

Could NAMA be Ireland's Largest Hotelier?

The advent of NAMA could have a massive affect on the Irish hotel industry, reports DR STEPHEN KINSELLA.

Dr Michael Somers, the chairman of the National Treasury Management Agency (NTMA), just might end up the largest hotelier in Ireland in 2010.

The NTMA is the body responsible for the creation of the National Asset Management Agency, or NAMA. NAMA's job is to buy so-called 'impaired' assets from troubled banks at a steep discount, using money borrowed from the international bond markets, the bonds underwritten by the future taxes of the Irish citizen.

The economic logic behind exchanging good debt for bad debt is simple: Ireland needs functioning banks to lend out credit to businesses, who can then employ people and produce things, and that productive activity will restart the economy.

Think of the problem in terms of an individual hotel that needs credit to pay its debts during a downturn in the market for its services. Many Irish banks find themselves unable to borrow sufficient funds to restart lending, because of too much potentially bad debt relative to their deposits. Because banks can't (or won't) lend, they don't extend enough credit to the hotel, and the hotel either finds money elsewhere, lets staff go to reduce its variable costs, trims its operations, or closes altogether. Without a functioning banking sector, the economy is, to use a technical term, toast. NAMA is currently being designed to avoid the immolation of Irish banks by under capitalisation, which stems fundamentally from the uncertainty of international investors surrounding the property-related loans on their books. No one has any idea which loans will go bad. Rather than take the chance, the investors choose not to invest, and this is crippling the banks. NAMA will remove the uncertainty surrounding the viability of individual banks' balance sheets.

Here's an example of how NAMA might work, from the banks' point of view. Say the bank has lent €200m to John Smith, so John can buy land, and develop it. John wanted to sell the developed property for €400m, and pay off the bank once he's sold off the development. Since the property market has collapsed, John can't sell the developed land, especially if it isn't fully developed. So John represents a potential bad debt to the bank. John, and the banks which lent to him, are in trouble. John might choose to go into liquidation or bankruptcy. He might throw the keys to the sites back at the banks, which, if enough developers like John did that, would sink every bank simultaneously, because they can't borrow enough on the open markets to write off such massive bad debts

and still balance their books. The bank can't borrow on international capital markets to finance any of its other projects, because the markets are worried about just how many Johns there might be on the books of the banks. Reducing this uncertainty is at the heart of what NAMA is supposed to achieve.

NAMA will exchange Government bonds, which are as good as money, for John's €200m worth of loans. The bank will be paid €140m, say, of the €200m loan, and hopefully go about its business as before. John will still owe €200m, but now he will owe it to NAMA rather than an individual bank or banks. NAMA will sit down with John and work out a payment schedule and an interest rate. If John cannot pay, or if there are legal proceedings taking place, NAMA may also be able to seize John's land. Either way, the banking system can return to normal, leaving the Government (via NAMA) holding a large number of loans, with mostly land as collateral on those loans. It stands to reason that at some point, the Government will want to sell off that land, and hopefully for a profit. This was the Swedish experience in the 1990s, when they attempted a version of NAMA (although on a much smaller scale than we are trying it). The Swedes actually made a small profit from sales of their seized land, and this did not cost the taxpayer very much.

There are substantial issues NAMA has not yet solved. The legislation to create NAMA is being written over the summer, to be enacted in the autumn. First, the actual marked down price of each impaired loan (and corresponding asset) must be worked out, case by case, and these calculations are not trivial ones – we won't see a 60% discounted price for every asset, which I assumed in the example. So we have a problem: NAMA needs to do something complex, which requires a lot of time, like getting a fair valuation on a property, in a simple manner, and quickly. There is great scope in this for complete failure.

Here a balance must be struck. Each bank requires a transfer of capital from the Government for the impaired assets they no longer wish to hold. If the price is too low, the banks will need to be recapitalised. Thus the price of the assets paid by the Government must be greater than the minimum level required to keep the banks afloat, then the banks will be nationalised in any case.

