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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re
PACIFIC PROPERTIES, a California limited
partnership,
Debtor.

Case No. 91-5-5806-MM
R.S. No. 92-1771
Chapter 11

**CONFIRMATION OF CHAPTER 11
PLAN AND RELIEF FROM STAY
(FEASIBILITY AND PRESENT VALUE)**

INTRODUCTION

Before the Court is Western Federal's motion for relief from stay, which was trailed by the hearing on confirmation of the debtor's plan of reorganization. For the following reasons, the debtor's plan is confirmed, and Western Federal's motion for relief from stay is denied.

FACTS

The debtor is a California limited partnership that was formed in 1974. Its only asset is its 40% interest in an apartment complex known as Cypress Park Apartments located at 2055 Summerside Drive in San Jose, California. The debtor, Summerwood Investments, and Northwest II Investments acquired the property in December 1984 for the purchase price of \$13,500,000. The owners refinanced the property in December 1987 by executing to Western Federal a promissory note in the amount of \$14 million secured by a deed of trust on the property. The Western Federal note is a 30 year note at a variable rate that is based on the 11th District Cost of Funds as an index. The

1 initial rate of interest on this note is 9.81%.

2 The property is 24 years old and caters primarily to families. It consists of 288 units
3 comprised of 8 3-story buildings of 36 units each. It includes a child care center, a garage and
4 additional covered parking for its tenants, an olympic-size swimming pool, tennis courts, basketball
5 courts, an exercise room, and sauna. Although the City of San Jose had issued notices of violation of
6 the City Housing Code, the debtor has performed considerable deferred maintenance since the
7 bankruptcy petition was filed responding to the City's concerns.

8 The debtor defaulted on its obligation to Western Federal in April 1991 by failing to pay real
9 estate taxes. Western Federal recorded a notice of default and had a receiver appointed to manage
10 and operate the property. The debtor filed its bankruptcy petition on September 20, 1991. As of
11 December 31, 1992, the debt to Western Federal totalled in excess of \$16.8 million.

12 Western Federal filed a motion for relief from stay on October 9, 1992 asserting that its
13 interest is not adequately protected, that the debtor does not have equity in the property, and that the
14 property is not necessary to an effective reorganization. The debtor filed a plan of reorganization on
15 September 8, 1992 that proposed to pay Western Federal deferred payments on interest and principal
16 at a variable rate based on the Eleventh District Cost of Funds over twenty-two years. It also
17 reduced the cap on the variable interest rate. Otherwise, the provisions are the same as those under
18 the original note. Western Federal objected to confirmation of the debtor's plan for the following
19 reasons:

20 1. The plan is not feasible because the debtor's projections are unrealistic and cannot
21 support its proposed plan;

22 2. The plan is not fair and equitable because the deferred plan payments fail to provide
23 Western Federal with the present value of its secured claim;

24 3. The plan discriminates unfairly against Western Federal by paying other junior
25 creditors in full before Western Federal's secured claim will be fully satisfied; and

26 4. The plan violates the best interest of creditors test because creditors would receive
27 more in a Chapter 7.

28

1 DISCUSSION

2 **A. The Plan is Feasible Under 11 U.S.C. 1129(a)(11)**

3 Section 1129(a)(11) provides that confirmation of a chapter 11 plan requires that the plan be
4 feasible. The feasibility requirement mandates that confirmation of the plan is not likely to be
5 followed by the liquidation, or the need for further financial reorganization, of the debtor. 11 U.S.C. §
6 1129(a)(11). The plan must have a reasonable probability of success. In re Acequia, 787 F.2d 1352,
7 1364 (9th Cir. 1986). Feasibility has been defined as whether the things which are to be done after
8 confirmation can be done as a practical matter under the facts. In re Jorgeson, 66 Bankr. 104, 108
9 (Bankr. 9th Cir. 1986).

10 The property is in good condition and is operated by competent management. Moreover, the
11 debtor cooperated with and worked with the Bank's consultants to address the maintenance needs of
12 the property. The debtor's November rent rolls scheduled rent receipts of \$230,325 from the
13 property, which exceeds the debtor's projections. The debtor's projected rent increases of 3% per
14 year are conservative in view of Mr. Free's testimony that 3-7% increases per year are supportable.
15 The vacancy rate is within the debtor's projected 8-10%.

