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Acquiring failed banks, squeezing borrowers: BB&T among lenders questioned by judges, commercial-loan customers

By Kerry Singe

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BB&T Corp. is attracting scrutiny from judges and complaints from some commercial borrowers who say the lender is aggressively pushing for full repayment of troubled or maturing loans when it acquires failed banks.

The complaints focus on an FDIC program designed to help banks that acquire failed lenders. The FDIC agrees to reimburse those banks for a portion of the losses they incur.

But a growing number of borrowers say the arrangements, known as shared-loss agreements, have unintended consequences.

They say the agreements give banks that buy failed institutions less incentive to work with customers at those banks. That's because the acquiring banks get partially reimbursed – usually 80 percent of the original principal – when commercial loans lose value or projects fail.

In a ruling this spring, a Florida judge said Winston-Salem-based BB&T breached its duties of good faith with a borrower because the bank "was motivated to behave in such a manner as a direct result of (the shared-loss agreement)."

The judge ruled that BB&T "stood to profit by declaring a fraudulent default" and collecting reimbursement for losses from the FDIC. The bank also stood to gain, the judge said, by foreclosing on the property and holding onto it until a real estate turnaround occurred.

The judge halted the foreclosure, and BB&T has

- How shared-loss agreements work

When a bank or thrift fails, the FDIC takes it over. The agency then reaches out to find a bidder that will buy the failed bank's assets and assume the deposits. The FDIC agrees to share potential losses with the winning bidder.

The goal of these shared-loss agreements is to encourage healthy banks to buy failed ones by protecting the acquirer from heavy losses. The FDIC also tries to maximize returns for creditors of failed banks.

With commercial loans – such as those to small businesses, developers, or small real estate investors – the FDIC will typically reimburse the acquiring bank 80 percent of the original loan principal. The FDIC argues that this saves money since it would be more costly for it to sell a failed bank's assets piece by piece.

The FDIC says shared-loss agreements have saved it $41 billion through July 31. Banks have collected $20.6 billion from the FDIC in shared-loss agreements since 2008.

The money the FDIC uses when it takes over a failed lender comes from its deposit-insurance fund, which is paid for by banks and thrifts, not taxpayers.

Consumers and borrowers benefit, the federal

appealed the case.

BB&T said in a statement it "is proud of our practice of seeking work-out solutions on delinquent loans that benefit both the client and the bank." The bank disputes the idea that shared-loss agreements influence its decisions on individual loans.

The FDIC says the borrowers' problems stem not from shared-loss agreements but from failed banks that were poorly managed. The agency says the agreements are the most effective way to deal with the fallout from bank failures caused by steep losses on bad commercial real estate loans. The agreements quickly return a failed bank's assets to the private sector, the agency says.

The complaints about shared-loss agreements – and about banks aggressively seeking repayment – highlight how the once-cozy relationship between commercial real estate developers and banks has soured.

Property values plummeted in the real estate meltdown, and all types of lenders are increasingly demanding full payment for loans they once routinely renewed.

It's unclear how many foreclosures have happened because of shared-loss agreements. But critics say the practice is depressing real estate markets and delaying the economic recovery.

U.S. Rep. Lynn Westmoreland, R-Ga., member of the House Financial Services Committee, fears the agreements are causing unintended harm to entire communities. Westmoreland sponsored a bill asking the FDIC's inspector general to look into the agreements' effect. A report is due to Congress in January.

government says, by "keeping the assets of the failed bank in the community and preserving banking relationships for customers who have both deposits and loans in the failed banks." Critics, however, maintain that some banks have been too quick to declare loans in default, and collect on the losses from the FDIC. Kerry Singe

- Top Loss Share banks

Banks with the most assets covered under shared-loss agreements

	Bank	Amount covered under shared-loss agreements
1	U.S. Bank	$10.6 billion
2	OneWest Bank	$8.35 billion
3	Banco Popular de Puerto Rico	$3.9 billion
4	BB&T Corp.	$3.7 billion
5	New York Community Bank	$3.4 billion

Source: FDIC and Forum Realty Capital

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Westmoreland, a former construction executive, said he doesn't blame the banks, because they are following the FDIC's terms. He thinks the agency needs to rework shared-loss agreements to provide better protection for commercial borrowers, who include not only big developers but small real estate investors.

