UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

HERBERT E. CONRAD, Case No. 89-560-C J

Debtor. Chapter 12

ORDER ON RELIEF FROM AUTOMATIC STAY AND REOUEST FOR ADEOUATE PROTECTION AND ON VALUATION

On June 22, 1989 a hearing on the motion for relief from the automatic stay and request for adequate protection brought by Farm Credit Bank of Omaha (FCB), f/k/a The Federal Land Bank of Omaha, was held in Des Moines, Iowa. Valuation of the real estate securing the FCB claim was also in issue. Thomas H. Burke appeared on behalf of FCB and James M. Becker, Jr. appeared on behalf of the debtor, Herbert E. Conrad. Anita L. Shodeen, the Chapter 12 trustee, was also present. The record consists of the testimony of the debtor and two experts and of documents entered into evidence at the hearing. Both parties submitted posthearing briefs. The matter is fully submitted.

FACTS

1. Herbert Conrad and Guadalupe Conrad executed a variable interest rate note with FCB in the sum of $581,000.00 on February 25, 1983 in order to finance the purchase of a 595 acre farm in Jefferson County, Iowa. On that same date, they granted FCB a real estate mortgage on the property. FCB recorded the mortgage in the office of the Jefferson County Recorder on March 1, 1983.

2. The Conrads filed for relief under Chapter 12 of the Bankruptcy Code on March 16, 1989.[1]

3. On March 21, 1989 FCB filed a motion for relief from the automatic stay and a request for adequate protection. Conrad filed a resistance and response on March 30, 1989.

4. The court conducted a telephonic hearing on FCB's motion and Conrad's resistance on April 17, 1989. At that time the FCB clarified that its immediate concern was that it be entitled to adequate protection in the form of rents pursuant to the granting clause in its mortgage.[2] Additionally, it advised the court that the valuation of the real estate would be an issue at the time of the confirmation hearing. Accordingly, the court ordered that the automatic stay remain in effect pending a final disposition of the matter on the merits and directed the parties to obtain a third-party appraiser to determine the value of the property for confirmation purposes. With respect to the specific adequate protection issue, the court directed the courtroom clerk to schedule an evidentiary hearing if the parties were unable to

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[1] Subsequent to filing a petition for dissolution of marriage, Guadalupe Conrad filed a motion to convert her Chapter 12 case to a Chapter 7 case on June 15, 1989. The motion was granted on July 1, 1989.

[2] By way of background information, the FCB advised that it had commenced a foreclosure proceeding against Conrad and that a receiver had been appointed before Conrad filed his bankruptcy petition.

resolve the matter within a week.

5. On June 8, 1989 Conrad filed his proposed Chapter 12 plan.

6. The adequate protection issue was set for hearing on June 8, 1989. A stipulated order granting a continuance of the hearing to June 22, 1989 was entered on May 31, 1989. Prior to the first hearing date, the FCB filed an application for a valuation hearing on the ground that the parties had "obtained separate and distinct appraisals on said property and are unable to agree on a third party appraiser". (Application filed May 26, 1989, ¶ 5.) Then, during an unrecorded status conference call on June 20, 1989, it was determined that the valuation of thereat estate would be addressed at the June 22, 1989 hearing in addition to the issue of adequate protection.

7. Darrell Limkeman, the FCB's expert witness, testified that the value of the real estate was $410,500.00 as of June 19, 1989, the date of his updated appraisal. (On May 3, 1988 he had valued the same acreage at $400,000.00.) Limkeman, who served as the receiver in the state court foreclosure action, indicated that a reasonable and customary rent for this property would be $44,151.00. He stated that his receivership fees would have been approximately 10% of the gross rental of the property and that the taxes due and owing amounted to $7,382.00. He explained that the common practice in a receivership setting required that 100% of the cash rental be paid a year in advance and on March 1 of a given year. In this case the cash rental would have been due on

March 1, 1989.

8. Karen Richard, Conrad's expert witness, testified that the value of the real estate was $345,000.00 as of March 24, 1989, the date of her updated appraisal. (On August 8, 1988 she had valued the same acreage at $350,000.00.) Richard did not testify regarding the reasonable rental value.

