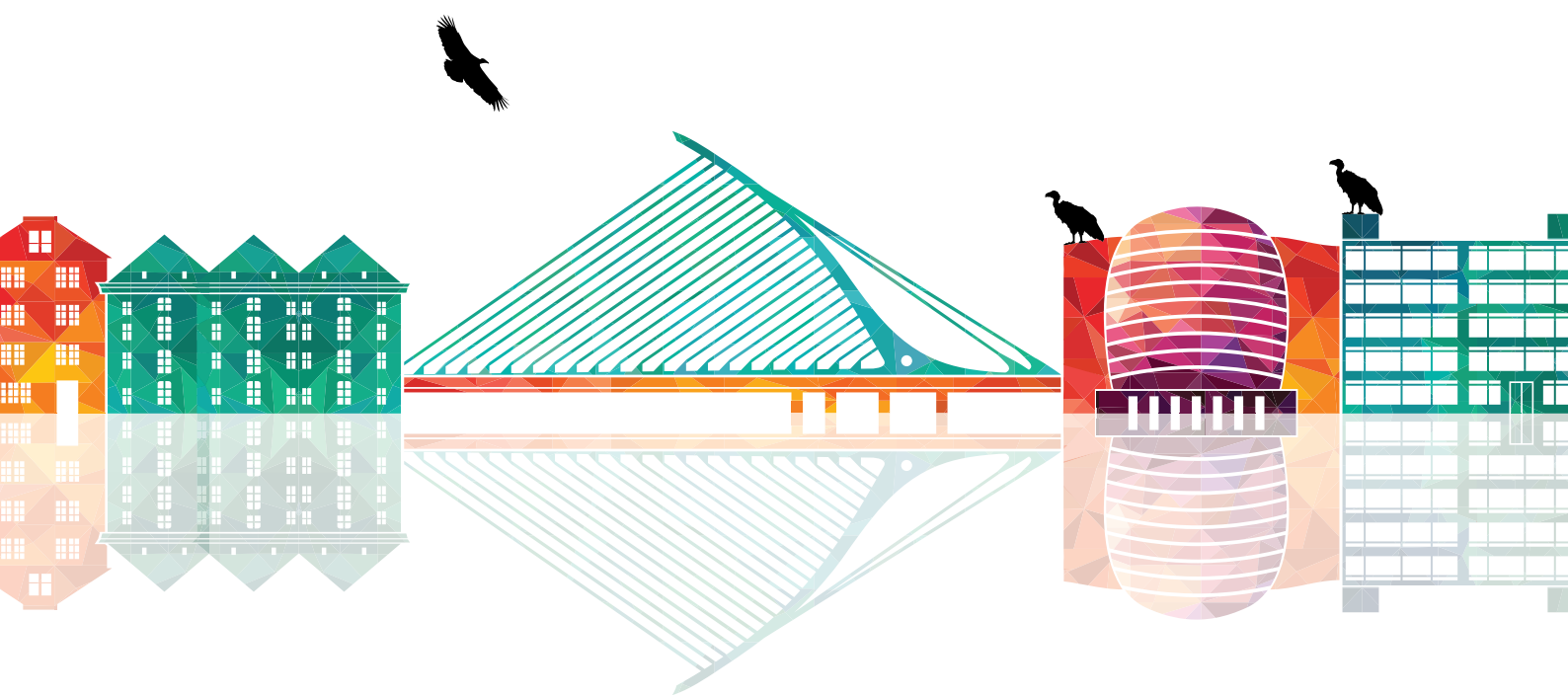


FROM PUERTO RICO TO THE DUBLIN DOCKLANDS;

Vulture funds and debt in Ireland
and the Global South



Debt and Development Coalition Ireland (DDCI) is a membership organisation working for global financial justice.

This report was commissioned by DDCI and written by Dr. Michael Byrne.

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1. Introduction

Vulture funds have become familiar to those concerned with debt justice over recent decades. Because of their speculative strategies and negative impacts on sovereign debt restructuring, they have come to symbolize the highly unequal and unjust nature of sovereign debt. Initially a subject of concern for those concerned about financial justice in the global south, in the last few years, vulture funds have been circling Europe. In Ireland, they have become major investors in real estate and owners of huge amounts of property and land in Dublin and across the country. While the funds in question are not household names, the important role they play should not be underestimated.

Vulture funds are typically hedge funds or private equity firms who invest in distressed debt. Two types of speculation vulture funds engage in – on sovereign debt and on real estate – involve different strategies and tactics. When investing in sovereign debt vulture funds pursue a ‘litigious’ strategy, aggressively using the courts and legal action against debtor nations. By contrast, investment in real estate and debt linked to real estate centres on using control over debt to squeeze underlying assets for maximum profit. What both approaches share is their focus on distressed debt; when loans go bad they create particular opportunities to achieve super-normal profits. This means that economic crisis becomes the natural hunting ground for vulture funds. This report examines how speculative investment in distressed debt works and looks at some of the companies involved, tracing the links between Ireland’s ‘property give away’ and the predatory practices of vulture funds in the global south. It analyses the economics and politics of distressed debt as a particular form of financial speculation and raises wider questions about the power of the financial system and the role of debt in our economies and societies. The report tries to document the negative social impacts and risks associated with the buying up of bad debt by global financial firms.

Despite the problems and risks associated with this kind of investment the Irish government has whole-heartedly embraced vulture funds. Indeed the latter’s aggressive entry into the Irish market could not have occurred without two major public financial institutions: the Irish Banking Resolution Corporation (IBRC) and the National Asset Management Agency (NAMA). Both these institutions were established in response to the Irish financial crisis, and yet by facilitating the arrival of vulture funds they have contributed to reproducing and reinforcing systemic risks.

The report is structured as follows: it begins by introducing vulture funds and the markets in which they operate. It then described the role of vulture funds in sovereign debt crises in the global south. The report goes on to explore their role in real estate investment in Ireland in the wake of the financial crisis, the risks this gives rise to and the role of the Irish government and public institutions in making it possible. The report concludes with an analysis of the significance of vulture funds and distressed debt investment in the wider context of global financialization and the systemic risks at stake here, and advances a number of recommendations.

Vulture funds are typically hedge funds or private equity firms who invest in distressed debt.

2. Vulture funds: speculating on debt and crisis

Vulture funds are a particular type of financial firm and financial investor. They usually take the form of private equity firms or hedge funds and their defining characteristic is that they specialise in investing in 'distressed debt'. Debt can be understood as 'distressed', also referred to as 'non performing' or 'toxic', when the debtor is no longer making full loan repayments and is therefore in breach of their obligations under the loan contract, or when there is a high risk that this will happen. In other words, a debt which is in or close to default. There are many different ways in which this can happen, for example when a state experiences a debt crisis due to economic decline and stops repaying its creditors.

Some debts are also secured by an underlying asset, such as a property. For example, mortgage loans are linked to the house such that the creditor (the bank or mortgage provider) may repossess the house if the debtor fails to meet their obligations under the terms of the loan. A secured debt of this nature can also sometimes be considered to be distressed when the value of the underlying security has depreciated (often referred to as negative equity in the case of property). Both forms of distressed debt may occur at the same time, for example a property developer can fail to make his or her debt repayments while at the same time the properties associated with those debts can decrease in value. A key factor which makes the role of vulture funds possible is the fact that debt can be bought and sold, i.e. traded on financial markets through the secondary debt market or secondary bond markets (for more on bonds, see section 3 below).

Secondary markets increase the overall availability of finance¹. If lenders can 'cash out' of their borrowing then lending is less risky; lenders have the option of changing their mind after signing the proverbial dotted line. The secondary markets are thus a way in which the financial system can manage and disperse risk.

This is why many mainstream commentators see secondary loan markets as improving the efficiency of markets. In reality, the global financial crisis demonstrated that 'managing risk more efficiently' in fact led to wildly excessive debt levels and the embedding of systemic instability at a global level.

