In Focus

Bank Deleveraging in Ireland – Where to from here?

Introduction

Since the start of the financial crisis in 2008 there has been widespread coverage of the need for banks in Ireland to deleverage their balance sheets. The banks have made significant progress on deleveraging during this period. The main focus to date has been on the disposal of non-core assets located outside Ireland. The question now is where the bank deleveraging process will go from here. This Briefing summarises what has happened to date and examines potential future trends and opportunities relating to bank deleveraging in Ireland.

NAMA

Since its establishment in 2009, the National Asset Management Agency has acquired bank loans with a total value of €74 billion from the Irish participating institutions at an average discount of 57%. This is the most significant deleveraging step taken to date. NAMA is now a very significant player in the Irish property and property finance markets and is also a significant player in the Northern Irish and British markets.

NAMA's CEO Brendan McDonagh recently announced that having completed its acquisition phase, the Agency is now moving into a new phase of managed disposals of property and loan assets. In pursuing its sales strategy NAMA will implement innovations to attract international investor capital and increase activity in the market. It has established two loan sales advisory panels, one for Europe and one for the US, and will pursue an active and structured marketing strategy for loans.

NAMA currently has over 1,100 properties listed for sale, with many more to follow. 72% of the properties currently listed for sale are located in Ireland, 13% in Northern Ireland and 15% in Britain. The Agency reports ongoing engagement with potential investors and growing overseas interest in acquiring Irish commercial assets, particularly prime office and retail properties in Dublin.

NAMA cites falls in commercial property prices of up to 65% from peak, yields of over 8% on investment assets and recent Irish tax incentives (see below) as factors contributing to investor interest. The Agency is offering vendor finance for appropriate projects at a minimum margin of 2.5% and up to 70% LTV to stimulate investor interest. NAMA is also working with the Irish Development Agency to identify potential sites which could facilitate foreign direct investment projects in Ireland.

NAMA has announced that it intends to launch a Qualified Investment Fund (***QIF***, see below) in 2012. The Agency may launch sub-funds based on regional or sectoral portfolios to attract institutional investors such as pension funds, sovereign wealth funds and private equity buyers.

NAMA has stated that it will repay €7.5 billion of its outstanding bonds by 31 December 2013. Clearly, NAMA's loan and asset sale performance will be a key factor in meeting these bond repayments.

Irish Banks

Many of the Irish institutions have already disposed of overseas subsidiaries and businesses as well as certain Irish assets, such as insurance and financial services subsidiaries, that are regarded as non-core. The focus is now turning to the disposal of Irish loan portfolios and distressed Irish property assets. There is considerable international interest in Irish loan portfolios and property assets from private equity funds, sovereign wealth funds and other specialist investors. The following is an overview of some of the main developments:

- **Deleveraging Targets:** The IMF/EU Programme for Ireland requires significant asset disposals by the Irish banks to meet the target loan to deposit ratio of 122.5% by end 2013. Allied Irish Banks (***AIB***), Bank of Ireland (***BoI***) and Irish Life & Permanent (***ILP***) are to dispose of €34 billion in aggregate of non-core assets by end 2013 under the Programme. AIB, BoI and ILP are all engaged in loan portfolio sales processes. Each bank has a defined non-core disposal team actively managing loan disposals under the supervision of the Department of Finance with regular reporting to the IMF/EU. The Central Bank is reported to be in discussions with the IMF/EU on the timing and structure of the deleveraging programme so as to control potential losses on sales for the Irish banks. The outcome of these discussions will be key in determining the future profile of the deleveraging process.

- **Irish Bank Resolution Corporation:** The former Anglo Irish Bank and Irish Nationwide are now merged as Irish Bank Resolution Corporation. IBRC is being resolved and wound down over the next 5-10 years and as part of that process it will dispose of its remaining assets and loans. IRBC has a loan book of approximately €25 billion (after the sale of its US loan portfolio). Over 70% of the loans are commercial property loans.

