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FEBRUARY/MARCH 2018

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Steven A. Meyerowitz

A POTENTIALLY MOMENTOUS DECISION: SECOND CIRCUIT EXPLAINS HOW TO CALCULATE CHAPTER 11 CRAMDOWN INTEREST RATE

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VOLUME 14

NUMBER 2

FEB./MAR. 2018

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Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

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An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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Outcomes in Single Asset Real Estate Chapter 11 Cases

*By Jerry L. Switzer, Jr., Jason A. Nagi, and James H. Billingsley**

This article tracks single asset real estate Chapter 11 bankruptcy cases across the nation in which the real estate is owned by an entity with assets above \$1 million, and analyzes and compares movement, timing, and results-based outcomes, collectively and comparatively, for all 50 states.

Single asset real estate Chapter 11 cases provide a window into the distressed real estate market. This Report tracks single asset real estate (“SARE”) Chapter 11 bankruptcy cases across the nation in which the real estate is owned by an entity with assets above \$1 million (the “Index Debtors”), and analyzes and compares movement, timing, and results-based outcomes, collectively and comparatively, for all 50 states.¹

In preparing this Report, we analyzed 228² Index Debtors in 2015 and learned some interesting information. For example, the highest percentage of SARE filings involved multifamily properties; the majority, by far, of case outcomes resulted in dismissal; a sale of property occurred in less than one quarter of the cases, but had the second highest likelihood of success; and although a plan of reorganization was the third most likely outcome, it took the longest to achieve.

* Jerry L. Switzer, Jr., is a shareholder at Polsinelli PC, representing senior secured lenders, mezzanine lenders, and other creditors, especially in bankruptcy and insolvency situations. Jason A. Nagi is a shareholder at the firm representing both traditional and non-traditional lenders in state, federal, and bankruptcy courts and pre-litigation workouts. James H. Billingsley is a shareholder at the firm handling matters ranging from complex business and bankruptcy to commercial disputes, asset acquisitions, and financial services matters. The authors may be contacted at jswitzer@polsinelli.com, jnagi@polsinelli.com, and jbillingsley@polsinelli.com, respectively.

¹ This Report relies on data provided by TrollerBK.com and analyzes the cases used to calculate the Polsinelli/TrBK Real Estate Distress Research Index (the “Index”). The Index has its baseline in 2010, and measures the comparative increase or decrease in real estate Chapter 11 filings since that time. Predictably, with the baseline set right at the end of the Great Recession, the Index shows that real estate distress has fallen significantly since 2010.

² There were two sets of Chapter 11 cases filed by related Index Debtors in California in which each Debtor held a tenant-in-common (“TIC”) interest in a common property. For purposes of this Report, we treated each set of cases as a single case involving a single property with a single Index Debtor, which resulted in an adjusted total number of cases in 2015 from 264 to 228.

METHODOLOGY

The first step in preparing this report was to examine publicly filed and available bankruptcy documents of the Index Debtors to determine the types of properties involved. Second, those filings were reviewed to determine the outcomes for the Index Debtors and the remedies of debtors, lenders, and other market participants used to achieve those outcomes. Third, we formulated averages and other analyses of the cases to provide an overall, market-wide perspective of the outcomes. Approaching the Chapter 11 filings in this manner allowed us to calculate: (1) the percentage of the Chapter 11 cases involving each type of property; (2) the percentage of the Chapter 11 cases in which each form of relief was requested and granted/denied; and (3) the average number of days from the filing of the Chapter 11 case (known as the “petition date”) that each form of relief was requested and granted/denied.

