National Asset Management Agency

Opening Statement by
Mr. Frank Daly, Chairman of NAMA

Joint Committee of Inquiry into the Banking Crisis
Wednesday, 22 April 2015

Thank you, Chairman and members of the committee, for the opportunity to address you today. We are of course here representing an Agency that was a key part of the response to the banking crisis rather than as a contributor to that crisis.

You have requested that I deal with five lines of enquiry.

- NAMA's understanding of the commercial real estate development model that existed in Ireland prior to the banking crisis
- NAMA's duty to obtain the best financial return for the State
- NAMA's contribution to a sustainable level of activity in the Irish property market
- NAMA's contribution to the social and economic development of the State
- The establishment of performance metrics by the Board of NAMA

The commercial real estate development model that existed before the crisis

The commercial real estate model that existed before the crisis was ultimately very costly for this State in terms of fixing the financial institutions that funded it. As a consequence an inordinate and painful burden has been placed on citizens as the necessary steps are taken to restore normality to our economy.

Volumes have been and will be written about the confluence of factors that made that model inherently high risk, vulnerable and unsustainable. Contributing factors such as zoning and planning policy, tax incentives, irresponsible developer funding, consumer mortgage lending, absence of market analysis and others have been well documented and no doubt will be explained to you by experts in those areas. The most effective way that I can contribute is to give you comment informed largely by NAMA's experience over the past five years in dealing with the consequences of the banking crisis and our role in fixing it.

As NAMA was established to acquire the loans of the largest real estate developers, I will focus on the structure of lending to those developers. NAMA, having bought these loans, is now, for such developers, the successor to the banks.

Debt funding dependence

From that vantage point, what jumps out most of all is a commercial real estate model with an almost complete dependence on debt funding. This had the effect of placing all of the risk with the banks and, as it transpired, ultimately with the State and its citizens. By way of background, traditionally, in lending, equity is provided by the borrower to mitigate a bank's risk. Equity, in effect, puts the borrower, not the bank, in the riskiest capital position; in the event of default, the borrower is the first to lose. New rules in mortgage lending, for instance, require that a person buying a home now has to come up with 20% deposit as equity. However, based on NAMA's experience, that fundamental pre-condition of bank funding was rarely observed in the pre-crash CRE model.

While internal bank lending documentation may indicate that loan-to-value ratios were, typically, less than 100% when the loan was drawn, the reality, in many cases, was that a developer's equity contribution was in the form of a rolling-up of unrealised, paper profit from other developments. This was presented as an equity position. Rarely, if ever, was it in the form of cash. On the face of it therefore, developers had some '*skin in the game*', but in reality that amounted to nothing more than unrealised equity positions levered by the developer to secure funding for new transactions. This meant that the banks were taking high equity-grade risk for low debt-grade returns – and, in fact, even those low debt returns were often not realised but rather accrued as rolled-up interest, booked as income in bank financial statements. These were and continue to be the accounting rules under IFRS, not just in Ireland but wherever IFRS is adopted.

In effect, therefore, the banks were providing all of the real cash funding for both acquisitions and development. It is safe to say that quite often the borrower's paper equity position never paid for an acre of land or concrete or scaffolding or a worker's wage at the end of the week. The safety zone of borrower equity usually existed only on paper. The result is that the borrower was typically not the first to lose. In the event of a crash, the banks stood to take 100% of the losses – and that's what happened. Those losses, as we now know to our cost, have had to be funded by Irish citizens to the tune of €64 billion – it would be no thanks to many of those who were the cause of this if ultimately the cost turns out to be less than €64 billion.

A relaxed approach to project feasibility

The recycling of unrealised equity positions from project to project meant that the model could only keep working as long as prices kept rising and the banks kept lending. Few questioned these assumptions. Many decisions seemed to be based on a view, shared by bankers and developers, that property prices could continue to defy the fundamental law of any market that, when prices rise unsustainably, there is always going to be a day of reckoning and the steeper the rise, the more painful the reckoning.

