National Asset Management Agency

Opening Statement by
Mr. Brendan McDonagh, Chief Executive of NAMA, to the Public Accounts Committee
Thursday, 20 September 2018

Chairman and Deputies,

You have invited us to discuss NAMA's 2016 and 2017 Financial Statements and the C&AG's Second Progress Report on NAMA which was published in July 2018.

The key financial results set out in the 2016 and 2017 Financial Statements represent significant progress for NAMA in terms of achieving its objectives. We recorded an aggregate profit of close to €2 billion over the two years: €1,503m in 2016 and €481m in 2017. We generated a total of €8 billion in cash in 2016 and 2017 and this was used to redeem €8.1 billion of senior Government-guaranteed debt, the last tranche of which was paid in October 2017, some three years ahead of schedule. The carrying value of our loan portfolio, which was €7.8 billion at the end of 2015, fell to €3.2 billion by the end of 2017 and further to €2.7 billion by end-June 2018.

We now project that we will deliver a terminal surplus of €3.5 billion to the Exchequer assuming that we can extract full value from the residual loan portfolio and that economic and property market conditions in Ireland remain relatively benign over the next two or three years. In addition, based on payments to date and projected payments, we estimate that NAMA's cumulative tax contribution to the Exchequer could ultimately be of the order of €400m which would bring NAMA's overall contribution close to €4 billion. This is a long way from the doomsday scenario painted by some commentators back in 2009 that NAMA could lose €10 billion or more.

Much of the portfolio that is left is secured by residual assets which have been retained so that we can maximise their value, either by funding their development or by funding their progression through the planning system and thereby enhancing their ultimate disposal value. Part of the residual portfolio is also secured by assets which are of relatively low value but which, in many cases, involve legal and other complications which will take time to resolve and which will require careful management if we are to extract maximum value. Maximising value is an obligation imposed on us by Section 10 of the NAMA Act which requires us to get the best financial return for taxpayers.

At this stage, the residual portfolio is almost exclusively secured by assets located in Ireland; as of now, the value of residual assets located in foreign jurisdictions is less than €100m. By comparison, the loan portfolio that we originally acquired was secured by some €15 billion of assets located outside of Ireland.

Progress

I now turn to the progress which has been made on the achievement of NAMA's principal objectives. This is the subject of the C&AG's second progress report. The report was prepared under Section 226 of the NAMA Act which requires the C&AG, on a triennial basis, to assess the extent to which NAMA has made progress towards achieving its overall objectives. The first C&AG progress report, which was published in 2014, concluded as follows:

> *Overall, taking account of NAMA's performance to date and its operating cash flow estimates for the period to 2020, it appears that, unless there is a further significant economic downturn in the next few years, NAMA will generate sufficient cash to meet its minimum key objective of redeeming the senior debt.*

Fortunately, there has been no significant economic downturn in the intervening four years. This second progress report notes that the key senior debt redemption objective has now been achieved and also records progress on a number of other major objectives. It is clear from the report that NAMA is well on course to achieve what it was set up to do and also to deliver a substantial surplus to the Exchequer. It has also made a number of other valuable collateral contributions, particularly in funding the provision of much-needed commercial and residential accommodation.

The principal objective set by NAMA in its early years was to redeem the debt of almost €32 billion which it issued to the participating institutions in 2010 and 2011 to acquire a large portion of their property-related loans. The senior debt of €30.2 billion, which was a contingent liability (Government-guaranteed) on taxpayers, was repaid in full by October 2017.

In addition, we have now repaid a third of the €1.6 billion subordinated debt and expect to redeem the rest of it by its first call date of 1 March 2020. Earlier this year, we made an offer to holders of our subordinated debt to indicate terms at which they were prepared to sell some or all of their holdings to us. In the intervening period, we have bought back €529m of the subordinated debt at prices which will achieve future savings for taxpayers.

We will continue to avail of any opportunities to redeem subordinated debt in advance of the March 2020 call date but it is quite possible that that some of the holders will wish to retain the debt until then. The NAMA private investors will be paid after the subordinated debt has been redeemed. Only then can NAMA's terminal surplus be transferred to the Exchequer.

In addition to the redemption of the senior debt, much progress has also been made on a number of other objectives set by the Board and mentioned in the C&AG's second progress report. I will refer to two in particular, namely, the development of the Dublin Docklands SDZ and the residential delivery programme. These initiatives were launched by NAMA in 2014 and 2015 respectively.

