
IN THE UNITED STATES BANKRUPTCY COURT
 FOR THE DISTRICT OF UTAH
 CENTRAL DIVISION

In re:

COLLEGE TERRACE, LTD.,

Debtor.

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Bankruptcy Number 88B-04591

[Chapter 11]

MEMORANDUM DECISION

J. Scott Lundberg, Esq. of Prince, Yeates and Geldzahler, Salt Lake City, Utah, appeared on behalf of First Western Savings Association.

William T. Thurman, Esq. and Scott C. Pierce, Esq., of McKay, Burton & Thurman, Salt Lake City, Utah, appeared on behalf of College Terrace, Ltd.

This matter comes before the court upon the motion of First Western Savings Association (First Western) for relief from the automatic stay pursuant to 11 U.S.C. § 362(d)(1) and (2) in order to allow it to foreclose its interest in the assets of College Terrace, Ltd. (College Terrace). The court has carefully considered and reviewed the arguments of counsel, assessed the credibility of the witnesses, and made an independent review of the pertinent authorities. The court, being fully advised, hereby renders the following decision.

BACKGROUND

The following is a summary of the facts adduced at trial.

1. On August 9, 1988, College Terrace filed a petition commencing a case under chapter 11, Title 11, United States Code.

2. College Terrace is a Utah limited partnership formed to develop and operate an apartment complex located at 673 West 1200 South, Orem, Utah (the property). College Terrace constructed the property in 1986. The property, its cash flow, and certain personal property located within the property are the sole assets of College Terrace. College Terrace has operated the property by leasing residential space mainly to students of Utah Valley Community College. The property can accommodate 300 paying tenants.

3. Certain general partners of College Terrace assist in the management of the partnership. College Terrace maintains resident managers on site. It experiences a low occupancy rate during the summer months but occupancy increases during the fall, winter, and spring school terms. College Terrace attempts to augment its income during the summer months by renting to participants in various summer camps during the slow period.

4. First Western, as successor in interest, is the beneficiary under a deed of trust with an assignment of rents dated May 15, 1986. The deed of trust secures performance by College Terrace of its obligations under a promissory note executed May

15, 1986, in the principal amount of \$2,500,000.00. The note incorporates a variable interest rate during construction of the project and leaseup. Beginning on the first day of the second year, interest is calculated at a floating gross annual rate of two and three-eighths percent over the cost of funds index defined in the note. The term of the note is amortized over 30 years with the outstanding principal and interest payable on May 1, 1996. First Western is further secured by a security agreement encompassing all of College Terrace's contract rights, general intangibles, and accounts receivable, as well as an interest in all personal property. The parties also entered into an assignment of rents and leases in favor of First Western.

5. First Western's interests in the collateral are properly perfected.

6. College Terrace failed to make payments to First Western.

7. First Western proceeded to foreclose its security interest which prompted the filing of the within petition.

8. As of July 7, 1989, the outstanding principal balance of the obligation owed to First Western was \$2,478,559.36. The interest accrued was \$212,903.71 with a per diem accrual of \$719.21. Attorneys fees of \$20,275.59 and appraisal costs of \$5,850.00 had been incurred by First Western as of July 7, 1989. Late fees accrued as of July 11, 1989, were \$13,119.25. College Terrace paid First Western \$43,749.30 on June 29, 1989.

9. Zions First National Bank (Zions) holds a security interest in the personal property of College Terrace which furnishes the property. The obligation is also

secured by a second deed of trust on the property. The total amount owing to Zions is \$87,400.00.

10. Utah County is a creditor having a claim for delinquent taxes in the approximate amount of \$62,887.21 which further encumbers the property.

11. College Terrace submitted an appraisal of the property as of June 17, 1989, by Mr. Jed Harward, M.A.I., valuing the real property, land, and buildings at \$2,900,000.00, and the furniture, fixtures, and equipment at \$100,000.00. An arithmetic error in the appraisal reduced the collective value to \$2,975,000.00.

12. First Western submitted an appraisal of the property as of October 13, 1988, by Mr. George Fujii, M.A.I., valuing the real property at \$2,910,000.00. Mr. Fujii updated his appraisal report as of May 30, 1989, and valued the property at \$2,800,000.00.

13. Principals of College Terrace value the property at \$3,300,000.00.

14. College Terrace has available cash assets of \$32,800.00.¹

15. Based upon all the evidence, the value of the real property, fixtures, and furniture is \$2,975,000.00.

16. A real estate sales commission of three percent is reasonable if the property were sold.

¹ Cash on hand as of July 26, 1989, was \$48,100.00. Outstanding utility bills of \$400.00, federal and state taxes of \$1,900.00, and deposits of \$13,000 should be charged against the gross cash on hand.

