

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION**

In re:

NEWSOM PROPERTIES, LLC,

Case No. 6:11-bk-04192-ABB

Chapter 11

Debtor.

_____ /

ORDER

This matter came before the Court on the Motion to Value (Doc. No. 3) filed by the Debtor Newsom Properties, LLC seeking to determine the value of the secured claim of Compass Bank and Compass Bank's response thereto (Doc. No. 64). The final evidentiary hearing was held on September 8, 2011 at which the principals of the Debtor William A. Newsom, M.D. and Laurie K. Newsom, Debtor's counsel, and counsel for Compass Bank appeared. The parties, pursuant to the Court's directive, filed post-hearing briefs (Doc. Nos. 74, 76). The Court makes the following findings and conclusions after reviewing the pleadings and exhibits, hearing live testimony and argument, and being otherwise fully advised in the premises.

Gainesville Properties

Dr. Newsom is an ophthalmic surgeon. He and his wife Laurie K. Newsom own and control the Debtor. The Debtor owns two parcels of commercial property located in Gainesville, Florida: (i) Parcel ID No. 06230-005-001 commonly known as 8475 NW 39th Avenue, Gainesville, Florida 32606,) with an adjoining vacant lot (collectively, "Parcel One"); and (ii) Parcel ID No. 06107-019-000 commonly known as 2521 NW 41st Street, Gainesville, Florida 32606 ("Parcel Two").

Parcel One contains a specialized medical services building constructed in 2007 for Dr. Newsom's ophthalmic diagnosis and surgical practice. Parcel One is encumbered by a Mortgage and Security Agreement executed on January 26, 2007 and an Assignment of Profits, Lease, Rents, and Contracts held by Compass Bank.¹ The Mortgage secures two commercial loans, Loan One for \$1,686,427.00 and Loan Two for \$2,677,500.00, and an interest rate swap agreement executed by the Debtor. Parcel Two is encumbered by a mortgage held by M&S Bank. Dr. and Mrs. Newsom personally guaranteed the Compass Bank and M&S Bank loan obligations.

The Debtor, pursuant to written leases, leases space in Parcel One to two tenants: (i) Eye Associates of Gainesville, LLC, a medical eye clinic; and (ii) Eye Surgicenter, LLC, an eye surgery center. Parcel Two contains a substantially similar building which houses an eye clinic and an eye surgery center. Dr. and Mrs. Newsom own and control the tenants. The Debtor's sole source of income is rents from the properties. The tenants of Parcel One are required to pay aggregate monthly rent of \$30,000.00 to the Debtor.

The Debtor filed this bankruptcy case on March 25, 2011 ("Petition Date"). The filing was caused by the Debtor's inability to collect sufficient rents and to make the mortgage payments as they came due. Compass Bank asserts the Newsoms intentionally caused the tenants to fail to make monthly rent payments and to vacate Parcel One.

Compass Bank filed three proofs of claim totaling \$3,661,744.66: (i) secured Claim No. 4-1 for \$2,496,260.20 arising from Loan One; (ii) Claim No. 5-1 for \$732,724.27, consisting of a secured claim of \$173,739.80 and an unsecured claim of \$558,984.47, arising from Loan Two; and (iii) Claim No. 6-1 for an unsecured claim of

¹ Debtor's Ex. 2.

\$432,760.19, arising from the swap agreement. Compass Bank's claims set forth \$2,670,000.00 as the value of Parcel One.

The Debtor seeks to value Parcel One securing Compass Bank's claims pursuant to 11 U.S.C. Section 506(a).² "Section 506(a) defines the secured and unsecured components of debts according to the value of the underlying collateral." Tanner v. FirstPlus Fin., Inc. (In re Tanner), 217 F.3d 1357, 1358 (11th Cir. 2000). The Debtor and Compass Bank disagree as to the value of Parcel One. The Debtor contends Compass Bank is oversecured; Compass Bank contends it is undersecured.

