AMERICAN BANKRUPTCY INSTITUTE

Mid-Atlantic Bankruptcy Workshop

Is a Tsunami of Commercial Real Estate Restructurings Coming?

PLENARY SESSION

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Valuing Commercial Real Estate

- In general, commercial property is valued using the sales comparison approach, income capitalization approach, and/or cost approach.
- Other valuation methods include the value per gross rent multiplier and the value per door approaches.

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Methods for Valuation of Income Producing Properties

- **Discounted Cash Flow** - calculated by adding (i) present value of the company's projected distributable cash flows (*i.e.*, cash flows available to all investors) during the forecast period, and (ii) present value of the company's terminal value (*i.e.,* value of the firm at end of forecast period). *In re Exide Techs.*, 303 B.R. 48, 63 (Bankr. D. Del. 2003).
- **Comparable Sales Approach** - Values a property using data from recent sales and/or listings of comparable properties in the market. *In re Museum of Am. Jewish Hist.*, 2020 WL 7786925, at *3 (Bankr. E.D. Pa. Dec. 4, 2020).
- **Cost Approach** - Determined by adjusting the company's assets and liabilities to their appraised fair market values or appraised liquidation values, depending on the valuation method used. *In re Greater Se. Cmty. Hosp. Corp. I*, 2008 WL 2037592, at *11 (Bankr. D.D.C. 2008) (internal citations omitted").

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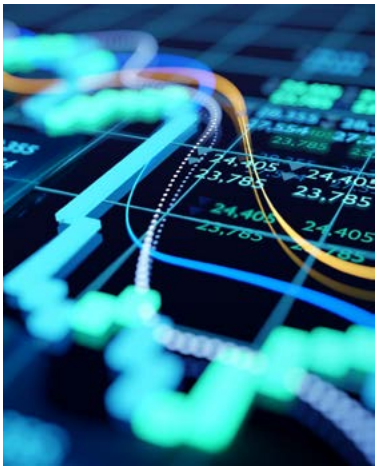
Valuing Commercial Real Estate – Interest Rate Issues

- Debtor must select an appropriate interest rate to provide an impaired secured creditor the present value of its interest in the collateral through payments to be made over time.
- Using the "formula approach," debtor selects a prime rate of interest and the adjusts based on several risk factors. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).
  - If there is an efficient market for exit or cram down financing, market rate is used instead of formula approach.



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Law of Valuation for Income Producing Properties

- "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*." *See* 11 U.S.C. § 506(a)(1) (emphasis added).
  - "Though the statute requires that collateral be valued, it does not specify the appropriate valuation standard." *See In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72, 73-74 (1st Cir. 1995).
  - "If that language is to be afforded any significance, then, the appropriate standard for valuing collateral must depend upon what is to be done with the property - whether it is to be liquidated, surrendered, or retained by the debtor." *In re Heritage Highgate, Inc.*, 679 F.3d 132, 141 (3d Cir. 2012).

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When is the Court Asked to Value the Asset?

- The purpose of valuation dictates its timing. *Deutsche Bank Nat'l Tr. Co. v. Jackson*, 2016 WL 5390594, at *2 (S.D. Fla., 2016) (internal citations omitted); *see also In re Addison Properties Ltd. P'ship*, 185 B.R. 766 (Bankr. N.D. Ill. 1995) (providing a lengthy discussion of timing and purposes of valuation during a chapter 11 case); *In re Columbia Off. Assocs. Ltd. P'ship*, 175 B.R. 199, 201-02 (Bankr. D. Md. 1994) ("In the instant case, the valuation of State Farm's claim is being determined in the context of the confirmation of the debtor's Chapter 11 plan.").
  - To assess adequate protection. *See* 11 U.S.C. § 361.
  - To determine the value of a claim to be treated under a proposed Chapter 11 plan of reorganization. *See* 11 U.S.C. § 1129(b).

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Pre-Pandemic Outcomes: Market Uncertainty

In re Three Flint Hill Ltd. P'ship, 213 B.R. 292 (D. Md. 1997)

- Single asset debtor/owner used cramdown strategy to assert that the value of the building was $5,000,000 while lender asserted that the value of the building was $12,000,000 in a period of market uncertainty. Market stabilized, and rental rates spiked in the region. Thereafter, the court denied the debtor's reorganization plan, with the final plan providing that the value of the building was $18,000,000.

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COVID-19/RTO Implications

- Currently, there is insufficient market data for valuation of commercial real estate due to COVID-19 and RTO, particularly in some regions.
- Availability of data generally lags real-time market results, adding a challenge for appraisers.
- The initial shock to the office space market has been somewhat alleviated due to the availability of the COVID-19 vaccine; however, there are still many uncertainties concerning future office space demand.
  - As of February 2022, about 60% of U.S. workers who say their jobs can be done from home are working from home all or most of the time. COVID-19 Pandemic Continues to Reshape Work in America, Pew Research Center (Feb. 16, 2022).

