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CHARLES F. WU

Songy 2011: Restructuring to Survive (Or, Surviving to Restructure?)

"What makes some people come through catastrophe and others, apparently just as able, strong, and brave go under? ... Gumption."

— Margaret Mitchell, Gone with the Wind

It was Bastille Day 2011 and David Songy was spending time at his happy place. He was fishing with his brother in Grand Isle, Louisiana, trying to momentarily forget the challenges facing him back at his Atlanta-based real estate development firm, Songy Partners. But try as he might, David could not ignore his problems. By mid-2011, many investors had begun to recover from the tumult of the Great Recession that came perilously close to destroying the global financial markets. David and his firm however, were still dealing with the challenges of the 2008 crisis and time was running out for him and his partners. With balloon payments on their loans due, Songy had to decide on what to do with three of their current portfolio's most challenged assets.

While the match that sparked the financial meltdown was the subprime mortgage crisis, the broader impact was felt across the globe, throughout all asset classes, and by people of all socioeconomic levels. As businesses struggled to survive the recession, they cut jobs causing the US unemployment rate to reach 10%.[1] The increased threat of job loss caused consumer spending to decline, and the issues that originally began in residential real estate spread to the commercial sector prompting property values to fall precipitously (**Exhibit 2**).

Like all real estate firms, Songy had to triage its properties through the cycle; however, as a development company, Songy Partners was in many ways more susceptible to the problems facing the rest of the industry. Non-cash flowing developments and declining values had caused the firm to write-off, sometimes "giving the keys back" for a number of sizeable investments. Unfortunately, recourse provisions on some loans continued to expose the firm to some of those ill-fated deals that had lost all invested equity. Meanwhile, the buildings still under the firm's control were struggling to recover from the recession requiring significant capital to survive until the real estate markets stabilized. As of 2011, the firm had exhausted most of its equity capital and their lenders were calling for more long-term solutions demanding lower leverage capital structures.

David and his partners' choices came with substantial consequences for the firm, their careers, relationships, and their Limited Partners' equity. Ideally, Songy would have the capital to buy time by

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refinancing until the properties stabilized. Yet even if they could find the capital, David wondered, if the assets worth saving at this point? The recourse provisions in many of the loans cycled through David's head, as did his reputation with his LPs and how that would change if he threw good money after bad. Regarding all of these issues, David had committed to present a plan to his investors on Monday.

The Great Recession

On September 15th, 2008 Lehman Brothers filed bankruptcy thereby becoming the biggest victim of the subprime mortgage crisis. Lehman became known as the poster child for the Great Recession and subprime mortgages' impact throughout the entirety of the market. In the month that followed, the global equity markets, which had peaked during the prior summer, lost nearly $10 trillion, the largest single month decline in history.[2] Just after having surged earlier in the year, commercial real estate prices plummeted.[3] As unemployment doubled to 10% and the US economy lost 8.4 million jobs, commercial tenant demand evaporated in almost every market and by 2009 office vacancy rates spiked to 17.7%.[4]

During this critical period, operating issues were compounded by financial illiquidity. In 2009, US commercial real estate investment activity was $54.4 billion, 90% less than 2007 levels (**Exhibit 3**).[5] A major factor in the decline was the lack of available financing and in particular, CMBS financing. Between 2007 and 2009, CMBS issuances fell from $230 billion to $3 billion (**Exhibit 4**).[6] Despite the slowdown in new issuances, ~$1.5 trillion in commercial real estate loans maturing between 2011 and 2015 remained (**Exhibit 5**).[7] Investors and lenders felt paralyzed as the lack of meaningful transactional volume and price discovery made it difficult for investors to value assets. Capital providers would not make commitments fearing that the market had not yet hit bottom—or even, whether the entire financial system would ever recover.

Prior to the crash, the total value of US commercial real estate was estimated to be $3.2 trillion[8] with debt financing 75% of value. Post-crash, prices were generally assumed to have declined between 25% and 50% with most estimates skewing towards the higher end of the range. Given a 40% decline in gross asset values, or $1.3 trillion in losses, the entire stack of $800 million in equity value of US real estate was theoretically wiped out. Despite the drop in valuations, evaporation of equity, and the unlikely chance of any possible exits, lenders were reluctant to seize properties for mere covenant breaches. Foreclosing on defaulted properties would have placed a large operating burden on the lenders, which most were unequipped to handle. The hesitation to foreclose allowed property owners to temporarily stay afloat while they could work towards long-term solutions to stabilize and recapitalize their properties.

Songy Partners

Atlanta-based Songy Partners was founded in 1992 by David Songy, Todd Nocerini, and Perry Waughtal. Songy Partners was founded upon the fundamentals of proven experience and market knowledge and on their firm's four core values of integrity, quality, partnerships, and innovation (**Exhibit 6**). These values guided the firm throughout its history and were the foundation from which the firm would grow. Initially, the firm was formed to take advantage of the opportunities created by the over-building of the 1980's by acquiring office buildings in the Southeast U.S. at prices well below replacement cost. Songy and his team extensively renovated the assets turning them into institutional quality properties and then positioned them for sale or refinancing. This relatively manageable risk but high yield approach taken by Songy is commonly referred to as "Value Add" investing.

With time, success, and experience, Songy Partners, was emboldened to grow and broaden its reach. Real estate markets had recovered since the early 1990's and trying to maintain equity investment yields over 20% became more and more difficult. Addressing the new market context, the firm expanded its investment scope. First, the core business widened to include hospitality and mixed use projects. Additionally, Songy began to selectively develop ground-up office buildings and hotels on high profile sites. Historically positioned as a Southeastern firm, over time Songy also expanded to other areas in the US including Chicago, Houston, Dallas, Washington, DC and even Mexico City. Finally, the complexity of projects and mastery of secondary markets were deemed to be areas that the firm's skills could better exploit. By 2008, the firm employed 38 individuals directly and over 300 people indirectly.

As of July 2011, Songy and his partners had raised two institutional funds totaling $20 million in capital. These funds, which included $2.5 million from the General Partners would serve both as equity capital for projects that the firm wanted to maintain full control of, as well as, sponsor co-investment capital for bigger transactions alongside large institutional limited partner participants. Such institutional partners have included top financial and real estate firms including Angelo Gordon, Assurant, BayNorth, Mellon Family, LNR, Goldman Sachs, The Carlyle Group, Elliott Capital Management, and UBS. Songy's relationships and strong reputation with its institutional investors date back many years and across multiple investments. Since its founding, Songy's 27 projects generated a weighted average equity IRR exceeding 20% with only three investments failing to return investor capital (**Exhibit 7**). During the capital raises, it appeared that the firm's investment strategy was working very well and that the team was on its way to creating a long standing organization that could continue to benefit from market opportunities.

Storm Clouds for Songy

Problems began for Songy even before the recession impacted the firm's properties' operating performance. The firm was unable to access $4 million in much needed capital after some of their investors who had also invested with the infamous Allen Stanford, had their accounts frozen when Stanford's Ponzi scheme was uncovered.

In addition to being victim of fraud, the change in the market created many challenges for Songy. The rise in vacancies impacted secondary markets especially hard, many of which were within Songy's portfolio. The drop in occupancy had a direct impact on building incomes, but cash flow shortfalls were exacerbated by the need for special leasing incentives such as rental concessions and excessive tenant allowances as the firm tried to maintain Net Operating Income (NOI) and compete with other properties in its markets. Given the uncertainty in the market, cap rates depressed further decreasing the value of Songy portfolio valuations by 40-50% in only 16 months between 2009 and 2010.

Part of the reason for the firm's liquidity problems was due to the type of financing they used for development and repositioning projects. For development, Songy's construction loans typically had a three-year term with floating interest rates, and some portion of recourse. The strategy was to complete the development and then either sell the asset or place long term fixed-rate financing on it. These loans typically carried three-year terms with two one-year renewals. In order to trigger the renewals the property had to meet certain loan-to-value hurdles, which were typically driven by income and occupancy.

