CARLTON FIELDS

Remedies in a Foreclosure Action

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Q: Once a lender has filed a foreclosure action, what interim remedies are available before the final judgment of foreclosure? **Mr. Giles:** There are several interim remedies, one of which, receivership, may be pursued even before the summons and complaint are served. **Q:** What is the role of a receiver? **Mr. Giles:** The receiver takes possession of the mortgaged property and, if necessary, employs new property management or leasing agents. The receiver may take other actions to better position the property in the rental market and more successfully rent the property. Receivers are often people with broad experience in the rental market who have rescued dozens, if not hundreds, of properties. They are not emotionally invested in the property and very often will take immediately the actions necessary to make the property more marketable or rentable. They get rid of tenants who aren't paying their rent or are causing problems for other tenants. Because they often have financial resources available to them, receivers can take action to clean up the property and address deferred maintenance issues. They can repaint, put up signage, and bring new life to a rental property. This allows the receiver to be more successful at renting the property than the property owner. **Q:** Are motions to appoint a receiver readily granted? **Mr. Giles:** The courts are fairly reluctant to grant motions for the appointment of a receiver because they see this as an extraordinary remedy, in that granting such an order deprives the borrower of possession of its property. Most loan documents contemplate that a receiver will be appointed upon a default in the borrower's performance of its obligations under the loan documents. It is a remedy that not only can protect the lender's interest in the collateral for the loan, but also can actually protect the borrower's interest in the property. For example, if the cash flow from a rental property declines to the point that the borrower does not have sufficient resources to immediately remedy a problem with the property, the receiver very often can obtain the resources necessary to do so, rent the property, and restore the cash flow. **Q:** You mentioned mortgage provisions in which the mortgagor consents to the appointment of a receiver upon default. Can you describe the effectiveness of these provisions? **Mr. Giles:** The language in mortgages is almost always extraordinarily broad. It will provide that the borrower consents to the appointment of a receiver on the application of the lender and waives any objections. The courts, however, seem to give very little credence to those provisions. Instead, they tend to act when there is actual waste, particularly waste that presents life safety issues, or when the loan balance is significantly greater than the current value of the property and the borrower is collecting rent but refusing to remit the net rent to the lender. **Q:** How does case law play into situations in which a borrower is failing to turn over rent, and provisions in the mortgage assign the

rights as collateral and consents to the appointment of the receiver? **Mr. Giles:** Although the initial burden is on the lender to establish that the borrower has pledged rents as collateral and is failing to turn over those rents, at that point, the burden shifts to the borrower to show that the value of the property is greater than the amount owed to the lender. A receiver is appropriate if the borrower cannot make this showing and is absconding with the rent. Absent this scenario, a lender generally is responsible for demonstrating actual waste sufficient to warrant the appointment of a receiver. **Q:** The assignment of rents also comes into play in a motion for assignment of rents under Florida Statute section 697.07. Can you address the effectiveness of this remedy? **Mr. Giles:** Almost all documents evidencing a commercial loan are going to provide for an assignment of rents. The burden on the lender to establish its entitlement to the assignment of rents is not as great as to establish the need for a receiver. On the other hand, the remedy is not going to be quite as beneficial for the lender as the appointment of the receiver because the court is more likely to require that the net rents be deposited in registry of the court. This means of course that the lender is not going to have access to the rents, and the rents are not going to be applied to the payments of monthly installments of interest or principal. The other problem for a lender is that the lender is not going to be as able to monitor the application of revenue to the payment of operating expenses as in the case of a receiver. Upon granting the motion for assignment of rents, the borrower is still in control of the property and collecting the revenue, but there is a rather short list of operating expenses that the borrower will be authorized to pay. It certainly is better than the borrower continuing to keep all the net revenue or failing to pay operating expenses, but it's not quite as good as having a receiver, from the lender's point of view. **Q:** Are there advantages or disadvantages to pursuing a motion for the assignment of rents contemporaneously with a motion to appoint a receiver? **Mr. Giles:** Some lawyers like to file the two together and have the two heard together. Let me talk first about the advantages of having the two heard together. If the court is disinclined to appoint a receiver, and a motion for assignment of rents is pending and being heard at the same time, the court might be more likely to at least give the lender some degree of protection by requiring that the net revenue be deposited in the registry of the court. On the other hand, it might be that giving the court that out will actually encourage the court to not appoint a receiver because it's an extraordinary remedy. An advantage to having them heard separately comes from the fact that a motion for the appointment of the receiver is treated like a motion for an injunction or a temporary restraining order. It can be heard ex parte before the complaint is even served, or between the time that it is served and the time the borrower appears and files its response. That would probably be the preferred approach where there was egregious waste - where there was real danger of dissipation of the value of the property. This could be the case where there is substantial damage to the property. For example, a fire or other damage resulting in the exposure of the building interior to the elements and requiring immediate restoration, but where the borrower doesn't have the resources or perhaps the willingness to undertake the restoration. **Q:** What are the strategic advantages to pursuing these interim remedies immediately after filing the complaint? **Mr. Giles:** I think lenders are best served by forcing a conversation with the borrower or the borrower's counsel as early in the proceedings as possible. The motion for the appointment of a receiver seems to be the most effective mechanism

