Comptroller and Auditor General
Special Report

National Asset Management Agency's sale of Project Eagle

Report number 94

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Report of the Comptroller and Auditor General

National Asset Management Agency's sale of Project Eagle

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 National Asset Management Agency's sale of Project Eagle.

This report was prepared on the basis of information, documentation and explanations obtained from the National Asset Management Agency and from the Department of Finance. The National Asset Management Agency and the Department of Finance were asked to review and comment on the draft report. The comments received have been taken into account, as appropriate, in the final version of the report.

References to any third parties (named or otherwise) are incidental to the purposes of assessing the performance by the National Asset Management Agency of its functions. Consequently, the report should not be read as constituting any comment, opinion or judgment in respect of any third party.

I hereby submit my report for presentation to Dáil Éireann in accordance with Section 11 of the Act.

Seamus Mc Carthy.

Seamus McCarthy
Comptroller and Auditor General

5 August 2016

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Summary

Summary

1. The National Asset Management Agency (NAMA) was established to acquire impaired property loans from Irish banks, to protect or enhance the value of those assets, and to dispose of them over time. In doing so, NAMA is required to obtain the best achievable financial return for the State.

2. The bulk of NAMA's income is in the form of proceeds from the sale of property and loans. In 2014, NAMA undertook the sale of a portfolio, code-named Project Eagle. The portfolio comprised all the remaining loans of NAMA's debtors based in Northern Ireland. The purchaser was Cerberus Capital Management (Cerberus).

3. NAMA incurred a net loss in 2014 of £162 million from Northern Ireland debtor asset sales, most of which related to Project Eagle. This was in addition to losses of £478 million on the loans which had already been recognised in impairment charges. This examination was carried out to establish and assess the circumstances that gave rise to the loss.

4. This report is concerned with assessing the performance by NAMA of its functions. References to any third parties (named or otherwise) are incidental to that purpose. Consequently, the report should not be read as constituting any comment, opinion or judgment in respect of any third party.

NAMA's strategy for Northern Ireland asset disposal

5. NAMA had a total of 56 debtor connections based in Northern Ireland, whose loans were secured by over 900 properties, mainly located in Northern Ireland (50%) and Great Britain (38%, mostly outside London). NAMA planned to dispose of the property over the medium to long term.

6. In June 2013, a firm of solicitors, Brown Rudnick, wrote to Northern Ireland's Minister for Finance and Personnel stating that it was acting on behalf of unnamed investment firms interested in buying the loans of the Northern Ireland debtors from NAMA. The Northern Ireland Minister sent a copy of the letter to his counterpart, the Minister for Finance, who in turn, sent it on to NAMA. In September 2013, NAMA received a direct expression of interest in its Northern Ireland portfolio from a Brown Rudnick client called PIMCO, which proposed a short and exclusive sales process. A timeline summarising the evolution of Project Eagle is presented on page 22.

7. There is no indication that NAMA or its Board had given consideration to a bulk sale of either its loan collateral in Northern Ireland or of the loans of the debtors based in Northern Ireland prior to Brown Rudnick's correspondence in June 2013. Following the approach, NAMA decided that a loan sale would be its preferred option if it could be achieved on terms that were in line with its obligations under section 10 of the NAMA Act 2009, requiring it to obtain the best achievable financial return.

8. NAMA has stated that, although not recorded formally, it considered and rejected alternative disposal options including aggregation by location of the property collateral or by property type (e.g. retail, offices, development land), and separate sales of loans of individual debtor connections.

9. Adopting PIMCO's proposal for the portfolio composition meant a significant shift in NAMA's strategy. It resulted in NAMA's biggest loan portfolio sale to that point, involving many debtor connections and varied asset types. While this gave rise to a number of project risks, NAMA did not seek formal external expert advice in relation to the strategy.

10. NAMA has stated that the factors that influenced its decision to change its Northern Ireland strategy were the emergence of the loan sale option, the political and cross-jurisdictional context in which it held the Northern Ireland debtor assets, and its assessment that its relationship with the Northern Ireland debtors was deteriorating. NAMA was concerned that a widespread lack of co-operation would adversely affect the proceeds that could be realised from a medium-term workout of the loans. NAMA also took account of the potential for the portfolio sale to contribute to NAMA's broader objectives.

Financial outcome of the loan sale

11. Some of the Northern Ireland debtor loans and/or the related property assets were already in the process of being sold when NAMA decided to undertake Project Eagle. These resulted in a number of separate sales.

12. The disposal proceeds from Northern Ireland debtors in 2014 amounted to a total of £1,322 million. This comprised £1,137 million from the disposal of the Project Eagle loan portfolio and £185 million from the disposal of other Northern Ireland debtor loans and properties. An additional £9 million was received from sales of Northern Ireland debtor assets in December 2013. Disposal costs for the portfolio incurred by NAMA amounted to £6 million.

13. The sales of Northern Ireland debtor assets outside Project Eagle involved disposals of 125 properties – mainly in Germany and Great Britain – and represented about one eighth of the carrying value (after impairment) of the Northern Ireland debtor portfolio. On average, NAMA incurred losses of around 1% on those sales. The corresponding loss rate on Project Eagle was 13%. NAMA attributes the higher loss rate to the fact that Project Eagle involved a loan portfolio sale, which purchasers are likely to bid for at a discount, as compared to the prices achievable in property disposals undertaken in agreement with the debtors.

The basis of the decision to sell the loans

14. The NAMA Board formally considered whether or not to sell the Northern Ireland debtor loan portfolio during meetings on 12 December 2013 and 8 January 2014. The Board considered that its core choice was whether it should sell all the loans of its Northern Ireland debtors together as a single portfolio, or work out the loans over a longer period. This required a comparison of the values of the alternatives.

15. In a paper submitted to the Board for the December 2013 meeting (reproduced in Appendix C), the NAMA executive sought the Board's approval for the sale of the loans. The paper indicated that the total NAMA debt for the loans at end November 2013 was £1.98 billion – equivalent to 43% of the par debt.[1] Cash flow projections indicated that NAMA would realise net receipts totalling £1.68 billion over the period 2014 to 2020 if it worked out the loans through the sale of the underlying assets in line with its formal strategy. The paper recommended a minimum price of £1.3 billion be set for a loan sale.

16. Money is generally regarded as having a 'time value' – in normal circumstances, an amount of money received today is considered to have a higher value than an equivalent amount expected to be received at some point in the future. For this reason, differences in the timing of cash flows are routinely taken into account by 'discounting' the value of future transactions to their estimated net present value (NPV).

17. In June 2013, the NAMA Board endorsed the use of a standard discount rate of 5.5% to evaluate the viability of potential transactions or commercial decisions, including decisions whether to hold or sell an asset. The examination team applied that standard rate of 5.5% to the projected cash flows in NAMA's December 2013 paper, and estimated the loans had a NPV of £1.49 billion. This amount represents the probable value to NAMA, as at the end of 2013, of working out the Northern Ireland debtor loans. As a result, the decision to sell the loans at a minimum price of £1.3 billion involved a significant probable loss of value to the State of up to £190 million in NPV terms.

18. NAMA has outlined the strategic and commercial rationale underpinning the decision to sell the loan portfolio. This report draws no conclusion about the merits of that decision.

NAMA's valuation of the loans

19. The paper submitted to the Board outlined three bases for valuing the Project Eagle loans. The examination found that two of the valuations underestimated the value of the loans. In the third case, no valuation was made.

- **Carrying value of the loans** – The paper presented to the Board projected the end-December 2013 carrying value of the loans at £1.48 billion. This was a forecast of the value of the loans that would be reported in NAMA's 2013 annual financial statements. However, the paper proposed a downward adjustment of £85 million in the carrying value to reflect additional expected impairment, resulting in an 'adjusted carrying value' of £1.39 billion. This examination found that the records supporting the December 2013 paper did not provide evidence justifying the adjustment. Other evidence presented by NAMA during this examination supports a downward adjustment of, at most, around £8 million in cash terms. Consequently, the adjusted carrying value of £1.39 billion presented in the paper to the Board underestimated the value of the Project Eagle loans.

1 **NAMA debt** is the acquisition value of a loan, adjusted for interest charged and cash advanced to, or received from, the debtor. **Par debt** refers to the full amount owed by the borrower based on the original terms and conditions with the participating bank and without taking account of any discount applied by NAMA when acquiring the loan.

- **Projected future cash flows** – Separately, the paper to the Board presented projected loan cash flows discounted at a rate of 5.5% which indicated the NPV of the loans was £1.38 billion – not £1.49 billion as reported above. The difference of £108 million occurred because NAMA applied a downward adjustment in projected 2017 receipts, which reduced the NPV of the loans by £69 million. As with the carrying value impairment adjustment, this was found not to be supported by evidence. In addition, NAMA's cash flow projections treated all cash flows as occurring at end year, which reduced the NPV of the loans by a further £39 million.[1] Additional 'scenario' analysis presented in the paper assumed further 'impairment' of the projected cash flows. Taken together, the analysis indicated that the Northern Ireland debtor portfolio was worth in the range £1.24 billion to £1.29 billion in NPV terms, depending on the assumptions used. The examination found that this underestimated the NPV of working out the loans.
- **Purchaser discounting** – The December 2013 paper to the Board also pointed out that, at that time, a purchaser of a non-performing loan portfolio would be likely to apply a discount of at least 10% to the value of the underlying property collateral. The paper did not provide an estimate of the current market value of the underlying property collateral for the Project Eagle loans, and did not state to what value the discount should be applied, or what the outcome of such a valuation would be.

Setting the minimum price

20. The NAMA paper for the Board recommended that the minimum price for the sale of the loans should be £1.3 billion, but did not state that this would represent the best achievable return, or what the recommended minimum price was based on.

21. The minutes of the meeting on 12 December 2013 record that

> *"The Board agreed that the paper and analysis presented therein presented a compelling commercial case to sell the portfolio, and that in addition such a portfolio sale would release NAMA from what had been a disproportionate burden of effort in light of the relative size of the portfolio."*

22. The minutes of the Board meeting on 8 January 2014 record that

> *"In relation to sales price, the Board noted that PIMCO had given an indicative bid of £1.1 billion to £1.3 billion subject to due diligence. The Board noted further that NAMA's own discounted cash flow valuation of the portfolio was in the £1.2 billion to £1.3 billion range depending on the assumptions used. In response to a question from the Board, it was noted that the original loan acquisition value for the portfolio was approximately £2 billion, with the current valuation reflecting significant impairments to date with further impairments expected. As agreed at its 12 December 2013 meeting, the Board noted it would not consider the sale of the Project Eagle portfolio of loans for a consideration less than £1.3 billion."*

23. In commenting on this report, the Board has stated that its decision on setting a minimum price was based on the portfolio's adjusted carrying value (i.e. £1.39 billion) and on the Board's acceptance that a purchaser's discount of at least 10% would apply if the loan sale were to proceed. The Board also stated that the minimum reserve price was the best price deemed achievable through a loan sale.

1 NAMA's standard assumption – reflecting the nature of its business – is that rental income and proceeds from sales are evenly distributed over the year of receipt.

NAMA's views on the workout value

24. The NAMA Board strongly rejects the conclusion that the decision to sell the loans at £1.3 billion involved a significant probable loss to taxpayers, and remains of the view that achieving £1.32 billion for the portfolio was the best achievable commercial outcome.

25. In a response to this report (reproduced in Annex 3A), NAMA has stated that the discounted cash flow analysis in the December 2013 Board paper was not intended as representing a loan workout value. It also stated that it would have been appropriate to use a discount rate of at least 10% (rather than 5.5%) in evaluating the Project Eagle cash flows to reflect all of the risks in the portfolio and the cost of capital of the purchaser. Risks NAMA considers specific to Project Eagle included the poor relative quality of the assets, weak market conditions, fractious debtor engagement and the political considerations specific to the Northern Ireland assets. Using a 10% discount rate, NAMA estimates the maximum loan workout value would have been £1.34 billion in NPV terms.

26. The argument that a discount rate of 10% would have been appropriate in calculating NAMA's workout value for the loans is not persuasive.

- No reference was made in the papers presented to the Board that a rate higher than NAMA's standard 5.5% discount rate would be appropriate in evaluating a decision whether to sell or hold an asset.
- NAMA conflates the perspectives of seller and buyer by arguing that, in estimating its own workout value, it would have been appropriate to use a discount rate of 10%, to reflect the rate a potential purchaser would apply in arriving at a bid price. NAMA's cost of funding – estimated at 1.2% in 2013 – is significantly lower than the cost of capital for a potential purchaser.
- NAMA took account of the relative quality of the property collateral in the price it paid for the loans at acquisition, and had provided for underlying economic and market conditions in its annual impairment reviews, so a high level of risk premium in the discount rate on those grounds would have meant double counting.

27. It is also difficult to accept NAMA's contention that the analysis it presented to the Board was not intended to represent an estimate of its expected loan workout value, since that was central to the decision the Board was being asked to make.

Loan sale strategy

28. The PIMCO approach to NAMA in September 2013 proposed a 'short and exclusive' process for the sale of the Northern Ireland debtor portfolio i.e. there would be no competition from other bidders. The Board did not agree to that proposal.

29. The Board agreed in October 2013 to consider a possible disposal of the Northern Ireland debtor loans in a portfolio sale, on the basis that there would be an open market process, in line with NAMA's loan sale policy. The Board authorised the NAMA executive to set up a virtual data room, containing information about the top 55 property assets – representing about 60% of the value of the portfolio – to allow PIMCO to commence 'due diligence' examination of the loans. On 4 December 2013, PIMCO submitted a more developed proposal containing an indicative offer in the range of £1.1 billion to £1.3 billion, and reiterated its request for an exclusive process.

30. The paper submitted to the Board for its meeting on 12 December 2013 did not make a recommendation as to how the loan sale should be managed. Instead, it sought the Board's guidance as to how to respond to PIMCO's request for exclusivity. The paper summarised the advantages and disadvantages of a closed transaction and stated that if the normal process for an open marketing sales process was carried out, it would be the fourth quarter of 2014 before the transaction would be completed. The Board asked the NAMA executive to propose an approach for a *"limited, focused and time bound open marketing process"*.

31. The NAMA paper for a special Board meeting of 8 January 2014 proposed very restricted marketing of the loans. It proposed the immediate appointment by NAMA of Lazard and Company Ltd as loan sale advisors to carry out the marketing to a minimum of two other selected firms, with the aim that the process would be completed by the end of January 2014.

32. Following discussion of this proposal, the Board agreed to appoint Lazard, and that the marketing of the loans would be restricted to a small number of potential bidders with the financial capacity to purchase the Northern Ireland debtor portfolio and would involve restrictions on potential bidders' access to information, subject to Lazard's advice about the time to be provided for access to the data room. There was a clear objective from the outset of ensuring that the planned loan sale would remain highly confidential.

33. Unlike loan sale advisors to NAMA in other sales, Lazard was not required to value the Project Eagle loan portfolio in advance of the sale. NAMA specified the key aspects of the marketing strategy, including the data provision strategy and that the process be completed within a tight timeframe. In contrast, the loan sale advisors for Project Arrow – another large 'granular' portfolio – valued the portfolio and presented detailed advice to NAMA on a range of marketing strategy issues, including a strong recommendation that a two-phase sales process be undertaken. A standard two-stage bidding process provides bidders with the opportunity to carry out initial pricing analysis and to establish their interest in a portfolio without committing to the more expensive full due diligence process which is carried out in the second stage.

Bidder access to the competition

34. Six firms were invited into the process. An initial group of three firms approached by Lazard yielded only one interested firm. A second group of three invitees yielded a further two firms. Subsequently, two other firms that applied were admitted to the process.

35. Of the eight firms (other than PIMCO) given the opportunity to enter the sale process, three firms declined to participate, and three withdrew. The firms cited dissatisfaction with the time allowed for the sale process and with the level of information available, and prior commitments to other sales already taking place or planned, rather than a lack of interest in the Northern Ireland loan book itself. One firm that declined to get involved cited the competitive advantage PIMCO had because of its early engagement with NAMA.

36. A media report in mid February 2014 about PIMCO's engagement with NAMA since 2013 resulted in the loss of confidentiality about the process, and presented an opportunity for NAMA to consider a revised marketing strategy. The NAMA Board agreed to give Lazard flexibility to increase the number of firms admitted to the process if genuine credible interest arose.

37. Just two of ten firms that sought entry to the competition following the media report were allowed to participate. In line with NAMA's original objectives for the competition, Lazard had given a commitment to those invited into the process that the number of potential bidders would be limited, and reported to NAMA that admitting more firms would undermine that commitment. In March 2016, Lazard stated that the eight firms were not admitted to the sales process because they did not meet NAMA's criteria for participation, including having the financial capacity to purchase the portfolio. One firm not admitted to the competition had originally been identified by Lazard for possible invitation, but had apparently not been approached on the basis that other firms deserved 'priority'.

38. On 12 March 2014, PIMCO withdrew from the sales process having informed NAMA of a proposed success fee arrangement involving Brown Rudnick, a Belfast law firm called Tughans, and a former member of NAMA's Northern Ireland Advisory Committee (NIAC). Following PIMCO's withdrawal, just two firms – Cerberus and Fortress – remained in the competition, and both subsequently submitted bids.

Access to loan information

39. In setting out its understanding of its brief, Lazard noted that only limited due diligence information on the portfolio would be available to potential bidders and commented that this would impact bidders' ability to obtain financing. Lazard told potential bidders that NAMA expected offers to be formulated on the basis of the information presented in the virtual data room, and that it did not expect any detailed 'questions and answers' in relation to the data. In the end, the data provided to bidders in the data room was more extensive than originally planned. By final bid stage, NAMA had made available in the data room around 2,800 documents relating to around 850 properties.

40. In contrast, NAMA's loan sale advisors for Project Arrow told potential bidders that "comprehensive information would be made available" to them. In that sale, around 22,000 documents were made available for around 1,900 property assets.

41. Some firms withdrew from the Project Eagle process citing a lack of relevant information. One firm withdrew in early March 2014 because, inter alia, it was refused a requested four week extension of time to examine and evaluate the information, but in mid March 2014, two extensions of time totalling two weeks were granted to the firms remaining in the process.

42. NAMA also imposed restrictions designed to prevent potential bidders contacting debtors, or availing of the services of valuers in Northern Ireland. Some of the firms invited into the sales process declined citing the difficulty they would have in carrying out due diligence without such third party assistance.

43. PIMCO had an advantage through its earlier engagement in the process – it, and its advisors, had more time than the other bidders to mobilise the teams required to assess the information available about the loans, to carry out their own research, and to plan a post-acquisition strategy.

Outcome of sale process

44. In late March 2014, just prior to submission of bids, NAMA reduced the minimum price by £70 million to £1,230 million as a result of asset sales completed during the loan sale process. Bidders were required to meet certain conditions including

- make a bid at least equal to the (adjusted) minimum price
- allocate the bid to the individual assets in the portfolio.

45. Two bids were received on 1 April 2014. Cerberus bid £1,241 million – i.e. £11 million higher than the revised minimum price – and Fortress bid £1,075 million – £155 million below the revised minimum. Cerberus allocated its bid to individual assets but the Fortress bid did not meet this condition.

Process assurance

46. The marketing of the Project Eagle portfolio involved a wider field of potential bidders, an increased level of information made available to the potential bidders, and more time for the firms to carry out due diligence than was initially planned. Nevertheless, the process adopted differed from NAMA's other large loan sale competitions. The restrictions imposed reduced both the level of competition and the level of information available to potential bidders to assess the value of the portfolio.

47. NAMA has a clear policy that where it decides to undertake a loan sale, this should normally be by way of an open, competitive process with the objective of maximising the sale price. The policy and related guidelines are consistent with the standard market approach for the sale of loan portfolios which, if implemented, should normally provide reasonable assurance that the best price currently achievable in the market is obtained.

48. NAMA's open competition policy was implemented in the Project Tower and Project Arrow loan portfolio sales. The Board has discretion to depart from its normal loan sale process, and exercised that discretion for Project Eagle. The restrictions NAMA implemented, relative to its standard process, reduced both the level of competition and the opportunity for potential bidders to assess the value of the portfolio. They acted as a deterrent for a number of bidders and had the potential to affect the price achievable.

49. The Board has stated that it is satisfied that all major credible investors with the capacity to submit bids for a portfolio of this scale and composition were approached during the process and that all investors who had a serious interest in acquiring the portfolio had adequate time and information to enable them to prepare and submit firm offers. Based on this, the Board is satisfied that the best price reasonably achievable for the portfolio was obtained.

50. Lazard reported to NAMA that the Cerberus offer was the better of the bids received. In addition, Lazard provided assurance that the 'sell-side' process for the transaction was appropriate, having regard to the information available to it at the time, and NAMA's objectives for the sale. In its assurance statement, Lazard expressly provided no opinion about the underlying NAMA decision to dispose of the portfolio, and did not address the relative merits of the Project Eagle sale as compared to alternative transactions, timing or strategies for the sale that might have been available to NAMA. Additional statements by Lazard to NAMA about the sales process – provided during the clearance of this report – do not materially extend the assurance they provided in 2014.

51. The restrictions on the sales process combined with the scope of Lazard's assurance statement do not provide sufficient assurance that a different marketing strategy for the loans, or different timing of the sale, could not have resulted in NAMA achieving a higher price from the sale of the loans.

Management of conflicts of interest

52. In order for State bodies to safeguard public resources and to maintain public trust in their operations, robust processes are required to deal with potential or perceived conflicts between the interests of the body and those of managers, decision makers and advisors.

53. The Northern Ireland Advisory Committee (NIAC) was established by the NAMA Board in January 2010. It comprised four NAMA Board members, NAMA's Head of Asset Recovery and two external members. The NIAC's main purpose was to make recommendations to the NAMA Board on matters pertaining to Northern Ireland in the context of NAMA's objectives and functions, and to make recommendations to the Board concerning NAMA's strategy for Northern Ireland assets. NAMA did not provide debtor-specific information to the external NIAC members.

54. During NIAC meetings and in annual statements of interests, one external NIAC member, Mr Frank Cushnahan, declared his involvement as an advisor, mainly on a non-fee basis, to six NAMA debtors and to a third party engaged in a joint venture with a seventh debtor. The examination team estimated that the loans of the six debtors represented about half the value of the Northern Ireland loan book. The NAMA Board should have formally considered whether Mr Cushnahan's engagement in discussion of the strategy – including the PIMCO/Brown Rudnick approach – was consistent with his ongoing involvement as financial advisor to a significant proportion of NAMA's Northern Ireland debtor connections.

55. Over a series of contacts with PIMCO between 10 and 12 March 2014, NAMA learned of the existence of an alleged success fee arrangement involving Brown Rudnick, the managing partner of Tughans and Mr Cushnahan, and that the potential payment was in the amount of £15 million to £16 million, to be shared equally. Mr Cushnahan had an office in Tughans' premises in Belfast, and two NIAC meetings had been held there. Given the joint agreement between the parties to the success fee arrangement with PIMCO, all of the payment – not just the payment to Mr Cushnahan – should have raised concerns for NAMA.

56. The Board subsequently learned of the existence of a success fee arrangement involving Cerberus, on the one hand, and Brown Rudnick and Tughans on the other. The understanding that Brown Rudnick and Tughans had allegedly been in an arrangement with a member of the NIAC at any stage of the process should have raised concerns for NAMA about potential impacts of such arrangements on the sale process, unless convincing explanations could be produced.

57. NAMA sought and relied on an assurance from Cerberus that no fee or payment was payable to anyone connected with NAMA *"in connection with any aspect of our (Cerberus) participation in the Project Eagle sales process".* NAMA only learned of Brown Rudnick's engagement with Cerberus on 2 April 2014, and do not appear to have asked Cerberus when it engaged Brown Rudnick, or what was the precise nature of the services Brown Rudnick and Tughans were providing to Cerberus.

58. The allegations of Mr Cushnahan's involvement in an arrangement to share fees with Brown Rudnick and Tughans (or the managing partner of Tughans) warranted more action by NAMA when the matter came to light, such as seeking advice from the unit within the National Treasury Management Agency that was responsible for providing compliance support to NAMA, or writing to Mr Cushnahan to seek confirmation or an explanation. Lazard was not briefed on the disclosures, and was not asked for its assessment of the potential implications for the integrity of the sales process. NAMA appears to have taken a narrow approach, focusing on what were its legal obligations, rather than on what were the options for action that should be considered.

National Asset Management Agency's sale of Project Eagle

1 Introduction

1.1 The National Asset Management Agency (NAMA) is an 'arms length' State agency[1] that was established in December 2009 with a limited time mandate. Its statutory purpose is to acquire impaired property loans from Irish banks, to protect or enhance the value of those assets, and to dispose of them over time. In doing so, NAMA is required to obtain the best achievable financial return for the State.

1.2 NAMA generates income from the assets it holds, and through the sale of assets. By the end of 2015, NAMA had generated around €32.7 billion in cash receipts, of which around €27.2 billion (83%) was from disposals of property and loans.

1.3 NAMA's loan sales up to the end of 2013 had resulted in recovery of marginally more than the value of the related NAMA debt. However, in 2014, it incurred net losses from loan sales amounting to €866 million, including the crystallisation of existing impairment provisions. This was mainly attributable to losses of just over €800 million from the disposal of all the loans of NAMA's Northern Ireland debtors, most of which were sold in a portfolio sale code-named Project Eagle.

Project Eagle

1.4 The interest of potential investors in buying the loans of its Northern Ireland debtors appears to have first come to NAMA's attention in July 2013, in an indirect way (see timeline in Figure 1.1). The London office of a US based firm of solicitors called Brown Rudnick wrote to Northern Ireland's Minister for Finance and Personnel, stating it was acting on behalf of unnamed investment firms and expressing an interest in the loans. The Northern Ireland Minister sent a copy of the letter to his counterpart, the Minister for Finance (the Minister), who in turn, sent it to NAMA.

1.5 In September 2013, a Brown Rudnick client – the Pacific Investment Management Company LLC (PIMCO) – sent NAMA a non-binding indication of interest in the Northern Ireland portfolio, with an indicative purchase price of €1.1 billion (£920 million), and asked for a short and exclusive sales process. In October 2013, the NAMA Board (the Board) agreed to consider the proposal subject to it being made clear to PIMCO that any sale would be by way of open marketing. In December 2013, following review of loan information made available to it by NAMA, PIMCO indicated that its offer for the portfolio would probably be in the range £1.1 billion to £1.3 billion.

1.6 The Board approved a confidential sales process in January 2014, which was to be restricted to a small number of potential bidders who had the capacity to purchase the Northern Ireland debtor portfolio, comprising loans secured by property assets located mainly in Northern Ireland and in Great Britain. The Board set a minimum price for the portfolio of £1.3 billion.

1.7 A restricted sale process commenced in February 2014. PIMCO withdrew from the process in March 2014, having informed NAMA of a 'success fee' arrangement it had in place with three parties which included a former member of NAMA's Northern Ireland Advisory Committee (NIAC). In April 2014, NAMA agreed the sale of the Project Eagle portfolio to Cerberus Capital Management (Cerberus) for a price just above the minimum price.

1 Under the NAMA Act 2009, NAMA operates independently of the Minister for Finance and his Department but the Minister may issue directions to NAMA.

Figure 1.1 Project Eagle key events timeline June 2013 – June 2014

Date	Event	Summary Details
24 June 2013	**Letter from Brown Rudnick to the NI Minister for Finance and Personnel**	Brown Rudnick state that ▪ Two of its clients are interested in a potential purchase of the NAMA Northern Ireland borrower connections loan book. One buyer is stated to be highly committed. ▪ That bidder would be able to submit a binding bid following a short four week due diligence process on the top borrower connections. ▪ Proceeding with one party would ensure a "focused, expedient process with guaranteed confidentiality" which Brown Rudnick stated was "absolutely vital".
24 June 2013	**Letter from NI Minister for Finance and Personnel to the Minister for Finance**	The NI Minister for Finance and Personnel requested that the Minister consider the proposal from Brown Rudnick to explore the potential purchase with NAMA and noted he ▪ had held discussions with some interested prospective buyers ▪ believed that there would be advantages in pursuing the proposal for both the Irish Government and the Northern Ireland Executive.
4 July 2013	**Department of Finance forwards the letter to NAMA**	
25 July 2013	**Response from Minister for Finance to NI Minister for Finance and Personnel**	The Minister noted that ▪ NAMA was required to obtain the best financial return on any loan sale. ▪ NAMA policy was to openly market loan sales. ▪ Brown Rudnick should enter into a dialogue with NAMA.
9 September 2013	**Approach by PIMCO to NAMA**	PIMCO submitted a 'non-binding indication of interest' for the purchase of NAMA's 'Northern Irish loan portfolio'. The submission included ▪ an indicative purchase price of €1,100 million (£920 million) in cash ▪ a request for a short and exclusive sale process to be completed by end-2013 and that NAMA provide information in order to enable PIMCO to complete due diligence.
12 September 2013	**Board notified of PIMCO interest**	The Chairman advised the Board of the correspondence between the Minister and the Minister for Finance and Personnel and of PIMCO's expression of interest.
10 October 2013	**Board approval to explore proposal**	The Board approved a recommendation to explore further the proposal from PIMCO.
4 December 2013	**Indicative offer by PIMCO**	PIMCO wrote to NAMA indicating that its offer for the portfolio would probably be in the range £1,100 million to £1,300 million – £950 million for the top 55 assets, representing about 60% of the value of the portfolio (on which it had conducted due diligence) and between £150 million and £350 million for the balance (for which only basic details had been provided).
12 December 2013 and 8 January 2014	**Board approval to dispose of Project Eagle portfolio**	Over the course of two meetings, the Board approved a proposal to sell Project Eagle for a consideration greater than £1,300 million.
8 January 2014	**Appointment of loan sale advisors approved**	Lazard and Company Ltd appointed as the loan sale advisor for Project Eagle.
13 February 2014	**Media report about the sale**	Press coverage reporting that PIMCO had approached NAMA in 2013 to buy its entire Northern Ireland portfolio.
14 February 2014	**Data room opened to all bidders**	Loan information in data room made available to selected bidders.
12 March 2014	**PIMCO withdraw from loan sale process**	PIMCO withdrew from the loan sales process having informed NAMA of a success fee arrangement with three other parties including a former member of the NIAC.
1 April 2014	**Closing date for bids**	NAMA received two bids for Project Eagle.
3 April 2014	**Board approves sale**	The Board approved the sale of the Project Eagle portfolio to Cerberus.
20 June 2014	**Sale closes**	Sale is finalised and NAMA receives payment from Cerberus.

NAMA Structures

NAMA's Board

1.8 Section 18 of the NAMA Act defines the Board's principal functions as

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

1.9 Section 19 of the NAMA Act provides for the NAMA Board to have nine members – seven appointed by the Minister and two ex-officio members i.e. NAMA's CEO and the CEO of the National Treasury Management Agency (NTMA).[1]

1.10 The Board carries out much of its work through sub-committees, to which it has delegated certain powers and responsibilities. Sub-committees may include members who are not members of the Board, but the majority of each committee must be members of the Board. Six sub-committees were established

- four statutory sub-committees specified in the NAMA Act – Audit, Credit, Risk Management, and Finance and Operations
- two advisory committees[2] – Planning, and the NIAC.

Northern Ireland Advisory Committee

1.11 The NIAC was established by the NAMA Board in January 2010. Its first meeting was held on 12 May 2010. It was dissolved following its last meeting on 8 September 2014, and after completion of the Project Eagle sale.

1.12 The NIAC comprised four NAMA Board members, NAMA's Head of Asset Recovery and two external members. It was chaired by the NAMA Chairman from late 2011 to its dissolution in September 2014. The two external members, Mr Frank Cushnahan and Mr Brian Rowntree, were appointed by the NAMA Board in May 2010. The appointments had been agreed by the Minister for Finance following consultation with the Northern Ireland Minister for Finance and Personnel.

1.13 There was no change in the external membership of the NIAC from its inception to 8 November 2013, when Mr Cushnahan resigned, citing personal reasons. Thereafter, Mr Rowntree remained the sole external member until the NIAC was dissolved.[3]

1.14 The NIAC's main purpose was to make recommendations to the NAMA Board on matters pertaining to Northern Ireland in the context of NAMA's objectives and functions and to make recommendations to the Board concerning NAMA's strategy for Northern Ireland assets. The NIAC did not have decision-making powers. Information relating to specific Northern Ireland debtors was not provided at NIAC meetings.

1 The number of Board members varied during the Project Eagle loan sale process. There was one vacancy in September 2013 and three vacancies between mid-January 2014 and early April 2014.

2 Section 33 of the NAMA Act provides for the establishment of non-statutory advisory committees.

3 Both external members were reappointed following a NAMA Board decision on 10 May 2012, and following consultation with the Ministers.

Focus and scope of this report

1.15 Due to the size of the losses incurred by NAMA on the sale of its Northern Ireland debtor loans, this examination was carried out to ascertain if, in the circumstances, NAMA had obtained the best achievable financial return for the State. The examination reviewed

- the financial outcome of the loan sales
- the basis upon which the Board made its decisions to sell the loans and to set the minimum price
- the competitiveness of the loan sales process and
- the management of conflicts of interest associated with the disposal and with the NIAC.

1.16 References to any third parties (named or otherwise) are incidental to the purposes of assessing the performance by NAMA of its functions. Consequently, the report should not be read as constituting any comment, opinion or judgment in respect of any third party.

Examination methodology

1.17 This report was prepared on the basis of information, including financial analysis, documentation and explanations obtained from NAMA and the Department of Finance. NAMA and the Department were asked to review and comment on the draft report.

Information gathering

1.18 The main source of information for the examination was the contemporaneous records held by NAMA. Key documents reviewed included Board minutes, submissions to the Board by the NAMA executive, documents or other evidence supporting the submissions, and correspondence and other documents (e.g. contracts) between NAMA and its loan sale advisors.

1.19 At the examination team's request, NAMA conducted a search of electronic documents using key Project Eagle-related words for a specific period (September 2013-April 2014) on email accounts of NAMA officials who had significant roles and responsibilities in the transaction. The search resulted in the creation of a database which contained in excess of 40,000 documents (including email attachments).