During the downturn, leasing and valuation tests were hard to achieve, resulting in technical "non-monetary" loan defaults.[a] Since 2008, the Songy team was constantly renegotiating 12-15 expired loans. Each of these negotiations took three to six months and produced only short 90-180-360 day extensions. When loan extensions were granted, they typically required a principal paydown of 10% or more, bank extension fees, heavy legal fees, and an interest rate increase. While the economic costs of such restructurings were high, the emotional toll was even greater. Longer term solutions were needed to give the properties a chance to recover and to free up the team's time.

Early in the downturn, Songy's partnerships encountered many unforeseen events.

In 2007, Songy Partners and its local equity partner acquired the Chicago Athletic Association for $35 mm, financed with $26 mm in debt from Anglo Irish Bank. The plan was to convert the historic building into a 4-5 star luxury hotel that would be operated by Omni Hotels. After David had secured the debt financing, Omni would buy in as a 50% partner in the $100 million project. Furthermore, this was to be the prototype Songy/Omni deal that would lead to a series of future ventures between the two groups. During the long and arduous search for a construction loan, however, Songy's acquisition equity partner unilaterally stopped paying their portion of the acquisition loan on the building. Struggling to protect the investment against default, Songy decided to assume payment of *100% of the entire loan's debt service* substantially increasing their mortgage payments. In order to make these payments, Songy Partners reluctantly obtained conflict waivers from their sponsor fund, Songy Fund II, to loan them funds, ultimately putting more equity in the deal.

During this time, the Chicago market froze. Songy determined that the investment would fail unless he could pay off or refinance the acquisition loan at a steep discount. In the midst of encouraging negotiations with the property's lender, Anglo Irish, the bank went bankrupt and all communication ceased. David continued "working and feeding" the project, while attempting to negotiate with Anglo Irish's bank recalcitrant conservators, but was concerned that his counterparties were not vested in his success as the loan was not issued under their watch. In the summer of 2010, three years after the acquisition and several unsuccessful bids to buy back or restructure the loan, the conservators foreclosed and took back the property resulting in a total loss of equity. Songy knew however, that he would have another chance at the asset as the bank would be selling the building. He wondered if the bank was going to have a sealed bid auction, an open auction, or a series of negotiations with interested parties. Given that the market would know that Songy had the most information about the asset, it was not clear what sales strategy the bank would employ.

During that same period Songy had issues on another Texas hotel development project. Similarly to Chicago, the plan was to convert the building into a 4-5 star hotel; however, the partnership again could not source construction financing resulting in Songy's equity partner, Omni Hotels, to withdraw. In this case however, the loan from Amegy Bank contained *a joint but not several corporate guarantee* from both Songy and Omni.[b] During several difficult and intense tri-party negotiations, it was clear that each party had unique objectives. While Omni wanted to simply pay its portion of the $7mm guarantee and walk away, Songy sought to avoid triggering the loan's recourse all-together. Amegy was most concerned with its own ability to take ownership and manage the empty building. To Amegy, the fear of the unknown superseded Songy's inability to pay its share of the guarantee. Sensing this reluctance, Songy's COO, Todd Nocerini, leveraging his long term relationship with Amegy senior management,

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[a] As opposed to "monetary defaults" such as failure to pay interest, required amortization, or principal when due, which are viewed by lenders to be more egregious offenses.

[b] Joint *but not* several means that each party is responsible for their own share of the guarantee. Joint *and* several means that the partners each individually are responsible for the total amount even if one party cannot or does not pay.

was able to negotiate a timely settlement with 1) Omni paying its $3.5mm recourse, 2) Amegy waiving Songy's guarantee payments, and 3) Songy's agreement to market the building on the bank's behalf. Ultimately, Songy sold the building for $4.8mm or, 40% of the Amegy acquisition loan (wiping out all of the deal's equity.) While the investment lost several million dollars of Songy's investors' equity, at least Songy's firm was able to earn a $100,000 brokerage fee for selling the asset on behalf of the bank.

During the recession, even investments considered to be safe with an assured return on capital proved to be vulnerable. In 2006, Songy purchased a Class A office building with Washington Mutual (WAMU) as the main tenant. While an investment grade tenant signed to a 5-year lease typically is stable, everything changed after the Lehman bankruptcy when the federal government seized WAMU selling the bank to JPMorgan Chase.[9] As part of the sale, the FDIC allowed the bank to reject certain leases including the one in the Songy property. In spite of the presumed stability of the property, it was impossible for Songy to recover from the unexpected loss in cash flows and in 2009 they eventually yielded ownership of the building to the lender.

Critical Assets 2011

Although the 2008-2009 experiences from the recession were difficult for Songy, the decisions on those projects were past history and the firm had moved on. The effects of the recession, however, still lingered and David and the Songy team had to resuscitate three properties that were clinging to life support still in the emergency room. The assets, located across the Southeast, represented a variety of property types and were each accompanied by their own unique circumstances (**Exhibit 1**).

Dallas Hilton Garden Inn

In 2003, Songy acquired the eight-story, 240-room Wilson World Hotel. The hotel was located just north of downtown Dallas, near Love Field Airport. The deal was capitalized with $22.4 million, originally structured with $2.85 mm of Songy investors' equity, $2.0 mm of mezzanine debt with a coupon of 10%, and $17.5 mm of floating rate debt from Capmark.

The plan was to spend $12.0 mm to renovate the property and convert it into a Hilton Garden Inn. In order to better compete with other hotels in the market, Songy added a ballroom thereby increasing the property's meeting space to 4,000 square feet. The addition of the ballroom by itself added $500,000 in annual revenues for the property, while, the broader renovation plan drove higher revenue per available room (RevPar) and increased occupancy rates, growing the building's NOI to $2.0 million in 2007—well exceeding Songy's original underwriting. In early 2007, the team needed only one more year of successful operations to prove its investment thesis before selling the asset for a projected IRR of over 30%.

When the recession came, the hotel sector was the hardest hit. By 2009 occupancy rates for the industry dipped to a twenty-year low of 55.1% and RevPAR dropped by 16.7% (**Exhibit 8**).[10] While a decrease in travel had a large impact on the hotel sector, the market was also massively oversupplied after hotel construction peaked in 2008 **(**Songy's Dallas Hilton Garden Inn suffered the same fate as the industry as occupancy fell to 60% and NOI declined to $1.1 million in 2009. In addition to losing individual travelers, Hilton also lost some of its corporate clients such as Southwest Airlines, which contracted with the hotels for bulk reservations. Despite the hotel's deteriorating performance, the Hilton Franchise Agreement still required Songy to make its annual Product Improvement Payments (PIP), scheduled capital expenditures to comply with Hilton's corporate standards. From 2008-2010, Songy spent $1.5 million on PIP updates. Going forward, Songy expected to pay another $300,000 in PIP annually. The only silver lining of the economic crises was that the Federal government's quantitative easing programs were reducing Songy's annual floating rate borrowing costs by 200-250 basis points.

At the end of 2009, Songy successfully negotiated a one-year loan extension with Capmark. But at the end of 2010, with the hotel's operations still suffering, the extension coming due, and Capmark seeking to reduce their real estate exposure the bank was unexpectedly acquired by Deutsche Bank requiring Songy to restart his negotiations. Deutsche Bank was willing to grant a two-year extension through the end of 2013 in exchange for an immediate $2.0 mm paydown of the $17.5 mm loan, and a significantly higher rate of 6.25% (interest only). Now David and his partners had to determine if they should make the expensive payment to buy more time, or let the asset go to the bank.

There were many factors for the Songy team to consider. While hotels were originally hurt the most, the sector had also recovered the quickest and was now the best performing asset class for Songy. The property was also showing signs of recovery as 2010 NOI had come in above forecasts at $1.3 mm; however with present cap rates at 9.0% (50-200 bps above the historical average), the equity was still worthless (**Exhibit 9**). In 2011, hotels were expected to continue to improve in terms of occupancy and average daily rate (ADR) and the Hilton's NOI was forecast to reach $1.4 mm. Investment activity in the hotel sector was also expected to increase in 2011 and beyond as investors released pent up demand.[11] Finally, the Texas market had recovered faster than other locations in the south because the state's economy was much more commodity based.[12] As such, Songy forecasted the building's NOI would recover beyond its 2007 performance of $2.0 million and grow to $2.3 mm by the end 2013.

