Comptroller and Auditor General

Special Report

National Asset Management Agency

Acquisition of Bank Assets

October 2010

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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.

The website of the Office of the Comptroller and Auditor General is the primary means of publishing reports of the Comptroller and Auditor General presented to Dáil Éireann. Should any errata arise they will be corrected and noted in the report published at www.audgen.irlgov.ie

Report of the Comptroller and Auditor General

National Asset Management Agency – Acquisition of Bank Assets

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 acquisition of bank assets 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

7 October 2010

Table of Contents

		Page
Summary of Findings		7
National Asset Management Agency – Acquisition of Bank Assets		
1	Introduction	17
2	Asset Acquisition Process	29
3	Outturn on Transfers	59
4	Corporate Governance	75
5	Resourcing and Procurement	85
Appendices		
A	European Institutions Guidance and Approvals	99
B	Eligibility of Applicant Banks to NAMA Scheme	105
C	Eligible Bank Asset Regulations	109
D	Asset Valuation Regulations	113
E	NAMA Structure	121
F	Post Acquisition Loan Management	127
G	Legal Review	139
H	Policy Guidance – Loan Valuation	145
I	Audit Coordinator	149
J	Valuation Disputes	153
K	NAMA Committees	157
L	Codes of Practice	163
Glossary		169

Summary of Findings

Summary of Findings

The National Asset Management Agency (NAMA) was established in December 2009. Its purpose is to acquire assets in the form of property-related loans from banks. The overall objective of this process is to bring stability to the banking system by removing impaired loans from the balance sheets of individual banks.

This initial review of NAMA outlines the asset acquisition process that has been established, the outturn of the first loan acquisition round and the arrangements for governing and resourcing the Agency. Its purpose is to give an early account of the process based on documentation examined by my Office of the structure, systems and procedures put in place by NAMA. The systems and outturns are currently being audited as part of the financial audit of the first accounting year of NAMA.

The NAMA Scheme

Under the scheme, NAMA acquires loans from participating banks at a long-term economic value. The National Asset Management Agency Act 2009 and associated regulations made by the Minister for Finance prescribe the types of loans that NAMA may acquire and how they are to be valued. Five financial institutions applied to take part in the scheme. All were designated as participating banks by the Minister.

The scheme operated by NAMA required the approval of the European Commission as it involves the provision of state aid to the participating banks. The Commission gave its approval for the establishment of NAMA on 26 February 2010. It stated that it will reassess the aid granted in light of the adequacy of restructuring plans submitted by the banks. The Commission will also review the transfer prices of the bank assets on an ongoing basis. On 3 August 2010, the Commission stated that it found the transfer of the first tranche to be in line with the approved scheme and with its guidance on the treatment of impaired assets.

Acquisition Process

As part of the acquisition process, NAMA had to determine the bank assets that are eligible for transfer, gather and assess information related to those loans and borrowers and value the eligible loans.

In practice, the valuation of loans is, in most cases, directly related to the value of the associated collateral and much of the valuation process focuses on the establishment of a value for that collateral.

As an initial step, the participating banks identified the eligible bank assets and provided NAMA with information about the loans and borrowers using standard templates provided by NAMA. The information included legal due diligence reports, current market valuations of properties pledged as collateral for loans and information about security, other than real estate, pledged as collateral by borrowers. The current market valuation of properties was to be made at 30 November 2009, a date stipulated by the NAMA Board.

NAMA validated the information through a process which included

- legal reviews that examined the accuracy and completeness of the information supplied by the banks as well as the validity of loan security, the soundness of title and whether any legal actions were outstanding for loans

- property valuation reviews which included a determination of the long-term value of property and
- valuations of financial derivative contracts associated with the loans and of non-real estate collateral.

In accordance with the Act and associated regulations, loan valuers, using a model developed by financial advisors, calculated a long-term value for each loan. These loan values took account of the value of the loan collateral - the present value of the cash that is expected to flow from the real estate collateral (after uplift for long-term economic value) and the current market value of non-real estate collateral. Adjustments were made to take account of due diligence and enforcement costs likely to be incurred by NAMA, collateral in excess of borrower obligations arising on some loans, legal discounts and the value of associated financial derivatives.

A firm acting as audit coordinator reviews all loan valuations and certifies whether they have been accurately calculated in accordance with the valuation model and whether the valuations of real estate collateral have been determined on a consistent basis in accordance with criteria determined by NAMA.

NAMA anticipates that it will acquire loans that have a book value including accrued interest of around €73 billion made by banks to approximately 850 borrowers.

Outturn on Transfers

The loans of ten of the borrowers with the highest debt were acquired in the first round of transfers.

Features of the first tranche of acquisitions were

- Borrowers' cumulative debt was €15.4 billion. NAMA paid around 50%, €7.7 billion, of the book value for the loans and associated financial derivative contracts that the borrowers had entered into for risk management purposes.
- The amount paid by NAMA to banks ranged from 35% to 58% below book value. The amount paid for individual loans ranged from 0-100% of the book value.
- The consideration paid was the lower of the loan obligations outstanding or the value of the associated collateral calculated as outlined below.
- The property associated with the acquired assets was valued at around €7.5 billion. The average uplift for long-term economic value was 11%. The post-uplift value was €8.3 billion.
- €5.9 billion, or 71% of the long-term value of the property, was accounted for by completed residential and commercial properties including hotels.
- After discounting all the projected cash flows from property (taking account of uplift factors) the present value of the loans exceeded the current market value of the properties derived using market valuation methods by almost 9%.
- The amount of other collateral, including cash assets of €162 million, in the first tranche which was included in the loan valuations amounted to €369 million accounting for just under 5% of the total consideration paid.
- The total value of the collateral (valued after uplift adjustment to take account of long-term economic value) that was provided by borrowers was €8.5 billion. €8.1 billion of this was the present value of property cash flows and €0.4 billion was made up of cash and other non-real estate collateral.

- There was €518 million of collateral in excess of borrower obligations. However, this would only be available to NAMA for offset against deficits in collateral in the case of other loans to the same borrowers in limited circumstances. No payment was made in respect of excess collateral.
- The consideration paid by NAMA was reduced by the application of a discount to the loan valuations to provide for due diligence and enforcement costs, the present value of this being €266 million.
- The estimated costs associated with a full enforcement process are 15%. 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 tranche would cover the cost of enforcement proceedings for around 25% of the collateral.
- Following direction by the Governor of the Central Bank and Financial Services Authority of Ireland and the acting CEO of the Irish Financial Services Regulatory Authority, no discount was applied to advances made by banks to borrowers after 7 April 2009 provided that it could be shown that the moneys were advanced as part of normal commercial banking arrangements. For loans that transferred in the first tranche, NAMA accepted that €299 million of those loans, issued after 7 April 2009, qualified for payment in full.
- The value of state aid as represented by the difference between the net loan value for purchase purposes (€7.7 billion) and the current market value of bank assets was €1.7 billion or 28% greater than the loans' current market value.

Settlement Arrangements

The loans are acquired by a NAMA group entity, a majority privately owned special purpose vehicle NAMA Asset Management Ltd. This entity issues debt to fund the consideration payable. Debt issued to pay for the first tranche of loans comprised

- €7.3 billion in securities guaranteed by the Minister for Finance and
- €0.4 billion in subordinated debt.

The guaranteed securities pay interest at a variable rate, which is reset twice annually. The rate up to 1 September 2010 was 1%.

The subordinated debt carries an interest rate linked to the yield on 10-year Irish Government Bonds. Payment of interest on the subordinated debt and its ultimate redemption are dependent upon NAMA's financial performance.

Risk Management – Interest and Foreign Exchange Risk

NAMA faces the risk of adverse movements in exchange rates in cases where it has purchased loans denominated in foreign currencies. It has addressed this risk through the use of cross-currency swaps designed to give NAMA some certainty about the rate at which it will exchange future receipts in foreign currencies for euro.

NAMA also faces the risk of upward movements in interest rates. Interest rate swap contracts can give NAMA certainty about the interest rate it will pay on some of its borrowings. It has hedged a portion of its borrowings for the next four years using these swap contracts.

The hedging strategies have been adopted on the basis of certain assumptions about the timing of foreign exchange receipts and the proportion of performing loans. A residual risk related to the

actual realisation of the predicted cash flows remains and gives rise to a need for NAMA to manage its hedging strategies actively in order to be able to respond appropriately to changes in predicted outcomes. On the interest side, there is some additional cost compared with interest rates prevailing at the contract date but this cost must be weighed against the certainty achieved.

Post-Acquisition Management

Borrowers will continue to owe the balances that are outstanding at the date their loans transfer to NAMA. NAMA requires each borrower to provide a detailed business plan setting out how the borrower intends to repay the amounts due. Following assessment of the plans, NAMA may continue to support the borrower or take enforcement proceedings. In circumstances where it takes enforcement proceedings, NAMA will acquire property which it will have to manage in a way that maximises the return to the State.

Structures and Resources

The report outlines the steps taken by the Board of NAMA to introduce systems and structures to assist it to govern and manage its operations. While these are evolving, the steps taken to date are reasonable and will be kept under review in the course of financial audit.

Since December 2009, NAMA has increased staff numbers to 75 with the aim of having a total staff complement of around 100 by end of 2010. Pending the recruitment of these full-time staff, NAMA uses the services of staff provided by accounting firms.

NAMA has also used the services of external advisors, either procured directly or on its behalf by the National Treasury Management Agency. Services procured include legal and financial services, real estate advice, financial derivative and loan valuations, loan valuation reviews and borrower business plan assessments. Procurement of providers of other services (e.g. enforcement and insolvency services) is currently taking place.

A major risk to be managed in NAMA's resourcing relates to its capacity to manage a very large set of services bought from private providers while at the same time integrating recruited personnel into a cohesive streamlined operation.

Next Steps in Audit

The practical operation of systems and practices established by NAMA are currently being reviewed in the course of ongoing financial audit by my Office and I will report on these in due course. That audit work is focused on the confirmation of the functioning of the controls and the evaluation of the transactions of NAMA.

Acquisition Process – Key Steps

The steps in the loan acquisition process are summarised below.

Identifying Eligible Assets

Banks participating in the NAMA scheme were required to notify NAMA of all eligible bank assets. NAMA intends to acquire eligible assets with a value in excess of €20 million in the case of Allied Irish Banks and Bank of Ireland, those in excess of €5 million from Anglo Irish Bank and all eligible assets from the smaller banks. By September 2010, the value of loans and associated derivatives that NAMA intended to acquire was estimated at around €73 billion.

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Gathering Loan and Borrower Data

Banks provide NAMA with data including legal due diligence reports which provide NAMA with specified information about each loan including details of loan balances, associated derivatives, property and other assets pledged as security for the loans as well as notifying NAMA of any legal issues associated with the loan or underlying security. The banks also provide their valuations for all real estate offered as security for loans.

↓

Assessing Loan and Borrower Data

NAMA has appointed legal advisors, property valuers, experts in financial derivatives and, where necessary, experts in other assets offered as security for loans to review the information provided by the banks and, in some instances, to carry out further valuations of property and other security. When NAMA is satisfied that the information provided about a loan is complete, it sends the loan for valuation to one of the firms on a panel of loan valuers it has appointed.

↓

Valuing Loans

Loan valuers, using a valuation model that derives from the Act and the asset valuation regulations made by the Minister and approved by the European Commission, value loans by calculating the present value of the cash flows associated with the loans' underlying securities. Two values are calculated for each loan – its current market value and its long-term economic value. Loan valuers send the results of their valuations along with supporting documentation to another firm, appointed by NAMA, referred to as the audit coordinator which carries out a series of validation checks to confirm the values calculated by the loan valuers.

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Acquiring Loans

When satisfied that the loan values are correct, the audit coordinator issues an acquisition schedule to the relevant bank setting out the loans being acquired by NAMA and the price it is paying for them. NAMA is acquiring the loans in tranches with all of a borrower's loans, regardless of which bank the loan is in, being acquired in the same tranche. The audit coordinator issues one acquisition schedule for each borrower to each bank.

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Payment

NAMA pays for the loans it acquires by issuing debt. It issues 95% of the debt in the form of Government Guaranteed Securities. NAMA pays interest to the banks on these securities while the banks may exchange the securities for cash by lodging them as collateral with the European Central Bank. The remaining 5% is issued in the form of subordinated debt, redemption of which is dependent on NAMA's financial performance.

National Asset Management Agency
Acquisition of Bank Assets

Chapter 1

Introduction

Introduction

1.1 Following the financial crisis, which came to a head in September 2008, Irish banks were left with considerable loans to property developers where the current value of the collateral was less than the amounts advanced together with any unpaid interest.

1.2 The establishment of an asset acquisition agency to acquire those impaired assets formed part of a set of measures taken to address the liquidity and solvency of Irish credit institutions. The evolution of the wider set of measures is outlined in Chapter 6 of my Report on the Accounts of the Public Services 2009.

1.3 The two major state interventions to address this crisis were

- the removal of impaired assets from the balance sheets of banks at a valuation that reflected their long term economic value – this involved giving state aid to banks
- the provision of new capital to banks to ensure that they met solvency requirements set by the Financial Regulator.

Capitalisation Measures

1.4 Up to the end of September 2010, the total cost to the State of measures aimed at recapitalising the credit institutions was €33.5 billion. In a statement on 30 September 2010, the Minister for Finance indicated that he expected to provide a further €12.8 billion in recapitalisation funds, bringing the total projected recapitalisation cost to €46.3 billion. Details are set out in Figure 1.1.

Figure 1.1 Capitalisation of Credit Institutions, September 2010

Credit Institution	Cost of Share Acquisition[a]	Cost of Preference Shares	Value of Promissory Notes Issued	Capital Provided to 30 September 2010	Projected Future Assistance	Projected Total Assistance
	€bn	€bn	€bn	€bn	€bn	€bn
Anglo Irish Bank	4.00	-	18.88	22.88	6.40	29.28
Allied Irish Banks	0.28	3.50	-	3.78	3.70	7.48
Bank of Ireland[b]	1.95	1.80	-	3.75	-	3.75
Irish Nationwide Building Society	0.10	-	2.60	2.70	2.70	5.40
EBS Building Society	0.10	-	0.25	0.35	-	0.35
Irish Life & Permanent	-	-	-	-	-	-
Total	**6.43**	**5.30**	**21.73**	**33.46**	**12.80**	**46.26**

Source: Department of Finance

Notes:

a This is the cost of the State's investment, not the market value of shares held. In 2010, Allied Irish Banks (€280 million) and Bank of Ireland (€250 million) paid the State dividends due on preference shares in the form of ordinary shares of the banks. These are included in the States investment at the value when the shares were acquired by the State.

b The State invested €3.5 billion in preference shares in Bank of Ireland. €1.7 billion of this was subsequently converted into share capital.

1.5 Capital for Allied Irish Banks and Bank of Ireland has been provided by way of investment by the National Pension Reserve Fund Commission. The Fund received €491 million in cash from

Bank of Ireland in respect of a buyback of warrants issued in conjunction with the preference shares.

1.6 The final cost of recapitalisation will be determined by a number of contingent events including the results of Allied Irish Banks' planned asset sales, the outcome of the sale process in the EBS, the results of negotiations with subordinated debt holders and the extent to which the central assumptions in stress tests of Anglo Irish Bank will be borne out[1].

State Response to Loan Impairment

1.7 Following an examination by a consultant of options to deal with impaired assets, the Minister for Finance (the Minister) announced on 7 April 2009 that the Government would establish a National Asset Management Agency (NAMA) under the aegis of the National Treasury Management Agency (NTMA) on the basis that it would be the most effective way to bring stability to the Irish banking system.

1.8 The Minister, when announcing the establishment of NAMA, stated that the Government had decided to bring forward measures to address the issue of asset quality in the banking system. He stated "*Assets will be transferred from the banks to the new National Asset Management Agency with the purpose of ensuring that the banks have a clean bill of health, their balance sheets are strengthened and uncertainty over bad debts is reduced. This will ensure a sustained flow of credit on a commercial basis to individuals, households and businesses in the real economy. The Agency will have a commercial mandate and will have the central objective of maximising over time the income and capital value of the assets entrusted to it.*"

1.9 The Minister stated that the initiative would be developed and implemented within the common European Union framework detailed in the European Commission (the Commission) guidance on the treatment of impaired assets[2] (Impaired Asset Communication) working closely with the Commission to obtain prior state aid approval.

1.10 The Minister also pointed out that all borrowers would be required to meet their full legal obligations for repayment.

Compliance with EU State Aid Rules

1.11 The Treaty on the Functioning of the European Union (the TFEU)[3] sets out a general prohibition on the provision of state aid which distorts or threatens to distort competition by favouring certain undertakings but exempts some categories of aid from the prohibition including aid to remedy a serious disturbance in the economy of a Member State. Under the TFEU, a new state aid scheme requires prior approval by the Commission even if the aid is justified by these considerations.

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1 These include an assumption that a discount of 67% will apply to the remaining €19bn of Anglo's loans that are yet to be transferred.

2 Communication from the Commission on the treatment of impaired assets in the Community banking sector, February 2009 (2009/C 72/01).

3 The Treaty establishing the European Community was amended and renamed by the Treaty of Lisbon to become the Treaty on the Functioning of the European Union (TFEU). The TFEU came into force on 1 December 2009.

1.12 In October 2008, the Commission[4] stated that, in the light of the level of seriousness that the financial crisis had reached and of its possible impact on the overall economy of Member States, it considered that aid granted by way of a general scheme available to several or all financial institutions in a Member State could be allowed. The Commission issued guidance[2] to Member States, in February 2009, about the design and implementation of asset relief measures which had been prepared in consultation with the European Central Bank (ECB). In the same month the ECB issued guiding principles for asset support schemes[5].

1.13 In its February 2009 guidance, the Commission noted that

- in order for an asset relief measure to deliver relief to a bank, assets[6] needed to be transferred at a value higher than current market value
- the transfer value should be the real economic value of an asset based on its underlying cash flows over time
- the amount of state aid allowed would be the difference between the current market value of an asset and its transfer value
- the difference between the book value and the transfer value would be the loss that a bank would bear in order to share the cost of the asset relief measure with the taxpayers.

1.14 In August 2009, in response to a request from the Minister for an opinion on the National Asset Management Agency Bill, 2009, the ECB stated[7] that the NAMA asset removal scheme (the NAMA scheme) was broadly consistent with the guiding principles and welcomed the fact that it had been designed to comply with Community state aid rules.

1.15 On 26 February 2010, the Commission approved, under EU state aid rules, the establishment of NAMA. The Commission stated that it was satisfied that the scheme was in line with its guidelines on impaired asset relief for banks that allow state aid designed to remedy a serious disturbance in a Member State's economy and that the scheme would help address the issue of asset quality in the Irish banking system and promote the return to a normally functioning financial market.

1.16 Appendix A provides more information about EU rules on state aid, the guidance from the Commission and the ECB on the treatment of impaired assets in the banking sector and the Commission approval for the NAMA scheme.

Legislation

1.17 The National Asset Management Agency Bill was presented to Dáil Éireann on 8 September 2009. The Bill was enacted on 22 November 2009[8] and NAMA was established on 21 December 2009[9].

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4 Communication from the Commission – the application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis.

5 European Central Bank/EuroSystem, Guiding Principles for Bank Asset Support Schemes, 25 February 2009.

6 The term assets, in the Commission's guidance, refers to loans issued by financial institutions and not to the underlying collateral e.g. real estate.

7 European Central Bank/EuroSystem, Opinion of the European Central Bank of 31 August 2009 on the establishment of the National Asset Management Agency (CON/2009/68).

8 National Asset Management Agency Act, 2009.

9 National Asset Management Agency Act, 2009 (Commencement) Order 2009.

1.18 Under the National Asset Management Agency Act, 2009 (the Act), NAMA's functions are to acquire eligible bank assets from banks participating[10] in the NAMA scheme and to hold, manage and realise those assets while, insofar as possible, obtaining the best achievable financial return for the State. NAMA is required to take all steps that are necessary or expedient to protect, enhance or realise the value of the acquired assets and is granted extensive powers under the Act in order to achieve this. These powers include the power to lend, to enter into joint ventures or partnerships, to invest, to purchase other property or rights, undertake land and property development in order to enhance the value of acquired assets, enforce securities and, in this connection, to borrow up to €5 billion.

1.19 Under the Act, the Minister has the power to make certain regulations. He has published two sets of regulations to date. These are in respect of eligible bank assets and the long-term economic value of property and bank assets.

Participation of Banks

1.20 Participation in the NAMA scheme is voluntary. Any bank could apply to the Minister within 60 days of the establishment day for it and its subsidiaries to be designated as a participating bank. The Minister, after consultation with the Governor of the Central Bank (the Governor) and the Financial Regulator, could designate a bank as a participating bank. In designating a bank as a participating bank, the Minister had to be satisfied that the applicant bank was systemically important to the financial system in the State and that the acquisition of eligible bank assets from the bank was necessary to achieve the Act's purposes. The factors under which the eligibility of applicant banks was assessed were specified by the Commission in its decision of February 2010 and are set out in Appendix B.

1.21 On various dates during early February 2010, the Minister wrote to both the Governor and the Head of Financial Supervision at the Financial Regulator (the Head of Financial Regulation) enclosing applications from each of the five banks that applied to participate in the scheme. Subsequent to the correspondence, officials from the Financial Regulator and the Central Bank met with representatives of the Department of Finance (the "Department") to discuss the applications. Letters from both the Governor and the Head of Financial Regulation to the Minister, in respect of each of the applicant banks, confirmed that the applicants had met the criteria set out in the Act and that the designation of each was necessary to achieve the purposes of the Act.

1.22 On 12 February 2010, the Minister designated all five banks[11] that applied as participating banks. The designated banks are

- Bank of Ireland (BOI) and each of its subsidiaries except Bank of Ireland (UK) plc
- Allied Irish Banks (AIB) and each of its subsidiaries except Bank Zachodni WBK S.A.
- Anglo Irish Bank Corporation Ltd (Anglo) and each of its subsidiaries
- Irish Nationwide Building Society (INBS) and each of its subsidiaries and
- EBS Building Society (EBS) and each of its subsidiaries.

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[10] There are five credit institutions participating in the NAMA scheme – three banks and two building societies. This report refers to all participating institutions as participating banks.

[11] The banks that applied to participate in the NAMA scheme were also covered by the Bank Guarantee Scheme. Two other institutions also covered by that scheme, Irish Life and Permanent and Post Bank, did not apply to participate in the NAMA scheme.

Eligible Bank Assets

1.23 Secondary legislation was used to set out what assets could be acquired by NAMA. The National Asset Management Agency (Designation of Eligible Bank Assets) Regulations 2009[12] (the eligible asset regulations) prescribe certain classes of bank assets as eligible bank assets. The Regulations are set out in Appendix C.

Classification of NAMA Group Entities

1.24 In order to ensure that debt issued to purchase eligible bank assets is not treated as part of the national debt under European accounting rules, the debt must be issued by an entity that is majority privately owned. In order to meet this requirement, NAMA has established a subsidiary structure headed by a company that is 51% owned by private investors[13].

1.25 This requirement stemmed from a Eurostat decision in mid-2009. In regard to the classification of new bodies, for the purposes of the national account, Eurostat stated that majority privately owned special purpose entities established for a short temporary duration and having the sole purpose of addressing the financial crisis, even if they receive a government guarantee, are to be recorded outside the general government sector if the expected losses that they will bear are small in comparison with the total size of their liabilities.

1.26 In late July 2009, the Central Statistics Office (CSO) informed Eurostat that, in line with the Eurostat decision, it considered that

- NAMA should be classified within the general government sector in the national accounts as it was publicly owned with a primary objective of arranging and supervising the removal of impaired property related loan books from the balance sheets of qualifying financial institutions
- the proposed special purpose vehicle should be classified within the financial corporations sector as it satisfied the requirements to be considered a separate institutional unit, could be considered to be a market unit and was 51% privately owned with the investors standing to lose capital if the special purpose vehicle did not make a profit
- on 16 October 2009, Eurostat gave its preliminary approval to the classification structure proposed by the CSO but reserved the right to reconsider its view if the structure actually implemented was different from that outlined by the CSO.

Valuing Loans Acquired

1.27 The NAMA concept involves paying an amount that is less than the book value of the loans acquired but recognises an uplift for the projected increase in long-term economic value. It also takes account of the enforceability of the related collateral.

- The price NAMA pays is the long-term economic value of the loans, which is, in turn, based on the value of the collateral (generally real estate – land and property) that borrowers have pledged for the loans. It strikes the price based on a valuation methodology that has been approved by the Commission.

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12 Statutory Instrument 568 of 2009.

13 Each of the following invested €17 million: Irish Life Assurance plc, New Ireland Assurance Company plc, AIB Investment Managers Ltd.

- In addition, NAMA reviews the extent to which a participating bank has secured its legal right to realise the underlying security and, in circumstances where this has not been done to NAMA's satisfaction, the price paid for a loan is further reduced.

1.28 The National Asset Management Agency (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations, 2010[14] (the asset valuation regulations) specify how the long-term economic value of property and associated loans should be derived. The regulations are set out in Appendix D.

Funding the Acquisitions

1.29 NAMA pays for the loans through the issue of Government Guaranteed Securities (95% of the cost) and subordinated debt (5%). The guaranteed securities carry an interest rate equivalent to six-month Euribor[15] while the subordinated debt carries a higher interest rate linked to the Irish 10 year Government Bond Yield. The debt for the purchase of the loans is issued by a private company known as National Asset Management Ltd. The company is a subsidiary of NAMA. Interest on the subordinated debt is not payable by NAMA unless certain objectives set by the Board of National Asset Management Ltd are achieved.

NAMA Group Structure

1.30 Six Special Purpose Vehicles (SPV) have been incorporated by NAMA. The function of each NAMA group entity is outlined in Figure 1.2.

Figure 1.2 Function of NAMA Group Entities[a]

Entity	Function
National Asset Management Agency Investment Limited	Facilitates making a return by way of dividend to private investors.
National Asset Management Ltd	A company that creates debt securities and subordinated debt transferred to the participating banks in return for the loans.
National Asset Loan Management Ltd	A company that acquires the loan assets from the participating banks.
National Asset Property Management Ltd	A company that holds property acquired after enforcement of security.
National Asset Management Services Ltd	An administrative company through which expenses will be paid.

