

SINGLE ASSET REAL ESTATE  
BANKRUPTCY & RECENT DEVELOPMENTS

P.C.

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## I. Single Asset Real Estate

- A. **§ 101(51B)**: Real property constituting a single property or project, other than residential real property with fewer than 4 units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.
- a. Prior to the 2005 BAPCPA amendments to the bankruptcy code, the definition of single asset real estate cases was limited to debtors who owed mortgage debt of no more than \$4 million. BAPCPA removed this monetary cap.
- B. Property that qualifies as Single Asset Real Estate must satisfy three conditions:
- a. **Income must derive primarily from operation of the real property**
- i. **APARTMENT BUILDINGS** (with at least 4 residential units): *In re Kkemko, Inc.*, B.R. 47 (Bankr.S.D. Ohio 1995) (because residential property with fewer than four units is specifically excluded from § 101(51B), other residential property including apartment buildings must be included in the definition of single asset real estate. Apartment buildings derive income primarily from operation of the real property by collecting rent from its tenants).
- ii. **OFFICE BUILDING**: *Id.* The court concluded that income from rental of office space is income from the operation of the property, not income from other business activity.
- iii. **STRIP-MALL SHOPPING CENTER**: *News and Insights: Defining “Single Asset Real Estate Debtors” Under the Amended Code*, (2006) (when owned by an entity whose sole purpose is to operate the real estate with money generated by the real estate, a strip mall is a single asset real estate).
- iv. **UNDEVELOPED LAND**: *In re Syed*, 238 B.R. 133, 140 (Bankr. N.D. III.1999) (finding that property formerly used as rental property but that was vacant at the time of the debtor’s bankruptcy constituted single asset real estate regardless of the fact that developed land generated no income).

b. **Single property or “single project”**

- i. Multiple properties constitute a “single project” when a group of properties have a related connection and purpose in a common plan or scheme involving their use. *In Re The McGreals*, 201 B.R. 736, 742 (Bankr.E.D. Pa.1996); *see also In re Philmont Dev.Co.*, 181 B.R. 220, 224 (Bankr.E.D. Pa 1995) (interpreting the term “single project” as broad enough to encompass a string of semi-detached houses).
- ii. To constitute a single project, the debtor’s properties do not have to be geographically proximate. *In Re Club Golf Partners, L.P.* No. 07-40096, 2007 WL 1176010, at \*5 (E.D. Tex.Feb.15, 2007) (holding that a debtor owning separate tracts of property collectively constituted a “single property,” however, the debtor was not a single asset real estate debtor because it generated substantial income from activities not related to the real property (i.e. renting golf carts and selling merchandise)).

c. **No business other than the operation of the Real Property and Activities Incidental Thereto**

- i. In *In re CBJ Development, Inc.*, 202 B.R. 467(9<sup>th</sup> Cir. B.A.P.1996), the court concluded that the bar, restaurant, and gift shop inside the debtor’s **hotel** constituted “substantial business....other than the business of operating the real property and the activities incidental thereto.” Therefore, the hotel did not qualify as a single asset real estate. Although the court rejected debtor’s contention that the mere operation of its hotel constituted “operation of a business “other than the business of operating the real property,” the court relied on the debtor’s additional substantial businesses in concluding that the property was not a single asset real estate.
- ii. In *In re Larry Goodwin Golf, Inc d/b/a Uwharrie Gold Club*, 219 B.R. 391 (Bankr. M.D.N.C 1997), the court held that a **golf course** was not a single asset real estate because “its activities constituted operating a business on the property rather than simply holding real property solely for income.” Debtor operated a golf course with associated golf car rentals, a pool, provided concessions, and owned adjacent property that was currently for sale.

- iii. In *In re Kkemko, Inc.*, B.R. 47 (Bankr.S.D. Ohio 1995), the court held that the function of a **marina** does not fall within congress’s definition of “single asset real estate.” The court concluded that the marina was not a single asset real estate due to its substantial businesses other than the mere operation of renting moorings. The marina stored, repaired, and winterized boats, and provided showers and a pool, sold gas, and sold concessions.
- iv. **Hospitals, Ranches, and manufacturing facilities** fall outside the scope of single asset real estate because they operate substantial businesses other than the operation of the property. John C. Murray, *The New Bankruptcy Act: Observation on Some of the Provisions Affecting Real Estate*, 19 Dec. Prop. And Prob. 43 (2005).

