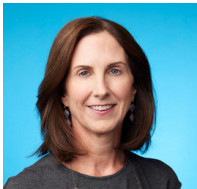


Commercial Real Estate Loan Defaults and Remedies (IL)

A Practical Guidance® Practice Note by
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This practice note discusses the typical borrower default and lender remedy provisions in commercial real estate financing documentation in Illinois prior to the COVID-19 pandemic. A brief overview of commonly used workout options is also included. Where appropriate, the note includes negotiation tips for counsel to the borrower and the lender. The practice note also highlights areas in flux as a result of the COVID-19 pandemic and various governmental measures to assist borrowers during this unprecedented time.

See also [Coronavirus Impact on Lenders and Borrowers: Client Alert Digest](#), [Market Trends 2020: COVID-19 Ramifications in Loan Documents](#), and [Amendments, Consents, and Waivers Resource Kit](#).

For further guidance, see [Multistate Real Estate Financing Transactions, Foreclosure of Real Property, Workouts of Commercial Real Estate Loans, Commercial Real Estate Financing Transactions \(IL\)](#), and [Commercial Real Estate Acquisition Loan Resource Kit \(IL\)](#). For a loan agreement template, see [Loan Agreement \(Acquisition Financing\)](#).

For a forbearance agreement template, see [Forbearance Agreement \(Commercial Real Estate Loan\) \(IL\)](#).

Context and Preliminary Considerations

Commercial real estate loan documents are often highly negotiated, and the negotiation process can be one of the most difficult aspects of closing a commercial real estate transaction. Borrowers tend to resist a lender's desire for control over the mortgaged property through the imposition of borrower covenants, whether affirmative, negative, or financial. Of paramount importance for lenders is that the mortgaged property generates enough cash flow to service the debt and financial covenants are instrumental in providing the lender assurance in this regard. Thus, negotiations tend to focus on provisions that can lead to borrower defaults and trigger the lender's remedies. The negotiation leverage of the parties depends on numerous factors, including loan-to-value ratio, the current state of the market, and strength and track record of the property owner.

Traditional mortgage lenders simply want to be repaid on the agreed upon terms. Their objective is not to become the property owner via foreclosure or the enforcement of other remedies. They also do not like to carry defaulted loans on their books, as this can necessitate reserving against their capital which could impact their lending capacity. In significant default scenarios, most loans will eventually result in some form of a workout because the lender will be hesitant to own and operate the real property. In today's environment, many lenders are forbearing from exercising remedies due to various governmental policies being enacted to assist borrowers in the current financial crisis.

Commercial real estate loans tend to be structured as nonrecourse loans, meaning that the lender's remedies are generally limited to the secured real property and related personal property. Since the majority of borrowers are single purpose entities (SPE) (where the sole asset of the borrower is the real property subject to the lender's first priority mortgage lien), the borrower is already structurally recourse limited. Apart from the real property itself, a lender can only look to any nonrecourse carve-out guarantor when exercising its remedies, and, typically, these remedies are only available following bad acts of the borrower, such as fraud or misappropriation, gross negligence or willful misconduct of the borrower, and when certain environmental issues arise. Construction loans are different. They are generally fully recourse until the construction is complete.

Default vs. Event of Default in Loan Documentation

A default exists from the date the event causing the default occurs until the expiration of any grace period or a default is cured. Once a default occurs, a lender may be required to notify the borrower of the default and the borrower may then have a set period of time to cure the default. More often than not, other than a payment default, a lender finds out about the existence of a default from the borrower (because the lender is not monitoring the borrower's day-to-day activities). Most loan agreements require the borrower to notify the lender within a very short specified time frame if it has knowledge of the existence of a default. Alternatively, a lender may become aware of a default upon reviewing the borrower's financial reporting package, which is a requirement mandated by all lenders to ensure that there are no material changes in the financial condition of the borrower or the mortgaged property.

