

SUBJECT: Assignment of rents to holders of security interests in real property

COMMITTEE: Business and Industry — favorable, without amendment

VOTE: 7 ayes — Deshotel, Orr, Bohac, Giddings, Quintanilla, Solomons,
Workman

0 nays

2 absent — Garza, S. Miller

SENATE VOTE: On final passage, March 24 — 31-0

WITNESSES: *(On House companion bill, HB 2486:)*
For — Richard Spencer, State Bar of Texas; *(Registered, but did not testify: Steve Scurlock, Independent Bankers Association of Texas)*

Against — None

DIGEST: SB 889 would add a chapter to the Property Code governing assignment of rents to a lienholder. Business and Commerce Code, ch. 9, governing secured transactions, would not apply to assignment of rents.

Creation of assignment of rents. An enforceable security instrument secured by real property would create an assignment of rents arising from the property unless the security instrument provided otherwise or the security instrument was governed by sections of the Texas Constitution relating to a home equity loan on a homestead, a reverse mortgage on a homestead, or financing concerning a manufactured home used as a homestead. An assignment of rents would create a security interest in all accrued and unaccrued rents arising from the real property. An assignment of rents would not reduce the secured obligation except to the extent that the assignee collected rents and applied, or was obligated to apply, the collected rents to payment of the secured obligation.

Recordation, perfection, and priority. A document creating an assignment of rents could be recorded in the county where any part of the real property was located. Recording the document would perfect the

security interest. This rule would prevail over a conflicting provision in the document or other Texas law.

A perfected security interest in rents would have priority over the rights of a person who, after the security interest was perfected, acquired a security interest in the rents or the real property or an interest in the rents or the real property. However, the priority for future advances of an assignee of a perfected security interest in rents would be the same as the assignee's priority for the security interest in the property.

Enforcement of security interest. An assignee could enforce an assignment of rents by notice to the assignor, notice to a tenant, or another method sufficient to enforce the assignment under other Texas law. On and after the date an assignee began to enforce an assignment of rents, the assignee would be entitled to collect all rents that accrued before, but remained unpaid on, that date and all rents that accrued on or after that date.

To enforce an assignment by notice to the assignor, the assignee could provide the assignor a notice demanding that the assignor pay the proceeds of any rents. Notice could be provided after default or as otherwise agreed by the assignor. Assignment of rents could not be enforced if, on the date the security instrument was signed and the date of prospective enforcement, the real property constituted the assignor's homestead.

To enforce an assignment by notice to a tenant, the assignee could provide a tenant a notice demanding that the tenant pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrued. Notice could be provided after default or as otherwise agreed by the assignor. The assignee would be required to provide a copy of the notice to the assignor. The notice would have to be signed by the assignee. After a tenant received notice:

- the tenant would be obligated to pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrued, unless the tenant had previously received a notice from another assignee of rents and the other assignee had not canceled notice;
- except as otherwise provided by a document signed by the tenant, the tenant would not be obligated to pay to an assignee rent that was prepaid to the assignor before the tenant received the notice;

- unless the tenant occupied the premises as his or her primary residence, the tenant would not be discharged from the obligation to pay rents to the assignee if the tenant paid rents to the assignor;
- the tenant's payment to the assignee of rents then due would satisfy the tenant's obligation to the assignor to the extent of the payment made; and
- the tenant's obligation to pay rents to the assignee would continue until the earliest date on which the tenant received:
 - a court order directing the tenant to pay the rents in a different manner;
 - a signed notice that a perfected security instrument that had priority over the assignee's security interest had been foreclosed; or
 - a signed document from the assignee canceling the assignee's notice.

Except as otherwise provided by a document signed by the tenant, a tenant who had received a notice would not be in default for nonpayment of rents until the earlier of the 10th day after the next regularly scheduled rental payment would be due or the 30th day after the tenant received the notice.

An assignee who had provided notice to a tenant would be required to immediately provide another notice to the tenant canceling the earlier notice after the assignee received a notice from another creditor with priority that a foreclosure sale of the property had been conducted or the creditor with priority was enforcing the creditor's interest in rents by notice to the tenant.

