National Asset Management Agency

Opening Address by

Mr. Brendan McDonagh, Chief Executive of NAMA, to the

Public Accounts Committee

Thursday, 26 September 2013

Chairman and Deputies,

Our appearance before you today arises from the publication some months ago of our results for 2012. For the second year in succession, we have been in a position to report profits after impairment despite the difficult market conditions that still prevailed in Ireland in 2012. Before discussing our 2012 results in greater detail, I would like to make a few general comments about the mandate which you, as legislators, gave us and the progress we have made in fulfilling it.

Commercial mandate

Just about four years ago, the Oireachtas enacted the legislation which established NAMA. Crucially and commendably, Section 10 of the NAMA Act outlines clearly the primary objective that the legislature set for NAMA, namely that it was to achieve the ***best financial return*** for the State from the assets entrusted to it. That statutory clarity has been very important in guiding us over the last four years, particularly when faced with a broad range of public views as to what NAMA should be doing.

At the time of our establishment, it was accepted widely that we could not expect to fulfil our commercial objective quickly, given the scale of our loan acquisition of over €70 billion and the distressed state of the Irish property market. There was an acceptance that the taxpayer's best interest would be served, in the words of the Act, "by protecting or otherwise enhancing the value" of the acquired assets.

And that is what we have sought to do. We adopted two key principles: no fire sales and no hoarding – the Board's Business Plan of July 2010 refers to a "phased and orderly" disposal of assets. A NAMA fire sale in the Irish market over the past three years would have caused serious disruption and would have had the effect of crystallising a major loss for taxpayers, on top of the losses that they have had to fund in recapitalising the various financial institutions.

Instead, our approach has been to release assets for sale in the Irish market in a manner which takes account of the market's capacity to absorb them; we should bear in mind that even in 2006, at the peak, there was only €3 billion of investment activity in the Irish market and fewer than 100 transactions. Within our overall approach, we are pragmatic: every asset supporting our loans is ultimately for sale and we are always open to reasonable offers.

But the reality is that there is limited demand for some segments of our portfolio in current Irish market conditions. Our approach to assets which are not currently for sale is to protect and enhance them, through asset management, so as to maximise their ultimate sales value when market conditions improve. That means ensuring that rental income from assets is maximised and that it is applied towards meeting debtor liabilities to NAMA.

Our phased asset disposal approach not only makes commercial sense but it is also in line with the rationale underlying the EU Commission's approval for the NAMA scheme in 2010. The Commission took the view that State Aid under the NAMA scheme was permissible if the State had a reasonable prospect, over a medium-/long-term horizon, of recovering NAMA's outlay on the acquired loans. The Commission approved the payment of an acquisition price corresponding to the long-term economic value of the loans. It did so on the basis that NAMA would be in a position to recover this over an expected ten-year life span, as market conditions normalised and the Irish economy recovered. And it was well acknowledged that the recovery of a very distressed Irish market in a distressed global economy would only be gradual.

Eurostat, when it determined in 2009 that NAMA debt would not be treated as part of the General Government Debt, did so on the basis that NAMA was established for the sole purpose of addressing the financial crisis, that it had a finite life span and that it was not expected to make material losses. This fits well with NAMA's key objective which is to ensure that the Irish taxpayer will not be faced an additional financial burden after we have completed our work.

For all of these reasons, we do not view our mandate as being the management of a massive fire sale which would have the effect of imposing a greater financial burden on the State; instead, we have adopted a phased and orderly approach in dealing with the disposal of our Irish assets, with a view to recovering what we believe to be their intrinsic value. In the British market, by contrast, we have been more very active in terms of asset sales because of the level of demand for those assets, the depth of the market relative to our asset holdings and the strong price performance of London and the South East over recent years.