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COVID-19/RTO Implications (continued)

- COVID-19/RTO assumption to each appraisal will vary. If COVID-19/RTO directly impacts any of the underlying assumptions, the overall value of the property could change.
- Difference in valuation between different classes of properties:
  - The latest cap rates for Class A office properties in Manhattan are the same as they were in the second half of 2019 — between 4.5% and 4.75% for stabilized properties. Sara Johnston, *CBRE Cap Rates Survey Finds Commercial Real Estate Values Return to Pre-Pandemic Levels in Many Markets*, CBRE (Sept. 20, 2021).

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COVID-19/RTO Implications (continued)

- Fitch Ratings' distress test to gauge potential impact of flexible working patterns on office real estate cash flows and values:
  - If people work remotely 3 days a week, the stress test indicated that the value of office properties would fall 54%.
  - However, many of the metrics used in this analysis, such as average days spent working remotely, are "very much in flux."

  Steven Marks, *CMBS Office Stress Tests Highlight Negatives of Remote Work*, FITCH RATINGS (Mar. 10, 2021).
- Green Street's March 31, 2022 "Office Insights" report: The "final chapter" of the COVID-19 pandemic's impact on office real estate "has still not yet been written." *Office Insights, WFH – Reassessing After Two Years*, GREEN STREET (Mar. 31, 2022).

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Pandemic Cases

In re Northbelt, LLC, 630 B.R. 228 (Bankr. S.D. Tex. 2020).

- Single asset debtor valued property, a 12-story, multi-tenant commercial office building, at $19,000,000 while the lender valued property at $7,600,000. Court conducted its own valuation analysis by subtracting the median monthly total expenses of the building from the "Effective Gross Revenue" to determine the "Net Operating Income" and applied this value to the lender's appraisal values to find that the property was valued at $13,200,000 (nearly an average of the two competing appraisals).
  - Market effects of COVID-19 pandemic not discussed, and no mention of either valuation considering COVID-19 effects.

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Pandemic Cases (continued)

In re Museum of Am. Jewish Hist., No. BR 20-11285-MDC, 2020 WL 7786925 (Bankr. E.D. Pa. Dec. 4, 2020), *aff'd*, No. CV 20-6341, 2021 WL 1264160 (E.D. Pa. Apr. 6, 2021), *appeal dismissed sub nom. In re Museum of Am. Jewish Hist*, No. 21-1762, 2021 WL 8154936 (3d Cir. Sept. 20, 2021).

- Debtor museum claimed the property was worth $10,150,000 while the lender claimed it was worth $66,000,000. Court held that property was worth $66,000,000 because the debtor's appraisal was based on its highest and best use—a multi-tenant office building—not as a museum (the intended use under 506(a)), and opined that there was no evidence as to how depreciation from factors related to COVID-19 could be calculated.

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Pandemic Cases (continued)

- *In re Kinser Grp. LLC*, No. 2:20-BK-09355-DPC, 2020 WL 7633854 (Bankr. D. Ariz. Dec. 18, 2020).

- Debtor hotel used cramdown strategy to reduce mortgagee's secured claim from $7,504,234 to $5,748,000. Court gave more weight to debtor's appraisal based on their belief that its COVID-19 adjustments were well founded, and agreed with the $5,748,000 valuation. Notably, court also gave significant weight to evidence regarding hotel's operating results, local issues impacting those results, and industry reports.

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Pandemic Cases (continued)

In re Chip's Southington, LLC, No. 20-21458, 2021 WL 5313546 (Bankr. D. Conn. Nov. 13, 2021).

- Debtor restaurant used 9% capitalization rate "to reflect a more risky investment environment for potential investors in light of COVID-19's impact on the restaurant industry," while lender used 7% discount rate asserting that COVID-19 had no real impact on the property value. Court determined that "current challenges to the hospitality/restaurant industry call for a higher discount rate," and held in favor of debtor's valuation.

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Thank you
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I. Introduction

II. What happened in the last two years? Unprecedented upheaval in the real estate markets

A. "The national vacancy rate remained flat at 15.4% year-over-year but marked a 30-basis-point downtick compared to April's 15.7% rate. While some of the top office markets still contended with vacancy rates in the high tens or even higher - 20% in Atlanta — others saw the pressure of high vacancies ease somewhat." National Office Report, CommercialEdge (June 2022).

B. "Leases for 243 million square feet of U.S. office space are set to expire in 2022, the most office space to hit the market in a single year since real-estate services firm JLL began tracking this data in 2015. The expiring leases represent about 11% of the nation's overall leased office space." Record High Office Lease Expirations Pose New Threat to Landlords and Banks - Wall Street Journal (April 12, 2022).