1.20 The examination team adopted a targeted approach in reviewing the database. All e-mail correspondence with Lazard (around 2,000 items) and the main prospective bidders was reviewed. The examination also reviewed internal correspondence between NAMA officials during key stages on specific matters in the loan sale process. These matters included PIMCO's early engagement in the process, the financial analysis underpinning submissions to the Board, the engagement of potential bidders, media coverage, PIMCO's withdrawal from the process, the submission of final bids and Cerberus' disclosure to NAMA of success fee payments.

1.21 In addition to examining the Project Eagle sales process, relevant records for NAMA's Project Tower and Project Arrow sales processes were reviewed. Those sales were similar in scale to Project Eagle. Project Tower comprised the sale of the loans of a single debtor with a large number of properties, mainly in Ireland. Project Arrow comprised the sale of the loans of a large number of Irish debtor connections.

1.22 The examination team met with NAMA officials from its Asset Recovery, Finance, and Legal functions, and with officials from the NTMA compliance unit, which provides support to NAMA. Some NAMA officials that had played key roles in the Project Eagle loan sale process were no longer with the Agency when the examination was being carried out.

1.23 NAMA provided further information and explanations throughout the examination process, including in response to drafts of the report.

Financial analysis

1.24 The examination team reviewed the financial analysis presented to the Board. This included examination of the projected debtor cash flows underpinning the loan valuations in the financial statements, an assessment of adjustments made by NAMA to the cash flows, including in a scenario analysis, and a reperformance of calculations of the net present value (NPV) of the cash flows.

1.25 The examination team also reviewed the financial outturn including a property-by-property comparison of the proceeds of the 2014 Northern Ireland debtor disposals with end 2013 workout cash flows.

Quality control process

1.26 The examination findings and draft report were subject to a number of internal quality reviews, conducted in accordance with the Office's quality control policies by persons independent of the examination team.

Formal clearance process

1.27 NAMA was provided with a statement of facts and evidence and four drafts of the report (see Figure 1.2). NAMA provided comprehensive replies to each draft. The responses were reviewed and endorsed by the NAMA Board on each occasion.

Figure 1.2 Report drafts issued to NAMA

Document	Issued to NAMA	Reply received from NAMA
Statement of facts and evidence	8 January 2016	29 January 2016
Draft 1	11 March 2016	6 April 2016
Draft 2	26 April 2016	12 May 2016
Draft 3	27 May 2016	10 June 2016
Draft 4 (including summary)	1 July 2016	15 July 2016

1.28 A number of meetings to discuss the drafts issued to NAMA were held (see Figure 1.3).

Figure 1.3 Meetings to discuss drafts

Date of meeting	NAMA	Office of the Comptroller and Auditor General
15 January 2016	CEO and relevant officials	Examination team
26 February 2016	Chairman, CEO and relevant officials	Examination team
15 March 2016	Chairman	Comptroller and Auditor General
23 March 2016	Relevant officials	Examination team
5 April 2016	Chairman	Comptroller and Auditor General

1.29 The points raised, and information provided, by NAMA in its responses and in meetings were given careful consideration. Schedules were provided to NAMA with subsequent drafts of the report setting out either the action taken in response to the detailed points raised or, where a point was not accepted (or accepted only in part), the basis for that position.

1.30 The drafts of 27 May 2016 and 1 July 2016 were also sent to the Department of Finance for comment. Officials from the Department of Finance met with the examination team to discuss the draft of 27 May 2016, and the Department responded in writing to the final draft.

Currency

1.31 The loans of the Northern Ireland debtors were mainly denominated in sterling and Project Eagle was transacted in sterling. That is the currency used in most instances throughout the report.

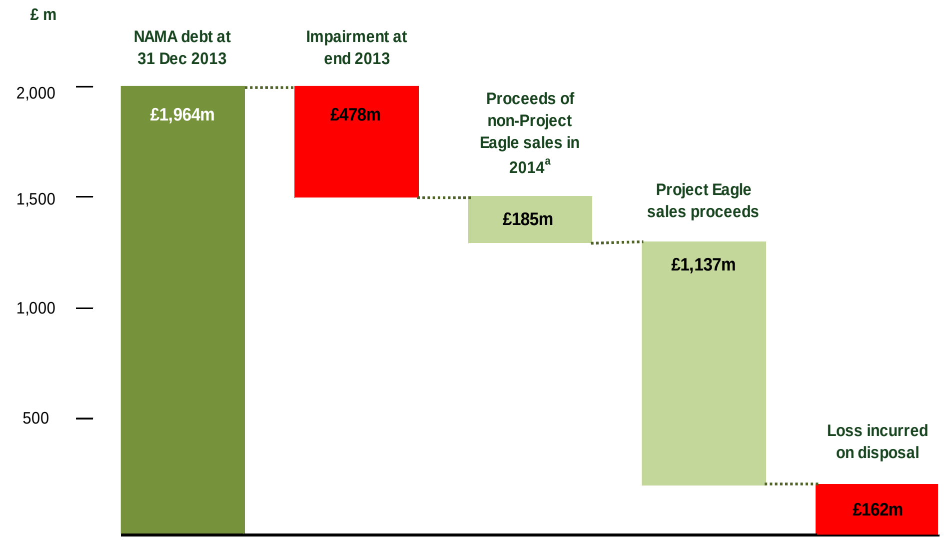
2 Financial outcome of the loan sale

2.1 Some of NAMA's Northern Ireland debtor loans and underlying collateral were already in the process of being sold when it was decided to proceed with Project Eagle. Those sales continued in parallel. As a result, the composition of the Project Eagle portfolio changed over time, and the final portfolio sold to Cerberus was smaller than originally envisaged. This chapter reviews the changes in value of the portfolio as the process evolved, and the impact of the sales on NAMA's financial position.

Loss on sale

2.2 The gross disposal proceeds from the sale of Northern Ireland debtor loans in 2014 amounted to £1,322 million.[1] This comprised £1,137 million from Project Eagle and £185 million from the disposal of other Northern Ireland debtor loans and properties. Relative to the corresponding NAMA debt at 31 December 2013[2], the total loss incurred by NAMA amounted to £640 million (€802 million). Just over one quarter of the loss was incurred in 2014. The balance of the loss had already been recognised in impairment charges by the end of 2013 (see Figure 2.1).

Figure 2.1 Losses incurred on loans of Northern Ireland debtors



Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

Notes:
a NAMA also received £9 million in proceeds from the sale of assets of Northern Ireland debtors in December 2013. As a result, total proceeds from the sale of the portfolio that was considered by the Board on 12 December 2013 amounted to £1.33 billion, before taking account of Project Eagle disposal costs.

b Loan movements in 2014 (other than those relating to disposals) such as loan interest income earned and cash received from debtors reduced the value of NAMA debt by a net £2 million between end-2013 and the close of the Project Eagle sale in June 2014.

1 Disposal costs of €6 million were incurred in respect of Project Eagle.

2 NAMA debt is the acquisition value of a loan, adjusted for interest charged and cash advanced to, or received from, the debtor.

2.3 NAMA incurred an overall loss of 13% on the sale of the Project Eagle loans relative to their carrying value at end 2013 (see Figure 2.2). The loss incurred was highest – at over 30% – on that part of the portfolio that was managed by the participating institutions rather than directly by NAMA.[1]

2.4 The contemporaneous sales by NAMA of Northern Ireland debtor properties and loans related to 125 properties in total, 78% (in value terms) of which were large assets located in Germany and Britain. In contrast to the losses on the Project Eagle loans, those sales resulted in losses averaging 1% relative to their carrying value.[2]

Figure 2.2 Comparison of the sales proceeds for Northern Ireland debtors' loans and assets with the carrying value after impairment of the properties in NAMA's books

	Carrying value after impairment 31 Dec 2013	Sales proceeds	Difference
	£m	£m	%[a]
Project Eagle disposals			
NAMA-managed debtors	1,092	993	(9.1%)
PI-managed debtors	207	144	(30.5%)
Disposal costs[b]		(6)	
All Project Eagle disposals	**1,299**	**1,131**	**(13%)**
Non-Project Eagle disposals			
NAMA-managed debtors			
Project Shift[c]	*74*	*76*	2.0%
Other large assets in Germany and Britain	*67*	*68*	1.5%
Other assets[d]	*24*	*21*	(10.5%)
PI-managed debtors[e]	22	20	(7.9%)
All non-Project Eagle disposals	**187**	**185**	**(1.0%)**
Totals	**1,486**	**1,316**	**(11.4%)**

Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

Notes:
a The differences in percentages were calculated before the proceeds and carrying values after impairment were rounded to £ million. Minor % inconsistencies due to rounding.
b The carrying value in NAMA's books is net of projected disposal costs. Therefore, for purposes of comparison, the costs of disposal for Project Eagle are included.
c The sale of assets under Project Shift was effected as a loan sale.
d In addition to these disposals, NAMA had agreed the sale of properties held by NAMA-managed debtors for around £20 million when the loan sale closed. These properties were sold at values marginally above the end-2013 carrying values. When these are taken into account, the value at which smaller assets were disposed of in 2014 was, on average, around 5% below end-2013 carrying values.
e NAMA did not estimate carrying values for individual properties held by PI-managed debtors. See side note 2.

1 NAMA manages its biggest debtor connections directly. Smaller debtors are managed on NAMA's behalf by the banks from whom these loans were acquired. The latter are referred to as 'participating institutions' (PIs).

2 For the properties held by NAMA-managed debtors, the price was compared on a property by property basis. For PI-managed debtors, NAMA did not have estimated realisable values for individual properties. The examination compared the aggregate carrying value of the loans, after impairment, with the Cerberus bid.

2.5 NAMA's sales outside Project Eagle included Project Shift, which was a portfolio of German property assets held by a Northern Ireland debtor. The sale of this portfolio, after an open marketing process, had commenced prior to Project Eagle. Coincidentally, Cerberus was the purchaser of those assets.

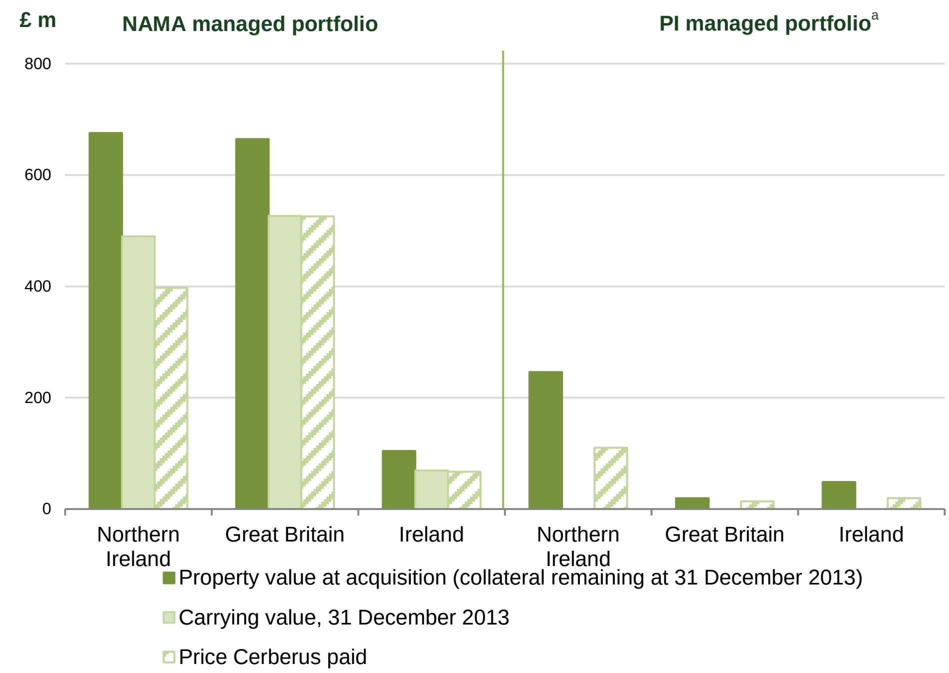
2.6 NAMA has stated that the sale of debt results in a discount being applied by a purchaser which does not apply in the case of a consensual property disposal and it considers that comparing the non-Project Eagle disposals to Project Eagle is incorrect as these sales were asset sales whereas Project Eagle was a loan sale.

2.7 Most of the losses incurred on the Project Eagle portfolio were on properties located in Northern Ireland. Assets elsewhere were, on average, sold at about their carrying value after impairment at end 2013 (see Figure 2.3).

2.8 Relative to par debt [1] values at 31 December 2013, NAMA realised through its sales in 2014

- 33 pence in the £ for NAMA-managed loans
- 15 pence in the £ for PI-managed loans
- Overall, 29 pence in the £ for the Northern Ireland debtor portfolio.

Figure 2.3 Comparison of Project Eagle sales price with estimated carrying values after impairment of properties at 31 December 2013 and their acquisition values



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

Note: a Property carrying values after impairment by location at 31 December 2013 have not been estimated for the PI managed portfolio because the level of detail required for that analysis was not available.

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

Post-bid claims

2.9 In June 2014, before the Project Eagle sale closed, the Board was informed of a number of issues which Cerberus had raised regarding the price, which was subject to further due diligence examination (see Figure 2.4). On the basis that the loan portfolio had been offered in a transparent manner, the Board decided not to change the basis upon which it had run the sales process, or to accept 'price chipping'.

Figure 2.4 Post-bid issues raised by Cerberus

Issues raised by Cerberus	NAMA's view
As part of the finalisation of due diligence on the 'tail' of Project Eagle (around 850 properties)[a], Cerberus proposes to place £128 million in escrow due to uncertainty in relation to the security of certain assets.	▪ The sale process required the bidder to purchase the 'tail' on a portfolio basis i.e. with limited data. ▪ Pricing would have been different if the 'tail' was not being sold on a portfolio basis. ▪ The portfolio had appreciated in value since the commencement of the process.
Cerberus' bid should be reduced by an estimated £20 million due to issues about recourse to assets of one debtor.	All information in relation to this debtor had been available in the data room and if Cerberus had inadvertently bid on an incorrect basis, that was its risk.
Cerberus objects to NAMA deducting bid amounts rather than sales proceeds for sales completed between bid date and completion.	NAMA retains gains amounting to approximately £5 million on these sales. However, Cerberus will benefit from other accrued gains in the order of £35 million (see Figure 2.5).[b]

Source: NAMA Board minutes 12 June 2014.

Note: a The 'tail' included all of the properties held by the PI-managed debtors and around 450 properties held by NAMA-managed debtors.

b The Board minutes of 12 June 2014 state that the benefits to Cerberus amounted to €33 million. However, the supporting documentation refers to an amount of £35 million.

2.10 A presentation to the Board at its June 2014 meeting detailed benefits valued at £35 million that could accrue to Cerberus but which had not been priced in its bid. These are summarised in Figure 2.5.

Figure 2.5 Benefits to Cerberus not priced into bid

Item	Value £ m
Profit on properties where sales were agreed but the sales were not closed when the Project Eagle sale completed[a]	14.1
Asset for which a significant bid had been submitted by a third party	8.0
Secured/blocked cash deposits	6.2
Assets not included in original bid list compiled by NAMA	5.3
Deferred income	1.8
Total	**35.4**

Source: NAMA; Analysis by the Office of the Comptroller and Auditor General – see Appendix A.

Note: a It is standard practice for the benefit of property disposals where the sale has not completed when the loan portfolio sale is closing to accrue to the purchaser. Cerberus was legally entitled to the profit on these sales.

2.11 NAMA stated that, at the time it presented the paper to the Board, there was considerable friction about the final price, on which Cerberus was seeking a significant reduction. In response, NAMA identified parts of the portfolio that could generate potential additional benefits to Cerberus, albeit that some of these would depend either on the cooperation of the debtor or enforcement by Cerberus.

2.12 The interest in secured/blocked cash deposits transferred to Cerberus – a total of £6.2 million – included a deposit of £3.7 million in respect of which NAMA gave full consideration when it acquired the associated loans. The deposit was subject to a 'letter of set off' from the borrower to the bank which held the deposit. NAMA stated that the debtor had refused to set off the deposits against amounts due to NAMA. Because of NAMA's statutory rights over the bank (as provider of services to NAMA), it could have directed the bank to enforce the letter of set off and hold the monies in trust for NAMA.[1] It did not do so. Cerberus paid no consideration to NAMA in respect of the deposit when it acquired the loan. NAMA has pointed out that Cerberus did not legally have the capacity to acquire this right.

2.13 Following a review in the course of the examination of the post-bid items set out in Figure 2.5, NAMA has concluded that it is potentially owed £1.6 million by Cerberus in respect of assets not included on the original bid list compiled by NAMA. In addition, following queries by the examination team, NAMA has now identified £1.2 million in respect of property sales that closed around June 2014, the proceeds of which were incorrectly paid to Cerberus. NAMA stated that it is seeking to recoup this £2.8 million. NAMA has subsequently stated that Cerberus has indicated its intention to revive a claim against NAMA for an amount of up to £20 million.

1 Payment for the deposit was consistent with NAMA's loan valuation methodology. Section 100 of the NAMA Act 2009 gave NAMA the right to direct the bank to enforce the letter of set off.

Conclusions

2.14 About one-eighth of the Northern Ireland debtor connection portfolio at end 2013 was disposed of during 2014 separately from, but in parallel with, Project Eagle – 78% of these were large assets located in Germany and Britain. On average, NAMA incurred a small loss on those sales (1%), in addition to the impairment already recognised.

2.15 The level of loss incurred by NAMA on the disposal of the remaining assets through Project Eagle was much higher, averaging 13% across the portfolio. Most of the loss was incurred on the disposal of assets located in Northern Ireland. On average, Cerberus bought property located elsewhere at around the NAMA carrying value after impairment.

2.16 The bid submitted by Cerberus was not final, and was conditional on the outcome of additional due diligence reviews up to finalisation of the sale. NAMA resisted additional claims from Cerberus to reduce the price. However, NAMA has now identified potential benefits to Cerberus that were not included in the sale price. In April 2016, following a review of these items, NAMA stated that it is seeking to recoup £2.8 million from Cerberus. NAMA has subsequently stated that Cerberus has indicated its intention to revive a claim against NAMA for an amount of up to £20 million.

3 The basis for the decision to sell the Northern Ireland debtor loans

3.1 The primary business challenge for NAMA is to establish the optimum timing to dispose of its assets, within its planned life span. This must take account of its primary objective to obtain the best achievable financial return for the State, while dealing expeditiously with the disposals.

3.2 Loan portfolios previously sold by NAMA had involved different characteristics to the proposed Project Eagle portfolio. In the main, the previous loan disposals involved small portfolios, or the loans of individual debtors, or loan sales at par debt value. The proposed Project Eagle portfolio involved a large bundle of loans of various sizes relating to multiple debtors.

3.3 This chapter examines how NAMA arrived at the decision to sell the bulk of the loans of its Northern Ireland debtors in a single portfolio, and how it determined the minimum price at which it was prepared to sell the portfolio. It does not comment on NAMA's strategy or on the merits of the decision to sell the portfolio.

3.4 The minutes of relevant Board meetings, and papers submitted to the Board to support its consideration of the options, are reproduced in Appendices B and C respectively.

NAMA's strategy for Northern Ireland debtors

3.5 NAMA developed separate strategies for parts of its portfolio, based on market analysis, and on business plans submitted by its debtor connections.[1] These strategies evolved over time as market conditions changed. NAMA updated its strategy in respect of property collateral located in Northern Ireland in May 2013. The aim was to

- protect and enhance the value of property assets in Northern Ireland by maximising rental income
- dispose of the property in the medium to long term (2014 to 2017)
- prioritise the disposal of grade A commercial property in Belfast
- explore opportunities for the block sale of multi-unit properties, subject to a critical assessment of value relative to individual sales.

3.6 A draft of the strategy in respect of property assets located in Northern Ireland had been provided to the NIAC in April 2013 for review. When the Board approved the policy in May 2013, it noted that the two external members of the NIAC had provided some observations on the policy and had commended its overall quality.

3.7 The NIAC discussed the Board-approved policy again at a meeting on 15 July 2013. The minutes of that meeting record a number of observations including *"…the external member perspective that the deleveraging intentions of other banks…suggested that notwithstanding NAMA's prudent policy position in relation to Northern Ireland assets, the approach may require re-evaluation to exploit any demand opportunities in the near term."*

1 Closely connected debtors, whose aggregate loans are considered by NAMA to be best managed as one cohesive connection rather than separately, are grouped together to form a 'debtor connection'.

Change in strategic approach

3.8 There is no indication, prior to Brown Rudnick's correspondence in June 2013, that NAMA or its Board had given consideration to the sale of either its loan collateral in Northern Ireland or of the loans of the debtors based in Northern Ireland, in a single sale.

3.9 NAMA has stated that a number of factors influenced its decision to sell the loans in a single lot rather than continue to work out the loans over the medium term. These included

- emergence of the loan sale option
- political considerations
- NAMA's deteriorating relationship with the Northern Ireland debtors.

Emergence of loan sale option

3.10 NAMA pointed out that the Board is obliged to keep its strategic options under regular review and, where new strategic options emerge, to give them due and full consideration. The existing strategy towards Northern Ireland assets – a phased medium to long-term disposal – was largely determined by the fact that there was no feasible alternative up to the autumn of 2013. There was little demand for Northern Ireland assets when sold individually – only £100 million of these assets had been sold since 2010 – and when it became evident in the autumn of 2013 that a loan sale might now create a second feasible option, the Board was obliged to give it full consideration. NAMA also stated that, having given the matter thorough consideration, it decided that a loan sale would be its preferred option if it could be achieved on terms that were in line with its obligations under section 10 of the Act i.e. to obtain the best achievable financial return.

Political considerations

3.11 NAMA stated that the political and cross-jurisdictional context in which it held Northern Ireland debtor assets also influenced the course of action it took. It noted that the acute sensitivity of the Northern Ireland portfolio was highlighted by the fact that, after NAMA's establishment, the Minister for Finance felt it necessary to recommend to NAMA that it establish the NIAC, and that this was not considered necessary for any other jurisdiction or sector. NAMA also pointed out that pressure had been applied on a regular basis by senior Northern Ireland politicians to have a Northern Ireland representative on the NAMA Board. The fact that NAMA was an agency of the Irish State contributed an additional level of complexity and sensitivity to the already formidable challenge of managing the Northern Ireland loan portfolio.

NAMA's relationship with its Northern Ireland debtors

3.12 NAMA stated that it had become increasingly evident to the Board in 2012 and 2013 that NAMA's ability to realise the value of its Northern Ireland debtor portfolio was more constrained than was the case with debtors based elsewhere. It recognised there was a probability of an increasingly attritional engagement with debtors and of an increasing reliance on enforcement both of which would ultimately be likely to lead to a significant erosion of the realisable value of the portfolio.

3.13 NAMA pointed out that it was also clear that enforcement in Northern Ireland by an agency of the Irish State was likely to give rise to political difficulties. In 2013, a decision to enforce against one of the smaller Northern Ireland debtor connections had given rise to negative and widely reported political comment. NAMA's view was that, if it had found it necessary to enforce against larger connections, it is very likely that it would have been faced with a major outcry from political and business interests, given the relatively small size of the Northern Ireland economy and the potential perception that the economy was being driven into a deeper recession by the actions of an Irish State agency. NAMA was also concerned that a widespread lack of co-operation would adversely affect the proceeds that could be realised from a medium-term workout of the assets.

Broader strategic context

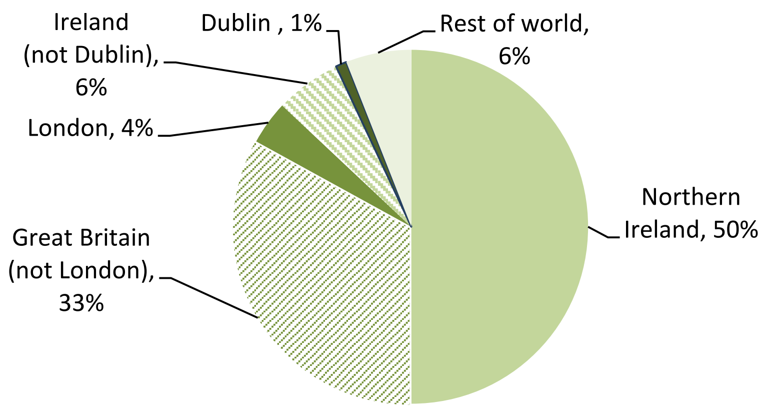
3.14 The Board has also pointed out that

- NAMA cannot ignore the wider political, economic and financial implications of its decisions and activities. The decision to sell the Project Eagle portfolio did not take place in a vacuum. NAMA's activities have had a direct impact on the economic and financial recovery experienced by Ireland over recent years. The contingent liability to Irish taxpayers represented by NAMA's senior debt has fallen to less than a fifth of its original scale. The accelerated debt redemption programme has been highlighted by the credit ratings agencies as a factor in their decisions to upgrade Ireland's sovereign credit ratings. Those upgrades, in turn, have contributed to a reduction in Ireland's borrowing costs.
- The commercial property market is now, by and large, functioning normally and the residential market is in recovery. Given the original scale of NAMA's involvement in the property market, the Board believe that NAMA's deleveraging was a major and necessary factor in stimulating the substantial volume of activity that has taken place over recent years and that it acted both prudently and commercially in taking advantage of opportunities in the British, Northern Irish and Irish markets when they arose between 2014 and 2016.
- The statutory requirement that NAMA act expeditiously meant that it could not have adopted a long-term holding strategy which would have involved awaiting some optimum price level at some indeterminate point in the future before disposing of its assets. Instead, NAMA had to respond to market conditions and to take advantage of opportunities to sell assets where demand and price conditions were favourable, as was the case with Project Eagle in 2014. Any analysis of the Project Eagle transaction and of other major NAMA sales should take into account the broader collateral benefits that have arisen in terms of the impact on State borrowing and on the property market.
- The proceeds realised from Project Eagle made a significant contribution to the major debt redemption achieved in 2014. The sale of Project Eagle also had the effect of de-risking the NAMA loan portfolio and of reducing the foreign exchange risk associated with sterling debt. Future costs arising from management of the Northern Ireland debtor loan portfolio were also obviated.

Disposal options considered by the Board

3.15 The PIMCO/Brown Rudnick proposal was for the purchase of the loans of Northern Ireland based debtors, rather than just of NAMA assets in Northern Ireland. In practice, the proposed portfolio included a considerable amount of property located outside Northern Ireland (see Figure 3.1).

Figure 3.1 Collateral for Project Eagle loans by location[a]



Source: NAMA.

Note: a Percentages are based on November 2009 property valuations.

3.16 Although the approved workout strategy for NAMA's Northern Ireland debtors was defined in terms of property location (and not by debtor location), the papers presented to the Board in relation to Project Eagle made only minimal reference to consideration of alternative options – for example, the possibility of aggregating the assets by location, or disposing of the more valuable properties, or groups of properties (retail, offices, hotels) separately, as occurred with Project Arrow.

3.17 The only reference to possible alternative portfolio compositions was in the December 2013 paper for the Board, which simply noted that the top five Northern Ireland debtor connections represented 80% of the total value and could be marketed together. In responding to the findings of this report, NAMA has stated that separate disposal of the loans of the largest connections would have left NAMA with around 50 residual connections whose loans/assets would have had little appeal to investors.

3.18 There is no evidence from the Board minutes that the Board considered any option/strategy for disposal, other than that proposed by PIMCO/Brown Rudnick.

3.19 NAMA has stated that, although not recorded formally, it gave adequate consideration to alternative disposal options. It stated that, given that four members of the Board were also members of the NIAC, the Board was very familiar with the difficulties associated with managing Northern Ireland debtors and with the feasibility of various potential disposal options. NAMA pointed out that all Board members were fully conversant with the challenges associated with the Northern Ireland portfolio and the difficulties NAMA was likely to encounter in its attempt to extract full value from it, regardless of the strategy adopted. Options considered and rejected included compiling a portfolio by reference to

- Aggregation by location of the property collateral – a sale of loans secured only by Northern Ireland assets was not considered feasible because of the extent to which individual debtor loans were cross-collateralised. For the majority of Northern Ireland debtors, particularly the larger ones, loans were typically secured by both Northern Ireland assets and assets located in other jurisdictions.
- Aggregation by property type (e.g. retail, offices, development land) – this was not considered feasible because this approach requires debtors' co-operation to facilitate the sales and NAMA considered it unlikely it would get the level of co-operation required.
- Separate sales of loans of individual debtor connections – this would also have required enhanced levels of debtor co-operation and was not considered feasible.

3.20 NAMA also stated that because of the portfolio composition, in terms of average asset value, asset mix, and asset location it was unlikely that potential investors would commit significant investment in due diligence unless a transaction was offered which was of sufficient scale to justify the cost and effort involved.

NIAC views in relation to Project Eagle

3.21 The NIAC minutes record that Project Eagle was first discussed at a meeting on 7 October 2013. The Chairman informed the Committee of PIMCO's unsolicited approach and that the Board would consider the matter at its meeting on 10 October 2013. He stated that achieving value and open marketing were key considerations for NAMA.

3.22 As recorded in the minutes, views expressed by NIAC members during the discussion included

- The sale of a portfolio on such a scale could lead to strategic 'land locking'.[1]
- Such a sale would require value to be achieved by NAMA, with transparency as a protection in this regard.
- The approach from PIMCO implied that value could be obtained from the portfolio, although the Northern Ireland debtor portfolio also included assets outside Northern Ireland – mainly in Great Britain; taken together, the portfolio could be considered a 'strategic purchase'.
- A discount would be sought, so the question of value would be key for NAMA – the decision whether to sell or hold the portfolio.

3.23 The NAMA Board minute of 10 October 2013 records the Chairman stating that the external members supported NAMA's approach and its key considerations regarding price and open marketing.

3.24 Aside from the foregoing, the examination found no documentary evidence of advice or recommendations being provided by the NIAC to the Board in respect of Project Eagle.

1 Strategic land locking is where sites are withheld from development or sale until development becomes more profitable.

Evaluating the alternatives

3.25 The core choice for NAMA when it received PIMCO's expression of interest was whether it should sell all the loans of its Northern Ireland debtors together as a single portfolio, or dispose of the assets over a longer period. This required a comparison of the values of the alternatives.

3.26 The results of NAMA's evaluation of the issues were presented in a paper submitted to the Board for its meeting on 12 December 2013 (reproduced in Appendix C). The paper focused in particular on three bases for valuing the loans

- the carrying value of the loans
- the present value of the projected future cash flows associated with the loans (i.e. the value if NAMA continued to work out the loans on an asset-by-asset basis)
- a potential purchaser's valuation of a portfolio of non-performing loans.

Carrying value of the loans

3.27 When NAMA acquired the property loans from the participating institutions in 2010, it applied a discount to the par value of the debt. It recognised the loans in its financial statements at 'fair value' using the long term economic valuation (LTEV) technique, taking account of the expected future cash flows under the loan agreements – the NAMA debt value. Thereafter, NAMA uses the effective interest rate (EIR) method to calculate the value of the loans at specific points in time for financial reporting purposes.

3.28 Where there is objective evidence that the expected future loan receipts are reduced due to events that have already occurred (for example, a drop in property market transaction values), the loan value is considered to be impaired. NAMA estimates the amount of the impairment loss as the difference between the NAMA debt amount and the net present value (NPV) of the projected future cash flows.[1]

3.29 The December 2013 paper for the Board indicated that the NAMA debt at end November 2013 was £1,980 million, or 43% of the par value (see Figure 3.2). The NAMA debt was 46% of par value for NAMA managed loans, and 32% for the loans managed by participating institutions.

3.30 Taking account of the expected results of its impairment review then under way, NAMA forecast the Project Eagle loans would have a carrying value of £1,475 million in present value terms at 31 December 2013. This resulted in forecast impairment of £505 million for the Northern Ireland debtor loans – an impairment rate of 25.5%. By comparison, the impairment rate across the whole NAMA loan book at end-2013 was 17.4%.

Adjustment to the forecast carrying value

3.31 The paper for the Board also presented the results of a downward adjustment of the projected receipts from the sale of Northern Ireland debtor properties expected to sell during the period 2017 to 2020. The paper stated that those properties were 'currently not impaired', and applied a 17% reduction in the projected sales receipts i.e. similar to the average impairment rate for the whole NAMA loan book at that time. This was estimated to reduce the forecast carrying value to £1,390 million and increase the forecast impairment by £85 million.[2] This would bring the average impairment rate for the Northern Ireland portfolio to just under 30%.

1 Expected surplus income may arise where the net present value of the loan cash flows exceeds the NAMA debt but under NAMA's accounting policies, such surpluses are only recognised in the financial statements under certain conditions.

2 Due to rounding this adjustment was referred to variously as £85 million or £86 million in NAMA documents.

Figure 3.2 Forecast carrying value of NAMA's Northern Ireland debtor loans at 31 December 2013[a]

	NAMA-managed loans	PI-managed loans[b]	Total
	£ m	£ m	£ m
Par value of the loans [c]	3,546	1,066	4,612
As % of total	77%	23%	100%
Baseline valuation			
NAMA debt	1,640	340	1,980
Carrying value (present value of forecast cash flows) [d]	(1,240)	(235)	(1,475)
Estimated impairment	400	105	505
Impairment rate (as % of NAMA debt)	*24.3%*	*30.9%*	*25.5%*
Adjusted valuation			
NAMA debt	1,640	340	1,980
Carrying value (present value of forecast cash flows) [c]	(1,155)	(235)	(1,390)
Estimated impairment	485	105	590
Impairment rate (as % of NAMA debt)	*29.6%*	*30.9%*	*29.8%*

Source: Analysis by Office of the Comptroller and Auditor General, based on NAMA working papers.

Notes:
a The forecast was made in November 2013 using cash flows prepared for year-end impairment review.
b Debtors managed by the participating institutions.
c The par value of the loans at acquisition was £3,777 million for the NAMA managed and £1,022 million for the PI managed. The balances at end 2013 reflect subsequent loan movements e.g. interest charged and cash advanced or received.
d The average EIR used to discount the cash flows was just under 4.8%.

3.32 The supporting documents presented to the examination team by NAMA state that the adjustment was made because the prices at which the properties were forecast to sell between 2017 and 2020 were still valued at November 2009 levels. The examination found that, in fact, the expected proceeds from those property disposals had already been reduced following individual reviews.

