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## WEATHERING THE STORM Single Asset Real Estate Cases

From 2010 until 2013, approximately \$1.4 trillion<sup>1</sup> of commercial real estate loans will mature. Notably, it has been estimated that nearly 50 percent<sup>2</sup> of the loans are under water and that a wave of defaults and bankruptcies may occur. Because many of the commercial real estate loans are secured by a single parcel of real estate, it is critical that lenders and debtors be aware of the rules governing Single Asset Real Estate (SARE) Chapter 11 cases.

The Bankruptcy Code establishes criteria for determining whether real property is SARE:

- The real property must constitute a single property or project;
- The property must not be residential real property with fewer than four residential units;
- The real property must generate substantially all of the gross income of a debtor;
- The debtor must not be a family farmer; and
- The debtor must not conduct any substantial business other than operating the real property and activities incidental.<sup>3</sup>

For example, courts have held that real estate development companies, residential home builders, commercial property lessors and residential property lessors with four or more residential units are SARE debtors.

Companies that use real estate to conduct businesses are not SARE debtors. In one case,<sup>4</sup> the court held that the debtor, owner of approximately 200,000 acres of private timberland, derived its income from harvesting and selling timber. The debtor not only employed more than sixty employees, but also hired independent contractors to help with its business. "Sophisticated operations" (planning, growing, and maintaining the timber) occurred on the timberland. The court concluded that the debtor's sale of timber was an activity extending beyond the sale or lease of the underlying land and that the debtor was not a SARE case. Marinas and golf courses have also been held not to be SARE.

A SARE designation is relevant because the Bankruptcy Code subjects SARE debtors to an expedited timeframe in which they must either file a confirmable Chapter 11 plan or begin making payments to creditors.<sup>5</sup> In a SARE case, a reasonably confirmable plan must be filed within the later of 90 days after the petition date or 30 days after the debtor's property is designated SARE. Alternatively, the debtor may choose to make cash payments equal to the non-default contract interest rate. If the debtor fails to meet either of these requirements, unless the court continues the automatic stay, for cause, within such 90 day period, the automatic stay is lifted, and the secured creditor may foreclose. The provision attempts to shift risk of delay from the secured lender to the debtor.

<sup>1</sup> See <http://www.realestateindustrynews.com/real-estate-market/1-4-trillion-in-commercial-loans-coming-due-nearly-half-are-underwater/> (last visited Feb. 22, 2010).

<sup>2</sup> *Id.*

<sup>3</sup> 11 U.S.C. § 101(51B).

<sup>4</sup> *Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (In re Scotia Pac. Co.)*, 508 F.3d 214 (5th Cir. 2007).

<sup>5</sup> 11 U.S.C. § 362(d)(3).

SARE debtors may be able to “cram down” claims of the secured lender over the objection of the secured lender. In the case of *In re Simons* the court stated:

For example, if a secured creditor held a lien on ten lots in a subdivision, it is possible that the plan would be fair and equitable to that creditor if it provided for the sale of three lots with the proceeds being applied to the secured claim, the return of four lots with the value thereof being applied to the secured claim, and the retention of three lots with a remaining secured claim being paid over time such that the present value of the income stream equaled the value of the secured creditors interest in the remaining lots.<sup>6</sup>

Lenders should also be aware that recent decisions in the *Philadelphia Newspapers*,<sup>7</sup> *Pacific Lumber*,<sup>8</sup> and *Fontainebleau Hotel*<sup>9</sup> cases appear to limit the right of secured creditors to credit bid at sales of the secured creditors’ collateral in bankruptcy cases. In addition, *Pacific Lumber* and *Philadelphia Newspapers* seem to endorse an expansive view of the “indubitable equivalent” cram down method which gives the bankruptcy judge wide discretion to determine the treatment of secured claims.

As commercial real estate loans continue to deteriorate, both lenders and borrowers need to be aware of their rights in these SARE cases.

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<sup>6</sup> *In re Simons*, 113 B.R. 942, 946 (Bankr. W.D. Tex. 1990).

<sup>7</sup> *In re Philadelphia Newspapers*, No. 09-11204 (Bankr. E.D. Pa. Nov. 10, 2009).

<sup>8</sup> *In re Pacific Lumber*, No. 08-40746 (5th Cir. Sept. 29, 2009).

<sup>9</sup> *In re Fontainebleau Las Vegas Holdings, LLC*, No. 09-2148-BKC-AJC (Bankr. S.D. Fla. Dec. 7, 2009).