2-24-2012

Comptroller and Auditor General Special Report: National Asset Management Agency: Management of Loans

Ireland: Comptroller and Auditor General

Comptroller and Auditor General

Special Report

National Asset Management Agency

Management of Loans

February 2012

This report was prepared on the basis of information, documentation and explanations obtained from the public bodies referred to in the report. The draft report was sent to the Department of Finance and the National Asset Management Agency. Where appropriate, the comments received were incorporated in the final version of the report.

Report of the Comptroller and Auditor General

National Asset Management Agency – Management of Loans

I have, in accordance with the provisions of Section 9 of the Comptroller and Auditor General (Amendment) Act, 1993, carried out an examination of the arrangements for the management of loans by the National Asset Management Agency.

I hereby submit my report on the above examination for presentation to Dáil Éireann pursuant to Section 11 of the said Act.

John Buckley
Comptroller and Auditor General

24 February 2012

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Summary of Findings

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NAMA has been operating for over two years.

By 31 December 2011 NAMA had acquired loans with a face value of €74 billion from the five financial institutions that participated in the scheme. It paid €32 billion for those loans. Almost €5 billion of the payment was made on an interim basis to the participating institutions in respect of loans that were valued provisionally. NAMA expects to have all valuations definitively completed by the end of the first quarter of 2012.

Status of Loan Acquisition

The key features of the acquisition were

- It is estimated that when all loans are finally valued the acquisition price paid by NAMA to the banks will represent around 43% of their par value i.e. the amount owed by borrowers to the banks.
- The uplift to long-term economic value in the valuation of the underlying property collateral was almost 9% for the loans that have been finally valued.
- When discount rates for distressed loans are applied, it is estimated that, even after a write-down of 57% at acquisition, that the acquisition price incorporates state aid of over one-fifth to the financial institutions.
- The vast bulk of the loans that were acquired related to properties that had been completed representing 71% of the collateral with land making up a further 20%. Around 9% is made up of properties that are in the course of development.
- Over half of the underlying collateral (56%) is in the State with a further one-third in Britain.

Report Focus

As NAMA has now acquired all the properties it intends to acquire from banks the attention now focuses on its arrangements for managing the loans it has acquired. Ultimately, the minimum target has to be to recover at least its outlay and costs from the interim management and ultimate disposal of the loan assets.

NAMA faces considerable challenges in achieving this income goal. Its interim target is to reduce its debt by 24% by the end of 2013 with the entire process extending up to 2020 at least. Risks to the achievement of the optimum financial outcome include

- the anticipated amelioration in economic conditions not materialising or further declines occurring in the property market, affecting the value of property collateral and loan assets
- not collecting all expected cash from debtors including ongoing rental proceeds of property
- failing to achieve the maximum obtainable price when assets whether loans, real estate property or other collateral are disposed of.

The focus of this report is, consequently, on

- the measures taken by NAMA to manage its relationships with borrowers and
- the results of its initial debt management activities.

Management of Debtor Relationships

The predominant relationship that NAMA is managing is one of lender-borrower. The bulk of the loan assets that are managed relate to property that continues to be managed by debtors. Overall, NAMA has taken steps to structure its relations with its debtors through legal and quasi-legal agreements.

In practice, most of the debt is managed directly by NAMA. However, of the original debt of €74 billion, €13 billion is managed on its behalf by the participating financial institutions.

While NAMA has, following the receipt of business plans, completed relatively few loan restructurings it is pursuing restructuring for around 28% of the directly managed debt. In broad terms a further 34% of these loans are subject to disposal or enforcement actions with a further third of them at an interim letter of support stage. No restructuring has occurred of loans managed by participating institutions.

As well as seeking to manage the loans, NAMA has taken steps to identify assets of borrowers that may be available as additional security. The principal sources of those assets are likely to be

- excess collateral identified in the course of the valuation process
- other assets that fall within the scope of personal guarantees
- assets identified in the course of business plan reviews
- assets identified in the course of searches.

It estimates that up to €500 million additional security may be pledged as a result.

NAMA has adopted strategies to guide its management on its approach to loan workouts and the timing of disposals as well as the approach to be adopted in different markets. These take account of conditions in both industrial sectors and geographic areas. It will be necessary for it to review these strategies on an ongoing basis in the light of alterations in its corporate strategy that take account of market conditions and have control and reporting mechanisms to assure itself that the individual loans are managed in accordance with policies tailored to the emerging conditions.

NAMA uses part of loan repayments to fund new advances. Up to the end of December 2011, it had approved new lending amounting to €975 million of which €720 million had been drawn down by debtors.

NAMA's most recent estimate of the amount of new lending by way of working capital and development loans that it anticipates making to all borrowers over the full period of NAMA's life is around €3.5 billion, the bulk of which (€2.6 billion) will be advanced in the period from 2012 to 2015. NAMA anticipates that it will recover the bulk of those funds it advances for capital and development.

Because the debtors continue to manage the underlying property NAMA agrees the level of overheads arising out of staffing and general administrative costs incurred by borrowers in managing the funded business. The principal determining component of the overhead is the agreement by NAMA with debtors of the appropriate organisational structure and associated cost that should relate to each business.

The other major cost that can occur arises out of the use of insolvency practitioners. In the case of receivers, NAMA is moving to a process of payment based on budgets that are submitted in advance by firms and requiring that receivers set out a strategy for the assets to which they have been appointed.

Income Collection and Disposals

One indicator of the challenge in generating the projected cashflows is the level of impairment experienced to date. Losses within the overall portfolio recognised in its accounts up to 31 December

2010 were around 5%. This assessment does not take account of post December 2010 market movements. The market had deteriorated further in 2011. For example, the residential property index produced by the Central Statistics Office indicated that residential property prices had fallen by an average of 16.7% in Ireland during 2011.

In the case of income from rents, in 2011 most borrowers whose performance was reviewed were showing payments that were lower than the levels projected when the loans were valued or when a business case was agreed. For six borrowers, 2011 rental income was around 26% less than that projected at acquisition and, for this sample, only €8 million out of €10.5 million subsequently projected in business plans had been realised.

The difference between rental income anticipated at loan valuation and net rental income received during 2011 on the cases sampled was mainly due to property management costs that were not provided for in the loan valuations which were conducted in line with industry norms for immediate sales.

When NAMA acquired loans, it found that it was not the general practice to require debtors to remit rent collected from properties to controlled bank accounts. The approach adopted by NAMA where debtors are co-operating has been to have rental income paid into an account, which NAMA monitors. Methods of oversight include the use of rent collection agents and financial monitors.

NAMA needs to investigate the emerging income trends outlined above in order to ensure that the amount and timing of its income projections are realistic and that its income collection is maximised and any amounts held back are authorised and transparently accounted for.

In practice, NAMA has not, to date, disposed of property directly. Property that has been disposed of has been sold either by debtors or by insolvency practitioners. This means that most disposals are not governed by the NAMA Code of Practice for the disposal of bank assets or the Code of Practice for the Governance of State Bodies, both of which require competitive processes when disposals above a certain value are being made. However, in July 2011 the Board issued a guidance note setting out a framework for the disposal of assets by NAMA debtors and insolvency advisors under which property disposals should be carried out on a competitive basis.

By the end of December 2011, following adjustment for disposals that were no longer expected to proceed, NAMA had approved asset (loan and property) disposals amounting to €5 billion.

Overall, NAMA had received around €6.2 billion in cash to the end of 2011. Up to that point, €2.9 billion had been received from the sale of property and a further €0.9 billion was received from the disposal of loan assets while a number of debtors had refinanced their loans and remitted the cash to NAMA.

In the sample reviewed the gross receipts for properties in Britain exceeded the market value at acquisition by 2.5% while there was a corresponding shortfall of 5% in the case of Irish disposals. The costs of disposal including taxation in the two jurisdictions reduced the gross proceeds by 3.7% in Britain and 6.7% in Ireland.

Wider State Costs and Liabilities

The State has contributed €63 billion by way of capital to Irish financial institutions. This capital was, in large measure, injected to meet the gap left by the acquisition of the loans at a discounted value. The bulk of the cost of the acquisition of those loans has been met by NAMA through the issue of State guaranteed bonds.

Audit Results

In general, the audit work commissioned by my Office from valuation and legal consultants together with the audit testing conducted in the course of the audit of the 2010 financial statements gives a reasonable degree of assurance that the Agency's valuation processes were robust.

In addition, the review found that NAMA has begun to implement systems and procedures to manage its relationship with debtors and, following recent restructuring within the Agency, this process is continuing in 2012.

In the area of debt management, preliminary audit testing indicates that

- new lending to debtors was duly authorised and the purpose documented
- receivers are being managed so as to achieve a measured service.

A major challenge NAMA faces is to ensure that remittances by debtors out of rental income are based on up to date control listings and that this element of its income is maximised.

The purpose of this report has been to give an early indication of the steps being taken by NAMA to manage its relationship with debtors and collect its income.

These matters are subject to further review in the course of the audit of the financial statements of the Agency for 2011.

Chapter 1

Introduction

Introduction

1.1 The National Asset Management Agency (NAMA) was established in late 2009 as part of a response to the financial crisis. Its purpose was to acquire certain property-related bank assets (largely property loans to debtors) from Irish credit institutions.[1] It formed part of a wider set of measures taken to address the liquidity and solvency of Irish credit institutions.

1.2 NAMA employed 194 staff at 31 December 2011. Those staff are deployed on the functions set out in Figure 1.1.

Figure 1.1 NAMA Human Resources - December 2011

Function	**Staff Numbers**	**Purpose of Function**
Executive Team[a]	8	To manage and control generally the administration and business of NAMA.
Portfolio Management	84	To manage the debtors that are handled directly by NAMA.
Credit and Risk	40	To carry out appraisals of credit, asset and debt management proposals and oversee the implementation of a credit and risk framework.
Legal and Taxation[b]	22	To act as an independent legal advisor to the Board, CEO and NAMA business divisions.
Business Services[b]	11	To manage and implement all data systems and IT projects to support NAMA. This area also covers the oversight of the financial institutions as primary servicers and Capita as Master Servicer.
Lending	8	To provide specialist advice on issues related to debt and equity.
Treasury	5	To manage NAMA's Balance Sheet risks and its liquidity requirements.
Insolvency	5	To advise on enforcement strategies and appoint enforcement specialists.
Asset Search	3	To provide internal advice on asset searches and appoint and manage asset searchers.
Financial Control[b]	8	To develop and implement financial and management reporting.
Total	**194**	

Notes: a Including Chief Executive Officer's personal assistant.

b In addition, there were a total of eight personnel on short term contracts in Business Services, Legal and Taxation and Financial Control.

1.3 Special Report 76[2] reviewed the processes established by NAMA to acquire bank assets. It did this by reference to the procedures employed in the course of acquisition of the first tranche of loans for which NAMA had paid €7.7 billion. That report also outlined NAMA's initial corporate governance structure and set out its resourcing and procurement arrangements.

1.4 Since Special Report 76 was published

1 Throughout the report the terms bank, financial institution and participating institution are used interchangeably to signify those five financial institutions that participated in the NAMA scheme.

2 Special Report 76, National Asset Management Agency – Acquisition of Bank Assets, Comptroller and Auditor General, October 2010.

- NAMA has reported the outcome of activities up to 31 December 2010 in its first set of financial statements
- it has continued to acquire bank loans from Irish credit institutions
- it has begun to put a structure in place to review plans by borrowers and manage the debt owed by them.[3]

The State has continued to address the capital requirements of Irish financial institutions.

Wider Bank Resolution Measures

1.5 The removal of impaired assets is part of the measures taken by the State to address the losses and consequent capital deficiency that occurred in Irish banks.

1.6 In March 2011, the Central Bank of Ireland (CBI) published the Financial Measures Programme (FMP) Report which included the results of

- an independent loan loss assessment carried out for the CBI
- a Prudential Capital Assessment Review
- a Prudential Liquidity Assessment Review.

1.7 The additional capital assistance required by the credit institutions following the FMP Report was identified as €24 billion. The capital required could be met directly by the State or by the credit institutions.

1.8 By the end of December 2011, the capital requirements had been substantially met through the investment of a total of €17.6 billion[4] by the State and €5.15 billion raised[5] by the credit institutions through capital raising measures.[6] Overall, the State has contributed €63 billion[7] by way of capital to the banks.

Financial Results of the Agency – 2010

1.9 The main features of the financial performance of NAMA to 31 December 2010 were as follows

- An operating profit of €305 million was recorded on its current operations as measured in accordance with accounting standards that apply to organisations that hold financial instruments.[8]
- Following an impairment charge of €1.5 billion arising out of a further diminution in the value of the loan assets purchased by NAMA, a loss of €1.12 billion was incurred.
- The carrying value of the loans held by NAMA at 31 December 2010 was €27.95 billion.
- NAMA held derivative financial instruments with a net market value of €325 million.

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3 Throughout the report those property debtors who owe money to NAMA are described as either borrowers or debtors depending on the context.

4 The State subsequently recouped just over €1 billion of this through the sale of shares in the Bank of Ireland to a group of institutional investors.

5 Around €1.3 billion had yet to be raised from other sources by Irish Life and Permanent.

6 Chapter 4 of the Report on the Public Services 2010 outlines this in greater detail.

7 Including the reinvestment of dividends totalling €0.29 billion received from AIB in the form of ordinary shares and after the sale by the State of shares to the value of €1 billion in Bank of Ireland.

8 The main feature of this measurement is the accrual of income at a constant rate over the deemed life of the loans. The timing of this reported income can differ from the timing of cash realisations, which is reported in NAMA's cash flow statement.

- NAMA's funding comprised Government guaranteed bonds amounting to €28.65 billion and €1.5 billion of subordinated debt.

1.10 The outlay on loans and associated derivatives acquired up to the end of 2010 was €30.18 billion of which €29.97 billion was paid for the loans. The closing balance on the loans was €27.95 billion. The movements in the loan balances between their valuation date and 31 December 2010 are set out in Figure 1.2.

Figure 1.2 NAMA – Movement in loan balances 2010

	€m	€m
Loans – Balance at valuation date		**29,971**
Valuation adjustments[a]		(477)
Due diligence costs[a]		60
Balance at transfer date		**29,554**
Advances to debtors		240
Interest receivable		448
Gross Amount Receivable		**30,242**
Cash receipts from debtors		
Collateral Disposal	(363)	
Other cash receipts	(371)	(734)
Foreign Exchange movement		(72)
Impairment		(1,485)
Loans – closing balance[b]		**27,951**

Note: a Valuation adjustments include net cash received from borrowers between the dates of loan valuations and the dates of transfer to NAMA (€386m) and adjustments arising from errors in valuations or acquisition (€115m) payable by borrowers to NAMA as well as other adjustments (€24m) payable by NAMA to borrowers. Adjustments following the completion of due diligence on some loans amounted to €60m payable to borrowers by NAMA.

b This represents the carrying value of the debt and not the original par value.

Interest Income and Cash Receipts

The total value of loans and receivables due to NAMA increases each year by the interest that is deemed to be earned and is, in turn, reduced as cash is received.

This interest income is calculated using an accounting technique known as the Effective Interest Rate method. This method spreads interest income at a constant rate over the life of a loan regardless of the timing of cash receipts. This means that in any given year there may be no obvious link between the amount recognised as interest income and cash received during the year. However, over the life of a loan the total cash received in excess of the opening loan balance will, following adjustment for any impairment losses, equal the interest income recognised.

In 2011, NAMA reported interest income of €448 million. The cash flow statement reported that borrowers had paid NAMA €734 million comprising €363 million from the sale of collateral and €371 million in other loan cash receipts.

Annual reviews for loan impairments must be undertaken when loans are accounted for using the Effective Interest Rate method. This is because interest income is calculated on the basis of the cash that a loan is expected to generate over its lifetime. Any change in expectations will cause adjustment of both income reported and the carrying value of the loans. At the end of each period, the expected cash flows are reviewed and if there is a fall in their present value, then the difference between the carrying value of the loan and any revised lower present value of the cash flows is recognised as an impairment loss.

Implementation of the NAMA Scheme

1.11 NAMA acquired loans from the five credit institutions[9] that participated in the scheme at a price determined in accordance with the National Asset Management Agency Act 2009 (the Act) and regulations made by the Minister for Finance (the Minister). Loan information provided by the participating institutions is subject to detailed review (property valuations and legal due diligence) by NAMA or advisors acting on its behalf prior to completion of acquisitions.

