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**Comptroller and Auditor General
Special Report**

National Asset Management Agency

Progress Report 2010 - 2012

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Report of the Comptroller and Auditor General

National Asset Management Agency

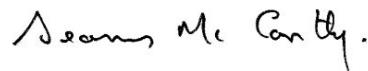
Progress report 2010 - 2012

The National Asset Management Agency (NAMA) was established in December 2009 under the National Asset Management Agency Act 2009 (the Act).

I have, in compliance with Section 226 of the Act, assessed the extent to which NAMA has made progress toward achieving its overall objectives for the period 2010 to 2012.

This report was prepared on the basis of work undertaken by staff of my Office, drawing on information, documentation and explanations obtained from the bodies and persons referred to in the report. The Department of Finance and NAMA were asked to review and comment on the draft report. Where appropriate, the comments received were incorporated in the final version of the report.

I hereby submit my report for presentation to the Houses of the Oireachtas in accordance with Section 226 of the Act.



Seamus McCarthy
Comptroller and Auditor General

24 April 2014

Summary

Summary

The National Asset Management Agency (NAMA) was established in December 2009 as part of the State's response to the 2008 banking crisis.

The core idea was for NAMA to acquire property-related loans from the commercial banks, to hold and manage the loans and related collateral — mainly property — and ultimately to dispose of all these assets in a manner that protected the State's interests. NAMA would then cease to exist.

The purposes and functions of NAMA are specified in the National Asset Management Agency Act 2009 (the NAMA Act). This Act requires the Comptroller and Auditor General to assess every three years the extent to which NAMA has made progress in achieving its overall objectives. This is the report of the first of those examinations. It considers progress in the context of the purposes of NAMA as set out in section 10 of the Act and of strategic objectives set by NAMA's Board.

Loan acquisition

One of NAMA's statutory purposes is to acquire property-related loans from banks and thereby contribute to the removal of uncertainty about the valuation of such assets.

NAMA acquired over 15,000 loans at a cost of €31.8 billion from the five banks that participated in the NAMA scheme. The face value of the loans and associated financial derivatives acquired was €74.4 billion. This crystallised losses in the banks of €42.6 billion or 57% of the amount owed by borrowers. These losses contributed significantly to the level of financial support required by the banking sector from the State.

Ultimately, NAMA acquired 90% of the identified eligible loans and the major uncertainty regarding the value of these loans was removed from the books of the banks. This was a significant achievement by NAMA in a relatively short time-span, given the scale of the task as well as the inadequate documentation and processes that it found in the banks.

NAMA issued government guaranteed bonds amounting to €30.2 billion to the banks to pay for the loans it acquired. The balance of 5% (€1.6 billion) was paid by the issue of subordinated debt. Payment of interest and value at redemption of the subordinated debt is dependent on NAMA's financial performance. Some uncertainty remains about the value to the banks of those subordinated debt assets.

Commercial objectives

The NAMA Act requires NAMA to obtain the best achievable financial return for the State from the assets acquired. The NAMA Board has set two related key commercial objectives

- at a minimum, to redeem senior debt and to meet all costs incurred by NAMA over its life — intermediate debt redemption targets were also set
- to optimise the realised value of assets.

Redeeming the senior debt

By the end of 2013, NAMA had met its first intermediate debt redemption target of €7.5 billion. In addition to meeting the target, it held almost €4 billion in cash and other liquid assets at that date.

NAMA annually prepares detailed estimates of its expected debtor cash flows. These estimates project a more favourable outcome than the minimum objective set by the Board. At the end of 2012, NAMA estimated it would, by 2020, generate sufficient cash to redeem all debt (senior and subordinated) and have a final surplus of around €300 million — a cash outturn around €1.9 billion better than the minimum target set.

Overall, taking account of NAMA's performance to date and its operating cash flow estimates for the period to 2020, it appears that, unless there is a further significant economic downturn in the next few years, NAMA will generate sufficient cash to meet its minimum key objective of redeeming the senior debt.

Realised value of assets

By the end of 2013, NAMA had realised around €10.5 billion from loan and property disposals. 75% of the disposals related to assets in Great Britain, with the bulk of these in London, and around 15% were in Ireland.

As part of this review, the disposal process for 144 properties with gross proceeds of about €1 billion was examined. Overall, the examination found evidence that almost all property disposals reviewed had been sold through an open competitive process, or with testing of disposal prices against market valuation. This provides reasonable assurance that the prices obtained were the best on offer in the market at the time a property was sold.

Rental return on property assets

NAMA has taken steps to ensure that debtors remit rental and other income to NAMA. In the three years to end-2012, NAMA realised €3.2 billion in rental and other non-disposal receipts. Almost €1.5 billion was received in 2012.¹ In 2013 it received a further €800 million approximately.

The expected gross rental yield from completed properties of NAMA-managed debtors is around 6.9%.² Property-related costs reduce this by almost 30%, giving an average net rental yield of 5%. The 15% of the portfolio held by debtors managed by the participating banks may have a different profile.

The NAMA Board does not set benchmarks against which to measure NAMA's performance with respect to the rental yields that its debtors' assets are achieving.

Investing to enhance properties

NAMA provides funding to develop or enhance properties. By the end of 2012, it had directly advanced around €1 billion to debtors. NAMA had also approved the retention, by debtors of a further €0.6 billion from rental income and property disposals. However, the extent to which the amounts approved for retention were applied by debtors is not known.

In 2012, NAMA set a minimum expected return of 15% on cost before a project proceeds. The expected return is an overall cash return and is not expressed as an annual expected rate of return.

¹ Analysis by NAMA showed that 30% of this was related to one-off items.

² Excluding land and development assets.

Rates of return

NAMA's focus has been on cash generation in order to meet debt redemption targets and to meet costs. However, the generation of cash does not, of itself, indicate whether the best achievable financial return has been obtained.

NAMA has not set expected or target rates of return on its investments and, therefore, the examination could not conclude on the extent to which NAMA has, to date, obtained the best achievable financial return.

In order to enable it to better measure its performance, the report recommends that the Board should set a number of key target financial return measures

- an overall expected or target rate of return against which to measure overall performance — this should be reviewed annually taking into account revised expectations for individual debtors and for property types and locations, including disposal values and rental income
- a target rate of return on disposals and on property held by debtors and insolvency practitioners.

The NAMA Board takes the view that such target rates of return would not be an appropriate metric for its business, on the basis that they would act as an unnecessary constraint on its flexibility, particularly given the imperative that it be open to commercially sensible disposal opportunities whenever they arise and given the stated objective of the Minister for Finance that NAMA should complete its work of deleveraging the portfolio as soon as possible.

Debtor management

Debtor strategies

Around 85% of the loans (by value) are managed directly by NAMA. The remainder are managed on NAMA's behalf by the participating banks.

By mid-2012, NAMA had management strategies in place for all debtors. It has adopted five broad strategic approaches including full or partial restructuring of loans (€9.5 billion of acquired debt), support for debtors subject to the achievement of certain milestones (€7.4 billion) and consensual disposal strategy (€7.6 billion). The remaining debtors (€7.3 billion) are subject to enforcement.

At the end of 2012, insolvency practitioners (usually receivers) had been appointed to some or all of the assets of around a quarter of debtors.

Debtor performance

By the end of 2012, the amount owed by debtors amounted to €26 billion before impairment charges. Cumulative impairment amounted to almost €3.3 billion or 12% of the debt. On the other hand, NAMA estimated that it would make gains (not recognised in the financial statements) of around €1.4 billion in present value terms from some debtors, in particular those with property in London.

There is an apparent inverse relationship between the level of debt and the relative impairment charges for individual debtors at the end of 2012. The rate of impairment for those debtors who owed €1 billion or more when their loans were acquired was just over 4% while for those whose debt was less than €75 million at acquisition, the impairment was around 21%.

NAMA made the assumption that the profile of the property collateral held by those debtors, and the associated cash flows, are broadly similar to those of all NAMA-managed debtors. However, this assumption may no longer be appropriate given the apparent inverse relationship between the size of a borrower's debt and the level of impairment. NAMA has commenced a detailed review of the portfolios managed by participating banks, and this will be supplemented by its semi-annual impairment review in June 2014.

Managing property assets

At end-2012, NAMA projected that it would realise €22.9 billion in disposal receipts between 2013 and 2016. Disposal receipts in 2013 amounted to €3.7 billion, leaving a further €19.2 billion to be achieved in the three years from 2014 to 2016. A significantly lower level of disposal will still allow NAMA to meet the intermediate debt redemption target it set for 2016.

Disposal receipts to the end of 2013 have been largely driven by the London market and, at the end of 2013, NAMA had disposed of over 60% of its London property.

Future sales will need to come from other markets — principally Ireland. About 10% of NAMA's Irish portfolio was sold up to the end of 2013, around half of which was in 2013. Over 70% is scheduled for disposal between 2014 and 2016. Projected disposal values are also predicated on significant recovery in Irish property values. This level of disposal receipts may be difficult to achieve in that timeframe.

NAMA has acknowledged that challenges remain in disposing of its Irish portfolio but has pointed to a heightened level of activity in the Irish property market in late 2013, increased interest from investors and the favourable location of much of its Irish property as positive factors that may facilitate disposals.

Other objectives

When disposing of properties, NAMA's primary objective is to achieve the best possible price. In addition, it has set two subordinate (or secondary) objectives — contributing to the social and economic development of the State and to a sustainable property market in Ireland.

Review of property disposals to public bodies and of residential properties to local authorities or housing associations for social housing showed that, in most instances, there was evidence that valuations had been carried out prior to disposal and the prices achieved equalled current market valuations. However, there has been limited use of two initiatives put in place by NAMA to stimulate activity in the property market — provision of vendor finance and NAMA's deferred payment initiative.

Report

1 Introduction

- 1.1** In April 2009, the Minister for Finance (the Minister) announced that the Government intended, as part of the State's response to the banking crisis that had emerged in 2008, to establish a body called the National Asset Management Agency (NAMA). NAMA was established in December 2009.
- 1.2** The National Asset Management Agency Act 2009 states that the Act's purposes are to address¹
- the serious threat to the economy and the stability of credit institutions in the State generally
 - the need for the maintenance and stabilisation of the financial system in the State and
 - the compelling need for a number of matters set out in the Act, including to remove uncertainty about the valuation and location of certain assets of credit institutions of systemic importance to the economy.
- 1.3** The stated statutory purposes of NAMA are to contribute to the achievement of the purposes of the Act by
- acquiring impaired assets from the credit institutions participating in the NAMA scheme
 - dealing expeditiously with the assets
 - protecting, or otherwise enhancing their value, in the interests of the State
 - insofar as possible and consistent with those purposes, obtaining the best achievable financial return for the State.²
- 1.4** Under the Act, NAMA was given extensive powers to enable it to carry out its functions in order to achieve its purposes. It is also required to comply with written directions of the Minister concerning the achievement of the purposes of the Act.
- 1.5** Five banks participated in the NAMA scheme.³
- Bank of Ireland (BOI) and each of its subsidiaries except Bank of Ireland (UK) plc
 - Allied Irish Banks (AIB) and each of its subsidiaries except Bank Zachodni WBK SA
 - Anglo Irish Bank Corporation Ltd (Anglo) and each of its subsidiaries
 - Irish Nationwide Building Society (INBS) and each of its subsidiaries
 - Educational Building Society (EBS) and each of its subsidiaries.
- 1.6** NAMA has established a subsidiary structure headed by a company, National Asset Management Agency Investment Limited, which is 51% owned by private investors, and currently NAMA has incorporated ten other special purpose vehicles within which to conduct its business.⁴
- 1.7** At the end of 2013, NAMA had 331 staff across five divisions. The largest of these was the asset recovery division with 190 staff, reflecting the focus on debtor and asset management.

¹ Section 2 of the Act. See Appendix A.

² Section 10 of the Act. See Appendix A.

³ This report refers to all participating credit institutions as banks.

⁴ Appendix B explains the NAMA group and organisational structures.

- 1.8** In addition, NAMA also uses a number of external service providers, including the banks, outsourced internal audit and loan administration functions, and external legal and expert advice. Around 550 staff are employed by participating banks to manage NAMA debtors and carry out day-to-day servicing of all NAMA loans.

Objectives and target setting

- 1.9** Responsibility for ensuring that NAMA's functions are carried out efficiently and effectively lies with the Board of NAMA. The Board comprises seven members appointed by the Minister and two ex-officio members, the chief executive officers of NAMA and of the National Treasury Management Agency.
- 1.10** The Board of NAMA is required to set the strategic objectives and targets of NAMA.¹
- 1.11** NAMA's initial strategic plan, in June 2010, stated that a guiding principle of the Board is to pursue all debts owed to the greatest extent feasible and to set targets for the redemption of bonds from 2013 on with full repayment by the end of 2019.² In order to achieve these timelines, the Board determined a set of strategic and policy decisions relating to pursuit and support of debtors, collateral management, disposal strategies, and management of NAMA's debtors by the banks.
- 1.12** NAMA is currently operating under a revised strategic plan approved by the Board in March 2012. This is reviewed annually in the first quarter of each year, with the most recent review conducted in February 2014.
- 1.13** The 2012 strategic plan defined NAMA's primary commercial objectives as being to
- redeem, at minimum, the senior bonds issued as consideration for loans
 - recover all State costs over the projected ten-year life of NAMA without recourse to further borrowing, meeting all of its future commitments out of its own resources, over the shortest possible time span
 - optimise the realised value of the assets acquired.
- 1.14** In addition, the plan stated that, where consistent with the objective of recovering all State costs, NAMA's objective is to
- contribute to a sustainable level of activity in the Irish property market
 - contribute to the social and economic development of the State.
- 1.15** The 2012 plan set a target of redeeming all NAMA debt by 2020, but noted that in an adverse scenario, the senior debt only would be repaid.³

¹ Section 18 of the Act.

² The 2010 plan was entitled 'Business Plan'. This report refers to it as a strategic plan. This plan was prepared when NAMA had only acquired 20% of the assets ultimately acquired.

³ Senior debt refers to government-guaranteed securities that NAMA issued to pay 95% of the loan acquisition price.

Focus and scope of this report

- 1.16** Section 226 of the Act requires the Comptroller and Auditor General, as soon as may be after 31 December 2012 and every three years thereafter, to assess the extent to which NAMA has made progress toward achieving its overall objectives. The review, therefore, considers progress in the context of the purposes of NAMA as set out in section 10 of the Act and of the strategic objectives set by the Board.
- 1.17** Two reports have previously been published under Section 9 of the Comptroller and Auditor General (Amendment) Act 1993. The first report, published in November 2010, reviewed the acquisition of bank assets, while the second report, published in May 2012, focused on the management of the loans acquired.

Report structure

- 1.18** Chapter 2 reviews the extent to which NAMA acquired eligible impaired assets from the banks participating in the NAMA scheme, the outcome of the loan acquisition process and its contribution to removing uncertainty regarding property-related loans held by participating banks.
- 1.19** Chapter 3 examines NAMA's financial performance and its progress towards meeting its debt redemption targets and obtaining the best achievable financial return.
- 1.20** The Act requires NAMA to deal expeditiously with the bank assets that it has acquired and to protect or otherwise enhance the value of the assets in the interest of the State. In its 2012 strategic plan, one of the key objectives set by NAMA is to manage assets intensively and invest in them to optimise their income producing potential and disposal value. Chapter 4 reviews the arrangements that NAMA has put in place for administering loans and the activities carried out by NAMA in managing its debtors, while Chapter 5 reviews steps NAMA has taken to protect and enhance the value of bank assets acquired and the underlying collateral.
- 1.21** Chapter 6 deals with the secondary objectives set by NAMA including to contribute to generating activity in the Irish property market and to contribute to the social and economic development of the State.

Developments in 2013

- 1.22** In February 2013, a Special Liquidator was appointed to the Irish Bank Resolution Corporation Limited (IBRC). Following receipt of directions from the Minister, NAMA issued €12.9 billion in the form of government guaranteed bonds which it used to acquire a loan facility deed between IBRC and the Central Bank of Ireland. The debt is secured by a floating charge over the assets of IBRC. NAMA also provided the Special Liquidator with working capital by way of a loan facility. These transactions and any issues arising are not within the scope of this report.
- 1.23** In the period to end-2013, 75% (by value) of property and loans disposals were in Great Britain, with the bulk of these in London. NAMA's principal focus from 2014 to 2020 will be in Ireland, where it has projected that almost 60% of property disposal receipts will arise during that period. In this regard, NAMA has reported that strong recovery has been evident in certain sectors of the Irish market during 2013 and that, in late 2013, there was a marked improvement in investor sentiment towards Ireland.

2 Loan Acquisition

2.1 One of the purposes of the Act is to remove uncertainty about the valuation and location of certain assets of credit institutions of systemic importance to the economy. In order to contribute to this purpose, the Act requires NAMA to acquire, from the banks participating in the NAMA scheme, such eligible bank assets as are appropriate.¹

2.2 Eligible bank assets are, broadly

- loans to a debtor for the purposes of purchasing, exploiting or developing development land or where security offered for a loan is development land
- all other loans to that debtor (excluding credit card debt)
- all loans to associated debtors of the debtor²
- associated financial contracts to the debtor (e.g. an interest rate derivative that hedges interest rate exposure).

2.3 Under section 84 of the Act, NAMA had discretion to decide whether or not to acquire an eligible asset. In its June 2010 strategic plan, based on the information that had been provided by the five participating banks, NAMA anticipated that the total eligible loans were around €81 billion. At that time, NAMA anticipated that the loans would be acquired for around 50% of their book value and that it would also acquire associated financial derivatives.

2.4 Ultimately, the Government, having consulted with the NAMA Board and the European Commission, decided that NAMA would not acquire loans from Allied Irish Banks and Bank of Ireland where a borrower's total exposure was less than €20 million. The total face value of these loans was around €6.6 billion. NAMA also decided not to acquire certain other loans with a face value of around €2.6 billion.³

2.5 NAMA acquired loans and associated derivatives where borrower debt totalled €74.4 billion. This represented around 90% of the eligible assets that it ultimately identified (almost €84 billion).⁴

2.6 In total, over 15,000 loans were acquired from almost 800 'debtor connections' (which included over 5,000 borrowing entities) at a cost to NAMA of €31.8 billion.⁵ The price paid represented a discount of 57% on the loans' face value of €74.4 billion.

Loan valuation process

2.7 The values at which eligible bank assets were acquired were determined in accordance with regulations made by the Minister for Finance in March 2010, using a methodology approved by the European Commission (the Commission).⁶ The process valued loans by calculating the present value of the cash flows associated with the loans' underlying collateral. The rates used to discount the cash flows to present values (NAMA discount rates) were set down in the regulations.

¹ The National Asset Management Agency (Designation of Bank Assets) Act Regulations 2009, made by the Minister under section 69 of the Act, prescribe certain classes of bank assets as eligible for the purposes of the Act.

² Associated debtors are defined in section 70 of the Act.

³ NAMA considered a number of factors including the scale of debtors' exposure to land and development relative to their total exposure when deciding whether to acquire a loan.

⁴ Loans continued to accrue interest after they were identified as eligible assets by NAMA. Therefore, the cumulative value of the assets ultimately identified was greater than the €81 billion originally identified.

⁵ There are around 1,000 individual borrowers. NAMA manages the debt by reference to debtor connections - grouping closely connected debtors whose aggregate debt is considered by NAMA to be best managed as one cohesive connection rather than separately.

⁶ The National Asset Management Agency (Determination of long-term economic value of property and bank assets) Act Regulations 2010.

2.8 Key features of the loan valuation process were

- Property collateral was valued as at 30 November 2009.
- NAMA applied 'uplift factors' to each property, ranging between 0% and 25%, to reflect its long-term value, which was the price NAMA estimated the property would realise when market conditions stabilised.
- NAMA carried out a legal due diligence process, the primary objectives of which were to confirm the validity of loan security, whether legal actions were outstanding for loans, and the accuracy of loan information provided by the banks.
- It was assumed that future enforcement and acquisition due diligence costs would reduce projected disposal receipts by 5.25%. This was deducted from amounts paid to the banks.

2.9 Two values were calculated for each loan — its long-term economic value and its current market value (at the time the loan was transferred to NAMA).

