are domiciled in Ireland, authorised under domestic legislation, and investing fifty per cent or more directly or indirectly in Irish property assets.

The materiality threshold of fifty per cent covers all direct and indirect exposures of AIFs to Irish property assets. Directly held assets refers to on-balance sheet holdings of property assets. An indirectly held property asset includes any investment undertaken by the property fund that gives exposure to, or which holds, Irish property assets. A non-exhaustive list of mechanisms used to achieve indirect exposure to Irish property assets includes the use of a special purpose entity (SPE) or similar vehicle; partnership arrangements; or investment in other funds that hold Irish property assets. The definition of indirect holdings excludes exposure to Irish property assets through holdings of equities, debt instruments and derivatives, where those instruments are (1) traded on a regulated trading venue; and (2) where the underlying Irish property asset is controlled by a party that is independent of the property fund, the AIFM and/or its delegates, and its investors. This definition may be subject to revision if circumvention of these rules via technical means is identified.

Only funds investing more than 50 per cent of their assets under management in Irish property assets are in scope of the Leverage Limit. The Central Bank has not previously differentiated between funds on the basis of location of assets, and investors are likely to be subject to similar risks from foreign property as from domestic property. However, the objective of the measures is a macroprudential one, in part driven by the significant share of Irish commercial property held by the property fund sector. Irish property funds' holdings of non-Irish property assets are small and account for a limited share of the underlying stock of foreign property assets. As such, the measures are not targeted at those funds invested mainly in non-Irish property assets.

Subject to a number of criteria, property funds investing at least eighty per cent of their AuM in social housing ("social housing funds") are not in scope of the leverage limits. The Central Bank considers that this cohort of funds poses less systemic risk than other property funds for a number of reasons, including:

- Social housing funds hold long term leases – the properties owned by a fund (or properties that are being developed by a fund) are leased (or pre-leased) to a local

authority for a fixed period of time (depending on the type of lease held). These leases are drawn up under the standard or enhanced leasing model as used by local authorities.

- The income is guaranteed - the local authority pays rent to the fund for the period of the lease (regardless of whether the property is occupied, or market conditions for example).

In order to be considered out of scope from the leverage limits, the social housing funds should:

- clearly state in its prospectus that it has an investment objective of investing in social housing;
- hold such a lease as outlined above;
- have no loan-to-value ("LTV") covenants or repayment-on-demand features associated with the debt; and
- Must invest at least eighty per cent of its AuM in social housing assets (any other assets should be limited to other property assets and/or cash or cash-like assets).

3.2. Choice of policy instrument

Leverage

A total debt -to -total asset value limit is the simplest, most direct approach to guard against the risk of excessive leverage in property funds. Property funds borrow from a number of sources, including banks, other financial institutions and their own shareholders. Limits on total debt-to-total asset values act to restrict this type of on-balance sheet leverage.[8] Rather than focusing on one type of loan or lender, which could increase the risk of regulatory arbitrage, the Central Bank has determined that a leverage limit covering all sources of debt is most aligned with the macroprudential purpose of the measures.

The inclusion of shareholder loans in the calculation of a fund's total debt is consistent with the Central Bank's expectations regarding these types of loans from an investor protection perspective. The Central Bank recognises that – from a financial stability perspective – third-party debt poses greater risks than shareholder debt. However, including shareholder debt in the definition of the leverage metric is consistent with the Bank' broader regulatory stance from an investor protection perspective. As outlined in in the AIFMD Q&A noted above, the Central Bank does not consider raising capital from investors by way of a shareholder loans to be in principle consistent with the objective of collective investment on behalf of investors. While there are circumstances in which such arrangements could take place, these transactions must meet a number of criteria that the Central Bank has set out, which make them more akin to

[8] The total debt to total assets ratio is a measure of on-balance sheet leverage. In general, unlike some other fund types, property funds do not currently utilise substantial volumes of synthetic (off-balance sheet) leverage. This will be kept under review as part of the monitoring of the implementation of the measures.

commercial lending arrangements. Further details on the analysis conducted regarding shareholder loans can be found in *Box B on Shareholder loans.*

The Central Bank recognises that there is substantial heterogeneity in property funds' CRE portfolios, as well as differences in their underlying investment strategies, however – given the objectives of the measures – the Central Bank is applying a single limit across the sector. Property funds' exposures to Irish CRE include sectors such as retail, office, industrial, and residential. These are affected by different sector-specific trends and the risk of price falls may be different across these. Furthermore, there is significant variation in the underlying investment strategies across different funds, with a diverse population of investors. Nonetheless, the Central Bank is applying a single limit across the property fund sector. This reflects three factors. First, in periods of stress, correlations between asset prices tend to increase, so in a severe shock it is likely that multiple segments of the CRE market would be adversely affected. Second, seeking to apply different leverage limits depending on exposure type or precise investment strategy would increase complexity in the macroprudential approach, which entails its own costs. Finally, while different investors may have varying investment strategies, such differences per se do not warrant variation in the application of these measures, as their objective is macroprudential. That is, the measures are intended to guard against the impacts of the collective behaviours of property funds, particularly in times of stress, which could have adverse macro-financial implications, even where the actions of funds and/or investors might be perfectly rational from an individual-perspective.

