NOTE TO ROBERT ELLIOTT

Pursuant to our conversation on Wednesday, I am attaching what I believe to be candid capsule analyses of the current status of the Title IV and VII new communities.

These analyses disclose that Jonathan, Park Forest South, and Cedar-Riverside, for various reasons, are in precarious circumstances, and that St. Charles, Gananda, and Soul City warrant especially close monitoring. Other project problems are identified. A question common to most of these projects is if, and under what circumstances, HUD will be willing to provide additional guarantee and other assistance.

You also asked that I comment on what might be done to rescue projects in trouble. In accordance with your earlier request, we have analyzed the remedies for Jonathan, whose difficulties evolve from the death of the project's prime sponsor, and this is being sent to you separately, as is a draft of the alternatives developed in considering a more conventional default situation (Riverton) prepared last May.

HUD has essentially three types of remedies: 1) the ad hoc, short term and stop gap solutions, with pressure on principals and lenders as needed, 2) exercise of the Share of Special Stock which allows HUD to elect a majority of the Board of Directors and to otherwise assume control of the company, or 3) utilization of some type of foreclosure procedure.

Remedies two or three will require competent professional advice regarding action which we might appropriately take under local law, either from HUD area legal staffs or from special counsel hired for the purpose. I recommend that we take such action as is necessary to acquire local advice regarding local foreclosure procedures and related actions as well as recommendations of firms which are experienced in managing bankrupt or distressed organizations.

GRANT E. MITCHELL

Grant Mitchell
Assistant General Counsel
New Communities

Attachment
Current Status

Henry T. McKnight, the moving force and controlling stockholder of this project, died in December, 1972. After estate squabbles, McKnight's stock is now held by several family members, the McKnight estate and several trusts. With the dispersal of interests in the project, strong supervisory direction has been missing. The McKnight interests are not interested in assuming management of the Developer and have been unwilling to contribute additional equity to the Developer.

The Developer presently is in default under Section 5.06 of the Indenture (liquid current assets test). Other defaults may exist. The Developer has fired half of its employees; the Controller has quit, and morale is low. Substantial non-title IV development activity (Green Giant headquarters building) has stopped; the presence of this highly visible half constructed building on the edge of the industrial park affects the credibility of the entire project. Developer is presently operating with draws under $1.543 million letter of credit with First National Bank of Saint Paul, to meet its cash needs.

Conclusion

Developer may well become bankrupt in next three to twelve months, unless it obtains a substantial infusion of new equity capital. (See longer memorandum on this project transmitted under separate cover which substantially expands this discussion.)

SAINT CHARLES COMMUNITIES

Current Status

James J. Wilson, the developer of Saint Charles Communities has a long history of feuds with Charles County, the HUD area office, FHA and other HUD officials. However, he is generally credited with exceptional resilience, resourcefulness and tough business acumen. The $5.5 million of proceeds in Escrow from the guaranteed Series B debentures issued in November 1973 are long since expended. The project is currently cash short and in liquid current assets default. Wilson
has just declared his inability to make the December $935,500 interest payment on the guaranteed debentures. Project development pace is substantially behind the Developer's earlier projections, which probably puts him in an additional default pending an overdue amendment of the Development Plan.

The Developer is in dispute with NCA over amendment of the Development Plan to reflect more accurately the realities of the applicable markets. Wilson has proposed a series of Interested Persons transactions designed to carry out elements of the development plan in the absence of a market for sales of various types of project land to third party merchant builders and developers. If past experience provides a model, however, negotiation of these transactions with this Developer will be an arduous and protracted process if the interests of the Secretary are to be adequately protected. At least some of the transactions, as yet not fully described, can be expected to contemplate soft terms for the Interested Person purchaser vis-a-vis the Title IV Developer. Also, the financing for at least one of these transactions, which the Developer initially claimed would be the source of funds to cure the liquid current assets default and provide for the December interest payment, has not materialized. Wilson has since applied to the Baltimore Area Office for insurance under Title X of the National Housing Act in aid of additional financing, but prospects for early approval are judged to be nil. Since Wilson habitually discloses as little as possible in his dealings with HUD, it is impossible accurately to assess what unused resources he may still have in reserve.