17. It is unlikely that a purchaser for the property could be found who would pay the appraised value in cash at closing. No purchaser currently exists.

18. A reasonable fee for closing costs and title insurance upon sale of the real property would be approximately \$6,600.00, but a developers discount of up to forty percent may be available.

19. Sales of similar properties in the area are increasing, as is the demand for student housing and, to a modest extent, rents.

20. College Terrace has proposed a First and Second Amended Plan. A confirmation hearing is scheduled for August 16, 1989.

21. The plan currently on file with the court pays First Western's allowed secured claim in 360 monthly deferred payments beginning October 1, 1990. The interest rate will be fixed at ten percent. The plan calls for monthly payments of \$21,874.56 to be made to First Western from December of 1988 through April of 1989.² Payments in a like amount will resume on October 1, 1989, and continue through April 1990. Payments for July through September 1989, and May 1990 through September 1990, will be calculated to equal an amount by which income from the property exceeds the operational expenses plus a \$20,000.00 reserve. All past due amounts will be added to the principal and the obligation will be reamortized as of October 1, 1990.

² May and June payments for 1989 have been made to First Western, though not called for in the plan.

22. First Western does not make loans on income producing property at less than a seventy-five to eighty percent loan to value ratio.

23. First Western's loans on income producing property are usually for a term of from twenty to thirty years with a ten year call.

24. The current interest rate under the term of the note is ten and one-half percent.

25. The current interest rate on loans on income producing property is three percent above the Federal Home Loan Bank of San Francisco rate, or eleven and one-half percent.

26. First Western is only offering adjustable rate mortgages at this time.

27. College Terrace has agreed in open court to pay the reamortized obligation in full on May 1, 1996; that date being the date the original obligation is due. It has further orally agreed to sell or refinance the property within eighteen months of confirmation.

28. College Terrace has submitted a variety of financial data in an attempt to present the most current information available. The data reflects a cash flow which College Terrace projects is sufficient to satisfy the plan of reorganization as proposed.

29. College Terrace has obtained more nine month leases as of July 28, 1989, than were in existence the previous year. It is probable that College Terrace will

be able to fully lease all available spaces for the winter months. It is also probable that it will be able to increase revenues during the summer.

30. Terry V. Pearce, one of the general partners of College Terrace, was ordered in open court to obtain a bond or insurance theft policy for the employees of College Terrace handling cash as a condition for the continued use of the cash collateral of First Western. The order was reduced to writing and executed June 23, 1989, and extended thereafter. As of July 28, 1989, when this matter was taken under advisement, College Terrace had not complied.

31. College Terrace has circumvented the direction of the United States trustee by establishing a "zero balance" checking account for use in making payments to trade creditors which does not bear the designation "Debtor-In-Possession".

32. College Terrace has transferred attorneys' fees, which may constitute cash collateral, to its attorney's trust account without court authorization before the fee application of counsel has been approved by the court.

33. College Terrace has paid fees for accounting services. No accountant has been approved by the court pursuant to 11 U.S.C. § 327 nor have fees been approved pursuant to 11 U.S.C. § 328.

34. College Terrace has failed to supply to First Western a key to its disbursement codes as requested in open court.

35. College Terrace has paid in excess of \$10,000 in any one month to postpetition creditors. The cash collateral order allowed the use of cash collateral up to a maximum of \$10,000 for expenses incurred in any specific month. No limitation in the cash collateral order prevented expenses incurred in one month from being paid in a subsequent month.

36. College Terrace has been late in submitting monthly financial reports to the court, First Western, and the United States trustee.

37. College Terrace has been late in paying First Western amounts agreed to in the cash collateral order.

DISCUSSION

1. JURISDICTION

The Court has jurisdiction over this contested core matter pursuant to 28 U.S.C. § 1334.

2. 11 U.S.C. § 362(d)(2)

A. Equity Analysis

Based upon the facts adduced at trial, First Western is and remains an oversecured creditor entitled to the accrual of postpetition interest and any reasonable fees, costs or charges pursuant to 11 U.S.C. § 506(b). The court concludes however that though a nominal positive balance remains in its favor after subtracting the indebtedness

from the value of its assets, College Terrace has no realizable equity in the real property, fixtures, and personalty.

The accrual of interest at \$719.21 per day, the additional costs and fees to which First Western is entitled, the speculative nature of College Terrace's ability to obtain a cash purchase price for the value of the property, and the fluctuating nature of College Terrace's cash reserves are such that, for all practical purposes, no equity exists. The nominal equity cushion which may exist on a purely balance sheet approach is so tenuous and subject to such fluctuation as to prevent a finding based on clear and convincing evidence that College Terrace has equity in the property.

