Gníomhaireacht Náisiúnta um Bhainistíocht Sócmhainní
National Asset Management Agency

Address by Mr. Frank Daly,
Chairman of the
National Asset Management Agency

Launch of Society of Chartered Surveyors Ireland

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Thank you for the invitation to speak at the launch of the Society of Chartered Surveyors Ireland. I welcome the opportunity to address this event held to mark the merger of the Society of Chartered Surveyors and the Irish Auctioneers and Valuers Institute into a single professional body for construction, land and property professionals in Ireland. I very much applaud the initiative you have shown in coming together. I am aware that one of your priorities will be to set and enforce high standards of professionalism among your members and, in that context, the introduction of the Valuer Registration Scheme this year is a welcome step in that direction.

NAMA

As professionals, you will be interested to hear about NAMA's plans and about their potential impact on the property market. We have two objectives over the coming year or two: to contribute to a re-activation of the property market and to act as a source of liquidity to potential buyers.

Let me state at the outset that we see it as very much part of our brief to generate transactions in the market and, by so doing, to play our part in reinvigorating it. It is important that transactions happen so as to ensure that we can accurately gauge where market prices have settled. It is only indeed when potential buyers are convinced that prices have flattened out that they will contemplate entering the market. A number of sales recently have illustrated the point that if prices are adjusted sufficiently, latent demand will surface; in other words, many sellers may still retain unreasonable expectations of the prices that can be realised for the foreseeable future. The only way that the market can be lifted out of its current slumber is by generating transactions at whatever prices buyers are currently willing to pay.

NAMA's impact on the property market over the next year or two will be felt indirectly through our engagement with debtors and through the receivership process. Debtors will either be disposing of property at our behest in order to reduce their debt or, if we enforce against them, receivers working under our instruction will be offering property for sale. Let me say a few words about where we stand in terms of debtor engagement at this point.

You will be aware that NAMA acquires loans, not properties. At this stage, we have acquired the property loans of about 850 debtors which aggregate to a nominal €72.3 billion and for these we have paid consideration of €30.5 billion. From our perspective, the 850 debtors fall into three groups.

The first group comprises the thirty largest debtors whose loans total €27 billion which is equivalent to 40% of the portfolio. In terms of dealing with them, we are at an advanced stage. Their business plans have been extensively reviewed and arising from that, in the majority of cases, we have come to agreements which encompass schedules of asset disposals and debt repayment. In a number of cases, debtors have been unable to convince us that their business plans are viable and, in these cases, we have already pursued enforcement or will be doing so shortly. There are also a small number who are attempting to prolong the process as much as they can and it is likely that we will end up enforcing against these debtors in the near term also.

The second group of debtors comprise the next 145 debtors whose combined debt amounts to about €34 billion. We have set a deadline of end-April for the submission by these debtors of their business plans. If they do not meet this deadline for convincing reasons, we will not indulge them further. They have been aware for some time of this requirement and, therefore, those who fail to meet the deadline are clearly not taking the NAMA process seriously and we will proceed straight to enforcement with them as soon as possible thereafter. Overall, we expect that the outlook for all debtors who submit Business Plans in this second group will be clear no later than the end of the year at the latest but many will be determined well before then. NAMA will either have agreed a debt repayment/asset disposal strategy with them or will have taken the enforcement route. These debtors and the debtors in the first group – about 175 in total - will be directly managed by NAMA staff.

In the case of the third group of debtors (about 675 debtors with outstanding debt of about €12/13 billion), their loans will be managed by the participating institutions under delegated authority from NAMA and each of them will be obliged to submit their business plans to their respective lending institutions. The institutions will be required to make recommendations to us as to the viability of these plans; NAMA will review the recommendations and determine appropriate strategies for each debtor. Work on this Group has already commenced and we expect that by end August over 200 cases will have been dealt with.

Sales

The overall impact of this debtor engagement process is that quite a number of properties will be going on the market over the rest of this year and into next year. NAMA has one key objective: to generate a commercial return for the taxpayer over time. Its main task, over the next seven to ten years, is to recover the €30 billion plus it has paid for the institutions' property loans, in addition to whatever it invests to enhance property assets underlying those loans. The cash that it generates either from debtors (receipts of debt interest and principal and the proceeds of asset sales) or from receiverships will be used to repay NAMA debt. It is of no value to NAMA, therefore, if debtors hoard property in the hope of a significant pick-up in prices. The plans that have been, or will be, agreed with them incorporate detailed schedules for asset disposals in conjunction with associated targets for debt repayment. I should mention that NAMA's asset management strategies for individual debtors will be informed and guided by a number of overall sectoral and Board strategies.

