Selling Real Estate Assets in Receivership

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A receiver is a court-appointed officer charged with taking possession and protecting assets for the benefit of all interested parties. A receiver has oversight and reporting duties and:

1. Is a neutral third party.
2. Acts on behalf of, and for the benefit of, all interested parties, including the secured lender, other creditors, tenants, property vendors, and the borrower.
3. Marshals, manages, protects, preserves, and enhances the assets for the benefit of the court and not for any specific party.

The right to appoint a receiver is statutory, and specific duties are set forth in a receivership order issued by a court. Receivership duties for real estate assets commonly include securing and stabilizing the asset, seizing control of receivership bank accounts, collecting rents, interfacing with tenants, and assisting with the resolution of outstanding property or lease issues, including deferred maintenance and general property management and maintenance issues.

Receivers appointed for real estate assets also typically negotiate, extend, and/or terminate contracts; renew permits and licenses; prosecute and defend lawsuits that impact the asset; address health- and safety-related issues; handle insurance issues; and value, market, lease, and in some cases sell property.

The most opportune time to sell a real estate asset may be while a receivership action is pending. Through hands-on management, a receiver should be able to stabilize the asset during a receivership, create interest in an off-market/pre-market asset, negotiate more favorable contracts and leases, and develop a meaningful and comprehensive due diligence package. A sale during receivership may also enable a lender to avoid liability issues, sell the asset with existing (or restructured) financing, and engage parties for an expedited sale by obtaining court approval.

Stabilizing assets in receivership begins with a thorough analysis involving a careful review of all documents that govern/impact the property, along with on-site inspections to gain an understanding of all operational issues. From the initial asset intake and on through monthly reports filed with the court, a receiver should detail short- and long-term operational strategies with a goal of implementing additional operational efficiencies. After carefully reviewing all contractual obligations and developing an in-depth understanding of the operational aspects of the property, a receiver accepts, rejects, or renegotiates agreements to preserve value, mitigate risk, and add value long-term.

Comprehensive management of on-site employees or off-site resources also may decrease expenses and increase operational efficiencies, adding value to the asset through more efficient and effective operations. With a clear understanding of the operation of a property, a receiver can then deploy leasing strategies to maximize occupancy/reduce vacancy, along with disposition strategies that may include the sale of the asset.

With detailed knowledge of the financial and physical aspects of an asset, a receiver is in a position to develop due diligence reports and packaging that are meaningful to all stakeholders, as well as to potential buyers. Hands-on management and extensive investigation leads to a well-developed due diligence package and eases the way for a receiver to bring an asset to market. A well-maintained and stable asset increases value.

Reducing Liability Exposure

Selling assets in receivership may reduce a lender's exposure to lender liability claims, property risks, and prior contractual obligations, expenses, and warranties. A sale in receivership can help lenders avoid being perceived as deep-pocket targets by vendors, suppliers, utilities, and business franchisors attempting to force payment of the borrower's debts. Armed with the power of a receivership order, a receiver should have no obligation to pay any pre-receivership debts and can assume a "bad cop" role with aggressive creditors to effect a clean break between borrower and prospective buyers.

Because the lender does not take possession or control of the asset and instead leaves this responsibility to a receiver subject to court supervision and reporting responsibilities, the lender eliminates its exposure to environmentally contaminated properties, which may require costly and time-intensive study, remediation, and reporting. In addition, a lender can avoid responsibility for the cost- and labor-intensive cure of warranty issues associated with residential subdivisions, condominium conversions, and other product under warranty.

In addition, many distressed real estate assets are targets of vandalism and other criminal activity. A lender avoids exposure to this potential liability when a receiver steps in to manage, maintain, mitigate damage to, and protect and preserve the property.

Often, the sooner a property is sold, the higher the price and better the recovery it brings for the secured lender, other creditors, and the borrower. Many receiverships involve businesses with specialty assets, such as hospitality and mini-storage businesses and gas stations. When collateral includes an operating business, the perception that the business is unstable must be overcome. Disgruntled employees, vendors, and customers can have a dramatically negative impact on the value of an asset. Being able to sell an asset earlier in receivership can help mitigate these issues.

Dedicated management of assets in receivership can help demonstrate stability and produce a perception of higher value by potential buyers. Receivers can market a property and build interest for a stabilized asset. They also often field inquiries and offers, and being able to sell during receivership can lead to faster and better recoveries for the interested parties.

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Facilitating Financing

Some courts allow receivers to facilitate the assumption or reworking of existing indebtedness, which in some cases maximizes pricing for an asset. In many instances, debt would otherwise be unavailable or available at a significantly lower loan to value or higher interest rate, or would require a personal guaranty. One recent Arizona case, *LaSalle Bank National Association et al. v. Phoenix Kingdom I, LLC*, provided that the receiver could sell seven Arizona apartment complexes over the borrower's objections and without requiring a foreclosure to occur first. But equally important, the court also allowed the buyer to assume the existing debt.

The original borrower, the Bethany Group of Irvine, California, walked away from these seven Arizona apartment complexes in December 2008, along with other properties financed separately. The initial acquisition of the apartment complexes was financed through commercial mortgage-backed securities (CMBS). In March 2009, the court appointed a receiver for the seven apartment complexes located in Phoenix, Mesa, and Glendale, Arizona, after it became known that Bethany Group had cut off employee salaries and operational funding for 60 of its apartment complexes nationwide.

The receiver fielded numerous offers on the portfolio, including one for $123 million—$53 million higher than the next highest offer— from Standard Portfolio, a real estate investment firm. The offer, however, was contingent on Standard Portfolio assuming the existing CMBS loan, which carried more favorable lending terms than those it could obtain through new financing.

In the current economic environment, most lenders are willing to offer no more than 60 percent loan to value. Being able to assume the existing financing would give Standard Portfolio access to low-cost capital originated when better market conditions existed. By assuming an existing loan with less stringent terms, a leveraged buyer like Standard Portfolio can offset a higher purchase price against its investment commitment, resulting in a higher cash-on-cash return.

As previously mentioned, the existing debt in the Bethany case was a CMBS loan. Special servicers can't offer collateral properties from defaulted CMBS loans for sale with assumable financing, nor can they offer seller financing by creating new debt in existing CMBS pools that they manage. Foreclosure would eliminate the original debt altogether. Prior to the Bethany Group case, no definitive law prohibited or allowed the sale of assets in receivership or specifically addressed the assumption of existing debt.

The court ruled that the buyer took the place of the existing borrower within that CMBS pool and allowed Standard Portfolio to assume the existing loan—replacing a non-performing borrower with a performing one. Had it foreclosed on the properties, Bethany's lender would have faced the prospect of selling the properties at a price more than $50 million less than Standard Portfolio's bid.

Increasing Awareness

The sale of real estate assets in receivership has become more common as the volume of distressed real estate assets has increased and stakeholders have become more familiar with the option. Stakeholders have found that a hands-on receiver can often stabilize assets in receivership by focusing attention on operational and contractual issues. That, along with meaningful due diligence information and packaging, can maximize value of the asset.

With well-capitalized entrepreneurial buyers ready to pull the trigger on deals that in many cases are trading below replacement cost, many stakeholders are seeking to avoid liability, mitigate damage, and maximize value by marketing and selling assets in receivership. CR

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