DISTRESS

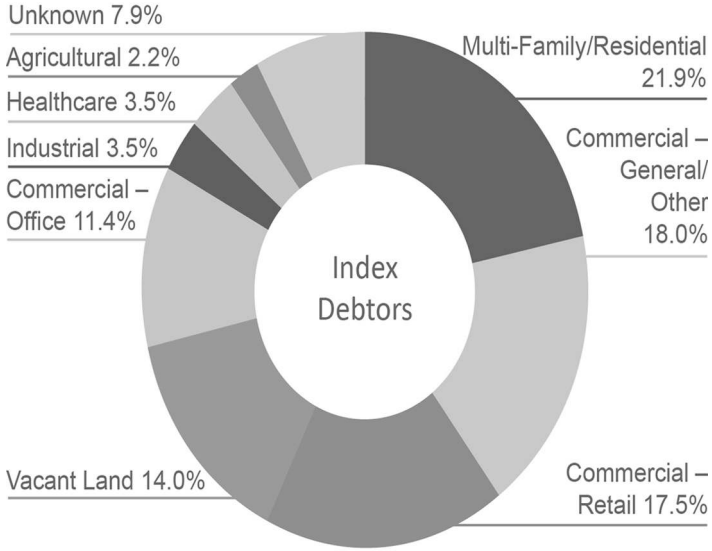
Distress often offers a window into the state of a market and opportunities in that market. By looking at failures, market participants can often develop strategies for success. Lenders, commercial property owners, developers, private equity funds, and other market participants, whether involved in the distressed real estate market or not, can thus benefit from examining these failures. This Report looks at how much distress still remains following the Great Recession, where distress remains, the relative success of remedies available to debtors, lenders and other market participants to resolve that distress, and the outcomes that real estate distress is yielding.

OUTCOMES IN SARE CASES

To determine the outcomes, we examined publicly filed bankruptcy documents to determine the types of properties involved. Those filings were reviewed to determine the outcomes and the remedies of (a) debtors, (b) lenders and (c) other market participants. We then calculated averages and other analyses of the cases to provide an overall, market-wide perspective of the outcomes.

First, the percentages of the Index Debtors' cases filed by property type were as follows:³

³ The case filings indicated that certain properties may be mixed-use. We relied upon the apparent predominant use for the property in determining in which category to place the



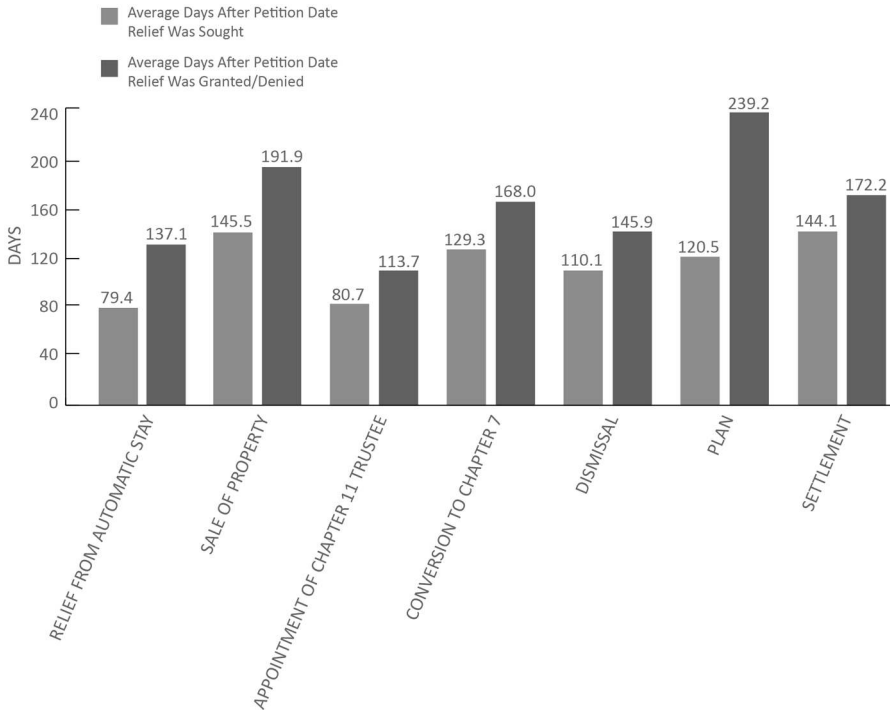
Second, the percentages of the Index Debtors’ cases by relief sought, and the percentages and total number of cases in which such relief was granted were as follows:⁴

