Mortgagee in Possession Doctrine and Receivership

• Suppose it is December, Mortgagor is in default, but isn’t answering Mortgagee’s phone calls, doesn’t appear to be at the home, and Mortgagee is worried about the pipes freezing
• Can Mortgagee enter the property, winterize it, and change the locks?
• Under lien theory, Mortgagee is not entitled to possession solely by virtue of having a mortgage
• Thus, Mortgagee will try to create such a right by contract
• Example: Freddie DOT ¶ 9 ostensibly allows Lender to “secure” Property, including “entering the Property to make repairs, change locks, replace or board up doors or windows,” etc.

• Note that under Freddie provision, Mortgagee’s right to enter the property depends on (1) having given advance notice [¶ 7], or (2) Mortgagor having “abandoned” the property [¶ 9(C)]
• Wheeler case (note 3, p. 376) is a cautionary tale
  • Mortgagee didn’t give reasonable advance notice
  • Mortgagor hadn’t actually abandoned property
  • Thus, Mortgagee’s self-help action in changing locks was unlawful entry [$100,000 in punitives!]
“Mortgagee in Possession”

• If mortgagee takes possession (by consent or after abandonment), it becomes a “mortgagee in possession” [Note 4, p. 378]

• Mortgagees may be reluctant to take possession, however, b/c becoming “mortgagee in possession” has legal consequences

• Consequences include:
  • Mortgagee becomes subject to potential premises tort liability (just like an owner would have)
  • Mortgagee owes duty to Mortgagor to maintain property (can’t just act for its sole benefit as mortgagee) [Cf. UCC § 9-207 duties of secured party]
  • These liabilities can’t be “disclaimed” in the loan documents
• Suppose that after Lambert defaults on several months’ worth of mortgage payments, Second Life (mortgagee) gives Lambert’s tenants notification to begin paying rents to Second Life
• Does this make Second Life a “mortgagee in possession”?

Appointment of a Receiver

• After default, mortgagee can also enforce assignment of rents by asking the court to appoint a receiver
  • A receiver is an agent of the court, who takes possession of the mortgaged property and manages it
  • Receivership is an equitable remedy, ancillary to another action (e.g., for foreclosure, or for judgment on the debt, or for specific performance of an assignment of rents)
• **Benefits of using receivership:**
  • Control of rents (no “skimming”)
  • Mortgagee does not have to take physical control of the property, become mortgagee-in-possession
  • Receiver can protect, manage and operate building during the foreclosure process
  • With court approval, Receiver can enter into new tenant leases for empty spaces in building***

• ***Why wouldn’t this happen without a receiver?***

• **The primary disadvantage to receivership is its expense (more expensive compared to direct rent collection, i.e., by notification to tenants):**
  • Attorneys’ fees for court processes
  • Receiver has to post surety bond
  • Receiver’s fees
    • These fees are paid from the rents, but if the property isn’t generating enough in rents, Lender may have to “front” the difference
Common “Receivership Clause”

**Appointment of Receiver.** Beneficiary, separately or in any action to foreclose this Deed of Trust, shall be entitled (without notice and without regard to the adequacy of any security for the Note, the absence of waste or deterioration of the Property or other arguments based in equity) to the appointment of a receiver of the Rents of the Property ...

**Dart (p. 414)**

• Should such a “consent to receivership” clause in a mortgage be enforced as matter of contract, or should the decision whether to appoint receiver be in court’s discretion?
• *Dart* (p. 414) decision reflects traditional judicial approach (discretionary remedy)
  • Equitable remedy, not a legal right; court is not required to appoint a receiver if mortgagee’s legal remedies (e.g., foreclosure) are adequate
  • Lender was “oversecured” (value of land >>> mortgage debt), so it was unlikely to suffer loss
  • No evidence of waste or that land was decreasing in value (thus no threat to Lender’s security)

**Ariz. Rev. Stat. § 33-702(B).** A mortgage or trust deed may provide for an assignment to the mortgagee or beneficiary of the interest of the mortgagor or trustor in leases, rents, issues, profits or income from the property covered thereby, whether effective before, upon or after a default under such mortgage or trust deed or any contract secured thereby, and such assignment may be enforced without regard to the adequacy of the security or the solvency of the mortgagor or trustor by any one or more of the following methods:

1. The appointment of a receiver....
Question

• What impact, if any, does Ariz. Rev. Stat. § 33-702(B) have on the issue in the *Dart* case?

N.Y. Real Prop. Law § 254(10). A covenant “that the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver,” must be construed as meaning that the mortgagee, his heirs, successors or assigns, in any action to foreclose the mortgage, shall be entitled, without notice and without regard to adequacy of any security of the debt, to the appointment of a receiver of the rents and profits of the premises covered by the mortgage....
• Later AZ decisions have interpreted the statute to supersede *Dart* (adequacy of security is no longer ground for a court to deny receiver’s appointment)

• Restatement § 4.3(b): mortgagee entitled to receiver after default, if mortgage explicitly so provides, w/out regard to adequacy of security [p. 398, note 2]

• UARA is similar [p. 386], as is UCRERA (2015) [p. 425-426] and statutes in WA, MN, IN, NY, NM (court must appoint receiver after default, if mortgagor consented by agreement in mortgage)

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**Ex parte Appointment of Receiver**

• Commercial mortgage documents often call for appointment of a receiver *ex parte*, w/out prior notice to borrower [Note 3]

• Courts: this is constitutional, as long as:
  • Motion is supported by sworn affidavits, and
  • Borrower has opportunity for prompt post-appointment hearing