for doing that because it can be made as an emergency motion, and if the court agrees that there is an emergency, the court will allow the hearing to be set within weeks, if not days, after the commencement of the foreclosure action. Otherwise, it could take two to three months to set a hearing on a motion for assignment of rents, because it can't be set until the summons and complaint have been served, and the defendants have appeared. **Q:** The other two interim remedies that we are going to talk about are orders to show cause why payments should not be made and why final judgment should not be entered. How does this strategy of beginning a conversation with the borrower apply to orders to show cause? **Mr. Giles:** The orders to show cause don't really create a situation where the lender might have an opportunity to talk to the borrower in the context of a legal proceeding early on because the orders to show cause have to be entered and then they have to be served, and there's a time frame within which they have to be served. A hearing cannot be set less than 20 days from service of the orders, and it must be held within 60 days of service. Coordinating the entry and service of the orders with the hearing is a bit of a challenge and, consequently, those hearings might not take place for two to three months after the foreclosure action is commenced. The order to show cause why final judgment of foreclosure should not be entered may be effective in motivating an unsophisticated borrower to begin a serious conversation with the lender, but it's not going to motivate an experienced lawyer because they are so easy to defeat. Section 702.10 requires only that the borrower file a verified answer. There still are some lawyers who don't know that or who don't figure that out until just before the hearing. We have seen at least one situation recently in which the borrower's counsel filed an answer and then came back the day before the hearing and filed a verified answer. Overall, however, they are so easily defeated that they're hardly worth pursing. However, we do purse them because if the borrower doesn't appear it may be a faster way to get to judgment than going through the process of getting a clerk's default and then a default judgment and, in the eyes of some, perhaps less subject to a later challenge. **Q:** What about the order to show cause why payment should not be made during the pendency of foreclosure proceedings? **Mr. Giles:** The order to show cause why payment should not be made ought to be a better remedy than it actually is. The idea behind it, which is reflected in the legislative history of the statute, is to create a situation like the one that exists with tenant evictions. If a tenant in certain situations wants to defend an eviction action, the tenant has to deposit the rent with the registry of the court. The drafters of this statute had a similar goal in mind for foreclosures – if a delinquent borrower wants to defend a foreclosure action, the borrower could be compelled to deposit the monthly payments into the registry of the court. In most situations, that might put the borrower under so much economic pressure, the borrower would likely relent in the foreclosure action. But, as with appointing receivers, the courts seem reluctant to enforce these orders to show cause. The borrower will often get away with not really showing cause. **Q:** Why do you speculate that is? **Mr. Giles:** I don't know. The language is perhaps not quite as clear as lender's counsel might want it to be. I understand that there's a bill being introduced in this upcoming session of the Legislature to make some changes to the statute on orders to show cause why payments should not be made. **Q:** Do you see any risks or downsides to pursuing all four of these remedies simultaneously in a case? **Mr. Giles:** I've made it a practice to file all of them contemporaneously with filing the complaint, serve them all with proposed orders along

with the complaint, and set them all for hearing as quickly as I possibly can. I have not found the courts to be aggravated by pursuing this multiplicity of motions, and while we recognize that the courts are reluctant to enter orders on some of these motions, borrowers don't necessarily want to take the risk that they'll have a receivership order or an order enforcing an assignment of rents entered against them. Borrowers are therefore often willing to talk about either a stipulation to a receivership order that maybe isn't quite as severe as the order the court might enter or, perhaps, some other creative solution to the problem. One such creative solution that I have seen recently involved the borrower essentially becoming the receiver, that is, agreeing to an order under which the borrower would undertake to perform all of the obligations that are normally imposed on a receiver, including reporting revenue and expenses to the lender, providing rent rolls, and remitting the net revenue to a lender on a monthly basis. You might say the borrower has an obligation to do those things anyway, but the obligations under the loan documents don't come with a threat of a contempt order the way they do under a court order charging the borrower with the same responsibilities as the receiver. In any event, whether it's a receivership order, a stipulated receivership order or some variation on that theme, the borrower is deprived of unfettered use of the revenue of the property, which is very often going to motivate the borrower to try to find a solution to the foreclosure action. Whether it's a reinstatement or stipulated foreclosure, the resolution is likely to be reached faster than if the case is simply allowed to proceed in the absence of these interim remedies. **Q:** Is this largely because it forces the conversation between the lender and the borrower? **Mr. Giles:** Yes. And it provides motivation to reach a resolution that otherwise would not exist. **Q:** Is that how you would characterize the interplay between reinstatement or settlement discussions and these interim remedies? **Mr. Giles:** I think what sometimes happens is when borrowers believe themselves to be under water – when they think the value of the property will not support the mortgage debt, and the revenue from the property won't allow them to make the mortgage payments in full – they often don't know what to do, and therefore they take the action that, in the very short term, seems to be in their best interest. They pay as few of the operating expenses of the property as they can and they pocket the rest of the revenue. They don't want to talk to the lender. These interim remedies force the conversation because the borrower understands early in the process that they not only might not be able to keep the revenue, but that they put at risk any possible favorable resolution – whether it's reinstatement, a stipulated foreclosure, or a deed in lieu of foreclosure – that allows them to avoid personal liability on a deficiency judgment or a judgment on a personal guaranty. These remedies therefore serve in many cases to motivate the borrower to stop ignoring the problem and to address it.

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