If a default is not timely cured during the grace period, it becomes an event of default, which triggers the availability of a lender's remedies pursuant to the loan documents. An event of default cannot technically be cured by the borrower since the grace period has expired. It is only subject to waiver by a lender, which, in today's world of addressing a myriad of COVID-19 issues, typically manifests itself in a forbearance agreement.

For further guidance, see [Commercial Real Estate Financing \(IL\)](#), [Commercial Real Estate Acquisition Loan Resource Kit \(IL\)](#). For a forbearance agreement template, see [Forbearance Agreement \(Commercial Real Estate Loan\) \(IL\)](#).

Borrower Defaults

Borrower defaults are generally classified as either monetary or nonmonetary. Each is discussed below.

Monetary Defaults

A monetary default occurs when the borrower fails to pay interest, principal, or other amounts payable to the lender in accordance with the terms of the loan documents (i.e., funding reserves). When representing a borrower, you should negotiate for a notice and cure period. Lenders typically hesitate to grant any notice and cure period for monetary defaults since a borrower knows well in advance when these payments are due. If they do grant a notice and cure period, it is usually very short (i.e., five days). It is not uncommon for a lender to refuse to provide notice and the cure period then runs from the date the amount payable was due. Regardless of whether there is a notice requirement, a borrower is typically not permitted to cure a monetary default more than twice during any 12-month period.

Some lenders take the view that any default that can be remedied by the payment of money falls within the ambit of monetary defaults and is therefore subject to minimal notice and cure periods. These include the (1) breach of financial covenants, where the prepayment of principal cures the breach and (2) failure to make payments to third parties, such as for real estate taxes and insurance policies. This is not the prevailing view among lenders, however, and these defaults are discussed below under nonmonetary defaults.

Nonmonetary Defaults

A nonmonetary default occurs when the borrower breaches a covenant. Often, these covenants are labeled affirmative covenants or negative covenants. Affirmative covenants are actions that the borrower agrees to take, while negative covenants prohibit the borrower from taking certain actions.

Typical affirmative covenants include:

- Financial reporting to the lender
- Compliance with financial covenants
- Maintenance of SPE status
- Compliance with applicable law
- Maintaining the property in good and safe condition, working order and repair
- Maintaining insurance on the property
- Paying and complying with third-party obligations, such as other debt, real estate taxes, insurance, and contractual obligations

- Allowing the lender to physically inspect the premises and conduct environmental testing
- Notifying the lender of a default, event of default, or litigation

Typical negative covenants prohibit the borrower from taking the following actions without the lender's consent:

- Incurring additional debt
- Incurring any additional liens or encumbrances
- Selling or transferring the mortgaged property
- Selling or transferring any ownership interests in the borrower
- Entering into additional leases or amending existing leases, except pursuant to preapproved guidelines
- Amending its organizational documents

A nonmonetary default can also occur if the borrower has breached a representation and warranty contained in the loan documentation.

Typical representations and warranties of the borrower include the following:

- The borrower has the necessary right, power, and authority to enter into the loan documents.
- The borrower holds the title to the property, free of any liens and encumbrances other than as disclosed to the lender.
- There are no material defaults on the borrower's other indebtedness.
- The borrower has all permits necessary to own, occupy, and operate the real property.
- The mortgaged property complies with all applicable laws.

Lenders are often willing to provide a borrower with notice of a default and a cure period (e.g., 30 days) for nonmonetary defaults. For certain nonmonetary defaults, lenders may even grant extension rights to the cure period, if the borrower is actively pursuing a cure.

Financial Covenants

Prior to the financial crisis of 2008–2012, most commercial real estate lenders tended to be lenient regarding financial covenants. Since that financial crisis, there has been an expansion of financial covenants in commercial real estate loans and lenders are now generally more focused on repayment than adequate collateral. Given the current financial issues related to COVID-19, lenders will continue to use financial covenants to exert influence and control over borrowers.