- Properties located in Northern Ireland were already 25% below the 2009 values – following the adjustment they were at 38% below 2009 values.
- Properties located in Britain were an average of 5% below the 2009 values – following the adjustment they were at 21% below 2009 values.
- Overall, the property values for that part of the portfolio were already more than 15% below November 2009 values, and following the adjustment they were 30% below 2009 values.[1]

3.33 Had NAMA carried out a review of the projected proceeds from the 2017-2020 disposals when it was preparing the paper for the Board in December 2013, it would have identified that the projected proceeds were, on average, well below November 2009 values.

1 For loan valuation purposes at acquisition, NAMA valued property collateral as at November 2009, and added an uplift (average 8%) for the long-term value of properties. When account is taken of the uplift, the 2017-2020 property disposal values were already impaired on average by over 20%, and following the adjustment by 34%.

3.34 In response to drafts of this report, NAMA has put forward a number of reasons for the adjustment of the 2017-2020 projected disposal receipts. These included that

- The adjustment was a high-level estimate made using management judgment.
- Given that the impairment reviews for financial reporting purposes had been of a limited nature, it was appropriate for a further review and adjustment of the 2017 to 2020 cash flows to be undertaken in the context of a commercial loan sale transaction.

3.35 NAMA also stated that subsequent analysis of property market data showed that the adjustment of the 2017-2020 disposals was reasonable

- by reference to a property price index for Northern Ireland, which showed a decline of 33%; and for properties in Britain (partially) by reference to a property index which showed a decline of 19%
- by reference to the prices achieved by NAMA for a representative sample of disposals of properties located in Northern Ireland in 2013 which showed that, on average, the gross disposal values had fallen by 28% since 2009.

3.36 In regard to each of these points, the examination found that

- No evidence was provided by NAMA to show that the cash flows for the period 2017 to 2020 had been subject to further review when the December 2013 paper was being prepared, and the basis for the management judgment was not set out.
- The Northern Ireland property index referred to by NAMA showed that property values had declined by 10% between 2009 and 2013. The decline of 33% referred to by NAMA related to the period from peak values around 2006, much of which had been taken into account when the loans were acquired by NAMA at November 2009 values.
- All of the UK property disposal values had been reviewed (some in 2013) when business plans were being prepared.
- The sample of 2013 disposals of Northern Ireland properties referred to by NAMA was not representative of the Project Eagle assets planned for disposal between 2017 and 2020 because
  - almost half of the 2013 disposals in the sample were land, while land comprised just 10% of the planned Project Eagle 2017-2020 disposals
  - there were no disposals of Northern Ireland retail properties in 2013, but retail property accounted for almost a third of the planned 2017-2020 disposals in Northern Ireland
  - NAMA excluded residential disposals in 2013 from the sample even though residential disposals were planned for 2017-2020.
- When price drops from November 2009 levels are applied on a weighted basis to reflect the composition of the projected 2017-2020 disposals, an additional reduction of around £8 million in the projected disposal values is indicated. This is about one-tenth of the adjustment applied by NAMA.

3.37 NAMA's baseline cash flow projections were based on the assumption that property values would remain at current levels until disposal. The adjustment downwards of projected future asset disposal proceeds in the paper presented to the Board was in contrast with PIMCO's reported view that the Northern Ireland economy had 'bottomed out' and that it wanted the exposure to capitalise on future growth/recovery.[1]

1 As noted in NAMA's paper to the Board in October 2013.

3.38 NAMA has stated that its impairment processes include a rigorous, bottom-up asset-by-asset review and that projected cash flows are estimated based on the best information known to NAMA at that particular time. NAMA pointed out that it has always adopted a conservative approach in its assumptions about future price inflation. It stated that in 2013, when the Northern Ireland property market was still weak, it would have been imprudent for NAMA to factor in potential price increases to its property collateral without any supporting evidence that such uplift was likely to take place.

Discounted cash flows

3.39 The NAMA paper for the Board presented the projected cash flows related to the expected workout of the Northern Ireland debtor loans through sale of the assets over the period 2014 to 2020.[1]

3.40 More detail was presented in the cash flows in relation to the larger, NAMA-managed debtors' loans than in relation to the loans managed on NAMA's behalf by the participating institutions. Before applying the adjustment referred to in the previous section, NAMA projected its net receipts from working out the Northern Ireland debtor loans over the period 2014 to 2020 would total £1,675 million (see Figure 3.3).

1 The underlying cash flows are those also used for estimating the loans' carrying value.

Figure 3.3 NAMA's Northern Ireland debtor loans – expected cash flows, 2014 to 2020[a]

	2014	2015	2016	2017	2018	2019	2020	Total
	£m	£m	£m	£m	£m	£m	£m	£m
NAMA-managed (20 debtor connections)								
Rent and other non-disposal receipts	88	59	43	18	—	—	—	208
Operating costs and overheads	(30)	(16)	(12)	(7)	—	—	—	(65)
Disposal proceeds	440	264	138	462	32	6	6	1,348
Disposal costs	(8)	(5)	(2)	(9)	(1)	—	—	(25)
Investment/new loans	(24)	(12)	(10)	(25)	(2)	(1)	—	(72)
Net receipts from NAMA managed debtors	*466*	*290*	*156*	*442*	*29*	*5*	*6*	*1,393*
PI-managed (36 debtor connections)								
Net receipts from PI-managed debtors	40	40	40	40	40	40	40	282
Total net receipts[b]	**506**	**330**	**196**	**482**	**69**	**45**	**46**	**1,675**
Net present value of cash flows[c]								
At 5.5% discount rate	**493**	**305**	**173**	**398**	**54**	**34**	**33**	**1,489**
At 2.5% discount rate	**500**	**318**	**185**	**441**	**62**	**40**	**39**	**1,585**

Source: NAMA paper for the Board, December 2013; analysis by Office of the Comptroller and Auditor General.

Notes:
a Inconsistent totals are due to rounding.
b For discounting purposes, it is assumed that net receipts arise evenly throughout the year.
c Net present value calculated by the examination team.

Discount rate

3.41 Differences in the timing of cash flows are routinely taken into account by discounting the value of future transactions to their estimated net present value (NPV).

3.42 In June 2013, the NAMA executive presented a paper to the Board that advised the continued use of a standard discount rate of 5.5% for *"evaluating the viability of potential transactions or commercial decisions e.g. a decision whether to hold or sell an asset"* (see Figure 3.4). This paper was presented against a background where NAMA's cost of borrowing had fallen since it had taken on the loans. The paper proposed that *"alternative NPV scenarios are generated using alternative discount rates, and that qualitative information would be considered as part of the decision making process"*. The Board agreed that the rate of 5.5% – which included a risk premium in excess of 4% – was commercially prudent and was justified on the basis that NAMA's current low cost of funds was not sustainable in the long term and that the rate acted as a guideline and was considered on a case-by-case basis in evaluating transactions.[1]

1 When NAMA was estimating what it would pay to acquire loans, the European Commission approved a risk premium of 1.7%. This was added to a 'risk-free' borrowing rate, based on the yield of Irish government bonds in December 2009, to give an average discount rate of around 5% for loan acquisition purposes.

3.43 Following from the approach agreed by the Board, the projected workout cash flows for the Northern Ireland debtors in NAMA's December 2013 paper were discounted at rates of 5.5% and 2.5%.

Figure 3.4 NAMA discount rate — paper to the Board June 2013

Background

NAMA has historically used 5.5% as its discount rate, based on the July 2010 NAMA Business Plan. The rate was originally derived from the 10 year Irish Government Bond yield as at 18 June 2010 and was used to discount projected cash flows as part of the Business Plan, the primary feature of which was the Board's strategy that NAMA should aim to complete its work within a ten-year horizon. The rate is broadly consistent with the average discount rate used in the original NAMA loan valuation process, ensuing EIR calculation and impairment cash flows.

Considerations as to the continued use of the 5.5% discount rate

When evaluating the viability of potential transactions or commercial decisions (e.g. a decision whether to sell or hold an asset), NPV calculations typically form part of the analysis. The key element in the NPV calculation, other than the projected cash flows, is the discount rate. While various complex arguments can be put forward in relation to setting a discount rate, it is commonly accepted business practice that a discount rate reflects two key considerations

- *a company's cost of funds; and*
- *risk premium.*

Taking the latter item, the risk premium involves considerable judgement. It should reflect the risks of the particular transaction or event (as viewed by the general market). Care must always be taken to avoid a situation where the underlying cash flows have been 'risk-adjusted' at source and then have a risk premium attached to them (i.e. which would represent essentially a double count of the risk). This could potentially lead to an overly conservative (i.e. low) NPV assessment of future cash flows, especially if such cash flows are based on current distressed market prices that might reasonably be expected to improve in the future.

Figure 3.4 (continued).

Such an analysis might point to selling assets too early. The level of judgement around this area highlights the need for transaction decisions to be based on qualitative factors as much as on quantitative factors.

Regarding cost of funds, NAMA currently has a low blended cost of funds – i.e. 0.3% floating rate (euribor) and a 1.21% weighted average funding rate (including hedging) at June 2013. That implies that the risk premium embedded in the 5.5% discount rate is in excess of 4% and it would be reasonable to ask whether such a premium was not excessive for application in all circumstances if we were to assume that NAMA's current cost of funds could be sustained over its projected lifespan. However, there is a serious doubt about the sustainability of NAMA's current cost of funds:

- *The ECB's main refinancing rate is currently at a record low of 0.5% and there is a possibility that it may be cut further. However, assuming that growth in the Eurozone economies picks up over the coming years, the ECB will at some point begin the process of tightening monetary conditions and interest rates will rise and will probably do so relatively quickly. This will have some impact on NAMA but, in light of its adopted interest rate hedging strategy (i.e. hedging 66% of projected 2017 outstanding senior debt obligations at an average rate of about 2%), NAMA's exposure to such interest rate increases would be significantly mitigated and NAMA's overall cost of funds would be contained within a 1.5%-2% range (based on NAMA Treasury analysis of projected forward ECB floating rates).*
- *The more pressing concern for NAMA is that there is no certainty that it can continue to fund itself by reference to ECB floating rates. [redacted] [a]*
- *The ECB will continue to demand repayment of NAMA senior debt so that the banks can reduce their reliance on ECB funding. A lower discount rate could result in NAMA making decisions to hold assets when in fact the more appropriate action would be to dispose of them.*

Having considered these factors, use of a 5.5% discount rate does not appear unreasonable over NAMA's projected lifespan to 2020, based on its existing portfolio. However, it should not be used as an over-arching discount rate to evaluate all potential transactions. It is important that flexibility be maintained when evaluating potential transactions, and that care be taken to ensure that both (a) alternative NPV scenarios are generated using alternative discount rates and (b) that qualitative information would be considered as part of the decision-making process.

a Redacted due to a commercial bank being identified.

Value of the loan workout

3.44 The projected NAMA cash flows presented in the paper for the Board (but without the adjustment referred to above) were discounted by the examination team at the rates used by NAMA (i.e. 5.5% and 2.5%). This results in an estimated NPV of the loan workout of £1,489 million at the 5.5% discount rate (see Figure 3.3).

3.45 The paper to the Board stated that *"the net present value of these forecast cash flows using a discount rate of 5.5% is £1,381 million"*. The difference of £108 million between the examination team's projection and that presented to the Board by NAMA is attributable to two factors.

- NAMA reduced the projected 2017 disposal receipts by £86 million in cash terms which, after discounting, reduces the NPV by £69 million. This adjustment was made for the reasons discussed in the previous section.[1]
- NAMA treated the projected cash flows as year-end receipts for discounting purposes, rather than NAMA's standard assumption of receipts being evenly distributed over the year of receipt. This reduced the NPV by £39 million.

Scenario analysis

3.46 In the paper for the Board, the NAMA executive also set out the results of a scenario analysis to assist the Board with analysing the future cash flows. The first scenario tested by NAMA was based on an assumption that the projected net cash flows from the working out of the Northern Ireland debtor loans would be delayed and received more evenly over the period 2014 to 2020 than was envisaged in the baseline projections (see Figure 3.5). The second scenario assumed both that the cash flows would be delayed, and that the net receipts would be lower.

3.47 Combined with the £85 million adjustment and the 'end of year' discounting effect, these assumptions yielded NPVs of £1,291 million and £1,236 million, respectively.

Delayed disposal of assets

3.48 NAMA's baseline cash flow analysis envisaged sales of NAMA-managed assets realising £432 million in 2014. The Board paper described the projected sales in 2014 as 'aggressive' relative to previous disposals, and projected delayed disposals under scenario 1.[2] However, by June 2014 (when the Project Eagle sale closed), NAMA had already received around £185 million in separate sales proceeds and had agreed the sale of additional property to the value of £34 million (including some sales of PI-managed debtors' assets).

3.49 While the scenario assumed delayed disposals of properties, no additional rental was included to reflect the longer holding periods. NAMA had rental receipts from Northern Ireland debtors' properties in 2013 of £100 million, and forecast receipts of £85 million in 2014, declining thereafter as properties were disposed of. Inclusion of additional rental – and of extra administration costs – would have been consistent with later disposal of properties.[3] When both of these factors are taken into account, application of the scenario 1 assumptions should have resulted in a net reduction of around £20 million in the NPV, rather than the £90 million indicated in the NAMA paper.

1 The NAMA paper treated the adjustment in the carrying value presentation as an undiscounted £85 million but discounted the reduction of £86 million in the 2017 receipts in the cash flow analysis to £69 million in NPV terms.

2 Scenario 1 projected disposals of around £190 million each year between 2014 and 2020 for NAMA-managed assets.

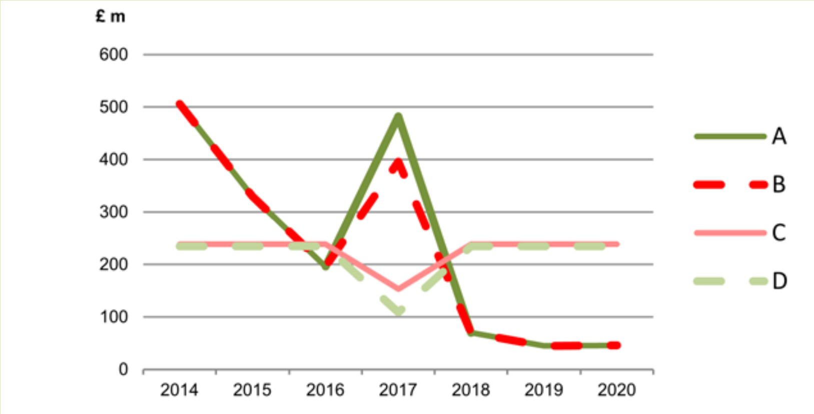
3 Additional funding costs arising from later disposal of assets are taken account of in the discounting of the cash flows.

Figure 3.5 Alternative cash flow assumptions – scenario analysis

The NAMA paper for the Board meeting on 12 December 2013 set out (in tables 9 and 11) the projected cash flows in respect of its Northern Ireland debtor connections for each year from 2014 to 2020 on the basis of three sets of assumptions. These are compared below to the discounted cash flows using standard NAMA assumptions and methodology

	NPV[a]	*Assumptions*
Baseline (A)	£1,489m	Standard NAMA assumptions (NPV as calculated by the examination team).
Adjusted baseline (B)	£1,381m	Adjusted cash flows – i.e. receipts in respect of disposal of NAMA-managed assets in 2017 reduced by £86 million, to a level of 30% below November 2009 levels; and end of year discounting. [b]
Scenario 1 (C)	£1,291m	Scenario 1 – As adjusted baseline, but with net cash generated evenly over the period 2014-2020 (except for 2017)
Scenario 2 (D)	£1,236m	Scenario 2 – As scenario 1, but with a further reduction of about 10% in projected net receipts from PI-managed debtors, and a further reduction in net receipts in respect of NAMA-managed debtors in 2017.

The impact of the scenario assumptions was to both delay and reduce the projected cash flows as shown in the graph below, with consequential reductions in the projected NPVs of the cash flows.



Source: Analysis by the Office of the Comptroller and Auditor General of NAMA Board paper 12 December 2013, and supporting documentation.

Notes: a All NPVs are derived using a discount rate of 5.5%.

b While the adjustment was stated to be in respect of all disposals for the period 2017-2020, NAMA applied the full adjustment in 2017.

Additional impairment

3.50 Scenario 2 included two further adjustments

- It assumed that the impairment rate for PI-managed debtors would increase "*from 17% to 25%*". In fact, the impairment rate reflected in the cash flows was already almost 32% for those debtors, and the effect of applying the additional scenario 2 impairment was to increase the rate to 39%.
- The second assumption was in respect of the 2017 to 2020 disposals of NAMA-managed debtors' assets where additional impairment of £32 million was applied. There was no evidence to support this assumed further reduction in net receipts.

Debtor enforcement costs

3.51 At the end of 2013, NAMA had enforced against 16 of the 56 Project Eagle debtors, representing 8% by value of the Project Eagle debt. By comparison, NAMA had enforced against 169 other debtors representing 17% of the non-Project Eagle debt. NAMA's engagement with six other Project Eagle debtors, representing a further 4% of the debt, was described as non-consensual. NAMA pointed out that by mid-2014, it had taken enforcement action (in respect of some or all debt) against approximately 40% of all debtor connections, including around 40% of Project Eagle debtors.

3.52 NAMA has stated that, in considering the case for Project Eagle, it was of the view that there would probably be an increasing reliance on enforcement of Northern Ireland debtors which would ultimately be likely to lead to a significant shortfall against carrying value. However, no estimates of the impact of possible additional enforcement were made by NAMA – for example, by reviewing the likelihood of enforcement for each individual debtor, and estimating the possible shortfall in value if enforcement was required. Such analysis would have allowed NAMA to quantify the potential impact of enforcement actions on the loan values.

Purchaser discount

3.53 Potential investors in loan assets generally price non-performing loan portfolios at a discount to the value of the underlying collateral assets. This is because they typically value a portfolio on the basis of taking ownership of the collateral via some form of enforcement and then selling the collateral to a more natural long-term owner. The main component of the return for the investor is, therefore, the difference between what it pays for the loans and the sale price for the collateral. If a debt investor acquired a loan portfolio at the market value of the underlying collateral, it would not generate a return on its capital when the collateral is sold. The precise discount applied by an investor depends on a wide range of factors at the relevant time, including

- the quality of the property collateral, the available information about it, and expectations of capital growth
- other available collateral
- the expected enforcement strategy
- the perceived complexity, costs and certainty of the route to asset ownership and
- the liquidity and risk appetite of potential purchasers.

3.54 The December 2013 paper to the Board pointed out that unless the purchaser of such a portfolio *"has an agreed strategy and consensual plan to take ownership of the assets"*, it would be taking on significant risk and would be likely to apply a discount of at least 10% to the value of the underlying collateral.[1]

3.55 The paper for the Board did not provide an estimate of the current market value of the underlying property collateral for the Project Eagle loans and no such valuation was carried out by NAMA prior to the disposal. Accordingly, there were no estimated current property values against which to apply the 10% (or higher) discount and the paper did not state to what value the discount should be applied.

3.56 A resolution strategy is a key consideration in a potential purchaser's pricing of a portfolio of non-performing loans. The paper to the Board stated that NAMA was not aware of any plan between PIMCO and NAMA's Northern Ireland borrowers. However, it noted that, following its initial financial due diligence examination, PIMCO was offering to pay more for the top 55 assets held by Northern Ireland debtors than NAMA projected it would sell them for.

The Board's decision

3.57 The paper submitted to the Board for its meeting on 12 December 2013 set out two matters for decision by the Board.

- The NAMA executive sought the guidance of the Board as to how it should respond to PIMCO's request for an exclusive/closed transaction.[2]
- Irrespective of the method chosen for the sale of the loans, the NAMA executive sought the Board's approval to complete the sale for consideration greater than £1.3 billion, subject to the Board's final approval.

3.58 The NAMA executive made no formal recommendation that a sale at £1.3 billion would represent the best achievable return and does not state what the recommended minimum price was based on.

3.59 The minutes of the meeting on 12 December 2013 record that

> *"The Board agreed that the paper and analysis presented therein presented a compelling commercial case to sell the portfolio, and that in addition such a portfolio sale would release NAMA from what had been a disproportionate burden of effort in light of the relative size of the portfolio."*

The Board agreed to consider the matter of price at a subsequent meeting, which was also to consider proposals about the sales process.

3.60 The minutes of the Board meeting on 8 January 2014 record that

> *"In relation to sales price, the Board noted that PIMCO had given an indicative bid of £1.1 billion to £1.3 billion subject to due diligence. The Board noted further that NAMA's own discounted cash flow valuation of the portfolio was in the £1.2 billion to £1.3 billion range depending on the assumptions used. In response to a question from the Board, it was noted that the original loan acquisition value for the portfolio was approximately £2 billion, with the current valuation reflecting significant impairments to date with further impairments expected. As agreed at its 12 December 2013 meeting, the Board noted it would not consider the sale of the Project Eagle portfolio of loans for a consideration less than £1.3 billion."*

1 In January 2016, NAMA obtained advice that the discount applied to the underlying property collateral of non-performing loans in early 2014 would probably have been 15% or more. See Appendix D, which reproduces the advice.

2 The Board's consideration of this matter is dealt with in Chapter 4.

3.61 The Board minutes do not explicitly state what the minimum price of £1.3 billion was based on.

3.62 In response to this examination's findings, the Board has stated that its decision on setting a minimum price was based on the portfolio's adjusted carrying value (after impairment) of £1.39 billion and on the Board's acceptance that a purchaser's discount of at least 10% would apply if the loan sale were to proceed. The Board also stated that the minimum reserve price of £1.3 billion was the best price deemed achievable through a loan sale.

3.63 NAMA has also stated that the sentence *"NAMA's own discounted cash flow valuation of the portfolio was in the £1.2 billion to £1.3 billion range depending on the assumptions used"* represented the minimum portfolio loan sale range that was considered by the Board, and did not refer to the scenario analysis valuations.

3.64 NAMA has pointed out that the Board was aware that the proceeds of a loan sale would be unlikely to match the carrying value of the portfolio. The Board minutes do not refer to the level of loss that might be involved.

NAMA's views on loan workout value

3.65 In response to the penultimate draft of this report, NAMA stated that loan workout value is a commercial term, used by management, which represents management's best estimate of the expected realisable net cash flows from a loan, or group of loans, under a scenario where NAMA would hold on to the loans and adopt a medium-term asset management and disposal strategy (see Annex 3A to this chapter).

3.66 NAMA pointed out that the discounted cash flow valuation presented in the paper to the Board in December 2013, and the associated scenario analysis, was not intended as representing a loan workout value. It stated that loan workout value is based on a management judgement and is typically discounted at a commercial discount rate that best reflects all the risks inherent in the loan portfolio and the cost of capital of the purchaser. The risks NAMA considered specific to the Project Eagle loans included the relatively poor quality of the collateral assets, underlying weak economic and market conditions, the cross-jurisdictional aspects, fractious debtor engagement and the wider political factors. NAMA considers that the appropriate rate to take account of this would have been at least 10%, and more likely closer to 15%, back in early 2014.

3.67 NAMA obtained advice from KPMG in May 2016 about the market value of a portfolio of distressed loans, when KPMG responded formally to a question from NAMA.[1] (This advice is set out at Annex 3A to this chapter, at pages 58 to 62).

3.68 KPMG noted that any valuation exercise provides a guide rather than a definitive view on an exact amount that could be realised. It set out a number of definitions of market value and noted that all of these shared a common theme i.e. ultimately, it requires a willing buyer and a willing seller and a *"well designed sales process"*.

1 NAMA asked KPMG the following question – "Is the carrying value of distressed loans and receivables a reliable indication of their underlying market value?"

3.69 KPMG also advised that potential buyers of distressed loans will consider many of the same issues that an owner of loans considers when reviewing their carrying value. KPMG noted that one area where there can be considerable divergence between buyers and sellers is the discount rate applied to the estimated cash flows. It stated that, typically, buyers of distressed loans finance the purchase using a mixture of debt (60% - 70%) and equity (30% - 40%). Required rates of return vary from transaction to transaction but interest margins of 4% to 4.5% above a benchmark borrowing rate would not be uncommon for the buyer's debt element, while investors providing equity for the purchaser may require returns of between 15% and 20%. The combination of these two factors determines the discount rate buyers would apply to cash flows associated with the distressed loans.

3.70 On this basis, NAMA has estimated that using a 10% discount rate with the projected cash flows would have resulted in a workout value for the Project Eagle loans of around £1.34 billion.

3.71 The Board has stated that it remains of the view that achieving £1.32 billion for the portfolio was the best achievable commercial outcome.

Conclusions

3.72 The PIMCO/Brown Rudnick proposal to buy the Northern Ireland debtor portfolio presented NAMA with an opportunity not previously envisaged by it – a single sale that would resolve the 56 Northern Ireland debtor connections, whose loans were secured by around 900 properties. The key question was whether the price obtainable through such a sale would represent the best return reasonably obtainable for the State.

3.73 NAMA considered that it had just two feasible options – to hold and work out the loans over the period 2014 – 2020, or to dispose of them in a single loan portfolio sale. This required a comparison of the values of the two options.

Estimated carrying value

3.74 The paper presented to the Board in December 2013 projected the end-year carrying value (after impairment) for the loans at £1.48 billion. However, the paper advised that a downward adjustment of £85 million was required that reduced the projected carrying value to £1.39 billion.

3.75 This examination has found that the rationale for that adjustment was not supported by the evidence presented. The adjustment was stated to have been made because projected disposal values for properties scheduled for disposal after 2016 were 'currently not impaired'. The projected property disposal values had in fact already been significantly reduced following review. NAMA also stated that subsequent analysis of property market data showed that the adjustment was reasonable, but this would have supported a downward adjustment of, at most, around £8 million. Furthermore, if the adjustment was warranted by reference to property price movements that had already occurred, it would have required reflection in NAMA's 2013 financial statements as a higher impairment charge. This was not done.

Discounted cash flow valuations

3.76 The cash flows presented to the Board indicated that NAMA forecast net receipts totalling £1.68 billion over the period 2014 to 2020, if it worked out the loans as planned. Taking account of the time value of money by discounting at NAMA's standard discount rate of 5.5%, the value that could be achieved by working out the loans was estimated by the examination team at £1.49 billion in NPV terms. The paper presented to the Board stated that the NPV of the forecast cash flows, after adjustment for additional impairment, was £1.38 billion. The difference of £108 million in the estimates of workout value is due to NAMA's adjustment of the projected 2017 disposal proceeds, which reduced the NPV by £69 million, and NAMA's treatment of all receipts as end year receipts, which reduces the NPV by £39 million.

3.77 Additional scenario analysis presented to the Board indicated that the discounted cash flow valuation of the portfolio was in the range of £1.24 billion to £1.29 billion, depending on the assumptions used.

3.78 The examination found that the analysis presented to the Board underestimated the workout value of the loans.

Choice of discount rate

3.79 In June 2013, the NAMA Board approved a proposal from the NAMA executive that, even though NAMA's cost of borrowing had fallen, it should continue to use a discount rate of 5.5% when evaluating the viability of potential transactions or commercial decisions, including decisions whether to sell or hold an asset. The proposal noted that this included a risk premium in excess of 4%.

3.80 In June 2016, in response to a draft of this report, NAMA stated that: the discounted cash flow analysis in the December 2013 Board paper – which used discount rates of 5.5% and 2.5% – was not intended as representing a loan workout value; that it would have been appropriate to use a discount rate of at least 10% in evaluating the Project Eagle cash flows to reflect all of the risks in the portfolio; and that using this discount rate, the maximum loan workout value would have been £1.34 billion (in NPV terms).

3.81 NAMA's argument that a discount rate of 10% would have been appropriate in calculating NAMA's workout value for the loans is not persuasive. No reference was made in the papers presented to the Board in June 2013 or in December 2013 that a rate higher than NAMA's standard 5.5% rate would be appropriate. NAMA conflates the perspectives of seller and buyer by arguing that it would have been appropriate to use a 10% rate to estimate its own workout value, given the rate a potential purchaser would apply in arriving at a bid price. NAMA's cost of funding, estimated at 1.2% in 2013, is significantly lower than the cost of capital for a potential purchaser. Furthermore, NAMA took account of what it describes as the relatively poor quality of the property collateral in the price it paid for the loans at acquisition, and had provided for underlying economic and market conditions in its annual impairment reviews, so a high risk premium in the discount rate would have meant double counting.

3.82 It is also difficult to accept NAMA's contention that the analysis it presented to the Board in December 2013 did not include an estimate of its expected loan workout value for the Northern Ireland debtor loans, since that was central to the decision the Board was being asked to make.

Minimum price

3.83 The NAMA executive made no formal recommendation that a sale at £1.3 billion would represent the best achievable return and does not state what the recommended minimum price was based on.

3.84 The Board minutes record that the Board noted that NAMA's discounted cash flow valuation of the portfolio was in the £1.2 billion to £1.3 billion range depending on the assumptions used and that it would not consider the sale of the Project Eagle portfolio of loans for a consideration less than £1.3 billion.

3.85 The Board has stated that its decision on setting a minimum price was based on the portfolio's adjusted carrying value (after impairment) of £1.39 billion and on the Board's acceptance that a purchaser's discount of at least 10% would apply if the loan sale were to proceed. The Board also stated that the minimum reserve price of £1.3 billion was the best price deemed achievable through a loan sale.

3.86 The minimum price of £1.3 billion set for the sale of the Project Eagle portfolio was significantly less than NAMA projected it would realise from working out the loans – an estimated £1.68 billion, equivalent to £1.49 billion in NPV terms, using NAMA's standard discount rate. The difference between the minimum price and the projected NPV of the workout was up to £190 million, depending on the extent to which the adjustment of the 2017 disposal proceeds was valid. As a result, the decision to sell the loans at £1.3 billion involved a significant probable loss of value to the State. Ultimately, the loss incurred when the sale was completed was recognised in NAMA's financial statements for 2014.

3.87 NAMA has outlined the strategic and commercial rationale underpinning the decision to sell the loan portfolio. This report draws no conclusions about the merits of that decision.

Annex 3A

NAMA's views on valuation of loan workout

3A.1 The NAMA Board emphatically rejects the Comptroller and Auditor General's conclusion (paragraph 3.86) that the minimum price of £1.3 billion set for the Project Eagle portfolio involved a significant probable loss of value to the State.

3A.2 The distinction between *'loan carrying value', 'loan workout value', and 'loan sale (or market) value'* appears to have been accepted in principle by the Comptroller and Auditor General but the full implications of this important distinction have not. In particular, he does not appear to accommodate the expert evidence of KPMG (attached) with regard to the appropriate discount rate to be applied in a loan workout value.

- The Comptroller and Auditor General's conclusion is arrived at by incorrectly conflating the scenario analysis in the December 2013 paper for the Board as representing a reliable loan workout value when, in fact, it was never intended as such, either then or now. The scenario analysis was not referred to as a workout value in the December 2013 Board paper
- Loan workout value is a commercial term, used by management, which represents management's best estimate of the expected realisable net cash flows from a loan or group of loans under a scenario where NAMA would hold onto the loans and adopt a medium-term asset management and disposal strategy. Loan workout value is based on a management judgement. Whilst the loan carrying value may be used as a proxy or starting point in assessing workout value, workout value is not calculated in accordance with IFRS accounting rules. This is illustrated by the key fact that under IFRS loan carrying value must be discounted at the effective interest rate (EIR) whilst loan workout value is typically discounted at a commercial discount rate that best reflects all the risks inherent in the loan portfolio and the cost of capital of the purchaser. This would have been at least 10% and more likely closer to 15% back in early 2014.
- The Comptroller and Auditor General's conclusion is based on computations which used a discount rate of 5.5%. The 5.5% discount rate used by NAMA in the loan sale scenario analysis was NAMA's standard internal discount rate. It was not a discount rate that reflected all the risks in the Project Eagle loan portfolio and, as such, could not have been used to arrive at a reliable loan workout value.
- There were considerable and unique risks in the Project Eagle portfolio that were not a feature of other NAMA portfolios including the relatively poor quality of the underlying assets, underlying weak economic and market conditions, the cross-jurisdictional aspects, the fractious debtor engagement and the wider political factors. It would have been necessary to factor in these additional risks when selecting a discount rate which could be used to determine a reliable loan workout value.
- An individual scenario analysis that would have reliably captured all the risks in the Project Eagle portfolio would, in all likelihood, have used a discount rate of at least 10%, which would have resulted in a maximum loan workout value of £1.34 billion. Accordingly, no material divergence arises between the Project Eagle loan workout value and the actual proceeds of £1.33 billion.

- The minimum 10% discount rate which reflects all the risks in the portfolio and which is used to calculate a workout value, corresponds to the minimum 10% non-performing loans (NPL) discount rate used by loan sale buyers when estimating a market value for a loan portfolio (this NPL discount was referred to in the December 2013 Board paper). NAMA has also been provided with supporting evidence from KPMG, a leading global professional accountancy and corporate finance firm, in which an expert opinion is provided on what constitutes workout value for either a buyer or seller of loans. KPMG state that "*the potential buyers for distressed, high loan to value assets are typically specialized distressed debt investors who base their pricing decisions on their proposed loan strategy post-acquisition and in particular their exit realisation strategy*" and that "*the workout valuations associated with the various strategies may be asset or debtor specific"* and furthermore that *"a buyer is free to use whatever discount rate they feel is appropriate to reflect not only the risks associated with the transaction or workout strategies but more fundamentally the financing of the transaction."*

3A.3 Had NAMA not sold the Project Eagle loan portfolio in line with its £1.3 billion minimum pricing level, it is very likely that it would have subsequently revised down what it expected to receive from the loans and, as a result, recorded further impairment on the Project Eagle portfolio.