9. Conrad testified that he approached the FCB in July of 1988 to restructure his debt.[3] The FCB gave him the names of three appraisers they had approved to value the property. Richard was one of the names that the FCB approved. Conrad identified the three names he provided FCB pursuant to this court's directive. (Perhaps because he had already obtained her updated appraisal early in this case, Conrad did not include Richard's name.) He indicated that FCB did not provide three names to him for the purpose of this proceeding. [4] Conrad also

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[3] Counsel for FCB advised that FCB and Conrad engaged in extensive restructuring in accordance with the 1987 Farm Credit Act. He further clarified that an agreement was reached but that Conrad could not comply with it and, accordingly, the FCB commenced a foreclosure action and Conrad subsequently filed for Chapter 12 relief.

[4] Counsel for FCB stated that he asked Conrad's counsel for three names after the first meeting of creditors (April 18, 1989) but did not hear from opposing counsel until June 16, 1989. Counsel for FCB stated that he could only speculate that the FCB deemed the three names given during the restructuring process to be satisfactory for the bankruptcy proceeding. Yet, he acknowledged that his client did not specifically give him three appraisers' names to pass on to Conrad's counsel.

testified that he obtained an in-house appraisal from FCB in February of 1988. That appraisal set the value of his property at $356,400.00. [5]

DISCUSSION

I. Motion for Relief From Stay and Request for Adequate Protection.

As clarified during the telephonic hearing and at the outset of the evidentiary hearing, FCB's motion for relief and request for adequate protection focus on the 1989-90 rental payments it would have received if the receivership in the state court foreclosure action had not been curtailed upon the filing of the Chapter 12 petition by operation of 11 U.S.C. section 543. Citing Federal Land Bank of Omaha v. Lower, 421 N.W.2d 126 (Iowa 1988), FCB claims a right to those rental payments pursuant to the conveyance of rents in the granting clause of its mortgage. FCB acknowledges that it is an undersecured creditor and that the value of the land is not decreasing. However, it contends that the value of the rental payments is not protected and is decreasing. Accordingly, pursuant to 11 U.S.C. section 362(d)(1), which provides for relief from the stay for lack of adequate

[5] Counsel for FCB objected to the admission of documentation pertaining to the in-house appraisal (Exhibits B and C) and to any testimony with respect to those exhibits on hearsay, relevancy and materiality grounds. The court received the exhibits and noted the objections as going to the weight of the evidence. The court now concludes that the appraisal is clearly that of the movant and it is relevant and material to the extent it has cumulative and comparative value.

protection, FCB seemingly seeks relief to obtain such rental payments from the debtor or an order specifically granting it adequate protection in a like amount.

Conrad argues that FCB's mortgage does not create a primary security interest in the rental payments. If the mortgage does create such an interest, he next contends that the interest was not properly perfected and, therefore, FCB's interest in postpetition rental payments did not survive the bankruptcy filing in accordance with section 552(b). Finally, Conrad maintains that there has been no noticeable diminution in the value of the security. Citing United Savings Ass'n of Texas v. Timers of Inwood Forest Assoc., Ltd.-, 484 U.S. 365, 108 S.Ct. 626 (1988), he concludes that the undersecured FCB is not entitled to adequate protection for a loss of use of its collateral.

With respect to FCB's interest in the rental payments, this court finds that the mortgage in this case is similar to that under consideration in the Lower case. [6] That is, the granting clause includes a conveyance of rents. Therefore, the FCB's lien on rents attached upon the execution of the mortgage on February 25, 1983.

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[6]The mortgage language in issue is likewise similar to that under consideration in Matter of Hollinrake, 93 B.R. 183 (Bankr. S.D. Iowa 1988) and in Matter of Rief, 83 B.R. 626 (Bankr. S.D. Iowa 1988). It is not similar to the pledge language in issue in Matter of Spears, 83 B.R. 621 (Bankr. S.D. Iowa 1987), aff'd sub nom. Farm Credit System Capital Corp. v. Spears, No. 87-569-A, slip op. (S.D. Iowa Nov. 4, 1987).

With respect to the perfection of the FCB's interest, the court observes that the earliest possible date of perfection would be March 1, 1983, the date FCB recorded its mortgage in the county recorder's office . 7 Certainly, the FCB's interest must be viewed as having been perfected before the bankruptcy case was commenced because the FCB requested and received the appointment of a receiver in the state court foreclosure action before Conrad filed his bankruptcy petition. Cf. Matter of Rief, 83 B.R. 626 (Bankr. S.D. Iowa 1988) (application to sequester rents and profits construed as a motion for relief from stay to complete perfection and granted where creditor held mortgage containing a granting clause regarding rents and profits and had commenced a foreclosure action and had requested the appointment of a receiver prior to the commencement of the bankruptcy case).