C. NYU study found a 32% decline in values for New York City commercial office buildings in 2020, with a 28% drop over the longer-run, equivalent to losing approximately $500 billion. Work from Home and the Office Real Estate Apocalypse (June 9, 2022).

D. "Both the direct vacancy rate (of office buildings in NYC) at 16.0%, and the indirect (or sublease) vacancy rate currently at 5.0%, exceed the vacancy rates of the 1990s recession and are far greater than the peak vacancies experienced during the 2001 and 2008 downturns." New York by the Numbers, Brad Lander, NYC Comptroller (June 6, 2022).

E. San Francisco hit 24% commercial real estate vacancy in May 2022. Katsuyama, Jana, "Office vacancies hit new high in San Francisco Bay Area" May 10, 2022 (KTVU TV) (Office vacancies hit new high in San Francisco Bay Area (ktvu.com)) ("'We're close to 24% vacancy for office space in the city,' said Matt Regan, Vice-President of the Bay Area Council."). San Francisco's Chief Economist predicted that commercial vacancy rates could reach 50% in 2024. Forecast: office vacancy in SF's Downtown could grow to 50 percent (therealdeal.com).

F. "Nearly two years into the COVID-19 pandemic, roughly six-in-ten U.S. workers who say their jobs can mainly be done from home (59%) are working from home all or most of the time." COVID-19 Pandemic Continues to Reshape Work in America, Pew Research Center (Feb. 16, 2022).

G. "A JLL quarter two analysis shows . . . nearly 20% of office spaces in Denver are vacant. . . . [V]acancy rates in a healthy market are considered 'to be around 10 or 12%.'" Denver office space vacancies continue to increase (thedenverchannel.com) (July 25, 2022).

H. However, some people are returning to the office for work - "[o]ffice occupancy pushed past 40 percent last week for the first time since the start of the pandemic, the City reported. The Kastle Back to Work Barometer increased to 41.2 percent; Kastle Systems measures office occupancy by entry into office buildings." Office occupancy in New York finally hits 40% (therealdeal.com).

III. Law of valuation for income producing properties – methodologies and applicable caselaw

A. "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*." *See* 11 U.S.C. § 506(a)(1) (emphasis added).

1. "Though the statute requires that collateral be valued, it does not specify the appropriate valuation standard." *See In re Winthrop Old Farm Nurseries, Inc.,* 50 F.3d 72, 73-74 (1st Cir. 1995).

2. "If that language is to be afforded any significance, then, the appropriate standard for valuing collateral must depend upon what is to be done with the property - whether it is to be liquidated, surrendered, or retained by the debtor." *In re Heritage Highgate, Inc.*, 679 F.3d 132, 141 (3d Cir. 2012).

3. Properties can be valued differently for different bankruptcy purposes, *e.g.* motions for relief from stay or plan confirmation. *See* 11 U.S.C. § 506(a)(1)

B. Timing matters: at what point during the bankruptcy case is the Court being asked to value the asset?

1. The text of 11 U.S.C. § 506(a)(1) "reflects the reality that valuations have a variety of potential purposes, even within Chapter 11. A valuation may, for example, be used to assess adequate protection, *see* 11 U.S.C. § 361, or to determine the value of a claim to be treated under a proposed Chapter 11 plan of reorganization, *see* 11 U.S.C. § 1129(b). These needs arise at different points during the life of a bankruptcy. Thus, the statute's text invites the conclusion that 'the purpose of the valuation dictates its timing.'" *Deutsche Bank Nat'l Tr. Co. v. Jackson*, 2016 WL 5390594, at *2 (S.D. Fla., 2016) (internal citations omitted); *see also In re Addison Properties Ltd. P'ship*, 185 B.R. 766 (Bankr. N.D. Ill. 1995) (lengthy discussion of timing and purposes of valuation during a chapter 11 case); *In re Columbia Off. Assocs. Ltd. P'ship*, 175 B.R. 199, 201-02 (Bankr. D. Md. 1994) ("In the instant case, the valuation of State Farm's claim is

being determined in the context of the confirmation of the debtor's Chapter 11 plan.").