- The NAMA discount rates were applied to the long-term economic value of property collateral and the rental incomes associated with the property when calculating a loan's long-term economic value.
- Commercial discount rates for distressed property were applied to the current market value of a property and its rental income when calculating a loan's current market value.

2.10 The price paid by NAMA for a loan was the lower of the amount owed by the borrower and the loan's long-term economic value.**2.11** The loans were acquired by NAMA in nine tranches, with most of the loans of the larger debtors being acquired first. In its June 2010 strategic plan, NAMA envisaged that it would have acquired all loans by the end of February 2011. However, in the course of 2010, NAMA found that the legal due diligence process would take much longer than initially envisaged. Significant contributory factors to the delay were the quality of the loan documentation held by the banks and the slower than expected pace of document submission.**2.12** In October 2010, the Minister made regulations under which the remaining loans to be acquired by NAMA were to be acquired prior to completion of due diligence.¹ NAMA paid an interim price determined in accordance with the revised regulations and criteria set by the Board of NAMA for these loans. By the end of 2010, almost all of the loans acquired from the participating banks had been transferred to NAMA. Following subsequent completion of due diligence, the price paid was adjusted — a net additional €0.5 billion (around 1.5% of the total consideration) was paid to the banks. The full valuation process was completed for all loans by March 2012.***State aid*****2.13** The Treaty on the Functioning of the European Union (Lisbon Treaty) includes a general prohibition on the provision of state aid which distorts or tends to distort competition. There are some exceptions including aid to remedy a serious disturbance in the economy of a member state. Under the Lisbon Treaty, a new state aid scheme requires prior approval by the Commission.

¹ Statutory Instrument No. 505 of 2010, National Asset Management Agency (Conferral of Additional Function) Order 2010.

- 2.14** In February 2009, in guidance issued to member states, the Commission defined an asset relief measure as arising where assets are transferred at a value higher than their current market value. The amount of state aid is the difference between a loan's current market value and its transfer value.
- 2.15** The Commission approved the establishment of NAMA in February 2010. The Commission pointed out that it would separately assess the compatibility with state aid rules (and, in particular, the actual transfer price) of the transferred assets when these were separately notified by the Irish authorities.
- 2.16** In August 2010, the Commission stated that it found the transfer of the first tranche of loans to be in line with the approved scheme and with its guidance on the treatment of impaired assets. It approved the valuations in the second tranche in November 2010. NAMA paid €13 billion for the loans transferred in the first two tranches — just over 40% of the total consideration paid. Commission approval for the transfer of the remaining two-thirds of the loans transferred had not been provided by mid-April 2014.
- 2.17** NAMA has pointed out that securing final European Commission approval for loan transfers is the responsibility of the Central Bank of Ireland (the Central Bank) and the Department of Finance and is beyond NAMA's direct control. The Department of Finance stated that it received the relevant documentation from the Central Bank in February 2014 and has submitted an application to secure European Commission approval for the loan tranche transfers.

Loan acquisition — outcomes

- 2.18** The total borrower debt acquired by NAMA amounted to €74.4 billion. The amount paid — €31.8 billion — represented a discount of 57% on the loans and crystallised losses of €42.6 billion for the banks. The discounts for individual banks varied between 44% and 61%, as shown in Figure 2.1.
- 2.19** In addition to the distressed property market, the size of the discounts applied also reflects the deficient administration of loans by the banks, including poor loan documentation, some collateral not being properly legally secured and inadequate stress testing of the borrowers and loans.

Figure 2.1 Loans acquired by NAMA

| Participating bank ^a | Total borrower debt € billion | NAMA payment for loans € billion | Discount | |
|-----------------------------------|----------------------------------|-------------------------------------|-------------|-----------|
| | | | € billion | % |
| AIB | 20.5 | 9.0 | 11.5 | 56 |
| Anglo | 34.4 | 13.4 | 21.0 | 61 |
| Bank of Ireland | 9.9 | 5.6 | 4.3 | 44 |
| Educational Building Society | 0.9 | 0.4 | 0.5 | 57 |
| Irish Nationwide Building Society | 8.7 | 3.4 | 5.3 | 61 |
| Total | 74.4 | 31.8 | 42.6 | 57 |

Source: National Asset Management Agency

Note: a In 2011, Allied Irish Banks merged with the EBS. Anglo merged with the INBS and was renamed the Irish Bank Resolution Corporation. The loan acquisitions were recorded under the names of each participating bank prior to the mergers.

2.20 The elements of the consideration paid for the loans together with explanations of each are set out in Figure 2.2.

Figure 2.2 Consideration for loans

| | AIB | Anglo | BOI | EBS | INBS | Total |
|--|---------------|---------------|--------------|------------|--------------|---------------|
| | €m | €m | €m | €m | €m | €m |
| Loan balance | 20,381 | 34,261 | 9,867 | 903 | 8,739 | 74,151 |
| Derivatives | 74 | 145 | 44 | - | - | 263 |
| Borrower debt | 20,455 | 34,406 | 9,911 | 903 | 8,739 | 74,414 |
| Market value of property (30 November 2009) | 9,261 | 13,310 | 5,681 | 399 | 3,766 | 32,417 |
| Long-term value of underlying property | | | | | | |
| Land (including development property < 30% complete) | 2,955 | 2,543 | 1,516 | 96 | 1,413 | 8,523 |
| Residential property for resale | 1,802 | 1,824 | 960 | 173 | 476 | 5,235 |
| Investment property | 4,051 | 8,202 | 2,788 | 151 | 1,072 | 16,264 |
| Hotels | 565 | 1,512 | 502 | 1 | 887 | 3,467 |
| Development property (>30% complete) | 564 | 397 | 423 | 6 | 217 | 1,607 |
| Total | 9,937 | 14,478 | 6,189 | 427 | 4,065 | 35,096 |
| NAMA valuation | | | | | | |
| Collateral associated with loans | | | | | | |
| Present value of property cash flows | 9,606 | 14,443 | 6,055 | 413 | 3,800 | 34,317 |
| Cash security | 94 | 319 | 61 | 4 | 10 | 488 |
| Other security | 577 | 619 | 137 | 8 | 27 | 1,368 |
| Total collateral | 10,277 | 15,381 | 6,253 | 425 | 3,837 | 36,173 |
| Excess collateral | (978) | (1,189) | (483) | (19) | (205) | (2,874) |
| Legal discount | (86) | (283) | (2) | (1) | (122) | (494) |
| Collateral available to the State | 9,213 | 13,909 | 5,768 | 405 | 3,510 | 32,805 |
| Due diligence and enforcement adjustment | (360) | (510) | (206) | (16) | (158) | (1,250) |
| Net loan collateral | 8,853 | 13,399 | 5,562 | 389 | 3,352 | 31,555 |
| Qualifying advances | 148 | 153 | 50 | - | 42 | 393 |
| Initial consideration | 9,001 | 13,552 | 5,612 | 389 | 3,394 | 31,948 |
| Post-acquisition adjustment | (30) | (144) | (23) | - | 27 | (170) |
| Final consideration | 8,971 | 13,408 | 5,589 | 389 | 3,421 | 31,778 |
| Discount | 56% | 61% | 44% | 57% | 61% | 57% |
| Loan current market value ^a | 7,403 | 11,162 | 4,590 | 317 | 2,679 | 26,150 |
| State aid | 21% | 20% | 22% | 23% | 28% | 22% |

Source: National Asset Management Agency and analysis by the Office of the Comptroller and Auditor General.

Note: a The current market value of the loans was calculated using a model developed by NAMA's financial advisors.

Figure 2.2 continued: Explanation of Elements

| | |
|---|--|
| Loan balance | The amounts owed by borrowers at loan valuation date and including qualifying advances made after 7 April 2009. ¹ |
| Derivatives | The market value at acquisition time of the performing financial derivatives for which NAMA gave consideration. |
| Borrower debt | This is the total of the loan balances and the value of the associated performing derivatives owed by the borrowers. |
| Market value of property | The market value of property at 30 November 2009 pledged as collateral by borrowers. |
| Long-term value of underlying property | The long-term value of land, residential and investment property, hotels and development property is the market value plus the uplift applied by NAMA to derive the property's long-term value. These are the proceeds that it is anticipated the properties would realise if disposed of when the market crisis conditions have normalised. |
| Present value of property cash flows | The present values of the real estate collateral cash flows associated with the loans that comprise the assumed disposal proceeds and any projected rental income discounted to present values using the NAMA discount rates. |
| Cash security | Cash held as collateral by the participating banks. |
| Other security | The collateral, other than property or cash, held as security by the participating banks. |
| Excess collateral | In some instances, the value of the collateral provided by borrowers exceeded amounts owed. Adjustments were made so that the consideration given did not exceed the loan balances and associated derivatives. In some cases, the legal structure of a borrower's loans prevented cross collateralisation to other loans. |
| Legal discount | The amount that has been deducted by NAMA arising from legal issues relating to the possible enforceability of NAMA's security and title rights over loan collateral. |
| Collateral available to the State | The net value of the collateral pledged by borrowers — the present value of property cash flows and the current market value of other securities less excess collateral and any legal discounts applied by NAMA. |
| Due diligence and enforcement ² | A discount of 5.25% was applied to the long-term value of the properties to provide for due diligence (0.25%) and enforcement costs (5%) incurred or likely to be incurred by NAMA. This is the present value, after application of the discounts, of the amount by which the consideration paid to the participating banks was reduced for this provision. |
| Net loan collateral | The value of the collateral following deduction of the provision for due diligence and enforcement costs. |
| Qualifying advances | Advances made by a participating institution to borrowers after 7 April 2009 (the date on which the Minister for Finance announced the Government's intention to establish NAMA). Under direction from the Central Bank and the Financial Regulator, following direction from the Minister, no discount was applied to such advances if they were deemed to be part of normal commercial banking arrangements. |
| Initial consideration | The initial amount paid by NAMA for the acquired loans and associated financial derivatives, prior to adjustments made under the Act. |
| Post-acquisition adjustments | The Act allows for the adjustment of the acquisition value of a loan subsequent to its acquisition where there has been an error in the acquisition process or value attributed to the loan. |
| Final consideration | The final amount paid by NAMA for the acquired loans and associated financial derivatives, post adjustments made under the Act. |
| Discount | The percentage difference between the consideration paid and borrower debt at loan valuation date. |
| Loan current market value | The present value of the property cash flows, using the current market value of the property, discounted at market rates for distressed loans. |
| State aid | The difference between the final consideration and the loan current market value expressed as a percentage of the loan current market value. |

1 NAMA paid the lower of the value of the collateral cash flows and the amount owed by the borrower, including derivatives, at a date specified by NAMA for each tranche and for each participating bank. For example, for the first tranche, the loan valuation date for all participating banks was 31 January 2010.

2 In implementing this provision, NAMA applied the 5.25% discount to the long-term value of property pledged as collateral for loans. There were some loans where the difference between the loan balance and the post-discount value of the collateral was less than the actual amount of the discount applied to the collateral. In these cases, not all of the discount was deducted from the consideration paid.

Valuation of underlying property collateral

- 2.21** Real estate accounted for almost 95% of the collateral provided by borrowers. The current market values of the property and the long-term uplift factors applied to those values were the key determinants of loan values.
- 2.22** Properties were valued initially by valuers acting for the participating banks. Valuations were provided for around 10,700 properties. Following review by NAMA-appointed valuers, NAMA accepted around 87% of the valuations by number representing around 73% of the total value.¹ In cases where the NAMA-appointed valuer did not accept the valuation submitted by the bank, a further valuation was carried out by an independent valuer and this valuation was accepted by NAMA. 90% of those valuations were lower than the valuations submitted by the banks while 5% were higher. The total net reduction in valuations was €2.3 billion, representing about 24% of the original valuations submitted by the banks in respect of those properties. The final valuation for all properties was €32.4 billion.
- 2.23** The uplift factors to derive the long-term economic value of properties were proposed by the NAMA-appointed valuers and reviewed by NAMA. The final decision for all uplift factors was made by NAMA. The average uplift factor was 8.3% (see Figure 2.3).

Figure 2.3 Property value uplift

| | Proportion of property at current market value ^a | Average property uplift adjustment |
|--|---|------------------------------------|
| Categorised by bank | | |
| AIB | 29% | 7.3% |
| Anglo | 41% | 8.8% |
| Bank of Ireland | 17% | 9.0% |
| Educational Building Society | 1% | 7.0% |
| Irish Nationwide Building Society | 12% | 8.0% |
| Overall | 100% | 8.3% |
| Categorised by property type | | |
| Investment property (complete) ^b | 71% | 8.4% |
| Development property (>30% complete) | 5% | 6.6% |
| Land (including development property < 30% complete) | 24% | 8.1% |

Source: National Asset Management Agency - analysis by Office of the Comptroller and Auditor General

Note: a At November 2009 values.

b This classification includes all completed commercial and residential properties.

¹ Valuers were appointed from a panel established by NAMA following a procurement competition.

Legal due diligence

- 2.24** Legal advisors to the banks provided legal due diligence reports for each loan. Legal advisors, appointed by NAMA, reviewed these reports and either accepted them or sent them back to the participating bank for revision and re-submission to NAMA. The NAMA legal advisors assessed the implications of legal deficiencies identified, for example, around the enforceability of the security for a loan, and completed a certificate expressing a view on the main issues in the report for each loan pack.¹
- 2.25** The legal certificates were reviewed by the head of NAMA's legal division who set out the legal discounts, if any, to be applied to a loan. Ultimately, legal discounts totalling €494 million were applied to the loans acquired.

Assurance about the loan acquisition process

- 2.26** The loan valuations were carried out by firms appointed as loan valuers by NAMA. Each loan valuation was then confirmed by a separate firm appointed by NAMA, referred to as the audit coordinator, which carried out a series of checks to validate the values calculated by the loan valuers. The audit coordinator issued a certificate in respect of each loan pack, stating that it had been valued in accordance with the valuation model and that the property collateral for the loans had been valued on a consistent basis.
- 2.27** As previously reported, in order to gain assurance about the property valuation and legal due diligence processes undertaken by NAMA, my Office used the services of²
- the Valuation Office and of a former Commissioner of Valuation in Northern Ireland to review the property valuation process and
 - a legal firm that had not been involved in NAMA's legal due diligence process to review the process.
- 2.28** The conclusions of the advisors provided assurance that
- the property valuation process had been carried out in accordance with standards prevailing in the industry
 - the legal due diligence process and steps taken by NAMA to address any issues relating to security arrangements identified in due diligence reports had been adequate.
- 2.29** In the course of the annual financial audits of NAMA, my Office also carried out audit tests to ensure that loans acquired were properly transferred and recorded in NAMA's books of account.

Payment for the loans

- 2.30** NAMA paid 95% of the cost of the bank assets (€30.2 billion) by issuing debt securities guaranteed by the Minister (senior debt).³ The government guaranteed bonds are eligible collateral for use by banks to obtain liquidity from the Central Bank of Ireland under monetary policy operations of the European Central Bank.
- 2.31** The balance of 5% was paid by way of subordinated bonds of €1.6 billion. Payment of interest and the value at redemption of the subordinated bonds is dependent on NAMA's financial performance and is at the discretion of the Board of National Asset Management Ltd.

¹ In some cases, the same collateral was provided by a borrower for one or more loans. Loans with the same collateral are valued together and are referred to as loan packs.

² Special Report 79, National Asset Management Agency — Management of Loans, Comptroller and Auditor General, February 2012.

³ The securities were issued by National Asset Management Ltd.

Conclusions and recommendation

- 2.32** Ultimately, NAMA acquired almost 90% of the identified eligible bank assets. The effect of the acquisitions was to remove uncertainty about the value of those loans in the books of the participating banks and their acquisition has made a significant contribution to the stabilisation of Allied Irish Banks and Bank of Ireland.
- 2.33** Subordinated debt issued by NAMA accounted for 5% of the bonds the banks received in exchange for the loans. Therefore, there is some remaining uncertainty for the banks as repayment of this debt is dependent on NAMA's financial performance.
- 2.34** The loan acquisition process was carried out expeditiously by NAMA. Almost all of the loans had transferred by the end of 2010, meeting the objective set by the Board in its 2010 strategic plan. While some of the loans transferred at interim valuations, the banks had been paid all but 1.5% of the total loan consideration by the end of 2010. The acquisition price of all loans was not finalised until 2012, following completion of the lengthy legal due diligence and loan valuation process.
- 2.35** Audits and examinations carried out by my Office between 2010 and 2012 concluded that the property valuations, legal due diligence and loan valuation processes were adequate and complied with the regulations made by the Minister. Given the task NAMA faced due to the scale and uncertain nature of the loan books, and the inadequate processes within the participating banks, this was a substantial achievement.
- 2.36** The NAMA scheme provides state aid to the participating banks because the prices paid for the loans were greater than their market value. Consequently, the transfer prices of the assets were subject to assessment by the European Commission. By April 2014, the Commission had approved the transfers of only around one-third of the loans.

Recommendation 2.1

In order to remove residual uncertainty about the transfer price of the remaining loans, the Department of Finance should engage with the European Commission to agree a timeframe for obtaining the outstanding approval for acquired loans.

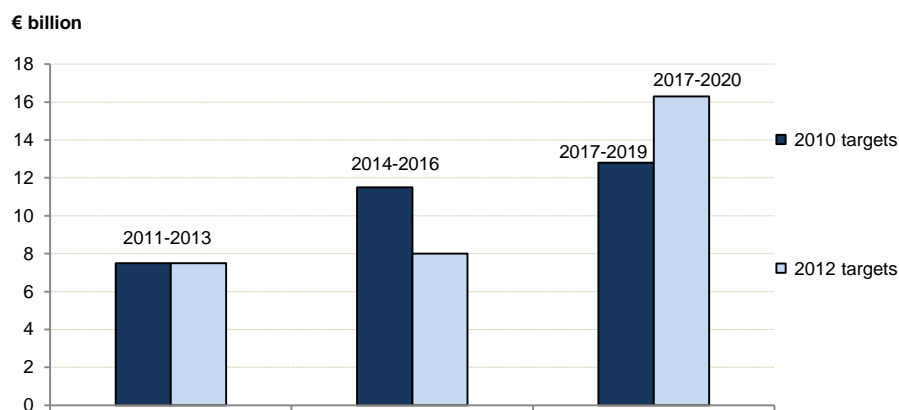
Secretary General's response

Accepted. In February 2014, the Department of Finance submitted an application to the European Commission for approval of the remaining loan transfers.

3 Financial Performance

- 3.1 The Act requires NAMA "to obtain, as far as possible, the best achievable financial return for the State" having regard to the cost of acquiring and dealing with the bank assets, NAMA's cost of capital and other costs and any other factor which NAMA considers relevant to the achievement of its purposes.¹
- 3.2 In its June 2010 strategic plan, the Board set a target of redeeming all its debt by 2019.² The March 2012 strategic plan included a revised target, whereby a greater proportion of the debt would be repaid towards the end of NAMA's life, with all debt (€31.8 billion) being repaid by 2020. Intermediate targets were also set (see Figure 3.1).

Figure 3.1 NAMA debt-redemption targets, 2010 and 2012^a



Source: NAMA Business Plan 2010; NAMA Strategic Plan, March 2012

Note: a The acquisition values had not been finalised when the 2010 plan was drawn up. Debt reduction targets in the plan were expressed in percentages of the total debt issued by NAMA.

- 3.3 In addition to the target of redeeming all NAMA debt, a key objective set by the NAMA Board in its 2012 strategic plan is that over its projected ten-year life, NAMA will, at a minimum, redeem the senior bonds (€30.2 billion) issued as consideration for loans, and recover its carrying costs and working and development capital expenditure advanced to debtors.

Financial results to end-2012

- 3.4 NAMA's financial statements to the end of 2012 reported accumulated losses of €710 million. Figure 3.2 outlines the income and expenditure recognised in NAMA's financial statements for 2010 to 2012.

¹ Section 10 (2) of the Act.

² NAMA debt comprises €30.2 billion in Government guaranteed bonds (senior bonds) and €1.6 billion in subordinated debt.

