Banking & Financial Services Report

JULY 2012

Receivership: A Smart Option for Troubled Loan Workouts

Secured commercial loans are generally documented in such a way that the lender is entitled to appointment of a receiver for the loan collateral upon default. In addition, most courts, both state and federal, have the power to appoint receivers pursuant to their general equitable powers and other statutory provisions.

Although often overlooked in favor of foreclosure or involuntary bankruptcy, receiverships can be an efficient method for lenders of all kinds to pursue workouts of troubled secured loans, particularly where foreclosure is inevitable.

Timing is Crucial

Because timing is a critical element of nearly every loan workout, lenders need to identify a strategy for dealing with the borrower as soon as there are signs that a loan is in trouble. The various benefits of receivership make it one option that lenders should consider with counsel early in the process of a loan workout, especially when a borrower is (i) diverting the profits generated from the loan collateral for purposes other than to repay the loan and/or (ii) neglecting the loan collateral and thereby lowering its value.

Receiverships can be *general*, where the receiver administers all of the borrower's assets, or *special*, where the Receiver only takes possession of a limited number of assets. In both cases, the receiver has a fiduciary duty to the court that appoints them. Receivers are expected to maximize the value of the borrower's assets and generally have a duty to protect the borrower's shareholders and creditors.

When Receiverships Make Sense

Receiverships can be particularly useful in connection with defaulted loans secured by commercial real estate and should be viewed as an interim step to save complex troubled property loans while preventing the borrower from using the loan collateral against the lender. Receivers can be useful to lenders in a variety of other contexts, including the following: misappropriation of assets by a borrower; mismanagement of assets; building code violations; waste, abandonment and deferred maintenance issues; tax delinquencies; insurance cancellation; hazardous materials and other environmental issues; and in the judgment collection process.

Receiverships can also be an effective way to deal with non-responsive or non-cooperative borrowers (for example, a borrower who does not respond within 30 days of a demand letter). Appointing a receiver can establish the

[*Continued on Reverse>>*]

Shapiro Sher Guinot & Sandler

About the Firm

In 2011 Shapiro Sher Guinot & Sandler was named the top medium-size law firm in Maryland for "Business & Transactions" by Super Lawyers, a division of Thomson Reuters. The firm represents clients in numerous practice areas, including banking, bankruptcy, corporate, real estate, tax, and commercial litigation.

The firm's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Co-chaired by K. Lee Riley, Jr. and Scott W. Foley, the firm's Banking & Financial Services Group represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

Mr. Riley advises financial institutions in commercial lending transactions; Mr. Foley advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With over thirty years of experience in the banking industry between them, Mr. Riley and Mr. Foley appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

For more information about the Banking & Financial Services Group, contact Mr. Riley at LRiley@ShapiroSher.com or Mr. Foley at SWF@ShapiroSher.com.

framework and a pathway for the workout to succeed, taking away the borrower's ability to stonewall or withhold information relating to the loan collateral.

The Many Benefits of Receiverships

For lenders, one of the most useful benefits of having a receiver appointed to take over possession and management of assets is that a receivership insulates the lender from having to take control of the borrower and being deemed a co-owner of the asset, a partner with the borrower or a mortgagee-in-possession, all of which carry significant ownership burdens and legal risks (including exposing the lender to lender liability claims). As many lenders discover—often after it's too late to pursue an alternative strategy—obtaining ownership of an asset through foreclosure or auction leaves the lender itself to manage the assets and directly assume the risk of loss.

Another potential benefit is that the receivership process can be used to "tighten up" imperfect loan documents. This is particularly true when it comes to drafting the receivership order. A carefully drafted receivership order will protect the lender and ensure that the receiver

- Obtains the documents and information he/she needs to effectively manage the assets;
- Is able to locate and secure all assets of the receivership estate, including any offsite assets;
- Is able to borrow funds that might be necessary to maintain the assets;
- Has unobstructed control over borrower accounts, as well as any bonds or deposits relating to the assets;
- Is able to lease and/or sell the assets, as appropriate, and in connection therewith to complete and record plats and maps, obtain certificates of occupancy, clear liens and resolve easement issues; and
- Will be able to obtain adequate insurance to manage the assets and operate any related businesses.

There will, of course, be additional issues to address in the receivership order, depending on the nature of the assets, the comprehensiveness of the loan documents in place, and the terms of the lender's existing relationship with the borrower. The drafting of the receivership order gives the lender a good opportunity to define the scope and extent of the receiver's powers, fix any previously noted problems with the loan documentation, and have a voice in how the receivership assets are managed and/or liquidated.

Properly managed, receiverships can be far less costly than bankruptcy proceedings. While receivers generally have to comply with periodic reporting requirement and submit to review by court auditors, these procedures are generally far less expensive than those involved in a bankruptcy case, where the process is overseen by the Office of the United States Trustee, as well as an additional trustee in Chapter 7, Chapter 13, and sometimes Chapter 11 cases.

Receiverships relieve lenders of most of the tasks associated with day-to-day management of the receivership assets, which can be helpful where the collateral includes specialized assets. Finding the right person to serve as receiver and taking the time and effort to work with counsel and the borrower in drafting the receivership order can save the lender resources and make it more likely that the lender will get the results it wants in a loan workout.

For those reasons, the lender should ensure that its commercial loan documents authorize it to move for the appointment of a receiver over the collateral in the event of default. The documents should grant the lender a contractual and equitable basis for the appointment. Then, should the prospect of default arise, the lender will be in a position to benefit from the many advantages of receivership.

If you have any questions regarding receiverships, please contact Scott Foley at (410) 385-4234.

Limit on SBA Small Loan Advantage Loans Increased

On July 11, 2012, the Obama Administration announced a new initiative that increases the maximum size of the Small Business Administration's Small Loan Advantage loans from $250,000 to $350,000. The SBA created this loan program in 2011 with the goal of providing more lower-dollar loans to businesses in underserved communities. With a two-page application and limited paperwork, the Small Loan Advantage program is an appealing option for some borrowers. Also, lenders can use their own note and guaranty agreement. According to the SBA, most Small Loan Advantage loans are approved within minutes through an electronic submission system, and non-delegated Small Loan Advantage loans are often approved within five to ten days.