National Asset Management Agency

<u>Opening Address by</u>

<u>Mr. Brendan McDonagh, Chief Executive of NAMA, to the</u>

<u>Public Accounts Committee</u>

<u>Thursday, 5 July 2012</u>

Chairman and Deputies,

Our appearance before you today arises from the recent publication of the second special C&AG report on NAMA which deals with our management of loans. You will be aware that the Comptroller's first report – on the acquisition of bank assets – was published in October 2010. In this brief opening address, I propose to refer to some of the key issues raised in the second report and to update you on progress made by NAMA in addressing the formidable challenges to which the report alludes.

From our perspective in NAMA, publication of this report is timely in that it comes at an important juncture in our evolution. Up to recently, our focus, by necessity, had been on establishing and consolidating the agency. This included recruitment of specialists in finance, property, banking, law and other disciplines to enable us to carry out the statutory functions conferred on us by the legislature. It also meant putting in place a suitable valuation framework to enable us to value and acquire the loans from the participating institutions in line with the approved EU Commission methodology. And it meant engaging either directly or indirectly with close to 800 debtors and determining an appropriate strategy towards them.

The C&AG report deals with many of these issues in some detail and, in this brief address, I will confine my comments to just a number of the key points raised in the report. Overall, from NAMA's perspective, we are satisfied that it reflects positively on our progress to date and that the Agency's establishment was managed in a manner which gave rise to no serious concerns on the part of the C&AG. To put this into context, it is worth bearing in mind that much of this work was carried out in very difficult circumstances. We started off with relatively few staff, with few precedents to guide us and had to work under constant and intense public scrutiny from the beginning with the very real threat of litigation. At one stage at the end of March 2010, I recall that there were probably as many auditors dealing with NAMA as there were NAMA staff. We found ourselves dealing with reluctant clients - debtors and bankers - who were struggling to adapt to the new circumstances and many of whom were less than enthusiastic about the idea of an outside party intervening in a relationship which had become, unfortunately, all too intimate.

The first part of the report deals with our acquisition of €74 billion in loans from the participating institutions and payment to the institutions of €32 billion as consideration for these loans. The C&AG concludes that, based on his audit and on specialist advice commissioned by him, he is satisfied that he has received a reasonable degree of assurance that NAMA's valuation processes were robust. It is important to point out that, for us to be in a position to provide this assurance required that we follow an extensive due diligence process which meant that every loan and every property securing those loans had to be valued individually. It also meant that loan and security documentation had to be reviewed in detail.

And that leads me to the question of costs and the rationale for incurring such costs. We incurred total due diligence costs of €74m, of which €64m was recovered from participating institutions through a reduction in the loan acquisition values. Our detailed review of close to 11,000 property valuations submitted by the participating institutions resulted in a reduction of €2.24 billion in the price we ultimately paid for loans. In addition, the extensive legal due diligence process we carried out resulted in a further downward adjustment of €477m in the acquisition value of loans resulting from diminution of legal security and title.

Altogether, therefore, a due diligence process which cost €74m led to a reduction of over €2.7 billion in the acquisition price of loans. Let me state emphatically that expenditure on professional fees was, and is, an aspect of the business that I find very unpalatable but, in this instance, I think it was money judiciously spent, given that otherwise the taxpayer would have paid substantially more for these loans than they were actually worth. Also, it was a requirement of the EU Commission so as to assist them in verifying the quantum of State Aid to the participating institutions.

State Aid

The report has been interpreted by some commentators as implying that we paid more for the loans than we ought to have done. I reject this categorically. The report refers to the State Aid component of the NAMA Scheme which was €4.96 billion by reference to the first five tranches and which proved ultimately to be €5.6 billion for all tranches. The report points out that NAMA, under the Act, had discretion to pay a price for loans which was less than their long-term economic value. The reality is that the State Aid is a function of the discount rate used: the EU-approved discount averaged just over 5% whereas, in an open market, buyers would have discounted the loans at a rate of about 15%.

In all cases, our acquisition price was the long-term economic value as determined by the EU Commission-approved methodology. I regard that as reasonable in the circumstances. It was never our objective to pay as little as we possibly could for the loans. Our aim was to pay the right price which, in this case, was the price that gave us a reasonable prospect of recovering the consideration paid on behalf of the taxpayer but also gave the banks as much State Aid as was permitted by the EU State Aid rules.

We have to remind ourselves at this point that the purpose of the NAMA Scheme was, first and foremost, to provide State Aid to participating institutions. From the State's perspective, therefore, it was important that the amount of State Aid available under the scheme be fully utilised before other State funding options were considered. Given the level of assistance required by the participating institutions, there would have been little point in NAMA paying less than the long-term economic value of loans if that meant that the resulting shortfall would have had to be funded from some other part of the State's coffers. **We paid as much for the loans as was allowed under State Aid rules, no more and no less.** Ultimately, because of the extent of impairment in their balance sheets, the amount of assistance required by the institutions proved to be well beyond what the NAMA Scheme (in the form approved by the Commission) could provide and other measures had to be taken to supplement it. A final point is that, despite the different discount rates, NAMA ultimately paid the participating institutions an amount close to the current market value of the underlying property as at 30 November 2009.

Debtors

Another major theme of the report is NAMA's management of debtor relationships. A key early priority for us was to identify any additional cashflows and unsecured assets controlled by debtors that could be applied towards maximising debt repayment. This included putting in place mechanisms which enabled us to fully capture rental income from debtor assets. This had been neglected by the banks and the report acknowledges our efforts to ensure that such income be paid directly into bank accounts over which we have control.

