FINANCIAL RESERVATIONS

DOWNTOWN'S WESTIN BOOK CADILLAC DETROIT HOTEL HAS BEEN OUTPERFORMING MOST OF ITS NATIONAL PEERS, BUT BEHIND THE SCENES, THE CITY AND ITS PENSION FUNDS THAT INVESTED IN THE DEAL NEARLY 10 YEARS AGO MAY NOW TAKE A HUGE LOSS

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The $188.9-million restoration of the Westin Book Cadillac hotel in downtown Detroit nearly a decade ago is widely acclaimed as the catalyst for the renaissance of new development that almost weekly is transforming a city that, for decades, suffered from a dilapidated and moribund national image.

As renovations began on the hotel in 2006, the "deal of all deals" to finance the project was described as one of the most complicated redevelopment efforts in the nation. "It's definitely the poster child for the most complicated historic tax credit deal ever done," Ronald DeGrandis, managing director of RSM McGladrey Inc., a major Cleveland accounting firm that oversaw the Book Cadillac's financial package, told *DBusiness* in an October 2008 cover story.

Cleveland-based developer John J. Ferchill and his team, using 22 different levels of financing — including tax credits and deductions — assembled a $117-million package in the total $188.9-million restoration tab. "The schematic of ownership and related entities is beyond comprehension," DeGrandis said. "It's like one of those Whac-A-Mole games where you hit one and another one pops up. And (Ferchill)'s the guy with the mallet. It's like a secret cult, and without a flow chart, we would've been lost."

Unfortunately, the city of Detroit — and especially its two major city worker pension funds — are among the moles that are currently getting whacked.

While in recent years the hotel has outperformed most of its peers nationally in terms of occupancy rates, dining receipts, and entertainment expenditures, the city and pension funds are collectively owed $42 million. Of that amount, the city guaranteed $18 million in federal HUD money for the redevelopment, while the pension funds together chipped in the remaining $24 million.

As it stands, neither the city, nor the Detroit Police and Fire Retirement System and the General Retirement System that covers retirement benefits for thousands of police, fire, and civilian employees, have received a dime of repayment since making those loans a decade ago. The General Retirement System is owed $9 million, while a $15 million loan

STANDING TALL
The Westin Book Cadillac Detroit Hotel was redeveloped in 2008 at a cost of $188.9 million. It was one of the most complicated restoration projects on record.

from the First Independence Bank of Detroit, which was defaulted on, was backed by the Detroit Police and Fire Retirement System.

In 2012, Ferchill, chairman and CEO of The Ferchill Group in Cleveland, informed the police and fire board trustees that he could not meet the terms of the bank loan from First Independence. With the default that followed, the police and fire fund was on the hook for $15 million. Ferchill, who was the catalyst for the redevelopment, says the 2008 global financial crisis, the pending bankruptcy of General Motors Corp., Chrysler Corp., and several automotive suppliers, along with a post-construction appraisal, contributed to the hotel's early financial challenges.

"The day all the loans were put into place, the hotel had an as-built appraisal value of $120 million, which means if you built it then it would have a value of $120 million," Ferchill says. "That was the basis of the financing. That means it was somewhere around 60 percent loan to value. It opened in November 2008, and we then had to do a second appraisal, and honest to God, it came out at $25 million because of the market being down. So there was this enormous hit. That meant the value of the hotel went down by 80 percent. We had $9 million of deficit money to ride it out for three years, but the money was going out so fast we knew eventually there would be a default."

