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OVERSIGHT OF THE STRUCTURED TRANSACTION PROGRAM
SUMMARY OF TESTIMONY OF SCOTT L. LEVENTHAL
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STATEMENT OF INTEREST OF SCOTT L. LEVENTHAL

This summary of testimony (this "**Summary**") is respectfully submitted by Scott L. Leventhal for use in the United States House of Representatives' Committee of Financial Services Subcommittee on Oversight and Investigation hearing on *Oversight of the Structured Transaction Program*.

I am an Atlanta-based real estate investor and developer and the president and chief executive officer of Tivoli Properties, Inc. During my tenure as a real estate investor and developer, I have developed urban high- and mid-rise condominiums, apartments and mixed-use projects, single-family subdivisions, both lifestyle communities and entry-level suburban communities, as well as planned the development of hotels. *See*, Background of Scott L. Leventhal attached hereto. My developments have been primarily financed through the use of recourse and non-recourse debt from banking institutions, insurance companies, real estate investment trusts and equity through funds and private investors.

Since the beginning of the Great Recession, several banks that originated my real estate loans have been seized by federal and state regulators. The Federal Deposit Insurance Corporation (the "**FDIC**") subsequently transferred the loans from the defunct banking institutions to other banks through whole-bank purchase and assumption agreements that have loss-share arrangements with the FDIC or

joint ventures between the FDIC and private partners through structured transactions ("**Structured Transactions**"). One was liquidated directly to a private investor.

INTRODUCTION

It is unquestionable that this country is still experiencing significant turmoil in the financial markets that began with the Great Recession. Capital for small-business borrowers, which are the pillars of job creation, still remains scarce and many small-business borrowers have been rendered financially insolvent. Borrowers of failed banking institutions have found themselves in strained relationships with federal regulators and their successors over a myriad of claims. Real-estate values have plummeted and many Americans have seen homes values decline to less than their mortgage. Our nation's ability to heal from the effects of the Great Recession rests, in part, on Washington's and the FDIC's ability to strengthen our banking system and allow our communities to rebuild.

Since January 1, 2008, federal and state banking regulators have closed 449 banks with 67 in Georgia alone. *See*, FDIC website. Many of these were community banks provided funding for small-business borrowers such as local builders and developers. Because the doors to mega-banking institutions are typically not open to smaller builders and developers, many builders and developers have found themselves in desperate situations.

In the modern era, there are many aspects of these bank failures that are worth this Subcommittee's consideration. First, when a bank is closed by federal regulators, federal law allows for the repudiation of the failed bank's contractual obligations with the borrower. This is causing significant damage around the county such as unnecessary litigation between the bank's borrower and the borrower's contractors who cannot be paid without bank funding. Second, Congress should require the FDIC to dispose of the assets of the failed banking institutions in a manner that promotes the best chance for recovery for the nation as a whole.

It is worth looking at the methods that the FDIC utilizes to liquidate the assets of failed banking institutions. One method of liquidation is through arrangements with financially sound banking institutions to transfer the assets of the failed banking institution. These assets are usually transferred by whole-bank purchase and assumptions and the FDIC backstops the losses that may be sustained on the loans of the failed bank. These transfers are to other banks that are still regulated by state and federal agencies and are not competitors of the borrowers.

Another way that the FDIC liquidates assets of failed banking institutions is through Structured Transactions with private partners in a joint venture. These Structured Transactions usually involve attractive financing and are meant to allow private partners with expertise in the real estate industry to recover on the assets.

These private partners are typically non-regulated entities and in some instances are direct competitors of the borrowers' under the loans of the failed bank.

There are several unintended consequences to Structured Transactions that respectfully require examination. First, in many instances, the private partners in Structured Transactions are experienced real estate investors, developers and builders, and are in fact direct competitors to the borrowers of the loans of the failed banking institution. These private-partner competitors are able to gain access to the borrowers' sensitive financial information as a result of these Structured Transactions. Most borrowers would have never applied for a loan from their competitor.

Second, the depth of the litigation over collections between borrowers and joint ventures under Structured Transactions has, in many cases, drastic consequences. This litigation is causing many quality builders and developers to seek insolvency protection.

Third, while the joint ventures attempt to collect on loan guaranties rather than seeking to first recover on the collateral securing the loan, the collateral wastes away and surrounding properties experience depressed values. This results in a vicious cycle that has prolonged the recovery of many local economies, when we should be resurrecting development activity to spur the creation of new jobs.

These joint ventures are purchasing the assets of failed institutions at a

fraction of book values. They are doing so with assistance from the federal government. This provides them with the opportunity to use their talents and resources to reinvigorate the assets, not let them waste.

