UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

BEAUMONT COURT ASSOCIATES	CASE NO. 95-63587
Debtor	Chapter 11

APPEARANCES:

LESLIE N. REIZES, ESQ.
Attorney for Debtor
106 East Court Street
Ithaca, NY 14850

HODGSON, RUSS, ANDREWS,
WOODS & GOODYEAR, LLP
Three City Square
Albany, New York 12207

RICHARD L. WEISZ, ESQ.
Of Counsel

U.S. DEPARTMENT OF JUSTICE
Attorneys for Internal Revenue Service
P.O. Box 7198
100 South Clinton Street
Syracuse, New York 13261-7198

ROBERT P. BROUILLARD, ESQ.
Of Counsel

CONNORS & CONNORS
Attorney for Limited Partners
45 Exchange Street
Rochester, NY 14614

EILEEN BUHOLZ, ESQ.
Of Counsel

NYS DEPARTMENT OF TAXATION
207 Genesee Street
Utica, New York 13501

ELIS J. DELIA, ESQ.
Of Counsel

GUY VAN BAALEN, ESQ.
Assistant U.S. Trustee
10 Broad Street
Utica, New York 13501

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court considers herein several matters which have arisen in the context of the proposed confirmation of the amended plan of reorganization ("Plan") filed by Beaumont Court Associates ("Debtor") on April 5, 1996.

On June 19, 1996, the Troy Savings Bank ("TSB") filed an objection to the Plan pursuant to §1129(a) of the Bankruptcy Code (11 U.S.C. §§101-1330) ("Code"). Simultaneous with its objection, TSB also filed a motion seeking relief from the automatic stay pursuant to Code §362(d). The hearing on confirmation of Debtor's Plan, as well as TSB's motion, was initially held on July 8, 1996, in Utica, New York ("Hearing"), and was adjourned to August 28, 1996, to address several objections filed to the Plan.[1] On August 20, 1996, Debtor filed an Application for Confirmation by Cram Down pursuant to Code §1129(b) requesting that the Court confirm the Plan over the objection of TSB. On August 28, 1996, the same date as the adjourned Hearing, Debtor filed a modification of its Plan with respect to its proposed treatment of TSB's claim.

In anticipation of receiving the Examiner's report,[2] the Hearing was again adjourned to October 25, 1996. In the interim, the Debtor filed another Application for Confirmation by Cram Down pursuant to Code §1129(b) on October 11, 1996, asserting that its modification of the Plan "demonstrates compliance with all requirements of 11 U.S.C. §1129(a)". TSB

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[1]The objections filed by the Internal Revenue Service and the New York State Department of Taxation and Finance were subsequently withdrawn at a later hearing, leaving only that of TSB.

[2]On March 27, 1996, the Court issued its Memorandum-Decision, Findings of Fact, Conclusions of Law and Order ("March 1996 Decision") in which *inter alia* the Court ordered the appointment of an Examiner pursuant to Code §1104(c).

responded by filing its opposition to Debtor's motion on October 18, 1996.

At the Hearing on October 25, 1996, the Court heard testimony from several witnesses. The parties were afforded an opportunity to file memoranda of law on the issues of feasibility, cramdown and "gerrymandering of claims", as well as the objection of TSB to its treatment under the terms of the Plan and its request for relief from the automatic stay. The matter was submitted for decision on November 22, 1996.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§1334(b), 157(a), (b)(1), (b)(2)(L) and (O).

FACTS

Debtor is a New York limited partnership, which was formed on or about December 9, 1987, with its principal place of business being 100 Graham Road, Ithaca, New York. Debtor's sole asset is a 220 unit apartment complex located in Beaumont, Texas ("Complex"), which Debtor purchased from TSB for $2.2 million in 1987. The Loan Agreement with TSB, signed December 9, 1987, provided for the simultaneous execution of a Bond in the amount of $2.1 million, along with a Deed of Trust, Assignment of Leases and Rents, and a Security Agreement. The Bond was to mature on December 31, 1996, with a balloon payment of the principal balance "together with all unpaid capitalized interest and all unpaid interest and fees, if any ..."

On October 10, 1995, Gerald R. Talandis ("Talandis"), as General Partner of the Debtor, filed a voluntary petition ("Petition") pursuant to Chapter 11 of the Code. TSB filed a proof of claim on January 23, 1996, in the amount of $2,459,422.54. However, in its March 1996 Decision, the Court concluded that TSB's claim as of the commencement of the case was actually $2,410,657.35. According to the March 1996 Decision, the value of the Complex as of October 10, 1995, was $2,275,000, and TSB was undersecured to the extent of $135,657.35.