Conclusion

While the prognosis for Saint Charles Communities is uncertain, so long as Wilson has substantial amounts of good land which he has not withdrawn from the Title IV Developer and he still can see possibilities of gain, the project should keep operating.

PARK FOREST SOUTH
$30,000,000 - March 1971

Current Status

The Developer does not presently have the funds necessary to deposit its interest payment with the Trustee by August 30 (which is 10 business days prior to the September 15 interest payment date). Financial collapse is probable unless
there is (1) a bank (Continental Illinois) repayment moratorium, (2) additional equity and (3) substantial additional Federal assistance.

The Developer has fallen well behind its anticipated residential pace. Poor management and organization, particularly in the earlier stages, have been part of the problem. The guarantee proceeds have all been used together with another $25,000,000 from the Developer and its affiliate. The Developer is currently in default under its liquid current assets test and perhaps other less important provisions of the project documents.

Negotiations are currently underway among HUD, the Manilow Organization (the operating partner of the developer and its affiliate, New Community Enterprises), Continental Illinois (our Trustee and a $9,000,000 unsecured lender of the Developer and its affiliate) and the two other partners (subsidiaries of U.S. Gypsum and the Illinois Central R.R., both of which want to get out of the project). Not much headway has been made to date. It appears as if at least $15,000,000 of additional guarantee assistance is being requested with a closing by June, 1975. Unless the bank and the partners can make available substantial amounts of cash in the interim, the project will not be able to last until June, 1975. There does not appear to be a basis for optimism on future short-term residential or industrial sales.

Conclusion

This project appears to be in serious financial trouble.

MAUMELLE
$7,500,000 - December 1971

Current Status

In July, 1974 Developer's liquidity position was marginal. Developer has very substantial inventory of marketable lots. It has received no substantial land sales revenues to date but in May, 1974 it retained a local realtor along with a national consultant to market property.

Developer expects to soon file application for $7,500,000 of additional guarantee commitment.
Conclusion

Sole stockholder of Developer appears to have sufficient assets to obtain credit necessary to carry project at least until HUD decides in next 6 to 12 months whether to make additional guarantee commitment to developer.

FLOWER MOUND
$14,000,000 - September 1971

Current Status

The Developer will be able to make its September 15 interest payment.

However, this fall the Developer will need to obtain the $4,000,000 of additional guarantee financing which is contemplated under the original project documents and, further, will be requesting at least another $5,000,000 guarantee for some time in the middle of 1975.

The Developer has fallen substantially behind in most categories of development. The principal reasons are an unanticipated year's delay following closing when the project was replanned and several top management changes occurred. The Developer is currently in default under its liquid current assets requirement. However, the project has subsequently picked up momentum.

Assuming a fall closing is consummated, there should be sufficient funds until late spring. Additional guarantee assistance will be requested. It is not known to what extent further equity will be forthcoming.

Conclusion

While not needing an additional guarantee commitment immediately, the Developer will be in serious difficulty without one by next spring.

CEDAR-RIVERSIDE
$24,000,000 - December 1971

Current Status

Developer has expended $22,500,000 since the issuance of the guaranteed debentures. Because of the rapid and lavish expenditure of funds by the
developer, NCA recently caused the developer to enter into a supplemental indenture which limits the developer's expenditures and gives the Secretary control over reimbursement to the developer for these expenditures.

The developer, HUD and others are defendants in NEPA litigation arising out of the alleged inadequacy of HUD's Environmental Impact Statement issued in 1971 prior to the guarantee of the developer's debentures. HUD and the other defendants propose to soon agree to an order which requires the issuance of a new Environmental Impact Statement relating to the project and prohibits Title VII land development activity or FHA mortgage subsidy assistance pending the issuance of a final Environmental Impact Statement. The draft Environmental Impact Statement should be issued in September.