BACKGROUND AND ORGANIZATION OF STRUCTURED TRANSACTIONS

Structured Transactions were created by the FDIC following the FDIC's experiences in the early 1990s when the Resolution Trust Corporation (the "**RTC**") was formed and the FDIC entered into a number of joint ventures or partnerships with the private investors. The purpose of those joint ventures was to facilitate the disposition of assets from primarily failed savings and loan institutions. These joint ventures purported to provide a greater chance of recovery on the assets of failed banks and thrifts by aligning the interests of the FDIC and its private partners, as opposed to liquidating the assets through conventional sales methods.

Since 2008, the FDIC has liquidated certain assets through Structured Transactions with private partners. At least thirty two Structured Transactions have been completed in the last four years involving more than forty-two thousand loans having book values exceeding $25 billion.[1] *See*, FDIC website.

Because the Structured Transactions allow the FDIC to retain an interest in

[1] Approximately 17% of the total book value of loans transferred through Structured Transactions was from the Corus Bank portfolio which was mostly, if not all, non-recourse loans.

the assets that that have been transferred, the FDIC believes that it has a better opportunity to recover on the loans of failed banking institutions than if the loans were just sold to private investors. Most of the FDIC's private investors that participate in Structured Transactions are distressed-debt funds and are not regulated by typical banking regulators.

The FDIC transfers the day-to-day management responsibility to the private partners and are responsible for the managing and servicing the loans held by the joint venture. In consideration of these management responsibilities, the private partner is paid a monthly management fee usually calculated on the gross asset value of the joint venture, as well as a negotiated share of the profits earned by the joint venture upon on the liquidation of its assets. Ostensibly these private partners have little to no incentive to promptly resolve the loans because of the dilution to their fees resulting from early liquidation of the portfolios.

While the private partner is responsible to adhering to reporting requirements to the FDIC, these private partners are not remotely monitored at the same levels as federally insured banking institutions. Additionally they do not operate in the same manner as banking institutions.

Many Structured Transactions also include seller-financing from the FDIC on favorable terms. In some cases the FDIC provides sixty percent of the total

capitalization for the joint venture at zero percent interest for five years. The FDIC also then invests a portion of the equity capital necessary to fund the joint venture's acquisition of the loans, thereby leaving as little as twenty percent to be invested by its private partner.

Some Structured Transactions include provisions that provide for the ownership percentage (*i.e.*, the right to profits) to increase in favor of the FDIC once the joint venture has achieved certain return thresholds, as opposed to increasing to the private partner. This is contrary to many traditional equity joint ventures where the manager is incentivized to generate more profits. The design of this structure is intended to prevent the private partners from earning windfalls over the FDIC and is part of the inherent issue in Structured Transactions because.

THE FDIC'S ABILITY TO REPUDIATE LOANS AND ITS EFFECTS

Bank's that are seized by federal and state regulators hold commercial real estate loans such as construction and development loans where the failed bank still remains obligated to advance funds. Because of federal preemption law, the FDIC is however permitted to repudiate those contractual obligations and may force the borrower to scramble to procure capital from other sources to complete the project. All the while the borrower is unable to pay its contractors and vendors because the loan advances have terminated. This, in and of itself, is causing contractors to file

liens and litigate to collect the amounts owed from the borrower for the improvements made to the project. In addition to starving the contractor from lack of payment, damages from federal repudiation causes many single-family communities to become abandoned with partially completed homes and negatively impacts values of surrounding properties.

Meanwhile, the successor creditor to the failed banking institution, which in some cases is the FDIC in a receiver capacity, still seeks to collect on the loan despite the fact that the creditor has failed to perform its contractual obligations. Those collection efforts include pursuing the guarantors of the loan for the amount of the funds that were previously advanced by the failed banking institution. Even though the ability to repay the debt was contingent on the completion and sale of the project, these collection efforts are still continuing to be pursued.

CONFLICTS WITHIN STRUCTURED TRANSACTIONS

The FDIC's decision to partner with private partners that are experts in the real estate industry – since many of these loans involve real estate – is very sensible. However, we need to address the conflict when a borrower now has an FDIC private partner, who in some cases is a direct competitor, as its lender.

First, a majority of the loans that are sold through Structural Transactions are recourse to the borrower and/or its principals pursuant to a guaranty. Since the obligations under the guaranties are also transferred, these guarantors are

defending collection efforts from a private partner – and not a regulated bank. Most borrowers or guarantors would not have agreed to provide guarantees to these private partners because they never would have applied for a loan from a competitor. However, now that there competitor holds the loan, the competitor is privy to the confidential and personal financial information of the borrower/guarantor, including sensitive financial information relating not only to the subject loan, but usually also to the global investments that the borrower maintains.

