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6  
7 IN THE UNITED STATES BANKRUPTCY COURT  
8 FOR THE DISTRICT OF ARIZONA

9 In re  
10 MORTGAGES LTD.,  
11 Debtor.

**Chapter 11**  
**Case No. 2:08-bk-07465-RJH**  
**SUPPLEMENT TO THE OBJECTION**  
**OF THE INVESTORS COMMITTEE TO**  
**UNIVERSITY & ASH SETTLEMENTS**  
**Date: November 18, 2008**  
**Time: 11:30 a.m.**

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13  
14 The Official Committee of Investors (“Investors Committee”) hereby files its  
15 Supplemental Objection to the University & Ash Settlements which is currently scheduled  
16 to be heard November 18, 2008. On November 11, 2008 at around 12:30 a.m., the Debtor  
17 filed its Notice of Filing Amended and Revised Settlement Agreement, Loan Restatement  
18 Agreement and Mutual Release (“Supplemental Documents”). The Supplemental  
19 Documents again make changes to the economic terms and the legal terms. Upon  
20 information and belief, the Investors may not have received a copy of this filing. There is  
21 no certificate to indicate the Investors in these loans were served with the new filings and  
22 even the old filings.

23 In addition to the grounds already stated in the original Objection and in its  
24 Statement of Position and Supplemental Statement of Position, the Investors Committee  
25 objects to the Settlement and to the Supplemental Documents for several reasons.  
26 Regardless of how many times they “tweak” the settlement, the Debtor is not authorized  
27 to agree to and implement such extreme provisions which substantially change the  
28 underlying loans. Further, the terms are still not reasonable. The maturity date is now 15

1 years, but this provision is inconsistent with the other provisions in the Supplemental  
2 Documents and may be 14 to 18 years. No payments are made or projected to be made  
3 for 5 years. The project is still speculative. Foreclosure rights have been significantly  
4 compromised. The principal amount of the University & Ash loan is still being reduced  
5 by \$15 million and the interest rate reduced. The Investors' interests will be subordinated  
6 to significant new construction loans and to new equity funding. The Debtor has added an  
7 "equity kicker" to the back end of the restated loans to provide the illusion that more  
8 money may flow to the investors but it really is a conversion of some of the principal  
9 amount of the secured loan to equity, which is not authorized in the operative documents  
10 or at law. The Debtor has no interest in the two Roosevelt Gateway loans and only a  
11 negligible interest in the University & Ash loan. (The Debtor may only have \$168,180 in  
12 the \$30 million University & Ash loan.) It appears that the primary reason the Debtor is  
13 entering into this settlement is because of the alleged lender liability exposure which  
14 exists solely because of its alleged failure to fund the University & Ash loan. This  
15 settlement was being made "to buy peace" with an aggressive borrower in the face of a  
16 motion to appoint a trustee. The Debtor is trying to use the assets of the investors as a  
17 way to satisfy its own exposure. This conflict of interest violates the Debtor's fiduciary  
18 duty to the principals it serves and irreparably damages the investors. This kind of action  
19 cannot be a reasonable exercise of the Debtor's business judgment.

20 **I. THE SETTLEMENT CONTINUES TO BE A *SUB ROSA* PLAN AND**  
21 **CANNOT BE APPROVED AS A 9019 MOTION**

22 The Settlement as proposed in the Supplemental Documents adds a few more  
23 provisions that are objectionable and that will substantively predetermine the terms of the  
24 treatment of the Borrowers and the investors in these loans. As such, it is a *sub rosa* plan  
25 and cannot be approved under a 9019 Motion. Its approval must await the plan  
26 confirmation.

27 For example, as described by Rich Feldheim, there is an "equity kicker" for the  
28 investors in the Supplemental Documents. It converts some of the principal to possible

1 recovery as equity. At best it is illusory and speculative. The Debtor is not authorized to  
2 do this under any of the operative documents and if possible could only do it under a plan  
3 of reorganization, not in a 9019 Motion.

