ZOEWE'S PLACE
NEGOTIATION

Confidential Information for Sixth/Fourth Bank Assoc. VP for Real Estate

You completed the post-MBA management training rotation at Sixth/Fourth Bank a year and a half ago, with an initial placement in loan workouts. Two months ago, you switched to the real estate division, your work mainly involves financing for real estate development in the tri-state area. Fortunately, only a few distressed or foreclosed properties are left in the bank's portfolio. Unfortunately, as the "new kid on the block," you were assigned to deal with several of the most difficult properties.

One of these is the Krugfeld Building in downtown Cincinnati. (You don't know who Krugfeld was, perhaps its original builder or architect in the early part of the 20th century.) A brick monstrosity, you know it was a Kiwanis Hall for a while, then a shabby auction house. The most recent title record indicates that a developer bought it twenty years ago, in the speculative '90s, for $4,000,000. Sixth/Fourth Bank held its $3,750,000 mortgage. At some point, the developer listed it for sale at $6,000,000. Eventually, he left town and stopped paying real estate taxes or the mortgage, leaving a $2 million mortgage balance. The city filed a $250,000 lien for back taxes and the bank initiated a foreclosure action. Your predecessor made diligent efforts to track down the developer and tried unsuccessfully to work out a sale or a loan repayment schedule. Shortly after you took on this job, the developer (by then in his 80s) died, and his LLC had no significant assets.

About a year ago, you had no choice but to bid on the property for Sixth/Fourth at a foreclosure auction and pay the real estate tax liens. You bid in at $2,250,000, the total of the tax liens and the mortgage balance (so your actual payment at auction was $0). There were no other serious bidders. Because the bank had a large portfolio of foreclosed properties, it has taken a while to focus real attention on this one. The property had been listed on the bank's broker's website with a notation that interested buyers could inquire for information. No one did.

More recently, with Cincinnati's downtown business and residential growth proven significant and stable, it finally seemed like the right time to put effort into selling the Krugfeld building. You had hoped a developer would purchase it for rehab as office or residential condominium units, with retail on the ground floor. You recently had the broker update the website listing price to an optimistic $5 million.

About three months ago, a wealthy condo developer expressed interest in the building, enough to conduct an inspection that scared him away! The inspector determined that the Krugfeld building must have originally been constructed with a large open interior space, from the ground floor to its four or five-story-height roof. He found the interior floors to be structurally inadequate. Put up in slap dash fashion and never up to code, they would not support the weight or movement loads required

for residential or most commercial uses. Realistically, the building's insides would have to be gutted and all new interior floors built for habitation.
Since then, you have fielded a few other expressions of interest and the bank's agent has shepherded a few curious bargain hunters through the building. However, no one else has made an offer or even sought to make an inspection.

More bad news came last week when the city's building inspector gave you a "courtesy call" to say that the building risked being condemned unless Sixth/Fourth initiated extensive repairs. Bricks and mortar were reported crumbling at the chimney; the wood on its boarded lower-level windows is beginning to rot. He confirmed that the interior floors are structurally weak and thus dangerous. Sixth/Fourth was looking at an estimate of $500,000 to tear it down, or $1,000,000 to complete absolutely minimum repairs necessary to satisfy the city's building department. The city is likely to force Sixth/Forth to begin that work very soon. You estimate that it would take $7,000,000 to completely rebuild the building's interior multi-floor structure and rehab its exterior. The project would take at least a year, and then you would have to put it up for sale and hope to recoup the investment. Annual real estate taxes are approximately $80,000 and accruing. Your boss has told you in no uncertain terms to get the property OFF of the bank's asset list, "Never mind the sweet location, it's still an eyesore and a financial sinkhole."

So, what's the value of the Krugfeld building? While its published tax assessment is $4,000,000, that's no doubt based on square footage and doesn't take into account the building's deplorable condition. All told, Sixth-Fourth has sunk the $2,000,000 mortgage loss in the building and paid $250,000 to clear the tax liens. You would be PLEASED to sell it for $2,250,000 and let someone else take on its demolition or total reconstruction. Given that the bank wrote off this investment a long time ago (and the original loan officer is long gone from the bank), you'd be willing to sell it for as little as $1,000,000, if need be. On the other hand, the higher the price the higher your star will rise at Sixth/Fourth.

Remarkably, the bank's agent informed you a few days ago that she had located a serious buyer: Zoewe's LLC. Zoewe's is the name of a midwestern movie theater chain; it seems fair to assume that this is a related entity. You don't know if Zoewe's also invests in other real estate ventures, or if they are interested in locating a theater downtown. One thing is for sure, if Zoewe's plans to finance the purchase, they would be a sound and solvent buyer.

Your arrangement with the bank's real estate agent is that she locates serious potential buyers, but you negotiate the terms of all purchases and sales. That's particularly important here, given the condition of the property and the pressure created by the city's building department.

Prepare to negotiate with the representative of Zoewe's.