

Albert N. Kennedy, OSB No. 82142 (Lead Attorney)
Direct Dial: (503) 802-2013
Facsimile: (503) 972-3713
E-Mail: al.kennedy@tonkon.com

TONKON TORP LLP
1600 Pioneer Tower
888 S.W. Fifth Avenue
Portland, OR 97204

Attorneys for Clyde Hamstreet, CRO

UNITED STATES DISTRICT COURT
DISTRICT OF OREGON

**SECURITIES AND EXCHANGE
COMMISSION,**

Civil No. 6:09-cv-06056

Plaintiffs,

v.

**SUNWEST MANAGEMENT, INC.,
CANYON CREEK DEVELOPMENT,
INC.; CANYON CREEK FINANCIAL
LLC, and JON M. HARDER**

**DECLARATION OF V. MATTHEW
MARCOS IN SUPPORT OF
DISTRIBUTION PLAN OF RECEIVER
AND CHIEF RESTRUCTURING
OFFICER FOR SUNWEST ENTERPRISE**

Defendants.

and

**DARRYL E. FISHER; J. WALLACE
GUTZLER; KRISTIN HARDER;
ENCORE INDEMNITY MANAGEMENT
LLC; SENENET LEASING COMPANY;
FUSE ADVERTISING, INC.; KDA
CONSTRUCTION, INC.; CLYDE
HAMSTREET and CLYDE A.
HAMSTREET & ASSOCIATES, LLC,**

Relief Defendants.

and

**DARRYL E. FISHER, J. WALLACE
GUTZLER, KRISTIN HARDER, ENCORE
INDEMNITY COMPANY, FUSE
ADVERTISING, INC., KDA
CONSTRUCTION, INC., CLYDE
HAMSTREET AND CLYDE A.
HAMSTREET & ASSOCIATES, LLC,**

Relief Defendants.

I, V. Matthew Marcos, make this declaration based on personal experience, knowledge and review of the business records of Sunwest Management, Inc. ("SMI"). I am competent to testify about the matters described herein.

1. I am a Senior Director in Alvarez & Marsal's Healthcare Investigatory Group ("A&M"). A&M, headquartered in New York, New York, is a global professional services firm specializing in, *inter alia*, crisis management, turnaround management, and business advisory services. A&M's Healthcare Investigatory Group works in healthcare related businesses ranging from academic institutions to investor-owned healthcare providers. I have over 15 years of diverse financial experience, including executing mergers, acquisitions, leveraged financings, and financial restructurings, and for the past 10 years have worked as a financial and restructuring advisor in the healthcare services field, primarily with senior housing businesses. I have completed dozens of sales, mergers, acquisitions, and financings in the healthcare services industry both in and out of Bankruptcy Court. I am supplemented by other A&M senior healthcare professionals who on average have over 25-years experience working with clients to improve their operational and financial performance. A&M's approach is fact-based and independent with an emphasis on integrity, execution, and fairness.

BACKGROUND OF SUNWEST'S FINANCIAL CRISIS AND INJUNCTION

2. I started working with Sunwest in May 2008 as a restructuring advisor. When we arrived Sunwest did not have enough funds to fund payroll, a clear indicator of the liquidity

crisis it faced. Sunwest was a collection of individual businesses with distinct shareholders usually majority owned by Messrs Jon Harder and Darryl Fisher. The businesses included over 350+ properties, including 289 assisted-living (“ALF”), independent-living (“ILF”), and Alzheimer-care (“ALZ”) facilities, a management company, development company, advertising agency, tenant-in-common (“TIC”) broker-dealer, and interior design company (collectively “Sunwest” or the “Company”). At its peak, Sunwest was the 4th largest owner/operator of senior housing facilities in the United States according to the *Assisted Living Executive*. In May 2008, Sunwest operated approximately 23,500 units in 37 states.

3. Many factors led to the financial crisis at Sunwest, including aggressive acquisition and development growth, over-leveraged capital structure, poor financial controls, under-performing operations performance, and tightening credit markets. As a result, Sunwest faced a severe liquidity crisis and defaulted on a number of its loans in mid-2008.