1.12 By December 2011, NAMA had paid around €27 billion for loans that had been subject to full due diligence. The original amounts owed by the borrowers totalled €60.4 billion.

1.13 In September 2010, the Minister made further regulations under which remaining loans to be acquired by NAMA at that point were to be acquired prior to completion of full due diligence. The prices paid for those loans, which were initially determined in accordance with the revised regulations and criteria set down by the Board of NAMA (the Board), are subject to adjustment on completion of the full due diligence process. Up to 31 December 2011, €11.8 billion[10] had been finally determined as the consideration for loans that were fully valued and €4.8 billion had been advanced on the basis of provisional valuation.

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9 Allied Irish Banks, Bank of Ireland, Anglo Irish Bank Corporation, Irish Nationwide Building Society and EBS Building Society.

10 This €11.8 billion is included in the €27 billion for loans where the full due diligence process had been completed at the end of 2011.

State Aid

1.14 The State paid €26.4 billion for the first five tranches of bank assets.[11] The deemed value of state aid as represented by the difference between the price paid for the loans and their current market value was €4.96 billion or 23% greater than their current market value. It is not possible to calculate the state aid for the remaining loans until they have been definitively valued.

Financial Objectives of NAMA

1.15 NAMA has a whole-life aim of achieving a surplus on its activities as well as intermediate objectives of reducing its debt by defined proportions over its lifetime.

- NAMA's immediate target is to reduce its debt by 24% by 2013.
- Its initial estimate was that the costs payable by NAMA over the course of its life would amount to around €1.6 billion excluding due diligence and funding costs. In early 2012, NAMA had revised this down to around €1.4 billion. About 50% of this amount represents an estimate of the amount payable to the financial institutions to administer the loan portfolio over the life of NAMA.[12]
- When it published its first business plan in mid-2010, the financial outcome of its activities over its expected lifespan was projected to range from a net present value deficiency of €0.8 billion, in circumstances where NAMA recovered 10% less than the long-term economic value of acquired loans, to a surplus of €3.9 billion where it recovered 10% more than the long-term economic value.

1.16 In this context, NAMA has continued to review its projections and its latest 'base case'[13] analysis is that all assets will be disposed of by the end of 2020. The outcome of these updated projections will inform a revised strategy that the Board is expected to approve in the first quarter of 2012 and which will be submitted to the Minister.

Financial Risk

1.17 After it has taken over and definitively valued the loan assets NAMA faces two major risks

- a risk that it will not establish an effective working relationship with those borrowers that owe it the debt it has purchased and
- a risk that it will not achieve its cash targets i.e. the assets and the economic environment do not accord with original expectations over NAMA's life.[14]

Loan Management Risk

1.18 Overall, there are almost 800 borrowers[15] with 12,000 loans and 35,000 properties that have debts owing to NAMA.

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[11] While due diligence had been completed for loans with an acquisition value of €27 billion, the detailed data for loans that transferred after the first five tranches had not been collated by the end of 2011.

[12] NAMA estimates that the financial institutions will assign up to 500 staff to carry out this work.

[13] As is common in such work, NAMA is considering a range of scenarios.

[14] Key environmental impacts could arise from land dezonings, loss of planning permissions, rent reductions, loss of tenants, declines in asset value in the market generally and non-availability of credit.

[15] There are around 1,000 individual borrowers. NAMA manages the debt by reference to 'borrower connections' – grouping closely connected borrowers whose aggregate debt is considered by NAMA to be best managed as one cohesive connection rather than separately. Throughout the report, the terms debtor and borrower are used interchangeably and both refer to 'borrower connections', which may include one or more individual borrowers.

1.19 Under the Act, NAMA is required, so far as possible, expeditiously and consistent with the purposes of the Act,[16] to achieve the best possible financial return for the State. The general approach that NAMA has taken to achieve its obligation under the NAMA Act is to engage with borrowers to see whether and to what extent agreement can be reached on how the borrowers will repay the amounts they owe.

1.20 While NAMA is projecting that it will have paid, on average, 43% of the face value of the debt originally owed by borrowers, borrowers continue to owe the full original par balances to NAMA. The first step in this loan management process is the seeking of business proposals (business plans) from borrowers setting out how their business will be managed in a way that repays the maximum amount of the debt.

1.21 For the top[17] 187 borrowers, whose cumulative loan balances at acquisition amounted to almost €61 billion, the business plans are subject to internal review within NAMA as well as review by independent advisors appointed by NAMA. For the remaining borrowers, who have lower levels of debt, the review of the business plans is delegated to the participating institutions with oversight by NAMA.

1.22 Like lenders generally, NAMA may take enforcement proceedings in circumstances where a borrower is in default of obligations under a loan agreement. The most common action is the appointment of a receiver to property pledged as collateral for a loan. Chapter 3 outlines how NAMA is managing its relationship with borrowers.

Cash Realisation Risk

1.23 NAMA continues to operate in a situation where property values in Ireland are depressed[18] and the availability of loan finance to purchase property constrained. In these circumstances, key risks to NAMA achieving its financial goals include the risks that

- property prices will not recover sufficiently to allow it to realise an amount equivalent to the cost of loans including the uplift for long-term economic value of the property collateral or that property prices will fall further
- cash generated by properties in the period before any disposals are effected will either be less than that projected when the loans were valued for acquisition purposes or borrowers will not pay all of the cash to NAMA
- operating costs incurred by NAMA will be greater than the €1.4 billion that NAMA has projected that it will incur over its lifetime.

1.24 In its business plan of mid-2010, NAMA anticipated that it would have disposed of all loans and associated properties by the end of 2019. In its most recent analysis, which will inform a revised strategy, disposals are projected to continue to the end of 2020 under a 'base case' scenario. Key operating assumptions that underlie the analysis for the 'base case' scenario include

- While assets in Britain are around a third of the NAMA portfolio, disposals in Britain are projected to account for over 50% of the overall disposals target in the period to 2016.
- The disposal of assets in Britain will be accelerated and it is estimated that around 47% of the assets will be sold by 2013, a further 42% by 2015 and the balance by 2020.

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16 Section 10(1) of the NAMA Act states that NAMA shall acquire eligible bank assets, deal expeditiously with them and protect or otherwise enhance the value of those assets in the interests of the State.

17 'Top' borrowers refers to those borrowers who owe the largest amounts to NAMA.

18 There have been declines in Irish property prices of over 20% from November 2009 to end December 2011 while some British property prices have increased by close to 10% in the same period.

- The disposal target for assets in Ireland up to 2016 is €7 billion or almost 40% of the Irish portfolio. The remaining 60% of Irish assets are targeted for realisation in the period 2017-2020 including over 90% of the €5.3 billion in the Agency's land and development assets portfolio.
- In Northern Ireland it is currently estimated that around one-third of assets will be realised by 2016 and the balance by 2020.
- Over 80% of the €1.9 billion of assets in the rest of the world[19] are targeted for disposal by the end of 2013 and the balance by the end of 2015.

Report Focus

The principal focus of this report is on the measures being taken by NAMA to structure its debt management operations. The material was generated in the course of the audit of the 2010 financial statements and interim work on the 2011 outturn.

The interim audit results for 2011 are, necessarily, preliminary in nature and further work is proceeding in the context of the final audit of the 2011 financial statements.

Overall, the report sets out the profile of the loans acquired by NAMA up to 31 December 2011 and outlines the measures being taken by it to manage those loan assets in order to achieve the objectives of the Act. It does this in the three chapters that follow.

- Chapter 2 reviews the extent to which the loan acquisition process has been completed and the profile of the collateral underlying the loans.
- Chapter 3 looks at the extent to which NAMA has moved to structure its relationships with borrowers.
- Chapter 4 examines the outturn of NAMA's debt management operations to date.

[19] Rest of the world covers areas other than Ireland, Northern Ireland and Britain.

Chapter 2

Loan Acquisition Progress

Loan Acquisition

2.1 At 31 December 2011 NAMA had acquired all eligible assets that it intends to acquire. The assets comprised €74 billion of property related loans that the five participating financial institutions had advanced to borrowers.[20] These loans fall into two categories – loans where a full due diligence process has been completed and loans acquired at a provisional valuation pending the completion of a full due diligence process. The total outlay was €31.7 billion. The loans acquired had the features set out in Figure 2.1.

Figure 2.1 Features of Loans Acquired to 31 December 2011

Basis of Acquisition	Borrower Numbers	Total Borrowings (Par debt)	Amount Paid (NAMA debt)
		€bn	€bn
Due diligence completed[a] – Tranches 1-5	381[b]	59.01	26.36
Due diligence completed[c] – Remaining loans	103	1.80	0.76
Post-acquisition adjustments[d]		(0.41)	(0.16)
Sub-total	**484**	**60.40**	**26.96**
Provisional valuation	292	13.46	4.77
All Loans	**776**	**73.86**	**31.73**

Notes: a Loans transferred in tranches 1 to 5. Following completion of the loan valuation, an audit coordinator (KPMG) collates the loan data for each tranche for all participating institutions. At the end of December 2011, this process had been completed for the first five tranches.

b 151 borrowers had some loans for which the due diligence process had been fully completed but other loans for which the process had not finished. These borrowers are included just once in the category 'due diligence completed'.

c Loans where the due diligence process was completed but the detailed information not yet collated.

d Under sections 88, 93 and 98 of the the Act, adjustments of €160 million were made for the first five tranches in respect of obvious errors or omissions, overpayments and objections to the value placed on acquired bank assets by the participating institutions.

2.2 Debtors are, following a Supreme Court decision of February 2011, entitled to make representations to NAMA prior to the decision on the acquisition of loans. This process applied to the final acquisitions made in the final quarter of 2011.

Transfers where Valuation Finalised

2.3 Loans were transferred to NAMA in tranches. At the end of December 2011, the due diligence process had been completed for the first five tranches of loans where total borrower debt amounted to €59 billion including derivative contracts. The amount paid by the State for loans was the lesser of the balance owed by the borrower or the value of the associated loan collateral adjusted for legal, enforcement and due diligence discounts.

2.4 Since financial derivatives, usually interest rate swaps, are assets of the bank in the same way that loans due by borrowers are assets, the bank was also compensated for the derivatives. NAMA acquired all of the derivatives. However, it gave consideration for them only in those circumstances where both

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20 Ultimately, land and development loans under €20 million in Bank of Ireland and Allied Irish Banks were not acquired.

the loan and derivative were performing[21] and where there was legal security in place and the value of the security was sufficient.

2.5 The total amount paid for derivatives in the first five tranches was €257 million - just under 1% of the total consideration. NAMA also acquired financial derivatives with a market value of approximately €410 million in favour of the participating banks for which no consideration was given because borrowers were not making payments under the derivative agreements which were, therefore, classified as non-performing.

2.6 The net valuation placed on the fully valued loans and associated derivatives was €26.4 billion resulting in an overall discount of over 55% when compared with the amounts owed by the borrowers to the financial institutions. Write-downs of loans for which a full due diligence process has been completed, in the case of individual financial institutions, ranged from around 43% to almost 62%. A summary of the outturn on this type of loan acquired from participating banks is set out in Figure 2.2.

Figure 2.2 Loans Acquired – Valuations Finalised

	AIB[a]	Anglo[a]	BOI	EBS[a]	INBS[a]	Total
	€bn	€bn	€bn	€bn	€bn	€bn
Borrower Debt	14.99	26.23	9.48	0.83	7.48	59.01
NAMA Payment	6.86	10.85	5.43	0.35	2.87	26.36
Discount	8.13	15.38	4.05	0.48	4.61	32.65
Discount	54%	59%	43%	58%	62%	55%

Source: NAMA.

Note: a In 2011, Allied Irish Banks merged with the EBS Building Society. Anglo Irish Bank merged with the Irish Nationwide Building Society and was renamed the Irish Bank Resolution Corporation. NAMA recorded all loan acquisitions under the names of the participating institutions prior to the mergers and this report does so also.

Transfers based on Provisional Valuation

2.7 At December 2011, the due diligence process had yet to be completed for a further €13.5 billion of loans for which NAMA had paid €4.8 billion based on the interim loan valuation process – giving a provisional discount on those loans of 65%. Figure 2.3 compares the provisional valuation and the original debt by financial institution.

Figure 2.3 Loans Acquired based on Provisional Valuations

	AIB	Anglo	Total
	€bn	€bn	€bn
Borrower Debt	5.43	8.03	13.46
Interim Consideration	2.28	2.49	4.77
	3.15	5.54	8.69
Provisional Discount	58%	69%	65%

Source: NAMA.

21 A derivative was classified as performing where payments were being made by the borrowers in respect of the derivative contracts.

2.8 In addition, by December 2011, the due diligence process had been completed for €1.80 billion of loans[22] transferred after the fifth tranche for which the final acquisition value was €0.76 billion. NAMA anticipates that it will have completed the loan valuation process for all loans by the end of first quarter of 2012.

Consideration Paid – Fully Valued Loans

2.9 €26.4 billion has been paid by NAMA in respect of loans that have been finally valued and the detailed data collated. The components of the consideration are set out in Figure 2.4 together with associated explanations of each element.

[22] The detailed data for these loans had not been collated by December 2011.

Figure 2.4 Consideration for Finally Valued Loans Paid – Initial Five Tranches

	AIB	Anglo	BOI	EBS	INBS	Total
	€m	**€m**	**€m**	**€m**	**€m**	**€m**
Loan Balance	14,928	26,085	9,437	826	7,476	58,752
Derivatives	70	143	44	-	-	257
Borrower Debt	**14,998**	**26,228**	**9.481**	**826**	**7,476**	**59,009**
Market Value of Property (30 November 2009)	**6,972**	**10,541**	**5,525**	**361**	**3,254**	**26,653**
Long-Term Value of Underlying Property						
Land (including development property < 30% complete)	*2,398*	*1,939*	*1,469*	*95*	*1,327*	*7,228*
Residential Property for resale	*1,174*	*1,320*	*915*	*164*	*360*	*3,933*
Investment Property	*3,106*	*6,824*	*2,715*	*121*	*809*	*13,575*
Hotels	*438*	*1,295*	*502*	*1*	*827*	*3,063*
Development Property (>30% complete)	*396*	*170*	*422*	*6*	*200*	*1,194*
Total	**7,512**	**11,548**	**6,023**	**387**	**3,523**	**28,993**
NAMA Valuation						
Collateral Associated with Loans						
Present Value of Property Cash Flows	7,240	11,510	5,888	372	3,240	28,250
Cash Security	76	286	60	4	7	433
Other Security	395	555	115	8	20	1,093
Total Collateral	**7,711**	**12,351**	**6,063**	**384**	**3,267**	**29,776**
Excess Collateral	(681)	(1,031)	(474)	(18)	(183)	(2,387)
Legal Discount	(34)	(217)	(1)	(1)	(115)	(368)
Collateral Available to the State	**6,996**	**11,103**	**5,588**	**365**	**2,969**	**27,021**
Due Diligence and Enforcement Adjustment	(275)	(394)	(198)	(14)	(136)	(1,017)
Net Loan Collateral	**6,721**	**10,709**	**5,390**	**351**	**2,833**	**26,004**
Qualifying Advances	140	137	43	-	39	359
Consideration	**6,861**	**10,846**	**5,433**	**351**	**2,872**	**26,363**
Discount	54%	59%	43%	58%	62%	55%
Loan CMV[a]	5,565	8,877	4,438	285	2,242	21,407
State Aid	**23%**	**22%**	**22%**	**23%**	**28%**	**23%**

Note: a The Current Market Value (CMV) of the loans was calculated using a model developed by NAMA's financial advisors.

Explanation of Elements

Loan Balance	The amounts owed by borrowers at loan valuation date[23] and including qualifying advances made after 7 April 2009.
Derivatives	The current market value of the performing financial derivatives for which NAMA gave consideration. NAMA also acquired financial derivatives with a value of approximately €410 million for which no consideration was given because these were non-performing (borrowers were not making payments).
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 current 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.
NAMA Valuation	
Collateral Associated with Loans	
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.
Total Collateral	The total value of the collateral pledged by borrowers.
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	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 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	Some loan balances due by borrowers included qualifying advances. The amounts by which these elements of the loan balances were reduced in the loan valuation process are added back so as to implement the direction of the Central Bank of Ireland that no discount should apply to qualifying advances.
Consideration	The total amount paid by NAMA for the acquired loans and associated financial derivatives.
Discount	The percentage difference between the consideration paid and borrower debt at loan valuation date.
Loan CMV	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 consideration and the Loan CMV expressed as a percentage of the Loan CMV.

