

# Resolving Shopping Center Foreclosures in Florida - Considerations for Lenders

October 12, 2016

Shopping centers in Florida—and across the country—are increasingly facing financial stress due to factors such as Internet commerce and rent pressures. Rents generated from a shopping center are usually pledged as collateral. Despite the pledge of rents, defaulting borrowers often feel entitled to use the rental income to pay their lawyers to defend against a lender's foreclosure action. In effect, these borrowers use the lender's own collateral against it to delay and obstruct the foreclosure. It is a priority to cut the borrower off from the income stream to which the lender is likely entitled. This article addresses how lenders can quickly and efficiently resolve these cases while maximizing value and return on collateral.

**Review Loan Documents** A thorough review and examination of the loan documents is critical, paying special attention to notice provisions regarding defaults and cure periods. In most cases involving a loan secured by a shopping center, there will be at minimum a note, a mortgage, an assignment of rents and a loan agreement. The assignment of rents can be a standalone document, or the assignment of rents language can be contained within the mortgage. The lender should decide up front whether it wants to keep some or all of the tenants that occupy the shopping center. As a first mortgage lienholder, the lender can usually foreclose the interests of the tenants on the property and ultimately have them removed. Tenants with leases that predate the recorded mortgage that are not subordinated and those tenants with subordination, non-disturbance and attorney agreement (SNDA) are an important exception. Often, a shopping center property is more valuable as an ongoing operation with paying tenants even if such tenant's rents are subordinated to the lender. However, in some cases there may be reasons for a lender to decide to foreclose and remove existing tenants. Leases and SNDAs should be carefully reviewed to ensure compliance with and recognition of any obligations owed to tenants by the landlord and other obligations that may be assumed by the lender or its designees. The decision to foreclose tenants should be made early in the process.

**Demand Rents From the Borrower** If the loan documents permit, the borrower should immediately be served with a written demand for turnover of all rents collected and to be collected from the shopping center. This written demand is an important

condition precedent to several of the claims and motions against the borrower discussed below. The demand on the borrower for a turnover of rents collected from tenants by the borrower should be made pursuant to the terms of the assignment of rents and §697.07, Fla. Stat. **Demand Rents From the Tenants** Rather than trusting the already defaulting borrower to turn over rents after demand, the lender can demand rent directly from tenants. Security agreements and assignments of rent often state that the lender may act in the place of a defaulted borrower and collect rents due directly from the tenants themselves. If the loan documents provide for it, the lender should send written demands that the tenants pay all subsequent rent payments directly to the lender, citing the assignment of rents or security documents. Rents received directly from a tenant by lender should be applied to the debt. A lender can use this valuable self-help tool before any foreclosure is filed in order to gain cash control and bring the borrower quickly to the bargaining table. Direct rent demands to tenants raise two important issues. First, often tenants faced with conflicting demands for rent from both the lender and the borrower/landlord refuse to pay rent to anyone, though more sophisticated tenants will at least make their future rent payments into an escrow account. Second, the fact that the lender is collecting rent directly from the tenant does not mean that the lender has assumed the landlord's responsibilities. No matter who collects the rent, the borrower remains responsible for its duties as landlord under its leases with the tenants. Any calls or correspondence from a tenant paying rent to the lender for maintenance should be directed to the borrower. **File Suit** Once the initial skirmish over the rents has begun, a foreclosure action should be filed, including a request that the court require immediate turnover of rents. A request to appoint a receiver should be considered at this time. If the lender has elected to foreclose some or all of the tenants, each such tenant should be added as a defendant to the action. Otherwise, tenants should not be named as defendants in the case.

a. "Hurry Up" Foreclosure Rule

i. Immediate Foreclosure Judgment

Florida provides lenders with highly useful tools in commercial foreclosures to speed up the foreclosure process with the potential to end the case almost as soon as it is filed. Specifically, §702.10, Fla. Stat. provides that a lender in a commercial foreclosure action may file a verified motion for entry of an order to show cause. The first part, §702.10(1), allows the court, without even hearing from the borrower, to set an early hearing at which the borrower must appear and show cause why an immediate judgment of foreclosure should not be entered. The lender can file this request with the complaint. Once the court signs the order setting the hearing, it can be served on the borrower together with the complaint. The potential for an immediate foreclosure judgment, can be avoided if the borrower files the appropriate pleading. However, the mere fact that an early hearing is set speeds up the foreclosure process in and of itself, because the borrower is unlikely to seek or receive an extension to respond to the complaint prior to the hearing, given the risk that the court will enter a prompt foreclosure judgment at the hearing. Admittedly, some judges are unfamiliar or have little experience with the statute and are reluctant to set "show cause" hearings at such an early stage. They simply need to be educated and convinced that this is the law. The effort is worth it because this can greatly speed up the foreclosure process. However, even if the borrower files the appropriate pleading and avoids an immediate foreclosure judgment, the lender has a second bite at the apple at the hearing—getting mortgage payments during foreclosure.

ii. Mortgage

**Payments** The statute also provides that in the event the borrower avoids the immediate entry of a foreclosure judgment by filing the right pleadings, the court shall review that pleading and determine if the lender is likely to prevail. Since this is usually the case, the court will usually order the borrower to make regular monthly mortgage payments into the court registry or directly to the lender. So, if the borrower tries to delay the foreclosure by raising defenses, the borrower must still pay for that privilege by continuing to make regular mortgage payments until the foreclosure action concludes. If the borrower fails to timely make a regular mortgage payment, the lender is entitled to immediate possession of the property. In most cases, if the borrower were able to make regular mortgage payments there would never have been a default in the first place. For this reason, borrowers are often unable to make the regular mortgage payments even after the entry of the court order under §702.10(2). It is worth noting that possession of the property is not the same as actual title to the property. The lender may not sell the property after it gains possession but before the entry of a foreclosure judgment. However, the lender does get cash control, but it is then also responsible for maintaining and operating the property. If the lender elects to take possession, there may be some potential pitfalls, so, it is recommended that it hire a professional management company to operate the shopping center, collect rents, have proper insurance in place, and deal with tenants and routine maintenance. The lender can also seek the appointment of a receiver. Often a professional management company can operate the property for less than the borrower was charging. The primary benefit of immediate possession of the property is that it brings order and control (including cash control) to the shopping center's operation. A downside of immediate possession is that it also brings potential liability as the operator of the shopping center during the period of possession.