If cap rates were more in-line with their historical averages, would that be enough to give his investors a reasonable return David wondered? Did the property's potential justify an additional equity investment of $2 mm to pay down the loan today? Did *any* amount make sense?

5433 Westheimer Office/ Hotel/ Retail

In Houston, Songy was also dealing with 5433 Westheimer, a 134,000 square foot multi-use property acquired in March 2006. The investment was a joint venture between Songy and AmREIT, a regional real estate investment trust that specializes in retail development. The deal was originally structured with $10.7 million of equity, and a $32 million interest-only Wachovia Bank construction loan for a total capitalization of $42.7 mm. The partnership paid $1.1 mm in debt service annually with a five-year balloon payment. While Songy estimated that he would use $16mm of the loan on the office building and utilize the remaining half on the hotel and retail, the borrowing was cross-collateralized across the entire development as a single loan.

The plan for the property was two-fold. First, it was to increase rents by updating the common areas and tenant spaces in the existing office building and replacing the ground floor bank tenant with a branded steakhouse. Second, it was to develop a new Starwood 153-room Aloft hotel and retail development on the excess land adjoining the office building.

By 2008, the renovation of the office building was completed and rental rates in the building increased from $16.50 psf to $20 psf; however it was still significantly short of the forecasted rents of $24 psf. In 2009, as the Houston office absorption rate dropped to negative 2.7 mm sf, occupancy rates in the building declined to 55%. The weak market also resulted in massive downward pressure on effective rental rates further hurting the building's NOI (**Exhibit 10**).[13] By 2010, the overall property's NOI was $2.0 mm, still below Songy's investment plan. This underperformance coincided with the expiration of the Wachovia loan in mid-2011. The loan had originally been issued by Wachovia, with whom Songy had a 20-year relationship; however, during the recession Wachovia was purchased by Wells Fargo with whom Songy had no previous history.

With the office turnaround still incomplete, the prospects for the office building were still uncertain. Songy suggested to Wells Fargo, it would likely take two years and an additional $4 mm to stabilize the office building's occupancy at 90%. If all went according to plan, by 2013 the office building would have $800,000 in NOI and could sell at a 7.5% cap rate. Of course these assumptions assumed no major disruption to commodity markets.

While the office building was struggling, the hotel and retail were thriving. The Aloft opened on time in 2009 and, despite the slow market, the branding of a new Starwood property helped maintain occupancy rates of over 70% beating its competitors and internal projections The above average recovery of the Houston market had a positive impact on the Aloft and by 2010, ADR increased to over $210 a night and occupancy increased to 82%.[14] In spite of the hotel's success, 1.8x debt service coverage on the $32mm loan, and improving fundamentals, Wells Fargo, the new holder of the loan, was threatening to foreclose upon maturity. The bank appraised the hotel portion at $19 mm. Songy commissioned its own appraisal, which came in significantly higher at $26 mm; however, without the trust or benefit of a long term relationship Wells Fargo refused to negotiate any extension to the loan, and demanded a sale to retire the loan. The restructuring executive told David, "You borrowed the money…the loan has matured. Do what you promised you would do and pay us back. That IS your name on the mortgage isn't it? If not, we are prepared to foreclose and take over these assets."

Earlier in 2011, during the extension discussions with Wachovia, Songy had received an offer for the Aloft of $29 mm or $190,000 per key (room), a U.S. record price for any Aloft hotel. While ecstatic about the offer, David and his team believed it still was not the correct time to sell. First, such a sale would yield proceeds that would go entirely to the lender. Second, the hotel's NOI was ahead of schedule for 2011 and was likely to surpass last year's $1.8 mm. Additionally, hotel demand was increasing quickly and was expected to continue to rise well into 2012.[15] If Songy held onto the Aloft for another two years, with additional capital spending of $500,000 per year, he believed the NOI would increase to $2.9 mm in 2013. By then he could likely sell the hotel for an 8% cap rate yielding a hefty profit to his equity investors.

David wondered how the dynamic might be different if he originally financed the office and hotel under two separate loans. Under the current structure, the profits from the hotel were subsidizing the losses on the office building. Alternatively, he could have used his control of the profitable hotel as a bargaining chip to restructure the office loan. Would the non-recourse feature of the $32 mm loan give him other options to encourage Wells to "play nicely."

David thought about his approach to Wells Fargo. Should he try to entice them to engage with a par offer and then "re-trade" the deal as the moribund financing markets proved the assets were impossible to refinance at their current levels? Perhaps he might he show them depressed numbers to "scare" them into cooperating at the onset? Should he threaten to tank everything and put it into bankruptcy resulting in depressed office leasing, reduced hotel revpar, and lower overall asset value? That would result in years of litigation and prolong the timetable for David to control of the asset. What did Wells think that David might do?

How should he best fulfill his fiduciary duties to his investors?

The Carpenter Building

Songy Partners was also at a crossroad with its property at 270 Carpenter Drive in Atlanta, GA. Songy had purchased the 97,000 square foot Class B office building in February 2006. The building was located just outside of the I-285 corridor known as The Perimeter and was only a few miles from Songy's office. Songy purchased the building for $9.0 million and structured the deal with $1.3 million of equity, and $7.7 million of low floating rate, interest-only debt from Regions Bank with a three- to five-year term depending on performance.

Unlike the complexity of other projects undertaken by Songy, this investment thesis was simple: buy a cheaper, lower quality office building in a pioneering, yet fast growing market, implement institutional management practices, make cosmetic improvements to the exterior, and capture the value of increasing the building's occupancy. At the time of acquisition, the occupancy for the building was at 50%, but still able to meet all of its debt obligations. In what was becoming a more challenging investment market, Songy believed that this project was a low risk way to continue to deliver high returns for their Limited Partners.

With the onset of 2008 recession, however, tenants' credit began to suffer thereby affecting the building's performance. Inability to pay rent, early move outs, and tenant defaults became commonplace. To combat the weakening market environment, Songy offered new tenants favorable lease packages including; free rent, aggressive pricing, and large tenant improvement offers. Existing tenants were offered attractive renewal terms in an effort by Songy to boost occupancy and limit turnover.

In spite of their efforts, occupancy never grew above 50%. For David's team, the building's leasing efforts felt like running on a treadmill. With every new tenant secured an existing tenant would default or leave. Fortunately, variable interest rates on their debt declined and Songy was able to keep the property cash flow positive. In 2010, NOI was $300,000, barely higher than that of 2009 but most importantly, $100,000 above their reduced annual debt service requirements.

Songy was also facing significant headwinds given the location of their building. Submarkets like The Perimeter were typically the first to decline and the last to rebound. Primary markets such as Buckhead and Midtown continued to attract tenants who used weak periods to find superior space at cheaper rents and who would otherwise be looking for office space in submarkets like The Perimeter. David feared that it could take over a decade for submarkets like The Perimeter, 15 miles north of downtown, to recover (**Exhibit 11**).[16]

Considering the lack of demand in The Perimeter, David's partners forecasted the need for another two years and an additional $3 mm in capital for tenant improvements and leasing commissions for the property to become stable.[17] Songy believed that while rents would likely not rise, occupancy could reach 85%, thereby increasing NOI to $700,000 by 2013. Analyzing today's cap rates and The Perimeter's historical range, Songy underwrote an exit cap of 9%. Today, however, Songy and his bank, Regions, feared that the property value was less than half of the loan's face value (**Exhibit 12**).

Regions was under new pressure from bank regulators to reduce its real estate exposure and refused to enter into restructuring discussions. Despite this, Todd and David believed that for the bank, the alternative of managing the property could be worse than merely extending and holding a non-performing loan. If Regions foreclosed and took possession of the building, the asset would be classified as Real Estate Owned (REO), exposing the bank's capital requirements to the property's future, potentially negative, performance and shifting the responsibilities and costs of asset management onto the bank and its management team.