- The £1.486 billion carrying value of the Project Eagle portfolio at 31 December 2013 reflected impairment that was calculated in accordance with NAMA's impairment process and related guidance which was in place at that time and on which the Comptroller and Auditor General gave a clear audit opinion.
- Had NAMA been unable to successfully complete the Project Eagle loan sale at its minimum price level of £1.3 billion, it would have become increasingly difficult for NAMA to justify an argument that it could ultimately realise significantly in excess of this £1.3 billion amount under a workout strategy. As such, further impairment on the Project Eagle related debtor connections would have been highly likely as at 30 June 2014 and/or 31 December 2014. NAMA's 31 December 2013 financial statements were signed by the directors and certified by the Comptroller and Auditor General on 9 May 2014. The Project Eagle transaction closed on 20 June 2014. The Comptroller and Auditor General's Office was aware on 9 May 2014 of the financial impact of the Project Eagle loan sale transaction and, notwithstanding that his Office agreed with the NAMA Chief Financial Officer and with the Audit Committee (and NAMA's accounting advisors) that it represented a 'non-adjusting' post balance sheet event that only required disclosure in NAMA's 2013 financial statements. In the event that the Project Eagle loan sale had not successfully completed it is unlikely that his Office would have disagreed with NAMA making further impairment on the Project Eagle debtor connections as at 30 June 2014 and 31 December 2014 based on the market evidence gleaned from the loan sale process.
- NAMA's recording of loan impairment did not cease as at 31 December 2013. NAMA recorded further impairment in 2014 of €170 million post the sale of Eagle. In line with this trend, it is highly likely that Project Eagle related debtors would have had significant incremental impairment in 2014 and, possibly 2015, if NAMA had retained the Eagle portfolio.

3A.4 As a general point, expected loan workout values and loan impairment, by their inherent nature, contain significant judgements, are highly fluid and evolve over time, particularly in response to changes to strategy or underlying economic and market conditions.

3A.5 Based on the above factors, the Comptroller and Auditor General's conclusion is neither supported by evidence nor by commercial reality. NAMA's position is supported by the independent advice it has obtained from highly respected international accountancy, corporate finance and loan sale specialists. On foot of the fact that the Comptroller and Auditor General has reached his conclusion without obtaining the requisite independent market expert advice, in particular specialist loan sales advice, the report's draft conclusion lacks support.

3A.6 Ultimately there was no loss of value for the taxpayer from the Project Eagle loan sale transaction and the NAMA Board is certain that it would not have achieved a better commercial outcome by pursuing an alternative loan workout strategy - debtor cooperation would have declined and additional enforcement could have driven collateral values down further and reduced NAMA's commercial outcome.

3A.7 NAMA rejects strongly the conclusion that the sale of the portfolio at £1.3 billion, by comparison with a long-term workout, involved a loss of £120 million to £190 million to taxpayers. This highly speculative conclusion is based on the questionable assumption that NAMA would have realised £1.49 billion had it retained the portfolio and disposed of it on an asset-by-asset basis up to 2020. For reasons which became increasingly evident to the Board during 2013, NAMA considered that there was a high probability of significant erosion in the proceeds that it would realise from an asset-by-asset workout, largely because of the difficulty of securing co-operation from Northern Ireland debtors and the ensuing need to engage in extensive enforcement to obtain direct access to assets.

3A.8 As has been pointed out above, if NAMA's minimum sales price for the Project Eagle portfolio had not been achieved, it is likely that the Office of the Comptroller and Auditor General would have insisted on an adjustment in the carrying value of the Eagle loans to reflect the objective market price evidence that had become available during the sales process. In that case, the Office of the Comptroller and Auditor General would rightly have treated the evidence offered by market bids as being more objective than NAMA's existing carrying values (as outlined in Chapter 2).

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FAO: Mr. Donal Rooney/Chief Financial Officer

11 May 2016

Dear Sirs and Madam:

Following recent discussions with Mr. Rooney and subsequent receipt of the signed Contract Order for Services, we have considered your question

"Is the carrying value of distressed loans and receivables a reliable indication of their underlying market value?"

We have outlined below our written response.

At the heart of this question is a comparison of two valuations; the first "carrying value" being a value calculated in accordance with accounting standards and the second a "market" value that is not subject to similar limitations and direction.

In addressing the question we have drawn upon both our accounting expertise and loan sale experience of advising banks and private equity firms on large loan sales transactions.

1. Carrying value

Financial statements – underlying basis of preparation

In addressing this question we have firstly reviewed the Group and Agency's audited financial statements for the year ended 31 December 2014, being the latest publicly available audited financial statements on its website. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, the International Financial Reporting interpretations Committee (IFRIC) interpretations and The NAMA Act 2009.

International Financial Reporting Standard (IFRS) 39

The primary standard providing guidance on the accounting for loans is IFRS 39 *Financial instruments Recognition and Measurement*. It sets out the general principles for initial recognition, classification and subsequent measurement of loans.

Loan amount initially recognised

The basic principle is that loans acquired in a direct asset purchase are measured initially in the accounts of the acquirer at fair value at the acquisition date. Normally, the fair value at initial recognition is the transaction price i.e. the consideration paid. Where the transaction is not based on market terms it is then necessary to use a valuation technique to determine the appropriate fair value for initial recognition of the loans e.g. Long Term Economic Value (LTEV).

Loan Classification

At initial recognition, a loan is classified into one of the measurement categories for financial assets set out in IAS 39. Initial classification determines the subsequent measurement of the asset in the financial statements.

The Agency uses the loans and receivables classification category to measure the loans subsequently at amortised cost using the Effective Interest Rate (EIR) method.

Effective Interest Rate (EIR)

Briefly, an effective interest rate calculation is required to determine interest income for loans measured at amortised cost. Therefore, at the acquisition date, the fair value determined for the loans and the cash flows expected over the remaining life of the loans are used by the purchaser to calculate an effective interest rate for the loans.

The effective interest rate is calculated on initial recognition of a loan and reflects a constant periodic return on the carrying value of the loans. It is the rate that exactly discounts estimated future receipts through the expected life of the loan, to the net carrying amount of the loan on initial recognition. There is a presumption that the cash flows and the expected life of a loan, or a portfolio consisting of similar loans, can be estimated reliably.

Calculating loan impairment losses

If there is objective evidence that a financial asset is impaired, then an entity determines the amount of any impairment loss. For a loan carried at amortised cost, impairment is measured as the difference between the loans carrying amount and the present value of estimated future cash flows discounted using the original effective interest rate. The estimated future cash flows include only those credit losses that have been incurred at the time of the impairment loss calculation. Losses expected as a result of future events, no matter how likely, are not taken into account.

Objective evidence of impairment

Note 2.12 of the Agency's financial statements outlines in detail the matters considered as objective evidence of impairment. These examples of evidence of impairment include both macro economic and debtor specific issues.

2. Market Value

Any valuation exercise by its nature provides a guide to a possible realisation amount as opposed to a definitive view on an exact amount that could be realised as part of a sale. The following definitions of market value from the Royal Institute of Chartered Surveyors ("RICS"), International Valuation Standards Council ("IVSC") and the International Accounting Standards Board ("IASB") all share a common theme around market value i.e. ultimately it requires willing participants and a well designed sales process.

RICS definition of market value

"The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller on an arm's length transaction and after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion."

IVCS definition of market value:
"The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing where the parties had each acted knowledgeably, prudently and without compulsion".

IASB, IFRS 13 definition of market value

"...the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

Distressed debt sales

The potential buyers for distressed, high Loan to Value assets are typically specialized distressed debt investors who base their pricing decisions on their proposed loan strategy post-acquisition and in particular their exit realisation strategy.

Exit strategies can range from Enforcement, Consensual sale, Discounted Payment Offer ("DPO") as well as variations on all of these strategies in isolation or combination within a portfolio. Consequently, the workout valuations associated with the various strategies may be asset or debtor specific.

Distressed debt buyers will consider many of the same issues that an owner of loans considers when reviewing the carrying value of their loans within the context of preparation of financial statements. However, although buyers may consider the same issues, their estimates of cash flows, property collateral values, property market evolution, timing of cash flows, costs of transaction, legal enforcement landscape etc. their views may vary considerably from those of a seller.

One area where there can be considerable divergence between buyers and sellers is the discount rate applied by each party to the estimated cash flows. In the case of a seller, the carrying value of loans in their financial statements is determined by accounting rules and more specifically the concept of Effective Interest Rate ("EIR"). In contrast, a buyer is free to use whatever discount rate they feel is appropriate to reflect not only the risks associated with the transaction or workout strategies but more fundamentally the financing of the transaction.

Typically, buyers of distressed loans use a mixture of debt and equity to fund transactions. For example, depending on the nature and quality of the collateral, debt funding of between 60% and 70% may be available to fund the transaction; the balancing 30% - 40% being provided through equity. The debt markets are dynamic and rates will vary from transaction to transaction. However, margins of between 400bps – 450bps would not be uncommon. Additionally, investors providing equity to fund the transaction may require returns of between 15% and 20% p.a. The combination of these factors will drive up the discount rate used by buyers.

Finally, in addition to calculating an intrinsic value for a transaction based on discounted cash flows, buyers will also benchmark their pricing against comparable deals and transactions when they have access to such information. It is usual to refer to their bid as a percentage of capped Real Estate Value, as the collateral value is the key driver of value in distressed loan sales transactions.

Conclusion

In answer to your question, we believe that carrying value is not a reliable indication of the underlying market value of loans and receivables due to the limitations and direction that is inherent in the calculation of carrying value under accounting standards, unless the loans were recently acquired.

The carrying value of loans carried at amortised cost in financial statements prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, the International Financial Reporting interpretations Committee

(IFRIC) interpretations and The NAMA Act 2009, usually equals its fair value on the initial date of recognition. Thereafter, accounting rules and more specifically the use of EIR considerably restricts the possibility of carrying value equating market value particularly when the loans have been held for some time.

Although buyers and sellers may consider the same issues impacting their valuations, it would be unusual for both parties to form exactly the same quantitative and qualitative assessments within the transaction. Consequently, some divergence in views and resulting valuation is normal.

Finally, even if both parties formed identical views on all estimates input to their discounted cash flow calculations, differing values may still be calculated due to the discount rates used by the parties; the EIR used by the seller in determining carrying value and a market discount rate used by the buyer taking account of the rates of return required by both debt and equity providers.

Should you have any questions or points of clarification in relation to the contents of this letter, please do not hesitate to contact me.

Yours sincerely

Alan Boyne

Alan Boyne
Partner

4 The Project Eagle loan sale process

4.1 Except where par debt on a loan is recovered, NAMA's policy is that the sale of all loans must be by open market competition in order to ensure that the best price available in the market is achieved. This is also a requirement of NAMA's code of practice for the disposal of bank assets, which was approved by the Minister for Finance.[1]

4.2 Key characteristics of open market competition are that all credible potential purchasers have the opportunity to participate in the sale competition, receive the same information about the assets being sold, and have sufficient time and an equal opportunity to assess that information. The provision of relevant information about assets should reduce the level of uncertainty among prospective purchasers and reduce the level of discounting they are likely to apply.

4.3 The loan sale process undertaken for Project Eagle differed significantly from that undertaken by NAMA for other large loan sales. While the processes adopted for Project Tower and Project Arrow conformed to the standard NAMA sales procedures, the Project Eagle process did not follow some of the standard procedures, and significantly modified many of the other procedures (see Figure 4.1 over).

4.4 NAMA has stated that the Project Eagle loan sale is not directly comparable with other significant NAMA loan portfolio sales processes because Project Tower involved a single consensual debtor while Project Arrow - although similar to Project Eagle in its granularity - did not involve the same unique jurisdictional and political sensitivities as Project Eagle. It has also stated that the Board had discretion to depart from its normal loan sale process, and in doing so, accepted that certain features of normal sales processes would not apply.

Project initiation and evaluation

Loan sale strategy

4.5 The PIMCO approach to NAMA in September 2013 proposed a 'short and exclusive' process for the sale of the Northern Ireland debtor portfolio i.e. there would be no competition from other bidders.

4.6 In October 2013, the Board approved a NAMA executive proposal to explore the possible disposal of the loans of the Project Eagle debtors to PIMCO, subject to it being made clear to PIMCO that any such transaction would be by way of open marketing. The paper presented to the Board for that meeting noted that the NAMA executive *"…in line with our Board policy…will only be recommending the sale subject to an open marketing process"*.

4.7 In December 2013, when the NAMA executive sought Board approval for Project Eagle, it did not recommend an open marketing process. Instead, it sought guidance from the Board as to how to respond to PIMCO's continuing request that it be granted exclusivity to enter into a closed transaction with no formal open marketing campaign for the loans.

1 The code of practice in place when the Project Eagle sale took place was approved by the Minister on 9 September 2013.

Figure 4.1 Loan sale process comparisons – Projects Eagle, Tower and Arrow

	Project Eagle	Project Tower	Project Arrow
Summary description of portfolio	**Multiple debtor connections Multiple properties**	**One debtor connection Multiple properties**	**Multiple debtor connections Multiple properties**
Evaluation			
Comparison of projected loan disposal proceeds to NPV of cash flows	◑	●	●
Board approval to commence an open market process	◑	●	●
Preparation			
Appointment of loan sales advisor	◑	●	●
Loan sales advisor input into loan sale strategy	◑	●	●
Loan sales advisor valuation of portfolio	○	●	●
Loan sales advisor minimum price analysis	○	●	●
Gathering due diligence information	◑	●	●
Launch			
Open marketing	◑	●	●
Non disclosure agreements with prospective bidders in place	●	●	●
Minimum or guide price disclosed to potential bidders[a]	●	●	●
Selection			
Round 1 data room	—	●	●
First round bids	—	●	●
Shortlisting of bidders	—	●	●
Round 2 data room[b]	●	●	●
Binding bids	●	●	●

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

Notes: a Projects Tower and Eagle – minimum price; Project Arrow – guide price.

b Project Eagle was a one-phase process.

● Feature present

○ Feature absent

◑ Feature present but differences with other major loan sales processes noted or partially present.

4.8 The paper prepared for the Board summarised the advantages and disadvantages of a closed transaction (see Figure 4.2) but made no recommendation in that regard. The paper noted that “while it would be possible to openly market the loans, the scale of the project would need careful planning, budget, management and execution”. It stated that if the normal process for an open marketing sales process was carried out, it would be the fourth quarter of 2014 before the Project Eagle transaction would be complete because it would require

- 3 to 6 months to gather the underlying banking and property information and a further 6 weeks before an open marketing campaign could commence
- a further 3 to 6 months to complete the transaction with a preferred bidder.

4.9 The Board noted that *“putting the entire Northern Ireland portfolio on the open market might provoke a hostile reaction in Northern Ireland political circles, with NAMA being deemed to be ‘auctioning’ the Northern Ireland portfolio”*. It agreed that such a portfolio sale would release NAMA from what had been a disproportionate burden in light of the relative size of the portfolio. It concluded that a *“limited, focused and time-bound open marketing process would be the best and prudent course of action”.* The Board asked the NAMA executive to revert quickly with a proposal for such a process.

Figure 4.2 Project Eagle portfolio – consideration of closed transaction with PIMCO

Advantages of a closed transaction	Risk of a closed sale
▪ Discreet process with minimal borrower involvement ▪ Likely to be supported by the (remaining) external member of NIAC given the controlled transaction and contribution it could make to economic regeneration ▪ NAMA loan sale team could complete the transaction and no loan sale advisor fee would be required, at a likely saving of £5 million. ▪ PIMCO had funds available to complete the transaction and was willing to complete it with minimum due diligence (subject to a reasonable claw back mechanism being agreed) ▪ The Northern Ireland debtor book represented a disproportionate draw on NAMA’s stretched resources primarily due to the political and cross-border sensitivities ▪ A commercial organisation could manage the portfolio alongside other banks in a way that could unlock asset concentration issues for the wider economic benefit of Northern Ireland	▪ A closed transaction could expose NAMA to the perception that maximum value was not achieved or that NAMA had not given the market the opportunity to bid ▪ PIMCO would require additional representations and warranties in the light of minimal due diligence ▪ If the Board authorised a closed transaction, PIMCO would not be legally obliged to complete the transaction ▪ NAMA would need an appropriate media, staff, borrower and other stakeholder response if a leak of the closed transaction were to occur

Source: NAMA Board Paper 12 December 2013 (See Appendix C).

4.10 The paper presented by the NAMA executive for the Board meeting on 8 January 2014 proposed a plan that involved the immediate appointment of loan sale advisors who would approach at least two major international investors (apart from PIMCO), with the intention of giving interested parties at least two weeks access to the data room to prepare immediate bids. It was also proposed that the loan sale advisors would make a recommendation to NAMA by the end of January 2014 in relation to the preferred bidder.

4.11 The Board minutes for the meeting on 8 January 2014 recorded that its key priorities were to obtain the optimum price and to conduct an open marketing sales process. The Board decided that the marketing strategy should be *"appropriate, focused, time bound (given sensitivities and confidentiality concerns), while being sensitive to the Northern Ireland position"*. The Board agreed that loan sales advisors should be appointed to advise NAMA on an appropriate marketing approach, to undertake marketing to suitable targeted bidders, to make a recommendation in relation to the preferred bidder and to provide a statement in relation to the probity of the marketing process.

4.12 In parallel with this, it was agreed that

- PIMCO would be permitted to complete their due diligence on the 'tail' of the portfolio, and finalise their bid, and
- NAMA would tell PIMCO about the process being undertaken by the loan sale advisor, and explain to them that *"the intended approach regarding the other short-listed investors noting that this would be as much to protect their interests with regard to integrity and credibility of the disposal process".*

Appointment of a loan sale advisor

4.13 During the preparation stage for the launch of an open loan sale marketing campaign, NAMA normally appoints loan sale advisors to advise it on the most appropriate loan sales strategy and to prepare and/or advise on valuations of the loans.

4.14 NAMA had an established loan sale advisor panel under a framework agreement arrangement, formed following a formal qualification process. Appointment of advisors for an individual sale was usually by way of a restricted tender competition among the firms on the panel. For Project Eagle, such a tender competition was not conducted. The Board approved a recommendation from the NAMA executive that, in view of the project sensitivities, Lazard and Company Ltd. – a London-based financial advisory firm – be appointed as the loan sale advisor for Project Eagle without a tender process, subject to any restriction on fee negotiations under the framework agreement. The Board agreed that a lower fee should be paid to Lazard if PIMCO emerged as the preferred bidder.[1]

1 A fee of 0.3% of the sale price was agreed with Lazard in the event PIMCO was the buyer; the fee rate for any other buyer was 0.35%.

4.15 The role of the loan sales advisor for Project Eagle was set out in a 'contract order for services' signed by NAMA and Lazard on 3 February 2014. The specified role differed from that of the advisors in other NAMA portfolio loan sales in some key areas.

- Advising on market strategy – for Project Eagle, NAMA specified key aspects of the marketing strategy to Lazard, including the data provision strategy and that the process be completed within a tight timeframe. In contrast, the loan sale advisors for Project Arrow – a similar 'granular' portfolio – presented detailed advice on a range of marketing strategy issues, including reasons underpinning a recommendation that a two-phase sales process be undertaken (see Figure 4.3).
- Valuing the portfolio — the loan sales advisors for Project Tower and Project Arrow were required to prepare valuations of the respective portfolios, including of the underlying collateral. These contained a summary of the collateral details and comparable market values supporting the projected valuations. Lazard was not asked to value the Project Eagle loan portfolio.

Figure 4.3 Proposed marketing approach for Project Arrow

NAMA sought tenders from a number of loan sale advisors on its framework panel to act as loan sales advisors for Project Arrow. This included advice regarding the most effective method of structuring the sale, and presentation of an overall strategy for either selling the portfolio in one sale or across several sales, taking into consideration the overall disposal proceeds achievable, timeframe and efficiency of each method. The winning tender included a thirty-page market overview and disposal strategy, examining three potential sales approaches. The advice included the following extracts giving the loan sale advisors' assessment of the advantages of a recommended two-stage sales process, compared with a one-stage process.

Disposal strategy – sales process (extract).

Greater potential for price appreciation in a two-phase marketing process

Consideration	Advantage
Confidentiality	A limited amount of information is disclosed during Phase 1 of marketing, only enough information for the initial pricing analysis (info memo, datatape and property reviews). No loan or property agreements are provided at this stage. The full due diligence package is only provided during Phase 2, when a limited amount of investors (3-4) have access to the data room. Throughout the process the information is protected and never distributed to a wide list of investors.
Market sounding	A long list of investors can be approached during Phase 1 without compromising confidentiality, but guaranteeing all relevant and potential buyers have been approached and therefore obtaining a wider pricing exercise. In a one-phase process, plenty of investors will not be interested in participating as it will be a long and wide process with considerable costs and a low probability of a successful execution.
Potential for price appreciation	Investors are not granted an "exclusivity period" in a two-phase marketing process. A shortlist of 3-4 investors are invited to Phase 2 to work on the due diligence and submit their binding bids (including executed loan sale agreement), creating a high competitive tension which in turn maximises the disposal price.
Investor expectations	Financial investors (i.e. hedge funds, private equity funds, investment banks, etc.) are the professional buyers for loan portfolios, and these type of investors are expecting a "mergers and acquisitions" type transaction process due to the reasons mentioned above. Having a single marketing phase process is not market practice and could possibly result in this type of investor deciding not to participate.

NAMA's objectives for the sale process

4.16 Instead of setting out formal objectives as a framework for the loan sale advisors, the Board agreed on 8 January 2014 that a verbal briefing would be provided to Lazard. NAMA does not have any briefing document or minutes of this initial briefing of Lazard.

4.17 Following the meeting, Lazard submitted a document to NAMA on 22 January 2014 setting out its understanding of NAMA's objectives for the sale process, including

- Strict confidentiality was to be maintained and potential bidders were to be prohibited from contacting the debtors.
- The overriding objective was to maximise recovery for the Irish taxpayer. The sales process should maintain competitive tension and allow for maximum 'price discovery' without jeopardising the requirement for confidentiality.[1]
- The process needed to be run in a fair and transparent manner which would stand up to public scrutiny. Other bidders would need to have sufficient time and information to submit offers for the portfolio that could be compared to PIMCO's.
- Given the number of participants in the sale process was to be limited, they would need to be very carefully selected and only credible bidders should be allowed to participate.

Valuation advice

4.18 When asset sales are proposed, standard NAMA procedures require that up-to-date valuations of properties are obtained. In a loan sale, the loan sale advisors generally provide advice about the estimated realisable value of the loans.

4.19 The loan valuation information required of Lazard was less than the information sought from loan sale advisors for other large loan portfolio sales (see Figure 4.4). Up to date valuations for all of the property collateral were not obtained and Lazard was not asked to provide valuation advice in relation to the proposed sale or to recommend a price.

4.20 NAMA has stated that if it had sought up-to-date valuations of all of the collateral, it would have required the services of local valuers and this would have jeopardised the confidential nature and timing of the transaction.

Figure 4.4 Projects Tower, Eagle and Arrow – approach to loan valuation

	Project Eagle	Project Tower	Project Arrow
Up to date valuation of property assets	○	●	●
Valuation advice from loan sales advisor	○	●	●
Net present value of projected cash flows	◑	●	●

Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

● Feature present
○ Feature absent
◑ Feature present but differences with other major loan sales processes noted or partially present.

1 A 'price discovery' process involves buyers and sellers arriving at an agreed transaction price for a specific item at a given time.

Provision of loan information

4.21 Potential purchasers of a portfolio of loans seek to gather as much information as possible about the target loans and underlying collateral through carrying out 'due diligence' examinations of loan information. Where information is incomplete or if there is insufficient time to examine the available information, bidders typically build a pricing discount into their bids.

4.22 In order to facilitate bidders' due diligence process, NAMA makes relevant information[1] available to potential bidders in a controlled way through a 'virtual data room'. The scope of the data included, and the time available for examining it, are critical factors in the process, with the potential to influence the level of the bids.

4.23 In setting out its understanding of its brief, Lazard noted that only limited due diligence information on the portfolio would be available to potential bidders and commented that this would impact bidders' ability to obtain financing.

4.24 On 14 February 2014, Lazard wrote to the firms that it had invited into the competition stating that the contents of the data room would be limited to the following

- full lists of the borrowers and of the related property collateral
- for the top 55 property assets (by value): loan facility, security and title documents, along with 2009 valuations of the properties and current tenancy schedules
- for the remaining assets: a brief description of the loan facility and security arrangements, and 2009 property valuations in valuation bands (not valuations for individual properties)
- forecast income from the portfolio for 2014 and the outstanding debt balances.

The letter added that NAMA expected offers to be formulated on the basis of the information in the data room, and that it did not expect any detailed questions and answers in relation to the data.

4.25 In the end, the data provided to bidders in the data room was more extensive than had originally been assumed by Lazard. By final bid stage, NAMA had made available in the data room around 2,800 documents relating to around 850 properties.

4.26 In contrast, NAMA's loan sale advisors for the Project Arrow noted to potential bidders that "comprehensive information would be made available" to them on the portfolio. At bid stage, NAMA had made available through the Project Arrow data room around 22,000 documents for around 1,900 property assets.

4.27 For Project Tower, the second-round bidders had an opportunity for site visits and introductions to the sole borrower involved, arranged by the loan sale advisor. For Project Arrow, which involved multiple borrowers, potential bidders had access in half-day presentations to the relevant NAMA case managers to discuss details of debtor connections. This type of contact increases the bidders' knowledge of a portfolio and potentially leads to higher bids. In the case of Project Eagle, NAMA did not authorise direct contact with either the debtors or the relevant NAMA case managers. Instead, Lazard was asked to channel bidders' written queries to NAMA for formal response.

1 This may include loan agreements, property title information, lease information, tenancy schedules etc.

4.28 Potential bidders in a loan sale process sign non-disclosure agreements before they are allowed to access the data in a data room. For Project Eagle, the non-disclosure agreements placed a number of obligations on potential bidders, including commitments that bidders (or their advisors) would not contact Project Eagle debtors, or engage Northern Ireland property valuers. These obligations only took effect on the dates the agreements were signed. No disclosures were sought about either form of data gathering that might have been undertaken prior to the agreement signing date.

4.29 NAMA has pointed out that for Project Eagle, one bidder made some site visits and that access to case managers was not common practice at the time of the Project Eagle loan sale. NAMA also stated that it is equally valid to surmise that increased knowledge of a portfolio may lead to lower bids.

Identifying potential bidders

4.30 Figure 4.5 provides an extract from a contemporary overview of European property loan sales market conditions at the time Lazard was approaching bidders about participation in Project Eagle. The overview – by one of the leading international firms of loan sale advisors – indicates that the volume of commercial real estate loan sales in 2014 was expected to be about one third up on 2013 levels, and that there was a high level of interest in such sales, including from large US firms interested in exploring opportunities in Europe.

Figure 4.5 Extract from "European Real Estate Loans Sale Market Report", February 2014

Key buyers: same big players but more opportunities for smaller investors

The market continues to be dominated by large investment firms headquartered in the USA which accounted for approximately 70% of all acquisitions in 2013. Firms such as Lone Star, Apollo and Cerberus continue to take advantage of the abundance of opportunities throughout Europe with pro forma returns above those achievable in the USA. Several formed partnerships to share the risks associated with larger loan portfolio acquisitions. A prime example is the €5bn Hypothekenbank Frankfurt ('Eurohypo') UK loan book; Wells Fargo purchased the performing pool of loans and also financed Lone Star's acquisition of the non performing loan portfolio. Many US firms have also set-up offices throughout Europe during 2013 in order to gain a better understanding of the market and to be "closer to the action".

However, as activity has spread across Europe and the average size of sales has decreased from €500m in 2012 to €360m in 2013, there has been a notable increase in the diversity of potential buyers with several smaller local investors paying premium prices to break into the market.

Furthermore, 63% of sales by number in 2013 had face values under €250m in comparison to 44% in 2012, with only five transactions having an OPB above the €1bn mark. These 'bite size' sales enable a more diverse range of investors to participate in the sale processes thereby creating a more competitive environment which in turn helps vendors to maximise proceeds.

Planned transactions: Irish opportunities contribute heavily to strong pipeline of €33.7bn

Looking ahead, activity in 2014 will be supported by the substantial pipeline of planned transactions which Cushman and Wakefield Corporate Finance estimates has a face value of c. €33.7bn, including the Co-Operative Bank's anticipated sale of €2.2bn of UK commercial real estate loans and further sales expected from Lloyds and the new internal "bad bank" of RBS.

Investor interest will remain high in Ireland where demand significantly outweighs supply, with a wealth of opportunities expected to come from NAMA, IBRC and Ulster Bank. Additionally, Permanent TSB (rescued by the Irish government in 2011) has announced that it will seek to dispose of its €6.9bn of UK residential mortgages and c. €10bn Irish commercial real estate loan book over the next three years.

Source: Cushman and Wakefield Corporate Finance Ltd (www.cushmanwakefield.com)

4.31 It also pointed out that the average size of sales was decreasing and that some smaller investors were 'paying premium prices to break into the market'. This was considered to be creating a more competitive environment which in turn was helping vendors to maximise proceeds. The commentators predicted that investor interest would remain high in Ireland 'where demand significantly outweighs supply'.

4.32 Generally when carrying out a loan sale process, NAMA's aim is to attract interest from as large a pool of suitable potential bidders as possible in order to achieve a competitive process. NAMA has pointed out that there was a limited number of potential bidders with the financial capacity to bid for a portfolio the size of Project Eagle.

4.33 Ultimately, seven potential bidders (including PIMCO) signed non-disclosure agreements in relation to Project Eagle. In contrast, 28 firms signed such agreements for Project Tower, and 18 signed agreements for Project Arrow.

4.34 Apart from PIMCO, the firms that signed agreements for Project Eagle were either approached by Lazard on a staged basis during the early stages of the process, or had approached NAMA when there was media coverage of the Project Eagle sales process in February 2014 (see Figure 4.6).

Figure 4.6 Project Eagle timeline – potential bidders

Source	Firm	Outcome
Brown Rudnick approach	PIMCO	Withdrew from competition
Round 1 approach by Lazard (1st week Feb 2014)	Blackstone Starwood Oaktree	Declined to enter Declined to enter Withdrew from competition
Round 2 approach by Lazard (2nd week Feb 2014)	Apollo Lone Star Cerberus	Declined to enter Withdrew from competition Submitted bid
Individual request to NAMA/Lazard to be allowed enter the competition (post 14 Feb 2014)	Goldman Sachs Fortress 8 other firms	Withdrew from competition Submitted bid Refused entry to the process

Source: NAMA.

Firms approached by Lazard

4.35 In total, Lazard had approached six potential bidders by mid-February 2014. Initially, it approached three potential bidders, but only one of these agreed to participate. Lazard then approached a further three potential bidders, two of whom agreed to join the process. As a result, by mid-February 2014 there were four potential bidders – PIMCO, Oaktree, Cerberus and Lone Star.

Requests to enter the process

4.36 On 13 February 2014, there was a national press report that PIMCO had approached NAMA in 2013 to buy its entire Northern Ireland loan portfolio.[1]

4.37 The NAMA Board held a normal scheduled meeting on the day the press article was published. Project Eagle was a planned agenda item. Although strict confidentiality had been a key project objective for the Board in all its deliberations up to then, and was cited as the reason for a decision to run a restricted sale process, neither the media report nor the breach of confidentiality are mentioned in the Board minutes. The only evidence that the Board reconsidered its objectives for the process is that the minutes record that the Board gave Lazard and the NAMA executive the flexibility to increase the number of bidders involved in the process if 'genuine, credible interest arose'.

4.38 Lazard issued a 'process letter' on 14 February 2014 to each of the prospective bidders involved at that stage setting out the terms of the Project Eagle loan sale process, and the key steps and timelines.

4.39 Following the media coverage, NAMA and/or Lazard received enquiries from a further ten firms. Two of these – Goldman Sachs and Fortress – were allowed to enter the process. Lazard informed NAMA that it had excluded the other eight firms, seven of whom it said were well known to Lazard and had excellent reputations. Lazard wrote to NAMA on 20 February 2014, stating that it believed that the six bidders then in the process would generate sufficient competition and, therefore, it did not intend to admit any further bidders.

1 The possible sale of Northern Ireland assets was reported in the Irish Times on 13 February 2014.

Reasons for non-participation of bidders

4.40 Figure 4.7 summarises the reasons cited by potential bidders and/or by Lazard in relation to firms who either declined to participate in, or withdrew from, the Project Eagle sale process, or were refused entry to the process.

Figure 4.7 Reasons for non-participation in the Project Eagle loan sale process

Status	No. of firms	Reasons cited by Lazard in report to NAMA
Declined to participate	3	▪ Exposure to Northern Ireland ▪ Limited due diligence information available ▪ A lack of confidence in being able to compete with PIMCO
Withdrew from process[a]	3	▪ Insufficient time in order to submit a meaningful bid – one firm requested an extension of four weeks (i.e. a total of eight weeks) for the due diligence process, but this was refused. ▪ Insufficient current internal capacity given the number of projects the firm was involved in (including IBRC projects) ▪ Limited timeframe and information available
Requests to enter process refused	8	▪ Ensure confidentiality of the process ▪ Need to adhere to timetable set at the start of the process ▪ Maintain the motivation of bidders already in the process who were told that only a limited number of parties would be included ▪ Some firms appeared only to be interested in parts of the portfolio

Source: Summarised from Lazard status report of 11 March 2014.

Note: a Excludes PIMCO

4.41 Correspondence between potential bidders and Lazard, and between Lazard and NAMA sets out more detail about the reasons for firms' non-participation in the loan sale process, and the reasons cited by Lazard not to admit firms seeking entry into the competition (see Figure 4.8).

Figure 4.8 Explanations of bidders non-participation in the Project Eagle Sale Process

Three firms that declined invitation to participate in the sale process

Firm A – Extract from an internal NAMA email in February 2014 about a phone conversation

I just had a call from [a named person in a named firm]. In summary:

- *He thanked us for the opportunity to participate and said they are 'extremely grateful'*
- *He said they have a lot of deals in progress at the moment and were concerned that if they advanced with Eagle they would be spread too thin*
- *He said that in the absence of access to valuers they don't have the internal resources to price the portfolio*
- *He said that they were being selective in which major portfolio opportunities to follow as they are aware of several European portfolios being prepared for sale.*

Firm B – Extract from a Lazard email to NAMA in February 2014 about a phone conversation

[A named firm] have decided not to join the process. They were attracted by the size of the transaction, the compressed timeframe and the limited competition (by number of participants). However, they are not particularly familiar with the Northern Ireland property market and do not typically invest in properties as small as the "tail" – which they believe they would struggle to price without input from third party advisors. The option of discounting the price for the tail does not appeal to them as they would risk being outbid.

They stressed their gratitude for being invited to join the process – it is not a decision they took lightly and they very much hope to be included in future NAMA sales processes. They offered to review information on the portfolio in case it prompted them to change their mind but in my view that's unlikely and we would lose valuable time.

