



## ARTICLE II

### HISTORY AND BACKGROUND OF THE DEBTOR AND SIGNIFICANT EVENTS DURING CHAPTER 11

#### *Background*

Kinsley Forest Estates originally was composed of 160 acres of vacant land located at the intersection of Hwy 169 and Hwy 29 in north Kansas City. The partnership was formed in 2003 principally by Hudson Gilliland and Douglas Gilliland (his son). The goal of the partnership was to zone, develop infrastructure and sell parcels of land to residential builders and commercial/retail developers. This business plan was similar to other real estate development programs the Gilliland's have successfully implemented for the past 30 years.

Based upon a strategic location and a strong economy, 143 acres was placed under contract to Pulte Homes in 2004. It was Pulte's plan to develop and build single family residential homes, and townhomes on the property. The contract allowed them to purchase the land over a period of time on a phase by phase basis. The remaining 17 acres held by the partnership was zoned for a neighborhood commercial/retail center and was planned for development after the residential component was completed.

Pulte developed the first 50 acres from 2003 to 2005 into 250 single family homes, and 110 townhomes. However, in 2006 they made a corporate decision to leave the Kansas City market. They defaulted on the remaining 111 acre contract obligations. In 2007, the Partners began a reevaluation of the market and site, and determined the best plan was to rezone the land by expanding the commercial/retail component to the highway frontage along Hwy 169, and rezoning the remaining single family and townhome land to multi-family. The result was by the beginning of 2009, the 111 acre zoning plan allowed 1,065 multi-family units and 158,500 square feet of commercial/retail.

As the marketing of the land with the new uses began in earnest in 2008 and 2009, the economy worsened. In particular the real estate market dramatically declined and a severe credit crunch occurred with banks. The ability to find buyers for the land lessened as the ability to finance real estate projects decreased.

After an extensive analysis of the financial markets the Partners found one source of construction and permanent financing that would allow project to move forward. This was the HUD insured 221 (d) (4) program. Efforts to gain approval of this program began in the latter part of 2008. Because of a slow and bureaucratic process, the approval of the application was not completed until early 2010. Because of the uncertainty and extensive time of obtaining the HUD Invitation Letter the partnership exhausted its' financial resources making interest payments to the bank. In October of 2009, because of a lack of funds interest payments were discontinued to the bank.

However, it was our belief and expectation that if and when the HUD approval took place, there would be a viable way for the project to resurrect itself and become viable again. Now that the HUD Invitation Letter has been obtained a realistic program can be created to

stabilize the program and successfully develop the property and liquidate the debt to Hillcrest Bank. That is the basis of the proposed workout plan contained herein.

*Liens, encumbrances and priority.*

Clay County has a priority claim in the amount of \$37,035.04 for unpaid real property taxes due for the period ended December 31, 2009.

Hillcrest Bank is the beneficiary of the *Deed of Trust, Security Agreement, Assignment of Rents and Fixture Filing*, recorded December 1, 2006, as Instrument No. 2006052804, at Book 5568, Page 25, securing payment of a Promissory Note in the principal amount of \$7,660,000 dated November 30, 2006.

After all extensions, the Note became due and payable on May 1, 2009. On October 30, 2009, Hillcrest Bank, through counsel, gave notice of the default and made demand for payment of principal and interest accrued through that date in the amount of \$7,741,685.27.

*Significant events after filing of the Petition.*

In July of 2008 a contract was signed with the Insight Group from Fort Worth to buy the property. (See attached contract) The contract provided for the purchase of the multifamily land in four phases over a five year period. It also included the commercial land. The total consideration was for just under \$16,000,000. The purchaser worked closely with us to get the property zoned for the use it has today- 1065 multi-family units and 158,500 sf of retail and commercial. Insight's investor partners, the Bass family of Fort Worth wanted to buy the property when the rezoning was complete, as well as the approval of certain TIF incentives and HUD 221 (d)4 financing was in place. After much effort to secure these things, Insight was not able to cause their investor to move forward with the purchase sighting the deteriorating financing market, and the overall rapid economic decline as their reason. Upon determining this, the contract was terminated.