B. Necessity For Effective Reorganization Which is in Prospect

The Code requires the court to make a determination whether or not this property is necessary for an effective reorganization and, under the decision of *United Savings Ass'n of Texas vs. Timbers of Inwood Forrest Assoc., Ltd.*, 108 S. Ct. 626 (1988), whether or not a reorganization is in prospect. This case is a one asset case and divesting College Terrace of this asset would render any potential for repayment of unsecured or administrative claimants moot. The court determines that this property is necessary to College Terrace's rehabilitation efforts.

Webster's Dictionary defines prospect as "something expected" or "possible". *Webster's II New Riverside Dictionary* 945 (1984). There are various factors the court

should consider to determine that a reorganization is expected or possible. However there are as many variables to this determination as there are reasons why a debtor files a chapter 11.

This determination must be made on a case-by-case basis but certain criteria are generally applicable. First, does the debtor have assets available for rehabilitation of an ongoing business or is the liquidation of assets the only option for reorganization of the debtor? Second, if the debtor is to continue in operation, does it have access to management with sufficient skill and competency to successfully operate? Third, is the debtor's financial data sufficiently accurate to form the basis of accurate projections? Fourth, are market or other factors outside the control of the debtor favorable to rehabilitation? Fifth, does the debtor have the ability to draft a plan which will technically comply with the requirements of 11 U.S.C. § 1129? Sixth, can the debtor make some showing that given the opposition of the moving creditor a plan could still be confirmed? Seventh, can the debtor show with some degree of probability that a plan would be feasible?

The degree of certainty with which the debtor must prove these elements depends upon the posture of the case at the time the court is considering the issue. If the case is recently filed and the exclusivity period is in effect, the burden upon the debtor to show that it has a plan of reorganization in prospect is less. As time passes the debtor must present a more convincing case.

At the early stages of a chapter 11, it may only be necessary to show that the debtor is proceeding with deliberate speed to propose a disclosure statement and plan. However, the mere failure to have a disclosure statement and plan on file should not give rise to the conclusion that no reorganization is in prospect. Certainly if extensive negotiations were being conducted with creditors and if the debtor was actively participating in the reorganization process that may be sufficient. Likewise, the mere filing of a disclosure statement and plan should not presume rehabilitation is likely. Any competent debtor's attorney can draft a disclosure statement and plan and file it with the court.

Consideration of the elements set forth above should assist the court to determine if a reorganization is possible. To require more, even late in a case, would be unduly burdensome both to the court and to the debtor. It cannot be the interpretation of *Timbers* that every stay lift hearing must encompass an evidentiary confirmation hearing. To do so would deny due process to those parties not actively participating in the stay lift hearing, and would be duplicative and wasteful of the court's time.

Application of the elements in this case is informative. First, College Terrace is anticipating an ongoing business rather than a liquidation and has sufficient assets to support that goal.

Second, this case presents an example of the evolution of the management of a debtor in the rehabilitation process. At the initial hearings, College Terrace had

management which, although attempting to comply with the provisions of the Code, had an inability to do so. One of the purposes of a chapter 11 is to make those necessary managerial alterations which increase the likelihood for success of the debtor's rehabilitation.

College Terrace has apparently overcome the characteristic inertia which often occurs to chapter 11 management the upon filing of a petition. Frequently this inertia is evidenced by an inability to make constructive decisions. The debtor must be able to shift from fending off creditors to moving forward aggressively to solve its problems. College Terrace has modified its managerial techniques over the course of this case. Rather than late payments and late financial reports, College Terrace shows some attempt to bring itself in line with those characteristics which would indicate a successfully rehabilitated debtor. College Terrace has analyzed the management of its assets and has made decisions which may indicate change in its financial prospects.

Third, College Terrace has improved its accounting functions and the accuracy of its projections. Failure to properly account for funds received and disbursed is a touchstone for insolvency. Rather than just producing volumes of computer projections, the data used now appears more accurate and is based on a more thoughtful analysis.

Fourth, the evidence indicates two market trends which may assist College Terrace. Other student housing leasing rates are rising while College Terrace's are

constant. That may increase the prospect for full occupancy. The evidence further indicates some increase in the marketability of the real property to College Terrace's benefit.

Fifth, no convincing evidence has been presented that College Terrace cannot comply with the technical provisions of 11 U.S.C. § 1129. To that end, College Terrace has previously obtained approval of its disclosure statement.

Sixth, College Terrace has evidenced a continuing attempt to propose a plan which would be palatable to First Western. At the final hearing College Terrace modified the period of time between confirmation and the sale, refinancing, or surrendering of the property. If College Terrace can eventually seize upon a combination of financial elements which would be palatable to the creditor between now and a final confirmation hearing, the court should not inhibit that process by lifting the automatic stay prematurely.