Procedure for providing notice. A person could provide notice:

- by sending the notice by certified mail;
- by depositing the properly addressed notice with the U.S. Postal Service or a commercially reasonable delivery service, postage paid; or
- by transmitting the notice to the recipient by any means agreed to by the recipient.

Notice to an assignee or assignor would have to be sent to the party's address as provided in the security instrument, unless a more recent address had been given or the parties agreed otherwise. Notice to an assignor also could be sent to an address to which a notice of default was

properly sent. Notice to a tenant, unless otherwise agreed, would have to be sent to:

- an address in a signed document entered into by the tenant and the person providing notice, unless a more recent address had been given;
- if the address described above did not exist, the address in a written agreement between the tenant and the assignor if the person sending the notice had received a copy of the agreement or had actual knowledge of the address; or
- if neither of the addresses described above existed, the tenant's address at the real property covered by the security instrument.

Notice would be considered received on the earliest of:

- the date the notice was received;
- the fifth day after the date the notice was deposited with the U.S. Postal Service or a commercially reasonable delivery service; or
- the date on which notice was considered provided in accordance with an agreement made by the person to whom the notice was provided.

Form of notice to tenant. Notice to a tenant would have to substantially comply with the form prescribed by the bill. The form would state that the assignee was entitled to collect rents under the document assigning rents, and that the tenant could obtain additional information at assignee's address. The form would state that a default existed between the landlord and the assignee, entitling the assignee to collect rents. It would state that the notice would affect the tenant's rights and obligations under the tenant's lease agreement. It would further state that the tenant would not be in default under the lease agreement for nonpayment until the 10th day after rent was due or the 30th day after receiving the notice, whichever occurred first. The tenant could consult a lawyer at the tenant's expense.

The form would state that the tenant would be required to pay to the assignee all rents under the lease agreement that were due and payable and rents accruing after receipt of the notice. It would explain that rents paid to the assignee would satisfy the tenant's rental obligation to the extent of the payment. The form would state that if the tenant paid any rents to the landlord after receiving the notice, that payment would not discharge the rental obligation unless the tenant occupied the premises as his or her

primary residence. It would state that if the tenant previously had received a notice from another person holding an assignment of rents, the tenant should continue paying rents to the first person until the notice was canceled. Once the notice was canceled, the tenant would have to begin paying rents to the second assignee.

Application of proceeds. Unless otherwise agreed by the assignor, an assignee who collected rents or collected on a judgment would have to apply the proceeds in the following order to:

- reimbursement of the assignee's expenses of enforcement, including reasonable attorney's fees and costs if provided for by agreement by the assignor and not prohibited by Texas law;
- reimbursement of any expenses incurred by the assignee to protect or maintain the real property if the assignee elected or was required to apply the proceeds to those expenses;
- payment of the secured obligation;
- payment of any obligation secured by a subordinate security interest or other lien on the rents if, before distribution of the proceeds, the assignee received a signed notice from the holder of the interest or lien demanding payment of the proceeds; and
- payment of any excess proceeds to the assignor.

Application of proceeds to protect real property. An assignee that collected rents following enforcement would not be obligated to apply the collected rents to the payment of expenses of protecting or maintaining the real property, unless otherwise agreed by the assignee. Unless otherwise agreed by a tenant, the right of the assignee to collect rents from the tenant would be subject to the terms of any agreement between the assignor and tenant and any claim or defense of the tenant arising from the assignor's nonperformance of that agreement.

Turnover of rents. If an assignor collected rents that the assignee was entitled to collect, the assignor would be required to turn over the proceeds to the assignee by the 30th day after the assignor received notice from the assignee or within another period prescribed by a security instrument, minus any amount representing payment of expenses authorized by a security instrument or other document signed by the assignee. If an assignor did not turn over proceeds to the assignee, the assignee could recover from the assignor in a civil lawsuit the proceeds and reasonable attorney's fees and costs incurred by the assignee to the extent provided

for by an agreement between the assignor and assignee and not prohibited by Texas law. The assignee could bring a civil lawsuit with or without taking action to foreclose on the real property.