Developer is in default under Section 5.08 of the Indenture for failure to submit audited financial statements for fiscal year 1973. Auditors have been studying the developer's books since the beginning of this year, and are unable to give a clean audit because of questions regarding 1969 land transactions and other substantial problems. Without a clean audit, no additional equity capital through sale of limited partnership interests can be raised. The developer also lacks liquidity and is in default under Section 5.06 of the Indenture (liquid current assets). Other defaults may exist.

Conclusion

The Developer may well become bankrupt in the next three to twelve months, unless the NEPA litigation is settled and the developer either obtains a substantial infusion of new equity capital or obtains new capital and receives substantial land revenues.

RIVERTON
$12,000,000 - May 1972

Current Status

The Developer will make its November 15 interest payment only if there is a closing on the initial $4,000,000 of the $11,000,000 commitment for additional guarantee assistance.
The Developer is making substantial progress toward meeting the conditions set forth in the May offer of commitment and an early October closing is contemplated. This project should have sufficient funds to carry on for the near term assuming its ability to generate the projected sales.

The Developer will probably want to close on at least a portion of the additional $7,000,000. Although the $11,000,000 of additional guarantee assistance was presented as being sufficient to complete the project, it would not be surprising if HUD were asked for more assistance within the next three or four years. The Developer will have to improve its marketing ability.

Conclusion

An October closing on the $4,000,000 will rescue this project from its immediate trouble.

GANANDA
$22,000,000 - December 1972

Current Status

The developer is just beginning to convey land to builders, hence the project is considerably behind schedule. Management problems are at the root of Gananda's difficulties. Management fell apart shortly after closing. The current management team is the fourth. This team is composed of major stockholders, so it will not lightly depart, and appears to be competent. The project is gaining momentum now. Covenants have been approved and land is being sold. A substantial amount of infrastructure and several large and expensive community facilities are near completion. The long delay, however, has put the project in a poor cash position; it will run out of money near the end of this year or in the first quarter of 1975. The developer is applying for $14,000,000 additional guarantee assistance. $3,500,000 additional cash equity would be needed to support such additional guarantee assistance. The developer's stockholders do not propose to put up any more cash. They are requesting that NCA take 1500 acres of adjacent land which they own into the project and to consider the purchase price of that land to be the required equity contribution. NCA has yet to determine the wisdom of including that land or whether additional cash will be needed to successfully complete the project.
Conclusion

Without additional guarantee assistance or a great deal of additional equity capital, or both, the prospects for Gananda are poor. The Developer may be unable to meet the next interest payment due December 2, 1974. However, it appears that a fair-sized industrial firm will shortly contract to buy land for its corporate headquarters in Gananda, and difficulties with local governments appear to have been resolved. With additional guarantee assistance and equity, the project may reward the civic-minded among its shareholders as a well-designed community, if not with a high degree of profitability.

THE WOODLANDS
$50,000,000 - August 1972

Current Status

Development of the Woodlands is well behind schedule. The 1973 building season, its first, was extraordinarily rainy. The Woodlands covenants were not completed, approved and recorded until January 1974. Development is now proceeding at a good overall pace, but "Interested Persons" are doing a large share of the development. The market appears weak for industrial land, some price ranges of townhouses, and apartments. The project is very short of cash. The Developer had to borrow to meet the $1,750,000 interest payment on the debentures due August 20, among other needs, and is negotiating with NCA for permission to borrow within 30-60 days up to $10,000,000, the borrowings to be secured by land which the Developer is entitled to take out of HUD's security pool. These borrowings exceed the debt permitted by the Project Agreement. The projection for peak debt has risen from approximately $61,000,000 to approximately $91,000,000.

Conclusion

In the long run, it appears that The Woodlands will be very successful financially. If the new projection of peak debt is correct, the project will not survive the current cash shortage without the almost immediate injection of $10,000,000 and probably further sums in the not too distant future. The parent corporation has put relatively little cash into the developer and appears to be a suitable and available source of cash, if required.
The project is in serious, but probably soluble short-term financial difficulty. Otherwise, it is basically sound.