Like other forms of debt, distressed debt can be bought and sold. It is easy to understand why a creditor would want to sell distressed debt, given that the debtor is either likely to default or already in default. But why would an investor wish to buy distressed debt? The reason is that distressed debt is extremely cheap and if a company can find a way to make the investment come good they can make profits that far exceed what can be made from more standard forms of investment. The new owner of the loan, it is important to note, continues to be legally entitled to collect the entire outstanding loan balance, regardless of how little they paid to buy it².

Buyers of distressed debt, such as vulture funds, can pursue various 'investment strategies' to make money from the bad loans they take on. However, because they are focused on buying the debt of borrowers who are in economic difficulty and often in the context of economic and financial crisis, vulture funds, by their very nature, must pursue aggressive and sometimes unusual strategies to recover their investment. This can include seizing underlying securities or even bringing the borrower to court in pursuit of full repayment of the loan (as in the case where vulture funds target sovereign debt, discussed further below). These strategies can be risky, however, and hence vulture funds seek super-normal profits to justify taking on greater risk. Super-normal profits are possible because vulture funds strike in situations of crisis, when a borrower or sometimes an entire economy has hit rock bottom. This is where they get their name from: they speculate on the carcass of a company or an economy.

¹ Bai, J. (2013). 'Stop them circling: Addressing vulture funds in Australian law'. *Sydney L. Rev.*, 35.

² The original loan balance is usually referred to as the 'par value'.

3. Vulture funds and sovereign debt in the global south

Vulture funds make use of a very specific strategy in sovereign debt crises. Their aim is to derive super-normal profits by investing in heavily distressed debt and pursuing aggressive litigation against debtor nations³. Governments the world over typically borrow by issuing bonds⁴. Bonds are contracts for repayment which set out the amount to be repaid, the interest rate, when the loan has to be repaid and related legal matters. However, countries often find themselves in a situation where their debt becomes unsustainable and they are forced to either stop paying their debt or renegotiate the terms of their debt, a process referred to as restructuring. Because of global inequalities and political instability, countries in the global south often find themselves renegotiating debts incurred by dictators and other undemocratic regimes⁵.

When a country faces severe economic crisis and the situation is critical, debt restructuring can be in the interest of both creditors and debtors. From the creditor point of view, 'you can't draw blood from a stone', i.e. it is better to cut your losses and get some of the debt repaid. However, creditors have a second option: selling the bonds they hold on secondary markets. Because in this case the bonds are from a country in a period of acute crisis and on the verge of default or debt restructuring they are a form of 'distressed debt'. The risk of failure to repay in full is extremely high and indeed the terms of the bond may have already been breached. To achieve super-normal profits, vulture funds pursue litigation against the debtor nation as their principal business strategy⁶. Bond holders can take the debtor nation to court and thus legally seek payment to the full original value of the bond, despite the fact that they bought the bond for considerably below its original value.

The most recent high profile case of this sort concerns Argentina⁷. The country's current debt difficulties originated with the huge volumes of debt incurred under the military dictatorship during the late 1970s and early 1980s. Argentina later signed up to an IMF structural adjustment programme which saw the country draw down new borrowings but forced the country to implement harsh austerity measures which further entrenched economic decline. By 2001 the debt burden was widely regarded as unsustainable and Argentina defaulted. International pressure from both the IMF and creditors led to two rounds of debt restructuring in 2005 and 2010. By the end of this process of renegotiation, Argentina had achieved a reduction in the nominal value of the bonds, lower interest rates and longer maturity terms. 92.4% of debt was restructured and the process was considered highly successful. However, this left 7.6% of debt unstructured and the holders of some of that debt include a number of vulture funds.

Vulture funds began purchasing Argentinian sovereign debt in 2001, achieving very low prices given the impending default. They have consistently sought to force Argentina to pay back the full original value of the bonds, thus undermining the debt restructuring process. The funds have pursued a number of legal actions against Argentina as well as somewhat spectacular and controversial asset seizures⁸. In February 2012, these strategies came to fruition when the vulture fund NML Capital brought a successful court action in New York. Judge Thomas Griesa ruled in favour the vulture fund on the basis of a somewhat controversial interpretation of the now infamous *pari passu* clause which stipulates that no creditor should be treated preferentially.

3 According to the African Development Bank Group, vulture funds have averaged rates of recovery of between 3 and 20 times their investment. They cite a recent case against Zambia in which a vulture bought sovereign debt for \$3 million and was awarded \$15.5 million after suing for full payment URL: <http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/>

4 Many countries of the global south converted sovereign debt into tradeable bonds (so called 'Brady bonds') in the late 1980s

5 Ambrose, S. (2005). 'Social movements and the politics of debt cancellation'. *Chicago Journal of International Law*, 6.

6 Bai, J. (2013). 'Stop them circling: Addressing vulture funds in Australian law'. *Sydney L. Rev.* 35.

7 For a fuller account of the Argentinian case see the recent DDCI report 'Toward justice centred debt solutions: lessons from Argentina', URL: http://debtireland.org/download/pdf/towards_justice_centred_debt_solutions_2015.pdf

8 Kupelian, R. and Rivas, M. S. (2013). Vulture Funds: The lawsuit against Argentina and the challenge they pose to the world economy. Centro de Economía y Finanzas para el Desarrollo de la Argentina (CEFID-AR), Working Paper 49

The implications of this ruling have been devastating for Argentina. At the most immediate level, there are three principal difficulties for the country if it complies with the ruling. First of all, it will involve paying NML the full original value of the bonds. NML is reported to stand to make 1600% profit if this happens, but for Argentina it means giving money to a hedge fund which could be much better spent on public services and economic development. Second of all, this sends a strong signal to the remaining 'hold outs' (the other holders of the 7.6% debt which was not restructured) to pursue similar lawsuits exposing Argentina to yet more debt repayments. Finally, the remaining 92.4% of creditors who did participate in the restructuring process may now have grounds to renege on the process and pursue full repayment, a turn of events which would push Argentina into a new sovereign debt crisis, and likely default, thus perpetuating the debt spiral. Similar cases have occurred in many heavily indebted countries in the global south⁹.

The nature of secondary bond markets mean a country's debt can be bought up anywhere in the world by funds who are unaccountable and lack transparency¹⁰. Many are based in tax haven jurisdictions with weak regulation. They encourage creditors and other investors to engage in 'hold out' behaviour and foment speculation on sovereign debt. All of this has very real consequences; debt repayments add to and reinforce the chronic lack of health care, education and other essential services in countries of the global south. The 'investment strategy' pursued by vulture funds is thus extremely damaging to the whole process of sovereign debt restructuring, undermining the very possibility of achieving meaningful agreement with creditors through renegotiations¹¹.

To achieve super-normal profits, vulture funds pursue litigation against the debtor nation as their principal business strategy.

9 For example Sierra Leone, Cote d'Ivoire, Burkina Faso, Angola, Cameroon, Congo, Democratic Republic of the Congo, Ethiopia, Liberia, Madagascar, Mozambique, Niger, Sao Tome and Principe, Tanzania, and Uganda.

10 Gentile, C. M. (2010). 'The market for odious debt', *Law and Contemporary Problems*, 73.

11 EURODAD (2014). Tackling the Vultures: Briefing on legislative action to address vulture funds. URL: <http://www.eurodad.org/Entries/view/1546364/2014/09/11/Tackling-the-Vultures-A-briefing-on-legislative-action-to-address-vulture-funds>

4. The vultures come to Europe

Until recently vulture funds were almost exclusively associated with countries in the global south and speculation in sovereign bond markets. The global financial crisis, however, led to the proliferation of distressed debt in Europe and across the global north. For many private equity firms and hedge funds, this crisis was an opportunity to buy up cheap financial assets and pursue enormous short term profits.

The first signs of vulture fund investment in European distressed debt arose during the Eurozone sovereign debt crisis. Following the debt restructuring process in 2012, Greece was forced to pay out to vulture funds who had bought billions of euro worth of distressed debt at a discount. Marathon Capital Management, a major investor in Irish distressed debt, was reported to be one of the 'hold outs' (see Case Study III). There was also speculative investment in relation to the debt of Irish banks. In response to the financial crisis, the Irish government issued a blanket guarantee of six domestic banking institutions covering both deposits and liabilities. Moreover numerous banks became effectively nationalised. A number of vulture funds bought discounted bonds which had been issued by these banks and initiated litigation to frustrate Irish government attempts to impose losses on some sets of bondholders (see Case Study II). The firms involved included Aurelius Capital Management and Fir Tree Partners; the former was also involved in vulture strategies in relation to Argentine debt.

