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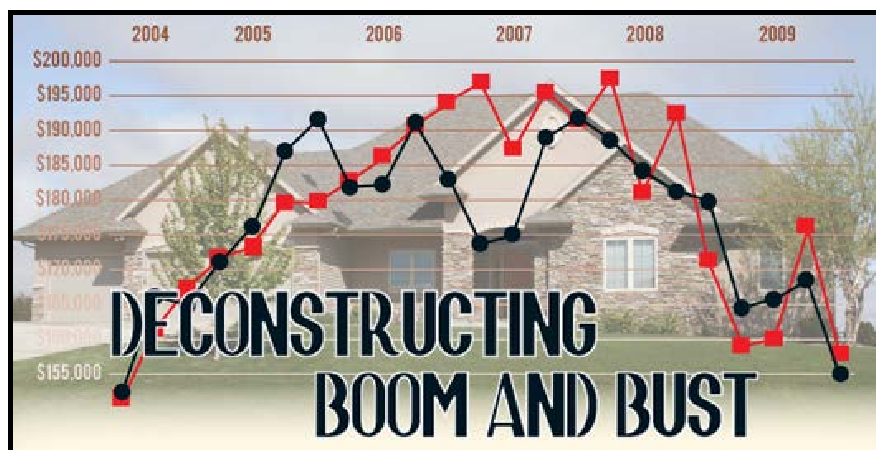
Deconstructing Boom and Bust: Bankruptcies filed by local developers demonstrate the national crisis

By Matt McGowan

"At the end of every seven-year period you shall have a relaxation of debts, which shall be observed as follows. Every creditor shall relax his claim on what he has loaned his neighbor; he must not press his neighbor, his kinsman, because a relaxation in honor of the LORD has been proclaimed."

– Deuteronomy 15:1/2



In 2005, when the economy hummed like Dallas traffic and citizens argued about how tall Fayetteville should grow, Kathy Deck, director of the Center for Business and Economic Research in the Sam M. Walton College of Business, ran into a contractor working on a building that had sparked the skyscraper debate. She told him that she had qualms about the financial viability of the project. Fayetteville didn't seem capable of supporting it.

"From my perspective," Deck says, "Fayetteville just didn't have the income or population density to support that kind of mixed-use, high-end development. I told him this, that I just didn't see how the cash flows, and he said, 'Well, it better. Do you know how many livelihoods depend on these projects?'"

But that's not how it works. Unfortunately, dependency of this sort does not ensure success. It does not fill up condominiums. Ultimately, the building's developer, Brandon Barber, crashed, a victim of excess and the collapse of a housing market that seemed invincible through most of the 1990s and 2000s.

After many months of personal and business tumult, including the bankruptcy filing of his company, Lynnkohn LLC, in 2008, Barber petitioned for personal bankruptcy in 2009. His chapter 7 petition listed zero assets, 50 creditors and $63 million of debt. More than a third of the debt was owed to several Arkansas banks, including $9.9 million to Legacy National Bank and $9.73 million to First State Bank of Northwest Arkansas. He also owed millions of dollars to local home centers and lumber companies.

Less than a year later, another high-profile chapter 7 landed in U.S. Bankruptcy Court. In a petition filed in late February 2010, John David Lindsey, real-estate developer and principal broker of Lindsey & Associates Real Estate, the highly successful firm started by Lindsey's father Jim more than 30 years ago, claimed assets of $9.99 million and liabilities of $169.6 million, including more than $19 million to Liberty Bank and more than $18 million to Bank of Fayetteville.

The Lindsey filing listed six personal businesses, 25 co-debtors and interest in 24 other Northwest Arkansas partnerships and companies. Assets included 226 single-family houses, 410 lots, 227 acres of land and three multi-family complexes. In May, the federal trustee for Lindsey's estate assigned much of this property to several creditors, including First Security Bank, which claimed 56 single-family residential dwellings and one two-family dwelling for unpaid loans totaling approximately $7.1 million. Further court hearings will settle additional property.

Despite the dollar figures – virtually unfathomable to the average wage earner – and the complexity of the cases in terms of property holdings and partnerships, both of the above bankruptcies were personal filings, even though a majority of the debt was business-related. How is this possible? How can an individual claim business-related debt in a personal bankruptcy filing?

The practice is not unusual, says Tim Tarvin, assistant professor of law and supervising attorney in the Federal Practice Clinic. Under Tarvin's direction, law students in the federal clinic handle bankruptcy cases for low-income individuals. Tarvin has practiced bankruptcy law for more than 30 years. He says individual chapter 7, which is the liquidation of a debtor's non-exempt assets for the purpose of selling the assets so the proceeds can be distributed to creditors, is the conventional way of handling bankruptcies such as Lindsey's and Barber's.