In its March 1996 Decision the Court ordered that the provisions set forth in its Interim Order of November 22, 1995, be incorporated in a Final Cash Collateral Order. Under the terms of the Interim Order, the Debtor was authorized to use cash collateral for the payment of its reasonable, necessary and ordinary operating expenses, exclusive of capital expenditures, management fees and/or administrative fees. After payment of its monthly operating expenses, Debtor was required to turn over any surplus funds to TSB for deposit into an escrow account ("Escrow Account"). As of the Hearing, Debtor alleged that there was $88,527.04 in the Escrow Account. According to the testimony of Joseph Karian, TSB's Vice President, there was only $69,488 in the account as approximately $19,000 represented the interest payment due TSB from Debtor in January or February.[3]

Debtor asserts that TSB's claim is impaired because, but for the terms of the Plan, the mortgage debt would have been due on December 31, 1996. Although TSB submitted a ballot as an unsecured creditor with a claim of $135,657.35 and another ballot as a secured creditor with

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[3]Pursuant to Code §362(d)(3), applicable to single asset real estate cases, Debtor was required to make monthly payments in an amount equal to interest at a current fair market rate since no plan had been filed within 90 days of the commencement of the case. Otherwise, the creditor is entitled to relief from the automatic stay following notice and a hearing.

a claim of $2,275,000, the ballot certification filed by counsel for the Debtor on August 22, 1996, lists TSB's claim as secured in the amount of $2,459,422.54. Debtor contends that any unsecured claim that TSB has should be reduced by applying the monies held by TSB in escrow against the unsecured portion of TSB's claim.

According to the terms of the Plan, Class I consists of creditors who are entitled to priority pursuant to Code §507(a)(1)-(5). Included in Class I are the professionals, including the Examiner, Debtor's counsel and counsel for the Committee of Equity Security Holders ("Committee")[4]. At the Hearing, Debtor's counsel estimated that his fees were $23,000, for which he agreed to defer payment. Counsel for the Committee estimated her fees to be $20,000. Neither attorney had information regarding the amount of the Examiner's fees.

Class II was identified as those creditors who provided goods and services to the Debtor postpetition and were receiving payment on ordinary credit terms.

Class III consists of the Internal Revenue Service and the New York State Department of Taxation and Finance. According to the Plan, they are to be paid in full over sixty months, with interest accruing at 9% per annum.

TSB's claim is classified in the Plan as secured and is the only member of Class IV. Debtor's Plan, as modified, proposes to pay the balance due on the mortgage as set forth in TSB's proof of claim, alleged by the Debtor to be $2,459,422.54, over 25 years with equal monthly payments of principal and interest at 8.5% per year for the first five years, with the first payment commencing thirty days after the effective date of the Plan.

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[4]The Committee is comprised of all of Debtor's limited partners with the exception of Talandis and his wife, Phyllis Polhemus.

Shackelford Roofing, who holds a claim in the amount of $22,700 and is secured by a mechanics lien on the Complex, is believed to be the only claim in Class V. Debtor's Plan proposes to pay the claim in twelve equal instalments, commencing thirty days after the effective date.

Class VI includes creditors with unsecured claims exceeding $500; Class VII consists of creditors with unsecured claims of $500 or less. The latter are to be paid in full thirty days after the effective date; the former are to be paid in full in sixty equal monthly instalments. Debtor has not included TSB's unsecured claim of $135,657.35 in Class VI.

Class VIII consists of the unsecured claim of G.R.T. Management-Texas, Inc. ("GRTM-TI")[5] in the amount of $162,622. GRTM-TI is to be paid in full, with interest at 9% per annum, after Classes I, II, III, V, VI and VII have been paid.

Finally, the Plan provides that the Debtor's partners, comprising Class IX, are to retain their present partnership interests in the Debtor without alteration.

TSB objects to the classification of its claim, as well as the Debtor's proposed treatment of its claim. In addition, TSB contends that the claim of Shackelford Roofing, although classified as secured, is unsecured and should be included in Class VI since it was previously decided by the Court in its March 1996 Decision that TSB was undersecured and there is no unencumbered property to which Shackelford Roofing's lien could attach. TSB also asserts that there is no basis for separately classifying Shakelford Roofing's claim except to create an impaired affirmative

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[5]GRTM-TI is a Texas corporation formed in July 1987 to manage the Debtor. Its sole shareholder is G.R.T. Management, Inc. ("GRTMI"), a New York corporation formed in May 1980. Talandis is the sole shareholder, officer and director of GRTMI and also is president and sole director of GRTM-TI. GRTM-TI has a contract to manage the Complex for a fee of 6% of gross rentals.

voting class.

According to the Operating Statement for the month of September 1996 (Debtor's Exhibit A), Debtor's income from rents totaled $45,519.82 for September. In addition, Debtor generated non-rental income identified as "Non-collateral cash" totaling $1,501.18. Rental income over the first nine months of 1996 amounted to $442,779.07; Non-collateral cash for the year totaled $14,041.00. The combined yearly income of the Debtor totaled $456,820.07 or $50,755.56 per month on average. Monthly operating expenses for September, exclusive of real estate taxes, totaled $25,451.78. Total operating expenses for the first nine months of 1996, exclusive of real estate taxes, amounted to $231,157.05 or $25,684 per month. Other expenses included monthly interest paid to TSB of $19,000. According to the Operating Statement, for September 1996, no monies were paid to TSB for deposit into the Escrow Account that month. Monies deposited into the Escrow Account year to date totaled $55,056.19.

Listed as an expense for September was $1,936.65, identified as "Non-collateral cash". The total amount of "Non-collateral cash" expended over the first nine months of 1996 was $20,946.46. Talandis testified that some of these monies had been used to pay his management fees since the Court had specifically directed that TSB's cash collateral was not be used to pay management fees. According to Talandis, the balance of the monies had been deposited into his personal account.

Andrew Sciarabba, C.P.A. ("Sciarabba ") testified on behalf of the Debtor that he had reviewed the Court's March 1996 Decision and the appraisals considered in connection with it, as well as the Examiner's Report, the Debtor's monthly operating reports, the operating reports for 1993-95 and the Debtor's Plan and Disclosure Statement. It was his opinion that the Plan

offered a reasonable prospect of success provided that the Debtor was able to achieve the occupancy rates and rental rates suggested in the Disclosure Statement. He testified that his assumptions were based on there being a cash infusion for capital improvements which would result in an increased rental stream.

Sciarabba also was asked to give an opinion regarding the Debtor's proposed rate of interest to be paid to TSB on its claim. Sciarabba testified that he often helped clients find the best finance terms and that he had recently been involved with the financing of a medical office building in Ithaca, New York. The loan in that case was for a period of 20 years with an interest rate of 8.75%, adjustable after five years. On cross-examination he acknowledged that not only had there been personal guaranties on the loan, but the debt service coverage was 120% and upon completion of the project it was anticipated that equity in the building would approximate 45%. Sciarabba testified that he also had had a conversation with a loan officer at the Savings Bank of Utica sometime in August 1996 who had indicated that the interest rates on commercial real estate ranged from 8.5%-9% for a three year loan and 8.75-9 1/8% for a five year loan with an expense ratio of 1.15.

With respect to the Debtor, Sciarabba testified that based on the Debtor's revenue projections, there was sufficient income to support financing at an interest rate of 8.5%. He was uncertain whether the Debtor could afford the payments if the interest rate was 9.5%, testifying that it would depend on the payoff terms of the loan.

On questioning by Debtor's attorney, Karian testified that in the last three months TSB had made a loan in the $2.5 million range at an interest rate of 8.75%. On redirect Karian testified that normally the most that TSB would be willing to lend to a borrower it considered

"good" was 75% of the appraised value of the real estate. He did not consider the Debtor a "good" borrower, however.

Debtor's Plan projections estimate collections from rent of $60,000 per month and a $1,000 per month increase until Debtor is able to achieve 90% occupancy.[6] Talandis testified that there had been a steady upward trend in rental income until August 1996, when the Debtor began experiencing a decline in income as a result of a drop in occupancy. Talandis acknowledged that as of the date of the Hearing rental income was down approximately $10,000 per month from that projected in the Plan. He attributed this to the Debtor's inability to expend monies on capital improvements using TSB's cash collateral.

The Plan estimates monthly expenses of $51,300 (*see* ¶20 of Disclosure Statement). These include:

Operating Expenses	$ 28,385
Reserves	6,000
Capital Improvements	1,935
Priority Claims	2,905
Troy Savings Bank	17,200[7]
Shackelford Roofing	1,985
Unsecured Creditors (large)[8]	785
Unsecured Creditors (small)	805

Talandis testified that even with the current decline in rental income, there was still sufficient income to support the Plan projections provided he deferred his monthly management

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[6]There was testimony that current occupancy is between 70 and 71%.