Figure 3.2 NAMA income and expenditure, 2010 to 2012

| | 2010 | 2011 | 2012 | Total |
|--|----------------|----------------|----------------|----------------|
| | € million | € million | € million | € million |
| Income | | | | |
| Interest and similar income | 525 | 1,283 | 1,387 | 3,195 |
| Net gains on derivatives and foreign exchange | 5 | 86 | — | 108 |
| Net profit on disposal of debtor assets and surplus income | — | 549 | 188 | 737 |
| Tax credit | — | 235 | — | 235 |
| | 530 | 2,153 | 1,575 | 4,275 |
| Expenditure | | | | |
| Interest and similar expenses | (179) | (512) | (493) | (1,184) |
| Net losses on derivatives and foreign exchange | — | — | (137) | (154) |
| Administration expenses | (46) | (128) | (119) | (293) |
| Impairment charges on loans and receivables | (1,485) | (1,267) | (518) | (3,270) |
| Tax expense | — | — | (76) | (76) |
| Dividend paid | — | (5) | (3) | (8) |
| | (1,710) | (1,912) | (1,346) | (4,985) |
| Gain/(loss) in the period | (1,180) | 241 | 229 | (710) |

Source: NAMA financial statements 2010 to 2012.

1 Net receipts from debtors, as presented to the Board on 13 March 2014, include receipts from property rental and the sale of loans and property, net of any amounts retained by the debtor or receiver to meet essential property costs and overheads, in addition to any other cash provided from the debtor less any advances to the debtor.

2 Payments include all costs and debt repayments incurred by NAMA, excluding those where a debtor or receiver has retained funds to meet costs approved by NAMA.

3 Most of the balance of the cash surplus generated to the end of 2012 was in the form of collateral, relating to financial derivatives, placed with the NTMA under a collateral posting agreement.

3.5 The financial statements are prepared under International Financial Reporting Standards (IFRS). Under the standards, income on loans is accrued at a constant rate over their expected life. The rate at which the income accrues (the effective interest rate) is determined by the cash flows that the loan is expected to generate when the loan is granted or acquired and does not change over the life of a loan. The expected cash flows are reviewed annually and any downward revisions are reflected in loan impairment charges. Impairment charges reduce the loan values on which interest income is measured. At the end of 2012, the carrying value of the loans was €22.8 billion.

3.6 By the end of 2012, NAMA had generated net receipts from debtors of €9.8 billion and had made cash payments of about €6.1 billion, of which €4.75 billion was in respect of NAMA senior debt repayments.^{1,2} €2.5 billion of the excess of receipts over payments of €3.6 billion was held in cash or short-term bonds.³ Thus, NAMA had, by the end of 2012, made significant progress towards meeting its target of redeeming €7.5 billion of debt by the end of 2013.

3.7 By the end of 2013, NAMA had received a further net €3.8 billion from debtors and paid out a further €3.5 billion, including further debt redemption of €2.75 billion. At that point, NAMA had met the Board's end-2013 debt redemption target. In March 2014, NAMA redeemed a further €3 billion of senior debt.

- 3.8** Ultimately, when NAMA is wound up, the cumulative profit or loss reported in the financial statements will equal the cash surplus or shortfall that NAMA has generated.¹ In the interim periods, NAMA may generate cash surpluses in excess of reported profits or losses due to timing differences between receiving the proceeds from the management and sale of debtors' assets, the payment of costs and the redemption of debt. It is necessary, therefore, to consider NAMA's expectations of net cash inflows and costs of operating NAMA over its full life in assessing the extent to which the cash generated to date has contributed to the achievement of its overall objectives.

NAMA projections to 2020

- 3.9** NAMA annually prepares detailed estimates of its expected cash flows for each year to 2020.² The main elements of these operational cash flows are

- Aggregate net receipts from debtors — estimated cash flows for debtors are revised annually to take account of revised information about the rental and disposal expectations for individual properties, as well as changes to broader assumptions that inform the reviews including, inter alia, the conditions in the markets in which NAMA operates (principally Ireland and Great Britain) and NAMA's view of future prospects
- NAMA's debt servicing costs and
- other NAMA operating costs.

- 3.10** Taking account of continuing decline in property values in Ireland since the end of 2011 and of the conditions in the other markets in which it operates (including increases in property values in London), NAMA has revised down its overall expectations of the net cash it will generate from debtors.

- At the end of 2011, NAMA anticipated that, by 2020, it would generate around €37.5 billion in net receipts from debtors, including net receipts of €5.5 billion by December 2011.³ At that stage, NAMA was projecting it would generate a surplus of around €1 billion.
- By the end of 2012, forecast net receipts from debtors had fallen by €0.7 billion to €36.8 billion, including net receipts of €9.8 billion by December 2012.^{4,5,6} At the end of 2012, NAMA anticipated that total payments to be made by NAMA, including redemption of all debt (senior and subordinated) would amount to around €36.6 billion leaving an anticipated surplus of around €300 million.

- 3.11** At the end of 2012, forecast net receipts from debtors were €27.1 billion for the period 2013 to 2020. If the net cash received from debtors in the period 2013 to 2020 is only €25.2 billion (7% less than the detailed estimates indicate), then NAMA will still achieve its minimum objective of redeeming the senior bonds but will not redeem the subordinated debt.

- 3.12** The uncertainty in the markets in which NAMA operates, in particular in Ireland, make forecasting difficult, even in the short to medium term. It is inevitable that the estimates that NAMA makes will undergo further changes across NAMA's lifespan, being adjusted upwards or downwards to take account of changing market and economic conditions.

¹ If not all property held by debtors has been sold at the end of NAMA's life, some of its assets may be in the form of loans or property rather than cash.

² In addition, NAMA carries out a mid-year review which takes account of significant changes in outlook.

³ At the end of 2011, NAMA prepared detailed estimates for NAMA-managed debtors, representing 82% of total borrower debt. The examination team extrapolated from those cash flows to estimate the total net cash expected from debtors.

⁴ The figure of €36.8 billion is based on detailed cash flows for about 85% of NAMA debt, extrapolated, by NAMA, for the remaining borrowers.

⁵ Net debtor receipts to end-2020 contained in the end-2012 plan comprise disposal proceeds (€33.7 billion), non-disposal proceeds (€5.7 billion), other receipts (€0.6 billion) less advances to debtors (€3.2 billion).

⁶ The main differences from the end-2011 figures were a reduction in forecast disposal receipts (€0.8 billion), a further reduction due to additional expected new lending (€0.8 billion higher), partially offset by an anticipated increase in non-disposal receipts (€0.9 billion).

Risks and opportunities

3.13 The key components of the outturn to date, the NAMA projections for each component to 2020 and some of the associated risks to achieving the projected outturn and opportunities to exceed it are discussed below.

Net receipts from debtors in 2012

3.14 The expected receipts from and advances to debtors are reviewed annually by NAMA. The reviews take account of the most recent review of a debtor's business plan, which includes target dates for the disposal of the debtors' properties.¹

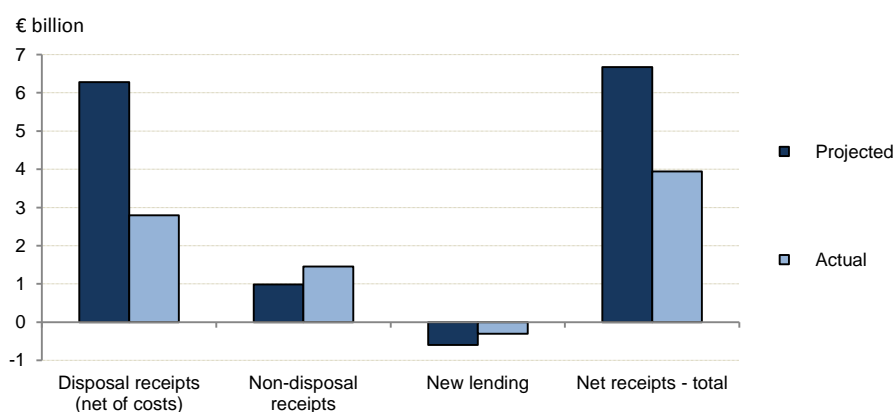
3.15 At the end of 2010, NAMA had not completed the acquisition due diligence process for some loans and it had completed less than half (by value) of the required detailed reviews of borrowers' business plans. Therefore, the projected cash flows for receipts from borrowers at the end of 2010 were drawn up with incomplete information.

3.16 The year-end reviews for 2011 and 2012 of expected cash from debtors focused in detail on property disposals expected to occur in the following two years while the projections for later years were less detailed and took account of guidance approved by the Board about the assumptions to be used in respect of the timing of, and expected disposal proceeds from, the sale of property in those years.

3.17 NAMA prepared detailed estimated cash flows for the bulk of its debtors for 2012. For that year — the first year projected — the outturn differed considerably from those estimates that had been finalised only in April.² Figure 3.3 shows that net receipts from debtors, at about €4 billion, were 59% of the amount forecast.

3.18 Receipts from disposal of property were 55% below the level projected for 2012. Non-disposal receipts, including rental receipts, were 47% ahead. New lending to debtors amounted to around €300 million, just half of what had been projected for 2012.

Figure 3.3 Net receipts from borrowers, projected and actual, 2012^a



¹ Some business plans are prepared by receivers.

² In 2011, receipts from those borrowers for which NAMA had prepared detailed cash flow projections were well below forecast also.

Source: NAMA cash flow projections end-2011 and cash outturn 2012

Note: a The end-2011 forecasts were based on the detailed forecasts for borrowers who held 82% of the carrying value of the debt. These were grossed up to include the borrowers for whom detailed cash flow projections were not in place, on the assumption that the cash flows for these debtors would be broadly similar to those for NAMA-managed debtors.

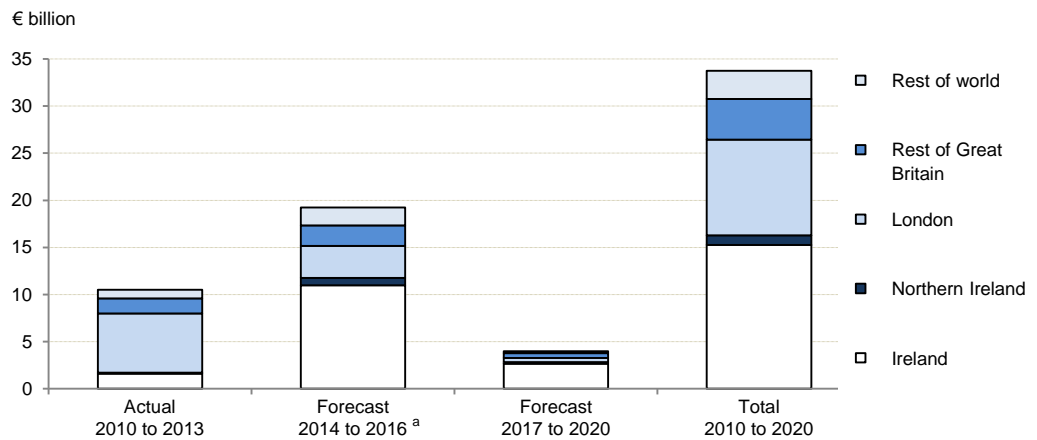
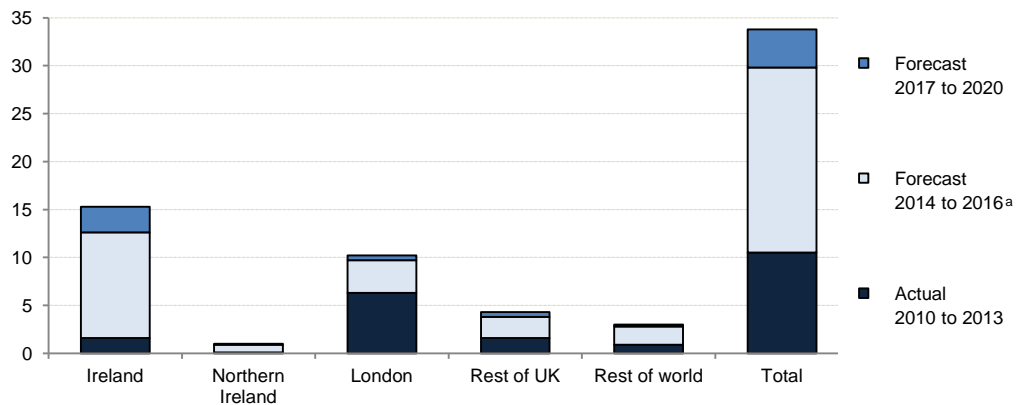
Estimated net receipts from debtors 2013 to 2020

- 3.19** The estimated net receipts of €27.1 billion from debtors for the period 2013 to 2020 comprise three elements
- disposal receipts of €26.9 billion
 - non-disposal receipts of €2.5 billion and
 - advances to debtors of €2.3 billion.
- 3.20** In 2013, net receipts from debtors amounted to €3.8 billion, around 62% of the year's estimate of €6.1 billion.¹
- Receipts from disposals at €3.7 billion were just 60% of the 2013 forecast.
 - Non-disposal receipts were marginally above target at €792 million.
 - New lending to debtors, €328 million, represented 45% of the planned advances for the year.
 - In addition, during 2013, NAMA advanced €337 million in vendor finance to purchasers of assets being disposed of by NAMA debtors. Under vendor finance arrangements, between 30% and 40% of the equity is received upfront by NAMA, with the remainder of the consideration being deferred.

Projected level of disposals

- 3.21** The 2012 cash flows projected receipts from disposals of €26.9 billion in the period 2013 to 2020. 85% of this, or €22.9 billion, would be achieved in the period to end-2016. Disposal receipts in 2013 amounted to €3.7 billion, leaving a further €19.2 billion to be achieved by the end of 2016.
- 3.22** The level of disposals projected in the detailed cash flow estimates for the period to end-2016 is ambitious, given the level of disposals achieved to date. In the period from the acquisition of the first loans in 2010 to end-2013, NAMA had received €10.5 billion in loan and property disposal receipts from debtors. Around 75% of disposals were in Great Britain with the bulk of these in London. Just 15% of the disposals were in Ireland. The end-2012 cash flow projections show that
- 57% of the balance (€19.2 billion) in projected loan and disposal receipts to end-2016 are expected to arise from disposals in Ireland.
 - In the period from 2017 to 2020, a further €4 billion is projected, with two-thirds of the disposals taking place in 2017. Around 70% of projected disposal receipts in the period 2017 to 2020 are located in Ireland.
- 3.23** Disposals to the end of 2013 and forecast disposals from 2014 to 2020 are shown in Figure 3.4.

¹ The cash receipts for 2013 are pre-audit figures.

Figure 3.4 Disposals to end-2013 and forecast disposals 2014 to 2020**Disposals proceeds by period****Disposal proceeds by location**

Source: NAMA cash flow estimates 2012 and cash receipts to end-2013 — Analysis by Office of Comptroller and Auditor General

Note: a Includes forecast disposals that did not proceed in 2013.

3.24 The 2012 strategic plan noted that a significant proportion of property located in Great Britain would be sold in the first half of the 2012 to 2020 period. In Ireland, the volume of disposals would depend principally on conditions in the market, the availability of credit and the impact of deleveraging being carried out by various banks. It was anticipated that the rate of disposal of Irish assets would accelerate from 2016 on.

3.25 Sales in the Irish market by NAMA have been lower than anticipated up until December 2013. Combined with the reducing amount of property held in Great Britain, especially London, this suggests that NAMA may have difficulty in achieving the level of disposals set out in the detailed cash flows.¹ For example,

- The overall level of loan and property disposals forecast for 2014 to 2016 is almost double that achieved in the period to end-2013. However, the main driver of the disposal receipts to date has been the London market. By the end of 2013, NAMA had sold 62% of the property that it will ultimately sell there so the forecast increase in future sales will have to be generated in other markets, principally Ireland.

¹ Property portfolios and market trends are discussed in detail in Chapter 5.

- €11 billion of disposals are forecast for Ireland in the period from 2014 to 2016. The total disposals in 2013 were around the same as the total for the previous two years combined. The rate of disposal for each year from 2014 to 2016 will need to be between four and five times the 2013 level to achieve the projected disposals. Delayed disposals will lead to increased financing and operating costs for NAMA, but this may be offset by rental and other operating receipts from debtors.
- A further risk is that properties will not be developed or enhanced sufficiently to enable NAMA to achieve the projected disposal proceeds, or developments and related disposals will be delayed. Advances to debtors to carry out capital developments were just 50% of those forecast in 2012 and 54% below forecast in 2013, indicating that anticipated levels of development may not be taking place.¹

3.26 A number of opportunities (which also have associated risks) could, if they occur, have a positive impact on the rate of disposals, in particular in Ireland.

- The extent to which NAMA sells loans (or portfolios of loans) or borrowers refinance loans could reduce the necessity for direct property sales. However, proceeds might be less than the cumulative proceeds that would be achieved for individual property sales.
- Increased demand for commercial property from investors might lead to accelerated sales.
- Improved availability of credit might increase the level of activity in both the commercial and residential markets in Ireland. However, competition from others with property to sell might limit NAMA's sales in these circumstances.
- Actions taken by NAMA, such as the provision of vendor finance, may help to stimulate activity in the Irish property market.
- NAMA has identified a number of projects that it may support in London and Dublin that were not included in detailed plans at the end of 2012. If some or all of these projects go ahead, then any associated interest on additional lending or gains from disposals would enhance NAMA's ultimate outturn.

NAMA's views on the projected level of disposals

3.27 NAMA stated that the level of disposals set out in the aggregated debtor cash flow estimates, which it views as realistic but ambitious, may not all be met as some planned asset sales may not take place in a particular year. NAMA also pointed out that it is not necessary to meet the disposal expectations for every debtor in order to generate sufficient cash to meet the Board's end-2016 target of redeeming a further €7.5 billion of senior debt.

3.28 NAMA has pointed out, in regard to the level of disposals to end-2013, that much of the first three years of operation were taken up with loan acquisition, establishment of the organisation, staff recruitment and business planning, and that NAMA is now fully engaged with its debtor and asset management activities.

¹ The total level of cash from operations retained by borrowers and used to complete developments is not known. While the information is available at individual debtor level, it has not been compiled by NAMA on a consolidated basis. This is further discussed in Chapter 5.

3.29 In regard to prospects for property disposals in Ireland, NAMA stated that conditions in the Irish property market improved during 2013. It stated that it does not underestimate the difficulty of achieving its Irish asset disposal targets but that it considers that due weight should be given to the probability that the macroeconomic, market and credit conditions likely to prevail during the period to end-2016 will be more benign than those which prevailed to end-2012. In particular, NAMA stated that

- The level of property and loan disposals by NAMA in the Irish market in 2013, at around €800 million, was the same as the total amount achieved in 2011 and 2012 combined.
- Strong recovery has been evident in certain sectors of the Irish market during 2013 and this has facilitated a substantial increase in NAMA's Irish disposals activity. By the end of February 2013, NAMA's cumulative sales in the Irish market had reached €900 million; by end-February 2014, that had increased to a cumulative €2.3 billion.
- The office and residential sectors in Dublin performed particularly well in 2013, buoyed by interest from international investors, by the return of domestic institutional investors to the market and by the introduction of two Irish real estate investment trusts (REITs). The shortage of prime office space in Dublin and increases in rents for these properties in Dublin in 2013 will support the commercial viability of a number of office development projects under consideration by NAMA.
- Assets owned by NAMA debtors and receivers are well located in terms of demand that is likely to emerge for property as the economic recovery becomes more sustained.
- 2013 saw a marked improvement in international investor sentiment towards Ireland and NAMA has responded by increasing the flow of assets offered for sale by debtors and receivers in order to meet emerging market demand. It noted that investors are now showing a willingness to reduce yield expectations in order to secure assets which will yield good returns on a medium to long-term basis.
- Based on international experience, loan sales often trade at a discount to asset value. However, the improved market conditions have enabled NAMA to sell a number of loan and asset portfolios without incurring price discounts relative to the pricing that would have been achieved on individual asset sales.

3.30 In regard to competition from other financial institutions with property to sell, NAMA stated that it will continue to be responsive to the supply of assets being released to the market by other participants. It noted, however, that the experience in 2013 and the early part of 2014 has been that demand from the domestic market and particularly international investors has been the dominant influence.

Non-disposal receipts

3.31 A significant challenge facing NAMA is to achieve the balance between generating cash from early disposals and holding properties until prices reach what NAMA considers to be their value in a stable market. Accurate data about the level of recurring income being generated by properties is essential in informing these decisions.

