

Commercial Property - USA

Illinois appeal courts affirm mortgagee's right to appointment of a receiver

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Introduction

As in many other jurisdictions, a foreclosure of commercial real property in the State of Illinois may take from several months to more than a year to complete before a mortgagee obtains title to the property. To protect and preserve the value of the property during the foreclosure process, many mortgagees seek the appointment of a court-appointed receiver to manage and operate the property. A receiver's powers and duties may include collecting rent and other income, securing prospective tenants, preserving existing tenants, insuring the property, employing custodians and counsel, and paying real estate taxes and other payables.

The Illinois mortgage foreclosure law provides⁽¹⁾ that in a mortgage foreclosure case involving non-residential real property, a mortgagee is entitled to be placed in possession of the property prior to the entry of a judgment of foreclosure upon the mortgagee's request, provided that the mortgagee shows that (i) the mortgage or other instrument authorises such possession, and (ii) there is a reasonable probability that the mortgagee will prevail on a final hearing. Furthermore, under the Illinois mortgage foreclosure law,⁽²⁾ whenever a mortgagee entitled to possession so requests, the court shall appoint a receiver. However, if the mortgagor objects and demonstrates good cause for not appointing a receiver, the court will allow the mortgagor to remain in possession.

Many mortgagors challenge the appointment of a receiver, arguing that the appointment of a receiver will cause harm to them and the property or inhibit their ability to market the property to prospective tenants; or that they are in a much better position to manage the property than a receiver. Two recent Illinois appellate cases - *Bank of America, NA v 108 N State Retail LLC*,⁽³⁾ and *Centerpoint Properties Trust v. Olde Prairie Block Owner, LLC*⁽⁴⁾ - have recently considered a mortgagee's right to the appointment of a receiver under Illinois law.

108 N State

In the *108 N State* case a lender made a construction loan to a developer secured by a mortgage on a mixed-use property being developed in Chicago, Illinois. After the occurrence of certain defaults under the loan documents, the mortgagee and the mortgagor entered into certain modification letter agreements in which the mortgagor acknowledged that certain defaults had occurred under the loan documents, and that the mortgagor had no defences, set-offs or counterclaims to the performance of any of its obligations under the loan documents.

The mortgagee subsequently filed a mortgage foreclosure action and a motion to appoint a receiver. The mortgagor first opposed the foreclosure action, arguing that the mortgagee's claims were barred by certain affirmative defences. However, the trial court granted the mortgagee's motion to strike the mortgagor's affirmative defences on the grounds that the mortgagor had acknowledged that the loan was in default, and that it had no defences in the letter agreements. The mortgagor then argued that a receiver should not be appointed because the mortgagee had failed to establish that there was a reasonable probability that it would prevail on a final hearing, as there had not been a default on the loan and the mortgagee had not demonstrated good cause for appointment of a receiver and no good cause could be shown. The trial court, however, granted the mortgagee's motion to appoint a receiver by finding that the statutory

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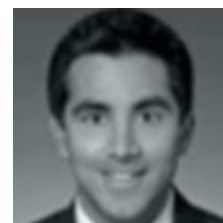
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requirements for such an appointment had been satisfied, and that the mortgagor had failed to establish good cause why a receiver should not be appointed.

On appeal, the mortgagor first argued that the mortgagee did not have a reasonable probability of succeeding in the underlying foreclosure action because there was no default or material breach of the loan agreement. The appellate court, however, held that events of default had occurred, and that the mortgagor acknowledged the events of default in the modification letter agreements. The court stated that under Illinois law, a proven default establishes a reasonable probability of succeeding in a mortgage foreclosure action. The mortgagor also argued that the mortgagee had no reasonable probability of succeeding in the underlying foreclosure action because the affirmative defences it raised in the trial court had been stricken in error and the affirmative defences defeated the mortgagor's claims. The court, however, held that the mortgagor's affirmative defences had been properly stricken by the trial court, because the trial court found that the mortgagor had waived all affirmative defences in the letter agreements.

Next, the mortgagor argued that it had established good cause for not appointing a receiver. The mortgagor's first argument was that it was in the best position to complete the project and protect the value of the collateral, especially given the project's complexity and the fact that it was in the late stages of development. The court, however, held that the qualifications of the current management were an insufficient basis to find that there was good cause to permit the mortgagor to remain in possession of the property. The mortgagor's second argument was that the mortgagee never alleged or demonstrated any fraud, mismanagement, waste or other dissipation of the property. The court, however, held that the mortgagee did not need to demonstrate such circumstances because the burden to establish good cause was on the mortgagor and not on the mortgagee. The mortgagor's third argument was that the appointed receiver was unprepared to take over the project. The court, however, held that there was no indication that the appointed receiver was incompetent, inexperienced or incapable of managing and completing the project. Finally, the mortgagor argued that the receiver - a large real estate services company - had disqualifying conflicts of interest because the firm also represented current and prospective tenants of the property. The court, however, held that such conflicts of interest are inherent in large commercial real estate projects and the trial court was thus not in error in deciding that such conflicts did not constitute good cause for not appointing a receiver.

Therefore, the appellate court upheld the trial court's order granting the appointment of a receiver to manage and operate the property. It held that the trial court did not err in finding that there was a reasonable probability that the mortgagee would prevail in the underlying foreclosure action, and that the mortgagor had not presented evidence to establish good cause for not appointing a receiver.

Olde Prairie

In the *Olde Prairie* case, a lender made a one-year term loan to a developer secured by a mortgage on real property in Chicago, Illinois, to be developed as a retail and hotel development. Following a maturity default, the mortgagee filed a mortgage foreclosure action and subsequently filed a motion to appoint a receiver. The mortgagor opposed the appointment of a receiver, arguing that a receiver would improperly interfere with a pending condemnation case and jeopardise any future refinancing. The trial court granted the mortgagee's motion to appoint a receiver.

On appeal, the appellate court at the outset stated that the mortgagee had satisfied the statutory requirements entitling it to possession, because the mortgagor admitted the loan default and a proven default is sufficient to establish a reasonable probability of succeeding on the underlying foreclosure action. Therefore, the court held that the mortgagee was entitled to possession of the property and the appointment of a receiver, unless the mortgagor could establish good cause for permitting it to retain possession of the property.

The mortgagor first argued that it had established good cause by showing that it could manage the property with greater efficiency than a receiver. The court, however, held that a showing by a mortgagor that it could better manage the property is not sufficient to overcome the statutory presumption in favour of appointing a receiver. The mortgagor also argued that the harm caused to the mortgagor by appointing a receiver outweighed any potential harm that the mortgagee could incur if the mortgagor were permitted to retain possession of the property. The mortgagor argued that the appointment of a receiver would make it difficult to attract prospective tenants, promote the project to investors and obtain refinancing in order to resolve the foreclosure action. Furthermore, the mortgagor argued that there would be no harm to the mortgagee if the mortgagor retained possession, because the property was effectively vacant, there was no significant rental stream or commercial business, and the receiver retained the same security personnel as the mortgagor to protect the property. The court held that although it did not dispute the assertion that the appointment of a receiver could impose additional hurdles to the mortgagor's efforts to develop, refinance or sell the property,

those potential impediments were not sufficient to overcome the statutory presumption in favour of placing the mortgagee in possession of the property.

Although the court held that the mortgagor had not established good cause for not appointing a receiver, the court discussed, in dicta, circumstances in which a court could find that good cause has been established. As an example, the court stated that if, while a motion for the appointment of a receiver is under consideration, the mortgagor presents evidence to the trial court that it has a commitment from an investor to provide funds for development of the property or has obtained a loan from another mortgagee to refinance, and the appointment of a receiver would likely impede those transactions, the trial court may find that there is good cause to permit the mortgagor to retain possession in the interim. The court specified that such a transaction would likely need to be imminent. As there was no such imminent transaction in this case, the court upheld the trial court order appointing the receiver because the mortgagee had satisfied the statutory requirements entitling it to possession of the property and the mortgagor had failed to establish good cause for permitting it to retain possession of the property.

Comment

These cases are timely in light of the increasing number of commercial mortgage loan defaults and foreclosures. The decisions indicate that under Illinois law, a mortgagee has the right to be placed in possession of a mortgage property prior to entry of a judgment of foreclosure where:

- the mortgagee so requests;
- the mortgagee shows that the mortgage authorises possession;
- there is a reasonable probability that the mortgagee will prevail on a final hearing; and
- the mortgagor has not established any good cause to remain in possession of the property.

The cases indicate that a proven default is sufficient to establish a reasonable probability that a mortgagee will prevail in the underlying foreclosure action. Furthermore, the cases clarify that the mortgagor bears the burden of proving good cause, and that good cause is not established by arguments that:

- the mortgagee has not alleged misdeeds, omissions, fraud, mismanagement, waste or other dissipation of the property;
- the harm incurred by the mortgagor by the appointment of a receiver outweighs the harm that would be incurred by the mortgagee if the mortgagor retained possession; or
- the current property management is more qualified to manage and protect the property than the receiver.

The court in *Olde Prairie*, however, discussed a potential argument for a mortgagor to establish good cause where the appointment of a receiver would likely impede an imminent transaction such as investment or refinancing.

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Endnotes

- (1) 735 ILCS 5/15-1701(b)(2).
- (2) 735 ILCS 5/15-1702(a).
- (3) 340 Ill Dec 323, 928 N E 2d 42 (2010).
- (4) 398 Ill App 3d 388, 923 N.E.2d 878 (2010).

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