"The banks' aggressiveness has caused many communities to lose a lot of their wealth," he said. "It's caused people to lose their retirements and their kids' college funds."

Some critics worry more bank failures are to come – meaning more borrowers could find themselves answering to new holders of their debt. Real estate analytics firm Trepp said in October that of 6,000 banks it analyzed,

one in eight is at risk of failing, largely because of steep commercial real estate losses.

One developer's nasty battle

BB&T, which acquired a failed bank in Alabama and another in Georgia after the financial crisis, has been heavily involved in the share-loss program. It has roughly $3.7 billion in assets protected by shared-loss agreements – the fourth-largest amount among U.S. banks, according to research by Forum Realty Capital in Charlotte. U.S. Bank ranks first, with roughly $10.6 billion in protected assets. Neither Bank of America Corp. nor Wells Fargo & Co. have any shared-loss loans.

One of the banks BB&T acquired was Alabama-based Colonial Bank, a regional bank. Colonial focused heavily in real estate lending, both residential and commercial. It was particularly active in Florida and other overheated markets.

New York developer Ed Kalikow and his partners took out a loan from Colonial in 2007 to develop land near Chapel Hill. About two years later, Colonial abruptly stopped advancing funds for Kalikow's project. Soon afterward, the bank failed, having paid out only $3.5 million of an expected $4.4 million for his loan.

Infrastructure work for the 45-acre site suddenly stopped, just three-quarters complete.

Because the developers halted their work, a buyer backed out of the deal, Kalikow says. The buyer was going to build an independent living facility, to be run by Duke University Health Systems. Kalikow and his partners planned to build around 70 residences there.

Kalikow said he hadn't missed a payment until Colonial failed to fund the loan as promised. He said he was pleased when BB&T took over because he thought he could restart the project. Kalikow and his partners had stopped paying on the loan when Colonial failed to pay advances.

Kalikow said BB&T refused to talk and told him and his partners to repay all of the loan or face foreclosure. He said he believes BB&T wanted the project to fail so it could be reimbursed for a portion of the losses from the FDIC.

"This is a $100 million project that would have brought jobs. It would have enhanced the tax base," Kalikow says. "I've been saying, 'I want to come in and work through the project. I want to pay you back.' "

The FDIC says the loan was in default before BB&T acquired it because the scope of the project changed, a claim Kalikow denies.

Kalikow then sued BB&T. This spring, in what legal experts say may be one of the first N.C. rulings involving shared-loss agreements, a judge ruled Kalikow and his partners have the right to sue BB&T for breach of contract.

The land, meanwhile, sits in weeds.

Kalikow said he is considering his next legal move. He said he and his partners have been told to hand over the property. They are not paying on the loan. As of early December, BB&T had not started foreclosure proceedings.

"This is not a pie-in-the-sky thing. This was a real project," Kalikow said. "We did nothing wrong. Yet, we are the collateral damage here."

The bank said it strongly disputes Kalikow's allegations "and submits that they only tell one side of the story." It did not comment further.

Regarding the Colonial acquisition, the bank said: "BB&T is following our long-standing prudent standards to minimize losses that may result from acquired loans."

FDIC examining hard choices

The FDIC says it understands bank failures can disrupt communities. Still, banks that acquire failed ones are not supposed to be "philanthropic" or forgive debt, said Pamela Farwig, deputy director of the FDIC's Division of Resolutions and Receiverships.

"These banks failed for a reason," she said. "A lot of these loans should never have been made."

The money the FDIC uses when it takes over a failed lender comes from its deposit-insurance fund, which is paid for by banks and thrifts, not taxpayers.

Banks that acquire failed lenders are required by federal law to maximize their recovery, Farwig says.

That may mean choosing not to work with borrowers when loans default or mature. Or it could mean pursuing remedies that lenders often ignored in the real estate market's boom days, such as declaring a loan is in default if a borrower fails to make payments on other debts.

The FDIC and banks "are going to pursue every avenue to get that asset repaid," Farwig said. "I think people are a little shocked we are actually going to call them on a document that they signed."

