



# Insight from Carlton Fields

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## Nuts and Bolts of the Florida Commercial Mortgage Foreclosure Process

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### Introduction

Florida is a judicial foreclosure state. Mortgage foreclosures in Florida are “judicial proceedings,” and are governed by Section 45.031, Florida Statutes. Florida’s statutory judicial procedure allows a mortgagee to force the sale of the mortgagor’s property at a public auction in order to satisfy the mortgage debt. Because Florida requires judicial foreclosure of any mortgage interest, any powers of sale or provisions in a mortgage recorded in Florida that give a mortgagee the right to take possession of mortgaged property, operate it, manage it, or sell it, without completion of a foreclosure action, are not enforceable in Florida.

Mortgage foreclosure actions are typically filed and prosecuted as civil lawsuits in state court. Mortgage foreclosure suits are typically treated no differently than any other type of civil suit, and are subject to the same rules governing discovery, including depositions, motion practice, affirmative defenses, counterclaims, trial, and rights of appeal, as any other civil action. A hotly contested mortgage foreclosure in Florida can conceivably take more than a year to resolve, not including any subsequent appeal.

### Pre-Suit Considerations & Alternatives

Once a loan has been identified as “distressed” (whether in default or otherwise), mortgage lenders begin considering how they will address the dis-

tressed loan. Mortgage lenders often consider actions that can be initiated without suit, consensual remedies such as loan workouts, and enforcement remedies that are initiated through suit.

Remedies that lenders can exercise without suit include:

- discontinuing advances on loan (if the loan has not been fully funded);
- making demand upon the borrower and possibly accelerating repayment of the loan;
- making demand for payment upon any or all of the guarantors of the mortgage loan;
- exercising any self-help rights to other collateral;
- drawing upon any pledged letters of credit; and
- exercising rights to set off against pledged deposits or reserve accounts.

Remedies available to mortgage lenders that are initiated by filing suit include:

- foreclosing the mortgage, with the possibility of the appointment of a receiver to oversee the property during the foreclosure proceeding;
- filing suit on the note;
- filing suit on any or all of the guaranties; and

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- enforcing various assignments (assignment of rents, contracts, etc.).

Consensual remedies available to the parties through loan workout include:

- modifying loan documents to provide the borrower additional time to perform or to refinance the mortgage loan with another lender;
- reconstituting the terms of the loan;
- transferring the property to the lender by means of a deed-in-lieu of foreclosure; and
- transferring the property to the lender through a “friendly” or uncontested foreclosure.

A lender’s decision as to whether to pursue litigation or a consensual remedy is often a decision that a lender reaches after weighing both business and legal considerations. Lenders are advised to analyze the facts and circumstances of the specific loan relationship, including the collateral, the borrower, the strengths and weaknesses of the loan documents and the prior dealings between the lender in order to reach a decision as to the appropriate remedy or remedies to pursue.

### **Commencing a Foreclosure Action**

Once a decision has been made to exercise through the filing of a foreclosure action, the first step is to provide any notice of default to the borrower and/or guarantors that may be required by the loan documents. These demands are usually sent by certified mail, return receipt requested. Notice must be sent in compliance with the method for delivery of notices specified in the mortgage or other loan documents. For income-producing properties, the lender should consider making a demand for rents pursuant to § 697.07, Florida Statutes. The lender should also consider notifying the tenants to pay rent directly to the lender, if appropriate.

If the borrower does not cure the defaults within the allotted time (if the mortgage or loan documents allow the borrower the opportunity to cure defaults) after the date of the notice of default, the lender may file an action to foreclose the mortgage and seek other remedies, as appropriate.

A typical commercial mortgage loan consists of a note evidencing the debt obligation, a mortgage granting a lien on real property, various security instruments granting a lien on personalty, various assignment documents assigning to the lender various rights (assignments of rents, assignments of contracts, assignments of permits, etc.), one or more personal guaranties providing additional security for payment of the obligation, and documents evidencing other collateral (letters of credit, reserve accounts, etc.). Florida law does not require a lender to elect to proceed separately against real and personal property. The lender may proceed in one action against both real and personal property collateral given for its loan. Further, under Florida law, a lender may sue to collect on its note and to foreclose its mortgage in one proceeding. It is advisable to pursue each remedy (foreclosure of the mortgage, enforcement of the note, enforcement of any grant of security interests and enforcement of any guaranty agreements) in a separate count in the foreclosure complaint. The lender also should allege its right to and request entry of a deficiency judgment unless the loan is non-recourse in nature.

A foreclosing lender may foreclose all liens inferior in priority to its mortgage lien. A foreclosure is not effective as to any junior lienholder not named or served in the action. To ensure that all appropriate parties are named, the lender should obtain a foreclosure commitment from a licensed title insurance company.