Hence, under the facts of this case and in accordance with 11 U.S.C. section 506(a), the 1989-90 rents in issue minus the costs of the receivership and taxes are part of the FCB's secured claim. Matter of Meeker, No. 87-978-D (Bankr. S.D. Iowa February 22, 1988). If Conrad wishes to use a like dollar amount in the debtor in possession account, he in effect is using the FCB's cash collateral and must provide sufficient adequate protection for that use in compliance with 11 U.S.C. sections 363 and 1205.

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7 The status of the state law regarding perfection of an interest created by a granting clause is not settled. Hollinrake, 93 B.R. at 188-89.

It should be noted that FCB brought this matter to the court's attention via a motion for relief from stay based on a lack of adequate protection rather than by means of a motion to prohibit the use of cash collateral. Since the FCB is undersecured and seeks relief based on a lack of adequate protection, the U.S. Supreme Court Timbers decision applies and requires only that actual value, not any decrease in value based on "lost opportunity costs", be protected. That is, to the extent Conrad uses some or all of the cash collateral he must adequately protect FCB in a like amount. However, the record does not reveal what amount, if any, of,the cash collateral has been used. Therefore, the court can not find that there has been a decrease in the value of the cash collateral [8] and can not specifically grant FCB relief from the stay under section 362(d)(1) [9]

Parenthetically, the court reminds the parties that section 1205, not section 361, governs adequate protection in a Chapter 12 case. Section 1205 provides in its entirety:

> (a) Section 361 does not apply in a case under this chapter.

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[8] Under the Timbers rationale, the undersecured FCB is not entitled to the "time value" of the cash collateral amount.

[9] At the hearings on this matter, FCB did not indicate that it was pursuing relief from the stay under section 362(d)(2). In any event, although Conrad lacks equity in the land and in the cash collateral, both appear to be necessary to an effective reorganization--at least at this point in time.

> (b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by--
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> > (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
> >
> > (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
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> > (3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income and earning capacity of the property; or (4) granting such other relief,
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> > other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property. (Emphasis added.)

Moreover, pursuant to section 363 and subsection 1205(b)(3), FCB appears to be entitled to the rents in issue without reference to the Lower holding and despite the Timbers rationale because Congress has specifically provided that

reasonable and customary rent is adequate protection "for the use of farmland". Unlike subsections 1205(b)(1) and (2), there is no "decrease in the value of property" limitation. Unlike subsection 1205(b)(4), there is no implicit requirement that the rents be part of the collateral securing the claim. Since FCB did not seek adequate protection based on Conrad's use of the farmland and pursuant to section 363, the court can not presently direct Conrad to pay the cash amount pursuant to subsection 1205(b)(3). However, in accordance with the subsection 1205(b)(4) concept of protecting the value of property and in response to FCB's alternative request for adequate protection, the court will direct that the cash collateral amount of $32,353.90 ($44,151.00 - $4,415.10 - $7,382.00) be segregated from other funds in the debtor in possession account or otherwise accounted for and be utilized only with the permission of FCB or upon order of this court pursuant to notice and hearing.

II. Valuation of the 595 Acre Farm.

11 U.S.C. section 1225(a)(5)(B)(ii) requires that the

value, as of the effective date of the plan, of property to be distributed to a creditor under the plan must not be less than the amount of that creditor's allowed secured claim. 11 U.S.C. section 506(a) states that "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with

any hearing on such disposition or use or on a plan affecting such creditor's interest". The Code's elastic approach to value determinations requires that a court take into account the interest being protected and the context in which a value determination is being made. 3 Collier on Bankruptcy, 506.04 (15 ed. 1986). In this Chapter 12 reorganization, the interest being protected is "the secured creditor's interest in the collateral, including the right to foreclose and realize the cash value of the collateral". In re Beyer, 72 B.R. 525, 527 (Bankr. D. Colo. 1987).

