STRATEGIES

for Restructuring Troubled Development Projects and Businesses

Recently there has been no shortage of difficulty with residential development projects and hotel and resort properties in Western Canada for owners, managers, lenders, creditors, and investors to deal with. Many would say that the danger signs were evident long before the global economic crisis. They were right!

DEVELOPMENT PROJECTS

Maximizing recoveries from failed real estate development projects and businesses requires a comprehensive business approach regardless of whether formal remedies of foreclosure, receivership, bankruptcy proceedings, or listings with real estate agents are intended. Experienced restructuring and industry specialists who seek business solutions by working with a debtor's management and other key advisors or stakeholders can often increase project recoveries.

The following are seven steps for dealing with failed development projects. These can also be applied to troubled businesses such as hospitality operations in hotels and resorts.

1. **Diagnose the underlying causes of the failure.** The first step in the restructuring process is to understand the primary reasons for project difficulties and the possible steps that might be taken to maximize recovery. For instance, sufficient market research is often not undertaken before designing a development project. Market research should help to determine a number of key variables:

- **Likely volume of demand and absorption period**
- **Type of product that should be built**
- **Who prospective buyers are and how to reach them**
- **Estimated selling price**
- **Competing supply from other projects**

This information constitutes a foundation for sound financial models but often this work is not completed adequately, if at all. One such example is a multi-family residential project we looked at in Calgary in late 2008. It was designed for mostly larger units starting at $450,000 per unit and averaging over $600,000 per unit. Our market research for the Calgary multi-family market found that 85% of all MLS sales occurred at prices of $350,000 or lower for 2007 and 2008. This was one of many projects that had missed the market.

2. **Identify continuing danger signs and underlying reasons for failure or poor performance and take immediate action.** When embarking on a restructuring process it is important to "stop the bleeding" quickly to avoid compounding existing financial problems, while conducting an overall analysis to develop potential solutions. Examples include curtailing expenditures that have limited immediate return, such as halting any pre-marketing for a product that is not suited to the market, reducing the cost of inputs (e.g. expensive appliances) because of price sensitivity, or replacing ineffective management staff who continue to make poor decisions or who block constructive actions.

Gary has over 30 years of professional experience assisting stakeholders in maximizing their operating results and asset values. He is a Chartered Accountant (FCA), a federally licensed Trustee in Bankruptcy, and is also licensed under the BC Real Estate Services Act as a Managing Broker for G-Force Real Estate Inc. G-Force Group assists stakeholders to enhance or recover their investments in business, real estate, or loans in a wide range of industries and real estate holdings. In the real estate and hospitality industries G-Force Group's senior expertise includes development, market research, marketing, sales, hotel and hospitality operations, management and corporate finance. www.g-forcegroup.ca

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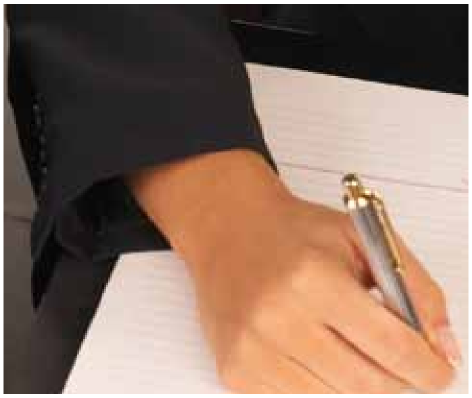
3. **Determine the objectives of management and owners and ensure they are compatible with those of the other key stakeholders**. When development projects or businesses get into difficulty we seldom see the owners or managers look externally for help. In many cases pride is a factor, control over decision making is unnecessarily guarded, and admissions of mistakes or lack of experience are avoided. Lenders and non-management investors are generally focused on obtaining assurance that their investment is protected and will be recovered. The lenders and non-management investors are more likely to question the capability and the integrity of owners and managers when access to key performance information is curtailed, management becomes unresponsive, or if there is a perception that management is hiding problems. The best restructuring outcomes occur when the interests of the debtors and the lenders can be aligned on a win-win basis and the solution is developed and implemented transparently. However, if trust breaks down and adversarial positions become entrenched, financial and reputational losses are often the outcome.

4. **Assess all key management personnel. Management deficiencies often underlie troubled real estate projects or businesses.** It may be the lead manager, the owner, or supporting management in marketing, development, or finance that lack the experience or required capabilities. Assessing the capability of management staff is imperative to determine the capability for assisting with the identification of the project's main problem areas and to execute workable solutions. Finding ways to augment or replace specific management skills and experience is often the greatest challenge but is crucial to maximizing recovery from the project. The need for competent management personnel is accentuated in management-sensitive businesses such as hospitality operations.