A subordinate creditor that enforced an interest before the priority assignee would not be obligated to turn over any proceeds that the subordinate creditor collected before receiving a signed notice from the priority assignee. The subordinate creditor would be required to turn over to a priority assignee any proceeds that he or she collected after receiving notice by the 30th day after receiving notice or as otherwise agreed between the priority assignee and the subordinate creditor. Any later proceeds would be due to the priority assignee by the 10th day after the proceeds were collected or as otherwise agreed between the priority assignee and the subordinate creditor.

Effect of enforcement, application of proceeds, and turnover of rents. Enforcement of an assignment of rents, the application of proceeds, or the turnover of rents to the assignee would not:

- make the assignee a mortgagee in possession of the real property;
- make the assignee an agent of the assignor;
- constitute an election of remedies that would preclude a later action to enforce the secured obligation;
- make the secured obligation unenforceable;
- limit any right available to the assignee with respect to the secured obligation; or
- bar a deficiency judgment.

Security interest in proceeds. An assignee's security interest in rents would attach to identifiable proceeds. If an assignee's security interest in rents was perfected, the assignee's security interest in identifiable cash proceeds would be perfected.

Except as provided above, the provisions of the Business and Commerce Code, ch. 9, or the Uniform Commercial Code, would determine:

- whether an assignee's security interest in proceeds was perfected;
- the effect of perfection or nonperfection;
- the priority of an interest in proceeds; and
- the law governing perfection, the effect of perfection or nonperfection, and the priority of an interest in proceeds.

Cash proceeds would be considered identifiable if they were maintained in a segregated deposit account or, if commingled with other funds, to the extent they could be identified by a method of tracing.

Priority subject to subordination. The bill would not preclude subordination by agreement by a person entitled to priority.

Effective date. The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2011. Except as otherwise provided, the bill would apply regardless of whether the document creating the assignment of rents was signed and delivered before the effective date. The bill would not affect an action or other proceeding commenced before the effective date. An enforceable security interest would create an assignment of rents only if the security instrument was signed and delivered on or after the effective date. The bill would not affect:

- the enforceability of an assignee's security interest in rents if the security interest was enforceable immediately before the effective date;
- the perfection of an assignee's security interest in rents if the security interest was perfected immediately before the effective date; or
- the priority of an assignee's security interest in rents if, immediately before the effective date, the interest of the other person was enforceable and perfected, and priority was established.

**SUPPORTERS
SAY:**

SB 889 would clarify the process for creating, perfecting, and enforcing a security interest in rents. In 1981, the Texas Supreme Court held in *Taylor v. Brennan*, 621 S.W.2d 592 (Tex. 1981), that a security interest in rents does not become operative until the lender proactively attempts to enforce it. This meant that in a priority contest between a mortgage lender with a recorded but unenforced assignment of rents and a judgment lien creditor who had served a writ of garnishment on rents, the judgment lien creditor would win.

Lenders responded by entering into absolute assignments of rents. Absolute assignments state that the lender is the owner of any rental income at the time it is paid, regardless of whether the lender ever actually takes possession of the rental income. Absolute assignments have created new problems for lenders. It has been argued in some bankruptcy cases

that rents collected and kept by a property owner should be credited against the owner's debt to the lender, even though the lender did not actually receive rent payments, because the lender "owns" the funds.

The bill would simplify a confusing area of the law, establish that rents not actually received by the lender could not be credited against the property owner's debt, establish that a lender with a recorded mortgage would have priority and perfection of its lien on rents upon filing of the mortgage, and set out a statutory means of enforcement. The bill is based on the Uniform Assignment of Rents Act that was proposed by the National Conference of Commissioners on Uniform State Laws.

**OPPONENTS
SAY:**

The bill could confuse residential tenants, leaving them unsure where to send rent payments. The notice to tenants prescribed by the bill is not in plain language and could be difficult for tenants to understand. For a property that was not the tenant's primary residence, such as a vacation property, if the tenant improperly sent a rent payment to the landlord, the tenant could be forced to pay rent twice, because the tenant would also owe rent to the lender.

NOTES:

The House companion, HB 2486, was considered in a public hearing by the House Business and Industry Committee on March 28 and left pending.