Typically in valuation disputes there is a wide disparity between the parties' conclusions as to the worth of the property in question. Most of these differences can be attributed to the elusive nature of "value". See generally 3 Collier on Bankruptcy, § 506.04, p. 506-25 (15th ed. 1986) ("valuation should not be viewed as an exact science by any means"). By far the best solution is for the parties to resolve the matter without court intervention. "Verily, it is preferable for the parties, reasonably and realistically, to agree upon such matters as the secured portion of a debt. True value is an elusive Pimpernel. The parties' discretion may be as good as the Court's." In re Jones, 5 B.R. 736, 738 (Bankr. E.D. Va. 1980). Cognizant of the certain uncertainty inherent in valuation determinations and of the costs generated and the time consumed in resolving value disputes through litigation, this court routinely directs the parties

to agree on a third party appraiser if a value dispute can not otherwise be resolved. The third party appraiser in effect becomes the court's expert subject to cross-examination by the parties if necessary. [10]

In this case, Conrad waited almost two months before submitting three names to FCB. Whether that was due to some hope of resolving the value dispute without additional appraisals or to some uncertainty regarding when the land valuation issue would be brought to the court's attention can not be ascertained from the record. on the other hand, FCB clearly did not provide three names to Conrad at any time during this bankruptcy case. FCB seemingly was determined to go forward with Limkeman as its appraiser at least as early as May 26, 1989 when its counsel filed the application for a valuation hearing. Contrary to the statement made by FCB's counsel at the close of the hearing, the court can not conclude from the behavior and attitude of FCB in this bankruptcy case that it negotiated in good faith with Conrad to attempt to find a third party appraisal.

Perhaps, FCB's rationale stems from this court's "one or the other" approach in her bench ruling on December 30, 1988 in Matter of Wonderlich Farms, Inc., No. 87-1497-D. In that

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[10] In the experience of the undersigned both as an advocate appearing before her predecessor and subsequently as a bankruptcy judge in this district, the percentage of cases in which third party appraisals are challenged is infinitesimal.

case it appeared that both the debtor and FCB failed to make any effort to agree on a third party appraiser. The court found the value of the land to be that established by FCB's witness--Limkeman. In comparing the two appraisers and appraisals presented, this court noted in part that Limkeman had more expertise, his appraisal was more recent and was based on more current sales.

The court will not take a "one or the other" approach in this case. Although Limkeman's credentials may be somewhat more impressive than those of Richard and his updated appraisal approximately three months more recent than that of Conrad's witness, he did not utilize current sales in his updated market approach. Although he followed the income, market and cost approaches to valuation and Richard presented only a market analysis, Limkeman acknowledged on cross-examination that the market approach seems to be the most commonly used of the three standard valuation tests.

In introductory materials to his May 1988 appraisal, Limkeman comments on the "market data approach to value":

> The market approach extracts data from the market on various sales of similar property to the subject farm. Since there are no two properties exactly alike, many factors such as the time of sale, the size of property, the location of the property, the physical characteristics, and financing along with buildings present on the property, must be adjusted by the appraiser. The appraiser will use the information gleaned from the market, his observation and experience, and his judgment to make an estimate of the value for the subject

> property under the market data approach.
> (Emphasis added.)

(FCB Exhibit #1, p. 30.) Despite the emphasis on market information being an integral part of the market approach, Limkeman did not seek out more recent sales for his updated appraisal in June of 1989. The five comparables used in his 1988 appraisal ranged from March of 1987 to February of 1988. He adjusted the time factor for the five comparables based on an increase of 10% in the value of the land only. Limkeman explained that the adjustment reflected today's sale prices based on Iowa State University's Standard Land Survey, which indicated a land value increase of 15.5 percent in Jefferson County, and on a USDA survey which revealed a 17 percent increase from February of 1988 to February of 1989. He did not elaborate upon the specific correlation between the overall land value increase in Jefferson county with his efforts to adjust the sale prices for the five stale comparables. Limkeman advised that he gave Conrad the benefit of the doubt in utilizing a 10 percent adjustment. In summary, his market valuation increased from $398,650.00 in May of 1988 to $416,500.00 in June of 1989.

Richard's updated valuation in March of 1989 is $5,000.00 less than her $350,000.00 appraisal in August of 1988. It is based on five comparables, of which one sale occurred in October of 1988, one in December of 1988, two in

January of 1989 and one in March of 1989. [11] Her market data format and formula are less sophisticated than those of Limkeman. Yet, she testified that her valuation took into account adjustments for certain differences between the comparables and the property in issue. [12] Hence, although Richard failed to bolster her market approach with income and cost analyses and although her updated appraisal curiously defies the general increase in land prices in this district, her opinion is entitled to some degree of weight.