Complicating the situation even further was the fact that the loan with Regions included a Songy Partners corporate guarantee. Under the guarantee, if the loan defaulted, the lender could pursue David's company for up to $4.5 million in shortfalls. David's firm had exhausted its equity and it was uncertain what would happen if Region's tried to collect on the guarantee. David was concerned that if the loan was sold then its next owner might take a harder line with Songy Partners potentially forcing him into bankruptcy. Alternatively, if one of the Songy Funds purchased the loan, could it restructure the Songy Partners' guarantee in a friendly manner? What kind of conflicts might this create?

Conclusion

The more that David thought about his properties and his options, the more he talked himself in circles. One thing that he couldn't help but wonder was if this situation could have been avoided. Did he get carried away during the market cycle or were all of these properties truly good investments that were simply the victims an unprecedented macroeconomic disaster? Yet, if these were bad decisions, how could David and his team avoid making the same mistakes again? The answers to these questions would help him better understand which properties were worth saving, how much additional capital Songy should be willing to invest, and what might be the best path forward.

The other obvious challenge was where would Songy find the necessary capital? Songy had already downsized the organization, reduced salaries, relocated their offices to their Carpenter building, and suspended over $1 million in heavily needed Songy Fund I and Fund II contractual fees, not to mention funding over $500,000 of mounting loan/litigation related legal costs for their various ailing partnerships. There was no more funding available within the organization. Given that the overall market had recovered considerably, David was fairly confident that for the right deal, he could scrape together a few million dollars from the firm's current investors. Additionally, Goldman Sachs had recently approached Songy to see if he needed "help" restructuring any of their properties. Obtaining the backing of a large institutional investor would be immensely helpful. Goldman Sachs sought a yield of 10-12% on its invested capital (an 800 basis point spread premium to treasury notes.) Under those terms, however, David was unsure if his firm and investors would be better off by simply letting the buildings lapse into the lenders' hands and see where the chips would fall regarding the guarantees.

Bankruptcy was also an option. Under that scenario, all of the firm's assets and liabilities would be included in the filing and receive an automatic stay, but Songy was also a guarantor on certain loans. He too would have to file for bankruptcy likely destroying his entire life's work and would be in conflict with the firm's core values of integrity and partnerships.

If Songy filed for bankruptcy, would all hopes of future funds and a successful career in real estate development disappear? But with $8.5 Million of guarantee liabilities sitting on the firm's balance sheet, it was hard to look past surviving the next day. No matter what, by the time that he returned to the office for the investor meeting on Monday, David needed to have an opinion on what the firm should do with the three properties.

Study Questions:

1. Which of David's predicaments are attributable to unique outside forces versus human error? What could he have done differently?
2. What are the "critical assets" worth?
    a. Dallas Garden Inn; should he make the $2 mm paydown?
    b. Westheimer; how would the negotiation be different if there were two *separate* loans instead of one cross-collateralized loan?
    c. Carpenter; how does the Songy corporate guarantee impact his strategy?
3. What are David's obligations to his limited partners?

Exhibit 1 Critical Assets as of June 30th, 2011

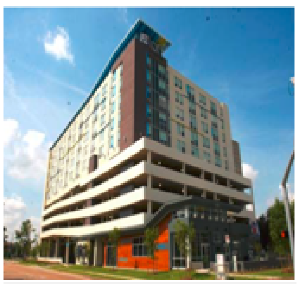
Acquired June 2003
Dallas, Texas
Hotel
240 Rooms
No Institutional Partner

Dallas Hilton Garden Inn

Investment Thesis:
- $12MM renovation to update property and add meeting space increasing NOI

Capital Structure:
- $2.9MM Equity
- $2.0MM Mezz Debt (10% coupon)
- $17.5MM Debt (Non-recourse)
  - Debt Service: 3% interest only (2010)

NOI:
- 2010 Actual: $1.3MM
- Stabilized Forecast: $2.3MM (2013)



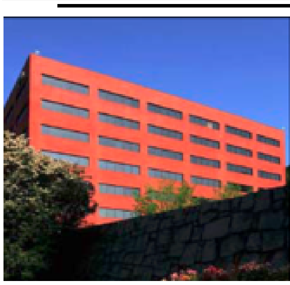
Acquired March 2006
Houston, Texas
Multi-use
152 Room Hotel
134K SF Office
Partner: AmREIT

5433 Westheimer

Investment Thesis:
- Renovate office common spaces to increase rents and occupancy
- Ground-up development of Aloft hotel and retail space

Capital Structure:
- $10.7MM Equity
- $32.0MM Debt (Non-recourse)
  - Debt Service: $1.1MM

NOI:
- 2010 Actual: $2.0MM
- Stabilized Forecast: $3.7MM (2013)
  - Office: $0.8MM
  - Hotel: $2.9MM



Acquired February 2006
Atlanta, Georgia
Office
98K SF Building
No Institutional Partner

The Carpenter Building

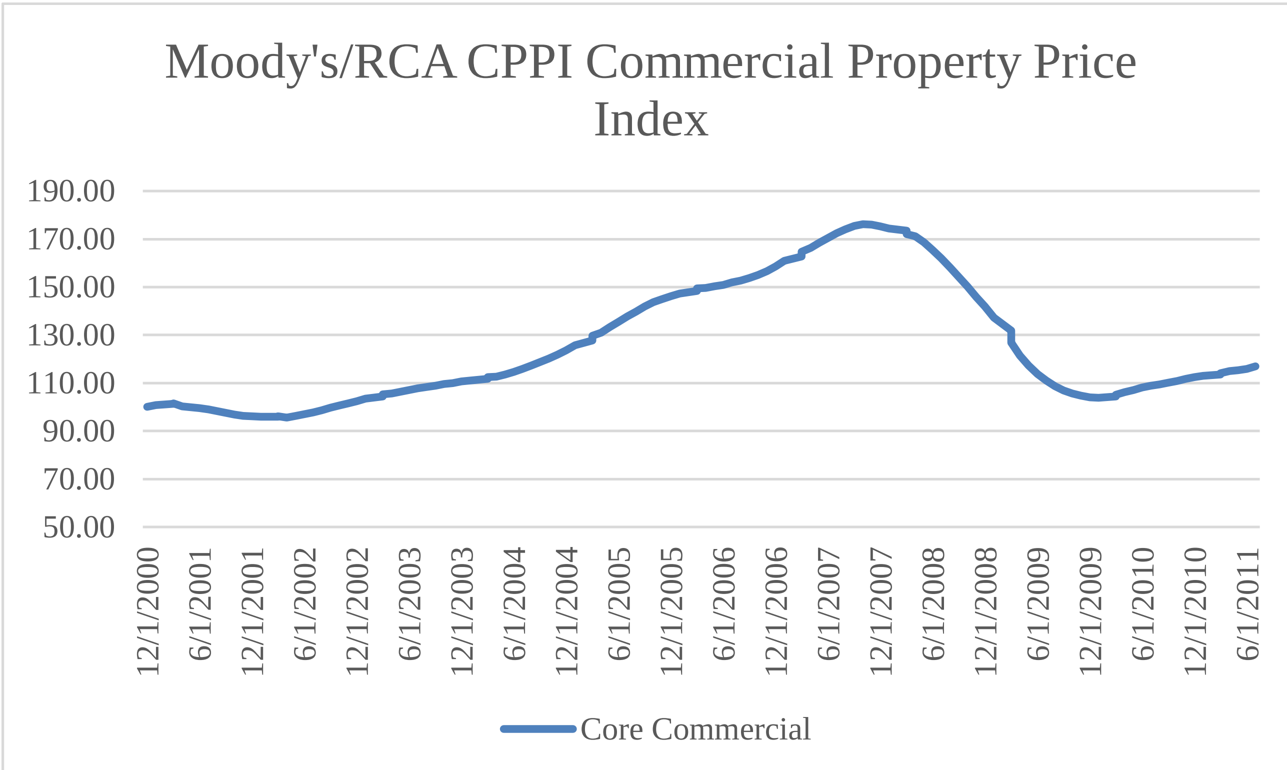
Investment Thesis:
- Purchase at deep discount to replacement in a fast growing submarket, make small renovations to increase occupancy and raise rental income

Capital Structure:
- $1.3MM Equity
- $7.7MM Debt (Songy guarantee)
  - Debt Service: $0.2MM

NOI:
- 2010 Actual: $0.3MM
- Stabilized Forecast: $0.7MM (2013)

Source: Adapted from company documents by casewriter.