If NAMA works, banks get a clean balance sheet, and return to business as usual. The taxpayer gets a large stock of impaired assets. Because of the recent property bubble and its subsequent collapse with

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Hotels	838	847	851	858	854	846	853	805	850	904	920
Rooms	36,282	39,656	40,008	41,983	43,043	43,178	45,480	44,610	51,774	57,282	60,548
Overseas Visitors	5,943,000	6,181,000	5,840,000	5,919,000	6,178,000	6,384,000	6,763,000	7,417,000	7,739,000	7,435,000	—
Domestic Trips**	4,167,000	3,678,000	4,244,000	4,166,000	4,366,000	4,851,000	4,875,000	5,056,000	5,522,000	5,683,000	—

* Hotel and room numbers as of 1 January each year

** Domestic trips exclude visits to friends and relatives (VFRs) – 3,118m (99); 1.8m (00); 2.063m (01); 2.286m (02); 2.291m (03); 2.24m (04); 2.298m (05); 2.254m (06); 2.42m (07); 2.656m (08)

SUPPLY OUTSTRIPS DEMAND

As the table above illustrates, hotel development in Ireland accelerated at a far greater pace than tourism numbers increased over the last decade.

While the number of actual hotels has increased by just seven per cent over a 10 year period, there has been a 57% increase in total room numbers. During the same period, the number of overseas visitors travelling to Ireland rose by 25% while domestic trips (excluding VFRs) increased by 36% showing that supply has outstripped demand.

While a number of smaller hotels have closed during the decade, in many instances old hotel stock has been replaced with larger properties with far greater room numbers. The average hotel in Ireland contained 43 guestrooms in 1999, compared to 63 in 2008. On average today, hotels offer 46% more rooms than they did 10 years ago.

all the attendant miseries for every part of the economy, workers and capitalists alike, most of the assets NAMA does end up with will be property-based. NAMA will be in the business of managing a land bank.

Some of this land, undoubtedly, has hotels built on it, which is why Dr Somers might end up being Ireland's largest hotelier in 2010.

The important question is: what will NAMA do with these hotels, given the slump in foreign visitors to Ireland in 2008 and 2009, and assuming this is likely to continue into 2010 as the world economy continues to falter?

Overall numbers of visitors to Ireland have fallen precipitously since their peak in late 2007. In the first five months of this year overseas visits have fallen by 9.6% while in May alone visits plunged by 18.4% on the corresponding period in 2008. While the industry is pinning much of its hopes on the home holiday market, first quarter figures from the CSO show that spend on domestic trips fell by 9.8% in the first three months of this year, while the number of nights spent away declined by 8.8% and the total number of domestic trips dropped by five per cent. 'Demand', to use one of the economists' terms, is well down. A range of policies designed to foster capital expenditure in the tourism sector has seen the number of hotels built since 1999 jump from 838 hotels to 920 hotels currently. The type of establishment has also changed, with each new hotel on average larger, and with more rooms, than older hotels. The number of hotel rooms has increased from 36,282 rooms in 1999 to 60,548 rooms in 2009. So the supply of accommodation, to use another economist's term, has increased.

In a given market, like the one for guestrooms, when supply exceeds demand, we have a surplus of empty hotel rooms. Empty guestrooms mean that many hotels will find it hard to cover their operating costs, and may be forced out of business as a result. The loans taken out to start each newly-failed hotel's business will be examined by the banks holding those loans, and a decision will be taken on what to do, case by case.

If economic conditions (and with them domestic and overseas visitor numbers) continue to worsen, many of the new hotels bought and developed over the years of the boom may find themselves among the portfolio of loans, land, and impaired assets being transferred by the banks over to NAMA's stewardship, making Dr Somers (or his appointee to run NAMA, Mr McDonagh) the largest single hotelier in Ireland. So, could NAMA become Ireland's biggest hotelier? Yes, it is quite possible.

What could that mean for the hospitality industry? For starters, the hospitality industry is, like the banks, systematically important to the Irish economy. Hospitality services directly employ more than 330,000 people – that's more than the entire Public Sector – and contribute more than €4bn to the Irish economy. The hotels and lands soon to be owned by NAMA may become political footballs, they may remain as going concerns with restructured loan agreements, or they may be folded all together and sold off when the markets attempt a recovery. Perhaps a mixture of all three eventualities will take place, on a case-by-case basis.

NAMA is initially tasked with ensuring the stability of the banking sector, and hence the entire economy. But, if NAMA becomes deeply enmeshed in other, equally large, areas of the Irish economy like tourism, a mission-creep might take place. Suddenly NAMA's responsibility for a vast property and business portfolio may also become dependent on supporting tourism, itself keyed to the pulse of the international economy as well as the domestic economy. The complexity of each property valuation will expand exponentially.

No solution is likely to be optimal, but a largely nationalised state run hospitality industry is a distinct possibility, as is the possibility of lucrative contracts to manage these new 'semi-state' hotel chains, and, further along, the option to cherry pick the best of these properties and businesses for the wily investor. The future certainly contains the seeds of a contraction in the tourism sector, and what role NAMA will play in this contraction remains a mystery. ♦

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