



THE GOLD STANDARD REMAINS: THE EFFECTIVE DISPOSITION OF REAL PROPERTY IN BANKRUPTCY

BY KEVIN H. MORSE, MEMBER, CLARK HILL &
TERRY ROCHFORD, JD, MANAGING DIRECTOR, STRETTO

The distress in commercial real estate is not resolving on its own. Trepp's commercial mortgage-backed securities (CMBS) delinquency rate reached 7.86% in July 2026, a 51-basis-point jump in a single month, and the office rate has sat above 11% for the better part of a year after peaking at an all-time high of 11.66% in August 2025. More telling than the headline number is its composition—non-performing matured balloon loans accounted for 66% of newly delinquent balances in July, with loans in foreclosure another 19%. These are not properties failing to cover operating expenses. They are properties

that cannot be refinanced. The Mortgage Bankers Association counts \$875 billion—17% of the \$5 trillion in outstanding commercial mortgages—scheduled to mature in 2026, with another \$652 billion behind it in 2027. Thirty percent of hotel loans and 17% of office loans come due this year alone.

Maturity-driven distress behaves differently than operating distress. A borrower that cannot refinance has no path back to performance and little reason to wait—and a lender holding a matured loan secured by an asset worth less than its balance has every reason to force resolution.

The result is a steady supply of assets that must change hands quickly, with clean title, over the objection of parties who will not consent. That is the problem Section 363 was built to solve, and it is why the national reach of a federal court's sale order matters more now than it has in years.

Yet, a sale through a bankruptcy process culminating in a sale order from a bankruptcy judge authorizing the sale free and clear of all liens, claims, and encumbrances remains the gold standard in providing purchasers and sellers the assurances they need in distressed transactions. This

article provides an overview of how professionals charged with this task can follow best practices to navigate unexpected obstacles that may present themselves along the way, leading to greater efficiency at each step.

Understanding Chapter 7 & Chapter 11 Bankruptcy

Chapter 7 involves the appointment of a trustee who takes control of the debtor's nonexempt assets, including real estate, to sell them and distribute proceeds to creditors. On the petition date, the estate succeeds to the debtor's legal and equitable interests in the property, and the trustee, as the estate's

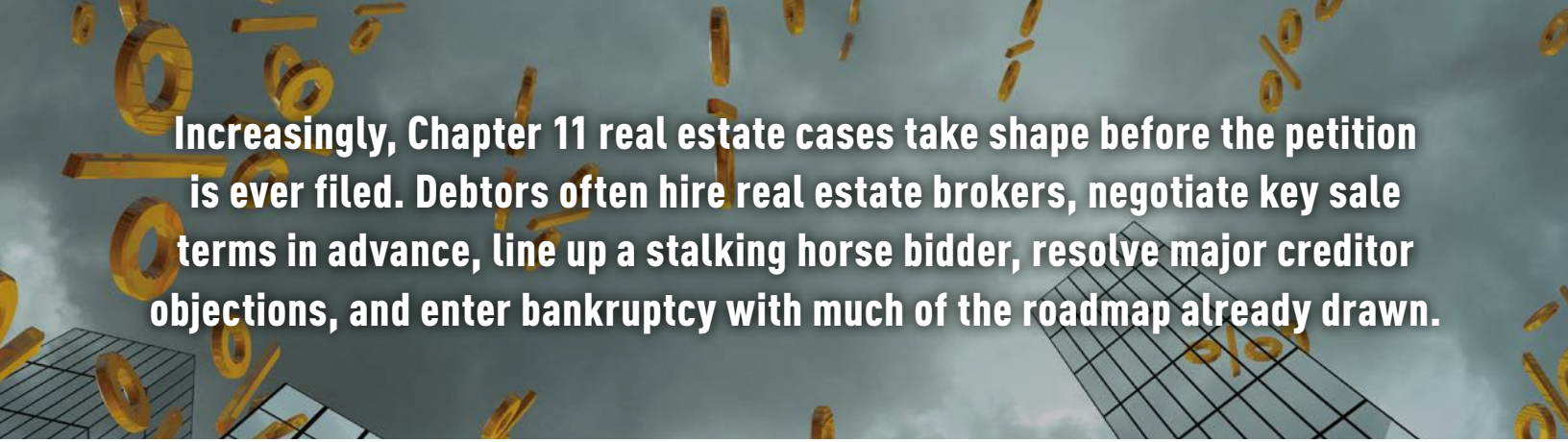
representative, exercises the business judgment the owner previously held — deciding whether disposition under Section 363 will return more to creditors than the alternatives.

Whether a Chapter 7 disposition approaches the sophistication of a Chapter 11 sale process depends less on the trustee than on the asset. Where there is enough equity above the liens to fund brokers, appraisers, and counsel, trustees run marketed processes that look much like their Chapter 11 counterparts. Where there is not, the economics do not support the effort, and the case moves toward

abandonment or a stipulated lift of the stay. Drawing that distinction early determines what kind of process a fiduciary can realistically deliver.