The FDIC also disputes that shared-loss agreements create an incentive to demand full repayment from borrowers. That's because banks are allowed to apply for losses as soon as the loan is considered impaired. This can occur as soon as the acquiring bank takes over a loan and learns that the collateral has lost value.

If acquiring banks are able to recover money on devalued assets, however, they must repay some of the gains to the FDIC.

"When a bank decides to foreclose, it's a business decision," said Dave Davis, an assistant director with the FDIC. "Loss-share isn't playing a factor."

The FDIC does not comment on operating banks. In general, Farwig said, the agency is not concerned about banks abusing shared-loss agreements.

The FDIC has received more than 500 complaints from borrowers concerned with how an acquiring bank is handling their loan. About 5 percent, or roughly 30, were filed against BB&T. BB&T has acquired nearly 45,000 loans under shared-loss agreements. The FDIC was unable to provide data on which banks received the most complaints.

Atlanta attorney Jerry Blanchard of Bryan Cave, LLP, which represents banks, said banks that acquire failed

lenders are limited in what they can do with loans. For example, if a bank significantly modified a loan, that new loan could be excluded from the FDIC's shared-loss protection.

The real estate industry has drastically changed and some loans no longer make sense, he said.

"We've come through a very difficult time," he said. "It's not a question of somebody wanting to be mean. ... It's just what the numbers show."

The banks have an incentive to maximize their recovery, he said. "They don't have an incentive to maximize relationships with borrowers."

'A scorched-earth strategy'

Jesse Ray, a Florida attorney battling BB&T in court over attempted foreclosures, contends that banks with shared-loss agreements are more likely to prolong costly court battles or refuse to discuss loan settlements.

He said banks generally don't like one of their borrowers to file for bankruptcy since that limits what the bank can recover. Now, he said, a borrower's decline into bankruptcy ensures the loan loses value and the bank can recover on most of its losses.

"Loss-share banks are way more aggressive. They are very litigious," said Ray, who is involved in nearly two dozen lawsuits against BB&T and other banks. "They will drive you into the ground. It's a scorched-earth strategy that doesn't make any sense."

BB&T, for example, "breached its duties of good faith and fair dealing" when it tried to foreclose on a loan for a mini-storage facility near Tampa, a Florida judge found.

Two investors had borrowed $5.2 million from Colonial Bank to build the facility. Colonial was required to provide written notice when payments changed from interest-only to principal-and-interest but never did. Colonial then "improperly" demanded borrowers repay, the judge found.

BB&T continued the foreclosure when it acquired Colonial, court records show. The bank also said the loan was in default because one of the guarantors had defaulted on a separate, unrelated loan. A judge found the bank acted improperly, since it was a guarantor, not the borrower, who defaulted.

In his ruling, 13th Judicial Circuit Court judge William Levens wrote: "A bona fide default never occurred, and the resulting loan acceleration and lawsuit were improvidently initiated by (BB&T) for purposes of trying to maximize collection simultaneously from the FDIC."

The bank, he wrote, "committed significant wrongdoing and breached the implied duty of good faith and fair dealing of a financial institution."

The judge also ruled that BB&T "stood to profit by declaring a fraudulent default."

Ray said the borrowers fought BB&T in court for two years over the loan. At one point, he said, the court appointed a receiver for the property at the bank's request. Under the receiver, the property produced less income than when the borrowers controlled it, Ray said.

In general, Ray said, "through litigation, BB&T is driving (borrowers) into financial ruin and maybe bankruptcy."

BB&T has appealed. It said in a statement: "Our goal is to strike a balance between the clients' needs for adequate funding and our ability to offer affordable credit."

Some commercial borrowers, however, are starting to speak out against what they see as unfair treatment by loss-share banks.

Scott Davenport, a Georgia real estate investor, held meetings last spring trying to organize fellow borrowers. He plans to hold more. Georgia has led the nation in bank failures, with more than 80 institutions failing since 2008.

Davenport said one shared-loss bank, Georgia-based Hamilton State Bank, told him he was in default on a performing loan because the loan documents included a former partner who had run into problems with a separate loan. Davenport said he'd bought out the partner years ago and hadn't missed a loan payment in more than a decade.

Officials with Hamilton State Bank didn't return a call for comment.

Said Davenport: "I never saw it coming where when you were still willing to make your payments, they would still take your stuff."

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