Seventh, College Terrace has demonstrated a reasonable likelihood that its projected income could fund its plan as proposed. It is inappropriate however for the court to consider every element necessary to confirm a plan under 11 U.S.C. § 1129 at this stay lift hearing. Whether the payment of a fixed interest rate of only ten percent with no override when the prevailing rate for seventy-five percent loan-to-equity ratios is eleven and one-half percent compensates First Western for the risks inherit in a one-hundred percent loan, or whether the negative amortization constitutes fair and equitable

treatment are issues best left to the confirmation hearing. *In re Memphis Partners, L.P.*, 99 B.R. 385 (Bankr. M.D. Tenn. 1989). Perhaps prior to that hearing, further modification in the plan will increase its likelihood of confirmation.

Consideration of the totality of the circumstances of this case prompts a conclusion that sufficient economic viability is inherent in the proposed plan that, although feasibility is not a forgone conclusion, a reasonable likelihood exists that College Terrace would be able to meet the payments set forth in the plan. Further, College Terrace has also evidenced an attitude and willingness to make the sacrifices and management alterations necessary to effectuate a plan. Based upon the modifications which College Terrace has and could propose which would provide for fair and equitable treatment of First Western, the court concludes that a plan is in prospect.

3. 11 U.S.C. § 362(d)(1)

First Western asserts that the litany of errors committed by College Terrace in this proceeding should be sufficient grounds to lift the automatic stay for cause. College Terrace has transferred funds to Lance Andrewsen, an insider, in payment of his accrued accounting fees. It attempts to characterize these payments as merely ordinary course of business payments not requiring any special approval of the Court. Since the payment is to a CPA for accounting services and the payee is an insider, it is inappropriate for College Terrace to make such payments without approval of the employment of Mr. Andrewsen and without approval of the amount and services

performed. Merely recharacterizing the payment as an ordinary course payment for bookkeeping fees is self serving and not within either the letter or the spirit of the statute.

In direct contravention of the explicit direction of the court to Terry Pearce to obtain a bond or employee theft policy for his employees handling cash, and despite having been reminded by First Western of the court's order on numerous occasions, College Terrace has failed to comply. This element constituted a condition of College Terrace's continued use of cash collateral. Default in the terms of that protection subjects College Terrace to potential termination of the right to use cash collateral.

College Terrace has transferred attorney fees to its attorneys' trust account prior to approval by the court of those fees. The funds may be cash collateral of First Western.

College Terrace has established a "zero-balance" account from which it pays trade creditors. That account does not inform creditors of the Debtor in Possession status by containing such a designation on the face of the checks. This practice is directly contrary to the intent of the United States trustee's directive and is a flagrant attempt to circumvent both the spirit and letter of those procedures. It is not within the discretion of College Terrace to pick and choose which procedures to follow. Should College Terrace desire relief from those procedures, the appropriate remedy is by motion, not by unilateral action of the debtor.

The court considers each of these matters as serious breaches of the cash collateral order and of the obligations of a Debtor in Possession. The court is also convinced however, that College Terrace has shown a recent improvement in following the court's orders and in complying with the United States trustee's requirements. College Terrace has experienced a change in management and it is apparent that the level of expertise and skill necessary to manage College Terrace's accounting has increased significantly. Likewise, payments in the recent past are timely, as are monthly financial reports.

The court considers the errors College Terrace has made in proceeding as a trustee of this estate to be significant, but not of the magnitude to constitute the type of "cause" anticipated by the statute. Other remedies are available to bring College Terrace's conduct into conformity with the orders of the court short of divesting College Terrace of its assets, thereby rendering any potential for rehabilitation moot.

CONCLUSION

The court determines that College Terrace has sustained its burden in showing that this property is necessary for an effective reorganization and that a reorganization is in prospect. Because less drastic remedies are available which are consistent with the Code's policy of fostering rehabilitation of troubled debtors while

protecting creditors, the court denies First Western's motion to lift the stay for cause. The automatic stay will remain in effect, however, conditioned upon the following:

1. College Terrace is **ORDERED** forthwith to refrain from issuing any checks without the designation "Debtor in Possession" on the face thereof;
2. College Terrace is **ORDERED** forthwith to place in effect an employee bond or theft policy;
3. College Terrace is **ORDERED** to cease transfers of funds to Lance Andrewsen or any other accountant in payment of accounting services, however denominated, absent appointment pursuant to 11 U.S.C. § 327 and approval of said fees;
4. College Terrace is **ORDERED** to hold in escrow, without the use of said funds, any fees to be applied prospectively to attorneys fees not yet approved;
5. In the event College Terrace fails to comply with the orders set forth above, the automatic stay shall be lifted and First Western allowed to exercise the remedies provided in its loan documentation.

DATED this 4th day of August, 1989.


JUDITH A. BOULDEN
United States Bankruptcy Judge