4.1 The European financial crisis: an investment opportunity for vulture funds

While the European sovereign debt crisis may have attracted the first vulture funds in search of big profits on distressed debt, the real feeding frenzy was unleashed in real estate debt markets from 2013. Economic growth in the euro area and the massive profits made by financial firms in the late 1990s and early 2000s were heavily linked to property speculation. Property prices grew rapidly in many European countries, in particular Ireland, Spain and the UK. Banks lent heavily to property developers to build houses, office blocks, shopping centres, hotels and other types of development. When the 'credit crunch' hit in 2008, however, property prices collapsed rapidly. While we often associate the property crash with countries like Ireland and Spain, in reality the crash went far beyond these countries. Many other countries experienced bubbles in residential and commercial real estate (including the UK, Greece, Latvia, Hungary and many others) Moreover, much

of the money invested in property in the peripheral European countries came from banks in the so-called core countries such as Germany, France and the UK¹².

The European property crash led to an avalanche of distressed debt in Europe. There are three key reasons for this. Firstly, borrowers were unable to repay their loans. This is true of many ordinary mortgage holders as well as for large scale property developers. Secondly, the value of the properties securing the loans (i.e. the loan collateral) declined sharply. Finally, these two problems extinguished demand for loans associated with real estate (i.e. the market in financial assets linked to real estate froze). This is the context in which vulture funds began to see the opportunity for super-normal profits.

Current estimates suggest that there are up to €879.1bn of 'non-performing loans' (i.e. distressed debt) held by European banks¹³. Most of this relates to property loans. Cushman and Wakefield estimate that there is over €541bn of distressed real estate debt in Europe. We are speaking of enormous quantities of financial assets here, worth several times the entire Irish economy, and hence representing exceptional opportunities for investment. It is also worth noting that much of this debt is held by public Asset Management Companies (AMCs) or 'bad banks'¹⁴, such as Ireland's NAMA and Spain's SAREB (see Table 1). 43% of all distressed real estate debt, or €233 billion is held by these entities. This debt is concentrated in the countries most heavily hit by the financial and property crisis – in particular Ireland, Spain and the UK.

The vast majority of this bad debt is being snapped up by global vulture funds, in particular US based private equity firms (See Table 2). Private equity firms accounted for an estimated 76% of such transactions in 2014¹⁵. Global giants like Cerberus, Lone Star Capital and Blackstone are among the top investors.

12 See Observatorio Metropolitano (2012) *Crisis and Revolution in Europe*. Madrid: Traficantes de Suenos. URL: http://www.observatoriomropolitano.org/wp-content/uploads-observatorio/2012/05/CR_eng_02.pdf

13 BTG Global Advisory (2015). *European Insight: the NPL market Europe 2015*. URL: http://www.btgga.com/assets/uploads/insights/1383%20Capital%20Markets_EMAIL.pdf

14 AMCs or 'bad banks' are agencies established by governments to acquire and manage distressed debt from the banking sector. They are seen as an important mechanisms in resolving systemic financial crises. For a fuller discussion see Byrne, M. 2015. 'Bad banks: the urban implications of Asset Management Companies', *Journal of Urban Research and Practice*, 8(2) 255-266.

15 Cushman and Wakefield (2014). *European Real Estate Loan Market Q3 2014*. URL: <http://www.worldpropertyjournal.com/downloads/European-CRE-Loan-REO-Sales-Market-Q3-2014.pdf>

Table 1. European Public Asset Management Companies.

Name	Country	Est.	Total original assets	Current assets	Current assets as % of original assets
Nama	Ireland	2009	€73.4bn	€52.2 bn	71%
EAA	Germany	2009	€15.9bn	€0bn	0%
KA Finanz	Austria	2009	€3.6bn	€0.7bn	19%
FMS	Germany	2010	€19.7bn	€7.3bn	37%
UKAR	UK	2010	€107bn	€71.8bn	67%
IBRC	Ireland	2011	€21.9bn	€0bn	0%
SAREB	Spain	2012	€107bn	€87.2	82%
Propertize	Netherlands	2013	€7.4bn	€6.5bn	88%
DUTB	Slovenia	2013	€1.3bn	€1.3bn	100%
BES bad bank	Portugal	2014	€2.9bn	€2.9bn	100%
Finansiel Stabilitet	Denmark	2008	€3.1bn	€1.9bn	61%
HETA	Austria	2014	€1.6bn	€1.4bn	89%

All figures are approximate. Source Cushman and Wakefield (2015). European Real Estate Loan Markets Q2 2015.

URL: <http://www.cushmanwakefield.com/~media/global-reports/European%20CRE%20Loan%20%20REO%20Sales%20Market%20Q2%202015.pdf>

Table2. Top ten investors in distressed European real estate debt, Q2 2015.

1	Cerberus
2	Deutsche Bank/Apollo
3	Lone Star
4	JP Morgan
5	Oaktree Capital
6	Fortress/Eurocastle
7	Sankaty
8	Blackstone
9	Goldman Sachs
10	Otto Group

All figures are approximate. Source Cushman and Wakefield (2015).

European Real Estate Loan Markets Q2 2015.

URL: <http://www.cushmanwakefield.com/~media/global-reports/European%20CRE%20Loan%20%20REO%20Sales%20Market%20Q2%202015.pdf>



4.2 Ireland's great property give away

Ireland has been the main focus of vulture funds investing in distressed European real estate debt, particularly in 2014. The market for distressed debt was formed when a number of foreign banks moved to sell their Irish loan portfolios, in particular Danske Bank, Lloyd's bank and Ulster Bank/RBS. However, what has really driven the market has been the two Irish AMCs or 'bad banks': the National Asset Management Agency (NAMA) and the Irish Banking Resolution Corporation (IBRC). The latter was formally Anglo Irish Bank, a financial institution which has become synonymous with reckless lending. Anglo was nationalized by the Irish government and converted into the IBRC, which was tasked with disposing of the bank's assets, much of which are loans linked to commercial real estate. The IBRC was liquidated in 2014 thus dumping a huge quantity of assets onto the market in one go. NAMA was set up in 2010 to acquire and manage distressed property loans from across the banking sector. It acquired €72bn worth of large scale (upwards of €5 million) real estate loans from five domestic banks, representing a staggering 47% of Irish GDP at the time. NAMA's job is to sell these assets off, with a deadline of 2020 to sell all assets. Under pressure from both the Irish government and the Troika NAMA has been selling huge volumes of assets in a very short space of time.

The IBRC and NAMA combined were the largest vendors of distressed real estate assets in Europe in 2014. Out of €96.7 billion of distressed real estate asset sales in Europe in 2013 and 2014, an incredible €36 billion related to assets sold by the two agencies¹⁶. In order to appreciate the intensity of this speculative feeding frenzy it is worth bearing in my mind Ireland's tiny size compared to other European countries. Almost all of this debt is being bought by private equity firms and hedge funds. The Texas based Lone Star Capital bought 60% of all assets brought to market by IBRC. 90% of assets sold by NAMA went to US firms and NAMA CEO Brendan McDonagh confirmed that the "vast majority" of these were private equity firms¹⁷. NAMA's single largest loan sale was that of Project Eagle, £4.4 billion worth of loans linked to Northern Irish real estate sold to Cerberus, another US private equity player. Private banks have also been selling to the same firms. Ulster Bank/RBS' Project Achill included €550 million of distressed loans secured by properties in both Ireland the UK and was sold to Lone Star in 2014. The most active buyers are Lone Star, Cerberus, Oaktree Capital, CarVal, Apollo Capital, Starwood Capital, Marathon, King Street Capital and Blackstone.