In Chapter 11, the debtor remains in possession and continues operating while restructuring debts. Disposition of real estate in Chapter 11 can occur through Section 363 asset sales to fund reorganization or confirmed Chapter 11 plans. Sales and leases of real property outside the ordinary course require court approval under Section 363,

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and using estate property to secure new borrowing (such as granting a mortgage) is governed by Section 364.

Increasingly, Chapter 11 real estate cases take shape before the petition is ever filed. Debtors often hire real estate brokers, negotiate key sale terms in advance, line up a stalking horse bidder, resolve major creditor objections, and enter bankruptcy with much of

the roadmap already drawn. That can shorten the case, reduce administrative expenses, and help prevent further deterioration of a property's value. But it also pressures fiduciaries to look past the speed and ask harder questions—whether the process was sufficiently marketed, whether valuation was tested, and whether the deal reflects a genuine market check.

Whatever the procedural posture, the framework generally protects the

bargains creditors struck before the case began, subject to the Bankruptcy Code's limits and remedies. The Supreme Court underscored the point in 2012 in *RadLAX Gateway Hotel v. Amalgamated Bank*. When the debtor proposed to sell the collateral under a plan while denying the lender the ability to bid its own debt, a unanimous court held that the debtor could not confirm a cramdown plan providing for a free-and-clear sale of the collateral without permitting



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the secured creditor to credit bid. For a fiduciary, the lesson is orienting: maximize what the estate can realize, but within a structure that accounts for the rights secured creditors hold under the Bankruptcy Code.

Challenges in Disposing of Real Estate Assets

Debtors (as fiduciaries to the Chapter 11 estate) and trustees face numerous hurdles when handling real estate in bankruptcy. Time constraints are paramount—trustees must act quickly to preserve asset value, especially in volatile markets, while complying with notice and hearing requirements. Valuation disputes often arise, as property may have little equity after accounting for liens, exemptions, and administrative costs, making sales unfeasible or contentious.

Secured creditors' interests complicate matters. Liens survive bankruptcy unless avoided, and a sale free and clear requires satisfying Section 363(f)—which is disjunctive, meaning the estate needs only one of five conditions:

- 1 Applicable non-bankruptcy law permits a free-and-clear sale.
- 2 The interest holder consents.
- 3 The interest is a lien and the sale price exceeds the aggregate value of all liens on the property.
- 4 The interest is in bona fide dispute.
- 5 The holder could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of its interest.

Practitioners should not assume Subsection (f)(3) does the work. Courts remain divided over what "aggregate value of all liens" means. Some read "value" as the face amount of the secured claims, which makes the prong unavailable in any underwater deal—that is, in most distressed commercial real estate today. Others read it as the economic value of the liens, permitting a sale for less than face so long as the

price exceeds what the collateral is actually worth. Which view a court takes can determine whether a free-and-clear sale is available at all, and it is worth knowing before the motion is drafted rather than after an objection is filed.

That division is why Subsection (f)(5) carries much of the practical load. If the lienholder could be compelled in some other proceeding to accept money rather than the collateral itself, the estate can sell free and clear without consent and without equity. Its reach is contested as well. *In Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)* (2008), the panel construed (f)(5) narrowly rather than let it swallow (f)(3) and, separately, held that Section 363(m) did not moot appellate review of the free-and-clear component of the sale order.

Consent under (f)(2) deserves more attention than it typically receives. Many courts treat a lienholder's

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failure to object after proper notice as implied consent, which is precisely why service is not a formality. Where the notice record is thin, the consent that supported the sale order becomes the opening for a later attack on title.

Best Practices for Identification & Valuation

Efficient disposition begins with thorough identification of assets. Trustees and fiduciaries should review the debtor's schedules, tax returns, and financial statements promptly upon appointment. They should also conduct site inspections, obtain professional appraisals, and investigate title records to uncover hidden interests or encumbrances.

The Section 341 meeting is often the market's first look at the asset, and the answers given there will travel. A trustee prepared to speak accurately about condition, occupancy, and encumbrances turns that meeting into the opening of the marketing

process rather than a source of misinformation to correct later.

For valuation, qualified real estate appraisers should be engaged early to assess fair market value versus liquidation value, considering market conditions and repair needs. Trustees and fiduciaries should also compare prospective proceeds against liens and exemptions to determine if asset sales benefit the estate. Within Chapter 11 reorganizations, it is advisable to integrate valuation into the disclosure statement for creditor review.

Best Practices for Sale Processes

In Chapter 7, trustees will generally pursue sales only if equity exists. Otherwise, abandonment to the secured lender is the most efficient means of disposal. Other times, the lender might be willing to fund a sale of the real property assets rather than take the assets into their portfolio of "real estate owned" or REO. For viable sales, they can proceed by filing a motion under Section 363(b) for court approval, providing notice to all

creditors and interested parties. The ultimate goal is to establish an auction to maximize proceeds for the estate, especially for unique properties.

