

DOWNTOWN SANTA CRUZ PROPERTY

One local bank sues another over lot

Lighthouse Bank suit against Santa Cruz County Bank alleges misrepresentation during pre-foreclosure talks

Pacific Avenue
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SANTA CRUZ — Not often do banks sue each other, but two local banks are going head to head over the only remaining empty lot downtown since the 1989 Loma Prieta earthquake.

A lawsuit filed July 30 by developer Bill Brooks, lender Bayside Capital Partners and Lighthouse Bank against Santa Cruz County Bank gives a look inside the lending industry and its practices five years before the real estate market crashed.

In this case, the crash has left the Lau property, a key piece of downtown real estate, tied up in litigation, with local lenders scrapping

to get their money back. The property is at 1547-1549 Pacific Ave.

Most of the parties involved are big names locally: Brooks, who planned to build the Park Pacific luxury condo complex on that empty lot; Santa Cruz County Bank, headed by David Heald; and Lighthouse Bank, headed by Rick Hofstetter.

Bayside Capital Partners of Capitola is a "hard money" lender. Basically, hard money lenders make loans based on the value of a property, and the interest rates are higher because of the risk involved.

The lawsuit alleges a loss that "exceeds

ON THE NET

To view a copy of the lawsuit, visit santacruzsentinel.com

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SUIT

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\$25,000." Attorney Stephen Pahl, who helped found Lighthouse Bank in 2007 and serves on its board, filed the papers.

At the heart of the lawsuit is an allegation that Gary Reece, Santa Cruz County Bank's chief credit officer, made "false and misleading statements" to representatives of Lighthouse Bank, Park Pacific and Bayside Capital Partners during a 2011 meeting to resolve loan defaults on the Park Pacific project.



HOFSTETTER



HEALD

The Sentinel tried to reach Reece, but Heald said Reece has been advised not to comment.

Santa Cruz County Bank got involved in Park Pacific in 2007 when the economic outlook was bullish, loaning Brooks \$2.9 million.

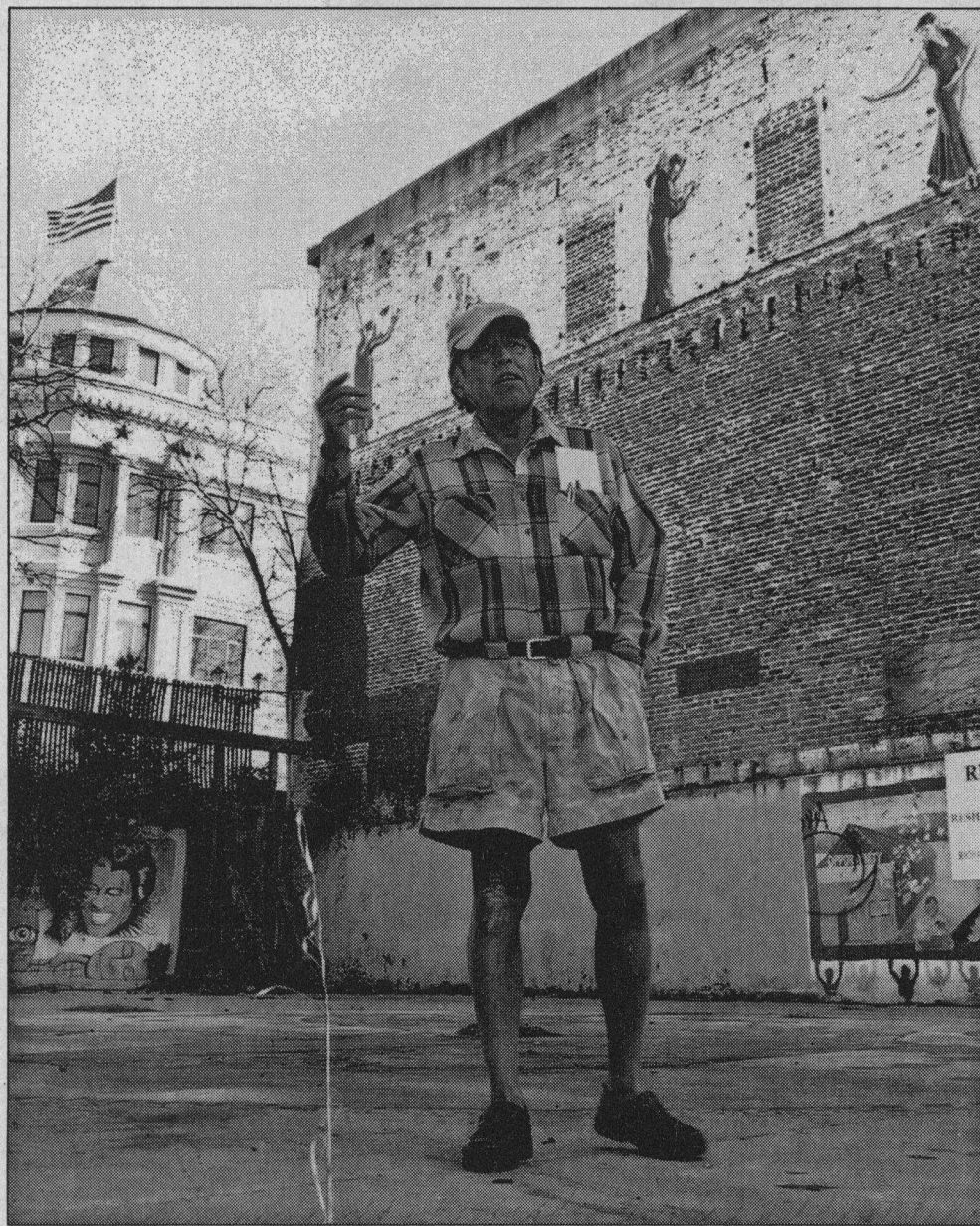
Neither Lighthouse Bank nor Bayside Capital invested in that project but Brooks worked with both lenders on another one, the Strawberry Business Center in Watsonville.