[7]This figure was based on a 30 year mortgage at 7.5% interest. The Plan as modified proposes a 25 year mortgage at 8.5% interest for the first five years.

[8]This does not include TSB's unsecured claim of $135,657.35 since Debtor proposes to treat TSB's entire claim as secured.

fee of $3,500[9] and did not expend monies on capital improvements or provide for reserves for a time. It was Talandis' testimony on cross-examination that as of the date of the Hearing, Debtor had not made the interest payment to TSB of $19,000 for October. He also acknowledged that there were past due real estate taxes totaling approximately $100,000 plus penalties and interest. He further testified that the Plan did not propose to make monthly payments on any of the real estate taxes until the twelfth month.[10] Talandis indicated that he hoped to be able to use the funds in the Escrow Account to pay the 1996 taxes of approximately $64,000 which are due February 1, 1997; otherwise, he intends to enter into an agreement with the City of Beaumont to make monthly payments beginning in June over a period of 12-24 months.

DISCUSSION

The Debtor, as the proponent of the Plan, has the burden of establishing compliance with the requirements of Code §1129. *See In re Valley Park Group, Inc.*, 96 B.R. 16, 21 (Bankr. N.D.N.Y. 1989) (citations omitted). In this case, TSB argues that the Debtor has failed to establish that the Plan is feasible under Code §1129(a)(11).

The standard for feasibility requires the Debtor to establish that the Plan offers a reasonable assurance of success. *See Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 649 (2d Cir. 1988). Although success need not be guaranteed (*see id.*), the

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[9]According to the Plan, Talandis, by virtue of an assignment from GRTM-TI, is to receive 4% of gross receipts.

[10]According to the projections attached to the Disclosure Statement, monthly operating expenses are to increase from $28,385 to $34,065 in the twelfth month of the Plan.

Debtor must present evidence that reorganization is more than "probable" or "possible." *See In re Kent Terminal Corp.*, 166 B.R. 555, 560 (Bankr. S.D.N.Y. 1994). "The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts." *Chase Manhattan Mortgage & Realty Trust v. Bergman (In re Bergman)*, 585 F.2d 1171, 1179 (2d Cir. 1978) (citation omitted).

In this case, the Court has reviewed both the Debtor's Plan and Disclosure Statement, as well as the testimony offered by the Debtor at the Hearing. In its Disclosure Statement, Debtor projects $60,000 in income for the first month of the Plan. Debtor also projects monthly operating expenses for the first month to be $28,385. At the Hearing, however, Talandis acknowledged that the Debtor's income for September 1996 amounted to approximately $47,000, $13,000 less than projected in the Disclosure Statement. Expenses, exclusive of real estate taxes, totaled $25,452.78, and the average for the year amounted to $25,684. Subtracting $2,400 from the projected monthly expenses to account for Talandis' management fee ($60,000 X 4%), projected monthly operating expenses total $25,985 for the first 12 months of the Plan, exclusive of any management fee for Talandis, which approximates the average of the monthly expenses over the first nine months of 1996.

In addition to the operating expenses, Debtor proposes to make the following payments pursuant to the terms of the Plan[11]:

Priority Claims	2,905

[11]The Court has not included $6,000 in replacement reserves and $1,935 for capital improvements, which Talandis testified would have to be deferred until income increased and monies were available.

Troy Savings Bank	17,200[12]
Shackelford Roofing	1,985
Unsecured Creditors (large)	785
	$22,875

When combined ($25,985 + 22,875), the Debtor's expenses for the first month of the Plan amount to $48,860, which exceeds the current monthly income of $47,000. This does not include the payment of $805 to the unsecured creditors whose claims total less than $500 or the payment of any professional fees pursuant to Code §503(b)(4). Furthermore, there is no provision for the payment of either past due real estate taxes or taxes currently accruing on the Complex. The fact that the Debtor may be able to reach an agreement with the City of Beaumont to defer the taxes due and payable in February 1997 (and there was no evidence of that presented at the Hearing) or may be able to use some of the monies in the Escrow Account does not provide any comfort to the Court knowing that there are substantial prepetition taxes due and that Debtor does not propose to begin accruing monies to pay any of the taxes, whether past or future, until twelve months into the Plan. Indeed, the commencement of the accrual of approximately $6,000 per month would actually coincide with the taxes that would come due February 1, 1998. In addition, the Court notes that the actual payment to TSB would also be more than $17,200, whether it be at the rate of 8.5% as Debtor now proposes or at the rate of 10% as suggested by TSB in its memorandum of law..