| Relief Sought | Percentage of Cases in which Relief Was Sought | Success Rate |
|------------------------------------|--|--------------|
| Relief from Automatic Stay: | 46.9% | 63.2% |
| Sale of Property: | 24.6% | 89.1% |
| Appointment of Chapter 11 Trustee: | 10.5% | 66.7% |
| Conversion to Chapter 7: | 19.3% | 40.0% |
| Dismissal: | 62.3% | 83.7% |
| Plan: | 39.5% | 70.0% |
| Settlement: | 4.0% | 100% |

property. In certain cases we were unable to determine the type of property involved because there was insufficient information available.

⁴ In numerous cases more than one form of relief was sought by one or more parties. In some cases more than one form of relief was granted, either simultaneously (e.g., stay relief and dismissal) or at different points in time (e.g., stay relief or sale of a property followed by conversion or dismissal). Only in a limited number of cases was a formal motion to approve a settlement between the debtor and secured lender filed pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure. However, some orders granting relief from the automatic stay were by agreement conditional in nature (e.g., stay relief effective only after the debtor was given time to seek to sell the property or confirm a plan) or orders of dismissal approved an agreement resolving a debtor/lender dispute, authorizing disbursement of proceeds from a sale, or granting forbearance so the debtor could seek to sell or refinance the mortgage loan following dismissal. We did not include these situations in cases involving a resolution via settlement.

Third, the average days after the petition date that each type of relief was sought, and granted or denied, were as follows:⁵



OBSERVATIONS

There are a number of observations that emerge from the data as they relate to the outcomes/remedies set forth above:

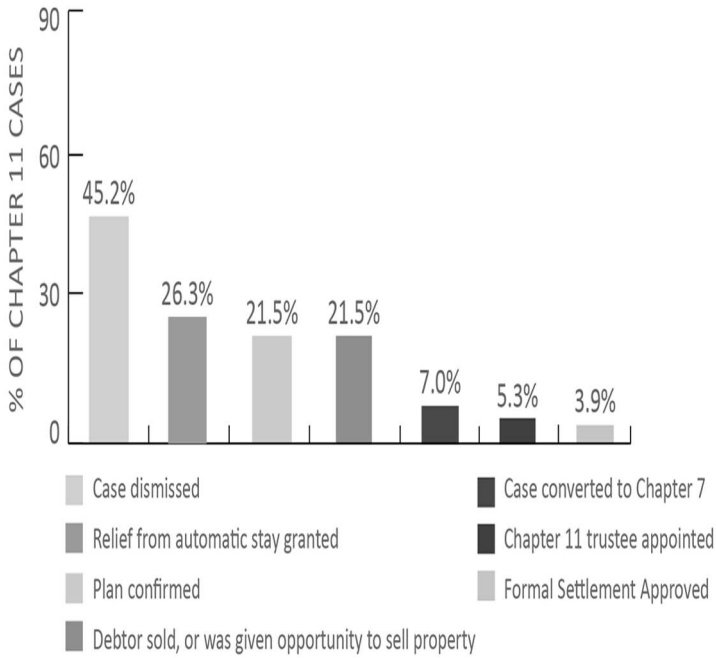
- On average secured lenders filed motions for relief from stay approximately *79.4 days after the petition date*. The data reflect that the 90-day period under Section 362(d)(3) of the Bankruptcy Code, which requires the debtor to either file a plan of reorganization or commence monthly, non-default interest payments or face a motion by the secured lender to lift the automatic stay, was not a significant factor in lenders determining when a stay relief motion would be filed.
- The average time by which debtors filed a plan of reorganization was *120.5 days after the petition date*. The data reflect that the 90-day period

⁵ We measured the time from the dates (a) a motion or other document was filed requesting one of the foregoing forms of relief, and (b) the relief was granted or denied.

under Section 362(d)(3) of the Bankruptcy Code may not have been a significant factor in debtors determining when a plan would be filed. Rather, the mean average timing of the filing of a plan is more consistent with the initial exclusive filing period under Section 1121(d) of the Bankruptcy Code. Alternatively, the debtors may have extended the 90-day deadline by making payments equal to at least the non-default contract interest rate under the note. It also indicates that the underlying real property either was “cash-flowing” or had enough intrinsic value to support an actual plan of reorganization.

