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Putting the 'stress' in distressed

Receiverships can offer solutions for struggling commercial properties, but they require skill

Within a year, Michelle C. Harrell saw commercial real estate markets shift, and distressed properties started to swallow banks' real estate owned (REO) departments. Between the end of 2007 and the end of 2008, bankers started to realize that something had to change.

The banks, she said, have been less interested in foreclosing on commercial properties, as their books are already flooded with residential foreclosures.

A 'viable' alternative

And that's when her practice, as managing shareholder of the general and complex litigation practice group at Maddin, Hauser, Wartell, Roth & Heller, PC in Southfield, started to turn "receivership," which used to be practically a dirty word, into a viable solution for lenders.

"Now it's a preservation tool rather than a stigma," she said. "The things I see are notices of default are remaining steady or growing. At the same time, foreclosures are falling off. That tells me the banks are not foreclosing. They're looking for alternatives."

Michelle Harrell

Lender clients were finding that sometimes foreclosure made

properties hard to sell, and often made it impossible to maintain the properties' values.

"If you have a multitenant apartment complex, for example, and the borrower has defaulted, the standard used to be that the lender would foreclose. But that led to a lot of problems. You'd have a borrower squatting at the property, and where was all the rent going?" Harrell said. "It's really easier to sell that property if you have tenants there paying rent and planting flowers, and kids riding around on bikes."

That's good for Harrell, who primarily represents court-appointed receivers, and in other cases represents lender clients who have properties in receivership, and she expects it to keep rising.

So naturally, she said, it's a practice area many receivers and lawyers are eager to get into.

No 'dabblers'

But attorney David Findling, of the Royal Oak-based Findling Law Firm, PLC, who is a court-appointed receiver on some $50 million worth of property per year, said that it's not a practice area for dabblers.

He notes that the statute itself, MCL 600.2926 is vague:

"Circuit court judges in the exercise of their equitable powers, may appoint receivers in all cases pending where appointment is allowed by law. This authority may be exercised in vacation, in chambers, and during sessions of the court. In all cases in which a receiver is appointed the court shall provide for bond and shall define the receiver's power and duties where they are not otherwise spelled out by law. Subject to limitations in the law or imposed by the court, the receiver shall e charged with all of the estate, real and personal debts of the debtor as trustee for the benefit of the debtor, creditors and others interested."

There are no particular qualifications, and no screenings for receivers, something that has bothered Findling for the 20 years he has worked in that area of the law.

He's advocated for licensing of receivers, and said that a few years ago the Supreme Court Administrators Office had assembled a work group to establish best practices for receivers, but it has gone nowhere.

“What we have out there is a problem with receivers not following the rules,” Findling said. “For example, the court must provide for bond of the receiver. Often judges don’t require it. So there may not be a bond.”

Another area that’s sometimes problematic is the sale of land, which a receiver cannot do without a special order of the court, Findling said.

“But often attorneys who act as a receiver will sell without the court’s approval,” he said.

And often, they just lack the expertise to make good business calls, he said.

“There are two ways to look at this. When you’re looking at vendors for receivership, you always want to give people a chance,” Findling said. “Having said that, there’s always a consequence.

“A judge can say that he’ll appoint you to give you a chance to do the work, and if you don’t do a good job, he’ll never appoint you again. That may not be a big deal if you’re just dabbling in it. But for me, there is a long term consequence for not running my show right.”

Harrell first started representing receivers in 2004, when one of her clients was appointed as a receiver.

“We learned the ropes and worked our way through it together,” she said.

What her clients need is help with document review, to determine the rights and responsibilities of often competing parties, she said.

There are options

“We have to help determine what options the receiver has,” she said.

Harry Cendrowski, president of Bloomfield Hills- and Chicago-based Cendrowski Corporate Advisers, is a licensed CPA and certified fraud examiner who has been working as a receiver since 1983.

He has worked with Harrell before, and calls on her to help identify legal entities in a distressed business or real estate property, and to determine each parties’ liabilities.

“Receivership often allows the parties to get a different idea, and a sense of what’s realistic,” Cendrowski said.

One of the trickier aspects, he said, is financing.

Receivership is a triggering event for a lender to call in a loan immediately, he said. Then there are compliance issues, and often there are contentious partners, who can make it difficult to obtain documents such as tax returns.

The “vultures,” buyers who are looking to acquire property for pennies on the dollar, come out, Cendrowski said. And still other times, buyers and tenants could be scared off a property because it’s in receivership, thinking that a sale or lease will become too complex.

“As a receiver, you’re trying to not listen to the noise,” he said. “The main thing you’re trying to do is to maintain and protect value.”

He agrees that there is a potential for an uptick in receivership activity, particularly in the hotel market.

But the potential for more receiverships doesn’t necessarily add up to a sure thing, Cendrowski said.

“What’s happening is some banks don’t want to go through receivership. They just want to sell and be done with it,” he said.

And even if they do go the route of receivership, in general the courts prefer to work with experienced receivers, he said.

That’s because even if you do everything right, the receivership can fall apart.

“Initial due diligence is crucial,” Cendrowski said. “But even then, if you have a very large regional mall or office center, where the tenants tend to be sophisticated, they could have a provision in the lease that says that if occupancy drops below 75 percent, for example, they can get out of the lease. That’s where things can unravel.”

At that point, parties can petition the court to end the receivership, and it’s up to the court to make a determination.

Harrell sometimes has to act as a stop-gap to keep receivers from acting too quickly.

“Receivers have the same sensibilities that any of us, so sometimes they’ll want to sell too quickly,” she said. “I’m there to ensure that they’re fulfilling their duties properly.”