The Central Bank will only authorise new property funds with leverage below the sixty per cent limit. In relation to Irish AIFMs with existing Irish property funds, the Central Bank will impose the leverage limit by way of condition of authorisation under Regulation 9 and Regulation 26 of the Irish AIFM Regulations. Where a non-Irish AIFM is managing an existing Irish Property Fund, the condition will be imposed under the relevant domestic funds legislation.

Liquidity mismatch

The regulatory framework for AIFMs already includes provisions to limit the degree of liquidity mismatch in funds. Regulation 18 of the Irish AIFM Regulations outlines *(inter-alia)* fund managers' obligations with respect to liquidity management in the funds that they manage. When applied appropriately by a fund manager, this should result in the investment strategy, the liquidity profile and the redemption policy of the AIF being consistent. In practice, however, the Central Bank has observed significant variation in how property funds align redemption policies with the liquidity profile of the assets, particularly in periods of market stress.

In principle, there are a number of means through which liquidity mismatch in property funds could be mitigated, but it is the view of the Central Bank that vulnerabilities would be best mitigated by better aligning redemption terms with the liquidity of the assets. Specifically:

- **While increasing liquid asset buffers is often considered a tool for addressing liquidity mismatch in funds, in the case of property funds it is likely to be ineffective.** Property

funds hold mainly real property assets, which are very illiquid. Therefore, it is likely to be difficult for property funds to replenish their liquid asset buffers, should they experience large volumes of withdrawals. In addition, it is much more difficult for property funds to slice vertically their portfolios to meet redemptions. This means that ex-ante higher liquid asset holdings are unlikely to be an effective approach to addressing liquidity mismatches for property funds, in a manner that treats all investors fairly.

- **Liquidity management tools (LMTs) can also be used to manage liquidity risk, but these are not substitutes for the alignment of redemption terms with the liquidity of the assets.** Notwithstanding the role of LMTs for funds, which are an important part of the idiosyncratic management of liquidity, these tools are often *ex post* in nature and as such do not address liquidity mismatch *ex ante*. In addition, *ex ante* tools that aim to better pass on the liquidity costs to redeeming investors are likely to be less effective in the case of property funds, given: (i) the very illiquid nature of property assets; (ii) the long timeframes for disposing of property; and (iii) the uncertainty associated with estimating those liquidity costs for property investments, especially in times of stress.

Given the above, and in the context of the very illiquid nature of property assets, the Central Bank is issuing Guidance with respect to how Regulation 18 of the Irish AIFM Regulations should be applied for property funds in the context of liquidity timeframes. The outcome of the Guidance is that Irish property funds may need to extend their notice and/or settlement periods, to better align with the liquidity profile of their assets. This is consistent with the Central Bank's expectation that property funds ensure there is alignment between the investment strategy, liquidity profile and redemption policy of funds under management.

The Central Bank acknowledges that there are some circumstances where the liquidity timeframe may not be required. In particular, and subject to prudent liquidity management by the fund manager, the liquidity timeframe may not be required for property funds 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 for the purpose of funding the redemption.

4. Calibration of leverage limits and liquidity timeframes

The Central Bank's calibration decisions are informed by a range of evidence, but ultimately guided by policymaker judgement. A single model for weighing-up all benefits and costs of policy action quantitatively does not exist. More broadly, over-reliance on any single model or approach would entail its own risks, since all models involve necessary simplifications. The calibration strategy for the property fund measures, therefore, involves a combination of quantitative impact assessment and judgement around harder-to measure elements of the cost-benefit relationship.

In general, the Central Bank considers the property fund measures to be a permanent feature of the domestic macroprudential framework going forward. The Central Bank does not intend

to recalibrate the measures regularly, but their calibration would be considered as part of a periodic framework review. The Central Bank reserves the right to take action as required in the face of significant macro-financial developments as outlined in Section 4.1.2.