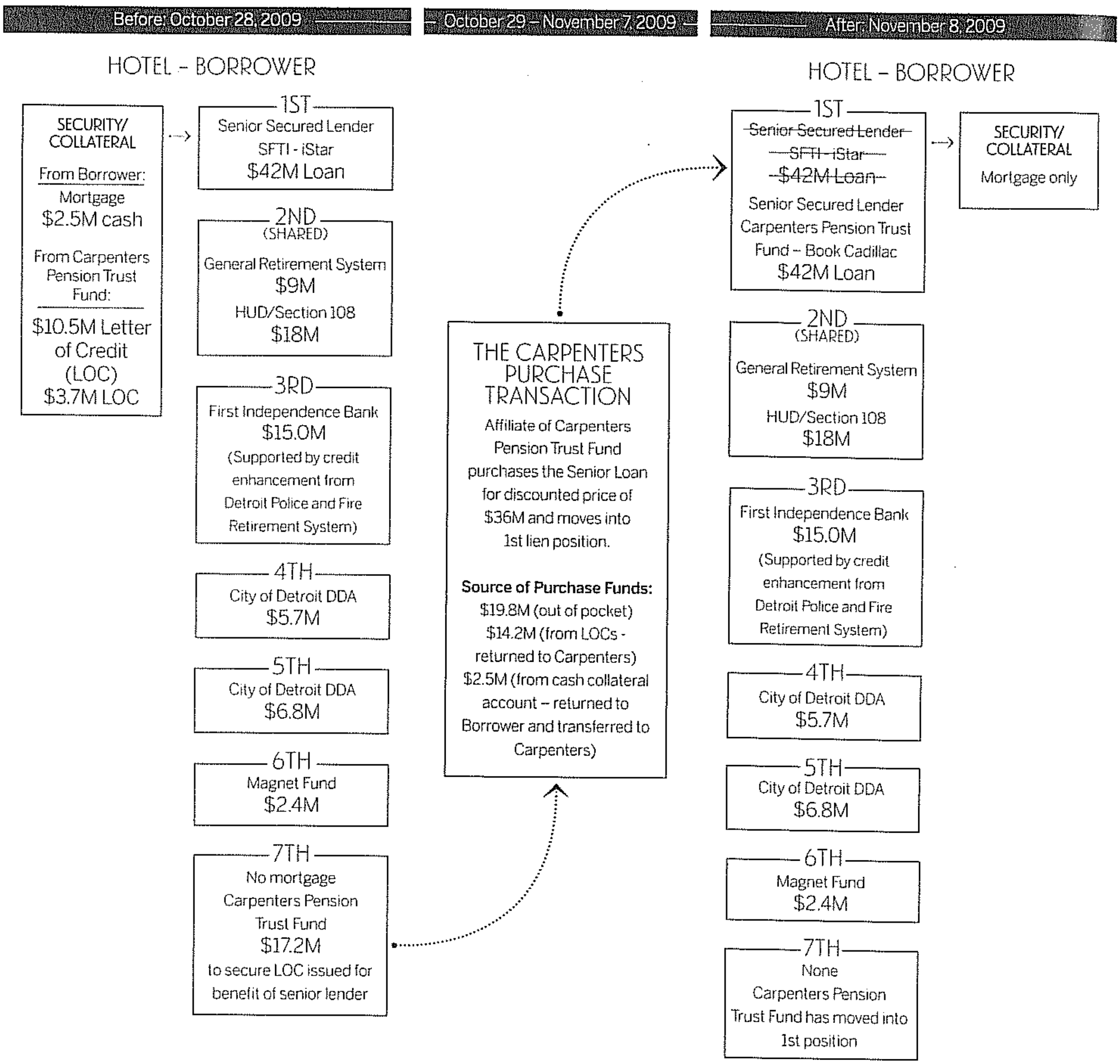
A source close to the original investment package says that, early on, the hotel didn't produce enough revenue to "pay off the junior lenders in the deal, let alone pay on the senior note.

"The original senior note-holder, iStar Financial (Star Financial Inc.), sold off their interest because the debt wasn't being serviced," the source continues. "They exited the deal at a loss. I would say now the hotel is performing quite well, and if that trend continues, the city and the pension funds should stay in the game because, over time, they should be able to get all of their money back."

In May, it appeared that the only return for the city and the pension fund investments would have come from a settlement in a lawsuit the city and the two funds filed in 2013 against the Carpenters Pension Trust Fund and its affiliate, CPTF Book Cadillac, an entity created by the carpenters to handle their involvement in the Book Cadillac project.

ANATOMY OF A DEAL

In the financial flow chart for the $188.9-million restoration of the Westin Book Cadillac Detroit, iStar Financial provided a $42-million senior loan. Due to the 2008 global financial crisis, the hotel, like other lodging properties, struggled to fill rooms due to cutbacks in business and leisure travel. As a result, iStar sold its interest to the Carpenters Pension Trust Fund for $36 million, which allowed the fund to take a senior loan position. In 2013, the City of Detroit and its two pension funds filed a lawsuit to compel the fund to pay off their loans.