Tarvin emphasizes that human beings run businesses, so when these individuals personally guarantee business loans, they become personally liable. The liability becomes personal because the business owner backs the loans with personal collateral. When all business entities become insolvent, as was the case with Lindsey, the individual backing the entities can file one bankruptcy rather than many separate business filings. This route is critical because it provides immediate protection from creditors, eventual cancellation of personal liability and protection of exempt property that will give the debtor an opportunity to start over.

"It's as if the debtor is calling in all artillery on himself," Tarvin says. "The business owner is admitting that the venture has proven unsuccessful, and the time has come for reckoning. And once the creditors get everything from the business entities, there's nothing left."

But Lindsey will be left with something. That's the reason for bankruptcy, Tarvin says, to give people an opportunity to start over, to leave them with something, usually a home and a vehicle, after all other assets have been liquidated and sold, and all debts paid or discharged.

"In our culture, there's a strong stigma associated with bankruptcy," Tarvin says. "I'm not trying to excuse people who've been greedy or financially reckless, but really bankruptcy should be viewed as one form of debt collection. It is a process of examining the financial health of an individual and trying to restore that individual to productive capacity while treating creditors fairly."

Tarvin says it's unfair to place all the blame squarely at the feet of John David Lindsey. He was simply doing business as usual, based on about 30 years or more of strong, steady growth in Northwest Arkansas. There's no way Lindsey could have predicted the regional and national real-estate bubble bursting, and, furthermore, it wasn't like he was begging banks for money with no demand for housing in Benton and Washington counties.

The banks, which Tarvin sees as partners in Lindsey's business ventures, have some responsibility -- they should not be regarded as helpless victims. They wanted in on the deal, Tarvin says. The general attitude was that if one bank didn't make the loan, another would. They had many experts analyzing the economy and real-estate market, and still continued to invest in real estate.

But the banks should not be a scapegoat either, Tarvin says. Their actions reflected what was happening all over the country. Their lending practices stemmed from the real-estate boom, and if the Federal Reserve and dozens of federal regulatory agencies could not have predicted the housing and mortgage crises, then it's unrealistic to expect local banks to have anticipated them.

Deck agrees. She says Northwest Arkansas' longstanding and steady growth had become perceived as a normal state of being. Washington County's population alone more than doubled between 1970 (77,370) and 2000 (157,715). So for more than a generation, developers and banks contributed to and benefitted from this growth. For many of the people who ran these companies, especially those born after 1970, growth was all they knew. There had been temporary lulls, but for the most part, since 1970 and probably before, Northwest Arkansas had not experienced anything close to economic stagnation.

"Calling that moment when growth will slow down is difficult and dangerous," Deck says.

In part, that's the charge of the Center for Business and Economic Research, to provide economic data, both local and national, that Arkansas businesses can use to make informed decisions. But because it is dangerous – livelihoods and sometimes the viability of companies depend on economic predictions – Deck avoids strong statements about what the economy will or won't do. She does the research and lets the facts speak for themselves.

Trends emerge in the Skyline Report, a quarterly analysis of the Northwest Arkansas' real-estate market. Since 2004, the report has tracked commercial, multi-family residential and single-family residential units. It focuses on important factors such as sales, vacancy rates, building permits and plat approvals to provide a comprehensive picture of the current local real-estate market.

When asked how the Lindsey bankruptcy will affect the local market, Deck points to a graph of median housing prices and inventories for Washington and Benton counties. The graph shows that home prices have declined from $175,000 to $160,000 since June of 2009, which reflects the nature of the market in general. In fact, since Lindsey filed for bankruptcy, median housing prices have remained steady. However, since the bankruptcy filing, the number of houses listed for sale by realtors has risen steadily from about 5,200 to 5,700.

It's difficult to know for sure, but Deck suspects this increase may be attributed to the Lindsey bankruptcy. As more homes are returned to banks, many of these homes will go on the market and be sold for much less than what was owed on them. The industry calls this a "short sell." Deck will not be surprised if housing prices dip further. If – or when – this happens, the local market and economy will suffer. Lower list

prices will drive down the market value of neighboring homes, and this dynamic could then transfer from subdivision to subdivision and community to community.

"This power of transitivity affects home prices all through the region," she says. "Suddenly, if Bentonville's been smashed by foreclosures and is now selling cheap, then Rogers has to compete with Bentonville, and this spreads all the way out to Prairie Grove and Pea Ridge. Overall, there will be hits to capital available to do anything good."

Today, five years after his comments to Deck, the contractor's words have a prophetic ring.

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