Note:

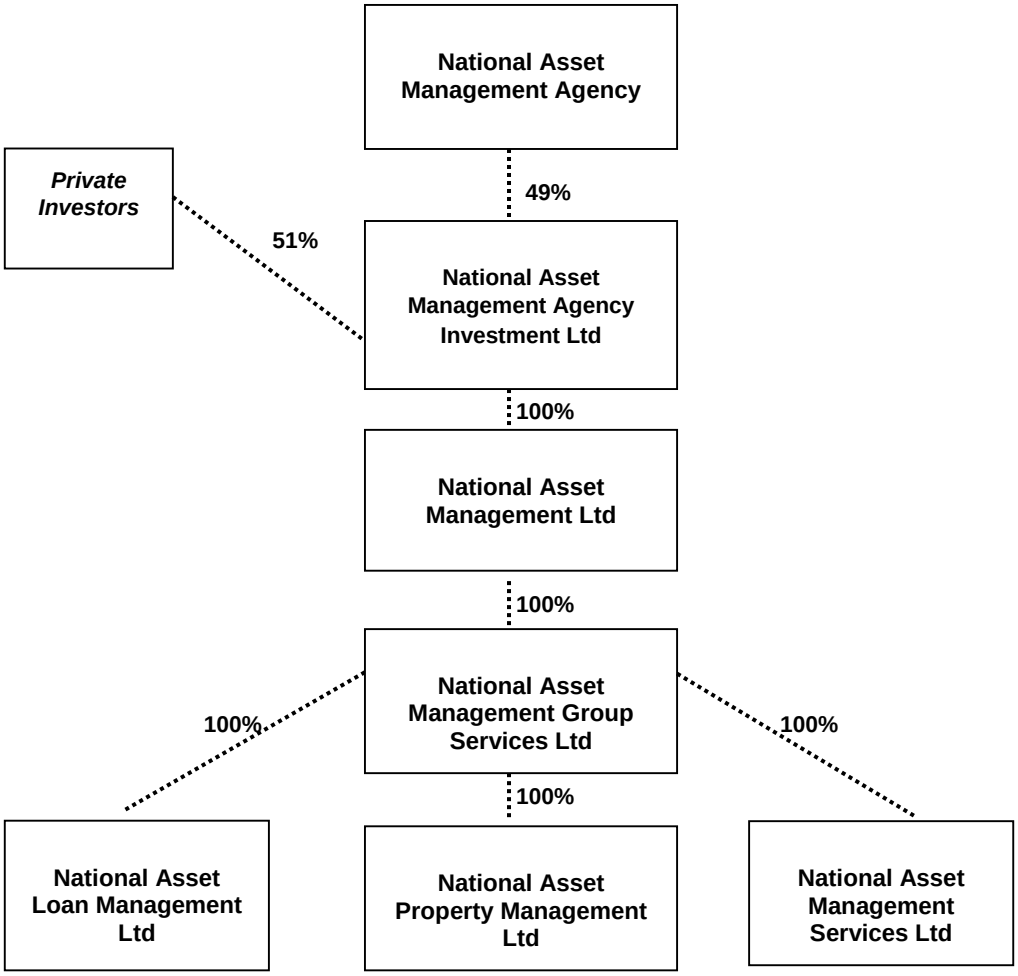
a A further company National Asset Management Group Services Ltd was incorporated but has no current function. NAMA stated that it may be used in the future.

1.31 The structure of the NAMA group and the interrelationship of the NAMA group entities are set out in Figure 1.3. The group structure and its taxation arrangements are outlined in more depth at Appendix E.

[14] Statutory Instrument 88 of 2010. This statutory instrument revoked a set of regulations that had been issued in December 2009 (Statutory Instrument 546 of 2009).

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

Figure 1.3 NAMA Structure[a]



Note:

a The percentages indicate the level of investment by each intermediate holding company or investor.

Post Acquisition Management

1.32 When NAMA acquires a loan the borrower continues to owe the full balance of the loan at the date of acquisition by NAMA. On acquisition of a loan, NAMA engages with the borrower in order to determine how the borrower intends to repay monies owed. Borrowers are requested to submit business plans for their projects and loans. On review of the business plans, NAMA makes decisions about the viability of projects and has a number of options including

- continuing to support the borrower through further lending to bring projects to completion, perhaps including a restructuring of the borrower's loans which might include the borrower divesting themselves of some assets in order to reduce borrowings
- taking enforcement proceedings where the borrower is in default and no realistic agreement can be reached. In these circumstances, NAMA will take control of the underlying properties and other collateral for the loans.

1.33 The arrangements for post acquisition management are set out at Appendix F.

Relationship with the NTMA

1.34 NAMA is an independent statutory body that operates under the aegis of the NTMA. NAMA shares services including IT, human resources and financial control with the other entities that operate under the NTMA's aegis (e.g. the National Pension Reserve Fund). The CEO of the NTMA is an *ex-officio* member of the NAMA Board.

1.35 The NTMA provides NAMA with, or procures for NAMA, those business and support services and systems that the NAMA Board determines are necessary for NAMA to perform its functions. At its meeting in January 2010, the NAMA Board decided that NAMA will make use of those business and support services.

1.36 As a result, all NAMA staff are employed by the NTMA which, in turn, assigns staff to NAMA. By early September 2010, NAMA had 75 staff members assigned by the NTMA and recruitment was continuing with the aim of achieving a complement of around 100 staff by the end of 2010. The costs of NTMA staff assigned to NAMA and other services provided by the NTMA are to be reimbursed by NAMA to the NTMA.

Pre-establishment Transactions

1.37 While NAMA was not established until December 2009, interim arrangements were put in place following the Minister's announcement that NAMA was to be set up. On 5 May 2009, the Minister appointed an interim Managing Director and a number of staff from the NTMA were appointed to assist him. In the period between the appointment of the interim Managing Director and the establishment of NAMA, advisors and consultants were appointed by the NTMA to provide services to NAMA. Any appointments of advisors and consultants after establishment have been made by NAMA. The procurement of advisors and consultants is reviewed in Chapter 5.

Report Focus

The transfer of the first tranche of loans (around 21% of the total) from the participating banks to NAMA commenced in late March 2010 and was completed in early May. The arrangements put in place to manage that transfer are reviewed in this report.

The report is set out in the four chapters that follow

- Chapter 2 examines the process for identification and valuation of acquired assets
- Chapter 3 sets out the outturn on transfers of the first tranche of loans
- Chapter 4 sets out the corporate governance structure
- Chapter 5 outlines the resourcing and procurement arrangements.

Because of the early stage of development of the workout, this report does not deal with the post-acquisition management of borrowers or arrangements to enhance or dispose of the assets acquired. It is intended to report on post-acquisition management during 2011. In addition, while preliminary testing and documentation of procedures has taken place, confirmation of their effectiveness in practice must await the audit of the first financial statements which will cover the period up to 31 December 2010 and which will be completed in 2011.

Chapter 2

Asset Acquisition Process

Asset Acquisition Process

2.1 NAMA is acquiring loans[16] issued to approximately 850 borrowers. The number of borrowers and the volume of loans made it impracticable for NAMA to value and acquire all eligible loans and associated derivatives at the same time. Its approach is to acquire them in tranches. Loans are acquired on a borrower-centric basis with all loans, both performing and non-performing, being acquired.

Borrower-centric Approach

Many borrowers have loans with more than one of the participating banks. NAMA, by acquiring all of the loans that a borrower has with those banks, is then in a position to make its decisions on the basis of the borrower's overall exposure. NAMA's approach, therefore, is to acquire all of a borrower's loans in the same tranche. Based on the information provided by the participating banks, NAMA ranked the borrowers according to the size of their overall borrowings and it has acquired acquiring the loans of those with the highest borrowings first. In the first tranche, for example, the loans of ten of the major borrowers were transferred[a].

Note:

a The list was drawn up on the basis of the preliminary information provided by the participating banks. In fact, the loans of one of the top ten borrowers were transferred in the second tranche.

2.2 A complicating factor that can arise is that in certain instances a borrower may have been lent funds by a bank that is not participating in the NAMA scheme. NAMA has drawn up, as is required under the Act, a code of practice setting out the manner in which it will take account of the commercial interests of credit institutions that are not participating in the NAMA scheme. The Code was approved by the Minister on 5 July 2010.

Features of the NAMA Scheme

2.3 Key elements of the NAMA scheme are

- NAMA acquires loans at their long-term economic value (Loan LTEV).
- NAMA takes over any existing security pledged as collateral by the borrower.
- In most instances, loan valuation entails valuing the associated collateral after applying an uplift to long-term economic value and making appropriate discounts for title defects and enforcement.
- Following acquisition, the borrower remains liable for the repayment of interest and capital on the balance outstanding at the time of transfer to NAMA.
- NAMA takes on the rights and obligations of the participating bank from which it acquires the loan.
- In managing the loans, NAMA is responsible for achieving the best financial return it can for the State, either through receiving repayment from borrowers, advancing further funds to borrowers to complete projects or foreclosing and taking control of the underlying assets or security.

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[16] Prior to the Ministers Statement on Banking on 30 September 2010, NAMA had anticipated that it would acquire over 14,000 loans from around 1,500 borrowers.

- Where NAMA takes control of underlying assets or security, its objective is to maximise their value. NAMA has a wide range of powers and options available in order to achieve this goal. It can, for example, dispose of assets or hold them for disposal at a later date, invest to carry out or complete projects or enter into arrangements with other investors through joint ventures.
- NAMA pays for the loans it acquires through issuing debt and it may also borrow to fund its ongoing activities.

2.4 In order to acquire the bank assets, NAMA had to identify and value eligible assets. Eligible assets[17] are, broadly,

- loans (or other credit facilities) to a debtor by one of the participating banks for the purposes (directly or indirectly) of purchasing, exploiting or developing development land or where the security offered for the loan is development land
- all loans to that debtor (i.e. non-land and development loans) excluding credit card debts
- all loans to associated debtors[18] of the debtor
- financial contracts between a debtor and a participating bank (e.g. an interest rate derivative that hedges interest rate exposure) that relate in whole or in part to acquired loans.

2.5 Loans and associated derivatives being acquired by NAMA are, generally, secured by collateral that borrowers have pledged to the lending bank. NAMA determines the price that it will pay for a loan by reference to the value of its underlying collateral – generally real estate.

2.6 Ultimately, the maximum that NAMA will pay for a loan is the lower of the outstanding balance on the loan or the present value of the underlying property cash flows adjusted for legal discounts, the value of non-real estate assets, qualifying advances and derivatives.

2.7 The price paid by NAMA for a loan is the Loan LTEV or, with the agreement of the Minister, a value between its current market value (Loan CMV) and its LTEV. In practice, all loans acquired to date have been at their LTEV. In order to calculate a Loan LTEV, NAMA needs to

- obtain the current market value of real estate collateral (Property CMV)
- identify the long-term economic value of the property (Property LTEV)
- obtain the current market value of any non-real estate collateral.

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

18 Section 70 of the National Asset Management Agency Act, 2009 defines 'associated debtors'.

Chapter Focus

This chapter describes the NAMA scheme and also reviews the asset transfer process including the arrangements put in place by NAMA

- to identify eligible bank assets held by participating banks
- to validate information supplied by the participating banks
- to value the bank assets transferring to NAMA and
- to fund the acquisitions and pay the banks.

Identifying Eligible Loan Assets

2.8 By May 2009, NAMA[19] had asked the guaranteed banks[20] to provide a detailed breakdown of the loans likely to transfer to NAMA in order to assist in detailed planning. In June 2009, NAMA sought specific information about each of the loans held by the top 100 borrowers in each bank.

2.9 In anticipation of the enactment of the enabling legislation which would require participating banks to provide NAMA with whatever information it requested about eligible assets, NAMA had two further formal communications with prospective participating banks between August and October 2009

- In August 2009, NAMA requested them to provide information about all land and development loans[21] and associated commercial loans. Information sought included whether loans were generating cash flow together with an estimate of the likely cash flows in 2009 and 2010.
- In October 2009, NAMA asked those banks to be in a position to submit details of eligible bank assets as soon as possible following introduction of regulations under the legislation. The banks were asked to include all eligible bank assets, including those less than €5 million[22].

2.10 In the October 2009 letter, the banks were requested to complete legal due diligence reports and property valuations in respect of all loans, in accordance with templates that NAMA had provided and to do so as soon as possible in order to facilitate a smooth and efficient process.

2.11 In February 2010, the NAMA Board was informed that, following a review by NAMA of the loans listed by the five participating banks, the approximate loan balances[23] owed by borrowers that were expected to transfer to NAMA totalled €82 billion and were made up of balances from the five participating banks of the following order

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19 In May 2009, the Government appointed an interim managing director to the then proposed NAMA. For ease of reference, for the period between May 2009 and NAMA's establishment in December 2009 the term NAMA is also used.

20 Financial institutions with liabilities guaranteed under the Credit Institutions (Financial Support) Scheme 2008.

21 Some institutions were asked to provide information only where a borrower's exposure was greater than €5 million.

22 Under the Act, NAMA may acquire such eligible bank assets from participating banks as it considers necessary or desirable for achieving its purposes.

23 These were the loan balances at end November 2009 for those assets that were identified as likely to transfer.

- Anglo Irish Bank - €37 billion
- Allied Irish Banks - €23 billion
- Bank of Ireland - €12 billion
- Irish Nationwide Building Society - €9 billion
- EBS Building Society - €1 billion.

2.12 The Minister subsequently announced on 30 September 2010 that all remaining NAMA transfers should be completed in one single tranche for each of the participating banks. The Government decided, having consulted with the NAMA Board and the European Commission, that where the total exposure of a borrower is below a €20 million threshold in Allied Irish Banks and Bank of Ireland, that borrower's loans will not now be transferred to NAMA. This reduced the aggregate value of loans to be taken over to something of the order of €73.4 billion[24].

Provision for Objections by Participating Banks

2.13 Participating banks could, when providing details to NAMA about a possible eligible loan, object to its acquisition by NAMA on the basis that it was not an eligible bank asset as defined in the legislation. The banks were asked to indicate if they intended to object to the acquisition of any individual asset on these grounds and to give the reason for the objection.

2.14 In circumstances where NAMA intends to continue with the acquisition of an asset despite a participating bank's objections it must inform the participating bank of this as soon as possible and also refer the matter to an Expert Reviewer[25] whose function is to examine objections by the participating banks. The Expert Reviewer, a senior counsel, was appointed by the Minister on 15 January 2010.

2.15 By the end of May 2010, NAMA had referred five loans to the Expert Reviewer. These are related to the first two tranches of loans and further loans may be referred from the later tranches.

Interim Dealings in Eligible Assets

2.16 In order to mitigate the risk that participating banks might not act in NAMA's best interests in relation to an eligible asset prior to its acquisition by NAMA, the participating banks are obliged under the Act to act as a prudent lender in respect of eligible bank assets in the interim between application to apply to participate in the scheme and the transfer of loans to NAMA.

2.17 NAMA instructed the participating banks, under section 71 of the Act, to comply with these requirements by acting at all times in good faith without reverting to it. However, in two situations approval is required on a case-by-case basis from NAMA. These relate to

- any action by a participating bank that might impair any security, right or priority held in connection with a bank asset
- varying or amending any contract relating to an eligible bank asset unless contractually obliged to do so.

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24 This is comprised of Anglo Irish Bank - €35 billion, Allied Irish Banks - €19 billion, Bank of Ireland - €10 billion, Irish Nationwide Building Society - €8.6 billion and EBS Building Society - €800 million.

25 Appointed by the Minister under section 112 of the Act.

Supply of Loan Information

2.18 NAMA uses standardised templates to collect loan and borrower data from the participating banks. Key information required for each loan includes

- a completed template in which a participating bank provides around 350 items of information under various headings including information about the borrower, the loan and the underlying collateral for the loan
- a legal due diligence report, prepared by legal advisors for the participating bank[26] in a format specified by NAMA
- a property valuation or valuations prepared in accordance with the Royal Institution of Chartered Surveyors (RICS) standards
- completed templates for each derivative relating to a loan
- information about any security for the loan other than real estate.

2.19 The legal due diligence report supplied by the banks contains information relating to the borrower, any guarantors or connected persons, the loan structure, associated hedging instruments and security completed by legal advisors of the participating bank. The report includes an executive summary in which the participating bank, *inter alia*, makes material disclosures about loan or interest default, security default or about other issues such as defects or flaws in the security held.

2.20 The property valuations, completed by valuers acting on behalf of the bank, reflect the current market value of properties that are the subject of security for the loan. Valuation reports also include, where relevant, details of tenancies and rents associated with the property. While the property valuers act on behalf of the banks, they are required to include in their reports a statement accepting their duty of care to NAMA. At its first meeting on 23 December 2009, the Board of NAMA agreed that 30 November 2009[27] should be the current valuation date for property secured on the loans transferring to NAMA.

Validation of Loan Information

2.21 The information submitted by the participating banks is subject to detailed review by NAMA, or advisors acting on its behalf, including

- legal reviews in which the information provided by the banks is reviewed for accuracy and completeness, validity of the security, deficiencies in title and whether any legal actions were outstanding for loans
- property valuation reviews in which the reasonableness of the valuations provided by the participating banks are independently reviewed on behalf of NAMA and an adjustment is made to the current market value to derive the long-term economic value of a property
- derivative and non-real estate valuations in which NAMA has financial derivative contracts associated with loans it is acquiring and non-real estate offered as collateral for them valued independently.

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[26] In October 2009, NAMA issued guidance to potential participating banks in regard to completing the legal due diligence reports.

[27] Section 73 of the Act states that NAMA may specify the date by reference to which the market value of bank assets and properties are to be determined.

Legal Reviews

2.22 Legal advisors, appointed by NAMA, were selected from a panel appointed following a tender in late 2009. These advisors review the legal due diligence reports provided by legal advisors of the participating banks. In circumstances where a report is not accepted, it is sent back to the participating bank and, following review and update in the participating bank, it is resubmitted to NAMA.

2.23 When a legal due diligence report completed to the NAMA legal advisors' satisfaction is received, the advisor

- evaluates the information provided for validity and enforceability of the security
- reviews the information for deficiencies in title to property or deficiencies in other security
- assesses the implications of legal deficiencies identified.

2.24 Thereafter, the NAMA legal advisor summarises any deficiencies in order to facilitate the application of a discount to the loan valuation ('the legal discount').

2.25 Following review of the legal due diligence report provided by the bank, the legal advisors complete a certificate[28] in which they express a view on the material issues that were disclosed in the executive summary of the bank's report. For example, in relation to disclosures about a loan or the underlying collateral, the legal advisor recommends how the matter disclosed could be remediated and comments on the severity of any defects. The legal advisors are also asked to comment on any other matters included in the due diligence report that are significant but which the participating bank has not considered to be sufficiently material to disclose in the executive summary.

2.26 The Head of Legal and Taxation in NAMA reviews the legal certificate submitted by the legal advisor and completes a further part of the certificate which

- sets out the legal discount, if any, to be applied to the loan and the reason for it
- sets out the discount, if any, to be applied to the value of non-real estate collateral
- identifies any other excluded or modified terms or conditions in relation to the loan and how these have been treated
- confirms that relevant parts of the legal certificate have been sent to the NAMA property valuation reviewer for consideration in the related property valuation.

2.27 Appendix G - Legal Review sets out the executive summary of the legal due diligence report template.

Establishing the Current Market Value of Property

2.28 NAMA reviews the current market valuations of property[29] provided by the participating banks in order to ensure that they are reasonable for the category and location of the property and applies an adjustment factor of between 0% and 25% to arrive at the long-term economic value.

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[28] The legal and property certificates are in a standard format specified by NAMA.

[29] Property refers to real estate that is the subject of the security for a credit facility that is a bank asset.

2.29 Property valuation reviewers, selected from a panel established following a tender competition, review the property current market valuation reports from the participating banks' valuers on behalf of NAMA. If the valuation is not agreed, NAMA commissions a second valuation from its appointed panel. The valuer is provided with the first valuer's opinion and the reasons it was not accepted. NAMA accepts the second valuation as the market value if it lies within a benchmark range it has established for the property category, type and location but may carry out further review if the valuation is outside the benchmark range.

Property Valuations – Benchmark Range

Properties are classified by category (e.g. investment property), by type (e.g. office or retail) and by geographical location. NAMA has established benchmarks for each classification. Benchmarks include value per square foot for office property and value per acre for undeveloped land in specific locations.

The initial benchmarks were determined by the Head of Portfolio Management in NAMA. However, the database is now populated with the actual valuations from the first tranche of loans transferred and these are now used as the benchmarks for the further tranches.

2.30 Property valuations are compared with the benchmarks for consistency and reasonableness, initially by NAMA, and subsequently by the Audit Coordinator that holds the benchmarks on a database. Valuations that are outside the range are subject to further review by NAMA to determine whether there is a reasonable explanation for the valuation.

Establishing the Property Long-Term Economic Value

2.31 The asset valuation regulations require NAMA to apply an uplift adjustment factor of between 0% and 25% to the current market value of property in order to determine its long-term economic value (Property LTEV) which is an input into the determination of the acquisition price of loan assets. The property valuation reviewers are required to propose the uplift adjustment factor. In forming an opinion about the uplift adjustment factor, the valuers consider the likely movement in values over an eight-year time horizon.

2.32 At the end of their work, property valuation reviewers issue a Property Reviewer Certificate to NAMA in which the reviewer

- confirms that property issues in the legal certificate have been taken into account in the property valuation
- confirms that the valuation has been completed in accordance with RICS valuation standards and guidance issued by NAMA
- confirms that the valuation provided by the bank's valuer is fair and reasonable or that a second valuation has been obtained
- proposes the long-term economic value uplift factor to be applied to the property.

Property LTEV – Adjustment Factor

The Property LTEV is the value that it can reasonably be expected to attain when the crisis conditions prevailing at the passing of the Act are ameliorated. The Property LTEV would take account of reasonable expectations having regard to the long-term historical average. The asset valuation regulations state that the adjustment factor for any individual property shall not exceed 25% of the property's current market value (Property CMV). In addition, 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%.

During 2009, the NTMA commissioned consultants (London Economics) to prepare a report (taking into account the then draft asset valuation regulations) on the historical correlation between property prices and factors such as demographic variables, interests rates and Gross Domestic Product (GDP). The consultants applied the correlations identified to assumptions about the variables between 2010 and 2016. The report cautioned that it did not provide forecasts but, rather, what would be the outcome if it is assumed that the historical correlations which were identified over the period[a] would apply in the future given the assumptions for future interest rates, population, employment, GDP and inflation. The report stated that it was not possible to factor some matters into the report – e.g. the nature of mortgages offered and the impact of taxation on incentives to purchase property - and stated that there was a need for caution in interpreting the results. For example, the extent of over or under supply of property relative to demand was a key issue which it assumed would be reflected in current market values of individual properties.

The report concluded that the range of implied property price changes (in nominal values) for the period 2010 to 2016 for a combination of commercial and residential property was

- Ireland – 17.7% to 28.8%
- UK – 14.7% to 20.3%
- US – 10.5% to 23.7%.

In a paper to the Board in January 2010, NAMA management stated that the analysis in the report supported the range of uplifts set out in the asset valuation regulations. The paper stated that the property valuation process would identify and take fully into account the existing and likely future supply and demand forecasts, local development plans, known possible legislative changes and that these would be reflected in the current market values of property reported to NAMA and its review panel of property valuers.

The Board was informed that, as the long-term economic uplift has an element of subjectivity, NAMA would expect to see some variations among the NAMA property reviewers. It, therefore, retained the right to review the property reviewers' opinions on the adjustment factors to ensure consistency across the assets and asset classes. The Head of Portfolio Management has responsibility for these reviews.

Note:

a The asset valuation regulations state that the period to be considered should be 1985 to 2005. The consultants also considered the period 1985 to 2009.

2.33 The final decisions about the market value and LTEV of a property lie with NAMA. Its Head of Portfolio Management reviews the property reviewer certificates and completes a further part of the valuation certificate in which he confirms

- that the market value of the property lies within the benchmark range for the type of property or, if it does not, that NAMA has received an acceptable explanation for the valuation from the property valuation reviewer
- NAMA's acceptance of the LTEV uplift factor or revises it and provides an explanation for the revision on the certificate.

Establishing the Value of Other Security

2.34 In addition to the legal and property certificates, NAMA also uses external advisors to carry out valuations and provide certificates to NAMA in respect of financial derivatives and non-real estate security for a loan

- financial derivatives are valued by a NAMA-appointed valuer who provides NAMA with a certificate confirming the market value of the derivative two days before a loan is transferred to NAMA
- non-real estate security may take the form of property such as art or shares that require specialist valuation. NAMA appoints a valuer with relevant expertise to carry out the valuation in accordance with its guidance and provide a valuation certificate to NAMA.

Loan Valuation

2.35 Ultimately, the loan is the asset being acquired. The value of the related property and security, as outlined above, is a key input into its valuation. However, further factors impinge on its ultimate acquisition value including adjustments for the cost of enforcement and due diligence as well as an estimate of the income it will earn prior to disposal.

- For acquisition purposes, NAMA establishes what is termed the Loan LTEV, which takes account of the projected disposal value of underlying property and the value of any income that it is estimated that it will generate in the interim. It also makes adjustments for due diligence and enforcement and excludes any excess collateral.
- For comparison purposes, it estimates a current market value of each loan (Loan CMV), which is the value of the loan on the market using assumptions that a willing purchaser might make in current conditions. This is used to calculate the state aid being given to banks.

Loan Valuation Process

2.36 In order to calculate the Loan LTEV and the Loan CMV, a panel of five Loan Valuers has been appointed following a tender by NAMA to conduct the valuations in accordance with the valuation methodology. For the first tranche of loans, one firm was assigned to value the loans of each bank. An Audit Coordinator (KPMG) has been appointed to review and certify all valuations in order to ensure consistency across the valuations and the loan valuers.

2.37 For each loan, NAMA provides the loan asset valuers with loan and borrower data provided by the participating banks. It also makes the outcomes of the NAMA reviews and valuations based on that data available to them.

2.38 The loan asset valuer reviews the loan data in order to ensure that it is complete and correct and that the loan can be valued in accordance with the valuation methodology. NAMA has issued guidance by way of 50 guidance notes that specify how certain issues are to be treated. The list of guidance notes is set out in Appendix H.

2.39 The loan asset valuer provides NAMA and the Audit Coordinator with a loan valuation certificate that sets out the Loan CMV and the Loan LTEV and confirms that

- all relevant data from the loan and borrower information provided by the relevant participating bank and from the various valuation reports and certificates has been correctly extracted
- cash inflows and outflows have been correctly extracted from source documentation
- the NAMA-advised legal and non-real estate discounts have been correctly applied
- the Loan CMV and Loan LTEV have been correctly calculated at the valuation date for the tranche in accordance with the NAMA approved valuation methodology and model and using data as provided by the participating bank and/or NAMA and its advisors.

Deriving the Present Value of Loans

2.40 In order to settle on a consideration, it is necessary to express future flows of funds associated with the loans in current values. Accordingly, the Loan LTEV is based on the value of the underlying collateral which comprises

- the present value of the cash that is expected to accrue to the loan from real estate collateral (cash flows). These cash flows which include the assumed disposal proceeds of property (the Property LTEV) as well as net rental income[30] (if any) are discounted using discount rates set by the Minister
- the current market value of non-real estate collateral.

[30] Anticipated rental income is adjusted for expenses that will be incurred by the property owner in respect of vacant units.

Present Value of Real Estate Collateral

The Act states that the net present value methodology may be used in the calculation of the value of bank assets while the asset valuation regulations state that NAMA shall use the methodology taking into account the projected cash flows of the asset. For loans with property collateral, the relevant cash flows are the property cash flows.

The present value of the property cash flows refers to the value, on the loan valuation date (31 January 2010 for the first tranche of loans) of the future payment or series of future payments, discounted at a rate that reflects the time value of money and other factors such as investment risk.

The Act states that the discount rate used by NAMA should reflect NAMA's cost of funds plus a margin that represents an adequate remuneration to the State that takes account of the risk in relation to the acquired bank assets.

NAMA Discount Rates

The discount rates used to bring projected cash flows to present values are set out in the asset valuation regulations and are referred to as NAMA discount rates. They incorporate two elements

- the risk-free rate for 3, 5 and 8 years, which is a rate equal to the yield on Irish Government Bonds as of 21 December 2009 and
- a risk margin of 1.7%.