[23] NAMA pays 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 institution. For example, for the first tranche, the loan valuation date for all participating institutions was 31 January 2010.

2.10 The amount paid by NAMA was based primarily on the current market value of the land and development property at 30 November 2009 for which the loans had been advanced together with any associated collateral. The value was adjusted by a factor designed to take account of the long term economic value that it was assumed would accrue when the economic conditions had stabilised. The process of valuation involved estimating the amount and timing of the cash flows associated with the property and deriving the value of those cashflows in current terms.

2.11 The property cash flows comprised two main elements

- the proceeds that would accrue to NAMA if the property was sold at its long-term economic value
- the rental cash flows that would accrue to NAMA prior to disposing of the property.

Process of Property Valuation

Market Value of Property

Initial valuations of properties were carried out by the participating banks who provided just over 10,600 property valuations.[24] This includes property valuations for those loans that have not yet been subject to the full due diligence and loan valuation process. Following review by NAMA-appointed valuers, a second valuation was sought for 1,313 valuations. In these cases, the second valuations were lower in 1,181 instances, higher in 64 and there was no change in the other 68. The net reduction in value following the second valuations was €2.3 billion. The final valuation, for calculation purposes, was either the agreed initial valuation or the second valuation. The total final valuation of the property amounted to around €31.7 billion.

Long-term Uplift Factor

The next major step was to apply an uplift for long-term economic value to the property valuations. The uplift factors are proposed by the NAMA-appointed valuers and are reviewed by NAMA. The final decision for all uplift factors was made by NAMA. The maximum uplift for any individual property cannot exceed 25% of the property's market value and the adjustment factor for all property valued in connection with the acquired portfolio of any one participating bank cannot exceed the aggregate of the property market values by more than 20%.

Rental Flows

The projected rental cash flows were identified by property valuers, appointed by the participating banks, taking account of factors such as current occupancy rates, current rental values, rent review dates and assumed vacancy rates following lease breaks and maturity dates.

Adjustment to Present Values

In order to express the assumed future proceeds from each property in current values it was necessary to discount the projected flows of income (including the disposal proceeds).

For practical calculation purposes, the point of assumed disposal is determined by reference to the level of uplift.

24 Some property valuations included valuations for more than one property – e.g. for a number of residential units.

Results of Property Valuation Process

2.12 In the case of loans that have been finally valued, the value of the associated property was uplifted from around €26.7 billion to just under €29 billion before discounting to present values.

2.13 71% of the value of all property comprised completed residential and commercial properties including hotels. The uplift adjustment to derive the long-term economic value of the property averaged 8.8%. The average uplift for the first tranche was 11% and this average has fallen for each of the subsequent tranches. The average property uplifts for each bank are set out in Figure 2.5.

Figure 2.5 Property Uplift Adjustments by Bank

	AIB	Anglo	BOI	EBS	INBS	Overall
Tranche 1	8.96%	11.68%	11.99%	8.10%	11.84%	11.01%
Tranche 2	8.86%	10.30%	9.75%	6.82%	11.16%	9.82%
Tranche 3	8.03%	7.57%	7.17%	7.68%	8.70%	7.91%
Tranche 4	6.46%	7.12%	8.08%	6.69%	7.87%	7.28%
Tranche 5	5.74%	6.66%	7.36%	6.20%	5.61%	6.37%
Average Uplift Adjustment	**7.8%**	**9.5%**	**9.0%**	**7.2%**	**8.3%**	**8.8%**

Source: NAMA – Analysis by Office of C&AG.

2.14 The level of uplift for long term economic value varied by type of property and the overall uplift was influenced by the relative proportion of each type of property in the overall portfolio. Figure 2.6 sets out the average uplift adjustments by property type for the first five tranches together with the relative proportion of the property in each category. Hotels had the highest average uplift of 9.6%, while development property that was more than 30% complete had the lowest average uplift of 7.2%.

Figure 2.6 Property Uplift Adjustments by Property Type – Completed Valuations

	Land (including development property < 30% complete)	Residential Property for resale	Investment Property	Hotels	Development Property (> 30% complete)
Average Uplift Adjustment	8.5%	7.3%	9.3%	9.6%	7.2%
Proportion of property collateral (CMV)	25.0%	13.7%	46.6%	10.5%	4.2%

Source: NAMA – Analysis by Office of C&AG.

2.15 For those loans that have been finally valued, the present value of the projected cash flows from the property, incorporating the presumed disposal proceeds of the uplifted long-term economic value of the property and any rental cash flows, was calculated at €28.3 billion.

2.16 The present value so derived exceeded the current market value of the properties using market valuation methods by around 6%. Figure 2.7 details this by financial institution.

Figure 2.7 Comparison of Amount Paid for Property with Market Value

Institution	AIB	Anglo	BOI	EBS	INBS	Total
	€bn	€bn	€bn	€bn	€bn	€bn
Amount Paid for Property[a]	7.24	11.51	5.89	0.37	3.24	28.25
Market Value of Property[b]	6.97	10.54	5.53	0.36	3.25	26.65
Difference	0.27	0.97	0.36	0.01	(0.01)	1.60
Difference %	3.9%	9.2%	6.5%	2.8%	(0.3%)	6.0%

Note: a This represents the present value of the property cash flows prior to any adjustments for excess collateral, due diligence and enforcement costs or legal discounts. The final adjusted consideration paid taking account of those factors was €26.36 billion.

b Market value at November 2009.

Other Settlement Factors

2.17 In addition to the present value of property associated with the loans other factors that impacted on the consideration that was ultimately paid included cash held in the accounts of borrowers and other security of €1.53 billion bringing the total estimated present value of all loan collateral to €29.78 billion. The value of other collateral was around 5.8% of the total consideration paid. The collateral other than property comprised

- cash security, for example deposit accounts held by borrowers, €433 million and
- other securities totalling €1.1 billion.

2.18 €26 billion of the total available collateral was taken into account in the determination of consideration after taking account of

- €1,017 million for due diligence and enforcement costs
- €2,387 million excess collateral which arose on some loans
- legal discounts of €368 million.

2.19 An outline of each of the foregoing components together with the settlement of the consideration paid for them is set out at Annex A to this Chapter.

Current Market Value of Loans and State Aid

2.20 The governing legislation provides that NAMA may, with the agreement of the Minister, pay a price between a loan's current market value and its long-term economic value. The cumulative current market value of the loans in the first five tranches was around €21.4 billion, about €4.96 billion less than the total consideration given for them. The loan market value is calculated by applying commercial discount rates for distressed loans to the current market value of the property and the rental income associated with it. However, NAMA paid the long-term economic value for all loans. The loan long-term economic value is calculated by applying the NAMA discount rates[25] to the long-term economic value of the associated property and the projected rental income associated with the property.

[25] The NAMA discount rates were set out in Statutory Instrument 88 of 2010 - the National Asset Management (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations. They are 4.54% (3 years), 5.57% (5 years) and 6.14% (eight years). The period over which cash flows were discounted was determined by the long-term uplift applied to the property collateral for the loan.

2.21 An Impaired Asset Communication from the European Commission[26] provided that public asset relief measures are considered as state aid if impaired assets are purchased at a value above the market price. The amount of state aid[27] for each bank is set out in Figure 2.8.

Figure 2.8 State Aid – Fully Valued Loans[a]

	AIB	Anglo	BOI	EBS	INBS	Total
	€m	€m	€m	€m	€m	€m
Loan Consideration	6,861	10,846	5,433	351	2,872	26,363
Loan CMV[a]	5,565	8,877	4,438	285	2,242	21,407
State Aid	1,296	1,969	995	66	630	4,956
State Aid %	23%	22%	22%	23%	28%	23%

Source: NAMA – Analysis by Office of C&AG.

Note: a These loans refer to those acquired and finally valued up to December 2011 in the first five tranches of transfers.

Profile of Property Collateral

2.22 While NAMA has paid €31.7 billion for loan assets to date, a key factor in recovering the value it has given for those assets will be the type of underlying collateral and its location. Figure 2.9 profiles the overall collateral behind the loans at the point of their acquisition.

26 Communication from the Commission on the Treatment of Impaired assets in the Community Banking Sector, February 2009. The Communication was issued following the announcements by several member states of their intention to provide some form of relief for impaired bank assets and was drawn up by the Commission in consultation with the European Central Bank and built on recommendations included in 'Guiding Principles for Bank Asset Support Schemes' issued by the Eurosystem in the same month.

27 NAMA is required to notify the European Commission of the level of State Aid in each tranche.

Figure 2.9 Property Collateral for Loans – by region and asset type[a]

	Dublin	Rest of Ireland	Ireland Total	London	Rest of Britain	Britain Total	Northern Ireland	Rest of World	Total	%
Office	2,442	224	2,666	1,222	878	2,100	215	272	5,253	16.5%
Retail	1,514	1,395	2,909	279	878	1,157	216	145	4,427	13.9%
Other Investment[b]	1,300	1,110	2,410	399	826	1,225	343	504	4,482	14.1%
Residential[c]	2,313	1,383	3,696	375	914	1,289	133	156	5,274	16.6%
Hotels	455	479	934	1,344	465	1,809	12	282	3,037	9.6%
Total Completed Properties	8,024	4,591	12,615	3,619	3,961	7,580	919	1,359	22,473	70.7%
Land	2,417	1,757	4,174	1,356	490	1,846	279	158	6,457	20.3%
Development	521	608	1,129	888	446	1,334	61	327	2,851	9.0%
Total Land and Development	2,938	2,365	5,303	2,244	936	3,180	340	485	9,308	29.3%
Total	**10,962**	**6,956**	**17,918**	**5,863**	**4,897**	**10,760**	**1,259**	**1,844**	**31,781**	
%	**34.5%**	**21.9%**	**56.4%**	**18.5%**	**15.4%**	**33.9%**	**3.9%**	**5.8%**		

Source: National Asset Management Agency.

Notes: a While some loans had not been subject to the full due diligence process by the end of December 2011, the property collateral for the loans had been valued.

b Other investment property includes industrial property and properties with mixed uses.

c Includes property to the value of €452 million classified as residential investments.

2.23 From a geographic perspective

- over 56% of the property is located in Ireland, with just over one-third of all property being located in Dublin
- a further 34% is in Britain, including 18.5% in London.

2.24 The composition by category of development can be classified as follows

- investment property which accounts for over 44% of the portfolio (excluding residential investment property and hotels)
- residential property which makes up 16.6% of the assets
- hotels which account for 10%
- partly completed developments make up 9% of the property
- just over 20% is made up of land with almost 70% of that being located in Ireland.

Valuation of Assets

2.25 The property collateral for loans was valued at 30 November 2009[28] while the acquisition value of the assets (loans and associated derivatives) acquired under the NAMA scheme was calculated at the loan

28 The Board of NAMA set this date in accordance with Section 73 of the Act.

valuation date set for each tranche.[29] Under conventional accounting rules the value of those assets was estimated to have reduced by €1.5 billion due to impairment by 31 December 2010 and the value of any further impairment during 2011 will be assessed in the course of the audit of the 2011 financial statements.

Property Valuation and Legal Due Diligence

2.26 Two of the critical elements of the loan valuation process were

- valuation of properties at their November 2009 valuations and
- the legal due diligence process which, primarily, established NAMA's right to the loan collateral.

In order to gain assurance about these two elements, the audit of the 2010 financial statements obtained expert advice.

Property Valuation

2.27 The Office of the C&AG used the services of the Valuation Office and of a former Commissioner of Valuation in Northern Ireland to review the property valuation process. In regard to the valuations at November 2009, the key issues on which advice was sought and the findings of the advisors were

- *Whether current market valuations at that date for the purposes of valuing loans being acquired from the participating institutions were carried out in accordance with the standards prevailing in the industry.*

  The advisors found that all of the sample valuations[30] had been carried out in accordance with the requirements of the Royal Institution of Chartered Surveyors Red Book, were in accordance with recognised national and international professional standards and that the valuers were qualified to carry out the valuations.

- *Whether there were any instructions to property valuers in regard to the current market valuations of property collateral that might have caused them to deviate from best industry standards.*

  The advisors noted that NAMA had issued guidance to the participating institutions on the concept of market value including guidance on how to deal with the extant circumstances in a falling market with diminishing transactional evidence. The advisors noted that they considered the guidance given to be sound advice and that they did not come across any evidence of instructions that might have caused valuers to deviate from best industry practice.

- *Whether the valuation process in regard to second valuations, where these were sought, was adequate.*

  The advisors noted that the second valuer's report is known as a Short Form Report and must meet the requirements of the Royal Institution of Chartered Surveyors Red Book valuation. The advisors pointed out that a second valuation was accepted as final by NAMA and was not subject to further review by the Property Reviewer[31] who could ensure that all issues raised by the Reviewer have been addressed. The advisors noted that, in response to this, the Head of Portfolio Management had pointed out that the valuation process needed to end somewhere and not become too lengthy or cumbersome.

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29 The acquisition value was the lower of the present value of the collateral cash flows and the amounts due by the borrowers (loans and derivatives) at the loan valuation date.

30 A sample of 39 properties was reviewed.

31 The Property Reviewer is a valuer appointed by NAMA who reviews the original property valuation submitted by the participating institutions. If the reviewer does not agree the valuation, NAMA commissions a second valuation.

2.28 Overall, the conclusions of the advisors provided assurance that the property valuation process had been carried out in accordance with standards prevailing in the industry.

Legal Due Diligence Process

2.29 The Office of the C&AG used the services of a legal firm that had not been involved in the legal due diligence process in NAMA to review the legal due diligence process established by NAMA and to report on

- the due diligence process and, in particular, its adequacy in terms of the legislative requirements and best practices and
- steps taken by NAMA to address any issues relating to security arrangements identified in due diligence reports and on the adequacy of those steps.

2.30 In their report[32], the advisors concluded that

- Each step in the legal due diligence process[33] was adequate and in accordance with good practice and that the relevant systems and procedures had been put in place by NAMA to ensure efficiency and transparency through the process.
- NAMA's success in its direct engagement with the participating institutions to deal with and resolve any issues arising that may lead to legal adjustments being applied was apparent from the review.

2.31 The conclusions of the advisors provided assurance that 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.

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[32] The advisors reviewed 25 files selected by the Office of the C&AG.

[33] The steps identified were the due diligence process, issue of guidelines by NAMA to the participating institutions, the due diligence report, NAMA Legal Quality Control Check and Tracking System, review by an independent legal firm and review by NAMA legal section (which includes consideration of legal adjustments for security issues – i.e. where the security held is not enforceable or where the security may be enforceable but further steps need to be taken).

Conclusion

Loans with an original value of €74 billion have been acquired by NAMA at a cost of €32 billion. Almost €5 billion of the outlays represents an on account payment in respect of loans that were valued provisionally. NAMA expects to have all valuations definitively completed by the end of March 2012.

The outlay on loans represents the initial carrying value in NAMA's books of account. This carrying value had reduced by €1.5 billion due to impairment at 31 December 2010 and further impairment in value is anticipated in 2011.

The discount that was applied on the loans that have been finally valued to date is 55% and is likely to marginally increase (up to 57%) when the remaining loans are valued definitively.

As the acquisition process developed, the uplift that was applied to arrive at the long term economic value of the collateral behind the loans has diminished from 11% in the case of the first tranche of loans to 6.4% in the latest tranche finally valued. Overall hotels received the biggest uplift across all acquisitions with their value increasing by almost 10% on average.

When discount rates for distressed loans are applied, it is estimated that State Aid of over one-fifth has been given to the financial institutions in the course of the acquisition process.

Over half of the underlying collateral (56%) is in Ireland with a further one-third in Britain.

Of the property that has been fully valued to date, completed investment type properties represent 71% of the collateral with land making up a further 20%. Around 9% is made up of properties that are in the course of development.

In general, the audit assurance received by my Office from valuation and legal consultants together with the audit testing conducted in the course of the audit of the 2010 financial statements gives a reasonable degree of assurance that the Agency's valuation processes were robust.

Annex A Elements Impacting on Consideration paid by NAMA

The consideration paid for finally valued loans took account of a number of factors in addition to the total collateral available to NAMA. These are outlined below.