2. Adequate protection: "'Adequate protection' means some form of assurance that the secured creditor will not suffer a decline in the value of its interest in the estate's property while the bankruptcy prevents the creditor from seizing and liquidating the collateral. If a creditor's interest is threatened with a decline in value, the estate must take action to make up the decline." *In re Thompson*, No. 08 A 182, 2008 WL 2157163, at *2 (Bankr. N.D. Ill. May 23, 2008) (internal citations omitted); *See also United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 370 (1988); *In re Bluejay Properties, LLC*, 512 B.R. 390 (B.A.P. 10th Cir. 2014)(unpublished) ("Thus, adequate protection is intended to protect against a decline in a creditor's security cushion, it is not intended to allow a creditor to improve the security cushion that it had at the time the bankruptcy petition was filed.") ; *In re Big3D, Inc.*, 438 B.R. 214, 220-21 (9th Cir. B.A.P. 2010) (adequate protection is intended to compensate a secured creditor whose collateral is declining); *In re DB Capital Holdings, LLC*, 454 B.R. 804, 816-17 Bankr. D. Colo. 2011) ("[T]he purpose of providing adequate protection is to insure that a creditor receives the value for which it bargained pre-bankruptcy"); *In re SW Boston Hotel Venture LLC*, 449 BR 156, 175-76 (Bankr. D. Mass. 2011) (same); *In re Panther Mountain Land Development, LLC*, 438 BR 169, 189-90 (the purposed of adequate protection is to guard the secured creditor's interest the declining collateral value).

3. Confirmation: "Where, as here, the purpose of the valuation is to determine the treatment of a claim by a plan, the values determined at the § 506(a) hearing must be compatible with the values that will prevail on the confirmation date . . . ." *In re Stanley*, 185 B.R. 417, 423-24 (Bankr. D. Conn. 1995). "For the purposes of confirmation, secured creditors' collateral must be valued at the time of confirmation." *In re Union Meeting Partners*, 178 B.R. 664, 674 (Bankr. E.D. Pa. 1995)

C. Real Estate Valuation Methodologies and standards

1. Income Capitalization or Discounted Cash Flow

a. "A discounted cash flow analysis attempts to measure value by forecasting a firm's ability to generate cash." Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 Bus. Law. 419, 427 (1996)

b. "The income capitalization approach values a property using data to capitalize anticipated future income from the subject property. An appraiser first calculates the net operating income a property could be expected to generate. The net operating income is then

divided by a capitalization rate, which results in a value figure. Costs that will be incurred in order to achieve stabilized income, meaning income from a property that is rented consistent with the market, are then deducted from the value figure." *In re Museum of Am. Jewish Hist.*, 2020 WL 7786925, at *3 (Bankr. E.D. Pa. Dec. 4, 2020), *aff'd*, 2021 WL 1264160 (E.D. Pa. Apr. 6, 2021) (internal citations omitted).

c. "The discounted cash flow ("DCF") analysis has been described as a 'forward-looking' method that measure[s] value by forecasting a firm's ability to generate cash. DCF is calculated by adding together (i) the present value of the company's projected distributable cash flows (i.e., cash flows available to all investors) during the forecast period, and (ii) the present value of the company's terminal value (i.e., value of the firm at the end of the forecast period). *In re Exide Techs.*, 303 B.R. 48, 63 (Bankr. D. Del. 2003).

d. "Many authorities recognize that the most reliable method for determining the value of a business is the discounted cash flow ('DCF') method." *Lippe v. Bairnco Corp.*, 288 B.R. 678, 689 (S.D.N.Y. 2003), *aff'd*, 99 F. App'x 274 (2d Cir. 2004). *See, also*, *Frymire–Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 186 (7th Cir.1993) (referring to DCF method as "the methodology that experts in valuation find essential"); Shannon P. Pratt et al., *Valuing A Business: The Analysis & Appraisal of Closely Held Companies* 154 (4th ed. 2000) ("[R]egardless of what valuation approach is used, in order for it to make rational economic sense from a financial point of view, the results should be compatible with what would result if a well-supported discounted economic income analysis were carried out.").

2. Comparable Sales: "The sales comparison approach values a property using data from recent sales and/or listings of comparable properties in the market." *In re Museum of Am. Jewish Hist.*, 2020 WL 7786925, at *3 (Bankr. E.D. Pa. Dec. 4, 2020).

3. Cost Approach: "The cost approach value of a business is based on the net aggregate value of its underlying assets. This approach focuses on the value of a company's assets in a hypothetical sale rather than on a company's earnings potential, which is the focus of the income approach. One of two valuation methods generally applies: (1) going concern value (which assumes that fair market value would be paid for the assets), or (2) liquidation value. The value of the business is determined by adjusting the company's assets and liabilities to their appraised fair market values or appraised liquidation values, depending on the valuation method used." *In*

re Greater Se. Cmty. Hosp. Corp. I, 2008 WL 2037592, at *11 (Bankr. D.D.C. 2008) (internal citations omitted").

D. Chapter 11 Plan Confirmation – Valuation/Interest Rate Issues

1. Cramdown of a Secured Creditor – Under § 1129(b)(2)(A)(ii), the Court may confirm a chapter 11 plan in the face of an objection by an impaired secured creditor so long as the plan includes a provision for deferred cash payments to the creditor totaling the present value of its interest in the collateral. *In re Deep River Warehouse*, *Inc.*, No. 04-52749, 2005 WL 2319201, at *8 (Bankr. M.D.N.C. Sept. 22, 2005). Thus, a debtor must select an appropriate interest rate to provide an impaired secured creditor the present value of its interest in the collateral through payments to be made over time.

