

# The Critical Role of the Foreclosure Receiver

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The rise of commercial foreclosure filings in the wake of the recent recession has grabbed plenty of headlines in Wisconsin. Lenders and others in the community take notice when a prominent developer, popular restaurant, or unfinished project becomes the subject of foreclosure. Public awareness is renewed when the real estate is finally auctioned by the Sheriff to a new owner. But in between the headlines and often overlooked is one of the most critical components of any commercial foreclosure action – the appointment of a receiver.

Contested foreclosure cases can often take a year or longer to resolve. When the subject property is commercial – like office buildings, multi-tenant apartment complexes, hotels, and partially completed condominium developments – one or more of the following characteristics is usually present:

- Rental income is generated during the foreclosure proceeding
- Vacancies, lease renewals, and tenant negotiations must be addressed
- Significant (and often delinquent) property tax liabilities may be present
- Maintenance and repairs do not abate while the property is in foreclosure

In the absence of a receiver, mortgagors are entitled to remain in possession and control of commercial property and any rental income the property generates during the foreclosure proceeding. The lender has no say in selecting tenants, determining rent terms, addressing vacancies, addressing maintenance issues, and the like, other than as may be provided for in its mortgage or loan agreement. Therefore, to take control of its collateral and ensure its protection and preservation, a foreclosing lender must consider whether to petition the court for the appointment of a receiver over the property and its rents.

This *Update* will examine the process of the appointment of a receiver in a Wisconsin foreclosure action and illustrate the benefits to the lender of such an appointment.

## **The Process of Appointing a Receiver in a Foreclosure Action**

Wisconsin foreclosure actions require the lender to file a complaint in civil court against, at a minimum, the mortgagor (which is usually its borrower too). If the lender is successful in obtaining a foreclosure judgment, the order for judgment will direct the local sheriff to sell the property at an auction with the proceeds paid to the lender in full or partial satisfaction of the debt. The sale will not occur until the expiration of the applicable redemption period. The final step in the foreclosure action is the confirmation of the sale by the court.

The court may appoint a receiver to preserve and protect the lender's collateral at any time during the foreclosure action, but generally the foreclosing lender should move for the appointment early in the case. A foreclosure receiver is receiver over the real estate (the land and buildings), the rent, and other collateral that may be implicated in the foreclosure action. The receiver is not a general receiver over the mortgagor or its other assets. A supporting affidavit should accompany the motion, and taken together, the motion papers must set forth the necessary law and facts to justify the appointment of a receiver. The mortgagor has the opportunity to object to the motion and present its own facts to dissuade the court from ordering the appointment. An evidentiary hearing may be necessary before a motion is granted.

### **The Receivership Trifecta; The Contract, the Statute, and the Case Law**

There are three primary sources of authority for a receiver appointment.

The first source is the mortgage itself. The mortgage will typically provide that, upon default (breach), the lender is or may be entitled to seek the appointment of a receiver in a foreclosure action, but the motion process described above must still be followed. Assignments of leases and rents usually contain a similar remedy. Lenders should bring this contractual remedy to the court's attention and emphasize that the mortgage and assignment of leases and rents authorize a receiver appointment.

The applicable statute governing receiver appointments, Wis. Stat. § 813.16(1), contains three conditions. First, the moving party must "establish an apparent right to or interest in" the property being foreclosed. Second, the property must be in the possession of a party other than the moving party (usually the mortgagor). Third, the property or the rent it generates must be "in danger of being lost or materially impaired."

The first and second elements are easily established by the foreclosing lender; its interest in the property arises from the mortgage and the lender generally will not have possession or control over the property or the rent at the commencement of a foreclosure action. To establish loss or impairment (or a danger of loss or impairment) under the third statutory element, the lender must establish in the affidavit accompanying the motion that (for example) the mortgagor is not adequately maintaining the property, or has misused or otherwise diverted the rental income instead of paying the secured debt or the property taxes (or both).

