



Creditor Newsletter #1
May 31st, 2005

Dear Interested Party –

This web site has been created to help disseminate information on the status of Brasota Mortgage Company, Inc. (“BMCI” or “Inc.”) and its related entities (Funding Management Corporation (“FMC”), Brasota Mortgage Company (“BMC” or “the partnership”) and BMC Realty Inc. (“BMCR”). The story of BMCI is somewhat tragic in that it has been in existence for over 35 years providing mortgage brokerage services to the Bradenton/Sarasota area.

BMCI operated as a traditional mortgage brokerage firm brokering conventional mortgages to third parties and additionally provided mortgages in the “sub-prime” borrowers. These mortgages were funded in large part by BMCI from investor funds advanced to it from BMC using investors’ funds advanced to BMC (the partnership). These investors in turn received, in some instances, assignments of mortgages as “collateral” for their advances. In most instances these investors did not receive such an assignment and even when an assignment was given an investor, generally, the actual notes from the third party borrower were not given the investor although a note from BMC may have been given the investor.

The lines between Inc. and the partnership were, at best, blurred. The bank accounts of the partnership were in the name of Brasota Mortgage Company, which for all practical purposes was indistinguishable to the outside world. The promissory notes given the investors were issued by BMC and the funds advanced by the investor deposited in the BMC bank accounts even though the receipts for funds being received by the investors were generally from an Inc. receipts book. Most investors seemed to be unaware of the existence of the partnership which had the same practical ownership as Inc.

The owner of BMCI, Mr. William J. Morrison, died on October 8th, 2004. After his death, it was discovered that the Companies had seriously breached their ethical obligations and had actually been using funds from new investors to continue to pay the interest to earlier investors. BMCI, FMC and BMC were placed in a voluntary receivership on February 8th, 2005. The receiver, John Ray, determined that losses exceeded \$20,000,000 and that investor loans exceeded the assets of the Company by at least that amount.

Upon motions filed by certain creditors of BMCI, it was effectively removed from the state court receivership and placed in involuntary bankruptcy on February 18th. The creditors who filed this petition were unaware of the existence of the partnership or presumably would have requested its inclusion in their petition. Subsequently, on April 4th, 2005, BMCI and FMI filed voluntary petitions. However, BMC did not file a

voluntary petition because no owners or officers were available who were willing to sign that petition.

On April 15th, 2005, the Bankruptcy Court appointed Gerard A. McHale, Jr, the undersigned, as Chapter 11 Bankruptcy Trustee over both BMCI and FMI. Because of the integral part that BMC and BMCR had in the overall operation, my attorneys have filed a motion with the court to essentially incorporate those two entities in the bankruptcy. Hearings on that motion are scheduled for June 8th.

Having dealt with some of the history, let's now deal with the ongoing operation of the bankrupt estate.

341 Hearing – On May 11th at the Federal Building Annex in Tampa, the first meeting of creditors was held. Although there was no officer of the Debtor present (and a crowd estimated at over 250 people showed up), it was decided that the meeting not be postponed. I requested that the meeting go forward and that the meeting be held in two sessions that afternoon so as to accommodate the large number of creditors. After a brief introduction of the key members having involvement in the bankruptcy process and an overview of the current status, the floor was opened to a question and answer period. Many of the questions answered were already in the Frequently Asked Questions (“FAQ’s”) which are available at this website and will be updated based on more recent inquiries. Please note that a transcript of the § 341 meeting may be ordered.

Creditors’ Committee – One of the first things undertaken by the US Trustee's office is the establishment of an unsecured creditors committee ("the Committee"). In this instance, the task was quite formidable from the standpoint that there are in excess of 1700 creditors. The unsecured creditors committee is generally made up of the largest of those unsecured creditors. In this instance, an unsecured creditor committee consisting of seven individuals, all of whom had claims in excess of \$400,000, was chosen. The committee has already met on the number of occasions and has selected W. Keith Fendrick of the Foley & Lardner law firm in Tampa to represent the Committee. For those not familiar with the operations of a bankruptcy, the Committee and its counsel represent all of the unsecured creditors as a group and not individual creditors within that group. Attorney's fees for the Committee are borne by the estate.