Neither Ferchill nor his partners were a party to the lawsuit. The plaintiffs, in their case, objected to the way they, as junior lenders in the deal, were being treated by the Carpenters Pension Trust Fund. In their filing, the city and the two pension funds argue that they should be held in the same position as the Carpenters, and are entitled to receive regular payments to eventually retire their debt.

Multiple news stories reported that the Detroit City Council voted 8-0 to accept a $22-million settlement the Carpenters Pension Trust Fund had offered to settle the debt to all parties. The reports quoted a city official saying the city would use $10 million that would go toward paying down the $18 million obligation to HUD. The remaining $12 million was to be split among the two pension funds. A spokeswoman for the General Retirement System was quoted as saying her group was on board with the settlement, and was negotiating with their police and fire counterpart on splitting their share — the General Retirement System is owed a total of $9 million, while the police and fire fund is owed a total of $15 million.

Those reports proved to be premature. The police and fire pension trustees balked at accepting what would have been less than 30 cents on the dollar for their loan, sources say. "While we appreciate the media interest in the Book Cadillac Hotel settlement proposal that was prematurely made public at a recent City Council meeting, this litigation matter is ongoing," says Bruce Babiarz, a spokesman for the police and fire fund trustees. "Accordingly, we cannot discuss any specifics of the case at this time. We are confident that the Police and Fire Retirement System Board of Trustees, staff, and legal counsel are working in the best fiduciary interests of pensioners toward a resolution."

However, Ferchill says there's a lot more to the story that the city and pension funds are not making public. He says the charge of secret deals and back door dealings alleged by the city and pension fund lawyers is simply untrue. Not only was there never any secret dealing; the idea to buy out iStar Financial's loan was one he proposed to his lenders.

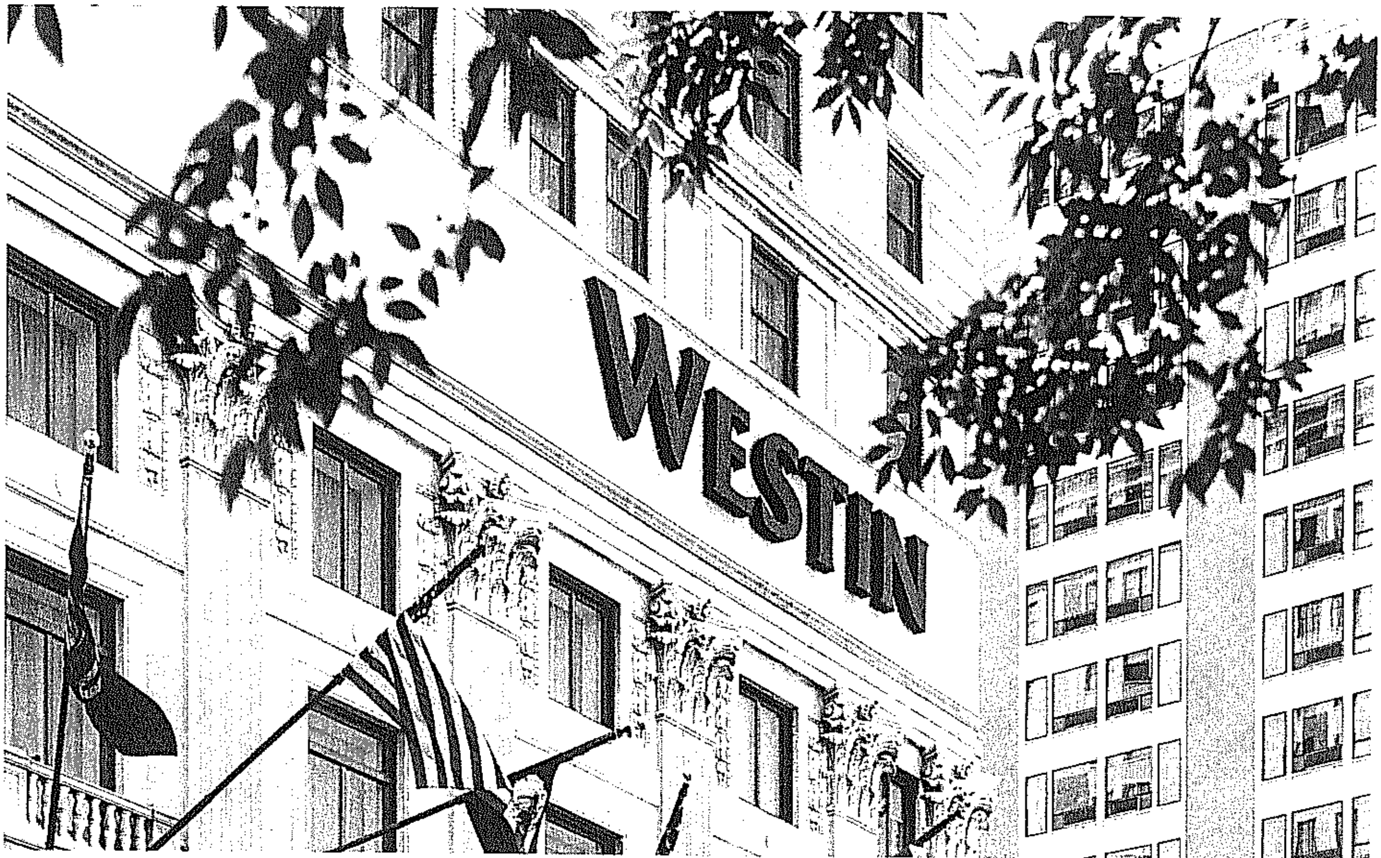
"I went to the pension funds, (and) all the secondary lenders, (including) the police and fire pension funds, the general (retirement fund), the city, the carpenters, and told them I can buy the New York firm's loan at a discount but I need help from you guys. But every single one of them except the carpenters turned me down," he says. "I asked them to come in with me and we'll buy out that first mortgage and everybody will be on that (new) first mortgage and I will get them paid. It was $36 to $38 million total to buy out this first mortgage. The carpenters made the decision to put the money up to save their $17 million."

