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What Is a Single Asset Real Estate Debtor Under the Bankruptcy Code?

By Michael J. Lichtenstein*

An important question bankruptcy courts have considered is: What is a single asset real estate entity? The author of this article discusses the criteria, the case law on the issue, and the implications of qualifying, or not, as a single asset real estate debtor.

One important question bankruptcy courts have struggled with is: What is a single asset real estate entity (SARE)? For example, are country clubs and hotels included in the definition? What about a single project that includes multiple properties or conducts several businesses? Because the Small Business Reorganization Act excludes SAREs, this question has become even more important. If a debtor qualifies as a SARE, it will be subject to other Bankruptcy Code provisions, including more limited automatic stay protection and requiring the filing of a confirmable plan or the resumption of interest payments to secured creditors within 90 days.

SINGLE ASSET REAL ESTATE DEFINED IN THE BANKRUPTCY CODE

Before the Bankruptcy Reform Act of 1994 (the 1994 Act), the Bankruptcy Code lacked an express provision for single asset real estate cases. The 1994 Act provided special treatment for single asset real estate entities by defining the term "single asset real estate" in Bankruptcy Code Section 101(51B) and by placing single asset real estate cases on an expedited reorganization track through the enactment of Bankruptcy Code §363(d)(3).[1] Initially, the definition of single asset real estate included a limitation to debtors with secured debts of no more than $4,000,000.00. That limitation was removed as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

Currently, the Bankruptcy Code defines single asset real estate as:

> [R]eal property constituting a single property or project, other than residential real property with fewer than 4 residential units,[2] which

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[1] In re Klemko, Inc., 181 B.R. 47 (Bankr. S. D. Ohio 1995); H.R. Rep. 103-835, 103 Cong.2d Sess. (1994).

[2] See In re ETS of Wash. LLC, 2021 LEXIS 268 *8 (Bankr. D.C., Feb. 4, 2021) (debtor fell under residential exception and therefore was not SARE).

> 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 thereto.[3]

Accordingly a SARE must meet three conditions:

(1) single property or project;

(2) single project generating substantially all of the revenue; and

(3) no other business activities.

BURDEN OF PROOF AND SARE DETERMINATION

While there is a box to check on the petition if a debtor is a SARE, if a debtor fails to do so, a creditor can seek a determination that the debtor is in fact a SARE. The motion to determine whether a debtor is subject to the SARE definition is likely to be filed at the beginning of the case. This is true because Section 362(d)(3) (expedited reorganization track) applies on a date that is 90 days after the order for relief is entered or 30 days after the court determines that the debtor is subject to the SARE definition, *whichever is later*.

While the Bankruptcy Code and Rules do not adress who has the burden of proof, many courts have held that the movant bears the burden to prove by a preponderance of evidence that the debtor is a SARE.[4]

SARE CASES

Single Property or Project

In evaluating whether a debtor qualifies as a SARE, courts have looked at various factors. Courts have found that even contiguous properties do not necessarily qualify as a SARE. Properties do not have to be contiguous to be a single project. Recently, a New York bankruptcy court concluded that contiguous commercial condominiums with common ownership, subject to the same mortgage, did not satisfy the SARE definition.[5] A creditor filed a notice

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[3] 11 U.S.C. Section 101(51B).

[4] In re Caribbean Motel Corp., 2022 Bankr. LEXIS 25 at *9 (Bankr. Puerto Rico, Jan. 5, 2022); see also In re Georgina, LLC, 2016 LEXIS 4212 *3 (Bankr. C.D. Cal., Dec. 7, 2016) (movant bears burden of showing SARE by preponderance of evidence); In re 218 Jackson LLC, 2021 LEXIS *4 (Bankr. M.D. Fla. June 2, 2021) (movant bears burden to prove by preponderance of evidence that Debtor is SARE).

[5] In re Nuovo Ciao-Di, LLC, 650 B.R. 785, 790 (Bankr. S.D.N.Y. 2013).

seeking to designate the debtor as a SARE.[6] The debtor argued that the properties were two separate entities that should not be considered either a single property or a single project.[7] The debtor argued that there were multiple parcels and also there was no common plan or purpose.[8] The bankruptcy court noted that common ownership or even a common border is insufficient to be a SARE.[9] The two condo units were not a single property even though adjacent and subject to the same mortgage.[10] Also, this was not a single project as the properties were not linked by a common plan or scheme.[11]

In re Evergreen Site Holdings, Inc.,[12] involved a debtor that owned two adjoining parcels of real property. A creditor objected to the filing as a subchapter V debtor, arguing that as a SARE the debtor was ineligible.[13] On one parcel of land was a small mobile home park with an adjoining barn and an inactive zip line course.[14] Most of the other parcel was vacant land other than a paintball course that a previous tenant used.[15] The debtor argued it was not a SARE because it owned two separate properties with two different county use codes.[16] The subchapter V trustee supported the debtor and noted that the zip line course and the mobile home rentals were "not commercially connected and have different purposes."[17] The court analyzed whether the two properties composed a single project and concluded that they were not being held together in a common scheme.[18] Accordingly, the debtor was not a SARE.[19]

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[6] Id. at 786.