3.1. Since its founding in 1991, Sunwest grew aggressively through numerous acquisitions and development projects. At its peak, Sunwest was completing 50+ acquisitions per year. Due to a slowdown in new acquisitions and development projects, Sunwest sustained higher than usual operating losses in its affiliated subsidiaries which depend on the acquisition and development business for fee income and excess cash flow from refinancings.

3.2. Sunwest had a cumbersome capital structure and financed its rapid growth primarily with investments from the retail marketplace using a TIC structure and with mortgage debt from institutional sources. Institutional lenders included General Electric Capital Corporation (“GECC”) and Credit Suisse First Boston (now known as Credit Suisse) through Column Financial, as agent, and many regional banks. Sunwest through its broker-dealer, Canyon Creek Financial, raised capital from retail investors through a TIC structure. The TIC investors acquired an undivided ownership stake in the real property and usually assumed a portion of any mortgage debt outstanding on the property. The cash costs of TIC financing

ranged from 8 to 10% per annum which in addition to the high senior leverage further negatively affected cash-flow. Sunwest raised more than \$440 million of TIC and over \$1.8 billion in mortgage debt.

3.3. Exacerbating the liquidity crisis, Sunwest was the target of dozens of lawsuits seeking to foreclose on properties, alleging securities fraud, and enforcing personal guarantees granted by Messrs Harder and Fisher. In March 2009, the Securities and Exchange Commission sued Sunwest and other defendants, alleging securities fraud. The U.S. District Court in Eugene, Oregon, issued an injunction halting most foreclosure proceedings allowing the estate important time to develop a restructuring and distribution plan to equitably treat all the stakeholders in the estate and on March 10, 2009 a receiver was appointed (the "Receivership").

VALUE OF COMPANY AT MARCH 2, 2009 IN A LIQUIDATION VERSUS A REORGANIZATION

4. For purposes of determining which strategy has the highest economic value to the stakeholders we compared: (i) equity value to the estate, i.e., whether the Company had more equity value to the stakeholders as a reorganized enterprise versus a sale of the individual facilities in an orderly manner or a liquidation; (ii) the number and amount of claims in a reorganized enterprise versus a liquidation; and (iii) the resulting recoveries estimated to be received by the claimants. For this comparison, A & M and Hamstreet & Associates prepared desktop valuations comparing economic value in an orderly liquidation to a going-concern reorganized business. These enterprise valuations are based on a combination of operating data, recent comparable public companies, recent sale transactions, market knowledge obtained from recent Sunwest facility marketing efforts, and A & M's industry knowledge and market research. Alvarez & Marsal has special expertise in senior healthcare facilities and strong general knowledge of real estate transactions. We chose March 1, 2009, as the baseline date because the injunction began the next day.

5. To calculate equity value for the estate in a liquidation or in a reorganized enterprise, we used similar methodologies as described below to calculate enterprise value. To calculate equity from the enterprise value slight variations exist due to the expected outcome of events in a liquidation versus a going-concern. Paul Rundell's declaration describes the assumptions underlying the net proceeds or equity to the estate for a liquidation. For the reorganized enterprise, we calculated equity value for each facility first by calculating enterprise value and then adding cash and deducting the current senior mortgage debt. In both cases, we calculated enterprise value using three industry-standard methodologies: (i) offers from bona fide third-party buyers, (ii) an income approach, and (iii) a per unit approach based on recent comparable transactions.

5.1. When recent third-party offers to acquire a property exist, we utilized those offers as the basis for our enterprise valuation. This method was only used for the liquidation analysis and not the reorganized enterprise. The reorganized enterprise value is based on prospective financial performance and therefore offers to acquire do not apply.

5.2. An income approach which utilizes a capitalization rate and net operating income ("NOI") to calculate the enterprise value of each facility. Annual net operating income is divided by a figure called the capitalization rate, or cap rate. The cap rate is similar to the expected yield an investor requires for his or her investment. The lower the cap rate the lower yield the investor expects. Lower cap rates indicate more active real estate markets, higher valuations, and more investor demand. Conversely, higher cap rates reflect investors' requirement for a higher return or yield on their investment, less active real estate markets, lower valuations, and less investor demand.

