BuchalterNemer
A Professional Law Corporation

Real Estate Alert

September 2011

Single Asset Real Estate Bankruptcies Revisited

Benjamin S. Seigel, Esq., Michael A. Williamson, Esq., and Anthony Napolitano, Esq.

In 2005, the *Bankruptcy Abuse Prevention and Consumer Protection Act* made substantial changes to the administration of bankruptcy cases that involve single asset real estate ("SARE") matters. Most notably, the 2005 Act greatly expanded the applicability of the SARE rules. Before the 2005 Act, the SARE provisions did not apply if the property's value exceeded $4 million. The 2005 Act eliminated this $4 million cap and, as a result, the SARE provisions are now applicable to a larger number of real estate cases.

The elimination of this cap coupled with the economic downturn of 2007 to 2009 has increased the importance of the SARE provisions in bankruptcy cases. Classifying a debtor's bankruptcy case as a SARE case greatly favors lenders by reducing the amount of time the debtor can spend in chapter 11. This Alert summarizes the key SARE provisions and provides a framework for dealing with issues that arise in SARE bankruptcy cases.

What is "Single Asset Real Estate"?

Real property constitutes "single asset real estate" when it is a single property or project, which generates substantially all of the debtor's gross income. SARE generally includes shopping centers, office buildings, industrial and warehouse properties, and apartment complexes, provided that the debtor's only business is operating the property and that the property generates substantially all of the debtor's income. SARE does not include family farmers, residential complexes with less than four units, or operating businesses that have revenues streams independent from the operation of the property. For example, hotels, resorts, hospitals or other types of real estate with independent revenue streams (e.g., restaurants, spas, and casinos) typically do not qualify for SARE status.

Whether a particular real estate interest constitutes a single "property" or "project" is frequently disputed in bankruptcy cases. Most bankruptcy courts have held that the SARE provisions can apply to a debtor with multiple properties where the properties are linked together in some fashion, such as a common plan or scheme involving their use. For example, courts have held that a debtor in the business of acquiring multiple parcels of land with the intent of constructing and selling homes is a SARE debtor. Courts have also held that the properties do not need to be contiguous or even geographically proximate. Multiple related properties will not defeat the applicability of the SARE rules.

The Benefit of a "Single Asset Real Estate" Classification

Determination of SARE status benefits secured lenders by significantly shortening the amount of time for the debtor to reorganize. Within 90 days of the petition date or 30 days after determination of SARE status by the court, the debtor must either (i) file a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable period of time or (ii) commence monthly payments to the secured lender in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate. These payments can be made from rents or other income generated by the property. If the debtor fails to do either, the court shall grant the secured lender relief from the automatic stay so that the lender may exercise its rights and remedies with respect to its collateral.

Strategies for Lenders Dealing with SARE Cases

Most debtors seeking to reorganize want to stay in chapter 11 for as long as possible. Their primary motivation is that the local real estate market will improve or that rents or other income derived from the property will increase thereby facilitating their reorganization. Accordingly, it is not uncommon for a debtor to willfully fail to check the "single asset real estate" box on their bankruptcy petition, even if there is no legitimate basis to assert that the SARE rules do not apply. In that event, the SARE provisions do not come into play unless an interested party seeks a determination from the court that the bankruptcy case should be administered as a SARE case.

If the debtor fails to check the SARE box, the secured lender should promptly file a motion requesting that the court determine whether the debtor's case is a SARE case. This motion should be brought promptly unless additional evidentiary support is required. Such evidence can be obtained at the 341(a) Meeting of Creditors which is an opportunity for any creditor to question the debtor's representative under oath. Additionally, lenders should

consider including within their loan documents representations and warranties where the borrower confirms that its asset(s) constitute "single asset real estate" within the meaning of Section 101(51B) of the Bankruptcy Code. Lenders should also include a covenant that the borrower will consent to SARE treatment in a bankruptcy case.

Further, real estate lenders will want to carefully consider the structure of their debtors and assets in order to take advantage of the SARE provisions in bankruptcy. While most borrowers will establish special-purpose entities to hold a single property for tax or liability reasons, if a borrower does not plan on using such a structure, the lender may want to insist on it in the event that the borrower ends up in bankruptcy. A debtor with a number of disparate properties may be able to stretch its bankruptcy case out for 12 to 15 months longer than a comparable SARE bankruptcy case.

Ultimately, if the court determines that the SARE provisions apply, then the debtor will have 30 days to file its plan or commence making interest payments. Since the interest payments are based on the nondefault contract rate of interest on the *value* of the creditor's interest in the property, some debtors have valued their properties substantially below the current fair market value in order to decrease the amount that the debtor has to pay to the secured lender. This can buy the debtor additional time if the debtor is not ready to proceed with the plan confirmation process. To avoid this inequitable result, secured lenders can seek a valuation of the collateral under the Bankruptcy Code at any time, which will result in an increase in the monthly payment that the debtor is required to pay. Such an increase may be too much for the debtor to bear resulting in a post-petition default and ideally relief from the automatic stay.

Finally, the debtor's failure to comply with the SARE provisions is just one means for obtaining relief from the automatic stay. Secured lenders may also seek relief from the automatic stay at any time during the bankruptcy case for "cause," which includes lack of adequate protection, bad faith, or waste. Lenders may also seek relief from the automatic stay if there is no equity in the property and the property is not necessary for an effective reorganization.

Conclusion

The 2005 Act's elimination of the $4 million cap for SARE cases and the recent economic downturn have brought single asset real estate cases into the forefront of recent reorganization attempts. With proper planning, a lender can take advantage of the SARE provisions to minimize the amount of time to administer the bankruptcy case.

While this Alert highlights some of the key aspects of SARE cases, it is not a complete dissertation on the subject and should not be construed as the provision of legal advice. Please contact us with any questions or if you would like more information.

Ben Seigel, Shareholder
Insolvency & Financial Solutions Practice Group
213.891.5006
bseigel@buchalter.com.

Michael Williamson, Shareholder
Real Estate Practice Group
213.891.5074
mwilliamson@buchalter.com.

Anthony Napolitano, Senior Counsel
Insolvency & Financial Solutions Practice Group
213.891.5109
anapolitano@buchalter.com.