In most instances distressed debt is being sold at huge discounts. In NAMA's largest transaction, mentioned above, Project Eagle was sold to Cerberus for £1.2 billion. The loan book had a £4.4bn nominal balance, i.e. it was sold at a 72.7% discount¹⁸. NAMA's Project Arrow consists of loans with an original value of over €7bn but is expected to sell for around €1bn. Similarly, Ulster Bank/RBS' Project Aran, a massive portfolio of distressed Irish real estate loans with an original value of €6 billion, was sold to Cerberus for just €1.1 billion in late 2014.

These heavy discounts are what make possible big profits for the vulture funds. They can pursue various 'investment strategies' including restructuring loans and re-selling them or repossessing underlying property assets to develop, refurbish or sell. In the case of the former, for example, a fund can buy a loan with an outstanding balance of €100 million for €30 million. The loan is sold at a discount because the debtor has failed to meet their repayments and the value of the underlying security (for example an office block) has fallen massively, i.e. because it is 'distressed'. The fund, having bought the loan, can restructure it such that the new outstanding debt is €40 million¹⁹. While the debtor may not have been able to pay the loan payments on a €100 million loan, they may be able to keep up with the smaller restructured amount. If so the loan is transformed from a distressed or 'non-performing' loan to a 'performing' loan. At this point, the fund has the option of holding on to the loan and collecting their €40 million. However, because they have restructured the loan into a performing loan they also have the option to sell it on to the much larger set of financial institutions that invest in performing loans, such as insurance or pension funds.

Funds can also pursue a 'loan-to-own' strategy, in which case they buy the loan solely to seize the underlying asset, for example an office block as in our above example. Because the loan in question is distressed, the debtor will already be in breach of their loan contract and as such the underlying asset can be repossessed usually without any great legal difficulty or delay. Once the fund has taken control of the underlying property assets, they can sell them on immediately at a profit or perhaps invest in them (e.g. refurbishment) with a view to extracting an even greater profit.

¹⁸ 'NAMA completes Project Eagle sale at loss', CoStar Finance, 23/05/2014. URL: <http://costarfinance.com/2014/06/23/nama-completes-project-eagle-sale-at-loss-with-cerberus-financing-with-nomura-and-bawag/>

¹⁹ In this example there has been a write down of the debt or 'hair cut' of €60 million for the debtor. This represents a loss for the seller of the loan, e.g. a bank or NAMA. In the Irish case, as in most European countries, this loss has been covered by the public in the form of bank bailouts (re-capitalization, emergency liquidity, guarantees etc.)

¹⁶ Cushman and Wakefield (2014). European Real Estate Loan Market Q3 2014. URL: <http://www.worldpropertyjournal.com/downloads/European-CRE-Loan-REO-Sales-Market-Q3-2014.pdf>

¹⁷ 'Nearly all the assets from Nama's €17.5 billion in fire sales have gone to offshore buyers', *thejournal.ie*, 22/10/2014. URL: <http://www.thejournal.ie/nama-sales-offshore-1740291-Oct2014/>

There are three key things that give vulture funds a decisive advantage in the Irish real estate market, both of which shed light on their wider operations in crisis-ridden economies. Firstly, vulture funds have swooped into Ireland because virtually all Irish financial institutions are simultaneously trying to get rid of bad real estate debts *en masse* (known as deleveraging). Because of the economic crisis, Irish financial institutions are forced to sell and to sell quickly, leading to what many call a 'fire sale' dynamic. Secondly, because the Irish financial system is in crisis there is an acute absence of finance. In other words, it is very hard or impossible for domestic actors to obtain credit to invest in Irish real estate. Because private equity funds and hedge funds have access to huge financial fire power, they can enter when others cannot. Thirdly, because they do not have a retail presence in Ireland or need to maintain client relationships (as domestic banks do, for example) they can squeeze debtors as hard as they like. This is why they are seen as very aggressive players with little regard for long term economic well-being.

4.3 Understanding the risks posed by vulture funds in Ireland

The entry of vulture funds as the dominant players in Ireland's financial and real estate markets marks a qualitative shift for Ireland. But what are the likely impacts of this? In relation to vulture fund's investment in sovereign debt we have already seen the exceptionally destructive role they play. Their involvement in European and Irish real estate is, however, much more recent and as such their effects on social and economic well-being are yet to materialize. Moreover, the investment strategies of vulture funds in Ireland are more varied and nuanced than their counterparts in the sovereign debt markets. Nevertheless, a number of significant risks can be clearly identified.

As noted, vulture funds have almost exclusively focused on real estate related debt and as such housing and urban development are most tangibly effected. Much of the distressed debt bought up by the funds is the mortgages of ordinary home owners, in particular 'non-performing' mortgages which are in serious arrears. This is one the most problematic sets of 'assets' for Irish banks; there are approximately 100,000 mortgages in serious arrears and some commentators estimate that we will see between 20,000 and 30,000 home repossessions. Research has documented the difficulties experienced by mortgage holders in arrears. Mortgage arrears typically occur in a context of unemployment, but harassment by banks and fear of repossession also lead to significant stress for families and impacts negatively on mental health²⁰.

20 Wallace, A. and Ford, J. (2010). Limiting Possessions? Managing Mortgage Arrears in a New Era. *International Journal of Housing Policy*, 10(3): 133-155.

Instead of protecting those in danger of repossession, however, banks have sometimes preferred simply to offload the mortgages to vulture funds.

Vulture funds are not regulated by the Irish Central Bank and as such the exact number of mortgages now owned by funds is unknown. Even the Department of Finance does not appear to have robust figures on this, however Minister for Finance Michael Noonan suggested that there are up to 10,000 mortgages now held by vulture funds²¹. Some commentators put that figure closer to 20,000. A number of high profile transactions which are in the public domain include Lone Star's acquisition of the entire mortgage book of Lloyd's Bank (4000 mortgages) as well as their acquisition of Start Mortgages, Ireland's dedicated sub-prime mortgage provider. Permanent TSB (over 90% government owned) sold its subprime mortgage book to Mars Capital Ireland, a fund linked to giant hedge fund Oaktree Capital²². The same fund also bought a mortgage loan book from IBRC. Tanager, a US private equity firm, was reported to have bought 2000 mortgages from Bank of Scotland Ireland²³.

Three key difficulties arise here. First of all, and as already noted, vulture funds pursue high returns over the short term. They engage in risky "investment", but they want to see big yields. This means aggressive 'asset management strategies', which in practice means squeezing debtors hard. This is likely to cause further difficulty for already vulnerable home owners and increase the likelihood of eviction. While we are yet to have sufficient data on this in Ireland, evidence from the US in relation to vulture funds investment in both residential and rental property raises serious concerns. For example, research in the US shows that private equity firms are more likely to foreclose on mortgage holders in arrears than banks are²⁴. Second of all, and relatedly, vulture funds are not interested in the long term. Here it is important to recall that although they operate in loan markets, vulture funds don't actually provide credit²⁵. They simply buy up credit that has gone bad.

21 'Fears as 10,000 mortgages now in the hands of vulture funds', *thejournal.ie*, 09/08/2014. URL: <http://www.thejournal.ie/mortgages-unregulated-bodies-1606582-Aug2014/>

22 'PTSB agrees sale of subprime mortgages', *The Irish Times*, 21/10/2014, URL: <http://www.irishtimes.com/business/financial-services/ptsb-agrees-sale-of-subprime-mortgages-1.1970622>

23 'Mortgage vultures may cast cold eye on new Irish clients', *The Irish Independent*, 04/01/2015, URL: <http://www.independent.ie/business/personal-finance/property-mortgages/mortgage-vultures-may-cast-cold-eye-on-new-irish-clients-30880255.html>

24 Razza, C. (2014). *Vulture Capital Hits Home*. The Right to the City Alliance and the Centre for Popular Democracy. URL: http://homesforall.org/wp-content/uploads/2014/09/HUD.DASP_RTC_v15.pdf

25 Kupelian, R. and Rivas, M. S. (2013). Vulture Funds: The lawsuit against Argentina and the challenge they pose to the world economy. Centro de Economía y Finanzas para el Desarrollo de la Argentina (CEFID-AR), Working Paper 49.

