

# Opening Statement by Mr. John Collison, Head of Residential Delivery, NAMA to the Public Accounts Committee Tuesday, 25 October 2016

Chairman and Deputies,

I would like to take the opportunity to introduce myself and my colleagues.

My name is John Collison and I am Head of Residential Delivery at NAMA. In that capacity, I am responsible for the management of NAMA's residential development funding programme, which is aimed at delivering on a commercial basis, through NAMA debtors and receivers, 20,000 new homes in Ireland in the period out to 2020.

Prior to this role, I held a number of senior positions in NAMA's Asset Recovery Division, including the position of Deputy Head of Asset Recovery at the time of the Project Eagle loan sale. As Deputy Head of Asset Recovery in 2014, I worked with the Head of Asset Recovery and the wider NAMA cross-functional team which executed the transaction following the Board's decision to initiate the sale of Project Eagle.

To my right is Michael Moriarty, who is Head of Asset Recovery at NAMA. At the time of the Project Eagle sale, Michael, like me, held the position of Deputy Head of Asset Recovery. Michael and I and the teams we supervised were responsible for the case management of the Northern Ireland debtors but Michael was not directly involved in the Project Eagle loan sales process.

To my left is Dónal Rooney, who up until recently held the position of Chief Financial Officer (CFO) at NAMA. Dónal resigned earlier this year to take up a role with another

employer. The involvement of the CFO division in Project Eagle was two-fold: the Finance team within the CFO Division provided routine baseline financial data on the portfolio which was included in various papers for Board. The Operations, Systems, Treasury and Tax teams, which also sit within the CFO Division, were involved in the cross-functional transaction team.

I am also joined by Alan Stewart who is, and was at the time, a Senior Divisional Solicitor and a senior member of the legal team engaged in the Project Eagle transaction. The legal team was involved in drafting and negotiating all transaction documents, the design and population of the legal section of the data room and dealing with legal due diligence queries.

We, together with our external advisors, Lazard and Hogan Lovells, were tasked with the detailed transaction execution work which followed the decision of the Board to offer Project Eagle for sale in January 2014.

## NAMA's experience of the loan sales market in 2013/2014

In 2011, NAMA procured European and US panels of loan sale advisers in order to be fully prepared to take advantage of deleveraging opportunities as they arose. We anticipated that there would be opportunities for assembling and marketing single connection and multiple connection loan portfolios over NAMA's lifespan.

NAMA also formed an internal loan sales team with experience in corporate finance, accountancy, banking, property and law.

By the time of the Project Eagle sale, NAMA had completed a number of loan sales - with total par debt of  $\notin$ 4 billion - and we were preparing for the sale of Project Tower.

We had also engaged with numerous international loan buyers as part of our strategy of developing a market for distressed property and loans in Ireland. The purpose of this strategy was to attract investment into the Irish market at a time, 2012 and 2013, when

there appeared to be little or no appetite for investment in Irish assets compared to what subsequently transpired during 2014 and 2015.

In 2013 and early 2014, the Irish loan sales market was at a very early stage of development. IBRC was placed into special liquidation in February 2013 and its loan books were the first large Irish portfolios to be brought to market. From 2013, the market evolved significantly and quickly within a relatively short period.

NAMA has always sought to implement best practice in its loan sales in order to maximise value. It continuously makes changes to its processes to improve efficiency and to retain investor interest.

From 2014 onwards, there was a move by sellers to offer more vendor due diligence in an effort to reduce bidders' due diligence costs which, for a large portfolio could be €2m - €3m. This was a very significant outlay for unsuccessful bidders.

Since 2014, bidders have demanded access to a greater volume of information in loan sale data rooms. However, it is important to note that single phase data rooms are still in use and the concept of a two-tier data room, like that used for Project Eagle, remains commonplace.

I think it is also important to note that there was, and is, no single "correct" way for NAMA or any other loan seller to market a loan portfolio. Marketing approach depends on the size, value and granularity of the portfolio and the size of the potential investor pool.

Some sales are single phase and some are in two phases. A two-phase marketing approach is generally used where there is a long list of potential buyers who have the financial capacity and credibility to be approached and that list needs to be substantially reduced before going into Phase 2. In a two-phase process, the Phase 1 data room has only very limited information and full due diligence is only provided to the short list of bidders, typically three final bidders, who reach Phase 2.

#### The Project Eagle Data Room

By reference to the loan sale practice at the time, the data room for Project Eagle was appropriate for the portfolio.

Because there was not a long list of potential buyers, a two-phase process was not appropriate. Lazard identified nine potential buyers of which five decided to review the data in detail. Accordingly, a single phase data room was set up so that the investors who sought access could get immediate access to full due diligence materials. In the circumstances, there was no need for a Phase 1 data room.