This was compounded by the fact that the model did not appear to require a stringent approach by borrowers to analysing project feasibility. It is much easier to take an optimistic view of a project when you are not being asked to put your own hard-earned capital at risk. Based on the loans that NAMA took over, feasibility analyses in respect of projects either didn't exist or were incomplete or were based on flawed, overly optimistic, assumptions about the future. In the residential development sector, for instance, feasibility workings seem to have been based on aspirational exit sales values in an already frenzied peak market. Very little, if any, consideration was given to the inherent cyclical nature of the property markets. The attitude appears to have been that the only way was up – that somehow the forces of gravity were suspended as far as the Irish market was concerned and that the long-established pattern of property market cycles was no longer relevant.

In this model the banks were taking the type of risk normally the preserve of private equity/hedge fund providers without demanding the same level of rigorous analysis that those providers would have made a condition of funding.

Dearth of professionally run developer platforms

Mr McDonagh has talked in some detail about another facet of the model – the dearth of professionally run developer platforms. The banks were quite clearly lending to individuals and companies that, notwithstanding the massive sums involved, had little or no supporting corporate infrastructure, poor governance and inadequate financial controls. This applied to companies of all sizes. The banks failed to ensure that Irish property companies, to whom they advanced billions of euros in lending, operated to the same corporate governance standards as their peers in other jurisdictions or indeed similarly-sized entities in other sectors of the Irish economy.

Over production of residential accommodation in the economy

The above, and a range of other factors at play, cumulatively resulted in a situation where development and construction output totally overshot what would be considered the normal level of production in an economy of this size. This is best illustrated by the construction of 90,000 new houses and apartments in Ireland in 2006 - for a population which was then 4.2 million people. This output was more than five times the European average at the time. In the same year in Britain, to meet demand from a population which was fourteen times the size of Ireland's, 190,000 new residential properties were built. The Irish development model, fuelled by a combination of the poor lending practices that I have just discussed, a scatter gun approach to tax incentives, poor zoning and planning decisions, and a complete absence of rigorous independent analysis of population and market trends, appears to have been relying blindly on the belief that if you build it, they will come – and, no matter what the price, that they will buy.

I should say, lest I give the wrong impression, that this problem was not peculiar to the residential sector. All segments of the market were affected by varying degrees of oversupply. You could be forgiven for describing the sentiment that informed this oversupply as hubris, and perhaps in some of the more spectacular land deals, as trophy-chasing.

Unfinished estates and defective building

Parts of the Irish landscape still bear the scars of that approach in the form of unfinished and half-finished housing estates, some of which have been inherited by NAMA and which NAMA is now funding to completion.

A final point I would like to mention relates to the quality of construction and in some cases, the absence of much quality at all. NAMA has incurred multi-million euro costs in remediating building defects, such as non-compliance with regulatory standards, including fire safety standards, as we prepare assets for sale or occupation.

Many of these defects stemmed from a lack of oversight and attention to detail from both the builder/developer and the building control divisions of the Local Authorities. This was compounded by the sheer volume of development which reduced the due diligence carried out. Hopefully these issues have been fully addressed with the recently enacted Building Control (Amendment) Regulation Act 2014.

Chairman, that gives you a picture of what the model was like before the crash – based again, I emphasise, on NAMA's experience of the aftermath.

So what would a sustainable model look like?

To finish off this segment could I suggest, learning from NAMA's experiences, that a sustainable model for the future would at a minimum include all of the following features:

Funding

- A sustainable financing model that includes both debt and equity finance
- Proper banking supervision – robust but not stifling.
- Macro prudential measures to flatten peaks and troughs.
- Adequate bonding for consumers.

- Pertinent audit standards (such as IFRS 9) implemented rigorously.

Development Sector

- Properly resourced and governed development and construction companies, including publicly quoted companies.
- Active and skilled boards of directors, with proper oversight.
- Prudent management of balance sheet exposures, especially debt arrangements.
- Adequate building regulations and appropriate oversight in relation to building standards.