This means they do not need a retail presence in the country nor do they need to build a positive brand or client relationships. They are not concerned with how they are perceived. This enables them, once again, to pursue aggressive strategies with scant regard for mortgage holders or the long term consequences. Third of all, vulture funds are not regulated by the Central Bank of Ireland, a problem raised by the governor of the Central Bank in April 2014 and various legal and consumer rights advocates.

In addition to distressed mortgages, vulture funds have also been aggressively buying development land, such as the 400 acres at Cherrywood in Dublin 18 which was bought by Texas based property developer Hines in partnership with New York private equity firm King Street Capital. Development land is an extremely precious resource in any city, and all the more so in a city like Dublin which is subject to population growth and an acute shortage of housing (in particular social and affordable housing). The acquisition of strategic land banks by vulture funds this has a significant opportunity cost as this land could be used for important social infrastructure, such as housing. Vulture funds are instead focusing on the construction of commercial office space and where they are developing housing, for example in the docklands, it is luxury apartments and high end housing. There is also some evidence that the arrival of vulture funds in the Irish real estate markets is already influencing the planning process. For example, in 2014 a Strategic Development Zone (SDZ) came into effect in Dublin's Docklands. The Docklands area contains one of the highest concentrations of NAMA assets; the agency controls 75% of undeveloped land within the SDZ. NAMA advocated strongly for the SDZ, in large part because the 'fast track' planning system provided by the SDZ is more attractive to global funds²⁶. More broadly, the acquisition of large and sometimes strategic tracts of development land may grant vulture funds significant influence over the planning process.

The frenzy of speculation associated with vulture fund's entry into Ireland, however, has also drove up land prices at an alarming rate. Commercial real estate (including development land) loan sales in 2014 amounted to an incredible €21 billion, while direct property sales in the sector also rose to €4.5 billion (CRBE, 2015; SCSi, 2015). Direct property transaction volumes represent a record high, surpassing boom-time peaks, and this is despite the collapse in commercial property prices, suggesting an enormous quantity of transactions and a veritable feeding frenzy (Goodbody, 2015). Increasing development land prices mean increasing house prices and increasing rents, which is bad news given Ireland's current housing crisis.

26 Byrne, M. 2015. 'Asset Management Companies and the financialization of urban development: lessons from Ireland and Spain'. *Progressive Planning Magazine*, winter.

In addition this makes the provision of social housing and other infrastructure more expensive for local authorities and central government.

Because vulture funds have been focused on real estate there is thus far limited information on their impact on employment. However, vulture funds may sometimes take control of a company in order to access or 'strip' its real estate assets. This can have very negative impacts for employees. The most prominent example of this in Ireland thus far has no doubt been the case of the iconic Clery's department Store on Dublin's O'Connell Street. The department store was bought by US investors Gordon Brothers out of receivership and these in turn sold the company on to a company majority owned by a London based investment and hedge fund (Cheyne). Clery's was immediately closed down leading to the loss of over 400 jobs. Clery's real estate assets had been separated into a separate vehicle prior to the sale, presumably to facilitate value extraction.

Taken together, the risks discussed above point to the wider issues around largely unaccountable global funds gaining control of a crucial social and economic resource: property and land. Because of their global reach, vulture funds are less susceptible to local economic or political pressure and in some cases are entirely unregulated. This leads to a further deterioration of local and national control and reinforces the power of largely unaccountable global actors.

4.4 The role of the Irish government in attracting vulture funds

Despite the risks outlined above, it is important to bear in mind that, as is the case with speculation on sovereign debt, the activities of vulture funds could not take place without a political and regulatory environment which facilitated them²⁷. Nowhere is this clearer than in the case of Ireland's property market. The initial entry of vulture funds into Ireland took place as a result of the rapid exit of foreign lenders from the market, specifically Danske Bank, Lloyd's Bank and Ulster Bank/RBS. This shifted to an industrial scale, however, as a result of the two public or quasi-public agencies discussed above: NAMA and the IBRC. These agencies are crucial here in three respects: they sell big, they sell quick and they sell cheap.

Both NAMA and the IBRC bundle loans together in what are called 'portfolios'. These typically range in value from between €100 million and several billion. The size of the portfolios in NAMA's case has increased over time.

27 Cibilis, A. (2015). 'Toward justice centred debt solutions: lessons from Argentina'. Dublin: Debt and Development Coalition Ireland. URL: http://debtireland.org/download/pdf/towards_justice_centred_debt_solutions_2015.pdf

Packaging assets together, or loan aggregation, is crucial because it gives assets the *scale* that makes them attractive to global funds. It is also crucial because it prices out local investors.

NAMA is also selling off its assets at a spectacular rate. The IBRC, in turn, virtually sold its assets in one go as the company was placed in liquidation (by the Irish government). NAMA's timeline is largely dictated by the Irish Department of Finance, which took the decision to place stringent bond redemption targets on NAMA. This puts NAMA in the position of needing to generate massive volumes of cash in a short period, thus effectively forcing it to sell as much as possible as quickly as possible. The massive volumes of assets dumped by NAMA and by the IBRC on the market at the same time created the conditions for the intense speculative frenzy witnessed in the last number of years. Relatedly, because NAMA and the IBRC have been selling under stringent time pressure they have sold assets at very steep discounts²⁸. The dramatic discounts available pushed yields on Irish real estate assets up, and high yields are the number one priority for vulture funds.

In essence, the IBRC and NAMA, both under the control of the Irish government, *created* large, high yielding assets and sold them *en masse*. This created a context which not only favoured vulture funds, in a sense it meant that *only* vulture funds had the financial fire power required to play this extremely high stakes game.

It should be noted that the way in which vulture funds have found fertile ground in Ireland is not an unintended consequence of NAMA's policies, but an explicit objective. NAMA's Annual Statement of 2013 sets out as an objective 'to attract international capital'²⁹. Breandan McDonagh (NAMA CEO) took the opportunity of a recent appearance before the public accounts committee to champion the fact that 'NAMA's market activity and deleveraging have contributed to the strong inflows of foreign capital'³⁰.

Courting the vultures

The Irish government has rolled out the red carpet for the vultures, engaging in frequent meetings with the key players. Funds like Blackstone and Apollo have had meetings with senior civil servants at the Dept. of Finance.

Blackstone also had a private meeting with the Taoiseach Enda Kenny in late 2011. The Minister for Finance met with Lone Star capital three times and Apollo capital twice in 2013 and 2014. All in all, the department of finance met with vulture funds no less than 65 times in 2013 and 2014. In contrast, they met with groups advocating on behalf of mortgage holders just five times.

On the 4th of March 2015 the Department of Finance went further still in its efforts to facilitate vulture funds by organising a conference in which figures from the Irish property industry could 'network' with private equity firms and other global financial players.

Tax regimes

Ireland's current tax regime is undoubtedly relevant to the activities of vulture funds here. We cannot provide a full and comprehensive account of the wide variety of tax structures which international funds can make use of here. However, it is worth briefly mentioning the principal Irish structures through which international funds invest in distressed debt in Ireland: the Qualifying Investor Fund and the Section 110 Company. QIFs must be register with the Central Bank but they are automatically exempt from borrowing and investment restrictions normally imposed on foreign funds and as such are favoured by 'alternative investment' funds such as hedge funds. QIFs are exempt from Irish tax on their income and gains, they do not pay a withholding tax and they can benefit from Ireland's vast network of double-taxation treaties³¹.

Section 110, of the Taxes Consolidation Act 1997 provides for the taxation of securitisation vehicles. In practice, however, Section 110 companies go beyond securitisation to include many forms of financial assets including loans and derivatives. Section 110 companies are theoretically liable at the higher rate of Irish corporation tax, but due to a wide variety of exemptions they are effectively tax neutral. It is also important to note that these two vehicles can be combined, sometimes referred to as a Super QIF structure. In these instances a QIF is established but in turn sets up a Section 110 company as a 100% subsidiary, this can enhance 'tax efficiency' still further. According to one of Ireland's principal corporate legal firms, the main private equity investors in Irish real estate have made use of the above structures, including Lone Star, Cerberus and Blackstone³².