2. *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) – Courts often look at the United States Supreme Court decision of *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) when determining the appropriate interest rate. In the context of a chapter 13 case, the Supreme Court in *Till* held that the formula approach constituted the best method for determining the appropriate interest rate in a cram down fight with an impaired secured claim. Using the formula approach, the debtor selects a prime rate of interest and the adjusts this rate based on several risk factors. *Id*. at 479. In a footnote, the Supreme Court, stated that "when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." *Id*. at 476 n. 14.

3. Application of *Till* – Courts interpreting *Till* in the context of chapter 11 cram downs have held that where there exists an efficient market for exit or cram down financing, the market rate is to be used. *In re American Homepatient Inc.*, 420 F.3d 559, 568 (6th Cir. 2005); *see also In re VDG Chicken, LLC*, *No. NV-10-1278*, 2011 Bankr. LEXIS 1795 (B.A.P. 9th Cir. Feb. 18, 2011); *SPCP Group LLC v. Cypress Creek Assisted Living Residence, Inc. (In re Cypress Creek Assisted Living Residence, Inc.)*, 434 B.R. 650, 660 (M.D. Fla. 2010); *In re Renegade Holdings, Inc.*, 429 B.R. 502, 525 (Bankr. M.D.N.C. 2010) *new trial granted on other grounds* No. 09-50140C-11W, 2010 WL 2772504 (Bankr. M.D.N.C. Jul. 13, 2010). However, if no efficient market exists, the formula approach should apply. *In re American Homepatient Inc.*, 420 F.3d at 568.

4. Efficient Market Rate

a. A debtor does not have to actually attempt to find exit or cram down financing before the bankruptcy court can determine whether an efficient market exists. *SPCP Group*, 434 B.R. at 658. Rather, an expert's testimony may establish whether such a market exists. *Id*. The determination of whether an efficient market exists "does

not necessarily entail consideration of the particular risks associated with the particular type of loan or property of the debtor." *Id*. at 659.

b. The Fifth Circuit Court of Appeals in *In re Texas Grand Prairie Hotel Realty, LLC*, refused to mandate the methodology for determining the cramdown rate for an impaired secured creditor in a chapter 11 case, holding that the court "will not tie bankruptcy courts to a specific methodology as they assess the appropriate Chapter 11 cramdown rate of interest". 710 F.3d 324, (5th Cir. 2013). The Fifth Circuit, while affirming the bankruptcy court's use of the formula approach under a "clear error" standard of review, stated that its opinion should not be read as a finding that "the prime-plus formula is the only – or even the optimal – method for calculating the Chapter 11 cramdown rate." *Id.* at 337.

5. Expert Testimony on Existence of Efficient Market

a. Key issue - an expert's qualifications with regard to credit markets must still comply with the general rules regarding admissibility of an expert opinion to the principles of expert testimony above, e.g. facts or data. For example, in *SPCP Group*, the party opposing confirmation sought to have an expert qualified as to the existence of an efficient credit market. The court denied the request for admission because the expert, while qualified, did not base his testimony on any facts or data concerning loans to an entity like the debtor and the court, therefore found the testimony unreliable. *Id*. at 659.

6. Establish the Prime Rate

a. The starting point under the formula approach is to determine the prime rate. While the prime rate could be the daily national prime rate, as stated in *Till*, the facts of the case may make another metric, such as U.S. Treasuries more appropriate. *See Deep River Warehouse*, Inc. 2005 WL 2319201, at *12 (using the interest rate on ten-year U.S. Treasury notes as the prime rate).

7. Adjust the Prime Rate

a. After establishing the prime rate, the court must consider whether "the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan" in order to make necessary adjustments to the rate. *Till*, 541 U.S. at 479. The creditor opposing the cramdown rate bears the burden of proof on this issue. *Till*, 541 U.S. at 479. Expert testimony, or testimony from witnesses with knowledge regarding the prospects of the

debtor's reorganization is necessary for proving a plan's feasibility. *See Deep River Warehouse, Inc.*, 2005 WL 2319201, at *3. Expert and lay testimony should focus on (1) the adequacy of the debtor's capital structure; (2) the earning power of its business; (3) the economic conditions; (4) the ability of the debtor's management; (5) the probability of the continuation of the same management; and (6) any other related matters which determine prospects of a sufficiently successful operation to enable performance of the provisions of the plan. *Id.* at *2 (citing 11 U.S.C. § 1129(a)(11)).