Once it became clear that the Insight Group was not able to perform, we listed the 27 acre commercial property with Copaken, White and Blitt and continued to pursue multifamily buyers ourselves. We worked with them to sell the property. (See listing agreement) Jon Copaken suggested the site might work well for a big box concept such as Walmart. We worked with their land planner to design such a site. (See attached conceptual plan). They indicated the market was very bad, and buyers were only interested in buying distressed or below market valued properties. We gave our consent to lower the price on a cash basis to \$4.00 per sq, with the understanding that we would go lower if they found a cash buyer. After much marketing effort, they were unsuccessful. While this effort was taking place we have been making extensive efforts to find buyers for the multifamily land ourselves. Through our networking process we located the current prospects, Double Eagle Development, and Apartment Development Services, Inc. Double Eagle has submitted a letter of intent to buy just the HUD Tract (approximately 13 acres) subject to rezoning a portion of the commercial tract to multifamily. We also continued to communicate with the Insight Group to determine if they were making headway with the Bass Family.

While the marketing efforts continue, we pursued the rezoning process. It has been moving forward since March of this year and is scheduled for completion in September. The Eagle Development group has our contract, but has not entered into a firm contract. They are experiencing some difficulties with a similar HUD transaction in Tulsa, Oklahoma and have said they must correct problems there before they will move forward with this purchase. While they try to work through their issues we are going through a due diligence process with Apartment Development Services. If they successfully complete this process, and Double Eagle does not move forward we will sell to them. Because of the difficulty in obtaining HUD Invitations, we believe if given the chance we will find a suitable buyer if one of this is not successful.

### ARTICLE III

#### SUMMARY OF THE PLAN

THE FOLLOWING IS A BRIEF SUMMARY OF THE PLAN. CREDITORS AND HOLDERS OF INTEREST ARE URGED TO READ THE ENTIRE PLAN, A COPY OF WHICH IS ENCLOSED WITH THIS DISCLOSURE STATEMENT, AND TO CONSULT WITH COUNSEL TO FULLY UNDERSTAND THE PLAN.

Debtor believes that its Plan provides the best opportunity for all creditors and parties in interest to recover.

#### PART ONE

##### HUD 221 (d) (4) Program

The HUD 221 (d) (4) program is one of the few financing plans available in the country today for multi-family housing. Following their guidelines, HUD insures the loan for a traditional bank. The bank provides construction and permanent financing to a HUD qualified builder. The term of the loan is 40 years at a 5 ¾% note rate on a non-recourse basis. To have an approved Invitation Letter from HUD and an approved loan from a traditional bank is extremely valuable and important to the workout plan for Kinsley Forest Estates.

On February 3, 2010, the Debtor received an Invitation Letter from HUD and a loan has been preliminarily approved by KeyBank for approximately \$20,000,000 to build 212 multi-family units. This approval is slightly different than the original application to HUD for 404 units. That application utilized a 37 acre MF site as it was zoned in early 2009. However, HUD felt the number of units was greater than the program was designed for. As a result the original application was denied in the fall of 2009. However HUD liked the project location and concept and indicated if we would resubmit our application with less than 225 units they would approve the application. To accomplish the smaller number of units, a new site on the property was selected to accommodate 212 units. A new market study, environmental study and product mix was created. While the application and site was acceptable to HUD, it is located in an area of the property that has commercial zoning. As a result the property is being rezoned to convert 13

acres of commercial land to multi-family land. This process is underway and is scheduled to be complete in September of this year.

**Buyers for the 13 acre HUD site**

A key element in the workout plan is to sell the 13 acre HUD site to a multi-family builder. Negotiations are going on with two buyers at the present time. The first is with Double Eagle Development Company and the second is Apartment Development Services, Inc. Double Eagle has submitted a contract. It has been signed by our partnership and is currently in the hands of the buyer's attorney. The terms of the contract are as follows:

Purchase Price: \$8,100 per door for 212 doors (approximately 16-17 ac)- \$1,717,200

Earnest Money- \$25,000 initially and an additional \$225,000 at the end of the Due Diligence Period

Contingency- Rezoning the site from Commercial to Multi-Family

Closing- 90 days after contract execution, and completion of rezoning

A second contract is currently being negotiated for \$9,000 per door. In the event this contract is agreed it, it would become the primary contract.

Under either contract, the workout strategy would include a land sale closing by the end of October 2010.

The attached **Exhibit "A" Kinsley Forest Work Out Plan** spread sheet shows the affect of the transaction on the bank loan.