Cash

One of the principal measures of our progress is the repayment of our senior debt. We issued just over €30 billion in Government-guaranteed senior debt to the financial institutions from which we acquired the loans in 2010 and 2011. We will redeem €750m next week, thereby bringing the cumulative redemption to date to €7 billion; we expect that will reach our target of €7.5 billion (25% of senior debt) by the end of this year. We expect that another 25% of senior debt will be redeemed by the end of 2016. That will leave €15 billion of NAMA's senior debt to be redeemed after 2016 and our current view is that we will be in a position to redeem all of our senior debt by 2020 and thus eliminate the State's contingent liability.

In order to meet our debt redemption targets, cash is key for NAMA. As of last Friday, we had generated ***€13.7 billion in cash***, including ***€9.2 billion in disposal receipts*** from property and loan sales and ***€4.5 billion in other income***, mainly rental income from assets controlled by our debtors and receivers. We have secured over €800m in additional security for debtors' loans by taking charges over previously unencumbered assets and by reversing asset transfers.

Much of the cash generated has been applied towards repaying NAMA'S senior debt; as I mentioned, €7.5 billion is scheduled for redemption by the end of this year. We also need to have sufficient cash reserves available to cover our costs, including debt interest and loan servicing fees to the banks. We also need cash to invest over the next three years in various commercial and residential projects which, when completed, are expected to yield a strong return for the taxpayer. By the end of August, we had approved funding of €2 billion across our entire portfolio, €900m of which relates to Ireland. It is important to note that NAMA is self-funding and does not cost the Exchequer anything and therefore is not a burden for the Government in the context of its annual budgetary arithmetic.

Market activity

Having emphasised earlier that we are not engaged in a fire sale, it is important, however, to draw attention to the many ways in which we are stimulating transactions in the Irish market:

- By approving asset sales by debtors and receivers, we are releasing a substantial flow of properties into the market. Our debtors and receivers have sold over 2,000 individual properties in Ireland to date and currently have €1.5 billion worth of Irish residential and commercial property on the market.

- That will increase by another €350m-€400m over the coming weeks as we will be bringing two portfolios, mainly high quality offices and residential, to the market. These portfolios will be attractive to the large institutional buyers in the markets, including the promoters of recently-established and proposed new REITs.

- We have indicated that we are willing to lend €2 billion in vendor finance to support transactions involving commercial property and loans. We have already advanced €375m of this in five transactions and there are a number of other transactions in the pipeline.

- We are also working closely with the IDA to facilitate the provision of accommodation for large businesses which have plans to create jobs in Ireland. These include Novartis which has entered into a letting transaction for a number of office blocks at Elm Park in Dublin. Other significant transactions include the purchase by Scottish and Southern Energy of its new corporate headquarters at Leopardstown and the investment of over €100m by the Kerry Group at Millennium Park in Naas.

- We hold security over a large number of properties and lands in the Docklands area of Dublin. The decision by Dublin City Council to establish a Strategic Development

Zone (SDZ) in the area is a very positive move. There would appear to be a good fit between NAMA properties in the Docklands area and the need to accommodate the continued expansion of the financial services and technology sectors. There are, however, various planning and infrastructural obstacles to be overcome and we continue to engage extensively with the Council with a view to promoting ideas which will hopefully resolve these issues.

- There are numerous other similar examples of development initiatives to which we are advancing funds and development capital. These include The Square Shopping Centre in Tallaght, the Beacon South Quarter and the Charlestown Shopping Centre in Dublin as well as Scotch Hall in Drogheda and developments in Cork, Kildare and Galway. There are other initiatives where we are at an advanced stage of evaluation of their commercial viability.

Social housing

One area of our activity which attracts regular comment is the area of social housing. Relative to the number of applicants on housing lists (which was estimated by the housing authorities to be close to 100,000 in 2011), NAMA debtors and receivers did not have a large stock of housing units available for sale or lease but we moved quickly to identify those which might be suitable and we have been very active since in terms of expediting delivery, to the extent that that is within our control.