Chapter 11 offers two principal paths for real estate dispositions: a sale under Section 363(b), which can move quickly when value is eroding, and a sale implemented through a confirmed plan under Section 1123, which may offer a fuller structure for creditor participation and dispute resolution. Courts generally require a sound business justification for a pre-confirmation sale, and debtors often point to preserving going concern value or avoiding further decline in asset value.

Debtor-in-possession financing may also be critical to fund the sale process, while Section 363(f) supplies the statutory basis for a sale free and clear of liens. Credit bidding adds another layer of strategy. Under Section 363(k), a secured creditor may bid using its allowed claim rather than new cash, protecting against distressed

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assets being sold for pennies on the dollar. At the same time, a robust credit bid may, in some cases, chill outside interest if other bidders view the auction as unwinnable before it begins. That tension makes procedure matter. Fiduciaries should examine whether break-up fees and expense reimbursements are encouraging real competition or quietly steering the property toward a lender-controlled outcome. Independent valuations, credible outreach, and meaningful exposure to the market remain the best antidotes to a one-bid auction masquerading as price discovery.

Courts have stepped in when the balance tips too far. *In re Fisker Automotive* (2014), a distressed-debt buyer sought to credit bid substantially more in connection with a fast sale process. The court capped the credit bid at \$25 million, citing concerns that an uncapped bid would freeze bidding, that the sale process was rushed, and that the scope and validity of liens on some assets were disputed. Two years later, *In re Aéropostale, Inc.* (2016) drew the line from the other side, holding that the possibility a credit bid may chill some interest is not enough, standing alone, to deny the right absent misconduct or a bona fide dispute over the lien. Together, the cases mark the outer edges of one idea: The credit bid is an important protection for a secured creditor, but it is not immune from limitation when cause exists under the statute.

Abandonment vs. Sale: Strategic Decisions

Abandonment is a key tool when property has little or no value to the estate, such as when burdened by liens exceeding its worth. In Chapter 7, trustees can abandon property after notice and a hearing, or after notice if no party in interest timely objects, removing it from the estate and returning it to the debtor's control. They should file a motion if needed and provide written confirmation for title purposes.

Selling rather than abandoning is advisable if the transaction produces a meaningful benefit to the estate, such as proceeds available for unsecured creditors or a documented carveout from secured-creditor collateral. In Chapter 7, trustees should be cautious about short sales or fully encumbered sales that merely shift foreclosure costs or benefit the debtor or lender



Kevin H. Morse is a member with Clark Hill. He supports businesses and their owners in a variety of industries afflicted with financial distress through out-of-court restructuring, bankruptcy, and litigation. Morse has more than a decade of experience handling insolvency matters nationwide in a breadth of industries, such as real estate, healthcare, food and agriculture, and construction. His clients include publicly traded companies, privately held corporations, REITs, start-ups, nonprofits, traditional and non-traditional financial entities, and individuals.



Terry Rochford, JD, is a managing director at Stretto. With three decades of experience in bankruptcy real estate disposition, he leads the strategic growth of Stretto Real Estate Services, working with debtor counsel, trustees, secured creditors, and other stakeholders to identify, market, and sell real estate assets in Chapter 7 and Chapter 11 cases nationwide. Previously, Rochford served as senior vice president at Hilco Real Estate, where he and his team were national leaders in Section 363 real estate sales.

without generating value for the estate. They should weigh factors such as lien amounts, exemptions, administrative costs, market value, default status, and whether the sale will produce a demonstrable creditor benefit. In Chapter 11, abandonment is less common but can occur if property does not aid reorganization. For omitted property, fiduciaries can reopen the case, amend schedules, and move to abandon to free it efficiently.

Legal Considerations & Gaining Efficiencies

To gain efficiencies, debtors and trustees need to carefully balance the needs for an urgent sale in Chapter 11 to cut fees and preserve value versus the ability to maximize value through a more fulsome and extended sale process. They can coordinate with secured lenders for funding for administrative costs. By engaging experienced counsel and brokers, they streamline the process and give stakeholders a credible account of value, which is what actually forestalls litigation. Prepackaged and prearranged cases can advance those efficiency goals by shifting negotiations, buyer outreach, and sale

preparation to the period before filing, when time may be less expensive and disruption easier to manage. A well-prepared case can enter bankruptcy with momentum instead of chaos.

Still, efficiency is not the same as fairness. When the framework for a sale was built before the petition date, fiduciaries should test whether the estate is inheriting a genuinely competitive process or merely ratifying a deal effectively decided in private. Valuation, marketing, and bid protections should all be revisited with that concern in mind. *In re Free Lance-Star* (2014) is the cautionary tale. There, a lender pursuing a loan-to-own strategy had recorded liens on property it did not actually hold and pushed for a sale process that was both fast and tightly controlled. Once those issues surfaced, the court limited the lender's credit-bidding rights to protect the integrity of the auction process. The point is not that a lender pursuing its collateral is automatically suspect, but that a deal wired before the petition was filed rewards exactly the hard look—at valuation, at marketing, at lien scope, and at who really had a seat at the table—that a fiduciary is there to give. ■