



Receiverships: Maximizing Returns From Distressed Real Property CMBS, COMMERCIAL, CONSTRUCTION, MULTI-UNIT RESIDENTIAL AND OTHER REAL PROPERTY LOANS

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Real property suffered disproportionately in the recent economic crisis leaving lenders, special servicers and other financial institutions facing myriad decisions as to how to maximize the value of distressed real property assets. Foreclosure, restructuring, receivership, and the like, once remedies of last resort, are now terms readily used in the daily lexicon of these institutions. Receivership provides a viable option to foreclosure in many instances, and may well soften the fall of the commercial mortgage-backed securities (CMBS) market, as well.

New Liabilities for Financial Institutions

Lenders, special servicers and financial institutions are now finding themselves in a very difficult position. While they may hold real property as a form of security, most lenders, particularly financial institutions, are not in the business of being landlords, developers, contractors, operators or property managers. Yet, traditional foreclosure proceedings place them in that very position, thus increasing the universe of claims against them and exposing them to years of potential liability.

Specifically, traditional foreclosure grants the lender full title to the property, including all of the costs, liabilities and problems associated with that property. For example, if after foreclosure the property is in the midst of construction, the burden and responsibility of completing construction or abandoning it, now lies with that institution along with the liabilities that flow therefrom. If the real property is a going concern, maintenance, tenant management and lease renegotiations (popular today) will be in the hands of the lender/servicer (or its designee) post foreclosure. This creates multiple avenues of lawsuit exposure for servicers and lenders. While the laws are complex, it is unequivocal that lenders/servicers will be seen as target “deep pockets” in future litigation by plaintiffs’ attorneys.

While there is no cure-all solution, it has become apparent that the appointment of a Receiver is a viable avenue for preserving, managing, restoring, completing and, ultimately, disposing of certain real property assets while protecting lenders from liability. A Receiver is a court-appointed neutral who holds the collateral in custodia legis (legal custody). Thus, the institution does not necessarily need to take title to the real property.

Protection to the Lender/Servicer Provided by a Receiver

The Receiver’s role as an officer of the Court protects the asset by providing Court oversight and approval of the Receiver’s business decisions—providing the lender or financial institution with insulation from many of the claims and hardships they would have inherited had they followed the traditional route of foreclosure and ownership.

In instances where there are multi-unit structures, multiple tenants, incomplete construction, code violations or other unique problems with a particular parcel and its structure, the Receiver can resolve these problems before the lender takes title or before the real property is sold. Further, in some unique instances, a Receiver can facilitate the restructuring of existing debt through the court, avoiding the need to identify replacement financing from a third party lender.

A Receiver can operate, under the Court’s supervision, to resolve unique problems inherent to a property and, ultimately, “clean-up” collateral for foreclosure or sell the property through a court approved sale process. Of course, each asset must be evaluated on a case-by-case basis to determine what avenue, including the appointment of a Receiver, is best for that particular asset. While a Receiver may not be appropriate in all cases, there are certain cases in which a Receiver will be beneficial to the financial institution.

What Problems Can a Receiver Tackle?

The appointment of a Receiver can facilitate the following:

- Provides the Court/Receiver the ability to sell real property “as is, where is” thus limiting exposure to the lender/servicer and the Receiver;
- A Receiver, with Court guidance, can manage complex CFD issues;
- A Receiver can acquire, confirm and/or reinstate insurance (including WRAP policies);
- Allows Receiver to hold assets to maximize value through improvements or through “time”;
- Can limit or avoid potential SB 800 liability;
- Can avoid having the lender be an “owner” (and thus, limits exposure and liability to the lender/servicer);
- Provides experienced day to day management for the real property;



- Provides expertise in construction, property management and other skills (depending on each respective properties' needs);
- Does not need to disrupt on-going construction or business;
- Encourages borrowers continued cooperation (motivated to see project through and avoid insolvency);
- Does not waive lender's rights against guarantors (and such claims may be raised in the same action);
- Gives lenders a non-judicial foreclosure "back door";
- Provides for equitable powers of the Court usually beyond those of a Bankruptcy Court; and (most importantly)
- Secures and maximizes the value of the asset.

When Is Appointment of a Receiver Appropriate?

The preparation of a lawsuit and application to appoint a Receiver by a lender must be carefully crafted. Each real property is different and the complaint and appointment order must be tailored to fit each situation. Some factors to be mindful of include:

- Is the borrower cooperative?
- If there are tenants, are they cooperative?
- Are the tenants solvent or operating?
- If applicable, is the general contractor cooperative?
- Is there an equipment lease in place?
- Is the borrower an individual or legal entity?
- Is there a guaranty?
- Where is the property located?
- Are there any code violations, permit problems, state regulatory concerns or other administrative or legal problems?
- What funds are available in the estate?
- Are there construction defect claims?
- Are there mechanics' lien claims?
- Are there other secured lenders? Are they priority or subordinate claims?
- Are there tax liabilities (recorded and unrecorded)?

These are just some of the concerns that may arise when deciding whether to seek the appointment of a Receiver. Each asset is different and requires a unique approach to limit a lender's liability and exposure and to maximize the value of that asset. All in all, a receiver, in many circumstances, may provide the protection, guidance and relief that many institutions require, in this economy, in connection with their real property collateral.

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