4 Further, in Section 16(c) of the Deed of Trust was modified to prevent the investors  
5 from transferring their interest in the notes and deeds of trust for each project. A  
6 restriction on the lender participants is extremely unusual. Plus, such a prohibition  
7 interferes with key plan issues. The parties were contemplating that under a consensual  
8 plan the notes and deeds of trust for each project will probably be transferred to new  
9 limited liability companies. Further, investors must be allowed to transfer their interests.  
10 Some investors may pass away before the 15-year period has matured and the projects are  
11 sold and they should be allowed to make lifetime transfers as part of their estate planning.  
12 This provision in the Deed of Trust predetermines an important provision in a possible  
13 plan and should not be approved as part of a 9019 Motion.

14 **II. THE TERMS OF THE SETTLEMENT AND THE SUPPLEMENTAL**  
15 **DOCUMENTS ARE NOT REASONABLE**

16 The terms of the Supplemental Documents are not within the zone or range of a  
17 reasonable settlement. Both the business and legal terms swing too far in favor of the  
18 Borrowers, create unreasonable risk for the investors, are illusory and minimize any  
19 chance of recovery. Here are the new provisions or changes in the Settlement Agreement  
20 based on the Supplemental Documents which are not appropriate or reasonable.

21 Section 2(e). The Debtor proposes to extend the maturity date to 15 years.

22 Section 2(f). If the Borrowers receive an “Additional Equity Funding” the  
23 Investors lose forever the right to foreclose and their sole remedy upon a default is to  
24 receive 95% of the Net Cash Available for Distribution” rather than 75% of such cash  
25 flow. Additional Equity Funding, as defined in Section 3, may consist of third party  
26 funding or funding by the principals or affiliates of the Borrowers or the sale of additional  
27 interests in the Borrowers each of which may affect the Net Cash Available for  
28 Distribution to the Investors. Unfortunately, under the provisions of Section 2(k)(ii), only

1 an Additional Equity Funding by a third party requires the consent of the Debtor. As a  
2 result, principals or affiliates of the Borrowers can make Additional Equity Fundings  
3 without the Investors' consent which both puts that money ahead of the Investors'  
4 recovery and all of this can be done before a construction loan is obtained. Without the  
5 assurance of a construction loan, the project may never be built but the Investors would  
6 have lost the ability to foreclose.

7 Section 2(h). The Investors are required to subordinate to a "First Priority Lender"  
8 loan for pre-development loans as well as construction loans and permanent financing.  
9 The Investors have no approval right unless the loan would cause a "Material Deviation  
10 from the Economic Results" projected for the project. It is impossible to tell if a pre-  
11 development loan will ultimately cause a "Material Deviation from the Economic  
12 Results" until all of the costs are known and the construction loan is obtained. Thus, the  
13 Investors are forced to subordinate before they know whether the project will ever be built  
14 and their deeds of trust lien are put behind additional money which must be repaid. It is  
15 extremely likely that a subordination agreement with a First Priority Lender will require  
16 the Investors to agree that they will not exercise foreclosure rights in the event of a default  
17 by Borrowers. Thus the Investors are effectively emasculated from exercising any  
18 remedy against the Borrowers because of small loans before they find out if the Borrowers  
19 can obtain a construction loan and actually build the project. If this right must be  
20 compromised, the Investors' right to foreclose should not be lost until both a construction  
21 loan and the required Additional Equity Funding are both obtained. They would also have  
22 to close at the same time in order to protect the Investors' lien rights in the projects.

23 Section 2(k)(1). This section which deals with the very limited requirements for  
24 Investor consent, permits the Borrowers to borrow up to \$100,000 at a time up to an  
25 aggregate of \$500,000 without Investor consent. This further illustrates the problems set  
26 forth under Section 2(h) above, since each such loan could be a first priority lien and the  
27 Investors would be required to subordinate their foreclosure rights before they know that  
28 the project will ever really be built. The section does not require Investor consent for any

1 transfer of a controlling interest in the Borrowers, which would allow the current  
2 Borrowers to sell out or transfer control of the Borrowers to another person or entity and  
3 make the Investors have to rely on someone unknown to finish the projects. This is  
4 simply not fair and not reasonable.