4.1 Leverage limit calibration

To guard against excessive levels of leverage across the property fund sector, the Central Bank has calibrated the leverage limit for property funds to sixty per cent of total debt to total assets. This limit applies to all in-scope property funds. Based on feedback received to CP145, the Central Bank anticipates that to avoid breaches of the leverage limit, property funds may seek to maintain a leverage ratio below sixty per cent in order to manage idiosyncratic variations in property prices. The Central Bank considers that maintaining such buffers would be prudent.

A number of factors were taken into account when calibrating the leverage limit. These included: actual observed levels of leverage of property funds in Ireland and other EU jurisdictions; the level of the limit that is likely to better protect against CRE price falls in periods of stress; the leverage limits that exists for other property investment entities in Ireland such as REITs and for property funds in other jurisdictions (where available); and the evidence and feedback provided in response to CP145.

The observed leverage in property funds in Ireland is significantly higher than the European average. New data from ESMA show that the median European property fund has very low leverage compared to those in Ireland. The difference is particularly evident in the tails of the distribution. The most highly leveraged ten per cent of property funds in Europe have leverage above 58 per cent, while in Ireland, the most highly leveraged ten per cent of property funds have leverage above 93 per cent. This means that the proposed limit of sixty per cent would lie above the 90th percentile of leverage across all EU real estate funds. This suggests that the limit would only be "cutting off" the tail or the outliers relative to the European distribution.

Historical experience shows that CRE markets can see large price falls in periods of stress. In the global financial crisis, peak-to-trough CRE prices falls exceeded thirty per cent in a number of jurisdictions. The Irish CRE market saw even larger falls. Year-on-year CRE price falls in Ireland exceeded forty per cent during the crisis, and the peak-to-trough price fall in the last crisis was almost seventy per cent. The calibration of the limit does not aim to guard against the most severe CRE price falls observed historically in Ireland. But future price falls in periods of stress could compromise funds' ability to remain within their covenant limits or refinance their debt, and may lead to forced sales of property assets. A historical Value at Risk (VaR) model estimates that there is a 95 per cent probability that the maximum annual loss in the CRE market is 24 per cent and a 99 per cent probability that the maximum annual loss in the CRE market is 43 per cent.

Consideration was given to limits that exist in other property investment entities in Ireland as well as for property funds in other jurisdictions. Within Ireland, leverage in REITs, another key

participant in the Irish CRE market, is also restricted, with the level of borrowings not allowed to exceed fifty per cent of the market value of the properties held (see the Finance Act 2013). In Germany, two limits exist – thirty per cent for public open-ended funds (similar to our retail AIFs), and sixty per cent for Immobilien-Spezialfonds (the fund group targeted for institutional investors, similar to qualified investor AIFs). The Central Bank's measures relate to funds that have a similar investor base as the German Immobilien-Spezialfonds.

4.1.1 Methodological adjustments for development activities

Property funds pursuing development activity may use a different methodological framework for the purposes of calculating leverage on development assets.[9] The Central Bank considers "development activity" as defined by the Revenue Commissioners, to include the construction of new buildings and the extension, alteration or demolition of existing buildings. It also covers engineering operations such as levelling, construction of roads, and the laying of sewers, or water or gas mains which adapt the land for materially altered use. It does not include maintenance or repair or engineering works which do not adapt the land for materially altered use. Borrowing for development activity is typically conducted on a loan-to-cost (LTC) basis, which is not the same as the proposed total debt-to-total assets in the Central Bank's methodology. This is a methodological accommodation for development activities, reflecting the fact that the cost-based valuation does not account for the value-added of a completed asset that development activity generates. Funds with development assets may use a different methodological framework for the purposes of calculating their leverage limit that takes account of the fact that borrowing for development is done on an LTC basis.

Property funds pursuing development activity will be permitted to apply a margin to the value of development assets (which are usually accounted for at cost) for the purposes of the calculation of the leverage limit. Once an asset which had been the subject of development activity becomes an investment asset, the standard calculation framework, in-line with the sixty per cent limit would apply. Based on a range of data sources, the Central Bank has judged that this margin be set at twenty per cent. This estimate holds across industry reported data, publicly available information, and proprietary data.

In practice, property funds pursuing development activity will have the option to use this different methodology, although it is not a requirement. If they choose to use this approach, they must include the relevant details in a tailored regulatory return that the Central Bank will issue in H1 2023.

In order to respond to market developments, the Central Bank may adjust the margin that property funds may apply to the valuation of development assets for the purposes of calculating the leverage limit. This could occur, for instance, in response to shifting margin levels witnessed in commercial development activity, or any unintended outcomes as a result of

[9] Development assets should typically equate to the sum of the development costs.

applying this methodological adjustment. In keeping with expected practice, as outlined in Section 2, the Central Bank would expect to provide an implementation period for any such adjustment in order to avoid pro-cyclical effects unless it is not feasible to do so.