The most common financial covenants prior to the resurgence of COVID-19 included:

- **Debt service coverage ratio (DSCR).** DSCR is the annual net operating income (NOI) produced by the real property divided by the annual debt service (interest and any required principal amortization) due to the lender. This covenant ensures that the property generates sufficient cash flow to service the debt, and lenders typically require at least a 1.2 DSCR. When representing the borrower, you should negotiate to exclude loan receipts and payments from the calculation. Lenders will want to include the debt service on any subordinated debt in the calculations.
- **Guarantor liquidity.** This covenant ensures that a guarantor is sufficiently liquid to pay off the debt. At a set measuring point (i.e., quarterly, semiannually, or annually), the guarantor must hold a certain amount of cash and cash securities. When representing the borrower, you should negotiate to include marketable securities in the calculating formula.
- **Loan-to-value ratio (LTV).** The loan-to-value ratio is the outstanding loan amount divided by the appraised value of the property, expressed as a percentage. This covenant ensures that the loan has adequate collateral. In a typical CRE loan, lenders will not go above 70%–80% LTV. Hard money loans are typically capped at 60% LTV.
- **Debt yield.** Annual NOI divided by the outstanding loan amount, expressed as a percentage. Debt yield shows what the lender's cash-on-cash return on its money would be if it foreclosed on the property at that specific moment. Lenders tend to require debt yields of at least 10%.

When representing a borrower, you should consider any seasonality issues with the borrower's business and their interplay with the testing frequencies when negotiating these provisions.

As lenders navigate various COVID-19 related issues, the covenants noted above will likely continue to evolve.

SPE Status

Lenders often request that a potential borrower form an SPE so that the lender's collateral will be segregated from the parent company's other assets and liabilities. This allows the lender to focus on the financial characteristics of the real estate asset without needing to consider other aspects of the parent's holdings. It also insulates the lender's collateral from claims of the parent's creditors. In addition, lenders typically require a laundry list of SPE covenants in the loan documents and in the SPE's organizational documents to ensure that a

borrower's SPE status will be maintained. Examples include covenants that:

- The borrower must limit the nature, purpose, and conduct of its business to solely acquire, own, hold, lease, operate, manage, maintain, and improve the mortgaged property and to contract for the operation, maintenance, management, and improvement of the mortgaged property
- The borrower must observe all limited liability company formalities necessary to maintain its separate existence
- The borrower may not commingle its assets or funds, including without limitation bank accounts, with those of any other person or entity
- The borrower must maintain its assets in such a manner that it is not costly or difficult to segregate, identify, or ascertain such assets from those of other persons or entities
- The borrower must hold all its assets and conduct all its business in its own name, and not that of any other person or entity
- The borrower must not pledge its assets for the benefit of any other person or entity, other than lender pursuant to the loan documents
- The borrower must hold itself out to its creditors and the public as a legal entity separate and distinct from any other person or entity

Failure of the borrower to maintain its SPE status poses a significant risk to the lender as it opens the doors to claims against the borrower by its affiliates, especially in the bankruptcy context where a lender could be barred from exercising its remedies against the borrower's property.

For a more detailed discussion of SPEs, see Borrower as a [Single Purpose Entity](#) and Article VI (Single Purpose, Representations, Warranties and Covenants) in [Loan Agreement \(Acquisition Financing\)](#).

Additional Debt/Liens

Loan documents typically include a negative covenant prohibiting the borrower from incurring additional debt or creating additional liens on the real property, except for any subordinated financing (i.e., mezzanine financing) closed contemporaneously with the senior loan, which would be subject to an intercreditor agreement between the senior lender and the mezzanine lender. For further guidance, see [Commercial Real Estate Mezzanine Financings](#) and [Intercreditor Agreements \(Mortgage Lender and Mezzanine Lender\)](#).

Limitations on additional debt and liens prevent the borrower from becoming overextended and provide lenders protections from other creditors. Typical carve-outs from this covenant include those for brokerage commissions, tenant improvements, certain capital expenditures, and disputes with taxing authorities.

