

# Commercial Foreclosures

Pillsbury's Distressed Real Estate Task Force  
Presents:

The Swimming Lesson Series - Surviving and  
Navigating the Choppy Waters of Distressed  
Real Estate

# Speakers



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# Today's Discussion

- General overview of the foreclosure process
  - Pre-foreclosure process and planning
  - Drafting the foreclosure complaint
  - Obtaining a judgment of foreclosure and sale
  - Post-sale issues

# First things first: get organized

- Conduct a careful review of all loan documents and any ancillary agreements
- Confirm default and notice requirements
- Key questions:
  - Are there any defects in the loan documents/assignments/signatures/collateral perfection?
  - Any post-closing changes that affect the secured party?

# Pre-foreclosure: the pre-negotiation agreement

- Content and purpose
  - Allows lenders and borrowers to freely engage in discussions, and not be bound by those discussions until a formal, written agreement is executed.
- Key terms
  - Discussions are confidential, non-binding, can be terminated at any time, and are not admissible in any court proceeding
  - Waiver of claims relating to negotiations themselves (but not relating to the loan documents)
  - Releases and estoppels

# Pre-foreclosure: the forbearance agreement

- Key terms and goals
  - Lender agrees to defer enforcement of remedies after a borrower's default in exchange for borrower's agreement to comply with the conditions laid out in the forbearance agreement.

# Pre-foreclosure: the forbearance agreement

- Terms may include:
  - Financial reporting beyond what is required in the loan documents
  - Payment of fees
  - Modification of debt service payment schedule
  - Interest rate adjustment
  - Provision of additional collateral/guaranties/adding new recourse events
  - Concessions/contributions from other lenders

# Pre-foreclosure: the forbearance agreement – what’s in it for the lender?

- The lender may want to use the forbearance agreement to:
  - Cure defects identified as part of loan document and collateral review
  - Obtain acknowledgment of default/amount due/lien validity
  - Reaffirm loan document reps and warranties
  - Start the clock running on contractual notice provisions
  - Ensure priority of optional advances
  - Obtain waiver of one-action and anti-deficiency rules
  - Obtain waiver of other defenses



# Pre-foreclosure: the forbearance agreement – what's in it for the borrower?

- The borrower may want to use the forbearance agreement to obtain:
  - cash flow relief in the form of reduced/deferred interest payments
  - contributions towards the property from junior lenders
  - a discounted pay-off option
  - covenant relief

# Pre-foreclosure: special issues

- Cross-defaults
- Hotel issues
  - Impact of the borrower's default/lender's foreclosure on hotel management agreement
- Construction issues
  - Who will complete the project?
  - Contractor/mechanic's lien issues
- Notice of default interest
- Lender's issues

# California: A land unto itself

- One-Action Rule
  - Security First: Must first foreclose on real property collateral before seeking to recover from obligor's non-collateral assets
  - One-Action Aspect: Only one action/lawsuit to enforce obligations secured by real estate; must include all remedies and relief sought

# California: A land unto itself

- One-Action rule considerations, cont'd.
  - Applies to all transactions involving CA real estate collateral with limited exceptions
    - CA obligor (state of physical operations)
    - Location of property not relevant (i.e. if obligor owns foreign real estate rule applies to any CA real estate collateral)
    - Exception for non-resident lender and borrower/owner where loan docs provide for application of other state law
    - Rule does not apply to settlor/trustor of irrevocable/non-revocable trusts
    - No protection for third parties (i.e. officers, shareholders, LLC members, Ltd. partners, guarantors)
    - Lender has recourse against any additional collateral
  - Severe consequences for violating: lender may lose its collateral
  - Lenders can “dual track” judicial and non-judicial foreclosures (one action rule applies on entry of final judgment)

# California: A land unto itself

- Anti-deficiency Issues
  - CA CCP 580(b), (d) – no deficiency claim if lender elects to proceed with non-judicial foreclosure unless debt is secured by additional collateral
  - deficiency judgment reduced by the amount of the full fair market value of the real property less senior debt owed
- Can waive rights only after default (except for certain PMSI transactions)

