

Uniform Laws Update Property

Uniform Laws Update Co-Editor:

Kieran Marion, Legislative Counsel, Uniform Law Commission, 111 N. Wabash Avenue, Suite 1010, Chicago, IL 60602-1917, kieran.marion@nccusl.org. **Guest Editor:** Ira J. Waldman is a partner with Cox, Castle & Nicholson LLP in Los Angeles, California, and served as the American Bar Association Advisor to the drafting committee on the Uniform Assignment of Rents Act. He is a member of the American College of Real Estate Lawyers and serves on the Joint Editorial Board for Uniform Real Property Acts.

Uniform Laws Update—Property provides information on uniform and model state laws in development as they apply to property, trust, and estate matters. The editors of *Probate & Property* welcome information and suggestions from readers.

Uniform Assignment of Rents Act

Article 9 of the Uniform Commercial Code (UCC) provides a comprehensive legal regime for creating, perfecting, and enforcing security interests in personal property. The goal of the Uniform Assignment of Rents Act (UARA), adopted by the Uniform Law Commission in 2005, was to provide a similarly comprehensive legal regime for the creation, perfection, and enforcement of security interests in rents from real property.

Most states do not have a comprehensive statute concerning rents derived from real property. Thus, for the most part, the common law governs, resulting in different and confusing rules, depending on whether a particular state is a “title theory” state (where a mortgage or deed of trust “transfers” legal title in the real property to the mortgagee, permitting the mortgagee to collect rents absent an agreement to the contrary) or a “lien theory” state (where a mortgage does not transfer legal title and the mortgagee does not have such a right to collect rents, absent an agreement so providing). Most commercial loan transactions include, either within the mortgage instrument itself or by a separate assignment document, an assignment of the rents to the lender. Historically, the mortgage provisions or a separate document has taken the form of either an “absolute” assignment, an “absolute” assignment for security purposes, or a security (or collateral) assignment. These various iterations of the assignment have resulted in unusual and varied judicial decisions, most often in the bankruptcy courts, concerning the nature and meaning of an “absolute” assignment (can there be an assignment that truly assigns ownership of the rents absolutely to a mortgagee, as some lenders have claimed?), the perfection of a security interest in rents (is it perfected by recording or enforcement?), and the enforcement actions, if

any, entitling the mortgagee to ownership of, or the right to collect, the rents.

The drafting committee and its various advisors and observers represented all of the various stakeholders with a potential interest in a uniform act and included the participation of lawyers involved in developing a comprehensive assignment of rents statute in the state of California, as well as lawyers involved in the drafting of the UCC, in order to avoid potential inconsistencies between the UARA and UCC. In the capable hands of Reporter Wilson Freyermuth, professor at the University of Missouri–Columbia Law School, the UARA accomplishes the following:

1. clarifies when perfection of a security interest in rents occurs, overriding the morass of case law concerning such “perfection”—perfection consists of recordation in the land records in accordance with state law, not enforcement of the assignment post-default, and priority is then established;
2. sets forth a variety of enforcement actions permitted by assignees post-default to establish entitlement to receive the rents (accrued and unpaid, as well as rents accruing in the future);
3. establishes the right to rents of competing interest holders and provides rules for payment by (and protection of) tenants that receive conflicting notices regarding enforcement of an assignment of rents;
4. eliminates the notion that there can be an “absolute” assignment of rents in connection with a real estate secured loan transaction—every assignment connected to a loan creates only a security interest in the rents;
5. broadens the definition of rents to include any sum paid by a tenant, licensee, or other person for the right to possess or occupy the real property of another;
6. provides rules to deal with potential conflicts with Article 9 regarding priority of rights to the proceeds of rents (personal property, cash in an account, and so on) as between an assignee of the rents and a secured creditor with a competing security interest in the proceeds as a result of an Article 9 security interest; and
7. provides for the circumstances when an assignee who receives the rents

may or must apply the rents for property protection or maintenance purposes.

Use of the rents by an assignee who enforces an assignment of rents generated the most discussion out of all the issues presented to the drafting committee. Although the common law may permit an assignee to retain the proceeds and reduce its loan, there was a vocal constituency whose perspective was that the proceeds should be required to be used for property protection or maintenance purposes, at least at some point in time following enforcement of the assignment and collection of the rents.

After considerable debate the resulting provision generally permits the assignee to use the proceeds of the rents,

when collected, in accordance with its loan documents, with the qualification that the right of the assignee to do that is subject to the terms of any agreement between the assignor and tenant (generally, the lease) and any defenses or claims that the tenant might have to payment of the rents to the assignee as a result of nonperformance of the assignor's obligations under the lease or other occupancy agreement. In other words, let the common law and the contracts between or among the parties govern. If a tenant did not protect itself in its contract with its landlord, or if the tenant waived its rights in a contract with a lender (for example, through an estoppel certificate or a subordination, nondisturbance, and attornment agreement), then so be it.

But, to offer some degree of

protection for the rights of a tenant, even to one that did not protect itself contractually, the UARA permits a tenant to obtain the appointment of a receiver if the nonpayment of property-related expenses harmed or could harm the tenant's interest in the property (there is an understanding that state law on the subject of receivers may need to be modified to accommodate this action).

Thus far, the UARA has been enacted in Nevada and Utah, with several pending enactments on the horizon. It is certainly a balanced and thoughtful approach to the issues involved in real estate secured lending and the entitlement to and use of rents generated from the real estate and merits strong consideration even in those states that have an existing assignment of rents law. ■