Ferchill says the Carpenters Pension Fund's action spared the hotel. "We went back and we saved the hotel, and now it's very successful. If anybody looks at this thing carefully, that hotel was the start of saving Detroit," he says. "If we didn't do that hotel, nobody would be (investing) there today."

Ferchill also says another false assumption about the $22 million settlement the police and fire pension fund turned down was that the money was coming from the Carpenter's Pension Fund. "I went out and raised that money myself," he says. "I offered to go out and get enough money to pay everybody off and let them go away. I went back and researched what second and third mortgage holders got out of city-owned deals like this one. The highest number I could find (and don't hold me to this) was about 40 percent, so I told them I would give you guys 50 cents on the dollar, meaning that if there was $42 million owed, I would come up with $21 million."

Ferchill says he sat in on the settlement meetings with a facilitator who thought that amount would lead to a settlement, but the facilitator was having trouble getting everyone to agree, and asked Ferchill if he could find more money.

VROOM ROOM
The Motor Bar inside the Westin Book Cadillac Hotel has hosted numerous luminaries since the hotel opened in 1924, including Henry Ford and Spencer Tracy.



» ONWARD AND UPWARD
While the Westin Book Cadillac struggled during the 2008 global financial crisis, it has since recovered and is now posting a healthy occupancy rate of 65 percent, on average.

"He comes back to me and he said, Could you find another couple million? And I said, If it makes the deal work, I'll find a couple more million," he says. "So we started going for around $23 million. In the meantime, we were in the best financing market I have ever seen. I told them all that. It's easier for me to get money right now, so you got to move on this — but nobody would move. Nobody would meet on this, nobody would settle. All they would do is just keep fighting."

Ferchill says he and the lawyers involved didn't share the same vision for the hotel.

"You can see why the lawyers were doing this, they were generating legal fees. You don't get any legal fees when you settle," he says. "There was no real interest in trying to clean this up. They wanted the first mortgage holder (the carpenters) to take a hit, and I said, Why would the carpenters do that? They put the money up when nobody else would."

Ferchill adds that other lenders and city loans for the project that were not part of the lawsuit have been paid.

"We borrowed some money from one of those funds for the Michael Symon restaurant (Roast), and that is currently paid off. We paid off the other lenders. Think about that. With the $25 million appraisal, the value of the hotel was down 80 percent. But we brought it back and made it work. I went and negotiated with the franchise guys, the hotel guys, and got all that stuff renegotiated to keep the hotel going. I love the hotel. It's nice that it's successful (and) I truly do love it."

