

The role of institutional investors in housing markets

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1. Recent Trends and Key Features: A Global Perspective
2. Institutional Investors in Euro Area Housing Markets
3. Selected Policy Considerations
4. Concluding Remarks

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Steady increase in RE institutional investment since the onset of GFC..

❑ Low interest rate environment

- Downward pressure on fixed income
- Search for yield in alternative markets (real estate sector)

❑ Reform of the prudential regulatory framework

- Tightening of mortgage lending standards

- Revitalized **rental housing markets**: [\(Gete and Reher \(2018\)\)](#)
- Increasing presence of **REIFs**:
 - Upward pressure on housing prices: [Lambie-Hanson, Li and Slonkosky \(2022\)](#)
 - Capacity to set prices and decreased affordability: [Mills et al. \(2016\)](#);
 - Reliance on external funding (Investors are the most affected by LTV limits): [\(Tzur – Ilan \(2020\)\)](#).
- Incentivized REIFs to rely on **non-bank funding**: [Hoesli et al. \(2017\)](#)

A global business: market expansion and concentration

World's largest property managers

Total real estate assets under management (€bn)



Sources: Inrev; Anrev; NCREIF
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The rise of Blackstone

Assets under management (\$bn)



Property is a key component of Blackstone's portfolio

Assets under management, 2019 (\$bn)

The role of direct lending and debt funds

□ Global markets

- *“Debt funds are often backed by institutional investors or by credit lines from banks, who do not have to account for such lending as real estate loans. Lending by these funds helped to propel a boom in high-end residential construction.”*

Sam Zell, Chicago-based real estate billionaire

- *“There may be a bubble in credit, and it’s not with the banks, but with the debt funds... We are already seeing cracks in the system, with loans not hitting their business plans.”*

Josh Zegen, co-founder of the US real estate private equity firm Madison Realty Capital

- *“Debt markets feel “frothy”. “Loan-to-value ratios have been really disciplined but there has been an aggressiveness in loan pricing which seems to know no bounds right now.”*

Matt Borstein, global head of commercial real estate at Deutsche Bank

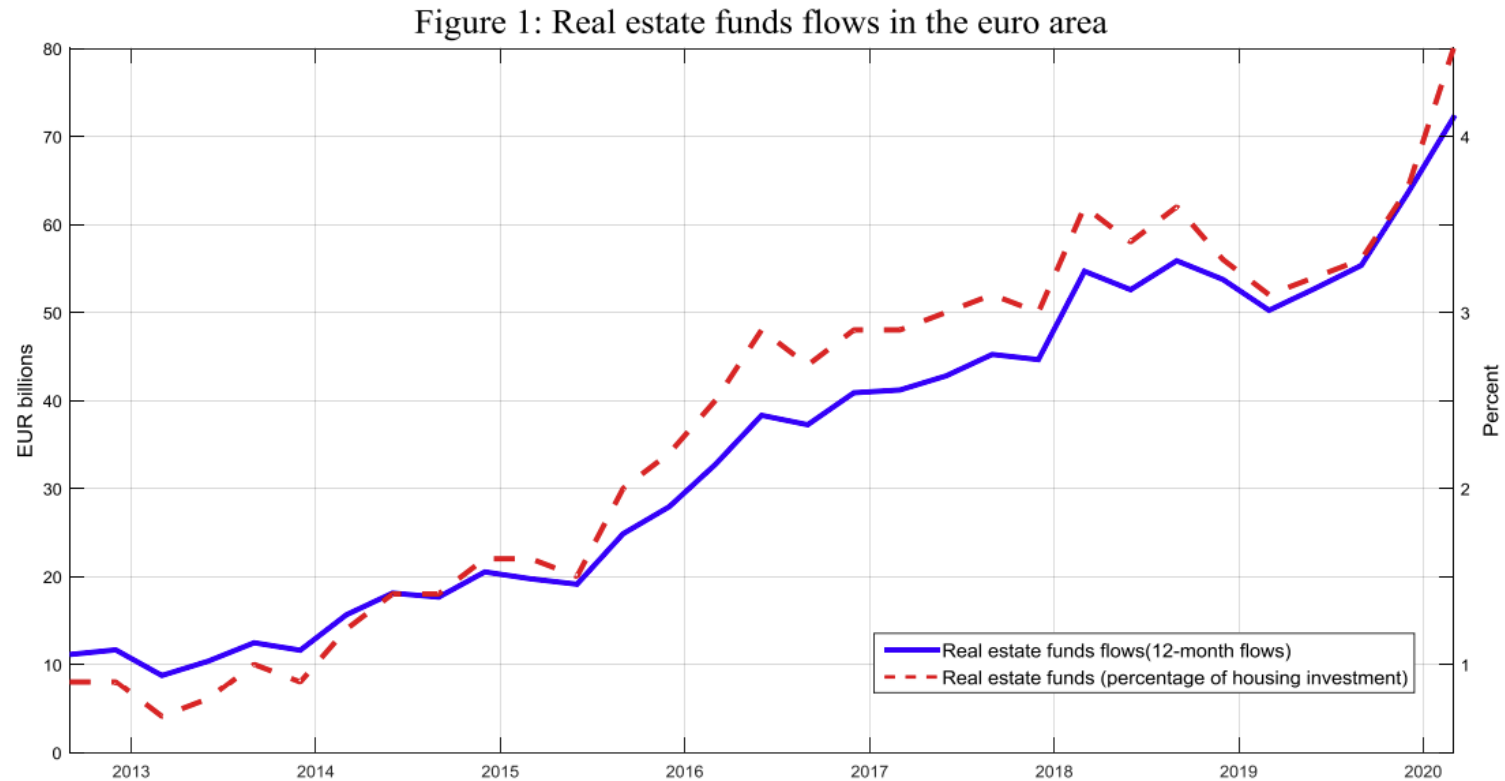
Evans, J., (2019). ["Real Estate: post-crisis boom draws to a close."](#) Financial Times. June 18,

Wigglesworth, R., (2017). ["Rise of private debt creates fears of a bubble."](#) Financial Times. April 13

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Real estate institutional investment in the euro area

- ❑ It has more than quadrupled in less than a decade.
- ❑ Limited data availability → ESRB 2019 recommendation.



Source: [Muñoz and Smets \(2022\)](#). Based on [Battistini et al. \(2018\)](#).

ESRB NBFi risk monitor 2022: Engagement in certain risky activities

Table 1

Mapping of activities to entity types

	Investment funds												Other financial institutions			
	MMFs			Bond funds		Mixed funds	Equity funds	Hedge funds	Real estate funds	ETFs	Private equity funds ⁴	Private debt funds	FVCs	SPEs	SDDs	FCLs
	CNAV	VNAV	LVNAV	Corporate	Sovereign											
Market size																
EA AuM (EUR trillion)	0.2	0.6	0.7	4.2	4.1	5.8	0.6	1.2	1.5	0.6	n.a	2.2	n.a	n.a	0.6	
Annual growth (%)	11	1.0	3.0	4.0	15	31	21	12	41	35	n.a	5.3	n.a	n.a	7.9	
Summary assessment																
Engagement	●	●	●	●	●	●	○	●	●	●	●	●	●	●	●	●
Risk transformation activities																
Credit intermediation	●	●	●	●	●	●	○	●	○	○	●	●	●	●	○	●
Maturity transformation	●	●	●	●	●	●	○	●	●	○	○	●	●	●	●	●
Liquidity transformation	●	●	●	●	●	●	○	●	●	○	○	●	●	●	●	●
Leverage ²	○	○	○	●	●	●	○	●	●	○	●	●	●	●	●	●
Market activities¹																
SFTs	●	●	●	●	●	●	●	●	○	●	○	○	○	○	●	○
Derivatives	●	●	●	●	●	●	●	●	●	○	●	●	●	●	●	○
Reuse of collateral	●	●	●	●	●	●	●	●	●	○	●	●	●	●	●	○
Interconnectedness																
Interconnectedness ³	●	●	●	○	○	○	○	●	●	●	○	○	●	●	○	●

Source: ESRB.

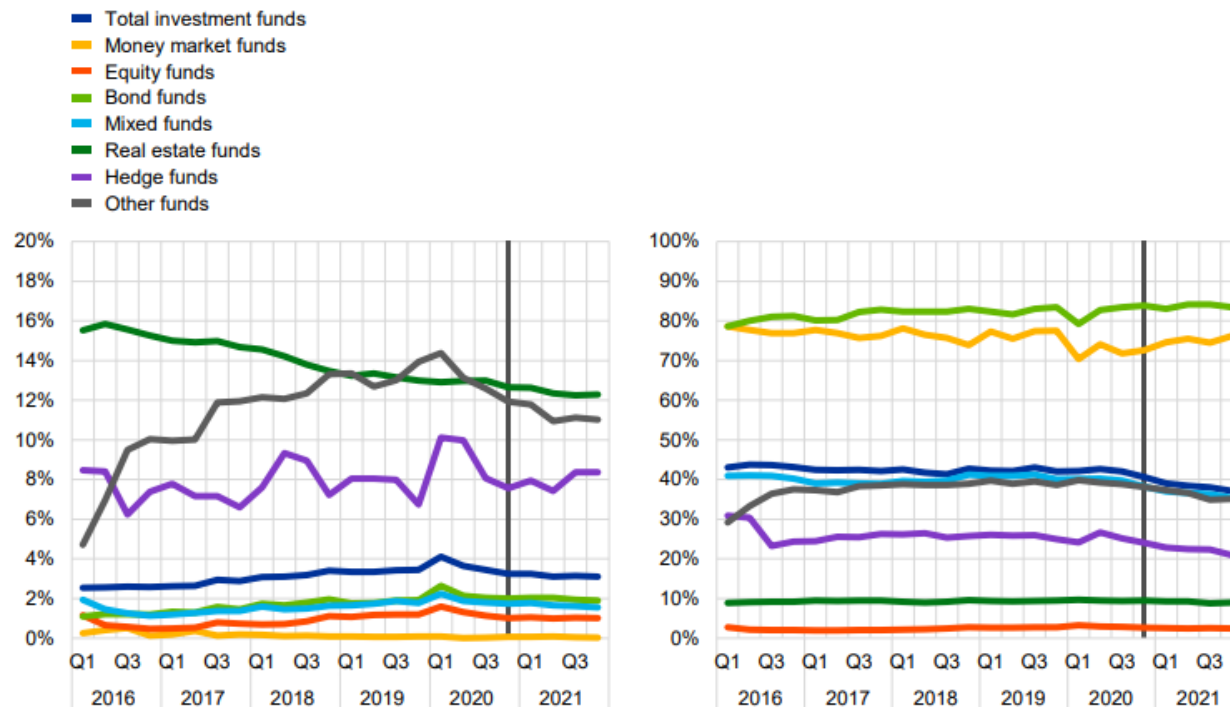
Colour coding: ●=pronounced engagement; ●=medium engagement; ●=low engagement; ○=unlikely or insignificant engagement.

ESRB NBFi risk monitor 2022: Engagement in certain risky activities

Charts A-16 and A-17

EU investment funds: financial leverage (left panel) and credit intermediation (right panel)

(percentages)



Source: ECB.

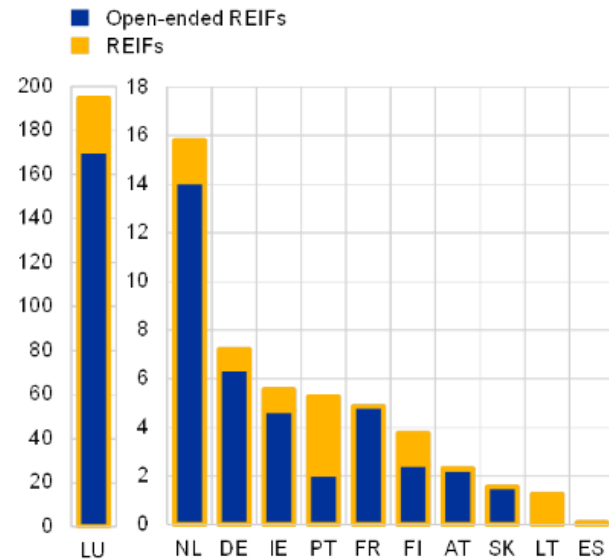
Notes: Data for the EU; Bulgaria, Denmark, Croatia, Sweden and the United Kingdom are not included. During 2016, some hedge funds were reclassified as "other funds". In Chart A-16, financial leverage is calculated as the ratio of loans received to total liabilities. In Chart A-17, credit intermediation is calculated as the ratio of holdings of loans and debt securities vis-à-vis non-MMFs to total assets. An estimate is made for non-MMF funds' loans to non-euro area counterparties.

REIFs and leverage

- ❑ REIFs operating in the EA are generally not subject to leverage limits (AIFMD)
- ❑ Uncertainty surrounding actual leverage measures of REIFs
- ❑ Recent evidence ([van der Veer et al. 2017](#) and [Molestina Vivar et al. 2020](#))
 - Fund managers in leveraged funds react in a more procyclical manner
 - Leverage amplifies financial fragility in the investment fund sector

Size of real estate investment funds

(Q4 2019, percentage of GDP)



Source: ECB investment fund statistics.

The Irish REIF industry: A deep-dive survey

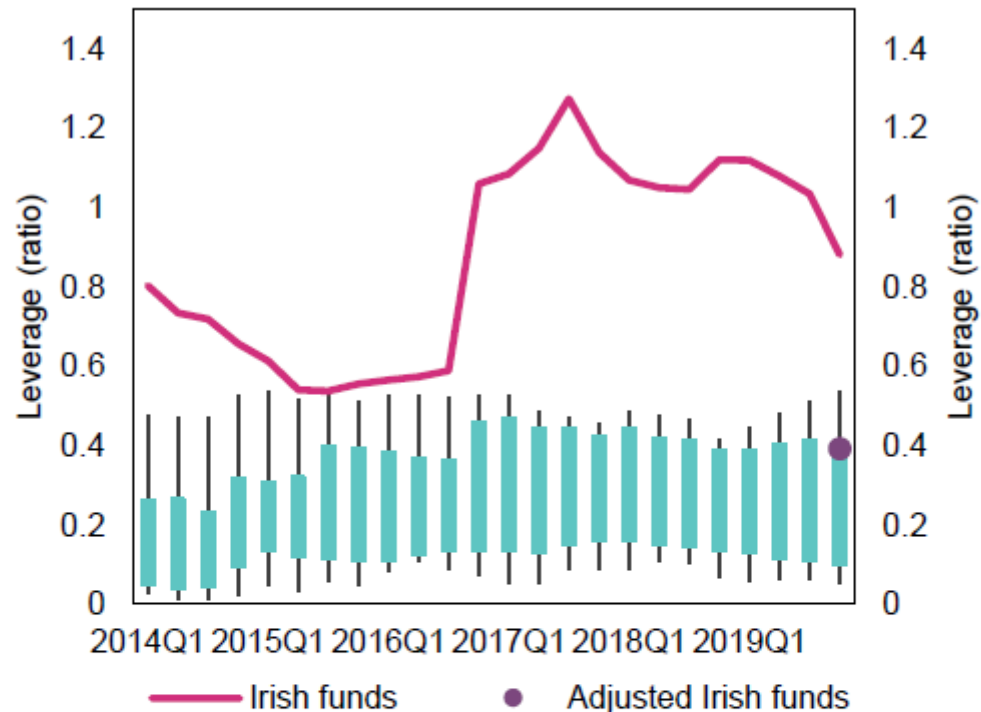
Recent deep-dive survey of the Irish REIF sector by the Central Bank of Ireland

□ Main findings summarized in Daly, P. Moloney, K., and S. Myers, 2021. "[Property funds and the Irish commercial real estate market](#)," [Financial Stability Notes](#) 1/FS/21, Central Bank of Ireland.

