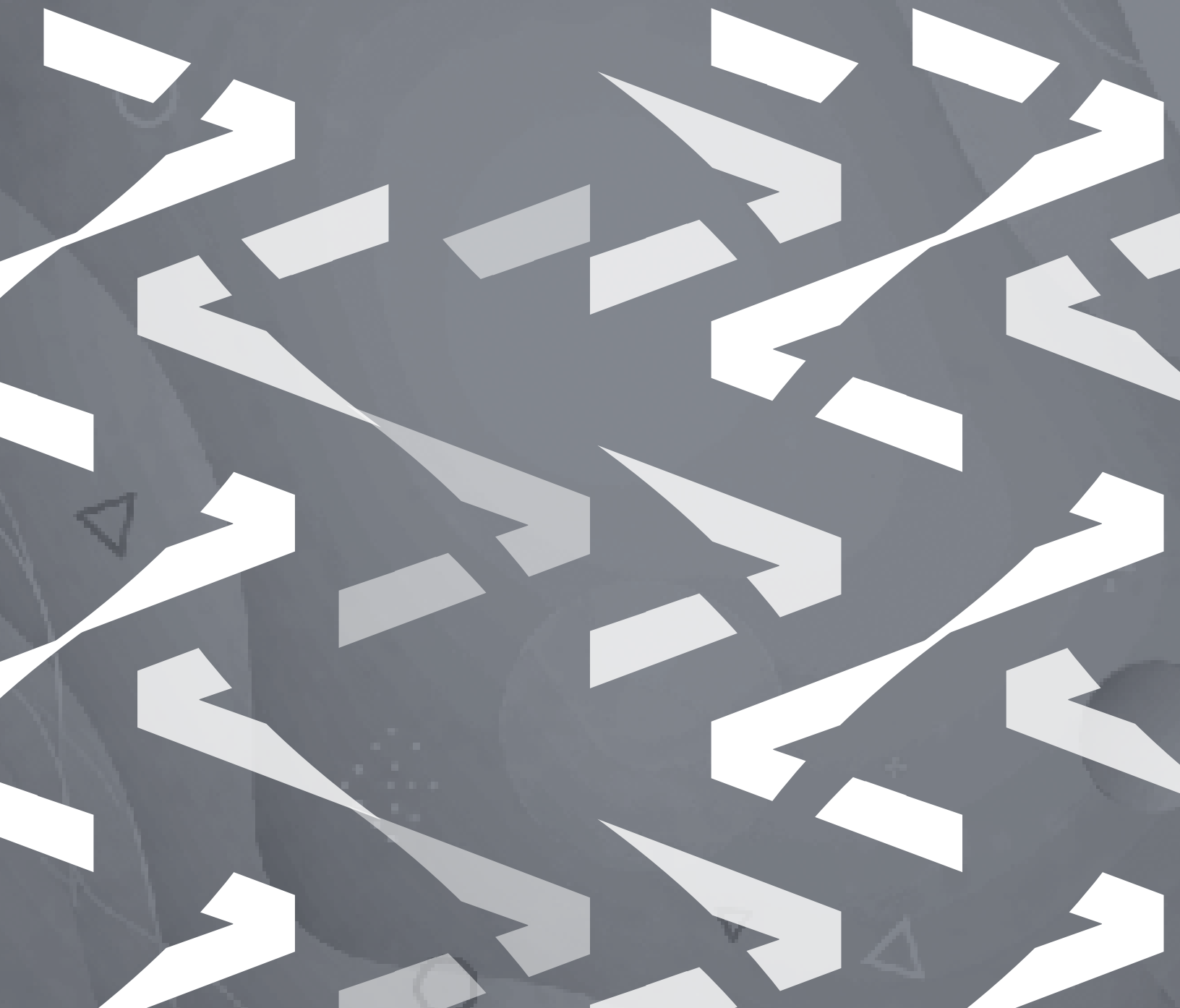




Understanding UCC Real Estate Foreclosures: What Buyers Need to Know



Understanding UCC Real Estate Foreclosures: What Buyers Need to Know

In today's distressed real estate landscape, more investors are encountering opportunities marketed as "UCC foreclosures." While these transactions can present attractive pricing and speed compared to traditional foreclosure sales, they come with a unique set of risks that every buyer must fully understand.

What Is a UCC Foreclosure in Real Estate?

A UCC foreclosure refers to the enforcement of a lender's security interest under the **Uniform Commercial Code**—specifically Article 9—against personal property.