Planning/Market

- Holistic, centralised approach to zoning, planning and infrastructure provision.
- Long-term social housing planning.
- Publicly available information of population projections, demand projections, likely supply outlook.

In regard to the latter NAMA has taken an initiative to fund research by the ESRI into the residential housing market, specifically the likely pattern of emerging demand and the potential supply constraints that may influence future market activity. That research and similar research from other sources will be important in terms of guiding future development investment plans in Ireland.

What the initial findings of the ESRI research tell us is that the vast majority of future housing demand will be located in Dublin, the surrounding commuter belt and the other major urban centres. Sadly, it is also clear from the research that some of the housing supply built at the height of the boom will never be occupied because it is located in areas where there is no demand.

NAMA's duty to obtain the best financial return and its contribution to property market activity

I am going to talk about NAMA's duty to obtain the best financial return for the State and its contribution to a sustainable level of activity in the Irish property market together.

NAMA's mandate derives from the NAMA Act

Section 10 of the NAMA Act 2009 defines the purposes of NAMA. It requires NAMA to obtain the best achievable financial return for the State, deal expeditiously with the assets acquired by it and to protect or otherwise enhance the value of those assets. That is the core of NAMA's mandate and it is quite clearly a commercial one.

Our raison d'etre is therefore to get the best financial return from the assets in our portfolio and, crucially, to do so expeditiously. It is not an option for us to adopt what might be termed a '*long term holding strategy*' – to await some optimum price level at some indeterminate point in the future before disposing of the assets. We have to do our business expeditiously, which means responding pragmatically to market conditions by taking advantage of opportunities to sell assets where demand and price are favorable.

Best financial return means more than getting the highest price

It is also the case that the phrase "achieving the best financial return for the State" has implications beyond simply getting the highest price for an asset (which of course we seek to do).

NAMA paid for the loans it acquired from the banks with senior debt of €30.2 billion guaranteed by the State. Central to the best financial return for the State is repaying that senior debt and doing so quickly – it is a contingent burden that should be removed from citizens as soon as practicable not just because of the amount, not just because of the interest payable, not just because of the impact on the banks' balance sheets but because of the wider implications for the sovereign.

It became very clear very quickly from early engagement with the Troika that they would have had serious concerns if NAMA had signaled or adopted any type of extended debt redemption schedule. They regarded repayment of the NAMA debt as one of the key recovery factors for this country and one of the key deliverables for exiting the bail out. I would contend that if NAMA had not reduced its debt as expeditiously as it has, Ireland could have been in a second bail out as market concerns about the contingent liability would have been very real. The Troika closely monitored the progress that we were making in meeting our first major senior debt redemption target - €7.5 billion by the end of 2013. To the Troika but also to the capital markets and rating agencies, the signal effect of reducing the State's contingent liability was very important. It was recognised that in so far as NAMA could make significant progress on redeeming its senior debt, there would be collateral benefits in terms of the creditworthiness of the sovereign and, by extension, in terms of Ireland's borrowing costs. This has been recognised in Ireland's ratings upgrades and is an obvious contributory factor to the very favourable positioning of Ireland right now in the bond and money markets.

I might also mention that, for the second year in succession, we have been in a position to pay a coupon to holders of our subordinated debt. This has had a positive impact on the balance sheets of AIB and Bank of Ireland manifested in the significant upward revision in the valuation of their holdings of our subordinated debt.

Debt redemption needs cash generation – cash generation needs asset sales.

We have been able to repay our senior debt well ahead of schedule because of our strong cash performance – nearly €20 billion to date through asset and loan sales and €5 billion in non-disposal, mainly rental, income. Thoughtful, well-aligned asset sales in the UK and Irish markets in particular have been key to this very strong cash generation.

NAMA actively instigated a programme of asset sales by its debtors in Britain in the period 2010 to 2012 when conditions were strong in that market. Likewise we responded actively when conditions in the Irish market improved significantly in 2013 and 2014. That approach accords fully with two key principles underpinning NAMA's strategy: no fire sales and no hoarding. In each of our main markets our approach has been to release assets for sale in a phased and orderly manner that is consistent with the level of demand, the availability of credit and the absorption capacity of each market.