The concepts of loss or impairment are also present in the third source of authority for the appointment of a receiver – the case law – which for more than 75 years has maintained and refined the "waste" standard as the basis for appointing a receiver. Waste can be demonstrated (again, by affidavit) by proving the mortgagor's failure to pay interest on the underlying loan or property taxes, both of which effect the value of the lender's collateral because accruing interest reduces any equity cushion, and unpaid property taxes constitute a priming lien and accrue interest and fees as well. However, the fact that a loan is undersecured does not in and of itself mean that waste is present. Other examples of waste include mismanagement of the property resulting in damage or low occupancy, failure to winterize or otherwise maintain vacant property, and the failure to insure the property.

Foreclosure receiverships under § 813.16(1) are primarily "preservation" receiverships as to the property that is the subject of the action. The appointed receiver does not take title to the property. A foreclosure receiver is different than a general insolvency receiver, who is appointed under Chapter 128 of the Wisconsin Statutes and takes title to all of the debtor's non-exempt property.

### **Selecting The Receiver And Identifying Responsibilities During Appointment**

The receiver, while nominated by the lender in its motion, is a fiduciary to all parties involved in the case. Wisconsin law requires that if the party seeking the appointment is a state or national bank, the court shall appoint (in the absence of an objection) one of the lender's officers as receiver to serve without compensation. However, lenders will commonly also seek authority in the motion for the receiver to hire and compensate a professional property manager to handle the rent collection, maintenance, leasing, and related matters. Any management fees should be identified in the motion.

If a lender does not want to designate an officer as receiver, it can request the appointment of a third party receiver. Ideally, this person has familiarity and experience with property management, leasing, and the foreclosure process. Lenders make the request for a third party receiver with the understanding that a mortgagor or the court could resist the requested appointment based on the statutory mandate that bank officers serve as receiver, as discussed above. Such third party receivers should expect (as required by the statute) to post a bond in an amount sufficient to cover the value of the property and any rent that may be collected during the term of the appointment.

Adequately defining the receiver's authority during the appointment is crucial. This is accomplished in the court's order granting the motion and appointing the receiver, which is usually drafted by the lender as the successful party on the motion. When advising foreclosing lenders as to the importance of a receiver appointment and the receiver's authority during the appointment, we urge our clients to include the following in the court order:

- All property subject to the receivership should be clearly identified.
- The order should compel the mortgagor to deliver all keys and access codes to any structures that will be under the receiver's control.
- Prompt delivery of all tenant leases, security deposits, and service contracts to the receiver should be required.
- The receiver's rights and responsibilities with respect to tenants should be defined. Typically, the receiver will have all of the same rights of the mortgagor/landlord to collect and receive rent, hire and pay for maintenance, make necessary repairs, pay property taxes, advertise vacant units for lease, enter into new leases or renewals of existing leases, institute legal proceedings to evict or remove tenants if circumstances warrant, and the like.
- The order should identify the manner by which the receiver may use collected rent to maintain the property, pay taxes, and then deliver the remainder to the lender to be applied against the defaulted obligation.
- The order may authorize the receiver to borrow funds that may be necessary for the continued preservation of the property in the event that there is no rental income or insufficient rental income. Any such advances should also be considered additional loans secured by the subject property and owed by the obligors.
- Although not required by statute, monthly reporting is sometimes required by the court or demanded by the mortgagor. Reporting may also be useful to the lender to keep tabs on its collateral during the foreclosure. The order should describe the content and frequency of any required reports.
- If the receiver is an officer of the lender, then he or she should be given all of the foregoing authority but the order should also permit the receiver to hire and to delegate any or all of these duties to a management company.
- Any management company compensation should also be specified.
- The order should fix the amount of the bond, if one is required.

A well-drafted order will facilitate a smooth transition of control to the receiver and reduce or eliminate disputes over the receiver's authority.

### **Concluding The Appointment**

The final step in any Wisconsin foreclosure action is the confirmation of the sheriff's sale by the court, and the lender should include a request to discharge the receiver with its confirmation motion. If periodic reports were required under the order, the receiver should submit a final report and accounting so that the court and the parties can see what was collected, what was spent, and what funds will be delivered to the lender upon the conclusion of the case.

Foreclosure actions are an unfortunate reality of commercial lending. A successful motion for the appointment of a receiver can mitigate the expense and delay of a typical case by allowing the lender to take control of the collateral from the mortgagor. Receivers frequently play a critical role in the outcome of foreclosure cases, and lenders should utilize this option whenever possible to preserve and protect their collateral.

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