Due Diligence and Enforcement Costs

The asset valuation regulations require NAMA to apply a discount in the calculation of the long-term economic value of all bank assets. The regulations set a rate of 5.25% (made up of 5% to provide for enforcement costs and 0.25% to provide for due diligence costs, incurred, or likely to be incurred by NAMA over its lifetime in the discharge of it functions).

In implementing this provision, NAMA applied the standard discount to the long-term economic value of property pledged as collateral for loans. NAMA stated that the methodology used was based on a financial model developed by HSBC which took account of practice in the industry. In some instances, the post-discount value of the collateral was greater than or close to[34] the loan balance due by the borrower to the bank and, therefore, not all of the discount was deducted from the consideration paid[35].

The amount by which the price paid for the loans was reduced in order to provide for due diligence and enforcement costs was ultimately €1,017 million. This amounted to around 3.9% of the consideration in aggregate.

The costs associated with a full enforcement process are estimated at 15%[36]. It is not possible for NAMA to predict the extent to which full enforcement proceedings will be required. However, assuming a 15% enforcement cost, the amount deducted from the acquisition value of loans in the first five tranches would cover the cost of enforcement proceedings for around 25% of the collateral[37].

Excess Collateral

When NAMA acquires a loan from a participating bank, it takes over any existing security pledged as collateral by the borrower and NAMA has the same entitlement to the collateral as the bank previously had.

In some instances, the present value of the cash flows of the collateral provided for a loan exceeded the loan balance (including associated derivatives, if any). The maximum that NAMA pays for a loan is the lower of a loan balance and associated derivatives and the value of the collateral cash flows. In circumstances where the collateral cash flows exceed the loan balance and the value of associated derivatives, the difference between the collateral and the consideration given by NAMA is excess collateral.

None of the excess collateral of approximately €2.4 billion has been regarded as available to NAMA and no payment has been made in respect of it. The rationale for this is that should a borrower clear a loan then NAMA will have no right to the excess collateral pledged for that loan. Also, in many cases, the collateral is pledged for a loan to a specific legal entity and cannot be called upon to meet other liabilities of the borrower – for example, where a loan to a different legal entity is non-performing and the related

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34 These were 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.

35 NAMA pays the lower of a loan balance and the value of the post-discount collateral.

36 European Commission decision on the establishment of NAMA.

37 The costs are assumed to be 15% of the value of the underlying property collateral. If enforcement costs of 15% were incurred on all loans, they would amount to €4 billion based on the November 2009 property values. The amount actually deducted from the acquisition cost would, therefore, cover the costs for around 25% of the collateral.

collateral is insufficient. However, NAMA may have a claim in circumstances where a borrower with excess collateral on a loan, but with insufficient collateral available for other loans, needs NAMA's support to complete projects. NAMA may be able to induce or compel the borrower to make the excess collateral available to it.

Legal Discounts

NAMA stated that, in the course of the loan valuation process, it was not always able to establish a participating bank's right to the collateral pledged by borrowers. Following its review and further discussions with participating banks in particular instances it applied legal discounts amounting to €368 million to the first five tranches of loans. This reduced the total consideration paid for these loans by around 1.4%. These legal discounts are applied in circumstances where issues about the enforceability of security have been identified. Property related issues (e.g. issues relating to title to a property) are addressed in the property valuation.

Advances after April 2009

In accordance with a direction from the Governor of the Central Bank and the Financial Regulator in May 2009, no discount is applied to advances after April 2009 and the full advance is treated as an asset. The amount by which the advances element of the loan balances was reduced by the application of the loan discounts, €359 million, was added back, as shown in Figure 2.4 to this chapter, so as to implement the direction that no discount should apply to these advances.

NAMA put in place a process for assessing claims for payment of amounts advanced by the participating banks after 7 April 2009. Participating banks were asked to provide a full listing of the amounts claimed and to provide supporting documentation for each. Among the items that the participating banks were asked to provide was evidence of the approval for the loan and evidence that the recipient had properly deployed the funds.[38] Only loans for purposes of protecting or enhancing qualifying assets can be funded in this category.

Following review of claims and supporting documentation for the loans transferring in the first five tranches, NAMA accepted claims totalling €869 million.

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[38] NAMA-appointed personnel reviewed the loan files in the participating banks.

Chapter 3

Managing Borrower Relationships

Managing Borrower Relationships

3.1 In order to properly manage the portfolio of loans it has acquired NAMA would need to

- comprehensively identify all assets of borrowers in order to position itself to recover the maximum possible amount of the debt
- develop and implement strategies to guide its staff and agents in the management of the underlying property assets of debtors
- structure its loan management function and management information in order to effectively manage its relationship with borrowers.

Chapter Focus

This chapter outlines the arrangements that NAMA has made to date in order to

- identify unencumbered assets of its debtors and make arrangements to have them pledged as security to the extent possible
- implement strategies appropriate to the different asset types that make up the collateral for loans
- document its relationship with its debtors
- fund the cost of managing the property of borrowers and
- meet the cost of enforcement professionals.

Identification of Debtor Assets

3.2 It is NAMA policy to pursue all debts and debtors and, in particular, to

- require debtors to provide a certified schedule of all their assets and liabilities
- as far as possible, acquire assets that are not subject to any claims by creditors (unencumbered assets) as additional security
- seek the recovery of unencumbered assets transferred to third parties and
- pursue all personal guarantees to the greatest extent feasible.

3.3 In its implementation of this policy, NAMA requires debtors, as part of the business plan process, to prepare a sworn statement of affairs that lists all their assets and liabilities in order to enable NAMA to identify unencumbered assets. This statement requires disclosure of asset transfers for the previous five years.

3.4 In regard to its approach to identification, the CEO of NAMA stated that

- Where NAMA finds unencumbered assets as part of the business plan process or otherwise, it will request that they be made available as part of the workout agreement. Alternatively, they may be pursued, if legally possible, under enforcement. He stated this is an ongoing process and can only be finalised after the business plan of the debtor has been drawn up.
- NAMA also engages in asset searches at different levels of intensity as appropriate.
- There have been instances where NAMA identified unencumbered assets and sought that they be pledged as additional security and that debtors who want a consensual deal have agreed to do this. If such an agreement cannot be achieved then NAMA has to pursue an appropriate legal route.

- Where a personal guarantee has been given by a debtor NAMA can use its leverage with these debtors to have unencumbered or transferred assets,[39] made available as further security including excess collateral identified on specific loans at the valuation stage.
- Where additional assets have been provided as security, their value is factored into the expected cash flows from the relevant debtor.

3.5 Information on the extent to which additional security has been pledged to NAMA is currently available on a case-by-case basis. NAMA is in the course of developing an information system which will become operational in 2012. At that point, information about assets provided as additional security will be available for each debtor and on an aggregate basis.

3.6 NAMA stated that based on its engagement with the largest 187 debtors under its direct management (with par debt of €61 billion)

- In the case of 32 of those debtors no asset transfers to relatives appear to have taken place in the past five years.
- In the case of another 31 debtors, reversal of asset transfers with an aggregate value of €160 million has been agreed to date by those debtors.
- In addition, 27 debtors have consented to a NAMA charge over unencumbered assets with an aggregate value of €221 million. This means that the debtor has given NAMA additional assets as part of NAMA's conditions for supporting the debtor.
- In another 17 cases, asset transfers have been identified and NAMA is confident that its current discussions with debtors will conclude with additional transfer reversals or the granting of charges to it over unencumbered assets. In five other cases to date, NAMA has initiated legal action to reverse asset transfers.

3.7 NAMA also stated that, in instances where debtors have borrowings with no recourse other than the asset borrowed against, those debtors would have no legal obligation to reverse asset transfers or offer additional unencumbered assets.

3.8 In the case of the residual directly-managed debtors, NAMA has either already enforced against the debtors concerned or is engaged in further investigation and legal review of possible asset transfers. Some of these cases will ultimately lead to additional reversals or the granting to NAMA of additional charges over assets which are currently unencumbered.

3.9 In summary, NAMA has stated that it secured assets to date of €381million[40] from its engagement with debtors. NAMA estimates that based on its work to date, the aggregate value of assets available to debtors to pledge to NAMA could ultimately prove to be in the region of €500 million.

Asset Searches

3.10 In some cases NAMA carries out asset searches following review of business plans and statements of affairs in order to obtain assurance about the veracity of a debtor’s statement of affairs. An Asset Search Team has been established to do this.

3.11 In early 2011, NAMA engaged the services of five firms of asset searchers. These firms were chosen by NAMA to do this work on selected debtors on a trial basis with the intention of carrying out the searches for all NAMA-managed debtors after the trial searches had been completed. Cases were

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39 Transferred assets, in this context, mean assets transferred by a debtor to a related third party e.g. a spouse in the past five years.

40 The valuations are estimates based on information provided by the debtors.

selected from the top 187 debtors. By the end of 2011, a total of nine trial searches on debtors were complete. Searches were conducted at two levels

- Level 1 searches relied on publicly accessible data for all debtors.
- Level 2 searches, in addition to publicly available information, tried to determine whether the observed behaviour of a debtor was consistent with the debtor's statement of affairs.

3.12 NAMA stated that Level 2 searches are triggered when more detailed enquiries arise out of the information found in the Level 1 searches and as a result of other information that it becomes aware of.

3.13 In September 2011, the Board was presented with the outcome of the searches. The findings included the following assessment

- There was little difference in the quality of services provided by the different firms although there were significant cost differences. The total cost of the searches was just over €146,000 while the cost of individual searches ranged from around €3,000 to €75,000.
- Some assets had been identified up to that point but they were insignificant in value terms[41] and not all would result in a benefit to NAMA. These included assets that had been provided as security to other lenders.

3.14 The Board was informed that

- in some jurisdictions, property searches cannot be conducted against certain individuals without their consent[42]
- where searches were limited to publicly available information, firms stated that they were unable to follow cash or financial assets
- the Level 2 searches, which occurred in three cases, incurred significantly higher costs and were of questionable value[43] due to the difficulty for the asset search providers in carrying out the searches and significant uncertainty about the outcomes
- there was difficulty reconciling the findings of the firms that conducted the searches with the information in the debtor's statement of affairs due to differences in the descriptions of assets or vagueness in the descriptions provided by the debtors.

3.15 Overall, it was concluded that the costs of the searches might outweigh any potential benefits to NAMA. Details of the asset searches conducted are set out in Annex A to this chapter. The results suggest that considerable follow up work may be necessary to conclude definitively on the financial position of debtors.

3.16 The Board approved a proposal whereby searches were to be carried out only in circumstances where demonstrable concerns existed that a debtor did not fully disclose all assets. In response to my inquiries, the Asset Search Team stated that the terms Level 1 and Level 2 searches are no longer used. In future, all searches will commence with publicly accessible data and only if the preliminary results warrant it will a search progress to more detailed enquiries.

3.17 In December 2011, NAMA commenced a tender competition for appointment to a panel to provide credit verification services to assist NAMA in establishing the accuracy and completeness of disclosures made by borrowers in relation to their assets, liabilities and income.

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41 However, asset searchers do not place a value on assets identified nor do they investigate whether the asset has been pledged as security to another lender.

42 The principal such jurisdictions identified were England, Wales and Switzerland.

43 The cost of these cases ranged from €500 to €30,000.

Conclusion – Identification of Debtor Assets

NAMA is continuing to develop its capacity to completely identify assets of debtors that may be made available as further security through

- ensuring that excess collateral identified in the course of the valuation process is made available to the maximum extent in order to increase its security
- levering additional security based on personal guarantees
- collating information collected from debtors that comes to light in the course of Business Plan reviews.

Overall, NAMA needs to position itself to capture all additional cash flows capable of being pledged subsequent to loan valuation. This will enable it to identify the nature of cash realisations that may accrue in future. It also needs to review the asset search outcome and refine its search policy accordingly.

Asset Management Strategies

3.18 The primary relationship that NAMA is required to manage is the lender-borrower one between itself and those debtors who had taken out the loans from the banks. The context for its loan management activities is

- a continuing legal obligation on the part of borrowers to repay all debts, together with interest
- a statutory obligation on NAMA to obtain the best achievable financial return for the State.

3.19 In managing its loan assets, NAMA must track the income from the underlying collateral as well as the prospect of recovering its investment through disposals. Chapter 4 examines this in more detail. In the longer term, the timing of disposals will be influenced both by the location of the assets and the nature of the development. Consequently, NAMA needs to communicate its strategies to its key managers through broad approaches that set out

- NAMA's assessment of the market and the broad strategy to be employed and
- how plans by borrowers (business plans), that detail how debt will be repaid, should be assessed.

3.20 From June 2011 NAMA began adopting specific individual strategies to guide its management of assets. These replaced broad high level strategies which it had set out in its June 2010 Business Plan. In this context, loan assets are classified in accordance with the nature of the underlying assets owned by the debtor. Figure 3.1 outlines the extent to which such strategies have been adopted to date.

Figure 3.1 Asset Strategy Programme

Asset Type	Proportion of portfolio at acquisition	Date asset strategy approved by Board
Hotel Assets	9.6%	June 2011
Completed Residential Assets	16.6%	October 2011
Investment Assets	44.6%	November 2011
Land and Development Assets	29.2%	November 2011

3.21 Within the classes of assets outlined in Figure 3.1 specific strategies have also been adopted for

- North American assets which were associated with 1.5% of the value of loans acquired
- Golf courses
- Residential apartments (11% of the loans acquired).

3.22 The asset strategies set out the approach that NAMA should adopt for the management of the different classes of assets. There were some policy guidelines that were common to all of the strategies

- additional credit requests should only be approved if they enhance or protect recoverable value
- sales at values below acquisition cost should only be considered if the net sale proceeds are higher than the net present value of the best alternative strategy.

3.23 The guidance set out in the current strategies for each class will fall to be adjusted in line with a new corporate level strategy that NAMA will finalise in the first quarter of 2012. Currently, the guidance on the main asset classes is as set out below.

Investment Assets

3.24 Investment Assets comprise around 45% of the property underpinning loans. In general, the existing approach for the Irish market would be a 'hold strategy', for the London market a 'sales strategy' while assets in other markets would require local assessment. Significant redevelopment risk should be avoided and sales should be phased. However, NAMA has stated that its strategic plan from 2012 onwards is likely to lead to a more nuanced approach to the management and disposal of Irish assets.

Land and Development Assets

3.25 Land and Development Assets comprised around 29% of the portfolio and NAMA's assessment was that demand will return at a different pace in individual market segments and that it would take a long-term perspective of viability. It also concluded that weak demand was expected to continue in Ireland in the short term and it was unwilling to support debtor proposals that incorporated significant forbearance or additional debt requirements.

Completed residential assets

3.26 NAMA concluded that, in general, rental strategies were preferable for properties generating rental yields in excess of 5% or more because short-term disposal strategies would be likely to result in bulk sales at discounts of 35% to 40% below acquisition value.

Hotels

3.27 The overall strategy approved by the Board was to progress the early sale of hotels in Britain and Europe while protecting the recoverable value of Irish hotels until market conditions improve.

Conclusion – Asset Management Strategies

NAMA has adopted strategies to guide its management around the timing of disposals and the approach to be adopted in different markets.

It will be necessary for it to review these strategies on an ongoing basis in the light of market conditions and have control and reporting mechanisms to assure itself that the individual loans are managed in accordance with those strategies.

Loan Management

3.28 When loans are acquired by NAMA, borrowers continue to owe full balances on the loans notwithstanding the discounted acquisition value.[44] NAMA has around 800 debtor connections. In practice, following acquisition, NAMA asks debtors to submit plans for their business. In these plans (business plans) they are requested to set out

- their financial position
- how the value of their assets might be enhanced and
- how they intend to repay what they owe.

3.29 Prior to completing the plans debtors generally meet with the relevant management team within NAMA (portfolio management) to discuss their financial position and the process for submission and review of business plans.

3.30 NAMA directly manages the relationship with those debtors who each owe €75 million or more while management of the remaining debtors is delegated to the participating institutions operating under guidelines issued by it.

3.31 The profile of the debtors managed through the two processes is set out in Figure 3.2.

Figure 3.2 Debtor Management Approach

Management Approach	Borrower Numbers	Value of Loans at acquisition €bn	Price of Loans €bn
NAMA Managed	**187**	**60.9**	**26.7**
- Borrower Debt> €750m	*15*	*24.0*	*11.6*
- Borrower Debt €250m to €750m	*48*	*21.2*	*9.1*
- Borrower Debt €75m to €250m[a]	*124*	*15.7*	*6.0*
Bank Managed	**589**	**13.0**	**5.0**
- Borrower Debt <€75m[a]			
Total	**776**	**73.9**	**31.7**

Source: NAMA.