- Motions for relief from the automatic stay and/or dismissal were granted in *71.5 percent of the Chapter 11 cases*.
- In contrast, *21.5 percent of the Chapter 11 cases* were resolved by way of confirmation of a plan of reorganization. In those cases where a plan of reorganization was actually filed, approximately 70.0 percent resulted in confirmation of a plan.
- In *21.5 percent of the Chapter 11 cases* of the Index Debtors, the debtor was able to sell, or was given the opportunity to sell, the property.
- Only *5.3 percent of the Chapter 11 cases* resulted in the appointment of a Chapter 11 trustee; only *7.0 percent of the Chapter 11 cases* resulted in conversion to Chapter 7. These figures indicate that typically there is little or nothing for a Chapter 11 or Chapter 7 trustee to administer because the single asset real estate is underwater and there would be no distribution to general unsecured creditors, or the case involves a two-party dispute between the debtor and its secured lender with few unsecured creditors involved.
- Only *3.9 percent of the Chapter 11 cases* were resolved pursuant to a formal settlement agreement approved pursuant to Bankruptcy Rule 9019, indicating that the parties pursued one or more of the seven other alternative remedies/outcomes. Nonetheless, complete or partial settlements between debtors and secured lenders were occasionally included in orders granting relief from the automatic stay, with the debtor being given time to sell or refinance the property prior to the stay relief becoming effective.
- On occasion, the debtor was granted an opportunity to sell or refinance the property after a dismissal order was entered.⁶

⁶ The total of the percentages listed in the accompanying bar graph exceeds 100 percent because in certain cases multiple forms of relief were granted.