b. "In the absence of a market for the loan proposed in the Plan, the Court must consider whether the cramdown interest rate proposed in the Plan includes an appropriate risk adjustment. Since there is no applicable market interest rate, it is appropriate to consider the formula approach set forth in *Till*. This approach provides that the cramdown interest rate may be determined by adjusting the national prime rate to reflect the amount of risk associated with the loan at issue. The appropriate risk adjustment is determined by considering factors including the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. Additional 'risk factors to consider include the debt service coverage ratio, the loan-to-value ratio, and the quality of any guarantors.'" *In re 20 Bayard Views, LLC*, 445 B.R. 83, 111 (Bankr. E.D.N.Y. 2011) (internal citations omitted)

E. Plan Confirmation - Feasibility

1. In order to confirm a plan, the bankruptcy court must make a finding that the plan is feasible. *See In re W.R. Grace & Co.*, 475 B.R. 34, 114 (D. Del. 2012), *aff'd In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013). This requires a finding that "the plan presents a workable scheme of organization and operation from which there may be reasonable expectation of success." *Id.* Factors considered include "assessment of the debtor's capital structure, the earning power of the business, economic conditions, and the ability of the corporation's management," with the most important factor being the debtor's future earning capacity. *Id. See also In re Flintkote Co.*, 486 B.R. 99, 139 (Bankr. D. Del. 2012).

2. Courts consider expert testimony on plan feasibility.

a. In *W.R. Grace*, the court found that the debtors' expert, who was "a vastly experienced investment banker and financial advisor" was "more than qualified to testify as to [the debtor's] future earning capacity, capital structure, and earning power," based on the expert's prior experience in similar bankruptcy cases. *Id.* at 115. The court noted that the expert's testimony was properly

based on analysis of the debtor's "corporate structure, internal records and historical precedent, financial reports of [the debtor's] current business performance, financial projections of its future earning capacity, review of cost-cutting measures and productivity programs implemented since [the debtor] entered bankruptcy, and analysis of a $37.3 million reserve established by [the debtor] to cover its unsettled property damage claims and allocate payment for future claims. *Id.* The expert's testimony was used to objections to plan feasibility. *Id.* at 117-20.

b. In *In re Flintkote Co.*, the court credited the testimony of the Debtors' expert on the company's earning power over an objection that it omitted federal income taxes, noting that the preferred method for evidence on earnings is "to present earnings before taxes." 486 B.R. 99, 143. In response to an argument based on the Debtors' failure to present complete company-wide financial statements" the court also noted that a debtor is not required to submit specific documents proving feasibility. *Id.* at 142.

F. Caselaw on Valuation of Commercial Real Estate in a Disrupted Market

1. *In re Three Flint Hill Ltd. P'ship*, 213 B.R. 292 (D. Md. 1997). Single asset real estate case where the debtor owner used the cramdown strategy to assert that the value of the building was $5,000,000 while the lender asserted that the value of the building was $12,000,000 in a period of market uncertainty. The market stabilized, and rental rates spiked in the region. The court denied the debtor's reorganization plan, with the final plan providing that the value of the building was $18,000,000.

2. *In re Northbelt, LLC*, 630 B.R. 228 (Bankr. S.D. Tex. 2020). Single asset real estate case where the debtor owner valued the property, a 12-story, multi-tenant commercial office building, at $19,000,000 while the lender valued the property at $7,600,000. The court opted to conduct its own valuation analysis by subtracting the median monthly total expenses of the building from the "Effective Gross Revenue" to determine the "Net Operating Income" and applied this value to the lender's appraisal values to find that the property was now valued at $13,200,000. Notably, this value is very close to an average of the two competing appraisals. Market effects related to the COVID-19 pandemic are not discussed at all in the opinion, and there is no mention of either valuations taking such considerations into their respective analyses.

3. *In re Museum of Am. Jewish Hist.*, 2020 WL 7786925 (Bankr. E.D. Pa. Dec. 4, 2020), *aff'd*, 2021 WL 1264160 (E.D. Pa. Apr. 6, 2021). Debtor was a museum and argued that its property was worth $10,150,000 while the lender alleged the property was worth $66,000,000. The court held that the property was worth $66,000,000 because the debtor's appraisal of

the property was based on its highest and best use—a multi-tenant office building—not as a museum (the intended use under section 506(a)), and opined that there was no evidence as to how depreciation from factors related to COVID-19 could be calculated.

4. *In re Kinser Grp. LLC*, 2020 WL 7633854 (Bankr. D. Ariz. Dec. 18, 2020). Debtor owned and operated a hotel. Debtor used the cramdown strategy to reduce a mortgagee's secured claim from $7,504,234 to $5,748,000. The court gave more weight to the debtor's appraisal based on their belief that the COVID-19 adjustments therein were well founded, and agreed with the $5,748,000 assessment. Notably, the court also gave significant weight to evidence regarding the hotel's operating results, local issues impacting those operating results, and industry reports.