We also set out to identify, and obtain charges over, unencumbered assets controlled by debtors. Not surprisingly, this was the most fractious and contentious part of our engagement with many of them but I am pleased to report that the effort has yielded a substantial return for the taxpayer. To end-December 2011, we had secured €384 million in unpledged security from debtors and, in the intervening period, we have secured an additional €130 million in unpledged assets, bringing the total secured to date to €514 million. This amount includes arrangements with certain debtors that the transfer of assets to connected parties be reversed. So far, this has yielded assets worth €160 million, including cash, property assets in Ireland and abroad, company shares and loans to family members. We continue to pursue a number of other debtors in order to obtain unpledged security and I expect that the value of our enhanced security will have increased further by the time these cases have been resolved. This figure is consistent with what we advised this Committee previously and it also confirms our sense that there is no 'pot of gold' out there that has been siphoned away by debtors.

Challenges

The report draws attention to the challenges facing us in terms of achieving our long-term objective of repaying our debt. We are well aware of these challenges. There is no doubt that price movements in the Irish market since 2009 have made our task much more difficult but we remain resolute in our determination to achieve our primary statutory objective.

In the impairment review which was conducted in preparation for the 2011 Financial Statements, we carried out a detailed assessment of projected debtor cashflows, including asset disposal proceeds and rental income. Based on this, we have already signalled that we will take a material impairment provision when our results are announced later in the month.

Notwithstanding that additional charge, however, we will be in a position to report both an operating profit and a profit after tax for the 2011 financial year of just over €200m.

Our strong cash position enabled us to redeem another €2 billion of our Senior Notes last week bringing the total redeemed to date to €3.25 billion. We are well on the way towards meeting our initial target of redeeming €7.5 billion in Senior Notes by the end of 2013. The Board, following a recent review of strategy, has recently re-affirmed its confidence that NAMA remains on course, at minimum, to redeem by 2020 all the Senior Bonds issued as consideration for its acquired loans.

We have now completed our assessment of all 800 or so debtor connection business plans. The results of that intensive engagement with debtors can be seen in the cash inflows to NAMA which have now reached in excess of €8 billion since inception. These include the proceeds of asset disposals – we have approved asset sales of €9.2 billion since March 2010 – as well as interest and other income which are used by debtors to reduce their indebtedness.

The credit decision-making framework is now up fully functioning and operating very efficiently: from inception to end-May 2012, some 11,000 credit decisions have been made and I particularly pleased to report that the average turnaround time for credit decisions is now down to 5.2 days. There are some outliers, of course, but the charge that NAMA is slow in its decision-making is comprehensively refuted by this statistic. Credit decisions taken include the approval of credit advances in excess of €1.3 billion to preserve and enhance the value of the assets securing our loans.

New phase

I mentioned earlier that we are very much alive to the challenges ahead and are taking appropriate measures to address them. We have entered a new phase of our evolution which will require us to develop and implement strategies aimed at maximising recovery from our assets.

As a first step, the Board approved a revised organisational structure designed to ensure that NAMA responds effectively and dynamically to these formidable challenges. The reorganisation, which was implemented three months ago, involved the restructuring of the agency into five divisions, one of which is an *Asset Management* division charged with identifying, appraising and implementing development projects which make commercial sense. This team is particularly focused on what can be achieved over a medium-term horizon: part of its job is to identify prospective supply shortages in the years ahead and to take the necessary action now to deal with those shortages.

Over 90% of Irish property under our debtors' control is located in or close to counties with large urban centres of population (Dublin and neighbouring commuter-belt counties as well as Cork, Limerick and Galway). Our view is that the long-term prospects for much of this are positive. For instance, there is an emerging shortage of large office accommodation in Dublin suitable for multinationals setting up or expanding operations in Ireland and we maintain close contact with the IDA so that we can anticipate and ultimately meet such requirements. We also expect that there may be pressure on the supply of certain types of housing stock in Dublin in the second half of this decade, particularly larger family houses in areas with good infrastructure (water, drainage, schools and transport links, in particular). In this and in other market segments, we will look to anticipate forthcoming supply shortages and will direct our funding accordingly.

We are also prepared and expect to make much use of vendor finance to generate commercial property transactions. Our best estimate at present is that up to €2 billion in vendor finance advances could be involved. An important point to make about vendor finance is that it will help to reduce the credit risk profile of the loan portfolio: lower quality credit risk is replaced by debtors with a much stronger capacity to repay. Our first vendor finance transaction was completed recently and there are currently a number of other transactions under consideration.

Another priority for us is to attract international investor capital through the creation of monetisation vehicles such as Qualifying Investor Funds (QIF). The establishment of the QIF is being sponsored by NAMA but it will operate independently of NAMA with its own Board. It will be an investor-friendly and tax-transparent vehicle with access to capital so that it can bid for and purchase Irish property assets in the market. The QIF is subject to receiving regulatory approval and, if this is forthcoming, the intention is to launch at least one QIF sub-fund before the end of the year.

Conclusion

Chairman and deputies, we in NAMA look forward to making an effective and vigorous contribution to national recovery. Our ultimate success is very much tied up with the performance of the Irish economy, not least because a vibrant domestic economy means increased demand for the property assets which secure our loans. Many pressing challenges have been tackled and surmounted to date and I assure you that we will be equally energetic and spirited in dealing with the challenges that are ahead of us.

I have addressed briefly some of the key issues that may be of interest to you and I and the Chairman, Frank Daly, are now happy to respond to any additional points you may wish to raise.