In its February 2010 decision about the NAMA scheme the European Commission stated that a risk margin of 1.7% above the risk-free rate was a reasonable estimate of the remuneration that market operators would have required at the time of pricing to cover unexpected future losses on the assets being acquired. The Commission noted that the loans being acquired had been granted over several years prior to the outset of the financial crisis and that it considered that the risk margin reflected "normalised market conditions".

2.41 In order to bring the projected property cash flows associated with loans back to present values, two key assumptions must be made

- over what period should the flows be discounted
- at what rate.

2.42 In practice, the period over which cash flows are discounted is determined by the uplift adjustment factor that has been applied to the property collateral to determine its long-term economic value. Three different discount rates are set out in the asset valuation regulations. The periods and rates are as follows

- where the uplift adjustment is 10% or less, cash flows are discounted over a three year period using a discount rate of 4.54%[31]
- where the uplift adjustment is greater than 10% but less than or equal to 15%, the property cash flows are discounted over five years using a discount rate of 5.57%

[31] The discount rates, which are specified in the asset valuation regulations, are based on the yield at 21 December 2009 for an Irish Government Bond whose maturity equals the period over which the cash flows are being discounted plus 1.7%. For example, the yield for a three-year bond was 2.84%. An additional margin of 1.7% gives a discount rate of 4.54%.

- for uplift adjustments greater than 15% the cash flows are discounted over an eight year period using a discount rate of 6.16%.

2.43 In circumstances where a bank asset is one for which the security is property which is producing cash flows in accordance with its contractual terms and the market value of the property is greater than the balance outstanding on the loan, the cash flows are discounted over eight years or a period that ends on the loan's maturity date, whichever is the shorter[32].

2.44 For some property, the only expected cash flows will be the anticipated proceeds at disposal (which is, as indicated above, assumed to be in three, five or eight years depending on the uplift factor applied). If NAMA is paying for non-real estate securities, the current market value of these is added to the present value of the property cash flows.

Period over which cash flows are discounted

The Commission, when approving the NAMA scheme, stated that it agreed with the principle put forward by the Irish authorities that the determination of the time horizon over which cash flows would be analysed should be derived from the property valuation performed by external experts and from their assessment of its recovery prospects. The Commission noted that the time horizon would, therefore, be determined as a function of the level of uplift above the current market value that the external valuers deem achievable if the loans are being worked out over a longer period of time. The Commission stated that it considered the valuation methodology to be in line with the principle it had set out in February 2009 that assets should be valued over a broader time horizon and that it used prudent and realistic assumptions for the work-out periods over which the optimal recovery prospects for each asset were likely to be achieved.

2.45 In fact, it is not possible to determine, in advance, the likely extent to which the method adopted may yield results in line with the actual work-out outcome. This will be tracked as the process evolves.

Provision for Enforcement and Due Diligence

2.46 The asset valuation regulations state that NAMA must apply a further reduction of 5.25% in the calculation of the long-term economic value of all bank assets in order to provide for enforcement costs and for due diligence costs.

Qualifying Advances

2.47 Arising from a concern that participating banks might not, following the announcement that NAMA was to be established, advance funds to borrowers to protect or enhance underlying securities, the Governor of the Central Bank and the Financial Regulator wrote in May 2009, to the banks that were 'covered banks' under the Credit Banks (Financial Support) Scheme, 2008 (2008 Scheme).

2.48 The letter stated that, following consultation with the Minister and pursuant to the 2008 Scheme, the Governor and Financial Regulator were directing the covered banks to conduct their

[32] For periods up to and including four and a half years, the three year discount rate is used, between four and a half and six and a half years, the five year rate is used and for periods greater than that, the eight year rate is used.

business without regard to the potential transfer of a loan (or other asset) to NAMA, including in regard to the following

- the loan portfolios were to be managed in a prudent, commercial manner
- all enforcement proceedings necessary or prudent to the management of the loan portfolio should be taken
- necessary or appropriate steps should be taken to ensure that overall security or cross-collateral arrangements were not compromised.

2.49 The letter went on to say that the Central Bank had been requested by the Minister to advise that he recognised that, in certain cases, further working capital might be required to fully realise the value of ongoing projects. It was the Minister's policy intention that no further discount would be applied on the transfer of loans to NAMA in respect of any moneys advanced after 7 April 2009, provided that it could be established to NAMA's ultimate satisfaction that the moneys were advanced as part of normal commercial banking arrangements.

2.50 NAMA classifies amounts advanced by the participating banks on foot of the letter as 'qualifying advances'. In order to comply with the Minister's stated policy intention NAMA, in determining the consideration for a loan, takes account of the face value of any qualifying advances that have been made that it deems to be in accordance with the direction.

State Aid

2.51 The difference between what NAMA pays and the amount that a willing buyer would pay represents the extent of state aid. In order to calculate this, the current market value of loans (Loan CMV) must be derived.

Market Value of Loans

2.52 The Act provides that NAMA may determine a Loan CMV by reference to a number of factors including

- a value that a participating bank may submit as being, in its opinion, the value of the loan
- the market value already determined by NAMA of a similar bank asset
- the creditworthiness of the debtor concerned
- the performance of the asset
- the market value of the property determined by NAMA in accordance with provisions of the Act.

2.53 A Loan CMV is calculated by discounting the property cash flows using market discount rates for distressed loans. The market discount rates are determined by the ratio of the loan to the value of the underlying property, which is, for the purposes of calculating a Loan CMV, the current market value of the property not its long-term economic value. The rates used to discount the cash flows to obtain the current market value of loans were provided to NAMA by its financial advisors (HSBC) and are set out in Figure 2.1.

Figure 2.1 Market Discount Rates for Distressed Loans

Loan to Value Ratio[a]	Investment Loan	Land and Development Loan
Below 65%	2.25%	3.25%
65%	2.50%	3.61%
70%	3.00%	4.33%
75%	3.50%	5.06%
80%	4.25%	6.14%
85%	5.50%	7.94%
90%	6.75%	9.75%
95%	8.50%	12.28%
100% or higher	11.00%	15.89%

Source: NAMA

Note:

a This is the ratio of the loan value to the value of the underlying collateral.

2.54 The state aid that is provided to the participating banks, represented by the difference between the Loan CMVs and the price paid by NAMA, is subject to review by the Commission.

2.55 On 3 August 2010 the European Commission authorised, under EU state aid rules, the transfer of the first tranche of assets to NAMA. The Commission stated that it found the transfer to be in line with the approved scheme and with its guidance on the treatment of impaired assets. The Commission concluded that the transfer of the first tranche of assets represented an appropriate means of remedying a serious disturbance in the Irish economy.

2.56 The Commission has stated that it will reassess the aid granted in light of the adequacy of the actual notified asset transfers and restructuring plans which the banks are required to submit to the Commission.

2.57 The Financial Regulator reviews the process on behalf of the Commission[33].

Calculation of Loan Acquisition Values

2.58 A summary of the process for the calculation of loan acquisition values for a typical loan is set out in Annex A to this chapter.

Process Coordination

2.59 NAMA has appointed an audit coordinator whose role is to ensure that

- the information provided by the participating banks and the NAMA-appointed reviewers and valuers is correctly input to the valuation model and that the valuation has been carried out in accordance with the approved methodology
- real estate has been valued on a consistent basis in accordance with criteria stipulated by NAMA.

[33] The Financial Regulator has approved the Tranche 1 transfer.

The Audit Coordinator certifies the valuations for NAMA and the Commission. The process is outlined at Appendix I.

Loan Acquisition and Completion Notices

2.60 NAMA may serve any number of acquisition schedules on a participating bank (e.g. one for each borrower for each tranche). When NAMA has served acquisition notices in respect of all of the bank assets that it intends to acquire from a participating bank, it then serves a completion notice on the participating bank. A completion notice specifies

- all of the bank assets NAMA has acquired or proposes to acquire
- the acquisition value for each asset
- the total acquisition value for all the assets.

2.61 Following the issue of a completion notice, NAMA cannot acquire any further bank assets from a participating bank unless the Minister prescribes further classes of eligible bank assets. The arrangements for settlement of valuation disputes are set out in Appendix J.

2.62 NAMA stated that the participating banks have appealed around 12.5% (by value) of the valuations in the first tranche. No action will be taken in respect of these appeals until completion notices issue to the participating banks.

Payment for Loans and Funding of Consideration

2.63 NAMA pays 95% of the acquisition value of bank assets by way of debt securities (senior debt) that are issued by National Asset Management Ltd and guaranteed by the Minister. The remaining 5% is paid by way of subordinated bonds (subordinated debt). Payment of interest and value at redemption of the subordinated bonds will be dependent on the financial performance of NAMA.

Terms of Debt

2.64 In February 2010, the Board approved the terms on which it was proposed to issue the debt. Some features of the senior debt (guaranteed securities) are

- the principal and interest are irrevocably guaranteed by the Minister
- the debt may be issued in euro, sterling or US dollars with a minimum denomination of one million in any currency and will be listed on the Irish Stock Exchange
- the debt will have a maximum maturity of one year and the interest rate will be six-month Euribor or Libor[34] (depending on the currency) with interest paid twice annually.

2.65 Some of the features of the subordinated debt which is entitled 'Floating Rate, Perpetual, Subordinated Bonds - First callable on 1 March 2020[35]' are

- the interest rate is the 10 year Irish Government Bond rate on the day of first issue plus 0.75%

[34] Libor (London Interbank Offered Rate) is the rate at which banks borrow unsecured funds from other banks in the London wholesale money market.

[35] This gives NAMA the right, but not the obligation, to redeem the subordinated bonds on 1 March 2020 or on 1 March annually thereafter.

- interest is payable on 1 March annually but will only be paid following a declaration by the Board of National Asset Management Ltd that it has achieved objectives set by the Board of National Asset Management Ltd in the year ending on the relevant interest payment date
- the bond may be called by NAMA on 1 March 2020 and on each subsequent interest date.

2.66 Participating banks had the once-off option, where the assets being transferred are denominated in sterling or US dollars, of opting for securities issued in the same currency as the asset being transferred or for securities in euro. No participating bank has opted for securities in foreign currency. As a result, all debt will be issued by NAMA in euro. The exchange rate used for translating foreign currency to euro is that prevailing two days before the issue of a final acquisition schedule.

Other Funding Arrangements for NAMA

2.67 In addition to the debt issued to fund the purchase of loans from the participating banks, NAMA requires funding to

- lend which includes lending to complete developments
- invest capital – for example, in joint ventures
- meet any losses that arise on disposal of assets
- meet its expenses.

2.68 During 2009, all costs incurred by the NTMA on behalf of NAMA prior to NAMA's establishment in December 2009 were borne by the NTMA. The total amount was €2.3 million.

2.69 Under the Act, NAMA or a NAMA group entity may borrow up to €5 billion to fund its operations with or without the guarantee of the Minister. The Minister may also lend to NAMA from the Central Fund and NAMA is required to repay any such funds out of its own resources from time to time.

2.70 In May 2010, the Head of Treasury presented a paper to the Board in which he set out a proposed funding strategy for NAMA. He stated that in the short-term, up to October 2010, NAMA was likely to require additional funding of up to €250 million. In order to avoid circumstances where NAMA would not have sufficient funds to meet a drawdown sanctioned by the Board or the Credit Committee[36], it was recommended that the Board approve a request to the Minister to provide €250 million, as provided for under Section 46 of the Act, to create a liquidity buffer. The funds, from the Central Fund, would carry an interest charge and NAMA would propose to repay it by the end of October 2010 when it should have longer term funding arrangements in place. The Board accepted the proposal and the funds were provided.

2.71 In regard to longer term funding, the Head of Treasury proposed that NAMA adopt a strategy under which it would put two programmes in place[37], with approval from the Board to raise up to €2.5 billion under each

- a short-term Euro Commercial Paper (ECP) programme where debt issued would have maturity of less than one year. Funds raised under this programme would be used to fund short-term cashflow requirements and provide liquidity buffers

[36] The Credit Committee is a statutory sub-committee of the Board.

[37] Debt under the programmes will be issued from National Asset Management Ltd.

- a Euro Medium Term Note (EMTN) programme under which debt issued would have a maturity of between two and ten years. Funds raised under this programme would be used, for example, for project finance or to fund investment in joint ventures.

2.72 The paper asked the Board to also approve a proposal to

- establish credit ratings, both for the securities issued to participating banks on acquisition and debt raised under the two proposed programmes
- request the Minister to guarantee securities issued under both programmes.

2.73 Reasons put forward for obtaining the credit ratings and the guarantee were that

- if they were not obtained, the cost of borrowing would be higher and National Asset Management Ltd might find it difficult to raise funds
- the Minister was of the view that NAMA should not be reliant on advances from the Central Fund.

2.74 The Board was informed that the fees associated with obtaining a credit rating would be around €40,000 in the first year and €100,000 per annum thereafter while other initial fees would be around €95,000 and additional ongoing annual fees would amount to around €60,000.

2.75 The Board approved the proposals to set up the ECP and EMTN programmes, to seek a Ministerial guarantee for securities issued under them and to obtain credit ratings for those securities and for the securities issued to acquire the loans.

2.76 On 2 September 2010, NAMA announced the establishment of a €2.5 billion[38] ECP programme. The debt is issued by National Asset Management Limited. Two rating agencies have issued short term ratings for the programme[39]. Debt issued under the programme is guaranteed by the Minister.

Risk Management

2.77 NAMA faces risks in regard to loans denominated in foreign currency and changes in interest rates. These risks are outlined at Annex B to this chapter.

[38] The maximum aggregate amount that NAMA can issue under the programme.

[39] Standard and Poor's (A-1+) and Moody's (P-1).

Annex A

Annex A Calculation of Loan Acquisition Value

	Loan Assets Acquired	
1	Loan balance	€100,182,904
	Derivatives	€2,955,704
	Total	€103,138,608
	Loan Collateral – Details	
2	Property (CMV at 30 November 2009)	€62,000,000
	Uplift adjustment for long-term economic value	15%
	Property – long-term economic value	€71,300,000
3	Approximate net rental annual cash flows over period	€3.7m to €5.7m[a]
4	Discount rate(s) for property cash flows	5.57%
	Discount period	5 years
	Loan Collateral – Valuation	
5	Present value of Property LTEV	€54,848,990
6	Provision for enforcement and due diligence costs	(€2,879,572)
	Net property cash flows at assumed disposal of property	**€51,969,418**
7	Present value of rental cash flows	€20,211,657
	Cash security	0
	Other security	0
	Total Value of Collateral	**€72,181,075**
8	**Acquisition Value (Loan LTEV)**	**€72,181,075**
9	**Loan Discount**	€30,957,533
		30.02%
10	**Loan CMV**	
	Collateral CMV	€62,000,000
	Approximate net rental annual cash flows	€3.7m to €5.7m
	Discount rate applied	11%
	Loan CMV	**€50,391,460**
11	**State Aid**	**43.2%**

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

Note:

a The gross annual rental income at November 2009 was around €4.3 million with some vacant units in the property. Costs associated with these units reduced rental income to €3.7 million net. From end 2011, an assumption was made that the vacant units will be let bringing the annual gross rental to €5.7 million (with no deduction for vacant units).

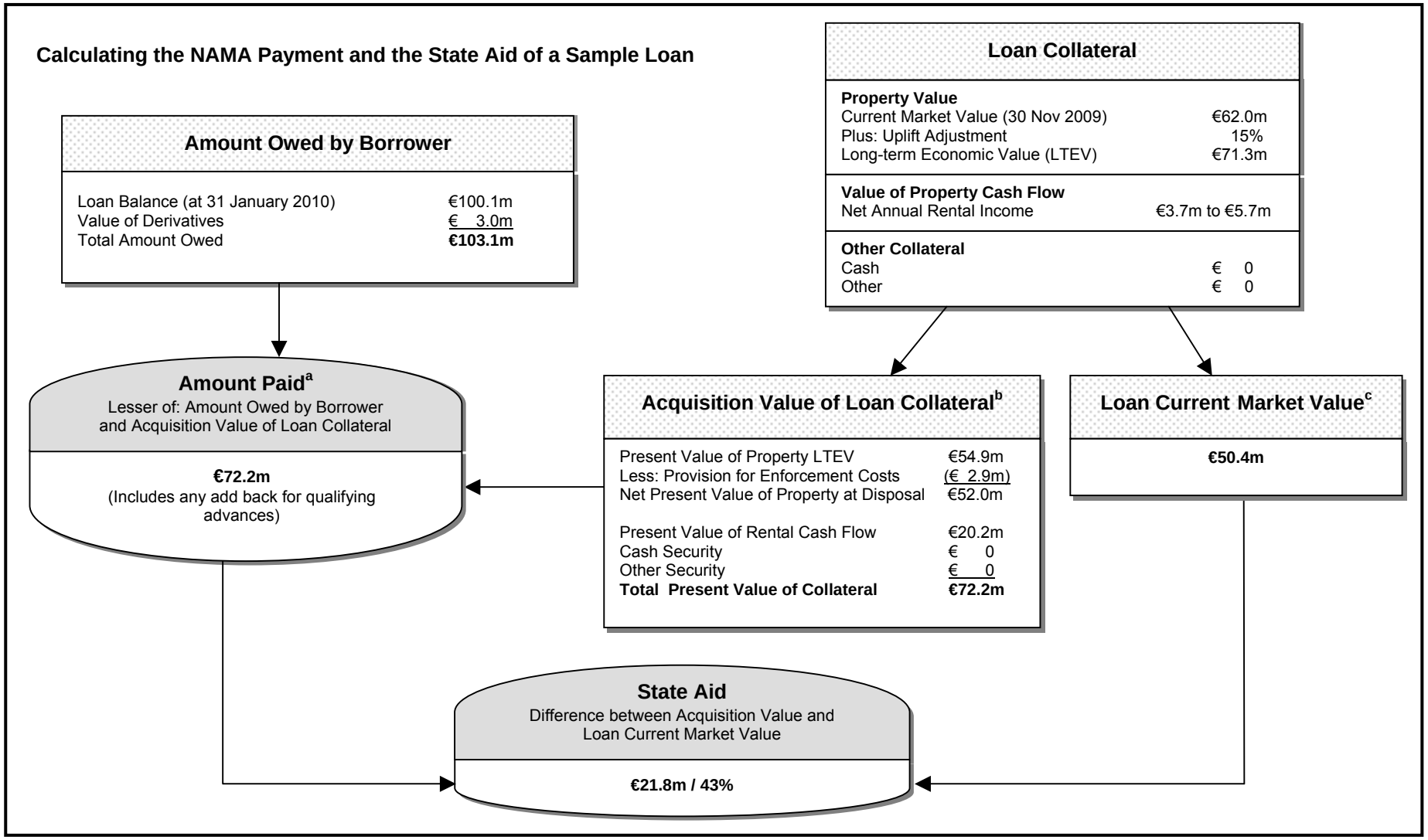
Calculation of Loan Acquisition Value – Explanatory Notes

The key elements in the calculation of a loan acquisition value are set out in an example from the first tranche of loan transfers. The example relates to a loan where the property collateral was a single investment property. The steps in the process are

1. Establishing the debt due by the borrower. This includes the loan balance at 31 January 2010 and the market value of any associated derivative contracts that the borrower has entered into with the participating banks.
2. Obtaining the market value at 30 November 2009 of any property pledged as security for the loan and determining the uplift factor to be used to derive the long-term economic value of the property.
3. Identifying the projected net rental cash flows, if any, associated with the property.
4. Identifying the discount rate to be applied to the property cash flows (both the long-term economic property value which is deemed to be the disposal proceeds at the end of the discount period and the projected rental flows) and the period over which they should be discounted. Both of these are determined by the uplift adjustment that has been applied to the property.
5. Calculate the present value of the long-term economic value of the property.
6. Apply the standard discount rate of 5.25% to calculate the amount to be deducted to provide for due diligence and enforcement costs and obtain the net property cash flows at the assumed disposal date of the property.
7. Calculate the present value of the rental cash flows associated with the property. Obtain the amount of cash pledged as security (if any) and the current market value of other security (if any) and calculate the total value of the loan collateral.
8. Compare the loan balance (including associated derivatives) with the total value of the collateral. The acquisition value is the lower of these two amounts. In this example, it is the Loan LTEV.
9. Calculate the total discount applied to the borrower debt by comparing the loan assets acquired and the acquisition value.
10. In order to calculate the current market value of the loan, the following steps are taken

- The assumed proceeds of the property at the end of the discount period are the property's current market value at 30 November 2009. No uplift factor is applied to the property.
- The discount rate that is applied in calculating the present value of the property cash flows is determined by the type of property and the loan to collateral ratio. (See paragraph 2.52).

11. Calculate the amount of state aid. This is the difference between the acquisition value and the Loan CMV expressed as a percentage of the Loan CMV.



Notes

a The amount paid is the lower of the amount owed by the borrower and the acquisition value of the loan collateral. The difference is referred to as the 'haircut'. The haircut in this example was almost €31m or 30% of the amount owed by the borrower.

b The acquisition value of the loan collateral is calculated by applying a discount rate set in Ministerial Regulations to the property LTEV and the projected rental income associated with the property. The collateral acquisition value also takes account of a provision for due diligence and enforcement costs.

c The loan market value is calculated by applying commercial discount rates for distressed loans to the current market value of the property collateral and the rental income associated with the property. The loan market value takes account of a provision for due diligence and enforcement costs.

Annex B

Annex B Risk Management

Currency Risk

The main risk that NAMA faces with loans denominated in foreign currency is that when proceeds are realised (either through borrower repayments or the disposal of assets following enforcement actions) the exchange rate at which the foreign currency proceeds accrue may be different to that ruling when the loan was purchased. While a change could be in NAMA's favour, the risk of adverse currency exchange rate movements exposes NAMA to possible significant losses.

In order to address the risk, the Board has adopted a strategy whereby NAMA hedges almost all of its foreign currency exposure, principally through the use of cross-currency swaps. These swaps give NAMA certainty about the future exchange rate at which it will exchange foreign currency loan receipts. However, NAMA still faces inherent uncertainty about the timing of proceeds. This exposes it to the risk that it may have to purchase some foreign currency at the prevailing market rates at the time that the contracted swaps mature. As NAMA may have other foreign currency cash flows in addition to loan proceeds – e.g. interest surpluses or shortfalls, new lending and some ongoing expenses – it will need to manage its foreign currency exposure carefully.

Interest Rate Risk

NAMA will have both interest inflows and outflows. The main interest rate risk that NAMA faces is in regard to the interest expense on the debt that it has issued to pay for the loans. While borrowers pay interest to NAMA on loans at a higher rate than NAMA pays to banks on the securities it has issued, the higher proportion of non-performing loans suggests that if interest rates (6-month Euribor) rise above 2.22% NAMA will face a net interest expense. For each 1% increase in interest rates above that level, based on an assumption that NAMA will require approximately €80 billion of loans at a 50% discount and 75% of loans will be non-performing, NAMA's net interest expense would increase by around €180 million annually[40].

In order to address the risk of this occurring, NAMA has put in place a hedging strategy using interest rate swaps. While this strategy reduces interest income, as longer term swaps are at higher rates than the prevailing 6 month Euribor, it reduces its exposure to interest rate rises.

NAMA also faces some interest rate risk in regard to performing interest rate swaps held by borrowers that it has acquired with some loans. In order to address this risk, NAMA has taken out interest rate swaps that are, broadly, equal and opposite to those held by the borrowers.

NAMA will in the future, also face interest rate risk in regard to its borrowings to fund new lending.

NAMA will acquire loans, across all the tranches, with approximate balances owed by borrowers of €73.4 billion. For the purposes of illustrating the effect of changes in interest rates on NAMA's interest income and expense, it has been assumed that the debt issued will be €40 billion. In that case, the debt issued will comprise

- guaranteed securities of €38 billion (95% of consideration) on which it will pay interest at 6-month Euribor (just under 1% at 1 March 2010) and

[40] If 25% of loans are performing, 1% interest payments from borrowers will amount to around €200 million. If NAMA pays €40 billion for the loans, 1% interest payments on €38 billion of senior debt will amount to €380 million.

- subordinated debt of €2 billion (5% of consideration) on which it will pay interest at the 10-year yield on Irish Government Bonds plus 0.75% (around 5.3% at 1 March 2010). Payment of this interest is dependent on NAMA achieving certain financial targets.

While the proportion of loans on which borrowers are making interest payments will not be known until all of the loans are transferred, NAMA estimates that the figure will be around 25% (in value of loans). This would mean that borrowers would be making interest payments on loans worth around €20 billion. Figure B.1 sets out NAMA's interest income and interest expense that would occur at various interest rates using the following assumptions

- NAMA pays interest on the full €38 billion of guaranteed securities
- interest is paid on the subordinated debt – it is assumed that this will be €100 million annually
- borrowers pay interest at an average rate of Euribor plus 2.5% on €20 billion of borrowings
- the foreign currency hedges put in place are effective and NAMA effectively receives interest on its foreign currency loans at Euribor-linked rates.

Figure B.1 NAMA – Interest Income and Interest Expense

Interest Rate (Euribor)	Interest Income (Euribor plus 2.5%)	Interest Expense – Guaranteed Securities (Euribor)	Interest Expense – Subordinated Debt	Net Interest Income/ (Expense)
	€m	€m	€m	€m
1%	700	(380)	(100)	220
2% [a]	900	(760)	(100)	40
3%	1,100	(1,140)	(100)	(140)
4%	1,300	(1,520)	(100)	(320)
5%	1,500	(1,900)	(100)	(500)

Source: Analysis by Office of C&AG

Note:

a For example, at 2% Euribor, NAMA pays €760 million interest on the guaranteed securities (2% of €38 billion) and receives €900 million interest on the debt (4.5% of €20 billion).

In the absence of a hedging strategy, NAMA's net interest income/expense is highly sensitive to upward movements in interest rates. This is because of the high volume of loans that it is assumed will be non-performing. While the additional margin paid by borrowers whose loans are performing is sufficient to cover NAMA's interest expense on its borrowings at low interest rates, even at rates as low as 2.2% Euribor, NAMA's interest expense would be greater than its interest income. Each 1% increase in rates increases NAMA's interest income by €200 million but increases the interest expense by €380 million. The break-even point – the point at which NAMA's interest income and interest expense match is 2.22% under the scenario set out.

The Board[41] has adopted a hedging strategy that will put interest rate swaps in place for some of the debt in order to reduce its exposure to increased interest expense on the securities issued to purchase the non-performing element of the loans. The effect of the swaps is to fix the interest rate on a certain amount of the securities that NAMA has issued at rates higher than current Euribor. To date, NAMA has entered into a number of swaps with financial institutions, through the NTMA, to cover a portion of these balance sheet liabilities.

The amount of the securities that NAMA hedges and the periods over which the hedges are entered into are reviewed and approved by the Board on a regular basis. For example, if NAMA decides to hedge €15 billion[42], the effect on its annual net interest income/expense is set out in Figure B.2.