5. *In re Chip's Southington*, 2021 WL 5313546 (Bankr. D. Conn. Nov. 13, 2021). Debtor owned and operated a restaurant. The debtor used a 9% capitalization rate "to reflect a more risky investment environment for potential investors in light of COVID-19's impact on the restaurant industry," while the lender used a 7% discount rate asserting that COVID-19 had no real impact on the property value. The bankruptcy court determined that "current challenges to the hospitality/restaurant industry call for a higher discount rate," and held in favor of the debtor's valuation.

6. *In re Sanam Conyers Lodging, LLC*, 619 B.R. 784, 789 (Bankr. N.D. Ga. 2020). Debtor owned and operated a small hotel that was damaged in a fire in 2019. Debtor filed for bankruptcy in March 2019 while still undergoing repairs from the fire. Debtor filed a plan in February 2020 and court held hearing on confirmation in June 2020. At the confirmation hearing, the Court heard detailed testimony on valuation including the impact of the Covid-19 pandemic on operations of the hotel. Testimony included revenue estimates from various witnesses which presumed when the pandemic would end. The court noted "[a]t this point, there is no consensus of scientific or political leaders as to when it is 'reasonably probable' the pandemic will subside, and life will return to 'pre pandemic normal.' At the same time, that cannot spell the end of attempts to reorganize during a pandemic. The Bankruptcy Code is meant to provide an opportunity for businesses to reorganize due to unforeseen circumstances, among others, and during this pandemic it is especially important that debtors be given the opportunity to reorganize if they can find ways to adapt to our current circumstances." Ultimately, the Court confirmed the plan.

G. Additional Pre-Covid Cases and Authorities for Reference

1. *In re GAC Storage Lansing, LLC*, 485 B.R. 174 (Bankr. N.D. Ill. 2013) – Court denied confirmation where expert projections failed to consider rent concessions, vacancy rate, and weak economic conditions.

2. *In re Exide Technologies*, 303 B.R. 48, 53 (Bankr. D. Del. 2003) – Court denied confirmation of plan after extensive valuation trial.

3. *In re 785 Partners LLC*, 2012 WL 959364 (Bankr. S.D.N.Y. 2012) – contains a discussion of the contested valuation of debtor's empty Manhattan apartment building at plan confirmation stage.

4. *In re Nellson Nutraceutical, Inc.*, 356 B.R. 364 (Bankr. D. Del. 2006) – Court excluded expert's opinion of value based upon discounted cash flow as unreliable where expert deducted cost of capital expenditures from EBITDA, a novel approach neither followed by other experts nor subjected to peer review.

5. *In re Nellson Nutraceutical, Inc.*, 2007 Bankr. Lexis 99 (Bankr D. Del. Jan 18, 2007) – where creditors' experts relied upon debtors' long-term business plan as basis for deriving enterprise value, and business plan had been deliberately manipulated by debtors to inflate values, court determined enterprise value by accepting creditor valuations and making judicial adjustments to reflect evidence, including evidence of declining debtor performance.

6. Must read for all bankruptcy lawyers: *Valuation Methodologies*: *A Judge's View*, by Hon. Christopher S. Sontchi, Valuation Methodologies: A Judge's View, 20 ABI Law Review 1 (2012).

IV. Discussion of Valuation Hypothetical

Faculty

Harold J. Bordwin is a principal and co-president of Keen-Summit Capital Partners LLC in New York, and focuses on developing and implementing strategic real estate and corporate finance plans for his clients. Those plans involve real estate analysis, real estate acquisitions and dispositions, lease modifications and terminations, and corporate finance and capital markets services. Mr. Bordwin has 34 years of real estate advisory/transactional and corporate finance experience. He has helped negotiate the sale of hundreds of properties, leaseholds and businesses nationwide; provided specialized valuation services; and provided in-depth workout services for retailers, financial institutions and corporate clients. As a recognized expert on real estate restructuring issues, Mr. Bordwin has testified as an expert before the Judiciary Committee of the U.S. House of Representatives. He also has been interviewed and quoted in articles for *The Wall Street Journal*, *The New York Times* and various trade publications. Before he joined Keen-Summit Capital Partners, he was co-president at GA Keen Realty Advisors, a principal with KPMG LLP, a managing director with KPMG Corporate Finance, CEO of Keen Consultants and an associate with the law firms of Stroock & Stroock & Lavan and McKenna, Conner & Cuneo. Mr. Bordwin received the 2016 Transaction of the Year Award by the Turnaround Management Association. He is a receiver and available as an independent board member. Mr. Bordwin received his undergraduate degree in government from Wesleyan University in 1982 and his J.D. from Georgetown University Law Center in 1985, where he was a staff member of *Law & Policy in International Business* and published articles in the *Ecology Law Quarterly* of the University of California at Berkeley Boalt Hall School of Law.

