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Six Tips for Lenders Foreclosing a Shopping Center

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Foreclosing on a mall or shopping center presents unique issues for a lender. Failing to anticipate these issues could cause problems, such as a lengthier foreclosure process or a lower resale value after the foreclosure.

Shopping centers across the country still face significant financial struggles as a consequence of the Covid-19 pandemic, the downturn in the economy, supply chain issues, inflation, the increasing market share of online retailers, and the relatively high price of motor vehicle fuel.

The drop in traditional retail shopping in the last few years has caused the bankruptcy and liquidation of many retail stores, including several big-box chains, leaving shopping malls and smaller retail centers struggling to fill vacancies.

"Consumers aren't just buying less stuff, they are shopping less, which means a loss of the impulse-shopping moments that are critical to retail growth," said Marshal Cohen, chief retail industry advisor at NPD Group, a market research firm, in a story published June 23, 2022, on CNBC's website.

The same story quoted Sally Henry, a professor of law at Texas Tech Law School and former partner at Skadden, Arps, Slate, Meagher & Flom LLP., who said, "We have potentially a perfect storm brewing... I wouldn't be surprised to see an uptick in retail bankruptcies."

If you are a lender foreclosing a mall or shopping center, you will often face unique issues not presented by other types of property. Failure to anticipate these issues could cause problems, either during the foreclosure process or when marketing the center for resale following foreclosure.

To that end, several members of our Distressed Real Estate Solutions Practice Group at Lowndes (specializing in such areas as creditor's rights and bankruptcy, commercial foreclosures and workouts, land use and zoning, real estate development and finance, and commercial lending) have compiled these top 6 tips to consider when foreclosing on a mall or

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shopping center.

1. Demand rents

   Send the borrower a written notice demanding the rents as soon as possible after a default occurs under the loan. Under Florida statutes, for example, this demand triggers the lender's interest in the rents and the lender's right to control the use of the rents.

2. Obtain rent roll

   Obtain a current rent roll to determine if you wish to foreclose and evict any existing tenants, perhaps because their rent is below market rates, or they are significantly delinquent in paying their rent, or they are otherwise undesirable tenants. This can be accomplished if a tenant´s lease was signed after your mortgage was recorded, or was subordinated to the mortgage.

   Some tenants' leases include provisions allowing the tenant to terminate if an anchor tenant's store closes. Many anchor tenants' leases preclude competing uses in the shopping center. An analysis of both the rent roll and the tenants´ leases will enable you to make informed decisions during the foreclosure process.

   If you cannot obtain a current rent roll, leases or other necessary information from the borrower, you can file a discovery request for it when the foreclosure lawsuit commences.

3. Perform due diligence

   Assemble evidence to present to the court for the possible appointment of a receiver. For example, take pictures of the condition of the mall or shopping center and note where it may be in disrepair. Investigate and document evidence of any code violations (violations should appear on the local government's website), and investigate whether adequate insurance exists or should be obtained.

   Code violations may result in accrual of daily fines. Sometimes such fines are secured by county or municipal liens. While these will not be superior to your mortgage if they were recorded afterwards, it is worthwhile for you to cure the violations, advance the funds needed to pay the fines (or negotiate them down) and add the amount of the advance to the debt being foreclosed. If you do not do this, even if you name the county or municipality as a defendant in the foreclosure in order to extinguish the liens, the property will still be in violation of code and another code enforcement lien could be recorded later, potentially interfering with a resale.

   Longer term, once a receiver is in place, think about what a future purchaser will investigate during its due diligence period, and whether there is anything you can do to limit a future purchaser's concerns and thereby enhance the resale value of the property. For example, deferred maintenance issues involving the retail building or common areas can detract from the center's appearance, cause the loss of desirable tenants and reduce the center's value to a potential purchaser.

   While considering or conducting a foreclosure, investigate the center in a manner similar to a prospective purchaser, with a view toward solving as many problems during the foreclosure as is economically feasible.

4. Verify entitlements

   If the center is not fully developed, or if it is slated for redevelopment, determine what development entitlements exist and whether they "run with the title" to the property (meaning that a new owner will acquire them automatically when they acquire the property), or can be acquired as part of the foreclosure.

   Sometimes borrowers who develop large tracts of land obtain entitlements such as impact fee credits in the names of an affiliate as master developer. In such instances, entitlements may not be included in the description of the mortgaged property, and they don't necessarily run with the title to the property that is being foreclosed.

   In addition, if the property is only a portion of the larger development, the master developer may have retained approval rights over redevelopment. These issues frequently take time to address, so it can be advantageous to do so early on.

   If you wait until after the foreclosure is complete and you are the owner of the property, these issues may be more costly to address. You may end up carrying the property for longer, or taking a large price reduction when you resell it.

5. Check the status of title

   In addition to performing the routine title search needed to foreclose junior liens and encumbrances, determine whether the center relies on any privately owned off-site improvements to provide access, drainage, parking or utilities to the mortgaged property. There should be appurtenant easements recorded for these purposes that benefit the center, hopefully insured as part of the lender's title insurance policy.

   It is not uncommon for shopping centers to share such infrastructure with outparcels that are separately owned. In the economic boom that preceded the current downturn, it is surprising how many mortgage loans were made without lenders verifying that all necessary beneficial easements were in place and insured as part of the title to the mortgaged property.

   Review any restrictive covenants, development agreements and similar documents affecting the title to the property to determine if there are any violations or other issues presented that can be cured. You can bet that a prospective purchaser will be doing so after the foreclosure.

   Addressing these potential issues at the commencement of a foreclosure provides more time to solve them. A prospective purchaser is sure to pay less for the property if they have to fix these issues.

6. Address taxes and assessments

   Unpaid real estate taxes and Community Development District (CDD) assessments can frequently be issues with distressed property. By state law, they constitute a first lien on the property and will survive a mortgage foreclosure (meaning that the purchaser will have to pay them after acquiring the property if they want to keep it).

Investigate whether the center is assessed by the County Property Appraiser at a value that exceeds what it is now worth. Property Appraisers are reluctant to reduce taxable values during market downturns, relying on the owner to challenge them if they are too high. A lender who anticipates this possibility should have included in its loan documents a provision granting the lender authority to seek reductions in the assessed value of the collateral, absent which the owner's cooperation would be required.

Generally speaking, property that is subject to real estate taxes past due can be sold after two years following the date that the taxes became delinquent, and such a tax sale will extinguish the lien of any mortgage on the property. It is important, therefore, to keep track of the status of real estate taxes so that you preserve your ability to pay them to avoid the extinguishment of your mortgage.

If a center is subject to high amounts of past due CDD assessments, it may be that the value of the collateral after taking past due and future CDD assessments into account does not justify the lender acquiring that collateral. In such a case, the lender may be able to negotiate a settlement with the CDD, whereby the CDD´s bondholders (who funded the CDD´s improvements by purchasing its bonds) accept less than or postpone what they are owed to pay down the bonds. A current appraisal that takes CDD assessments into account can be important in assessing the lender's options.

Addressing these potential issues early on can maximize the resale value of the shopping center and shorten the time period required to dispose of your interest in the mortgaged property. This will be beneficial whether you are selling your loan documents or foreclosure judgment, or completing the foreclosure and reselling the property itself. As the old adage goes, "a stitch in time saves nine."

A lawyer or law firm having expertise in these matters may be able to add significant resale value to a distressed shopping center.

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