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LOSS SHARING

BB&T Bank's purchase of the failed Colonial Bank of Alabama in 2009 included a number of construction loans for projects that were in progress. One of those was the Kalikow Group's managed health care and residential project in Hillsborough, N.C. Kalikow filed a breach of contract suit against BB&T for its refusal to restart funding of the project's loan. But he ran into unexpected headwinds when it appeared that the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) might bar direct action against BB&T. However, a North Carolina trial court recently held that Kalikow's action may have life as a breach of contract action depending on the wording of BB&T's loss sharing agreement with the FDIC (Front Street Construction LLC, et al. v. Colonial Bank N.A., et al., N.C. Super., No. 10 CV 15759, 5/11/12). BNA's Eric Topor recently spoke with Edward Kalikow, owner of the Kalikow Group, about the effect of Colonial Bank's failure on his project and the fallout of the FDIC's process of selling failed bank assets to new owners.

Developer: Bank Only Interested in FDIC Funds, Not in Restarting Stalled Project

BNA: You are the owner of the Kalikow Group and Kaled Management. What type of commercial real estate work do those firms engage in?

Edward Kalikow

Kalikow: We own and manage 7,000 rental, condo, co-op, [homeowners association] units in the metropolitan New York area. In addition to that we do a lot of investing in joint venture new construction projects around the country, retail, residential, and land development.

BNA: Can you give some background on the North Carolina project?

Kalikow: The project in question is in a small town called Hillsborough, North Carolina. It's outside of Chapel Hill. We had worked for about five years to get that property rezoned to be able to build an independent living facility and about 70 homes scattered around the campus of that facility.

BNA: So the project was a managed care facility, plus 70 residential units?

Kalikow: Right. It was going to account for about 230 beds. Duke University Health Systems was planning to come in and run the facility and operate a wellness center on the site as well.

BNA: From what I read in the court decision, your construction lender failed?

Colonial Bank Fails. Kalikow: Yes, our investors had put all of their money up, we had closed a loan with Colonial Bank in Florida, and they started funding the infrastructure development because, contractually we were obligated to deliver to the assisted living facility operator a finished, graded pad [site]. We were going to sell him that, and he was going to build his 230-unit fa-

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cility on that, and we were going to retain the balance of the land and put the homes on it. The parcel was 40 acres. We weren't going to build the assisted living facility. We were in contract with a local developer, and we were going to deliver to him a PAD-ready site.

Then, of course, as you read [in the case], Colonial Bank failed. We were communicating with them, and they were avoiding calls, giving very cryptic answers. Of course, in the interim, they had stopped funding our [loan]. We were putting in monthly requisitions, because we got about 75 percent of the way through the infrastructure work. They stopped funding the loan, the contractor left the job, we missed our delivery date for the independent group that was going to buy the PAD-ready site from us and build their facility. Then Colonial officially failed, and almost simultaneously it seemed that BB&T—and I understand these things happen quickly to prevent runs on banks—stepped into the shoes [of Colonial] and bought most of the assets of Colonial, and called us up subsequently to their takeover, and basically said, ''So when are you guys paying off your loan?''

We said maybe there needs to be a time-out. We think you have some lender liability issues here because, but for Colonial failing and stopping our funding, we would have been able to finish our project. We're glad that you, BB&T, have come in with the FDIC [Federal Deposit Insurance Corporation] and your shared loss agreement with them, and we're very happy that you bought the assets of the failed Colonial, but we think that . . . we're now ''collateral damage.'' We're left with a busted project through no fault of ours.

No Muss, No Fuss. BB&T basically told us to pound salt. Their position was that, ''When we buy from the FDIC, we buy as clean as a baby's bottom. No muss, no fuss, no obligations. Leave us alone; you have to pay off the note.''

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So we started a court action against them, which resulted in [this decision]. I think the decision was significant for many reasons. First of all, it was a case of first impression in North Carolina, which I think is significant. I think it's also significant in that the court actually ruled that BB&T could not hide behind [the purchase and assumption agreement]. What they claimed in the lawsuit is that, ''You, borrower, can't sue us directly; you have to go against the federal government. You have to act under the FIRREA's jurisdictional regime.'' They were throwing as many boulders down the mountain as they could to stop us.

The judge was pretty cool. He said, ''Let's have some discovery. Why doesn't BB&T produce a copy of its purchase and sale agreement of the Colonial assets?'' Which they did. And the P&S agreement very clearly stated that BB&T did agree to assume the commitments of Colonial as related to construction loans. So very clearly the judge said in his ruling . . . that we as the borrower have a breach of contract action against BB&T. I think that's the significant holding. And you can see, notwithstanding all of the [procedural hurdles] that you had to go through the FIRREA and the FDIC, the judge basically said, ''Enough. This is in the purchase and sale agreement. You, BB&T, may be liable to a breach of contract action.''