²⁸ It should also be noted that in some instances NAMA has actually financed the very vulture funds snapping up its assets. Under a programme called 'vendor finance' NAMA lends to vulture funds to buy its assets.

²⁹ NAMA (2013). Section 53 Annual Statement 2013. URL: https://www.nama.ie/fileadmin/user_upload/NamaAnnualStatement2013.pdf

³⁰ McDonagh, B. Opening Statement to the Public Accounts Committee, 01/10/2015, URL: https://www.nama.ie/fileadmin/user_upload/Brendan_McDonagh_-_Opening_Address_to_the_PAC_-_1_October_2015.pdf

³¹ Davy. Ireland as a location for distressed debt funds. URL: <http://www.davy.ie/binaries/content/assets/davypublic/fund-services/briefings/ireland-as-a-location-for-distressed-debt-funds-web.pdf>

³² Dillon Eustace. Irish structures for investing in distressed assets. URL: <http://www.dilloneustace.ie/download/1/Irish%20Structures%20for%20investing%20in%20Distressed%20Assets.pdf>

5. Vulture funds, distressed debt and global financialization

Thus far we have looked at the activities of vulture funds in relation to sovereign debt in the global south and real estate in Ireland. What are the common traits and dynamics at stake here and what do they tell us about our increasingly financialized world? At the heart of vulture fund “investment” in both spheres is the question of distressed debt and secondary loan markets.

Secondary loan markets create a market in speculative investment in debt. This means that many companies can make money investing in debt without lending at all, and as such without making any direct contribution to the productive economy. Economic crisis becomes an investment opportunity. For nations this means that mounting debt, rising unemployment, economic crisis or environmental catastrophe can all become sources of speculative investment by vulture funds. For banks and other lenders to real estate, as we have seen, this means that financial and property crises become an opportunity for speculative investment. Finding ‘opportunities’ in distressed debt markets, then, is the common trait amongst vulture funds.

In both cases (sovereign debt and real estate), vulture funds need to pursue aggressive strategies in order to make money in a context of crisis. In the global south, this means using litigation to effectively prey upon the public purse of sovereign nations. In real estate markets, it means buying up debt to gain control over income streams and capital values of underlying assets.

The rise of the vulture funds, however, needs to be placed in systemic perspective. The growth of distressed debt markets is linked to a larger shift in the global economy: the process described as ‘financialization’. The process of financialization can be generally defined as the growing power of finance and financial actors over social, economic and political processes³³. The financial system has grown exponentially in recent decades and now far outweighs the so-called real economy in terms of sheer volumes of wealth. Financial actors – banks, insurance and pension funds, hedge funds and private equity firms, and other kinds of financial intermediaries - have all become incredibly powerful actors.

The rapid increase in levels of debt is at the heart of this. Levels of both public and private debt have sky rocketed over recent decades. In the global south this has been associated with crippling levels of sovereign debt while in the global north levels of private debt (residential mortgages, credit card debt etc.) have increased dramatically.

Secondary debt markets play an important role here. As mentioned above, by allowing creditors to more easily enter and exit lending arrangements they increase the possibility for financial institutions to manage the risks associated with lending. They thus increase the overall availability of credit in the economy while at the same time dispersing risk throughout the financial system. With increased debt and increased risk comes increasing economic volatility. This was brought home to many by the recent global financial crisis.

Some brief reflections on Ireland’s property bubble and crisis are worth mentioning here. Ireland’s bubble was driven by international credit. Between 1999 and 2007 Irish banks’ net borrowing from abroad went from 10% to 60% of GDP³⁴. Irish banks borrowed short term on international money markets to lend long term into property development and property speculation³⁵. When credit ‘crunched’ in 2008 the credit tap was turned off leaving Irish banks exposed, with disastrous consequences for the Irish economy and society. The lesson from this is that when you plug local real estate into the international circuit board of finance you can get sharp shocks. The amount of credit available can sky-rocket, causing a bubble, but can also ‘crunch’ and disappear just as quickly, causing an economic and social crisis. The solution to that crisis, as argued here, has been to connect the Irish market to a new source of finance – the global vulture funds – thus once again linking local property development with global flows of finance. The systemic risk here is that the creation of a direct link between global financial firms and local Irish real estate can lead to a sharp increase in the price of property and the amount and value of financial assets linked to property. There is already evidence that this may be happening. In 2014 Irish commercial real estate was thought to be one of the best performing asset classes in the world, increasing in value by over 30% in one year³⁶.

34 O’Riain, S. (2014). *The rise and fall of Ireland’s Celtic Tiger: liberalism, boom and bust*. Cambridge: Cambridge University Press.

35 MacLaran, A. (2014). Ready money: over-development in the offices sector. In A. MacLaran and S. Kelly (eds) *Neoliberal Urban Policy and the Transformation of the city: reshaping Dublin*. Basingstoke: Palgrave Macmillan.

36 CBRE (2015). *Commercial Property Outlook 2015*. Dublin: CRBE.

33 Blackburn, R. (2006). Finance and the fourth dimension. *New Left Review*, 39, 39-70.

This is an extremely rapid rise driven almost exclusively by global investments.

When global flows of credit drive erratic changes in property markets it exposes the economy and society to sharp fluctuations in available credit and finance. These fluctuations, moreover, may be triggered by events very much outside the control of the Irish political and regulatory system. For example, an increase in interest rates by the US Federal Reserve could have negative knock on effects for the Irish property and financial markets.

The accumulation of wealth and power by the financial system is leading to increased volatility, both in particular markets and in the global economy as a whole. Booms and busts become more frequent and more painful. But, as we have seen, when a boom is based on credit the inevitable bust leads to the proliferation of distressed debt. In other words, with more debt and volatility comes more opportunities for vulture funds. Vulture funds thus play a role in this wider process, by buying up financial assets when a country is at its weakest, they play a part in maintaining and breathing new life into the financial system, accumulating ever greater power and wealth for financial actors. The vulture funds, in their guise as both sovereign debt speculators and real estate players, are thus a symptom of a wider transition in our world in which debt becomes a key driver of the global economy.

We can and indeed must introduce regulations that challenge the power of vulture funds and protect resources from them. However, there are other, perhaps more systemic, questions that we need to ask about the wider process of financialization and the role of civil society, social movements and public institutions in creating a world where the suffering of the many can never be an investment opportunity for the few.

...many
companies can
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investing in debt
without lending
at all, and as such
without making
any direct
contribution to
the productive
economy

6. Clipping the vulture's wings: recommendations

6.1 Vulture funds in the global south: recommendations

There is already a substantial set of proposals aimed at mitigating the effects of vulture funds on sovereign debt restructuring. Proposals have been put forward by debt justice campaigners as well as international financial institutions and multi-lateral organisations.³⁷

1. Promote multiple and concurrent measures rather than focusing exclusively on “market solutions”:

National governments should support more effective collective action clauses, national and/or regional legislation limiting vulture fund activity, and a multilateral approach that should ultimately aim to override the inadequacies and limitations of the former mechanisms. Tackling the problem of sovereign defaults and debt restructuring from these different angles will make it less likely that vulture funds will be able to intervene.

2. Participate in negotiations to develop a sovereign debt resolution mechanism, on the basis of non-negotiable working principles, to include:

- *Non-participation of the IMF and other international financial institutions;*
- *The resulting mechanism should be legitimate and impartial;*
- *Equality of all sovereign nations.* All nations should receive equal treatment and have equal rights, whether periphery or centre countries.
- *Protection of the entire range of human rights.* No population should be expected to have to forego fulfilment of their human rights in order to fulfil financial obligations.

3. Participate actively in multilateral framework negotiations:

The multi-lateral approach has many areas in need of greater clarity: institutional framework, trigger mechanisms, scope of the process, and arbitration criteria, to name a few (see section 2 above for more detail). Therefore, it is critical that a wide range of organizations participate in the process—especially those expressing the views of people affected by debt crises—through the available UN channels. The upcoming meetings of the ad-hoc committee should provide opportunities for such voices to be heard.

