



IT IS ORDERED as set forth below:

Date: April 3, 2012

Mary Grace Diehl

**Mary Grace Diehl
U.S. Bankruptcy Court Judge**

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

In re:)	Case Number:
)	
ALLIECE JOHNSON-HINES)	11-84228-MGD
)	
Debtor.)	Chapter 13
)	
ALLIECE JOHNSON-HINES,)	
)	
Movant,)	
)	
vs.)	Contested Matter
)	
RES-GA EIGHT, LLC)	
)	
Respondent.)	

Order Determining Valuation of Real Property
for Purposes of Chapter 13 Plan Confirmation

This matter revolves around Debtor Alliece Johnson-Hines' ("Debtor") attempt to "strip down" the first lien on an apartment building, which includes her residence, and to "strip off" the second lien on that same property. RES-GA EIGHT, LLC ("RES-GA EIGHT"), holder of a first

priority deed to secure debt on the property, opposes Debtor's motion to value its collateral and objects to confirmation of Debtor's Chapter 13 Plan based on the value of the property. An evidentiary hearing was held on March 28, 2012 and the Court heard testimony from the Debtor and two real estate appraisers. G. Scott Buff represented Debtor and Samuel Arden and Sabrina Fitze appeared for RES-GA EIGHT. Movant's exhibits 1 through 5 and Respondent's exhibits 1 through 8 were admitted into evidence without objection. The parties stipulated that their appraisers would be qualified as experts to value real estate. Based upon the testimony and other evidence, the Court determines the value of the property to be \$102,785.00.

I. Facts, Procedural Posture, and Jurisdiction

The basic facts are not disputed. Debtor purchased the property located at 650 Jett Street, NW, Atlanta, Georgia ("property") in 2005 for a purchase price of \$125,000. The property had 7 rental units at the time of her purchase. Debtor assumed a mortgage from Omni National Bank to finance the purchase of the property. Omni's lien was a perfected first priority lien against the property. Debtor purchased the property for the purpose of rehabilitating it and selling the individual units as condominiums. In furtherance of this goal, Debtor obtained government grants, received second mortgage financing from Clark Development Group, LLC, and invested substantial savings of her own in the property. The rehabilitation involved new wiring and plumbing, a new roof, and new appliances in the units. The building was reconfigured to have only 5 units. The real estate crisis interrupted Debtor's plans and she was unable to complete the conversion to condominiums.

Debtor currently resides in one of the three 2-bedroom units. There are also two 1-bedroom units. Currently, the property is fully occupied and all tenants (besides Debtor) are paying rent.¹

¹Debtor's sister occupies one of the units and is paying rent.

Over the past three years, at least one of the units has been unoccupied for approximately 2 months each year.

The neighborhood is known as "Vine City" and all the witnesses explained that it is a "rough" area with a higher than normal crime rate. Many of the other buildings in the area are boarded up; some have fire damage; and others appear to be used in connection with illegal drug activity. Debtor lives on-site to increase the security of her building. Her property is well maintained. The apartment building is the nicest property in its immediate area.

The first lien on the property is currently held by RES-GA EIGHT. The loan giving rise to the security interest was purchased from the FDIC when it closed Omni National Bank. While RES-GA EIGHT had not filed a proof of claim at the time of the hearing, the proof of claim filed on March 29, 2012 reflects a debt of \$125,807.86. (Claim No. 13). Debtor represents that Clark Development Group, LLC has a second priority security interest in the property with an underlying note balance of approximately \$39,000. (Docket No. 48). Debtor's Chapter 13 Plan proposes to treat the claim of RES-GA EIGHT, LLC as secured to the extent of \$75,000 and unsecured for the balance of the claim pursuant to 11 U.S.C. § 506(d) and to treat the claim of Clark Development Group as wholly unsecured with the liens of both creditors to be cancelled upon completion of debtor's plan and entry of a discharge. (Docket No. 21).²

Several motions pending before the Court are affected by Debtor's ability to confirm her plan and the valuation of this property: Debtor's Motion for Determination of Secured Status of RES-GA EIGHT's Claim and Release of Lien of Real Property and RES-GA EIGHT's response thereto

² Debtor's proposed Chapter 13 plan has since been amended, but its treatment of the secured claims on this property were not altered in the latest amended plan. (Docket No. 52).