The key assumptions in this transaction are as follows:

- One of the two transactions closes by the end of October 2010
- The Bank will accrue interest on a principal amount of \$7,660,000 at a rate of 6.5% from October 2009 through October of 2010
- Current property taxes due for 2009 are \$37,500
- The Bank has incurred \$50,000 in legal expenses related to this transaction

The net result of this transaction is as follows:

- Allow the bank to reduce the original principal loan amount over 20%
- Collect all past due interest from October of 2009
- Pay for the Property Taxes for 2009
- In addition, the Partners will pay \$1,000 per month beginning in June and continuing until the land transaction closes that will apply toward the interest accrual as an act of "Good Faith"

## PART TWO

### **Scenario 1:**

#### **Restructure and Pay-Off of Remaining Balance**

Once the closing of the HUD site is completed, and the loan is paid down and interest and taxes are paid current, the Workout Plan requests the loan be renewed for a period of 24 months with interest at 6.5%. (Hereinafter, the "Renewal.") This Renewal will only be done if the following conditions are met:

- A two year interest reserve is created by the new Partners
- The closing of the multi-family tract has been completed

The rationale for renewing the loan as opposed to paying it off immediately is based on the current distressed condition of the real estate market and the lack of available credit. Land cannot be sold for fair market value in this environment because of the "vulture" mentality. Investor expectations require too much discount. The vast majority of the transactions that are occurring now are based upon distressed sale prices. Investors expect a significant return for taking risks in this market. As a result, the only cash investor buyers in the current market are demanding to buy the property in the \$4,000,000 to \$5,000,000 range even though the most recent appraisal of the property was for almost \$16,000,000. These prices would cause the Bank to lose \$3-4,000,000. Even with Judgments against the guarantors, the bank would not recover anywhere near the amount of losses incurred. By renewing the loan with an appropriate loan reduction and 2-year interest reserve, the bank will:

- Allow the real estate and financial markets time to recover
- Allow the multi-family construction to take place, which will energize the site and add demand and value to the remaining 95 acres

#### **Attract Investor**

With the loan Renewal structure, as opposed to a forced sale, the ability to attract new investment capital to the transaction is much greater. Instead of having to invest over \$6,500,000 (assuming the HUD sale takes place), the investor could invest approximately \$1,000,000 immediately (not including the purchase price of the HUD land). The ability for future land sales to provide a proper return on the smaller investment, and also pay of the Bank are much greater.

The **Exhibit "A" Kinsley Forest Work Out Plan** provides an illustration of a likely business plan based upon a \$900,000-\$1,000,000 investment from a new investor. A new investor can capitalize on the HUD sale knowing that a floor of value for the multi-family has been set in the \$8,100 to \$9,000 range. It will take about 18-24 months for the units to be built and leased. There will be demand for a second, third, fourth and fifth phase of the multi-family land. Assuming a 5% per year rate of appreciation, the model reflects the value of the land in future sales. In addition, it assumes a land sale at a very conservative value for the commercial land which fronts on Hwy 169 four years from now.

Using these realistic assumptions, at the end of the two year renewal, the Partners would be able to reduce the loan an additional approximate \$1,500,000 by selling the next phase of multi-family land. This assumes the bank will accept a 65% release fee from the net proceeds of the sale of 266 units (approximately 20 acres of land). The remaining cash flow from the transaction allows the investor to create a new 2-year interest reserve, and renew the loan for an additional 2 years.

By the end of the 2014, based upon one more phase of multifamily being sold, and the commercial land along Hwy 169 selling as well, the loan could be paid down to just over \$1,000,000. With one additional renewal at the end of 2014, the Bank would be completely paid of in 2016 assuming one more phase of multi-family sales in that time.

By taking this approach, the Bank will receive all of its principal and interest, and there will no deficiencies or losses. The key result is the bank will has a chance to get all principal, interest, taxes and legal fees. The alternative is to get 50-60% of value with judgments against people that have few assets.

**Scenario 2:**  
**Liquidation of the Remaining Tract**

In the event an investor cannot be found within ninety (90) days of the entry of a Confirmation Order, any tracts remaining not already under contract for sale shall be liquidated through auction.

**ARTICLE IV**

**CLAIMS**

A. **Classification of Claims.**

Class 1. Administrative claims not already paid, to include attorney's fees, and trustee fees. Class 1 is unimpaired.

Class 2. Priority Real Property Tax Claim of Clay County for unpaid real property taxes. Class 2 is unimpaired.

Class 3. Secured claim of Hillcrest Bank. Class 3 is impaired.

Class 4. Unsecured allowed claims. Class 4 is impaired.

Class 5. Interests of partners of Kinsley Forest. Class 5 is impaired.

B. **Estimated Amount and Treatment of Claims.**

Class 1: Administrative expenses shall be paid in full upon confirmation of a plan.

Class 2: The Priority Real Property Tax Claim of Clay County shall be paid in full upon the earlier of: (a) closing of the sale of HUD 221 (d) (4) Program, (b) sale of any other portion of the Property, or (c) Renewal of the loan.