Figure B.2 NAMA – Annual Interest Income and Interest Expense, €15 Billion Hedged

Interest Rate (Euribor)	Interest Income (Euribor plus 2.5%)	Interest Expense – Guaranteed Securities (€23 billion[a] – Euribor €15 billion – 1.9%)	Interest Expense – Subordinated Debt	Net Interest Income/(Expense)
	€m	€m	€m	€m
1%	700	(515)	(100)	85
2%[b]	900	(745)	(100)	55
3%	1,100	(975)	(100)	25
4%	1,300	(1,205)	(100)	(5)
5%	1,500	(1,435)	(100)	(35)

Source: Analysis by Office of C&AG

Notes:

a This is the €38 billion euro of guaranteed securities (95% of €40 billion) less the hedged amount of €15 billion, leaving €23 billion payable at Euribor rates.

b For example, at 2% Euribor, NAMA would pay €760 million on the guaranteed securities (2% of €38 billion) and €285 million in the swap (fixed interest on €15 billion at around 1.9%) and would receive €300 million in the swap (2% of €15 billion) – giving a net interest expense of €745 million.

The actual annual net interest income or interest expense will depend on the amount of securities hedged through interest rate swaps, the average interest rate paid by NAMA on those swaps and the average periods over which the hedges are entered into.

The effect of the interest rate hedges outlined above on NAMA's annual net interest income/interest expense is set out in Figure B.3.

41 Board of National Asset Management Agency

42 In the scenario outlined, it is assumed that the average weighted interest rate paid for interest rate swaps on €15 billion would be 1.9%. The actual interest rate on hedges entered into by NAMA may vary from this.

Figure B.3 NAMA – Annual Interest Income and Interest Expense, Effect of Hedging Strategy

Interest Rate (Euribor)	Net Interest Income/(Expense) - no hedging	Net Interest Income/(Expense) - hedging in place	Increase/(decrease) in NAMA's net interest income from Hedging Strategy
	€m	€m	€m
1%	220	85	(135)
2%	40	55	15
3%	(140)	25	165
4%	(320)	(5)	315
5%	(500)	(35)	465

Source: Analysis by Office of C&AG

By putting interest rate swaps in place to hedge its exposure on the debt it has issued, NAMA foregoes a portion of positive net interest income at interest rates below 2% for the certainty that a portion of its exposure will be limited if interest rates rise. In the scenario outlined, its break-even point would rise from 2.22% to 3.8%.

NAMA's projected interest income and interest expense are based on a number of assumptions. If these assumptions are not borne out then the outcome will be different. For example

- the proportion of performing loans may not be 25%. At Euribor of 1%, each 1% change in the proportion of performing loans would cause an increase or decrease of around €28 million in NAMA's annual interest income[43]
- the average rate of interest paid by borrowers may be greater or lesser than Euribor plus 2.5%
- NAMA may not meet the objectives that the Board of National Asset Management Ltd sets to enable NAMA to pay interest on the subordinated debt. Non-payment of this interest would increase NAMA's net interest income by around €100 million annually
- NAMA may foreclose on some non-performing loans and dispose of the assets allowing it to pay off some of the NAMA debt and reduce its interest expense.

Currency and Interest Rate Uncertainties

The hedging strategies undertaken by NAMA are all informed by assumptions, in particular assumptions about the level of non-performing loans, the timing of payments by borrowers or proceeds from asset disposals and the rate of interest paid by borrowers. If events materialise that are significantly different from those assumed, the outcomes could be very different. This gives rise to the need for NAMA to manage its hedging strategies actively in order to be able to respond appropriately to changes in predicted outcomes.

[43] For example, if the proportion of performing loans fell from 25% to 24%, NAMA's interest income would fall from €700 million to €672 million.

Chapter 3

Outturn on Transfers

Outturn on Transfers

3.1 By May 2010, the transfer of the first tranche, comprising the loans of ten of the borrowers with the highest exposures, had been completed. The total borrower debt outstanding on the first tranche of loans was €15.4 billion[44].

Chapter Focus

This chapter reviews the outturn on the first tranche of loans that transferred to NAMA and examines the valuation of the loans, the underlying security and the calculation of the consideration paid. The chapter focuses on the outcome of the valuations while a description of the process for each stage can be found in Chapter 2.

3.2 The transfer of the second tranche of loans, which had 19 borrowers with loans outstanding of around €12 billion was completed in late August 2010. The remaining loans are expected to transfer before 31 December 2010.

Consideration for Loans

3.3 The amount which the State paid for the first tranche of loans was the lesser of the balance owed by the borrower or the value and the associated loan collateral adjusted for legal, enforcement and due diligence discounts. The net valuation (or the present value of the loans after taking account of all associated cash flows and adjustments) of these loans and associated derivatives was €7.7 billion, resulting in the application of a discount of just under 50% in the valuation.

3.4 Write-downs ranged from around 35% (Bank of Ireland) to over 58% (Irish Nationwide Building Society). A summary of the outturn on the loans transferred by each participating bank is set out in Figure 3.1.

Figure 3.1 Loan Acquisitions – Tranche 1, March – May 2010

	Allied Irish Banks	Anglo Irish Bank	Bank of Ireland	EBS Building Society	Irish Nationwide Building Society	Total
	€m	€m	€m	€m	€m	€m
Borrower Debt	3,357	9,331	1,946	144	669	**15,447**
State Consideration	1,906	4,157	1,262	91	280	**7,696**
Discount	43%	55%	35%	37%	58%	**50%**

Source: NAMA

3.5 Annex A to this chapter summarises the key components of the valuations used in the calculation of the consideration paid by NAMA.

[44] The total amount owed by borrowers whose loans transferred in the first tranche was almost €17 billion. The transfer of some loans was deferred due to delays in the legal due diligence process.

Property Cash Flows

3.6 A computerised loan valuation model was constructed. It was designed to compute the consideration payable. A key element in the model was the estimated cash flows associated with the property to which the loans related.

3.7 The model assumes that the minimum cash flows to which NAMA would be entitled from a loan are those that would be available if NAMA took control of the property. The cash flows comprise two elements

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

3.8 For practical calculation purposes, the point of assumed disposal is determined by reference to the level of uplift which derives the long-term economic value.

Rental Cash Flows

3.9 The projected rental cash flows are 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.

Long-term Economic Value of the Property

Market Value of Property

3.10 Initial valuations of properties were carried out by the participating banks who valued 766 properties for the first tranche. Following review by NAMA-appointed valuers, a second valuation was sought for 145 properties. In these cases, the valuations were lower in 85 instances, higher in 20 and there was no change in the other 40. The final valuation, for calculation purposes, was either the agreed initial valuation or the second valuation.

Long-term Uplift Factor

3.11 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.

Adjustment to Present Values

3.12 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 on enforcement).

Results of Property Valuation Process

3.13 The maximum uplift factor 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%. In the first tranche, before discounting to present values, the value of the property was uplifted from around €7.5 billion to just under €8.3 billion, of which 71% was accounted for by completed residential and commercial properties including hotels. The uplift adjustment to derive the long-term economic value of the property averaged 11%. The average property uplifts for each bank are set out in Figure 3.2.

Figure 3.2 Property Uplift Adjustments by Bank, First Tranche, May 2010

	Allied Irish Banks	Anglo Irish Bank	Bank of Ireland	EBS Building Society	Irish Nationwide Building Society
Average Uplift Adjustment	8.9%	11.7%	11.9%	8.4%	12.1%

Source: NAMA. Analysis by Office of C&AG

3.14 Figure 3.3 sets out the average uplift adjustments by property type. Hotels had the highest average uplift of 12.6%, while residential property for resale had the lowest average uplift of 9.8%.

Figure 3.3 Property Uplift Adjustments by Property Type, First Tranche, May 2010

	Land (including development property < 30% complete)	Residential Property for resale	Investment Property	Hotels	Development Property (> 30% complete)
Average Uplift Adjustment	11.0%	9.8%	11.2%	12.6%	9.4%

Source: NAMA. Analysis by Office of C&AG

3.15 The range of uplift factors suggested by the reviewers and the range following the review by the Head of Portfolio Management in NAMA is set out in Figure 3.4.

Figure 3.4 Property Long-Term Economic Value Uplifts – Tranche 1

LTEV Uplift Factor[a]	Reviewer	NAMA
0 -10%	584	581
15%	87	163
20% - 25%	95	22
Total	**766**	**766**

Source: NAMA

Note:

a All uplift factors were expressed in units of 5%.

3.16 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 the projected rental cash flows, was calculated at €8.1 billion.

3.17 The present value so derived exceeded the current market value of the properties using market valuation methods by almost 9%.

Deriving the Consideration

3.18 In addition to the present value of property associated with the loans further collateral was available including cash and other security of €369 million bringing the total estimated present value of all loan collateral to €8,473 million. The value of other collateral in the first tranche was just under 5% of the total consideration paid. The collateral other than property comprised

- cash security, for example deposit accounts held by borrowers, €162 million and
- other securities totalling €207 million.

3.19 €7,570 million of the total available collateral is reckonable in the determination of consideration after taking account of

- €266 million for due diligence and enforcement costs
- €518 million excess collateral which arose on some loans
- legal discounts of €119 million.

Due Diligence and Enforcement Costs

3.20 The asset valuation regulations require NAMA to apply a standard discount rate 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). NAMA stated that the methodology used was based on a financial model developed by HSBC which took account of practice in the industry.

3.21 In implementing this provision, NAMA applied the standard discount rate to the long-term economic value of property pledged as collateral for loans. In some instances the post-discount value of the collateral was greater than or close to[45] the loan balance due by the borrower to the bank and, therefore, not all of the discount was deducted from the consideration paid[46].

3.22 Overall, the amount by which the price paid for the loans was reduced in order to provide for due diligence and enforcement costs was ultimately €266 million. This amounted to around 3.4% of the consideration in aggregate.

3.23 The costs associated with a full enforcement process are 15%[47]. It is not possible for NAMA to predict the extent to which full enforcement proceedings will be required. However,

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45 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.

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

47 European Commission decision on the establishment of NAMA.

assuming a 15% enforcement cost, the amount deducted from the acquisition value of loans in the first tranche would cover the cost of enforcement proceedings for around 25% of the collateral[48].

Excess Collateral

3.24 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.

3.25 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 and associated derivatives is the lower of this adjusted loan balance 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.

3.26 All of the excess collateral of approximately €518 million has not 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 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 collateral is insufficient. However, NAMA may have a contingent 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 provide to it the excess collateral pledged as collateral for other loans.

Legal Discounts

3.27 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 €119 million to the first tranche of loans. This reduced the total consideration paid for the first tranche of loans by around 1.5%.

3.28 In response to my inquiries, NAMA stated that it was satisfied that the legal discounts it applied were adequate. NAMA also pointed out that it had agreed with participating banks to defer acquiring over €1 billion of loans in the first tranche to give the banks an opportunity to remedy legal defects.

Financial Derivatives

3.29 There were financial derivatives attached to around €6 billion of the loans that transferred in the first tranche. Generally, the market value of these derivatives, mainly interest rate swaps, at the time of acquisition by NAMA was in favour of the banks as the borrowers had committed to paying interest at a fixed rate that was higher than the variable rate payable on the loans. As these derivatives are assets of the bank in the same way that loans due by borrowers are assets, the bank

[48] The costs are assumed to be 15% of the value of the underlying property collateral. The present value of the long-term value of the property collateral in the first tranche is €6.8 billion. If enforcement costs of 15% were incurred on all loans, they would amount to just over €1 billion. The amount actually deducted from the acquisition would, therefore, cover the costs for around 25% of the collateral.

is also compensated for the derivatives. NAMA acquired all of the derivatives. However, it gave consideration for them only in those circumstances where both the loan and derivative were performing[49] and where there was legal security in place and the value of the security was sufficient.

3.30 The total amount paid for derivatives in the first tranche was €163 million - just over 2% of the total consideration. NAMA also acquired financial derivatives with a market value of approximately €150 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.

Advances after April 2009

3.31 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[50]. Only loans for purposes of protecting or enhancing qualifying assets can be funded in this category.

3.32 Following review of claims and supporting documentation for the loans transferring in the first tranche, NAMA accepted claims totalling €299 million.

3.33 In accordance with the 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, €126 million, was added back, as shown in Annex A to this chapter, so as to implement the direction that no discount should apply to these advances.

Current Market Value of Loans

3.34 The Act states 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 tranche was around €6 billion, about €1.7 billion less than the total consideration given for the loans. However, NAMA paid the long-term economic value for all loans.

State Aid

3.35 The Impaired Asset Communication[51] states that public asset relief measures are considered as state aid if impaired assets are purchased at a value above the market price. For the first tranche of loans, NAMA is purchasing bank assets at their long-term economic value of €7.7 billion which is €1.7 billion or 28% greater than the loans' current market value. The amount of state aid for each bank is set out in Figure 3.5.

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49 A derivative was classified as performing where payments were being made by the borrowers.

50 NAMA-appointed personnel reviewed the loan files in the participating banks.

51 Communication from the Commission on the Treatment of Impaired assets in the Community Banking Sector, February 2009.

Figure 3.5 State Aid, First Tranche, May 2010

	Allied Irish Banks	Anglo Irish Bank	Bank of Ireland	EBS Building Society	Irish Nationwide Building Society	Total
	€m	€m	€m	€m	€m	€m
Loan Consideration[a]	1,906	4,157	1,262	91	280	7,696
Loan CMV[a]	1,484	3,287	966	73	210	6,020
State Aid	422	870	296	18	70	1,676
State Aid %	28%	26%	31%	25%	33%	28%

Source: NAMA. Analysis by Office of C&AG

Note:

a Including derivatives.

Settlement Arrangements

3.36 A special purpose vehicle, National Asset Management Ltd, issued debt to pay for the first tranche of loans. The debt is issued in units of €1 million. The amounts paid to the banks are, therefore, rounded up or down to the nearest €1 million. The surplus or shortfall on the debt issued was taken into account when the reconciliation between loan balances at 31 January 2010 and at the acquisition date was carried out. Figure 3.6 sets out the cost of the acquisitions and the debt issued for the first tranche of loans.

Figure 3.6 First Tranche, Payment for Transferred Loans

	Allied Irish Banks	Anglo Irish Bank	Bank of Ireland	EBS Building Society	Irish Nationwide Building Society	Total
	€000	€000	€000	€000	€000	€000
Acquisition Value	**1,905,760**	**4,157,286**	**1,261,840**	**90,894**	**280,084**	**7,695,864**
Debt issued						
Guaranteed Securities	1,810,000	3,949,000	1,199,000	86,000	266,000	7,310,000
Subordinated Debt	95,000	208,000	63,000	5,000	14,000	385,000
Total Debt Issued	**1,905,000**	**4,157,000**	**1,262,000**	**91,000**	**280,000**	**7,695,000**
Overpayment/ (Underpayment)[a]	**(760)**	**(286)**	**160**	**106**	**(84)**	**(864)**

Source: NAMA

Note:

a This over/(under) payment is settled following a post-acquisition reconciliation of the changes on the loan balances between 31 January 2010 and the acquisition date.

Terms of the Debt

3.37 95% of the consideration is paid by way of debt securities with the balance in the form of subordinated debt.

3.38 The interest rate on the securities is set at the six-month Euribor rate and is payable twice annually on 1 March and 1 September. The rate at 1 March 2010 was just under 1%. This rate will pertain for all guaranteed securities issued between then and 1 September 2010. The interest rate is reset every six months at the rate prevailing on 1 March and 1 September.

3.39 The interest rate on the subordinated debt, which is only payable following a declaration by the Board of National Asset Management Ltd that it has achieved its objectives in the year ending on the relevant interest payment date, is the yield on the 10-year Irish Government Bond as at the date the debt was first issued plus 0.75%.

Adjustment of Consideration – Post-Acquisition Transactions

3.40 For each tranche of loans NAMA sets a date at which the loan balances are agreed with the participating banks and confirmed in the due diligence process. For the first tranche, the date was 31 January 2010. The loan balances at that date are used when conducting the loan valuations. The benefit, or cost, of any transactions after this date – e.g. interest payments by borrowers – accrues to NAMA. Following acquisition of a tranche of loans from a participating bank, NAMA carries out a reconciliation of the movement on loan balances between 31 January 2010 and acquisition date. The settlement takes account of the following

- the banks pay NAMA any interest and capital received in the period
- NAMA pays interest to the banks to cover their cost of funding the loans for the period from 31 January to the date of acquisition[52]
- NAMA reimburses the banks for any qualifying advances that have been made after 31 January 2010.

3.41 The reconciliation also takes account of the difference between the debt issued to pay for the loans, which is issued in units of €1 million, and the actual acquisition values. Details are set out in Figure 3.7.

[52] The interest is paid at Euribor and is based on the amount that NAMA pays for the loans, not the loan balances for the period.

Figure 3.7 First Tranche, Post 31 January 2010 Adjustment

	Allied Irish Banks	Anglo Irish Bank	Bank of Ireland	EBS Building Society	Irish Nationwide Building Society	Total
	€000	€000	€000	€000	€000	€000
Overpayment/ (Underpayment) in Issued Debt[a]	(760)	(286)	160	106	(84)	(864)
Movements from 31 January 2010						
Interest Paid by Borrowers	7,602	-	1,541	302	-	9,445
Capital Repayments by Borrowers	1,679	68,615	2,747	173	1,466	74,680
Advances to Borrowers	(911)	-	(3,023)	-	(539)	(4,473)
Interest Due by NAMA	(3,273)	(10,686)	(2,032)	(136)	(421)	(16,548)
Derivative Cash Received from Borrowers	1,968	-	528	-	-	2,496
Due to NAMA/ (to Bank)[b]	**6,305**	**57,643**	**(79)**	**445**	**422**	**64,736**

Source: NAMA

Notes:

a Details of the debt issued to pay for the loans are set out in Figure 3.6.

b NAMA either receives this balance from the participating banks, or pays it, as appropriate.

Conclusion - Financial Features of the First Tranche

Consideration

The State paid approximately 50% of the book value of the debt while the borrowers continue to owe NAMA the full €15.4 billion of the debt. NAMA paid the lesser of the amount owed by the borrower or the present value of the associated loan collateral and income streams adjusted for legal, enforcement and due diligence discounts.

The consideration paid by NAMA was reduced by the application of a discount to provide for due diligence and enforcement costs, the present value of this being €266 million. This is estimated as adequate to meet the cost of full enforcement proceedings for 25% of the collateral.

Property Values

The property associated with the acquired assets was valued at around €7.5 billion, which was uplifted by 11% to €8.3 billion after adjustment to long-term economic value. When this sum and the projected income stream of the property were discounted back the present value of the property cash flows was put at €8.1 billion.

This present value of the projected cash flows from property taking account of uplift factors exceeded the current market value of the properties using market valuation methods by almost 9%.

€5.9 billion or 71% of the long-term value of the property was accounted for by completed residential and commercial properties including hotels.

The amounts of other collateral, including cash assets of €162 million, included in the loan valuations amounted to €369 million, just under 5% of the total price paid for the loans.

The value of collateral exceeded the amount owed in some cases. In aggregate, €518 million of excess collateral was associated with transferred loans. It was assumed that this will not be available to the State and no payment was made for these contingent assets.

State Aid

The State paid €7.7 billion for the first tranche of bank assets.

The value of state aid as represented by the difference between the price paid and the current market value of bank assets was €1.7 billion or 28% greater than their current market value.

Advances to Borrowers

Following direction by the Governor of the Central Bank and the Financial Regulator, no discount was applied to advances made by banks to borrowers after 7 April 2009 provided that it could be shown that the moneys were advanced as part of normal commercial banking arrangements. NAMA accepted around €299 million of the amounts claimed for the first tranche of transfers.

Method of Payment

NAMA issued debt to pay for the loans, of which around €7.3 billion was in debt securities guaranteed by the Government. The remainder of the consideration, €385 million, was in the form of subordinated debt, the repayment of which is dependent on NAMA's financial performance.

Annex A

Annex A – Acquired Loans, First Tranche

	AIB	Anglo	BOI	EBS	INBS	Total
	€m	€m	€m	€m	€m	€m
Loan Balance	3,290	9,251	1,930	144	669	**15,284**
Derivatives	67	80	16	-	-	163
Borrower Debt	**3,357**	**9,331**	**1,946**	**144**	**669**	**15,447**
Current Market Value of Property	**1,872**	**3,860**	**1,264**	**95**	**363**	**7,454**
Long-Term Value of Underlying Property						
Land (including development property < 30% complete)	*715*	*952*	*464*	*13*	*161*	*2,305*
Residential Property for resale	*259*	*649*	*162*	*71*	*33*	*1,174*
Investment Property	*1,065*	*2,413*	*750*	*19*	*83*	*4,330*
Hotels	*-*	*279*	*2*	*-*	*68*	*349*
Development Property (> 30% complete)	*-*	*18*	*37*	*-*	*62*	*117*
Total	**2,039**	**4,311**	**1,415**	**103**	**407**	**8,275**
NAMA Valuation						
Collateral Associated with Loans						
Present Value of Property Cash Flows	*1,997*	*4,285*	*1,373*	*97*	*352*	*8,104*
Cash Security	*14*	*144*	*3*	*1*	*-*	*162*
Other Security	*61*	*142*	*4*	*-*	*-*	*207*
Total Collateral	***2,072***	***4,571***	***1,380***	***98***	***352***	***8,473***
Excess Collateral	*(122)*	*(281)*	*(73)*	*(5)*	*(37)*	*(518)*
Legal Discount	*(17)*	*(71)*	*-*	*-*	*(31)*	*(119)*
Collateral Available to the State	***1,933***	***4,219***	***1,307***	***93***	***284***	***7,836***
Due Diligence and Enforcement Adjustment	*(62)*	*(137)*	*(50)*	*(2)*	*(15)*	*(266)*
Net Loan Collateral	***1,871***	***4,082***	***1,257***	***91***	***269***	***7,570***
Qualifying Advances	*35*	*75*	*5*	*-*	*11*	*126*
Consideration	**1,906**	**4,157**	**1,262**	**91**	**280**	**7,696**
Discount	43%	55%	35%	37%	58%	**50%**
Loan CMV[a]	1,484	3,287	966	73	210	**6,020**
State Aid	28%	26%	31%	25%	33%	**28%**

Notes

a The Loan CMV was calculated using a model developed by NAMA's financial advisors.

Explanation of Elements

Loan Balance	The amounts owed by borrowers at 31 January 2010 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 €150 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.
Current 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 current 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 outlined in Chapter 2.
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 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 31 January 2010.
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.

Chapter 4

Corporate Governance

Corporate Governance

4.1 This Chapter sets out the arrangements that NAMA has put in place to date to govern and manage its operations.

4.2 The Chapter examines

- how the Board is structured, remunerated and its affairs regulated
- the arrangements to regulate the practice in dealing with the business of NAMA
- the extent of delegation
- the extent to which internal control has been addressed.

The Board

4.3 The Board has nine members including two *ex-officio* members. Excluding *ex-officio* members, six of the members were appointed by the Minister on 22 December 2009 and a seventh on 26 May 2010. The members and the periods for which the Minister has appointed them, are

- Frank Daly (Chairman) (five years)
- Michael Connolly (five years)
- Brian McEnery (four years)
- William Soffe (four years)
- Eilish Finan (four years)
- Peter Stewart (three years)
- Steven Seelig (three years from 26 May 2010)
- John Corrigan (*ex-officio*, CEO NTMA)
- Brendan McDonagh (*ex-officio*, CEO NAMA).

4.4 Board procedures and business are regulated by standing orders that were adopted by the Board at its first meeting on 23 December 2009. The standing orders prescribe that a minimum of six Board meetings are held per annum. By end of September 2010, it had held 13 regular meetings. In addition, it had held a full day meeting, with members of the NAMA management team, to discuss NAMA's strategy.

4.5 The Act sets out the principal functions of the Board, which are to

- ensure that the functions of NAMA are performed effectively and efficiently
- set the strategic objectives and targets of NAMA
- ensure the appropriate systems and procedures are in place to achieve NAMA's strategic objectives and targets and to take all reasonable steps to achieve those targets and objectives.

4.6 The Act also sets out some related matters including Board members' remuneration and the requirement for

- Board members to make certain disclosures
- the Board to establish sub-committees and other advisory committees that it considers desirable

- the Board to prepare certain Codes of Conduct for approval by the Minister.

Board Remuneration

4.7 The Minister determines the level of remuneration of appointed members and their entitlement to reimbursement for expenses.

4.8 In December 2009, when the Minister appointed the Board he set the fees for Board members. The letter from the Department of Finance notifying the CEO of the NTMA of the fees pointed out that the duties and responsibilities of the Board members were significantly greater than normal State Boards. The fees set were

- Chairperson €100,000 per annum, subject to review if he worked more than 100 days in a year
- €38,000 for the other Board members.

4.9 On 10 March 2010, the Department again wrote to the CEO of the NTMA stating that, having regard to the exceptional responsibilities of the NAMA Board and accepting that the Board's workload would be excessive by normal standards in the first year, the Minister had approved revised fee arrangements for Board members and other members of Board sub-committees from specified dates

- the Chairperson's fee was increased to €170,000 per annum with effect from the date of the letter subject to the Chairperson being available without restriction, with total flexibility, as required
- ordinary Board members' fees were increased to €50,000 per annum with effect from the date of the letter
- the Chairperson of the Credit Committee, in recognition of the exceptional level of involvement required in the initial year of operation, will receive a fee of €150,000, inclusive of the Board member ordinary fee, on the understanding that the incumbent works no fewer than three to four days a week
- the Chairs of other committees will receive a fee of €10,000 per annum in addition to the Board member ordinary fee from the date appointed subject to a maximum of one such fee per Board member
- external members of the Audit Committee will receive, from the date of their appointment, a fee of €1,000 per meeting, inclusive of preparatory work, subject to a maximum of €10,000 per annum
- external members of other committees will receive, from the date of their appointments, a fee of €1,000 per meeting subject to a maximum of €5,000 per annum.

4.10 The letter pointed out that the arrangements would be subject to review after one year and that the Minister was strongly of the view that these exceptional fees could only be justified in the start-up phase of NAMA.

Expense Policy

4.11 At its meeting in February 2010, the Board approved a policy for expense reimbursement for Board members.

4.12 The policy addresses travel, accommodation and meals and out of pocket expenses as well as how expenses are to be reimbursed. All Board members' expenses are to be approved by the Chairperson of the Board (or by two members in his absence). The Chairperson's expenses are to be approved by two Board members one of which is the Chairperson of the Audit Committee.

4.13 An annual review of each Board member's expenses, prepared by NAMA management, will be carried out by the Chairperson. An annual summary of the Chairperson's expenses will be reviewed by the Audit Committee.

Disclosures

4.14 Section 31 of the Act requires Board members to

- provide annually a statement of registrable interests (within the meaning of the Ethics in Public Office Act, 1995)
- disclose any pecuniary or beneficial interest[53] in a matter to be decided by the Board prior to its consideration.

4.15 The reference period for the purposes of the annual statement of registrable interests is the previous calendar year. The Board agreed that the reference period for 2009 would be from 21 December 2009 to 31 December 2009. At its meeting on 4 February 2010 the Board noted that all members had returned their statements for that period.

4.16 At its meeting on 7 January 2010, the Board approved guidelines in regard to what constitutes an interest having regard to the Ethics in Public Office Act.

4.17 In regard to conflict of interests, the Board agreed at its meeting on 23 December 2009, that given the market-sensitive information that would be available to members as part of their duties, members would be prohibited from dealing in the shares of participating banks. At its meeting on 7 January 2010, the Board approved a 'Personal Account Transaction Policy'. The policy extended the application of the principle agreed at its December 2009 meeting to

- shares in quoted property companies, unquoted property companies and units in pooled funds and indexed products
- self-administered or self-directed pension funds
- direct investment in commercial property
- closely connected persons.