Box B: Recent trends in shareholder loans

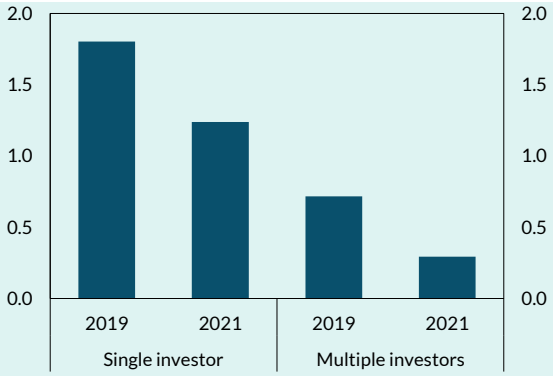
Extensive analysis has been conducted by the Central Bank on the use of shareholder loans by property funds. Recent financial statements of property funds were analysed to gain further information and insights into the use of shareholder loans. The main findings were as follows:

- Outstanding shareholder loans in funds which explicitly reported this type of debt decreased by 39 per cent, from €2.52bn in 2019 to €1.53bn at end 2021.[10]
- Single and multi-investor funds reduced their reported shareholder loans by 31 per cent (€0.56bn) and 59 per cent (€0.42bn) respectively between 2019 and 2021 (see Chart 3).
- For those funds that report a maturity date, 73 per cent of the remaining balance of shareholder loans is set to mature by the end of 2027 (see Chart 4).
- In order to meet the sixty per cent leverage limit, the sector would need to replace around €1.67 billion of debt with equity in total. A large portion of that (€0.56bn) is estimated to be in the form of shareholder loans which will have matured by end-2027.
- Approximately €1.11bn of 'excess' debt would remain after the implementation period, taking the maturing of shareholder loans into account (and assuming that these loans convert to equity).
- An additional €0.34bn of shareholder loans do not report a maturity date or are due to mature after end-2027. Converting these to equity is one of the means through which funds could adjust to the meet the leverage limits. Once these are taken into account the estimate of 'excess' debt falls to €0.83bn.

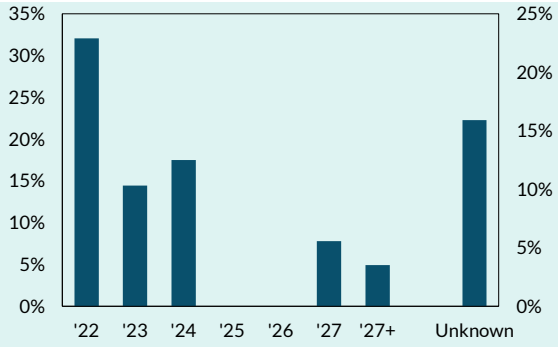
Chart 3 Value of shareholder loans since 2019

Chart 4 Remaining maturities for shareholder loans

[10] Figures based on a review of financial statements issued by investment funds identified as being in-scope of the measures. Only funds which reported to the Deep Dive Survey and continue to have more than fifty per cent of their AuM invested in Irish real estate according to MMIF-returns as of end-2021 are taken into account. This was done for the sake of sample comparability. This is used throughout the box.



Sources: Deep Dive Survey (2020) and latest available financial statements as of August 2022.
Notes: Based on a sample of matched funds between the list of current property funds and funds present in the Deep Dive Survey data (115 funds in total, of which 49 have shareholder loans outstanding as of end-2021).



Sources: Sources: Deep Dive Survey (2020) and latest available financial statements as of August 2022.
Notes: Based on a sample of matched funds between the list of current property funds and funds present in the Deep Dive Survey data (115 funds in total, of which 49 have shareholder loans outstanding as of end-2021).

4.1.2 Approach to calibration of the leverage limit over the cycle

The Central Bank does not intend to recalibrate the leverage limit regularly. These measures are intended to deliver a structural level of resilience for the property fund sector to adverse shocks. The measures will be subject to a periodic framework review which will consider the calibration of the leverage limit among other things. Nevertheless, to achieve its macroprudential objective, there will be flexibility to respond to material changes in the macro-financial environment. The leverage limits will thus be counter-cyclical in nature.

