

# RESCUING THE LOSING FORECLOSURE WITH A RECEIVERSHIP

By Bruce J. Bergman



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## BACKGROUND

Lenders and servicers sadly know the scenario. The borrower has leased the house, is earning a tidy sum in rent and tastes the profit in delaying the foreclosure interminably. The desire to impede would be even greater where the mortgaged property is a two family house, and more enticing still with an illegal apartment or two. That the lender is legally correct in proceeding to foreclose upon a defaulted mortgage and should not suffer this baseless detainment may not be enough to secure justice.

Thus, a strategic suggestion is pursuing a receivership in the difficult mortgage foreclosure case as a means to protect the lender. Because the concept may seem obscure in the residential arena, and particularly when a subordinate mortgage may be at issue, some analysis should be instructive.

Certainly, most defaulted mortgages which even precipitate foreclosures do not become especially lengthy or contentious. This is particularly true in non-judicial foreclosure locales. But in judicial foreclosure states, like New York, some foreclosure actions can become very lengthy, unduly expensive and in the end, result in a loss for the very reason that the litigious borrower mesmerized the lender with legal footwork.

## Laws in Various States

If a receiver is potentially as valuable as suggested here, knowledge of how to obtain the appointment would seem to be a consideration. Putting aside the idea that this is best left to lender's counsel in the state where the foreclosure was brought, the availability of receiverships is pervasive enough throughout the country that generalizations retain substantial validity.

Procedures do, of course, vary. The mortgage at issue will require certain key language (which most often it will contain in any event) and some states do welcome a receiver's appointment with more warmth than others. Nonetheless, the underlying point is the same.

For lenders of some, or many, second mortgages, there is then the thought that seeking a receiver typically devolves to the holder of a first mortgage. That is true enough, but not every senior mortgagee is sophisticated enough to address the remedy. There may be enough equity available to the senior lender that it doesn't need a receiver. Moreover, the second mortgagee may ultimately succeed to the first position through the natural course of event or via a protective advance to satisfy the senior loan. In the end, while receiverships do have more application to a first mortgagee, the maxim does not devoid the concept of merit to a second mortgagee.

## WHY A RECEIVERSHIP AND WHAT IT CAN DO

A foreclosing lender may contemplate appointment of a receiver to preserve the premises when it believes that The secured property might decline in value during the course of the action, or that the defaulting borrower, or other party in possession, may allow or cause the premises to deteriorate or otherwise be placed in jeopardy. Although most often sought for income producing or commercial properties and multiple residential dwellings, appointment prudently can be sought for one- and two-family homes as well when the properties are in peril or if the foreclosure action is expected to be protracted.

The receiver can potentially fulfill a dual purpose. First, and more obvious significance, the receiver preserves the integrity of the security and maintains the property physically by providing for repairs. The integrity of the security is further safeguarded through payment by the receiver of taxes, utilities and other expenses. Still further, where applicable, rentals are initiated or renewed.

The second purpose, which is

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less apparent, is the effect a receivership has upon a mortgagor bent upon litigating. Although legitimate defenses to foreclosure are uncommon, some mortgagors may strive to forestall a foreclosure, believing either that the lender can be forced into a settlement or that sufficient time will be captured to somehow save the situation through a sale or refinance. Other borrowers may be motivated by a desire to bleed the property during the course of the litigation by garnering income, while at the same time neglecting upkeep.

Whatever the motive, time can be a potent enemy of the mortgage holder. The passage of time, translated into constantly accruing interest, combined with ever increasing legal fees attendant to interminable litigation, can precipitously erode or ultimately eliminate the equity cushion. If that happens, the foreclosure sale may be only a phyric victory for the hapless lender or servicer.

A receiver, however, tends to cool the ardor of a borrower intent upon obfuscation dilatory litigation. Once a receiver is in place, the income of the property, if any, goes not to the borrower, but to the receiver. Then, not only does the borrower's profit dissipate, but a source of funds to fuel the litigation

evaporates. And if it is the borrower who lives at the premises, he may himself be required to pay rent to the receiver. So, while receiverships are not generally viewed as an offensive weapon, they may assume such a role for the benefit of a foreclosing lender.

At what precise moment a foreclosing plaintiff should move for the receiver's appointment may often be a matter of happenstance, although a thorough knowledge of events at, and the condition of, the mortgaged premises could remove the decision making process from the realm of conjecture.

When a lender or servicer decides that foreclosure is to be pursued, it is obviously aware of a default under the terms of the mortgage. Most often, but not necessarily, the nature of the default is failure to remit payments due. If the resultant foreclosure is to follow its usual course, initially there may be no compelling reason to contemplate appointment of a receiver. It is only during the course of the action that lender will recognize that the interposition of defenses, perhaps combined with dilatory tactics of the borrower or of other defendants, presage unusual delay in the case. If the accrual of interest during the protracted case will erode the margin of equity, appointment of a receiver may be appropriate. Even if the passage of time alone will not jeopardize the loan, during progress of the case the servicer may become aware of the physical deterioration of the mortgaged premises. This circumstance too would highlight the need for a receiver. In either instance, the need to obtain a receiver could become apparent only as the foreclosure progresses.

Alternately, if the mortgage default immediately suggests danger to the property-such as unauthorized or illegal alterations, failure to correct serious municipal violations or substantial neglect of repair - the efficacy of a receiver may be apparent at the outset of the case. Even with a monetary default, where the servicer has specific knowledge that the secured property is likely to suffer diminution in value, the need for a receiver may again be noticeable at initiation of the case.

**CONCLUSION**

There are cost factors in pursuing the receivership. Additional legal fees are typically charged to obtain the order and guide the receiver. Critically, a receiver is entitled to a commission on the income collected. Where no profits emerge, some reasonable payment to the receiver will be required and responsibility to pay

will be upon the foreclosing plaintiff.

Nevertheless, it should be apparent that sometimes, in some special cases, appointment of a receiver could be the difference between success and failure, to say nothing of avoiding obtrusive dismay. That being so, knowledge of how to attack the difficult case with this device should be welcome ammunition in the lender or servicer's armamentarium.

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*The views expressed in this article are those of the author.*

*Rescuing the Losing Foreclosure With a Receivership*

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B PROGRAM	B+	1st-2nd add 80 bps	9.75%	180,180/360,240	75%, 80% add 75 bps	80%	2
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