Frederick W.H. Carter is counsel with Venable LLP in Washington, D.C., and represents creditors, debtors, creditors' committees, asset-purchasers and trustees in business reorganization and business liquidation. His clients have included financial institutions, technology companies, a major international airport authority, energy-trading companies, health care providers, chapter 11 and 7 trustees, and liquidating agents appointed under chapter 11 plans. Mr. Carter represents plaintiffs and defendants in a wide variety of bankruptcy litigation in courts throughout the country. Prior to joining Venable, he practiced law in Texas and Colorado. He also served as a member of the standing panel of chapter 7 bankruptcy trustees in the District of Colorado. Mr. Carter is an at-large member of the board of the Maryland Bankruptcy Bar Association, and he frequently lectures on bankruptcy and creditors' rights topics at seminars and bar association events. He is admitted to practice in Colorado, the District of Columbia, Maryland, Texs and Virginia. Mr. Carter received his B.A. in 1983 from Gustavus Adolphus College and his J.D. in 1987 from Southern Methodist University, where he served as notes editor of the *Journal of Air Law and Commerce*.

Hon. Vincent F. Papalia is a U.S. Bankruptcy Judge for the District of New Jersey in Newark, sworn in on Dec. 29, 2014, following a 30-year career in private practice. For 20 years, he had been a partner with the law firm of Saiber LLC and the head of its Bankruptcy and Creditors' Rights Department. Prior to joining Saiber LLC, he was an associate and then a partner with Clapp & Eisenberg, P.C. For virtually his entire career, Judge Papalia focused his practice on representing various parties-in-interest in bankruptcy and foreclosure-related litigation and proceedings before federal, state and bankruptcy courts. He also served for many years as a court-appointed mediator for the U.S. Bankruptcy Court for the District of New Jersey and was vice-chair of the District V-A Ethics

Committee from 2013-14. He also chaired the Debtor-Creditor Committee of the Essex County Bar Association. Judge Papalia has authored or co-authored numerous articles on bankruptcy and creditors' rights issues and has often spoken on those topics. While in private practice, he was listed in *Chambers USA* and *New Jersey's Best Lawyers*. Judge Papalia received his B.B.A. in 1980 *summa cum laude* from Pace University and his J.D. *cum laude* from Fordham University School of Law in 1984, where he was a member of its law review.

Lynn Lewis Tavenner is a founding member of Tavenner & Beran, PLC in Richmond, Va., where she has practiced law since 2002. She also has served as a receiver, liquidation trustee, litigation trustee, chapter 11 trustee, mediator and, since 1997, a member of the Richmond Chapter 7 panel of trustees. Before entering private practice, Ms. Tavenner clerked for Hon. Douglas O. Tice Jr. in the U.S. Bankruptcy Court for the Eastern District of Virginia. She is a Fellow of the American College of Bankruptcy, a current member of the board of the American College of Bankruptcy Foundation, and a former member of the Boards of Directors for ABI and Credit Abuse Resistance Education (CARE). In addition, she served on the board of governors for the Bankruptcy Section of the Virginia State Bar. An AV-rated attorney by Martindale-Hubbell, Ms. Tavenner has been recognized in her field in numerous editions of *Chambers USA*, *The Best Lawyers in America*, *Virginia Super Lawyers* and *Virginia Business* magazine, including recognition for five consecutive years by *Best Lawyers* as the Richmond Area Bankruptcy Lawyer of the Year in her fields. She received her undergraduate degree *magna cum laude* from Bridgewater College and her J.D. from Washington & Lee University School of Law.

Edward H. Tillinghast, III is a partner and Practice Group Leader of Sheppard Mullin's Finance and Bankruptcy Practice Group in New York. He specializes in U.S. and cross-border insolvencies, particularly involving Asia and Latin America, and related creditors' rights and bankruptcy-related litigation. Mr. Tillinghast's broad bankruptcy and creditors' rights litigation and appellate experience, and his understanding of business realities, is helpful in creating and implementing business solutions to complex financially driven problems and resulting opportunities, regardless of whether they involve structuring a business deal or litigating related issues. He has been involved in many real estate-related bankruptcies representing commercial real estate developers, lenders, lessors and lessees. Mr. Tillinghast has represented ad hoc and official committees, debtors, distressed asset-purchasers, equityholders, funds, indenture trustees and institutional lenders. He also has litigated creditors' rights-related cases in many courts, including the U.S. Supreme Court, various U.S. Circuit Courts of Appeals, and various district and bankruptcy courts, and he has led cases in courts in Australia, Bermuda, the British Virgin Islands, the Cayman Islands, China, England, Germany, Hong Kong, Indonesia and Japan. Mr. Tillinghast received his undergraduate degree with honors from Lake Forest College and his J.D. from Chicago-Kent College of Law, where he served on the editorial board of the *Chicago-Kent Law Review*.