[7] Id. at 787.

[8] Id.

[9] Id. at 788.

[10] Id. at 789.

[11] Id. See also In re 218 Jackson, LLC, 2021 LEXIS 2284 * 10 (Bankr. M.D. Fla., June 2, 2021) (movant failed to shoulder its burden to demonstrate by preponderance of evidence that debtor was single project and so debtor was not SARE). But see In re Light Foot group LLC, 2011 LEXIS 4399 *10-11 (five contiguous parcels of land constituted single project and debtor was SARE); and In re Aspen Club & Spa, LLC.

[12] 652 B.R. 307 (Bankr. S.D. Ohio 2023).

[13] Id. at 309.

[14] Id. at 312.

[15] Id.

[16] Id. at 313.

[17] Id.

[18] Id. at 318-19.

[19] Id. at 319. But see In re Georgina, LLC, 2016 LEXIS 4212 * 8-9 (Bankr. C.D. Cal., Dec. 7, 2016) (debtor that owned two properties marked together for purpose of residential real estate

The question of whether there is a common scheme is a factual one and courts consider several issues when analyzing this requirement, including:

(i) The use of the properties;

(ii) The circumstances surrounding the acquisition of the properties, including the time of the acquisition and the funds used to acquire the properties;

(iii) The location of the properties and proximity of the properties to one another; and

(iv) Any plans for future development, sale, or abandonment of the properties.[20]

Courts will examine the debtor's intent when deciding whether a property comprised of multiple parcels constitutes a single project for SARE purposes and will weigh evidence about whether the separate parcels are intertwined enough to constitute a single project.[21] So, the single project requirement recognizes that real estate development can be accomplished through separate projects, comprised of several tracts or parcels of land, and still constitute a single property for SARE case purposes.[22] Therefore, a SARE case can consist of noncontiguous parcels of property that are linked together in a common scheme or plan of use (for example, separate apartment buildings can be considered a single project when the debtor has a common plan or purpose for the buildings).[23]

Single Project Generating Substantially All of the Revenue

In *In re Club Golf Partners, L.P.*, together with its Chapter 11 petition, the debtor filed a motion for determination that it was not a SARE.[24] The debtor's property included an 18 hole golf course, a driving range, tennis courts and a club house with a casual dining restaurant.[25] The debtor also sold merchandise

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development was SARE); In re JJMM Int'l Corp., 467 B.R. 275, 277–78 (Bankr. E.D.N.Y. 2012) (common ownership alone is not enough for property or properties to constitute single project; debtor must also have common plan or purpose for property).

[20] In re Georgina, LLC, 2016 LEXIS 4212 at **3-4.

[21] In re Alvion Props., 538 B.R. 527 (Bankr. S.D. Ill. 2015).

[22] In re Pioneer Austin East Dev. I, Ltd., 2010 LEXIS 2160, at *4 (Bankr. N.D. Tex. July 1, 2010).

[23] Id.

[24] In re Club Golf Partners, L.P., (E.D. Tex. Feb. 15, 2007).

[25] Id.

in the pro shop and alcohol and charged fees for golf tournaments, golf lessons and charity events.[26] Citing four other cases holding that a golf course is not a SARE, the court looked at the revenue generation on and by the property.[27] If the revenue is the "product of entrepreneual, active labor and effort," the debtor is not a SARE.[28] The court concluded that the debtor's real estate did not generate the revenue; rather, the revenue was the product of management and workers on the land, bringing in customers and selling them services and goods.[29] Considering all the sources of revenue, and the employment of third-party employees, the court concluded that the debtor's golf course did not fall within the definition of single asset real estate.