The Committee regularly interfaces with the Chapter 11 Bankruptcy Trustee and will be consulted with respect to future property sales and all major aspects of the bankruptcy proceeding.

The Trustee has already met with the Committee and has established procedures for reviewing proposals for sales and reviewing any fundings yet to occur under loan commitments outstanding under loan agreements which were in existence prior to the filing of the bankruptcies.

Additionally, although the ultimate responsibility for the approval of fees for the trustee and his professionals lies with the bankruptcy judge, the US Trustee and the Committee will receive monthly updates on the fees and expenses incurred to date.

Proof of Claims – A proof of claim need not be filed at this time. However, in excess of 690 proofs of claim have already been processed by our office. If you have

filed a proof of claim, it is not, I repeat **not**, necessary to file again when a proof of claim filing date has been set. This is referred to as a claims bar date -- however, again, if you have already submitted a claim you are not required to submit a claim again, even when you're notified of the claims bar date.

Loan Portfolios - The condition of the loan portfolios was, and is, pathetic. There was not a trial balance of active loans which could be relied on and we are still in the process of attempting to determine how much is owed us by various borrowers. There were virtually no controls over the lending process, and it is necessary to review every loan on a file by file basis to determine how much is currently owed. Once we got into the review process it was quickly determined that the losses were well in excess of \$20 million. When the bankruptcy schedules were filed by us in early May, the losses were in excess of \$38 million; a number which I anticipate will grow as additional information becomes available.

It is also evident that there has been virtually no collection efforts put into the portfolio for at least nine months, and in some instances, one would have to question whether any collection efforts were ever made on some of the delinquencies. Many loans went delinquent on their first payment and there is no indication of collection efforts on those loans.

We have retained Mark Hildreth of the law firm of Abel, Band in Sarasota to be responsible for our collection and foreclosure efforts. We would anticipate that in the coming month at a minimum 50 files will be turned over to him for collection or foreclosure.

Although originally it was thought that the residential portion of the loan portfolio totaled \$23 million and the developer portion \$51 million, as we delve deeper into the files, it is clearly evident that the actual collectible numbers will be substantially less.

Real Estate Owned (REO) - Currently, the company has approximately 50 properties in REO, generally with an overall value in the \$6.5 million range, most of which are single-family and one to four unit rental properties. Almost all of the properties have a unit value of less than \$100,000. We will be obtaining appraisals for all properties with values in excess of \$150,000 and working with the Committee to review any proposed purchase and sale agreements.

The properties do generate rental income and Eric Sconberg, who has worked for BMC Realty is handling the rental operations.

Recovery of Professional Fees – It was discovered that on the morning that the Companies were placed into voluntary receivership there was \$205,000 paid to counsel as retainers for representation of individual officers or directors of the Brasota entities. We have filed litigation to recover those fees and in one instance, a firm who received \$100,000 has agreed to return those fees forthwith.

Recent newspaper articles have indicated that approximately \$800,000 was spent in receiver fees and fees for the receiver's attorney prior to my appointment. Those fees will be reviewed by the US Trustee's office, the Committee and the bankruptcy judge for their appropriateness.

Insurance - Unfortunately, unbeknownst to the Trustee, insurance for all of the real estate owned ("REO") had been canceled by the insurance company on March 31, 2005, prior to his appointment. The insurance company had sent a letter on February 14, indicating its intent to cancel. However, nothing had been done to respond to that letter. Working with my attorney, Mike Markham, we did file a lawsuit to have that policy reinstated and the insurance company has acquiesced and reinstated the policy without lapse of coverage.