3.32 In 2012, non-disposal receipts of almost €1.5 billion exceeded the forecast for that year by 47%.

- 3.33** In 2013, however, the level of non-disposal receipts fell by 46% from 2012. Analysis carried out by NAMA in late 2013 indicated that around 30% of the non-disposal receipts in 2012 (around €450 million) arose from once-off payments from debtors and did not represent recurring debtor income. This exercise also identified some minor misclassifications of disposal receipts.¹
- 3.34** The level of non-disposal receipts projected for the period from 2014 on is broadly similar to the level of receipts in 2013, after allowing for the scheduled disposal of income generating properties each year. Notwithstanding the decline in non-disposal receipts in 2013, the level of recurring receipts in 2013 indicates that NAMA should achieve the projected level of receipts for the period from 2014 on. Delayed disposals of income generating properties might increase the level of non-disposal receipts above the estimates.

Board monitoring of net receipts from borrowers

- 3.35** The Board receives monthly reports setting out the cash flows to the end of the previous month. The reports also set out, for key NAMA-managed debtors, the main reasons why disposal receipts in respect of debtors vary from expectations. The debtors for whom explanations are provided represent a significant proportion of the total expected cash for the year under review. For example, the report for year-ended December 2012 provided explanations in respect of borrowers representing almost 70% of all expected cash during 2012. However, the reports do not provide explanations as to why non-disposal receipts differ from expectations.
- 3.36** It would be beneficial, therefore, if the reports to the Board also identified the causes of material variances from forecasts in respect of non-disposal receipts. This would assist the Board in determining whether unexpected receipts were due to one-off factors or represented recurring debtor income. This could inform it in strategic decisions about holding or disposing of certain types of property.
- 3.37** In clearing the final draft, NAMA confirmed that a framework for analysis of non-disposal receipts by reference to budget is now in place.

Debt servicing costs

- 3.38** The most significant cost that NAMA faces is the interest expense it incurs on the debt it has issued to participating banks to pay for the loans. NAMA estimates that the total interest expense will amount to around €3.5 billion by the time the final debt repayments are made in 2020. Payments to service the debt in the period to the end of 2012 amounted to €1.1 billion. Figure 3.5 (over) sets out the interest rates applicable to the government guaranteed senior bonds and the unguaranteed subordinated debt.

¹ NAMA continues to review and reclassify disposal and non-disposal receipts on an on-going basis.

Figure 3.5 Interest rate types applicable to NAMA bonds issued

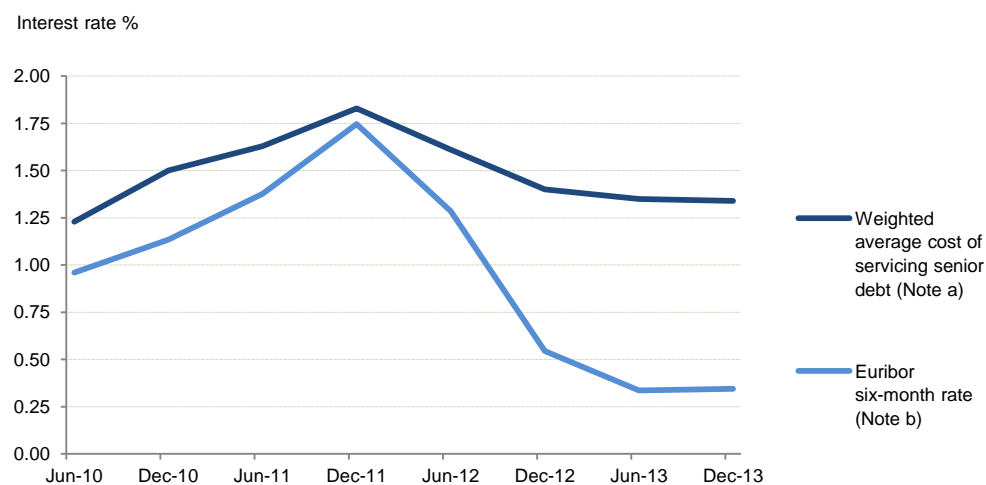
| Debt type | Issue value € billion | Interest rate type |
|------------------------------------|--------------------------|---|
| Government guaranteed senior bonds | 30.2 | Variable rate — six-month Euribor ^a |
| Unguaranteed subordinated debt | 1.6 | Fixed rate — ten-year yield on Irish Government bonds (as at the first issue date of end-March 2010) plus 0.75% (5.264%) ^b |

Source National Asset Management Agency

Note a Euribor (Euro Interbank Offered Rate) is the rate at which euro interbank deposits are offered by one prime bank to another within the Eurozone.

b Payment of interest on the subordinated debt is dependent on NAMA achieving certain financial targets and is at the discretion of the Board of National Asset Management Limited.

- 3.39** In order to address the risk that increases in the six-monthly Euribor rate will make the cost of servicing the senior debt excessive, NAMA has a hedging strategy in place, using interest rate swaps for a substantial part of the senior bonds it has issued. The amount of senior bonds hedged by NAMA and the periods over which the hedges are put in place are reviewed and approved by the Board on a regular basis.
- 3.40** At the end of 2013, NAMA had hedges in place for 55% of the senior bonds that had yet to be redeemed. The weighted average interest rate on senior bond hedges stood at 2.16% at that date and the weighted average cost of servicing senior debt was 1.34%.
- 3.41** In the absence of hedges, NAMA's interest expense on the senior debt would be determined by the six-month Euribor rate. The Euribor rate stood at 0.96% when NAMA issued its first senior bonds in 2010. The movement in the rate between June 2010 and December 2013 and NAMA's weighted average cost of servicing senior debt, including the costs of hedging are set out in Figure 3.6.

Figure 3.6 Movement in NAMA's weighted average cost of senior debt and the Euribor six-month interest rate, 2010 - 2013

Source: National Asset Management Agency

Note: a The weighted average cost of servicing senior debt, excluding subordinated debt, is as at June and December of each year.

b The Euribor six-month rate is set in March and September each year.

- 3.42** Future interest rates are uncertain and NAMA would, in the absence of a hedging strategy, face the risk that future rate increases could increase its overall interest expense significantly. The additional cost at current rates must be weighed against the certainty that is achieved for interest rates on the proportion of debt that is hedged.

Projected cost of servicing the debt

- 3.43** The projected debt servicing cost of €3.5 billion is based on assumptions that NAMA has made about the interest rates up to 2020.¹ There is potential for the cost to be lower than that projected. NAMA's end-2012 projections indicate that it anticipates holding significant cash surpluses each year and it may be in a position to redeem debt earlier than forecast and thereby lower its interest costs.

Operating costs

- 3.44** By the end of 2012, NAMA had paid €294 million in operating costs (see Figure 3.7). Its end-2012 cash flow projections indicate that total operating costs over its lifetime will amount to around €1.2 billion.
- 3.45** The most significant direct operating costs incurred by NAMA were
- Fees payable to primary servicers amounting to €126 million. Primary servicer fees are paid to the participating banks for administering all of the loans acquired by NAMA. The annual fees are set as the lower of 0.1% of the par debt owed by borrowers or the actual costs incurred by the primary servicer.² In 2012, the fees were an average of 0.08% of the borrower par debt.
 - €80 million in administrative costs, which are paid to the NTMA. The most significant component is staff costs which amounted to around €64 million. Personnel who work in NAMA are employed by the NTMA.
 - €78 million in due diligence costs, most of which were recovered in the form of the deduction from expected property disposal proceeds when loans were valued for acquisition.

Figure 3.7 NAMA operating costs, 2010 to 2012

| Cost | 2010 | 2011 | 2012 | Total |
|------------------------------|-----------|------------|------------|------------|
| | € million | € million | € million | € million |
| Primary servicer | 13 | 57 | 56 | 126 |
| Master servicer | 2 | 3 | 4 | 9 |
| NTMA staff | 10 | 24 | 30 | 64 |
| NTMA shared services | 5 | 4 | 7 | 16 |
| Due diligence | 30 | 44 | 4 | 78 |
| Due diligence fees recovered | (30) | (34) | — | (64) |
| Portfolio management | 5 | 16 | 7 | 28 |
| Legal fees | 3 | 9 | 5 | 17 |
| Other | 8 | 5 | 7 | 20 |
| Total | 46 | 128 | 120 | 294 |

1 NAMA uses market forward interest rates when estimating its future interest expense.

2 Par debt refers to the full amount owed by the borrower based on the original terms and conditions with the participating bank and without taking account of any discount applied by NAMA when acquiring the loan.

Source: NAMA Financial Statements, 2010 to 2012

- 3.46** NAMA has made extensive use of external service providers in addition to the primary servicers. These include the master servicer, providers of legal, accountancy and internal audit services, and insolvency practitioners. With the exception of the primary servicers, NAMA procures these services through competitive procurement practices that comply with EU and national procurement requirements. My Office has reviewed the procurement competitions undertaken by NAMA with satisfactory results.¹
- 3.47** In addition to costs borne directly by NAMA, some costs, including debtor overheads, are paid by debtors and receivers from disposal and non-disposal receipts prior to remittance of the (net) receipts to NAMA. Much of the cost of insolvency practitioners is met in this way and, thus, the financial statements disclose neither the income which is retained nor the costs which it is used to discharge. NAMA's approval is required for retention of funds by debtors and receivers. While the costs incurred and funds retained are monitored on a case-by-case basis, NAMA does not maintain a central record of the total amounts that have been retained by debtors and receivers. At the end of 2011, NAMA estimated that just under €900 million would be retained by debtors and receivers between 2012 and 2020 to meet asset management expenses pending disposal.

Obtaining the best achievable financial return

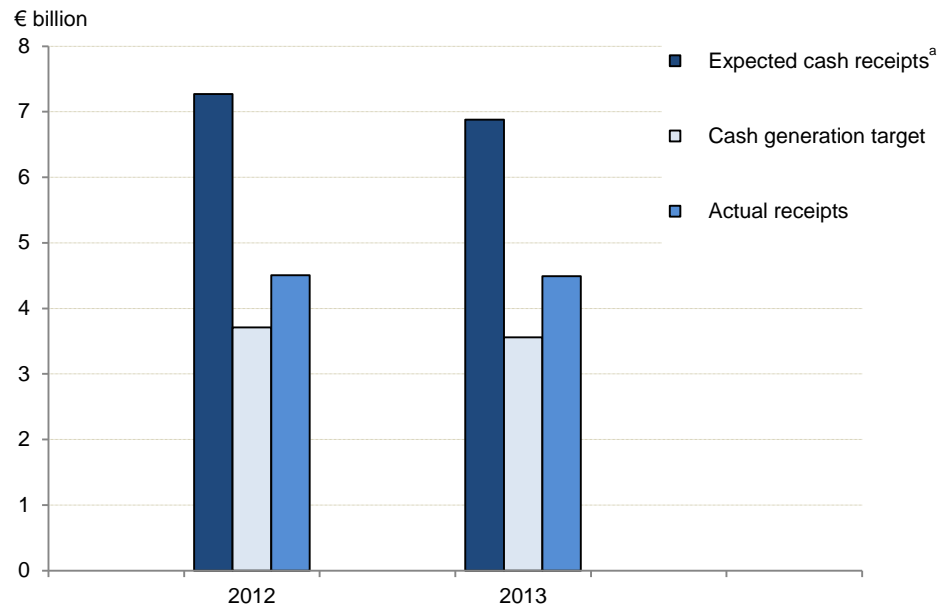
- 3.48** The Act specifically requires NAMA to obtain “the best achievable financial return” for the State. While the rate of return is a key performance measure for investments, NAMA has not set an expected or target rate of return.
- 3.49** In its February 2010 decision about the NAMA scheme, the European Commission stated that a risk margin of 1.7% above the risk-free rate of return was a reasonable estimate of the remuneration that market operators would have required at that time to cover unexpected future losses on assets being acquired. The discount rates used to calculate the acquisition value of loans averaged around 5%. This incorporated two elements
- a risk-free rate of return of 3.25%, which was the weighted average yield on the relevant Irish government bonds as of 21 December 2009 and ²
 - a risk margin of 1.7%.
- 3.50** Accordingly, if the cash flows that were anticipated at loan acquisition had occurred, NAMA would have generated an annual rate of return on investment of 5% and no impairment would have taken place.
- 3.51** The decline in Irish property values since November 2009 and the new lending since then are major factors that have changed NAMA's expectations. The impact of these has reduced the estimated annual return to around 3.8% at the year-end 2012.^{3,4} After debt servicing and operating costs, the projected return was just under 0.2%.
- 3.52** The Board has set an overall financial objective of, at a minimum, redeeming the senior bonds and meeting all costs. The Board intends to meet this objective over the shortest possible time span, having regard to market conditions and to optimising the realised value of assets.
- 3.53** The Board sets an annual cash generation target, which is the key measure by which it monitors progress towards that overall objective. This target has been exceeded in 2012 and 2013 (see Figure 3.8).

¹ In the course of the annual audits of NAMA's financial statements for the years 2010 to 2012.

² The rates were determined by the period over which a loan's cash flows were discounted i.e. 3, 5 or 8 years.

³ The rate of return was estimated by the examination team using NAMA's end-2012 cash flow projections. NAMA does not calculate the expected rate of return.

⁴ Under IFRS, NAMA is required to recognise income at the rate of 5%. However, the loan value on which the interest is calculated has been reduced by the cumulative impairment charges.

Figure 3.8 Gross receipts, 2012 - 2013

Source: Analysis by the Office of the Comptroller and Auditor General

Note: a The expectation for 2012 is using end-2011 cash flow projection. Expectations for 2013 are based on the cash flow projections prepared at the end of 2012.

- 3.54** However, the generation of sufficient cash to meet or surpass short-term targets does not indicate whether the best achievable financial return has been obtained or whether the realised value of assets has been optimised.
- 3.55** For 2012 and 2013, NAMA's expected cash flows anticipated cash receipts around twice the target.

Conclusions and recommendation

- 3.56** By the end of 2012, NAMA had made significant progress towards meeting its first debt redemption target. It had redeemed €4.75 billion of the debt and held cash of around €2.5 billion at that date. By the end of 2013, it had redeemed a total of €7.5 billion of senior debt and met the target. In March 2014, NAMA redeemed a further €3 billion of debt.
- 3.57** The NAMA Board has set a key objective of, at a minimum, redeeming the senior bonds issued to buy the loans and meeting all costs. The Board annually sets a gross cash generation target. The targets are linked to the cash required to meet NAMA's debt redemption and other costs in the following year. NAMA exceeded the cash generation targets in 2012 and 2013.
- 3.58** The Act requires NAMA to obtain the best achievable financial return. The objective of redeeming the debt is not an adequate or relevant performance measure in regard to this specific statutory requirement. While the Board has also set an objective of optimising the realised value of its assets, it has not set an expected or target rate of return. A rate of return takes account of both the cash generated and when it is received.

- 3.59** In the absence of an expected or target rate of return, it is not possible to conclude on the extent to which NAMA's performance to date has contributed to obtaining the best achievable financial return. It is also difficult to assess the impact of accelerated or delayed cash receipts on NAMA's profitability.
- 3.60** The detailed debtor cash flows drawn up by NAMA project a more favourable outcome than the Board's minimum objective. At the end of 2012, the cash flows prepared by NAMA indicated that it anticipated a surplus of around €300 million by 2020, if the assumptions underpinning the cash flows are borne out.
- 3.61** It appears, taking account of NAMA's detailed cash flow projections at the end of 2012 and increased levels of activity in the Irish market in 2013, that unless there is a further significant economic downturn in the next few years, NAMA should meet its minimum objective. NAMA will generate sufficient cash to redeem the senior debt, provided that net receipts from debtors do not fall more than 7% from the end-2012 forecasts for the period 2013 to 2020 and costs are not higher than forecast.
- 3.62** If the net receipts from debtors occur as projected, then NAMA will be holding significant cash balances and may be in a position to redeem debt earlier than its strategic plan anticipates.
- 3.63** In aiming to optimise the value of assets, a significant challenge facing NAMA is to achieve an appropriate balance between generating sufficient cash from disposals to meet its debt redemption targets, and making decisions on whether to hold properties for future disposal taking into account both the level of income being generated by a property and NAMA's view about the prospects for increases in value.

Recommendation 3.1

The Board should set an overall expected or target rate of return and measure overall performance against this target. This should be reviewed annually taking into account revised expectations for individual debtors and for property types and locations, including disposal values and rental income.

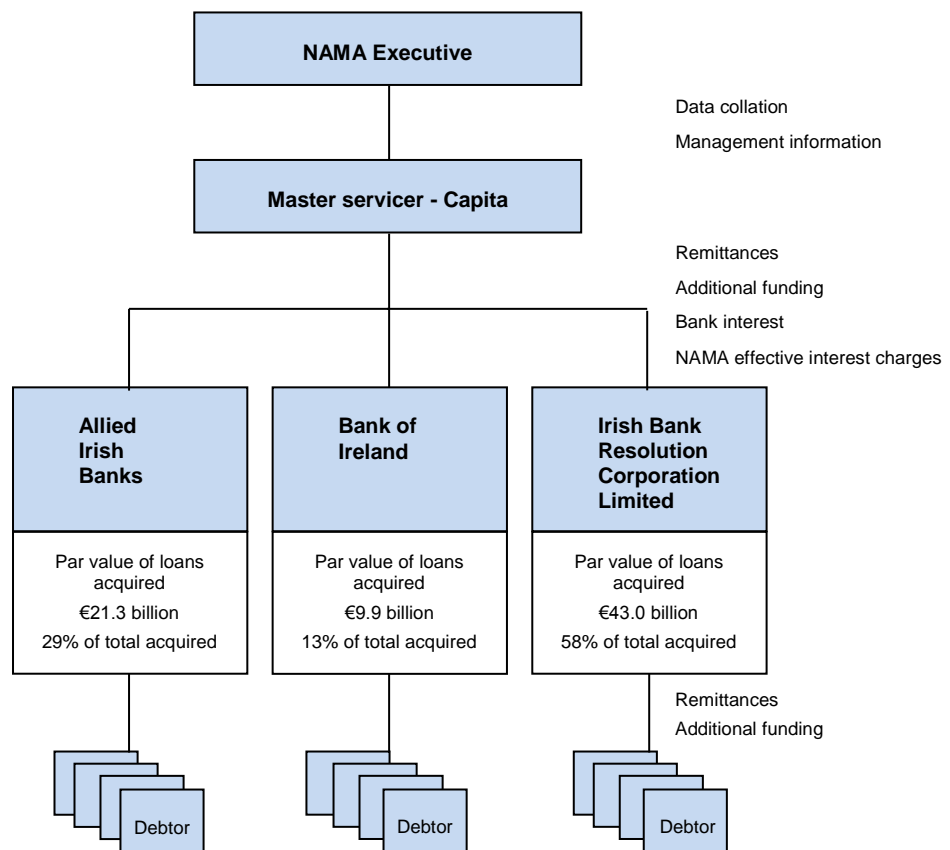
Chief Executive Officer's response

Not accepted. NAMA is not a long-term pension/investment fund. The Board considers that setting a target rate of return would act as an unnecessary constraint on its flexibility, particularly given the imperative that it be open to commercially sensible disposal opportunities whenever they arise, and given also the stated objective of the Minister for Finance that NAMA should complete its work of deleveraging its portfolio as soon as possible. Furthermore, the detailed annual impairment review includes a net present value of all expected future cash flows and this is reconciled to the Board's strategic plan.

4 Debtor Management

- 4.1** One of the first steps NAMA needed to take was to put arrangements in place for administration of acquired loans. Because many borrowers had multiple loans with more than one of the participating banks, all loan data was collated in order to provide NAMA with a complete record for each debtor.
- 4.2** In 2010, NAMA appointed each of the participating banks to act as primary servicers and Capita Asset Management Services (Capita) as master servicer for the loans NAMA had acquired. In 2013, following the liquidation of the Irish Bank Resolution Corporation (IBRC), Capita was also appointed as primary servicer for the loans administered and managed by IBRC. The loan administration arrangements are set out in Figure 4.1.
- 4.3** The participating banks carry out their roles as primary servicers in accordance with directions issued by NAMA under section 131 of the Act. The primary servicer role includes maintaining and updating debtors' loan records, processing receipts from debtors and transferring cash received to NAMA, and reporting all transactions to the master servicer. Primary servicers' performance is measured against a series of indicators, for example in relation to the timely transfer of cash to NAMA. In 2012, almost all of the service level targets were met by all of the primary servicers. Primary servicer fees for 2012 amounted to €56 million.¹

Figure 4.1 NAMA loan administration arrangements



¹ Total paid to primary servicers over the period 2010 to 2012 was €126 million.