Firm C – Extract from an e-mail to NAMA from a non-participating bidder in March 2014

We are grateful for the opportunity to discuss Project Eagle with your colleagues and advisors earlier this week in Dublin. We appreciate the candid discussion of your objectives for a discrete, single stage sales process and the issues for consideration given the size of the portfolio and sensitivities surrounding its potential divestment. We also note our disappointment to learn of the extensive discussions with one investor in advance of the start of the process, which we believe creates a very material advantage for that party.

Although our funds have sufficient capacity to complete an investment of the envisaged size, the size and nature of the investment would require significant dialogue with our investment committee and limited partners.

Given the limitations imposed on the retention of certain advisors or prospective financing partners, we do not believe a sufficiently robust discussion of the opportunity and challenges is achievable to prudently commit to an investment of this magnitude within the requested timeline. Consequently, we regret to inform you that we are not in a position to commit resources to the process under the stipulated guidelines and timeline.

However, we view this opportunity as fully appropriate for our investment strategy and of considerable interest. We would welcome an opportunity to participate in the sale process if it were revised to mitigate any perceived advantage through the provision of additional time and access to advisory and prospective financing partners.

Figure 4.8 (continued)

A firm that withdrew from the sale process

Firm D - Extract of email to Lazard in March 2014

Over 20 members of our investment and workout teams have been working tirelessly with several advisors over the past few weeks (at a not insignificant cost) to decipher and piece together a base set of information on the loans and assets from which to form a view on (a) collateral value, (b) loan/security/ enforcement/control considerations, and (c) other deal level considerations (such as swaps mis-selling).

On (a), our initial work suggested a collateral valuation commensurate with your reserve pricing aspirations, which is great.

On (b), we have not been able to receive sufficient information or comfort around one key issue we discussed in our original meeting in Dublin i.e. whether we would be able to get comfortable with the risk that certain agreements may have been struck with borrowers that could ultimately impact economics and/or control – both are obviously key drivers of valuation. This is all the more important when dealing in a jurisdiction where some borrowers like to litigate, perhaps fuelled by a legal system/process that might be viewed by some to favour borrowers. Some variables we have typically relied upon in the past to alleviate such concerns include

- *a schedule laying out what agreements (express or implied, actual or alleged) that may exist with borrower*
- *a reasonable amount of access to correspondence with borrowers*
- *access to the lender i.e. NAMA's asset recovery managers*
- *access to borrowers*
- *a fluid question and answer mechanism*

Sadly, owing to the inherent constraints of this process we have not benefitted from many of these variables.

On (c), we haven't received sufficient information and don't envision there being sufficient remaining time to facilitate a prudent assessment of such risks.

Owing to the lack of or quality of information available to perform due diligence, we believe we need to amend our initial underwriting and pricing assessment to reflect these possible risks that cannot be assessed or quantified in a meaningful way. While we are really attracted to the overall size and underlying collateral of the portfolio, the adjustments required would cause our likely offer to fall below the stated reserve price. Consequently, we are reluctant to continue further with the knowledge that we wouldn't meet the reserve price when the dead deal costs we would incur between now and bid date would amount to c.£3m.

Subsequently, Lazard notified NAMA that Firm D had contacted it again with proposed terms that were "clearly designed for NAMA to reject". These included

- a request for more information, including access to borrower correspondence
- an eight week extension of time and
- a guarantee of the firm's due diligence costs.

Lazard stated that Firm D had also referred to numerous loan portfolio sales currently in the market or coming to the market soon.

Figure 4.8 (continued)

Firms refused entry to the process

On 26 February 2014, NAMA emailed Lazard to inform them that NAMA had received two further enquiries (from two named firms) in relation to Project Eagle. NAMA requested Lazard's advice/recommendation. Lazard responded to NAMA the same day by email stating, inter alia,

We know both of these firms well and hold them in high regard. However, our advice would be not to include them in the process on the grounds that we already have sufficient competition and including them would undermine our assertion to the existing participants that the process is restricted to a 'handful' of parties. It would also put the confidentiality of the process at risk, taking into account the number of people (both internal and external) that the firms would seek to involve.

The same arguments apply to [three other named firms] – to all of whom we have already explained that, in this particular instance, the process is closed to new entrants.

Firm E – Lazard email to NAMA

NAMA was contacted on 27 February 2014 by one of the firms refused admission to the competition. NAMA asked Lazard "to follow up with the firm and close off the matter". Subsequently, an official from Lazard sent a further email to NAMA stating

I have just spoken to [a named person in a named firm] to reiterate the message I conveyed to her last night that the process is closed to new entrants and therefore we would not be admitting that firm or any other party who had approached NAMA on the back of the recent press coverage. [She] was clearly quite frustrated and asked why that was the case, given that NAMA typically runs open processes. I explained that this transaction was unusual in that respect but that I was not in a position to elaborate further.

Firm F – Lazard email to NAMA

Lazard separately emailed NAMA, also on 27 February 2014, setting out its conversation with another firm that was refused entry into the process.

I spoke to [a named person in a named firm] this evening and explained that the Eagle process – unusually for NAMA – was closed to new entrants. Unlike [a named person in another named firm], he did not seem fazed by the process, but was very frustrated that his firm had not been included in the first place, given their track record in Ireland and their relationship both with NAMA and Lazard. I didn't say this to him but I recall discussing [Firm F] with you all at the outset but concluding that there were other firms who deserved priority. He said he would call his contacts at NAMA to express his unhappiness with the situation.

NAMA's views on bidder access

4.42 In NAMA's view, no serious credible bidders were excluded from the process who could have attained the target sales price. Nine bidders were permitted access to the sales process. In aggregate, as is shown in Figure 4.9, these nine firms accounted for 88% (by par value) of all European commercial real estate loan sales of portfolios in excess of €1 billion over the same period.

Figure 4.9 Europe and UK/Ireland commercial real estate loan sales of €1 billion or more (par value) by purchaser shares

Purchaser(s)	European sales 2013-2015	UK/Ireland sales 2013-2015
Cerberus	30%	37%
Lone Star	30%	28%
Goldman Sachs	13%	16%
Apollo/Deutsche	8%	8%
Blackstone	2%	3%
Fortress	3%	—
PIMCO	2%	—
Others[a]	12%	8%
Total	**100%**	**100%**

Source: Complied by NAMA from reports published by Cushman and Wakefield

Note: a Most of these were either special purchases or sales of performing loan portfolios, and therefore not directly comparable with non-performing loan sales.

4.43 The eight firms refused access to the Project Eagle loan sale process on Lazard's recommendation accounted for no European commercial real estate sales of €1 billion plus nominal, and no UK/Ireland commercial real estate sales of €1 billion plus nominal during the period 2013 to 2015.

4.44 In response to a series of questions put to them by NAMA, Lazard stated to NAMA on 31 March 2016 that

- Apart from the nine global investors who participated in the process, there is no evidence that any other investor existed at the time (the first quarter of 2014) who was as credible and as well qualified such that it appeared that they were in a position to pay a higher price to NAMA than that secured from Cerberus.
- The process was open to the most qualified and credible potential counterparties. There were fewer participants in this process than in some other transactions because there were fewer investors that were sufficiently qualified and credible.
- The firms that were not admitted into the process did not meet NAMA's criteria, namely the ability to pay £1.3 billion in cash, the human capital and resources to review such a large, complex and granular portfolio, the ability to purchase the entirety of the portfolio, and the ability to transact on the basis of the limited information available on the portfolio.

- Several investors might have requested information on the portfolio in order to inform themselves of the contents with a view to positioning themselves for subsequent transactions with the eventual purchaser without being qualified to acquire the portfolio as a whole.
- The fact that seven of the nine suitably qualified investors admitted into the process decided not to submit a bid suggests that the Project Eagle portfolio was not particularly appealing as an investment proposition.
- In our experience, it is not uncommon in a transaction of this complexity and scale for the number of bidders to be distilled down to just two or three final bidders. It is crucial to ensure in a process such as Project Eagle that bidders are sufficiently motivated to spend time and money on due diligence in a competitive situation. This objective was achieved in the Project Eagle process.
- In our professional judgment and given, inter alia, NAMA's objectives and the nature of, and limited information available on, the portfolio, the process was appropriate for a transaction of this nature. The process was competitive throughout and resulted in a price being achieved which was higher than NAMA's target price and also met NAMA's other objectives.

PIMCO withdrawal

4.45 On 10 March 2014, PIMCO disclosed to NAMA that it had a success fee arrangement in place with Brown Rudnick that involved substantial payments to a former member of the NIAC (Mr Cushnahan). NAMA told PIMCO it would have an issue with such a payment, and PIMCO subsequently withdrew from the competition.[1]

4.46 NAMA did not explain to Lazard the reason for PIMCO's withdrawal. Lazard heard of the withdrawal from PIMCO, and reported to NAMA that the reason given by PIMCO was that the Project Eagle portfolio was 'not for them'.

The Project Eagle data room

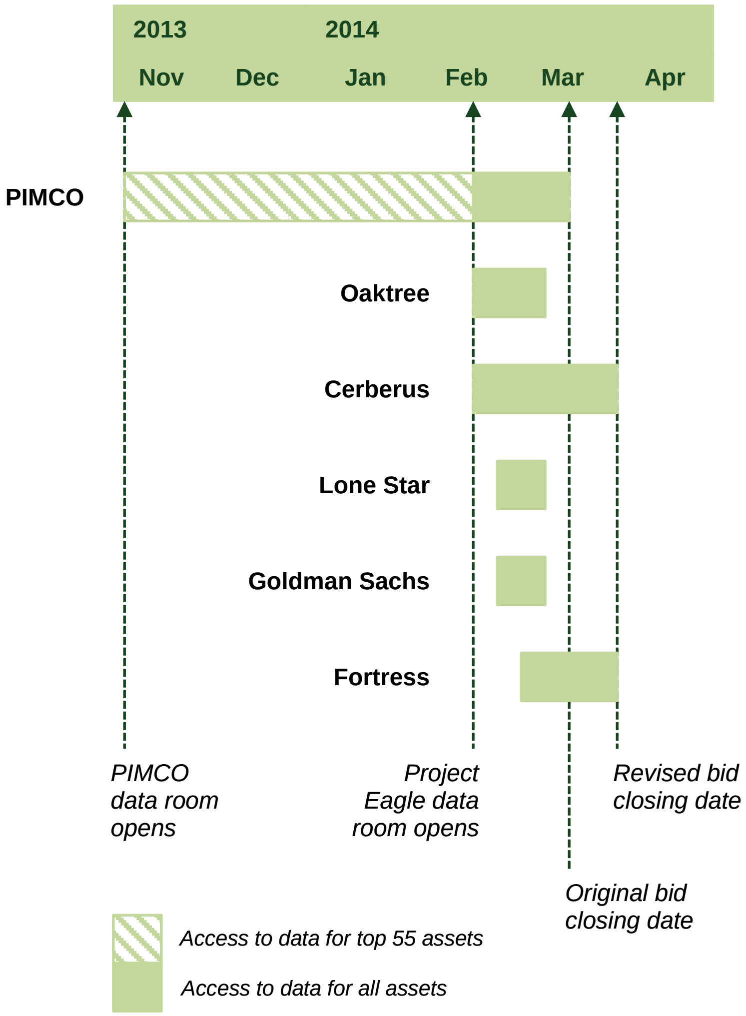
Availability of the data room

4.47 A minimum of four weeks access to the data room was provided to all firms admitted to the process, and an additional two weeks was provided for the two firms remaining in the process at mid-March 2014. PIMCO and its advisors had an additional 14 weeks access prior to other firms entering the process. This contrasted with the approach for Project Tower, where firms had four weeks access to data rooms at each phase (a total of eight weeks), and Project Arrow, where firms had four weeks access in round one and six weeks in round two (a total of ten weeks).

4.48 One firm admitted to the Project Eagle process requested an additional four weeks to carry out due diligence as it did not believe it had had sufficient time to submit a meaningful bid by the 18 March 2014 deadline. NAMA has stated that this request was refused, on the grounds that agreeing to extend the due diligence period by as much as four weeks could have alienated other firms. The firm then withdrew from the process. On 14 March 2014 – following PIMCO's withdrawal – NAMA agreed to provide the two firms then remaining in the process (Cerberus and Fortress) with data room access for an additional week. A further week's access was subsequently allowed i.e. a 1 April 2014 bid submission date.

1 NAMA's handling of PIMCO's disclosure is considered in Chapter 5.

Figure 4.10 Project Eagle Data room – available access of prospective bidders[a]



Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

Note: a Data room opened on 14 February 2014 to all potential bidders who had signed non-disclosure agreements at that time.

4.49 NAMA has stated that the marketing approach for Project Eagle was dictated by the Board's desire to have the transaction completed in a sensitive and timely manner, and that there was no advantage to PIMCO from its early engagement in the process. All firms were provided with the same information through the data room. The data room made available to all potential bidders from 14 February 2014 included all of the information in the initial data room to which PIMCO had access, and additional information.

Data room activity

4.50 Management of the data room normally falls under the loan sales advisor's remit. The level of activity in the data room by bidders and/or their advisors can be monitored, and potentially provides feedback on how much active interest exists in a portfolio, and who may be preparing to submit a bid.

4.51 In the case of Project Eagle, NAMA directly managed the data room itself, instead of Lazard. It prepared a report detailing the level of data room activity from 14 February to 5 March 2014. NAMA informed the examination team that it was unable to provide reports detailing activity levels by prospective bidders for later periods.

4.52 In response to the penultimate draft of this report, NAMA provided additional data room activity information, which it had recently obtained from Intralinks, the data room service provider. The additional information – presented in Figure 4.11 – indicates that all of the 2,785 documents provided in the data room were accessed by Cerberus, while 98% were accessed by Fortress. Three other firms – Oaktree, Goldman Sachs and PIMCO – accessed 96% or more of the 1,929 documents available in the data room up to 6 March 2014. (The data for the other firm that engaged in the process, Lone Star, was not provided by NAMA).

Figure 4.11 Project Eagle data room activity by firm

Potential bidder	Period	Available documents accessed	No. of docs viewed	No. of times data room accessed
Oaktree	14 Feb – 6 Mar 2014	100%	1,929	544
PIMCO	14 Feb – 6 Mar 2014	97%	1,863	158
Goldman Sachs	14 Feb – 6 Mar 2014	96%	1,850	58
Cerberus	14 Feb – 28 Mar 2014	100%	2,785	1,025
Fortress	26 Feb – 28 Mar 2014	98%	2,746	1,043

Source: NAMA.

4.53 The differences in the number of documents viewed reflects the increase in the number of documents made available from the start of March 2014 until the end of the process as more information was uploaded to the data room. Participants in the process were alerted whenever new documents were uploaded.

Undertakings on engagement of advisors

4.54 Potential bidders appoint professional advisors (e.g. legal, accountancy and property advisory firms) to carry out due diligence on their behalf. Following PIMCO's withdrawal from the process on 13 March 2014, its professional advisors moved to advise other firms that were still engaged in the process

- Brown Rudnick, PIMCO's legal advisors, moved to Cerberus as strategic advisors
- New River Retail, PIMCO's retail property advisors, moved to Cerberus
- Cushman and Wakefield, PIMCO's property advisors, moved to Fortress.

4.55 Prospective bidders for Project Eagle were required to seek written consent from NAMA in relation to any advisors they wished to engage or retain during the loan sale process. In accordance with the terms of the agreement, Cerberus notified Lazard of its intention to engage New River Retail and Fortress notified Lazard of its intention to use Cushman and Wakefield.

4.56 When it was considering the two bids received on 1 April 2014, NAMA asked Cerberus if it had any success fee payment arrangements in place. NAMA has stated that it became aware only then of the relationship between Brown Rudnick and Cerberus.

The bid process

Submission of bids

4.57 NAMA's general policy for loan sales in excess of €50 million is to have two rounds of bids.[1]

- In the first round, bidders are invited to submit indicative bids after which NAMA shortlists a number of firms which are invited to make final bids. A first round also provides bidders with the opportunity to carry out initial pricing analysis and to establish their interest without committing to the more expensive full due diligence process.
- Following a further period of due diligence, final and binding bids are submitted and NAMA selects a preferred bidder.

4.58 There were two-round bidding processes for both Projects Arrow and Tower. Project Eagle involved just one round (see Figure 4.12). Apart from Project Eagle, a one-round loan sales process was used only in the case of the sale of the loans of a single debtor which was openly marketed and which generated proceeds of €66 million. A one-round process was considered sufficient in that case as there were only two qualifying first round bids, and the lead bid was substantially better than the other bid.

Figure 4.12 Projects Tower, Eagle and Arrow – bidder engagement

	Project		
	Eagle	Tower	Arrow
Firms signed non-disclosure agreements	7[a]	28	18
Number of first round bids	na[b]	7	5
Bidders shortlisted	na[b]	3	3
Number of final/binding bids	2	3	2

Source: NAMA.

Notes: a One of the 7 firms signed an agreement, but withdrew from the process without accessing the data room.

b Not applicable

4.59 The Board-approved minimum price of £1,300 million was communicated to bidders at the start of the process, in early February 2014. In late March 2014, just prior to submission of bids, NAMA reduced the minimum price by £70 million to £1,230 million as a result of asset sales completed during the loan sale process. Lazard confirmed to NAMA that the adjusted minimum price was communicated to the two remaining parties in the process.

4.60 The bids received on 1 April 2014 are summarised in Figure 4.13. Bidders were required to meet certain conditions including

- make a bid at least equal to the (adjusted) minimum price
- allocate the bid to the individual assets in the portfolio.

Only the Cerberus bid met both conditions.[2]

1 While a two-round process is the norm for large NAMA transactions, loan sales are considered on a case-by-case basis. NAMA's policy provides for some process steps to be dispensed with, depending on the specifics of the sale.

2 The Board set a target price for Project Tower and a guide price for Project Arrow. In both cases, all final bids submitted by the bidders either met or were above the prices set by the NAMA Board.

Figure 4.13 Project Eagle – bids submitted

	Cerberus	Fortress
Bid amount	£1,241 million	£1,075 million
Excess/(shortfall) on adjusted minimum price	£11 million	(£155 million)
Allocation of bid to each individual asset	Yes	No

Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

Lazard recommendation

4.61 Having assessed the bids received, Lazard provided a report to NAMA in a letter dated 2 April 2014. Lazard noted that

- In its professional advisory judgment, given NAMA's objectives, the process had been appropriate for a transaction of the nature of Project Eagle.
- The process involved a limited number of highly qualified bidders, limited due diligence information, a single round of bidding and the requirement for bidders to acquire the portfolio 'entirely in cash' (i.e. with the required funding in place).
- Four bidders had withdrawn from the process but, in Lazard's view, competitive tension remained in the process following those withdrawals.

4.62 Lazard pointed out that, unlike Cerberus, Fortress had refused to allocate its offer price to individual assets and stated that

> *"In summary, Cerberus's offer is far superior in terms of price and, in respect of the other elements, it is either superior (for example in terms of timing or business plan) or broadly equivalent to Fortress's (for example in respect of remaining due diligence).*
> *…we recommend moving forward solely with Cerberus with a view to executing the loan sale agreement on agreed terms at a price of £1,241 million as quickly as possible, ideally within two weeks, and completing the transaction as soon as possible thereafter".*

4.63 A paper submitted to the NAMA Board at its meeting of 3 April 2014 summarised the two bids received and the recommendation from Lazard. The Board approved the recommendation to

- continue negotiations solely with Cerberus
- approve the Cerberus offer of £1,241 million[1]
- delegate authority to the CEO and NAMA's Head of Asset Recovery to approve a revised minimum sales price of £1,200 million should final due diligence issues emerge which could impact value, and to negotiate the terms and conditions of the final legal documentation.

1 The amount ultimately paid by Cerberus was less than the bid price because some further properties were sold (with the proceeds retained by NAMA) before the Project Eagle sale closed.

Assessment of sales competition

4.64 When Lazard wrote to NAMA on 22 January 2014 setting out its understanding of its role in the Project Eagle process, it acknowledged NAMA's requirement for Lazard to provide a 'comfort letter' at the end of the transaction confirming that the process was appropriate in light of the nature of the portfolio and NAMA's objectives. Lazard provided a draft of the letter to NAMA on 24 January 2014.

4.65 On 25 June 2014, Lazard issued its completion letter to NAMA. In addition to a restatement of NAMA's objectives for the competition and a summary of the stages of a loan sale process, Lazard provided formal advice as follows

> *"Our advice relates to the appropriateness from a financial advisory perspective of the sale process which has been run which culminated in the offer from Cerberus, and does not address any other aspect or implication of the Transaction. We express no opinion regarding the underlying decision to dispose of the portfolio and our advice does not address the relative merits of the transaction as compared to alternative transactions, timing or strategies that might be available to NAMA. Our advice is based on the economic, monetary, market and other conditions existing at the date hereof. It should be understood that events occurring after the date hereof may affect our advice and the assumptions used in preparing it and that we do not have any obligation to update, revise or reaffirm our advice.*
>
> *This letter is provided solely for the benefit of NAMA in connection with, and for the purposes of, your consideration of the transaction, and shall not confer rights or remedies upon any beneficiary of NAMA or any other person or be used, or relied upon, for any other purpose. This letter is confidential and other than as may be disclosed by you on a confidential basis to the Minister for Finance and to your auditors, may not be used or relied upon by, or disclosed, referred to or communicated by you (in whole or in part) to any third party for any purpose whatsoever except with our prior written consent. This letter is provided pursuant to, and is subject to, the terms of the engagement letter entered into between NAMA and us related to Project Eagle.*
>
> *Based upon and subject to the foregoing, we believe that as of the date hereof, in our professional financial advisory judgement, having regard to the information available to us and NAMA's objectives, the sell-side process for the transaction was appropriate for the sale of a loan portfolio of this nature."*

NAMA's expenditure on advisors

Loan sale advisors' fees

4.66 The amount of Lazard's fee was contingent on the sale of the Project Eagle loan portfolio. In the event of the loan process not resulting in a sale, Lazard's claim for fees would have been based on the reimbursement of "reasonable costs and expenses" they incurred during the process.

4.67 The final fee paid to Lazard in respect of services provided on the Project Eagle portfolio sale amounted to £4.32 million. The fees paid were in line with the fee structure agreed between NAMA and Lazard, and comprised three elements

- £4.24 million – representing 0.35% of the final sale price received
- £71,500 – an additional 0.65% payable on that part of the final sale price above the minimum price
- £11,193 – for out-of-pocket expenses incurred by Lazard.

4.68 The percentage fee rates paid to Lazard were similar to the rates agreed with the loan sales advisors for Project Tower, but almost double the rates agreed with the loan sales advisors for Project Arrow. This was in contrast to the lower level of work NAMA required Lazard to carry out for Project Eagle when compared with either of the other projects. For example, Lazard's functions did not include valuing of the portfolio, sub-portfolio analysis, or data room management; and it had a lower number of potential bidders to engage with, a lower level of queries to process and a significantly shorter timeline for the project.

Legal advisors' fees

4.69 Following a tender process, under an existing framework agreement, NAMA appointed Hogan Lovells in February 2014 as legal advisors for the Project Eagle loan sale for a 'fixed fee' of £290,000. The final fee paid to Hogan Lovells in respect of their work on Project Eagle totalled £1.1 million, representing around 3.5 times the level of the fixed fee.

4.70 NAMA has stated that the fixed fee agreed with Hogan Lovells did not cover the entire transaction as the full scope had not been identified at the time the request for tender was issued on 27 January 2014. The full scope was to be discussed and agreed and be charged at standard hourly rates set for the framework agreement.

Conclusions

Marketing strategy

4.71 The paper for the Board meeting of 8 January 2014 proposed a 'marketing approach' which was extremely restricted, with a proposed date of 31 January 2014 for Lazard to submit its recommendation on bid acceptance.

4.72 The NAMA Board did not agree to PIMCO's request for exclusivity but decided also not to pursue its normal sale process. Instead, it directed that the sale should be effected through a "limited, focused and time-bound open marketing process", involving tightly restricted entry to the sale competition and restrictions on potential bidders' access to information, subject to Lazard's advice about the time to be provided for access to the data room. Lazard was to be given a reasonable time to market the portfolio. Furthermore, there was a clear objective from the outset of ensuring that the planned loan sale would remain highly confidential.

4.73 Ultimately, the strategy that was implemented involved a wider field of potential bidders, and an increased level of information and more time for the eventual bidders to carry out due diligence than was initially planned. Nevertheless, the process adopted differed from NAMA's other loan sale competitions and, compared to NAMA's standard approach, the restrictions reduced both the level of competition and the level of information available to potential bidders to assess the value of the portfolio.

Potential bidders

4.74 There was a limited number of potential bidders with the financial capacity to bid for a portfolio the size of Project Eagle. Apart from PIMCO, eight firms were given the opportunity to bid. Three firms declined to participate, and three (not including PIMCO) withdrew from the process. One firm declined to participate citing the competitive advantage to PIMCO of its early engagement with NAMA. Firms that declined to participate or that withdrew cited dissatisfaction with the time allowed for the sale process and with the level of information available, and prior commitments to other sales already taking place or planned, rather than a lack of interest in the Northern Ireland loan book itself.

4.75 The loss of confidentiality of the process in mid February 2014 presented an opportunity for NAMA to consider a revised marketing strategy for the portfolio. The Board gave Lazard the flexibility to increase the number of bidders involved in the process if 'genuine, credible interest arose'. However, just two of the ten firms that subsequently sought entry to the competition were allowed to join the process. In line with NAMA's objectives for the competition, Lazard had given a prior commitment to those that joined the process early that the number of potential bidders in the competition would be limited, and reported to NAMA in March 2014 that admitting more firms would have undermined that commitment. In March 2016, Lazard stated that the eight firms were not admitted because they did not meet NAMA's criteria for participation, including the financial capacity to purchase the portfolio.

Loan information for due diligence purposes

4.76 The firms that engaged in the process did not all have the same data about the loans because additional documents were added to the data room after some firms had withdrawn. One firm withdrew from the competition after it was refused a requested four-week extension of time to examine and evaluate the information, but a two-week extension was subsequently granted to the firms remaining in the process.

4.77 PIMCO had an advantage through its earlier engagement in the process – it, and its advisors, had more time than the other bidders to mobilise the teams required to carry out due diligence, to assess the information available about the loans, to carry out their own due diligence research, and to plan a post-acquisition strategy.

Process assurance

4.78 NAMA has a clear policy that where it decides to undertake a loan sale, this should normally be by way of an open, competitive process with the objective of maximising the sale price. The policy, which includes guidelines for the sale of loan portfolios, is consistent with the standard market approach which, if implemented, should normally provide reasonable assurance that the best price currently achievable in the market is obtained.

4.79 NAMA's policy was implemented in the Project Tower and Project Arrow loan portfolio sales. The Board has discretion to depart from its normal loan sale process, and exercised that discretion for Project Eagle. For example,

- The loan sale advisors were not required to prepare a valuation of the portfolio, including of the underlying collateral.
- The sales process was constrained to a short single phase, rather than the market standard two-phase approach.
- The level of information made available for due diligence purposes was limited, and was expanded after some firms had withdrawn.
- Potential bidders were prohibited from accessing the services of Northern Ireland based property valuers (and from contacting the debtors).
- The time available for potential bidders to prepare for and carry out due diligence work was limited, but the bid date was deferred after some firms had withdrawn when they were refused extensions of time.

4.80 In addition, one large investment firm identified as a potential bidder was not included in the Project Eagle 'invitation list' on the basis that there were 'other firms who deserved priority'. When the Project Eagle sale became known publicly, the same firm was refused the opportunity to participate. The restrictions reduced both the level of competition in the process and the opportunity for potential bidders to assess the value of the portfolio. They acted as a deterrent for a number of bidders and had the potential to affect the price achievable.

4.81 The Board has stated that it is satisfied that all major credible investors with the capacity to submit bids for a portfolio of this scale and composition were approached during the process and that all investors who had a serious interest in acquiring the portfolio had adequate time and information to enable them to prepare and submit firm offers. Based on this, the Board is satisfied that the best price reasonably achievable for the portfolio was obtained.

4.82 Lazard reported to NAMA that the Cerberus offer was the better of the bids received. In addition, Lazard provided assurance that the sell-side process for the transaction was appropriate, having regard to the information available to it and NAMA's objectives. At the time, Lazard did not know the circumstances of PIMCO's withdrawal. In its assurance statement, Lazard expressly provided no opinion about the underlying NAMA decision to dispose of the portfolio, and did not address the relative merits of the Project Eagle sale as compared to alternative transactions, timing or strategies for the sale that might have been available to NAMA. Lazard's recent statements to NAMA about the sales process do not materially extend the assurance they provided in 2014.

4.83 The restrictions on the sales process combined with the scope of Lazard's assurance statement do not provide sufficient assurance that a different marketing strategy for the loans, or different timing of the sale, could not have resulted in NAMA achieving a higher price from the sale of the loans.

Record keeping by NAMA

4.84 A formal, standard framework for operations lessens the requirement for an organisation to create records of process decisions. Where a process departs from the standard framework, particularly for a significant transaction or event, it is important that a clear record exists of the reasons for these departures. For Project Eagle, NAMA did not keep an adequate record of key decisions and events even though the sales process deviated from standard. For example

- The Board minutes do not record clearly the basis for the Board's decision about the minimum price for the portfolio. The papers submitted to the Board are also unclear about the basis for their recommendations.
- Neither the Board minutes nor the Board papers record consideration or evaluation of other options for the portfolio structure, which it has been asserted was undertaken.

4.85 Board minutes are the official record of decisions made by the Board. Minutes of meetings cannot practically record everything that is said, or every argument made. Nevertheless, it is particularly unsatisfactory that Board minutes would not clearly record the basis upon which critical financial decisions were made.

4.86 NAMA does not accept that the Board minutes do not record clearly the basis for the Board's decision about the minimum price for the portfolio.

5 Management of Conflicts of Interest

5.1 In order for State bodies to safeguard public resources and to maintain public trust in their operations, robust processes are required to deal with potential or perceived conflicts between the interests of the body and those of managers, decision makers and advisors (or connected persons). This chapter examines NAMA's management of conflicts of interest associated with the Project Eagle disposal and with the Northern Ireland Advisory Committee (NIAC).

Provision of information to the NIAC

Level of information

5.2 The initial NIAC terms of reference (adopted in 2010) stated that "for the avoidance of doubt, no information concerning a debtor will be disclosed to any member of the NIAC who is not also a Board member." The terms of reference were amended in July 2011, and subsequently stated that NIAC members would be provided with 'relevant information' to allow the Committee to meet its purpose and objectives. The amendment followed a proposal by the NIAC in February 2011.

5.3 A review of all the minutes of the NIAC meetings indicates that the primary focus of the briefings and discussions was on the property market generally in Northern Ireland and on NAMA's property portfolio in Northern Ireland, and not on the loans of debtor connections based in Northern Ireland. Apart from some information about enforcement proceedings against named Northern Ireland debtors, there is no evidence of information relating to specific Northern Ireland debtors being provided at NIAC meetings.

5.4 The minutes indicate that verbal updates provided to the NIAC on NAMA's Northern Ireland portfolio included

- reports on the level of NAMA's Northern Ireland property asset sales and new lending to Northern Ireland debtors
- reports on the numbers of insolvency and enforcement appointments and enforced assets related to Northern Ireland debtors
- at a meeting on 12 March 2012, a breakdown of the Northern Ireland loan portfolio by category of property asset and by loan acquisition and par debt values.

Circulation of NIAC information

5.5 Papers for NIAC meetings were emailed to NIAC external members using a secure NTMA file transfer system. From around mid-2010, Mr Cushnahan's papers were sent to him via email to a nominated person at Tughans solicitors in Northern Ireland, where he kept an office. Two of the NIAC meetings were also held in the Tughans offices.

Disclosure of members' interests

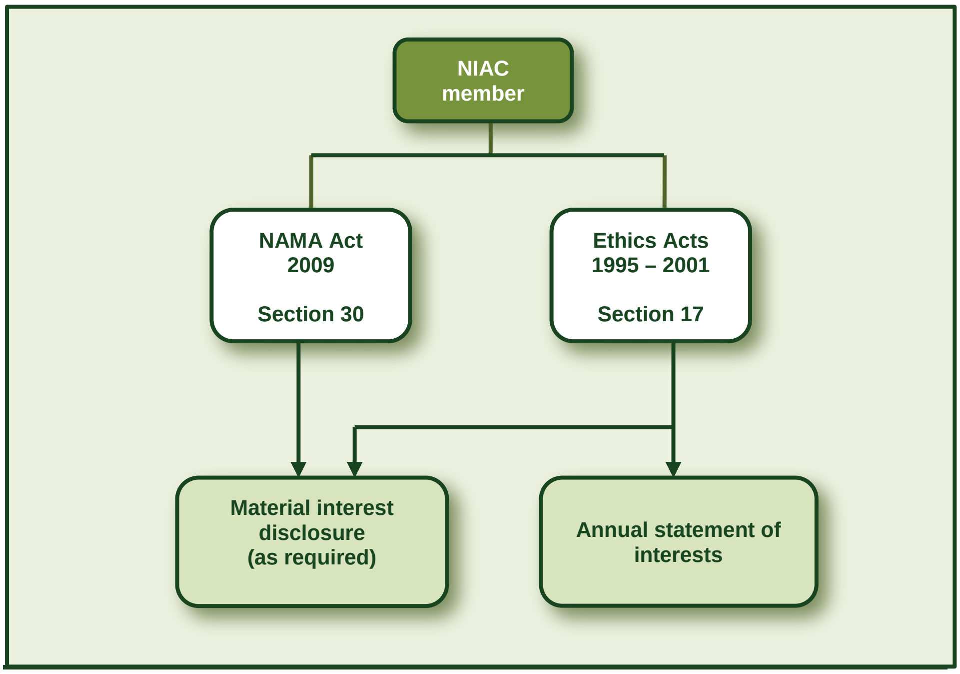
5.6 NAMA Board and sub-committee members are legally obliged to make annual statutory declarations of relevant interests, and to declare material interests in matters relating to their functions, where they arise (see Figure 5.1). Where they, or a connected party have such interests, the member must

- disclose the interest
- not seek to influence a decision in the matter
- absent themselves from the meeting or that part of the meeting during which the matter is discussed.

The Minister has statutory powers to remove a Board or sub-committee member should the member contravene their obligation to disclose an interest.