To date, we have offered 4,350 units to the local authorities. About 2,150 of these were either deemed to be unsuitable or no longer available by the time the authorities had assessed their suitability. Another 300 are still being assessed. That leaves about 1,900 which have been deemed suitable by the local authorities. Over 400 of these have been delivered or contracted to date, with at least another 200 by year-end; for the other 1,300, we are awaiting the final go-ahead to acquire them on the assumption that they will be deemed suitable by the Housing Agency or local authority concerned.

Let me emphasise that all we can do is to identify the units, offer them to the local authorities and housing bodies and then await their formal agreement to contract. The pace at which units are delivered to the people who need them is largely beyond our control: in some cases, certain works are needed to finish off the units and, in fact, we have provided funding of €10m to enable at least 600 housing units to be delivered by the end of this year. Often there are issues with certification, performance bonds and levies and compliance with legislation such as the Multi-Unit Developments Act. It is untrue to suggest that NAMA is responsible for the slow pace of delivery to date; I will confine myself to the suggestion that the earlier everyone engages, the sooner progress will be made.

Market overview

In terms of market activity in Ireland, there have been a lot of positive developments this year. The residential market in certain urban areas appears to be stabilising. Commercial prices are improving and the volume of investment transactions is already well up on last year. It is estimated that close to €1 billion of transactions have been completed by the end of August, which is almost twice the level achieved in the whole of 2012. The nature of investor interest has also changed: we are seeing fewer investors with overly ambitious return expectations and short payback horizons. We are seeing instead more interest from long-term players, such as pension funds and real estate investment trusts, who tend to focus more on the long-term income generated by assets than on the prospect of near-term price appreciation. This is a welcome sign of a market easing back towards normalisation.

However, I would caution that the resurgence evident in the Irish market is not yet broadly based or homogenous. Investors are mainly interested in prime Dublin office space and income-yielding apartment blocks. There are only a limited number of such assets available in the NAMA portfolio or anywhere else for that matter. As the supply of available prime assets reduces relative to demand and as economic recovery gathers pace, we can expect investor interest to diversify both geographically away from Dublin and also into a broader range of asset classes as investors seek yield in a low interest rate environment.

2012 results

I would like to turn now to our results in 2012. I am pleased to report that we recorded an operating profit, before impairment, of €826m in 2012. The main positive contributors to this profitability were interest and fee income of close to €1.4 billion and a net profit on loan and property disposals of €188m. On the costs side, we incurred interest expense of close to €500m on our debt. Administration costs of €119m included two major elements: first, fees of €56m paid to the banks to carry out loan servicing and, secondly, €37m in costs, mainly staff costs, reimbursed to the NTMA.

I should point out that our costs are low by comparison with similar entities internationally. One indicator commonly used for asset resolution entities such as NAMA is the ratio of operating costs to cash generated: for NAMA in 2012, this was 2.6%; internationally, the ratio for similar entities has typically averaged 6% and in some cases has been as high as 12%. By comparison with our peers, therefore, we run an efficient operation and that is indeed appropriate given that we ultimately work to a mandate from the taxpayer.

Our profit for 2012 after tax and impairment was €228m, reflecting an impairment charge of €518m. This brought our cumulative impairment provision to €3.3 billion by the end of 2012. I wish that I could report that there will be no further impairment. But, unfortunately, in a portfolio as diverse in asset class and geographically as NAMA's, that is not the case. Over the coming days, we will be submitting to the Minister for Finance our results for the first half of 2013 and, while I cannot disclose the specifics now, I am happy to report NAMA made a profit in first half of this year.

In terms of assessing impairment, we go through a rigorous review which tests the robustness of the cashflows that we expect our portfolio to generate all the way out to 2020. We look at expected disposal proceeds and the income projections for assets and we ask hard questions about whether they remain realistic. These disposal projections evolve over time, as harder market information comes to light about particular assets or market segments. Our impairment process involves taking a detailed look at cash projections for about 85% of our loan portfolio and making an assessment for the entire duration of the loan (i.e. to 2020, in many instances). This contrasts with the approach that, we understand, is typically adopted by banks internationally which involves a detailed review of approximately 25% of their projected loan cashflows. We also take a very conservative approach to recognising projected gains and losses: losses are recognised immediately whereas gains are not recognised until they are realised in cash.