5.2.1. As an example, the facilities sold in the Lone Star transaction, which was negotiated in the fall of 2008, were some of Sunwest's best facilities and had very few TICs. The cap rate for that sale was 9.1%. No major transactions have taken place since

then, but in general markets have worsened and cap rates in March 2009 are estimated to be between 9% and 10%.

5.3. Cap rates cannot be usefully applied to facilities with negative NOI or whose performance is changing rapidly. In these cases, we used per unit estimates for enterprise value taking into consideration the size, age and condition of the facility, market area, and other factors. Recent transactions suggest per unit values ranged from \$50,000 to \$110,000.

5.3.1. By way of comparison, average per-unit values were \$105,000 for the Lone Star transaction and \$67,000 for the Carolina 7 transaction.

5.4. For the liquidation analysis, described in more detail in Paul Rundell's declaration, the estimate of equity value to the estate ranged from a low of \$97 million to a high of \$145 million in an orderly liquidation. Recoveries in this analysis ranged from 3% to 13%.

5.5. In analyzing the equity value of the potential reorganized business, a number of assumptions regarding improving operations and debt principal amortization were made and are described in more detail below. Based on the projections described below and the methodologies described above, we estimate the value of the reorganized enterprise to be \$1.4 billion and after deducting mortgage debt and adding cash, we estimate the value of the equity to the estate is approximately \$500 million. Recoveries in this analysis could exceed 65%.

DEVELOPMENT OF FINANCIAL INFORMATION IN SUPPORT OF THE PLAN

6. To estimate the recovery potential claimants may receive in this plan, we determined the value of the equity of the reorganized enterprise on a going-concern basis, estimated the amount of claims, and calculated an estimated recovery percentage by dividing the total equity value of the reorganized enterprise by the estimated amount of claims.

7. We determined the enterprise value of the reorganized enterprise by developing a forecast of financial improvements, incorporating improvements to the operations described, and applying a cap rate to the forecasted NOI.

7.1. The reorganized enterprise is sometimes referred to as HoldCo. A number of factors were considered to determine which facilities are placed in HoldCo. The overriding criteria is whether the facility contributed positive value to the enterprise currently or is expected within a reasonable timeframe to contribute positive value.

7.2. The criteria considered include, *inter alia*, (i) does the facility have positive NOI, (ii) does the facility have enough NOI to cover debt service, (iii) does the facility have enough cash flow after paying debt service to pay for capital expenditures, (iv) if the facility does not have positive cash flow, are there extraordinary factors that lead us to determine the facility will improve in the near-term. For example, (a) if the facility recently opened and residents are moving in and leasing up, the facility may be retained in HoldCo; or (b) the facility may be cross-collateralized with other facilities and collectively the cross-collateralized facilities are cash flow positive.

7.3. Using a baseline actual financial performance as of April 2009, we forecast financial performance through December 2013.

7.4. The reorganized company will own 149 facilities with over 12,000 units serving over 9,600 residents. Based on the first quarter of 2009, the Company had annualized NOI of approximately \$97 million on annualized revenues of approximately \$340 million or a 28% NOI margin. During the same period, the Company's occupancy was averaging 77%.

7.5. We are in the process of preparing projections for the reorganized company assuming the following operational improvements over a 5-year period: (i) occupancy improves from about 77% to 82%, (ii) average rents improve from \$3,000 per month per resident to \$3,250 per month per resident, (iii) modest expense growth factoring in inflation and higher occupancy, and (iv) restructured long-term debt with lower interest rates than currently exist. Preliminary results show NOI growing from \$97 million to \$125 million, a 32% NOI margin or a compound annual growth rate of 6.5%.

7.5.1. As a point of reference, according to the *National Investment Center for the Senior Housing and Care Industry*, NOI margins in the assisted-living industry average approximately 35% and occupancy rates average 88%. Management is taking steps to improve the operational performance and occupancy of the reorganized company's facilities.