The sales process has already begun: since 1 March 2010, we have approved the sale of an estimated €2.7 billion in property assets held by debtors in Ireland and in the UK. These funds will be used to pay down debts either to the Agency itself, to participating institutions or to non-NAMA banks where they had co-lent on developments. We expect that asset disposal by debtors will provide significant momentum to the property market this year and into 2012 and 2013. Where appropriate, NAMA will also advance new money to enable unfinished developments to be completed or otherwise to enhance the value of assets. Under the Act, we can borrow up to €5 billion for this purpose and, so far, we have approved close to €730m in new money advances to projects which are commercially viable.

Liquidity

A second key prerequisite of recovery in the property market is the provision of liquidity to enable potential buyers to obtain finance to purchase assets. NAMA has already provided liquidity to the participating institutions in the form of over €30 billion in NAMA bonds which can be exchanged for cash with the ECB. In addition, NAMA is currently exploring ways in which it could further facilitate the provision of liquidity into the market by providing staple finance for commercial deals and also by exploring options on the residential front. Following the PCAR2 exercise we would, for example, be interested in talking with the two Pillar banks to see how we could work together to move things along in this area. At a time like this, it is imperative that NAMA is creative in terms of identifying solutions to get the market moving.

Outlook for property market

You will all be aware that commercial property is down about 60% from its peak levels at the end of 2007. The outlook for commercial property cannot be divorced from the outlook for economic growth in general over the coming years. The macro-economic projections recently published by the Central Bank as part of its PCAR2 stress-testing exercise on bank assets include a baseline scenario which sees a slight fall in commercial property prices in 2011 (minus 2.5%) followed by slight increases of 1.5% in each of 2012 and 2013. I recently came across some analysis which suggested that commercial property prices, which had accelerated well ahead of GDP growth throughout much of the last decade, have now corrected to such an extent that they are back to the levels that would have been expected had they faithfully followed the trend of GDP growth over that time. There are a number of other signs that prices may be close to stabilisation: office and retail yields are back to levels seen in the mid-nineties and office vacancy rates in Dublin are beginning to stabilise.

Commercial property will receive support from the strong performance of certain sectors of the economy (technology, pharmaceuticals and exports) which will sustain demand for good property assets in Dublin and elsewhere in Ireland. An inflow of capital from abroad will be crucial; domestic investors will be wary given the fact that many of them are already over-exposed to Irish commercial property. The recent purchase by Google of the Montevetro Building, a transaction facilitated by NAMA, is hopefully a portent of things to come. I am confident that we can facilitate many similar transactions over the coming months and years, not least because of the level of interest that we have seen from foreign investors in assets that may be available for disposal over the coming years. So, without wishing to assume the precarious mantle of forecaster, I would suggest that there is limited downside for the commercial property market from current levels.

On the residential sector, the Central Bank exercise used forecasts of close to 60% fall from peak (end-2006 to end-2012) under its adverse scenario and 55% under its baseline scenario. The PTSB/ESRI index is currently indicating a fall of close to 40% from peak but we do not think that this index has, to date, fully captured the scale of the decline. As many of you will know, NAMA's base valuation date was November 2009 and, by that stage, we had assumed a 50% fall in average residential property values from peak. We believe, therefore, that the bulk of the decline has already occurred but we would be more tentative in our view of residential property than we would be of commercial property.

In terms of reviewing the outlook for residential property, it makes sense to discriminate by reference to asset type and location. In certain parts of Dublin and other cities, supply/demand considerations suggest that prices have stabilised with a positive outlook over a two/three year horizon. However, there are parts of the country where the level of supply is way above any conceivable demand and there is little or no expectation of even modest price recovery. Site acquisition and development costs can never be recovered and the only option is to sell the properties at whatever price purchasers are now willing to pay.

Valuation

The crisis in which Ireland now finds itself has, as its source, a banking implosion which was driven ultimately by a property market bubble. It would be remiss of me to appear in front of a gathering of construction and property professionals such as this without raising the question of whether, at least collectively, you could have been more vigilant in drawing attention to the enormous systemic risk which was being created. Many of you must have wondered about the sustainability of the ever-escalating upward price spiral that was developing by the middle of the last decide, a spiral driven by cheap money and by a coterie of bankers and market participants who appeared to lack a basic understanding of the dynamics of a properly-functioning market. You must have questioned whether a fourfold increase in commercial and residential property prices in the decade after 1997 could possibly have been justified given its ever-increasing divergence from the trend of economic growth over the same period.