Robert M. Carson, a lawyer who represents the carpenter's affiliate, CPTF Book Cadillac, declined to comment on the case, or even acknowledge there was an agreement to settle. "I can't comment one way or another whether there was ever a settlement discussion or what the terms were because, if it did exist, it would have been confidential," says Carson, a principal at Carson Fischer in Bloomfield Hills. "We abide by the agreements and expect one day that the agreements that exist will be enforced."

The lawsuit alleges that the Carpenter's Pension Trust Fund, which backed three lines of credit from Fifth Third Bank worth $17 million, made a secret deal in the fall of 2009 to buy out the senior lender in the project, New York-based Star Financial, which was owed $42 million.

The firm sold that loan and its secured No. 1 lender position among the other creditors to the carpenter's union for a discounted price of $36 million, with a down payment of $19.8 million, according to the lawsuit. The remaining $16.7 million was to be paid in five days.

The arrangement, the suit claims, allowed the carpenters fund — which initially had no secured protection as a lender in the original loan structure — to vault over six other creditors, including the city and the two pension funds, to be first in line for repayment.

As part of that transaction, the suit alleges that the carpenter's fund, as the new senior lender, modified a subordination agreement and diverted $16.7 million of cash, collateral, and letters of credit already committed to the project to pay off the balance it owed the New York lender.

In effect, the carpenters fund purchased the senior loan for $19.8 million in new money, the suit alleges. And while it paid $36 million overall, the balance of the senior loan remained at $42 million.

"Essentially, the lowest priority lender, the Carpenters Pension Fund, diverted money intended for the benefit of mortgage lenders and the project and used it instead to buy the senior debt to the detriment of all other lenders, including the city pension funds," says Dan Wagner, a shareholder of Couzens, Lansky, Fealk, Ellis, Roeder, and Lazar in Farmington Hills, who represents the city pension fund.

While he would not discuss the case, Carson says the Carpenter's fund will prevail in the suit. "We fully intend to have the first mortgage position of my client upheld, and we intend to prevail," he says.

In legal papers filed with the court, Carson said under terms of the senior lender's contract with the project, the senior lender has the discretion to assign the loan to another party. He pointed out that, in fact, there was an original senior lender who had previously sold their loan to the New York firm without a challenge. Carson also argued that the contract gave his client the right to modify the agreement involving the $16.7 million.

"Money is fungible and there can be no assertion that a particular dollar was used or that any particular dollar went to the transaction," Carson wrote in the court records.

The voluminous Wayne County Circuit Court file shows that since the case was filed in October 2013, lawyers for both sides have traded barrages of motions, briefs, and court appearances month after month before Judge Brian Sullivan.

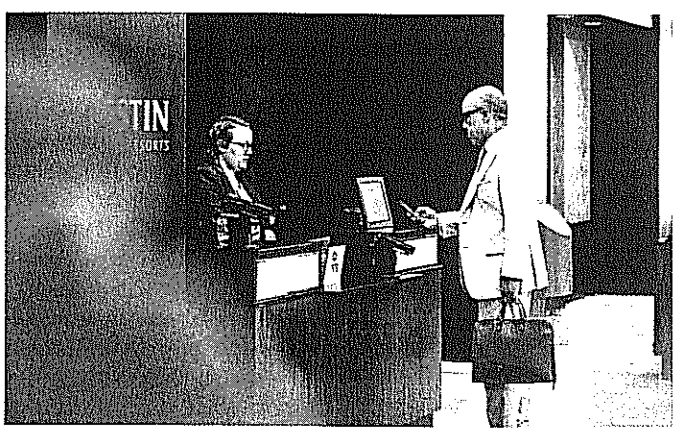
Even the lawyers complained about the avalanche of paperwork as they traded motions demanding one side or the other produce more documents, while the other side pleaded with Judge Sullivan that they had, indeed, provided their opponents with the information they were demanding.

To speed the case along, the judge set a date of May 24 for settlement terms to be completed. Short of that, the case would continue. While the city and the General Retirement System trustees publicly announced they would take the deal, the deadline passed without the police and fire trustees taking any action.