Borrowers should feel comfortable that when they apply for loans that the financial information that is being submitted will remain strictly confidential and not worry that the information will end up in the hands of their competitors. Consider the sensitive financial information that is provided when a loan is sought. A borrower and its principals usually provide, in addition to the financial information of the project, personal and corporate tax returns, bank records and personal financial statements. This financial information is provided based on a clear expectation of confidentiality and incumbent duties of the banking institution to maintain customer records. When regulators close a bank and transfer the assets to a joint venture through Structured Transactions, all of the customers' sensitive financial information is also transferred.

Second, there is tremendous litigation transpiring around the county brought by Structured Transaction joint ventures for claims on guaranties.[2] Under most state laws, guarantors are fully obligated on the guaranties they sign. However, the Great Recession has prevented many willing guarantors from being able to fulfill their obligation. While it is true that some guarantors are capable of paying, but unwilling to do so, a majority are not.

In order to defend collection efforts from this litigation, many borrowers have been forced to seek insolvency protection such as personal bankruptcy. Since it is the goal of the FDIC to maximize recovery on assets of failed institutions, some joint venture partners of Structured Transactions are forcing same to occur. This eliminates competition within the real estate industry and has created an unfair advantage for certain private partners which should not be facilitated by the federal government.

Lastly, by pursuing the loan guarantors without realizing on the collateral first, many communities around the country – and particularly the State of Georgia – have begun wasting away. This waste is causing a prolonged negative effect to a recovery from the Great Recession.

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[2] Notably, I was a borrower of a failed bank that ended up transferring a recourse loan to a private partner through a Structured Transaction. Litigation ensued over claims against the lender and against me as a guarantor that were ultimately settled.

For example, consider a single-family community where half of the planned homes have been constructed and the other half are vacant lots. The builder/developer of that community has its loan transferred to a joint venture through a Structured Transaction and faces collection efforts from the joint venture on the guaranties. Rather than pursuing the collateral securing the loan (*i.e.*, the vacant lots) and liquidating them to another builder, the joint venture is simply suing on the notes and guaranties. During the time that this litigation is proceeding, the family that lives in one of the completed houses in the subdivision is living next door to a lot or lots that are becoming weed infested and accumulating trash. The value of this family's home is directly impacted by the waste in this community and the uncertainly of the financial stability of the community. When appraisers then value homes for new mortgage financing, they lower the value of properties that are proximate to these troubled communities. In order to rectify this situation, we must stabilize our communities and not let them waste, create jobs and allow real-estate values to increase to pre-recession levels.

EXAMPLES OF SOUND STRUCTURED TRANSACTIONS

Not all Structured Transactions, however, have resulted in the unpleasant situations described above. Because some Structured Transactions are primarily comprised of loans that are non-recourse to the principals' of the borrower, some

private partners have focused on collecting and liquidating the collateral as opposed to pursuing guarantors.

For example, a majority of the loans that were made by Chicago-based Corus Bank were non-recourse to the borrowers' principals. Following the closure of Corus Bank, the FDIC transferred the majority of Corus' assets to a joint venture through a Structured Transaction.[3] The joint venture proceeded to take control of the collateral securing the loans and used its skill set to liquidate the properties. Through these efforts in Atlanta, Georgia alone, the joint venture has sold so many condominium units in the last two years Atlanta's condominium inventory is nearing normal levels.

CONCLUSION

The FDIC has done an admirable job working through the effects of the Great Recession. My hope is that the FDIC will consider the unintended consequences of Structured Transactions and the types of debt obligations that are transferred. Bank customers should not be forced to resolve their loan obligations

[3] At the time of Corus' seizure, I had two outstanding loans. I was able to payoff one of the two loans but, because of the dramatic decline in value of the property, was unable to pay the other and the property was foreclosed. The inability to payoff the other loan was despite the fact that the units in this project were intended to be sold as condominiums and I was able to convert the entire project into a rental apartment project, and lease-up the project to over 90% occupancy with positive cash flow. While stabilized and cash flowing, the value of the property had been so severally impacted by the Great Recession that I was still unable to refinance the loan.

with non-regulated entities, many of whom are direct competitors of the borrower. There is significant financial plight that is compounded upon these borrowers. Also, there is collateral damaged that is being sustained within local communities.

It is important that we all focus on rebuilding our economy to bring the Great Recession to conclusion. While the concept of Structured Transactions makes sense, Structured Transactions should be limited to loans that are non-recourse to the principals' of the borrower where private partners who are experts in the real estate industry can improve the assets and create value to the FDIC and local communities. This will permit local economies to start growing by allowing the small-business borrower to resolve its obligations with federally regulated banking institutions and be in a position to focus on the creation of jobs. As we have all seen in so many parts of the world, sometimes we have to accept the reality of our situation, learn from our mistakes and work towards rectifying them.

This 15th day of May, 2012.

Respectfully submitted,

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