

**Opening Statement by
Mr. Brendan McDonagh, Chief Executive of NAMA, to the
Joint Committee on Finance, Public Expenditure and Reform
Thursday, 13 July 2017**

Chairman, Deputies and Senators,

You invited us to discuss the operations and functioning of NAMA, including the recently published NAMA Annual Report and Financial Statements for 2016.

I am pleased to report that we generated a profit of €1.5 billion in the 2016 financial year. Taking into account the profit of €1.8 billion reported for the 2015 financial year brings to €3.3 billion the cumulative profit reported since we last appeared before this Committee in late 2015. This strong performance reflects the impact of market recovery but also the detailed, professional asset management and corporate finance work that had been put in place by NAMA in earlier years towards enhancing asset values through focused planning work, remediation and capital expenditure.

Since we last appeared before you, we have redeemed €7.6 billion in senior debt. That leaves only €500m to be redeemed later this year from the original €30.2 billion that we issued in senior debt. The €30.2 billion has been redeemed from cash generated by debtor asset sales and by NAMA loan sales. The reason we no longer have a contingent liability of €30 billion potentially falling on Irish taxpayers is that international and domestic investors have invested heavily in Irish property assets since Ireland exited the Troika programme at the end of 2013. That has enabled NAMA to generate almost €40 billion in cash from inception to date, including €5.4 billion generated in 2016.

The carrying value of our loans at the end of 2016 was €3.9 billion. Over 80% of our residual exposure is to assets located in Ireland. Our exposure to UK assets is now relatively low. When

we acquired our loans, the associated UK asset portfolio was valued at over €12 billion; that portfolio has now fallen to less than €600m.

Residential delivery programme

As regards Irish assets, part of NAMA's residual loan portfolio is secured by sites which have capacity to deliver houses and apartments in the years ahead. There has been much talk of the shortage of housing in urban areas and the reasons why supply has been so slow in responding.

In my view, the principal explanation for the supply shortage was that residential prices fell by over 50% between 2007 and 2013 and only in recent years has it become commercially viable to build houses again. No funder, be it NAMA, banks or otherwise, could have funded the building of housing unless it was profitable to do so. Apartment schemes are still very challenging to fund given the planning requirements and restrictions.

NAMA's role in residential delivery has to be understood in that context. To the extent that we fund residential development by our debtors, it is to ensure that they maximise the return from their sites and thereby maximise their debt repayment. We will only fund residential development

- (a) which is commercially viable;
- (b) which is under the control of co-operative debtors and receivers; and
- (c) which is under the control of debtors who have a proven capability to deliver quality houses and apartments.

Sites which don't meet these three criteria and the loans secured by them are subject to sale.

We can only fund residential development projects which generate a better commercial return through funding than they would generate from alternative options such as the sale of the sites concerned. A debtor or receiver will want to maximise their debt repayment and therefore it is important that the management and disposal of the asset yields the highest return.

Restriction of sales to certain purchasers

There has been some commentary to the effect that NAMA should not sell its interest in residential sites to international funds and that, instead, any sales should have been restricted

to domestic developers. The reality is that, under our legislation, we could not have limited the field of potential buyers if the effect of doing so was to reduce the sales proceeds generated by sales. In any event, these funds bought less than 40% of interests in sites sold and they did so mainly through loan sales.

Crucially, under our Section 10 objective, we cannot refuse to sell to funds or any other financial institutions that submit the best bid for the asset concerned. We are obliged to get the best price. This is normally achieved through open marketing of loans and assets. We depart from the open marketing policy only if a better price can be achieved through a more restricted sales process.

It has also been suggested that, as part of its asset and loan sales, NAMA should have imposed covenants requiring purchasers to develop sites within certain pre-determined periods. There are two difficulties with such an approach. The first is that it would have led to discounts on the prices achieved on the assets and sales concerned. Second, there are doubts as to the enforceability of such covenants: I am not convinced that you can force a purchaser to develop a site if he/she considers it unprofitable to do so.

I would point out that we have a number of licencing arrangements in place and are actively reviewing the feasibility of a number of other potential licences. Generally speaking, licencing arrangements are suitable for sites controlled by receivers. They usually involve smaller builders who acquire the development rights and build out the sites.