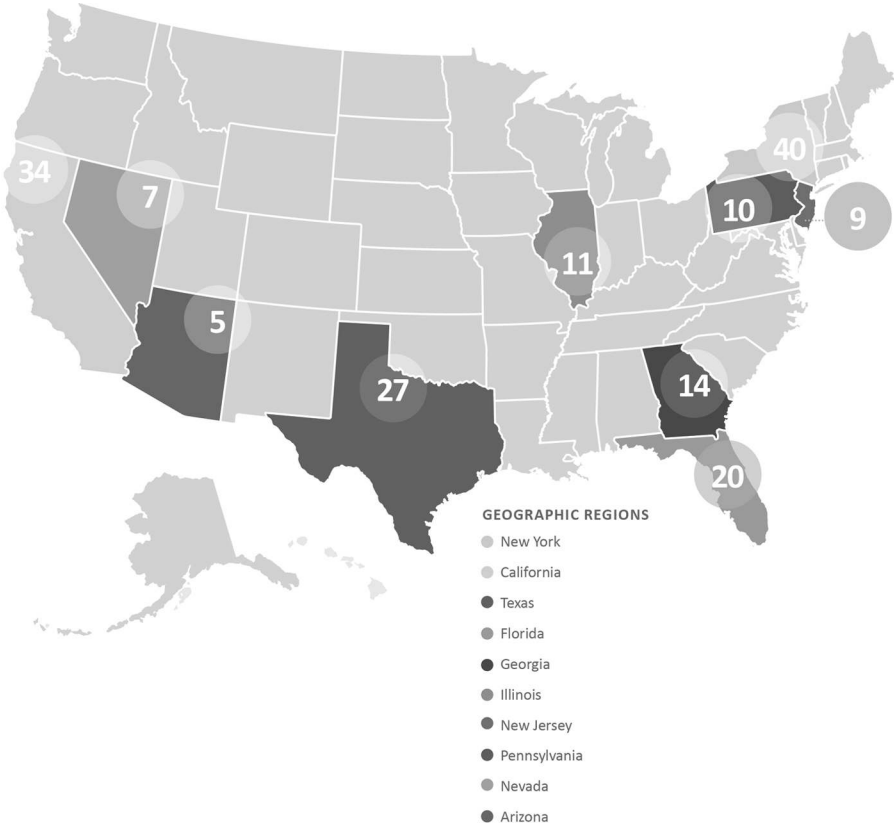
CASE SIZE AND GEOGRAPHIC DISPERSION

Overall and by Region

The quarterly report of the Distress Indices includes a breakdown of the asset size of the filings of the Indices, and also includes a geographic breakdown of the filings. Note that the location of the filing used in the Index is not always the same as the location of the property owned by the applicable Index Debtor although the filing location for real estate cases tends to correlate more closely to the location of the property than in Chapter 11 filings generally.

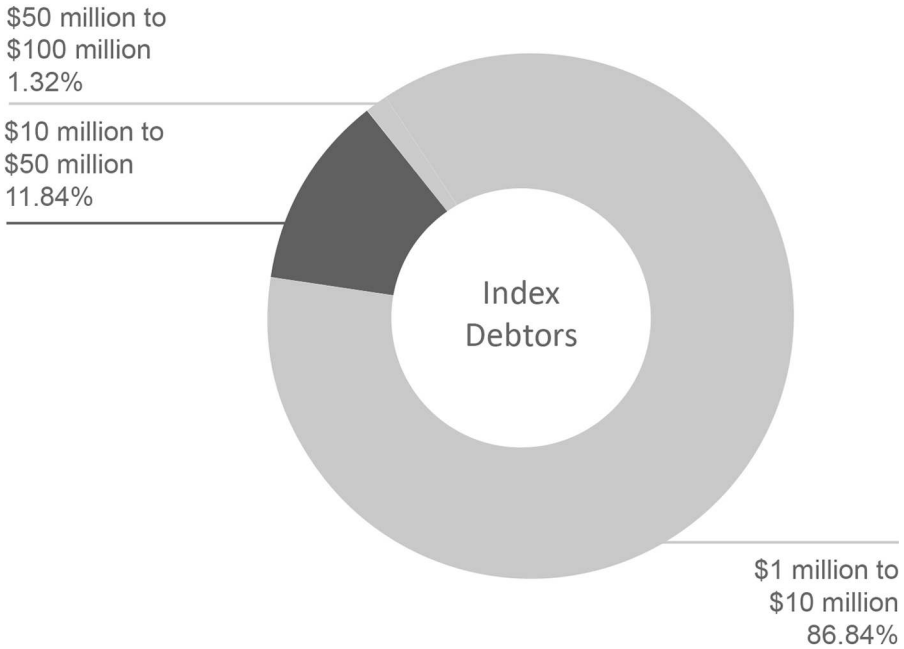
Geography by State

In terms of geographic location, the Index Debtors filed cases in 33 different states. The top 10 states in terms of the number of filings were as follows:



Case Size

The Index includes only cases in which the Index Debtor reports owning a property or other assets with an aggregate value greater than \$1 million. The Index divides the cases into asset value ranges, including (i) \$1 million to \$10 million, (ii) \$10 million to \$50 million, and (iii) \$50 million to \$100 million. In 2015, the asset value ranges of the cases broke down as follows:



UNDERSTANDING THE OBSERVATIONS

A brief explanation of the categories is helpful in understanding the Outcomes/Remedies.

- In a few cases, a debtor selected the “single asset real estate” designation on its initial Chapter 11 petition even though its bankruptcy filings indicated that it owned more than one property and/or the property did not meet the technical requirements for such designation under the Chapter 11. We did not remove these debtors from the list of Index Debtors.
- In the early stages of certain Chapter 11 cases of the Index Debtors, the United States Trustee filed a motion to dismiss or convert the Chapter 11 case due to the debtor’s failure to comply with technical filing and other requirements. Often the debtor would cure these deficiencies which would result in the United States Trustee withdrawing the motion to dismiss/convert. We did not track such a motion unless the debtor did not remedy its noncompliance with the result that its case was dismissed or converted.
- We did not track motions for relief from the automatic stay that were not filed by the secured lender or related to assets or issues unrelated,

or only tangentially related, to the property at issue in the case, as these are generally not central to the outcome of the bankruptcy case. For example, motions for relief from the automatic stay to continue or pursue litigation relating to insurance coverage for general casualty incidents were not tracked.

