

Why the Number of UCC Foreclosures in CRE Has Spiked in Recent Months

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'It's years worth of work wrapped into a quarter for us'

By [Larry Getlen](#) July 8, 2024 6:00 am

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While “foreclosure” is generally bad news for businesses, for those who work in commercial real estate foreclosures it’s good — and the news has been especially good of late.

“Foreclosures are definitely up — there’s an absolute ton right now,” said foreclosure auctioneer Matthew D. Mannion, principal at [Mannion Auctions](#). “This is the busiest we’ve been since before COVID.”

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While foreclosures are up across the board, Mannion and others note that Uniform Commercial Code (UCC) foreclosures, which foreclose on mezzanine debt and compress the process to just a few months as opposed to years for judicial foreclosures, are through the roof.

To demonstrate the intensity of the increase, Mannion reports that he advised on and/or executed 19 UCC disposition auctions in 2019 and 25 in 2022. This year, he has already completed or advised on 41, and expects that number to reach 70 by year's end.

Bankruptcy attorney Jonathan S. Pasternak, a partner at Davidoff Hutcher & Citron, blames the uptick on the business interruptions that occurred during the early days of COVID.

“The real estate industry didn't really get to take advantage of PPP loans, and very few took disaster loans from the SBA,” said Pasternak, citing the Small Business Administration and its Paycheck Protection Program. “Since these development deals are leveraged — and quite often with either institutional or private loans — interest continued to accrue. When they ran out of capital, default rates started to compound, which eroded the equity in the deals and made it less attractive for developers to put more of their own money in.”

This, combined with the increase in interest rates, created what Pasternak calls a “perfect storm” of defaulting properties.

Jason Nagi, chair of the distressed real estate and fintech practice groups at Offit Kurman, has represented lenders in commercial foreclosure litigation for around 20 years. Nagi believes the marked increase in foreclosures is a sign of commercial real estate trying to get back to normal after the world-changing COVID years.

“People have started to move forward,” said Nagi. “At this point in the cycle, any issues that were caused by COVID, whether they were the primary or tertiary reason for the default, have either been fixed and worked out, or they can't be worked out and the loan is in default. So if you haven't been able to right the ship as a borrower, lenders are looking to foreclose.”

Greg Corbin, president of the bankruptcy, foreclosure and restructuring advisory firm Northgate Real Estate Group, said that foreclosures are up by “an exponential amount” this year compared to previous years.

“It's years worth of work wrapped up into a quarter for us right now,” said Corbin.

While foreclosures are up across the board, the UCC foreclosures in particular have exploded in popularity, mostly due to the incredibly short time frame for initiating the process.

Corbin notes that a UCC foreclosure used to be as short as 30 days, but that 60 is more the norm now due to a requirement for “commercial reasonableness,” meaning not handling the foreclosure so quickly that the borrower has no time to try to make things right.

The compressed time frame for foreclosure has made UCC the preferred process for CRE lenders.

“Before COVID, private lenders would do auctions for mezzanine debt,” said Mannion. “You wouldn’t see a lot of senior or B notes secured by pledges of equity, which is what you need for a UCC auction. Now you’re seeing private lenders and even institutional lenders require borrowers to not just sign a note but also to sign a pledge of equity. Because, in the five boroughs, if you want to do a regular judicial mortgage foreclosure and your borrower has any resources, it could take you two, three, even four years to do it.”

The increase in UCCs, therefore, has been facilitated in part by lenders handling both the senior and mezzanine loans for more of their funding projects.

“I’ve seen that shift for several years,” said Jay Neveloff, a partner at Kramer Levin Naftalis & Frankel LLP. “It’s just now becoming more relevant.”

Properties that Northgate is currently marketing for a UCC foreclosure sale include 200 Kent Avenue in Williamsburg, Brooklyn, a 135,611-square-foot, Class A, mixed-use building that occupies an entire city block housing a Trader Joe’s at street level. Corbin said that the building has “over \$140 million of debt on it as a UCC.”

While the increase in foreclosures is occurring across all asset classes, Nagi said there’s a particularly heavy concentration in multifamily, with perhaps less activity in the office space.

“I think that in multifamily, lenders are probably a bit more likely to commence foreclosures because it’s easier to value the property. They actually know what they can get for it, and whether the property is underwater or not,” said Nagi. “Part of the problem with office is that the values are so uncertain. They’re not necessarily bad, it’s just very hard to pinpoint.”

Corbin narrows this further, saying that rent-stabilized apartment buildings are seeing heavy rates of foreclosure.

“We’ve got a lot of rent-stabilized buildings because they’ve lost so much value. We’re seeing most of the activity with those,” said Corbin.

Corbin also notes that many foreclosed projects involve stalled construction, as banks have been providing funding for projects in a piecemeal fashion.

“During COVID, the banks weren’t giving full construction loans — they set up financing with milestones, or hurdles,” said Corbin. “When a milestone was hit, they released more funds. So the banks stopped funding and builders stopped building, and everyone was pointing their fingers at the other party. A lot of these buildings are now up for sale. And they not only lost value, but, because they’ve been sitting and weathering the elements for years, a lot of the work that was done needs to be undone and then redone.”

As for how far these values have fallen, Northgate’s Corbin characterizes the value losses as drastic.

“Buildings are trading now for numbers no one could have ever forecasted,” said Corbin. “You have household name real estate companies with billions of dollars of holdings that are taking 50, 60 cents on the dollar on their initial investment. They’re losing large amounts of money on investments. There are a lot of deals right now at a third of the value they were purchased at.”

At this point, Davidoff Hutcher’s Pasternak believes that the popularity of UCC foreclosures is just beginning.

“This is going to be a new tool in the lenders’ tool belt for accelerating outcomes of distressed loans,” said Pasternak. “Whether it’s forestalling delay with a bankruptcy, getting an extension or forbearance, or forcing a sale or refinance, it is quite an effective tool. I think you’re going to see more and more of them.”

And, in contrast to the doom and gloom that increased foreclosures and collapsing valuations portend for many, Kramer Levin’s Neveloff said he believes that, for investors, all of this has created a deal-friendly environment. That is, for all the negatives associated with foreclosures, the next few years will be filled with windfalls for those who know where to look.

“What I tell my clients who have money to invest is, this is going to be the time to seriously look at deals,” said Neveloff. “It doesn’t mean deals are flying off the shelf, but there are deals out there with numbers that make sense because of some form of distress. But I think there’s going to be an incredible amount of activity, and it will go on for a while. If you look at the next year or probably two years, the level of activity of transactions will increase dramatically.”