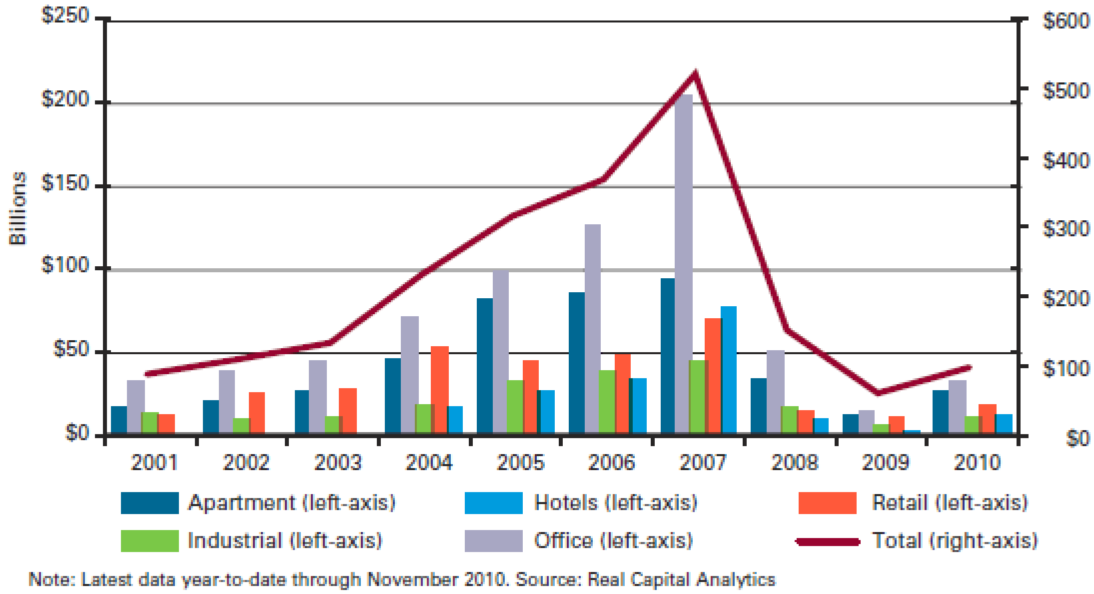
Exhibit 2 National Commercial Real Estate Price Index



December 2000 = 100

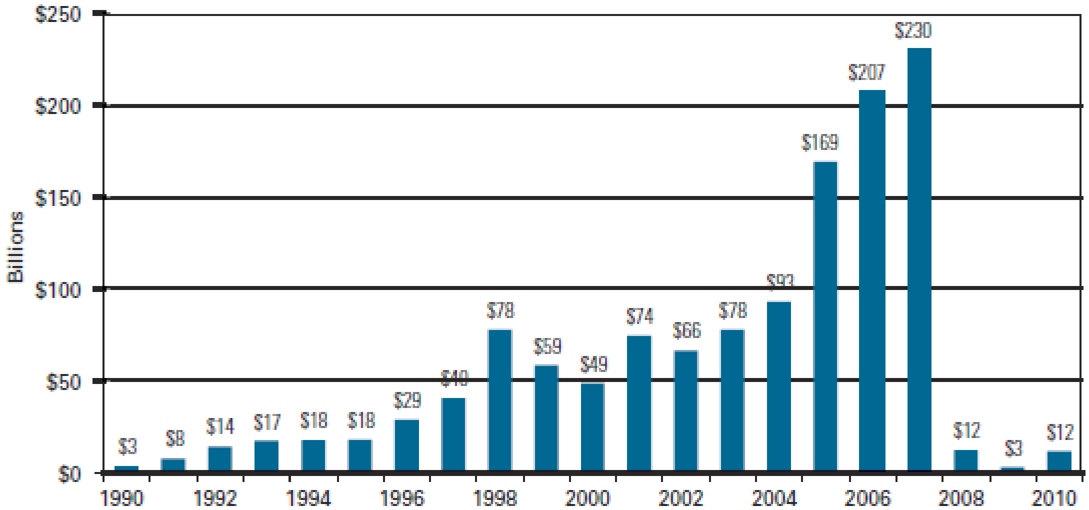
Source: Real Capital Analytics, Inc, https://www.rcanalytics.com/Public/rca_cppi.aspx, accessed August 1, 2016.

Exhibit 3 National Commercial Real Estate Transaction Volume



Source: "State of Commercial Real Estate Market," Figure 1, Rosen, Kenneth, Zell / Lurie Real Estate Center, accessed August 1, 2016.

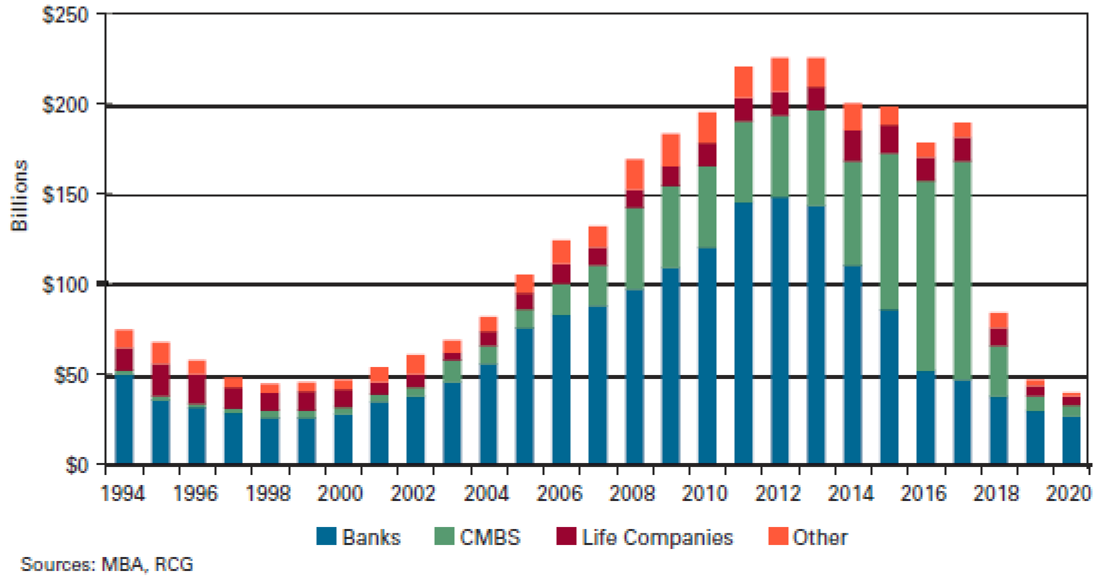
Exhibit 4 US Mortgage Backed Securities Gross Issuances



Note: Latest data year-to-date as of January 14, 2011. Source: Commercial Mortgage Alert

Source: "State of Commercial Real Estate Market," Figure 3, Rosen, Kenneth, Zell / Lurie Real Estate Center, accessed August 1, 2016.

Exhibit 5 US Commercial Mortgage Maturities



Source: "State of Commercial Real Estate Market," Figure 4, Rosen, Kenneth, Zell / Lurie Real Estate Center, accessed August 1, 2016.

Exhibit 6 Songy Mission and Values

MISSION

Songy Highroads LLC is founded upon the fundamentals of proven experience, integrity, and market knowledge—principles that have allowed for solid performance and growth throughout our history. These dynamics have enabled us to compile a solid base of individual and institutional investors. We at Songy Highroads desire to be recognized by the office and hotel sectors as a proven market leader, providing institutional quality real estate with innovative strategies.

VALUES

INTEGRITY:

We believe that honesty is the best policy and are therefore "upfront and open" with our partners. We strive to maintain the highest ethical and moral standards in our business practices.

QUALITY:

We are leaders in our field and ensure that our assembled teams have outstanding credentials, extensive records of professional accomplishments and a commitment to completing the project in an effective and efficient manner.