At the Hearing, Talandis was asked on direct examination "Where is money to come from for capital improvements?" to which he responded that he would defer his management fees

[12]As noted at Footnote 5, this figure was based on a 30 year mortgage at 7.5% interest. The Plan as modified proposes a 25 year mortgage at 8.5% interest for the first five years, which would increase the amount of the monthly payments.

which he stated were $3,500 per month. He was also asked, "If the Plan is confirmed, what is your intention with respect to capital improvements?" Rather than responding directly to the question, he simply estimated that there were approximately $150,000 of improvements needed and that monies would become available as more apartments were rented. The Court also queried Talandis: "Forgetting tax accruals, forgetting payment of professional fees, where is there money to make capital improvements?" Again, Talandis replied that the Debtor would need to rent the 24 vacant apartments. He felt that although the Plan anticipated an additional 2 ½ units per month being available to rent, that was a conservative estimate. He felt that five additional units could be rented each month once the Complex had been cleaned up and new countertops installed. However, he failed to give any indication of the initial source of the monies for any improvements.

While Talandis' testimony suggests a significant return for a minimum investment in countertops, carpeting, paint, etc., the Court also finds it rather disturbing that Talandis elected to use the "Non-collateral cash", not for improvements to the Complex, but for management fees to himself . Confronted with a "Catch-22" in which the "only way to make money was to spend money", arguably the "Non-collateral cash" could have been spent on the improvements and additional apartments made available to rent. Indeed, the Debtor acknowledged in its Disclosure Statement that "until approximately $6,000 per month from cash flow can be used for replacement items such as carpeting and appliances, occupancy rates will decline." (*See* pg. 4 of Disclosure Statement, filed April 5, 1996).

The Debtor has proposed a Plan which does not have any basis in reality as it existed at the time of the Hearing. Indeed, the Court pointed out at that time that the Debtor had insisted

on going forward with the Hearing knowing full well that its budget projections never were actualized. The Plan fails to address the very contingencies that have occurred since the initial projections were made. No effort was made to modify those projections. Counsel for the Debtor argues that the Debtor has succeeded for twelve months without capital improvements and should be afforded an opportunity to demonstrate that the Plan is feasible. However, it is difficult to accept his definition of "success" when real estate taxes continue to accrue and occupancy rates continue to decline. Code §1129(a)(1) "prevents confirmation of 'visionary schemes' beyond the financial wherewithal of a debtor or, in other words, outside a reasonable probability of success." *Kent Terminal*, 166 B.R. at 560 (citation omitted). Based on its review of the Debtor's Plan and Disclosure Statement, as well as the testimony presented at the Hearing, the Court finds that the Debtor has failed meet its burden. There is no reasonable assurance that the Plan is feasible and that reorganization can be accomplished as a practical matter. Therefore, the Court shall deny confirmation of the Debtor's Plan.

Having concluded that the Plan is not feasible and having denied confirmation, the Court need not address TSB's arguments concerning the proposed classification of the various claims and the treatment of its claims, in particular. However, the Court still has before it TSB's motion seeking relief from the automatic stay pursuant to Code §362(d).

To satisfy the requirements of Code §362(d)(2), TSB must establish that there is no equity in the property **and** that the property is not necessary for an effective organization. In its March 1996 Decision, the Court concluded that Debtor had no equity in the Complex and that TSB was undersecured. In interpreting Code §362(d)(2)(B), the Supreme Court stated that an "effective reorganization" requires that there be "a reasonable possibility of a successful reorganization

within a reasonable time." *See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 375-76, 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). It has been over a year since Debtor filed its Petition. Beyond the 120-day exclusivity period set forth in Code §1121, the Debtor is expected to prove more than a "reasonable possibility" of confirmation of its Plan if the stay is to remain in effect; it must prove that it is "probable." *Kent Terminal*, 166 B.R. at 561. Based on the Court's foregoing analysis and its finding that the Debtor's Plan is not feasible, it is evident that the Complex is not necessary for a reorganization that has no realistic prospect of being effective under the terms of the Plan. Therefore, the Court will grant TSB's motion for relief from the automatic stay under Code §362(d)(2). *See Timbers*, 484 U.S. at 376, 108 S.Ct. at 633.

Based on the foregoing, it is hereby

ORDERED that confirmation of Debtor's Plan is denied; and

ORDERED that TSB's motion for relief from the automatic stay is granted pursuant to Code §362(d)(2), effective 30 days from the date of this Order.

Dated at Utica, New York

this 17th day of January 1997

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge