National Asset
Management Agency

Mr. Michael Noonan TD
Minister for Finance
Government Buildings
Merrion Street
Dublin 2.

12 September 2016

Dear Minister,

The C&AG's Special Report on the Project Eagle transaction, prepared under Section 9 of the *Comptroller and Auditor General (Amendment) Act 1993*, was submitted to you some weeks ago. NAMA engaged openly and extensively with the C&AG throughout the examination process and the NAMA Board provided its views on the various drafts of the report. The Board disagrees fundamentally with many of the conclusions reached by the C&AG in this report and intends to rebut these comprehensively and vigorously at the earliest appropriate opportunity after the report is published. In this context, we note the completely misleading and inaccurate speculation in the weekend media that the report found "irregularities" in the loan sale process – as you know, there are no such findings in the report.

Sales price

The Board rejects categorically the C&AG's conclusion that the decision to sell the Eagle portfolio at a minimum price of £1.3 billion involved "*a significant probable loss of value to the State*". This conclusion is based on a C&AG analysis of the transaction which is both flawed and hypothetical and which completely ignores the conventional market-standard valuation methodology for estimating the market value of any loan portfolio being sold by either NAMA or by any other deleveraging entity. The Board is strongly of the view that achieving £1.322 billion for the Eagle portfolio in 2014 – in excess of Board's minimum sales price of £1.3 billion - was the best commercial outcome achievable.

The source of the difference of views on the sales price between NAMA and the C&AG is a technical valuation point and relates to the correct discount rate used by a potential purchaser or investor to discount projected future cash flows arising from the loan portfolio. Cash flows arising from property assets are inherently uncertain; this uncertainty is much greater in the case of granular, non-prime and non-income producing assets (such as those comprising Project Eagle with assets in Northern Ireland and in regional UK) than in the case of prime commercial assets with a strong income stream located in sought-after locations such as Dublin or London. In general, the less attractive the assets and the income stream securing a loan portfolio and the less certain that the associated cash flows will actually be received, the higher the discount rate that will be applied by buyers. This is considered to be self-evident in the loan sale market.

The view of NAMA, supported by expert evidence from three internationally recognised loan sales experts, evidence which has been provided to the C&AG, is that a discount rate in the 10%-15% range would have been appropriate to apply to the cash flows associated with the Eagle portfolio. Accordingly, the minimum sales price set by the Board (£1.3 billion) and the price actually achieved (£1.322 billion) fall within the commercially acceptable range of values (£1.25 billion to £1.36 billion) that would have been generated by the range of discount rates that were applied by purchasers or investors bidding for the Eagle portfolio.

The Board notes that the C&AG did not utilise any loan sale expert to advise him on the matter. Contrary to the well-established market view outlined above, the C&AG is alone in the view that it would have been appropriate for NAMA to use a 5.5% discount rate to assess the Eagle portfolio's sales value in 2014. In relation to the discount rate, the evidence of NAMA, and of professional market experts actually engaged on a day-to-day basis in the loan sales market, is surprisingly disregarded by the C&AG but he offers no market-based counter evidence to justify his own view that a 5.5% discount rate would have been appropriate for a potential bidder. In fact, his view appears to be based on nothing more than a misinterpretation of a 2013 NAMA Board paper. It would seem reasonable to expect that the C&AG report which purports to offer an authoritative view of a major loan sale transaction would be supported by appropriate expert evidence but that is not the case.

Strategic considerations

In effect, the practical consequence of the stance adopted by the C&AG is that NAMA would be placed in the extraordinary position that, notwithstanding its commercial mandate, it could never sell any loan portfolio as, by definition, a portfolio valued at a discount rate of 5.5% could never be matched by bidder valuations based on discount rates of 10%-15%. This utterly uncommercial stance adopted by the C&AG is not one that could realistically be adopted by NAMA or indeed by any other commercial entity and it highlights the glaring absence of the commercial perspective which should have informed this Section 9 examination.