4. Support sovereign nation prerogative to default:

The international financial architecture being what it currently is means that debt will continue to be an issue, especially for periphery countries, for quite some time. Until lasting solutions are found, solidarity with national government decisions to not pay illegitimate and unsustainable debts must deepen. As we have learned from the experience of Argentina, default was the wisest choice even if the media narrative demonised the country for taking this step.

5. Work to bring about a more equitable and balanced international economic order:

As highlighted in the last section, sovereign debt issues expose the power and economic imbalances that are at the core of the global economic system. New debt resolution tools and mechanisms may alleviate some suffering in times of debt crises, but will not ultimately change the international financial architecture nor solve its many profound problems. This is why much deeper changes are needed including:

- Putting an end to the macroeconomic policies of fiscal consolidation and austerity, often imposed through external policy conditionality. These policies cause deep recessions that hurt working people the most and turn debt burdens more unsustainable. Policies should be aimed at improving worker welfare and maintaining high levels of employment.
- Putting an end to fiscal benefits for economically powerful actors and the wealthy. Tax justice should be implemented to ensure support for achieving economies that serve the public good and not powerful minority interests.

³⁷ This set of recommendations was originally published in the report *Towards Justice-Centred Debt Solutions: Lessons from Argentina* (2015), written by Dr. Alan Cibils for DDCI.

- Implementing more detailed controls on lending practices to regulate the intense level of debt flows in the global economy.³⁸

6.2 Vulture funds in Ireland: recommendations

The arrival of vulture funds in Irish and European real estate markets is very novel and as such few proposals have been developed to mitigate their detrimental impacts on social and economic wellbeing. Nevertheless, there is a clear rationale for robust regulation. Firstly, vulture funds manage enormous amounts of wealth. Secondly, and relatedly, because of their sheer size and the fact that they represent a direct link between local real estate and the global financial systems, vulture funds may raise potential systemic risks to the Irish financial system. Thirdly, the aggressive business strategies of vulture funds has already been documented. Finally, distressed debt, by its nature, tends to arise in the course of economic and financial crises, and as such during a period in which states and populations are particularly vulnerable. On the basis of this research report we can set out a number of provisional areas where greater regulation is required and can usefully be developed.

Research

Given the novelty of vulture fund investment in European real estate there is a pressing need for further research. Research is required in a number of areas. For example, we lack evidence in relation to the investment strategies of vulture funds. What are the strategies via which funds can extract value from distressed debt or seize control of underlying assets? In addition, what features of the regulatory and fiscal environment facilitate or promote vulture funds?

Research is also urgently required in relation to the impact of vulture funds on housing. A small amount of research has been carried out in the US and suggests that vulture funds pose significant risks in terms of the right to housing³⁹. This is true in particular for mortgage holders and the rental sector.

The most significant gap however relates to the systemic dynamics within which vulture funds operate. Private equity firms and hedge funds are a vehicle through which global capital flows into and through local real estate; they are a mechanism for integrating local property markets into global financial networks. This raises an unprecedented situation and host of issues requiring further research. Foremost among these is the impact of international processes. For example, further knowledge is required in relation to how US interest rates and policies of quantitative easing impact on vulture funds.

Transparency

The importance of further research raises the issue of transparency. There is a limit to how much we can know about a rather opaque area of economic activity. On the one hand, many vulture funds are located in off-shore jurisdictions with extremely weak regulatory regimes, allowing them to act with a very high degree of secrecy. On the other hand, Ireland itself has a tax regime which allows vulture funds and many others to reveal little of what they do. There is a strong argument to be made for introducing legislation and further regulation to ensure much greater transparency for investors in distressed debt, for example requiring all investors in distressed debt to produce detailed financial reports for the Central Bank of Ireland.

³⁸ For example, Eurodad's Charter on Responsible Finance, available at: (http://eurodad.org/uploadedfiles/whats_new/reports/charter_final_23-11.pdf)

³⁹ See Fields, D. (2014). The Rise of the Corporate Landlord: The Institutionalization of the Single-Family Rental Market and Potential Impacts on Renters. Right to the City Alliance: Homes for All campaign, URL: <http://homesforall.org/wp-content/uploads/2014/07/corp-landlord-report-web.pdf>

Protection for mortgage holders

Housing is a key area of concern, particularly the protection of mortgage holders. The government has very recently introduced the Consumer Protection (Credit Servicing) Act 2015 which deals with the regulation of entities involved in servicing mortgage credit. In particular, the Act extends the Central Bank's Code of Conduct around mortgage arrears to unregulated entities. However, legal advocates Free Legal Aid Centres (FLAC) have pointed to two principal limitations of this new legislation. First of all, the Act extends the Code of Conduct to 'credit servicing firms'⁴⁰ rather than the owners of distressed debt per se. Important issues which go beyond the limited definition of 'credit servicing', such as the setting of interest rates or of overall strategies for portfolio management, appear to be excluded from the Act. This suggests that mortgage holders will not be able to bring disputes with the owners of their loan to the Financial Services ombudsman. Second of all, the Code of Conduct is itself insufficient in terms of protecting borrowers on a number of levels. Most importantly, perhaps, the Supreme Court recently ruled that the Code of Conduct had effectively no legal standing.

Much better regulation is required here and one which has the right to housing at its heart. This includes a strengthened Code of Conduct that protects mortgage holders and the extension of that Code to all holders of mortgage credit. The regulation of all investors in distressed debt by the Central Bank of Ireland should be explored, as should the legislation to prevent the selling of mortgage loans to vulture funds during housing crises.

Taxation

The role of taxation in facilitating and incentivising the operation of vulture funds is part and parcel of the wider and very extensive issues relating to tax justice in Ireland and the country's status as a tax haven and as what has been called 'the wild west' of European finance. Taxation should not incentivise aggressive, speculative and socially destructive forms of investment which, moreover, sap wealth away from the productive economy and public services.

6.3 Financial crisis and distressed debt

Above we have seen that there are a number of areas of policy and regulation that require action in order to mitigate the detrimental impacts of vulture funds to social and economic well-being, as well as the potential systemic risks they pose. However, our examination of vulture funds poses larger questions in relation to the management of financial crises. As noted, financial crisis is the natural habitat of the vulture fund because of their focus on distressed debt. How financial crises are managed by national and global institutions is thus a central concern. In particular, how distressed debt is dealt with will play a major role here.

The Irish case suggests that at the centre of the vulture's arrival in Ireland was the massive and simultaneous deleveraging of distressed debt by major quasi-public financial institutions. At bottom, this arises from a political and policy decision to expunge distressed debt from Irish banks rapidly and to offload that debt onto the market as quickly as possible. This created a situation in which global private sector actors were best placed to benefit from the crisis and to reinforce their position of wealth and power. This has been a consistent feature of government and EU responses to the financial crisis in many areas, notably bank bailouts and austerity policies.

We need to fundamentally rethink how we respond to and manage financial crises and distressed debt. At the heart of any new approach should be the objective of the public good and of retrieving wealth and power from the financial system. When there is systemic government intervention in a financial system opportunities abound for fundamental transformation. To take one very tangible example, NAMA is in a position to use financial assets for the public good, yet instead it chooses to sell them to vulture funds at significant discounts.

A similar ethos should also be central to the management of sovereign debt crises and is already evident in the proposals advanced by debt justice activists, discussed above.

⁴⁰ Funds often contracted third parties to carry out the day to day servicing of loans, although this work can also be carried out 'in house'.

Annex 1: Case Studies

Case Study I: Lone Star and the housing crisis

Lone Star is a Dallas based US private equity firm that “seeks investment opportunities in developed markets that have suffered an economic and/or banking crisis”⁴¹. It manages around \$60 billion worth of assets and since the financial crisis has become a major player in real estate in the US and in Europe. Its impact on housing is already drawing criticism from housing advocates and lawyers.

Much like Ireland, the USA experienced a sharp property and financial crisis from 2008, symbolized by the now infamous collapse of Lehman Brothers. The country has also experienced a deep housing crisis, with millions of families finding themselves unable to keep up with their mortgage payments. Almost five million families have already lost their home due to foreclosure⁴². In this context Lone Star and its affiliated entities have bought up distressed property assets, including mortgages, often from Federal Agencies⁴³. In June 2014, for example, they purchased over 17,000 distressed mortgages from the Department of Housing and Urban Development. The firm is reported to have already foreclosed on (repossessed) at least 1,500 of these.

