

PAC-R-173



**Correspondence 3.4
Meeting – 01/12/2011**

23 November 2011

Ms. Eimear Lavelle,
Committee Secretariat,
Committee of Public Accounts,
Leinster House,
Dublin 2.



Dear Ms. Lavelle

In accordance with your letter of 9th November, please find enclosed responses to the issues raised following NAMA's appearance before the Committee on 26th October 2011.

I trust these responses are sufficient, but please do not hesitate to contact me should further information be required.

Yours sincerely,

A handwritten signature in blue ink, which appears to read "Brendan McDonagh", is written above the printed name.

Brendan McDonagh
Chief Executive Officer

Responses to issues raised

1. *Financial Milestones*

A note providing information on how financial milestones are calculated when properties are sold, to include information on sales commission paid to debtors and the title documents on the sold property having regard to the original value of the loan before the NAMA hair-cut was applied.

No sales commission is paid to debtors. Also no amount is paid with respect to any individual asset sale.

NAMA has signed legally binding agreements with nine debtors under which proposed incentives are in place, linked to the attainment of NAMA approved financial milestones based on achieving aggregate targets at the end of the realisation of all the assets (likely to be a number of years hence) and demonstrable debtor co-operation.

Each incentive arrangement is bespoke to the specific debtor situation, therefore no uniform formula exists for all debtors. These arrangements have common characteristics and the proposed incentives all have the same underlying commercial rationale.

Such incentive type arrangements are set out in NAMA's 2010 Annual Report on page 22. An example of this will usually entail a restructuring of the original loan (Par Loan) into three loans. **Loan A** is comprised of interest bearing debt, **Loan B** comprises non-interest bearing debt (but with a back-end fee of up to 25% payable to NAMA) and **Loan C**, if required, entails new facilities advanced for working capital and capital expenditure. Typically, interest on Loan A is charged at a rate of 2.5% above six-month Euribor. The interest rate on Loan C may be up to 4% above Euribor.

Incentivisation mechanisms may sometimes be included; for example, profit above a target NAMA repayment level could be shared 90% to NAMA and 10% to the debtor. The following example illustrates how debt restructuring is expected to operate:

	€m
Par debt outstanding	1,000
Current market value of underlying property	480
Long-term economic value (LEV) of debt (incorporating a discounted uplift)	490
Loan A (LEV plus additional repayment target)	540
Working capital advanced by NAMA (Loan C)	20
Total interest-bearing debt	560
Loan B (non-interest bearing)	440

In the above example, the incentivisation mechanism could be triggered after the debtor repays the target interest-bearing debt of €560m. If, for example, the debtor fully engages and fully co-operates with NAMA and an amount of

Responses to issues raised

€570m is realised, the €10m in additional proceeds realised will be distributed with €9m (90%) going to NAMA and €1m (10%) to the debtor. The €1m will only be paid to the debtor at the end of the process which is likely to be well into the future. As the Chairman and I outlined, looking at the current economic situation both in Ireland and in other locations where assets are located unless there is a significant global economic improvement it is likely that no debtor will ever achieve the aggregate targets to qualify for an incentivisation arrangement.

On your query re title when an asset is sold title is passed to the purchaser.

2. *Debtors*

A breakdown of the amounts being paid to NAMA debtors to manage properties and the number of debtors in receipt of these payments.

NAMA does not pay remuneration to its debtors. Rather NAMA approves a level of overheads that the debtor may incur to run the debtor's business. Included in such approved overheads is an allotted salary allowance for the debtor owner/manager.

These overheads are a matter of particular focus in the assessment of each debtor's business plan. The focus has been to reduce to the minimum the overheads required to properly manage the business and protect the assets that are security for the loans NAMA has acquired.

Overheads are costs incurred but not directly attributable to a specific property. They are costs incurred to manage the portfolio of property assets which are secured against the loans NAMA has acquired. These costs, in many cases, include the following expenses other than the remuneration of the debtor:

- Repairs and maintenance of properties
- Insurance
- Wages and salaries of the staff employed by the debtor to supervise and manage the portfolio
- Remuneration of third party asset managers where these are required for expertise or for greater control of rent roll and activity
- Other professional fees such as accounting and audit services

Responses to issues raised

The total salary allowances (included in approved overhead budgets) attributable to NAMA debtors to manage properties and the number of individual debtors in receipt of such payments is as follows:

Total number of individual debtors with approved overheads	41
	€'m
Salary allowance included within the approved overhead for 41 debtors	4.1
	€'bn
Total PAR debt managed by these Debtors, which represents 25% of total NAMA portfolio	18.6

3. Loan Interest

A note outlining how interest is calculated on loans, to incorporate technical details and information on whether the debtor is paying the interest on the original value of the loan or the marked down value.

At the end of 2010, NAMA had acquired a portfolio of €71.2 billion loan nominal for total consideration of €30.5 billion. This has since increased to €74 billion with overall consideration paid of €31.7 billion.

NAMA is required to prepare its financial statements in accordance with International Financial Reporting Standards (IFRS).

While the debtor continues to be liable for interest accrued on the original value of the loan (par debt), IFRS accounting standards do not allow NAMA to use this as the basis to recognise interest income on its loan portfolio for the purposes of financial reporting.