In the event of a sudden adverse CRE market shock, the Central Bank may temporarily remove the leverage limit, subject to conditions. Large, unanticipated price corrections may mean that some property funds would inadvertently breach the limit, even if they maintained a prudent buffer. The objective of the measures is to ensure that property funds are better able to absorb – rather than amplify – shocks in times of stress. To achieve that aim, funds need to be able to absorb price falls in times of system-wide stress, without needing to reduce leverage over a short period of time through asset sales. Therefore, in the case of a substantial decline in values across the sector, the Central Bank would consider temporarily removing the limit for existing property funds, subject to certain conditions. [11]

The Central Bank's strategy would be to only tighten the limit if there was evidence of significant market overheating. In those circumstances, the risk of larger price falls – and associated adverse macro-financial implications – would increase, so property funds may be required by the Central Bank to adjust their leverage counter-cyclically in order to be resilient to potential shocks. Given the calibration of the limit, the Central Bank would not be expecting

[11] For example, it is anticipated that if the limit was to be temporarily removed for existing funds, it would continue to apply to any new funds authorised during that period.

to take this action unless there was evidence of significant price misalignments. In the instance of a tightening of the limit, the Central Bank will judge the implementation timeframe taking account of the prevailing macro-financial environment.

The Central Bank will typically communicate any changes to the limit as part of the Financial Stability Review, including the rationale for any changes. This is especially the case for any counter-cyclical tightening of the limit. In the instance of a tightening of the limit, the Central Bank will judge the implementation timeframe taking account of the prevailing macro-financial environment. In the case of a temporary removal of the limit, the announcement could take place outside the Financial Stability Review cycle which occurs bi-annually. The Central Bank would expect to move much more rapidly in such a scenario, for example, in the event of substantial market shock. A public consultation will not be conducted in the event of changes to the calibration, such as temporary removal of the limit or a counter-cyclical tightening. Rather, the communication process will be similar to the process taken for the counter-cyclical capital buffer in the banking sector, with public announcements and market updates provided.

4.2 Liquidity timeframe calibration

In order to determine the appropriate liquidity timeframe for Irish property funds, the Central Bank considered the length of time it takes Irish property. Based on funds' own assessments in the Deep Dive Survey (Table 2), as of early 2020 €17.6bn or 75 per cent of property assets can be sold in less than 12 months, while €4.2bn or 18 per cent of property assets take longer than 12 months to sell (6 per cent of assets have a time to sell which is unknown). It should be noted that these are estimates of time to sell in normal market conditions and it would be expected that time to sell could become considerably longer in times of stress. For example, the average time-to-sell that property funds use in their internal stress tests is 14 months. The Central Bank judges that – in considering their redemption policy – property funds should focus not only on liquidity under normal market conditions, but also on liquidity under stressed conditions.

Separately, there is significant variance in the underlying liquidity of Irish property funds' assets by type of CRE. For example, using the Deep Dive Survey, only €1bn (19 per cent) of retail CRE could be sold in less than six months while €4.1bn (51 per cent) of office CRE could be sold within this timeframe under non-stressed conditions (see Table 2).

Table 2: Reported liquidity of funds' property assets, by liquidity bucket, € billions and property type (2019)

Property Type	Property Liquidity Buckets (€ Billions)			
	< 180 days	*180-365 days*	*>365 Days*	*N/A*
Office	4.1	3.4	0.5	
Retail	1.0	2.2	1.9	
Residential	0.5	2.4	0.7	

Industrial	0.6	0.2	0.2	
Land/Development	0.1	0.8	0.5	
Other	0.1	2.2	0.3	
Unknown				1.6
Total Property Assets	**6.4**	**11.2**	**4.2**	**1.6**

Source: MMIF Q4 2020 & Deep Dive Survey

Notes: Information on portfolio liquidity taken from Deep Dive Survey. €1.6bn in 'unknown' CRE assets relates to funds for which information is not available in the Deep Dive Survey on property type or its liquidity.

According to the ESRB Non-Bank Financial Intermediation Monitor (2021) '*...liquidity mismatch remains a key vulnerability in the open-ended CRE fund sector*', and as such there are a wide range of measures used across other European jurisdictions to manage liquidity mismatch in property funds. Some jurisdictions such as Belgium, Italy, the Netherlands and Poland have only closed-ended property funds (ESRB, 2021). Others, such as Germany, Hungary and Portugal some form of a minimum notification period to manage liquidity mismatch in property funds.

Based on the Central Bank's analysis, property funds should generally provide for a liquidity timeframes of at least 12 months, taking into account the nature of the asset held. This reflects the following factors:

- Even in normal times, and according to property fund managers' own assessments, the average time to sell an Irish property asset is around six to seven months. Further, there is substantial variance around those averages, depending on the individual asset.