I expect that the valuation professionals amongst you will claim that your job is to provide the best estimate of the market price of a particular property at a particular point in time. However, there is a widespread external view that your responsibilities are more extensive than that. This applies also to other professions such as accounting and auditing which have been similarly criticised for adopting a narrow interpretation of their responsibilities during the evolution of the banking and property bubbles. At a time when many lay people with no great knowledge of the property business were becoming increasingly alarmed at the disconnection between the prices being paid for properties and the intrinsic long-term economic value of those properties, could the two professional bodies not have signalled some concern at what was taking place?

I expect that I am saying nothing which has not been said by many individual members of the Society over recent years. Given your evident determination to cultivate and maintain the highest professional standards, I would suggest, as an outsider, that a critique of the performance of the profession during the evolution of the property price bubble would be a cathartic exercise for the new Society to initiate and support. The credibility of your profession would be enhanced if you could show that steps were being taken to address the mistakes of the last decade.

Incidentally, one of the many lessons that can be drawn from the events of the past decade is the need for greater transparency in market transactions. I know that the Society is a strong advocate of the need for public databases of all commercial sales, rental and leasing information and of residential property transactions in order to provide transparent information which would be of benefit to practitioners, tenants, landlords and investors alike. We are currently one of the few exceptions, internationally, in not having such a database and NAMA is fully supportive of any initiatives designed to accelerate the process of putting these databases in place. In fact, we believe that the register should apply to all residential as well as commercial transactions. I recall in fact that the Commission on Taxation, which I chaired, called for just such a register in its Report in September 2009. I believe that the infrastructure is already in place in the form of the Property Registration Authority and it is now high time we got on with it.

Upward-only rent reviews

Another issue that is of concern to many of you is the possible retrospective abolition of upward-only rent reviews in commercial leases. A provision in the **Land and Conveyancing Law Reform Act 2009**, which banned upward-only rent review clauses, came into operation for <u>**new**</u> leases in February 2010 but existing lease arrangements were unaffected. The recent Programme for Government includes a commitment to legislate to end upward-only rent reviews for existing leases and I am aware that this proposal has given rise to much debate among the members of the Society.

There is merit in many of the arguments made on both sides. We know that many businesses are struggling in the current recession and that their current lease arrangements – in many cases, put in place at the height of the market - impose a punitive and inflexible burden on them at a time of falling sales and business activity and against a background of a significant decline in market rents. We could also infer perhaps that some landlords are being unrealistic in their demands.

On the other hand, the introduction of laws with retrospective effect gives rise to all kinds of legal uncertainly which is likely to have a knock-on effect in terms of investment. There is a substantial risk that a retrospective ban on existing contracts with upward-only reviews will give rise to litigation. This litigation could prolong the current stasis in the property market at a time when stability and certainty is needed to attract international investors. I mentioned earlier that one of the key roles of NAMA is to contribute to the revitalisation of the property market by generating sales activity and attracting international investors into Ireland. From our perspective, it is important that, one way or another, the current uncertainty be resolved as quickly as possible so as to ensure that we maintain and capitalise on the appetite of those with funds for investing in Irish property. The uncertainty is leading to international capital not being deployed here as investors cannot determine if the Irish market is an investible proposition and we all know we need foreign capital, attracted to the good yields currently available, to revitalise the Irish property market. In making these points today I want to stress that I am not commenting on Government policy but simply outlining the effect on NAMA assets and therefore on the taxpayer. Whatever decision is to be made it is important that it be made quickly so the market can digest it and move on.

Property Receivers

A number of your members are on NAMA panels to act as Property Receivers. I am pleased to note that NAMA has led the charge in Ireland in terms of appointing property receivers to property assets rather than follow the practice of banks which have traditionally used corporate receivers, such as accounting firms. This arrangement should work well for you and also for NAMA.

Conclusion

Collectively, we face a long and arduous path back to economic recovery but if we walk it together we can “shorten the road". NAMA was established in recognition of the scale of the crisis in property lending and of the fact that those who created the crisis were in no position to resolve it. NAMA will play its part in the forthcoming recovery, as will many others, including the members of this newly-merged Society.

A recovery in the commercial and residential property markets depends on a recovery in business and consumer confidence. This, in turn, depends on evidence that we have turned the corner in terms of the outlook for the Exchequer finances and the crisis in the banking sector. We can only hope that the strong rally seen in Irish Government bond yields since the announcement of the results of the PCAR2 exercise at the end of March is an early signal that foreign investors have taken the view that Ireland has now fully faced up to its difficulties and again represents an attractive option for long-term investment.

President and Society members, I know that you are keen to play an active part and I wish you well with the new Society and thank you for your attention today.