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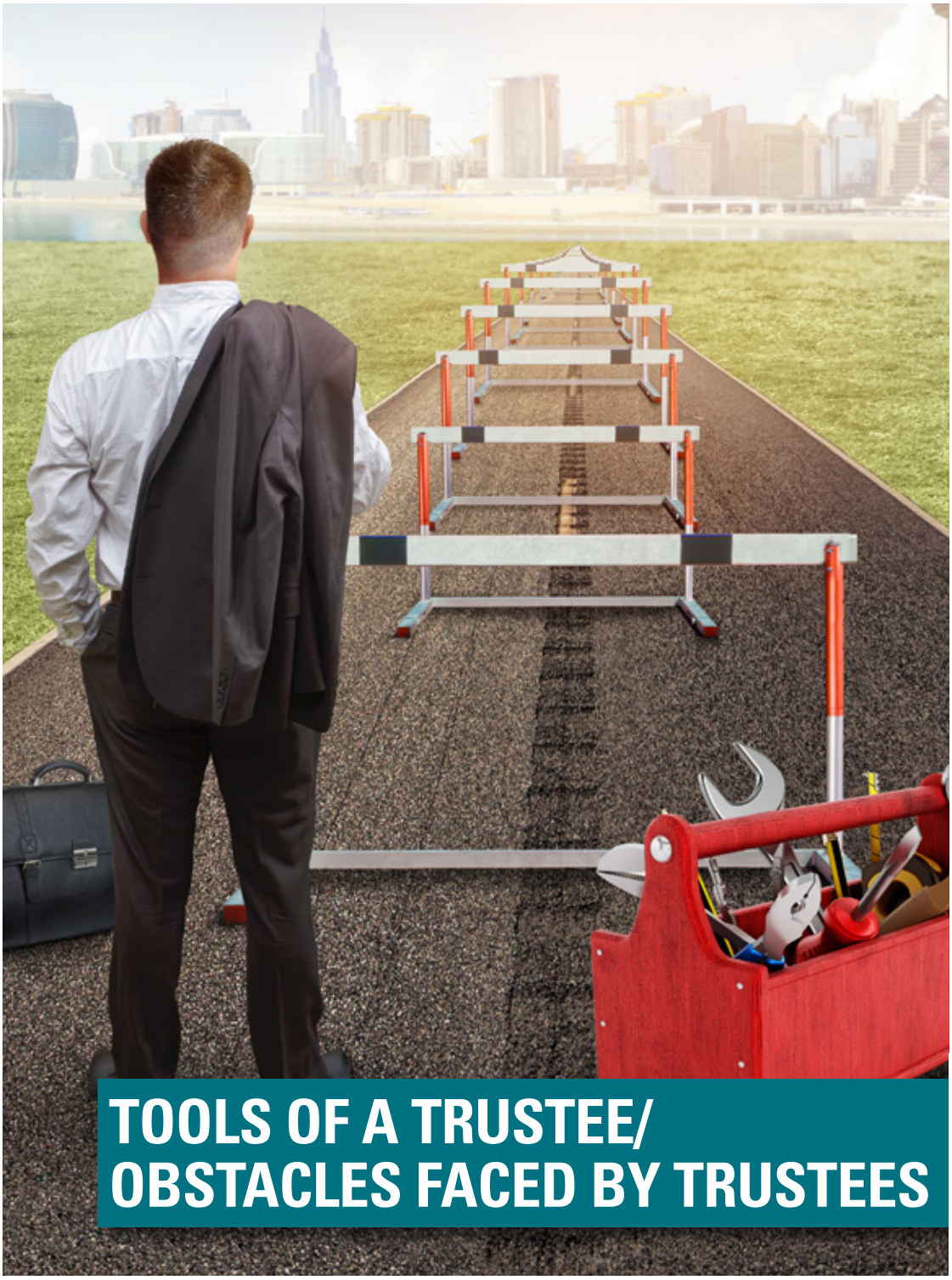

TOOLS OF A TRUSTEE/ OBSTACLES FACED BY TRUSTEES

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Long-term Thinking
Creates Short-term Gains for the Estate

By John A. Palumbo, principal of Bankruptcy Asset Management, Jacksonville, Florida

As you sit at your desk, your paralegal just walked in and asked you again about the one-third interest you have in some real estate. The case has been open for seven months now. You've written to the other two owners with no response. The property, as a whole, is valued at approximately $100,000, which means the estate portion should theoretically be worth approximately $33,000. The question is, what do you do to sell the one-third interest in this real estate? You could file an action under §363(h) to sell the entire property. Unfortunately, sometimes that can be met with resistance, or there could be other circumstances that just don't make sense for that to work. You're thinking, "Well, I could put it on the NABT website, list it on eBay, or try one of the auction companies that regularly advertise."

However, in most circumstances, that one-third interest will not bring nearly as much money in the open market as it would if the person who owned it, or possibly to the other co-owners were interested in purchasing the property.

Let's take a different approach. Instead of trying to sell a 25%, 33%, or 50% interest in real estate in the open market directly under §363(b), you might want to consider selling the estate's interest in the property back to the debtor and/or the other family members at a much higher price. That's right, I did say at a much higher price. Some trustees have discovered that they can get closer to fair market value for the estate's fractional interest by shifting their mindset and becoming a bit more creative. Here's an example based on the above scenario.