- 4.4 The master servicer, Capita, is responsible for the collation and validation, by debtor connection, of all loan information submitted by the primary servicers. It also provides centralised reporting and management information services to NAMA. Capita's performance is also measured against a series of monthly performance indicators. In 2012, all targets were met. Capita's fees for the three years to end-2012 amounted to €9 million.
- 4.5 In 2012, NAMA's internal audit carried out a review of the master servicer and reported that, while there were a number of areas where improvement was needed, none of these were rated as high risk.

Debtor management

- 4.6 NAMA directly manages those debtors who owed approximately €75 million or more when their loans were acquired. The remainder are managed by the participating banks under delegated authority from NAMA and under NAMA's supervision.¹ At the end of 2012
- NAMA was directly managing 189 debtors, whose debt totalled around €61 billion at acquisition — 82% of the loans acquired. NAMA paid around €27 billion for this debt — a 56% write-down.
 - The remaining 586 debtors are managed by the participating banks. Their cumulative debt at acquisition amounted to €13 billion for which NAMA paid around €4.8 billion — a 63% discount.
- 4.7 Appendix C sets out the management activities carried out by NAMA and the participating banks under each management arrangement.

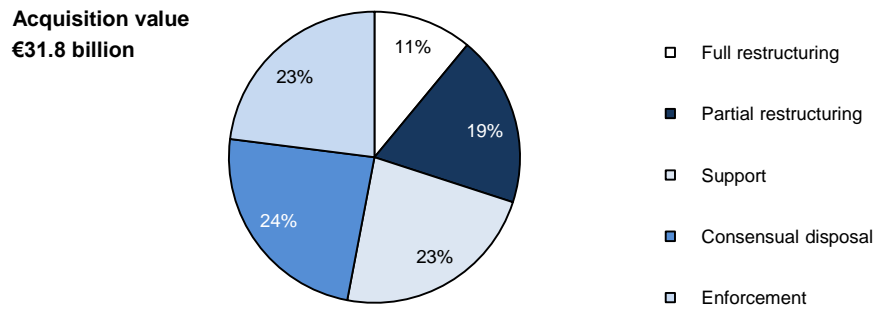
Debtor strategies

- 4.8 Each debtor was asked to submit business plans setting out how they proposed to discharge their debt to NAMA. The plans submitted were reviewed by NAMA while the plans submitted by the NAMA-managed debtors were also reviewed by independent business reviewers appointed by NAMA.
- 4.9 By July 2012, NAMA had reviewed the position of all debtor connections. This was broadly in line with targets set by the Board. NAMA has adopted five debtor strategy types. These are
- **Full restructuring** of debt occurs when existing loan agreements are replaced by new loan agreements with revised terms and conditions, including restructuring the loans into primary and secondary loans.
 - **Partial restructuring** of debt is similar to full restructuring but new loan agreements are not put in place. A 'connection management agreement' between NAMA and the debtor sets out the terms for implementing the business plan.
 - **Support for the debtor** subject to attainment of certain milestones set by NAMA.
 - **Consensual disposal strategy** over a relatively short-term horizon.
 - **Enforcement** usually occurs where either a plan that is acceptable to NAMA cannot be agreed or a debtor does not co-operate with NAMA.

Debtor strategies as at 31 December 2012 are summarised in Figure 4.2.

¹ NAMA's Delegated Authority Credit Policy is approved by the Board.

Figure 4.2 Debtor strategies adopted at 31 December 2012, as a % of loan acquisition



Source: National Asset Management Agency

- 4.10** At the end of 2012, NAMA had appointed insolvency practitioners (usually receivers) to some or all of the assets of around a quarter of debtors.
- 4.11** In April 2013, the insolvency team in NAMA reported to the Board on insolvency practitioner performance and concluded that, overall, insolvency practitioners were either meeting performance expectations or there were only some minor reservations about their performance.

Day to day management of debtors

- 4.12** The Board has issued guidance on how individual debtors are to be managed. The asset recovery team has responsibility for day to day management of the majority of debtors, including ongoing review to assess the extent to which targets have been met, to review a debtor's credit grading and to consider whether the strategy adopted continues to be appropriate.
- 4.13** NAMA's credit and risk policy requires that each debtor will be subject to strategic credit review at least annually.¹ All NAMA-managed cases had been subject to at least one review by the end of 2012. However, the system for recording reviews for the smaller debtor cases managed by the participating banks was not completely developed by the end of 2012. NAMA has estimated that, at the end of December 2012, for 27 debtors out of the 586 managed by the participating banks, strategic credit reviews were overdue.
- 4.14** Debtors and insolvency practitioners are required to submit periodic reports (at least twice annually) to NAMA about their performance, including cash flows generated from key properties compared with previous forecasts. In addition, in some instances, NAMA requires debtors to appoint financial monitors, with a duty of care to NAMA, whose remit is to report to NAMA on the completeness and accuracy of information provided by the debtor, both in relation to historical and future activity and performance against agreed milestones. At the end of 2012, 97 of the NAMA-managed debtors had such monitors appointed.
- 4.15** The Credit Committee oversees the credit review functions and is presented with quarterly reports from quality assurance teams who review the management of debtors.² In addition, the Board and Committee carry out bi-annual reviews of the strategies for the largest debtors, who account for around 50% of NAMA's debt.³

1 NAMA's Credit and Risk Policy Framework, 18 January 2011.

2 NAMA's Credit Committee is a statutory committee of the Board. Its terms of reference are reviewed and approved annually by the Board.

3 Under delegated authority, all cases with NAMA debt levels greater than €250 million are reviewed by the Credit Committee and those greater than €500 million are referred to the Board, following review by the Credit Committee. The practice with the larger cases is for them to be reviewed 3-4 times in a year.

Quality reviews

- 4.16** NAMA has established a quality review team within the Audit and Risk Division. Its function is to test the application of NAMA's debtor management policies. Tests are carried out on a selection of debtors under each of the debtor management teams, including the participating banks. The objectives of the quality assurance reviews are to
- ensure that delegated authorities are being used appropriately and responsibly
 - assess the quality of decision-making and management of the assets
 - test adherence to NAMA policy and internal policies in participating banks.
- Performance is assessed as follows
- red status — multiple breaches of policies
 - amber — marginal breaches of policies or scope for improvement
 - green — satisfactory.
- 4.17** The first quality assurance report in respect of NAMA-managed debtors was issued in August 2011.
- 4.18** The review gave an overall rating of amber and concluded that case managers displayed that they understood their debtors and current developments in the cases. However, the review noted that there was an absence of relevant documentation apparent when reviewing files, in particular, documentary evidence confirming adherence to conditions of sanction, tracking milestones and monitoring of legal work or documentation. It concluded that this appeared to be due to lack of a formal diary or monitoring system and a lack of clarity around the roles and responsibilities both within NAMA and between NAMA and the participating banks.
- 4.19** A further review in July 2012 noted that while there were improvements in some respects, there were also deteriorations in others, in particular in credit management processes. While a review in May 2013 of NAMA-managed debtors, again gave an overall amber rating, it did note that there had been improvements in the areas of credit management analysis, credit processes and administration.
- 4.20** In February 2012, the first reviews of debtor management in the participating banks were completed. Each bank was given an amber rating. The reviews concluded that there was a lack of evidence of comprehensive credit risk analysis, along with other administrative shortcomings across all three participating banks.
- 4.21** Further reviews of the management of debtors by participating banks were completed before the end of 2012. The reviews noted that some delays were evident in agreeing strategies for debtors in the cases managed by participating banks. One of the participating banks received a green rating overall while the other two received amber ratings overall.

4.22 NAMA's internal audit function has also carried out a number of examinations regarding the administration and management of debtors.

- In 2011, a report by internal audit concluded that NAMA's portfolio management process was partially effective.¹ The internal audit report noted that the absence of a formal system and diary for monitoring progress by debtors against milestones (for example, cash recovery) was an issue which needed attention, while a number of other issues also needed to be addressed by NAMA.
- In 2013, internal audit concluded that debtor management in two participating banks was effective while it was rated as partially effective in the third. The main issues noted across all participating banks were the need for setting cash recovery targets for debtors and monitoring performance against target. NAMA stated that cash recovery targets were set by NAMA for the participating banks in 2013.

Credit decisions

4.23 The Board, or the relevant delegated authority, has the authority for credit decisions.

4.24 NAMA's credit framework sets out the delegated authority levels for credit decisions. The level of approval required for each credit decision is determined by the amount of the debtor's outstanding debt and the value of the proposed transaction. Credit decisions include approval of debtor strategy reviews, advances of funds by NAMA to debtors, retention of funds by debtors from operating or disposal income, amendment or extension to loan and overdraft facilities available to debtors, enforcement action, loan impairment, disposal decisions and asset management decisions.

4.25 From inception to December 2012, there were a total of around 20,000 credit decisions made of which 13,700 were in 2012. Approximately 18,200 credit requests were approved, while about 1,800 were declined. The approved decisions comprised (approximately)

- 7,400 decisions approving additional debtor expenditures amounting to about €2.3 billion, of which €1.7 billion was to be advanced by NAMA. NAMA has not classified these approvals between capital and operational categories of expenditure
- 800 decisions amending loan and overdraft facilities, including facility extensions, restructure of and refinancing of debts owed by NAMA debtors
- 2,800 approvals of asset sales
- 2,500 decisions regarding lease arrangements
- 600 appointment decisions, mainly related to enforcement
- 4,100 other debtor and asset review decisions
- 60 debt compromise decisions
- 2 decisions regarding vendor finance.

4.26 In 2012, NAMA has estimated that the average time taken to process decisions, from the time of receipt of the application from the bank to the time of the decision within NAMA, is around five working days against an internal target of seven working days.

¹ A partially effective rating by internal audit indicates that all key controls are operating other than one or two isolated exceptions. A number of control improvements are required or a strengthening of the area's risk management / control culture is needed.

Debtor performance

- 4.27** By the end of 2012, the loan balances on NAMA's books amounted to €26 billion before impairment charges of almost €3.3 billion.¹ At that time, NAMA also anticipated that it would make gains of around €1.4 billion in present value terms, from some borrowers.²
- 4.28** The strategic credit review for each debtor includes a credit grading whereby the debtor is rated by reference to the expectation of recovery of NAMA's carrying value of the loans and whether the debtor is impaired. The gradings are
- **High recovery rating** when the net present value of the future cash expected from the debtor is greater than the carrying values of the NAMA loan. This grade is applicable (where appropriate) to NAMA-managed debtors only.
 - A **medium recovery rating** occurs when the anticipated future cash receipts undiscounted are greater than the carrying value of the loan. In the case of NAMA-managed debtors, this grade is assigned if the net present value of the cash receipts is less than the carrying value of the loans and, therefore, impaired. In cases managed by participating banks, individual net present value calculations have not been carried out, so the extent to which individual debtors graded as medium recovery are impaired is not known.
 - A **low recovery rating** occurs when the anticipated future undiscounted cash receipts are less than the carrying value of the loan.
- 4.29** Figure 4.3 sets out the value of NAMA debt in each rating category in late 2012.

Figure 4.3 Credit grading of debtors at end 2012^a

| | Carrying value of debt ^b | | |
|-------------------------------------|-------------------------------------|------------------------------------|--------------------|
| | NAMA € billion | Participating bank € billion | Total € billion |
| High recovery rating (not impaired) | 8.6 | — | 8.6 |
| Medium recovery rating ^c | 7.8 | 1.4 | 9.2 |
| Low recovery rating (impaired) | 5.5 | 2.7 | 8.2 |
| Total | 21.9 | 4.1 | 26.0 |

Source: National Asset Management Agency

Note: a No credit grading had been assigned to five NAMA debtors with a carrying value of €74 million.

b Does not include borrower derivatives.

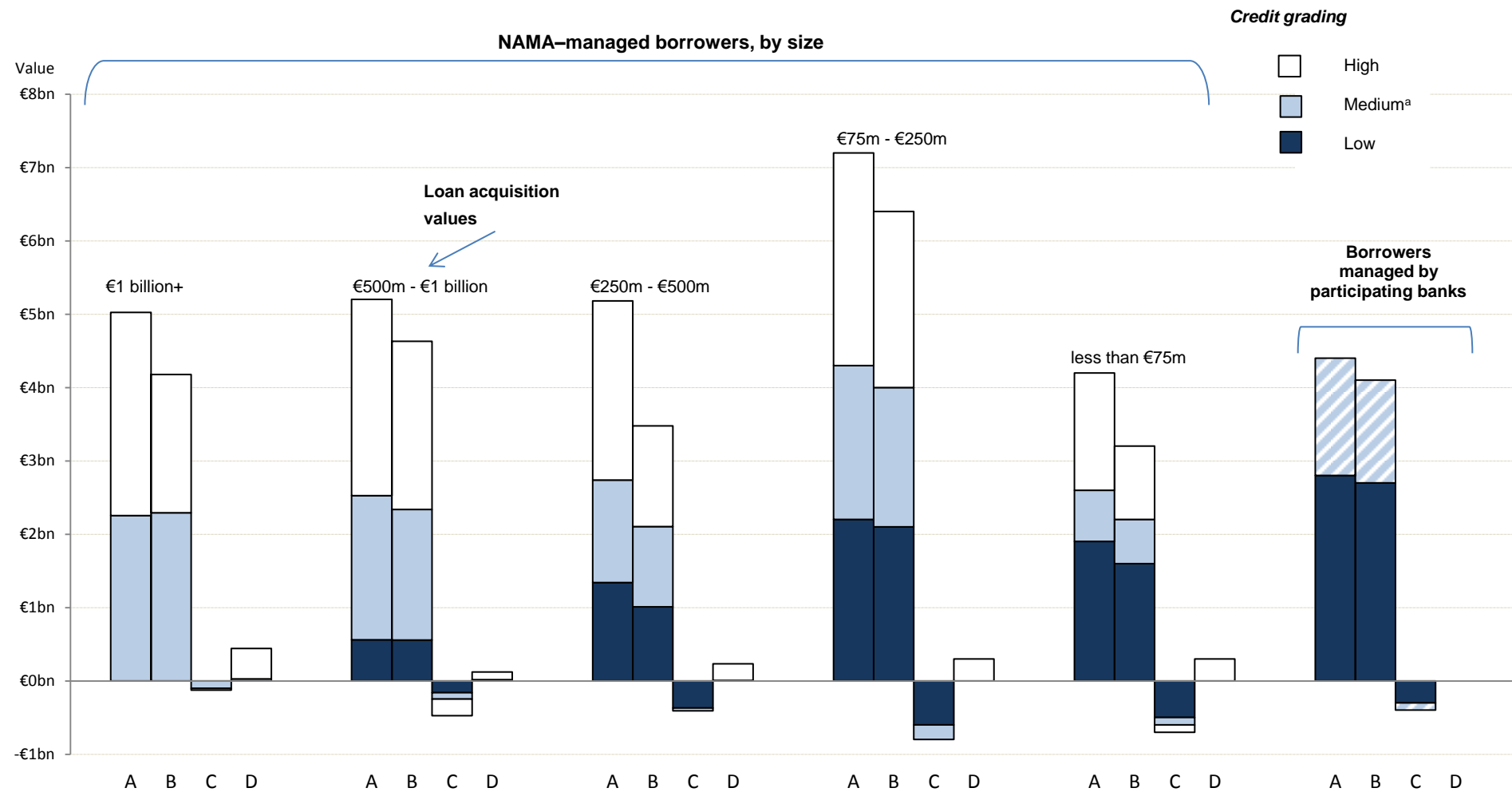
c The NAMA-managed debtors are impaired. The impairment status of the debtors managed by the participating banks, where cash generation expectations are greater than the carrying value of the debt, is unknown because the net present values of the expected cash flows have not been calculated.

- 4.30** Figure 4.4 sets out the performance by debtors in each credit grading, stratified into four categories, measured against the loan acquisition values. For each category of debtors
- **A** shows the total value of the debt at acquisition
 - **B** shows the total balance of the NAMA debt at end-2012 before impairment charges - the balance at acquisition less any cash received since acquisition plus accrued interest and advances to the debtor
 - **C** shows the cumulative impairment at 31 December 2012
 - **D** shows the net present value of future expected gains.

1 In addition to loan balances debtors owed around €300 million in respect of financial derivatives.

2 When loans were acquired, borrowers continued to owe NAMA the full amount of their loans although NAMA, generally, paid less than face value for them. Any amounts recovered by NAMA in excess of the amounts paid, for example arising from increased property values in London, represent gains for NAMA. In addition, development arising from further funds advanced by NAMA provides further anticipated gains, again most notably in London.

Figure 4.4 Recovery expectations classified by size of acquisition debt, December 2012



Source: Analysis by the Office of the Comptroller and Auditor General

Note: a The NAMA-managed debtors are impaired. The impairment status of the debtors managed by the participating banks, where cash generation expectations are greater than the carrying value of the debt, is unknown because the net present values of the expected cash flows have not been calculated.

NAMA-managed debtors

- 4.31** While the average impairment charge for all NAMA debtors was around 12% at the end of 2012, the level of impairment varied between groups of debtors and showed a correlation with the level of individual debt levels.
- Impairment was around 4% for those debtors for whom loan acquisition values exceeded €1 billion.
 - It was around 12% where loan acquisition values were between €250 million and €1 billion.
 - For those debtors where NAMA paid between €75 million and €250 million for their debt, the impairment charge at the end of 2012 was around 14%.
 - In cases where the loan acquisition values were less than €75 million, the impairment charge was 21%.
- 4.32** Generally, the level of impairment for each grouping of debtors is broadly consistent with what might be expected given the debtors' credit gradings. Some debtors, whose credit grading is high, were in fact impaired at the end of 2012 when their detailed projected cash flows were compiled. The apparent discrepancies may be due to a change in the debtor's impairment status between when the debtor's credit grading was reviewed in 2012 and the end-2012 detailed cash flow exercise. NAMA should review those cases where there is inconsistency between the credit grading and impairment status to ensure that the credit gradings are kept up to date as this is key management information.
- 4.33** NAMA stated that, in some cases, there may be a temporary misalignment between credit grade snapshots taken at year-end and the outcome of individual connection impairment reviews and provisions that are, typically, completed in March. It also stated that, for 2014 and subsequent years, it has been decided that credit grades will be updated as soon as impairment provisions have been finalised and approved by the Board.
- 4.34** The highest level of net debt reduction was in the group whose acquisition debt was between €250 million and €500 million.¹ The carrying value of debt, before impairment, for this group fell by a third between loan acquisition and the end of 2012 while the reduction for the other groups was between 10% and 21%.
- 4.35** The end-2012 cash flows also showed that NAMA anticipates that it will recover more than the carrying value of the debt for some debtors (all with a high credit grade). The largest gains are anticipated for the small number of debtors whose debt at acquisition exceeded €1 billion. In total, at the end of 2012, NAMA anticipated that the net present value of prospective gains was of the order of €1.4 billion. The cash flows giving rise to these prospective gains are included in the total net cash expected from borrowers set out in chapter 3.

Debtors managed by participating banks

- 4.36** The carrying value of the debt for debtors managed by the participating banks had reduced by around 15% from €4.8 billion to €4.1 billion between loan acquisition and the end of 2012. The average cost of acquiring these loans was just over €8 million, ranging from one euro to just under €60 million.

¹ Changes in debt arise from interest charged by NAMA, additional funds advanced by NAMA and repayments by the debtor.

- 4.37** The debtors managed by the participating banks have not been subjected to discounted cash flow analysis. At the end of 2012, the average impairment rate of just over 12% for all NAMA-managed borrowers was applied to those managed by the participating banks, because NAMA assumed that the profile of the property collateral held by these debtors was broadly similar to that held by the NAMA-managed debtors.
- 4.38** However, the impairment trend in Figure 4.4 indicates that the level of impairment is higher for those borrowers with lower debt levels. When this is combined with the proportion of debtors managed by the participating banks with a low debt recovery expectation (65% compared with 25% for NAMA-managed debtors), it suggests that the level of impairment for the borrowers managed by the participating banks is likely to be higher than the average impairment for the NAMA-managed borrowers.