4.18 The 'Personal Account Transaction Policy' requires Board members to make an annual disclosure to be returned to the Chairman of the Board and to be maintained by the Secretary to the Board.

4.19 The Board also agreed at its meeting in January 2010 that a mechanism was required whereby prohibited assets already held by Board members prior to their appointment could be divested with the approval of the Chairman of the Board.

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[53] This requirement also applies to officers of NAMA where directed by the Board to do so and to all directors of NAMA group entities.

Conflicts of Interest

4.20 At the Board meeting of 7 January 2010, it was noted that a Board member (Brian McEnery) had a conflict of interest in relation to Howarth Bastow Charleton which is a reserve panellist on the loan asset valuers panel.

4.21 At the Board meeting held on 4 March 2010, two Board members declared that they had conflicts of interest in regard to the tender for the Business Plan Reviewers, which the Board was considering. The two members, Brian McEnery and Eilish Finan, excused themselves from the part of the meeting at which the tenders were considered.

Board Sub-Committees

4.22 The Board carries out much of its work through sub-committees to which it has delegated certain powers and responsibilities. At its meeting on 7 January 2010, the Board adopted terms of reference for the four statutory Board sub-committees and, at its meeting on 6 May 2010, it adopted terms of reference for the two advisory sub-committees. A brief summary is set out in Figure 4.1 and further information on the role of each sub-committee is contained in Appendix K.

Figure 4.1 Sub-Committees of the Board

Statutory Sub-Committees	Membership
Audit	Four Board members plus two appointed by the Minister. Ministerial appointments not yet made.
Credit	Two Board members plus the CEO NAMA and the NAMA Heads of Legal and Taxation, Credit and Risk, Portfolio Management and Lending.
Risk Management	Two Board members plus the CEO NAMA and the NAMA Heads of Portfolio Management, Legal and Taxation, Credit and Risk, Lending, Treasury and Business Services.
Finance and Operations	Two Board members plus the CEO NAMA, the NAMA Heads of Portfolio Management and Business Services and the NTMA Finance Director.
Non-Statutory Sub-Committees[a]	
Northern Ireland	Three Board members, the Head of Credit and Risk and two external members.
Planning	Two Board members plus the CEO NAMA, the Head of Portfolio Management and two external members.

Source: NAMA

Note:

a The Act states that the advisory committees may include members who are not members of the Board but the majority of each committee shall be members of the Board.

Codes of Practice

4.23 Under Section 35 of the NAMA Act 2009, the Board must prepare certain codes of conduct, to be approved by the Minister for Finance, to guide its activities including

- the conduct of officers of NAMA
- servicing standards for acquired bank assets

- risk management including with regard to debtors
- disposal of bank assets
- the manner in which NAMA is to take account of the commercial interests of credit institutions that are not participating institutions
- any other matter in relation to which the Minister directs NAMA to prepare a code of practice.

4.24 At its meeting in January 2010, the Board approved the code of practice for the conduct of officers of NAMA while it approved the remaining four codes of practice at its meeting in March 2010. The codes of practice were sent to the Minister for his approval. In May, a senior representative of the Department of Finance presented revised codes of practice, with some amendments, to the Board for its consideration. The Board adopted the revised codes.

4.25 On 5 July 2010, the Minister approved the five codes of practice, subject to the inclusion of certain amendments being carried through to the final published version of the codes. The Minister pointed out that, prior to approval of the codes, his Department had consulted with interested parties including the European Commission.

4.26 In the event of any conflict between the Act and any of the codes of practice, the Act takes precedence. All of the codes of practice were approved by the Minister on 5 July 2010. Further information on the codes is set out in Appendix L.

Delegated Authority

4.27 At its meeting in July 2010, the Board approved[54] delegated authority levels in respect of approval or decision taking in the following areas

- credit facilities
- enforcement action
- loan provisions
- property management decisions
- approval for property and loan disposals
- approval for personal guarantee waiver
- urgent decisions.

Approval of Credit Facilities

4.28 Limits on capacity to approve credit facilities are set based on a combination of a borrower's exposure (to NAMA) and the credit grade[55] assigned to NAMA.

4.29 Board approval is required where a borrower's exposure exceeds the relevant limit. For example, all credit decisions regarding new lending above €35 million require Board approval while all decisions about borrower business plans – e.g. restructuring of loans – where no new

[54] This approval superseded delegated authorities that the Board had approved in February 2010.

[55] Loan credit grades are determined by reference to the discount applied to the loan. Loans are classified as performing where the discount was less than 20%, watch where the discount was between 20% and 40% and impaired where the discount exceeded 40%. Borrower credit grades are determined based on the weighted average discounts of all borrower's loans.

lending is required require Board approval where the borrower's exposure exceeds €500 million. Below these levels, the Board has delegated approval authority to the Credit Committee, the NAMA CEO or NAMA senior executives and senior managers. No one individual can make any credit decision. For example, where the relevant credit grade classification is performing or watch, approval for a loan of €35 million[56] is required from both the CEO and the Head of Credit and Risk.

Enforcement Action

4.30 Where a borrower's exposure exceeds €250 million a decision about whether or not to take enforcement action rests with the Board, between €20 million and €250 million with the Credit Committee and below that level with the CEO and Head of Credit and Risk acting jointly. When either the Credit Committee or the CEO and the Head of Credit and Risk are considering taking enforcement proceedings the Board must be informed.

Loan Provisions

4.31 In circumstances where it is proposed to make provision against a loan or group of loans, the provisions are to be calculated and submitted for credit approval. Provisions greater than €25m require Board approval and all provisions are to be advised quarterly to the Credit Committee and the Board.

Property Management Decisions

4.32 Property management decisions include, for example, decisions to grant new leases or agree changes to rent agreements. The appropriate approval level for these decisions is determined by the annual value of the rental or other charge. Any decisions where the annual charge exceeds €1 million require Board approval.

Loan and Property Disposals

4.33 Approval is required to carry out disposals of loans or property. The approval thresholds are the same for both. Board approval is required for disposals where the anticipated disposal value is greater than €100 million and the approval of the Credit Committee is required for disposals between €20 million and €100 million while below that level joint approval is required from

- one of the Chairman of the Credit Committee, the CEO or the Head of Credit and Risk in combination with
- one of either the Head of Portfolio Management or the Head of Lending.

4.34 In circumstances where the disposal value is less than 90% of the acquisition cost for property and less than 95% of the acquisition cost for loans, approval is required at one authority level higher.

Personal Guarantee Waiver

4.35 Approval limits for decisions about waiver of guarantees is based on the gross amount of the personal guarantee. Where this exceeds €50 million Board approval is required regardless of

[56] Provided the loan will not increase the borrower's overall exposure by 10% or more.

the amount being waived. Between €5 million and €50 million the approval of the Credit Committee is required, while below that value joint approval is required from

- one of the Chairman of the Credit Committee, the CEO or the Head of Credit and Risk in combination with
- one of either the Head of Portfolio Management or the Head of Lending.

Urgent Decisions

4.36 For exceptional cases, where a speedy decision is required and the delegated authorities are not available, the Board permits exceptions to the delegated authorities provided that all exceptions are presented to the Board and the Credit Committee at their subsequent meetings with a full justification. All such decisions are to be advised to the Chairs of the Board and the Credit Committee and the CEO as soon as practicable.

Internal Control

4.37 To date NAMA has developed policies and procedures in relation to many of the major risks it faces including, for example,

- independent reviews of valuations of loans and their underlying assets, of NAMA's legal entitlement to enforce its rights over these and of the information provided by the participating banks
- a credit policy and policy guidance for the participating banks for those loans for which they have been given delegated authority to make credit decisions
- operating manuals for case management and enforcement proceedings
- delegated authority by the Board for decisions in relation to credit, investment and enforcement proceedings
- board approval for strategies for managing currency and interest rate risks
- procedures covering the review of debtor business plans.

4.38 NAMA appointed Deloitte and Touche as Internal Auditors in late August 2010.

4.39 The functioning of the control system will be tested as part of the 2010 financial audit.

Chapter 5

Resourcing and Procurement

Resourcing and Procurement

5.1 The main resources available to NAMA are

- staff assigned to it by the NTMA
- personnel contracted on a short-term basis from accountancy firms
- consultancy and advisory services.

This Chapter reviews how those resources were engaged or procured.

Staffing of NAMA

5.2 NAMA operated, on an interim basis between May and December 2009 with a small number of staff. The interim CEO was appointed in May 2009. He combined this post with other responsibilities in the NTMA as Director of Finance, Technology and Risk until the end of July 2009 when he commenced working full-time for NAMA. He was assisted during 2009 by three staff members from the NTMA and three who were recruited for NAMA, initially on a seconded or temporary basis. The six personnel who assisted the interim CEO included three who have been appointed as heads of function in NAMA following its establishment. The total cost for all staff, whether employed directly or seconded, for 2009 was just over €640,000.

5.3 By September 2010, NAMA had 75 staff members assigned by the NTMA and recruitment was continuing with the aim of achieving a complement of 104 staff. The proposed staff numbers are set out by function in Figure 5.1.

Figure 5.1 NAMA Proposed Staff Resources, September 2010

Function	Proposed Total Complement
CEO	1
Business Services	12
Credit & Risk	30
Legal and Taxation	8
Portfolio Management	43
Treasury	4
Lending	6
Total	**104**

Source: NAMA

Contracted Personnel

5.4 In the period from December 2009 to April 2010, NAMA entered into a number of contracts with two firms to provide staff to carry out specified services.

5.5 In December 2009, the NTMA contracted with PricewaterhouseCoopers (PwC) to provide the following services at a cost of approximately €125,000 plus incidental costs and VAT

- a review of the terms of reference for Board sub-committees
- an outline of the operating and control environment required to support the Credit Committee

- production of loan review plan and borrower business plan templates
- a review of the job descriptions for the heads of Credit and Risk, Banking and Lending and Portfolio Management and the provision of advice on recruitment
- advice on the feasibility of putting in place a partnering arrangement with one or more organisations to provide back-up resources for NAMA in the future.

5.6 In January 2010, NAMA entered into a second contract with the same firm to provide a team of specialist personnel to work collaboratively with NAMA on key aspects of the set-up phase. The contract set out the areas in which the personnel would be working and identified some of the outputs that they would assist NAMA in completing. These included certain codes of practice, credit policy and procedures, enforcement procedures, workout procedures, business plan review procedures and an operating model for NAMA units[57] in the participating banks. The period covered by the contract was 13 weeks from 25 January 2010. The contract stated that the fee would be around €1.9 million, including out of pocket expenses but excluding VAT, based on a defined core team of 15 personnel with hourly rates set out for each and assumptions about their deployment over the period.

5.7 In April 2010, NAMA entered into a further contract with the same firm for four[58] named personnel to be seconded to NAMA from 7 April to 31 May 2010 at a cost of €60,000 per week based on a 37.5 hour week, including out of pocket expenses but excluding VAT. The role of the personnel, reporting to the Head of Portfolio Management, was to assist NAMA, pending the recruitment of full time staff, in managing its relationship with the borrowers whose loans NAMA acquired and in developing individual workout strategies with those borrowers. NAMA retained the services of the four personnel from 1 June 2010 at a cost of €40,000 per week excluding VAT.

5.8 In March 2010, NAMA contracted with a different firm, Deloitte, to provide five personnel on secondment for a period of eight weeks. Reporting to the Head of Portfolio Management, their role was, broadly, to provide assistance in regard to the business plans and credit requests of borrowers. The fee was €33,000 per week to which a discount was to be applied to give a total cost of €220,000 excluding VAT for the period.

Consultancy and Advice

5.9 During 2009, the NTMA procured the services of a number of consultants and advisors. Details of these services, including any costs incurred to the end of 2009, are set out in Figure 5.2.

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57 Each Participating Institution is obliged to set up a separate NAMA Unit within its organisation, separate from its other activities.

58 The firm supplied one extra resource within the terms at no additional cost.

Figure 5.2 Consultants and Advisors

Provider of Service	Service	Method of Procurement	Fees (excluding VAT)	Costs in 2009 (including VAT)[a]
Arthur Cox Solicitors	Legal Advisory Services	Open tender	Fixed fee €200,000 to September 2009. Monthly fee €40,000 thereafter.	€911,250[b]
Panel of 67 Firms	Legal Due Diligence Services	Open tender	€1,000 (Ireland) to £1,500 (UK) [b]	
HSBC Investment Bank Ltd	Financial Advisory Services	Open tender	Fixed fee €250,000 to September 2009. €65,000 per month thereafter.	€502,051
PwC	Tax Advisory Services	Open tender	Fixed fee €195,000 to September 2009. Hourly rates thereafter.	€341,851
Capita Services Ireland Ltd	Master, Backup and Specialist Loan Service Provider (Master Servicer)	Open tender[c]	€3.2 million per annum for four years.	-
KPMG	Audit Coordinator for Loan Valuations	Open tender[c]	€5.8 million (Nov 2009 to June 2010).	-
Société Générale	Derivative Valuation Services	Open tender[c]	€260,000.	-
Panel of Five Firms[d]	Loan and Asset Valuation	Open tender[c]	€500,000 per 500 loans.	-
Panel of 33 firms	Real Estate Valuation	Open tender[c]	Approximately €31,920 per bundle of valuations[b.]	-
Allen and Overy	Legal Advisors (UK)	Selected by NAMA	Hourly rates with a discount depending on the volume of work.	€247,667
London Economics – Indecon	Report on derivation of long-term economic value adjustment factors	Three firms invited to tender	€94,080.	€94,080

Source: NAMA

Notes:

a €1.69 million of the costs was paid by the NTMA out of its own administration budget during 2009. The balance was outstanding at the end of 2009.

b See paragraphs 5.19 – 5.34 below.

c This tender competition was advertised in the Official Journal of the EU (OJEU).

d The five firms appointed as loan and asset valuers were Ernst and Young, PwC, UHY Hacker Young, Alvarez and Marsal and FTI Consulting.

Procurement Processes

5.10 Each competition was overseen by process auditors.

- The Head of Control in the NTMA was the process auditor for three of the initial competitions – legal, financial and tax advisory services. He signed each of the evaluation group reports confirming that the process followed had been fair and equitable.

- The former Governor of the Central Bank, Maurice O'Connell, was the process auditor for the remaining open tender competitions. In a letter dated 25 November 2009, he confirmed that, to the best of his knowledge, all stages of the tendering processes had been conducted in a fair, equitable and transparent manner, in accordance with the established criteria advised to the participants.

5.11 Procurement of goods and services by public sector bodies must be conducted in accordance with EU and national procurement requirements. Under EU regulations, for services with an expected contract value in excess of €206,000[59], there is a requirement to place a contract notice in the OJEU and to follow certain procurement procedures. All except four of the open tender competitions were conducted under EU regulations using the restricted procedure which is a two stage process where, following requests for expressions of interest in the OJEU, those parties which meet minimum requirements in regard to capability, experience and financial capacity are invited to tender.

5.12 Four of the open tender competitions were not advertised in the OJEU but were advertised on the national public procurement website (etenders). These were

- financial advisory services
- tax advisory services
- legal advisory services
- legal due diligence services.

5.13 The NTMA anticipated that the cost would be below the EU threshold for the financial advisory and tax advisory services. The successful tender for the tax advisory services was below the threshold. In the financial advisory competition three firms tendered prices below the threshold but none of these firms was successful. Tenders were evaluated on the basis of four criteria of which fees had a weighting of 30%. The successful firm tendered a price of €250,000 (exclusive of VAT) for a contract to the end of September 2009 and €65,000 per month thereafter if the contract extended beyond that date.

5.14 Under EU procurement regulations, legal services are defined as non-priority services and are not subject to the full scope of EU procurement directives. Public bodies seeking these services are not required to advertise in the OJEU. The European Commission must be notified of the award of the contract. For the legal advisory and legal due diligence competitions, a contract award notice was placed on the etenders website.

5.15 The contract for legal services in the UK was awarded to a firm that the NTMA selected without holding a procurement competition. NTMA stated that the firm was chosen due to its global banking law reputation which was a prerequisite for review of the draft legislation as well as other work required on NAMA debt and key banking and UK/US issues central to the acquisition and transfer of the bank assets. The NTMA stated that no tender was conducted as it was not required under EU procurement law, NTMA's choice of firm for such a mandate was limited and the firm chosen was considered to be the most appropriate by reference to its lack of corporate involvement with any of the prospective participating banks and prospective debtors.

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[59] The threshold for services procured by Government Departments and Offices in 2008 and 2009 was €133,000. A higher threshold - €206,000 applies to local and regional authorities and public bodies outside the utilities sector.

Award of Contracts

5.16 In June 2009, the interim NAMA team appointed the firms to provide the financial, legal and tax advisory services. In January 2010, the Board approved the extension of these contracts on a month-by-month basis until completion of the loan acquisition process.

5.17 In November 2009, in response to a request from the interim CEO, the Minister agreed that NAMA could notify the successful firms of the results of the tender competitions in respect of

- a master, backup and specialist loan service provider
- a panel for the provision of legal services in respect of the due diligence process
- a framework for the provision of real estate valuation services
- an audit coordinator
- loan asset valuers
- a derivatives valuation service provider.

5.18 The interim CEO of NAMA stated that all of the service providers had been appointed under EU and national procurement rules in tender competitions overseen by the former Governor of the Central Bank who had declined to accept any fees. In January 2010, the Board formally approved the appointments and, also, the appointment of the firm who provided the report on the derivation of the long-term economic value adjustment factors[60].

Fee Agreement

Legal Advisory Services

5.19 Following evaluation of the tenders for the legal advisory services, the NTMA contacted the three firms with the highest scores seeking clarification of the fixed fees that had been quoted. The NTMA pointed out that the evaluation group considered that the fixed fees proposed may have overestimated the time and resources required to deliver the service requirements and that the group had noted that the range of fixed fees was far greater than it would have expected. The NTMA pointed out that it was likely that the most extensive phase of the engagement would have concluded by the end of July 2009 and that the draft heads of bill had reached an advanced stage. However, it noted that any rescaling of the fixed fee was optional and that the firms might choose not to adjust their quoted fees.

5.20 All three responded with reduced fee proposals[61]. Following further evaluation, the evaluation group agreed to award the contract to Arthur Cox Solicitors[62] (Arthur Cox) on the basis of a fixed fee of €200,000 for the period to September 2009 with a monthly fixed fee of €40,000 thereafter (both exclusive of VAT). A contract was signed between Arthur Cox and the NTMA (acting on behalf of NAMA) on 22 June 2009. In regard to costs, the contract set out a fixed fee of €200,000 for the period from 22 June 2009 to 30 September 2009 and a fixed fee of €40,000 per month thereafter. The proposal stated that

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60 Technical Economic Advice to Irish Governments National Asset Management Agency Concerning Estimation of Adjustment Factors Required Under the Long-Term Economic Value Regulation.

61 The scores in the tender competition for the criteria other than fees placed the top three ranked firms well ahead of the fourth placed firm. Given the formula used to score the fee proposals, revised lower fees from the fourth or lower placed tenderers could not have closed the gap with the third placed firm.

62 This firm had also been ranked first in the tender scoring using the original fees proposed.

"*The information in the schedule for costs is based on the assumptions in the request for proposals dated 29 May 2009, as adjusted by the email of the process auditor dated 12 June 2009. These assumptions include that the Heads of Bill are at an advanced stage and that the intensive phase of the engagement in this matter has concluded by 31 July 2009*"

5.21 In fact, the fees charged (and paid) up to 12 November 2009 were in accordance with the fee proposal in the original tender, which had quoted a fixed fee of €480,000 to the end of September 2009 and €150,000 per month thereafter. The fee for the period from 12 November 2009 to the end of December 2009 was based on the contract fee of €40,000 per month. Arthur Cox charged the fees in a single invoice in December 2009.

5.22 In their original fee proposal in the tender documents Arthur Cox had stated

"*Our fixed fee proposal is €480,000*[63] *or such lesser amount which represents our actual hours spent at a 10% discount to our hourly rates (set out in the document). Therefore, should we have overestimated the level of input required, and given the unprecedented nature of the issues involved this is possible although unlikely, NAMA is protected against an unduly high fee. Our fixed monthly fee (if the project extended beyond September 2009) would be €150,000 per month or such lesser amount which represents the actual hours spent per month (or part thereof) at a 10% discount to our hourly rates*".

5.23 In a submission to NAMA prior to settlement of the cost, Arthur Cox pointed out that a number of external factors had come to bear which moved the project and timescale substantially beyond the assumptions set out including

- the evolution of the Bill to meet the policy requirements of the Department of Finance
- the intensity of the engagement required with the Attorney General's Office
- the issuing of the draft Bill for public consultation and subsequent assessment of and responses to submissions
- the extended parliamentary process for the Bill
- the extended period of time involved and
- the major development of the Bill.

5.24 It maintained that these developments had resulted in a project and level of work, time and resources, which was very materially beyond the assumptions in the Request for Proposals (RFP) and in the subsequent correspondence from the NTMA. Arthur Cox went on to state that additional phases of work were required arising from the significant changes to the Bill between issue for public consultation on 30 July 2009 and its initiation as a Bill on 10 September 2009 (including the addition of 34 new sections) and amendments to the Bill between initiation and enactment on 22 November 2009.

5.25 Arthur Cox asserted that the assumptions in the original RFP, particularly on the Act being passed and the primary services being fully delivered by the end of September 2009 as well as the level of interaction required with the Department and the Attorney General's Office resulted in a very material understatement of the time and resources required by the project. The revised assumptions represented an even greater understatement and described an entirely different project.

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[63] The fees proposed were based on 775 partner hours at a discounted rate of €470 per hour and 425 associate hours at a discounted rate of €290 per hour. The total (€487,500) was rounded down to €480,000.

5.26 Arthur Cox stated that, in the current economic environment notwithstanding the very substantial difference between the work described by the original RFP assumptions and the work actually required to be carried out in the project, they proposed that the fee be limited to the original tender pricing submitted in response to the RFP and that this was advantageous to the NTMA and the State as it meant that they would not calculate the additional work required on the basis set out in their tender (i.e. normal hourly rates less 10%) and would therefore reduce their fee to that originally proposed, irrespective of the additional work required over a much longer timeframe.

5.27 In response to an audit enquiry, the CEO of NAMA pointed out that, while the NTMA was the contracting party for the legal advisory services, most of the extra legal work for the Steering Group was directed by the evolving policy decisions of the Minister, the Government and the Oireachtas in the period from mid-August to November 2009. If the work had been substantially completed at end July 2009 with a residual follow up in September 2009 then the original tender price would have applied but as the Bill required quite technical legal changes, it was logical to extend the use of Arthur Cox as legal advisors. He also stated that it would not be optimal to change advisors as policy was being developed by the Minister and Government and legislation written by the Attorney General.

5.28 In subsequent correspondence with NAMA, Arthur Cox stated that the amounts of time, including additional services, which were required on the development of the NAMA legislation and ancillary work was more than 30% greater than the €690,000 agreed for the work up to the passing of the Act on 12 November 2009.

5.29 Arthur Cox stated that the firm had €844,062[64] of time recorded on its system for the required work over the period to 12 November 2009 but that this was a very substantial understatement of the additional services required and additional work actually undertaken which would have been billed as additional services were it not for the agreement reached. The correspondence from Arthur Cox pointed out that, for example, while the managing partner led the team and was personally involved intensively on every day of the project, his time was not recorded on the system. The correspondence also stated that many others on the team either stopped recording time or under-recorded time as they knew it would not be billed.

Legal Advisory Fees

The fees paid to the legal advisors, Arthur Cox, were in excess of those agreed and set out in the contract between Arthur Cox and the NTMA. The contracted fee was lower than that proposed by Arthur Cox when tendering for the contract. The contract did not state the number of hours work reflected in the fee.

Arthur Cox, in a submission justifying the fees, pointed out that the amount of work required under the contract was considerably greater than that described in the RFP and the correspondence from the NTMA. Despite the fact that the contract provided for lower fees, Arthur Cox was paid a fee for the period from late June 2009 to mid-November 2009 that was based on the original fixed fee proposal contained in its tender documentation. Arthur Cox subsequently informed NAMA that the total value of the hours worked on the NAMA project exceeded the charge to NAMA by over 30%.

[64] Following application of the 10% discount on hourly rates set out in the contract the value of the time recorded was €767,329.

Real Estate Valuation Services

5.30 The tender competition for the provision of real estate valuation services was for appointment to a panel under a framework agreement. The evaluation group considered the tenders in early November 2009 in respect of the evaluation criteria of quality, technical merit and the project team but excluding fees. Following this, the group sought legal advice as the range of pricing models used by the tendering firms made it impossible to fairly compare the fee proposals received. The report of the evaluation group noted that legal advice it had obtained permitted a request for supplemental information to be issued to all candidates that had been invited to tender in order to standardise the pricing.

5.31 The NTMA contacted the firms that had tendered requesting them to confirm agreement with a fixed fee matrix[65] proposed by the NTMA or, alternatively, to provide their own fixed fee matrix. The total fees on the matrix are referred to as a bundle of fees. 22 firms confirmed agreement with the fee matrix while a further ten submitted alternatives (all proposed higher fees). The firms that accepted the NTMA proposal received full marks for the fee element of the tender while the others were scored on the basis of a pre-agreed formula.

5.32 The highest scoring firms, taking into account all the evaluation criteria, were placed on seven regional panels as shown in Figure 5.3.

Figure 5.3 Real Estate Valuation Services Panels

Regional Panels	Number of Firms	Fees per bundle
Ireland (National Coverage)	5	€31,920 (3 firms) to €40,200
Connacht	3	€31,920
Dublin and Leinster	5	€31,920
Munster	5	€31,920
Ulster	4	€31,920
Great Britain	6	€31,920 (5 firms) to €36,450
United States	4	€31,920 (3 firms) to €66,450

Source: NAMA

Legal Due Diligence Services

5.33 This competition was for appointment to a panel of legal advisors to assist NAMA in carrying out legal due diligence on the bank assets to be acquired by NAMA. The competition was advertised on the etenders website. 137 firms responded and, following consideration of the firms' ability and technical capacity to meet the specified service requirements, the evaluation group appointed 65 firms to a panel. While the firms had submitted fee proposals, these were not taken into account at the evaluation stage[66].

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65 The matrix includes nine property classifications and three value ranges, giving a total of 27 property/value classifications. Each has a set fee for a valuation – for example, the fee proposed for a multi-let investment property valued between €20 million and €100 million is €1,000, the fee for a shopping centre valued over €100 million is €2,200 while the fee for undeveloped land valued at less than €20 million is €900.

66 Firms quoted hourly rates ranging from €100 per hour (the lowest, quoted for a trainee solicitor) to €485 per hour (the highest, quoted for a senior partner) for 11 firms appointed to carry out the legal due diligence work for the first tranche.

5.34 In December 2009, the Board was informed that a panel of 67 firms had been conditionally appointed[67] to the panel of which eleven had been appointed to conduct legal due diligence work on the first tranche of loans at a rate of €1,000 per report for the Irish firms and £1,500 for the UK firms. The Head of Legal and Taxation stated that, at the time this fee was notified to the Board, it was anticipated that one report per loan would be required. In the event, due to the complex nature of some loans – for example, some reports covered a number of properties with a single loan and the quantum of work required was greater than envisaged for individual loans. These expenses will be reviewed in detail in the course of the financial audit.