As a result, London and the UK accounted for almost 80% of all disposals between 2010 and 2012. Ireland, in contrast, accounted for just 12% of disposals during this period. That approach enabled NAMA not only to achieve the best possible return during its early deleveraging phase, but it also allowed the Irish market time to reach its trough and to begin its recovery. A fire sale in the Irish market at that time would have had the effect of intensifying and prolonging the market's downturn and would have been contrary to both NAMA's overriding commercial objective of achieving the best possible return for the State and its ancillary objective of contributing to a sustainable level of activity in the Irish property market. It could also have crystallised a loss on the NAMA portfolio which, because of the State guarantee, would have created additional losses for taxpayers on top of the losses that they have already had to fund in recapitalising the various financial institutions.

Asset management and stimulating the market

We were not however sitting on our hands in Ireland during that 2010 to 2012 period. During that time NAMA placed a major emphasis on asset management to enhance the future disposal value of the collateral securing its loans, most notably by working with debtors and receivers to complete unfinished projects, to fund new viable commercial and residential development and to enhance planning permissions and remove other obstacles to development. During that period, when there was little other activity in the Irish market, we invested over €600 million in the sector. During that crucial period we also placed a major emphasis on stimulating the market's recovery and fostering the sense that the market was "open for business" despite perceptions to the contrary. For example, given the lack of finance at the time, NAMA made available a €2 billion vendor finance fund to help part fund Irish transactions. Vendor finance was deployed in the sale of One Warrington Place, home to Bord Gáis, in April 2012, which was the first commercial property transaction of note in Ireland since the crash. And it was deployed in NAMA's first large scale debtor loan sale, Project Aspen, in 2013. In all,

€400m has been drawn down as vendor finance to date, and while the market has changed for the positive in terms of available finance, NAMA's vendor finance fund played an important part in generating activity in the early days of recovery when the banks had stopped lending for commercial property and investors were still wary of committing funds to Ireland.

Those early transactions signalled to international and domestic investors that the Irish market was open for business and played a vital role in attracting finance and activity, particularly from overseas investors, where previously there was little or none.

An active Irish market now and NAMA taking advantage

The major improvements in the market over the past eighteen months have enabled NAMA to shift its disposal focus more to the Irish market. Reflecting this, in 2014, disposals in Ireland accounted for 46% of all disposals, whilst London and the rest of the UK accounted for 33%. In addition to responding to the opportunity to accelerate disposals through existing channels, we have also been taking advantage of new opportunities as they emerge, such as packaging assets for sale to satisfy demand. To sustain the positive momentum we are coordinating our disposal activity to deliver a more consistent pipeline of large packaged sales to the market. Transactions with a minimum value of €250 million are being offered for sale every quarter on an open market basis. Such regular flows are providing greater clarity to potential investors, allowing those with limited capacity to bid on a greater number of transactions, thus widening the number of potential bidders and increasing the potential return to the State.

In light of the positive shift in the Irish property market and its outlook, the Board of NAMA undertook a review of strategy in early 2014. Following that review, we moved to take further advantage of strong investor appetite and to accelerate disposals with a view to redeeming 80% of senior debt by the end of 2016 – two years ahead of the original schedule – and to completing the deleveraging process in 2017/2018.

In the context of the clear supply shortages evident in the Dublin residential and office markets, NAMA is also facilitating and funding the delivery of 4,500 new homes in

Dublin and the greater Dublin area and also facilitating the provision of 3.84m square feet of prime office space in the Dublin Docklands SDZ, to ensure adequate office supply to meet growing demand.

In summary, Chairman, as the committee has specifically asked the question, I would say that NAMA **has** played an important role in stimulating activity in the market. Our interventions were at all times strategic - helping to lift the market off the floor and to stimulate activity levels that are more sustainable in the long run. For quite a while indeed, we were almost alone in doing this.