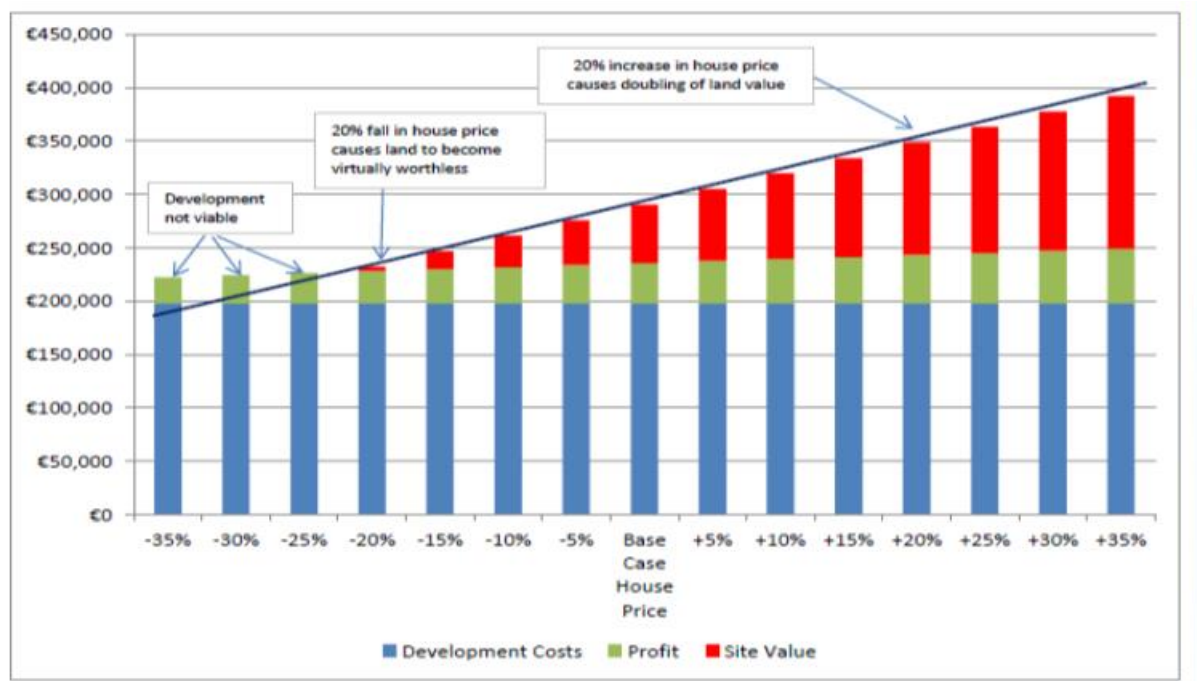
Slow market response

For reasons which I have outlined earlier, we fund sites which are commercially viable to develop and which are under the control of co-operative and capable debtors. We have and will continue to dispose of our interest in other sites. Since inception, we have disposed, either through loan sales or through asset sales by our debtors and receivers, of sites with a capacity to deliver 50,000 units. About 38% of these interests have been sold to financial institutions or funds; the remaining 62% have been sold to developers and other private purchasers. You may have noted from recent media coverage that some of the funds and financial institutions have established, or are preparing to establish, residential development operations with a view to actively funding the delivery of new supply.

We estimate that, at this stage, over 50% of the 50,000 unit delivery capacity disposed of by NAMA is commercially viable to develop although it is difficult to be certain about this in the absence of detailed project-by-project information. About 10,000 of these units had planning permission or were in the planning system prior to sale. To our knowledge, only about 3,700 have been built or are under construction to date. Why are so few being delivered?

In the short time available here, I will outline some of the many factors that are at play:

1. There is no doubt that land hoarding is an issue although it is not the full story. For any given site, there is little disincentive to hoarding as long as the owner expects house prices to rise. Costs remain relatively fixed and, as is illustrated by the chart below, any rise in house prices translates into profit on land.



2. The fact that planning permission has been obtained does not make development viable. Construction costs remained relatively stable during the financial and property crisis as prices collapsed. Therefore, the key factor in determining viability now is the sales prices that can be achieved on newly-built houses and apartments. In some cases, prices have risen sufficiently to make development viable but this is not necessarily the case throughout the country.

3. For many residential sites it is not possible to proceed until such time as critical infrastructure is in place, including roads, sewerage and water services, schools and recreational amenities. The introduction of the LIHAF programme is a welcome move in this respect.
4. There are particular difficulties with the viability of developing apartment blocks which are, at best, commercially marginal at present. We need to build many more apartment blocks if we are to make a serious impact on new supply. Height restrictions which apply under current planning policy have an impact on the viability of commercial apartment development. In some cases, statutory development plans set a height restriction which is less than the most cost-effective scale. A city centre apartment development project that is not commercially viable at 6-7 storeys is more likely to be commercially viable at, say, 12-15 storeys. In our view, the height restrictions currently applied, particularly in city centre locations, are no longer appropriate given current and prospective housing needs. Amending height restrictions to 15 storeys in city centre locations and to 10 storeys in suburban areas merits serious consideration.
5. The provision of basement car parks can add considerably to the development cost of an apartment project. Most urban apartment schemes require basement parking as a condition of planning, usually on the basis of a car space for every two apartments. Basement parking costs are estimated, on average, to add about €30,000 per car space to development costs. Greater flexibility in relation to the exclusion of expensive car parking requirements would improve the commercial viability of certain apartment schemes, particularly in city centre locations or locations which are otherwise already well served in terms of access to good quality public transport.

Finally, it is worth mentioning that there are practical reasons why the market can be slow to respond to supply shortages. In practice, the development process from initial site assessment to the start of construction takes at least two years: it involves assessing a site, resolving issues relating to services or legal title, employing a design team, completing pre-planning consultations, lodging a planning application, dealing with additional information requests, awaiting planning permission, raising construction finance, tendering to construction firms, appointing a construction team and then commencing construction.

That two-year timeframe assumes that all goes well; however, in many cases there are delays which may be caused by planning refusals, objections, legal problems or funding difficulties.

After that preparatory period of two years or more, building commences with the start-up phase and initial site works for roads and other infrastructure; thereafter, the completion of a 100-unit scheme can take another 18 to 24 months.

For these various practical reasons, the house building deficit is not going to be resolved quickly.

Thank you.