5.7 The NAMA Board adopted a code of conduct for its members and members of the sub-committees on 20 December 2010.[1] The code states, inter alia, the obligations on members in relation to disclosures of interests in the course of business, and non disclosure of privileged information that they receive from NAMA. The code also states members' non-disclosure obligations do not cease when their membership of the Board or sub-committee ceases.

Figure 5.1 NIAC– members' disclosure of interests obligations



Source: NAMA Code of Conduct.

1 The code was updated annually thereafter.

Interests disclosed by NIAC members

5.8 The examination team reviewed the declarations made by the external members of the NIAC from 2010 to 2014. The results are summarised in Figure 5.2.

Figure 5.2 Summary of disclosures by external members of NIAC, 2010 – 2014

Type of disclosure	Member	2010	2011	2012	2013	2014
Annual statement of interests	Mr Cushnahan	✓[a]	✓	✓	✓	N/A
	Mr Rowntree	✓	✓	✓	✓	✓
Material interests disclosures at meetings	Mr Cushnahan[b]	—	5	3	—	—
	Mr Rowntree	—	—	2	—	—

Source: NTMA Compliance Unit

✓ Statement provided

Notes: a The NTMA Compliance Unit confirmed that Mr Cushnahan made a 2010 return. However, the unit could not locate the return in the course of the examination.

b Mr Cushnahan's eight disclosures related to five NAMA debtor connections.

5.9 Both external members completed annual statements of interests in respect of each of the years during which they were NIAC members. Members were required to send their annual statements of interests to the Standards in Public Office Commission and to the Chairman of NAMA. The NTMA Compliance Unit (which provides compliance support to NAMA) maintained a register of interests which was updated following receipt of the annual statements. The Head of NTMA Compliance met annually with the Chairman of NAMA to review the disclosures and the register.

5.10 Both external members also made disclosures of material interests at NIAC meetings.

- In eight declarations over the course of meetings held between 18 April 2011 and 10 December 2012, Mr Cushnahan disclosed his involvement with a total of five different debtor connections, in respect of which he was providing financial consultancy services. Those disclosures of interest did not relate to matters scheduled on the agenda at the Committee meetings where the disclosures were made.
- Mr Rowntree's two disclosures related to agenda items for the meetings where the disclosures were made, and did not relate to NAMA debtor connections.

5.11 In addition to his disclosures at meetings, Mr Cushnahan's annual statements for 2011 to 2013 disclosed his interests in a further two NAMA debtor connections i.e. a total of seven debtor connections. He stated that his interests related to the provision of consultancy services and that this was on a non-remuneration basis in all but one case.

5.12 The examination found that six of the seven debtor connections in respect of whom Mr Cushnahan disclosed an interest had a combined NAMA debt at 31 December 2013 of £997 million. This accounted for 50% of the total NAMA debt of the Project Eagle debtors.[1]

1 Mr Cushnahan's disclosure in respect of one NAMA connection related to negotiations he was carrying out on behalf of a third party engaged in a joint venture with the debtor. The debtor connection represented around 8% of the Project Eagle debt. This is excluded from the estimate of 50%.

5.13 In June 2011, Mr Cushnahan disclosed an engagement with an investment banking firm – not PIMCO or Cerberus – with which he had met. He also stated that the investment firm was accompanied at the meeting by representatives of a named NAMA debtor and consequently he should not be associated with any matter pertaining to either party. These parties were included in his annual returns thereafter.

5.14 The NIAC minutes do not record Mr Cushnahan declaring any interests in relation to PIMCO, the Project Eagle loan sale or any shareholding in a NAMA debtor company.

PIMCO's withdrawal

5.15 PIMCO withdrew from the loan sale process on 12 March 2014 having informed NAMA on 10 March 2014 of a proposed success fee payment arrangement involving three other parties which included Mr Cushnahan. The key events surrounding PIMCO's withdrawal are summarised in Figure 5.3.

Figure 5.3 Timeline of key events surrounding PIMCO disclosure and withdrawal 7 March – 3 April 2014

7 March	PIMCO's legal and compliance unit contacts NAMA's legal unit requesting a conference call on Project Eagle
10 March	▪ PIMCO informs NAMA of its success fee arrangement involving Brown Rudnick, Tughans and Mr Cushnahan. ▪ NAMA confirms to PIMCO it was unaware of this arrangement.
11 March	▪ NAMA Board concludes that Mr Cushnahan's involvement in the proposed success fee arrangement is a 'significant issue'. Board notes he had resigned from the NIAC in November 2013. ▪ PIMCO is asked to consider the Board's view and revert to NAMA.
12 March	PIMCO withdraws from the loan sale process.
13 March	▪ NAMA Board is informed two bidders remain. ▪ Board minutes record that "Lazard had advised that there should be sufficient competitive tension in the process with the remaining two bidders". ▪ Closing date for bids extended to 1 April 2014.
1 April	Bids are received from Cerberus and Fortress.
3 April	▪ Cerberus discloses it has a success fee agreement, with a fee to be split equally between Brown Rudnick and Tughans. ▪ Board approves Cerberus as preferred bidder subject to Cerberus confirming in writing that no fee or other remuneration is payable to any current or former member of the NAMA Board, executive or advisory committee. ▪ Cerberus provides the requested confirmation.

Source: NAMA Board minutes

5.16 There were a number of telephone conversations between NAMA and PIMCO executives between 10 and 12 March 2014.[1] NAMA did not ask PIMCO for a copy of the success fee agreement in the course of these engagements, or later. NAMA has stated that it had no entitlement to receive, let alone review, a copy of the proposed success fee arrangement between PIMCO and Brown Rudnick, and that PIMCO did not indicate a willingness to provide a copy.

Deliberations following PIMCO disclosure

5.17 During two meetings on 11 and 13 March 2014, the Board was informed of PIMCO's disclosure regarding the proposed success fee arrangement between it and Brown Rudnick, and that it was to be split equally between Brown Rudnick, Tughans and Mr Cushnahan. The minutes record that the Board agreed that

- the payment of a success fee to Brown Rudnick would not be a concern
- it had some reservations regarding a payment to Tughans due to the co-location of offices between Tughans and Mr Cushnahan
- the potential payment of a success fee to Mr Cushnahan was a 'significant issue' for the NAMA Board and this should be communicated to PIMCO.

5.18 The minutes also record that a potential failure by Mr Cushnahan to disclose a conflict of interest was discussed during the Board meeting on 11 March 2014. The minutes note that Mr Cushnahan had resigned from the NIAC shortly after the unsolicited approach from PIMCO and that he had had no access to debtor information held by NAMA in his capacity as an external member of the NIAC.

5.19 The minutes of the Board meeting on 13 March 2014 record that

> *"In the interest of full transparency, PIMCO disclosed that the success fee arrangement had involved a potential payment of £16 million split equally three ways between Brown Rudnick Solicitors (London), Managing Partner Tughans Solicitors (Belfast), and Frank Cushnahan. The Board noted that PIMCO had advised that the negotiations had commenced in April 2013 and noted further that Frank Cushnahan had not resigned as a member of the Northern Ireland Advisory Committee until 7th November 2013 nor had he made any disclosure of his involvement."*

5.20 NAMA's contemporaneous notes record that the fee was in the range £15 million to £16 million (see Appendix E).

5.21 There is no reference in the March or April 2014 minutes about consideration being given to any additional steps that should be taken. NTMA's Compliance Unit was not consulted for advice in relation to potential conflicts of interest.

5.22 Briefing notes compiled by the Department of Finance state that the Chairman of NAMA informed the Minister on 13 March 2014 of PIMCO's withdrawal from the process, and the reasons. The examination team found no contemporaneous record of the content of that communication.

1 Summaries of the communications between PIMCO and NAMA are presented in Appendix E.

5.23 An individual to whom a written statement is furnished under section 11 of the Standards in Public Office Act 2001 may request the person who furnished it to provide him or her with information in relation to the statement or any matter arising in connection with it. There is no evidence that when NAMA learned of Mr Cushnahan's alleged involvement with PIMCO, it considered whether the Chairman – who received the annual statements – should make enquires of Mr Cushnahan as provided for under the 2001 Act.

NAMA's views

5.24 NAMA has stated that although Mr Cushnahan was no longer a member of the NIAC at the time of PIMCO's disclosure and never had access to debtor information, the Board considered the potential payment to Mr Cushnahan was a significant issue because, if implemented, it created a significant reputational risk for NAMA, and could be perceived as undermining the integrity of the sales process. NAMA considers that the integrity of the process was preserved by PIMCO's withdrawal.

5.25 The Board considers that it took appropriate and meaningful action by ensuring, in effect, that Mr Cushnahan was not the beneficiary of any fee arrangements agreed by the successful bidder. It is not clear how any other steps NAMA might take could have any relevance to the completion of the transaction, particularly given that Mr Cushnahan was no longer a member of the NIAC. NTMA Compliance has indicated that, given the information available at the time, there was no additional action that it could have advised to be taken that had not already been taken by NAMA.

5.26 NAMA was not aware in March 2014 of success fee negotiations that may have taken place in April 2013 between various parties. The minutes of the Board meeting of 13 March 2014 state that *"the Board noted that PIMCO advised that the negotiations had commenced in April 2013"*. This disclosure was taken by the Board to mean that negotiations between PIMCO and Brown Rudnick had commenced in April 2013, and not that negotiations over success fee payments had commenced at that stage.

Success fee payable by Cerberus

5.27 The NAMA Board asked the NAMA executive to establish if there was any potential success fee payments payable by Cerberus following their bid submission on 1 April 2014. NAMA's Asset Recovery division engaged with Cerberus on the matter.

5.28 On 3 April 2014, Cerberus confirmed that it had agreed a success fee with Brown Rudnick as a strategic advisor, to advise on the bid structure and on doing business in Northern Ireland. Cerberus also confirmed that Brown Rudnick had "subcontracted certain work to Tughans Solicitors (Belfast)" and that the success fee was to be split 50:50 between Brown Rudnick and Tughans.

5.29 Following email correspondence in which NAMA specified the form of assurance it required, Cerberus' Chief Compliance Officer provided the Head of NAMA Legal with the following assurance on 3 April 2014

> *"We confirm that no fee, commission or other remuneration or payment is payable to any current or former member of the Board of the National Asset Management Agency (NAMA), any current or former member of the Executive of NAMA or any current member or former member of an advisory committee of NAMA in connection with any aspect of our participation in the Project Eagle sales process."*

5.30 NAMA did not seek assurances in this regard directly from Brown Rudnick or Tughans.

5.31 The Board minutes of 3 April 2014 noted that Cerberus' had provided assurance that *"the success fee was to be split 50:50 between Brown Rudnick and Tughans."*

Conclusions

5.32 Mr Cushnahan's declared involvement with NAMA debtors whose loans represented at least half the value of the Northern Ireland loan book meant that a potential conflict of interest arose that would not be managed sufficiently by the withholding of debtor-specific information. NAMA should have formally considered whether Mr Cushnahan's engagement in discussion of its Northern Ireland strategy – including the PIMCO/Brown Rudnick approach – was consistent with his ongoing involvement as financial advisor to a significant proportion of the Northern Ireland debtor connections.

5.33 Over a series of contacts with PIMCO between 10 and 12 March 2014, NAMA learned of the existence of an alleged success fee arrangement involving Brown Rudnick, the managing partner of Tughans solicitors and Mr Cushnahan, and that the potential payment was in the amount of £15 million to £16 million, to be shared equally. Given the joint agreement between the parties to the success fee arrangement with PIMCO, all of the payment – not just the payment to Mr Cushnahan – should have raised concerns for NAMA.

5.34 NAMA subsequently learned of the existence of a success fee arrangement involving Cerberus, on the one hand, and Brown Rudnick and Tughans on the other. The understanding that Brown Rudnick and Tughans had allegedly been in an arrangement with a member of the NIAC at any stage of the process should have raised concerns for NAMA about potential impacts of such arrangements on the sale process, unless convincing explanations could be produced.

5.35 NAMA sought and relied on an assurance from Cerberus that no fee or payment was payable to anyone connected with NAMA *"in connection with any aspect of our (Cerberus) participation in the Project Eagle sales process."* NAMA only learned of Brown Rudnick's engagement with Cerberus on 2 April 2014, and do not appear to have asked Cerberus when it engaged Brown Rudnick, or what was the precise nature of the services Brown Rudnick and Tughans were providing to Cerberus.

5.36 The allegations of Mr Cushnahan's involvement in an arrangement to share fees with Brown Rudnick and Tughans (or the managing partner of Tughans) warranted more action by NAMA when the matter came to light, such as contacting the NTMA Compliance Unit for advice, or writing to Mr Cushnahan to seek confirmation or an explanation. Lazard was not informed of the matter, and was not asked for its assessment of the potential implications for the integrity of the sales process. NAMA appears to have taken a narrow approach, focusing on what were the legal obligations, rather than on what were the options for action that should be considered.

Appendices

Appendix A Benefits to Cerberus not priced in bid

Gains on asset sales due to close

When the Project Eagle sale closed in June 2014, NAMA identified assets which were sold (sale agreed) but where the sale had not yet been finalised. The total expected sales proceeds were £33.1 million, net of disposal costs compared to Cerberus' bid of just under £19 million for the same assets — a difference of £14.1 million or 74% of the Cerberus bid.

It is normal for gains (or losses) of this nature to accrue to a purchaser of loans, but the scale of the gains in this case is significant. The examination compared the sale agreed prices to the amounts Cerberus had bid and noted that in all cases, the sales agreed price significantly exceeded the Cerberus bid. Figure A.1 presents the examination's findings.

Twenty of the assets were held by NAMA-managed debtors. Using figures from NAMA's December 2013 cash flows, the examination identified the workout value for these assets. The cumulative workout value of the assets at end-2013 of £19.8 million was very close to the sale agreed values (almost £20 million). The Cerberus bid price for those assets was £12.3 million – almost £7.5 million or around 38% lower than the workout value at end 2013.

Figure A.1 Comparison of Cerberus bid to sales agreed price for 54 assets

Country / Sector	No. of assets	Cerberus bid £m	Sales agreed price £m	Adjust for costs of disposal	Variance £m	Variance from bid price %[a]
Great Britain						
Commercial	1	2.2	3.0		0.8	
Land and development	1	0.2	1.2		1.0	
Ireland						
Land and development	1	0.2	0.5		0.3	
Residential	1	0.03	0.06		0.03	
Northern Ireland						
Commercial	4	3.2	4.3		1.1	
Hotel and leisure	2	4.9	6.1		1.2	
Land and development	25	6.1	13.8		7.7	
Residential	18	2.1	4.6		2.5	
Unable to identify	1	0.07	0.2		0.13	
Total	**54**	**19.0**	**33.76**	**33.08**	**14.08**	**74%**

Source: NAMA; Analysis by the Office of the Comptroller and Auditor General.

Note: a Variances are based on the actual (non-rounded) bid and sales prices. The variances take account of NAMA's costs of disposal which are, on average, around 2% of disposal prices.

Potential surplus proceeds on an asset disposal - £8 million

NAMA had agreed with one debtor that, in the event of a specific asset achieving in excess of par debt upon sale, NAMA would receive an additional portion of the proceeds. The asset remained unsold in June 2014. However, an offer of £12.2 million had been received for the asset, of which around £10.6 million would accrue to NAMA. As Cerberus had bid £2.6 million, NAMA estimated that the gain to Cerberus would be around £8 million, before disposal costs. As the basis for NAMA's assessment was an offer, and not an agreed sale, there is a level of uncertainty about the level of gain achievable.

NAMA has stated that the offer of £12.2 million was highly conditional on further due diligence and the bid converting to an actual sale. Due to the lack of a tangible, fully backed, credible, and binding bid Cerberus submitted a much lower level bid of £2.6 million.

Cash deposits - £6.2 million

NAMA identified eleven Project Eagle-related cash deposit accounts valued at £6.2 million charged to NAMA. Although these accounts were part of the collateral securing the Northern Ireland debtor loans, these accounts were not included on the asset listing provided to bidders for submitting their bids. However, because these accounts were charged to NAMA, the successful bidder became entitled to the benefit of these funds for zero further consideration.

The balances included £3.7 million for which NAMA had given full value when it acquired the debtor's loans. NAMA stated that the debtor had refused to set off the deposit against amounts due to NAMA.

NAMA has since stated that any form of security that was in place over these accounts prior to completion of the sale to Cerberus was not capable of being assigned legally and/or operationally to Cerberus by NAMA. NAMA was merely advising Cerberus that monies remained in those accounts and it was up to Cerberus to put the necessary controls in place with the debtors to capture these cash balances.

Assets omitted from the bid list - £5.3 million

Bidders were asked to allocate their total bid price across unsold real estate assets. However, some previously unencumbered assets with an estimated value of £1.8 million, which had become charged to NAMA, were omitted from the asset listing circulated for bidding purposes. As a result, bidders were not required to bid for these assets, all of which were to transfer to the purchaser upon the loan sale completion.

NAMA has since stated (in March 2016) that it is currently seeking to recover £1.64 million in relation to unencumbered assets that transferred to Cerberus.

In addition, NAMA had been advised to expect an amount of £3.5 million by end 2014 in respect of a second charge it held on an asset in England. Cerberus did not bid on the second charge. However, it stood to gain from any proceeds due to NAMA.

NAMA has stated that there was significant development and sales risk to any potential benefit to NAMA. The potential £3.5 million benefit was not in any way guaranteed. NAMA did not attribute any value to this second charge when acquiring the associated loans.

Deferred consideration - £1.75 million

Two deferred consideration amounts totalling £1.75 million in respect of properties sold prior to Project Eagle were not included on the bid list and Cerberus obtained the benefit of these.

- The first (worth around £1 million) was dependent on planning permission being obtained in the future. However, the purchaser, a reputable supermarket chain, had offered £0.75 million for a speedy settlement.
- The second amount of £0.75 million was payable to NAMA in two instalments, one in 2014 and the other in 2015.

NAMA has stated that the potential deferred consideration amounts were by no means certain to accrue and no value had been attributed to them by NAMA.

Property disposals completed in May and June 2014

The examination team queried why NAMA had not received any proceeds for a number of property sales that had closed prior to completion of the loan sale to Cerberus. Cerberus did not acquire these properties.

NAMA stated that

- For two properties, with total sales proceeds of £573,000, the proceeds were incorrectly transferred to Cerberus as part of a ‘true-up’ exercise in July 2014
- For six other disposals, with total proceeds of £627,000, the sales closed after the loan sale but Cerberus’ bid was incorrectly amended to the effect that a zero value was placed on the assets. The sales proceeds were, however, transferred to Cerberus.

NAMA has stated, in March 2016, that it is seeking to recoup these amounts from Cerberus.

Appendix B

Minutes of NAMA Board meetings about Project Eagle

This appendix comprises extracts from the NAMA Board meetings during 2013 and 2014 at which Project Eagle was discussed. The minutes were provided by NAMA without redaction. They have been redacted here for publication by removing

- names of PIMCO employees / advisors (all)
- NAMA employee names
- third party names and titles
- third party company names
- NAMA debtor names

Figure B.1 Attendance at NAMA Board meetings when Project Eagle was discussed

Board member	2013			2014							
	12 Sep	10 Oct	12 Dec	8 Jan[a]	16 Jan	13 Feb	11 Mar[a]	13 Mar	3 Apr[a]	10 Apr	12 Jun
Frank Daly	✓	✓	✓	☎	✓	✓	☎	✓	☎	✓	✓
Brendan Mc Donagh	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
John Corrigan	✓	A	✓	✓	✓	☎	☎	✓	A	✓	✓
Oliver Ellingham	☎	✓	✓	☎	✓	✓	☎	✓	☎	✓	✓
Eilish Finan[b]	A	✓	✓								
John Mulcahy[b]	✓	✓	✓	✓	✓						
William Soffe	✓	✓	✓	☎	✓	✓	✓	✓	☎	✓	✓
Brian McEnery	✓	✓	✓	☎	✓	✓	☎	☎	☎	✓	☎
Mari Hurley[b]										✓	✓

Source: Analysis by Office of the Comptroller and Auditor General

Note: a ad hoc meeting

b Eilish Finan completed her term of appointment on 21 December 2013; John Mulcahy resigned from NAMA and the Board with effect from 17 January 2014; Mari Hurley was appointed to the Board on 8 April 2014.

✓: Attended in person

☎: Attended by conference call (provided for in section 27 of the NAMA Act 2009)

A: Apologies.

1. Extract from signed minutes of Board's 12th September 2013 meeting

19. AOB

Northern Ireland Portfolio

The Chairman advised the Board that on foot of a letter from then Minister Wilson in NI to Minister Noonan regarding investor interest in the NAMA NI portfolio, and a response from Minister Noonan (with NAMA input), Pimco has expressed an interest in acquiring the NI portfolio for a €1.1 billion consideration. NAMA plans to meet with Pimco to discuss it further.

There is an issue about open marketing, and the Chairman advised that such an initiative is highly politically sensitive and should be treated as very confidential.

2. Extract from signed minutes of Board's 10th October 2013 meeting (Private Session)

2(b). Project Eagle[2]

Matter for Board Approval

Board Paper: *Project Eagle – Northern Ireland Debtors Portfolio*

The Head of Asset Recovery presented the paper to the Board, which noted the nature of PIMCO's interest and its stated flexibility in terms of final price and portfolio size. It noted that PIMCO's interest was based upon: a) its view that the NI market had bottomed out, b) the underlying value of the GB assets held by NI debtors, and c) the quantum of assets in the portfolio.

The Chairman advised the Board that the Minister for Finance had spoken informally with him on a number of occasions regarding the proposal, and that the Minister was cognisant of the price and transparency considerations from NAMA's perspective. He advised that the Minister (accompanied by the Head of Asset Recovery) had discussed the proposal with his counterpart in Northern Ireland, and that the Minister for Finance & Personnel (MFP) was supportive of the proposal – as similarly expressed at the Chairman's meeting with the MFP on 7th October 2013. The Chairman further advised that he had briefed the NI Advisory Committee on the matter at its meeting on 7th October 2013 and that the external members were supportive of NAMA's approach and its key considerations in terms of price and open marketing.

The Board noted that a transaction will carry risks, including the fact that the portfolio is not fixed per se, with individual transactions in progress at any one time, and that should the proposal not proceed to conclusion, PIMCO will have had visibility of the portfolio (via the data room), notwithstanding that an NDA will be in place - in this regard the Head of Asset Recovery requested the Board's view on the level of access to data.

The Board **agreed** strongly that while PIMCO's modus operandi includes a preference for off-market transaction, NAMA's clear policy is that transactions occur via open marketing.

The Board noted that in the event of a completed sale, NAMA would not be writing off any personal guarantees (PGs) but selling them to the purchaser. Therefore, what happens to the PGs thereafter would be a matter for the purchaser.

Following consideration, and subject to it being made clear to PIMCO that any such transaction will be by way of open marketing, the Board **resolved** to approve the recommendation as presented in the paper, to explore the proposal further with PIMCO, including the signing of an NDA with a view to conducting further due diligence towards the completion, ultimately, of an openly marketed Loan Sale - in accordance with Board policy in respect of the Portfolio. The Board **agreed** that access to the data room should be no less than that provided in any other loan sales process.

The Board noted that any final offer will be brought back to Board for formal approval at a later date.

The Chairman reminded the Board that the matter remains acutely politically sensitive, and notwithstanding the widening knowledge of the proposal in government and NI circles, it should be treated with the utmost confidentiality by NAMA.

[2] The Head of Asset Recovery, CFO and [redacted] Senior Divisional Manager (Asset Recovery), attended for this item.

3. Extract from signed minutes of Board's 12th December 2013 meeting (Private Session)

Project Eagle[1]

Matter for Board Approval

Board Paper: *Project Eagle – Loan Portfolio Disposal*

The Head of Asset Recovery presented the paper to the Board, which noted the contents of same, and that Pimco was very serious about progressing to transaction (although more valuation work had yet to be completed by Pimco).

The Board noted that the key issues for NAMA were sale price and sales process and that in relation to the latter issue, NAMA had been consistently and publicly clear about its position on open marketing. Should it therefore transact off market, the Board noted the potential reputational risk to the Agency in principle, and in relation to other NAMA debtors who might seek off market loan sales. The Board also noted the sensitive matter of PGs and the risk to wider NAMA debtor management should Pimco release debtors from PGs – notwithstanding this could occur following any completed loan sale.

The Board agreed that the paper and analysis presented therein presented a compelling commercial case to sell the portfolio, and that in addition such a portfolio sale would release NAMA from what has been a disproportionate burden of effort in light of the relative size of the portfolio.

While noting that transacting off market was not without precedent, the Board discussed the best way to manage the sales process to reduce the reputational risk associated with an off market sales process of this size and sensitivity. It noted that Pimco had not formally rejected the possibility of transacting on the open market, but also the view that putting the entire NI portfolio on the open market might provoke a hostile reaction in NI political circles, with NAMA deemed to be "auctioning" the NI portfolio (although the Board noted that this could be countered with the fact that it followed receipt of a credible commercial offer).

Following considerable discussion of the options available, the Board **agreed** that a limited, focused and time bound open marketing process would be the best and prudent course of action to take, and it requested that the Head of Asset Recovery revert to Board with a paper on such a process for its consideration within a week.

The Board **agreed** that if necessary, it would meet by conference call the week of the 16th December to consider the paper, or alternatively shortly after Christmas if such appeared to represent more satisfactory timing.

The Board **agreed** to consider the matter of price in conjunction with consideration of the above sales process paper.

[1] The Head of Asset Recovery and Deputy Head of Asset Recovery [redacted] also attended for this item.

4. Signed minutes of Board's 8th January 2014 (Private Session) meeting attached

National Asset Management Agency

NAMA BOARD MINUTES

First Meeting of 2014: 12.30pm. to 1.00pm., 8th January 2014,

Treasury Building

BOARD ONLY

Attendance:

NAMA Board

Frank Daly, Chairman[1]

Brendan McDonagh, CEO, NAMA

John Corrigan, CEO, NTMA

Oliver Ellingham[1]

John Mulcahy

William Soffe[1]

Brian McEnery[1]

NAMA Executives

[redacted]

Secretary

[redacted]

On opening the meeting the Chairman welcomed the Board members to the first meeting of 2014 and the agenda was noted. It was noted that the meeting had been duly convened and that a quorum was present.

Issues Considered:

1. **Disclosures of Interests**

   There were no disclosures made.

2. **Board Private Session**

   The Board held a private session without the Executive present.

   Board Papers: *Project Eagle – Loan Portfolio Disposal*

   The Chairman noted at the outset that he had been contacted by the Northern Ireland Executive Minister for Finance and Personnel who, while acknowledging that the potential sale of the entire NI portfolio was a matter

[1] By telephone in accordance with section 27 of the NAMA Act 2009

for the NAMA Board, expressed the NI political position that any such process undertaken by NAMA should not be seen as publicly "auctioning" the NI portfolio.

The Head of Asset Recovery presented the paper to the Board, which noted the compelling commercial case to sell the NI portfolio. In the context of a potential sale the Board noted that the key priorities for NAMA were (i) obtaining the optimum sale price and (ii) conducting an appropriate open marketing sales process. The Board then proceeded to discuss each in turn.

In relation to sales price, the Board noted that PIMCO had given an indicative bid of STG£1.1 to STG£1.3 billion subject to due diligence. The Board noted further that NAMA's own discounted cash flow valuation of the portfolio was in the STG£1.2 to STG£1.3 billion range depending on the assumptions used. In response to a question from the Board it was noted that the original LAV for the Portfolio was approximately STG£2 billion, with the current valuation reflecting significant impairments to date and with further impairments expected. As agreed at its 12th December 2013 meeting the Board noted it would not consider the sale of Project Eagle portfolio of loans for a consideration less than STG£1.3 billion.

In relation to the sales process, the Chairman noted that a key priority for NAMA was to have an open marketing approach which was appropriate, focused, time bound (given sensitivities & confidentiality concerns) while of course being sensitive to the NI position. The Board noted that the proposed approach involved the appointment of a Corporate Finance Advisor, who would (i) advise NAMA on an appropriate marketing approach which would balance the open marketing requirement with the need for confidentiality, (ii) undertake appropriate marketing to suitable targeted bidders with the financial wherewithal and appetite to purchase such a portfolio and capacity to perform in a timely manner, with a timeline as recommended by the advisor and (iii) make a recommendation to NAMA in relation to the preferred bidder and provide a statement in relation to the probity of the open marketing process.

In view of sensitivities pertaining to the sale, the Board noted that it was recommended that Lazard (Loan Sale Advisory Services panel member) be appointed as Corporate Finance advisor without running a mini tender. In response to a question from the Board, it was noted that the rationale for selecting Lazard (as opposed to other advisors) from the Panel was that they were an Investment Bank and unlike some other similar advisors were not currently advising on other NAMA business. After considerable discussion, the Board recommended that, subject to any restrictions on fee negotiations under the Framework Agreement, that Asset Recovery would seek Lazard to propose their fee arrangements so that a lower fee would be payable in the event that PIMCO was the preferred bidder.

Following lengthy discussion, the Board **resolved** that:

(1) Corporate Finance Advisors, Lazard (Loan Sale Advisory Services panel member) be appointed to advise NAMA. In view of sensitivities pertaining to the deal NAMA would provide Lazard with a verbal briefing on the project to date subject to NDA, following which they would be appointed without tendering;

(2) Lazard would advise NAMA on an appropriate marketing approach which would balance open marketing requirement with need for confidentiality. Such an approach would enable Lazard to confirm to NAMA that appropriate marketing to suitable targeted bidders with financial wherewithal for such a portfolio sale had taken place;

(3) the likely approach would involve Lazard approaching at least 2 other major international investors to establish interest in such an acquisition with the intention of giving interested parties, under NDA and subject to Lazard's advice, at least 2-week access to our data room to prepare an immediate bid.

(4) In parallel, PIMCO were permitted to complete their due diligence on the "tail" of the Eagle Portfolio and formalise their bid. AR would, at this juncture, meet with PIMCO to advise them of the intended approach regarding the other short-listed investors noting that this would be as much to protect PIMCO's interests with regard to the integrity and credibility of the disposal process;

(5) Lazard would submit a recommendation to NAMA within an appropriate timeframe based on their recommendation on bid acceptance.

In addition Board advised that:

- Lazard was to be fully briefed in relation to the sensitivities and utmost confidentiality required in relation to the sale and was to only approach parties with the capability/interest to purchase the Portfolio.

- Lazard was to be given a reasonable time to market the portfolio.

The Board acknowledged that PIMCO would be sensitive to becoming price setters.

3. AOB

There was no other business.

There being no further business the meeting concluded.

Frank Daly, Chairman
16th January 2014

5. Extract from Signed minutes of Board's 16th January 2014 (Private Session) meeting below

Project Eagle[3]

Matter for Board Approval

Board Paper: *N/A*

The Head of Asset Recovery provided an update to the Board in relation to progress with Lazard, following Board approval on 8th January to appoint the firm to advise NAMA on the potential loan sale of the NI portfolio. In view of the sensitivities pertaining to the deal and as requested by the Board, Lazard had signed a Non-Disclosure Agreement (NDA) prior to a meeting on 13th January. The Board noted that Lazard had been fully briefed in relation to the utmost confidentiality required in relation to the sale. As requested by the Board, Lazard had been asked to consider whether a revised fee arrangement could be put in place so that a lower fee would be payable in the event that PIMCO was the preferred bidder.

The Board noted that Lazard had indicated that they would propose to adopt an approach (as had been expected) which would involve them approaching three to four potential investors, under NDA, with the capability/interest to purchase the Portfolio. The envisaged timeframe for bidders to submit bids would be four weeks. The Board noted that AR was due to meet Lazard on 22nd January with a view to Lazard submitting a proposal on the proposed sales and marketing process/approach by the 24th January.

The Chairman informed the Board that he had asked the Head of Asset Recovery to participate on a conference call with the Northern Ireland First Minister, Peter Robinson; Deputy First Minister, Martin McGuinness; the Minister for Finance, Michael Noonan and senior banking official Department of Finance, Declan Reid to discuss the potential sale of the NI portfolio following the purchase offer from PIMCO. The Head of Asset Recovery said that following a reference to a "letter of intent" between PIMCO and the Northern Ireland Executive that a copy of same would be forwarded to NAMA. The Board noted that it would review the contents of the Letter of Intent following receipt.

After considerable discussion, the Board **agreed** that PIMCO should be advised, post Lazard's appointment, of the intended approach regarding marketing to a limited number of potential investors. The Board agreed further to convene next week, if required, to discuss Lazard's proposal.

[3] The Head of Asset Recovery and Deputy Head of Asset Recovery [redacted] attended for this item.

6. <u>Extract from Signed minutes of Board's 13th February 2014 (Private Session) meeting below.</u>

Project Eagle[2]

Matter for Information

<u>Board Paper</u>: *N/A*

The Head of Asset Recovery provided an update to the Board in relation to progress on the potential loan sale of the NI portfolio including Lazard's formal appointment as advisor to NAMA and the lower fee arrangement put in place in the event that PIMCO was the preferred bidder. The Board noted that Lazard had recommended that they would approach (as had been expected) a shortlist of three potential investors in addition to PIMCO, under NDA[3], with the capability/interest to purchase the Portfolio, nominating Blackstone, Starwood and Oaktree in this regard with a reserve list of Cerberus, Apollo, Lonestar and Varde. The Board noted that as Blackstone and Starwood had declined to participate, Lazard had subsequently approached (under NDA) Cerberus and Apollo.

The Head of Asset Recovery proposed that the data room, which would be accessible to all bidders simultaneously later this week/early next week, would contain redacted Nov 09 valuations for the Top 55 properties (85% by value) and full valuations for the balance of 800 properties (15% by value). The Board noted that while the latter was an exception to Loan Policy, it was not possible for bidders to approach Debtors. It was noted that once all bidders had access to the data room there would be a four week period to binding bids. It was further noted that bidders would be advised of the Board's minimum reserve price of £1.3 billion.

Following considerable discussion, the Board **resolved** (i) to confirm the exception to Loan Policy in respect of the provision of valuations in the data room on the basis of the unique circumstances of the potential loan sale and (ii) to give AR/Lazard flexibility to increase the number of bidders involved in the process if genuine, credible interest arose.

[2] The Head of Asset Recovery and Deputy Head of Asset Recovery ([redacted]) attended for this item.