PARTNERSHIPS

Integrity, full disclosure, and unwavering advocacy of our clients' interests produce tangible value that distinguishes our firm from all others. Our fundamental goal is to build and manage a successful organization by providing the very best business, based on establishing longterm partnerships. We will work collaboratively across functions to achieve our common goals. Our team will welcome change and seek improvements in both process and product while continuing the traditions that are the foundation of our success.

INNOVATION:

We provide creative problem solving, cutting-edge technology and superior systems to insure the best outcome for the client.

Source: Company documents, http://songyhighroads.com/about-the-firm/mission-and-values/.

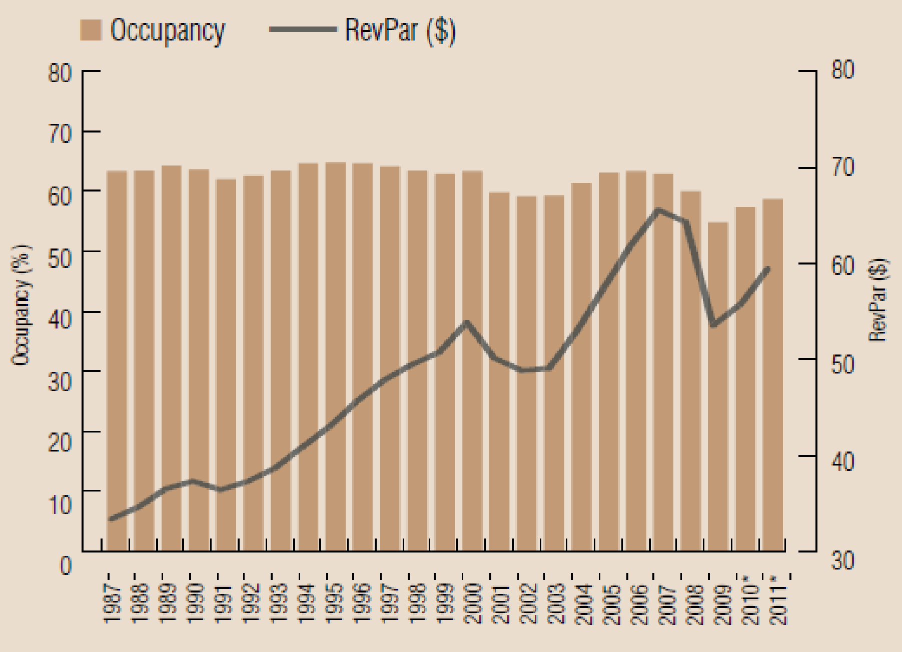
Exhibit 7 Songy's Completed/Sold Operating Projects Track Record Thru 2009

Project Name and Location	Project Size (SF)	Acquisition Date	Total Investment Basis	Investment Period	Institutional Partner	IRR Percentage
Sheraton Hotel* New Orleans, LA	180 keys REO Property	09/10	$13M	5 years	Aimbridge/ Argonaut	25%
Washington Mutual Hdqtr.*** Boca Raton, FL	172,000 (Office)	12/06	$43.5M	3-5 years	Songy Fund II	**
Lakeridge Technology Park* Atlanta, GA	4 Buildings 188,000 (Office Business Park)	05/06	$20M	8 years	Assurant	15%
Wyndham Vinings Atlanta, GA	159 Rooms w 2,845 s.f. of flexible meeting space	11/04	$13M	2 years	Angelo Gordon Co.	85%
Buckhead Art Institute Atlanta, GA	5-story vacated building and 1.5 acres (Dev. Site)	07/03	$6.5M	1 year	BayNorth/Mellon	48%
Jackson Plaza Oakridge, TN	178,000 (Office)	04/03	$5M	4 years	BayNorth/Mellon	30%
15150 Memorial Dr. Houston, TX	150,000 (Office) + 11 undeveloped acres	12/02	$15M	3 years	BayNorth/Mellon	12%
951 Yamato Rd. Boca Raton, FL	150,000 (Office)	06/02	$14M	3 years	BayNorth/Mellon	2%
Marriott Residence Inn Atlanta, GA	125,000	10/00	$20M	5 years	Case Pomeroy, Mellon Family	22%
1945 Broadway Oakland, TN	200,000 (Office)	06/00	$12M	3 years	UBS	**
Club Albatros Metepec Mexico City, Mexico	80,000 (Athletic Club)	08/99	$2M	6 years	Songy	32%
Club Albatros Cuatitlan Izcale Mexico City, Mexico	80,000 (Athletic Club)	08/98	$2M	7 years	Songy	30%
Wachovia Plaza Boca Raton, FL	110,000 (Office) + 235 Apartments	12/98	$22M	4 years	Case Pomeroy	18%
Energy Plaza Lafayette, LA	78,000(Office)	07/98	$5M	7 years	GE Capital	12%
1600 West Loop South Site Houston, TX	500,000 (Dev. Site)	06/98	$8M	2 years	Transworld	20%
Park Tower Lafayette, LA	28,000 (Office)	11/97	$14M	8 years	LNR	18%
777 Post Oak Blvd. Houston, TX	175,000 (Office)	04/97	$17M	2.5 years	Assurant	43%
Peachtree Palisades East Atlanta, GA	128,000 (Office)	05/97	$10M	2.5 years	Songy	51%
University Park Phase I Fort Myers, FL	400,000 (Office) 130,000	08/96 08/96	$20M	3 years	Assurant	33%
Palm Lake Tampa, FL	84,000 (Office)	07/96	$7M	7 years	Assurant	21%
Bank Boston Financial Plaza Boca Raton, FL	16,500 (Office)	10/95	$3M	3 years	Songy	24%
Lakes Plaza Miami Lake, FL	45,000 (Office)	10/94	$5M	8 years	Songy	9%
Intracoastal Point Jupiter, FL	80,000 (Office)	04/94	$3M	3 years	Songy	30%
Columbus Center Coral Gable, FL	300,000 (Office/Retail)	09/89	$70M	10 years	IBM/USAA	Under Orig. Ownership
Miami Arena Miami, FL	350,000 (Arena)	07/86	$60M	10 years	LTCB/Japan	12%
Cypress Financial Center Ft. Lauderdale, FL	200,000 (Office)	08/86	$35M	8 years	TCW Realty	18%
Baker International Place Houston, TX	250,000 (Office)	07/82	$30M	10 years	Keller	22%

**Loss of equity due to Technology market crash
*** Washington Mutual Lease terminated by FDIC in 2009

Source: Company documents.

Exhibit 8 U.S. Hotel Occupancy Rates and RevPAR



Sources: Smith Travel Research (1987 to 2009), PricewaterhouseCoopers LLP (2010 and 2011).
* Forecast.

Source: Urban Land Institute and PricewaterhouseCoopers LLP. "Emerging Trends in Real Estate 2011," Figures 4-17, accessed August 1, 2016.