Steps taken by NAMA to optimise income from debtors

- 4.39** The overall performance of debtors is influenced by a number of factors including changes in property values since 2009, the extent to which NAMA has maximised non-disposal receipts or acquired previously unencumbered assets and any gains arising from further development of assets.
- 4.40** In its 2012 strategic plan, one of the key objectives set by NAMA is to manage assets intensively and, where appropriate, to invest in them to optimise their income producing potential and disposal value. In order to achieve this objective, NAMA has, inter alia,
- taken steps to maximise rental and operating income
 - acquired previously unencumbered assets as additional collateral for loans
 - advanced funds to debtors for operational and capital expenditure (this is dealt with in chapter 5).

Rental and operating income

- 4.41** Rental income from letting of debtor properties and operating income from debtor companies are the main sources of non-disposal receipts. When NAMA acquired loans, the value of the cash flows associated with a property comprised both anticipated disposal proceeds and rental income. Around an estimated 15% of the present value of property cash flows at acquisition was attributable to expected rental income.¹
- 4.42** After its acquisition of loans, NAMA concluded that there had been significant and widespread leakage of funds when the loans were owned by the participating banks. Most of the losses were of rental income, which should have been applied by debtors towards debt repayment. NAMA found that, while rental income was being generated by properties, debtors had not generally been required to remit that rental income to a controlled bank account and the banks had poor visibility over the application of the income.
- 4.43** As part of the NAMA debtor business plan review process and on-going management of debtors, rental and other non-disposal incomes are identified and arrangements put in place to remit these to NAMA. In some cases, particularly where NAMA works closely with the debtor's management team, an annual budget is agreed for debtor overhead and asset management costs and spending is controlled and monitored.

¹ The present value of the property cash flows is set out in Figure 2.2.

- 4.44** In some cases where rental income is substantial, NAMA requires that agents (with a duty of care to NAMA) be appointed to collect rents and to discharge associated property expenses. Rents are lodged to bank accounts over which NAMA has imposed security arrangements that preclude the release of funds. This is in addition to the control that NAMA has in place in some cases through the appointment, by the debtor, of a financial monitor with a duty of care to NAMA to report monthly on the collection of rental income and overhead expenses incurred.
- 4.45** Other factors influencing the level of rental income include reductions in some rental levels, some tenants going out of business and the low level of growth in the Irish economy. On the other hand, new lettings — particularly in the residential sector — have provided additional rental income. Chapter 5 provides further data on the rental income being generated by the property portfolio held by NAMA-managed debtors.
- 4.46** By the end of 2012, NAMA had received just over €2.7 billion from debtors' rental and operating income from debtors. The amount of recurring rental and operating income has fallen by around €300 million each year since 2011 as a large proportion of disposals have been of income-generating properties. In 2013, non-disposal receipts amounted to just under €800 million.
- 4.47** A NAMA internal audit carried out in 2012 concluded that systems in place for the control and management of non-disposal income were partially effective. The main deficiencies noted were the absence of duty of care agreements with property management agents or financial monitors engaged by debtors, an inconsistent approach to remitting cash receipts to NAMA and inconsistencies in monitoring of non-disposal receipts.

Securing unencumbered assets

- 4.48** As part of the business plan process, debtors were required to submit a sworn statement of affairs that included details of any unencumbered assets. In some cases, NAMA has conducted asset searches designed to verify debtors' asset statements.¹
- 4.49** It is an offence to provide false or inaccurate information in the statement and by the end of 2012, NAMA had made two formal complaints to the Garda Bureau of Fraud Investigation regarding possible failures by debtors to properly disclose their affairs.
- 4.50** In circumstances where NAMA identifies assets in the course of the business plan process (or otherwise), it requests the debtor to make the assets available as a condition of NAMA continuing to support the debtor. From inception to the end of 2012, NAMA had obtained charges over additional security with an aggregate value of about €642 million from 47 debtors. The values of the assets secured ranged from €14,000 to €179 million.²
- 4.51** The €642 million includes around €160 million arising from the reversal of transferred assets, whether by agreement with NAMA or following court action.³
- 4.52** Other sources of assets obtained as additional security include excess collateral identified in the course of loan valuations and assets that were made available to NAMA arising from personal guarantees.

¹ By the end of 2012, asset searches had been completed in respect of 95 debtor connections and further assets valued at €32 million had been identified.

² NAMA estimates that it will ultimately take over assets to the value of about €800 million.

³ Transferred assets are those transferred by a debtor to a related party in the last five years at less than market value.

Conclusions and recommendation

- 4.53** NAMA has adopted five broad approaches to dealing with debtors. Following review of each debtor's position, including appraisal of business plans submitted by debtors, NAMA had strategies in place for all debtors at the end of 2012. Enforcement strategies had been put in place in relation to debtors who held around 20% of the debt at acquisition.
- 4.54** A debtor grading system has been put in place but there have been some delays in updating debtors' credit gradings following impairment reviews.
- 4.55** Impairment charges of €3.3 billion were recognised by NAMA at the end of 2012. For NAMA-managed debtors, the rate of impairment increases as the size of the debt decreases.
- 4.56** Using an assumption that the profile of the property collateral held by the debtors managed by the participating banks is broadly similar to that held by the NAMA-managed debtors, the average rate of impairment for NAMA-managed debtors has been applied to the debt managed by the participating banks. This assumption may no longer be appropriate, given the apparent inverse relationship between the rate of impairment for NAMA-managed debtors and debt levels, and the fact that a higher proportion of debtors managed by the participating banks have a low credit grading.

Recommendation 4.1

NAMA should carry out a detailed review of the participating bank-managed portfolio to test its impairment assumption and to determine whether the characteristics of the property collateral held by debtors is significantly different to that held by the NAMA-managed debtors (for example, debtors managed by the participating banks may hold a higher proportion of Irish property).

Chief Executive Officer's response

Accepted. This more detailed analysis has been underway for some months as part of the end-2013 impairment review and will be further supplemented by the next semi-annual impairment review that will be carried out in June 2014.

5 Loan Collateral Management

5.1 The focus of this chapter is on NAMA's management of property assets pledged as collateral by debtors. The chapter sets out

- the location of property at acquisition and at the end of 2012
- property management strategies adopted by NAMA
- disposal of property collateral to end December 2012
- the expected return on the collateral portfolio
- lending by NAMA for development
- key risks to the remaining portfolio.

Location of property

5.2 At the time of acquisition, real estate property pledged as collateral for NAMA loans comprised around 10,700 properties and around 59,000 individual units. 54% of the value of properties was in Ireland, 34% in Great Britain (of which two-thirds was in London) and 4% in Northern Ireland. Most of the remainder was in Europe.

5.3 At the end of 2012, around 82% of property collateral acquired remained unsold. Due to the high level of disposals in London up to the end of 2012, the geographical distribution of the property had changed significantly.

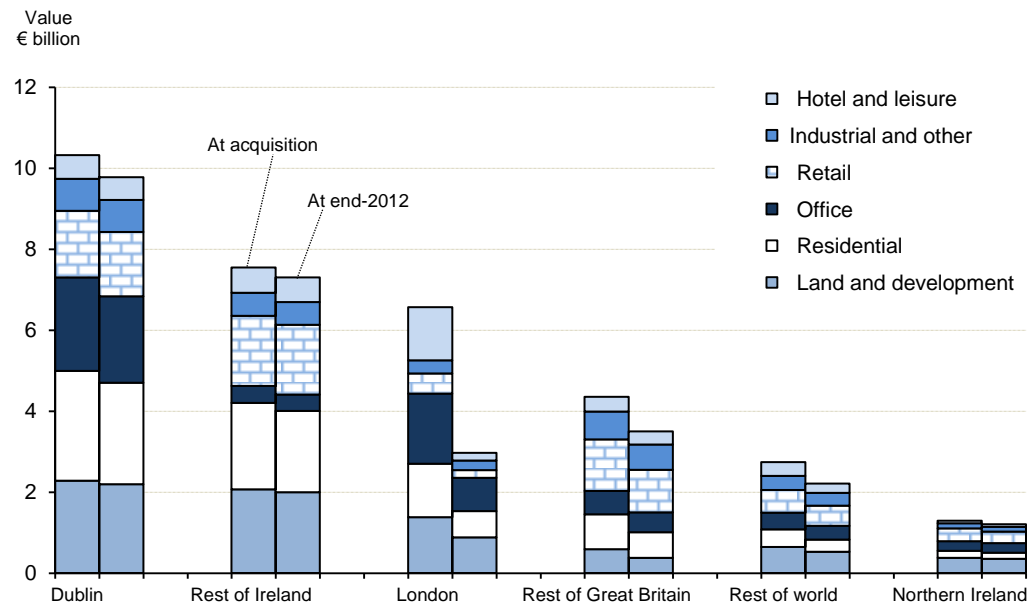
- Property in Ireland had increased to 63% of the total.
- Property collateral in London had fallen from 20% of the portfolio at acquisition to 11% at the end of 2012.
- The proportion of the portfolio in the other locations was broadly unchanged since acquisition.

5.4 By mid-2013, NAMA had put details of every property provided as loan collateral onto its portfolio management system. In the course of that exercise, NAMA reviewed the values, categories and locations of properties by reference to the source data and took account of significant changes since the loans were acquired. There were some changes to the profile of the portfolio from the profile at acquisition.

- The classification of some properties had changed since the loans were acquired. For example, some development projects had been completed or substantially completed and these properties were reclassified as residential or commercial.
- Some properties had been classified as investment properties at acquisition, as the debtor was renting out the property, and these properties were re-classified as residential.
- Some classifications at loan acquisition were corrected. For example, some commercial properties originally classified by property valuers as 'other' were reclassified as retail properties by NAMA.

5.5 Figure 5.1 sets out the property collateral acquired by location and categories of property at acquisition and at the end of 2012.

Figure 5.1 Collateral acquired and collateral still held at end-2012, by category and location



Source: National Asset Management Agency — Portfolio Management System

Property management strategies

5.6 A key challenge for NAMA was to develop an approach to property collateral that would enable it to achieve its objective of maximising the income producing potential and disposal value.

5.7 Property values in Ireland continued to decline after loan acquisition. During 2011, NAMA adopted a number of individual strategies to guide its management of property assets. NAMA considered three broad strategies for each sector — whether to dispose of properties in the short-term, to hold them for later disposal or to add value through further development. Different strategies were adopted for

- investment properties, where the approach adopted was, in general, to sell property in London, hold property in Ireland and assess other markets
- completed residential assets, where the preferred approach was rental of properties generating rental yields of 5% or more
- hotels, where the strategy was to progress the early sale of hotels in Great Britain and Europe and protection of the recoverable value of Irish hotels until conditions improve
- land and development assets, where NAMA concluded that demand would return at a different pace in individual markets. Weak demand was expected to continue in Ireland in the medium-term.

Disposals to end-2012

- 5.8 By the end of 2012, NAMA debtors and receivers had sold property for €6.8 billion — a net excess of almost €1 billion over their 2009 valuations. Figure 5.2 sets out the property sales up to the end of 2012, by location.

Figure 5.2 Property collateral sold at the end of 2012 by location^a

| | Collateral sold November 2009 value | Proceeds of disposal | Proceeds excess/(deficit) over November 2009 values |
|-----------------------|---|-------------------------|---|
| | € billion | € billion | € billion |
| Dublin | 0.5 | 0.4 | (0.1) |
| Rest of Ireland | 0.2 | 0.2 | — |
| Northern Ireland | 0.1 | 0.1 | — |
| London | 3.6 | 4.7 | 1.1 |
| Rest of Great Britain | 0.9 | 0.9 | — |
| Rest of world | 0.5 | 0.5 | — |
| Total | 5.8 | 6.8 | 1.0 |

Source: NAMA Portfolio Management System

Note: a Includes the proceeds of both loan and property disposals.

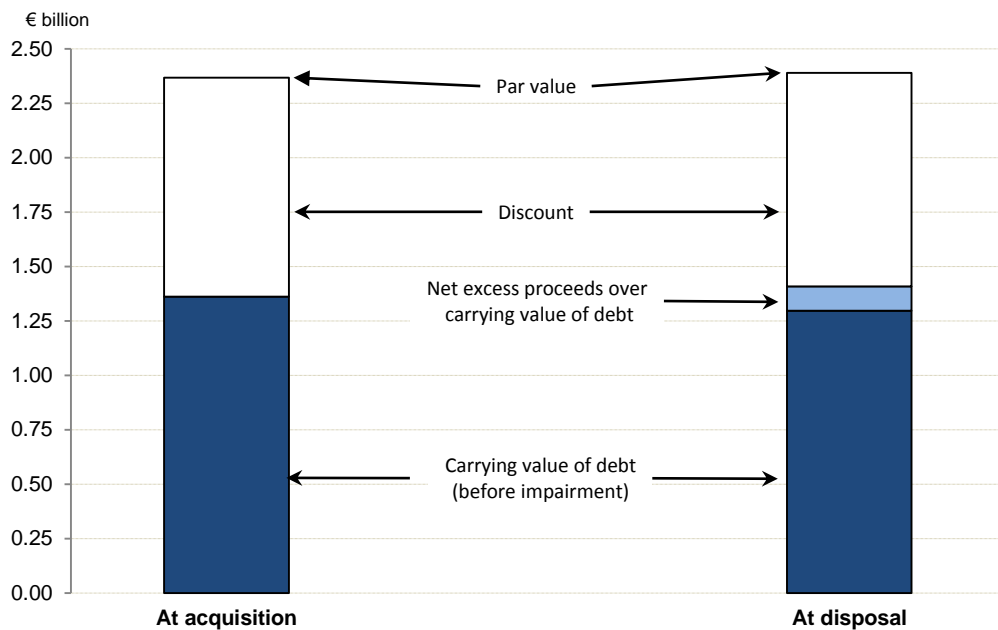
- 5.9 The extent to which additional costs in the form of capital investment were incurred for these properties either through funds retained by developers or advances from NAMA between November 2009 and the dates of disposal is not available on a summary basis.¹ Therefore, it is not possible to conclude on the extent to which the excess of €1 billion would be reduced by such costs.
- 5.10 By the end of 2012, around 18% of the property collateral (at 2009 valuations) had been sold. In accordance with NAMA's disposal strategies, disposals have been concentrated in Great Britain.
- In London, where net proceeds amounted to €4.7 billion, 55% of the property collateral acquired had been sold. (The trend continued in 2013 — further disposals in London amounted to €2 billion and accounted for around 54% of NAMA's net disposal proceeds in 2013).
 - Around 20% of the collateral in the rest of Great Britain and the rest of the world had been sold.
 - In Ireland, just 4% of the property collateral had been sold by the end of 2012 and a similar proportion had been disposed of in Northern Ireland.

¹ Detailed information about properties, including capital investment, after November 2009, is held by the manager in NAMA with responsibility for a debtor whose property is being sold. That information is available when decisions whether to approve a proposed disposal are made. However, the information has not been collated by NAMA.

Loan disposals

5.11 By the end of 2012, NAMA had disposed of 16 loans relating to 13 borrowers for €1.4 billion. Figure 5.3 sets out an overview of the loan sales from inception to the end of 2012.

Figure 5.3 Loans sold from inception to end-2012^a



Source: National Asset Management Agency

Note: a Between acquisition and disposal of the loans there was a net increase in the par value debt of €21 million and a net reduction in the carrying value of the loans of about €65 million. The changes were mainly due to a combination of cash received and interest applied. Differences in the amount by which par value and carrying value change arise mainly because of different interest rates and amounts charged by banks and NAMA.

5.12 NAMA sold the loans for a cumulative €1.4 billion, a gain of €112 million over the amount due to NAMA when the disposals occurred.¹

Property disposals

5.13 As part of this review, the disposal process for a sample of 144 properties with gross proceeds of about €1.3 billion was examined. The results of the examination showed that 118 disposals were openly marketed. The gross proceeds, before selling costs, amounted to around €1.1 billion or 85% of the value of the disposals reviewed. Independent valuations had not been obtained for 19 of these prior to disposal.

¹ NAMA had recorded gains of €93 million on loan disposals by the end of 2012. €19 million in gains were not recognised in the financial statements as the debtors were impaired on other loans.

- 5.14** There was no evidence of open marketing of 26 properties.
- In 15 cases, the reasons put forward for the lack of open marketing were reasonable. These included, for example, contractual options for the purchase being in place before NAMA acquired the related loan or where the sale was agreed prior to acquisition by NAMA. The total gross proceeds from the sale of these properties were around €151 million.
 - The sales, with gross proceeds of €12.1 million, of six other properties not openly marketed, were to state bodies in Ireland or Great Britain.
 - In one case, a property was sold in Ireland for €27 million. Extensive marketing had been conducted over an eight week period, and a winning bid chosen from a shortlist. This transaction failed to complete. Another party, not previously included on the shortlist, completed the purchase at the same price five months after the end of the marketing campaign. No evidence was provided to show how the purchaser was selected. Nor was there any evidence of the asset being returned to the market after the failed initial competition. NAMA stated that it engaged with the eventual purchaser, who had previously expressed interest in acquiring NAMA-controlled assets. NAMA also stated that its view was that it would have had to accept a lower price if it returned to the underbidders and that it achieved the best possible price for the taxpayer by taking this decision.
 - In another four cases with a gross disposal value of about €0.5 million, there was no evidence that the properties had been openly marketed and the files did not provide explanations for this. In three of these cases, there was evidence that NAMA had either obtained assurance regarding the market price of the property or had otherwise compared the selling price with similar properties. There was no evidence of open marketing or obtaining market assurance for the remaining property. NAMA stated that it is satisfied that the properties in these cases were openly marketed because fees had been paid to selling agents.

Return on property assets

- 5.15** Due to a lack of information technology systems, NAMA was not in a position to maintain a central record of capital or other funding provided in respect of individual properties or to identify the rental receipts for individual properties. Therefore, it is not possible to calculate the returns that were earned on properties that have been sold. In addition, NAMA does not estimate the rental yield that is being generated by different types of property.
- 5.16** NAMA stated that it began operations with no information technology systems and that its information technology systems were, and to a lesser extent are, still in development. NAMA has also pointed out that it has other compensating controls over debtors in place, including the use of financial monitors, controls over the payment of invoices greater than €20,000 and the oversight exercised by NAMA's case management teams.
- 5.17** Using the end-2012 cash flow projections for the NAMA-managed debtors, the examination team has identified
- the sources of the debtor rental income that NAMA anticipated receiving in 2013 and
 - the gross and net rental yields for the types of property held.

Projected rental income and rental yields

- 5.18** The end-2012 cash flows for the NAMA-managed debtors, indicate that
- Gross property rental income would amount to €1,050 million if all of the properties were held for the full year.¹
 - Property-related costs (including the cost of maintaining and securing vacant units) would reduce the cash accruing to NAMA by around 30%, resulting in net rental receipts of €730 million in 2013.
- 5.19** Three sectors were projected to account for around 71% of expected gross rental income in 2013 i.e. retail (€336 million), offices (€288 million) and residential property (€122 million). Figure 5.4 shows the total projected disposal values for these sectors and the projected gross rental income and rental yields in Ireland, Northern Ireland and Great Britain.²
- 5.20** In addition to debtor rental income, NAMA receives some other debtor property-related income, for example trading income. Apart from the hotel and leisure sector (which is discussed separately below), this trading income is insignificant.

Rental yields

- 5.21** Debtors' expected gross rental income in 2013 represented 4.9% of the forecast disposal values of all properties.³ Expected net rental income was around 3.4%. For completed properties (i.e. excluding land and development assets), the gross rental yield is just over 6.9% and the net yield is 5%.
- 5.22** For the sectors and locations set out in Figure 5.4
- the forecast disposal proceeds are around €11 billion
 - the expected aggregated gross rental yield for these properties for 2013 is around 6.3% and the net rental yield is around 5.0%.
- 5.23** Property related costs amount to⁴
- around 18% of the gross rental yield for offices
 - around 16% of the gross rental yield for retail properties
 - around 40% of the gross rental yield in the residential sector.
- 5.24** The effect of property-related costs on debtor rental incomes is broadly similar among locations, although they are higher than average across all sectors in Northern Ireland and are around 20% for retail property in the rest of Ireland.

1 Gross property rental income includes trading income for the hotel sector.

2 These locations account for 92% of the expected gross rental income for these sectors. The expected rental income from residential property in London and Northern Ireland are not included in Figure 5.4 because the expected rental income is very low.