Class 3: The secured claim of Hillcrest Bank shall be paid all proceeds from any sale or transfer of the Property, up to \$7,660,000 plus interest at the non-default rate. It shall release that portion of HUD 221(d)(4) Property and accept the proceeds thereof after payment of the Class 2 claim above, to be applied to its secured claim, first to past due interest and expenses, and then to principal. If thereafter Debtor nominates new investors to the partnership acceptable to Hillcrest Bank and deposits two (2) years interest reserve on the principal balance remaining, Hillcrest Bank shall renew the note and deed of trust for two (2) additional years.

Class 4: There is one unsecured claim in the amount of \$2,297, which shall be paid as follows: In the event the loan is renewed for two (2) additional years, this claim shall be paid in full within ten (10) days of the execution of such Renewal; however, if the Property is liquidated in whole or in part, then Class 4 shall receive any proceeds remaining after the distribution to Classes 1-3, above, up to the amount of its claim.

Class 5: The partners' interest shall be subordinate to the claims of the foregoing creditors and they will not receive a distribution under the Plan unless and until all foregoing claims are paid in full.

**Only those claimants whose claims or interests are impaired under the Plan may cast ballots with respect to acceptance or rejection of the Plan.**

C. Means of Implementation of the Plan.

Upon confirmation of the Plan, the Court shall set a date not less than sixty (60) days from the date of the Confirmation Order, approving the sale of a portion of the Property for the HUD 221(d)(4) Program, free and clear of all liens and encumbrances (the "HUD Closing"), and a date not less than ninety (90) days from the date of the Confirmation Order for either: (a) the Renewal of the loan; or (b) the auction of any remaining portion of the Property.

**ARTICLE V**

**OWNERSHIP AND MANAGEMENT**

Kinsley Forest shall be primarily responsible for the sale of the Property necessary for the development of the HUD 221(d)(4) program and shall at closing prorate taxes, insurance and other costs of doing business, and cause the proceeds of such sale to pay the claims as set forth herein. Kinsley Forest shall continue to seek investors to accomplish the Renewal and purchasers for the remainder of the Property. If Kinsley Forest is unsuccessful in finding one or more buyers or investors and any or all of the Property remains after the expiration of the time periods set forth herein, Debtor shall cause the Property to be sold at auction.



**ARTICLE VI**

**FEDERAL INCOME TAX CONSEQUENCES OF THE PLAN**

The implementation of the Plan may have certain tax consequences. YOU ARE THEREFORE URGED TO CONSULT YOUR OWN TAX ADVISOR AS TO THE POSSIBLE TAX CONSEQUENCES OF YOUR PARTICIPATION IN THE PLAN.

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ARTICLE VII

LIQUIDATION ANALYSIS

<u>Claims</u>	<u>Treatment Under the Plan</u>	<u>Treatment on Liquidation</u>
Class 1	Paid in full.	Paid in full.
Class 2	Paid in full	Paid in full
Class 3	Paid in full <sup>1/</sup> (\$7,800,000)	\$4,600,000
Class 4	Paid in full	\$ - 0 -
Class 5	No liability	(\$3,200,000)

Classes 3-5 are clearly better off under the Plan because they will receive more than in a Chapter 7 liquidation.

NOTES

<sup>1/</sup> The approximate principal and interest due is \$7,800,000.

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CONCLUSION

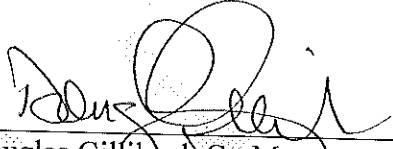
The material provided in this Disclosure Statement is intended to assist you in voting on the Plan of Reorganization. If the Plan is confirmed, you will be bound by its terms. Accordingly, you are urged to carefully review these materials and the Plan and to make sure such further inquiries as you may deem appropriate to cast an informed vote on the Plan.

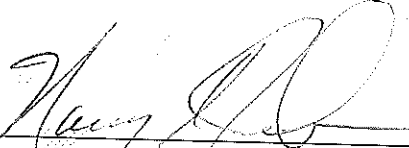
I declare under penalty of perjury that I have read the foregoing Disclosure Statement and that it is true and correct to the best of my knowledge, information, and belief.

Respectfully submitted,

KINSLEY FOREST, LLC  
Debtor-in-Possession

Dated: June 1, 2010.

By:   
\_\_\_\_\_  
Douglas Gilliland, Co-Manager

  
\_\_\_\_\_  
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