# Pre-foreclosure: preparing to file

- Title report – naming all required junior interest holders
- One-Action rule considerations
  - Applies in NY unless the property is outside the state.
- Required notices of default/acceleration
  - In NY, commencement of the foreclosure action itself can serve as notice of acceleration

# Preparing to file: the complaint

- Ensure all appropriate parties are named
- Calculate amounts due
- Prepare the lis pendens
- Venue
- Standing
  - Original holder of the note
  - Assignee of the note/person entitled to enforce
  - Delegated authority (special servicer)

# The complaint (cont'd)

- One-Action rule compliance (no other action to recover any part of the mortgage debt)
- Deficiency claims
  - In NY, assert deficiency claims against borrower(s) and any guarantor in the foreclosure complaint



# The complaint (cont'd)

- Serve any notices required by statute and/or the loan documents
- Verify the complaint and attach the loan documents
- Timing vs. non-judicial foreclosure
  - California – anti-deficiency and One-Action rule considerations

# The foreclosure action

- Receivership?
  - Contract and statutory authority
  - Powers and responsibilities
  - Cost
  - In CA, does not violate the One-Action rule

# The foreclosure action: common defenses

- Most loan documents (or the forbearance agreement) will have broad waivers of defenses, counterclaims and setoffs. Such provisions are generally enforceable
- Estoppel
- Unclean hands
- Statute of limitations
- Failure of condition precedent

# The foreclosure action: common defenses

- Waiver
- Champerty
  - Not subject to waiver, but unlikely to apply
- Usury
  - In NY, civil usury is set at 16% and criminal usury at 25%. Statutory safe harbors and loan size exceptions make the defense generally inapplicable to commercial mortgage loans
- Oral modification

# The foreclosure action

- Motion for default judgment
  - Based on borrower's non-appearance.
  - Establish basis of default and amount due through client affidavit
  - 'affidavit of regularity'
- Motion for summary judgment
  - Supported by evidentiary proof in admissible form
  - No genuine issue of material fact
  - Dismissal of all defenses and counterclaims

# The sale process

- Judgment of foreclosure and sale
- Appointment of a referee
- Sale process
- Taxes
- Deficiency judgment/surplus monies
- Redemption

# Pillsbury's Distressed Real Estate Practice

We understand that clients must act *quickly and decisively* to create or preserve value, achieve stability and seize market opportunities. Pillsbury's Real Estate team is adept at working with clients to capitalize on the effects of market disruptions – whether resulting from inefficient capital structures, asset-specific difficulties or event-driven (or macroeconomic) distress situations.

## Pre-bankruptcy experience:

- debt and equity restructurings, including loan modifications and workouts, and extension and forbearance agreements
- preferred equity investments and mezzanine loans in distressed situations
- acquisition and restructuring of distressed loans or interests in loans and ownership vehicle (including from government entities)
- formation of investment structures to acquire such assets
- loan enforcement and lien priority disputes, including judicial and non-judicial foreclosures and UCC foreclosures, deeds or assignments-in-lieu-of-foreclosure, receiverships and property recovery issues, writs of attachment or possession, analysis and defense of liability claims and analysis of intercreditor or co-lender agreements in complex debt stacks
- providing advice on alternatives to bankruptcy
- negotiation of rescue and exit financing

## Real Estate bankruptcy experience:

- relief from stay litigation
- cash collateral stipulations and adequate protection
- bankruptcy sales
- resolution of lien priority and intercreditor issues
- cram-down litigation
- prosecution and defense of avoidance actions (e.g., fraudulent transfers and preferences)
- representation of indenture trustees
- all facets of unexpired leases, executory contracts and intellectual property licenses
- bankruptcy discharge and non-dischargeability actions
- negotiating and confirming plans of reorganization

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The Pillsbury logo, featuring the word "pillsbury" in a lowercase, sans-serif font. The letters are a dark red or maroon color. The 'i' in "pillsbury" has a distinctive dot.