National Asset Management Agency

Opening Statement by

Mr. Brendan McDonagh, Chief Executive of NAMA,

to the Public Accounts Committee

Thursday, 29 May 2014

Chairman and Deputies,

We have been invited before you today to discuss two recent publications: the **NAMA Progress Report 2010-2012** published last week by the Comptroller and Auditor General and our **2013 Annual Report and Financial Statements** which was published two days ago. I will, first of all, comment briefly on our results for 2013 before discussing the C&AG's Progress Report. I understand that a copy of our Annual Report and Financial Statements and a presentation summarising our 2013 results have been circulated to you and, for that reason, I do not propose to comment on them in any great detail in this statement.

For 2013, we have reported an operating profit before impairment of €1.2 billion, a 45% increase on 2012. Taking into account an impairment charge of €914m, profit after impairment, tax and dividends was €211m, broadly in line with that of 2012. Our 2013 results incorporate the impact of a comprehensive review of impairment provisioning, including analysis of the smaller debtor connections which are being managed on our behalf by the banks.

Excluding cash flows arising from the sale of IBRC assets, we generated cash of €4.5 billion in 2013; this included the proceeds of asset disposals by debtors and receivers, the proceeds of our own loan sales and non-disposal receipts, mainly rental income.

From inception to last Friday (23rd May), NAMA had generated €18.6 billion in cash, including €14.1billion from asset disposals. €3.5billion of this has been generated in the first five months of 2014.

We have been very active in terms of sales in the early part of this year. We are close to completing the sale of some €5.7 billion in loans relating to our Northern Ireland debtors – Project Eagle. And we recently closed the sale of a major debtor loan portfolio with nominal loan balances of €1.8 billion. This is in addition to a number of other portfolio sales which have been concluded over recent months and some other portfolios which are currently on the market.

Not only is there strong demand for Irish assets at the moment but purchasers are willing to pay what we consider to be fair value for them. During the period up to end-2012, the period covered by this Progress Report, demand for Irish assets was very limited and potential purchasers were generally interested only in transacting at 'fire sale' prices. Thankfully, market conditions are now much more positive and we are keen to take advantage of that to the greatest extent possible, subject to the proviso that we can continue to transact at prices that make commercial sense for us.

Section 226 Progress Report

Section 226 of the NAMA Act 2009 requires that, as soon as may be after 31 December 2012 and every three years thereafter, the C&AG must assess the extent to which NAMA has made progress towards achieving its overall objectives.

As you will be aware, the Minister for Finance is separately required, under Section 227 of the Act, to assess the extent to which NAMA has made progress towards achieving its overall objectives and the Minister has stated that he intends to be in a position to publish his findings by the end of June or in early July.

From NAMA's perspective, we welcome the C&AG's Section 226 Report and we consider it to be broadly positive in its assessment of the progress that NAMA has made to date.

Understandably, perhaps, given that the report's focus is largely on the period from 2010 to 2012, it does not fully reflect the major progress that has been made in the seventeen months since December 2012, particularly the improvement in Irish economy and property market.

At one stage, the taxpayer was faced with a contingent liability of over **€43 billion relating to NAMA**: €30 billion arising from the senior bonds that NAMA issued in 2010/2011 and an additional €12.9 billion in senior bonds used to purchase the IBRC floating charge from the Central Bank as part of the liquidation of IBRC in February 2013.

By the end of this year, we expect that the contingent liability associated with NAMA will have reduced from **€43 billion to €15 billion**. Current indications are that the cash proceeds of the IBRC sales process will be sufficient to enable NAMA to redeem all of the €12.9 billion in senior bonds that we issued to the Central Bank. In addition, the stronger performance of the Irish market over the past year has enabled us to accelerate the sale of Irish assets securing our loans.

This, in turn, has meant that we have been in a position to exceed the bond redemption targets that we had initially set for 2014. In addition to the €2.75 billion redeemed in 2013 and the €3 billion redeemed in March 2014, we aim to redeem another €2.5 billion over the coming weeks and an additional €2 billion by the end of this year. If achieved, this would mean the redemption of 50% of the original senior bonds by end-2014 and would leave a residual €15 billion outstanding at that stage. Subject to market conditions, we aim to make substantial progress on further reducing this over the course of 2015 and 2016.

Establishment

The C&AG's Progress Report contains a great amount of detail about our activities, particularly during the initial phase of the Agency's existence from 2010 to 2012. I would point out that, for much of this period, we were in the process of establishing the

Agency, including the recruitment of staff with the expertise and experience to carry out our statutory mandate.