Note a While €75 million is, generally, the level above which a borrower's debt is managed by NAMA, there are some exceptions.

3.32 NAMA requires that business plans be prepared under set templates. There are two templates in use

- the first, more detailed template, applies to approximately 42 larger debtors who generally have more complex legal structures. The amounts owed by each such debtor are in the region of €500 million or above that level.
- a shorter template applies to the remaining debtors.

[44] In reality, the State has met something equivalent to the full cost by virtue of the fact that the gap in capital occasioned by the write-downs in the books of the banks was largely met through State capitalisation measures.

3.33 The process for reviewing business plans for NAMA-managed debtors can be summarised as follows

- independent reviewers recommend actions for the recovery of debt
- NAMA's portfolio management function draws up debt management proposals
- the proposals are submitted for decision to the relevant delegated authority of the Agency.

3.34 The management actions that are taken depend on whether NAMA decides to manage the loan on an ongoing basis, seeks to dispose of particular collateral or proceeds to enforcement. The approach adopted requires approval at the appropriate level in NAMA – either the Board or the appropriate delegated authority.[45]

Status of Debt Management

3.35 The status of debt management in respect of NAMA-managed debtors, who accounted for around 83% by value of all debt as at the end of December 2011, is set out in Figure 3.3.

Figure 3.3 NAMA-managed Debtors, Debt Management Status, December 2011

Debtor strategy	Status	Number of Debtors	Borrower par debt December 2011 €m	Acquisition value €m
Refinanced by debtor[a]	Complete	1	0	35
Loan restructuring	Complete	2	1,664	1,132
	Terms signed	11	14,302	6,701
	Negotiation	3	1,052	667
Letter of Support[b]	In place	32	9,983	3,480
	Under negotiation/trial period	55	11,165	4,282
Disposal	Complete	2	8	64
	Under way	21	6,721	3,975
Enforcement	Insolvency Practitioner appointed	34	11,210	4,175
	Legal/security review ongoing	21	3,069	888
To be decided		10	2,274	1,350
Total[c]		**192**	**61,448**	**26,749**

Source: National Asset Management Agency.

Note a The par debt of the loans was €41 million when the loans were acquired.

b Prior to using Letters of Support, NAMA entered into Memorandums of Understanding with debtors.

c For some borrower connections, there is more than one business plan.

45 Under the latest Delegated Authority Credit Policy approved by the Board on 13 October 2011.

3.36 In circumstances where NAMA decides on a strategy to offer support to a borrower, and agreement is reached with the borrower, there are a number of possible stages in documenting and giving business effect to the agreement. The principal governing documents are outlined below.

Letters of Support

3.37 Letters of Support are put in place when NAMA has decided to provide support to a debtor that is conditional on certain steps being taken by the debtor including steps in relation to the operation of the debtor's business, perfecting security and taking security over unencumbered assets and rental income. Letters of Support may be for periods of up to 12 months. A Letter of Support does not replace a debtor's loan agreements which remain in force until amended. It is a mechanism to resolve matters between the parties with a view to a restructuring of the debt should key milestones agreed in a Letter of Support be achieved by the debtor.

Loan Restructuring

3.38 Loan restructuring occurs when a debtor's existing loan agreements are amended by new legal agreements incorporating revised terms and conditions. Typically, NAMA amends and restates the existing facilities and agrees new loan pricing and interest payment terms - usually an interest bearing tranche and a tranche[46] on which interest does not accrue until the interest bearing tranche has been repaid. If further funds are advanced to the debtor, they are subject to application of interest.

3.39 A full loan restructuring is time consuming and expensive and NAMA is currently developing alternative approaches for less complex restructurings under which revised legal agreements could be put in place with a debtor alongside existing security and other legal documentation known as limited restructuring.

Other Agreements

3.40 In addition to the foregoing arrangements, NAMA may put separate legal agreements in place with the individual debtors. These agreements, known as Connection Management Agreements (CMA), set out the incentivisation arrangements including arrangements in respect of personal guarantees that will apply if the debtor meets the targets agreed with NAMA and complies with any other terms set out in the agreement. In practice, many debtors either borrowed in their personal name or provided personal guarantees to participating institutions under which they would be personally liable if the loans to their companies are not repaid or where debtors are the principal shareholders in companies with full recourse debt. NAMA stated that the purpose of a CMA is to provide certainty to the debtor about what will occur if the restructured loan provisions are met. The number of CMAs in place at February 2012 was seven.

Ongoing Management of Debtors

3.41 Responsibility for the day-to-day management of NAMA-managed debtors lies with the portfolio management team while authority for credit decisions rests with the Board or the relevant delegated authority.

3.42 Progress against the approved business plan[47] is reviewed as follows

- NAMA's credit and risk function monitors the delivery and execution of the agreed debtor business plan on a quarterly basis. In the course of this review, cases with risk features are selected for discussion at a Credit Review Forum (CRF).

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46 Conditions may be attached to the non-interest bearing tranche that provide for sharing of amounts repaid on that loan between the debtor and NAMA.

47 The basis of this review is set out in NAMA's Credit and Risk Policy, May 2011

- It is NAMA's policy to review the performance of each debtor against the approved strategy on an annual basis. This includes an assessment of a debtor's overall credit standing and consideration of the ongoing appropriateness of the approved strategy. Any consequent adjustments to the strategy must be approved at the appropriate delegated authority level.

Credit Review Forum

The Credit Review Forum (CRF) is part of the system for monitoring performance of debtors against their agreed business plans. The CRF is chaired by a person delegated by the Board. The membership comprises up to four members including the chair. The other members are drawn from the NAMA Executive and/or senior managers from Credit and Risk, Portfolio Management and Lending. There must always be at least one member of the Credit and Risk function present.

3.43 NAMA's Credit and Risk function reviews the quarterly business plan updates and selects the higher risk cases for discussion at the CRF. In cases where a debtor has deviated from the agreed strategy, it is the NAMA policy that the cases be referred to the appropriate delegated authority. During 2011, 29 meetings[48] of the CRF were held. For NAMA-managed cases, the CRF reviews

- cases with action plans arising from their previous review
- cases identified as exhibiting deteriorating risk and requiring regular monitoring
- quarterly business plan updates on a selective basis.

3.44 The Credit Committee of the Board oversees the credit review functions. Under the Credit and Risk policy that Committee is presented with quarterly reports.

Debtors Managed by Participating Institutions

3.45 The status of debt management in respect of debtors managed by the participating institutions at the end of December 2011 is set out in Figure 3.4. The total amount owed at 31 December 2011 for these debtors was just under €13 billion. The debt had been acquired for €5 billion.

Figure 3.4 Debtors Managed by Participating Institution, Business Plan Status,[ab] December 2011

Status	'Top 180'[c]	Remainder[c]	Total
Business Plan not yet provided	7	19	26
Business Plans with Bank	16	72	88
Business Plans with NAMA for review	28	26	54
Business Plans Approved	131	299	430
Total	**182**	**416**	**598**

Source: National Asset Management Agency

Notes: a The number of business plans is not the same as the number of borrowers due to the amalgamation of some borrowers under one business plan.

b NAMA has delegated approval authority to the participating institutions for cases where the debt owed by the borrower is less than €30 million. NAMA retains oversight on all approvals.

c The 'top 180' are the debtors managed by the participating institutions that have the highest debt. The average debt of these debtors at the end of 2011 was around €45 million while the average debt of the remaining debtors is around €11m.

48 Six for NAMA-managed debtors and 23 for participating institution-managed debtors.

3.46 The process for reviewing business plans for debtors managed by the participating institutions is

- The participating institutions recommend actions for the recovery of debt – there is no external independent review of debtor plans.
- Where the total owed by the debtor exceeds €30 million, the recommendation is considered by the CRF and approval is required at the appropriate delegated authority level in NAMA.
- Where the total debt is less than €30 million, the decision is delegated to the participating institution. The CRF reviews a sample of these cases.

3.47 In respect of debtors managed by the participating institution, there have been 30 cases referred to enforcement. Where reviews have been completed, letters of support have issued.

3.48 No loan restructurings, either full or partial, of loans managed by the participating institutions have occurred to date.

3.49 Annex B outlines the business plan review process and further elaborates on the nature of the various types of agreement that may be reached with debtors.

Advances to Complete Developments

3.50 NAMA's most recent estimate of the total amount of new lending that it anticipates making to all borrowers over the full period of NAMA's life is around €3.5 billion, the bulk of which (€2.6 billion) will be advanced in the period from 2012 to 2015.

3.51 Under the governing legislation, the Agency may borrow up to €5 billion for purposes of providing new funds to debtors to enable them to complete developments and improve assets. NAMA has not, to date, borrowed under this provision of the Act.

3.52 NAMA has, instead, used repayments by borrowers to fund new advances. At the end of December 2011, it had approved new lending amounting to €975 million of which €720 million[49] had been drawn down by debtors.

3.53 The audit of the 2010 financial statements, in which year €240 million of new lending had been advanced, found that the lending had been appropriately approved by NAMA and that documentation[50] was held by the participating institutions indicating the purpose to which the funds had been put. Approval limits for advances of funds to debtors are based on a combination of the borrower's exposure to NAMA and the debtor credit grade assigned by NAMA.

Debtor Credit Grading

3.54 In 2010, NAMA adopted its first loan credit grading policy for the purposes of managing debtors and as part of the approval process for further loan advances. Loan credit grades were based on the discount that applied to the loan at acquisition.

3.55 In November 2011, the Board approved a revised debtor credit rating system. The grading scale is designed to help to ensure that

- the level of time and resources applied to the management of a debtor is proportionate to the level of risk and

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49 Including €176 million of funding approved under Section 71 of the Act (pre-acquisition credit proposals).

50 For example, supplier invoices and certificates from quantity surveyors.

- consistent evaluation, reporting, analysis and monitoring for debtors of similar risk characteristics would occur.

3.56 Under the revised policy, a debtor's credit rating is based on two factors

- debt recovery rating – the extent to which NAMA expects to recover the NAMA debt (what NAMA paid for the loans plus interest)
- debtor cooperation with NAMA.

3.57 The intention is that all NAMA-managed debtors will be regraded by the end of the first quarter of 2012 and that all debtors will be graded under its policy by June 2012.

Disposal Strategies

3.58 An option available to NAMA is to dispose of the debtor's assets with the agreement of the debtor. By the end of December 2011, the assets of two debtors had been fully disposed of while a disposal process had commenced for a further 21 debtors. Chapter 4 examines the general outcome of disposals.

Enforcement

3.59 In circumstances where a debtor is in default and NAMA cannot reach agreement with that debtor, NAMA is likely to take enforcement action. The most common form of enforcement action is the appointment of an insolvency practitioner, usually a receiver. At the end of December 2011, insolvency practitioners were in place for 34 NAMA-managed debtors while an enforcement strategy was proposed for a further 21 debtors.

3.60 In circumstances where NAMA determines that enforcement action is to be taken against a debtor, its options include appointing a receiver under its governing legislation (statutory receiver[51]), other receivership arrangements, mortgagee sales, liquidation, vesting orders and compulsory acquisition.

3.61 A receiver's main duty, regardless of the method of appointment, is, usually, to achieve the best price possible for the asset(s) over which the receiver has been appointed. However, under the Act, a statutory receiver is not obliged to sell a charged property.

3.62 By 31 December 2011, 408 insolvency practitioner appointments had been made in respect of 64 debtors. The appointments included receivers appointed to a debtor's loans and receivers appointed to individual properties. Details are set out in Figure 3.5.

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[51] Under Section 148 of the Act, a statutory receiver has the powers, rights and obligations that a receiver has under the Companies Acts and, in addition, powers, rights and obligations set out in Schedule 1 of the Act. Under Section 147, a statutory receiver is not subject to the restrictions in the Conveyancing Act 1881 or the Land and Conveyancing Reform Act 2009 on the appointment of a receiver.

Figure 3.5 Insolvency Appointments, December 2011

Type of appointment	NAMA-managed cases	Bank – managed cases	Total
Administrator	9	7	16
Fixed Charge Receiver	10	42	52
Receiver[a]	11	5	16
Statutory Receiver[b]	266	55	324
Total	**296**	**109**	**408**

Source: National Asset Management Agency

Note: a This category includes receivers appointed outside Ireland and receivers other than statutory receivers appointed in Ireland.

b Including receivers appointed when there is a charge over a specific asset (Fixed Charge Receivers), or when there is a floating charge over a number of assets (Floating Charge or Corporate Receiver).

Conclusion – Loan Management

The loans acquired by NAMA have to be managed in the light of the underlying business of the debtor, the prevailing economic circumstances and that debtor's capacity to meet the loan obligations out of cashflows generated by the business.

NAMA has to date completed relatively few full restructurings. It is, however, pursuing restructuring for around 28% of the directly managed debt. In broad terms around 34% of these loans are subject to disposal or enforcement actions with a further 34% at an interim letter of support stage.

In addition to letters of support and restructuring agreements which operate at the level of loans (and associated security) NAMA may conclude connection management agreements with persons who have given personal undertakings in relation to the borrowing.

Property Management Costs

3.63 Costs of managing property assets may be incurred by a debtor or by a third party appointed by NAMA to pursue enforcement action, usually receivers.

Costs incurred by debtors

3.64 In circumstances where NAMA has either concluded an agreement with a debtor or is in the course of negotiation with a debtor and the debtor continues to manage the business, the costs of managing those property assets fall to be met out of the rental income or other property proceeds that accrue to the debtor.

3.65 Property management costs fall under two broad headings

- property costs that are incurred in order to keep a property in good order[52]
- general overheads associated with running the debtor's business.

3.66 When a borrower continues to manage the affairs of the business the biggest cost element is generally staff costs. As part of the outcome of the business plan process NAMA, after taking advice

[52] Essential property costs e.g. insurance, repairs and maintenance.

from an independent business reviewer[53] determines and agrees with the debtor the appropriate organisational structure and number of staff for the debtor to manage the business. It determines a monetary value by applying what it considers to be an appropriate overhead allocation including the salary for the main debtor. NAMA then approves an overall amount for the debtor's total overheads and the debtor is required to submit a proposal on how the overhead will be applied in practice. The level of overheads agreed with a debtor is recorded in a Letter of Support or Memorandum of Understanding as appropriate. Chapter 4 reports the result of a preliminary audit review of the level of overheads for a sample of debtors.

Procurement and Management of Receivers

3.67 In November 2010, following a tender competition, NAMA appointed 45 firms to two panels for the provision of enforcement and insolvency services. The panels were for

- insolvency practitioners and
- property firms to advise in relation to enforcement and insolvency matters and act as receivers for specific properties.

3.68 In each proposed enforcement case, NAMA conducts a mini-tender[54] within which at least three firms are invited to tender

- from the panel of property firms where the appointment relates to property only and
- from the panel of insolvency practitioners where the appointment is to an entity or a borrower and the assets under their ownership.

3.69 NAMA evaluates tenders against predetermined criteria. The award criteria are based on a review of

- the proposed project leader and team and the range of resources to be made available to the project
- strategy, proposals and detailed work plans for the debtor or property and
- the fee proposal – NAMA seeks fixed fee proposals for specified periods of time (usually six to twelve months).

3.70 Those carrying out the evaluation include a Senior Insolvency Advisor, a Portfolio Management Team Leader (or a person deputising) and a Senior Credit Manager (or a deputy).

Receivers' Costs

3.71 The governing legislation provides that a debtor is responsible for remuneration, contracts, engagements, acts, omissions, defaults and losses of a statutory receiver. In circumstances where the funds are not available from the debtor's business to pay a receiver's ongoing costs, NAMA advances funds to the receiver which are added to the amounts owed by the debtor to NAMA and used to pay the receiver's costs.

3.72 During 2011, receivers were required to apply for funding from NAMA on an ongoing basis. NAMA stated that the level of administration required to process these applications was onerous. NAMA is moving, in 2012, to a position where receivers will submit budgets for its approval and funds will be advanced by NAMA in accordance with the approved budget. While there is a risk that costs may be

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[53] In this context, an independent business reviewer is an external firm from a panel that NAMA has appointed to review borrower business plans.