## II. Relief from Automatic Stay

- A. **§ 362(d)(1)and(2):** After notice and hearing, the court shall grant relief
  - (1) for lack of adequate protection;
  - (2) with respect to a stay of an act against property, if
    - (A) the debtor does not have an equity in the property; and
    - (B) the property is not necessary to an effective reorganization.

## III. Relief from Automatic Stay in Single Asset Real Estate Cases (applicable only to single asset real estate)

- A. **§ 362(d)(3):** On request of a party in interest and after notice and hearing, the court shall grant relief from the stay... with respect to a stay of an act against single asset real estate..., unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within the 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later-<sup>1</sup>
  - (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
  - (B) the debtor has commenced monthly payments that-
    - (i) may, in the debtor’s sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate and

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<sup>1</sup> The 2005 BAPCPA amendment to § 362(d)(3), added the phrase “or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later.”

- (ii) are 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.

**B. Single Asset Real Estate Debtors subject to § 362(d)(3) Relief from Automatic Stay are not restricted to that Section and are also subject to § 362(d)(1) and § 362(d)(2)**

- a. In *In re Pacific Rim Investments, LLP*, 243 B.R. 768, 772 (D.Colo. 2000), the court rejected the debtor's argument that § 362(d)(3) is the exclusive provision by which relief from stay can be obtained as to a single asset real estate.

**C. Purpose of 90 day filing Requirement for Single Asset Debtors**

- a. The purpose of § 362(d)(3) is to address perceived **abuses in single asset real estate cases** in which debtors, by filing for bankruptcy relief, have attempted to delay mortgage foreclosures even when there is little chance that they can reorganize successfully. *See 3 COLLIER ON BANKRUPTCY* ¶ 362.07[5][b] (15<sup>th</sup> ed. Rev. 2007).
- b. There is no time requirement in the Bankruptcy Code for the filing of a plan for any other kind of Chapter 11 case. *See, John Butler III, A Singular Provision of the Bankruptcy Code*, 6 DePaul Bus. & comm. L.J. 205 (2008).

**D. Consequence of failing to meet the 90 day requirement**

- a. Although the court may technically condition or modify the stay rather than terminate it, legislative intention was to terminate the stay when the debtor neither proposes a viable plan nor makes payments to the secured party. As such, courts are split over whether they must terminate or may terminate when the debtor fails to timely file or make payments. *See 3 COLLIER ON BANKRUPTCY* ¶ 362.07[4][b] (15<sup>th</sup> ed. Rev. 2007).
  - (i) In *In re Archway Apartments, Ltd.*, 206 B.R. 463 (Bankr.M.D.T.N 1997), the court stated that it has discretionary power to terminate, annul, modify or condition the stay. Therefore, the court is free to fashion the relief appropriate for the creditor's failure to meet § 362(d)(3)(A) or (B). In this case, debtor made an "honest" error by filing the plans outside the 90 day period. Clearly, this court focused on the plain language meaning of § 362(d)(3) in determining that it possesses discretionary power to choose any form of relief from stay, and not limit itself to exercising termination as a sole form of relief.

**E. Cause for extension of 90 day period**

- a. Courts often measure the existence of **cause** by weighing the debtor’s reason for seeking an extension against the congressional intent of the 90 day limitation. Thus, in many instances cause would consist of “extraordinary” circumstances. *See, In re Heather Apartment Ltd. P’ship*, 366 B.R. 45 (Bankr. D. Minn. 2007).
  - (i) In *In re Heather Apartment Ltd. P’ship*, 366 B.R. 45 (Bankr. D. Minn. 2007), the court denied debtor’s timely filed motion to defer commencement of interest payments. The court held that debtor had not shown cause for relief by merely asserting blanket bankruptcy protections and by offering into evidence a “very thin” one page alleged “letter of intent” to purchase the property.
- b. **Impact of Current Economic Conditions on extensions**
  - (i) The current recession(shrinking tenant rosters and depreciation of real estate) coupled with the unavailability of investment capital will likely impair a debtor’s ability to demonstrate cause for an extension of the 90 day period, particularly in light of congressional intent. *See infra*, III(C)(a) of this outline.