Further Consultancy Procurement

5.35 During 2010, NAMA has conducted, or is conducting tender competitions for the provision of the following

- advisory services for borrower business plans (contracts awarded in May 2010)
- internal audit services
- legal services
- enforcement and insolvency services
- property management services related to enforcement and insolvency services
- a document management and workflow system
- a portfolio management system.

[67] This included two firms from the UK that had been added to the panel.

Appendices

Appendix A

European Institutions Guidance and Approvals

This appendix sets out EU rules on state aid, the guidance from the Commission and the European Central Bank on the treatment of impaired assets in the banking sector and the Commission approval for the NAMA scheme.

EU Treaty – Provisions in Regard to State Aid

Article 107 of the Treaty on the Functioning of the European Union[68] (the TFEU), sets out a general prohibition on the provision of state aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, insofar as it affects trade between Member States, as this is incompatible with the common market.

The Article exempts some categories of aid from the prohibition, stating that they are compatible with the common market including

- aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned
- aid to make good the damage caused by natural disasters or exceptional occurrences.

Article 107 (3) also provides a possible justification for state aid that is aimed at the following purposes (subject to some conditions and provisos in each case)

- aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment
- aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State
- aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest
- aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest
- such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the European Commission (the Commission).

Article 108 of the TFEU provides for the enforcement of the Article 107 state aid rules. Under Article 108(3)[69], a new state aid scheme is subject to prior approval by the Commission even if justified under Article 107(3).

Communications from the Commission and the ECB

Commission, October 2008 – the Application of State Aid Rules

In October 2008, the Commission[70] stated that, in the light of the level of seriousness that the financial crisis had reached and of its possible impact on the overall economy of Member States, it considered that Article 107 (3) was available as a legal basis for aid measures to address the systemic crisis. This applied, in particular, to aid granted by way of a general scheme available to several or all financial institutions in a Member State.

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68 Previously Article 87 in the Treaty establishing the European Community.

69 Previously Article 88 in the Treaty establishing the European Community.

70 Communication from the Commission – The application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis.

Commission, February 2009 – Treatment of Impaired Assets

In February 2009, the Commission issued guidance[71] to Member States on designing and implementing asset relief measures. The guidance noted that it had been prepared in consultation with the European Central Bank (ECB).

The Commission stated that aid for asset relief measures should comply with the general principles of necessity, proportionality and minimisation of competition distortions and that participation in an asset relief scheme should be conditioned upon clearly defined and objective criteria in order to avoid individual banks taking unwarranted advantage.

The Commission guidance also stated that effective asset relief measures should have, as a consequence, the maintenance of lending to the real economy. The Commission provided guidance in regard to

- the need for full *ex-ante* transparency and disclosure of impairments and an upfront assessment of eligible banks
- burden sharing of the costs related to impaired assets between the State, shareholders and creditors
- aligning incentives for banks to participate in asset relief with public policy objectives
- the identification of eligible assets
- valuation of eligible assets
- the management of assets subject to relief measures and procedural aspects.

Annex 5 to the Commission guidance set out the procedures to be followed by Member States for notifying the Commission of the details of an asset relief scheme. Information to be provided includes a detailed description of the valuation methodology. Commission approval would be granted for a period of six months, and conditional on presenting either a restructuring plan or a viability review for each beneficiary institution, within three months from its accession to an asset relief programme.

ECB, February 2009 – Guiding Principles for Bank Asset Support Schemes

Also in February 2009, the Eurosystem (the ECB and the Central Banks of the Member States that belong to the Eurozone) identified seven guiding principles for asset support schemes[72]

- participation by institutions should be voluntary
- the definition of eligible assets should be kept relatively broad
- the valuation of assets should be transparent
- there should be an adequate degree of risk-sharing in order to limit the cost to government, provide the right incentives to institutions and maintain a level playing field across the institutions
- the duration of the asset support schemes should be sufficiently long
- institutions that receive support should continue to be run according to business principles

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71 Communication from the Commission, on the Treatment of Impaired Assets in the Community Banking Sector, (2009/C72/01) dated 25th February 2009 (Impaired Asset Communication).

72 European Central Bank/EuroSystem, Guiding Principles for Bank Asset Support Schemes, 25 February 2009.

- it would be reasonable to condition the public support schemes to some measurable yardsticks such as commitments to continue providing credit and appropriately meet demand according to commercial criteria.

ECB, August 2009 – Opinion on the Establishment of NAMA

In August 2009, in response to a request from the Minister for an opinion on the National Asset Management Agency Bill, 2009, the ECB stated[73] that the NAMA scheme was broadly consistent with the seven guiding principles identified by the Eurosystem and welcomed that it had been designed to comply with Community state aid rules. The ECB also made two specific comments

- it understood that the role of the Governor of the Central Bank and Financial Services Authority of Ireland (Central Bank) would be exclusively limited to providing advice and opinions through consultations and would be compatible with its institutional and financial independence
- NAMA's assets would be under the effective control of the Irish State and, therefore, overdraft facilities or any other type of credit facility with the Central Bank in favour of NAMA, as well as the direct purchase from NAMA by Eurosystem Central Banks of debt instruments, would not be possible in view of the prohibition of monetary financing under Article 123[74] of the TFEU.

Commission, February 2010 – Approval of the NAMA Scheme

On 26 February 2010[75], the Commission announced that it had approved, under EU state aid rules, the establishment of the National Asset Management Agency, an impaired asset relief scheme for financial institutions in Ireland. The Commission stated that it was satisfied that the scheme was in line with its guidelines on impaired asset relief for banks that allow state aid to remedy a serious disturbance in a Member State's economy and that the scheme would help address the issue of asset quality in the Irish banking system and promote the return to a normally functioning financial market.

In its announcement, the Commission noted that

- The purpose of NAMA is to restore stability to the Irish banking system by allowing participating financial institutions to sell to the Agency, assets whose declining and uncertain value is preventing the long-term shoring-up of the financial institutions' capital.
- The scheme was open to all systemically important credit institutions established in Ireland, including subsidiaries of foreign banks, with a 60-day application window that expired on 19 February 2010.
- The assets targeted by the measure are all loans issued for the purchase, exploitation or development of land and associated loans. Following the bursting of the Irish real estate bubble, these constituted the riskiest parts of the participating institutions' asset portfolios. The Irish authorities anticipated that NAMA would purchase land and development loans

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73 European Central Bank/EuroSystem, Opinion of the European Central Bank of 31 August 2009 on the establishment of the National Asset Management Agency (CON/2009/68).

74 Referred to as Article 101 of the Treaty in the Opinion of the European Central Bank but was changed to Article 123 in the TFEU following ratification of the Treaty of Lisbon.

75 European Commission Communication: State aid N725/2009 Ireland, Establishment of a National Asset Management Agency (NAMA): Asset Relief scheme for banks in Ireland, Brussels, 26.2.2010 C(2010)1155 final.

as well as associated commercial loans with a nominal value of approximately €80 billion for an estimated purchase price of €54 billion.

- NAMA's main objective is to manage the assets expeditiously with a view to maximising their value and recovery prospects in the interest of the State.

The Commission found that the establishment of NAMA constitutes state aid to the participating institutions which is generally prohibited by Article 107(1) of the TFEU, but that this aid is compatible with EU state aid rules by virtue of Article 107(3).

The Commission stated that the scheme and intended operations of NAMA are in compliance with the guidelines set out in the Commission's Communication on the treatment of impaired assets as regards disclosure and *ex ante* transparency, eligibility of institutions and assets and the alignment of banks' incentives with public policy objectives. In particular, the Commission stated that it found that the scheme includes an adequate burden sharing mechanism through the payment of a transfer price which is no greater than the assets' long-term economic value, and the inclusion of an adequate remuneration for the State in the rate used to discount the assets' long-term economic cash flows.

The Commission stated that it viewed positively the valuation methodology which the Irish authorities intended to use to value the bank assets and found it in compliance with the requirements of the Impaired Assets Communication.

The Commission pointed out that the approval concerned only the NAMA scheme and that the Commission would assess the compatibility (and, in particular, the actual transfer price) of the transferred assets when these are separately notified by the Irish authorities.

The Commission stated that it relied on a number of commitments from the Irish authorities to ensure that NAMA, whilst it performs its goal of maximising the recovery value of the purchased assets, does not lead to distortions of competition through the use of some of the specific powers, rights and exemptions granted in the NAMA Act, 2009. The Commission stated that it will also review individual restructuring plans to ensure that the participation of the financial institutions in this measure is followed up with appropriate restructuring measures to promote the return of those institutions to long-term viability.

The Commission concluded that the introduction of an asset relief scheme for certain financial institutions in Ireland constitutes state aid within the meaning of Article 107(1) TFEU. Since this measure fulfils the requirements of Article 107(3) TFEU, as a scheme it is compatible with the internal market, with the result that the Commission raised no objections.

Appendix B

Eligibility of Applicant Banks to NAMA Scheme

This appendix sets out the factors under which the eligibility of applicant banks was assessed by the Commission in its decision of February 2010 on the Establishment of the National Asset Management Agency.

Eligibility of Applicant Banks to NAMA Scheme

In its decision of 26 February 2010[76], the European Commission stated that the Minister after consultation with the Governor of the Central Bank and the Regulatory Authority, will designate participating institutions within three months of application, based on the three following factors

- the applicant credit institution must be systemically important
- the Minister must be satisfied that the acquisition of bank assets from the applicant credit institution is necessary to achieve the purposes of the Act, having regard to the support available or received by the applicant institution, the financial position of the applicant institution and the resources available to the Minister
- the applicant credit institution must have complied with all relevant obligations under the National Asset Management Agency Act, 2009.

These three factors are set out in Annex 1 of its decision as follows

Factor 1 - Systemic Importance

In order to appreciate the systemic importance of the applicant credit institution, the Minister will first assess whether exclusion from participation will have a materially negative effect on the stability and proper functioning of the Irish financial system or the Exchequer. If the Minister concludes that an applicant credit institution qualifies under either of these factors it will be deemed systemic. Otherwise, before concluding that the institution is not deemed systemic, a marking scheme (see below) will be applied and if the institution does not score above 60%, it will not be deemed systemic.

The marking scheme is made up of the following ten sub-criteria, for which a score ranging between 1 and 10 is granted

- level of deposits in the State (1 is 0% market share, 10 is dominant market position)
- number of retail depositors in the State (1 is 0 depositors, 10 is dominant market position)
- number of customer accounts in the State (1 is 0 customer accounts, 10 is dominant market position)
- existence and scale of branch network in the State (1 is no branches, 10 is complete branch network)
- position in Irish mortgage market (1 is no market participation, 10 is dominant market position)
- position in Irish SME[77] lending market (1 is no market participation, 10 is dominant market position)
- position in other business lending market (1 is no market participation, 10 is dominant market position)
- position in Irish consumer lending (1 is no market participation, 10 is dominant market position)

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[76] European Commission decision State aid N725/2009 – Ireland, Establishment of a National Asset Management Agency (NAMA) Asset relief scheme for banks in Ireland, Brussels 26.2.2010, C (2010) 1155 final.

[77] Small and Medium Enterprises

- number of borrowers in Ireland (1 is no lending function, 10 is dominant market position)
- role played in State's payment system (1 is no role in payment system, 10 is control over the State's payment system).

Factor 2 - Available Support, Financial Position of the Institution and Resources Available to the Minister

The second assessment covers the following elements: (i) the support available to the applicant credit institution, (ii) the financial position of the applicant credit institution and its subsidiaries, (iii) the impact that a non-participation would have on the financial position of the applicant's group and (iv) the resources available to the Minister.

First, the support available to the applicant credit institution will be assessed under three categories, based on which the Minister will make a judgment following consultation with the Governor of the Central Bank and the Regulatory Authority on whether support for the institution is required

- liquidity support received, available, reasonably expected to be or have been available from (i) the Irish Government, (ii) any other Member State, and (iii) the parent company
- capital support received, available, reasonably expected to be or have been available from (i) the Irish Government, (ii) any other Member State, and (iii) the parent company
- asset relief support received, available, reasonably expected to be or have been available from (i) the Irish Government, (ii) any other Member State, and (iii) the parent company.

Second, the financial position of the applicant credit institution and its subsidiaries will be assessed based on a thorough review of financial data and stress testing. More particularly, the following elements will be reviewed - the liquidity position, the funding position, the capital position, the asset quality and risk exposures. The Minister will make a judgment following consultation with the Governor of the Central Bank and the Regulatory Authority on whether support for the institution is required.

Third, the impact that non-participation would have on the financial position of the applicant's group will be assessed based on the same above-mentioned elements, but to the extent that non-designation would impact on the applicant institution's group.

Finally, the factor to be applied by the Minister is an assessment of whether designation as a participating institution would be appropriate having regard to the resources available to him/her. Where a number of applications have been received and an assessment of the eligible assets of all applicants would result in the purchase of assets above the level of €54 billion, the threshold set out in the Act, institutions will be ranked by the Minister taking account of the assessment above. Where insufficient resources are available, and taking account of the ranking in priority, the Minister may determine either to exclude the lowest ranking institution(s) or to purchase only a proportion of assets from those institutions.

Factor 3 - Compliance with all Applicable Obligations

This is a factual assessment only.

Appendix C

Eligible Bank Asset Regulations

This appendix sets out the National Asset Management Agency (Designation of Eligible Bank Assets) Regulations, 2009 (the eligible asset regulations) which prescribe certain classes of bank assets as eligible bank assets.

National Asset Management Agency (Designation of Eligible Bank Assets) Regulations, 2009

I, BRIAN LENIHAN, Minister for Finance, in exercise of the powers conferred on me by section 69 of the National Asset Management Agency Act, 2009 (No. 34 of 2009) and having consulted with NAMA, the Governor and the Regulatory Authority, considered the purposes of NAMA and the resources available, and taken into account the matters referred to in section 69(3) of that Act, hereby make the following regulations:

Citation

1. These Regulations may be cited as the National Asset Management Agency (Designation of Eligible Bank Assets) Regulations, 2009.

Eligible bank assets

2. The following classes of bank assets are prescribed as classes of eligible bank assets for the purposes of the National Asset Management Agency Act, 2009 (No. 34 of 2009):

(*a*) credit facilities issued, created or otherwise provided by a participating institution—

> (i) to a debtor for the direct or indirect purpose, whether in whole or in part, of purchasing, exploiting or developing development land,
>
> (ii) to a debtor for any purpose, where the security connected with the credit facility is or includes development land,
>
> (iii) to a debtor for any purpose, where the security connected with the credit facility is or includes an interest in a body corporate or partnership engaged in purchasing, exploiting or developing development land,
>
> (iv) to a debtor for any purpose, where the credit facility is directly or indirectly guaranteed by a body corporate or partnership referred to in subparagraph (iii), or
>
> (v) directly or indirectly to a debtor who has provided security referred to in subparagraph (ii) or (iii), for any purpose;

(*b*) credit facilities issued to, created for or otherwise provided to, directly or indirectly, a person who is or was at any time an associated debtor of a debtor referred to in paragraph (*a*), whether by a participating institution to which the debtor is indebted or by another participating institution;

(*c*) credit facilities (other than credit facilities referred to in paragraph (*a*) and credit cards) issued to, created for or otherwise provided to, directly or indirectly, debtors referred to in paragraph (*a*) for any purpose;

(*d*) any security relating to credit facilities referred to in paragraphs (*a*) to (*c*);

(*e*) shares or other interests, or options in or over shares or other interests, in the debtors referred to in paragraph (*a*), in associated debtors referred to in paragraph (*b*) or in any other person, which the participating institution acquired in connection with credit facilities referred to in paragraphs (*a*) to (*c*);

(*f*) other bank assets arising directly or indirectly in connection with credit facilities referred to in paragraphs (*a*) to (*c*) or security referred to in paragraph (*d*), including—

(i) a contract to which the participating institution is a party or in which it has an interest,

(ii) a benefit to which the participating institution is entitled, and

(iii) any other asset in which the participating institution has an interest;

(*g*) financial contracts, including financial contracts within the meaning of section 1 of the Netting of Financial Contracts Act 1995, that relate in whole or in part to bank assets specified in paragraphs (*a*) to (*f*), but not including financial contracts between a participating institution and a credit institution or between a participating institution and a financial institution (within the meaning of the Central Bank Act 1997).

23 December 2009

BRIAN LENIHAN,

Minister for Finance

Appendix D

Asset Valuation Regulations

This appendix sets out the National Asset Management Agency (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations, 2010 (the asset valuation regulations) which specify how the long-term economic value of property and associated loans should be derived.

National Asset Management Agency (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations, 2010

I, BRIAN LENIHAN, Minister for Finance, in exercise of the powers conferred on me by sections 75, 76 and 79 of the National Asset Management Agency Act 2009 (No. 34 of 2009) ("the Act"), having had regard to the laws of the European Communities governing state aid and the other matters referred to section 79(2) of the Act, hereby make the following regulations:

Citation

1. These Regulations may be cited as the National Asset Management Agency (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations 2010.

Definitions

2. (1) In these Regulations—

"class", in relation to land, means any class of land that is differentiated by reference to any characteristic or combination of characteristics of the land, including the type of land, the purpose for which the land is used and the location of the land;

"relevant period" means the period that began on 1 January 1985 and ended on 31 December 2005.

(2) For the purposes of these Regulations—

(*a*) the NAMA 3-year discount rate, for bank assets denominated in euro or any other ` currency, is 4.54 per cent (which includes a risk margin of 1.7 per cent),

(*b*) the NAMA 5-year discount rate, for bank assets denominated in euro or any other currency, is 5.57 per cent (which includes a risk margin of 1.7 per cent), and

(*c*) the NAMA 8-year discount rate, for bank assets denominated in euro or any other currency, is 6.16 per cent (which includes a risk margin of 1.7 per cent).

Long-term economic value of property other than land

3. The long-term economic value of property other than land shall for all purposes be its market value at a date specified by NAMA.

Long-term economic value of land

4. In determining the long-term economic value of land under section 76 of the Act, NAMA shall use or apply the adjustment factor it derives by reference to such of the matters specified in Regulation 5 or 6, as the case may be, as it considers appropriate.

Land located in State

5. (1) The adjustment factor for land located in the State shall be derived by NAMA in accordance with these Regulations in such manner as it thinks fit, by reference to such of the following as it considers relevant:

(*a*) the difference, as determined by NAMA, between—

(i) the prices or yields of land located in the State on the valuation date, and

(ii) the prices or yields of land located in the State over the relevant period as determined by reference to such of the bulletins and indices specified in Schedule 1 and such other similar relevant bulletins and indices as NAMA may consider appropriate in the circumstances;

(*b*) the correlation, in the relevant period, as determined by NAMA in accordance with paragraph (2)—

(i) between land prices and demographic variables relating to the State,

(ii) between land prices and interest rates in the State, and

(iii) between land prices and the State's gross domestic product;

(*c*) projections of land prices, demographic variables, interest rates, other relevant variables and the State's gross domestic product referable to any period or periods that end on a day or days not later than 7 years after the valuation date, which are made by the bodies mentioned in paragraph (2) and which were made available to NAMA on or after 21 December 2009 but not later than 10 January 2010; and

(*d*) data and analyses referred to in the following sub-subparagraphs, which were provided to NAMA by the persons specified in those sub-subparagraphs on or after 21 December 2009 but not later than 10 January 2010:

(i) data and analyses on the extent to which existing land zoning and planning permissions granted and in force meet or exceed projected growth requirements in the State, which are provided by the Minister for the Environment, Heritage and Local Government;

(ii) data and analyses on existing and future transport planning and the associated supply and demand projections for land use, which are provided by the Minister for Transport, or the Dublin Transportation Office or an appropriate national transportation authority; and

(iii) data and analyses in relation to the potential rise in energy and other costs due to the long-term decline in non-renewable resources, which are provided by the Minister for Communications, Energy and Natural Resources.

(2) In determining the correlation for the purposes of paragraph (1)(*b*), NAMA shall have regard to such of the data and analyses as it considers appropriate and which were available to NAMA on or after 21 December 2009 but not later than 10 January 2010, and as are prepared by any or all of the following:

(a) Central Statistics Office;

(*b*) Economic and Social Research Institute; and

(*c*) Central Bank and Financial Services Authority of Ireland.

Land located in state other than the State

6. (1) The adjustment factor for land located in a state other than the State shall be derived by NAMA in accordance with these Regulations in such manner as it thinks fit, by reference to such of the following as it considers relevant:

(*a*) the difference, as determined by NAMA, between—

(i) the prices or yields of land located in the state concerned on the evaluation date, and

(ii) the prices or yields of land located in that state over the relevant period as determined by reference to such of the published bulletins and indices specified in Schedule 2, and such other similar relevant bulletins and indices, as NAMA may consider appropriate in the circumstances;

(*b*) the correlation, in the relevant period, as determined by NAMA in accordance with paragraph (2)—

(i) between land prices and demographic variables relating to the state in which the land is located,

(ii) between land prices and interest rates in that state, and

(iii) between land prices and that state's gross domestic product; and

(*c*) data and analyses which were provided to NAMA on or after 21December 2009 but not later than 10 January 2010, by the Minister for Communications, Energy and Natural Resources in relation to the potential rise in energy and other costs due to the long-term decline in non-renewable resources.

(2) In determining the correlation for the purposes of paragraph (1)(*b*), NAMA shall have regard to such of the data and analyses as it considers appropriate, and which were published, on or after 21 December 2009 but not later than 10 January 2010, by any official national bodies equivalent or comparable to those specified in Regulation 5(2) of the state in which the land is located, and any other equivalent bodies, as NAMA may consider appropriate in the circumstances.

Determination of long-term economic value of bank assets

7. In calculating the long-term economic value of a bank asset—

(*a*) where the bank asset is a bank asset for which the security is land for which the adjustment factor is less than or equal to 10 per cent of the land's value, NAMA shall take into account the projected cash flows of the bank asset over a period of 3 years using the NAMA 3-year discount rate,

(*b*) where the bank asset is a bank asset for which the security is land for which the adjustment factor is more than 10 per cent of the land's value but less than or equal to 15 percent of that value, NAMA shall take into account the projected cash flows of the bank asset over a period of 5 years using the NAMA 5-year discount rate,

(*c*) where the bank asset is a bank asset for which the security is land for which the adjustment factor is more than 15 percent of the land's value but less than or equal to 25

per cent of that value, NAMA shall take into account the projected cash flows of the bank asset over a period of 8 years using the NAMA 8-year discount rate,

(*d*) where the bank asset is a bank asset for which the security is land which is cash flow producing in accordance with its contractual terms, and the market value of the land is greater than the balance outstanding on the credit facility concerned, NAMA shall take into account the projected cash flows of the bank asset during a period that ends on the bank asset's maturity date, or over a period of 8 years, whichever is the lesser period, using whichever of the NAMA 3-year, 5-year and 8-year discount rates corresponds most closely, in NAMA's opinion, to the maturity period of the loan, and

(*e*) NAMA may take into account such of the following as it considers relevant:

(i) the long-term economic value of property;

(ii) the net present value of the anticipated income stream associated with bank assets of the same kind as the bank asset concerned;

(iii) if the bank asset concerned is secured in whole or in part, by rental property, current and projected vacancy rates;

(iv) loan margins;

(v) the mark-to-market value of any derivative contracts associated with bank assets of the same kind as the bank asset concerned;

(vi) any ancillary security such as personal guarantees and corporate assets;

(vii) fees reflecting the costs of loan operation, maintenance and enforcement.

Standard discount rate

8. The standard discount rate that NAMA shall apply in the calculation of the long-term economic value of all bank assets is 5.25 per cent (made up of 5 per cent to provide for enforcement costs, and 0.25 per cent to provide for due diligence costs, incurred or likely to be incurred by NAMA over its lifetime in the discharge of its functions).

Prescribed fractions for the purposes of section 76(2) of the Act

9. (1) For the purposes of section 76(2)(*a*) of the Act, the fraction by which the long-term economic value determined by NAMA for a parcel of land shall not exceed its market value is one-quarter.

(2) For the purposes of section 76(2)(*b*) of the Act, the fraction by which the aggregate of the long -term economic value of all land valued in connection with the acquired portfolio of each participating institution shall not exceed the aggregate of the market values of that land is one-fifth.

Revocation

10. The National Asset Management Agency (Determination of Long-Term Economic Value of Property and Bank Assets) Regulations 2009 (S.I. No. 546 of 2009) are revoked.

SCHEDULE 1

- SCS/IPD Irish Quarterly Property Index except for the years 2005 to 2008.
- Department of the Environment Housing Statistics Bulletin, except for the years 2005 to 2008.
- JLL Irish Property Index except for the years 2005 to 2008.

SCHEDULE 2

Location of Property	Bulletins and Indices
Great Britain or Northern Ireland	Nationwide House Price Indices Including Northern Ireland Halifax House Price Indices including Northern Ireland IPD Monthly Index UK All Sectors Land Registry House Price Index
United States of America	Case – Shiller Home Price Index NECREIF Property Index Moodys/REAL Commercial Property Price Index FTSE NAREIT US Real Estate Index Historical Values and Returns
Europe, except for the State, Great Britain and Northern Ireland	EPRA Index IPD Pan European Index Any equivalent document published in the relevant place or regarding that place
Any other place	Any equivalent document published in the relevant place or regarding that place

3 March 2010

Brian Lenihan

Minister for Finance

Appendix E

NAMA Structure

This appendix sets out the NAMA group structure, the interrelationship of the entities and the taxation arrangements.

NAMA Group Structure

The purpose of each company within the NAMA group is set out below. The group structure is graphically outlined in Figure 1.2 (Chapter 1). A number of the companies are what are styled section 110 companies.

The key drivers of the structure are

- the need to comply with Eurostat requirements for the debt issued to purchase loans from the participating institutions to be regarded as outside the general government sector
- the need to ensure that distributable reserves are available to the maximum extent in order to meet dividend payments to the private investors
- the desire to conduct the overall operations on a tax exclusive basis to the extent possible.

NAMA Tax Liabilities

NAMA is exempt from Irish Corporation tax and any surplus that it earns over its lifetime will be paid to the State. However, majority privately owned entities are not exempt from Irish Corporation Tax. The rationale for a majority privately owned entity to issue the debt to purchase the loans is to ensure that debt issued to purchase eligible bank assets is not treated as part of the national debt. While the subsidiary structure is fully taxable, it is structured to maximise the retention of income within the group through limiting exposure to taxable events. This will, to the extent that the group makes taxable profits, reduce the requirement for funding by the State or for the group to issue debt to raise funds. The structure that NAMA has put in place has been approved by the Revenue Commissioners.

One of the mechanisms used to minimise tax exposure is the use of what are referred to as Section 110 companies. National Asset Management Ltd, National Asset Management Group Services Ltd and National Asset Loan Management Ltd are Section 110 companies.

Section 110 Companies

Section 110 refers to the Taxes Consolidation Act, 1997 under which "qualifying companies" are entitled to specific tax treatment. A qualifying company is one whose business is to hold and manage qualifying assets (which include shares and collateralised loans) and which, apart from activities ancillary to that business, carries on no other activities.