Tina Bassett, a spokeswoman for the General Retirement System, says when the city and the retirement systems made their investments in the Book Cadillac project, it was their hope that everyone would be made whole and the funds would not lose money. "But the city is benefiting because we have the beautiful Book Cadillac hotel back, and it wouldn't have happened without everyone participating," she says.

When it opened in 1924 at the corner of Washington Boulevard and Michigan Avenue, the 33-floor Book Cadillac, designed in an Italian Renaissance style with Venetian overtones by nationally acclaimed architect Louis Kamper, was the tallest hotel in the world. For 60 years it was listed among the best hotels in the country, until the city began sliding into decline following the 1967 race riots. Due to a lack of upkeep and reinvestment, the Book Cadillac merely lingered until it was closed in 1984.

Prior to turning to Ferchill in 2005, Detroit Economic Growth Corp., a quasi-public development agency, held title to the property. The organization initially selected Historic Hospitality, a division of Kimberly-Clark that specialized in restoring historic properties, to do the restoration. After two years, however, Historic Hospitality walked away from the project.



» RISING ALL SHIPS
Michael O'Callaghan, COO of the Detroit Metro Convention and Visitors Bureau, says the occupancy rate for downtown hotels is 64.5 percent, some 10 points above the national average.

During the time the Book Cadillac deal was being put together, both city pension funds were plagued by shaky lending practices and, in other instances, corrupt criminal conduct.

The federal government investigation into the scandal-ridden administration of former Mayor Kwame Kilpatrick found that bribery and kickback schemes involving pension officials and trustees involved the investment of more than $200 million. Jeff Beasley, a former city treasurer who was a trustee to both pension boards; Ronald Zajac, who for more than 30 years served as general counsel to both funds; and Paul Stewart, a veteran Detroit police officer and fund trustee, were indicted and later convicted of conspiracy, bribery, and extortion.

Beasley was sentenced to 11 years in federal prison and Stewart received 57 months, with three years of federalized supervision after his release. Zajac, who was 70 years old at the time, died weeks before his sentencing date.

Since that time, both pension funds have adopted strict reforms covering how they invest and hire professional firms to advise them. In 2014, as part of other financial reforms that came out of the city's bankruptcy case, Gov. Rick Snyder's office announced the formation of separate investment committees agreed upon by both pension boards of trustees to further oversee investments made on behalf of city retirees.

The hotel, now known as the Westin Book Cadillac Detroit, survived a shaky 2008 start with the global financial crisis, but in recent years has posted impressive numbers with an occupancy rate of as high as 65 percent, more than 10 points above the national average.

At the time of the opening of the 455-room hotel, the structure included 67 condominiums whose sales were initially blunted by the recession. The Ferchill Group announced after the hotel opened that they had received deposits on 64 of the condos, which ranged in price from $280,000 to more than $1.4 million. Many of those sales, however, never materialized, as would-be owners melted away with the economic downturn or could not get mortgages. Instead, the hotel development team rented out most of the units.

Since then, the Book Cadillac's condo sales have perked up. According to the hotel's website, only a handful of the units are now available, with prices ranging from $465,000 for a two-bedroom unit to $1.3 million for the penthouses.

The hotel also is home to two restaurants — Roast, operated by celebrity chef Michael Symon; and 24 Grille — which, in addition to offering a restaurant designed by Ron Roman Concept and Design in Birmingham, includes a 30-seat private dining room and a champagne bar.

James McTevia, principal of McTevia and Associates in Novi, which works with companies in severe financial troubles and serves as an advisory to banks and pension funds, says Judge Sullivan and the authorities should delve into how the Carpenters Pension Trust Fund transformed their position in the deal, which he says may have been done illegally.

"In the beginning you had a facility that wasn't performing, (and) you had a lender that got very uncomfortable and, in my opinion, did something very irregular, if not illegal, in terms of how they and the carpenter's fund arranged the buyout," he says. "It was highly unusual. Thank goodness the Detroit Police and Fire Fund was on the ball and saw what was happening, and filed a lawsuit to try and stop it.

"It is highly ironic that, over the decades, the carpenter's union used their influence with the city to get them to approve projects that the carpenters could get work from," McTevia says. "And today, with the Book Cadillac deal, the carpenters are trying to give the city and its two pension funds a severe haircut. The pension funds have a fiduciary duty to see that 100 percent of their money is returned. They never told the carpenters to do what they did. There are some very serious issues that need to be looked at here." **db**