**F. Motions for relief from automatic stay pursuant to § 362(d)(3) should not be filed before the debtor’s 90-day period has expired.**

- a. In *Hope Plantation Group, LLC*, 2007 WL(Bankr. D.S.C. June 14, 2007), the bankruptcy court denied a motion for stay relief without prejudice because the motion was filed 73 days after the petition date. The court found that the motion was premature because it was filed before the 90-day “breathing space” set forth in § 362(d)(3). The fact that the hearing was held on the 93<sup>rd</sup> day after petition was filed was irrelevant.

**G. As the market continues to decline, courts are more likely to grant an increasing number of stay relief motions.**

- a. Debtors will have difficulty demonstrating adequate protection of the mortgagee pursuant to § 362(d)(1) and (2) and filing a confirmable plan or making monthly payments in accordance with § 362(d)(3)demonstrating adequate protection of the mortgagee, that it can confirm a plan in a reasonable period of time
  - (i) In *In Re Sterling Development Inc* 243 Bankr.(D. New Mexico, 2009), the court determined that the property of a single asset real estate debtor was depreciating in value even though no proof was offered. The court stated that,

“although no testimony was offered to quantify the rate of depreciation of the property, the value of the property is declining given the current economic market conditions for sales of commercial real estate.”

#### IV. Relief from Stay as a result of attempt to scheme, delay, and defraud creditors

- A. § 362(4): If the court finds that the filing of the bankruptcy petition was part of a scheme to delay, hinder, and defraud creditors, the court will grant creditors stay relief.

#### V. Confirmation Issues

##### A. § 1111(b) Election

- a. The claims of the electing class are treated as secured to the extent allowed, notwithstanding the bifurcation of the secured and undersecured claims otherwise required by 506(a).
- b. Under 1129(a)(7)(B), an electing creditor, retains its lien to secure the full amount of its claim and must receive deferred cash payments totaling at least the amount of the claim, having a present value of at least the actual value of the collateral.
- c. The electing creditor waives its deficiency claim as well as its attendant voting rights.
- d. While making the election was designed to afford the creditor the option to take advantage of a rising market for its collateral, it appears that in practice, creditors are exercising their remedies to obtain possession of their collateral.

##### B. Feasibility

- a. The recession and frozen credit market have manifestly impaired a debtor's ability to demonstrate financial wherewithal to meet plan commitments.

#### VI. Current Trends and New Alternatives

- A. **The plummeting market has deterred many commercial debtors from reorganizing under Chapter 11. More cases are progressing straight into**

**liquidation because banks are reluctant to grant DIP financing, even at 20% rates.** See, Mark L. Claster, Duffield Meyercord, *As DIP Financing Falls by the Wayside, Restructuring Options Still Exist*, ABF Journal, Mar/Apr 2009, at 23.

- B. DIP loans have dropped by nearly 65% since the second quarter of 2008 (based on research conducted by Deal Pipeline) See, MarkL.Claster, Duffield Meyercord, *As DIP Financing Falls by the Wayside, Restructuring Options Still Exist*, ABF Journal, Mar/Apr 2009, at 23.
- B. Recent case law and data, suggest that mortgagees are more eager to repossesses their undervalued property than to work out a reorganization plan with debtor. See, *In In Re Sterling Development Inc 243 Bankr.*(D. New Mexico, 2009) (where creditor sought relief from stay in 2009).
- C. **Loan-to-own** deals are becoming more popular as the market continues to decline. A loan-to-own typically starts when an entity buys a company's outstanding debt, usually at a discount, and then negotiates terms to convert the debt to equity. Mark L. Claster, Duffield Meyercord, *As DIP Financing Falls by the Wayside, Restructuring Options Still Exist*, ABF Journal, March/Apr 2009
  - a. **Disadvantages of loan-to-own:** This process of converting the debt to equity can take considerable time. If the investor fails to gain control of the company, other creditors might question such actions.
  - b. It is not entirely clear whether these loan-to-own deals have gained popularity in the single asset real estate market. However, it is quite likely that they will.

## VII. Conclusion

Despite the good intentions of Congress to prevent abuses by enacting § 362(d)(3), it has clearly made it more difficult for a single asset real estate debtor to reorganize, especially in light of the current economic conditions. Indeed, the recession and lack of financing have rendered Chapter 11 relief itself a less attainable, if not impossible remedy for an owner of single asset real estate.