



TO RECEIVE OR NOT TO RECEIVE, THAT IS THE QUESTION:

*Legal and Accounting Principles
for Boards and Associations to Consider When
Contemplating a Request For Appointment
of a Rent Receiver*

Submitted By:
Marie D. Mirra, CPA,
Mirra & Associates CPAs, LLC
and
Angela M. Morisco, Esq.,
Becker & Poliakoff LLP

In a well-known soliloquy from Shakespeare, we find Hamlet pondering the question, “To be or not to be, that is the question.” At that moment, it is speculated that Hamlet is experiencing the frustration of making a serious and important decision as to whether to choose between two competing courses of action, both of which have different and significant consequences. Generally speaking, one would assume that taking action is preferable to doing nothing at all if the goal is to change the status quo. However, one must be mindful of the challenges and consequences involved in deciding on a specific course of action.

Undoubtedly, in the current economic climate, many community associations and boards are faced with the dilemma of dealing with and managing units that are vacant and have been abandoned by the owners. Generally, these units are burdened with significant debt and maintenance arrears that continue to accrue each month. Additionally, these units are commonly in the process of being foreclosed by the lender. However, the lender is usually not acting expeditiously to advance the foreclosure proceeding to a sheriff’s sale. As such, associations and boards have become interested in requesting the court to appoint a rent receiver with author-

ity to obtain a tenant and to rent and to lease the unit and to apply the income received to pay down the arrears. Oftentimes, this may be the only opportunity an association will have to achieve some sort of monetary recovery against an absent and/or judgment proof owner.

Since an application must be made to the court, expenses and legal fees will necessarily be incurred and a decision also needs to be made to select a qualified entity or individual who will be approved by the court to be the appointed receiver. The receiver will charge a fee for its services that will likely be in the form of a percentage of the rent collected each month. Often, the percentage is negotiable.

The decision sounds simple at first glance, until associations and boards are made aware of the legal considerations that will be considered by the judge who will hear the application and who will make the decision to grant or to deny the request for a receiver. Associations and boards must also be aware of the accounting principles implicated by receiverships.

Some of the legal issues to consider are as follows: First, there is no guarantee that the application will be granted. The relief requested is equitable in nature and the court has discretion to grant or deny the applica-

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tion based on the facts. Currently, there is no statutory basis or specific legal precedent that affords associations the absolute right to have a receiver appointed. The decisions on these applications vary by court and by judge. As a general rule, receivers may be appointed where the party seeking the receivership has “an equitable interest in the property seized or...judgments that cannot otherwise be satisfied...”. *Leone Industries v Associated Packaging, et al.*, 795 F. Supp. 117 (D.N.J. 1992). Accordingly the association can argue that it has an interest and right in the property by virtue of a recorded claim of lien and judgment, if any.

Second, all courts and judges will require that the foreclosing lender be served with notice of the application and the lender will generally submit an objection and opposition to the application based on protection of the alleged superiority of its first mortgage and security interest.

Third, although some association governing documents contain provisions that do

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allow for the appointment of a rent receiver, the presence of such a provision will not be dispositive of the motion. (See, *Barclay's Bank P.L.C. v. Davidson Avenue Associates, Ltd.*, 274 N.J. Super 519 (App. Div. 1994).

Fourth, the court may be more inclined to grant the application where the association can demonstrate that the financial burden to the association outweighs any objection made by the lender since the lien of the first mortgage will remain in place. The effects of the receivership can be minimized by requesting that any lease or rental be limited to specific one year terms.

Finally, it is suggested that a court considering an application to grant a rent receiver will be more inclined to act in favor of the association where the lender is at the beginning stages of its mortgage foreclosure proceeding.

In addition to the legal consequences, associations and boards must also be aware of and consider the complexity of bookkeeping and accounting procedures implicated by rent receivers and the income that is generated. The discussion of such issues is continued herein.

Once the association's board of directors

has made a decision to move forward with a rent receiver for a particular unit with a delinquent balance, often times the unit has been abandoned for quite some time and the association may need to rehabilitate the unit in order to bring it back to conditions which meet the requirements of renting in New Jersey. This may cost several hundreds or thousands of dollars depending on the significance of the condition of the unit. The amount the association incurs in order to rent the unit may be charged back to the unit owner's delinquent balance which, in effect, would be paid down by future monthly rental income once the unit is rented to a tenant.