Exhibit 9 US Hotel Cap Rate by City

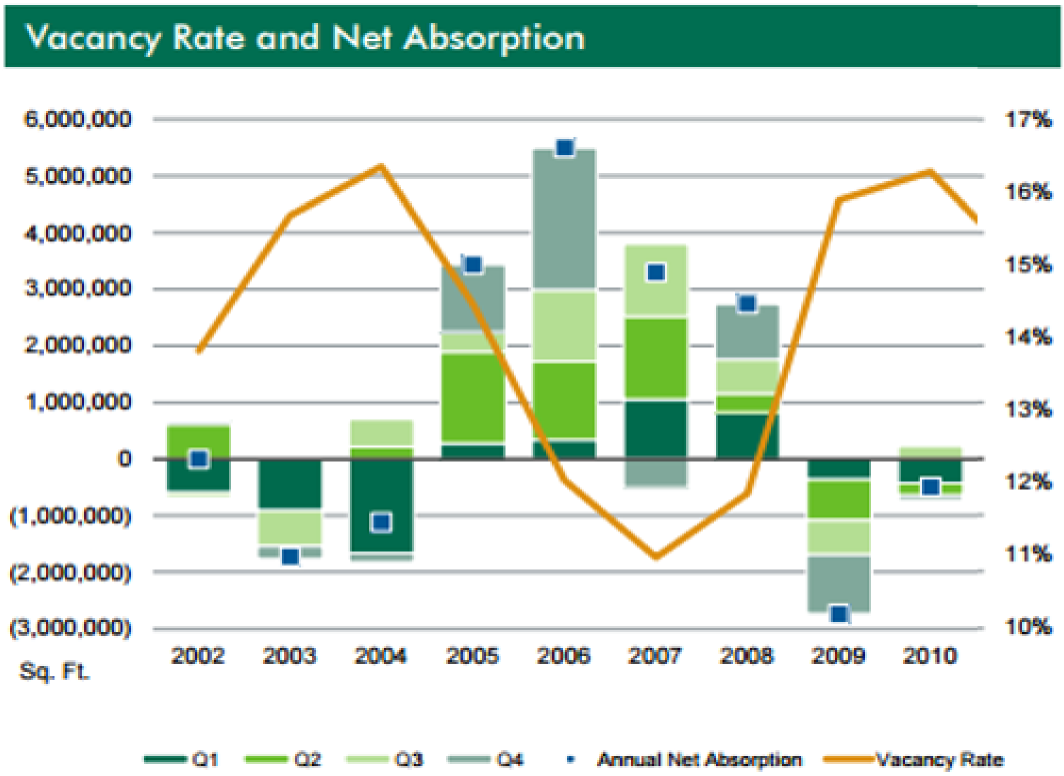
Hotels | National

	Select Service				Economy			
	Stabilized	Trend*	Value Add**	Trend*	Stabilized	Trend*	Value Add**	Trend*
Albuquerque	8.50% - 9.00%	N/A	9.00% - 9.50%	N/A	10.50% - 11.00%	N/A	11.50% - 11.75%	N/A
Atlanta	8.00% - 8.50%	↔	8.50% - 9.00%	↓	9.00% - 10.00%	↔	10.00% - 12.00%	↑
Austin	8.75% - 9.25%	N/A	9.00% - 9.50%	N/A	9.00% - 10.00%	N/A	9.00% - 10.00%	N/A
Baltimore	8.25% - 9.25%	↑	8.75% - 9.75%	↔	10.75%	↔	11.25%	↔
Boston	6.00% - 7.00%	N/A	6.50% - 7.50%	N/A	7.00% - 8.00%	N/A	8.00% - 9.00%	N/A
Charlotte	9.00% - 10.00%	N/A	9.50% - 10.50%	N/A	10.50%	N/A	12.00% - 13.00%	N/A
Chicago	8.00% - 9.00%	↔	8.25% - 9.25%	↓	N/A	N/A	N/A	N/A
Columbus	9.00% - 10.00%	N/A	9.50% - 10.50%	N/A	10.50% - 12.00%	N/A	11.00% - 12.50%	N/A
Dallas	8.50% - 9.00%	↓	9.00% - 9.50%	↓	10.00% - 10.50%	↓	10.50% - 11.50%	↔
Denver	7.50% - 8.00%	↔	8.00% - 8.50%	↑	9.50% - 10.00%	↑	10.50% - 10.75%	↔
Jacksonville	9.50% - 10.00%	N/A	9.75% - 11.00%	N/A	10.00% - 10.50%	N/A	11.00% - 12.00%	N/A
Kansas City	8.50% - 11.00%	N/A	12.00%	N/A	10.00% - 12.00%	N/A	15.00%	N/A
Las Vegas	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Los Angeles	7.00% - 9.00%	↑	7.00% - 10.00%	↑	8.00% - 10.00%	↔	9.50% - 11.50%	↔
Miami	9.00% - 10.00%	↑	9.50% - 11.00%	↑	9.50% - 10.50%	↑	10.00% - 12.00%	↑
New York City	6.75% - 8.00%	↓	10.00%	↑	8.00% - 9.00%	↓	10.00%	↑
Orange County	7.00% - 9.00%	↑	7.00% - 10.00%	↔	8.00% - 10.00%	↔	9.50% - 11.50%	↓
Orlando	9.00% - 10.00%	↔	9.50% - 11.00%	↑	9.50% - 10.50%	↔	10.00% - 12.00%	↔
Philadelphia	7.50% - 8.50%	N/A	10.00%	N/A	9.00% - 10.00%	N/A	10.00%	N/A
Phoenix	8.00% - 9.50%	N/A	9.50% - 10.50%	N/A	10.00% - 11.00%	N/A	10.00% - 13.00%	N/A
Pittsburgh	10.00% - 14.00%	N/A	11.00% - 14.00%	N/A	12.00% - 15.00%	N/A	N/A	N/A
Portland	8.00% - 9.00%	N/A	8.50% - 10.00%	N/A	9.75% - 11.50%	N/A	10.50% - 12.50%	N/A
Raleigh	9.50% - 10.50%	N/A	10.00% - 11.00%	N/A	11.00%	N/A	12.50% - 13.50%	N/A
San Antonio	8.00% - 9.00%	N/A	8.00% - 10.00%	N/A	9.50% - 11.00%	N/A	10.00% - 13.00%	N/A
San Diego	7.00% - 9.00%	↔	7.00% - 10.00%	↔	8.00% - 10.00%	↔	9.50% - 11.50%	↑
San Francisco	7.00% - 9.00%	↑	N/A	N/A	8.00% - 10.00%	↔	N/A	N/A
Seattle	6.25% - 7.25%	↓	6.50% - 7.50%	↓	9.50% - 10.50%	↓	11.00% - 13.00%	↔
St. Louis	8.50% - 11.00%	N/A	12.00%	N/A	10.00% - 12.00%	N/A	15.00%	N/A
Washington, DC	7.50% - 8.50%	↑	7.75% - 8.75%	↔	10.00%	↔	10.25%	↔

* Compared to 2nd Half 2010
** Value-add cap rates are based on a year 3 stabilized NOI divided by total cost

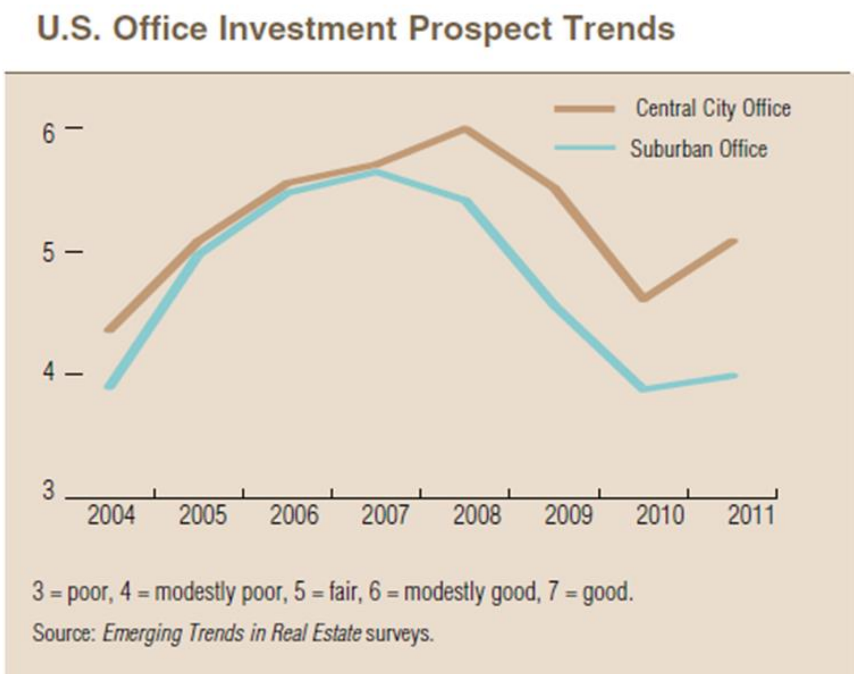
Source: CBRE Cap Rate Survey, August 2011, page 26, accessed August 1, 2016.