The Debtor, in its Plan, treats Compass Bank as unimpaired and intends to transfer, via quitclaim deed on the effective date, Parcel One to Compass Bank in full satisfaction of Compass Bank's allowed secured claim (Doc. No. 4, p. 6). The Debtor intends to retain Parcel Two and make mortgage payments to M&S Bank from the rental income stream from Parcel Two's tenants. Compass Bank asserts it is impaired and voted to reject the Plan. The Debtor has not sought releases of the Newsoms from their personal guarantees. The intended transfer of Parcel One to Compass in full satisfaction of its secured claim will satisfy the Newsoms' personal guarantees.

² Section 506(a) of the Bankruptcy Code provides:

An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a).

Valuation Presentation

Compass Bank engaged Don Emerson, Jr. with Emerson Appraisal Company, Inc. to conduct two appraisals of Parcel One: (i) a prepetition appraisal on November 15, 2010; and (ii) a post-petition appraisal on June 23, 2011.³ The Debtor did not have an appraisal conducted, but relies upon Compass Bank's November 15, 2010 appraisal to establish the value of Parcel One.⁴ Compass Bank relies upon the June 23, 2011 appraisal. The Debtor stipulated to the admission of the June 23, 2011 appraisal and Compass Bank did not object to the admission of the November 15, 2010 appraisal.⁵

Compass Bank presented the June 23, 2011 appraisal as its sole exhibit relating to the value of Parcel One. It presented three witnesses: Mrs. Newsom, Kent A. Jones, and French Yarborough. Mrs. Newsom's testimony was not relevant to valuation. French Yarborough, an officer of Compass Bank, testified as to Compass Bank's internal procedures for obtaining appraisals, but presented no testimony relevant to valuation. Kent Jones, who is an officer of M&S Bank and who had no connection to the Debtor's Compass Bank loans or to Parcel One, was presented by Compass Bank to establish a comparable value for Parcel One. Mr. Jones was not familiar with Parcel One and his testimony was not relevant to the valuation of Parcel One. The Debtor presented no witnesses.

³ Debtor's Ex. 3 and Compass Bank's Ex. 31, respectively. Compass Bank moved the June 23, 2011 appraisal (Ex. 31) into evidence. The November 15, 2010 appraisal was entered into evidence as Debtor's Ex. 3.

⁴ Debtor's counsel stated: "We did not engage our own appraiser because I told [Compass Bank] that was fine with me, I would stipulate to both appraisals coming in. So that's the appraisals that are in . . . It's we like the bank's number and we're giving it back to them as the indubitable equivalent." Sept. 8, 2011 Hr'g Tr. pp. 10, 12.

⁵ Sept. 8, 2011 Hr'g Tr. pp. 7-8.

Neither Compass Bank nor the Debtor presented Mr. Emerson as a witness. Debtor's counsel, at the opening of the hearing, informed the Court Compass Bank had communicated to him Mr. Emerson would not be present at the hearing.⁶ Compass Bank, at the opening of the hearing and throughout the hearing, did not make any mention of Mr. Emerson's whereabouts. Compass Bank, during closing argument, stated Mr. Emerson was in the courtroom.⁷ Debtor's counsel did not know Mr. Emerson was in the courtroom.⁸

The Appraisals

November 15, 2010 Appraisal: Mr. Emerson's first appraisal was conducted for the purpose of "loan underwriting and/or credit decisions by [Compass Bank]"⁹ The report sets forth the surgical center is 8,445 square feet, the surgical center pad is 0.281 acres, and the vacant lot is 0.926 acres.¹⁰ The surgical center was "100 percent owner occupied" when this appraisal was conducted.

Mr. Emerson concluded:

- (i) the surgical center on Parcel One has an "as is" fair market value of \$3,400,000.00 and the vacant lot has an "as is" fair market value of \$560,000.00;
- (ii) the surgical center has a 90-day liquidation value of \$2,550,000.00 and the vacant lot has a 90-day liquidation value of \$392,000.00.

⁶ *Id.* p. 8.

⁷ *Id.* pp. 106-107.

⁸ *Id.*

⁹ Debtor's Ex. 3, p. 21.

