

## **How Receivers Can Maximize Returns in a Distressed Market**

by:

Richard P. Ormond, Esq.  
Buchalter Nemer, P.C.

This current economic crisis is unlike any seen in recent memory and is affecting commerce from top to bottom. Lenders, special servicers and other financial institutions are now faced with a myriad of decisions as to how to maximize the value of distressed collateralized assets. Foreclosure, restructuring, Receivership, etc. once remedies of last resort are now terms readily used in the daily lexicon of these institutions. This financial “storm” is indiscriminate and, if a lender, servicer or financial institution does not protect its interests properly it can and will be exposed to additional costs and liabilities.

### **New Liabilities for Financial Institutions**

Lenders, special servicers and financial institutions are now finding themselves in a very difficult position and with new potential liability exposures. Although they may hold a form of security, most lenders (and particularly financial institutions) are not in the business of being landlords, developers, contractors, operators or property managers.

The pending collapse of the commercial real estate market is going to further cripple CMBS servicers (and, for that matter, TIC lenders and/or managers are in the economic downturn’s crosshairs as well). The biggest concern is that traditional foreclosure may trigger unforeseen problems including insurability, liability, claim exposure, tenant management (and retention) and construction management and construction defect issues.

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. Further (and, if necessary) a Receiver can facilitate, through the court, the restructuring of existing debt—converting a non-performing loan into a new performing loan.

Non-judicial foreclosure guarantees that the lender will become fee title holder of the foreclosed distressed real property. All of the costs, liabilities and problems associated with that property will now become the burden of the lender. If the property is in the midst of construction, the burden and responsibility of completing construction or abandoning it, lies with the bank after a foreclosure.

After foreclosure, 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). 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.

### **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 appointment of a Receiver provides “insulation” to the lender/servicer from certain claims and responsibilities. Those responsibilities are shifted to the Court, through its neutral, the Receiver.

A Receiver can operate, under the Court’s supervision to resolve these unique problems and, ultimately, “clean-up” collateral for foreclosure or sell the property through a court approved sale process. 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.

As such, to protect the interests of the lenders and financial institutions, this firm, in many instances, has recommended that the lender seek the appointment of a Receiver. 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.

### **Problems that Can be Avoided Through the Appointment of a Receiver**

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);
- Allows for funding to complete projects through Receiver Certificates;
- 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.

### **Important Factors in Considering a Receiver**

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

- Is the borrower cooperative?
- Are the tenants cooperative?
- Are the tenants solvent and/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? (Remember, a foreclosure action must be filed in the district in which the property lies. The Court's jurisdiction must be *in rem*).
- Are there any code violations, state regulatory concerns or other administrative or legal problems?
- What funds are available in the estate?
- Are there construction defect claims?
- Are there mechanics' liens?
- 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.



*Richard P. Ormond is a Shareholder in Buchalter Nemer's Los Angeles office. Mr. Ormond is available to answer questions about Receiverships and to assist in training financial institution members in how to deal with distressed assets including real estate.*

*Mr. Ormond's practice includes expertise in Receiverships, lender representation, remedies, and business litigation. He is a Board Member of the California Receivers Forum and is an officer of the Executive Committee of the Remedies Division of the L.A. County Bar Association. His clients include financial institutions, Receivers and other businesses.*