The trustee sells the property back to the debtor, in exchange for a promissory note secured by mortgage or deed of trust for the debtor's one-third interest in the property. At the same time, the trustee looks for a buyer to buy the promissory note. Oftentimes, debtors would like to keep their property but simply don't have the means to do so. Obtaining bank financing is usually not an option for them.

On a normal day, it's easy to work out a buy-back agreement with the debtors on their personal property and a variety of other things for 6, 12, 18, or maybe even 24 months. However, very little consideration is given to taking back a promissory note and mortgage for real estate that could stretch out for 10-15 years in length, mainly because no one is capable of holding a case open for that many years.

Solution: Consider selling the property back to the debtor and/or the debtor's family and, instead of taking a deep discount on the fractional interest property, offer the property back to the debtor with little or no money down, by creating a five, ten, or fifteen year note, which would be secured by the debtor's interest in the real estate. [This could also be a strategy for property owned with an existing first mortgage but substantial equity, although the second mortgage might not be quite a valuable on re-sale.]

The reason most trustees would not consider this option is that they would think, "I can't keep a case open for 5-15 years!" That is exactly what this solution is trying to eliminate. Once the trustee and buyer have reached amicable terms, the note is created. In some cases, you may choose to collect payments for six months to a year in order to "season" the note so that it becomes more appealing in the open market. In most circumstances, the selling of a note and mortgage will net the estate a much higher yield than selling the fractional real estate.

Here is another example of thinking outside the box. One of my colleagues, Eugene Johnson, Esq., who regularly represents Chapter 7 Trustee's in the Jacksonville Division of the Middle District of Florida, and one of his Chapter 7 Trustee clients, decided to get creative when faced with a difficult fact pattern. Prior to Eugene's employment, the Trustee and the Debtors entered into a First Rule 9019 Compromise of Claims which provided for the Debtors to make payments as and for settlement of certain issues related to the estate's portion of the Debtors' Federal Income Tax Refund, non-exempt household goods and furnishings, and a small preferential transfer. After entering into the First Compromise, the Trustee was made aware that the Debtors inherited an interest in a family member's estate that was not previously disclosed in the Debtors' Schedules or Statement of Financial Affairs. Naturally, the money was spent before the Trustee got wind.

Rather than pursue post-petition transfers, the Trustee made a business decision to hire Eugene as Special Counsel to the estate to consummate a settlement of these issues directly with the Debtors by taking a note and mortgage secured by the Debtor's homestead. Bear in mind, the Trustee already knew the Debtors reaffirmed their first mortgage and the Trustee's research revealed there may be substantial equity in the property. The Trustee entered into a Second Rule 9019 Compromise of Claims that provided for the Debtors to resolve these issues by giving the Trustee a promissory note for $19,000, plus 7% interest, payable at the rate of $200 per month. Furthermore, under the Second Compromise, the Debtors agreed to give the Trustee a first mortgage and security interest in the Debtors' homestead property and to cooperate with the Trustee in executing a mortgage and promissory note encumbering the property.

Eugene's office obtained a title exam, a broker's price opinion to ascertain the FMV of the property and a payoff from the lender on the first mortgage to confirm the estate's mortgage would be in second lien position, and backed with substantial equity. These actions were taken not only to protect the estate, but to effectively market the note and mortgage to another buyer. The note and mortgage were prepared and executed by the Debtors and the Compromise was approved by Order of the Court. The Trustee then held the note long enough to collect just under $3,000 from the Debtors, again, to prop-up the discount value of the note and mortgage as he now had a payment history to show potential buyers the Debtors were paying.

The Trustee later conducted an auction of the note and mortgage, from which the estate received gross auction proceeds in the amount of $11,000. Altogether, the estate received approximately $14,000 from the note and mortgage, instead of pursuing contingent §549 claims, which even if successful, would require collection efforts from Debtors who might not have the resources to pay the judgment. The end result – a winning formula.

Before you throw in the towel, because you can't find anyone to purchase that one-third interest, consider the idea above. It may be more lucrative that you imagined!

John A. Palumbo is the principal of Bankruptcy Asset Management, based in Jacksonville, Florida, as well as one of the nation's leading authorities on the evaluation and liquidation of unusual assets in bankruptcy. His ability to recover and monetize assets (oftentimes deemed unworthy) has helped trustees achieve the maximum value for countless asset cases. He is a member of the National Association of Bankruptcy Trustees and is invited regularly to their Spring Seminars and Annual Conventions as an expert speaker. Currently serving attorneys, CPAs, and bank trust officers nationwide, John consults, advises, and serves as principal in matters of bankruptcy, probate, and trust estates with banks, and has assisted in liquidating assets in foreign countries such as Greece, Jamaica, Morocco, Italy, Guam, and Mexico, just to name a few. He can be reached at PalumboJ@aol.com; www.chapter7assets.com; 10175 Fortune Parkway, Suite 101, Jacksonville, FL 32256; P: 904-641-2043; F: 904-448-1112