(Docket Nos. 33 & 34), Debtor's Motion for Determination of Secured Status of Clark Development Group, LLC's Claim and Release of Lien of Real Property (Docket No. 48), Confirmation, and RES-GA EIGHT's Motion to Dismiss (Docket No. 15). All of these matters were before the Court for hearing on March 28, 2012.

Jurisdiction over this action is set forth in 28 U.S.C. §§ 157(b) and 1334(b). The matter is a core proceeding under 28 U.S.C. § 157(b)(2)(A) & (K) and venue is proper.

II. Legal and Valuation Analysis

The parties presented a valuation dispute to the Court. While RES-GA EIGHT did not raise the issue of whether § 1322(b)(2)'s anti-modification provision would apply to its claim, the Court must first independently consider whether § 1322(b)(2) limits Debtor's proposed treatment of RES-GA EIGHT's interest in this context. The legal issue is whether RES-GA EIGHT's security interest in the property would be protected from modification because the property is "real property that is the debtor's principal residence." Courts addressing the application of § 1322(b)(2) with a mixed use property look at the use of the property at the time the loan was made to determine whether the anti-modification clause applies.³ Since Debtor assumed an existing loan, and RES-GA EIGHT bought the loan after Debtor had owned the property in its current configuration, this approach is not helpful under these facts. It is clear that the property currently serves as Debtor's principal residence but that it also serves as an income producing property and that the rental income is a significant source of the income that will fund Debtor's Chapter 13 plan. The majority of cases looking at this issue conclude that a loan on a mixed use property does not fall within the category of loans that are

³ See, e.g., *Scarborough v. Chase Manhattan Mortg. Corp., (In re Scarborough)*, 461 F. 3d 406, 412 (3d Cir. 2006); *In re Bulson*, 327 B.R. 830 (Bankr. W.D. Mich. 2005).

protected by 1322(b)(2).⁴ The Court agrees with these cases and concludes that RES-GA EIGHT's security interest is subject to modification in the Chapter 13 Plan.

The use of § 506(d) to bifurcate RES-GA EIGHT's claim requires the Court to determine the value of the collateral. Debtor and RES-GA EIGHT each presented an appraisal and had their respective appraisers testify. Mr. Mark Meyer, the appraiser hired by the Debtor, opined that the property had a value of \$75,000, using both the income and sales comparison approaches. (Movant's Exhibit 2; Respondent's Exhibit 2). Mr. Mark Wood, the appraiser hired by an agent for the servicer of the loan held by RES-GA EIGHT, opined that the value was \$255,000. (Movant's Exhibit 1; Respondent's Exhibit 1). He also relied upon the same two valuation methods.

The Court does not find either opinion wholly persuasive. For the sales comparison approach, Mr. Meyer used properties that were geographically close to Debtor's property but were also in substantially inferior condition and had substantially lower occupancy rates. No rental rate information was provided or used in the methodology. In contrast, Mr. Wood used comparables from neighborhoods in Atlanta which are not at all comparable to the Vine City area. Virginia Highlands, Inman Park, and College Park are all areas which have substantially completed the gentrification process that Vine City had been targeted for when Debtor purchased the property. Both appraisers agree that this property is the best of its kind in a very poor neighborhood.

Since this is an income producing property, the income capitalization approach appears to be a superior valuation method. Both appraisers used this approach and agree on the methodology. The difference in the results is a function of the numbers that were put into the formula. The Court can,

⁴ *In re Zaldivar*, 441 B.R. 389, 390 (Bankr. S.D. Fla. 2011)(predominant character of the property governs) and *In re Brunson*, 201 B.R. 351 (Bankr. W.D.N.Y. 1996) (applying a totality of the circumstances test).

therefore, derive an independent value of the property by determining the relevant facts as to income, expenses, and which discount rate better reflects what an investor would require in purchasing the property based on the testimony of the experts.