Indeed, if this approach had been adopted by NAMA, it could not have fulfilled the commitment, endorsed by you as part of the Section 227 review in 2014, to a managed process of accelerating disposals with the target of redeeming 80% of senior debt (a cumulative €24 billion) by end-2016. As you know, this ambitious target, which has not only been achieved but exceeded some nine months ahead of schedule, could not have been attained without the sale of a number of large loan portfolios at market value.

The scale of NAMA's exposure to property markets in Ireland, Britain and Northern Ireland and the amount of debt that it had to redeem (almost €23 billion of Government-guaranteed senior NAMA debt was still outstanding at end-2013) meant that it had to take advantage of any commercially sensible opportunities that became available, particularly for the less liquid segments in the portfolio. The overall NAMA portfolio carried huge risks for Irish taxpayers given that NAMA senior bonds were guaranteed by the State. In early 2014, the NTMA was seeking to re-enter the bond markets after the exit of the Troika and the contingent liabilities of NAMA and IBRC were still weighing heavily on the sovereign. Any professional and prudent asset manager faced with risks on such a scale would have acted to reduce them as quickly as was commercially feasible.

The outcome of the Brexit vote and its subsequent impact on investment sentiment and property markets in Britain and Northern Ireland, taken in conjunction with the fall in the sterling exchange rate, demonstrate clearly how injudicious it would have been for NAMA to have passed up a good opportunity to dispose of British and NI assets in the speculative hope that an even better opportunity might possibly have arisen at some stage in the future. We are satisfied that, if NAMA had retained the Eagle portfolio, there would be no investor interest in purchasing it now, or for the foreseeable future, at anything close to the price that was actually achieved. The Section 9 report makes no attempt to address this strategic and commercial reality or to incorporate it into its analysis.

In fact, we note that the C&AG states clearly in his conclusion at Par. 3.87 that the report draws no conclusions about the merits of NAMA's decision to sell the loan portfolio.

C&AG's approach to the examination

The Board's key decisions in relation to the Eagle transaction were based primarily on its extensive discussion of the issues involved. Accordingly, to get a full understanding of the basis for various decisions taken by the Board, due process required that the C&AG engage directly with Board members, as would be normal for an audit practice. The Board's request for such engagement with the C&AG was refused. Given Lazard's key advisory role in the transaction, it would also seem reasonable that senior OCAG staff should have engaged directly with Lazard. This did not happen.

We note that prior to commencing his examination of Project Eagle, the C&AG launched a public procurement process seeking external specialist advice to assist him in his examination. This was, in effect, an acknowledgement of the reality that he did <u>not</u> have market expertise within his Office and that he needed external advice if he was to conduct the examination in a properly informed manner. When the attempt to procure such expert advice through public procurement failed, there appears to have been no further attempt to secure advice through some other means.

Instead, the examination's conclusions are based entirely on opinions formed by the C&AG and his staff who have no market experience. I understand that your Department, following a meeting with OCAG staff on 7th June 2016, indicated to NAMA its surprise at OCAG's lack of knowledge of the loan sales market and advised that they would benefit greatly from external advice to help them achieve a better understanding of loan portfolio sales in general. We reiterate our view that it is incomprehensible that a report which purports to present an authoritative view on a major loan sale transaction is not informed by any supporting expert insight or market knowledge.

As indicated above, the main area of disagreement between NAMA and the C&AG relates to the price at which the portfolio was offered to the market. This in turn stems from disagreement on a technical valuation point as to the appropriate discount rate that should have been used.

The NAMA Board is of the view that, had the C&AG's examination had the benefit of being informed by market knowledge and expertise, its conclusions on many of the key issues – and, in particular, its conclusion on the sales price achieved by NAMA - would have been different.

Given the Board's fundamental disagreement with this conclusion and given that this conclusion arises directly from the inadequate examination approach that was adopted, notably the C&AG's failure to secure loan sale market advice or expertise, the Board considers that it would be entirely unsatisfactory if the C&AG's poorly-informed and flawed conclusion were to be left unchallenged. Taxpayers are entitled to expect that examinations of this nature should be conducted to a high standard and, in particular, that any conclusions reached should be rigorously established and supported by appropriate market evidence and expertise.

Yours sincerely,

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Frank Daly
Chairman