- This timeframe is likely to be longer in periods of market stress. For example, the average time-to-sell that property funds use in their internal stress tests is 14 months. This is consistent with broader evidence around market liquidity and increased uncertainty, as well as property fund managers' own views in response to the Central Bank's Deep Dive Survey.

- More broadly, while individual property funds may judge that they could dispose of a property over a given timeframe without affecting market prices, that timeframe is likely to be longer if all property funds were behaving in a similar manner.

- Finally, although some properties may be able to be sold more quickly, a longer timeframe reduces the risk that the fund manager may choose to sell the fund's highest quality, most liquid assets to meet redemptions, which would risk disadvantaging remaining investors or lead to potential first-move advantage dynamics.

The Guidance also outlines the Central Bank's judgement that longer notice periods are better able to guard against 'first mover advantage' dynamics than longer settlement periods. Property funds should appropriately balance their notification and settlement periods. There should be sufficient time after the notification of an investor's intention to withdraw funds for

both the liquidation of property assets held by the fund and the settlement of redemption proceeds with the underlying investor. The use of longer notification periods would help to prevent the development of misaligned incentives that can contribute to first-mover advantage dynamics.

4.3 Implementation period

Leverage limit

The Central Bank recognises that existing property funds will require time to adjust. The Central Bank is therefore providing a five - year implementation period for existing funds from the date of publication of this document. The implementation period time is longer than initially proposed in order to facilitate a gradual and orderly adjustment to the measures, but also it is reflective of the current macro-economic environment of rising interest rates and a slowdown in global and Irish economic growth since the consultation paper was launched.

Over the implementation period, existing property funds that are currently in excess of the limit are expected to reduce gradually their leverage to meet the new limit. Those funds identified with leverage close to or above the sixty per cent leverage limit will be required to submit plans to the Central Bank on how they will deleverage or maintain leverage below sixty per cent throughout the implementation period in a gradual and orderly manner. During the implementation period the Central Bank would not expect funds with leverage above the limit to increase the quantum of their debt. The Central Bank will be actively monitoring and following up to ensure appropriate progress is being made throughout the implementation period and expects that deleveraging should be significantly progressed by the end of year three.

The Central Bank will only authorise new funds with leverage below the sixty per cent leverage limit.

Liquidity timeframes

Existing funds will be given 18 months to take appropriate action in response to the Guidance. The Central Bank would expect that funds authorised on or after 24 November 2022 will adhere to the Guidance at inception.

4.4 Monitoring and review

Consistent with the Central Bank's macroprudential policy approach for banks and borrowers, the property fund policy measures will be subject to periodic framework review, while monitoring of the implementation of the measures will be more frequent. A periodic framework review will be undertaken to ensure that the main elements of the package are commensurate with the financial stability risks posed by the potential collective actions of the property fund sector. Such a review would include, for example, the impact of these

macroprudential measures, the evolving macro-economic and financial risk environment and any unintended consequences of the policy measures.

Leverage Limit

Consistent with other regulatory requirements, the leverage limit would be subject to regular monitoring in the Central Bank. The implementation of the limit will be assessed via the Article 25 AIFMD risk assessment process which ESMA require to be conducted at least on an annual basis. This assessment will be supplemented with a tailored return where further information will be sought, including, for example, information on meeting exclusion criteria (for social housing funds); the use of the different methodological framework in the case of development activity; and the indirect holdings of funds and the maturity of shareholder loans. It will be the responsibility of funds to ensure that all reporting is accurate and that reported valuations are up to date ahead of the assessment deadline each year. Funds may be asked to resubmit data in the event that the Central Bank identifies errors in reported values.

In general, the Central Bank will deal with breaches of the leverage limit as and when they occur, in accordance with the wider supervisory practice for investment funds. . As part of this process, the Central Bank's approach to enforcement of the leverage limit will be cognisant of the fact that forced asset sales run contrary to the underlying objective of the limit itself.

Liquidity Timeframes

While there are not the same annual review requirement as per Article 25 AIFMD, the Central Bank would conduct regulator monitoring of the implementation and effects of the Guidance as part of its overall monitoring of the measures. In addition, the Central Bank may undertake periodic framework reviews of this Guidance alongside any wider reviews of domestic AIF rules or regulations.

5. Impact analysis of the measures

The macroprudential policy measures are expected to increase the resilience of the property fund sector and bring Irish property funds more in line with their European peers. The leverage limit will increase the sector's resilience to CRE price falls while longer liquidity timeframes will reduce the potential for liquidity mismatch. In introducing these measures, the potential for leverage and liquidity mismatch to contribute to a disruption in the CRE market when shocks hit will be reduced. This would, in turn, limit the knock-on effects onto the financial sector and real economy, and better equip the sector to serve its purpose as a sustainable source of funding for economic activity.

