



**BANKRUPTCY CONSIDERATIONS FOR HOUSING AND
CONDOMINIUM DEVELOPERS AND THEIR SECURED CREDITORS**

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Many have speculated about the viability of new housing and condominium developments in today's depressed economy and current real estate slump and wondered whether these development projects will end up in bankruptcy. The benefit that can be obtained from a bankruptcy filing in these difficult situations may depend in large part upon whether the entity that owns the project will be deemed a "single asset real estate" debtor, as defined in the Bankruptcy Code. This determination is critical because secured creditors in single asset real estate cases are entitled to favorable treatment that severely hampers a debtor's ability to reorganize. In single asset real estate cases, the debtor must commence monthly interest payments to its secured creditors or file a plan of reorganization no later than 90 days after the filing of the bankruptcy case, both of which may be difficult for an entity relying on the development and sale of its real estate for income.

Special provisions governing single asset real estate cases were first enacted in 1994, but had limited impact prior to 2005 because the provisions applied only when the debtor's secured debt did not exceed \$4,000,000. This limitation meant that larger, higher profile developments were exempt. In the 2005 amendments to the Bankruptcy Code in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Congress amended the definition to exclude family farmer cases and to remove the cap on secured debt. The lifting of the cap means that many projects that previously would have been exempt, including multi-story condominiums and large residential developments, may now qualify as single asset real estate cases.

Determining whether a particular bankruptcy will qualify as a single asset real estate case may not always be simple. In light of this fact, developers and secured lenders should seriously consider actions designed to increase the chance that a particular project either will, or will not, fall within the Code's definition.

The Bankruptcy Code defines "single asset real estate" to mean:

. . . real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.



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11 U.S.C. § 101(51B). Under this definition, to qualify as single asset real estate, the debtor must satisfy three elements: (1) the debtor must have real property that constitutes a “single property” or a “single project”, and that is not residential real property with fewer than 4 residential units; (2) the real property generates substantially all of the gross income of the debtor; and (3) the debtor does not conduct substantial business on the property other than operating the real property and conducting activities incidental thereto. *Ad Hoc Group of Timber Noteholders v. Pac. Lumber Co. (in re Scotia Pac., Co., LLC)*, 508 F.3d 214, 220 (5th Cir. 2007).

The first element of the definition is satisfied if the particular development is the debtor’s only real property asset. Presumably, this requirement would not be met if the debtor owns two or more unrelated projects. For this reason, developers may want to rethink a common practice of putting all of their projects under the ownership of separate entities, and secured lenders may want to insist even more that their development borrowers be single purpose or single project entities.

Owning more than one parcel of real estate may not be enough to take a developer out of the single asset real estate definition, because several parcels of real property that are tied together under one development scheme may constitute a “single project” under the Code’s definition. See, e.g., *In re Philmont Dev., Inc.*, 181 B.R. 220, 224-25 (Bankr. E.D. Pa. 1995)(development of a series of virtually identical semi-detached houses was considered a “single project”); *In re Rear Still Hill Road, LLC*, 2007 WL 2935483 (Bankr. D. Conn. Oct. 5, 2007)(debtor had a common plan to develop a 50 acre parcel and 7 acre parcel together in one single-family home development); cf., *In re McGreals*, 201 B.R. 736, 741-43 (Bankr. E.D. Pa. 1996)(Holding that two adjacent parcels lacked the requisite common plan or scheme for development and use where one parcel was developed and leased and the other was wholly undeveloped, and the debtor had no plans to combine the two properties in any way). Further, a “single project” under the Code may include multiple sub-projects, especially if the real estate is still in the development stage. See, e.g., *In re Webb MTN, LLC*, 2008 WL 656271 (Bankr. E.D. Tenn. March 6, 2008)(Resort development covering five separate, but contiguous, parcels of real estate with a concept plan for two golf courses, a luxury hotel, a convention center, a spa, a retail commercial center, and single-family homes and condominiums, many of which projects overlapped boundary lines, was determined to be one single land development project; however, the court found relevant that the land remained largely undeveloped at the time.).

The typical residential real estate developer is not likely to escape the single asset real estate definition by contesting the second and third elements.

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For example, in *In re Kara Homes, Inc.*, 363 B.R. 399, 402-7 (Bankr. D. N.J. 2007), the affiliated debtors, each owning separate real estate development projects for the construction of single family homes and condominiums, argued that they were not single asset real estate debtors because they conducted other substantial business and activities, such as acquiring developable land, designing homes and/or condominiums, arranging for construction, and then marketing the homes. The court, however, disagreed. *Id.* at 406. It found that such actions were merely incidental to the debtors' efforts to sell the homes or condominiums and they did not constitute the conduct of other "substantial business" on the property. *Id.* The court held that the Kara Homes debtors were single asset real estate debtors. *Id.*

Businesses that have been held to not satisfy the third element regarding the conduct of substantial other business on the property include: (1) the business of growing, replenishing and selling timber, *In re Scotia Pacific Co., LLC*, 508 F.3d 214 (5th Cir. 2007); (2) operation of a golf course, which sold memberships, charged green fees, rented golf carts, sold merchandise in its pro shop, and food and beverages in its restaurant and bar, and charged fees for golf lessons, *In re Club Golf Partners, L.P.*, 2007 WL 1176010 (E.D. Tex. April 20, 2007); (3) operation of a marina, which rented moorings for boats, stored, repaired and winterized boats, provided showers and a pool as well as other activities for those who moored their boats, and intended to begin selling gas, *In re Kkemko, Inc.*, 181 B.R. 47, 51 (Bankr. S.D. Ohio 1995); and (4) operation of a hotel, which had 89 rooms to rent, served continental breakfast, maintained a swimming pool and common areas, and provided phone and internet service, room cleaning and towel laundering services, *In re Whispering Pines Estate, Inc.*, 341 B.R. 134, 136 (Bankr. D. N.H. 2006).

