Mortgage Lending Institute

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Workouts: Winter is Coming (Lessons from 2008)

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I. INTRODUCTION

There will be a downturn. The question is when, not if. There have been 33 business cycles in the United States between 1854 and 2009.[1] During that period, the average length of a growing economy was 3.2 years (38.7 months), and the average recession lasted 1.5 years (17.5 months).[2] As of August 2019, the current boom has lasted in excess of 10 years (over 122 months). The next longest boom period was the period following the downturn in the early 1990s and ending with the subprime mortgage crisis, collapse of the United States housing bubble and global financial crisis deemed the "Great Recession" that lasted from December 2007 through June 2009. Economists and other experts disagree on when the next downturn will occur, but all agree that another downturn is inevitable.

What changes, if any, were made in the underwriting, origination and documentation of loans secured by commercial real estate as a result of the Great Recession to soften the blow when the inevitable downturn occurs? What remedies are available to lenders and servicers when the loan goes in default, and which of those remedies will be the preferred tools used by lenders and servicers of commercial real estate secured debt the next time around?

This paper addresses some of the remedies available to lenders in connection with the collection of loans secured by commercial real estate, and the oral presentation will address these remedies as well as some insight from real estate finance attorneys and from lenders who experienced the "Great Recession" and who have made efforts to try to diminish the impact of the next downturn. This presentation is a collaborative effort of Winstead PC. This presentation is from the perspective of a lender, but hopefully, the presentation will be relevant and useful to any party dealing with a troubled real estate secured loan, whether lender, borrower, guarantor or equity source.

II. REMEDIES AND TOOLS

A. Receiverships

Receiverships were commonly used during the Great Recession and often by special servicers. A receivership enables the lender or servicer to preserve, manage, restore, market and ultimately dispose of real estate collateral through a receiver while being insulated from and avoiding potential claims and liabilities resulting from ownership of the real estate. Receiverships were often pursued in judicial foreclosure states where there was a backlog of cases and it could take years to obtain a judgment or order for foreclosure. A receivership could be used to avoid that delay in the sale of the property via a sale by the receiver or to enable the receiver to preserve, maintain and rehabilitate the property pending a judicial foreclosure. In Texas, receiverships were often used as an alternative to a nonjudicial foreclosure sale to enable the lender to sell the property (a court-approved sale of the property by the receiver) without

[1] Cameron Kong, "Recession is Overdue by 4.5 Years, Here's How to Prepare," Forbes, October 23, 2018.

[2] Id.

taking title and assuming the risks and liabilities of ownership.

1. Receivership is an Extraordinary and Harsh Remedy. A receivership has been deemed and held "to be a harsh, drastic and extraordinary remedy" which is "to be used cautiously and only in extraordinary cases . . .." Hunt v. Merchandise Mart, Inc., 391 S.W.2d 141, 145 (Tex. Civ. App. - Dallas 1965, writ ref'd. n.r.e.); see also, In re Estate of Price, 528 S.W.3d 591, 593-594 (Tex. App. – Texarkana 2017, no pet.). "Receivership is an extraordinarily harsh remedy and one that courts are particularly loathe to utilize." Rusk v. Rusk, 5 S.W.3d 299, 306 (Tex. Civ. App. – Houston [14th Dist.] 1999, pet denied). Because a receivership deprives an owner of the use of the owner's property, a receivership is one of the harshest remedies known to the law. Jones v. Strayhorn, 321 S.W.2d 290, 294 (Tex. 1959). The appointment of a receiver for property without notice "is one of the most drastic actions known to law or equity and should be exercised with extreme caution and only where great emergency or imperative necessity requires it . . .." Independent Am. Sav. Ass'n v. Preston 117 Joint Venture, 753 S.W.2d 759, 750 (Tex. App. – Dallas 1980, no writ); see also, Elliott v. Weatherman, 396 S.W.3d 224, 229 (Tex. App. – Austin 2013, no pet.).

Even though the remedy is "extraordinary" and "must be used cautiously," some lenders and servicers have the expectation that an application for a receiver is a routine matter and that the court's appointment of a receiver is perfunctory. This perception is based largely on the prevalence of receiverships during and immediately following the Great Recession. However, many, if not most, of those receiverships were agreed or unopposed. In many instances, borrowers and/or guarantors were motivated to agree to the appointment of a receiver to avoid liability for an otherwise nonrecourse debt created by springing provisions in the loan documents.

2. Nature of Remedy and Use. A receiver is a disinterested party appointed by the court to hold possession of property that is at issue in litigation. First S. Properties, Inc. v. Vallone, 533 S.W.2d 339, 343 (Tex. 1976). The receiver protects and represents the interests of all persons in the subject property, including all owners and creditors. Security Trust Co. v. Lipscomb County, 180 S.W.2d 151, 158 (Tex. 1944).

Although some lenders and servicers operate under the misconception that the receiver answers to the party who obtained the appointment of the receiver, the receiver answers to the court and is not an agent of any of the parties. The receiver is not an agent of any of the parties, but is an officer of the court and the medium through which the court acts. Security Trust Co., 180 S.W.2d at 158. The receiver is an agent of the trial court. Spiganer v. Wallis, 80 S.W.3d 174, 183 (Tex. App. – Waco 2002, no pet.) The receiver represents all persons interested in the litigation in which the receiver is appointed. Payne v. Snyder, 661 S.W.2d 134, 143-144 (Tex. App. – Amarillo 1983, writ ref'd. n.r.e.).

Receivership is available in equity and pursuant to statutory authority. Chapter 64 of the Texas Civil Practice & Remedies Code is the primary governing authority for receiverships in Texas, but Chapter 64 does not exclusively govern all receiverships. Tex. Civ. Prac. & Rem. Code Ann. §64.001, et. seq. Chapter 11, Subchapter I of the Texas Business Organizations Code governs the appointment of receivers for domestic entities and assets of domestic entities. Tex. Bus. Org. Code §11.401, et. seq. A receiver for a domestic entity or for a domestic entity's property or business may be appointed "only as provided

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