

Initiation Report I: Heritage Residential/Highgate

(Publication Date: Feb 7, 2009)

Chapter 11 Bankruptcy, District of New Jersey

Heritage Residential at Wilton's Corner, TH-4, LLC

2500 York Road

Jamison, PA 18929

Tax ID / EIN: 20-2191425

Heritage Highgate, Inc.

773 Yorkshire Drive

Breinigsville, PA 18031

Tax ID / EIN: 20-3450062

Date	Event
01/20/09	Companies files Chapter 11 voluntary bankruptcy petition and first day motions to sell real property
01/28/09	Companies file motion to use cash collateral
01/28/09	Order approving sale of various properties

Company Profile

Various affiliates of Heritage Building Group, a developer, have filed for bankruptcy on January 20, 2009, namely: Heritage Highgate, Inc ("Highgate"), Heritage-Twin Ponds, II LP ("Twin Ponds") and Heritage Residential at Wilton's Corner, TH-4 LLC, Heritage Residential at Wilton's Corner, VII LLC (together, "Heritage Residential"). Note that Heritage Building Group itself is not part of the bankruptcy filing, though it is listed as an unsecured creditor in Highgate's petition which is owed more than \$60,000.

Highgate and Twin Ponds own and develop a residential subdivision in Lehigh County known as Highgate. Highgate is the main contracting and selling entity. Twin Ponds owned one of the tracts that

constitute Highgate. As of the bankruptcy date, they have delivered 101 units of a 411-unit subdivision, with sales pending for 35 units.

The Heritage Residential entities own and develop a residential subdivision in Sicklerville NJ called Wilton's Comer. The projects were adjacent to each other and the entities had many similar creditors. At the time of bankruptcy, the entities have already delivered 104 units of a 195 unit Subdivision, with sales pending for 12 units.

Creditors

Heritage Residential stated that Wachovia Bank was owed \$2,466,944 from the SF-7 entity and \$4,000,719 from the TH-4 entity under a senior secured lien. Both entities had combined trade debt of \$1,950,000.00 in unpaid subcontractors. In subsequent court filings, Wachovia asserted secured claims of \$2.47 million against the SF-7 entity and \$3.8 million against the TH-4 entity.

Highgate, on the other hand, stated that Wachovia held a senior secured claim in the balance of \$14,608,005. Cornerstone Investors held a second lien mortgage in the the approximate amount of \$1,400,000. The Highgate entities owed approximately \$4,000,000 to unpaid subcontractors. In subsequent court filings, Wachovia asserted a secured claim of \$16.48 million in principal amount, on behalf of itself, PNC Bank and Sovereign Bank.

Ongoing Sales

In one of its first day motions, both companies sought authorization to sell certain properties free and clear of liens. It is fairly typical for home builders in bankruptcy to make this a priority following bankruptcy, such that they can continue closing home sales and generate cash to fund ongoing operations.

As for home owners' deposits, the companies stated that they have kept these deposits in separate, segregated escrow accounts, and they are ready to close and consummate these home sale transactions.

What is atypical is that the companies stated on the day of bankruptcy that they had not conferred with their lender, Wachovia in this case, regarding the sales of the properties. Nonetheless, court orders have already been entered authorizing some of the sales, such as Lots 53, 44, 31, 30. Interestingly, the companies and Wachovia had been unable to reach an agreement on the release price for the liens of Wachovia Bank for future sales. The companies had requested a reduction in release prices from Wachovia, in order to pay their subcontractors and suppliers. The Companies stated in their motions that, as a result, they were “required to file the Bankruptcy so that it could deliver clean title to third party consumer buyers”.

Another set of motions were filed on February 3, 2009, by the Companies to authorize the sale of remaining units. Heritage Highgate was requesting permission to sell 14 units under sale contracts and 68 unit not currently under contract; and Heritage Residential was requesting permission for 7 units under contract and 35 not currently under contract.

Use of Cash to Fund Operations

Another significant (and typical) motion which the companies have filed is the request for authorization to use cash collateral, i.e., proceeds of the sale of existing homes which Wachovia and other secured creditors are collateralized upon. These proceeds would allow the companies to continue selling homes and complete construction, etc. In the cash flow budgets prepared by the companies to support this motion, Highgate projected that it would generate \$1,213,000.00 in proceeds within 30 days, while Heritage Residential projected \$786,000 combined in proceeds within 30 days.

We have provided in the Appendix a list of sales which the companies intended to close in the near future, showing the respective sale prices and projected cash flow generated. For more details on the cash flow budget and sales projections (including selling prices of homes) prepared by the companies, please look at [Heritage Residential/Highgate Initiation Report II \(Addendum\)](#).

On February 2, 2009, Wachovia filed an objection against the cash collateral motion with 2 primary grounds. First, it argued that the companies' contentions that the lenders' interests are adequately protected were based on speculative financial projections. Second and more interestingly, it raised the issue that the "predominant purpose" for the use of cash collateral "is to allow the Debtors to fund the direct and indirect expenses of their affiliated non-Debtor construction company". The bank identified, from the companies' projections, significant payments to be made to Heritage Building Group, Inc and Heritage Homes Group, Inc (neither were in bankruptcy at the moment). Specifically, Heritage Highgate's budget included \$101,565 per month, commencing in March 2009, to fund "HBG/HHG Admin Overhead" – the appropriateness of these intercompany transfers were questioned. Nonetheless, the bank stated that it would continue to work with the Companies to reach a consensual agreement regarding the use of cash collateral.

Warranties

The companies stated in their motions that they have offered and continued to offer all home buyers warranties. They would fund all warranty items arising in the initial one year period following closing and, beyond that, a national warranty company steps in. The warranty expense has also been included as a line item in the companies' cash projections in the budget submitted to court. The companies stated that the estimated warranty expense is minimal on a monthly basis and, depending on the claim, the entire repair may be the responsibility of a subcontractor.