PROBABILITY OF PLAN SUCCESS

8.. Nationally, estimated expenditures for the assisted-living industry (including independent living and Alzheimer's care) were nearly \$40 billion in 2008. Due to favorable demographic trends, cost-containment pressures, and favorable supply/demand characteristics, the assisted-living industry has experienced moderate growth of 3% per annum over the past decade and is expected to continue at this growth rate going forward. There are an estimated 7,500 ALFs, 4,350 ILFs, and 2,900 ALZs with 452,000 units, 575,000 units, and 81,000 units, respectively in the United States serving approximately one million residents. Capacity growth has slowed considerably recently due to the credit and housing crisis after a robust expansion during the mid-1990s.

9. Despite business challenges, an economic downturn, complicated tax issues and competing stakeholder interests, this Plan provides an optimal recovery for the stakeholders by balancing the sometimes competing goals of increasing value and addressing stakeholders' interests. The Plan creates a higher recovery to stakeholders through a reorganized enterprise with a better chance to succeed as a business as compared to the existing organization or through an orderly liquidation. The Plan provides for stable a senior care organization which improves resident safety. The Plan also treats the stakeholders' competing interests reasonably fairly in light of the facts regarding security interests, alleged commingling of cash, alleged improper raising of capital, and tax consequences for many investors and employees. The reorganized enterprise has a strong chance to succeed due to strong industry fundamentals, investment in the business, accountable management, and a stable capital structure.

9.1. The reorganized business is in an attractive industry which has strong growth fundamentals. The economic downturn has dampened demand but this hesitation in seniors moving into assisted living is likely to create a backlog of senior move-ins once the economy returns to growth.

9.2. Sunwest has traditionally underinvested in its existing facilities as it chased new developments and acquisitions. The Plan provides for nearly \$24 million in investment in the facilities to make up for the past and provides for routine on-going capital expenditures. The updated facilities should allow Sunwest to care more effectively for residents, increase retention of residents, and increase rental rates.

9.3. The reorganized enterprise will need to contract with independent management to manage the facilities' operations. The management contract will have performance criteria which hold the management company accountable for meeting certain performance benchmarks. These criteria will likely consist of performance bonuses for meeting certain objectives in, for example, increased occupancy, and improved regulatory survey results. In addition, these contracts will likely provide for covenants with penalties, including reduced fees, removal of facilities from the contract or cancellation of the contract if certain criteria fail to be met. These contractual terms are meant to motivate the independent management company to improve the Company's facilities' performance.

9.4. The Plan provides for the restructuring of loans to reduce current interest rates, extend loan maturity, reduce limitations on the use of cash, loosen covenants, and remove defaults. With these changes, the business will have a stable capital structure. Based on current net operating income of the reorganized business, NOI will exceed debt service by 1.5 times. Based on the current NOI of the reorganized businesses and its capital expenditures needs, NOI is sufficient to cover fixed charges (debt service plus capital expenditures). While there remains room for improvement, these credit indicators coupled with extended maturities imply a stable

capital structure. Further, if the reorganized business meets its projections and amortizes the principal as forecast, the company will have a loan-to-value ratio of less than 70%, which will allow the Company a more likely chance to refinance when the current loans mature.

10. The success of the Plan not only depends on a viable reorganized business, it requires fairness in the treatment of the stakeholders. There are many competing stakeholders whose interests drive different corporate, legal, and tax structures. This plan balances these stakeholder interests in a form that does not seriously hinder the businesses chance to succeed. This is not to say that the plan created for the treatment of stakeholders' interests in a fair a manner has not created administrative burdens to the reorganized business. It has.

11. This plan will succeed because it treats the stakeholders fairly and is built on a solid business foundation with specific plans to turnaround the business.

I declare under penalty of perjury and the laws of the State of Oregon that the foregoing is true and correct, and that this Declaration was executed on this 25th day of August, 2009 at 12 PM EST.

/s/ V. Matthew Marcos
V. Matthew Marcos

Submitted by:

/s/ Albert N. Kennedy

Albert N. Kennedy, OSB No. 82142

Direct Dial: 503.802.2013

Email: al.kennedy@tonkon.com

Attorney for Clyde A. Hamstreet, CRO

034845/00001/1734269v1