When representing the borrower, you should discuss the potential need for additional indebtedness required to operate the mortgaged property with the borrower to negotiate the appropriate carve-outs in the loan documentation.

Transfers

It is of paramount importance to lenders that operational control of the borrower remains in the hands of persons that are qualified to manage the mortgaged property. Thus, lenders typically prohibit the borrower from allowing or consenting to the transfer of its interests. A lender will also typically require that the borrower include certain provisions to this effect in its organizational documents. Notwithstanding the foregoing, lenders may allow certain transfers of ownership interests to accommodate the typical, complex ownership structures of borrowers. When representing a borrower, you should discuss any anticipated transfers with your client and negotiate any necessary carve-outs. If the borrower views the debt as attractive to a potential purchaser of the ownership interests, it may wish to negotiate preapproved guidelines for a potential acquirer, such as meeting certain financial tests and real estate experience thresholds.

Leases

Rents from tenants are often the primary source of revenue for a borrower. Thus, lenders want to prohibit any changes to this income stream without their consent. A lender may insist that all new leases and all amendments to or terminations of existing leases require its consent, but this is not very common and is administratively burdensome. More often, loan agreements set forth preapproved leasing guidelines and lease forms as exhibits. When representing a borrower, you should require that the lender's consent not be unreasonably withheld. In addition, if the lender does not respond to a consent request within a certain time frame, the lender's consent should be deemed given.

Cross-Default Clauses

Lenders typically seek to include provisions where if the borrower defaults under other debt, it gives rise to an event of default. The rationale is that if the borrower cannot make

payments under one agreement, it will also not be able to make payments on the subject loan. When representing a borrower, you should attempt to limit cross-defaults to monetary defaults or material, nonmonetary defaults. An extremely broad cross-default provisions can cause significant headaches for a borrower as it could be forced to deal with multiple lenders in a workout scenario.

Material Adverse Change (MAC) Clauses

Many lenders seek to include MAC clauses in their loan agreements. MAC clauses typically provide that an event of default will occur under the loan agreement if a MAC occurs in the business or financial condition of the borrower or the mortgaged property. A typical MAC clause reads as follows:

“Material Adverse Change” means a material adverse change in (a) the condition (financial or otherwise), operations, assets, liabilities, business, or prospects of the borrower or (b) the ability of the Borrower to repay the debt or to perform its obligations under the loan documents, or (c) the rights and remedies of the lender under the loan documents, or (d) the legality, validity; or enforceability of any loan document or (e) the liens granted the lender pursuant to the loan documents.

Prior to the financial crisis of 2008–2012, MAC clauses were not commonly included in commercial real estate loan documentation. They were viewed as a subjective, catchall for the lender that basically allowed it to declare an event of default under most scenarios. Since that time, however, the use of these clauses in commercial real estate loans has expanded. And, given the current financial crisis, MAC clauses will likely play a role in an array of forbearance and workout discussions. When representing a borrower, you should define what is material and negotiate to include as high a threshold as possible. At a minimum, the lender should agree that its determination of materiality be reasonable and not in its sole discretion.

Representations and Warranties

Loan agreements typically contain certain representations and warranties that are intended to induce the lender to make the loan to the borrower. The representations and warranties generally focus on matters pertaining to the borrower, including its financial condition, and to the real property collateral. Representations and warranties are made as of a specific date. Typically, it is only the closing date unless there are also further disbursements to be made. For example, in constructions loans, borrowers are required to “bring down” or restate the representations and warranties on the dates of each advance.

When representing the borrower, you should review the representations and warranties with the borrower to confirm their accuracy and to compile a disclosure schedule which sets forth the exceptions to the representations and warranties. You should also attempt to include knowledge qualifiers where appropriate. Knowledge qualifiers are one of the most effective tools in limiting representations and warranties. Lenders tend to allow knowledge qualifiers if they are limited to the knowledge of the individuals who are responsible for the day-to-day operations of the mortgaged property. For example, a representation as to litigation threatened against the borrower is typically qualified as to knowledge while a representation as to the enforceability of the loan documentation is never qualified as to knowledge.