- In instances where the secured lender or other party in interest filed a motion requesting alternative forms of relief, the bankruptcy court may have granted one form of relief but did not specifically deny (or grant) the other relief requested. In such instances, we deemed the request for the other relief as having been denied as of the date the other form of relief was granted even in the absence of an express order to that effect.
- In 2015, several dozen related debtors filed Chapter 11 petitions in the Northern District of California, with each debtor holding a percentage tenant-in-common (“TIC”) interest in the same underlying property. Also, four related debtors filed Chapter 11 petitions in the Central District of California, with each debtor holding a percentage TIC interest in the same property. For purposes of this Report, we treated each set of related cases as a single case involving a single property. Otherwise, these two sets of cases, which accounted for approximately 16.7 percent of all single asset real estate cases filed in 2015, would skew the analysis and results in this Report. Additionally, under a court-approved settlement in the first set of cases, all of the TIC interests held by the related debtors were to be transferred to a single entity in connection with a proposed refinancing, which further supports our treatment of these related cases as a single case involving a single property.
- In certain instances, two or more affiliated debtors filed separate Chapter 11 cases which were jointly administered by the presiding court. We treated each Chapter 11 case as a separate case for purposes of our analysis. Thus, for example, if a lender or other party in interest filed a single motion in the lead case to dismiss all of the related cases, we treated the motion as having been filed in all of the cases, not just the lead case.

UNDERSTANDING THE REAL ESTATE DISTRESS RESEARCH INDEX AND THIS REPORT

This Report is based on the data used to calculate the Index, which tracks bankruptcy filings specific to the real estate sector. Although there are many different types of bankruptcy filings, the Index carefully filters bankruptcy

filings to create a consistent subset anticipated to provide insights into long-term trends. To be included in the Index, the struggling real estate company must own a property or related assets with an aggregate value greater than \$1 million dollars, must be a company rather than an individual, and must select the “single asset real estate” designation on the initial Chapter 11 petition. These criteria mean that small filings, consumer matters, and filings that are not indicated as real estate are excluded, all of which is anticipated to yield a more indicative index.

One major difference between the Index and many other commonly referenced financial indices is that the Index is not limited to publicly-traded companies. It includes any corporate bankruptcy debtor. Consequently, the Index provides a broader picture of the distressed real estate market and can be used to understand both healthy and distressed markets separately, when viewed in conjunction with what is available through the public markets.

To qualify as a single asset real estate filing, the Bankruptcy Code requires the case to involve “real property constituting a single property or project, other than residential real property with fewer than 4 residential units.”⁷ The property must generate substantially all of the gross income of the company, and the company must not conduct substantial business other than the business of operating the real property and activities incidental thereto. Because many real estate businesses are set up in the form of special purpose entities (e.g., a parent company owning 20 commercial properties will often own each one through a separate subsidiary company), the single asset real estate designation picks up a significant amount of real estate distress. Some real estate such as hotels are often, but not always, excluded because they are sometimes deemed to provide additional services to guests as opposed to simply acting as a landlord. In preparing this Report, we analyzed all of the cases that were included in the calculation of the 2015 Index, which comprises 264 cases in all. The Index Debtors represent numerous subsectors in the real estate industry, including commercial, industrial, healthcare, multi-family, agricultural and other properties. We focused on cases filed in 2015 for this study because it provides approximately a one year “tail” period for cases to be resolved, so that the report can give the final outcomes of substantially all of the underlying real estate cases. In contrast, many cases filed in 2016 have not yet been resolved. 2015 can serve as a baseline for analyzing trends in the real estate market in subsequent years.

⁷ See 11 U.S.C. 101(51B).