[3] Non Disclosure Agreement

7. Extract from Signed minutes of Board's 11th March 2014 (Private Session) meeting below

2. Project Eagle

Matter for Board Approval

Board Paper: *N/A*

The Chairman advised that the background to the meeting was a potential issue which had arisen in relation to Project Eagle during a conference call between the Head of Asset Recovery and Senior Divisional Manager, NAMA Legal and Legal Counsel for PIMCO which had taken place on Monday 10th March 2014.

The Head of Asset Recovery briefed the Board on the conference call which involved [redacted] Senior Divisional Manager NAMA Legal and the Head of Asset Recovery. He informed the Board that PIMCO advised NAMA of a success fee arrangement in place in the event that PIMCO was successful in its bid for Project Eagle. PIMCO advised that the success fee arrangement involved potential payments to three parties, namely Brown Rudnick Solicitors (London) – who had introduced the deal to PIMCO, Tughans Solicitors (Belfast) and Frank Cushnahan, former member of the Northern Ireland Advisory Committee. PIMCO, ostensibly in the spirit of transparency, wished to advise NAMA about the success fee arrangement and sought NAMA's agreement that it was appropriate. The Head of Asset Recovery advised that he had undertaken to revert to PIMCO as to whether this voluntary disclosure in relation to the success fee arrangement represented an issue for NAMA.

The Board noted that Frank Cushnahan had resigned from the Northern Ireland Advisory Committee with effect from 7th November 2013 which was shortly after the initial unsolicited approach from PIMCO in relation to the Northern Ireland loan Portfolio. It was noted that Frank Cushnahan had not disclosed any conflicts of interest in relation to the matter (Project EAGLE/PIMCO) during his term of office and had not made any disclosure to NAMA since his resignation. The Board noted further that the external members of the Northern Ireland Advisory Committee had no access to debtor information and there were no discussions in relation to individual debtors at Committee meetings. However, the Board acknowledged that Frank Cushnahan would be knowledgeable about NAMA's strategy with respect to NI and noted that the involvement of Frank Cushnahan with PIMCO raised a significant reputational risk to NAMA.

Following discussion the Board agreed that there was no specific issue in relation to PIMCO's success fee payments to Brown Rudnick Solicitors (London). The Board noted that, in light of the co-location of offices between Frank Cushnahan and Tughans Solicitors (Belfast), there were some reservations in respect to a success fee payment to the latter. However the Board members raised concerns in relation to the payment of a success fee to Frank Cushnahan, who had failed to disclose a potential beneficial interest with respect to the success fee to NAMA. The Head of Asset Recovery advised the Board that three bidders remained in the bidding process for Project Eagle which was due to close on 25th March namely Cerberus, Fortress and PIMCO. In light of Frank Cushnahan's involvement in the PIMCO bid, the Board discussed whether PIMCO's bid, at this stage, was fatally flawed given the potential perception that PIMCO might have benefitted from insider information as a result of Frank Cushnahan's involvement.

Following consideration, the Board **agreed** that the success fee arrangement in respect of Frank Cushnahan as advised by PIMCO on the conference call of 10th March 2014 represented a significant issue for the Board. The Head of Asset Recovery undertook to advise PIMCO of the Board's view of the matter. The Board noted that a verbal update would be given at the Board's upcoming meeting on 13th March 2014.

8. <u>Extract from Signed minutes of Board's 13th March 2014 (Private Session) meeting below.</u>

Project Eagle

Matter for Board Approval

Board Paper: *N/A*

Following the recent disclosure by PIMCO Legal and Compliance units of the existence of a success fee sharing arrangement in relation to Project Eagle negotiated by PIMCO's Commercial team (first disclosed to HoAR and [redacted], NAMA Legal via conference call on 10th March 2014), PIMCO had sought NAMA's acquiescence to this which NAMA had not acceded to. NAMA Chief Executive Officer advised the Board that PIMCO had confirmed that they felt obligated to withdraw from the bidding process for Project Eagle on foot of the aforementioned disclosures (as discussed via conference call between NAMA's Head of Legal and PIMCO's Legal Counsel on 13th March 2014). In the interest of full transparency, PIMCO disclosed that the success fee arrangement had involved a potential payment of £16 million split equally three ways between Brown Rudnick Solicitors (London), Managing Partner, Tughans Solicitors (Belfast) and Frank Cushnahan. The Board noted that PIMCO had advised that the negotiations had commenced in April 2013 and noted further that Frank Cushnahan had not resigned as a member of the Northern Ireland Advisory Committee until 7th November 2013 nor had he made any disclosure of his involvement.

In response to a question from the Board, it was noted that, notwithstanding the premeditated fee sharing arrangement that had been put in place by PIMCO, the catalyst for disclosure of the arrangement to NAMA was allegedly the insistence of PIMCO's Legal and Compliance Department. The Board noted that following the withdrawal of PIMCO, two bidders, namely Cerberus and Fortress, remained in the bidding process which was due to close on 25th March. The Board noted further that the situation was evolving and would need to be carefully managed. Following further discussion the Board noted that, subject to Lazard's advice, it was minded to be as upfront as was possible with other bidders in relation to PIMCO's withdrawal.

9. **Extract from Signed minutes of Board's 13th March 2014 (Ordinary Business) meeting below**

11(d). Project Eagle

Matter for Information

Board Paper: *N/A*

The Deputy Head of Asset Recovery provided a verbal update to Board which noted that following the withdrawal of PIMCO from the bidding process, (details of the rationale for their withdrawal were discussed during the Board's private session), two bidders remained in the process for Project Eagle which was due to close on 25th March namely Cerberus and Fortress. The Board noted further that Lazard had advised that there should be sufficient competitive tension in the process with the remaining two bidders. The DHoAR advised that based on indications arising from their limited data room activity Fortress appeared to be less actively engaged in the process than Cerberus to date.

10. Signed minutes of Board's 3rd April 2014 (Private Session) meeting

National Asset Management Agency

NAMA BOARD MINUTES

Tenth Meeting of 2014: 4pm. to 4.30pm., 3rd April 2014,

Treasury Building

Board Only

Attendance:

NAMA Board

Frank Daly[1]

Brendan McDonagh

Oliver Ellingham[1]

Brian McEnery[1]

Willie Soffe[1]

Invited:

[redacted]

Secretary:

[redacted]

Apologies:

John Corrigan

On opening the meeting the Chairman welcomed the Board members to the tenth meeting of 2014 and the agenda was noted. It was noted that the meeting had been duly convened and that a quorum was present.

Issues Considered:

1. **Disclosures of Interests**

   There were no disclosures made.

2. **Project Eagle**

   Matter for Board Approval

   Board Paper: *Project Eagle – Loan Portfolio Disposal*

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[1] By telephone in accordance with section 27 of the NAMA Act 2009.

The Chairman acknowledged the short notice of the meeting arising from the tight timelines in relation to Project Eagle and, in advance of substantive discussion, requested that the NAMA Chief Executive update the Board in relation to recent developments pertaining to enquiries made by NAMA to Cerberus about success fees.

The NAMA Chief Executive advised that following a discussion with the Chairman, AR had engaged with Cerberus to ascertain whether there were success fees payable and to whom. Cerberus confirmed that they had engaged New River as retail advisor. Cerberus also advised that they had agreed a success fee with Brown Rudnick as a strategic advisor. It was noted that Brown Rudnick had originally introduced the NI portfolio proposal to PIMCO and had an agreed success fee with PIMCO. Following a request from AR for further clarification, Cerberus confirmed that Brown Rudnick had sub-contracted certain work to Tughans Solicitors (Belfast) and that the success fee was to be split 50:50 between Brown Rudnick and Tughans.

Arising from this further disclosure, Cerberus were requested to provide an assurance (in writing) that the success fee was limited exclusively to the aforementioned parties i.e.; that no further sharing of the fee was agreed. In response to a question from the Board, the Head of Legal confirmed that Cerberus had confirmed that the potential fee was payable to Tughans and no individual partner had been named (unlike the PIMCO success fee arrangement which appeared to have been payable to Tughan's [redacted]).

The Board then considered the AR paper. It was noted that the paper contained a very clear recommendation in favour of Cerberus. The Deputy Head of Asset Recovery (DHoAR) briefed the Board on the key points of the bidding process to date. The Board noted that, following sales of assets within the Eagle Portfolio (for a combined value of c. £83.6m) since the sales process commenced, the minimum reserve price had been adjusted downwards to £1.23bn. The Board noted further that while Fortress had stated their readiness to fund the acquisition in cash at completion from their internal resources, their intention to use [redacted] as their primary servicer (which would streamline the on-boarding process during the TSA period) and their willingness to conclude the deal in a timely manner, (i) their final bid was below the adjusted minimum reserve (c €155 million below), (ii) unlike Cerberus, they had refused to allocate their offer price to individual assets (which was one of the requirements of the process), (iii) unlike Cerberus, their offer was conditional on being granted exclusivity for 30 days (with a 30 day extension) from 4th April and (iv) their Business Plan and Portfolio Strategy lacked detail relative to Cerberus'. DHoAR advised that, notwithstanding similarities between the bids in terms of being fully funded, committed to timely closing and the intention to use [redacted] as Primary Servicer, the Cerberus bid was far superior as it was above minimum reserve price and their Business Plan was more detailed.

The Board noted that it had been indicated that Cerberus' strong bid was a deliberate strategy to outbid their competitors and to establish a relationship with NAMA. DHoAR advised that one weakness or risk in relation to the Cerberus offer was their statement within Section 4 of page 4 of their offer letter wherein they referred to the need to undertake *'further customary legal due diligence'* on the tail of the portfolio. Following discussion the Board noted that NAMA would facilitate their requests for further information where appropriate. In response to a question from the Board, it was noted that NAMA had expected the requirement to satisfy the ultimate purchaser in terms of the relatively standard conditionality outlined in the bid offers.

DHoAR informed the Board that, an ancillary benefit of Cerberus being selected as preferred bidder in relation to Eagle, would be to facilitate the swift conclusion of negotiations in relation to the sale of German assets (Project Shift, [redacted] Connection c. €95m) within the Eagle Portfolio, where coincidentally, Cerberus were the preferred bidder.

The Board noted that Lazard had confirmed in their letter that the sales and marketing process to date was appropriate given the nature and scale of the transaction and that sufficient competitive tension had remained in the process following the withdrawal of PIMCO and they would issue a final letter to reiterate this on successful closing of the transaction. The Board noted further that Cerberus were a very credible counterparty, experienced in transactions of this nature and were highly rated by Lazards. It was noted that Cerberus' stated policies to be sensitive to the jurisdiction in which they were working and to work consensually with Debtors would be welcomed in the context of the Northern Ireland Portfolio.

In response to a question from the Board, it was noted that, while the preferred bidder could in theory sell the Portfolio on to PIMCO, there was no suggestion that Cerberus was acting as a 'surrogate' purchaser for PIMCO. In any event once the Portfolio was sold, that was a matter for Cerberus.

Following further discussion the Board **agreed** that NAMA should seek written assurance from Cerberus that no fee, commission or other remuneration or payment was payable to any current or former member of the Board of the National Asset Management Agency (NAMA), any current or former member of the Executive of NAMA or any current or former member of an advisory committee of NAMA in connection with any aspect of Cerberus' participation in the Project Eagle sales process.

Following considerable discussion the Board **resolved** to approve the following (as recommended in the paper), subject to receipt of the aforementioned written assurance from Cerberus:

(i) In line with recommendation from NAMA Corporate Finance Advisors, Lazard, to continue negotiations solely with the lead bidder, Cerberus Capital Management (Cerberus), noting that the Fortress offer would expire on Friday 4 April, with a view to closing the Project Eagle Loan Sale by May 31 2014;

(ii) To approve the offer from Cerberus at a level of £1.241bn as compared with NAMA's minimum revised discounted carrying value of £1.23bn adjusted as a result of recent asset sales within the Project Eagle Portfolio and

(iii) To sub-delegate to CEO & HoAR/DHoAR to approve a revised minimum sale price of £1.2bn should the final sale price reduce from the current bid level as a result of issues emerging from the final due diligence which have a value impact and to sub-delegate to CEO & HoAR/DHoAR to negotiate the terms and conditions of the final legal documentation including the TSA and LSA.

The Board discussed timing in the relation to next steps. It was noted that following agreement by the Board, the Chairman had undertaken to advise the Minister for Finance and the Northern Ireland Executive Minister for Finance and Personnel of the outcome. The Board **agreed** that Lazard and Fortress should be advised as soon as practicable of the Board's decision and that a draft press statement, approved by all relevant parties, confirming Cerberus as preferred bidder subject to satisfactory contract negotiations should be issued on 4th April 2014.

The Chairman, on behalf of the Board, acknowledged the significant contribution of the various NAMA case managers and NAMA legal staff in managing the portfolio since acquisition and commended the hard work and determination of the NAMA Officers (particularly AR and Legal) involved in bringing the loan sales transaction to a successful conclusion, which when it came to fruition would represent a very positive outcome for the Agency.

3. AOB [Comptroller and Auditor General s226 review]

In relation to the draft response to S226 circulated to the Board on 31st March 2014, the Board confirmed that they were satisfied with the draft comments and in particular with the three comments from Board in relation to rate of return.

There being no further business the meeting concluded.

Frank Daly, Chairman
10th April 2014

11. <u>Extract from Signed minutes of Board's 10th April 2014 (Ordinary Business) meeting below</u>

9(d) Project Eagle

Matter for Information

<u>Board Paper</u>: *N/A*

The Head of Asset Recovery briefed the Board on a meeting which had taken place between NAMA AR, Legal, Lazard and Cerberus and their legal advisors. The Board noted that the request from Cerberus to split the exchange and closing dates was resisted by NAMA and that broad consensus had been reached on portfolio decision–making pre-closing, swap novations, overdrafts, undrawn commitments and general information sharing. While Cerberus intended to use [redacted] as primary servicer, it was noted that Cerberus's ability to handle special servicing would be somewhat dependent on the extent of information sharing between now and closing. The Board noted that, while good progress had been made and there was real willingness on the part of Cerberus to see the deal through and to see it through quickly, there was a significant amount of work to be undertaken to meet the deadline of 16th May.

The Chairman, on behalf of the Board, commended the hard work and determination of the NAMA Officers (particularly AR and Legal) involved in achieving NAMA's largest loan sale transaction to date. He acknowledged that the transaction had been fraught with challenges, and thanked all involved for a well-managed transaction which represented a very positive outcome for the Agency. The Chairman advised that the Chairman of Cerberus had commended NAMA and the NAMA team for the manner in which the sales process had been conducted. The Chairman advised, following conversations with the Minister for Finance and First Minister of Northern Ireland respectively, that political sensitivities in relation to the transaction had been well managed.

12. <u>Extract from Signed minutes of Board's 12th June 2014 (Ordinary Business) meeting below</u>

15(b) Project Eagle PI indemnities

Matter for Board Approval

<u>**Board Paper**</u>: *Project Eagle Approval to Provide Indemnities to the Participating Institutions and IBRC special liquidators to cover their contractual liability to Cerberus*

The Head of Legal provided an overview of the paper to Board which noted that approval in principle was sought in anticipation of some or all of the Participating Institutions and IBRC special liquidators (PIs) seeking to re-insure risks arising from the assumption by them of (i) contractual obligations to Cerberus or (ii) operational risks in relation to the provision of services to NAMA post completion to facilitate the provision of transitional services by NAMA to Cerberus. The Head of Legal advised that any such request for indemnification was reasonable in the context of the operational risks assumed by the PIs, noting that the TSA period was likely to be of short duration in any event. The Head of Legal noted that the Project Eagle portfolio sale involved a two tier process with the bidders having access to a comprehensive data room for Top 55 properties with a very limited data room available for the balance of some 850 properties. She added that there was a very significant logistical exercise underway in the location, collation and delivery of facility, security and title documentation to Cerberus (most of which would be delivered post completion). The Board noted that there was a six month further assurance period under the Loan Sale Agreement (LSA).

Following consideration the Board **resolved** to approve, if required, the provision of an indemnity by NAMA to the PIs in respect of any loss or claims relating to the assumption by them of contractual obligations to Cerberus or the assumption by them of operational risks arising from the provision of services to NAMA post completion to facilitate the provision of transitional services by NAMA to Cerberus.

15(c) Project Eagle

Matter for Information

Board Paper: *N/A*

The Head of Asset Recovery briefed the Board in relation to the Project Eagle loan sale process noting that the Loan Sale Agreement (LSA) was due to be signed on the 19th June and the sale was due to close on 23rd June 2014. He advised that Cerberus had issued a memo to AR outlining 11 issues which could be distilled into three main issues as follows:

(i) As part of the finalisation of due diligence on the 'tail' of the Project Eagle Portfolio (comprising 850 properties) Cerberus were proposing to place £128 million in escrow due to uncertainty in relation to security documentation of certain assets.

(ii) Whether Cerberus' bid for [redacted] would be reduced – due to arguments raised by Cerberus about recourse and default status – estimated value €20 million.

(iii) Cerberus' continued objection to NAMA deducting bid amounts (rather than sales proceeds) for sales completing between bid date and completion.

Taking each in turn, HoAR advised that

(i) the process of sale required the bidder to purchase the 'tail' with limited data. Notwithstanding the process, a very significant due diligence has been undertaken by Cerberus on the "tail", facilitated by NAMA. Furthermore, Lazard (NAMA's loan sale advisor on the transaction) had confirmed that NAMA had significantly exceeded expectations in terms of information and support provided to Cerberus in relation to the tail. The Board noted that there were no 'missing documents' as NAMA had only undertaken to provide security and title documentation post completion (within six months of the LSA). HoAR advised that the loan sale process and pricing would have been different if the 'tail' was not being sold on a portfolio basis and that the portfolio had appreciated in value since the commencement of the process.

(ii) all information in relation to the facilities and security for this Debtor was in the data room and if Cerberus had inadvertently bid on an incorrect basis, that was their risk.

(iii) Notwithstanding the gains Cerberus were disputing which NAMA had retained, amounting to approximately €5 million, Cerberus would benefit from other gains in the order of €33 million accrued for example from asset sales yet to close and unencumbered assets which were not priced in the Cerberus bid.

Following considerable discussion the Board agreed that the loan portfolio had been offered in a transparent manner and that it should not change the rules of engagement during the sale process. The Board agreed further that it would not countenance a 'price chip' of any sort on the Portfolio, being cognisant of the robustness of the market since the Portfolio was offered and being conscious not to create a market precedent.

Appendix C

NAMA Board papers in relation to Project Eagle

This appendix contains the papers relating to Project Eagle presented at the October 2013, December 2013, January 2014 and April 2014 NAMA Board meetings for decision making purposes. The papers have been redacted here for publication by removing

- names of PIMCO employees / advisors (all)
- NAMA employee names
- third party names and titles
- third party company names
- NAMA debtor names
- NAMA debt, impairment and disposal figures
- property identifiers
- PIMCO modus operandi

In addition, the following appendices originally attached to the papers have not been included for reasons of commercial confidentiality

- 12 December 2013 - Appendix 1: PIMCO's offer letter to NAMA, 4 December 2013.
- 3 April 2014 - Appendix 1: Lazard's recommendation letter to NAMA, 2 April 2014.
- 3 April 2014 - Appendix 2: the bid offers of Cerberus and Fortress, 1 April 2014.

1. Board paper presented to the 10 October 2013 NAMA Board meeting

National Asset Management Agency

NAMA BOARD MEETING

10th October, 2013

AGENDA ITEM NO: 2

Project Eagle - Northern Ireland Debtors Portfolio

[redacted]

FOR APPROVAL

This item is for decision.

Recommendation:

Notwithstanding the inherent risks with such a politically sensitive transaction, AR believes there is merit in exploring this proposal further with PIMCO, taking cognisance of the substance of the counterparty involved.

Accordingly AR now seek approval to engage with PIMCO, signing a NDA with NAMA with a view to conducting further due diligence towards the completion, ultimately, of an openly marketed Loan Sale in accordance with Board policy in respect of the Portfolio - the request for which will be brought back to Board for formal approval at a later date.

Summary of Proposal / Background:

NAMA recently received a direct unsolicited approach from Pacific Investment Management Company LLC (“PIMCO”) who submitted a non-binding indication of interest at **€1.1bn** for the acquisition of NAMA’s Northern Irish Loan Portfolio (“the Portfolio”).

HoAR and Deputy HoAR met with PIMCO to explore their offer. They have indicated that they are prepared to increase their offer if necessary to purchase the NI debtor portfolio.

AR now proposes engaging further with PIMCO with a view to conducting a Loan Sale in respect of the NI debtors Portfolio, the details of which will be brought back to the Board for final approval. It should be noted that PIMCO have proposed that the transaction would not be openly marketed, but in line with our Board policy, AR will only be recommending the sale subject to an open marketing process.

Assessment of Proposal:

In terms of their credentials, PIMCO is a global investment management firm that was founded in California in 1971. As of June 2013, PIMCO has $1.97 trillion in assets under management, 687 investment professionals and 2,380 employees. It has over $18bn in CMBS and CRE holdings under management. PIMCO is owned by Allianz SE, a global diversified financial services provider.

In 2011 PIMCO raised a US $2.45bn private equity fund (PIMCO Bravo Fund LP) that targets real estate assets for acquisition and through a subsidiary of this fund, the offer for the Portfolio has been submitted.

At a recent meeting with PIMCO, they advised that their normal modus operandi is as follows:

- [redacted]

- [redacted]

- [redacted]

With regard to the proposed acquisition of the NI Debtors Portfolio, PIMCO confirmed the following: -

- They have not completed any due diligence or engaged directly with any NAMA debtors in this regard;

- PIMCO's analysis was conducted by way of reverse engineering NAMA's Balance Sheet and cross-referencing the publicly available information on NAMA's portfolio;

- Their approach is based on debtors who are based in Northern Ireland although they fully acknowledged that these debtors typically tended to also acquire assets in GB and other jurisdictions and PIMCO intend to acquire all such related debt. As an example, they advised that they did not wish to include [redacted] within their portfolio analysis as their view was that this debtor's investment / development activities is predominantly based in RoI;

- PIMCO are prepared to be flexible and work with what NAMA's judgement of what constitutes the NI Portfolio. They could increase their offer in line with any incremental value within the Portfolio and advised that they could, for example, ingest the scale of a €2bn portfolio. In this regard, they would require internal approval to increase beyond the initial bid of €1.1bn, but were confident that would be granted and if required, could be approved very quickly considering this proposal has support at the highest level in PIMCO (ref [redacted]);

- PIMCO have not yet factored in swap exposures but acknowledged that they would have to pay for any NAMA-funded derivatives;

- [redacted]

In terms of rationale, PIMCO advised that their macro house view was that the NI economy has "bottomed out" and wanted exposure to capitalise on future growth / recovery, while also citing their expertise in the GB market. PIMCO believe the Portfolio would provide them with quantum quickly and overall they like the value proposition. PIMCO would very much see this as a "bolt-on" acquisition believing that the secondary markets offer good opportunities for incremental capex to drive value.

Portfolio Composition:

While there are likely to be issues agreeing and defining the NI debtors book, PIMCO reiterated their flexibility in this regard. In the context of a proposed structure, AR has undertaken an initial selection process using the following criteria:

(i) Connections with primary business headquartered based in NI;
(ii) Connections with primary debtor resident in NI;
- Connections included under (i) and (ii) to include all cross-collateralised debt and secured assets irrespective of their location / jurisdiction;
- All swaps (interest rate / fx /inflation etc) to be included.

Using this criteria, the Portfolio composition can be summarised as follows:

- 16 NAMA-Managed Connections amounting NAMA debt of €1.6bn after impairment of €0.32bn (list attached).
- Further NAMA debt is estimated in the PI/SP-Managed portfolio of €0.2bn after impairment. In total, subject to further due diligence the value of the Portfolio based on NAMA debt net of impairment is estimated at €1.8bn as at 30 June 2013. However it would be reasonable to expect that this portfolio would be impaired further at year end noting the 3 year look forward review proposed and the concentration of Retail assets and NI land bank assets.
- The largest 10 NI debtor connections comprise 82% of the Portfolio.
- We have assessed both the geographical and sectoral split of the Portfolio which indicates that 85% of the assets are split between NI (42%) and GB (43%) while more than half the portfolio comprises Retail assets (57%). Combined Retail, Office and Industrial account for 72% of the Portfolio. (Note: This analysis is based on the cash flows relating to the NAMA-Managed Connections which comprise 87% of the overall value).

Key Risks / Mitigants:

Reputational Risk: We should not underestimate how highly politically sensitive this proposal would be and the need for confidentiality is therefore crucial.

Portfolio Definition Risk: This is not a discreet portfolio and as such we will need to exercise care with regard to debtor selection / exclusion

Execution Risk: This proposal involves multiple counterparties and debtor cooperation will be important to ensure a successful outcome. Collation of a substantial amount of documentation / security items will be required to close out. The execution risk is heightened by the inevitable resource stretch and assumption that all debt is transferrable.

Recommendation:

Notwithstanding the inherent risks with such a politically sensitive transaction, AR believes there is merit in exploring this proposal further with PIMCO taking cognisance of the substance of the counterparty involved.

Accordingly AR now seek approval to engage with PIMCO signing a NDA with NAMA with a view to conducting further due diligence towards the completion ultimately of a openly marketed Loan Sale in accordance with Board policy in respect of the Portfolio, the request for which will be brought back to Board for formal approval at a later date.

NI Based NAMA Managed Connections				
Master ID	Master Connection	NAMA Debt (pre-impairment)	30 June 2013 Impairment	30/06/2013 NAMA Debt post-impairment
158	[redacted]	[redacted]	[redacted]	[redacted]
28	[redacted]	[redacted]	[redacted]	[redacted]
108	[redacted]	[redacted]	[redacted]	[redacted]
70	[redacted]	[redacted]	[redacted]	[redacted]
131	[redacted]	[redacted]	[redacted]	[redacted]
135	[redacted]	[redacted]	[redacted]	[redacted]
407	[redacted]	[redacted]	[redacted]	[redacted]
104	[redacted]	[redacted]	[redacted]	[redacted]
287	[redacted]	[redacted]	[redacted]	[redacted]
153	[redacted]	[redacted]	[redacted]	[redacted]
61	[redacted]	[redacted]	[redacted]	[redacted]
106	[redacted]	[redacted]	[redacted]	[redacted]
761	[redacted]	[redacted]	[redacted]	[redacted]
411	[redacted]	[redacted]	[redacted]	[redacted]
367	[redacted]	[redacted]	[redacted]	[redacted]
1079	[redacted]	[redacted]	[redacted]	[redacted]
	NI Based Connections Total	**1,921,047,878**	**(316,095,110)**	**1,604,952,768**

2. Board paper presented to the 12 December 2013 NAMA Board meeting

National Asset Management Agency

NAMA BOARD MEETING (Private Session)

December 12th, 2013

AGENDA ITEM NO: 2

Project Eagle – Loan Portfolio Disposal

PRESENTER: [redacted]

FOR BOARD APPROVAL

This item is for decision

RECOMMENDATION

NAMA AR is seeking guidance from Board as to the appropriate response to grant exclusivity to PIMCO to enter into a closed transaction with no formal open marketing campaign of the Project Eagle portfolio of loans.

Should Board authorise a closed market exclusive transaction with PIMCO or authorise the commencement of an open loan sale process NAMA AR seeks approval to complete the sale of Project Eagle for consideration greater than STG£1.3 billion (EUR€1.57 billion), subject to final transaction terms and conditions being approved by the Board in due course.

BACKGROUND/RATIONALE:

On 10 October 2013, the NAMA Board considered and discussed Agenda Item No 2 [Project Eagle – Northern Ireland Debtors Portfolio] and approved advancing discussions with Pacific Investment Management Company LLC ("PIMCO"). On 16 October PIMCO signed a non-disclosure agreement with NAMA and thereafter NAMA Asset Recovery ("AR") met PIMCO and their legal advisor to advance matters.

The Project Eagle portfolio consists of 56 NAMA borrower connections (20 NAMA managed and 36 PI managed), secured by 933 property assets. NAMA CFO has advised that NAMA debt across the 56 connections (post the financial year end 2013 impairment exercise and an adjustment for assets forecast to sell during 2017 to 2020) is estimated at £1.39 billion, with current PAR debt of £4.6 billion.

On 4 December, PIMCO submitted a bid range of £1.1m to £1.3m for the whole portfolio. This bid is based on financial due diligence by PIMCO on the top 55 assets by value (£950m) and a bid range of £150m to £350m for the remaining 878 assets, subject to further diligence on the latter assets.

Project Name	Project Eagle – Loan Portfolio Disposal

CONTENTS – DRAFT

Note: All numbers in this paper are in £Sterling and sourced from NAMA CFO or NAMA Operations

1.0 SECTION ONE – Background and update

On 10 October 2013, the NAMA Board considered and discussed Agenda Item No 2 [Project Eagle – Northern Ireland Debtors Portfolio] and approved advancing discussions with Pacific Investment Management Company LLC ("**PIMCO**"). On 16 October PIMCO signed a non-disclosure agreement with NAMA and thereafter NAMA Asset Recovery ("**AR**") met PIMCO and their legal advisor to advance matters.

Since 16 October through to 5 December, AR has been in frequent contact with PIMCO. AR and NAMA CFO have carried out detailed financial and commercial analysis of the loans and the properties in the Project Eagle portfolio.

The Project Eagle portfolio consists of 56 NAMA borrower connections (20 NAMA managed and 36 PI managed), secured by 933 property assets. NAMA CFO has advised that NAMA debt across the 56 connections (post the financial year end 2013 impairment exercise and an adjustment for assets forecast to sell during 2017 to 2020) is estimated at **£1.39 billion**[1], with current PAR debt of £4.6 billion.

There are 24 shopping centres in the portfolio with a NAMA debt value of £558 million. PIMCO and its affiliate organisation New River Retail are experienced shopping centre managers. The weighting of shopping centres in the portfolio (mostly in the UK) is a key attraction for PIMCO.

On 4 November AR opened an online data room to PIMCO and their advisors (Cushman & Wakefield and New River Retail). AR provided redacted November 2009 valuation reports and latest tenancy schedules for the top 55 property assets in the portfolio. For assets 56 through to 933 only the property address and the sector of the security (land, office etc.) has been disclosed.

On 4 December, PIMCO submitted a bid range of **£1.1 to £1.3 billion** for the whole portfolio (Appendix 1)

[redacted]

[1] Source: NAMA CFO. The £1.39 billion number is subject to change pending the final QA and the January 2014 'true-up' process, see Section Three for more details. Throughout this paper this debt is defined as "Nov 13 debt"

[redacted]

1.1 Project Eagle portfolio analysis

As at 25 November 2013 outstanding PAR debt across the 56 connections was £4.6 billion. As detailed in Section Three of this paper, NAMA CFO has advised that £1.39 billion is the most appropriate NAMA debt balance for assessing a bid. The debt is secured on 933 property assets.

A summary of Eagle borrower connections is detailed in **Table 1** and **Table 2**:

Table 1 – Total borrower analysis

	Total	Restructured	Support	Enforced	**# of properties**
NAMA Managed	**20**	2	12	6	**535**
PI – Bank of Ireland	**14**	-	11	3	**175**
PI - AIB	**11**	-	6	5	**136**
PI - Capita	**11**	-	5	6	**87**
Total	**56**	**2**	**34**	**20**	**933**

Table 2 - Key connections £'m

Borrower	**PAR Debt Nov 13**	**Debt Nov 09**	**Debt Nov 13**	**# of properties**
1 - [redacted]	[redacted]	[redacted]	[redacted]	85
2 – [redacted]	[redacted]	[redacted]	[redacted]	59
3 - [redacted]	[redacted]	[redacted]	[redacted]	49
4 - [redacted]	[redacted]	[redacted]	[redacted]	56
5 - [redacted]	[redacted]	[redacted]	[redacted]	19
Total	**£2,192**	**£1,487**	**£924**	**268**

The top 5 connections account for 66% of Nov 13 NAMA debt and account for 29% of the property assets by number

Table 3 - Property location £'m

Location	**# of properties**	**Nov 09**	**% of Nov 09**
Northern Ireland	638 (68%)	930	46%
Great Britain	116 (12%)	781	39%
Republic of Ireland	167 (18%)	180	9%
Germany	10	129	6%
Slovakia	2	7	0%
Total	**933**	**£2,028**	**100%**

A summary of the geographic location of the 933 properties is detailed in **Table 3**. 68% of the assets by number are located in Northern Ireland, or 46% by value

Table 4 - Property sector

Sector	**# of properties**	**Nov 09 £'m**	**% of Nov 09**
Office	62	242	12%
Retail	110	922	45%
Industrial	35	63	3%
Ancillary	57	170	8%
Land & Dev	407	376	19%
Hotel & Leisure	18	110	5%
Residential	244	146	7%
Total	**933**	**£2,028**	**100%**

A summary of the sectors for the 933 properties is detailed in **Table 4.** Land and development accounts for 44% by number, Retail accounts for 45% by value (with shopping centres accounting for the majority)

As detailed in **Table 5**, 4 of the 5 key assets in the portfolio are forecast to sell in 2017

Table 5- Key properties £'m				
Property	**Borrower**	**Location**	**Debt Nov 09 £'m**	**Disposal forecast £'m**
1 [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2 [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
4 [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total			**£330**	**£299**
Note 1: Shopping Centre ("SC")				

An analysis of property and value concentration is detailed in **Table 6**:

Table 6 - Concentration of value £'m			
Value range	**Properties**	**Debt Nov 09**	**% of Total**
>20m	23	761	38%
<20m + >10m	26	381	19%
<10m & >8m	10	90	4%
<8m & >5m	20	124	6%
<5m & >4m	16	72	4%
<4m & >3m	29	99	5%
<3m & >2m	49	118	6%
<2m & >1m	117	166	8%
<1m & >0.1m	528	209	10%
<0.1m	115	8	0%
Total	**933**	**£2,028**	**100%**

As detailed in **Table 6**, 49 assets have a Nov-09 value of greater than £10 million, accounting for 57% of Nov-09 value

752 properties in the portfolio had a Nov-09 value of less than £2.0 million

1.2 PIMCO bid

PIMCO has carried out financial due diligence on assets 1 to 55 and has placed a value of £950.0 million against these assets. This represents 79% by value of the mid-point of their bid (£1.2 billion), initial bid indicating a range of £1.1 billion to £1.3 billion.

