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Tips for Lenders in Single-Asset Real Estate Bankruptcy Cases

Lenders experiencing collection and/or enforcement delays caused by borrowers who file for bankruptcy protection can, in appropriate circumstances, shorten and mitigate these delays by having the bankruptcy designated as a Single-Asset Real Estate (SARE) case. By monitoring the case and, where necessary, filing motions with the court, the lender can efficiently recommence enforcing its rights against collateral owned by single-asset debtors. Moreover, knowing the bankruptcy rules and procedures governing SARE cases will enable lenders to make informed decisions when handling loan enforcement measures for non-performing commercial loans involving borrowers who own single projects or properties.

Qualifying as a single-asset real estate bankruptcy

Congress first enacted SARE provisions in 1994 to address the unfairness of lengthy delays faced by secured lenders in bankruptcy cases where the debtor owns a single project or property. Due to 2005 Amendments to the Bankruptcy Code eliminating previous requirements on the size of the secured debt at issue, projects of all sizes now qualify for SARE status. For a bankruptcy case to be designated as a SARE case, Section 101(51B) of the Bankruptcy Code requires that three elements be met:

1. The property must be "real property constituting a single property or project";
2. The property must account for "substantially all of the gross income of the debtor";
3. The debtor has "no substantial business … other than the business of operating the real property and activities incidental".

These criteria are not without ambiguity. For example, in determining what constitutes a "single project" for purposes of SARE case, courts have held that a single project may consist of more than one parcel of real estate provided that such parcels are "linked together in some fashion in a common plan or scheme involving their use" and that the core requirement is the existence of a "common purpose."[1]

With respect to the second criterion—that the property must account for substantially all of the gross income of the debtor—it is critical that the revenue derives from the property itself and not from business operation that occur on the property. In other words, the "revenues received by the owner must be passive in nature," which generally amounts to simply collecting rents or engaging in other incidental activities such as arranging for

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The firm's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Co-chaired by **K. Lee Riley, Jr.** and **Scott W. Foley**, the firm's **Banking & Financial Services Group** represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

Mr. Riley advises financial institutions in commercial lending transactions; Mr. Foley advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With over thirty years of experience in the banking industry between them, Mr. Riley and Mr. Foley appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

For more information about the Banking & Financial Services Group, contact Mr. Riley at LRiley@ShapiroSher.com or Mr. Foley at SWF@ShapiroSher.com.

maintenance or performing limited marketing activities to sell the property.[2]

How secured lenders benefit from special automatic stay provisions for SARE cases

As in other bankruptcy cases, the filing of a SARE case creates an automatic stay that bars creditors from taking action to collect debts due from the debtor. However, even though the debtor in a SARE case still gets some breathing room, the intent of the SARE provisions is to streamline and expedite the bankruptcy process. In SARE cases, the automatic stay is generally only imposed until the later of (a) 90 days after the filing of a voluntary bankruptcy, or (b) 30 days after the court designates a bankruptcy filing as a SARE case, although the court may possess the discretion to extend some time periods.

At the conclusion of this 90-day (or 30-day) period, the bankruptcy court is empowered to modify or terminate the automatic stay (for example, to permit the secured creditor to pursue or continue a foreclosure). In order to prevent this from happening, the SARE debtor must (a) propose a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time, or (b) have commenced making monthly payments to the secured lender at the non-default interest rate on the secured value of the real estate.

With respect to proposing a confirmable plan, the standard is not a precise one, and the debtor is generally required to produce some evidence that its plan could be confirmed by a reasonable bankruptcy judge. Some courts, however, take a more liberal approach to find compliance even when a plan has not actually been filed within the time period.[3] As to the interest payment option, the debtor can utilize rents or other income generated by the property (that would otherwise constitute cash collateral subject to the restrictions imposed thereon). It is important to note that while the provision as written states that the court shall terminate, modify, or condition the automatic stay, case law diverges on whether, absent strict compliance, (a) the stay should immediately be lifted in its entirety or (b) the court retains some discretion to tailor relief (such as imposing a drop-dead date for confirmation of a plan).[4]

Lender motions in SARE bankruptcies

When a single-asset or single-project debtor files a bankruptcy case, the secured lender should first determine whether the debtor has designated the bankruptcy as a SARE case on the bankruptcy petition. If not, the lender should confer with legal counsel to determine whether it would be beneficial to have the case designated by the court as a SARE case because, as explained above, the SARE rules were intended to favor secured creditors by protecting them against lengthy delays in enforcement. This can be done by promptly filing a written motion with the bankruptcy court. A SARE determination motion should seek entry of an order determining that the debtor is a SARE entity retroactively to the filing of the bankruptcy petition (*i.e., nunc pro tunc*, in legalese).

In addition to SARE determination motions, when a SARE debtor fails to comply with Section 362(d)(3) by filing a plan or commencing monthly payments within 90 days, secured lenders should be prepared to file motions for relief from the automatic stay. While the debtors' noncompliance with Section 362(d)(3) is one ground for relief from the stay, there are also other grounds for relief, so lenders should consult with counsel about the details of the loan history. In some cases, valuation evidence (including appraisals) will be needed to bolster a case for lifting the stay in a SARE case where there is a dispute as to whether the debtor has violated Section 362(d)(3).

In conclusion while courts have sought to retain flexibility in handling the accelerated timetable provided for in Section 362(d)(3), with careful planning, secured lenders can use the SARE rules to their benefit in single-asset bankruptcy cases by avoiding costly enforcement delays.

For further information on SARE cases, contact Scott W. Foley at SWF@ShaprioSher.com.

[1] See e.g. *In re McGreals*, 201 Br. 736, 742 (Bankr. E.D. Pa. 1996); *Philmont Dev. Co.*, 181 B.R. 220, 224 (E.D. Pa. 1995).
[2] See *In the Matter of Scotia Pac. Co., LLC*, 508 F.3d 214, 221 (5th Cir. 2007).
[3] See, e.g., *In re Harmony Holdings, LLC*, 393 B.R. 409 (Bankr.D.S.C. 2008); *In re Windwood Heights, Inc.*, 385 B.R. 832 (Bankr.N.D.W.V. 2008).
[4] Compare *In re LDN Corp.*, 191 B.R. 320, 323 (Bankr.E.D.Va. 1996) with *In re Planet 10*, L.C., 213 B.R. 478 (Bankr.E.D.Va. 1997).