In *In re Caribbean Motel Corp.*,[30] the debtor owned real estate in Puerto Rico where it operated a by-the-hour motel with 22 operational rooms for rent. The motel operation required 9 to 11 employees to clean the rooms (frequently!!!) and to assist guests checking in and out.[31] Additionally, the debtor sold prophylactics and aspirin, which generated about 5-7% of the debtor's income.[32] The court determined that the debtor was not a SARE because the motel with 9-11 employees engaged in an active business, which was not just incidental to renting or managing real estate.[33] Moreover, the debtor also provided additional services for its guests by selling food, prophylactics and aspirin.[34]

No Substantial Other Business on the Property

This requirement focuses on whether the debtor is conducting business operations other than operating the real property and activities incidental to such ownership. For example, if there is no business activity conducted on the property because it is being held for future development, this requirement is met. In *Shady Bird Lending, LLC v. Source Hotel, LLC*, the lender, Shady Bird

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[26] Id.

[27] Id.

[28] Id.

[29] Id.

[30] 2022 Bankr. LEXIS 25 at *4.

[31] Id. at *5.

[32] Id.

[33] Id. *12-13.

[34] Id. at *13. See also In re ENKOGS1, LLC, 626 B.R. 860 (Bankr. M.D. Fla. 2021) (hotel was not SARE because in addition to renting rooms, debtor cleaned rooms, changed linens and offered reception desk).

Lending sought a determination that the debtor was a SARE. The bankruptcy court ruled in the debtor's favor (not a SARE) and the district court reversed.[35] The bankruptcy court held (a minority view) that if the property produced no income, the debtor was not eligible to be a SARE.[36] The district court disagreed and adopted the majority view which holds that the statutory definition of a SARE included properties that generate no income.[37] As to the third factor, whether any substantial business is being conducted on the property other than operating the real property and activities incidental thereto, the court agreed with Shady Bird Lending that it should look at present activities and not consider the debtor's future intentions.[38] Because there was no current income, there was no substantial business other than operating the real property and so the debtor was a SARE.

In *In re Meruelo Maddux Props., Inc.*,[39] the U.S. Court of Appeals for the Ninth Circuit affirmed the district court's holding that the debtor was a SARE. The debtor, one of fifty-three subsidiaries of a non-debtor holding company, sought a determination that it and the other subsidiaries were not subject to the SARE provisions and the secured creditor filed a motion seeking the opposite result.[40] The bankruptcy court held that, while the debtor appeared to have SARE characteristics, the appellation would not apply because of the consolidated interrelated business relationship with the parent and the other subsidiaries.[41] The district court reversed because there is no "whole enterprise exception" to the SARE provisions.[42]

The debtor owned a 92-unit apartment complex. The parent company and its 53 subsidiaries each filed a Chapter 11 that were then joint administered but not substantively consolidated.[43] To determine whether the debtor was a SARE, the Ninth Circuit looked at the plain language of the statute and considered the

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[35] Shady Bird Lending, LLC v. Source Hotel, LLC, 606 F. Supp. 3d 952, 955 (C.D. Cal. 2022).

[36] Id. at 958.

[37] Id. at 961.

[38] Id. at 962. See also In re ETS of Wash. LLC, 2021 LEXIS 268 *7 (Bankr. D.C., Feb. 4, 2021) (acknowledging that court must look at current facts not future plans and finding that debtor's property that fell under residential exception was not SARE).

[39] 667 F.3d 1072, 1074–76 (9th Cir. 2012).

[40] Id. at 1074.

[41] Id.

[42] Id.

[43] Id. at 1075.

three enumerated factors.[44] The Ninth Circuit agreed with the bankruptcy court that the debtor was a SARE because it was a single property that generated all or substantially all of the debtor's income and the only business activities were collecting rent. Additionally, there is no "whole business enterprise" exception for a SARE. Absent substantive consolidation, the Ninth Circuit held that a court should only look at the debtor's assets, income and operation when deciding whether or not it was a SARE.[45]

Where there is other business activity, the pertinent question is whether such business activity is incidental to the main business. Activities that are intrinsic to owning and developing real estate are considered incidental to the debtor's business. So, a debtor that operated a full-service hotel was not considered a SARE because it also operated a restaurant, bar, and gift shop which constituted significant unrelated business.[46]

CONCLUSION

Assuming that a debtor fails to check the box acknowledging that it is a SARE, a creditor should file a motion seeking a determination that the debtor is a SARE expeditiously. If the motion is granted, the debtor will be on an expedited reorganization track. Determination of whether a debtor is a SARE is a factual inquiry where the court will look at various factors, including whether there is one property or project, are there revenues and, if so, are they generated from the real estate and finally is there any other substantial business on the property or project. Obtaining a court order that a debtor is a SARE provides a secured creditor with greater leverage and puts time pressure on the debtor to reorganize or make interest payments to the secured creditor.

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[44] Id.

[45] Id. at 1077.

[46] In re CBJ Dev., Inc., 202 B.R. 467, 473 (B.A.P. 9th Cir. 1996).