[54] Prior to inviting firms to tender, NAMA contacts the firms and asks them to confirm that there are no conflicts of interest for the firm in respect of the proposed assignment.

incurred that are not envisaged when the budget is agreed, receivers have a personal liability for any payments that are deemed to be outside the terms of the agreed budget or are otherwise deemed not necessary by NAMA.

Oversight of Receivers

3.73 Receiverships are monitored in the first instance by the portfolio manager responsible for the debtor or property to whom a receiver has been appointed. This oversight includes day-to-day engagement, as required, with the receiver. In addition, receivers are required to submit

- An initial report setting out their proposed strategy for the properties or entities to which they have been appointed. NAMA now requires these reports to be provided within four weeks of appointment.
- Progress reports on a quarterly basis. These progress reports are reviewed by the portfolio management team responsible for the debtor and form part of the quarterly Strategic Credit Review for the debtor.

3.74 An insolvency team in NAMA, which was established in the last quarter of 2011, is now responsible for the appointment and overall management of receivers including assessment of the quality of their performance in meeting the requirements of their appointments. The head of the team stated that NAMA was developing, in early 2012, a rating system for measuring receiver performance.

Audit Review of Receivers

3.75 Ten receivership files were selected for review. Four of the receivers had been appointed prior to NAMA acquiring the relevant loans. For the remaining six

- three were appointed to a number of assets[55] of debtors and three to specific properties
- approval at the appropriate level had been given within NAMA for the appointments
- mini-tenders had been held and properly evaluated
- quarterly reports had been delivered by all receivers.

3.76 Fixed fees were agreed for periods of between six and twelve months. Fees ranged from €20,000 to €142,500 for receivers appointed to properties (six-month assignments), €152,000 for a six-month appointment to a borrower and from €195,000 to €770,000 for 12-month appointments to borrowers. If receiverships are extended beyond the initial agreed period, revised fees are agreed. The first period of the receiverships reviewed had not yet expired at the time of review.

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55 Such assets included both companies and properties.

Conclusion – Property Management Costs

Property underlying the loans continues to be managed by the borrower except where NAMA has moved to enforce its security.

NAMA has established a process to agree the level of overheads arising out of staffing and general administrative costs. The principal determining component is the establishment by NAMA of the appropriate organisational structure and associated cost.

In the case of receivers, who are the subject of public procurement, NAMA is moving to a process of payment based on budgets that are submitted in advance by firms and requires that receivers set out a strategy for the assets to which they have been appointed.

Overall Conclusion – Managing Borrower Relationships

NAMA needs to position itself to identify all additional cash flows that are capable of being pledged subsequent to loan valuation so as to maximise the security available to the State.

NAMA has taken steps to identify assets of borrowers that may be available as additional security. The principal sources of those assets are likely to be

- excess collateral identified in the course of the valuation process
- other assets that fall within the scope of personal guarantees
- assets identified in the course of business plan reviews
- assets identified as a result of searches.

The predominant relationship that NAMA is managing is one of lender-borrower. The bulk of the loan assets it manages is in relation to property that continues to be managed by debtors. Overall, NAMA has taken steps to structure its relations with its borrowers through legal and quasi-legal agreements.

NAMA has to date completed relatively few full loan restructurings. It is, however, pursuing restructuring for around 28% of the directly managed debt. In broad terms around 34% of these loans are subject to disposal or enforcement actions with a further 34% at an interim letter of support stage.

NAMA has adopted strategies to guide its management on its approach to loan workouts and the timing of disposals as well as the approach to be adopted in different markets. It will be necessary for it to review these strategies on an ongoing basis in the light of market conditions and have control and reporting mechanisms to assure itself that the individual loans are managed in accordance with those policies. A forthcoming corporate strategy is likely to lead to adjustment of these asset specific strategies.

NAMA has established a process to agree the level of overheads arising out of staffing and general administrative costs incurred by borrowers in managing the business that is funded by the loans. The principal determining component of the overhead is the establishment by NAMA of the appropriate organisational structure and associated cost that should relate to each business.

In the case of receivers who are the subject of public procurement, NAMA is moving to a process of payment based on budgets that are submitted in advance by firms and requires that receivers set out a strategy for the assets to which they have been appointed.

Overall, the audit review confirmed that NAMA has put systems in place to manage its relationships with debtors and this work is continuing, in some cases, into 2012.

Preliminary audit testing also indicates that

- new lending to debtors was duly authorised and the purpose documented
- receivers are being managed so as to achieve a measured service.

The testing which was necessarily preliminary in nature will be extended in the course of the audit of the 2011 financial statements.

Annex A Asset Searches 2011

Figure A.1 Asset Search Results – September 2011

Search	Cost of search[a]	Assets identified	Unencumbered	NAMA follow up
1	€7,000	Two strips of land (Dublin) [b]	Yes	Likely to be of minimal value. Assessment to be carried out.[f]
		Two undisclosed shareholdings; possible small strip of land (Munster) [c]	Possible charge to named bank	Nature of charge to be confirmed. Assessment to be carried out.[f]
		Commercial premises (Greater Dublin) [c]	Mortgage to named bank (to be confirmed)	Lease details and nature of charge to be confirmed. Assessment to be carried out. [f]
2	€2,900	Transfer of Private Dwelling house to related parties to be held in trust for debtor [b]	Possible charge to named bank	Engagement of legal firm in process to assess recoverability. Assessment of need for further investigation to be carried out.
		Apartment (Europe) [b]	No	Unlikely due to corporate holding.
3	€15,800	Four Irish residential properties Crèche and 29 separate parking spaces (Greater Dublin) Site (Connaught) [d]	To be confirmed	Review property descriptions to confirm if property is additional/undisclosed. *Broaden scope and perform further property searches.*
		Large extension to existing house (Europe) [d]	No	Source of funding for extension to be investigated.
4	€10,300 (of this €2,800 was a Level 2 search)	Residential property (Britain) [d]	To be confirmed	Review property descriptions to confirm if property is additional/undisclosed. *Broaden scope and perform further searches.*
		Residential property (Connaught)[b]	To be confirmed	Owner to be confirmed in case it is a namesake.
		Numerous properties (Ireland) [d]	To be confirmed	Review listing to determine if these are residual strips of land from completed developments.
5	€7,300	House (Britain) [d]	To be confirmed	Debtor previously owned asset. Current owner to be confirmed.
		Undisclosed directorships [e]	Not applicable	All relevant companies listed as “dormant” or “not trading”.
6	€15,000 (of this €500 was a Level 2 search)	Residential property (outside Europe) [b]	Yes	Assessment to be carried out. [f]
		Residual strips of land (Leinster) [b]	Yes	Assessment to be carried out. [f]
		Two race horses [b]	Yes	Assessment to be carried out.[f]

Search	Cost of search[a]	Assets identified	Unencumbered	NAMA follow up
6 contd)		Links to six corporate shareholdings (outside Europe) [d]	To be confirmed	Assessment to be carried out. [f]
7	€2,900	Two previously disclosed residential properties (Europe) [d]	To be confirmed	Seek confirmation of arm's length disposal. Assessment of need for further investigation to be carried out.
		Undisclosed corporate shareholdings [e]	To be confirmed	Confirm location of companies, and where relevant, if they hold additional assets.
		Strip of land (Dublin) [b]	No charge noted	Assessment to be carried out.[f]
8	€10,000	Retail units (Greater Dublin) [d]	Mortgage to named bank	Clarify status of current mortgage.
		Undisclosed corporate shareholdings [e]	To be confirmed	Confirm location of companies, and where relevant, if they hold additional assets.
9	€75,000 (of this €30,000 was a Level 2 search)	Three properties (USA) [c]	No charges identified	Obtain legal advice to ascertain ultimate owner in this jurisdiction, and possible tax and money laundering issues
		Four high value vehicles [d]	To be confirmed	Obtain legal advice to ascertain ultimate owner in this jurisdiction.
		Share of office building (Dublin) [c]	No	Assess cost/benefit of gaining charge over asset.
		Transfer of asset to spouse (Europe) [b]	Property sold	Consider if transfer for nil consideration warrants challenge
		New corporate activity [b]	To be confirmed	Obtain legal advice to ascertain if there exists any value.
		Previously disclosed corporate shareholding (outside Europe) [b]	To be confirmed	Assessment to be carried out. [f]
		Previously undisclosed shareholding [b]	To be confirmed	Obtain legal advice on how to gain greater transparency in this jurisdiction.
		Additional breakdown of non-NAMA asset (outside Europe) [b]	No	Assessment of need for further investigation to be carried out.

Source: NAMA

Notes:
- a All rounded to nearest €100. NAMA stated that the asset search providers offered discounted prices for these searches.
- b Confirmed additional asset/confirmed transaction (subject to accuracy of public records e.g. Land Registry).
- c Likely additional asset.
- d Previously undisclosed asset but NAMA research indicates nil or insignificant value.
- e Possible additional/unconfirmed transaction. For example, not possible to match asset descriptions due to vagueness of descriptions in Statement of Affairs; unable to confirm shareholdings if a company does not allow access to share register.
- f NAMA Portfolio Management/Credit and Risk/Legal (as appropriate) to assess cost benefit of gaining charge over or pursuing the asset.

Annex B Business Plan Administration

Business plans submitted by NAMA-managed debtors (generally those whose debt exceeds €75 million), are sent for review to firms selected by NAMA from a panel of 38 firms appointed in May 2010 following a tender competition.

The Board approved a detailed template setting out the information that the reviewers should include in their reports. Reviewers are asked to include their recommended actions for recovery of a debtor's loans including

- overall considerations and recommendations
- recommended actions for the immediate, medium and long-term and
- resource implications for NAMA.

Reviewers are also asked to present, to the extent possible, a recommended action and the reason for this including

- discussion and evaluation of cash generating options considered and the reasons for their acceptance or rejection
- the implications for NAMA of enforcing security
- the implications of debt hierarchy and/or disturbance of tax structures on NAMA's entitlement to recover proceeds from enforcement and
- matters that NAMA should raise with their other advisors – for example, complex tax structures, existing legal actions or pending creditor actions.

Assessment of Business Plans

Following receipt of the independent review, NAMA carries out its own internal assessment. This is done by the portfolio management function and includes, where required, further discussions with the debtor prior to submitting the debtor's plan for decision on the review recommendations and the strategy to be adopted with the debtor. The Board has set the authority levels for approving proposals. These depend on the debtor's total financial exposure and whether or not new funds have been requested. The authority levels are set out in Figure B.1.

Figure B.1 NAMA Delegated Authority for Debtor Business Plan and Annual Reviews[a]

NAMA Debtor Exposure[bc]	Delegated Authority Level
> €500m	Board
> €250m - €500m	Credit Committee
> €150m - €250m	CEO and Head of Credit & Risk
> €125m - €150m	CEO/Head of Credit & Risk and Head of Portfolio Management / Head of Lending
> €75m - €125m	Deputy Head of Credit & Risk and Deputy Head of Portfolio Management or Deputy Head of Credit & Risk and Deputy Head Lending
< €75m	Senior Credit Manager and Senior Portfolio Manager or Senior Credit Manager and Senior Lending Manager.

Notes
a Delegated Authority Credit Policy approved by the Board on 13 October 2011.
b The debtor exposure is the total owed by the debtor and includes any new funds advanced to the debtor.
c Where a debtor is impaired, then approval is required at one authority level higher.

Under the Delegated Authority Policy, lower level authorities may refer their decisions to higher level authorities if a second opinion is deemed desirable or where there is a conflict of opinion.

Under NAMA's Quality Assurance (QA) Policy, the application of the Credit Policy Framework is to be tested on a regular basis on both the NAMA and participating institution managed portfolios, *inter alia*, to ensure that delegated authorities are being used appropriately and responsibly. NAMA has established a QA team within the Credit and Risk function to carry out these reviews. By the end of 2011, a review of the delegated authority function in NAMA had yet to be carried out by the QA team but it has been subject to internal audit review.

Following approval by the Board or at the appropriate delegated authority level, NAMA enters into further discussions with a debtor in order to implement the decision about the strategy to be adopted with a debtor. The process may culminate in a

- Letter of Support (and, previously, a Memorandum of Understanding)
- Loan restructuring (full or limited)
- Disposal
- Enforcement and
- Connection Management Agreement.

Debtors managed by the participating institutions

The process for reviewing business plans for participating institution-managed debtors is

- The participating institutions recommend actions for the recovery of debt – there is no external independent review of debtor's plans.
- Where the total owed by the debtor exceeds €30 million, the recommendation is considered by the Credit Review Forum and approval is required at the appropriate delegated authority level in NAMA.
- Where the total debt is less than €30 million, the decision is delegated to the participating institution. The Credit Review Forum reviews a sample of these cases.

Types of Agreement

NAMA's approach to documenting the relationship with debtors evolves in the course of the relationship. In general, a letter of support is used to cover an interim arrangement with borrowers. Thereafter, the debtor's overall financial obligation may be restructured.

Letters of Support

A letter of support while not legally binding signals an agreement between the debtor and NAMA to manage the business along defined lines and cooperate with NAMA. While it can be extended it represents a holding arrangement.

Letters of Support are generally for periods of up to twelve months. The letter does not constitute a legally binding commitment by NAMA or the debtor. Terms in typical Letters of Support include

- Conditions to be met in the period covered by the letter – for example, in respect of rental income, maximum amount of overhead to be incurred, actions to be undertaken in respect of specific properties or the provision of additional information by the debtor.
- The requirement for the debtor to fully cooperate with NAMA and its advisors.

Letters of Support are signed by both NAMA and the debtor. When a Letter of Support expires, NAMA may extend the period covered, move to the next stage – a revised legal arrangement including full loan restructuring – or enforce on the assets.

A Letter of Support does not replace a debtor's loan agreements which remain in force until replaced by separate legal agreements.

Memorandum of Understanding

Prior to issuing Letters of Support, NAMA entered into Memorandums of Understanding with a number of the larger debtors.

By the end of 2011, there were four signed Memorandums of Understanding still in place with debtors.

Loan Restructuring

Loan restructuring occurs when a debtor's existing loan agreements are replaced by new legal agreements incorporating revised terms and conditions for the debtor's loans. Typically, NAMA replaces the existing facilities with two loans – an interest bearing loan and a non-interest bearing loan while a further interest bearing loan will be put in place if further funds are advanced to the debtor.

Payments on the non-interest bearing loan do not start until the interest bearing loan has been repaid in full including interest but there can be a provision for the debtor to pay a back-end fee of up to 25%. Conditions may be attached to the non-interest bearing loan that provide for sharing of amounts repaid on that loan between the debtor and NAMA.

Connection Management Agreement

A Connection Management Agreement (CMA) can be entered into when the debtor loans are restructured or key commercial terms of the original loan facility agreements are being varied and deals with repayment terms and incentivisation. A CMA is an agreement between a debtor personally and NAMA while loan restructurings lead to revised agreements between NAMA and the entities to which the loans have been made.

The context for these agreements is that many debtors have provided guarantees to participating institutions under which they would be personally liable if the loans to the entities are not repaid and a CMA provides certainty to those debtors about what will occur if the restructured loan provisions are met.

A CMA sets out details of key commercial terms between NAMA and a debtor that are not reflected in loan facility agreements. By the end of 2011, seven debtors had signed CMAs.

By way of illustration, a CMA reviewed included the following repayment and cash management terms[56]

- The borrower's debt stood at €440 million. The CMA proposed restructuring this debt into two loans – an interest bearing loan of €300 million and a non-interest bearing loan of €140 million.
- The NAMA debt - the balance on the acquisition value adjusted for advances and repayments following acquisition – amounted to €267 million.
- Cumulative principal repayment targets of €300 million (excluding working capital advances) between 2011 and 2017.

[56] The amounts shown are not those in the CMA. However, the relationship between the amounts is the same as that in the CMA.

Incentivisation payments would only apply if all security held by NAMA was realised or released (through refinancing by the debtor) and principal repayments sufficient to meet an agreed target were made. In this case

- If the principal and interest on €300 million was repaid then, of the next €30 million generated, 75% would be applied to reduce the balance of non-interest bearing debt and 25% would be placed in escrow for incentive payments pending the NAMA approved disposal or refinancing of all assets. Therefore, if the borrower repaid €330 million plus interest thereon and all assets had been sold or refinanced, the incentive payments to the debtor would amount to €7.5 million.
- For any repayments of principal in excess of €330 million, 65% would be paid to NAMA as repayment of the balance of the capital of non-interest bearing debt and then as compensation for interest foregone on that debt and 35% would be placed in the escrow account.
- On completion of a NAMA approved disposal or a NAMA approved refinancing of all secured assets, the funds in the escrow account would be released to the borrower.