Further, once the policy was reinstated it was discovered that the policy only covered real estate held in the name of FMC, and even at that not all of the FMC property had been covered. A new policy has been put into place covering the balance of the properties and a binder was issued on May 28. It is anticipated that with the delinquencies currently existing in the loan portfolio there will be much more REO as the liquidating process moves forward.

Clancy's North - In a transaction that is not yet fully understood, the deed to a property known as Clancy's North was transferred to what appears to be an unaffiliated party, Sarah Denton Umbrella Corp. for no consideration. Brasota continued to fund the operating expenses for Clancy's and over a period of two years, funded in excess of \$1.4 million, in addition to the underlying value of the property. The property was sold for \$1.2 million, and Brasota received no funds from the closing of that sale. An injunction has been filed to prevent the release of those funds, and the trustee is confident that there will be a substantial recovery. Sarah Denton Umbrella Corp. has already indicated a willingness to return an amount in excess of \$900,000.

Secured vs. Unsecured Creditors - Certainly the most perplexing aspect of this case is the status of the secured and unsecured creditors. As previously mentioned, the Companies, on a great many of occasions, did record assignments of mortgages, however, never delivered the actual notes to the assignee. The Trustee will likely be taking the position that all creditors are unsecured creditors, and anyone wishing to contest that status will be required to provide documentation of both the recorded assignment and the proof that they are holding the original note (not the note that was given to them signed by Brasota Mortgage Company). As mentioned often, the bankruptcy judge will have to ultimately decide the issue.

Operational Notes - The companies are no longer making loans and are now in the process of administering and collecting what loans had been made (approximately 400 loans). There were eight members on staff at the time of my appointment as Trustee, two have been let go and further reductions will be occurring as "institutional knowledge" has been obtained. The Trustee is aware that many investors are not particularly overjoyed at the prospect of having some of the staff remaining in place, but I assure you that the cost of recovery with absolutely no background would be greatly increased without that staff.

All attorneys who had been representing the Companies have turned files over to the Trustee's attorneys. If there are any files missing, the Trustee's attorneys will promptly seek the turnover of the information.

As we move forward, the facilities will be evaluated with an eye for cost reductions and sale of the existing office facility.

State Investigations – The State of Florida Bureau of Financial Regulations has been to the facility and copied all investor files. In addition they have been in touch with many investors and interviewed the employees of Brasota. Their investigation focuses on the sale of unregistered securities and receipt of commissions by unlicensed individuals. We have been cooperating fully with the state investigation and will continue to do so.

We have also talked with the State Department of Revenue who advised us that they anticipate auditing the documentary stamps paid by Brasota in the past. No determination has been made at this time as to if and when that audit will go forward

Federal Income Taxes - The Companies' tax returns for the year ended 2004 were due on April 15. Extensions for those returns have been filed and once the transactions have been sorted out, the returns for the companies will be filed. The Trustee will not be giving advice as to the treatment of losses of individual creditors when they are determinable and creditors are advised to contact their own counsel or tax return preparer with respect to any losses incurred on the investment.

Creditor Communications - Although this particular letter has been somewhat lengthy, I will attempt to get a letter posted at the end of each month with an update of the prior month's activity.

To date I have attempted to return every phone call or have my office do so. Should you really need to contact me, please call the Brasota offices in Sarasota (941) 746 - 6119 or e-mail me at Jerry@Brasota.com. If I or my offices do not get back to you in a reasonable amount of time, please try again. Please remember that time is money and I really want to attempt to hold costs to a minimum as the task ahead is truly staggering. Remember that with over 1700 creditors, a 15 minute discussion with each creditor would cost the estate an additional \$100,000.

I will attempt to keep the creditors updated with monthly postings and if you have any questions please feel free to contact me and I'll open a column to address questions that apply to the general creditor group.

Best Regards,
Brasota Mortgage Company, Inc.



Gerard A. McHale Jr.
Chapter 11 Bankruptcy Trustee