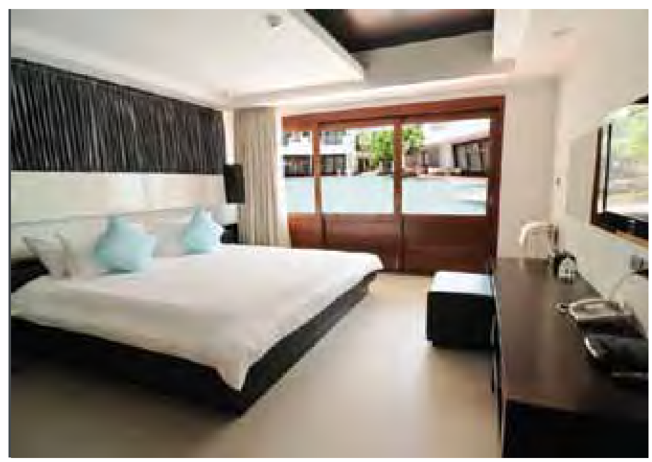
5. **Ensure adequate monitoring and reporting of the continuing development activities.** When projects get into difficulty, regular and accurate reporting to lenders or to owners and investors usually stops. Often management is struggling and does not have adequate information to



make sound decisions, let alone report to others about problems for which they do not have workable solutions. In virtually every restructuring situation, the quality and timing of information needs to be improved to enable good decision making by management and to keep key stakeholders informed and supportive of the progress being made.

6. **Consider all options for restructuring and recovery including value-added options.** Owners and managers involved with projects often get locked into their standard approaches (e.g. trying to maximize the amount of density rather than develop the density that can be marketable at a profit in a tough market), and they may remain committed to past decisions that no longer make sense (e.g. keeping construction in-house when outsourcing it would significantly reduce costs and risks). Often developers do not do the detailed analysis or know where to look for value-added solutions. Also, asking for help means giving up control, which developers are generally reluctant to do. Our experience is that owners and managers who have enough at risk will want to salvage the best out of a difficult situation. They will usually be receptive to working with lenders and investors and considering other approaches for adding value. Lenders often get locked into standard approaches as well, supporting the completion of an ill-designed project, commencing standard foreclosure proceedings, or listing the assets for sale with a broker when none of these actions capture the additional value that may be possible with other value-added options developed through sound analysis and experience.

7. **Utilize the proper legal framework to assist in the restructuring.** Sound analysis, problem diagnosis, identification of solutions, and effective implementation accounts for 95% of the restructuring effort required to maximize values of failing real estate projects. Less than 5% of the restructuring effort should involve determining and managing the proper legal framework to be utilized. The normal "going concern" legal framework should be maintained if possible. Unfortunately, the situation often deteriorates to the point where a legal insolvency or restructuring framework (formal proposal to creditors, Companies' Creditors Arrangement Act (CCAA), receivership, etc.) is required for various reasons. These reasons may include protecting some of the stakeholders' interests (e.g. minimizing directors' liabilities or preventing further erosion of a supportive secured creditor's position), or helping with the implementation of specific solutions (e.g. attracting new capital or financing). However, implementation of these frameworks should not detract from the work required to develop and implement the best business solutions.



HOTEL AND RESORT PROPERTIES

Hotel and resort properties include hospitality operations—which are unique for three reasons. First, they have perishable inventory that is written off every day: rooms that are not let; restaurant seats that are not occupied at each sitting; capacity for golf rounds or ski visits not filled. Second, they have an extremely high service component to support a positive customer experience, which leads to high labour costs. Third, there are often many brand differentiators and commodity suppliers in the market. These reasons make hospitality operations one of the most management-sensitive businesses in the market. This accentuates the need for the thoughtful management assessment and analysis raised earlier in the seven key steps for dealing with development projects.

The hospitality operations are usually considered amenities to assist the developer with the sale of the real estate development and the profitability of the hospitality operation is not a key objective.

Resort properties are usually a combination of a residential development and hospitality operations. Generally, the prime objective for the owners of a resort is to maximize the return from the real estate development. The hospitality operations are usually considered amenities to assist the developer with the sale of the real estate development and the profitability of the hospitality operation is not a key objective. Most often the challenge is to maintain the cost of the amenity at reasonable levels.

APPLICATIONS TO REFINANCING OR SALE SOLUTIONS

Dealing with the issues outlined in the seven steps above and setting out the results in a well-designed refinancing proposal or sale process adds significant value to troubled real estate projects and hospitality operations. Another key component of refinancing or sale packages is the financial models and projections provided. The financial models need to be based upon sound assumptions and provide for sensitivity analysis so the user, manager, or an existing or new lender or buyer can easily determine the range of reasonably predictable results. The financial models should also be easy to update or modify at any time to take into account changes in key variables or actual results.

NEW PROJECTS

The key steps and issues discussed above should not be reserved only for real estate projects or businesses in trouble. They are good principles to be applied to new or proposed projects as well; if they were, fewer real estate developments and hospitality properties would end up in distress.