Dublin Docklands

As regards the Dublin Docklands SDZ, the 15 sites in which NAMA initially had an involvement had the capacity to deliver 4.2 million square feet of office and other commercial space and some 2,200 residential units. The NAMA Board approved its **Dublin Docklands Strategy and Business Plan** four years ago and, at that stage, only 1% of the delivery capacity of the Docklands' sites had progressed beyond the pre-planning stage. NAMA undertook to generate activity in the Docklands, to bring coherence, direction and drive to its regeneration and development. We said that we would work closely with Dublin City Council and others to bring that about and that we would provide the entire funding, if that proved necessary.

Today, four years later, some **61%** of the 4.2m sq. ft. capacity is at the construction stage. Another **18%** has been completed or sold and planning permission has been achieved for the development of the remaining **21%**. We are pleased that we have been able to act as a catalyst for the development of the Docklands area without putting taxpayer funds at risk – much of the funding for the area's development has come from private investors and financial institutions. The development of the Dublin Docklands has substantially improved Dublin's capacity to attract investment, including businesses which may be considering moving out of Britain over the coming years in response to the impact of Brexit.

Housing

One of our other major objectives is to facilitate the delivery of housing from sites controlled by our debtors and receivers. Under EU law, we are required to operate on the same basis as private market operators. This means that we can fund the development of residential projects only if they are commercially viable. Otherwise, we could be deemed to be in breach of State aid rules. Deputies may be aware that, in January of this year, further to a complaint made in late 2015 the EU Commission undertook an extensive review over a period of two years, and concluded that NAMA's residential funding programme was not in breach of EU State aid rules.

Judging by some of the public discussion on housing, I am not sure that it is widely understood that the State has limited room for manoeuvre when it comes to funding private residential development. If a State body is in the business of funding the delivery of private housing, it is required to operate on the same commercial basis as a market operator. That means that, under State aid rules, a State body cannot fund the development of sites that are not commercially viable to develop for private housing, regardless of the scale of the supply shortfall in Ireland. Nor can it subsidise residential development by means of low interest rates or other special concessions that the market would not countenance. Accordingly, the ability of any State body, including NAMA, to fund the delivery of housing is limited to those sites which are commercially viable at any particular point in time.

Despite the strong growth in sales prices in recent years, commercial viability is still a constraint on residential development. Two years ago, the Society of Chartered Surveyors Ireland (SCSI) estimated that the total cost of delivering a three-bedroom semi-detached house in the Dublin area was of the order of €330,000, including a site cost of €57,500. In the period since the SCSI published its report, the rise in sales prices has been matched by increases in development land prices and, as a result, achieving commercial viability on many sites remains challenging. Rising sales prices mean that affordability has become a major issue, particularly in the context of the macroprudential loan-to-income (LTI) and loan-to-value (LTV) restrictions.

Hoarding?

Some of the recent public and media discussion on housing delivery has tended to be overly simplistic in its analysis: there seems to be a widespread but fallacious assumption that any land with residential planning permission which is not actually being developed is thereby being 'hoarded'. I can only speak on behalf of NAMA but the point applies to others also: the reality is that you cannot fund the development of a residential site if it is not commercially viable to do so. Does that mean that we are supporting the 'hoarding' of land? We are not. I can assure you that, as soon as a site becomes commercially viable, there is no hesitation on our part to fund its development.

There are other complications to be considered also. Each site has its own unique aspects. Some large sites require rezoning decisions by local authorities if they are to be developed. Others require revised planning approval if they are to become viable. Others still cannot be developed in advance of the provision of infrastructure such as roads, water, sewerage and services. All of these issues can be resolved over time but they require extensive and patient engagement with planning authorities and others. The prolonged effort that is often required to bring sites to the 'shovel-ready' stage is not widely appreciated – it can often involve detailed preparation for two or three years in advance.

If there is to be a well-informed public discussion on housing supply, it needs to be recognised that not all of the sites which are zoned or have planning permission for residential development are in fact commercially viable to develop at prevailing prices. In my view, the more pertinent issue is whether all of the sites which are commercially viable are in fact being developed and, if not, why not? Only in those cases would it be reasonable to claim that sites were being 'hoarded'. In relation to any sites which have viable planning permissions but which are not being developed, I would fully support the '***use it or lose it***' principle.

