AN EMPIRICAL STUDY OF RESIDENTIAL DEVELOPER BANKRUPTCIES IN THE UNITED STATES 2007- 2008

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ABSTRACT

With falling home prices and home foreclosures currently acknowledged as a severe problem in the U.S., more attention needs to be paid to the contributing phenomenon of residential developers undergoing liquidation, which has left behind a trail of partially-completed or abandoned properties. This dissertation presents the results of an empirical investigation aimed at understanding this phenomenon. Specifically, we addressed the following research questions: How have the Chapter 11 bankruptcy cases of residential developers and home builders during this downturn been resolved? How did the actions taken by secured lenders in the course of bankruptcy proceedings shape the resolution outcome? To what extent was bank behavior during these bankruptcies affected and constrained by the banking regulatory framework and culture?

This dissertation research involves the analysis of more than 200 residential developers that filed Chapter 11 bankruptcy petitions between November 2007 and December 2008. The main finding is that only a small minority of these developers confirmed a reorganization plan. The majority of the cases were dismissed or converted to Chapter 7, culminating in foreclosure or liquidation. Over 70% of the cases showed at least one instance where a secured lender sought lift-stay motions to pursue foreclosure. Among such cases, orders granting the lift-stay motions were granted most of the time.

Investigating this insistence on quick foreclosure, more nuanced views of banks' lending functions, risk management and their regulatory environment are explored through a study of FDIC data, interviews with industry participants and banks’ comment letters. A key finding is that, during a recession, banks may have a preference for liquidation in bankruptcy because of capital shortfalls and procyclical regulatory pressure to reduce portfolio concentrations, particularly in real estate lending. This would be inconsistent with theories that secured lenders will choose economically optimal outcomes within a bankruptcy case, as they may choose
outcomes that are sub-optimal within a bankruptcy to maximize an exogenous urgent need for capital.
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