In a real estate context, this structure is commonly used where:

- The borrower owns real estate through a limited liability company (LLC)
- The lender takes a pledge of the LLC membership interests as collateral
- Upon default, the lender forecloses on the ownership interests in the LLC—not the real estate itself

This framework allows lenders to bypass traditional judicial foreclosure and instead sell the equity interests in a private or public UCC sale.



Image source: Freepik – www.freepik.com



Key Distinction: It's Not a Real Estate Foreclosure

The most critical concept for buyers to understand is this:

In a UCC foreclosure, you are not acquiring title to the real estate—you are acquiring ownership of the entity that holds title.

That distinction has far-reaching implications. The real estate remains owned by the LLC, and all liabilities, encumbrances, and contractual obligations tied to that entity remain in place after the sale. As a result, the transaction must be analyzed as both a real estate acquisition and a business acquisition.

What Does the Buyer Actually Acquire?

At a UCC sale, the winning bidder typically acquires:

- *100% or a minority portion of the LLC membership interests
- Indirect ownership and control of the underlying real estate
- All rights, obligations, and liabilities tied to the entity

From a practical standpoint, the buyer is stepping into the exact position of the prior equity owner. There is no “reset” of the ownership structure. Whatever existed before the sale—financially, legally, or operationally—continues after closing.

This is why sophisticated buyers approach these opportunities with a dual lens: evaluating both the asset and the entity that owns it.

Major Risks Buyers Must Understand

1. The Property Is Still Subject to Existing Liens

- Existing mortgages remain in place
- Tax liens are not extinguished
- Judgments and other encumbrances continue to attach to the property

Unlike a traditional foreclosure, where junior liens may be wiped out, a UCC foreclosure does not affect title to the real estate itself. The lender is only foreclosing on the equity interests—not the underlying asset.

As a result, the buyer must underwrite the deal with a full understanding of the capital stack. In many cases, the winning bidder is effectively acquiring a “subject-to” position, where the existing debt must either be serviced, restructured, or refinanced. Failure to properly account for these obligations can quickly erode any perceived discount in the purchase price.

2. You Inherit the Entire LLC—Known and Unknown

- Outstanding vendor obligations
- Pending or threatened litigation
- Environmental or regulatory issues
- Unpaid taxes or reporting deficiencies

When acquiring membership interests, the buyer assumes ownership of the entity as-is. This includes both disclosed and undisclosed liabilities.

Unlike a typical real estate closing, there are no customary representations, warranties, or indemnities from a cooperative seller. The lender conducting the UCC sale is generally disclaiming all liability and selling strictly on an “as-is, where-is” basis.

This makes entity-level diligence essential. Buyers must independently verify the financial condition of the LLC, review historical operations, and identify any potential exposure that could survive the closing.

3. Due Diligence Is Broader and More Complex

Real Estate Due Diligence

- Title report and lien search
- Survey and zoning compliance
- Physical inspections and environmental review

Entity-Level Due Diligence

- Operating agreement and amendments
- Membership ledger and capital structure
- UCC filings and lien priority
- Financial statements and tax returns

Legal Review

- Validity and perfection of the pledge
- Compliance with UCC sale procedures
- Potential challenges from other stakeholders

Because the buyer is acquiring an entity rather than a deed, diligence must extend well beyond the property itself. A failure in any one of these areas—particularly at the entity or legal level—can materially impact the value of the investment.

4. Sale Structure and Notice Requirements Matter

Under the Uniform Commercial Code, the lender must conduct a “commercially reasonable” sale.

- Notice must be provided to required parties
- The marketing process must meet a reasonableness standard
- The sale must be conducted in good faith

If these standards are not met, the transaction may be subject to post-sale challenges. Borrowers, guarantors, or other creditors may assert that the sale was not commercially reasonable, potentially seeking damages or, in extreme cases, unwinding of the transaction.

For buyers, this introduces an additional layer of legal risk that is not typically present in court-supervised foreclosure proceedings.

5. *Minority Interest Sales: A Hidden Layer of Risk

Not all UCC foreclosures result in the sale of 100% of the membership interests. In some cases, the lender’s collateral may consist of only a partial or minority interest in the LLC.

- The buyer may acquire less than a controlling stake
- Existing members may retain decision-making authority
- Operating agreements may severely restrict control rights

This scenario can create significant complications. A minority interest holder may have limited or no ability to influence major decisions such as refinancing, sale of the property, leasing strategy, or capital improvements.