- **Disposals by non-Irish owned banks:** Bank of Scotland (Ireland) Limited (a subsidiary of UK Lloyds) has ceased lending in Ireland and is winding down its Irish operations. Its loan book is approximately €27 billion, comprising approximately €11.6 billion of commercial loans, €8 billion of corporate loans and €7.6 billion of retail loans. MBNA Ireland has recently announced the sale of its Irish credit card business to funds managed by Apollo. Recent media reports suggest that Ulster Bank (the local RBS subsidiary) is to sell up to €1 billion worth of assets.

Sale Structures

There are a number of attractive and tax efficient structures that can be utilised in Ireland to implement loan or asset portfolio sales. For example:

- **Qualified Investor Funds (QIFs):** Ireland is a globally recognised jurisdiction in which8/ to establish and administer regulated investment funds, including QIFs. QIFs can be used for bespoke investments such as property and loan portfolios. QIFs are aimed at sophisticated investors who meet minimum net worth and minimum subscription tests. QIFs enjoy specific tax benefits, a key one being that non-Irish resident investors are not subject to any charge to Irish tax on the income or gains on the assets held by the fund. The authorisation process for QIFs is fast-tracked by the Central Bank of Ireland and QIFs are subject to less ongoing regulatory requirements than retail funds. The Irish Stock Exchange provides a streamlined listing process for QIFs.

- **Section 110 Companies:** Irish special purpose companies known as Section 110 Companies can also be used to acquire loan portfolios and other assets. A Section 110 Company can be established as an effectively tax neutral vehicle. While Section 110 companies are subject to Irish corporation tax, due to the generous rules regarding deductibility of expenditure it is generally possible to structure a transaction so there is little or no taxable profit. Section 110 Companies benefit from a range of Irish tax advantages and can avail of Ireland's double tax treaty network with in excess of 50 countries. Section 110 Companies can also be combined with QIFs to facilitate loan portfolio transactions.

- **Credit Institutions (Stabilisation) Act 2010:** The Stabilisation Act allows the Irish Minister for Finance to apply to the High Court for an order to transfer specific assets of an Irish State guaranteed bank notwithstanding certain legal and contractual restrictions that would otherwise apply. This Act could be availed of in appropriate circumstances by certain of the Irish banks to transfer bank assets where this would otherwise be problematic.

Tax and Other Incentives

The 2012 Irish Budget focused on stimulating the Irish property sector and broader economic growth. Key measures included:

- **Stamp duty Reduction:** Stamp Duty on all commercial property is now 2% (reduced from 6%). Stamp duty on residential property remains at 1% up to €1 million and 2% above €1 million.
- **Capital Gains Tax (CGT) Exemption:** No CGT in respect of gains accrued over the first 7 years of ownership for property purchased between 7 December 2011 and end of 2013 and is held for at least 7 years.

In addition, upward only rent reviews in existing leases will not be changed. The Government's proposed change to the law in this area has been reviewed and will not now occur.

Loan Servicing

There has been increased interest in loan servicing capabilities in Ireland. Many financial investors require a suitable servicing arrangement for loan assets, either on a transitional or longer term basis. Often the vendor or one of its affiliates provides the necessary servicing, at least initially. There is demand however for independent loan servicing in Ireland for residential and commercial portfolios. A number of specialist loan servicing firms have established or are in the process of expanding in Ireland to meet this demand.

Conclusion

The bank deleveraging process is taking place in Ireland against the backdrop of similar bank deleveraging in the UK, across Europe and elsewhere. In addition, many overseas banks have operations or subsidiaries in Ireland as outlined above and the deleveraging programmes of these institutions will in many cases directly affect the Irish market. The main focus to date for the banks in Ireland and NAMA has been selling non-Irish assets. The focus is now shifting to selling Irish located assets.

The Irish banks are in many instances required to deleverage to meet IMF/EU Programme targets and they will need to continue their deleveraging programmes on a phased basis to meet these requirements. NAMA, the Irish banks, potential investors, the Central Bank, the Department of Finance and other market participants are monitoring deal activity closely to establish price levels in the Irish market. We are seeing increased interest and activity in this area and it appears that the bank deleveraging process is set to gather momentum during 2012 and 2013.

A&L Goodbody Bank Deleveraging Group

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