There has been much talk recently of the emergence of Private Rented Sector (PRS) opportunities. PRS involves the commitment of capital by investors to the development of mainly apartments which are then rented in the market thereby creating an income stream for the investors. PRS is a relatively new asset class and, to the extent that it contributes to an expansion of residential supply, it is to be welcomed. There is no doubt that some apartment sites would not be developed without PRS capital. However, I would caution against the view of PRS as some kind of panacea which will make a major contribution to long-term supply. Funds directed towards PRS seek higher returns than are currently available from money and bond market investments and, as long as bond yields are low, PRS will be an attractive asset class to those investors. It will be interesting to see, however, whether PRS will retain its appeal to investors in an environment of rising bond yields as quantitative easing tapers off.

NAMA-funded delivery

We remain focused on maximising the delivery of housing from sites controlled by our debtors and receivers. I believe that the almost 8,000 units that NAMA has directly funded since 2014 represents a significant contribution to housing supply. Another 2,500 units have been indirectly delivered on sites that we facilitated and supported. Our target is to facilitate the delivery of 20,000 units by the end of 2020. We will fund much of this delivery directly but in some cases, where sites are at the 'shovel-ready' stage, it is possible to transfer the development risk to licensees or to private developers.

Some of our debtors have refinanced their loans and have now made the transition to bank funding or to other sources of funding; others will do so over the next two/three years. In funding residential development, our primary goal is to recover as much as we can from our acquired loans. The ability of some debtors to refinance their loans – on terms that also make commercial sense for us - is a clear sign that the market is reverting to more normal conditions.

Poolbeg West SDZ

One site which has the capacity to make a major contribution to housing supply in central Dublin is the Poolbeg West Strategic Development Zone (SDZ) site in Ringsend. This site, which is under the control of a receiver, is one of the few large development opportunities still available in Dublin. It has the capacity to potentially provide up to 3,500 residential units and 860,000 sq. ft. of commercial development as well as school sites and community space.

This site provides a good illustration of the lead-in time and effort involved in bringing a major residential project to the point at which construction can actually begin. It was designated as a SDZ by the Government in May 2016. Dublin City Council, acting as the development agency, published the draft Poolbeg West SDZ Planning Scheme in January 2017. Over 100 submissions were received from various parties and had to be considered by the Council before it approved the SDZ Plan in October 2017. There was an oral hearing held by An Bord Pleanála in April 2018 and final adoption of the Poolbeg planning scheme by An Bord Pleanála is expected to occur over the coming months. It will then be necessary to submit planning applications to the Council for the development of site infrastructure (roads, etc.) and for the first phase of the project. From the design stage to final planning approval, each phase approval process is expected to each take about twelve months. It is unlikely that construction of the first phase of apartments will begin before 2020 – some four years after the Government designated the site as a SDZ.

Clearly, development of this strategic site will be a massive undertaking in terms of the capital expenditure required, the significant risks involved and the envisaged seven-/ten-year duration of the project. The receiver is currently engaged in negotiation with the City Council with a view to reaching a commercial agreement in relation to the funding of the 900 social and affordable units which are required under the plan approved by the Council. If agreement can be reached between the receiver and the Council, it will then be possible, after adoption of the scheme by An Bord Pleanála, to proceed with implementation of the delivery strategy.

Conclusion

Overall, the market is responding – albeit slowly - to the shortfall in residential supply. The CSO estimates that almost 14,500 new dwellings were completed in 2017, an increase of 46% on the output for 2016. Projections suggest that output in 2018 will be of the order of 18,000 units. This is still well short of the 30,000-35,000 units annual estimated requirement but things are moving in the right direction. Funding is now more readily available, particularly from non-bank sources, and the proposed establishment of Home Building Finance Ireland (HBFI) should help to expand further the supply of residential funding. Capacity is also an issue and there is clearly a shortage of key housebuilding skills. Against that background, I believe that the gap between annual private housing supply and demand is unlikely to close for three or four years. The more difficult issue is how the demand for social and affordable housing will be met in the near term – resolving this will be crucial if we are to have a more orderly market for renters and purchasers.

To sum up, Chairman and Committee members, I believe that NAMA has made major progress towards achieving its objectives. Its principal objective - redeeming the €30 billion in senior debt which was a contingent liability for taxpayers – has been achieved.

There is still a great deal of work to be done by NAMA. Our focus now is twofold: first, extract as much value as possible from our residual portfolio with a view to maximising the terminal surplus that we ultimately hand over to the Exchequer; and, second, fund or otherwise facilitate the delivery of as much housing as is commercially feasible from the loans attached to our debtor and receiver sites.

Thank you.