Contribution to the social and economic development of the State

In the context of the overriding commercial mandate that we have just discussed, NAMA seeks to manage its portfolio in Ireland in a manner that complements the objectives of other public bodies, including Government departments, State agencies and local authorities. One way that NAMA gives practical effect to this is by giving public bodies first option on the purchase, at current assessed market valuations, of property securing NAMA's loans. In line with that commitment, we have facilitated the sale of land and property for a range of public uses including schools and healthcare facilities.

Social Housing

An aspect of that work that's very important to NAMA is the delivery of houses and apartments for social housing. Where we can make properties available for social housing in a way that is consistent with Section 10 of the Act it's a win-win for everybody involved. We have identified more than 6,000 properties as being available and potentially suitable for social housing. Local authorities have confirmed demand for about 2,000 of these. Whilst I am a little disappointed that take-up hasn't been higher, I understand that local authorities and the Housing Agency are obliged to comply with their own policies on the location of social housing.

We are working hard to deliver the properties for which demand has been confirmed. At the end of 2014, more than 1,000 had been delivered. Today that figure is over 1,100 and by the end of the year, we would hope to achieve delivery of all of the remaining properties for which the local authorities have indicated demand.

It's important to say that it's not just a case of handing over the keys to the local authorities. In most cases, significant investment is required to complete the properties and carry out estate-wide works. In this way, the beneficiaries of NAMA social housing extend beyond the new residents of the properties. For existing residents, empty houses become inhabited and outstanding works are completed. Capital expenditure in excess of €20m has been incurred to date in carrying out such work.

Of the properties delivered to date, more than 40% were delivered through the NARPS mechanism, a special purpose vehicle established to purchase units from our debtors and receivers and to make them available to approved housing bodies by way of a long term lease. It is unlikely that these units would otherwise have been delivered due to the lack of available funding for approved housing bodies.

Facilitating commercial transactions

Another important part of NAMA's work is facilitating important transactions in the Irish property market that might not otherwise take place. A good example of this is NAMA's on-going work in identifying suitable properties for companies looking to establish or expand existing business operations in Ireland and facilitating engagement between these companies and NAMA debtors and receivers. NAMA's work in this area is closely aligned with that of IDA Ireland and other State agencies whose core responsibility it is to attract and expand Foreign Direct Investment (FDI) activity and employment in Ireland. This has resulted in a number of very significant property transactions in Ireland with companies such as Google, Facebook, Eli Lilly, Kerry Group, Novartis, LinkedIn, Amazon, BskyB, Adroll, and Scottish and Southern Energy. Examples of such transactions in the past year include the letting of a combined 250,000 sq. ft. of Grade A office space at 4 and 5 Grand Canal Square in the Dublin Docklands to Facebook for its EMEA headquarters, the sale of an office development site in Dublin 2 to LinkedIn, and the sale of 227 acres of industrially zoned land in Clonee, Co. Meath to an IDA client for the construction and operation of data warehousing facilities.

Rent abatement

NAMA's wider contribution is also evident in its rent abatement initiative to help retailers that are struggling to meet their contracted rent obligations. The aggregate annual value of abatements agreed to date is in excess of €23 million. In addition to this, NAMA has agreed long-term rent reductions worth over €40 million. This means that NAMA has agreed to forgo rent due to it, but the corollary is that we safeguards jobs and activity in the wider economy.

Responsive to local community concerns

We also work hard, including through our interaction with public representatives, to facilitate the letting and sale of land to local community and sporting organisations and to accommodate other local requests where we can. Often these may not be particularly high profile initiatives but they are important locally. A very recent illustration is our capacity to accommodate a request from the Blarney Community Association for the provision of temporary car parking facilities for the community's St. Patrick's Day festival.

The overall point I would make is that whilst NAMA is guided by its commercial objective, it doesn't operate in a vacuum. We are conscious of the impact of our work in the wider Irish economy and on communities and we work hard to ensure that our impact is a positive one.