Recruitment was, of necessity, an orderly process, not least because in NAMA's case we were in a position to offer potential recruits only **specified purpose contracts** which expire when our work has been completed. With over 350 professional staff now on board, we are adequately staffed to undertake the intensive and detailed asset and loan management work required to carry out the statutory functions assigned to us, including managing our assets to extinguish the State's contingent liability.

In parallel with recruitment, we also had to make the necessary arrangements to carry out a major transaction for which there was no precedent in terms of scale and complexity: the valuation and transfer of loan balances of €74 billion from five financial institutions. Sweden is often quoted as a parallel but their corresponding State asset management operation – which was called Securum – had assets of only €6 billion by comparison. The report has looked in considerable detail at the loan valuation and acquisition process and it has concluded that the property valuation, legal due diligence and loan valuation processes were adequate and complied with the regulations made by the Minister. The report describes this as "a significant achievement" by NAMA in a relatively short time-span, given the scale of the task as well as the inadequate documentation and processes that we found in the banks.

Bearing in mind that the last time we appeared before this committee in December 2013, we were faced with serious but unsubstantiated allegations of wrongdoing relating to the loan acquisition and valuation process, the C&AG's conclusions in respect of this major area of our work is particularly welcome and reassuring.

Debt repayment

We are also pleased that the report, based on analysis of NAMA's performance to date and of our operating cash flow estimates, has concluded 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. Our own analysis indicates that we will repay the senior and subordinated debt. Given that the value of our Irish based collateral fell by about 25% after its acquisition price was determined, we consider it to be a notable achievement that we are now talking of the possibility of at least breaking even over our lifetime. Meeting this objective is very important for us given that the senior debt that we issued was guaranteed by the Minister and is, therefore, a contingent liability on Irish taxpayers.

Incidentally, there has been some press comment over recent days to the effect that NAMA expects to make a surplus of €1 billion over its lifetime. Our current expectation, based on our most recent forecast analysis and assuming a phased and orderly disposal of assets, is that we will repay our senior and subordinated debt and there is a possibility that we may be able to generate a surplus but we are not at this stage able to speculate as to the size of such a surplus. Attaining a surplus is dependent on a number of economic and timing factors which are beyond NAMA's control but based on current conditions our outlook would be positive. Needless to say the fact that NAMA may do better than anybody expected has ramifications well beyond NAMA to the wider economy.

Irish disposal targets

The report expresses some doubts as to whether NAMA can achieve its Irish asset disposal targets. I wish to make a number of comments on this opinion.

NAMA's exposure to Irish assets is largely urban-centric with 92% based in Dublin, the Dublin Commuter Belt, Cork, Limerick and Galway. As you will see from the presentation which we have separately circulated to you, we have limited exposure to other regions in Ireland.

It is very important to make a distinction between the aggregation of the disposal targets that we set for individual debtors and the overall targets that need to be achieved in order to enable us to generate sufficient cash to meet the Board's debt redemption targets.

In line with normal commercial practice, ambitious but realistic cash targets are set for debtors in the expectation that, for various reasons, those targets are unlikely to be met in the aggregate. Planned asset sales, for instance, may not proceed as originally scheduled in a particular year and will accordingly be rescheduled for a later period.

Because of the reality that not all debtor disposal targets will be met in any one year, NAMA must set aggregate targets for debtors which are well in excess of the cash target that is set by the Board in order to meet debt redemption targets. Typically the latter would be 60% to 70% of the former. Hypothetically, for instance, individual disposal targets totalling €5 billion could be set for debtors in the expectation that 70% or €3.5 billion will be achieved. In each year of NAMA's existence so far, the Board annual cash target has been exceeded, thereby enabling us to meet our debt redemption targets. It is not therefore, in our view, reasonable that a judgement on NAMA's prospects of achieving its Irish disposal targets should be based on the aggregate disposal targets set for debtors. This will inevitably be much higher than the minimum that will need to be achieved.

Secondly, we consider that the report does not give sufficient weight to the much-improved conditions which have prevailed in the Irish market since the second quarter of 2013. Up to early 2013, Irish assets could only be sold on an asset-by-asset basis and demand was, at best, sporadic. Over the past year or so, investors have been willing to increase substantially their exposure to the Irish market and this has enabled NAMA and others to sell asset and loan portfolios in sizeable volume. On pages 33 and 34 of the C&AG's Progress Report, we outline some of the reasons for our positive outlook.