5 Section 2(h). This section provides that if the Borrowers want to make a first  
6 priority lien the Investors are required to agree to a subordination agreement that is  
7 commercially required by the lender which has terms reasonably consistent with the  
8 commercial market at the time of the subordination. If Borrowers have demanded  
9 subordination or requested a consent to the provision of Section 2(k)(12) (i)-(vi), the latter  
10 of which contain the very limited consent rights given to the Investors, which require such  
11 consent not be unreasonably withheld, then if the Investors object then if the Borrowers  
12 simply “claim” that the consent or approval is being unreasonably withheld, the maturity  
13 date under Section 2(e), the no development period under 2(i) and any interest accruing  
14 under the loan are tolled until a final determination by a court of competent jurisdiction.  
15 The provision does not say that if the Investors are upheld, all periods are retroactively  
16 reset back to where they were before.

17 Section 2(i). This section now extends the period within which the Borrowers are  
18 obligated to get a construction loan to 4 years from the effective date and as a result  
19 extended the projected 10 and 14 years holding periods shown in the projections by an  
20 additional 3 years. The Investors’ short term construction loans are being converted into  
21 long term loans of up to 17 years. Many of the Investors will not be around long enough  
22 to ever see any money. This section also says if no construction loan is obtained within  
23 the 4 years or the Borrowers have not started development on one of the properties that  
24 the Investors can foreclose. First, there is no definition of what constitutes the start of  
25 development. Second, if the Borrowers have given a pre-development loan to a First  
26 Priority Lender the Investors no longer have any foreclosure rights as indicated above.

27 Section 2(k)(1)(i). The Investor consents are required for any decision which will  
28 cause a “Material Deviation from Economic Results” which have been projected. As

1 stated in Section 2(k)(2), the definition is on the total aggregate development cost and sale  
2 price of each project within 6 years of construction. The problem is that until such time as  
3 they have all of the construction contract which locks in costs, the construction loan and  
4 the Additional Equity Funding and Mezzanine Loan that are contemplated to determine  
5 that they have enough money to build the project, there is no way of knowing whether  
6 decisions will have caused a Material Deviation from Economic Results. As a result, the  
7 Investors have no basis upon which to refuse consent to any early decisions until all of the  
8 foregoing are in place and by then it may be too late. The Material Deviation from  
9 Economic Results is not a workable criteria for the Investors' consents since they may not  
10 know until the end of the projected holding period whether there has been a deviation and  
11 the amount thereof. At a minimum, the Investors should have the right to approve the  
12 construction contract, the construction loan, the Additional Equity Fundings and the  
13 Mezzanine Loan before giving up their rights.

14 Section 2(k)(L). This section which defines "Net Cash Available for Distribution"  
15 requires the return of Additional Equity Funding prior to determine the availability of  
16 funds to distribute to the Investors. Since the principals of the Borrowers can make equity  
17 contributions or loans to the Borrowers which qualify as Additional Equity Funding, the  
18 result is that the Borrower principals or affiliates get any new money put into a project  
19 back before the Investors get any return. In the same section, the Borrowers do not even  
20 want to carry the taxes and insurance on the property. They are allowed to make loans to  
21 pay these items which once again are recovered before the Investors get anything. In  
22 short, everyone is put in front of the Investors in getting their money back.

23 Section 2(k)(1). The section permits the Borrowers or Borrower principals or  
24 affiliates to take financing fees and real estate management and sales fees with no  
25 specified limit. Part of the Borrowers' justification for the split of Net Cash Available for  
26 Distribution has always been they are doing the work getting the financing and the deal  
27 put together and they should be entitled to sweat equity. Why are they now asking to be  
28 paid separately for things that should be included in the cash flow splits?

1           Section 2(m). This section adds a provision which allows the Borrowers, at their  
2 option, to buy the three properties at their appraised value if Borrowers have tried for two  
3 years to obtain the necessary loans and joint venture equity or to obtain a subordination  
4 from the Investors and the Investors have wrongfully withheld consent which Borrowers  
5 think is required under the agreement. The issue of wrongful withholding is to be decided  
6 by arbitration in a short period of time under Section 2(n), whereas when it is to the  
7 Borrowers' advantage to toll the running of time period and interest on the same claim  
8 under Section 2(h) above, the tolling continues until there is a final court decision about  
9 that the Investors wrongfully withheld their consent or not which might take years. This  
10 is simply an attempt to get the properties for less than the loan balances owed to the  
11 Investors by claiming a wrongful withholding. There is no rationale for this one-sided  
12 option in favor of the Borrowers. There is no option in favor of the Investors in the  
13 agreement. This is just another one-sided provision in favor of the Borrowers in a very  
14 one-sided agreement which the Debtor is trying to force on the Investors.