The formula employed by the experts is to take net operating income (“NOI”) and divide that number by the appropriate discount rate. In turn, NOI is determined by deducting normalized expenses from normalized income. The potential gross income for the 5 units on the property is \$43,800.⁵ This potential income includes rental income of \$10,200 for the unit occupied by debtor for which no cash rent is received.⁶ Thus, the court will reduce the gross income to \$33,600 to account for use of one 2-bedroom unit for Debtor’s residence. To this, a vacancy rate must be applied to the rents from the remaining 4 units. Mr. Wood used a 10% vacancy rate based on the industry average. Mr. Meyer used a 40% vacancy rate, which included treating Debtor's unit as vacant since it was not an income-generating unit. The Court will use the 10% vacancy rate for the remaining 4 units, since that rate is a fair assessment of the historic vacancy rate for this property over the past 3 years. Based on these figures, normalized gross income is reduced to \$30,240.

On the expense side, the appraisers’ figures varied widely. Mr. Meyer used \$17,383 as the property’s annual expenses. Mr. Wood used \$10,000.⁷ The expenses on Debtor's Amended Schedule

⁵ This is the amount used by Mr. Meyer and is based on the actual rental amounts received by Debtor. Mr. Wood used \$45,000 for his gross rental income, so there is not a significant difference in this number between the two appraisers.

⁶ The testimony supports the need for an on-site manager to due to the property’s location and security concerns. Thus, even an investor would have the need to use one unit for the on-site manager and could not reasonably expect all of the units to generate income.

⁷ While the text of Mr. Wood’s report states that NOI is \$35,000 based on \$10,000 of expenses, the actual NOI number he used to arrive at his value was \$36,500. (Respondent’s Exhibit 1, p. 21).

J reflect \$15,851.52 on an annual basis. The court finds these expenses to be reasonable and necessary. While RES-GA EIGHT disputes the amounts for water, storage fees and electricity, these numbers appear appropriate. The water bill introduced into evidence by RES-GA EIGHT reflects a February 2012 charge of \$190 and shows that 10 of the past 12 months included higher charges than the February charges. (Respondent's Exhibit 6). While the storage unit may contain some personal items, the testimony was clear that the unit would not be rented if it were not necessary to have a place to store equipment for the maintenance of the property. The electricity bill includes Debtor's personal usage, but there is no evidence as to the appropriate allocation or whether an on-site apartment manager would typically have the utilities included. The Court also notes that the amount of the real estate taxes used by both appraisers is higher than the amount used by the Debtor in her Schedule J. This difference (approximately \$800) would offset any personal use of electricity.⁸ The resulting NOI (\$30,240 less \$15,850) is \$14,390.00.

The remaining figure to determine is the appropriate discount rate. This is essentially the rate that an investor would require to utilize its money to acquire this property. Mr. Meyer used a rate of 12%. Mr. Wood used a 14% rate to reflect the higher risk based on the location of the property. Both appraisers thought it was appropriate to use a rate higher than a normal rate of 10%. Given the testimony with respect to the location of the neighborhood and the condition of the surrounding properties, the Court believes that the higher rate better reflects what an investor would require under these circumstances. Thus, a 14% discount rate will be used.

Applying the discount rate to the NOI yields a value of \$102,785.00. This value will govern

⁸ Mr. Wood indicated that real estate taxes for 2011 were \$3,409.78. Mr. Meyer used \$3,383.00 for his calculations. Debtor's Schedule J has an amount of \$219.87 per month which annualizes to \$2,638.44.

the determinations of whether Debtor's Chapter 13 Plan can be confirmed and whether Debtor is entitled to the relief in her Motion to Strip Lien with Clark Development Group, LLC. Accordingly, it is

ORDERED that for purposes of Debtor's Motion for Determination of Secured Status of RES-GA EIGHT's Claim and Release of Lien of Real Property the value of the property is hereby determined to be \$102,785.00.

It is **FURTHER ORDERED** that, based on the determined value on the property, Debtor's Motion for Determination of Secured Status of Clark Development Group, LLC's Claim and Release of Lien of Real Property is hereby **GRANTED**. Debtor's counsel is directed to submit a proposed order on this Motion (Docket No. 48).

It is **FURTHER ORDERED and NOTICE IS HEREBY GIVEN** that a continue hearing on confirmation and RES-GA EIGHT's Motion to Dismiss (Docket No. 15) will be held before the undersigned on **May 2, 2012** at **9:30 a.m.**, in **Room 1201, United States Courthouse, 75 Spring Street, S.W., Atlanta, GA 30303**.

The Clerk is directed to serve a copy of this Order upon the parties listed on the attached distribution list.

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