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Lawyers should be prepared, revisit receiverships

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Receiverships have been around for a long time but until recently have not received much attention. Except for those regularly dealing with distressed properties, real estate attorneys did not think about receiverships. The recent publicity about the battle to have a receiver appointed to take control of Block 37 — the redevelopment project in downtown Chicago which was finally nearing completion — reminded many about this heretofore ignored device.

On Oct. 20, 2009 Bank of America filed a foreclosure action against Block 37 claiming that its developer, Joseph Freed & Associates had defaulted on the loan, had high cost overruns and had run out of money to complete the project. The developer denied the bank's allegations.

Three days later, the bank asked to have a receiver appointed to take possession of the project because removing the developer was essential for the well-being of the project. The bank alleged that a receiver would be able to: maintain the pace of construction, enable tenants to open in time for the holiday shopping season and open the pedway. The developer did not agree, contested the appointment and continued with construction and store openings. Nevertheless, the court appointed a receiver which finally took possession and control of Block 37 on Jan. 22, 2010.

All the publicity about the battle to oust the developer and put Block 37 in possession of a receiver, remind real estate attorneys that perhaps they should revisit the requirements for and the situations in which a receiver can be appointed – topics which they may have last encountered in a law school transactions course.

In his co-authored article prepared for the American College of Real Estate Lawyers (Fall 2009) "Tis Better to Receive -- The Use of a Receiver in Managing Distressed Real Estate" Samuel H. Levine (Arnstein & Lehr LLP) noted that the "lack of use of receiverships for many years has created a serious consequence in addition to general unfamiliarity. Unlike federal bankruptcy law, few states have a well-developed body of statutory or case law defining the powers and liabilities of receivers."

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Receiverships are available in all states as part of a foreclosure action brought by a lender against a borrower who has defaulted on a mortgage loan. However, the law governing the appointment of receivers varies from state to state.

In Illinois, a foreclosing lender may have a receiver appointed based upon a claim that the borrower is in default and that the loan documents provide for the appointment of a receiver. 735 ILCS 5/15-1701. The appointment of a receiver is not viewed by Illinois courts as a 'drastic' remedy. (See, *Traveler Ins. Co. v. LaSalle Nat'l Bank*, 200 Ill. App. 3d 139(2d Dist. 1990).

The Illinois Mortgage Foreclosure Law (IMFL Section 5/15-1702) presumes that when a loan on non-residential real property is in default that the mortgagee/lender is entitled to possession. It is incumbent on the borrower/mortgagor to show good cause why a receiver should not be appointed.

The Illinois courts' favorable approach to the appointment of receivers does not prevail in many other jurisdictions or in the federal courts. In other jurisdictions judges more actively consider whether or not to exercise their equitable power to appointment a receiver. When determining if a receiver should be appointed, factors that courts consider include: insolvency of the borrower, actual or threatened waste of the mortgaged property, mismanagement by the borrower and if the value of the mortgaged property is inadequate to cover the debt.

The receiver appointed in a foreclosure action is a "special" or "limited" receiver which takes possession only of the mortgaged property involved in the foreclosure action. Any other property owned by the defaulting borrower remains under the control of the borrower.

Appointment of a receiver is an equitable remedy which transfers control of the property to a receiver, which takes possession and operates the property while the foreclosure action is proceeding. As a court appointee, the receiver is obligated to account to the court for the monies received from tenants and for how such monies have expended.

By having a receiver appointed as part of a foreclosure, lenders avoid the potential risk of claims of mismanagement that borrowers raise when the lender elects to become a "mortgagee in possession." It also makes sense because receivers, unlike lenders who are experienced in making loans but who are neophytes when it comes to operating properties, are experienced in property management.

Receivers can also be appointed in proceedings not involving a foreclosure but which involve real estate which needs to be managed or disposed of. These proceedings may include winding up the affairs of an insolvent entity or disposing of the assets to resolve and settle a dispute between shareholders or partners.

Receivers derive their powers from state statutes, case law and very importantly, the order appointing the receiver. The order not only identifies the property that is included in the receivership estate but it also sets forth the authority of the receiver over those asset, which can include borrowing money, contracting with third parties for services and applying for new permits and licenses if existing ones cannot be transferred plus the compensation that the receiver will receive.

As a result of the recent downturn in real estate, many communities are faced with the need to do something about distressed condominium properties. Effective Jan. 1, 2010, a new provision in the Illinois Condominium Act (765 ILCS 605/14.5) gives municipalities the right to have a receiver appointed for distressed condominium properties in their community which are operated in a manner or which have conditions which may constitute a danger, blight or nuisance to the community. This legislation recognizes the increasing use of receivers in the current crisis.

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