Now how did that really help me? Well it's sort of a Pyrrhic victory because the court went on to say that because in this action we didn't bring in the shared loss agreement that BB&T has with the FDIC. In that shared loss agreement would be the language dealing with who has responsibility for the tortious, or consequential, or punitive damages we suffered as a result of our project failing. It could have stayed with the FDIC, or it could be with BB&T. So the court really couldn't figure that part of it out.

And it is interesting because . . . the FDIC comes in and, in this case I think the assets of Colonial were $24 billion. BB&T pays about $16 billion, which was the reduced value of the assets after the failure. The FDIC covers a portion of the deficiency ($8 billion) up front and the balance is covered by a shared loss agreement. The bottom line is that the government has to come up with $8 billion less than if they had to bail out the institution.

Loans Written Down. Of course, BB&T takes over these loans from Colonial. They write them down—we don't know by how much—but I've read articles that say they wrote the loans down by 37 percent. I think in our case the loan got up to about $4 million, not a tremendous number. Now, to the extent BB&T has losses, out of the first $5 billion they get $4 billion from the FDIC on the loans they purchased.

So one might ask, ''What incentive does the bank have to work with the borrowers on any of these loans?'' And obviously the answer is ''none.'' Obviously, BB&T doesn't like this decision, and I think what really

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disturbs me about it is, one, BB&T is a North Carolina-based bank, [and] two, this project is in North Carolina. This project would have been a $100 million project that would have brought jobs. I am a jobs creator; that's what I am as a developer. This project would have enhanced the tax base of the town, created jobs during construction and subsequent to the finishing and development of the facility. Basically BB&T has told us in not so many words, ''We don't want to talk with you, Mr. Borrower.''

I said to my attorney that there is still a need for this project. I would like to come in and sit with BB&T and show them my plan not only to pay them back everything I owe them, 100 percent, but also give me an opportunity to get my money and my investors' money out. Basically the answer we indirectly get from BB&T is, ''No, we really don't want to talk to you, Mr. Borrower, because if we did and worked something out with you, we couldn't collect under our shared loss agreement.''

BNA: So BB&T was focused on simply collecting the 80 percent of losses that the FDIC would reimburse under the shared loss agreement?

Kalikow: Right. To me, the FDIC should be jumping up and down saying, ''Wait a minute, instead of you coming to us to collect under the shared loss agreement, you should go back . . . trying to work out with the borrowers on these projects.'' But you know what? It's just easier for the bank to kick the can down the street and say, ''We'll file our claim with our [insurer] and we'll be done with it.''

Developer, Investors, Town Lose. I really can't imagine that that's how the system was supposed to work. I, as a developer who did nothing wrong, have my carcass left on the side of the road like collateral damage. My investors lost their money. I've lost my money, the town lost its project, and here BB&T buys the assets of the failed bank and they say, ''We don't have to work out these loans. We'll just collect on our insurance policy, and let the taxpayer pay for it.'' It's outrageous.

BNA: What then are your next steps in the lawsuit and the project?

Kalikow: If we continue on with the case, my next step would be to try and get the shared loss agreement. If there is some scintilla of an implied obligation on the part of BB&T to act in good faith . . . it would seem to me that if the borrower is saying . . . ''I would like to come in and explore how to make you whole so you don't have to go to the FDIC and put in a claim and further burden the taxpayers,'' they should say, ''Sure, come on down. Let's talk.'' You would like to think that's the response that you would get. But it's not working like that.

BNA: Does the FDIC have any discretion on how they compose the shared loss agreements, or are they just pushing them through as quickly as possible?

Similar Case in Florida. **Kalikow:** There was another developer who had a project in Florida, a retail project in Miami. Similar situation. He had a loan with Colonial Bank; they were supposed to fund some tenant improvements, but the bank failed. Colonial was going to start a foreclosure so the borrower gave a deed in lieu to Colonial. BB&T came in and bought the failed loan. They sold the asset to a third party, and they go after the original borrower for a deficiency judgment.

In that shared loss agreement would be the language dealing with who has responsibility for the tortious, or consequential, or punitive damages we suffered as a result of our project failing. It could have stayed with the FDIC, or it could be with BB&T. So the court really couldn't figure that part of it out.

So they are in court, and the judge says to BB&T, ''OK, where is the original note?'' Unfortunately for BB&T they did not have it. The judge went nuts and said he was going to overturn the foreclosure, and [told BB&T's attorneys], ''You settle this action and forget about collecting on the deficiency judgment.'' And the lawyers for BB&T said, which sort of ties in to what I'm saying to you, ''You know what, Judge, we can't settle because if we settle, we can't collect from the FDIC. So we would prefer that you rule against us, because if you rule against us, then we can collect on our insurance policy (the shared loss agreement).'' So the judge ruled against them. They dropped the deficiency judgment action against the borrower, and now they're going to put in their claim and collect their 80 percent.