¹⁰ Debtor's Ex. 3. The appraisal utilizes an address of 8505 Northwest 39th Avenue, Gainesville, Alachua County, Florida 32606 for Parcel One. The address discrepancy between the appraisal's address and the address provided by the Debtor in its schedules of 8475 NW 39th Avenue, Gainesville, Florida 32606 has not been explained.

The valuations do not include any furniture, fixtures, equipment, and/or any business goodwill.¹¹ The valuations have two extraordinary assumptions, which could impact the appraiser's valuation conclusions: (a) no survey or title work was provided or obtained; and (b) the vacant lot has not gone through a final site plan review process and the exact uses and densities that may be made of the lot are unknown.¹²

The appraisal sets forth current economic conditions were considered for the 'as is' value estimate.¹³ "[C]urrent economic conditions have reduced demand in the area"¹⁴ "Gainesville and Alachua County are experiencing an economic downturn consistent with the national economy and other communities in the State of Florida."¹⁵

The appraisal is internally inconsistent in that at page 24 it sets forth Mr. Emerson employed the cost, sales comparison, and income approaches in valuing Parcel One. Page 23, however, sets forth no income records, including historical rental data, or expense records were available. The report is inconsistent regarding the usage of the property and how usage impacts value. The report states the highest and best use of Parcel One is continued usage as a medical surgical center and for medical office use of the adjoining vacant lot, but the report describes the future land use of Parcel One as "Medium Density – Residential" land use.¹⁶ The report discusses how the area where Parcel One is located is in flux developmentally.

June 23, 2011 Appraisal: Compass Bank ordered a second appraisal when Parcel One became vacant in early June 2011. The building was vacant when Mr. Emerson

¹¹ Debtor's Ex. 3, p. 21.

¹² Debtor's Ex. 3, p. 29.

¹³ Debtor's Ex. 3 p. 23.

¹⁴ Id. at p. 43.

¹⁵ Debtor's Ex. 3, p. 44.

¹⁶ Debtor's Ex. 3, p. 1.

conducted his second appraisal. The valuation report he prepared values the real estate only and does not include any business value, medical equipment, inventory, and/or business goodwill. The report states the highest and best use of Parcel One is continued usage as a medical surgical center and for medical office use of the adjoining vacant lot.

The appraiser concluded the surgical center on Parcel One has:

- (i) an “as is” fair market value of \$3,125,000.00 for the surgical center and an “as is” fair market value of \$472,000.00 for the vacant lot; and
- (ii) a 90-day liquidation value of \$2,340,000.00 for the surgical center and \$330,000.00 for the vacant lot.

The valuations, as in Mr. Emerson’s first report, have two extraordinary assumptions, which could impact the valuation conclusions: (a) no survey or title work was provided or obtained; and (b) the vacant lot has not gone through a final site plan review process and the exact uses and densities that may be made of the lot are unknown.¹⁷

Mr. Emerson, as with the first appraisal, combined the cost, sales comparison, and income approaches in calculating the “as is” market value. The report does not explain why and how these approaches were combined. He did not explain how he could employ an income approach when no income records, including historical rental data, or expense records were available and the property is vacant. The appraiser had substantial difficulty in employing the sales comparison approach because there were so few sales of comparable buildings within the region.¹⁸

Current economic conditions were considered for the ‘as is’ value estimate.¹⁹ The report’s discussion of the geographic area in which Parcel One is located is substantially

¹⁷ Debtor’s Ex. 3, p. 29.

¹⁸ Compass Bank’s Ex. 30, pp. 92-93.

¹⁹ Debtor’s Ex. 3 p. 23.

similar to the discussion in the first report. The area is a new developing commercial district surrounded by residential expansion. The area is experiencing an economic downturn and there is little demand for commercial property.²⁰

The Parties' Positions: The Debtor, relying upon the November 15, 2010 appraisal, asserts Parcel One has an "as is" market value of \$3,960,000.00.²¹ Compass Bank asserts the appropriate valuation is liquidation value as of date of confirmation and Parcel One, pursuant to the June 23, 2011 appraisal, has a value of \$2,670,000.00.