Brooks went to newly opened Lighthouse Bank to refinance a \$2 million construction loan he had with Coast Commercial Bank to build the Watsonville development — 19 business condos he hoped would fetch \$8 million. He got another \$1.1 million from Bayside Capital for the project.

Then the economy tanked.

DOWN ECONOMY

The price for the business condos was lowered 30 percent, and there wasn't enough money to pay off the loans. Brooks gave both lenders an interest in the Lau property down



Ron Lau on the site of his former property at 1547 Pacific Ave. in 2004.

DAN COYRO/SENTINEL FILE

town, making them "junior lienholders," an arrangement not permitted under the terms of the loan with Santa Cruz County Bank.

Two years later, as Brooks was running short of funds, he got a \$220,000 loan from the city of Santa Cruz Redevelopment Agency to make his interest payments to Santa Cruz County Bank. In exchange, the redevelopment agency got an interest in Park Pacific, and the agency's claims for payoff were put ahead of those for Lighthouse Bank and Bayside Capital.

By 2011, Brooks was so far behind in payments to Santa Cruz County Bank that he was in default. The bank could have foreclosed.

He had city approval to build a seven-story complex with 58 condos but couldn't afford to move ahead because of the escalating price of steel.

One option was to file for a bankruptcy reorganization. Another was to sell the Pacific Avenue property.

Brooks proposed to sell the Lau property to resolve the defaults while remaining a part-

ner in the project. He contends he had three qualified buyers willing to pay \$3.8 million.

The lawsuit claims Reece asked Brooks to wait until the city approved the development, which would make the property more valuable.

THE CLAIM

Reece's plan, according to the lawsuit, was for Brooks to cooperate on the foreclosure, which would wipe out the interests of Lighthouse Bank and Bayside Capital, then sell the property and pay off

the \$2.9 million loan, "with remaining funds going to the Santa Cruz Redevelopment Agency, Lighthouse Bank and Bayside Capital."

He claims Reece offered him a 6 percent commission, about \$228,000, for brokering the deal, out of which he could keep a third and use the rest to pay consultants, architects, permit fees and taxes.

But there was another complication.

Former property owner Ron Lau was demanding either \$700,000 or two of the yet-to-be-built Park Pacific condos under a condemnation settlement with the city.

According to the lawsuit, Brooks claims Reece assured him the Lau lien could be negotiated down to "\$200,000 maximum."

That would have freed up \$500,000 to pay toward the loans from the Redevelopment Agency, Lighthouse Bank and Bayside Capital.

Brooks said he was told the agreement with Lau was in violation of the state Subdivision Map Act and could be challenged in court.

Brooks said he agreed to cooperate with Santa Cruz County Bank.

So did Lighthouse Bank and Bayside Capital.

According to the lawsuit, they "completely relied on Mr. Reece's representations and took no action to protect their rights prior to and after the foreclosure proceeding."

All of the parties waited for the Santa Cruz City Council to approve the development project, which they did. On Oct. 11, a 70-unit condo complex was approved unanimously.

CALLING IN THE LOAN

Two weeks later, according to the lawsuit, Reece told Brooks, Hofstetter and a Bayside Capital representative that Santa Cruz County Bank wanted a full payoff of its loan and "would make no concessions" other than waiving "default interest," the higher interest a borrower pays after defaulting on payments.

When Santa Cruz County

Bank foreclosed on the property in April, Brooks owed \$270,000 in unpaid interest and fees.

But he owes more to Lighthouse Bank, \$750,000, and Bayside Capital, \$500,000.

The day after the sale, Santa Cruz County Bank owed a property tax bill in excess of \$100,000.

The lawsuit claims the bank went into escrow afterward with Clarum Homes with a price of \$3.2 million subject to the Lau agreement and no distributions to Lighthouse Bank, Bayside Capital, Park Pacific or other creditors.

Santa Cruz County Bank has yet to file a response, but Heald issued this statement, "We have worked on this particular project with the city of Santa Cruz for over five years. As a bank we never like to foreclose on any project, and we do everything in our power to avoid such action; however, when this occurs there is commonly conflict."

He added, "Our entire procedure has been in strict accordance with California and federal law and all processes have been properly followed, which includes proper notification to all parties including junior lienholders. The bank has great confidence in the legal system and prefers to litigate claims in court rather than in the press. We expect to be vindicated in court."

Rick Hofstetter, Lighthouse Bank president, said, "We find it extremely unfortunate that legal action proved necessary. The group's clear preference was dialogue."

Pahl, the Lighthouse Bank attorney, said it's "quite rare" for banks to sue each other.

"Normally banks work it out," he said.

"I've done a lot of business with Santa Cruz County Bank," Brooks said. "They've always been good. I'm really disappointed we had to do this."

Added Cliff Bixler of Bayside Capital, "None of us are very happy about it."

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