AR has not provided PIMCO with any financial information on assets 56 to 933. As per the PIMCO bid letter, PIMCO has put forward a bid range of £150 million to £350 million for these assets. Table 7 below compares the PIMCO bid with NAMA forecast disposal values (**excluding rent & opex**).

Table 7 – NAMA net disposal forecast vs. PIMCO bid £'m			
Assets	**Net disposal cash – No NPV**	**Net disposal NPV (5.5%)**	**PIMCO bid**
1 - 55	891	766	950
56 - 933	556	478	150 to 350
Total	**£1,447**	**£1,244**	**£1.1 to £1.3 b**

The bid for assets 1 to 55 is £59m above NAMA's net disposal forecast in real terms, or £184m above on a net present value basis using a 5.5% discount rate

If the Board was to authorise a closed transaction with PIMCO, PIMCO would carry out further financial analysis on assets 56 to 933 to finalise their bid for the entire portfolio.

2.0 SECTION TWO – Open marketing vs. closed transaction

2.1 Challenges of an open marketing sale process

Throughout discussions with PIMCO, AR has highlighted NAMA loan sale policy. While the bid letter is not subject to a closed transaction, PIMCO has represented to AR that this is their preferred transaction structure.

To assist the Board with making a decision, AR highlights below some of the key challenges that NAMA would face to successfully manage an open marketing process and highlights some key advantages of a closed transaction.

- Quantum of connections
  - Selling 56 connections as a single portfolio would be a significant challenge with a high probability of failure
  - Successful NAMA loan sales have focused on single connections
- Timing
  - It would take between 3 and 6 months to gather the underlying banking and property information. It would likely take a further 6 weeks to prepare an information memorandum and populate an online data room before an open marketing campaign could commence
  - If the open marketing campaign led to a preferred bidder it would likely take a further 3 to 6 months to complete the transaction
  - In summary, if Project Eagle was brought to the open market it would likely be Q4 2014 before the transaction would complete
- Resources
  - Significant NAMA human resources would be required to gather the information required in advance of commencing an open marketing process
- Disruption
  - NAMA borrowers would be aware of the process and seek to negotiate their positions
  - A sales process would likely distract borrowers and perhaps receivers from day to day asset management
  - Forecast cash flow disposal proceeds for 2014 from individual asset sales would be at risk as individual sales could not commence/proceed if Project Eagle was being marketed
- Proceeds
  - There is a limited number of investors who would have the ability to pay £1.39 billion cash for the portfolio

2.2 Advantages of a closed transaction

AR summarises below certain advantages that a closed transaction with PIMCO would offer.

- Discreet process
  - If confidentiality can be maintained through the process there would be minimal/no borrower involvement
  - The transaction could realistically complete by end Q1 2014
  - If the sale collapses there is minimal/no negative publicity
- NI Advisory Committee
  - A closed transaction structure is likely to be supported by the external member of the NI Advisory Committee given the controlled nature of the transaction and the contribution it could make to economic regeneration
- Resources
  - With appropriate personnel reallocations the NAMA loan sale team has the competency to complete the transaction, albeit the Project Eagle transaction would be running simultaneous to the Project Thames loan sale
  - No broker fee is required (likely saving of £5 million), although the Board could consider the appointment of an advisor at a reduced fee to oversee and sign-off the proposed transaction
- Purchaser
  - PIMCO has the funds available to compete the transaction and has investment committee approval
  - PIMCO is willing to complete the transaction with minimal due diligence (subject to a reasonable claw-back mechanic being agreed)
- NAMA budget saving
  - At c4% of the total NAMA Portfolio, the NI Debtor book represents a disproportionate draw on NAMA’s stretched resource base, this primarily due to the political and cross-border sensitivities. This is manifested but not limited to the following:
    - the NI Advisory Sub Board Committee apparatus and operation;
    - an extensive stakeholder and communication plan for NI with attendant cost;
    - 3 separate PI and service provider offices are maintained in Belfast with the impact on the Service Fee; and
    - enforcement challenges in the jurisdiction
- A commercial organisation could manage the portfolio alongside other deleveraging Banks in a way that could unlock asset concentration issues for the wider economic benefit of NI.

2.3 Risks of a closed sale

To balance the above points AR summarises below some of the disadvantages of a closed transaction.

- NAMA loan sale policy
  - A closed transaction could expose NAMA to perception that maximum value was not achieved from the loans or NAMA had not given the market the opportunity to bid.
- Loan sale deed
  - PIMCO will require additional representations and warranties in the loan sale deed in light of minimal/no due diligence. AR will ensure any such representations and warranties are minimised in conjunction with NAMA Legal and external legal advisor
- Completion
  - Even if the Board authorised a closed transaction PIMCO would not be legally obliged to complete the transaction
- Post-acquisition
  - If the transaction completed, NAMA would have to act as a transitional services provider until such times that PIMCO could migrate day to day asset management and loan management to their platform
- Confidentiality
  - NAMA would need an appropriate media, staff, borrower and other stakeholder response if a 'leak' of the closed transaction were to occur

In summary, while it would be possible to openly market the loans, the scale of the project would need careful planning, budget, management and execution.

The sale of the largest 5 connections represents approximately 80% of the value of the 56 connections and these could be openly marketed together.

3.0 SECTION THREE – Price analysis

AR has worked closely with NAMA CFO and Treasury to ensure the most up to date financial information available to the Board is included in this Paper.

As detailed in **Table 8** below, the Eagle portfolio had a NAMA carrying value of **£1,665 million** before the current Financial Year End 2013 impairment exercise (“**FYE13**”).

NAMA CFO has advised that a further impairment of £190 million is likely following the FYE13 exercise, resulting in a post FYE13 impairment NAMA debt of £1,475 million.

NAMA CFO has advised that the £1,475 million carrying value should be amended by a further £85 million to take account of assets that are forecast to sell during the period 2017 to 2020.

Following this adjustment, NAMA CFO has advised that the appropriate NAMA debt number to compare against the offer from PIMCO is **£1,390 million.**

Table 8 – Current NAMA debt £'m			
	NAMA mgd	PI mgd	Total
PAR debt at 25 Nov 2013			**4,612**
NAMA debt pre FYE13 exercise			**1,980**
Impairments taken pre FYE13 exercise			(315)
Subtotal			**1,665**
Additional impairment following FYE13 exercise			(190)
NAMA debt post FYE13 exercise	**1,240**	**235**	**1,475**
Adjust for assets held at in 2017 to 2020 period (Assumption 1)			**(85)**
NAMA debt for Project Eagle comparison			**£1,390**
Notes			
1 - PI managed book is impaired in FYE 2013 exercise (increasing coverage from 14.7% to 17.0%)			
2 - PI managed cash is recovered in equal amounts per annum from 2014 to 2020			
Assumptions			
1 - Assets forecast to sell from 2017 to 2020 are adjusted by 17% or £85.0m			
Source: NAMA CFO Note: Numbers rounded			

Table 9 details the base line cash flow forecasts for NAMA and PI managed connections from 2014 through to 2020 that supports the £1,390 million guidance from NAMA CFO.

As per Table 9, total net cash forecast across the 56 connections is forecast at **£1,589 million**.

The net present value of these forecast cash flows using a discount rate of 5.5% is **£1,381 million** increasing to £1,488 million when using a discount rate of 2.5%.

Gross rent from the 56 connections was approximately £100 million in 2013. Forecast gross rent in 2014 is £85 million. If PIMCO were to purchase the portfolio for £1.2 billion, the £85 million gross rent would provide PIMCO with a simple yield of 7.08%, however, this has to be viewed in the context that 19% of the portfolio is Land & Development and not income producing.

Table 9 - NAMA Nov 13 cash flow and debt analysis £'s

Baseline	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**Total**	**NPV at 5.5%**	**NPV @ 2.5%**
NAMA MANAGED – 20 connections										
Non disposal net cash										
Rent	85	57	41	18	-	-	-	202	182	192
Other	4	2	1	-	-	-	-	7	6	6
Opex	(24)	(11)	(7)	(3)	-	-	-	(45)	(41)	(44)
Overhead	(6)	(5)	(5)	(4)	-	-	-	(20)	(17)	(19)
Subtotal	**58**	**43**	**31**	**12**	**-**	**-**	**-**	**143**	**129**	**136**
Disposal and capex net cash										
Proceeds	440	264	138	462	32	6	6	1,348	1,178	1,266
Capex	(8)	(5)	(2)	(9)	(1)	-	-	(25)	(22)	(24)
Subtotal	**432**	**259**	**135**	**453**	**31**	**6**	**6**	**1,322**	**1,155**	**1,242**
Total asset cash										
Subtotal	**490**	**302**	**166**	**465**	**31**	**6**	**6**	1,465	**1,284**	**1,378**
Capex	**(24)**	**(12)**	**(10)**	**(25)**	**(2)**	**(1)**	**-**	**(72)**	**(63)**	**(68)**
Subtotal	**466**	**290**	**156**	**442**	**29**	**5**	**6**	**1,393**	**1,221**	**1,310**
Note 3	**-**	**-**	**-**	**(86)**	**-**	**-**	**-**	**(86)**	**(69)**	**(78)**
Subtotal	**466**	**290**	**156**	**356**	**29**	**5**	**6**	**1,307**	**1,152**	**1,233**
PI MANAGED – 36 connections										
Subtotal	**40**	**40**	**40**	**40**	**40**	**40**	**40**	**282**	**229**	**256**
NAMA MANAGED plus PI MANAGED										
Net Cash	**506**	**330**	**196**	**396**	**69**	**45**	**46**	**1,589**	**1,381**	**1,488**
Number of individual property disposals required to reach the cash flow forecast										
Total	**255**	**165**	**126**	**117**	**121**	**74**	**72**	**933**		
Notes										
1 - PI managed book is impaired by 2.6% in FYE 2013 exercise (increasing from 14.4% to 17.0%)										
2 - PI managed cash is recovered in equal amounts per annum from 2014 to 2020										
3 - Assets forecast to sell from 2017 to 2020 are impaired by 17% or £85.0m (currently not impaired)										
Source: NAMA CFO Note: numbers rounded										

It is important to note that significant sales of £432 million are forecast from the 20 NAMA Managed connections in 2014.

255 separate property sales are forecast to complete to support this forecast.

The £432 million of forecast sales for 2014 from the 20 NAMA managed connections are geographically spread as follows:

- £146 million from UK excluding London,
- £135 million from Northern Ireland, and
- £117 million from Germany/Slovakia

The £432 million forecast for 2014 appears aggressive, as disposal proceeds generated from the 20 connections in 2012 and 2013 combined was £99 million and since acquisition £285 million with the [redacted] connection accounting for 51% of these sale proceeds.

Table 10 -NAMA managed net disposal proceeds by location £'m								
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**Total**
Dublin	-	4	1	3	-	-	-	8
Rest of ROI	11	29	23	2	-	-	-	65
Total ROI	**11**	**33**	**24**	**5**	**-**	**-**	**-**	**73**
London	22	-	-	34	-	-		55
Rest of UK	146	98	29	226	-	-	-	499
Total UK	**168**	**98**	**29**	**259**	**-**	**-**	**-**	**544**
Northern Ireland	135	129	82	189	31	6	6	578
Germany & Slovakia	117	-	-	-	-	-	-	117
Total Rest of World	252	129	82	189	31	6	6	695
Total	**£432**	**£259**	**£135**	**£453**	**£31**	**£6**	**£6**	**£1,322**

To assist the Board with analysing the future cash flows, AR and NAMA Finance present two scenarios in **Table 11** using the Baseline numbers from Table 10.

Scenario 1 assumptions – (1) Disposal income is generated evenly over 7 years

Key result: NAMA Nov 13 debt, using a discount rate of 5.5% results in a current value of **£1,291 million**

Scenario 2 assumptions – (1) Disposal income is generated evenly over 7 years, (2) PI impairment increases from 17% to 25% and (3) 2017-2020 disposal impairment increases from 17% to 25%

Key result: NAMA Nov 13 debt, using a discount rate of 5.5% results in a current value of **£1,236 million**

Table 11 - NAMA Nov 13 debt with two alternative scenarios £'m										
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**Total**	**NPV @5.5%**	**NPV @2.5%**
Baseline										
Net Cash	506	330	196	396	70	45	46	**1,589**	**1,381**	**1,488**
Scenario 1										
Net cash	239	239	239	153	239	239	239	**1,589**	**1,291**	**1,442**
Scenario 2										
Net cash	235	235	235	109	235	235	235	**1,522**	**1,236**	**1,380**
Source: NAMA CFO										

3.1 NPL discount

In general, acquiring non-performing loans, without an agreed strategy and consensual plan to simultaneous take direct ownership of the secured property or shares, carries significant risk.

AR is not aware of any such plan between PIMCO and existing NAMA borrowers.

In NAMA AR experience, a party buying a non-performing loan portfolio, without taking simultaneous ownership of the underlying security (purchasing shares or property title directly from the current owner or insolvency practitioner) is likely to discount the value of the underlying security by at least 10% to reflect the associated risks and costs of purchasing the loans in the absence of a simultaneous property/share transaction.

As detailed in this Paper, the PIMCO bid has minimal/no discount to the property values of assets 1 to 55.

SECTION FOUR – Work streams, key risks and timeline

4.1 Work streams

If NAMA Board was to approve **a closed sale** to PIMCO, some of the key work streams would be:

Pre-acquisition	
1	NAMA and PIMCO to negotiate and finalise heads of agreement with all key deal terms
2	NAMA to appoint an external legal advisor
3	PIMCO to complete due diligence on assets 56 to 938
4	Negotiate and finalise the loan sale deed
5	Agree a transaction structure (likely to be an Irish QIF)
6	Agree an allocated property price for each of the 940 assets
7	Agree a completion balance sheet mechanic for revenue and costs
8	Ensure anti money laundering process adhered to
9	Negotiate and agree a transitional services agreement
At acquisition	
1	Notify borrowers/receivers
2	Notify Capita
3	Notify NAMA staff and PI's
4	Media release
Post-acquisition	
1	Finalise schedules of loans for insertion into the loan sale deed
2	Implement transitional services agreement
3	Source and hand over all banking files
4	PIMCO to meet with borrowers/receivers

4.2 Key risks

If NAMA Board was to approve a closed sale to PIMCO, some of the key risk associated with the proposed transaction (both pre and post-acquisition) would be:

- Reputational issues
  - Borrowers involved in current NAMA loan sale process might seek clarification as to why their loans are subject to an open marketing process
- PIMCO fails to complete
  - NAMA could consider an abort fee, PIMCO to cover NAMA costs or other such mechanic to mitigate the financial impact of such an event
- Post-acquisition integration
  - NAMA will have to provide PIMCO with significant services post-acquisition to ensure there is a seamless handover of the borrower connections
- Post-acquisition PIMCO events
  - PIMCO would likely forgive personal recourse in return for the borrowers handing over their property assets in a consensual manner
  - Borrowers might be in a position to buy back their loans from PIMCO
  - PIMCO might 'carve-up' the Eagle portfolio and sell certain assets/mini-portfolios

4.3 Time line

- If NAMA Board was to approve a closed sale to PIMCO, the likely time line between now and completion would be:
    - Agree heads of agreement to be signed by 20 December
    - Appointment of NAMA external legal advisor by 20 December
    - PIMCO to confirm price by 31 January (following completion of due diligence)
    - Loan sale deed to be agreed by 14 February
    - Revert to Board with final transaction terms for approval
    - Completion by 28 February 2014

SECTION FIVE – For consideration

Throughout all discussions with PIMCO, NAMA AR has highlighted current NAMA Policy in relation to loans being openly marketed.

As detailed in this Paper an open marketing process of the 56 borrower connections would be very challenging, however not insurmountable, but would take a considerable time.

While PIMCO recognises NAMA's loan sale policy, PIMCO has represented to AR that the £1.1 to £1.3 billion bid to acquire Project Eagle is on the basis that NAMA Board would **grant exclusivity** to PIMCO to enter into a closed transaction with no formal open marketing campaign of the loans.

NAMA AR is seeking guidance from the Board as to the appropriate response to this exclusivity request.

If the Board was to authorise a closed market exclusive transaction with PIMCO or was to authorise the commencement of an open loan sale process **NAMA AR seeks approval** to complete the sale of Project Eagle for consideration greater than **STG£1.3 billion** (EUR€1.57 billion), subject to final transaction terms and conditions being approved by the Board in due course.

Approval			
Name		**Name**	
Position/Title		**Position/Title**	
Date		**Date**	

3. Board paper presented to the 8 January 2014 NAMA Board meeting.

National Asset Management Agency

NAMA BOARD MEETING (Private Session)

January 8th, 2014

AGENDA ITEM NO: 2

Project Eagle – Loan Portfolio Disposal

PRESENTER: [redacted]

FOR BOARD APPROVAL

This item is for decision

It is recommended that the Board resolve to approve the appointment of Lazard[1] as Corporate Finance Advisors to NAMA in relation to the Project Eagle Loan Portfolio Disposal in line with the specific recommendations hereunder.

BACKGROUND/RATIONALE:

Update was provided to Board on 12 December seeking guidance on:

(i) Whether to grant exclusivity to PIMCO to enter into a closed transaction with no formal open marketing campaign of the Project Eagle portfolio of loans;

(ii) Subject to clarity surrounding (i) above, to recommend approval of the sale of Project Eagle for consideration no less than STG£1.3 billion, subject to final terms and conditions being approved by Board in due course.

The Board deferred a decision on the PIMCO bid at its December 2013 meeting and requested AR to consider options to ensure open marketing requirement is appropriately fulfilled.

RECOMMENDATION

AR recommends the following:

---

[1] Lazard are on NAMA's Loan sales Panel established by public tender. Given the political and commercial sensitivity at this time it is recommended they are appointed without running a mini tender.

(1) Corporate Finance Advisors, Lazard (Loan Sale Advisory Services panel member) are appointed to advise NAMA. In view of sensitivities pertaining to the deal, it is recommended that Lazard are appointed without tendering, following which NAMA will provide them with a verbal briefing on the project to date;

(2) Lazard advise NAMA on an appropriate marketing approach which will balance open marketing requirement with need for confidentiality. Such an approach will enable Lazard to confirm to NAMA that appropriate marketing to suitable targeted bidders with financial wherewithal for such a portfolio sale has taken place;

(3) Likely approach will involve Lazard approaching at least 2 other major international investors to establish interest in such an acquisition with the intention of giving interested parties, under NDA and subject to Lazard's advice, at least 2-week access to our data room to prepare an immediate bid.

(4) In parallel, PIMCO are permitted to complete their due diligence on the "tail" of the Eagle Portfolio and formalise their bid. AR will, at this juncture, meet with PIMCO to advise them of our intended approach regarding the other short-listed investors noting that this will be as much to protect their interests with regard to the integrity and credibility of the disposal process;

(5) Lazard to submit recommendation to NAMA by 31st January 2014 on bid acceptance.

4. Board paper presented to the 3 April NAMA Board meeting.

National Asset Management Agency

NAMA BOARD MEETING
April 3 2014

AGENDA ITEM NO: 2

Project Eagle – Loan Portfolio Disposal

PRESENTER: [redacted] / [redacted]

FOR BOARD APPROVAL

This item is for decision

It is **recommended** that the Board resolve to approve the following:

(i) In line with recommendation from our Corporate Finance Advisors, Lazard **(attached at Appendix 1)**, to continue negotiations solely with the lead bidder, Cerberus Capital Management (Cerberus), noting that the Fortress offer will expire on Friday 4 April, with a view to closing the Project Eagle Loan Sale by May 31 2014;

(ii) To approve the offer from Cerberus at a level of £1.241bn as compared with NAMA's minimum revised discounted carrying value of £1.23bn adjusted as a result of recent asset sales within the Project Eagle Portfolio (see "Background/Rationale" section below); and

(iii) To sub-delegate to CEO & HoAR/DHoAR to approve a revised minimum sale price of £1.2bn should the final sale price reduce from the current bid level as a result of issues emerging from the final due diligence which have a value impact. AR also seeks sub-delegation to CEO & HoAR/DHoAR to negotiate the terms and conditions of the final legal documentation including the TSA and LSA.

BACKGROUND/RATIONALE:

On 8th January 2014 Board approved the sale of the Eagle Portfolio for a sum not less than £1.3bn while also approving the appointment of Lazard to advise on an appropriate marketing approach which would balance our open marketing requirement with the need for confidentiality. It should be noted that NAMA has completed sales of assets within the Eagle Portfolio for a combined value of c. £83.6m since the sales process commenced and as a consequence, the minimum reserve price has been adjusted downwards to £1.23bn to reflect these sales and provide NAMA with a minor uplift. Lazard subsequently recommended a targeted process with a limited number of highly qualified, major international investors.

Initially, Blackstone, Oaktree and Starwood Capital were approached by Lazard under NDA but for different reasons only Oaktree wished to participate. Lazard also approached Apollo but they also opted not to participate. Ultimately, Cerberus, Lone Star, Goldman Sachs and Fortress together with PIMCO entered the process under NDA. Following initial data-room access, Lone Star, Goldman Sachs and Oaktree withdrew leaving PIMCO, Cerberus and Fortress to continue their due diligence. As Board are aware, PIMCO then withdrew from the process leaving Cerberus and Fortress as the final two bidders. Final bids **(attached at Appendix 2)** from the two remaining bidders were received by Lazard and NAMA on April 1 and are summarised in *Table 1* below.

Table 1

Terms	**Fortress**	**Cerberus**	**Assessment**
Price	£1.075bn	£1.241bn	NAMA's minimum Reserve price was revised downwards in line with recent sales to £1.23bn leaving Fortress some £155m below while Cerberus exceeded the reserve.
Timing	30 days (plus 30-day extension) to close but exclusivity sought for this period	2 weeks to sign LSA and 4 weeks after to close (mid-May)	Broadly similar timing but Cerberus have not sought exclusivity thus potentially avoiding delays drafting Exclusivity Agreements.
Financing	Not specific	Cash	While the bid from Fortress is assumed to be cash, Cerberus have specifically confirmed their bid is fully funded equity.
Due Diligence	Largely completed	Commercial d/d completed. Further "customary" legal d/d required	Fortress appear to have completed most of their d/d apart from final negotiation of the transaction docs. Main weakness in terms of the Cerberus offer given they have advised of further legal d/d on the tail of the portfolio.
Onboarding	Short TSA period	Short TSA period	Both bidders have advised that they intend to engage [redacted] which will serve to streamline the portfolio onboarding.
Conditionality / Key Features	Main differences relate to (i) business plan and (ii) allocation of offer price to individual assets. In terms of (i) Cerberus provide more detail than Fortress regarding their proposed strategic approach to the Eagle portfolio citing their intention to work closely in a consensual manner with the debtors. Regarding the latter point, Fortress have refused to allocate their bid on an asset-by-asset basis which they were required to do under the agreed process whereas Cerberus have done so.		

RECOMMENDATION

In summary, AR concurs with the Lazard recommendation that the Cerberus offer is far superior largely based on price but also factoring in the terms as assessed in *Table 1* above. Lazard have confirmed that the sales and marketing process to date is appropriate given the nature and scale of the transaction and will issue a final letter to reiterate this on successful closing of the transaction. Accordingly, AR **recommends** items listed (i) to (iii) above.

Appendix D Purchaser Discounts

Advice received by NAMA in January 2016

Eastdil Secured

NPL Pricing

The pricing and underwriting of non-performing loan portfolios is normally a very extensive process that can take several months to complete. Whilst % discount to asset value has compressed, as the market fundamentals have improved, it's important to take a number of variables into account.

The pricing of loan portfolios is highly dependent on a number of factors, including:

- the characteristics of each specific portfolio;
- legal jurisdiction, loan / security documentation and a buyer's practical ability to enforce on the loans;
- the extent to which the underlying assets are generating a cash flow;
- the value of collateral other than property securing the loans;
- market depth and liquidity in the underlying property markets;
- availability of loan on loan financing for the portfolio; and
- general market conditions prevailing at the time of sale.

Buyers of NPL portfolios typically take a bottom-up approach to pricing, making assumptions around (a) property values, (b) resolution strategies and (c) resolution timeframe, on an asset-by-asset and borrower connection-by-connection basis. The resulting cash flows are then aggregated and assessed on a leveraged basis, in the context of financing terms that can be secured for the portfolio and the overall timeframe of the investment.

It is therefore generally not feasible or meaningful to assess pricing solely by reference to the par value of the loans or the value of the underlying properties as there are numerous variables to account for.

Having said this, we have seen on a broad brush basis, the loan pricing discount to asset value for granular loan pools in Ireland compress over the past 36 months from +20% to +10% as the underlying market fundamentals have improved. For Q1/Q2 2014, the average discount to asset value for Irish loan books would have been in the 15% range. Having said this, every portfolio is different, and the % discount is completely dependent on the specific valuer's view, and the vintage of the valuation.

Eastdil Secured is a leading loan sale advisor, having advised on over €30 billion in European non-performing loan (NPL) sale transactions since 2013.

Lazard

Debt investors typically price NPL portfolios at a discount to so-called recovery value i.e. the value of the underlying collateral. This is because the purchasers of NPL portfolios typically plan on taking ownership of the collateral via some form of enforcement and then selling the collateral to a more natural long term owner. The main component of the return for the purchaser of an NPL portfolio is therefore the difference between the purchase price for the loans and the sale price for the collateral. If a debt investor acquired a loan portfolio at the value of the underlying collateral, he would not generate a return on his capital when he sold the collateral. The return that a debt investor expects to generate from acquiring an NPL portfolio (which manifests itself in the form of a discount to recovery value) is justified by reference to the risk and costs associated with obtaining ownership of the underlying collateral and the time value of money. This is why discounts to recovery value tend to be wider in jurisdictions like Spain and Italy, where the route to asset ownership is lengthier and more uncertain, than in jurisdictions like the UK and Ireland. Larger, more granular loan portfolios secured on assets that are secondary in nature typically trade at wider discounts than loans secured on individual, high quality assets.

It is difficult to define the “typical” discount to recovery value as when NPL portfolios are sold the discount that is normally reported publicly is the discount to par value – which is a function of the original loan underwriting/prevailing market conditions at the time. The purchaser’s underwriting assumptions in respect of the value of the underlying collateral are confidential and not publicly disclosed. However, anecdotally, the discount to recovery value for real estate NPL portfolios in Europe has narrowed over the past five years, as the market has recovered, from c.20% to c.7- 12%. The precise discount will depend on a number of factors at the relevant time including the quality of the real estate (and information relating thereto) and expectations of capital growth, the enforcement strategy, the perceived complexity, costs and certainty of the route to asset ownership and both the liquidity and risk appetite of potential purchasers. Clearly, every situation is different.

Cushman and Wakefield

Cushman and Wakefield (“C&W”) has provided corporate finance advisory services to the market for over 20 years operating from London, Frankfurt, New York and Washington DC. Our extensive experience covers sell-side, buy-side, valuation and advisory mandates across some of the biggest loan portfolios and most granular collateral sets.

C&W has developed a proven and extensively used loan portfolio pricing model, able to produce accurate indicative value estimates, taking into consideration the quality of individual loans, the quality of the collateral, various portfolio work-out time scales, deal structures, market appetite for the product and how investors approach their own pricing exercise (including their exit strategies, return requirements, and likely financing arrangements).

The pricing of non-performing loan (“NPL”) portfolios is complex and the pricing may vary with investors own liquidity and risk appetite as well as prevailing conditions in the global financial markets. NPL portfolios are typically priced at a discount to the value of the underlying collateral, with larger, more granular loan portfolios secured on secondary assets typically trading at wider discounts and taking longer to work-out.

In arriving at a purchase price based upon its proposed discount rate, investors would evaluate a number of key considerations when underwriting a NPL portfolio, including but not limited to:

- **Equity surplus** – Once investors have mapped the cross-collateralisation between loans within a connection, equity surplus can be identified where the collective outstanding principal balance ("OPB") of the cross-collateralised loans is below the collective value of the associated assets.
- **Legal haircuts** – Investors would need to consider a discount to value to cover certain legal issues including prior charges, the security not being registered, solicitor's undertaking or as they are resting in contract, or missing documentation.
- **Operational costs** – Costs relating to loan servicing, asset management, capex, and working capital would need to be considered in an investor's work-out cash flow.
- **Undrawn amounts** – Investors would need to consider the effect on the purchase price due to any undrawn amounts which they foresee as future commitments to borrowers.
- **Enforcement and legal costs** – Having developed a work-out strategy, investors would need to consider the associated timings and costs of enforcing or negotiating a deal with the borrowers.
- **Work-out timing** – An investor's exit strategy and resulting cash flow would be highly dependent on the timing to dispose all the collateral taking into consideration market absorption, asset pricing, and asset liquidity. For these reasons, larger, more granular loan portfolios secured on secondary assets typically trade at wider discounts and take longer to work-out.
- **Financing** – The availability and terms of loan-on-loan financing will have a significant effect on an investor's potential returns and hence its offered purchase price.

Due to all the aforementioned reasons, NPL portfolios with these portfolio characteristics and market conditions inevitably trade at a discount to today's price for the individual underlying real estate collateral, with pricing levels at discounts above 15% below underlying asset value. The ultimate discount applied will be dependent on the quality of the underlying collateral, loan and security information and borrowers' characteristics as well as investors' own financing and work-out arrangements.

Appendix E

Communications between PIMCO and NAMA

This note summarises the communications - mainly conference calls - between PIMCO and NAMA in March 2014 regarding PIMCO's withdrawal from the Project Eagle loan sale process. The summary is based on meetings with NAMA officials and the examination team review of the following

- a typed minute of a conference call on 10 March 2014 which was prepared by NAMA's Senior Divisional Manager Legal and reviewed by NAMA's Head of Asset Recovery
- contemporaneous notes taken by the Senior Divisional Manager Legal on 11, 12 and 13 March 2014
- copies of email correspondence between NAMA Legal and PIMCO.

Conference call - 10 March 2014

On 7 March 2014, PIMCO's Legal and Compliance Unit requested a conference call with NAMA Legal in relation to Project Eagle. The call took place between PIMCO's legal counsel (internal and external representatives) and NAMA's Senior Divisional Manager Legal and Head of Asset Recovery on 10 March 2014.

PIMCO informed NAMA that its external legal advisors, Brown Rudnick, had initially proposed the Project Eagle deal to PIMCO and that a success fee arrangement was in place between PIMCO and Brown Rudnick. Following enquiries, PIMCO had learnt that the fee was to be split three ways between Brown Rudnick, Tughans and Mr Frank Cushnahan, a former NIAC member.

PIMCO asked the Head of Asset Recovery if NAMA was aware that Mr Cushnahan stood to gain in the event of PIMCO acquiring the Project Eagle loans. The Head of Asset Recovery confirmed that NAMA was unaware of that situation and stated that NAMA would need to consider the matter further.

The Head of Asset Recovery asked how the matter came to light and was informed that when PIMCO's Legal and Compliance Unit reviewed the engagement letter, it had noted the success fee arrangement. While such a fee of itself was not unusual, enquiries about the fee resulted in the three way split being identified. PIMCO was still investigating the matter but wanted to be transparent.

The Head of Asset Recovery asked whether PIMCO would continue to proceed with its work on the proposed transaction if what had been outlined was an issue for NAMA. PIMCO confirmed that its legal due diligence would not proceed until NAMA's position was clarified and that, if NAMA considered the fee arrangement to be an issue, PIMCO would have concerns over continuing to deal with the three counterparties and would need to consider if the transaction could be progressed without their involvement. The Head of Asset Recovery agreed to revert to PIMCO the next day if possible.

Conference calls – 11 March 2014

Following a special meeting of the NAMA Board on 11 March 2014, a call was convened with PIMCO. The Head of Asset Recovery informed PIMCO that the proposed success fee arrangement was considered by the NAMA Board to be a very serious issue. The Head of Asset Recovery asked PIMCO to reflect on the matter and revert to NAMA.

During a call later that evening (11 March 2014), PIMCO expressed its disappointment that disclosures of interest had not been made by relevant parties to NAMA. PIMCO stated that it did not want to remain in a process that could be associated with impropriety for either PIMCO or NAMA and that it was willing to withdraw completely from the process. The Head of Asset Recovery enquired about 'other options'. When PIMCO asked what he meant by this, the Head of Asset Recovery asked if the deal could be "shaped differently for the arrangement fee to come out".[1] The Head of Asset Recovery advised PIMCO that NAMA's concern was about the proposed success fee payable to Frank Cushnahan. At this point, it was also noted that one third of the fee was in fact payable to a named individual at Tughans. PIMCO's willingness to withdraw was reiterated.

Conference call – 12 March 2014

Around 5pm on 12 March 2014, PIMCO advised NAMA that it had no option but to withdraw from the process. The fee arrangement was a serious issue for it and NAMA. PIMCO was unwilling to proceed in the absence of disclosures of interest it expected would have been made to NAMA, particularly given the quantum of the fee (£15m to £16m). PIMCO further stated that it could not see how any 'change' would allow the organisation to continue with the transaction.

NAMA's Head of Legal expressed an appreciation of PIMCO's position and of alternatives having been considered. She expressed disappointment but accepted the decision.[2] PIMCO stated that it would confirm its withdrawal in writing and PIMCO's external legal representative noted that it was clear that NAMA had not been aware of the 'finder's fee'.

It was agreed that NAMA and PIMCO should adopt an agreed approach to communications regarding the matter. They would consult with each other before responding to any comments. PIMCO indicated that it had not yet notified Brown Rudnick of its decision to withdraw and that it would be sensible to have a joint view of how to proceed. The notes then indicate that, in NAMA Legal's opinion, NAMA had no reporting obligations in regard to Lazard and there was "no need to take positive action". PIMCO would discuss with its external legal advisors how to communicate the decision to its (other) advisors. A call would take place on 13 March to discuss the communication of the message.

1 NAMA has stated that the context for this question was the conference call on 10 March 2014 during which PIMCO said that if its disclosure was an issue for NAMA, PIMCO would need to consider if the transaction could be progressed without the proposed recipients of the success fee.

2 NAMA has provided the following context which was not set out in the contemporaneous notes. The NAMA Head of Legal thanked PIMCO for bringing the matter to NAMA's attention and expressed disappointment only to the extent that what had been disclosed by PIMCO had effectively made PIMCO's withdrawal inevitable.