16 The debtor's projections have been conservative, and it is currently ahead of its projections.
17 They indicate clearly that the debtor's plan is feasible. Mr. Gregerson's forecasting was supportable
18 and conservative, and his testimony was credible. The Court finds that given the evidence
19 presented, the debtor's projections are not unrealistic, and the plan is feasible at the interest rate
20 proposed.

21 **B. The Interest Rate Set Forth in the Plan Provides**
22 **Western Federal with the Present Value of its Claim**

23 If all impaired classes have not accepted the plan, the "cramdown" requirement of section
24 1129(b) provides that the plan may nonetheless be confirmed over a dissenting creditor's objection
25 only if the plan is fair and equitable with respect to and does not discriminate unfairly against each
26 impaired class. That the plan be fair and equitable requires that a class of secured claims either retain
27 its lien and receive on account of its secured claim deferred cash payments totalling the present value
28 of its secured claim or realize the indubitable equivalent of its secured claim. 11 U.S.C. §
1129(b)(2)(A).

1 The plan provides that Western Federal will retain its lien. It further provides that Western
2 Federal will receive deferred payments on account of its secured claim at a variable rate projected to
3 be 7.44% in order to provide Western Federal with the present value of its claim. The rate of interest
4 on deferred payments should be the rate of interest that the debtor would pay to borrow a similar
5 amount on similar terms in the commercial loan market. In re Camino Real Landscape Maint.
6 Contractors, 818 F.2d 1503, 1506 (9th Cir. 1987). Factors that affect the market rate includes the
7 quality of the security and the risk of default. Id. at 1507-08. The appropriate interest rate must be
8 determined on a case-by-case basis. Id. at 1508.

9 Building a formula rate to determine the appropriate market cramdown rate is an accepted
10 approach in the Ninth Circuit. In re Fowler, 903 F.2d 694, 697 (9th Cir. 1990). Under this
11 approach, the court begins with a base rate and either adds or subtracts points based on factors such
12 as the risk of default and the nature of the security. Id. This approach requires the court to assess the
13 risks associated with a given debtor and the security associated with a specific debt. Id. at 698. It is
14 the debtor's characteristics that determine the appropriate interest rate; the creditors' characteristics
15 are irrelevant. Camino Real, 818 F.2d at 1506.

16 The debtor has used the Eleventh District Cost of Funds as its base rate for structuring its
17 payments to Western Federal under the plan. The Court finds that this is a permissible base rate. In
18 re Little Fox Investors, Ltd., Case No. 91-53443-JRG (Bankr. N.D. Cal. 1991). As of February 1,
19 1993, the Eleventh District Cost of Funds was 4.360%, down from the rate of 4.597 at the time of
20 the confirmation hearing in December 1992.

21 The loan proposed in the debtor's plan does not compel an upward adjustment from the base
22 rate because the term of the loan is actually shorter than the term under Western Federal's original
23 note. The original note is also a variable rate note which matured in 30 years. The proposed note is a
24 twenty-two year note that matures three years earlier than the original note. The only other
25 modification to the original note is that the debtor has lowered the allowable cap on adjustments to
26 the interest rate from 4.681% to 2.681%. Moreover, Western Federal is retaining its lien on the
27 debtor's property. Also, the loan to value ratio, which Western Federal believes to be in excess of
28 100%, is not a significant variable under the formula approach because it is irrelevant to the

1 determination of the value of a future stream of payments. In re Orosco, 77 Bankr. 246, 254 (Bankr.
2 N.D. Cal. 1987).

3 Because the plan proposes a secured loan, an upward adjustment to the interest rate to
4 compensate for the lack of security is unnecessary. Little Fox Investors. With respect to the quality
5 of the collateral, the property is over twenty years old, so higher deferred maintenance can be
6 anticipated. However, the debtor has introduced substantial evidence that although it is an older
7 property, it is in very good condition. Cypress Park is a desirable rental property which includes
8 abundant tenant amenities. The structures and the grounds are well maintained. Since the filing of its
9 petition, the debtor has performed the required deferred maintenance on and have made other
10 substantial improvements to the property. There are no unremedied Housing Code violations. These
11 factors support an upward adjustment of the interest rate by 200 basis points, which results in an
12 interest rate of 6.360%.