Because the top 55 properties represented a significant proportion of the underlying value of the portfolio, we adopted a two-tier approach to vendor due diligence. The legal section of the data room contained a vendor due diligence report and copies of loan, security and title documentation for each of the top 55 assets and also included all of their anchor leases. The commercial section of the data room contained redacted November 2009 red book valuations and up-to-date tenancy schedules for the Top 55 assets. This provided the bidders with all the cash flow information necessary to make their assessment of value. Extensive 'data tapes' (schedules of information) were also provided along with registers of receiverships, litigation and bankruptcies.

For the smaller assets, the legal section of the data room contained a vendor due diligence report on each connection which set out details of the loans, security and guarantees. The commercial section of the data room contained November 2009 red book valuations for the smaller assets.

#### PIMCO's reverse enquiry

It has been suggested that some potential investors were discouraged from participating in the Eagle process because PIMCO had a head start.

That does not reflect our experience – generally or by reference to Project Eagle.

Loan sales are frequently initiated as a result of an unsolicited third party approach – known as a reverse enquiry. In fact, over 50% of our significant loan sales were initiated following credible reverse inquiries. In assessing such approaches our key consideration is whether the proposed transaction optimises the financial return to NAMA. If it does, and if NAMA believes that the party making the reverse enquiry has the financial capacity to deliver on it, we will prepare a formal assessment and seek a decision to initiate a formal loan sales process.

To date, of those significant NAMA loan sales triggered by credible reverse enquiries, only about a third have been won by the party that made the original reverse enquiry. This is strong evidence that PIMCO had no advantage over the other potential bidders.

Following its expression of interest in September 2013, PIMCO was given access only to the redacted 2009 red book valuations for the top 55 assets and some information regarding portfolio cash flows. More limited information was provided about the smaller assets and no legal documentation of any type was provided to PIMCO.

The letter of offer from PIMCO, submitted on 4 December 2013, was based on its evaluation of the material provided on the top 55 assets.

Following the Board's decision to market the portfolio, a single-phase data room was opened in February 2014 and six potential bidders signed Non-Disclosure Agreements permitting them access. As is normal in loan sales, documents were uploaded to the data room throughout the process. The six potential bidders admitted to the data room were PIMCO, Oaktree, Cerberus, Lone Star, Goldman Sachs and Fortress.

The only distinction between PIMCO and the other five bidders in the data room was that PIMCO had already seen November 2009 redacted red book valuation reports for the top 55 properties in late 2013. We don't consider that to have been a material advantage.

## Role of Lazard

The Committee has already heard from the Chairman and CEO that, following the Board's decision to market the portfolio, Lazard was appointed in January 2014 as the loan sale broker to identify all other credible bidders for the portfolio and to advise on and manage the sales process through to completion. Lazard's role involved designing the bid process, initiating engagement with potential credible bidders, managing the due diligence query process (in conjunction with legal advisers), engaging with bidders throughout the process, leading the commercial negotiations and managing the sale execution.

The identification of other credible bidders and the sequence for engaging with those bidders was based on Lazard's assessment of the loan sales market and we relied on their advice in that respect. Lazard identified a bidder list and then engaged with potential credible bidders to ascertain their level of interest in the portfolio. Based on detailed bidder engagement, Lazard confirmed to NAMA that all potentially credible bidders were given the opportunity to participate in the sales process.

Lazard worked with NAMA and our external legal advisers to design and populate the commercial and legal sections of the data room and decide on the detailed process. Lazard engaged intensively with bidders throughout the due diligence query process. Final bids were received on 1 April 2014 and Lazard evaluated the bids received from Fortress and Cerberus and recommended the latter's bid to the Board. Lazard confirmed to the Board that there was sufficient competitive tension in the process until the receipt of the bids, and that the process was appropriate for a transaction of its nature.

Based on Lazard's advice we recommended to the NAMA Board that it accept the bid from Cerberus to achieve a combined £1.322 billon for Project Eagle.

Lazard's role in this sale was similar to the role played by loan sale brokers in other NAMA sales. A copy of the Lazard contract has been provided to the Committee and it

gives you a sense of the range of responsibilities involved. In summary, Lazard was engaged to:

- advise on the overall strategy, timing and tactics of the sale
- identify prospective purchasers
- advise on the data room and process letter
- engage in direct discussions with purchasers Lazard provided ongoing updates to NAMA on its engagement with prospective purchasers through weekly conference calls, update emails and formal reports
- manage the ongoing sales process
- assess submitted bids
- make a final recommendation to NAMA
- manage the close-out of the process from the selection of the preferred bidder.