Housing advocates argue that Lone Star are quick to pursue foreclosure and unwilling to renegotiate with mortgage holders⁴⁴. In addition, part of Lone Star’s strategy involves the securitisation of distressed mortgages⁴⁵. This means pooling many thousands of mortgages together into one large bundle and selling it on. Securitisation was one of the main causes of the housing and financial bubble in the US and is also seen as a leading factor in the intensity and extent of the crash.

Housing advocates argue that Lone Star’s aggressive investment strategy and the securitisation of mortgage loans lead to a greater likelihood that mortgage holders will lose their home. In addition, housing associations have criticized Federal Agencies like the HUD who sell, at significant discounts, to private equity firms like Lone Star instead of working with groups dedicated to the right to housing.

Lone Star is one of the top two buyers of distressed real estate debt in Europe. It has bought up assets in many European countries. In Ireland, they have been among the most aggressive purchasers of distressed mortgages. The Irish housing crisis has made the country particularly attractive to vulture funds interested in real estate. Although we are yet to see mass repossessions in Ireland, over 100,000 residential mortgages are in arrears and some commentators suggest as many as 25,000 repossessions may be on the way. The Irish banks, despite being bailed out themselves, have failed to take action to restructure mortgages in order to protect vulnerable mortgage holders. In some instances they have sought the easy way out by selling mortgages to private equity firms and hedge funds⁴⁶.

Lone Star has bought thousands of distressed mortgages. The fund purchased the entire Irish mortgage book of Lloyd’s Bank (approximately 4000 mortgages) as well as buying the company Start Mortgages, Ireland’s dedicated subprime lender. It was also one of the buyers of mortgages from the IBRC. In fact, some commentators believe Lone Star is the single largest investor in Irish property since the crash. Like other vulture funds, Lone Star falls outside of consumer protection regulations, as argued by mortgage advocate groups such as the Irish Mortgage Holders Organisation and FLAC.

41 Quoted in Razza, C. (2014). *Vulture Capital Hits Home*. The Right to the City Alliance and the Centre for Popular Democracy. URL: http://homesforall.org/wp-content/uploads/2014/09/HUD.DASP_RTC_v15.pdf

42 Squires, G. (2015). ‘Surging Inequality and the Foreclosure Crisis’. *Progressive Planning Magazine*, winter.

43 Razza, C. (2014). *Vulture Capital Hits Home*. The Right to the City Alliance and the Centre for Popular Democracy. URL: http://homesforall.org/wp-content/uploads/2014/09/HUD.DASP_RTC_v15.pdf

44 ‘As banks retreat, private equity rushes to buy troubled home mortgages’, *New York Times*, 29/09/2015. URL: http://www.nytimes.com/2015/09/29/business/dealbook/as-banks-retreat-private-equity-rushes-to-buy-troubled-home-mortgages.html?smid=nytcore-iphone-share&smprod=nytcore-iphone&_r=0

45 Razza, C. (2014). *Vulture Capital Hits Home*. The Right to the City Alliance and the Centre for Popular Democracy. URL: http://homesforall.org/wp-content/uploads/2014/09/HUD.DASP_RTC_v15.pdf

46 It is important to note that the Irish government is a significant or majority shareholder in many such banks.

Case study II: Fir Tree Partners

Fir Tree Partners is a US hedge fund which manages approximately \$13 billion in assets. It has been involved in public debt in Argentina, Puerto Rico and Greece. More recently, it has also invested in the Irish rental property market.

Fir Tree established a fund to invest in distressed Argentinian debt during the countries turmoil in 2013. It began buying up bonds a few months after a US court issued a ruling to block Argentina from making payments until it settled with the group of holdout funds. Rather than pursuing the hold out strategy associated with NML Capital and Elliott Management, Fir Tree liquidated its position in Argentinian bonds in late 2014, and is reported to have enjoyed profits of up to 20%⁴⁷.

Fir Tree was also in the news recently due to its controversial activities in the Puerto Rican public debt market⁴⁸. In 2015 the governor of Puerto Rico announced that the country's debt levels were unsustainable, giving rise to fears of a default. The immediate context has been years of economic decline coupled with rising debt levels. A Fitch report from 2014⁴⁹ suggested that 60 hedge funds owned almost a quarter of Puerto Rico's outstanding debt, although more recent reports suggest this figure may have grown to up to 50% as Puerto Rico's debt position has deteriorated. Following the announcement, however, a group of vulture funds have moved to force debt payment at all costs, including a whole new set of harsh austerity measures. Hedge funds, organised in two groups (one of which is reported to be led by Fir Tree Partners), have recommended that Puerto Rico cut public spending and reduce the minimum wage and other workers' rights⁵⁰.

Fir Tree has also found fertile ground for investment in the European financial crisis, entering a number of markets. They were one of the many hedge funds to invest in distressed Greek debt, a phenomenon which would later risk undermining Greek debt restructuring (for a fuller discussion of this see Case Study III). In Ireland, Fir Tree Partners was subject to much public criticism following its investment in Anglo Irish Bank subordinated bonds. Anglo, later renamed the IBRC, is thought to have suffered one of the most severe bankruptcies in recorded history following the credit crunch of 2008 and, following a number of government measures to support the failing bank, was eventually nationalised by the Irish government. In late 2010 Fir Tree purchased \$200 million in Anglo Irish Bank subordinated bonds and went on to unsuccessfully sue Anglo in US courts in opposition to government enforced write downs of the value of subordinated bonds.

Finally, Fir Tree are one of a number of hedge funds to invest in the Irish rental market by buying shares in the Irish Residential Real Estate Investment Trust (IRES). IRES is now Ireland's largest landlord, buying most of the apartments it owns from NAMA. Some of its largest shareholders include Fir Tree, Franklin Templeton (one of the larger holders of Puerto Rican debt) and a Canadian Real Estate Investment Trust. Having purchased discounted apartments from the NAMA, IRES have states that they will pursue a massive 20% rent increases across their portfolio in 2015.

47 'Hedge Funds Crowd Into Argentina as Fir Tree Cashes Out', *Bloomberg*, 04/12/2014, URL: <http://www.bloomberg.com/news/articles/2014-12-04/hedge-funds-crowd-into-argentina-as-fir-tree-cashes-out>

48 'La trayectoria de los fondos de cobertura que llegaron a Puerto Rico', *Periodismo Investigativo*, 14/07/2015, URL: <http://periodismoinvestigativo.com/2015/07/la-trayectoria-de-los-fondos-de-cobertura-que-llegaron-a-puerto-rico/>

49 "Big Changes for Puerto Rico Bond Market," Fitch Ratings, August 13, 2014

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Case Study III: Marathon Asset Management

The New York based Marathon Asset Management, like Fir Tree partners, have been involved in Puerto Rican and Greek debt speculation in recent years, and has also invested heavily in distressed Irish property assets.

Their role in Greece has perhaps been most controversial. In early 2012, at the height of the European sovereign debt crisis, the Greek government sought to restructure a portion of its debt in order to avoid a disorderly default. It engaged in a series of meetings and negotiations with private sector creditors to this end, but the negotiations were frustrated by a small group of hedge funds who had bought Greek debt at heavy discounts – one of which was Marathon Asset Management⁵¹. At this point the possibility of a Greek default was widely considered to be catastrophic not only for the Greek people but for the global economy.

Marathon have also been among the many vulture funds buying Ireland piece by piece. It has bought a number of retail focused assets, including the Manor West Retail Park (Trallee, Co. Kerry) and loans backed by the Heuston South Quarter development (Dublin). Marathon also bought almost 600 apartments in the form of NAMA's 'Plum Portfolio', turning it into one of Ireland's largest landlords overnight.

⁵¹ 'Greek rescue blocked by hedge funds', *The Independent* 18/01/2012, URL: <http://www.independent.co.uk/news/business/news/greek-rescue-blocked-by-hedge-fund-greed-6291112.html>

Annex 2: Further Reading

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