There is a long-lived, ongoing debate as to whether representations and warranties are curable. Since they are made as of a certain date, technically they cannot be cured. Thus, many lenders will reject a borrower’s attempt to negotiate notice and cure periods for representations and warranties. That said, if you represent a borrower, you should always attempt to obtain notice and cure periods for breaches of representations and warranties.

Workouts

As noted above, lenders do not want to hold defaulted loans on their books. Thus, they will typically pursue a workout solution before pursuing other costly and lengthy remedies. The parties may negotiate:

- A restructuring of the loan, such as increasing the term and lowering the interest rate
- A waiver of the event giving rise to the event of default
- A forbearance agreement, in which a lender agrees not to exercise any remedies under the loan agreement for a specified time, subject to certain conditions (e.g., no other events of default occurring or a payment of fixed sum from the borrower)
- An amendment to the loan agreement, revising a provision that may no longer be appropriate, such as a financial covenant

For a detailed discussion of workouts, see [Workouts of Commercial Real Estate Loans](#). For information on representing the lender in a workout, see [Representing the Lender in a Workout Checklist](#). For a forbearance agreement template for use in Illinois, see [Forbearance Agreement \(Commercial Real Estate Loan\) \(IL\)](#).

Lender Remedies in Illinois

If a workout is not feasible, lenders typically have the following remedies available under the loan documents:

- Acceleration
- Setoff
- Lawsuit on the promissory note
- Judicial foreclosure
- UCC foreclosure
- Receivership
- Deed in lieu of foreclosure

The loan documents typically allow the lender to pursue any and all remedies and that the remedies may be exercised simultaneously. However, in most instances in Illinois, the lender will accelerate the loan before taking additional action. In addition to the above remedies, there are financial remedies that a lender can impose. For instance, most loan documents specify a default rate of interest and late fees. When coupled with acceleration, these financial remedies can wipe out any theoretical equity in the property.

In Illinois (as in most jurisdictions), a lender cannot use the remedies listed above unless the event of default is monetary or, if nonmonetary, then material. If there is any question as to its materiality of an event of default, when representing a lender, you must carefully analyze applicable law to determine which remedies the lender may exercise. For example, the repeated breach of a financial covenant or a reporting covenant is generally considered material.

Acceleration

As previously stated, acceleration is typically the lender's first step before proceeding with the other enforcement remedies. The lender should provide notice of default and acceleration of the mortgage debt. The form and manner of this notice will be prescribed in the mortgage and/or by state law. Absent an acceleration provision, a lender would either have to foreclose each installment as it comes due or wait until the amortization period expires to foreclose on account of the entire mortgage obligation.

Important factors to consider at this stage include the following (these factors are applicable in most states and vary depending on the terms of the mortgage):

- Whether, prior to acceleration, the borrower may cure the default and reinstate the mortgage
- Whether, following acceleration, the borrower may only prevent foreclosure by tendering the full mortgage obligation

- Whether the lender has waived its right to accelerate through consistently accepting late payments (A waiver will generally not be found where a creditor accepts a nominal number of late payments. However, if a consistent pattern of acceptance of late payments has been established over time, the lender may be deemed to have waived its right to accelerate the mortgage debt on the basis of a missed or late payment. Such a waiver may be revoked by communicating to the borrower that no further late payments will be accepted.)

Acceleration is not only permitted for failure to make debt-service payments, it may also be based upon breaches of covenants in the mortgage, such as those covenants requiring the mortgagor to maintain insurance, pay taxes, not commit waste, or maintain a certain financial condition.

Setoff

The lender may set off amounts due to it under the loan documents against any and all accounts, credits, money, securities, or other property of borrower on deposit with or in the possession of the lender. To the extent that the borrower's operating accounts are with the lender, this remedy can significantly impede the borrower's ability to continue to operate the real estate.