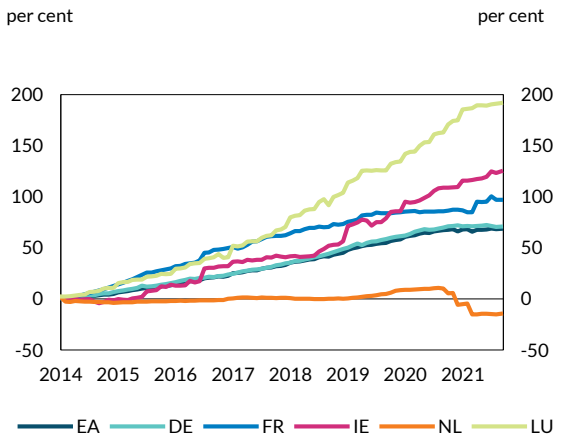
As with all macroprudential policy interventions, the benefits have to be weighed against the potential costs and effects of the measures. One of the main potential channels in terms of cost-benefit that the Central Bank has considered relates to the possible impact of the measures on

the volume of CRE investment. Another potential channel relates to the possible "leakage" from the measures with property fund managers moving CRE investment to either unregulated structures or re-domiciling their funds. As outlined above, a single model for weighing up all benefits and costs of policy action quantitatively does not exist, so there is a significant role for policymaker judgement.

Evidence from Germany – host of the largest property fund sector in Europe, where similar limits have existed for several years – suggests that flows into property funds have remained robust. Germany has the largest property fund sector in Europe and has had limits both on leverage (for both retail and professional investor property funds) and minimum notification periods (for retail property funds) for a number of years. Nevertheless, in recent years, flows into property funds in Germany have remained broadly comparable to those in other European jurisdictions (see Chart 5). This points to such limits not having acted as a material constraint on sustainable investment in the CRE market.

Chart 5: German real estate fund inflows have remained in line with euro area averages after the introduction of leverage limits

Cumulative net inflows as a percentage of end-2014 real estate funds industry



Source: ECB IVF dataset, Central Bank of Ireland calculations
Notes: Data includes both UCITs and non-UCITS funds in addition to property funds. The sample includes all real estate funds, including those investing in non-domestic real estate. EA has a changing composition. Last observation 2022-08.

Similarly, it is anticipated that any effect on residential investment would be limited. Property funds form only one part of the private non-household institution sector, which collectively accounted for around €1.6 billion, or 11.1 per cent of total residential real estate transactions, in 2020. This €1.6 billion also includes purchases by companies, financial institutions, and other private institutional investors. In terms of their total stock, according to AIFMD data, of the funds in scope of the measures as of end-2021, 37 funds (or 23 per cent of property funds identified) had more than half of their portfolio invested in residential real estate assets, totalling €3.1 billion. Of this group, the average leverage ratio was 52 per cent as of end-2021,

compared with 55 per cent for those with no residential property, while funds invested entirely in residential real estate had an average leverage level of 41 per cent. Funds with significant exposure to residential real estate would therefore be less constrained on average by the proposed leverage limit, relative to those with no residential property. Given the high rental yields in Ireland relative to the rest of Europe, it is expected that after the required adjustment investment in residential rental property, which forms the vast majority of residential investment, would still provide an attractive return for sustainable investment.[12] [13]

As with policy interventions generally, there is the potential for "leakage" as an unintended consequence or cost. There is a risk that these measures make investing in property via regulated investment funds less attractive vis-à-vis other options, i.e. unregulated funds or SPEs; and managers may re-domicile funds to other EU jurisdictions, which would be outside of the scope of the measures. While, in and of itself, this would not be reason enough on its own not to try and enhance the resilience of the property fund sector domiciled in Ireland currently, it could have implications for regulatory effectiveness, in addition to investor protection, if movement was into unregulated structures. Re-domiciliation risk suggests reciprocity may be key to ensuring the success of these measures. While this is currently not provided for in Article 25 AIFMD, is it something the Central Bank believes should be aimed for. The Central Bank will actively pursue reciprocity with other European jurisdictions in this area. The Central Bank will continue to monitor developments in the CRE market for evidence of changing investment patterns following the announcement of the measures, alongside other relevant macro factors. The Central Bank will act as needed to amend the scope of the measures in the instance of material shifts in the approach to CRE investment by property funds.