We currently estimate that we will need to sell about €6 billion in Irish assets over the period from 2014 to 2016 and we aim to do so through a combination of packaged property sales, individual property sales and loan sales. Bearing in mind the success of the IBRC sales process and our own success in selling assets and loans secured on Irish property over the past year, we consider an annual Irish sales target of €2 billion to be achievable assuming continuation of recent benign conditions in the Irish market. Of course, if these benign conditions do not endure, we will be commercially sensible and will adapt our strategy and targets to the changed market conditions.

Open marketing

Given that selling assets – mainly through our debtors and receivers - is an important element of our business, it is crucial for us that we achieve the best price available in the market on any asset sale and, for that reason, we place a major emphasis on the open marketing of assets. Having examined a sample of 144 property disposals, the report concludes that "overall, almost all had been sold through an open competitive process or with testing of disposal prices against market valuation." The report goes on to state that this provides reasonable assurance that the prices obtained by NAMA were the best on offer in the market at the time a property was sold.

In 4 of the 144 cases sampled, the report states that there was no evidence that the properties had been openly marketed. The gross disposal value in these four cases was about €500,000. In relation to these four cases, we disagree with the report's conclusions that there was no open marketing. We have looked in detail at the four cases and we are satisfied, based on evidence available to us and that we have since provided to the C&AG team, that the assets were openly marketed.

Rates of return

The report includes a number of recommendations in relation to how we conduct our business. Some of the recommendations are ones that we have no difficulty in accepting and indeed we consider them to be sensible in terms of the evolution of our business. A number of other recommendations were examined by the NAMA Board but not accepted.

I wish to refer to two in particular. Recommendation 3.1 (page 40) states that the Board should set an overall expected or target rate of return and measure overall performance against this target. Recommendation 5.1 (page 65) states that the Board should set targets for the overall return on disposals and on property held by debtors and insolvency practitioners and performance should be measured against these targets.

The Board has reviewed these recommendations and has taken the view that such target rates of return would not be an appropriate metric for its business, on the basis that they would act as an unnecessary constraint on its flexibility. In taking this view, we are cognisant of the need to be open to commercially sensible disposal opportunities whenever they arise. We are also mindful of the stated view of the Minister for Finance – reiterated this week at the launch of our 2013 Annual Report - that NAMA's main focus should be on reducing the State's contingent liabilities as quickly as is feasible.

As you will know, Moody's recently upgraded Ireland's credit rating by two notches and, when doing so, they highlighted the progress that has been made by NAMA and the disposal of the IBRC portfolio in bringing about a "very sharp reduction" in Government contingent liabilities. NAMA cannot afford to ignore the wider public and national interest and for that reason we are acutely conscious of the contribution that our deleveraging activity makes to the overall Irish economic and financial recovery.

NAMA is not a long-term investment fund which would be in a position to set target rates of return for its assets and to then wait indefinitely for those targets to be achieved. NAMA was created in the midst of a crisis and its primary purposes, under Section 10 of the Act, were to acquire property loans from banks so as to reduce their excessive exposure to that sector and to obtain the best achievable financial return for the State on those loans.

Importantly, under Section 10, we were required to conduct our work **expeditiously**. The idea was that NAMA would make a major contribution to the normalisation of conditions in the financial system but that it would not be a permanent feature of the landscape thereafter.

We never, therefore, saw ourselves as having the same frame of reference as would an investment fund. Unlike such a fund, we had little discretion as to the assets which we acquired and no control over the prices that we paid for them. An investment fund, on the other hand, has complete discretion as to its asset selection and will only invest in assets which it expects to yield a positive return, be that over a short-, medium- or long-term horizon. We had no expectation that each and every asset that we acquired would yield a positive return. Indeed in the first three years after our loan acquisition, Irish property prices declined and despite this, our initial minimal objective, taking the positive with the negative, was to break even over our lifespan. As I mentioned earlier, we remain confident that we will achieve breakeven but, based on our current outlook, there is a strong possibility that we will achieve it over a shorter lifespan than we initially envisaged.

Our objective is to optimise the realised value of our acquired assets but we do not have an open-ended horizon in which to do so. For that reason, we do not consider that it would be appropriate to use performance metrics which would be relevant in the case of a discretionary long-term portfolio but not for the task that we have been asked to carry out.

I would point out that, unlike other public entities, the NAMA Act specifically provides that the Minister may dissolve NAMA as soon as he considers that it has fulfilled its purposes. Given, therefore, that NAMA has no control over how long it stays in business, it is prudent for us to assume that we are operating to a short to medium timeframe and to adopt the appropriate deleveraging strategy to extinguish the contingent liability and the appropriate performance metrics to match that timeframe.

Chairman and Committee members, we are happy to discuss these or any other issues that you may wish to raise with us arising from the C&AG Progress Report and our 2013 Annual Report.