3 For properties held by NAMA-managed debtors. The yields are based on projected disposal values (after excluding the recovery of capital investments which have yet to take place),

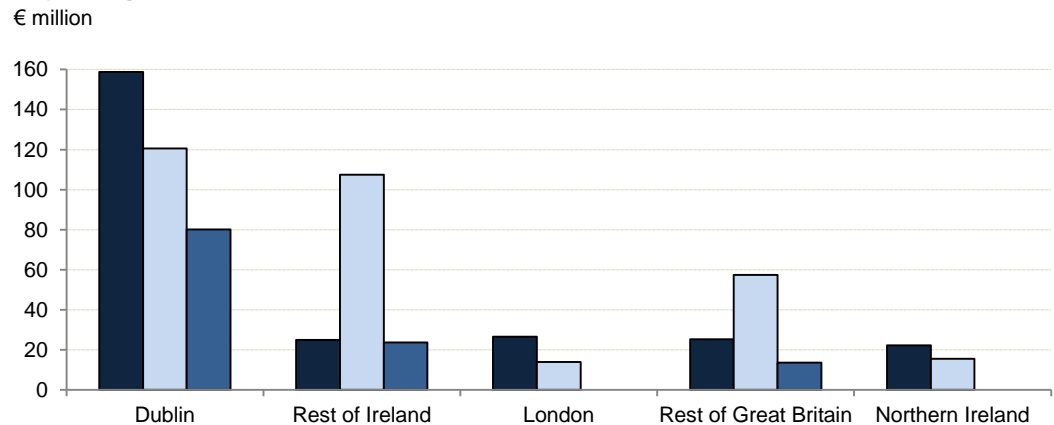
4 These costs do not include overheads for debtors to manage their businesses or costs of insolvency practitioners.

Figure 5.4 Key sectors — projected disposal values, gross rental yields and gross rental income^a

Projected disposal values and gross rental yields



Projected gross rental income, 2013



Sources: See Appendix D

Note: a Disposal values exclude proceeds that represent recovery of planned future capital investment.

5.25 The NAMA Board has not set targets or benchmarks for the level of gross and net rental yields.

Proportion of properties yielding rental income

5.26 The gross and net rental yields have been calculated based on all properties held in these locations by NAMA-managed debtors whether these are generating rent or not.¹

- In the retail sector, the proportion of properties with no expected rental income in 2013 was below 5% in all locations.²
- In the office sector, no rental income was expected for between 12% and 17% of properties in Great Britain, 12% in Dublin, 4% in the rest of Ireland and 7% in Northern Ireland.
- In the residential sector, no rental income was expected from 5% of property in Dublin; over 22% of property in the rest of Ireland; and 15% in the rest of Great Britain.

Appendix D sets out further detail on the expected returns from these sectors.

¹ This analysis identifies properties (and not individual units) for which no rent was anticipated in 2013.

² The proportions are measured in terms of disposal values.

Hotel and leisure sector

- 5.27** The projected disposal value of hotels and leisure facilities held by NAMA-managed debtors is almost €2 billion or around 13% of the total forecast disposal value of completed properties at the end of 2012. Projected income in 2013 from the hotel sector represented 17% of all rental and operating income and comprises both rental and other, mainly trading, income. Operating costs associated with hotels are high. Figure 5.5 sets out details of the forecast disposal values of the hotels and leisure facilities and the expected net yield from rental and other income for them in 2013.

Figure 5.5 Hotel and leisure sector, expected net yield in 2013

| | Number of hotels and leisure facilities | Estimated disposal values | Expected net yield 2013 |
|-----------------------|--|--------------------------------------|--|
| | | €m | % |
| Dublin | 54 | 451 | 6.1% |
| Rest of Ireland | 95 | 451 | 4.6% |
| London | 7 | 229 | 2.4% |
| Rest of Great Britain | 40 | 377 | 7.3% |
| Northern Ireland | 6 | 48 | 8.4% |
| Rest of the world | 23 | 429 | 4.0% |
| Total | 225 | 1,985 | 5.2% |

Source: NAMA end-2012 debtor cash flow forecasts — analysis by the Office of the Comptroller and Auditor General

- 5.28** NAMA uses a number of sectoral performance indicators, including a debt servicing capacity benchmark, to review and assess the performance of hotel and leisure assets. An in-house specialist provides analysis to the asset recovery managers to inform their debtor management strategies. The Board has not set a target for the expected yield for this sector.

Support for debtors and developing assets

- 5.29** When submitting business plans (or in subsequent engagement with NAMA), debtors put forward proposals for how they intend to repay their debt, including proposals about the timing of property disposals. For some properties, further development is put forward as the best way to optimise value. NAMA must then decide what is the best option for each property and whether it can enhance the value of a property through providing funds for development.

Advances by NAMA

- 5.30** By the end of 2012, NAMA had directly advanced around €1 billion to debtors.¹ It had also approved around €0.6 billion for retention by debtors but, because NAMA does not maintain a central record of actual retentions by debtors out of rental and other income, it was not possible to determine the extent to which debtors had used these approved advances.²

¹ The funds advanced includes €180 million that had been paid to participating banks in respect of further loans made by them to debtors between the date of loan valuation and when they were transferred to NAMA.

² NAMA refers to both direct advances and funds retained by debtors as advances.

- 5.31** It is also not possible to analyse the direct advances between development and non-development (e.g. operating costs) payments, as NAMA has not maintained a central record of this information.
- 5.32** As part of this examination, the management and monitoring of €22 million advanced by NAMA to ten debtors was examined in detail. This testing found that NAMA was monitoring the expenditure sufficiently at individual debtor level to ensure that it was used for the purposes for which it was approved.
- 5.33** At the end of 2012, NAMA planned to directly advance a further €2.3 billion to debtors for development purposes. Taking account of the direct advances made to the end of 2012 and the planned advances, the total direct advances will be in respect of properties in the following regions
- Great Britain, including London — around 52% (around €1.7 billion), primarily for residential development
 - Ireland — around 43% (€1.4 billion), for a mix of residential and commercial developments
 - Northern Ireland and the rest of the world — around 5% (about €200 million).
- The amount to be invested could increase as additional investment opportunities are identified.

Project appraisal

- 5.34** In June 2012, the Board approved an asset management plan. The plan provided that the decision to hold or sell assets would be continually reviewed, with the objective of maximising the financial return. The asset management plan set out two target return scenarios
- a minimum return on cost of 15% over the life of construction projects¹
 - for site disposals, to achieve sales proceeds equivalent to at least double the current value, through active asset management.
- 5.35** In the course of 2012, an asset management unit was established with the main purpose of identifying, appraising and implementing property development proposals in order to increase long-term recoverable value. In September 2012, the unit presented a paper to the Board in which it identified 24 proposed projects in two locations.
- 12 projects are in London where the construction of around 5,300 residential units and just over 330,000 square feet of commercial space, including offices and retail developments, was proposed. Many of these projects are either under way or planning is well advanced.² The prospective capital investment is of the order of just under €1.5 billion. The projected project return ranged from 20% to 95%.
 - A further 12 projects were proposed in Dublin, with just over 5,000 residential units and almost 1.7 million square feet of commercial development proposed. The proposed capital investment is just over €1.3 billion.³ The paper noted that, in order for the proposed projects to be viable, there would have to be a significant rise in projected disposal values, the Irish economy would need to return to a sustained level of economic growth and credit would need to be available on affordable terms. Many of the proposed projects would require suitable planning permission to proceed and the paper noted that the planning process generates considerable uncertainties as to time and outcome.

¹ The return refers to an overall return, not an annual rate of return. It is the difference between projected sales proceeds and costs (market value of site at the time of appraisal plus construction costs plus construction financing cost).

² The paper noted that at least 90% of proposed capital expenditure in 2013 and 2014 was likely to be in London.

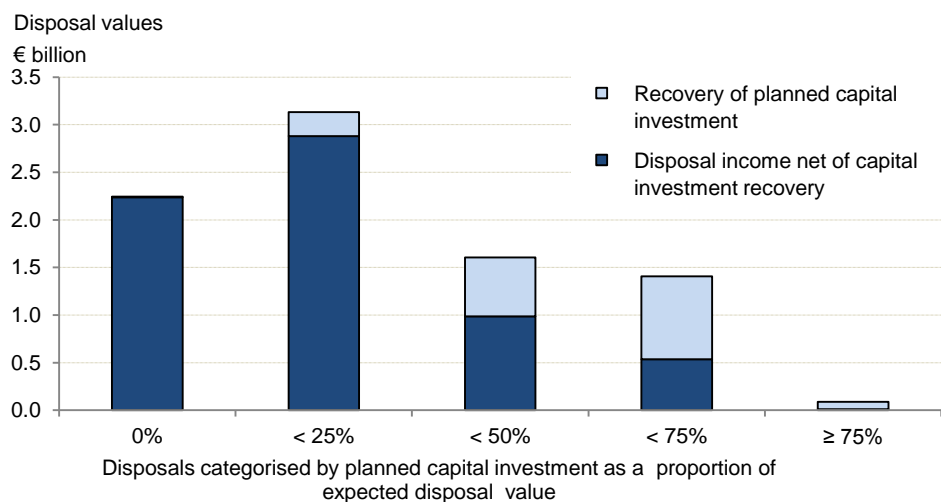
³ None of this was included in the end-2012 planned capital investment of €2.3 billion as the projects were not sufficiently advanced.

- 5.36** For a number of the projects, NAMA proposed carrying out the developments with joint venture partners. The paper also noted that the options for each project would be constantly revisited and all options, including sale of sites prior to development, would be considered.
- 5.37** The paper indicated that, if the projects proceed and property values are of the order projected in the project appraisals, NAMA could make significant gains on the London projects, perhaps up to €600 million in addition to the interest earned on advances to debtors. The prospective outcome for the Dublin projects is less clear — the figures for the projects in the paper indicated that, while NAMA should make gains from the construction element of the projects in addition to interest on related advances, declines in the values of many of the sites since 2009 would offset much of the gains.
- 5.38** NAMA stated that the projects are now in progress and it is likely that the final strategies, following the continuous review process, will include a mix of construction scenarios and earlier disposals, depending on the optimum financial return.
- 5.39** The outturn on these projects will be examined by the Office of the Comptroller and Auditor General in due course and may be further reported upon.

Investment in land and development assets

- 5.40** The examination team reviewed the end-2012 debtor cash flows to ascertain the extent to which NAMA plans to invest in land and development assets.
- 5.41** Figure 5.6 sets out the estimated disposal proceeds for these assets and the amount of planned capital investment. The properties have been stratified, based on the extent of further investment anticipated.

Figure 5.6 Land and development assets — expected disposal values^a



Source: NAMA end-2012 debtor cash flow forecasts — analysis by the Office of the Comptroller and Auditor General

Note: a The planned capital expenditure in Figure 5.6 (around €1.8 billion) does not include the approximately €2 billion of additional expenditure that will be spent if the additional projects proposed by the asset management team proceed.

- 5.43** NAMA expects to make either no capital investment or just a small capital investment in assets representing around two-thirds of the expected disposal proceeds of all land and development assets. This rises to around 80% when the recovery of planned investments is excluded from disposal proceeds. For the remaining assets, planned capital investment represents around half of the anticipated disposal proceeds.
- 5.44** Further analysis by the examination team showed that the profile for the Irish land and development assets is broadly similar to the full land and development portfolio. Around 80% of the disposal value from land and development assets, when recovery of planned investments is excluded, is expected to arise from properties where little or no capital investment is planned.

Key risks to remaining portfolio

- 5.45** Values have fallen since November 2009 in the principal markets in which NAMA operates, with the exceptions of London and some types of property in the rest of Great Britain, as shown in Figure 5.7.

Figure 5.7 Changes in property values, November 2009 to December 2012^a

| | Dublin | Rest of Ireland | London | Rest of Great Britain |
|--------------------|---------|-----------------|--------|-----------------------|
| Office | ↓ (25%) | ↓ (24%) | ↑ 25% | ↓ (11%) |
| Retail | ↓ (27%) | ↓ (28%) | ↑ 21% | ↔ 0% |
| Hotel and leisure | ↔ 0% | ↓ (26%) | ↑ 21% | ↑ 7% |
| Industrial | ↓ (30%) | ↓ (29%) | ↑ 10% | ↔ 0% |
| Residential | ↓ (31%) | ↓ (30%) | ↑ 14% | ↓ (3%) |
| Other ^b | ↓ (26%) | ↓ (26%) | ↑ 7% | ↑ 7% |

Source: NAMA strategy unit using indices from the Investment Property Databank, the Central Statistics Office, the UK Land Registry and the University of Ulster

Note: a Changes in value have been rounded to the nearest 1%.

b The category 'Other' does not include development land, for which no price index is available.

- 5.46** Indices only provide a general guide to changes in a market. The characteristics of individual properties may vary from the properties on which an index is based. For example, indices of office values are often based on prime office properties. The change in value for a property in a secondary location may differ significantly from that suggested by an index while, on the other hand, an exceptional property may not have suffered the same decline as shown in an index. However, given the size of NAMA's portfolio, the indices are likely to be a reasonable guide to the changes in value for the properties held by NAMA since 2009.
- 5.47** There is no index for the changes in value in land and no recent valuations had been undertaken of the land portfolio at the end of 2012. However, the September 2012 asset management unit's paper to the Board set out estimated values of the sites for eleven of the proposed projects in Dublin. The current market value of those sites had declined, on average, by around 77% since 2009. Estimated declines in value ranged from 1% to over 90%.

5.48 In regard to the site values NAMA stated that

- The sites identified in the September 2012 paper, which are generally well located, were identified by the asset management unit as significant projects most likely to benefit from active asset management, and that this selection of sites was not intended to be representative of the overall NAMA development land portfolio.
- The estimated current market value of the 11 Irish sites included in the paper, was on the basis of the lands as they were at that time, without planning permission, and without taking any longer term view or account of further intervention or asset management. The absence of a significant level of site sale transactions in Ireland over the period 2009 to 2012 also contributed to its valuation assumptions.
- A full review of NAMA land was undertaken in 2013 and there will be additional impairment provisions in respect of land in its end-2013 financial statements.

5.49 It is clear from the volume of property that NAMA held in Ireland and Great Britain at the end of 2012 (63% and 24% of the remaining portfolio respectively), that the most significant risks to NAMA generating the level of proceeds that it anticipates lie in these parts of its portfolio. In Ireland, key factors affecting NAMA's ability to meet its targets for disposals — both in terms of time and projected disposal values — include the volume of property collateral that is held by NAMA debtors, the timeframe within which it proposes to sell it, the increase in property values that is needed to achieve the proposed disposal values and the availability of credit for prospective purchasers. For example,

- Over a third of NAMA's remaining property is in Dublin where the declines in value from November 2009 for all types of completed property (except hotels) as indicated by Figure 5.7, are of the order of 25% to 30%. In contrast, the bulk of NAMA's planned disposals at the end of 2012 are scheduled for the period to 2016 at average values around 11% below 2009 values across all property types. NAMA's own analysis of certain sites in its land and development portfolio, without planning permission, suggests rates of decline averaging 77%. However the average values at which NAMA anticipates selling land and development assets are around 17% below 2009 values. There was some increase in Dublin property values in 2013. Nevertheless, it will require significant further recovery in market prices across all asset types if the projected prices are to be achieved.
- In the rest of Ireland, where over a quarter of the remaining portfolio is located, the projected disposal values for retail developments are around 10% below 2009 values compared with a decline of 28% in the sectoral index. Land and development assets account for a quarter of the rest of Ireland portfolio and the planned disposal values for these properties is, on average, around 23% below 2009 values.

Conclusions and recommendations

Disposals

- 5.50** By the end of 2012, around 18% (based on 2009 valuations) of the property collateral had been sold. Two-thirds of the disposal proceeds arose from the disposal of properties in London.
- 5.51** Examination of documentation for a sample of property disposals found that, overall, almost all had been sold through an open competitive process or with testing of disposal prices against market valuation. This provides reasonable assurance that the prices obtained were the best on offer in the market at the time a property was sold.
- 5.52** While the total disposal proceeds were around €1 billion higher than the 2009 valuations of the properties, it was not possible to calculate the return that NAMA made on these properties (or the associated loans) as NAMA did not maintain a centralised record of any expenditure on the properties after November 2009, nor of the rental income generated by individual properties.

Expected return from collateral held at end-2012

- 5.53** At the end of 2012, NAMA anticipated receiving rental income generated by all but a small proportion (by value) of the completed property collateral held by NAMA-managed debtors. The projected gross rental yield from completed properties (i.e. excluding land and development assets) is around 6.9%. Property-related costs reduce this by almost 30%, giving an average net rental yield of 5%.
- 5.54** The Board does not set benchmarks against which to measure NAMA's performance in the rental yields that its debtors' assets are achieving.

Recommendation 5.1

The Board should set targets for the overall return on disposals and on property held by debtors and insolvency practitioners and performance should be measured against these targets.

Chief Executive Officer's response

Not accepted. The NAMA Board takes the view that setting a target rate of return is not an appropriate metric for NAMA's business.

Such a metric would be inappropriate as it would act as an unnecessary constraint on NAMA's flexibility, particularly given the imperative that it be open to commercially sensible disposal opportunities whenever they arise and also given the stated objective of the Minister for Finance that NAMA should complete its work of deleveraging the portfolio as soon as possible.

The achievement or otherwise of rate of return targets is not, in NAMA's view, a valid measure of its success given

- the circumstances in which the loans were acquired i.e. acquisition at prices in excess of market values
- the variable quality of the underlying assets

- the significant deterioration in the Irish property market in the three years after acquisition
- the imperative of reducing, as soon as possible, the contingent liability that NAMA senior bonds represent for Irish taxpayers and
- the associated necessity for NAMA to take advantage of favourable Irish market conditions when they present themselves rather than hold out for better conditions and better target returns which may not be achievable over the envisaged NAMA lifespan.

Investment to enhance properties

- 5.55** For a set of projects that were appraised in 2012, NAMA set a minimum expected return of 15% on cost before a project could proceed.
- 5.56** By the end of 2012, NAMA had advanced around €1 billion directly to debtors as additional loans. In addition, debtors retain funds from rental income and the proceeds of property disposals. However, as NAMA does not maintain a central record of the amounts retained by debtors, it was not possible to determine the extent to which amounts approved for retention (€0.6 billion) were applied by debtors.

Recommendation 5.2

In order to enable itself to accurately identify the total cost of developing and enhancing properties, NAMA should maintain a central record of amounts retained by debtors and the purposes for which the funds have been used.

Chief Executive Officer's response

Accepted. This information is available at individual debtor level and is currently being compiled on a consolidated portfolio basis. It will be maintained on an on-going basis.

Land and development assets

- 5.57** NAMA expects to make little or no capital investment in around 80% of its debtors' land and development assets. It anticipates selling such assets in Ireland at values between 17% and 23%, on average, below November 2009 valuations. While it is difficult in current circumstances to establish the value of land, these values appear to be inconsistent with NAMA's own analysis which suggests that certain sites in its portfolio, without planning permission, may have fallen in value by an average of 77% since November 2009.

Prospective gains and significant risks

- 5.58** The detailed cash flows prepared by NAMA for debtors with projects under way and the assumptions underpinning the other projects under consideration indicate that almost all of the gains that NAMA has projected will come from the London portfolio, and will depend on continuing market buoyancy there.

5.59 NAMA continues to face challenges in its Irish portfolio. Up to the end of 2012, NAMA had sold just 4% of the Irish property collateral. At the end of 2012, property values for almost all types of completed property were around 25% to 30% below November 2009 values while land and development sites had fallen by 77%, based on project appraisals carried out by NAMA. NAMA's detailed cash flow projections at the end of 2012 indicate that it intends to dispose of the bulk of its Irish portfolio by the end of 2016 and the projected disposal values are predicated on significant recovery in Irish property values. NAMA has reported increased levels of activity and investor interest in the Irish market in late 2013 and early 2014 and pointed out that the level of disposals in Ireland in 2013 was significantly higher than in its first three years of operation.

6 Other Objectives of NAMA

6.1 In addition to its key commercial objective of redeeming the senior debt and recovering all of its costs, NAMA has also set objectives which are secondary to its key commercial objectives. These are to

- aim to contribute to the social and economic development of the State and
- generate transactions which will aim to contribute to a renewal of sustainable activity in the property market in Ireland.