Overall the court finds Limkeman's appraisal in May of 1988 too high and the difference between that appraisal and

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[11] Limkeman's five comparables consisted of parcels measuring 90, 160, 200, 240 and 377 acres. Richard's five comparables included parcels measuring 77, 79, 114, 125 and 160 acres. Neither expert commented on the effect the size of a parcel has on the ultimate sales price. Additionally, both appraisers valued Conrad's farm as one 595 acre parcel. Actually, Conrad's farm consists of one 258 acre parcel and one 337 acre parcel.

12 Much time was spent by counsel for both parties on the impact of the corn suitability ratings (CSR) on the market approach. Limkeman figured a CSR of 54.7 for Conrad's property based on his own analysis. Richard relied on the county assessor's records which indicated the CSR was 47. The bare record does not suggest to this court that one rating must be found better or more reliable than the other. That is, no evidence indicates that the assessor's records are inherently flawed.

Additionally, Limkeman apparently factored in the differences with respect to the CSR on his market data grid. Richard reduced the sales price of each comparable to a price per CSR unit to account for the CSR differences between the comparables and Conrad's property.

his update in June of 1989 seemingly too little. Certainly his first appraisal far exceeded FCB's in-house appraisal in February of 1988 and the third party appraisal by Richard in August of 1988. Indeed, in the "final estimate of value" in his May 1988 appraisal, Limkeman states:

> In most cases, the primary emphasis is placed on the market approach to value. However, in the case of this appraisal, all three approaches were very close to the same value estimate.
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> It should be noted, however, that during the past several months, the land market has been somewhat uncertain. This makes the appraisal process considerably more difficult than in the past.

(FCB Exhibit #1, p. 37.) Yet, his June 1989 appraisal appears to be more in keeping with the general upward trend in land values. The opposite is true of Richard's appraisals. That is, the first appraisal is within a reasonable range of the FCB's in-house appraisal but the updated appraisal is contrary to the land value trends in Jefferson county. [13]

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[13] Often the CSR ajustment is a valid objective method of ascertaining the true sales price for the subject property. Ironically, reducing the sale prices of the comparables in Limkemants May 1988 appraisal to a price per CSR unit and then multiplying the average price per unit times the CSR for Conrad's property and times the 595 acres seemingly yields a price between $320,000.00 and $380,000.00 depending upon whether the CSR of 47 or 54.7 is used. Likewise, following the same format for Richard's March 1989 appraisal seemingly yields a price in excess of $400,000.00 even if a CSR unit of 47 is used. Nor does adjusting the comparables to determine an average price per acre mitigate the disparity between the two market assessments. Presumably, the other "adjustments" account for the ultimate chasm between the market valuations each appraiser rendered.

Parenthetically, both appraisals appeared to contain numerous but generally insignificant arithmetic errors.

Without the benefit of an independent third party appraisal to act as a ballast between the two expert opinions, the court finds it necessary to attempt to fashion an equitable assessment based on the ethereal record. Accordingly, the court finds that Richard's August 1988 appraisal of $350,000.00 should be adjusted upward by 12%. The value of the 595 acre farm is set at $392,000.00 for purposes of confirmation.

CONCLUSION

WHEREFORE, based on the foregoing analysis, the court finds that:

1. The FCB's secured claim includes $32,353.90 in 1989-90 rents.

2. There has not been an established decrease in valuewith respect to the 1989-90 rents.

3. The value of the 595 acres is determined by adjusting Karen Richard's August 1988 appraisal of $350,000.00 upward by 12%.

ORDER

THEREFORE, IT IS HEREBY ORDERED that:

1. The motion for relief from stay is denied as to the 1989-90 rents. However, Herbert Conrad shall segregate $32,353.90 from other funds in the debtor in possession account or otherwise account for such amount. The segregated funds may be utilized only with the permission of the Farm Credit Bank of Omaha or upon order of this court pursuant to notice and hearing.

2. The value of the 595 acres is set at $392,000.00 for confirmation purposes.

Signed and filed this 21st day of August, 1989.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE