

Buyer Beware: Purchasing Assets From a Receiver

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In prior economic downturns, lenders generally sold real estate assets as REO following a foreclosure sale. To avoid the expense, delay and potential liability of acquiring title through the foreclosure process, lenders are increasingly using direct sales by receivers to dispose of distressed assets. Receiver sales may also generate higher sales prices by enabling purchasers to assume below market CMBS financing. Given this trend, purchasers should be aware of the unique issues applicable to receivership sales.

Nature of Receiver's Power. A receiver is appointed by the court to take possession and control of property while litigation between the lender and the borrower is pending. The receiver works for the court, not the parties. The receiver's authority derives solely from statutes and court orders, including the order appointing the receiver. If authorized by court order, the receiver may sell receivership assets. However, a sale must also be confirmed by the court and may be subject to an overbid process. A receiver generally is not personally liability for actions taken within the scope of her or his authority and recourse is limited to the assets of the receivership estate. The receivership is discharged by the court upon certain events, including a bankruptcy filing by the borrower or the disposition of the receivership assets. Following discharge, a receiver generally has no further liability.

Determine Scope of Receiver's Authority. The receiver's authority depends on the applicable court orders. Initially, the purchaser should review the order appointing the receiver to confirm that the receiver has the authority to sell the property (subject to court confirmation) and that the description of the receivership assets includes all necessary property. For example, if permits, plans, trademarks or other similar rights are important, the purchaser should confirm that these property interests are included in the appointment order. The purchaser should also review subsequent court orders, including the order confirming the sale, to ensure consistency with the terms of the purchase agreement and the title company's requirements to issue a title policy.

Conditional Nature of Purchase Agreement. Unlike typical real estate transactions, a purchase agreement with a receiver is not effective without court confirmation. Court confirmation generally is obtained only after the purchaser waives all due diligence contingencies. Therefore, the purchaser is at risk until court confirmation is obtained and any applicable overbid process is completed.

Determine Whether Other Parties are Likely to Object to the Sale. If the court does not ultimately confirm the sale, the purchaser will lose its transaction costs and may harm its relationships with lenders and investors. Therefore, the purchaser should review whether the borrower or other creditors, including junior lenders, are likely to object to the sale. Moreover, unless these parties consent to the order confirming the sale, most title companies will not issue a title policy to the purchaser. The borrower's cooperation may also be important for other reasons, such as providing documents and information relevant to the property.

Effect on Purchaser's Remedies. When a seller in a real estate transaction defaults, a purchaser typically has the right to actual damages or specific performance. For practical reasons, these remedies may not be available in a receivership sale. In order to bring an action against the receiver, court approval is necessary. Courts are unlikely to approve a purchaser's lawsuit against a receiver, especially prior to court confirmation of the sale. To provide an effective remedy, the purchaser should negotiate a breakup fee payable upon the receiver's breach of the purchase agreement. To be enforceable, this type of damages provision must first be approved by the court.

Lack of Representations and Warranties. Receivers generally will not provide any representations and warranties regarding the property. Even if representations and warranties are given, they will have little or no value after closing because the receiver will have been discharged.

Security Deposits and Prepaid Rent. California law does not require landlords to segregate security deposits of commercial tenants. Therefore, security deposits often disappear before a receiver is appointed. Because receivers often provide a closing credit only for security deposits actually held by the receiver, the purchase price offered by the purchaser should reflect the amount of missing security deposits.

Lack of Continuing Liability. In a typical purchase and sale transaction, a seller may retain liability after closing for certain matters, including representations and warranties, adjustments to prorations and indemnities for broker commissions. Post-closing remedies in a receivership sale are essentially meaningless because sales proceeds are distributed at closing to the lender and the receiver is often discharged soon after the closing. In a receiver sale, provisions for post-closing adjustments to prorations of real property taxes, tenant common area expenses and other items that cannot be precisely determined as of closing are therefore not effective.

Conclusion. While increasingly common, receivership sales create risks for purchasers that do not apply to other real estate transactions. A purchaser must account for these risks in determining the purchase price and other sales terms and in conducting due diligence investigations.

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