SOUL CITY
$5,000,000 - February 1974
($9,000,000 - Reserved)

Current Status

Little has been done since financial closing in February. The Developer has failed to produce draft covenants and is unable to market any land. Development of the project is dependent upon attracting or creating jobs. No industry has yet been convinced to locate in Soul City. Unless at least 300 jobs exist by the end of the first development year, the developer will not be permitted to issue more guaranteed debentures. The project is also dependent upon the construction of a regional water system. The water system was projected to cost $9,000,000, but the lowest bids came in at $12,000,000. Additional funds, except for HUD's pro rata grant share, have allegedly been committed. The latter is on appeal to OMB. The first industrial building in the project is to be built by "Interested Persons", and there are difficulties in obtaining financing. Project management appears to be only marginally competent. National Housing Partnerships has not been providing the expected managerial expertise and is attempting to limit its financial exposure, despite the fact that it is a general partner.

The margin for error in Soul City's cash flow is minimal. The cost overruns in the water system and the industrial building suggest that the development costs on which that cash flow is based are over-optimistic and hence the project is unlikely to be profitable.

Conclusion

The project is, as it always has been, extremely marginal, and nothing has happened since the February closing to strengthen its position. HUD may have to make the decision by the second development year whether to continue to extend its support or to cut its losses.
NEWFIELDS
$18,000,000 - November 1973

Current Status

No financial difficulties are currently indicated, but since the Dayton market for land sales to merchant builders and developers is soft, the Developer has relied almost exclusively upon a series of Interested Persons Transactions with Donald L. Huber owned or related companies in order to meet current commitments for construction under the Development Plan.

SHENANDOAH
$25,000,000 - March 21, 1974
$15,000,000 - Series B Guaranteed Debentures remain to be issued

Current Status

Substantial land sales are expected to begin in September and no defaults exist or are expected to exist during next six to twelve months.

SAN ANTONIO RANCH

Conditional offer to guarantee $18,000,000 of debentures is outstanding.

Decision by Fifth Circuit Court of Appeals regarding NEPA compliance by HUD in initially approving project is expected soon, at which time an extensive re-evaluation of project's financial viability will be required.

RADISSON AND ROOSEVELT ISLAND

Agreements enabling New York Urban Development Corporation to receive assistance under Title VII (other than guarantee or interest loan assistance) are to be executed before the end of August.
HARBISON
$13,000,000 - Guarantee authority not yet closed

Current Status

Drafts of the project documents have been submitted and are being reviewed. The Developer hopes to close by December 1, a date which will probably slip somewhat. The Developer is beginning to construct infrastructure in September, which will require further advances from Banker's Trust, which has already advanced $6,800,000. Banker's Trust is very nervous that the financial closing will not occur or will not occur on time. The Bank has cause for nervousness inasmuch as it has represented to HUD that its security interest in the land would yield only $4,000,000 at an immediate sale. The project has moved slowly since the offer of commitment was accepted because there was a substantial conflict of authority in its management structure. Since that conflict was resolved by the removal of the executive director, the project has moved at a good pace. Management now appears competent. The cost side of the project's cash flow appears good in that the bids for the initial sections of infrastructure were within the projections. The revenue side, however, looks unreliable in that one-half of the units to be built in the early years of the project are multifamily and the vacancy rate in multifamily units in the Columbia market is 15% and rising. Subdivision approvals have been obtained from both counties, but no formal approval of the project as a whole has yet been obtained from Lexington County.

Conclusion

Considering the multifamily market in the area and the fact that the project's cash flow was only marginally acceptable in December, the project may well have great difficulty generating revenues in excess of expenses. As the developer is a non-profit corporation, that is not disastrous in itself, but the project appears underfinanced. $13,000,000 in guaranteed debentures is probably inadequate and the developer may well be back in two or so years for $5,000,000 or more in additional assistance. The developer does not appear to have any source of equity to support an additional amount of assistance. The project thus represents a substantial degree of financial risk.