Lawsuit on the Promissory Note

The lender may file a lawsuit to recover the accelerated amount of the promissory note. After receiving a judgment, the lender may seek to attach the judgment to the real property. Unlike some states, Illinois does not have a one-action rule, and the lender will then typically proceed with a foreclosure.

UCC Foreclosure

In some cases, the collateral for a mortgage loan also includes the pledge of an equity interest in the borrower, which collateral is evidenced by a pledge agreement and a UCC-1 financing statement. This financing arrangement is often referred to as a mezzanine loan and is subordinate to the mortgage loan. If the mortgage lender and the mezzanine lender are the same entity and if there is an event of default under the pledge agreement, the mortgage lender has the right to foreclose on the equity interest by selling the equity interest in the borrower at a UCC sale. See ILCS 810 ILCS 5/9-601 et seq. Typically, the lender will bid the amount owed by the borrower to acquire the interest. While there are some risks related to acquiring the equity interest subject to the borrower's creditors, this is a more streamlined and efficient process for gaining control of the borrower and the property without appointing a receiver. For further guidance, see

[UCC Financing Statements, Fixture Filings, and Amendments \(IL\)](#), [Commercial Real Estate Mezzanine Financings](#), and [Intercreditor Agreements \(Mortgage Lender and Mezzanine Lender\)](#).

During the COVID-19 pandemic, many borrowers raised concerns about the commercial reasonableness of UCC foreclosure actions. For a time, New York courts were sympathetic to this argument and granted injunctions in borrowers' favor. See *D2 Mark LLC v. Orei VI Investments LLC*, 2020 NY Slip Op 32057(U) (N.Y. Sup. Ct.); *Shelbourne BRF LLC v. SR 677 BWAY LLC*, 2020 N.Y. Misc. LEXIS 19824 (Sup. Ct. Aug. 3, 2020); and *Atlas Brookview Mezzanine LLC, et al. v. DB Brookview LLC*, No. 653986/2020 (Sup. Ct. N.Y. Cnty. Aug. 24, 2020). But New York's Appellate Division later held that a borrower was not entitled to a preliminary injunction because "the existence of the COVID-19 pandemic, the feared loss of an investment can be compensated in money damages," and therefore there was no irreparable harm. *Shelbourne BRF LLC v. SR 677 Bway LLC*, 139 N.Y.S.3d 799, 800 (1st Dep't 2021); see also *1248 Assoc. Mezz II LLC v. 12E48 Mezz II LLC*, 2020 N.Y. Misc. Lexis 5099 (Sup. Ct. May 18, 2020) (vacating preliminary injunction for failure to demonstrate irreparable harm). For more detailed information about the UCC foreclosure process, see [Commercial Real Estate Mezzanine Financings](#).

Judicial Foreclosure

Nonjudicial foreclosure is not permitted under Illinois law and, with very limited exceptions, lenders must foreclose judicially. Lenders are permitted to both retake the property and obtain a deficiency judgment. For detailed guidance on the foreclosure process in Illinois, including templates, see [Foreclosure Resource Kit \(IL\)](#). For a discussion of strict foreclosures and alternatives to judicial foreclosures in Illinois, see [Strict Foreclosures and Judicial Foreclosure Alternatives \(IL\)](#).

Commencement of Action

Judicial foreclosure in Illinois is governed by the Illinois Mortgage Foreclosure Law, 735 ILCS 5/15-1101 et seq. Before beginning a foreclosure action, it is important to review the mortgage, promissory note, guaranty, and other loan documentation to ensure compliance with any contractual notice or other pre-suit requirements contained in these documents. Once all pre-suit requirements are satisfied, the lender may file a lawsuit in the county where the property is located to recover the outstanding amount of the accelerated indebtedness under the promissory note. Lenders typically obtain a foreclosure guaranty from a title company that discloses all the parties that need to be named as defendants in the lawsuit and served.