Contributing to the social and economic development of the State

6.2 In regard to contributing to the social and economic development of the State, NAMA has

- identified and offered to public bodies properties suitable for their use, including properties for social housing
- provided funding for work on unfinished housing estates.

Properties for public use and social housing

6.3 In its 2010 strategic plan, NAMA undertook to engage actively with State agencies and bodies in relation to their possible need for land or properties. It committed to offering suitable land and property to those bodies at a reserve price.

6.4 In this regard, NAMA has sold a number of sites and properties to schools, universities, health care facilities and county councils. The sample of disposals tested for the purposes of this examination included some of the disposals to public bodies and, for these disposals, the agreed disposal values were in accordance with independent valuations of the properties.

6.5 In relation to social housing, NAMA identified almost 4,400 residential properties in Ireland that might be suitable for social housing needs. At the end of 2013, demand had been confirmed for almost 2,100 of those properties by local authorities and a small number were still under consideration. 2,300 properties were no longer under consideration.

6.6 Three disposals where the properties were sold for social housing use were included in the sample of disposals reviewed for this report. The findings from those tests were that

- open marketing of the property was evident in one case and a housing association was the only interested party
- in another case, there was no evidence of marketing but market valuation had been sought
- in the third case, a contract for sale to a local authority had been in place since 2007 for the sale for 60% of the units in the property and the remaining units were also sold to that local authority on the basis that no market existed for the units.

6.7 In July 2012, NAMA set up a subsidiary, National Asset Residential Property Services Limited (NARPSL), to acquire residential properties from debtors and to lease these properties to approved housing bodies for social purposes.

Unfinished housing estates

- 6.8** A report by the Advisory Group on Unfinished Housing Development in May 2011 categorised unfinished estates into four categories.¹
- Category 1 — The developer was active and the housing development was being completed and appropriately managed.
 - Category 2 — A receiver had been appointed and the development was being appropriately managed.
 - Category 3 — The developer was in place but there was no on-site activity and there were significant planning, building control compliance and public safety issues to be addressed.
 - Category 4 — The developer or site owner was effectively not contactable, no receiver had been appointed and similar problems to category 3 existed.
- 6.9** The Advisory Group's report focused primarily on category 3 and category 4 developments, on the basis that categories 1 and 2 could be resolved within the standard procedures that exist, by developers, financial institutions and/or receivers, and may involve interaction with local authority planning and building control sections.
- 6.10** A total of 1,655 unfinished estates were identified over all categories. 30 category 4 estates across 14 counties were identified as under NAMA control, as were 136 category 3 estates. NAMA committed €3 million to remedy the on-site issues.
- 6.11** In October 2012, NAMA reported that all the public safety works on ten of the category 4 unfinished estates were complete and that the remaining 20 were in progress. The remedial work on the category 3 sites was also progressing.
- 6.12** In April 2013, NAMA estimated that 335 unfinished estates were under its control and that 210 of these were described as being in the 'most problematic' category.²

¹ The Advisory Group was established by the Minister of State with responsibility for housing.

² By January 2013, the Advisory Group had ceased categorising unfinished estates as 1 to 4.

Vendor finance

- 6.18** The vendor finance programme was introduced by NAMA in 2012, when it perceived that many potential investors were constrained by a lack of access to capital.
- 6.19** Under the programme, loan finance of up to 75% of the purchase price of NAMA-controlled commercial properties is available to suitable purchasers. NAMA envisages that €2 billion may be made available in the form of vendor finance, mainly in Ireland, but with some advances in Great Britain. NAMA has stated that the programme has the potential to generate new investor equity of between €800 and €900 million and it envisages that the majority of this new equity will be generated in 2013 and 2014.
- 6.20** The main aim of the programme is to eliminate the risk of a deal falling through because the potential buyer cannot get the finance required to complete the purchase from another source. Generally, vendor finance may be made available to creditworthy purchasers of investment properties with a value of at least €10 million. It may also be made available to purchasers of development properties, where the limit will be around 60% of the purchase price. Vendor finance arrangements may be for periods of up to seven years.
- 6.21** The advancing of vendor finance replaces the debt of an existing NAMA debtor with a loan to a new debtor, but for a lower amount as the new debtor will have provided at least 25% of funds for the purchase of the property.
- 6.22** By the end of March 2014, NAMA had completed a total of six vendor finance transactions involving advances of €373 million.
- 6.23** NAMA stated that a number of developments during 2013 indicate that the need for vendor financing may be reducing. These include the prevalence of international investors with ready access to capital, a gradual increase in domestic lending and the introduction of Irish REITs as an alternative investment mechanism.

Conclusions

- 6.24** The secondary objectives that NAMA has set — contributing to a sustainable property market in Ireland and to the social and economic development of the State — are subordinate to its key commercial objectives. When disposing of properties, NAMA's primary objective is to achieve the best possible price.
- 6.25** Review of property disposals to public bodies and of residential properties to local authorities or housing associations for social housing showed that, in most instances, there was evidence that valuations had been carried out prior to disposal and the prices achieved by NAMA equalled current market valuations.
- 6.26** There has been limited use of two initiatives which NAMA put in place to stimulate activity in the property market. There was a low take up of the DPI, and NAMA is of the view that the requirement for vendor finance may be reducing because alternative sources of finance are becoming available.

Appendices

Appendix A — Extracts from the NAMA Act 2009

Section 2 of the NAMA Act, 2009 sets out that the State's overall objective in establishing NAMA was

- (a) to address the serious threat to the economy and the stability of credit institutions in the State generally and the need for the maintenance and stabilisation of the financial system in the State, and
- (b) to address the compelling need
 - (i) to facilitate the availability of credit in the economy,
 - (ii) to resolve the problems created by the financial crisis in an expeditious and efficient manner and achieve a recovery in the economy,
 - (iii) to protect the State's interest in respect of the guarantees issued by the State pursuant to the Credit Institutions (Financial Support) Act 2008 and to underpin the steps taken by the Government in that regard,
 - (iv) to protect the interests of taxpayers,
 - (v) to facilitate restructuring of credit institutions of systemic importance to the economy,
 - (vi) to remove uncertainty about the valuation and location of certain assets of credit institutions of systemic importance to the economy,
 - (vii) to restore confidence in the banking sector and to underpin the effect of Government support measures in relation to that sector, and
 - (viii) to contribute to the social and economic development of the State.

Section 10 of the Act states that

- 1) NAMA's purposes shall be to contribute to the achievement of the purposes specified in section 2 by
 - (a) the acquisition from participating institutions of such eligible bank assets as is appropriate,
 - (b) dealing expeditiously with the assets acquired by it, and
 - (c) protecting or otherwise enhancing the value of those assets, in the interests of the State.
- 2) So far as possible, NAMA shall, expeditiously and consistently with the achievement of the purposes specified in subsection (1), obtain the best achievable financial return for the State having regard to
 - (a) the cost to the Exchequer of acquiring bank assets and dealing with acquired bank assets,
 - (b) NAMA's cost of capital and other costs, and
 - (c) any other factor which NAMA considers relevant to the achievement of its purposes.

Section 11 of the Act states that

- 1) In order to achieve its purposes, NAMA shall perform the following functions:
 - (a) acquire, in accordance with Part 6, such eligible bank assets from participating institutions as it considers necessary or desirable for achieving its purposes;
 - (b) hold, manage and realise acquired bank assets (including the collection of interest, principal and capital due, the taking or taking over of collateral where necessary and the provision of funds where appropriate);
 - (c) perform such other functions, related to the management or realisation of acquired bank assets, as the Minister directs pursuant to section 14;
 - (d) take all steps necessary or expedient to protect, enhance or realise the value of acquired bank assets, including—
 - (i) the disposal of loans or portfolios of loans in the market for the best achievable price,
 - (ii) the securitisation or refinancing of portfolios of loans, and
 - (iii) holding, refinancing, realising and disposing of any relevant security.
- 2) In the exercise of its functions NAMA shall have regard to the need to avoid undue concentrations or distortions in the market for development land.
- 3) The Minister may confer on NAMA, by order, such additional functions connected with the functions for the time being of NAMA as he or she thinks necessary for the achievement of its purposes, subject to such conditions (if any) as may be specified in the order.
- 4) An order under this section may contain such incidental, supplemental and consequential provisions as are, in the opinion of the Minister, necessary to give full effect to the order.
- 5) An order under subsection (3) shall be laid before each House of the Oireachtas as soon as may be after it is made and, if a resolution annulling the order is passed by either such House within the next 21 days on which that House has sat after the order is laid before it, the order shall be annulled accordingly, but without prejudice to the validity of anything previously done thereunder.
- 6) NAMA shall act in a transparent manner in carrying out its functions under this Act to the extent that to do so is consistent with the proper and efficient and effective discharge of those functions.

Section 18 of the Act states that

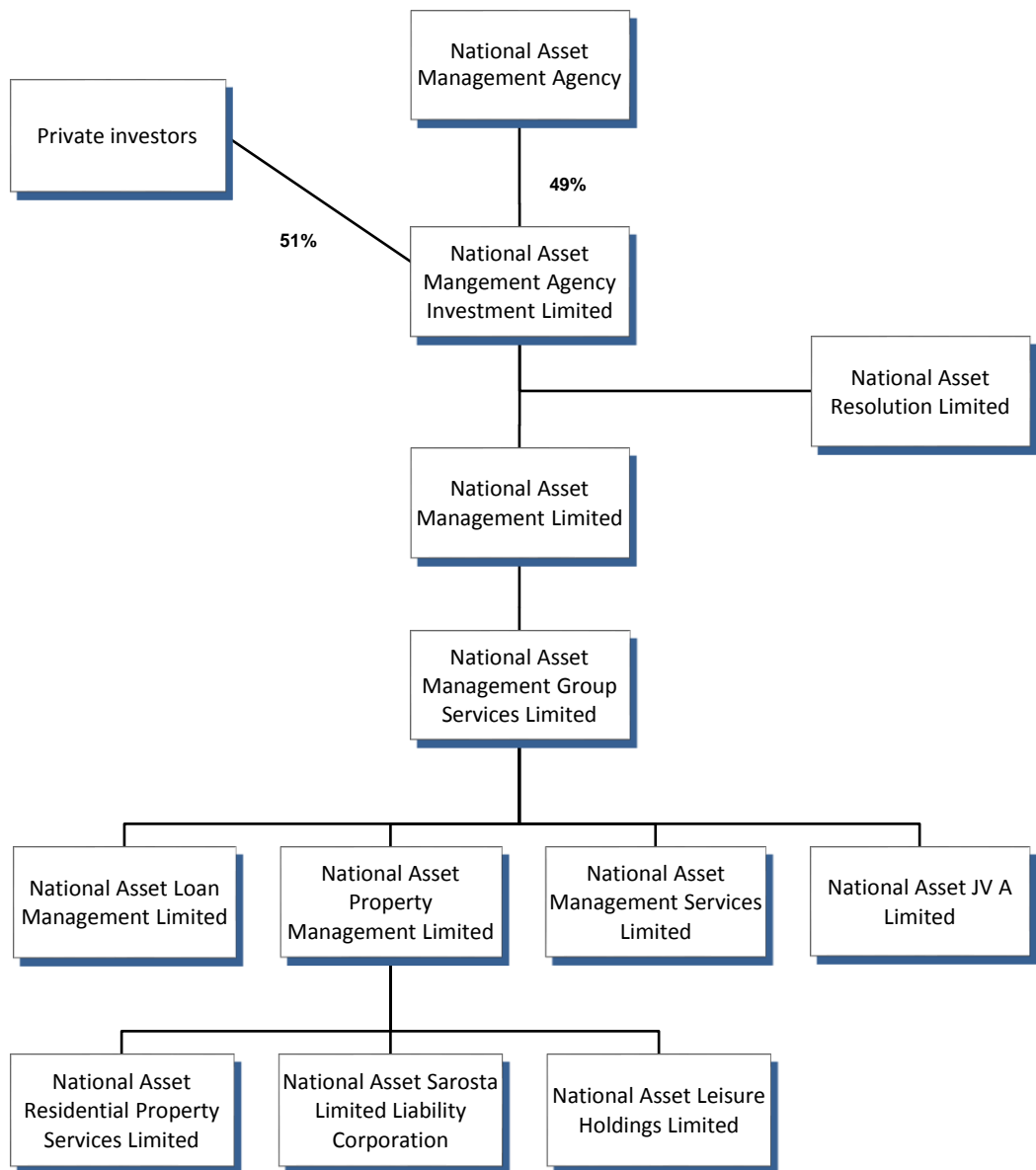
- (1) There shall be a Board of NAMA, whose functions are as follows:
 - (a) to ensure that the functions of NAMA are performed effectively and efficiently
 - (b) to set the strategic objectives and targets of NAMA
 - (c) to ensure that appropriate systems and procedures are in place to achieve NAMA's strategic objectives and targets and to take all reasonable steps available to it to achieve those targets and objectives.
- (2) For the purposes of the Board exercising its functions under subsection (1), and without prejudice to any of its powers at law, the Board may provide for the performance of any such function by an officer of NAMA.
- (3) In performing its functions, the Board shall act in utmost good faith with care, skill and diligence.

Appendix B — NAMA Group Structure and Resources

In order to ensure that debt issued by NAMA to acquire loans is not treated as part of the General Government Debt under European accounting rules, the debt must be issued by an entity that is majority privately owned. In order to meet this requirement, NAMA has established a subsidiary structure headed by a company, National Asset Management Agency Investment Limited, which is 51% owned by private investors.¹

Currently, ten special purpose vehicles (SPV) have been incorporated by National Asset Management Agency Investment Limited. The structure of the NAMA group and the function of each NAMA group entity is set out below.

NAMA Group Structure



¹ The investors in 2010, each of which invested €17 million, were Irish Life Assurance plc, New Ireland Assurance Company plc and AIB Investment Managers Ltd. In 2012, following the purchase by the State of Irish Life, the Irish Life shareholding was disposed of to private investors.

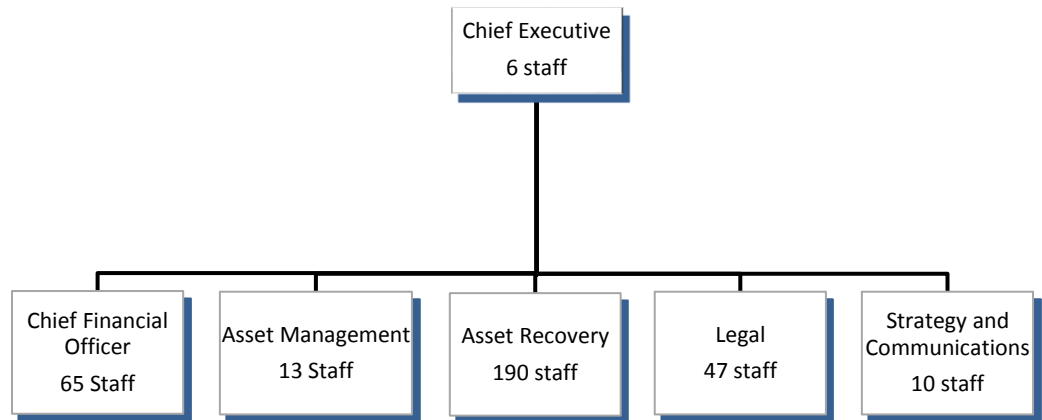
Functions of NAMA Group Entities

| Entity | Function |
|---|--|
| National Asset Management Agency Investment Limited | Facilitates making a return by way of dividend to private investors. |
| National Asset Resolution Limited | Established in February 2013, to facilitate the acquisition of a floating charge from the Central Bank over the assets of the Irish Bank Resolution Corporation Limited. |
| National Asset Management Limited | Creates debt securities and subordinated debt that are transferred to the participating banks in return for the loans. |
| National Asset Management Group Services Limited. | Holding company for subsidiaries. |
| National Asset Loan Management Limited | Acquired and manages the loan assets from the participating banks. |
| National Asset Property Management Limited | Holds property acquired after enforcement of security. |
| National Asset Management Services Limited | An administrative company through which expenses are paid. |
| National Asset JV A Limited | Established in July 2013 to facilitate the acquisition of a twenty per cent interest in a partnership, incidental to a joint venture arrangement entered into by NAMA with a consortium. |
| National Asset Residential Property Services Limited | Established in 2012, to acquire residential properties and to lease these properties to approved housing bodies for social housing purposes. |
| National Asset Sarasota Limited Liability Corporation | Established in 1 August 2013 in the US state of Florida to acquire certain property assets located in the US, in settlement of debt owed to NAMA. |
| National Asset Leisure Holdings Limited | Established in February 2014, National Asset Leisure Holdings Limited has no activity at present. |

In 2010 and 2011, NAMA's structure reflected its focus on recruitment, loan acquisition, debtor engagement and debtor strategies. By the end of 2011, 202 staff were engaged directly by NAMA.

During 2012, when the acquisition process was largely completed and NAMA's focus had shifted to debtor and asset management, NAMA reorganised its structure to reflect this changed focus and had 224 staff. At the end of 2013, NAMA had 331 staff as outlined out below.

NAMA Organisation Structure and Staff Numbers, 31 December 2013



Source: National Asset Management Agency

In addition, NAMA uses a number of external service providers, including the participating banks which administer the loans acquired by NAMA, outsourced internal audit and loan data administration functions, and external legal and expert advice. During the acquisition phase in 2010 and 2011, external services were also used for independent audit and appraisal of the various aspects of acquisitions.

Appendix C — Management Activities by NAMA and Participating Banks (Banks)

| | NAMA managed debtors | Bank managed debtors |
|---|---|-------------------------|
| Carrying value of debt at 31 December 2012 | €22.2 billion | €4.1 billion |
| Number of debtors/debtor connections | 189 | 586 |
| Management activity | Management activity carried out by | |
| Overall case strategy and management | NAMA | NAMA / banks |
| Strategic credit review | NAMA | NAMA / banks |
| Credit grading | NAMA | NAMA / banks |
| Credit decisions | NAMA | NAMA / banks |
| Credit requests management | NAMA | Banks |
| Debtor monitoring | | |
| Monitor conditions of credit approval | NAMA | Banks |
| Drawdown approvals and security arrangements | NAMA | NAMA / banks |
| Drawdown administration | Banks | Banks |
| Enforcement | | |
| Decision to appoint insolvency practitioner | NAMA | NAMA |
| Manage and monitor insolvency practitioners | NAMA / banks | NAMA / banks |
| Management of legal documentation | NAMA | NAMA / banks |
| Senior management engagement with bank | NAMA | NAMA |
| Day-to-day banking, administration and account monitoring | Banks | Banks |

Source: National Asset Management Agency

Appendix D- Expected disposal values and rental yields for selected property sectors and locations

| | Expected disposal value | Gross rental yield | Net rental yield | Proportion of properties with no expected rental income in 2013 |
|------------------------------|-------------------------|--------------------|------------------|---|
| | € million | % | % | % |
| Dublin | | | | |
| Office | 2,101 | 7.6% | 6.2% | 12.5% |
| Retail | 1,721 | 7.0% | 6.1% | 2.3% |
| Residential | 1,675 | 4.8% | 3.0% | 5.2% |
| Rest of Ireland | | | | |
| Office | 295 | 8.5% | 7.5% | 3.8% |
| Retail | 1,405 | 7.7% | 6.1% | 2.7% |
| Residential | 643 | 3.7% | 2.1% | 22.3% |
| London | | | | |
| Office | 1,091 | 2.4% | 2.1% | 16.8% |
| Retail | 196 | 7.1% | 6.0% | 2.5% |
| Northern Ireland | | | | |
| Office | 222 | 10.1% | 7.1% | 7.0% |
| Retail | 206 | 7.6% | 6.0% | 1.5% |
| Rest of Great Britain | | | | |
| Office | 309 | 8.2% | 6.7% | 12.7% |
| Retail | 767 | 7.5% | 6.5% | 1.8% |
| Residential | 281 | 4.9% | 2.9% | 15.1% |

Source: NAMA end-2012 debtor cash flow forecasts - analysis by the Office of the Comptroller and Auditor General

Notes: a Analysis based on property held by NAMA-managed debtors only.

b The expected disposal value is the forecast gross disposal value less the recovery of capital investments after 2012.