**Rents Under §697.07, Fla. Stat.** When moving for an order to show cause under §702.10, the lender should also move for an expedited hearing to be paid rents from the property under §697.07, Fla. Stat. The Florida rents statute is straightforward and provides that a lender is entitled to be paid rents from the property from the date of the original demand upon the showing that the rents were pledged as collateral, a default occurred, and there was a demand for rents. Significantly, the statute also provides that rents shall be paid to the lender, regardless of any defense the borrower raises. Once the lender makes an initial showing by affidavit or verified motion, the entry of an order directing the borrower to turn over rents is perfunctory. Note that the borrower's obligation to pay rents under §697.07 is separate and apart from the borrower's obligation to make mortgage payments under §702.10(2). So the borrower can be ordered to simultaneously pay both the rents and the mortgage payments to the lender, out of pocket if necessary. A good analogy is that if one owned a rental property, was using rents to pay the mortgage on it, and the tenant left, the owner would still be obligated to make its mortgage payments to the lender. Many borrowers will argue that they cannot both turn over rents and make the necessary mortgage payments. This has led several courts to enter hybrid orders that direct the borrower to make both mortgage payments under §702.10(2) and pay over all rents under §697.07, but which also direct the lender to apply the rental payments to the mortgage payments due, with the borrower being responsible for making up any monthly shortfall. **Motions for Appointment of a Receiver** By the time negotiations over a longstanding loan default have failed, lenders often view the borrower as irresponsible, duplicitous,

or both. The lender's first instinct is to wrest control of the shopping center from the unworthy borrower. For that reason, many lenders' first thought is to seek appointment of a receiver, a court appointed officer charged with taking possession of, operating, and maintaining a business or property. While there are often good reasons to seek appointment of a receiver, this remedy is not available in every situation and carries its own costs and potential problems. Florida law is clear that the appointment of a receiver is an extraordinary remedy. Even if the loan documents expressly provide that the lender is entitled to the appointment of a receiver upon default, a Florida court will not appoint one until after an evidentiary hearing at which the lender must prove (1) that the value of the property is less than the debt; and (2) the property is suffering "waste" (typically physical deterioration) that adversely affects the value of the collateral; or (3) the borrower is diverting rents from the property. Typically, a hearing on a motion for appointment of a receiver requires a combination of expert and fact testimony regarding the physical condition of the property, diversion of the rents and the borrower's defaults. A specific receiver should be suggested and presented to the court for examination regarding its experience and skill in operating shopping centers. The borrower also gets to present its own testimony regarding valuation, the financial details of the operation (as it affects value and charges of waste), the physical condition of the property, and any defenses it may have regarding the debt and default. Borrowers often blame lenders for their financial difficulties. Note that most of the information relevant to a receivership hearing is uniquely in the borrower's hands—access to the property for an appraisal, the current financial books and records, the physical condition and efforts to maintain the property. If the relationship between the lender and borrower has remained sour for some time, the lender's information may be dated and extended discovery may be necessary to obtain current facts to support a receivership motion. Consequently, it is imperative that lenders regularly enforce reporting obligations under the loan documents particularly as current market conditions worsen. When appointing a receiver, courts often follow, but are not bound by, the lender's suggested receiver. The court may choose its own receiver based on its personal judgment and experience. Occasionally, a judge will select a local lawyer or retired judge, who must in turn hire a professional manager to do the operational work, adding another layer of expense. Once a receiver motion succeeds, the court will sign a receivership order establishing the receiver's powers and authority. The lender has significant leeway when preparing a receivership order for the court's consideration. The receiver's powers can be as broad or narrow as the court will accept after input from the lender and the borrower. Reporting requirements, receiver's fees and costs, amounts which can be expended without court approval, and receiver certificates are all areas to consider when drafting a receivership order for the court's consideration. An important consideration is whether the receiver should have the power to market the property, during the litigation. While the evidentiary burden is high and cannot be met in every case, there is often good reason to seek appointment of a receiver. A significant advantage of having a receiver is the order, accountability, and control a receiver brings to the property's operation. If a borrower is difficult or assets go missing, a receiver can often quickly obtain relief from the court. Most importantly, the receiver insulates the lender from potential liability during the course of the receivership. However, it must be noted that receiverships can be a significant expense, receivers are



typically paid first, and lenders are often asked to pay any shortfall in the cost of a receivership. It is also worth noting that receivers work for the court, not the lender. Therefore, some receivers may feel bound to do things for the good of the estate rather than solely for the lender's benefit.

**Conclusion** In the event the retail market continues to deteriorate and shopping center foreclosures become more prevalent, Florida lenders must anticipate the responses of their borrowers. Lenders should be proactive in enforcing the reporting requirements in the loan documents and, if necessary, utilize several tools at their disposal. When used in combination, these tools provide a powerful weapon to help lenders end foreclosure cases as efficiently and effectively as possible.

## Authored By



Alan M. Grunspan

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