Appointment of Receiver

In most states, a lender can take control of the mortgaged property during the foreclosure process through the appointment of a receiver. The process begins with a petition to the court to appoint a receiver. All necessary parties need to be served. The receiver then runs and operates the property by paying the operating expenses and debt service, collecting rent, and entering into leases. If approved by the court, a receiver can also sell the property. The foreclosure process can be very lengthy, and there may be a risk that the borrower will retain the income it receives from the property without providing for its upkeep. Thus, lenders typically move to appoint a receiver pending the completion of the foreclosure to preserve the property's value.

In Illinois, the request for an appointment of a receiver is made by motion supported by affidavit or sworn pleading. The court will hold a hearing after reasonable notice has been given to all other parties; however, if no objection to the receiver request is made prior to the hearing, the court may rule without a hearing, and if a party is default, the court may rule without service on such party. See 735 ILCS 5/15-1706. The cost of the appointment of a receiver is usually determined by a percentage of the sums received and disbursed by the receiver. In deciding whether to request the appointment of a receiver, the lender should compare the costs of the appointment with the potential benefits. For further guidance, see [Commercial and Residential Mortgage Foreclosure: Preliminary Procedures and Commencement of Action \(IL\)](#).

Defenses to Foreclosure

Common defenses to foreclosure include equitable defenses such as equitable estoppel, waiver, laches, and unclean hands. These defenses can often be overcome by the lender by citing to provisions of the mortgage loan documents and applicable law. Contractual defenses such as failure to comply with the provisions of the loan documents, unless frivolously asserted, can raise bigger problems. Examples of these defenses include lack of notice, defective acceleration, accord and satisfaction, and reinstatement and tender. Refuting these defenses tends to be fact-driven and depends on the conduct of the parties in conjunction with their rights and obligations under the loan documents. A borrower can seek bankruptcy protection, but this is dangerous as it could trigger the recourse provisions of the guaranty.

In Illinois, language stating that a borrower has "no claims or defenses" to the enforcement of the lender's rights does not result in the waiver of the borrower's affirmative defenses and counterclaims arising out of the lender's alleged breach of the duty of good faith and fair dealing or violation of the Consumer Fraud and Deceptive Business Practices Act.

RBS Citizens, Nat. Ass'n v. RTG-Oak Lawn, LLC, 943 N.E.2d 198, 203 (Ill. App. Ct. 2011) (refusing to enforce a waiver of defense in a forbearance agreement where it did not specifically address the duty of good faith and fair dealing).

In light of the COVID-19 orders and policies in place in Illinois and other jurisdictions, many borrowers are also invoking common law defenses related to the doctrine of impossibility or frustration of purpose to excuse certain defaults. To date, these defenses have been unsuccessful in Illinois, but the caselaw is not fully developed at this point in time.

Calculation of Amount Due

Before a foreclosure judgment can be issued, the amount due to the lender must be determined. The lender prepares and delivers a statement of the total outstanding balance required to satisfy the borrower's obligation in full. The statement, first called a payoff demand statement (see 735 ILCS 5/15-1505.5) and then a prove-up affidavit (see ILCS S. Ct. Rule 113), also includes estimated charges that the lender reasonably believes may be incurred within the following 30 days. Typically, the total amount consists of:

- The outstanding principal balance of the loan
- Interest to the date of the computation
- Late charges
- Amounts paid by the lender to protect the lien of the mortgage
- Legal fees, costs, and disbursements (See 735 ILCS 5/15-1510, Attorney's Fees and Costs)

Regardless of the method used for computing the amount due under the mortgage obligation, it is standard practice that the borrower be given an opportunity to challenge the figures proposed by the lender.

Foreclosure Judgment and Sale

The foreclosure judgment establishes the amount due to the lender and directs the sale of the property. The judgment may also establish the place of the sale, who is authorized to conduct the sale, and whether the mortgaged property will be sold as one or separate parcels. The procedures for the sale are governed by 735 ILCS 5/15-1507. Court confirmation pursuant to 735 ILCS 5/15-1508 is required to complete the sale. Once confirmation is given, the court gives approval to the sale and authorizes the execution of a deed to the mortgaged property.