As part of the arrangements, in this particular case, the debtor also provided NAMA with additional security of €30 million.

The key financial features of the CMA at the initiation of the arrangement can be depicted as follows.

Connection Management Agreement – Revised Loan Arrangements with Debtor

	€m	Incentivisation Features
Amount owed by debtor	440	
Revised arrangements		
Interest Bearing Loan	300	
Non-Interest Bearing loan	140	Following repayment of €300 million plus interest, 25% of the next €30 million repayments of principal on this loan would accrue to the debtor[a.] Thereafter' up to 35% of any further repayments of principal would accrue to the debtor[a]
NAMA Debt		
Balance	267	

Note a Provided that all assets have been sold or refinanced.

Chapter 4

Debt Management

Debt Management

4.1 NAMA generates cash from the loans it has acquired in the form of receipts from borrowers as well as the proceeds of disposal of loans or underlying properties. Ongoing receipts from borrowers comprise, in the main, the net rental income generated by the borrowers' property transactions. In some instances, payments are also made by borrowers out of funds that were not part of the collateral at the point the loans were valued.

4.2 NAMA's overall debt reduction targets are set out in its business and strategic plans. NAMA has a target of reducing its debt[57] by around €7.5 billion by the end of 2013. In order to meet this target, it will need to generate net cash of this amount after meeting its interest and other costs as well as funding any new lending that it undertakes.

4.3 In its business plan of June 2010, NAMA set itself a target of reducing the debt that it issued to pay for the acquired loans over the course of the agency's expected life. By early 2012, taking account of economic conditions now prevailing, NAMA estimated that in a 'base case' scenario the full disposal of all assets could extend into 2020. However, given the nature of the NAMA project such estimates will change across its lifespan and can only reflect current conditions.

4.4 Figure 4.1 sets out NAMA's current and previous estimates of the level of its outstanding debt over the medium term.

Figure 4.1 Debt Reduction Estimates

	NAMA Estimate of Debt Outstanding	
Milestone	**2010 Estimate[a]**	**2012 Estimate[b]**
End of 2013[c]	76%	76%
End of 2015	60%	60%
End of 2017	20%	38%
End of 2019	0%	13%
End of 2020		0%

Notes
a This was set out in its 2010 business plan.
b This is a base case estimate. It is subject to review as part of a revised strategy formulation process.
c The May 2011 Memorandum of Economic and Financial Policies[58] between the European Commission and Ireland notes that NAMA will constructively contribute to the restoration of the Irish property market in the course of meeting asset disposal targets established and monitored by the NAMA Board including disposal of 25% of assets by end 2013.

57 NAMA debt refers to the approximately €31.8 billion debt issued in the form of securities guaranteed by the Minister for Finance comprising €30.2 billion senior debt and the subordinated debt of €1.6 billion.

58 In December 2010, when the Programme of Financial Support was established, a Memorandum of Economic and Financial Policies setting out the economic and financial policies that Ireland would implement to strengthen Ireland's banking sector and financial position was drawn up. The Memorandum is updated following quarterly reviews of Ireland's progress in meeting targets set under the Programme.

Chapter Focus

In order to manage the debt due to it by its debtors, NAMA would need to

- position itself to monitor overall income receivable to ensure that it is being collected in line with expectations
- control the collection of rental income through appropriate arrangements with borrowers and their tenants
- manage the disposal of property in a manner that contributes to the achievement of its overall financial goals.

This chapter examines NAMA's arrangements for the foregoing aspects of its debt management activities.

Cash Collection Trends

4.5 Underlying the value that NAMA has placed on its assets, which are predominantly loans to property debtors, are assumptions about the cash flows that will arise from those assets. These cash receipts are, in turn, based on the income that will be generated from the property assets that the loans have financed. Assessments of the likely flow of funds to NAMA have been made for the Agency's major debtors at two stages to date

- the original loan valuation stage
- the business plan review stage.

4.6 Based on its initial review of the business plans, the extent to which the amounts projected at initial valuation are likely to be realised has been revised at the end of NAMA's first year of account. Differences in cash projections arose out of a number of factors, including

- changes in estimates of the amounts recoverable and their timing
- more refined information on property management costs of borrowers.

4.7 By the time it formulated its 2010 financial statements, NAMA had carried out assessments of the cash flows that were projected to be received from 29 debtors whose business plans had been reviewed.[59] Of these 29 debtors reviewed, in 18 cases the present value of the projected cashflows in the business plans at the end of 2010 was less than the carrying value of the debtors' loans in NAMA's books at the same date.[60] The rate of reduction for those debtors averaged 11.7%. When the effect of the reduced cashflows was assessed, in terms of the full sample of 29 debtors, it indicated that, in present value terms, cashflows would be in the order of 5% less than originally projected. If this were replicated across the entire NAMA portfolio 5% less (in present value terms) than the price paid for the loan assets would be recovered. The key factors contributing to this view of likely recoveries were

- revised assessments of the extent to which declines in values were projected to recover before disposal of a property or the extent to which increases in value would be retained or accrue in the future
- judgments about the optimum disposal time for properties while taking account of the debt reduction targets set by the Board

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59 While the in-depth process was only completed by end 2010 for 29 debtors, whose debt of €13.3 billion amounted to around 45% of the total loan balances at the end of 2010, the results are instructive for the overall loan portfolio.

60 Because all of the original bank loans were consolidated the impairment assessment focused on the overall debtor position thus netting gains and losses for each debtor.

- the extent to which the value of properties or developments could be enhanced through the provision of new funds
- the amount of essential property costs that would arise
- the level of overheads that was necessary to allow a borrower to continue to develop and run the business or alternatively the provision that would be necessary to meet the costs of receivers.

Movement in Loan Valuations 2010

4.8 The audit compared the cash flows that were projected at the time the loans were valued with the cash flows that were projected in the business plans at the end of 2010 in order to isolate the impact of altered cash flow projection from timing factors.[61]

4.9 The comparison showed that for 18 of the 29 debtors, whose loans were impaired by a total of €719 million or 11.7% of the related loan balances at end 2010

- There was a drop of 12.6% in the expected gross (undiscounted) cash flows.
- The effect of timing differences in the expected receipt of the cashflows reduced the impairment rate by around 1%.

4.10 On the other hand, for 11 of the 29 debtors, the reviewed business plans projected an expected gain of almost €600 million or 8.2% of the amounts owed by those debtors. Analysis of this showed that

- the expected gross cashflows had increased by around 1.6%
- timing differences accounted for the balance of the increase in the net present value of those loans.

4.11 These potential gains are not factored into accounting results since the purpose of the impairment assessment is to determine the extent of losses that have arisen i.e. how much the carrying value of the loan assets has diminished due to reductions in cash flows.

4.12 Most of the gains that were projected arose on a small number of loans with the loans of one debtor accounting for 54% of the total. While the undiscounted cash flows expected from that debtor were 8% lower than those projected in the loan valuation calculation, planned property disposal dates in the business plan were earlier than those assumed when the loan was acquired. This meant that this debtor is expected to show a surplus of €320 million or almost 30% of the debtor's loan balances at the end of 2010. Four debtors accounted for a further 32% of the expected gains.

4.13 At the start of 2012, NAMA is undertaking a detailed review of the cash flows expected from the NAMA-managed borrowers. This analysis will take account of the most recent projections of property disposals and, following this, the cash flows and associated property details will be consolidated in a database. The enhanced information will be used as part of the loan impairment review process for 2011 and will also provide better information about those debtors for whom a gain is expected.

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61 This was done for the 29 debtors whose loans could be individually assessed due to the fact that the NAMA debt management process had sufficiently developed i.e. business plans had been assessed.

Conclusion - Cash Flow Comparison

18 of the 29 debtors whose business plans had been reviewed were projecting less cash proceeds by comparison with assumptions made when the loans were acquired by NAMA. The impact of this was a reduction of 5% in the net present value of the cash proceeds that were projected when the loans were purchased.

While 11 of the 29 debtors showed expected gains, the cash expected from those debtors was only 1.6% greater than that expected when the loans were valued. In this set of cases, the major factor contributing to the expected gains is a projected earlier than anticipated receipt of cash. Consequently, the realisation of these amounts is dependent upon the early receipt of the associated cash through accelerated disposals.

Overall, the results to date suggest that the level of losses within the overall portfolio up to 31 December 2010 was around 5%. The assessment was completed in connection with the audit of the 2010 financial statements and does not take account of post December 2010 market movements. The market had deteriorated further in 2011, in particular in Ireland. For example, the residential property index produced by the Central Statistics Office indicated that residential property prices fell by an average of 16.7% in Ireland during 2011.

Caution is necessary in interpreting these results in a dynamic changing environment. In addition, the pattern is likely to become clearer as more business plans are completed and the 2012 review of expected cash flows and the timing of their receipt is completed. The extent to which either the impairment losses or the expected gains will ultimately be realised will depend on the performance of the property markets over the expected remaining life of NAMA.

Rental Income Trends

4.14 The amount of income received by NAMA prior to the disposal of property depends on the extent to which rental income generated by the properties is remitted to it. Assumptions were made at valuation stage about the extent of these income flows.

4.15 In order to examine the trend to date a sample of eight borrowers (682 loans) with original loan obligations of €4 billion was examined for 2011. Analysis of these loans found that they fell into two categories when the effect of disposal related income[62] is excluded.

- Two borrowers (A and B) remitted more than the expected cash due to the fact that they made additional payments out of sources not factored into the collateral identified when the loans were valued. In addition to the €40 million expected by way of rental income at valuation stage, these two borrowers remitted an additional €113 million in 2011.
- In the case of the other six borrowers the analysis showed that overall, the non-disposal cash[63] received was around 26% less than that expected from rental income in the loan valuation model. For two debtors, the non-disposal cash being received exceeded the expected rental income in the loan valuation model by between 32% and 69% whereas for the other four debtors, the non-disposal cash received was between 43% and 82% less than that expected when the loans were valued. The pattern for these six loans is set out in Figure 4.2.

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62 This analysis distinguishes expected receipts when properties are ultimately disposed of from those that accrue from the management of the properties prior to their disposal.

63 Non-disposal cash is all cash received other than proceeds from disposal. It principally comprises rental income and, for some debtors, trading income.

Figure 4.2 Net Rental Income Receipts 2011

Debtor	C	D	E	F	G	H	Total
	€m	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**
Borrower debt at acquisition	119	720	470	411	166	78	**1,964**
Loan acquisition value	53	298	120	169	34	33	**707**
	€'000	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**
Expected net rental income at loan valuation	1,792	3,963	691	1,139	1,142	2,004	**10,731**
Receipts attributable to net rental income [a]	**2,364**	**2,270**	**124**	**1,925**	**640**	**646**	**7,969**
Surplus/(shortfall)	**572**	**(1,693)**	**(567)**	**786**	**(502)**	**(1,358)**	**(2,762)**
Surplus/(shortfall) %	**32%**	**(43%)**	**(82%)**	**69%**	**(44%)**	**(68%)**	**(26%)**

Source: NAMA – Analysis by Office of C&AG.

Note a The receipts attributable to net rental income are derived after netting disposal cash against the gross income. €1.3 million of rental receipts had been applied by a debtor, with NAMA's approval, for capital works.

4.16 Overall, with the exception of those borrowers who have remitted cash out of sources not identified when the loans were acquired, there is a considerable divergence between the amount of cash being projected in the year 2011 and that being realised. This demonstrates the need to identify and control the factors that contribute to the overall shortfall including

- debtors using rental income to pay expenses or diverting them to other uses
- lower rents than envisaged being achieved
- tenants failing to pay rent that is due or vacating units.

4.17 As part of this process, NAMA would also need to take account of income that was not envisaged when loans were acquired – for example, rental income on previously unencumbered assets that a debtor has subsequently pledged as security.

4.18 A further relevant factor is that the valuation process at loan acquisition stage did not provide for overheads that would have to be incurred in the running of a developer's business. There was an assumption inherent in the valuation model that all rental flows less the cost associated with empty units would accrue to NAMA. The non-reckoning of these overhead costs is the primary cause of the net rental income accruing to NAMA being less than that included in the calculation of the loan acquisition value.

4.19 NAMA pointed out that property valuations at loan acquisition stage had been carried out in accordance with the requirements of the Royal Institute of Chartered Surveyors Red Book valuation method.[64] The valuation methodology, approved by the European Commission, did not provide for the indirect costs of managing real estate collateral.

Revisions following Business Plan Review

4.20 As part of the business plan review process and ongoing management of debtors, NAMA identifies the property-related[65] and overhead[66] costs associated with managing a property portfolio. For

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64 The valuations are made based on values at 30 November 2009.

65 For example, insurance and maintenance costs.

66 Overhead costs refer to the administrative costs incurred by a debtor in managing a property portfolio. Salaries of debtors and their staff account for the largest component.

those debtors who are continuing to manage their properties, these payments are made from rental income and the balance is submitted to NAMA. For the same six debtors that are referred to in Figure 4.2 debtor overheads accounted for 18% of gross rental income with essential property costs accounting for a further 26%. The net rental income was, accordingly 56% of the gross amount.

4.21 Overall, while the net rental income expected following business plan reviews from the six borrowers was around the same as that projected at loan valuation, the net rental income received in 2011 was around 24% below the revised expectations for those borrowers in that net rental income before funds were applied for capital expenditure amounted to €8 million which was 76% of the expected net rental income of €10.5 million.

Figure 4.3 Projected and Actual Rental Income, 2011

	Total **€'000**
Expected gross rental income 2011	18,934
Essential property costs	(5,058)
Debtor overheads	(3,334)
Expected net rental income after deduction of property costs and overheads[a]	***10,542***
Actual Income[b]	7,969
Shortfall	**2,573**
% Shortfall	**24.4%**

Source: NAMA

Note a The projections for the net rental income were provided by the portfolio managers with responsibility for the management of the six debtors whose cases are summarised. They are derived from the debtors' business plans.

b €1.3 million of rental receipts had been applied by a debtor, with NAMA's approval, for capital works.

4.22 The Chief Executive Officer pointed out that when NAMA valued loans it was by reference to leases and rentals in place as at 30 November 2009 and that the loan valuation model used did not take account of debtor overhead costs. He stated that when NAMA acquired the loans it found that while rental income was being generated by properties, debtors were not generally required to remit or mandate that rent to a controlled bank account and that the financial institutions had poor visibility over the application of that income. This led to a situation where debtors were collecting rental income but paying only some, or in some cases none, of this income to service loans. In addition, the CEO pointed out that the general economic environment has caused some tenants to go out of business or for reduced rents to be agreed after November 2009. NAMA, following receipt of business plans, requires debtors to mandate rental income and NAMA permits an agreed allocation to meet a debtor's overheads. The CEO stated that NAMA is making significant progress in controlling rental income and that it is closing the gap between gross rental income and the amount applied to meet debtors' loan obligations.

Conclusion - Rental Income

The cash flows that were estimated when the loans were initially valued took account of rental income that was expected to accrue from the property collateral underpinning the loans. When the loans were valued, adjustments were made for the costs of maintaining vacant units. However, no provision was made for the property and administrative costs associated with managing the properties. A comparison of the receipts from eight debtors who accounted for 682 loans in 2011 showed that

- Two of the borrowers made payments from cash accumulated prior to the loans being acquired by NAMA and it was not possible to associate the rental income being remitted by those borrowers with that estimated at acquisition.
- For the other six borrowers, while the receipts from two borrowers exceeded those projected when the loans were valued, overall the net rental income remitted to NAMA was 26% less than that projected at loan valuation.
- While the projected income was revised when the business cases were reviewed, the outurn in 2011 across the six borrowers was 24% below the revised expectations.

A significant factor contributing to the shortfall in net rental income when compared to that estimated at loan valuation is the cost of managing the properties, which was not provided for in the loan valuation.

NAMA needs to continually refine its processes for the management of loans in order to ensure that it is in a position to estimate its likely income, ensure that that income is collected and that any costs met at source are transparently accounted for.

Rental Income Collection Procedures

4.23 Control over income is likely to be most effective when transparency is achieved around actual and estimated cashflows and where there are routines in place to ensure that income is remitted promptly to NAMA or its agents.