The establishment of performance metrics by the Board of NAMA

The key measure of NAMA is our capacity to repay our €31.8 billion debt. The progress that we are making therefore can be seen by the fact that NAMA has already exceeded the cumulative 50% (€15.1 billion) senior debt redemption target originally set for the end of 2016 and has done so two years ahead of schedule. In March 2015 we redeemed another €1 billion of senior bonds, bringing to €17.6 billion the amount of senior debt redeemed to date, 58% of the €30.2 billion of senior debt originally issued in 2010 and 2011 to acquire bank loans.

We are able to repay our debt ahead of schedule because of the strong cash performance – €25 billion to date - that I talked about earlier.

NAMA, whilst not a publically limited company (PLC), is an organisation that operates at the highest end of the public interest and governance spectrum. The fact alone that NAMA must publish quarterly financial statements that are prepared in accordance with IFRS shows that NAMA also operates at the highest end of the transparency spectrum. NAMA has adopted the best practices of corporate governance, including financial and management reporting practices, Board composition and structure and risk management. NAMA has designed and implemented a robust Management Information System and has clearly defined key performance indicators (KPIs) in place, which form the basis of its internal reporting and monitoring framework whereby the NAMA Board and sub committees are regularly kept informed of the organisation's commercial and operational progress.

The Board of NAMA also recently reviewed a C&AG recommendation to the effect that it should set an expected or target rate of return to measure its overall performance and that it should also measure its performance by reference to targets for the return on disposals and on property held by debtors and insolvency practitioners. In line with this, the Board has approved a number of rate of return measures which it considers appropriate for its business. We propose to report on these additional measures in our 2014 Annual Report which we expect to publish at the end of May.

Conclusion

Chairman, in conclusion, I would simply emphasise again the point I made at the outset that NAMA is a key contributor to dealing with the fallout from the banking crisis and not a contributor to its cause. I know you have asked NAMA to attend this Committee of Inquiry in the context of the *"appropriateness and effectiveness of the domestic policy responses".*

It is for others to ultimately take a view on whether NAMA has indeed been such *"an appropriate and effective response."* Any assessment of such however must take account of the following points:

- NAMA has delivered in respect of each aspect of our mandate as laid down in the NAMA Act.

- We quickly and effectively acquired the eligible assets from the banks and the acquisition and valuation of those assets has been cleared without qualification by the C&AG and EU Commission; as the CEO has said, this enabled the Irish banking system to recognise and address upfront the loan loss difficulties it had created for itself.

- We have generated €25 billion cash in the past five years, paid our own way and generated profits of more than €200 million in each of the last four years despite the constraints of a challenged property market backdrop for much of that period.

- We have actively intervened in the property market in Ireland and contributed to the recovery now taking place. That intervention was strategically timed to minimise further damage, stimulate the market at the right time and take advantage of growing investor interest. I do believe we called it right.

- We have advanced over €1 billion into construction projects in Ireland in the past five years. We plan and have the capacity to invest another €3 billion if required.

- We have to date funded the construction of more than 1,500 new homes in Dublin. In fact, NAMA funded the construction of 40% of all new homes delivered in Dublin in 2014 – a statistic which in itself is telling.

- We have made significant progress in facilitating the timely delivery of Grade A office space, retail, leisure and residential accommodation in the Dublin

Docklands SDZ and wider central business district. We have the capacity to invest €3 billion in this and other capital projects in Ireland.

- We have facilitated the delivery of 1,114 properties for social housing to date and will have delivered 2,000 in total by the end of the year.

- We are supporting 15,000 jobs in trading businesses directly linked to our loans.

- Most importantly we have made excellent progress on debt repayment:

    - already two years ahead of target in repaying our senior debt; €17.6 billion (58%) repaid to date;
    - committed to repaying 80% of senior debt by the end of next year;
    - committed to repaying 100% of senior debt by 2017/2018; and
    - committed to full repayment of subordinated debt.

And finally, should conditions in the economy and in the property market continue to remain favourable, we are hopeful, based on our current projections, that NAMA may realise a surplus of up to €1 billion for the Irish taxpayer by the time it completes its work.

Thank you Chairman