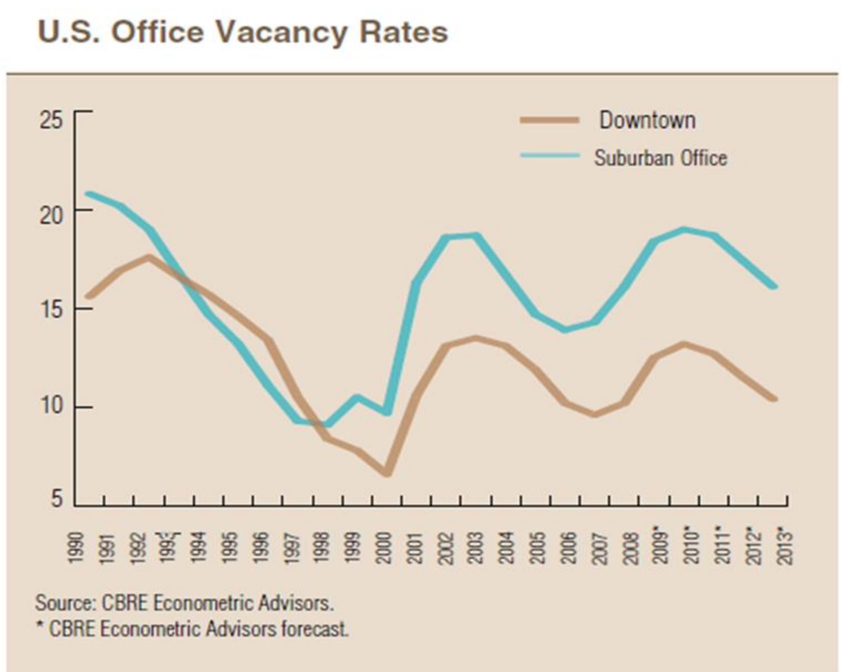
Exhibit 10 Houston Office Vacancy Rate and Net Absorption



Source: CBRE Houston Office MarketView, 2012 Q3, accessed August 1, 2016.

Exhibit 11





Source: Urban Land Institute and PricewaterhouseCoopers LLP. “Emerging Trends in Real Estate 2011,” Figures 4-19 & 4-23, accessed August 1, 2016.

Exhibit 12 CBRE Office Outlook

Office Suburban | Eastern Region

	Class A				Class B			
	Stabilized	Trend*	Value Add	Trend*	Stabilized	Trend*	Value Add	Trend*
Atlanta	7.30% - 7.50%	↓	8.50%	↓	8.25% - 9.00%	↓	9.00% - 10.00%	↓
Baltimore	6.50% - 7.00%	↓	8.75% - 9.25%	↔	8.00% - 8.50%	↓	9.75% - 10.25%	↓
Boston	6.50% - 7.50%	↓	7.50% - 8.50%	↓	7.50% - 8.50%	↓	8.00% - 9.00%	↓
Charlotte	7.50% - 8.00%	↓	8.00% - 8.50%	↓	8.00% - 8.50%	↓	8.75% - 9.25%	↓
Jacksonville	7.50% - 8.00%	↓	9.00% - 10.00%	↓	9.00% - 10.00%	↓	10.00% - 10.50%	↓
Miami	6.50% - 7.50%	↓	7.50% - 8.50%	↓	7.25% - 8.25%	↓	8.50% - 9.75%	↓
Nashville	7.50% - 7.75%	↔	8.50% - 8.75%	↑	9.00% - 9.50%	↑	9.50% - 9.75%	↔
Orlando	7.25% - 7.50%	↓	8.00% - 8.25%	↓	8.50% - 8.75%	↓	8.75% - 9.00%	↓
Philadelphia	7.50% - 8.00%	↔	8.00% - 8.50%	↔	9.50% - 10.00%	↔	10.00% - 10.50%	↔
Pittsburgh	7.50% - 8.00%	↑	8.00% - 8.50%	↔	8.50% - 9.00%	↓	9.00% - 10.00%	↓
Raleigh	7.00% - 8.50%	↓	8.00% - 8.75%	↓	8.00% - 9.00%	↓	8.50% - 9.25%	↓
Tampa	7.00% - 8.00%	↔	8.00% - 9.00%	↔	8.00% - 9.00%	↔	8.75% - 9.75%	↔
Washington, DC	5.75% - 6.25%	↓	6.25% - 6.75%	↓	6.50% - 7.50%	↓	7.00% - 8.25%	↓

* Compared to 2nd Half 2010

Office CBD | Central Region

	Class A				Class B			
	Stabilized	Trend*	Value Add	Trend*	Stabilized	Trend*	Value Add	Trend*
Austin	5.75% - 7.75%	↓	6.00% - 8.00%	↓	7.25% - 8.50%	↓	7.50% - 9.00%	↓
Chicago	6.25% - 6.50%	↔	6.50% - 6.75%	↔	7.00% - 7.25%	↓	7.25% - 7.50%	↓
Cincinnati	8.25% - 9.25%	↓	9.00% - 10.00%	↓	9.50% - 10.50%	↓	10.00% - 11.00%	↓
Cleveland	8.75% - 9.00%	N/A	9.25% - 9.50%	N/A	9.50% - 10.00%	N/A	10.50% - 11.00%	N/A
Columbus	8.00% - 9.00%	↓	9.00% - 10.00%	↓	10.00% - 11.00%	↔	10.75% - 11.50%	↔
Dallas	8.50% - 9.00%	↓	8.50% - 9.00%	↓	9.50% - 10.00%	↔	10.00% - 11.00%	↓
Detroit	8.50% - 10.00%	↔	9.00% - 11.00%	↔	9.00% - 12.00%	↔	10.00% - 14.00%	↑
Houston	6.00% - 7.00%	↔	7.50%	↔	7.50% - 8.00%	↓	8.50% - 8.50%	↓
Indianapolis	8.00% - 8.50%	↓	10.50% - 11.25%	↑	9.75% - 10.25%	↔	13.00% - 13.50%	↑
Kansas City	8.50% - 9.50%	↓	9.00% - 10.00%	↑	9.50% - 10.50%	↑	10.00% - 11.00%	↓
Minneapolis	6.75% - 7.50%	↓	8.25% - 9.00%	↔	8.00% - 8.75%	↓	9.50% - 10.50%	↔
San Antonio	6.25% - 7.00%	↓	6.75% - 7.50%	↓	7.75% - 8.25%	↓	8.25% - 8.75%	↓
St. Louis	8.75% - 9.75%	↓	9.25% - 10.25%	↓	9.75% - 10.75%	↓	10.25% - 11.25%	↓

* Compared to 2nd Half 2010

Source: CBRE Cap Rate Survey, August 2011, pages 7 & 9, accessed August 1, 2016.

Endnotes

[1] "How the Government Measures Unemployment," Bureau of Labor Statistics, October 8, 2015 http://www.bls.gov/cps/cps_htgm.htm.

[2] "Case Study: The Collapse of Lehman Brothers." Investopedia. http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp, assessed March 2015.

[3] Rosen, Kenneth. "State of Commercial Real Estate Market." Zell / Lurie Real Estate Center.

[4] Ibid.

[5] Rosen, Kenneth. "State of Commercial Real Estate Market." Zell / Lurie Real Estate Center.

[6] Ibid.

[7] Ori, Joseph. "Distressed Commercial Real Estate: The Elephant in the Banking Room." Real Estate Finance & Investment. www.Iirealestate.com.

[8] Pickett, Victor. "2012 Capital Markets & Real Estate Finance." 2012 Hampton Roads market Review.

[9] Sidel, Robin, David Enrich, and Dan Fitzpatrick. "WaMu Is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History." Wall Street Journal. September 26, 2008.

[10] Rosen, Kenneth. "State of Commercial Real Estate Market." Zell / Lurie Real Estate Center.

[11] 2011 Songy Investor Report.

[12] Ibid.

[13] CBRE Research Report.

[14] 2010 Songy Investor Report.

[15] 2011 United States hotel Valuation Index. HVS. January 2012.

[16] "2011 Emerging Trends in Real Estate." PwC Urban Land Institute.

[17] "Global Office Outlook." Jones Lang LaSalle. March 2011.