Most importantly, the companies stated that they would honor all valid pre-petition and post-petition claims arising under the warranty. This would be subject to court authorization. This is not that common in recent home builder bankruptcies, and it does indicate a confidence by the home builder that it would remain a going concern and could repay lenders in full. Perhaps this confidence is boosted by the fact that Heritage Building Group itself is not part of the bankruptcy filings.

Since home owners with claims under warranties are generally considered unsecured creditors, their priority to repayment by the bankrupt entities is low, compared to secured creditors. It should be noted, however, that the companies asserted that they had substantial equity in their properties which provide

a healthy cushion for the Bank (an issue which we will probe in the next [Heritage Highgate Research Update](#)). They also asserted that the warranty program was an integral part of selling and marketing the homes – while this was true, it did not necessarily mean (to lenders) that they should honor warranty claims which arose prior to bankruptcy as this might deplete cash which should be earmarked for repayment of secured debt. If secured creditors, especially Wachovia (the first lien creditor), determine that there are insufficient funds to cover their debt, we should expect a flurry of objections to the final motions relating to cash collateral and financing in the coming weeks.

Watch for our Research Update on Heritage Residential/Highgate as more details are unveiled in bankruptcy proceedings in the first month.

Appendix: Projected Cash Flow from Lots with Sale Contracts

Heritage Homes Group
 Projected Cash Flow
 1/15/2009

														est (3%)	
Community	Lot #	Date	Buyer	Sales Price	Revolver Payoff	A & D Payoff	Site Fees	Trnsfr Tax	Sales Dep	Opt Dep	Wrnty	O/S Comm	Misc	Total Cash	Total Cash Including Deposits
Highgate - Carriage Court	73	1/23/2009	Wohlbach	255,000.00	105,790.00	115,000.00	2,634.00	2,550.00	2,500.00	-	315.69	7,650.00	500.00	18,060.31	20,580.31
Highgate - Manors	48	1/21/2009	Thayer	396,425.00	93,651.62	175,000.00	5,075.00	3,964.25	80,000.00	-	490.77	11,892.75	500.00	25,850.61	105,850.61
Highgate - Villas	34	1/29/2009	Wagner	214,655.00	93,954.08	105,000.00	2,634.00	2,146.55	6,000.00	-	265.74	-	500.00	4,154.63	10,154.63
Highgate - Villas	31	1/29/2009	Keefe	199,613.00	83,212.80	105,000.00	2,634.00	1,996.13	10,995.00	-	247.12	-	500.00	(4,972.05)	6,022.95
Highgate - Villas	30	1/29/2009	Wiltout	196,130.00	85,104.00	105,000.00	2,634.00	1,961.30	9,695.00	679.00	242.81	-	500.00	(9,886.11)	687.89
Wilton's Corner - SF7	321		Lampkin	346,815.00	124,527.00	142,500.00	1,549.00	3,468.15	16,475.00	592.00	429.36	-	500.00	56,774.49	73,841.49
Wilton's Corner - SF7	345		Mays	345,785.00	132,476.00	142,500.00	1,549.00	3,457.85	16,745.00	700.00	428.08	10,373.55	500.00	37,055.52	54,500.52
Wilton's Corner - SF7	319	1/23/2009	Page/Chapman	370,509.00	99,864.69	142,500.00	1,549.00	3,705.09	5,000.00	-	458.69	-	500.00	116,931.53	121,931.53
Wilton's Corner - KC	44	1/30/2009	Gaines	203,900.00	80,883.36	97,000.00	1,150.00	2,039.00	5,000.00	-	252.43	-	500.00	17,075.21	22,075.21
Wilton's Corner - KC	31	1/30/2009	Gray	206,900.00	87,873.28	97,000.00	1,150.00	2,069.00	6,382.93	35.00	256.14	6,207.00	500.00	5,426.65	11,844.58
Wilton's Corner - KC	53	1/26/2009	Llewellyn	204,900.00	103,051.00	97,000.00	1,150.00	2,049.00	6,150.00	-	253.67	-	500.00	(5,253.67)	896.33
Totals				2,940,632.00	1,090,387.83	1,323,500.00	23,708.00	29,406.32	165,142.93	2,006.00	3,640.50	36,123.30	5,500.00	261,217.12	428,366.05

This report contains information from a variety of public and proprietary sources. The owners of TheDownturnAnalyst.com website and domain ("TDA") have relied on the information provided to it from such sources. TDA does not warrant or guarantee the completeness, accuracy, timeliness, or authenticity of such information in preparing this report. The information and methodology used to compile this report, and the analysis and services intended to be provided by this report, are provided "AS IS" WITHOUT WARRANTY OF ANY KIND, EITHER EXPRESSED OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, OR NON-INFRINGEMENT.

The information contained herein is for informational purposes, and is not legal advice or a substitute for legal counsel. The information contained herein may or may not reflect the most current legal developments; accordingly, information on this website is not promised or guaranteed to be correct or complete, and should not be considered an indication of future results.

In no event shall TDA be liable for any direct, indirect, special, punitive, consequential or similar damages, whether arising out of contract, tort or otherwise, arising out of this report and the information contained herein, or for any decision made or action taken or not taken in reliance on this report and the information contained herein, even if TDA has been advised of the possibility that such damages may arise. TDA expressly disclaims all liability in respect to actions taken or not taken based on any or all the contents of this report.

Entire contents copyright 2008-9 by the owners of TheDownturnAnalyst.com website and domain. All rights reserved. Reproduction in any media or format, in whole or in part, of any report or data of TDA or their affiliates is prohibited without prior written permission. Additional information may be available upon request to research@thedownturnanalyst.com.