Under IFRS, the interest rate recognised in the financial statements is calculated using the Effective Interest Rate (EIR) methodology. Under the EIR method, the expected loan cash flows over the expected life of a loan are assessed. The EIR rate is the rate that exactly discounts (a) estimated future cash payments or receipts over the expected life of the loan to (b) the carrying value of the loan.

The effect of this is that, for accounting purposes, NAMA is required to record, in its income statement, interest income by multiplying a calculated interest rate (the EIR) by the acquisition value of its loan portfolio (including changes since acquisition, such as cash receipts, impairments etc). In respect of loans where due diligence was incomplete at year-end 2010, NAMA adjusted the basis of income recognised on such loans to include only contractual interest received from these debtors in the period.

However, it is important to state that the IFRS accounting requirements NAAM is obliged to adhere to in no way change what a debtor is legally obliged to repay. This obligation is to the original value of the loan (par debt), plus

NAMA – Annual Report and Financial Statements 2010

Responses to issues raised

accrued interest at the original contractual interest rate on that loan balance until and unless NAMA agrees to restructure the loan.

Responses to issues raised

4. Debtors in receipt of €200,000

A note confirming that the two NAMA debtors in receipt of €200,000 (for working with NAMA on working out their loans) are resident in the Republic of Ireland and are registered to pay their tax here.

We confirm that two individual NAMA debtors are being paid salaries of €200,000 per annum by their businesses out of their overhead budget with NAMA's approval as at 30 September.

Both cases are among the largest connections on which NAMA Board approval and reporting applies.

Of the two NAMA debtors one is resident and tax resident in the Republic of Ireland. The other debtor is an Irish citizen whose principal business interests and assets are in the UK and is not currently tax resident in Ireland.

5. Receivership

A note providing information on the receivers NAMA has appointed, the number of cases involved and the value of loans where properties have gone into receivership.

As at 30 September 2011, NAMA has appointed 91 receivers with a par debt value of €5.3 billion (and carrying value of €2.2 billion).

A list of all properties subject to an insolvency process together with the name of the appointed receiver is on www.nama.ie.

Responses to issues raised

6. *Interest*

A note providing details of the number of loans where interest is being rolled or zero interest is being charged, to include the value of such loans.

Interest continues to be accrued on all outstanding loans in accordance with the contractual terms of the loan whether performing or non-performing (See Table 3 below for a definition of performing or non-performing).

NAMA reports the status of its loans on a quarterly basis to the Minister for Finance categorising them between a) performing and b) the various categories of non-performing (based on the categorisations set out in Table 3 below).

Based on the latest analysis provided to the Minister for Finance, within the Section 55 Quarterly Report as of 30th June, there were 8,613 loans with a Loan nominal (or “par debt”) of €54.8 billion (carrying value of €18.8 billion) which were non-performing.

The number and condition of outstanding loans as at the 30th of June 2011 as reported in the Section 55 report are detailed in Table 1 below:

Table 1 format

Classification	Number	Loan Nominal €m	NAMA Value less Impairment €m
Performing	3,254	16,641	8,610
Non-Performing	8,613	54,799	18,765
Total	11,867	71,440	27,376

The Loan Nominal amount (or ‘par debt’) is €71.4 billion and represents the full amount owed by NAMA debtors in respect of the loan portfolio. The NAMA Value amount is the carrying value of the loans on NAMA’s Balance Sheet and represents the accounting value of the assets taking into account the discount applied at acquisition.

NAMA – Annual Report and Financial Statements 2010

Responses to issues raised

The detailed split of the non-performing loans is included in the Table 2 below:

Table 2

Loan Payment Status	Degree of Default	Number	Loan Nominal €m	NAMA Value less Impairment €m
9	Current Non Cash	199	1,857	838
1	30-59 Days Delinquent	155	448	133
2	60-89 Days Delinquent	141	533	190
3	90+ Days Delinquent	282	2,365	861
4	120+ Days Delinquent	6,793	43,496	15,143
7	Foreclosure	1,043	6,098	1,600
8	Otherwise Enforced	0	0	0
	Total	8,613	54,799	18,765

The code for the loan payment status is set out on the next page.

NAMA – Annual Report and Financial Statements 2010

Responses to issues raised

Table 3 below sets out the definition of each of the loan categorisations:

Table 3

CodeID	CultureValue	Description	Comment
0	Current Cash	Performing	Accounts not in arrears due to cash receipts or where the arrears are outstanding less than 30 days. It includes matured loans that are still producing cash in accordance with their contractual terms
9	Current Non Cash	Non Performing	Accounts not in arrears because arrears are capitalized or account has a zero interest rate applying.
1	30-59 Days Delinquent	Non Performing	Accounts in arrears where the amounts due are between 30 and 59 days outstanding
2	60-89 Days Delinquent	Non Performing	Accounts in arrears where the amounts due are between 60 and 89 days outstanding
3	90+ Days Delinquent	Non Performing	Accounts in arrears where the amounts due are between 90 and 119 days outstanding
4	120+ Days Delinquent	Non Performing	Accounts in arrears where the amounts due are 120 days or more outstanding
7	Foreclosure	Non Performing	Accounts foreclosed
8	Otherwise Enforced	Non Performing	Accounts which do not fall into any of the above categories