Developers may want to consider operating income-generating businesses on their real estate, such as a convenience store or fitness center that charges membership fees. These activities should remove the debtor from the definition of single asset real estate if the revenues are sufficient to establish that the debtor does not generate substantially all of its gross income from the real property. Operation of these businesses would also support an argument that the debtor conducts substantial business other than operating the real property and conducting activities incidental thereto. At present, the case law is insufficient to predict with any certainty how much revenue or what types of business operations are sufficient to remove a condominium or housing development case from the single asset real estate definition.

The reason single asset real estate status matters is that the Bankruptcy Code imposes certain requirements on the debtor in a single asset real estate case that are often difficult, if not impossible, to meet. Should the debtor fail to meet the requirements, the secured creditor may quickly obtain relief from the automatic stay to foreclose on its real property collateral.



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The filing of a bankruptcy case imposes an automatic stay against any acts to collect against or enforce a lien against property of the bankruptcy estate, among others prohibited actions. 11 U.S.C. § 362. This means that once the developer debtor files for bankruptcy, the secured creditor cannot foreclose on its real property collateral, except by first obtaining permission of the bankruptcy court. Obtaining this permission is substantially easier in single asset real estate cases.

At the time Congress added the definition for single asset real estate, it also added section 362(d)(3) to the Bankruptcy Code. In re Kkemko, Inc., 181 B.R. at 49. Courts have interpreted this section's meager legislative history as suggesting "that Congress was concerned about the relative unfairness of lengthy delay in Chapter 11 cases involving single-asset real estate projects; that one of its goals [is] to expedite the proposal of meritorious plans of reorganization in such cases; and that where the case does not early kick forward toward confirmation, a debtor must compensate its mortgagee for the time-value of the mortgagee's debt investment, by the payment of interest" In re Heather Apts. Ltd. P'ship, 366 B.R. 45, 49-50 (Bankr. D. Minn. 2007)(internal citations omitted).

Section 362(d)(3) of the Bankruptcy Code requires that a secured creditor be granted relief from the automatic stay upon request if the single asset real estate debtor does not, within 90 days after entry of the order for relief (i.e., typically, the order for relief is considered entered simultaneously with filing of the petition) or 30 days after the court determines that the debtor is a single asset real estate debtor, whichever is later, (i) file a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time or (ii) commence monthly payments of interest to its secured creditors. 11 U.S.C. § 362(d)(3). Judgment lienholders and unmatured statutory lienholders are not entitled to the interest payments, *id.*, but they may benefit from 362(d)(3) if the debtor does not timely file a reasonably confirmable plan, see *In re Windwood Heights, Inc.*, 2008 WL 519410, *2-3 (Bankr. N.D. W. Va. Feb. 25, 2008). Stay relief may be in the form of foreclosure or the court may modify or condition the stay in some way, such as to place a deadline on confirmation of the debtor's plan. See *Condor One v. Green Acres, Ltd. (In re Archway Apartments, Ltd.)*, 206 B.R. 463, 465 (Bankr. M.D. Tenn. 1997). Some form of relief, however, is mandatory if the conditions of 362(d)(3) are not met. *Id.*



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Section 362(d)(3) greatly increases the chances that a secured creditor will be able to obtain the right to foreclose on a development project after a bankruptcy filing. In non-single asset real estate cases and in single asset cases when the elements of section 362(d)(3) do not apply, a party requesting stay relief must show one of the following: (i) cause, such as lack of adequate protection of its interest in property, § 362(d)(1); (ii) that the debtor has no equity in the property and the property is not necessary to an effective reorganization, § 362(d)(2); or (iii) that the filing of the petition was part of a scheme to delay, hinder and defraud creditors, § 362(d)(4). Unless it is clear that the debtor has no equity in the property, the secured creditor in a non-single asset real estate case may have to engage in extended litigation and discovery before the court determines that relief from stay should be granted.

If the single asset real estate debtor is dependent on its loans from secured creditors and is not yet earning income, or earning insufficient income, from its real estate development, it may not be able to make and sustain the monthly interest payments necessary to forestall stay relief. Likewise, if the developer debtor does not have adequate resources of its own to fund a plan of reorganization with increased equity or if it cannot show that its development is close enough to completion to begin earning income sufficient to fund a plan of reorganization, the debtor may not be able to stave off stay relief by proposing a plan of reorganization with a reasonable possibility of being confirmed.

Both developer debtors and their secured creditors should be aware of the requirements and deadlines placed on single asset real estate debtors. If the debtor wants to retain its real property and reorganize, ideally it should have a plan in place at the outset of its bankruptcy case for funding monthly interest payments to secured creditors or for quickly filing a viable plan of reorganization. Debtors should also note that if they want an extension of the 90 day period in section 362(d)(3), they must request it from the court in an adequate amount of time for the court's order granting the extension to be entered within the 90-day period. 11 U.S.C. § 362(d)(3); see *In re Heather Apts. Ltd. P'ship*, 366 B.R. 45, 47 (Bankr. D. Minn. 2007).

Secured creditors should consult with their counsel if one of their real estate development customers files bankruptcy but does not voluntarily acknowledge its single asset status. The creditor may want to seek court determination of the single asset status, so that it can have the benefits of monthly interest payments or perhaps expedited relief from stay.