Deficiency Judgment

Unless the mortgage is nonrecourse, a lender may be entitled to a deficiency judgment if the sale of the mortgaged property does not satisfy the outstanding balance owed on

the debt. In Illinois, a deficiency judgment may be entered and enforced against the person personally liable for the mortgage for any balance of money that may be found due to the requester. See 735 ILCS 5/15-1508. Counsel to the lender should examine Illinois statutory and procedural requirements for deficiency judgments before commencing the foreclosure.

For guidance on the foreclosure judgment and sale and on deficiency judgments, see [Commercial and Residential Mortgage Foreclosure: Judgment, Sale, Possession, and Right of Redemption \(IL\)](#).

Deed in Lieu of Foreclosure

A much faster and less expensive method for a lender to take title to the real property is through a deed in lieu of foreclosure (DIL). The lender and borrower negotiate a DIL agreement that sets forth the terms of the borrower's transfer of the property to the lender. Typically, in a DIL agreement, the lender agrees to waiver of a claim seeking a deficiency judgment. In certain instances, a lender may even agree to a cash payment to the borrower. The lender then typically takes title in the name of an SPE affiliate to protect the lender from property-specific liability.

A disadvantage of a DIL is that, unlike a mortgage foreclosure, it does not eliminate junior liens, such as judgments, junior mortgages, or mechanic's liens. To protect against junior liens, a lender typically leaves the lien of the underlying mortgage open and includes a non-merger clause in the deed stating that the underlying mortgage does not merge into the deed. This allows the lender to proceed with foreclosure if junior lienholders become problematic. Courts and title companies do not favor DILs because they pose significant creditors' rights risks. Title policies exclude coverage against fraudulent transfer claims by unsecured creditors of the borrower.

For further guidance, see [Deed in Lieu of Foreclosure Checklist \(Commercial\) \(Pro-lender\)](#).

Looking Ahead

Commercial real estate finance law has not changed significantly over the past several decades. In light of the weakening economy and the myriad of issues raised by COVID-19, however, legislation may be forthcoming to protect distressed borrowers. Lenders continue to maintain the advantage when it comes to exercising its remedies following an event of default, but there are certain complicating factors at play related to COVID-19. While new loans are unlikely to be originated in the next few months, lenders will be seeking to negotiate language to address potential COVID-related defenses on a going forward basis.

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Ms. Kailus is an accomplished real estate lawyer with substantial experience representing public and privately held companies in a broad range of transactional matters, including real estate, leasing, finance and corporate matters. Prior to joining the firm, Ms. Kailus was associate general counsel at GGP, Inc. (a publicly traded real estate investment trust owning, operating and developing Class A shopping centers), vice president-associate general counsel at Joseph Freed and Associates (a privately owned family real estate company specializing in the development of mixed-use real estate projects) and senior counsel at Equity Office Properties Trust (a publicly traded real estate investment trust, founded by Sam Zell, which owned and operated Class A office buildings). Throughout her career, Ms. Kailus has focused on acquisitions, dispositions, financing, leasing and development of commercial real estate.

Ms. Kailus received her AB in history at Princeton University in 1994 and her JD at the University of Illinois College of Law in 1997.

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Abe Salander is a commercial real estate attorney, representing landlords, tenants, buyers, sellers, investors, developers, REITs, and private equity firms in a range of transactional and litigation real estate matters and counseling them on high-value aspects of their business.

Mr. Salander's real estate transactional experience includes leasing, asset sales, financing, and workouts. He also has cross-disciplinary experience with mergers and acquisitions, as well as risk and compliance.

Mr. Salander's real estate litigation experience includes representing clients in connection with disputes involving commercial leases, acquisitions, rights of first refusal, partnerships, development projects, construction, financing, judicial foreclosures, UCC foreclosures, evictions, specific performance, property management, special servicers, eminent domain, and allegations of failure to maintain. He has litigated in state and federal courts and before arbitration associations across the country.

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