Analysis

The November 15, 2010 and June 23, 2011 appraisal reports are deficient in several respects and are internally inconsistent regarding fundamental valuation issues. The appraiser employed an income approach as a component of his valuation methodology, yet he reviewed no income and expense data for either appraisal. The November 15, 2010 appraisal report, prepared four months prior to the Petition Date and before the tenants vacated, has limited relevancy. Parcel One is vacant and generating no rental income. It was not generating any income on the Petition Date.²² Parcel One had no income at the time of the June 23, 2011 appraisal because the tenants had vacated.

The appraisals do not fully and adequately explain the sales approach methodology and the assumptions employed by the appraiser. The usage of a 90-day liquidation period is unexplained, as is the impact on valuation of a longer liquidation period. The future allowed development of the vacant lot is unknown. Parcel One is

²⁰ Compass Bank's Ex. 31, p.45.

²¹ Debtor's counsel stated at the opening of the hearing: "So three million nine hundred and sixty thousand dollars in November 2010. We are happy with that number." Sept. 8, 2011 Hr'g Tr. p. 9.

²² The Debtor's Monthly Operating Reports reflect the Debtor had \$935.45 on hand as of March 1, 2011 and has received no rental income during the pendency of this case (Doc. Nos. 29, 36, 43, 49, 57, 75).

located in a declining economic corridor that is not fully developed and is not showing signs of recovery. It is uncertain whether the market has reached a bottom point. There is little demand for commercial property in that corridor and, as established by the comparables contained in the appraisal report, virtually no demand for highly specialized medical facilities like the surgical center.²³

Many substantive questions regarding Mr. Emerson's appraisals remain unanswered because Mr. Emerson was not presented as a witness to explain and defend his appraisals. Compass Bank listed Mr. Emerson in its Witness List and had him present in the courtroom, but did not call Mr. Emerson as a witness.²⁴ Compass Bank informed Debtor's counsel Mr. Emerson would not be present for the hearing and the Debtor presented its motion believing Mr. Emerson was not present.

Mr. Emerson's testimony was important to the Debtor's Motion. The Debtor, in its closing argument, raised many questions regarding Mr. Emerson's methodologies, yet the Debtor made no effort to present Mr. Emerson as a witness. The Debtor did not list Mr. Emerson on its witness list, did not contact him to arrange his appearance at the hearing, or subpoena him. Compass disclosed, at the conclusion of the hearing, Mr. Emerson had been in the courtroom. The Debtor could have sought permission to reopen the evidence or continue the hearing to call Mr. Emerson as a witness.

The parties had ample opportunity to prepare for the valuation hearing and present evidence supporting their positions. The valuation hearing was originally scheduled for May 18, 2011 and was continued to July 14, 2011 to allow the parties additional time to

²³ Compass Bank's Ex. 30, pp. 92-93.

²⁴ Doc. No. 68.

conduct discovery. The hearing was continued to September 8, 2011 upon Compass Bank's motion for additional time for discovery.

The only evidence before the Court relevant to the valuation of Parcel One are Mr. Emerson's two appraisals. The parties stipulated to the admission of the appraisals and rely upon them for their valuation positions. Both parties fell short in their presentations and neither established the value of Parcel One by a preponderance of the evidence. The Court has a responsibility to evaluate the evidence before it and to adjudicate the valuation issue, which is central to this Chapter 11 case. The value of Parcel One is \$3,411,000.00, based upon the evidence stipulated to by the parties.

Accordingly, it is

ORDERED, ADJUDGED and DECREED that the Parcel One has a value of \$3,411,000.00; and it is further

ORDERED, ADJUDGED and DECREED that Compass Bank has an allowed secured claim in the amount of \$3,411,000.00 and the balance of Claim Nos. 4-1, 5-1, and 6-1 is unsecured; and it is further

ORDERED, ADJUDGED and DECREED that the Debtor is hereby directed to file and serve an Amended Disclosure Statement and Plan within fourteen (14) days of the date of entry of this Order.

Dated this 9th day of November, 2011.

/s/ Arthur B. Briskman
ARTHUR B. BRISKMAN
United States Bankruptcy Judge