13 The risk of default on the loan is another factor that affects the appropriate market rate. Here,
14 the Court finds that the risk of default is higher because this is a long-term note. However, the value
15 of the property is stabilizing. The debtor has employed experienced and competent management to
16 operate its real property. The occupancy rate at Cypress Park has been improving, and the income
17 stream is increasing. In the current real estate market, it appears that the debtor will likely meet its
18 projected income level, which is conservative. Its cash flow forecasts indicate an ability to satisfy its
19 operating expenses and debt service. Under these circumstances, the Court believes that it is
20 reasonable that the debtor will be able to maintain its plan payments to Western Federal at the interest
21 rate proposed in the plan. Moreover, market rates have been declining, which further enables the
22 debtor to make its plan payments. Because there is some risk of default on this long-term loan, an
23 upward adjustment of 100 basis points is appropriate. This results in an interest rate of 7.360%.

24 Upon determining the appropriate interest rate, the court must determine whether the debtor
25 can reasonably make the plan payments to satisfy that interest rate. All inferences drawn from the
26 underlying facts and the matters contained in the plan and disclosure statement should be viewed in a
27 light most favorable to the debtor. In re Spanish Lake Associates, 92 Bankr. 875, 877 (Bankr. E.D.
28 Mo. 1988). Here, the Court finds that the debtor's projected interest rate of 7.44% is attainable and

1 provides Western Federal with the present value of its claim.

2 Having found that the plan provides Western Federal with retention of its lien and the present
3 value of its claim, the Court finds that the cramdown provision of § 1129(b)(2) is satisfied, and it is
4 irrelevant whether Western Federal will receive the indubitable equivalent of its claim. The plan is fair
5 and equitable.

6 **C. The Plan Does Not Discriminate Unfairly
Against Western Federal**

7 Western Federal further argues that the plan discriminates unfairly against Western Federal by
8 paying other creditors in full before Western Federal's secured claim is fully satisfied. To determine
9 whether a plan discriminates unfairly against a creditor, the Court must inquire as to (1) whether the
10 discriminating treatment has a reasonable basis; (2) whether the debtor could carry out a plan without
11 the discrimination; and (3) whether the plan and the discriminatory treatment are proposed in good
12 faith; and (4) the treatment of the class discriminated against. In re Kemp, 134 Bankr. 413, 417
13 (Bankr. E.D. Cal. 1991). The cramdown provision of section 1129(b) requires only that a senior
14 class of creditors be "provided for" under the plan and not "paid in full" before payments can be made
15 to a junior class of claimants. In re Johnston, 140 Bankr. 526, 530 (Bankr. 9th Cir. 1992). The
16 Court has determined that Western Federal will receive the present value of the amount of its claim
17 on the effective date. Because the plan provides Western Federal's secured claim before any
18 payments are made to unsecured creditors, it does not discriminate unfairly against Western Federal.

19 **D. The Plan Does Not Violate the Best Interest
of Creditors' Test**

20 Western Federal argues that the plan does not meet the best interest of creditors' test under
21 section 1129(a)(7) because it provides Western Federal with less on the effective date of the plan than
22 it would in a Chapter 7 liquidation. The Court rejects this argument because the plan provides for
23 payment in full on all claims.

24 **E. Relief from Stay is Not Warranted Under
Sections 362(d)(1) and (d)(2)**

25 Western Federal moved for relief from stay pursuant to sections 362(d)(1) and (d)(2). It argues
26 that it is entitled to relief for cause because the debtor has failed to preserve the security, and the value
27 of the collateral is declining during the case. The evidence does not support Western Federal's
28 contentions. Section 362(d)(2) provides for relief from the stay if the debtor has no equity in the

1 property, and the property is not necessary to an effective reorganization. Both requirements must be
2 satisfied. Not only because the Cypress Park is necessary to an effective reorganization, but also because
3 a reorganization is in prospect immediately, the motion must be denied.

4
5 **CONCLUSION**

6 The debtor's plan is hereby confirmed, and Western Federal's motion for relief from the automatic
7 stay is denied.

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