Yes, it is about the money and time that I lost, but I can't really imagine that this is good for the country, or good for the taxpayer. It's just a bust. If you're in an industry where you do create jobs, you do put people to work, you want to build homes, you want to build the economy, this isn't helping. And no one seems to care. And BB&T—you saw from the lawsuit—they're just going to keep rolling the boulders down the mountain, because they can spend a lot more money on their lawyers than I can.

BNA: What are the implications for developers and contractors from this ruling?

Kalikow: I guess the first rule is: don't do business with a bank that's going to fail. Assuming you had a crystal ball and you knew that, that would make life a lot easier. I think this court recognized from doing some research of other rulings in the country [and] is saying, ''No, if a developer happens to be in this position . . . BB&T, you can't hide behind the fact that you bought this as a result of the FDIC's involvement; you can't use that as a shield. And you might be liable for a breach of contract action, and you might liable for consequential damages.''

So even though the court has said that, as we saw in that other case, what does that mean to BB&T? They'll say, ''We're not settling anyway. We don't care and you know what, court, please rule against me, because if you rule against me, then I can collect from the FDIC under my shared loss agreement.''

You read how banks are working with the borrowers, trying to resolve things. It's a joke. Here's a case where a bank could do the right thing, could get a project up and running in its own backyard. But no.

Making Lemonade? **BNA:** What do you see as the remedy for this type of situation? How should the FDIC, or regulators, fix this?

Kalikow: I think the FDIC, under their shared loss agreements, should require the lenders to—where they can—go back and try to work the project out with the borrowers. And instead of having these shared loss agreements . . . say, ''Here, BB&T, you work with these guys, and you extend them the money they need to finish the project, and we will guarantee part of the loan, or we'll underwrite some of your losses, if any.'' Take lemons, and make lemonade. The FDIC should say, ''Work with the developers, if the project makes sense. We'll underwrite it and we'll guarantee your losses.'' There's something that the government could be doing instead of just adding to the foreclosure heap of projects.

BNA: So some incentive for banks to work with borrowers to get projects from failed banks moving again, instead of filing insurance claims?

Kalikow: Right. Instead of coming after us with your insurance claim and ringing the cash register—they have a shared loss agreement anyway—so why can't they just extend that and say if a developer comes back to you, and has a sound business plan that makes sense, we'll underwrite.

BNA: Is there anything that developers can do to protect themselves from this type of situation?

Kalikow: Well, how does any developer know that they are entering into an agreement with a bank that may be failing? [I've seen information from Trepp] that there's $9 billion in non-performing construction loans held by banks at risk of failure as of the end of the first quarter of 2012. Someone's going to have to end up paying for that, right? Wouldn't it make better sense if you could save half of them? I bet at least half of them probably still make sense if the original borrower could get the financing. If the government is going to back the losses of the bank anyway, at least try to minimize them and get some of these projects off the ground. That to me is what would really make sense, but I seem to be a voice screaming in the wilderness.

BNA: Do you think contractors are aware that they might not get paid for work done under these shared loss agreements as well?

Contractors Getting Burned. **Kalikow:** That's a good point. We had a contractor, [S.T. Wooten Corporation] if you read the case. I feel terribly for him. We had a personal relationship with him and he got burned for $700,000. Look at all the people he can't pay. It's got a ripple effect. When you close down the mine, it's not just the mine that suffers; it's all the collateral industries that support the mine. You raise a good point. Maybe contractors—because those are the guys who work for me as a developer—maybe they're the ones that need to rally around this. Because if you have $9 billion of failed construction projects, I guarantee you there is a lot of money owed to contractors.

BNA: They are probably getting hit with suits and liens from subcontractors too.

Kalikow: That's right. Under the way it's structured now, everybody loses. There are no winners here except BB&T. Somehow, when you throw all the equities in a blender, it just doesn't seem like this is the way it should be working.

BNA: What happens to these projects that are in various stages of construction when their lender fails and their funding dries up or they are foreclosed on and they can't find alternative financing?

Kalikow: Well, take our project—it's tumbleweeds. There are fire plugs in there. There are roads in there. You tell me. We'll be litigating with the bank for probably three, four, five years, however long it's going to take. In other cases the developer will tender a deed in lieu and the bank will rip up the guarantee, and maybe this thing will bring $1 million at a distress sale. And if the bank wrote it down to $3 million, they'll say, ''Okay, FDIC, give me my check for $1.6 million—80 percent of my $2 million loss.''

So that's what's going to happen, and years and years from now someone will come in and do something else on the property.

Editor's Note: BNA asked for comment from BB&T and the FDIC. BB&T did not respond. The FDIC declined to comment on the matter.

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