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COMMERCIAL INVESTMENT

REAL ESTATE

DISTRESSED ASSETS

Receivership 101

Learn the inside track to working with receivers.

By Stephen J. Donell, CCIM, CPM |

The gloomy news about the real estate recession continues to pour in. Trepp recently confirmed that the current commercial mortgage-backed securities delinquency rate is the highest in its history. Commercial mortgage defaults likely will continue at staggering levels in the near term.

During these challenging times, receiverships offer a lucrative opportunity for educated, savvy real estate professionals to assist lenders with their distressed assets. In addition, a mutually beneficial relationship between brokers and receivers is gaining in importance. Those who become familiar with the receivership process can gain a significant competitive advantage.

Default Decision

When confronting commercial loan defaults and protecting the distressed assets, lenders and servicers often rely on one of four common remedies: workouts, receiverships, deeds in lieu, and foreclosures. Among these, the role of receivers is growing at an accelerated pace, as lenders pursue receivership appointments to minimize losses, preserve property values, and avoid liability exposure.

Often, lenders will pursue receivership because of the extreme costs and potential liabilities associated with other courses of action. For example, by using a receiver in the case of an unfinished property, the lender can fund construction completion without ever taking title as an owner, thereby avoiding construction defect litigation. The receiver can sell the property as-is per court order and similarly avoid such exposure. Environmental exposure is another common factor that

lenders consider, especially with gas stations or industrial property.

However, receivership itself can be costly. If the property's net operating income is less than a receiver's fees and costs, it may not make sense to pursue receivership. In addition, the mere threat of receivership may prompt the borrower to be more responsive to the lender.

Rules of the Role

Although some federal receivership rules exist, no single area of law governs the use and practice of all receiverships.

However, in most appointments the receiver is

- a fiduciary;
- an agent of the court; and
- holds assets in custodia legis to preserve and protect the property/asset.

Receivers do not work for lenders and they are neutral, although some states provide for more direct interaction with receivers than others. Generally, a receiver is an individual and not a company.

When a loan goes into default, the lender is said to have a prima facie case for the appointment of a receiver, assuming the appropriate language exists in the loan documents. Most loans originated by commercial lenders contain such language; however, even if these provisions do not exist, the lender generally can have a receiver appointed to protect its loan collateral.

After appointment by the court, a receiver has legal possession of the property but does not hold title. However, a receiver virtually steps into the owner's shoes, assuming all duties and responsibilities.

Anyone can be a receiver. While the types of receiverships include business, marital dissolution, government enforcement, judgment enforcement, construction completion, and partnership dissolution, the most common receivership involves traditional real estate cases, also known as rents, issues, and profits cases. In addition to having experience and knowledge in the basics of receivership administration and the various local rules of the appointing court, the proposed receiver should have related asset/property management, brokerage, legal, and/or development experience.

A receiver's powers and duties are expressly stated in the appointing order and are further defined by statute and additional orders of the court. As an officer of the court, a receiver is offered limited judicial immunity; however, if a receiver acts outside their scope of authority, they may be personally liable.

Receivers generally are paid on an hourly basis, with rates varying greatly based on geographic location. Rates typically range from \$200 to \$500 per hour, although in some cases fixed fees are charged. The receiver may use his own management company with proper disclosure. Generally fees are paid on a monthly basis directly from the proceeds of the property after proper notice to all parties. However, the court retains jurisdiction to approve all fees paid and reserves the right to deny certain improper fees, requiring a receiver return such fees. This surcharge is a receiver's worst nightmare. Novice receivers or service providers working for inexperienced receivers should take note.

30-Day Delinquency: Percentage of CMBS loans 30 or more days delinquent or in foreclosure or REO

Broker Opportunities

The sale of assets by receivers is much more prevalent today than in past cycles. This is partly a result of the huge number of incomplete residential properties that would subject lenders to construction defect liability if they were to foreclose. It also is a function of receivers' greater degree of sophistication, the impact of securitized loans, and the different goals and objectives of servicers and balance-sheet lenders. If a receiver can demonstrate to the court that it is in the best interest of all parties and the receivership estate to sell the asset, the court may grant such authority despite objections from the other parties.

Receivers regularly utilize the services of qualified brokers to obtain broker opinions of value in lieu of obtaining costly appraisals. The use of BOVs may have a significant impact on the receiver's ability and decision to sell the property. Similarly, in-depth market reports are required to establish market lease rates, tenant improvement allowances, escalations, free rent, and other concessions. It's also vital to hire professionals that are experts in entitlement, permitting, and construction costs. In this regard, the receiver is oftentimes acting as an owner, property manager, asset manager, developer, seller, and consultant all at once.

Since all receivership matters involve underlying litigation, receivers are under enormous scrutiny. Not only are the lender's asset manager and attorney involved, but the borrower and borrower's counsel, as well as the court, are involved at every step. Therefore, receivers utilize property managers, leasing agents, brokers, and other professionals that demonstrate specific knowledge of the market and property type, and have a keen understanding of the nuances and limitations of leasing or selling a property in receivership. Choosing the best in class by calling on CCIMs is one way to demonstrate to all parties that the proper professionals are being retained.

Assisting receivers presents a huge opportunity for brokers. But first, they must demonstrate an understanding of receiverships. This includes knowing that a listing agreement may be canceled at any time in the event of a court order, foreclosure, bankruptcy, or case termination; that fees are subject to court approval; and that the process may be handled through either ex parte or noticed motion and/or stipulation. Moreover, in a sale, proper disclosure by the broker is vital; buyers must understand that the asset is being sold with no representations or warranties, free and clear of liens, and is potentially subject to overbid. Possessing this kind of insider knowledge may mean the difference between getting hired by the receiver or not.

Once a receiver finds a qualified broker who understands this process, repeat business is very likely. And a broker who experiences the receivership process firsthand may be considered for nomination as a receiver in the future.

One of the most common mistakes brokers make is using the terms bankruptcy and receivership interchangeably. Once this occurs, the receiver immediately knows that the broker probably is unaware of even the most basic elements of receiverships. A receivership is not a bankruptcy, and a receiver is not a bankruptcy trustee.

Brokers who do their homework and understand the complex issues involved in a receivership can expect to develop an ongoing relationship with an individual receiver who will often think of that broker as the go-to person when dealing with receiverships in that area.

Finding a Receiver

As the opportunities for distressed asset and receivership services grow, there are a number of ways to seek out receivers. There are numerous organizations that are directly or indirectly involved in the receivership industry such as the California Receivers Forum. Many bankruptcy trade organizations have members that are involved in receiverships. Most large law firms have creditors' rights departments that will represent lenders in the process of selecting receivers to be nominated. Finally, most career receivers have developed extensive Web sites describing their services.

The economic downturn has dismantled the real estate market's financial architecture, and the entire financial system has been re-leveraged. While the pain of pressing the reset button has hurt developers, lenders, and brokers alike, a new opportunity has sprung out of this turmoil. By partnering together, receivers and brokers can develop symbiotic relationships that might seem at first unlikely but could ultimately profit both sides.