IBRC

As you know, the Government decided earlier this year to appoint Special Liquidators to IBRC with a mandate to arrange for the valuation and sale of the IBRC loan portfolio. As part of that decision, NAMA has been asked to acquire any loans not sold by the Special Liquidators. This acquisition is likely to happen late this year or early in 2014. Our working assumption is that we will acquire a substantial proportion of the IBRC loans and we are making our preparations on that basis. We have, as yet, limited visibility on what we may acquire and, for that reason, it would be unwise of me to speculate too much on the strategies we might adopt or the time horizon over which we might expect to manage out the portfolio.

What is abundantly clear at this stage is that this new portfolio will present a major challenge for NAMA. Potentially, we could be acquiring a portfolio of ***commercial loans with par balances totalling €20 billion***. Operationally, it is likely that we will manage the larger debtor connections directly, as we do with the existing portfolio. The smaller IBRC debtors – of which there could be up to 2,400 – will be managed on a day-to-day basis by a service provider acting under delegated authority from us. To put this into context, we currently deal – either directly or through the participating institutions – with about 800 debtors. If the bulk of the IBRC portfolio does transfer to us, the number of commercial debtors being managed by NAMA, directly or indirectly, could increase from 800 to over 3,000. That does not include over 13,000 **mortgage holders whose loans – aggregating to par debt of €1.8 billion** - may also transfer to us if the residential portfolio is not sold by the Liquidators.

Staffing

We expect that we will need to recruit between 180 and 220 additional staff directly in NAMA to carry out a range of services in relation to the new IBRC portfolio if we end up acquiring the bulk of it. Such recruitment would be challenging enough at the best of times but, faced with public pay restrictions, it becomes much more so. Already this year, NAMA has lost 28 members of staff, over 10% of our headcount, on top of the 22 staff that left in 2012. With each departure, there is a loss also of business knowledge, a loss of continuity and of momentum. In all probability, the exodus will continue as the market improves and the high quality people in NAMA are targeted by entities such as banks, property firms and private equity funds.

May I state that I very much understand the rationale for the reductions in public sector pay and the need to ensure that no sector is left unaffected by the burden of adjustment. And indeed a certain level of staff turnover is to be expected as the property market recovers and this is particularly so in an agency with a finite lifespan.

But the reality is that NAMA is still continuing to expand due to the liquidation of IBRC: the portfolio under our management may well increase by up to 50% over the coming months – potentially by about €12 billion. And NAMA is also a commercial organisation which must operate on behalf of the taxpayer in the international arena. Against that background, it faces potentially serious consequences arising from the scale of staff turnover and the quality and experience of the departing staff.

Four years ago, the legislature set NAMA a challenging commercial mandate. I hope that you consider that we addressed our mandate with vigour, realism and commercial dexterity. The various milestones reached to date, in terms of cash generation and debt repayment, could not have been achieved without the very able staff that we were fortunate to recruit.

Our difficulty now is that we are losing many able and talented people and we are facing an uphill battle in retaining others. Replacing specialist staff is difficult; we cannot pressgang property, banking and other specialists into joining NAMA nor can we force them to stay if better opportunities arise elsewhere.

Chairman and Deputies, in conclusion, NAMA is an enormous undertaking for the State and we have proved that we can deliver on our commercial mandate in what has been a very tough economic environment, both domestically and globally. The commitment and resolve of the Board and staff to contribute to a resolution of Ireland's difficulties is beyond doubt and I must pay tribute to them. I assure you all here today that we will continue to do our very best for the citizens of the State.

I have addressed some of the key issues in relation to NAMA as I see them at this stage of our evolution.

The NAMA Chairman, Frank Daly, and I are now happy to discuss any issues that you may wish to raise with us.