



NAMA upside

Conor Houlihan, partner with Dillon Eustace, discusses investment opportunities in Irish distressed debt

Ireland's well-documented property-fuelled boom has come to a crashing halt, leaving billions of euros of distressed assets on the loan books of the major Irish banks. As a result, Ireland is becoming a focal point for buy-out and distressed investment activity, with individual assets now changing hands at discounts of 50% and upwards.

In an effort to repair the Irish banking system, late last year the Irish government established a specific asset management body – the National Asset Management Agency (NAMA) – to acquire approximately €81bn face value of eligible assets from five Irish banks – namely AIB, Bank of Ireland, Anglo Irish Bank, EBS Building Society and Irish Nationwide Building Society. The overall portfolio size has recently been reduced, to exclude loans of less than €20m, in order to expedite the transfer process. It is estimated that this exclusion of smaller-scale developers will reduce the face value of the overall portfolio by €6.6bn.

Investment opportunities are emerging in relation to not only NAMA-related assets, but also other assets remaining on the balance sheets of the NAMA participating banks, as well as the loan books of non-NAMA Irish banks. Of course, pricing is a key issue.

Although the NAMA valuation methodology is prescribed by law, the discount or hair-cuts applied to date on these assets may be instructive. The weighted average discount for the loans acquired in tranches one and two was over 50% and for certain institutions was over 70%. Obviously certain assets within these portfolios suffered even higher discounts.

The process of NAMA acquiring assets from the banks is ongoing. At the end of August this year, NAMA had completed the acquisition of 3,518 individual loans with a nominal value of €27.2bn.

It is anticipated that NAMA will directly manage the 150 or so largest borrowers. The management of the remaining debtors will be delegated by NAMA back to the banks, who themselves will act as primary servicers for NAMA.

So what exactly is NAMA supposed to do with these assets? In a nutshell, its primary goal is to protect and enhance the value of the asset, and to do so in the interests of the State and the Irish taxpayer. Since acquiring the assets, NAMA has been engaging with debtors to assess their viability based on business plans that borrowers are required to prepare in good faith.

NAMA has indicated that it expects to see realistic targets of achieving a significant reduction of debt over a three-year horizon in order for a borrower to be considered viable. To be considered

viable by NAMA, debtors will generally need to be able to identify assets that can be realised or re-financed within three years to repay a substantial portion of the debt owed to NAMA. Where a borrower is not paying its loans and is not able to produce a sufficiently compelling case in its business plan, it seems likely that NAMA will foreclose on the secured property.

What does this mean for investors and where do the opportunities now lie? Clearly, market factors will influence the timing of asset sales. However, NAMA has indicated that it will not engage in the "speculative hoarding of assets".

In some cases, it may make sense for NAMA to make an additional investment in assets that it acquires; for example, if it was felt commercially viable to complete a particular property development.

In such cases, NAMA has indicated that it will be proactively seeking joint venture partners. Indeed, since the announcement of the establishment of NAMA there have been numerous approaches and expressions of interest to the Irish ministry of finance, to NAMA and to the Irish banks themselves from distressed debt investors and advisory firms looking to provide capital and/or expertise.

Given the sensitive Irish political and economic climate, NAMA is coming under intense pressure to start showing some value for the taxpayer – and in the process, help restore stability to the Irish banking system and the commercial property market. It therefore seems likely that NAMA's work over the coming months and years will – directly and indirectly – present a multitude of opportunities for investors.

The relative size of the NAMA portfolio, coupled with current market conditions, will no doubt make the task a difficult one. In such circumstances, a model whereby NAMA can reduce its current exposure while retaining a right to participate in any future upside will surely be strongly considered. We have seen some recent innovative refinancings by European banks that may serve as a useful precedent in this regard.

Of course, NAMA is not the only potential port of call for investors looking for openings in distressed assets. A recent review of the prudential capital requirements by the Irish Central Bank and Financial Regulator specified an amount of additional capital that needs to be raised by each of the banks.

Some, such as Bank of Ireland, have already completed an extensive capital raising exercise. Others, namely EBS, are reported to be in discussions with potential investors (including private equity funds) who have submitted proposals to acquire a stake in the building society.

In addition, work is ongoing on restructuring proposals for the two more distressed Irish financial institutions - Anglo Irish Bank and Irish Nationwide Building Society. It is expected that similar opportunities may also arise in relation to non-NAMA assets of the other NAMA banks and in relation to the non-NAMA banks operating in Ireland, some of whom are now signalling they want to exit the market.

The scope for banks to continue to "pretend and extend" may wane as the economic recovery becomes more protracted and there are greater incentives to resolve their impaired asset problems. Potential opportunities may take the form of joint ventures with the banks and debtors, individual loan and portfolio sales, securitisation or some other form.

There have already been some recent cases where the debtors and banks have successfully received additional capital commitments from outside investors in the form of new equity and an assumption of debt. There have also been cases where, rather than forcing a fire sale upon

liquidation, banks have done debt for equity swaps. Such as in the case of Anglo Irish Bank, Ulster Bank and the iconic Dublin department store, Arnotts.

However, while some further debt for equity swaps can be expected, it seems that this can only be a solution in a limited number of cases. As such, it may increasingly become the case that the only real solution to resolving non-performing loan issues will be for the banks to realise their losses through sales of these assets. By also transferring the management of such assets to investors who specialise in this area, the banks may in addition usefully free up resources to focus on rebuilding their businesses.

This article was published in [Structured Credit Investor](#) on 20 October 2010.