It has also been commented that Lazard did not have total control of the data room as loan sale advisors tend to do in most loan sales. That is a technical point and is not material to how the process was managed. Data room set-up varies from transaction to transaction. Data rooms are typically provided by an external specialist company (such as Intralinks) with substantial IT security and tracking features. NAMA and its legal advisers uploaded all the documentation to an Intralinks secure site. Only the bidders who had executed the Non-Disclosure Agreement (and their advisors) could access the secure data room. Lazard had the same access rights as NAMA and maintained full oversight of all data room activity throughout the sales process.

## **Role of Hogan Lovells**

Hogan Lovells were appointed as lead legal adviser for the transaction. Hogan Lovells provided legal advice, project management and transaction management to NAMA in respect of the Eagle sale, and provided advice on all strategic legal issues that arose during the process. Specifically, Hogan Lovells' role included the following:

• Legal advice on all aspects of the transaction

- Design, collation and population of the legal data room
- Preparation of Vendor Due Diligence reports
- Drafting and negotiation of all transaction documentation
- Co-ordination of all legal due diligence queries/responses
- Project management of the legal process across all jurisdictions
- Post completion delivery of documentation and transfers of security

#### NI debtor engagement

NAMA's engagement with Northern Ireland debtors had been difficult. Progress on sales had been poor – only £112m of NI asset sales and loan redemptions had been achieved between 2010 and 2013. Whilst the enforcement rate - 39% - was the same as for the overall portfolio, it was clear that, if Eagle did not go ahead, there were a number of probable additional enforcements in the pipeline.

This is supported by an analysis of the Credit Grading profile of our loan book. NAMA assigned a risk rating to each debtor connection on a credit grading matrix based on certain criteria. The key criteria were mainly based on (a) the projected financial outcome (level of recovery of our debt) and (b) the overall level of cooperation, largely measured by debtor performance in meeting milestones.

Comparing the levels of co-operation by debtors within the Project Eagle portfolio with the rest of the NAMA portfolio, just **15%** of Eagle debtors were graded as **Cooperating**, compared with **28%** on the rest of the NAMA portfolio.

Also, based on the limited number of sales achieved, falling asset values and increasing impairments, the percentage of Eagle debtors which attracted a **credit grading of either** <u>3B or 3C</u> was 76%. These are the lowest debtor credit gradings in NAMA's risk matrix. These gradings relate to debtors whose case managers projected <u>the worst</u> <u>financial outcome</u> and by definition those that were projecting a loss greater than 20% below original expected recovery targets. In addition, debtors with these gradings also displayed evidence of significant milestone slippage (e.g. missed sales, assets not being pledged to NAMA, difficulty in supplying documentation, etc).

This **76%** credit grading for Northern Ireland debtors compares with just **36%** for the rest of the NAMA portfolio and clearly demonstrates the scale of the challenge we were facing with these debtors.

#### Fair value of the Project Eagle loans

I wish to comment briefly on the issue of the fair value of the Project Eagle portfolio as of the end of 2013. The gross cash flows arising from the Eagle loans aggregated to  $\pm$ 1,675m. The C&AG's report has discounted these cash flows at a discount rate of 5.5% and has produced a NPV of £1,489m.

However, it should be pointed out that this is not in line with the fair value methodology that was used in preparing information required as part of the end-2012 and end-2013 NAMA Financial Statements, both of which were certified by the C&AG. The fair value methodology for the 2012 accounts agreed with the C&AG was based on a discount rate of 10% and, had this fair value discount rate been applied to the Eagle portfolio, the NPV would have been **£1,365m**. This was the prevailing fair value discount rate that applied at the time that the sale of the Eagle portfolio was being considered by NAMA in Q4 of 2013.

The fair value methodology adopted in the 2013 accounts involved the application of a discount rate of 5.5% for cashflows arising in the period 2014-2016 and a rate of 10% for cash flows arising during the period from 2017 to 2020 ("the blended portfolio rate"). However, the blended portfolio 'fair value' rate would not, in our view, have been appropriate for the Eagle loans given the particular characteristics of that portfolio - the Eagle portfolio carried higher risk and would therefore have warranted a discount rate higher than the blended portfolio rate, and indeed higher than the 10% fair value rate used in 2012, in order to derive its fair value.

## Conclusion

Chairman, when PIMCO expressed an interest in this portfolio, the Board instructed the Executive to assess the opportunity.

Following detailed assessment, the Board took the view that the assets securing the Eagle loan portfolio did not have sufficient upside potential to justify a hold strategy and if NAMA could, in effect, lock down the value of the portfolio upfront – by selling it in 2014 - that would be the optimum commercial outcome. The NAMA Executives supported that view and remain convinced that the decision to sell and the method of execution were appropriate and that the price achieved was the best available.

Thank you.