6. Conclusion

Irish-authorised funds investing in Irish property have become a key participant in the Irish CRE market. The CRE market is systemically important to the broader Irish economy and dislocation in this market has the potential to cause and/or amplify adverse macro-economic shocks. Central Bank analysis has identified excessive leverage and, to a lesser extent, liquidity mismatch as vulnerabilities in the Irish property fund sector.

In order to safeguard the resilience of this growing form of financial intermediation to shocks, the Central Bank is introducing new macroprudential measures for property funds. The Central Bank has consulted extensively and conducted in-depth analysis on the measures. The Central Bank is introducing a sixty per cent leverage limit on the ratio of property funds' total debt to their total assets, with certain conditions, and Central Bank Guidance to limit liquidity mismatch for property funds.

[12] Yields are based on Catella Real Estate data.
[13] The other category of residential investment is build-to-sell, where a small number of funds have been active.

The Central Bank will closely monitor the adoption of the measures, their impact and conduct a periodic review of the framework. The Central Bank will conduct regular monitoring of the leverage limits to ensure that they are achieving their macroprudential aims and that they are not imposing undue burden on market participants or on the broader economy. Consistent with the Central Bank's macroprudential policy approach for banks and borrowers, the property fund policy measures will be subject to a periodic framework review. Such a review would include, for example, the impact of these macroprudential measures, the evolving macro-economic and financial risk environment and any unintended consequences of the policy.

Appendix 1

Final Guidance on redemption terms for property funds

This Guidance is relevant to Alternative Investment Funds (AIFs) domiciled in Ireland, authorised under domestic legislation, and investing fifty per cent or more directly or indirectly in Irish property assets , hereafter termed 'property funds'. It is supplementary to the provisions of the AIF rulebook.

Regulation 18 of the European Union (Alternative Investment Fund Managers) Regulations (S.I. No. 257/2013) (the Irish AIFM Regulations) requires, inter alia, that an AIFM shall ensure that, for each AIF that it manages, the investment strategy, the liquidity profile and the redemption policy are consistent. In order to further mitigate vulnerabilities stemming from liquidity mismatch in property funds, AIFMs managing property funds should take into account the following:

1. The Central Bank will not authorise property funds if they are not structured as (i) closed-ended or (ii) open-ended with limited liquidity as per the Central Bank's AIF Rulebook. During the design phase for such property funds, the Board of the AIFM should carefully consider and document what structure may be most appropriate, taking into account the nature of the assets held, whether a secondary market exists for such assets and whether redemption requests could be met without recourse to selling large portions of the property fund's portfolio.

2. Given the highly illiquid nature of property assets, the Central Bank expects that the redemption policies of property funds provide for a significant timeframe between the dealing deadline and payment of redemption proceeds (i.e. the liquidity timeframe). When designing their redemption terms, AIFMs must take into account the liquidity of property assets under both normal and stressed market conditions. It can take between six and seven months to sell an Irish property asset under normal market conditions. This timeframe is likely to be higher during periods of market stress and/or if a number of property funds are trying to sell similar assets at the same time.

3. The Central Bank recognises that there are a number of means through which liquidity mismatch in property funds could be mitigated. However, liquidity management tools should be considered as complementary to effective redemption policies (and not a replacement for appropriate alignment of redemption terms with the liquidity profile of a funds' assets). AIFMs of property funds should not place undue reliance on the availability of liquid asset buffers to manage liquidity risk, given that this may amplify first-mover advantage dynamics.

4. Property funds should have liquidity timeframes that explicitly allow for a significant timeframe between the point at which an investor must submit a redemption request for a particular dealing day (notification point) and the point at which investors will

expect to receive redemption proceeds from the fund (settlement point). Generally, property funds should provide for a liquidity timeframe of at least 12 months, taking into account the nature of the assets held.

5. Such a liquidity timeframe will assist in ensuring that the redemption terms of the property fund 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.

6. Subject to prudent liquidity management by the AIFM, the liquidity timeframe may not be required where (i) the designation of a redemption dealing day is at the discretion of Directors (and not 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. The terms on which redemptions will be satisfied must be set out in the prospectus.

7. The liquidity timeframe should be appropriately balanced between the notification period and the settlement period reflecting the importance of each. Settlement periods give the property fund time to dispose of property assets in order to limit any impact on market prices. However, the notification period plays an additional role, as it assists the AIFM in appropriately managing redemption requests and provides more time to ensure valuations accurately reflect the price they expect to receive, including under stressed market conditions.

8. Property funds that cannot sell their assets within the minimum timeframe should consider having longer liquidity timeframes in place, consistent with Regulation 18 of the Irish AIFM Regulations.