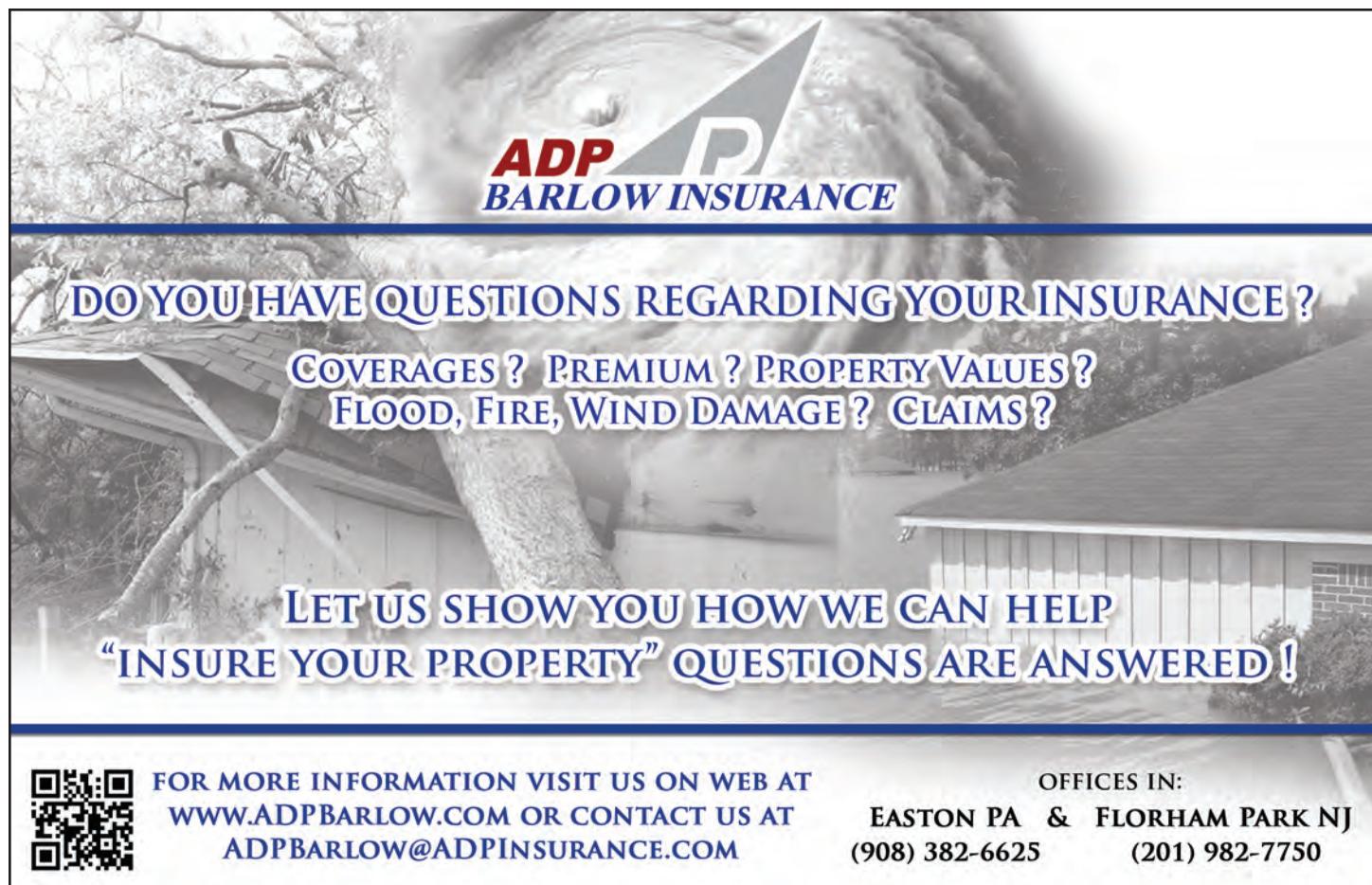
The accounting procedures which should be established for a rent receiver – tenant situation are comparable to those in a “tenant-landlord” relationship. These should clearly be reviewed with the board and legal counsel to establish the proper accounting controls and bookkeeping procedures which could be complex.

Once a determination has been made of who the court-appointed rent receiver will be, the responsibility of the rent receiver is to find a tenant to rent the association unit

and enter into a rental lease agreement with the association. The rental lease agreement would include a provision for a security deposit to be paid by the tenant, followed by monthly rental lease payments usually over a one-year term. The responsibility of the rent receiver also includes the need to establish and maintain a separate cash account for the transactions of the renter; i.e. security deposit, monthly rental income, unit expenses, etc. This account should be maintained separate from the association's financial statements.

Once the tenant lease agreement has been finalized, late fees and interest charges would no longer be charged on the unit owner's delinquent account and legal collection fees would also cease.

The overall intent is to continue to pay down the delinquent balance on the unit owner's account with rental income payments until the entire balance is satisfied. After the rent receiver is paid its fee, the balance of the rent should be disbursed to the delinquent account of the association to pay the current monthly maintenance fee and a portion of the arrears balance. While these agreements are often one year in term, they may be renewed or extended



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as the board deems most beneficial for the association. The objective is for the outstanding balance to be paid down to zero by the amount of rental income received by the rent receiver on behalf of the tenant. Once the association has been made “whole” on the amount owed from that unit for all past due maintenance fees, legal collection fees, late fees, penalties, etc. and the balance is zero, then any future rental income, net of the monthly maintenance fee on the unit, would generate rental income to the association. Such rental income may be taxable to the association. You should consult with your accountant regarding the tax effects of your particular situation.

Despite the various nuances of rent receivers, the overall concept has become increasingly popular amongst CIRAs in the board’s efforts to recover significant balances from delinquent unit owners.

The continued viability of the procedure will depend on each individual judge’s interpretation as to whether the balance of the equities weighs in favor of assisting associations to recoup substantial maintenance arrears versus a mortgage lender’s assertion of the priority of its mortgage and its right to assignment of the rent, a right which is generally not being exercised by the lender. The resolution of this issue likely rests with the legislature at this juncture. ■

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Samuel J. McNulty, Esq.

smcnulty@huestonmcnulty.com / www.huestonmcnulty.com

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