15           Projections. The projections attached to the agreement indicate that if all goes well  
16 after a 10-year period, the Investors would receive \$47,040,000 and the Borrowers would  
17 receive \$38,451,398 on development of the first two properties. The three Investor loans  
18 total about \$43,000,000 today and after 10 years the Investors may get back \$4,000,000  
19 more based upon the lower interest rate. It should be apparent that the economics are  
20 radically shifted in favor of the Borrowers which have little money in the game and  
21 therefore little risk. The Investors are providing all of the capital so the Borrowers can  
22 make millions. The 14 year hold projections are even worse. The Investors receive, if all  
23 goes exactly according to projections, \$54,656,000 while the Borrowers make  
24 \$73,405,443.

25           Draft Loan Documents. The Debtor has agreed to the following changes in the  
26 Deeds of Trust which are not reasonable:

27           1. Section 4.h which required financial statements be given to the Investors was  
28 deleted. The Borrower should provide monthly financial statements and reports to the

1 Investors during construction so that the Investors can monitor progress and compliance  
2 with budgets and after construction is complete, leasing and cash flow reports to allow  
3 Investors to monitor Net Cash Available for Distribution.

4 2. In Section 16(c) of the Deeds of Trust was modified to prevent the Investors  
5 from transferring their interest in the Notes and Deeds of Trust for each project. This does  
6 not work since the Notes and Deeds of Trust for each project will probably be transferred  
7 to new limited liability companies as part of the approved Reorganization Plan. Further,  
8 individual Investors must be allowed to transfer their interests as many are likely to pass  
9 on before the projects are complete and they should be allowed to make lifetime transfers  
10 as part of their estate planning.

11 Therefore, the Investors Committee requests that the Settlement Motion be denied.

12 DATED this 14th day of November, 2008.

13 FENNEMORE CRAIG, P.C.

14  
15 By /s/ Cathy Reece (005932)

16 Cathy L. Reece  
17 Keith L. Hendricks  
18 Attorneys for the Official Committee of  
19 Investors

20 COPY of the foregoing emailed or mailed  
21 this 14<sup>th</sup> day of November, 2008 to the parties  
22 on the attached Service List.

23 /s/ Susan Stanczak-Ingram

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2133516.1

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**File an Answer/Response/Objection to a Motion:**2:08-bk-07465-RJH Mortgages Ltd. CASE CONVERTED on 06/24/2008

Type: bk Chapter: 11 i Office: 2 (Phoenix)  
Judge: RJH Assets: y Case Flag: Appeal, Exhibits

**U.S. Bankruptcy Court****District of Arizona**

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The following transaction was received from CATHY L. REECE entered on 11/14/2008 at 11:12 PM AZ and filed on 11/14/2008

**Case Name:** Mortgages Ltd.  
**Case Number:** 2:08-bk-07465-RJH  
**Document Number:** 999

**Docket Text:**

Supplemental Objection to Motion/Application *University & Ash Settlements* (related to motions(s) [570]) filed by CATHY L. REECE of FENNEMORE CRAIG on behalf of Official Committee of Investors (related document(s)[570] motion Motion to Approve Compromise/Settlement) (Attachments: # (1) Service List). (REECE, CATHY)

The following document(s) are associated with this transaction:

**Document description:**Main Document

**Original filename:**C:\Documents and Settings\sstancza\My Documents\Mtg Ltd - Supplement to Objection to University & Ash Settlement (hearing 11 18 08).pdf

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[STAMP bkecfStamp\_ID=875559564 [Date=11/14/2008] [FileNumber=12621693-0] [515711217cd62a0d4169fd1c17561b0e14ecff5e9e37e0eaa3f6bce3be30ea509109cb65e81cd764d8954e1932268b7201276bb9101ab1e36ff7c0d43a4b93ac]]

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[STAMP bkecfStamp\_ID=875559564 [Date=11/14/2008] [FileNumber=12621693-1] [4207ddb6c5155106f4de39bd3645320dc6bbbf50de1e745805c0adc6e05ea178f93d3907914dff46ca0e575065826974f2ec3ab490bdf95cfee0dcba34eac7b]]

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