In addition, operating agreements often include provisions such as:

- Transfer restrictions
- Buy-sell rights
- Rights of first refusal
- Manager-controlled governance structures

Without a controlling interest, the buyer could find themselves economically invested in the property but operationally sidelined. In some cases, this can lead to deadlock situations, disputes with other members, or an inability to execute a business plan.

For this reason, understanding exactly **what percentage interest is being sold—and what rights accompany that interest—is critical** before participating in a UCC sale.



Image source: Freepik – www.freepik.com

Why Do Lenders Use UCC Foreclosure?

Lenders often favor UCC foreclosure because it is:

- Faster than judicial foreclosure
- Less expensive
- Conducted outside of court supervision
- Flexible in terms of timing and structure

However, that efficiency comes at the cost of reduced procedural protections, which shifts more risk onto the buyer.

Best Practices for Buyers



Image source: Freepik — www.freepik.com

Before bidding on a UCC foreclosure:

- Engage experienced real estate and UCC counsel
- Conduct both property-level and entity-level diligence
- Analyze the full debt structure and lien position
- Review the operating agreement in detail
- Confirm whether the sale involves a controlling or minority interest

Sophisticated buyers approach these transactions with the understanding that they are not simply acquiring real estate—they are acquiring a legal structure with embedded risks.

Final Thoughts

UCC real estate foreclosures are powerful tools that can unlock value in distressed situations. However, they require a level of sophistication and diligence that goes beyond traditional acquisitions.

The buyer is not purchasing a clean asset—they are stepping into an existing story.

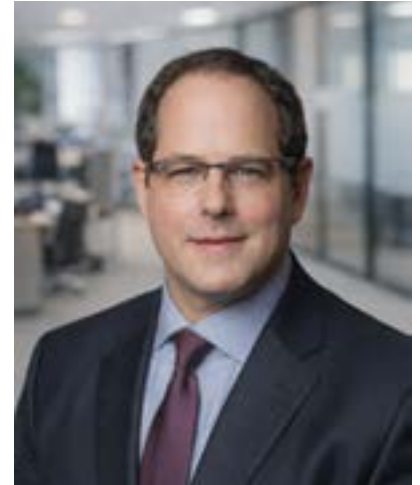
Understanding that story in full is what separates a successful investment from a costly mistake.

LEADERSHIP

JOSHUA OLSHIN

Joshua Olshin is a partner at AuctionAdvisors and brings his extensive experience advising corporations, financial institutions, municipalities and individuals on the disposition of assets throughout the United States. Before entering the auction business, Mr. Olshin worked as a corporate/transactional attorney in private practice for more than 8 years, beginning his career at Skadden Arps Slate Meagher & Flom and then at Friedman Kaplan Seiler & Adelman. During his time as an attorney, he advised top Fortune 500 companies on the acquisition and disposition of corporate assets.

Mr. Olshin received his B.A. from Johns Hopkins University, his J.D. from Northwestern University Law School and his M.B.A from INSEAD (Fontainebleau, France). Mr. Olshin is a member of various trade organizations and his affiliations have included: Turnaround Management Association (TMA), American Bankruptcy Institute (ABI), National Association of Home Builders (NAHB), Urban Land Institute (ULI), Mortgage Bankers Association (MBA), National Association of Auctioneers (NAA) and is admitted to the New York Bar Association.



OREN KLEIN



Oren Klein is a restructuring and insolvency professional specializing in assignments concerning bankruptcy trustees, federal and state receiverships, special fiscal agents, special masters and assignments for the benefit of creditors. Mr. Klein has served as a Partner with AuctionAdvisors for the past 12 years. Prior to his position at AuctionAdvisors, Mr. Klein was a Partner at Integrated Property Group, LLC for over 4 years. Mr. Klein currently serves as the Chairman of the Turnaround Management Association's New Jersey Chapter with over 220 members in the insolvency and restructuring industry. He also served as a member of the Chapter Resource and Response Committee for the Global Turnaround Management Association serving 52 Chapters with over 10,000 members worldwide.

Mr. Klein holds a bachelor's degree from Rutgers University and is a graduate of The World Champion College of Auctioneering. He is a real estate broker in 5 states and a licensed auctioneer. Mr. Klein has also served as Special Master and Court-Appointed Receiver in several state court actions.



Oren Klein, 973-753-1313 ext 703
oklein@auctionadvisors.com

Joshua Olshin, (212) 375-1222 ext. 705
jolshin@auctionadvisors.com