- Benefits
 - *Diversification of RE financing*
 - *Investment that supports domestic economic activity*

- Risks
 - *Liquidity mismatches*
 - *Leverage*
 - *High leverage levels*
 - *Relevance of non-bank funding*

The leverage ratio in the Irish REIF industry



Source: Central Bank of Ireland, *Deep Dive Survey*, European Central Bank and authors' calculations.

Notes: Leverage ratio here is calculated as total assets under management divided by total net asset value minus 1. This can be biased where non-equity liabilities are used by funds for purposes other than leverage. Aside from shareholder loans, this bias is expected to be small for Irish real estate funds. Box plots show the 90th, 75th, 25th and 10th percentiles of leverage of real estate funds across other European countries. Adjusted value assumes shareholder and related party loans would be equivalent to equity. Data for 2014Q1-2019Q4.

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Addressing liquidity mismatch and leverage in the NBF sector

- ❑ Underscores the importance of developing the policy framework for NBF from a macroprudential perspective to:
 - Tackle structural vulnerabilities
 - Strengthen the sector's resilience

- ❑ The use of leverage by NBFs is a key financial stability concern which needs to be tackled by enhancing the policy framework along three dimensions:
 - Non-bank (“client”) dimension: ensure a consistent approach to leverage rules for NBFs, such as across the AIFMD and the UCITS Directives.
 - Bank dimension: enhance risk management practices and regulation for dealer banks which either lend to NBFs facing lighter or no leverage constraints or act as counterparties in derivatives transactions which embed synthetic leverage.
 - Activity dimension: Policies around haircuts and margins should reflect the possible indirect impact on synthetic leverage in derivatives portfolios.

CBI Consultation Paper 145: Macroprudential measures for the property fund sector

In November 2021, the Central Bank of Ireland proposed two new macroprudential measures

❑ Objective: “To safeguard the resilience of this growing form of financial intermediation, so that it is better able to absorb – rather than amplify – future adverse shocks.”

❑ **Guidance, to better align redemption terms with the liquidity of assets**

❑ **Macroprudential leverage limit**

- “would be imposed through existing regulation under the Irish transposition of the AIFMD, in line with ESMA guidelines.”

❑ *ESRB (2022): “This will be the first time that Article 25 has been triggered in Ireland (and possibly in the EU).”*

- Three-year transition period to give existing REIFs time to adjust in a gradual and orderly manner.
- The Central Bank may temporarily remove or tighten the leverage limit

Simulating the potential effects of a macroprudential leverage limit

Muñoz, M. A. and F. Smets, 2022. "[Macroprudential policy and the role of institutional investors in housing markets](#)," ESRB Working Paper Series 137.

- ❑ Previous versions and related work: [Muñoz \(2020a\)](#) and [Muñoz \(2020b\)](#)
 - Honohan, P., (2020). "[Memorandum on the Financial Stability Board's Role Against Rising Nonbank Risks.](#)" In Rebuilding the Global Economy, edited by A. Posen, Peterson Institute of International Economics, February 2021

❑ Policy messages

- Leakages of macroprudential regulation: Existing regulation could trigger a de-stabilizing credit reallocation towards the REIF sector
- Complementing existing regulation with a macroprudential leverage limit on REIFs improves the capacity of macroprudential policy to:
 - ❑ *Smooth the financial cycle*
 - ❑ *Induce social welfare gains*
- The proposed policy measure would also contribute to a less abrupt increase in competitive prices in rental housing markets during the boom.

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- ❑ Steady increase in RE institutional investment since the Global Financial Crisis
- ❑ This pattern has the potential to bring economic benefits for the economy where the real estate assets are located but..
- ❑ .. it can also entail financial stability risks.
- ❑ Macroprudential policy can play a key role in preventing such risks.

Thank you