4.24 NAMA's general policy is to have rental income from investment assets, that are controlled by a debtor, mandated[67] to NAMA. In addition, where those debtors are unable to fully meet their current repayment obligations, it has set a policy that debtors should pay all available cash to NAMA.

4.25 There are a variety of approaches to securing the transfer of funds to NAMA arising out of a policy set in April 2011. These include

- the transfer of property income by the debtor by standing order to a current account controlled by the debtor, a debtor loan account or an account controlled by NAMA
- the lodgement by standing order of property income to an account controlled by the debtor with NAMA obtaining a floating charge over the account
- the transfer of property income by standing order to an account controlled by the debtor with NAMA obtaining a fixed charge over the account
- the assignment from the debtor of rent combined with one of the first three options[68]
- the appointment by NAMA of an agent to collect the rent.

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67 A mandate is an instruction issued to a bank to make payments to a specified bank account. In NAMA's case it could be an instruction by either a debtor or by one of their tenants.

68 Under this option, tenants pay their rent directly into a designated account. This contrasts with the first three options where the tenants pay their rent to the debtor who then transfers it to the designated account.

4.26 Factors identified for consideration in making a decision about the approach to be adopted included the security offered by each option, the level of administration involved, the cost and time of putting an option in place and the risks of debtors diverting property income to an account other than the designated account. The policy stated that the most important step, in most cases, was to have rent assigned to NAMA.

4.27 In practice, in most cases, NAMA has not yet taken the step of having rent assigned. In the course of audit, portfolio managers stated that the priority when commencing discussions with debtors is to ensure that NAMA is aware of all rental income that a debtor is due to receive and that this is paid into an account where NAMA, through the participating institution managing the loan on behalf of NAMA, has visibility[69] of all rental income received. NAMA stated that where a debtor is engaging in a constructive manner any payments from the account – whether unavoidable property costs or overheads required by the debtor for property management purposes – must be within limits set by NAMA even in circumstances where a formal agreement with the debtor is not yet in place.

4.28 NAMA pointed out that being aware of and monitoring the receipt of rental income is an essential element of its engagement with debtors and that taking the steps set out in its Credit and Risk policy would occur later in the process. The requirement for controlling rent and steps to be taken by a borrower to achieve this are, typically, set out in Letters of Support. NAMA also pointed out that, while there was no legal impediment to a debtor withdrawing funds from an account over which NAMA does not have a charge, in practice NAMA would become aware of withdrawals and that debtors were aware that it would not support them if they took such action.

4.29 In the sample of eight debtors whose original debt amounted to €4 billion and whose net rental receipts were reviewed

- Letters of Support were in place for four debtors and negotiations were advanced to agree terms for the other four.
- In all cases, the portfolio managers had compiled schedules that recorded the rent that was known to NAMA.
- In three cases, some or all of the rental income was controlled through the use of rent collection agents who account to NAMA for rental due. In two cases, the majority of the rent was coming from a few large assets in one instance and NAMA stated that it was planning to appoint a rental collection agent in the other. In the other three cases, the portfolio managers indicated that they are satisfied that the rent due is being paid to NAMA.
- In two cases reviewed, including one case where a rent collection agent is in place**,** a further control was the appointment of a financial monitor by the debtor. The financial monitor is responsible for reporting monthly on the collection of rental income and overheads incurred and has a duty of care to NAMA.
- In two cases, some rent has been assigned to NAMA - around 50% in one instance. Apart from these two cases, there was no evidence that rent has been assigned to NAMA but NAMA has advised that it has visibility and effective management control over such income.

[69] Visibility in this context means being able to trace rental receipts to specific properties and being able to determine which properties are yielding rental income and which are not.

Conclusion - Control over the Collection of Rental Income

Rent is payable by tenants to the owners of a property, whether directly or through a collection agent. A practice used by some lenders is to require debtors who have loans secured on investment properties to have their tenants pay their property rent directly into a specified bank account. The bank account into which the rent is paid may be controlled by the debtor or by the lender.

However, this practice was not very widespread and in fact in the majority of loans that NAMA acquired the selling financial institution did not have this in place. NAMA has adopted a policy of having rental income mandated by debtors and the matter is addressed in the course of the business plan reviews. NAMA has a number of options available when doing this. The internal Credit and Risk policy makes it clear that, in most cases, the most important step is for NAMA to have debtors assign rental income to them. Some rent had been assigned to NAMA in two of the eight cases reviewed.

In practice, the approach adopted by NAMA where debtors are co-operating has been to have rental income paid into an account, which NAMA monitors. Methods of control include the use of rent collection agents and the use of financial monitors.

NAMA has set limits to the costs and overheads that borrowers can meet from rental income.

The level of preliminary testing was necessarily limited and the extent to which NAMA has achieved control over rental income will be further reviewed in the course of the 2011 financial audit.

Asset Disposals

4.30 NAMA may dispose of its assets through a sale of the loans it purchased or through the disposal of underlying collateral.

Loan Disposals

4.31 Up to the end of 2011, NAMA had disposed of loans related to three borrowers[70] with the following outcome

- The sales proceeds amounted to €873 million.
- NAMA realised almost the full amount of the nominal, or par debts owed by the borrowers.[71]
- The loan sales were approved at the appropriate level in NAMA i.e. by either the Board or Credit Committee.
- NAMA estimates that it made a gain of around €114 million[72] from the disposals.

4.32 The environment in which NAMA operates changed considerably in 2011. Following stress tests carried out on 90 European banks by the European Banking Authority in July 2011 and the pressure on banks to meet minimum Tier One capital requirements, banks are seeking to reduce their loan books. As a result, NAMA is facing significant competitive challenges from banks that are deleveraging in Ireland and in other European markets. This may affect its capacity to sell the volume of property, loans or portfolios of loans in its lifetime as there is limited credit available and buyers have greater choice in these conditions.

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70 In addition, some borrowers had refinanced their loans and remitted the cash to NAMA.

71 The nominal or par debt is the amount owed by the borrowers to the participating institutions when the loans were acquired, adjusted for subsequent interest charges, advances and loan repayments.

72 The gain is the difference between the loan proceeds and the carrying value in NAMA's books at the time of disposal.

Property Disposals

4.33 The property underlying a loan may be disposed of in a number of ways. These include

- direct disposal by NAMA
- disposal by debtors
- disposal through insolvency advisors.

4.34 NAMA has only taken direct ownership of a small amount of property (around €6 million in value) and, by December 2011, had not yet disposed of any property directly.

Disposals by Borrowers

4.35 By the end of December 2011, NAMA reported that it had approved asset disposals of €6.95 billion - €1.9 billion in 2010 and just over €5 billion in 2011. This included approval for loan sales of €873 million and property disposals of almost €6.1 billion. Following adjustment, by NAMA, for approved disposals it no longer expects to complete, the adjusted approved asset sales figure at the end of December 2011 was €5 billion.

4.36 There are some circumstances where NAMA may have approved a sale which proceeded but where NAMA would not be entitled to receive the proceeds or would be entitled to some of the proceeds only

- where a property is the subject of a number of loans some of which are from non-NAMA banks
- if a sale took place after a participating institution joined the NAMA scheme, NAMA's approval was required. However, if the sale was completed prior to the date set for valuing the loan for acquisition purposes, then the proceeds would accrue to the participating institution and not to NAMA.

4.37 By the end of December 2011, NAMA had received €2.9 billion related to net proceeds from the sale of property – over €2.5 billion of which was received in 2011. The proceeds, classified by geographic location, are set out in Figure 4.4.

Figure 4.4 NAMA Property Disposal Net Proceeds to end December 2011

Location	Total €m	% of proceeds
Britain	2,358	80.7%
Ireland	329	11.3%
Northern Ireland	30	1.0%
Rest of World	204	7.0%
Total	**2,921**	

Source: National Asset Management Agency

4.38 A comparison of the gross proceeds with the 2009 current market value for a number of disposals in 2011 was carried out. In general, the gross amounts realised were lower than the valuation in the case of Irish property and higher in the case of property in Britain.

- For seven properties sold in Britain with a total disposal value of €190 million, the disposal prices were, on average 2.5% greater than the current market value of the properties in November 2009. The disposals were in the period January 2011 to July 2011.

- For 29 Irish property disposals with a total disposal value of €6.1 million, the gross disposal prices were, on average 5% lower than the current market value of the properties in November 2009. Six residential units in one development sold, on average, for 7% more than their 2009 valuation while the price achieved for the remaining units was, on average 9% lower than the 2009 valuations. The disposals took place during 2011.
- For two properties sold in the United States, the disposal value of €20 million was 0.5% higher than the November 2009 valuations.

4.39 In regard to the methods of disposal there was evidence, for the cases reviewed, that the sales process used provided for more than one interested party to bid for a property. Methods used included

- open marketing (residential and commercial properties)
- restricted marketing (commercial)[73]
- negotiated sale following advertisement (commercial).

The disposals reviewed all took place prior to NAMA issuing a guidance note setting out the framework for the disposal of property by NAMA debtors and insolvency advisors which is outlined below.

4.40 Properties are sold at the price approved by the appropriate delegated authority. NAMA reconciles the net amounts received from the sale of properties to the approved disposal value. For the disposals in 2011, analysis of the NAMA record of the disposal costs for almost 1,500 sales with a gross value of €1.9 billion showed that the cost of disposal ranged from 3.65% in Britain to 6.76% in Ireland. The relative costs of disposal are set out in Figure 4.5.

Figure 4.5 NAMA Costs of Property Disposal

Cost type	Britain	Ireland
Legal costs	0.29%	0.41%
Sales fees	0.49%	0.37%
Other	2.21%	2.09%
Sub-total	*2.99%*	*2.87%*
Tax	0.66%	3.89%
Total	**3.65%**	**6.76%**

Analysis by Comptroller and Auditor General.

4.41 The cost of disposal attributable to legal, sales and other fees was approximately the same in Ireland and Britain at around 3%. However, the amount of gross sales accounted for by taxation was almost 4% in Ireland compared with 0.66% in Britain. The higher taxation cost in Ireland was attributable to the proportion of sales that comprised of new property which attracts a Value Added Tax rate of 13.5% in Ireland. Disposals in Britain were dominated by sales of older commercial property.

Disposal of Real Estate Assets

4.42 The Board of NAMA issued guidance in respect of the disposal of real estate assets by NAMA debtors and insolvency advisors. The guidance provides that

73 Properties are marketed to specific investors. The cases reviewed where this method was used were large or specialised properties in Britain and the United States.

- Property disposals should be carried out on a competitive basis and in accordance with prevailing market norms for the asset class and jurisdiction having regard to NAMA's objectives as set out in the Act.
- In circumstances where the expected proceeds exceed €250,000,[74] agents should generally be appointed and are expected to prepare a report outlining their recommended marketing approach. In circumstances where the expected proceeds are less than €250,000 such a report need not be submitted.
- The methods of disposal can be by private treaty, sale by public auction, public tender or by way of sealed bids or by a disposal mechanism tailored to the characteristics of the underlying real estate.
- Agents are expected to enter into a duty of care obligation to NAMA including acknowledgement of NAMA's statutory obligations in general and under section 172 (3) of the Act.

4.43 The legislation prevents debtors or associated debtors acquiring in a sale by NAMA, the security for loans upon which they have defaulted.

4.44 Section 172 (3) of the NAMA Act provides that a person who is a debtor in relation to an acquired bank asset or an associated debtor of that debtor or their nominee shall not, if any of them is in default in relation to any acquired bank asset, acquire from NAMA or a NAMA group entity any legal or beneficial interest in property comprised in the security forming part of any acquired bank asset to which the default has occurred.

4.45 In the case of sales under its direct superintendence, NAMA has developed a statutory declaration to be provided by purchasers in which they confirm that they have had no connection with the debtor within the meaning of Section 172 (3).

4.46 A practical consideration that arose was how to ensure that sales by insolvency practitioners would follow a similar pattern. NAMA has adopted a policy that recommends that a receiver or other insolvency practitioner should be made aware of the reputational risks that NAMA is seeking to protect itself against but should otherwise have the discretion to determine, in each case, the level of enquiry to be made about the purchaser's identity and in cases where the insolvency practitioner determines that assurance is required from a purchaser, he or she chooses which form of assurance is provided.

4.47 For property sales by debtors, NAMA will not require purchasers to make a declaration or provide other confirmation that they have no connection with the debtor.

[74] Or exceeding £200,000 or $325,000.

Conclusion - Disposal of Property

In practice NAMA has not disposed of property directly – it has been sold either by debtors or by insolvency practitioners. This means that disposals are not governed by the NAMA Code of Practice for the disposal of bank assets or the Code of Practice for the Governance of State Bodies both of which require competitive processes when disposals above a certain value are being made.

In July 2011, the NAMA Board issued a guidance note setting out a framework for the disposal of assets by debtors and insolvency practitioners requiring a competitive disposal process.

Under the Act, debtors (and associated debtors) who are in default in relation to a bank asset cannot acquire from NAMA a property which is part of the security of any acquired loan in respect of which default has occurred and, in the case of sales by NAMA, purchasers must make a statutory declaration confirming that they have no connection with the debtor whose property is being sold. This provision of the Act does not apply to sales by the debtors themselves or by insolvency practitioners.

In an attempt to address this, the NAMA Board approved guidance, in July 2011, in respect of sales by borrowers and insolvency advisors under which insolvency practitioners, if they determine that a sale to a connected party should proceed but NAMA disagrees, must refer the matter to the appropriate NAMA authority for consideration. For property sales by debtors, NAMA does not require the debtor to obtain a declaration from the purchaser that they are not connected to the debtor. However, NAMA approval is required in respect of all disposals.

By the end of December 2011, NAMA had approved asset (loan and property) disposals amounting to €5 billion.

Up to the end of 2011, €2.9 billion had been received from the sale of property and a further €0.9 billion had been received from the disposal of loan assets.

In the sample of cases reviewed, the gross receipts for properties in Britain exceeded the market value at acquisition by 2.5% while there was a shortfall of 5% in the case of Irish disposals. The costs of disposal including taxation in the two jurisdictions reduced the gross proceeds by 3.7% in Britain and 6.7% in Ireland.

Overall Conclusion – Debt Management

NAMA has funded its acquisition of loans from the banks by means of a combination of bonds and subordinated debt. Its capacity to repay that funding is dependent upon its performance in managing the loans to debtors.

An ongoing measure of this repayment capacity is given by the level of impairment of its loan portfolio. The level of losses up to 31 December 2010 representing projected cash flows that are now not expected to materialise within the portfolio of loans acquired by NAMA up to 31 December 2010 was estimated at 5%. This does not take account of post December 2010 market movements. The market had deteriorated further in 2011, in particular in Ireland. For example, the residential property index produced by the Central Statistics Office indicated that residential property prices fell by an average of 16.7% in Ireland during 2011. Consequently, NAMA is managing its debt in the context of a business environment that militates against full realisation of its initial investment.

Factors that will impact on its performance include the amount and timing of disposals, refinancing by debtors and the level of new security pledged by borrowers.

In managing its debtors, NAMA needs to maximise the flow of current income from the underlying assets ensuring that it is, at least, in line with that projected. The approach adopted by NAMA where debtors are co-operating has been to have rental income paid into an account, which NAMA monitors. Methods of control include the use of rent collection agents and financial monitors.

When a sample of loans was reviewed in 2011, rental receipts from most of the borrowers were below the level projected at loan valuation stage. For six of the eight debtors examined, the shortfall was 26%. Two borrowers introduced new cash, making it difficult to conclude on the outturn for that year in their cases. Much of the difference was accounted for by property management costs that were not provided for in the loan valuations. When the comparison was made against the subsequently agreed business case projections there continued to be a rental income shortfall.

NAMA needs to continually refine its processes for the management of loans in order to ensure that it is in a position to estimate its likely income, ensure that that income is collected and that any costs met at source are transparently accounted for.

By the end of December 2011, following adjustment for disposals that were no longer expected to proceed, NAMA had approved asset (loan and property) disposals amounting to €5 billion.

Up to the end of 2011, €2.9 billion had been received from the sale of property and a further €0.9 billion had been received from the disposal of loan assets.

In the sample of cases reviewed, the gross receipts for properties in Britain exceeded the market value at acquisition by 2.5% while there was a corresponding shortfall of 5% in the case of Irish disposals. The costs of disposal, including taxation, in the two jurisdictions reduced the gross proceeds by 3.7% in Britain and 6.7% in Ireland.