The principal tax benefits that accrue to a qualifying company are

- As interest incurred can be deducted as a tax expense, the company can be structured in such a way that income and expenditure are equal and that no tax liability arises. This is achieved through the parent (or sister) company making a 'Profit Participating Loan' to the Section 110 company. The interest on this loan will be tax deductible for the Section 110 company and designed to ensure that the Section 110 company makes no taxable profits. The interest paid is taxable in the hands of the recipient so, for the establishment of a Section 110 company to make economic sense, the recipient must have no tax liability on the interest paid. If a Section 110 company makes taxable profits, these are subject to Corporation Tax.
- In common with all Irish resident companies generally, a Section 110 company may receive interest from abroad without deduction of withholding tax provided that Ireland has a Double Tax Treaty with the other country.

National Asset Management Agency Investment Ltd

This company facilitates making a return by way of dividend to private investors

National Asset Management Agency Investment Ltd facilitates the participation of private investors. It will earn interest income on a loan it has made to National Asset Management Ltd. This interest, which will be subject to corporation tax, provides the income to enable it to pay a dividend to the private investors. The interest earned will have to be sufficient to pay both the tax and the dividend.

National Asset Management Ltd

This company creates debt securities and subordinated debt to transfer to the participating banks as consideration for the loans.

National Asset Management Ltd is a Section 110 company and is the entity which is creating the debt securities and subordinated debt which are transferred to the participating institutions in return for the loans. The assets of National Asset Management Ltd are the shares that it holds in the other subsidiaries. Through the use of Profit Participating Loans, it will receive any profits from the Section 110 subsidiary (National Asset Loan Management Ltd) in the form of interest. NAMA (the State body) will have a Profit Participating Loan with National Asset Management Ltd under which it will receive any surplus of National Asset Management Ltd and which it will ultimately pay to the exchequer.

National Asset Loan Management Ltd

This company acquires the loan assets from the participating banks.

National Asset Loan Management Ltd is also a Section 110 company. This entity acquires the loan assets from the participating banks. To the extent that the loans are performing and cash generating, interest income will be earned by this company. Under a Profit Participating Loan any profit earned in National Asset Loan Management Ltd (interest earned on loans less interest paid on debt) will be paid to the National Asset Management Ltd.

National Asset Loan Management Ltd cannot carry on any activities ancillary to holding and managing the loans. It cannot, therefore, hold properties that NAMA acquires following enforcement proceedings against a borrower. Any properties acquired by National Asset Loan Management Ltd through enforcement proceedings will be sold to National Asset Property Management Ltd. Consideration for the properties will not be paid by National Asset Property Management Ltd but will be left outstanding (as a loan from the Loan Management Company to the Property Company) until disposal of the properties transferred to it.

National Asset Property Management Ltd

This company holds property acquired after enforcement of security.

National Asset Property Management Ltd will acquire property from National Asset Loan Management Ltd arising from enforcement proceedings. The Property company will manage the properties in accordance with strategies adopted by the Board of NAMA.

There are no special tax considerations applying to this company. Any profits it earns will be subject to corporation tax and will be distributed to its shareholder (National Asset Management Ltd).

National Asset Management Services Ltd

This is an administrative company through which expenses will be paid.

National Asset Management Services Ltd is an administrative company through which all expenses will be charged. It will not own either loan or property assets and should not make any profits.

National Asset Management Group Services Ltd

The company, National Asset Management Group Services Ltd, was put in place prior to NAMA finalising its operating structure and it does not, under the current structure, have a function.

Interrelationship of NAMA Group Entities

National Asset Management Agency Investment Ltd has share capital of €100 million, of which private investors[78] subscribed €51 million and NAMA €49 million. National Asset Management Ltd[79], a subsidiary of National Asset Management Agency Investment Ltd, is the company that issues the securities and subordinated debt to pay for the loans.

Under a shareholders' agreement between NAMA and the private investors, dated 29 March 2010, NAMA has a veto over the activities of National Asset Management Agency Investment Ltd (and, therefore, its subsidiaries). The agreement states *inter alia* that *"each of the private investors agrees, as a fundamental term of its entering into the agreement that the company shall, in accordance with its Memorandum of Association, act in the furtherance of NAMA as described in the Act, and that no action shall be taken by the company or any subsidiary (or be omitted to be taken by the company or any subsidiary) where NAMA has notified the company in writing that it considers (acting in its sole discretion) that such action or omission may not be in the interests or pursuant to the objectives of NAMA or the State or may adversely affect the financial interests of the State."*

National Asset Management Agency Investment Ltd has lent €99.9 million[80] to National Asset Management Ltd in an agreement effective from 31 March 2010. The interest on the loan is at a fixed rate of 4% per annum. The interest provides the income from which National Asset Management Agency Investment Ltd pays a dividend to the investors. The shareholders agreement provides that the aggregate amount of dividends or other cash payment in the form of a distribution in respect of any financial year will not exceed the paid up share capital multiplied by an interest rate capped at the 10-year Irish Government Bond yield applicable at the date the dividend or distribution is declared.

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78 Each of the following invested €17 million, Irish Life Assurance plc, New Ireland Assurance Company plc, AIB Investment Managers Ltd each.

79 Sometimes referred to as the Master SPV (Special Purpose Vehicle).

80 As per loan agreement dated 31 March 2010, between National Asset Management Agency Investment Limited and National Asset Management Ltd, the borrower (National Asset Management Ltd shall not borrow more than €99.9 million from National Asset Management Agency Investment Ltd.

The shareholders' agreement provides for an exit mechanism for the private investors. NAMA has purchased an option (at a cost of €1 per investor) which it must exercise within a six-month period commencing on the tenth anniversary of the date of the agreement, to purchase the private investors shares at a cost equal to the paid up share capital plus 10%.

The remaining four companies are subsidiaries of National Asset Management Ltd.

While National Asset Management Ltd and its subsidiaries are the entities to which the costs of running NAMA will be charged and to which the revenues will accrue, NAMA will carry out almost all of the work (including through the use of subcontractors) of the Special Purpose Vehicles under a Services Agreement between it and National Asset Management Ltd. NAMA will be reimbursed by National Asset Management Ltd, or its subsidiaries, for the cost of the services provided.

Appendix F

Post-Acquisition Loan Management

This appendix sets out the arrangement for managing NAMA's relationship with the borrowers whose loans have been acquired.

Post-Acquisition Loan Management

When NAMA acquires a loan, the borrower continues to owe NAMA the full balance of the loan at the date of acquisition by NAMA. NAMA requires each borrower to provide a detailed business plan setting out how the borrower intends to repay the amounts due.

NAMA has provided borrowers with a template for the business plans. Information to be provided includes

- an executive summary including details of all loans, a repayment plan, details of the underlying properties, cash requirements, refinancing schedules and other cash generating options that are available to the debtor
- detailed financial information including, for example, the level of indebtedness to non-NAMA banks. Borrowers are requested to provide information e.g. projected cash flows for at least a three-year period.
- market analysis of each of the sectors in which they hold property
- corporate overview including details of subsidiaries and partial holdings of the borrower
- details of management and employees including details of any lending by the borrower and related entities to officers, directors and key employees of the borrower and details of pension funds owned by or managed for the borrower
- legal considerations including a detailed legal structure chart for the borrower, including any holding companies, all wholly and partially owned subsidiaries and holdings in other structures such as joint ventures, consortiums and partnerships, if any, and
- other information which should be considered and reviewed in order to adequately disclose the borrower's repayment plan to NAMA and its business, assets, liabilities, prospects, financial condition or results of operations.

In May 2010, NAMA appointed a panel of 38 firms to review and evaluate the business plans. The Board has approved a detailed template setting out the information that the reviewers should include in their reports. The reviewers are asked to include their recommended actions for NAMA to meet its objectives relating to recovery of NAMA borrower loans including

- overall considerations and recommendations
    - recommended immediate, medium and long term actions to protect NAMA's interests and to optimise and expedite the recovery of NAMA loans
    - recommendations in respect of imminent funding requirements and cash flows
    - resource implications for NAMA (e.g. those relating to ongoing monitoring and/or insertion of NAMA supervisor(s) into the business).
- on a property-by-property basis (or property sub-group, if meaningful) and/or, on an entity-by-entity basis if this favours value preservation, to present the following to the extent relevant
    - a recommended action and reasoning
    - discussion and evaluation of any relevant cash generating options considered and the reason for their rejection or acceptance, including the cash implications of each option
    - the implications for NAMA of enforcing security (including risks, potential outcomes and recommendations for security enforcement)
    - the implications of debt hierarchy and/or disturbance of tax structures on NAMA's entitlement to recover disposal proceeds from enforcement

- matters identified that NAMA should raise with their other advisors (e.g. existing legal matters, complex tax structures shared with borrowers or pending creditor actions etc.).

Decisions on the recommendations are made at the appropriate level in NAMA, depending on the borrower's total exposure and whether or not new funds have been requested, in accordance with authorities approved by the Board. These are set out in Figure F.1 below.

Figure F.1 Borrower Business Plans – Delegated Authorities

	Approval Threshold (Total borrower exposure)	
Authority Level	**New lending to borrower[a]**	**Restructuring – no new lending to borrower**
	€ millions	**€ millions**
Board	>75	>500
Credit Committee	35 – 75	250 – 500
CEO NAMA and Head of Credit and Risk	15 – 35	100 – 250
Two Senior Managers[b]	7.5 – 15	35 – 100
Two Senior Managers[c]	1 – 7.5	20 – 35
Participating Banks [d]	<1	<20

Source: NAMA

Notes:

a The lower of the threshold specified or 10% of a borrower's total exposure to NAMA when the loans were acquired.

b One of the senior managers must be the CEO or the Head of Credit and Risk. The other may be the Head of Portfolio Management or the Head of Lending.

c One of the senior managers must be a senior credit manager. The other may be a senior portfolio manager or a senior lending manager.

d This authority will not be delegated until a credit policy for participating banks for the loans that they will manage on behalf of NAMA has been approved by the Board.

Options Available to NAMA

Among the options available to NAMA following consideration of a business plan are

- doing nothing in circumstances where a borrower is able to make scheduled payments and is not seeking further funding
- continuing to support a borrower through further lending to bring projects to completion or
- taking enforcement proceedings.

In circumstances where NAMA is successful in enforcement proceedings against a borrower, NAMA will take control of the underlying properties.

The guidance issued by NAMA in relation to Business Plans of borrowers is set out at Annex A to this Appendix.

Annex A

NAMA Debtor Business Plan Requirements

The purpose of this document is to provide consistent instruction to debtors in respect of the Debtor Business Plan (the “Business Plan”) that debtors are required to submit to NAMA within a timeframe defined by NAMA.

The primary purpose of the Business Plan and the accompanying Datapack (the “Datapack”) is

- to present a complete account of each Debtor’s financial affairs; and
- to provide a detailed plan of how and when all Debtor liabilities to NAMA will be redeemed.

The instructions prescribe subject areas that must, at a minimum, be included in the Business Plan and describe the key information and explanations that must be included in each area.

In addition, the appendix accompanying these instructions contains a 'Datapack' guidance template of the detailed financial analyses / schedules required to support the Business Plan.

This is not intended to be exhaustive, and therefore debtors should include other information which, in their judgment, is significant with respect to any portion of the business of the Debtor or which should be considered and reviewed in order to adequately disclose the Debtor's business, assets, liabilities, prospects, financial condition or results of operations.

The preparers of this Business Plan should also note important practical guidance regarding delivery format and logistics which are set out on the back page of this document.

The Business Plan will be reviewed by NAMA and its advisors and will be relied upon. Decisions made by NAMA regarding a Debtor may partially or wholly be based upon the Business Plan. The Business Plan should be completed in utmost good faith with full disclosure of all facts, assumptions and issues likely to influence NAMA in reaching a decision on a course of action regarding a Debtor.

Contents

Section 1: Executive Summary

Section 2: Financial Information

Section 3: Market Analysis

Section 4: Corporate Overview

Section 5: Management and Employees

Section 6: Legal Considerations

Section 7: Other

Business Plan Requirements Guidance Note

Section 1: Executive Summary

As per the guidance notes, the information in this section must be consistent with that presented in the Datapack.

1.1 Summary schedule of all current Debtor lending facilities by property / development analysed by loan (specifying NAMA and non-NAMA facilities), from all sources.

1.2 A summary NAMA full repayment plan setting out

- Key actions necessary to fully repay NAMA; and
- An aggregated expected quarterly repayment schedule for a minimum of three years, (analysed between NAMA and non-NAMA facilities).

1.3 Business Plan summary, to include

- Property description (tenure, use, size etc);
- Where the property is a development site, an overview of the proposed scheme (size, costs, values etc);
- Property exit/disposal strategy, including timescale;
- Cost benefit analysis of strategy including identification of key risks and dependencies;
- Ranking of properties based on their suitability for completion, future hold or sale and any other factors that are considered pertinent to ensuring the recovery of relevant outstanding borrowings for NAMA; and
- Current and expected management involvement, including management incentivisation.

1.4 Cash requirement highlights, to include

- Summary of the current cash position;
- Any new monies to be provided from third party sources (including those under any committed facilities);
- Any money to be paid out, including in relation to any proposed or newly established joint ventures or other entity structures (including those committed to but not yet established);
- Summary and description of any short, medium or long term cash needs, including potential timescale and quantification of such needs;
- Peak borrowing requirement for base case, including requirement(s) for any new monies (and timing); and
- Details of any proposed amendment of debt terms including conversion/amendment of terms to the extent that borrowings cannot be repaid.

1.5 Short, medium and long-term asset / property disposal and refinancing schedule.

1.6 Summary to be provided, describing all cash generating options, other than NAMA, that are available to the Debtor, including reasons for their rejection/acceptance.

Section 2: Financial Information

The Datapack forms an integral part of this financial section and will be reviewed as part of the Business Plan. All information included in this section must be consistent with that presented in the Datapack. Three years of projected financial information are required. You may include further years if you so choose. In addition, you should prepare the projected financial information under a base case scenario and under one downside and one upside scenario.

2.1 For each property, provide an expected repayment schedule by lending facility on a quarterly basis, (split between NAMA and non-NAMA facilities).

2.2 Commentary on a property-by-property basis. Information to include

- Full property address
- Classification by property type (refer to Appendix 1)
- Tenure
- Property location and description
- An opinion as to whether the property is in a prime/secondary or tertiary location
- Detail of any leases if the property is occupied, details of holding costs if the property is vacant
- Planning history including details of current consent, any applications awaiting determination and any boundary disputes
- Details of any litigation pending or in progress and quantification
- If the property comprises of a development opportunity also include details of
    - The proposed development including floor area schedule of scheme
    - Any site/construction works undertaken to date
    - Development costs (itemised) including the value of any work in progress
    - Gross development value including details of any prelets or forward sales
    - Timescale to completion
- Disposal/exit strategy including
    - Cost benefit analysis of any expenditure required
    - Key risks and dependencies upon which the strategy is predicated, (including those that are beyond the control of the developer)
    - Timescale to exit; and
    - Projected realisation at exit.

2.3 If the property asset comprises of a development site, provide a residual appraisal, including cashflow for a minimum of three years. If the property asset comprises of a property investment, provide investment valuation, including cashflow for a minimum of three years. In addition, provide a list of valuation assumptions and rationale.

2.4 Provide details of any new monies to be provided (as set out in 1.4), including counterparty, status of negotiations, nature of investment, etc.

2.5 Provide details of intra-group funding arrangements and any proposed changes to these.

2.6 Description of any and all contingent liabilities, including cross guarantees.

2.7 Details of any existing covenant breaches split between NAMA loans and non-NAMA loans. (Use the template provided in *Section 5 of the Datapack* and provide any additional commentary here).

2.8 Commentary on the loan by loan covenant compliance calculations for both NAMA and non-NAMA loans, based on existing covenants (as per *Section 5 of the Datapack*).

2.9 Provide a summary of any current loan defaults, including quantum of the default, the date(s) it occurred and actions taken to remedy the default.

2.10 Extent of current creditor pressure, including a schedule of the top 10 creditors and commentary on relationship and position with each one and on any other creditor with whom you are currently experiencing any difficulties.

2.11 Provide a summary table of Group results for the two years up to the date of the latest available accounts (whether audited or unaudited) and projections for the following three years, and provide commentary on the underlying group assumptions used to prepare this and the other financial information in *Section 1 of the Datapack*. For the avoidance of doubt, all interest and fees should be modelled in accordance with existing lending terms. All information shown here should be consistent with that presented in the Datapack.

2.12 Overview of key accounting policies, including hedging, and details of interest rate and foreign exchange hedging strategy to date and going forward.

2.13 Taxation

- Have all tax returns and tax payments been filed/made by the required deadlines over the last three years? If not please explain;
- Details of any ongoing audits, investigations or disputes with the tax authorities in the Republic of Ireland or any other jurisdiction and a high-level quantification of potential exposures. This should include any areas of possible dispute/investigation with the Revenue authorities of which management are aware but which has not yet commenced as well as a high-level quantification of the potential risk involved; and
- The tax assumptions used in the preparation of the projections. This may include the use of losses or particular reliefs which reduce the projected tax liability.
- Details of any properties ‘resting on contract’ (i.e. impending stamp duty liability), inherent or rolled up CGT liabilities, SPVs (Special Purpose Vehicles), off-shore vehicles or other structuring arrangements entered into, that could impact on the saleability of individual properties or on the ultimate sales proceeds that would be realisable on a change of ownership.
- Indicate if your projections include all potential VAT liabilities, including any implications relating to capital goods schemes.

Section 3: Market Analysis

This information should be consistent with that presented in the Datapack.

3.1 Local market analysis for the relevant market sectors of each of your property locations, including identifying competing properties/schemes and comparing and contrasting the properties and their pricing.

3.2 Comment on occupier demand (strength of demand, incentives, voids, vacancy rates, sales rates etc).

3.3 Provide comparable evidence, where appropriate, of rents, yields and capital values to back up residual appraisal/investment valuation provided in section 2 above.

3.4 Comment on enhancement potential and active management proposals to maintain/enhance value.

3.5 Comment on the attractiveness of the property to the market both now and in the future.

3.6 Clearly state all assumptions used in your projections, their source and the rationale for their use.

Section 4: Corporate Overview

4.1 Provide a detailed company overview, including an overview of your company strategy and a description of all activities undertaken by the Debtor not covered under Section 2 above.

4.2 A detailed operational structure/chart for the Debtor indicating how you manage and monitor your business. Note any areas of your structure/operations where there are known weaknesses, current plans to address these and any other changes or restructuring that is planned.

4.3 A schedule of all subsidiaries and partial holdings of the Debtor (consistent with legal structure specified at (6.1). The schedule should indicate the percentage ownership by the Debtor and, to the extent any subsidiary or other entity is not wholly owned, provide the names and percentage ownership interests for each other stockholder of such subsidiary or entity. The schedule should include a description of the role of the other stockholder(s) in the management or development of the property; indicate whether the other stockholder(s) is/are a related party to the Debtor; and detail any disputes between the Debtor and other stockholders.

Section 5: Management and Employees

5.1 A list of the Management Team, Board of Directors, and Investment Committee, if any, indicating relevant track record, roles and primary responsibilities of all members of the management team.

5.2 Details of any personal guarantees given on NAMA and non-NAMA related facilities.

5.3 Details of any transfers (including sale) of Group assets out of the Group entities that were undertaken during the past three years to the benefit of the Ultimate Beneficial Owner(s) (UBO) or their related parties.

5.4 Details of any lending by the Debtor and related entities to officers, directors and key employees of the Debtor.

5.5 Details of any borrowings by officers, directors, key employees and family and friends of the Debtor that are guaranteed by, or secured against assets of the Debtor.

5.6 Details of any personal tax refunds, personal income and other gains applicable to the UBO, including his/her family and friends.

5.7 Details of pension funds owned by/managed for the Debtor, the UBO, including his/her family and friends.

Section 6: Legal Considerations

6.1 A detailed legal structure chart for the Debtor, including any holding companies, all wholly and partially owned subsidiaries and holdings in other structures such as joint ventures, consortiums, partnerships etc, if any. The chart should list the correct legal name of entity, the entity number assigned in the Datapack, its jurisdiction of incorporation and ownership percentage, incorporating the ultimate beneficial owner and related entities.

6.2 All security (including, but not limited to: debentures, mortgages/charges and guarantees) the Debtor and related entities have granted, and the parties to whom they have granted such security. This information should be mapped onto the legal structure chart referenced above.

6.3 A schedule of each jurisdiction in which the Debtor conducts business and where companies incorporated in such jurisdictions are used, evidence of due incorporation/registration in that jurisdiction, together with (if available) any legal opinions confirming the ability of such companies to grant security.

6.4 Details of any insolvency or similar proceedings that have already commenced, or are expected to commence or have been threatened with regard to the Debtor, any holding companies, its subsidiaries/related entities or any of its shareholders or directors. Whether any advice has been sought with regard to the above (either legal or insolvency specific).

6.5 Details of any court judgments registered against any entity set out on the legal structure chart.

Section 7: Other

7.1 Any other documents or information which, in your judgment, are significant with respect to any portion of the business of the Debtor or which should be considered and reviewed in order to adequately disclose the Debtor's repayment plan to NAMA, business, assets, liabilities, prospects, financial condition or results of operations.

Business Plan Requirements Guidance Note

A Business Plan presentation standards

- The front cover should include the following information
  - (i) Debtor name and Ultimate Beneficial Owner
  - (ii) Debtor ID (as issued by NAMA)
  - (iii) Publication date of Business Plan
  - (iv) Version number
  - (v) Name (first and last name in full) and contact details (direct dial and email address) of the key contact for queries regarding the Business Plan and Business Plan Datapack (the "Datapack")
- Include a contents page
- Include your Debtor name and ID number in the header on every page
- Please present all information in Euros noting the base currency, base currency balance and exchange rate used where balances have been translated into Euros
- Each section should commence on a new page.

B Photographs and site/development plans should be provided on a separate CD and should not be included in the Business Plan, unless specifically required.

C All information included in the Business Plan must be consistent with that included in the Datapack, unless otherwise specified.

D If you are unable to provide any of the information requested, detail the reasons. If not applicable detail the reasons.

- For queries regarding this guidance or any other matters related to the Business Plan or Business Plan Datapack send an email to namapm@nama.ie.
- Delivery of finished Business Plan and Datapack to NAMA:

  Four, double sided, A4 bound copies of the Business Plan, printed in colour, should be sent via recorded delivery to: Business Plan Review Team. NAMA, Treasury Building, Grand Canal Street, Dublin 2.

The term 'Debtor' has the meaning ascribed to it in the National Asset Management Agency Act, 2009.

The term 'Group', insofar as it relates to a Debtor, includes all entities wherever resident, whether wholly or partly owned, that share the same Ultimate Beneficial Owner ("UBO") as the Debtor.

The term 'Ultimate Beneficial Owner' has the meaning and intent commonly ascribed to it under anti-money laundering provisions. It is therefore intended to look through trusts, trustees, fund structures, joint ventures, partnerships, connected and related parties and similar, to identify the ultimate controlling beneficiary(ies).

The term 'NAMA loans' is used to refer to loans to debtors by participating institutions, while 'non-NAMA loans' is used to refer to loans to debtors by non-participating institutions.

Appendix G

Legal Review

This appendix sets out the summary section of the legal due diligence report provided by participating banks and the certificate and warranty provided as part of those certificates.

NAMA - PARTICIPATING INSTITUTION DUE DILIGENCE REPORT
COMMENCEMENT SECTION

EXECUTIVE SUMMARY	
Participating Institution:	
Loan Reference No:	
Borrower:	
Property (the "Secured Property"):	
Individual Responsible for overseeing Report[81]:	
Firm of solicitors advising Participating Institution in preparing report:	
1.	**LOAN AND SECURITY SECTION:**
1.1 Executive Summary[82]: (a) Loan Facility (b) Hedging (c) Security	
(i) (ii) (iii) (iv)	

[81] Officer of Participating Institution.

[82] Insert details of all loan and security documents under headings below.

	(d)	Inter-lender Arrangement
	(e)	Limitations on Recourse
	1.2	Material Disclosures: (a) Loan/Interest Default (b) Security Default (c) Other disclosures such as defects/flaws in security held.
2.	**PROPERTY AND CONSTRUCTION SECTION**	
	2.1	Executive Summary[83]:
	2.2	Material Disclosures: [Resting in Contract must be disclosed]

[83] Include details of the property category, the current and proposed use, status of any development and the title structure.

CERTIFICATE AND WARRANTY OF PARTICIPATING INSTITUTION:

IT IS HEREBY CERTIFIED, WARRANTED AND REPRESENTED by *[insert name of Participating Institution]* to the National Asset Management Agency that:-

1. The disclosure(s) set out at Section 1.2 of the Commencement Section are conclusive in respect of all matters that might materially affect, or that might reasonably be expected to materially affect, the decision of the National Asset Management Agency to acquire the eligible bank asset(s) the subject matter of this Report, or the determination of the acquisition value of such eligible bank asset(s), for the purpose of section *[78(7)]* of the National Asset Management Agency Act 2009. Save for such disclosure(s), the loan and security documents specified at 1.1 in the Commencement Section above (the "Documents") are legal, valid and binding against the relevant debtor, associated debtor or surety (as appropriate) (the "Obligors") under the Documents, represent the entire agreement between *[the Participating Institution]* and the Obligors in connection with the facility referred to in the Documents and are fully enforceable against the Obligors under the Documents subject only to:

   (a) the equitable discretion of the courts;

   (b) the limitation of enforcement by laws relating to bankruptcy, liquidation and examinership;

   (c) the time barring of claims which may be made after the date hereof;

   (d) the possibility that any undertaking to assume liability for or to indemnify a person against non-payment of stamp duty may be void; and

   (e) in the case of a foreign Obligor only, any applicable principles of law of any relevant jurisdiction limiting the obligations of that Obligor;

2. The disclosure(s) set out at Section 2.2 in the Commencement Section are conclusive in respect of all matters that might materially affect, or that might reasonably be expected to materially affect, the decision of the National Asset Management Agency to acquire the eligible bank asset(s) the subject matter of this Report, or the determination of the acquisition value of such eligible bank asset(s), for the purpose of section [78(7)] of the National Asset Management Agency Act 2009. Save for such disclosure(s), the Borrower enjoys good and marketable title to the Secured Property and all other rights and interests required for the current and proposed use, enjoyment and development of the Secured Property, all of which are mortgaged/charged to the Participating Institution pursuant to the Documents. Good and marketable title means, in respect of real property, title commensurate with prudent standards of current conveyancing practice in Ireland and, in respect of all other property, unencumbered and freely alienable full legal and beneficial title to that property;

3. Save as disclosed, where a 'resting in contract' or equivalent structure has been utilised in relation to the eligible bank asset(s) the subject matter of this Report, the security adequately catches any outstanding legal estate and includes a mechanism whereby this interest can be assured in a default scenario, and there is no outstanding liability to Stamp Duty relating to the Secured Property;

4. The contents of this Report are true, accurate and complete in all respects; and

5. This Certificate and Warranty and the queries set out in this Report are those of the Due Diligence Report issued by the National Asset Management Agency on *[issue date to be inserted]* without any amendment, alteration or omission whatsoever.