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### **Prosecuting a Foreclosure Action**

A traditional foreclosure action is prosecuted to judgment in the same fashion as any other Florida lawsuit. Once the complaint has been filed and the parties served, Florida law allows a 20-day period for answers to be filed, responding to the complaint. So long as no substantive affirmative defenses are raised, the lender may then proceed to request entry of a summary final judgment in foreclosure on the basis of motions and affidavits filed. A hearing is set on the motion, and generally a judgment in favor of the lender is obtained at the hearing. The court sets the foreclosure sale in the final judgment. At the conclusion of the suit, a judgment of foreclosure is obtained from the court either after a trial, or after a hearing on a motion for summary or default judgment.

In 1993, in an effort to streamline the foreclosure process, the Florida legislature enacted Section 702.10, Florida Statutes, which created a statutory foreclosure procedure utilizing orders to show cause. The statute authorizes two separate and distinct show cause proceedings, one focused upon resolution of the entire proceeding and one focused upon payment during the pendency of a non-residential foreclosure proceeding. If a lender anticipates that the foreclosure will be contested, a lender is likely better served by following the more traditional foreclosure procedure.

If the foreclosure is contested and substantive affirmative defenses are raised in any answer to the complaint, to the extent any issue may not be disposed of through a show cause or a partial summary judgment proceeding, a non-jury trial will be scheduled. If counterclaims are filed in connection with a foreclosure action, Florida law provides that they may be severed so that the lender may proceed to foreclosure through a final hearing or a trial on the foreclosure with the counterclaim to be tried at a

later date. Severance of counterclaims, however, is discretionary. In contested foreclosures, discovery is conducted and the process becomes more costly and time-consuming.

### **Summary Judgment**

Proof offered by the lender in support of its motion for summary judgment, by means of affidavits, or in the case of the show cause procedures by means of the verified (sworn) complaint, or if the matter is contested by testimony presented at trial, includes: (1) proof of the execution, delivery of the promissory note and mortgage and recordation of the mortgage; (2) proof that the lender is currently the holder of the note and mortgage; (3) proof of the borrower's default and failure to cure; (4) proof that all required notices have been given; and (5) proof of the amount of the debt owed the lender. If attorneys' fees and costs are sought, proof must be offered that the lender is entitled to collect these (citing to the provision in the loan documents for collection of attorneys' fees and court costs), the amount of such fees and costs and that the fees sought are reasonable. (This proof also applies to late fees and other charges to the borrower.) The original loan documents must be filed with the court. If the original loan documents are not available, the lender should seek to re-establish the loan documents in the foreclosure complaint.

### **Final Judgment & Foreclosure Sale**

The final judgment will foreclose the property interest of the various parties to the action, recite the amounts found to be due the lender from the borrower, set the foreclosure sale date and direct the distribution of any excess sale. The foreclosure sale is generally scheduled approximately 35 days after entry of the final judgment of foreclosure. The final judgment may also determine the liability of endorsers of the note or guarantors, with a reservation of the right



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to determine the amounts due from the endorsers or guarantors after the foreclosure sale. The final judgment may also reserve the right of the lender to any deficiency judgment, to be determined after the foreclosure sale.

Foreclosure sales in Florida are handled by the clerk of court of the various judicial circuits. Traditionally, foreclosure sales were live auctions literally held on the courthouse steps. Many circuits still hold live auctions, albeit now inside the courthouse. However, an increasing number of circuits now hold on-line sales in place of live auctions. In limited circumstances, various parties and prospective bidders may object to aspects of the foreclosure sale. Such objections are rare. If no objections to the foreclosure sale are filed, a certificate of title may be issued to the successful bidder at the foreclosure sale 10 days after the sale date. The borrower is entitled to redeem the property up to the sale date unless an extension of time is provided in the final judgment of foreclosure. This is the only redemption period available to the borrower. Once a certificate of title has been issued and recorded in connection with a foreclosure sale, the successful bidder is the record owner of the property.

### Deficiency Judgments

If the loan at issue in the suit is a recourse loan, and if the proceeds from the sale of the foreclosed property are not sufficient to satisfy the underlying indebtedness arising from the final judgment of foreclosure, the lender may seek to have a deficiency judgment (a money judgment) entered by the court against the borrower and/or the guarantors of the debt for the amount of the deficiency. If the lender is entitled to seek a deficiency judgment after the foreclosure sale, and if the judgment preserves the lender's right to seek a deficiency action, the lender should take steps to seek the deficiency judgment within one year of the foreclosure sale date or risk dismissal of the action.

See *Frohman v. Bar-Or*, 660 So. 2d 633 (Fla. 1995). Generally, seeking the entry of a deficiency judgment is a continuation of the foreclosure proceeding, and will not require any new pleadings or service of process on the borrower. In such cases, the process is commenced by motion. However, in some circumstances, a new case at law may also be initiated. See Fla. Stat. § 702.06.

The amount of the deficiency is the difference between the amount of the judgment and the fair market value of the property on the date of the foreclosure sale, as determined by a court. See *Kahn v. Simkins Indus., Inc.*, 687 So. 2d 16, 18 (Fla. 3d DCA 1996). The fair market value of the property at the time of the sale will determine the amount of the deficiency. *Estepa v. Jordan*, 678 So. 2d 876, 878 (Fla. 5th DCA 1996). An appraisal of the foreclosed property at or very near the date of the foreclosure sale is extremely useful in establishing a deficiency judgment. Although the court may consider various factors in connection with the award of the deficiency, Florida case law provides that entry of deficiency judgments is the rule rather than the exception. *Lloyd v. Cannon*, 399 So. 2d 1095 (Fla. 1st DCA 1981). If the deficiency action is contested, the lender would likely be required to present evidence of the fair market value of the property by means of testimony from the appraiser and would be required to show that the value of the property is less than the amount of the judgment awarded the lender.