[Participating Institution] **HEREBY ACKNOWLEDGES AND CONFIRMS** that:

1. The National Asset Management Agency shall be placing reliance on this Report;

2. The delivery of documents with this Report does not diminish the responsibility of *[the Participating Institution]* to provide full and accurate details in this Report of all issues relevant to the Participating Institution's loan and security and the Secured Property, details of which are required under the relevant headings;

3. Any reliance placed on a certificate of title or report on title by *[the Participating Institution]* is entirely at *[the Participating Institution's]* own risk and does not in any way limit the certificate warranty and representation set out in paragraphs 1 to 5 above upon which the National Asset Management Agency shall be entitled to conclusively rely;

4. Failure by *[the Participating Institution]* to provide satisfactory replies to due diligence queries may impact on the acquisition value placed by the National Asset Management Agency on the eligible bank assets(s);

5. Any variations in the information given in this Report shall be supplied by *[the Participating Institution]* to the National Asset Management Agency immediately upon the variations becoming known to *[the Participating Institution];* and

6. Notwithstanding the delivery of this Report *[the Participating Institution]* acknowledges the right and entitlement of the National Asset Management Agency to conduct such further due diligence into the loans and underlying security described in this Report as it deems fit and *[the Participating Institution]* shall co-operate with and facilitate such further due diligence as may be undertaken.

DATED this day of

PRESENT when the Common Seal of [PARTICIPATING INSTITUTION] was affixed hereto:-

Appendix H

Policy Guidance – Loan Valuation

This appendix sets out a list of the guidance notes issued by NAMA in connection with valuing the loans

Policy Guidance

Number	Title
1	Legal Due Diligence and impact on valuations
2	Uplift application policy
3	Personal Guarantees treatment policy
4	Cross Loan Collateral
5	Overdraft facilities
6	Cash flow treatments – development assets
7	Foreign currency loans/property
8	Land and development definition
9	Treatment of excess collateral policy
10	Treatment of syndicated loans and how Loan Asset Valuers should split
11	Transactions occurring after property valuation date
12	At acquisition date NAMA provide guidance on how changes in mark-to-market of derivatives is dealt with
13	Cash flow treatments – investment assets
14	Hedging strategy
15	Disposition dates
16	Confirmation that all eligible assets are being acquired
17	Clearing system for queries
18	Policy for Loan Asset Valuers on which rental flows to include in model
19	Practical guidance on treatment of bundles of draw-downs secured by same bundle of security
20	Data flow to and from Loan Asset Valuers
21	Profit share arrangements (if any)
22	Final model – sharing with institutions
23	Credit cards/Electronic Funds Transfer facilities
24	Loan arrangement fees
25	Policy on the currency of the NAMA guaranteed securities to be issued where both the property and loan are non-Euro denominated. All subordinated debt will be issued in Euro.
26	Guidance on whether the €5m floor is applicable to the participating banks share or total on syndicated loans
27	Off market terms/stepped interest rates
28	Guidance on the valuation implications of Property Company/Operating Company structure whereby Operation Company services the debt of Property Company debt
29	Guidance on how rent should be determined where it is linked to turnover
30	Guidance on how to model complex loan scenarios
31	Undrawn facilities

Number	Title
32	Changes to status of property post 30 November
33	Identification and valuation of Non-Real Estate Assets
34	Performing loans with no security
35	Qualifying advances
36	Interest rolled-up to account different than the loan account
37	Cash security
38	Valuation of derivative transactions to be acquired by NAMA
39	Model Guidance for applying interest rates in certain securities
40	On-demand loans
41	Residential Investment Properties
42	Dealing with derivative mark-to-market in the model
43	Tranche 2 – Rationale for legal adjustment factor and Non-Real Estate security haircut
44	Difference between certificates and underlying documents
45	Estimating Estimated Rental Values (ERVs) and current rents when these are not provided in the property valuation report
46	Sharing second property valuations and legal haircuts with the Participating Banks
47	Treatment of vacant periods, void costs and rent arrears
48	Non-personal guarantees
49	Warehouse loans and guarantees
50	Compulsory Purchase Orders

Source: NAMA

Appendix I

Audit Coordinator

This appendix outlines the role of the Audit Coordinator in the loan valuation process.

Role of Audit Coordinator

Loan asset valuers provide the Audit Coordinator with a valuation of each loan together with all of the associated data, valuations and certificates – referred to as a loan data pack. Loan data packs are transferred electronically to the Audit Coordinator. The Audit Coordinator uploads the material to a system that has been custom built for NAMA and carries out a review comprising

- procedures to ensure that the information is complete and accurate (e.g. that fields in the certificates are all complete and all required reports are present)
- consistency checks to ensure that data has been correctly transferred from the data submitted by the banks to the various reports and certificates and correctly input by the loan asset valuers to the valuation model
- audit procedures including manual checks of data in the loan asset valuers' model, a re-run of the model's calculations and reasonableness tests
- consistency checks on property valuations.

If the Audit Coordinator finds that there is incomplete or inconsistent data, it either resolves the matter directly with the loan asset valuer or it requests them to correct the issues and to resubmit the loan data pack.

Acquisition Schedules

When the Audit Coordinator is satisfied that the data and loan valuation calculations are correct, it prepares draft acquisition schedules in which it sets out the bank assets that NAMA will be acquiring. A draft acquisition schedule, which includes the prices to be paid for the assets being acquired, is sent to NAMA, the relevant participating bank, the loan asset valuer and the Financial Regulator[84] for review. All of a borrower's loans with a participating bank are listed on a single acquisition schedule. Accordingly, a bank receives one acquisition schedule for each borrower whose loans are transferring to NAMA

The participating banks have five days within which to apply to NAMA to have any errors or omissions in a draft acquisition schedule amended while NAMA may also amend a draft acquisition schedule and require a revised draft schedule to be issued in its place. When NAMA has considered any issues raised by the participating banks and made any consequent amendments, the Audit Coordinator issues a final acquisition schedule.

Reporting Review Results

The Audit Coordinator issues a report in the form of an audit opinion to NAMA in respect of each acquisition schedule that includes its opinion on the results of the agreed audit procedures that it has carried out. The opinion states that, except for any unresolved issues that it has noted in the report

- the valuation of each loan set out in the acquisition schedule has been accurately calculated in accordance with the valuation model and
- the valuations of real estate collateral attaching to those loans have been determined on a consistent basis in accordance with criteria determined by NAMA.

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[84] The Financial Regulator reviews the process on behalf of the European Commission.

Following the completion of the first tranche transfers, the Audit Coordinator prepared a consistency report for NAMA summarising the results.

Appendix J

Valuation Disputes

This appendix sets out the process to be followed if a participating bank objects to the acquisition value of its bank assets.

Valuation Disputes

A participating bank may object to the acquisition value of any bank asset by serving a notice of objection within 14 days of receipt of an acquisition schedule. On receipt of a notice, NAMA may remove the disputed bank asset from the acquisition schedule, revoke the acquisition schedule or continue with the acquisition in accordance with the schedule. An objection on valuation does not halt the overall acquisition process.

In circumstances where NAMA decides to continue with an acquisition, a participating bank may only dispute the total portfolio acquisition value of all of its acquired assets. A participating bank does this after receipt of a completion notice and may only do so if

- it believes that the aggregate market value of the acquired portfolio exceeds the total portfolio acquisition value (the market value refers to the market value of the loans and associated derivatives and not to the market value of the underlying collateral)
- it has previously objected to the acquisition of at least 12.5% (by value) of the total portfolio acquisition value
- it serves notice within 14 days of receipt of a completion notice.

On receipt of a notice that a participating bank is disputing the portfolio acquisition value, the Minister refers the dispute to a valuation panel.

Valuation Panel

This process occurs when NAMA has completed acquiring all bank assets.

Under the Act, the Minister may appoint up to 12 members to the valuation panel and may also regulate its procedures. As of September 2010, the panel has not yet been appointed.

A participating bank must provide the panel, within 28 days of serving notice, with the material on which its dispute is based and with any comments it wishes to make. NAMA must provide the information upon which it based its determination of the market value of the bank assets.

The valuation panel has 90 days, after receipt of the material from the participating bank and NAMA, to provide its advice on the aggregate market value of the acquired portfolio to the Minister. The Minister may either

- confirm the aggregate value as advised by the valuation panel or
- if the valuation panel determines that the market value is greater than the total portfolio acquisition value and the Minister considers that the advice is wrong, remit the matter to the valuation panel setting out his reasons for doing so.

Where the Minister determines that the aggregate market value is greater than the acquisition value, the Minister will direct NAMA to compensate the participating bank to the amount of the appropriate difference by providing further consideration or by the return of bank assets or a combination of both.

The costs of each valuation review are payable by the participating bank unless the review results in the participating bank being entitled to compensation.

Appendix K

NAMA Committees

This appendix sets out the role of each sub-committee and advisory committee of the NAMA Board.

Board Sub-Committees and Advisory Committees

The board has, to date, established four sub-committees and two advisory committees.

Audit Committee

The terms of reference for the Audit Committee state that its role is to assist the Board in fulfilling its oversight responsibilities with regard to NAMA. In particular, it will

- oversee the financial reporting process
- review the executive team's system of internal control
- review the internal and external audit process and ensure the integrity of external and internal auditors
- review the executive team's process for monitoring the compliance of NAMA's loan service providers with their contractual obligations to NAMA
- review the processes, procedures and practices for ensuring compliance with all relevant legal, regulatory and taxation requirements as they affect NAMA
- oversee the processes, procedures and practices for establishing the terms of employment (including remuneration) of the executive team
- establish and keep under review a mechanism for whistle-blowing and good faith reporting.

The Audit Committee has decided to meet bi-monthly and had held eleven meetings by late September 2010.

Credit Committee

The terms of reference for the Credit Committee state that it is responsible, subject to agreed policy and portfolio limits and commensurate with the risk approved by the Board, for the approval of credit applications which exceed the credit approval authority delegated to the CEO (or have been specifically referred to the Credit Committee) in a timely manner to support efficient lending operations. In circumstances where a borrower's total exposure exceeds €1.5 billion, the Board of NAMA has responsibility for credit decisions.

The Credit Committee also has a role in regard to decisions to initiate enforcement proceedings against borrowers. Where a borrower's total exposure exceeds €250 million, decisions about enforcement proceedings lie with the Board, between €20 million and €250 million with the Credit Committee and below €20 million with the CEO of NAMA, acting on recommendations from the Head of Credit and Risk. In circumstances where the Board is not making a decision, it is to be informed in advance that a borrower's position is under consideration for enforcement and informed of the decision as soon as possible thereafter.

Under its terms of reference, the Credit Committee is required to meet at least monthly. However, at its first meeting, the Committee agreed to meet weekly. By mid September 2010, the Committee had met on 36 occasions. Some of the items that the Committee has addressed to date are

- a comprehensive credit policy which it approved for recommendation to the Board
- the Business Plan template to be completed by borrowers which it approved at its meeting on 16 March 2010, having previously considered it in some detail at previous meetings
- a template for independent business plan reviews

- policy guidance for the participating banks in regard to credit management of loans for which they have been given delegated authority
- the state of preparedness of NAMA for conducting its business following transfer of the loans
- operating manuals for case management and enforcement procedures
- a business risk policy
- credit applications from borrowers whose loans NAMA has acquired
- requests from participating banks to advance funds to borrowers in the period from the date of the participating banks application to the transfer date.

Risk Management Committee

The terms of reference for the Risk Management Committee state that it is responsible for the ongoing review and oversight of the risk profile of NAMA within the context of Board approved risk. The Committee makes recommendations to the Board concerning NAMA's risk and must satisfy itself that appropriate actions are taken in the event of any significant deviation from the Board approved risk.

The Risk Management Committee has the responsibility for reviewing and overseeing the executive's plans for the identification, management, reporting and mitigation of the material risks faced by NAMA on an enterprise-wide basis and should satisfy itself that appropriate actions are taken in the event that any significant concerns are identified.

In performing its risk management role, the Risk Committee will review, approve and recommend as appropriate to the Board strategies and policies to govern the identification, measurement, reporting and mitigation of material risks and monitor the extent to which the strategies and policies have been implemented and are functioning.

The Board member appointed by the Board as Chairperson of the Risk Committee was not appointed until 26 May 2010 and the Committee has met twice since then.

Finance and Operating Committee

The purpose of the Finance and Operating Committee as set out in its terms of reference is to monitor the financial and operational management of NAMA and its budgetary and management reporting. The Committee's responsibilities include

- the preparation of NAMA's long-term business plan for Board approval
- the preparation of annual budgets and other forecasts for Board approval
- the preparation of regular management accounts
- the review of performance and variance against budget and prior year performance including explanations for variances
- the development and implementation of key financial policies
- oversight of the executive team's responsibilities in relation to operational matters including the approval of major expenditure and investments, the management of procurement and oversight of service providers other than those whose oversight is reserved specifically to the Risk Management Committee, Audit Committee or Credit Committee
- to meet privately with the internal auditor at least quarterly

- all financial and management reporting whether to the Minister for Finance, the Oireachtas or otherwise. For the avoidance of doubt, NAMA's annual (statutory) accounts will be the responsibility of the Audit Committee.

Under its terms of reference, the Committee is required to meet monthly and it had met eleven times by late September 2010. Among items that the Committee has discussed to date are

- NAMA Codes of Practice
- NAMA accounting policies and the form of NAMA financial accounts
- the operational workflow
- the NAMA cash position
- the NAMA budget including fees to be paid to the NTMA and payments to be received from participating banks
- borrower business plans.

Advisory Committees

At its meeting on 4 February 2010, the Board agreed to establish the Northern Ireland Advisory Committee and Planning Advisory Committee and appointed Board members to chair each Committee. In May 2010, the Board adopted terms of reference for both Advisory Committees.

Northern Ireland Advisory Committee

The purpose of the Northern Ireland Advisory Committee is to advise the Board on matters pertaining to Northern Ireland in the context of NAMA's objectives and functions as set down in the Act. Advice from the Committee will include its view in relation to the impact on Northern Ireland of the implementation of the Board's strategy and the Committee will make recommendations to the Board concerning NAMA's strategy for Northern Ireland assets.

The Committee has met three times by mid September 2010.

Planning Advisory Committee

The purpose of the Committee is to advise the Board on planning issues, land and related matters that may influence the valuation and realisation of NAMA assets insofar as they relate to or impact on the achievement of NAMA's purposes and functions. The Committee may make recommendations to the Board concerning NAMA's objectives with respect to approved planning strategy and impact on NAMA's assets.

The Committee had held five meetings by mid September 2010.

Appendix L

Codes of Practice

This appendix sets out details of each of the codes of practice approved by the Minister for Finance to guide the activities of NAMA.

Codes of Practice

The Minister approved five codes of practice for NAMA on 5 July 2010 regarding

- the conduct of officers of NAMA
- servicing standards for acquired bank assets
- risk management, including with regard to debtors
- disposal of bank assets
- the manner in which NAMA is to take account of the commercial interests of credit institutions that are not participating institutions.

These codes are available on the NAMA website.

Conduct of Officers of NAMA

The Code of Practice and Professional Conduct for the Officers of NAMA sets out requirements in regard to confidentiality, conflicts of interest, market abuse, personal account transactions and misconduct by officers of NAMA.

Servicing Acquired Bank Assets

The Code of Practice, Servicing Standards for Acquired Bank Assets notes that the acquired bank assets will be administered and serviced by the participating banks acting as primary servicers. In addition, NAMA may retain another service provider to deliver loan administration services. The code notes that NAMA has, under Section 131 of the Act, directed the participating banks to comply with minimum standards of service to include

- NAMA's right to audit the services
- security and business continuity planning
- regulatory compliance including, but not limited to, data protection and anti-money laundering
- compliance with the Act and applicable law
- service levels including remedies for defective services.

The code identifies some of the servicing functions that are set out in the NAMA direction to the participating banks (e.g. collection of monies due to NAMA and ensuring borrower compliance with the terms of loan agreements). Among the issues addressed in the code is the requirement for participating banks, when acting as primary servicers, to utilise experienced and competent staff. NAMA has directed that the participating banks ensure that staff servicing bank assets on NAMA's behalf, are not the same as were involved in the relationship management relating to the assets prior to NAMA's acquisition of them.

Risk Management

The Code of Practice, Risk Management including with Regard to Debtors, states that the code applies to all aspects of NAMA's decisions and actions relating to risk management. It also states that NAMA is subject to the Code of Practice for the Governance of State Bodies as it relates to risk management. The NAMA code identifies the two key risk areas as

- credit risk which it defines as a measure of the degree of uncertainty with regard to the extent to which loans will be repaid or otherwise discharged, through enforcement of security, and/or the timing of such repayment or discharge
- business risks which may impact on its financial and operational performance.

The code sets out some key principles

- Debtors will be treated in a reasonable manner.
- NAMA recognises that both NAMA and debtors have mutual obligations to each other.
- NAMA will operate a strong corporate governance framework including delegated authorities from the Board to the CEO.
- The Board, through its risk management committee, will monitor ongoing risk exposures and the appropriateness of actions to address these.
- NAMA will not undertake any proprietary trading or transacting with financial instruments unrelated to the management of its exposures. The use of market instruments (e.g. interest rate swaps) are intended to be for the purpose of mitigating potential market risk associated with the management of any of its assets.
- In accordance with the terms of the EU state aid approval, NAMA commits to certain conditions or restrictions to the exercise of some of the powers conferred on it by the Act – e.g. NAMA will not use a vesting order for syndicated loans without the agreement of the other syndicate members and NAMA will not use its power to request tax information from the Revenue Commissioners available to it under the Act.

Disposal of Bank Assets

The Code of Practice for the Disposal of Bank Assets states that the Board has overall responsibility for the custody, safekeeping, access to and disposal of all NAMA assets and that it will establish a bank asset disposal strategy with appropriate procedures and delegation of authority in line with best international practice and the Code of Practice for the Governance of State Bodies. The CEO of NAMA has responsibility for ensuring that the process for disposal of bank assets complies with the Board's broader strategy and procedures for the disposal of bank assets.

The code states that the Board will establish and define procedures for the disposal of bank assets consistent with its bank asset disposal strategy. There will be a requirement for a current independent appraisal for each bank asset prior to disposal. For larger value or more complex bank assets in excess of €100 million in value, two independent appraisals will be required. The Board will assess and decide on all potential disposals under consideration in accordance with approved NAMA policies and procedures. The appropriate timing and method of disposal of bank assets will be determined by the Board in line with its asset disposal strategy with the objective of realising the best achievable price.

The code states that it does not cover the disposal of property and assets other than bank assets and that NAMA confirms that the disposal of property and other assets will be subject to the provisions of the Code of Practice for the Governance of State Bodies.

Commercial Interests of Non-Participating Institutions

The Code of Practice on the Commercial Interests of Non-Participating Institutions states that its purpose is to set out how NAMA will take account of the commercial interests of credit

institutions that are not participating institutions both in respect of loans and assets under its direction and control (both NAMA-managed and participating institution-managed) and generally in relation to its operations and performance.

The code states that NAMA will, in its dealings with non-participating institutions under the Act, have due regard to their commercial interests, act reasonably in the exercise of its powers under the Act and adopt a consultation approach where appropriate.

The code states, *inter alia*,

- NAMA will adopt a long-term view, where appropriate, with regard to non-participating institution and states that NAMA is cognisant of the non-participating institutions' role in the commercial property market in Ireland and their future role in the provision of funding options for debtors
- consultation will be held between NAMA and the non-participating institution in circumstances where there are debtors that are common to both in an effort to agree a common approach. The consultation may be limited if the debtor does not agree to an exchange of information
- where a loan is the subject of a syndicate agreement between lenders, at least one of which is a participating institution, and at least one is a non-participating institution, the relationship between NAMA and the non-participating institution will be governed by such agreement previously entered into between the lenders in relation to the operation of the facilities and the enforcement of the security held for the facilities
- the legal rules of priority will apply where NAMA and a non-participating institution have a charge on the same assets.

Glossary

Glossary of Terms

Associated Debtor	Associated debtor has the meaning given to it by *section 70* of the Act 2009 Section 70 '*For the purposes of this Act, a person is an "associated Debtor" of a Debtor if the person—* *(a) is or was at any time directly or indirectly indebted or otherwise obligated to a Participating Institution under or in connection with a credit facility, and* *(b) is or was at any time—* *(i) a body corporate that was a subsidiary of, or a related company (within the meaning given by section 140(5) of the Companies Act 1990) to, the Debtor,* *(ii) a nominee of the Debtor, including a person who may or does in fact act at the express or implied direction or instruction of the Debtor or another associated Debtor of the Debtor,* *(iii) acting in the capacity of trustee of a declared or undeclared trust the beneficiaries of which include (directly or indirectly)—* *(I) the Debtor,* *(II) a person referred to in subparagraph (ii), or* *(III) a body corporate controlled by the Debtor or a person referred to in that subparagraph,* *(iv) in partnership, within the meaning of the laws of any relevant place, with the Debtor, in relation to a bank asset which at the time of the partnership was, or subsequently became, of a class of bank assets prescribed under section 69(1),* *(v) a body corporate of which the Debtor is the sole member, or* *(vi) a body corporate controlled by the Debtor, or* *(c) a member of any other class of person prescribed by the Minister for the purposes of this subsection.*
Bank Asset	A Bank Asset includes (a) a credit facility, (b) any security relating to a credit facility, (c) every other right arising directly or indirectly in connection with a credit facility, (d) every other asset owned by a participating institution, and (e) an interest in a bank asset referred to in any of paragraphs (a) to (d).
Borrower Centric	An approach whereby all loans of a particular borrower across all participating banks transfer simultaneously enabling NAMA to make decisions on the basis of the borrower's overall exposure.
Collateral	A borrower's pledge of specific property to a lender, to be forfeited in the event of default.
Commercial Paper	An unsecured, short-term debt instrument issued by a corporation/bank.
Consideration	Payment made by NAMA for bank assets.
Counterparty	The party with whom a contract or financial transaction is effected.
Cross Collateralisation	Cross collateralisation occurs when collateral for one loan is also used as collateral for another loan.

Cross Currency Swap	An agreement to swap cash flows on loans of the same size and terms but denominated in different currencies. These agreements are used by NAMA to fix the Euro cost of transactions denominated in foreign currency.
Current Market Value	The estimated amount for which a property would exchange between a willing buyer and seller in an arm's-length transaction.
Derivative	A derivative is a financial instrument that derives its value from an underlying item e.g. interest rates or currency, and can be used to manage risks associated with changes in the value of the underlying item.
Discount Rate	The rate used to discount future cash flows to their present values.
Distressed Loan	A loan already in default, under bankruptcy protection, or in distress and heading toward such a condition.
Double Tax Treaty	An agreement between countries to limit double taxation on income earned in those countries.
Due Diligence	A comprehensive appraisal of a business especially to establish the value of its assets and liabilities.
ECP	Euro Commercial Paper (ECP) is an unsecured general obligation in the form of a promissory bearer note either issued at a discount or bearing interest.
Eligible Asset	Classes of bank assets prescribed as eligible bank assets through Regulations issued by the Minister for Finance under the National Asset Management Agency Act, 2009. These are detailed in Appendix C of this report.
EMTN	Euro Medium Term Note – a medium-term debt instrument that is issued directly to the market generally with maturities of less than five years.
Enforcement Proceedings	Proceedings to compel compliance with legal contracts.
Euribor	The Euro Interbank Offered Rate is the rate at which euro interbank deposits are offered by one prime bank to another within the Eurozone.
Eurozone	The Eurozone comprises the member states of the European Union that have adopted the euro as their currency.
Excess Collateral	Where the value of collateral provided by a borrower for a loan exceeds the amount due on that loan.
Expert Reviewer	A suitably qualified person who, in the Minister's opinion, has the expertise necessary to review the eligibility of bank assets when disputed by participating banks.
Floating Rate	An interest rate that changes over time. The change is usually tied to the movement of an outside indicator such as the interest rate set by the ECB.
Hedge	Entering into an agreement to manage the risks of adverse changes in the price of an asset or liability.
Impaired Loan	A loan is impaired when it is unlikely the lender will collect the full value of the loan.
Interest Rate Swap	A derivative in which one party exchanges a stream of cash flows for another party's stream of cash flows based on a specified principal amount. Typically this comprises a swap of the cash flows equivalent to variable interest payments for cash flows equivalent to fixed interest payments on the same principal amount.

Land	As defined in the Land and Conveyancing Law Reform Act 2009, but also includes any right or interest in or over land.
Land and Development Loan	A loan issued for the purchase, exploitation or development of land.
Long-term economic value	The value as determined by NAMA in accordance with the NAMA Act, that it can reasonably expected to attain in a stable financial system when the crisis conditions prevailing at the time of the passing of the Act are ameliorated and, in the case of property, in which a future price or yield of the property is consistent with reasonable expectations having regard to the long-term historical average.
Mark-to-Market Value	The price or value of a security, portfolio or account that reflects its current market value rather than its book value.
Non-Performing Loan	A loan is non-performing, under the Act, if (a) it is in the course of being foreclosed or otherwise enforced, (b) principal or interest both in arrears, (c) interest is being or has been capitalised or otherwise deferred otherwise than in accordance with its terms, (d) payments are not being or have not been, met, (e) its covenants are not being, or have not been, complied with, or (f) other obligations are not being or have not been complied with.
Participating Bank/Institution	A Credit Institution that has been designated by the Minister under *section 67* of the Act 2009, including any of its subsidiaries that has not been excluded under that section.
Perpetual Bond	A bond with no maturity date.
Present Value	A value on a given date of a future payment or series of future payments, discounted to reflect the time value of money and other factors such as investment risk.
Primary Servicer	A participating bank/institution managing debtors on NAMA's behalf within authority limits approved by the NAMA Board.
Profit Participating Loan	A loan that provides the creditor with a return that depends, at least in part, on the profitability of the debtor.
Promissory Note	An unconditional promise in writing, made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.
Qualifying Advance	An advance made by a participating bank to a borrower (whose loans are eligible assets) following the announcement of NAMA by the Minister for Finance on 7 April 2009. The advance is only qualifying if it was made as part of normal commercial banking arrangements. No discount applied to these advances.
Security	Includes (*a*) a Charge, (*b*) a guarantee, indemnity or Surety, (*c*) a right of set-off, (*d*) a debenture, (*e*) a bill of exchange, (*f*) a promissory note, (*g*) collateral, (*h*) any other means of securing—(i) the payment of a debt, or (ii) the discharge or performance of an obligation or liability, and (*i*) any other agreement or arrangement having a similar effect.
Special Purpose Vehicle	A legal entity created to fulfil narrow, specific or temporary objectives.
State Aid	Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

Standard Discount Rate	The rate that NAMA shall apply in the calculation of the long-term economic value of all bank assets to provide for enforcement and due diligence costs incurred or likely to be incurred by NAMA over its lifetime in the discharge of its functions.
Subordinated Debt	Debt which is repayable only after other debts have been repaid. NAMA pays 5% of the purchase price of the loans it acquires in the form of subordinated bonds. These bonds will not be repaid unless NAMA has the funds to do so at the end of the period.
Syndicated Loan	A syndicated loan is one that is provided by a group of lenders and is structured, arranged, and administered by one or several commercial or investment banks known as arrangers.
Tranche	A group of loans which will transfer to NAMA.
Uplift Factor	A percentage increase added to the current market value of properties by NAMA valuers to derive their long-term economic value.