### Assignment of Rents

A lender can seek to take control of the rents and profits arising from the mortgaged real property in a foreclosure action. Typically, a mortgage or separate instrument provides for an assignment of rents of real property or any interest therein as security for repayment of the underlying indebtedness. If such an assignment is made, the mortgagee holds a lien



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on the rents, and the lien created by the assignment is perfected and effective against third parties upon recordation of the mortgage or separate instrument in the public records of the county in which the real property is located.

Pursuant to Section 697.07, Florida Statutes, a contractual assignment of rents provision shall be enforceable upon the mortgagor's default and written demand for the rents made by the mortgagee to the mortgagor, whereupon the mortgagor shall turn over all rents in the possession or control of the mortgagor at the time of the written demand (or collected thereafter), less payment of any expenses authorized by the mortgagee in writing. Additionally, pursuant to Section 697.07, the court is required to expedite a hearing on the application by the mortgagee or mortgagor to enforce the assignment of rents. The procedures authorized by this statute are in addition to any other rights or remedies of the mortgagee or mortgagor under the mortgage, separate assignment of rents instrument, promissory note, at law, or in equity.

As part of a foreclosure action, upon application by the mortgagee, and notwithstanding any asserted defenses or counterclaims of the mortgagor, a court – pending final adjudication of the action – may require the mortgagor to deposit the collected rents into the registry of the court or in such other depository as the court may designate, or the court may authorize the use of the collected rents before deposit into the registry of the court or other depository. If authorized by the court, the collected rents may be used to: (1) pay the reasonable expenses solely to protect, preserve, and operate the real property, including, without limitation, real estate taxes and insurance; escrow sums required by the mortgagee or separate assignment of rents instrument; and (2) make payments to the mortgagee. The court will typically require the mortgagor

to account to the court and the mortgagee for the receipt and use of the collected rents and may also impose other conditions on the mortgagor's use of the collected rents. The request that the assignment of rents be enforced may be made in the original foreclosure complaint, by means of a motion filed after commencement of the foreclosure action, or by a separate action filed to enforce the assignment of rents instrument.

### Appointment of a Receiver

Many commercial mortgages contain provisions allowing for the appointment of a receiver to take charge of the property during the course of the foreclosure proceeding. Additionally, common law grounds for appointing a receiver exist to prevent the wasting of the property. A foreclosing lender in Florida may request appointment of a receiver for income-earning property in connection with a foreclosure action or in an action filed separately. The request for a receiver is made by filing a verified (notarized) motion for appointment of a receiver which states the reasons appointment of a receiver is necessary.

The appointment of a receiver is an equitable remedy, not a matter of right. Florida law requires substantial impairment to the security of the lender prior to appointment of a receiver. In a foreclosure action, a receiver should be appointed by the court to manage the secured real and personal property where: (1) "there is a strong reason to believe that the party asking for a receiver will recover;" and (2) there is evidence that the appointment of a receiver is necessary "for the preservation of the property." See *Smith v. State Life Ins. Co.*, 153 So. 842 (Fla. 1934); *Carolina Portland Cement Co. v. Baumgartner*, 128 So. 241 (Fla. 1930); see also *Silver Pines Partners Ltd. v. The Resolution Trust Corp.*, 588 So. 2d 63 (Fla. 5th DCA 1991); *Interdevco, Inc. v. Brickellbanc Sav. Ass'n*, 524



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So. 2d 1087 (Fla. 3d DCA 1988); *Colley v. First Fed. Savs. and Loan Ass'n of Panama City*, 516 So. 2d 344 (Fla. 1st DCA 1987); *Fla. Reinvestment Corp. v. Cypress Savs. Ass'n*, 509 So. 2d 1352 (Fla. 4th DCA 1987).

Grounds for appointment of a receiver include the borrower's failure (1) to maintain the property (make necessary repairs and/or pay for upkeep and salaries for the property's employees), (2) to assign rents and profits to the plaintiff (where that is provided for in the mortgage), (3) pay the insurance on the property, and/or (4) pay the taxes on the property. Receivers are usually funded through special court-approved loans made by the lender, which are secured by the property and are given a super-priority over all other liens, including the mortgage.

Often, as a compromise, a receivership is reached using Section 697.07, Florida Statutes, which provides the mechanism for enforcement of an assignment of rents granted the lender. Section 697.07 provides the lender with an alternative remedy if the loan documents contain an assignment of rents to the lender from the borrower. According to the statute, the assignment of rents acts as a lien on the rents, enforceable on the borrower's default. The lender may then seek to enforce this lien in a foreclosure action or by a separate action to enforce the assignment of rents.

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